STATE STREET GLOBAL ADVISORS

May 10, 2024
Commentary

Weekly Economic Perspectives

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The Economy

The BoE delivers a dovish hold, the RBA a hawkish one.

US

High interest rates are weighing on demand for **consumer credit**. Admittedly, the data has been quite volatile of late, but the message seems to be that consumers are seeking to pay down debt in an effort to lower interest costs. Overall consumer credit grew by a modest $6.3 billion in March, nearly all of that driven by non-revolving credit. Indeed, revolving credit was nearly flat. While there has been a period of sizable and sustained declines in revolving consumer credit in 2021 and early 2022, such declines are rare. Our interpretation is that in 2021-22 consumers paid down debt because they had the money due to excess savings. Now, they are most likely paying down debt because carrying balances has become very expensive. This dynamic makes consumption more dependent on the flow of income, and hence, more dependent on labor income. With hours weak and wages soft in April, this suggests either a pullback in consumption or a renewed utilization of credit despite costs. We suspect weaker consumption lies ahead.

The **University of Michigan consumer sentiment index** posted an unexpectedly large decline in the preliminary May reading, down 9.8 points to a five-month low of 67.4. By contrast, inflation expectations jumped. Short-term (1 year) inflation expectations rose three-tenths to a six-month high of 3.5% and long-term (5-10 year) inflation expectations rose a tenth to 3.1%, also a six-month high. The dynamics in this report are reminiscent of the October-November time period, when inflation expectations surged in a delayed reaction to rising gas prices, taking confidence down. That episode proved fleeting as expectations pulled back shortly thereafter. We suspect a similar outcome this round, though this data bears close watching.

Canada

Following March's slight contraction, Canadian employment increased far more than expected in April. The economy added 90.4k jobs in April, with full-time employment up 40.1k and part-time employment up 50.3k. The increase was driven mainly by the private sector. The **unemployment rate** was unchanged at 6.1% as the participation rate rose 0.1 percentage point to 65.4%. This was the largest employment gain in 15 months, leading to total hours worked jumping 0.8% m/m. Meanwhile, wage growth slowed to 4.8% y/y from 5.0% y/y in March. Given the labor market showing renewed strength, it is likely that consumer spending will rise in the coming months, leading to higher inflation. This is a concern for the BoC. For our part, we continue to look for first rate cut in July.

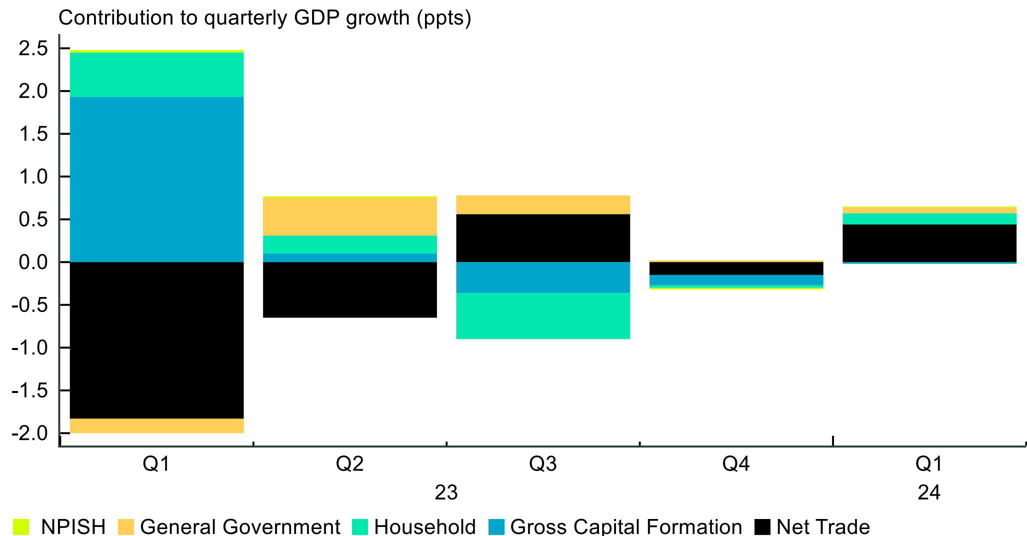
UK

The **Bank of England (BoE)** left the policy rate unchanged at 5.25%, but there were two dissenting votes in favor of a cut. Despite the bank’s concern around persistently robust growth in wages and services prices, Governor Bailey said in the press conference that “It's likely that we will need to cut bank rates over the coming quarters and make monetary policy somewhat less restrictive over the forecast period, possibly more so than currently priced into market rates.” This left little doubt that the committee is inching closer to its first rate cut. There was acknowledgement that recent inflation data has come in little better than previously expected, but the

persistence of domestic inflationary pressures cautions against premature policy easing. Specifically, while the Bank expects inflation to approach the 2.0% target in the near term, it is also expecting inflation to pick up again during the second part of the year. The timing of the first interest rate cut will depend on the next inflation and labor market releases. We continue to expect it between June and August.

The economy grew a better-than-expected 0.6% q/q during the first quarter, following a mild technical recession in the second half of 2023. Net trade was the major contribution to the quarterly **GDP growth**, which added 0.44 percentage points to the overall performance. Household spending and government consumption also added 0.13 ppt and 0.07 ppt. Meanwhile, gross capital formation detracted 0.02 ppt. Admittedly, the economy is still weak with only 0.2% y/y growth and the underlying data has been quite volatile. Even so, we expect the economy growth should continue to be strong in the second quarter with lower inflation and rising real wages.

Figure 1: UK Economy Back Into Growth Territory



Sources: SSGA Economics, ONS
Updated as of 5/11/2024

Eurozone

The revival in eurozone services activity comes not a moment too soon given the ongoing softness in industrial activity. The divergence is evidence across the region but especially in ***Germany***, where the **purchasing managers' index for services** surged 3.2 points to 53.2 in April, the largest monthly gain since early 2022 and the highest level in ten months. Meanwhile, both **factory orders** and **industrial production** disappointed, declining 0.4% m/m each in March.

Japan

After a couple of suspected interventions last week, the yen resumed its slide against the dollar. Like we have been writing, Governor Kazuo Ueda ramped up guidance that monetary policy may respond to currency developments. After 'regular

exchanges' with Prime Minister Kishida on Wednesday, he said that '*if the risk of a weak yen affecting inflation is high, the Bank of Japan (BoJ) may respond with monetary policy*'. The next day, the Governor sharpened the guidance by saying '*BoJ will scrutinize recent weak yen in guiding monetary policy.*'

Furthermore, the Summary of Opinions of the April meeting validated the outlook on higher interest rates. One member said that '*if forecasts in the quarterly report are met, interest rates might rise to levels higher than markets currently price in.*' Furthermore, *'BoJ must deepen debate on timing, and pace of future **hikes**.'* Interest rates on deposits have been rising since the BoJ exited negative rates. We expect the renewed drive in the equity markets, and higher deposit rates to help households with additional interest income.

Meanwhile, the fifth release of this year's *shunto* wage negotiations showed an average raise of 3.57%, down from 3.70% in the first. Industry wise, there is a wide dispersion; manufacturing and IT pay the highest base-up rates around 4.0%, and services and hotels somewhat confoundingly pay low around 2.0% and 1.7%. Meanwhile, **nominal cash earnings** slowed sharply to 0.6% y/y in March from 1.4% in February. However, basic wages maintained their momentum by rising 1.7%. However, special wages (bonuses etc) fell 9.4% and depressed the overall wages. This series is quite volatile, but we are somewhat concerned about the possibility that firms may raise regular pay but at the expense of bonuses. Real wages declined 2.5% y/y, the twenty fourth consecutive decline. We are yet to see pick up in domestic consumption-led demand.

Following a big jump in February, consumption activity softened in March. The **BoJ real consumption activity index** retreated 0.3% m/m in March, with incremental moderation across all components (durable and non-durable goods, as well as services). Compared to a year ago, however, consumption was up 0.3%.

Next week, we expect Q1 GDP to have contracted 0.4% q/q on production halts at some automakers. Private consumption as such will contract, but there may also be some headwinds from services exports.

Australia

The **Reserve Bank of Australia (RBA)** held the cash rate at 4.35% and maintained their unflinching hawkish bias by still "not ruling anything in or out" on interest rate. This is at odds with central banks and markets in other advanced economies. Aussie markets are now pricing a 30% chance that the RBA will hike in August, as opposed to our still standing forecast of a cut.

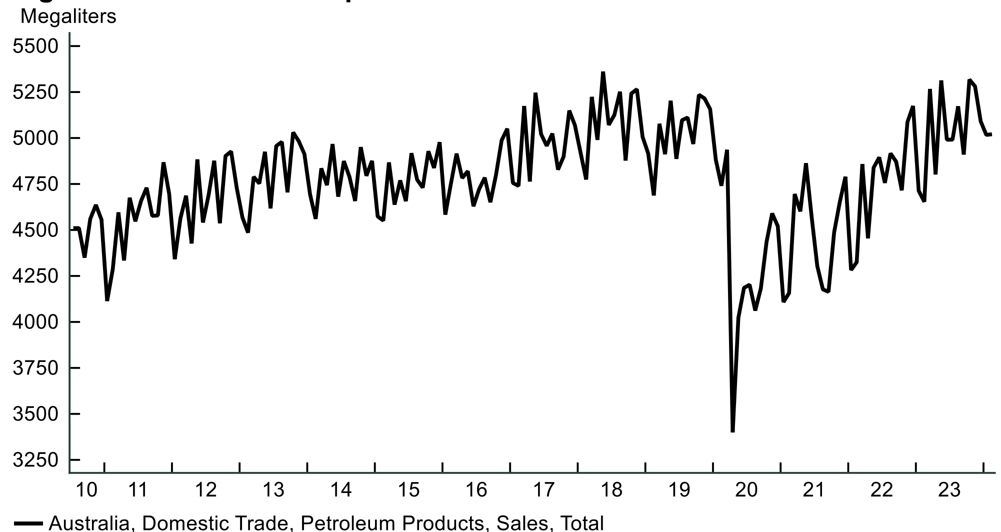
The RBA now forecasts the current interest rates will remain in place till mid-2025, nine months longer than previously expected. We are cautious not to read too much into this, because the Bank itself admitted that these projections are entirely "*derived from financial market pricing*". More surprisingly, the Bank did not consider the surveys of professional economists as it used to as "*recent staff analysis has found that using only financial market pricing is the best predictor of the future cash rate path unless there is unusual financial market volatility.*" We cannot help but wonder if markets should be pricing expectations based on the RBA or the other way around. The Bank risks demeriting its forward guidance by this new practice, and that is dangerous. Why? Because markets do not expect a

hike in any advanced economy.

Inflation forecasts were taken higher quite substantially to 3.8% y/y by December 2024, a massive 0.6 ppts rise. Services inflation declined a “little less than expected”, and higher petrol prices and the soon-to-end energy rebates are expected to lift headline inflation. We disagree on the labor market and as such, but agree that higher oil could add headwinds to the next phase in disinflation. However, petrol consumption has barely hit the pre-pandemic peak (figure 4).

Housing CPI (rents especially) could continue to increase but reliable leading indicators imply that overall inflation could be coming down into the target (under 3%) this year. We still see two rate cuts this year, but even probability between August and September, both of which are still clearly out of consensus.

Figure 2: Petrol Consumption In Australia Still Near Pre-Pandemic Levels



Sources: SSGA Economics, Australian Department of the Environment & Energy, Macrobond
Updated as of 5/11/2024

In the press conference Governor Michele Bullock maintained the same “not ruling anything in or out” stance and also mentioned that the Board did discuss a rate hike in May. It is crucial for incoming data to come in softer than expectations.

Next week, we expect Q1 Wage Price Index (WPI) to have risen 1.0% q/q and April employment data to have risen by 20k, below the consensus of 25k.

Week in Review (May 06 – May 10)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, May 06					
EC	Services PMI (April, final)	52.9 (p)	53.3	51.5	Best in a year.
GE	Services PMI (April, final)	53.3 (p)	53.2	50.1	Best in ten months.
Tuesday, May 07					
US	Consumer Credit (Mar, $ bn)	15.00	6.27	15.02 (↑)	Very soft.
GE	Factory Orders (Mar, m/m)	0.4%	-0.4%	-0.8% (↓)	Weak.
FR	Wages (Q1, q/q, prelim)	na	1.3%	0.4%	Up 3.3% y/y
AU	Retail Sales Ex Inflation (Q1, q/q)	-0.3%	-0.4%	0.4% (↑)	Negative impulse for Q1 GDP.
AU	RBA Cash Rate Target	4.35%	4.35%	4.35%	Very hawkish hold.
Wednesday, May 08					
GE	Industrial Production (Mar, m/m)	-0.7%	-0.4%	1.7% (↓)	Still weak.
IT	Retail Sales (Mar, m/m)	0.1%	0.0%	0.1%	Soft.
JN	Labor Cash Earnings (Mar, y/y)	1.4%	0.6%	1.4% (↓)	Slow but, could be sampling biases.
Thursday, May 09					
US	Initial Jobless Claims (May 04, thous)	212	231	208	Quirky increase, likely noise.
US	Continuing Claims (Apr 27, thous)	1,782	1,785	1,774	Very low.
UK	BoE Bank Rate	5.25%	5.25%	5.25%	Dovish hold.
JN	Leading Index CI	111.2	111.4	112.1	Negative impulse to Q1 GDP.
Friday, May 10					
US	U. of Mich. Sentiment (May, prelim)	76.2	67.4	77.2	Inflation expectations rose.
US	Monthly Budget Statement (Apr, $ bn)	250.0	209.5	176.2	Better, but far from good.
CA	Unemployment Rate (Apr)	6.2%	6.1%	6.1%	Strong rebound in employment.
UK	GDP (Q1, q/q, prelim)	0.4%	0.6%	-0.3%	Good.
UK	Industrial Production (Mar, m/m)	-0.5%	0.2%	1.0%(↓)	Encouraging.
IT	Industrial Production (Mar, m/m)	0.3%	-0.5%	0.0% (↓)	Soft.

Source: for data, Bloomberg®; for commentary, SSGA Economics.

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