STATE STREET GLOBAL ADVISORS

June 21, 2024
Commentary

Weekly Economic Perspectives

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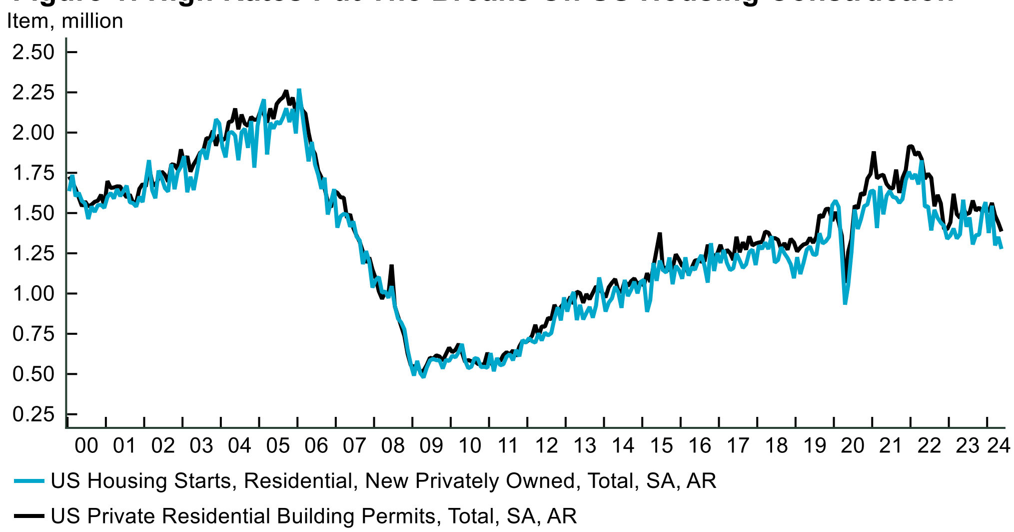
The Economy

Monetary policy differences highlighted by BoE's dovish hold, RBA's hawkish one.

US

Housing activity is relapsing amid elevated interest rates. **Housing starts** missed expectations quite badly, down 5.5% m/m to the lowest level since June 2020. No imminent improvement is in sight either as **building permits** also took another big step lower. They declined 3.8% m/m to also reach the lowest level since June 2020. Meanwhile, homebuilder sentiment eroded further, with the **NAHB index** down 2.0 points to a six-month low of 43. Finally, existing home sales declined 0.7% m/m in May and were down 2.8% y/y. After a surprisingly strong rebound in Q1, residential fixed investment may be heading for a contraction in Q2.

Figure 1: High Rates Put The Breaks On US Housing Construction



Sources:SSGA Economics, USCB

For the second month in a row, **retail sales** were softer than expected. And for the second month in a row, there were downward revisions to the prior two months. Retail sales increased 0.1% m/m in May, partly retracing April's 0.2% drop and leaving them just 2.9% higher y/y. Control sales (excluding food services, building materials, autos dealers, and gas stations) rose 0.4% m/m. However, downward revisions left the level of sales in May lower than where we initially thought April to be. Performance was very mixed, with the biggest declines in gasoline stations (-2.2% m/m, due to lower prices), furniture (-1.1%) and restaurants and bars (-0.4%). The best-performing category by far was sporting goods (+2.8% m/m), but this comes after two large declines so it may be just a brief rebound.

The industrial sector is in the process of bottoming out…and it is a *process*. **Industrial production** grew a better-than-expected 0.9% m/m in May, but only 0.4% versus a year ago. In fact, during the first five months of the year, industrial output was down marginally. Gains were broad-based during the month, with a 0.9% m/m increase in manufacturing, a 1.6% m/m gain in utilities, and a 0.3% m/m advance in mining. Within manufacturing, there was notable strength in machinery (+2.3% m/m) although this came after contractions in four of the previous five months.

Canada

Existing home sales declined for the second consecutive month, down 0.6% m/m in May. This left the current existing home sales 12% below their pre-pandemic level. Meanwhile, new listings inched 0.5% higher m/m, leaving them fully in line with their long-term average, and leading the sales-to-new listings ratio to drop to 52.8%, slightly below the long-term average.

Housing starts rebounded more than expected, with the seasonally adjusted annualized rate rising 10% m/m to a solid level of 264.5k in May. The six-month moving average of starts was also up 4% m/m at 247.8k. Latest gain was concentrated in multi-urban starts, which was up 13% m/m.

Retail sales rose 0.7% m/m in April on broad gains led by gasoline stations and fuel vendors, as well as food and beverage retailers. Core retail sales, which excludes auto, and gas were up by 1.4% m/m. Real retail sales rose 0.5% m/m in April.

UK

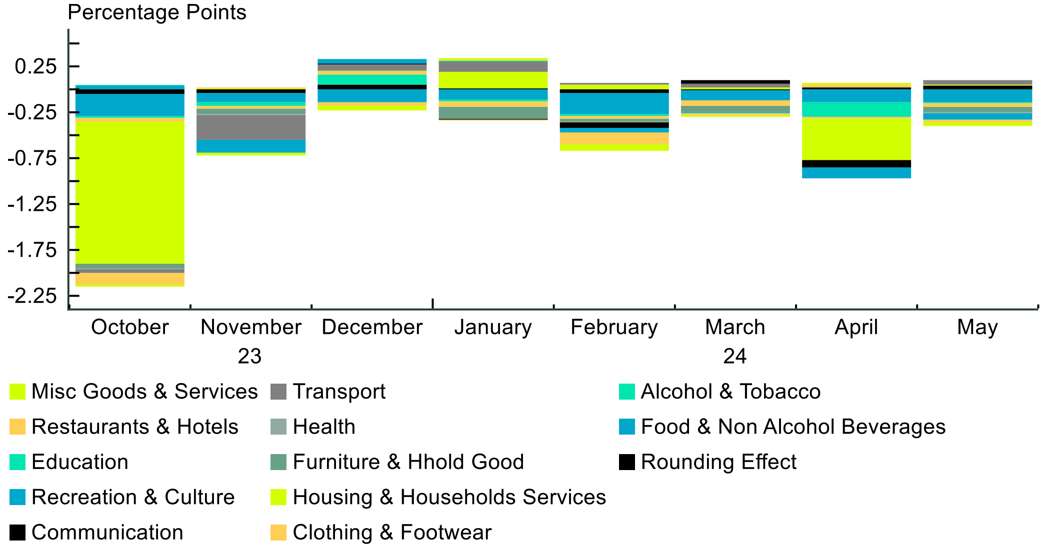
The **Bank of England (BoE)**’s decision to leave the policy rate unchanged at 5.25% was in line with market expectations but the bank’s statement was slightly more dovish. The decision was a split 7-2 vote, with two dissenting votes favoring a 25bps cut. And the decision was described as "finely balanced" for some policymakers, implying that an August rate cut is possible. In addition, policymakers appear less concerned by recent upside surprises in services inflation and seem to see them as reflecting noise related to annual price resets, rather than true signals. There was also new wording that “as part of the August forecast round, members of the Committee will consider all of the information available and how this affects the assessment that the risks from inflation persistence are receding”. Assuming the next inflation report in mid-July is aligned with the BoE’s expectations, we think that the Bank will vote for a rate cut in August, which is also our base case. We also look for at least two cuts this year (possibly three) from the BoE.

Headline **inflation** eased to 2.0% y/y in May, from 2.3%y/y in previous month, in line with market expectations (Figure 2, page 4). The slowdown was broad-based with food inflation the largest downward contributor to the monthly change in annual CPI rate. Core inflation fell from 3.9% y/y to 3.5% y/y, in line with market expectations. Goods inflation dropped from negative 0.8% to negative 1.3%, while the CPI services inflation eased modestly from 5.9% to 5.7%.

Real retail sales rebounded stronger than expected as consumer confidence improved amid slowing inflation. May retail sales expanded by 2.9% m/m, from a downwardly revised decline of 1.8% previous month. Sales volumes increase across all categories, led by clothing retailers and furniture stores.

Meanwhile, consumers felt more optimistic in June as concerns over living costs subsided. **The GFK consumer confidence index** increased more than expected, up three points to a 32-month high of -14. We expect to see the improvement in consumer confidence to further boost retail sales in the next few months.

Figure 2. UK Headline Inflation Fell with Lower Food Prices

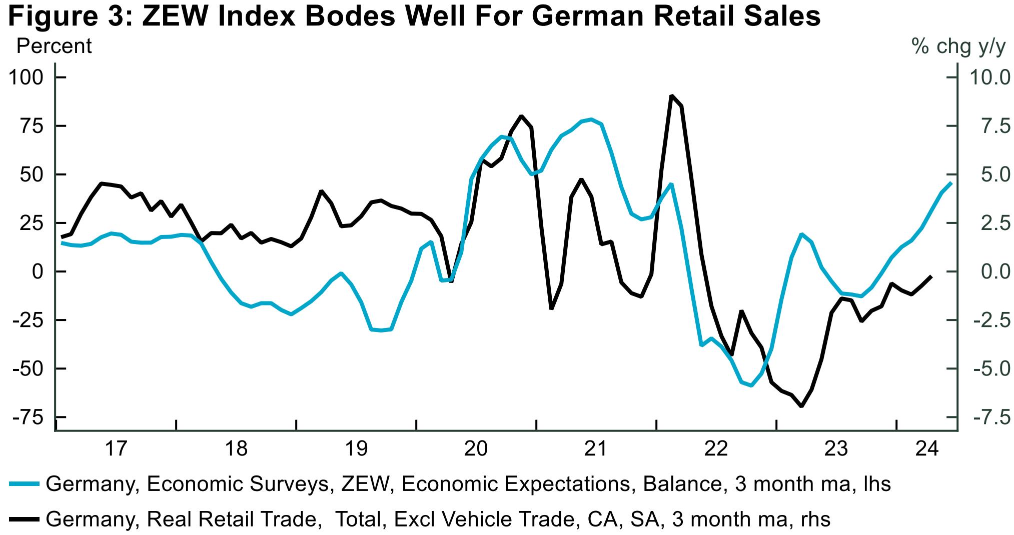


Sources: Macrobond, SSGA Economics, ONS
Updated as of 6/24/2024

Eurozone

The **ZEW index** of ***German*** investor confidence has been steadily improving over the past half a year and a half. The pace of improvement slowed in May, but the index now stands at its highest levels since February 2022, just before the Ukraine war. This is welcome news, especially since it has historically been a reasonably good leading indicator for of consumption.

Figure 3: ZEW Index Bodes Well For German Retail Sales



Sources: Macrobond, SSGA Economics, DESTATIS, ZEW
Updated as of 6/23/2024

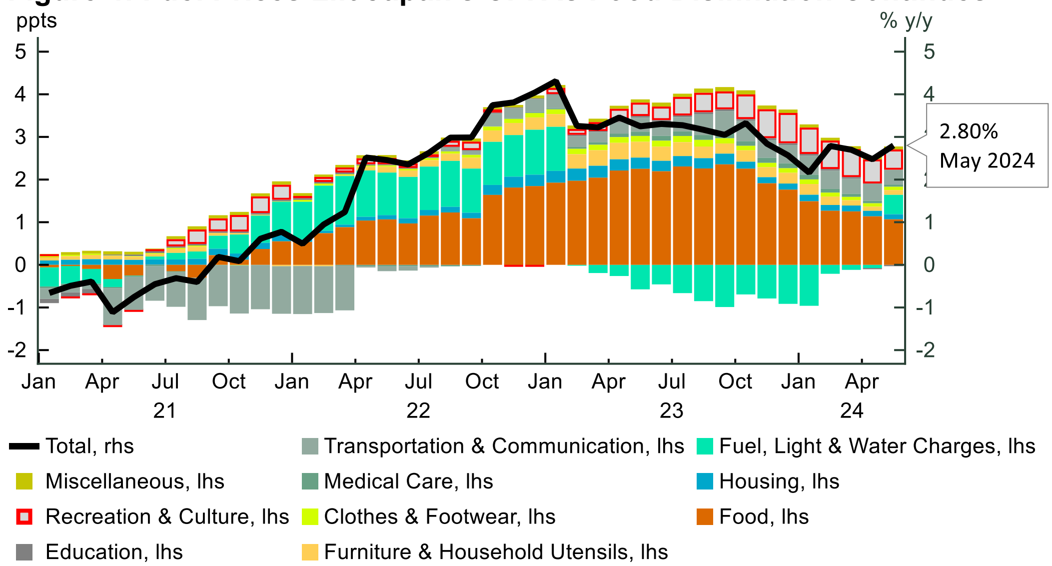
Meanwhile, preliminary readings on the June **purchasing managers' indexes** across the eurozone showed a disappointing acceleration in the rate of decline in

manufacturing activity, with German manufacturing PMI down a full 2.0 points to 43.4, French manufacturing PMI down 1.1 points to 45.3 and the eurozone index down 1.7 points to 45.6. These outcomes were all the more disappointing since consensus expectations had been for modest improvements in all three. Thankfully, service activity continued to expand, albeit at a somewhat less robust pace. Still, **services PMIs** remain in the low 50s range, indicting expansion.

Japan

National CPI inflation jumped three tenths to 2.8% y/y in May, as widely expected. This was entirely due to surging renewable energy charges, as electricity prices rose a massive 14.7% y/y. Domestic demand remained muted however, as the global core CPI (excluding all food and energy) rose just 2.1% y/y, down three tenths and also below the consensus of 2.3%. However, recreation CPI remained intact (5.2% y/y), and food disinflation continued, as annual rise slowed two-tenths to 4.1%.

Figure 4: Fuel Prices Lift Japan's CPI As Food Disinflation Continues



Sources: SSGA Economics, SBJ, Macrobond
Updated as of 6/23/2024

Prime Minister Fumio Kishida announced plans late Friday to extend the fuel subsidies (which were supposed to expire between July and August) to year-end, and also to roll out electricity and gas subsidies by October. These measures are expected to lower annual CPI inflation by 0.5 pp each month. We still expect underlying inflation to remain above 2% in the near term and be highlighted in the three inflation data releases before the Bank of Japan (BoJ) meets on July 31. So effectively, inflation should remain above the Bank's target.

Governor Kazuo Ueda said during the week that there is a chance the Bank could '*raise interest rates at July meeting*' subject to incoming data. This comes just days after we wrote that the June meeting was a calm before the storm, as we expect the BoJ to not only raise rates, but also begin tapering their JGB purchases. Deputy Governor Shinichi Uchida further clarified that the Bank's reduction in JGB purchases could be ‘significant’, starting July. We expect monthly purchases to still be around 5 trillion yen, down from an average of 6 trillion yen for a while. However, if markets continue taking the well guided normalization process in stride, we see a possibility of a stealth taper, whereby the BoJ reduces its monthly purchases continually over two years to let markets decide long-term interest rates in Japan. We see the 10y JGB yield between the current 1.0% level to 1.5% in the medium term. That the BoJ was able to normalize policy so far without any adverse event is in itself a testament to their proactive guidance.

Furthermore, efforts to sell more of the shorter tenured debt are underway, as the BoJ turns hawkish, and there is no meaningful improvement in domestic demand for JGBs. A finance ministry panel is likely to suggest that domestic banks could play a ‘big role’ in the bond market, Reuters reported this week—a point we made repeatedly over the past year. This will mark another big change in Japan, as it has been a long-standing practice to issue more longer tenured debt.

Finally, **flash PMIs** disappointed in June, with the services index slipping into contraction (49.8) for the first time since mid-2022. The new business, new export orders, and employment indices declined 3.0, 4.1 and 1.3 points, respectively. The manufacturing index declined only modestly by 0.2 points to 50.1 with relatively more upbeat details. Most importantly, input prices for both manufacturing and services rose by 1.2 and 0.5 points, respectively, but output prices declined 2.8 points for services and rose 0.6 points. The overall takeaway is that services are vulnerable to labor costs as wages rise, while manufacturing is relatively in better shape.

Next week’s focus will be on the Summary of Opinions of the BoJ’s June meeting, while we expect July Tokyo CPI to have risen 2.5% y/y.

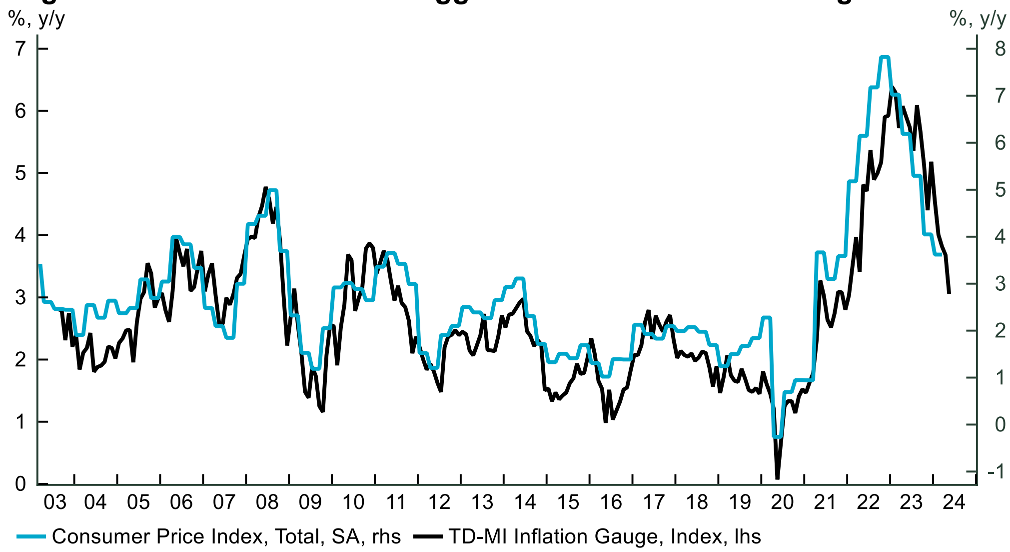
Australia

The **Reserve Bank of Australia (RBA)**, held the cash rate steady at 4.35%, but dialed up their hawkishness in the statement. The last paragraph brought back the clause that the Bank “*will do what is necessary to achieve the outcome*” after two meetings. The board opined that the “persistence of inflation suggest that risks to the upside remain,” and noted that inflation is proving persistent and sees a ‘reinforced’ need to remain ‘vigilant to upside risks’. Eventually, the Bank did not rule anything in or out on rates.

Most surprisingly, Governor Michele Bullock said that the board considered hiking rates in this meeting, and did not consider cutting; this was the main hawkish surprise in this meeting and has dialed up the risk of another rate hike this year. She did mention that being vigilant did not mean that a hike was coming. We continue to see a rate hike as an unlikely event, and still look for the first rate cut to be delivered in November. But it is crucial for inflation data to highlight softening price pressures.

Next week, we expect the May monthly CPI to have risen 3.8% y/y.

Figure 5: Alternative Metric Suggests Aussie CPI Within Target Soon



Sources: SSGA Economics, Melbourne Institute of Applied Economic & Social Research, ABS, Macrobond
Updated as of 6/23/2024

Week in Review (Jun 17 – Jun 21)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Jun 17					
US	Empire Manufacturing (Jun)	-10.0	-6.0	-15.6	Mixed.
CA	Housing Starts (May, thous)	245.1	264.5	241.1 (↑)	Solid level.
CA	Existing Home Sales (May, m/m)	-1.0%	-0.6%	-1.7%	Contracted less than expected.
JN	Core Machine Orders (Apr, m/m)	-3.0%	-2.9%	2.9%	Month-to-month gyrations.
Tuesday, Jun 18					
US	Retail Sales Advance (May, m/m)	0.3%	0.1%	-0.2% (↓)	Second month of downward revisions.
US	Industrial Production (May, m/m)	0.3%	0.9%	0.0%	In process of bottoming out.
US	Business Inventories (Apr, m/m)	0.3%	0.3%	-0.1%	As expected.
EC	CPI (May, y/y, final)	2.6%	2.6%	2.4% (↓)	Confirms preliminary reléase.
GE	ZEW Survey Expectations (Jun)	50.0	47.5	47.1	Improvement continues.
AU	RBA Cash Rate Target	4.35%	4.35%	4.35%	Hawkish turn, we expect one cut this year in Nov.
Wednesday, Jun 19					
US	NAHB Housing Market Index (Jun)	46.0	43.0	45.0	Lowest in six months.
UK	CPI (May, y/y)	2.0%	2.0%	2.3%	Services inflation still high.
Thursday, Jun 20					
US	Initial Jobless Claims (Jun 15, thous)	235.0	238.0	243.0 (↑)	Second month of elevated readings.
US	Continuing Claims (Jun 08, thous)	1,810	1,828	1,813 (↓)	Ticking higher, but too soon to be concerned.
US	Housing Starts (May, thous)	1,310	1,277	1,352 (↓)	Lowest since June 2020.
US	Building Permits (May, thous)	1,450	1,386	1,440	Lowest since June 2020.
US	Philadelphia Fed Business Outlook (Jun)	5.0	1.3	4.5	The details were noticeably better.
UK	Bank of England Bank Rate	5.25%	5.25%	5.25%	In line with expectations
Friday, Jun 21					
US	Leading Index (May, m/m)	-0.3%	-0.5%	-0.6%	Deteriorating again.
US	Existing Home Sales (May, m/m)	-1.0%	-0.7%	-1.9%	Down 2.8% y/y.
CA	Retail Sales (Apr, m/m)	0.7%	0.7%	-0.3% (↓)	As expected.
UK	GfK Consumer Confidence (Jun)	-16.0	-14.0	-17.0	Welcome improvement.
UK	Retail Sales Inc Auto Fuel (May, m/m)	1.8%	2.9%	-1.8% (↑)	Good.
UK	Manufacturing PMI (Jun, prelim)	51.1	51.4	51.2	OK.
UK	Services PMI (Jun, prelim)	53.0	51.2	52.9	OK.
EC	Manufacturing PMI (Jun, prelim)	47.9	45.6	47.3	Relapsing or just a brief dip?
EC	Services PMI (Jun, prelim)	53.4	52.6	53.2	OK.
GE	Manufacturing PMI (Jun, prelim)	46.4	43.4	45.4	Concerning.
GE	Services PMI (Jun, prelim)	54.4	53.5	54.2	OK.
FR	Manufacturing PMI (Jun, prelim)	46.8	45.3	46.4	Disappointing.
JN	National CPI (May, y/y)	2.9%	2.8%	2.5%	Sharp rise in renewable energy costs.
JN	Manufacturing PMI (Jun, prelim)	na	50.1	50.4	Services in bad shape, and concerning.

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

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* Pensions & Investments Research Center, as of December 31, 2022.

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