STATE STREET GLOBAL ADVISORS

May 31, 2024
Commentary

Weekly Economic Perspectives

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The Economy

String of mixed global macro data continues.

US

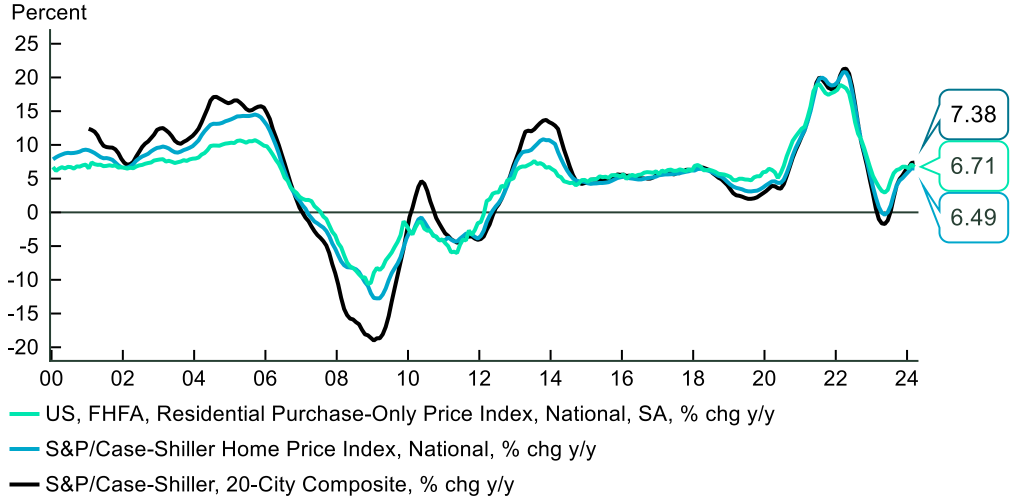
The downward revisions to **first quarter GDP growth** (from 1.6% to 1.3% annualized) were not a game changer but were meaningful enough to underscore a point we've been making for months: rather than reaccelerating, the US economy is slowing. The outcome, which may still be tweaked in the final revision, stands at nearly half the initial 2.5% consensus expectations for Q1 performance. The revisions were largely due to lower goods consumption and lower inventories. We would not be surprised if the former has further to run, given that goods consumption as a share of total household consumption continues to run about 2 percentage points higher than pre-Covid. As we are now in the fourth year post-pandemic, we would expect some further normalization in consumption patterns at the expense of goods consumption. Services spending growth was unchanged at 1.0% q/q but this, too, seems untenable. This was the strongest growth since Q3 2021, when services demand was in full blown resurgence; we struggle to find a convincing driver for sustained growth at this pace. This is especially so given a sizable downward revision to estimates for wage and salary income in Q4 2023. While households in the aggregate can draw down on massive accumulated wealth to finance consumption, for a growing share of consumers, future consumption will be constrained by future income growth given that the savings rate is already at a historical low of 3.6%. The inventories revision may be a one-off given the big surge in imports during the quarter, so we anticipate a bit of an inventory buildout from here. Elsewhere, the investment picture was little changed post-revisions. Real GDP grew 2.9% y/y in Q1, and the GDP deflator was up 2.4% y/y. The latter marked the lowest reading since Q4 2020.

The **Conference Board Consumer Confidence Index** rebounded 4.5 points in May, well ahead of expectations. Even so, this did not manage to fully retrace the April decline, let alone the cumulative losses since February: at 102, the headline is still nearly 9 points lower than it was at the start of the year. Looking at the details, expectations improved more than assessments of the present situation. The important labor differential metric (which measures the difference between those who think jobs are abundant and those who think jobs are scarce) improved a little, but only from a downwardly revised April reading. In fact, the May level is below where April originally printed and marks the fourth-lowest level since April 2021. We see this as another indication that the labor market is gradually loosening. All in all, the signal from this release is less upbeat than the headline alone would suggest.

Homebuilder sentiment had declined for the first time in six months in May and this week's update on pending home sales makes it clear why. **Pending home sales**—sales of existing homes where the buyer and seller have agreed on the transaction but the purchase hasn't "closed" yet—were expected to ease 1.0% m/m in April, but plunged 7.7% instead, the worst monthly decline since February 2021. They remain 0.8% below last year's already depressed levels. 30-year mortgage rates are hovering just above 7.0%, up roughly 40 basis points since the start of the year and depressing both demand and supply.

Houses that do sell still command higher prices because the market remains in a structural under-supply situation, but constrained affordability nonetheless appears to be limiting the upside. The **S&P CoreLogic/Case-Shiller** composite 20-city home price index stood 7.4% higher y/y in March while the **FHFA** existing single family home prices rose 6.7% % y/y. While still somewhat elevated, these increases no longer seem particularly excessive relative to the ranges that prevailed in the pre-Covid years.

Figure 1: Growth In US Home Prices Not Extreme



Sources: Macrobond, SSGA Economics, S&P Global, FHFA
Updated as of 5/30/2024

Personal income growth moderated two tenths to 0.3% m/m in April, while **spending** undershot expectations with a modest 0.2% nominal increase (the robust March gain was also revised a tenth lower). In real terms, spending contracted 0.1% m/m, the first decline since January and only the third in the past year. Wage and salary income was soft at 0.2% m/m but this was well telegraphed by modest gains in average hourly earnings and weak hours worked in the payrolls report, so it wasn't much of a surprise. Importantly, though, growth in real personal disposable income slowed to 1.0% y/y; this is not a robust reading by any means. We've pointed to moderating growth here for some time because unless consumers can continue to dis-save to finance spending, consumption must slow to be closer in line with underlying income growth. With the savings rate at a low 3.6%, the scope for further dissaving is increasingly limited for an increasing number of consumers. The second implication is that consumption health depends increasingly on the health of labor-related incomes. The third implication is that labor market data becomes more relevant for the Fed path. (To read our latest thoughts on the Fed and other key central banks, please see here.)

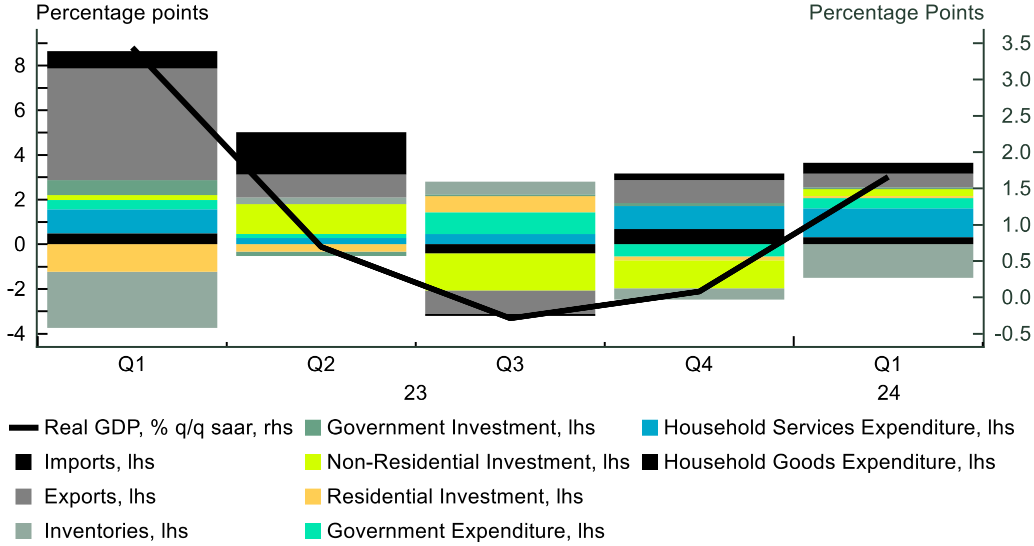
The good news is that inflationary pressures moderated. Admittedly, this moderation was in line with expectations and so not a surprise per se. The PCE deflator increased 0.3% m/m and the core PCE deflator rose 0.2% m/m, leaving both measures of inflation steady at 2.7% y/y and 2.8% y/y, respectively.

Canada

The latest **GDP** data showed weaker-than expected Q1 GDP growth and a big downward revision to Q4 growth, but the most important detail from the data was stronger-than-expected household consumption. Q1 GDP grew 1.7% q/q saar, softer than consensus at 2.2% and much lower than the BoC's latest forecast of 2.8%. Q4 growth was also revised lower to just 0.1% from 1.0%. However, final domestic demand came in at a very strong 2.9% q/q, with consumer spending supporting growth (+3.0% q/q). In addition, final domestic demand was revised higher in Q4. Business investment rebounded during the quarter (+3.1% q/q), driven by higher housing activity and investment in oil and gas sector. Meanwhile, net trade contributed a minor lift to GDP (adding 0.1 percentage point) and inventories were a substantial 1.6pp drag on GDP.

Softer-than-expected GDP growth supports an early rate cut in June. However, we expect that the BoC will leave rates unchanged next week and use the meeting to communicate about the upcoming rate cut (very likely in July) given the divergent signals on inflation outlook and stronger household spending, in addition to renewed strength in labor market.

Figure 2: Consumer Spending Supports Canadian Q1 GDP Growth



Sources: Macrobond, SSGA Economics, StatCan
Updated as of 6/2/2024

UK

The UK housing market shows resilience, supported by an improvement in consumer confidence. **The Nationwide house price index** rose by 0.4% in May, exceeding market expectations of 0.2% m/m. In annual terms, the growth rate picked up to 1.3% during the month, from 0.6% in April.

The effect of high interest rates on the housing market continues to fade but not as much as we expected. **Mortgage approvals** fell slightly to 61.1 k in April, lower than market expectations of 61.5k, and from a downwardly revised 61.3k in March.

Eurozone

***German* consumer confidence** improved to the highest level since April 2022, with the economic outlook component reaching its highest level since February of that year. Given healthy household balance sheets, we anticipate this to lead to some visible improvement in consumer spending in coming quarters.

Italy's improved economic growth over the last few years has allowed steady improvements in the labor market such that the headline **unemployment rate** dipped to 6.9% in April, the first sub-7.0% reading since December 2008.

Figure 3: Italian Unemployment Rate Nears Record Lows

Sources: Macrobond, SSGA Economics, Istat
Updated as of 6/2/2024

Broadening signs of improvement on the growth front, coupled with substantial improvement in inflation (preliminary readings put May's inflation at 2.4% y/y in Germany, 2.2% y/y in France, and 0.8% y/y in Italy) lay the ground for what is widely anticipated to be the start of an easing cycle by the **ECB** next week. We look for a 25-basis point cut and a cautious signaling that more would follow. We anticipate 75 basis points in total cuts from the ECB this year.

Japan

The **Tokyo CPI** data for May hinted that inflation is turning back up in Japan. The core-CPI metric (which excludes fresh-food) reversed its downward trend since 2023 and rose 0.4% m/m (or 1.9% y/y). A jump in renewable energy levy drove the turnaround, as electricity prices rose 6.9% m/m. In the next two months, the impact will increase, as electricity subsidies will be removed. Still, underlying inflation remained rather muted as the global standard metric of core (which excludes both food and energy) softened two tenths to 1.2% y/y, on drag from the recently introduced policy of free high school tuition introduced in April.

Industrial production declined 0.1% m/m in April, after rising 4.4% in March, severely undershooting expectations. Production rose in eight of 15 industries. Transportation equipment (excluding automobiles) declined sharply by 13.4% and dragged the overall index, due to an accident at a large aircraft manufacturer.

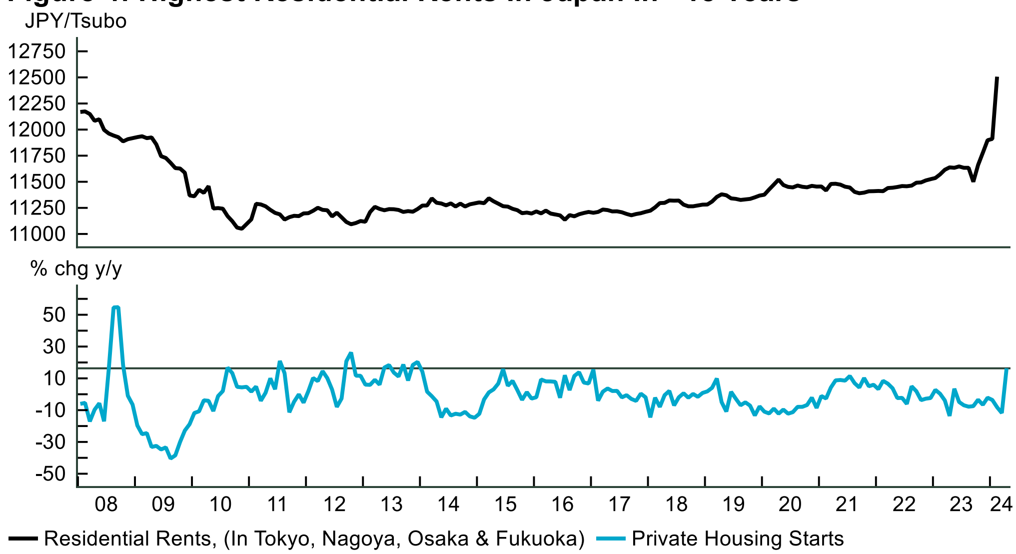
Retail sales rose 2.4% y/y, higher than the consensus of 1.9% in April. Sales have been strong for the last two months, and were led by machinery equipment (5.7%), and textiles (3.2%). However, sales of fuel (-2.3%) and beverages (-0.7%) and other sales (-0.3%) balanced the rise in other categories. Meanwhile, the labor market remained tight in April, as the unemployment rate was steady at 2.6%.

However, **consumer confidence** is taking longer to resume an upward trend; the index worsened for a second month to 36.2 in May, below the consensus of 38.9. The Cabinet Office too noted that the recovery was at a 'standstill'. All the four components of the index declined, with the willingness to buy durable goods declining the most by 2.8 points. Inflation expectations rose markedly; with those expecting prices to rise 5% or more rising by 9.2 points in the last 3 months to 46.8%. The ending of energy subsidies perhaps had a role in the decline.

Housing starts rebounded impressively by 13.9% y/y in April, the largest rise since July 2015, and led by the Tokyo prefecture. Japan's housing market is broadly characterized by oversupply, but in general urban areas see good demand, reflected in rising property prices, as well as rents. We do not know how long will this trend will continue, but it is certainly another reason to believe that the macro-picture in Japan has changed greatly since the pandemic.

Next week, we expect wages to have risen in April, while household spending would have turned positive after February 2023.

Figure 4: Highest Residential Rents In Japan In ~18 Years



Sources: SSGA Economics, ARES, MLIT, Macrobond
Updated as of 6/2/2024

Australia

The April **monthly CPI** rose 0.7% m/m and 3.6% y/y. We believe seasonality had a role to play, as the metric adjusted for it rose just 0.2% m/m, which will be the smallest monthly rise since December. Compositionally, the upside surprise was driven by volatile components like fruits (7.3% m/m), oils and fats (4.6%), clothing for children (6.8%), women, (4.5%), and international travel (11.0%) and health (2.0%). Their weights added up to 7.5%, so these one-time rises had an effect. The health component captured the annual increases in health insurance premiums, which typically go into effect from April 01 every year.

Again, when we adjust these components for seasonality, we see a significantly lower growth rate than the headline. Nonetheless, markets again swung into pricing hikes, but we still believe the headline quarterly CPI will reach the target before expectations as we also believe there might be sampling issues in April (every first month of a quarter has sampling bias to services).

Meanwhile, total **private sector credit** rose 0.5% m/m in April, a touch above expectations. Housing credit rose 0.5%, while business credit remained at 0.6%.

All eyes will be on the release of Q1 real GDP next Wednesday, and is currently tracking at 0.3% q/q, after a set of partials released this week. **Capital expenditures** rose 1.0% q/q and indicate a positive outlook for FY 2025. The ABS noted strength in data centers and renewable energy related infrastructure. However, **construction work done** declined unusually by 2.9% q/q, worse than the consensus of a modest rise. Nonresidential construction was particularly weak as it declined by 7.0%.

We expect domestic consumption to have declined in Q1, only for a sixth time in over six decades. We noted last week that retail trade (volumes) in Q1 declined by 0.4% q/q, almost twice what was expected. Another key driver of growth, net exports could also be negative. However **nominal retail sales** rose a tenth below expectations by just 0.1% m/m in April, the ABS highlighted that the unusual timing of Easter holidays added some volatility, as April’s spending on food was brought forward in March.

Week in Review (May 27 – May 31)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, May 27					
GE	IFO Business Climate (May)	90.4	89.3	89.3 (↑)	Moving sideways, no breakthrough yet.
JN	Leading Index CI (Mar, final)	111.4 (p)	112.2	112.1	Rebounding after a Q1 lull.
Tuesday, May 28					
US	FHFA House Price Index (Mar, m/m)	0.5%	0.1%	1.2%	Up 6.7% y/y.
US	CoreLogic CS 20-City (Mar, m/m)	0.30%	0.33%	0.55% (↓)	Up 7.4% y/y.
US	Conf. Board Consumer Confidence (May)	96.0	102.0	97.5 (↑)	But labor differential soft.
JN	PPI Services (Apr, y/y)	2.3%	2.8%	2.4% (↑)	Great!
AU	Retail Sales (Apr, m/m)	0.2%	0.1%	-0.4%	Aussie consumption trading water for 5-quarters.
Wednesday, May 29					
GE	GfK Consumer Confidence (Jun)	-22.5	-20.9	-24.0 (↑)	Steady improvement.
GE	CPI (May, y/y, prelim)	2.4%	2.4%	2.2%	Green light for June ECB cut.
FR	Consumer Confidence (May)	91.0	90.0	90.0	Uptrend has paused a little.
IT	Consumer Confidence Index (May)	96.0	96.4	95.2	Moving sideways.
IT	Manufacturing Confidence (May)	88.0	88.4	87.7 (↑)	Trying to bottom.
JN	Consumer Confidence Index (May)	39.5	36.2	38.3	Needs to improve.
Thursday, May 30					
US	GDP (Q1, q/q saar, second)	1.6% (p)	1.3%	3.4%	Downgrades to consumption, inventories.
US	Initial Jobless Claims (May 25, thous)	217	219	216 (↑)	Extremely low.
US	Continuing Claims (May 18, thous)	1,796	1,791	1,787	Extremely low.
US	Pending Home Sales (Apr, m/m)	-1.0%	-7.7%	3.4%	Down 0.8% y/y.
IT	Unemployment Rate (Apr)	7.3%	6.9%	7.2%	Lowest since 2008!
Friday, May 31					
US	Personal Income (Apr, m/m)	0.3%	0.3%	0.5%	Wage and salary income grew just 0.2%.
US	Personal Spending (Apr, m/m)	0.3%	0.2%	0.7% (↓)	Softening.
CA	GDP (Q1, q/q saar)	2.2%	1.7%	0.1% (↓)	Softer-than-expected.
UK	Nationwide House PX (May, m/m)	0.2%	0.4%	-0.4%	Good.
UK	Mortgage Approvals (Apr, thous)	61.5	61.1	61.3	OK.
GE	Retail Sales (Apr, m/m)	-0.3%	-1.2%	2.3% (↑)	Very volatile!
FR	CPI (May, y/y, prelim)	2.4%	2.2%	2.2%	Green light for June ECB cut.
FR	GDP (Q1, q/q, final)	0.2%	0.2%	0.3%	Up 1.3% y/y.
IT	GDP WDA (Q1, q/q, final)	0.3%	0.3%	0.1%	Up 0.7% y/y.
IT	CPI NIC incl. tobacco (May, y/y, prelim)	0.7%	0.8%	0.8% (↓)	Green light for June ECB cut.
IT	Industrial Sales (Mar, m/m)	na	-2.9%	1.9% (↓)	Unimpressive.
JN	Unemployment Rate (Apr)	2.6%	2.6%	2.6%	Very tight labor market.
JN	Job-To-Applicant Ratio (Apr)	1.28	1.26	1.28	Very tight labor market.
JN	Industrial Production (Apr, m/m, prelim)	0.9%	-0.1%	4.4%	Decline on temporary factors, should rebound.
JN	Retail Sales (Apr, m/m)	0.6%	2.4%	-1.2%	Great!
AU	Private Sector Credit (Apr, m/m)	0.4%	0.5%	0.3%	High in level, still a risk.

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

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- Build from breadth
- Invest as stewards
- Invent the future

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

† This figure is presented as of June 30, 2023, and includes approximately $63 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.

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