STATE STREET GLOBAL ADVISORS

May 24, 2024
Commentary

Weekly Economic Perspectives

Contents

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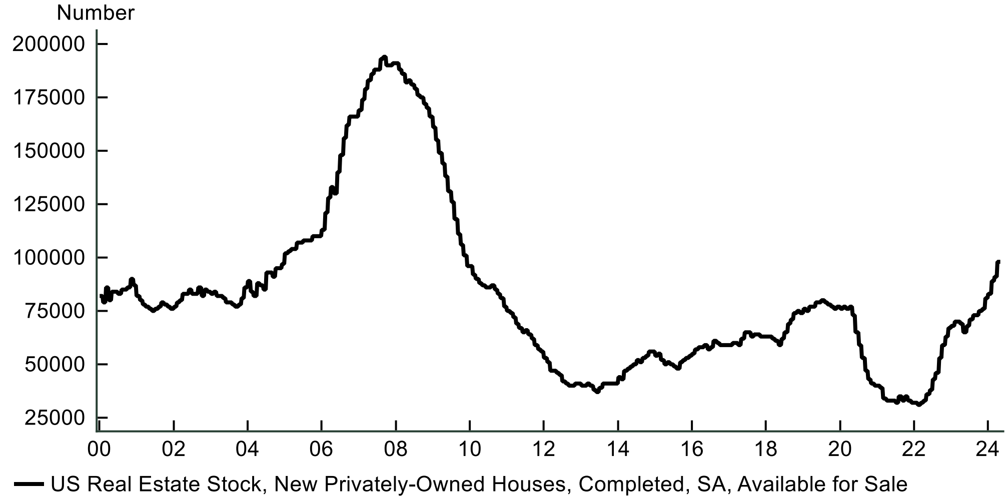
The Economy

Mixed macro data leaves hawkish central bank speak to drive rate expectations.

US

The soft patch in housing sector data evident in last week's homebuilder sentiment and housing starts/ permits extended this week to new and existing home sales. **New home sales** dropped 4.7% m/m, a weak showing exacerbated by sizable downward revisions to the prior two months. April sales were 7.7% lower than a year earlier, the first y/y contraction since April 2023. Inventory improved to 9.1 months' worth of sales, the highest since November 2022. Importantly, the number of already completed homes available for sale is now the highest since late 2009 (Figure 1). Presumably, the increased availability of completed homes should put some downward pressure on prices, especially since the inventory of existing homes has also picked up a little recently. Still, given the general undersupply of housing, this may simply cap price increases rather than driving outright price declines. That seems, indeed, to be happening at the moment, as the median price increased 3.9% y/y and the average price rose 1.0% y/y.

Figure 1: US Inventory Of New Completed Homes Near 15-Year High



Sources: Macrobond, SSGA Economics, US Census Bureau
Updated as of 5/27/2024

Existing home sales dipped 1.9% m/m in April, bucking expectations of a small gain. Sales were also 1.9% lower than in April 2023. Inventory improved further, although at 3.5 months' worth of sales, it is still very low by historical standards. However, with the exception of last October, this was the second highest inventory level since June 2020. While current homeowners are reluctant to give up their current low-rate mortgages, thus keeping supply constrained, the passage of time likely forces a growing number of sellers to move in response to changing life circumstances. Home prices continue to rise, but not at an excessive pace. The median price of an existing single-family home increased 5.6% y/y in April.

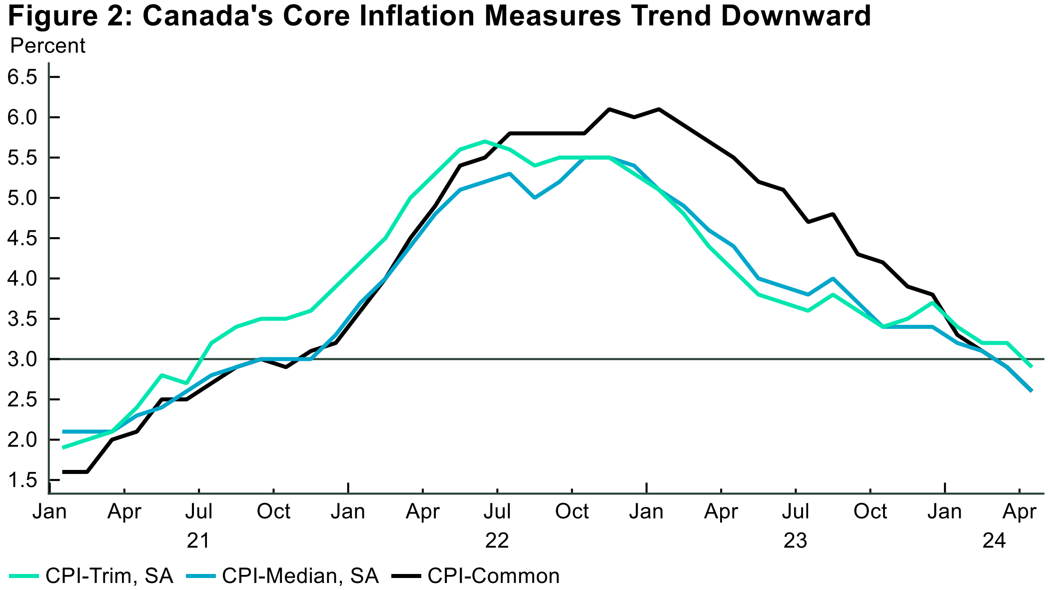
The preliminary **durable goods orders** data for April should not be viewed as an upside surprise, even though orders rose 0.7% versus expectations for a 0.8% decline. The reason is that prior data was revised sharply lower. Orders for core capital goods (non-defense capital goods excluding aircraft) increased 0.3% n/n. The good news is that gains were broad in April, with all categories experiencing gains with the exception of non-defense aircraft. However, the story is far from truly upbeat as overall durable goods orders are up just 0.7% y/y on average so far in 2024.

The best news in the final reading for the May **University of Michigan consumer sentiment index** was not so much the modest improvement in the headline, but the pullback in inflation expectations. The final reading of 69.1 was noticeably better than the initial 67.4 read, but still 8.1 points lower than the March print and marked a six-month low. However, the pullback in inflation expectations is perhaps the more important story here. Initially, short-term (1 year) inflation expectations were reported at 3.5% and long-term (5-10 year) inflation expectations were reported at 3.1%, both marking six-month highs. The final release put the former at 3.3% and the latter at 3.0%. We commented with the initial release that the rise in inflation expectations likely reflected delayed responses to rising gas prices and was likely to be short-lived. The revised numbers support that view, especially since gasoline prices have stabilized in recent weeks.

Canada

Headline **CPI inflation** eased two tenths in April to 2.7% y/y, in line with expectations. The slowdown was led by food prices, services, and durable goods. However, the easing was moderated by gasoline prices which rose 6.1% versus a year y/y, compared to 4.5% in March. Excluding gasoline, annual inflation slowed to 2.5% y/y in April, down from 2.8% in March. Goods inflation continued to slow, up only 1.0% y/y in April. Consumers are also seeing lower inflation for food, which is at 2.3% y/y in April, down from 3.0% y/y in March. Shelter inflation which is in the interest of the BoC, took a small step in the right direction, edging up one-tenth to 6.4% y/y. Rent inflation cooled slightly to 8.2% y/y as did mortgage interest costs, which remain high at 24.5% y/y. CPI ex-shelter was up only 1.2% y/y on April.

Figure 2: Canada's Core Inflation Measures Trend Downward



Sources: Macrobond, SSGA Economics, StatCan
Updated as of 5/27/2024

Meanwhile, the Bank of Canada's preferred **core inflation measures** continued to make good progress towards the target (Figure 2, page 3). The weighted median, common, and trimmed mean measures all eased by 0.3 percentage points to 2.6% y/y, 2.6% y/y and 1.9% y/y respectively. This is the first time since June 2021 that the measures moved into the target 1-3% range, albeit at the upper bound of the range. This is not the final proof that the BoC has been waiting for before starting rate cuts, but an important piece of evidence.

Consumer spending continues to be dampened by high rates. **Retail sales** contracted 0.2% m/m in March, slightly worse than market expectations of -0.1% m/m. The decline was widespread and led by furniture, home furnishings, electronics and appliances. Core retail sales, which exclude auto and gas, fell by 0.6% m/m. Statistics Canada estimates that sales were likely to increase by 0.7% m/m in April.

UK

As we expected, headline and services **CPI inflation** came in hotter than both the BoE and market expectations in April, which would favor another “hold” decision next month. The headline inflation rate eased sharply to 2.3% y/y from 3.2% y/y in the previous month, but still two tenths above the BoE and market expectations. The deceleration was led by food inflation and utility inflation, which was moderated by sticky services inflation. Services inflation edged only one-tenth lower to 5.9% y/y, largely above the BoE and consensus estimates of 5.4% y/y. That led to core inflation also dropping less than expected to 4.2% y/y from 3.9% y/y in March although goods inflation slowed from 0.8% y/y to -0.8% y/y.

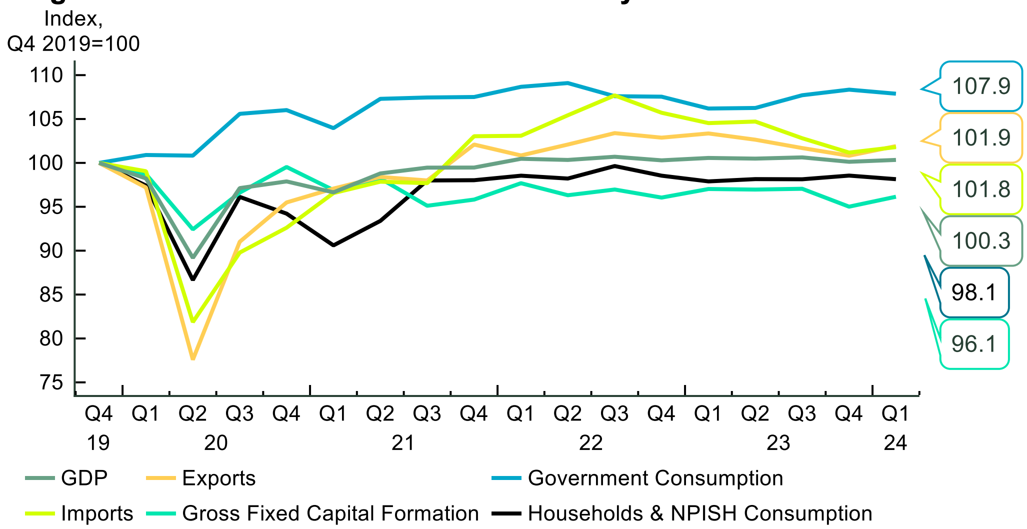
A combination of increasing fuel prices, high living costs and wet weather continued to have a negative impact on sales. April **retail sales** contracted 2.3% m/m, much worse than market expectations of -0.4% m/m, with declines across all categories. Automotive fuel sales volumes showed their largest monthly decline since October 2021, mainly due to rising fuel prices. Excluding fuel, retail sales fell by 2.0% m/m.

Consumers turned more optimistic in May as concerns on living cost subsided. The UK **GFK consumer confidence** index increased more than expected, by two points to its 29-month high of -17 in May. Four measures were up and only the major purchase index slightly declined from last month. We expect to see the improvement in consumer confidence to boost retail sales in the next few months.

Eurozone

An analysis of ***German*** economic performance since Covid makes for depressing reading. Admittedly, the first two years of that period were relatively OK as real **GDP** regained its pre-pandemic peak by Q1 2022. Unfortunately, surging energy costs following the Ukraine invasion hit German industrial competitiveness hard while the following inflation wave depressed household consumption to such an extent that further progress was hindered. Indeed, the German economy today is a mere 0.3% larger than it was in Q4 2019. By contrast, the US economy is 8.7% larger, the Japanese economy 2.5% larger, and the UK economy 1.7% larger. The outcome would have been worse still if not for considerable fiscal support, with real government consumption up roughly 8.0% over the same period. Unsurprisingly, fixed investment has been the biggest laggard: having outperformed in the early stages of the recovery, it now stands almost 4.0% below pre-Covid levels.

Figure 3: German Real GDP Has Practically Stalled Since Covid



Sources: Macrobond, SSGA Economics, DESTATIS

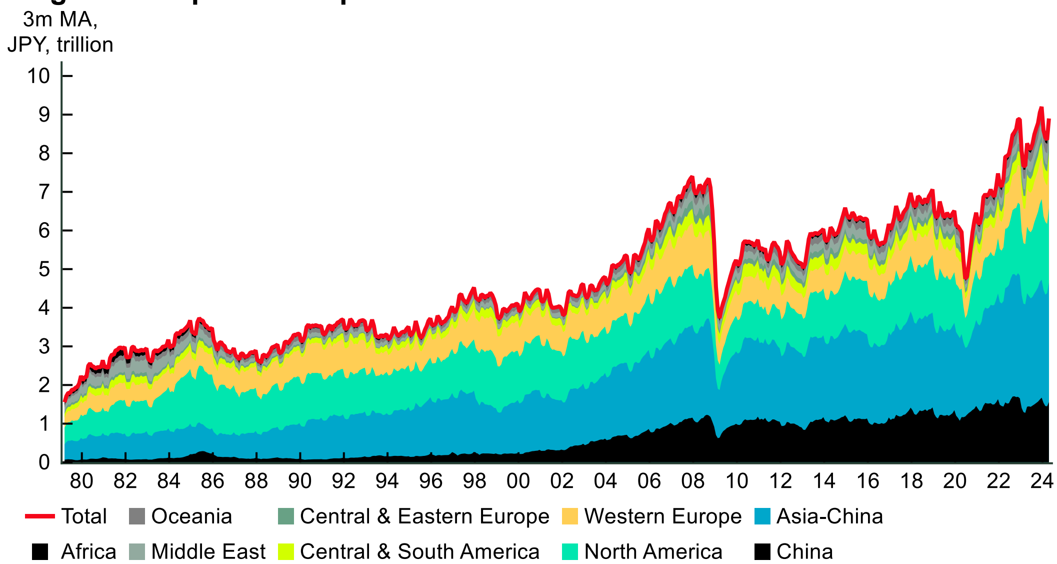
But Germany's lackluster performance has not been solely a function of weak investment; it has been also a function of weak consumption. This was very much the case during the first quarter of 2024, when real household consumption contracted 0.4% q/q, essentially retracting the prior quarter's improvement and leaving it a mere 0.3% higher y/y. Unlike in previous quarters, this was matched by a similar decline in government spending, the combination weighing heaving on GDP performance. The 0.2% q/q gain in GDP was made possible by a little rebound in investment following a dismal Q4 performance, and by improving foreign trade. Even so, real GDP was down 0.2% y/y. We anticipate some improvement from here on the assumption that improving real incomes will spur a bit of a revival in consumer spending. Even so, however, our 0.6% 2024 growth forecast from March may need to be trimmed in the next forecast update.

Japan

Headline **inflation** cooled for a second month in April, down two tenths to 2.5% y/y, but a tenth above the consensus. Sequentially, overall CPI picked up 0.4% m/m, the most since October. The Bank of Japan's (BoJ) target metric, the core-CPI (excluding fresh food) rose 2.2% y/y and matched expectations. This is the 25th month when inflation printed above the BoJ's target. The global core metric (excluding all food and energy) rose 0.3% m/m or 2.0% y/y, driven by goods prices, which rose 0.4% m/m as services fell 0.1%. The decline in services is attributable to changes in tuition fees in Tokyo, which are temporary. We expect inflation to reaccelerate from May, as energy prices will rise sharply on increasing renewable energy charges and the end of subsidies. Overall, we expect inflation to turn sticky, which will support the BoJ efforts to further normalize monetary policy.

Nominal **exports** recovered for a second month in April by rising 0.9% m/m (or 8.3% y/y), but volumes rose just 0.1%, when adjusted for seasonality. Meanwhile, import value declined sequentially by 0.5% m/m (+1.5% y/y). This resulted in a trade deficit of 462.5 bn yen, larger than the consensus for a deficit of 295.0 bn yen. Exports were affected by a temporary stoppage in automobile production in the first two months of the year. Industry-wise, auto exports rebounded strongly by 8.0% m/m, balancing the declines in capital goods and technology exports. Exports to China also seem to have stabilized, but as we have long argued, exports to the US and Asia ex-China are far more important. Either way, we do not see exports driving growth in the rest of 2024.

Figure 4: Japanese Exports To China & Asia-Ex China In Focus



Sources: SSGA Economics, MOF, Macrobond
Updated as of 5/27/2024

The preliminary **manufacturing PMI** rose to 50.5, up 0.9 points into expansionary territory in May. A notable jump in output drove the overall improvement. The PMI data also highlighted the oncoming push in inflation; output prices rose to 55.7 for manufacturing, while those for services stayed close to a 10-year high at 55.1.

Machinery orders rose 19.4% m/m in March and core orders rose 2.9% m/m, bucking expectations of a decline. This drove the first quarterly rise in a year. Strong gains were registered in IT (53.7% q/q) and electrical machinery (27.7%) while chemicals declined (-31.0%). But on a more cautious note, external orders declined for the first time in a year, adding to our worries that exports may not drive growth.

The 10y JGB yield has risen to the key level of 1.0% this week, for the first time in 11 years. The yield has steadily risen since last week when the BoJ surprised markets with smaller than usual JGB purchases. Similar moves are observed in the ultra-long JGBs as well. Furthermore, bank deposits are also yielding higher, which allows households to earn higher interest income and eventually better returns on domestic investments. All of these are in line with our forecast that Japan's macroeconomy is improving markedly.

Australia

There was no new information in the **minutes** of the Reserve Bank of Australia (RBA) meeting this month. The board did discuss rate hikes; for our part, we still think a hike from the current levels would be a policy error and continue to view that as a very unlikely scenario. Everything now hinges on how inflation would move towards the target zone, and we still expect that to happen ahead of the RBA's and even market expectation.

Next week, we expect the April monthly CPI to have risen 3.3% y/y, and retail sales to have risen 0.3% m/m.

Week in Review (May 20 – May 24)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, May 20					
JN	Tertiary Industry Index (Mar, m/m)	-0.1%	-2.4%	1.1% (↑)	Big revision in Feb, overall capex still very good.
AU	Westpac Consumer Conf Index (may)	na	82.2	82.4	Cannot improve without policy support.
Tuesday, May 21					
CA	CPI (Apr, y/y)	2.7%	2.7%	2.9%	In line with expectations.
GE	PPI (Apr, y/y)	-3.1%	-3.3%	-2.9%	Moderating declines.
JN	Core Machine Orders (Mar, m/m)	-2.0%	2.9%	7.7%	One of our favorite indicators building optimism.
Wednesday, May 22					
US	Existing Home Sales (Apr, m/m)	0.8%	-1.9%	-3.7%	Also down 1.9% y/y.
UK	CPI (Apr, y/y)	2.1%	2.3%	3.2%	Slightly overshoot.
JN	Manufacturing PMI (May, prelim)	na	50.5	49.6	First expansion in a year. All is well.
Thursday, May 23					
US	Initial Jobless Claims (May 18, thous)	220	215	223 (↑)	Very low and have been so for a while.
US	Continuing Claims (May 11, thous)	1,793	1,794	1,786 (↓)	Very low.
US	New Home Sales (Apr, thous)	678	634	665 (↓)	Inventory has been rising.
UK	Manufacturing PMI (May, prelim)	49.5	51.3	49.1	Good.
UK	Services PMI (May, prelim)	54.7	52.9	55.0	Good.
UK	GfK Consumer Confidence (May)	-18.0	-17.0	-19.0	Welcome increase.
EC	Manufacturing PMI (May, prelim)	46.1	47.4	45.7	Soft, but not as soft as before.
EC	Services PMI (May, prelim)	53.6	53.3	53.3	Good.
GE	Manufacturing PMI (May, prelim)	43.5	45.4	42.5	Still very weak.
GE	Services PMI (May, prelim)	53.5	53.9	53.2	Good.
FR	Manufacturing PMI (May, prelim)	45.9	46.7	45.3	Still quite weak.
Friday, May 24					
US	Durable Goods Orders (Apr, prelim)	-0.8%	0.7%	0.9% (↓)	Not a real “beat” given downward revisions.
US	U. of Mich. Sentiment (May, final)	67.7	69.1	67.4	Inflation expectations lower than initially reported.
CA	Retail Sales (Mar, m/m)	-0.1%	-0.2%	-0.1%	Weak.
UK	Retail Sales Inc Auto Fuel (Apr, m/m)	-0.5%	-2.3%	0.0%	Very weak.
GE	GDP (Q1, q/q, final)	0.2%(p)	0.2%	-0.5%%	Down 0.2% y/y.
JN	National CPI (Apr, y/y)	2.4%	2.5%	2.7%	Calm before the storm (May CPI to rise strongly).

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

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- Start with rigor
- 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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Marketing Communication

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