August 23, 2024
Commentary

Weekly Economic Perspectives

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The Economy

Chair Powell cements start of Fed easing cycle in September.

US

It was an unusually light data week in the US, dominated by Chair Powell's speech at the Jackson Hole symposium. It was a speech we could have written ourselves. Arguably, we have…not the words themselves, of course, but definitely the sentiments and views expressed thereby.

Specifically, **Chair Powell** noted that:

"All told, labor market conditions are now less tight than just before the pandemic in 2019—a year when inflation ran below 2 percent. It seems unlikely that the labor market will be a source of elevated inflationary pressures anytime soon." Check: we have long highlighted the moderation in nominal wages and the dramatic slowdown in until labor costs, which stood at just 0.5% y/y in Q2.

"The upside risks to inflation have diminished. And the downside risks to employment have increased. As we highlighted in our last FOMC statement, we are attentive to the risks to both sides of our dual mandate." Check: since early this year, we talked about 2024 being the year when the dual mandate returns; as early as April, we made the case that the labor market will become more important as a policy driver than inflation during the second half of the year.

"The current level of our policy rate gives us ample room to respond to any risks we may face, including the risk of unwelcome further weakening in labor market conditions." Check: we had long argued that the Fed has ample room to calibrate the policy rate lower without fear of reigniting inflation. Admittedly, late last year we called for 150 basis points worth of cuts in 2024. By June, we stood almost entirely alone in still forecasting three rate cuts after the June SEP only showed one. With three meetings left, current market pricing for 100 bp of 2024 cuts is reasonable. We expect a 25 bp cut in September; 50 would require a really bad August labor report.

"The limits of our knowledge—so clearly evident during the pandemic—demand humility and a questioning spirit focused on learning lessons from the past and applying them flexibly to our current challenges." We certainly strive to maintain such humility and questioning spirit in our daily work. Sometimes we jokingly refer to "common-sense economics" as our preferred approach. At times, that means you have to recognize when the tools (i.e., models) of the past do not apply to the current situation. It was why we were so upbeat on the economy back in 2021 and dared to forecast disinflation without a recession in 2023. That same common sense makes us worried about the US fiscal picture…but that's a discussion for another time.

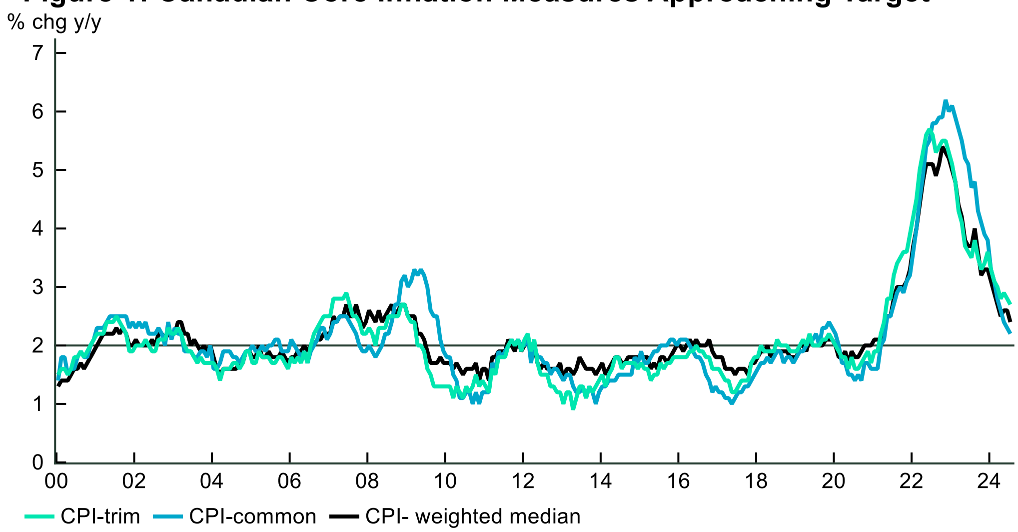
Data this week showed a holding pattern for unemployment claims and an unmistakable untick in home sales. The latter is a clear reflection of the 50-basis point decline in the 30-year mortgage rate since the start of July as Fed cuts began being priced back into the market. **New home sales** surged 10.6% m/m in July, the largest monthly gain since August 2022 and the highest level (admittedly, by a very small margin) since May 2023. **Existing home sales** inched up 1.3% m/m.

Canada

Canada inflation continued to ease in July. Headline **CPI inflation** fell to 40-month low of 2.5% y/y, in line with expectations and down from 2.7% previous month. The slowdown was mainly due to base effects for items like travel tours, passenger vehicles and electricity, which were moderated by an increase in gasoline prices (+1.9% y/y). Shelter inflation remains elevated and continues to account for large share in the increase. However, the pace of shelter inflation has decelerated from 6.2% y/y in June to 5.7% y/y. Excluding shelter, annual inflation was just 1.2% y/y.

Bank of Canada's preferred core inflation measures continued to make good progress towards the 2% target. Both common and trimmed mean measures inched down one-tenth to 2.2% y/y and 2.7% y/y respectively. Weighted-median measure dropped slightly to 2.4%y/y in July, down from 2.6% y/y previous month.

Figure 1: Canadian Core Inflation Measures Approaching Target



Sources: SSGA Economics, StatCan

UK

The upside surprise in latest UK PMIs show that UK private sector's expanding more robustly than expected. The August flash UK **manufacturing PMI** inched up four tenths to a 26-month high of 52.5, while the preliminary **services PMI** index reached 54.2, the highest since April. Both sectors recorded strong output growth and higher business expectations, which contributed to an acceleration in employment growth. The surveys also show that input cost inflation was down to its lowest for just over three-and-a-half years while selling prices rose less aggressively than they were.

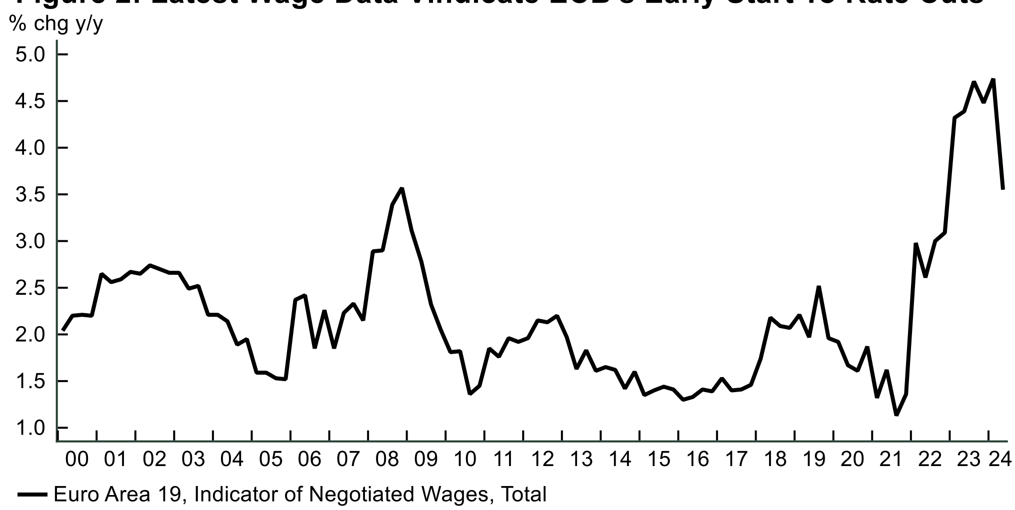
Consumer confidence remained subdued in August, with the **GFK UK consumer confidence index** unchanged at -13. Personal financial expectations improved, as this major purchase intentions. But expectations for the economy worsened for the first time since February.

Eurozone

Neither the PMI nor the inflation data released this week changed the narrative on either front. Service activity is holding up, but manufacturing remains weak, with no end in sight to the ongoing contraction. Headline eurozone inflation ticked up a tenth in July to 2.6% y/y; it has moved in a very tight rates of just a couple of tenths over the last six months. This may continue in the near term before ticking higher towards the end of the year on less favorable base effects.

To us, the most interesting release was the update on negotiated wages. When the ECB began the rate cutting cycle in June, we praised it for demonstrating some "guts" in cutting rates at a time of record low unemployment and near record-high wage inflation. Of course, the ECB did so because it looked to where wage inflation was going, not where it stood in that very moment. Fortunately, the latest data vindicated its action, with the eurozone indicator of negotiated wages taking a big step down.

Figure 2: Latest Wage Data Vindicate ECB's Early Start To Rate Cuts



Sources: Macrobond, SSGA Economics, ECB
Updated as of 8/26/2024

Japan

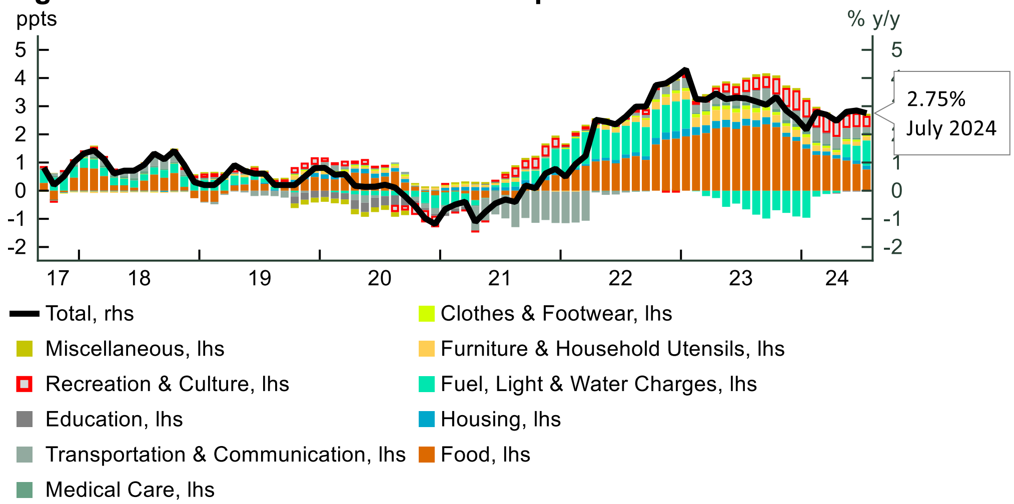
Real exports rose 1.0% m/m in July, slower than the 1.4% increase in imports. Export volumes to the EU and Asia ex China improved, while those to China remained sluggish.

The all-industry **flash-PMI** improved 0.5 points to 53.0 in August. The improvements are broad-based but modest; manufacturing PMI was in slight contraction at 49.5 but, services was strong at 54.0. The manufacturing output PMI rose 1.1 points to a 16-month high of 50.9, which implies a potential big move up in industrial production next week. The price metrics were mixed but indicate a built-up of goods costs for producers, as the input costs index rose to 63.7.

Headline **CPI** rose 2.8% y/y, in line with expectations in July. However, the default core (excluding fresh food) was a touch stronger at 2.7%, primarily due to the end of energy subsidies despite the disinflation in food and hotel charges. The BoJ core (excluding fresh-food and energy) however decelerated to 1.9%, the first sub-2.0% print since September 2022. The global core (excluding all food and energy) rose only 0.1% m/m or just 1.6% y/y. This slowing was led by a 0.2% m/m decline in core goods prices but were supported by 0.1% rise in services. Food prices (0.1% m/m but, 2.9% y/y) are adding base-effects and dragging overall goods prices (figure 3). Among services, the contribution from culture/recreation eased.

Looking ahead, we expect inflation to ease somewhat as energy subsidies are reintroduced during summer in August (electricity) and September (gas), at a slightly higher rate. So, inflation may ease temporarily, but still may remain close to the Bank of Japan's (BoJ) target of 2%.

Figure 3: Food Prices Disinflate In Japan CPI



Sources: SSGA Economics, SBJ, Macrobond
Updated as of 8/23/2024

We continue expecting the BoJ to be on hold until December at least. This is consistent with Governor Ueda's remarks during his Diet testimony on Friday. He said that conditional on the Bank feeling confident that the economy evolves as per expectations, the Bank may "*...continue to adjust the degree of monetary easing.*" Furthermore, there was a deeper emphasis on the neutral rate. Governor Ueda said that the current policy rate of 0.25% is below the lower bound estimate of the nominal neutral rate (around 1%). It is indirectly clear that the Bank estimates the real neutral rate is deeply negative. However, he indicated that the Bank may publish the data once the range of estimates narrows sufficiently in the future.

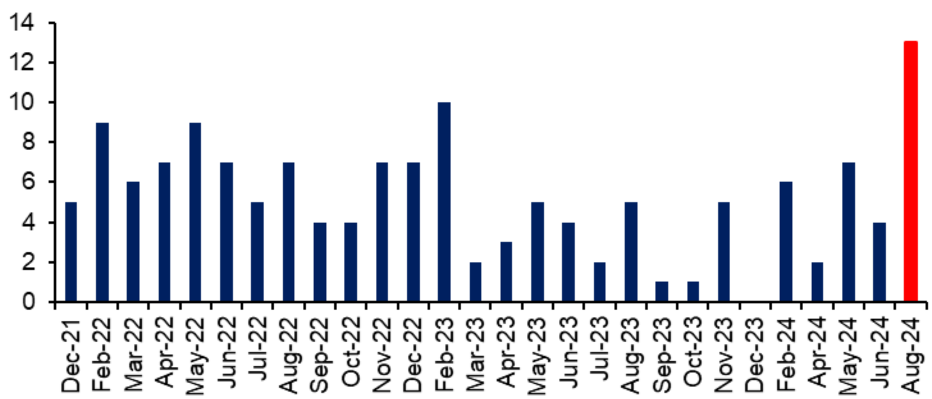
Australia

The Reserve Bank of Australia (RBA) maintained its hawkish bias in the minutes of their latest meeting in August. They revealed that the Bank's dual mandate of balancing employment and inflation came into play in August, as they maintained interest rates against fears of a hike. Members of the board found the rise in unemployment rate was more due to ‘reduced flows of workers into employment’ than an increase in layoffs. The board also found the Q2 CPI data was ‘broadly in line’ with their May forecast.

The standout feature of the minutes, however, was how uncertain the RBA seemed. The minutes featured the word 13 times, the most since December 2021, during the Covid pandemic. The board noted uncertainties around inflation, forecasts, and the outlook of the labor market. Everything, basically…

Figure 4: High Uncertainty In Australia

The Number Of Times RBA's Minutes Had The Word 'Uncertain'



Source: SSGA Economics, RBA
Updated As Of 08/22/2024

However, we expect some progress could be made next week, as the July monthly CPI data could decline sharply and come very close to the RBA’s target. We expect headline CPI to decline sequentially, but rise 2.9% y/y annually. The primary driver will be the reintroduction of electricity subsidies, but the underlying price pressures could also be seen easing including rents and holiday travel. We will also get a handle on the GDP partials of construction work done and capex during the second quarter (GDP data on Sep 04).

Week in Review (Aug 19 –Aug 23)

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Aug 19					
US	Leading Index (Jul)	-0.4%	-0.6%	-0.2%	Downtrend continues.
Tuesday, Aug 20					
CA	CPI (Jul, y/y)	2.5%	2.5%	2.7%	In line with expectations.
EC	CPI (Jul, y/y, final)	2.6%	2.6%	2.5% (↓)	In tight range for past six months.
Wednesday, Aug 21					
JN	PMI Manufacturing (Aug, prelim)	n/a	49.5	49.1	Still weak.
Thursday, Aug 22					
US	Initial Jobless Claims (17-Aug, thous)	232	232	228 (↑)	OK.
US	Continuing Claims (10-Aug, thous)	1,869	1,863	1,859 (↓)	OK.
US	Existing Home Sales (Jul, m/m)	1.0%	1.3%	-5.1% (↑)	First improvement in five months.
US	Kansas City Fed Manf. Activity (Aug)	-9	-3	-12	Large jump, questioning sustainability.
UK	Manufacturing PMI (Aug, prelim)	52.2	52.5	52.1	Good.
UK	Services PMI (Aug, prelim)	52.8	54.2	52.5	Good.
UK	GfK Consumer Confidence (Aug)	-12	-13	-13	Concerns on future economy remain.
EC	Manufacturing PMI (Aug, prelim)	45.8	45.6	45.8	Weak.
EC	Services PMI (Aug, prelim)	51.7	53.3	51.9	Welcome.
GE	Manufacturing PMI (Aug, prelim)	43.3	42.1	43.2	Quite terrible…
GE	Services PMI (Aug, prelim)	52.3	51.4	52.5	OK, but not great.
FR	Manufacturing PMI (Aug, prelim)	44.5	42.1	44	Weak.
JN	Natl CPI (Jul, y/y)	2.7%	2.8%	2.8%	To decline next month on energy subsidies.
Friday, Aug 23					
US	New Home Sales (Jul, thous)	625	739	668(↑)	What lower mortgage rates can do…
CA	Retail Sales (Jun, m/m)	-0.3%	-0.3	-0.8%	As expected
FR	Business Confidence (Aug)	96	97	94	Recovering after recent slide but eroding trend.

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

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* Pensions & Investments Research Center, as of December 31, 2023.

† This figure is presented as of June 30, 2024 and includes ETF AUM of $1,393.92 billion USD of which approximately $69.35 billion USD is in gold 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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