STATE STREET GLOBAL ADVISORS

November 22, 2024
Commentary

Weekly Economic Perspectives

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Weekly Highlights

A light data week as investors digest US cabinet appointment announcements.

Eurozone Composite PMI (Nov., preliminary)
48.1
Signals weak Q4 GDP.

France Services PMI (Nov., preliminary)
45.7
Lowest since January.

German Services PMI (Nov., preliminary)
49.4
Lowest since February.

Canada CPI (Oct, y/y)
2.0%
Above expectations

UK CPI (Oct, y/y)
2.3%
Above expectations.

UK Services PMI (Nov)
50.0
Flash data. Sharp fall.

Japan Services PMI (Nov, preliminary)
50.2 ↑
Marginal improvement.

JP Global Core CPI (Oct, m/m)
0.3% ↑
Driven by food & public services.

JP Machinery Orders (Sep, y/y)
-4.8% ↓
Consistent with weak capex in Q3.

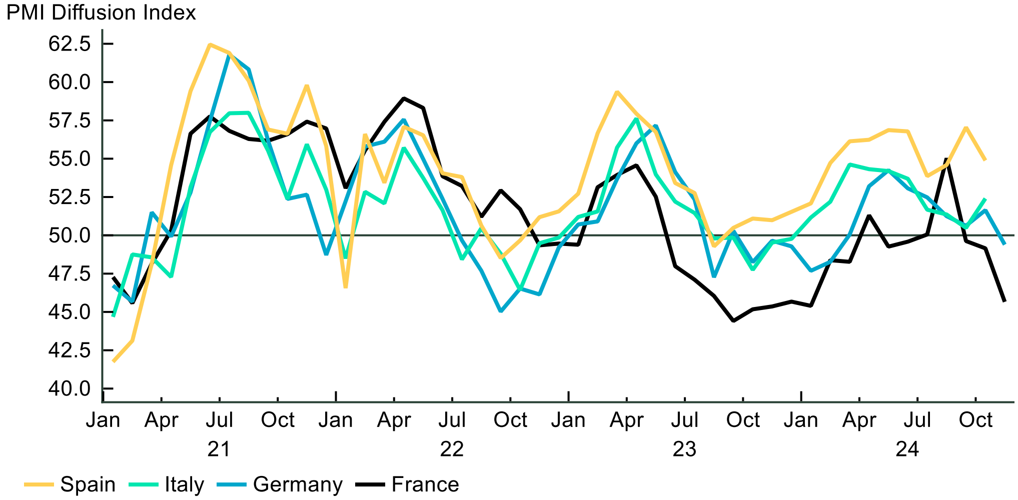
Eurozone: Needs to Help Itself

Speaking at a European banking conference this week, ECB President Lagarde lamented the lack of capital markets integration in the region, saying that while the urgency for action has risen over the past year, it "has not been met by tangible progress". As a case in point, she highlighted that the EU had nearly 300 different trading venues in 2023.

We wholeheartedly agree with President Lagarde's assessment. In fact, we would take it a few steps further. The need and urgency for action are not contained to capital markets; they run the gamut from energy policy, defense, general business regulatory environment, fiscal policy, etc. We had long in these pages highlighted the need for a more pro-growth mindset and policy impetus in the region but progress has been incremental at best (see A Better Macro Policy Framework for Europe). France is trading places with Italy as a key source of fiscal instability in the region (see France's Fiscal Fragility Strains the Eurozone).

The region's growth outlook remains anemic and increasingly vulnerable to changes in external demand, whether for goods (China) or services (United States). The latest purchasing managers' indexes released this week (preliminary readings for November) showed a veritable nosedive, particularly in service industries. The ***German* services PMI** index dipped into contraction (49.4) for the first time since February. The ***French* services PMI** index plunged to 3.5 points to 45.7, the weakest level since January.

Figure 1: Eurozone Service Industries Under Renewed Pressure



Sources: Macrobond, SSGA Economics, S&P Global
Updated as of 11/22/2024

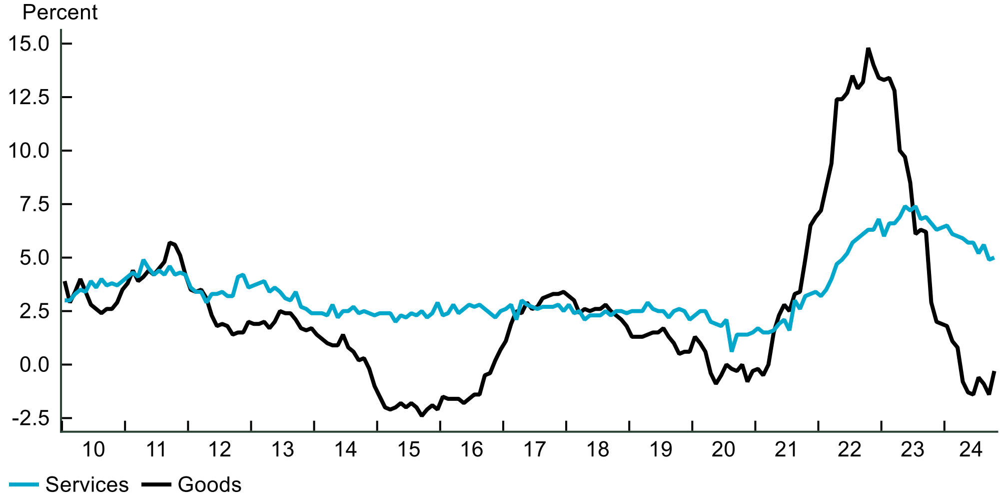
The combination raises the odds of a 50-bp ECB rate cut at either the December or January meetings. For now, we stick to our prior 25-bp cut projections. However, even if the ECB were to speed up the pace of rate cuts, that would still be nothing more that a small bandage on the region's much larger injury of competitive decline. The solution does not rest with the ECB but with the national governments and the European Commission. It is time for Europe to not only discuss and debate the Draghi report, but to implement it. The region's economic leaders agree on this, but will its political leaders?

UK: Will Weak Activity Accelerate Rate Cuts?

As expected, **CPI inflation** is now back above the Bank of England's 2% target. Headline inflation rebounded strongly to 2.3% in October, above market expectations and is expected to get close to 3% in January. Importantly, services inflation is likely to oscillate around the current level of 5% for the next couple of months. All that means that, without any downside surprises, the December rate cut is very unlikely, and the bank will most likely continue its gradual rate-cutting path for now.

However, concerns on recent activity may mean the bank will be more actively reconsidering the position. Both October's retail sales and November's flash UK PMIs disappointed, reflecting some impact from the budget announcement.

Figure 2: UK Services Inflation Remains Elevated



Sources: Macrobond, SSGA Economics, ONS
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Retail sales fell a sharp 0.7% m/m in October, partly due to household concerns about recently announced tax increases. Meanwhile, both UK manufacturing and services **PMIs** fell markedly to 48.6 and 50.0, respectively, indicating that real GDP growth is slowing in mid-Q4. PMI weakness stemmed from declining output, job cuts, persistently high inflation, and lower business optimism. Worryingly, the bigger drag is likely to come from services sector with loss of confidence being linked to rising payroll costs and disincentives to invest largely due to an increase in employer NICs.

Admittedly, there were noises around the October retail sales data and the fall followed three consecutive monthly gains. The PMIs also does not include government spending which is rising. Still, the underlying momentum of the economy appears to be weaker than we previously thought.

BoJ Waiting in the Wings Now

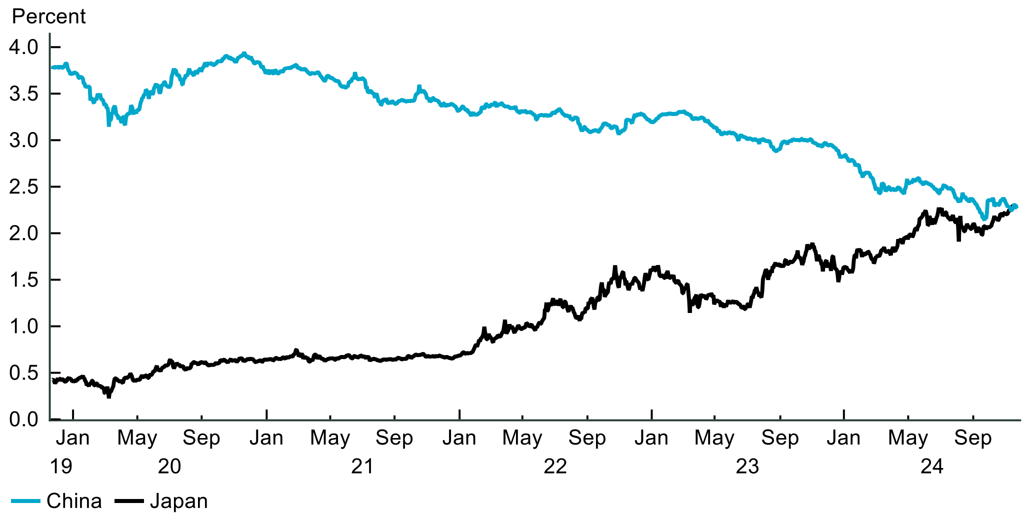
This week's inflation data brightened the chances of a December hike by the Bank of Japan (BoJ). Nationwide CPI weakened two tenths to 2.3% y/y in October, but the core CPI (excluding fresh food) surprised the consensus by a tenth to the same 2.3%. The global equivalent metric (excluding all food and energy) accelerated sequentially to 0.3% m/m from a flat reading in September. Higher prices were observed for rice, food away from home, and public services. Goods contributed 1.53 ppts, slightly lower than last month, and services added slightly more, 0.72 ppts. As higher labor costs are increasingly passed through to output prices, we expect inflation to remain around the 2% price target with a bias for staying above target, given the weaker yen in the recent times.

Separately, the government had approved a stimulus package of JPY21.9 trillion ($141.8 billion), matching that of the last year and having cash handouts to low-income families and those with children. When private sector's spending is taken into account, the total stimulus rises to JPY 39.0 trillion. The government would allocate only JPY 13.9 trillion from the general account, limiting the hit on revenues for now.

Furthermore, the government was reportedly also considering lifting the ceiling of tax-free income from JPY1.03 million, the main campaign promise of the key partner, the Democratic Party for the People. If the limit is raised to the party's proposed JPY1.78 million, revenues could take a JPY8 trillion hit according to government estimates, which may eventually lead to higher government borrowing.

This higher borrowing is not necessarily a bad idea for Japanese markets; as such, yields on the long end of the curve have steadily been eclipsing those of China's. Such higher long-end yields will help Japan's domestic institutions invest more at home, one of the most important long-term changes that are yet to happen to complete the post-Covid revival of the economy. One of Japan's largest insurers, the Nippon Life Insurance was reportedly lifting their promised yields in January from 0.6% to 1.0% for annuity insurance and others, for the first time in 40-years.

Figure 3: Japan's 30-Year Government Bond Yields Higher Than China's
Government Benchmark 30 Year Yields



Sources: Macrobond, SSGA Economics, JBT, Macrobond
Updated as of 11/22/2024

Governor Ueda also confirmed our big call this year that the Bank was indeed 'seriously' considering the yen movements for their policy. All these developments bode well for a December BoJ hike, which is our base-case now.

The RBA Risks a Policy Mistake

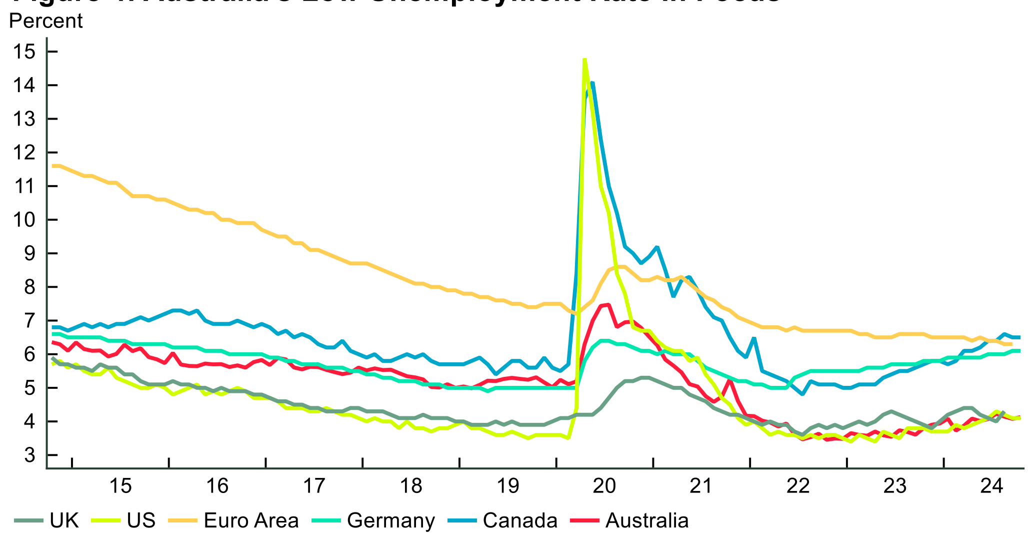
We had long argued for an early start to the calibration of rates lower by the RBA and had maintained November as a base-case for the start of the easing cycle. However, we recently pared back those expectations as the perennially hawkish Reserve Bank of Australia (RBA) seems to consider 'mid-2025' as its base case.

The minutes of the RBA's November meeting were released this week and they brought in new hawkish elements that resulted in market pricing and consensus forecasts to be further pushed out into 'mid-2025', a phrase that originated in the November Statement of Monetary Policy.

The minutes discussed scenarios for policy rate evolving in either direction but, the key takeaway is that the "members noted that (lower inflation) could warrant an easing in the cash rate target, but that they would need to observe more than **one good quarterly inflation outcome** to be confident that such a decline in inflation was sustainable". Given the quarterly nature of Australia's CPI, this might mean that the RBA wants to see Q1 2025 CPI (to be released on April 30!) data as a base case for cutting rates. The Bank also noted that the outcome of the recent US elections could be *'significantly lower global growth and increased inflationary pressures'*. The Bank however asserted the need to remain forward looking and noted that if 'consumption proves to be persistently and materially weaker', a reduction in cash rate could be warranted.

We sympathize that modern day central banking is remarkably tough, but the RBA has been sitting on the fence and playing the plausible ambiguity throughout 2024, famously 'not giving in or out' on policy rate. While it is independent of what other central banks do, almost all minutes this year discussed what other central banks have done. While the labor market remains very resilient, much like the US, the difference is that the US is still slated to grow solidly in Q4. Atlanta Fed GDP Nowcast of 2.5% seems an impossible feat for Australia in the current policy setting.

Figure 4: Australia's Low Unemployment Rate In Focus



Sources: SSGA Economics, ABS, StatCan, German Federal Employment Agency (Bundesagentur fuer Arbeit), Eurostat, BLS, ONS, Macrobond
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We fear the RBA may maintain restrictive policy longer than ideal, which may result in continued economic underperformance. We move our base case for the first cut to February 2025, but a recalibration in December is still ideal in the interest of growth. To be sure, a materially eased inflation remains the key reason to cut rates. Next week, we expect the weighted CPI to have risen 2.4% y/y in October, a couple notches higher than in September, but comfortably within the RBA's target band of 2-3%. On the other side, we see a higher probability of prolonged weak economic growth if the RBA remains restrictive till 'mid-2025'.

Week in Review

A summary of the key global data releases from the past week.

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Nov 18					
US	NAHB Housing Market Index (Nov)	42	46	43	Surprising bounce.
CA	Housing Starts (Oct, thous)	240	240.8	223.4 (↓)	OK.
Tuesday, Nov 19					
US	Housing Starts (Oct, thous)	1,334	1,311	1,353 (↓)	Drop in single-family homes.
US	Building Permits (Oct, thous)	1,435	1,416	1,425 (↓)	Persistently sluggish amid high mortgage rates.
CA	CPI (Oct, y/y)	1.9%	2.0%	1.6%	Above expectations.
EC	CPI (Oct, y/y, final)	2.0%	2.0%	1.7%	OK.
Wednesday, Nov 20					
UK	CPI (Oct, y/y)	2.2%	2.3%	1.7%	Above expectations,
Thursday, Nov 21					
US	Philadelphia Fed Business Outlook (Nov)	8	-5.5	10.3	Details looked better.
US	Initial Jobless Claims (16 Nov, thous)	220	213	219 (↑)	Low (which is good).
US	Continuing Claims (09 Nov, thous)	1,880	1,908	1,872 (↓)	Low but in gentle upslope.
US	Leading Index (Oct)	-0.3%	-0.4%	-0.3% (↑)	Weak, with weak details.
US	Existing Home Sales (Oct, m/m)	2.9%	3.4%	-1.3% (↓)	First y/y increase since July 2021.
US	Kansas City Fed Manf. Activity (Nov)	-5	-2	-4	Mixed, soft.
JN	National CPI (Oct, y/y)	2.3%	2.3%	2.5%	Core CPI remains strong.
JN	Manufacturing PMI (Nov, prelim)	--	49.0	49.2	Input costs at a 7m low, but still high.
Friday, Nov 22					
US	U. of Mich. Sentiment (Nov, final)	73.0 (p)	71.8	70.5	Long-term inflation expectations rose.
CA	Retail Sales (Sep, m/m)	0.40%	0.4%	0.40%	Fine.
UK	Retail Sales Inc Auto Fuel (Oct, m/m)	-0.30%	-0.7%	0.1% (↓)	Weak.
UK	Manufacturing PMI (Nov, prelim)	50.0	48.6	49.9	Lost momentum.
UK	Services PMI (Nov, prelim)	52.0	50.0	52.0	Lost momentum.
EC	Manufacturing PMI (Nov, prelim)	46.0	45.2	46.0	Really weak.
EC	Services PMI (Nov, prelim)	51.6	49.4	51.6	Weak.
GE	GDP (Q3, q/q, final)	0.2%	0.1%	-0.1%	Don’t expect much better in Q4 either…
GE	Manufacturing PMI (Nov, prelim)	43.0	43.2	43.0	Dismal.
GE	Services PMI (Nov, prelim)	51.7	49.4	51.6	Troubling.
FR	Manufacturing PMI (Nov, prelim)	44.5	43.2	44.5	Dismal.

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

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

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