STATE STREET GLOBAL ADVISORS

December 13, 2024
Commentary

Weekly Economic Perspectives

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Weekly Highlights

Monetary easing cycle deepens, Japan the big exception among developed markets.

US CPI (Nov, y/y)
2.7%
Cements December cut.

US Core CPI (Nov, y/y)
3.3%
As expected.

US NFIB Index (Nov)
101.7
Highest since June 2021.

ECB Policy Rate
3.15%
As widely expected.

JP Tankan Big Mfg. Index (Q4)
14.0
Far above expectations.

JP Tankan Small Non-Mfg. Index (Q4)
16.0
Green light for BoJ hike.

BoC Policy Rate
3.25%
As widely expected.

UK Industrial Production (Oct, m/m)
-0.6%
Worrying performance.

UK GFK Consumer Confidence (Dec)
-17
Still very low.

US: FOMC To Ease But Signal Fewer Cuts in 2025

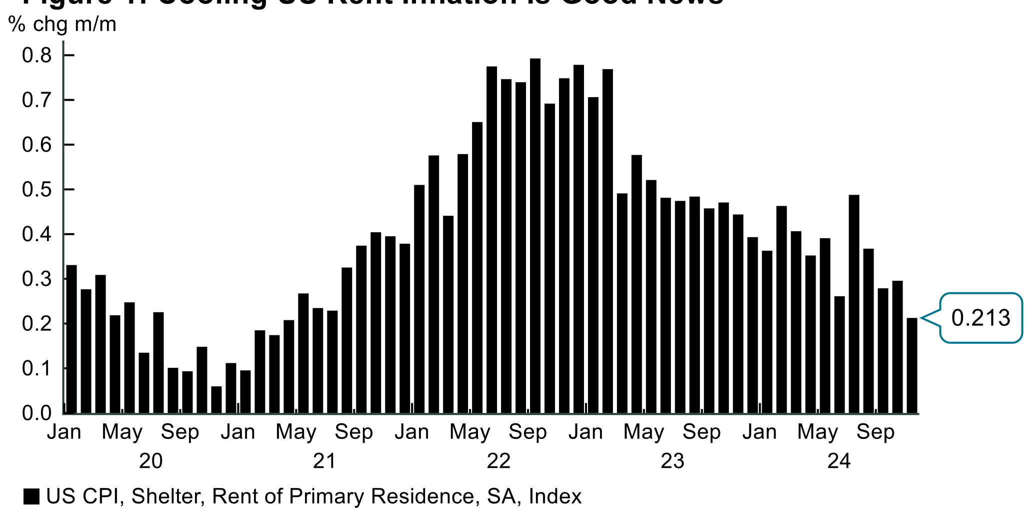
The last **inflation report** before year-end cemented market expectations of another Fed rate cut at the December 18 meeting. This had long been our view, even as doubts grew around its likelihood following the election results.

This is not to say that this was a "nothing to see here" type of report. There remain persistent inflationary pressures in some corners of the economy and the outlook has also become more inflationary given policy ideas (we would not call them proposals just yet) put forth by the incoming republican administration. But timing matters. If those policies impact the Fed path, they will do so in 2025. In fact, our forecasts have already adjusted to reflect the combination of positive data revisions (pre-election) and policy impulse (post-election); we now only expect three Fed rate cuts next year versus five previously. Importantly, we perceive risks to that call to be two-sided: amid inflation worries, let's not forget about the softening labor market.

Now, back to the November inflation data. Overall prices rose 0.3% m/m as expected, but an upward revision to October lifted the headline inflation rate by a tenth to 2.7% y/y. Core prices also increased 0.3% (also as expected), leaving the core inflation rate at 3.3% where it has been sitting since September. Food played a big role in November, helping to lift goods prices 0.4% m/m. Food prices rose 0.4% m/m, with food at home up an outsized 0.5%, the most since January 2023. Increases within this space were reasonably broad-based, though the surge in egg prices may not be sustained. Motor vehicles were another source of goods inflation, with new vehicle prices up 0.6% m/m and used vehicles up 2.0% m/m. Car auction data had signaled gains here, but that correction has largely played out by now.

Services brought good news, with services inflation up 0.3%. Shelter prices increased 0.3% as a whole, but rent of primary residence increased just 0.2% m/m, the least since April 2021. Hotel prices surged 3.2%, the most since October 2022 and, prior to that, July 2021. We see this as a one-off hit and look for some relief next month. Motor vehicle insurance, which had been a hot spot for inflationary pressures this year, appears to be normalizing. Following a 0.1% m/m decline in October, prices rose a tepid 0.1% in November. The inflation rate for this category has eased from April's peak of 22.6% to 12.7% y/y in November. Recreation services inflation is also cooling: events admission inflation has cooled from 9.1% in May to under 2.0%.

Figure 1: Cooling US Rent Inflation Is Good News



Sources: Macrobond, SSGA Economics, BLS
Updated as of 12/15/2024

All in all, this was a report that argued vigilance, not panic, on inflation.

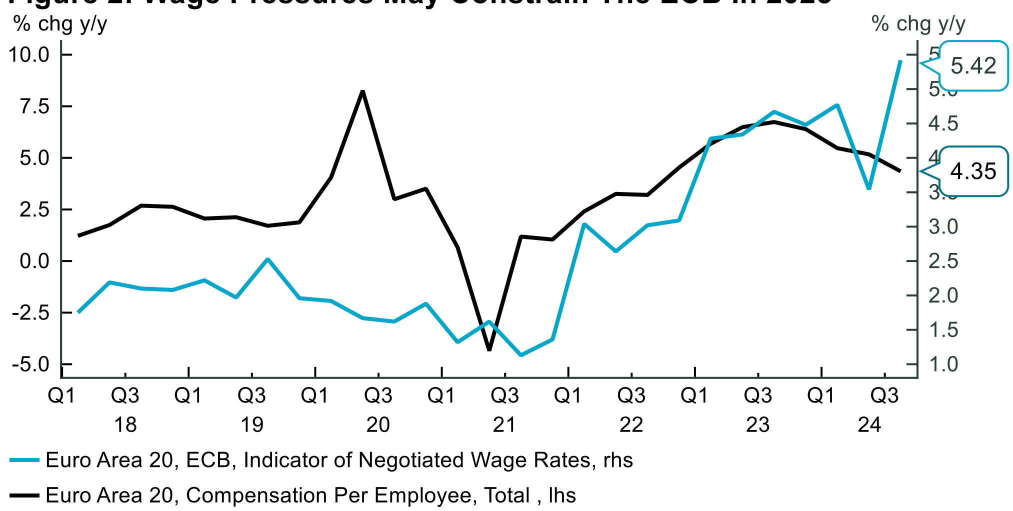
Eurozone: How Far Can the ECB Go?

With the disinflation process "well on track", the **ECB** not only cut policy rates by 25 bp as expected at the December meeting, but, unsurprisingly, signaled further cuts.

New staff forecasts did little to change perceptions of the outlook. Headline inflation was lowered by a tenth this year and next to 2.4% and 2.1%, respectively. The new figures exactly match our forecasts from September. Growth projections were also reduced slightly, with real GDP growth this year down a tenth to 0.7% and 2025 growth down two tenths to 1.1%. The new figures at one tenth below our September forecasts (look for an update next week). The core message is unchanged: the economy faces considerable headwinds, but the gradual fading of tight monetary policy impact should help revive domestic demand. Strong household balance sheets are a big plus in this regard, political unrest and uncertainty a big negative. So, it will not be all smooth sailing for European growth next year.

This is why, although the press release reiterated the usual point that there is no preset course to monetary policy, all indications are for considerable further easing in the year ahead. However, we wonder whether the ECB will be able to cut rates quite as much as the market is currently expecting. The main reason is that wage pressures may prove more persistent than currently anticipated. It is true—as President Lagarde highlighted—that growth in compensation per employee has eased over the past year, but the Q3 data on negotiated wages was a little troublesome. And while labor demand is slowing, tight supply has driven the unemployment rate to record lows. This is why we continue to expect just 100 bp worth of cuts from the ECB next year, versus about 150 bp for the consensus.

Figure 2: Wage Pressures May Constrain The ECB In 2025



Sources: Macrobond, SSGA Economics, ECB, BLS
Updated as of 12/15/2024

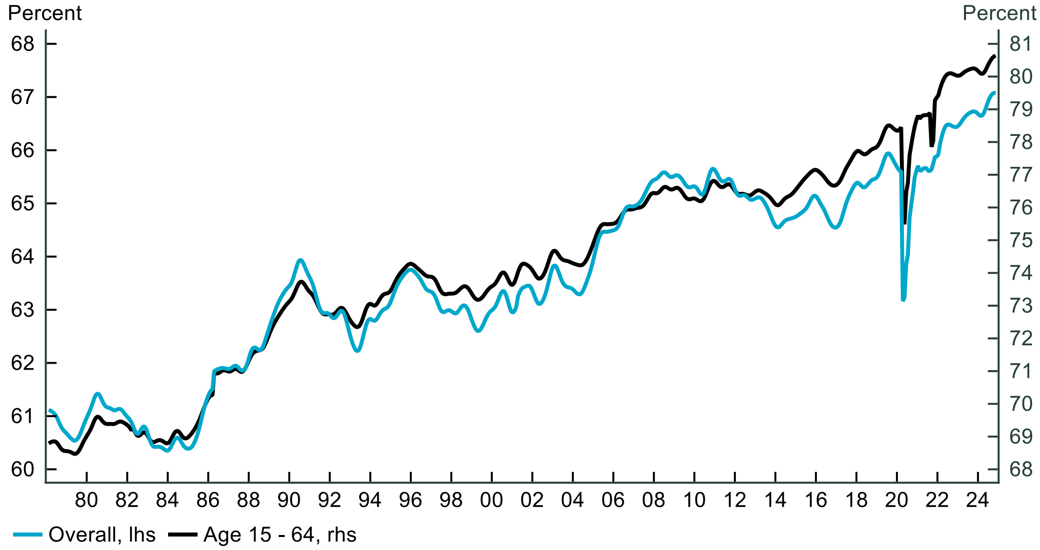
RBA: An Overdue Dovish Pivot

There was no change in the policy rate in Australia, but the **Reserve Bank of Australia (RBA)** finally made the dovish pivot that has been our long-standing call. While the statement dropped many hawkish refences including the infamous *'not giving in or out'*, Governor Michele Bullock's press-conference was markedly more dovish. She said the dovish changes in the statement were *"deliberate"* and mentioned that the opinions of the Board were *"evolving"*. Market pricing for the first cut converged into our expectation of February 2025 from May 2025.

Earlier the statement read that the Board was *"gaining some confidence"* that inflation was moving towards the target instead of *"vigilant to upside risks to inflation"*. We expected this pivot after the recent GDP data, as opposed to the consensus. **Regular readers would recall our long standing call that the poor spell of economic growth may not change without lower rates in Australia**.

The November employment report that was released two days later flew right in the face of these dovish developments. Employment growth (+35.6k) outpaced expectations (25.0k). More worryingly, the unemployment rate declined to 3.9% against a consensus of 4.2%. This may be due to various data related issues; the total unemployed declined by a large 27k, indicating that the flows between those who are employed, unemployed and not in the labor force acted unusually. The participation rate easing a tenth to 67.0% also influenced the outcome. In fact, the trend-adjusted metric, which the ABS says is a better measure has hit an all-time-high of 80.63% for those in prime age.

Figure 3: Trend Adjusted Participation Rates In Australia



Sources: SSGA Economics, ABS, Macrobond
Updated as of 12/13/2024

Furthermore, seasonal adjustments may have played a role too, which have historically favored the adjusted metric to be lower in November and not in January. Finally, although the ABS survey has the highest 93% response rate, the survey was conducted “one week earlier than usual” and we suspect if the differences between the incoming and outgoing rotation groups caused the 0.1 pp decline in participation, which resulted in the fall in the unemployment rate.

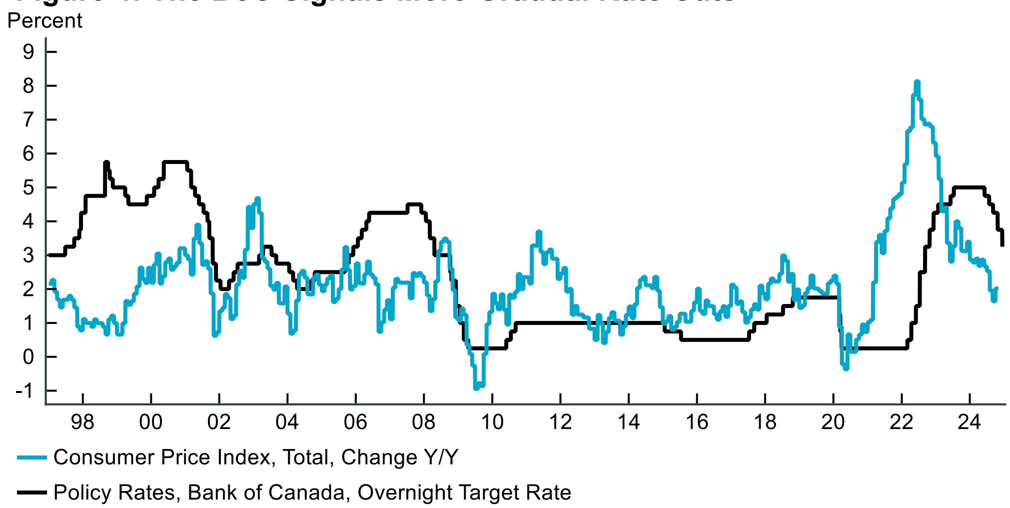
Our simple takeaway is that more people may be looking for employment in light of higher interest rates, but are able to find it rather easily. Hence, a lower unemployment rate should not be seen as proof that policy is not restrictive. Hence, this report may not sway the RBA. The biggest risk is for the rate to remain low in December too (data release on January 16 2025), although we think it is unlikely.

BoC: Further Rate Cuts Ahead But At Slower Pace

As expected, the Bank of Canada (BoC) delivered a second consecutive 50 bp rate cut, bringing the policy rate to 3.25%. Subdued economic momentum, and labor market loosening explain the move. Inflation has also stabilized around the 2% target, justifying a faster move towards neutral rates than in other countries.

The BoC maintained a clear easing bias, but the guidance was fairly hawkish, suggesting more gradual cuts in 2025. The BoC also conceded that growth next year is likely to be softer than in the October projection. Q3 GDP growth underwhelmed at 1.0% (seasonally adjusted annualized), with soft business investment and exports partly offsetting strength in consumer spending and housing. The government's unprecedented immigration curbs will simultaneously reduce aggregate demand and the labor supply next year, offsetting support from lower interest rates. Continued softness in labor markets and less pressure on housing and infrastructure also means that inflationary pressures will diminish further, supporting rates normalization.

Figure 4: The BoC Signals More Gradual Rate Cuts



Sources: Macrobond, SSGA Economics, BoC, StatCan
Updated as of 12/15/2024

The BoC also acknowledged other temporary factors that will impact the inflation numbers such as GST tax holiday. Another major uncertainty was the potential for tariffs on exports to the US. It is very unlikely that the bank will react to tariffs before they become official but the uncertainty ahead of tariffs could depress business investments in coming months.

Overall, softer growth outlook and at-target inflation justify further rate cuts, albeit at a slower pace. The policy rate has already been lowered by 175 bp since June. At this stage, we continue to anticipate that the bank will steadily cut rates until it reaches 2.25% by June 2025. We also see a lower chance that the BoC could bring rates down to accommodative territory, perhaps at 2% by end next year given increasing downside risks from immigration policy changes and trade disruptions, as well as sustained weakening in the economy.

Week in Review

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

Country	Release (Date, format)	Consensus	Actual	Last	Comments
Monday, Dec 9					
No major data releases.					
Tuesday, Dec 10					
US	NFIB Small Business Optimism (Nov)	95.3	101.7	93.7	Immediate reaction to election outcome.
GE	CPI YoY (Nov, final)	2.2%	2.2%	2.0%	Not a concern.
IT	Industrial Production (Oct, m/m)	0.0%	0.0%	-0.3%	Weak.
JN	PPI (Nov, y/y)	3.4%	3.7%	3.6% (↑)	BoJ has want it needs for a hike.
AU	NAB Business Confidence (Nov)	--	-3	5	Poor and lowest in years.
AU	RBA Cash Rate Target	4.35%	4.35%	4.35%	Dovish pivot, finally!
Wednesday, Dec 11					
US	CPI (Nov, y/y)	2.7%	2.7%	2.6%	Core steady at 3.3%. Green light for Dec cut.
CA	Bank of Canada Rate Decision	3.25%	3.25%	3.75%	In line with expectations.
Thursday, Dec 12					
US	Initial Jobless Claims (Dec -07, thous)	220	242	225	Still low.
US	Continuing Claims (Nov -30, thous)	1,878	1,888	1,871	In gentle uptrend.
CA	Building Permits (Oct, m/m)	-4.9%	-3.1%	11.5%	Better than expected.
EC	ECB Policy Rate Decision	4.15%	4.15%	4.40%	More to come.
AU	Unemployment Rate (Nov)	4.2%	3.9%	4.1%	Muddy data, which may mean-revert.
Friday, Dec 13					
UK	GfK Consumer Confidence (Dec)	-18	-17	-18	Still very low.
UK	Industrial Production (Oct, m/m)	0.3%	-0.6%	-0.5%	Worrying.
CA	Manufacturing Sales (Oct, m/m)	1.3%	2.1%	-0.6% (↓)	Good, not great.
FR	Wages (Q3, q/q, final)	0.3% (p)	0.4%	0.4%	Wage inflation has moderated notably.
FR	CPI (Nov, y/y, final)	1.3%	1.3%	1.2%	Not a concern.
JN	Industrial Production (Oct, m/m, final)	--	2.8%	1.6%	Up 1.4% y/y.

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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