January 17, 2025
Commentary

Weekly Economic Perspectives

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Weekly Highlights

A sigh of relief after reassuring US inflation data. Eyes now turn to the BoJ.

US CPI Inflation (Dec, y/y)
2.9%
As expected.

US Core CPI Inflation (Dec, y/y)
3.2%
A touch better than expected.

US Philly Fed Manuf. Index (Dec)
44.5
Massive surge!

UK CPI Inflation (Dec, y/y)
2.5%
Softer than expected.

Canada Existing Home Sales (Dec, m/m)
-5.8%
Subdued month of activity.

Canada Housing Starts (Dec, annualised)
231.5k
Weaker than expected.

AU: Unemployment Rate (Dec)
4.0%
In line with consensus, but below our pick.

AU: Full-Time Employment (Dec, m/m)
-23.7k
Overall employment surpassed expectations due to temporary jobs.

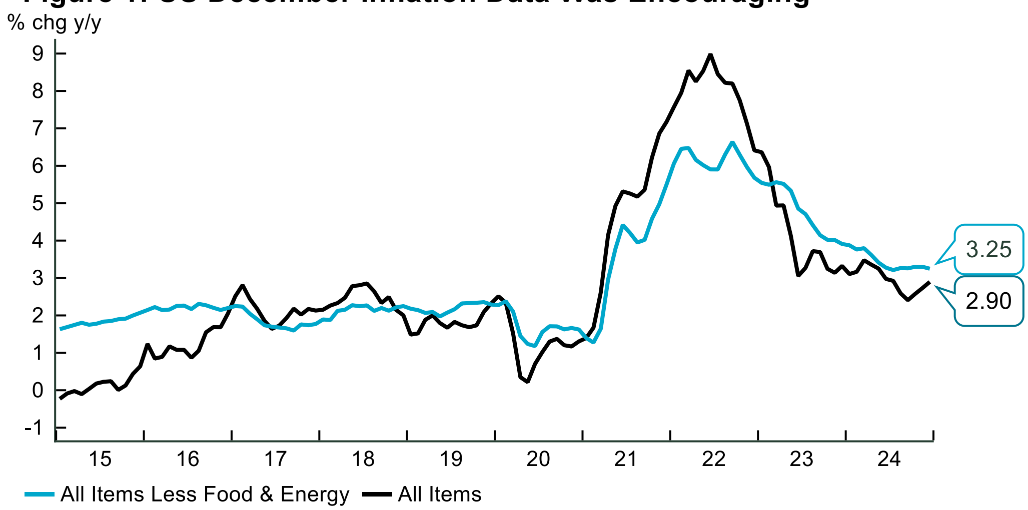
JP: Household Spending (Nov, m/m)
0.4%
Beat down beat consensus of -0.9%.

US: Misleading Strength?

Last month, we said that the December inflation report “argued vigilance, not panic, on inflation”. And we concluded that three rate cuts in 2025 still made sense as a baseline expectation. That remained our view even in the aftermath of the hawkish December dot plot showing just two cuts and despite market pricing that has shifted into an even more hawkish direction.

The **January inflation report** was therefore reassuring. It by no means settles anything in and of its own, but it offers a counterpoint to the inflation fears that have once again gripped investors. Overall consumer prices increased 0.4% m/m, in line with expectations, lifting the headline inflation rate two tenths to 2.9% y/y. There was a sizable contribution from energy (up 2.6% m/m) and especially fuel oil and gasoline (each up 4.4% m/m). Food prices rose 0.3%, in line with recent trends. The good news is that core prices rose just 0.2%, breaking a string of four consecutive 0.3% gains and lowering the core inflation rate by a tenth to 3.2% y/y. Performance was mixed across categories, which we see as a positive: we’d be more worried with every category that posted unusually soft readings as that would not be sustainable. That was not the case. Within services, for instance, airfares jumped 3.9% m/m; within goods, new vehicle prices rose 0.5% and used vehicle prices increased 1.2%. But shelter, medical care, and other services such as insurance were encouraging. Rent of shelter increased a low 0.3% (0.25%) m/m, a reading that sit between the October and November ones and appears to confirm the ongoing downtrend in shelter inflation. Ongoing disinflation in this space is a key factor supporting our Fed Funds view. Rent of shelter inflation peaked at 8.3% y/y in March 2023, eased to 6.2% y/y by December 2023 and ended 2024 at 4.6% y/y. Market rent data suggests that getting to the low 3.0% range by end of this year is achievable. Motor vehicle insurance increased 0.4% m/m; this follows two extremely benign readings and still allowed the inflation rate to ease 1.4 percentage points to 11.3% y/y (the least since September 2022).

Figure 1: US December Inflation Data Was Encouraging



Sources: Macrobond, SSGA Economics, BLS
Updated as of 1/16/2025

All in all, it's probably best to think of this report as simply a step along the windy road of 2025 macro releases. It offers an encouraging but far from a definitive signal on the inflation outlook since that outlook can be heavily skewed by policy forces (trade, immigration, etc.) not yet at play. In the same vein, we welcome the dovish comments from Fed Governor Waller this week, but also see them as a highly conditional statement. He commented that if incoming inflation reports mirror December's, three or four cuts in 2025 might be possible. Then again, the upsurge in small business sentiment since the election and the explosion higher in the latest Philly Fed manufacturing index say "maybe not". Only time will tell.

Canada: Headwinds to Housing Market

Lower interest rates have ignited a recovery in the housing market but immigration curbs and higher bond yields present downside risks to both house price growth and residential investment in coming months. As such, we think that a slight pullback in housing activity towards Q2 and Q3 this year is quite likely and that will contribute to a slowdown in consumer spending and GDP growth this year.

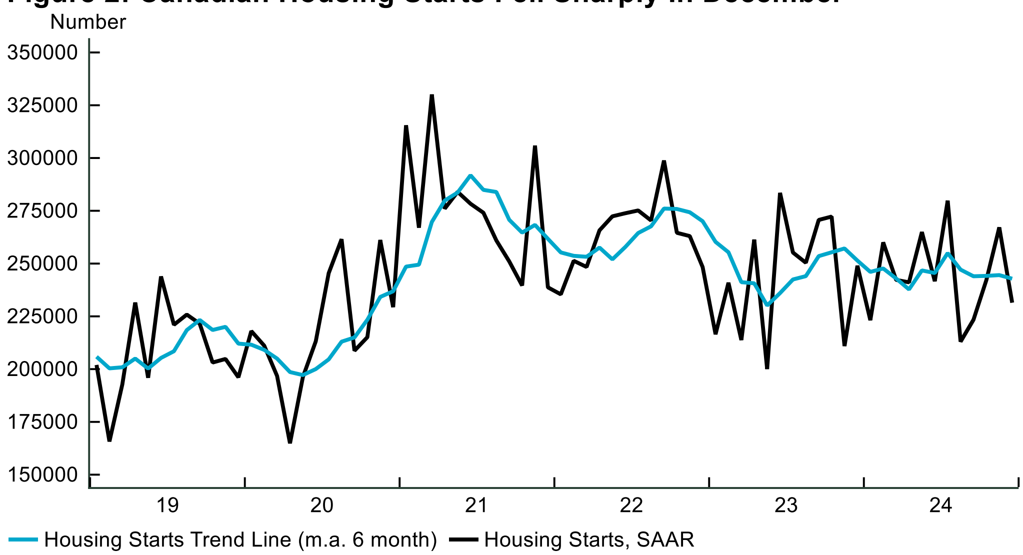
Despite the slump in December sales, Q4 2024 was still among the strongest quarters for activity in the last 20 years, with existing home sales up 10% compared to previous quarter. The December sales level was also well above that in May by 13%, right before the BoC's first rate cut in June, further evidencing that lower borrowing costs are feeding through the economy.

House price also seems to have reached the bottom as prices rose decently by 0.3% m/m, which was broad-based and following 0.5% gain in November. Still, in year-on-year terms, price growth remained muted, with HPI down 0.2% y/y and the Canadian average home price up only slightly by 2.5% y/y.

Our sense is that lower population growth will have a small impact on ownership housing demand as immigrants tend to rent when they first arrive in the country. However, there is a meaningful risk that demand will soften in near-term given recent moves in the bond market although it seems temporary. We expect that the BoC will steadily lower rates until it reaches 2.25% by June 2025, reducing the impact of higher bond yields.

Meanwhile, lower population growth will curb rent growth and likely weigh on housing starts. In December, housing starts fell by 13% to a four-month low of 231.5k annualized and the decline is highly likely to continue throughout this year.

Figure 2: Canadian Housing Starts Fell Sharply In December



Sources: SSGA Economics, CMHC
Updated as of 16/01/2025

Japan: BoJ All Set to Hike

The Bank of Japan (BoJ) is all but set to hike their policy rate by another 25 bps to 0.50% on the next Friday. We have long maintained that the economy was ready, but the Bank has been waiting in the wings. The possibility is well flagged by a flurry of speeches, and a supportive assessment in the Bank's regional branch managers survey. This is another surprising turn by the BoJ, this time swinging from the December dovishness into a hawkish stance. So, what changed since December?

First, the BoJ's Regional Economic Report painted a very optimistic picture on this year's *shunto* rate negotiations. The key takeaway is that *'a wide range of firms'* seemed to be open to the idea of wage hikes, with the Osaka Branch Manager noting more big firms in the region open to wage hikes this time.

And then came the Deputy Governor Ryozo Himino's speech, in which he explicitly said that the Board would debate whether to raise policy rate or not. These remarks were confirmed by Governor Ueda on the next day, which was unusual. Even more unusual was the economy minister Akazawa's speech the same day, in which he mentioned that the BoJ's consideration of a hike is not in contradiction of the accord shared with the government. Although there is no doubt it is true, the explicit mentioning was rather unusual. Finally, governor Ueda spoke again on Thursday (Jan 16) in which he reiterated confidence in the wage growth and flagged the possibility of a hike. The final nail in the coffin was the unsurprising and now customary media leak (in Bloomberg this round), that the Bank sees a *'good chance'* of a hike by *'people familiar with the matter'*. Market pricing for the hike next week rose to 80% following the above developments.

The only constraining factor could be potential volatility following President Trump's inauguration on Monday (Jan 20). **We believe that there is a reasonable chance for that, and hence see a small chance for the hike to not materialize.**

Although the BoJ's newfound confidence on wages is welcome, this is a second major pivot after a dovish turn in December, which led us to revise our terminal policy rate down a notch to 0.75%. If the BoJ does hike next week, that would leave just one more hike per our forecast for the remainder of 2025. The speeches obviate upside risks to our forecast, which we maintain for now.

It is perplexing that the BoJ was not as confident on wage growth during the December meeting despite varying degree of opinions expressed, with a clear support for hike in the Summary of Opinions of the December meeting (4/12 favored hike, 5/12 hold with 3/5 "hold" this time and 3/12 unrelated to timing of a hike).

Back to January, the speeches indicate that there is better agreement now, with Himino joining the chorus. However, we still see a good chance for a surprising turn in US trade policy, with potential announcements on tariffs jittering markets, which might play spoilsport for a January hike. The flip side of the unusual guidance through speeches is expectation management on the yen. As we have written in December, the yen has weakened sharply to around 158.0, but has rallied to 155.5 following the speeches. We still see the yen weakening directionally, in an adverse case scenario involving tariffs beginning on a higher level.

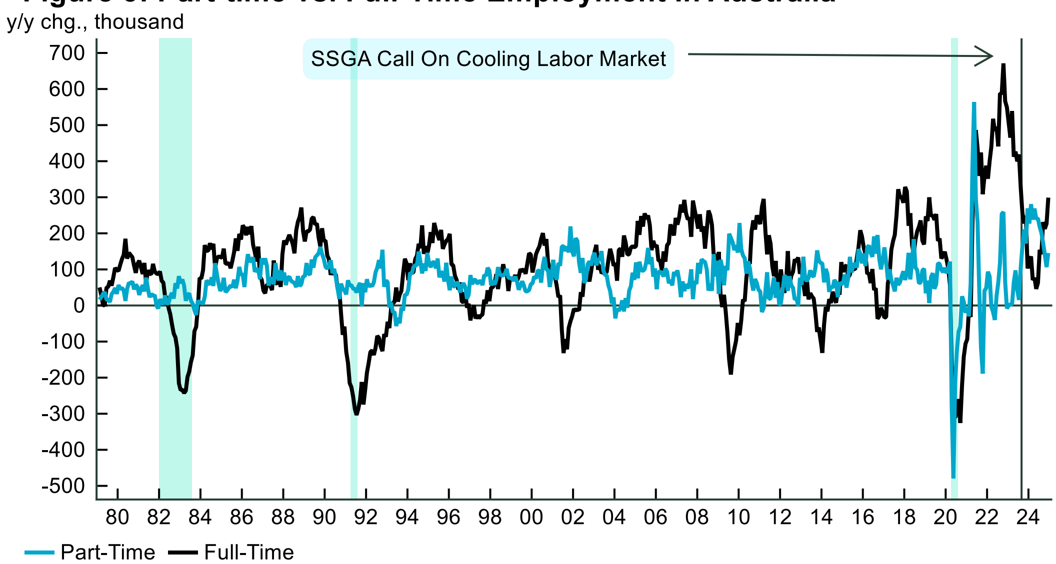
Nonetheless, a rate hike is now almost a certain, but we still see a chance of a surprise and the guidance serving as a well thought support for the yen.

Australia: Unemployment Rises

As expected, the unemployment rate reverted back up a tenth to 4.0% in December. This comes after an unexpected drop to 3.9% in November due to some data oddities and seasonal adjustment issues. However, we think the payback was only modest and more normalization in store, consistent with the thinking that the labor market strength masks some of the broader weakness in the economy.

Full time employment contracted 24k, but a massive 80k spike in part-time jobs ensured that overall employment beat the modest consensus of 15k (ours was -15k). The data for both the categories jumps with considerable differences between the seasonally adjusted and unadjusted data. For example, seasonally adjusted full-time employment rose by 299k in 2024, whereas the unadjusted data shows that it jumped 546k. These data divergences muddy the employment picture, but the rise in annual employment (in both categories) in 2024 makes the revival undeniable. It may be a feature of the Australian labor market that it cools down for some time and picks back up again (figure 3). This is something that we had written extensively in 2023.

Figure 3: Part-time vs. Full-Time Employment In Australia



Sources: SSGA Economics, ABS, RBA, Macrobond
Updated as of 1/17/2025

Back to December, the average hours worked per employed person too rose a tenth after a two-tenths of a drop in November. Furthermore, the underemployment eased a tenth to 6.0%. The ABS noted some divergence between young males and females of late. The full-time/part-time mix and underemployment are influenced by migration flows as what we have observed since the reopening after the Covid pandemic.

Nonetheless, considering the non-accelerating inflation of unemployment rate is around the current lows, we do not see the employment gains to be inflationary. This should keep the coast clear for the first interest rate cut in February. However, it is vital for Q4 CPI to come in without upside surprises, which is something we count on. We expect three rate cuts to a terminal of 3.60% by December 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, Jan 13					
AU	Westpac Consumer Conf Index (Jan)	n/a	92.1	92.8	Still not substantial improvement.
Tuesday, Jan 14					
US	NFIB Small Business Optimism (Dec)	102.1	105.1	101.7	Second consecutive big increase.
IT	Industrial Production (Nov, m/m)	0.1%	0.3%	0.1% (↑)	Down 1.5% y/y.
Wednesday, Jan 15					
US	Empire Manufacturing (Jan)	3	-12.6	2.1 (↑)	Mixed details.
US	CPI (Dec, y/y)	2.9%	2.9%	2.7%	Core inflation eased a tenth to 3.2% y/y.
CA	Manufacturing Sales (Nov, m/m)	0.5%	0.8%	2.1%	OK.
CA	Existing Home Sales (Dec, m/m)	-2.2%	-5.8%	2.8%	Subdued activity.
UK	CPI (Dec, y/y)	2.6%	2.5%	2.6%	Good, supporting rate cut in February.
FR	CPI (Dec, y/y)	1.3%	1.3%	1.3%	Nothing new.
JN	PPI (Dec, y/y)	3.8%	3.8%	3.8% (↑)	Supportive of a hike.
Thursday, Jan 16					
US	Philadelphia Fed Business Outlook (Jan)	-5	44.3	-10.9 (↑)	Extraordinary surge!
US	Retail Sales Advance (Dec, m/m)	0.6%	0.4%	0.8% (↑)	Solid, control sales up 0.7% m/m.
US	Initial Jobless Claims (11 Jan, thous)	210	217	203 (↑)	Low.
US	Continuing Claims (04 Jan, thous)	1,870	1,859	1,877 (↑)	Still low.
US	NAHB Housing Market Index (Jan)	45	47	46	Mixed details.
CA	Housing Starts (Dec, thous)	250	231.5	267.1(↑)	Softer than expected.
UK	Industrial Production (Nov, m/m)	0.1%	-0.4%	-0.6%	Weak.
GE	CPI (Dec, y/y, final)	2.6%	2.6%	2.2%	In line with expectations.
AU	Unemployment Rate (Dec)	4.0%	4.0%	3.9%	Good reversion in line with expectations.
Friday, Jan 17					
US	Housing Starts (Dec, thous)	1,325	1,499	1,294 (↑)	Stronger than expected.
US	Building Permits (Dec, thous, prelim)	1,460	1,483	1,493	Above expectations.
US	Industrial Production (Dec, m/m)	0.3%	0.9%	-0.2% (↑)	Good.
UK	Retail Sales Ex Auto Fuel (Dec, m/m)	0.3%	-0.6%	0.1% (↓)	Disappointing.

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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