BEHIND THE HEADLINES

with **Ronald Temple**, Chief Market Strategist

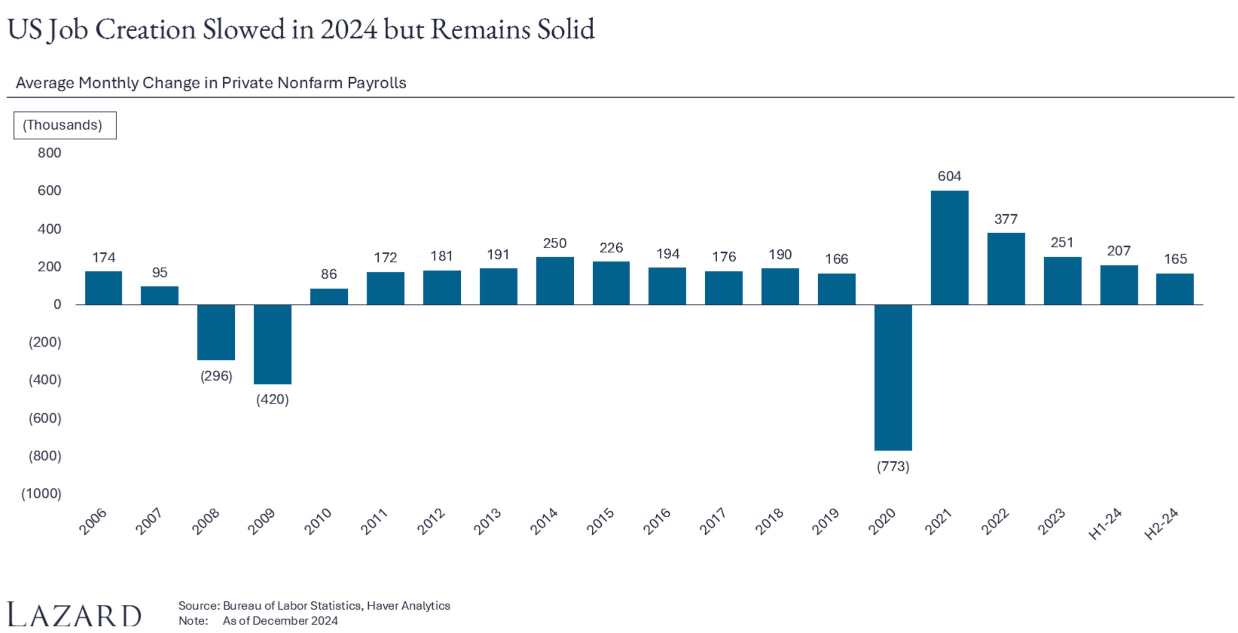
January 10, 2025

The Three Weeks Behind

1. **US labor market data offered mixed messages about the employment outlook with strong nonfarm payrolls on the one hand but weakening hire and quit rates on the other.**

   The December employment report was the bright spot with nonfarm payroll growth of 256k far outpacing the consensus expectation for 165k. Prior months' job growth estimates were revised lower by 8k. With the December figures in hand, we now know that job growth in 2024 averaged 186k per month versus the very strong 251k per month in 2023. However, the job growth deceleration remains notable from 207k per month in H1-24 to 165k per month in H2-24.

   The unemployment rate eased slightly to 4.1% versus 4.2% while average hourly earnings grew 0.3% month-on-month (m-o-m) and 3.9% year-on-year (y-o-y) versus 0.4% and 4.0%, respectively, in November.



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The Job Openings and Labor Turnover Survey (JOLTS) offered a more mixed picture with the number of open jobs in the United States rising to 8.1mn in November from 7.8mn in October taking unfilled positions to 4.8% of all jobs from the recent low of 4.4% in September.

The quit rate, on the other hand, fell to 1.9% from the prior month's 2.1% suggesting less strength in the labor market, as workers typically only quit a job when they have found higher pay or better conditions elsewhere. The quit rate matched the cycle low and compares to levels seen in 2015.

Finally, the hire rate of 3.3% of total jobs fell to the lowest level since 2013. Many observers have attributed the 80 basis points (bps) increase in the unemployment rate over the last two years to a strong economy that has been drawing more people into the labor force rather than a cause for worry from factors such as rising layoffs. The hire rate, however, begs the question of why employers are so reluctant to add staff against such a strong economic backdrop. As I previewed in my last note, the low hire rate (along with the falling quit rate) could signal that there is underlying weakness in the labor market that is not fully evidenced in the unemployment rate. I will be watching nonfarm payroll growth through 2025 to reach a verdict on this conundrum.

Overall, the US labor market appears strong to me, but there are potential causes for concern vis-à-vis the quit and hire rates. Given data quality differences and larger revisions to recent months' figures, we will need more than one month to reach a verdict on the 2025 labor market outlook.

From a market perspective, bonds sold off after the employment report with the US 10-Year Treasury yield at 4.75% and the Moody's Baa Corporate Bond Index yield approaching 6.25%. If we see material further upside moves in rates, asset allocators could begin to shift capital away from equities into fixed income to reduce volatility while locking in attractive returns.

2. **China Purchasing Managers' Index (PMI) data surprised on the upside for services.**

   The National Bureau of Statistics (NBS) PMI which focuses more on large, state-owned enterprises showed stability for manufacturing but a two-point upside surprise for non-manufacturing. The Caixin PMI which has greater representation from small and medium-sized private companies delivered a lower-than-expected reading for manufacturing and an upside services surprise.

January China PMI Data

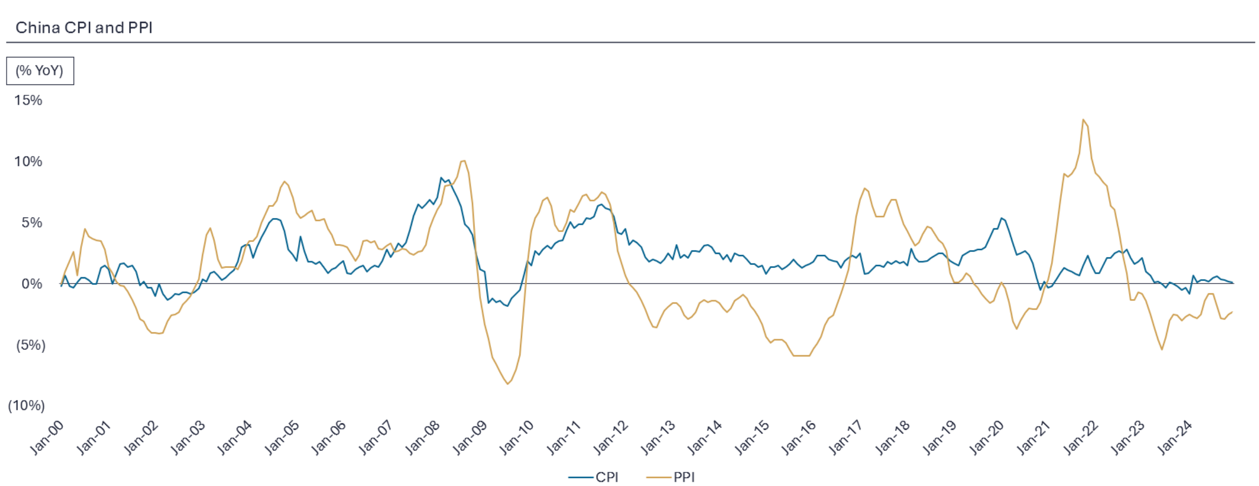
Release Date		Consensus	Actual	Prior Month
12/30/2024 NBS	Manufacturing	50.2	50.1	50.3
	Non-Manufacturing	50.2	52.2	50.0
	Composite	*	52.2	50.8
1/1/2025 Caixin	Manufacturing	51.7	50.5	51.5
1/5/2025	Services	51.4	52.2	51.5
1/5/2025	Composite	*	51.4	52.3

Source: Bloomberg, China Federation of Logistics & Purchasing, S&P Global
* No consensus estimate available on Bloomberg.

3. **China's inflation remained undesirably low in December.**

The Producer Price Index (PPI) remained in deflation for the 27th consecutive month while Consumer Price Index (CPI) inflation of only 0.1% y-o-y remains concerningly close to deflationary levels. The CPI figure was dragged down in December by normalizing fresh food prices which had risen in prior months due to supply disruptions. Non-food inflation nudged higher in December to 0.2% y-o-y from a flat y-o-y reading in November. While inflation can decline due to lower input prices, the biggest challenge in China is weak domestic demand which contributes to excess supplies and lower prices. Markets continue to wait for meaningful fiscal stimulus which is most likely to be delivered at the Two Sessions meeting in March, if at all.

China Inflation Is Undesirably Low with PPI Deflation for 27 Months and CPI ≤1% for 23 Months



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Source: Bloomberg, National Bureau of Statistics
Note: As of December 2024

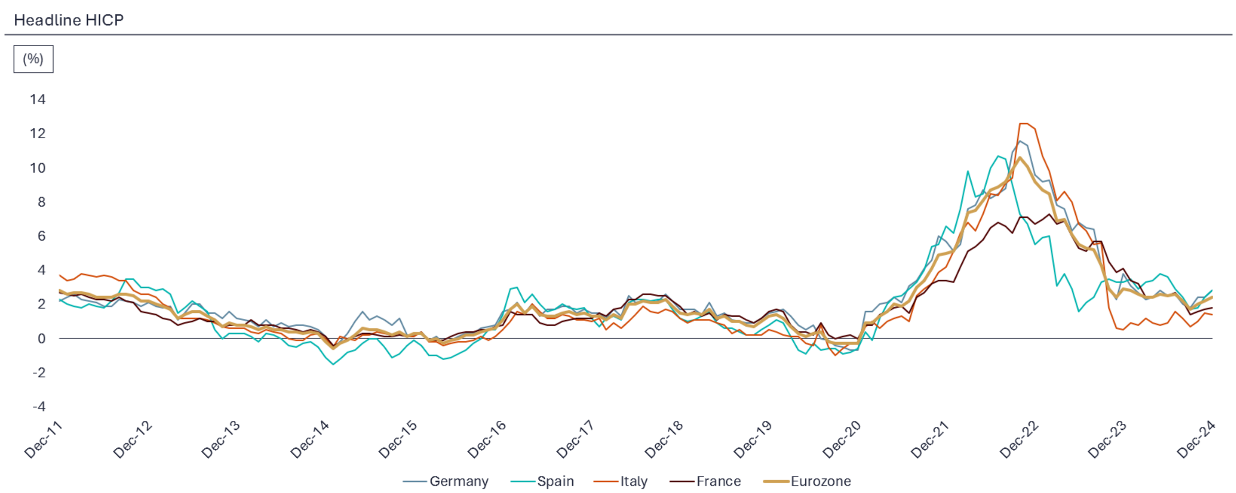
4. **Eurozone inflation ticked higher as expected on the back of energy price base effects.**

   Eurozone headline inflation rose 2.4% y-o-y versus 2.2% in the prior month. Core inflation was stable, as expected, at 2.7% y-o-y. Peeling back the onion, energy prices (9.9% of the index weight) rose 0.1% y-o-y versus the -2% November reading, largely driving the marginal increase in headline inflation. Non-energy industrial goods (25.7% weight) inflation remained well contained rising 0.5% y-o-y while services (44.9% weight) prices rose 4.0% y-o-y, a tick higher than the 3.9% in November.

   Compared to December of 2023, national-level inflation dispersion across Eurozone members narrowed. Y-o-y inflation ranged from 0.5% in Belgium and Italy to 6.6% in Slovakia in 2023 versus a low of 1.0% in Ireland to a high of 4.5% in Croatia in 2024.

   Overall, I see the December figures as representing ongoing progress toward sustainably meeting the European Central Bank's 2% inflation target and allowing for further rate cuts in 2025.

Headline Inflation Has Decelerated Meaningfully in Major European Economies



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Source: Statistical Office of the European Communities, Haver Analytics
Note: As of December 2024

EU Harmonized HICP for December

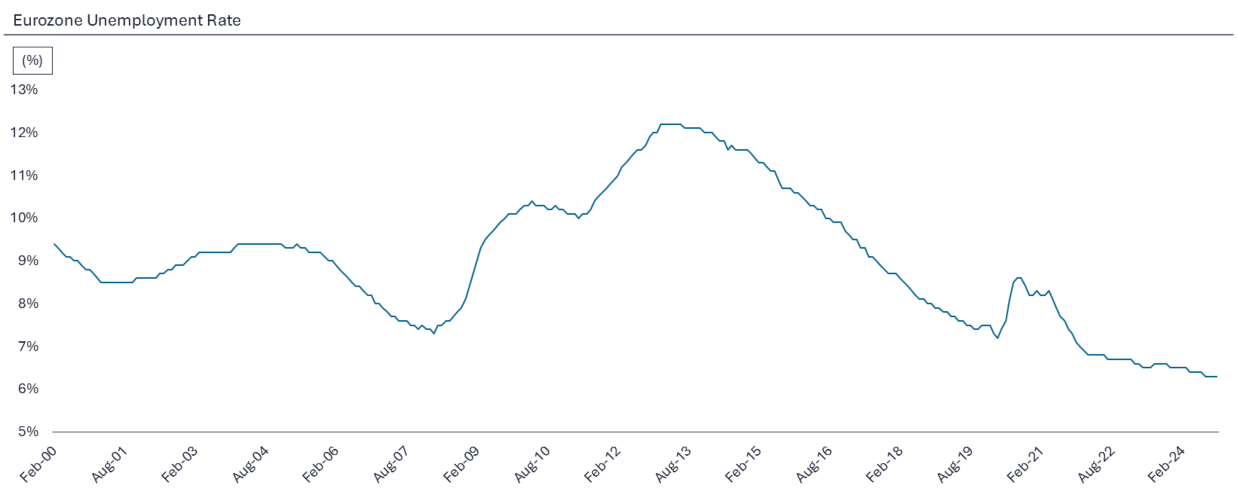
Release Date	Country		Consensus	Actual	Prior Reading
12/30/2024	Spain	Headline m-o-m	0.3%	0.4%	0.0%
		Headline y-o-y	2.6%	2.8%	2.4%
1/6/2025	Germany	Headline m-o-m	0.5%	0.7%	-0.7%
		Headline y-o-y	2.6%	2.8%	2.4%
1/7/2025	Eurozone	Headline m-o-m	0.4%	0.4%	-0.3%
		Headline y-o-y	2.4%	2.4%	2.2%
		Core y-o-y	2.7%	2.7%	2.7%
1/7/2025	France	Headline m-o-m	0.4%	0.2%	-0.1%
		Headline y-o-y	1.9%	1.8%	1.7%
1/7/2025	Italy	Headline m-o-m	0.3%	0.1%	0.0%
		Headline y-o-y	1.6%	1.4%	1.5%

Source: Bloomberg

5. **Eurozone unemployment held steady at the lowest level since the creation of the euro.**

   Eurozone unemployment was in line with expectations at 6.3%, the lowest level since 1999.

Eurozone Unemployment Is at the Lowest Level since the Inception of the Common Currency



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Source: Eurostat, Haver Analytics
Note: As of November 2024

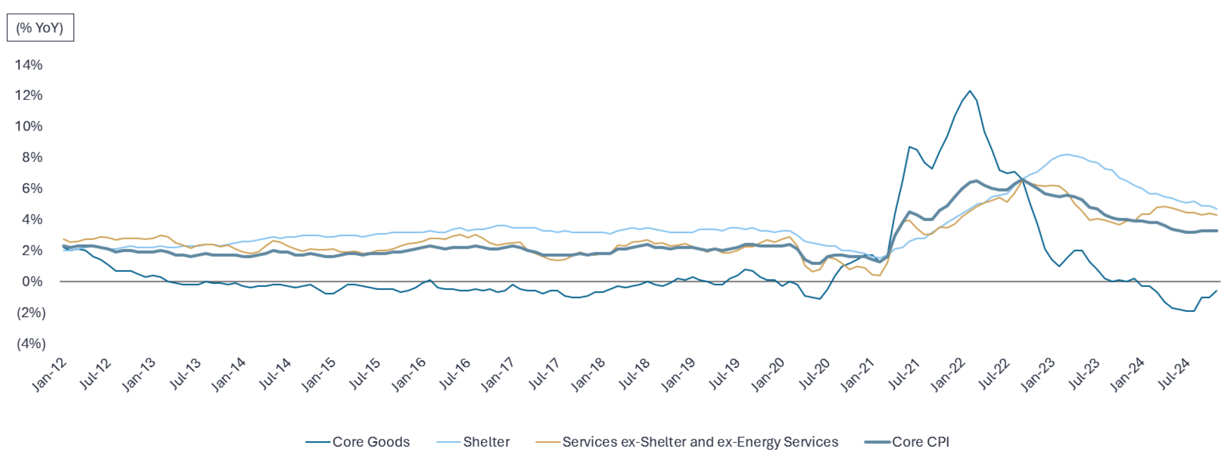
The Week Ahead

1. US core CPI inflation is expected to be stable y-o-y versus a slight uptick in headline CPI.

US headline CPI is expected to increase 0.3% m-o-m and 2.9% y-o-y versus the prior month's 0.3% and 2.7%, respectively. Core CPI is expected to increase 0.2% m-o-m and 3.3% y-o-y versus November's increases of 0.3% and 3.3%, respectively.

Shelter and Services Inflation Have Remained Stubbornly High and Goods Deflation Is Dissipating

US Consumer Price Index Inflation for Key Categories



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Source: Bureau of Labor Statistics, Haver Analytics
Note: As of November 2024
Core goods represent ~23% of core CPI, shelter represents ~46%, and other services ex-shelter and ex-energy services represent ~31%.

My primary focus over the next several months will be to determine whether progress has stalled in getting core inflation down to the Federal Reserve's 2% target. For the last six months, the core CPI has stabilized at 3.2% to 3.3% y-o-y. Over the same period, the core Personal Consumption Expenditure (PCE) price index has also stabilized between 2.6% and 2.8%. While these levels still allow for further Fed rate cuts (absent potentially inflationary policy changes introduced by the new Trump administration), neither would allow for taking rates to a level that could be described as neutral, i.e., neither restrictive nor accommodative.

To determine if the disinflation story remains on track, I will be watching to see whether shelter inflation remains at the lower rate observed in November, and I will be eager to see whether core goods prices remain in positive territory after surprising on the upside last month on the back of higher automobile prices.

Note: The Fed's preferred inflation metric is the PCE price index which captures the cost of all goods and services consumed regardless of who pays for them while the CPI captures the inflation for goods paid for directly by households. The biggest differences between the two indices are housing and healthcare. CPI has a much lower weighting for healthcare given that employers and the government pay for most healthcare expenses. The offset is that CPI has a much higher weighting for shelter costs than does the PCE.

2. **US retail sales will offer an important gauge of US household resiliency through 2025.**

   One surprise of the last two years has been the durability of US consumer spending. In hindsight, this probably should not have been a surprise given a full-employment economy and rising real wages. However, given that the initial spending wave after the pandemic was largely driven by excess accumulated savings, many had expected spending to falter as funds accumulated during the pandemic were depleted. Now, with labor market tightness easing and with rising delinquency rates on credit cards and auto loans signaling that lower- and some middle-income households are having trouble making ends meet, we could see cracks form in the household spending metrics. I do not expect to see those signs in this month's retail sales, but will be on the lookout through 2025.

December US Retail Sales	Consensus	Prior Month
Retail Sales m-o-m	0.5%	0.7%
Retail Sales ex-Auto m-o-m	0.5%	0.2%
Retail Sales ex-Auto and Gas m-o-m	0.4%	0.2%
Retail Sales Control Group	0.3%	0.4%

Source: Bloomberg, U.S. Census Bureau

3. **China Q4-24 GDP and monthly economic data are expected to show stable growth.**

   China's Q4-24 GDP release will be the highlight of the week and will likely show the government achieved its stated 5% real growth target. However, there is reason for skepticism regarding the veracity of the report given the ongoing weakness in residential real estate. Given that real estate accounted for as much as 25% to 30% of Chinese economic activity at the peak, it's highly unlikely that the broad economy has continued to grow at a 5% or higher pace even while new property construction has fallen by over 60%. In 2023, for example, I believe the true growth rate of the Chinese economy might have been less than half of the 5.2% figure reported by the government. In 2024, the decline in real estate was less severe than in 2023 which would translate to a better growth picture, but one still falling short of 5%. All said, I would not overemphasize the GDP figures but would instead focus on the monthly data to determine whether there are signs of sustained improvement at a more granular level.

Importantly, in recent months, there have been signs of a potential turn in real estate sales and prices. We have also seen trade-in subsidies drive higher demand for targeted consumer durables. At this point, all eyes will be on the national Two Sessions meeting in March where we should learn whether the central government has determined that it needs to intervene more aggressively to accelerate growth through fiscal stimulus measures. To date, monetary policy tools have been the primary levers to prop up growth, and they have not been particularly effective.

December China Economic Data		Consensus	Prior
GDP for Q4-24	y-o-y	5.0%	4.6%
	YTD y-o-y	4.9%	4.8%
	q-o-q	1.6%	0.9%
Industrial Production	y-o-y	5.4%	5.4%
	YTD y-o-y	5.7%	5.8%
Retail Sales	y-o-y	3.5%	3.0%
	YTD y-o-y	3.5%	3.5%
Fixed Asset Investment	YTD y-o-y	3.3%	3.3%
Property Investment	YTD y-o-y	-10.4%	-10.4%
Residential Property Sales	YTD y-o-y	*	-20.0%
New Home Prices	m-o-m	*	-0.20%
Used Home Prices	m-o-m	*	-0.35%

Source: Bloomberg, National Bureau of Statistics
* No consensus estimate available on Bloomberg.

4. **UK core and services inflation are expected to tick lower in December albeit from high levels.**

UK CPI inflation figures are likely to exceed Bank of England forecasts in December, and prospects for inflation in 2025 do not look great as increases in the National Living Wage and employer National Insurance Contributions are likely to be passed on to consumers. The recent slide in the British pound likely adds insult to injury as prices for imported goods increase.

UK December CPI

	Consensus	Prior Reading
Headline m-o-m	0.4%	0.1%
Headline y-o-y	2.7%	2.6%
Core y-o-y	3.4%	3.5%
Services y-o-y	4.9%	5.0%

Source: Bloomberg, UK Office for National Statistics

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