BNY MELLON

iFlow

MACRO MORNING BRIEFING

April 29, 2024

Robust US Growth And Inflation

- US GDP stronger than top line suggests
- US PCE inflation remains troublingly strong
- Appetite for trending currencies lowest ever

Strong Growth Continues Into 2024

Last week's US growth and inflation data don't change the narrative that the economy remains robust and inflation remains sticky. While headline GDP was weaker than expected, below we explain why we think the print wasn't as weak as it appeared at the top line. PCE inflation was in line with expectations and suggests that inflation has currently plateaued at a high level. Getting inflation down remains job number one for monetary policy.

Let's start with the GDP data released last Thursday. While the seasonally adjusted quarterly annualized rate of growth fell to just 1.6% in Q1, compared to 3.4% in Q4 last year and 4.9% in Q3, we don't think growth has meaningfully slowed. Much of the weaker-than-expected top line was pulled down by statistical quirks and – ironically – strong demand.

• Inventory build declined, to $35bn from $55bn and $78bn in Q4 2023 and Q3 2023, respectively. The decline over the previous quarter subtracted 0.35% from top line GDP. This actually suggests that demand was strong enough in the quarter to reduce stockpiles.
• Net exports (exports minus imports) were nearly $1trn in the negative. This too actually represents strong domestic demand, as imports alone were up 7.2%. Overall, trade took another 0.9% off top line growth.
• Real final sales to private domestic purchasers – this is the best measure of aggregate demand: it strips out the trade data, ignores government consumption, and doesn't look at inventories. It is what the name suggests – stuff bought in the US by US persons. It was up 3.1%, in the range of where it's been for several quarters. That's a very strong pace of domestic demand. The chart below shows that since Q1 2023, real final sales to domestic

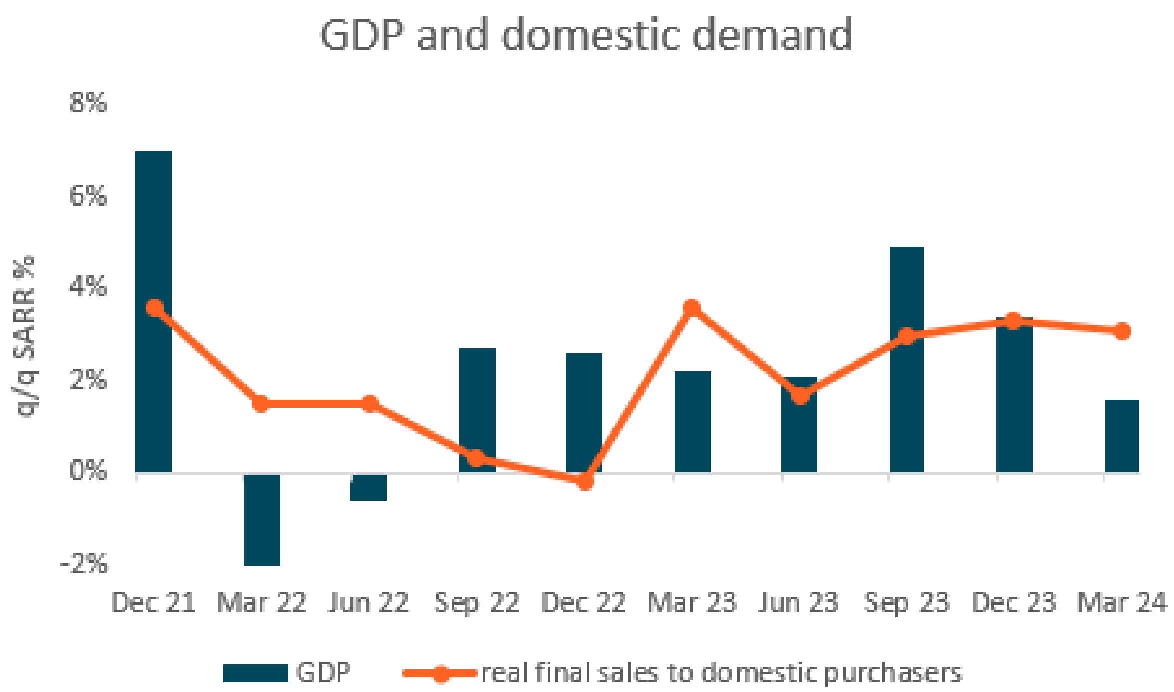
purchasers averaged just under 3%, roughly in line with the pre-pandemic average going almost all the way back to the Global Financial Crisis.

• Even though personal consumption was below expectations and lower than in Q3 and Q4 last year, 2.5% is still a strong clip. Goods, especially durable goods – reflecting declining auto sales – was the drag. Services consumption, by contrast, was a brisk 4%.

This is not an economy slowing significantly. Rather, it appears to be humming along nicely.

The associated price deflator data, at a 3.1% seasonally adjusted annualized rate, was stronger than expected and higher than last quarter's 1.6%. The core personal consumption expenditures price deflator was up 3.7% versus just 2% at the end of 2023.

Domestic Demand Stays Strong



Source: BNY Mellon Markets, Bureau of Economic Analysis

No Relief In Core PCE

Turning to the monthly PCE inflation data published last Friday, we see an inflation picture not much changed from recent months. As noted above, the very strong GDP-related price deflator data on Thursday were quite high, and the focus of the Thursday morning reaction to GDP was related to fears that the quarterly GDP-related price deflators were presaging a similarly high PCE inflation print the following day. Instead, the PCE data were in line with expectations, providing the market some relief that they weren't worse than expected. Nevertheless, these data reveal a price environment that is anything but benign.

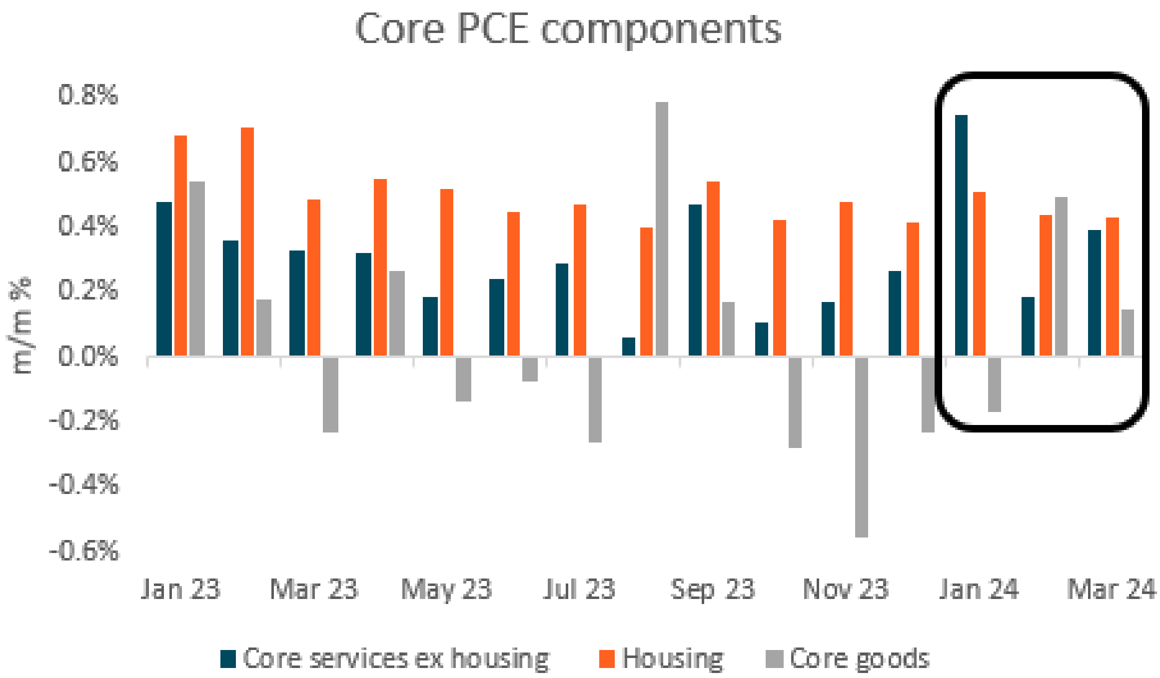
We like to examine PCE data via the three main components of the core – housing, core goods, and core services ex housing. This allows us to decompose price pressures across the Federal Reserve's preferred inflation gauge and see which set of prices is still misbehaving. The chart below shows monthly changes in these three sub-aggregates. Note the strength in all three since the beginning of 2024, a development we weren’t expecting, and which has been the main factor behind receding Fed rate-cut expectations.

Housing remains on a strong monthly pace. While less important than shelter is in CPI in terms of weighting in and influence on the index, housing continues to be well-elevated, and one of the most important upward influences on prices. Housing is coming down, albeit quite slowly. We are optimistic that as rental prices continue to decelerate nationally, this will work its way into the housing component of PCE and provide some relief by mid-year.

Goods prices have been almost flat for most of the period covered in the chart below. Note that there were eight different months in the 14-month sample we show in which goods prices actually fell. Their annual rate of increase in March was just 0.15%. However, we note that since the beginning of 2024, the disinflationary tendency in core goods prices has petered out and we've seen increasing monthly readings recently.

The real problem we see in the core PCE inflation data remains core services less housing. This measure, known as the “supercore”, owing to the explicit attention paid to it by Fed Chair Powell, remains sticky. The blue bars in the chart below show steady, persistent and high readings. We simply aren’t getting enough relief here. As long as services prices remain under pressure, we don’t see the Fed cutting rates – we’d need a few months at least of discernable progress in getting the supercore lower before cuts can be considered. As things stand, we’re still somewhat optimistic that into the US summer there will be some moderation in core services less housing to allow the Fed to cut rates in September.

Monthly Inflation Picking Back Up



Source: BNY Mellon Markets, Bureau of Economic Analysis

iFlow Trend Is Not Your Friend

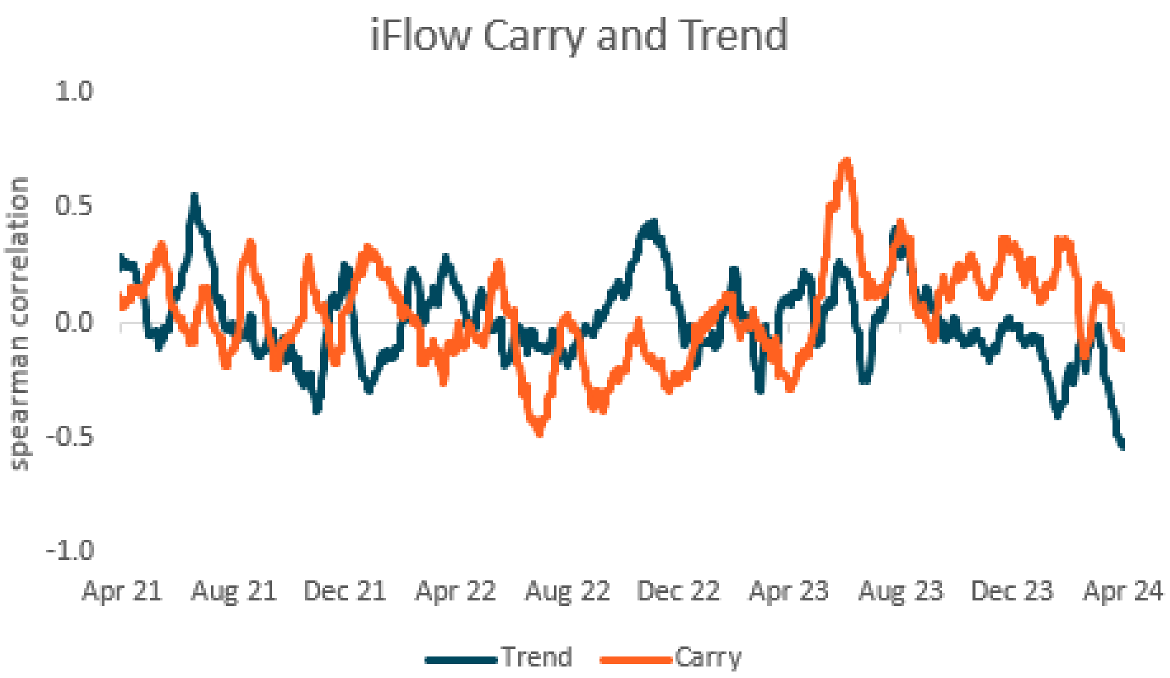
In this section, we wish to draw readers' attention to some notable behavior in our iFlow FX styles indices. In particular, iFlow Trend, which measures real money appetite for momentum in currency rates, has collapsed. At the same time, iFlow Carry, a more familiar indictor which measures the strength of the carry trade in FX, has also come off lofty levels. These developments explain some recent currency movements – and could be setting the stage for some currency reversals in coming weeks.

iFlow Trend is a measure of investor behavior towards the momentum trade in FX. We correlate flows into each of the 36 currencies we cover in iFlow with each currency’s 50-vs-200-day moving averages, a common momentum measure. When the daily correlation of flows with trending currencies is high, we infer that flows are chasing momentum. When the daily correlation is negative, we are looking for currency reversals, momentum is being sold.

iFlow Trend currently is quite negative, in fact these are the lowest readings this measure has ever recorded in over ten years of history. At the same time, iFlow Carry is falling from the lofty heights it had occupied for most of the last 12 months. We infer from this that while iFlow Carry was so strong and demand for carry strategies was so high, currencies exhibiting high carry became trending currencies as well, and demand for carry was showing up as demand for momentum.

That has inverted with the slow demise of the carry trend. Those high-carry currencies which were also trending currencies now appear set to weaken. We have seen this already with the Mexican peso. We expect to see it with more high-carry currencies.

Downtrend



Source: BNY Mellon Markets, iFlow

Disclaimer & Disclosures

Please direct questions or comments to: iFlow@BNYMellon.com

John Velis

AMERICAS MACRO STRATEGIST

CONTACT JOHN