May 22, 2025

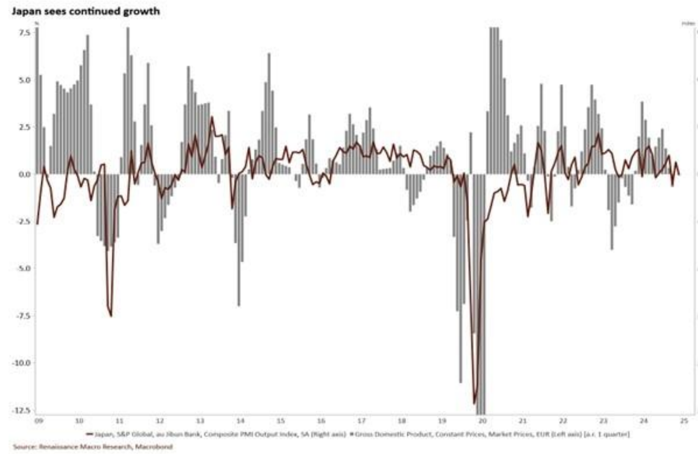
# Dutta's Economic Daily

This ain't really about US fiscal

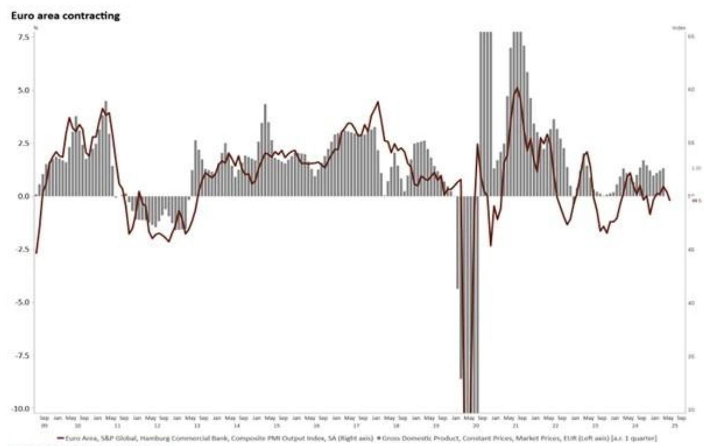
**Neil Dutta**

## Data were a mixed bag overseas

- Conditions were soft in Japan with manufacturing activity continuing to contract in May. Service industries slowed but remain barely in expansion territory. All told, the composite PMI slid 0.4pts to 49.8 in May, the second month below 50 in the last three months. Composite new orders slid over the month to its lowest level since January 2023. Recall that in Q1 real GDP declined 0.7% SAAR. With financial conditions tightening in Japan, stronger currency and higher interest rates, growth is likely to slow from here.

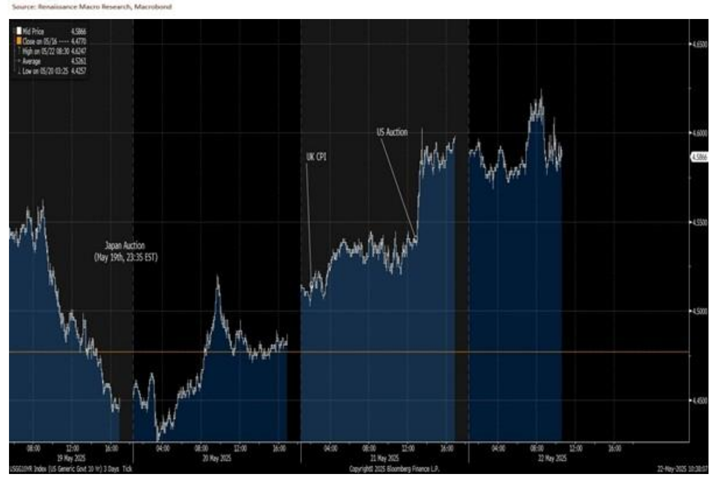



- A similar situation unfolded in the Eurozone; the composite PMI slid 0.9pts to 49.5, the lowest level since November 2024. The drop was led primarily by services, which unexpectedly declined 0.2pts to 48.9. Finally, in the UK, the composite PMI improved to 49.4, the second consecutive month below 50 with contraction in manufacturing being offset by a pickup in services. The outlook isn't great with composite new orders declining to its lowest level since November 2022.
- India remains a standout with its composite PMI unexpectedly strengthening 0.4pts to 61.2.

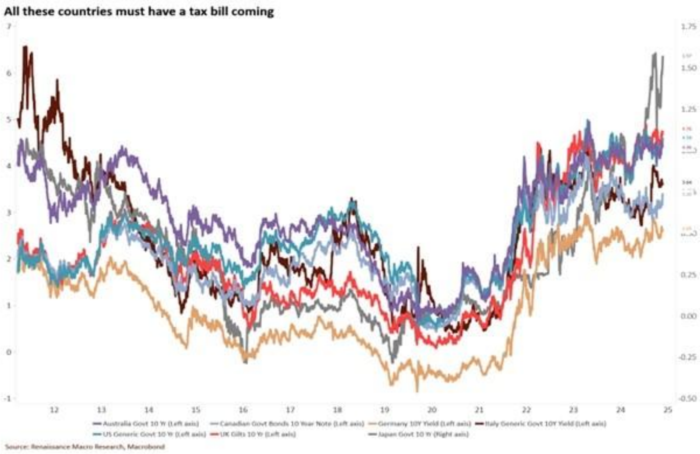


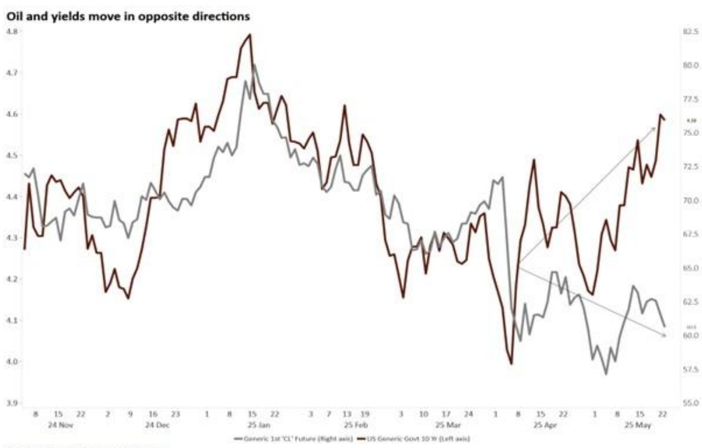

## Global factory behind rates

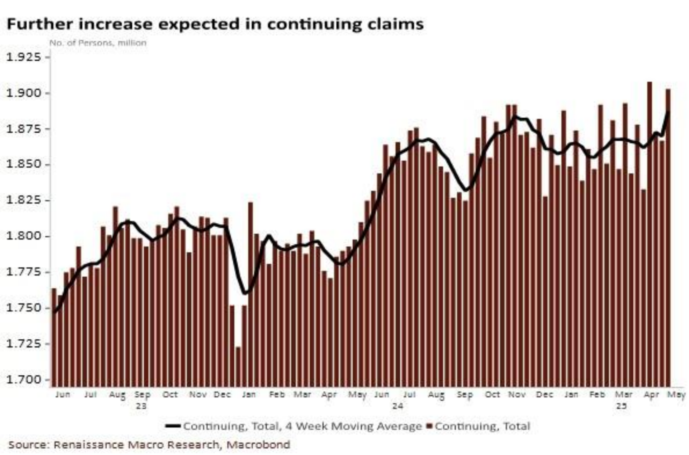
- There is clearly a global factor to the rise in longer-term interest rates. Yesterday, the initial sell-off in longer term bonds began with a weak Japanese bond auction followed by a stronger than expected UK inflation report. The weak Treasury auction in the US made matters worse but about half the increase came from overseas.




Economics



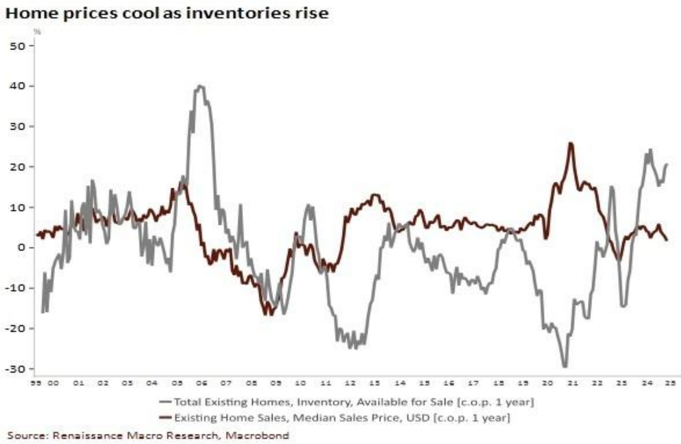

• Yes, there is fiscal legislation making its way through Congress, but I think analysts using this as the main rationale for higher rates are trying to fit a narrative to the data and more importantly, making inconsistent assumptions about the market's forwardlooking behavior. The market has known that some version of this legislation was coming at least since the election; so, my sense is that this expectation is becoming a reality is a small driver of rates now. Moreover, the net fiscal impulse is relatively small; that's because the deficit is not changing much relative to GDP.

• Instead, term premiums are rising, pushing up interest rates around the world. Nominal growth is running below longer-term government bond yields in many countries including Germany, France, and Italy. The US looks okay by comparison. At any rate, the increase in term premiums represents a tightening of financial conditions, which is why corporate credit spreads have widened a little bit and oil has declined.

## Continuing claims maintain upward trend

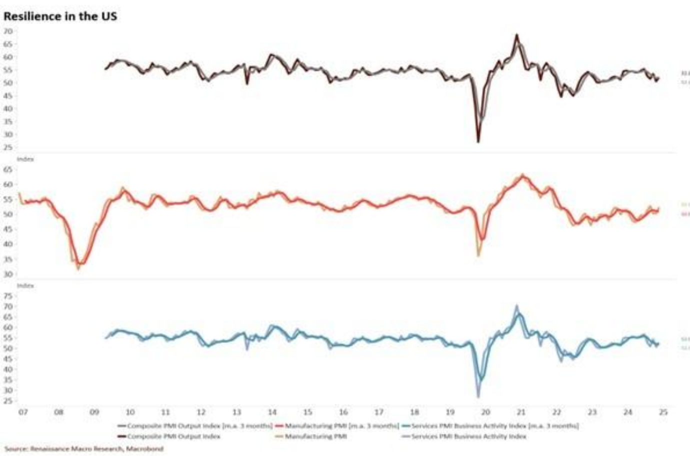
• The upward drift in continuing unemployment claims continues. The four-week moving average stands at a fresh high of 1.8875 million. Continuing claims are climbing roughly 5-6% against last year. So, don't be surprised if continuing claims are close to two million by July.

## Rising inventory slowing home price growth



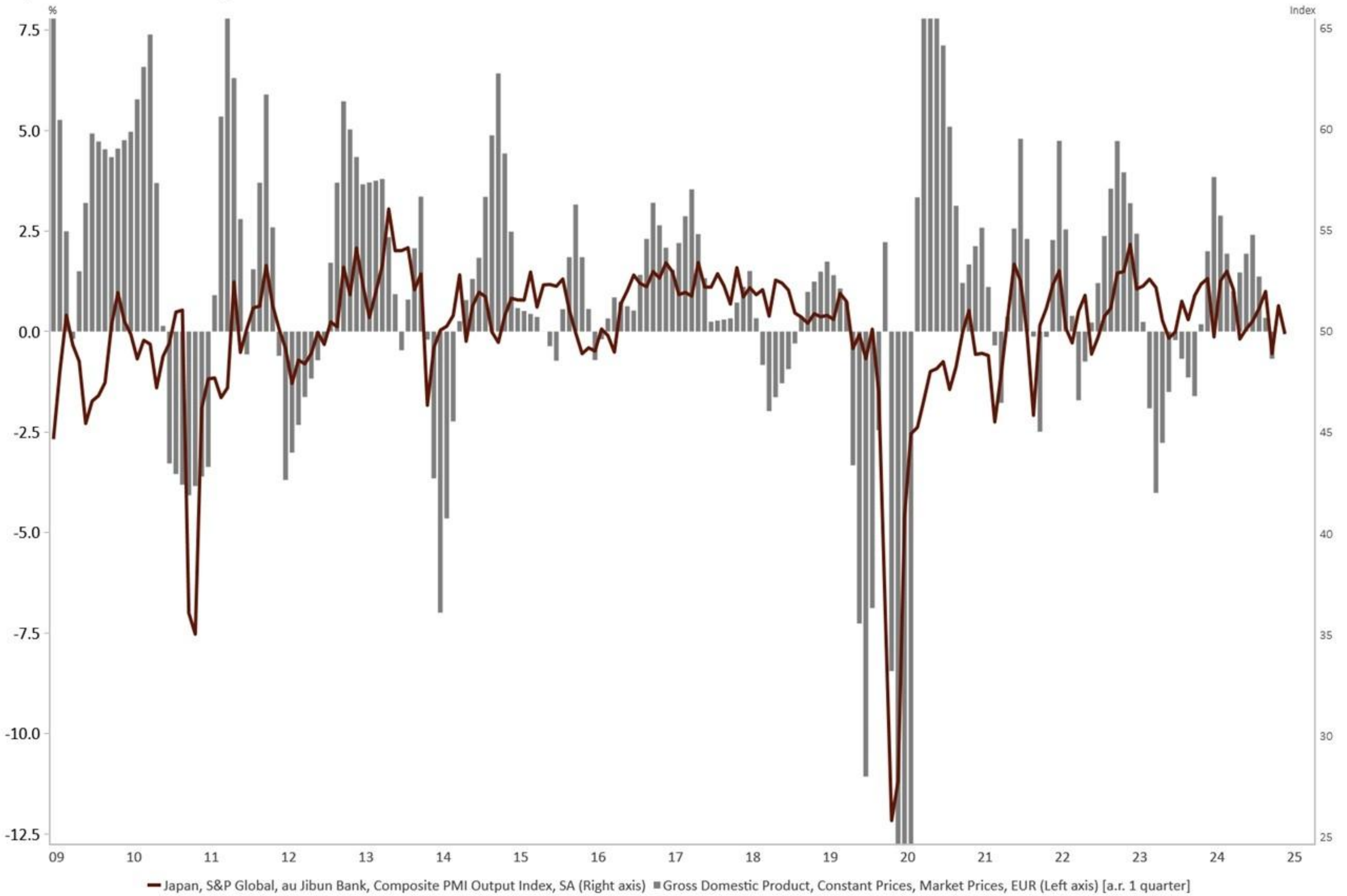

• Home prices cooling off as inventories rise. In April, existing homes available for sale rose 20.8% against last year. Existing home prices up just 1.8%, the weakest since mid-2023. More inventory in the resale market means that homebuilders are no longer the only game in town.

## Resilience in US, but employment down



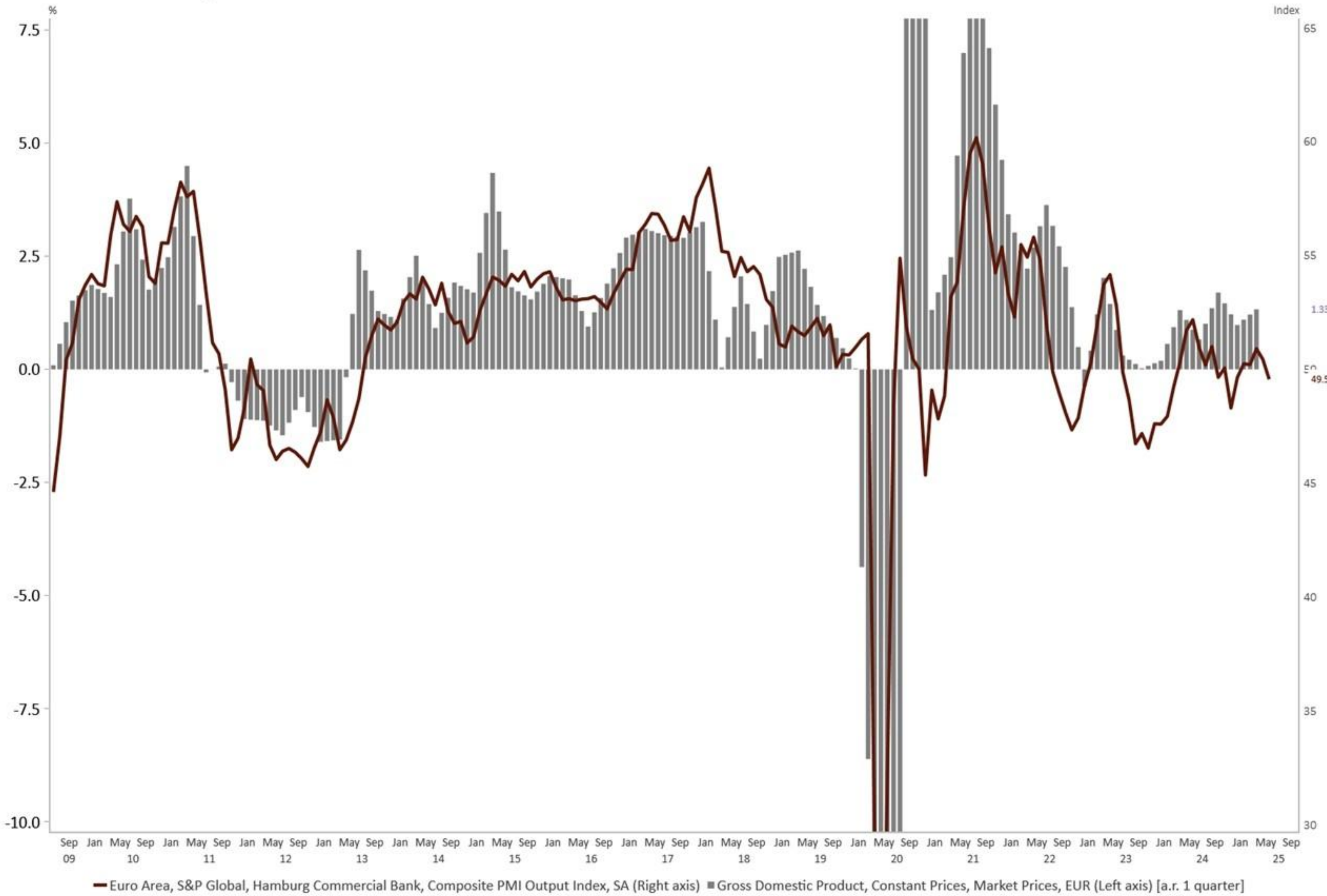

• US PMIs show resilience in the economy in May. The composite PMI improved 1.5pts to 52.1, about where it has been for the last three months. In theory, tariffs ought to shift growth to manufacturing output, away from services. We saw some of that in May with the factory PMI rising more quickly than services. While I am skeptical US growth is picking up, today's data does imply that weakness in Q1 GDP likely understates the underlying trend in activity. The fly-in-the-ointment? Employment, which is contracting and the price index, which is picking up.

Japan sees continued growth



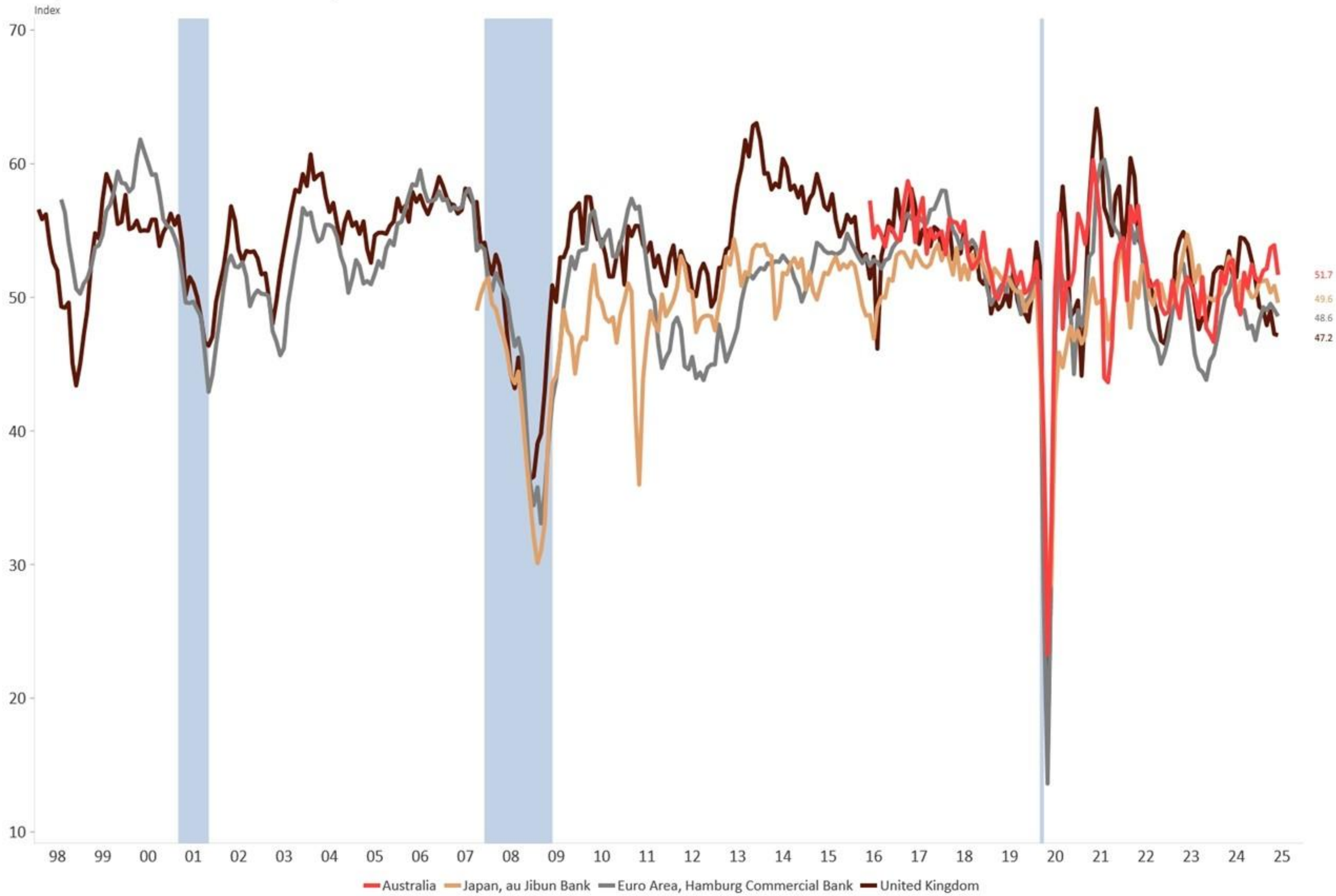

Source: Renaissance Macro Research, Macrobond

**Euro area contracting**

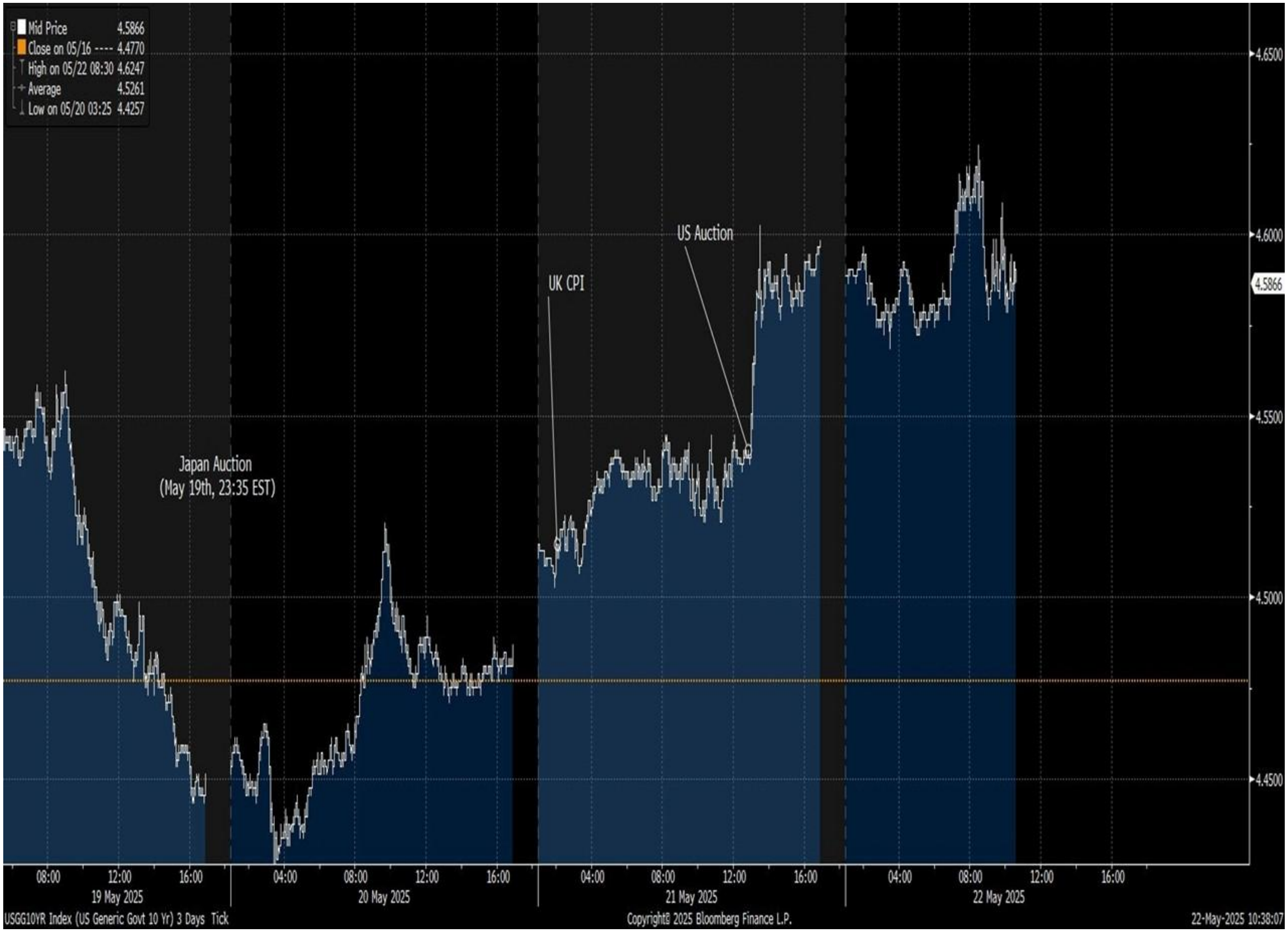



Source: Renaissance Macro Research, Macrobond

**Composite new orders slid in May**




Source: Renaissance Macro Research, Macrobond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UK CPI
US Auction
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20 May 2025
21 May 2025
22 May 2025
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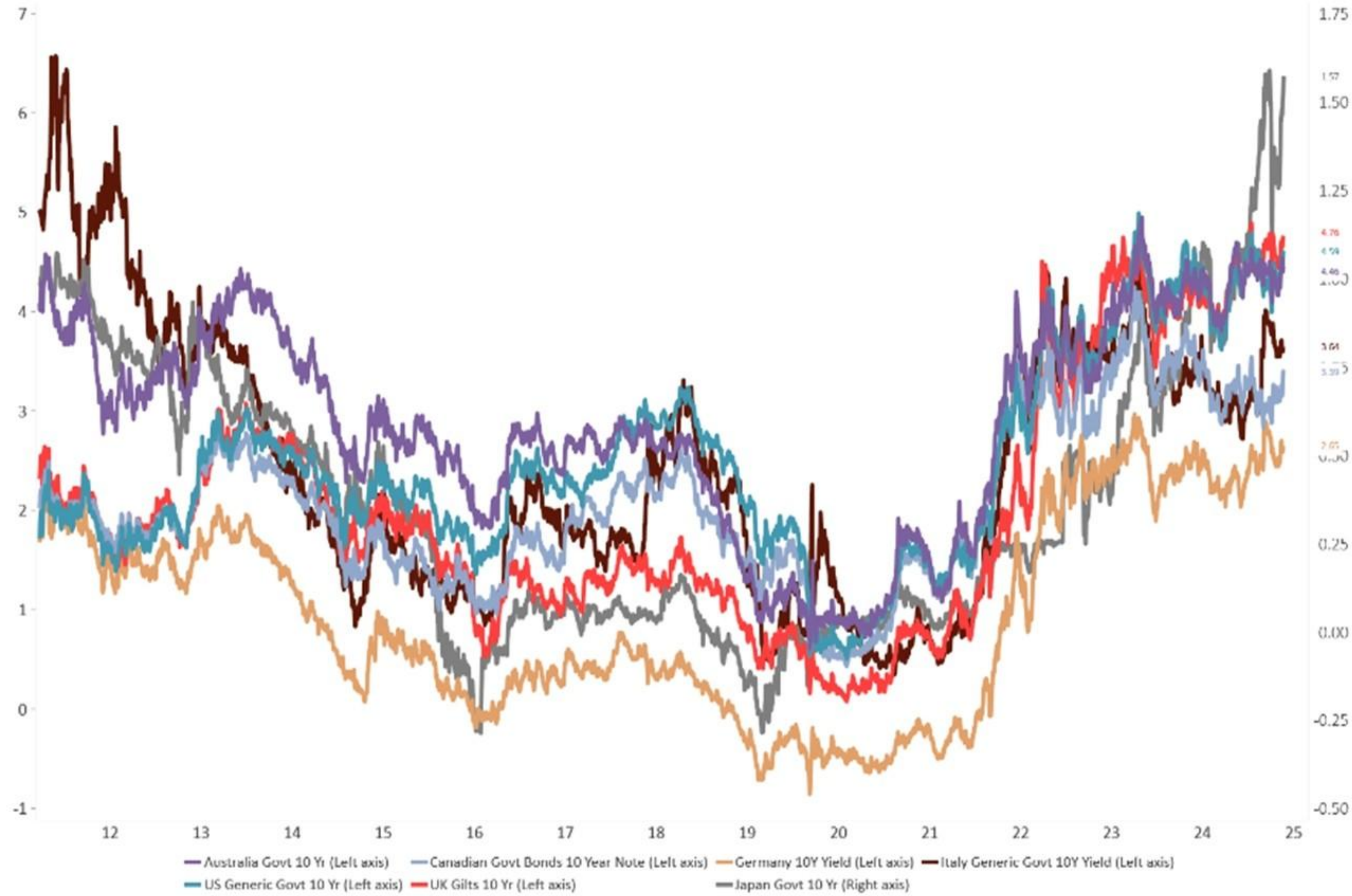
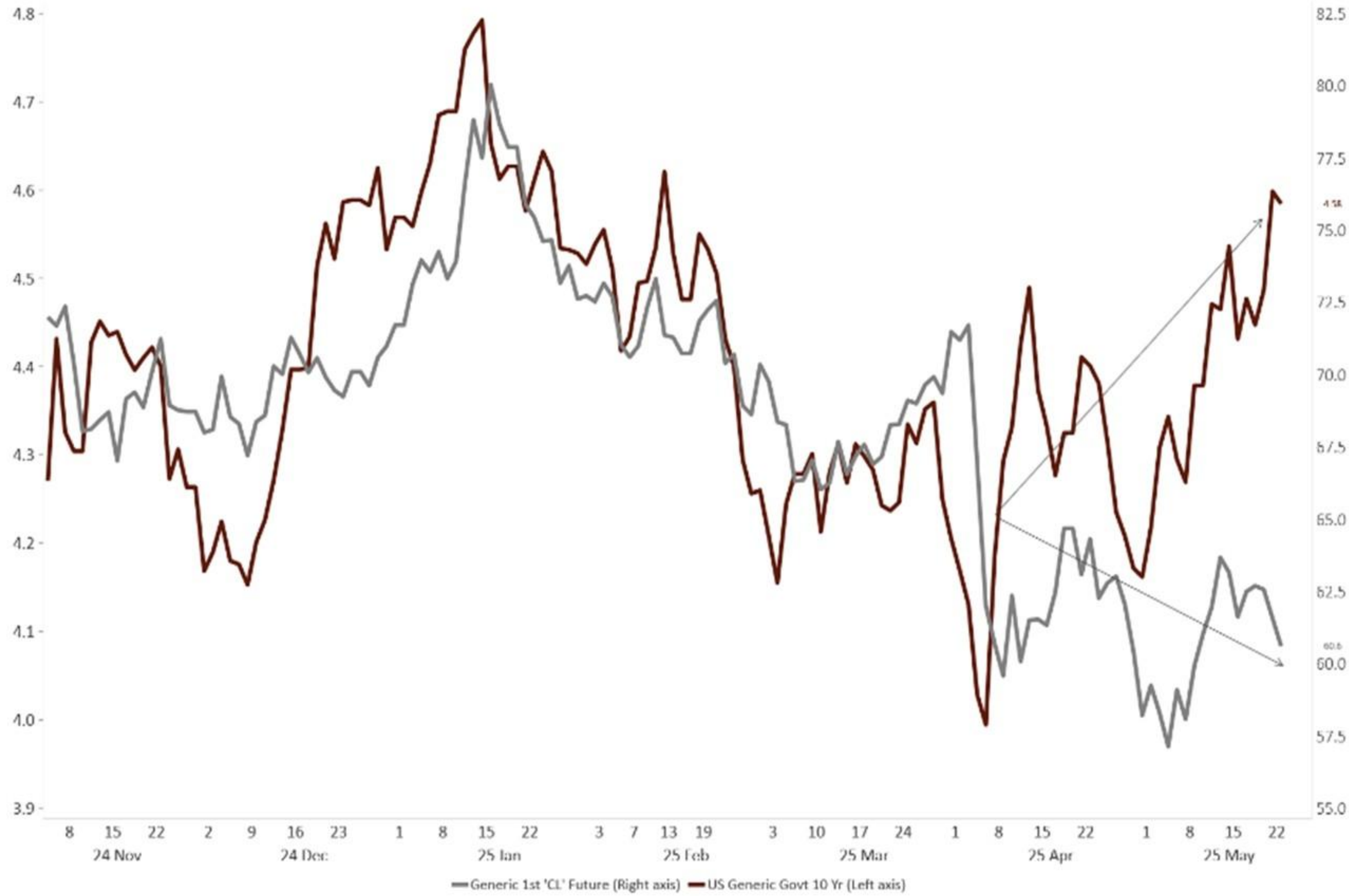
All these countries must have a tax bill coming



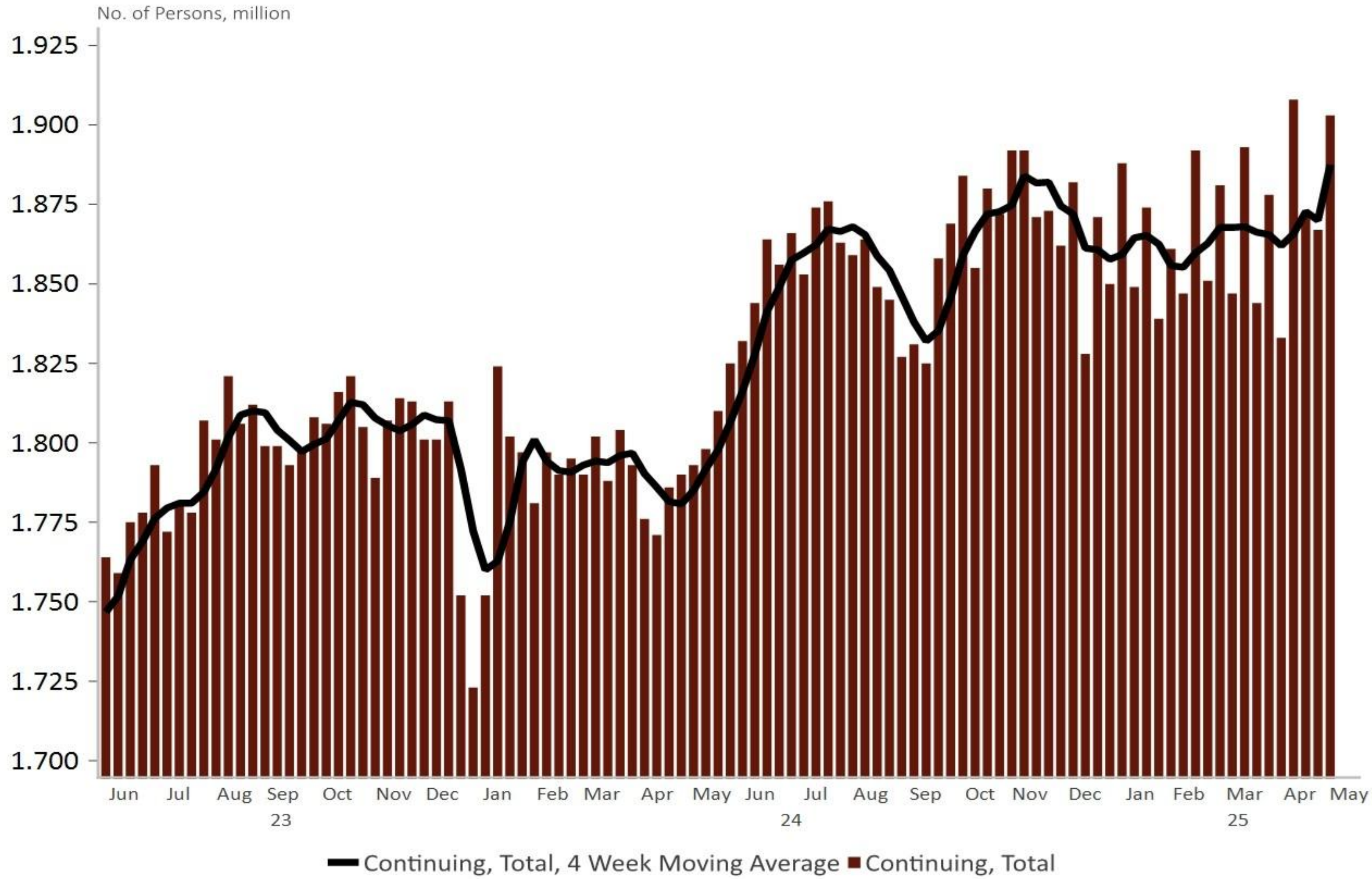

Source: Renaissance Macro Research, Macrobond

Oil and yields move in opposite directions



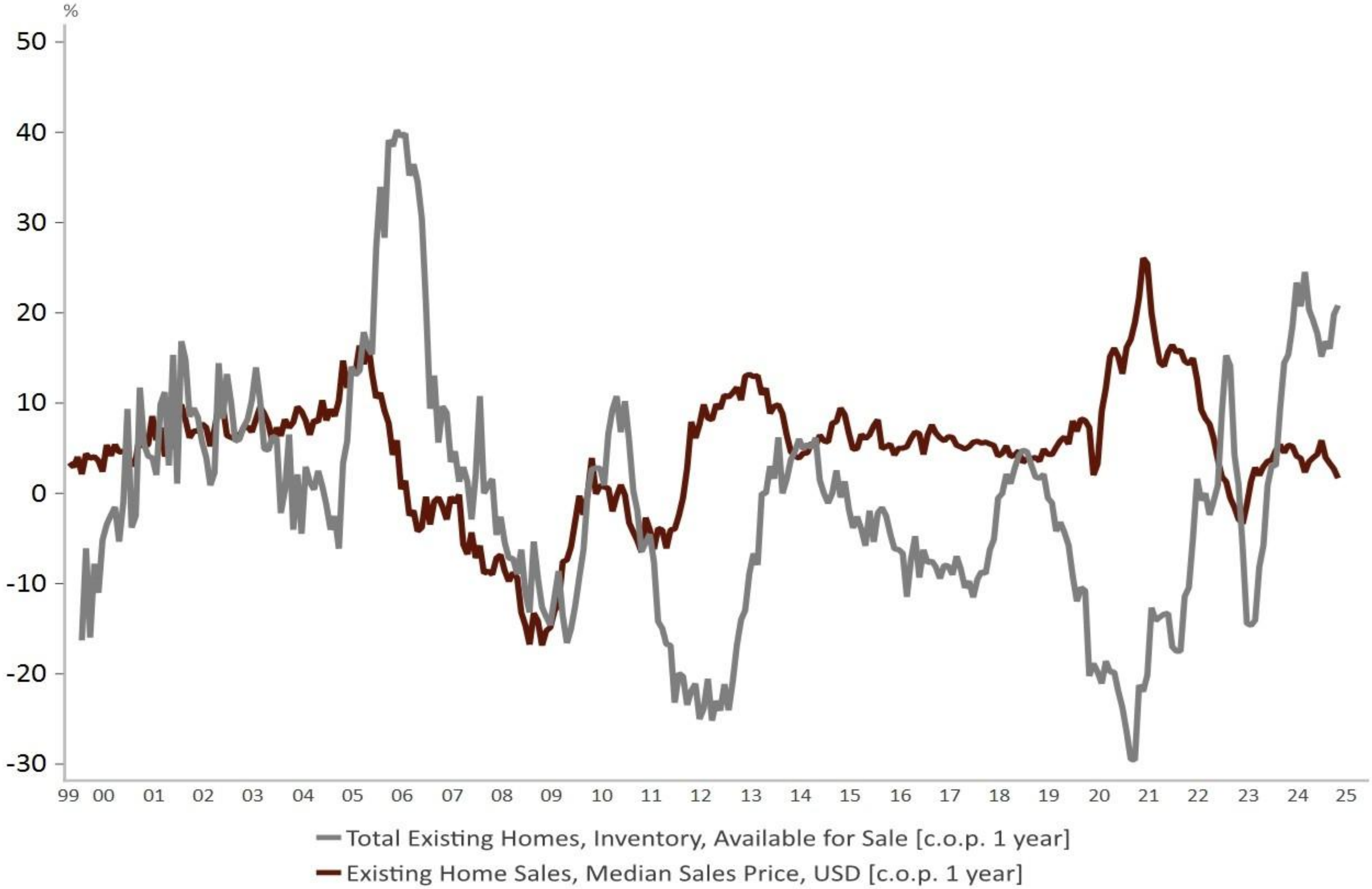

Source: Renaissance Macro Research, Macrobond

## Further increase expected in continuing claims




Source: Renaissance Macro Research, Macrobond

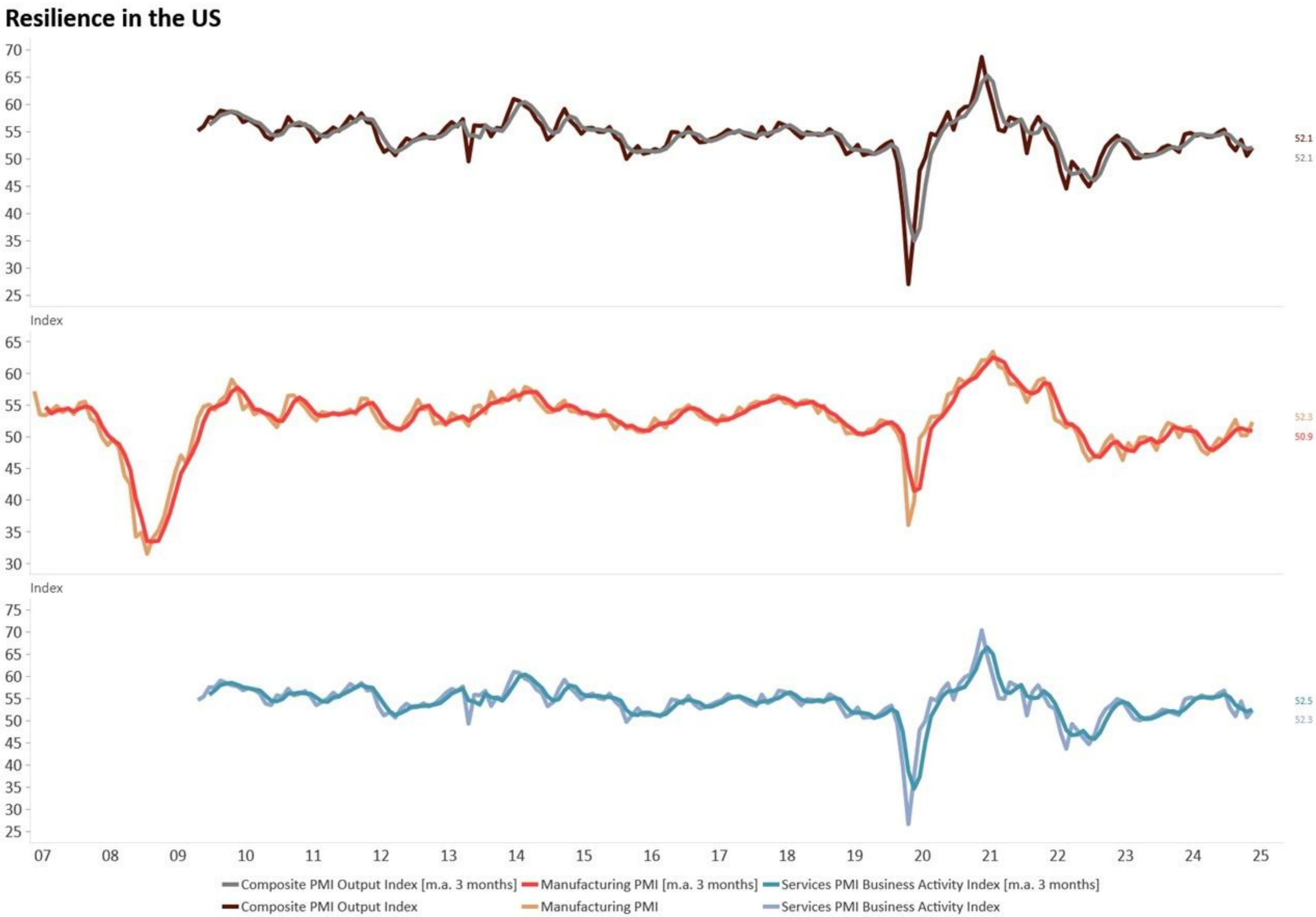
## Home prices cool as inventories rise




Source: Renaissance Macro Research, Macrobond

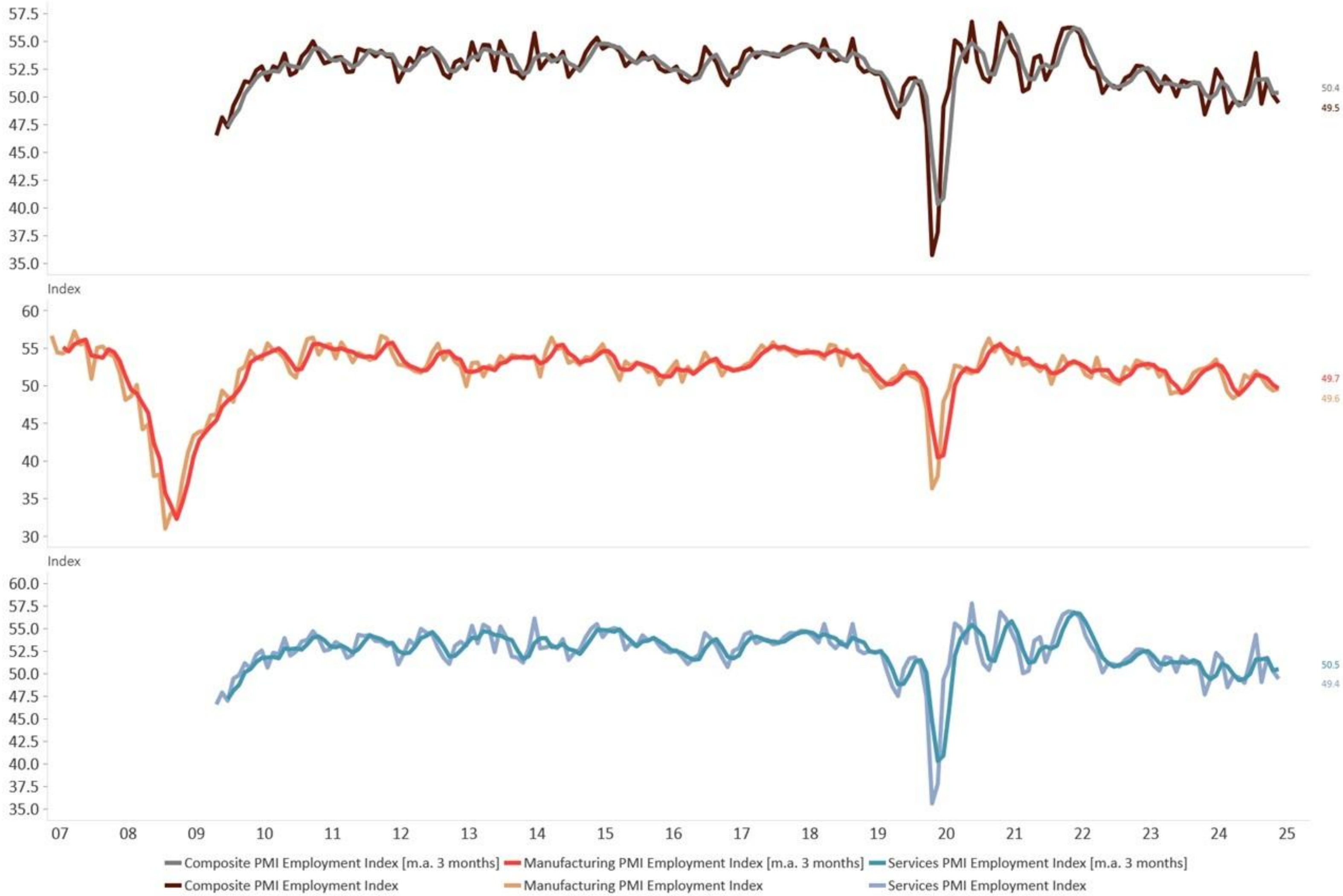
**Mortgage rates will continue to pressure housing**


Source: Renaissance Macro Research, Macrobond



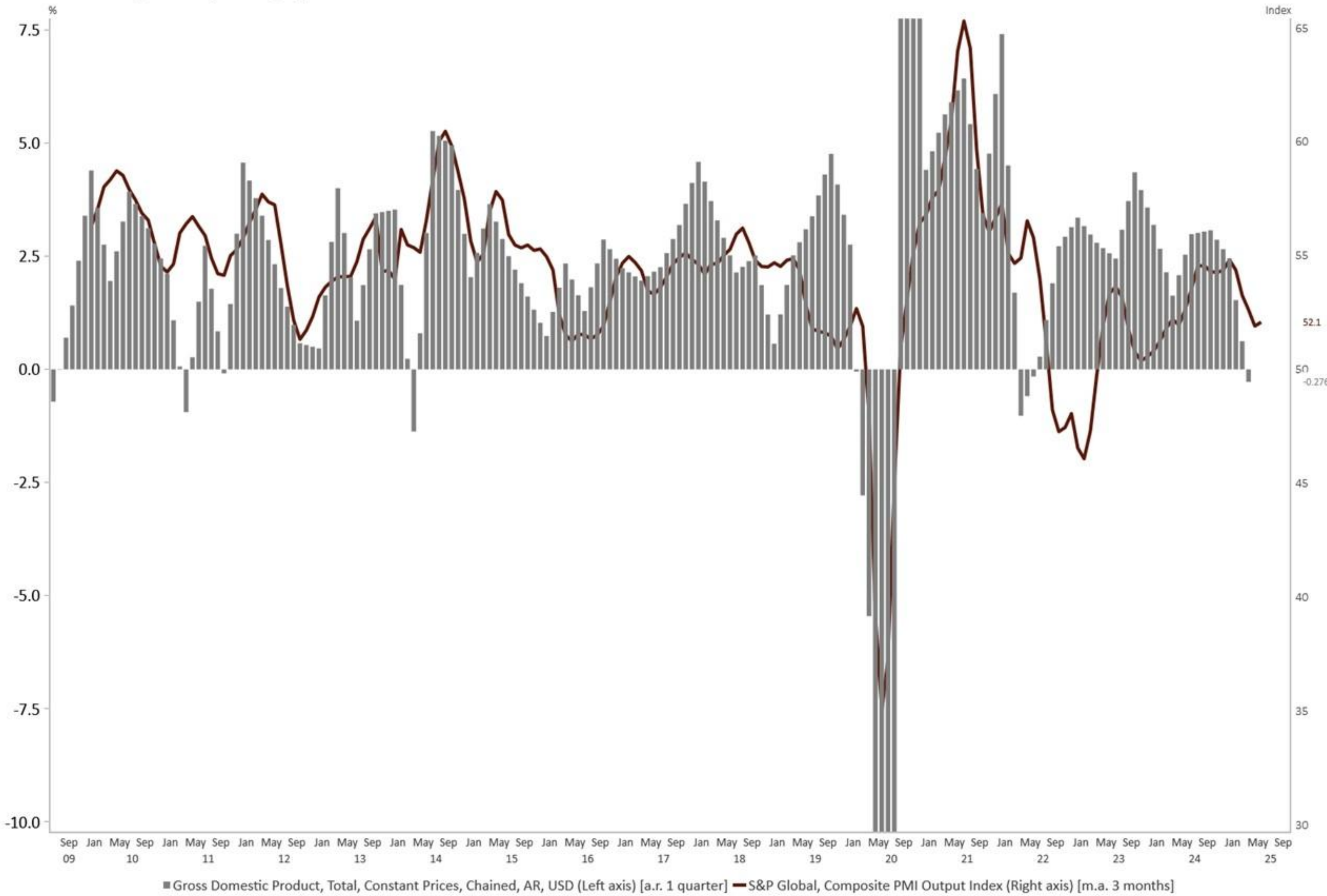

Source: Renaissance Macro Research, Macrobond

**Employment contracting**




Source: Renaissance Macro Research, Macrobond

**How much is growth picking up?**




Source: Renaissance Macro Research, Macrobond