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GLOBAL ECONOMIC HIGHLIGHTS

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China Slows Sharply on Real Estate and Electricity Supply Headwinds; U.S. Core CPI Slowed in the Third Quarter

CHINA: China's economy weakened sharply in the third quarter as the Delta wave, electrical power shortages, and the real estate slowdown weighed on growth. Real GDP growth slowed to a weak 0.2% quarterly rate (seasonally adjusted but not annualized) in the advance estimate for the third quarter of 2021, less than half the second quarter's 1.3% increase, and undershooting the 0.4% consensus forecast. In year-over-year terms, real GDP growth slowed to 4.9% from 7.9% in the second quarter. Growth in the primary sector (agriculture) slowed to 7.1% from 7.6%, growth in the secondary (industrial) sector slowed to 3.6% from 7.5%, and growth in the tertiary (services) sector slowed to 5.4% from 8.3%.

Industrial production slowed sharply in September, with value added of industry (sectoral GDP from the industrial sector) up just 0.05% from August; in year-ago terms, growth of value added of industry slowed to 3.1% from 5.3%, with outright declines in value added of primary metal manufacture and auto manufacture; primary metal manufacturers were hit by the limits on power consumption late in the quarter. China's government has been limiting electricity consumption to meet emissions reduction targets; manage a tight supply of imported coal due to Chinese-Australian political frictions; and slow the passthrough of higher global energy prices into the Chinese consumer basket.

Value added of cement manufacturing also fell in year-ago terms in September; this sector is a high-frequency indicator of real estate investment activity, and its year-ago decline demonstrates the headwinds caused by financial regulators slowing the flow of credit to highly indebted property developers.

Retail sales grew 0.3% on the month in September after falling 0.2% in July during lockdowns to control the Delta wave, and rising a modest 0.2% in August—that only brought activity back to the June level. Retail sales growth has been stop-and-go throughout 2021 as rolling lockdowns caused alternating months of weak and stronger growth.

The various headwinds that held back the third quarter are likely to persist through year-end and into the first half of 2022. The pandemic is likely to slow the recovery of high-contact service sectors until more effective vaccines are widely distributed in China. Real estate headwinds are likely to persist at least through the turn of the year and weigh on fixed investment, manufacturing, and demand for imported iron ore and other industrial commodities. Global energy supply bottlenecks are likely to persist through the Northern Hemisphere's winter months; jumping energy prices will pressure manufacturers' profit margins and push up CPI inflation. And demand for Chinese goods exports will cool as consumers in advanced economies redirect spending toward domestically-produced services and away from made-in-China goods.

UNITED STATES: The Consumer Price Index for Urban Consumers (CPI-U or CPI) rose 0.4% in September after a 0.3% increase in August. Volatile food and energy prices were responsible for half of the CPI's net monthly increase: Food prices rose 0.9 percent and energy prices 1.3%. In the "core" CPI excluding food and energy, the prices of most of the goods and services that surged in the first half of 2021 pulled back in September. Airline fares fell 5.0%, prices of car and truck rentals fell 2.9%, apparel fell 1.3%, used cars and trucks fell 0.7%, and the category of lodging services that includes hotels and motels fell 0.6%. These prices jumped in the second quarter of 2021 as consumers became less cautious and demand rebounded faster

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than businesses could react; their decline in September reduced overall CPI by 0.12 percentage point. But housing costs accelerated, pushing in the other direction: rent of primary residence and owners' equivalent rent of primary residence (OER) rose 0.5% and 0.4% on the month, respectively, and accounted for 70% of the net monthly increase of the core CPI. September saw the fastest monthly increase in residential rents since October 2016 and the fastest increase in OER since June 2006. New car and truck prices also rose rapidly in September, up 1.3% on the month. Producer price inflation slowed in September. The producer price index (PPI) for final demand rose 0.5% from August, down from 0.7% in August and 1.0% in July. Core producer prices, excluding foods, energy, and trade services, rose 0.1% in September after a 0.3% in August; September's increase in core producer prices was the lowest since May 2020.

Retail and food service sales rose 0.7% in September from August, beating the consensus expectation for a 0.2% decline. Gas station sales rose 1.8% largely reflecting the 1.2% increase in CPI gas prices, while motor vehicle and parts dealer sales rose 0.5%. Food services and drinking places sales rose 0.3% but fell in real terms since CPI prices of food away from home rose 0.5%. Control sales—sales excluding autos, gasoline, food service, and building materials, and which go into nominal consumer spending in GDP—rose a solid 0.8% after jumping 2.7% in August (revised up from 2.6% in the prior release). The University of Michigan's Consumer Sentiment Index edged down to 71.4 in the October preliminary release from 72.8 in September and was again below its 2020 trough; the Delta variant, the end of enhanced UI benefits, supply chain turmoil, and high consumer prices are weighing on consumer sentiment.

PNC forecasts for the September industrial production report, to be released on Monday October 18, to show industrial production up 0.2% on the month, with manufacturing production also up 0.2%.

EUROZONE: Supply chain turmoil weighed on Eurozone industrial production in August. Industrial production fell a seasonally-adjusted 1.6% from July. Capital goods production fell 3.9%, durable goods production fell 3.4%, intermediate goods production fell 1.5%, non-durable goods production fell 0.8%; energy production rose 0.5%. From a year earlier, industrial production growth slowed to 5.1% from 8.0% in July.

UNITED KINGDOM: Natural gas futures for delivery to the UK hit a record high of nearly £300 pounds sterling per 1,000 therms per calendar day on October 5, double the level of early September, and four times that of mid-June. The price pulled back, but in mid-October was still double mid-August levels and more than three times the pre-pandemic cyclical peak in the fall of 2018. Business associations representing energy-intensive British businesses are warning that these businesses may have to pause production this winter if energy prices continue to surge or if the government rations electricity. Bank of England Governor Andrew Bailey warned that the Bank "Will have to ask and must do so if we see a risk, particularly to medium-term inflation and to medium-term inflation expectations." Financial markets price in roughly two in three odds that the Bank of England raises the Bank Rate by its December 16 Monetary Policy Committee decision, around when the BoE's QE program will end.

MEXICO: The Minutes of the Bank of Mexico's September 30 Governing Board decision, released on October 14, showed that the Bank is likely to again raise the policy interbank rate 0.25 percentage point at the next scheduled decision on November 11. The Bank raised the interbank rate 0.25 percentage point to 4.75% at the September 30 decision in reaction to rising inflation in Mexico and expectations of a faster withdrawal of monetary stimulus in the United States.

CANADA: Existing home sales rose 0.9% in September on a month-over-month basis, the first increase in six months, according to the Canadian Real Estate Association (CREA). The accompanying report noted that the real estate market "remains very challenging" due to strong demand and very limited supply.

BRAZIL: The IBC-BR Economic Activity Index, a proxy for GDP, fell 0.2% in August from July, following a downwardly revised 0.2% rise in July; the IBC-BR Economic Activity Index was up 4.7% in the twelve months to August. The IBC-Br was just 0.2% below its February 2020 level in August 2021. The Central Bank of Brazil's weekly survey of professional forecasters showed the median estimate for real GDP growth in 2021 was 5.0% in the October 8th survey, unchanged from the prior week. The median estimate for real GDP growth in 2022 was 1.5%.

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INDIA: CPI inflation cooled further in September as prices rose 4.4% from a year ago, following a 5.3% increase in August. Food inflation eased to 1.6% in September from 3.7% in August while housing costs, which make up 10% of the CPI basket, increased 3.6% in September following a 3.9% increase in August. Core inflation (excluding food, fuel, and light) eased to 5.1% in September from 5.2% in August. Exports jumped 22.6% in September from a year earlier following a 45.8% increase in August; imports rose 84.8% following a 51.7% increase in August. India's monthly exports hit a record high \$35.4 billion in July and have exceeded \$30 billion for seven straight months.

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