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GLOBAL ECONOMIC HIGHLIGHTS

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FOMC Accelerates Taper and Signals Rates Could Rise Faster in 2022; ECB Also Is On Course To End Crisis-Era QE in March

This is the last edition of Global Economic Highlights for 2021. Wishing a safe and joyous holiday to all of our readers!

UNITED STATES: The Federal Open Market Committee (FOMC) accelerated the pace at which they are tapering purchases of government-backed bonds at their December 15 decision. Beginning in January, the Fed will reduce monthly purchases of Treasurys by $20 billion to $40bn per month, and reduce monthly purchases of mortgage-backed securities by $10bn to $20bn per month. These monthly reductions are twice as large as those announced at the November FOMC decision, and put the Fed on track to end quantitative easing in March. The Fed is pivoting quickly. They began the taper in November with a plan that would complete it by mid-2022, then accelerated it in December. Between the November and December FOMC decisions, the November jobs report showed a big drop in the unemployment rate to 4.2% from 4.6%, and the November CPI report showed another month in which inflation overshot the Fed's target. The FOMC's December statement acknowledged that inflation has exceeded the 2% objective "for some time." The December dot plot, summarizing FOMC members' assessment of the appropriate course for monetary policy, shows that 10 of the 18 members expect it to be appropriate to raise the target three quarters of a percent in 2022, implying three rate hikes of one quarter percentage point. This is a big shift from the September dot plot, which showed 15 of 18 members expecting to raise rates a quarter percentage point or less next year.

Retail sales growth slowed in November after a big increase in October, but industrial production had another big increase as chip shortages weighed less on auto makers. Retail sales growth slowed to 0.3% in November in seasonally-adjusted terms after a big 1.8% increase in October (revised up from 1.7% in the prior release). With consumer prices up 0.8% in November, the volume of retail goods sold fell slightly after a big increase the month before. Sales at gasoline stations rose 1.7% in November, considerably slower than the 6.1% jump in retail gasoline prices. Restaurant sales rose 1.0%, faster than the 0.6% increase in prices of food away from home; people dined in restaurants more in November, another sign that the November jobs report is likely to be revised higher—it showed employment in food services and drinking places up just 11,000 on the month. Industrial production rose 0.5% in November, and October's level of production was revised up 0.2 percentage point from the prior release. Manufacturing rose 0.7% on a 2.8% increase in production of auto products. Mining output rose 0.7%, while utilities output fell 0.8%. Retail sales and industrial production are up considerably in November from their third quarter levels; growth is accelerating after a weak third quarter in which supply chain problems and the Delta surge slowed the recovery.

The IHS Markit services PMI for the US pulled back to 57.5 in the November flash estimate from 58.0 in October, and the manufacturing PMI fell to 57.8 from 58.3 and was the lowest in 12 months. Hiring by service sector businesses weakened on the month. In the manufacturing survey, some of the decline in the headline number was from slower increases of input costs; energy and metal commodity futures are down in December from November, which is starting to pass through to lower producer prices. Over time this will slow consumer price inflation as well.

The December 23 release of personal income and expenditures for November will likely show incomes up 0.4% on the month; a decline in unemployment benefits partially offset the 0.7% increase of aggregate weekly payrolls during the month. Personal consumption expenditures likely rose 0.3% from October, faster than retail sales, as consumers shifted spending to non-retail services.

EUROZONE: The European Central Bank is also tapering its most important crisis-era QE program by March, but pre-crisis stimulus programs will continue and keep their monetary stance more accommodative than the Fed's. As expected, the ECB's Governing Council announced a slower pace of purchases made by their Pandemic Emergency Purchase Programme ("PEPP") in the first quarter of 2022, down from the roughly €60 billion euro monthly pace of the fourth quarter of 2021, and signaled that PEPP purchases would end in March. They also announced partially offsetting increases to purchases made by the pre-crisis Asset Purchase Programme (APP), raising monthly asset purchases from €20 billion currently to €40 billion in the second quarter and €30 billion in the third quarter, returning to €20 billion in the fourth quarter of 2022 and continuing on an open-ended basis ("as long as is necessary").

The ECB is continuing to make Targeted Longer-Term Refinancing Operation loans to Eurozone commercial banks; these loans provide funding to Eurozone banks at negative interest rates. They will continue at least through June, and the ECB is working on a plan for the second half of the year to "ensure that the maturing of TLTRO III operations does not hamper the smooth transmission of our monetary policy." The ECB is likely to shorten the tenor of negative-rate loans offered after mid-2022, but not phase them out entirely.

CHINA: Monthly activity indicators were weak as expected in November. Industrial production grew a soft 3.8% from a year earlier, not much better than October's 3.5% increase; growth of retail sales slowed to 13.7% from 14.9% despite inflation accelerating to 2.3% from 1.5%. Investment in fixed assets grew 5.2% from a year earlier in the first 11 months of 2021, down from a 6.1% increase in the first 10 months of the year. The survey-based urban unemployment rate ticked up to 5.0% from 4.9% in October; this likely implies a meaningful softening of the labor market since the series is not seasonally adjusted and was either flat or down on the month in the prior three November releases.

UNITED KINGDOM: Matching PNC's forecast, the Bank of England ended its quantitative easing program as scheduled at its December 16 Monetary Policy Committee decision and raised the Bank Rate from 0.10% to 0.25%. The decision was a near coin-toss; arguing against the hike, the British economy is headed into another weak winter, with combined headwinds of Omicron, renewed restrictions on activity, and reduced discretionary consumer spending due to a surge in British natural gas prices. The argument for the hike (which the BoE found more convincing), the UK's economic recovery is quickly absorbing the remaining slack in their job market. A rate hike also signals responsiveness to higher energy prices and will help anchor inflation expectations.

JAPAN: The Bank of Japan was the odd man out in December, holding its policy stance steady while other major central banks reined in stimulus. The BoJ continues to hold its negative short-term policy rate at -0.1%, targets 10-year government bond yields of around zero percent, and continues to make open-ended purchases of exchange traded funds and real estate investment trusts.

CANADA: CPI inflation held unchanged at the highest rate in nearly two decades in November, as prices rose 4.7% from a year ago. Shelter (up 4.8%), transportation (up 10.0%) and food (up 4.4%) were the key drivers of November's inflation reading. CPI inflation slowed to 0.2% in November on a month-over-month basis, following a 0.7% increase in October. The Bank of Canada's three measures of inflation, CPI-common, CPI-median and CPI trim, were 2.0%, 2.8%, and 3.4% in November, respectively, all in year-ago terms. Housing starts rose 26.4% to 301,300 annualized units in November from an upwardly revised 238,400 units in October. Housing starts rebounded in November after declining for five straight months. The Teranet-National House Price Index™ increased 15.2% in November from twelve months earlier, the third straight month of slowing house price growth, following a 15.8% increase in October. House prices grew 0.4% in November on a month-over-month basis, following a flat reading in October.

AUSTRALIA: Inflation expectations increased by 0.2% in December to 4.8%, the highest level since August 2012, according to a survey by the Melbourne Institute; the survey of inflationary and wage expectations measures consumers' expectations for inflation over the next twelve months. The governor of the Reserve Bank of Australia, Philip Lowe, stated in a speech on December 15 that the RBA may end its QE program as early as February 2022. The governor also noted that the RBA is "very much influenced by the actions of other central banks." Australia's real GDP surpassed the pre-pandemic level in the first quarter of 2021 and employment, as measured by the Australian Bureau of Statistics' household survey, reached a record-high in November. Employment rose a record-high 366,100 (2.9%) in November, much better than consensus expectations for a gain of 200,000, as restrictions were lifted. The unemployment rate fell to 4.6% from 5.2% in October. The labor force participation rate rose to 66.1% from the downwardly revised 64.6% in October. The labor force participation rate is above the pre-pandemic rate and is only slightly below the record-high of 66.3% reached in March 2021. The reopening of Australian borders to skilled migrants and international students should boost labor supply in the near term, tampering down wage growth. The Australia flash manufacturing PMI dropped to 57.4 in December from 59.2 in November; the flash services PMI dropped to 55.1 from 55.7 in November. Supply-side challenges and extended delivery times continue to negatively impact businesses in the manufacturing and service sectors.

MEXICO: The Bank of Mexico made a larger-than-expected 0.5 percentage point hike to its interbank target rate to 5.5% at the December 16 decision; most forecasters had expected a 0.25 percentage point hike. The monetary policy statement cited upward revisions to the expected trajectory of inflation in 2022 to justify the larger-than-expected hike.

BRAZIL: The Central Bank of Brazil (BCB) raised its inflation forecasts for 2021 and 2022 to 10.2% and 4.7%, respectively, in its quarterly *Inflation Report*, up from 8.5% and 3.7% in the September report. Annual inflation has increased in every month this year and registered at 10.7% in November. The BCB downgraded its 2021 GDP forecast to 4.4% from 4.7%. The IBC-BR Economic Activity Index, a proxy for GDP, fell 0.4% in October from September, in line with consensus expectations, following a downwardly-revised 0.5% decline in September. The IBC-BR Economic Activity Index has declined for four straight months and is 1.5% below the October 2020 level. The Brazil economy slipped into a technical recession in the third quarter of this year as extreme weather conditions, high inflation, high interest rates, and supply-chain restrictions weighed on economy activity. Inflation remains a big concern despite the BCB raising the policy Selic rate by 7.25% this year.

INDIA: CPI inflation rose less than expected in November as the government cut fuel taxes paid on petrol and diesel. Annual CPI inflation registered at 4.9% in November, lower than consensus expectations for a 5.1% increase, and following a 4.5% reading in October. The fuels and lighting (up 13.4%) and housing (up 3.7%) categories were the key drivers of inflation in November. Core inflation (excluding food, fuel and lighting) remained unchanged at 6.2% in November. CPI inflation has remained within the RBI's 2% to 6% target range since July but will likely accelerate in the coming months as supply chain bottlenecks add upward pressure on inflation. Wholesale prices rose 14.2% in November from a year earlier, the highest reading in three decades, as high input costs and high commodity prices weighed on businesses. Wholesale inflation has stayed in double digits since April and has increased in every month since July. India's trade deficit worsened in November as exports rose 27.2% from a year earlier while imports rose 56.6%.