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GLOBAL ECONOMIC HIGHLIGHTS

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Trade and Inventories Distort Negative First Quarter GDP Print; FOMC Raises Funds Rate by Half of Percentage Point

UNITED STATES: The U.S. economy contracted slightly in the first quarter of 2022, with real GDP down 1.4% at an annualized rate, according to the advance estimate from the Bureau of Economic Analysis. This was the first contraction in real GDP since the second quarter of 2020, when the pandemic caused a short but very severe recession. The big drags on growth in the first quarter came from a much larger trade deficit, and a smaller increase in inventories relative to the fourth quarter. Consumer spending rose 2.7% at an annualized rate in the first quarter and gross private fixed investment increased 2.3%, so underlying demand in the economy remains solid.

The GDP price index increased 8.0% at an annualized rate in the first quarter, up from 7.1% in the fourth quarter of last year. This was the biggest quarterly increase in the GDP price index since 1981. The personal consumption expenditures price index rose 7.0% in the first quarter, and the core PCE price index, excluding food and energy prices, rose 5.2%. GDP growth will resume in the second quarter. Consumer spending growth remains solid, businesses are investing, and the housing market continues to expand.

The advance nominal-goods trade deficit widened to a record in March as nominal goods exports rose 7.2% and nominal goods imports rose 11.5%. The trade deficit has widened to record levels during the pandemic as the consumer-led economic recovery in the U.S. has been a major driver of global economic growth. The shift in consumer spending patterns away from services toward durable goods has driven strong imports while global supply-chain disruptions and a slower economic recovery in many other countries have weighed on exports.

House price appreciation in February accelerated to 20.2% from 19.0% in January, as measured by the S&P CoreLogic Case-Shiller 20-City Composite Index. House prices continued their climb in February owing to resilient demand and constrained inventories. The housing market remains undersupplied, and it will be a sellers' market for some time, but demand should soften with rising mortgage rates, reducing the demand-supply imbalance and slowing price growth.

Consumer spending adjusted for inflation rose 0.2% in March, the third straight increase in real spending. Real after-tax income fell 0.4% in March. Real after-tax income has declined monthly in ten of the last twelve months. The personal consumption expenditures (PCE) index jumped 0.9% in March from February; this was the biggest one-month jump in prices since 2005. The core PCE index, excluding volatile food and energy prices, rose a much more moderate 0.3% in March, the same pace as in February and down from 0.5% in January. The personal saving rate fell to 6.2% in March from 6.8% in February. A very strong labor market and record-high household wealth are positives for consumer spending in 2022, while inflation and rising interest rates are negatives. Consumers are still in good shape and the U.S. economy should continue to expand over 2022.

The Employment Cost Index (ECI) rose by 1.4% in the first quarter of 2022 following a 1.0% increase in the fourth quarter of 2021. Demand for labor is very strong, and with the labor force smaller than it was before the pandemic, firms are competing for workers and bidding up wages. The labor force is 174,000 (0.1%) below the pre-pandemic level and the labor force participation rate is a percentage point below the pre-

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pandemic rate. The National Federation of Independent Business survey in March showed that 47% of all small businesses reported unfilled job openings.

The FOMC increased the fed funds rate by 50 basis points at its decision on May 4. This is the second increase in the fed funds rate in the current tightening cycle; the FOMC raised the fed funds rate by 25 basis points at its last meeting, in mid-March. The FOMC also announced details on reducing the size of the Federal Reserve's balance sheet beginning on June 1.

EUROZONE: Euro area GDP rose slightly in the first quarter of 2022, with real GDP up a small 0.8% at an annualized rate, according to the European Statistical Office. On a quarter-over-quarter basis, economic growth slowed to 0.2% in the first quarter of 2022 from 0.3% in the fourth quarter of 2021. Inflation-adjusted annualized economic output in the first quarter of 2022 rose 0.8% in Germany and 1.3% in Spain, and declined 0.2% in France and 0.7% in Italy. COVID-related restrictions, and higher energy prices and decreased consumer and business sentiment in the wake of the Russia-Ukraine crisis weighed on economic activity in the first quarter of 2022. The economic outlook remains uncertain; lockdowns in China and the Ukraine invasion are headwinds to the euro area economy. The inflation outlook has grown more uncertain in recent weeks. Gazprom, Russia's state-owned energy company, cut off gas supplies to Poland and Bulgaria on April 27 after both countries refused to pay in rubles. An expansion of Gazprom's cuts to include euro area economies or an embargo on Russian oil imports by the eurozone would increase the already elevated recession risk.

Yearly inflation as measured by the harmonized index of consumer prices registered at 7.5% in April, unchanged from March. Across the main countries of the eurozone, consumer prices rose at the strongest pace in Estonia, Lithuania, Latvia, Netherlands, and Slovakia--the countries geographically close to Russia and Ukraine. Yearly core inflation (excluding energy, food, alcohol, and tobacco) surprised to the upside at 3.5% in April; the consensus expectation was for a 3.2% reading.

Weak growth, high inflation, and a deteriorating economic outlook put the European Central Bank (ECB) in a bind. PNC Economics expects the ECB to raise its deposit facility rate by 25 basis points in September and again in December, taking its policy rate from -0.5% to 0% by the end of this year. With strong wage gains in the labor market, high global inflation and a deteriorating inflation outlook, a July hike by the ECB is on the table.

CHINA: Economic activity contracted sharply in April as the Caixin manufacturing PMI dropped to 46.0 from 48.1 in March. April's reading marked the lowest level since February 2020. The official services PMI fell in April to 41.9, the lowest level since February 2020, from 48.4 in March. Readings above 50 indicate growth while readings below 50 suggest contraction. COVID-related lockdowns, a weak real estate sector, higher energy prices and a slower growing global economy have weighed on China's economy in 2022.

UNITED KINGDOM: As expected, the Bank of England (BoE) increased its policy rate, the Bank Rate, from 0.75% to 1.0% when policymakers met on May 5. The BoE's forecast showed inflation climbing above 10% in October due to an increase in energy prices. The U.K. is currently in a cost-of-living crisis. Consumer confidence in April plunged to the lowest level since 2008, inflation is at a thirty-year high, and the outlooks for inflation and the broader economy have deteriorated significantly since the Ukraine invasion started. Risks to the inflation outlook are to the upside; a tight labor market and higher global commodity prices will put upward pressures on inflation as the BoE tightens.

JAPAN: The Bank of Japan (BoJ) kept its negative interest rate, asset purchases and yield curve control policies unchanged when policymakers met on April 28.

March industrial production was weaker than expected as a big earthquake in northern Japan disrupted output. Industrial production in March rose 0.3% on the month, lower than the consensus expectation for a 0.5% increase. On a year-over-year basis, industrial production in March was down 1.7%.

Retail sales grew 2.0% in March from February, following a 0.9% decline in February, as restrictions on mobility were lifted. On a year-over-year basis, retail sales in March expanded 0.9%.

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CANADA: Inflation-adjusted economic output rose 0.5% in March from February, according to preliminary data from Statistics Canada. This comes after GDP grew at a faster-than-expected 1.1% pace in February. Economic activity picked up in February and March after COVID restrictions were lifted.

AUSTRALIA: CPI inflation accelerated in the first quarter of 2022 to 2.1% from 1.3% in the fourth quarter of 2021, driven by surging prices in automotive fuels. Annual CPI inflation jumped to 5.1% in the first quarter of 2022, the fastest pace in over two decades, from 3.5% in the fourth quarter of 2021.

BRAZIL: The Central Bank of Brazil (BCB) will likely raise its policy rate by 100 basis points from 11.75% to 12.75% when central bankers meet on May 4. Inflation has been in double digits for seven straight months and near-term inflation risks are tilted to the upside.

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