Global Economic Highlights

PNC

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FOMC Expected to Deliver Final Hike This Week; Demand for Credit Plunges in the Eurozone in the First Quarter

UNITED STATES: PNC forecasts for the Federal Reserve to deliver its final 25-basis-point hike at its meeting on May 2-3. PNC then expects the FOMC to start cutting the fed funds rate in early 2024 as the U.S. economy falls into recession in the second half of this year due to the cumulative impact of monetary tightening and when it becomes increasingly apparent that inflation is moving toward 2%. While the 25-basis-point increase this week is all but set, the move after this meeting is very uncertain. With renewed fears about the banking system after the collapse of First Republic Bank and rising debt ceiling tensions, the FOMC will try to balance financial and price stability risks in its statement while leaving the door open for additional changes to monetary policy.

Real GDP increased 1.1% at an annual rate in the first quarter of 2023 from the fourth quarter of 2022, according to the advance estimate from the Bureau of Economic Analysis. This was the weakest quarter since the economy contracted in the second quarter of last year. Growth was well below the consensus expectation of 2.0% growth.

While the headline number was weak, underlying demand was strong, especially from consumers. Final sales of domestic production, which is GDP minus the change in inventories and measures demand for goods and service produced in the U.S., rose a very strong 3.4% in the first quarter. But firms cut back on investment in inventories, which subtracted 2.3 percentage points from annualized growth in the quarter, the largest drag from inventories in two years. After-tax household income, adjusted for inflation, increased a strong 8% at an annualized rate in the first quarter. This will support continued consumer spending growth in the near term.

Results for consumers were mixed in March. Inflation-adjusted consumer spending was flat in March from February after declining 0.2% in February (revised from a 0.1% decline), even as real after-tax household income rose 0.3% in March. Real consumer spending jumped 1.4% in January, so real household spending was still up sharply for the first quarter as a whole (up 8.0% on an annualized basis).

The PCE price index rose 0.1% in March from February, the lowest monthly inflation since prices fell last July, with the core index (excluding food and energy prices) up 0.3%. On a year-ago basis, overall PCE inflation slowed to 4.2% in March from 5.1% from February; most of the big drop came from base effects as prices soared in March 2022 following the Russian invasion of Ukraine. But year-over-year core PCE inflation, which matters more for Federal Reserve policy, slowed only slightly, to 4.6% in March from 4.7% in February. Overall PCE inflation peaked at 7% in mid-2022, while core PCE inflation peaked at above 5% in early 2022. Nominal after-tax income rose 0.3% in March from February, with nominal consumer spending flat. With income up more than spending, the personal saving rate rose to 5.1% in March from 4.8% in February and was up from a low of around 3% in the summer of 2022. Households had been running down their savings last summer as high inflation took a bite out of their pocketbooks. But with inflation slowing, they are now saving somewhat more; this is another drag on consumer spending.

Total compensation costs for civilian workers rose 1.2%, seasonally adjusted, for the three-month period ending in March 2023, according to the Bureau of Labor Statistics. This was slightly stronger than the consensus expectation for a 1.1% increase and following a 1.1% (revised from 1.0%) increase for the three-month period ending in December. Wages and salaries increased 1.2% (versus 1.2% increase prior), and benefit costs increased 1.2% (versus 1.0% increase prior). On a

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year-over-year basis, the ECI rose 4.9% in the prior quarter, down from 5.1% in the fourth quarter of 2022. The ECI tracks pay for individual workers over time and takes into account both pay and benefits. The ECI controls for industry and occupation, so it is a better measure of wage and compensation growth for an individual worker than the average hourly earnings measure from the monthly jobs report.

House prices rose modestly in February from January after declining for seven straight months, according to the S&P CoreLogic Case-Shiller National Composite Index. The index rose 0.2% (after seasonally adjustments) in February from January following a 0.2% decline in January. Annual house price appreciation decelerated to 2.1% in February, the slowest pace since July 2012, from 3.8% in January. Annual price appreciation has now decelerated for eleven straight months. With the increase in February, house prices are now 4.9% below the June 2022 peak. The housing market correction has been more evident in the West where house prices skyrocketed in recent years. Miami recorded the biggest year-over-year gain in February for the seventh straight month. San Diego, Seattle, and San Francisco recorded the sharpest yearly declines for the second straight month. Looking ahead, the housing market correction will likely continue through 2023 as the Fed keeps the fed funds rate elevated and the U.S. economy slows.

U.S. consumer sentiment improved in April to 63.5 from 62.0 in March, according to the University of Michigan's final Consumer Sentiment Index report. The current conditions index rose to 68.2 from 66.3 in March while the consumer expectations index rose to 60.5 in April from 59.2 in March.

EUROZONE: Banks in the eurozone reported a "further substantial tightening" in lending standards in the first quarter, according to the ECB's bank lending survey. The survey also showed that demand for loans decreased strongly in the first quarter, driven mainly by rising interest rates. The decline in loans in the first quarter was the largest net decline since the global financial crisis.

Inflation in the eurozone as measured by the Harmonized Index of Consumer Prices (HICP) decelerated in April as higher interest rates weighed on consumer spending, according to a preliminary release from Eurostat. Consumer prices rose 0.7% in April from March following a 0.9% increase in March. On an annual basis, headline inflation rose slightly in April to 7.0% from 6.9% in the prior month. Core inflation, which excludes energy, food, alcohol and tobacco prices, decelerated to 5.6% in April from 5.7% in March. Core services inflation rose to 5.2% in April from 5.1% while core goods inflation fell to 6.2% from 6.6%. While the decline in core inflation in April is great news for the European Central Bank (ECB), the increase in services inflation and the very tight labor market suggest that the ECB will continue its hiking cycle at its meeting on May 4.

The eurozone economy grew weaker than expected in the first three months of the year, according to a first estimate by the Eurostat. Real GDP grew 0.1% in the first quarter from the previous quarter after a 0.1% contraction (revised from no growth) in the fourth quarter of 2022. Economic output grew 1.3% in the first quarter from a year ago, following a 1.8% increase in the fourth quarter. With the slight increase in the prior quarter, real GDP is now 2.4% above the pre-pandemic level.

Eurozone economic confidence increased slightly in April after declining for two straight months, according to the European Commission. Despite the slight improvement in economic confidence, the eurozone economic outlook remains gloomy. Industrial confidence declined in April for the second straight month. The order book component fell in April to the lowest level since March 2021 and the export orders indicator declined in April to the lowest level since December 2022.

With slower core inflation in April and weaker-than-expected GDP growth, PNC Economics expects the ECB to raise its three policy rates by 25 basis points at its meeting this week.

JAPAN: The Bank of Japan (BoJ) maintained its accommodative stance at its meeting last week. Policymakers kept the negative interest rate, yield curve control and asset purchase policies unchanged at the meeting on April 28. The BoJ also revised its core CPI forecast for the fiscal year 2023 (April 2023 to March 2024) to 1.8% in its quarterly outlook report, up from 1.6% in the previous report. The BoJ's GDP forecast for 2023 was lowered to 1.4% from 1.7%.

CANADA: Preliminary data from Statistics Canada show that Canada's economy contracted 0.1% in March driven by declines in retail, wholesale, and mining sectors. The contraction in March followed a 0.1% expansion in February. With the release of the flash estimate for March, real GDP grew at an annualized rate of 2.5% in the first quarter.

BRAZIL: The IPCA-15 mid-month inflation index slowed to 0.6% in April from 0.7% in March (the IPCA-15 is not seasonally adjusted). On a year-over-year basis, IPCA-15 inflation decelerated to 4.2% in April from 5.4% in March. Annual IPCA-15 inflation has now decelerated for eleven straight months. The slowing in annual inflation in April is good news for the Central Bank of Brazil (BCB) as inflation is now within the BCB's preferred target range of 1.75%-to-4.75%.

The IBC-BR Economic Activity Index, a proxy of GDP, rose 3.3% in February from January, above consensus expectations for a 1.1% increase; the IBC-BR Economic Activity Index was up 2.8% in the twelve months to February.

Retail sales fell 0.1% in February, matching consensus expectations, and following a 3.8% increase in January. Retail sales rose 1.0% in February from twelve months earlier.

195,171 formal jobs were added in March, the third straight month of job gains, according to the government's survey of employers. However, the household survey showed a worsening in the labor market situation. The unemployment rate rose to 8.8% in the three months to March from 8.6% in the three months to February.

The bigger-than-expected increase in economic activity in February puts Brazil's economy on track for growth in the first quarter but the outlook remains weak. Elevated domestic interest rates and a slower growing global economy will weigh on Brazil's economy this year.

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