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GLOBAL ECONOMIC HIGHLIGHTS

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SOME PROGRESS IN NAFTA RENEGOTIATION; CHINA TARIFF TIT-FOR-TAT COULD INTENSIFY IN EARLY SEPTEMBER

UNITED STATES: The United States reached a preliminary understanding with Mexico on August 27 about some terms of the NAFTA renegotiation. The revised agreement would raise the minimum amount of content sourced from within the NAFTA bloc in NAFTA-traded autos to 75 percent from 62.5 percent currently, and raise the minimum amount of auto content produced by workers earning at least $16 per hour to 40-45 percent. The agreement drops the Trump administration’s demand for a five-year sunset clause mandating periodic renegotiation of NAFTA, and instead keeps the agreement permanent. The agreement also would raise the value of packages that can be shipped within NAFTA without customs duties or taxes to $100 from $25, facilitating growth of cross-border ecommerce. The US and Canada discussed outstanding bilateral issues affecting the NAFTA renegotiation on August 29-31, but did not reach a deal. Canada opposes US demands to curb the power of expert panels to challenge US countervailing duties and anti-dumping actions against Canadian or Mexican imports. Time is very short for a renegotiated NAFTA to be ratified before Mexico’s lame duck president Enrique Pena Nieto hands over power to president-elect Andres Manuel Lopez Obrador; it also looks like it will fall to the next US congress (to be elected in November’s election) to ratify or reject the renegotiation. The next US congress could impose new demands on the renegotiation. But President Trump’s claim of success in his negotiations with Mexico means that the US is now very unlikely to unilaterally withdraw from NAFTA.

The US trade deficit in goods widened for second consecutive month in July to $72.2 billion from $67.9 billion in June; exports fell 1.7 percent on the month with lower exports of foods, feeds & beverages accounting for two fifths of the monthly decline. US exporters front-loaded sales of soybeans ahead of Chinese retaliatory tariffs. Real GDP growth in the 2nd quarter of 2018 was revised up to 4.2 percent annualized in the second estimate from 4.1 annualized in the first estimate; real gross domestic income rose a slower 1.8 percent in the second quarter, a sign that the trend for real GDP is around 3 percent in 2018. The Conference Board’s Consumer Confidence Index® rose to its highest since October 2000 in August; assessments of the labor market, current economic conditions, and forward-looking expectations all improved from July. The Fed’s preferred measure of inflation, the price index for consumption expenditures in GDP or the PCE index, rose 0.1 percent in July from June and 2.3 percent from a year earlier; core PCE excluding food and energy rose 0.2 percent on the month and 2.0 percent on the year, exactly matching the Fed’s inflation goal. US interest rates rose modestly during the week of August 27 and the yield curve steepened slightly as NAFTA-related uncertainty abated, spilling over to depreciation of emerging market currencies. The largest depreciations are still among currencies of countries with large fiscal deficits and foreign borrowing needs, especially Turkey and Argentina. PNC forecasts another solid jobs report for August at the Bureau of Labor Statistics’ Employment Situation Summary’s release on September 7, with 200,000 payroll jobs added on the month, the unemployment rate edging down to 3.8 percent from 3.9 percent, and average hourly earnings growth edging up to 2.8 percent in year-ago terms from 2.7 percent in July.

CHINA: Bloomberg reported August 30 that the Trump administration could impose tariffs on $200 billion in Chinese goods imports very soon after the September 6 conclusion of the US Trade Representative’s public comment period on them. China has threatened to retaliate against the US tariffs with their own tariffs on $60 billion of US exports. The Caixin General Manufacturing PMI for China dipped to 50.6 in August from 50.8 in July and was its weakest in 14 months.

EUROZONE: Growth is stabilizing in the second half of 2018 after a slowdown in the first half. The Ifo business climate index rose to 103.8 in August from 101.7 in July and was its strongest since January, and the EU economic sentiment index held unchanged from July at 112.3, slightly above its year-to-date low in June. The EU business climate indicator continued to soften in August, though. The benchmark HICP consumer inflation index slowed to 2.0 percent in year over year terms in the August flash release from 2.1 percent in July; measures of core inflation also slowed by 0.1 percentage point to 1.0-1.3 percent. The euro area unemployment rate was 8.2 percent in July, unchanged from June after a downward revision from 8.3 percent and the lowest since 2008.

CANADA: Real GDP grew 2.9 percent annualized in the second quarter of 2018, up from 1.4 percent annualized in the first. Stronger household consumption and exports fueled the acceleration, and housing was less of a drag. Residential fixed capital formation rose 1.1 percent annualized in the second quarter after falling 10.5 percent annualized in the first; it has fallen in three of the five most recent quarters and was up a weak 0.7 percent from a year earlier. Average weekly earnings rose 2.8 percent from a year earlier in June, or 2.5 percent per hour, matching CPI inflation over the same period. With employment up 1.3 percent in the latest household survey for July and 2.1 percent in the latest payroll survey, real GDP per worker is rising faster than compensation, a sign that a strong job market is not yet fueling significant inflation pressures. PNC expects the Bank of Canada to hold its benchmark policy rate unchanged at 1.5 percent at its September 5 monetary policy decision and to wait until January 2019 for a next rate hike. PNC Economics forecasts for the Canadian Labor Force Survey for August to show a 22,300 monthly increase in employment, with the unemployment rate unchanged from July at 5.8 percent.

JAPAN: The unemployment rate rose 0.1 percentage point to 2.5 percent in July; it has been 2.4 or 2.5 percent in six of the seven most recent months, and in May dipped briefly to 2.2 percent which was the lowest since 1992. The flash estimate of CPI inflation for Tokyo accelerated to 1.3 percent in year over year terms in August from 0.9 percent in July, and core inflation excluding fresh food and energy edged up to 0.6 percent from 0.5 percent. Bank of Japan Governor Haruhiko Kuroda stated in a September 1 interview that the Bank of Japan would hold unchanged its -0.1 percent overnight policy rate and target for the ten-year government bond yield of “around zero percent” for “quite a long time.” Governor Kuroda had stated after the BoJ’s July 30-31 decision that they could widen the band around which the ten-year bond yield is permitted to fluctuate to a range of -0.2 percent from 0.2 percent, from -0.1 percent to 0.1 percent previously. In practice, the BoJ has held the 10-year bond yield very close to 0.1 percent since the July 31 decision. Governor’s Kuroda’s latest guidance is consistent with PNC’s expectation that the BoJ holds its policy stance basically unchanged until after the October 2019 value-added tax hike.

MEXICO: The unemployment rate was unchanged from June in July at 3.4 percent and up from a recovery to date low of 3.2 percent in May. Gross fixed investment spending on imported equipment, a proxy for capital spending in Mexican links in globally-integrated manufacturing supply chains, fell in March, April and May, but will improve after the abatement of NAFTA uncertainty. The Bank of Mexico’s quarterly *Inflation Report* released August 29 downgraded the outlook for real GDP growth in 2018 to a range of 2.0 to 2.6 percent from 2.0 to 3.0 percent in the May *Report*, and downgraded the outlook for growth in 2019 to a range of 1.8 to 2.8 percent from a range of 2.2 to 3.2 percent previously. The *Report* expects Mexico’s output gap to widen over the Bank’s forecast horizon, and for inflation to exceed the Bank’s 3.0 percent medium-term target. The Bank raised its forecast for headline inflation in the fourth quarters of 2018 and 2019 to 4.2 percent and 3.3 percent, respectively, from 3.8 percent and 3.1 percent respective increases in the prior *Inflation Report*, and raised forecasts for core inflation by 0.1 percentage point for both periods. We believe that the Mexican policy rate at 7.75 percent has peaked for the cycle, and that the Bank of Mexico will begin cutting interest rates when emerging market financial volatility stabilizes.

BRAZIL: The Brazilian real depreciated to a new record low of 4.16 per US dollar on August 30 as the Argentine and Turkish currency crises spilled over to spur volatility in other emerging market currencies. The Central Bank of Brazil auctioned $1.5 billion US dollars in swaps on August 30 to bolster the real’s exchange rate. Brazil’s economy continues to recover at mid-year but at a slower pace. The unemployment rate was 12.3 percent in the three months through July, down from 12.8 percent in the year-earlier period, and fell slower than the 0.7 percentage point year-over-year decline in the prior quarter. Employment grew 1.1 percent on the year in the three months through July and real wages rose 0.8 percent from a year earlier. Election-related uncertainty and global aversion to emerging market financial risks will be a headwind to Brazilian growth through the October 25 election. Brazil's Supreme Electoral Tribunal ruled August 31 that leftist former President Luis Inacio Lula da Silva cannot run in the October 25 presidential election due to his conviction on corruption charges. Polls show that Lula would have been the most popular candidate if were allowed to run; he governed Brazil during the fondly remembered boom years of the first decade of the 20th century. Lula will probably throw his support behind the Workers Party's candidate, who will oppose deficit reduction policies that would help Brazil improve its sovereign credit rating.