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GLOBAL ECONOMIC HIGHLIGHTS

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BREXIT DEAL A BITTER PILL FOR UK TO SWALLOW; OIL PRICES DROP; EUROPEAN GROWTH FALTERS

UNITED KINGDOM: The UK government and European Union on November 21 published their Withdrawal Agreement dictating the terms of the UK's withdrawal from the EU, as well as a non-binding "political declaration" about their aspirations for their future relationship. The Withdrawal Agreement is a bitter pill to swallow. It would keep the UK in the EU customs union, and under the jurisdiction of EU economic rulemaking and the European Court of Justice, unless or until the UK convinces the EU that goods shipped into Northern Ireland from the rest of the UK cannot be smuggled across the open border with the Republic of Ireland into the EU common market. The Withdrawal Agreement leaves open the possibility that the UK invents some alternative, but EU's default position (misleadingly called the "backstop") requires the UK to impose customs controls between Northern Ireland and the rest of the UK if the UK leaves the customs union. In other words, the deal makes the trade-offs of Brexit very tangible, and does not deliver on Tory promises that Britain can have its Brexit cake and eat it too. Unsurprisingly, many British politicians loudly object to the Agreement. Many members of the ruling Tory Party oppose it, as do the junior partners to the Conservative's coalition government, the Democratic Unionist Party of Northern Ireland, since the Agreement would impose barriers between Northern Ireland and the rest of the UK. The opposition Labor party also opposes the deal. But with no alternative to it, Prime Minister Theresa May has so far maintained her hold on power and is working to persuade members of her ruling coalition to fall in line. The EU ratified the deal November 25, and the UK's parliament might pass it as well. But a vote against it seems more likely. If so, British financial market reactions would likely be moderate – further depreciation of the UK's currency of a few cents per British pound sterling, and knock-on effects on British stocks – but the reaction would be tempered by perceptions that the British government is bluffing and is highly unlikely to bear the pain of a no-deal Brexit. If the British National Health Service begins to describe how rationing of medications and medical supplies caused by a no-deal Brexit would affect healthcare, Parliament will reassess. Our view continues to be that the unpopularity of the Withdrawal Agreement makes its passage unlikely, and the huge costs of a No-Deal Brexit make it even more unlikely. By process of elimination, the UK will most likely remain at least a de facto member of the EU common market after March 2019, either because a second referendum reverses the Brexit decision, or because the EU and UK extend the UK's EU membership (an open-ended "transition period") and muddle through.

UNITED STATES: WTI and Brent crude oil prices fell to their lowest since October 2017 on November 23 as rising production in the US, Saudi Arabia, and Russia offset declines in Venezuela and Iran; the International Energy Agency noted strong inventory growth in advanced economies in their most recent monthly Oil Market Report, exerting downward pressure on prices. Weak business sentiment in Europe and China also contribute to the drop in oil prices. Inventories of crude and refined petroleum in the US have risen to their highest in a year in November after bottoming out in April 2018. If lower oil prices are sustained, they will put downward pressure on headline inflation and – in combination with the continued strength of the dollar – slow CPI inflation in 2019. CPI inflation was 2.5 percent in year-over-year terms in October, up from 2.3 percent in September, but CPI excluding food and energy was unchanged at 2.2 percent. Retail sales rose 0.8 percent in October from September, with sales excluding motor vehicle and parts and gasoline retailers up 0.3 percent on the month and 4.7 percent on the year. Housing starts rose 1.5 percent in October from September, but were still 2.9 percent below their level a year earlier; permits for new residential construction fell 0.6 percent on the month and 6.0 percent on the year. Ten-year government bond yields pulled back about 0.2 percentage points in November as oil prices fell, a support to housing activity – which has been a headwind to growth in 2018 – if sustained. PNC forecasts for the second estimate of real GDP growth in the third quarter, to be released Wednesday November 28, to revise up growth to 3.7 percent from the first estimate of 3.5 percent.

EUROZONE: Growth momentum continues to falter. The IHS Markit manufacturing PMI for the Eurozone fell to the lowest since June 2013 in the November flash release, while the services PMI was the softest since October 2016. The European Commission issued a report on November 21 formally declaring Italy's 2019 budget as not in compliance with the debt-reduction criteria of the Stability and Growth Pact, and recommended that the Commission launch an Excessive Deficit Procedure to bring Italy into compliance or impose a fine on the Italian Government if it refuses to cooperate. The premium on Italian 10-year government bond yields relative to German yields has widened to more than 3 percentage points, and orders for Italy's bi-annual sale of inflation-protected government bonds to retail and institutional investors dried up amid the conflict.

CHINA: China's unemployment rate was unchanged in October from September at 4.7 percent. The unemployment rate is not seasonally adjusted and 2018 is the first year the National Bureau of Statistics has released unemployment data for October, so any interpretation is tentative, but other releases of the unemployment rate in 2018 have been markedly lower than in previous years (The National Bureau of Statistics' unemployment time series begins in 2013). Value added of industrial production grew 5.9 percent from a year earlier in October, close to September's 5.8 percent, and investment in fixed assets accelerated to 5.7 percent in the year through October from 5.4 percent in the year through September. However, retail sales and housing sales growth both slowed in October from September. We do not expect a resolution to US-Chinese trade frictions when President Trump meets Chinese President Xi Jinping on December 1 during the G20 meeting in Argentina.

CANADA: Housing is still Canada's Achilles Heel: National home sales fell 1.6 percent in October from September according to the Canadian Real Estate Association, and fell 3.7 percent from a year earlier. New home listings also fell on the month, by 1.1 percent. The CREA Composite MLS® Home Price Index rose 2.3 percent from a year earlier. An alternative price index, the Teranet-National Bank House Price Index™, rose 2.8 percent from a year earlier in October.

BRAZIL: The Central Bank of Brazil's monthly proxy for real GDP growth, the IBC-Br index, fell 0.1 percent in September from August after growing 0.5 percent in August; from a year earlier, the index grew 2.0 percent in September, down from 2.5 percent in August. Growth momentum is likely recovering with the uncertainty of the October presidential election resolved.

MEXICO: Matching PNC's forecast, the Bank of Mexico raised its benchmark interbank policy rate 0.25 percentage points to 8.00 percent at its November 15 monetary policy decision; the Bank's policy has refocused on supporting the exchange rate after president-elect Andres Manuel Lopez Obrador spooked financial markets by cancelling the construction of Mexico City's new airport in late October. Mexican real GDP returned to growth in the third quarter, increasing 3.4 percent annualized after a small drop in the second quarter; from a year earlier, real GDP grew 2.5 percent, little changed from the second quarter's 2.6 percent. Primary or agricultural output grew 2.2 percent, industrial output 1.1 percent, and services 3.2 percent. The Bank of Mexico's shift toward a tightening monetary stance and rising perceptions of political risk will limit growth prospects for Mexican construction in late 2018 and 2019, but capital spending in manufacturing will still accelerate after the end of the NAFTA renegotiation, likely fueling a modest uptick in economic growth.

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