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GLOBAL ECONOMIC HIGHLIGHTS

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GREAT US JOBS REPORT FOR DECEMBER, BUT GLOBAL MANUFACTURING LOSES STEAM

UNITED STATES: The U.S. capped out 2018 with an excellent December jobs report: 312,000 nonfarm payroll jobs added, the most since February and well above the consensus expectation and our forecast of 180,000. Just as noteworthy, after 58,000 in upward revisions to the prior two months, job growth actually accelerated in the fourth quarter to 254,000 per month, above the average pace for all of 2018 of 220,000 and 182,000 per month in 2017. This large upward revision erases the slowdown in job growth which had been apparent in the November jobs report. The unemployment rate rose 0.2 percentage point in December to 3.9 percent, mostly due to good news – a strong job market and higher wages are attracting jobseekers: The labor force rose a large 419,000, lifting the labor force participation rate to 63.1 percent, the highest in more than a year, from November's 62.9 percent. The number of people employed in the household survey (different from the survey of employers) rose by 142,000 in December, and averaged 240,000 per month in 2018, up from 150,000 per month in 2017. The broader U-6 unemployment rate (unemployed, underemployed and too discouraged to look for a job) held steady at 7.6 percent, near a cyclical low. Job growth was broad-based across industries in December. Construction jobs rose 38,000, manufacturing 32,000, education/healthcare 82,000 (the biggest monthly increase in almost seven years) and leisure/hospitality 55,000. Professional/business services added 43,000 jobs (with temp jobs up 10,000), and retail trade 24,000 after 29,000 in November. Financial activities employment rose by 6,000 in December. Federal government employment dipped 3,000 but state and local government employment rose 14,000. The partial federal government shutdown did not show up in the data, as that started after the survey week. A long-awaited acceleration in wage growth is taking hold as the job market tightens: Average hourly earnings rose 0.4 percent in December, after gains of 0.2 percent in November and October (October revised up from a 0.1 percent increase). Year-over-year growth in wages was 3.2 percent in December (3.153 percent before rounding). Wage growth has been 3.1-3.2 percent for the past three months, after being below this since early 2009. The average workweek rose by 0.1 hour in December to 34.5 hours; it has been between 34.4 and 34.6 hours for over a year. With many more jobs, higher wages, and a longer workweek, aggregate weekly earnings were up 0.9 percent in December, the largest increase since March 2014. The unemployment rate is set to move even lower, to around 3.4 percent at the end of 2019. The federal government shutdown may lead to job losses in January, but employment will quickly recover once the shutdown ends. Job growth will slow to around 150,000 per month in 2019 as businesses find it more and more difficult to hire. Real GDP growth also will slow over the course of 2019 and into 2020, as fiscal stimulus from tax cuts and federal spending increases fades, some businesses delay capex until there is clarity on trade policy, and higher interest rates restrain consumer spending in credit-intensive sectors like real estate and auto sales. In a January 4 speech, Federal Reserve Chair Jerome Powell emphasized that monetary policy remains flexible, saying "there is no preset path for policy." In light of recent market volatility, PNC has revised its fed funds rate forecast to expect one fed funds rate increase in 2019, in September, down from the two we had forecast as of December. PNC expects markets to settle down by the spring, solid job growth to continue throughout 2019, and inflationary pressures to gradually reassert themselves: Oil prices will move from disinflationary to inflationary by the mid-2019, and wage growth continues to accelerate. Business sentiment surveys point to a cooler manufacturing sector, consistent with trade policy uncertainty holding back activity. The ISM manufacturing PMI fell a sharp 5.2 percentage points in December to 54.1 percent, its lowest since November 2016. The IHS manufacturing PMI also fell to a 15-

month low, while the IHS services PMI dipped but stayed near its 2017-2018 average. New orders components of all three surveys were soft.

CHINA: Manufacturing business sentiment is weakening while service sector sentiment is more resilient in China, like the US: The Caixin China general manufacturing PMI dipped to 49.7 in December from 50.2 in November, and the CFLP PMI fell to 49.4 from 50.0 and was the weakest since February 2016. By contrast, the CFLP nonmanufacturing PMI rose to 53.8 from 53.4, supported by a 3.3 percentage point increase in the construction industry PMI; the Caixin services PMI rose to 52.2 from 51.9. Tight credit policies continue to restrain Chinese housing and industrial growth, and trade tensions are a headwind to manufacturers, but the service sector is growing – China is not having a hard landing. The Chinese and US governments are restarting trade talks in January, and have pledged to hold off on further escalation of tariffs while talks proceed. China's government is anxious to avoid further headwinds to its economy and the Trump administration is similarly eager to support stock market sentiment, so the prospects for a resolution to trade frictions seem better in 2019 than earlier in the Trump administration.

UNITED KINGDOM: Brexit survivalism fueled a pickup in manufacturing in December, but underlying economic momentum is weakening. The IHS manufacturing PMI rose to a six-month high, as businesses reported record-high stocks of purchases and of unfinished goods. Manufacturers are pulling forward production schedules to be ready for a worst-case Brexit, so activity will slow sharply by April. The services PMI was 51.2 in December, a little above November's 28-month low of 50.4. Higher manufacturing activity is a reflection of caution, not optimism about the outlook, and the British economy is at risk of a recession in the first half of 2019 as businesses brace for the possibility of a Hard Brexit. The Prime Minister currently plans to begin debate on a vote on her Brexit deal the week of January 14, but may delay the vote again if, as expected, a majority continues to oppose her deal. Further delays in a resolution to Brexit add to the risk of a precautionary recession. We still see a Hard Brexit as very unlikely.

EUROZONE: The IHS Markit manufacturing PMI for the Eurozone fell to 51.4 in December, the lowest since February 2016, from 51.8 in December; expectations for output 12 months in the future fell to their lowest since late 2012. The IHS Markit services PMI fell to 51.2 from 53.4 and was the lowest in more than four years. HICP inflation slowed to 1.6 percent in December, back below the ECB's target of "below but near two percent," from 1.9 percent in November as energy prices fell. We expect growth in the Eurozone to stabilize by spring 2019 and for the ECB to make their initial interest rate hike in September, but if momentum continues to falter, the ECB will delay its initial interest rate hike to December 2019 or March 2020.

CANADA: Employment rose a modest 9,300 in December and the unemployment rate held steady at 5.6 percent, the lowest since comparable statistics began in the 1970s. In 2018, job growth averaged 13,600 per month or 0.9 percent in year over year terms, with full time employment up 1.2 percent and part-time employment down 0.6 percent; 2018's job growth slowed significantly from 2017's 34,900 per month average. Average hourly wages rose 2.0 percent from a year earlier in December, roughly keeping pace with inflation and implying that labor market tightness is not yet a bottleneck to economic growth in Canada. PNC forecasts for the Bank of Canada to next raise its overnight rate target 0.25 percentage point to 2.0 percent in April 2019, and then again raise it 0.25 percentage point in October. In Canada like most other major economies, manufacturing growth is slowing – the IHS manufacturing PMI fell to its lowest since January 2017 in December – and housing is a headwind, but other sectors are resilient.

JAPAN: Good current conditions, but the drop in global oil prices, prospect of a tax hike, and poorly anchored inflation expectations will keep Japan's monetary policy stance unchanged in 2019. Japan's unemployment rate has been between 2.2 and 2.5 percent since January 2018, and growth of average contractual cash earnings (base pay) has risen to around 1.5 percent in year-over-year terms in late 2018 after averaging 0.2 percent in 2015-2016. The fourth quarter of 2018's drop in global oil prices will hold back inflation in 2019, and the Japanese value added tax hike in late 2019 to 10 percent from 8 percent will at least slow real GDP growth, and could cause a moderate recession. The Bank of Japan believes that expectations for inflation are poorly anchored – that is, that inflation expectations fall much more in Japan than other advanced economies when a shock like lower oil prices slows current inflation – and so they will maintain their current policy stance unchanged at least until the drag from the October tax hike dissipates in the second half of 2020. This means a continued aggressive quantitative easing program including purchases of government bonds, private stocks, and real estate investment trusts, a negative 0.1 percent policy rate, and a 10-year government yield target of “around zero percent” – in practice, the BoJ has allowed falling global bond yields to pull down Japanese 10-year yields into negative territory since the turn of the year. Japan’s manufacturing PMI rose to 52.6 in December from 52.2 in November and matched its average in the second half of 2018; Japanese manufacturing growth slowed in 2018 after an above-trend 2017.

MEXICO: The Markit manufacturing PMI for Mexico was 49.7 in December, like in other countries marking a multi-year low; the PMI in December matched November for the weakest since 2013. The minutes of the Bank of Mexico’s December 20 monetary policy committee meeting struck a balanced tone. “Most” members of the Monetary Policy Committee noted upside risks to inflation from a weak peso, the risk of a commodity price shock, trade protectionism, and the risk of larger public deficits. But they also note downside risks to growth, including some downside risks that have already been realized: Weak business sentiment, dour prospects for business investment, obstacles to USMCA ratification, and post-election uncertainty about Mexican economic policies. We expect business sentiment to recover as Mexico’s conservative business establishment gets used to the idea of a left-leaning government, and as the AMLO administration climbs the learning curve of managing financial market sentiment. Financial markets price in roughly four in five odds of a 0.25 percentage point Mexican interest rate hike by March, but with expectations for US rate hikes receding and global energy prices lower, the Bank of Mexico likely has room to delay its next hike or cease further hikes entirely. A lower trajectory for Mexican interest rates probably will not hurt the peso since it would support both growth prospects and foreign capital inflows into Mexican bonds.

BRAZIL: The Brazilian economy is again marching to the beat of its own drummer, and in 2019 that means good news: Business sentiment bounced in late 2018 after the end of election-related uncertainty. The IHS Markit manufacturing PMI for Brazil was 52.6 in December, close to November’s 52.7 which was a nine-month high. The IHS Markit services PMI rose to 51.9 from 51.3 and was the strongest in nine months.

INDIA: No slowdown here: The Nikkei manufacturing PMI for India was a good 53.2 in December, down from 54.0 in November which was the second-highest in over two years. The Nikkei services PMI was also solid in December and also 53.2, the third highest reading in the last two years (the highest and second-highest were in July and November 2018). Both headline and core CPI (excluding food and energy) slowed in the most recent November release. We and the economic consensus forecast no change in the Indian policy repo rate, currently 6.5 percent, until after the next general election to be held between April and May. The Reserve Bank of India’s next move after the election is more likely a hike than a cut.