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GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Abbey Omodunbi** Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

EMERGING MARKET STIMULUS: CHINESE CREDIT GROWTH ACCELERATES, AND INDIA'S CENTRAL BANK CUTS RATES

CHINA: Chinese credit growth accelerated in January for the first time in 18 months. Growth in aggregate financing to the nonfinancial sector – the broadest measure of credit to the real economy – picked up in January to 10.4 percent in year-over-year terms from 9.8 percent in December, the first time since July 2017 that financing growth accelerated. January economic and financial data are often volatile due to the influence of the Lunar New Year, so one observation might not signal a new trend, but it is at least a break in the prior trend. Inflation also is slowing – CPI inflation was 1.7 percent in January and PPI only 0.1 percent, also both in year-over-year terms – making real credit growth the strongest since August 2016. China's central bank cut the reserve requirement ratio for commercial banks by a percentage point in January, and also announced plans to channel funding from the central bank to bolster the capital bases of commercial banks, both of which will make it easier for banks to increase lending and support economic growth. Policy support in China, both from credit policy as in the last week as well as in fiscal policy measures announced in late 2018, limit downside risks to the global outlook from China's trend slowdown.

INDIA: The Reserve Bank of India cut its policy repo rate 0.25 percentage point to 6.25 percent at its February 7 monetary policy decision, citing inflation below its 4.0 percent medium-term target (Indian CPI inflation was just 2.1 percent in December and January in year-over-year terms) and signs of weakening global economic growth. Downside risks to the global economy are obvious in recent data, and since central banks around the world often change interest rates in tandem, India's rate cut could be a sign that the global interest rate hiking cycle has turned. However, the recent pressure on the central bank's independence from the Indian government, and the absence of interest rate cuts from other central banks, suggests India's cut could be for country-specific reasons. The government has been pressuring the RBI to loosen policy ahead of the general election to be held in April or May, and February's cut could be a sign that political pressure – which forced former RBI Governor Urjit Patel to resign in December – is yielding the result the government wants.

UNITED STATES: Many economic indicators were weak in December and January but labor market data held solid. The ISM nonmanufacturing index fell to 56.7 from 58.0 in December and was the coolest since July, with many survey respondents citing the government shutdown as an economic drag. The IHS Markit services PMI was the weakest since October 2017. Retail sales dropped a sharp 1.2 percent in December and the November gain was revised down to 0.1 percent from the 0.2 percent previously reported; December's report was weak across categories. Industrial production fell 0.6 percent in January, with manufacturing production down 0.9 percent, and December industrial production growth was revised down to 0.1 percent from 0.3 percent reported previously. The IP report also revised higher production in August through November, so the level of production in December was actually stronger in the latest report than the prior one – but the last two months' slowdown is still more pronounced. Job openings reached a new record high of 7.3 million in December (data began in December 2000), bouncing back after a dip between September and November. There have been more job openings than active jobseekers (people who looked for a job in the prior four weeks) since March 2018. Claims for unemployment insurance rose to a seasonally-adjusted 239,000 in the week of February 9 from an upwardly revised 235,000 a week earlier, and the four-week moving average rose to its highest since January 2018 as the government shutdown temporarily boosted the number of claimants. The January CPI slowed to only 1.6 percent from a year ago from 1.9 percent in December on falling energy prices, while the core CPI held steady at 2.2. Cool inflation and slowing economic momentum justify the FOMC's "patience" before raising (or lowering) their Fed funds rate target range. PNC still forecasts one last hike in the funds rate in September as inflation moves back up towards the FOMC's 2 percent target in the spring and summer months and economic growth converges to a slower but still positive rate. Policy risks to the economic outlook diminished in the week of February 10: President Trump stopped threatening a government shutdown as leverage to build the wall, and is leaning toward extending the negotiation with China over trade policies, curbing two of the three major sources of policy risk to the US outlook (the third is the deadline for Brexit negotiators at the end of March).

EUROZONE: Real GDP for the fourth quarter of 2018 was unrevised in the second estimate at 0.2 percent (not annualized), and 1.2 percent in year-over-year terms. Employment also grew 1.2 percent from a year earlier. Real GDP growth in Germany, the Eurozone's economic engine, stalled in the fourth quarter (zero growth), but the country narrowly avoided a technical recession (which is conventionally defined as two consecutive quarters of falling real GDP). Even so, the global slowdown is a clear headwind to the German and Eurozone economy, compounding problems from Brexit, the auto industry, and recent financial turbulence.

JAPAN: Real GDP recovered slightly in the fourth quarter of 2018, rising a seasonally adjusted annualized 1.4 percent after dropping more than twice as much in the third quarter. While Japan like Germany dodged a technical recession in the fourth quarter, the composition of recent growth is worrying for the global outlook. Japanese net exports fell for a third consecutive quarter as global manufacturing momentum waned.

UNITED KINGDOM: Matching PNC's forecast, the Bank of England's Monetary Policy Committee held the policy Bank Rate unchanged at 0.75 percent at their February 7 decision. Bank of England External Monetary Policy Committee Member Gertjan Vlieghe stated in a February 14 speech that Brexit-related uncertainty was dragging on growth, justifying a slower pace of monetary tightening after (or if) a Brexit decision is made. Prime Minister May's government continues to play chicken with March 29, the deadline for Parliament to ratify her Brexit deal, extend the negotiation, or accept a disastrous Hard Brexit and crippling supply chain bottlenecks. PNC continues to expect the UK and EU to extend the negotiating period; a Hard Brexit is not impossible, but is unlikely. The unemployment rate held unchanged at 4.0 percent in the fourth quarter of 2018, unchanged from the September to November quarter. Employment rose a modest 0.7 percent from a year earlier, and average hourly earnings rose 3.4 percent on the year both including and excluding bonuses; employment of EU nationals fell 2.6 percent on the year.

CANADA: Employment rose an excellent 67,000 in January, but the unemployment rate still rose 0.2 percentage points to 5.8 percent from December's and November's multi-decade low of 5.6 percent as more Canadians searched for work. The composition of job growth was so-so. From a year earlier, employment rose 1.8 percent, but full-time jobs rose just 1.1 percent; much of January's job growth was concentrated in part-time jobs held by workers aged 16-24 and men over 55. The average workweek dipped to 34.9 hours from 35.0 a year earlier as the share of part-time workers rose. The level of unemployment rose for men ages 25 to 54 as more jobseekers entered the labor market than found employment. Goods-producing employment fell 32,300 from December, with declines in resource sectors, utilities, construction and manufacturing; manufacturing employment was down from a year earlier, as was employment in finance, insurance, real estate, rental and leasing services. The drop in the employment categories including construction and real estate services are consistent with other signs of the ongoing housing correction, like the Teranet—National Bank National Composite House Price Index™ falling 0.1 percent in January for a fifth consecutive monthly decline. Average hourly earnings rose a tepid 2.0 percent on the year, keeping pace with trend inflation. Canada's cool wage growth suggests there is still a margin of slack in the Canadian labor market, an observation further supported by January's rise in the unemployment rate. But robust headline employment growth is a sign that the downside risks to the global economy are not all being realized, and that a rate hike is still on the table from the Bank of Canada at its pivotal April decision.

MEXICO: Mexican stock prices have fallen in local currency terms and the peso depreciated since Fitch downgraded the credit rating of state-owned oil company Pemex to BBB- on January 29 due to concerns about the company's gradually deteriorating finances. In response, the government on February 15 announced a plan to cut Pemex's tax burden, freeing up funds to increase exploration and other capital expenditures. Pemex's oil production peaked in 2004, and has fallen by roughly half since then; the company would have to dramatically increase capex to prevent further production declines as legacy wells become less productive. But allowing Pemex to retain more of its operating profits reduces the company's contribution to Mexican public finances: while the oil industry's contribution to federal revenues is down sharply from a third of total revenues in 2012, additional tax relief for Pemex is still an important headwind to Mexico's compliance with its fiscal responsibility law. Furthermore, even as Pemex benefits from lower taxes, it faces new challenges from the government's plan to cut oil exports and instead refine Pemex's output domestically – a capital intensive line of business for a company already hard-pressed to meet its capex needs. Pemex's problems are important to Mexico, but even a large deterioration in its finances would not be insurmountable for the country: Pemex's roughly $100 billion in debt is equivalent to about 10 percent of Mexican GDP, but federal government debt is low at about 35 percent of GDP and, in a worst-case scenario, the country could service Pemex's debts as general government obligations. But the company's financial difficulties, and the possibility that credit rating agencies could further download its credit rating, will be a cloud over Mexico's macroeconomic outlook in the near term.

BRAZIL: Matching PNC's forecast, the Central Bank of Brazil held its benchmark Selic policy rate unchanged at 6.50 percent at its monetary policy decision Wednesday February 6. With unemployment still high, inflation cool by Brazilian standards, and growth slowing since the second half of 2018, the central bank has room to support the economy with record low interest rates.