FED TO HOLD RATES STEADY IN 2019, END BALANCE SHEET REDUCTION; GLOBAL MANUFACTURING WEAK IN MARCH

UNITED STATES: The Federal Open Market Committee’s March 20 policy statement was even more dovish than expected, and pointed to no rate hikes this year. The committee held the fed funds target steady in a range of 2.25 to 2.50 percent, as expected. But the Summary of Economic Projections (a.k.a the "dot plot") showed the median FOMC participant does not expect to increase the fed funds rate at all in 2019. This is down from two rate hikes projected in 2019 in the previous dot plot, published in December 2018. The new median projection is then for one increase in the fed funds rate in 2020. Chair Powell was even more dovish than the median FOMC member in the press conference following the decision, saying “the data that we’re seeing are not currently sending a signal” for either a rate hike or rate cut. The policy statement cited “slower growth of household spending and business fixed investment in the first quarter,” and slower inflation in recent months, as the reason why the Fed can be “patient as it determines what future adjustments to the target range for the federal funds rate may be appropriate.” The decision was unanimous. FOMC members’ projections for GDP growth and inflation in 2019 were a bit softer in March than in December, and the projection for the unemployment rate in the fourth quarter of 2019 was a bit higher (3.7 percent, versus 3.5 percent in December). Still, the median participant expects solid economic growth and further improvement in the labor market this year. The FOMC also announced a plan to end the reduction in the size of the Federal Reserve’s balance sheet. The balance sheet increased from less than a trillion dollars before the financial crisis to around $4.5 trillion in its aftermath, as the Fed bought long-term Treasuries, mortgage-backed securities, and GSE debt in an effort to push down longer-term interest rates and support economic growth. The Fed began to shrink the balance sheet in late 2017, and in recent months has been letting maturing securities roll off the balance sheet, about $30 billion of Treasuries and $20 billion in housing-related debt every month. The balance sheet is currently about $3.8 trillion. The FOMC plans to slow the roll off of Treasuries to $15 billion per month in May, then end them in September. The balance sheet will stabilize at around $3.55 trillion. In October, the Fed will begin reinvesting the proceeds of $20 billion per month of maturing mortgage-related debt into Treasuries, so over time the balance sheet will return to holding only Treasuries. PNC’s updated March interest rate forecast foresees the federal funds target steady at its current level throughout the forecast horizon. This is lower than the median of the Fed dot plot, which anticipates one 0.25 percentage point hike in 2020, and higher than financial futures markets, which “prices in” roughly 50-50 odds of a 25 bps rate cut over the next 12 months. Incoming economic data validate the Fed’s downgrade of its growth outlook. The IHS Markit US manufacturing PMI dipped to 52.5 in the March flash release from 53.0 in February. But manufacturing weakness is not spilling over to other sectors. The services PMI dipped to 54.8 in the March flash release from 56.0; while lower, it still points to solid service sector growth. In housing, the National Association of Realtors’ existing-home sales index jumped 11.8 percent in February to its strongest level since March 2018, buoyed by the drop in long-term interest rates since early October.

EUROZONE: The IHS Markit Eurozone manufacturing PMI fell to 47.6 in the March flash release from 49.3 in February, and had the worst reading since Apr 2013. The IHS Markit services PMI was little changed at 52.7 after 52.8 in February. Weakness was especially pronounced in Germany, where the manufacturing PMI fell to 44.7 from 47.6 and was the lowest since August 2012. The German services PMI was down a bit from February but still in firmly expansionary territory, at 54.9 after 55.3.
GLOBAL ECONOMIC HIGHLIGHTS

JAPAN: The Nikkei manufacturing PMI for Japan was unchanged in the March flash release at 48.9, pointing to ongoing contraction of Japanese manufacturing and tying February for the weakest since June 2016. Early 2019’s manufacturing weakness extends to all of the world’s major industrial economies.

UNITED KINGDOM: A small kick of the Brexit can: The European Council agreed to at least a short extension of the Brexit negotiation on March 21, extending the negotiating period to April 12 without conditions, and extending it to May 22 if Parliament votes to ratify the UK-EU withdrawal agreement. Parliament will need to vote to accept the EU’s offer, but there is extremely little chance that they fail to do so. After March 29, if Parliament does not ratify the Withdrawal Agreement, they have three other choices. They could withdraw from the EU with no deal, but they already voted against doing so on March 13. They could agree to a much longer extension of the negotiation period, but the EU would require the UK to participate in EU parliamentary elections May 23-26. EU politicians do not want the UK to participate in the EU election since pro-Brexit voters are likely to support far-right candidates; similarly, a bad showing for the UK’s ruling center-right Tory party would weaken Prime Minister May’s mandate. Finally, the UK could unilaterally cancel the Brexit decision. In the near term, a short Brexit delay will do nothing to lift the cloud of uncertainty that is slowing Britain’s economy: Investment intentions in manufacturing fell to the worst since February 2009 in the first quarter of 2019 according to the Bank of England Agents’ Summary of Business Conditions, and investment intentions in services also weakened though not as severely. Manufacturing employment intentions were the weakest in more than two years. The latest jobs report was much stronger than these survey data, and in fact showed the unemployment rate holding unchanged at 4.0 percent in the fourth quarter, the lowest since February 1975. But if Brexit uncertainty and weak business activity persist, the job market will eventually weaken as well.

CHINA: US Treasury Secretary Steve Mnuchin and Trade Representative Robert Lighthizer are scheduled to conduct a series of meetings with their Chinese counterpart Vice Premier Liu He during the weeks of March 25 and April 1 to work toward a trade deal, further evidence that US tariffs on Chinese imports and Chinese retaliation against them are unlikely to increase.

CANADA: Data outside of the monthly jobs report look notably weaker, and point to downside risk for the March jobs report. Retail sales fell 0.3 percent in January from December, repeating December’s 0.3 percent decline and following November’s 0.7 percent drop. New claims for employment insurance fell 5.3 percent in February from a year earlier, but were still up 2.2 percent in the combined first two months of 2019 after a double-digit jump in January.

BRAZIL: The Central Bank of Brazil held its benchmark Selic rate unchanged at 6.50 percent at its March 19 monetary policy decision: The Bank noted both the dovish shift in forward guidance by advanced economy central banks, which is good for Brazil, and the growing downside risks to the global growth outlook, which is bad. The Brazilian monetary policy stance is neutral, but the Bank will probably cut its policy rate in the next 12 months once it becomes apparent that the global slowdown is not the start of a global recession.

MEXICO: PNC forecasts for the Bank of Mexico to hold its benchmark interbank target rate unchanged at 8.25 percent at its next monetary policy committee decision on March 28. Like Brazil, Mexico will benefit from the more dovish outlook for monetary policy in advance economies, with the Fed’s guidance most important to Mexico. But the US and global slowdown is an offsetting downside risk. Financial markets anticipate the Mexican policy rate will be unchanged at the March decision, but imply a 50-50 chance of a 25 bps rate cut over the next three months.

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