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GLOBAL ECONOMIC HIGHLIGHTS

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2ND BREXIT DELAY; FOMC'S MARCH MINUTES EMPHASIZE NEUTRAL STANCE; ECB TO LAUNCH INTEREST RATE TIERING

UNITED KINGDOM: As expected, the European Council (the heads of state of the EU countries) on April 10 approved a request from the UK for a second extension of the Brexit negotiation, pushing out the deadline for the UK to choose its course forward to October 31. Parliament authorized Prime Minister Theresa May to ask for a second extension on April 9, after voting April 8 to reject a number of variations on the three concrete choices to resolve Brexit – either leaving the EU with a deal, leaving without a deal, or staying a member.

Britain's political paralysis stems from the core dilemma of Brexit: The June 2016 referendum, which narrowly favored Brexit, mandated for the UK government to withdraw from the EU. But since Brexiteers argued before the referendum that Brexit would create huge benefits and few costs, the government has no mandate to impose the tangible costs of Brexit. As it turns out, these costs would be large: The Bank of England predicts that a no-deal Brexit would cause a recession as severe as the US Great Recession. This is primarily due to how customs checks on the Channel Tunnel would interrupt supply chains. To ensure a steady flow of essential goods through this bottleneck – chemicals for water treatment plants, lifesaving drugs for hospitals, and so forth – the British government would ration shipping capacity for the private sector after a no-deal Brexit. This would impose huge costs on businesses and cause large job losses.

Withdrawing with a deal would mean less economic pain, but also less political benefit. The withdrawal agreement's "backstop" clause prevents the UK from negotiating free trade agreements with countries outside the EU, which many Brexiteers thought would be one of Brexit's main benefits. In theory, the "backstop" would only apply if the EU objects to Britain's proposal for post-Brexit trade arrangements. But the EU has already rejected Britain's trade proposal, so the "backstop" is the withdrawal agreement's default outcome.

The UK's third option is to unilaterally cancel Brexit. When Parliament voted on the options for Brexit in March and April, the choices that came closest to a majority were the EU Customs Union (a closer UK-EU relationship than the withdrawal agreement) and holding a second referendum. The UK's most likely path forward is for Parliament to hold a referendum on either joining the Customs Union or cancelling Brexit.

In the meantime, the economy is weakening. The monthly GDP report for February showed sluggish growth, much of which looked like front-loaded purchases by households and manufacturers, who were doomsday prepping ahead of the original March 29 Brexit deadline. Real GDP grew 0.3 percent in the three months through February from the prior quarter. Retail sales rose 0.8 percent on the quarter; media reports reminiscent of the Y2K scare described some Britons stockpiling canned foods and other non-perishables. Similarly, manufacturing output jumped 1.4 percent, which the statistics agency attributed in part to manufacturers adding to inventories in case of supply chain disruptions. Activity in industries that cannot stockpile looks bad: Construction output fell 0.6 percent on the quarter. A mild recession seems likely in the second and third quarters of 2019 as front-loaded purchases end. For more detailed analysis and forecasts, please see PNC's April 12 economic report on the Brexit extension on the PNC Economics website.

UNITED STATES: The minutes of the March 19 and 20 meeting of the Federal Open Market Committee emphasize that members are in no hurry to change interest rates – they say "a majority of participants expected that the evolution of the economic outlook would likely warrant leaving the target range [for the federal funds rate] unchanged for the remainder of the year." This view is based both on slow growth in the first quarter of 2019, as well as on FOMC members' expectation that growth will pick up in the remainder of the year. "Some" participants still expect a rate hike by year-end as long as growth recovers, and there was no discussion of a rate cut mentioned. This contrasts sharply with financial market expectations, which see a much higher likelihood of a cut than a hike over the next 12 months.

Economic data released since the March jobs report show slow growth persisting and inflation mild, but the labor market still strong. Durable goods orders fell 1.6 percent in February as expected, and the NFIB Small Business Optimism index was little changed at 101.8 in March after 101.7 in February; while the index has risen since January, the last three months' readings were the weakest three since November 2016. The University of Michigan's Consumer Sentiment Index dipped to 96.9 in April from 98.6 in March. The consumer price index rose 0.4 percent in March on a 6.5 percent increase in gasoline prices – CPI excluding food and energy rose 0.1 percent on the month and 2.0 percent on the year, slowing because of a large drop in volatile apparel prices. The producer price index jumped 0.6 percent in March on a 5.6 percent increase in energy prices, and PPI excluding food and energy rose a moderate 0.2 percent. From a year earlier, PPI rose 2.2 percent in March, up from 1.9 percent in February, while PPI excluding food, energy and trade rose 2.0 percent, down from 2.3 percent a month earlier.

The number of job openings fell to 7.1 million in February from 7.6 million in January, and the job openings rate (the ratio of openings to total employment plus openings) fell to 4.5 percent, the lowest since March 2018. The indicator is volatile and one month does not make a trend, especially since the release is contradicted by the four-week moving average of initial claims for unemployment insurance, which reached a new 50-year low in the period through April 6. This is a reassuring sign that the US economy's rocky start to the year was a temporary bump in the road and not a detour toward a recession.

EUROZONE: As expected, the ECB held its monetary stance unchanged at its April 10 Governing Council decision. The Bank expects weak growth to continue in 2019 due to drags from geopolitical risks and protectionism, as well as several country- and industry-specific slowdowns: unnamed by the ECB, these are principally China, Turkey, Brexit, and the German auto sector. The announcement strongly suggested that the ECB will introduce a tiered deposit rate at its next decision June 6. Instead of charging the deposit rate on all of commercial banks' excess cash deposited at the central bank as the ECB does now, a large portion of deposits will be exempted from negative rates. This will increase Eurozone commercial banks' net interest income and allow the ECB to keep interest rates negative for longer, if necessary, without damaging the Eurozone financial sector's viability.

The ECB did not change its forward guidance, but President Draghi emphasized in the press conference that their guidance has for quite a while kept open the possibility of another round of quantitative easing if needed. Every monetary policy statement since June 2018, the meeting after the ECB announced the taper of its QE program, included verbatim the line, "The Governing Council stands ready to adjust all of its instruments, as appropriate, to ensure that inflation continues to move towards the Governing Council's aim in a sustained manner." The ECB did not update their economic forecasts in April; President Draghi said risks to the outlook are to the downside, but that growth should improve in coming months: "The external component [that is, the contribution of exports to GDP] is weighing on growth now, and that is not going to last - in fact, we see signs of stabilization." Draghi also said the ECB continues to view a Eurozone recession as unlikely. Echoing recent weakness in PMIs, industrial production fell 0.2 percent in February, with capital and durable goods production both down 0.4 percent. From a year earlier, industrial production fell 0.3 percent, less bad than its 0.7 percent decline in January.

CHINA: Trade improved sharply in March due to seasonality affecting economic data. The Lunar New Year holiday was celebrated entirely in February in 2019, instead of split between February and March as in 2018, so March's export growth (up 14.1 percent on the year) improved sharply from February's decline (down 21.2 percent). In the first quarter as a whole, dollar-denominated exports grew a meagre 1.0 percent from a year earlier, less than the fourth quarter of 2018's 4.4 percent increase or the third quarter's 11.1 percent. Credit growth also picked up in March due to holiday timing: Aggregate financing to nonfinancial borrowers rose 10.6 percent on the year, up from 10.1 percent in February. The first quarter as a whole had faster credit and money supply growth than the fourth of 2018, but slower growth than the third quarter of 2018.

JAPAN: Machine tool orders confirmed the weakness of Asian PMIs in March, falling 28.5 percent from a year earlier after a 29.3 percent decline in February. Machine tool orders are a leading indicator of Asian manufacturing capex, and suggest that manufacturing's weakness will persist into the second quarter.

CANADA: Building permits fell 5.7 percent in February from January, with residential permits down 8.5 percent and nonresidential permits down 0.5 percent. The indicator is very volatile month to month, but is still consistent with the broader picture of persistent weakness in the housing sector.

MEXICO: Manufacturing output grew 0.2 percent on the month in February and 1.2 percent on the year, with overall industrial production up 0.3 percent on the month but down 0.9 percent on the year due to drops in petroleum production and construction. Given the weakness of manufacturing sentiment surveys in March, the prior month's growth in manufacturing seems unlikely to last.

BRAZIL: Faster inflation, mostly reflecting pass-through of higher energy prices; prices of other parts of the consumer basket are rising slower and in line with the central bank's goal of 4.25 percent give or take 1.5 percentage points. Inflation by the benchmark IPCA index picked up to 4.6 percent in March from 3.9 percent in February, with sticky services prices rising 3.6 percent after 3.4 percent. Regulated prices rose 6.3 percent in March after 5.8 percent in February, reflecting large increases in gasoline prices, up 2.9 percent on the month, and ethanol prices, up 7.0 percent.

INDIA: CPI inflation rose to 2.9 percent in year over year terms in March on faster increases in food and energy prices, but CPI excluding food and energy slowed to 4.8 percent from 5.1 percent and was the slowest since November 2017. The dip in Indian core CPI validates the Reserve Bank of India's decision to cut its benchmark repo rate 0.25 percentage point to 6.00 percent at its April 4 monetary policy decision.