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GLOBAL ECONOMIC HIGHLIGHTS

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FED HOLDS RATES UNCHANGED AND PUSHES BACK ON CUT TALK, SAYS LOWER CORE INFLATION "MAY BE TRANSIENT"

UNITED STATES: The Federal Open Market Committee held the federal funds target range unchanged at 2.25 to 2.50 percent as expected at their April 30 to May 1 meeting, ignoring President Trump's call for a 1 percentage point interest rate cut and reaffirming the independent and nonpartisan leadership of the Federal Reserve. Their monetary policy statement noted that global risks to the US growth outlook "have moderated somewhat" since the turn of the year, and upgraded their assessment of growth in early 2019 to incorporate the first quarter's better than expected first estimate of GDP growth. During the press conference following the interest rate decision, Fed Chair Jay Powell said of recent slower inflation that "some or all of the decrease in core inflation may be transient," a reason for the Fed to maintain interest rates unchanged and not cut, as financial markets had anticipated prior to the Fed meeting. Powell's comments support PNC's forecast for the federal funds target to hold steady throughout our forecast horizon. The Federal Reserve did cut the interest on excess reserves rate, the rate the Fed pays on commercial banks' excess cash deposited there, by 0.05 percentage point to 2.35 percent to ensure that the federal funds rate stays near the center of the target range. Payroll employment jumped 263,000 in April, beating the 180,000 consensus, and the unemployment rate fell 0.2 percentage points to 3.6 percent, the lowest since 1969. Within the household survey used to calculate the unemployment rate, the number of unemployed, employed, and labor force participants all fell on the month; these statistics are much more volatile than the unemployment rate, which provides the clearer signal about short term economic developments. The employed share of the working-age population held steady at 60.6 percent. Payroll job gains in February and March were revised up a net 16,000. The employment cost index, a broad measure of compensation for workers which the Fed uses to gauge the state of the job market, rose 0.7 percent in the first quarter of 2019 from the fourth quarter of 2018. From a year earlier, the ECI's growth slowed to 2.8 percent from 2.9 percent in the fourth quarter of 2018. Employer costs for health benefits rose 1.9 percent on the year in the first quarter; health benefit costs have grown slower than total benefit costs since the first quarter of 2017. Construction spending fell 0.9 percent in March and growth in January and February was revised down a cumulative 2.0 percent in the Census Bureau's latest construction spending report: Residential spending fell 1.8 percent on the month and 8.4 percent on the year, while nonresidential fell 0.3 percent on the month but rose 4.8 percent on the year. Forward-looking sentiment surveys point to slower growth in the second quarter: The ISM manufacturing PMI dropped to 52.8 in April, the lowest since October 2016, from 55.3 in March, with export orders contracting for the first time since February 2016. The IHS Markit manufacturing PMI was the second lowest since June 2017 in April, at 52.6 after March's 52.4. The ISM non-manufacturing PMI and the Markit services PMI pulled back to the lowest since August 2017 and March 2017, respectively. Financial markets' assessment of the likelihood of a federal funds rate cut by year-end fell from 70 percent before Chair Powell's comments about "transient" inflation to under 50-50 after the release of the April jobs report. President Trump tweeted on May 5 that the US would broaden the 25 percent tariffs on Chinese imports to apply first to the next $200 billion of goods imports, then eventually to all imported goods, if a trade deal is not finished by Friday May 10. Before this latest deadline, his administration had extended the deadline first from January 1st to March 3rd, then beyond, without specifying an end date.

CANADA: Monthly real GDP fell 0.1 percent in February, partially reversing January's 0.3 percent gain. Output in goods-producing industries fell 0.2 percent on a 1.6 percent decline in mining and a 0.4 percent drop in manufacturing, partially offset by gains in construction and utilities. Services output fell 0.1 percent, with transportation and warehousing down 1.6 percent, finance and insurance 0.6 percent, and real estate, rental and leasing 0.2 percent. From a year earlier, real GDP growth slowed to 1.1 percent from 1.6 percent in January and was the second slowest since August 2016. Mining declined notably, down 5.0 percent from February 2018, as did construction, down 4.5 percent (it grew in the last two months after falling in the preceding seven). PNC forecasts for Canadian employment to rise a moderate 11,600 in the April Labor Force Survey, to be released May 10, with the unemployment rate holding steady at 5.8 percent and average hourly earnings rising 2.3 percent on the year, also the same as March.

EUROZONE: Real GDP grew a better than expected 0.4 percent in the preliminary flash estimate for the first quarter of 2019 from the fourth of 2018, not annualized; it was the Eurozone's fastest quarterly growth since the second quarter of 2018 and a welcome upside surprise after weak PMIs in recent months. From a year earlier, real GDP growth held steady at 1.2 percent in the first quarter. The Eurozone unemployment rate fell to 7.7 percent in March from 7.8 percent in February and was the lowest since September 2008. Inflation saw its usual seasonal uptick during the month in which Easter falls: The benchmark Harmonized Index of Consumer Prices rose 1.7 percent in April from a year earlier, up from 1.4 percent in March, as services inflation jumped to 1.9 percent from 1.1 percent in March. Service prices include airfares and other travel-related expenses, which jump during the Easter holiday and fall when it ends; inflation will slow in May.

CHINA: Three of China's four key PMI indices dipped in April. The CFLP manufacturing PMI for China receded to 50.1 from 50.5, the CFLP nonmanufacturing PMI to 54.3 from 54.8, and the Caixin general manufacturing PMI to 50.2 from 50.8. The Caixin general services PMI was basically unchanged at 54.5 after 54.4. The bad news from the PMIs pull-back is that, as we suspected, March's strong showing was partly due to residual seasonality caused by the timing of the Lunar New Year holiday, which fell entirely in the month of February in 2019 and made March's economic data look deceptively strong. The good news from the April PMIs is that these clean reads on China's economy following the end of the Lunar New Year holiday look okay. The CFLP manufacturing PMI was the second strongest since October, the CFLP nonmanufacturing PMI was noticeably stronger than the fourth quarter of 2018's 53.7 average, and the Caixin general manufacturing PMI was the second strongest since November. The worst of China's late 2018 and early 2019 slowdown is over. Credit growth has picked up a bit over the last few months, and the government seems to have loosened administrative controls on real estate investment to support construction and construction material manufacturers, as demonstrated by the jump in value added of industry in nonmetallic mineral products (cement), which grew the fastest since 2011 in March. In its latest easing measure, the People's Bank of China announced May 6 that beginning May 15 it would reduce the reserve requirement ratio for small- and medium-size banks, freeing up 280 billion yuan (0.3 percent of GDP) in additional lending capacity. But the economy's stabilization is narrow so far, and sectors outside real estate are shakier. This is why the surveyed unemployment rate for China's 31 largest cities rose to 5.1 percent, the highest since 2016, in March. Incremental stimulus will prevent a hard landing in China, but is insufficient to revive global growth.

UNITED KINGDOM: The Bank of England held its policy bank rate unchanged at 0.75 percent at its May 2 monetary policy decision, but signaled that interest rates will rise faster and by more than anticipated by financial markets over the next few quarters, barring a Hard Brexit. The BoE's base case forecast, described in the quarterly *Inflation Report*, takes as its interest rate forecast the very shallow rate hike path anticipated by financial markets (only one 0.25 percentage point interest rate hike over the next two years), as is the Bank's standard practice in drafting *Inflation Reports*. The Bank's models predict this very dovish path for interest rates would cause the British economy to overheat by the end of their three year forecast horizon. If and when the British government commits to a course of action that rules out a Hard Brexit, as seems most likely, the Bank will begin hiking interest rates more aggressively than financial markets anticipate and will fuel a large appreciation of pound sterling vis-à-vis the US dollar. Early returns in local elections held May 2 in England and Northern Ireland showed huge losses for pro-Brexit parties: the ruling Tory party lost nearly 30 percent of their local council seats, the Brexit-ambivalent Labour party lost 4 percent of their seats, and the UK Independence Party lost 82 percent. Local council seats represented by members of the pro-EU Liberal Democrats increased 109 percent and those represented by the pro-EU Greens 273 percent.

MEXICO: Real GDP fell 0.2 percent, not annualized, in the seasonally-adjusted advance estimate for the first quarter of 2019 from the fourth of 2018. From a year earlier, real GDP was only barely higher, up 0.2

percent, with agricultural output up 5.6 percent, industrial output down 2.1 percent, and services output up 1.0 percent. The drop in first quarter GDP corroborates the signal from the unemployment rate's increase in March to 3.6 percent, which matched December for the highest since December 2016. Separately, Mexico's statistics agency reported that its index of employment rose 1.6 percent from a year earlier in February, the second-slowest month of employment growth since March 2015. Fuel shortages, caused by the government's campaign against fuel theft, continued declines in oil production, strikes, and uncertainty about trade and domestic economic policies are dampening growth momentum.

BRAZIL: Industrial production output was down 1.3 percent in March from February, the biggest decline in six months, and more than double analyst's expectations for a 0.6 percent decline. The main decreases were seen in the production of food products, down 4.9 percent, and production of motor vehicles, trailers and semi-trailers, down 3.2 percent. The Central Bank of Brazil is likely to keep its policy Selic interest rate unchanged at 6.5 percent at its May 8 interest rate decision, amid cross-cutting risks from weak growth, high inflation, and pension reform uncertainties. The Central Bank's weekly consensus survey shows the median private forecaster expects for the Selic rate to hold unchanged through year-end, while financial market futures imply one 0.25 percentage point hike over the next six months.

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