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GLOBAL ECONOMIC HIGHLIGHTS

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NEW FRONTS OPEN IN TRADE WAR: MORE TARIFFS ON MEXICO, RESTRICTIONS ON TECH EXPORTS TO HUAWEI

UNITED STATES: President Trump on May 30 tweeted a threat to impose 5 percent tariffs on all Mexican imports beginning June 10 unless Mexico prevents Central American migrants from crossing Mexico to the US border; a statement from the White House said the tariff will increase 5 percentage points per month to a maximum of 25 percent unless Mexico satisfies US demands. Mexico dispatched its Foreign Minister to Washington on May 31 to begin negotiations to prevent the tariffs. US manufacturing sentiment weakened in May according to the Markit flash PMI, which dipped to 50.6 from 52.6 and was the weakest since September 2009. The flash services PMI also weakened on the month, to 50.9 from 53.0, and was the weakest since March 2016. The manufacturing business cycle is global, and the US slowdown parallels weakness in leading indicators for China, Japan and the Eurozone in the month. But US consumer sentiment has recovered from late 2018's stock market volatility: The Conference Board's Consumer Confidence Indicator® rose to 134.1 in May – below the levels of August to November 2018 but otherwise the highest since October 2000. This mirrors the University of Michigan Consumer Sentiment Index, which was the fourth-strongest in May since January 2004. Personal income rose a strong 0.5 percent in April from March, with disposable personal income up 0.4 percent in nominal and 0.1 percent in inflation-adjusted terms. Personal consumption expenditures rose 0.3 percent in nominal terms and were unchanged after accounting for inflation. Housing indicators were mixed in April, but generally point to modest to moderate growth over the rest of 2019. Existing home sales disappointed, falling 0.4 percent from March and 4.4 percent from a year earlier, as did permits for new construction, up just 0.6 percent from March after falling 2.9 percent from December to March. But other measures of downstream housing demand are better: New single family home sales dipped 0.8 percent in April, but rose a strong 7.0 percent from a year earlier after growing 17.3 percent in the first quarter from the fourth quarter of 2018. Leading indicators for home sales are also upbeat: Mortgage applications for home purchases are up 5.6 percent in the April to mid-May period from their average in the first quarter, when they rose 9.3 percent from the fourth quarter of 2018. After being a headwind to economic growth in 2018, housing will be a modest tailwind over the rest of 2019. The second estimate of real GDP growth in the first quarter was 3.1 percent, little changed from the 3.2 percent first estimate; corporate profits, released for the first time in the second estimate, fell 2.8 percent in the first quarter, a second sequential decline. Federal Reserve Vice Chair Richard Clarida commented on recent financial market speculation that the Federal Reserve could cut interest rates in a speech May 30, saying that if data "show a persistent shortfall in inflation… or… global economic and financial developments present a material downside risk to our baseline outlook, then these are developments the Committee would take into account." With first quarter real GDP growth outpacing the Fed dot plot's median forecast of 2.1 percent for 2019, inflation is more immediately relevant to the interest rate outlook; PNC forecasts no change in the federal funds target over our multi-year forecast horizon. Inflation stabilized in April but is still below the Fed's 2.0 percent goal: The price index for personal consumption expenditures, the Fed's preferred inflation gauge, rose 1.5 percent from a year earlier, up from 1.4 percent in March, and the PCE index excluding food and energy a.k.a. "core inflation" picked up to 1.6 percent from 1.5 percent.

CHINA: The other new front opened in the US trade war is with China. The US Department of Commerce added Chinese telecom manufacturer Huawei to its Entity List on May 20, requiring Huawei to obtain a US license each time it buys components from US suppliers and threatening to cut Huawei off from essential technology suppliers. The Commerce Department delayed implementation of Huawei's classification for 90 days, recycling the threat-and-delay tactic used to pressure China with tariffs. In retaliation, China's government threatened to restrict exports of rare earths to the United States if the Huawei restrictions are implemented; China supplies a majority of the world's rare earths, essential components in electronics manufacturing. Export bans could disrupt electronics and other manufacturing supply chains. China is also compiling an "unreliable entities list" of foreign companies and individuals that "do not follow market rules, violate the spirit of contracts, blockade and stop supplying Chinese companies for noncommercial reasons, and seriously damage the legitimate rights and interests of Chinese companies." The CFLP manufacturing PMI fell to 49.4 in May after 50.1 in April and 50.5 in March; the PMI has been below 50, indicating contraction of the manufacturing sector, for four of the last six months. The employment component of the manufacturing index was the weakest since March 2009. China's unemployment rate will rise in 2019. The Caixin general manufacturing PMI was unchanged in May from April at 50.2.

JAPAN: The Nikkei manufacturing PMI for Japan fell to 49.8 in May from 50.2 in April; it has been under 50.0, indicating a contraction of the manufacturing sector, for three of the past four months. Industrial production fell 0.6 percent on the month in March and 4.3 percent on the year, but core machine orders rose 3.8 percent on the month (though they still fell 0.7 percent on the year). The Bank of Japan's three measures of core inflation held well below the Bank's 2.0 percent target in April: trimmed-mean CPI rose to 0.7 percent from 0.5 percent and modal CPI to 0.3 percent from 0.2 percent, while weighted median CPI was unchanged at 0.2 percent.

CANADA: New claims for employment insurance rose 10.5 percent from a year earlier in March; the data series is conceptually equivalent to the closely watched US new unemployment insurance claims, but released at a much longer lag. Employment insurance claims were essentially unchanged from a year earlier in the first quarter of 2019 (up 0.1 percent) after rising 3.7 percent in the same terms in the fourth quarter of 2018; the data are not seasonally-adjusted so month to month comparisons are unreliable. Retail sales rose 1.1 percent by value and 0.3 percent by volume in March, and were up 2.6 percent by value and 1.2 percent by volume from a year earlier; retail sales excluding motor vehicle and parts dealers and gas stations rose 1.0 percent on the month and 3.6 percent on the year. Payroll employment, released at a long lag to the household survey from which the unemployment rate is derived, rose 27,500 in March from February and a solid 2.1 percent from a year earlier. Average weekly and hourly earnings rose 1.9 percent from a year earlier in March, with the average workweek unchanged. Wholesale sales rose 1.4 percent by value and 1.0 percent by volume in March from February; from a year earlier, they rose 2.8 percent by value but fell 0.2 percent by volume due to lower motor vehicle sales, down 4.0 percent on the year; wholesale sales excluding motor vehicles and parts rose 3.8 percent on the year. Real GDP grew a meagre 0.4 percent annualized in the first quarter of 2019, close to the 0.3 percent of the fourth quarter of 2018; a sharp worsening of the trade balance and slower inventory accumulation held back growth in the first quarter. The Bank of Canada held their benchmark overnight rate target unchanged at 1.75 percent as expected at their May 29 interest rate decision, and signaled that interest rates are on hold for the time being. Financial markets price in one to two 0.25 percentage point Canadian policy interest rate cuts over the next 12 months. But with the labor market historically tight and the Bank of Canada persuaded that many of the headwinds that held back growth in the first quarter were temporary, a rate hike is the more likely choice for the Bank of Canada over the next year unless the Canadian or US economies fall into recession.

EUROZONE: No light at the end of the tunnel yet from the Eurozone's May PMI's. The Markit manufacturing PMI edged down to 47.7 in the May flash release from 47.9 in April, and the services PMI dipped to 52.5 from 52.8. The German manufacturing PMI similarly dipped to 44.3 from 44.4, and the German services PMI to 55.0 from 55.7. The French manufacturing PMI was 50.6 in the May flash release, up from 50.0 in April, while the services PMI rose to 51.7 from 50.5. The IFO business confidence index for Germany fell to 97.9 in May, the lowest since November 2014, from 99.2 in April. The European Central Bank's Governing Council is likely to keep policy rates unchanged at their June 6 monetary policy decision, and also announce plans to exempt some deposits owned by commercial banks from the ECB's negative deposit rate, boosting net interest income for the Eurozone banking sector and making it easier for the ECB to keep interest rates negative for an extended period if necessary.

UNITED KINGDOM: The ruling Tory party lost badly in the May 23 election for Members of European Parliament, as did the main opposition Labour party. The Brexit party won 31 percent of the vote, and the pro-remain Liberal Democrats and Greens won a combined 31.6 percent. The Tories won just 9 percent and Labour 14 percent. Prime Minister Theresa May announced she will step down from office on June 7, triggering a public contest among Tory Members of Parliament to succeed her. Brexit negotiations will be on hold until the next Prime Minister is named. The European Commission meanwhile has said that it will not renegotiate the UK's Withdrawal Agreement with a new government. From their perspective, they negotiated a deal with the UK, not with a Prime Minister, and it is the deal no matter who the Prime Minister is.

MEXICO: Real GDP fell 0.2 percent in the first quarter (not annualized) and slowed to 1.2 percent in year over year terms from 1.3 percent in the fourth quarter of 2018; agricultural output rose 2.6 percent on the quarter, while industrial output fell 0.6 percent and is down a cumulative 2.2 percent since the first quarter of 2018. The chronic decline of Mexico's energy industry is the root cause of industry's weakness. The service sector contracted 0.2 percent in the first quarter of 2019. The monthly GDP indicator fell a seasonally-adjusted 0.6 percent in March from February and the same amount from a year earlier. The unemployment rate dipped to 3.5 percent in April from 3.6 percent in March as the labor force participation rate fell to 59.9 percent from 60.3 percent; Mexico's unemployment rate has been little changed on balance since mid-2017 and is at a level which the Bank of Mexico believes is consistent with full employment. The Bank of Mexico's quarterly inflation report released May 29 marked down the forecast for real GDP growth in 2019 to a range of 0.8 to 1.8 percent from their prior forecast of 1.1 to 2.1 percent made in their report released in February. Tariffs on Mexican goods exports to the United States, which account for 30 percent of Mexican GDP, would further weaken Mexican economic growth in 2019 and 2020 if enacted.

BRAZIL: Real GDP contracted 0.2 percent in the first quarter of 2019, not annualized, marking the first quarterly contraction since the fourth quarter of 2016. Agricultural output, which is volatile quarter to quarter and not correlated with the business cycle, fell 0.5 percent, while industrial output fell 0.7 percent as mining activity weakened in the aftermath of the collapse of Vale's tailing dam, which caused hundreds of deaths in January. Analysts cut their forecast for Brazilian real GDP growth in 2019 to 1.2 percent in the Central Bank of Brazil's weekly consensus survey released May 24 from 1.7 percent a month earlier. The optimism that President Jair Bolsonaro would promote pro-growth economic reforms is giving way to frustration with the unemployment rate still over 12 percent, the economy contracting, and a lack of tangible progress on the pension reforms needed to improve Brazil's sovereign credit rating.