June 10, 2019

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

US JOB GROWTH WEAK IN MAY, FED CLOSELY MONITORING TRADE IMPACT; ECB MAY EASE; INDIA POLICY RATE CUT

UNITED STATES: May's jobs report disappointed: A weaker than expected 75,000 payroll jobs added on the month and also 75,000 in downward revisions to prior months' job growth, resulting in no net change in employment from the level reported a month earlier for April. The unemployment rate held steady at 3.6 percent and average hourly earnings growth slowed to 3.1 percent from 3.2 percent in April and the recovery-to-date peak of 3.4 percent in February. Payroll growth is likely to average 160,000 jobs per month through year-end 2019, close to the year-to-date average of 164,000 and slower than 2018's 223,000 per month rate. May's weaker job growth echoes retrenchment of forward-looking business sentiment surveys: The US manufacturing PMI in May fell to the lowest since September 2009 in the Markit survey and October 2016 in the ISM survey. The ISM nonmanufacturing PMI rose to 56.9 in May after reaching the lowest since August 2017 in April, while the Markit services PMI dipped to the weakest since February 2016 in May. Exports and imports both fell 2.2 percent in April from March, with the trade deficit edging down 2.1 percent to $50.8 billion US dollars. Petroleum exports rose 3.9 percent on the month, while non-petroleum exports fell 4.1 percent to their lowest since October 2017. A large drop in civilian aircraft exports could reflect the beginning of the drag from cancelled Boeing 737 Max orders. Exports of autos and parts also fell on the month. Trade deficits increase during economic booms and fall during slowdowns since imports rise and fall with domestic investment and consumption; the lower April trade deficit is another sign that US growth is cooling, not that tariffs are shrinking the deficit. In fact, the trade deficit with China widened on the month: Exports to China plunged a seasonally-adjusted 17.1 percent from March while imports rose 0.9 percent. Federal Reserve Chair Jay Powell stated in a speech on June 4 that the Fed is "closely monitoring" the impact of the trade war on the US economic outlook, and "will act as appropriate to sustain the expansion." Financial markets price in an 18 percent chance of a Federal Funds rate cut at the June 19 FOMC meeting and an 84 percent chance of a cut at the July 31 meeting. PNC sees a cut as unlikely in June but possible in July or later this year if May's disappointing job growth marks the start of a new trend.

EUROZONE: The ECB was modestly less dovish than expected at its June 6 Governing Council decision. As promised, they launched a new round of Targeted Longer-Term Refinancing Operations (TLTROs), but did not take any other actions. They did tweak their forward guidance to be modestly more dovish, and signaled other stimulus is possible if growth or inflation weaken further. The ECB refrained from granting partial exemptions to the negative policy interest rate to commercial banks, which would have boosted Eurozone commercial banking profitability and removed a potential obstacle to interest rate cuts. The latest TLTROs were announced earlier this year, and roll over maturing TLTRO loans made in 2016; their terms are similar to prior TLTROs. The updated forward guidance says that interest rates will not increase until at least the second half of 2020. Prior forward guidance had ruled out a rate hike before the end of 2019. But the change has negligible relevance since financial markets see a cut as more likely than a hike. President Draghi stated in the press conference after the decision that "several members" of the Governing Council discussed rate cuts and "other members" restarting QE. But the ECB held off on these actions, and President Draghi did not describe how much the outlook would have to deteriorate to justify them. Notably, the Eurozone inflation rate implied by the 5-year breakeven swap contract has been falling steadily since November, and now implies financial markets expect inflation of just 1.3 percent over the next five years, well short of the ECB's target of below but near 2 percent. This reflects both weak current inflation (The Eurozone's benchmark HICP index rose just 1.2 percent from a year earlier in May), the risk of a global downturn pushing inflation even lower, and fears that the ECB lacks tools to offset the next downturn. The ECB could still use quantitative easing and rate cuts to some extent if the economy deteriorates, but the negative 0.4 percent deposit rate is likely close to the effective lower bound for interest rates, and the ECB's quantitative easing program came close to running out of eligible assets to purchase the last time it was used. Low inflation expectations also reflect fear that the next ECB President could be unwilling to use unconventional monetary stimulus in the next downturn; German central bank president Jens Weidmann, a candidate to replace Draghi after his October retirement, said at the G-20 meeting June 9 that "Monetary policy normalization shouldn't be unnecessarily postponed."

INDIA: The Reserve Bank of India cut its policy repo rate 0.25 percentage points to 5.75 percent from 6.00 percent as expected at its June 6 monetary policy decision, reacting to "global economic activity [that] has been losing pace," falling household inflation expectations, and a forecast for CPI inflation to average below the RBI's 4.0 percent inflation target over the next year.

CHINA: The Caixin general services PMI dipped to 51.5 in May from 52.7 in April while the CFLP nonmanufacturing PMI was unchanged on the month at 54.3. China's foreign reserves rose $6.05 billion dollars to $3.101 trillion in May; they have been roughly stable since bottoming out at just under $3 trillion in January 2017 and are well below their mid-2014 peak of nearly $4 trillion. China's trade surplus rose to 279 billion yuan ($40 billion dollars) in May from $93 billion yuan ($13 billion dollars) in April in non-seasonally-adjusted terms; a larger trade surplus is a sign that domestic demand is weakening.

JAPAN: Household spending grew 1.3 percent in year over year terms in April, down from 2.2 percent in March; cash earnings fell 0.1 percent from a year earlier, better than March's 1.3 percent drop but still a fourth consecutive decline. Japan's PMIs were little changed in May from April at 49.8 after 49.6 for the Nikkei manufacturing PMI and 51.7 after 51.8 for the services PMI.

CANADA: Household employment rose 27,700 in May, better than the 5,000 consensus, and the unemployment rate fell to 5.4 percent, the lowest since comparable data begin in 1974. Average hourly earnings for permanent workers grew 2.6 percent from a year earlier, up from the recent trough of 1.5 percent made in November 2018. Financial markets' implied probability of a rate cut by December 2019 fell to back under 50-50 after the strong jobs report's June 7 release and President Trump's decision against new tariffs on Mexican imports, down from nearly 75 percent on June 4.

UNITED KINGDOM: Prime Minister Theresa May resigned as Tory Party leader June 7, formally launching the contest to replace her. Brexit negotiations are on hold until a new leader is chosen, and could progress slowly until the October deadline for a deal forces the next Prime Minister to commit to the sort of tradeoffs that doomed Prime Minister May's deal. Several candidates are advocating Brexit strategies that would put the UK on course for a Hard Brexit. But unless there is a general election, Members of Parliament will continue to veto hard Brexit and require the government to maintain a close relationship with the EU as signaled in the March-April indicative votes. The Markit/CIPS UK manufacturing PMI fell to a contractionary 49.4 in May and was the lowest since July 2016, the construction PMI fell to 48.6 and was the weakest since March 2018, and the services PMI rose to 51.1 from 50.4, within its range since November 2018.

MEXICO: Negotiators reached a deal on June 7 that President Trump called sufficient to withdraw his threat made on May 31 to impose 5 percent tariffs on all Mexican imports. Meanwhile, Moody's changed its outlook on Mexico's sovereign credit rating to negative from stable on June 5 because of "less predictable policymaking" by the Mexican government, and Fitch downgraded Mexico's sovereign rating on June 5, citing risks to finances from Pemex. Fitch also downgraded Pemex to below investment grade on June 6.

BRAZIL: Inflation slowed to 0.1 percent in May from 0.6 percent in April as food and beverage prices fell 0.6 percent. Annual inflation was 4.7 percent in May, down from 5.0 percent in April. The median forecast for real GDP growth in 2019 was 1.1 percent in the Central Bank's survey of professional forecasters conducted May 31, down from 1.2 percent a week prior. The median forecast has fallen for 14 consecutive weeks.