August 5, 2019

GLOBAL ECONOMIC HIGHLIGHTS

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YUAN DEPRECIATES TO WEAKEST SINCE 2008; FED RATE CUT, EMERGING MARKET CENTRAL BANKS FOLLOWING SUIT

CHINA: The yuan depreciated to more than seven per US dollar on August 5, the weakest since 2008, after President Trump announced August 1st that on September 1st the US government would apply a ten percent incremental tariff on the $300 billion of Chinese goods imports not already subject to tariffs. The Trump administration has already applied 25 percentage point incremental tariffs to $250 billion of Chinese goods imports. If enacted as promised, higher tariffs will be a small direct headwind to US growth by raising inflation, reducing real disposable income, and pressuring businesses' profit margins. China has promised to respond to additional US tariffs with its own unspecified "countermeasures," which (like the now weaker yuan) will be a further headwind to US exports and businesses' foreign profits. Higher US tariffs also will lower US business and consumer confidence, slowing capex and discretionary consumer spending. In China, the broadened tariffs will add to the chill on the export-oriented manufacturing industry, which was wobbly in July according to PMI surveys: The CFLP manufacturing PMI rose a bit to 49.7 from 49.4 in June, but still indicated a monthly contraction, as the survey has for five of the seven preceding months. The privately-compiled Caixin manufacturing PMI rose to 49.9 from 49.4, and has been contractionary for five of the last eight months. The CFLP non-manufacturing PMI fell to 53.7 from 54.2 and was the weakest since November, while the Caixin services PMI fell to 51.2 from 52.0 and was the weakest since February. PNC forecasts for the yuan to depreciate further to 7.15 per dollar by year-end 2019 and average around that level in 2020. For additional detail, please refer to PNC's China Update published May 10, "China to Loosen Monetary Policy and Allow Yuan to Depreciate to Offset Escalating Tariffs."

UNITED STATES: As expected, the Federal Reserve lowered the federal funds target 0.25 percentage point to a range of 2.00 to 2.25 percent at its July 31 monetary policy decision; Fed Chair Jay Powell cited downside risks to growth from trade tensions and inflation below the Fed's 2.0 percent aim to justify the cut, which he called a "mid-cycle adjustment" and "not the beginning of a long series of rate cuts." The Fed also announced the end of balance sheet reductions a.k.a. quantitative tightening in August, two months earlier than previously scheduled; the impact is mostly symbolic. PNC forecasts for the Fed to again cut the federal funds target 0.25 percentage point at its October decision, and hold it unchanged after that; financial markets price in three more interest rate cuts over the next 12 months, substantially more than in our baseline forecast or than implied by Chair Powell's "mid-cycle adjustment" language. The last three mid-cycle adjustments in 1995, 1998, and 2002 lowered the federal funds target by the equivalent of about three 25 basis point rate cuts.

The US economy added 164,000 jobs in July, but job report in May and June was revised down a net 41,000; the unemployment rate held steady at 3.7 percent, near a multi-decade low. Job growth averaged 140,000 per month over the last three months, slower than the year-to-date average of 165,000 or 223,000 in 2018. Some details were good: The labor force participation rate ticked back up to 62.9 percent from 62.8 percent, and average hourly earnings rose 0.3 percent on the month and accelerated to 3.2 percent on the year from 3.1 percent in May and June. Negatively, the average workweek fell 0.1 hour to 34.3 hours, and the average manufacturing workweek dipped 0.3 hour to 40.4 hours with average weekly manufacturing overtime down 0.2 hour to 3.2 hours. Manufacturing hours can be volatile, particularly in the summer when plants retool, and so manufacturing hours might bounce back. With the caveat noted, year-over-year growth of private sector aggregate hours worked slowed to 1.2 percent in July from 1.5 percent in June and was the third-slowest since July 2010, while production and nonsupervisory employees' hours grew the slowest since July 2010, 0.7 percent on the year. Businesses could be throttling back on hourly workers' hours to avoid headcount reductions since the tight labor market would make it difficult to ramp back up when conditions improve.

The consumer and household sectors continue to be the US economy's brightest spot. Personal income rose 0.4 percent in June, and May's income growth was revised up 0.1 percentage point to 0.5 percent; personal spending rose 0.3 percent on the month and spending growth in May was revised down 0.1 percentage point to 0.2 percent. The Conference Board's Consumer Confidence Index® jumped to 135.7 in July and was the strongest since last November. But the ISM purchasing managers' index fell to 51.2 in July from 51.7 in June and was the weakest since August 2016, while construction spending fell 1.3 percent in June from May and 2.1 percent from a year earlier, with private residential spending down 8.1 percent and private nonresidential spending down 0.4 percent; public construction spending rose 6.1 percent. Exports of goods and services fell 2.1 percent in June from May and imports a smaller 1.7 percent.

MEXICO: More evidence of a protracted slump in the Mexican economy although probably not an outright recession. Real GDP rose an anemic 0.1 percent in the second quarter from the first (not annualized) after adjusting for seasonality, and was up just 0.4 percent from a year earlier, close to the first quarter's 0.3 percent year-over-year increase. Real GDP in the agricultural sector rose 1.7 percent on the year in the first quarter, real GDP in the industrial sector fell 1.6 percent on the year, and real GDP in the service sector rose 1.0 percent. The index of persons employed rose 0.3 percent in May from April and 0.8 percent from a year earlier; employment stagnated between April and November 2018, and has returned to slow growth since then. The seasonally-adjusted unemployment rate rose 0.06 percentage point in June from May but was unchanged after rounding at 3.5 percent, and up from its 3.2 percent low in October 2018. Financial markets price in just under a one in four chance of a policy interest rate cut at the Central Bank of Mexico's next interest rate decision on August 15, but over a two in three chance of a cut by year-end.

BRAZIL: The Central Bank of Brazil's Monetary Policy Committee (Copom) unanimously voted to lower the Selic policy rate at their July 31 decision to a record-low 6.00 percent from 6.50 percent, the first cut in over a year. The Copcom stated that "the balance of risks has evolved favorably, but the risk of a possible frustration of expectations regarding the continuation of reforms still prevails." The Copom signaled further easing citing that "the consolidation of the benign scenario for prospective inflation should permit additional adjustment of the degree of stimulus." The six-month market implied policy rate is 5.2 percent, reflecting expectations of one to two more 0.50 percentage point rate cuts. The unemployment rate fell to 12.0 percent in June from 12.3 percent in May, and has fallen for three consecutive months; the statistic is not seasonally-adjusted. The Markit manufacturing PMI fell to 49.9 in July, its lowest reading in a year.

INDIA: Financial markets price in near certainty of a rate cut at the Reserve Bank of India's August 7 monetary policy decision: Core CPI slowed to 4.1 percent in July from 4.2 percent in June and was the coolest since July 2017, industrial production growth has been sluggish since November, and the Fed's July rate cut and expectations of further easing from advanced economy central banks create room for the RBI, like other emerging market central banks, to use monetary policy to offset downside risks to growth.

EUROZONE: Economy-wide indicators point to cool but still positive growth, but the manufacturing sector continues to contract. The European Commission's Eurozone Business Climate Indicator for the manufacturing sector fell to the weakest since September 2013 in July, with Industrial Confidence the weakest since July 2013. The Services Confidence Index was the weakest since September 2016, but consumer confidence rose on the month and was above its year-to-date average. Real GDP slowed slightly to 1.1 percent in year-over-year terms in the advanced estimate for the second quarter from 1.2 percent in the first quarter; in quarterly terms, real GDP grew 0.2 percent (not annualized), down from 0.4 percent in the first quarter and the same as the third and fourth quarters of 2018. Both year-over-year and quarter-over-quarter real GDP growth were near consensus forecasts. HICP inflation slowed to 1.1 percent in July from 1.3 percent in June, with various measures of core HICP ranging between 0.9 percent and 1.1 percent, down a bit from their 1.1 to 1.3 percent range in June. The Eurozone unemployment rate was 7.5 percent in June, down from 7.6 percent in May, which was revised up from the 7.5 percent previously reported.

JAPAN: The Bank of Japan held its monetary stance unchanged at its July 30 Policy Board decision but signaled an increase in monetary stimulus is coming at is next decision September 12. The monetary policy statement added a new phrase, reading, “In a situation where downside risks to economic activity and prices, mainly regarding developments in overseas economies, are significant, the Bank will not hesitate to take additional easing measures if there is a greater possibility that the momentum toward achieving the price stability target will be lost.” PNC forecasts for the Bank of Japan to cut its short-term policy rate from -0.10 percent to -0.20 percent and increase its purchases of exchange traded funds to ¥10 trillion yen annually from the current ¥6 trillion yen annual rate. Additional details on PNC’s forecast for the Japanese economy and yen exchange rate are available in PNC’s latest Japan Update.

CANADA: Real GDP rose 0.2 percent on the month in May from April and 1.4 percent from a year earlier with output in goods-producing industries up 0.6 percent, led by a jump in manufacturing and construction output. Services output rose 0.1 percent with wholesale and retail trade down on the month. PNC forecasts for Canadian employment to rise a solid 25,400 in the July Labour Force Survey to be released August 9 and for the unemployment rate to edge back down to match May’s 43 year low of 5.4 percent from June’s 5.5 percent.

UNITED KINGDOM: PMI surveys continue to point to recession underway in mid-2019: The Markit/CIPS construction PMI was a contractionary 45.3 in July after 43.1 in June and the Markit/CIPS manufacturing PMI was unchanged at 48.0. The government of newly-appointed Prime Minister Boris Johnson continues to demand the EU renegotiate the Brexit Withdrawal Agreement set by the prior government to remove the backstop, which forces the UK to maintain an open border and common customs territory between Northern Ireland and the Republic of Ireland; the EU continues to refuse. Since Parliament already demonstrated that it would prevent a Hard Brexit while Theresa May was PM, the hard line taken by the Johnson administration is seen by British political analysts as a ploy to position the Prime Minister to win a stronger majority in a general election that could occur in October; the pound sterling exchange rate is at its weakest against the US dollar since early 2017 in reaction to the British government’s brinksmanship. As all but assured, the Bank of England held its policy bank rate unchanged at 0.75 percent at its August 1 Monetary Policy Committee decision, and signaled that Brexit uncertainty is the most important determinant of the path for interest rates and the pound sterling exchange rate.