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GLOBAL ECONOMIC HIGHLIGHTS

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US-CHINA TRADE WAR ESCALATES; US GROWTH SLOWING; INDIAN CENTRAL BANK CUTS RATES, FOLLOWING FED

CHINA: Escalation of the US-China trade conflict roiled global capital markets the week of August 5 to 9. The Chinese government announced Chinese companies would suspend purchases of US agricultural products after President Trump's August 1 announcement that the US would broaden tariffs to apply to all Chinese goods imports on September 1. China also allowed the yuan to depreciate to more than 7 per US dollar, the weakest since 2008. In further retaliation, the US government delayed licenses that would have allowed US exporters to sell components to Chinese telecommunications manufacturer Huawei, according to reporting by Bloomberg. President Trump signaled that his administration will continue its "maximum pressure" strategy in the next round of negotiations with China in September in comments to the press on August 15, saying that the talks may even be cancelled: "If we do [cancel the meeting], that's fine. If we don't, that's fine." The yuan finished the US trading week on August 9 at 7.02 per dollar in the onshore (CNY) market and 7.10 per dollar in the offshore (CNH) market. The People's Bank of China is likely to cut its benchmark policy rate, the seven-day reverse repo rate, 20 basis points from 2.55 percent to 2.35 percent in August to cushion the impact of trade war escalation and keep pace with the Federal Reserve's July rate cut; longer tenor Chinese swap interest rates are 30 to 40 basis points lower in early August than in early May before President Trump's May 6 tweet which first threatened to broaden tariffs on Chinese imports.

UNITED STATES: Economic growth and job growth are slowing. The Markit US services PMI rose to 53.0 in July after two months' recovery from May's 50.9, which was the lowest since March 2016, but was still the third-weakest reading since March 2017; the ISM non-manufacturing PMI fell to 53.7 from 55.1 and was the softest since August 2016. The number of job openings edged down to 7.35 million in June from 7.38 million in May (revised up from 7.32 million); job openings are down 3.6 percent from their peak in November 2018. Bloomberg's weekly Consumer Comfort Index dipped in the week of August 4 to the lowest since June 30 after reaching a record high the week of July 30.

INDIA: The Reserve Bank of India reduced its policy repo rate 0.35 percentage points to 5.00 percent at its August 7 decision, more than the 0.25 percentage point cut expected. The monetary policy statement was extremely dovish: "Addressing growth concerns by boosting aggregate demand, especially private investment, assumes the highest priority at this juncture while remaining consistent with the inflation mandate." The RBI's business and household surveys indicate softening domestic growth: Consumer confidence edged lower in the RBI's bi-monthly survey of households to the softest since December, and expectations for inflation one year in the future also edged lower; the consensus of professional forecasters surveyed by the RBI lowered their projection for real GDP growth in the 2019-2020 and 2020-2021 Indian fiscal years by 0.3 percentage point and 0.1 percentage point respectively to 6.9 percent and 7.2 percent, respectively. The survey of manufacturers' business expectations softened to the lowest since the first quarter of 2017 as new orders contracted for a second consecutive quarter. The RBI's rate cut mirrored cuts by the Reserve Bank of New Zealand and Bank of Thailand during the week of August 5 to 9 as emerging market and commodity-exporting economies' central banks reacted to the Fed's July rate cut and the escalation of the US-China trade war.

MEXICO: CPI inflation slowed to 3.8 percent in July from 4.0 percent in June, and consumer confidence fell to the weakest since November. Financial markets price in roughly one in three odds of a policy rate cut by the Bank of Mexico at its next decision August 15, rising to nearly nine in ten odds of one or more 0.25 percentage point interest rate cuts by year-end 2019.

BRAZIL: The services sector contracted 1.0 percent in June from May. The Central Bank of Brazil's weekly survey of professional forecasters showed the median estimate for real GDP growth in 2019 was 0.8 percent in the August 2nd survey, unchanged from the previous week. Brazil's month-over-month inflation rate in July was 0.2 percent, the lowest monthly change for July since 2014. Year-over-year inflation slowed to 3.2 percent from 3.4 percent and was the slowest since May 2018. The Central Bank of Brazil will likely cut its benchmark Selic policy rate 0.50 percentage points to 5.50 percent at its next decision September 18; financial markets price in one to two 0.50 percentage point policy interest rate cuts from the central bank over the next three months.

EUROZONE: Service sector activity remains resilient, and improving factory orders might point to green shoots for the lagging German industrial sector. The Markit services PMI was little changed at 53.2 in July after 53.3 in June. German factory orders rose 2.5 percent in June from May, better than the 0.5 percent expected, and fell 3.6 percent from a year earlier, the smallest year-over-year decline since January. Italian sovereign bond yields jumped to the highest since July 2 after far-right Deputy Prime Minister Matteo Salvini called for a snap election on August 9. Polls show far-right parties likely to win a larger share of parliamentary seats in a snap election. This could destabilize the truce between the current Italian government, a coalition of the far-right and far-left parties, and the European Commission, which has criticized Italy's compliance with EU deficit and debt rules.

JAPAN: Better-than-expected growth in the second quarter likely reflects businesses and consumers pulling forward spending plans ahead of the October value added tax hike. Real GDP grew 1.8 percent annualized in the second quarter from the first, better than the 0.5 percent expected, and down from 2.8 percent in the first quarter. Private nonresidential investment jumped 6.1 percent annualized, while private consumption grew 2.5 percent annualized and exports fell 0.2 percent annualized. Household spending grew 2.7 percent from a year earlier in June, down from 4.0 percent in May but still the third-strongest growth since 2015. Growth similarly strengthened in 2013 and early 2014 ahead of the 2014 value added tax hike, only to turn to a sharp contraction when the tax hike went into effect. Japanese real GDP will likely fall in the fourth quarter of 2019 when a similar pullback occurs.

CANADA: Employment fell 24,200 in July from June after edging down 2,200 in June, and the unemployment rate rose to 5.7 percent from 5.5 percent in June and 5.4 percent in May, which had been the lowest since 1976. Details were generally weak. Full-time employment fell 11,600 and part-time 12,600, while the number of unemployed grew 35,500 as 11,200 jobseekers entered the labor force. Private sector employees dropped a large 69,300 on the month, while public employment rose 17,500 and self-employment 27,700. Sectors with notable declines in employment included wholesale and retail trade, down 20,600, transportation and warehousing, down 14,800, "other services" (like domestic services and dry cleaners), down 10,600, and manufacturing, down 5,900. The market-implied probability of an interest rate cut by the Bank of Canada is still under one in five for the next interest rate decision September 4, but has risen to over 50-50 for the October 30 decision after the China trade conflict escalated the week of August 5, the yuan depreciated, and then Canada's July jobs report disappointed. After these negative developments, PNC also has changed the forecast for the Bank of Canada's Canada's overnight rate target to anticipate a 0.25 percentage point interest rate cut at the BoC's October monetary policy decision to 1.50 percent from the current 1.75 percent.

UNITED KINGDOM: Real GDP fell 0.2 percent (not annualized) in the second quarter of 2019, the first quarterly decline since 2012, after rising 0.5 percent in the first. From a year earlier, growth slowed to 1.2 percent in the second quarter from 1.8 percent in the first and was the slowest since the first quarter of 2018. By industry, the largest declines were in manufacturing, where a 2.3 percent quarterly decline (8.9 percent annualized) more than reversed the first quarter's 1.9 percent increase, and construction, where output fell 1.3 percent in the second quarter after growth of 1.4 percent in the first. Services output grew 0.1 percent in the second quarter, the slowest since the second quarter of 2016, the quarter during which the Brexit referendum was held. In the expenditure GDP accounts, the most notable drop was in business investment, which fell 0.5 percent on the quarter or 2.0 percent annualized; it fell 1.6 percent from a year earlier, and was down 2.7 percent from its peak in the fourth quarter of 2017. Exports also fell 3.3 percent after rising a cumulative 3.1 percent in the two previous quarters. Imports plunged 12.9 percent to the lowest since the fourth quarter of 2016. The IHS Markit services PMI pointed to slight growth of service-producing sectors in July, though likely not enough to offset continuing declines in manufacturing and construction: The services PMI rose to 51.4 in July from 50.2 in June. The UK is likely experiencing a recession in mid-2019 as businesses unwind inventories accumulated prior to the original March Brexit deadline, and delay investment plans due to the overhang of Brexit uncertainty.

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