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GLOBAL ECONOMIC HIGHLIGHTS

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OIL PRICES SPIKE ON ATTACK ON SAUDI OILFIELDS; ECB CUTS RATES AND RESTARTS QUANTITATIVE EASING

UNITED STATES: Benchmark crude oil prices jumped over 10 percent after a drone attack on Saudi oil facilities September 14 disrupted production accounting for 5 percent of world supply. Dow Jones quoted unnamed Saudi officials as expecting half of disrupted capacity to return by September 16, and the rest within a few weeks. But the disruption still could worsen if the conflict that generated it does too. President Trump threatened retaliation on September 15, tweeting American forces "are locked and loaded." Oil price spikes were partially responsible for most recessions since the end of World War II. PNC sees a continued US expansion as more likely than recession, but an oil price spike could add to recession risks.

The Job Openings and Labor Turnover Survey for July was mixed, with strong measures of current activity but weaker indications for future hiring. July had the second highest hires rate in 11 years and the highest quits rate in 18 years. Since quits rise when workers see more alternatives to their current jobs, the latest data signal a dynamic labor market. But the number of job openings—a leading indicator of hiring intentions—dropped 0.4 percent on the month, with June's openings revised down 1.4 percent, bringing July's job openings to the second lowest since May 2018. The NFIB's Small Business Optimism Index receded to 103.1 in August from 104.7 in July and was the lowest since March. The University of Michigan Consumer Sentiment Index edged up to 92.0 in the September preliminary release but was still the third weakest since October 2016, after August's 89.8, the weakest. Retail sales grew 0.4 percent in August: Sales of autos and parts jumped 1.8 percent, while sales excluding autos and gasoline edged up just 0.1 percent. Slower growth of sales excluding autos and gasoline is unsurprising after annualized growth of better than 9 percent in the five months through July. Overall retail sales rose 4.1 percent from a year earlier in August, up from 3.6 percent in July and 1.4 percent at their recent trough in December 2018.

President Trump on September 11 delayed from October 1 to October 15 the implementation of the 5 percentage point tariff increase on $250 billion of Chinese goods imports. This fits his well-established pattern of escalating the trade war, and then signaling conciliation to calm the stock market. CPI inflation was 0.1 percent in August, held back by a 3.5 percent drop in gasoline prices, while "core" CPI excluding food and energy rose a larger 0.3 percent. Faster core CPI is largely due to a 0.9 percent jump in the volatile medical care services index. Core CPI rose 2.4 percent in year-ago terms in August, the fastest since September 2008; by contrast, core PCE inflation (the Fed's preferred measure) rose just 1.6 percent in the latest release for July; some of core CPI's acceleration might be noise. In any case, Fed policymakers have signaled they can tolerate a period of inflation over their 2 percent aim after undershooting it for most of the current expansion. PNC forecasts for the Fed to cut the federal funds target 0.25 percentage point to a range of 1.75 to 2.00 percent at the next Open Market Committee decision September 18, and again October 30.

EUROZONE: The ECB's September 12 monetary policy decision was as expected. The Governing Council cut the benchmark negative deposit rate 0.10 percentage point to -0.50 percent, matching PNC's forecast, and left its other policy interest rates unchanged. The main refinancing operation rate is 0.00 percent and the marginal lending facility rate 0.25 percent. The Governing Council strengthened forward guidance on interest rates, saying they would "remain at their present or lower levels until [the ECB] has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2 percent within [the ECB's] projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics." "Robustly" probably indicates no rate hike until the ECB's quarterly forecasts predict headline and core HICP inflation rising to at least 1.8 percent. These projections forecast inflation two to three years in the future, so monetary policy is still linked to ECB forecasts, not data. This is less binding guidance than the Bank of Japan's, which commits the bank to quantitative easing until realized inflation meets and exceeds their 2 percent inflation target. It is also less binding than the Federal Reserve's 2012 commitment to delay an interest rate hike until after the unemployment rate fell below 6.5 percent.

The ECB's QE program will buy €20 billion euros of assets per month starting November 1, for "as long as necessary to reinforce the accommodative impact of [the ECB's] policy rates." This modestly undershoots PNC's forecast of €30 billion purchases per month, somewhat offset by the program being open ended. They expect QE "to run for as long as necessary to reinforce the accommodative impact of policy rates, and to end shortly before [they] start raising the key ECB interest rates." It is a soft commitment, only committing the ECB to QE until they forecast it becoming unnecessary. The ECB will buy the same types of assets as in prior rounds of QE, including central government and local government bonds, covered bonds and asset backed securities issued by banks, and corporate bonds. In addition, they will now purchase private sector assets yielding less than the -0.50 percent deposit rate; in the last round of QE they only bought public debt yielding less than the deposit rate.

The ECB's staff economists do not expect inflation to reach their target over their forecast horizon. The benchmark HICP inflation rate is forecast at 1.2 percent in 2019 vs 1.3 percent forecast at the June ECB meeting, 1.0 percent in 2020 vs 1.4 percent forecast in June, and 1.5 percent in 2021 vs 1.6 percent forecast in June. The lower inflation forecast reflects both lower energy prices and weaker growth prospects. Real GDP is forecast to grow 1.1 percent in 2019 vs 1.2 percent forecast in June, 1.2 percent in 2020 vs 1.4 percent forecast in June, and 1.4 percent in 2021, unchanged from the June forecast.

The ECB lengthened the maturity of the Targeted Long Term Refinancing Operation or TLTRO loans to commercial banks to three years from two years. Interest rates on TLTROs were cut 0.1 percentage points to equal the main refinancing operation rate (0.00 percent), and banks can win incentives to lower the effective interest rate to as low as the deposit rate by growing their lending books, up from the previous lower limit of 0.10 percentage point above the deposit rate. Liquidity is cheap and ample for Eurozone commercial banks. The ECB also "tiered" the implementation of the deposit rate, exempting some of commercial banks' excess cash from the negative deposit rate. Specifically, a multiple of commercial bank's excess reserves will be exempted from the deposit rate, with the multiple initially set at six times reserves; this exempts around half of banks' excess cash from negative interest rates. The exemption boosts commercial banks net interest margins, profitability, and allow banks to keep growing lending to support economic growth.

Finally, President Draghi called on Eurozone governments to launch fiscal stimulus, saying monetary policy alone is not enough to support the Eurozone economy. He even welcomed stimulus from governments with high public debt (Italy is the Eurozone's largest public borrower) through automatic stabilizer programs, which pay out more when the economy weakens.

CHINA: China's government reciprocated the Trump administration's conciliatory actions on trade on September 13 by reversing its decision to further increase tariffs on US soybeans, pork, and other agricultural products; existing retaliatory tariffs on those products will stay in place. CNBC also reported that Chinese importers bought the largest shipment of US soybeans in more than a year on September 12. The concession is an easy one for China to make, since Chinese pork prices surged 46.7 percent in August from a year earlier; an African swine flu epidemic in Chinese farms has made 2019 a disastrous year for Chinese pork production and contributed to soaring prices and import demand. Chinese inflation is cool otherwise, with CPI excluding food and energy rising just 1.5 percent on the year (slower than US core CPI), down from 1.6 percent in July, and producer prices falling 0.8 percent on the year. China's credit conditions look broadly unchanged in August: Bank deposits as measured by the M2 money supply grew 8.2 percent on the year in August, up from 8.1 percent in July, while aggregate financing to nonfinancial borrowers grew 10.7 percent on the year, unchanged from July. Growth of yuan loans, accounting for two thirds of aggregate financing to nonfinancial borrowers, slowed marginally to 12.6 percent in the same terms from 12.7 percent a month earlier. Credit provided by non-bank financial intermediaries (entrusted loans and trust loans) fell at a slightly slower year-over-year rate in August, and corporate bond financing grew 11.3 percent, down from 11.6 percent in July. Growth of local government bond issuance slowed to 43.1 percent from 47.5 percent; this is a new category in China's monetary statistics and increasing from a very small base, 4.3 percent of total financing, largely reflecting the shift of local government financing out of other categories and into a newly-created Chinese equivalent of the municipal bond market. Industrial production slowed to 4.4 percent in August from 4.8 percent in July and was the weakest since 2002; investment in fixed assets slowed to the weakest since September 2018. The surveyed jobless rate was 5.2 percent, up 0.2 percentage point from a year earlier – the same year-over-year increase as in July. The surveyed unemployment rate in the 31 largest cities was also 5.2 percent, up 0.3 percentage points from a year earlier.

UNITED KINGDOM: Prime Minister Boris Johnson prorogued a.k.a. suspended parliament on September 10, but not before parliament passed a law requiring the government to prevent a Hard Brexit at the October 31 deadline for a deal. Parliament will not re-open until October 14. Johnson's opponents are challenging the legality of prorogation in the courts, but the more important question for the British economic outlook and currency is whether the government complies with the law – as seem very likely – and reaches another agreement with the EU to extend the Brexit deadline. The pound sterling appreciated to $1.25 per pound September 13, the strongest since late July, on the lower probability of a Hard Brexit.

JAPAN: The producer price index fell 0.9 percent on the year in August, faster deflation than July's 0.6 percent and the steepest producer price deflation since December 2016. The Bank of Japan will follow the Fed and ECB by expanding monetary stimulus this fall, either at its next decision September 19 or the following one October 31; the Japanese government is hiking taxes in October, so Japan will need more monetary stimulus to offset tighter fiscal policy.

CANADA: Canadian real estate sector activity continues to recover, and prices are largely stable on the year. Housing starts rose to 226,600 in August from 222,500 in July and rose 14.3 percent from a year earlier according to the Canada Mortgage and Housing Corporation, and building permits rose 3.0 percent in July from June. Statistics Canada's new housing price index fell 0.1 percent in July from June, and 0.4 percent from a year earlier, and has been flat or lower for twelve consecutive months; however, the index is seen as a less accurate measure of Canadian housing prices than the Canadian Real Estate Association's MLS® HPI, which was a little strong in July, rising 0.6 percent on the month and 0.2 percent on the year.

MEXICO: Mexico is likely in recession in mid-2019. Industrial production fell a seasonally adjusted 0.4 percent in July from June and 2.8 percent from a year earlier. Manufacturing edged up 0.2 percent on the month and 1.2 percent on the year. Mining and oil output fell 2.9 percent on the month and 7.4 percent on the year, while construction fell 1.4 percent on the month and 9.1 percent on the year.

BRAZIL: The Central Bank of Brazil's weekly survey of professional forecasters showed the median estimate for real GDP growth in 2019 was 0.9 percent in the September 6th survey, unchanged on the week. Retail sales grew 1.0 percent month over month in July, up from 0.5 percent in June. July was the third consecutive monthly increase in retail sales; retail sales have increased by 1.6 percent year-to-date.

INDIA: Headline CPI in August was 3.2 percent in year-ago terms, below the consensus of 3.3 percent, unchanged from July after rounding, and below the Reserve Bank of India's (RBI) medium-term target of 4.0 percent for the 13th consecutive month. Core CPI excluding food and energy was unchanged in August from July at 4.1 percent, the slowest since August 2017.