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GLOBAL ECONOMIC HIGHLIGHTS

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DOWNGRADING CHINESE GROWTH OUTLOOK DUE TO CORONAVIRUS; US GDP GREW MODERATELY AT YEAR-END

CHINA: PNC downgraded the forecast for Chinese real GDP growth in the first quarter of 2020 to 5.2 percent in year-over-year terms from 5.9 percent in the prior forecast. The Chinese government's policies to contain the coronavirus' spread, as well as the public atmosphere of fear in many parts of China, will cause a sharp drop in discretionary consumer spending in the first quarter. The People's Bank of China lowered its benchmark 7-day reverse repo policy rate on February 3 to 2.40 percent from 2.50 percent at the prior lending operation December 19. PNC forecasts an additional 0.40 percentage point cut in this policy rate by August and a marked acceleration of growth in the money supply and credit; if the coronavirus outbreak is contained by the second quarter, Chinese economic growth will likely make a V-shaped recovery over the remainder of 2020. For additional details, please refer to PNC's China Update for the first quarter of 2020, published at https://www.pnc.com/economicreports. In a now-dated release, the Caixin general manufacturing PMI for China dipped to 51.1 in January from 51.5 in December; the survey's data collection ended the day before the Chinese government imposed a ban on all travel to and from Wuhan, so it does not capture the impact of the coronavirus on manufacturers.

UNITED STATES: The US economy grew moderately through the end of 2019, but will slow in early 2020 due to the Boeing 737 MAX production shutdown. Real GDP grew 2.1 percent at an annualized rate in the fourth quarter of 2019, the same pace as in the third quarter. For all of 2019, the US economy grew 2.3 percent, down from 2.9 percent in 2018. On a year-over-year basis real GDP growth was also 2.3 percent in the fourth quarter, down slightly from 2.5 percent in the fourth quarter of 2018. Growth has slowed since mid-2018, but is still running at a pace allowing for improvement in the labor market. Consumer spending grew 1.8 percent in the fourth quarter, while fixed business investment declined for a third straight quarter, down 1.5 percent. Business fixed investment has been falling since the second quarter of 2019 due to a number of drags, including low energy prices, uncertainty surrounding the trade war between the US and China, slower global economic growth, and the problems with the Boeing 737 MAX. Residential fixed investment, primarily homebuilding, rose a strong 5.8 percent in the fourth quarter, adding 0.2 percentage point to growth. Inventories subtracted a large 1.1 percentage point from growth. Exports rose 1.4 percent, while imports fell 8.7 percent; a decline in imports boosts GDP. Much of the decline in imports is likely due to increased tariffs on Chinese-made goods. Overall, trade added 1.5 percentage points to growth in the fourth quarter. Government purchases rose 2.7 percent in the fourth quarter, adding 0.5 percentage point to growth. There were large increases in both federal (3.6 percent) and state and local (2.2 percent) spending. The GDP price index rose a cool 1.4 percent in the fourth quarter at an annual rate. The personal consumption expenditures price index, the Federal Reserve's preferred inflation measure, rose 1.6 percent in the fourth quarter in the same terms, and was up 1.5 percent from a year earlier. The core PCE price index, excluding volatile food and energy prices, was up 1.3 percent annualized in the fourth quarter, and 1.6 percent on a year-ago basis. Despite the lowest unemployment rate in 50 years, inflation remains consistently below the Federal Reserve's 2 percent objective.

Nominal consumer spending rose 0.3 percent in December, close to pace of the past few months. Spending on durable goods fell 0.8 percent over the month as auto sales were down, but nondurable goods spending rose 0.9 percent, largely because of higher gasoline prices, and spending on services rose 0.3 percent. Personal income rose 0.2 percent in December, with wages and salaries up 0.3 percent. After-tax income was also up 0.2 percent. With spending up slightly more than income, the personal saving rate fell to 7.6 percent in December, from 7.8 percent in October and November; it is still much higher than its level prior to the Great Recession, when consumers were financially overstretched. Inflation as measured by the personal consumption expenditures price index was 0.3 percent in December, the fastest monthly pace since April 2019. Core inflation, excluding volatile food and energy prices, was 0.2 percent in December, a modest acceleration from the 0.1 percent monthly pace of the past four months. On a year-ago basis overall inflation was 1.6 percent in December, up from 1.4 percent in November. Core inflation was 1.6 percent in December, up from 1.5 percent in November, but down from the 1.7-1.8 percent pace over the summer.

Durable goods orders rose 2.3 percent in the December preliminary release but the details were worse than the headline; defense aircraft and parts orders jumped 168.3 percent after plunging 69.1 percent a month earlier and accounted for two-thirds of December's net increase. Nondefense aircraft and parts orders fell 74.7 percent on the month and a cumulative 81.9 percent from October to December, reflecting the impact of the Boeing 737 MAX's troubles. Nondefense capital goods orders excluding aircraft fell 0.9 percent on the month; they rose 1.8 percent on the year, but that mostly reflects comparison against a very weak month of December 2018; December 2019's nondefense capital goods orders excluding aircraft were 0.4 percent less than the average of the November 2018 and January 2019 levels. Private sector demand for durable goods will contract slightly in early 2020. The Conference Board's Consumer Confidence Index rose to 131.6 in the January from 128.2 in December, and was above the 2019 average. The Present Conditions component of the index was the second-strongest since December 2000. As expected, the Federal Reserve held its target for the federal funds rate unchanged at a range of 1.50 to 1.75 percent at its January 29 Open Market Committee meeting; the committee made a minor tweak to the policy statement to acknowledge that inflation has undershot their symmetric 2 percent objective recently. Federal Reserve Chair Jay Powell stated in the press conference following the decision that the Fed would maintain reserves (cash owned by commercial banks that they keep on deposit at the Fed) at a level of no less than $1.5 trillion, implying that the Fed will continue to grow its balance sheet in line with the banking system's increasing demand for reserves even after the end of the second quarter. PNC forecasts for the Bureau of Labor Statistics' January jobs report to show nonfarm payroll employment up 165,000 from December, the unemployment rate unchanged at a 50-year low of 3.5 percent, and average hourly earnings up 0.3 percent on the month and 3.0 percent on the year.

UNITED KINGDOM: Matching PNC's forecast, the Bank of England held its policy bank rate unchanged at 0.75 percent at its January 30 Monetary Policy Committee meeting. The BoE judged real GDP in the fourth quarter was likely flat in year-over-year terms, and marked down its forecasts for real GDP growth in the first quarters of 2020, 2021, and 2022 to 0.4 percent, 1.4 percent, and 1.6 percent, all in year-over-year terms and all 0.3 percentage point lower than the BoE's prior forecast. But the BoE also projects that growth will "pick up a little in early 2020," reflecting the sharp improvement of sentiment surveys since the December general election. Barring a deterioration in the global outlook due to coronavirus or some other external shock, the Bank of England is likely on hold in 2020. The UK officially withdrew from the European Union on January 31, but aside from symbolism, the status quo of EU membership remains in place through the end of the transition period, currently scheduled to end in December 2020 – like the original March 2019 deadline for the UK to officially leave the EU, the end of the transition could also be extended.

EUROZONE: Real GDP growth slowed to 1.0 percent in year-over-year terms in the advance estimate for the fourth quarter of 2019, the slowest in six years. In quarterly terms, real GDP increased just 0.1 percent in the fourth quarter, the slowest since the first quarter of 2013. Even with weak growth, the unemployment rate fell to 7.4 percent in December from 7.5 percent in November, marking a new 11-year low. Consumer inflation by the benchmark HICP index edged up to 1.4 percent in year-over-year terms in January, but core inflation excluding energy, food, alcohol and tobacco dipped to 1.1 percent from 1.3 percent; inflation continues to trend below the ECB's target of below but near two percent.

JAPAN: The labor market remains solid despite a drop in economic activity in the fourth quarter, supporting the Bank of Japan's decision to hold its monetary policy unchanged after the October tax hike. The unemployment rate was unchanged at a 27-year low of 2.2 percent in December, while the jobs to applicants ratio held unchanged on the month at 1.57 and was down from its cyclical peak of 1.63, most recently reached in April 2019. Industrial production rose 1.3 percent on the month in December but fell 3.0 percent on the year. The Jibun Bank manufacturing PMI rose to 48.8 in the January final release, up from 48.4 in December but down from the 49.3 flash estimate.

CANADA: Real GDP rose 0.1 percent in November month-over-month, beating economists' estimates of a flat reading, and reversing the 0.1 percent contraction in the prior month. Utilities rose 2.1 percent (the strongest sector contribution), construction rose 0.5 percent, and manufacturing was flat month-over-month. Canada's job growth in 2019 was revised lower to 299,000 from the 320,300 initially reported. After the revisions, December's unemployment rate remained at 5.6 percent, close to May 2019's 5.4 percent, which was the lowest since comparable data began in 1976.

BRAZIL: The unemployment rate fell to 11.0 percent in the fourth quarter of 2019, a slight decrease from 11.2 percent in the three months through November; the unemployment rate averaged 11.9 percent in 2019, the lowest since 2016. The Brazilian real depreciated to a record low of 4.28 per US dollar on January 31, its weakest level against the dollar ever, as fears of the coronavirus weighed on expectations for Chinese commodity demand. While domestic factors are not a slam dunk case for a rate cut – the slight improvement of Brazil's labor market in 2019, a recent uptick in inflation, and generally solid economic data – the deterioration of the Chinese economic outlook will likely cause the Central Bank of Brazil to cut the record-low Selic policy rate 0.25 percentage point to 4.25 percent at the next monetary policy decision on February 5; this is a change from PNC's prior forecast, which was made before last week's deterioration of the Chinese outlook. The Central Bank of Brazil's weekly survey of professional forecasters showed the median estimate for the Selic rate at the end of 2020 was 4.25 percent, a decrease from 4.5 percent the prior week, in the January 24th survey.

MEXICO: The Bank of Mexico will likely cut its benchmark interbank target rate 0.25 percentage point to 7.00 percent at its next interest rate decision February 13. Real GDP contracted 0.3 percent from a year earlier in the fourth quarter of 2019 according to the preliminary estimate, a third consecutive quarter of decline in those terms.

INDIA: India's fiscal deficit in the April 2019 to March 2020 fiscal year was 3.8 percent of GDP, higher than the Finance Ministry's 3.3 percent target.

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