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GLOBAL ECONOMIC HIGHLIGHTS

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CHINA'S FEBRUARY PMI'S SIGNAL A SHARP CONTRACTION; FED CHAIR POWELL OPENS THE DOOR TO US RATE CUTS

CHINA: PMI surveys fell to the worst on record in February, signaling a sharp drop in Chinese real activity in the first quarter of 2020. The government-produced CFLP manufacturing PMI plunged to 35.7 from 50.0 in January, and the CFLP non-manufacturing PMI to 29.6 from 54.1. The privately-produced Caixin general manufacturing PMI also dropped to the lowest in its nearly 16-year history, 40.3 after 51.1. Data for the manufacturing survey begin in 2005 and for the nonmanufacturing survey in 2007. Their sharp drops reflect both supply and demand shocks from the COVID-19 crisis, which collectively point to February's extreme weakness persisting for at least a few more months, even if Chinese policymakers roll out an aggressive economic stimulus package. On the supply side, some restrictions on business activities are starting to ease, since policymakers are impatient to jumpstart manufacturing, shipping, and agriculture. But restrictions on other sectors will persist for at least a few months. Municipal governments are requiring people entering their cities to self-quarantine, a huge drag on travel and commercial services. School closures force parents to provide childcare and supervise their children's home-schooling, cutting into working hours and productivity. Beyond policy, mass psychology will weigh on consumption as long as Chinese people fear infection at movie theaters, restaurants, stores, and other businesses. And after these shocks subside, the income lost during this crisis will weigh on subsequent demand from companies and households with high debt. The COVID-19 fallout should start subsiding in March, but real GDP growth still will slow to low single digits or even zero in year-over-year terms in the first quarter of 2020, consistent with a sharp drop in quarter-over-quarter activity. If China's situation deteriorates further, real GDP could even be negative in year-over-year terms in the first quarter, but that is not our base case. Chinese economic policy will become highly expansionary this year to offset the demand shocks of COVID-19 and prevent an even worse outcome.

UNITED STATES: Federal Reserve Chair Jay Powell issued an unscheduled statement the afternoon of Friday February 28 stating that despite the US economy's "strong" fundamentals, "the coronavirus poses evolving risks to economic activity," and so the Federal Reserve will "use [their] tools and act as appropriate to support the economy." The statement opens the door for the Fed to cut the federal funds rate if the COVID-19 outbreak worsens, after a week in which US equity indices fell over 10 percent, new COVID-19 diagnoses outside China began to exceed those in China, and global companies began announcing cancellations of travel, conferences, and other events. The US economy's fundamentals were strong at the open of 2020, with a low unemployment rate, wage growth outpacing inflation, and strong consumer sentiment. In the most recent example of this, the University of Michigan Consumer Sentiment Index was revised up to a two-year high of 101.0 in the February final release (incorporating survey data from the back half of the month) from the 100.9 preliminary release. But the US economy is about to experience headwinds to tourism and travel that, even if not as severe as China's, will nevertheless be painful near-term, and which will compound the drag on GDP from Boeing's ongoing problems with the 737 MAX. US real GDP growth will slow noticeably in the first half of 2020. PNC forecasts for nonfarm payroll employment to increase 100,000 in the Bureau of Labor Statistics' March 6 release of the February Employment Situation Summary, supported by about 35,000 temporary hires into Census jobs, and for the unemployment rate to again touch its 50-year low of 3.5 percent. But job growth will subsequently slow in the rest of 2020. PNC currently estimates a one-in-three risk of recession in 2020, up from a one-in-five estimate before COVID-19. If COVID-19 becomes a bigger hit to the US economy than expected, fed funds rate cuts this year would be inevitable. Financial markets price in roughly three to four 25 basis point federal funds rate cuts over the next 12 months.

EUROZONE: European Central Bank President Christine Lagarde on Friday February 28 gave a statement closely paralleling that made by Fed Chair Powell the same day, saying the ECB is monitoring the economic fallout of COVID-19 “very carefully” but needs more information before being convinced that further monetary easing is justified. Eurozone sentiment surveys were generally good ahead of the COVID-19 outbreak, but the most recent data have started to show its impact. The European Commission’s Economic Sentiment Index rose to 103.0 in February from 102.5 in January and was the strongest since June, with notable gains in the industrial and consumer sentiment sub-indices. The ZEW survey of German investor sentiment toward Eurozone growth expectations pulled back to 10.4 in February from a 23-month high of 25.6 in January. The final release of the Markit manufacturing PMI for the Eurozone showed that supplier delivery times lengthened notably in February and businesses ran down inventories as COVID-19 disrupted the flow of goods from China, and that foreign sales contracted on the month.

UNITED KINGDOM: The flash release of the Markit manufacturing and services PMIs for the UK showed that like in the Eurozone, British manufacturers and service sector businesses are suffering spillovers from Chinese supply-chain disruptions. British manufacturers reported the largest increase in suppliers’ delivery times in the survey’s 28-year history, and a sharp drop in inventories as a consequence. Service-sector businesses reported a drop in customer demand from Asia in the flash release of Markit’s February PMI.

JAPAN: Japan’s economy deteriorated in early 2020, hit by the triple-whammy of the October 2019 tax hike, Typhoon Hagibis, and now COVID-19. The unemployment rate rose 0.2 percentage point to 2.4 percent in January; while still historically low by Japanese standards, this ties for the highest since March 2019. The job openings-to-applicants ratio dropped sharply in January to the lowest since May 2017; January’s fall was the sharpest monthly decline in job openings since at least 1989. The Jibun Bank manufacturing and services PMIs weakened in the February flash release, with service sector respondents citing fewer Chinese tourists.

CANADA: Real GDP growth slowed to 0.3 percent annualized in the fourth quarter of 2019 from 1.1 percent in the third as nonresidential fixed investment fell and the trade deficit worsened. CPI inflation rose to 2.4 percent in January from 2.2 percent in December, but trimmed-mean core inflation was unchanged at 2.1 percent. Retail sales were flat in December and down 1.6 percent in the full year of 2019, the worst annual result since 2009. Details of the December retail sales report were mixed, with vehicle and part sales down 0.4 percent but sales ex-autos and gas up 1.0 percent. Canada’s Finance Minister is relaxing mortgage underwriting standards to support the housing market. The mortgage benchmark rate will be based on actual rates (after discounts), rather than advertised rates. The BoC is very likely to cut the overnight rate target 0.25 percentage point to 1.50 percent at its next rate decision March 4; financial markets price in a meaningful probability of an even larger 0.50 percentage point cut. Canada’s benchmark crude oil price Western Canada Select fell 15.1 percent from February 21 to February 28.

BRAZIL: The CNI Industrial Confidence fell to 64.8 in February from January’s nearly 10-year peak of 65.3, while the FGV Consumer Confidence index dipped to 87.8 in February, the lowest since May 2019, from 90.4 in January. The IPCA-15 consumer price index rose 4.2 percent in the twelve months to mid-February, down slightly from 4.3 percent the prior month. The Central Bank of Brazil will cut the reserve requirement ratio on time deposits to 25 percent from 31 percent effective March 16 to boost lending.

MEXICO: Real GDP fell 0.1 percent in 2019 from 2018, and is set to contract again in 2020. Mexico reported its first confirmed COVID-19 case on February 28, and President Trump publicly weighed new restrictions on the US-Mexico border on February 29 as a potential response to COVID-19, before walking his comments back. The unemployment rate rose to 3.7 percent in January, the highest since September 2016. The Mexican peso plunged 5.5 percent against the US dollar between February 19 and 28.

INDIA: Real GDP grew 4.7 percent in year-over-year terms in the fourth quarter of 2019, the slowest pace in nearly seven years, in line with consensus estimates and below the revised 5.1 percent growth in the third quarter of 2019. On the demand side, private consumption expenditure rose 4.7 percent, government consumption expenditure rose 11.8 percent while exports and imports declined 5.5 percent and 11.2 percent respectively. On the supply side, agriculture rose 3.5 percent, mining and quarrying was up 3.2 percent, construction rose a soft 0.3 percent, and manufacturing fell 0.2 percent. Risks remain weighted to the downside as India struggles with a weak manufacturing sector, lackluster consumption, slower global growth and the RBI taking a wait-and-see approach to examine the impact of the COVID-19 on hard data. India's manufacturing sector seemed to be recovering ahead of the impact of COVID-19: The IHS manufacturing PMI for India was 54.5 in February, not far from January's 55.3, which was the highest in nearly eight years.