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GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Abbey Omodunbi** Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

CENTRAL BANKS OPEN THE FLOOD GATES, GOVERNMENTS PLAN STIMULUS TO MITIGATE COVID-19'S ECONOMIC TOLL

UNITED STATES: The Federal Reserve made their second emergency interest rate cut in less than two weeks on Sunday March 15: They lowered the target for the federal funds rate a full percentage point to a range of zero to one quarter percent, the lowest since December 2015. In the accompanying policy statement, Fed policymakers said they expect interest rates to stay near zero until the Fed is "confident that the economy has weathered recent events and is on track to achieve our maximum employment and price stability goals." The Fed will want to see the drop in real GDP that they expect for the second quarter to be reversed, as well as at least a partial reversal of the increase in unemployment that is expected over the next several months, before they consider raising interest rates. Financial markets price in essentially no change in interest rates over the next year following the cut to near zero.

The Fed also resumed large-scale asset purchases, with $500 billion in purchases of Treasury securities and $200 billion of agency debt purchases planned "over coming months." In the press conference following the decision, Chair Powell did not commit to a specific pace at which the Fed would make these asset purchases, but said that the Fed would "go in strong" to address "signs of stress and impaired liquidity" in Treasury markets during the week of March 9-13. Treasury bond yields and prices swung wildly during that week amid very high volatility in broader capital markets as the economic cost of the COVID-19 outbreak became clearer. The Fed's stated purpose for these asset purchases is to tame volatility in Treasury markets, a different reason than for QE1, QE2, and QE3, which were intended to stimulate the economy. But in substance, the asset purchases are very similar: The Fed will rapidly grow its balance sheet in coming months to improve financial conditions and "ease hardship caused by the disruptions to the economy and… support a swift return to normal once they have passed."

Furthermore, the Federal Reserve, Bank of England, Bank of Japan, European Central Bank, and Swiss National Bank jointly announced a 25 basis point coordinated cut in the interest rate applied to loans made by foreign central banks' US dollar liquidity swap facilities. Foreign central banks will now offer 84-day dollar-denominated credit in their jurisdictions, in addition to the 1-week loans offered previously. The Fed's March 15 actions followed $120 billion in credit extended through its 1- and 3-month repo lending facilities during the prior week, and a half a percentage point cut to the federal funds target on March 3.

Fiscal policy stimulus is also set to cushion the blow from the crisis. President Trump announced several policies to address the economic costs of COVID-19 when he declared a national emergency March 13. The federal government will release as much as $50 billion dollars in funding to state and local governments to address the crisis, and suspend interest payments on federal student loans. The President also instructed the strategic oil reserve to buy crude oil to support energy prices. The House of Representatives passed a bill March 14 to mandate paid sick leave for some workers; bolster state unemployment insurance programs; and increase funding for food assistance programs.

The first economic releases covering the US COVID-19 outbreak show a modest impact through early March. The preliminary release of the University of Michigan Consumer Sentiment index dipped to 95.9 in March from 101.0 in February, but the index still matched its October level. The expectations component dropped the most, from 92.1 to 85.3, while present conditions were little changed at 114.8 after 112.5. Initial claims for unemployment insurance actually fell slightly for the week ending March 7 (released on March 12) and remained historically low. However, unofficial data, such as daily restaurant seatings tracked by the online reservation service OpenTable, show traffic in some restaurants was already falling at over a 30-percent year-over-year rate by March 12; declines in restaurant traffic will accelerate after many state and local governments ordered bars and restaurants to close in recent days. Food services and drinking places account for 8 percent of nonfarm payroll employment, so restrictions on restaurants and bars, the drag on the retail industry, and the contraction in tourism and business travel will cause aggregate US economic activity to fall for at least a few months.

EUROZONE: The European Central Bank added to monetary stimulus as expected March 12, but confusing messaging by President Christine Lagarde overshadowed the decision. In response to a question about whether the ECB would help Italy manage rising government bond yields caused by COVID-19's damage to its economy, President Lagarde responded that the ECB is "not here to close spreads." She clarified in a post-press conference interview that the ECB is, in fact, here to close spreads, saying that the ECB's March 12 policy package was intended to ensure the ECB's low interest rates translate into low borrowing costs for the real economy. Other ECB policymakers made statements in the subsequent 24 hours emphasizing that the longstanding ECB goal of limiting interest rates in the Eurozone's weaker economies stands. But the yield on Italy's 10-year government bond still jumped 0.6 percentage point in the day after Lagarde's statement. The monetary policy decision itself was a moderate but temporary increase of monetary stimulus, about as expected: The ECB raised asset purchases a.k.a. QE a cumulative €120 billion euros through year-end or about €13 billion monthly, close to PNC's €10 billion expectation. Instead of cutting the deposit rate, the ECB made an effective 0.25 percentage point reduction in the interest rate on its TLTRO facility: Commercial banks will be able to borrow from the ECB for three years at an interest rate of 0.25 percentage point less than the ECB deposit rate, currently -0.50. That means that if the deposit rate holds unchanged over the next three years, a commercial bank that borrows €100 euro in June 2020 would only owe the ECB €99.77 three years later when the loan comes due – the magic of negative interest rates. A TLTRO rate cut is relatively narrow, since it only applies to credit for Eurozone commercial banks that are growing lending and seek funding through the TLTRO facility. ECB TLTRO lending outstanding accounts for just 5 percent of GDP. In addition to asset purchases and the TLTRO rate cut, the ECB also reduced commercial banks' capital and liquidity coverage requirements, a regulatory decision intended to encourage faster loan growth.

The President of the Eurozone's deficit watchdog the European Commission suspended the EU's budget rules March 13 to allow for emergency stimulus spending. The European Commission itself announced a €25 billion plan to spend on national health systems, support for small and medium businesses, workers, and other vulnerable groups. The Eurozone's national governments also are announcing stimulus plans. Also on March 13, Germany announced up to €550 billion euros in loans to businesses from its state-owned development bank the KfW to help businesses survive the crisis and programs to defer tax payments. Italy also announced a €28 billion euro stimulus package.

UNITED KINGDOM: The Bank of England made a 0.50 percentage point emergency cut to their policy bank rate on March 11, lowering it to 0.25 percent. The Bank also introduced a new "Term Funding scheme" to fund loans to small and medium-size businesses, and cut the countercyclical capital buffer from 1 percent to 0 percent (a regulatory change intended to grow lending). The British government announced a £30 billion pound sterling stimulus package, also on March 11.

CHINA: Economic indicators for January and February were historically bad, as expected. Retail sales fell 20.5 percent from a year earlier, industrial production 13.5 percent, and investment in fixed assets 24.5 percent. The survey-based unemployment rate in urban areas jumped to 6.2 percent from 5.2 percent in December, and the survey-based unemployment rate in the 31 largest cities jumped to 5.7 percent from 5.2 percent.

CANADA: The Bank of Canada cut its overnight target rate 50 basis points to 0.75 percent in an unscheduled meeting March 13; this was the first unscheduled cut since 2009 and was made less than ten days after the 50 basis point cut at the March 4 meeting. The BoC also announced a new Bankers' Acceptance Purchase Facility to extend credit to small-and medium-size businesses. Housing starts fell 1.9 percent in February to 210,100 annualized units from 214,000 at a seasonally-adjusted annualized rate;

housing starts have been above 200,000 annualized units in eight of the last nine months thanks to low interest rates and a solid construction industry. Building permits increased 4.0 percent in January month-over-month, down from a 9.9 percent increase in December and beating economists' expectations of a 3 percent decline. The Canadian economy will likely experience a recession in 2020 unless the COVID-19 crisis rapidly resolves and oil prices sharply rebound. PNC Economics expects another 50 basis point cut at the Bank of Canada's next meeting in April if not earlier; financial markets price in a 1 percentage point cut by the April meeting, which would reduce the overnight rate into negative territory.

BRAZIL: PNC expects the Central Bank of Brazil to cut its policy Selic interest rate 50 basis points from the current record-low level of 4.25 percent to 3.75 percent at the next BCB meeting on March 18 if not before. Brazil's economy was weak and inflation moderate even before the COVID-19 shock: Inflation measured by the benchmark IPCA index slowed to 4.0 percent in the twelve months through February, matching the central bank's target, from 4.2 percent in January. Core prices as measured by the Central Bank of Brazil's trimmed mean index increased 3.2 percent on the year in February; core inflation has been below 4.0 percent for nine consecutive months. Industrial production declined fell 0.9 percent on the year in January, a third consecutive monthly decline, following a 1.2 percent decline in December.

INDIA: The Reserve Bank of India on March 12 announced plans for $2 billion in foreign currency swap agreements to support the rupee after it plunged to a record low of ₹74.5 per dollar that day. Inflation is slowing, expanding the RBI's space for monetary easing. CPI inflation eased in February to 6.6 percent in year-over-year terms from 7.6 percent in January, following six consecutive monthly increases. The drop of crude oil prices caused by the Saudi-Russian oil price war will further slow Indian inflation in coming months. Core CPI excluding food and energy was 4.1 percent in February, slightly below January's 4.2 percent increase.