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GLOBAL ECONOMIC HIGHLIGHTS

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Fed Formally Announces Average Inflation Targeting Plan; Personal Income Rose in July, but Likely Lower in August

UNITED STATES: Housing continued to lead the U.S. recovery in July. New single-family home sales jumped to the strongest since 2006 in the month, echoing the jump in existing home sales; pending home sales rose 5.9 percent after a 15.8 percent increase the prior month and were the strongest since 2005, and only 3.9 percent short of their housing bubble-era peak in mid-2005. The trade deficit increased to $79.3 billion dollars in the July advance release from $70.6 billion in June, with exports up 11.9 percent and imports up 11.8 percent. The trade deficit fell to the lowest since 2016 in February as the pandemic snarled global shipping, first affecting China and then the rest of the world; in this context, July's higher trade deficit is actually an encouraging sign that the supply chain disruptions that hampered the global economy this spring are easing.

Personal income and expenditures beat expectations in July. Personal income rose 0.4 percent from June versus a consensus forecast for a 0.2 percent decline; revisions to prior months left personal income in June 0.5 percent higher than previously reported. The unfolding economic recovery offset smaller stimulus payments in July to leave income higher on net. Personal consumption expenditures increased 1.9 percent from June, with revisions leaving the June level 0.6 percent higher than in the prior release; spending on goods rose 2.0 percent in July and on services 1.9 percent. Since personal consumption grew faster than personal income, the personal saving rate fell, to 17.8 percent from 19.2 percent; the saving rate was still extremely high in July but down from the record 33.7 percent in April, when restrictions on activity sharply curbed consumers' ability to spend. Personal disposable income, which is personal income less taxes, grew 0.2 percent in July after pull-backs in June and May and the surge in April (stimulus tax credits and increased unemployment insurance). Real personal income edged down 0.1 percent on the month in July, since the price index of personal consumption expenditures rose 0.3 percent in July as energy prices rose 2.5 percent, food prices fell 0.9 percent, and other prices (PCE excluding food and energy a.k.a. core inflation) rose 0.3 percent.

From a year earlier the PCE price index was up just 1.0 percent, little changed from June's 0.9 percent. Inflation is undershooting the Fed's 2.0 percent goal. In addition, Fed Chair Jay Powell stated in a speech August 27 that the Fed would like inflation to modestly overshoot its goal near term, to compensate for weak inflation in recent years, and cause inflation to average at the Fed's goal. The Fed will cite extremely high unemployment, excessively weak inflation, and this new inflation averaging goal to justify aggressive forward guidance later this year, when they are likely to formally pledge to keep short-term interest rates at current near-zero levels until the economy reaches quantifiable benchmarks toward a full recovery.

Consumer sentiment was mixed in August. The Conference Board's Consumer Confidence Index® fell to 84.8 in August from 92.6 in July and was even weaker than its recent trough in April and May; the last time the index was this low was in 2014. By contrast, the University of Michigan's Consumer Sentiment Index rose in the month, and was the second highest since the crisis first sent consumer sentiment plunging in April. Consumers were buffeted by crosswinds in August: The $600 increase in weekly unemployment insurance benefits funded by the CARES act expired at the end of July. An executive order authorized FEMA to provide a $300 benefit to offset the end of the $600, but administrative delays prevented most unemployed Americans from receiving them in August. In addition, not all UI beneficiaries are eligible for the substitute benefit. Personal income likely fell in August as reduced UI benefits offset gains in earned income and capital income. Personal income will partially bounce back in September as the $300 FEMA benefit, which will be paid in arrears to August 1, begins to be paid out. But not all consumers were worse off in August; many were heartened by the stock market's increase to new record high levels, which boosts wealth for households who own stocks, and by the jobs recovered in the month implied by weekly economic indicators. Most recently, initial claims for unemployment insurance fell 107,000 to 1.068 million the week of August 22 from 1.175 million the prior week, while claims for Pandemic Unemployment Assistance rose 83,000 to 608,000; PUA claims data are not adjusted for seasonal variations. Insured unemployment fell to 14.535 million the week of August 15 from 14.758 a week earlier, and the number of total claimants for all unemployment programs (including PUA and PEUC, the program for job losers whose other benefits have been used up) fell to 27.017 million the week of August 8 from 28.060 the prior week. The Federal Reserve Bank of New York's Weekly Economic Index fell 4.9 percent from a year earlier the week of August 22, the smallest such decline since March. PNC forecasts for the August jobs report from the Bureau of Labor Statistics to show 1.5 million nonfarm payroll jobs added on the month, with the unemployment rate falling to 9.8 percent from 10.2 percent in June.

EUROZONE: ECB Chief Economist Philip Lane laid out the ECB's strategy to return inflation to the target of below but near two percent in a speech delivered August 27 to the Federal Reserve's Jackson Hole virtual monetary policy conference. The ECB's strategy is to use its emergency programs, including the Pandemic Emergency Purchase Program, Targeted Long-Term Refinancing Operations, and easier collateral requirements, for a "temporary" period, until inflation is back on the same trajectory towards the ECB's inflation goal as it was before the crisis hit in February. Strictly interpreted, that could mean keeping the ECB's temporary emergency programs in place until 2022: The ECB's December 2019 Eurosystem staff macroeconomic projection forecasted 1.1 percent HICP inflation in 2020, 1.4 percent in 2021, and 1.6 percent in 2022. The Eurosystem staff projections released in June 2020 forecast HICP of 0.3 percent in 2020, 0.8 percent in 2021, and 1.3 percent in 2022. If the ECB Eurosystem staff projections are correct, inflation could be back on the path forecast in December 2019 by 2022. However, the risks to this plan are that the ECB could get "stimulus fatigue" and withdraws stimulus prematurely, or alternatively, that inflation expectations fall in the rest of 2020 and in 2021 as realized inflation sharply undershoots the ECB's target.

CHINA: China's recovery continued in August. The CFLP manufacturing PMI was little changed at 51.0 in August after 51.1 in July, while the nonmanufacturing PMI rose to 55.2 from 54.2 and was the strongest since January 2018.

CANADA: Real GDP fell 38.7 percent in the second quarter at a seasonally-adjusted annualized rate, the largest contraction on record, close to economists' estimate for a 39.6 percent decline and following an 8.2 percent decline the previous quarter. From peak to trough (fourth quarter of 2019 to second quarter of 2020), the Canadian economy has shrunk 13.4 percent in the current crisis. To put that in context, the Canadian economy contracted 4.0 percent during the global financial crisis (third quarter of 2008 to third quarter of 2009). The details of the second quarter real GDP reading were equally terrible; consumption declined 34.9 percent, gross fixed capital formation dropped 45.6 percent while exports and imports declined 55.6 percent and 64.1 percent respectively. Final domestic demand, which is the sum of final consumption, investment and stock building expenditures by the private and government sectors, plunged 37.4 percent.

Household disposable income rose 50.9 percent in the second quarter on an annualized basis, following a 5.1 percent rise the previous quarter; the household savings rate rose to a record-high 28.2 percent in the second quarter from 7.6 percent the previous quarter. Household disposable income and savings both rose thanks to the Canada Emergency Response Benefit, the government's financial stimulus response to the pandemic.

The second-quarter GDP reading is backward looking and doesn't reflect the current pulse of the economy. Measured monthly, real GDP grew 6.5 percent in June from May following 4.5 percent growth the prior month; twenty-one out of twenty-two sectors grew from May to June. June's data on the labor market, housing market, manufacturing, and consumer spending likewise suggest that a recovery has already begun; the strength of that recovery depends primarily on the path of the virus.

BRAZIL: Brazil's mid-month release of its consumer price index, the IPCA-15, rose 2.3 percent from a year earlier in mid-August, following a 2.1 percent rise the prior month. Inflation is still below the lower-bound of the central bank’s 2.5 to 5.5 percent target range and will remain below the 4.0 percent inflation target in the near term as economic activity slowly picks up.

MEXICO: Real GDP fell 53 percent annualized in the second quarter of 2020, in line with expectations prior to the data’s release August 26; monthly real GDP rose 8.9 percent in June from May after falling 21.6 percent from a year earlier in May. Real GDP contracted in consecutive terms in nine of the 12 months through May 2020. Mexico’s economy had serious problems prior to the current crisis, and will still be faced with those problems after the immediate cyclical bounce from the economy reopening is realized.

JAPAN: There are only tentative signs of a recovery underway in Japan’s economy. CPI inflation in Tokyo (a leading indicator of national inflation, released prior to the national CPI report) was 0.3 percent in year-over-year terms in August, down from 0.6 percent in July; core CPI excluding fresh food and energy turned negative in August, falling 0.1 percent from a year earlier after a 0.6 percent increase in July. Industrial production rose 8.0 percent in July from June, but still fell 16.1 percent from a year earlier; retail sales fell 3.3 percent in July from June and 2.8 percent from a year earlier.