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GLOBAL ECONOMIC HIGHLIGHTS

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Fed Links Funds Rate to Inflation, but Commitment to QE Is Less Specific; More Brinksmanship by U.K. Government

UNITED STATES: The Federal Reserve announced a major change to its forward guidance at the September 16 Open Market Committee decision: The Fed committed to keeping the federal funds target at a range of zero to a quarter percent until "inflation has risen to 2 percent and is on track to moderately exceed 2 percent for some time." Since the relationship between unemployment and inflation has weakened over time, the Fed stated that they would not raise interest rates pre-emptively, even if the unemployment rate returns to or drops below the historically low levels that prevailed in early 2020, as long as inflation stays well behaved. PNC forecasts for the Fed to keep the Federal Funds target at its current level at least until 2024.

The Fed also incorporated average inflation targeting into its guidance. This is the strategy that Fed Chair Jay Powell announced in a speech in August. Because inflation has averaged below the Fed's 2 percent target for the last decade, the Fed will now aim for "inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent." Since mid-2019, yields on inflation-protected bonds have implied financial markets expect inflation to average below two percent over the coming five years.

In contrast to the Fed's interest rate guidance, their guidance on quantitative easing is less specific and binding. "Over coming months," the Fed will buy "Treasury securities and agency mortgage-backed securities at least at the current pace"—the Fed is not yet committing to a course for asset purchases come 2021. The S&P500 stock index dipped 2.4 percent in the two trading days following the decision, which provided less certainty about the outlook for asset purchases than for short-term interest rates.

High-frequency activity indicators so far in hand for August are mixed. Growth of retail sales and industrial production slowed, while single-family homebuilding was the strongest since 2007. Retail sales grew 0.6 percent from July, slower than July's 0.9 percent increase (revised down from 1.2 percent in the prior estimate). Retail sales excluding autos rose 0.7 percent, as did sales excluding autos and gasoline. Industrial production grew 0.4 percent in August, likewise slower than July's 3.5 percent increase or June's 6.1 percent. Manufacturing rose 1.0 percent in August, mining output fell 2.5 percent as hurricanes temporarily shut down oil and gas extraction along the Gulf Coast, and utilities output fell 0.4 percent. From a year earlier, industrial production fell 7.7 percent in August. Housing starts fell 5.1 percent in August, and permits for new construction fell 0.9 percent. But below the headline, single-family starts rose 4.1 percent to their highest level since February, and single-family permits rose 6.0 percent to their highest since 2007.

Initial claims for unemployment insurance fell 33,000 to a seasonally-adjusted 860,000 the week of September 12, and initial claims for Pandemic Unemployment Assistance fell 209,577 to 658,737; the latter statistic is not adjusted for seasonal variation. Insured unemployment fell 916,000 the week of September 5 to 12.628 million. The more dated but more comprehensive measure of continuing unemployment insurance recipients, persons claiming UI benefits in all programs, rose in the week of August 29 by nearly 100,000 to 29.768 million from 29.670 million a week earlier.

The Federal Reserve Bank of New York's Weekly Economic Index fell 5.1 percent in year-ago terms in the first revision of data for the week of September 12, worse than the 4.3 percent decline in the first revision for the

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prior week, but matching the final estimate for that week. The most recent WEI releases show the economy's recovery slowing since the end of August.

UNITED KINGDOM: On September 15 a majority of Members of Parliament voted for the government's Internal Market Bill, which would violate the terms of the EU Withdrawal Agreement by unilaterally removing customs checks between Northern Ireland and the rest of the UK. These checks were mandated by the Withdrawal Agreement ratified by the U.K. in January, which placed the customs border between Northern Ireland and the rest of the UK to prevent a hard border between Northern Ireland and the Republic of Ireland; this is a condition of the peace agreement that ended Northern Ireland's civil war. If the Internal Market Bill becomes British law rather than being another element of brinksmanship ahead of the year-end deadline to complete a UK-EU trade deal, a no-deal Brexit would be likely at the end of 2020.

The unemployment rate rose to 4.1 percent in the May-to-July period from 3.9 percent in the February-to-April quarter and was the highest since the fourth quarter of 2018; these and all British labor market data are seasonally adjusted. The unemployment rate severely understates the weakness of the UK's job market; hours worked by British workers, while up 2.0 percent in the latest quarter from the April-to-June trough, were still down 17.8 percent from their peak in the December 2019 to February 2020 rolling three-month period. Redundancies (layoffs) rose to the highest level since the fourth quarter of 2012 in the latest three months' data. Employment of EU nationals in the UK is down 13.6 percent from the peak in the first quarter of 2019.

As expected, the Bank of England held its policy Bank Rate unchanged at 0.1 percent at its September 16 monetary policy decision. Somewhat less expected, the Monetary Policy Committee signaled they are preparing contingency plans to lower the Bank Rate to negative territory if the British economy needs more monetary stimulus in coming months, either because of a Brexit shock, the second wave of coronavirus, or some other shock. Financial markets currently price in fifty-fifty odds of a reduction in the Bank Rate to negative territory by March 2021.

EUROZONE: The Financial Times reported September 20 that the ECB is conducting a review of its Pandemic Emergency Purchase Programme (PEPP), including whether its non-emergency QE programs should adopt the same looser asset purchase guidelines as the PEPP, such as targeting sovereign bond purchases to the most stressed sovereign bond issuers rather than buying bonds in proportion to each Eurozone member state's share in Eurozone GDP. ECB President Christine Lagarde may respond to the article, which cited two anonymous ECB Governing Council members, in a speech to the Franco-German Parliamentary Assembly on September 21. The speech is scheduled to begin at 9:45am U.S. Eastern time.

CHINA: China's August activity indicators showed its recovery continued to gain traction in the month. Retail sales grew 0.5 percent from a year earlier in the month after falling 1.1 percent in the same terms in July; August's report was an improvement but still indicated a decline in retail sales volumes since CPI inflation was 2.4 percent in the same terms. Investment in fixed assets contracted 0.3 percent on the year in the first eight months of 2020, better than the 1.6 percent contraction in the year through July; investment in real estate grew 4.6 percent in those terms in the year through August, up from 3.4 percent in July and fueling the acceleration over overall investment. Value added of industrial production grew 5.6 percent from a year earlier in August, up from 4.8 percent in July and the fastest since last December.

CANADA: CPI inflation was a cool 0.1 percent in August in year-over-year terms, unchanged from July and a third consecutive positive reading. August's subdued inflation reading reflects continued lackluster demand for goods and services following the slow relaxation of shelter-in-place orders; inflation remains far below the Bank of Canada's 2.0 percent target, giving the central bank leeway to hold its benchmark interest rate near zero for a couple of years. The Bank of Canada's three preferred measures of core inflation continued to hold in a tight range in August, ranging from 1.5 percent to 1.9 percent and averaging 1.7 percent, below the bank's 2.0 percent target. The Teranet – National Bank National Composite House Price Index™ rose a slow 0.6 percent in August from the prior month, following a 0.3 percent rise in July; the index was led upward by Victoria (2.3 percent), Ottawa (2.2 percent) and Hamilton (1.6 percent). The index rose 5.7 percent from a year earlier, up from a 5.5 percent rise in the prior month. Existing home sales rose 6.2 percent in August on

a month-over-month basis, following a 26.0 percent rise in July; existing home sales have increased in every month following the record 56.8 percent plunge in April, but the pace of increase has slowed recently. Retail sales increased 0.6 percent in July, a third consecutive monthly increase, following a 22.7 percent increase in June.

JAPAN: As expected, the Bank of Japan held unchanged its negative policy interest rate at -0.1 percent at its September 17 rate decision, and also held unchanged its target for the ten-year government bond yield at around zero percent. The BoJ maintained other aspects of its quantitative and qualitative easing programs unchanged as well. Core CPI excluding food and energy slowed to -0.1 percent (deflation) in August from 0.4 percent in July as the government introduced financial incentives to spur spending on travel and reduce mobile phone fees, both of which lower measured inflation. This policy-driven dip in inflation will not prompt the BoJ to intensify monetary stimulus.

BRAZIL: As expected, the Central Bank of Brazil's Monetary Policy Committee unanimously voted to hold the Selic rate at the record-low 2.0 percent when central bankers met on September 15. Their monetary policy announcement stated that "economic conditions continue to recommend an unusually strong monetary stimulus but due to prudential and financial stability reasons, the remaining space for monetary policy stimulus, if it exists, should be small." The BCB raised its inflation forecast for 2020 to 2.1 percent from 1.9 at the previous meeting in August, consistent with the pickup in economic activity in recent months and also with pass-through of a weaker currency to higher prices of imported and globally-priced goods.

Recent economic data covering the retail, services and manufacturing sectors suggest that Brazil continues to recover as cities gradually reopen, but economic activity remains well below pre-pandemic levels. The IBC-BR Economic Activity Index, a monthly proxy of GDP, increased 2.2 percent in July from June following an upwardly-revised 5.3 percent increase the prior month. The IBC-BR fell 4.9 percent in the twelve months to July following an upwardly-revised 6.3 percent decrease in the prior month; both were much better than the record-low 14.3 percent annual plunge in April.

INDIA: CPI inflation was 6.7 percent in August in year-ago terms, overshooting the upper bound of the Reserve Bank of India's 2.0 to 6.0 percent target range; inflation has exceeded the upper bound for five consecutive months, leaving little room for central bankers to reduce interest rates to boost the pandemic-stricken economy. August's inflation reading was mainly driven by an 11.2 percent increase in prices of pan (a recreational substance), tobacco and intoxicants, and an 8.3 percent increase in food and beverage prices. Core inflation excluding food and energy was 5.4 percent in August, the highest in almost two years. Exports fell 12.7 percent to $22.7 billion in August from a year earlier, while imports dropped 26 percent to $29.5 billion, resulting in a trade gap of $6.8 billion. India's economy has shown signs of improvement following the relaxation of strict stay-at-home guidelines but a spike in cases (India has the world's second-highest number of cases) and a challenged banking sector are downside risks to its recovery.

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