GLOBAL ECONOMIC HIGHLIGHTS

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U.K. Re-Enters Partial Lockdown; Central Banks in Mexico and Brazil Are Wrapping Up Their Easing Cycles

UNITED KINGDOM: Prime Minister Boris Johnson on September 21 announced a partial lockdown of the U.K., ordering early closures of bars and restaurants, encouraging work-from-home, and limiting other group activities. The partial lockdown means that many workers in labor-intensive industries like retail, hospitality and accommodations will not be able return from furlough to full-time work near term, a major setback for the British recovery. Unlike in the United States, the nearly 12 percent of the U.K.'s labor force who are currently on furlough are not considered unemployed; this has prevented a sharp increase in measured unemployment and masked the extent of the U.K.'s economic shock. The U.K.'s employment in accommodation and food services was down nearly 5 percent in the second quarter from the first; by comparison, U.S. employment in those sectors was most recently down by 25 percent in August from the pre-crisis peak.

The British government is extending its furlough program since the partial lockdown will slow the handoff from public income support to private employment. The government announced September 24 that they will continue the furlough program for another six months after its scheduled end on October 31. But fewer workers will qualify in the extended program, called the Job Support Scheme, and the government will subsidize smaller shares of pre-crisis earnings than in the prior program. In the new program, employers must pay slightly more than half the regular wages of participating workers, who in turn will only work one third of their scheduled hours. As a result, workers in positions that are totally unable to return to work, like those working in stadiums, movie theaters, and other businesses made unviable by social distancing, will be ineligible and will become formally unemployed.

In more bad news, the U.K.'s recovery seems to have lost some steam in September. The Markit/CIPS services PMI pulled back to 55.1 in the September flash release from 58.8 in August and the manufacturing PMI to 54.3 from 55.2. The Confederation of British Industry's Orders Index likewise weakened to -48 in September from -44 in August although it was above its May trough of -62.

The headwinds from the partial lockdown and the year-end deadline for a Brexit trade agreement explain why the Bank of England is signaling that a rate cut to a negative Bank Rate is "in the tool bag," as Bank of England Governor Andrew Bailey said on September 22. Financial markets price in roughly fifty-fifty odds of a cut in the Bank Rate, currently 0.1 percent, to a negative level by August 2021.

MEXICO: The Central Bank of Brazil lowered its policy interbank target rate 0.25 percentage point to 4.25 percent at its September 24 monetary policy decision, but signaled that its rate cut cycle is near its end. The Monetary Policy Committee's statement emphasized the "narrow" space for the central bank to maneuver: The risk of further peso depreciation and higher import prices, and the "elevated persistence of core inflation," both pressure the Bank to abstain from further rate cuts.

Financial markets price in greater than fifty-fifty odds of another 0.25 percentage point rate cut over the next six months. But either way, Mexico's rate cut cycle is either nearly over or already over, after a 4.0 percentage point reduction in the policy rate over the last 13 months. Mexico's position in the monetary policy cycle mirrors that of Brazil and India, emerging market economies where inflation and the need to prop up exchange rates are preventing further interest rate cuts despite very high unemployment, which is set to persist for years.

BRAZIL: As in Mexico, the Central Bank of Brazil is signaling that interest rates are going on hold after cutting its Selic policy rate 4.5 percentage points between July 2019 and August 2020. The minutes of the Central Bank of Brazil's (BCB) September 15 Monetary Policy Committee meeting state that the benchmark Selic rate is close to its lower limit and further interest rate cuts will be dependent on the fiscal regime and inflation outlook (meaning, unlikely).

Central bankers also noted that a partial recovery is underway but sectors that are more directly affected by social distancing remain depressed. The central bank raised its 2020 real GDP forecast to -5.0 percent in its September *Inflation Report* from -6.4 percent in the June report, reflecting "more favorable prospects for [the third quarter of 2020], available domestic indicators, the most recent information on the pandemic, and the expected evolution of the international economy." The BCB expects real GDP growth of 3.9 percent in 2021 and stated that the continuation of the reform agenda remains essential for a sustainable economic recovery. After successfully passing and enacting a pension reform in late 2019, reforms of trade and tax policies and privatization of state-owned enterprises are next on the government's policy reform agenda.

Brazil's consumer price index the IPCA-15 increased for the third consecutive month in the twelve months to mid-September to 2.7 percent from 2.3 percent in August; the IPCA-15 remains below the central bank's 4.0 percent inflation target, but will likely rise toward the target in 2021.

UNITED STATES: Housing continues to lead the U.S. recovery. Existing home sales rose 2.4 percent in August to a 6.0 million unit annualized pace, and new home sales jumped 4.8 percent from an upwardly-revised July level; both indicators reached the strongest levels since 2006. The Mortgage Bankers Association purchase index rose to the strongest level since 2008 in the week of September 18.

Manufacturing is recovering too, but activity is still well below pre-downturn levels; the energy sector is a huge drag on industrial production. The Markit manufacturing PMI rose to 53.5 in the September flash estimate from 53.1 in August, and durable goods orders rose 0.4 percent in August but were still 5.2 percent below their level in February, before the downturn began. The Baker Hughes count of oil and gas drilling rigs operating in the United States was down 70 percent from a year earlier in the week of September 25.

The timeliest U.S. economic data suggest the recovery continues in September but at a slower pace than August. The Markit services PMI dipped to 54.6 in the September flash estimate from 55.0 in August. Initial claims for unemployment insurance rose nearly 4 percent the week ending September 19 to almost 825,000 before seasonal adjustment, and rose less than 1 percent after seasonal adjustment. Continued claims fell 1 percent before seasonal adjustment to 12.264 million in the week ended September 12, and fell 1.3 percent after seasonal adjustment. Claimants under all UI programs fell 12.5 percent before seasonal adjustment to over 26 million in the week ending September 5. The Federal Reserve Bank of New York's Weekly Economic Index fell 4.5 percent from a year earlier in the week of September 19, little improved from its 4.8 percent year-over-year decline in the week of August 29.

PNC forecasts for the Bureau of Labor Statistics' September Employment Situation Summary, to be released Friday October 2, to show a 1.05 million monthly increase in nonfarm payroll employment, with the unemployment rate edging down to 8.2 percent from 8.4 percent in August.

EUROZONE: Sentiment surveys for September are mixed in the Eurozone, reflecting the headwinds from renewed restrictions on activity imposed in August, which are similar to those imposed in the U.K. in September. The Markit services PMI fell to a contractionary 47.6 in the September flash estimate from 50.5 in August, while the manufacturing PMI rose to 56.8 from 55.6 and was the strongest in 31 months. Eurozone consumer confidence edged higher to -13.9 in September from -14.7 in August; it is still well below the -6.6 it registered in February, prior to the downturn.

CHINA: China's loan prime rates for 1-year and 5-year maturities were unchanged in September at 3.85 percent and 4.65 percent, respectively. The People's Bank of China has made little use of interest rates as a stimulus tool during this downturn, cutting its benchmark 7-day reverse repo rate only 0.2 percentage point in February and March; with China's recovery continuing to gain traction, further interest rate cuts look quite unlikely. Profits of industrial enterprises rose 19.1 percent from a year earlier in August, down slightly from 19.6 percent in July but still indicating that industry leads China's economic recovery.

JAPAN: No sign of a return to growth yet for the Japanese economy. The au Jibun manufacturing and services PMIs were little changed in the September flash estimates from August and point to continued moderate contractions underway in both sectors. The services PMI was 45.6 after 45.0 and the manufacturing PMI 45.2 after 45.8.