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# GLOBAL ECONOMIC HIGHLIGHTS

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## Fed on Hold in January as U.S. Muddles Through Early 2021's Economic Soft Patch; ECB Is Trying to Talk Down the Euro

**UNITED STATES:** The Federal Reserve held its monetary stance unchanged as expected at the January 27 Federal Open Market Committee (FOMC) decision. The federal funds target stays at a range of 0% to ¼% and quantitative easing (QE) continues at a rate of at least $120 billion per month in purchases of Treasury and agency bonds. The FOMC's statement reiterated the Fed's forward guidance: They will wait until the labor market reaches maximum employment and inflation "has risen to 2 percent and is on track to moderately exceed 2 percent for some time" before hiking. PNC forecasts for the Fed to not raise the fed funds rate until 2024. Regarding QE, the Fed will wait until "substantial" progress is made towards maximum employment and 2% inflation before slowing purchases; asset purchases will probably continue at the current rate throughout 2021. Inflation continued to undershoot the Fed's 2% goal in December as measured by the personal consumption expenditures price index, the average price of goods and services consumed by Americans. The PCE price index was up 1.3% from a year earlier, while core PCE prices excluding food and energy rose 1.5%.

The winter wave of the pandemic has made consumers more cautious and weakened the recovery. While personal income rose 0.6% in December, personal consumption expenditures fell 0.2%, a second consecutive monthly decline. From a year earlier, personal consumption expenditures were down 2.0% in December, worse than November's 1.6% drop. Real GDP grew 4.0% annualized in the fourth quarter of 2020 according to the first advance estimate, a little higher than PNC's 3.0% forecast, but will slow sharply in early 2021 as the pandemic weighs on high-contact sectors of the economy.

Weekly data and preliminary indicators for January are consistent with a soft patch. The Conference Board's Consumer Confidence Index rose to 89.3 in January, but the present situation sub-index—which is sensitive to job market conditions—dipped to the lowest since May. The Federal Reserve Bank of New York's Weekly Economic Index fell 2.3% from a year earlier in the week ended January 23, worse than the prior week's 1.7% drop. Initial claims for unemployment insurance improved modestly on the week in the week ended January 23, but were still very high: Initial claims fell a seasonally-adjusted 67,000 on the week to 847,000, and Pandemic Unemployment Assistance claims fell 20,000 to 427,000. In light of these data, PNC forecasts for the January jobs report to show a weak 50,000 increase in nonfarm payroll employment after December's 140,000 decline, with the unemployment rate edging up to 6.8% from 6.7% as more laid off workers search for jobs and are counted as officially unemployed.

**EUROZONE:** Recent monetary policy and political risk headlines have pushed the euro slightly lower against the dollar. Bloomberg's ECB correspondent reported that ECB policymakers say they are closer to making the negative policy rate even more negative than markets believe. The euro weakened only slightly on the headline, indicating financial markets are very skeptical that the ECB would follow through on cutting the deposit rate to weaken the exchange rate when they have refrained from cutting it to raise inflation expectations—financial markets currently price in inflation of just 1.0% over the next five years, far from the ECB's target of below-but-near 2%. PNC sees an ECB deposit rate cut as very unlikely in 2021. Separately, Italy's Prime Minister resigned January 26 after a partner to his ruling coalition withdrew support January 13. The Prime Minister will probably cobble together a new government, but Italy might be forced into early elections, which could conceivably bring a Euroskeptic government to power. The crisis is very sedate by recent American standards, but even so has caused the spread of Italian bond yields to widen 20 bps between early and mid-January.

**CHINA:** The CFLP manufacturing PMI pulled back to 51.3 in January from 51.9 in December and pointed to the slowest growth since August, while the Caixin manufacturing PMI dipped to 51.5 from 53.0. The new export orders component of the CFLP manufacturing PMI pulled back 1.1 points in January, a larger drop than the overall index; early 2021's global economic soft patch is a drag on Chinese manufacturers. The CFLP services PMI dipped to 52.4 in January from 55.7 in December and was the lowest since last March. The expectations component had the steepest drop among the CFLP nonmanufacturing PMI's components, falling 5.5 points on the month; re-imposed pandemic controls are slowing China's service sector.

**UNITED KINGDOM:** With vaccine distribution underway in the UK, the Bank of England will almost certainly hold its monetary policy steady at its next policy decision on February 4. Even so, the decision will be noteworthy for the release of the Bank's updated quarterly *Inflation Report*, which will assess how the Brexit trade deal affects Britain's potential growth. The BoE may also update guidance about negative rates; financial markets price in roughly two in five odds of a policy rate cut to negative territory by year-end 2021.

**CANADA:** Real GDP grew 0.7% in November from October, a seventh straight monthly gain, beating market expectations for growth of 0.4%. Output of goods-producing industries rose 1.2% while that of services-providing industries grew 0.5%. 15 out of 22 sectors expanded in November from October. Building permits fell 4.1% in December, slightly better than market expectations for a drop of 5.0%, following a downwardly revised 12.5% rise the prior month; building permits were up 1.7% from a year earlier in December, with 23.7% growth of residential permits offsetting a 28.1% drop in nonresidential permits.

With the exception of the residential sector, Canada's economic recovery appears to be weakening. A resurgence of coronavirus cases and a slow vaccine rollout will likely keep economic growth slow in the near term. 950,787 vaccine doses had been administered in Canada as of January 31, 2021 according to Bloomberg. Health Canada projects to have 3 million Canadians, 8% of those able to be vaccinated, vaccinated by the end of the first quarter of this year.

**MEXICO:** The flash estimate for real GDP in the fourth quarter of 2020 showed a 3.1% increase from the third quarter, un-annualized, following a 12.1% rebound in the third quarter and a 17.0% plunge in the second. From a year earlier, real GDP fell 4.5% in the fourth quarter after an 8.6% decline in the third. Mexican real GDP's most recent cyclical peak was in the first quarter of 2019, well before the pandemic struck. Mexico faces a long, slow, and uncertain road to recovery: Even after two large increases in the third and fourth quarters of 2020, real GDP is still 6.1% below its prior peak.

**BRAZIL:** 67,900 formal sector jobs were lost in December after five straight months of job gains according to the government's survey of employers; there were job losses in every sector except retail, which added 63,000 jobs in December. The household survey showed that Brazil's unemployment rate fell to 14.1% in the three months through November from 14.3% in the three months through October.

Consumer prices as measured by Brazil's IPCA-15 price index increased 0.8% in January from December; inflation was 4.3% in the twelve months to mid-January following a 4.2% rise the prior month. Core inflation by the Central Bank of Brazil's trimmed mean index was 2.7% in the twelve months to December.

The minutes from the Central Bank of Brazil's (BCB) January 19 meeting indicate that the BCB is likely to raise the policy rate this year. The BCB stated that "inflation projections are around the target" and "fiscal risks generate an upward bias in inflation projections, potentially justifying an increase in policy rates earlier than assumed in the baseline scenario." Financial markets are currently pricing 0.8% in hikes over the next three months, while The Central Bank of Brazil's weekly survey of professional forecasters has the BCB holding the Selic rate unchanged at the next meeting in March. The expiration of Bolsa Familia—the government's pandemic-related aid program—in December, resurgence of coronavirus cases and slow vaccine rollout will keep economic conditions soft in Brazil in the near term.

**JAPAN:** Japan's economy could be contracting in early 2021, but the data are less clear cut than other weak economies. The unemployment rate was unchanged on the month in December at 2.9%, and below its October peak at 3.1%. The jobs openings-to-applicants ratio held steady on the month at 1.06; it has improved slightly from its low in September but remains very depressed relative to its last cyclical peak in 2018 and 2019. The Jibun Bank manufacturing PMI for Japan was revised up to 49.8 in the January final release from 49.7 in the flash estimate, but was still down slightly from 50.0 in December.