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GLOBAL ECONOMIC HIGHLIGHTS

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Fed "Dot Plot" Pulls Forward Projection for First Rate Hike; Bank of Mexico Likely to Signal Rate Hike in 2nd Half of 2021

UNITED STATES: The most notable feature of the Federal Open Market Committee's June 16 meeting was the updated economic projections. They show members are pulling forward the time when they expect to begin raising the federal funds rate. The median FOMC member now sees two quarter-percentage-point rate hikes over the course of 2023 as the most appropriate course of policy; in March, the median member thought it was appropriate to wait until 2024 before beginning to raise rates. Chair Powell emphasized in the press conference following the decision that FOMC members' conviction about the appropriate path of policy so far in the future is low; even so, the revision demonstrates a marked shift in tone.

The June Summary of Economic Projections (SEP, a.k.a. dot plot) shows FOMC members expecting faster real GDP growth in 2021 than they did in March; the median forecast was for 7.0% growth in 2021, up from 6.5% in the March SEP. They also expect substantially faster inflation, with PCE inflation expected at 3.0% versus 2.2% in the March SEP. Accordingly, the June monetary policy statement was more upbeat than the prior statement in April. For the first time in more than one year, the FOMC dropped language on the "tremendous human and economic hardship" tied to the pandemic. Their statement discussed "progress on vaccinations" and said that "indicators of economic activity and employment have strengthened." As virtually assured, the FOMC held their policy stance unchanged, and signaled that they are "a ways off" from slowing bond purchases a.k.a. tapering quantitative easing. PNC expects the Fed to signal a plan for tapering in a few months. Most likely, the Fed will gradually reduce its asset purchases starting in early 2022, and end those purchases by the end of 2022. PNC expects this cycle's first increase in the fed funds rate to come in mid-2023, when the U.S. economy returns to full employment and inflation registers consistently above 2%.

Retail sales fell 1.3% in May from April, against expectations for a 0.4% decline. However, April sales growth was revised up from no change to a 0.9% increase, and March's was revised up to 11.3% from 10.7%. Much of the May decline was because of lower auto and parts sales, down 3.7%; retail sales excluding autos and parts fell 0.7%, while sales excluding autos and gasoline fell 0.8%. Control sales—sales excluding autos, gasoline, food service and building materials, and which go into consumer spending in GDP—fell 0.7% over the month. Food service (restaurant) sales rose 1.8% in May, after gains of 4.5% in April and 13.9% in March. Lean inventories and higher prices due to production disruptions weighed on sales of autos and parts as well as sales of electronics and appliances, which fell 3.4% in May. Americans also spent less on goods used around the home—sales of building materials fell 5.9% and sales of furniture and home furnishings fell 2.1%.

Industrial production rose 0.8% in May from April, against expectations for a 0.4% increase. Production growth in April was revised down to a 0.1% increase from the initially reported 0.7% gain. Manufacturing production was up 0.9% in May after dipping 0.1% in April. Mining output rose 1.2% in May, while utilities output was up 0.2%. Automotive production jumped 5.7% in May after a 4.1% decline in April. Shortages of parts, especially semiconductors, weighed on auto manufacturing in the spring, but May showed the first signs of improvement; it will take time, but eventually supply chains will normalize, and auto production and sales will be very strong in the second half of the year. Industrial production was 2% below its pre-pandemic level in May. The capacity utilization rate rose to 75.2% in May, up from 74.6% in April. The capacity utilization rate in manufacturing rose over the month to 75.6% from 74.9%. The capacity utilization rate in February 2020 was 76.3%, then plunged to 63.4% in April 2020 as the pandemic came to the United States.

The Producer Price Index for final demand increased 0.8% in May from April, after an unrevised 0.6% increase in April and a 1.0% increase in March. PPI final demand rose 6.6% from a year earlier in May, but like in the May CPI report, the year-ago PPI exaggerates recent inflation since prices fell outright in the first half of 2020. Relative to January 2020, PPI final demand was up 4.7% in May 2021. Consumer and business demand are racing ahead of businesses' ability to reopen, pushing up prices. The details of the May producer price report are similar to April's: Bottlenecks constricted the supply of autos and lumber, causing sharp increases in prices of related goods and services; food and energy prices jumped on the month too.

Housing starts rose 3.6% in May, but starts in April were revised down 3.3% and March's was revised down 0.5%. Building permits fell 3.0% in May; they are up 34.9% from a year earlier but down 10.7% from their 15-year high reached in January 2021. The NAHB Housing Market Index dipped to a 10-month low of 81 in June from 83 in May; it is down from a high of 90 reached last November but still well above its 67 average between 2017 and 2019.

PNC forecasts for the May existing home sales report, to be released June 23, to rise modestly to 5.86 million annualized units from 5.85 million in June; existing home sales will pick up later in 2021 as older homeowners finally list their homes after waiting out the pandemic before downsizing. The May personal income and expenditures report, to be released June 25, will likely show a 1.2% drop in personal income on fewer stimulus checks, and personal consumption expenditures down 0.3% after a 0.5% increase in April, echoing May's monthly drop in retail sales. The personal consumption expenditures deflator, the Fed's preferred measure of inflation, likely rose 0.5% in May and was up 3.9% on the year, with core PCE prices excluding food and energy up 0.5% on the month and 3.5% on the year.

MEXICO: The Bank of Mexico is likely to hold their policy interbank rate steady at 4.0% at their June 24 monetary policy committee decision, but signal that a rate hike is coming in the second half of the year. Higher oil prices are raising energy sector income, and the vaccination drives in the U.S. and Europe are boosting prospects for a revival of Mexican tourism. The peso depreciated sharply in the two days after the Fed's June decision; this will figure prominently in the Bank of Mexico's thinking. Financial markets price in no change in Mexico's policy rate at this June decision but more than 50-50 odds of a 0.25 percentage point rate hike by September. Mexican rate hike expectations have risen since the June 16 Fed decision: Markets price in a cumulative one and a half percentage points of hikes over the next 12 months, up from one and a quarter percentage points prior to the Fed meeting.

BRAZIL: Matching PNC's and the consensus forecast, the Central Bank of Brazil raised their policy Selic rate 0.75 percentage point to 4.25% when central bankers met on June 16. Following the decision, Brazil's policy rate is now higher than Mexico's. Brazil's economy is more closely tied to commodity prices than Mexico's, partly explaining why Brazil's central bank began raising rates before Mexico; the Central Bank of Brazil's June hike reinforces expectations for Mexico to begin to raise its policy rate in the second half of the year.

EUROZONE: Activity indicators confirm a solid albeit volatile recovery of the Eurozone's goods-producing sectors was already underway in the spring, consistent with recent months' PMI reports. Eurozone industrial production rose 0.8% in April, better than the 0.4% forecast; March's industrial production was revised up to show a 0.4% increase versus 0.1% previously. Industrial production excluding construction was 0.3% below its pre-crisis level in April, and down 4.7% from its peak in December 2017. Construction output fell 2.2% on the month in April after a 4.1% increase in March and was 3.1% below its pre-crisis peak of January 2020. Exports fell 2.3% in April from March, while imports rose 2.4%. EU-UK trade remains depressed relative to the pre-Brexit period: Exports to the UK fell 1.7% in April while imports from the UK rose 2.5%. In the first four months of 2021, exports to the UK were down 15.3% from a year earlier, while imports were down 30.3%.

CANADA: Canada's CPI index rose 0.4% in May from April on a seasonally-adjusted basis, and was up 3.6% from a year earlier, up from 3.4% in April; May's faster year-over-year inflation largely reflects the comparison against the spring of 2020, when Canadian consumer prices were falling. The CPI was up a more moderate 2.2% in May 2021 relative to February 2020. The Bank of Canada's three measures of core inflation all rose in May, with CPI-common up to 1.8% from 1.7%, CPI-median at 2.4% after 2.3%, and CPI-trim jumping to 2.7% from 2.3%; all are reported in year-over-year terms and so subject to the same base effect distortions as the total CPI. The same factors driving inflation higher in the United States—base effects, supply chain disruptions, higher commodity prices, and rapid shifts in consumer preferences—are pushing up inflation in Canada as well. The Bank of Canada, like the Federal Reserve, expects these inflationary pressures to be short lived, meaning that they will fade in the second half of the year.

CHINA: Monthly activity indicators for May met expectations for continued moderate growth, with the underlying trend obscured by base comparisons against the volatile spring of 2020. The most important signal from the May indicators is that the labor market continues to recover, and consumer spending is reviving, after both lagged manufacturing and exports as early drivers of China's recovery. The survey-based urban unemployment rate dipped to 5.0% in May from 5.1% in April reflecting the job market's usual seasonal tightening after the Lunar New Year holiday. Year-over-year growth of other key indicators slowed, reflecting shifting base comparisons; the base effects were so large that the year-ago comparisons say less about the current state of the economy than do comparisons against the same months of 2019. From two years earlier, most indicators grew faster in May than April. Industrial value added (like industrial production) rose 13.6% from two years earlier in May 2021 after a 14.1% increase in April; investment in fixed assets rose 8.1% in the first five months of 2021 from two years earlier versus a 7.6% increase in the first four months; and retail sales rose 9.3% in May from two years earlier after an 8.9% increase in April.

UNITED KINGDOM: Recent economic indicators confirm a rapid economic recovery led by the reopening service sector. Real GDP rose 2.3% in April from March after a 2.1% increase in March, with services activity up 3.4%, manufacturing down 0.3%, and construction down 2.0%. The Office of National Statistics' monthly modeled estimate of the unemployment rate (their survey reaches the entire country only on a three-month rolling basis) fell to 4.7% in April from 5.0% in March; employment rose by 0.2% or 55,000 on the month in April, while unemployment fell by 75,000 or 4.6%. The Bank of England is expected to hold its monetary policy stance unchanged at its June 24 Monetary Policy Committee decision.

JAPAN: As expected, the Bank of Japan held its monetary stance unchanged at their June 18 Policy Board decision. They continue to hold their negative policy rate at -0.1%; purchase ten-year government bonds to hold their yield around zero percent; and purchase enough exchange traded funds (ETFs) and Japanese real estate investment trusts (J-REITs) to maintain favorable financial conditions, at annual rates of up to ¥12 trillion for ETFs and ¥180 billion for J-REITs. In addition, the BoJ announced a funding facility that will provide financing "to address climate change issues"; the BoJ will provide details about the program at their July 16 decision and plans to launch it by the end of 2021. CPI deflation slowed in May, with the total CPI index down 0.1% from a year earlier, less than April's 0.4% decline in the same terms; core CPI excluding food and energy fell 0.2% on the year in May, unchanged from April; core CPI has been negative in those terms for six of the last 10 months.

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