July 26, 2021

GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher Chief Economist
Stuart Hoffman Senior Economic Advisor
William Adams Senior Economist
Abbey Omodunbi Senior Economist
Kurt Rankin Economist

ECB Strengthens Rate Guidance; U.S. Real GDP to Recover Above Pre-Crisis Peak in Second Quarter's Release

EUROZONE: As expected, the European Central Bank strengthened its forward guidance regarding interest rates at its July 22 Governing Council Decision. The decision was the first after their announcement of a more dovish monetary policy strategy on July 8. The Governing Council now "expects" to keep interest rates at current or lower levels until two criteria are met: First, their economists must forecast inflation reaching 2% "well ahead of the end of [the ECB's 2-3 year] projection horizon," and staying "durably" at or above 2% through the end of the projection. President Lagarde clarified in the post-decision press conference that "well ahead" means the midpoint of the projection. Second, core inflation should rise substantially from its current 1% level: They want to see "realized progress in underlying inflation… sufficiently advanced to be consistent with" 2% inflation over the medium term. Governing Council members no doubt disagree about how much core inflation must rise, but a good guess is that it would have to exceed 1.5% in year-ago terms for a quarter or two before a majority of Governing Council members would consider a rate hike.

The ECB did not change their quantitative easing programs or forward guidance about them. President Lagarde said the Governing Council did not even discuss them at the meeting. Did the debate over interest rate guidance take two whole days? At the next decision on September 9, the Governing Council will set the target for quantitative easing purchases to be made by their Pandemic Emergency Purchase Program (PEPP) in the fourth quarter and update forward guidance for the program. The ECB might start overweighting asset purchases toward more environmentally sustainable businesses in September; the new monetary policy strategy places a strong emphasis on addressing the impact of climate risk on the economy.

The ECB ramped up monthly PEPP purchases to €80 billion in the second quarter and third quarters of 2021 from a €62 billion monthly average in the first quarter in reaction to the Eurozone's double-dip downturn in the winter months. They will likely hold monthly purchases at €80 billion in the fourth quarter of 2021, with health experts wary about another winter wave of the pandemic. If the recovery stays on track, the ECB will likely taper PEPP in the first quarter of 2022, potentially making an offsetting increase in purchases under the pre-crisis Asset Purchase Programme (APP)—the APP has purchased €20 billion in public and private assets per month since November 2019. The ECB's monthly flow of QE purchases (PEPP and APP) will probably slow from €100 billion at the end of 2021 to €25-50 billion at the end of 2022. The ECB is expected to continue making medium-term loans to Eurozone commercial banks at negative interest rates, a.k.a. Targeted Longer-Term Refinancing Operations or TLTROs, for at least as long as the APP continues. There is no basis to expect an ECB interest rate hike before the end of 2023, and it is easy to imagine euro rates staying negative through the end of the decade.

The Markit manufacturing PMI for the Eurozone pulled back to 60.9 in the July flash estimate from 62.6 in June, but the services PMI rose to a fifteen-year high of 60.4 from 58.3 as pandemic restrictions loosened. Both manufacturers and service sector businesses reported widespread price increases and continued supplier delivery delays.

UNITED STATES: Initial claims for unemployment insurance rose to 419,000 the week of July 17 from 368,000 the prior week and were the highest since mid-May; Pandemic Unemployment Assistance (PUA) claims also rose on the week, to 110,000 from 96,000 (not seasonally adjusted). The four-week moving average of initial claims edged up on the week to 385,250 from 384,000. Continued claims under regular programs fell 29,000 to 3.236 million the week of July 10; with most people receiving benefits via pandemic-related programs, continued claims are a less informative indicator than pre-crisis. Continued beneficiaries of all programs fell more than a million to 12.574 million in the week ending July 3 from 13.837 a week earlier. The week's drop included more than 600,000 fewer beneficiaries in Texas as the state ended participation in the PUA and Pandemic Emergency Unemployment Compensation (PEUC) programs. Some other states are dropping out of these programs as well; they are scheduled to end nationally in September. The expectation is that this will spur more job-seeking among people losing benefits as demand for labor improves. Many employers have said that they would like to hire, but that the supply of workers has not kept up. On top of unemployment benefits, continued concern about the coronavirus and a lack of access to childcare are holding back labor supply.

The Markit manufacturing PMI for the United States rose to 63.1 in the July flash release, the highest since the survey began in 2007, from 62.1 in June, while the services PMI pulled back to 59.8 from 64.6. Both manufacturing and service-sector businesses reported widespread labor shortages and supply chain delays, which prevented an even faster recovery; through July, the survey's last three releases reported the most widespread price increases since data begin in 2009.

Housing data mostly firmed in June after pullbacks in the spring months. Existing home sales rose 1.4% to 5.86 million annualized units in June, the first increase in five months. The median sale price of an existing home rose 23.4% on the year to a new high of $363,000. Housing starts rose 6.3% in June, above consensus expectations for a 1.2% increase. Starts in May were revised 1.7% lower. Single-family starts rose 6.3% in June and multifamily (apartment and condo) starts rose 6.2%. Residential construction permits decreased 5.1%; May permits were revised up 0.1%. Single-family permits fell 6.3% and multi-family permits fell 2.6%. Housing completions were down 1.4% in June.

Homebuilder confidence as measured by the NAHB Housing Market Index is at an eleven-month low but has been well above the 50-point threshold since July last year. Despite the big runup in house prices, housing fundamentals are still good. Mortgage rates are low, consumer balance sheets are solid, the job market is improving, and there's a growing demographic of potential home buyers. There are negatives for the sector—rising homebuilding and labor costs are near-term constraints and higher prices have taken the edge off consumer demand. Even so, the housing sector will remain very strong in the back half of 2021.

The Federal Open Market Committee is likely to acknowledge continued progress toward recovery at the conclusion of their July 27 and 28 meeting, and begin to provide information about when and how they will taper their quantitative easing program, but no change in policy is expected. PNC forecasts for the advance report of real GDP for the second quarter to show an 8.0% annualized increase from the first quarter; in the second quarter, real GDP surpassed the pre-crisis peak of the fourth quarter of 2019. Real GDP has recovered faster than employment, which was still 4.4% below the precrisis level at the quarter's close.

CANADA: Retail sales fell for a second straight month in May as restrictions were imposed in many parts of the country. Retail sales dropped 2.1% from April, slightly better than consensus expectations for a 3.0% drop, and following an upwardly revised 5.6% fall in April. Preliminary estimates from Statistics Canada show that retail sales rebounded 4.4% in June as restrictions were lifted in many provinces. The largest decline in retail sales in May occurred at building material and garden equipment and supplies dealers, down 11.3%. Household spending will shift toward services and away from durable goods as vaccination rates increase and consumers feel more comfortable going out.

UNITED KINGDOM: The Markit manufacturing PMI for the UK pulled back to 60.4 in the July flash release from 63.9 in June, with businesses citing supply chain disruptions and labor shortages as constraints on output. The services PMI fell to 57.8 from 62.4. Price increases for manufacturers' sales prices were the most widespread since 1998, while service sector businesses reported the most widespread increases in input costs since 1996.

BRAZIL: Inflation slowed in July but was still the highest for the month in 17 years. The IPCA-15 index increased 0.7% from mid-June to mid-July (not seasonally adjusted), in line with consensus expectations, following a 0.8% reading in the prior month. Prices accelerated 8.6% in the twelve months to mid-July.

Inflation has overshot the central bank's 5.25% upper threshold in every month since March. In response central bankers have indicated that "a quicker adjustment in the current pace of stimulus reduction may be required" at the June meeting. The Selic rate was raised 0.75 percentage point to 4.25% at the June meeting, just below the pre-pandemic level of 4.5%. The health crisis remains a headwind to Brazil's economic outlook. The vaccination rollout has been slow with only 18% of the population fully vaccinated as of July 24.

JAPAN: Of no surprise to anyone who has been following the Olympics, the latest PMI surveys confirm that the restrictions forced by the delta variant continue to drag on the recovery in July. The au Jibun Bank manufacturing PMI for Japan dipped to 52.2 in the July flash release from 52.4 in June, while the services PMI fell to 46.4 from 48.0.