September 13, 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 Tapers On An "Increasingly Advanced" Economic Rebound, But Its QE Program Will Outlast The Fed's

EUROZONE: The Governing Council of the European Central Bank (ECB) announced a taper of its quantitative easing program at its September 9 decision. Net purchases under the Pandemic Emergency Purchase Programme (PEPP) will slow in the fourth quarter of 2021 to a "moderately lower pace" than in the second and third quarters. Like previous PEPP announcements, the ECB did not set a quantitative target for purchases. Monthly PEPP purchases averaged about €60 billion in the first quarter of 2021 and rose to about €80 bn in the second and third quarters, so "moderately lower" than that could mean €65bn to €70bn. A vague target leaves the ECB wiggle room to raise the pace if financial conditions worsen, or lower it if inflation accelerates.

The ECB's policy stance is otherwise unchanged. They continue to target €20bn in monthly purchases under their pre-crisis Asset Purchase Programme (APP); hold the negative benchmark policy deposit rate at -0.5%; and will make quarterly medium-term loans at negative interest rates to Eurozone commercial banks under their longer-term refinancing operation facility through year-end (LTROs).

The ECB justifies the taper by citing modest upward revisions to their forecasts for growth and inflation, reduced coronavirus restrictions, and benign financial conditions in euro capital markets. They see risks to the outlook as "balanced," with upside from the possibility of a faster resolution of the pandemic, consumers spending down crisis-era savings faster than expected, or temporary inflation pressures lasting longer than expected. To the downside, they recognize the risk from Delta, as well as supply bottlenecks that could impede the recovery. The ECB forecasts for real GDP to recover its pre-crisis level by the end of 2021—but this depends on whether high-contact service industries can stay open. If Covid cases rise again as weather turns colder, Eurozone governments may have to reinstate restrictions. So the health situation will set the pace that the ECB tapers PEPP in 2022 or potentially reduces the availability of LTROs.

The ECB is tapering the PEPP separately from the APP; PEPP is a reaction to the crisis, while the APP was launched before the pandemic in reaction to core inflation undershooting the ECB target since 2013. With inflation rising in 2021 due to higher energy prices but expected to slow into 2023, the ECB is on course to continue APP purchases at least through the end of 2022, and most likely for years beyond. That means the Fed is on course to normalize monetary policy more than the ECB in 2022 and 2023. PNC forecasts for the euro to be modestly weaker over that time horizon, with price targets of $1.17 for year-end 2022 And $1.16 for year-end 2023.

UNITED STATES: The Federal Reserve's survey of U.S. business conditions a.k.a. the Beige Book reported that economic growth "downshifted" somewhat but remained "moderate" in the period from early July through August. The Beige Book's themes were familiar to readers of U.S. business surveys: Weaker activity in high-contact industries; difficulties from supply chain and labor shortages; "brisk" wage gains for low-wage workers; and elevated inflation. Inflation as measured by the producer price index (PPI) stayed historically high in August, though core PPI is already starting to slow. The PPI for final demand rose 0.7% in August after increases of 1.0% in June and July. Final demand energy prices rose 0.4%; final demand foods rose 2.9% after falling 2.1% in July; final demand transportation and warehousing rose 2.8%, and final demand trade services rose 1.5%. PPI final demand less foods, energy, and trade slowed to 0.3% in August and was the lowest since November 2020. August saw notable price increases in margins for health, beauty, and optical goods retailing; meat prices; and passenger transportation. In year-over-year terms, PPI final demand rose 8.3% in August, up from 7.8% in July and marking another record increase since comparable data became available in 2010. An older aggregate of producer prices, the PPI for all commodities index, rose 19.9% on the year in August, up from 19.8% in July and the fastest increase since 1974.

Initial claims for unemployment insurance fell 35,000 on the week to 310,000 in the week ended September 4. This was the lowest level of initial claims since March 2020. 11.930 million people received some form of unemployment insurance benefit in the week ending August 21, down from 12.186 million the previous week (not seasonally adjusted). Most of those were beneficiaries of special pandemic-related programs. Total beneficiaries rose from about 2 million in early 2020 to a peak of 33.2 million in June 2020 and have been around 12 million since mid-July. The biggest question is what happens to the labor market, and consumer spending, after pandemic-related unemployment insurance programs expired on September 6. These programs made benefits available for a longer period of time than usual; increased eligibility by providing benefits to the self-employed, gig workers, and independent contractors; and increased the level of benefits. Many states have been ending their programs over the past few months, with little apparent impact on job-seeking behavior or consumer spending so far.

The August consumer price index (CPI) report, to be released September 14, will likely show total CPI up 0.4% on the month and "core" CPI excluding food and energy up 0.3%. The August industrial production report to be released September 15 will likely show a 0.5% monthly increase, while the retail sales report out September 16 is forecast to show a 0.5% decline in total sales with retail sales excluding autos up 0.5% (auto sales fell on the month due to continued supply chain problems).

CANADA: As expected, the Bank of Canada held the policy interest rate steady at a quarter percent when central bankers met September 8. The Bank also maintained the target pace of the quantitative easing (QE) program at C$2 billion per week in government bond purchases. In the accompanying statement, the Bank acknowledged weaker than forecasted second quarter GDP data but remained cautiously optimistic about a strong recovery in the second half of the year. The Bank stated that factors pushing up inflation "are expected to be transitory, but their persistence and magnitude are uncertain." In a speech the day after the decision, Governor Tiff Macklem stated that the Bank of Canada will increase the policy interest rate before it winds down the quantitative easing program. This means that the Bank will first cease making new net purchases but continue to reinvest maturing securities for a period of time to keep the size of their holdings stable. During this period, they will start increasing the policy interest rate. Later, as the economic recovery matures, they will eventually start reducing bond holdings.

90,200 jobs were added in August, a 0.5% increase, above consensus expectations of 68,200, according to Statistics Canada's Labour Force Survey. The same percentage increase in U.S. payroll employment would create around 735,000 jobs. Canada's services-providing sector added almost 93,000 jobs while the goods-producing sector lost 2,600 jobs. The unemployment rate fell to 7.1% in August from 7.5% in July; it was below 6% before the pandemic. The capacity utilization rate increased for the fourth straight quarter to 82% in the second quarter from a downwardly revised 81.4% in the first.

CHINA: China's CPI rose 0.8% from a year earlier in August, down from a 1.0% increase in July; core CPI excluding food and energy also slowed on the month in those terms, to 1.2% from 1.3%. China's PPI rose to 9.5% from 9.0% and was the highest since 2008. Growth of aggregate financing to the real economy slowed to 10.3% in year-over-year terms in August from 10.7% in July and 11.0% in May and June and was the slowest since late 2018. Growth of the broad money supply M2 slowed to 8.2% in the same terms from 8.3% in July; M2 grew 8.1% in 2018 and 8.7% in 2019. Monthly activity indicators for August, to be released the night of September 14 in U.S. time zones, will likely show a slowdown in retail sales and investment in fixed assets due to tighter restrictions on activity in the month.

BRAZIL: Consumer prices as measured by the IPCA index increased 0.9% in August from the prior month, above the consensus forecast of 0.7%, and following a 1.0% reading in July. Consumer prices were up 9.7% in August from twelve months earlier, the highest increase since 2016. High year-over-year inflation was primarily driven by surges in transportation (16.6%) and housing costs (11.6%). IPCA inflation has overshot the 5.25% upper limit of the central bank's target for six straight months.

Despite a 3.25% increase in the Selic rate from March to August of this year, inflation remains red hot. With the inflation outlook worsening, PNC expects the Central Bank of Brazil to raise the Selic rate again by 1% at the next scheduled decision on September 22. Retail sales rose 1.2% in July, the fourth straight increase, following an upwardly-revised 0.9% increase in June.

INDIA: Industrial production jumped 11.5% in July from a year earlier, above the consensus forecast of 10.1%, and following a 13.6% increase in June; industrial production rose in four out of five production categories in the month.

UNITED KINGDOM: A hike in the Bank Rate to 0.25% is increasingly likely by the Monetary Policy Committee's December 16 meeting. The minutes of the Bank of England's (BoE) August 4 Monetary Policy Committee decision said that "some" MPC members thought the conditions for an initial rate hike were fully met at the time of the meeting; their forward guidance requires "Significant progress" toward eliminating spare capacity and sustainable 2% inflation before hiking rates. On September 8, BoE Governor Bailey clarified in testimony to Parliament that the August vote was a 4-4 split. The timing is awkward, since the BoE's £150 billion pound sterling budget for gilt purchases set in January 2021 will not be finished until mid-December. It would create some cognitive dissonance if the BoE were to say that the conditions for a rate hike are met at one of the next two meetings (September 23 and November 4), but does not hike.

Monthly GDP growth slowed to 0.1% in July from 1.0% in June. Services output was flat on the month after a 1.5% increase in June; industrial production rose 1.2% after falling 0.7% in June; and construction output fell 1.6% after a 1.3% decline in June. July's unchanged level of services activity reflects a 9.0% jump in activity in arts, entertainment, and recreation, offset by a 2.5% drop in retail sales. Monthly real GDP in July was 2.1% below its February 2020 level.