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GLOBAL ECONOMIC HIGHLIGHTS

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U.S. GDP Disappointed on Supply Chain Woes, But Job Growth Is Picking Up; FOMC Expected to Start Taper; ECB on Hold

UNITED STATES: Real GDP growth slowed to a seasonally-adjusted annualized 2.0% in the third quarter of 2021 from 6.7% in the second quarter, undershooting the 2.8% consensus forecast. Supply chain turmoil was a huge drag on GDP in the third quarter. Consumers' spending on motor vehicles and parts plunged due to shortages of new vehicles, subtracting 2.4 percentage points from annualized growth in the quarter; and shortages of building materials and construction workers led to lower residential fixed investment despite buoyant housing demand, subtracting another 0.4 percentage point. Net exports were also a big drag: Higher imports of services (Americans vacationing overseas) subtracted 0.9 percentage point from real GDP, and lower exports of goods subtracted 0.4 percentage point. Growth of personal consumption expenditures of services slowed in the third quarter to a 7.9% annualized rate from 11.5% in the second quarter as the Delta variant made people warier about venturing out; its contribution to annualized real GDP growth was 1.7 percentage points less than in the second quarter.

The jobs recovery accelerated in October, though the end of enhanced unemployment benefits clouds the data somewhat. Initial claims for state unemployment insurance programs fell 10,000 in the week ending October 23 to a seasonally-adjusted 281,000 and marked a new recovery-to-date low. Initial claims for state programs are unaffected by the end of enhanced UI programs; layoffs are falling as the labor market continues to tighten. Continued claims under regular state programs a.k.a. insured unemployment fell a seasonally-adjusted 237,000 to 2.243 million in the week ending October 16; the decline suggests faster hiring in October after a weak 194,000 nonfarm payroll jobs added in September. Consumers' assessment of the job market in The Conference Board's Consumer Confidence Index® strengthened to the best since the year 2000 in the October release. The November 5 release of the October jobs report will likely show payroll job growth of two to three times September's disappointing 194,000, and the unemployment rate edging up to 4.9% from 4.8% as the strong job market attracts more jobseekers into the labor force.

The Federal Open Market Committee (FOMC) will most likely announce a reduction in asset purchases in its next scheduled monetary policy statement November 3, with the actual reduction in asset purchases to start a few weeks after that. According to the minutes from the FOMC's meeting on September 21 and 22, the central bank is ready to reduce its purchases of long-term Treasury and mortgage-backed securities "soon." The minutes indicate that the central bank will initially reduce its purchases of long term Treasurys from $80 billion per month to $70 billion, and its purchases of mortgage-backed securities from $40 billion per month to $35 billion. At that pace of tapering per month, the FOMC will end their asset purchases (QE) by mid-year 2022. At that point the Fed would roll over maturing securities, but not undertake new asset purchases, keeping the central bank's balance sheet roughly steady. The decision to reduce asset purchases is based on FOMC members' view that the economy is making "substantial further progress" toward their goals of full employment and average long-run inflation of 2 percent.

PNC has changed its forecast for the federal funds rate. In our October 2021 baseline forecast, we now expect the FOMC will first increase their fed funds rate target range by 0.25 percentage point in December 2022; This compares to June 2023 in the PNC September 2021 baseline forecast. Currently the fed funds rate is in a target range of 0.00% to 0.25%. PNC's October baseline forecast is for the FOMC's fed funds rate target range to end 2022 at 0.25% to 0.50%, and end 2023 at 1.00% to 1.25%.

EUROZONE: As virtually assured, the European Central Bank delivered no surprises at its October 28 Governing Council decision: They stuck with their September commitment to a "moderately lower" pace of asset purchases under the Pandemic Emergency Purchase Program (PEPP) in the fourth quarter of 2021 than in the second or third quarters of the year, and held their two other key policy tools unchanged—the negative policy rate is -0.5%, and unlimited negative rate loans will be available to Eurozone commercial banks through at least the end of 2021.

Of more note, President Lagarde stated directly that she expects PEPP to end in March 2022; previously the Governing Council's commitment had been for the program to continue at least until March and also until "the COVID-19 crisis phase" ends. Lagarde noted that the pandemic's drag on the Eurozone economy is fading as vaccination rates rise.

However, President Lagarde pushed back against expectations for the ECB to raise interest rates in 2022; this is in reaction to financial markets pricing in one to two 0.1 percentage point hikes in the deposit rate over the next 12 months. The ECB continues to expect inflation to slow in 2022 as one-off shocks from supply chain disruptions and higher energy prices fade. Their guidance commits to waiting to raise interest rates until they forecast headline inflation to reach 2% "well ahead of the end of the projection horizon," meaning no later than the second year of their three-year forecast window, and to stay at least at two percent through the end of the forecast. The ECB bases their energy price assumptions in their forecasts on commodity futures prices. Energy plays a big role in the course of overall inflation, and the futures curve prices in a 10% drop in Brent crude between December 2022 and December 2023, so it would be hard for the ECB to forecast inflation staying above 2% over a three-year forecast horizon.

President Lagarde said the Governing Council has not yet discussed plans for asset purchases once PEPP ends, but will discuss them at their December meeting. They are currently purchasing about €80 billion per month, with €60 billion through PEPP and €20 billion through the open-ended Asset Purchase Programme a.k.a. APP. PNC forecasts for asset purchases to continue in 2022, beyond the conclusion of the PEPP in March, and to slow to a €25-50 billion monthly rate by the end of 2022.

Real GDP increased 2.2% in quarterly seasonally-adjusted terms (not annualized) in the third quarter of 2021 by Eurostat's advance estimate, leaving the level of output 0.5 percentage points below the pre-crisis level of the fourth quarter of 2019. Inflation by the benchmark HICP index accelerated to 4.1% in the flash estimate for October, up from 3.4% in September and the fastest since 2008; energy prices rose 23.5% on the year in October, up from 17.6% in September. HICP excluding energy, food, alcohol, and tobacco rose to 2.1% in the October flash estimate from 1.9% in September.

UNITED KINGDOM: The Bank of England's November 4 decision is a tough call. The Bank will probably use it to tee up a hike at the December 16 decision that would raise the Bank Rate to 0.5% from the current 0.1%, but an immediate hike would not be a surprise after many recent warnings from BoE policymakers that they need to react to rising inflation. Natural gas futures for delivery to the UK in January 2022 surged to £304 pound sterling per thousand therms per day on October 5, then fell to about £171 by the end of October, but were still double the June 2021 level. Natural gas prices are surging because of the V-shaped recovery of energy demand; expectations for an especially cold winter; Russia throttling back on natural gas delivery; and European utilities that decommissioned fossil fuel capacity faster than they brought renewable substitutes online. Gas futures fell by about a quarter on October 28 and 29 after Vladimir Putin ordered Russia's natural gas company to increase shipments. Surging natural gas prices come hot on the heels of a gasoline shortage in late September and the first half of October, which was caused by a shortage of truckers to supply British gas stations (blue collar labor shortages are even more severe than in the U.S. because many blue collar immigrants from the rest of the EU went home during the lockdowns and have not returned. Energy price shocks will weigh on consumer spending in the winter months, putting the UK at risk of a triple-dip downturn (real GDP contracted in the fourth quarter of 2020 and first quarter of 2021).

CHINA: China's economy may have weakened further in October. The government-produced CFLP manufacturing PMI fell to 49.2 in October from 49.6 in September; after the 35.7 of the February 2020 lockdown, October was the weakest month since February 2019. The nonmanufacturing PMI pulled back to

52.4 from 53.2 but was above its August low of 47.5. The privately-compiled Caixin general manufacturing PMI for China rose to 50.6 from 50.0.

MEXICO: Real GDP fell 0.2% in seasonally-adjusted quarterly terms (not annualized) in the third quarter of 2021 after a 1.5% quarterly increase in the second quarter. Activity in the agriculture and industrial sectors rose 0.7%, offset by a 0.6% decline in the service sector. In year-over-year terms, real GDP growth slowed to 4.6% in the third quarter from 19.6% in the second (though some of the apparent slowdown is due to the comparison against the rapid recovery in the third quarter of 2020).

JAPAN: The ruling Liberal Democratic Party lost seats in the October 31 elections for the lower house of parliament but held its majority. The majority should provide Prime Minister Fumio Kishida with leeway to enact his economic policies focused on redistributing wealth in Japan; Kishida wants to raise high-income Japanese taxpayers' rates on capital income to match the much higher rates on earned income.

As expected, the Bank of Japan's Policy Board held its monetary stance unchanged at its October decision, the night of October 27 in U.S. time zones: The short-term negative policy rate is -0.1%; the Bank will conduct open-ended government bond purchases targeting a 10-year bond yield of around zero; and will buy ETFs and J-REITs at annual rates of up to ¥12 trillion and ¥180 billion yen, respectively. The BoJ downgraded its forecasts for real GDP growth in the 2021 and 2022 fiscal years; lowered the forecast for CPI inflation in the 2021 fiscal year; and otherwise held its forecasts unchanged. Inflation is forecast at a range of 0.0 to 0.2% in fiscal year 2021, rising to around 1% by fiscal year 2023.

CANADA: The Bank of Canada (BOC) announced the end of its quantitative easing program and the start of its reinvestment phase when central bankers met on October 27. The BOC also revised their forward guidance and pulled forward when they expect to start raising the policy rate, saying a complete recovery could be achieved "sometime in the middle quarters of 2022." Policymakers noted that supply-side constraints are limiting the economy's productive capacity but the "impact and persistence of these supply factors are hard to quantify." The BOC expects CPI inflation to be elevated into next year and ease back to around the 2% target by late 2022. The BOC also noted that housing activity is expected to remain elevated.

Canada's economy grew 0.4% in August, weaker than Statistics Canada's initial estimate of 0.7%. Accommodation and food services, retail trade and transportation led the way as further reopening increased activity in services-providing sectors. Goods-producing sectors shrunk 0.1% while services-providing sectors grew 0.6%. Goods-producing sectors have declined in four of the last five months as supply-chain restrictions and high input costs continue to weigh on businesses. Preliminary estimates from Statistics Canada showed that real GDP was unchanged in September.

BRAZIL: The Central Bank of Brazil (BCB) announced its biggest interest rate hike in almost two decades at the October 27 monetary policy decision, increasing the Selic rate by 1.5 percentage points to 7.75%. This was the sixth consecutive hike and brings the Selic rate to the highest level since October 2017. Policymakers noted that the "recent questioning regarding the fiscal framework increased the risk of de-anchoring inflation expectations." The BCB also noted that domestic economic data released after the last meeting has been worse than expected and signaled a hike of the same magnitude at the next meeting on December 8. The BCB had increased the Selic rate by 1.0% at the last two meetings. Larger rate hikes are a response to high and sticky inflation, the government's proposed breach of its spending cap rule, and a worsening inflation outlook. The IPCA-15 mid-month read of inflation rose 1.2% from mid-September to mid-October, the biggest monthly increase since February 2016, following a 1.1% increase the prior month. Annual IPCA-15 inflation accelerated to 10.3%, the highest reading since February 2016.

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