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GLOBAL ECONOMIC HIGHLIGHTS

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Major Central Banks Maintain Hawkish Stance but BOJ Remains Dovish Outlier

UNITED STATES: The Federal Open Market Committee (FOMC) raised the federal funds rate by 75 basis points, to a range of 1.50% to 1.75% at its meeting on June 15. This was the biggest increase since 1994. The FOMC had been telegraphing a 50 basis points increase in the fed funds rate until a few days ago, when news reports started to indicate that a 75-basis-point increase was likely. The FOMC is attempting to slow economic growth after inflation has moved well above the FOMC's 2% objective. In his post-meeting press conference, Fed Chair Powell said that the FOMC would "like to see demand moderate..[with a] better balance between supply and demand" in the labor market.

The meeting also included the release of the Summary of Economic Projections (SEP), or "dot plot." GDP growth expectations have fallen compared to the previous release, in March. The median growth forecast for this year (Q4 to Q4) is now 1.7%, down from 2.8% in March, and for 2023 expected growth is now 1.7%, down from 2.2% in March. There was a correspondingly upward revision to the unemployment rate, to 3.7% at the end of this year, up from 3.5% in March. The median unemployment rate forecast for the fourth quarter of 2023 is now 3.9%, up from 3.5% in March.

The near-term outlook for inflation has moved higher, especially as measured by the overall personal consumption expenditures (PCE) price index. The SEP has the overall PCE price index up 5.2% in the fourth quarter of this year from one year earlier, compared to 4.3% in March. But inflation is expected to slow to 2.6% by the end of 2023. Inflation as measured by the core PCE price index, excluding food and energy prices, is expected to be 4.3% at the end of this year (up from 4.1% in the March projections) and 2.7% in 2023 (up from 2.6%).

The outlook for the fed funds rate has moved much higher for 2022 compared to March. The median forecast is that the fed funds rate will be 3.4% at the end of this year; that is up from 1.9% in March. This means that the fed funds rate would increase by 1.75 percentage points for the rest of 2022. Considering the new "dot plot," PNC has updated its fed funds rate forecast; the rate is now expected to end this year in a range between 3.25% and 3.5%, up from between 2.50% and 2.75% in the May forecast. The fed funds rate is now expected to peak between 3.50% and 3.75% in mid-2023; in May, the peak range was 3.25% to 3.5%. PNC has the fed funds rate over the long run between 2.50% and 2.75%.

Retail sales disappointed in May, falling 0.3% from April against the consensus forecast for a small 0.1% increase. This was the first decline in retail sales in five months. The decline in May was driven by big swings in key components. Sales excluding autos and parts were up 0.5% over the month, while sales excluding autos and gasoline were up 0.1%. Control sales-retail sales excluding food services, autos, gasoline, and building materials, and which go into consumer goods spending in GDP- fell 0.1% in May from April.

The consumer spending outlook through the rest of the year is mixed. Households saved an additional $2 trillion during the pandemic, and they will continue to spend down some of the extra savings through the year. Solid wage growth and an excessively tight labor market are also positives for consumers. Notwithstanding, the negatives are building: inflation, higher interest rates, a declining stock market, and slower house price growth are downside risks to consumer spending growth.

Housing continued to show signs of softer activity. Housing starts and permits declined in May. Starts fell 14.4% in May from April, the biggest drop since April 2020. Permits were down 7.0% in May from April, the biggest drop since September 2021. The number of homes under construction rose in May to the highest level on record. The National Association of Homebuilders (NAHB) index fell in June to 67, a two-year low, from 69 in May. With mortgage rates rising, lower consumer sentiment, and a declining stock market, housing demand will slow further this year. Supply-side challenges remain but should improve through the year. As demand cools and supply improves, house price growth in the U.S. will slow to a low double-digit rate this year.

UNITED KINGDOM: As expected, the Bank of England's Monetary Policy Committee (MPC) voted by a majority of 6-3 to raise the Bank Rate by 25 basis points to 1.25% at the June 16 meeting. In the minutes, the MPC members noted that most of the current inflation is driven by energy and core goods. Annual CPI inflation in May rose to a new forty-year high of 9.1% and inflation has accelerated for eight straight months. The near-term inflation outlook is worse and recession risks are elevated. The MPC forecasts inflation to hit 11% by October. PNC expects the MPC to raise the Bank Rate by 50 basis points at its next meeting on August 4. With the U.K. economy in a more vulnerable position than the U.S., the MPC faces a very difficult tradeoff between inflation and growth. With the Ukraine invasion set to drag into the second half of the year, Brexit-related labor supply issues, and global supply-chain issues, the risk of a recession in 2022 or 2023 is around 50%.

Economic conditions have softened in recent months as inflation and rising interest rates continue to take a toll. Monthly GDP fell 0.3% in April from March, following a 0.1% decline in March. Production declined 0.6%, construction fell 0.3% while service sector output fell 0.3%. A 5.6% decline in health and social output drove the GDP contraction in April as the government wound down its Test & Trace scheme.

CANADA: Inflation surprised to the upside in May as the consumer price index (CPI) rose 7.7% from a year ago, worse than the consensus expectation for a 7.3% increase. This followed a 6.8% reading in April. CPI inflation has accelerated for six straight months and May's reading marked the fastest pace since 1983. Inflation has exceeded the central bank's 1%-to-3% target range in every month since April 2021. The Bank of Canada's three measures of core inflation, CPI-common, CPI-median, and CPI-trim, were 3.9%, 4.9% and 5.4% in May. With a tight labor market, escalating inflationary pressures, and excessive domestic demand, the Bank of Canada (BOC) will likely raise its policy rate by 75 basis points, from 1.5% to 2.25%, when policy makers meet on July 13.

EUROZONE: Consumer and business surveys showed softer activity in the euro area. The flash estimate for the euro area's consumer confidence indicator fell to -23.6 in June from -21.1 in May, according to the European Commission. The June reading is near the record low reached in April 2020 after the pandemic started. The preliminary estimate of the S&P Global eurozone composite PMI fell to 51.9 in June, the lowest level since February 2021, from 54.8 in May. The flash manufacturing PMI fell to a near two-year low of 52.0 in June from 56.1 in May while the flash services PMI fell to five-month low of 52.8 from 56.1. Readings above 50 indicate growth while readings below 50 suggest contraction. The details of the report showed an improvement in supply-chain issues as average supplier delivery times increased by the least extent since December 2020.

Annual eurozone CPI inflation increased to a new record-high of 8.1% in May from 7.4% in April, according to the European Statistical Office. Inflation has worsened in recent months due to the impact of the Ukraine invasion on food and energy prices. Annual core inflation (excluding energy, food, alcohol, and tobacco) rose for the fourth straight month, rising to 3.8% in May from 3.5% in April.

With inflation pressures building, the European Central Bank (ECB) announced a faster completion of its Asset Purchase Programme (APP), now set to end on July 1. Additionally, the ECB will raise its deposit rate by 25 basis points in July and likely by 50 basis points in September. To contain the recent surge in bond yields in the eurozone, the ECB announced a plan on June 15 to create a tool to reduce the risk of fragmentation.

JAPAN: The Bank of Japan (BOJ) maintained its ultra-dovish policy when central bankers met on June 16. The BOJ held its short-term policy rate at -0.1%, maintained its yield curve control policy (leaving the cap of 10-year Japanese Government Bonds at 0.25%) and continued its quantitative easing program. Japan's ultra-dovish policy is in contrast with the hawkish stance taken by global central banks in recent weeks. With inflation above the BOJ's target and severe yen weakness, the BOJ is under pressure to remove policy accommodation. Annual inflation as measured by the consumer price index was 2.5% in May, unchanged from April. Annual core inflation (excluding fresh food) held at 2.1% in May.

Manufacturing activity in Japan expanded at a slower pace as the flash Jibun Bank manufacturing PMI fell slightly to 52.7 in June from 53.3 in May, while the flash services PMI rose to 54.2 from 52.6.

BRAZIL: As expected, the Central Bank of Brazil (BCB) raised the Selic rate by 50 basis points, from 12.75% to 13.25%, when policy makers met on June 15. In the accompanying statement, the BCB signaled another increase of 50 basis points or less at its next meeting on August 3. Inflation has been in double digits in every month since September 2021 mainly driven by higher global commodity costs and supply-chain disruptions. The BCB has raised the Selic rate by 11.25 percentage points in over a year and will likely continue to raise interest rates well into 2023 to get inflation under the BCB's 4.0% target.