Larger-Than-Expected ECB Hike but BOJ Maintains Status Quo; Fed to Stick to 75bps Next Week

EUROZONE: The European Central Bank (ECB) surprised financial markets and raised its three key policy rates for the first time in eleven years as policy makers grapple with sticky high inflation, political chaos, and a fragile eurozone economy. The ECB’s Governing Council ended its negative interest rate policy and raised its benchmark deposit facility rate by 50 basis points to 0.5% from 0%. This was larger than the 25 basis points signaled at the ECB’s previous meeting in June. The ECB also announced its new spread containment tool, the Transmission Protection Instrument (TPI). The TPI will be used to “make secondary market purchases of securities issued in jurisdictions experiencing a deterioration in financing conditions not warranted by country-specific fundamentals.”

Consumer price inflation accelerated to 8.6% in June on a year-over-year basis from 8.1% in May. With a deteriorating inflation outlook, energy security issues, and political chaos in Italy, the ECB will likely raise its key policy rates by 50 basis points at each of its meetings in September and October.

JAPAN: Consumer price inflation remained above the Bank of Japan’s 2% target for the third straight month in June. The nationwide consumer price index (CPI) rose 2.4% in June from a year ago following a 2.5% increase in May. The nationwide core consumer price index (CPI) (excluding volatile fresh food costs) rose 2.2% in June from a year earlier, slightly higher than May’s 2.1% print. Despite the above-target inflation print, the BOJ maintained status quo when central bankers met on July 21 by continuing its ultra-dovish monetary policies. The BOJ kept its key policy rate negative, maintained its asset purchases, and continued its yield curve control program. The BOJ raised its core inflation forecast for the current fiscal year ending in March 2023 to 2.3% from 1.9% at the April 2022 meeting. The BOJ also downgraded its growth forecast; policymakers now expect real GDP growth of 2.4% for the current fiscal year, down from the 2.9% projected at the April 2022 meeting.

With the yen plunging to a twenty-four-year low against the dollar in June, and the inflation outlook deteriorating, PNC Economics expects the BOJ to raise its policy rate by 25 basis points from -0.1% to 0.15% in the fourth quarter of this year.

UNITED STATES: Housing data pulled back further in June and July. Existing-home sales fell for a fifth straight month in June. Starts and permits fell in June to the lowest level since 2021; single-family starts and permits fell to two-year lows in June. Homebuilder confidence fell for the seventh straight month in July as the NAHB Housing Market Index (HMI) collapsed to 55 from 67 in June. July’s reading marked the lowest level of homebuilder confidence since May 2020. Housing activity is set to slow further over the next couple of years as the FOMC removes monetary policy accommodation and mortgage rates increase.

Initial claims for unemployment insurance rose by 7,000 to 251,000 in the week ending July 16 from an unrevised 244,000 in the week ending July 9. The four-week moving average of initial claims, which smooths out some of the volatility, moved up 5,000 to 241,000 in the week ending July 16. It hit a low of 172,000 in early April. The insured unemployment rate edged up to a still very low 1.0% in the week ending July 9 from 0.9% in the prior week. The labor market remains in solid shape as the summer quarter begins but the rise in initial claims since early April is a cool breeze blowing at the hot labor market this summer. The recent rise in
the 4-week moving average of initial claims to 241,000 in the week ending July 16 from a low of 172,000 in early-April is a clear sign that layoffs are happening at a growing number of companies.

PNC Economics expects the FOMC to raise the fed funds rate by 75 basis points to a range of 2.25% to 2.50% at the conclusion of its July 26 and July 27 meeting. The advance report of real GDP for the second quarter will likely show a 1.4% annualized increase from the first quarter.

**CHINA:** China’s economy contracted sharper than expected in the second quarter of 2022 as seasonally-adjusted (but not annualized) real GDP declined at a 2.6% quarterly rate, worse than expectations for a 2.0% decline, and down from the upwardly-revised 1.4% increase in the first quarter. In year-over-year terms, real GDP growth slowed to 0.4% in the second quarter from 4.8% in the first quarter. This was the slowest pace of growth since the pandemic started. Growth in the primary (agriculture) sector slowed to 4.4% in the second quarter from 6.0% in the first quarter, growth in the secondary (industrial) sector slowed to 0.9% from 5.8%, and the tertiary (services) sector contracted 0.4% following a 4.0% increase in the first quarter. Real GDP growth declined in the second quarter (on a year-over-year basis) as government-imposed lockdowns, a weak real estate sector, and a weaker global economy weighed on growth.

Despite the weak second quarter GDP print, there were signs of a rebound in economic activity in June as lockdowns were lifted. The Caixin manufacturing PMI rose to 51.7 in June, the strongest reading in over a year, from 48.1 in May. The Caixin services PMI rose to 54.5 in June, the strongest pace of expansion since May 2021. Industrial production was up 3.9% in June from a year ago.

Like Japan, the People’s Bank of China (PBoC) has been a major outlier by keeping monetary policy accommodative to stimulate its economy. Looking ahead, China’s economic outlook in the second half of this year is highly dependent on its implementation of its “zero-COVID” strategy.

**UNITED KINGDOM:** Inflation surged again in June as food and energy prices soared. Yearly CPI inflation rose to a fresh forty-year high of 9.4% in June from 9.1% in May, according to the Office for National Statistics. Prices of goods increased at a record-high 12.7% pace while prices of services were up 5.2%, both on a year-over-year basis. Energy prices were up an astounding 57.3% in June from June 2021, following a 52.8% increase in May. Food prices increased 9.8% on a year-over-year basis from 8.5% in May. On a month-over-month basis, CPI inflation rose to 0.8% in June from 0.7% in May. Core inflation (excluding energy, food, alcohol, and tobacco) fell slightly to 5.8% in June from 5.9% in May. Headline inflation has accelerated in every month of this year.

The number of employees on payrolls increased by 31,000 in June, unchanged from May and below consensus expectations for a 68,000 increase. With June’s increase, the number of employees on payrolls is now 561,000 above the pre-pandemic level. The unemployment rate held at 3.8% in the three months through May, unchanged from the preceding three-month period.

With strong demand for labor, solid wage growth, elevated inflation and deteriorating inflation expectations, the Bank of England (BoE) will likely increase the Bank Rate by 50 basis points to 1.75% when central bankers meet on August 4.

**CANADA:** CPI inflation jumped in June to 8.1% in year-over-year terms, the highest reading since January 1983. June marked the seventh straight month of accelerating inflation and the fifteenth month that inflation exceeded the central bank’s 1%-to-3% target range. Food, shelter, and energy were the main drivers of June’s inflation reading. In seasonally-adjusted terms, the CPI index rose 0.6% in June from May, the smallest increase since January 2022. The Bank of Canada’s three measures of core inflation, CPI-common, CPI-median, and CPI-trim, were 4.6%, 4.9% and 5.5% in June, respectively, all in year-ago terms.

Earlier this month, the Bank of Canada (BoC) raised its key policy rate by a full percentage point to 2.5%, the biggest single increase since August 1998, in the face of “higher and more persistent inflation” than it forecasted in April. The BoC now expects inflation to decline to “roughly 3%” by the end of 2023 and return to the 2% target by the end of 2024.
With most of the inflation driven by global supply-chain disruptions and the Ukraine invasion, PNC Economics expects the BoC to raise its key policy rate by 75 basis points to 3.25% when central bankers meet on September 7.