U.S. Unemployment Rate Expected to Hold at 3.5% in August Report; BOC to Stick to 75bps Next Week

UNITED STATES: Fed Chair Powell strongly committed to achieving “price stability” in his long-awaited speech August 26 at the Kansas City Fed’s annual Jackson Hole monetary policy conference. He noted the benefits of price stability, that without it, “we will not achieve a sustained period of strong labor market conditions that benefit all.” Powell noted that the fed funds rate will need to be above neutral “for some time” and that “the historical record cautions strongly against prematurely loosening policy.”

In terms of near-term monetary policy, Powell said that the size of the rate increase at the FOMC’s meeting on September 21 “will depend on the totality of the incoming data and the evolving outlook. At some point, as the stance of monetary policy tightens further, it will likely become appropriate to slow the pace of increases.” He did note that after increases of 75 basis points at the past two FOMC meetings, “another unusually large increase could be appropriate” in September.

The fed funds futures market is currently pricing in a 30% probability of a 50-basis point increase in the fed funds rate on September 21, down from 47% a week ago, and a 70% probability of a 75-basis point increase, up from 53% a week ago. PNC’s baseline forecast is for a 50-basis point increase on September 21, although it will depend on the August jobs report (September 2) and the August CPI report (September 13). Market reaction was muted right after the meeting, but stock prices plunged by about 3% for the day, the worst daily decline since mid-June.

Real GDP declined 0.6% at an annual rate in the second quarter, according to the second estimate from the Bureau of Economic Analysis. This is an upward revision from a 0.9% decline in the advance estimate. Compared to the advance estimate, there were upward revisions to consumer spending, investment in inventories, and state and local government spending; these were somewhat offset by downward revisions to investment in housing, federal government spending, and exports.

The goods trade deficit contracted for the fourth straight month in July. The goods trade deficit shrank 9.7% to $89.1 billion last month from $98.6 billion in June, according to data from the U.S. Department of Commerce. Nominal goods exports fell 0.2% on the month while nominal goods imports fell 3.5%.

The personal consumption expenditures price index fell 0.1% in July from June, the first drop in overall prices since April 2020, when the pandemic first hit the US economy. After months of very high inflation, the small drop in prices was welcome. The core PCE price index, excluding food and energy, rose a modest 0.1% in July, the smallest increase since February 2021. Energy prices fell almost 5% in July, but food prices were up 1.3%, the sixth straight month of increases of 1% or more. The PCE price indices are the Federal Reserve’s preferred inflation measures. On a year-over-year basis overall PCE inflation was 6.3% in July, down from 6.8% in June. Core PCE was 4.6% year-over-year in July, down from 4.8% in June. Although inflation slowed in July, both overall and core remain far above the Fed’s 2% objective and is running at close to the fastest pace in 40 years.
The Bureau of Labor Statistics’ August report, to be released Friday September 2, is forecast to show the unemployment rate unchanged at the pre-pandemic low of 3.5%, with nonfarm payroll employment up 290,000 on the month, and the average hourly earnings up 0.5% on the month and 5.3% on the year.

**UNITED KINGDOM:** Economic conditions continued to deteriorate in the U.K. as the S&P Global/CIPS services PMI fell slightly to an eighteen-month low 52.5 in the August flash estimate from 52.6 in July. The manufacturing PMI fell in August to 46.0, the sharpest contraction since May 2020, from 52.1 in July. Respondents noted that reduced customer demand, delayed delivery of inputs and labor shortages, all weighed on the manufacturing industry in August. PMI readings over 50 indicate growth while readings below 50 imply contraction.

**EUROZONE:** Business surveys released on August 23 showed declining economic activity in the Euro area. The flash S&P Global/CIPS composite PMI fell to an eighteen-month low 49.2 in August from 49.9 in July. PMI readings over 50 indicate growth while readings below 50 imply contraction. According to the report, Germany posted the sharpest decline in output since June 2020 while economic activity in France decreased for the first time in eighteen months. The S&P Global/CIPS composite PMI plunged to 13.6 in April 2020 when businesses in the Euro area were in lockdown after the pandemic started. The flash manufacturing PMI fell slightly to 49.7 in August, the lowest level in 26 months, from 49.8 in July. Respondents noted that post-production inventories increased in the manufacturing sector at the sharpest pace in more than twenty-five years. With elevated inflation, rising interest rates and deteriorating consumer confidence, demand for goods will likely continue to fall in the near term.

The spike in energy prices after Russia’s invasion of Ukraine has resulted in record inflation in the Euro area. More challenges lie ahead for the economy; with Russian natural gas supplies to the Euro area currently running at 20% of its capacity, the economy is likely to tip into recession this winter as natural gas demand peaks. Unlike the Fed, the European Central Bank has one mandate - price stability. With sky-high inflation, a deteriorating inflation outlook and the Fed committed to remain hawkish, PNC Economics expects the ECB to raise its policy rates by 50 basis points on September 8.

**CANADA:** Recent economic data continue to show extreme tightness in Canada’s labor market. Job vacancies increased 3.2% in June to a record-high 1.03 million, according to Statistics Canada. The job vacancy rate, which measures the number of vacant positions as a proportion of all positions, was a record-high 5.9% in June.

Small business confidence as measured by the Canadian Federation of Independent Business (CFIB) Barometer index increased to 53.5 in August from 52.7 in July. The CFIB Barometer index is a diffusion index; readings over 50 indicate growth while readings below 50 imply contraction.

After raising the target for the overnight rate by a full percentage point on July 13, the Bank of Canada (BOC) will likely continue its hiking cycle with more sharp interest rate hikes in the near term. PNC Economics expects the BOC to raise the target of its overnight rate by 75 basis points to 3.25% from 2.5% when central bankers meet on September 7.

**JAPAN:** Consumer price inflation accelerated in August, remaining above the Bank of Japan’s 2% target for the fifth straight month in August. The nationwide consumer price index (CPI) rose 2.9% in August from a year ago following a 2.5% increase in July. The nationwide core CPI (excluding volatile fresh food costs) rose 2.6% in August from a year earlier, higher than July’s 2.3% print.

Manufacturing activity in Japan expanded at a slower pace in August as the flash Jibun Bank manufacturing PMI fell slightly to 51.0 from 52.1 in July. The services PMI dipped to 49.2 in August, the lowest level in six months, from 50.3 in July. PMI readings over 50 indicate growth while readings below 50 imply contraction.

**MEXICO:** Real GDP expanded 2.0% in the second quarter from a year ago, according to the final estimate from the National Institute of Statistics and Geography (INEGI). GDP rose 0.9% from the previous quarter following a 1.0% increase in the first quarter.
Mexico’s economic activity indicator, the Global Indicator of Economic Activity (IGAE) declined 0.3% in June from May, following a 0.2% contraction in May. On a year-over-year basis, the economic activity index rose 1.6% in June.