November 10, 2022

GLOBAL ECONOMIC HIGHLIGHTS

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Inflation Hits Double Digits in the U.K. and the Eurozone; Chinese Exports Unexpectedly Drop

UNITED KINGDOM: Annual CPI inflation registered at 10.1% in September, up slightly from 9.9% in August. Annual inflation in September was driven by goods inflation. Goods inflation accelerated to 13.2% in September on a year-over-year basis from 12.9% in August. Services inflation increased to 6.1% from 5.9%. Rising energy prices, supply-side shocks from Brexit and the pandemic, and a tight labor market will continue to put upward pressures on inflation in the near term, but inflation should moderate in 2023 as the aggressive interest rate hikes in 2022 slow the economy.

As expected, the Bank of England's Monetary Policy Committee (MPC) voted by a majority of 7-2 and raised its Bank Rate by 75 basis points, to 3% when policy makers met on November 3. The BOE expects inflation to pick up to around 11% in the fourth quarter of this year before declining in 2023. In its Monetary Policy Report released after the meeting, the BOE forecasts CPI inflation to fall "some way below the 2% target" in two years' time, and further below the target in three years' time.

Economic activity contracted in the services sector at the strongest pace since January 2021 according to the U.K S&P services PMI. The U.K. S&P services PMI fell to 48.8 in October from 50 in September. The manufacturing sector also contracted in October as the S&P manufacturing PMI fell to 46.2 from 48.4 in September. PMI readings above 50 indicate growth while readings below 50 imply contraction. PMI data suggest that the U.K. economy is in recession. Aggressive interest-rate hikes by the BOE, sticky inflation, and a slower growing global economy have weighed on economic activity this year.

EUROZONE: Annual inflation as measured by the consumer price index (CPI) accelerated in October to 10.7%, a new all-time high, from 10% in September. Yearly inflation in the eurozone has accelerated for six straight months. On a month-over-month basis, consumer prices rose 1.5% in October following a 1.2% increase in September. Core inflation (excluding food, alcohol, and tobacco) rose 5% in October from a year ago, up slightly from 4.8% in September. Producer price inflation eased in September as the producer price index (PPI) rose 41.9% in September from a year ago, following a 43.4% increase in August. Core PPI (excluding energy) rose 0.4% on the month following a 0.4% increase in August. The European Central Bank (ECB) raised its three key policy rates by 75 basis points when central bankers met on October 27. The interest rates on the main refinancing operations, marginal lending facility and deposit facility are now 2%, 2.25% and 1.5% respectively. PNC Economics expects the deposit facility rate to peak at 2.5% in the second half of 2023.

The euro-area economy grew in the third quarter as gross domestic product (GDP) expanded 0.2% (seasonally adjusted) from the second quarter following a 0.8% increase in the second quarter, according to the European Statistical Office.

The unemployment rate in September edged lower in September to 6.6% from 7.7% in August. The eurozone S&P services PMI fell slightly to 48.6 in October from 48.8 in September while the manufacturing PMI fell to 46.4 from 48.4 in September.

PNC

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UNITED STATES: As expected, the Federal Open Market Committee raised the federal funds rate by 75 basis points, to a range of 3.75% to 4.00%. At the beginning of the year the fed funds rate target range was 0% to 0.25%; the central bank has been raising the rate aggressively to push back against inflation that is far above the Fed 2% objective. Today's statement said that the FOMC "anticipates that ongoing increases in the target range will be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2% over time." However, the statement also said that the FOMC "will take into account the cumulative tightening of monetary policy, [and] the Lags with which monetary policy affects economic activity and inflation."

PNC expects the FOMC to raise the fed funds rate by 50 basis points when it meets next, in mid-December, 50 basis points in February and 25 basis points in March. This would take the rate to a range of 5.0% to 5.25%, which would be a weight on economic activity. At that point inflation should be softening and job growth should be slowing to a more sustainable pace, allowing the FOMC to stop raising the fed funds rate. PNC Economics forecasts a mild recession starting in the second quarter of 2023 as its baseline outcome given that inflation and higher interest rates have and will continue to undercut U.S. consumer sentiment and spending capacity. The recession will likely last for three quarters with a peak-to-trough decline in real GDP of less than 1%.

The labor market is still tight. Employment increased by 261,000 in October, according to a survey of employers from the Bureau of Labor Statistics. Payroll job growth has slowed in 2022 as higher interest rates and high inflation weigh on the U.S. economy but remains above its long-run potential. The three-month moving average of payroll job growth through October was 289,000, down from around 600,000 at the beginning of 2022. The October unemployment jumped to 3.7%, from 3.5% in September; it was also 3.7% in August. Employment as measured in a survey of households (different from the survey of employers) fell by 328,000 in October, more than reversing the 204,000 increase in September. According to the BLS, the establishment survey series has a smaller margin of error than the household survey. A monthly change of about 100,000 is statistically significant in the establishment survey, while the threshold is 500,000 in the household survey. PNC expects job growth to continue to slow in the near term as the impact of higher interest rates continues to filter its way through the economy. In particular construction employment continues to increase, but should decline in 2023 with the steep contraction in homebuilding. Job openings rose in September to 10.7 million from 10.3 million in August. Job openings peaked at 11.9 million in March 2022 and remain well above the pre-pandemic level of 7 million. Initial unemployment claims fell to 217,000 in the week ended October 29 from an upwardly-revised 218,000 in the previous week.

The manufacturing and services sectors remained in expansion territory in October. The ISM manufacturing index fell to 50.2 in October from 50.9 in September. The ISM services index fell to 54.4 in October from 56.7 in September. The ISM manufacturing and services indices have remained above 50 since June 2020. PMI readings above 50 indicate growth while readings below 50 imply contraction.

The U.S. trade deficit widened to $73.3 billion in September from $65.7 billion in August. A narrower trade deficit drove economic growth in the third quarter, but trade will likely be a drag on growth in the near term. A stronger dollar and a slower growing global economy will contribute to a wider trade deficit in 2023.

CHINA: Exports unexpectedly dropped in October as higher interest rates and inflation weigh on the global economy. U.S. dollar-denominated exports fell 0.3% in October in year-over-year terms, the first decline since May 2020, and following a 5.7% increase in September. The consensus expectation was for an increase of 4.5% in October. Imports fell 0.7% in October, the first decline since August 2020, following a 0.3% increase in September. Slowing global demand will be a weight on Chinese exports in 2023. The real estate crisis and the zero-COVID strategy will continue to weigh on Chinese imports in the near term.

JAPAN: Activity in the services sector expanded at a slightly stronger pace in September as the flash Jibun Bank services PMI rose to 53.2 from 53.0 in August. The Jibun Bank services PMI has been above the 50-point threshold for four of the last five months. PMI readings above 50 indicate growth while readings below 50 imply contraction.

CANADA: A very strong 108,300 jobs were added in October, much better than the consensus expectation for an increase of 10,000. The same percentage in U.S. nonfarm payroll employment would be around 850,000 jobs. Canada's unemployment rate was unchanged at 5.2% in October as the labor force increased. The labor force participation rate increased slightly in October to 64.9% from 64.7% in September. 45,100 jobs were gained in the goods sector while the services-producing sector added 63,200 jobs. Average hourly wages increased 5.5% in October from a year ago, following a 5.2% increase in September. Strong wage growth from the tight labor market will put more pressure on the Bank of Canada to remain aggressive in its hiking cycle. The BOC surprisingly dialed back its pace of rate hikes in October and raised its policy rate by 50 basis points, less than the consensus expectation for a 75-basis point increase. PNC Economics expects the BOC to raise its policy rate by 50 basis points when policymakers meet on December 7, taking the policy rate to 4.25%.

The value of building permits dropped 17.5% in September from August following a 12% increase in August. Building permits were down 2.5% on a year-over-year basis.