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GLOBAL ECONOMIC HIGHLIGHTS

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China's Economy Slowed Last Year; BOJ Likely To Adjust Stance Again This Week

CHINA: China's economy grew at one of the slowest paces in almost five decades last year as its zero-Covid policy weighed on economic activity. Real GDP grew 3% in 2022 according to the National Bureau of Statistics. Last year marked the slowest rate of growth since 1974 (excluding 2020 when the pandemic hit the global economy.) China's economy grew more than expected in the fourth quarter on a year-over-year basis and was flat compared with the third quarter. Real GDP growth decelerated to a 2.9% quarterly rate in the fourth quarter, beating consensus expectations of 1.6%, and down from 3.9% in the third quarter. Growth in the primary (agriculture) sector increased to 4.0% in the fourth quarter from 3.4%, growth in the secondary (industrial) sector decelerated to 3.4% from 5.2% and growth in the tertiary (services) sector slowed to 2.3% from 3.2%.

Nominal retail sales fell 1.8% in December in year-over-year terms following a 5.9% decline in November, as the rapid surge in COVID cases weighed on consumer spending.

Industrial production rose 1.3% in December on a year-over-year basis following a 2.2% increase in November.

The consumer price index rose 1.8% in December from a year ago, matching consensus expectations, and following a 1.6% increase in December. Food inflation drove the increase in December as food prices rose 4.8%. Core inflation (excluding food and energy prices) rose to 0.7% from 0.6% in the prior month. China's reopening has led to a new wave of infections which will weigh on economic activity in the near term and limit consumer price inflation. The producer price index fell 0.7% in December from a year earlier after declining 1.3% in the previous month. The producer price index fell in every month of the fourth quarter of 2022 thanks to a decline in commodity prices.

U.S. dollar-denominated exports fell 9.9% in December in year-over-year terms, better than the consensus forecast for a 11.1% decline, and following a downwardly revised 8.9% drop in November. December's decline was the biggest in 2022. Imports fell 7.5% in December following a 10.6% decline in November. The slump in exports was driven by slowing global demand while the decrease in imports followed a surge in COVID cases after China's reopening.

Exports will remain a headwind to China's economy as global demand for goods falls but solid domestic consumer spending and business investment should lift the economy this year.

UNITED STATES: The consumer price index fell 0.1% in December, after a 0.1% increase in November. This marked the first monthly decline since January 2019. The core (excluding food and energy prices) consumer price index rose 0.3% in December. The decline in the headline measure was driven by a drop in energy prices as the energy index fell 4.5% on the month following a 1.6% decline in November. On a year-ago basis, headline CPI inflation was 6.5% in December, down from 7.1% in November, and 9.1% in June. Year-over-year core inflation was 5.7%, down from 6% in November. The Fed's inflation target is 2% using the personal consumption expenditures price index, which tends to run below CPI inflation. CPI inflation has been well above 2% for the past two years and the Fed has been very aggressive with monetary policy to get inflation down without causing a recession. December's CPI report is only one data point, but recent reports have been very encouraging, positioning the Fed to slow its pace of interest-rate hikes going forward. PNC's baseline forecast is for two 25 basis point increases in the fed funds rate at the FOMC's first two meetings this year, in early February and mid-March. This would take the fed funds rate to a range between 4.75% and 5.00%, up from essentially zero in early 2022. PNC then expects the FOMC to keep the fed funds rate in this range through most of 2023, until a sustained slowing in inflation and a deteriorating labor market lead to a rate cut at the end of the year.

The inflation outlook remains mostly encouraging. Supply-side pressures have improved significantly, goods inflation continues to improve, but wage growth is too hot. To slow inflation, the Fed wants softer job growth, probably of around 100,000 per month; weaker wage growth; and a slight uptick in the unemployment rate, indicating more labor market slack.

Initial claims for unemployment insurance fell by 1,000 to 205,000 in the week ending January 7, 2023, from an upwardly revised 206,000 (was 204,000) in the previous week. The four-week moving average of claims for the week ending January 7, 2023, was 213,000. This was down 2,000 from the previous week's unrevised 214,000. The four-week moving average is down to its lowest level since mid-October. Continuing claims plunged by 63,000 to 1.634 million in the week ending December 31, 2022, from an upwardly revised 1.697 million (was 1.695 million) in the previous week. The four-week moving average of continuing claims for the week ending December 31, 2022, was 1.680 million, down 9,000 from the previous week.

U.S. consumer sentiment rose more than expected in January despite higher interest rates and elevated inflation, according to the University of Michigan's preliminary Consumer Sentiment Index report. The index rose to an eight-month high of 64.6 in January from 59.7 in December. January's preliminary reading was above consensus expectations of 60.7. The increase in the index is surprising considering expectations for more interest-rate hikes by the Fed and elevated recession fears. However, the index places a great emphasis on the financial health of consumers, and it is very sensitive to gas prices and the equity market.

JAPAN: The producer price index rose 10.2% in December from a year ago following an upwardly revised 9.7% increase in November. On a month-over-month basis, the producer price index rose 0.5% following an upwardly revised 0.8% increase in November.

The Bank of Japan surprised global financial markets at its meeting in December when it adjusted its monetary policy stance by increasing the target range on 10-year bond yields to around plus and minus 0.5 percentage points from around plus and minus 0.25 percentage points. The BOJ maintained its negative interest rate policy and continued its quantitative easing program. The BOJ stated that it adjusted its yield curve control to "improve market functioning and encourage a smoother functioning of the entire yield curve, while maintaining accommodative financial conditions."

Ultra-loose monetary policy has failed to stimulate Japan's economy and it also resulted in a massive depreciation of the yen in 2022. Economic activity was weak in 2021 and 2022 and real GDP as of the third quarter of 2022 was only 0.9% above the pre-pandemic level.

The BOJ meets for its first policy review of the year on January 17 and 18 and it's likely that central bankers will adjust its yield-curve control policy again after consumer price inflation hit a forty-year high in December.

EUROZONE: The eurozone economy was surprisingly resilient at the end of last year thanks to a milder winter and higher-than-average gas storage levels. After peaking in October 2022, inflation eased in November and December thanks to aggressive monetary and fiscal policy measures. Industrial production was stronger than expected and the unemployment rate remained unchanged at the all-time low in November. With the tight labor market and global supply-side issues still unresolved, the ECB will likely continue its hawkish stance to get inflation down to its 2% objective.

UNITED KINGDOM: Payroll growth decelerated in December to 28,000 from a downwardly revised 70,000 in November. The unemployment rate remained unchanged at 3.7% in the three months to November from the preceding three-month period. Yearly wage growth (average weekly earnings) rose to 6.4% in the three months to November from 6.2% in the preceding three-month period. Wages grew in November at the fastest pace since April 2022.

GDP rose 0.1% in November, better than consensus expectations for a 0.2% decline, from October following a 0.5% increase in October. With better-than-expected GDP data and wage growth well above the sustainable pace, the Bank of England will likely increase its policy rate, the Bank Rate, by 50 basis points to 4.00% from 3.50% when central bankers meet on February 2.

CANADA: Housing starts declined for the third straight month in December as higher mortgage rates weighed on housing activity. Housing starts fell 5.5% in December to 248,625 seasonally-adjusted annualized units, worse than consensus expectations for 257,600, from 263,000 in November.