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GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher, Chief Economist
Stuart Hoffman, Senior Economic Advisor
Kurt Rankin, Senior Economist
Abbey Omodunbi, Senior Economist
Ershang Liang, Economist

Blockbuster U.S. Jobs Report; ECB Virtually Assures Another 50 Basis Point Hike in March

UNITED STATES: Employment increased by 517,000 in January from December, according to a survey of employers, the largest increase since July 2022. The consensus expectation was for a gain of 185,000. The unemployment rate fell to 3.4% in January from 3.5% in December; this is the lowest unemployment rate since May 1969. Average hourly earnings rose 0.3% in January from December, the same pace as in December. The Federal Reserve wants the labor market to cool off to slow inflation, but instead it heated up in January. The extremely strong jobs report means that the Federal Open Market Committee will continue to raise the federal funds rate in the near term in an effort to slow economic growth, create more slack in the labor market, and cool off inflationary wage pressures.

The Federal Open Market Committee raised the federal funds rate, its key short-term policy rate, by 25 basis points as expected at its January 31 to February 1 policy meeting. The FOMC continued to reduce the size of the Fed's balance sheet by up to $95 billion per month, allowing long-term Treasurys and mortgage-backed securities to roll off the balance sheet without replacing them. In its press release, the FOMC said 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." The use of increases (plural) suggests that the FOMC will raise the fed funds rate at least two more times in the near term. However, PNC expects just one more 25 basis point increase in 2023 in mid-March. The difference comes from the outlook for the economy. PNC expects the U.S. economy to enter into recession over the next few months, which would deter the FOMC from raising the fed funds rate beyond the committee's next meeting. PNC expects a peak-to-trough decline in real GDP of around 1% through the end of this year, with the unemployment rate up above 5% by the end of 2023, from 3.5% in December 2022. The FOMC, however, is projecting weak economic growth in 2023, but no near-term recession, which would indicate at least two more rate increases this year.

Initial claims for unemployment insurance fell again by 3,000 to 183,000 in the week ending January 28, 2023, from an unrevised 186,000 in the previous week. This is the lowest level of initial claims since early-April 2022. The four-week moving average of claims for the week ending January 28, 2023, which smooths out some of the volatility in weekly claims, especially during holiday times, fell 6,000 to 192,000 from the previous week's unrevised 198,000.

Job openings in December rose to a five-month high according to the Job Openings and Labor Turnover Survey (JOLTS). The JOLTS report is released at a one-month lag to the Employment Situation Summary, the report containing nonfarm payroll growth and the unemployment rate.

Wage pressures eased in the fourth quarter of last year as the employment cost index (ECI), which includes the cost of fringe benefits as well as wages, and which accounts for changes in workforce composition, rose a slower 1% from a year earlier in the fourth quarter of 2022, from 1.2% in the third quarter.

House price appreciation in November, as measured by the S&P CoreLogic Case-Shiller National Composite Index fell 0.3% (after seasonal adjustments) in November from October, following a 0.2% decline in October. This marked the fifth straight monthly decline. Annual house price appreciation decelerated to 7.7% in November, the slowest pace in over two years, from 9.2% in October. The S&P CoreLogic Case-Shiller 20-City

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Index recorded a 6.8% gain in November versus November 2021, down from 8.6% in October. The sharpest monthly declines from the prior month were in Las Vegas (1.2%), Phoenix (1.4%) and San Francisco (1.4%).

The housing market downturn continued in November as higher mortgage rates and deteriorating affordability priced out potential homebuyers. The average on a 30-year fixed mortgage rate peaked at around 7% in November but home financing costs have declined in recent months thanks to better inflation prints, rising recession fears, and a less hawkish Fed. The housing sector correction will likely continue through 2023 but there is some good news for potential homebuyers. Strong wage growth from the labor market and declining mortgage rates will provide some support to demand and unusually low supply should limit house price declines. PNC's baseline forecast expects house prices to decline 12% in 2023.

EUROZONE: In contrast to the Fed, the European Central Bank maintained its hawkish stance when central bankers met on February 2nd. The ECB delivered no surprises at its February 2 Governing Council decision by raising its three key interest rates by 50 basis points. With the February 2 decision, the interest rate on the main refinancing operations and the interest rates on the marginal lending facility and the deposit facility will be increased to 3.00%, 3.25% and 2.50% respectively, with effect from February 8, 2023. The Governing Council will also continue its quantitative tightening policy by reducing its holdings under the asset purchase programme (APP) at an average pace of €15 billion per month from March until the end of June 2023. The press release noted that "the Governing Council will stay the course in raising interest rates significantly at a steady pace and keep them at levels that are sufficiently restrictive to ensure a timely return of inflation to its 2% medium-term target.

Of more note, President Lagarde virtually assured another 50 basis point hike in March and said that the Council "will evaluate the subsequent path of its monetary policy" after the hike in March. Lagarde noted that the risks to inflation are "more balanced" since December but "a stronger than expected rebound in China could give a fresh boost to commodity prices and foreign demand." PNC Economics expects the ECB to raise its key policy rates by 50 basis points in March, then 25 basis points each in May and June.

Gross domestic product grew by a small 0.1% in the fourth quarter from the third quarter, better than consensus expectations for a 0.1% contraction, according to the flash estimate from the European Statistical Office. This followed a 0.3% increase in the third quarter. On a year-ago basis, GDP grew 1.9% in the fourth quarter. On a quarter-over-quarter basis, German and Italian output contracted while GDP grew in Spain, France, and Ireland.

Inflation eased more than expected in January as the consumer price index rose 8.5% from a year ago. This was better than consensus expectations for an 8.9% increase and followed a 9.2% increase in December. CPI inflation peaked at 10.7% in October and has now declined for three straight months thanks to a drop in energy prices. Core yearly inflation (excluding energy, food, alcohol and tobacco) registered at the all-time high of 5.2% in January, unchanged from December.

Although headline inflation has slowed in recent months, core inflation remains sticky, which would likely lead to the ECB holding its hawkish stance through most of the year. Risks to the inflation outlook are tilted strongly to the upside; China's reopening and/or the escalation of the Ukraine crisis could lead to more persistent inflation in the euro area.

UNITED KINGDOM: As expected, the Bank of England's Monetary Policy Committee (MPC) voted by a majority of 7-2 to increase the Bank Rate, its key short-term policy rate, by 50 basis points to 4.00%, the highest rate since 2008, at its meeting which ended on February 1. The MPC also released the February Monetary Policy Report with revised forecasts from November. Central bankers now expect CPI inflation to fall from 10.5% in December to 4% towards the end of this year. They also now expect a much shallower recession, starting in the first quarter of this year. With a tight labor market, China's reopening, and a highly uncertain economic outlook, inflation risks are skewed significantly to the upside. However, recession risks are elevated, and the BoE risks overtightening monetary policy. PNC Economics expects the BoE to slow the pace of interest-rate hikes and raise the Bank Rate by 25 basis points to 4.25% at its March 23 meeting. PNC

Economics then expects the BoE to keep the Bank Rate at this rate before reducing it in early 2024 as the labor market slackens and inflation moderates.

CANADA: GDP grew in the fourth quarter of 2022 according to preliminary data from Statistics Canada. Economic growth slowed to 1.6% in the fourth quarter on an annualized basis, down sharply from a 2.9% pace in the third quarter. Gross domestic product was flat in December from November following a 0.1% increase in November. The Bank of Canada raised its policy rate by 25 basis point to 4.50% at its meeting on January 25, and it noted that it will hold its policy rate at the current level while it "assesses the impact of the cumulative interest rate increases." Building permits fell 7.3% in December, worse than consensus expectations for a 3.9% decline, following an upwardly-revised 14.9% increase in November. The sharp increase in mortgage rates last year and a highly uncertain economic outlook will be weights on housing activity this year.

BRAZIL: The Central Bank of Brazil's (BCB) Monetary Policy Committee (COPOM) maintained the Selic rate at 13.75% at its meeting on February 1. In the accompanying statement, the BCB signaled that it will hold interest rates at the current level until inflation eases to the BCB's 3% target. The BCB expects annual IPCA inflation to moderate from 5.8% in December 2022 to 3.1% in the third quarter of 2024 and 2.8% at the end of 2024.

MEXICO: GDP grew in the fourth quarter of 2022 according to preliminary data from the National Institute of Statistics and Geography (INEGI). GDP growth slowed to 3.5% in the fourth quarter from a year ago following a 4.3% increase in the third quarter. On a quarter-over-quarter basis, real GDP grew 0.4% following a 0.9% increase in the third quarter.

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