Global Economic Highlights

PNC

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Fed Delivers Final Hike and U.S. April Jobs Report Surprises to the Upside

UNITED STATES: As widely expected, the Federal Open Market Committee raised the federal funds rate by 25 basis points, to a range of 5.00% to 5.25% at its meeting on May 2-3. This was the tenth straight meeting where the FOMC has raised the fed funds rate, although it has slowed the pace of rate hikes recently, with increases of 25 basis points at each of its three meetings this year. The FOMC statement indicated that rate hikes might continue in the near term, with the statement saying that the committee would determine "the extent to which additional policy firming may be appropriate to return inflation to 2% over time." This does not mean that additional rate hikes are a certainty, but it does suggest that the FOMC could increase the fed funds rate in the near term, rather than keep it steady. In his press conference Chair Powell did note a change in language from the previous statement in mid-March; that statement said that the FOMC "anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2% over time." The removal of language about making policy "sufficiently restrictive" suggests that at its current level the fed funds rate might be "sufficiently restrictive" to slow inflation. In its discussion of current economic conditions, the statement said that the "U.S. banking system is sound and resilient," despite the recent turmoil, although the statement also noted that "tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation."

PNC's forecast is for the FOMC to hold the fed funds rate steady in its current range into early 2024. Monetary policy is contractionary right now, weighing on economic growth, and recent problems in the banking system are a further drag due to a tightening in credit availability. Incoming data are likely to show a slowing labor market and an easing in inflation, giving the FOMC the leeway to pause its rate hikes. PNC then expects the FOMC to start cutting the fed funds rate in early 2024 as it becomes apparent the U.S. economy is in recession, that the labor market is deteriorating, and that inflation is moving decisively to 2%.

The U.S. economy added 253,000 jobs in April, according to a survey of employers from the Bureau of Labor Statistics, well above the consensus expectation of 180,000. However, there were substantial downward revisions to job growth in February and March, with average gains over the past three months of 222,000. This is down from around 300,000 at the end of 2022 and indicates that monetary policy tightening is weighing on the labor market. The unemployment rate fell to 3.4% in April from 3.5% in March. Outside of a 3.4% rate in January 2023, this is the lowest unemployment rate since 1969. The labor force participation rate (share of adults either working or looking for work) held steady in April at 62.6%. One bit of bad news on the inflation front was an increase of 0.5% in average hourly earnings, an acceleration from 0.3% growth in March and the biggest increase since July 2022. Average hourly earnings were up 4.4% on a year-over-year basis in April, too hot from the Fed's perspective.

Job openings fell in March to the lowest level since April 2021 suggesting that the labor market is cooling. The number of job openings fell to 9.6 million in March from 9.97 million (revised from 9.93 million) in February. The ratio of openings to unemployed people fell to 1.6 in March from 1.7 people in April. The ratio was 1.2 before the pandemic started.

Initial claims for unemployment insurance (UI) increased by 13,000 to 242,000 for the week ending April 29. This is up from a modestly revised prior week's result of 229,000 (-1000 revision). The four-week moving average of claims, which smooths out some of the weekly volatility, was up by 4,000 to 239,000. Initial claims have been consistently elevated for

Gus Faucher
Chief Economist

Stuart Hoffman
Senior Economic Advisor

Kurt Rankin
Senior Economist

Abbey Omodunbi
Senior Economist

Ershang Liang
Economist

long enough now that the four-week moving average also reflects an increase from the sub-200,000 results that had been the lowest observed for UI claims since the data began in the late 1960s.

Weekly claims are up from exceptionally low levels throughout 2022 which sometimes dipped below 200,000 per week. However, a new plateau in the initial claims results does seem to have formed at close to 245,000. Job losses have begun to spread from the tech and finance industries that had dominated headlines through the end of last year and into the first months of 2023. Headline-grabbing layoff announcements, however, typically take some time to be put into effect. This delay accounts for the recent rise in initial claims, based upon high profile layoff announcements that spanned the transition from 2022 into 2023. This effect could also portend another escalation in the months to come, alongside the ever-widening net of jobs cuts spreads across industries.

The job market is slowing in 2023, although it is still running too strong from an inflation perspective. The Federal Open Market Committee would like to see a bit more slack in the labor market, with average monthly job growth of below 200,000, an unemployment rate of around 4%, and annual wage growth of around 3.5%. The question is whether the FOMC thinks that the monetary policy tightening that has already occurred over the past couple of years is sufficient to achieve this, or if the committee sees the need to raise rates even more to further cool off the job market. The job report is consistent with a soft landing, in which the economy slows and the labor market cools off to a more sustainable pace, but without a recession.

EUROZONE: As forecasted by PNC, the Governing Council of the European Central Bank (ECB) slowed its pace of monetary policy tightening and raised its three policy rates by 25 basis points at its meeting on May 4. The ECB had previously raised its policy rates by 50 basis points and 75 basis points since it started this hiking cycle in July 2022. With the May 4 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 3.75%, 4.00% and 3.25% respectively, with effect from May 10. In the accompanying press release, policymakers noted that “headline inflation has declined over recent months, but underlying price pressures remain strong.” Annual CPI inflation in the eurozone has dropped from a peak of 10.7% in October 2022 to 7.0% in April 2023. However, core CPI inflation, which excludes energy, food, alcohol, and tobacco prices, has remained resilient. Core CPI peaked at 5.7% in March 2023 and decelerated slightly to 5.6% in April. Core inflation is a better measure of the underlying inflationary pressures in an economy as it excludes volatile components such as food and energy. With stricter lending standards, a tight labor market and sticky core inflation, PNC Economics expects the ECB to raise its policy rates by 25 basis points at its next meeting, in June, and then increase them by a further 25 basis points at the subsequent meeting, in July.

The eurozone’s unemployment rate fell to a record-low of 6.5% in March from 6.6% in February. Retail sales fell more than expected in March as high inflation and rising interest rates continue to weigh on consumers in the eurozone. After increasing by 1.0% in January, retail sales fell in February and March. Retail sales in March were 3.8% down from a year ago.

UNITED KINGDOM: The economic outlook in the U.K. has improved in recent months thanks to several fiscal policy measures announced by Jeremy Hunt, the Chancellor of the Exchequer (finance minister), when he presented his spring budget on March 15. These measures include the continuation of the energy price guarantee scheme, tax deductions for business investment, an extension of the free childcare scheme, etc. GDP likely increased modestly in the prior quarter after data from the Office for National Statistics (ONS) showed no monthly growth in February but growth of 0.4% in January. Business surveys also suggest that economic activity increased late in the prior quarter. The S&P Global/CIPS U.K. composite PMI showed growth in February and March. Inflation, however, remains a big concern for U.K. consumers and businesses. Headline consumer price index (CPI) inflation has registered in double digits for seven straight months. The Bank of England (BoE) meets on May 11, and PNC expects central bankers to raise the Bank Rate by 25 basis points to 4.50%. PNC then expects a subsequent increase in the Bank Rate by 25 basis points at the June meeting.

CANADA: Job growth in April surprised to the upside despite elevated interest rates. Canada's economy added 41,400 jobs in April, well above consensus expectations for a 20,000 increase, and following a 34,700 increase in January. Job growth in April would be equivalent to job growth of 331,574 in the U.S. 47,000 part-time jobs were added in Canada in April while 6,200 full-time jobs were lost. The unemployment rate remained unchanged at 5.0%, just above the record-low rate of 4.9%. Average hourly wages rose 5.2% in April from a year ago, too hot from the Bank of Canada's perspective. Annual growth of hourly wages averaged 2.5% in 2019. With the increase in April, employment in Canada is 4.7% above the pre-pandemic level. The Bank of Canada (BoC) held its policy rate at its March and April meetings and promised to take a wait-and-see approach before deciding on the next step. While momentum has remained strong in the labor market and economic growth continued early this year (GDP expanded 0.6% in January and 0.1% in February), core CPI inflation decelerated to 4.3% in March, the lowest rate since January 2022. With core CPI inflation decelerating and expected slower global economic growth, PNC Economics expects the BoC to keep interest rates steady until early 2024, when core inflation will be very close to the BoC's 2% objective.

INDIA: Business surveys point to continued expansion in India's economy in the first half of this year. The S&P Global India composite PMI jumped to 61.6 in April from 58.4 in the prior month. The manufacturing PMI rose to 57.2 in April from 56.4 in March while the services PMI rose to a thirteen-year high of 62.0 from 57.8 in March.

MEXICO: Consumer confidence fell in April, according to data from Mexico's statistics agency, the National Institute of Statistics and Geography (INEGI). The consumer confidence indicator fell to 44.1 in April from 44.4 in March. Despite the decline, consumer confidence in April was slightly above the pre-pandemic level of 43.8. Mexico's unemployment rate fell to a historic low of 2.4% in March from the previous historic low of 2.7% in February.

BRAZIL: The Central Bank of Brazil's monetary policy committee maintained its benchmark policy rate, the Selic rate, for the sixth straight meeting at 13.75% as expected at its meeting on May 3. Policymakers signaled a continuation of the wait-and-see approach in the accompanying press release noting that they will maintain the Selic rate for a long period "until the disinflationary process consolidates and inflation expectations anchor around its targets." Annual inflation has slowed in 2023, with annual IPCA-15 inflation coming in at 4.2% in April, within the BCB's 1.75%-to-4.75% target range. Despite the deceleration in inflation this year, the committee expects inflation to register at 5.8% by the end of 2023 and 3.6% by the end of 2024.

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