Fed and ECB Expected to Raise Interest Rates This Week While BoJ Will Keep Policy Unchanged

UNITED STATES: The Federal Reserve is expected to raise the federal funds rate by a quarter percentage point at its meeting on July 26 given continued high inflation and the strong job market. PNC then expects the FOMC to keep the fed funds rate in a range between 5.25% and 5.50% until March 2024, when a deteriorating labor market and inflation moving decisively to 2% will prompt monetary easing. The FOMC will continue to cut the fed funds rate through the rest of next year and the first half of 2025 until it reaches its terminal range of 2.75% to 3.00%.

Retail sales increased 0.2% in June from May, weaker than the consensus expectation for a 0.5% increase. Sales were up 0.2% excluding motor vehicles and parts, and up 0.3% excluding motor vehicles, parts, and gasoline. Control sales – sales excluding autos, parts, gasoline, restaurants, and building materials, and which go into nominal consumer spending in GDP – rose 0.6% in June. On a year-ago basis, retail sales growth was 1.5% in June, down from 2.0% in May. PNC expects retail sales growth to slow further in the near term as elevated interest rates and inflation weigh on consumer spending.

Industrial production fell 0.5% in June from May following a 0.5% (revised from 0.2%) decline in May. Tighter monetary policy has been a weight on industrial production. Other headwinds include a shift in U.S. consumer spending from goods to services and weaker-than-expected economic growth in China.

Homebuilder confidence edged higher in July. U.S. housing starts and permits pulled back in June after sharp increases in May. Housing starts and permits tend to be highly volatile from month to month, but homebuilding sentiment improved in the first half of 2023 thanks to a resilient U.S. economy and the Federal Reserve signaling a potential end to its hiking cycle. PNC expects slower activity in the housing sector in the second half of the year as elevated mortgage rates and declining affordability weigh on housing demand. Existing-home sales fell in June to the slowest pace since January. Limited resale inventories are weighing on existing-home sales.

Initial claims for unemployment insurance fell by 9,000 to 228,000 in the week ending July 15, a second weekly decline and the lowest since mid-May. The four-week moving average of initial claims, which smooths out some of the volatility, was down by 9,000 to 238,000, reversing the rise in June. Continuing claims jumped by 33,000 to 1.754 million in the week ending July 8 but the four-week moving average of continuing claims was down by 2,000 to 1.732 million, its lowest level since mid-February. PNC expects a shallow recession to start in late 2023 or early 2024 as the impact of higher interest rates continues to work its way through the economy. Also, the resumption of student loan principal and interest rate payments starting in October (estimated between an average of $350-$400 per month) for close to 27 million borrowers and the cancellation by the SCOTUS of Biden’s $20K loan forgiveness are both moderate negatives for consumer spending in the final holiday quarter of this year and in 2024.

The advance estimate of real GDP for the second quarter of 2023, to be released July 27, will likely show growth slowed to 1.7% in seasonally-adjusted annualized terms from 2.0% in the first quarter.

June personal income and expenditures, to be released July 28, will likely show personal income up 0.5% on the month driven by gains in employment and wages and personal consumption expenditures up 0.5% with strength in both goods
(new vehicles) and services. Headline PCE inflation likely slowed to 3.1% in June on a year-ago basis from 3.8% in May. Core PCE inflation likely slowed to 4.2% from 4.6% in May.

**EUROZONE:** The European Central Bank (ECB) is expected to raise its three policy rates by 25 basis points when central bankers meet on July 27. The eurozone economy contracted more than expected in July according to preliminary estimates from S&P Global. The S&P Global composite PMI fell to 48.9 in July from 49.9 June, worse than consensus expectations for a decline to 49.6. The July estimate marks the lowest reading since November.

**JAPAN:** The Bank of Japan (BoJ) is expected to leave its monetary policy unchanged when policymakers meet on July 28. The BoJ’s current monetary policy framework includes a negative interest rate policy, yield curve control and quantitative easing. GDP growth in the first quarter of this year was revised sharply higher to an annualized 2.7% from 1.6% and core CPI inflation, which excludes fresh food and energy costs, has been above 3% in every month of 2023.

**CANADA:** Inflation decelerated in June to the slowest pace in over two years as elevated interest rates continue to weigh on Canada’s economy. Canada’s CPI index rose 0.1% in June on a seasonally-adjusted basis, and increased 2.8% from a year earlier. Year-over-year measures of core inflation were mixed in June, with CPI-trim falling to 3.7% from 3.8% and CPI-median remaining unchanged at 3.9%.

**MEXICO:** Retail sales fell 0.5% in May from April and April’s increase was revised downwards to 1.3% from 1.5%. Retail sales increased 2.6% in May from a year ago, down from 3.8% in April.

---

**Disclaimer:** The material presented is of a general nature and does not constitute the provision of investment or economic advice to any person, or a recommendation to buy or sell any security or adopt any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy. You should seek the advice of an investment professional to tailor a financial plan to your needs.

Forward-looking statements are necessarily subject to numerous assumptions, risks and uncertainties, which change over time. Future events or circumstances may change our outlook and may also affect the nature of the assumptions, risks and uncertainties to which our forward-looking statements are subject. Forward-looking statements speak only as of the date made. We do not assume any duty and do not undertake any obligation to update forward-looking statements. Actual results or future events could differ, possibly materially, from those anticipated in forward-looking statements, as well as from historical performance. As a result, we caution against placing undue reliance on any forward-looking statements.

© 2023 The PNC Financial Services Group, Inc. All rights reserved.

Visit [pnc.com/economicreports](pnc.com/economicreports) for more information from PNC Economics.