CHINA’S SOLID 2017 GROWTH LIKELY TO SLOW IN 2018; EUROPEAN CENTRAL BANK AND BANK OF JAPAN ON HOLD

CHINA: China’s economy grew solidly in 2017 but will probably slow in 2018. Real GDP grew 6.8 percent from a year earlier in the fourth quarter of 2017, unchanged from the third quarter and down from 6.9 percent in the first half of the year. For the full year, real GDP grew 6.9 percent, up from 6.7 percent in 2016. Other indicators show a larger (and arguably more accurate) acceleration in 2017 from 2016: Nominal GDP grew 11.3 percent in 2017, up from 8.0 percent in 2016. Value added of the industrial sector grew 6.6 percent, up from 6.0 percent, and the manufacturing capacity utilization rate averaged 77.0 percent, the highest since 2011. Consumer spending made relatively less of a contribution to growth in 2017, with retail sales growth of 10.2 percent down a hair from 10.4 percent in 2016. Passenger vehicle sales grew 1.9 percent to 24.7 million units, much slower growth than 2016’s 15.1 percent increase. And sales of market-priced real estate grew 7.7 percent in real terms (i.e. floor space sold), down from 22.5 percent in 2016. 2017’s acceleration is unlikely to give way to even faster growth in 2018. Money supply growth was the slowest in 2017 after adjusting for inflation since comparable data began in 1998, and the People’s Bank of China raised benchmark interest rates three times in 2017 by a cumulative 25 basis points – a meaningful tightening measure given the heavily indebted balance sheets of China’s nonfinancial corporations. The strength of the yuan will likely cause headwinds for Chinese exporters in 2018: The exchange rate broke below 6.4 per dollar this month, and is the strongest since December 2015 – China’s exchange rate policy is limiting the degree to which the recent increase in global oil prices will spill over to the Chinese CPI basket. The yuan could stay stronger until oil prices retrace some of their late-2017 and early-2018 increases. Chinese real GDP growth will likely moderate to 6.5 percent in 2018, with risks skewed toward a larger slowdown than in our baseline forecast.

EUROZONE: The European Central Bank will not change their policy stance and is unlikely to change their forward guidance at their Governing Council meeting on Thursday January 25: They have committed to carry out quantitative easing by buying real economy assets at a rate of €30 billion euros per month at least through September 2018, and to hold their benchmark deposit rate at -0.40 percent until “well beyond the horizon” of when quantitative easing ends; this phrase suggests to us that the earliest the ECB could conceivably raise short term interest rates is March 2019.

JAPAN: The Bank of Japan decision late night on Monday January 22 in US time zones will maintain Japan’s monetary stance unchanged: The short-term interest rate will be -0.1 percent, the target for the 10-year government bond yield “around zero percent” (which the Bank of Japan implements as a range of -0.1 percent to 0.1 percent), and purchases of exchange traded funds and real estate investment trusts will continue at unchanged rates. At some point, the Bank of Japan will acknowledge that it is slowing its asset purchases because fewer are necessary to hold interest rates at the BoJ’s targets; this policy is best understood as stable monetary policy, not tightening, since the key instruments of monetary policy are the interest rates. The Bank of Japan’s forward guidance is that they will continue to expand their balance sheet (in other words, continue with quantitative easing) until inflation exceeds their 2 percent target in a stable manner. This means headline and core inflation must reach two percent, above current weak levels, and Japanese households do not expect this anytime soon. The Bank of Japan’s opinion survey of the general public for December 2017, released January 18, shows most Japanese believe prices are rising slightly and will still be rising only slightly a year in the future.
GLOBAL ECONOMIC HIGHLIGHTS

CANADA: Matching our forecast, the Bank of Canada raised the overnight rate target 0.25 percentage points to 1.25 percent at its January 17 monetary policy decision, maintaining a stable premium for Canadian short-term interest rates above US benchmarks, since the Fed raised the federal funds target in December and the Bank of Canada was on hold. The BoC signaled that they will be “cautious” in making further interest rate hikes in the remainder of 2018, balancing the strength of recent growth and jobs data against downside risks from the NAFTA renegotiation, a highly indebted household sector, and an ongoing housing correction. PNC Economics forecasts for the Bank of Canada to make only one more interest rate hike in 2018, most likely in July. Our dovhish view of the outlook for Canadian interest rates underlies our forecast for a weaker Canadian dollar over a multi-quarter time horizon. However, the recent increase in crude oil prices creates upside risks for Canadian growth, and consequently Canadian interest rates, if it persists.

UNITED STATES: The federal government’s partial shut-down, like shut-downs during the Obama administration, will likely have limited effect on economic output since delayed spending will be made up when the government reopens. Industrial production rose 0.9 percent in December from November, mostly due to cold weather that helped utility output surge 5.6 percent; manufacturing output rose a modest 0.1 percent on the month, and grew 2.4 percent from a year earlier, keeping pace with real GDP. Mining output jumped a large 1.6 percent, reflecting crude oil production at its strongest at least since comparable weekly statistics began in 1983. Brent crude touched $70 per barrel in December for the first time since December 2014, boosted by drawdowns in US petroleum inventories, down 12.2 percent from their August 2016 peaks, as well as lower global inventories. Both the IEA and OPEC’s January forecasts anticipate for the Venezuelan energy industry’s collapse and supply disruptions among other OPEC members to offset growing production in the US and Canada and keep global petroleum inventories tighter in 2018 than in 2016.

AUSTRALIA: The seasonally-adjusted unemployment rate rose to 5.5 percent in December from 5.4 percent in November, which had been the lowest since 2013. Details were stronger than the headline: Employment jumped 34,700 or 0.3 percent on the month and 3.3 percent on the year, and the labor force participation rate rose to 65.7 percent from 65.5 percent in November and 64.8 percent a year earlier. Consumer spending is solid too: Vehicle sales rose 4.5 percent in December from November on a seasonally-adjusted basis and 6.7 percent from a year earlier. Solid job growth and consumer spending keep Australia on course for a policy interest rate hike by the fourth quarter of 2018.

UNITED KINGDOM: Real retail sales grew a weak 1.4 percent in year-over-year terms in December, and 1.9 percent in all of 2017. This was the weakest year for real retail sales growth since the stagnant economy of 2013. Weak growth and slowing inflation will likely keep the Bank of England on hold throughout 2018.

BRAZIL: Real services output grew 1.0 percent in November from a month earlier after declines of 0.8 percent in October and 0.1 percent in September. From a year earlier, services output dipped 0.7 percent in November. Brazil’s recovery is still led by mining, industry, and exports, but domestic demand should recover in 2018 if political risks stay contained.

MEXICO: The bi-monthly CPI report to be released January 24 will likely show a sharp slowdown from the 16-year record of 6.8 percent reached in December, reflecting the January 2017 surge in energy prices dropping out of the year-ago comparison. The Bank of Mexico is likely to lower interest rates in 2018 as inflation slows and growth continues below Mexico’s potential.

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