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GLOBAL ECONOMIC HIGHLIGHTS

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US POURS GAS ON TURKISH LIRA SELL-OFF; EURO AND EMERGING MARKET CURRENCIES WEAKEN IN SYMPATHY

UNITED STATES: President Trump on August 10 tweeted plans to increase tariffs on Turkish metal imports to pressure the Turkish government into releasing a detained American pastor, pressure which pushed the Turkish lira to a record low against the US dollar and spilled over to a broad-based depreciation of other currencies. The lira depreciated from 3.8 per dollar in January to 4.9 per dollar in the beginning of August and to 7.0 per dollar early in the week of August 13, a depreciation of about 30 percent in the first half of August and of 45 percent year to date. Turkey's footprint in the global economy and financial system is very small, but its financial volatility is rippling into other emerging market currencies, and to a lesser extent to European currencies, amplifying the impact of the country's currency crisis. The US Trade Representative announced that tariffs on another $16 billion of Chinese goods imports would become effective August 23, following through on President Trump's threat to incrementally impose tariffs on all Chinese imports. Small businesses, whose direct exposure to global risk is limited, remained extremely upbeat in July. The NFIB Small Business Optimism Index rose to 107.9 from 107.2 and nearly touched the 45-year high set in 1983. The consumer price index for all items rose 0.2 percent in July, up from 0.1 percent in June. Core CPI excluding food and energy rose 0.2 percent for a third consecutive month. On a year-ago basis, overall inflation was 2.9 percent in July, the fastest since 2012, and core inflation 2.4 percent, up from 2.3 percent in June and the fastest since 2008. Rising wages, reduced economic slack, higher energy prices, and tariffs are pushing inflation higher, and the one-time factors that held down inflation in 2017 have faded. The Fed's preferred inflation measure, the price index of consumption expenditures in GDP, was 1.9 percent in year-over-year terms in June, just below the Federal Reserve's 2 percent objective – it tends to run about a quarter percentage point slower than CPI. The continued tightening of the labor market will push core PCE inflation slightly above the Fed's 2 percent objective by the end of this year and into 2019. The pickup in inflation is consistent with one more quarter percentage point increase in the federal funds target in 2018, at the Fed's late September meeting, to a range of 2.00 to 2.25 percent.

EUROZONE: The euro weakened in response to the Turkish currency crisis: The Financial Times on August 10 reported that the Eurozone's banking regulator, the Single Supervisory Mechanism, was concerned about European banks' exposure to Turkish borrowers and the lira. Foreign currency-denominated claims against Turkish borrowers totaled approximately $180 billion US dollars in the first quarter of 2018 according to the Bank for International Settlements' statistics, equivalent to about 30 percent of Turkish GDP using July 12's exchange rate of 4.9 Turkish lira per US dollar or about 40 percent of GDP at the 7.0 lira per US dollar of August 12. Turkey poses much smaller risk to the Eurozone's financial system than Greece did in 2010. While global banks (especially European banks) have exposures to Turkey, the country is not a Eurozone member and so the Eurozone's risk management framework is much better designed to manage volatility in Turkey than it was for Greece's sovereign debt crisis. In addition, extremely accommodative monetary conditions in advanced economies outside of the United States – euro and yen interest rates are still negative – provide a buffer that should limit contagion from Turkey to other emerging markets. In the near term, financial volatility centered on Turkey will likely continue until they tighten fiscal and monetary policy, institute capital controls, secure aid from the International Monetary Fund, or all of the above.

CHINA: China announced August 8 that they will retaliate dollar for dollar against increased US tariffs with equivalent tariffs on $16 billion in US exports to China, covering autos, motorcycles, coal, and recyclables.

Despite falling on-shore interest rates and rising short- and medium-term interest rates in the United States, Chinese foreign reserves rose $5.8 billion dollars in July to $3.117 trillion dollars, a second consecutive monthly increase. Exports rose 11.2 percent by value in July from a year earlier, and imports 27.7 percent as Chinese buyers rushed to bring in products ahead of tariffs becoming effective; growth in Chinese trade will likely slow in the rest of 2018 and in 2019. CPI inflation picked up to 2.1 percent in year-over-year terms in July from 1.9 percent in June, with CPI excluding food and energy unchanged at 1.9 percent, and gasoline prices up 22.2 percent after a 17.8 percent year-over-year increase in June.

CANADA: A very good jobs report: Employment rose a strong 54,100 in July from June and the unemployment rate fell 0.2 percentage point to 5.8 percent from 6.0 percent. Job growth exceeded the consensus forecast of 17,000 and PNC's forecast for an 18,300 gain. All of July's monthly job growth was in part-time work, but from a year earlier, full-time employment grew 1.4 percent, outpacing the 1.0 percent growth of part-time work. Hours worked matched the year-over-year growth rate of all employment in July at 1.3 percent. Average hourly wages rose 3.1 percent on the year in July, down from 3.6 percent in June and 3.9 percent in May. We expect the Bank of Canada to next raise the overnight rate target in January.

UNITED KINGDOM: Media reports suggest the UK will propose a "Jersey model" for UK-EU relations after Brexit when the EU's heads of state meet next on September 20. This would keep the UK in the EU customs union, allow the UK to limit immigration from the EU, and require the UK to accept EU regulations governing environmental rules, labor relations, and other regulatory policies governing goods production – basically a "soft Brexit." Real GDP growth edged up to 1.3 percent in year-over-year terms in the second quarter of 2018 from 1.2 percent in the first quarter; the temporary drag on growth from bad winter weather abated in the second quarter, matching the Bank of England's current projections. We expect the Bank of England to next raise the Bank Rate in January.

JAPAN: Real GDP picked up to 1.9 percent at a seasonally adjusted annual rate in the second quarter of 2018 after a decline in the first quarter. From a year earlier, real GDP grew 1.0 percent in both the first and second quarters, with positive contributions from net exports, business investment, and consumption offsetting drags from residential investment. Wage growth is picking up as well. Average cash earnings rose 3.6 percent from a year earlier in June, up from 2.1 percent in May and the fastest since 1997. June's cash earnings reflects higher bonus payments; Japanese employers pay bonuses twice per year, once in either June or July and once in December. June's accelerating wage growth might just reflect the timing of bonuses, but other data also point to a pickup in wage growth: The monthly survey on household incomes and expenditures shows incomes of households with working members up 10.0 percent from a year earlier in June, and up 4.8 percent from a year earlier during the first half of 2018. Reuters reports that the Bank of Japan was working on plans to begin to withdraw monetary stimulus earlier this year, but given weak recent inflation data, a dovish monetary policy statement from the Bank of Japan in August, and impending headwinds from the tax hike scheduled for October 2019, a taper of Japanese quantitative easing seems unlikely before year-end 2019.

MEXICO: Consumer confidence surged 13.1 points to the highest since March 2008 in July, reflecting optimism after the July 1 Presidential election which chose a replacement for the incredibly unpopular incumbent Enrique Peña Nieto. CPI inflation picked up to 4.8 percent in July from 4.6 percent in June and 4.5 percent in May, with core inflation unchanged at 3.6 percent, a bit above the central bank's 3.0 percent target. The Bank of Mexico held interest rates unchanged in August on the peso's appreciation between the July 1 election and the August monetary policy decision; the peso depreciated subsequent to that monetary policy decision in sympathy with the Turkish lira. The index of industrial production rose 0.3 percent in June from May and 0.5 percent from a year earlier, with output up on the month in manufacturing, construction, and utilities, and down in mining.

INDIA: Industrial production grew a robust 7.0 percent from a year earlier in June, with manufacturing production up 6.9 percent, mining production up 6.6 percent, and electricity production up 8.5 percent, the fastest electricity production growth since November 2016. CPI inflation dipped to 4.2 percent in year-over-year terms in July from 4.9 percent in May and June, with CPI excluding food and energy slowing to 5.7 percent from 6.1 percent. Strong industrial production data match the robust industrial conditions reported in the Reserve Bank of India's capacity utilization survey released on August 1. We expect the RBI to again raise the policy repo rate by 0.25 percentage point to 6.75 percent at their next meeting October 5.

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