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GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher
Chief Economist

Stuart Hoffman
Senior Economic Advisor

William Adams
Senior Economist

Kurt Rankin
Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

US RETAIL SALES RISING ON STRONG FUNDAMENTALS; US SET TO BROADEN TARIFFS ON CHINESE IMPORTS

UNITED STATES: Retail sales increased 0.1 percent in August, below the consensus expectation for an increase of 0.4 percent, but there was a substantial upward revision to July sales leaving the trend very strong. Overall retail sales rose a robust 6.6 percent in August from one year earlier, down slightly from 6.7 percent growth in July but still the second-strongest gain since early 2012. Consumers are in excellent shape heading into the fall of 2018. Their fundamentals are positive: strong job growth, accelerating wage growth, sturdy household balance sheets, and increasing wealth thanks to rising stock prices and home values. Higher energy prices are a headwind to spending, but one partially offset by the tax cut passed at the end of last year. Consumer spending will continue to increase at a sturdy pace through the rest of this year and into 2019. Tariffs on imported goods are a downside risk to consumer spending; importers pay the cost of tariffs when goods are brought into the United States, and typically pass on the cost to end consumers, raising prices and slowing growth in retail sales volumes. Hurricane Florence may skew the retail numbers for September, with purchases ahead of the storm, declines in sales in the immediate aftermath, and then gains again during the recovery phase. But the hurricane should have minimal impact on consumer spending and the national economy over the longer run and does not affect the outlook for monetary policy. The Wall Street Journal reported on September 15 and 16 that President Trump is preparing to announce tariffs of 10 percent on $200 billion of goods imported from China on September 17. These tariffs, following the tariffs of 25 percent already in force on $50 billion in goods imports, would broaden US tariffs to encompass roughly half of all Chinese goods imported into the United States. The US has invited China to restart trade negotiations in late September, but Chinese sources suggest their government will balk at negotiations after the tariffs are announced, unwilling to negotiate "with a gun to their heads."

CHINA: Activity indicators were cool in August, but not bad enough to force China's government into concessions on trade policy, in our view. Retail sales picked up to 9.0 percent in year-ago terms from 8.8 percent in July, holding steady in real terms since CPI inflation accelerated by the same amount. Real industrial production growth also held steady from a month earlier at 6.1 percent. Cumulative investment in fixed assets slowed to 5.3 percent in August from 5.4 percent in July. Investment fell in the year-to-date period from 2017 for railways, utilities, and chemical manufacturers, and grew weakly in most other manufacturing subsectors. The area where investment is stronger is housing. China appears to again be loosening controls on the sector to offset slower government-funded infrastructure spending and investment in manufacturing. The job market is holding up. The survey-based unemployment rate was 4.9 percent in August after 5.1 percent in July, matching its level in August 2017, and below the 5.1 percent recorded in August of 2016 and 2015. China's unemployment rate is not seasonally adjusted, but a comparison of 2018 readings against prior years' points to a solid Chinese job market despite slowing growth. In sum, August's monthly data reflect an okay economy, but one slowed by the lagged effects of tight credit and money policies. Our estimate of the inflation-adjusted money supply grew a weak 4.7 percent from a year earlier in August, while real loans grew 9.1 percent. China's financial regulators independently determine the volume of money and its price (interest rates). The spread of the one-month interbank rate above the seven-day policy repo rate dropped in the third quarter to the lowest since 2015, indicating abundant interbank liquidity, and contrasting with slow growth of credit aggregates which have restrained spending on investment in fixed assets. Going forward, loosening interbank liquidity is likely to spur faster growth of credit to the nonfinancial sector in late 2018 and 2019. China's August data are a reality check to the perception that its economy has weakened enough to force Chinese concessions on trade policy. While Chinese data have indeed softened in 2018, they are not nearly as weak as Chinese stock indices. Exports to the United States, even counting exports routed through Hong Kong, are less than 4 percent of China's GDP, so the country can stomach trade frictions with the United States for an extended period, if necessary. This makes it quite unlikely, in our view, that Chinese and US tariffs be rescinded near-term.

EUROZONE: The ECB left monetary policy on autopilot at its September 13 Governing Council decision, the last before the taper of its quantitative easing begins in October. The ECB staff macroeconomic projections released at the meeting downgraded slightly the annual real GDP growth outlook for both 2018 and 2019 by 0.1 percentage point, to 2.0 percent and 1.8 percent, respectively. The projections for HICP inflation were unchanged, foreseeing inflation at 1.7 percent in 2018, 2019 and 2020, but the projection for core HICP excluding energy and food in 2019 and 2020 was reduced by 0.1 percentage point in both years, to 1.5 percent and 1.8 percent, respectively. The ECB confirmed that after its QE taper ends in December, they will not begin reducing the size of their balance sheet for an "extended period" – following the same approach as the Federal Reserve and so not a surprise. Economic data are good: Employment rose 0.4 percent in the second quarter of 2018 from the first, not annualized, and 1.5 percent from a year earlier; both growth rates were unchanged from the first quarter and reflect continued steady improvement of Eurozone labor markets. Manufacturing employment grew 0.3 percent on the quarter and 1.6 percent on the year, and construction 0.5 percent on the quarter and 2.2 percent on the year, both outpacing total employment in year-ago terms.

UNITED KINGDOM: Matching our forecast and market consensus, the Bank of England held its bank rate unchanged at 0.75 percent at its monetary policy decision on September 13 and continues to guide financial markets to expect future interest rate hikes to be "at a gradual pace and to a limited extent." Last week delivered no new progress on Brexit negotiations. The labor market is holding up despite slow GDP growth – the unemployment rate was unchanged at 4.0 percent in July, and growth of average earnings including bonuses picked up to 2.6 percent in year-over-year terms from 2.4 percent in June.

CANADA: The housing downturn continues. The Teranet-National Bank National Composite House Price Index™ rose 1.4 percent from a year earlier in August, the weakest increase since October 2009. The seasonally-adjusted index for Toronto fell for a fifth consecutive month, and the seasonally-adjusted indices for Vancouver and Victoria for third consecutive months. Canadian negotiators continue to run down the clock with the United States over the NAFTA renegotiation; if the US midterm elections deliver a Democratic majority in the US House of Representatives, as seems most likely, it would effectively prevent President Trump from unilaterally dropping Canada from NAFTA (the AFL-CIO opposes a Canada-free NAFTA).

MEXICO: Industrial production grew 0.2 percent on the month and 1.2 percent on the year in July, the strongest year-ago growth since November 2016. Manufacturing was flat on the month and up 2.0 percent on the year, down from 2.8 percent in June. The pickup in industrial production was due to stronger nonresidential construction, up 2.5 percent on the month and 11.9 percent on the year.

BRAZIL: Polls show that the leading two candidates in the October Presidential election are now right-wing candidate Jair Bolsonaro and either the Worker's Party candidate or the Democratic Labor Party's; the latter two parties seem likely to beat the polarizing Bolsonaro in a run-off campaign; a leftist President would reduce the likelihood that Brazil takes rapid post-election steps to reduce its fiscal deficit.

INDIA: A welcome drop in inflation: CPI inflation slowed to 3.7 percent in year-ago terms in August, the slowest since October 2017, with inflation excluding food and energy slowing to 5.5 percent from 5.8 percent in July and 6.1 percent in June.