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GLOBAL ECONOMIC HIGHLIGHTS

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FED SIGNALS DECEMBER RATE HIKE; EUROZONE SLOWS; CHINESE FOREIGN RESERVES FALL; BREXIT MORASS

UNITED STATES: As expected, the Federal Open Market Committee unanimously held the federal funds target unchanged at its November 7 meeting, in a range of 2.00 to 2.25 percent. At its previous meeting, on September 26, the FOMC increased the range for the federal funds rate by a quarter of a percentage point. The FOMC began the current tightening cycle in late 2015, and has raised the fed funds target every other meeting (roughly once every three months) since late 2017. The FOMC is set to raise the fed funds rate by another 0.25 percentage point at its next meeting, in mid-December. Its November statement was quite positive on the economic outlook, saying that "economic activity has been rising at a strong rate," with "strong" job and consumer spending growth, but did note business investment moderated. With the potential for labor market overheating, PNC expects two further one-quarter of a percentage point increases in the fed funds target range in 2019, in June and September, which would take the rate to a range of 2.75 to 3.00 percent by this time next year. This is PNC's estimate of the neutral rate, where monetary policy is neither adding to nor subtracting from economic growth, and PNC expects the FOMC to hold the fed funds rate steady there over the longer run. This is somewhat below the median FOMC projection for the fed funds rate of 3.1 percent at the end of 2019 and 3.4 percent at the ends of 2020 and 2021, implying that the FOMC expects monetary policy to become slightly contractionary for growth over the next few years. The fed funds futures market is pricing in a 76 percent probability of a 25 basis point increase in December, and projects a fed funds rate of 2.9 percent at the end of next year, consistent with PNC's forecast. The FOMC's November decision followed the release of an excellent jobs report for October, which showed nonfarm payroll employment up a very good 250,000 from September, exceeding PNC's and the consensus forecast for a 190,000 increase. October's rebound followed weak job growth in September, held back by Hurricane Florence. The unemployment rate was unchanged at 3.7 percent in October, matching our forecast, consensus, and the prior month's reading for the lowest since 1969. The household measure of employment (different from nonfarm payroll employment) rose 600,000 from September, while the labor force rose an even larger 711,000. The labor force participation rate rose to 62.9 percent from 62.7 percent in September; it has been between 62.3 percent and 63.0 percent since the first half of 2014. The broader U-6 measure of under- and unemployment returned to 7.4 percent in October after rising 0.1 percentage point to 7.5 percent in September, and tied for the lowest since April 2001. Revisions to September and August's payroll job growth were modest and offset each other; job growth has averaged 212,500 per month so far in 2018, up from 182,000 per month in 2017. The first 10 months of 2018's rapid job growth demonstrates that the US economy has yet to bump up against labor supply bottlenecks that could put an end to the current expansion. This is despite a job market that is extremely tight by most measures. The number of job openings has exceeded that of active jobseekers since March. As employers compete to attract and retain workers, growth of average hourly earnings is finally accelerating, and in October reached 3.1 percent in year-over-year terms, the fastest since April 2009. In short, the US labor market was in excellent shape in October. The unemployment rate was the lowest since 1969, wage growth the strongest since 2009, and the number of job openings has exceeded active jobseekers since March. A strong job market and buoyant consumer confidence – The Conference Board's Consumer Confidence Index® was the highest since the fall of 2000 in October – will make 2018 a very good year for holiday spending. However, trade is becoming a headwind for US growth as trade frictions grow: The new export orders sub-index of the closely watched ISM manufacturing index dipped to its lowest level since November 2016 in October.

EUROZONE: The Eurozone's slowdown continues. The Markit services PMI fell to 53.7 in October and, while better than the 53.3 flash estimate, was still down from 54.7 in September to the weakest since January 2017. The Markit composite PMI (which Markit calculates as the simple average of the manufacturing and services PMIs) in October fell to its lowest since September 2016. The more growth wanes, the more likely that the European Central Bank delays their initial interest rate hike until after June 2019, PNC's current forecast for the initial rate hike.

CHINA: Official foreign reserve assets fell $86.9 billion dollars to $3.053 trillion in October; foreign reserves have fallen in six of the first ten months of 2018, and are down $86.9 billion from their 2017 close. Rising US interest rates, tighter US financial conditions, trade friction, a bear market in Chinese stocks, and lagging Chinese growth momentum are all contributing to capital outflows from China. But unlike in 2015 and 2016, when capital outflows were seen as both a sign and catalyst of domestic financial turbulence, capital outflows in 2018 can be clearly attributed to developments outside of China. Even after the drop in foreign reserves through October, China's central bank still holds over $3 trillion, situating it well to withstand potential financial turbulence as advanced economy central banks normalize monetary policy. We expect some of the pressure on China's currency and financial system to abate in the next few quarters as US growth momentum peaks, the US yield curve flattens, the US trade deficit widens, and the dollar depreciates against most foreign currencies. The Trump Administration leaked news November 12 that they could soon impose tariffs on imported automobiles and components on national security grounds.

UNITED KINGDOM: Matching our forecast, the Bank of England held their policy Bank Rate unchanged at their November 1 Monetary Policy Committee decision. The Conservative-led governing coalition is showing more cracks as the end of the Brexit negotiation approaches and forces difficult decisions. Its Transportation Minister resigned November 9 after deciding the Brexit deal currently under negotiation is too different from the vision Brexiteers offered prior to the referendum to be supportable, and that a no deal Brexit would be disastrous for British logistics. He is the sixth minister to resign so far over the government's Brexit position. The Democratic Unionist Party, the Northern Irish junior party to the government, reiterated their opposition to Prime Minister May accepting the EU's proposal for a "backstop" that would keep Northern Ireland inside the EU's regulatory and trade rules after Brexit, and in a separate customs regime than the rest of the UK, if a mutually acceptable alternative cannot be identified. As junior party to the government, the DUP hold the power to force a special election to veto the Brexit deal. Both the resigning Transportation Minister and the yet-to-resign Brexit Secretary emphasized last week that leaving the EU's customs union would cause seismic supply chain disruptions, since the UK's just-in-time logistics system has no substitute to free trade across the Channel Tunnel, which connects the UK to France (the Brexit Secretary also admitted that he had not, until quite recently, understood the importance of the Channel Tunnel to the economy). A Hard Brexit would be an unacceptable disaster to any government, but the government seems unable to reach a Soft Brexit deal that a majority in parliament can support. By process of elimination, the UK will most likely remain in the EU at the end of Brexit negotiation. A poll released November 5 showed 54 percent of respondents would support remaining in the EU in a second referendum, and two thirds support continued close relations with the EU.

CANADA: The unemployment rate edged back down to a four-decade low of 5.8 percent in October, but the jobs report's details disappointed. Employment rose a modest 11,200, while the labor force fell 18,200, lowering the labor force participation rate to 65.2 percent, down 0.2 percentage points on the month and 0.5 percentage points on the year. Full-time employment rose 33,900 on the month and part-time employment fell 22,600, but since self-employed workers are all considered full-time, this statistic overstates the quality of job growth. The number of employees fell 10,600 in October, offset by a 21,800 rise in self-employment. Tellingly, growth in total hours worked lagged that of jobs in the last 12 months as self-employed workers averaged fewer productive hours. Employment fell 12,000 in goods-producing sectors, with drops in resource extraction, construction and agriculture and a small 1,700 gain in manufacturing employment. The mediocre composition of October's employment gains held back wage growth: Growth of average hourly earnings slowed to 2.2 percent in October from 2.4 percent in September and was the slowest since September 2017; hourly earnings growth is down sharply from its recent peak of 3.9 percent in May 2018. Real wages were essentially unchanged in October – the most recent CPI report for September showed inflation was also 2.2 percent in year-over-year terms. Wage growth continues to disappoint in Canada, reinforcing our expectation that the Bank of Canada will hike interest rates slower than the Federal Reserve in 2019, contributing to further depreciation of the Canadian dollar against the US dollar.

BRAZIL: The IHS Markit Brazil services PMI rebounded to 50.5 in October from 46.4 in September, and the manufacturing index rose to 51.1 from 50.9. CPI inflation was little changed in October, at 4.56 percent in year-over-year terms after 4.53 percent in September. Trimmed mean core inflation was 2.7 percent after 2.8 percent, well below the central bank's target of 4.5 percent plus or minus 1.5 percent. The Brazilian real at 3.7 per dollar is holding the gains registered since financial markets began assuming a return to orthodox market-oriented economic policy following the October Presidential election. Execution risks remain substantial, but a path is clearing for Brazil to return to a lower inflation, faster growth economic trajectory.

MEXICO: Mexican stocks fell to their lowest since February 2016 in November 9's intraday trading after another sudden shift in economic policy from the government of incoming President Andres Manuel Lopez Obrador (AMLO). Senators of President AMLO's Morena party unexpectedly introduced a bill Friday morning to reduce domestic banking commissions, pushing down financial stocks. The latest surprise reinforced a deterioration of financial market sentiment that began when the new government cancelled construction, already 30 percent completed, of the world's second largest airport for Mexico City. An October 25-28 referendum rejected the project, which had been financed by a multi-billion dollar international bond issue. Ratings agency Fitch lowered the outlook on Mexico's sovereign credit rating to negative on October 31, after the project's cancellation, citing increased policy uncertainty. President AMLO stated in a press conference late on November 9 that he would not support the Senator's bill to cut banking commissions, and that banking laws would be unchanged for the next three years,; equity losses reversed by the day's close. AMLO's Morena party was only founded in 2011, has never held national power before this year, and is going through obvious growing pains. AMLO, though, is politically experienced. He was seen as an effective Head of Government of Mexico's wealthiest and largest city Mexico City from 2000 to 2005, a period during which Mexico City had successful public-private partnerships and rapid investment in urban revitalization. Over time, the Morena government will probably find a balance between left-leaning social policy goals and policies that attract the foreign investment needed for economic growth, but there will probably be further bumps in the road along the way. In the meantime, the Bank of Mexico will likely tighten monetary policy to bolster the currency and maintain capital inflows to Mexico during the present period of uncertainty, limiting the economy's ability accelerate. We forecast for the Bank of Mexico to raise its policy rate 0.25 percentage point to 8.0 percent at its November 15 decision. Recent economic data point to a pickup in manufacturing activity after the end of the NAFTA renegotiation. Industrial production rose 1.0 percent in September from August. Manufacturing output rose an even larger 1.1 percent, and was up 3.9 percent from a year earlier, the fastest growth in those terms since May 2017. Construction output also grew solidly on the month, but this was only a partial recovery from August's even larger drop; construction output was unchanged from a year earlier. CPI inflation slowed to 4.9 percent in year-over-year terms in October from 5.0 percent in September due to slower inflation in energy prices and tariffs set by the government; core services inflation accelerated to 3.5 percent from 3.4 percent and exceeded the central bank's 3.0 percent target.

INDIA: A flurry of news coverage in late October and early November have focused attention on frictions between India's mostly-independent central bank and its government. The central bank has been raising interest rates and tightening oversight of the financial system to maintain access to foreign capital, after the default of a nonbank financial corporation in October added to pressures on foreign funding caused by rising Indian inflation and higher interest rates in the United States. Tensions over central bank independence will likely stay prominent as current economic data pressure the Reserve Bank of India to keep raising interest rates into 2019 during the lead-up to the next general election in April or May of 2019. Industrial production growth slowed to 4.5 percent in September from 4.7 percent in August on slower manufacturing growth, 4.6 percent in September after 5.1 percent in August and 7.0 percent in July. Manufacturing and industrial production will likely pick up again in October: The Nikkei manufacturing PMI rose to 53.1 in October from 52.2 in September, and the services PMI rose to 52.2 from 50.9. CPI inflation slowed to 3.3 percent in October from 3.7 percent in September as food prices fell from a year earlier, but CPI excluding food and energy accelerated, to 5.7 percent from 5.4 percent.

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