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GLOBAL ECONOMIC HIGHLIGHTS

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US AND CHINA PAUSE TARIFF ESCALATION FOR AT LEAST A FEW MONTHS; UK PARLIAMENT TO VOTE ON BREXIT BILL

UNITED STATES: The US and Chinese governments announced a 90-day pause in tariff escalation after Presidents Trump and Xi Jinping's Saturday night working dinner at the Buenos Aires meeting of the heads of state of the Group of 20, the world's largest economies. Both countries' governments pledged to refrain from raising further barriers to trade while their representatives negotiate. The gap between their positions is wide on the fundamental issues: The US-China trade imbalance, unfair Chinese trade practices, and Chinese state support for economic champions. 90 days is very little time to fix these perennial issues. But at least, a delay in tariff escalation is positive for the near-term economic outlook, and the decision keeps alive the prospect of a resolution of the US-China trade conflict. The Federal Reserve's recent language describing the outlook for interest rate hikes seems to be preparing markets for a slowdown in their pace; the Fed has raised interest rates at every other Open Market Committee meeting (roughly quarterly) since late 2017. Chairman Jerome Powell stated in a speech on November 28 that interest rates were "just below" the range where Fed policymakers believe they will neither hinder nor boost growth (a.k.a. the "neutral" rate). His statement is a sharp contrast to his prior statement on the neutral rate made October 3, when he said interest rates were "a long way from neutral" – the Federal Funds rate was essentially the same October 3 and November 28, so Powell's change in tone reflects a change in thinking. On November 29, the Fed released the minutes of its November 7-8 Open Market Committee meeting, revealing that FOMC members debated altering the statement that they expect to make "further gradual increases" in the Federal Funds rate in future monetary policy statements. This is another sign the Fed is preparing to slow rate hikes, or end them entirely. PNC Economics forecasts for the Fed to raise the Federal Funds target 0.25 percentage point to 2.25 to 2.50 percent at its last meeting of this year December 18 and 19, and then to pause rate hikes until mid-2019.

UNITED KINGDOM: Parliament will vote December 11 on the Withdrawal Agreement negotiated by the Prime Minister's team with the European Union. British press coverage and informal surveys of Members of Parliament make a vote against the Agreement seem most likely. If so, near-term British financial market reactions would likely be only moderate – further depreciation of the UK's currency of a few US cents per British pound sterling, and knock-on effects on British stocks – and tempered by perceptions that the British government is bluffing, and in fact is very unlikely to follow through with a no-deal Brexit. If the British National Health Service begins to describe how rationing of medications and medical supplies caused by a no-deal Brexit would affect healthcare, Parliament will quickly reassess. Our view continues to be that the unpopularity of the Withdrawal Agreement makes its passage unlikely, and the huge costs of a No-Deal Brexit make it even more unlikely. By process of elimination, the UK will most likely remain at least a de facto member of the EU single market after March 2019, either because a second referendum reverses the Brexit decision, or because the EU and UK extend the UK's EU membership (an open-ended "transition period") and muddle through.

EUROZONE: ECB President Mario Draghi acknowledged the Eurozone's recent slowdown in economic growth in his comments to the European Parliament November 26, but argued that "some of the slowdown may also be temporary" and due to "country and sector-specific factors." The Eurozone's unemployment rate was 8.1 percent in October, unchanged from September and the lowest since November 2008. The lowest unemployment rate recorded in the Eurozone since its founding in 1999 was 7.3 percent in late 2007 and early 2008. The Eurozone's benchmark inflation rate the Harmonized Index of Consumer Prices was 2.0 percent in November, down from 2.2 percent in October on slower increases in energy and food prices; core measures of HICP edged 0.1 percentage point lower on the month to a range of 1.0 to 1.2 percent depending on the price basket used. After November's drop in global oil prices, inflation will slow further in the Eurozone after the turn of the year. Cooler inflation and the slower growth signaled by recent PMI surveys will likely cause the ECB to hold off on their initial interest rate hike until September 2019 or later.

CHINA: China's growth continues to slow: The CFLP manufacturing PMI was 50.0 in November, the weakest since July 2016, and the CFLP nonmanufacturing PMI was 53.4, the weakest since August 2017. The Caixin general manufacturing PMI edged up to 50.2 from 50.1 a month earlier. Business and financial sentiment in China will get a modest boost from the pause in tariff escalation with the US, but the Chinese government's policy of slowing credit growth is still hindering economic growth.

CANADA: US, Canadian, and Mexican governments formally signed off on the NAFTA-rewrite, the US-Mexico-Canada Agreement, at the G20 meeting on December 1, but the deal will not enter into effect until ratified by the US Congress. President Trump is threatening to unilaterally withdraw from NAFTA to force Congress to sign the USMCA as its replacement. Real GDP growth slowed to 2.0 percent annualized in the third quarter of 2018 from 2.9 percent in the second quarter, held back by a contraction in investment in residential and nonresidential structures as well as slower growth of household spending. We expect nonresidential spending to pick up again with USMCA signed, but residential investment will still be a headwind.

BRAZIL: Real GDP grew 1.3 percent from a year earlier in the third quarter of 2018, up from 0.9 percent in the second quarter (revised down from 1.0 percent in the prior report). The unemployment rate fell to 11.7 percent in the August to October quarter, the lowest since the May to July quarter of 2016. Growth momentum in early 2019 will likely improve upon the modest growth implied by these data, since uncertainty ahead of the October election likely held back economic activity in September and October.

MEXICO: As expected, the minutes of the Bank of Mexico's November monetary policy committee meeting, which raised Mexico's policy rate 0.25 percentage points to 8.0 percent, cited domestic policy uncertainty and global financial volatility as reasons to tighten monetary policy, and said that the risks to inflation had deteriorated since the committee's prior meeting. President Andres Manuel Lopez Obrador was sworn into office on December 1, promising policies to prioritize Mexico's poor, reduce wasteful government spending and corruption, and fund increases in social services. After President Lopez Obrador spooked financial markets by cancelling construction of Mexico City's new airport (a project financed by a global bond issue) in October, we expect the Mexican peso to stay weak near term. But if President AMLO regains market confidence, the peso can also recover, buoyed by the end of NAFTA uncertainty and a related pickup in export-oriented manufacturing.