December 10, 2018

GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Abbey Omodunbi** Economist

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

US ADDED FEWER JOBS IN NOVEMBER, BUT WAGE GROWTH STILL STRONG; BREXIT VOTE DECEMBER 11

UNITED STATES: A cooler jobs report for November after a hot October. The unemployment rate held steady at the lowest since 1969 and wage growth was solid, but payroll job growth slowed and other details like the U6 broad un-and-underemployment rate and average number of hours worked softened. Payroll jobs growth slowed to 155,000 in November after a 237,000 gain in October, downwardly revised from 250,000 in the prior report. The unemployment rate was unchanged at 3.7 percent in November, the lowest since 1969. PNC had forecast a 190,000 gain in payroll employment and consensus a 200,000 gain. In addition to the downward revision to October job growth, September payroll jobs growth was revised up a hair to 119,000 from 118,000, so net downward revisions to payrolls were a modestly negative 12,000. 2018's above-trend job growth has slowed at the year's end: Job growth averaged 206,000 per month in the first eleven months of 2018 but just 170,000 over the last three months. The more volatile household survey data from which the unemployment rate is calculated tell a better story, though. Household employment rose 233,000 in November after a huge 600,000 added in October. The labor force rose 133,000 in November after a 711,000 gain in October. However, the average workweek edged down to 34.4 hours in November from 34.5 hours in October and the broad U6 alternative measure of labor force slack – including unemployed, people who would like to work but haven't actively sought a job, and part-time workers who want to work full-time – rose to 7.6 percent in December from 7.4 percent in October to the highest since June. By industry job gains were fairly broad-based. Employment rose 27,000 in manufacturing and 5,000 in construction, though fell 3,000 in mining; retail was up 18,000, transportation and warehousing 25,000, and professional and business services 32,000. Employment in education and health services rose 34,000, and leisure and hospitality employment rose 15,000. Government employment fell 6,000 with federal up 3,000, state down 13,000, and local up 6,000. Hours worked edged lower in construction, durable goods manufacturing, education and health services, and leisure and hospitality. The labor market continues to be tight, with the number of job openings exceeding active job seekers (the officially unemployed) since March. Wage growth is picking up as a result: Average hourly earnings rose 0.2 percent on the month and 3.05 percent on the year, close to October's 3.1 percent year-over-year increase, which was the fastest since April 2009. Slower job growth is no surprise in a tight job market. With the unemployment rate below the Fed's estimate of where it will average over the course of the business cycle, and inflation near the Fed's target, the Fed will probably still hike the federal funds in December unless the stock market sell-off gets far worse. But slower recent job growth supports our forecast that the Fed will pause rate hikes in the first half of 2019, and raise rates only twice in 2019, slower than 2018's four hikes.

UNITED KINGDOM: The past week's news flow reinforces our impression that Parliament is likely to vote against the Withdrawal Agreement negotiated by the Prime Minister and the European Union on December 11. If so, financial market reactions will likely be far smaller than the reaction to the 2016 referendum, tempered by perceptions that Parliament is bluffing, and is in fact very unlikely to follow through with a no-deal Brexit. The UK has over a period of decades dismantled the infrastructure necessary to conduct customs checks on trade between it and the rest of the EU, and would suffer severe logistical bottlenecks in a no deal Brexit that would require quotas for shipping capacity across the UK's most important logistics link with the outside world, the Channel Tunnel, a huge hindrance to private enterprise. It seems very possible that a new Prime Minister will take power after the December 11 vote – while this person could technically try to play chicken with the no deal Brexit iceberg, the huge costs of actually following through make it an extremely unlikely policy choice. The unpopularity of the Withdrawal Agreement makes its passage unlikely as well. 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: The ECB's December 12 Governing Council meeting will be the last before the Bank ends its quantitative easing program December 31. The aspect of the meeting with the most market-moving potential is the release of economic projections, which will incorporate recent signs of slower growth and the large drop in oil prices since the last round of projections was compiled ahead of the September meeting. The September economic projections foresaw real GDP growth of 1.8 percent in 2019 and 1.7 percent in 2020 and HICP inflation of 1.9 percent in 2019 and 1.7 percent in 2020. The December-round projections will mark down the 2019 real GDP growth forecast to 1.5-1.7 percent after Eurozone business sentiment surveys reached multi-year lows in November, and lower the HICP inflation projection at least for 2019 – and potentially for 2020 as well. PNC forecasts for the ECB to refrain from raising policy interest rates until September 2019 or later depending on the degree to which slower growth persists in early 2019.

CHINA: China's trade surplus with the United States hit a record high $35.6 billion US dollars in November as Chinese exports to the US grew 9.8 percent from a year earlier and imports plunged 25.0 percent; China's retaliatory tariffs on US grains and other food exports are depressing demand for US products, while the robust US expansion is fueling strong demand for Chinese goods; US businesses are front-loading purchases of Chinese goods in case US tariffs rise further down the road, further fueling purchases of Chinese goods. Chinese imports and exports from all countries both slowed in November in year over year terms, but some of this slowdown reflects falling prices of oil and other commodities. Chinese foreign reserves rose $8.6 billion US dollars in November after falling $33.9 billion in October; foreign reserves have been trending down since January as the dollar strengthened and US interest rates rose. CPI inflation slowed to 2.2 percent in November from 2.5 percent in October on slower food price inflation. Core CPI inflation excluding food and energy was unchanged at 1.8 percent.

CANADA: A stellar November jobs report: Employment surged 94,000 and the unemployment rate fell 0.2 percentage points to 5.6 percent, the lowest since comparable data began in 1976. From a year earlier, employment grew a moderate 1.2 percent and hours worked 2.0 percent as full-time employment grew 1.5 percent and part-time fell 0.2 percent. By industry, employment in goods-producing sectors was up 27,000 on the month but basically unchanged (zero growth) from a year earlier, with a 54,000 year over year decline in manufacturing employment offsetting growth in agriculture, construction, utilities and the resource sector. Average hourly wages grew a tepid 1.7 percent from a year earlier in November, down from 2.2 percent in October and lagging Canada's most recent 2.4 percent increase in consumer prices from the October CPI report. While the monthly change in employment was excellent, and the unemployment rate is at a record low, Canada's tepid wage growth reinforces the view expressed in the Bank of Canada's December monetary policy statement that "there may be additional room for non-inflationary growth." The Bank of Canada held its benchmark overnight rate target unchanged as expected December 5, and emphasized the downside risks to GDP growth from the drop in Canada's oil price benchmark Western Canada Select to under $20 per barrel in November. Western Canada Select recovered in December but due to planned production cuts, not an improvement in transportation bottlenecks. The energy sector will be a drag on growth near term. PNC continues to forecast that the Bank of Canada will next raise its policy interest rate in April 2019, and will then make one more rate hike in 2019 at the October meeting.

BRAZIL: We expect the Central Bank of Brazil to hold its benchmark Selic rate unchanged at 6.5 percent at its next monetary policy decision December 12. While inflation slowed to 4.1 percent in November from 4.6 percent in October, much of this was pass-through of lower commodity prices to the CPI basket and the less weak Brazilian currency. More important for Brazil's interest rate outlook is whether the administration of new president Jair Bolsonaro can push through fiscal austerity measures in 2019 that help Brazil regain an investment grade credit rating.

MEXICO: CPI inflation slowed to 4.7 percent in year over year terms in November from 4.9 percent in October on slower increases of energy prices, up 13.3 percent in November after 17.1 percent in October;

core inflation slowed marginally as inflation in non-food merchandise and services slowed by a tenth of a percentage point. Inflation is coming closer to the Bank of Mexico's 3 percent target, but the central bank is unlikely to cut interest rates until financial market perceptions of Mexican political risk improve.