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GLOBAL ECONOMIC HIGHLIGHTS

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MONETARY POLICY ON HOLD IN U.S. AND JAPAN THIS WEEK, AND LIKELY IN U.K. TOMORROW, TOO

UNITED STATES: As expected, the Federal Open Market Committee held the target for the federal funds rate unchanged at a range of 0.50-0.75 percent at its meeting today. PNC Economics forecasts that nonfarm payroll employment will rise by 200,000 at the release of the January report on Friday, with the unemployment rate unchanged at 4.7 percent and average hourly earnings up 0.2 percent on the month and 2.6 percent year on year, down from December's 2.9 percent year-ago increase. ADP's survey of private employers showed 246,000 private payroll jobs added in January from December.

JAPAN: As expected, the Bank of Japan held its monetary stance unchanged at its interest rate decision January 31. The BoJ's targets for its short-term policy rate and 10-year JGB yield are unchanged at -0.1 percent and "around zero percent," respectively. The BoJ will continue to purchase Japanese government bonds, ETFs, and REITs at unchanged paces. The BoJ Policy Board upgraded its forecasts for Japanese economic growth in the January "Outlook for Economic Activity and Prices," a report which plays the same role for the BoJ that the "dot plot" does for the Federal Reserve. The median member of the BoJ Policy Board raised their real GDP growth forecast for fiscal year 2016 (April 2016 – March 2017), FY 2017, and FY 2018 by 0.4 percentage points, 0.2 percentage points, and 0.2 percentage points, respectively, to 1.4 percent, 1.3 percent, and 1.1 percent, respectively. The Policy Board's forecasts for CPI excluding fresh food, by contrast, are little changed at -0.1 percent (previously -0.2 percent) for FY2016, 1.5 percent for FY2017, and 1.7 percent for FY2018. Japan's shrinking labor market means that even with real GDP growth of barely more than 1.0 percent, its economy is growing above potential, tightening the labor market. Offsetting a labor market that is cyclically hot and getting hotter is Japan's incredibly weak demographic makeup. New hiring is concentrated among Japanese women over 30 and men over 50, demographic groups who tend to be hired into lower-paid part-time and casual employment, and who consequently tend to earn lower wages, on average, than incumbents in the Japanese workforce. This change in Japan's employment composition is holding down Japanese wage growth and preventing a faster rise in inflation expectations. Despite above trend real GDP growth, the Bank of Japan shows little inclination to withdraw monetary stimulus, and in fact, the Policy Board's January monetary policy statement reiterates its commitment to "continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner." The Bank of Japan will not reduce its asset purchases in 2017, and, like the ECB, seems unlikely to raise short-term interest rates out of negative territory in 2018. With the BoJ, ECB and BoE maintaining super loose monetary policies and Trumponomics set to push the Fed to raise interest rates faster in 2017 and 2018, interest rate differentials favor further appreciation of the dollar against the currencies of other advanced economies in 2017 and 2018.

UNITED KINGDOM: The Bank of England will likely extend its quantitative easing program and leave interest rates unchanged at its Monetary Policy Committee meeting tomorrow, February 2. The Bank of England still expects Brexit to be negative for British consumer spending as higher import prices erode real spending power, and for increased barriers to British services exports to the EU (5 percent of the UK's GDP) to reduce growth in the next two years.

CHINA: China's economy started 2017 growing faster than at the start of 2016. The CFLP manufacturing PMI at 51.3 in January was little changed from December's 51.4, as was the nonmanufacturing PMI, at 54.6

after 54.5. The two indexes in January 2016 were up 1.9 and 1.1 percentage points, respectively, from their respective January 2016 levels of 49.4 and 53.5.

EUROZONE: Real GDP grew 0.5 percent in quarterly (not annualized) terms in the flash estimate for the fourth quarter of 2016, and 1.8 percent in year-ago terms, unchanged from the third quarter. Real GDP growth was an above-trend 1.7 percent for the full year of 2016. CPI inflation picked up to 1.8 percent in January from 1.1 percent in December on an 8.1 percent year-ago increase in energy prices (up 2.6 percent in December); core inflation of HICP excluding energy, food, alcohol & tobacco was unchanged at 0.9 percent. The ECB has said they will look through temporary increases in headline inflation and focus on core inflation, wages, and the output gap in making monetary policy. The unemployment rate fell to 9.6 percent in December from 9.7 percent in November and was the lowest since May 2009. The Markit manufacturing PMI for the Eurozone rose to 55.2 in January from 54.9 in December and was its strongest since April 2011.

CANADA: PNC Economics forecasts a 24,000 monthly decline in Canadian household employment in the January jobs report, which Statistics Canada will release on Friday, February 10. Canadian economic growth picked up in the second half of 2016 as the drag from lower oil prices abated, and as Canadian consumers powered domestic demand. Nevertheless, a monthly decline in employment seems likely in January after December’s outsized 54,000 monthly increase, and the second half of 2016’s 171,000 or 1.9 percent annualized increase. Even if employment falls in January, it would still be up a respectable 1.1 percent from a year earlier; that would be the second-fastest month of annual employment growth since May 2015. While Canadian topline job growth is holding up, the composition of Canada’s recent employment gains leaves something to be desired. Among prime working-age Canadian men, who are disproportionately employed in Canada’s extractive, manufacturing, and construction industries, full-time employment fell 0.1 percent on the year in December, while part-time employment rose 11.9 percent. Given the modest 0.9 percent year-ago growth of goods sector output in the latest monthly GDP report for November, job creation in these higher-wage industries likely continued to lag the overall economy in January. Headline monthly real GDP grew 1.7 percent on the year in November, lifted by a 2.0 percent increase in services output. Notwithstanding our forecast for a downbeat headline for the January jobs report, the Bank of Canada is very unlikely to cut interest rates this year. The year-over-year comparison of energy prices will start to raise Canadian headline inflation in 2017, and the US fiscal stimulus program which looks like it will be announced soon should spill over and boost Canada’s growth outlook in 2017 and 2018. With US interest rates already at a premium to comparable Canadian benchmarks and headed higher, the Bank of Canada is going to come under pressure to follow the Fed and raise rates. In the base case, we expect a first Canadian interest rate hike in the first quarter of 2018; a widening premium of US interest rates above Canadian interest rates seems likely to pressure the Loonie to depreciate against the dollar in 2017 and 2018. PNC Economics forecasts for the Loonie to average $1.36 Canadian per US dollar in the first half of 2017, and $1.37 Canadian per US dollar in the second half of 2017 and in 2018. The Markit manufacturing PMI for Canada rose to 53.5 in January from 51.8 in December and was its strongest since December 2014.

MEXICO: January’s weak Mexican business confidence surveys support our view that a Mexican recession is likely in 2017. The Mexican statistical agency INEGI’s index of business confidence fell to 42.8 in January from 46.4 in December, with investment intentions an abysmal 32.0. We forecast a contraction in Mexican fixed capital investment, which accounts for about 5 percent of GDP, in the first quarter. The survey of manufacturing orders also fell in January although by less, to 51.2 from 51.4. Pessimistic business managers will limit levels of inventories in early 2017, also negative for Mexican growth prospects. Business expectations (a separate survey conducted by Mexico’s statistical agency) fell to 52.0 in January from 52.4 in December. While the Markit manufacturing PMI for Mexico edged higher in January to 50.8 from December’s 50.2, it is still close to its weakest since mid-2013. The Bank of Mexico is likely to raise its benchmark target interest rate 0.50 percentage points to 6.25 percent at its next interest rate decision Thursday, February 9, a further drag on Mexican capital investment and durable goods demand. Real GDP grew 2.2 percent in year-ago terms in the fourth quarter of 2016, up from 2.0 percent in the third quarter, and grew a below-potential 2.3 percent for the full year of 2016. In the fourth quarter, primary or agricultural activity rose 6.4 percent on the year, tertiary or services activity rose 3.2 percent, and secondary or industrial activity fell 0.2 percent.

BRAZIL: Industrial production rose 2.3 percent on the month in December, and contracted 0.1 percent on the year, the least-bad month for Brazilian industry since February 2014. Manufacturing production fell 1.2 percent on the year December, while mining output grew solidly, up 6.9 percent. The Markit manufacturing PMI for Brazil points to a sharper contraction in January; it dropped to 44.0, the weakest in seven months, from 45.2 in December. But global reflation is helping Brazilian mining and will contribute to a modest recovery of real GDP in 2017.

AUSTRALIA: Business conditions improved in December, but a reversal of the prior six months' downtrend is not yet in the cards. The National Australia Bank's index of business conditions surged to +11 in December from +6 in November. This is well-above its long-run average of +6. Big gains in trading conditions, profitability and orders boosted the monthly index, especially in wholesaling and transportation industries. The separately calculated business confidence index at +6 in December was unchanged from November and was up from +4 in December 2015. Despite this year-end bounce, it is too early to declare that business conditions are on an upward trajectory. Business conditions for retailers deteriorated during most of the second half of 2016 and ended the year at -6 in December. This shows that Australia's economic growth is vulnerable, since consumer spending is the economy's largest growth driver. Moreover, other important industries such as manufacturing and mining have yet to stage comebacks after enduring their own bouts of weakness. In sum, the NAB's data show the Australian economy went into 2017 bouncing along in a positive, but less sure-footed manner than when it went into 2016.

INDIA: Demonetization continues to drag on the Indian economy. The Nikkei manufacturing PMI for India edged higher to 50.4 in January from December's 49.6, but was still the second weakest since December 2015, when the Chennai floods caused severe dislocations in Indian manufacturing supply chains. Modinomics is not living up to the hype.