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GLOBAL ECONOMIC HIGHLIGHTS

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US WAGE GROWTH ACCELERATES ON TIGHT JOB MARKET; BROAD BASED GLOBAL GROWTH CONTINUES

UNITED STATES: Average hourly earnings rose 0.3 percent in January from December and, after revisions to earnings growth in 2017, grew 2.9 percent in year-over-year terms, the fastest since June 2009. Minimum wage increases likely lifted January wage growth, and some employers may have delayed year-end bonuses into 2018 when tax rates are lower. The unemployment rate held steady at 4.1 percent, and nonfarm payrolls rose 200,000 from December with 24,000 net downward revisions to job growth in the prior two months. Stocks fell Friday and the yield on the 10-year Treasury bond touched 2.85 percent as faster wage growth reinforced expectations for higher inflation. Inflation data in hand are still below the Fed's target: The personal consumption expenditures price index (the Fed's preferred measure of inflation) rose 0.1 percent in December from November and 1.7 percent from a year earlier, and core PCE excluding food and energy rose 0.2 percent on the month and 1.5 percent on the year. President Trump's State of the Union address on January 30 laid out several economic policy goals for the year ahead: Bipartisan compromises on infrastructure spending and immigration, new vocational training programs, and a program to help former inmates find jobs. President Trump also repeated his pledge to ensure fair and reciprocal trade relationships, but not his campaign threats to unilaterally withdraw from NAFTA or impose across the board tariffs on imports from China, Mexico, or Japan. He did not mention the budget deficit, which the Tax Cuts and Jobs Act will increase, and which higher infrastructure spending would increase further – another reason for inflation expectations to be rising. The Federal Reserve's policy statement on January 31 said inflation is "expected to move up this year and stabilize around the Committee's 2 percent objective over the medium term," a little more hawkish than the previous statement's view that inflation "is expected to remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term." The January statement is consistent with PNC's call for three fed funds rate increase in 2018, matching the median of the last Summary of Economic Projections, or "dot plot," from December 13. But the timing remains uncertain: PNC's January interest rate forecast assumes the increases in the fed funds rate will come at the FOMC's June, September, and December meetings. However, the fed funds futures market is currently pricing in an 86 percent probability of a rate increase at the FOMC's next meeting, on March 21. Risks to the PNC forecast are for rate hikes to take place sooner, rather than later, and for more rate hikes than in our baseline forecast, not fewer. The next FOMC meeting will be Jerome Powell's first as chair of the Federal Reserve. He is currently a member of the Fed Board of Governors, and is expected to represent continuity with Chair Yellen's monetary policy. Yellen's tenure was largely successful, with the unemployment rate falling to a 17-year low. The one blemish is that inflation remained consistently below the FOMC's 2 percent objective, but it is expected to move toward that goal this year.

EUROZONE: Growth continues above trend. According to Eurostat's flash estimate, real GDP grew 0.6 percent on the quarter in the fourth quarter (not annualized) and 2.7 percent on the year, close to the third quarter's 0.7 percent and 2.8 percent respective increases. Over the whole year of 2017, real GDP grew 2.5 percent, faster than the US's 2.3 percent increase. HICP inflation slowed to 1.3 percent in the January flash estimate from 1.4 percent in December, both in year-over-year terms, as the stronger euro caused food and energy prices to rise more slowly. Core inflation was either flat or marginally higher and between 1.0 and 1.25 percent, depending on the price basket referenced. The unemployment rate held steady at 8.7 percent in December, the lowest since January 2009.

JAPAN: The Bank of Japan offered unlimited purchases of government bonds with 5 to 10 years remaining maturity on February 1 to prevent the benchmark 10-year government bond yield from rising above 0.1 percent. The BoJ's quantitate easing program targets a 10-year government bond yield of "around zero" percent, which in practice means holding the 10-year bond yield within a range of -0.1 to 0.1 percent. The BoJ shows no inclination to change their monetary stance in 2018. The summary of opinions from their January 22 and 23 Policy Board meeting shows broadly dovish views on the outlook for inflation: Board members expect inflation to "increase moderately," but the change is expected "gradually," and one Policy Board member thinks that the unemployment rate needs to fall to 2.0 percent (the lowest since 1992!) from December's 2.8 percent before wage costs rise and push inflation up to the BoJ's two percent target. Trend inflation is rising, but still well below the target. Trimmed mean inflation rose from 0.3 percent in year-over-year terms in June 2017 to 0.7 percent in December, weighted median CPI to 0.2 percent from 0.0 percent, and modal CPI was unchanged at 0.2 percent. Despite the yen's appreciation, the Nikkei manufacturing PMI rose to 54.8 in January from 54.0 in December and was the strongest since February 2014.

CANADA: Real GDP grew 0.4 percent in November from October, with goods output up 0.8 percent on a 1.8 percent increase in manufacturing GDP, and services output up 0.3 percent. From a year earlier, real GDP grew 3.5 percent in November, with goods output up 4.1 percent and services output up 3.2 percent. PNC Economics forecasts a strong 36,700 jobs added in January from December in Friday's release of the January Labor Force Survey, with the unemployment rate unchanged at 5.7 percent, the lowest since at least 1976.

MEXICO: Real GDP grew 1.0 percent, not annualized, in the fourth quarter from the third, bouncing back after the third quarter's 0.3 percent contraction. From a year earlier, real GDP grew a lackluster 1.7 percent in the fourth quarter, close to the third quarter's 1.6 percent increase, and down from an average of 3.0 percent in the first half of 2017. Growth in the fourth quarter was boosted by a large contribution from primary or agricultural output. The rest of the economy saw year-over-year growth slow to around 1.3 percent in the fourth quarter from 1.4 percent in the third. For the full year of 2017, real GDP grew 2.3 percent, down from 2.7 percent in 2016 and 3.3 percent in 2015. Meanwhile, inflation is slowing sharply. CPI inflation receded to 5.5 percent in year-over-year terms in the mid-January report from December's 17-year high of 6.8 percent as energy price inflation slowed to 6.4 percent from 17.7 percent. 2017's surge in energy prices is beginning to fall out of the year-ago comparison. Trend price increases in Mexico are weaker than the headline numbers, and will slow further if the peso's strength holds. Financial markets currently price in more than a 90 percent likelihood of a 0.25 percentage point increase in the Mexican policy rate at the Bank of Mexico's February 8 monetary policy decision, which would raise the policy rate to 7.5 percent from its current 7.25 percent. One-sided market expectations mean the Bank of Mexico will probably follow through with a February rate hike, but this could be the end of the tightening cycle. Growth is below trend, inflation is slowing, and the odds continue to fall that the US will unilaterally withdraw from NAFTA. Interest rate cuts in the second half of 2018 are more likely than current market expectations: The hefty premium of Mexican interest rates above US benchmarks gives the Bank of Mexico room to lower rates and support growth. Mexico's July Presidential election is a potential catalyst for exchange rate volatility: Higher consumer energy prices, a missing growth dividend from energy sector liberalization, anti-Mexican rhetoric in the United States, and worsening Mexican public safety increase the likelihood that leftist populist candidate Andres Manuel Lopez Obrador a.k.a. AMLO wins. AMLO has advocated in the past for a reversal of market-oriented energy sector liberalization, but has made anti-corruption – a resonant issue in Mexico – the cornerstone of his 2018 campaign. Since a leftist president has not yet held office since Mexico became a competitive democracy in 2000, the change could temporarily spook financial markets.

CHINA: Solid growth in China at the turn of the year: The Caixin general services PMI rose to 54.7 in January from 53.9 in December and tied for the strongest since October 2010, and the manufacturing PMI was unchanged at 51.5. The CFLP manufacturing PMI dipped to 51.3 in January from 51.6 in December, and the nonmanufacturing index rose to 55.3 from 55.0.

UNITED KINGDOM: Real GDP grew 1.5 percent from a year earlier in the preliminary estimate for the fourth quarter of 2017, with manufacturing up 3.1 percent, services 1.4 percent, and construction 0.6 percent. For all of 2017, real GDP grew 1.8 percent, close to 2016's 1.9 percent increase. The fourth quarter's real GDP growth weakened for a fourth consecutive quarter, from 1.7 percent in the third quarter, 1.9 percent in the second, 2.3 percent in the first, and 2.7 percent in the fourth quarter of 2016. Most of the slowdown from 2016 to 2017 is from weaker growth of services output; construction weakened in the fourth quarter as well. This weakness persists into 2018: The IHS Markit/CIPS services PMI fell to 53.0 in January from 54.2 in December and was the lowest since September 2016, and the construction PMI receded to 50.2 from 52.2. The European Council on January 29 offered the UK a transition period to complete Brexit negotiations which would last through December 31 2020, during which the UK would be subject to all EU rules, including allowing free in-migration of non-UK EU citizens. The European Council decision gives a mandate for their Brexit negotiator to offer a deal on the transition period with the UK; the British government has yet to accept it.

BRAZIL: The unemployment rate fell from 12.4 percent in the third quarter of 2017 to 11.8 percent in the fourth quarter, not seasonally-adjusted, and was down from 12.0 percent in the fourth quarter of 2016. Employment grew 2.0 percent in the fourth quarter of 2017 from a year earlier, and the labor force participation rate rose to 61.8 percent from 61.4 percent. The IHS Markit services PMI rose to 50.7 in January from 48.8 in December and pointed to growth for the first time since September.

INDIA: India’s economy is getting past the stumbling block of the Goods and Services Tax implementation. The Nikkei services PMI rose to 51.7 in January from 50.9 in December, and the manufacturing PMI receded to 52.4 from December’s 60-month high of 54.7. Higher global interest rates and energy prices will be a headwind to India’s economy in 2018.