GLOBAL ECONOMIC HIGHLIGHTS

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GREAT US AND CANADIAN JOBS REPORTS; CENTRAL BANKS ON HOLD IN CANADA, EUROZONE, AND JAPAN

UNITED STATES: Payroll employment surged 313,000 in February, with a big 44,000 upward revision to hiring in January and December. The three-month moving average for payroll job growth stands at 242,000, well above the rate needed to absorb new entrants to the labor market. The unemployment rate held steady for a fifth straight month at 4.1 percent, the lowest since December 2000, as the volatile household survey (from which the unemployment rate is calculated) showed large increases in both employment and the labor force. From a year earlier, employment grew 1.3 percent in February, with growth fastest among black men (6.0 percent), foreign born women and men (5.5 percent and 5.3 percent, respectively), Hispanic men and women (3.3 percent and 3.0 percent, respectively) and Asian men and women (2.6 percent; BLS does not provide a gender breakdown). Average hourly earnings rose 0.1 percent on the month and 2.6 percent on the year, a little slower than January's 2.8 percent increase (revised down from 2.9 percent in the prior release). Even so, the general trend is an acceleration in wages that will gather momentum as the labor market tightens further. February's strong jobs report reinforces our forecast that the Federal Open Market Committee will raise the federal funds target 0.25 percentage points to a range of 1.50 to 1.75 percent at their next meeting March 20 and 21.

CANADA: Solid jobs growth in February pushed the unemployment rate back down 0.1 percentage points to 5.8 percent, the lowest since 1976. Household employment rose 15,400, with part-time employment up 54,700 and full-time down 39,300. The trend over the past year has been solid gains in full-time employment (up 282,900 or 1.9 percent) with part-time employment flat; aggregate hours worked surged 3.2 percent in year-ago terms in February. Many men who took part-time jobs after the 2016 energy downturn found full-time employment in the last year. Full-time employment of prime working age (25+) men grew a strong 218,600 or 2.9 percent in the last 12 months, with part-time employment down 71,300 or 9.7 percent. Among prime working age women the trend was the opposite: full-time employment grew 39,800 or 0.7 percent in the last year, and part-time employment grew a much faster 80,900 or 5.2 percent. In February, jobs held by employees rose 58,800 from January, while jobs held by the self-employed fell 43,300; over the last 12 months, employment of employees grew 190,900 or 0.4 percent, and of self-employed Canadians 91,600 or 3.3 percent. Employment in goods-producing sectors fell 10,400 from January, with manufacturing employment down 16,500; over the last year, manufacturing employment is still up a solid 71,100 or 4.2 percent, and goods-producing employment 3.0 percent. Resource sector employment is recovering, up 7,600 (2.3 percent) on the month and 11.0 percent (3.4 percent) on the year. Services employment grew 1.2 percent on the year in February, with the strongest gains in transportation and warehousing, up 47,800 or 5.1 percent from a year earlier. The last week's developments have ended positively for the Canadian outlook: The Trump administration exempted Canada from metal tariffs, Canada won access to promising export markets by joining the Trans Pacific Partnership 11, and employment is growing solidly. Housing is still the Canadian economy's Achilles heel (notably, employment in finance, insurance, real estate and leasing fell 11,600 from January and was flat on the year), but the rest of the economy is doing quite well. Our baseline forecast is for the Bank of Canada to wait until July to next raise the overnight rate target 0.25 percentage points to 1.50 percent, and to make no additional rate hikes in 2018. The Bank of Canada's March 7 monetary policy announcement dovishly noted downside risks to the economy that justify their "cautious" approach to raising interest rates: The housing market is facing headwinds from 2017’s interest rate hikes and tightened mortgage underwriting rules, the NAFTA renegotiation is weighing on business investment, and wage growth is tepid. Average weekly earnings grew only 2.3 percent in year-ago terms in the latest release for December, despite a 0.7 percent year-ago gain in average hours worked. This implies Canadian average hourly earnings grew 1.7 percent in year-over-year terms, just keeping pace with Canadian CPI inflation, and slower than the 2.6 percent gain of US average hourly earnings in February.

EUROZONE: The European Central Bank held its monetary stance unchanged as expected March 8, but tweaked its forward guidance to reinforce expectations for a taper of QE later in 2018. The benchmark deposit rate is held unchanged at -0.4 percent and asset purchases (a.k.a. QE) continue at a €30 billion euro per month pace at least through September 2018. The March monetary policy decision dropped the “easing bias” included in ECB decisions between December 2016 and January 2018. This sentence described how the ECB would react if downside tail risks to the Eurozone outlook materialized: “If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Governing Council stands ready to increase the asset purchase programme (APP) in terms of size and/or duration.” Dropping this language is consistent with the ECB’s assessment in late 2017 and early 2018 that downside risks to inflation have receded as the unemployment rate has fallen and real GDP growth has accelerated. It follows that the ECB is less likely to need to increase stimulus in the near term. The removal of the easing bias reinforces expectations for the ECB to reduce their monthly asset purchases in October 2018. But other parts of the Governing Council’s March statement signal they will withdraw stimulus slowly to avoid further euro appreciation: “Measures of underlying inflation remain subdued and have yet to show convincing signs of an upward trend. In this context, the Governing Council will continue to monitor developments in the exchange rate and financial conditions with regard to their possible implications for the inflation outlook.” The ECB’s staff economic forecasts now project for inflation to undershoot their goal of below but close to two percent throughout 2018 and 2019: The projections marginally revised up the outlook for real GDP growth in 2018 to 2.4 percent from 2.3 percent in their December 2017 forecast, but marginally revised down the 2019 HICP inflation forecast to 1.4 percent, same as 2018, from 1.5 percent previously. Other forecasts were held unchanged. If the ECB’s projections are accurate, they will have ample latitude to withdraw monetary stimulus slowly. In the base case, we expect the ECB to slow asset purchases to €10 billion per month between October 2018 and March 2019, after which they will cease net new purchases and hold the size of their balance sheet steady. The ECB will likely wait until the second half of 2019 to raise the benchmark deposit rate. If the ECB’s staff estimates overestimate how fast inflation picks up, as they have throughout this recovery, then the ECB would withdraw stimulus even slower than in our base case. Farther out, the balance of risks to Eurozone monetary policy is very different. Short-term interest rates will likely still be negative when President Draghi’s term ends in October 2019, but after that, monetary decisions will be the remit of a different policymaker. If the hawkish German Bundesbank President Jens Weidmann is chosen to replace President Draghi, the ECB may raise policy rates faster in late 2019 and early 2020 than other central banks who recently exited quantitative easing programs. This is a meaningful upside risk to euro medium-term interest rates in 2018.

JAPAN: As expected the Bank of Japan held its monetary policy stance and forward guidance unchanged at its March 9 Policy Board decision: The BoJ maintains policy interest rate targets of -0.1 percent on the overnight rate and “around zero percent” for the ten year government bond yield, and continues to buy exchange traded funds and real estate investment trusts at annual rates of 6 trillion yen and 90 billion yen, respectively. The BoJ pledges to continue with QE until “the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner,” meaning that both headline CPI and the Bank of Japan’s measures of underlying inflation must reach 2 percent. The Bank of Japan will not alter its monetary policy stance in 2018 since the value added tax hike from 8 to 10 percent scheduled for October 2019 will at least slow, if not end, the current expansion.

UNITED KINGDOM: EU President Donald Tusk rejected Prime Minister Theresa May’s counterproposal for a sector-by-sector free trade deal in a speech March 7, stating that “A pick-and-mix approach for a non-member state is out of the question. We are not going to sacrifice these principles. It's simply not in our interest.” UK growth is below trend, reflecting Brexit-related supply constraints. Construction output fell 3.4 percent in January from December and is down a cumulative 4.1 percent from its recent peak in March 2017.

The IHS Markit UK Report on Jobs showed permanent job placements growing slower, temporary job placements growing faster, staff vacancies dipping to a 14-month low, and starting salary inflation close to a 31-month high as fewer workers come to the UK from other EU states.

CHINA: Official foreign reserve assets fell $27.0 billion dollars to $3.134 trillion in February, the largest monthly decline since December 2016. The move up in long-term US interest rates in February and the stabilization of the dollar against non-Chinese currencies reignited Chinese capital outflows. If US interest rates rise further in 2018, capital outflows from China will resume as well. Aggregate financing to the nonfinancial economy grew 11.2 percent in year-ago terms in February, the slowest since December 2005, while year-over-year growth of the broad M2 money supply picked up to 8.8 percent from 8.6 percent in January and 8.1 percent in December, which had been the slowest since at least 1997.

MEXICO: Mexico, Canada, Japan, Australia, Malaysia, Singapore, Chile, New Zealand, Vietnam, Peru, and Brunei signed the Comprehensive and Progressive Trans Pacific Partnership (CPTPP) trade deal on March 8, which eliminates tariffs on most industrial and consumer manufactured goods between the trading partners, eliminates tariffs on most food products and lifts quotas on others, and harmonizes pharmaceutical and food safety regulations to make it easier for exporters in CPTPP member states to sell their products in other participating markets. Mexico and Canada joined the CPTPP in part to diversify their foreign trade relationships away from the United States in case of a failure of the NAFTA renegotiation.

BRAZIL: Low inflation provides room for the Central Bank of Brazil to surprise financial markets with additional interest rate cuts in late 2018 or 2019. Inflation was barely changed in February at 2.84 percent in year-ago terms after 2.86 percent in January; trimmed mean CPI slowed to 2.7 percent from 2.8 percent, and services prices rose 4.2 percent, the slowest in year-over-year terms since July 2001. With real GDP on track to grow about 2.5 percent in 2018, the current policy interest rate of 6.75 percent is modestly contractionary. The central bank has room for neutral or even expansionary monetary policy considering the high level of Brazilian unemployment.

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