GLOBAL ECONOMIC HIGHLIGHTS

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FED HIKES AS EXPECTED; BANK OF ENGLAND AND BANK OF JAPAN LIKELY ON HOLD THIS WEEK

UNITED STATES: As expected, the Federal Open Market Committee raised the federal funds target range 0.25 percentage points to a range of 0.75 to 1.00 percent at its meeting today; FOMC members' forecasts for real GDP growth, the unemployment rate, and PCE inflation were little changed in their March 2017 round from prior forecasts made in December 2016. As telegraphed in FOMC member speeches made in recent weeks, FOMC members upwardly revised their projections for the most appropriate path for the federal funds rate in 2017 and 2018 to include about one more 0.25 percentage point hike than they had projected in December 2016. The WTI benchmark crude oil price dropped back under $50 per barrel for the first time since December last week and is around $48.50 today. While US crude inventories slipped 0.6 percent in the week of March 10 from a week earlier, they are only 2.6 percent below their all-time highs, and the IEA's monthly Oil Market Report showed inventories rose in non-US developed economies in February. US oil production is up 3.6 percent in the most recent three months to just 5.2 percent below its June 2015 peak, and Saudi production rose in the month of February. In a presentation yesterday to the Economic Club of Pittsburgh, Marcellus Shale Coalition President David Spigelmyer explained the disconnect between robust US oil production and the low number of oil rigs operating in the US (the Baker Hughes rig count is down more than 60 percent from its 2011 peak) as due to recent years' advances in horizontal drilling technology, which allow a rig to complete wells up to 3 times faster, with up to 5 times larger horizontal fracking radiuses, than would have been possible a few year earlier. If US crude oil production continues to grow despite low oil prices, it will tend to put downward pressure on global inflation and upward pressure on the US dollar relative to the Canadian dollar and currencies of other commodity-exporting economies.

UNITED KINGDOM: We expect for the Bank of England's Monetary Policy Committee (BoE MPC) to leave the bank rate unchanged at 0.25 percent at its meeting tomorrow and to refrain from further expansions of its quantitative easing program (the "Asset Purchase Programme") at this meeting. The British jobs report released this morning showed moderate headline job growth through January but mixed details: Total employment rose 0.3 percent on the quarter and 1.0 percent on the year in the rolling three-month period ended January 2017; Full-time employment grew faster than part-time, a positive detail, but some workers shifted from work as employees to self-employment, a negative detail. Full-time employment was up 1.3 percent on the year and part-time employment flat, while employees increased 0.5 percent on the year and the self-employed 3.2 percent. Wage growth slowed. Average weekly earnings in the private sector rose 1.9 percent on the year in January, the slowest year-ago increase since February 2016. Slower wage growth and a shift to self-employment (possibly a disguised form of underemployment) reinforces our view that slack has increased in the British labor market since the June 2016 Brexit referendum, making a bank rate hike unlikely in 2017. Another reason not to expect a rate hike is that the BoE's MPC believes Brexit will be a headwind to British output over the medium term, for example by reducing market access for British services exports to EU end-markets which account for 5 percent of the UK's GDP. The British Parliament Monday passed a law authorizing the government to formally begin the UK's withdrawal from the European Union, clearing the last institutional hurdle to Article 50. Substantial political hurdles remain: Also on Monday, Scotland's First Minister Nicola Sturgeon announced that she will seek a new referendum on Scottish independence from the UK between the fall of 2018 and spring of 2019. If the British government invokes Article 50 by the end of March 2017 as Prime Minister Theresa May wants, the Scottish independence referendum will fall during the sensitive final half year of the UK's negotiations with the EU on post-Brexit trade and political relations.

JAPAN: We expect for the Bank of Japan to leave its monetary policy stance unchanged at its decision overnight tonight, expanding its monetary base at an ¥80 trillion yen annual rate, holding the policy rate steady at -0.1 percent, and holding the target for the ten-year government bond steady at around zero percent. There seems little risk that inflation will suddenly overshoot the Bank of Japan's 2.0 percent target: The BoJ's measures of core inflation were steady at around 0.25 percent in year-ago terms in January and average incomes in workers' households rose 1.6 percent, while total cash earnings (a separate measure of earned income) rose a weaker 0.5 percent on the year. The Bank of Japan has committed since September 2016 to continue expanding Japan's monetary base until CPI sees a sustained increase to 2 percent or higher.

EUROZONE: As expected, the ECB last Thursday left its benchmark interest rates unchanged at the conclusion of the Governing Council meeting and made no changes to its quantitative easing program's parameters ("Asset Purchase Programme"). The benchmark deposit rate held steady at -0.4 percent. As announced in January, the ECB will reduce its monthly asset purchases from €80 billion per month in March to €60 billion between April and December. The ECB has not given guidance about asset purchases in 2018 and beyond, but tweaks to its qualitative guidance in March are consistent with tapering in 2018. The Governing Council's March policy statement dropped a sentence used in the January policy statement reading "If warranted to achieve its objective, the Governing Council will act by using all the instruments available within its mandate." This hairy-chested tautology (they will act if they decide to act; they will use the tools they are allowed to use) emphasized that the ECB had enough tools in its toolkit to intensify stimulus if necessary. But with the Eurozone's economic data improving, the ECB is more confident that its next move is a withdrawal of stimulus rather than an intensification. President Draghi stated at last Thursday's press conference that "risks of deflation have largely disappeared," a very definitive statement by his standards.

The ECB's real GDP growth and inflation forecasts updated last Thursday reinforce his upbeat view. The ECB's staff forecast for inflation as measured by the harmonized index of consumer prices (HICP) was 1.7 percent for 2017, 1.6 percent for 2018, and 1.7 percent for 2019. The 2017 forecast was upgraded from the 1.3 percent HICP inflation forecasted in the Eurosystem staff estimates released in Dec 2016; the forecasts for HICP in 2018 and 2019 were little changed from the 1.5 percent and 1.7 percent respective increases forecast in December 2016. The ECB's real GDP growth forecasts were upgraded marginally to 1.8 percent for 2017, 1.7 percent for 2018, and 1.6 percent for 2019, from 1.7 percent, 1.6 percent, and 1.6 percent respective increases forecast in the December 2016 forecast round. President Draghi discussed in detail last Thursday why the ECB is not changing its policy stance despite an upgraded forecast for HICP inflation in 2017. He reiterated four criteria the ECB laid out in January for how the ECB would react to higher inflation, saying they would change policy if (1) An increase in inflation occurs over the medium term, generally understood to be 1-2 years in the future; (2) Higher inflation is durable rather than transient; (3) Higher inflation is expected to persist even if monetary stimulus is withdrawn; and (4) Higher inflation affects the whole of the Eurozone. While the Eurozone is currently experiencing an uptick in headline HICP inflation, which was 2.0 percent in year-ago terms in February, core HICP is stable at 0.9 percent, and wage inflation is also stable at a modest level. If economic growth continues above trend in 2017 and the growth outlook for 2018 appears solid, the ECB will likely make further reductions in asset purchases in 2018. But since the ECB "expects" interest rates to be at present or lower levels "well past the horizon" of the end of QE, Eurozone benchmark interest rates will likely remain negative through at least the end of 2018, if not through the end of President Draghi's term in October 2019.

Exit polls for the Dutch elections today suggest that the far-right Freedom Party will not be part of the next government.

CANADA: Canadian employment grew 15,300 in February from March, better than the consensus forecast for a 5,000 monthly decline; we had forecast a 6,400 monthly gain. The unemployment rate dropped to 6.6 percent from 6.8 percent in January on a 23,000 drop in the labor force; the labor force participation rate fell to 65.8 percent in February from 65.9 percent in January. From a year earlier, employment grew by 288,000 or 1.6 percent, the fastest year-ago increase since February 2013. The composition of February's job growth was mostly good. There was a large shift from part-time to full-time employment: Full-time employment surged 105,100 from January, while part-time employment dropped 89,800. However, employment in higher-paying goods-producing sectors lagged, falling 14,800 on the month, with employment in lowerpaying services sectors up by 30,100. Employment in Canadian manufacturing fell by 5,200 on the month and was down 2.9 percent on the year, but will likely improve in coming months: The Markit manufacturing PMI for Canada rose to a 27-month high in February, and manufacturing in the United States is strengthening as well. This should pass through to manufacturing employment gains later in 2017. Similarly, the Bank of Canada's Winter Business Outlook survey showed investment intentions and employment intentions improving on the quarter, including in the higher-wage energy sector. The Bank of Canada will see February's job gains as a step in the right direction, but is still unlikely to raise the overnight rate target before the first quarter of 2018. Higher medium- and long-term US interest rates are already spilling over to raise comparable Canadian benchmarks, including mortgage rates, without any action from the Bank of Canada.

AUSTRALIA: Business confidence and conditions fell sharply in February but are still consistent with solid economic growth. The National Australia Bank's index of business conditions dropped to +9 in February from +16 in January and was unchanged from a year earlier. A big drop in trading conditions drove much of the month's decline. Profitability and employment slid a bit while orders held steady. The separately calculated business confidence index fell to +7 in February from +10 in January. The index was at +4 in February 2016. In both cases the numbers were returning to more reasonable levels after an unusually strong January. Also, the conditions index is still above the long-run average of +6. One trouble spot in the report is that business conditions for retailers have deteriorated since early-2016. While recent consumer confidence and retail trade data have been resilient, recent weak job and income growth pose downside risks to consumption in 2017.

CHINA: The newly-released services activity index grew 8.2 percent in year-ago terms in the first two months of 2017, up from 8.1 percent growth in December 2016. This indicator will become an important measure of China's services industry as its history grows, but its growth rate will likely deviate from the growth rate of services GDP because the new index omits many public services and non-market intermediated services.

INDIA: The BJP Party increased its seats in state (regional) elections over the weekend; their electoral victory will pass through to more seats for the BJP in the upper house of parliament, whose members are mostly indirectly elected by regional legislatures. CPI inflation accelerated to 3.7 percent in year-ago terms in February from 3.2 percent in January on faster increases in food prices, up 2.0 percent and 0.6 percent respectively in February and January, and fuel & light prices, up 3.9 percent and 3.3 percent respectively in the two months. CPI excluding food, fuel & light, which the Reserve Bank of India is increasingly using as a core measure of inflation, slowed in February, to 4.8 percent from 5.0 percent in January. Core inflation has held in a narrow range around 4.8 percent since the fourth quarter of 2014.

Indian industrial production grew a tepid 2.7 percent in year-ago terms in January after a 0.1 percent year-ago contraction in December and a 1.6 percent year-ago decline in January 2016. Manufacturing rose 2.3 percent on the year in January, mining 5.3 percent, and electricity production 3.9 percent. India's industrial production index continues to be much weaker than the industrial components of the GDP accounts – manufacturing GDP grew 8.5 percent in the fourth quarter of 2016 versus a 0.5 percent increase in the manufacturing industrial production index. The Indian statistical agency explains the disconnect by saying that its GDP accounts better capture the activity of smaller, faster growing firms than the IP index. But judging from the IP index, which has a longer track record than the recently revised GDP accounts and which is more consistent with privately-compiled surveys of business sentiment, Indian manufacturing and industry continue to underperform following 2016's demonetization. With global energy prices and US interest rates rising, the external environment is becoming less favorable for India's economy. While lower global oil prices have boosted India's terms of trade and currency recently, we remain pessimistic about the outlook for the Indian rupee, which we forecast to depreciate to 74 per US dollar by the end of 2017.

MEXICO: January's increase in manufacturing production is an encouraging sign that Mexico may dodge recession after all. Industrial production rose, albeit modestly, by 0.1 percent on the month in January, reversing December's 0.1 percent monthly decline. Manufacturing output rose 0.5 percent on the month, mining output (including petroleum and gas production) rose 1.1 percent, construction was flat, and utilities output fell 2.0 percent. From a year earlier, industrial production contracted 0.3 percent in January after a 0.1 percent annual decline in December 2016. Manufacturing output grew 3.8 percent on the year, up from 2.5 percent in December and the fastest since April 2015, but other components of industrial production were much weaker. Utilities output grew just 1.1 percent on the year, construction dropped 1.0 percent, and mining plunged 9.8 percent.

A key risk to the Mexican outlook is that manufacturers, uncertain of the outlook for trade with the US, could slow production in early 2017 to run down inventories and avoid being caught off-sides by policy changes. But with manufacturing output up in January, this is not happening (or at least has not happened yet). Another key risk is that manufacturing capital expenditures could plunge during this period of uncertainty, but instead they are holding up very well. Specialized construction work, which includes construction for industrial use, grew 0.7 percent on the month in January, a second consecutive month of expansion after contraction in three of four months between August and November (the lead-up to the US election). Specialized construction work grew a very rapid 19.3 percent on the year in January. Trade uncertainties continue to pose substantial risk to Mexico's economic outlook, but the first activity data for early 2017 are quite a bit better than feared. Going forward it is still US-Mexico trade relations that will determine the outlook for Mexican growth and the Mexican peso. As such it makes sense to wait for more clarity about this relationship before altering the Mexico forecast. For now, PNC Economics is taking the US government's proposed renegotiation of NAFTA at face value, and assuming that Mexican exporters will experience reduced access to US markets in the future. Because of this, we also assume that the Mexican peso will depreciate over our forecast horizon, to 23.0 per US dollar by year-end 2018.