INDIA RAISES POLICY RATE IN APRIL, A THIRD EMERGING MARKET TO FOLLOW THE FED’S TIGHTENING LEAD

INDIA: CPI inflation was unchanged in March from February at 3.7 percent in year-ago terms. Food prices rose an annual 2.0 percent in both months, food and light inflation accelerated to 5.6 percent in March from 3.9 percent in February, and CPI excluding food and light slowed to 4.6 percent from 4.8 percent. March saw the slowest increase in CPI excluding food and light since August 2015. This measure of core inflation has been close to 4.8 percent plus or minus a few tenths of a percentage point since late 2014. Indian industrial production fell 1.2 percent on the year in February, with a 3.3 percent increase in mining production offset by a 2.0 percent annual decline in manufacturing production. Electricity production was close to stagnant on the year, up a tepid 0.3 percent, bad news for overall growth prospects since real GDP growth in an emerging market like India tends to be closely correlated with electricity output. Modest economic growth momentum and stable core inflation means domestically-fueled inflationary pressures should hold stable or slow in coming quarters. Despite this, the Reserve Bank of India raised its reverse repo rate 0.25 percentage points from 5.75 percent to 6.00 percent at its April 6 decision. This modest tightening measure (the RBI held the more important policy repo rate unchanged) echoed the policy rate hikes made by the People’s Bank of China and Bank of Mexico in March after the Fed’s 0.25 percentage point federal funds rate hike. Emerging market central banks are pacing rate hikes against the Fed in 2017. The RBI like the People’s Bank of China characterizes its monetary policy stance as neutral, and like the PBoC will probably pace interest rate hikes against the Fed over the rest of 2017 and in 2018. The key risk faced by the Reserve Bank of India is a faster pace of US interest rate hikes, which might pressure the rupee to depreciate and increase inflation from imported goods.

UNITED STATES: Job openings rose 118,000 to 5.74 million, the fourth highest level since data began in December 2000, in the Bureau of Labor Statistics’ Job Openings and Labor Turnover Survey or JOLTS report for February. Hires also rose on the month, but fell on the year, and separations (including both laid-off workers as well as workers who chose to leave jobs to take new ones) fell on both the month and on the year. Hires rose on the year in manufacturing and construction, but both hires and separations fell in the services sector. President Trump has pushed back his initial goal of enacting tax reform by August, and now aims to enact tax reform by the end of 2017. The 10-year Treasury bond yield has fallen from its high of 2.6 percent in early March to 2.3 percent today on increased geopolitical risks and markets having second thoughts about the US government’s plans for reflationary tax cuts, infrastructure spending, and tariffs on imports. PNC Economics incorporates expectations of a deficit-funded fiscal stimulus plan, including tax cuts and infrastructure spending with “buy American” conditions attached, in our forecast for real GDP growth accelerating to almost 3 percent in 2018 from 2.3 percent in 2017.

UNITED KINGDOM: The British labor market is softening, but falling labor force participation is keeping the unemployment rate low. The unemployment rate was 4.7 percent in the December to February quarter, down from 4.8 percent in the September to November period and 5.1 percent a year earlier. Other details were weaker than the headline. Employment edged 0.1 percent higher on the quarter, and grew 1.0 percent in year-ago terms, only half as fast as the 2.0 percent year-ago growth in the March to May 2016 quarter, the last before the Brexit referendum. Falling labor force participation among younger workers is keeping the unemployment rate low: The labor force of workers aged 18 to 24 fell 1.5 percent on the quarter and 2.8 percent on the year, and employment among this age cohort fell 1.1 percent and 1.3 percent, respectively,
in both terms. Younger workers are often last to be hired and first to be let go, so weakness in this segment of the labor market is a negative sign. In the latest breakdown of employment by gender (for the three months through January), employment of women was flat on the quarter and up 1.6 percent on the year, while employment of men was up 0.2 percent on the quarter and 0.4 percent on the year. Private sector average weekly earnings grew 2.5 percent on the year in the three months through February, slower than the 3.2 percent year-ago increase seen in the three months through November; because the younger workers whose employment fell in February tend to be lower paid than more experienced workers, the growth in average weekly earnings could overstate the trend in compensation growth. With the weak pound pushing inflation higher, real wage growth slowed to 0.2 percent in February from a year earlier, down from 1.5 percent in November and 1.3 percent in February 2016. Businesses are likely waiting for more clarity about the UK’s trade relations with the EU before making staffing decisions that would be expensive to reverse, so declines in employment among younger workers (who are more likely to be employed on casual zero hour contracts) could spread to workers in more formal work arrangements if it becomes clear that Brexit will negatively affect British exports. A bank rate hike from the Bank of England seems unlikely before year-end.

JAPAN: Nominal income growth is very slow. Average cash earnings rose 0.4 percent in year-ago terms in February according to the Ministry of Health, Labor and Welfare, little changed from January’s 0.3 percent year-ago increase or the 0.5 percent growth seen in December and November. Total hours worked fell 0.3 percent on the year in February, so hourly compensation grew about 0.7 percent on the year in this survey, down from 1.4 percent in January but unchanged from December. Hourly cash earnings grew 1.0 percent during calendar-year 2016. The separately-reported monthly survey of income and expenditure showed working households’ average incomes up 1.1 percent on the year in February. Japan’s income growth is nowhere near fast enough to raise trend inflation to the Bank of Japan’s target of 2 percent and keep it there on a sustained basis anytime soon. Since this is one of the BoJ’s qualitative criteria for completing the taper of its asset purchases, there seems little risk of a near-term shift in Japanese monetary policy. If the Bank of Japan slows purchases in 2017, it will be because of a scarcity of government bonds; they already own nearly two fifths of all outstanding. A dwindling market of government bonds could allow the BoJ to hold interest rates at their “yield control” targets with slower purchases.

CANADA: Employment rose a solid 19,400 on the month in March, slightly above PNC’s 18,700 forecast and significantly better than the 5,700 consensus. The unemployment rate edged up to 6.7 percent on a 47,000 monthly surge in the labor force which raised the participation rate to 65.9 percent from 65.8 percent. More Canadians are entering the labor force and searching for work, a sign of increased confidence in Canadian employment prospects. The composition of job growth was mostly good: Manufacturing employment surged, and workers shifted from full-time to part-time employment, but resources sector employment was still down on the month, and the number of prime working age men in part-time work has jumped in the past year. Full-time employment rose 18,400 on the month, while part-time rose just 1,000; after rapid growth in full-time employment in early 2017, full-time and part-time employment are up by about the same amount on the year in March, 1.5 percent and 1.6 percent respectively. There are large gender differences, though: The number of men over age 25 working part-time was up 10.2 percent on the year in March, while the number of women was down 1.0 percent. The number of Canadians working as employees was nearly flat in March from February, up just 1,000, while self-employment grew by 18,400. Both are corrections of recent strong gains in work by employees, up 1.9 percent on the year, and a drop in self-employment, down 0.4 percent. Employment in goods-producing sectors rose 21,800 on the month in March, with manufacturing surging 24,400 or 1.5 percent, and construction up 8,300 or 0.6 percent. These gains were offset by cumulative declines of 10,800 in utilities, agriculture, and natural resources. Employment in services was down 2,400 on the month but up a robust 300,600 or 2.1 percent on the year, with notably rapid growth in finance/insurance/real estate/leasing, up 5.3 percent, and information/culture/recreation, up 31,900 or 4.2 percent. March’s surge in manufacturing employment will likely be followed by further gains later in 2017: Manufacturers and wholesalers entered the year with low inventories and will need to add to them in the near-term, and will need more workers to do it. Similarly, the outlook for construction is upbeat, at least on the nonresidential side: The Bank of Canada’s Business Outlook Survey showed business investment intentions at their second highest in a decade this spring. The trajectory of Canada’s job market has clearly improved. The large increase in the number of prime working age men in part-time work over the last year
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points to significant underemployment, but if current trends hold, that problem should abate over the course of 2017. With job growth, output, and sentiment all improving, the Bank of Canada’s next move is likely a hike. The Bank of Canada held the overnight rate target unchanged today at 0.50 percent as expected, and Governor Stephen Poloz continues to signal (as he has since taking office in 2013) that after years of false dawns, the Canadian economy must be clearly firing on all cylinders before tighter policy is justified. If growth continues to pick up in 2017 by as much as the Bank of Canada’s most recent Outlook survey suggests, the Bank of Canada might have that evidence in hand before its January 2018 meeting. In the base case we expect a Canadian policy rate hike in January 2018, but the risks to Canadian rate hikes are weighted toward earlier hikes than in our baseline forecast.

AUSTRALIA: The National Australia Bank’s indices of business conditions and business confidence are pointing in different directions. Nevertheless, they remain consistent with PNC Economics’ forecast of 2.4 percent real GDP growth in 2017. The business conditions index surged from +9 in February to +14 in March, its highest reading since February 2008 and well above its long-run average of +5. The trading conditions sub-index (i.e. sales) jumped ten points while profitability and forward orders rose 3 and 2 points, respectively. On an industry basis, higher commodities prices lifted conditions in the mining sector while nearly all services saw an improvement in business conditions. The retail sector was the exception, where business conditions have been deteriorating since early-2016. The separately reported business confidence index painted a less rosy picture of the economy—it slipped to +6 in March from +7 in February, and was close to its long-run average. The index may retreat further in April, given that the number of respondents in Queensland dropped substantially in March because of Cyclone Debbie. Looking through the volatility, these sentiment surveys point to healthy rates of economic growth.

MEXICO: CPI inflation rose to 5.4 percent in March, the highest since July 2009, from 4.9 percent in February. Energy prices surged following the deregulation of gasoline and LPG prices in January (a.k.a. the gasolinazo) and were up 17.1 percent on the year in March, close to February’s 17.2 percent which had been the largest increase since January 2003. Inflation elsewhere in the consumer price basket was also higher, but not by nearly as much: Core services prices, which follow the trend in underlying inflation, rose 3.3 percent on the year in March, up from their recent cyclical low of 2.0 percent touched in April and November 2015. Industrial production edged 0.1 percent higher on the month in February, but fell 0.1 percent on the year. Mining output fell 1.0 percent on the month and 10.6 percent on the year, with extraction of petroleum and gas down 0.9 percent and 13.5 percent, respectively, in both terms. Auxiliary services related to mining plummeted 17.6 percent on the month and 44.2 percent on the year. Utilities output fell 1.5 percent on the month and 2.3 percent on the year, a bad sign for real GDP growth since energy consumption is often closely correlated with GDP. Construction and manufacturing were relative bright spots during February although not terribly strong. Construction output grew 0.4 percent on the month and 4.0 percent on the year, and manufacturing was flat on the month and up 3.3 percent on the year. Surging inflation and weak industrial production are both symptoms of the state-owned oil company’s declining oil output, which peaked more than a decade ago and has dropped since. The Mexican government liberalized consumer energy prices in 2017 because Pemex’s revenues have become insufficient to keep the Mexican state fiscally sound and also supply Mexican consumers with subsidized energy. Unlike in the United States, where oil output is up 10 percent from its mid-2016 lows, Mexican oil output is falling fast and oilfield services spending is falling even faster. As oil production falls, Mexico will need to make further cuts to public spending or raise taxes to compensate for lower oil revenues, a significant constraint on growth.

CHINA: Foreign reserves rose to $3.009 trillion US dollars in March from $3.005 trillion in February as US long-term interest rates retreated and the dollar weakened against other advanced economy currencies. Chinese CPI was 0.9 percent in March, up from 0.8 percent in February; core CPI was 2.0 percent, matching the January-February average. PPI slowed to 7.6 percent from 7.8 percent. High PPI inflation mostly reflects the global recovery in energy prices; producer prices for auto manufacturers are actually down on the year, by 0.6 percent in the first quarter from a year earlier.

BRAZIL: Headline IPCA inflation slowed to 4.6 percent in March, the slowest since August 2010, from 4.7 percent in the mid-March IPCA-15 report and 4.8 percent in February. Falling energy prices which reflect the pass-through of Brazil’s stronger currency made a large contribution to March’s slower inflation. Gasoline
prices fell 2.1 percent in year-ago terms in March, ethanol prices 5.9 percent, and residential electricity costs 3.1 percent. By contrast, prices of labor-intensive services rose rapidly: Housekeeping services were up 9.6 percent on the year, medical and dental services 6.5 percent, and personal hygiene services 7.2 percent. The persistence of inflation in “sticky” services prices could be an obstacle to further policy interest rate cuts that would open space for domestic demand growth in 2017; an apparent impasse in the government’s negotiations to reduce pension spending, which is widely seen as necessary to bolster Brazil’s sovereign creditworthiness, is another. The March PMI surveys point to Brazil edging closer to recovery, but they were also still in contractionary territory. In the base case, we are assuming that Brazil will eventually work out some sort of a deal on fiscal reforms, that the dramatic drop in headline inflation will pass through to lower core inflation later this year, and that the economy will see a modest expansion in 2017. However, many pitfalls still stand between Brazil and a durable economic recovery.