April 19, 2017

GLOBAL ECONOMIC HIGHLIGHTS

Gus Faucher Chief Economist | **Stuart Hoffman** Senior Economic Advisor | **William Adams** Senior Economist | **Kurt Rankin** Economist | **Mekael Teshome** Economist

THE PNC FINANCIAL SERVICES GROUP | The Tower at PNC Plaza | 300 Fifth Avenue | Pittsburgh, PA 15222-2401

ODDS OF SURPRISES FROM UPCOMING FRENCH AND BRITISH ELECTIONS SEEM LOW

EUROZONE: French voters will vote in the first round of their country's presidential election on Sunday, April 23, with the two candidates receiving the most votes advancing to the second and final round vote scheduled for May 7. Current polls suggest that center-right candidate Emmanuel Macron and far-right candidate Marine le Pen will advance to the final round, which Macron would most likely win. An electoral upset could surprise and potentially roil capital markets: Among le Pen's policy proposals are withdrawing from the European Central Bank and using the Bank of France to finance deficit spending, while the far-left candidate Jean-Luc Melechon advocates a tax of 100 percent on incomes above €400,000 euros.

UNITED KINGDOM: Prime Minister Theresa May has called for a special general election on June 8 in an attempt to increase the Tory Party's majority in Parliament ahead of the UK's negotiations with the EU over its exit from the political and economic union. If the Tories increase their seats in the June 8 election, PM May will gain a freer hand in the negotiations. The Tories currently hold a majority of only one seat in the House of Commons, giving individual Tory members of parliament effective vetoes over concessions the UK could make to maximize its access to EU export markets after Brexit.

UNITED STATES: Weather-related distortions held back housing starts and raised industrial production in March, but housing should still contribute solidly to growth in 2017, as, to a lesser extent, should industry. Housing starts fell 6.8 percent in March, with single-family starts down 6.2 percent and multifamily (apartment and condominium) down 7.9 percent. By contrast, permits rose 3.6 percent in March, with single-family permits down 1.1 percent and the more volatile multifamily permits up 13.8 percent. Starts and permits rose 9.2 percent and 17.0 percent, respectively, from a year earlier. March's monthly drop in housing starts can in large part be explained by January and February's mild winter weather, which pulled construction forward and muted the seasonal pickup usually seen in March. For the first quarter of 2017 as a whole, both housing starts and permits were their strongest since 2007. An improving job market, higher consumer confidence, and good affordability are convincing many households that put off purchasing a new home over the past few years to buy. Residential construction will add to economic growth throughout 2017. Industrial production jumped 0.5 percent in March on a huge 8.6 percent jump in utilities output; utilities production rebounded after big declines in January (down 6.8 percent) and February (down 5.8 percent) because of a much warmer-than-usual winter. However, manufacturing production fell 0.4 percent in March, including a 2.6 percent drop for autos and parts, while mining production rose 0.1 percent. The manufacturing capacity utilization rate fell to 75.3 percent from 75.6 percent. From a year earlier, industrial production grew a modest 1.5 percent, with manufacturing up 0.8 percent, mining up 2.9 percent, and utilities output up 4.6 percent. March's pull back in US auto manufacturing echoes soft Canadian data also released this week. Looking forward, US industrial production will increase about 1.7 percent this year, lagging a bit behind overall economic growth but better than in 2015 and 2016 when industrial output was essentially flat. However, lingering industrial excess capacity will continue to limit pricing power.

JAPAN: Strong industrial output boosts the outlook for real GDP growth in 2017. Industrial production rose a seasonally-adjusted 3.2 percent in February from January and was up 6.7 percent from a year earlier. Industrial production was its strongest since January 2014, and production of industrial robots, semiconductor parts, and chemicals were the highest since comparable data begin in 2008. But this seems unlikely to add to Japan's inflation outlook. With the yen close to 110 per US dollar, Japanese manufacturers are unlikely to grant faster wage increases in 2017 than in 2016, even if output grows faster. The Bank of Japan sees faster wage growth as a vital precondition for faster trend inflation.

CANADA: Manufacturing sales fell 0.2 percent by value and 0.1 percent by volume in February from January, and rose 6.8 percent and 4.1 percent, respectively, in year-ago terms. Manufacturers' inventories rose 1.6 percent on the month, but were up only 2.3 percent on the year, growing slower than sales. Manufacturers entered 2017 with unusually low inventories and even some restocking in February, inventories are not high. The inventory to sales ratio rose to 1.34 in February from 1.32 in January, both below the ten-year average of 1.37. New manufacturing orders rose 0.8 percent on the month and 12.6 percent on the year in February. By industry, both February's monthly decline and its annual increase in sales can mostly be explained by wide swings in petroleum and coal product sales, down 5 percent on the month and up 49.5 percent on the year and reflecting recent large swings in energy prices. More concerning, and echoing the US industrial production report, Canadian motor vehicle sales also fell in February, down 5.3 percent on the month and 3.8 percent on the year. Motor vehicle units sold fell 4.6 percent on the month in February. With new orders growing in double-digit year-ago terms and the Markit Manufacturing PMI for Canada at its strongest in March since October 2013, February's dip in manufacturing sales does not reflect fundamental problems. Instead it is a sign of fluctuating energy prices and inventory management in the auto sector. Canadian manufacturing is still on an upward trajectory, and will contribute solidly to GDP growth, employment growth, and income growth in 2017, keeping the Bank of Canada on track for an overnight target rate hike by January 2018 if not sooner.

AUSTRALIA: Minutes from the Reserve Bank of Australia's April 4 policy meeting showed central bankers are becoming increasingly concerned that persistent slack in the labor market could cause inflation in 2017 to undershoot their 2 percent forecast. The data policymakers had on hand showed the unemployment rate rose to 5.9 percent in February from 5.7 percent in January. In addition to the high level of unemployment, a high level of underemployment continues to hold back wage growth. Data released subsequent to the RBA's April meeting, showing no improvement in the unemployment rate in March, are unlikely to encourage policymakers much during the upcoming May meeting. Employment rose by a very large 64,900, but a spike of this magnitude is more likely noise than signal. Besides, the employment gain in March was offset by an increase in the labor force. Finally, average hours worked per employee declined by 0.3 percent. PNC Economics expects the RBA to hold the target cash rate at 1.5 percent until the second half of 2018. First quarter inflation data out next week will help refine the forecast.

CHINA: Real GDP growth grew 6.9 percent in year-ago terms in the first quarter of 2017, up from 6.8 percent in the fourth quarter of 2016 and 6.7 percent in the prior three quarters. In nominal terms, real GDP grew 11.8 percent in the first quarter of 2017, the fastest since the first quarter of 2012, when real GDP grew 8.1 percent. Stronger fixed investment and residential construction supported industrial production in the first quarter; Chinese property developers ran down an overhang of inventories in 2014, 2015 and 2016, and are now starting to ramp up construction again. This will support global commodity demand in the near term. Nominal GDP's growth rate was roughly the same rate as that of aggregate debt financing channeled to the real economy, which was up 12.0 percent in year-ago terms in March. As a result, the first quarter marked the end (or at least a pause) in a long period in which growth of credit outpaced that of output. If this becomes a trend, longstanding concerns about the sustainability of China's growth model will seem less urgent. However, China's fiscal deficit is still large, 4.0 percent of GDP in the twelve months through March. After the first quarter's pickup in real GDP growth, PNC Economics' forecast for real GDP to grow only 6.5 percent in all of 2017 looks conservative, but could still be correct if China trims its fiscal deficit. For additional details, please see PNC Economics' International Economic Report on the Chinese GDP release.

BRAZIL: The light at the end of Brazil's tunnel is getting brighter. The central bank's monthly proxy for real GDP growth, the IBC-Br index, jumped a seasonally-adjusted 1.3 percent in February from January, and rose 0.5 percent in year-ago terms. While many sentiment indicators improved in 2016, this is the first hard activity indicator showing an aggregate recovery from Brazil's long economic contraction. Political uncertainty related to the ongoing "car wash" scandal still poses downside risks to the economic outlook.