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GLOBAL ECONOMIC HIGHLIGHTS

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ANOTHER SOLID US JOBS REPORT ON TAP; POLICY RATE CUTS IN BRAZIL, INDIA – MAYBE EVEN MEXICO SOON TOO?

UNITED STATES: PNC Economics forecasts for Friday's release of the July Bureau of Labor Statistics employment situation summary to show nonfarm payroll employment up by 180,000 from June, and the unemployment rate returning to its cyclical low of 4.3 percent from 4.4 percent. Average hourly earnings likely rose 0.4 percent in July from June and 2.5 percent from a year earlier, an unchanged year-over-year rate of increase. Economic growth was moderate in the first half of 2017: Real GDP grew 2.6 percent annualized in the second quarter, up from 1.2 percent annualized in the first; in year-over-year terms, real GDP grew 2.1 percent in the second quarter, nearly matching the first quarter's 2.0 percent increase. Payroll processing company ADP estimated that US private payroll employment grew 178,000 in July from June. In the base case, a tightening job market is likely to fuel stronger wage growth and inflation in coming quarters, supporting PNC's forecast for gradual federal funds rate hikes, higher long-term interest rates as the Fed shrinks its balance sheet, and a consequent appreciation of the dollar in the second half of 2017, 2018 and 2019. If the government enacts fiscal stimulus in the form of a ten-year deficit-funded tax cut (i.e. similar to the Bush tax cuts), it could increase upside risks to our interest rate forecast.

BRAZIL: As expected, the Central Bank of Brazil loosened monetary policy again last Wednesday, cutting the benchmark Selic rate 1.0 percentage point to 9.25 percent. The economy is improving: The unemployment rate dipped to 13.0 percent in the second quarter of 2017 from 13.7 percent in the first. The unemployment rate was 11.3 percent in the second quarter of 2016. Employment grew 0.6 percent on the quarter in the second quarter of 2017, but fell 0.6 percent on the year. Brazil's labor market data are not adjusted for seasonal variation, and the unemployment rate typically falls in the second quarter from the first. Nevertheless, the second quarter's improving labor market data are corroborated by output and sentiment survey data which collectively point to a recovery from 2014-2016's economic depression. Political uncertainty continues to cast a shadow over Brazil's outlook, but business cycle dynamics looks quite favorable. Stabilizing terms of trade, policy interest rate cuts, improved financial conditions, and, going forward, the changes to labor market law passed in July will lower inflation and support domestic demand. If the Brazilian political system avoids a plunge into turmoil – an admittedly big if – the country's economy will likely grow modestly in 2017 and accelerate further in 2018. Industrial production was unchanged in June from May and grew 0.5 percent from a year earlier, slower than May's 4.1 percent increase.

INDIA: The Reserve Bank of India cut the policy repo rate 0.25 percentage points to 6.0 percent at its monetary policy decision August 2. The RBI noted numerous signs that weak demand is putting downward pressure on inflation in its policy statement: "Clearance sales across commodities," a "telecommunications pricing war," slow increases in health, clothing, and footwear prices, and weak business pricing power reported in the RBI's business sentiment survey. Weaker growth after the redenomination of the currency in late 2016 is holding down inflation in 2017. The RBI also made note of stable international financial conditions as a factor making August's reduction in policy rates feasible. The RBI is evaluating whether inflation's recent slowdown is likely to be transitory or more persistent. If weak demand keeps inflation low persistently, the RBI could cut interest rates further in the rest of 2017. But if US interest rates begin to move higher in coming months, the RBI may not see room for further accommodation.

MEXICO: Real GDP grew 0.6 percent in quarter over quarter terms in the second quarter, with tertiary or services output up 0.8 percent, secondary output up 0.1 percent, and primary output down 2.0 percent. From a year earlier, real GDP grew 3.0 percent in the second quarter, with tertiary output up 4.1 percent, primary output up 1.0 percent, and secondary output up 0.6 percent. Financial markets currently price in no change in Mexican policy rates through the second quarter of 2018, but a rate cut from the Bank of Mexico before then – perhaps even as early as the bank's next monetary policy committee meeting on August 10 - is not out of the question. The premium of Mexico's policy rate above the top of the federal funds target range has more than doubled from 2.75 percentage points in 2014 and 2015 to 5.75 percentage points in early August 2017. Mexico's extremely hawkish monetary stance seemed justified in early 2017 when the peso was at record weak levels against the US dollar, Mexico was raising consumer energy prices, and drastic changes in Mexico's trade relations with the United States seemed likely. But the peso's steady appreciation in the first half of 2017 and the more conciliatory stance toward NAFTA renegotiations signaled by the Trump administration since the spring have dramatically changed the balance of risks to the Mexican economy, and created room for monetary policy to focus less on bolstering confidence in the currency and focus more on supporting economic growth.

JAPAN: No change in trend in Japan's June jobs report: A shift into part-time work and rising share of workers outside of traditional working years continue to hold down wage growth in a very tight labor market. Japan's unemployment rate returned to 2.8 percent in June, matching the February to April period for the lowest since 1994, after 3.1 percent in May. Employment grew 0.9 percent from a year earlier in June, but this growth was disproportionately concentrated in older workers, and in particular older female workers. For example, employment of Japanese women over age 65 grew 2.7 percent on the year in June, and employment of women ages 55 to 64 grew 2.1 percent. Employment of older Japanese men is also growing, but not as rapidly; employment of men 65+ was up 2.5 percent on the year, but employment of men 55–64 actually fell 0.5 percent. Japanese labor force entrants outside of traditional working years are disproportionately being hired into part-time positions. As a result, average weekly hours fell 0.5 percent on the year in June, and average monthly hours 0.4 percent. A business cycle causes wage growth to pick up when a tight labor market causes employment growth to slow and employers raise wages to compete for scarce workers. The current rise in labor force participation of older Japanese workers is preventing labor scarcity from fueling stronger wage growth and faster inflation. In short, Japan is not there yet: The Bank of Japan's measures of underlying inflation were unchanged in June, pointing to trend inflation of about 0.25 percent in year-over-year terms – this is despite the yen being about 5 percent weaker vis-à-vis the dollar in June 2017 than June 2016. The Bank of Japan's qualitative guidance commits to continuing with quantitative easing until inflation reaches and exceeds 2 percent on a sustained basis, meaning both headline and trend inflation likely must reach that target – Japan is a long way from a withdrawal of monetary stimulus. The interest rate differential between the dollar and yen is set to widen in the next 12 months as the Fed begins to shrink its balance sheet and continues to gradually raise the federal funds target, supporting our forecast for the yen to depreciate against the US dollar.

EUROZONE: Real GDP grew 0.6 percent quarter-over-quarter, or 2.3 percent annualized, in the preliminary estimate for the second quarter of 2017. In year-ago terms, real GDP grew 2.1 percent, matching growth of the US economy. The unemployment rate fell to 9.1 percent in June, and the rate for May was revised down to 9.2 percent from the 9.3 percent reported previously. June's unemployment rate is the lowest since February 2009. Inflation as measured by the benchmark harmonized index of consumer prices was 1.3 percent in year-over-year terms in July, and core inflation excluding energy, food, alcohol and tobacco was 1.2 percent, little changed from June's 1.1 percent and well below the ECB's target of below but close to two percent. Energy prices rose 2.2 percent on the year in July after 1.9 percent in June, and service prices rose 1.5 percent after 1.6 percent. Persistently weak inflation and the euro's appreciation in the last week to its strongest since January 2015 will likely encourage ECB policymakers to emphasize the slow pace at which they expect to remove policy stimulus in 2018 when they release details about their tapering plans later this year. PNC Economics expects the ECB to reduce asset purchases from €60 billion euros per month in December 2017 by €5-€10 billion euros per month beginning in January 2018, to conclude a taper sometime in the second half of 2018, and not to raise the benchmark policy rate until sometime in 2019 – a more gradual removal of policy stimulus than is currently priced into euro interest rate futures.

UNITED KINGDOM: The Bank of England's Monetary Policy Committee will likely hold the bank rate unchanged at 0.25 percent at their monetary policy decision tomorrow, August 3. Slower economic growth is reducing pressure on the Bank of England to make a near-term rate increase: Real GDP growth slowed to 1.7 percent in year-ago terms in the preliminary estimate for the second quarter of 2017 from 2.0 percent in the first quarter of 2017, itself revised down from 2.2 percent in the prior release, and real GDP growth for 2016 was also revised down in the latest release, to 1.8 percent from the 2.0 percent reported previously. Global banks are beginning to announce plans to relocate thousands of staff from London to cities that will be within the EU after Brexit, and many of the high-wage service-providing jobs linked to London's financial sector – lawyers, accountants, management consultants, IT professionals, and the like – will follow.

CANADA: After surging in the first half of 2017, Canadian household employment is likely to take a breather in July. We expect headline household employment to drop 10,000 on the month in July and for the unemployment rate to hold steady at 6.5 percent, giveback after 49,900 jobs added per month in May and June. Even if July sees a drop in employment, cross-checks of the health of the labor market confirm its strength in mid-2017. Unemployment insurance claims fell 6.4 percent on the year in March and April (May's data were distorted by the comparison against the month of the 2016 Fort McMurray wildfire), and payroll employment, a component of Statistics Canada's Survey of Employment, Payrolls, and Hours, grew a strong 1.6 percent on the year in May. Real GDP grew 0.6 percent on the month in May, with both resource sector and manufacturing output up solidly from April, offsetting declines in construction and real estate activity. The key question for the Bank of Canada is whether the growth of the energy and manufacturing industries can offset the correction underway in Canada's housing sector. If the housing correction continues and becomes more severe, it could have knock-on effects on household wealth, industrial activity, and employment. For now, the Bank of Canada is focused on upside risks to Canadian growth. But if the housing correction worsens, financial markets could mark down how rapidly they expect the Bank of Canada to raise interest rates in 2018.

AUSTRALIA: The Reserve Bank of Australia held the target cash rate at 1.50 percent, as expected, at its August 1 decision. The RBA's outlook changed little from the July meeting. Central bankers still expect consumer price inflation to slowly climb to the RBA's 2 to 3 percent target range, from the second quarter's 1.7 percent on a year-ago basis. Officials still believe Australian real GDP will grow at about a 3 percent pace over the next couple of years and remain concerned that weak wage growth may undermine consumer spending. The big change in the August statement is that the RBA is now concerned about the currency's unexpected 5 percent appreciation since early July. PNC Economics expects the Aussie dollar to weaken from its current 0.80 USD level as commodity prices slide and the U.S. Federal Reserve tightens its monetary policy relative to the RBA. If the currency instead sustains its strength, economic growth may slow. The Australian Industry Group's Performance of Manufacturing Index rose to 56.0 in July from 55.0 in June. Six out of seven activity sub-indices signaled expansion during the month, with gains led by production and employment sub-indices. Average selling prices, which are not included in the headline PMI, also rose in July. The July PMI reading is close to the index's 56.2 point average in the first half of 2017 and points to steady manufacturing growth at the beginning of the second half of the year.

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