September 6, 2017

GLOBAL ECONOMIC HIGHLIGHTS

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BANK OF CANADA HIKES, AND ECB COULD ANNOUNCE PLANS TO TAPER QE PROGRAM IN 2018

CANADA: The Bank of Canada raised the target for its policy rate 0.25 percentage points to 1.0 percent at its September 6 monetary policy decision, a month earlier than our expectation for an October rate hike. Their monetary policy statement highlighted both upside and downside risks to Canada's economic outlook. On the upside, economic growth has been faster than expected in 2017, fueling "solid employment and income growth." Business investment and exports have seen more broad-based growth than earlier in the recovery. On the downside, "uncertainties around international trade and fiscal policies remain," and inflation is "still more subdued than historical relationships would suggest," an acknowledgement that the trend in inflation may be lower in Canada – and for that matter, other advanced economies – than it was before the global recession of 2008-2009. If so, that would justify keeping Canada's policy rate lower, on average, over the course of the Canadian business cycle than it was in the past. The Bank of Canada also made note of the recent "cooling" of the housing market, and said that "close attention will be paid to the sensitivity of the economy to higher interest rates." Higher interest rates will be a headwind to Canada's housing sector and will raise debt service expense for Canadian households, whose debt has risen to record high levels relative to disposable incomes. Canada's housing market also faces headwinds from taxes imposed by foreign buyers targeting the Toronto and Vancouver markets and by Chinese government restrictions on capital outflows, which may slow the flow of investment into Canada. The Bank of Canada's mention of reasons to raise interest rates only gradually demonstrates that September's hike is part of an earlier increase in Canadian interest rates than markets anticipated at the beginning of 2017, but not necessarily a faster one. In the base case, the Bank of Canada will likely time future interest rate hikes to match the Federal Reserve's gradual normalization of US policy interest rates in the remainder of 2017 and in 2018. As such, the Bank of Canada will likely next raise its overnight rate target another 0.25 percentage points at either its December or January monetary policy decision, corresponding to our forecast for the Federal Reserve to raise the federal funds target by the same amount in December 2017.

September's rate hike followed the release of an excellent GDP report for the second quarter of 2017: Real GDP grew a robust 4.5 percent annualized after a 3.7 percent annualized gain in the first quarter, both up from a 1.4 percent annualized contraction in the second quarter of 2016. In the second quarter of 2017, strong growth in business investment in non-residential structures, machinery and equipment, up a quarterly 7.1 percent annualized, and intellectual property products, up 8.7 percent, offset a 4.7 percent annualized decline in residential investment. Household consumption grew a robust 4.6 percent annualized on the back of the first half of 2017's strong employment growth. Trade was a net tailwind to Canadian real GDP in the second quarter, with exports up 9.6 percent annualized and imports 7.4 percent. In June, monthly real GDP grew 0.3 percent from May, with construction up 2.0 percent, manufacturing up 0.2 percent, and mining and quarrying down 0.2 percent. From a year earlier, Canada's monthly real GDP index grew 4.3 percent, with resource sector output surging 20.5 percent (comparison against a very weak June 2016, when the Alberta wildfires depressed GDP), manufacturing up 4.0 percent, construction up 4.2 percent, utilities up 4.1 percent, and services up 3.0 percent. PNC Economics expects the September 8 release of the Labour Force Survey to show a solid 20,200 increase in household employment in August from July, with the unemployment rate down 0.1 percentage point to 6.2 percent, the lowest since October 2008.

EUROZONE: Inflation as measured by the benchmark Harmonized Index of Consumer Prices (HICP) rose to 1.5 percent in year-over-year terms in the August preliminary report from 1.3 percent in July. Faster increases in energy prices, up 4.0 percent in August after 2.2 percent in July, were behind faster headline inflation. Core HICP inflation excluding energy, food, alcohol and tobacco was unchanged at 1.2 percent in year-over-year terms. The Eurozone unemployment rate was 9.1 percent in July, unchanged from June's level which had been the lowest since February 2009. While the Eurozone has made great strides since the crisis and deflation is no longer a risk, it is far from generating domestic inflationary pressures that could raise inflation to the European Central Bank's target of below but close to 2 percent. Underemployment, weak wage growth, labor market deregulation, and aging consumers are persistent headwinds to inflation. The European Central Bank's September 7 Governing Council decision will likely provide a first glimpse of their plans to incrementally taper quantitative easing in January 2018. Recent leaks from ECB policymakers have tamped down expectations for a September announcement of their plans for 2018, but they are likely to make clear that the door is open to continued quantitative easing next year. In the base case, we expect the ECB to leave benchmark interest rates unchanged throughout 2018, and announce asset purchases at a €40 billion euro monthly rate between January and March 2018, incrementally slower rate than the €60 billion euros in monthly purchases between April and December 2017. A benchmark interest rate hike is very unlikely in 2018 given the European Central Bank's forward guidance that interest rates will stay at present levels "well beyond the horizon" of when QE ends.

UNITED STATES: Job growth took a breather in August. US payrolls added 156,000 jobs from July and job growth in June and July was revised down by a net 41,000; the unemployment rate ticked back to 4.4 percent from July's recovery-to-date low of 4.3 percent. The unemployment rate rose despite only modest monthly growth in labor force participation: The volatile household employment survey from which the unemployment rate is calculated showed a 74,000 monthly decline in employment after gains of near 300,000 in June and July, and a 77,000 monthly increase in the labor force. Average hourly earnings rose 0.1 percent in August from July and 2.5 percent from a year earlier, in line with the recent trend.

JAPAN: Moderate growth continues. The Nikkei manufacturing PMI was little changed at 52.2 in August after 52.1 in July and the services PMI dipped to 51.6 in August from 52.0 in July. The services PMI pointed to the slowest service sector growth in six months.

UNITED KINGDOM: More signs that the UK's economy is slowing: The IHS Markit/CIPS services PMI dipped to an 11-month low of 53.2 in August from 53.8 in July, and the construction PMI dipped to a 12-month low of 51.1 from 51.9. The manufacturing PMI bucked the trend, rising to 56.9 from 55.3; the weak pound benefits the manufacturing sector, not construction or services.

AUSTRALIA: Real GDP growth accelerated to an annualized 3.3 percent pace in the second quarter from 1.3 percent in the first quarter of 2017. Also, the first quarter's growth rate was revised up from 1.1 percent. On a year-over-year basis, the economy grew 1.8 percent in the second quarter, unchanged from the first quarter. The second quarter's growth rate was unremarkable; a pickup in growth was to be expected after a below-trend first quarter. Nevertheless, the details were encouraging as they showed broad-based improvement. Spending by households and the government sector continued to be important economic growth drivers. Rising agricultural exports improved net exports and mining-related investment is stabilizing. PNC Economics expects economic growth to pick up in the second half of 2017 to bring the growth rate for all of 2017 up to 2.4 percent. However, the risks to this forecast are to the downside. Consumer spending could weaken because households carry significant debt burdens and face weak income growth. The household saving rate declined to 4.6 percent of disposable income in the second quarter from 5.3 percent in the first quarter as spending outstripped income growth. Also, residential investment, which is still contributing to economic growth, could soften as the Reserve Bank of Australia aims to cool hot housing markets. Earlier this week, central bankers held the target cash rate at 1.5 percent during their policy-setting meeting. PNC Economics expects the RBA's next move to be a rate hike in the second half of 2018.

CHINA: The Chinese Communist Party will hold its 19th national congress on October 18th, when it will name the membership of the Politburo Standing Committee who will hold office between 2017 and 2022. While Communist Party Chairman Xi Jinping will retain his position following the congress, there may be considerable turnover among other Politburo members. Growth is holding up ahead of the congress: The

CFLP manufacturing PMI for China rose to 51.7 in August from 51.4 in July, and the Caixin general manufacturing PMI rose to 51.6 from 51.1. The CFLP nonmanufacturing PMI dipped to 53.4, its weakest since May 2016, while the Caixin services PMI rose to 52.4 from 51.9 and was the strongest in six months.

MEXICO: Survey data for August were upbeat: The IHS Markit manufacturing PMI rose to 52.2 in August from 51.2 in July, the Mexican statistical agency INEGI's manufacturing orders index was unchanged from a month earlier at 51.9, business production expectations rose to 53.2 from 51.4, and consumer confidence rose 0.7 percentage points. The second round of NAFTA renegotiation talks concluded September 5 in Mexico City with little sign that a revised agreement will address the US government's priorities of reducing the bilateral US-Mexico trade deficit.

BRAZIL: Brazil's recovery continues. Real GDP grew 1.0 percent annualized in the second quarter of 2017 after 4.2 percent annualized in the first quarter, with falling government spending and business capital spending offsetting a strong increase in household consumption and net exports. From a year earlier, real GDP grew 0.2 percent in the second quarter, the first year-ago increase since the first quarter of 2014.

INDIA: India's economy is suffering headwinds to growth from last year's demonetization. Real GDP growth slowed to 5.7 percent in year-ago terms in the second quarter of calendar year 2017 from 6.1 percent in the first quarter; real GDP grew 7.9 percent in the second quarter of calendar year 2016.

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