September 20, 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

AS EXPECTED, THE FEDERAL RESERVE WILL BEGIN A VERY GRADUAL BALANCE SHEET REDUCTION IN OCTOBER

UNITED STATES: As expected, the Federal Open Market Committee decided at its September 20 meeting to begin reducing the size of the Federal Reserve's balance sheet on October 1, and to hold the federal funds target unchanged at a range of 1.00 to 1.25 percent. Before deciding when balance sheet reduction would begin, the Fed decided how: In June, they announced the plan to reduce their balance sheet by allowing up to $10 billion dollars of maturing securities to run off each month, instead of reinvesting proceeds as they had been doing. Balance sheet reductions will be split 60-40 between Treasury bonds and agency debt. The Fed will increase the amount of securities running off the balance sheet by $10 billion dollars per quarter until the fourth quarter of 2018, after which reductions will continue indefinitely at $50 billion per month. At this rate, the Fed's balance sheet, currently $4.5 trillion US dollars, will not shrink to near its pre-crisis size until well into the next decade. This process will put modest upward pressure on long-term interest rates, but, since today's decision was clearly telegraphed prior to its announcement, much of this effect was priced into financial markets beforehand. As balance sheet reduction proceeds, the Fed will monitor financial market conditions to decide when to stop run offs. In addition, the Fed's updated quarterly economic projections support PNC's forecast that the FOMC will next increase the federal funds target range by 0.25 percentage points at their December 13 and 14 meeting. PNC also expects the Fed to raise the target another three times in 2018, but leadership turnover in coming months increases uncertainty about the outlook for policy in 2018 and beyond. There are already three empty seats on the Federal Reserve Board, Vice Chair Fischer will retire in October, and Chair Yellen is unlikely to be reappointed after her term ends in early 2018. Thus, the "dot plot" of policy makers' projections for policy rates in 2018 and 2019 are *a* forecast for policy, but not *the* forecast of the policy makers who will decide on it—they have not yet been appointed.

UNITED KINGDOM: The Bank of England's monetary policy decision on September 14 points to a rate hike in the near future, a change in guidance. Their policy statement's key phrase was that "some withdrawal of monetary stimulus is likely to be appropriate over the coming months." British monetary policy is pulled in opposite directions by the expected negative impact of Brexit on the one hand, and the UK's strong current economic data on the other. Prior to September, the BoE had attached a stronger weight to Brexit, but now now seem more swayed by current data pointing to moderate economic growth and the tightest labor market in over 40 years. Retail sales rose 1.0 percent in both value and volume terms in August from July, and 5.6 percent by value and 2.4 percent by volume from August 2016. Sales values and volumes for the June through August period both rose 1.2 percent from the prior three months.

CANADA: Manufacturing sales fell 2.6 percent by value and 1.4 percent by volume in July, with motor vehicle and parts sales down 13.8 percent on the month and other categories up 0.2 percent. Statistics Canada attributes weak motor vehicle and parts sales to auto makers shutting down production for retooling for more of July 2017 than in typical years. Inventories fell 0.2 percent, and the inventory to sales ratio rose from 1.37 to 1.40. From a year earlier, manufacturing sales grew 3.4 percent by value and 2.1 percent by volume. Strong vehicle sales reinforce that July's manufacturing sales drop is a blip and not a trend: Canadian vehicle sales grew 9.6 percent in year-over-year terms in July, down from 14.3 percent in June; units sold grew 5.1 percent in year-over-year terms in July, down from 6.8 percent in June.

JAPAN: The Bank of Japan's September 21 monetary policy decision will almost certainly hold the Bank's monetary stance unchanged: The short-term policy rate will remain at -0.1 percent, government bond purchases will continue at a rate sufficient to hold the ten-year government bond yield around zero percent, and central bank purchases of exchange-traded funds and real estate investment trusts will continue at unchanged rates. The Bank of Japan's forward guidance commits to continuing with quantitative easing until both headline inflation and the BoJ's measures of core inflation rise above the BoJ's target of 2.0 percent, a goal they are very unlikely to reach before 2019 at the earliest.

AUSTRALIA: Strong labor market data for August: Employment rose by 54,200, nearly double the 27,900 consensus. July's job gains were revised up by 1,400. The unemployment rate held steady at 5.6 percent for a third month in August but the participation rate edged up 0.2 percentage points to 65.3 percent, the highest since September 2012 and an indication of rising confidence in the job market. Details were good: Full-time employment increased by 40,100 in August, more than reversing July's 19,000 decline. Part-time employment rose by 14,100 following July's 49,100 gain. Labor market data are improving markedly in 2017 from 2016. Job growth has averaged 33,500 per month so far this year, more than triple 2016's 8,900 average gain. Full-time jobs added in 2017 have outnumbered part-time jobs by nearly four to one. Even after August's upbeat employment data, the Reserve Bank of Australia is unlikely to change the target cash rate in 2017. Further labor market gains are needed to absorb Australia's remaining labor market slack and underemployment. Until those gains are made, wage growth likely will be weak, and inflation will continue to undershoot the RBA's 2 to 3 percent target range.

CHINA: Activity indicators slowed in August. Value added of industry, the monthly index of GDP created by the industrial sector, grew 6.0 percent in year-over-year terms, down from 6.4 percent in July and the slowest since December 2016. Retail sales growth slowed to 10.1 percent from 10.4 percent, also in year-over-year terms. Investment in fixed assets slowed to 7.8 percent in year-ago terms for the January to August period from 8.3 percent in the January to July period.

BRAZIL: The Central Bank of Brazil's monthly proxy for real GDP, the IBC-Br index, rose 0.4 percent in July from June and 1.5 percent from July 2016. Brazilian economic growth is holding up despite a revival of political uncertainty. A poll released this week showed former President Luiz Ignacio Lula de Silva the most popular among potential candidates for the October 2018 Presidential election. Lula is a member of the Worker's Party, which held power during Brazil's descent into its 2014 to 2016 economic depression.

MEXICO: Our sympathies are with all those affected by the major earthquake which struck Mexico City on September 19, causing over 200 deaths. This is a significant human tragedy; it does not affect the outlook for Mexico's monetary policy or exchange rate.

Disclaimer: The material presented is of a general nature and does not constitute the provision of investment or economic advice to any person, or a recommendation to buy or sell any security or adopt any investment strategy. Opinions and forecasts expressed herein are subject to change without notice. Relevant information was obtained from sources deemed reliable. Such information is not guaranteed as to its accuracy. You should seek the advice of an investment professional to tailor a financial plan to your particular needs. © 2017 The PNC Financial Services Group, Inc. All rights reserved.

Visit http://www.pnc.com/economicreports to view the full listing of economic reports published by PNC's economists.