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GLOBAL ECONOMIC HIGHLIGHTS

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US BROADENS TARIFFS ON CHINESE IMPORTS AS FED GETS SET TO HIKE; ITALIAN BUDGET, UK BREXIT NEGOTIATIONS

UNITED STATES: The US will begin charging US importers a 10 percent incremental tariff—a type of tax—on purchases of $200 billion of Chinese goods starting September 24. Unlike earlier tariffs on industrial products, this round applies to many types of consumer goods. The tariff rate will increase to 25 percent on January 1 if China does not satisfy US demands to alter economic and trade policies and reduce its trade surplus with the US. The Trump administration has threatened to place tariffs on all Chinese goods imports if China retaliates against US escalation, as China has promised to do. For full analysis of the tariffs see our report on the PNC Economics website. Amid 2018's robust expansion, housing remains notably less robust than most other sectors. Annualized housing starts rose 9.2 percent in August from July and 9.4 percent from a year earlier, but were still 3.9 percent below their recovery to date peak reached in January 2018; building permits fell 5.7 percent in August from July and 5.5 percent from August 2017. The National Association of Realtors' Housing Affordability Index reported that the typical (median) American family could afford a home 38.8 percent more expensive than the typical (median-priced) home. That means housing affordability is still good, but higher housing prices and rising interest rates mean affordability is not as good as in January when the typical family could afford a home 62.4 percent more expensive than the typical one. Broadened tariffs have cross-cutting implications for monetary policy: They will cause a short-lived increase in inflation, but also add to medium- and long-term downside risks to growth. PNC forecasts for the Federal Reserve to raise the federal funds target a quarter percentage point to a range of 2.00-2.25 percent at their September 26 decision; the FOMC statement and dot plot will be closely watched for signs of whether the Fed will next raise interest rates at its December or March decision.

EUROZONE: Italy's 2019 budget announcement on September 27 will be closely scrutinized: The country is governed by a coalition of an anti-establishment right party, the League, and an anti-establishment left party, the Five Star Movement, and both want to increase the fiscal deficit to fund campaign promises for tax cuts and a universal basic income. The European Commission could sanction Italy if its budget violates deficit limits, but doing so would test EU powers not yet used outside of a debt crisis, which Italy is not in. Italy's economy minister, who does not belong to either anti-establishment party and who was chosen to maintain financial market confidence in the government, holds ultimate responsibility for the budget. We expect Italy's budget to push the limits of the EU's rules but not to exceed them. An Italian debt crisis is an unlikely tail risk in 2019.

UNITED KINGDOM: The European Union's heads of state collectively rejected Prime Minister Theresa May's Brexit proposal at a meeting in Salzburg on September 20. Prime Minister May describes the plan as the only proposal that the UK can make; by that she means is the proposal is the only one that her political coalition would support, since it must satisfy Brexit hardliners within the Conservative Party as well as members of the Northern Irish Democratic Unionist Party, who would veto any Brexit deal that changes the status quo of Northern Ireland's relationship with the rest of the UK. However, a different British government might advocate a different plan – possibly before year end. The British press are reporting that the British government is preparing to hold a Parliamentary election in November. The parallel to Greece's 2015 negotiations with the EU is obvious: Greece held a referendum in July 2015 in which voters rejected the EU's austerity and aid package, but without a viable alternative to the EU, Greece's government accepted austerity a week after their referendum.

JAPAN: The Bank of Japan held its monetary stance unchanged as expected at its September 19 Policy Board decision: The negative short term policy rate and ten-year government bond yield target were held unchanged at -0.1 percent and "around zero percent," respectively. The BoJ continues to buy government bonds, exchange traded funds, and real estate investment trusts as part of its quantitative easing program. The BoJ has changed its forward guidance to prepare financial markets for an eventual taper of its quantitative easing program, but also signaled that a taper is unlikely until after the headwind from the October 2019 value added tax hike fades.

CANADA: Canadian Real Estate Association sales data were less bad in August, rising a seasonally-adjusted 0.9 percent from July and down a smaller 3.8 percent from a year earlier. New listings were unchanged on the month. The MLS® home price index rose a cool 2.5 percent from a year earlier, and the national average sales price 1.0 percent. CPI inflation slowed to 2.8 percent in August in year-over-year terms from 3.0 percent in July. Each of the Bank of Canada's three measures of core inflation edged a slight 0.1 percentage point higher to a range of 2.0-2.2 percent in August, up from 1.9-2.1 percent in July and still close to the Bank of Canada's 2.0 percent target.

CHINA: China is retaliating against US tariffs by imposing tariffs of their own on $60 billion of US goods exports. China's president hinted at unspecific non-tariff retaliation as well: China may expand tariffs to apply to US services exports; encourage its consumers and businesses to boycott American brands; permit Chinese businesses to violate sanctions against Iran, North Korea, and others sanctioned by the US government; or signal open seasons on violations of US intellectual property and theft of US trade secrets.

BRAZIL: The Central Bank of Brazil held its Selic policy rate unchanged at 6.50 percent as expected at its September 19 decision. Its monetary policy statement was mostly unchanged from recent statements: The Bank sees upside risks to inflation from the possibility of further capital outflows from Brazil and other emerging markets, and downside risks to inflation from economic slack. The central bank also emphasized that their ability to maintain stimulative interest rates depends on whether Brazil's government follows through with necessary but unpopular deficit reduction policies like making pensions less generous. The Brazilian real will likely stay under pressure until the October 25 presidential election, and could recover subsequently if the policy outlook becomes clearer.

MEXICO: We expect the Bank of Mexico to hold their policy interbank rate unchanged at 7.75 percent at their October 4 monetary policy decision, seeing room in the peso's appreciation to below 19 per US dollar to support growth instead of matching pace with the Fed and bolstering the value of the exchange rate.

INDIA: Financial tensions are rising in onshore capital markets after the default of Infrastructure Leasing & Financial Services, a private nonbank financial intermediary, on a letter of credit September 21. The Reserve Bank of India and Securities and Exchange Board of India jointly announced the same day that they "are closely monitoring recent developments in financial markets and are ready to take appropriate actions, if necessary."