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GLOBAL ECONOMIC HIGHLIGHTS

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US LABOR DATA SOLID; NEW PACIFIC FREE TRADE ZONE; MEXICAN CENTRAL BANK ON HOLD

UNITED STATES: Solid US jobs data reinforces our forecast for the Federal Open Market Committee to raise the federal funds target 0.25 percentage points to a range of 1.25 to 1.50 percent at its December 13 meeting. Job openings were little changed near a record high at 6.093 million in September after 6.090 in August, and separations rose on the month, a sign workers are confident in job prospects and are leaving current jobs for better ones; the "quits rate," measuring the share of workers who voluntarily leave jobs, edged up to 2.2 percent in September from 2.1 percent in August and tied several other months in 2017 for the highest since May 2007. The four-week moving average of initial claims for unemployment insurance fell to 231,250 in the period through November 4, the lowest since March 1973. These data confirm the signal from the October jobs report, in which payroll jobs rose 261,000 and reversed September's hurricane-related weakness. Job growth in the prior two months was revised up a net 90,000, and the unemployment rate fell to 4.1 percent, the lowest since December 2000. The Baker Hughes rig count, tallying the number of oil drilling rigs operating in the United States, rose in the week of November 10 to the highest since the summer of 2015. Higher global oil prices after Saudi Arabia arrested members of its royal family in early November will likely pass through to higher US energy industry activity in coming months and raise domestic crude output to a new record in 2018.

JAPAN: Trade ministers for 11 Asia Pacific countries made progress toward a new free trade agreement at the Asia Pacific Economic Cooperation forum last week. The countries – ranked by GDP, they are Japan, Canada, Australia, Mexico, Malaysia, Singapore, Chile, Vietnam, Peru, New Zealand, and Brunei Darussalam – have a collective GDP of nearly half the United States ($10.5 billion dollars) and 500 million in population. The US actually led the negotiation of the agreement, originally called the Trans-Pacific Partnership, from 2010 to 2016. But after the 2016 election, the US withdrew from TPP and prioritized bilateral trade agreements ("America First" trade policy). In response, the remaining members agreed to implement a modified agreement, which they call the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). This agreement, like the TPP, will reduce many behind the border restrictions on trade, and in particular, significantly liberalize trade in food products. The CPTPP will also change thousands of small national regulations governing business and trade to be consistent across member states, modestly boosting trend growth in the years following its implementation. More importantly, these ground rules for Asian regional trade provide the members a counterbalance to China's influence in the pacific – the CFTPP bloc is roughly equal in size to China. The CFTPP differs from the TPP by omitting intellectual property protections and exclusivity periods for biological drug patents, changes that would have helped US exports if the US were a member. The US is a net exporter of technologically-advanced pharma products and IP-intensive products. One of the sticking points in the current round of CPTPP negotiations was reportedly related to rules of origin for components of auto exports, an issue that Canada and Mexico are currently negotiating with the United States as part of the NAFTA renegotiation. As a result, the CPTPP will likely not go into effect until the NAFTA renegotiation is done as well. But an agreement on CPTPP ultimately seems quite likely, since its members can negotiate more favorable trading terms with each other than on a lopsided bilateral basis with either the US or China – and, if the CPTPP comes into effect, its terms will strongly influence the rules under which the US, China, or other countries can trade in the Pacific.

MEXICO: No interest rate cuts yet. As expected, the Central Bank of Mexico held its policy rate unchanged at 7.0 percent at its November 9 monetary policy decision. The Bank cited upside and downside risks to the growth and inflation outlook from many factors, but the NAFTA renegotiation ranks top on both lists. A resolution to NAFTA that preserves Mexican access to US markets would likely catalyze the beginning of a rate cut cycle from Mexico's central bank, while barriers to Mexican imports could cause the Bank to keep interest rates high to defend the currency. The NAFTA negotiations have so far been extended into the first quarter of 2017 after Mexico and Canada rebuffed US proposals to require higher US-produced components in autos traded in the region, and a provision that would change NAFTA from a permanent agreement to a temporary one that must be re-ratified every five years. If the US withdraws from NAFTA or imposes tariffs on Mexican exports, the Mexican government would retaliate, targeting US exports to Mexico and in particular agricultural products. Mexican CPI inflation picked up slightly to 6.4 percent in October from 6.3 percent in September despite core inflation holding stable at 4.8 percent; non-core prices rose faster on a spike in government-set tariffs, which rose 8.1 percent on the year in October after a 6.1 percent increase in September. Consumer energy costs also rose faster, up 16.3 percent on the year in October after a 15.3 percent increase in September.

UNITED KINGDOM: Eight months into the 24-month Brexit divorce negotiation, the UK and EU are still stuck on the first step, the "divorce bill" the UK must pay the EU to settle prior commitments to EU finances. The EU is refusing to discuss British market access to export to the EU as a non-member until they reach an agreement on the divorce bill. The EU has taken a much harder line against the UK during negotiations than the British government expected, putting considerable stress on the cohesion of the Tory party minority government. The British pound sterling's retreat to $1.31 the week of November 9 from a peak of $1.36 in mid-September reflects these political risks to the UK inherent in the Brexit process. The Bank of England's *Agents' Summary of Business Conditions* for October showed further tightening of the labor market despite lackluster output growth; slower immigration from EU countries and outmigration of EU workers after the 2016 Brexit referendum are tightening the British job market and reducing potential output.

CANADA: Look past the unemployment rate's uptick and there's more good news in Canada's October jobs report. Headline employment rose 35,000 from September. The labor force rose even more, by 56,800, so the unemployment edged back up to 6.3 percent: More Canadians are out looking for jobs as employers rapidly add positions. Measures of job quality continue to improve. Full-time employment rose 88,700 in October from September and part-time fell 53,400, while jobs held by employees rose 34,500 and self-employment just 800. Over the last 12 months, full-time employment rose 396,800, while part-time fell 88,700. Employment in higher-wage goods-producing industries rose 33,900 from September, with construction jobs up 18,400, manufacturing 7,800, agriculture 6,100, resource sectors 1,100, and utilities up 500. Service sector employment was essentially flat in October (+1,400), with a large decline in wholesale and retail trade (-35,900) offset by gains in information, culture, and recreation (+15,300), professional, scientific, and technical services (+8,000) and other services (+21,400). Educational service employment fell 10,000 due to the Ontario college teachers' strike. Solid job growth and improving job quality helped the year-over-year increase in total hours worked, 2.7 percent, handily outpace growth in employment, 1.7 percent. Solid Canadian jobs data reinforce our expectation for the Bank of Canada to raise the overnight rate target another 0.25 percentage points to 1.25 percent at either its December meeting, matching when we expect the Fed to next hike, or at its January meeting, when the BoC will release their next Monetary Policy Report and forecasts. We expect Canadian short-term interest rates and US interest rates to move higher in tandem in 2018. In 2019 though, Canada's high household debt and cooling housing sector could slow the Bank of Canada relative to the Fed.

AUSTRALIA: Weak consumption figures bode ill for third quarter GDP growth. Seasonally-adjusted retail sales were unchanged in September, following 0.5 and 0.3 percent respective month-over-month declines in August and July. The consensus expected a 0.4 percent increase in September. Third quarter retail sales fell 0.3 percent from the second quarter, compared with an average increase of 0.9 percent in the previous four quarters. The loss of sales momentum reflects price pressures. Retailers are cutting prices because households faced higher utility bills recently while contending with weak wage growth and high levels of debt. The good news is that the job market is on the mend and that could help consumer spending get back on track. For now, the overall outlook for the Australian economy remains positive as investment and labor market conditions improve, but downside risks are mounting.

CHINA: Both the Chinese and US governments are emphasizing negotiating “wins” following bilateral meetings in early November. Vice Minister of Finance Zhu Guangyao announced at a November 10 press conference that China would take additional steps toward allowing wholly-foreign owned financial firms, including banks, securities companies, financial futures companies, asset managers, and life insurers. Chinese and US companies announced approximately $250 billion in deals during President Trump’s visit to China; companies routinely time these announcements to coincide with state visits, so the headlines do not influence our view of the outlook for US exports to China. The signal for financial markets from both governments’ messaging is that a trade war between the US and China has become less likely. Since China would respond to US tariffs with retaliatory restrictions on US exports and businesses, the outcome of November’s summit shows the current administration following the precedent of previous US administrations, in shifting to a cooperative approach with China after taking office following confrontational messaging during the electoral campaign. The economic cost of conflict with China are too high. The Trump administration’s pursuit of Chinese cooperation to pressure North Korea is a further reason why broad-based US tariffs on Chinese imports are unlikely.

BRAZIL: Benchmark inflation ticked higher in October: The IPCA index rose 2.7 percent in year-ago terms, up from 2.5 percent in September. Food and beverage prices fell 2.1 percent on the year, unchanged from September, and transport cost inflation slowed to 3.7 percent from 4.0 percent. IPCA excluding food, beverage, and transport (equivalent to core CPI excluding food and energy) rose 4.6 percent on the year in October, up from 4.2 percent in September. Even after October’s uptick, core inflation is low by Brazilian historical standards, keeping the door open for further benchmark interest rate cuts in 2018 if political risks remain contained.