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GLOBAL ECONOMIC HIGHLIGHTS

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BRITISH CONFIDENCE JUMPED AFTER DECEMBER'S ELECTION; CORONAVIRUS LOWERING CHINESE GROWTH

UNITED KINGDOM: Business confidence jumped after the UK's December 12 general election. The Confederation of British Industry's Business Optimism Index surged to 23 in January from -44 in October and was the strongest since April 2014; the Markit services PMI rose to 52.9 from 50.0 and was the strongest since September 2018; and the Markit manufacturing PMI rose to 49.8 from 47.5 and was the least weak since April 2019. The jump in business sentiment makes the Bank of England's next monetary policy decision on January 30 a close call: Real GDP likely fell in the fourth quarter, and the UK was probably in a technical recession in the second through fourth quarters of 2019. But confidence surveys suggest a rebound is already underway in January. The Bank of England seems more likely to hold its bank rate unchanged at 0.75 percent than cut it; if there is a cut, it will be a "one and done" insurance cut.

CHINA: Policies to contain the spread of the Coronavirus outbreak will slow economic growth near-term. China's government has suspended public transportation in the city of Wuhan, where Coronavirus was first identified in December, and as of January 26 had imposed travel restrictions on regions with an aggregate population of 50 million people; that is 4 percent of China's population. Many public and private celebrations of the January 25 Lunar New Year have been cancelled; and the government has extended the Lunar New Year national holiday three days, to February 2, delaying the restart of manufacturing, which slows dramatically during the holiday while migrant workers visit their hometowns. PNC forecasts for Chinese real GDP growth to slow to 5.9 percent in year-over-year terms in the first quarter of 2020 from 6.0 percent in the prior quarter; the economy could slow more if the outbreak worsens and forces a more aggressive policy response.

EUROZONE: The European Central Bank's January 23 Governing Council decision was as expected: The ECB held the benchmark negative deposit rate unchanged at -0.50 percent, where it has sat since September, and continue to conduct open-ended asset purchases a.k.a. QE at a €20 billion euro monthly rate. Their forward guidance was also unchanged: They will conduct asset purchases "as long as is necessary," and only end them "shortly" before when they start raising interest rates. As for rate hikes, those are not expected until the ECB begins to forecast inflation rising to their target of below but near two percent; a far-off prospect. The Governing Council noted that the Eurozone's economic data improved modestly in recent months; while they believe downside risks have receded since the US-China Phase One trade agreement, they still see more downside than upside risk to Eurozone growth and inflation. In the press conference following the decision, President Lagarde said the Phase One deal would divert Chinese import demand away from third party economies, potentially negatively affecting the Eurozone. The ECB is likely on hold this year.

In addition to the rate decision, the ECB also announced the scope of their 2020 strategic review, which was largely as expected and sparse on details. The review will evaluate whether to revise their quantitative target for inflation; the ECB historically has reacted more to inflation overshooting their target than undershooting it, and could adopt a symmetric target like the Fed, Bank of England, and Bank of Japan. All things equal, a symmetric inflation target would make a rate hike an even more remote prospect. In addition, President Lagarde said in her press conference following the decision that the ECB would "listen," and drew an explicit parallel to the Federal Reserve's "Fed Listens" program. On its face, this might seem to offer an olive branch to the Eurozone's monetary hawks, who believe former President Draghi was deaf to complaints about the costs imposed on savers and pensioners by low and negative interest rates. The Bundesbank would like the ECB to listen to savers more. However, it is worth considering that "Fed Listens" actually had the opposite effect on US monetary policy: Fed Chair Powell has repeatedly said that Fed Listens reinforced the importance of a tight labor market to ensure the benefits of economic expansion extend to people of color, low-income Americans, and marginalized groups. Fed Listens is one reason why the Fed continues to keep US interest rates low despite an historically low unemployment rate. An "ECB Listens" program could give a louder voice to Europeans in lagging economies, and bias the ECB toward continued negative rates.

The ECB will also review the costs and benefits of its various monetary policy tools; it is possible although unlikely that they could decide quantitative easing has preferable tradeoffs to negative interest rates, and raise short-term interest rates while increasing asset purchases. But this could flatten the Eurozone yield curve, and reinforce pressures on Eurozone financial sector profitability, with questionable benefit to pensioners. Finally, President Lagarde said the ECB could consider rebalancing its private sector asset purchases toward companies that advance the EU's goal of mitigating climate change, and could incorporate climate risk assessments into their financial supervision frameworks.

Recent Eurozone business sentiment data are mixed. The Markit manufacturing PMI for the Eurozone rose to 47.8 in the January flash release from 46.3 in December and was the least weak since April 2019, while the services PMI receded to 52.2 from 52.8.

UNITED STATES: The Markit services PMI for the United States rose to 53.2 in the January flash release from 52.8 in December and was the strongest since March 2019, while the Markit manufacturing PMI receded to 51.7 from 52.4 (the more closely-followed ISM manufacturing PMI will be released February 3). Existing home sales rose 3.6 percent in December from November to the strongest since February 2018; they are now only 1.8 percent short of their recent peak in January 2017. PNC forecasts for the Federal Reserve to hold the target for the federal funds rate unchanged at a range of 1.50 to 1.75 percent at their next Open Market Committee meeting January 29. PNC does not forecast any change in the Federal Funds target in 2020; financial markets price in roughly seven in ten odds of a 25 bps cut by year-end.

JAPAN: The Jibun Bank manufacturing PMI for Japan rose to 49.3 in the January flash estimate from 48.4 in December, and the services PMI rose to 52.1 from 49.4; the services PMI averaged 49.8 in the fourth quarter of 2019. The all-industry activity index rose 0.9 percent in November after a huge 4.8 percent drop in October; averaging October and November and comparing against the June to August average to filter out some of the volatility around the October tax hike, economic activity in the first two months after the hike has averaged 2.5 percent below the pre-hike trend.

CANADA: As widely expected, the Bank of Canada held its overnight rate target unchanged at 1.75 percent for the tenth straight meeting at its January 22 monetary policy decision. The BoC stated that while there have been positive developments in trade and the global economy, the outlook for the Canadian economy remains cloudy. Their policy statement reads, "Data for Canada indicate that growth in the near term will be weaker, and the output gap wider, than the Bank projected in October." This is a departure from their previous more positive assessment of the economy, and opens the door for an interest rate cut at the next meeting on March 4. Financial markets price in roughly 30 percent odds of a 25 bps cut at that meeting, and 80 percent odds of a cut by year-end.

MEXICO: The Bank of Mexico will likely cut its benchmark interbank target rate 0.25 percentage point to 7.00 percent at its next interest rate decision February 13. The bi-weekly CPI inflation rate edged up to 3.2 percent in mid-January from 2.8 percent in December, but weak growth is a more pressing issue for the Bank of Mexico than inflation: The central bank's monthly GDP index fell 1.2 percent from a year earlier in November, worse than October's 0.8 percent year-over-year decline, and has been negative in those terms for six of the past eight months.

BRAZIL: The Brazilian National Confederation of Industry (CNI) Industrial Confidence Index rose to 65.3 in January, the highest in over nine years, from 64.3 in December. Readings over 50 indicate industrial optimism; the CNI Index has been above 50 since July 2018. Brazil's consumer price index the IPCA-15 rose 4.3 percent in the 12 months through mid-January, slightly above the 4.0 percent center of the Bank of

Brazil's inflation target band, and up from 3.9 percent the prior month. 307,311 formal sector jobs were lost in December, slightly lower than the 324,000 lost jobs expected by economists and a decrease from the 99,232 jobs added in November. Despite the December's job losses, 644,079 net jobs were added in 2019, making it the best year for job growth since 2013. The recent uptick in inflation, positive business sentiment, and generally solid economic data will likely cause the Central Bank of Brazil to hold the record-low Selic policy rate unchanged at the next monetary policy decision on February 5. The Central Bank of Brazil's weekly survey of professional forecasters showed the median estimate for the Selic rate at the end of 2020 was 4.5 percent, matching the current level, in the January 17th survey.

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