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GLOBAL ECONOMIC HIGHLIGHTS

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Brexit Uncertainty Resolves, but UK-EU Trade Tensions to Persist; US Jobless Claims Edged Lower in Late December

UNITED KINGDOM: The UK and EU reached an agreement on Christmas Eve for a trade deal to go into effect January 1, when the UK ceased participating in the EU common market. The deal averts a breakdown of UK-EU economic relations, which seemed possible during the brinkmanship ahead of the year-end deadline to reach a deal. Cross-border trade in goods will continue without tariffs or quotas, although the agreement limits trade in other ways. British service providers will face new limits on sales to the EU; health and safety regulations will increase the paperwork associated with sales of agricultural products; and shippers will need to adjust to new customs procedures and paperwork. In addition, the agreement includes a "level playing field" provision that allows the EU to impose new tariffs on British imports if the UK changes its domestic economic policies in ways that disadvantage EU competitors to British exporters, including policies like business subsidies, relaxing labor regulations, or lowered environmental standards. UK Prime Minister Boris Johnson wants to subsidize growth industries like the tech sector and make other pro-business policy changes; as the UK government proposes these changes, they will enter what could be a new, permanent push-pull relationship with the EU about economic standards and EU trade retaliation.

Even so, the trade deal greatly reduces uncertainty about the UK-EU economic relationship. This is reflected in the foreign exchange market with the pound sterling appreciating to \$1.37 per pound at the beginning of 2021, the strongest since the first half of 2018. Brexit-related optimism will continue to bolster pound sterling near-term, but the UK's domestic economic challenges are likely to play a more important role in determining the exchange rate on a longer time horizon. Economic growth will be slower after Brexit due to less immigration, which slows labor supply growth; and the UK will sell less services to the EU, meaning service-exporting companies will need fewer workers. In recent decades, developed economies with slower GDP and job growth have tended to experience less inflation and lower interest rates; the UK will be more like those countries after Brexit. Financial markets currently price in nearly fifty-fifty odds that the Bank of England cuts its policy bank rate to negative territory over the next twelve months. These factors are likely to be negative for the value of the pound sterling over a one to two-year time horizon. Also and more immediately, the British government has tightened restrictions on activities in recent weeks as a new, more contagious strain of coronavirus spread in the UK, straining hospitals and pushing deaths to their worst so far in this crisis. British economic activity likely contracted in late 2020 and will continue to fall in early 2021.

UNITED STATES: U.S. economic data were resilient in the second half of December, indicating that the worsening pandemic is slowing the recovery less than seemed possible at the beginning of that month. Initial claims for unemployment insurance dipped to 787,000 in the week ended December 25, the first report under 800,000 since late November; initial claims for Pandemic Unemployment Assistance fell to 308,000 in the last week of December and were likewise the lowest since late November. The number of weeks claimed in all unemployment programs pulled back to 19.56 million in the week of December 12 from 20.36 million a week earlier and was the second-lowest since April. The Federal Reserve Bank of New York's Weekly Economic Index hit a new recovery-to-date high in the week ending December 26 with a 1.3 percent year-ago decline.

Early sentiment surveys for December look slightly weaker than November. The Conference Board and University of Michigan's consumer sentiment surveys both pulled back in December from November, and

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business sentiment was mixed: The Markit manufacturing PMI was nearly unchanged in the December flash release at 56.5 after 56.7 in November, while the services PMI pulled back to 55.3 from 58.4.

In more concrete good news for the U.S. economy, Washington on December 27 agreed on another \$900 billion fiscal stimulus package. The package includes \$284 billion for Paycheck Protection Program loans; an extension of unemployment insurance benefits that would have expired at year-end, with the Federal government providing an additional \$300 per week through mid-March on top of standard benefits; and a \$600 tax credit for most adults. This latest round of fiscal stimulus will prevent households affected by job losses from pulling back on spending in the first quarter.

The Bloomberg consensus calls for the January 8 release of the December jobs report to show a slowdown in nonfarm payroll job growth to 50,000 from 245,000 jobs added in November, with the unemployment rate edging up to 6.8 percent from 6.7 percent in November. But with additional stimulus now being distributed and vaccines rolling out, the recovery should regain traction by mid-2021.

EUROZONE: The Markit manufacturing PMI for the Eurozone rose to 55.5 in the December flash estimate from 53.8 in November, and the services PMI rose to 47.3 from 41.7. The Eurozone economy likely contracted in the fourth quarter of 2020 as states re-imposed restrictions on activity in response to new record-high coronavirus cases and deaths.

JAPAN: The unemployment rate was 2.9 percent in November, down from 3.1 percent in October but still elevated by Japanese standards; the last time the unemployment rate was this high prior to the current crisis was in mid-2017. Industrial production was unchanged on the month in the preliminary estimate for November, and down 3.4 percent from a year earlier, a little worse than October's 3.0 percent year-over-year decline. Retail sales were up 6.4 percent year-over-year in November, but this is a comparison against the onset of Japan's current recession in the fourth quarter of 2020, which began when the Japanese government raised the value-added tax (a kind of sales tax) from 8 to 10 percent in October 2019.

CANADA: The Bloomberg consensus forecast for Canada's December jobs report, to be released Friday January 8, is for a 20,000 drop in household employment following November's 62,000 surge (a good normal month for Canada sees 15,000 to 20,000 jobs added) and for the unemployment rate to edge up 8.6 percent from 8.5 percent a month earlier.

CHINA: China continues to lead the global economic recovery. The CFLP manufacturing PMI was little changed in December at 51.9 after 52.1 in November, while the non-manufacturing PMI pulled back to a still-solid 55.7 from 56.4. The China financial press have begun to speculate about whether the People's Bank of China will tighten monetary policy to prevent the economic recovery from spilling over to excessive increases in property prices or irrational exuberance in the stock market. The PBoC could slow growth of loans and other sources of credit slightly in mid-2021, but a policy interest rate hike is unlikely: Total CPI inflation was negative in November from a year earlier, core inflation was under one percent, and unemployment in November was still elevated relative to the recent cyclical trough in mid-2018.

BRAZIL: Brazil added a better-than-expected 415,000 formal sector jobs in November, nearly fifty percent more than the 278,000 expected by consensus. Inflation by the IPCA-15 index was 4.2 percent from a year earlier in mid-December, down slightly from 4.3 percent in November. Brazil's recovery gained traction in the second half of 2020, but could slow again in 2021 if fiscal pressures force the government to curtail transfers that supplemented household incomes during 2020.

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