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GLOBAL ECONOMIC HIGHLIGHTS

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Fed's September Decision Likely to Tee Up a November Taper of QE Programs; Bank of England Is Nearing a First Rate Hike

UNITED STATES: The Federal Reserve's September 21 and 22 Federal Open Market Committee (FOMC) meeting is expected to tee up a November announcement of a taper (slower purchases) of their quantitative easing programs. The FOMC will update their Summary of Economic Projections a.k.a. dot plot at the meeting, too. Financial markets will closely read the pace of rate hikes implied by the dot plot. The last dot plot released in June 2021 showed the median dot thought the Fed should wait until 2023 to raise the Fed Funds rate and make two quarter percentage point rate hikes by the end of that year if the economy performed as expected. Financial markets currently price in a considerably earlier start of rate hikes—a first hike is priced in for mid-2022.

Inflation slowed notably in August. The consumer price index for urban consumers (CPI) rose 0.3% in the month, down from 0.5% in July; August's increase was the lowest since January. Food prices rose 0.4% on the month and energy prices rose 2.0% on a 2.8% increase in gasoline prices. The CPI excluding food and energy a.k.a. core CPI rose 0.1% in August, the lowest increase since February. CPI components that made inflation surge in the first half of 2021 fell or slowed in August. Used car and truck prices fell 1.5% from July; car and truck rental prices fell 8.5%; and airline fares fell 9.1%. Prices of lodging away from home fell 2.9%. New vehicle prices were an exception, jumping 1.2% after rising more than 1.5% in each of the prior three months. Manufacturing bottlenecks from semiconductor shortages are limiting the supply of new vehicles to dealer lots and pushing up new car prices. Major household appliance prices rose 1.5% in August. The CPI index for rent rose 0.2% in August, while the index for owners' equivalent rent of residences rose 0.3%. Housing costs in the CPI have risen much slower than sale prices of new and used homes since the pandemic struck. The CPI rent index is likewise rising slower than some privately compiled measures of residential rents. Inflation will cool into early 2022, then rise again over the course of 2022 as the expansion matures. The biggest near-term upside risk to inflation is pass-through of higher house prices to the CPI shelter component, which is about a third of the total index. The biggest downside risk is from prices of durable goods, which should be flat or fall in the next few quarters as bottlenecks abate.

Retail sales rose 0.7% in August, much better than the consensus expectation for a 0.8% decline. Sales excluding autos were up a very strong 1.8%, while sales excluding autos and gasoline were up 2.0%. Control sales—sales excluding autos, gasoline, food service, and building materials, and which go into nominal consumer spending in GDP—rose a very strong 2.6% in August. Sales of motor vehicles and parts fell 3.6% in August on shortages; sales at gasoline stations were up 0.2% (a decline in volume terms considering how much gas prices rose). Other retail segments saw big gains. Sales at nonstore retailers, primarily online sales, jumped 5.3% over the month, while sales at general merchandise stores rose 3.5%. Sales of home furnishings and furniture were up 3.7%, and sales of building materials were up 0.9%. Sales of electronics and appliances dropped 3.1%, perhaps because of limited inventories due to supply-chain problems. Grocery sales rose 2.1% in August while sales at food service and drinking establishments were flat; concern about the Delta variant may have discouraged dining at restaurants and encouraged at-home meals.

Industrial production rose 0.4% in August after a 0.8% increase in July; revisions left the path for industrial production modestly higher in June and July. Manufacturing production rose 0.2% in August, mining output fell 0.6% after a 1.0% jump in July, and utilities output jumped 3.3%. Industrial production in August was

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0.3% above its February 2020 level, but still down 2.5% from its pre-crisis peak in August 2018. The assembly rate for cars and light trucks was the highest since January but still 11.5% below the January level.

Sentiment surveys are holding at softer levels than the early summer months. The NFIB Small Business optimism index rose 0.4 points to 100.1 in August but was still down from July's 102.5. Hiring, capex, and inventory building expectations rose on the month in August, offset by less optimistic expectations for the economy to improve. The University of Michigan's Consumer Sentiment Indicator rose to 71.0 in the September preliminary release from 70.3 in August but was still the second lowest since the pandemic struck and below the spring 2020 trough. Inflation, the Delta outbreak, and the end of enhanced unemployment benefits are likely weighing on consumer sentiment.

UNITED KINGDOM: The Bank of England's (BoE) Monetary Policy Committee (MPC) will likely use their September 23 decision to announce plans to start raising the policy Bank Rate in the next few months. A hike is possible although unlikely at the September 23 meeting. The BoE's £150 billion pound sterling budget for gilt purchases (QE), set in January 2021, will not be finished until mid-December—it would be awkward to raise rates before ending QE. It is easier to imagine them hiking at the December 16 meeting. Financial markets price in roughly 50-50 odds of a rate hike by March, but risks are skewed toward an earlier start to policy normalization after BoE Governor Andrew Bailey stated to Parliament on September 8 that the MPC was split 4-4 at the August meeting over whether the conditions for raising interest rates had been met.

CHINA: Recent media reports suggest that the China Evergrande Group, a major real estate developer, could default on bank loan and bond interest payments in the next few days. Evergrande is a huge company; it would rank in the top 50 companies by revenue in the United States, and its gross debt exceeds \$100 billion U.S. dollars at market exchange rates. The company's difficulties demonstrate the stress that highly-levered Chinese companies face due to the withdrawal of monetary stimulus in 2021.

Economic activity slowed sharply in August as the government reimposed restrictions in response to Delta. Retail sales growth plunged to 2.5% in year-over-year terms in August from 8.5% in July, sharply undershooting the 7.0% consensus forecast. Industrial production growth also slowed, to 5.3% in the same terms from 6.4% in July. Growth of investment in fixed assets in the year to date slowed to 8.9% from 10.3% in the year through July, and floor space under development by the Chinese real estate industry fell 3.2% from a year earlier. Slower growth is now showing up in labor market statistics; the surveyed jobless rate in urban areas held steady at 5.1%.

EUROZONE: Eurozone industrial production rose a solid 1.5% in July and was 0.2% above its February 2020 level; this is the highest level of Eurozone industrial production since October 2019. Eurozone industrial production peaked in December 2017, then fell through early 2020 due to problems in the German auto industry and slower global demand for Eurozone capital goods exports. In July, durable goods production was the highest since 2008, and nondurable goods production was at a record high; capital goods production was still 1.3% below its February 2020 level in July.

CANADA: CPI inflation jumped to 4.1% in August in year-over-year terms, the highest reading since March 2003. August marked the fifth straight month that inflation exceeded the central bank's 1%-to-3% target range. Housing, transportation, and consumer durable costs were the main drivers of August's high inflation reading. In seasonally-adjusted terms, the CPI index rose 0.2% in August from July, the lowest monthly increase this year. The Bank of Canada's three measures of core inflation, CPI-common, CPI-median and CPI-trim, were 1.8%, 2.6% and 3.3% in August, respectively, all in year-ago terms. The high inflation seen in August will be short-lived; price increases should moderate in the next six months.

Housing activity slowed again in August as existing home sales fell 0.5% from the prior month; existing home sales have fallen for five straight months. Housing starts also pulled back, to 260,200 annualized units from 272,200 units in July. Even after this drop, Canadian housing activity remains very elevated and investment in residential structures is a major driver of economic growth in 2021.

BRAZIL: PNC expects Brazil's central bank to raise the Selic policy rate by a percentage point to 6.25% on Wednesday, September 22, as telegraphed at its last meeting. This would be the second consecutive monthly

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hike of a full percentage point. Inflation remains a challenge for the central bank; IPCA inflation has accelerated in every month this year and has overshoot the 5.25% upper limit of the central bank's target for six straight months.

INDIA: CPI inflation eased to 5.3% in August, following a 5.6% reading in July. After exceeding the central bank's 2%-to-6% target range in May and June, inflation was within the target range in July and August. Core inflation (excluding food, fuel, and light) was 5.9% in August. Price increases will likely accelerate again in the near term as the economy continues to grapple with supply-chain disruptions.

JAPAN: The Bank of Japan is expected to hold its monetary stance steady at its September Policy Board meeting; the decision will be announced late the night of September 21 in U.S. time zones. The BoJ's negative short-term policy rate is -0.1%; they buy government bonds (QE) to hold the 10-year government bond yield in a range of -0.1% to 0.1%; buy exchange-traded funds and real estate investment trusts at annual rates of up to ¥12 trillion yen and ¥180 billion yen, respectively; and buy corporate bonds at a flexible rate, with an upper limit on purchases of ¥20 trillion through March 2022 (their holdings were just over ¥8 trillion in the first half of September).

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