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GLOBAL ECONOMIC HIGHLIGHTS

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Fed Signals They Could Start Reducing Asset Purchases “Soon”; Bank of England Nearing a Rate Hike

UNITED STATES: As expected, the Federal Open Market Committee used their September 22 Monetary Policy Decision to tee up a reduction in monetary stimulus. The key phrase from their monetary policy statement reads, “A moderation in the pace of asset purchases may soon be warranted.” Barring big economic surprises, the Federal Reserve will likely announce a slower pace of purchases of government-backed bonds (“tapering the QE program”) at the next scheduled Open Market Committee decision on November 3. The taper is most likely to conclude by mid-2022. The September Survey of Economic Projections a.k.a. dot plot shows that many FOMC members have pulled forward the timing of when they believe it will be appropriate to raise the fed funds rate from the previous dot plot published in June. Half of the FOMC see an initial rate hike in 2023 or later, and half see it in 2022. The dots include all the Federal Reserve Board governors and the Regional Fed Bank presidents. Governors vote every meeting and are more dovish than the regional Fed presidents, who vote on a rotating basis. Because of this the median dot skews a little more hawkish than the median vote at an FOMC decision. Thus, a majority of the voting members of the FOMC likely still see it appropriate to wait until 2023 to raise the policy rate.

The median dot on the dot plot expects the fed funds rate to be around 1% at the end of 2023, up from 0.6% in the June dot plot. This is consistent with PNC’s forecast for the next increase in the fed funds rate to come in June 2023. The median FOMC participant sees it appropriate for the fed funds rate to end 2024 at 1.8%, with a long-run rate of 2.5% (unchanged from June). U.S. long-term interest rates rose on September 23 and 24 as markets digested the Fed decision and dot plot; the 10-year Treasury bond yield closed that week at 1.43%, its first time above its 50-day, 100-day, and 200-day moving averages since May.

The most important economic release in the coming week will be personal income and expenditures for August on October 1, along with the price index for personal consumption expenditures, which is the Fed’s preferred measure of inflation. Core PCE inflation likely slowed on the month, echoing the releases of CPI and PPI indices. Within the personal spending release, spending on services likely grew faster than spending on goods; new car shortages weighed on goods spending again in August.

UNITED KINGDOM: The Bank of England’s September 23 decision revealed that a growing minority of Monetary Policy Committee (MPC) members support an immediate taper of the Bank’s main QE program. The MPC held the monetary policy stance unchanged at the decision, but two of nine members voted for an immediate reduction in the target for government bond purchases (a.k.a. QE). The vote for the program had been 8-1 at the May, June, and August meetings, and unanimous prior to that.

It is an awkward moment for the BoE. Through the August decision, their forward guidance had committed to holding off on tightening monetary policy “Until there was clear evidence that significant progress was being made in eliminating spare capacity and achieving the 2% inflation target sustainably.” BoE Governor Andrew Bailey stated in testimony to Parliament on September 8 that the MPC was split 4-4 at the August decision about whether that standard was met. At the September decision they outright dropped the guidance: “all members agreed that the previous formal guidance was no longer useful in the present situation.” The majority who voted for holding off on an immediate reduction in the QE program justified it by referencing

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the end of the UK's furlough scheme at the end of September, which they thought could lead to an increase in the labor supply and unemployment rate and relieve labor scarcity.

Since the pandemic's start, the UK's statistical agency has begun releasing more timely experimental labor market data, and the most recent releases point to sharp improvement in employment in August: The flash estimate of payroll employment in August stood at 29.060 million, matching the pre-crisis peak of February 2020 (and actually a smidgen higher before rounding). The weekly estimate of household employment was about 2% below the pre-crisis peak in the latest report for the week ending August 1. Job vacancies hit a record high in the June-to-August reporting period.

The BoE's current QE program is on track to complete purchases by the December 16 meeting. They could cut short the program at the November 4 meeting if the recovery remains rapid and the labor market continues to tighten after the end of the furlough scheme; a rate hike is possible as early as December, and in any case is likely by the end of the first quarter of 2022.

CHINA: As widely expected, the China Evergrande Group missed the September 23 payment of interest on its bonds. China's real estate industry is likely to be a large drag on economic growth for at least the next three to six months as Evergrande's lenders and regulators manage the crisis. The situation is reminiscent of the Mexican homebuilder defaults of 2013-2014, which caused Mexico's economy to weaken sharply and contract outright for a quarter; however, Mexico avoided a broader and longer-lived downturn—an outright contraction of China's economy is unlikely but growth will probably weaken considerably in the next few months. The median forecast for Chinese real GDP growth in the fourth quarter of 2021 has been marked down to 4.5% as of September 24 from 5.0% on July 30, reflecting both the drag of Evergrande and of intensified restrictions on service-sector activity during August's Delta outbreak.

EUROZONE: Germans voted September 26 in a national election that will choose the successor to Chancellor Angela Merkel. Early projections of the election results suggest that no party will command a decisive plurality in parliament; instead the most likely outcome is a coalition government between one of the two main centrist parties, a quasi-libertarian party, and the left-leaning Greens.

MEXICO: The consumer price index rose 5.9% from a year earlier in mid-September, up from a 5.6% percent increase in August; prices of produce, energy and government-determined tariffs, and core goods rose sharply on the month. The Bank of Mexico will likely hike its benchmark interbank policy rate 0.25 percentage point to 4.75% at their next scheduled rate decision September 30, reacting both to the Fed's announcement that a taper of the U.S. quantitative easing program is close, as well as to accelerating inflation in Mexico.

CANADA: Retail sales fell 0.6% in July from June, giving back some of June's 4.2% surge. Retail sales rose 5.3% in July on a year-over-year basis. Preliminary estimates from Statistics Canada show that retail sales rose 2.1% in August on a month-over-month basis. Retail sales have been volatile this year, rising from January to March, falling in April and May, and rising again in June. Consumer spending was still below the pre-crisis level at the end of the second quarter of this year but will grow rapidly and drive economic growth in late 2021 and into early 2022.

BRAZIL: As expected, the Central Bank of Brazil's monetary policy committee raised the Selic policy rate by a full percentage point from 5.25% to 6.25% when central bankers met on September 22. This is the fifth consecutive hike and brings the Selic rate to the highest level since July 2019. In the accompanying statement, policy makers acknowledged recent high inflation and signaled another 1% hike at the next meeting on October 27. The BCB noted that inflation will remain intense in the near term and increased their inflation forecast for 2021 and 2022 to 8.5% and 3.7%, respectively, from 6.5% and 3.5% at the August 4 meeting. Supply disruptions, adverse weather conditions, and high energy prices continue to put upward pressure on inflation. The IPCA-15 rose 10.1% in the twelve months to mid-September, the highest reading since February 2016.

JAPAN: As nearly assured, the Bank of Japan held its monetary stance unchanged at its September 21 Policy Board decision. As before, the BoJ's negative short-term policy rate is -0.1%; they buy government bonds



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(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 below ¥8 trillion in the second half of September).

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