Week Ahead Economic Preview

Global overview

- China and US industrial production and retail sales updates to provide trade war impact assessment
- Eurozone second quarter production insights
- UK employment report and GDP data to give BoE guidance
- Special reports on China's countermeasures in the US trade war and Eurozone export woes

With tensions rising between the US and China, the impact of the escalating trade war will be under scrutiny amid fresh data from both economies. China updates its industrial production, retail sales, lending and investment data, which will shed light on the extent to which stimulus measures may be helping offset the impact of the trade war, and whether more stimulus might be expected (see page 5).

Similarly, the US, industrial production and retail sales updates will give further steers on the Fed's next move after. Markets have increasingly priced-in rate cuts for later in 2019 (see page 3) amid growing worries about growth prospects.

The European Central Bank has meanwhile joined the US Fed in growing more uneasy about the outlook, and official industrial production data will be eyed for confirmation of recent survey data which have signalled a disappointing second quarter so far in terms of both GDP growth and price pressures (see page 4).

While the Bank of England continues to hope that a clean Brexit will open the door for tighter policy in the UK, much could depend on how the labour market has shaped up, shifting the focus to updated jobs growth and wage data. However, with PMI surveys hinting that the UK economy's resilience in the first quarter is fading in the second quarter, GDP data for April will also be eagerly awaited (see page 4).

This week we have two highly-topical special reports. One looks at China's countermeasures in the escalating US-China trade war (see page 6), while the second analyses the recent data on eurozone growth and the prospects for the region, focusing in particular from an export perspective (see page 9).

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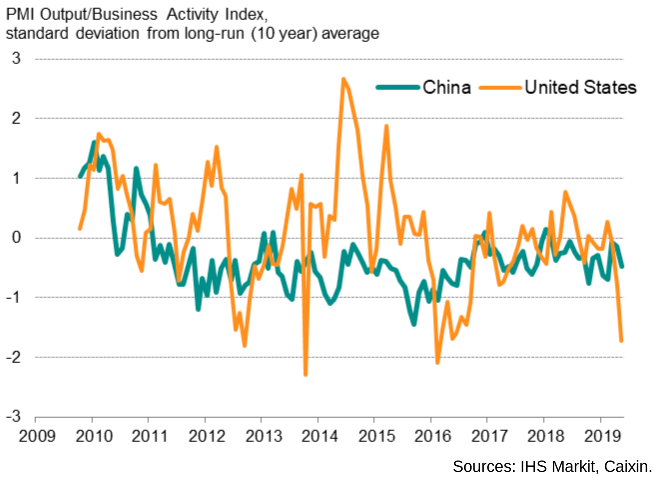
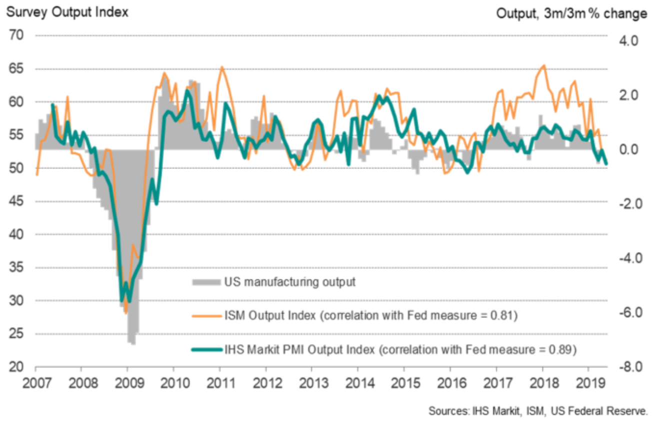
Special reports

PMI survey data for May indicate that US economic performance has fallen below its long-run average to a greater extent than in China. Official data updates will add colour to the trade war picture



Business survey data hint at a disappointing month for US manufacturing in May



Key diary events

Monday 10 Jun

Japan GDP (final, Q1)

China trade (May)

Indonesia inflation (May)

Taiwan trade (May)

Italy industrial production (Apr)

UK GDP, trade balance, industrial production, construction output (Apr)

UK NIESR monthly GDP tracker (May)

US JOLTs job openings (Apr)

Tuesday 11 Jun

Philippines trade (Apr)

Australia business confidence (May)

Malaysia industrial production (Apr)

UK jobless rate, average earnings (Apr), claimant count change (May)

US PPI (May)

Wednesday 12 Jun

South Korea jobless rate (May)

Japan machinery orders (Apr)

Australia consumer confidence (Jun)

India industrial production (Apr), inflation (May)

China inflation (May), FDI (YTD, May)

Spain inflation (final, May)

Brazil retail sales (Apr)

US inflation (May)

Thursday 13 Jun

Australia jobless rate, employment change (May)

Singapore unemployment rate (final, Q1)

India current account (Q1)

Euro area industrial output (Apr)

Friday 14 Jun

China industrial production, retail sales (May),

China fixed asset investment (YTD, May)

China new yuan loans, total social financing, M2 (May)

Japan industrial output (final, Apr)

India WPI, trade balance (May)

France and Italy inflation (final, May)

Euro area trade balance (Apr)

Russia monetary policy decision

US business inventories (Apr),

US retail sales (May)

US industrial output (May),

University of Michigan US consumer surveys (prelim, Jun)

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Economic Research

10 June 2019

United States Week Ahead

Industrial production, inflation and retail sales

By Siân Jones

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The release of industrial production and inflation data will be closely watched in the coming week amid growing signs of weaker demand conditions and downward pressure on prices. Interest in inflation will be especially heightened ahead of the FOMC decision in mid-June. The release of retail sales data will also provide greater clues as to consumer conditions.

Industrial production and retail sales

Following disappointing PMI results for May, weak demand conditions are expected to weigh on industrial production yet again. IHS Markit PMI data point to a marginal contraction in overall manufacturing output, with the survey's Output Index dipped to its lowest level since mid-2016 amid lacklustre client demand.

The continuation of a muted industrial performance will add to growing expectations of rate cuts, supporting the dovish stance of the FOMC in recent months.

Delving deeper into demand conditions across the wider US economy, retail sales data will give an indication to markets and policy makers as to how consumers are reacting to global trade tensions. Retail sales were weighed down by lacklustre automotive sales in April. That said, the consensus points to a rise in consumer sales in May, in part reflecting the strong labour market.

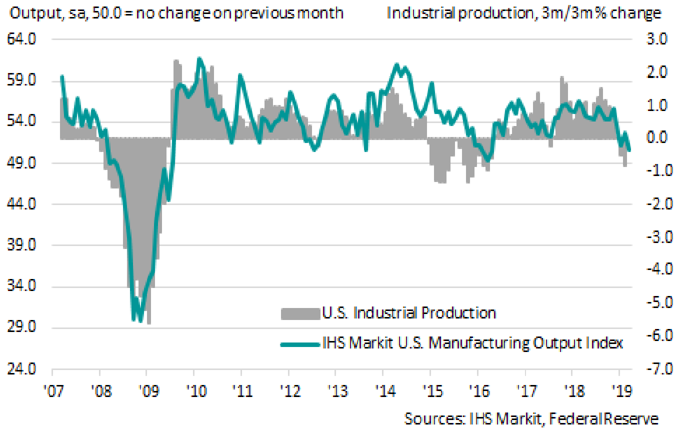
Inflation

Although core inflation is not expected to move away from the 2.1% annual rate seen in April, headline CPI is forecast to weaken in May according to the consensus. Softer rises in input costs and increasing pressure to discount selling prices amid greater competition, as demonstrated in the latest IHS Markit US PMI release, hints at marked downward pressure on overall inflation.

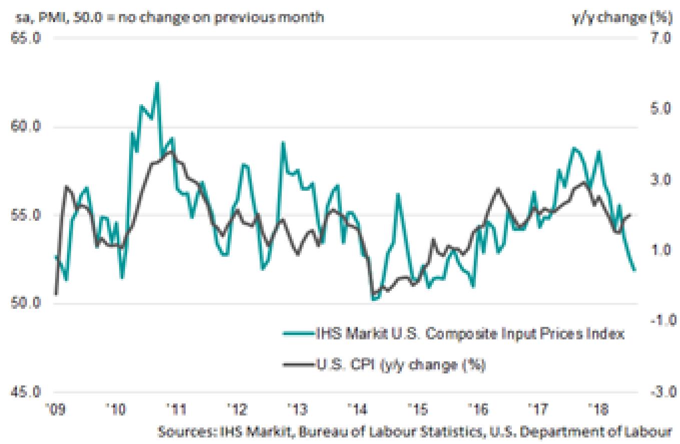
Meanwhile, the rate of producer price inflation has eased steadily through 2018, following the spike in costs after the introduction of tariffs, and PPI inflation could to dip further in May following slower rises in survey gauges of input costs.

Other key data releases include JOLTs employment, business inventories and the first cut of the University of Michigan consumer survey for June.

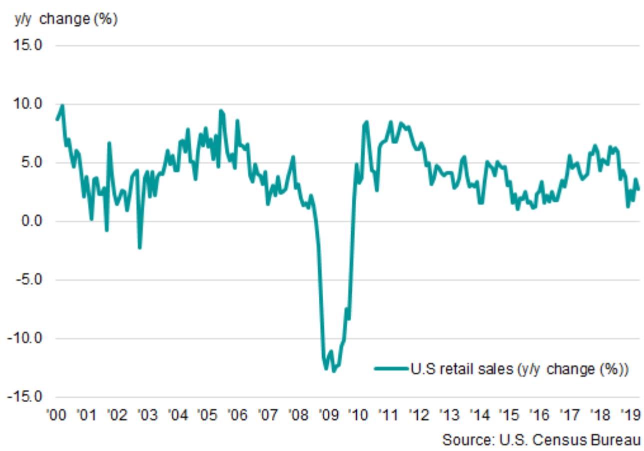
US industrial production expected to remain in contractionary territory



US inflationary pressures set to soften further



US retail sales remain solid



Europe Week Ahead

PMI surveys lead ECB monetary policy meeting

By Joe Hayes

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UK data leads the bill for Europe, with April's GDP estimate giving insight into second quarter economic growth. UK labour market statistics will also be scrutinised for any new developments on the jobs front, notably wage growth. Elsewhere, industrial production and trade data for the euro-area have the potential to crank up the pressure for more stimulus from the European Central Bank.

UK monthly GDP

The 0.5% expansion in GDP recorded in the UK for the first quarter is likely to be proven temporary by a weaker second quarter estimate, as Brexit-related manufacturing stockpiling in the run up to the initial EU exit date (end of March) is unwound. Survey data also hint that fragility persists in the service sector as Brexit uncertainty has restricted spending.

Survey data so far in the second quarter has indicated subdued growth, with the "all sector" PMI falling to 50.7 in May, indicating near stagnation. Manufacturing production rose at the softest pace since July 2016 and construction output fell, offsetting a slight pick-up in services activity.

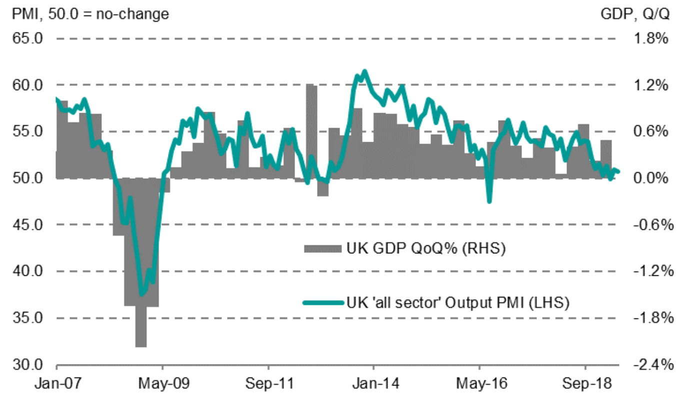
UK labour market update

The KPMG/REC Report on Jobs data has shown increasing signs in recent months that the UK labour market has started to cool. Job vacancy growth has eased, both in the survey and official statistics, while pay pressures failed to gain much ground and appeared to have peaked. Official employment and earnings statistics for April are released on Tuesday.

Eurozone industrial production

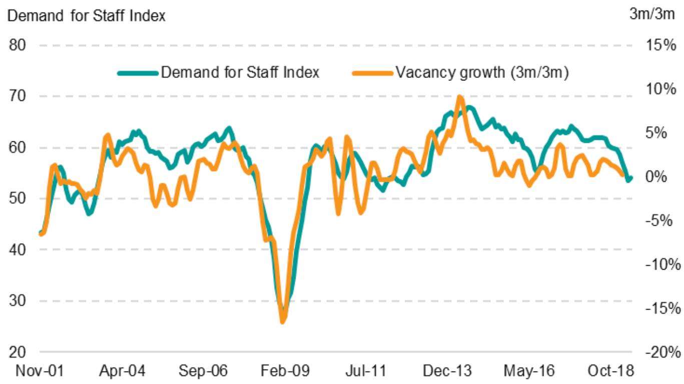
April trade and industrial output are the key picks from the euro area data calendar. Signs of stress in the eurozone's manufacturing economy have persisted into the second quarter, according to PMI surveys. With the ECB already announcing in June that it will keep rates on hold for longer, any further weakness could encourage the ECB to dig deeper into its stimulus toolbox.

Survey data point to subdued UK economic growth in the second quarter



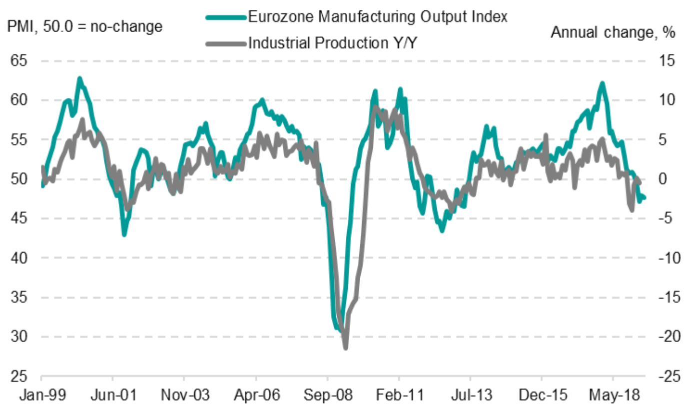
Sources: IHS Markit, ONS

Job vacancy growth in the UK has eased in recent months



Sources: KPMG, REC, ONS

Eurozone manufacturing remains in downturn



Sources: IHS Markit, Eurostat

Economic Research

10 June 2019

Asia Pacific Week Ahead

China data salvo and Japan GDP in focus

By Bernard Aw

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With the US-China trade war remaining a dominant theme in the financial markets, a raft of updated Chinese economic data will be in focus, including trade, fixed investment, industrial output and credit growth. Moreover, trade figures from several other Asian economies, including India and Taiwan, will be scoured for further clues into regional trade performance. The final estimate of Japan's first quarter GDP should also attract attention.

China data in limelight amid trade wars

Chinese analysts will eagerly await a slew of data that will provide updates to the health of China's economy in May, after latest Caixin PMI surveys painted a darkening picture for the country. Trade figures, fixed investment and credit growth will be particularly scrutinised for clues that more policy support is needed. Caixin PMI data showed business expectations for the year ahead sinking to the lowest in the series history, reflecting rising concerns over the impact of the US-China trade tensions. The government-sponsored PMI data also signalled deteriorating manufacturing conditions despite the recent fiscal stimulus.

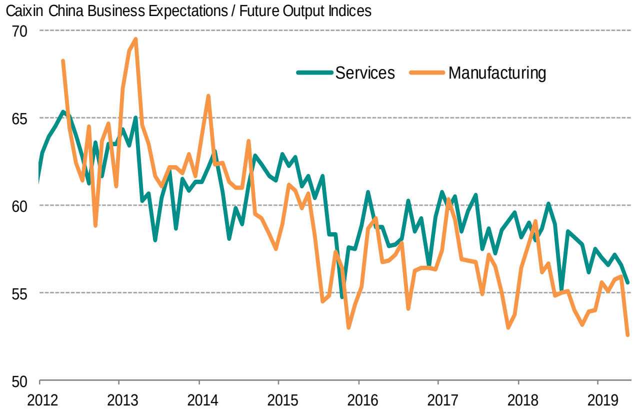
More Asian trade statistics ahead

Market participants will also parse trade data in Taiwan and India to assess the impact of a widening trade war. Taiwanese exports, widely considered a barometer of global trade and demand for technology goods, will be highly anticipated. Taiwan's export orders shrank for a sixth straight month in April, suggesting that trade flows have remained under pressure.

Japan GDP for first quarter may revise up

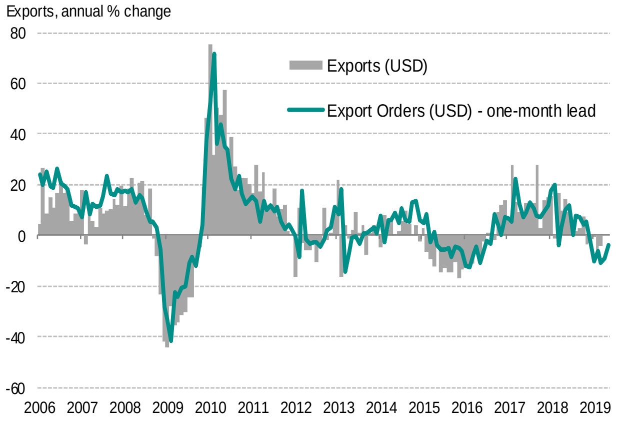
There are growing expectations for an upward revision to Japan's first quarter GDP after the Ministry of Finance released updated statistics showing a faster annual growth in business investment during the January-March period. But recent PMI surveys suggest that growth momentum may remain subdued in the second quarter. While services activity remained fairly resilient in May, manufacturing output declined. The gloomier outlook for the Japanese economy would also cast doubts on the timing of the sales tax hike scheduled in October. Meanwhile, April updates to industrial output and machinery orders would provide more insights into second quarter economic performance.

PMI: Chinese firms have become less optimistic



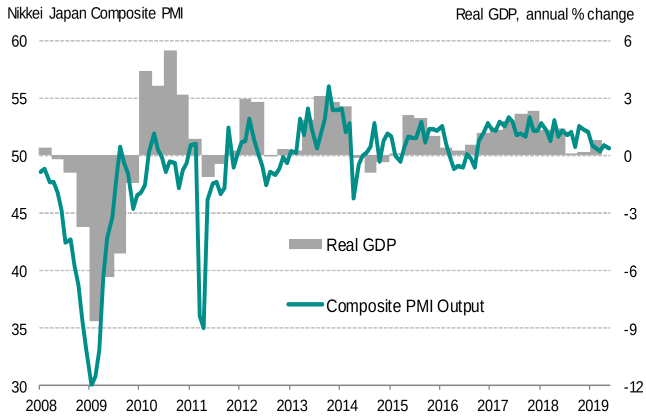
Sources: IHS Markit, Caixin

Taiwan export downturn



Source: DGBAS

Japan PMI surveys point to subdued GDP growth



Sources: IHS Markit, Nikkei, Japan Cabinet Office

Asia Pacific Special Focus

China's Countermeasures in the Trade War with the US

By Rajiv Biswas

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Following the escalation in the US-China trade and technology wars during May, China has announced a range of countermeasures that will impact US firms. These include tariff measures as well as creating its own list of foreign firms in response to the US Department of Commerce's 'Entity List'. This US 'Entity List' was used to implement a ban on US firms from selling or transferring technology to Huawei or 70 of its affiliates. Other Chinese countermeasures are also being considered, including possible restrictions on exports of rare earths to the US.

The US-China trade war escalation

On 10th May, the US government ramped up tariffs on USD 200 billion of Chinese exports from 10% to 25%, which represents a significant blow to the competitiveness of China's export sector. The Trump Administration has also signalled that it may apply 25% tariffs to the remaining USD 300 billion of imports from China that have not yet been subject to punitive tariff measures if no trade deal is rapidly reached. This would create a further large negative shock to China's export sector and to the wider Asia-Pacific (APAC) manufacturing supply chain.

US-China bilateral trade

Source: US Census Bureau

The US also escalated the technology war with China during May. On 15th May 2019, President Trump signed an executive order that will ban US firms from using telecommunications equipment and services supplied by firms that are deemed to pose a national security risk. While no country or company was specifically named in the executive order, the US Department of Commerce's Bureau of Industry and Security immediately added Huawei Technologies Co Ltd and 70 of its affiliates to its Entity List. This immediately bans US firms from selling or transferring technology to Huawei without first obtaining a US government license.

The US Department of Commerce has been tasked with implementing the executive order. This could eventually result in a US ban on use of equipment and services provided by other telecommunications companies from mainland China.

The US executive order came just days after the US Federal Communications Commission rejected an application by China Mobile to provide communications services in the US. Many recent Chinese M&A proposals for the acquisition of US technology companies have also been rejected by the US Committee on Foreign Investment in the United States (CFIUS), a US government interagency committee that screens proposed M&A deals to assess the national security implications. The heightened US regulatory restrictions have resulted in a collapse of Chinese M&A acquisitions in the US during 2018 and early 2019 by deal value.

China's tariff countermeasures

Following the US government's decision to hike tariffs on USD 200 billion of Chinese products from 10% to 25% on 10th May, China has retaliated with countermeasures on 13th May, increasing tariffs on around USD 60 billion of US products from 1st June.

An important aspect of the Chinese tariff countermeasures is that China has announced a hike on tariffs on imports of US liquid natural gas from 10% to 25% with effect from 1st June. If the trade war is protracted, this could become a major constraint to new Chinese investment in US LNG projects, diverting Chinese LNG supply contracts and project investments to other global LNG suppliers, such as Australia, Papua New Guinea, Russia and Mozambique.

However, due to the large bilateral trade imbalance between China and the US, the ability of China to respond to US tariff measures is relatively limited. This large bilateral trade imbalance gives the US considerable asymmetric ability to use tariff measures as leverage in the bilateral trade negotiations.

Potential rare earths restrictions

China has also prepared a plan to potentially restrict exports of rare earths to the US. China is the world's largest exporter of rare earths, and accounts for an estimated 70% of global rare earths production. Rare earths are an important input into many high technology manufactures, including for aerospace applications, rechargeable batteries including for electric vehicles, as well as for mobile phones.

(See: "Elevated risks for US companies' short-term access to Chinese rare earths; supply disruptions unlikely beyond one-year outlook", IHS Markit Country Risk Report, 31st May 2019.)

Japan has already been diversifying its sourcing of rare earths away from China after some temporary supply disruptions during a bilateral territorial dispute in 2010. Japan has reduced its reliance on China from around 80% of total rare earths imports in 2010 to around 50% by 2018. In December 2017, President Trump signed an Executive Order entitled "A Federal Strategy to Ensure Secure and Reliable Supplies of Critical Minerals" which resulted in accelerated exploration and development of rare earths production in the US. The Mountain Pass mine in California is already mining rare earths but ships 50,000 tons of rare earths to China for processing and separation. Processing facilities are currently being built at Mountain Pass and should be completed by 2020.

Australia also has significant rare earths production, while a number of countries have smaller amounts of rare earths production, including Myanmar, Russia, Vietnam and Malaysia. A number of rare earths mining exploration projects are underway in the US, Canada and Australia, with significant rare earths reserves also in Brazil and Vietnam.

China's response to US 'Entity List'

Following the decision by the US Department of Commerce's Bureau of Industry and Security to add Huawei Technologies Co Ltd and 70 of its affiliates to its Entity List, China has responded by creating its own equivalent list, which is designated as the 'Unreliable List' of foreign companies, organisations and individuals. Certain main criteria have been designated for deciding who should be placed on this list. These factors include whether the foreign entity has taken discriminatory measures against Chinese entities; whether a foreign entity's actions cause damage to Chinese companies; and whether such actions pose any threat to China's national security.

Clearly US technology firms would be at the forefront of potential entities that could be placed on China's "Unreliable List'.

Travel warnings

China's Ministry of Foreign Affairs has issued a travel warning for Chinese citizens travelling to the US, and the Chinese Ministry of Culture and Tourism has also issued a similar warning, citing concerns about the safety of Chinese citizens in the US due to crime-related issues.

China's Ministry of Education has also warned Chinese students studying or planning to study in the US about increased difficulties they may face in obtaining a US visa. This is likely to encourage Chinese students to consider alternative popular locations for pursuing studies abroad, such as the EU or Australia.

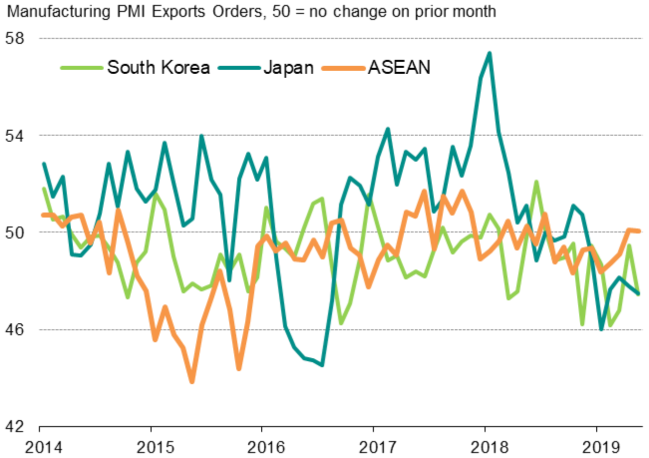
Impact on Asia-Pacific region

With escalating trade and technology related measures being adopted by both the US and China in the bilateral trade and technology wars, the spillover effects on the rest of Asia are intensifying. With Chinese economic growth expected to be dented by the impact of the intensifying US-China trade and technology wars, contagion effects will spill over into the Asia-Pacific manufacturing supply chain. Economies such as Japan and South Korea, which send a high share of their total exports to China, are particularly vulnerable to any further slowdown in China's export sector and signs of softer domestic demand in China.

China Manufacturing PMI (Caixin) new export orders

Sources: IHS Markit, Caixin.

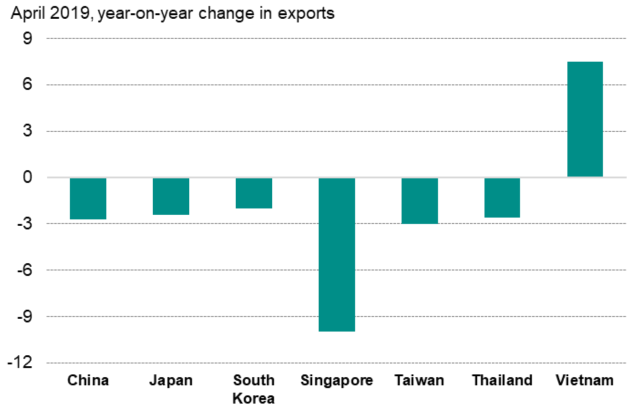
Manufacturing PMI New Export Orders



Source: IHS Markit.

Concerns are increasing among APAC policymakers about the negative impact of the escalating US-China trade war on regional growth prospects. This has contributed to the decisions by many APAC central banks to cut policy interest rates in recent weeks, including the Reserve Bank of Australia, the Reserve Bank of New Zealand, Bank Negara Malaysia and the Philippines central bank, Bangko Sentral ng Pilipinas.

Asian exports hit by US-China trade war



Source: US Census Bureau

With another round of US tariff hikes on a further USD 300 billion of Chinese exports looming, the negative spillover effects on the APAC export sector are increasing. With the recent decline in oil prices reducing concerns about near-term inflationary pressures, further policy easing by a number of APAC central banks is likely in coming months.

Economic Research

10 June 2019

Europe Special Focus

Eurozone economy stuck in a rut

By Ken Wattret

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Export momentum and its spillover effects have been pivotal to the eurozone economy's ups and downs over recent years. Our modelling suggests export growth will flatline even given decent global growth and the waning effects of prior trade-weighted euro appreciation. Moreover, there are numerous downside risks which need to be monitored closely, including a proliferation of protectionist measures.

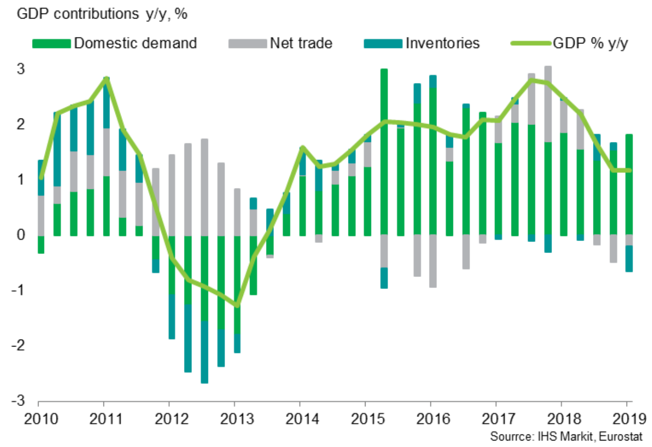
Trade boost fades

This week's first expenditure breakdown of the first quarter national accounts in the eurozone highlighted the importance of private consumption (up 0.5% on the prior quarter, a five-quarter high) to the pick-up in the quarterly growth rate in GDP to 0.4%, double the average seen in the second half of 2018. Indeed, private consumption has been the mainstay of the current economic expansion in the eurozone, driven initially by the beneficial effect of very low inflation on household real income growth and latterly by solid employment and rising compensation growth.

In contrast, it was the pick-up in net trade contributions that saw the eurozone expansion step up a gear back in 2017 (see chart), when the 2.5% annual GDP growth rate was the strongest for a decade. The boost from net trade proved short-lived, however, fading from early 2018 and then subtracting from growth by the second half of last year, primarily due to a sharp slowdown in eurozone export growth.

From a peak of over 6% at the end of 2017, the annual rate of growth in exports had slumped to just 2% by the end of 2018. While the initial breakdown of first quarter 2019's GDP showed a rebound, to just over 3% year-on-year, this was partly attributable to favourable base effects. The quarterly change in exports in the first three months of 2019 was just 0.6%, roughly a third of the average rate of increase seen during 2017.

Eurozone growth swings driven primarily by net trade

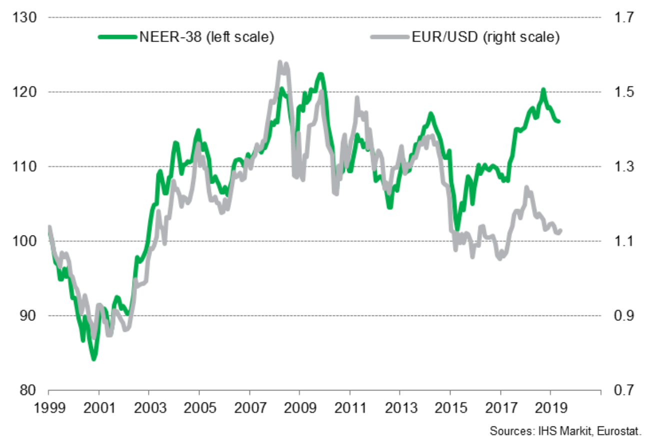


The impact of the slowdown in world trade on eurozone export performance has been well documented, particularly for the most trade-sensitive economies like Germany. The growth rate in world trade volumes accelerated sharply from 2016, peaking at around 5% in the second half of 2017 before falling away equally rapidly since early 2018.

Elevated trade-weighted euro

The adverse impact of the appreciating effective euro exchange rate has been less well documented. On a trade-weighted basis, the euro reached its highest in almost a decade in autumn 2018 (see chart). While the euro stayed soft against the US dollar, due in large part to the European Central Bank's highly accommodative monetary policy stance, euro appreciation against the Chinese, UK and some emerging market currencies (including the Turkish lira in particular) pushed the trade-weighted euro upwards (defined here as the ECB's broad nominal effective exchange rate, known as the NEER-38).

Trade-weighted euro elevated but below 2018's peak



Lower growth trajectory

From spring 2018, we flagged the likelihood of a much lower growth trajectory for the eurozone due to the two key headwinds highlighted above. At the time, market consensus growth expectations for 2019 were still overly elevated at around 2%, a legacy of 2017's upward surprises. They have subsequently shifted down to broadly match our own forecasts: i.e. eurozone GDP growth of a little over 1% this year.

Where do we go from here? Could a pick-up in exports propel the eurozone out of the doldrums, or will the slump continue or intensify?

In tandem with our Global Link Model-driven forecasting process, we update an export model for the eurozone every month based on our updated global forecasts in order to gauge growth prospects for the coming two to three years. The model is driven by our forecasts for domestic demand growth in the eurozone's most important export markets (weighted according to their respective importance to trade), along with the expected evolution of the trade-weighted euro exchange rate.

The indications for eurozone export volume growth, based on our current forecasts, are shown in the chart.

IHS Markit eurozone exports volume model

Sources: Eurostat, IHS Markit

In brief, the model suggests that annual growth in exports will go broadly sideways in coming years. The growth rate is expected to remain relatively subdued, peaking at around 3½%, about half the cycle high during the current expansion and well down on previous cycle peaks.

The solidity of the predicted growth rate in eurozone exports primarily reflects our assumption that there will not be a "hard landing" globally. Growth rates in the US and China, for example, which are key contributors to the model, are expected to lose momentum as policy stimulus effects fade, but are forecast to do so only gradually.

The euro exchange rate also has a part to play. Since topping out in September 2018, the trade-weighted euro has weakened by around 3%. This again partly reflects euro weakness versus the US dollar but also rebounds in some other currencies against the euro, including those in the UK and China. Based on our forecasts for the key euro cross rates, the trade-weighted euro is also expected to go broadly sideways in the next couple of years.

ECB looser for longer

This outlook is predicated on our long-standing view that the ECB will maintain a highly accommodative policy stance for longer than most forecasters expect (we do not expect a first policy rate hike until 2022). While the euro does not depreciate on a trade-weighted basis in our forecast, the drag from its prior appreciation fades, feeding into the export model with a lag of a few quarters.

Some important caveats need to be emphasised with the model's indications. First, given the high levels of uncertainty at present the transmission effects of continued growth in exports through to other areas of the economy may be less powerful than normal. An improvement in future export dynamics can have multiplier effects on the economy via the implications for business confidence, profit trends, investment expenditure and employment. But the reverse also applies, and the cloudy skies presently are clearly unhelpful.

Second, the inputs into the model do not capture potential shocks. Additional protectionist measures could make a material difference to the eurozone export outlook, for example, either indirectly via weaker demand from China or directly via the imposition of US tariffs on EU autos and parts, with significant spillovers to the economy more broadly. So too a "no deal" Brexit. We do not embed such outcomes into our baseline scenarios and forecasts, but they suggest that the balance of risks is increasingly tilted to the downside.