Economic Research

17 June 2019

Week Ahead Economic Preview

Global overview

- **FOMC meeting forms highlight of the week amid increased bets of rate cuts**
- **Bank of England policymakers likely on hold, adrift in Brexit fog**
- **Clues to further stimulus sought in Japan**
- **Flash PMIs for the US, Eurozone, Japan and Australia**
- **Special report on ECB policy options**

The coming week sees key central bank meetings, including the US, UK, Brazil, Japan and several other Asian countries. Central bankers face growing unease about the global economic environment and are widely expected to tilt to the dovish side as downside risks prevail amid concerns about the impact of trade frictions and geopolitical uncertainty. Flash PMI survey data for June will add to the policy outlook.

After the ECB announced it was open to new stimulus if required (see our special report on page 6 looking at policy options), attention turns this week to policymakers in the US, UK and Japan. Markets are pricing in several rate cuts from the Federal Reserve this year, and the Bank of Japan appears increasingly eager to find new stimulus measures. In contrast, the Bank of England seems to be bucking the trend with hawkish comments from some policymakers, but the widespread expectation is that the UK will not see any rate hikes for some time as the Brexit fog lingers.

The policy meetings come ahead of updates to flash PMI survey data, which will provide an important steer on global economic developments, notably in the US, Japan and Eurozone. The US surveys pointed to a sharp slowing in the pace of economic growth and an accompanying slump in price pressures in May. The eurozone meanwhile remained stuck in the slow lane. Both surveys will likely feed into rate expectations for the second half of the year. Japan's PMI has meanwhile indicated a steep export-led downturn of the manufacturing sector in recent months, adding to concern about the health of the economy ahead of planned tax rises later in the year.

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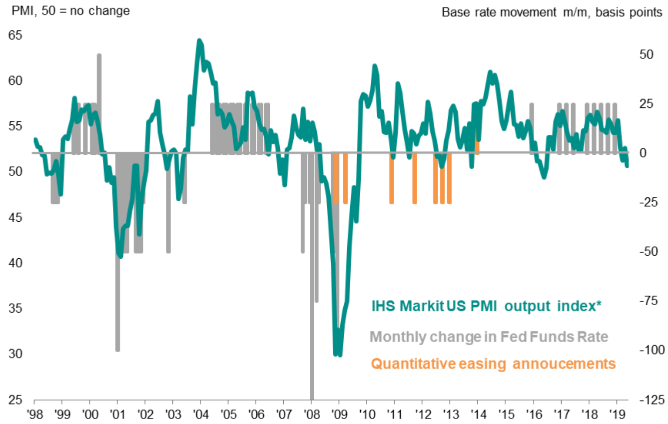
Special reports

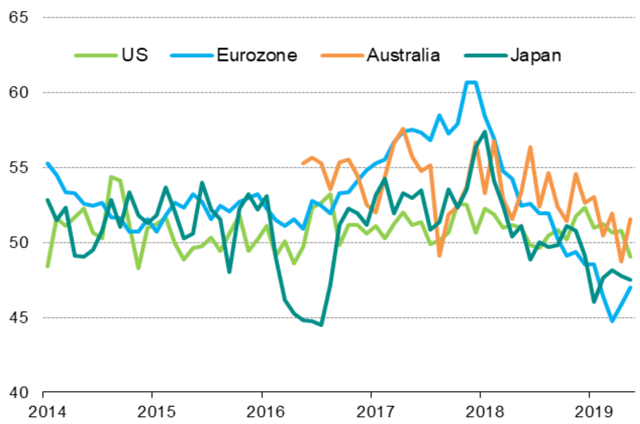
The FOMC meets as bets of US interest rate cuts this year have risen amid signs of a sharp slowing in the pace of economic growth

FOMC policy decisions and US manufacturing PMI*



Sources: PMI uses IHS Markit post-2007 and a re-based ISM series pre-crisis, Federal Reserve. QE announcements are depicted with no scaling regarding size of asset purchase/taper

Flash PMI survey data will be published for June, providing updates into economic trends in some of the world's largest economies



Sources: IHS Markit, Caixin.

Key diary events

Monday 17 Jun

Singapore NODX (May)

Indonesia trade (May)

US NY Empire State manufacturing index, NAHB housing market index (Jun)

Tuesday 18 Jun

Singapore trade balance (May)

Australia house price index (Q1)

RBA meeting minutes

China house price index (May)

Germany PPI (May), ZEW surveys (Jun)

Euro area trade balance (Apr), inflation (May), ZEW economic sentiment (Jun)

US building permits, housing starts (May)

Russia GDP (final, Q1), industrial output (May)

Wednesday 19 Jun

Japan trade (May)

Thailand interest rate decision

Hong Kong unemployment rate (May)

UK inflation (May)

Euro area construction output

Brazil business confidence (Jun)

Thursday 20 Jun

FOMC meeting and economic projections

BoE monetary policy

Brazil, Japan, Indonesia, Philippines, Taiwan monetary policy meeting

RBA bulletin & RBI meeting minutes

Taiwan export orders (May)

UK retail sales (May)

US current account (Q1), Philadelphia Fed manufacturing index (Jun)

Euro area consumer confidence (flash, Jun)

Friday 21 Jun

Flash PMI surveys for Australia, Japan, US, Eurozone, Germany and France (Jun)

Japan inflation (May)

Thailand trade (May)

Hong Kong current account (Q1), inflation (May)

US existing home sales (May)

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United States Week Ahead

FOMC meeting, flash PMIs and current account update

By Siân Jones
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The highlight of the week is the FOMC meeting as bets of an imminent rate cut have been bolstered by weak inflationary pressures and a broad-based economic slowdown. Flash PMI data will meanwhile provide a health check of the economy in June. Current account data are also released.

FOMC meeting

The eagerly anticipated meeting of the FOMC will be watched closely to gauge policymakers' appetite for lower interest rates. A rate cut so soon looks unlikely but many Fed watchers are stepping up their expectations of a cut in July, with financial markets pricing in several cuts this year after increasing dovish signals from the Fed. While PMI surveys suggest that Fed should consider potential rate cuts, they will likely stick with the current policy stance unless the negative trends continue well into the third quarter.

Flash PMI data

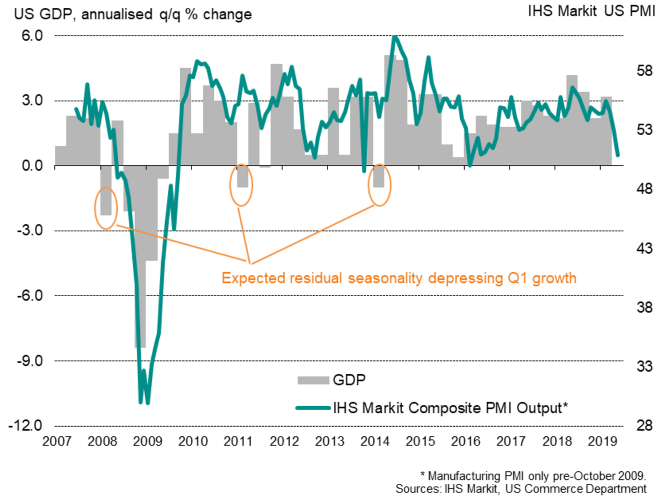
Fed concerns are focused on the impact of tariffs on demand, the slower pace of global economic growth and weaker than expected inflation. Insight into all these issues will be provided by the June flash PMI from IHS Markit. The May surveys indicated an on-going trade-led global slowdown which showed signs of spreading in the US from manufacturing to services. New business growth among US service providers eased to its slowest for over three years, as manufacturers registered the first fall in client demand since August 2009.

Current account

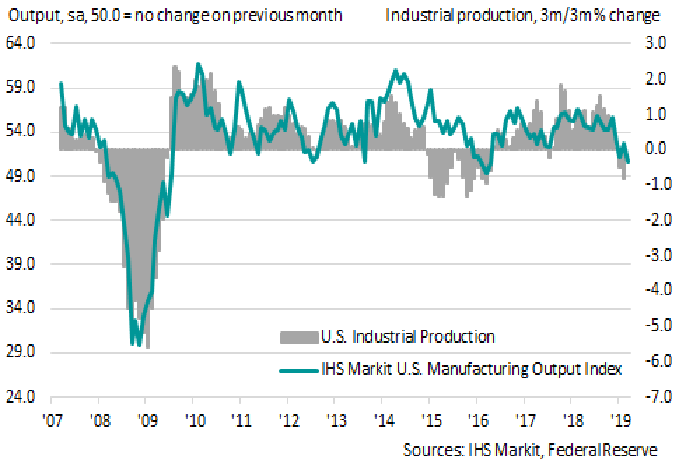
Meanwhile, the release of current account data for the start of 2019 may give further detail on how tariffs and muted manufacturing growth have impacted the goods account deficit. With the largest gap in ten years in the final quarter of 2018, the current account also indicated a fall in the services surplus. That said, the strength of first quarter GDP was partly export-led. More vociferous language surrounding global trade tensions may have dented good exports into the end-quarter.

Other key data releases include new housing starts, continuing jobless claims and regional manufacturing indexes including Philadelphia Fed and New York Empire State Index.

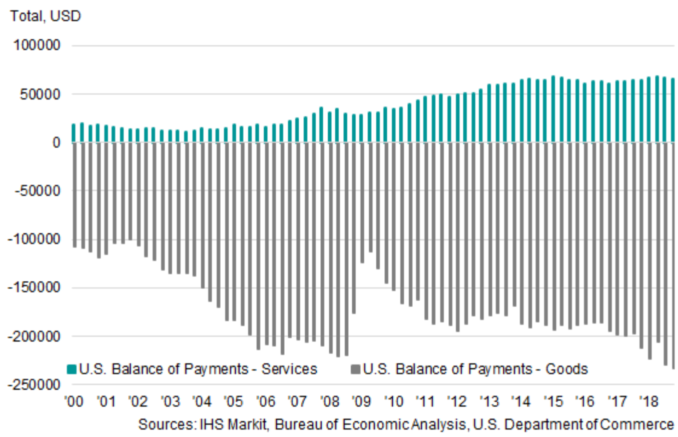
US flash PMI data will be under particular scrutiny after May data showed a sharp slowing in the pace of economic growth



Manufacturing output falls amid lacklustre demand



A services export surplus has been weighed down by manufacturing deficit



Europe Week Ahead

Flash PMIs and Bank of England meeting take centre stage

By Joe Hayes
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After the European Central Bank (ECB) cranked up its dovish stance during its last meeting, the focus moves to the Bank of England (BoE), which meets to set interest rates and provide an updated assessment of the economy. Inflation and retail sales data for the UK are also due. Latest economic developments in the euro area since Draghi revealed that monetary stimulus was back on the table come in the form of flash PMI data, as well as ZEW sentiment and consumer confidence surveys.

Bank of England

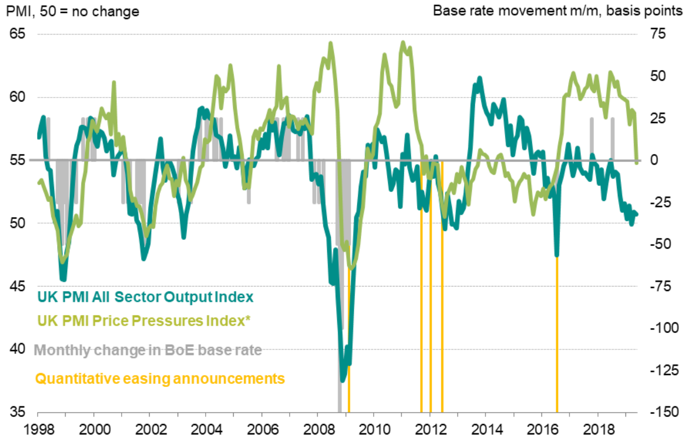
The Bank of England's Monetary Policy Committee meets to set interest rates as the latest data flow brings mixed signals. Recent rhetoric from MPC members suggests that views have become more split, with hawks focusing on decent wage growth amid low employment. However, PMI surveys have indicated a stagnant economy, amid heightened Brexit uncertainty, with the labour market showing signs of cooling and GDP shrank sharply in April. Hence IHS Markit's forecasting team is not anticipating the first UK rate rise until May 2021. Inflation and retail sales data for the UK are also due.

Eurozone PMIs

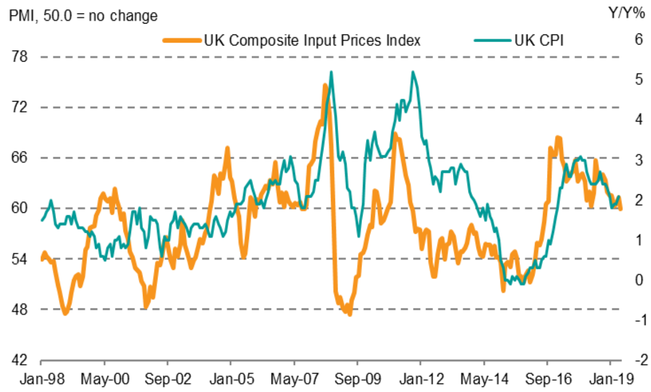
PMI data for the euro area will be updated with the preliminary June 'flash' reading, helping to shape expectations for second quarter performance. The PMI Composite Output Index hit a three-month high in May, but was only indicative of a modest 0.2% expansion. Analysts will be especially keen to see if the trade-led downturn in the manufacturing sector has spread to services.

The ECB are on stand-by to inject additional stimulus into the single-currency area, revealing that a reboot of the asset purchasing programme remains an option if economic conditions deteriorate. Although survey data showed some tentative signs that the manufacturing malaise may be bottoming out, while also signalling service sector growth has been sustained at a solid pace, risks are tilted to the downside given escalated global trade frictions and Brexit uncertainty.

UK PMI data and Bank of England policy changes

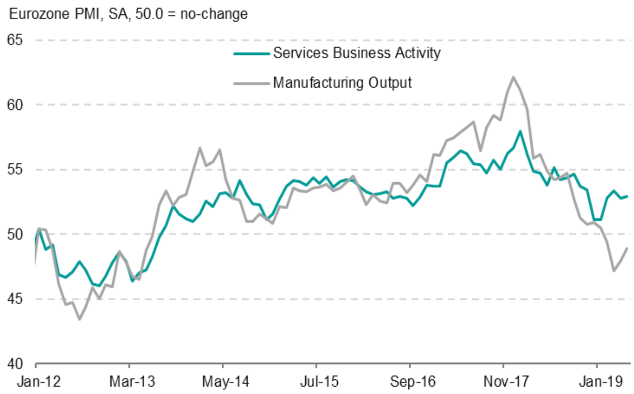


Current inflationary pressures no cause for concern to Bank of England



Source: IHS Markit, ONS

Tentative signs that euro area manufacturing malaise is starting to bottom out



Source: IHS Markit

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Asia Pacific Week Ahead

Asian central bank meetings and regional trade data

By Bernard Aw

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Central bank meetings dominate the agenda next week. Japan, Taiwan, Thailand, Indonesia, and the Philippines will set monetary policy as well as the US Fed, with analysts eagerly watching for further signs of monetary easing. Several countries in the region recently cut interest rates to support growth in an environment where the data signalled the weakest pace of global economic growth for nearly three years.

Asian central banks

With Australia, New Zealand, India, Malaysia and the Philippines having cut interest rates recently, there is growing expectation of more regional central banks looking to provide greater monetary support to economic activity. However, country-specific nuances would limit the extent to which policy easing is viable in the central banks that are meeting next week.

Despite its massive monetary easing, the Bank of Japan's actions have been insufficient to lift inflation to its target. There are increasing doubts as to what else the central bank could do to revive inflationary pressures and support the economy amid rising signs of slowing growth momentum. May updates to inflation figures will be scrutinised alongside the flash manufacturing PMI, which has indicated a steep downturn in recent months as trade woes intensified, albeit with some signs of the rate of decline easing.

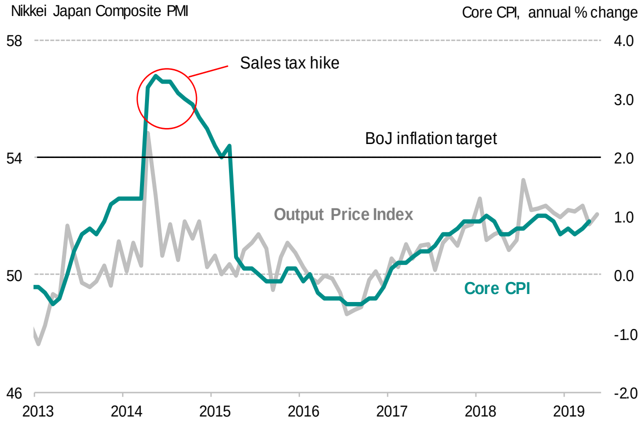
Thailand has meanwhile eased its hawkish stance, given political and external uncertainties. However, no rate cut is expected in next week's meeting, which is accompanied by updated economic forecasts that will provide clues to future policy directions. Domestic financial stability risks remain a major concern.

Indonesia recently hinted at possible rate cuts if there is a need to stimulate domestic growth. For now, May PMI survey data suggest second quarter economic growth has remained over 5%. That said, any Indonesian monetary easing will depend on rupiah stability and prospects of a Fed rate cut.

Japan and Taiwan trade statistics

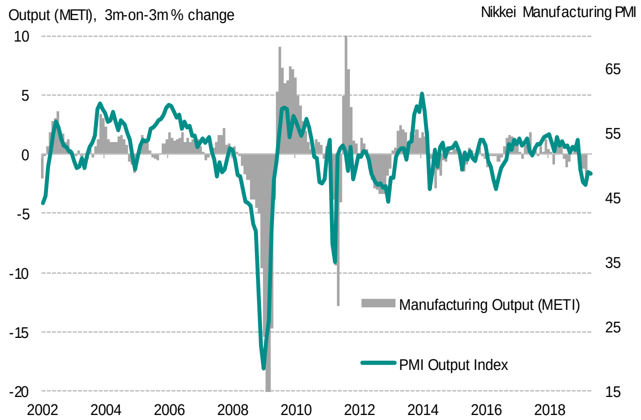
With PMI surveys revealing a marked spike in concerns over global trade wars in May and growing worries about broader economic growth prospects, analysts will assess trade figures in Japan and Singapore, as well as Taiwan's export orders for any impact arising from ongoing US-China trade tensions.

Subdued inflation in Japan



Sources: IHS Markit, MIAC

Japan's manufacturing downturn



Sources: IHS Markit, METI

Taiwan PMI surveys suggest another export order decline in May

Sources: IHS Markit, DGBAS

Europe Special Focus

ECB opens the door to more policy easing, but will it be enough?

By Ken Wattret

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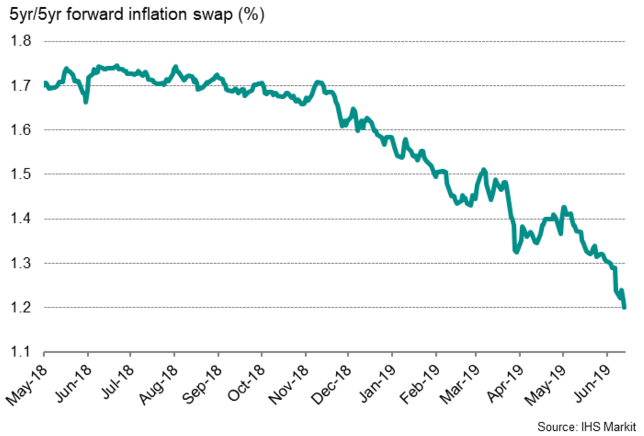
The announcements on 6th June highlighted the ECB's sensitivity to low growth and inflation and potentially opened the door to restarting QE and an even lower deposit facility rate. Additional monetary policy easing will be mostly about mitigating downside risks, however. The impact on eurozone financial conditions, and in turn growth and inflation prospects, is likely to be limited. To make a material difference, other policy levers will also need to be used more effectively.

ECB looser for longer

One of our key out-of-consensus forecasts has been that the normalisation of ECB policy rates would begin much later than markets and most forecasters have been discounting, driven primarily by our expectation of persistent low growth and underlying inflation in the eurozone. Our baseline forecast remains for an initial increase in the Deposit Facility Rate (DFR), currently at -0.40%, only in the first quarter of 2022.

Market expectations of the timing of the first hike have been belatedly shifting back, partly in response to the ECB's announcements following its latest policy meeting. On 6th June, the ECB extended its forward guidance for the second time in three months, with uncomfortably low inflation expectations (see chart) one of many concerns.

Eurozone inflation expectations have tumbled



Source: IHS Markit

The ECB now expects that its policy rates will remain at their present levels "at least through the first half of 2020" compared to "at least through the end of 2019" previously. At the same time, the ECB stressed its determination to take action "in case of adverse contingencies" and that it "stands ready to adjust all of its instruments". This opened the door to a potential restart of net asset purchases, with president Mario Draghi citing "considerable headroom" in that respect, while he also mentioned that the DFR could go even further below zero.

QE or rate cuts?

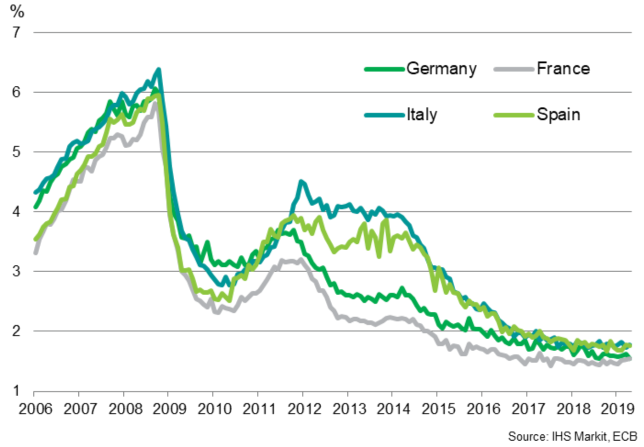
Weighing up the pros and cons of more QE versus rate cuts, we see the former as the more likely of the two, in part due to the potentially adverse consequences for banking sector profitability, and in turn lending conditions, of even deeper negative interest rates (though the ECB's recent analysis of negative rates concluded that there was no evidence so far of adverse side effects on "bank-based intermediation").

The outlook for US policy rates and the impact on the euro exchange rate are potential swing factors, however, and could shift the relative probabilities. For now, we see the flagging of a potentially lower DFR as jawboning by the ECB to try and prevent a marked appreciation of the euro at a time when markets have shifted to discount a series of US rate cuts this year. The view of our US economics team is that the Fed will not lower rates this year, hence our conclusion that additional QE is the more probable option for the ECB. But if the Fed were to cut, this would make it much more likely that the ECB would do both.

The broader question is whether additional monetary policy easing would make much difference to the eurozone outlook, partly due to the various constraints which limit what the ECB would probably be willing to do absent a major shock. In short, it is unlikely to be a game changer. ECB policy easing in the current environment is mainly about trying to avoid a tightening of monetary conditions.

Regarding a more negative DFR, the ECB could follow other central banks and adopt a tiering system to limit the effective cost to banks and avoid any negative knock-on effects on credit supply and costs. While the ECB communicated on 6th June that it saw no need for tiering at that stage, it did not rule out the option at a later stage. Either way, we are probably talking about marginal DFR reductions, in the tens of basis points. With the effective cost of borrowing already so low in the eurozone (see chart), it is difficult to see a lower DFR making much difference, though it could help to avoid an unhelpful euro appreciation.

Average interest rate on new loans to non-financial corporates



As for asset purchases, when Mario Draghi cited on 6th June the "considerable headroom" available he referred specifically to the European Court of Justice's backing for the ECB to act "in a proportionate manner" to ensure it complies with its price stability mandate. This could be interpreted as a sign that the ECB is willing to raise the issue and issuer limits under its asset purchase programme (APP) to create more room to purchase sovereign bonds within the confines of the current capital-key based framework.

This could allow the ECB to restart monthly net purchases at a relatively high rate (they have ranged from EUR15bn to EUR80bn per month). But again, aside from the exchange rate implications, the impact on financial conditions and economic prospects would probably be limited unless there is a radical change to the structure of the APP. In other words, either including a broader range of assets and/or targeting sovereign debt purchases where they could make the most difference (e.g. in the most heavily indebted member states).

Either option would have drawbacks. Regarding the former, the riskier the assets (e.g. equities), the stronger the opposition within the ECB's Governing Council. As for the latter, "moral hazard" is a key problem. Targeting Italian sovereign debt, for example, looks inconceivable given the political and fiscal backdrop. Indeed, we could only envisage the ECB pursuing either of these options in extremis, for example in response to a severe deterioration in the economic and financial outlook which was potentially deflationary and/or threatened an existential crisis for the eurozone.

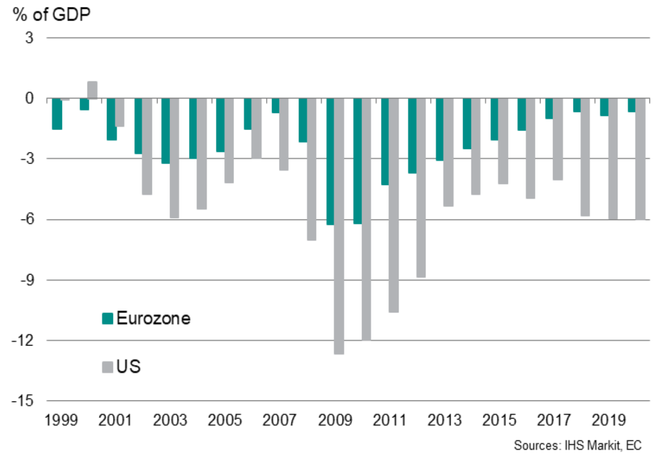
Outright Monetary Transactions (OMT) are an alternative route but this requires governments to sign up to an IMF-style adjustment programme which they would be very reluctant to do in the absence of extreme market pressure.

Monetary (and fiscal) policy limitations

Put simply, there are limits to what monetary policy can achieve, though this does not mean that the ECB will not try. Both March and June's announcements have demonstrated its sensitivity to downside risks and willingness to act. But the eurozone will need to utilise other policy levers much more effectively. This was acknowledged in the ECB's June press conference, with Mario Draghi commenting that "in case these adverse contingencies were to happen, certainly fiscal policy will have to also come into consideration and play a fundamental role."

He added, however, that there were some "wrinkles" to this view. There are indeed. Highly indebted economies have little fiscal space and need to focus on doing more to raise potential growth rates. In such circumstances, tax cuts would need to be funded, preferably by reductions in current rather than capital expenditure. The lack of effective policy co-ordination is also a key problem. On aggregate, the eurozone's public finances are in comparatively good shape (see chart). But where there is fiscal space, there is often little appetite to use it, particularly pre-emptively.

General government budget balances



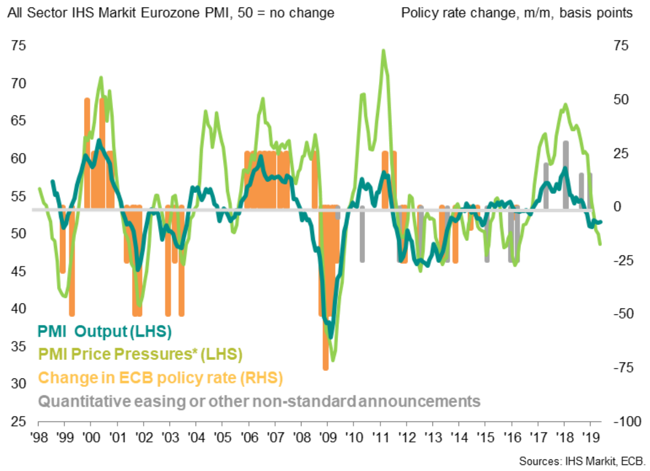
Monetary policy cannot fix the problem of low potential growth rates. Some would argue to the contrary: i.e. that unconventional monetary policy is a hindrance to the market pressure required to elicit the supply-side adjustments which could raise productivity and labour force participation. But reforms which only yield tangible benefits some way down the road are increasingly difficult to implement given the political climate in many member states. The political landscape is also a hindrance to the deeper integration of the eurozone which could help to harness more effectively its collective resources.

The bottom line? The onus will likely remain on monetary policy to take the lead should financial and economic conditions deteriorate. The ECB has already signalled its readiness to step up but with its policy ammunition limited by various constraints, and subject to diminishing returns, we need to be realistic about the likely results.

Eurozone PMI

An update to the health of the euro area economy will be provided on 21st June by the flash PMI survey. The data will provide the first insight into business conditions at the end of the second quarter, and is a series closely watched by the ECB.

Recent data showed the economy stuck in a low gear in May, running at a level commensurate with GDP rising at a modest quarterly rate of 0.2%. Price pressures meanwhile slumped lower. As our chart below shows, the PMI price and output data have fallen to levels historically consistent with an easing bias at the ECB.



For more details of our PMI surveys or our economic research capabilities please contact economics@ihsmarkit.com.