Economic Research

15 July 2019

Week Ahead Economic Preview

Global overview

- Global business outlook surveys
- China GDP
- US industrial production and retail sales
- UK labour market, retail sales and inflation
- Eurozone trade and inflation
- Special reports on Spain and India

Contents

1 Global overview
2 Key diary events
3 US week ahead
4 Europe week ahead
5 Asia Pacific week ahead

Special reports

6 Spain remains the "poster boy" of the eurozone
9 India's Economic Roadmap to 2025

With policymakers around the world continuing to worry about the health of the global economy, the release of IHS Markit's Global Business Outlook Survey on Monday will give fresh insight into corporate expectations for the year ahead. The survey is based on respondents from the worldwide PMIs and has been conducted three times per year since 2009, looking at output and profits expectations as well as intentions for employment and investment. The latest survey comes at a time when the monthly PMI indicators are pointing to the weakest pace of global economic growth for three years, and will help assess how entrenched the slowdown has become.

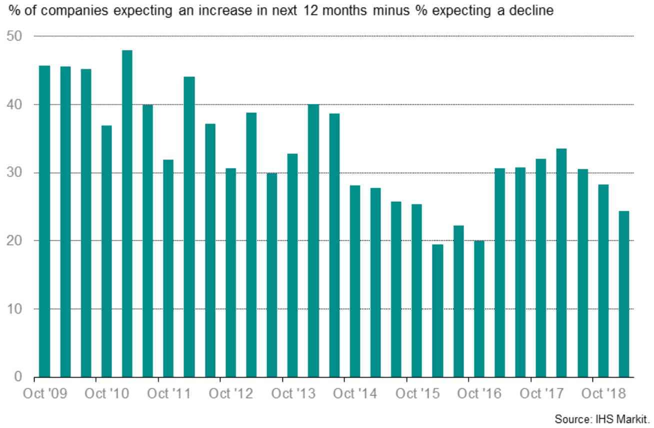
While the US Fed and ECB have opened the door for more stimulus in the face of the deteriorating economic climate, the Bank of England has remained hawkish, albeit decreasingly so. Key UK labour market statistics, notably wage growth, will therefore be eagerly awaited for further clues as to bank's policy stance, as will retail sales and inflation data (see page 4).

With the Fed already widely expected to cut interest rates at the FOMC's July meeting, the release of industrial production and retail sales data will be eyed for indications of the scale of – and indeed need for – any future loosening of policy (see page 3).

In Asia, the key release is China's second quarter GDP, which we expect to show the pace of expansion easing amid escalating trade tensions. The extent of the slowdown will be important in assessing the impact of recent policy stimulus, as well as guiding the need for any potential future action from the authorities (page 5).

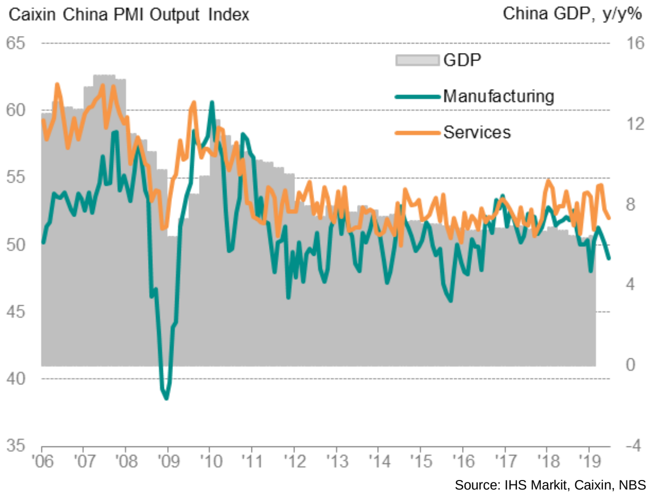
Our first special report on page 6 looks at how Spain remains the "poster boy" of the eurozone, while our second report explores the Indian government's new roadmap for transforming India from a USD 3 trillion economy in 2019 to a USD 5 trillion economy by 2025 (see page 9).

IHS Markit's Global Business Outlook Survey is updated. The prior (February) research showed companies' output expectations having slumped to the lowest since 2016



Source: IHS Markit.

Official data are expected to show that China's GDP growth slowed in the second quarter



Source: IHS Markit, Caixin, NBS

Key diary events

Monday 15 July

IHS Markit Global Business Outlook Surveys (Jun)

China GDP (Q2), industrial production, retail sales, fixed asset investment, house price index (Jun)

Indonesia trade (Jun)

India WPI, trade balance (Jun)

US NY Empire State manufacturing index (Jul)

Tuesday 16 July

RBA meeting minutes

UK jobless rate, earnings (May), claimant count change (Jun)

Euro area and Germany ZEW surveys (Jul)

Euro area trade balance (May)

Italy inflation (final, Jun)

US retail sales, industrial output (Jun), business inventories (May), housing market index (Jul)

Wednesday 17 July

Singapore trade balance, NODX (Jun)

UK inflation (Jun)

Euro area inflation (final, Jun), construction output (May)

US building permits, housing starts (Jun)

Russia unemployment rate, GDP (Jun)

Thursday 18 July

Japan trade (Jun)

South Korea monetary policy

Australia jobless rate, employment change (Jun)

Indonesia monetary policy

Hong Kong unemployment rate (Jun)

UK retail sales (Jun)

US Philadelphia Fed manufacturing index

Brazil business confidence (Jul)

Friday 19 July

Japan inflation (Jun)

Hong Kong business confidence (Q3)

US Michigan inflation and consumer expectations (prelim, Jul)

For further information:

If you would like to receive this report on a regular basis, please email economics@ihsmarkit.com to be placed on the distribution list.

For more information on our products, including economic forecasting and industry research, please visit the Solutions section of www.ihsmarkit.com

For more information on our PMI business surveys, please visit www.ihsmarkit.com/products/PMI

Click here for more PMI and economic commentary.

For all further information, please visit
www.ihsmarkit.com

Chris Williamson
Chief Business Economist
IHS Markit
Email: chris.williamson@ihsmarkit.com

United States Week Ahead

Industrial production, retail sales and business inventories

By Siân Jones
Economist, IHS Markit, London
Email: sian.jones@ihsmarkit.com

Leading the US economic calendar is the release of industrial production, retail sales and business inventories data. With July's FOMC meeting fast approaching, the performance of the manufacturing sector and consumer spending data will be greatly anticipated for confirmatory signs of a widely touted rate cut.

Industrial production

Official industrial production numbers for June come on the heel of survey data which showed US manufacturers reported business conditions to have remained the toughest for nearly a decade. The past two months have seen the lowest IHS Markit PMI readings since the height of the global financial crisis in 2009. The June survey was consistent with manufacturing output contracting at a quarterly rate of 0.7%. Similar data from the ISM have also slumped lower in recent months, and now pointing to falling manufacturing output in the second quarter. Regional manufacturing indexes, including the NY Empire State and Philadelphia Fed surveys, will give updated clues as to manufacturing performance in July.

Retail sales

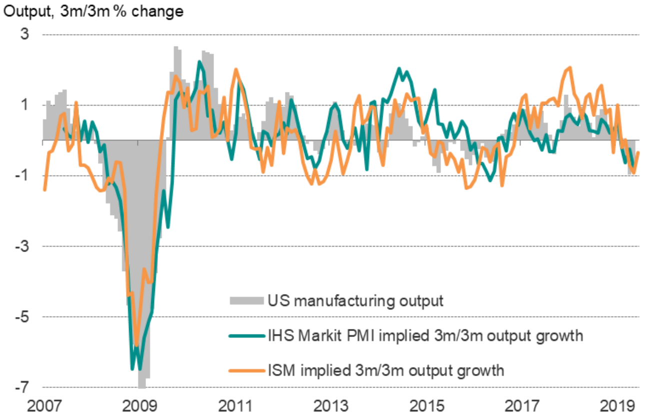
Alongside a greater than forecast increase in non-farm payrolls, a robust retail sales reading could add to speculation that the Fed's approach to cutting interest rates could be less urgent than previously thought. A rise in retail sales in May and upwardly revised data in April suggest that a tight labour market and buoyant consumer sentiment have shown that the divergence in consumer and business sentiment seen since mid-2014 has widened further over the last year.

Business inventories

May data for business inventories are meanwhile expected to show another increase in stocks, albeit only a fractional rise. Muted demand conditions across the manufacturing sector are leading to hesitancy among firms, according to business surveys, with many holding fewer goods in anticipation of a further drop in client demand.

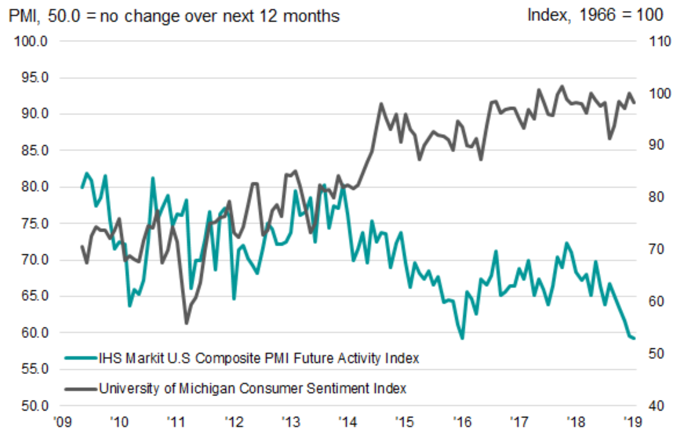
Other key data releases include housing starts, import and export prices and the Chicago Fed national index.

Surveys imply falling manufacturing output



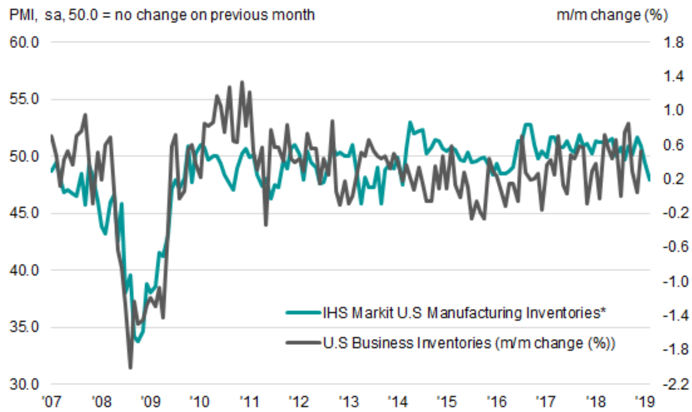
Source: based on IHS Markit regression analysis of survey output indices as explanatory variables of official changes in official data.

Business and consumer sentiment continue to diverge



Sources: IHS Markit, University of Michigan Surveys on Consumers

Inventories set to rise only slightly in May



*weighted average of U.S Manufacturing PMI Stocks of Purchases and Stocks of Finished Goods Indexes

Sources: IHS Markit, U.S Census Bureau

Economic Research

15 July 2019

Europe Week Ahead

Euro area trade data, UK labour market, retail sales and inflation updates

By Joe Hayes

Economist, IHS Markit, London

Email: joseph.hayes@ihsmarkit.com

The key releases on the European calendar focus primarily on the UK, with employment and inflation statistics having the potential to sway expectations of the next move in policy at the Bank of England. An update to the eurozone trade balance comes in addition to ZEW surveys, while final June prices data are set to confirm subdued inflationary pressures evident in Eurostat's 'flash' CPI release. Our special report on page 6 looks at how Spain has enjoyed robust growth in recent years.

UK inflation & labour market

Updated labour market data could be instrumental in determining whether the Bank of England could switch tack to favour a loosening of policy. Although the bank is expected to leave policy on hold this year amid the fog of Brexit, any further weakness in the UK economy after signs of the economy contracting may create a stronger case for loosening, especially if wage growth disappoints or the employment numbers start to fade.

PMI data, GDP numbers and our latest Nowcast[1] model all now suggest the economy contracted in the second quarter. REC/KMPG recruitment industry survey data have meanwhile indicated that demand for staff has become less robust amid rising uncertainty, though wage growth remains elevated.

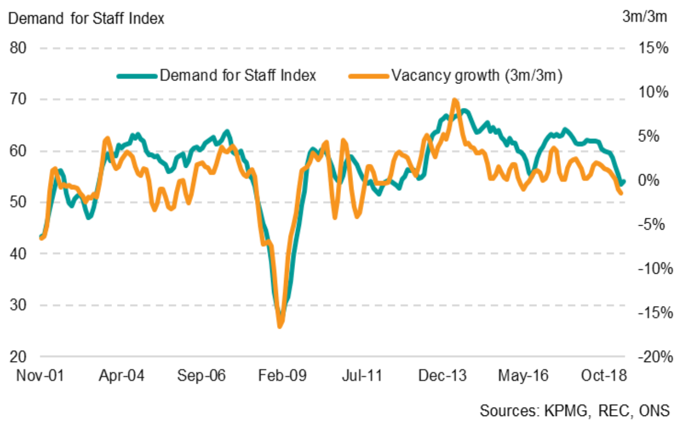
At the same time, updated UK consumer price data are likely to show that inflation is proving to be no cause for concern to policymakers. Although the recent weakness in sterling may provide some unwanted pressure in coming months, inflation is expected to remain at the central bank's 2% target rate in June.

One area of the UK economy that has shown resilience amid Brexit uncertainty is the consumer, though recent surveys have shown signs of retail sales being hit by deteriorating consumer confidence. Official June sales data will therefore be eagerly watched for signs that the consumer remains alive and spending.

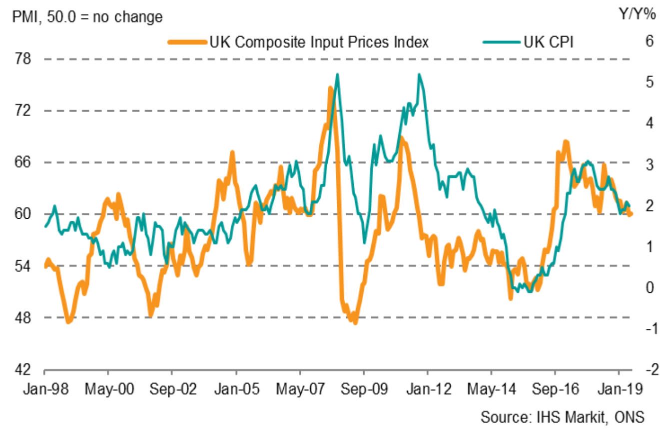
Business outlook

Setting the scene for the week is the release of business outlook survey data for the Eurozone and UK on Monday, adding further insight into how entrenched the recent slowdown may have become.

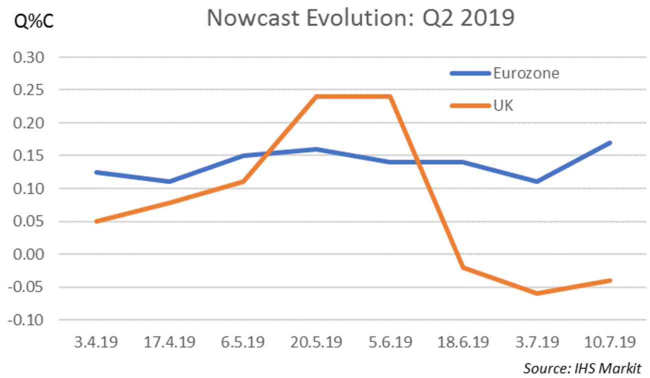
Signs of cooling UK labour market



Inflation no problem for Bank of England



Nowcast model developments during second quarter



[1] Our judgement-free nowcast models suggest the euro area grew by 0.17% in the second quarter, while the UK is set to contract by 0.04%. Manufacturing weakness in the eurozone remains heavily centred on Germany, but resilience across services has kept the economy afloat. Meanwhile, the volatile growth profile across the second quarter (see chart) for the UK has steadied recently. Despite a partial manufacturing bounce back in May, weakness in June PMI data keep our nowcast in contraction.

Asia Pacific Week Ahead

China GDP, Asia trade performance and central bank meetings

By Bernard Aw

Principal Economist, IHS Markit, Singapore

Email: bernard.aw@ihsmarkit.com

China statistics and Asian trade figures dominate next week's data-heavy diary, with a particular spotlight on Chinese GDP. With markets eager to assess global trade conditions, incoming trade data from Japan, Indonesia, Singapore and India will be closely scrutinised for trade war impact. For the latter, our special report on page 9 looks at the Indian government's latest economic development plans. Central bank meetings in South Korea and Indonesia accompany the data releases.

China data

In China, GDP data will provide an updated official snapshot of the economy's health during the second quarter after recent Caixin PMI surveys providing early signs of slowing momentum. The PMI Composite Output Index sank to its lowest for eight months in June. IHS Markit forecast economic growth to ease from 6.4% in the opening quarter of the year to 6.3%. Other data highlights include industrial output, fixed asset investments and retail sales, which will be eyed for evidence of whether more policy support is needed.

Asia trade

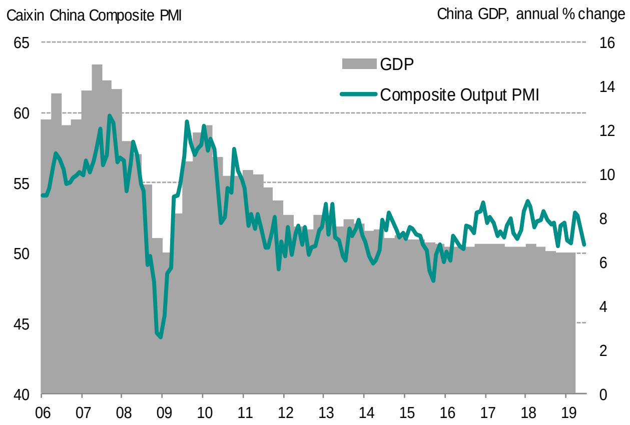
The June update to trade data from Japan, Singapore, Indonesia and India will give clues as to Asian trade conditions that could steer monetary policy around the region. Furthermore, trade figures in Indonesia and India will provide insights into the countries' balance of payment positions at a time of increasing protectionism.

Korea and Indonesia monetary policy

Central banks have grown increasingly dovish on concerns that the global economy is slowing, with several monetary authorities in the Asia Pacific region having reduced interest rates recently to support growth. South Korea and Indonesia are deciding on monetary policy in the forthcoming week.

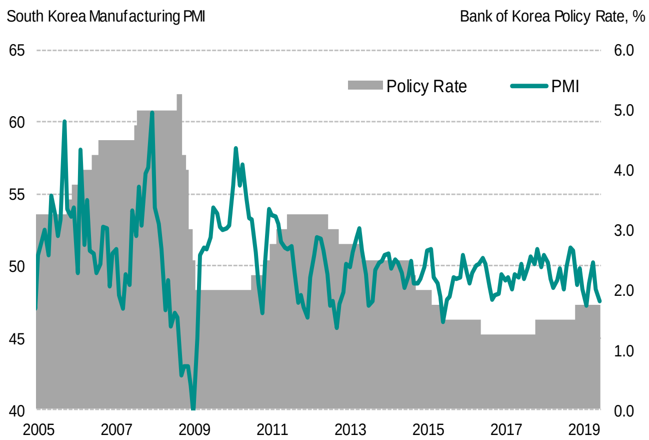
While the Bank of Korea is not expected to cut its policy rate in July, there are mounting pressures for more monetary support in the face of flagging economic activity. As for Indonesia, any policy adjustment will depend to a large extent on expectations of future US Fed moves and rupiah volatility, with Bank Indonesia ready to cut interest rates if necessary, according to recent comments from governor Perry Warjiyo.

China PMI signals weakening growth momentum



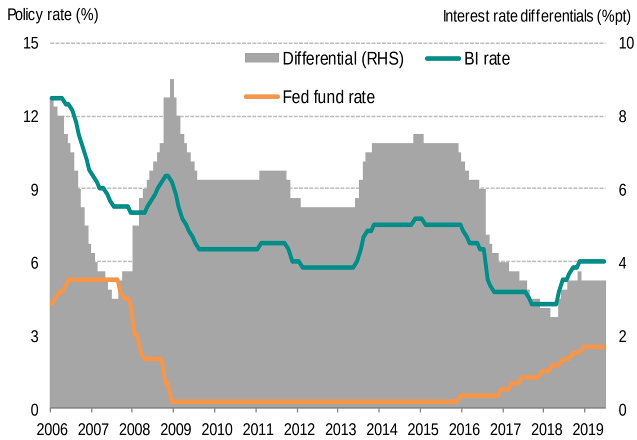
Sources: IHS Markit, Caixin, NBS

South Korea PMI and monetary policy



Sources: IHS Markit, BOK

US-Indonesia interest rate differentials



Sources: Federal Reserve, Bank Indonesia

Europe
Special Focus

Spain remains the "poster boy" of the eurozone

By Raj Badiani
Economics Director, IHS Markit, London
Email: raj.badiani@ihsmarkit.com

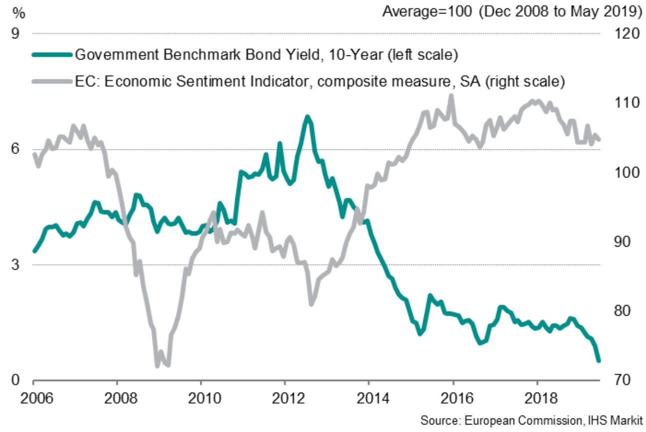
The Spanish economy grew solidly for a fifth consecutive year in 2018, which has been an impressive turnaround from the sharp output losses endured during its economic and financial crisis that lasted from 2008 to 2013. Although, Spain's current economic upturn has passed its cyclical peak, it still displays some solid momentum. Importantly, the country's growth model is transforming from one driven by debt-fuelled domestic demand, an excessively large and uncompetitive construction sector and a real estate boom, to one that is broader-based and more sustainable than in past recoveries.

Major reform push fuels prolonged Spanish economic recovery

Spain has been described as the "poster boy" of the eurozone, illustrating how a troubled member state can revive its economy by undertaking a major structural overhaul, led by far-reaching labour market and banking reforms alongside aggressive fiscal consolidation. It also received 'oxygen' from very accommodating ECB monetary conditions (ultra-low interest rates, the promise of unlimited buying of distressed government bonds in 2012 and a Quantitative Easing programme from March 2015) and financial assistance from the eurozone's European Stability Mechanism.

External support from the ECB and other the European Union (EU) member states were important catalysts in Spain's recovery. This helped to bring about a steady retreat of the country's sovereign borrowing costs after they peaked at 6.9% in July 2012 (at 0.9% in May 2019) and prompting a 'game-changing' recovery in business and consumer sentiment (see chart 1), encouraging consumers and firms to release of pent-up demand, amid healthier employment intentions.

Chart 1: Spain bond yields & economic sentiment



Spain deserves credit for its economic recovery after two deep recessions between 2008 and the end of 2013 resulted in real GDP shrinking by 10.3% over the whole period. Indeed, the economy returned to its pre-crisis level in mid-2017 (see chart 2), while employment has been growing at more than 3% per annum, with 2.2 million jobs created since 2013 (see chart 3), supported by wage moderation and labour market reforms.

Chart 2: Real GDP

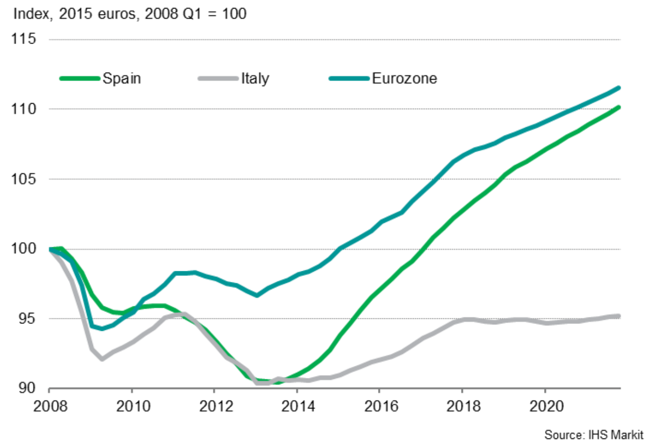
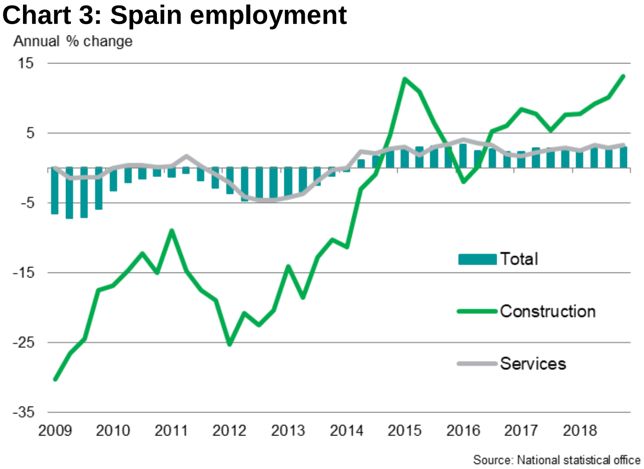


Chart 3: Spain employment



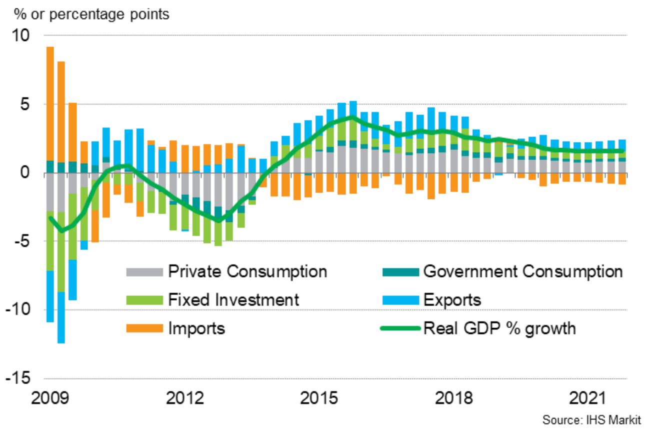
Despite losing some growth momentum in 2018 and early 2019, the Spanish economy remains on a stronger footing when compared to most of the Eurozone. The resilience of the economy is illustrated by the contained impact on Spanish economic sentiment and growth from the uncertainty of fractured governance in Madrid, the ongoing Catalan crisis and global trade and Brexit tensions.

Real GDP growth in Spain outperformed the Eurozone for a fourth successive year by 2018 (admittedly from a low base). Encouragingly, the Spanish economy outdid the Eurozone in the first half of 2019. The country's real GDP grew by 0.7% quarter-on-quarter (q/q) in the first quarter and an estimated 0.5% q/q in the second (the Bank of Spain's estimate is higher at 0.6% q/q). The comparable values for the Eurozone are 0.4% q/q and 0.2% q/q (estimated), respectively.

This implies that growth in Spain is projected to stand at 2.2% in 2019 and 1.7% in 2020, compared to the comparable Eurozone projection of 1.2% in both years.

The Spanish economy continues to enjoy the benefits from a flurry of reforms in the past decade, ensuring Spain is no longer on the front page of potential Eurozone sovereign debt stress recipients. The country's reforms have delivered a more efficient wage bargaining system to allow firms to better align wages with productivity, triggering an export-boosting fall in unit labour costs. In addition, the country has a healthier financial sector, allowing some restoration of normal credit channels to both households and firms.

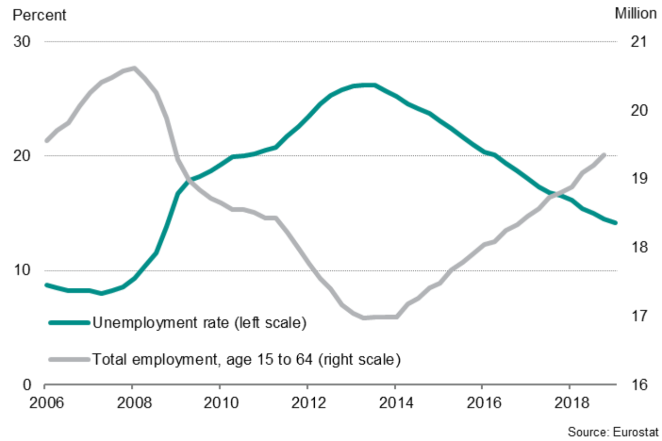
Chart 4: Spanish GDP growth and expenditure contributions



Labour market reforms play role in reversing past employment losses

Spain undertook two key labour market reforms in 2010 and 2012, with the latter being the game changer. The 2012 reform injected greater flexibility into Spain's wage bargaining system. The main change was to allow company-level agreements to supersede collective bargaining agreements. Companies can now act independently to adjust their wage levels and hours to meet their trading conditions. Companies can also override their sectoral collective bargaining agreements by simply opting out. This has appeared to encourage wage growth moderation, with increased wage flexibility first helping to slow the employment losses before encouraging sustained job creation.

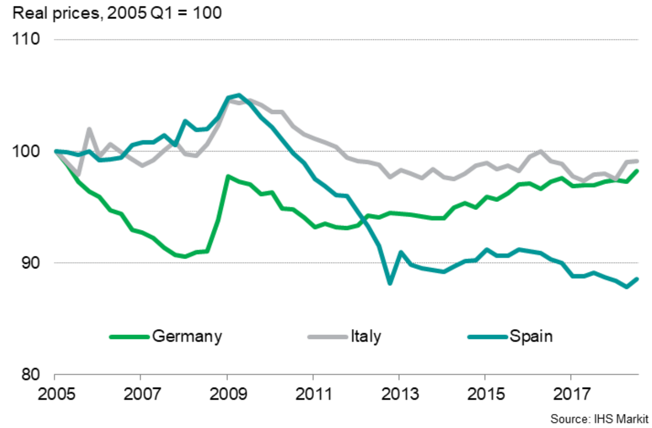
Chart 5: Spain labour market developments



Internal devaluation stiffens export prowess

After a period of overheating and a loss of competitiveness prior to the Great Recession, Spain had little choice but to endure a period of internal devaluation, or a sustained period of wage moderation. This implies that improved external competitiveness is achieved through lowering prices, including wages, across the economy, typically in cases where currency devaluation is not an option due to the existence of a fixed exchange rate regime. This was accomplished with tough fiscal measures, labour market reforms and the 2012–14 Agreement for Employment and Collective Bargaining signed by social agents in early 2012. The net outcome was to improve its external competitiveness, led by several years of falling unit labour costs.

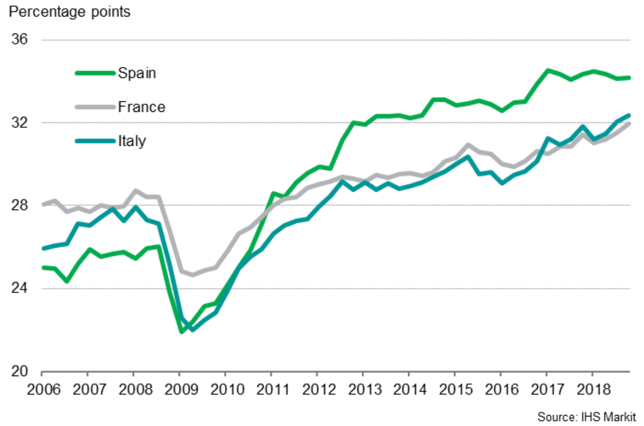
Chart 6: Unit labour costs



The country's higher propensity to export has played a significant role in the current upturn, aided by the improvement in Spain's external competitiveness relative to its EU trading partners. As a result, more Spanish firms are exporting, with the number exporting for four years continually rising from 38,373 in 2012 to 50,562 in 2017 (World Finance, April 2019).

Spain has also increased its share of global exports (compared with the decline in share of other European countries). Furthermore, Spain's exports have greater presence in relatively fast-growing countries outside the eurozone, including emerging and developing markets in Asia, Latin America, North Africa, and the Middle East. This helped to deliver an improved export performance, with Spanish exports, as a share of nominal GDP, 10 percentage points higher than 2007's level (see chart 7). The improvement has been broad-based across sectors (traded goods and non-tourism services) and has been an important catalyst for sustained employment creation since mid-2014.

Chart 7: Exports, share of nominal GDP



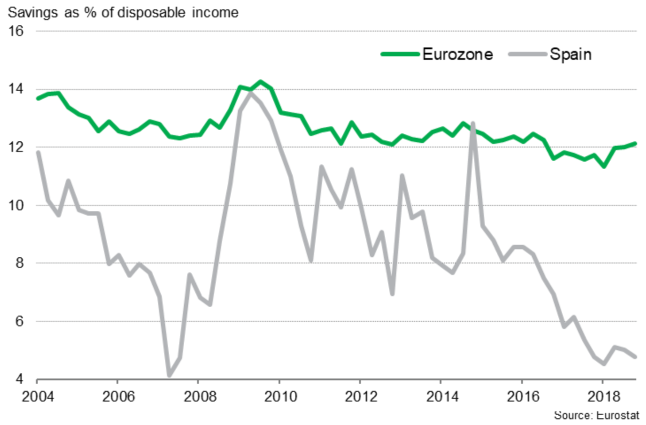
Less cautious households are saving less, spending more

Domestic demand has also made considerable and broad-based gains, initially led by consumer spending and industrial investment, before the resumption of growth in dwelling construction after housing market meltdown.

Private consumption has been main engine of growth, and its continued resilience has been a major contributor to stronger than expected Spanish GDP growth developments. This is due to several factors:

- Robust job creation continues to stoke the recovery in household real incomes. The demand for labour remains robust, led by reviving demand for labour in the construction sector and strong service sector employment gains. Indeed, annual employment growth accelerated to 3.1% in the first quarter of 2019, after gains of 2.7% in 2018 and 2.6% in 2017.
- Spanish workers are experiencing rising real wage gains because of lower inflation and return of some earnings growth.
- Against the backdrop of increasing job security and more elevated confidence, households are prepared to save less to finance their spending plans (see chart 8).
- In addition, the pace of consumer deleveraging has slowed markedly. Households continue to enjoy very easy financial conditions, with the European Central Bank (ECB) in no rush to tighten its very accommodative monetary policy stance. Indeed, consumer lending rose again in 2018, up by 0.9% on a year ago in December, the first increase since 2010. This was underpinned by rising other loans (excluding dwellings) for a third successive year in 2018
- The improvement in credit flows to households also reflect the major overhaul of the country's banking sector. Spain now has a leaner, better capitalised and more profitable banking sector after a period of crisis and reform. Overall, retreating non-performing loans (NPLs), less indebted households and firms and more balanced loan portfolios suggest less pressure on bank lending.

Chart 8: Household savings



Business investment has also picked up due to firms releasing pent-up demand for investment goods, amid favourable financing conditions, lower corporate indebtedness and a higher level of capacity utilisation.

Meanwhile, the upturn in construction investment continued in early 2019 and sits comfortably with other economic information pointing to the continued revival in residential construction during the latter stages of 2018 and 2019. This includes very robust employment growth in the construction sector and sustained house price growth.

Asia Pacific Special Focus

India's Economic Roadmap to 2025

By Rajiv Biswas
Asia-Pacific Chief Economist, IHS Markit
Email: Rajiv.Biswas@ihsmarkit.com

Following the re-election of the BJP government led by Prime Minister Modi to a second term of office in May 2019, the Indian Ministry of Finance has published an economic roadmap to 2025 in its latest annual Economic Survey. The key goal is to transform India from a USD 3 trillion economy in 2019 to a USD 5 trillion economy by 2025, lifting India into the ranks of the world's upper middle-income countries.

IHS Markit estimates that India will overtake the UK to become the world's fifth largest economy in 2019, and forecasts that Indian GDP will reach USD 5.9 trillion in 2025, surpassing Japanese GDP to make India the world's third largest economy.

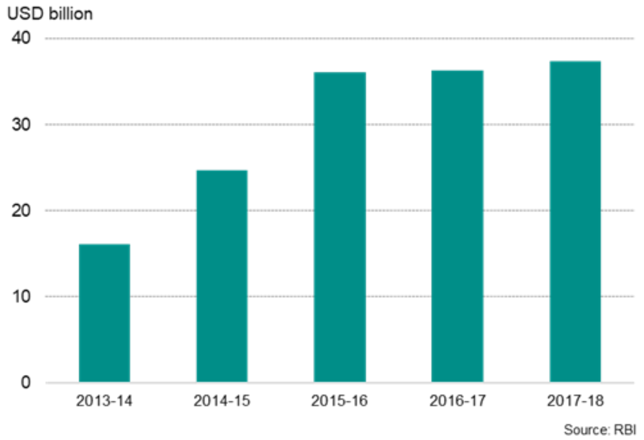
India's new economic roadmap

In order to achieve the objective of becoming an upper middle-income nation by 2025, India's new economic roadmap highlights the importance of creating a virtuous cycle of investment, savings and exports in order to sustain rapid economic growth over the next five years.

The role of investment is seen as a critical enabler for innovation, rapid productivity growth and new technology, helping to boost jobs growth. The roadmap described in the latest Economic Survey published by the government highlights the importance of creating a favourable ecosystem for private investment, particularly in the new economy. to encourage investment in start-ups and new ventures. India already has some notable home-grown unicorns, such as Flipkart, India's biggest online store which has been acquired by Walmart, as well as Snapdeal, an online retail store and OYO, India's largest hospitality company. Accelerating the development of similar new economy start-ups and growing new unicorns is seen as a critical strategy for creating value-added and skilled jobs growth.

The strong upturn in foreign direct investment inflows during the Modi Administration's first term of office is a positive signal that foreign private capital inflows will play an important role in financing new economy start-ups.

Indian Foreign Direct Investment Inflows

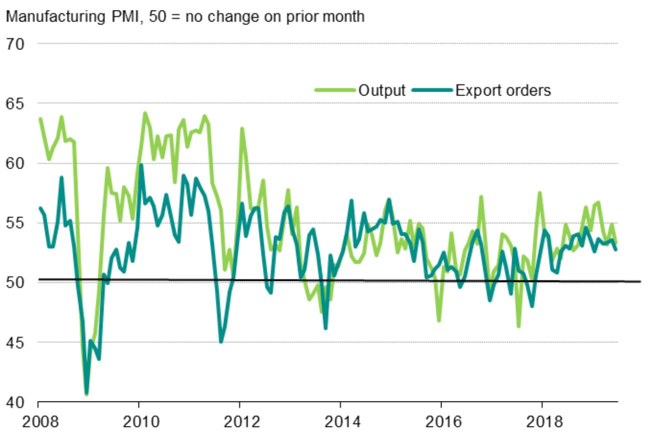


Continuing to drive the transformation of India's industrial sector through PM Modi's 'Make in India' strategy will also be a strategic priority, in order to improve manufacturing sector output growth and generate stronger employment growth.

When PM Modi launched the Make in India strategy in 2014, he set a target of increasing the contribution of manufacturing to GDP to 25%. However, by 2018, the manufacturing sector share of GDP was still at 18%, which still leaves a substantial gap to bridge in order to achieve this vision. Catalysing more dynamic growth in the manufacturing sector will therefore be very important as a key pillar to achieve India's objective of becoming an upper middle-income economy by 2025.

Latest IHS Markit Purchasing Managers' Index data for India's manufacturing sector still signal a relatively weak rate of expansion in the manufacturing sector, highlighting the need for more government initiatives to accelerate the development of the manufacturing sector.

India Manufacturing PMI



Source: IHS Markit.

Obstacles to economic development

Despite significant achievements in new infrastructure construction during PM Modi's first term, rapid infrastructure development in key sectors such as transport and power infrastructure remain important priorities, as well as reducing the regulatory burden of government red tape. India was ranked 77 out of 190 countries that are included on the World Bank's Ease of Doing Business Index for 2019.

The government's economic roadmap highlights the importance of reforms to the legal system, citing the World Bank's Ease of Doing Business Report, which ranks India 163rd in the world for contract enforcement. The Economic Survey recommends the hiring of additional judges to rapidly reduce the number of unfilled vacancies and clear long backlogs in the court system. Another important reform that is highlighted as a priority in the Economic Survey is changing labour market law to removes restrictive labour regulation.

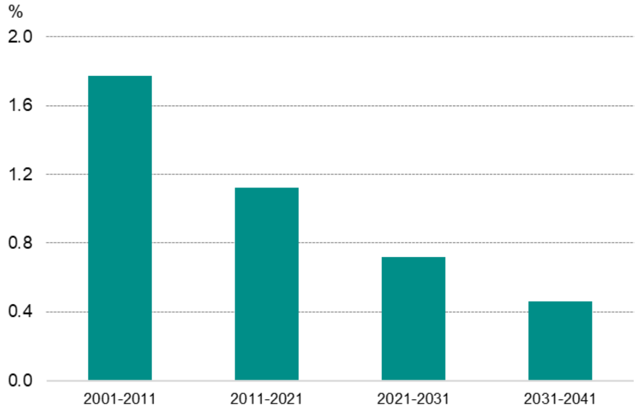
However, although India still lags behind other large emerging markets such as Turkey (43rd), China (46th) and Mexico (54th) on this ranking, India has made remarkable progress in improving its ranking compared with its ranking at 142nd out of 189 countries in the Ease of Doing Business ranking for 2015. The 2015 survey was undertaken during the last year of the UPA Congress-led coalition government. The substantial improvement reflects the considerable efforts made during PM Modi's first term of office to try to reduce the regulatory burden of the Indian national and state bureaucracies on Indian businesses.

For example, the introduction of the unified sales tax (GST) across all Indian states has helped to significantly reduce the regulatory burden on interstate transportation of goods. This is estimated to have substantially reduced logistics costs for firms, improving the efficiency and competitiveness of the domestic manufacturing sector.

India's demographic dividend

Indian economic growth is also expected to be underpinned by favourable demographic factors, helped by a relatively youthful demographic profile compared to other large Asian industrial nations, notably Japan, South Korea and China. Between 2021 and 2031, India's working age population is projected to grow at around 9.7 million persons per year, which will help to underpin the long-term potential growth rate. However, this also creates a major challenge for the Indian government, as millions of new jobs will need to be generated in the Indian economy each year in order to prevent rising unemployment and escalating social discontent.

India's population growth rate



Source: Economic Survey 2018-19.

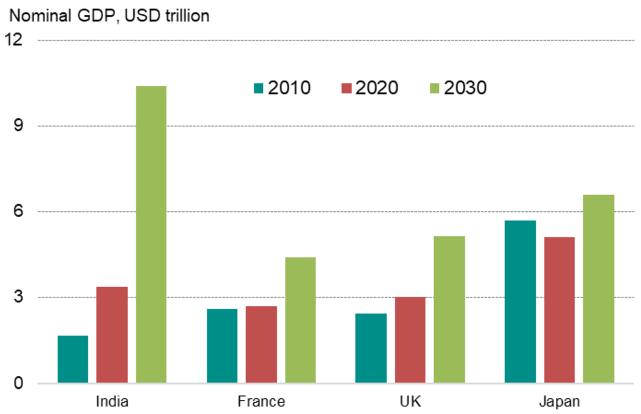
This will create strong pressure on the Modi government to generate sustained rapid employment growth in both the manufacturing and services sectors in order to prevent rising unemployment and underemployment in the Indian labour force.

Moreover, the increase in India's total population between 2015 and 2050 is projected at around 350 million persons, creating significant fiscal challenges for the government in order to deliver adequate physical infrastructure such as electricity, sanitation, affordable housing and public transport. At the same time, India's population growth rate is also projected to slow rapidly over the next two decades, resulting in gradual ageing of the population, bringing additional fiscal challenges relating to health care, pensions and social welfare for senior citizens.

Medium-term economic outlook

Despite the wide range of economic challenges facing the nation, the economic outlook looks positive for the second term of the Modi-led BJP government, with GDP growth forecast by IHS Markit to average around 7% per year over the 2019-2023 period.

GDP Outlook, 2010 to 2030



Source: IHS Markit.

Total Indian GDP is forecast to rise from USD 3.1 trillion in 2019 to USD 5.9 trillion by 2025, while the size of the Indian consumer market is forecast to increase from USD 1.9 trillion in 2019 to USD 3.6 trillion by 2025.

As India continues to ascend in the rankings of the world's largest economies, its contribution to global GDP growth momentum will also increase. As the size of its consumer market continues to grow at a rapid pace, India will also play an increasingly important role as one of the Asia-Pacific region's major economic growth engines, helping to drive Asian regional trade and investment flows.