Week Ahead Economic Preview

Global overview

- **Flash PMI surveys for the US, Eurozone, Japan and Australia**
- **US second quarter GDP and earnings season**
- **ECB policy meeting**
- **Brexit in spotlight with new UK Prime Minister**
- **Special reports on EU convergence and Japan-South Korea trade tensions**

Second quarter US GDP numbers are expected to add to signs that economic growth has slowed sharply for many economies after a better than expected start to the year and intensified trade tensions. Earnings updates from the likes of Amazon, Facebook, Intel, VW and Caterpillar will likewise provide insights into second quarter performance.

The earnings data follow PMI surveys showing global growth at a three-year low and the business outlook for growth and profits sliding to the lowest since 2009, according to IHS Markit's Global Business Outlook Survey. However, the week also sees important updates of forward-looking data which will be useful in assessing whether the global slowdown has persisted into the third quarter. Flash July PMI numbers for the US, Eurozone, Australia and Japan are released, the latter including the service sector for the first time.

The US GDP, PMI and durable goods data releases take on particular significance ahead of the FOMC meeting at the end of the month, at which the Fed is widely expected to cut interest rates (see page 3).

A rise in the eurozone PMI in June caused analysts to pull back on expectations of the scale of anticipated ECB stimulus, meaning July's flash data will be especially closely watched ahead of the ECB's policy meeting. Political uncertainty amid Brexit chaos meanwhile looks set to dominate UK markets with the appointment of a new Prime Minister (see page 4).

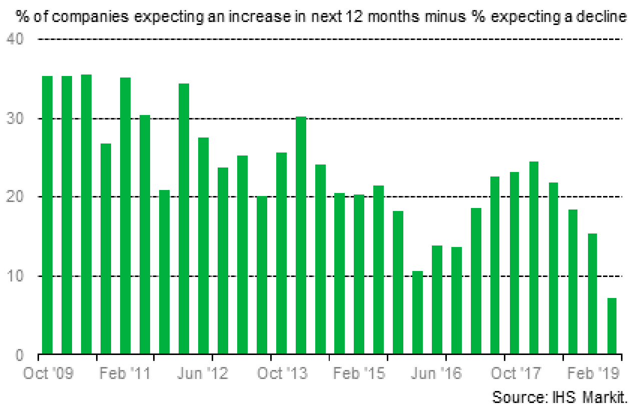
In Asia, the PMI and trade data will be scoured for signs of trade war impact (page 5), especially as mounting Japan-South Korea trade tensions could trigger a new trade war (see special report on page 9).

Our other special report this week looks at the extent to which EU national economies have converged and the varying outlooks for different countries (page 6).

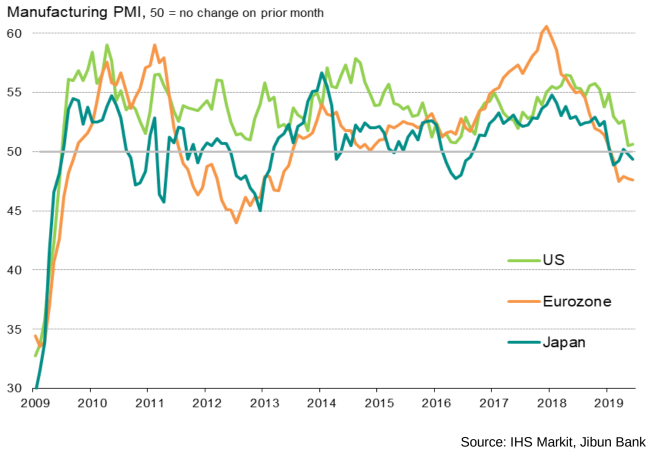
Contents

Special reports

IHS Markit's Global Business Outlook Survey found companies output and profits expectations for the year head were the lowest since 2009



Flash PMI surveys are updated and will provide the first insights into third quarter trends for some of the world's largest economies



Key diary events

Monday 22 July

Thailand trade (Jun)

Taiwan export orders, jobless rate (Jun)

Hong Kong inflation (Jun)

IHS Markit UK Household Finance Index (Jun)

Tuesday 23 July

Singapore inflation (Jun)

Taiwan industrial output, retail sales, M2 supply (Jun)

UK Conservative Party new leader announcement

BoE Financial Policy Committee minutes

Euro area consumer confidence (flash, Jul)

Hungary monetary policy decision

US house price index (May), existing home sales (Jun), Richmond Fed Manufacturing Index (Jul)

Wednesday 24 July

Flash PMI for Australia, Japan, US and Eurozone (Jul)

New Zealand trade (Jun)

Malaysia inflation (Jun)

France business confidence (Jul)

UK finance mortgage approvals (Jun)

US new home sales (Jun)

Thursday 25 July

South Korea GDP (adv, Q2)

Australia inflation (Q2)

Speech by RBA Governor Philip Lowe

Hong Kong trade (Jun)

Germany Ifo surveys (Jul)

ECB monetary policy decision

Turkey monetary policy decision

US durable goods orders, wholesale inventories (Jun), Kansas Fed manufacturing index (Jul)

APEC finance ministers' meeting

Friday 26 July

South Korea consumer confidence (Jul)

Singapore jobless rate (prelim, Q2), industrial output (Jun)

France consumer confidence (Jul)

Russia interest rate decision

US GDP, PCE prices (Adv, Q2)

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Economic Research

22 July 2019

United States Week Ahead

Second quarter GDP, flash PMIs and durable goods orders

By Siân Jones

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As the FOMC meeting at the end of July approaches, all data releases will be parsed for further clues to any decision on interest rates. Of key importance is the release of GDP data for the second quarter, which is expected to show a slowdown, while flash PMI data will give insight into whether growth has continued to weaken in the third quarter.

Second quarter GDP

The first official GDP estimate for the second quarter of 2019 is hotly anticipated amid widespread indications that growth has slowed sharply from the first quarter. Consensus currently expects an annualised expansion of 1.9%, further extending one of the longest periods of growth on record, despite the upturn slowing. IHS Markit's US economists' GDP tracker forecasts 2.1% growth, while our PMI data point to a 1.5% annualised expansion.

Flash PMIs

The advanced GDP estimate will be one of the final key pieces of information released before the FOMC decision on the 31st July and will therefore be dissected for signs of the need for economic stimulus. However, perhaps even more important for future policy expectations will be whether the slowdown has persisted into the third quarter. In that respect, flash PMI data for manufacturing and services will be updated to give fresh insights into output, employment and inflation trends in July.

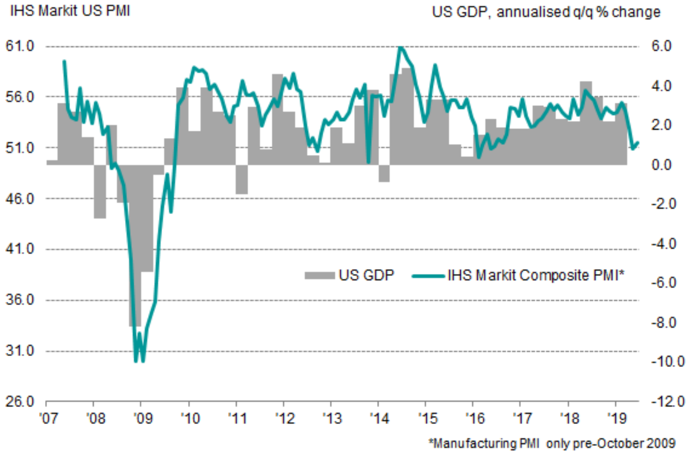
Although June PMI data signalled further subdued growth in business activity and new orders, there was some light at the end of the tunnel, as private sector new business emerged from contractionary territory.

Durable goods orders

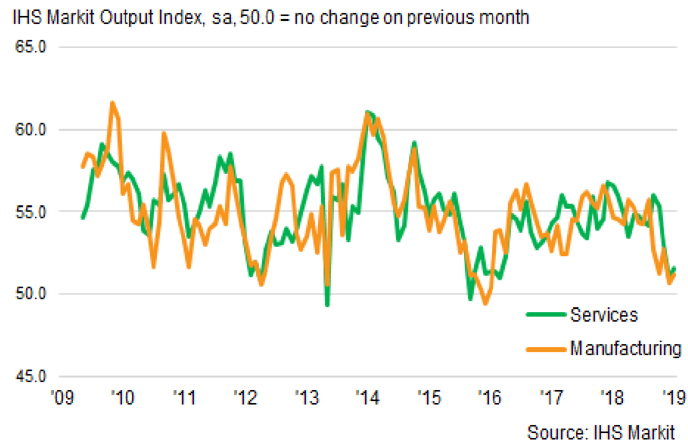
Orders for durable goods meanwhile look set to fall again in June, as sentiment across the goods-producing sector remained subdued. The contraction is expected to moderate, however, following a stronger than predicted decline in May, which had been driven by a poor performance among transport equipment manufacturers.

Other key data releases include home sales, house price index, wholesale inventories and jobless claims.

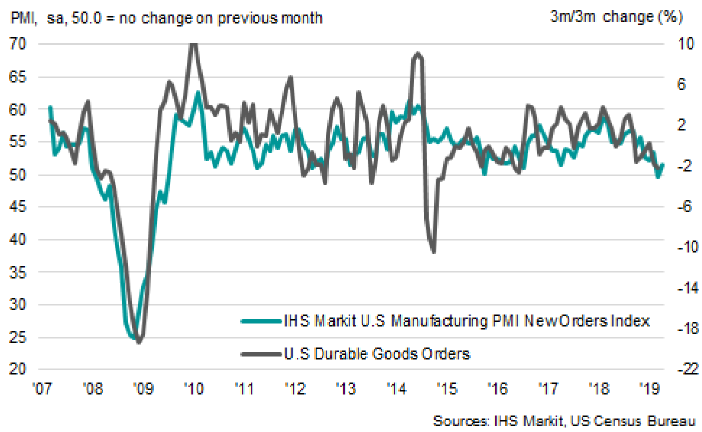
GDP growth is forecast to have eased sharply in the second quarter of 2019



Manufacturing and service sector growth remains muted according to the IHS Markit PMI surveys



Durable goods orders set to contract further in June



Europe Week Ahead

Flash PMI data lead July ECB policy meeting

By Joe Hayes

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A full week sees plenty of potential to move markets. Our key focus is on the 'flash' PMI release for the eurozone, which comes at a crucial time before the European Central Bank (ECB) policy meeting. Other survey data include euro area consumer confidence as well as the German Ifo and UK CBI business surveys.

We also draw attention to the UK conservative party leadership result, as well as the rates meeting in Turkey following the controversial change in governor.

Flash eurozone PMI & ECB meeting

Flash eurozone PMI data will show the health of the economy at the start of the third quarter and provide guidance on the scale and timing of the ECB's planned upcoming stimulus. Although growth ticked higher in June, our PMI-based nowcast model (see chart) suggests the euro area economy grew at a slower rate of 0.2% in the second quarter. A worrying divergence has also opened up between the manufacturing and service sectors.

The ECB will meet later in the week with current head Mario Draghi addressing the press as his tenure approaches an end. While the ECB are not expected to act in July, a planned renewal of the asset purchasing programme is widely touted, possibly starting in September, as well as a cut to the deposit facility rate.

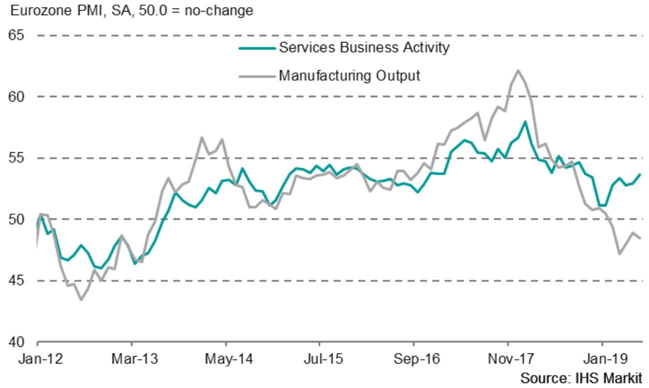
New UK Prime Minister

A new UK Prime Minister will be appointed as the Conservative Party leadership contest comes to a conclusion on the 23rd July. Polls suggest Boris Johnson is likely to succeed. While the parliamentary summer recess begins on the 25th July, Brexit developments may be limited, but markets will be eager to assess the likelihood of Johnson pushing though Brexit on 31st October even without a deal.

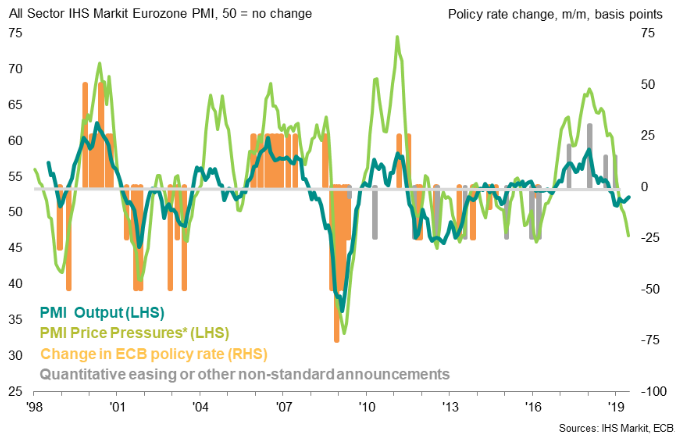
Turkish monetary policy

The newly promoted head of Turkey's central bank, Murat Uysal, has already indicated his willingness to ease policy and hinted that we could see a rate cut this month.

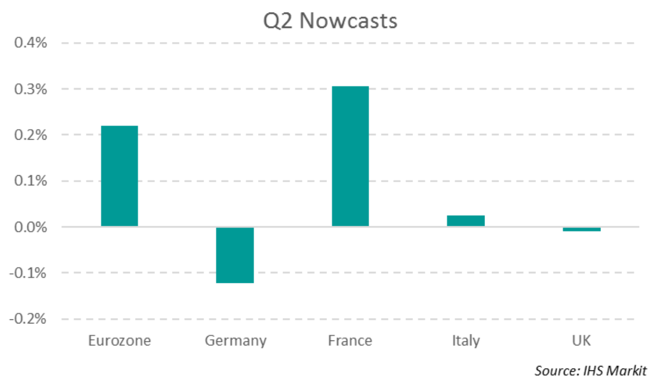
Flash PMI will show whether manufacturing and service sector divergence is going to continue into third quarter



ECB policy vs. euro area PMI



European second quarter GDP nowcasts



Our judgement-free nowcast models (updated 17.7.19) suggest the euro area grew by 0.22% in the second quarter. Manufacturing weakness remains heavily centred on Germany, but resilience across services has kept the economy afloat. Our model indicates a 0.12% contraction in German GDP during Q2, while positive surprises in French data has led our model to now point to a 0.30% expansion in France. Following some positive trade and industrial data, our Italy nowcast has been revised to show fractional growth of 0.03%.

Meanwhile, our UK nowcast remains unchanged from last week, pointing to a 0.04% contraction.

Asia Pacific Week Ahead

Flash PMI data, South Korea GDP and regional trade numbers

By Bernard Aw
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With signs of the regional trade tensions growing between Japan and South Korea (see special report on page 9), potentially exacerbating the impact of the US-China trade spat, incoming flash PMI data for Japan and Australia and Asian export data will be scrutinised for signs that more policy support is needed to combat the trade woes. Elsewhere, South Korea releases second quarter GDP numbers, while analysts will monitor a speech by the Reserve Bank of Australia's Governor for policy clues.

Flash PMI surveys

With worldwide business confidence slumping to the lowest since the heights of the global financial crisis in July, according to the latest IHS Markit Global Business Outlook survey, investors will scan the flash PMI surveys, (covering US, Eurozone, Japan and Australia) for further assessment as to the extent of the global economic slowdown. The survey releases include the launch of the Jibun Bank flash services PMI for Japan.

Asia trade

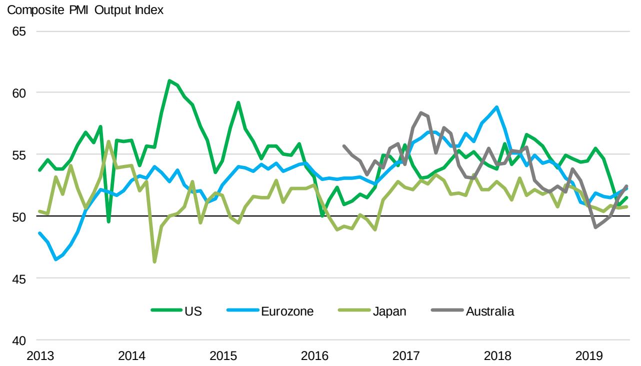
Trade woes continued to dominate Asian financial markets on the heels of Singapore's exports – widely seen as a bellwether for regional trade– which plunged at the steepest rate for six years in June. The fall raises concerns that the ongoing trade malaise will weigh on GDP across Asia. Markets will therefore eye June export data for Thailand, Hong Kong and Taiwan to assess the odds of monetary easing.

South Korea GDP

South Korea releases an advance estimate of second quarter GDP, with IHS Markit forecasting economic growth to weaken further to an annual rate of 1.4%, down from the near-decade low of 1.6% in the opening three months of 2019 amid trade weakness. Latest PMI surveys signalled the deepest contraction in production over the past four years during June.

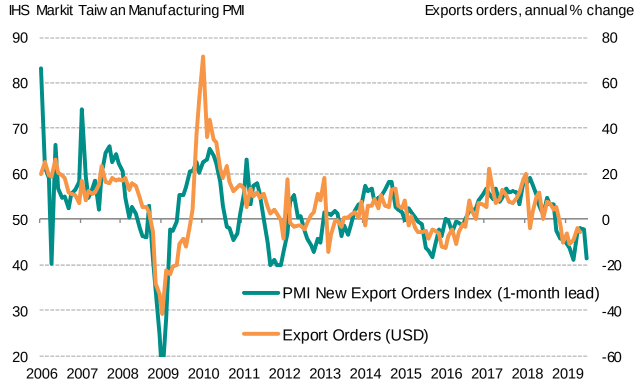
Australia watchers will meanwhile monitor a speech by RBA governor Philip Lowe after latest meeting minutes hint at further monetary easing to engender stronger labour market growth. Australia's jobless rate remained stuck at 5.2% in June.

PMI surveys of major economies



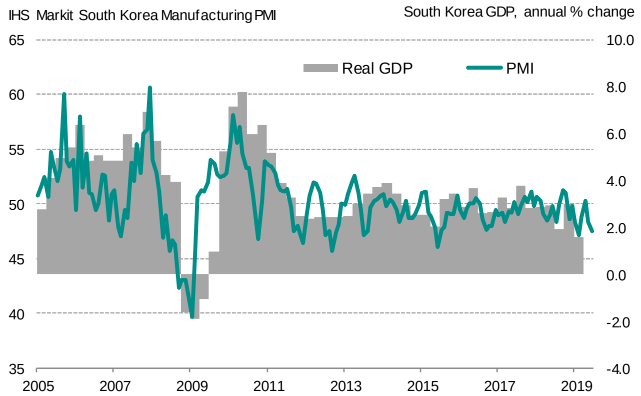
Sources: IHS Markit, Jibun Bank, Commonwealth Bank

Taiwan PMI and export orders



Source: IHS Markit, DGBAS

South Korea PMI and economic growth



Sources: IHS Markit, Bank of Korea

Economic Research

22 July 2019

Europe
Special Focus

EU convergence: Slippery path ahead, with no low-hanging fruit in sight

By Vaiva Seckute

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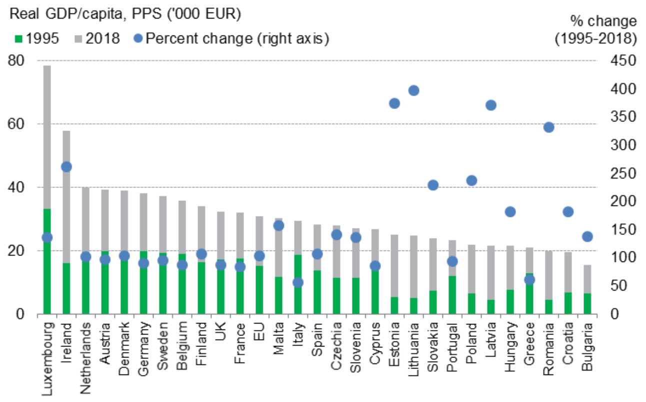
Since 1995, Emerging Europe's convergence with the EU average has been remarkable, and IHS Markit projects that all countries except for Croatia and Bulgaria will reach the EU average GDP per capita by the end of the forecast period in 2049. In contrast, several Western European countries (Greece, Italy, and Portugal) are expected to emerge as the bloc's poorest. Innovation and education, the functioning of the labour market, infrastructure and technology will serve as important factors for future convergence.

Growth convergence comparisons

Since 1995, Ireland has been growing at the fastest pace relative to the EU average, with GDP per capita by purchasing power standards (PPS) surging from 105% to 187% in 2018. The convergence of Central and Eastern European countries that joined the EU in 2004–13 has also been remarkable, with all 11 recording significant progress. Within Emerging Europe, the three Baltic states have seen the fastest rate of convergence, followed by Romania, Slovakia, and Poland. Still, most Emerging Europe countries (aside from Poland) have seen a slowdown in convergence progress in the aftermath of the 2008–09 global financial crisis.

Convergence has occurred since 1995, although significant variations are apparent



Source: IHS Markit, Eurostat.

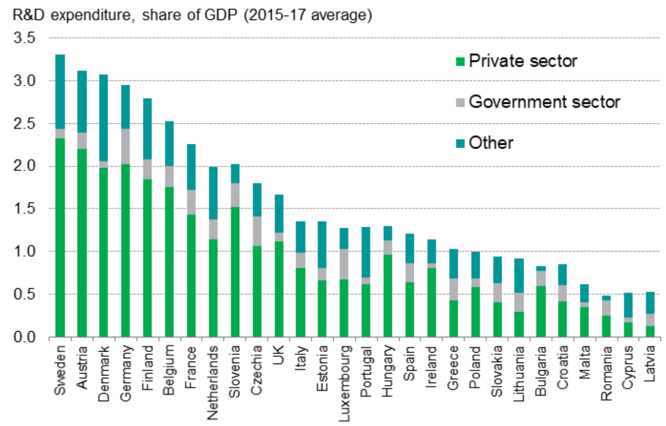
Many West European countries have recorded a relative decline in GDP per capita since 1995. The steepest drop by far has come from Italy (which plunged from 123% of the EU average in 1995 to 95% in 2018), followed by Greece. Whereas Italy's relative decline has been steady and gradual, Greece's has been more sudden and dramatic, dropping from a peak of 96% of the EU average in 2006. In 2018, Greek GDP per capita stood at just 68% of the EU average, lower than all of the new member states except for Romania, Croatia, and Bulgaria.

One of the reasons why many Emerging Europe countries have become more productive and achieved high convergence rates is the activity shift from less productive sectors, such as agriculture, to more productive ones, such as services and industry. However, a shift within sectors to more productive branches in manufacturing, for example, is important as well. In order for this to happen, a country needs to have the right kind (and level) of investments, required skills in the labour force, good infrastructure, efficient regulation and institutional framework, as well as innovative capacity.

Research and development

Research and development (R&D) investments do not appear to have been a defining factor behind the speed of convergence so far in Emerging Europe. They might still be too low even in Slovenia, as the share of GDP there is still slightly below the eurozone average (at 2%) and also lower than the European Commission's Europe 2020 target (at 3% of GDP).

Chart 2: R&D spending has not been a defining factor in the speed of convergence



Source: Eurostat, IHS Markit

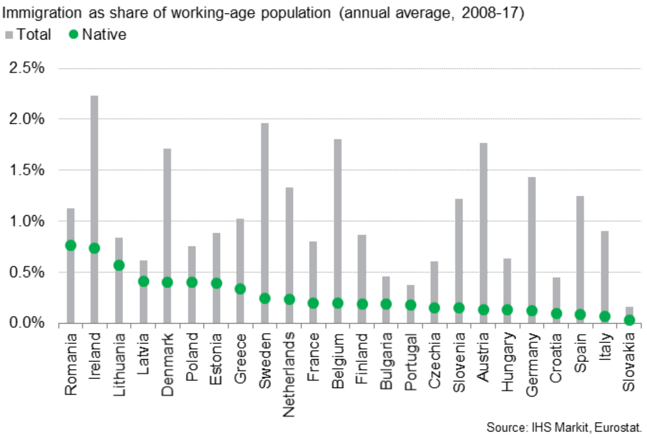
For poorer countries such as Romania and Bulgaria, R&D investments may become more important at later stages of development, especially as the low wage advantage over Western Europe begins to fade. Moreover, the effect on convergence might also depend on countries' capacity to translate R&D into productivity gains. This capacity might be affected by many other factors, such as the education system, the presence of innovative firms providing positive externalities, and business regulation and infrastructure.

Labour markets

Adequate skills of the labour force can determine if a country is able to make use of investments and infrastructure provided. First of all, this depends on the education system within the country, but also on the ability to attract and retain talent. The latter can be challenging for lower-income countries in the EU as a result of the free movement of labour. Nevertheless, if a country is able to encourage return migration, that might serve as a push factor for economic potential by providing new stimulus from the labour force with international experience.

Although migration is difficult to measure within the EU because of the free movement of labour, the Baltic countries and Romania appear to have been comparatively successful in attracting some foreign immigrants and bringing back some of those who had left.

More efforts are needed to bring emigrees back

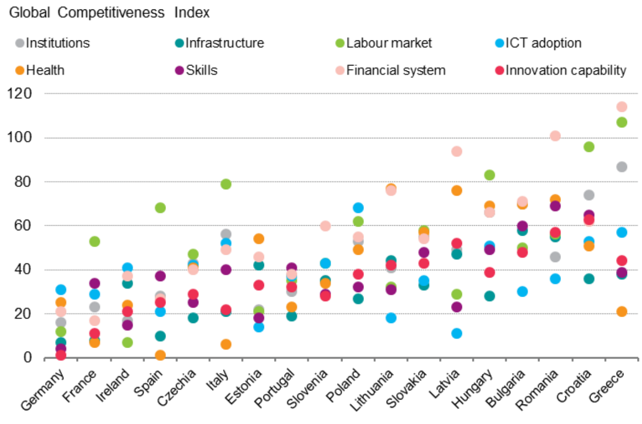


Source: IHS Markit, Eurostat.

Competitiveness

The quality of the education system plays a central role in how productive the labour force can be with the given physical capital and infrastructure. Romania, Croatia and Bulgaria score the lowest in terms of quality of skills of the labour force, according to the Global Competitiveness Index. Those countries suffer from poor staff training, a weak skillset among graduates, poor quality of vocational training, and a lack of focus on critical thinking in teaching, making it hard for businesses to find skilled employees. In contrast, Estonia, which has embraced the Nordic type of education system, appears to be the leader, with strong digital skills and a focus on critical thinking in teaching.

Most of Emerging Europe still lags in competitiveness



Source: Global Competitiveness Index, IHS Markit

Outlook

Emerging Europe's post-communist growth model (based on plentiful, cheap labour) is coming to an end, and further convergence will require structural reforms aimed at raising efficiency and productivity, boosting labour-market participation and reducing the skills mismatch. The Emerging Europe countries with the highest income levels (Czechia, Slovenia, and Estonia) also have the highest innovative capacity, making them well positioned for faster growth. However, growth is not certain, as was demonstrated by the Slovenian example. While at lower income levels, countries can converge more easily just by increasing their investments due to capital scarcity in those economies, at higher income levels convergence becomes more challenging. Countries have to compete with innovative economies that benefit from a high quality of education and highly skilled labour, a favourable institutional environment, and well-developed infrastructure.

Moreover, the uncertain outlook for global trade openness might limit most of those countries' opportunities to further raise their productivity. Slower growth in advanced Europe could also limit growth opportunities for the emerging countries. The expansion of global trade and supply chains has slowed and will probably no longer serve as a top source of growth in Emerging Europe, especially as wage differentials narrow.

Despite those limitations, countries that are able to address their weaknesses by implementing effective and timely reforms will do better than those that postpone them. It is also true that some reforms will bear fruit faster than others. For example, it might require decades to see the positive results from improvements in the education system. Nevertheless, the delayed impact does not decrease the importance of this step, as good skills will be essential in attracting investments and raising innovative capacity in the years of technological change and a declining and ageing labour force.

According to IHS Markit's latest projections, all of the Emerging Europe countries except for Croatia and Bulgaria will converge with the EU average by the end of the forecast period in 2049. Five countries (Czechia, Slovenia, Lithuania, Slovakia and Estonia) will reach the EU average in the first half of the 2030s, while Romania, Latvia, Hungary and Poland will have to wait longer. All the Emerging Europe countries are projected to record faster-than-average GDP growth and a steeper-than-average decline in population.

At the other end of the spectrum, Greece, Italy and Portugal are expected to emerge as the lowest-income countries in the EU by 2049. While Greece and Portugal already stand behind a number of countries in Emerging Europe, Italy is projected to fall behind Czechia by 2021 and Slovakia in 2024.

Our optimism about Emerging Europe stems from the fact that these countries tend to be smaller, more flexible and more reform-oriented than their Western European counterparts. They also have much lower public debt-to-GDP ratios on average: while three countries from the region have debt above the 60%-of-GDP Maastricht limit (Hungary, Slovenia, Croatia), all of them are below the 2018 EU average (at 80%).

Asia Pacific Special Focus

Will Japan-South Korea trade tensions trigger a new trade war?

By Rajiv Biswas
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Even as the US-China trade war and downturn in global electronics sector new orders have hit East Asian exports, opening skirmishes in what could be a new trade confrontation between Japan and South Korea have commenced. The escalating trade tensions between Japan and South Korea have added to downside risks for the APAC trade outlook. South Korea's manufacturing supply chain remains heavily reliant on imports of Japanese intermediate goods, notably for electronics components and chemicals products.

Japan imposes restrictions for some exports to South Korea

Japan's Ministry of Economy, Trade and Industry announced that from 4th July it would restrict exports of fluorinated polyimide, resist and hydrogen fluoride, which are used for semiconductor and display production, and their relevant technologies, to South Korea. The new restriction will require Japanese exporters to obtain licenses to export these products to South Korea, creating significant administrative delays to the export process that could potentially disrupt the flow of these products to South Korea's electronics industry.

The Japanese government has also indicated that, by August, it plans to remove South Korea from a "white list" of 27 countries which receive preferential treatment for trade with Japan. The Japanese cabinet will consider revising legislation to this effect in late July. The implications of being removed from this white list for South Korea are that Japanese exporters may need to obtain permission from the Japanese government for the export of an additional 850 items, which are considered by the Japanese government to be sensitive products.

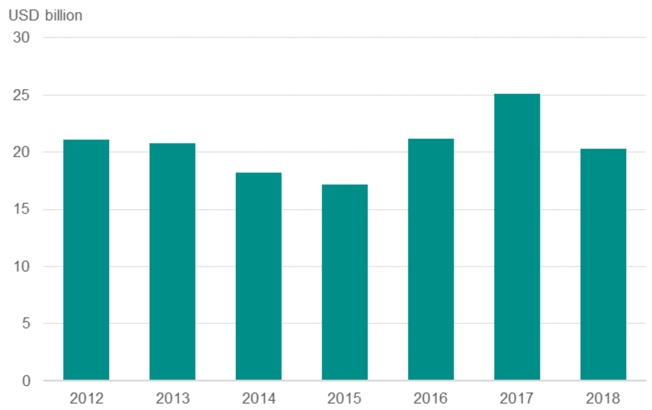
Japan would also be able to restrict exports of any items on national security grounds. The South Korean government is currently considering whether to take the case to the World Trade Organisation (WTO), although it is uncertain that there would be sufficient legal grounds for South Korea to win such a WTO case. The WTO General Council has agreed to discuss the Japan-South Korea trade dispute at its meeting on July 23rd-24th.

Difference between US-China trade dispute and Japan-South Korea trade row

Unlike the US-China trade war, where each side has applied tariffs to imports from the other country, the Japanese government has applied restrictions on some of its own exports to South Korea. Furthermore, in the US-China trade negotiation, the large US bilateral trade deficit with China was a key reason for the US to take trade policy measures to put negotiating pressure on China to reduce the US bilateral trade deficit with China. In contrast, Japan has a long-standing trade surplus with South Korea, which amounted to USD 20.3 billion in 2018.

South Korea is heavily reliant on imports of Japanese intermediate parts and materials for its manufacturing industry, with South Korea having recorded a bilateral trade deficit in parts and materials with Japan amounting to USD 15.1 billion in 2018. The South Korean trade deficit with Japan in parts and materials accounts for around three-quarters of the total bilateral trade deficit. The bilateral trade deficit is particularly large for imports of Japanese electronics parts and materials as well as chemical products. This highlights the vulnerability of South Korea's manufacturing supply chain to Japanese intermediate goods, notably for electronics components and chemicals products.

Japan's merchandise trade surplus with South Korea



Source: JETRO.

Japan-South Korea trade dispute implications

The ongoing trade dispute between Japan and South Korea could have serious consequences to the global semiconductor industry if a resolution cannot be identified in the near term.

According to IHS Markit's Technology division, SK Hynix and Samsung Electronics supplied 61% of memory components in 2018 that are used in a variety of electronics systems. Potentially many electronic devices and systems that employ DRAM and/or NAND flash could face supply allocation challenges if there is any protracted disruption of Japanese exports of key materials to the South Korean semiconductor industry.

South Korean exports of memory chips reached USD 127 billion in 2018, with China and the US being key markets. China imported USD 300 billion of semiconductors in 2018, with South Korea, Taiwan and the US being key suppliers. Since China is heavily reliant on imported semiconductors, its electronics supply chain is vulnerable to disruption of South Korean supplies of memory chips. The US imported USD 54 billion of semiconductors in 2018, with South Korea and Taiwan being key suppliers, even though the US is also a major global producer of chips.

If supply constraints arise in South Korean memory chip production, the price of memory components could significantly increase due to the inability of the other memory suppliers to meet global demand. End products, including servers, mobile handsets, PCs and a variety of consumer electronics would be impacted. Consequently, some US electronics firms, which have large production hubs in either the US and China, are vulnerable to supply shortages of South Korean memory chips, given the importance of South Korea as a supplier of chips to both China and the US.

The South Korean export sector has already seen a sharp contraction in exports during the first half of 2019 due to weak Chinese demand and the downturn in global electronics orders. Any protracted disruption of Japanese exports of the key materials to South Korea could disrupt the global electronics supply chain, since South Korea is a dominant global producer of memory components used in many electronics products.

New manufacturing export orders

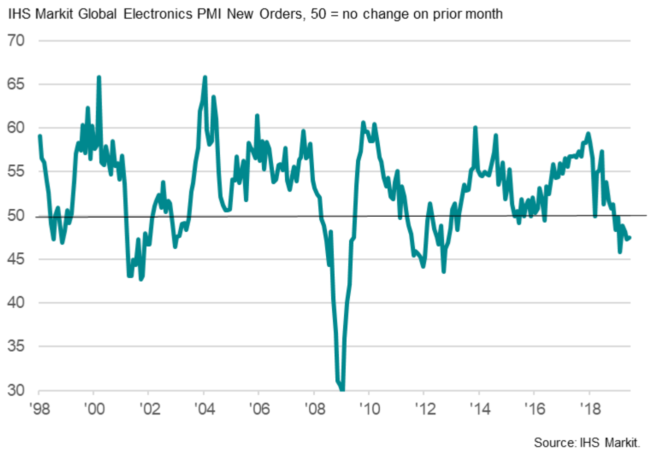
The increased use of trade sanctions as a policy tool by several large economies has been one of the factors contributing to a significant slowdown in world trade and weakening new export orders during past 12 months. Both Japan and South Korea have seen a significant downturn in new export orders in recent months, according to latest IHS Markit manufacturing export orders surveys.

Global electronics sector downturn continues

The latest IHS Markit Global Electronics PMI Survey for June 2019 showed the seventh consecutive monthly contraction in global electronics sector new orders, which has already hit South Korea's electronics export sector hard.

The downturn in the global electronics sector has been an important factor contributing to the weakness of APAC exports during the first half of 2019, with electronics accounting for a significant share of exports for many East Asian economies, including South Korea, Taiwan, Japan, Singapore, Malaysia, Thailand and the Philippines. June data from the IHS Markit Global Electronics PMI survey pointed to the fastest deterioration in operating conditions faced by global electronics manufacturers since November 2012.

IHS Markit Global Electronics PMI



If the bilateral Japan-South Korea trade frictions significantly disrupt South Korea's electronics supply chain, this could be a further negative factor for the global electronics industry outlook.

Trilateral China-Japan-South Korea trade negotiations

The escalating trade frictions between Japan and South Korea could also impede the progress of negotiations for a trilateral free trade agreement between China, Japan and South Korea. The three nations had agreed to accelerate the pace of negotiations in 2018, and a 15th round of talks was held in April 2019. With Japan and South Korea also important players in other Asia-Pacific economic and trade co-operation frameworks, including in the Regional Comprehensive Economic Partnership (RCEP) trade negotiations among 16 APAC nations, the bilateral dispute could also have a negative impact on other regional trade liberalisation initiatives.

Outlook

The use of trade sanctions as a negotiating lever in government-to-government negotiations has escalated over the past two years, with negative repercussions for world trade growth and new export orders. Exports are a key growth engine for many Asian economies, and the shockwaves from increased trade sanctions are having a negative impact on many exporting companies across the APAC region. A larger number of countries are also using trade policy countermeasures in retaliation for trade sanctions against their countries.

Trade disputes and trade sanctions are throwing sand into the wheels of world trade flows, eroding the progress made by decades of trade liberalization under the General Agreement on Tariffs and Trade (GATT) and WTO.

The Japanese trade measures taken against South Korea will add to global trade tensions at a time when Asia's export sector is already facing strong headwinds from the US-China trade dispute as well as the slowdown in global electronics sector new orders.

With both Japan and South Korea suffering from contracting exports during the first half of 2019 due to the impact of the US-China trade war and the global electronics sector downturn, the additional impact of an escalating Japan-South Korea trade row is further bad news for the exporters of both nations.

With public sentiment in South Korea swinging towards some forms of retaliatory measures, such as boycotting the Tokyo Olympics, and some South Korean retail stores already having stopped selling Japanese products, there is a danger that the trade frictions could escalate into a protracted trade war unless some negotiated compromise can be found. An escalating bilateral trade dispute between Japan and South Korea will also endanger regional momentum for further trade liberalization. It is also likely to damage the further progress of negotiations between China, Japan and South Korea towards establishing a new trilateral free trade agreement.

With South Korea having significant vulnerability in its manufacturing supply chain to imports of manufactured parts and materials from Japan, the new export restrictions applied by Japan could create disruption in the South Korean manufacturing supply chain, notably for the electronics and chemicals sectors.

In the medium term, these Japanese government export controls on South Korea are likely to trigger trade diversion effects, as South Korean firms try to reconfigure their global supply chains to reduce their dependency on Japanese inputs and seek alternative supply sources for critical products. This could be damaging in the medium to long term to Japanese exporters, as South Korea may eventually substantially reduce its reliance on imports of Japanese parts and materials for its manufacturing supply chain.