Economic Research

5 August 2019

Week Ahead Economic Preview

Global overview

- **Global services PMI for July, including IHS Markit and ISM US surveys**
- **UK GDP, German industrial updates**
- **Japan GDP, China inflation and trade**
- **Special reports on European growth forecasts and global manufacturing**

With central bankers around the world focusing on the extent to which global economic conditions might necessitate further stimulus, services PMIs will provide an important steer at the start of the third quarter.

While the global factory downturn hit the fiercest since 2012 in July, according to PMI numbers (see page 8), a key question for policymaking is whether services growth will have helped support economies, as had been seen in June. The overall pace of global economic growth remained stuck at a three-year low in June, adding to policymakers' worries.

The Fed responded to the deteriorating economic environment with the first cut to US interest rates for a decade in July, and forthcoming services PMI and ISM data could provide useful steers as to whether weak US growth will have persisted into the third quarter, provoking further cuts later in the year (see page 3).

No change in policy was meanwhile seen at the Bank of England in July, but any signs of a possible UK recession could add to rate cut calls and put further downward pressure on sterling. Official GDP data look likely to show stagnation at best in the second quarter. Services PMI data for July will meanwhile provide an important steer on third quarter UK GDP (page 4).

In the eurozone, final services PMI data are updated alongside key industrial production and trade data for Germany. Germany lies at the heart of the region's recent slowdown and has drawn particular attention at the ECB as it prepares for more stimulus.

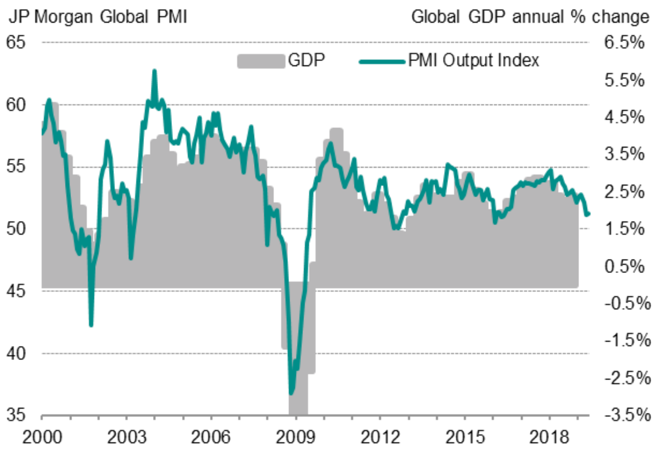
While the Bank of England and ECB have recently revised down their outlooks for growth, our first special report looks at how consensus forecasts for Europe still look overly optimistic (see page 6).

In Asia, central bank meetings in Australia, New Zealand, India, Thailand and the Philippines will be watched for more stimulus, while Japan's GDP update will be of particular interest as the country gears up for a sales tax hike. China and Taiwan inflation and trade data will also be scrutinised alongside services PMIs for the region's largest economies (see page 5).

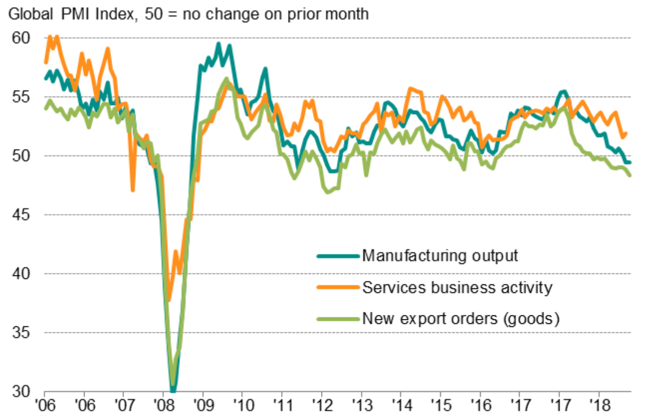
Contents

Special reports

IHS Markit's PMI surveys will be updated to give insight into global economic trends in July. June's data showed global growth stuck at a three-year low



The PMI surveys indicated a deepening manufacturing downturn in July, but services sector will be eyed for signs of ongoing resilience



Source: IHS Markit, Jibun Bank

Key diary events

Monday 5 August

Worldwide releases of IHS Markit services PMI (Jul)
Indonesia GDP (Q2)
US ISM non-manufacturing PMI (Jul)

Tuesday 6 August

Japan household spending, average earnings (Jun)
Philippines inflation (Jul), industrial output (Jun)
Australia trade (Jun)
Australia monetary policy decision
Taiwan inflation (Jul)
Germany Construction PMI (Jul), factory orders (Jun)
US JOLTs job openings (Jun)

Wednesday 7 August

Bank of Japan Summary of Opinions
Philippines trade (Jun)
New Zealand monetary policy decision
India and Thailand interest rate decision
Taiwan trade (Jul)
Germany industrial output (Jun)
UK Halifax house price index (Jul)
Brazil retail sales (Jun)
ECB non-monetary policy meeting

Thursday 8 August

Japan current account (Jun), Eco watchers survey outlook (Jul)
Philippines GDP (Q2), interest rate decision
China trade (Jul)
Brazil inflation (Jul)
US wholesale inventories (Jun)

Friday 9 August

Japan GDP (Prelim, Q2)
RBA statement on monetary policy
China inflation (Jul)
Malaysia industrial output (Jun)
Germany trade (Jun)
UK GDP, business investment (Prelim, Q2)
UK trade balance, industrial output (Jun), NIESR GDP tracker (Jul)
Italy inflation (final, Jul)
US PPI (Jul)
Russia GDP (Prelim, Q2)

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United States Week Ahead

FOMC guidance from PMI surveys and producer prices

By Siân Jones

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Following the hotly anticipated FOMC decision to cut interest rates for the first time in a decade, final service sector PMI and ISM non-manufacturing data will give further guidance on the health of the US economy going into the third quarter, with accompanying implications for future policy action. The calendar also includes producer price and inventory data.

PMIs to help guide FOMC rate path

Upcoming data will help guide the next move from the Fed. The FOMC's July rate cut was described as a "mid-cycle adjustment" and, while the latest statement implied further cuts could take place in 2019, the markets duly noted that the July cut was not seen by Fed chair Powell as the start of an easing cycle. The economic data may need to worsen for any further rate cuts to be in the bag.

Service sector PMI data from IHS Markit and the ISM non-manufacturing survey will therefore provide important steers as to whether the current soft patch remains contained to the goods-producing sector. According to flash PMI data for July, new business rose at a sharper pace as domestic-demand helped faster service sector growth offset a deepening manufacturing downturn. However, the overall rate of GDP growth signalled remained below 2% and optimism about the year ahead slipped to new series lows among both manufacturers and service providers.

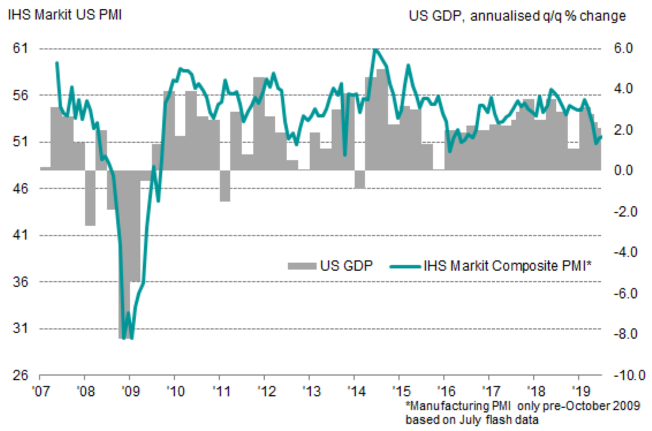
Producer prices

June data saw the slowest annual rise in producer prices since January 2017, as inflationary risks continued to err on the downside despite worries of tariffs. Consensus points towards a similarly muted increase in July (1.7%), with IHS Markit Manufacturing PMI data signalling further downward pressure on costs, consistent with concerns among the FOMC regarding muted long-term inflation expectations.

Wholesale inventories

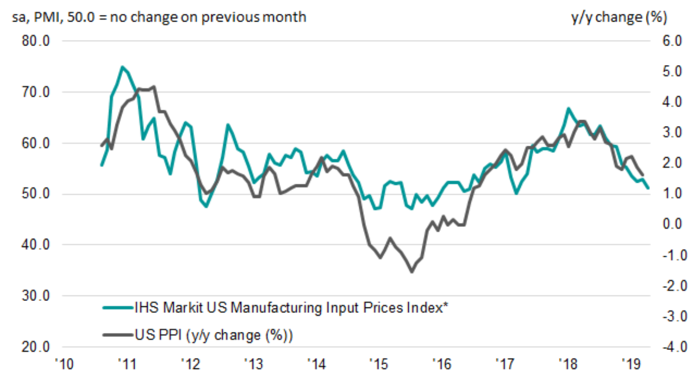
Holdings of durable and non-durable inventories at manufacturers are set to have risen only slightly in July, as ongoing uncertainty and muted client demand provide disincentives to store finished goods. Official exports and factory orders data consequently look prone to weakening when updated on Friday.

Moderated GDP growth set to continue through Q3



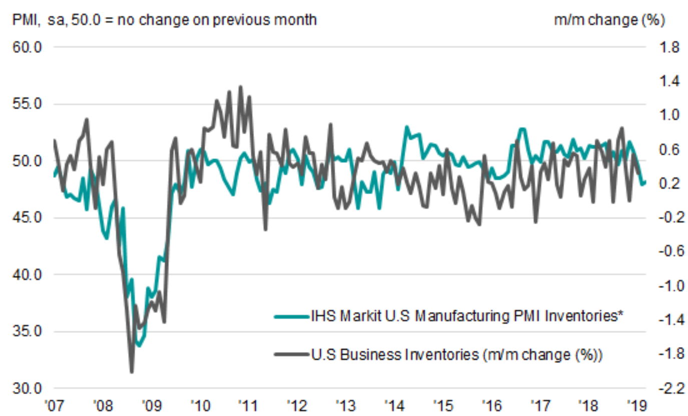
Sources: IHS Markit, Bureau of Economic Analysis.

Producer prices look set to remain subdued



Sources: IHS Markit, U.S. Department of Labour, Bureau of Labour Statistics
*based on flash data

Inventory holdings to pick up only fractionally amid uncertainty



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

Sources: IHS Markit, U.S Census Bureau
*based on July flash data

Europe Week Ahead

July services PMI updates ahead of UK GDP and German industrial data

By Joe Hayes
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Services PMI releases will kick off yet another big week on the European economic calendar. Data coming from the UK will garner most of the attention, however, especially as the PMI is joined by an official second quarter GDP estimate, which could possibly point to contraction. Meanwhile, German industrial data for June will help mould expectations for the second quarter ahead of the official GDP estimate later in August.

We argue that a weakening dataflow in Europe will lead to lower consensus forecasts, which remain too optimistic for both the UK and Eurozone (see page 6).

UK PMI and second quarter GDP

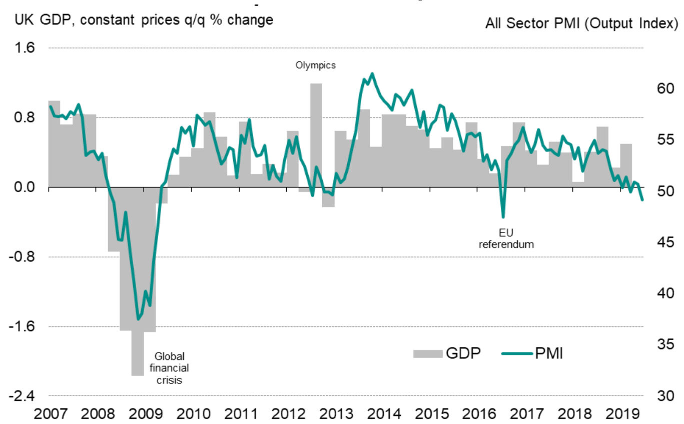
Ahead of the publication of UK second quarter GDP on Friday, PMI data will indicate how the UK's services economy has started the third quarter. GDP is widely expected to have stagnated at best in the second quarter, with PMI surveys pointing to a marginal contraction of 0.1%. Out nowcast model indicates a similar 0.04% decline. More interesting will be the PMI data, as the performance of the vast service sector will be instrumental in determining whether the weak GDP trend has persisted into the third quarter. With sterling already sliding sharply on Brexit worries, disappointing GDP and PMI numbers will likely add momentum to the downward trajectory.

Eurozone PMIs, German factory data

Eurozone service sector PMI data will be eyed for hopes of ongoing resilience to offset the deepening manufacturing downturn. Robust labour market conditions have helped support the domestic economy, but with the flash services readings for the eurozone, Germany and France all dipping, and overall employment growth waning, there is a suggestion that some of this support is being lost.

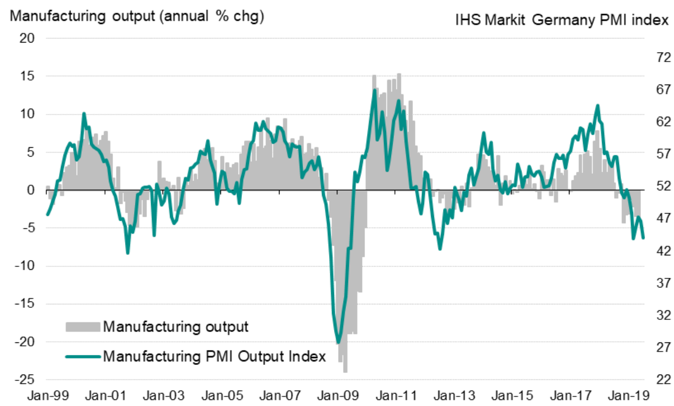
Elsewhere, industrial production and factory orders data are due from Germany for June. Germany will release its GDP data in mid-August, and these data will steer expectations for the euro area's largest economy. Both series are likely to continue to indicate a worrying weakness in Germany's manufacturing sector, which the PMI shows to have been contracting at the steepest rate since 2012 in recent months.

UK PMI and GDP data will both be updated



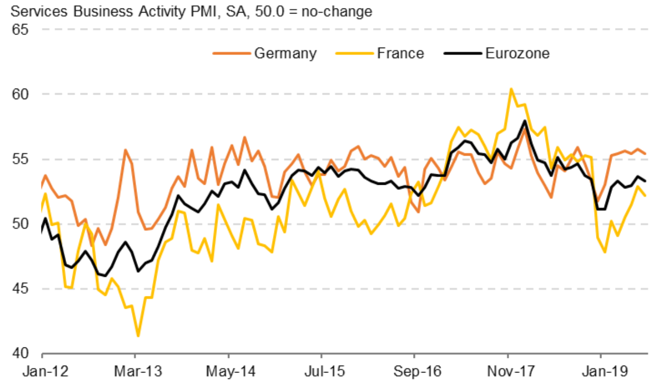
Sources: IHS Markit, CIPS, ONS.

German production data are expected to disappoint



Sources: IHS Markit, FSO.

Service sectors PMIs will be eyed for ongoing resilience



Source: IHS Markit

Third quarter nowcast updates await services PMIs

Our judgement-free nowcast models are based on limited data so far for the third quarter, with the July 'flash' PMIs providing the first real insight into the euro area. However, official GDP estimates for Q2 have started to come in for eurozone countries, so far confirming the signals of easing growth that our Nowcast models foretold. Germany and the UK are the outstanding pair. We expect the UK economy to post a small contraction of 0.04%, while Germany is predicted to have declined by around 0.11%.

Asia Pacific Week Ahead

Central bank meetings, GDP, inflation and trade data

By Bernard Aw

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Next week sees a full diary, including central bank meetings in Australia, New Zealand, India, Thailand and the Philippines, plus GDP releases for several regional countries including Japan. China and Taiwan trade and inflation data will also be scrutinised while services PMI surveys are also in focus.

Monetary policy

With the US Fed having delivered a widely expected rate cut, analysts are monitoring forthcoming monetary policy meetings across Asia Pacific next week. Australia, New Zealand, India and the Philippines have already lowered interest rates in recent months, and may consider doing more easing amid a deepening slowdown in global manufacturing.

Thailand has so far resisted joining the global shift towards looser monetary policy because of concerns over financial stability and rising household debt levels. But significant capital inflow pressures, an economic growth slowdown and a strong baht has intensified pressure on the Bank of Thailand to cut its policy rate to support the economy.

GDP numbers

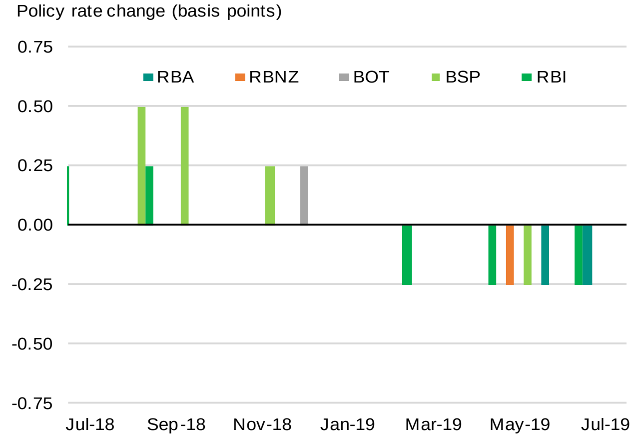
Second quarter GDP numbers in Japan, Indonesia and the Philippines will be released in the coming week. The Japanese economy is likely to have expanded at a slower annual rate of 0.4%, down from 0.9% in the first quarter. The flash July PMI surveys signalled a steady start to the third quarter, though the expansion continued to be reliant on the service sector.

Indonesia's economic growth is also expected to slow, down to 4.9% in the three months ending June, with the economy still facing further challenging conditions in July, as indicated by latest PMI data. Meanwhile, second quarter GDP in the Philippines is expected to have accelerated from 5.6% to an annual rate of 6%.

Trade and inflation

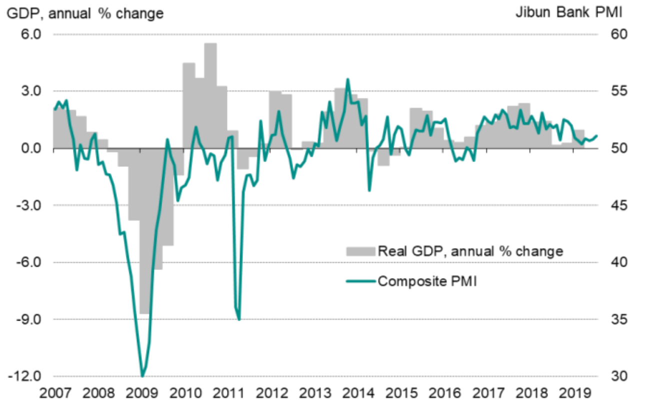
Inflation updates are published in China and Taiwan, as well as trade data. The latter will provide clearer signals of trade war impacts on export growth. Taiwan PMI surveys showed that new export orders continued to shrink sharply in July, while Caixin PMI data pointed to stagnant export sales volumes.

Recent rate changes in regional central banks



Sources: Various central banks

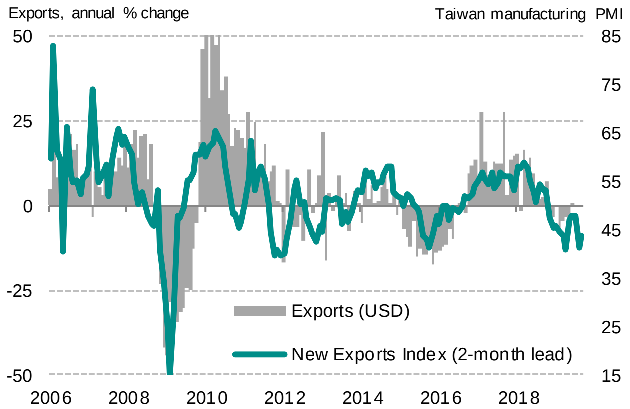
Japan PMI* and economic growth



Sources: Jibun Bank, IHS Markit, Cabinet Office

*Latest PMI is flash July data

Taiwan PMI and export growth



Source: IHS Markit, DGBAS

Europe Special Focus

European growth expectations remain too optimistic

By Ken Wattret
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The initial estimate for second quarter GDP in the eurozone showed a halving of the quarter-on-quarter growth rate versus that seen in the first quarter. Leading indicators suggest the economy will continue to struggle going forward, with increasing spillovers from persistent weakness in the manufacturing sector a prime concern. As with 2018 and 2019's growth rates, we again expect market consensus expectations for 2020 eurozone growth to be surprised to the downside. Consensus expectations for 2020 growth in the UK look particularly deluded. Even if a "no deal" Brexit is averted, which is far from clear, persistent uncertainty is likely to continue to weigh heavily on the UK economy.

Broad-based eurozone slowdown in second quarter

The 0.2% quarter-on-quarter increase in eurozone GDP in the preliminary flash estimate for the second quarter of 2019 was less than half first quarter's pace (0.45%). On a year-on-year basis, the growth rate of 1.1% was the weakest since the fourth quarter of 2013 and way down on mid-2017's 2.8% cycle peak. As always, there will be a frustratingly long delay until a second quarter breakdown is available (6th September). But the high frequency indicators and member states' GDP data currently available point to a broad-based, and persistent, slowdown.

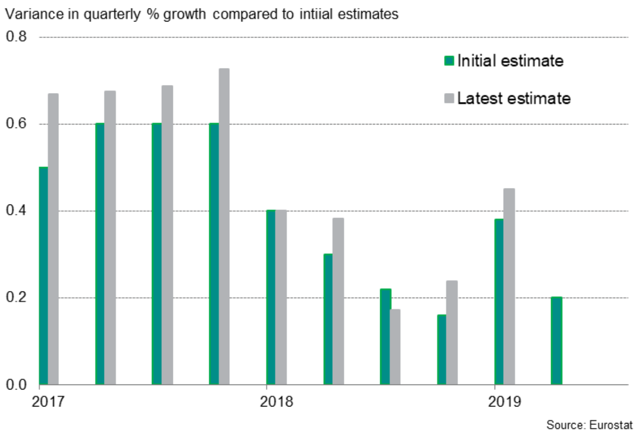
From a sectoral perspective, industrial output is on track to be unchanged quarter-on-quarter in the second quarter (based on figures to May) following an unsustainably robust 0.9% quarter-on-quarter gain in the first quarter. Construction output will decline sharply quarter-on-quarter in the second quarter, again following exceptional strength in the first quarter. Activity in the service sector seems to be holding up comparatively well but has also slowed relative to 2017's peaks.

From the expenditure side, trade data (again available to May) point to a decline in exports though, with imports also on course for a similar drop, net trade is shaping up to be broadly neutral in the second quarter. Business investment has been surprisingly resilient to persistent high levels of uncertainty, though member states' data for the second quarter have been mixed (France robust, Spain weak – albeit after a strong first quarter). Private consumption remains the mainstay of the eurozone expansion, driven by 2%-plus household real income growth. Low inflation will remain supportive (down to just 1.1% according to July's flash HICP data), but the prospects for the labour market are an increasing concern – discussed below.

2019 growth of around 1% baked in the cake, 2020 to disappoint (again)

Given the historic pattern of upward revisions to initial growth estimates for the eurozone (see chart), the second quarter's performance could subsequently turn out to be a bit stronger than it currently appears. At the same time, the second quarter's weakness in construction will likely be followed by a partial rebound in the third quarter, though the latest surveys suggest underlying momentum there is also starting to ebb. The risk to our current forecast of 1.0% annual eurozone growth in 2019 is therefore probably tilted marginally to the upside (our baseline assumes similar quarter-on-quarter growth rates in the second half of the year to that seen in the second quarter.)

Upward revisions to initial eurozone GDP growth estimates



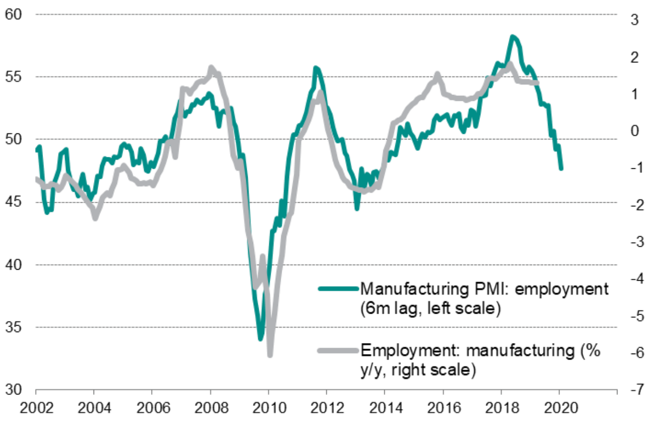
But with 2019's growth rate pretty much baked in the cake already, the prospects for 2020 are more interesting. The market consensus growth expectation for the eurozone in 2020 has been edging down recently, to 1.2% as of July, but this still looks too optimistic in our view. Most forecasters are still clinging onto expectations of an upswing in growth momentum from later this year, driven by assumptions which look increasingly rose-tinted. These include: a relief rebound as Brexit risk dissipates; improving global trade relations as the Trump administration throttles back; and an upswing in global manufacturing activity due to more accommodative monetary policy.

The first two look unlikely any time soon. As for the third, while we have been expecting more policy easing for some while, we continue to have doubts about its effectiveness. See "More ECB policy easing on the way, and soon, but will it make much difference?"

Employment spillovers from manufacturing weakness

In 2018 and 2019, we had forecast downward surprises on eurozone growth relative to consensus expectations and we see a high chance of a repeat in 2020. Leading indicators, including our composite PMI, suggest the eurozone will continue to struggle in the period ahead. While they do not signal an imminent lurch into recession, they suggest that spillovers from persistent weakness in manufacturing activity are likely to build. The recent batch of business surveys for July have again highlighted the likelihood of job losses in the manufacturing sector – the employment sub-index of the manufacturing PMI fell to its weakest level for over six years (see chart) – with spillovers onto household incomes and spending. The lack of growth momentum also leaves the eurozone very vulnerable to adverse shocks, which could easily tip the economy into recession.

Eurozone manufacturing employment to decline



Source: Eurostat, IHS Markit

UK forecasters in denial…

In the UK, we still await the first estimate of second quarter GDP (due 9th August), but the monthly data to May currently suggest no change or even a small quarter-on-quarter decline. Looking further ahead, consensus expectations of a marked pick-up in UK growth in 2020 look particularly out of whack with (political) reality. July's consensus for 2020 growth is 1.3%, but our baseline forecast is half a percentage point lower at 0.8%, even assuming a "no deal" Brexit does not materialise at the end of October. Clearly, the risk of such an outcome has risen given the stance of the new Prime Minister and his cabinet. Still, despite the "do or die" Brexit rhetoric, "no deal" is not a done deal given parliamentary opposition (and the preference of moderate Conservative MPs for a no confidence motion rather than "no deal").

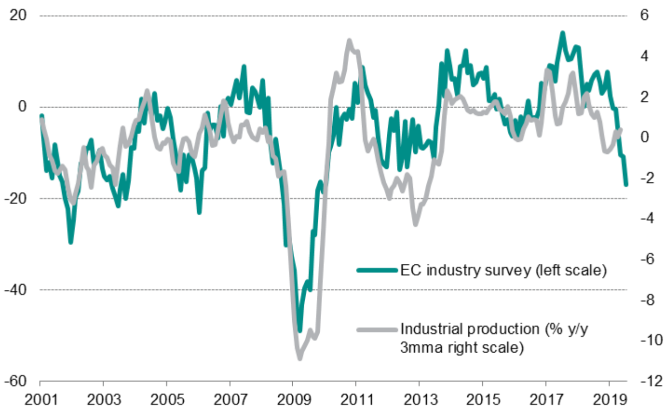
…even if "no deal" is not a done deal

But even if a Brexit shock in October is averted for now, we should expect the UK economy to continue to struggle. For one thing, the uncertainty holding back investment is unlikely to disappear as an election and another Brexit leaving date extension look a more likely way of resolving the current impasse than a renegotiated withdrawal agreement. Also, the recent substantial fall in the pound will lift import prices and inflation, damaging household purchasing power while having little, if any, positive effect on goods exports.

The experience after the referendum was that the weaker pound saw exporters raise their prices rather than boost volumes. Moreover, the external demand backdrop is much less supportive now than in 2016. Indeed, the weakness of demand and alarm over political developments has seen sentiment in the UK manufacturing sector plunge (see chart).

There is also a technical factor which will weigh on 2020's annual growth rate: first quarter 2019's inventory-fuelled jump in UK GDP growth (0.5% quarter-on-quarter) will drop out of the annual comparison in first quarter 2020, leaning down on year-on-year growth. All things considered, therefore, 2020's growth expectations are highly likely to be adjusted downwards as reality bites.

UK industrial sentiment in freefall



Source: Eurostat, EC

Global
Special Focus

Global manufacturing downturn deepens at start of third quarter

By Chris Williamson
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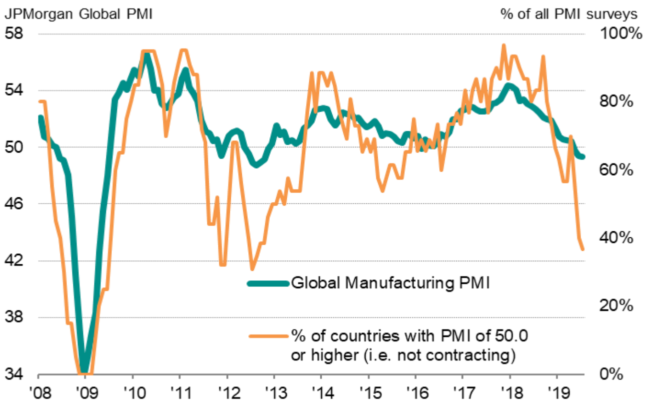
PMI surveys indicated that the global manufacturing downturn deepened in July, causing greater job losses and reducing pricing power, as the downturn widened to encompass more countries.

Deepening rate of decline

The headline **JPMorgan Global Manufacturing PMI**, compiled by IHS Markit, fell from 49.4 in June to 49.3 in July, its lowest since October 2012 and indicating a third successive month of deteriorating business conditions.

The number of countries now in decline has increased to 19 out of 30 covered by IHS Markit's manufacturing PMIs which, at 63%, is the highest proportion since August 2012.

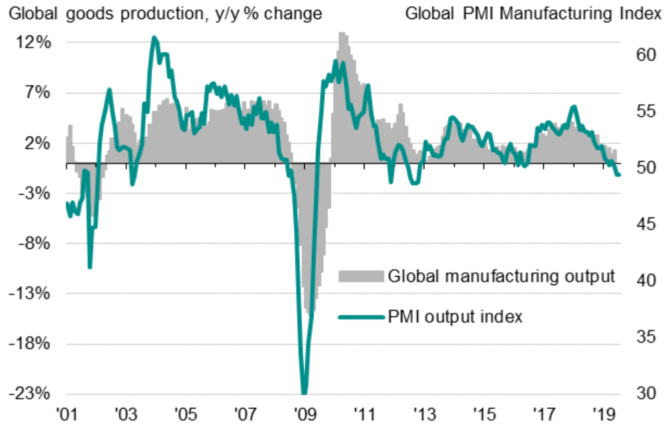
Global manufacturing PMI surveys



Sources: IHS Markit, JPMorgan.

The national surveys collectively indicated that worldwide factory production fell at a rate unchanged on June, dropping for a second successive month in response to the fourth decline in new orders seen over the past five months. The downturn was fuelled by an increased rate of deterioration of worldwide trade flows, with global exports falling to an eleventh consecutive month in July. The latest export decline was the largest since October 2012.

Global manufacturing output



Sources: IHS Markit, JPMorgan, Caixin.

Historical comparisons with official data suggest that the latest drop in the PMI's output index is commensurate with global factory output contracting at an annual rate of just over 1%.

While the rates of decline in output, new orders and exports remained relatively modest compared to that seen ten years ago during height of the global financial crisis, the only other time that the survey has recorded a steeper global manufacturing downturn has been the Asian financial crisis of 1998-1999, the dot-com bubble bursting in 2000-2001 and the European sovereign debt crisis of 2012.

Global manufacturing exports

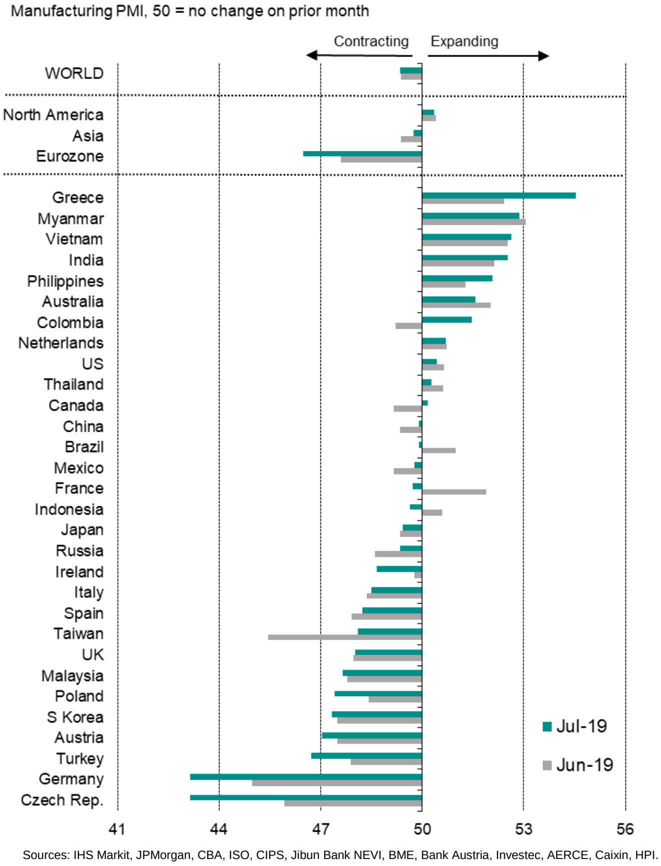
Sources: IHS Markit, CPB Wortld Trade Monitor.

Downturn spreads

The broadening out of the manufacturing malaise was highlighted by almost two-thirds of all surveyed countries reporting a deterioration of manufacturing conditions in July. The countries in decline now include notable names such as China, Japan, Germany, the UK, Spain, Italy, Brazil, Russia, Taiwan, South Korea and Mexico.

Looking at the world's largest economies, the eurozone as a whole reported the steepest decline (led by intensifying weakness in Germany) followed by the UK and then Japan. A marginal decline was seen in China while business conditions more or less stagnated in both the US and Canada, with the US PMI down to its lowest since 2009[1].

Manufacturing PMI rankings



Trade war winners and losers

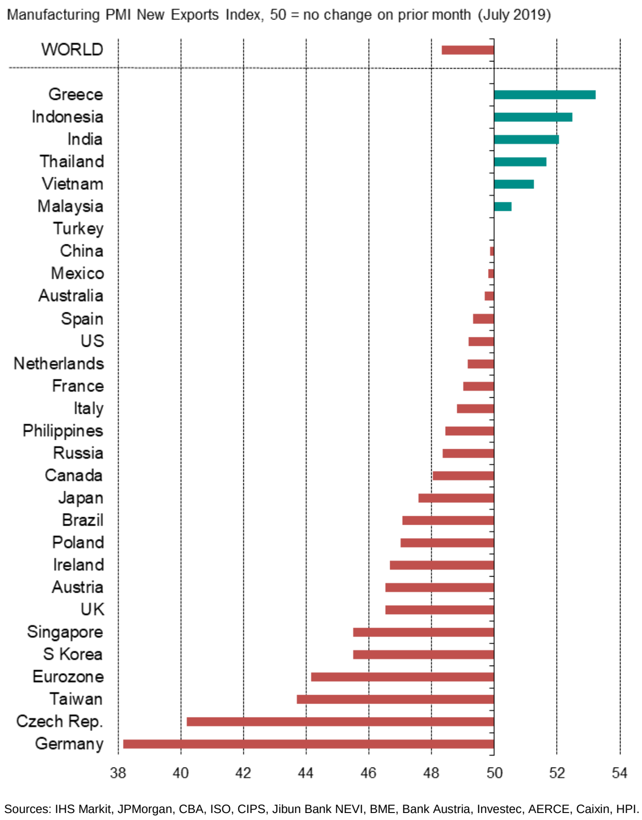
Topping the list of manufacturers' reasons for lost orders and reduced output was trade war tensions, notably between the US and China, followed by geopolitical uncertainty which is often itself linked to trade wars. Other companies merely attributed the downturn to a peaking of economic growth.

Some countries nevertheless continue to buck the global slowdown trend. Greece led the manufacturing rankings in July, albeit building from a low base after production slumped in the decade after the global financial crisis, followed by Myanmar, Vietnam, India and the Philippines. The relative success of some of these Asian manufacturing economies appears to be at least in part attributable to trade diversion arising from the US-China spat.

Looking at export performance in July, only six of the 28 countries for which trade data are available reported a rise in exports. These included Indonesia, India, Thailand, Vietnam and Malaysia. The only non-Asia country reporting higher exports was Greece.

However, other Asian countries saw steep falls in exports, notably Taiwan, South Korea and Singapore, in part reflecting the dominance of electronics in these countries, a sector which has seen output and orders fall especially sharply in recent months (the global electronics PMI fell to its lowest since 2012 in June). The steepest drop in exports was seen in Germany, followed by the Czech Republic.

Manufacturing PMI export rankings



Job cuts accelerate to seven-year high

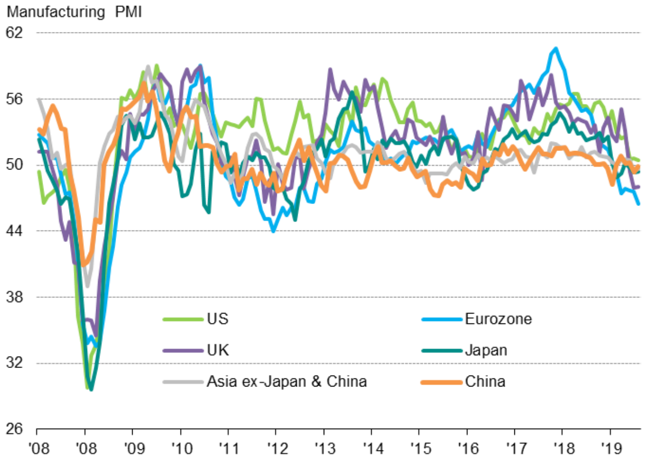
The further deterioration in new order inflows meant firms increasingly relied on previously placed orders to support production. Backlogs of work consequently fell at the fastest rate since November 2012, dropping for a seventh straight month.

Such a sustained decline in backlogs of work typically indicates the development of spare capacity, which commonly results in job losses as companies adjust production volumes lower to meet the reduced demand. Such a situation was indeed seen in July, with the global PMI indicating a third successive monthly decline in factory employment, which fell at the steepest rate for seven years. Notable economies

[1] It should be noted that even the near-50 PMI reading seen in the US in fact translates into a contraction in the official measure of manufacturing output (see our recent US research note and a recent analysis on what a PMI of 50 means for different countries).

reporting a decline in employment included the US, China, the eurozone and the UK.

Manufacturing PMI



Sources: IHS Markit, JPMorgan, CIPS, Caixin,

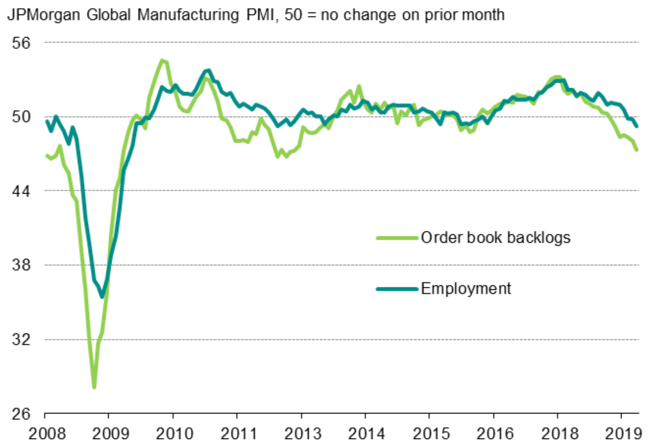
Prices fail to rise for first time in three years

The development of spare capacity was also indicated by a further shortening of average supplier lead-times. Although only marginal over the past two months, recent months have seen the first shift to faster deliveries for the first time in six years as suppliers faced weaker demand. The amount of inputs bought by manufacturers worldwide fell in July at the sharpest rate since September 2012.

The drop in demand for inputs also meant suppliers increasingly offered discounts to shift unsold stock, meaning average input costs rose globally at the slowest rate since prices began rising in April 2016.

Average selling prices at the factory gate meanwhile failed to rise for the first time since August 2016 as manufacturers likewise increasingly competed on price.

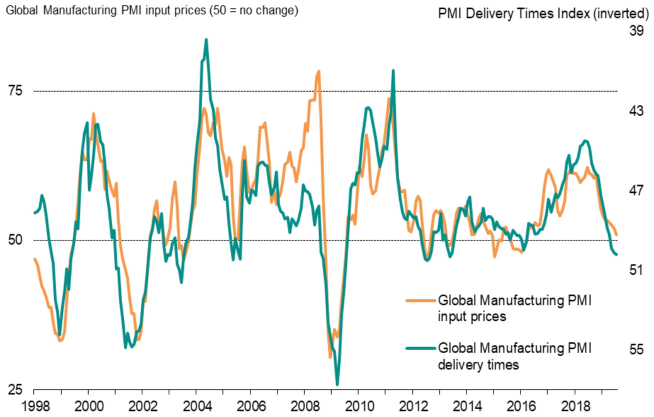
Global factory backlogs of work and employment



Sources: IHS Markit, JPMorgan.

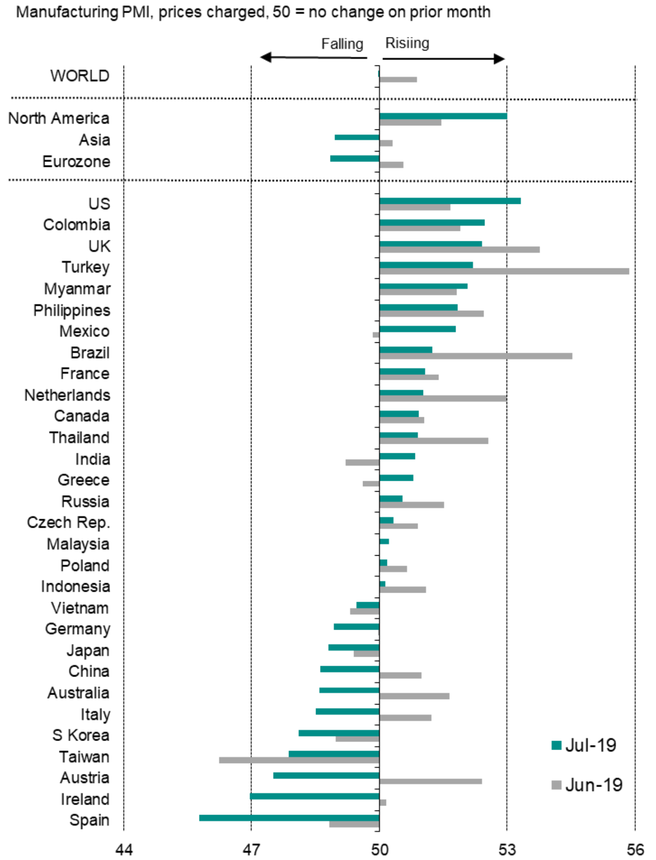
Prices fell in China, Japan and across the rest of Asia as a whole, as well as in the Eurozone. UK prices rose at the slowest rate for three years. In contrast, selling prices rose at an increased rate in the US, rising to a greater extent than any other country surveyed in July.

Global input prices and supply chain delays



Sources: IHS Markit, JPMorgan.

Manufacturing selling prices



Sources: IHS Markit, JPMorgan, CBA, ISO, CIPS, Jibun Bank NEVI, BME, Bank Austria, Investec, AERCE, Caixin, HPI.