IHS Markit

Economic commentary
28/09/2018

Week Ahead Asia-Pacific Economic Preview

- **Worldwide release of IHS Markit PMI surveys to provide growth, trade and inflation trends**
- **Inflation data released across Asia**
- **Australia and India set monetary policy**
- **US non-farm payrolls**
- **Special focus on the impact of higher oil prices**

The coming week sees a worldwide release of IHS Markit PMI surveys, covering both manufacturing and services, which will provide up-to-date insights into global economic activity and price trends at the end of the third quarter. Other data highlights for Asia include inflation data for a number of countries, while Australia and India will decide on monetary policy. China will meanwhile celebrate its Golden Week.

Elsewhere, US nonfarm payrolls and wages data will receive close attention from market participants.

Our special focus this week looks at the impact of higher oil prices on APAC countries, highlighting the most vulnerable as well as those that stand to benefit.

September PMI data eyed for trade impact

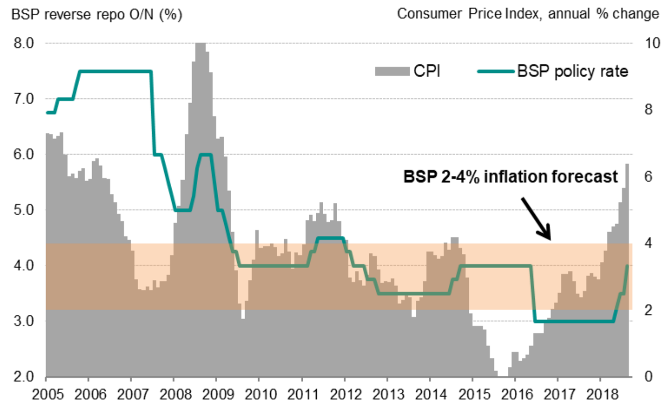
Analysts will keenly monitor the September updates to PMI data for insights into the extent of any negative impact on economic activity brought about by recent trade frictions. Prior data had indicated softer growth momentum across the world, led by near-stagnant global trade flows, with business confidence also hurt by rising trade tensions between the US and its major trade partners, particularly China (read a full overview of last month's PMI data here).

Inflation updates

A number of Asia Pacific countries report inflation numbers, which will provide further clues of price trends amid rising commodity prices, particularly oil.

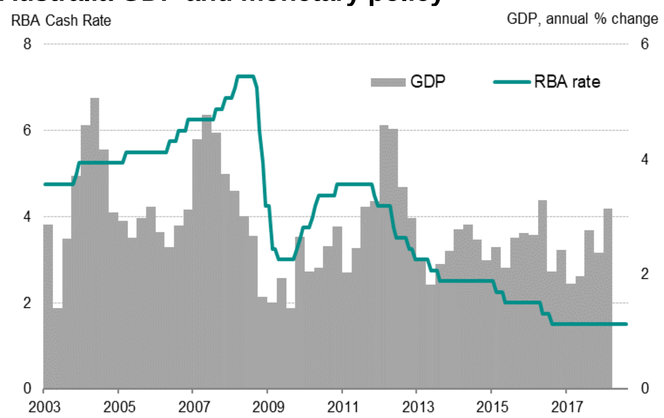
In the Philippines, strong inflationary pressure in recent months had led to a series of rate hikes as the central bank has sought to anchor inflation expectations. The CPI annual rate hit an over nine-year high of 6.4% in August, well above the 2–4% target range. The Bangko Sentral ng Philipinas (BSP) has revised up its consumer inflation forecast from 4.9% to 5.2% for calendar 2018 as it hiked policy rates by 50bps at its Monetary Board meeting on 27th September.

Philippines monetary policy and inflation



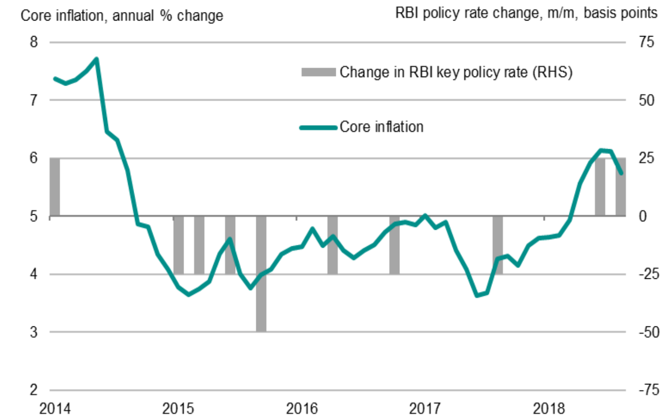
Sources: PSA, BSP

Australia GDP and monetary policy



Sources: IHS Markit, ABS, RBA

India core inflation and monetary policy



Sources: RBI, CSO, IHS Markit calculations

Continued…

As such, updates to the Philippine's CPI will be closely watched. The consensus is for an annual rate of 5.9%. The September PMI update will also provide clues on prices ahead of the official data.

Indonesia, Thailand, South Korea and Taiwan also update their inflation numbers.

Australia policy meeting

The Reserve Bank of Australia decides on interest rates early in the week but is widely expected to keep monetary policy unchanged. The policy statement will also be assessed for insights into the central bank's thinking on the impact of rising trade frictions.

Meanwhile, the CBA PMI surveys indicated a further easing of growth momentum in the Australian economy. September's update to the CBA PMI surveys during the week will meanwhile provide clues to economic growth, hiring and price at the end of the third quarter.

India monetary policy

A strong second quarter GDP growth rate of 8.2% sparked concerns of whether the Indian economy is overheating. Core inflation has risen noticeably since earlier this year. All this had raised expectations that the Reserve Bank of India could tighten monetary policy further at the coming policy meeting. The RBI had already raised interest rates twice from 6.0% to 6.5% since May. Furthermore, the rupee has depreciated nearly 14% against the dollar so far this year, as a number of factors, including dollar strength and rising oil prices, has led to a worrying deterioration in the balance of payments.

US employment report

The week closes with the release of the monthly US employment report, which includes non-farm payroll numbers, the jobless rate and employee earnings, which are all seen as important indicators for Fed rate guidance and hence dollar direction. IHS Markit's PMI employment index points to another solid month of job gains, in excess of 200,000, though it remains uncertain how much the official data may have been affected by storms during the month. The earnings data may therefore be seen by markets as the better guide to the health of the labour market and timing of the next rate hike.

August data showed payrolls up 201,000 and average hourly earnings rising at an annual rate of 2.9%, its highest since April 2009. The jobless rate held at 3.9%, the lowest since the late 1960s.

Monday 1 October

Worldwide IHS Markit manufacturing PMI surveys (Sep)

South Korea business confidence (Oct) and trade (Sep)

Japan Tankan surveys (Q3)

Indonesia and Thailand inflation (Sep)

Germany and Spain retail sales (Aug)

UK consumer credit and mortgage lending (Aug)

Euro area unemployment rate (Aug)

US ISM manufacturing (Sep) and construction spending (Aug)

Tuesday 2 October

Brazil trade balance (Sep)

South Korea industrial production, construction output and retail sales (Aug)

RBA monetary policy meeting

Japan consumer confidence (Sep)

Hong Kong retail sales (Aug)

UK construction PMI

Brazil industrial production (Aug)

Singapore SIPMM manufacturing PMI (Sep)

Wednesday 3 October

Worldwide IHS Markit services PMI and whole economy PMI surveys (Sep)

Australia building permits (Aug)

Turkey inflation (Sep)

Euro area and France retail sales (Aug)

US ADP employment and ISM non-manufacturing (Sep)

Thursday 4 October

Australia trade and new home sales (Aug)

Germany construction PMI (Sep)

US factory orders (Aug)

Friday 5 October

South Korea, Philippines and Taiwan inflation (Sep)

Japan household spending (Aug)

Australia retail sales (Aug)

Malaysia trade (Aug)

India monetary policy decision

Indonesia FX reserves (Sep)

Germany factory orders and PPI (Aug)

UK Halifax house price index (Sep)

Brazil inflation (Sep)

US nonfarm payrolls, wage growth and jobless rate (Sep)

Russia inflation (Sep)

Special Focus

The Economic Impact of Rising Oil Prices on APAC Economies

By Rajiv Biswas, Asia-Pacific Chief Economist, IHS Markit

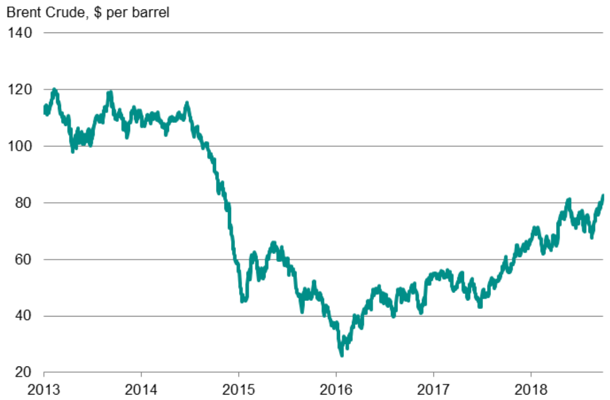
The recent rise in oil prices will benefit energy exporting countries but will exacerbate existing challenges in countries already suffering from higher inflation, depreciating currencies and widening current account deficits. We look at which countries and sectors are seeing the greatest impact

Overview

With US sanctions on Iranian oil due to come into effect in November 2018, world oil prices have risen further in recent weeks. IHS Markit estimates that strictly-enforced US sanctions will reduce Iranian crude exports by around 1.1m b/d between the second quarter of 2018 and the first quarter of 2019. South Korea has already stopped buying Iranian crude, and Japan will cease importing Iranian oil by October. Brent crude hit USD 82 per barrel on 25th September, the highest since November 2014. The long rally in world oil prices since January 2016 has significantly increased the cost of crude oil imports for many Asia oil importing nations.

While the collapse in world oil prices in late 2014 delivered significant improvements in inflation and trade balances for many Asian oil importing nations during 2015 and 2016, these effects have been substantially unwound as world oil prices have gradually recovered.

Brent crude oil price



Source: Datatrseam.

Economic Impact on APAC Economies

World oil prices have risen by around 40% since September 2017, when the oil price was at USD 58 per barrel. This has substantially increasing the cost of oil imports for many Asian developing countries that are heavily dependent on imported oil, including India, Philippines, Sri Lanka, Pakistan and Bangladesh.

To compound this oil price shock, the currencies of many Asian nations, including the Indian rupee and the Indonesian rupiah, have depreciated against the USD during the first three quarters of 2018, adding to the impact of rising oil prices since oil is usually priced in USD terms.

With many Asian emerging markets being net oil importers, the impact of rising oil prices has contributed to worsening current account balances. Higher oil prices have also contributed to rising inflation and creating additional pressure for monetary policy tightening in some Asian economies, including India, Pakistan and the Philippines. However, for Asian economies with current account surpluses and strong external account positions, such as Japan, China, South Korea, Taiwan and Singapore, the impact of rising oil import bills is substantially mitigated.

Energy Exporting Nations

With Asian long-term gas contracts often linked to oil prices, nations such as Australia, Malaysia and Myanmar benefit from rising gas prices due to their large gas exports, helping to boost total exports and fiscal revenue. Australian liquid natural gas (LNG) exports reached 56.8 million tonnes in 2017, up 26% year-on-year due to large new LNG projects coming onstream, as well as the impact of higher LNG prices. Australian LNG exports are expected to rise from AUD 30.8 billion in 2017-18 to AUD 42.4 billion in 2019-2020 due to further volume and price rises, according to estimates made in June by the Australian Government's Department of Industry, Innovation and Science.

The Malaysian economy will meanwhile benefit from higher oil and gas prices in a number of ways, notably through the positive impact on profits of oil and gas industry firms, after several years of painful restructuring and consolidation in the Malaysian oil and gas sector after the protracted slump in world oil prices.

The impact of higher oil and gas prices will also boost Malaysian fiscal revenues, helping the government to achieve its fiscal targets at a critical time, given the incoming government has reformed the indirect taxation system in recent months (which is expected to lower fiscal revenue from indirect taxation).

Malaysian consumers will suffer the impact of higher retail pump prices for petrol, although the impact on

CPI inflation is also mitigated by the significant reduction in inflation pressures due to the removal of the GST tax since June.

Oil Importing Nations

In low income Asian developing countries, oil products often account for a significant weight in wholesale and consumer price inflation baskets, for example due to the importance of fuel as a segment of overall transportation and power costs as well as the widespread use of kerosene as a fuel in low income households in some countries.

A number of Asian oil importing economies have also experienced significant declines in their currencies versus the USD during 2018, reflecting a number of factors, including US Fed tightening, emerging markets contagion following the Turkish economic crisis, and the negative transmission effects of the escalating US-China trade war. This has increased the negative impact of rising world oil prices in local currency terms.

As a result, global investor concern about some major Asian emerging markets with weak external accounts have increased, with the Indian rupee, Indonesian rupiah and Philippines peso being among the weaker Asian currencies versus the USD during 2018. Pakistan and Sri Lanka have also experienced significant currency depreciation due to their external debt problems and weak foreign exchange reserves, among other factors. Consequently, the impact of currency depreciation has compounded the impact of rising world oil prices on their domestic economies when measured in local currency terms.

Energy intensive industries

Among the usual suspects of industry sectors most vulnerable to rising oil prices in the APAC region are the airlines, due to the high weight of jet fuel in their overall cost structure. Rising oil prices will also have a negative impact on profit margins for road transport, shipping transport and logistics firms. Petrol and diesel are important inputs for the road haulage industry. Diesel fuel is also a significant input for agricultural irrigation in some South Asian and Southeast Asian nations, including India and Thailand.

The Asian petrochemicals industry, which saw strong profitability during 2015-17 when oil feedstock prices were low, is also vulnerable to rising oil and gas prices because of their high dependency on imported oil-derived feedstocks. Many Asian chemicals producers may find it hard to pass on higher inputs costs to their buyers, which will put pressure on their profit margins.

South and Southeast Asian Oil Importing Nations

Due to India's high level of dependency on imported oil and gas, which accounted for over 80% of Indian oil consumption in fiscal year 2017-18, a key vulnerability for India is the impact of higher oil prices on the current account deficit.

India's current account deficit as a share of GDP had narrowed significantly in 2015 and 2016, as a result of the slump in world oil prices in late 2014. However, with the rebound in world oil prices during 2017, Indian crude oil imports have risen from USD 70 billion in fiscal year 2016-17 to USD 87.7 billion in fiscal year 2017-18, with the oil import bill set to widen further in 2018-19 to above USD 120 billion.

Indian gasoline demand has meanwhile shown strong growth, rising by just under 8% on a year ago in August. Indian crude oil imports during April to August period of fiscal year 2018-19 have already risen to USD 58.8 billion, up by 54% compared to the same period a year ago. This has been a key factor contributing to India's widening current account deficit, which rose from 0.6% in 2016-17 to 1.9% in 2017-18, and is expected to widen further in 2018-19.

A key risk is from any upturn in CPI inflation pressures due to higher oil prices. The Reserve Bank of India (RBI) had already hiked policy rates in early June, reflecting concerns about rising oil prices and a broader upturn in inflation pressures. Any further near-term tightening of monetary policy would constrain growth momentum.

Pakistan has also faced a widening trade deficit, which has risen from USD 32.5 billion in 2016-17 to USD 37.7 billion in 2017-18, with the impact of currency depreciation contributing to higher oil import costs. The current account deficit widened to USD 18 billion, or 5.7% of GDP in fiscal year 2017-18, up 45% on the previous year. Oil and gas imports rose from USD 10.9 billion in 2016-17 to USD 14.4 billion in 2017-18, with LNG imports up 87% on a year ago and crude oil imports up 66%. With FX reserves at critically low levels and confronted with a heavy external debt burden, Pakistan is still facing a high likelihood of requiring another IMF bailout.

In Bangladesh, rising oil import costs have also contributed to the sharp deterioration of the current account. Rising oil and capital imports have pushed the current account into a deficit of 2.6% of GDP in 2017 following five consecutive years of surpluses, with the current account deficit reaching a record high of USD 10 billion, or 4% of GDP, in 2017-18.

Despite its large LNG exports, Indonesia is a net oil importing nation. Indonesian oil demand growth has been supported by government price controls on 88 RON gasoline, which is priced at a 20% discount to import parity pricing and has sheltered consumers from the significant depreciation of the Indonesian rupiah against the USD during 2018. However, the widening current account deficit and balance of payments deficit in the second quarter of 2018 have been key factors causing rupiah depreciation in recent months, triggering a series of policy rate hikes by the Indonesian central bank, Bank Indonesia, to support the fragile currency. Rising oil prices and the falling rupiah have contributed to the rising oil import bill.

Similarly, the Philippines has also faced rising net oil import costs, which have risen to USD 5.7 billion in the first half of 2018, up 32.8% on a year ago. Rising oil prices are also contributing to higher inflation pressures, with the annual CPI inflation rate rising to 6.4% in August, triggering a further 50bp rate hike by the central bank at its 27th September Monetary Board meeting, following previous rate hikes of a cumulative 100bp since May 2018.

Outlook

The impact of rising oil prices has already resulted in widening current account deficits and rising inflation pressures in some Asian oil importing nations. The impact of rising oil prices has been compounded by currency depreciation in countries with weak external account positions. In an environment of heightened emerging market financial contagion risks, widening current account deficits due to higher oil prices could intensify existing downward pressure on more vulnerable Asian currencies in nations with external account fragilities.

While the ability of most Asian oil importing nations to weather the impact of rising oil prices has been underpinned by strong macroeconomic fundamentals and a favourable regional growth outlook, a downside risk scenario of further significant rises in world oil prices could amplify external account vulnerabilities and inflation risks in a number of major Asian oil-importing emerging markets.

Monitoring oil price fundamentals

As with most commodities, it is often difficult to know if price changes are being driven by demand or supply side factors, or even just speculation. Looking at economic data can help, though most data such as GDP suffer the disadvantage of being published with such a delay that their value is low for traders and analysts looking for real time signals.

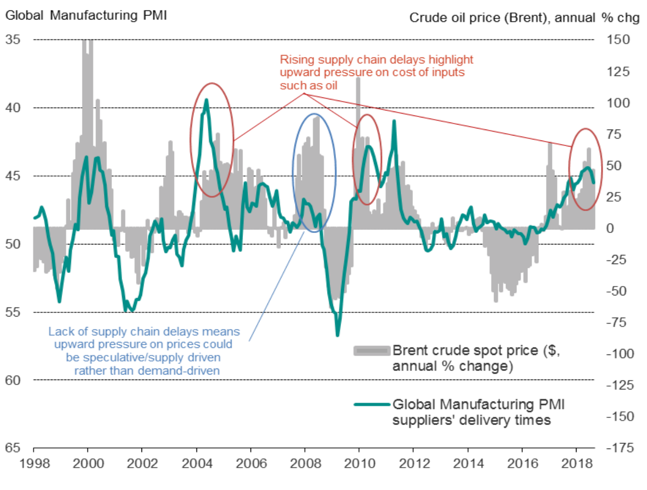
Enter the IHS Markit PMI surveys, which are published at the start of each month with data referring to the month just past. The data are collected from all major developed and emerging markets and include an array of indicators for both manufacturing and services. Indices such as output, new orders, employment and prices are all widely used to gauge changing macro trends such as GDP. However, a lesser used but equally valuable index is the Suppliers' Delivery Times Index, which tracks the extent to which supplier deliveries to factories are changing. Longer deliveries are usually a sign of rising bottlenecks and improved pricing power as demand picks up. Shorter delivery times mean suppliers are less busy and more willing to offer discounts.

The global Suppliers' Delivery Times Index is therefore useful for analysing underlying demand and supply fundamentals, either on a global, regional, national or sector basis. Out chart track the global index against the annual change in crude oil prices, and highlights how periods of lengthening supply chains (i.e. busier factories, as indicated by the line rising in the chart) are usually accompanied by rising prices for commodities such as oil. Periods of faster delivery times (less busy factories with lower demand) generally see prices stabilise or even fall.

The current rise in oil prices can therefore be seen to be supported by rising global demand conditions, as was also the case in 1999, 2003 and after the global financial crisis.

The index also highlights anomalies, such as 2007-8, when oil prices rose to a greater extent than the economic data were indicating the demand fundamentals supported. Such a situation suggests prices could be prone to a correction.

Oil prices and Global PMI supplier delivery times



For more information on the PMI surveys contact economics@ihsmarkit.com.

For further information:

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