IHS Markit

Economic commentary

22/02/2019

Week Ahead Asia-Pacific Economic Preview

- **Manufacturing PMI surveys to provide further insights into worldwide manufacturing slowdown**
- **South Korea trade data and monetary policy**
- **GDP figures in Hong Kong and India**
- **Special report on the impact of Brexit on APAC**

Worldwide release of February manufacturing PMI surveys gives early clues as to the extent of the slowdown in global manufacturing midway through the first quarter. [January PMI data] indicated a spreading manufacturing downturn across the world, pushing the global manufacturing PMI down to the lowest since mid-2016.

In Asia, South Korean trade figures for February will be closely monitored for insights into regional trade performance. The Bank of Korea will also be setting monetary policy while a clutch of economic data in Japan, including capital spending, industrial output and retail sales, should gather interest as well. Hong Kong and India are reporting GDP data. The second US-North Korea Summit will take place in the same week.

Elsewhere, updated GDP estimates in the US and [France] will be watched, alongside preliminary releases of inflation data across the Euro area.

Our special report this week looks at the economic impact of Brexit on Asia Pacific.

February manufacturing PMI data

February manufacturing PMI data will provide important insights into the global economy, coming on the back of disappointing January surveys. The start of 2019 saw the weakest expansion in global growth since September 2016, according to PMI data. Manufacturing led the slowdown, with factory output growth easing to the slowest in just over two-and-a-half years, slipping closer to stagnation amid an increased rate of decline in worldwide export orders. Analysts therefore are monitoring manufacturing trends in Asia and Europe, both of which are showing weakening conditions.

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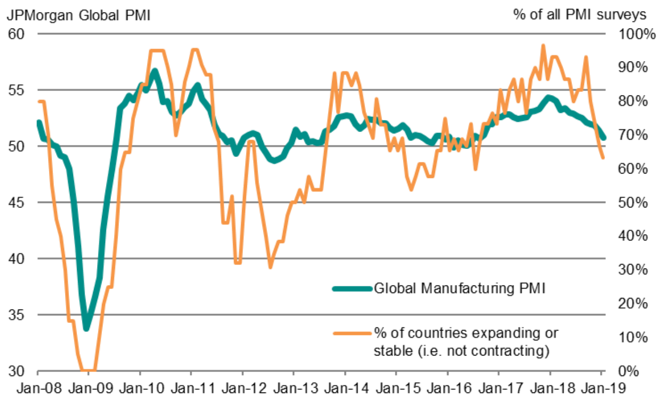
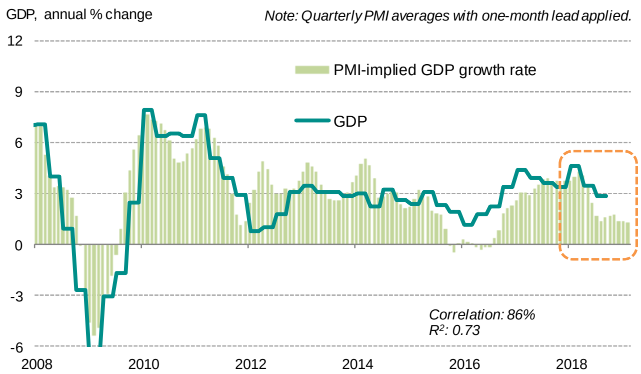
Global manufacturing PMI surveys

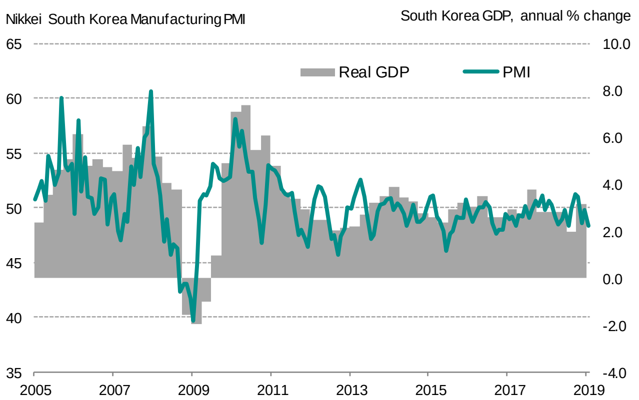


Hong Kong PMI-implied GDP growth rates



Sources: IHS Markit, Nikkei, CSD Hong Kong

South Korea PMI and economic growth



Sources: IHS Markit, Nikkei, BOK

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Hong Kong's slowing growth

Fourth quarter GDP growth in Hong Kong is expected to slow to less than 1.5%, well below the 2.9% in the third quarter, according to Financial Secretary Paul Chan. This is consistent with the projections from PMI-based models, with recent PMI surveys painting an increasingly challenging economic environment for Hong Kong.

Bank of Korea

The Bank of Korea is widely expected to keep interest rates unchanged at its meeting in the coming week. With the Fed taking a more cautious approach towards further rate hikes, the view is that central banks in Asia, including BOK, are also becoming less hawkish from a policy perspective. South Korea's GDP has eased in line with the global slowdown, with PMI data signalling worsening manufacturing conditions at the start of the year, mostly driven by an ongoing decline in export orders. On a related note, the February update to export figures will be closely watched.

Rest of world

The updated estimate to GDP for the US will be closely watched while flash inflation data across the Eurozone will also be in focus. The Eurozone started 2019 on a flat note, setting the scene for the region's worst quarter since 2013, which could lead to more dovish signals from the ECB.

Monday 25 February

Singapore inflation (Jan)

US wholesale inventories (Dec)

Tuesday 26 February

South Korea consumer confidence (Feb)

Singapore industrial production (Jan)

Taiwan industrial production, jobless rate (Jan)

HK trade (Jan)

Germany consumer confidence (Mar)

US building permits, housing starts (Dec)

Wednesday 27 February

South Korea business confidence (Feb)

China industrial profits (YTD, Jan)

Hong Kong GDP (Q4)

Euro area business confidence (Feb)

Spain business confidence (Feb)

Brazil jobless rate (Jan)

US pending home sales (Jan) and factory orders (Dec)

US-North Korea Summit (27-28 Feb)

Thursday 28 February

South Korea industrial production and retail sales (Jan)

Japan industrial production (prelim, Jan), retail sales, housing starts, construction orders (Jan)

Australia private capex (Q4), private sector credit (Jan)

China NBS PMI surveys (Feb)

Bank of Korea monetary policy decision

Vietnam trade balance, industrial output, inflation rate (Feb)

Thailand industrial output, current account, private consumption (Jan)

UK nationwide housing prices (Feb)

France GDP (2^{nd} est, Q4)

Germany, France, Italy and Spain inflation (prelim, Feb)

Brazil and India GDP (Q4)

US GDP, PCE prices (2^{nd} est, Q4)

US wholesale inventories (adv, Jan)

Friday 1 March

Worldwide IHS Markit manufacturing PMI (Feb)

Japan consumer confidence (Feb), capital spending (Q4)

South Korea trade (Feb)

Indonesia and Thailand inflation (Feb)

Germany unemployment rate (Feb)

UK BoE consumer credit, mortgage lending (Jan)

Euro area inflation (flash, Feb), jobless rate (Jan)

Italy GDP (2018), government budget

US PCE price index (Jan), personal income (Dec, Jan), personal spending (Dec), ISM manufacturing PMI (Feb)

Special Focus

Brexit: The Economic Impact on the Asia-Pacific

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

As the Brexit date looms on 29th March, the political and economic uncertainty around the implications of Brexit continue to mount. Asia-Pacific governments and companies are watching the UK political debacle unfold from the sidelines and becoming increasingly concerned about the potential economic impact on their trade and investment with the UK. With the Eurozone economy already slowing, the possible wider transmission effects of Brexit are also a downside risk to the European growth outlook.

Political uncertainty over Brexit

With just over a month to go until the Brexit deadline of 29th March 2019, the UK remains deeply divided politically about leaving the EU. The June 2016 Brexit referendum decision to leave the EU was won with a thin majority, amidst considerable uncertainty about the detailed economic implications.

Since then, it has become increasingly apparent that Brexit will have significant negative economic consequences for the UK economy, whatever Brexit scenario unfolds. The UK Government published its own economic assessment of the long-term economic impact of Brexit in November 2018.

Even by its own analysis, every Brexit scenario resulted in UK GDP being worse over the next 15 years than if the UK remained within the EU. The UK Government's analysis estimates that new trade barriers between the UK and the EU would be expected to result in lower UK-EU trade volumes in the long run in all Brexit scenarios assessed.

Hard Brexit impact

The scenario of Brexit with no deal in place with the EU, known as 'Hard Brexit', remains a possible outcome as the UK is still negotiating exit terms with the EU with only a few weeks remaining before the actual date of Brexit. According to the UK Government's assessment, a Hard Brexit would result in UK GDP being 9.3% lower at the end of 15 years than if the UK remained in the EU. Even the proposed Brexit agreement between the UK and EU which was subsequently rejected by the UK Parliament would have resulted in UK GDP being lower at the end of 15 years than if the UK remained in the EU.

The UK manufacturing sector, which accounts for 8 per cent of economic production, is estimated to be the worst affected industry sector in the no deal scenario, according to the UK Government analysis. Around 48% of UK goods exports and 37% of services exports went to the EU in 2016, highlighting the vulnerability of the UK to trade disruptions with the EU post-Brexit.

The Bank of England's modelling of the UK economy also assesses that the UK would be tipped into a recession in the immediate aftermath of a "disorderly" no deal Brexit scenario, with positive GDP growth not expected to resume until 2023.

According to macroeconomic forecasts prepared by IHS Markit's European economic team, a no-deal scenario would result in a protracted recession for the UK economy from mid-2019 to early 2021. In a Hard Brexit scenario, the UK economy would contract by 0.9% in 2019, 2.4% in 2020, and 0.5% in 2021. By 2026, real GDP would be 9% lower in the no-deal scenario when compared with the September 2018 baseline, which assumes an orderly exit and transition period for the UK.

In the no deal scenario, IHS Markit estimates that sterling would depreciate notably in the immediate aftermath of Brexit without a deal, with markets expecting significant damage to the UK economy. Sterling has lost its safe-haven characteristics since the June 2016 Brexit referendum result.

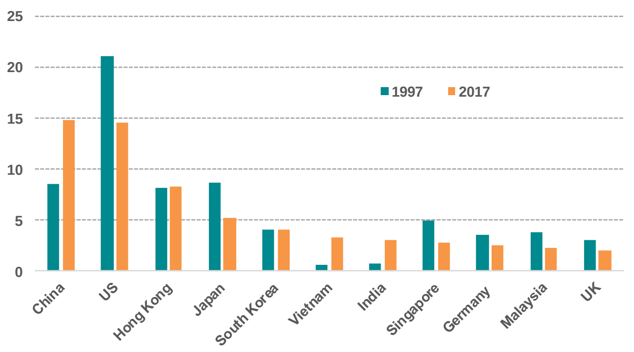
Asia-Pacific trade flows with the UK

The relative importance of the UK as an export market for Asia-Pacific countries has declined over the past three decades, as Asian exports to fast-growing emerging Asian economies such as China and India have risen rapidly.

For the APAC region as a whole, total exports to the UK accounted for only 2% of total exports in 2017, just a fraction of the region's exports to China, which accounted for 14.8% of total APAC exports.

The US accounted for a further 14.6% of total APAC exports, while Japan and South Korea accounted for 5.2% and 4.1% respectively. Even Singapore accounted for a larger share of total APAC exports in 2017 than the UK.

Key markets for APAC exports

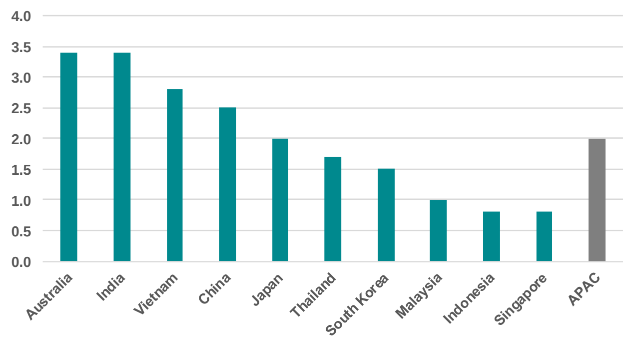


Sources: IHS Markit, World Bank

Therefore, the economic impact of Brexit on APAC economies is relatively marginal in terms of the direct impact on the export sectors of most APAC countries. However, with Eurozone GDP growth already slowing, APAC governments and companies are concerned about the potential further negative shockwaves from Brexit on the EU growth outlook. The uncertainty over the UK's future trading arrangements is also a key concern, as the tariff and other trade rules that will apply to trade between the UK and Asia-Pacific nations are dependent upon the Brexit conditions agreed between the UK and the EU.

A priority for the UK government will be to establish new trade agreements with APAC trade partners after Brexit, since the umbrella EU trade agreements with many other nations that governed UK trade with their nations may no longer apply to the UK, depending on the Brexit agreement terms. Beyond this urgent priority, the UK is likely to seek to negotiate new free trade agreements with many APAC nations. However, the process of negotiating a free trade agreement can be protracted, so it may take some years before the UK can establish a wide network of FTAs with APAC nations to replicate the existing EU FTAs with key Asian nations such as Japan and South Korea as well as new EU FTAs in the ratification process such as with Singapore and Vietnam. The negotiating position of the UK on its own trying to agree such FTA deals with large Asian economies like Japan or South Korea will also be weaker than the EU as a one of the world's largest economic regions with a collective GDP (ex-UK) of around USD 16 trillion.

APAC exports to UK, 2017



Sources: IHS Markit

Impact on Asia-Pacific companies

For APAC exporters, the post-Brexit economic outlook is that the UK will at best be a low growth export market in the medium-term. APAC multinationals with manufacturing operations in the UK will have to reposition their production to adapt to the new post-Brexit tariff environment in relation to the new UK trade arrangements with the EU. For some firms, they may choose to eventually relocate at least some of their UK production to within the EU borders, readjusting their European supply chain in order to benefit from the EU internal free market for trade as well as free movement of labour. In the event of a Hard Brexit, expectations of a protracted UK recession will create an even more negative outlook for the UK as an export market.

Japan's Brexit Exodus: Auf Wiedersehen and Adieu

Decisions made in early 2019 by Japanese auto manufacturing companies with auto production in the UK have been an important signal of the rising concerns of Asian companies operating in the UK. Nissan's decision on 4th February 2019 to cancel plans to build the new model X-Trail SUV at its Sunderland plant created shockwaves in the UK. This was followed by the announcement on 19th February 2019 that Honda would close its UK auto plant in Swindon in 2021, resulting in the loss of an estimated 3,500 direct jobs with indirect job losses also expected to be significant within its UK supply chain. Honda currently manufactures 160,000 Honda Civics per year at its Swindon plant, with 90% of production exported to the EU and US.

Japanese auto manufacturers produce around 800,000 vehicles annually in the UK, amounting to around half of total UK production. Although these decisions were ostensibly not due to Brexit, and other factors such as the new Japan-EU Economic Partnership Agreement played a role, the timing of the announcements conveys its own message.

Meanwhile Japanese electronics manufacturers Panasonic and Sony have both decided to move their European headquarters from the UK to the Netherlands.

APAC financial services firms are also repositioning their EU operations to adapt to the post-Brexit world. The legal consequence of Brexit is that non-EU financial service providers that have been using the UK as their EU operational headquarters for doing business throughout the EU will lose their EU passporting rights after Brexit. These firms must therefore must establish new operational headquarters for their EU business within the EU.

From 2019, Nomura Financial Products Europe will be headquartered in Frankfurt, while Daiwa Securities have established a new subsidiary called Daiwa Capital Markets Deutschland GmbH (DCMD) so that Daiwa can continue to provide a full service to its EU-based clients post-Brexit. Mitsubishi UFJ Financial Group (MUFG) has set up a new subsidiary in Amsterdam, which will be the new home of its European HQ for corporate and retail banking.

Japanese Firms Brexit to New European HQs

Company	Brexit to new EU HQ
Panasonic	Amsterdam
Sony	Amsterdam
Nomura	Frankfurt
Daiwa Securities	Frankfurt
MUFG	Amsterdam
Norinchukin Bank	Amsterdam
Sumitomo Mitsui	Frankfurt

The Outlook Beyond Brexit

The medium-term economic outlook for the UK following Brexit is for a protracted period of weak economic growth even if a Brexit deal with the EU is secured. In the event of a Hard Brexit, the UK is expected to enter a protracted recession. This will create an adverse medium-term trade outlook for APAC firms exporting to the UK.

The political and economic uncertainty clouding the UK is also unlikely to end after Brexit. The medium-term implications of Brexit for the UK still contain political risks. In Scotland, the Scottish National Party is still seeking an opportunity to hold another referendum on Scottish independence. A large proportion (45%) of Scottish voters voted in favour of Scottish independence in the Scottish referendum in 2014 and a large majority of Scottish voters (62%) also voted to stay in the EU in the Brexit referendum.

Faced with considerable uncertainties about the UK political and economic outlook, as well as imminent disruption to the rules governing trade flows, there is a growing momentum among APAC firms to ‘Brexit’ out of the UK and relocate their European headquarters to other major cities within the EU.

For further information:

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