Week Ahead Economic Preview

Global overview

- Jackson Hole and G7 summit
- Flash PMI surveys for the US, Eurozone, Japan and Australia
- Meeting minutes from FOMC, RBA and RBI
- Japan trade and inflation update
- Special report on German recession risk

Increasing uncertainty over the outlook of US monetary policy and heightened fears of potential economic recessions rattled financial markets around the world, meaning that the Jackson Hole symposium and G7 summit next week will take on particular significance with investors seeking updated thinking from policymakers.

These multilateral meetings follow PMI surveys showing global growth remaining among the weakest seen over the past three years, with the worldwide outlook becoming increasingly gloomy. The week also sees important updates of forward-looking data which will be useful in assessing whether the global slowdown has persisted midway through the third quarter, thereby raising recession risks that would cue further central bank stimulus around the world. Flash August PMI numbers for the US, Eurozone, Australia and Japan are released. Our special report this week looks at the recession risks facing the German economy (page 6).

In the US, the Jackson Hole symposium and flash PMI data will take centre stage, but FOMC minutes for July's meeting that saw the first rate cut since 2008 will also be scrutinised for clarity on the future direction of US monetary policy (page 3).

With rising expectations of ECB stimulus, the account of July's policy meeting may give some signals about the scale of anticipated monetary support. August's flash PMI data will also be closely watched. The release of final inflation estimates is also likely to lend support to the case for greater monetary support (page 4).

In Asia, the PMI and trade data will be scoured for signs of trade war impact amid growing tensions between Japan and South Korea. Given the wave of monetary easing, Asian watchers will monitor Bank Indonesia's policy meeting as well as minutes from latest central bank meetings in Australia and India (page 5).

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Special reports

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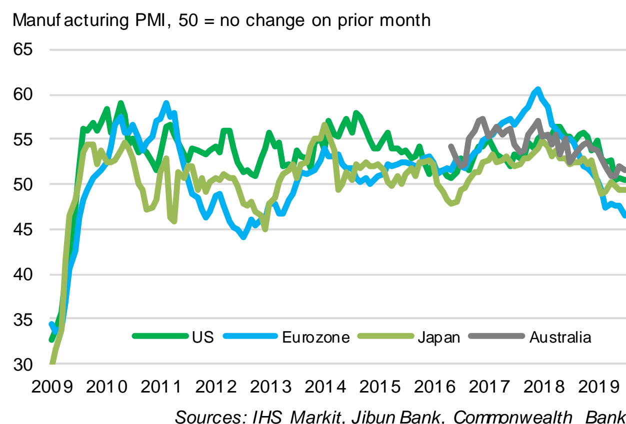
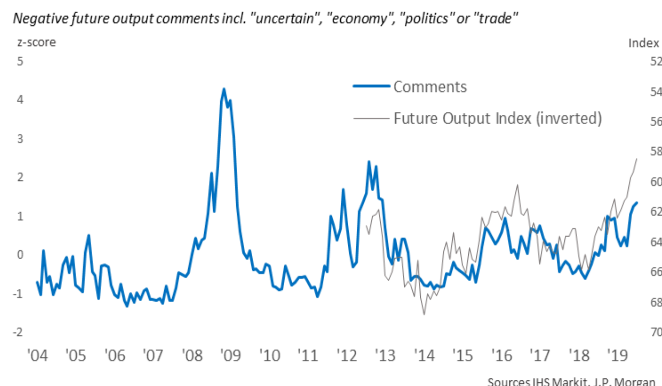
Flash PMI surveys are updated and will provide the first insights into third quarter trends for some of the world's largest economies



PMI survey comments show mounting global pessimism as economic, political and trade worries intensify



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Key diary events

Monday 19 August

Japan trade (Jul)
Thailand GDP (Q2)
Hong Kong unemployment rate (Jul)
Euro area inflation (final, Jul), current account (Jun)
UK Household Finance Index (Jul)

Tuesday 20 August

RBA meeting minutes (6 Aug)
Taiwan export orders (Jul), current account (Q2)
Euro area construction output (Jun)
Brazil business confidence (Aug)

Wednesday 21 August

Thailand trade (Jul)
RBI meeting minutes (5-7 Aug)
US existing home sales (Jul)

Thursday 22 August

Jackson Hole symposium (22-24 Aug)
Flash PMI for Australia, Japan, Eurozone, US (Aug)
FOMC minutes (30-31 July)
Australia construction work done (Q2)
Indonesia interest rate decision
ECB monetary policy accounts
Euro area consumer confidence (flash, Aug)
US Kansas Fed manufacturing index (Aug)

Friday 23 August

New Zealand retail sales (Q2)
Japan inflation (Jul)
Singapore inflation (Jul)
Taiwan industrial production, retail sales (Jul)
US new home sales (Jul)

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United States Week Ahead

Jackson Hole, flash PMI, FOMC minutes to give clues of future Fed policy

By Siân Jones

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The annual Jackson Hole symposium next week will be assessed for updated Fed thinking over prospects for future US monetary policy, alongside US flash PMI surveys that will shed light on progress across the US economy midway through the third quarter. Other key data highlights include housing data.

Jackson Hole and FOMC minutes

The lack of communication from Fed policymakers since the last FOMC meeting and press conference saw growing uncertainty about the outlook of US monetary policy, which was reflected in the bond markets and interest rate futures. With no more Fed officials scheduled to speak for the rest of August, market participants will look to the annual Jackson Hole symposium (22-24 Aug) for guidance on future policy action. The key question is whether the Fed should wait to assess the impact of July's rate cut and recent financial developments on the broader economic outlook before considering more aggressive policy adjustments.

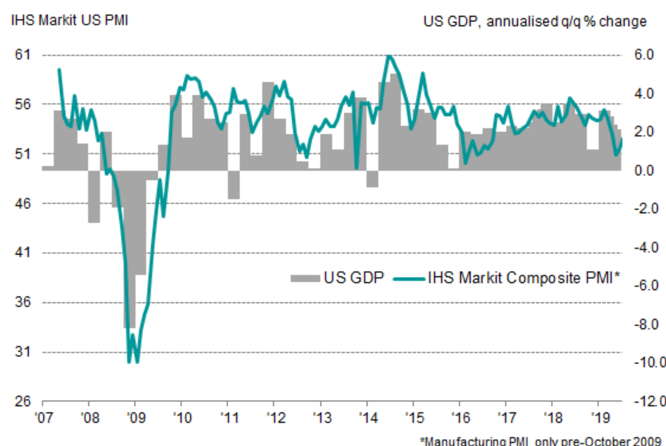
Part of the answer to this question will come from the release of minutes from July's FOMC, which will also offer clues as to the potential for further rate cuts. Our view is that the Fed will remain on hold at upcoming policy meetings, including in September, although this base outlook could change in the face of a culmination of risk factors, including increased market volatility, further global economic weakness and lower inflation.

Flash PMI

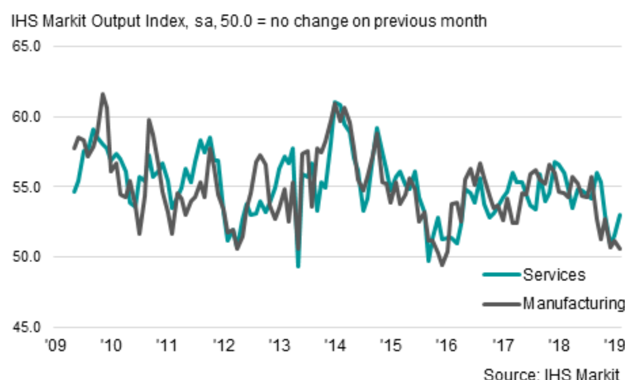
In this regard, Fed watchers will closely monitor the flash August US PMI (compiled by IHS Markit) for an updated view of the strength of US economic growth in the third quarter. PMI surveys for July hinted that US economic expansion could remain relatively lacklustre as companies grew increasingly cautious about the longer-term outlook amid trade war worries and wider geopolitical jitters. The survey also signalled a renewed divergence between US manufacturing and services sectors.

Also featured on the upcoming release calendar is data on home sales, jobless claims and regional business surveys including the Kansas Fed Manufacturing Indexes.

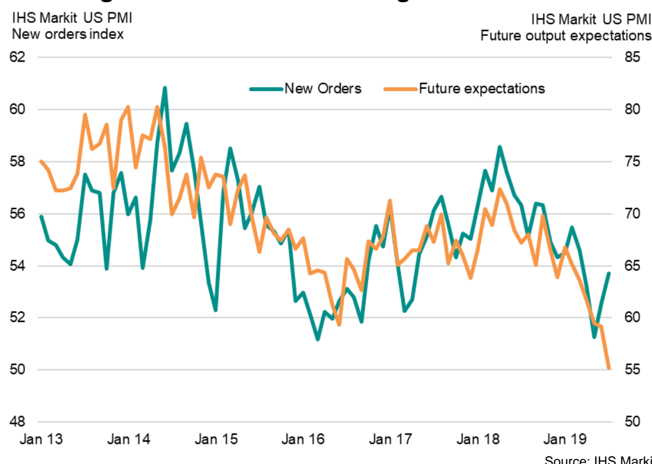
US service sector supports further economic growth



PMI points to renewed manufacturing-services divide



Mixed signals from forward-looking indicators



Economic Research

19 August 2019

Europe Week Ahead

ECB monetary policy accounts and PMI eyed for monetary stimulus odds

By Joe Hayes

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The account of July's ECB policy meeting should support our expectation that another package of stimulus measures will be announced in September. The flash August PMI will provide important clues as to whether the current growth slowdown in the euro area has extended into the third quarter. July inflation numbers will be closely watched for further justification for looser policy. June construction output and current account data will also gather some interest.

Flash PMI surveys

ECB watchers will be eagerly anticipating the flash PMI surveys for further signs of economic weakness after the July PMI data indicated one of the weakest expansions seen over the past six years amid a deepening manufacturing downturn. Economic growth remains driven by the service sector amid growing headwinds to manufacturers such as Brexit, escalating trade frictions and softer global growth.

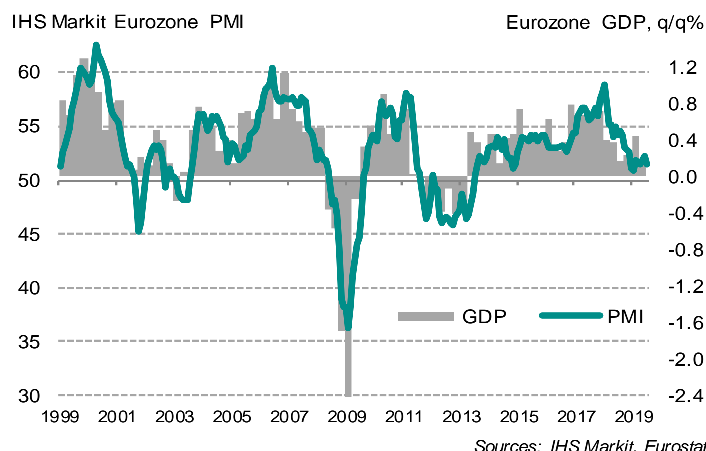
Driving expansion in the service sector has been robust consumer spending, supported by resilient labour market conditions, but latest PMI surveys indicated the weakest gain in jobs across the euro area for over three years, calling into question as to how long the service sector can sustain growth in the absence of an expanding manufacturing sector.

Overall, July data are consistent with the Eurozone economy expanding at a quarterly rate closer to 0.1%. Further weakness signalled by the August PMI would raise the likelihood of a sustained loss of growth momentum in the third quarter.

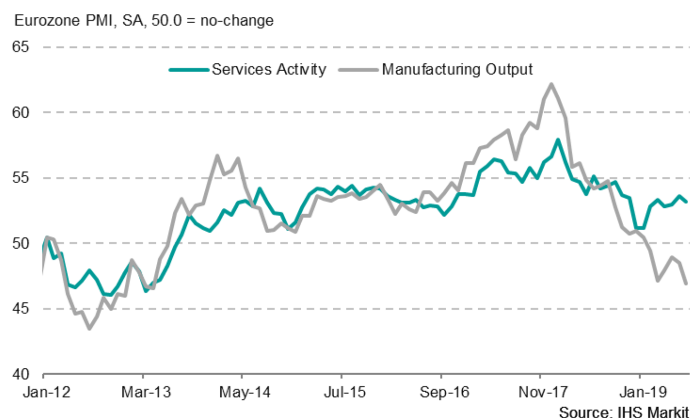
Low inflation boosts ECB stimulus odds

With core inflation stuck at around 1%, there are strong grounds for additional policy stimulus. The low inflation environment is also highlighted by PMI data (see chart). Final HICP data for July are likely to confirm subdued price pressures, adding to the case for policy action.

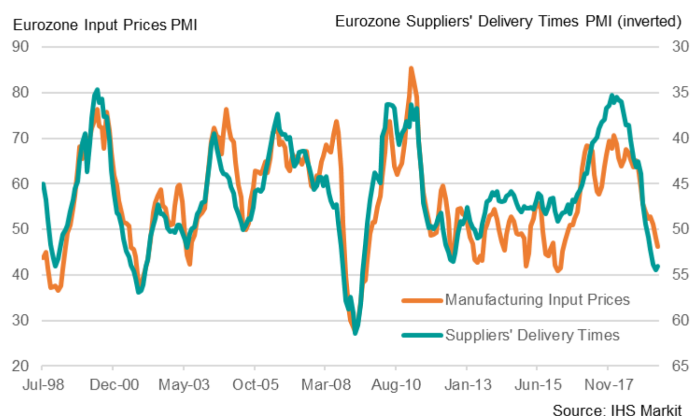
IHS Markit Eurozone PMI and GDP



Widening divergence between manufacturing and services



Price pressures across the euro area are weak



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Asia Pacific Week Ahead

Flash PMIs, Asia trade data, Thai GDP and Bank Indonesia

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With growing anxiety about the state of the global economy amid rising growth headwinds, insights into third quarter economic trends and trade developments will come from next week's flash August PMI updates for major economies, including Australia and Japan. Trade figures from Japan, Taiwan and Thailand will also provide an up-to-date view of regional trade conditions, with a picture of continued export weakness expected. Thailand will publish second quarter GDP data while Indonesia sets its monetary policy. The release of central bank meeting minutes in Australia and India should also offer clues on the timing of future policy action.

Flash PMIs

With signs of a darkening economic outlook for Japan in the run-up to October sales tax hike, eyes will be on the flash August update to PMI surveys, which covers both manufacturing and services. In recent months, growth has been fuelled by the service sector, which is highly reliant on the strength of domestic demand. Meanwhile, flash Australia PMI surveys will indicate if the loss of momentum in the Australian economy during July persisted in the middle of the third quarter.

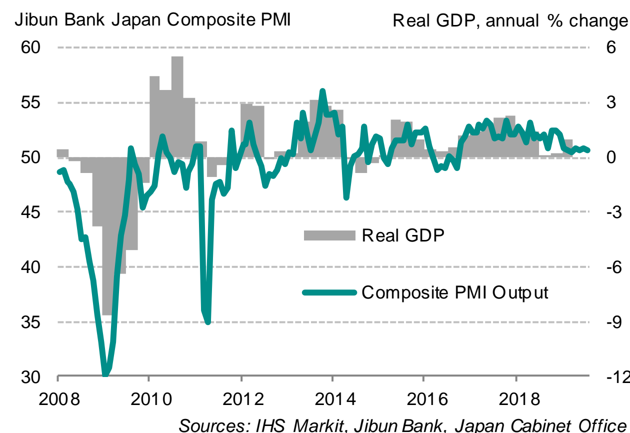
Thailand GDP and Asia trade

Thailand's economic growth is likely to have picked up slightly to 2.9% in the second quarter, up from 2.8% in the opening quarter of 2019, according to our forecast. The average PMI reading for the second quarter was also higher than in the first, although the July data suggest a softening of manufacturing growth. Meanwhile, the July update for Thailand's trade figures will be assessed for signs that further monetary support is needed following a surprise rate cut in early August. Elsewhere, trade data from Japan and Taiwan will give additional insight into Asia's export climate.

Central banks

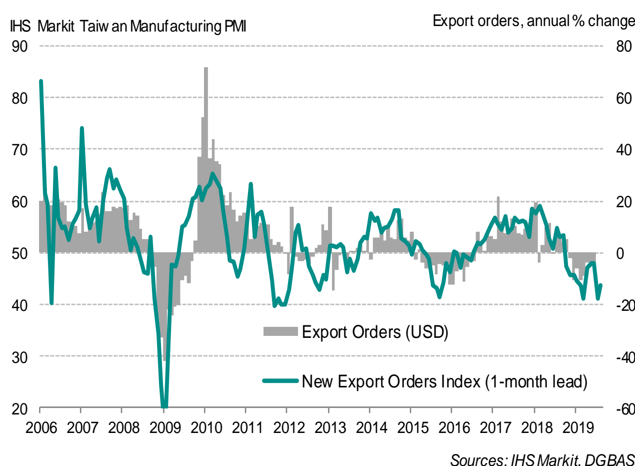
Indonesia will decide on monetary policy, with expectations of no change in rates. Monetary policy meeting minutes for Australia and India are to be published, with analysts parsing the latter for reasons behind the larger-than-expected rate cut and clues on the likelihood of further stimulus.

Japan PMI and economic growth



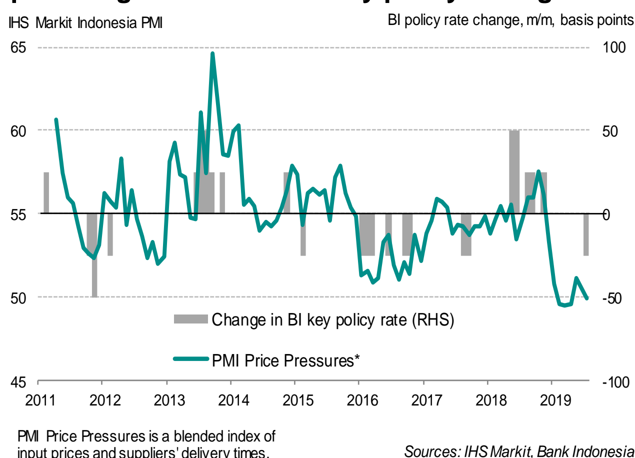
Sources: IHS Markit, Jibun Bank, Japan Cabinet Office

Taiwan PMI points to continued export weakness



Sources: IHS Markit, DGBAS

Indonesia PMI shows low inflationary pressure providing room for monetary policy easing



PMI Price Pressures is a blended index of input prices and suppliers' delivery times.

Sources: IHS Markit, Bank Indonesia

Europe Special Focus

German recession risk revisited

By Ken Wattret

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German GDP contracted on a q/q basis in Q2, albeit marginally. With June's plunge in industrial production implying a weak carry over for Q3 growth, the chances of a "technical" recession have increased. We assume in our baseline forecast that it will be avoided, but only just, with domestic demand proving relatively resilient to date. As the weakness in the industrial sector is set to continue, recession risks are going to persist.

Back in the red

Following June's exceptionally weak industrial production figures, the market consensus expectation for German Q2 GDP had shifted to a 0.1% q/q decline. In the event, the preliminary release matched this expectation (-0.07% to two decimal places), with GDP contracting for the second time in four quarters. While there were modest upward revisions to the data for the second half of last year, the y/y rate of growth slipped to just 0.4% in Q2, a six-year low.

Even if the economy can avoid further q/q contractions in the next couple of quarters, which is by no means certain, the annual growth rate in 2019 will be around 0.5% (our forecast is 0.6%). This would compare to a cycle high of 2.8% in 2017 and average annual growth of just over 2% from 2014-18. Our updated forecast for 2020, at just 0.8%, is over half a percentage point below July's consensus expectation.

Trading difficulties

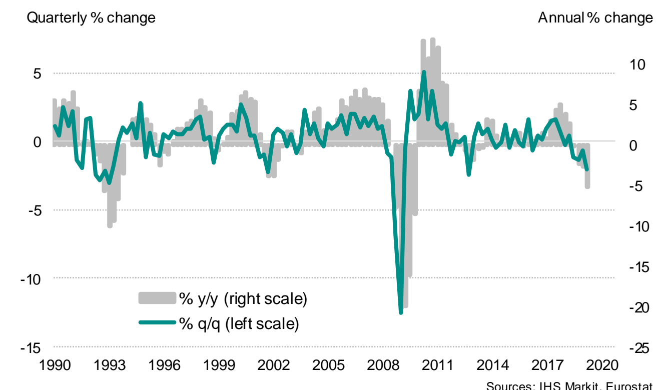
In line with the normal practice, an expenditure breakdown did not accompany the preliminary GDP release (this will follow on 27 August). While this constrains our ability to analyse fully the economy's evolution and probable path for the subsequent quarter(s), there were the usual hints from the statistical office which provide a few helpful pointers, along with the higher frequency surveys and "hard" data.

From the expenditure side, net trade was again the main drag on growth in Q2, with exports declining faster than imports on a q/q basis. Germany's openness to trade – exports are around 50% of GDP – means that the economy is highly vulnerable to deteriorating external demand even when the domestic fundamentals look rather positive (as now).

Industry in the mire

From the output side, the industrial sector is in the midst of a major slump. Production fell by almost 2% q/q in Q2, the fourth consecutive decline and the biggest contraction since the depths of the eurozone crisis in Q4 2012. The severity of the global financial crisis-induced collapse in the late 2000s makes every other contraction in industrial production look like a non-event (see chart).

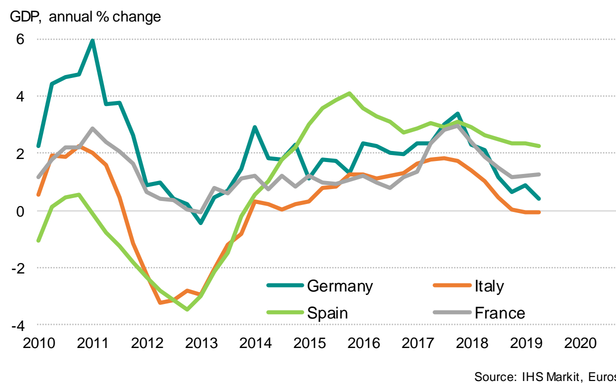
German industrial sector already in deep recession



But make no mistake this is already a severe downturn by any comparable standard. As of June, the cumulative output loss since the industrial cycle peaked in late 2017 was in excess of six percentage points and leading indicators for the sector point to more of the same in the period ahead. It is shaping up to be somewhere between the early 1990s' experience (when production declined by around 15% from peak to trough) and the early 2000s (a 5% decline). In both periods, GDP contracted markedly, albeit in very different circumstances from now.

As we highlighted previously – see When will the German manufacturing sector recover? from 24 June 2019 - the comparatively high share of industrial value added in German GDP (around 23%) is a key issue. This is roughly twice the equivalent ratio for France which has been much less affected by the recent downturn (see chart).

Germany hit comparatively hard since 2017



Source: IHS Markit, Eurostat

The type of goods produced in Germany is also relevant. Weaker investment in China and high uncertainty globally is hitting output of capital goods, while the German auto sector is really struggling (around three quarters of production is for overseas markets). The downturn in the auto sector in 2018 was exacerbated by backlogs caused by more stringent emissions testing but the absence of a rebound since highlights much deeper problems at play (including a structural shift towards electric vehicles). As of June, German auto output had fallen by around 15% versus its late 2017 peak.

Domestic demand holding up, so far

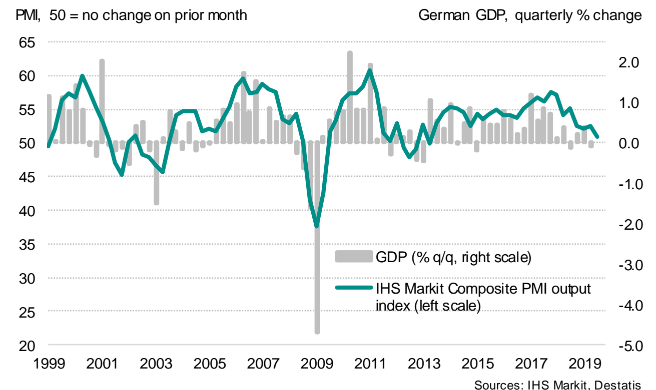
Despite this negative backdrop, the qualitative assessment for Q2 domestic demand provided by the statistics office was, at face value, encouraging. Private and public consumption and investment were all reported to have increased versus Q1. By how much, however, we do not know at this point. Still, machinery and equipment investment must have been robust for investment overall to increase q/q as we know construction sector output fell sharply in Q2.

This resilience is striking and is one key facet of the current debate over whether Germany will fall into recession. As investment cycles typically have much higher amplitudes than GDP, they are a key swing factor. The resilience of machinery and equipment to date can be explained by various influences, including: low borrowing costs; easy access to finance; capacity constraints; catch-up following weak investment early in the post-crisis expansion; and expectations that the current weakness in demand is merely a soft patch. The increasing risk, particularly regarding the latter issue, is for a sudden mood change.

Leading indicators signal stagnation

For now, though, leading indicators do not suggest that the economy is about to lurch into a deep recession (see chart). Rather, they point to the economy flatlining, implying that there is a significant risk of a "technical" recession (i.e. successive q/q contractions in GDP).

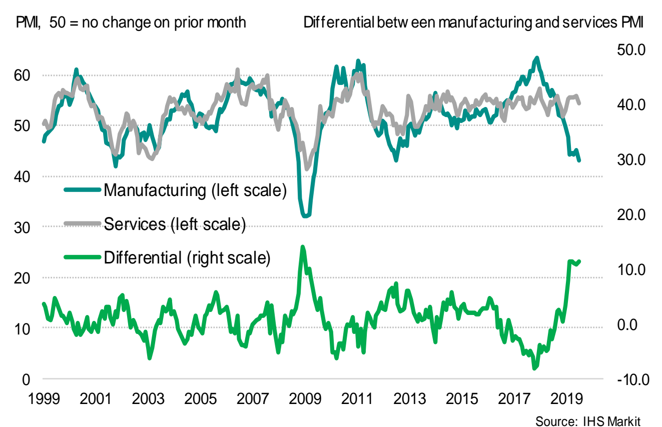
PMI points to German economy flatlining



Sources: IHS Markit, Destatis

Breaking down the PMI by sector, the current divergence between manufacturing and services is exceptional (see chart). Historically, the differential between the two indices has not stayed wide for very long, while the current gap has only been exceeded briefly in the past, for just two months at the height of the global financial crisis. Could this time be different? It already looks different in one respect – its longevity - as the differential has been in double digits, and stable, in each of the five months to July.

German PMI gap exceptional (and unsustainable?)



Source: IHS Markit

With household real wage growth robust, savings rates already elevated and fiscal policy likely to become more accommodative, the domestic backdrop looks supportive. Moreover, a key factor which triggered the recessions in the early 1990s and 2000s is not present currently: i.e. restrictive monetary policy.

That said, one of the other drivers of the prior recessions, financial market turbulence, is becoming more evident, Moreover, while the services PMI has looked relatively resilient so far, there have been signs

of a loss of momentum in the more forward-looking sub-indices such as incoming new business. This is a key area for us to monitor in the period ahead when assessing recession risks.

While we do not have a “technical” recession in our baseline, we still believe the market consensus expectation for German growth in 2020 is too optimistic (1.4% according to July’s Consensus Economics, over half a percentage point above our estimate). Expectations have long been centred on an upswing from late this year based on a series of assumptions, such as a rebound in auto demand, an easing of trade hostilities and a relief from Brexit-related uncertainty, which look increasingly unlikely to materialise any time soon. As we see it, even if a recession is avoided, the German economy will probably be flirting with such an outcome for some time yet, meaning 2020 will be another year of low growth – and it could be much worse.

Two downside risks in particular stand out which could result in an outcome for Germany much more severe than just a “technical” recession. First, a “no deal” Brexit. With Germany accounting for the biggest single share of UK imports (around 14% of the total), the likely hit to UK household real incomes and expenditure would be a big deal. So too would a US decision to impose tariffs on EU exports of autos and parts. The recent US announcement to push back the deadline for the third round of tariffs on China to December arguably reduces this risk near-term - the present deadline for a US decision on EU autos and parts is November - but the threat remains.