Economic Research

13 January 2020

Week Ahead Economic Preview

Global overview

- **US fourth quarter growth indications provided by industrial production and retail sales data**
- **UK GDP data and Eurozone industrial production releases**
- **China GDP, production, trade, investment and retail sales updates**

The week sees a wealth of key official data releases that will add to our knowledge of how the World's major economies fared in the closing months of 2019.

In the US, there have been mixed signals on the health of manufacturing, with a steep decline in the ISM survey contrasting with a more stable – though still very subdued – picture from the IHS Markit PMI survey. Industrial production numbers will therefore provide important evidence on actual growth trends. Likewise, retail sales data will be eyed for hope that consumer spending continued to provide support the US economy and counteract the manufacturing weakness (see page 3).

In the UK, GDP, retail sales and inflation numbers are expected to show the economy struggling to expand amid weak price pressures late last year. The hope – supported by tentative signs of business sentiment improving since December's decisive general election – is that the economy will now pick up pace again. However, the PMI survey illustrates just how weak the business sector remained at the end of 2019, and recent comments from Bank of England governor Mark Carney have underscored how a swift acceleration in growth is by no means assured.

Similarly, in the Eurozone, industrial production data are expected to add to signs that the region's producers endured a tough end to the year, and will likely bolster speculation of more stimulus (see page 4 for more insights to Europe).

In the Asia-Pacific the focus is on China, where GDP, industrial production, retail sales and investment numbers will reveal whether the pace of economic growth managed to steady after slipping to the lowest since at least 1992 in the third quarter. We expect GDP growth to have picked up marginally in the fourth quarter, but that this revival will be short-lived, with growth edging below 6% in 2020 to continue the longer-term slowdown trend. Regional trade numbers will also help assess trade war impacts (see page 5).

Special reports

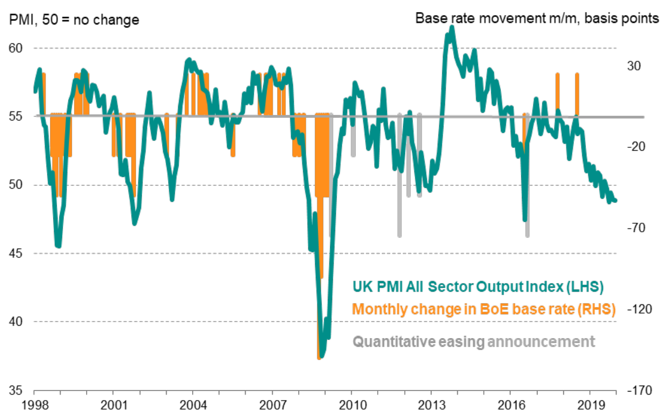
Asia Pacific/Oil: Rising geopolitical tensions in the Middle East at the outset of 2020 have increased the risk of an oil price shock impacting the Asia-Pacific region (page 6).

Eurozone: Consumer spending has been the bright spot for the eurozone economy. However, the recent pick-up in crude oil prices and its impact on eurozone inflation requires close monitoring. (page 8)

China's fourth quarter GDP numbers will likely show the economy growing at one of the slowest rates in recent history

Sources: IHS Markit, Jibun Bank.

UK GDP data for November will be eagerly awaited after surveys hinted at an economy stagnating at best in the fourth quarter, especially as the Bank of England governor has raised the prospect of a rate cut



Sources: IHS Markit, Bank of England.

Key diary events (UTC)

Monday 13 January

Italy retail sales, industrial orders (Nov)

UK trade balance, construction output, industrial production, index of services, GDP (Nov)

Japan current account (Nov)

Tuesday 14 January

China exports, imports, trade balance (Dec)

US inflation, NFIB business optimism index (Dec)

South Korea unemployment rate (Dec)

Wednesday 15 January

Indonesia exports, imports, trade balance (Dec)

India trade balance (Dec)

Japan machinery orders (Nov)

Germany full year GDP (2019)

France inflation (Dec)

Spain inflation (Dec)

UK inflation (Dec)

Eurozone balance of trade, industrial production (Nov)

NY empire state manufacturing index (Jan)

Thursday 16 January

Germany inflation (Dec)

ECB monetary policy meeting accounts

South Africa, Turkey interest rate decisions

US retail sales, export prices, business inventories (Dec)

US Philadelphia Fed manufacturing index, NAHB housing market index, jobless claims (Jan)

Canada ADP employment (Dec)

Friday 17 January

Singapore non-oil exports, balance of trade (Dec)

China GDP (Q4)

China industrial production, retail sales (Dec)

Eurozone current account, construction output (Nov)

Eurozone, Italy inflation (Dec)

UK retail sales (Dec)

US JOLTs (Nov)

US industrial production, housing starts (Dec)

US Michigan consumer surveys (Jan)

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United States Week Ahead

Industrial production, retail sales and inflation

By Siân Jones
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The upcoming economic release calendar focuses on key indicators of manufacturing performance and consumer sentiment, with industrial production and retail sales data for the final month of 2019 taking centre stage. Also featuring is the release of inflation figures for December, which is expected to remain stable and just above the target rate of 2%.

Industrial production

According to December IHS Markit PMI data, US manufacturing output continued to rise, albeit with the rate of growth slowing slightly from an already weak pace to hint at a sluggish recovery from lows earlier in the year. The overall trend remains relatively soft as several factors continue to weigh on manufacturing, including a strong dollar and tariffs (on US exports). Troubles at Boeing are also dampening activity.

Retail sales

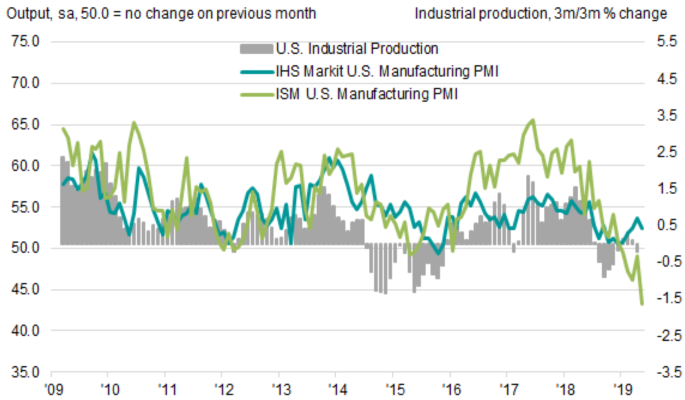
US consumers have remained resilient throughout 2019, helping to drive overall growth through strong growth in spending. November sales data, however, fell short of the mark and missed expectations, suggesting the overall expansion may receive less support from the consumer in the fourth quarter unless December numbers rebound somewhat. Core retail sales growth (excluding volatile items such as autos and fuel) also undershot expectations. However, with employment data remaining solid overall in the fourth quarter, the strong job market should aid an upturn in consumer spending.

Inflation

December data from our PMI surveys indicated a faster rise in prices, which may in turn lead to a slight uptick in the rate of inflation at the end of 2019. But underlying inflation trends remain contained: recent minutes from the December FOMC meeting suggest the Fed are not expecting any notable changes to inflationary pressures in the coming months, meaning we expect policy to remain unchanged through 2021.

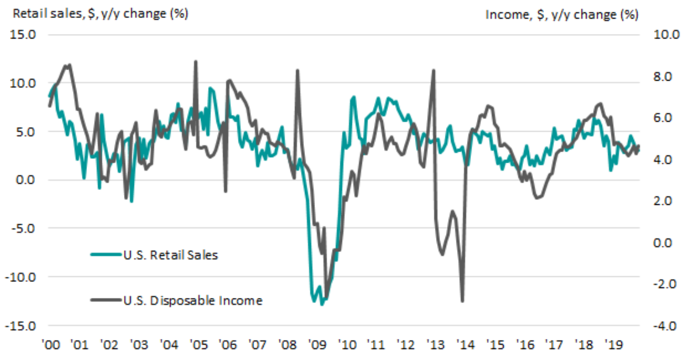
Also released are updates to consumer inflation expectations, producer prices and regional surveys such as the Philadelphia Fed and NY Empire State manufacturing indexes.

Stumbling recovery in the manufacturing sector



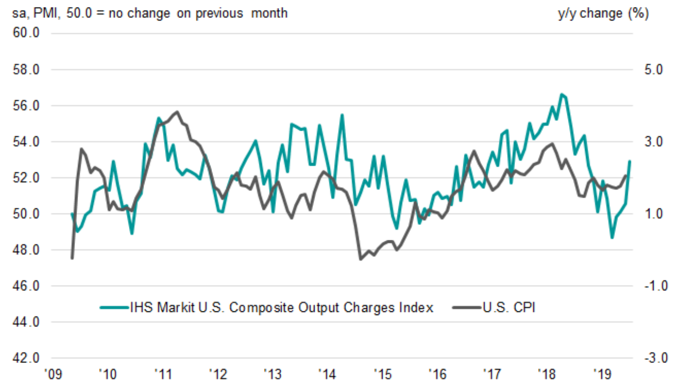
Sources: IHS Markit, ISM, Federal Reserve

Solid trend in retail sales growth stabilises



Source: U.S. Census Bureau, Bureau of Economic Analysis and U.S Department of Commerce

Inflationary pressures look set to pick up



Sources: IHS Markit, Bureau of Labour Statistics, U.S. Department of Labour

More insight into the US economic outlook is available from our colleagues at Macroeconomic Advisers.

Economic Research

13 January 2020

Europe Week Ahead

UK GDP, retail sales and inflation plus eurozone industrial production

By Chris Williamson

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The UK releases updates to GDP, inflation and retail sales, while euro area highlights include industrial production and inflation.

UK GDP and inflation updates

The latest monthly GDP numbers are widely expected to show the UK economy having treaded water in November, but the flat month-on-month picture looks to have pushed the three-month rate into negative territory for only the second-time since 2012. The official data follow recent PMI surveys, which indicated business activity contracting marginally again in December. Ongoing Brexit-related uncertainty and sluggish global economic growth were exacerbated by increased hesitancy toward spending in the lead up to the general election. However, the final PMI for December hinted at a post-election upturn in business sentiment, linked in part to greater political clarity.

The GDP numbers will include details of sector output. The PMI data suggest that the main drags will have come from manufacturing and construction, though services growth has also more or less stalled.

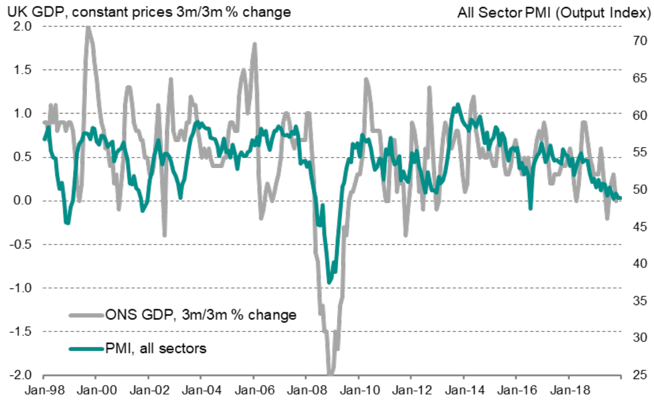
UK retail sales and inflation statistics are also updated, showing spending and price trends over the important Christmas period. November data showed inflation holding steady at a three-year low of 1.5% while retail sales fell for a fourth month in a row, taking the annual rate of increase to its lowest for one and a half years.

Eurozone production and inflation

With the European Central Bank widely touted to consider more stimulus in coming months, official data on eurozone industrial production and inflation will be eagerly awaited and fuel further speculation as to the timing, size and nature of stimulus.

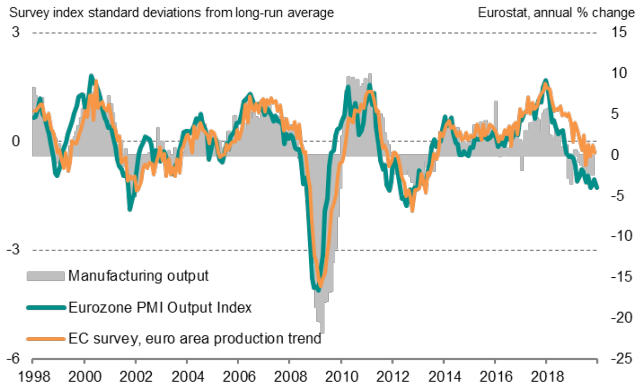
PMI survey data have indicated that the euro area manufacturing sector continued to struggle in the closing months of 2019, with the rate of production decline accelerating again in December to indicate an annual rate of contraction of approximately 4-5%. Eurozone inflation meanwhile hit a six-month high of 1.3%, according to flash December data, but remains well below the ECB's target of below but close to 2%. Oil prices remain a key aspect to watch in terms of future price trends (see special report on page 8)

PMI survey data hint at a stalled UK economy in the fourth quarter, though sentiment numbers have shown signs of perking up since the general election



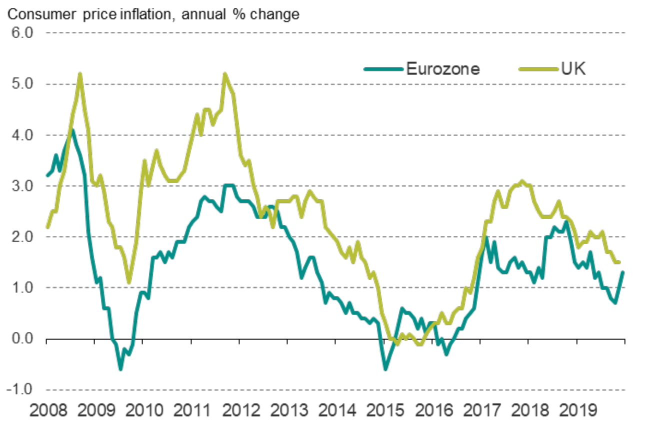
Sources: IHS Markit, CIPS, ONS.

PMI survey data hint at a further deterioration in eurozone manufacturing in December



Sources: IHS Markit, European Commission.

Inflation has fallen sharply in the UK but picked up from recent three-year lows in the eurozone



Sources: IHS Markit, ONS, Eurostat.

Economic Research

13 January 2020

Asia Pacific Week Ahead

China GDP and regional trade data, Japan machinery orders

By Chris Williamson
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Key releases out of Asia Pacific in the week ahead include GDP numbers from China plus a clutch of trade statistics updates which will provide insights into how trade wars have impacted exports from some of the region's key economies. Japan watchers will eye current account data plus the latest numbers on machinery orders. The latter will not only give clues as to the latest production trends but also provide guidance on wider capex spending trends.

China GDP

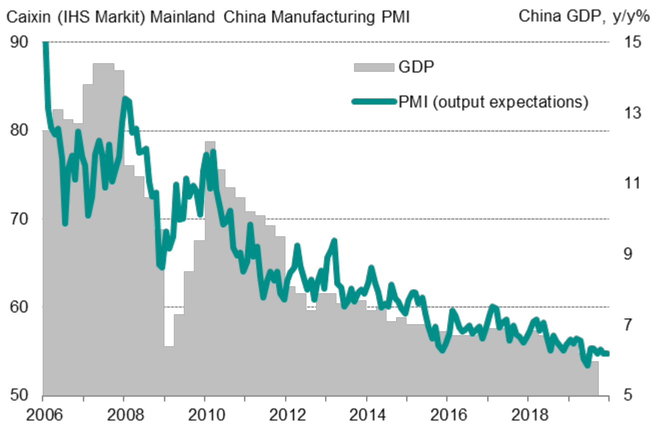
China releases it fourth quarter GDP data, which is expected to show the pace of growth ticking slightly higher compared to the third quarter, but remaining close to recent historical lows. GDP increased at an annual rate of 6.0% in the three months to September, the lowest since quarterly records began in March 1992. IHS Markit expects growth to have edged up to 6.1% at the end of 2019, before waning again to 5.8% in calendar year 2020. Annual growth of fixed investment is expected to have picked up but consumer spending growth is likely to have moderated further.

The anticipated uptick in fourth quarter GDP tallies with survey data from IHS Markit, which compiles the Caixin mainland PMI for China, as well as NBS survey data, both of which showed manufacturing output growth accelerating during the closing months of the year as a boost from domestic stimulus coincided with an easing of trade war tensions. However, a further moderation of companies' future expectations recorded by the Caixin survey highlights the ongoing trend of slower growth anticipated for China, notably in the more domestically-focused service sector, where future output expectations are running close to survey record lows.

Trade data

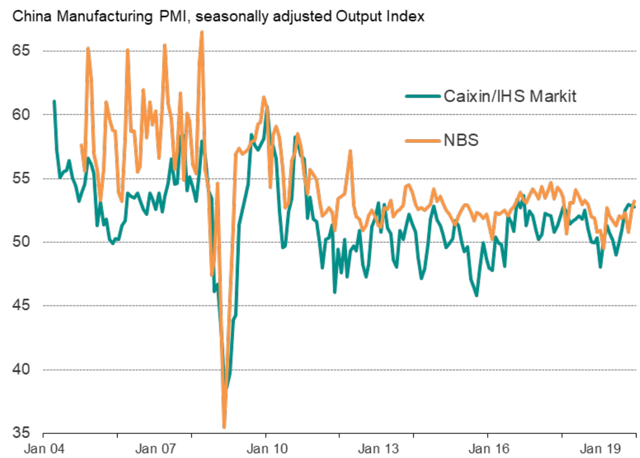
With a slowdown in global trade having led the worldwide economic slowdown in 2019, we will be looking for signs that export growth is beginning to perk up again given the recent easing in US-China trade tensions and indications from surveys that manufacturing has started to stabilise as the trade drag has moderated. Trade statistics are published for China, Indonesia and Singapore.

China GDP



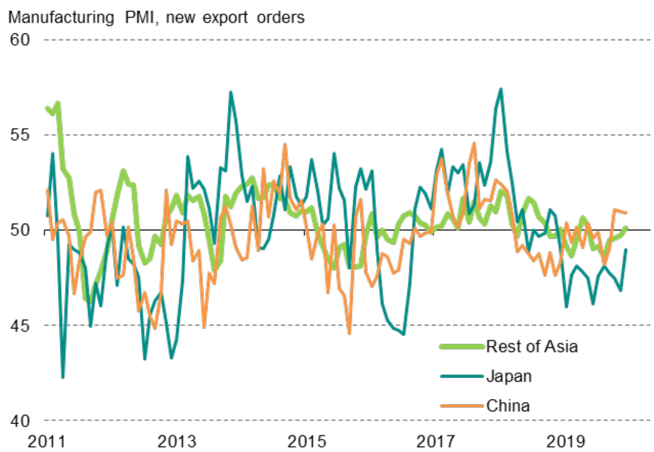
Sources: IHS Markit, NBS, Caixin.

China manufacturing PMI surveys



Sources: IHS Markit, NBS, Caixin.

Asian exports



Sources: IHS Markit, Caixin, Jibun Bank.

Asia Pacific Special Focus

The economic impact of rising oil prices on Asia-Pacific economies

By Rajiv Biswas

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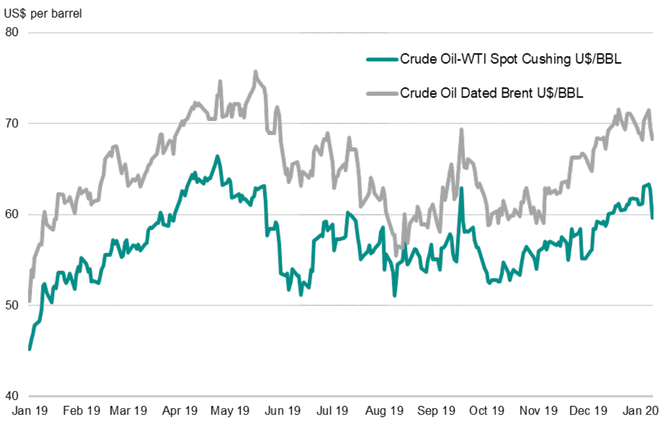
Rising geopolitical tensions in the Middle East at the outset of 2020 have increased the risk of an oil price shock impacting on the Asia-Pacific region. As many Asian industrial economies, including China and India, are highly dependent on imported crude oil, they are vulnerable both to a large increase in world oil prices as well as to potential disruptions of oil supplies from the Middle East.

Escalating Middle East tensions drive world oil prices higher

Geopolitical tensions in the Middle East have escalated significantly following the US drone strike that killed Iran's Major General Qasem Soleimani, commander of Iran's elite Quds Force on 3rd January 2020, followed by Iran's launch of more than a dozen ballistic missiles on 8th January against US military and coalition forces in Iraq at the Al-Asad and Irbil military bases. This intensification of geopolitical risks pushed up world crude oil prices sharply in the first few days of 2020, with Brent crude breaking through briefly above USD 70 several times, from recent lows of USD 59 in mid-October 2019, albeit easing again after both the US and Iran appeared to step back from further imminent escalation.

Oil prices



Source: IHS Markit via Datastream.

APAC vulnerability to oil imports

As many Asia-Pacific (APAC) economies are highly dependent on imported crude oil supplies, a large number of APAC nations are vulnerable both to large increases in the world price of oil as well as to potential disruptions of oil supply through the Strait of Hormuz, a key global chokepoint for world oil shipments. Around 21% of total world petroleum liquids consumption is shipped through the Strait of Hormuz.

Many Asian industrial nations, including China, Japan, South Korea, India and Singapore, are heavily reliant on imported crude oil supplies, with a high level of sourcing from Middle East oil exporting nations, such as Saudi Arabia and UAE. Significant shipments of liquid natural gas (LNG) also go through the Strait of Hormuz, creating additional vulnerability for Asian countries that are reliant on Middle East supplies of LNG. The US Energy Information Administration has estimated that 76% of total oil and condensate that is shipped through the Strait of Hormuz is for Asian markets.

India is amongst the most vulnerable Asian industrial economies to rising world oil prices, with oil import dependence having reached 84% in the 2018-19 financial year, while total oil imports cost USD 112 billion in 2018-19, or around 22% of the total value of merchandise imports. China is also heavily reliant on imported oil, which accounted for around 70% of total oil consumption in China in 2018. For the first 11 months of 2019, China's oil imports averaged ten million barrels per day.

The escalation of geopolitical tensions in the Middle East and ongoing confrontation between the US and Iran are likely to continue to drive efforts by Asian countries to improve energy security by diversifying oil and gas supply sourcing towards other major suppliers, notably the US. US exports of crude oil have averaged around 3.4 million barrels per day during late November and the first three weeks of December 2019, compared with only 470,000 barrels per day in December 2015.

In order to improve their energy security, Asian LNG importing nations are also likely to continue to diversify their sourcing of LNG supplies towards other major global LNG exporters outside of the Middle East, such as the US and Australia. China has also started to import large volumes of natural gas by pipeline from Russia, with the first gas from the Power of Siberia pipeline project having started to flow to the Chinese gas market since early December 2019.

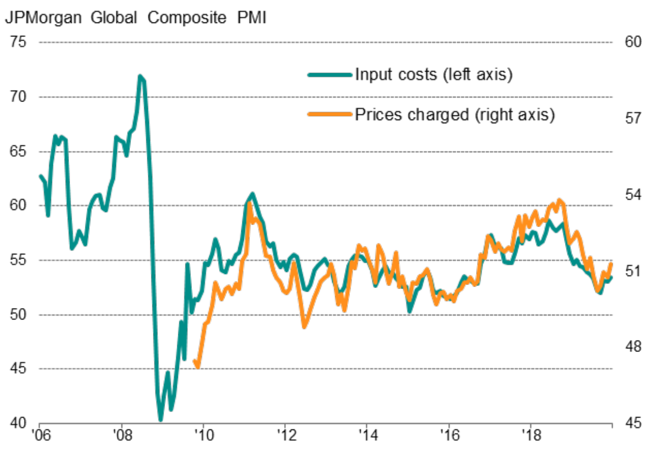
The Phase One US-China trade deal also includes energy products as one of the four main core components for expanding Chinese imports from the US. China will provide detailed commitments for increasing imports from the US, and increased imports of US oil and LNG are likely be part of the large increase in Chinese imports from the US planned for 2020 and 2021.

Impact of rising oil import prices on inflation

If world oil prices rise sharply due to a further escalation in the Middle East crisis, many Asian nations would also be vulnerable to the impact of higher oil import prices on retail inflation. During 2019, many Asia-Pacific central banks had been easing monetary policy due to lower inflationary pressures, assisted by declining world oil prices, including Bank Indonesia, Bank Negara Malaysia, Bank of Thailand, Bangko Sentral ng Pilipinas, Bank of Korea, the Reserve Bank of India and the Reserve Bank of Australia.

However, if inflation pressures are pushed higher in some heavily oil-dependent Asian economies due to rising world oil prices, this could remove scope for further monetary easing by some Asia-Pacific central banks. Global input prices had already shown early signs of an upturn in late 2019, feeding though to higher prices charged for goods and services. The IHS Markit Materials Price Index has shown a significant upturn during November and December 2019, with rising world oil prices and the rebound in iron ore prices being important drivers.

Global PMI survey price indices



Sources: IHS Markit, JPMorgan.

Headline consumer price inflation rates had also been rising in several large Asian economies, including China and India, mainly due to the impact of higher food prices. China's headline CPI annual inflation rate was 4.5% in December 2019, with a 97% year-on-year rise in pork prices due to the ongoing negative impact of African swine fever heavily impacting on retail inflation. In India, CPI annual inflation reached 5.54% in November 2019, the highest rate since July 2016, driven by higher prices for food items, notably a 36% year-on-year rise in vegetable prices. Consequently, if world oil prices also move significantly higher in early 2020, this will add to retail inflationary pressures in both countries.

Industry sector impact effects

Asian industry sectors that would be heavily exposed to any significant rise in world oil prices include transportation-related industries, notably aviation, road haulage, shipping and logistics. Jet fuel accounts for an estimated 25% of total operating costs for the airline industry. The shipping industry is also vulnerable to higher oil prices, with IHS Markit estimates indicating that fuel costs already represent more than 50% of total operating expenses for the shipping industry. The new International Maritime Organization (IMO) 2020 regulation on sulfur oxide emissions that took effect on 1st January 2020 have already has pushed up fuel costs for the shipping industry for IMO compliant low sulphur fuel.

Oil is also a major input cost for the petrochemicals industry, with large regional petrochemicals producers, such as China, Japan, South Korea and India, vulnerable to the impact of higher oil import costs. Rising crude oil prices would drive up petrochemical costs as well as market prices for many downstream chemical intermediates and plastics. The agricultural sector in many developing countries would also be adversely impacted due to the higher costs for petrol and diesel for tractors and irrigation pumps.

Outlook

Overall, many economies in the Asia-Pacific region remain vulnerable to an oil price shock from a large and rapid rise in world oil prices, as well as any disruption in oil and LNG shipments from Middle East markets. Any sharp rise in world oil prices would also be expected to result in international investors shifting their asset allocation towards traditional safe haven assets, such as gold, US Treasuries, the USD and JPY, and away from growth assets, such as Asian emerging markets' equities and currencies.

Europe
Special Focus

Eurozone: Consumer resilience continues (but watch oil prices)

By Ken Wattret
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Consumer spending has been the bright spot during a difficult period for the eurozone economy and the latest batch of data, in the form of stronger than expected retail sales and services PMIs, was encouraging. Given slowing employment and compensation growth rates, however, the recent pick-up in crude oil prices and its impact on eurozone inflation requires close monitoring. A sustained rise due to an intensification of tensions in the Middle East would hit household real income growth hard, choking off the key source of support for the fragile eurozone expansion.

Domestic durability

The resilience of consumer spending in 2019 allowed the eurozone expansion to continue into a seventh year, despite the persistent drag from weakness in global trade and exports. Private consumption expanded by 0.5% q/q in Q3 2019, the fastest rate of increase for eight quarters. For Q4, the picture is incomplete at this point but the recent retail sales data for November delivered a positive surprise (Chart 1).

Chart 1: Eurozone retail sales resilient to date

Source: IHS Markit, Eurostat, EC

On top of retail sales volumes rising by a much larger than expected 1.0% m/m, October's initially reported 0.6% m/m contraction was reduced to a 0.3% m/m dip. Unchanged sales volumes in December would yield a q/q rise for Q4 2019 of 0.5% q/q, matching Q3's rate of increase, though down a little versus the average 0.7% q/q increase during the first half of the year.

The final eurozone services PMI for December also brought a little festive cheer, with the consumer demand-sensitive data revised upwards from the prior "flash" estimate. At 52.8, the headline business activity index is still comfortably in expansion territory, while the future activity index rose above 60 for the first time in five months.

Constraints on real compensation growth

Household real compensation growth fared pretty well during 2019, rising by around 2% overall (incorporating estimates for Q4 data yet to be released). In our baseline for 2020, we forecast a moderation to around 1½%, reflecting:

- a slowdown in employment growth below 1%
- a gradual deceleration in compensation growth to around 2%
- a broadly stable inflation rate of around 1¼%

The latter assumption, however, is predicated on an average oil price in 2020 of around EUR57 per barrel. The recent upward shift, if sustained, would be consistent with a rather higher rate of inflation (see below) which is very unlikely to be offset by a commensurate pick-up in compensation growth given the economic climate, implying a significant headwind to growth at a time of high vulnerability for the eurozone economy.

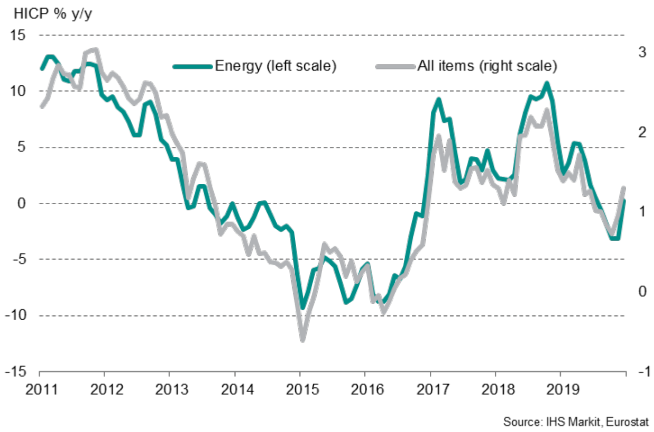
Different inflation drivers

Eurozone inflation almost doubled in the last two months, from a low of 0.7% in October up to 1.3% based on December's "flash" estimate. With inflation having been so far below the "below but close to 2%" objective, one might expect the pick-up to be welcomed by the ECB. The central bank's interpretation of the data, however, will depend on what is driving the acceleration and with this in mind, differentiating between November and December's inflation developments is important.

In both months, inflation accelerated by 0.3 percentage points but the factors driving the pick-up were very different. In November, higher services inflation was the primary reason. It surged from 1.4% to 1.9%, its highest rate in seven months, adding a little under 0.4 percentage points to the inflation rate. Notably, there was only a partial reversal of this acceleration in December and at 1.8%, services inflation was well above the 1.4% average over the first ten months of 2019. Methodological changes to the treatment of package holiday prices in Germany contributed to the pick-up, complicating the assessment of the data.

In December, the rise in inflation was almost entirely due to energy prices. The y/y rate of energy inflation jumped back into positive territory (albeit only just), boosting inflation by 0.3 percentage points. The rise in oil prices during December was compounded by unfavourable base effects, with energy prices (worth almost 10% of the HICP) having fallen by over 3% m/m in December 2018.

Chart 2: Energy price swings driving eurozone inflation



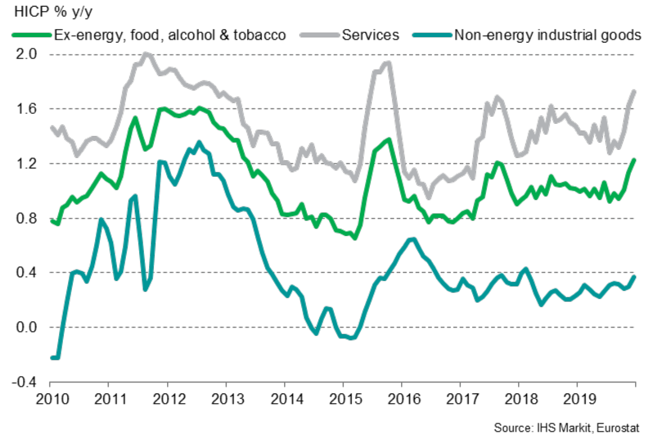
Energy-fuelled inflation increase a potential game changer

At the time of writing, it looks like the energy-led pick up will continue in January given recent upward pressure on crude oil prices. Base effects will also lean up, though to a lesser extent than in December, with energy prices having fallen by 0.9% m/m in January 2019. If crude oil prices in euro terms were to remain broadly unchanged at around their peak recent level through the remainder of this month (around EUR62-63 per barrel), the eurozone inflation rate would likely rise by another 0.1-0.2 percentage points in January, other things equal.

But what if it goes further? By way of illustration, in the event of an additional 10% rise from the recent peak being sustained through 2020 - i.e. an average price of around EUR70 per barrel – the inflation rate would be half a percentage point above our current baseline forecast (even assuming no indirect effects beyond the direct impact on energy prices). With inflation near 2% in such a scenario, this would likely cut 2020's rate of real compensation growth in the eurozone by half relative to 2019, to around 1%.

While there is a theoretical cushion available in the form of high household savings rates in the eurozone, the uncertain economic outlook and deteriorating labour market conditions suggest a significant drop in savings is unlikely. Indeed, as Chart 1 shows, consumer sentiment had been slipping even before the recent oil price rises. Such a scenario for oil prices could well tip the eurozone into recession therefore, so how political developments evolve from here, and the impact on oil prices, is a key risk to monitor, including for the ECB.

Chart 3: Eurozone services inflation driving core rate up



Policy prospects

The jump in headline inflation from October to December, and the prospect of another rise in January, should not concern the ECB from a price stability perspective. The acceleration comes from a very low level, inflation remains well below the ECB's "below but close to 2%" objective and the probability of second round effects on wages is low.

While there has been an upward shift in core inflation momentum recently, albeit from a low starting point of around 1%, the methodological changes to package holiday prices complicate matters, while services inflation rates can be very volatile from month to month.

For ECB watchers, the initial reaction to the recent rise in inflation is probably to reinforce the consensus expectation that it is done easing. We see it differently. Its prime concern is likely to be the adverse impact that a sustained supply-driven increase in oil prices and inflation could have on household real incomes and consumption, keeping the door open for additional easing should the damage to growth prospects build.