Week Ahead Economic Preview

Global overview

- **UK flash PMI data to steer next Bank of England rate decision**
- **Eurozone PMI released alongside ECB meeting**
- **US flash PMI updates to guide Q1 growth expectations**
- **Japan PMI eyed for signs of downturn easing**

A week which sees Davos host the 50th World Economic Forum commences with the IMF's latest forecast on Monday and rounds off on Friday with the flash PMI surveys, which will provide the first insights into global economic trends at the start of the year.

One of the key updates will be the UK flash PMI, as any failure of the survey data to show a revival of economic growth at the start of the year is likely to trigger an imminent rate cut by the Bank of England when its Monetary Policy Committee next meets on 30th January. Policy had been kept on hold during Brexit uncertainty in the lead up to December's General Election, but recent weeks have seen growing numbers of policy setters grow uneasy about the ability of the economy to spring back into life. The PMI has been specifically cited as a determinant of whether a swift loosening of policy is warranted (see page 4).

Similarly in the eurozone, where ECB policymakers meeting during the week, insight into the scale and timing of further potential monetary stimulus will be provided by the flash PMI, which showed growth picking up only modestly in December to end the weakest quarter since 2013, as well as EC sentiment surveys. Of particular interest will be whether the services sector has continued to show resilience in the face of the manufacturing downturn (see page 4).

In the US, the flash PMI numbers will be especially important for ascertaining whether manufacturing and services sectors have started the year with growth sufficiently strong to support our estimates of first quarter GDP growth running at just below 2%. Survey jobs numbers will also help guide non-farm payroll estimates (page 3).

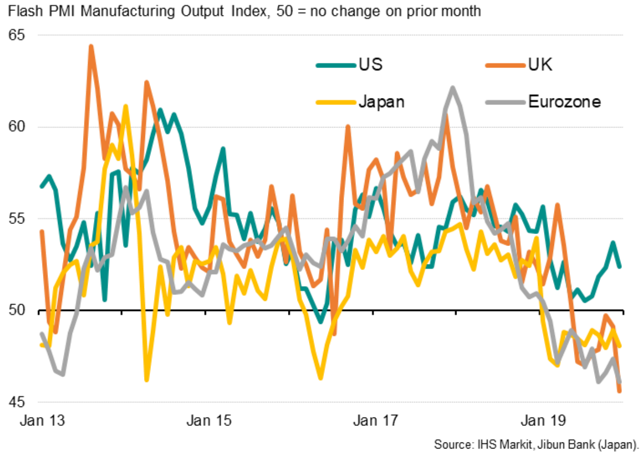
In Asia Pacific, Japan PMI numbers will be eyed for hopes that post-tax-hike weakness, exacerbated by typhoon disruptions, will have begun to fade, helping the economy lift from the fourth quarter malaise. Central banks in Japan, Indonesia and Malaysia also meet to decide on monetary policy (see page 5).

Special reports

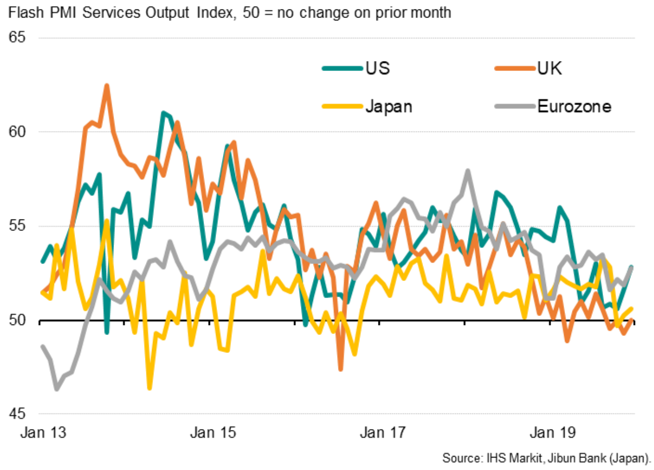
Japan: A look at how the government of Japan's record-high 2020 budget aims at social spending and sustaining economic growth (**page 6**).

Spain: Insights into how the new Spanish government's economic plan threatens the country's jobs recovery, which has in turn been a key driver of economic growth in recent years. (**page 9**)

Flash PMI data showed the US manufacturing sector enjoying relatively benign conditions relative to Europe and Japan



News on service sector growth rates will be eagerly awaited from the flash PMI surveys for warning signs of spill-over weakness from manufacturing



Key diary events (UTC)

Monday 20 January

IMF World Economic Outlook update (Jan)
China loan prime rate (Jan)
Japan industrial output (Final, Nov)
Indonesia monetary policy decision
Taiwan export orders (Dec)
Hong Kong unemployment rate (Dec)
UK Household Finance Index (Dec)
Germany PPI (Dec)

Tuesday 21 January

BoJ monetary policy decision, quarterly outlook report
Hong Kong inflation (Dec)
UK jobless rate, average earnings (Nov), claimant count change (Dec)
Euro area and Germany ZEW economic sentiment index (Jan)

Wednesday 22 January

South Korea GDP (Adv, Q4)
Thailand trade (Dec)
Malaysia interest rate decision
Taiwan industrial output, retail sales (Dec)
UK CBI industrial trends orders (Jan)
US Chicago Fed national activity index, existing home sales (Dec), house price index (Nov)

Thursday 23 January

Australia consumer confidence index (Jan), jobless rate, employment change (Dec)
Japan trade (Dec)
Philippines GDP (Q4)
Singapore inflation (Dec)
ECB monetary policy decision
Euro area consumer confidence (Flash, Jan)
Brazil business confidence (Jan)

Friday 24 January

IHS Markit Flash PMI surveys for US, Eurozone, UK, Germany, France, Japan, Australia (Jan)
Japan inflation (Dec), BoJ meeting minutes
Singapore industrial production (Dec)

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Economic Research

20 January 2020

United States Week Ahead

Flash manufacturing and services PMIs for January, plus jobless claims

By Siân Jones

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Leading the US economic release calendar are the flash PMI data for January. The survey data will give an early view to actual operating conditions and future business sentiment following a positive end to 2019. Also released are jobless claims numbers for the second week of 2020, giving a snapshot into the labour market landscape going into the start of the year.

Flash PMIs

Although IHS Markit Manufacturing PMI data at the end of 2019 continued to point towards a slight recovery in the goods-producing sector, the upturn faltered amid ongoing weak demand. Knock-on effects were also seen in the services sector, where growth slowed in the final quarter of 2019, following sharper expansions earlier in the year. Eagerly anticipated flash data should help gauge progress for the ongoing private sector recovery, with GDP expected to rise 1.9% in the opening quarter of 2020.

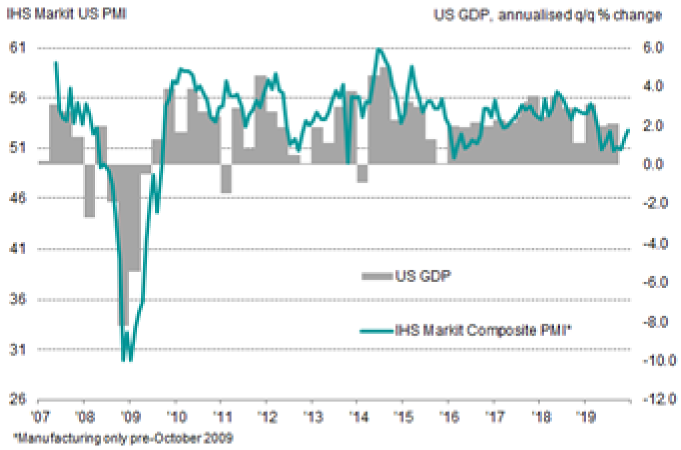
While business activity continued to rise, albeit at a modest pace, business confidence across the private sector remained more conspicuously subdued in December. The PMI's Future Output Index signalled that firms are relatively guarded in their expectations for the coming year, with sentiment running at one of the lowest levels seen since 2012. This is in contrast to elevated levels of consumer sentiment, according to the University of Michigan Consumer. Among other factors, strong labour market conditions are seemingly helping support expectations for economic growth.

Jobless claims

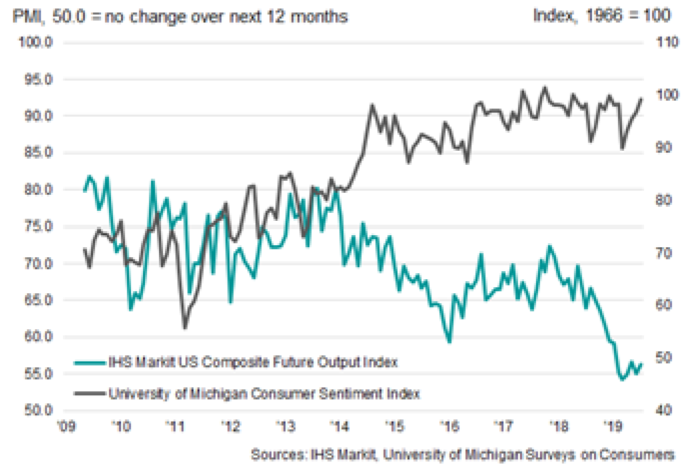
While the PMI's employment indices will provide an insight into whether the labour market continued to improve in January, so will official data on jobless claims. Initial jobless claims continued to fall in the opening week of 2020, supporting anecdotes published by the Federal Reserve from their 'Fed Listens' discussions that job opportunities remain widespread across a broad range of areas. A fourth successive drop in weekly unemployment numbers supported trends seen in the PMI, which pointed to renewed job creation across the private sector in November and December.

Also featuring in the release calendar are existing home sales, house prices and regional survey data.

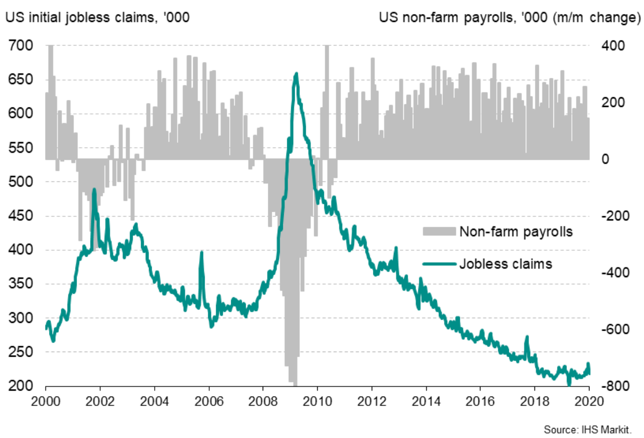
Private sector output expansion is expected to continue into the first quarter of 2020



A wide divergence is apparent between business and consumer sentiment



US labour market indicators



Economic Research

20 January 2020

Europe Week Ahead

January flash PMIs, ECB meeting and UK labour market update

By Joe Hayes

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Flash PMI numbers will provide the first insight into how the major European economies have started the new decade. Prior to this, Christine Lagarde chairs her second ECB Governing Council meeting, UK labour market and household sentiment figures are updated, plus ZEW sentiment surveys for the euro area are published.

Flash PMIs and HFI

Fresh clues as to what direction the major European economies will take in the opening quarter of 2020 will come from the January flash PMI data. The surveys indicate that euro area growth hit a low late last year, with fourth quarter growth expected to weaken to around 0.1% q/q. A pickup to start the year will be welcomed particularly for the European Central Bank, given its diminished arsenal of policy tools.

Survey data also have heightened importance for UK policymaking. The Bank of England has expected a lifting of uncertainty after the General Election to release pent-up demand and investment, boosting economic activity. However, four of the nine rate setters have already indicated an appetite for an immediate cut to rates, which will most likely turn to a majority if the flash PMI data fail to indicate stronger growth and if the Household Finance Index, also closely watched by the MPC, fails to show a post-election upturn in consumer sentiment in January.

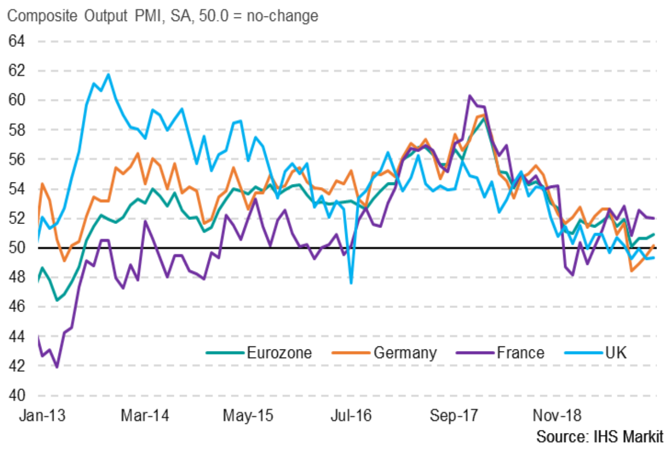
European Central Bank

We expect the ECB to maintain the status quo in the coming policy meeting although, in our view, below-potential growth and a subdued inflation environment merits additional policy stimulus. However, Lagarde's preference for a more consensual approach puts our baseline forecasts of a further 10-basis-point cut in the deposit facility rate in March at risk. Lagarde may also provide some additional information on the ECB's strategic review, which we have previewed here.

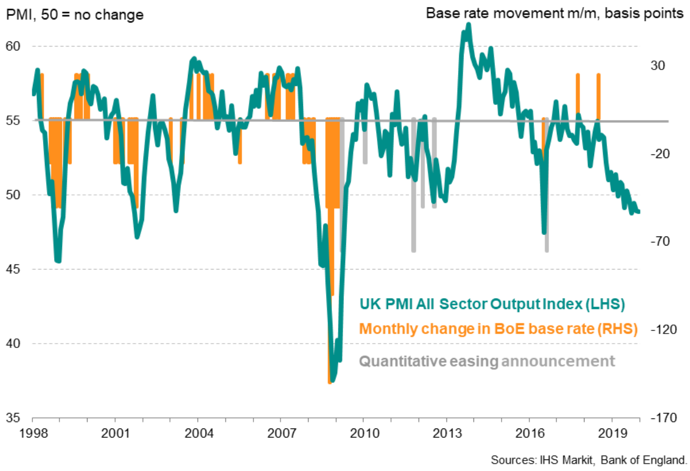
UK labour market

The focus remains on earnings growth in the UK, which remains key to supporting domestic spending. However, evidence from our Report on Jobs survey has hinted at downward pressure on wages due to weaker demand for staff.

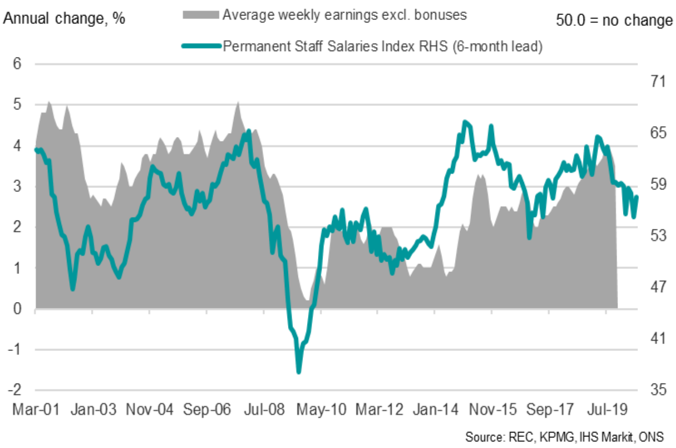
PMIs have stabilised across Europe, but still point to weak growth or contraction



January flash PMI data will provide a key input as to whether interest rates will go lower in the UK



Softer job vacancy growth has been leading to weaker pay pressures



Economic Research

20 January 2020

Asia Pacific Week Ahead

Flash PMI, monetary policy, regional trade data and Korea GDP

By Bernard Aw

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The release of flash January PMI next week will provide important steers on growth of major economies, including Japan and Australia, at the start of the year after December surveys showed a brightening economic trend. Investors will also assess regional trade conditions from official trade data out of Thailand and Taiwan, plus Singapore's industrial output. Policy action will come from Japan, Indonesia and Malaysia, while South Korea and the Philippines report fourth quarter GDP numbers. The January update of IMF World Economic Outlook will also be closely watched.

Flash PMI

Japan watchers will monitor the flash PMI surveys for signs of a rebound after December data pointed to a decline in the fourth quarter, with business hit by the double-whammy of the October sales tax hike and Typhoon Hagibis. With the recent escalation of Australia's bushfires, flash PMI data will also provide insights into the economic impact of the forest fires on Australian business activity at the start of the year. Recent PMI data had showed a slowing Australian economy.

Trade and economic growth

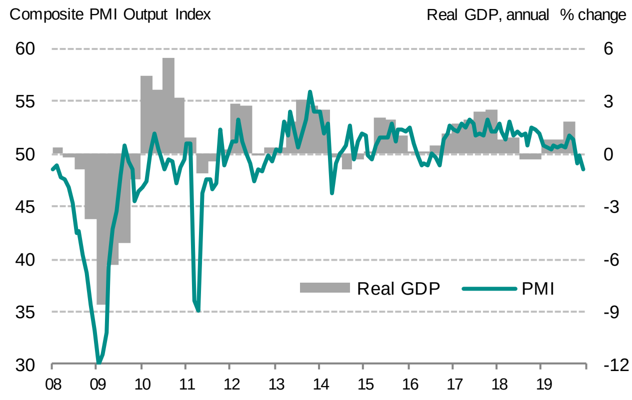
Taiwan's export orders and Thailand's export data will provide new clues of the regional trade environment at the end of 2019, following an easing of US-China trade tensions. Singapore's industrial output numbers will also add insights into the nation-state's export performance, as well as clues of the final GDP estimate of the closing quarter of 2019.

South Korea's economic growth is expected to have slowed to an annual rate of 0.9% in the fourth quarter, down notably from 2% in the third quarter, thanks to export declines. In contrast, the Philippines economic expansion is expected to have accelerated to an annual rate of 6.3% on the back of increased public spending, according to IHS Markit's estimates.

Central banks

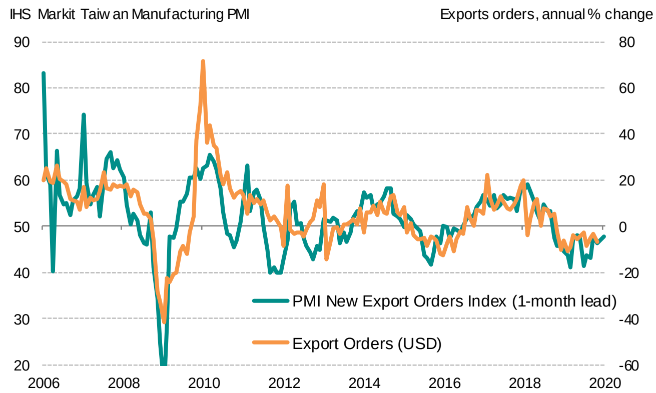
Japan, Indonesia and Malaysia will meet to decide on monetary policy. While no policy changes are expected in Japan and Indonesia, there are some expectations of an 'insurance' rate cut in Malaysia amid rising external headwinds.

Japan PMI and economic growth



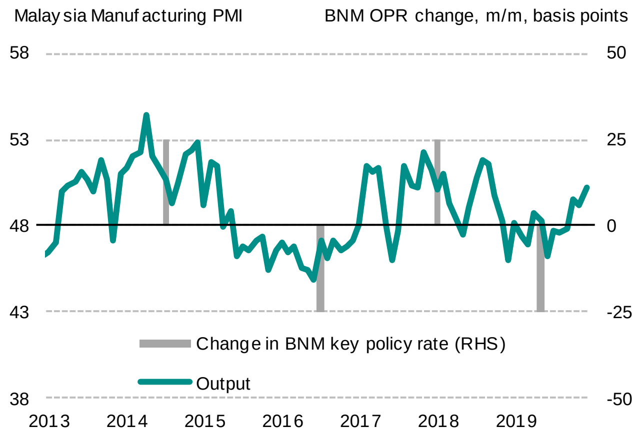
Sources: IHS Markit, Jibun Bank, Cabinet Office

Taiwan export orders and PMI



Source: IHS Markit, DGBAS

Malaysia PMI and monetary policy



Sources: IHS Markit, Bank Negara Malaysia

Asia Pacific Special Focus

Japan's record-high budget aims at social spending and sustaining growth

By Harumi Taguchi*

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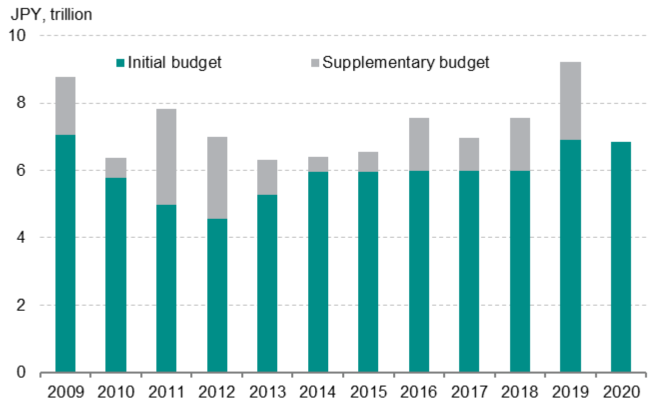
Increases in social security and measures to counter downside risks for the economy are the main contributors to the year-on-year expansion in Japan's budget for the 2020 fiscal year. other notable increases are in defence spending and on measures to promote new technologies. Although the October 2019 consumption tax increase is likely to mitigate the government's need to issue new bonds to fund spending, fiscal consolidation remains a concern.

Japan's Cabinet Office approved the fiscal year (FY) 2020 budget (starting 1st April 2020) on 20th December. General account total expenditure is JPY102.7 trillion (USD947 billion), reaching a record high for an eighth consecutive year, up 1.2% (or JPY1.2 trillion) from the FY2019 initial budget. The FY2020 spending includes JPY1.8 trillion for temporal and special measures in line with the stimulus package announced on 5th December 2019. These measures are largely for reconstruction from natural disasters and disaster prevention. The measures also include additional funding to mitigate downsides from the 1st October 2019 consumption tax increase from 8% to 10% through a reward programme whereby consumers get an immediate price reduction for non-cash payments in certain stores.

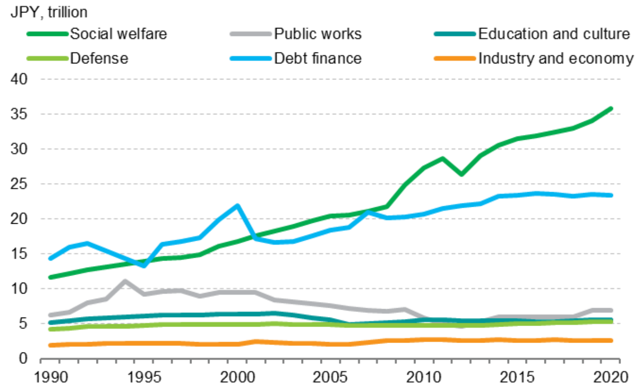
Costs of public works rise due to natural disasters



Source: IHS Markit via Cabinet Office of Japan, years are fiscal years.

The major factor behind the increase in spending is a 5.1% rise from the FY2019 initial budget in social security outlays, which now comprise 34.9% of total expenditure. Increases in social security outlays are a natural consequence of Japan's increasingly ageing population, but were suppressed by revisions to drug prices and nursing care benefits. Instead the increase in social security expenses are largely for free pre-school education for all and free tertiary education for low-income households, support for low pension recipients, and preventative health care. These increases in social spending are financed by the additional revenues from the October 2019 consumption tax hike, expected to increase revenue 1.6% to JPY63.5 trillion, with other revenues contributing an additional 4.6% (JPY6.6 trillion). The increases indicate that Prime Minister Shinzo Abe continues to deliver on key promises that secure his ruling Liberal Democratic Party voter-support despite alleged involvement in corruption scandals in 2018 and 2019.

Social welfare outlays keep expanding



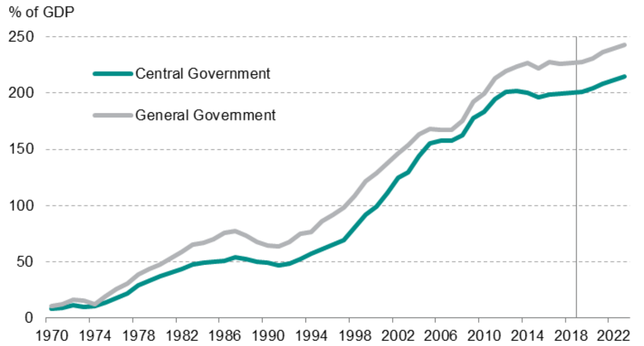
Source: IHS Markit via Cabinet Office of Japan, years are fiscal years.

Another notable increase in spending is in national defence, which comprises 2% of total expenditure. It rose also for the eighth consecutive increase year, 1.1% higher than the FY2019 initial budget. In line with the government's Medium-Term Defense Program (FY2019-FY2023), it includes spending for defence capabilities in space and cyberspace, next-generation fighter jets, and naval troops in the Middle East (to protect Japanese vessels transporting oil).

Lastly, the spending plans include measures to promote new technologies (such as self-driving cars, robots and 5G development); to increase Japan's competitiveness in the agriculture, forestry and fisheries sectors; to improve tourism infrastructure; and to increase employment of the so-called "ice-age" generation, which struggled particularly during the economic downturn and tight labour market of the late 1990s and early 2000s.

Importantly, the national debt service is down by 0.7% from FY2019 initial budget to JPY23.4 trillion. This reflects the downward trend of outstanding government bonds' interest rates, thanks largely to the Bank of Japan (BOJ)'s negative interest rate policy and asset purchasing. Despite the continued expansion of general account expenditure, the amount of planned bond issuance has declined for eight consecutive years.

Japan's debt



Note: Figures after 2018 are IHS Markit forecasts
Source: Cabinet Office, Bank of Japan, IHS Markit

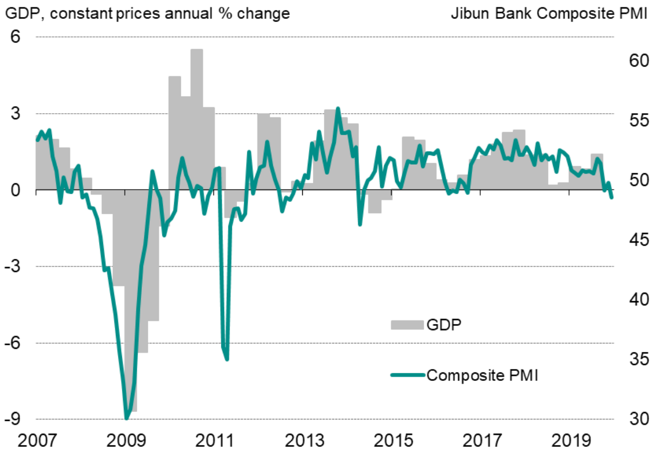
Japan's primary budget balance surplus/deficit

Notes: Figures after 2018 are IHS Markit forecasts
Source: Cabinet Office of Japan, IHS Markit

Outlook

Real GDP growth likely declined in the fourth quarter of 2019. Industrial production fell 4.5% m/m in October and 0.9% m/m in November. Indices of Tertiary Industry Activity decreased 4.6% m/m in October, reflecting persistently weak external demand and sluggish domestic demand following the consumption tax hike and disruptions caused by Typhoon Hagibis. The Jibun Bank Japan PMI Composite Output Index (compiled by IHS Markit) recorded 48.6 in December, signaling the sharpest contraction in private sector business activity for over five-and-a-half years. IHS Markit expects quarter-to-quarter real GDP growth to turn positive marginally in the first quarter of 2020.

Japan PMI* and GDP



Sources: IHS Markit, Jibun Bank, Japan Cabinet Office.

*PMI shown above is a GDP weighted average of the manufacturing and services indices.

The FY2020 budget with FY2019 supplementary budget in line with the stimulus package is likely to provide a boost to Japan's GDP growth in 2020 (see **Japan: 18 December 2019:** [Stimulus package including supplemental budget likely to mitigate downside risks, boost support for Abe administration in Japan]). IHS Markit expects stimulus measures to start contributing to economic activities from the second quarter. Even so, IHS Markit expects Japan's GDP growth rate to be modest, at only 0.6% in 2020. Consequently, we assess in contrast to the government's forecast that it will need to issue new bonds to mitigate lower income tax revenues and keep up stimulus plans.

The government's budget revenue projection is based on its assumption that the economy will grow in FY2020 at 1.4% in real terms, which is faster than IHS Markit currently expects. Weaker growth than the government projection could mean lower tax revenue and larger financing needs. Therefore we assess that a supplementary budget is highly likely, especially considering continuing global uncertainty and that the BOJ is unlikely to be able to further expand monetary easing. Moreover, this scenario would make it more difficult for the government to improve fiscal consolidation and eliminating the primary balance deficit.

The FY2020 Budget includes spending to enhance the productivity of small- and medium-sized enterprises, and to promote innovation and implementation of advanced technologies and human capital. These measures are unlikely to be expanded beyond 2020, however, because of increasing social security outlays.

The government's reliance on supplementary budgets to cover social security spending is not sustainable and indicates that from FY2021 more policies will be aimed at accelerating structural reforms and reduce overall expenses. These reforms include overall review of costs and benefit of care insurance payments, inefficient tax benefits, and redundant measures across ministries.

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Europe Special Focus

New Spanish government's economic plan threatens jobs recovery

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The Spanish government's proposed agenda of a higher minimum wage and the partial repeal of the 2012 labour market reform threatens the country's jobs market recovery, which has in turn been the cornerstone of Spain's broad-based and sustainable upturn that begun in end-2013. In addition, diluting past labour market reforms could reintroduce a past characteristic of previous recessions in Spain, namely rapid and deep employment losses triggering deeper recessionary conditions.

New government, new plan

Pedro Sánchez, leader of the Spanish Socialist Workers' Party (Partido Socialista Obrero Español: PSOE), was approved by Congress on 7th January 2020 as prime minister by a margin of two votes in a second confidence vote. He will lead a minority government in coalition with the left-of-centre Podemos party led by Pablo Iglesias. Congressional approval was permitted by the abstention of Catalan and Basque parties, with the pro-independence Republican Left of Catalonia (Esquerra Republicana de Catalunya: ERC) agreeing to abstain from the vote in exchange for early and free-ranging discussions with the new government on the Catalan constitutional issue. However, given that the PSOE and Podemos together hold only 155 seats in the 350-seat lower house of parliament, the government will need ongoing ad-hoc support from other parties to pass legislation.

After several prior failed efforts at inauguration, the installation of the new government removes the immediate risk of further general elections and will improve political stability. However, the administration's lack of working majority will make its key policy objectives subject to other parties' approval. Areas of sensitivity include Catalonia, where the government hopes it can compromise with pro-independence forces, notably the ERC, by offering to widen regional powers.

The coalition parties prior to the confidence votes outlined their economic agenda, which is dominated by higher taxes for large corporations and top salary earners, a rise in the minimum wage and some push back from recent labour market and pension legislation.

The main proposals in the plan

The main proposals included in the plan are as follows:

- A minimum corporate tax rate of 15%, which rises to 18% for banks and energy utilities on taxable income. The standard rate is 25% but it can be adjusted because of qualification, valuation or imputation rules.
- Tax on capital gains above EUR140,000 will increase by 4 percentage points to 27%.
- Higher income tax rate for employees earning more than EUR130,000 and EUR300,000 per annum.

The new government anticipates that the proposed tax reform will affect less than 1% of taxpayers and companies.

Other proposals include:

- The minimum wage will rise steadily to reach 60% of average national wage, estimated at EUR1,200 per month over the government's lifetime. This was preceded by a 22% rise to EUR900 per month from 1st January 2019. According to the trade union, UGT, the 2019 rise benefited 2.6 million workers.
- The agenda also promises to create a Statute of Workers. It wants to recover "labour rights taken away by the labour reform of 2012" and repeal the priority of company wage agreements over sectorial ones.
- Other labour proposals include strengthening protection against dismissal for absences caused by illness.
- Podemos has agreed that the new government will abide by EU rules on fiscal discipline and deliver its agreed budgetary targets.

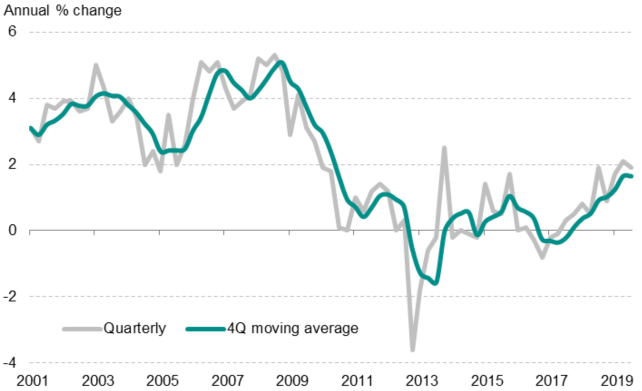
Implications for the Spanish economy and labour market

The impact on the proposed economic agenda on growth is expected to be mixed, but we would argue that the balance of risks is tilting to the downside, particularly in the medium-term.

The continuous rise in the minimum wage will provide further assistance to the more distressed parts of the household economy, characterized by compressed real income growth and poor employment quality.

Despite a prolonged economic upturn, Spain is gripped by a standard of living crisis, while its incidence or risk of poverty is higher than its eurozone peers. A key factor has been the prolonged squeeze on nominal wages, with labour costs per worker little changed when compared to late 2013, the start of the economic recovery.

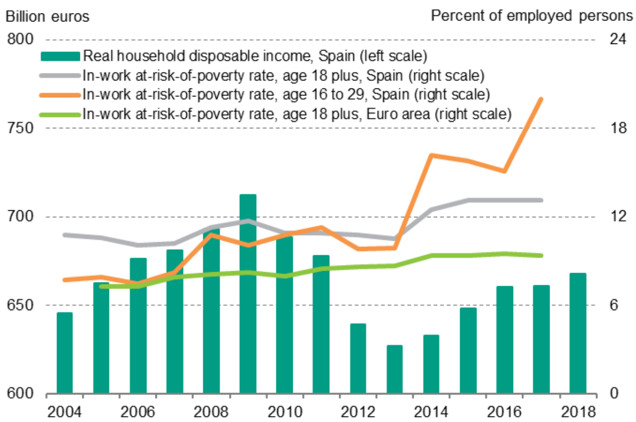
Spain: total wage cost per worker



Source: IHS Markit, National Statistics Office

The recent and proposed rises in the minimum wage aim to confront the creation of a new class of "working poor", with the "in-work at risk of poverty rate" in Spain notably higher than the eurozone average.

Spain: household income and in-work poverty



Source: IHS Markit and Eurostat

With regards to the economy, a higher minimum wage for several million workers will assist the poorer households with a traditionally higher marginal propensity to consume.

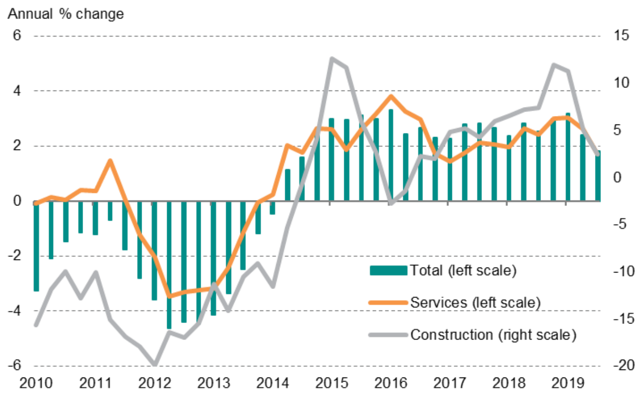
But, a cumulative rise in the minimum wage by an estimated 60% in five years represents a significant rise in wage costs for labour-intensive sectors of the economy and is a risk to already slowing employment creation. The demand for labour in tourism and leisure services and construction is likely to be the most affected.

Additional labour market risk

The new government's plan to part repeal the 2012 labour market reform presents an additional risk to improved employment conditions.

The 2012 labour reform which reduced redundancy payments and injected greater flexibility into Spain's wage bargaining system which, in tandem with improved economic conditions, helped to trigger a sustained recovery in employment.

Spain: employment

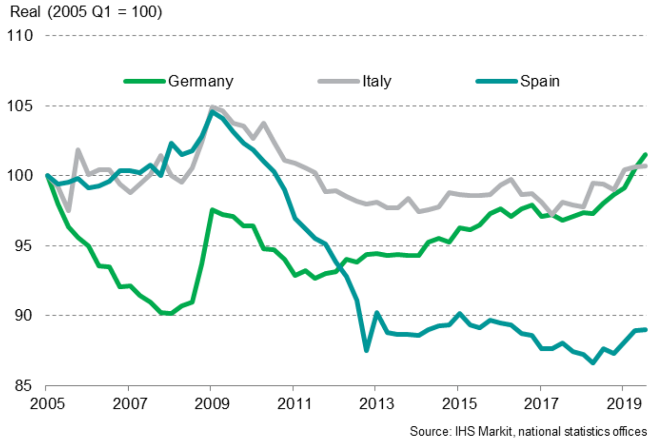


Source: IHS Markit, National Statistics Office

The 2012 reform allows company-level agreements to supersede collective bargaining agreements. Companies can now act independently to adjust their wage levels and hours to meet their trading conditions. Companies can also override their sectoral collective bargaining agreements by simply opting out. This has appeared to encourage wage growth moderation, with increased wage flexibility first helping to slow the employment losses before encouraging job creation.

In addition, wage moderation filtered through to improve the country's external competitiveness, signaled by several years of falling unit labour costs. This helped to deliver an improved export performance, with Spanish exports rising steadily relative to nominal GDP, rising from a historical low of 21.0% in early 2009 to 34.2% at end 2018.

Unit labour cost comparisons



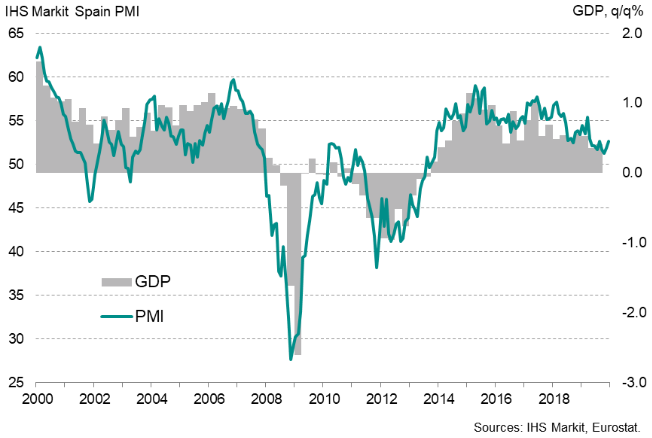
The part-repeal of 2012 labour market reform would prevent firms from opting out of sectoral wage agreements when faced with tougher trading conditions or have little scope to adjust wages and working hours locally. Firms would have to resort to past practices of reducing their workforces by not renewing temporary contracts, triggering deeper job destruction during recessionary conditions.

A more flexible wage bargaining system and recent agreements between the social partners have resulted in wages and productivity trends being better aligned. However, the sharp rise in the minimum wage in 2019 has weakened the relationship, and the proposed hike during the next few years is likely to trigger further divergence.

Spain: wages and productivity

Currently, we expect the economy to expand by 1.5% in both 2020 and 2021 after an estimated 1.9% gain in 2019. This outlook is based on orderly slowdown in near-term employment growth, but this could be at risk with the new government proposing a significant rise in the minimum wage and a more rigid wage bargaining system.

Spain: Economic growth



In addition, nominal wage growth has accelerated during 2019, aided by a higher minimum wage and a 2.25% rise in public sector wages. However, the prospect of even more elevated wage growth could be ill-timed with the repair of the Spanish labour market far from complete, with the unemployment rate at 13.9% in the third quarter of 2019.

Political instability just a vote away

Yolanda Diaz from Podemos has been appointed the minister of labour, suggesting the partial repeal of the 2012 labour reform is a significant government objective. Nevertheless, any tampering with past labour reforms is likely to meet congressional opposition from the conservative People's Party (Partido Popular: PP), far-right Vox, and centrist Citizens (Ciudadanos: C's). Before this, a key test of the new government's ability to obtain congressional support will be its eventual attempt to pass a budget; failure to do so would signal the likelihood of government inability to implement key legislation throughout 2020 and the prospect of further general elections.