Economic Research

27 January 2020

Week Ahead Economic Preview

Global overview

- **UK faces Brexit Day at end of week**
- **FOMC and BoE decide monetary policy**
- **US and Eurozone GDP**
- **Bank of Japan document eyed for future policy changes**

A week which sees the UK leaves the European Union is also packed with policy action from the Fed and the Bank of England, alongside GDP updates from major economies.

Brexit is high on the list of global concerns. Increasing market jitters are expected as Brexit Day approaches at the end of the week, with analysts assessing the ability of the UK government to make trade deals with the EU before the transition period runs out at the end of the year. The Bank of England also meets in the week, and prospects of a rate cut hinge on British economic performance at the start of the year.

In the US, where Fed policymakers meet during the week, the FOMC looks set to continue sitting on its hands for an extended period barring any material changes to the outlook. Nonetheless, rhetoric from the press conference will be scrutinised by analysts for clues as to future policy direction. Meanwhile fourth quarter GDP update will be in focus as well, with expectations of steady growth during the closing quarter of last year.

In the eurozone, updated GDP figures will likely provide confirmation to expectations of subdued growth. The December PMI surveys showed that the European economy closed out 2019 in its worst spell since 2013, with near-stagnant demand and gloomy prospects likely extending into the new year.

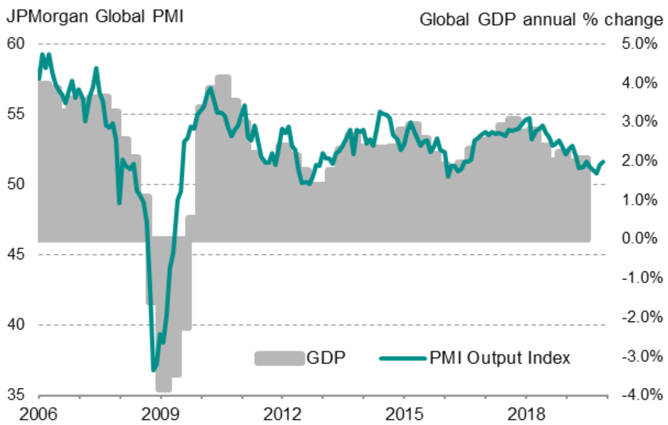
In Asia Pacific, BoJ summary of opinions will be scrutinised for clues of the likelihood of tighter monetary policy following growth forecast upgrades at the recent policy meeting. India's 2020 budget will also be watched closely for any announcements of fiscal measures amid a growth slowdown, while an updated official estimate of FY19/20 GDP projection will be eagerly anticipated. Meanwhile, China's government-sponsored PMI figures would provide clues as to whether recent manufacturing recovery had gained pace.

Special reports

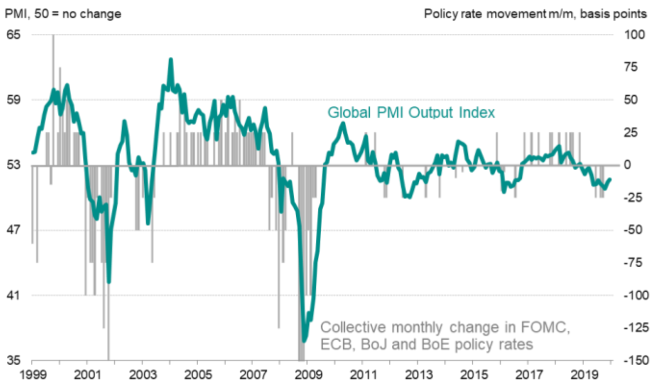
US-China: A look at the impact of the Phase One trade deal on Asia-Pacific growth (**page 6**).

Sweden: Insights into how optimistic forecasts for inflation underpinned Riksbank's December rate hike and what the Swedish central bank would do if inflation underwhelms projections. (**page 9**)

PMI data showed accelerated worldwide growth at the end of 2019, underscoring the brightening picture of global economic trends



Global PMI data still stuck in territory commonly associated with accommodative monetary policy of major central banks



Source: IHS Markit, JPMorgan.

Key diary events (UTC)

Monday 27 January
Germany Ifo surveys (Jan)
Hungary interest rate decision
UK finance mortgage approvals (Dec)
France unemployment benefit claims (Dec)
US new home sales (Dec), Dallas Fed manufacturing index (Jan)

Tuesday 28 January
Australia business confidence (Dec)
Russia unemployment rate (Dec)
US durable goods orders (Dec), Case-Shiller home price (Nov)
South Korea consumer confidence (Jan)
BoJ summary of opinions

Wednesday 29 January
Japan consumer confidence (Jan)
Australia inflation (Q4)
Vietnam trade, inflation, industrial output (Jan)
Thailand industrial output (Dec)
Germany consumer confidence (Feb)
UK nationwide housing prices (Jan)
US goods trade balance, wholesale inventories (Adv, Dec), pending home sales (Dec)
FOMC monetary policy
South Korea business confidence (Jan)

Thursday 30 January
Hong Kong trade (Dec)
Germany unemployment rate (Jan)
Italy unemployment rate (Dec)
Euro area business confidence, economic sentiment (Jan), jobless rate (Dec)
BoE interest rate decision
Germany inflation (Prelim, Jan)
US GDP (Adv, Q4)
Japan jobless rate, retail sales (Dec), industrial production (Prelim, Dec)

Friday 31 January
UK Article 50 extension expires
UK consumer confidence (Jan)
China NBS manufacturing PMI (Jan)
Singapore jobless rate (Prelim, Q4)
Euro area, Spain and France inflation (Flash, Jan)
Germany retail sales (Dec)
India GDP (Final, FY19-20)
US personal spending and income (Dec)
US PCE price index (Dec), employment cost index (Q4)

Sat-Sun 1-2 February
1: India union budget 2020

For further information:

If you would like to receive this report on a regular basis, please email economics@ihsmarkit.com to be placed on the distribution list.

For more information on our products, including economic forecasting and industry research, please visit the Solutions section of www.ihsmarkit.com

For more information on our PMI business surveys, please visit www.ihsmarkit.com/products/PMI

Click here for more PMI and economic commentary.

For all further information, please visit
www.ihsmarkit.com

Chris Williamson
Chief Business Economist
IHS Markit
Email: chris.williamson@ihsmarkit.com

United States Week Ahead

Advanced GDP estimate, Fed decision and PCE price index

By Siân Jones
Economist, IHS Markit, London
Email: sian.jones@ihsmarkit.com

Key events and data releases coming out of the US in this busy week include the policy decision from the Fed, the first estimate for fourth quarter GDP and PCE prices data, which will together give a broad view as to the health of the US economy at the end of 2019. The FOMC press conference will also provide insights into future policy moves for the rest of 2020. Also released are updates to durable goods orders, housing sales, wholesale inventories and personal income data.

Fourth quarter GDP estimate

Composite PMI data for the final three months of 2019 pointed towards another solid expansion in GDP during the fourth quarter, which is expected at 2.1%, according to IHS Markit estimate that has been revised down recently to reflect a slower than expected rise in official retail inventories and sales. This forecast matches the final figure for the third quarter and would indicate stable expansion across the US economy through the second half of 2019.

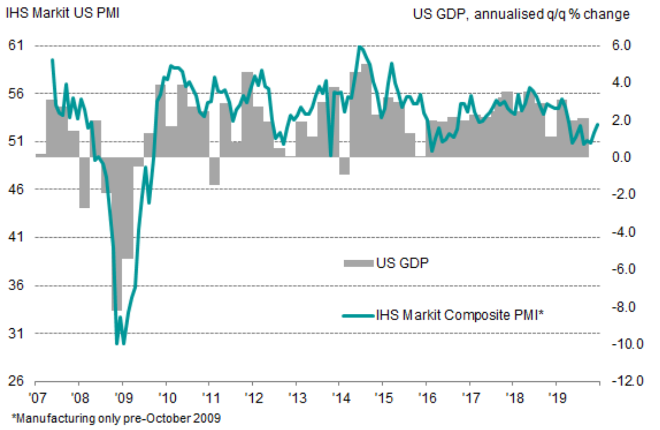
Fed rate decision

Kickstarting the FOMC meeting calendar for 2020, January's decision is unlikely to surprise, with no movement in the key policy rate, according to consensus expectations. In fact, as inflationary pressures look set to remain stable and below target during the medium term, our US economic team do not foresee a change in Fed policy until mid-2021. Expectations of little change to the federal funds rate also come as the Fed continues to evaluate the impact of several cuts made during 2019, while remaining committed to their goals of stable prices and maximum employment.

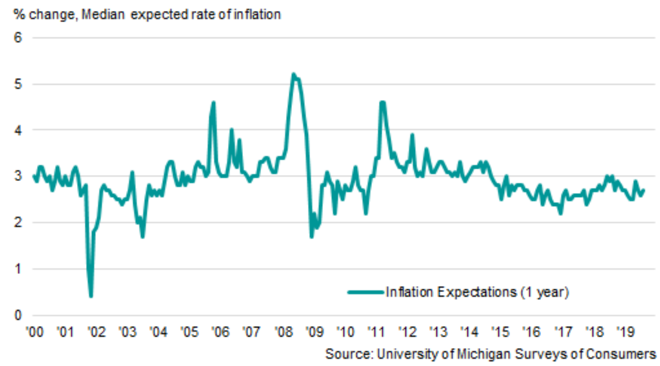
PCE Price Index

In line with predictions for monetary policy, price pressures are expected to remain historically soft in December. According to December PMI data, the pace of increase in core PCE prices (excluding volatile items such as food and fuel) looks set to pick-up during November, albeit remaining below 2%. Although consumer expectations regarding inflation ticked up in December, survey data for the medium term remain relatively soft.

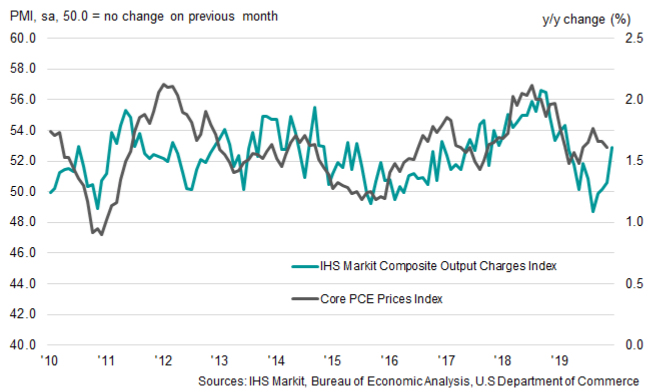
Q4 GDP expected to remain solid



Inflation expectations are unlikely cause concern for the FOMC



Price pressures to remain relatively soft



Europe Week Ahead

Brexit day, crucial Bank of England meeting and euro area GDP

By Joe Hayes
Economist, IHS Markit, London
Email: joseph.hayes@ihsmarkit.com

In a week which sees the UK formally leave the European Union, the Bank of England will set monetary policy, while euro area GDP for the fourth quarter is also released. Labour market and inflation figures for the euro zone also carry the potential to put pressure on policymakers.

Eurozone GDP

Fourth quarter GDP for the euro area looks set to disappoint, with available data so far suggesting the quarterly growth rate will slow to around 0.1%. Given a diminishing arsenal of policy tools, the European Central Bank will be hopeful that GDP provides no downside surprises, particularly given that inflation remains well below target and December survey data hinted that labour market conditions have softened further.

We have to wait a bit longer for Germany's fourth quarter GDP estimate, but other growth figures from the likes of France and Italy are expected to show how widely diverged growth profiles are at the regional level.

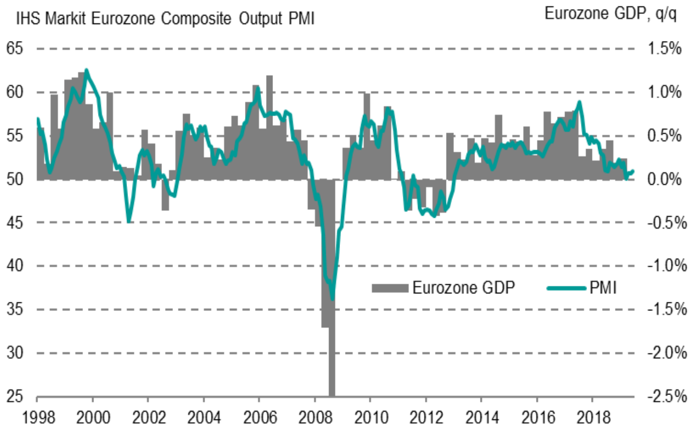
Bank of England

The prospect of a rate cut in the UK hangs in the balance. Pre-election data have been broadly mixed, with poor retail sales data contrasting with a robust jobs market update earlier this week. However, flash PMI data out later today (24 Jan) will be pivotal as it provides the bank with their first insight into economic conditions so far in 2020. A weak print could push policymakers into action in order to avoid further deterioration, although any post-election boost to output may be sufficient to keep the doves at bay for now. With four out of the nine committee members signalling an intent to cut, the decision remains on a knife edge.

Brexit day

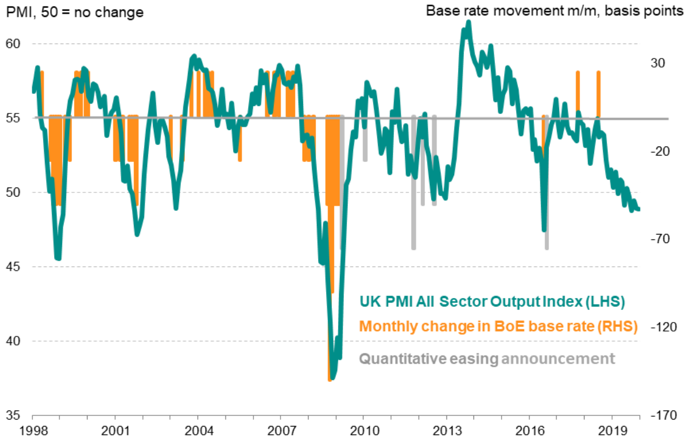
With the Withdrawal Agreement Bill taking the UK out of the EU on 31 January, the UK will enter the transition period until the end of 2020 and attention will now be fixated on the government's ability to reach a new trade deal with the EU. While the General Election result has helped lift confidence in the UK, this could easily unravel if uncertainty towards future trade arrangements remains at large for the next 11 months.

Fourth quarter euro area growth set to underwhelm



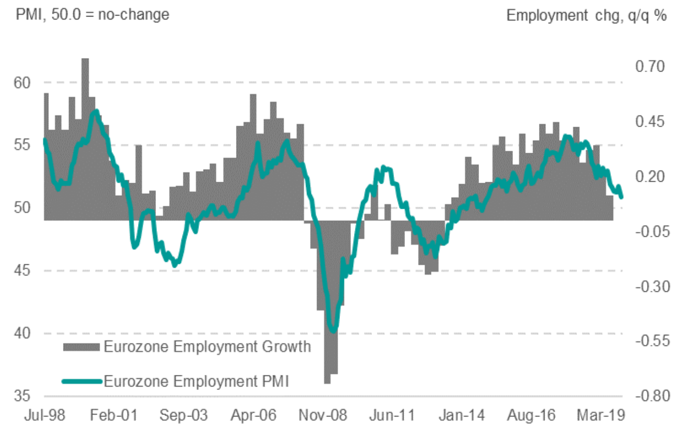
Sources: IHS Markit, Eurostat

Bank of England decision on a knife edge



Sources: IHS Markit, Bank of England.

Uninspiring eurozone employment growth



Sources: IHS Markit, Eurostat

Economic Research

27 January 2020

Asia Pacific Week Ahead

Japan data, India budget, Hong Kong trade and Thai factory output

By Bernard Aw

Principal Economist, IHS Markit, Singapore

Email: bernard.aw@ihsmarkit.com

With several Asian countries away for Lunar New Year, the calendar next week is relatively light. Investors will focus on the Bank of Japan's Summary of Opinions following a growth forecast upgrade at its recent policy meeting. China government-sponsored PMI will also gather interest for clues as to whether the recent manufacturing recovery has been sustained at the start of the year. India's budget will also draw scrutiny amid signs of an economic slowdown, while the second government projection of FY2019-20 GDP will also be in focus. Other key data highlights include Hong Kong's trade data and Thai industrial production numbers. Markets will also be monitoring developments of the Wuhan coronavirus situation.

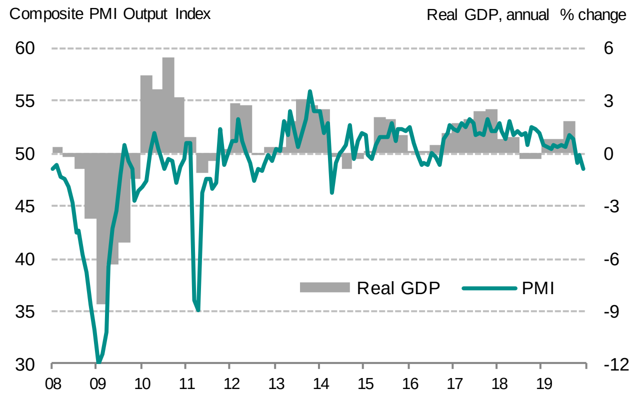
Japan monetary policy and data

With the BoJ leaving monetary policy unchanged and revising higher its growth forecast, analysts will be keen to scrutinise the Summary of Opinions for clues on future policy direction, in particular any likelihood of some withdrawal of current stimulus measures. Recent PMI data continued to point to economic weakness in the Japanese economy, with growth also hurt by the negative twin effects of a sales tax hike and Typhoon Hagibis. Retail sales data meanwhile will be closely watched for hopes that consumer spending has continued to recover to provide support to business activity and counteract the manufacturing downturn. Updates to jobs and industrial output numbers will also provide more information on the health of the Japanese economy.

India budget and growth forecast

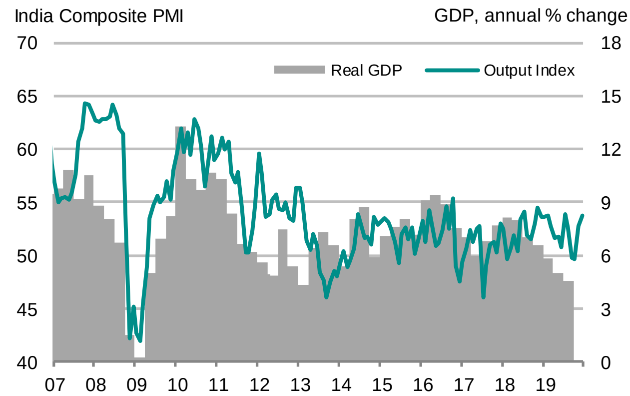
Facing an economic slowdown, Indian watchers will keenly look to the 2020 union budget for any announcements of fiscal stimulus measures to revive growth. According to the first projection, the government expects GDP for the FY2019-20 to come in at 5%, notably lower than the 6.8% recorded in the FY2018-19. An updated GDP projection will be released next week. PMI data however have been more encouraging, showing the service sector recovery gaining momentum in December, with manufacturing weakness also fading.

Japan PMI and economic growth



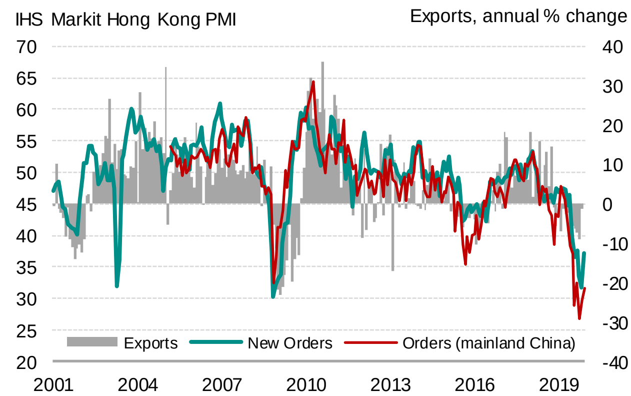
Sources: IHS Markit, Jibun Bank, Cabinet Office

India PMI and economic growth



Sources: IHS Markit, CSO

Hong Kong PMI and exports



Sources: IHS Markit, C&SD

Asia Pacific Special Focus

The US-China Phase One Trade Deal: Economic Impact on APAC

By Rajiv Biswas
Asia-Pacific Chief Economist, IHS Markit
Email: rajiv.biswas@ihsmarkit.com

The US-China phase one trade deal is a major step forward in defusing bilateral trade tensions between the US and China. The trade deal is expected to boost Chinese exports to the US in 2020, as well as having a positive impact on the wider Asia-Pacific manufacturing supply chain, which had been negatively impacted by the US-China trade war.

US-China Phase One Trade Deal Signed

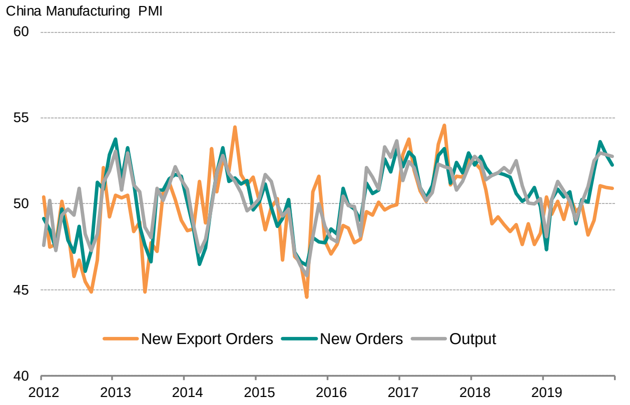
The signing of the US-China phase one trade deal by US President Donald Trump and China's Vice Premier Liu He in Washington DC on 15 January 2020 represents a major positive step for world trade, after a protracted bilateral trade dispute that has had significant negative transmission effects to international trade flows. The Dow Jones and S&P 500 indexes rallied on the news, reaching new record highs on 15 January on the news of the signing of the phase one trade deal, which is very positive for US exports to China and also will boost Chinese exports to the US.

Strong Boost for Bilateral Trade

For China, the phase one trade deal will bring significant reductions in US tariffs, which should help to boost US orders for Chinese products during H1 2020. China's exports to the US were significantly hurt by the impact of the US tariff measures, with total mainland Chinese exports to the US having declined by 12.5% in 2019.

Under the phase one agreement, US tariffs of 15% that were in force since September 2019 on USD 120 billion of Chinese exports will be halved to 7.5%. Chinese manufacturing export orders had already begun to improve even prior to the phase one trade deal and are expected to be boosted in H1 2020 following the reduction in US tariffs. However, US tariffs of 25% on USD 250 billion of Chinese exports will remain in place.

China Manufacturing PMI: Output, New Orders, and New Export Orders



Sources: IHS Markit, Caixin

Meanwhile total US exports to China are expected to be strongly buoyed by an additional USD 200 billion of Chinese imports of US goods and services over 2020 and 2021, under the terms of the phase one trade deal.

Total US exports to China will be USD 123.3 billion higher than the 2017 baseline, which would amount to a very large reduction in the US-China bilateral trade deficit and a large boost to US exports of manufactures, agricultural products, energy products and services.

For the manufacturing sector, China has committed to import an additional USD 32.9 billion of US manufactured goods above the 2017 baseline amount in 2020 and USD 44.8 billion above the 2017 baseline amounts in 2021. For the agricultural sector, China has committed to import an additional USD 12.5 billion of US agricultural products above the 2017 baseline amount in 2020 and USD 19.5 billion above the 2017 baseline amounts in 2021.

For the energy sector, China has committed to import an additional USD 18.5 billion of US energy products above the 2017 baseline amount in 2020 and USD 33.9 billion above the 2017 baseline amounts in 2021. US exports of crude oil, LNG and refined petroleum products are expected to be key winners from this overall large ramp-up in China's imports of energy products from the US.

With the escalation of geopolitical tensions in the Middle East, the US-China phase one trade deal will help to drive China's policy objective of improving energy security by diversifying oil and gas supply sourcing away from the Middle East and towards the US and other non-Middle East oil and gas exporting nations.

For the services sector, China has committed to import an additional USD 12.8 billion of US services above the 2017 baseline amount in 2020 and USD 25.1

billion above the 2017 baseline amounts in 2021. The US financial services industry will be a key winner, with the phase one trade deal providing for increased market access to China's market for banking, insurance, securities and credit rating services.

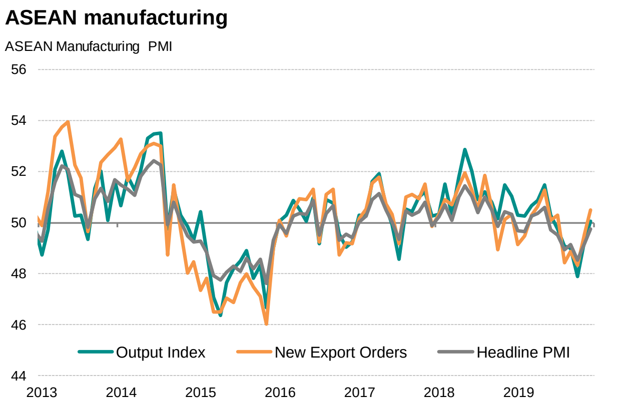
Another important positive under the phase one trade deal is the agreement on macroeconomic policies and exchange rate matters, which provides policy commitments to refrain from competitive devaluations to unfairly compete in international trade. As a result of this bilateral deal covering exchange rate matters, the US Treasury has withdrawn its designation of China as a currency manipulator in its twice-yearly report to Congress released on 13 January 2020.

Impact on Asia-Pacific Trade Flows

The Asia-Pacific manufacturing supply chain was badly hit by the contagion effects of the significant downturn in China's exports to the US during 2018 and 2019, which occurred at the same time as the sharp slowdown in global electronics new orders as well as the European Union manufacturing sector slump.

The new bilateral trade deal is expected to help boost Asia-Pacific regional trade flows, as China's manufacturing exports to the US are expected to rebound following the significant reduction in US tariffs agreed under the phase one deal. Furthermore, US exports to China will also increase significantly, helping to boost US new orders for Asia-Pacific exports of intermediate goods and materials for the US export sector. New export orders for China and Southeast Asia have already been strengthening in recent months, according to the Caixin China Manufacturing Purchasing Managers' Index produced by IHS Markit and the IHS Markit ASEAN Manufacturing PMI.

ASEAN Manufacturing PMI: Output and New Export Orders



Sources: IHS Markit

Outlook

The phase one trade deal represents an important positive development for the Asia-Pacific trade outlook in 2020. However, the US has still kept in place steep tariffs at a rate of 25% on USD 250 billion of Chinese exports to the US, so the US-China trade dispute remains a significant drag on regional trade. Therefore, a key focus in 2020 will be on the progress of US-China phase two trade talks, which could provide another positive boost to global and APAC trade flows if a further phase two trade deal can be agreed.

Despite the phase one trade deal, the process of supply chain diversification by global multinationals away from China is expected to continue, since substantial US tariffs remain in place on Chinese exports to the US and also because of rising manufacturing wage costs in mainland China. These factors are expected to continue to boost foreign direct investment inflows into Southeast Asian low-cost manufacturing hubs, including Vietnam, Philippines, Indonesia, Thailand and Myanmar.

Europe Special Focus

Riksbank's policy minutes reveal important policy splits

By Daniel Kral

Senior Economist, IHS Markit, London

Email: Daniel.Kral@ihsmarkit.com

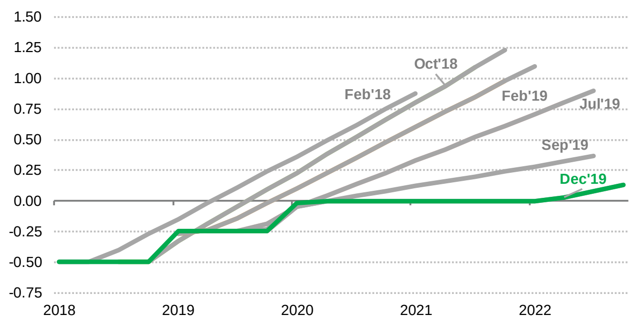
Minutes from Riksbank's December monetary policy meeting reveal important policy splits, but also highlighted several points, including the central bank's willingness to act if the outlook deteriorates; further rate hikes hinge on having a higher inflation rate for an much more extended period; and hints of a de facto exchange rate policy.

Riksbank tightens policy

Although the Riksbank stuck to the course it has been signalling throughout 2019, the decision for December's highly unusual "one and done" rate hike was not unanimous. Minutes from the meeting revealed important differences within the executive board. Although officially the next move is to be a hike after a prolonged period of rates on hold, there is a clear commitment to act if the outlook deteriorates.

In a highly anticipated yet unusual move, the Riksbank hiked the repo rate by 25 basis points, from -0.25% to 0.00%, in its December meeting. This ends the five-year period when the repo rate was negative (from February 2015 to January 2020), but it is not the start of a tightening cycle. The Riksbank has been consistently lowering the repo rate path (forecast of future movements in the repo rate), with the next hike expected well into 2022 (Chart 1).

Chart 1: Riksbank repo rate path forecasts



Source: Riksbank © 2020 IHS Markit

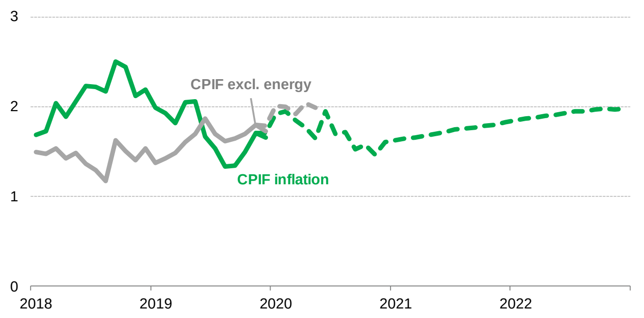
The Riksbank faced a delicate balancing act. On the one hand, its message for some time has been that the Swedish economy is entering a normal phase of lower growth with inflation close to target and in line with the forecasts, warranting a rate hike. It has also grown increasingly concerned about the negative side effects of below zero rates, such as high household indebtedness or the prospect of negative interest on retail deposits. On the other hand, a "one and done" rate hike is highly unusual. Holding the repo rate at zero for the duration of Riksbank's forecast period is not evidence of normalization, especially as the real repo rate will remain deeply negative. Recently released minutes from the meeting cast light on the debate within the executive board.

Internal split

Two out of six members of the executive board, Anna Breman and Per Jansson, voted against the rate hike, meaning one more dissenter would have required the governor, Stefan Ingves, to rely on his casting vote. Both dissenters preferred to keep rates on hold for now to reinforce the Riksbank's ability to achieve its inflation target on a sustained basis.

Per Jansson's dissent was based on three lines of reasoning. First, according to Riksbank's latest forecast, CPIF inflation is expected to average 1.7% in 2020 and 2021 (Chart 2), based on which he has "difficulty seeing an urgent need for a higher repo rate." Second, long-term inflation expectations have continued to fall, particularly among labour market organisations, which are crucial in Swedish wage-bargaining system. Although the falls are marginal, Jansson notes that it is "difficult to reverse a negative trend, once it has begun." Finally, financial markets have priced in a rate hike since late October, resulting in a significant rally in the Krona. A stronger Krona, which is deflationary, is not part of Riksbank's baseline forecast, making achieving the inflation target even harder.

Chart 2: Riksbank December inflation forecast

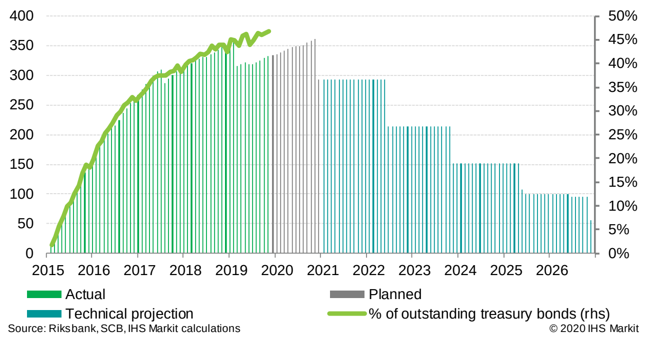


Source: Riksbank © 2020 IHS Markit

Anna Breman's dissent was based on her assessment that "economic activity in Sweden is still in a downward phase" and with the balance of risks "still dominant on the downside." She advocated signalling a rate hike in the first half of 2020, on the condition that economic activity has stabilised by then, followed by one rate hike in 2021 and 2022. Amid ongoing uncertainty, declining resource utilization and downside risks to growth and inflation, she notes that a one-and-done rate hike may do more harm than good, damaging an early recovery and resulting in the repo rate being at zero for longer than would be the case if the Riksbank waited for longer to hike.

The governor, Stefan Ingves, noted that monetary policy in Sweden, as well as globally, is in "wait and see" mode, and in this context "a zero policy rate is a better vantage point than a negative policy rate." Contradicting Per Jansson's assessment of below target inflation and downward revisions in inflation expectations, he noted that "our target attainment is good" and "the inflation forecast points to a rate of inflation close to the target in the coming years." The governor as well as other members of the executive board were keen to emphasize that the overall stance remains expansionary, due to the ongoing quantitative easing programme thanks to which at the end of 2019 the Riksbank held almost half of outstanding Swedish government debt (Chart 3).

Chart 3: Riksbank holdings of government bonds (SEK billion)

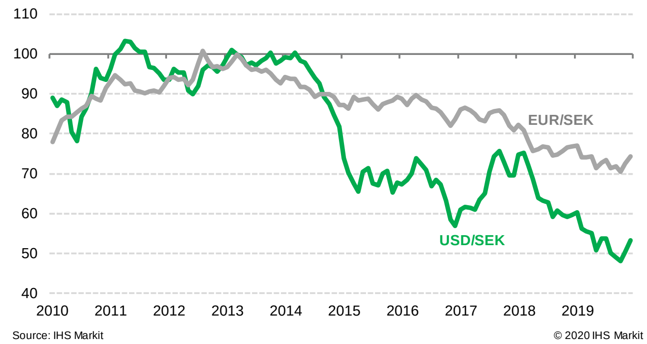


There are a few important takeaways from the minutes of the last meeting. First, every executive board member emphasized that the Riksbank is ready to act, should the outlook deteriorate. As governor Ingves noted, in such a scenario "a large expansion of our balance sheet is closer to hand than a negative policy rate below what we have seen in the past five years." Other members have also expressed a preference over a balance sheet expansion or "more innovative methods" than a rate cut.

Second, the Riksbank is ready to tolerate higher inflation for a sustained period before hiking rates. Board member Martin Floden noted "fairly major changes in inflationary pressures will be required before there is a need to raise the repo rate further." Governor Ingves added that "the inflation rate can overshoot the target for a period of time, especially given that inflation has in historical terms more often been under than over the target."

Third, the Riksbank hints at a de facto exchange rate policy. Although since early 2013, the Swedish Krona has been the worst performing G10 currency, losing almost 50% against the dollar and 30% against the euro (Chart 4), some members of the executive board are concerned with the recent appreciation, rather than the longer-term weakness, due to its impact on inflation. Finally, the differences among executive board members are quite significant. This highlights the extraordinary circumstances, to a large extent self-made, in which the Riksbank operates.

Chart 4: Krona exchange rate vs USD and EUR (March 2013=100)



Outlook

At the start of 2020, the Riksbank finds itself in a bind. According to its forecast, headline and core inflation should hit the target in the coming months, as economic activity picks up. This is not in our baseline. The question is what the Riksbank will do, if inflation significantly undershoots, potentially as early as this spring. There is a clear reluctance to cut the policy rate back to negative territory, while the scope and effectiveness of further balance sheet expansion is limited. Indeed, a rate cut to negative territory would be an open admission that the December rate hike was a mistake. Although not in our baseline, it may turn out to be the preferred course, in case of a negative surprise.