Week Ahead Economic Preview

Global overview

- **US industrial production, retail sales and CPI**
- **US Fed semi-annual testimony**
- **GDP updates for the UK and Germany**
- **Japan GDP and New Zealand rate decision**

Key releases include GDP numbers for Japan, the UK and Germany, which look set to show both European economies avoided sliding into contraction, but that Japan slipped into decline. Industrial production, retail sales and inflation data are released for the US, while policy action comes from New Zealand. US Fed chair Powell will also give the semi-annual testimony.

The US earnings season meanwhile continues with 488 companies reporting (including PepsiCo; Nvidia; Cisco systems; CME group, Adidas and Astrazeneca), as do the US primaries. Markets will of course also be eager to assess novel coronavirus developments. Global growth hit a ten-month high in January, but that was prior to the virus outbreak. Analysts are keen to get more information on the scale and impact of the virus before updating 2020 growth forecasts.

With manufacturing representing a weak link in the recent performance of the US economy (factory output fell 0.3% in the fourth quarter), official production updates for January will be important to gauge growth momentum at the start of the first quarter. Retail sales data will meanwhile provide an important further steer on GDP trends, while inflation numbers will help guide markets on upcoming FOMC decisions. A solid retail sales trend will be needed to reassure on continuing robust GDP growth at the start of the first quarter, while inflation should start to firm in coming months to meet FOMC expectations (see page 3).

In Europe, fourth quarter GDP releases for the UK and Germany are expected to show downturns have been narrowly avoided, while Eurozone industrial production numbers will be eyed for confirmation of the recent green shoots seen in the January PMI data (page 4)

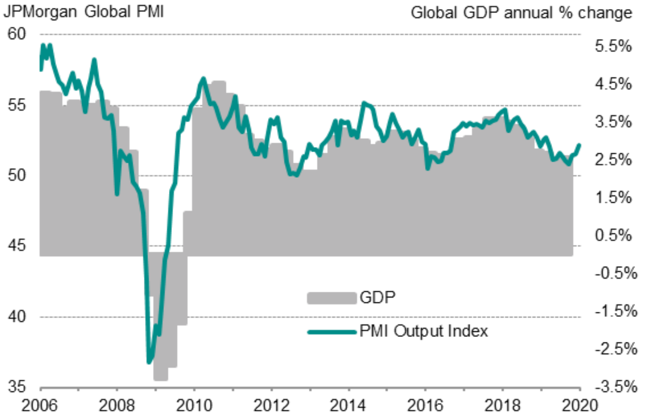
In Asia Pacific, Japan's fourth quarter GDP may well show the economy sliding into a downturn as weakened demand resulting from the sales tax hike was exacerbated by typhoon disruptions. Indian economic statistics will also garner attention following the recent budget announcement. Malaysia will also publish fourth quarter GDP performance while New Zealand will decide on monetary policy. The Reserve Bank is expected to remain on hold but may sound more hawkish after a recent rise in inflation (page 5).

Special reports

India: India's 2020–21 budget permits an expanded fiscal deficit; but few significant reforms look likely despite the government's ambitious privatisation programme (**page 6**).

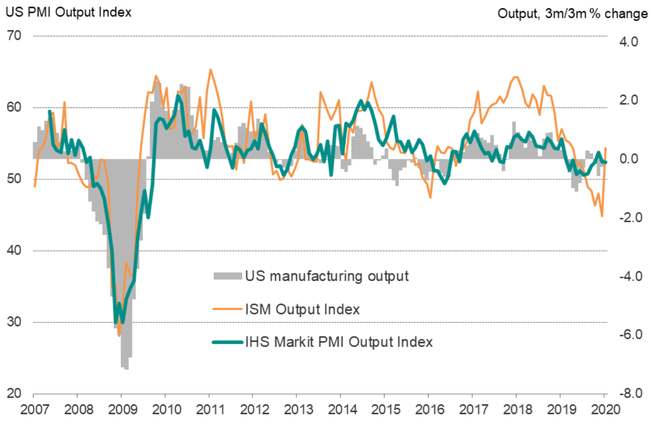
Europe's digital services tax. Digital services taxes are expected to remain a source of tension between the EU and the US, despite a recent truce. (**page 9**)

PMI data indicated global growth to have hit a ten-month high in January, but the coronavirus poses a key threat to the near-term outlook. Markets will be eager to assess virus developments to gauge the impact on growth



Source: IHS Markit, JPMorgan.

US manufacturing surveys have come back into line, indicating a broadly stagnant factory performance at the start of the year



Sources: IHS Markit, ISM, US Federal Reserve.

Key diary events (UTC)

Monday 10 February
China inflation (Jan)
Indonesia current account (Q4)
Japan Eco watchers survey outlook (Jan)
Italy industrial output (Dec)

Tuesday 11 February
Australia business confidence (Jan)
Philippines trade (Dec)
UK BRC retail sales (Jan)
UK GDP, business investment (Prelim, Q4)
UK trade balance, industrial output (Dec)
US Fed semi-annual testimony to Congress
US JOLTs job opening (Dec)
US New Hampshire primary
Australia consumer confidence (Feb)

Wednesday 12 February
RBNZ interest rate decision
Malaysia GDP (Q4)
Japan machine tools orders (Jan)
Euro area industrial output (Dec)
Brazil retail sales (Dec)
India industrial output (Dec), inflation (Jan)
US monthly budget statement (Jan)

Thursday 13 February
China vehicle sales (Jan), FDI (YTD, Jan)
France jobless rate (Q4)
Germany inflation (Final, Jan)
US inflation (Jan)

Friday 14 February
Japan tertiary industry index (Dec)
India WPI, trade balance (Jan)
Germany GDP (Flash, Q4)
Spain inflation (Final, Jan)
China new yuan loans, total social financing, M2 (Jan)
Euro area GDP (2nd Est, Q4)
Euro area trade balance (Dec), employment change (Prelim, Q4)
US retail sales, industrial output (Jan), business inventories (Dec)
US Michigan consumer surveys (Feb)

Sat-Sun 15-16 February
16: Japan GDP (Prelim, Q4)
16: Temporary General License for export of US components and services to Huawei expires

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United States Week Ahead

Industrial production, retail sales and inflation

By Siân Jones
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Key economic data releases for the week ahead centre around some of the first high-profile offerings for January from official sources. Industrial production data in particular will be eyed for signs of manufacturing sector health. Meanwhile, a gauge of wider economic performance will be taken with the publication of retail sales numbers and inflation figures. Also released this week are consumer inflation expectations, JOLTs and inventories data, as well as the monthly budget statement.

Industrial production

PMI data for the opening month of 2020 indicated a stuttering start to the year, with the manufacturing output index corresponding to a slight monthly contraction in official industrial production data. On an annualised basis, the latest data signals a decline of around 1% during the first quarter. Subdued levels of business confidence also hint at caution among goods producers going into the new year, as they struggle to kickstart sales growth. However, the divergence between survey data narrowed during January, giving greater clarity to the performance of the manufacturing sector, which is struggling rather than collapsing.

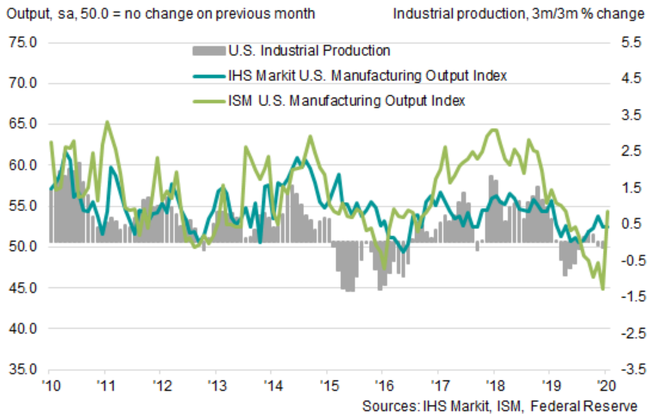
Retail sales

Annual growth in retail sales in January is expected to slow from December's recent high, easing closer to the long-run trend. The important consumer sector is a key gauge of the performance of the economy as a whole. A softer rise in disposable incomes in December may result in a slower trend in spending through the first quarter. Consumer confidence data will also be closely watched for signs that recent stock market gains and better trade war news are boosting sentiment.

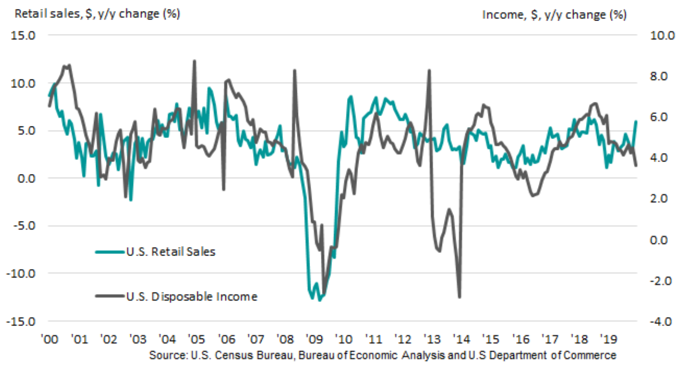
Inflation

As was reiterated in latest press conference by FOMC Chair Jay Powell, core inflation ran below 2% through much of 2019, a trend that is expected to end during 2020. According to the latest PMI data, the annual rate of CPI increase is expected to soften at that start of 2020 having climbed through the latter stages of 2019, with consensus forecasting little change to the pace of core inflation. However, this trend is expected to move towards the target rate through the coming months.

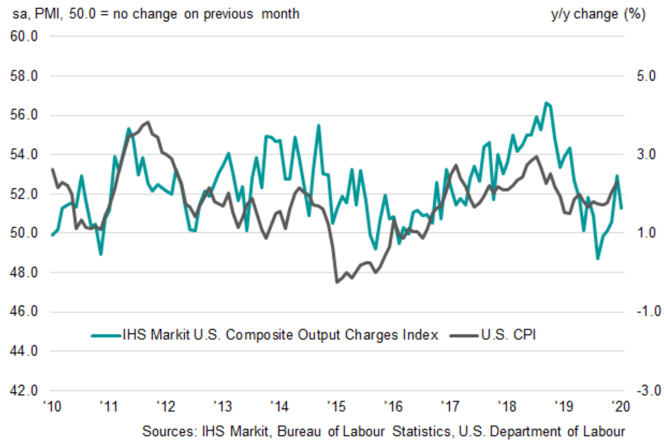
Survey data divergence reversed at the start of 2020



Retail sales growth set to ease amid slower rise disposable income



Inflation set to soften in January, according to latest PMI data



Economic Research

10 February 2020

Europe Week Ahead

UK and Germany GDP, eurozone employment and industrial output

By Joe Hayes

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Fourth quarter GDP for the UK is our key release in the coming week. BRC retail sales numbers for January will also be of interest to the data-dependent Bank of England, as they try to gauge the health of the economy in the post-election period. Fourth quarter GDP for Germany is also due, as is employment, trade, industrial output and the second first quarter GDP estimate for the euro area as a whole.

UK GDP

While UK fourth quarter GDP is unlikely to impact the direction of monetary policy, given the latter's focus on the post-election period, a disappointing outturn could trigger action in FX and money markets, which have both been data-sensitive in recent weeks. We expect GDP to have stagnated from the previous quarter following disappointing PMI figures across both manufacturing and service sectors.

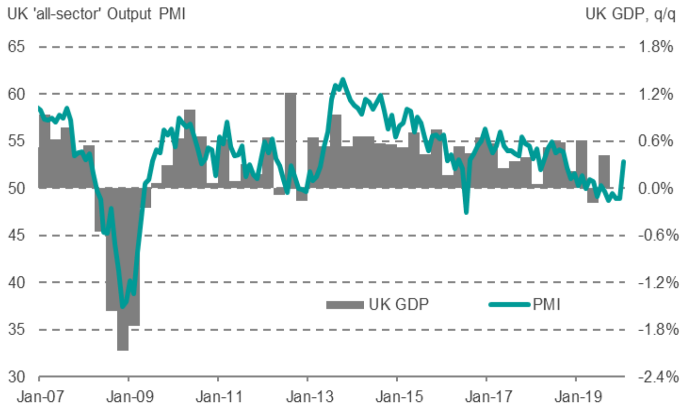
As well as the expenditure and sector breakdown from the national accounts, BRC retail sales data are due. The latter are arguably more relevant to the current state of play at the Monetary Policy Committee, who are trying to assess whether a looser bias is necessary in a post-election environment. To that end, a speech after these releases from Bank of England policymaker Jonathan Haskel (one of the two MPC members that voted to cut rates) will be scrutinised for any change in views.

Germany GDP and euro area data

In light of surprisingly weak GDP figures for France and Italy, it's a possibility, based on the aggregate euro area GDP estimate, that Germany has squeezed out a small quarter-on-quarter expansion in the final quarter of 2019. From a more contemporary perspective, January PMI data suggest that Germany's economy has picked up in the new year owing to an easing of the manufacturing downturn and a still-robust services economy, although our nowcast model suggests underlying growth is set to be only marginal for the opening quarter in Germany.

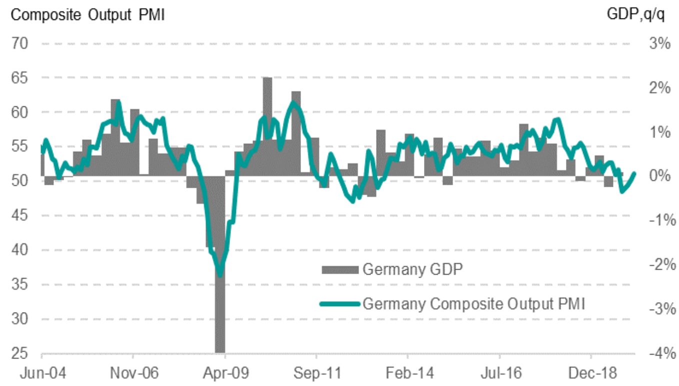
Trade, industrial production and employment figures across the euro area are also due. Employment data will be of particular focus, with growth prospects across the currency union hinging on a continuation of jobs and wage growth.

Fourth quarter GDP to be flat at best for the UK, but reasonable growth looks set for opening quarter of 2020



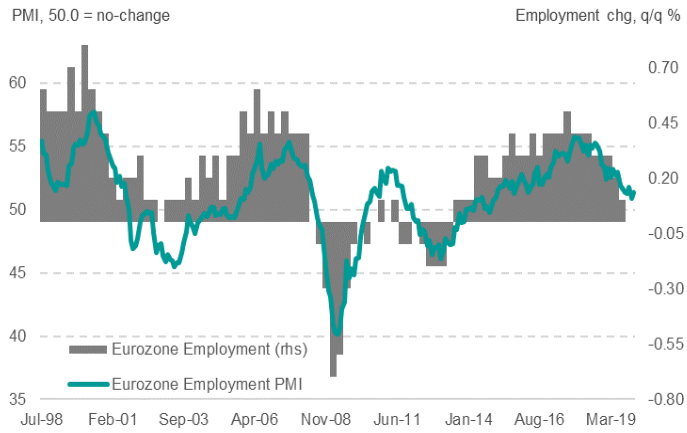
Sources: IHS Markit, ONS

Analysis of the data available so far suggest Germany could sneak an expansion in fourth quarter



Source: FSO, IHS Markit

Employment still growing in euro area, although growth has eased and remains relatively sluggish



Sources: IHS Markit, Eurostat

Economic Research

10 February 2020

Asia Pacific Week Ahead

China and India data in focus, plus Malaysia and Japan GDP

By Bernard Aw

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Escalating concerns over the economic impact of the coronavirus will bring China's January data into focus next week, while investors will monitor further developments out of China, including any new measures to contain the virus. Indian economic statistics will also gather attention following the recent budget announcement. Malaysia and Japan will publish fourth quarter GDP performance while New Zealand will decide on monetary policy.

China data eyed for coronavirus impact

While the latest Caixin PMI data showed a further slowdown in Mainland China's business activity in January, signs of the coronavirus impacting businesses weren't reflected yet in the surveys as responses had been collected prior to the escalation in the coronavirus situation. It is likely that forthcoming government data for January, including inflation, credit, money supply and financing, may likewise shed little light on the economic impact of the epidemic. The true impact on business expectations and activity is expected to only be reflected in February PMI data at the earliest. However, the updated statistics will at least give important clues as to the health of the economy prior to the virus hitting.

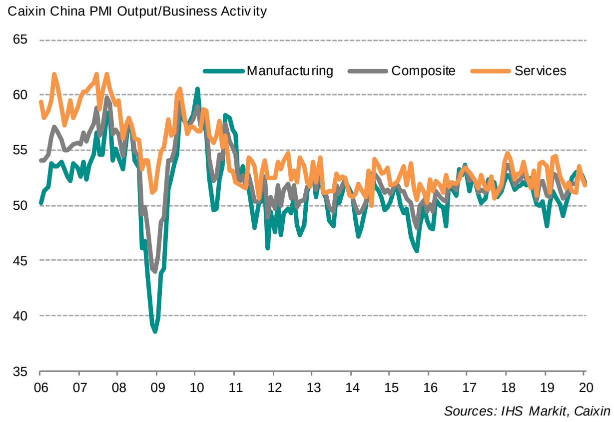
India statistics

The release of several Indian economic statistics, including inflation, industrial output and the trade balance, will provide a further look into the health of the economy. This come on the heels of the latest PMI data showing that growth of private sector activity moved up a gear in January on the back of broad-based accelerations across manufacturing and services, fuelled by a strong wave of new business, thereby alleviating concerns of a deeper slowdown.

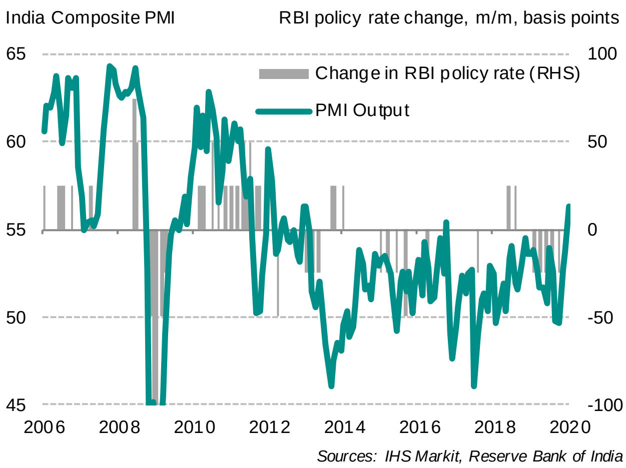
Malaysia GDP

Malaysia releases its fourth quarter GDP numbers next week, with recent PMI data consistent with an annual rate of just over 5%. However, January PMI update showed Malaysian manufacturers starting the year on a softer footing, which warrants closer monitoring of survey results in coming months.

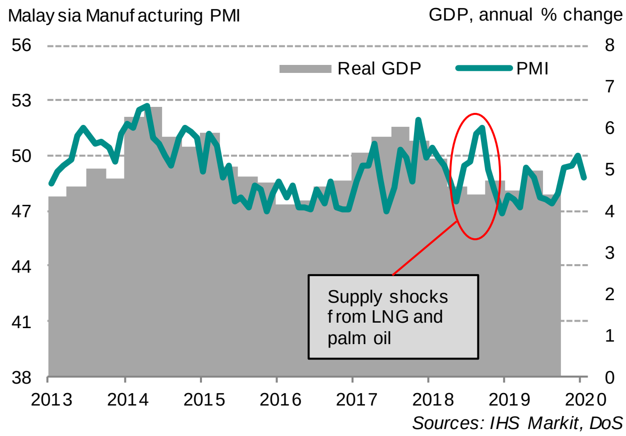
Chinese business activity growth slows



India PMI and monetary policy



Malaysia PMI and economic growth



Asia Pacific Special Focus

India: 2020–21 budget to permit an expanded fiscal deficit; but few reforms look likely despite ambitious privatisation programme

By Bree Neff
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Indian Finance Minister Nirmala Sitharaman presented the government's fiscal year (FY) 2020-21 budget on 1st February, the first full budget in Prime Minister Narendra Modi's second term. The budget plans an expanded fiscal deficit worth 3.5% of GDP versus a prior 3% target, but the policy choices indicate that the government has little room for significant policy manoeuvre.

Continued delay in fiscal consolidation indicates government's intent to bolster the economy

For FY 2020–21 (1st April 2020–31st March 2021) the government has invoked an "escape clause" that was included in the 2018 revision of the Fiscal Responsibility and Budget Management Act. This enables it to overshoot budget targets by up to 0.5% of GDP in the event of sharply weaker economic activity. Accordingly, the FY 2019–20 budget shortfall has been revised to 3.8% of GDP from 3.3%, and the return to the previously targeted fiscal deficit of 3.0% of GDP has been deferred from FY 2020–21 until at least FY 2023–24.

The increased fiscal deficit target of 3.5% of GDP for FY 2020–21 is intended to boost the Indian economy, but the announced stimulus measures have been received cautiously by local media and business representatives. Strong pre-budget demands for the government to cut personal income taxes translated only into modest tax cuts that are available only if taxpayers waive deductions, thus limiting the net benefits of the changes to households and instead increasing policy uncertainty.

More significantly, the agricultural sector received a budget increase of 28%. Combined with the rural development budget, this should provide support to India's struggling rural economy. Some of the funding is earmarked for farms to set up solar power generation and to develop a national cold storage system for perishables. However, the budget allocation for the PM-Kisan programme – which provides minimum-income support for farmers – was left unchanged from the current fiscal year, and fertiliser subsidies were reduced.

The transport budget was increased by 7% to support infrastructure works, including expanded highway and airport development. The government also introduced a 100% tax exemption for sovereign wealth funds on interest and dividend receipts, and for capital gains achieved on investments made before 31 March 2024, in an effort to encourage external funding for infrastructure projects.

One notable omission (as had been indicated prior to the budget release) is that no further state capital injections are budgeted to support India's banking sector, particularly its weaker public-sector banks.

Revenue measures limited to focus on state divestments and import tariffs in support of "Make in India"

The revenue target from divestment from public-sector companies in FY 2020–21 was expanded sharply to INR2.1 trillion, just over twice the current fiscal year's target. This is a hugely ambitious target, given that the current fiscal year's earnings from divestment reportedly reached just one-quarter of the targeted amount. Firms involved in planned divestment include the country's largest insurer – Life Insurance Corporation (LIC) – and Air India. The LIC sale requires specific legislation and could entail India's largest equity sale to date, given LIC's dominant role within the country's insurance and asset-management segments. Local media suggest that the LIC flotation is likely to be attempted late within the fiscal year.

The budget also includes increased import tariffs on more than 30 products, aligning with the government's protectionist stance within its "Make in India" policy, which seeks to favour domestic job creation. As an example, this is the second consecutive budget where tariffs on imported mobile phones have been increased by 5% to boost domestic production.

Besides mobiles, three key areas for tariff increases are dairy products, medical devices, and electronic vehicles, again to encourage domestic production of these goods. The government has faced pressure in these sectors from local trade groups that oppose imports. Opposition from the dairy sector compelled the government to withdraw from Asia's Regional Comprehensive Economic Partnership in November 2019.

The tariffs on medical devices – taxed at 5% to help fund health-sector infrastructure spending – has been a key negotiation issue between India and the United States. The announced increase is likely to be contested during US President Donald Trump's visit to India in late February, potentially affecting India-US trade talks.

Growing opposition from interest groups limits government's capability for reform

Ongoing nationwide protests against the Citizenship Amendment Act (CAA) involving tens of thousands of people have presented the first major political challenge to Prime Minister Narendra Modi, and fit within the broader context of growing opposition from farmers, labour groups, and the general public against perceived government inability to address popular concerns. This increased pressure on the government, limiting its ability to attempt structural reforms.

As a result, the FY 2020–21 budget is attempting piecemeal measures affecting such interest groups, which will likely fail to satisfy their objectives. The absence of any significant increase in the PM-Kisan programme appears particularly sensitive.

Further indicators of government caution include its avoidance of controversial labour code changes or subjecting more goods and services to higher rates under the Goods and Services Tax (GST) to reflect fiscal shortfalls. Given such constraints, the main area for projected revenue growth is the country's planned privatisation programme. However, this is likely to face significant opposition from affected employees and requires extensive technical preparation, while also being subject to market volatility.

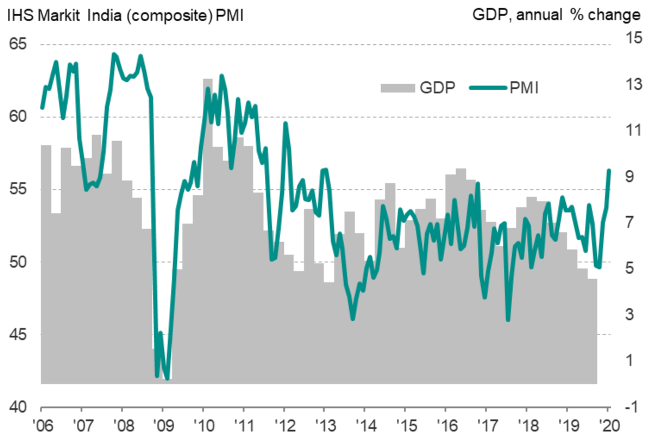
Outlook

IHS Markit expects the government to overshoot the 3.5% of GDP target for FY 2020–21, largely due to revenue underperformance. With corporate tax cuts and the government's privatisation programme repeatedly falling short of past targets, chronic revenue underperformance appears likely to continue. In turn, this will limit the government's financial flexibility in its attempts to revive the economy.

The budget's outlined spending plans do not appear to significantly address the key issues driving the current economic slowdown, including continued weakness affecting banks and non-bank financial companies. This will negatively affect credit provision, in turn constraining private consumption and investment. IHS Markit continues to forecast real GDP growth in the mid-5% range for FY 2020–21 versus the government's 6.0–6.5% projection.

The latest IHS Markit India Composite PMI survey, conducted during the month of January, does show early signs of a rebound in business activity at the outset of 2020. This may signal that the downturn in growth momentum during 2019 has now stabilised and is starting to improve. Latest Indian industrial production for the month of November 2019 also showed a modest positive rise of 1.8% y/y, after three consecutive months of contraction.

PMI data hint at faster economic growth



Source: IHS Markit

Policy change will be further restricted by the government's minority position in the upper parliamentary house, increasing scope for opposition parties to stall its policy agenda. This indicates an increased likelihood that policy adjustments will be attempted through cabinet decrees rather than parliamentary legislation.

Overall, IHS Markit believes that critical land acquisition legislation and labour reforms are unlikely in at least the six-month outlook. On the upside, the government is likely to increase foreign direct investment levels, notably in insurance. However, the government's limitations in pursuing reforms indicates that new projects under Make in India will progress slowly, limiting scope to expand employment or improve India's position in global supply chains.

Europe
Special Focus

What next for the digital services tax?

By Diego Iscaro
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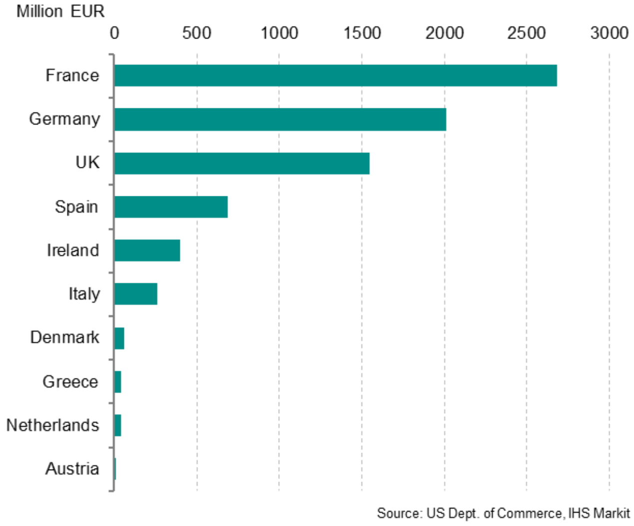
Digital services taxes are expected to remain a source of tension between the EU and the US, despite a recent truce. Although the US has agreed to delay its proposed tariffs in retaliation for France's digital services tax, tensions are likely to remain given that similar taxes are planned in other EU countries and in light of the difficulties in reaching a global agreement on a unified approach to taxing digital companies.

Tariffs and digital sales tax

Digital services taxes (DSTs) have become a source of tension between the EU and the US. When the French government legislated its version of the tax in July 2019, the US administration argued that it represented a protectionist measure as, in its view, it discriminates or "imposes undue burdens" on US tech companies. In November 2019, the Office of the United States Trade Representative (USTR) announced that it was contemplating imposing tariffs on USD2.4 billion-worth of French goods in retaliation. The preliminary list of goods targeted by the US mainly includes cosmetic, dairy products, as well as sparkling wine. The USTR was expected to unveil its decision by the end of January 2020.

However, the two sides agreed to continue negotiations until the end of this year following a meeting between French President Emmanuel Macron and US President Donald Trump on 20 January 2020. In return, France will postpone collecting the tax until the end of 2020, while the US has pledged not to introduce tariffs while negotiations remain ongoing. It is worth noting that France had been the country most affected by the punitive tariffs imposed by the US in October 2019 as a result of the WTO ruling regarding subsidies received by Airbus (see chart 1).

Chart 1: US tariffs on EU imports due to Airbus WTO ruling, breakdown by country



The truce between France and the United States lowers the risk of further US tariffs on French products before the end of 2020. But it does not completely remove the risk of further punitive tariffs on US imports of EU products. Indeed, France is not the only EU country where DSTs are being planned or implemented. The Austrian, Czech, Italian, Spanish, and UK governments have legislated, or are considering legislating, their own DSTs (see table below). In all cases, these country-specific taxes are designed to be phased out once there is a global DST in place. The temporary nature of these country DSTs has not stopped the US from announcing that it is ready to implement retaliatory tariffs if they are not withdrawn.

Digital Sales Tax legislation

Country	Tax Rate	Taxable persons	Status
Austria	5%	Digital companies with worldwide annual revenues of EUR750 million and more than EUR25 million of taxable revenues in Austria.	Effective since 1 January 2020
Czechia	7%	Digital companies with worldwide annual revenues of EUR750 million and more than EUR4 million of taxable revenues in Czechia.	Due to be voted by Parliament in Q1 2020.
France	3%	Digital companies with worldwide annual revenues of EUR750 million and more than EUR25 million of taxable revenues in France.	Effective since 1 January 2020
Italy	3%	Digital companies with worldwide annual revenues of EUR750 million and more than EUR5.5 million of taxable revenues in Italy.	Effective since 1 January 2020
Spain	3%	Digital companies with worldwide annual revenues of EUR750 million and more than EUR3 million of taxable revenues in Spain.	Draft bill currently being discussed in Parliament
UK	2%	Digital companies with worldwide annual revenues of GBP500 million and more than GBP25 million of taxable revenues in the UK.	In consultation. Expected April 2020.

This makes a global agreement on an international unified approach to taxing technology companies all the more pressing. However, there is a great deal of uncertainty as to whether such an agreement is possible. The OECD has been working on a two-pillar unified approach: the first, which is the source of tension between the US and the EU, deals with how profits are allocated among different jurisdictions. The second pillar targets the design of a system which will ensure that multinational companies pay a minimum level of tax.

The OECD published a proposal for a unified approach, which was endorsed by the G20 in October 2019. Its aim is to agree on a global framework by July and have it implemented before the end of 2020. Negotiations at the OECD, which involve 137 countries, will be challenging, particularly given the very tight timeframe.

The position taken by the US during the negotiations will be key in determining whether the OECD's efforts are successful. Following initial backing during the latest G20, the US government withdrew its support in December 2019, arguing that the tax should be optional. The truce reached with France suggests that the US is willing to negotiate, but opposition to DSTs within the Trump administration is strong. The OECD will present its latest plans during the meeting of G20 Finance Ministers in Saudi Arabia on 22/23 February.

If the OECD negotiations are not successful, the European Commission is expected to seek an EU-level agreement on DSTs by the end of 2020. Given the opposition from some EU member countries such as Ireland and Sweden, it is likely that there will be a push for a “softer” DST mechanism to achieve an agreement by the end of 2020 probably through allowing discretion in implementation for certain countries. More likely, however, there will be protracted negotiations within the EU beyond 2020 that would aim to achieve a wider consensus within the bloc.

A (limited) trade deal is still possible

In our view, the prospect of DST-related retaliatory measures is unlikely to preclude a trade deal between the EU and the US in 2020. Indeed, both sides have recently sounded more upbeat about reaching a deal. Following a meeting with Trump in Davos on 22 January, European Commission President Ursula von der Leyen sounded upbeat about the prospect of an agreement between the EU and the US "in a few weeks". The White House responded that it expected "tangible progress" in the "near future".

In April 2019, the European Commission was given a mandate to conclude two trade agreements with the US: one on tariffs strictly focused on industrial products that excludes agriculture; and one on technical standardisation (mutual acceptance of standards). In November 2019, the Commission submitted a formal proposal on an agreement between the two sides on the "mutual acceptance of results of conformity assessment" for industrial products.

We estimate that it is likely that the EU and the US will agree on a limited free-trade agreement in 2020, in line with the deal negotiated between the two sides in July 2018 that led to an increase in EU imports of US soya beans for biofuels and liquefied natural gas. If reached, an agreement between the US and the EU would be likely to focus on removing regulatory costs through the mutual acceptance of regulations and removing or substantially reducing tariffs for manufactured products.

As per the Commission's draft proposal, industrial goods include machinery, chemicals, textiles, passenger cars and trucks, and fisheries. Such a deal, if agreed, would probably materialise before the end of August 2020 considering the upcoming presidential election in the US in November 2020. The EU is very unlikely to accept any inclusion of regulations on food safety in an agreement with the US. Therefore, if the US were to insist on including agriculture in a deal with the EU, this would be an indicator of the potential failure of the talks.

Another source of disagreement may be the environmental regulations being considered by the EU as part of its efforts to cut net greenhouse gas emissions to zero by 2050 are also likely to be a source of tension in the future. For example, the proposal to introduce a carbon border tax is expected to be heavily contested by the US, although the plans are currently in an embryonic state.

A further complication for concluding a trade agreement before the US presidential election in 2020 would be an attempt to include a deal regarding tariffs related to subsidies received by aircraft manufacturers Airbus and Boeing. In October 2019, the US imposed tariffs on USD7.5 billion of imports from the EU following a ruling from the WTO. The WTO is expected to release its final ruling regarding the Boeing case before the end of the first quarter of 2020.

Trade uncertainty is here to stay, with or without trade deal

With the US still threatening to impose tariffs in retaliation for the DSTs, even a limited trade deal between the US and the EU is unlikely to be enough to substantially ease concerns about trade protectionism.

A trade agreement including food safety standardisation would signal a marked improvement in the trade environment, but we believe that this outcome is unlikely given strong opposition from countries such as France, likely protest activity by environmental and consumer groups across the EU, and probable opposition from the European Parliament.

The EU's large trade surplus with the US (see chart below) leaves it exposed to further retaliatory measures by the US. In recent weeks, US government officials have reiterated that they would consider imposing tariffs on imports from the EU, particularly on European cars, if there is no agreement on trade. The prospect of punitive tariffs on cars could be a strong incentive to accelerate negotiations: the automotive sector is a key part of the EU economy, accounting for 10% of its manufacturing production. It is particularly large in Germany, where it is estimated to employ more than 500,000 people, almost half of all employees involved in car manufacturing in the European Union.

Chart 2: US largest trade deficits, top 10 (2018)