Economic Research

16 September 2019

Week Ahead Economic Preview

Global overview

- **Fed, Bank of England and Bank of Japan policy meetings**
- **China fixed asset investment, factory output**
- **Asia trade numbers**
- **UK retail sales and inflation data**
- **Special report on trade-weighted euro**

The week ahead is dominated by central bank policy meetings around the world, with the FOMC being at the front and centre. China economic data will also be closely scrutinised, as will trade updates from a number of Asian economies.

Monetary policymaking at the world's central banks is being led by concerns about the health of the global economy and especially the extent to which growth is being hurt by trade wars. The JPMorgan global PMI, compiled by IHS Markit, was close to a three-year low in August amid a worsening trade picture, with goods exports falling at the fastest rate since late 2012.

Given increasing signs of global growth weakness, anything less than a quarter-point interest rate cut from the US Fed will surprise markets when the FOMC meets. Markets are near certain of a second Fed rate cut, according to futures data, after recent dovish remarks from Fed chair Jerome Powell. PMI data from IHS Markit continued to be consistent with US monetary policy remaining in dovish territory (page 3).

No change in policy is meanwhile expected at the Bank of England, although increasing signs of the economy sliding into decline and heightened risks of a no-deal Brexit could see the MPC adopt a more dovish stance (page 4).

In Asia, concerns that the yen may spike if Japan fails to loosen monetary policy at a time of Fed and ECB easing will place the Bank of Japan's policy meeting in focus, with attention paid to any discussions of possible options available to the central bank. Other regional central banks will also be eyed. Chinese data will be assessed for damage from trade wars as well as effectiveness of fiscal stimulus (page 5).

The weakening of the renminbi on a combination of slowing global growth and protracted trade wars has implications not just for the US, but also the eurozone. Our special report looks at how CNY depreciation impact eurozone growth prospects (page 6).

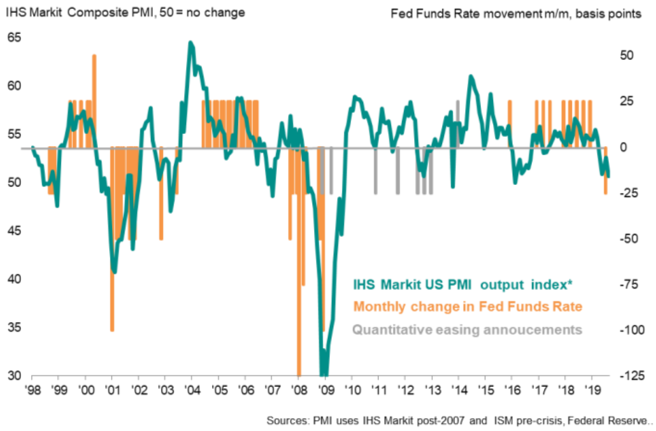
Contents

1 Global overview
2 Key diary events
3 US week ahead
4 Europe week ahead
5 Asia Pacific week ahead

Special reports

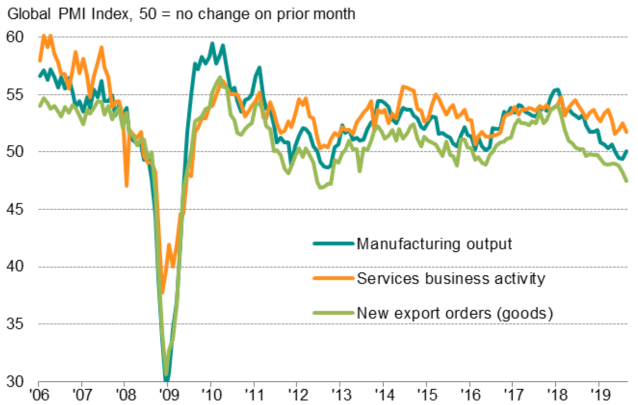
6 Why a weaker Chinese currency is a headache for the eurozone as well as the US

IHS Markit's US composite PMI remained in dovish territory in August, supporting the case for a second Fed rate cut



Sources: IHS Markit, Federal Reserve.

Global trade downturn intensifies in August, weighing on manufacturing activity



Sources: IHS Markit, JPMorgan

Key diary events

Monday 16 September

China fixed asset investment, industrial production, retail sales (Aug)

India WPI, trade balance (Aug)

Italy inflation (final, Aug)

US Empire State manufacturing index (Sep)

Brazil central bank Focus-Market Readout

Tuesday 17 September

Singapore NODX (Aug)

RBA minutes

Australia house price index (Q2)

China house price index (Aug)

Hong Kong unemployment rate (Aug)

Euro area and Germany ZEW surveys (Sep)

US industrial production (Aug)

US NAHB housing market index (Sep)

Opening of the UN General Assembly (74th session)

Wednesday 18 September

Japan trade (Aug)

UK inflation (Aug)

Euro area construction output (Jul), inflation (final, Aug)

US building permits, housing starts (Aug)

Thursday 19 September

FOMC meeting and quarterly economic projections

BoE and BoJ monetary policy meetings

Indonesia, Taiwan, Brazil interest rate decision

New Zealand GDP (Q2)

Australia unemployment rate (Aug)

UK retail sales (Aug)

US existing home sales (Aug), Philadelphia Fed manufacturing index (Sep)

Friday 20 September

Japan inflation (Aug)

China loan prime rate (LPR) announcement

Thailand trade (Aug)

Taiwan export orders (Aug)

Hong Kong inflation (Aug)

Germany PPI (Aug)

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United States Week Ahead

Federal Reserve set to cut interest rates

By Joe Hayes
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The FOMC meeting will take the spotlight as a 25bps rate cut is strongly anticipated and almost fully priced in by markets. The post-decision press conference and the release of the FOMC's latest quarterly summary of economic projections, which include updated GDP and inflation forecasts, as well as the closely watched dot plot, containing the FOMC's predictions for the Fed Funds rate, all have plenty of marketing-moving potential. Elsewhere, industrial production data for August will be closely watched following disappointing PMI data at the midway point in the third quarter.

Federal Reserve

When the FOMC cut rates for the first time in over a decade during July, rising global uncertainties was the main justification. External headwinds remain at large for the US, most notably in the form of trade tensions and slowing growth across the world's largest economies. Our US macro team expect that the FOMC will not disappoint markets and will action the first of two more 25bps rate cuts this year in September, with the second to follow in December. Indeed, the signal from our PMI data also suggests that the US economy has dipped into dovish territory and remained there.

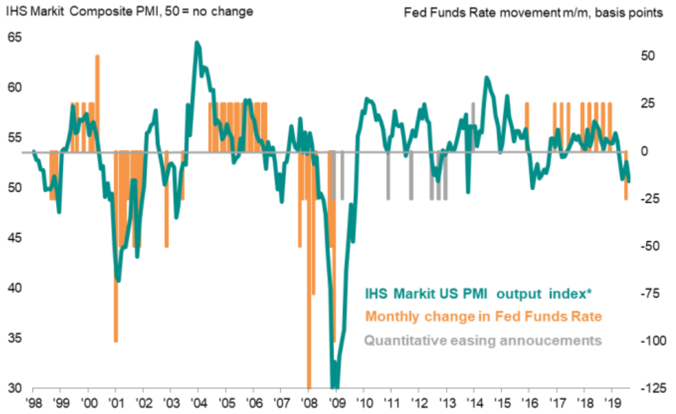
The press conference will follow the rate decision, with the publication of the FOMC's latest forecasts for GDP, inflation and the funds rate eagerly anticipated. The dot plot in particular will be closely watched to assess Fed policymakers' latest thinking about the interest rate trajectory since June's projections. Deviations between what the FOMC sees and market expectations could lead to volatility and repricing of expectations.

Manufacturing recession continues

Industrial production data will merit extra attention after our US Manufacturing PMI fell to a near 10-year low in August, suggesting that the goods-producing sector remains firmly stuck in recession, posing a significant drag on the economy in the third quarter. Our US macro team recently revised their forecast for the third quarter lower and are now anticipating a 2% annual rate of growth in the third quarter (2.3% previously).

Other data releases include the second quarter current account, jobless claims, housing starts and the Philadelphia Fed manufacturing index.

US PMI stuck in dovish territory

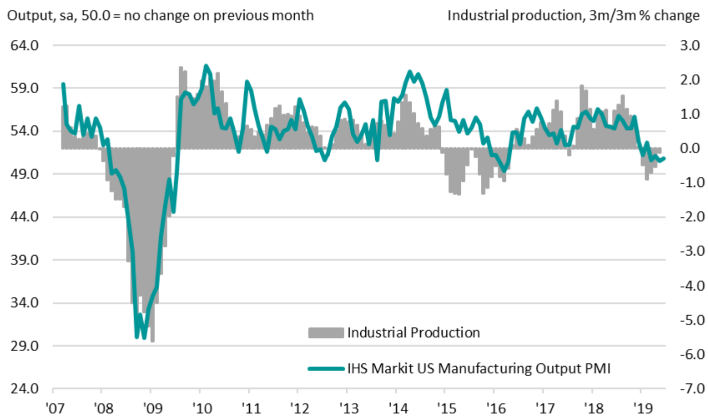


Sources: PMI uses IHS Markit post-2007 and ISM pre-crisis, Federal Reserve.

FOMC dot plot to be updated following September announcement

Source: Federal Reserve

PMI shows no light at the end of the tunnel for US manufacturers



Sources: IHS Markit, Federal Reserve

Europe Week Ahead

Bank of England unlikely to change tack amid heightened uncertainty

By Joe Hayes

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No policy action is expected from the Bank of England, but the MPC meeting will warrant close attention for change in rhetoric in the minutes. UK Inflation numbers are also due, although price pressures remain of no concern to policymakers for now, while retail sales data will help gauge the health of the consumer. ZEW sentiment surveys for the euro area are also due.

Bank of England to sit tight

The Bank of England meeting is likely to be a non-event, with another unanimous decision for no change to the base rate expected. Although July GDP data suggest that a technical recession could be avoided for the UK, PMI data for the first two months in the third quarter are consistent with GDP falling by 0.1%. At these levels, survey data is typically associated with looser monetary policy (see first chart).

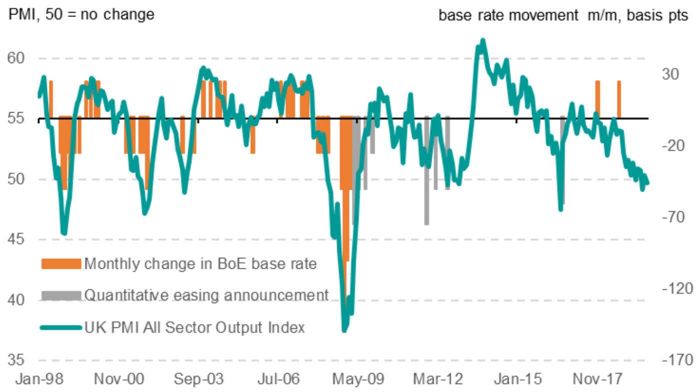
Given that political and Brexit-related uncertainty has intensified over the last few weeks, growth risks are firmly tilted to the downside. Our view is that, even if a no-deal Brexit is avoided, the uncertainty relating to the UK's trading position with the EU will spill into 2020, dampening demand, exports and investment. We therefore remain unconvinced that the Bank of England will be in any position to hike interest rates at least until 2021, and the deteriorating data flow raises the possibility that, whatever happens in terms of Brexit, the next interest rate could be a cut. To that end, the minutes from the latest MPC meeting will be closely watched for any signs of a more dovish stance.

Consumer inflation and retail sales numbers will also provide clues on consumer spending. The benign inflation environment looks set to continue, although the recent bout of sterling weakness may push up price pressures in the near-term. Meanwhile, given the robustness of the UK labour market, there is potential for retail sales data to remain positive.

Euro area sentiment dives

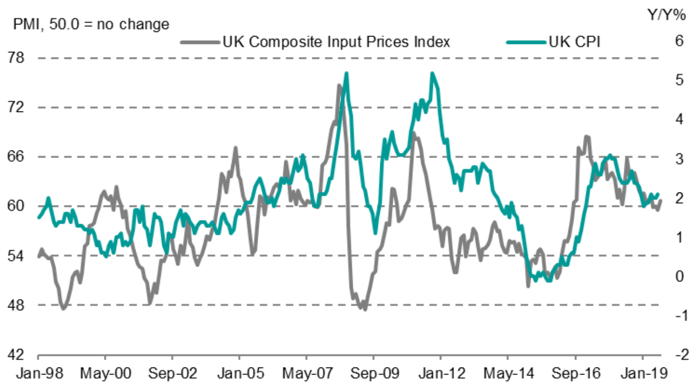
After the ECB's latest package of measures, it will be a quiet week on the data front for the eurozone, with the ZEW survey the main item. Sentiment-based indicators have shown deteriorating confidence across the euro area, in line with slowing growth. The ZEW survey hit its lowest level for almost eight years in August.

Bank of England unlikely to move despite survey data signalling for looser policy



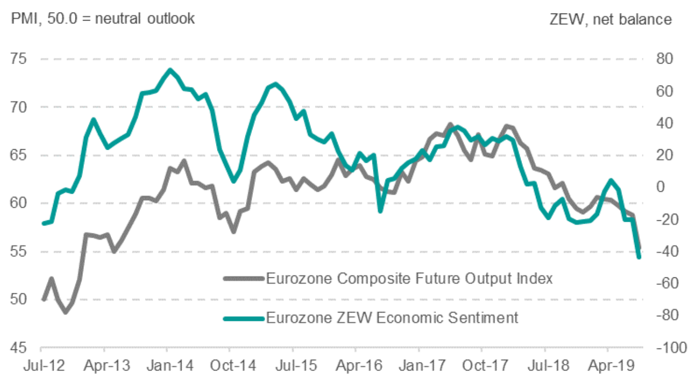
Sources: IHS Markit, Bank of England

Inflationary pressures remain benign in the UK



Source: IHS Markit, ONS

Sentiment across the euro area has deteriorated notably during third quarter so far



Sources: IHS Markit, datasteam

Asia Pacific Week Ahead

Asian central banks, China data, Japan inflation, regional trade numbers

By Bernard Aw
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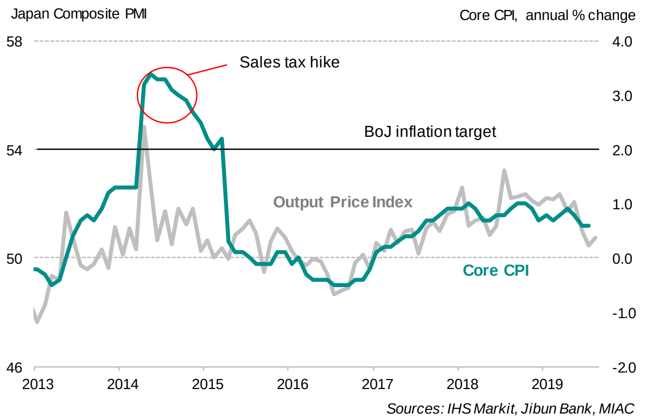
The coming week will be dominated by central bank meetings, of which the FOMC in particular will be eyed amid heightened expectations of further rate cuts. Japan, Indonesia and Taiwan will also set monetary policy against the backdrop of increasing growth risks. Meanwhile, China data on fixed investment, industrial output and credit will be closely scrutinised, while Japanese inflation will gather some interest. Other key data highlights include trade figures from Japan, Thailand, Singapore and Taiwan, alongside New Zealand's GDP figures.

Japan PMI points to muted inflation



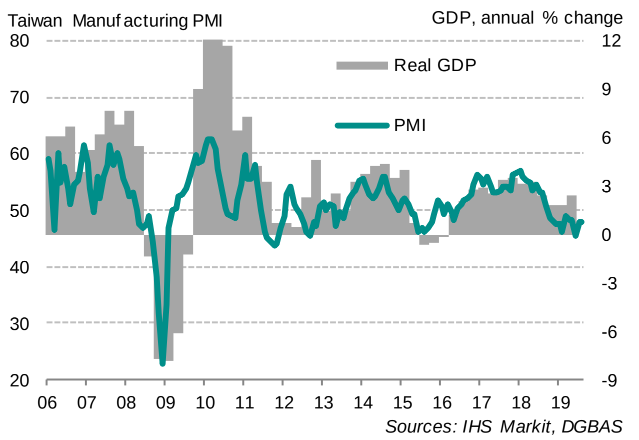
Source: IHS Markit, Jibun Bank.

Monetary policy

With high expectations of another Fed rate cut (following fresh stimulus measures from the ECB), the absence of US policy moves could lead to greater market volatility. Meanwhile, eyes will be on the Bank of Japan as to whether new stimulus measures, including options such as deeper negative rates and a reverse 'operation twist', will be announced – or at least considered in the face of a global growth slowdown. Japanese business activity growth picked up in August, according to latest PMI data, but other PMI sub-indices questioned the strength of the upturn.

Elsewhere in Asia, following two consecutive rate cuts, Bank Indonesia will likely monitor closely the Fed's next moves and the stability of the rupiah before considering if further easing measures are necessary. In Taiwan, subdued inflation and growing risks to economic activity will add pressure on the central bank to consider lowering its policy rate. Latest PMI data showed Taiwan's important manufacturing sector continued to struggle in August amid trade tensions.

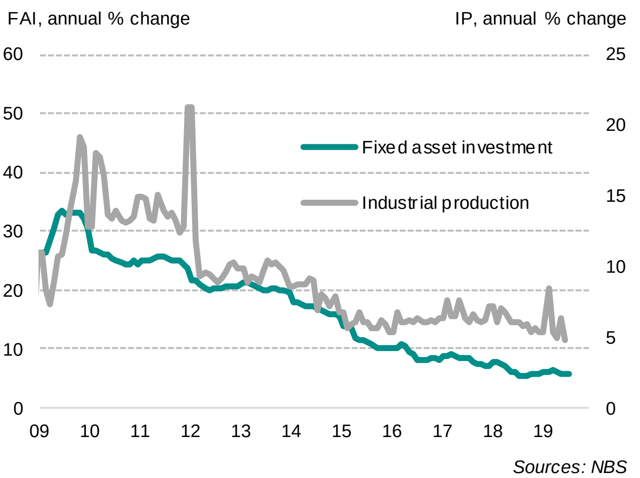
Taiwan's manufacturing sector struggles



China data

The forthcoming batch of Chinese economic data will help assess the health of China's economy. Analysts will scrutinise fixed investment and industrial production numbers in particular for clues on the extent of the effectiveness of current stimulus measures. Latest Caixin PMI surveys suggest fiscal pump-priming has provided support to manufacturing activity. Investors will also monitor the new benchmark lending rate, the Loan Prime Rate (LPR) for indication of bank lending rates.

China fixed asset investment and industrial output



Europe
Special Focus

Why a weaker Chinese currency is a headache for the eurozone as well as the US

By Ken Wattret
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The intensification of trade tensions between the US and China has been accompanied by a downward shift in the CNY. While the latter has been a focus from a US perspective, it is also a concern for the euro area, as we explain below, and is one of various factors behind the ECB's latest package of policy stimulus measures (see here for our latest ECB update).

The spill-over effects on global demand of tit-for-tat protectionist measures are hitting eurozone growth prospects, while at the same time, CNY weakness implies a higher trade-weighted euro, leaning further down on growth and inflation. The CNY accounts for the highest weight by far in the ECB's broad measure of the trade-weighted euro (the NEER-38), reflecting shifting patterns of trade.

August's rise in the NEER-38 was the biggest for almost a year, with this measure of the euro exchange rate now almost 14% above its long-run average.

Low EUR/USD rate but euro strong on a trade-weighted basis

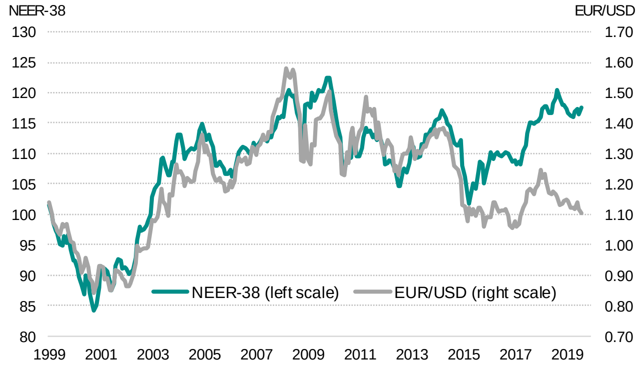
The As we have highlighted previously – see Watching the effectives: Why the trade-weighted euro keeps on rising from October 2018 – the hitherto stable relationship between the EUR/USD rate and the trade-weighted euro exchange rate has broken down in recent years. While the EUR/USD rate is typically the focus of attention, the evolution of the euro in trade-weighted terms is more important when it comes to gauging the potential economic effects of currency movements.

We tend to focus on the changes in the ECB's broad measure of the nominal effective exchange rate (known as the NEER-38) for a variety of reasons, including: the speed and frequency of updates (monthly without a lag); regular revisions to weightings (every three years); and its relevance to monetary policy decisions.

From 1999 to spring 2015, the relationship between EUR/USD and the NEER-38 was relatively stable at a ratio of roughly 2:1. In other words, a 10% appreciation (or depreciation) of EUR/USD would typically translate into an appreciation (or depreciation) of the effective euro of about half the size.

From spring 2015 through to spring 2017, however, the euro went broadly sideways against the dollar but the NEER-38 appreciated markedly (see first chart).

Trade-weighted euro elevated despite weak EUR/USD rate



Source: IHS Markit, Eurostat

The shift in the relationship over this period can be largely attributed to three factors.

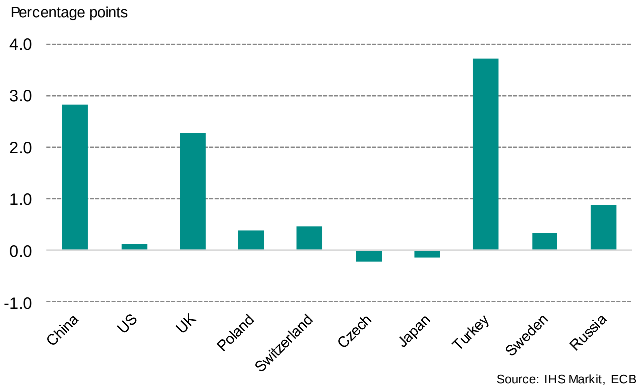
- The depreciation of the Chinese currency, which began in spring 2015;
- The depreciation of the UK pound related to the decision to leave the EU via the referendum in June 2016;
- The weakness of some emerging market currencies, particularly the Turkish lira.

Trade-weighted euro at its highest level for almost a decade in late 2018

With the EUR/USD subsequently rising from late 2017 on the back of the (short-lived) eurozone growth spurt, and vulnerable emerging market currencies under increasing pressure, by October 2018, the NEER-38 had reached its highest level for almost a decade. From April 2015 to the peak in October 2018, the rise in the NEER-38 was around 17%, with the peak level roughly 15% above its long-run average (the series goes back to 1993).

Looking at the contributions of each of the ten highest weighted currencies in the NEER-38 to its appreciation over the period in question, the movements against the Chinese (first), UK (third) and Turkish (eighth) currencies dominate (see second chart).

Contributions to NEER-38 rise (Apr 2015-Oct 2018)

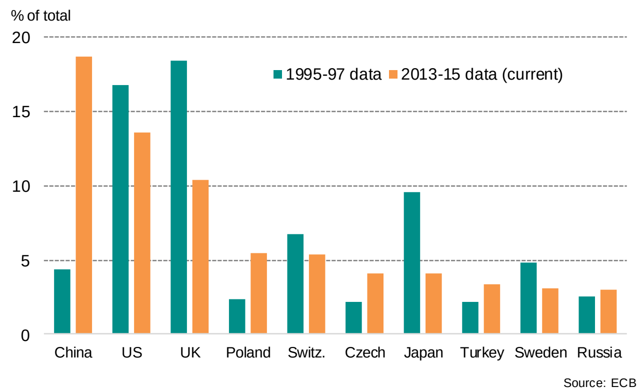


Shifting trade patterns means much higher weights for China and emerging markets

The respective weights in the NEER-38 have changed significantly over time (see third chart). To illustrate the point, we compare the top ten weights in the current version of the NEER-38 (which were updated in 2017, based on 2013-15 trade data) with the weights from the late 1990s (i.e. based on 1995-97 trade data).

The standout feature is the huge increase in China's weight, to over 18% of the NEER-38 currently versus just 5% in the late 1990s. This reflects China's increasing share of eurozone exports and its importance as a competitor to the eurozone in third markets, but most importantly, China's increased import penetration into the eurozone.

Changes in NEER-38's top ten weights (% of total)



Emerging markets in general are much more important than they were, including the economies of central and eastern Europe. Hungary now ranks fourth, above Switzerland, with the Czech Republic ranked sixth, ahead of Japan.

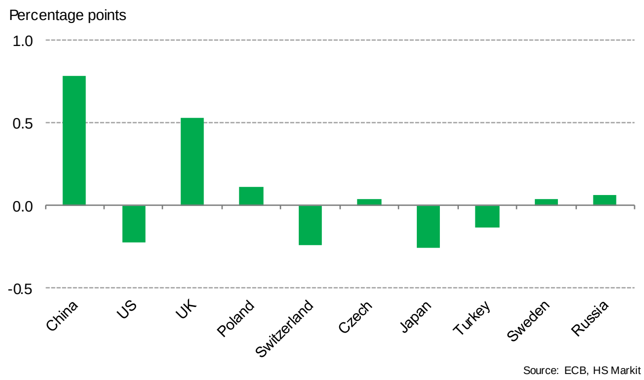
The US and UK rank second and third, respectively, with their respective weights having fallen significantly versus the late 1990s. Still, combined, they account for around a quarter of the NEER-38 overall. While the Turkish currency has a much lower weight (3.4%) than those of China (18.7%) and the UK (10.4%), its contribution to the NEER-38's appreciation has been larger given the magnitude of its depreciation.

To put the movements in the NEER-38 between 2015 and 2018 into some economic context, a 10% appreciation is estimated to reduce both eurozone growth and inflation by around a half percentage point over the subsequent year. For an economy like the eurozone with a potential growth rate not far above 1% and with the underlying inflation rate stuck well beneath the ECB's "below but close to 2%" objective", large swings in the exchange rate are a big deal.

Currency weakness in China and UK again pushing trade-weighted euro upwards

The NEER-38 fell back from its late 2018 highs during the early part of this year, largely because of the easing of the pressure on emerging market currencies (in turn related to the US Federal Reserve's shift from tightening to easing policy). But more recently, it has started to reappreciate. The monthly rise during August, for example, was the largest for almost a year and now the rate is almost 14% above its long-run average.

Contributions to NEER-38 rise (Apr-Aug 2019)



The NEER-38 has been rising since April, with some of the usual suspects again to the fore. The euro has risen by over 4% and 5%, respectively, versus the Chinese and UK currencies over that period. At the same time as worries about the Chinese currency have resurfaced, the Brexit-related problems in the UK have led to a marked decline in sterling. In contrast to the prior period, however, the euro has lost some ground against the Turkish lira (see fourth chart).

ECB eases policy again, with door left open for more

The announcement of another wide-ranging package of easing measures from the ECB on 12 September did not come as a surprise. We had been expecting a restart of QE and a lower deposit facility rate (DFR) for some time, given our long-standing call for persistent low growth and inflation, accompanied by tiering of negative rates on banks' excess reserves in order to keep the door open for an even lower DFR in future. We expect a further 10bp cut in the period ahead, possibly as soon as December's meeting, by which time Christine Lagarde will have taken the helm.

The ECB's decision to cut the DFR for the first time since 2016, and belatedly to copy other central banks with tiering, is an illustration of its high sensitivity to the risk of financial conditions in the eurozone tightening via an unwelcome exchange rate appreciation. The euro may have been soft against the US dollar recently but as we have highlighted above, this is not the only exchange rate that matters.