Economic Research

30 September 2019

Week Ahead Economic Preview

Global overview

- **Worldwide manufacturing and services PMI surveys**
- **US non-farm payrolls, employment report**
- **UK GDP, eurozone inflation**
- **Policy decisions in Australia and India**
- **Special reports on how the ECB would react to an oil price spike, and India's corporate tax cut**

The week ahead starts with PMI™ surveys and ends with the US monthly employment report, providing a wealth of data for markets to digest and gain insight into economic trends at the end of the third quarter.

The PMI surveys will provide key signals of worldwide growth, inflation and hiring trends at the end of the third quarter. The numbers will be especially eagerly awaited as policymakers at many central banks, including the US Fed, have become increasingly concerned over the global economic environment. The August surveys showed global growth slipping to one of the slowest seen for three years, with signs of weakness spreading from manufacturing to services, in part due to softening labour markets. Price gauges meanwhile also eased to three-year lows.

In the US, the PMIs from IHS Markit and ISM showed manufacturing struggling in August but the ISM sent a stronger picture for services. September updates will therefore help clarify growth momentum at the end of the third quarter, and will be accompanied by non-farm payrolls and wage growth data, as well as trade and factory orders, all of which will help guide Fed policy. Shutdown fears could also steer markets (page 3).

In Europe, PMI updates will be eyed for signs of recession risk in Germany, Italy and the UK, the latter also seeing updated estimates of second quarter GDP. Business investment data will be scrutinised for signs of Brexit impact. Eurozone inflation data will support the case for further ECB stimulus (page 4). We also look at how the ECB would react to higher oil prices (see page 6)

In Asia, China's Golden Week means the only data releases are the PMIs, but Japan in particular sees a wealth of key indicators ahead of the impending sales tax rise. Monetary policy decisions will come from central banks in both Australia and India (see page 5). The latter has seen recent corporate tax cuts, which we expect to drive faster growth (see page 9).

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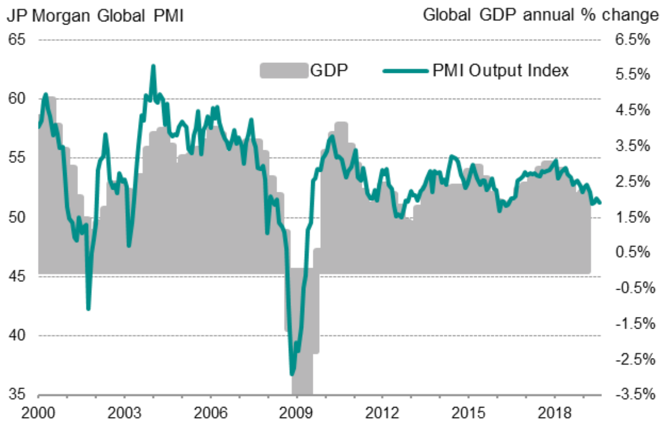
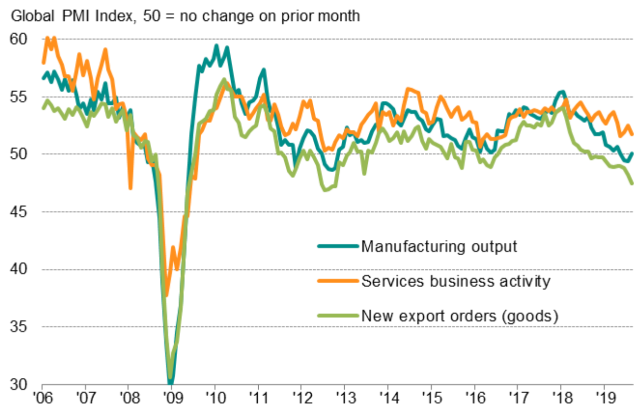
Special reports

IHS Markit's worldwide PMI™ data are updated to September. August's numbers showed the pace of global economic growth slowing to one of the weakest seen over the past three years



Sources: IHS Markit, JPMorgan.

The PMIs showed global goods exports falling at the sharpest rate since 2012, leading the downturn. Global service sector growth has remained more resilient, but nevertheless waned to the second-weakest in three years.



Sources: IHS Markit, JPMorgan.

Key diary events

Monday 30 September

China Caixin manufacturing PMI (Sep)
South Korea industrial production (Aug)
Japan industrial output, retail sales, housing starts, construction orders (Aug)
BoJ Summary of Opinions (18-19 Sep)
China NBS manufacturing PMI (Sep)
Euro area unemployment (Aug)
Spain GDP (Final, Q2)
UK GDP, business investment (Final, Q2), mortgage lending and approvals (Aug)
Germany and Italy inflation (Prelim, Sep)
US Chicago PMI, Dallas Fed index (Sep)

Tuesday 1 October

Worldwide release of IHS Markit manufacturing PMI data (Sep)
South Korea trade, inflation (Sep)
Japan jobless rate (Aug), Tankan surveys (Q3)
Australia monetary policy decision
Thailand and Indonesia inflation (Sep)
Euro area inflation (Flash, Sep)
Brazil industrial production (Aug)
US ISM manufacturing PMI (Sep), construction spending (Aug)
US fiscal budget deadline

Wednesday 2 October

Japan consumer confidence (Sep)
Hong Kong retail sales (Aug)
Singapore SIPMM manufacturing PMI (Sep)
UK construction PMI (Sep), BoE FPC meeting
US ADP employment change (Sep)

Thursday 3 October

Worldwide release of IHS Markit services PMI (Sep)
IHS Markit Singapore Whole Economy PMI (Sep)
Australia trade (Aug)
Euro area retail sales (Aug)
US ISM non-manufacturing PMI (Sep), factory orders (Aug)

Friday 4 October

IHS Markit PMI for Hong Kong SAR (Sep)
Australia new home sales, retail sales (Aug)
Philippines inflation (Sep)
Malaysia trade (Aug)
India monetary policy decision
Germany construction PMI
US non-farm payrolls, jobless rate, earnings (Sep)
US trade (Aug)
Russia inflation (Sep)

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United States Week Ahead

Final PMIs and non-farm payrolls

By Siân Jones
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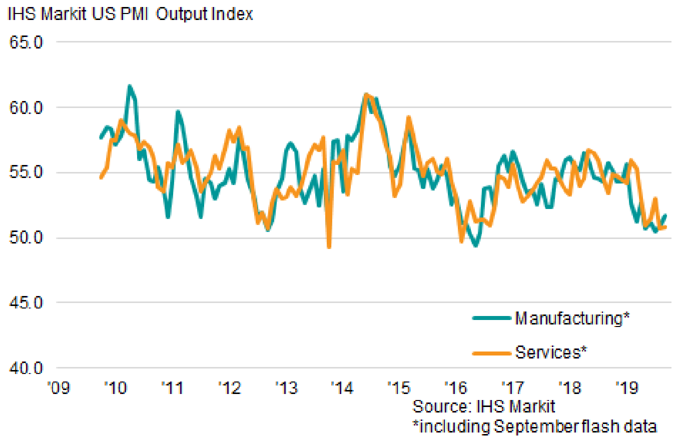
A stabilisation in the slowdown seen across the manufacturing sector in the third quarter was signalled by the release of flash data for September, but worryingly, the service sector remained subdued. The increasing impact of weak demand on the US economy will place even greater importance with regards to confidence and policy on upcoming employment data, with non-farm payrolls and wage growth data due to be released.

Meanwhile, the conclusion to current talks on the fiscal budget will be highly anticipated amid potential for another government shutdown.

Manufacturing upturn overtakes services growth according to September flash PMI release

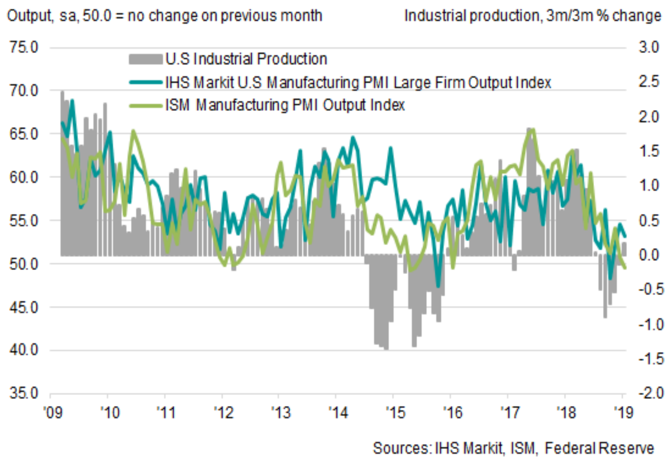


Final PMIs

Flash PMI data indicated a glint of hope for struggling goods producers as the downturn seemingly moderated, with new orders rising at a faster rate. Nonetheless, final PMI data from both IHS Markit and ISM are expected to show that goods producers remained cautious amid subdued global demand conditions. Official factory orders data will also be keenly eyed after official manufacturing output numbers showed a surprise uplift in August.

Of concern in the flash PMI was a further muted upturn in activity across the service sector. The final PMI data release will give greater insight into sectoral trends towards the end of 2019. Our US economists currently expect annualised GDP growth to ease in the final quarter of the year to 1.8% after a 2.2% rise in the third quarter.

Large manufacturers struggle to maintain output growth



Non-farm payrolls

September non-farm payrolls data will be keenly watched for any further insights into monetary policy over the coming months. Any signs of weaker employment growth could add to widespread expectations of one more cut this year. Recently released flash PMI data signals a downbeat assessment, with the employment index pointing to jobs growing at a sub-100,000 trend. That said, consensus forecasts suggest a pick-up in non-farm payroll numbers (an increase of 162,000).

Other data releases include jobless rate, earnings, trade, fiscal budget deadline and regional indexes.

Key employment data to gauge strength of the labour market

Europe Week Ahead

September PMIs, eurozone inflation and unemployment

By Joe Hayes
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A full spectrum of euro area data will help assess whether downside growth risks have manifested themselves beyond manufacturing, in line with the latest signals from the PMI. Unemployment, retail sales and inflation data are all due. Final September PMIs for the euro area will be accompanied by PMIs for the wider reaches of Europe. Particular focus will be paid to the UK given the political uncertainty. Disappointing data would fuel already-notable growth concerns.

PMIs in focus

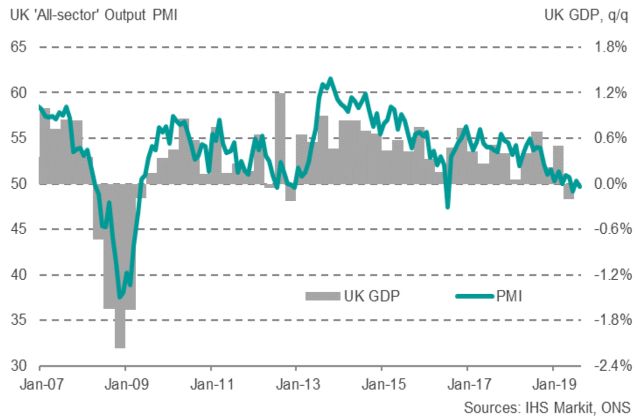
Final eurozone numbers will be closely watched after the flash release showed the economy almost stalling in September. The survey data suggest a quarterly GDP rise of just 0.1% in Q3, in line with our baseline forecast, and our nowcast also points to meagre growth. The forward-looking indicators from the flash surveys cast a worrisome outlook for the euro area, particularly new orders and employment indices. Importantly, slowing jobs (see chart) and wage growth has the potential to rock the hitherto-resilient domestic economy. Retail sales have already shown a loss of momentum, though September's flash consumer sentiment index showed a surprise pick-up and remains four points above its long-run average.

Close attention will be paid to the UK survey numbers following the increased uncertainty surrounding Brexit and now also, political leadership. Although recession risk has faded somewhat following stronger than expected July GDP data, any growth in the third quarter is likely to be marginal at best. Our nowcast points to quarterly growth of just 0.09%. Again, forward-looking indicators will serve as a good mould for expectations going into the end of the year. Second quarter GDP data are also updated.

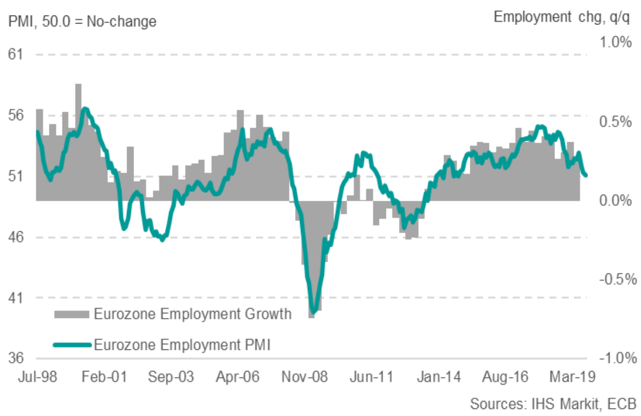
Eurozone inflation

The inflation environment in the euro area has been stable and subdued for some time now, with core stuck at around 1%. With the rise in crude oil following the attack in Saudi Arabia mostly unwound, any impact on headline inflation is now likely to be minimal (see our deeper read on how the ECB would react to higher oil prices on page 6). We continue to expect persistent low growth and inflation and further monetary policy easing, most likely via a lower deposit facility rate.

UK economy showing little signs of life in third quarter



Labour market conditions are cooling in the euro area



We expect inflation to remain below ECB's target level

Asia Pacific Week Ahead

Asia PMIs, central banks, Japan data, China golden week

By Bernard Aw

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With global manufacturing struggling against trade woes and falling business investment, next week's focus in Asia will fall on September PMI updates, in particular for China and Japan. IHS Markit PMI for Hong Kong SAR will also attract attention. Japan's data releases, including industrial output and retail sales, will also be scrutinised as the country braces for a sales tax hike on 1st October. Australia and India will set monetary policy, while trade figures from the region will also offer fresh insights into Asian trade conditions.

Third quarter GDP clues from PMI updates

September update to China PMI surveys will provide important steers on third quarter GDP and, more importantly, guidance on whether more stimulus is needed to bolster growth momentum. August dataflow signalled cooling economic activity: industrial production growth fell to a 17-year low; fixed asset investment slowed to 5.5% on the year; exports shrank.

Flash estimates of PMI data meanwhile raised concerns whether Japan's private-sector economy can withstand the impending consumption tax increase, where a deep dive into anecdotal evidence in the PMI surveys found evidence that demand for manufactured goods could pull back further after the tax hike. Official data releases for August will also come under scrutiny to gauge the health of the Japanese economy.

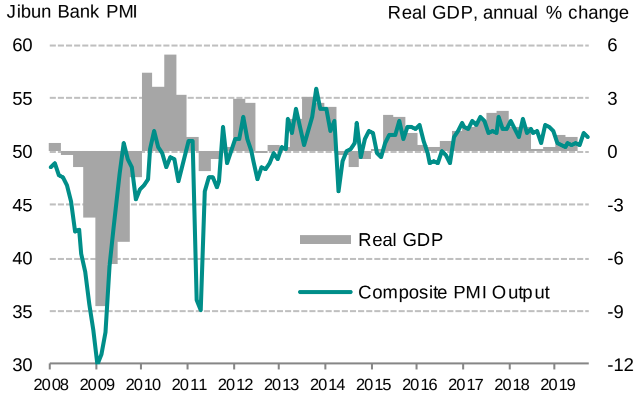
Escalating protests will draw focus to the September PMI update for Hong Kong SAR, which provides a complete view of third quarter GDP performance. Recent PMI results are broadly indicative of the economy contracting at an annual rate of around 3%.

Australia and India set policy rates

The Reserve Bank of India meets to decide on monetary policy next week. Having cut interest rates four times since February, governor Shaktikanta Das said there is room for more easing, though much depends on incoming data. As such, India PMI surveys would provide some guidance on future policy moves.

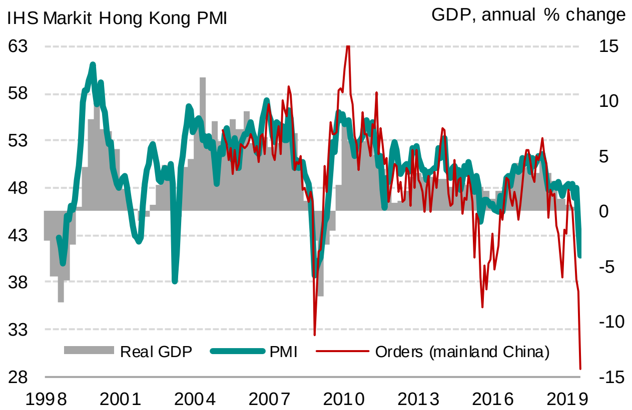
Australia meanwhile is widely expected to cut interest rates. Governor Lowe recently commented that the RBA is prepared to ease policy further if necessary.

Japan PMI* and GDP



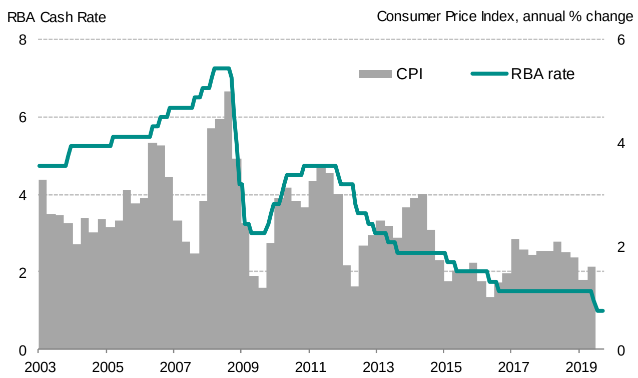
Sources: IHS Markit, Jibun Bank, Cabinet Office
**September PMI is flash*

August PMI for Hong Kong SAR points to falling GDP, dragged by trade war impact and protests



Sources: IHS Markit, C&SD

Australia's policy rate and consumer inflation



Sources: ABS, RBA

Europe
Special Focus

How would the ECB react to a surge in oil prices?

By Ken Wattret

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The jump in crude oil prices following the attack on Saudi Arabia's Abqaiq facility earlier this month proved short-lived. But what if subsequent disruptions to supply led to sustained higher prices, how should, and would, central banks respond?

In the eurozone, while higher energy prices would push up the headline HICP inflation rate and require mechanical upward revisions to staff inflation projections, the ECB would look through the direct impact. One reason would be the low likelihood of "second round" effects on other prices and wages given the challenging economic environment.

Another would be the hit to household real income growth, with growth rates in employment and pay already slowing. As consumer spending has been the mainstay of the current expansion, a sustained, supply-driven oil price surge would likely push the eurozone into recession, prompting the ECB to deliver additional monetary policy accommodation.

Demand or supply shock?

How a central bank would respond to a surge in crude oil prices, and the consequent acceleration in consumer price inflation, would depend on a range of factors, including:

- the reason for the increase in oil prices: i.e. whether it is supply or demand driven;
- the persistence of the shock;
- the likelihood of pass-through to other prices and wages ("second round" effects);
- the sensitivity of the economy to higher oil prices;
- the stage of the economic cycle and the degree of spare capacity.

An adverse supply shock (e.g. an attack on a key oil facility causing disruption to production) and a positive demand shock (e.g. a surge in demand from a key importer, like China) could both drive prices markedly higher but the economic and policy implications would be very different. Given the current geopolitical and economic conditions, the former has looked much the more likely of the two risks to materialise and indeed, on 14 September, drone attacks on oil processing facilities in Saudi Arabia led to a surge in crude prices (in double digits in percentage terms).

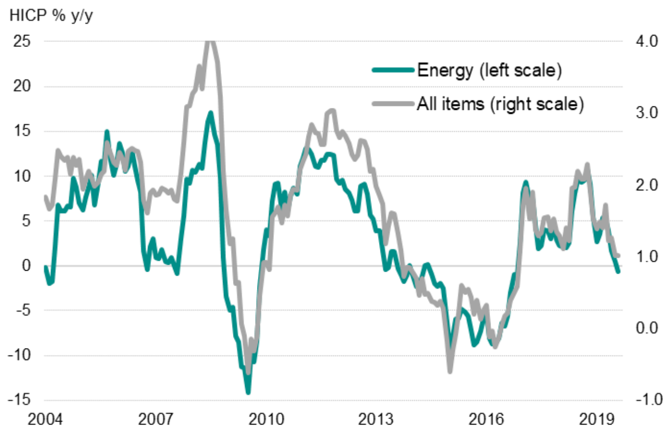
Minimal effect on eurozone inflation near-term

At the time of writing, crude oil prices have subsequently unwound most of their gains in the immediate aftermath of the strikes on Abqaiq. Based on a series of assumptions about the near-term evolution of the crude price, the EUR/USD exchange rate and the pass-through to the energy component of the HICP, we can estimate the short-term effects on eurozone inflation. In short, they are likely to be minimal, in part due to base effects. (Eurostat will publish the flash HICP data for September on 1 October).

If we assume, for example, that the closing price for Brent crude on 24 September (i.e. just over EUR 57 p/barrel) is sustained through to the end of this month, this would translate into an overall m/m increase of around 7% compared to August's average level. In September 2018, there was a similar m/m rise in crude prices in euro terms, implying that a significant pick-up in the y/y rate of change in energy prices in September's HICP is unlikely.

In August, energy inflation was -0.6% y/y, versus a peak of 10.8% in October 2018, with the deceleration accounting for one percentage point of the total 1.3 percentage point deceleration in headline inflation over this period (Chart 1).

Chart 1: Energy prices driving headline eurozone inflation dynamics



Source: Eurostat, IHS Markit

Base effects a complication in coming months

Crude prices also rose sharply in October 2018 (by over 4% m/m). This was a period during which US sanctions on Iran generated supply concerns, driving prices sharply higher. As those worries faded, so oil prices corrected sharply. Therefore, energy base effects will lean up on eurozone inflation from November this year through to January 2020. During the equivalent period a year previously, the Brent crude price tumbled by around 30%, dragging the energy HICP inflation rate down by over five percentage points and knocking about half a percentage point off the overall inflation rate. Flat crude oil prices over the three months from November 2019 onwards, therefore, would see the eurozone inflation rate rise by a similar magnitude, other things equal.

The ECB will look through such base effects driving headline inflation upwards. The upward pressure from energy late this year has already been explicitly factored into the ECB's assessment of the expected path of inflation, while the importance of higher inflation being "consistently reflected in underlying inflation dynamics" is also explicit.

How big a rise in oil prices would be needed to push inflation to 2%?

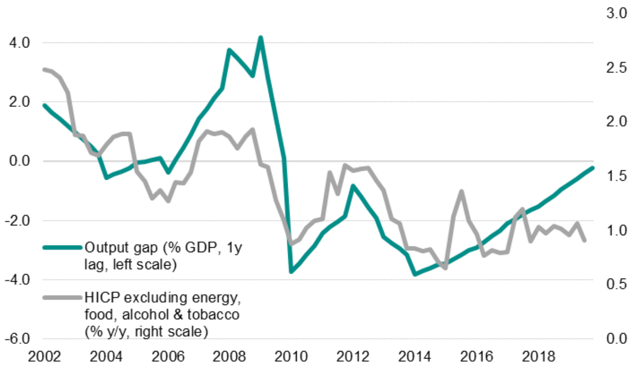
Based on past relationships, we can work out some simple rules of thumb to assess the movement in the crude oil price required to make a material difference to the headline inflation rate in the eurozone. To raise it from the current 1.0% level (as of August) to 2%, other things equal, the Brent price would need to rise from around USD63 p/barrel currently (again based on the 24 September close) to north of USD90 p/barrel, assuming a constant EUR/USD exchange rate.

The key issues for monetary policy in such circumstances would be, first, whether the rise in oil prices would be sustained and second, whether this would then pass through to underlying inflation via "second round" effects on other prices and pay growth. Given the economic environment in the eurozone at present, the pass-through would likely be modest.

Little chance of significant "second round" effects

Core HICP inflation has been going sideways at around 1% for the past two years now, despite an already pronounced acceleration in unit labour cost growth. The latter has been running above 2% y/y for the past four quarters, having picked up from barely above zero in mid-2017. Yet this has not been passed into prices, even when economic conditions were more favourable than they are currently. Unlike in the past, the erosion of slack has not translated into higher underlying inflation (Chart 2). Businesses have been reluctant to raise prices for fear of losing market share and so have absorbed the cost increases in their margins. We would expect the same again.

Chart 2: Recent disconnect between eurozone output gap and inflation



Sources: Eurostat, EC, IHS Markit

The bigger concern for the ECB would likely be the detrimental effect of higher energy and overall inflation on economic growth via a squeeze on households' real compensation growth. Between 2014 and 2018, real compensation growth in the eurozone averaged a little over 2%, with private consumption the mainstay of the current expansion as a result.

Real compensation is already weakening, however, with employment and pay growth moderating as output growth has slowed. We expect sub-potential eurozone growth rates in 2019-2021, with the increase in slack making it very unlikely that households would be able to secure higher nominal wage growth to compensate for the energy-induced pick-up in inflation.

For 2020, we are currently forecasting real compensation growth of around 1¼%, which is partly based on an inflation forecast in the low 1s. Inflation running at 2% instead would knock another ¾ of a percentage point off real compensation relative to our baseline, other things equal, meaning that private consumption would be unlikely to deliver the rates of growth required to stave off a eurozone recession, given the slump in net trade and weakness in investment.

The ECB would therefore look through the rise in headline inflation and focus on the prospect of increasing slack and therefore downward pressure on underlying inflation from already uncomfortably low levels, implying additional policy accommodation would be required.

An example from the prior eurozone downturn supports the policy conclusion above. Post-global financial crisis stimulus, in China particularly, led to a surge in oil prices and a related energy-driven pick-up in eurozone inflation during 2011.

The headline HICP inflation rate rose above 3% (again see Chart 1), well above the ECB's objective, while the core inflation rate was also much higher then than now, trending at around 1.6% in late 2011. But the focus of monetary policy at the time, rightly, was the deteriorating economic and financial environment in the eurozone and likely low future underlying inflation. This triggered another round of ECB easing from November 2011, initially in the form of policy rate cuts, delivered by the newly installed president Mario Draghi. This occurred at precisely the same time as headline inflation shot up, breaching 3%.

Asia Pacific Special Focus

India's corporate tax reforms boost economic competitiveness

By Rajiv Biswas

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The Indian government announced a major reform of corporate tax rates on 20th September. This is expected to significantly improve the relative competitiveness of India's corporation tax rates compared to other Asian industrial economies, as India's corporate tax rates had been relatively high compared to regional peers prior to the latest tax reform measures. The lower rates should help to boost corporate investment in India over the medium-term, at a time when economic growth momentum in the Indian economy has faced increasing headwinds.

The Indian corporate tax rate reforms reflect the global fiscal policy trend towards lowering corporate tax rates. The average corporate income tax rate across the OECD has dropped from 32.5% in 2000 to 23.9% in 2018, with notable corporate tax cuts in the US and UK in recent years.

Corporate tax cuts will boost investment

The Indian Finance Minister Nirmala Sitharaman announced on Friday 20th September a major reform of India's corporate taxation, with large reductions in the base corporate tax rate, from a rate of 30% to the new rate of 22%. The new tax rates will be effective from the beginning of the 2019-20 fiscal year starting 1st April 2019. As a result of these tax cuts, corporations in India will now be taxed at an effective rate of 25.75%, down from an effective tax rate of 30%.

The corporate tax cuts will apply to existing domestic companies as well as newly formed domestic manufacturing companies. Companies that do not claim benefits for incentives or concessions will be eligible for the 22% corporate tax rate, while new manufacturing firms established after 1st October 2019 are eligible for an even lower corporate tax rate of 15% if they make fresh new investments in manufacturing by 2023 and are not claiming incentives.

Indian financial markets reacted enthusiastically to the tax cuts, with the India S&P BSE Sensex index jumping 5.3% on the day of the announcement, recording its biggest one-day gain since May 5th 2009.

Services firms are expected to be major winners, while manufacturing companies in the consumer goods, capital goods and steel sectors will also reap significant benefits as many of them have an effective tax rate of around 30%.

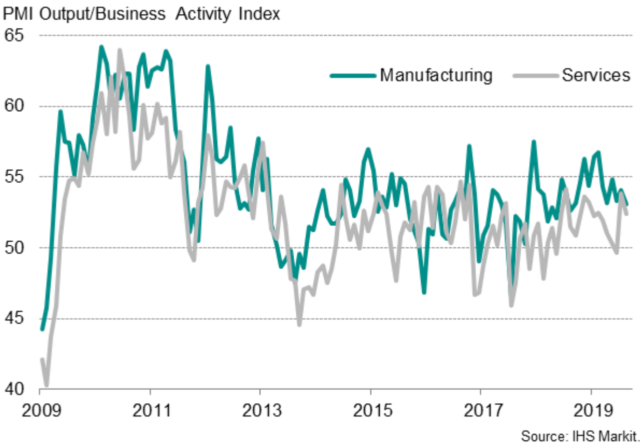
Indian economy faces headwinds

The decision to implement the sweeping corporate tax reform measures reflects the slowdown in economic growth momentum in recent quarters as well as the need to improve India's international competitiveness as a manufacturing hub.

The Indian economy is facing headwinds in 2019 due to weakening domestic demand. The Indian central bank, the Reserve Bank of India, has eased monetary policy four times so far in 2019, by a total of 110bps, over concerns that growth momentum is slowing down.

In the April to June 2019 quarter, Indian GDP growth slowed to 5.0% year-on-year, the weakest pace of growth since 2013. The pace of manufacturing output growth has also stalled, heavily impact by weakening auto sector sales. The Indian auto industry has slumped into a crisis, with passenger vehicle sales down 31% year-on-year in July 2019, while domestic passenger vehicle production fell by 17% year-on-year.

IHS Markit Indian PMI survey, output indices



Source: IHS Markit.

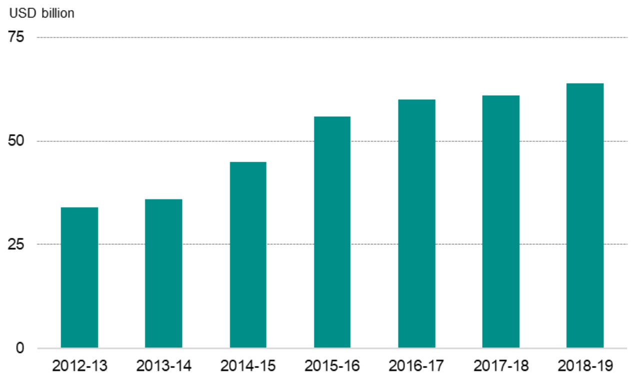
Improving India's business competitiveness

Since taking office in 2014, PM Modi has put a strong policy focus on improving the business landscape to attract investment by both foreign and domestic firms. When the BJP took office, India was ranked at 142nd out of 189 countries in the World Bank's Ease of Doing Business ranking for 2015, which reflected results from the annual survey undertaken during the 2014 calendar year. Reflecting significant progress in reducing barriers to business investment, India was ranked 77 out of 190 countries that are included on the World Bank's Ease of Doing Business Index in 2019.

The improving macroeconomic environment since 2014 has also helped to improve India's attractiveness as an investment destination, as falling world oil prices have helped to reduce inflation pressures and have also trimmed the current account deficit as a share of GDP as India's oil import bill has moderated. Sustained strong GDP growth over the past decade have also reinforced confidence among international investors towards the Indian economy.

An important economic reform that has improved the competitiveness of India for manufacturing has been the introduction of the unified GST tax across all Indian states in 2017. This has helped to significantly reduce the regulatory burden on interstate transportation of goods. The unified GST is estimated to have substantially reduced logistics costs for firms, improving the efficiency and competitiveness of the domestic manufacturing sector.

Indian FDI inflows



Source: Ministry of Commerce & Industry.

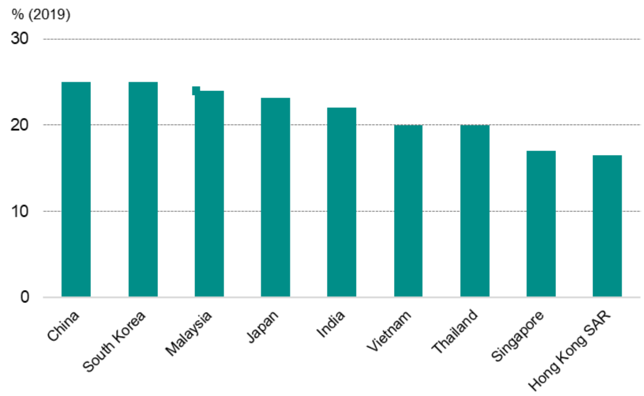
'Make in India' strategy

When PM Modi launched the Make in India strategy in 2014, he set a target of increasing the contribution of manufacturing to GDP to 25%. However, by 2018, the manufacturing sector share of GDP was still at 18%, which still leaves a substantial gap to bridge in order to achieve this vision.

Continuing to drive the transformation of India's industrial sector through PM Modi's 'Make in India' strategy is a key strategic priority for the Indian government, in order to improve manufacturing sector output growth and generate stronger employment growth. Catalysing more dynamic growth in the manufacturing sector will therefore be very important as a key pillar to achieve India's objective of becoming an upper middle-income economy by 2025.

The corporate tax reforms will lower India's effective corporate tax rates to levels that are more competitive with other Asian emerging markets, which should help to improve India's attractiveness for investment into the manufacturing sector.

Asia base corporate tax rates



Source: IHS Markit.

US-China trade war reshapes Asian supply chains

With China facing a combination of rapidly rising manufacturing wage costs as well as the impact of the US-China trade war through higher US tariffs, many multinationals are diversifying their global manufacturing supply chains towards other Asian manufacturing hubs. India may be able to benefit from this trend over the medium term, with global manufacturers increasingly focused on the rapidly growing Indian domestic consumer market. For example, Foxconn Technology Group has opened a factory near Chennai this year in order to assemble new model Apple iPhones, and already has two other facilities in India for assembly of Xiaomi and Nokia smartphones.

International private equity funds are also investing into a wide range of Indian assets, such as infrastructure projects and technology firms. For example, Canada's Brookfield Asset Management has invested USD 1.9 billion in early 2019 to acquire Pipeline Infrastructure Private Limited, which owns a Indian natural gas pipeline. Blackstone has been a leading international private equity investor in India since 2006, and has committed USD 9.8 billion of investments in India through private equity and real estate, including co-owning India's first Real Estate Investment Trust, the Embassy Office Parks REIT, which was launched in April 2019

However, in trying to boost manufacturing investment, India faces significant competition from other Asian developing countries, with many manufacturers from

Japan, South Korea, mainland China and Taiwan investing in establishing or expanding their manufacturing production facilities in countries like Vietnam, Malaysia, Thailand, Philippines and Indonesia. Other Asian governments are also implementing policy measures to attract new investment inflows.

In early September 2019, the Thai Board of Investment announced that the Thai cabinet had approved a new package of incentives for firms investing in Thailand, including a 50% reduction in corporate income tax for a five-year period for firms investing one billion Thai baht in foreign direct investment, with even larger incentives for investment involving technology training for Thai staff or involving advanced industrial automation. The incentives package is intended to attract firms considering relocation of their manufacturing production away from mainland China.

Medium-term outlook

Stronger capital expenditure growth by manufacturers can play an important role in improving India's economic growth rate over the medium to long term outlook, as companies build manufacturing plants in India both to tap the fast-growing domestic consumer market and to diversify their Asian manufacturing supply chains. India's corporate tax reforms are an important positive reform that will help to improve the attractiveness of India as a manufacturing hub as well as improving the business landscape for the broader Indian corporate sector.