Week Ahead Economic Preview

Global overview

- Global PMI surveys updated for October
- FOMC meeting
- Non-farm payrolls
- US, Eurozone, Hong Kong and Taiwan GDP
- Brexit and US earnings season
- Special reports on diverging investment trends in the eurozone and the headwinds facing South Korea's economy

A busy week ahead includes the eagerly awaited FOMC meeting, manufacturing PMIs from around the world, US non-farm payrolls, GDP data from both the US and eurozone, as well as a key Bank of Japan meeting. All of which takes place against the backdrops of escalating Brexit drama and a US earnings season in full swing.

Markets will be on tenterhooks ahead of the FOMC's meeting on Wednesday, currently pricing-in a further cut. No change in policy will therefore upset markets, but a cut is by no means assured. Similarly, US GDP, non-farm payrolls and PMIs from both the ISM and IHS Markit will guide markets in what will also be a key week for earnings reporting (see page 3).

UK PMI data will meanwhile be watched for recession signals, but the markets will be dominated by politics as Brexit tensions mount, with the focus shifting from an exit on 31st October to an extension and whether Boris Johnson can persuade MPs to vote for a general election. Eurozone PMI data meanwhile accompany the single currency area's official GDP release for the third quarter, and will help steer policymaking at the ECB as Christine Lagarde steps in to take the helm of the central bank (see page 4).

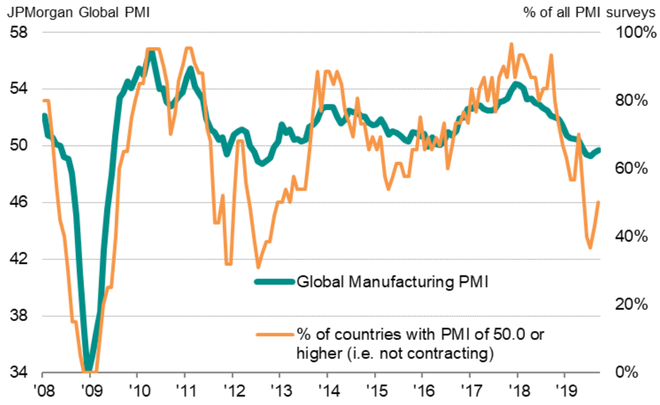
In Asia, China PMIs form just one of a 12 survey releases for the region from the global manufacturing PMI suite, though the Bank of Japan policy meeting will also be under the limelight after signs of the economy being hit by the recent sales tax hike. Hong Kong and Taiwan GDP data are also published, with the former likely to draw particular attention (page 5).

Our special reports this week look at how the eurozone looks likely to see a divergence in investment trends between construction and machinery, (page 6) while South Korea is showing signs of being hit by global headwinds (page 9).

Contents

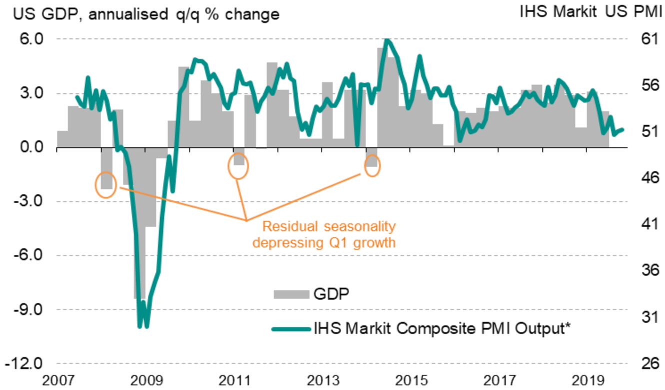
Special report

The JPMorgan Global Manufacturing PMI, compiled by IHS Markit, is updated on Friday. The index rose in September but signalled a fifth straight month of deteriorating business conditions. The current downturn is the longest and deepest since 2012. However, the number of countries reporting manufacturing downturns eased from 17 to 14



Sources: IHS Markit, JPMorgan.

US GDP growth is expected to have moderated in the third quarter, one of many factors that has led markets to price in a rate cut by the FOMC



* Manufacturing PMI only pre-October 2009.
Sources: IHS Markit, US Commerce Department

Key diary events

Monday 28 October

US Chicago Fed national activity index, wholesale inventories (Sep)

US goods trade balance (Adv, Sep), Dallas Fed manufacturing index (Oct)

Tuesday 29 October

South Korea business confidence (Oct)

Vietnam industrial production, trade balance (Oct)

Thailand industrial output (Sep)

UK mortgage lending and approvals (Sep)

US Case-Shiller home price (Aug), pending home sales (Sep)

Wednesday 30 October

Japan retail sales (Sep)

Australia new home sales (Sep), inflation (Q3)

France GDP (Prelim, Q3)

Germany unemployment rate (Oct)

UK nationwide housing prices (Oct)

Germany and Spain inflation (Prelim, Oct)

Euro area business and consumer confidence (Oct)

US GDP (Adv, Q3), ADP employment change (Oct)

FOMC meeting

Brazil monetary policy decision

Thursday 31 October

South Korea industrial production (Sep)

Japan industrial production (Prelim, Sep)

Japan consumer confidence (Oct), housing starts, construction orders (Sep)

Australia private sector credit, building permits (Sep)

UK consumer confidence (Oct)

Hong Kong monetary policy

Hong Kong and Taiwan GDP (Adv, Q3)

China NBS manufacturing PMI (Oct)

BOJ interest rate decision, quarterly outlook report

Singapore business confidence (Q3)

Germany retail sales (Sep)

Euro area, Spain, Italy GDP (Flash, Q3)

Euro area inflation (Flash, Oct), jobless rate (Sep)

Italy inflation (Prelim, Oct)

US PCE price index, personal income, personal spending (Sep), employment cost index (Q3)

ASEAN Summit (31 Oct – 4 Nov)

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Friday 1 November

Worldwide release of IHS Markit manufacturing PMI (Oct)

South Korea inflation, trade (Oct)

Japan jobless rate (Sep)

Indonesia and Thailand inflation (Oct)

US nonfarm payrolls, average earnings (Oct), construction spending (Sep)

US ISM manufacturing PMI (Oct)

United States Week Ahead

Q3 GDP, Manufacturing PMIs and October FOMC meeting

By Siân Jones
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Accompanying the heavily anticipated October FOMC meeting, the release of final PMI data from IHS Markit and the ISM, GDP figures for Q3 and non-farm payrolls will all be eagerly awaited. Other key data releases include PCE price index, wholesale inventories, ADP employment and personal spending.

FOMC meeting and GDP

Despite market expectations pointing towards a further Fed rate cut in October, several key data releases in the lead up to the FOMC meeting and disagreements among the committee could lead to hesitancy.

Throughout the third quarter IHS Markit PMI data pointed towards a notable slowdown in GDP. Although the data are not suggestive of a downturn, manufacturing weakness showed signs of spilling over to services, weighing on the overall expansion. PMI data on their own point towards annualised growth of 1.5%, with our US economists forecasting a rise of 1.3%. If further lacklustre investment opportunities and challenging external demand conditions are seen to have dragged on growth, this may factor into any decision made by the Fed.

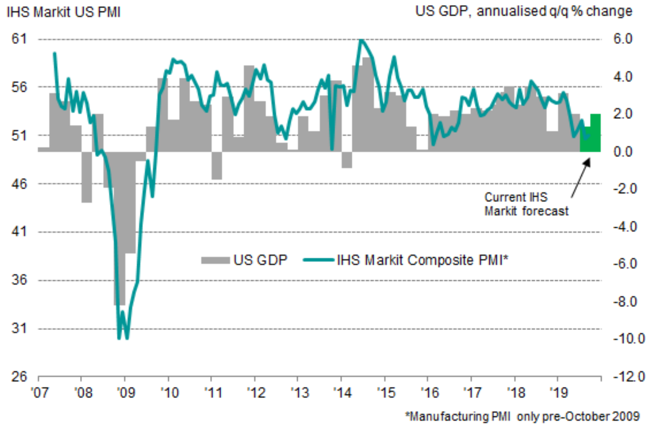
Manufacturing PMIs

Signals that the worst of the manufacturing slowdown may be over seen in the recent IHS Markit PMI releases have contrasted with a sharper downturn among ISM respondents. Therefore, October data will be keenly watched for any further divergence. Although our September and October flash US PMI Manufacturing Output Index posted above the 50.0 neutral mark, it corresponded to only a modest increase in official production data.

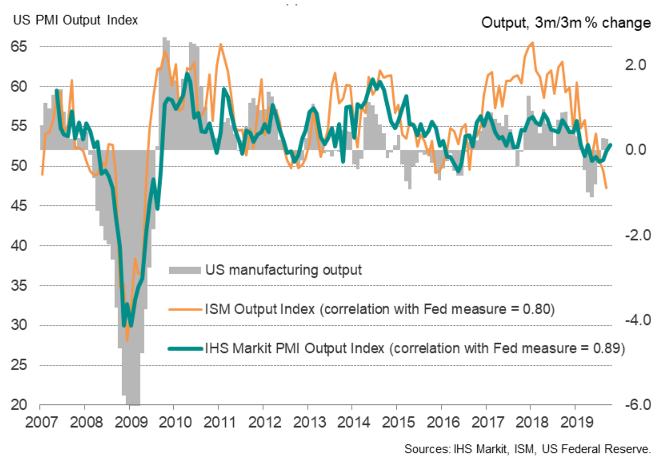
Non-farm payrolls

The week closes with the employment report, in which markets will be hoping for another solid but un-spectacular rise in payrolls: not enough to deter Fed stimulus but also not too few to fuel worries about the health of the economy. However, our PMI data have hinted at a weakening jobs trend and suggest risks are tilted to the downside. Pay and unemployment data will also be released. Last month saw the jobless rate fall to a 50-year low of 3.5% but pay growth disappointed at 2.9%, its lowest for over a year.

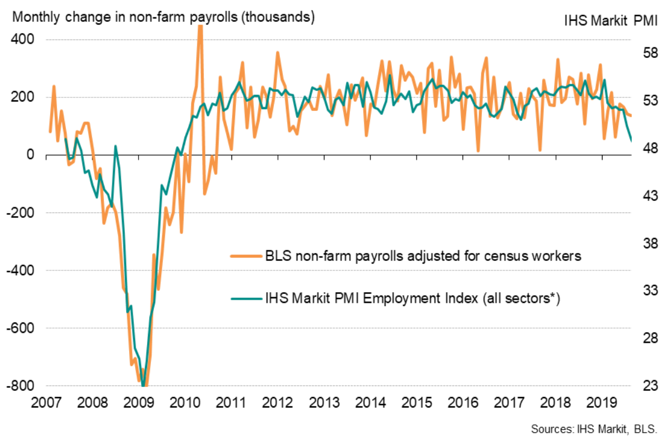
US GDP slowdown expected to recover in fourth quarter



Lacklustre demand conditions continue to be seen in manufacturing sector, but surveys have diverged



Flash PMI points to downward trend in employment



More insight into the US economic outlook is available from our award-winning team at Macroeconomic Advisers.

Europe Week Ahead

Brexit, manufacturing PMIs, eurozone GDP, unemployment and inflation

By Joe Hayes

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Third quarter GDP for the euro area is our key highlight from the economic data calendar as concerns grow that the region could be headed for recession in coming months. Employment and inflation data are also due, with any bearish signals here likely to put immediate pressure on new ECB chief Christine Lagarde for more policy action.

Across the channel, the week ahead looks set to be dominated by an extension to the 31st October Brexit deadline and a vote on Monday in which Boris Johnson will seek to persuade MPs to call a general election before Christmas, to thereby hopefully achieve a majority for his deal. However, at the time of writing, neither are the details of any potential extension granted by Brussels clear, nor is the opposition party keen for an election.

Manufacturing PMIs

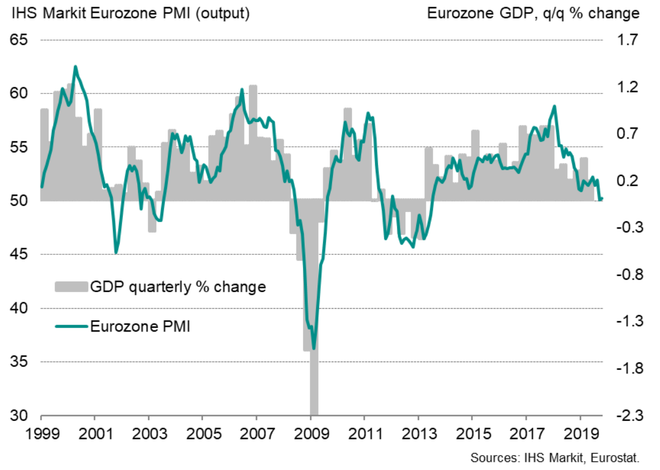
October manufacturing survey data will provide the first insight into economic conditions at the start of the fourth quarter. UK data will be scrutinised for any signs of a pre-Brexit stockpiling boost to goods producers, which was seen earlier in the year in March before the initial EU departure date. That said, the risk of a no-deal this time round is significantly lower than it was earlier in the year, which may have not only reduced the need for stock-building but also provided a much-needed fillip to beleaguered UK producers.

Eurozone GDP

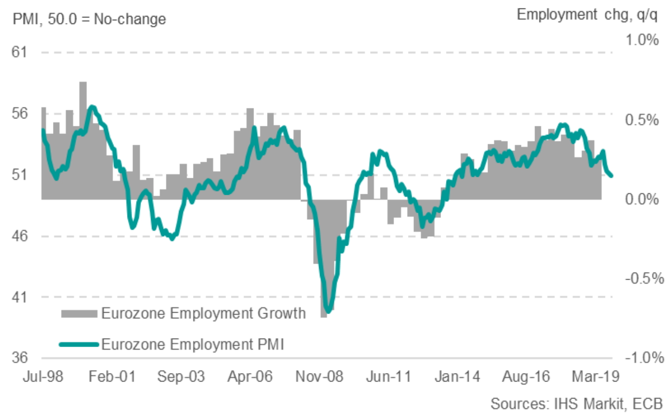
The initial estimate of eurozone GDP will warrant close attention, especially after October flash PMI data showed the economy continuing to stagnate. Our PMI-based nowcast model suggests that the euro area economy expanded by around 0.1% in the three months to September. However, notable divergences appeared at the country level, with the model predicting solid growth in France and a contraction in Germany.

Sentiment surveys are also due for the euro area, as well as unemployment and inflation data. The unemployment rate declined in August, although PMI data suggests that labour market conditions have continued to soften throughout the second half of the year.

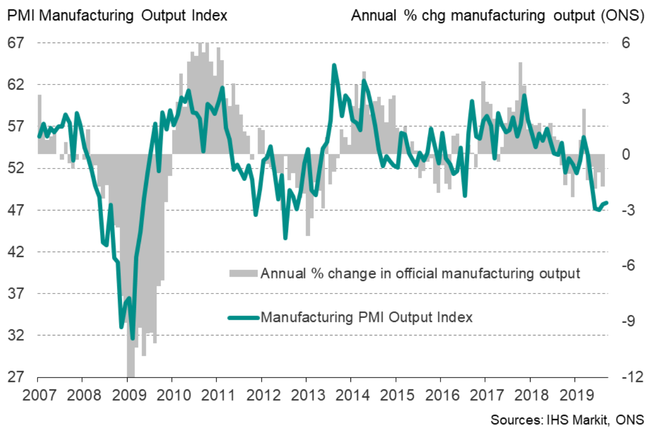
Marginal growth at best for the eurozone in third quarter



Employment trend continues to cool across euro area



Will October see a pre-Brexit boost for beleaguered UK manufacturers?



Economic Research

28 October 2019

Asia Pacific Week Ahead

Manufacturing PMI, BOJ, Hong Kong and Taiwan GDP, inflation

By Bernard Aw

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The release of manufacturing PMI data, including for 12 Asia Pacific economies, will provide important steers on economic trends and the impact of a broadening trade war. The Bank of Japan meeting will also be under the limelight after the recent sales tax hike, with analysts eyeing the quarterly outlook report for clues of future policy. Hong Kong and Taiwan GDP data are also published, with the former drawing particular attention given recent events. Inflation data for a number of regional countries will also be watched.

October manufacturing PMI

With September survey data showing the pace of global economic growth slipping to the joint-lowest for three years, October updates to Asian manufacturing surveys next week will be assessed for the health of the regional economy. China's data will be scrutinised especially as to whether the recent output recovery was extended into October.

Bank of Japan to deepen negative rates?

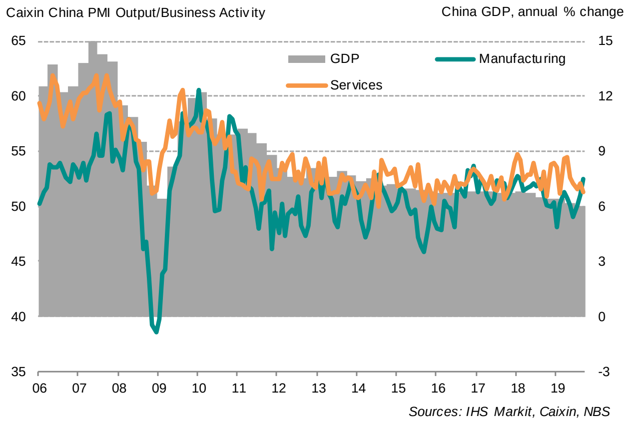
The Bank of Japan meets to decide on monetary policy with increasing expectations that the central bank will reduce its short-term interest rates amid growing downside risks. The Jibun Bank flash PMI signalled the first contraction of business activity for three years in October as the sales tax hike took its toll. Investors will also look to the quarterly outlook report for updates of the BOJ's view on economic growth and inflation.

Hong Kong SAR and Taiwan GDP

Battered by the deepening political and economic malaise, the economy of Hong Kong SAR is expected to have contracted by 0.5% in the third quarter, according to IHS Markit's estimate. With an escalating domestic unrest with no quick resolution in sight, the deepening economic downturn has fuelled business gloom in September, with sentiment plummeting to a new record low. The Hong Kong Monetary Authority also decides on monetary policy, with eyes on any announcements of further support measures.

Taiwan's GDP is forecast to have expanded by 2%, down from 2.2% in the second quarter. Recent PMI surveys point to a stabilisation in manufacturing activity and official data indicated increased electronics output. October's PMI update will reveal more on the sustainability of the recent improvement in activity.

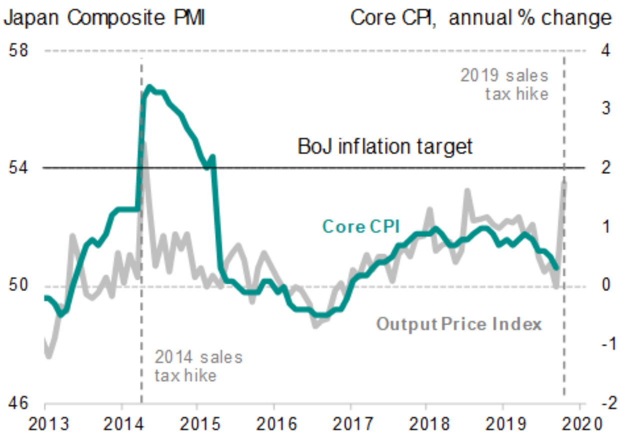
China PMI: manufacturing and services



Sources: IHS Markit, Caixin, NBS

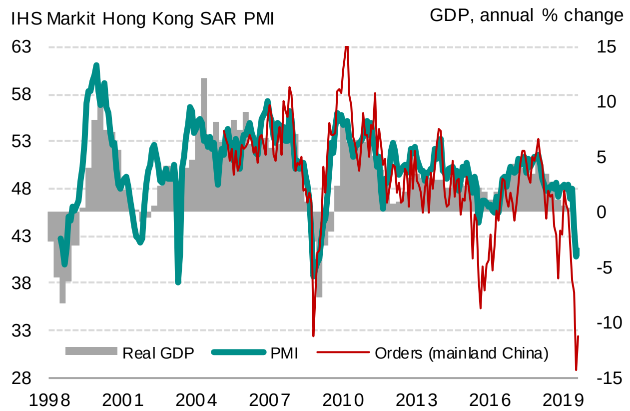
Japan PMI and core inflation

PMI points to core CPI surge on sales tax hike



Sources: IHS Markit, Jibun Bank, MIAC

HKSAR PMI signals recession in third quarter



Sources: IHS Markit, C&SD

Europe
Special Focus

Eurozone investment divergence ahead

By Ken Wattret
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The ECB's Bank Lending Survey (BLS) for Q3 offered mixed signals. On the supply side, credit standards in the eurozone continued to ease for most types of loan, albeit marginally. On the demand side, however, there was a contrast between fading demand for loans from businesses, including for fixed investment, and elevated household demand for mortgages.

This divergence is likely to be reflected in the evolution of the main sub-components of eurozone investment in the period ahead. The contribution from machinery and equipment investment should diminish, with its share in GDP already close to its record high, and uncertainty likely to persist. The construction sector, including residential, should outperform, albeit with national variations.

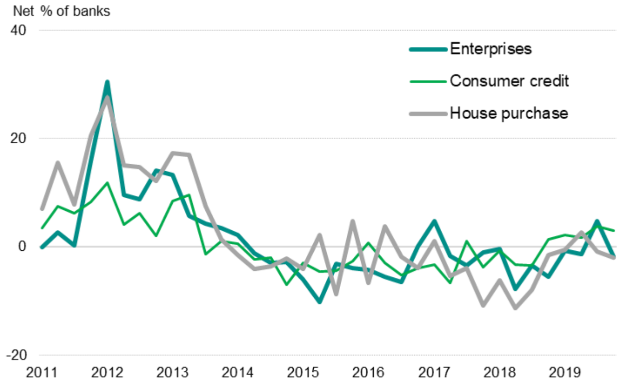
Credit conditions still growth-supportive

The ECB's quarterly BLS for the eurozone was published on 22 October, based on survey replies from 144 banks across the eurozone's member states which were received between 13 and 30 September. The results were rather mixed.

Looking first at the supply side of the survey, credit conditions generally remained growth-friendly (see first chart). For loans to eurozone enterprises, the net percentage of banks reporting tighter credit standards dropped back to -2 in Q3 (i.e. conditions eased). This unwound Q2's unexpected rise in the net percentage (to +5), which was only the second time in five and a half years that the survey had shown a tightening of credit conditions in this area.

For household loans for house purchase, credit standards also eased in Q3 (-2).

Eurozone credit standards mainly easing still



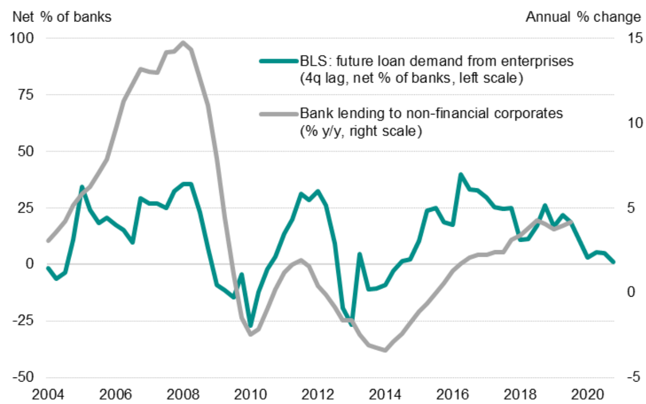
Source: IHS Markit, Eurostat, ECB

The picture was not uniformly positive, however. The expectation for Q4 was for a marginal tightening of credit standards for loans to enterprises (+1). Also, Q3's net percentage of banks reporting rejected loan applications from eurozone enterprises remained at its highest level since the inception of this sub-series series back in 2015 (+7). Moreover, for consumer credit, there was a tightening of credit standards for the fifth straight quarter (+5, again see first chart).

Loan demand diverging, with the business side losing momentum…

Switching to the demand side of the survey, the net percentage of banks reporting higher loan demand from enterprises slipped from +6 to +1, well below the predicted balance from Q2's survey. The net percentage is now only marginally above its long-run average (of -1) and this part of the BLS is increasingly indicative of a slowdown in bank lending growth to eurozone non-financial corporates (see second chart).

Eurozone bank lending growth to NFCs set to slow



Source: IHS Markit, Eurostat, ECB

The expected evolution of loan demand taken from the BLS does not have a perfect relationship with actual lending growth rates in the eurozone but it is usually a decent guide to momentum.

It suggests that lending growth to non-financial corporates, currently trending at around 4% y/y, will slow markedly in the coming quarters.

This augurs poorly for eurozone investment prospects, as does the downturn in loan demand for fixed investment purposes in the BLS. The contribution to loan demand from fixed investment has weakened markedly over the past few quarters, with Q3's net percentage barely positive (+2) and down by almost twenty percentage points versus its cycle high in Q1 2018.

…but household demand remains robust, for mortgages especially

In contrast, the net percentage of banks reporting increasing demand from eurozone households for loans for house purchases remained rather elevated in Q3 (+15). While this represents a moderation following Q2's unexpected surge (to +26), the net percentage has been running well above its long-run average (of +5) for four straight quarters. The BLS indicates that robust demand continues to be predominantly driven by the low level of interest rates and housing market prospects.

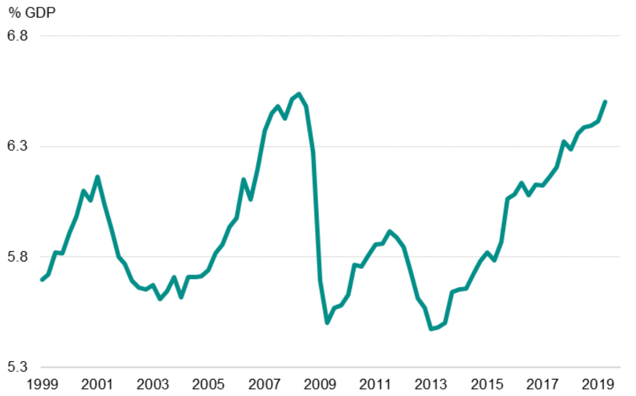
Demand for consumer credit also improved in Q3, with the net percentage (of +8) above both the long-run average (of +4) and Q2's expectation. The low level of interest rates was again the primary reason for the improvement in loan demand.

While accommodative monetary policy is having the desired effect on supply and demand conditions overall, it appears to be mainly boosting demand for mortgages at present rather than fuelling business investment, which is not the ECB's preference. (Note that under the ECB's targeted long-term refinancing operations, bank lending to households for house purchases is excluded). Persistent weakness in the industrial sector, coupled with high uncertainty, appears to be taking a toll on the demand for business loans and the willingness to invest, while the resilience of labour markets to date is encouraging households to capitalise on low interest rates.

Investment breakdown suggests different scope for growth

Breaking down the sub-components of gross fixed capital formation in the eurozone also suggests that a period of divergence is increasingly likely. The share of machinery and equipment investment in eurozone GDP is currently close to its record high (see third chart), reached back in Q2 2008 just prior to the onset of the Global Financial Crisis (GFC). While the initial stages of the subsequent recovery in investment expenditure were sluggish, not least because of the intensification of the eurozone crisis during 2011-12, once the upturn became more established a growth spurt followed, with the rate of increase in machinery and equipment investment peaking at 8% y/y in 2016. As of Q2 this year, it had slowed to around 3% y/y.

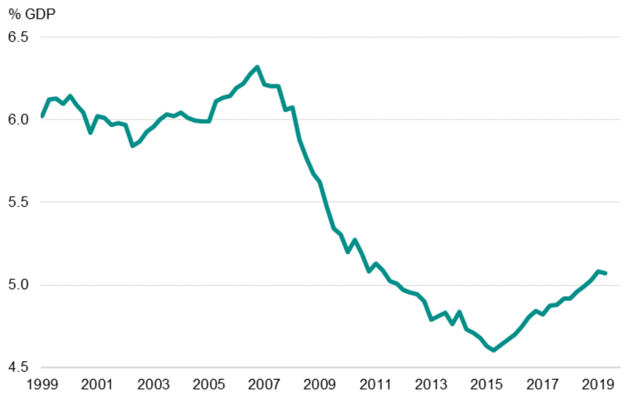
Eurozone machinery and equipment investment



Source: Eurostat, IHS Markit

In contrast, the construction to GDP ratio in the eurozone remains low by historical standards, a hangover of the excesses that built up in the sector during the pre-GFC period. This is true for residential construction investment also, which accounts for about 53% of overall construction, despite some upward momentum having been evident since 2015 (see fourth chart).

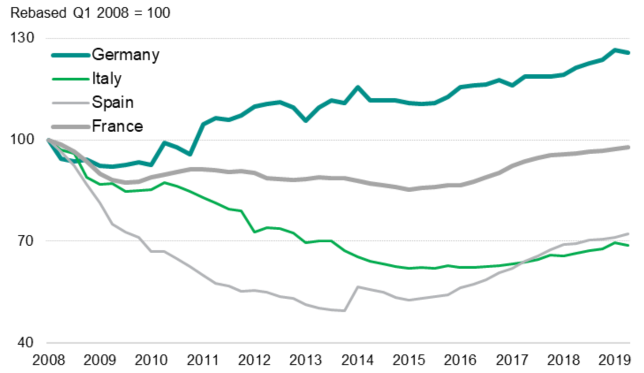
Eurozone residential construction investment



Source: Eurostat, IHS Markit

Given the huge variations in this area across the member states of the eurozone since the single currency's inception back in 1999, a national perspective is essential. Looking at the current levels of residential construction investment across the four largest member states in relation to Q1 2008, prior to the escalation of the GFC, the contrasts are striking (see fifth chart).

Eurozone-4 residential construction investment versus 2008

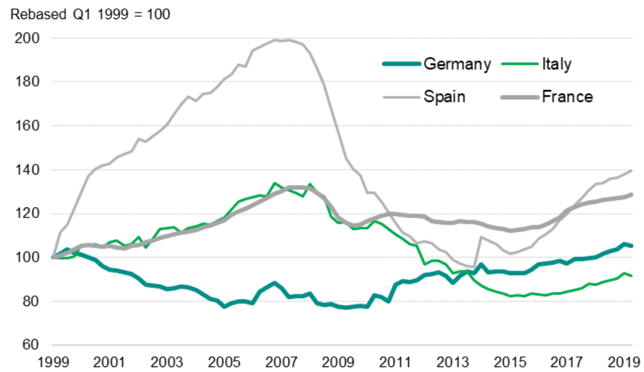


Source: Eurostat, IHS Markit

In Germany, residential construction investment is currently around 25% higher than its Q1 2008 level, whereas in Italy and Spain, it is still around 30% below despite their respective pick-ups in recent years. The shortfall in Italy is particularly remarkable as, in contrast to Spain, it did not experience a pre-GFC boom.

Comparing to Q1 1999's levels is also insightful (see sixth chart). Despite its relative strength during the current expansion, residential construction investment in Germany is presently only 5% above its level back in Q1 1999, suggesting potential to continue to contribute to growth going forward. So too Italy, where there is a 10% shortfall still relative to 1999.

Eurozone-4 residential construction investment versus 1999



Source: Eurostat, IHS Markit

In Spain, in contrast, residential construction investment is currently 40% above its Q1 1999 level. The pre-crisis boom was so huge (a cumulative rise of 100% between 1999 and 2008) that, despite a huge post-GFC correction, Spanish residential construction investment did not fall significantly below Q1 1999's level subsequently – unlike I n Germany and Italy, albeit during different periods. This implies comparatively less scope for this sector to contribute to future growth in Spain. Indeed, the BLS for Q3 indicated that demand for loans in this area was much weaker in Spain than in the other large eurozone member states.

Asia Pacific Special Focus

South Korean GDP growth moderates as global headwinds rise

By Rajiv Biswas
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South Korea's GDP growth rate moderated to a pace of 2.0% year-on-year (y/y) in Q3 2019, compared to 2.7% annual growth in the 2018 calendar year. The softening in growth momentum in Q3 2019 reflected weaker consumer spending and a contraction in investment expenditure, with construction-related investment falling sharply. South Korea's manufacturing export sector is also still facing strong headwinds from the transmission effects of the US-China trade war as well as the continued slowdown in the global electronics sector. South Korea's economy is heavily export-oriented, and the weakness of manufacturing exports has been a key factor contributing to the moderating pace of South Korean economic growth in 2019.

In response to the weakness of the South Korean economy during 2019 and continued downside risks to the global economy in 2020, the Bank of Korea has lowered its policy rate twice in recent months, while the South Korean government has introduced fiscal stimulus measures as part of a supplementary budget that was approved by the National Assembly in August.

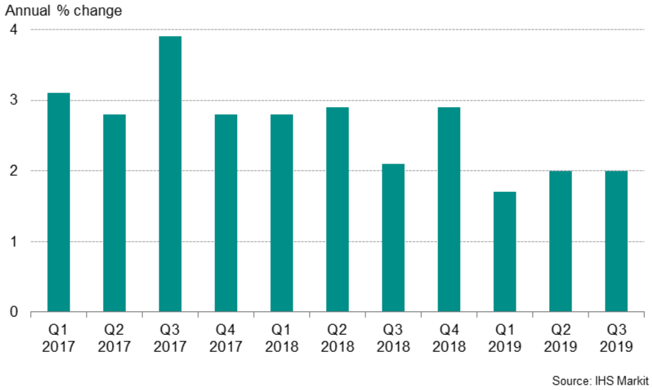
GDP growth slowdown

South Korea's GDP growth rate moderated to 0.4% quarter-on-quarter (q/q) in Q3 2019, according to the Advance Estimate of Q3 2019 GDP released by the Bank of Korea. The pace of growth was considerably softer than the 1.0% q/q GDP growth rate recorded in Q2 2019. Compared to a year ago, the Q3 2019 GDP growth rate was 2.0%, the same rate as in Q2 2019. During 2019, GDP growth has moderated significantly compared to the 2018 calendar year, when GDP grew by 2.7% y/y.

The moderation in q/q growth in Q3 2019 reflected a significant slowdown in consumption expenditure, which rose by only 0.4% q/q, compared to rapid growth of 1.1% q/q in Q2 2019. Private consumption recorded only marginal growth of 0.1% q/q in Q3 2019, compared to an increase of 0.7% q/q in Q2 2019.

A contraction in gross fixed capital formation, which fell by 2.3% q/q, also contributed to the weak Q3 2019 GDP figure, with construction-related investment contracting by 5.2% q/q.

South Korea GDP growth

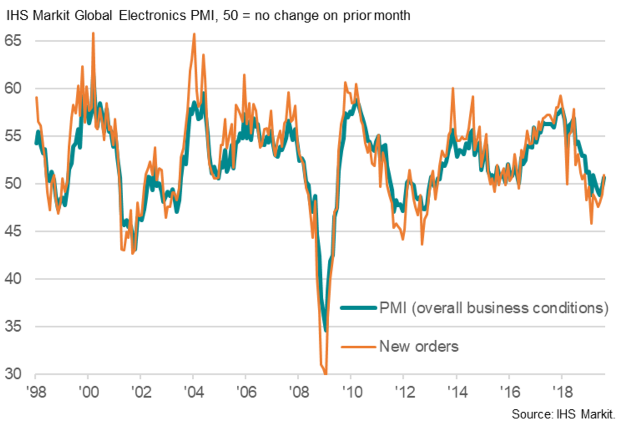


South Korea's export sector downturn

While exports of goods rose by 4.9% q/q in Q3 2019, helped by an upturn in exports of semiconductors and motor vehicles, nevertheless exports of goods still recorded a contraction of 0.5% year-on-year, the third consecutive quarter of contraction in the goods-exporting sector. South Korea's manufacturing export sector has been hit by a perfect storm during 2019 due to the negative impact of the US-China trade war on South Korean exports to China's manufacturing sector, as well as the Eurozone manufacturing recession and the slump in global electronics orders.

South Korean exports have been very weak throughout the first ten months of 2019, with exports declining by 19.5% year-on-year during the first 20 days of October, according to Korea Customs Service data.

IHS Markit Global Electronics PMI



A key factor contributing to the weak performance of South Korean exports has been the global slowdown in electronics sector orders, as electronics exports are one of South Korea's most important export industries. Exports of semiconductors fell by 28.8% y/y in the first 20 days of October.

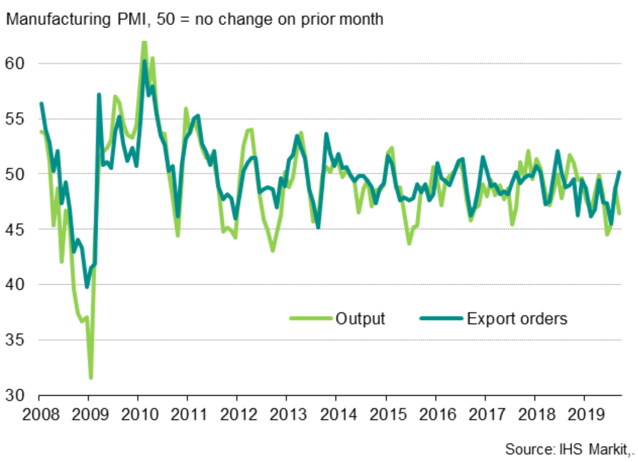
South Korean exports of information and communications technology products in September decreased 22 percent to USD 15.8 billion from a year earlier, with semiconductor shipments down 31.5 percent to USD 8.6 billion, according to export statistics for the calendar month of September from the Ministry of Trade, Industry and Energy. Display exports fell by 20.0 percent y/y to USD 2.1 billion, reflecting falling shipments of liquid crystal display panels.

South Korean policy stimulus measures

In response to weakening economic growth, the Bank of Korea has taken action to try to stimulate the economy with a 25bp rate cut on 18 July and another 25bp rate cut on 16 October, bring the base rate down to just 1.25%. However, monetary policy acts with long lags, so is unlikely to have much stimulatory impact on overall economic growth during the latter part of 2019. If the South Korean economy remains weak into 2020, the BOK could undertake further monetary policy easing, with the Monetary Policy Board of the BOK having retained an accommodative stance at its most recent Monetary Policy meeting in October.

Some fiscal stimulus from the recent South Korean supplementary budget of USD 4.9 billion that was approved by the National Assembly in August will also flow through into the economy during the fourth quarter of 2019 and into early 2020.

IHS Markit South Korea PMI



Impact of regional trade wars

South Korea's export sector has been impacted by the contagion effects of the US-China trade war, as the slowdown in China's manufacturing export sector together with some moderation in domestic demand has resulted in weaker new orders for South Korean exports. Slowing Chinese orders for South Korean exports have been a key factor contributing to the weak export performance, with South Korean exports to China in the first 20 days of October showing a steep contraction of 20% year-on-year. China is South Korea's largest export market, and accounted for around 27% of total South Korean exports in 2018.

With South Korean economic growth momentum already weakening, the escalating trade tensions between Japan and South Korea have added to downside risks facing the South Korean economy. The potential negative impact to South Korea's export sector from Japan's export restrictions on key materials critical for the electronics industry add to the economic shocks that have already hit South Korea's export sector. The Japanese government's decision to remove South Korea from its 'white list,' could also substantially increase the negative impact of trade frictions with Japan on the South Korean economy.

South Korea is heavily reliant on imports of Japanese intermediate parts and materials for its manufacturing industry, having recorded a bilateral trade deficit in parts and materials with Japan amounting to USD 15.1 billion in 2018 – around three-quarters of the total bilateral trade deficit. This highlights the vulnerability of South Korea's manufacturing supply chain to any disruption of Japanese intermediate goods, notably for electronics components and chemicals products.

Recent trade frictions between Japan and South Korea are also likely to trigger some reconfiguration of supply chains for South Korean multinationals, as they try to reduce their vulnerability to Japanese intermediate materials and components.

Economic outlook

South Korea's GDP growth rate has moderated significantly during 2019, with private consumption growth having weakened and fixed investment having contracted in Q3 2019. The outlook for 2020 is for continued constrained growth momentum. South Korea's export sector is also expected to continue to face headwinds in 2020 because of the combined impact of the ongoing US-China trade war, the global electronics cycle downturn, and moderating growth in the key US and EU export markets.

As a result, South Korean real GDP growth is forecast to be below 2% in both 2019 and 2020, likely triggering more accommodative monetary and fiscal policies to underpin growth.