Economic Research

4 November 2019

Week Ahead Economic Preview

Global overview

- Service sector PMI surveys updated for October to provide insight into global growth trends
- Bank of England MPC meeting
- Germany's industrial production
- Indonesia and Philippines GDP
- Special reports on the potential for meaningful fiscal stimulus in the eurozone, and India's shadow banking crisis

The dovish tilt to global policy making continued in October with the US Fed cutting rates for the third time, but whether this represents the end of the easing cycle could be dependent on how economic growth fares in the fourth quarter. In this respect, global PMI data will give a comprehensive picture of how the world economy started the closing quarter of 2019.

While national economic trends will naturally be of importance to policy makers, the global environment has been increasingly cited as a key source of concern at key central banks, helping persuade rate-setters to add more stimulus. The global PMI signalled the weakest expansion for three years in September, and preliminary data for October so far suggest little scope for any uplift. The flash PMIs were consistent with only modest US GDP growth, with a weakening service sector offsetting signs of life from manufacturing (page 3). The eurozone meanwhile stagnated and Japan contracted for the first time in three years. The final PMI data will provide a far more comprehensive global picture. Of note, the UK services PMI is released as the Bank of England meets to set policy amid growing political unease in the UK (page 4).

In the eurozone, final PMI data and key industrial numbers for Germany will give a steer to the region's economic health, with a risk of Germany slipping in to recession likely to fuel debate on the need for stimulus. We therefore look at how potential there is for a boost from fiscal stimulus in our special paper (page 6).

In Asia, the PMI surveys will be in particular focus for signs of trade war impact and fresh news on Hong Kong SAR's recession. Monetary policy decisions are meanwhile awaited for from Australia, Malaysia and Thailand, while Indonesia and the Philippines will release their third quarter GDP data (page 5).

Our special report from Asia this week assess the severity of India's shadow banking crisis (page 9).

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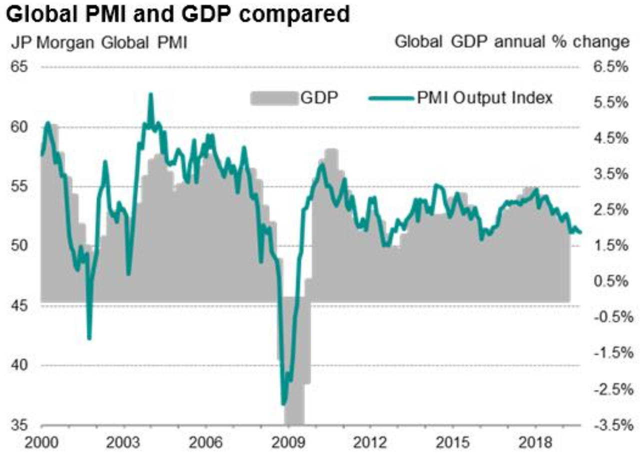
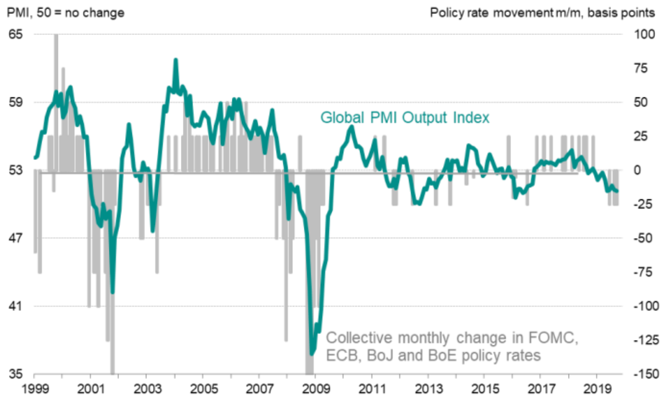
Special report

Global PMI and GDP compared



Sources: IHS Markit, JP Morgan.

Global PMI and G4 central bank policy rates



Source: IHS Markit, JPMorgan.

Key diary events

Monday 4 November
Australia retail sales (Sep)
Malaysia trade (Sep)
UK construction PMI (Oct)
Singapore SIPMM manufacturing PMI (Oct)
US factory orders (Sep)

Tuesday 5 November
Worldwide release of IHS Markit services PMI (Oct)
Hong Kong and Singapore whole economy PMI (Oct)
2nd China International Import Expo (5-10 Nov)
Philippines inflation (Oct), industrial production (Sep)
Australia and Malaysia monetary policy decision
Indonesia GDP (Q3)
US trade, JOLTS job opening (Sep), ISM non-manufacturing PMI (Oct)

Wednesday 6 November
IHS Markit services PMI for Japan, Germany, France, Spain, Italy, Russia (Oct)
JPMorgan global composite PMI (Oct), Eurozone composite PMI (Final, Oct)
BOJ monetary policy meeting minutes (18-19 Sep)
Philippines trade (Sep)
Thailand monetary policy decision
Germany factory orders (Sep)
Taiwan inflation (Oct)
Euro area retail sales (Sep)
ECB non-monetary policy meeting

Thursday 7 November
Australia trade (Sep)
Philippines GDP (Q3)
Germany construction PMI (Oct), industrial output (Sep)
UK Halifax house price index (Oct)
BoE monetary policy meeting, inflation report
Brazil inflation (Oct)
Eurogroup meeting

Friday 8 November
Japan household spending, average earnings (Sep)
RBA statement on monetary policy (Nov); home loans (Sep)
China and Taiwan trade (Oct)
Germany trade (Sep)
France industrial output, trade balance (Sep)
US Michigan consumer surveys (Prelim, Nov), wholesale inventories (Sep)

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Economic Research

4 November 2019

United States Week Ahead

Final services & composite PMIs, inventories and factory orders

By Siân Jones

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Following a bumper week for data releases which saw GDP come in above expectations and a further cut to interest rates, we now look ahead to indicators of US growth in the final quarter of 2019. Leading the economic releases is the PMI data, with further colour added via consumer confidence, factory orders and inventory data.

Services and Composite PMIs

With consumers having helped boost the US economy to achieved stronger than widely-expected growth in the third quarter, services and non-manufacturing PMI data from IHS Markit and the ISM respectively will provide steers as to whether the domestic economy has continued to support growth in the fourth quarter.

Although the manufacturing sector appears to have turned a corner and is starting to put the recent slowdown behind it, demand conditions among service providers remained gloomy according to our 'flash' services PMI data. The New Business Index hit a series low (since October 2009) as client demand was unchanged from September. Exports of services also dropped to a fresh low. A slip in the service sector upturn carries importance due to the knock-on effects it can have on consumer confidence and spending. Overall, the flash PMI data are running at a level consistent with modest annualised GDP growth of just under 1.5% in October.

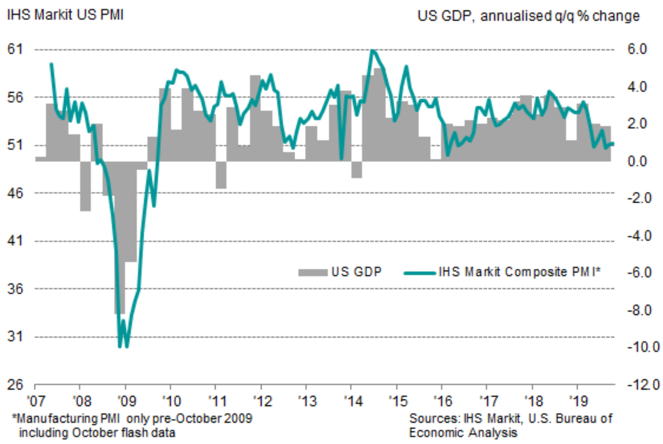
Inventories

Third quarter GDP was also buoyed by inventory building, so an update to September's inventories data will be monitored to assess any potential scope to GDP revisions, and also of course to gauge manufacturers' appetite to invest in stock or destock as they lead up to fourth quarter.

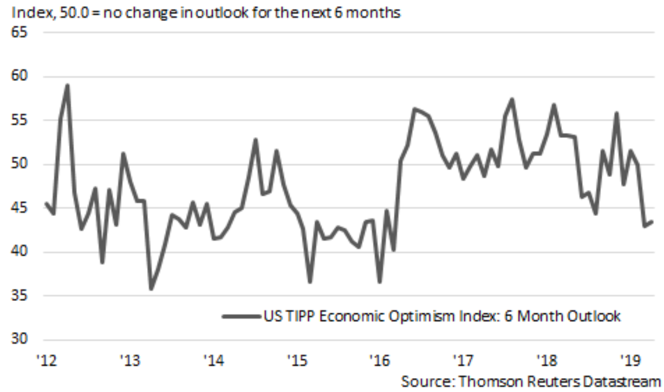
Factory orders

Also released is the latest instalment of factory orders data. Encouragingly, our flash manufacturing PMI data pointed towards a pick-up in client demand during October for the second month running, providing tentative evidence that the worst of the manufacturing downturn may be behind us.

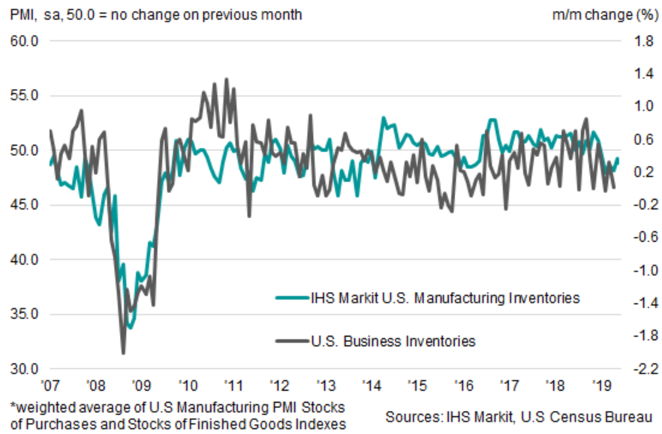
US GDP faster than expected in Q3, supported by retail sales



Consumers remained pessimistic in October



Inventories set to rise fractionally as investment weighs on the overall expansion



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

Economic Research

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Europe Week Ahead

PMI surveys, Bank of England MPC meeting and Germany industrial data

By Joe Hayes
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October PMI data will be met with strong interest as we receive our first taste of European economic performance into year-end. The Bank of England meanwhile sets interest rates, although given the high degree of economic and political uncertainty, we expect no change.

Bank of England and services PMI

The Bank of England's Monetary Policy Committee is expected to sit on its hands given the still-unclear Brexit process, stable inflation and volatile GDP developments, but the meeting will be closely watched for how the Bank sees the economy faring as Brexit uncertainty intensifies with an upcoming general election. We expect UK policymakers will leave rates on hold until the first half of 2021 although, based on survey data, current economic conditions are historically aligned with looser monetary policy. UK services PMI data will therefore be high on the agenda. A move deeper into negative territory could push the Bank of England closer to cutting rates.

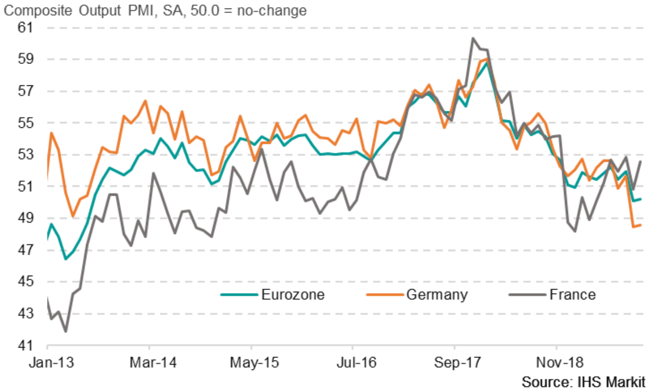
Eurozone PMI

Final PMI data for the eurozone and neighbour countries will be eyed for clues of fourth quarter performance. The flash PMIs showed the euro area had practically ground to a halt in October after having correctly signalled a weak third quarter, in which GDP grew 0.2%. Forward-looking indicators such as new orders and employment portray a particularly downbeat picture. Divergences are still notable by country, however, as a degree of resilience in France contrasts with a manufacturing-led downturn in Germany.

Germany industrial and trade data

September industrial output data will be eyed to gauge whether Germany has managed to avoid recession. Manufacturing output fell at the fastest rate since July 2012 in September, according to PMI numbers, suggesting heightened recession risks persist for Germany. We expect a small quarterly contraction in GDP for the third quarter. Trade and factory orders data will also provide insight into demand conditions.

Flash PMIs showed eurozone economy flatlining

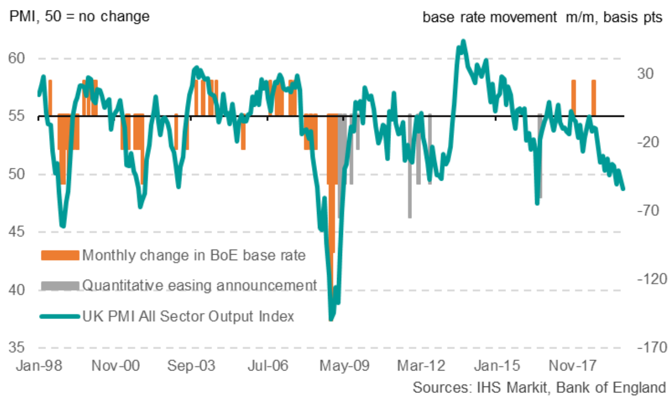


Source: IHS Markit

Germany's industrial recession has deepened

Sources: IHS Markit, FSO

PMI survey data have moved firmly inside easing territory for the UK



Sources: IHS Markit, Bank of England

Economic Research

4 November 2019

Asia Pacific Week Ahead

PMI data, central bank meetings, China trade, GDP updates

By Bernard Aw

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The market next week will remain dominated by trade, with plenty of events and data to concentrate the minds of investors across Asia Pacific. The worldwide release of services PMI surveys will provide a more comprehensive view of global economic performance at the start of the fourth quarter, focusing on China and Hong Kong SAR in particular.

China's trade figures will draw scrutiny, while President Xi's keynote speech at the 2nd China International Import Expo will be closely watched for new trade developments. Any announcements about the US-China 'phase one' deal will have an effect on markets. Signs of electronics sector performance can be gleaned from trade updates from Taiwan and Malaysia. Meanwhile, several regional central banks are setting policy, including Australia, Malaysia and Thailand, while Indonesia and the Philippines will release their third quarter GDP data.

Regional monetary policy

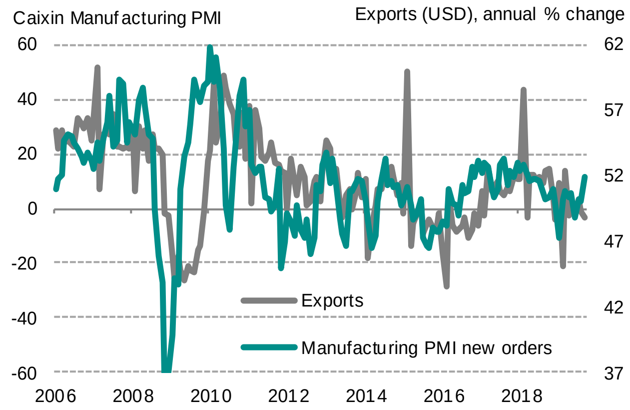
With dovish stances dominating monetary policy across the region, eyes will be on Australia, Thailand and Malaysia as they decide on interest rates next week. Australia is expected to leave its cash rate unchanged, though governor Philip Lowe said in recent remarks that the central bank is prepared to ease policy further if needed. Flash PMI data showed subdued business conditions in October.

The policy decision could be a close call at the Bank of Thailand and at the Bank Negara Malaysia. Thailand is facing strong upward currency pressures and an economic slowdown, with the central bank planning to deploy other measures to contain the baht appreciation in addition to rate cuts. Meanwhile, Malaysia could opt for a rate cut amid growing external headwinds.

Indonesia and Philippines GDP

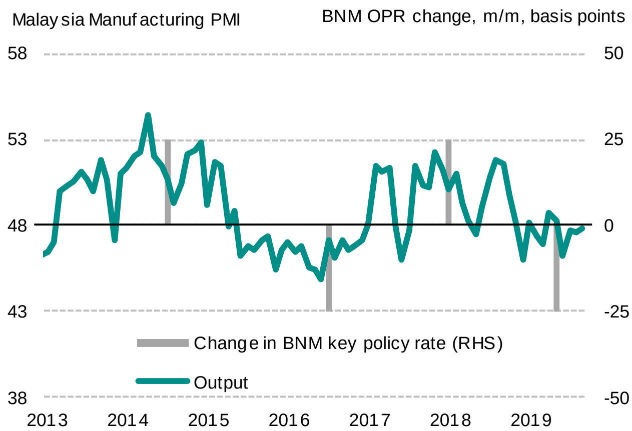
Indonesia's third quarter GDP is forecast to have expanded by 5%, down from 5.1% in the second quarter. Recent PMI surveys have highlighted an ongoing deterioration in manufacturing conditions. In contrast, the Philippines' economy is expected to have grown at a faster rate of 5.8% in the third quarter, up from 5.5%, according to IHS Markit's estimate. Our economists expect accelerating growth momentum due to higher infrastructure spending.

China PMI and exports



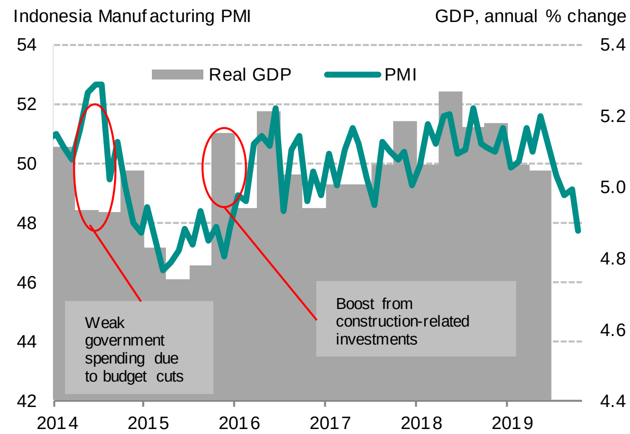
Sources: IHS Markit, Caixin, China Customs

Malaysia PMI and monetary policy



Sources: IHS Markit, Bank Negara Malaysia

October Indonesia PMI signals further slowdown in start of fourth quarter



Sources: IHS Markit, Statistics Indonesia

Europe
Special Focus

Eurozone fiscal space: how much is there and is it a game changer?

By Daniel Kral

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Given the weak economic outlook and diminishing returns from already very loose monetary policy, there are growing calls for the use of fiscal policy to support growth in the Eurozone. However, any estimate of Eurozone's fiscal space depends on the underlying assumptions about compliance with different rules and allowed flexibility.

Based on the baseline evolution of structural budget balances and legally binding adjustment paths towards medium-term budgetary objectives, we estimate Eurozone's additional fiscal space at just over EUR40 billion each year between 2019 and 2021 (0.4% of eurozone GDP), almost all from Germany and the Netherlands. According to the draft budgets submitted to the European Commission, the mild fiscal loosening planned for 2020 is already largely incorporated in our baseline.

Eurozone fiscal governance

The eurozone's fiscal governance framework has grown more complex and less transparent over time with the financial crisis acting as a watershed. In the 1990s, the Stability and Growth Pact (SGP) has strengthened monitoring and co-ordination instruments to ensure compliance with the two basic stipulations of the Maastricht Treaty: public deficits of less than 3% and public debt levels below 60% of GDP. The SGP includes a "preventive arm", which established medium-term budgetary objectives (MTOs) for member states, and a "corrective arm", which created a process to compel member states to correct excessive deficits or debts (the excessive deficit procedure, or EDP). The SGP was first reformed in 2005, creating new quantitative benchmarks for MTOs and clarifying the scope of adjustment in the corrective arm under different economic conditions.

In the wake of the financial and subsequent European sovereign debt crises, which exposed severe fiscal and macroeconomic imbalances in several member states that threatened the very existence of the eurozone, the SGP framework has undergone major reforms.

The main legislative packages reforming the SGP were the "six-pack" reform of 2011, applicable to all EU member states, and the "two-pack" reform of 2013, which applies only to eurozone member states. In addition to the Commission-led six-pack and two-pack legislation, an inter-governmental treaty, the Treaty on Stability, Coordination and Governance (TSCG), entered into force in January 2013. This is formally binding for all eurozone member states plus Bulgaria, Denmark, and Romania.

The main elements of Title III of the TSCG, known as the Fiscal Compact, are:

- Transposing into domestic legislation an MTO of a deficit of no more than 0.5% of potential GDP or 1.0% of potential GDP when public debt levels are significantly below 60% of GDP, and a requirement of rapid convergence to MTOs.
- Transposing into domestic legislation a requirement to reduce debt levels, if exceeding 60% of GDP (reference value), by an average of one-twentieth of the total above the reference value per year.
- Strengthening of the excessive deficit procedure, by making its operation more automatic and introducing a bias towards adopting Commission proposals (by requiring reverse qualified majority in EU Council to oppose them).

Evolution of the eurozone's fiscal stance

The eurozone's fiscal stance has improved significantly since the financial crisis with the general government deficit improving from 6.2% to 0.5% of GDP between 2010 and 2018. This reflects both an improvement in the primary balance (the fiscal balance excluding interest payments on outstanding debt), from a deficit of 3.4% of GDP in 2010 to a surplus of 1.3% of GDP in 2018, and lower interest expenditures, from 2.8% of GDP to 1.8% during the same period (see Chart 1).

Public debt peaked at 92.1% of GDP in 2014, declining to 85.4% by 2018 (see Chart 2), but still significantly above the 60% reference value spelled out in the SGP. As of late 2019, no country is subject to an EDP for the first time since 2003, implying a marked improvement in the eurozone's fiscal health. However, several countries remain subject to the preventive arm of the SGP, including for significant deviation from the agreed paths to MTOs, as structural balances barely improved in some of the key deficit countries during the cyclical upswing of 2015–18.

Chart 1: Eurozone general government balance

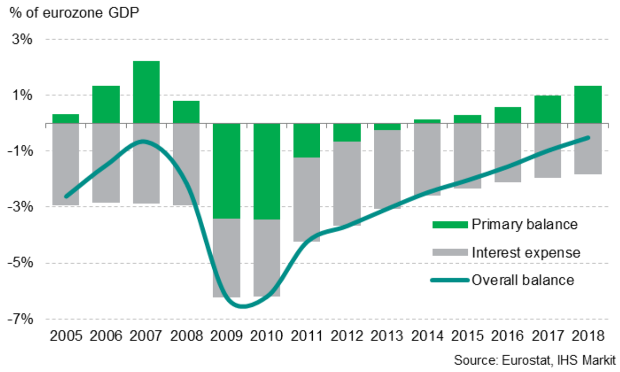
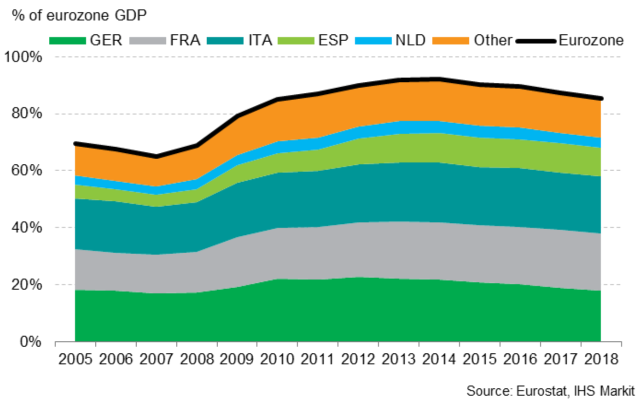
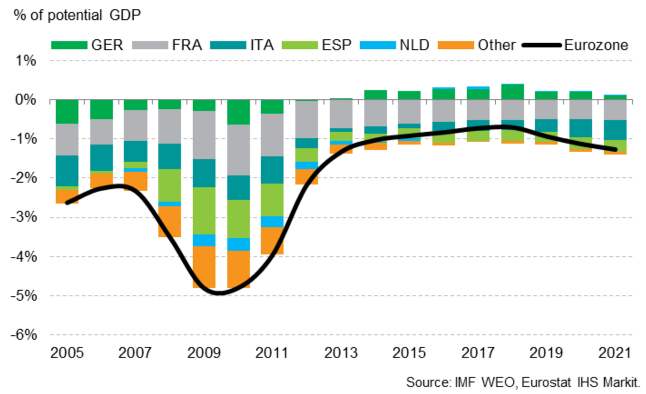


Chart 2: Eurozone public debt



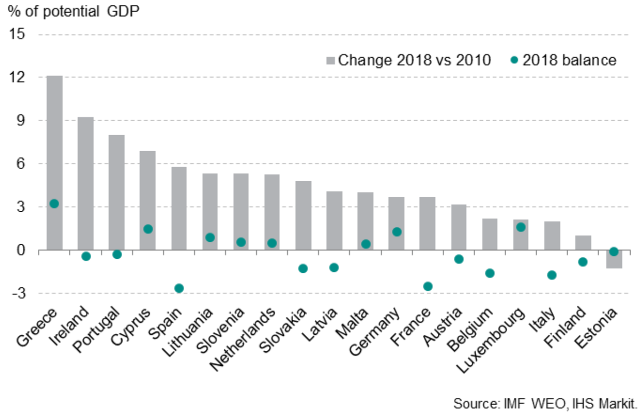
Indeed, fiscal consolidation has proceeded at a different pace among member states. Overall, the eurozone's structural deficit shrank from 4.8% of potential GDP in 2010 to 0.7% in 2018, which is close to the 0.5% deficit target spelled out in the TSCG (see Chart 3).

Chart 3: Structural budget balance



The largest consolidation during this period was achieved by countries that have required external financial assistance (Greece, Ireland, Portugal, Cyprus and Spain), which came with strict conditions attached (Chart 4). However, the eurozone's structural balance is set to deteriorate, as part of the baseline, to a deficit of 1.3% of potential GDP by 2021, driven by a lower German surplus and a widening Italian deficit (the two account for 80% of the change). As part of the baseline, there is no fiscal tightening planned in Italy, Spain and France in the near term, despite their still elevated structural deficits.

Chart 4: Structural budget balances

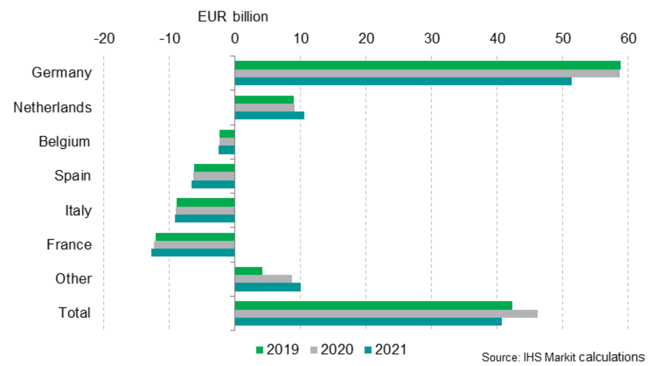


Estimating eurozone's fiscal space

We have constructed a Fiscal Compact-based indicator, composed of the difference between the structural deficit under the baseline scenario and the maximum allowed deficit of 1.0% of potential GDP for countries whose debt is below 60% of GDP; this is offset by countries whose structural deficit is set to deteriorate to significantly below 1.0%, which are assumed to make a 0.5% adjustment each year against the baseline. We use the IMF's World Economic Outlook database as the baseline.

We estimate additional fiscal capacity at the eurozone level to be EUR46 billion in 2020, declining to EUR41 billion by 2021 (0.4 to 0.3% of GDP). In this scenario, the fiscal space in Germany, the Netherlands (the two together again make up more than 90% of total space), and some of the smaller countries is partially offset by fiscal tightening in Belgium, France, Italy, and Spain (see Chart 5).

Chart 5: Fiscal space based on Fiscal Compact rule

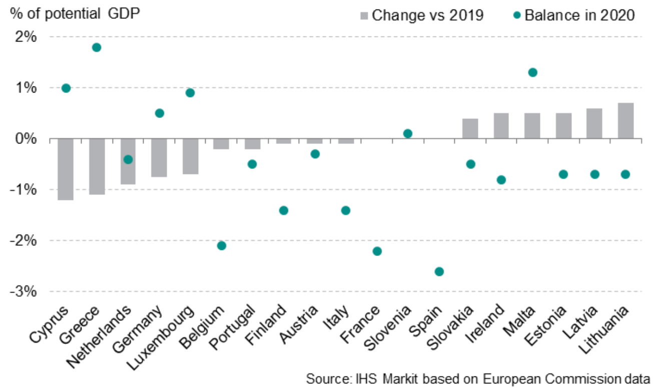


We believe this to be an accurate reflection of the fiscal space as it is based on the maximum allowed leeway for countries with fiscal headroom and a moderate pace of tightening in high-deficit countries.

Fiscal stance in 2020

According to the draft budget submissions to the European Commission, Eurozone's aggregate discretionary fiscal effort in 2020 amounts to 0.3% of GDP, which is largely incorporated in our baseline already (see Chart 6). This is based on a loosening in Germany (structural budget surplus declining from 1.25% to 0.5% of potential GDP in 2019-20) and the Netherlands (from 0.5% to -0.4%), and no adjustment in high deficit countries (Spain, France, Italy, Belgium).

Chart 6: Structural budget balances



Although the final budget may differ slightly, Germany's draft budget points to significant unused fiscal space (1.5% of potential GDP, or EUR 50 billion). On the other hand, the high deficit countries may agree to undergo some tightening. Given our eurozone GDP growth projection of less than 1.0% in 2020, any moderate fiscal stimulus, for example amounting to half of the available fiscal space on top of the baseline projection (0.2% of GDP), that is successfully channelled into higher spending would marginally improve the economic outlook.

Asia Pacific Special Focus

India's shadow banking crisis: how severe is its economic impact?

By Rajiv Biswas

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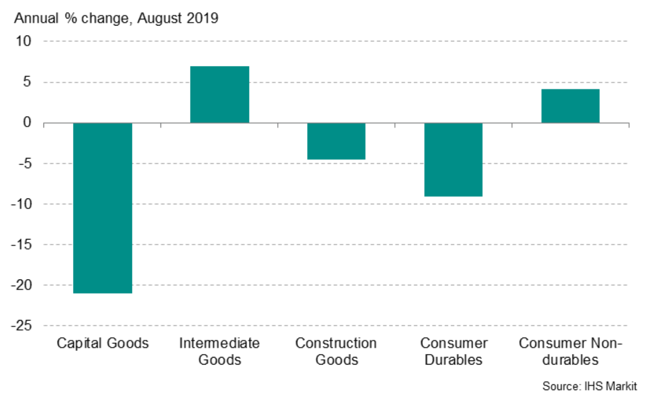
The pace of Indian economic growth has moderated during 2019 due to softening domestic demand as well as the economic impact of the high level of non-performing loans on the balance sheets of the public sector banks, constraining their new lending. Furthermore, there are also risks from potential contagion effects from troubled non-bank financial companies to the balance sheets of some commercial banks, which could further weigh on the overall pace of credit expansion.

In response to the growth slowdown, the Reserve Bank of India (RBI) has eased policy rates five times during 2019, while the Indian government announced a large reduction in corporate tax rates in September, in order to help boost new investment spending.

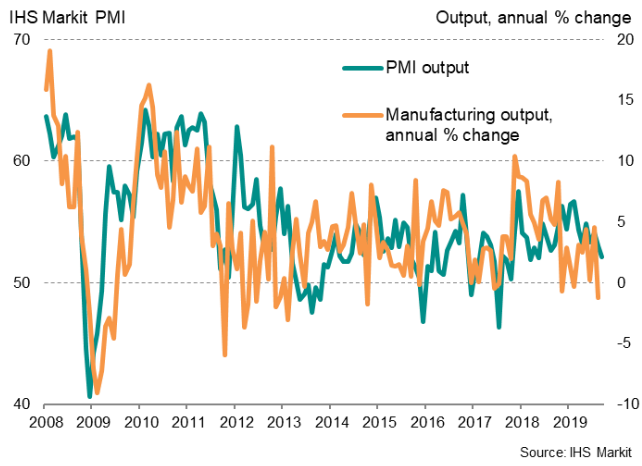
Indian economy faces headwinds

In the April to June 2019 quarter, Indian GDP growth slowed to 5.0% y/y, the weakest pace since 2013. The pace of manufacturing output growth has also stalled. In August 2019, manufacturing production contracted by 1.2% year-on-year, with 15 out of 23 sectors of manufacturing showing a contraction in output compared to a year ago.

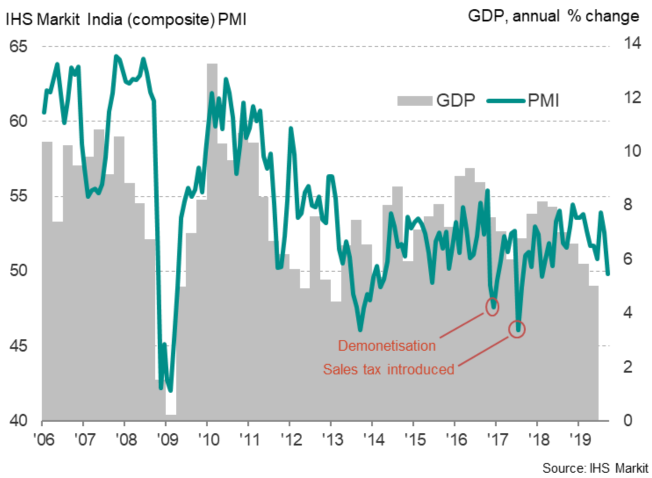
India's latest industrial production



IHS Markit India Manufacturing PMI



IHS Markit India Composite PMI v GDP



A key concern is that output of capital goods declined by 21% year-on-year, signalling continuing weak capital expenditure. For the April to August 2019 period, manufacturing output was up just 2.1% year-on-year, less than half the pace of expansion recorded in the same period of 2018, when manufacturing output rose by 5.5% y/y.

The headline seasonally adjusted IHS Markit India Manufacturing PMI was at 51.4 in September, posting its joint-lowest reading since May 2018. Indian manufacturers were again hit by subdued demand conditions domestically and externally, which led them to limit production.

The weakness in manufacturing output has been heavily impacted by declining motor vehicles output, which fell by 23% year-on-year in August, while output of other transport equipment fell by 13.6% y/y. The Indian auto industry has slumped into a crisis, with hundreds of thousands of auto sector workers in both the production and distribution segments having been laid off over the past twelve months.

The causes of the Indian auto sector crisis include a number of factors including new emissions standards as well as the squeeze on consumer credit for auto financing by non-bank financial companies (NBFCs). Domestic passenger vehicle sales fell for the tenth straight month in August, declining 31.6%.

Non-bank financial companies face growing crisis

India's NBFCs have faced a liquidity squeeze since the collapse of Infrastructure Leasing & Financial Services, one of India's largest non-bank financial services firms, in 2018. Shadow banks account for an estimated 20% of total Indian financial sector lending, and the sharp slowdown in their credit approvals has hurt overall economic activity levels.

Indian NBFCs are a major source of consumer finance for auto loans, other consumer durables and mortgages. NBFCs are facing a major debt refinancing peak in 2020, with around USD 60 billion of refinancing estimated to be needed. Furthermore, banks and mutual funds have reduced lending to NBFCs due to concerns about the increasing problems in the sector, further intensifying the funding pressures they are facing.

The RBI has estimated that the gross non-performing asset ratio for commercial banks was 9.3% in March 2019. Although the RBI has stated that it expects the gross non-performing asset ratio to stabilize over 2019-2020, there is a growing risk that the increasing problems in the NBFC sector could result in contagion effects adding further bad debts to the balance sheets of commercial banks.

Although the pace of credit expansion in the commercial banking sector improved to 13.2% year-on-year growth in March 2019, this was mainly driven by strong lending growth of 21% year-on-year by the private commercial banks, while lending by public sector banks rose by only 9.6% y/y. Furthermore, short-lending data for the fortnight to end-August indicated that the pace of credit growth by commercial banks slowed to 10.2% y/y. Nevertheless, the pace of credit growth at public sector banks is still much improved compared to 2017, when it had completely stalled.

However, the problems in the non-bank financial sector have significantly constrained credit growth from that sector, slowing the overall pace of credit growth in the Indian financial sector. For example, auto loans from the NBFC sector are estimated to have fallen sharply during 2019. NBFCs also have been a significant source of lending in recent years to real estate developers and are exposed to rising defaults in this segment due to a large stock of unsold properties as well as a significant number of stalled property development projects.

There have also been problems within the co-operative banking sector, highlighted by the recent crisis at the Punjab and Maharashtra Co-operative Bank (PMC), one of the top five co-operative banks. The RBI took control of the PMC Bank in September 2019, with investigations by police of serious fraud and discovery of significant balance sheet exposure to a bankrupt real estate developer. The PMC Bank has been temporarily banned from making any new loans. Another 23 co-operative banks have also been placed under central bank administration in 2019.

Monetary and fiscal policy stimulus measures

Faced with the softening economic growth outlook, the Indian central bank, the RBI, has eased monetary policy five times so far in 2019, by a total of 135bps, over concerns that growth momentum is slowing down and also to try to boost liquidity in the financial system. With the RBI Monetary Policy Committee having decided to retain an accommodative stance following its October rate cut, further rate cuts are possible if economic conditions remain weak.

The Indian government has also announced new fiscal policy measures to try to boost private sector investment. Finance Minister Nirmala Sitharaman announced on 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%.

Improving India's business competitiveness

In addition to the recent corporate tax cuts, the Indian government has undertaken other reforms to try to improve the business environment. 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 77th out of 190 countries that are included on the World Bank's Ease of Doing Business Index in 2019. In the most recent World Bank Ease of Doing Business Survey for 2020, India advanced even higher, rising 14 places to 63rd in the world.

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.

Medium-term economic outlook

India's financial sector continues to suffer from considerable fragilities. Public sector banks are still struggling under the burden of high non-performing loans on their balance sheets. Contagion from the NBFC crisis could also further impair the balance sheets of some public sector banks. With constraints on the pace of credit expansion, IHS Markit forecasts that Indian GDP growth will moderate from a pace of 6.8% in 2018-19 to 5.8% in 2019-20, a full percentage point slower than the previous financial year.

Given the process of strengthening bank balance sheets has already been slow and protracted, India's financial sector problems are likely to remain a drag on the pace of economic growth over the medium-term outlook.