Economic Research

18 November 2019

Week Ahead Economic Preview

Global overview

- **Flash PMI survey data for the US, Eurozone, Japan, Australia**
- **New UK flash PMI survey releases**
- **FOMC minutes**

Flash PMI surveys provide the highlight of the economic calendar, with newly released UK PMI surveys meaning the flash data are now available for all 'G4' economies as well as Australia.

The November flash data come on the heels of October's worldwide PMI surveys having registering one of the weakest monthly expansions since the global financial crisis. Key things to watch in the flash numbers will be whether the manufacturing downturn is easing, or if the service sector is suffering spill-over effects from the weakened goods-producing sector.

In the US, the FOMC appears satisfied that its third rate cut represented the end of its policy loosening, but the PMIs have brought mixed news. Although manufacturing has shown some signs of stabilising, the service sector reported the weakest inflow of new business since 2009 in October, and job losses were also more widely reported. Flash PMI data will give a good insight into both GDP and employment growth in the fourth quarter (see page 3).

In contrast to the US, the eurozone service sector has shown more resilience, and ahead of the eurozone flash release we explore just how resilient the service sector in the single currency area might be in the coming months in our special report on (page 6).

The week also sees the existing flash PMIs accompanied by UK data. The commencement of flash PMIs for the UK comes at a time of the economy suffering from heightened Brexit-related uncertainty, an upcoming general election and a newly-split Monetary Policy Committee at the Bank of England (page 4).

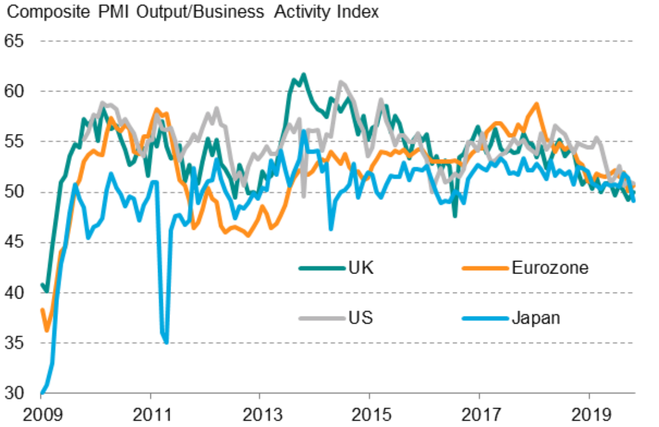
In Asia Pacific, the Japan flash PMI will give further insight into how the economy is faring after October's sales tax hike, and whether Australia is slipping closer to stagnation (page 5). Local elections in Hong Kong SAR will also be a key event, in the lead up to which we look at how the deepening recession looks set to extend into the fourth quarter (page 9).

Special reports

Eurozone: a resilient service sector will be key to the eurozone's near-term economic outlook. We explore why we think the spill-overs from weakness in industry to services have diminished (**page 6**)

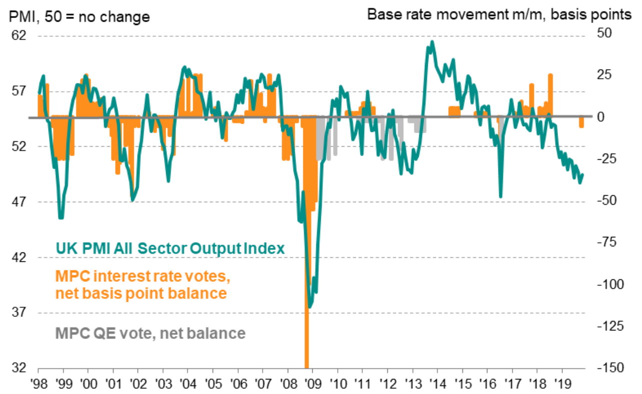
Hong Kong SAR has plunged into recession. We look at the causes of the downturn and prospects for coming months amid escalating political tensions and an upcoming local election (**page 9**).

Flash PMI releases now include the UK, extending coverage to all G4 economies



Source~: IHS Markit, Jibun Bank.

The UK flash PMI comes at a time of the economy being hit by increased political uncertainty, and some Bank of England policymakers now voting for a rate cut



Sources: IHS Markit, Bank of England.
Voting balances shows rate hike votes minus rate cut votes, taking into account size of each vote per MPC member.
£25bn QE converted to 25 basis points equivalent

Key diary events (UTC +8)

Monday 18 November
US housing market index (Nov)
Singapore NODX (Oct)
Thailand GDP (Q3)
Hong Kong jobless rate (Oct)
UK Household Finance Index (Oct)

Tuesday 19 November
US/China: temporary general licence for US exports of component and services to Huawei expires
RBA meeting minutes
Euro area construction output (Sep)
US housing starts, building permits (Oct)

Wednesday 20 November
Japan trade (Oct)
China loan prime rate
Malaysia inflation (Oct)
Taiwan export orders (Oct), current account (Q3)
Brazil business confidence (Nov)

Thursday 21 November
FOMC minutes (29-30 Oct)
Thailand trade (Oct)
Indonesia monetary policy decision
Hong Kong inflation (Oct)
France business confidence (Nov)
Spain trade balance, industrial orders (Sep)
US existing home sales (Oct), Philadelphia Fed manufacturing index (Nov)
Euro area consumer confidence (Flash, Nov)

Friday 22 November
Flash PMI surveys for US, Eurozone, Germany, France, Japan and Australia (Nov)
Japan inflation (Oct)
Singapore current account (Q3)
Germany GDP (Final, Q3)

Sat-Sun 23-24 November
23: Singapore inflation (Oct)
23: Taiwan industrial output, retail sales (Oct)
24: Hong Kong District Council elections

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Economic Research

18 November 2019

United States Week Ahead

Flash PMIs and FOMC minutes

By Siân Jones

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Leading the key economic releases are the November flash PMI data from IHS Markit and FOMC minutes from the latest meeting. The latter will shed light on the recent decision to cut interest rates further, whereas the former will continue to build the picture for the health of the US economy during the fourth quarter. Other releases include existing home sales and housing starts, plus the Philly and Kansas Fed surveys.

Flash PMIs

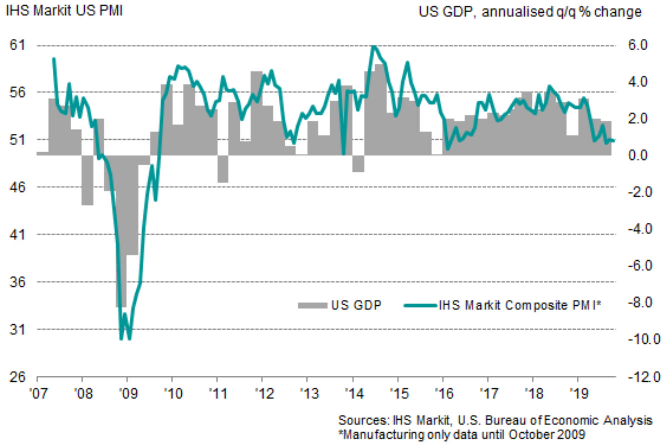
The IHS Markit November flash data will help ascertain if the recent economic soft patch has persisted. A slowdown in service sector growth has weighed on the overall expansion in recent months, keeping the overall indicators pointing to sluggish GDP growth and reduced hiring at the start of the fourth quarter. However, the manufacturing sector has shown tentative signs of stabilising, contrasting with gloomier ISM data (which appear to have also diverged from official data – read about the differences between the surveys here). It's too early to say if a corner's been turned, especially after the IHS Markit Business Outlook survey data pointed towards more muted optimism for the coming year, but the flash PMI data and regional Fed surveys will help guide on fourth quarter trends.

FOMC minutes

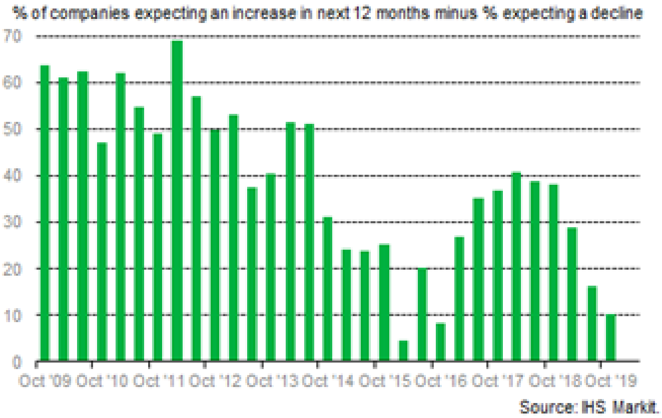
October's FOMC meeting saw the federal funds rate cut for a third time, with committee members highlighting concerns towards the outlook for employment, activity and inflation. That said, stronger than expected GDP growth in the third quarter and a further solid expansion in employment led policymakers to tone down any language surrounding further cuts. It is expected that, unless there is a significant change to the outlook, the committee will not change their policy decision in the near future.

Our colleagues at Macroeconomic Advisers expect the target for the federal funds rate to remain at its current setting of a range of 1.50-1.75% well into next year, after which they expect there will be pressure to begin reversing the 2019 rate cuts. The release of the minutes from the latest meeting will, however, give more colour to reasons for cutting and potentially further clues to future policy decisions.

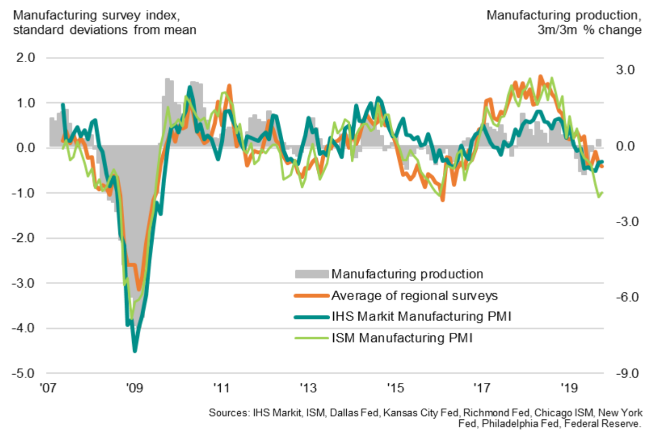
IHS Markit US flash PMI data signalled a sluggish start to the fourth quarter. November data are released on Friday



US business optimism has dropped to a three-year low



ISM data have diverged from US regional Fed and IHS Markit manufacturing surveys, with the latter indicating a more benign trend in production



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

Europe Week Ahead

November flash PMI surveys to guide fourth quarter expectations

By Joe Hayes
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Key data for Europe in the week ahead includes flash PMI surveys, with the Eurozone PMI now accompanied by UK flash Manufacturing and Services PMIs. Eurozone consumer confidence, construction output, and current account data are also released, as well as final German GDP.

Eurozone and UK Flash PMIs

The November flash PMI surveys will provide a valuable layer of insight into economic conditions ahead of Christine Lagarde's first meeting as European Central Bank governor next month. Further signs of sluggishness could ramp up the pressure for more policy action. The October survey showed the eurozone remained close to stagnation, with risks tilted towards contraction as forward-looking indicators, particularly new orders, deteriorated. However, there was a notable divergence between France and Germany, with the latter struggling while the former showed signs of renewed life.

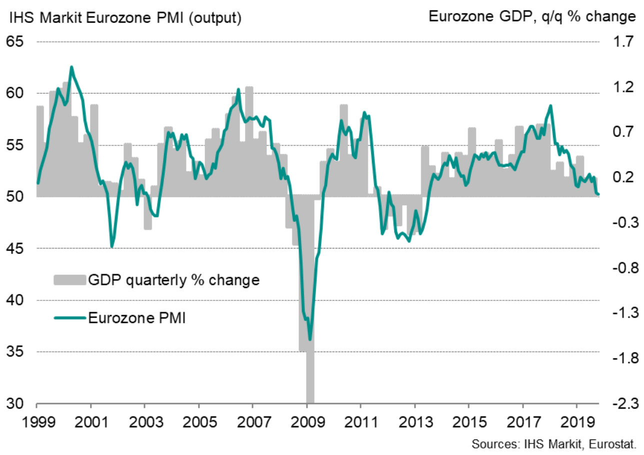
The PMI also indicated that service sector resilience has ebbed slightly, providing a tentative sign that manufacturing woes are beginning to spill over. However, the extent to which this spill-over will continue remains uncertain and is potentially limited. We explore this more in our special report on page 6.

The week also sees the launch of the UK flash Manufacturing and Services PMI surveys. With GDP having been volatile this year, and difficult to gauge the underlying trend, the PMIs have provided a smoother signal of an economy that has slowed markedly, enduring its toughest spell since 2009. November's data will not only give an insight into how business output has fared as a December general election draws closer, but will also be eagerly awaited for employment signals, as recent PMI data showed jobs falling at the fastest rate since 2009, a deterioration that has since been corroborated by official data.

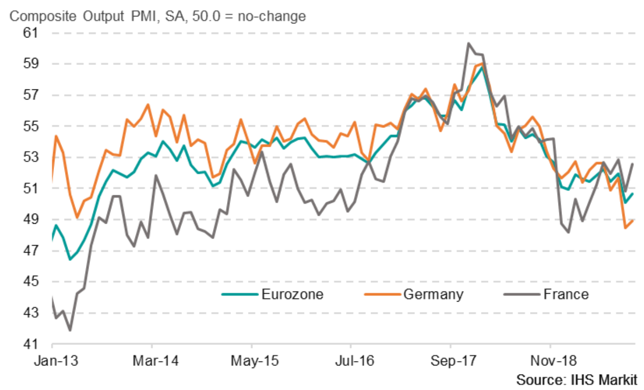
Confidence, construction & trade

Elsewhere, flash consumer confidence for November across the euro area will assess whether some of the weakness on the PMI data, such as softening employment trends, have filtered down to household sentiment. Construction output and the September current account are both also due.

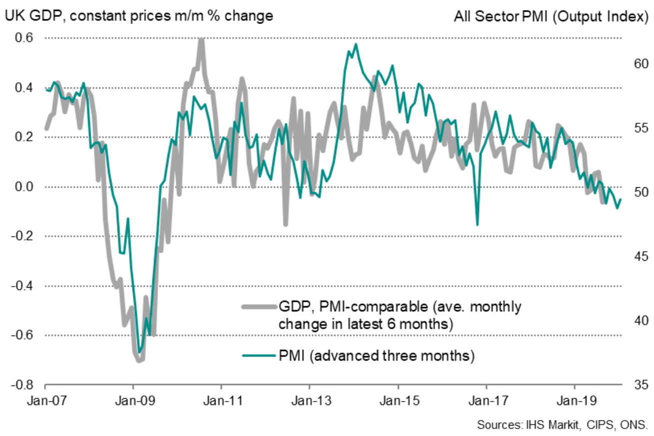
HIS Markit PMI data showed the Eurozone economy broadly stagnated in October



Stronger French PMI numbers contrasted with weakness in Germany, the latter more exposed to global trade headwinds



A new UK flash PMI will help assess the health of the economy as a general election nears



Asia Pacific Week Ahead

Flash PMI, Asia trade, Thai GDP, Indonesia rate policy, HKSAR polls

By Bernard Aw

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Flash November PMI data will provide an updated view of global fourth quarter economic performance, thereby providing an important steer on global monetary policy as the end of the year approaches. In Asia, investors will eye flash PMI reports in Japan and Australia. Trade figures from Japan, Taiwan and Singapore, alongside Thai GDP update will meanwhile also be closely watched for ongoing trade war impact. Indonesia sets monetary policy while Hong Kong SAR braces for local election amid escalating political unrest (We explore the HKSAR economy in this week's APAC special report).

Flash Japan PMI

With October PMI and recent official data signalling that the Japanese economy is at risk of contracting following the recent sales tax hike, the flash November PMIs will draw particular scrutiny as a further weak reading will see growing calls for fiscal interventions. Japanese business activity was also weighed down also by typhoon-related disruptions in October, meaning the November PMI would show a fuller picture of the tax impact on demand. Trade data for October will also be assessed for the health of the external sector amid an ongoing fall in exports since the end of 2018.

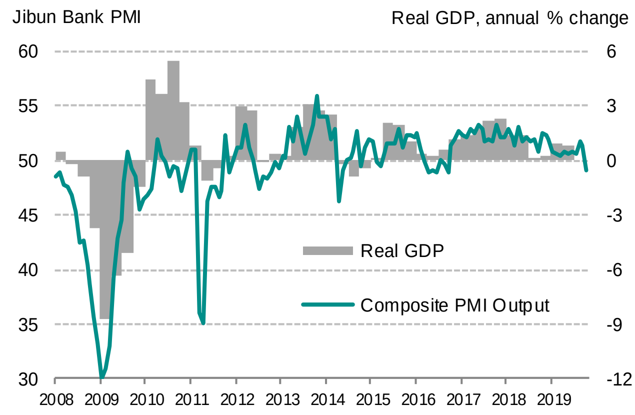
Another check on Asian trade conditions, in particular for electronics, will come from updates to Singapore's non-oil domestic exports and Taiwan's export orders.

Thai GDP and Indonesia monetary policy

According to IHS Markit estimates, Thailand's GDP is expected to have grown at an annual rate of 2.5% during the third quarter, up from 2.3% in the previous quarter, but that will still be one of the weakest growth rates seen for five years since the 2013-14 political crisis. Latest PMI data showed Thai manufacturing conditions stagnate in October in an environment of softening global trade and a strong baht.

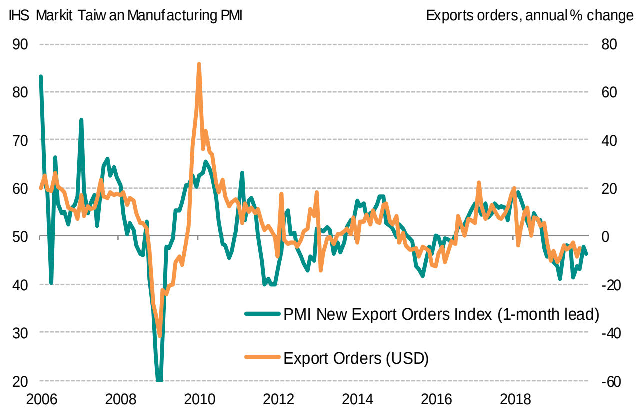
With a weak third quarter GDP print and the Indonesia PMI sending a warning signal of a further slowdown at the start of the fourth quarter, Bank Indonesia could decide to cut the policy rate again at the forthcoming meeting. The bank has already delivered four successive rate cuts in each month since July. The current seven-day reverse repo rate stands at 5.00%.

Flash Japan PMI to show full impact of tax hike



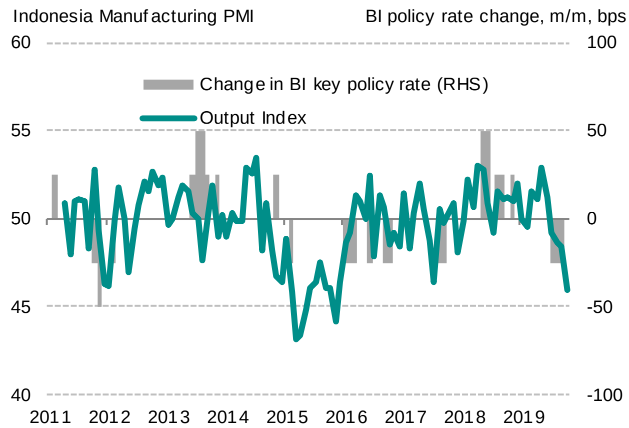
Sources: IHS Markit, Jibun Bank, Cabinet Office

Taiwan PMI points to further export order decline



Source: IHS Markit, DGBAS

Indonesia PMI shows monetary policy remain in easing territory



Sources: IHS Markit, Bank Indonesia

Europe
Special Focus

Mind the gap: why the spillovers from weakness in eurozone industry to services have diminished

By Ken Wattret
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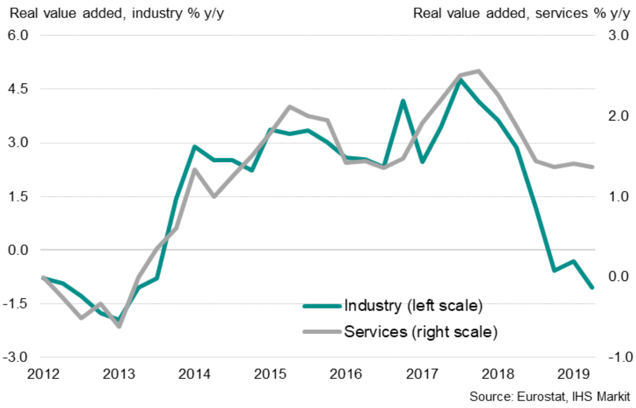
The potential knock-on effects of persistent weakness in industrial activity onto services is one of the key uncertainties facing the eurozone economy at present. Some spillovers are inevitable given supply chain linkages, and these have started to become more apparent in recent services PMI releases. Nonetheless, there are reasons to expect less contagion than in previous industrial downturns, including the absence of a common shock and the resilience of consumer spending.

Exceptional divergence…

Looking at 'hard' activity data and business surveys, the divergence between the performance of the eurozone's industrial and services sectors has been exceptional recently. Chart 1 highlights the deviation in growth rates of industry and services output since early 2018.

Chart 1: Eurozone sectoral growth rates are unusually divergent



The divergence of IHS Markit's eurozone manufacturing and services PMIs has been equally striking (Chart 2). As the weakness of the manufacturing sector intensified from early 2018 onwards, so the gap between the two PMIs rose to unusually high levels as services data held relatively firm. Only once before in the history of the surveys has the recent differential of around six percentage points been exceeded, and that was during late 2008 and early 2009, when the GFC reached maximum intensity, leading to a collapse in industrial production across the globe.

…which has been unusually persistent

Unlike the recent period, however, the exceptionally wide PMI differential back then proved short-lived. It lasted just three months, with the concerted policy stimulus in response to the GFC leading to a swift and strong rebound in industrial production. This year, the PMI gap has been running close to its record highs for six months.

Chart 2: Eurozone PMIs showing exceptional sectoral divergence

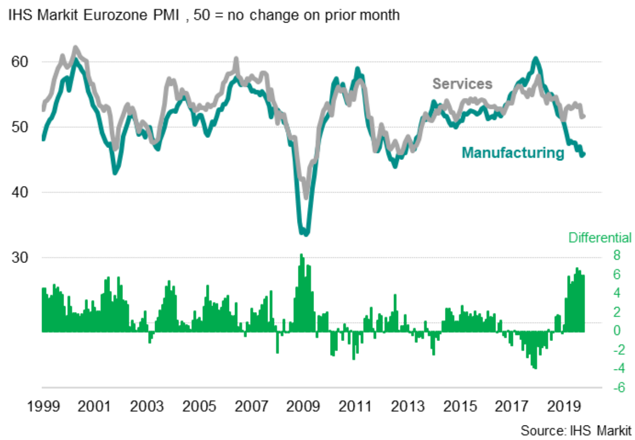
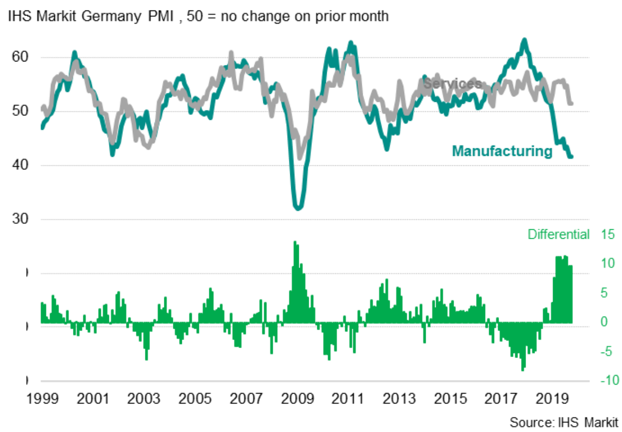


Chart 3: German PMI gap exceptionally wide and persistent



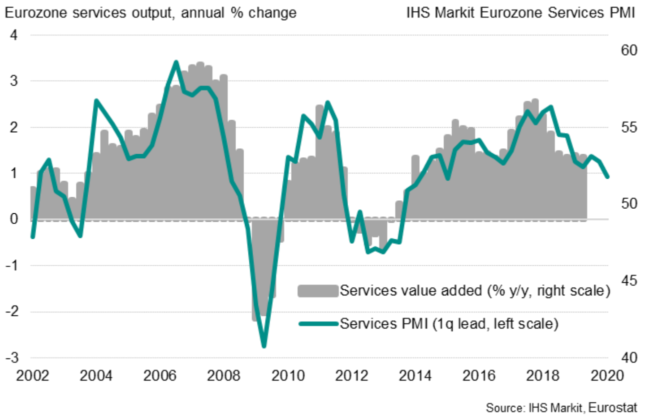
As Chart 3 highlights, the PMI divergence has been even more pronounced and persistent in Germany. The differential between the two sectors has been in double digits, or close to it, for eight months now. While the recent peak (of around 11 percentage points) is lower than in 2008 (14 percentage points), the extreme divergence has lasted twice as long so far. This reflects the unusual dichotomy between recessionary conditions in German industry and solid consumer spending growth (the sustainability of which we discuss below).

In the two decade-plus history of the PMIs, the periodic divergences of manufacturing and services have generally not lasted for long (again, see Chart 2). Either manufacturing recovers, as in 2008/9, or negative spillovers to the service sector build. The transmission from manufacturing sector weakness through to services in large part reflects supply chain linkages. Key services supplied to manufacturers include transport, communication, administration, finance and so on.

Recent signs of spillovers to services

While the services PMI data for the eurozone have been holding up relatively well, the very recent releases have been exhibiting some signs of weakness. October's headline index of 52.2 was around half a percentage point lower than its Q3 average. At that level, it is indicative of y/y growth in services value added slowing to a little over 1%, versus a growth rate of 1.4% in the first half of 2019 (Chart 4).

Chart 4: Growth of eurozone services output to moderate



For the divergence in value added growth rates in industry and services (Chart 1) to be eliminated entirely by services 'catching down', this would imply, based on past relationships, a further fall in the eurozone services PMI of another couple of percentage points to around the 50 level. A drop of this magnitude is not factored into our baseline growth forecast for the eurozone, as it would imply negative y/y rates of change in GDP, which we consider unlikely for various reasons including highly accommodative monetary policy, additional fiscal policy loosening and signs of an easing in the industrial sector headwinds (see below).

In our base case, we expect the y/y rate of eurozone GDP growth to trough at around 0.6% in Q1 and Q2 2020, down from the current 1.1% rate (reported in Q3 2019's preliminary flash estimate).

Still, we are monitoring the downside risks closely given that the more forward-looking components of the services PMI have lost quite a lot of ground in the past couple of months. The new business sub-index was around half a percentage point below its Q3 average, while the future activity sub-index was close to a six-year low.

The forward-looking sub-components of Germany's services PMIs have been even weaker still recently (Chart 5), echoing the underperformance of the German manufacturing PMI over 2019 to date (Chart 6). Germany's new business and future activity sub-indices for services were both below 50 in October, though they tend to be more volatile than their eurozone equivalents.

Chart 5: Germany's services PMI for new business is underperforming

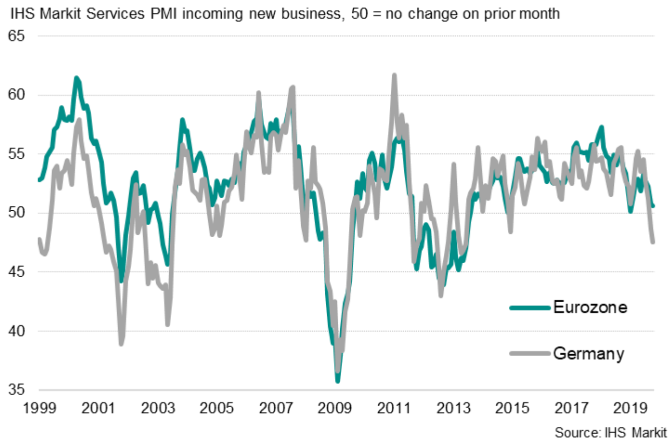
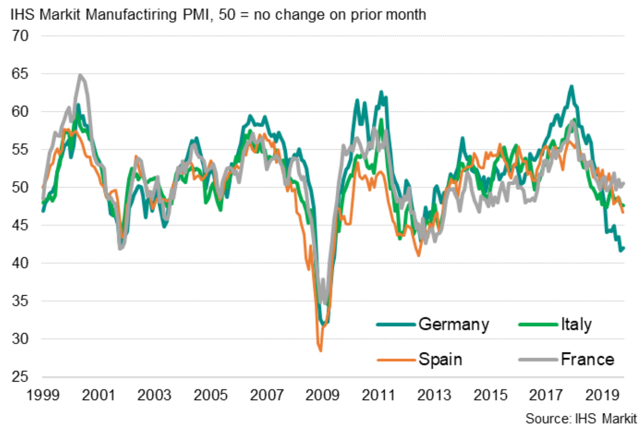


Chart 6: German manufacturing PMI exceptionally weak



Why contagion has diminished

Given the direct supply chain linkages highlighted above, the services sector in the eurozone is clearly not going to be immune to a prolonged industrial slump and spillovers are starting to come through, albeit more slowly than in past cycles. Despite this, however, there are still reasons to expect lesser knock-on effects from industrial weakness to services than we have seen in the past. These include:

- The absence of a common shock: e.g. policy tightening, financial crisis.
- Linked to the point above, investment and consumption growth dynamics have been less correlated in the aftermath of the GFC than they were beforehand.
- Policy uncertainties, including concerns over protectionism, are weighing on investment, which has a high concentration of manufacturing inputs.
- Consumption has been more resilient, supported by solid labour market conditions and wealth effects from elevated asset prices, related in turn to loose monetary policy.
- Weak global demand has leant down on oil prices and consumer price inflation, supporting household real incomes in oil-importing countries.

In the G7 economies (as the OECD's analysis has highlighted), on average around two thirds of the output of market services is produced directly for domestic private and public consumption. Therefore, so long as these areas of expenditure remain firm, the service sector spillovers should be more contained than in the past.

Watch the labour market

As private consumption's share in eurozone GDP is almost three times that of public consumption (around 55% to 20%), it is likely to be the key determinant of how the service sector evolves. In turn, labour market conditions will be the key influence on the evolution of private consumption from here, and the recent signals have been mixed.

Surveys of hiring for the eurozone industrial sector look ominous, with large-scale job losses signalled (Chart 7). However, 'hard' employment data for the industrial sector have fared better in recent quarters than the surveys have been suggesting. Indeed, employment in the eurozone industrial sector continued to expand on a q/q basis in both Q1 and Q2 2019, albeit at a slower pace.

Chart 7: Eurozone PMI points to manufacturing job losses

Source: IHS Markit, Eurostat.

Given the costs of dismissing and rehiring skilled workers in European industry, businesses will remain reluctant to make significant headcount reductions as long as they expect demand to recover before long. This is particularly true for Germany. First, because it was not that long ago that German manufacturers were struggling with severe shortages of skilled labour. Second, as subsidised short-time working has proved effective in the past (including during the fall-out from the global financial crisis) at bridging the period until there is a recovery in demand.

The length of industrial downturn is key

The longevity of the slump in industry is therefore a pivotal issue. Some of the factors causing the downturn are persistent, including uncertainty over trade relations (given US protectionism) and worries about the sustainability (US) and vigour (China) of the global expansion.

That said, there have been some tentatively positive signs recently. While the manufacturing PMIs for the eurozone remain weak across the board, the rate of deterioration is easing off. The forward-looking aspects of the data, including the new orders to inventory ratio and expectations of future output, have started to turn upwards. While they remain consistent with output contractions still, they suggest the rate of contraction is diminishing.

A US decision not to go ahead with threatened tariffs on imports of autos and parts (a decision is due in mid-November), or a post-election resolution to the UK's Brexit impasse, could help sustain the improvement. One of the key models we use to gauge future export dynamics in the eurozone, which typically dovetails with industrial cycles, also points to a pick-up from Q2 2020.

Asia Pacific Special Focus

Hong Kong SAR economy faces deepening economic downturn

By Ling-Wei Chung, David Li & Bernard Aw

Growing US protectionism and mainland China growth slowdown adversely affected the Hong Kong SAR economy, which is highly reliant on trade. But in recent months, the political flare-up leading to widespread protests in the Special Administrative Region is having an increasing negative impact on economic activity, as reflected in official economic statistics and PMI surveys.

The political unrest is expected to persist for the rest of the year and possibly into the next year given limited scope for a compromise between the government and protesters, with hardening stances on both sides. As long as the protests continue, the economic outlook remains uncertain, with no clear recovery expected until at least the second half of 2020.

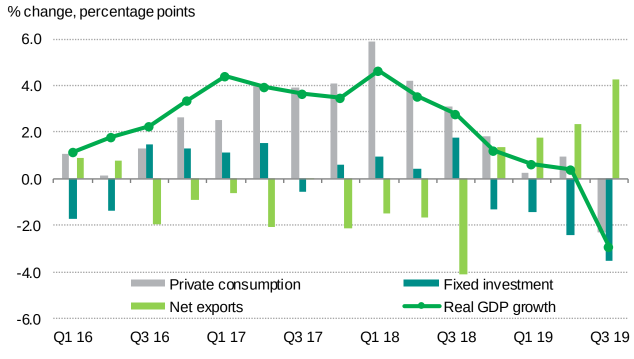
Economic woes amid ongoing trade tensions and political protests

The Hong Kong SAR economy has sunk into its deepest downturn for a decade. Preliminary GDP data showed the economy plunging into a steep contraction during the third quarter of 2019 amid deepening political turmoil.

Real GDP contracted sharply by 2.9% year on year (y/y) in the third quarter, reversing a revised gain of 0.4% y/y in the second quarter. It marked the largest contraction for a decade since the depths of the global financial crisis in the second quarter of 2009. In seasonally adjusted terms, the economy also slumped by a sharp 3.2% from the preceding quarter, accelerating from a 0.5% fall recorded in the second quarter, sending the economy into a recession.

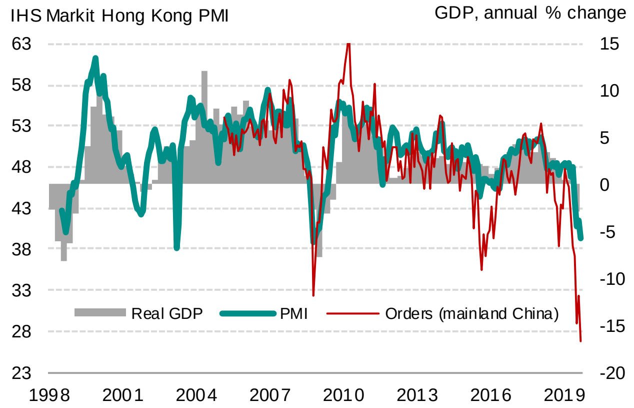
The recession looks to have extended into the fourth quarter as anti-government protests show no signs of abating. The latest Hong Kong SAR PMI data, compiled by IHS Markit, indicated that the private sector economy remained mired in one of its worst downturns for the past two decades in October (See chart 2).

Chart 1: Real GDP growth and component contributions (Y/Y)



Source: IHS Markit, Eurostat.

Chart 2: PMI signals deepening downturn



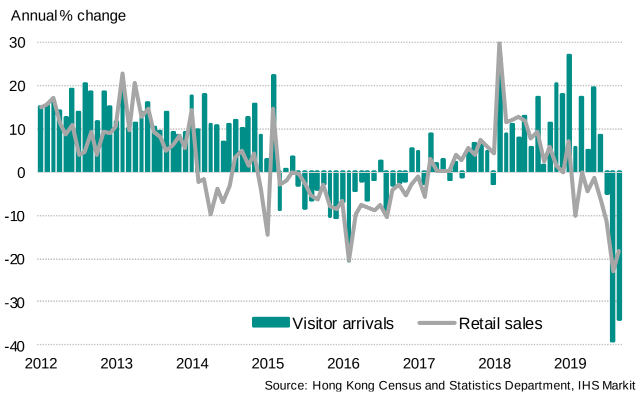
Sources: IHS Markit, C&SD

The PMI survey also brought signs of a deepening economic malaise, as the impact of the ongoing political unrest and a worsening global trade environment continued to dampen business activity and hurt investment at the start of the fourth quarter.

Since early 2019, the economy has felt a stronger pinch from both escalating mainland China-US trade tensions and a slowdown in mainland China's economy, even before political unrest escalated in June. Hong Kong SAR's merchandise exports are mainly re-exports in and out of mainland China. With exports to mainland China accounting for more than 50% of total exports, Hong Kong SAR's exposure to the mainland China-US trade friction and weaker Chinese demand has been, and will remain, most significant among regional economies.

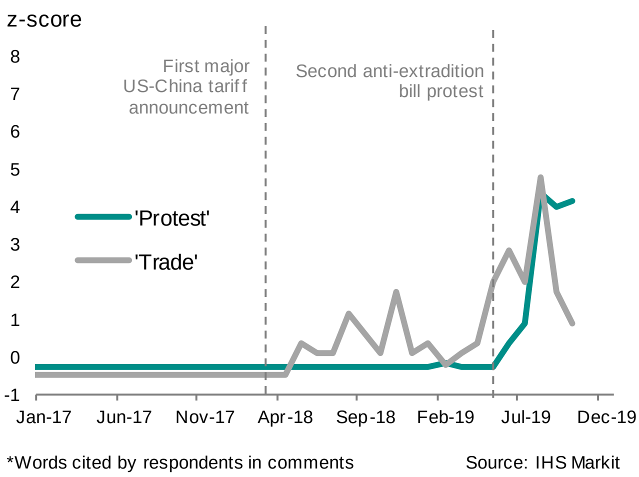
Intensified political turmoil has meanwhile contributed to 30-40% y/y drops in tourist arrivals in recent months and around a 20% fall in retail sales during August-September (Chart 3).

Chart 3: Visitor arrivals and retail sales (annual % change)



While both a deteriorating global trade environment and the political crisis are key factors behind the recent economic weakness in Hong Kong, panel comments from recent PMI surveys indicate that the ongoing protests have been playing an increasingly larger role in dampening business activity in the special administrative region, suggesting that an easing of the local political situation could help to alleviate the economic headwinds to some extent (Chart 4).

Chart 4: PMI comments indicate 'protest' was key factor behind falling business activity in October



Limited scope for political compromise

There is a clear risk that protests could intensify for the rest of the fourth quarter of 2019, with demonstrations having spread citywide, raising the likelihood of large-scale protests and disruptive activities in business centres, transport nodes and, following the 12 November clashes between police and students in the Chinese University of Hong Kong, academic institutions.

Sporadic disruptions to transport infrastructure and commercial activities for hours in protest areas are highly likely. While it is unlikely that protesters will indiscriminately target commercial property, there is a high risk of isolated attacks against government offices, police stations, retail shopfronts or street-level businesses perceived to be pro-government, with a high likelihood of collateral damage to commercial assets.

The Hong Kong SAR government has so far not directly addressed the four remaining demands from protesters: an independent investigation into alleged police violence, an unconditional release of detained protesters, the removal of "riot" categorisation of protesters, and progress in full universal suffrage of chief executive and Legislative Council members.

There appears to be limited scope for compromise between the government and protesters, with no official mediation channels between the two sides. The lack of a central leadership among the protesting groups also complicates the government's efforts in seeking a compromise. While previously stating an intent to create a "sustainable, perhaps long-term" dialogue platform between government and citizens, Chief Executive Carrie Lam has subsequently changed to a hardening stance. At the time of this publication, there are no explicit indications of further concessions being made.

CE Lam met Chinese President Xi Jinping on 5th November in Shanghai, during which President Xi emphasised a "high degree of trust" and "fully affirms the work" of the Hong Kong SAR government, which helps lend credibility to Lam's administration. In a subsequent meeting with Politburo Standing Committee member Han Zheng, who also heads the Hong Kong SAR and Macau Affairs Office, mainland China's support for Lam was further emphasised.

Following the Fourth Plenum meeting which concluded on 31st October, mainland China has emphasised the need for "party leadership" under the "One Country, Two Systems" approach for Hong Kong SAR as a long-term strategy, indicating its desire for Hong Kong SAR's authorities to strengthen national security legislation to counter perceived pro-independence and separatist forces. This includes reforms over the appointment of "chief executive and principal government officials", patriotic education for civil servants and young people, strengthening law enforcement and national security capabilities, and closer economic integration to the Greater Bay Area and broader Chinese markets. The latter policy was further specified following CE Lam's meeting with Han

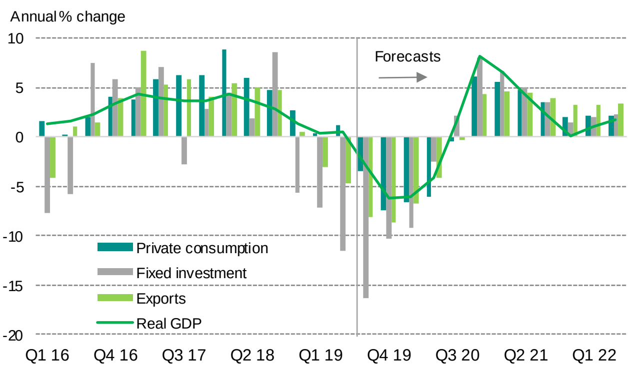
Zheng, which listed 16 economic policies favourable to Hong Kong SAR and Macau residents, including loosening visa restrictions and regulations over buying property, plus better access to banking and investment services.

Deeper economic downturn expected ahead

In the baseline scenario, we expect at least another quarter of a steep contraction for the fourth quarter of this year, following the deepest GDP decline for 10 years in the third quarter (Chart 5). If the violent protests are sustained during November and December, severe disruptions on retail stores, tourism, businesses, and other economic activities, plus heightened distress sentiments of consumers, businesses, investors, and tourists, will continue to batter the economy. These factors, compounded by a substantial drop in exports amid prolonged uncertainties over mainland China-US trade conflicts, are expected to drag on economic growth further.

Amid the deteriorating political and economic situation, real GDP is projected to fall by a steeper 6.2% y/y during the fourth quarter, driven by a 10.3% y/y slump in fixed investment, an 8.6% y/y drop in total exports, and a 7.5% y/y decline in private consumption. With the number of tourist arrivals tumbling by more than 30% y/y alongside weakening consumer and business sentiment, retail sales are projected to slump at a double-digit pace this year, with a fall of more than 20% y/y in the fourth quarter, according to IHS Markit estimates.

Chart 5: Baseline real GDP growth (Y/Y)



Sources: IHS Markit., Hong Kong Census and Statistics Department

As long as the protests persist, the economic outlook will continue to be uncertain as domestic and tourist sentiment remains unnerved. That said, even if an easing in the political situation emerges early next year, economic decline is still expected because confidence – from consumer, tourist, investor, to business – requires time to restore and the political and economic wounds will take time to heal. All this indicates that economic growth for 2020 will remain sluggish, although a low base effect is expected to provide some support in the later part of 2020. Therefore, we do not expect a clear recovery to emerge until the second half of 2020, when domestic confidence is forecast to be restored to pre-crisis levels. Overall, real GDP is expected to plunge 2.1% in 2019, followed by a milder decline of 0.3% in 2020.

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