Economic Research

2 December 2019

Week Ahead Economic Preview

Global overview

- **Worldwide PMI survey releases for manufacturing and services**
- **US employment report including non-farm payrolls**
- **Central bank meetings in India and Australia**

The week kicks off with worldwide manufacturing PMIs on Monday, followed by services and composite PMIs mid-week and rounding off with US non-farm payrolls. The heavy data flow will help steer our understanding of fourth quarter economic growth, jobs and inflation trends, thereby providing guidance on likely future policy at key central banks, including this week's policy decisions from India and Australia.

Updated worldwide PMI data for November will be eagerly awaited after October's numbers showed the global economy losing further momentum. The JPMorgan Global PMI™ (compiled by IHS Markit) fell to its lowest since February 2016, registering one of the weakest expansions since the global financial crisis. Although manufacturing showed further tentative signs of improving, recent months have seen signs of slower service sector growth. Flash November PMIs pointed to a near-stalled Eurozone, with falling output seen in Japan, the UK and Australia. Growth picked up in the US but still hinted strongly at weak fourth quarter GDP.

The lacklustre survey data also point to a slowing hiring trend in the US, so November's non-farm payroll report could disappoint. However, recent job numbers have shown encouraging resilience in the face of economic growth and trade war worries (see page 3 for more US highlights).

In Europe, the PMIs are accompanied by official data on German industrial production and eurozone retail sales, with the former of particular interest as Europe's largest economy skirts with recession (page 4).

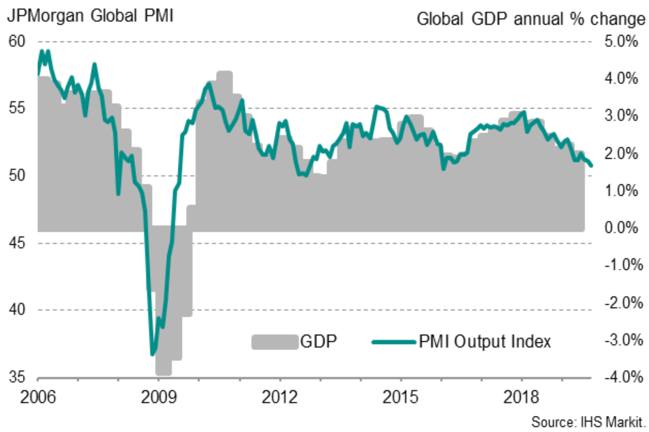
In Asia Pacific, China PMI data will give an important steer on the likelihood of further stimulus from China's authorities. Meanwhile, policy action this week comes from the central banks of Australia and India, both of which will be eagerly awaited to gauge policymaker concerns over slowing growth. While both banks are expected to loosen policy further, only India looks ready to cut this week, with Australia's central bank more likely to wait until early next year (see page 5).

Special reports

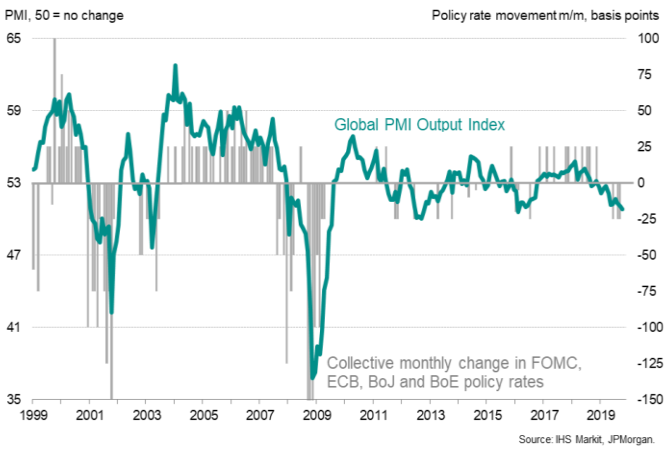
Indonesia: A look at President Jokowi's plans to build a new Indonesian capital city by 2024, and the challenges and opportunities that will arise (**page 6**).

United States: Manufacturing business surveys have sent diverging signals in recent months. We explore some of the reasons being the variances in the surveys and see how they compare with official data (**page 9**)

The global PMI sank to one of the lowest levels seen over the past decade in October as manufacturing-led weakness spread to the service sector



With policymakers at the world's major central banks concerned about the global economy, developments in the global PMI during November could provide key steers on monetary policy in the months ahead



Key diary events (UTC +8)

Monday 2 December
Global release of IHS Markit Manufacturing PMI (Nov)
South Korea, Indonesia and Thailand inflation (Nov)
Australia building permits (Oct)
NATO Summit (2-4 Dec)

Tuesday 3 December
South Korea GDP (Final, Q3)
Australia monetary policy decision
Singapore SIPMM Manufacturing PMI (Nov)
Spain unemployment change (Nov)
UK Construction PMI (Nov)
BoE FPC meeting
Brazil GDP (Q3), trade balance (Nov)

Wednesday 4 December
Worldwide release of IHS Markit Services PMI (Nov)
IHS Markit Singapore and Hong Kong PMI (Nov)
Australia GDP (Q3)
Malaysia trade (Oct)
Brazil industrial production (Oct)
Euro area Eurogroup meeting
ECB non-monetary policy meeting

Thursday 5 December
Australia trade, retail sales (Oct)
Philippines inflation (Nov), jobless rate (Q4)
India monetary policy decision
Taiwan inflation (Nov)
Germany Construction PMI
Euro area GDP, employment change (3rd Est, Q3), retail sales (Oct)
ECB General Council Meeting
Spain consumer confidence (Nov)

Friday 6 December
IHS Markit Sector PMI for Global, US, Europe, Asia (Nov), Global Metal Users PMI (Nov)
Japan household spending, average earnings (Oct), coincident index, leading economic index (Prelim, Oct)
Germany industrial production (Oct)
France trade balance (Oct)
UK Halifax House Price Index (Nov)
Brazil inflation (Nov)

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Chris Williamson
Chief Business Economist
IHS Markit
Email: chris.williamson@ihsmarkit.com

Sat-Sun 7-8 December
08: China trade data (Nov)

United States Week Ahead

IHS Markit and ISM PMIs, non-farm payrolls

By Siân Jones
Economist, IHS Markit, London
Email: sian.jones@ihsmarkit.com

Next week's economic releases include manufacturing and services PMIs, giving a greater indication of economic growth and sector performances midway through the fourth quarter. Also released is the monthly employment report, including non-farm payrolls. Robust employment growth throughout 2019 and low unemployment has so far helped support consumer spending and overall growth, November data will give clues as to whether this has continued.

PMI surveys

November 'flash' PMI data from IHS Markit pointed to a further recovery in manufacturing growth, with upturns in output and new orders gaining strength. Manufacturers also highlighted improved export demand, following lacklustre foreign demand in recent months due to the ongoing impact of tariffs.

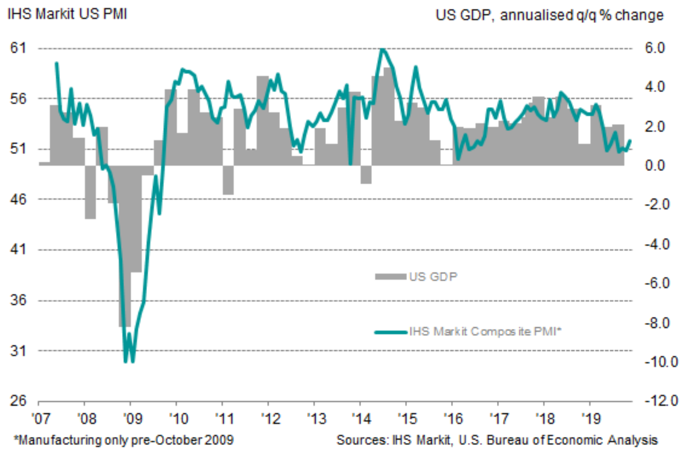
Service providers, however, showed signs of struggling to build growth momentum towards the end of the year, according to the 'flash' PMI data. Although the upwardly revised GDP figure for the third quarter suggested that consumer spending helped drive the expansion, firms appear to have lost some traction in attracting new clients. The overall signal for GDP from the composite IHS Markit PMI data for November merely hints at annualised growth of around 1.5% in the final quarter of 2019.

Non-farm payrolls

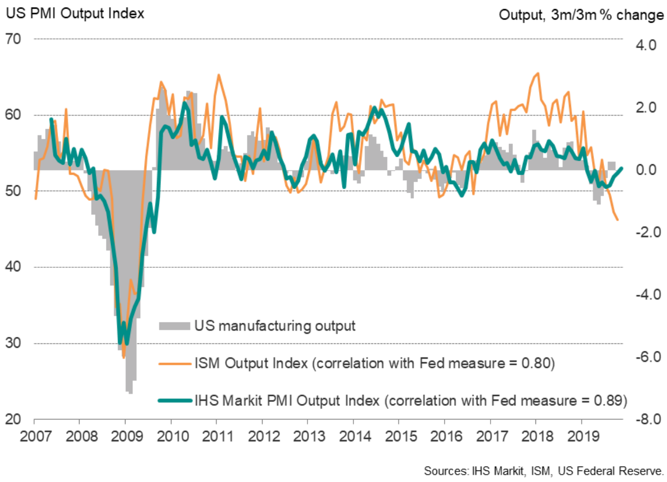
Trends in consumer spending have been widely acknowledged as having supported US economic growth throughout 2019, with tight labour market conditions helping drive expenditure. Updates non-farm payrolls and unemployment numbers will therefore be eagerly awaited for signs that consumer spending continues to be underpinned by the strong US labour market, supporting the FOMC's view that policy remains sufficiently accommodative. While PMI data showed jobs growth ticking higher in November, the surveys continue to hint at a slowing hiring trend compared to earlier in the year.

Also released are updates to the ISM surveys, which have diverged from our PMIs (read more about survey difference here) ADP employment estimates, the balance of trade and factory orders.

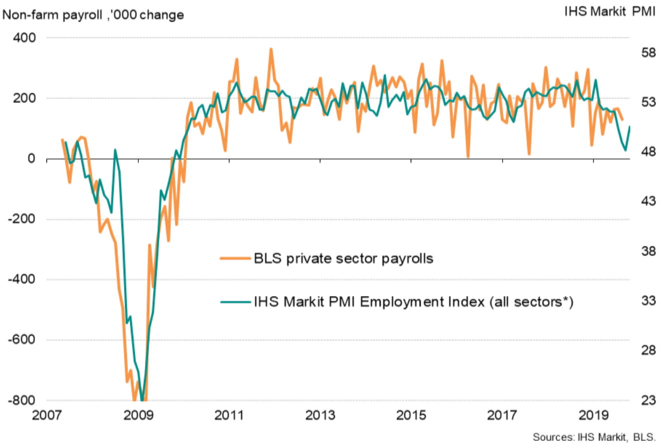
US economic growth looks to have remained subdued in the fourth quarter



US manufacturing surveys have diverged



Non-farm payrolls forecast to increase to a larger extent



More insight into the US economic outlook is available from our colleagues at Macroeconomic Advisers.

Europe Week Ahead

November PMIs, Germany industrial data, eurozone retail sales

By Joe Hayes
Economist, IHS Markit, London
Email: joseph.hayes@ihsmarkit.com

European PMI surveys for November lead the bill in the coming week as data availability for the fourth quarter begins to build. Final eurozone and UK numbers following flash PMI releases will also be accompanied by data on the wider reaches of the continent. October figures on eurozone retail sales will also be released, as well as German industrial production and factory orders numbers.

November PMI surveys

European PMI survey data provides the first insights into economic conditions at the midway point in the fourth quarter, helping to shape up expectations as we head into year-end. Flash data showed the eurozone still in near-stagnation, albeit with signs of improving trends in France and – to a lesser extent – Germany contrasting with the first drop in output in the rest of the region since 2016. The data suggest that lacklustre final data could confine GDP growth in the final quarter to just 0.1% at best, barring any upside surprise in December.

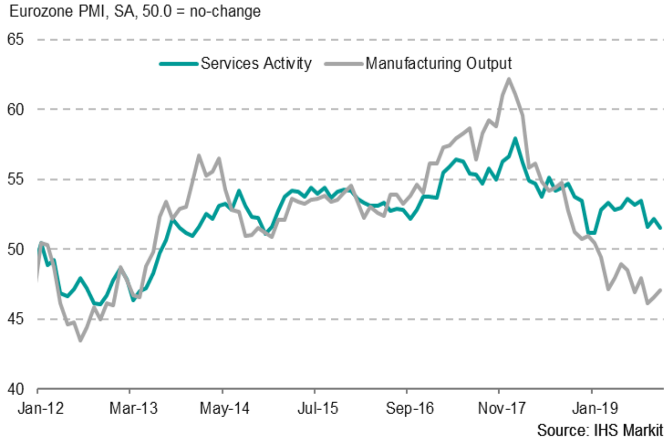
Crucially, the sector split of the PMI data will warrant close attention after the flash reading showed that factory weakness was spilling over to services.

Meanwhile, the UK economy recorded its fastest contraction in output for over three years according to the flash PMI data, prompting a sell-off in sterling. Final UK survey data will therefore provide markets with more information to digest, including construction updates, as political campaigning intensifies ahead of the general election on 12th December.

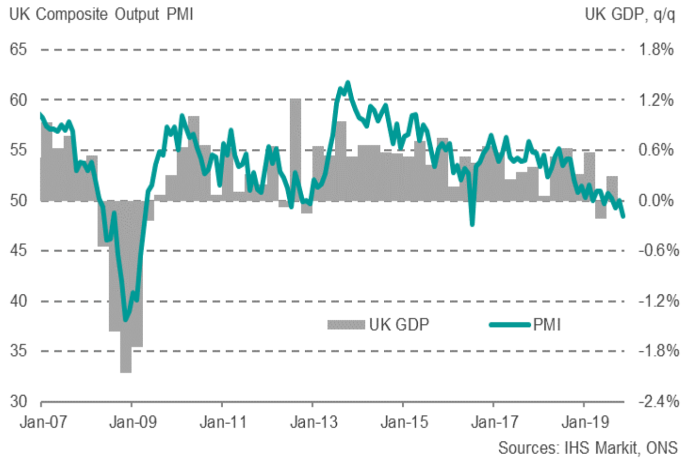
German industrial data

With Germany narrowly avoiding a recession in the third quarter, October industrial production and factory orders data will be high on the agenda to gauge contraction risks in the final quarter of 2019. PMI surveys are still indicating that Germany's manufacturing sector is in a recession, although there are signs that the downturn has become less aggressive. Output declined at a weaker rate for the second month running, according to November flash data.

Is the worst over for eurozone manufacturers?



November flash data signalled deteriorating UK economy



Eurozone industrial downturn has been deeply rooted in Germany

Economic Research

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Asia Pacific Week Ahead

Asia PMI, RBA and RBI meetings, Australia GDP, China trade

By Bernard Aw

Principal Economist, IHS Markit, Singapore

Email: bernard.aw@ihsmarkit.com

Next week brings the release of November PMI data, for which the fourth quarter economic performance of China will be assessed in particular, as well as trade figures. Hong Kong SAR's PMI will also be in focus in a month of escalating political tensions. GDP updates for Australia and South Korea will be closely watched, while the tax hike impact on Japan will be sought from the PMIs as well as household spending data. Central banks in Australia and India will meanwhile set policy.

PMI updates

China watchers will eagerly anticipate the November updates of Caixin and NBS PMI surveys for further insight into the health of the manufacturing sector, especially after the survey data diverged in October. Meanwhile, Hong Kong SAR's PMI will provide the earliest clue as to its fourth quarter GDP performance. Hong Kong SAR's economy contracted during the third quarter amid escalating protests and the ongoing trade war impact.

Australia GDP and monetary policy

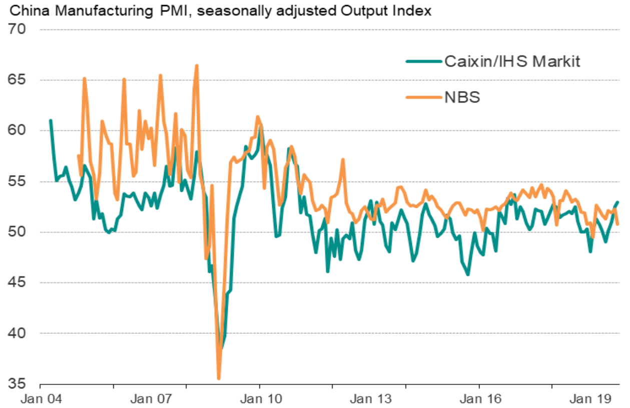
Next week's policy meeting is likely to see the Reserve Bank of Australia keeping its policy rate unchanged. We expect the next rate cut to come in February 2020 should key economic data, such as the PMIs, the unemployment rate and consumer spending, fail to improve in the coming months. Flash Composite PMI data for Australia signalled a renewed fall in business activity during November. The release of third quarter GDP figures will also be closely monitored, with the economy expected to expand at an annual rate of 1.8%, up from 1.4% in the second quarter, according to IHS Markit estimates.

South Korea will also publish its final estimate of the third quarter GDP.

India poises to cut policy rate again

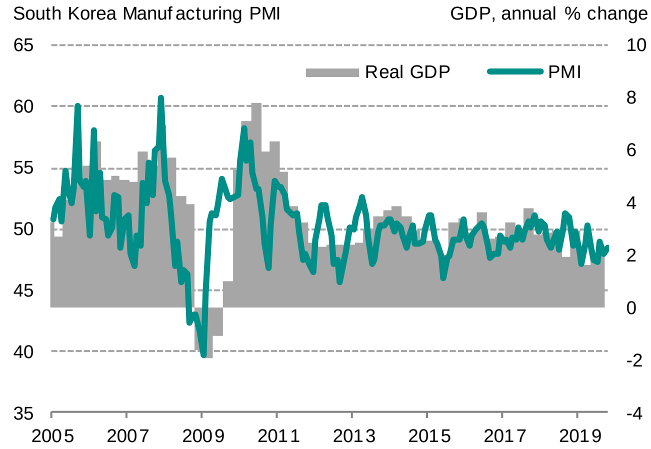
The Reserve Bank of India is widely expected to cut interest rates further at the forthcoming policy meeting despite rising inflation, as bolstering growth emerges as a key priority. According to PMI data, India's private sector activity shrank for a second straight month in October, led by a weakening service sector. Business confidence among Indian firms sank to a survey low.

Manufacturing PMI* surveys for mainland China diverged in October



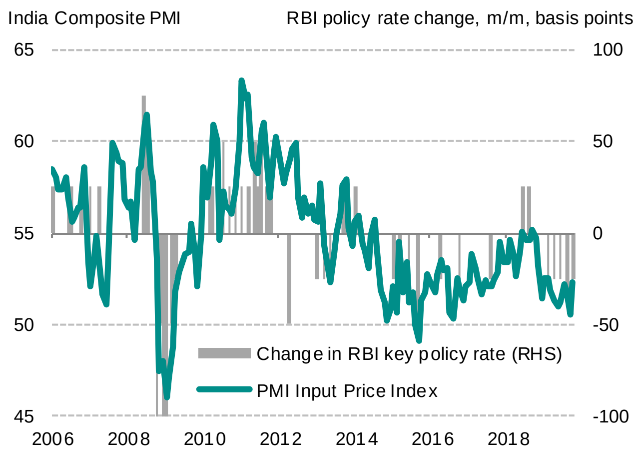
*Data available as of 29 November 2019

South Korea PMI and real GDP



Sources: IHS Markit, Bank of Korea

India PMI consistent with RBI policy in dovish zone



Sources: IHS Markit, Reserve Bank of India

Asia Pacific Special Focus

President Jokowi plans for a new Indonesian capital city by 2024

By Rajiv Biswas

Asia-Pacific Chief Economist, IHS Markit

Email: Rajiv.Biswas@ihsmarkit.com

Following President Jokowi's re-election to a second term of office in April 2019, he has announced the decision that Indonesia's new capital city would be built in East Kalimantan province on the island of Borneo.

The location of the new city will be on a greenfield site located in between the cities of Balikpapan and Samarinda. Momentum for planning of this new capital city has intensified in recent weeks after President Jokowi was inaugurated for his second term of office on 20th October 2019 and announced a major ministerial reshuffle.

A design competition for the new capital city has been launched by the Indonesian Public Works and Housing Ministry, with initial ground-breaking for construction estimated to begin later in 2020. The aim of the Indonesian government is that central government civil servants should start transferring to the new city by 2024, before the end of President Jokowi's second and final term of office. However, the plan for a new capital city will need to be approved by the Indonesian Parliament, after which the process of land acquisition would start in 2020.

The case for a new capital city

Although the concept of building a new capital city for Indonesia has been discussed ever since President Sukarno took office as Indonesia's first president following independence from Dutch colonial rule, it has assumed renewed urgency during President Jokowi's term of office.

One of the most important reasons why the Indonesian government has decided that a new capital city is needed is that the nation's current capital city, Jakarta, is vulnerable to flooding and is also slowly subsiding in some areas due to the impact of ongoing extraction of groundwater resources. The long-term impact of climate change is also expected to result in rising sea levels which will also increase the vulnerability of Jakarta to coastal flooding, particularly in northern Jakarta where significant areas are already below sea level.

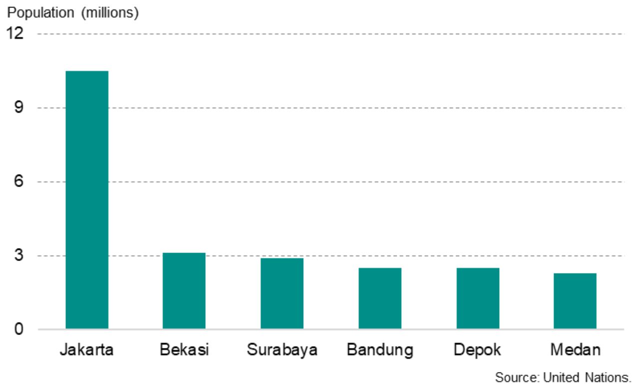
The East Kalimantan location for the new capital city is considered by the Indonesian government to relatively less vulnerable to natural disasters such as tsunamis and flooding. Given many locations in Indonesia have suffered devastating natural disasters due to volcanic eruptions, tsunamis and earthquakes.

Another major factor that has contributed to the decision to build a new capital city is that Jakarta has become one of Asia's largest megacities, with the economic and social costs of congestion and increasingly dense urbanisation continuing to rise despite heavy government investment in transport and other urban infrastructure.

With around 1.4 million central government employees currently working in the greater Jakarta urban area, the gradual relocation of a significant proportion of these employees and their families to a new capital city would significantly alleviate the severity of population pressures and urban congestion in Jakarta.

Furthermore, the creation of a major new city in East Kalimantan province would help to address regional income inequality, which is a significant structural challenge facing the Indonesian economy. The current urban population distribution of Indonesia is heavily skewed towards Jakarta, whose population is projected to rise even further over the next two decades, dwarfing the population of other major Indonesian cities.

Indonesia's largest cities, 2018

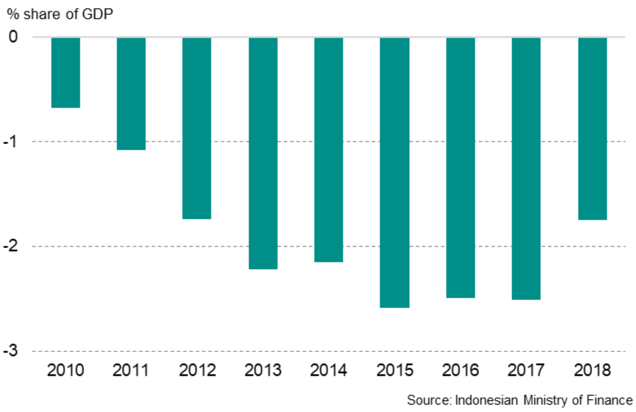


Infrastructure development for the new capital city

The estimated initial costs of infrastructure development for the new city are in the order of around USD 33 billion to USD 50 billion over the next decade. The Indonesian government has estimated that the government itself would finance around one-third of these infrastructure costs, while the remainder would be financed by the private sector. Around one-fifth of the total costs would be financed from the national budget, with the government also using public-private partnerships for infrastructure projects. Direct investment by the private sector and state-owned enterprises would also play a key role in financing the development of the new capital city.

With Indonesia's current GDP level having reached USD 1.1 trillion, the impact on the government's fiscal position would be relatively limited if these current infrastructure financing estimates are achievable. Indonesia's government debt to GDP ratio is very low by international standards and much below the OECD average, at an estimated 29.8% of GDP in 2018, according to the Indonesian Ministry of Finance. The annual budget deficit has also been moderate in recent years, and was estimated to be at 1.75% in 2018.

Indonesian fiscal deficit

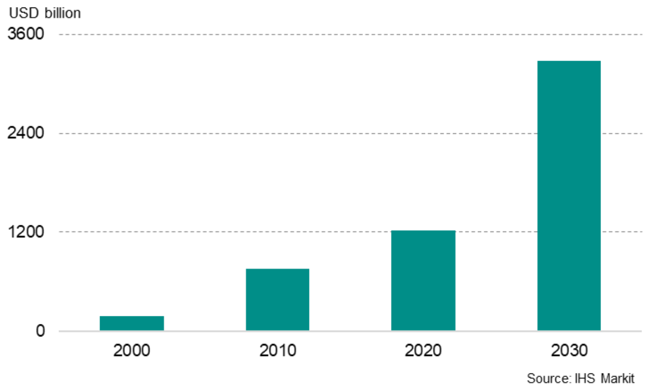


With Indonesia's total GDP estimated by IHS Markit to have reached USD 1.1 trillion in 2019, the average annual fiscal spending for the infrastructure development of the new city would be a relatively moderate share of total annual GDP if the government share of infrastructure spending is able to be constrained to one-third of the infrastructure development costs.

Furthermore, the average annual total annual infrastructure spending involved, including both government and private sector spending, would provide a significant positive boost to annual GDP growth, contributing to the government's goal of boosting national economic growth from the current annual pace of around 5% of GDP per year.

Private sector financing is expected to come from a wide range of sources, including public-private partnerships for infrastructure development projects such as the new airport and power stations, as well as private financing for residential and commercial real estate development. Indonesian Finance Minister Sri Mulyani Indrawati has signalled that the Indonesian government would consider financing from multilateral development banks as part of the funding sources for the new capital city project, with Asian Infrastructure Investment Bank (AIIB) President Jin Liqun having stated that the AIIB would consider contributing to the overall financing of the infrastructure development of the new capital city.

Indonesian GDP



President Jokowi's vision for the new Indonesian capital city is to create Indonesia's first smart city, with state-of-art infrastructure for utilities, communications and energy. The Indonesian government intends to use global technology partners that provide leading edge technology for building the new capital city. Since the new capital city will be developed on a greenfield site, a new airport and power generation infrastructure will also be required.

The new capital city is likely to attract a number of significant industry clusters to support the large number of government departments and well as large resident population, including healthcare, education and transportation services. An important advantage of the new location is that land costs will be significantly lower than Jakarta, which should allow the development of affordable housing for the new capital city's residents.

Outlook for Indonesia's new capital city

Across the Asia-Pacific region, many national governments have been developing new smart cities in order to create modern urban infrastructure for fast-growing urban populations. China has been at the forefront of this wave of Asian smart cities, with a number of new smart cities having been built. South Korea has also been one of the leading nations in Asia developing new smart cities, notably the showcase Songdo smart city in Incheon. In India, the Modi government has also been giving a high priority to developing smart city projects to address the rapidly growing size of India's urban population.

The concept of creating a new capital city has also been implemented by a number of nations worldwide, including Washington DC in the US, Canberra in Australia, Brasilia in Brazil, and Putrajaya in Malaysia. The Indonesian government will draw on the experiences of other governments in developing their new capital city.

Indonesia's vision to create a new greenfield capital city is an important positive step to improve its urban infrastructure, as well as helping to address the severe environmental and congestion challenges facing Jakarta. The new capital city will also create a new hub for the economic development of Kalimantan, helping to broaden and diversify economic development to other regions beyond Java. The new capital city will therefore help to address the challenges Indonesia is facing from climate change as well as income inequality, which are two of the most important policy priorities for governments worldwide.

United States Special Focus

Explaining US manufacturing survey divergences

By Chris Williamson

Chief Business Economist, IHS Markit

Email: chris.williamson@ihsmarkit.com

Business surveys sent conflicting signals on the health of the US manufacturing sector in recent months. A recovering picture from IHS Markit's PMI contrasts with a steepening downturn signalled by the ISM. But dig deeper and the survey divergences can be explained. Our analysis highlights how the IHS Markit PMI has outperformed the ISM survey in providing more accurate indications of actual manufacturing trends in recent years, most likely due to differences in panel structure and questionnaire design.

Diverging survey signals

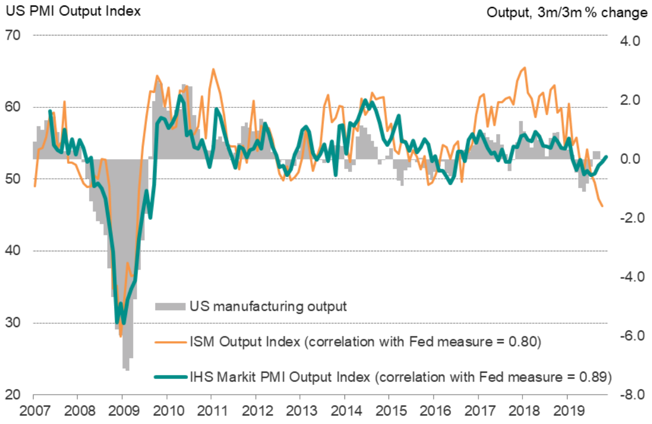
The IHS Markit Manufacturing PMI™ hit a seven-month high in November, according to the flash reading. Having now risen for four successive months, the IHS Markit PMI hints strongly that the US manufacturing sector has pulled off the lows seen in the summer. In contrast, the ISM survey's manufacturing PMI remained close to decade-lows in October, having sunk to its lowest since 2009 in September, with output continuing to fall at an accelerating rate in October.

Both surveys use diffusion indices whereby 50 denotes no change on the previous month. Both headline PMIs are also composite indicators derived from five individual survey questions relating to output, new orders, employment, inventories and suppliers' delivery times. Note however that ISM uses a straight average of its five components whereas IHS Markit uses a system such that forward-looking components carry a higher weight. These differing weights can therefore lead to divergences between the two PMIs.

However, dig deeper into the survey sub-indices rather than analysing the headline PMI numbers, and the divergences remain striking.

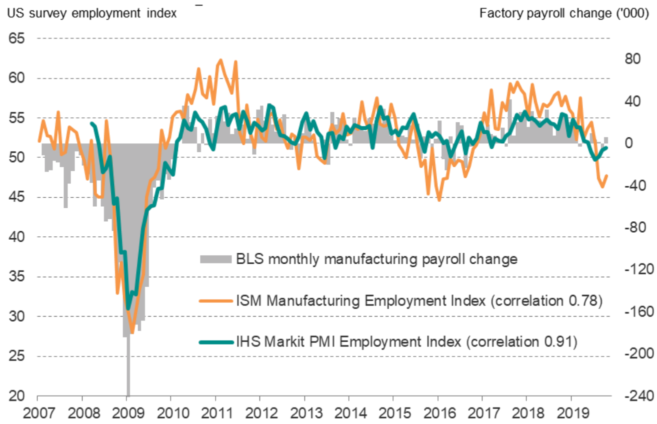
In theory, the sub-indices such as output, new orders and employment should be directly comparable between the two surveys, as they measure the change in each variable from one month to the next over a consistent definition of manufacturing. However, as charts 1, 2 and 3 demonstrate, some large variations have been seen over the survey history.

Chart 1: US manufacturing output



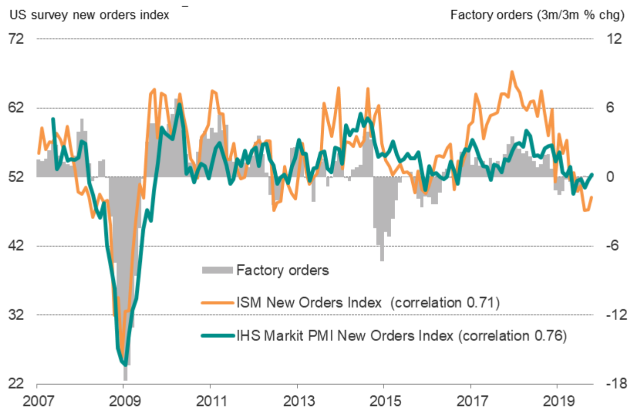
Sources: IHS Markit, ISM, US Federal Reserve.

Chart 2: US manufacturing payrolls



October data adjusted for 42,000 loss arising from GM strike.
Source: BEA, HIS Markit, ISM

Chart 3: US factory orders



Source: BEA, HIS Markit, ISM

All three charts show that the ISM indices ran considerably higher than the IHS Markit indices through 2017 and 2018, and have also tended to show greater volatility over the past 12 years for which data are available for both surveys.

Using some simple statistical analysis, it is evident that the IHS Markit indices have a stronger relationship with official output, factory orders and employment data than the equivalent ISM indices. The IHS Markit data show consistently higher correlation coefficients and adjusted r-squares than the ISM data when compared with a rolling three-month rate of change in comparable official data, which is the most widely used metric for comparing survey data with government statistics (see table 1).

Table 1: Statistical analysis of surveys with official data

	IHS Markit PMI	ISM
Manufacturing output (3m/3m % change)		
Correlation	0.89	0.81
Adjusted r-square	0.79	0.64
Manufacturing employment (monthly change)		
Correlation	0.91	0.78
Adjusted r-square	0.84	0.70
Factory orders (3m/3m % change)		
Correlation	0.76	0.72
Adjusted r-square	0.57	0.51
Durable goods orders (3m/3m % change)		
Correlation	0.76	0.65
Adjusted r-square	0.58	0.42

Note: Comparisons use monthly data from June 2007 to October 2018.

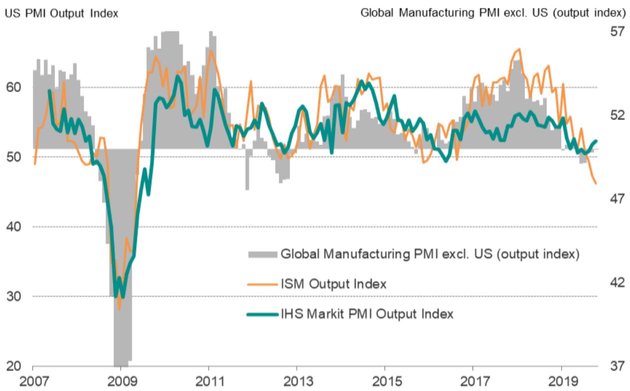
Potential causes of survey divergence

Some clues as to why the ISM and IHS Markit surveys have diverged can be found through a closer inspection of the survey methodologies:

- Survey panel sizes are different: IHS Markit's survey panel is larger than the ISM's stated panel size. IHS Markit surveys around 800 manufacturing companies (approximately double the size of the ISM panel size) from which an 80% response rate is typically received. However, unlike IHS Markit, ISM does not disclose actual numbers of questionnaires received. As a general rule, a large panel size produces more stable and accurate survey results, meaning the data tend to be less volatile and 'noisy'.
- The surveys also use different panel structures: ISM data are based only on ISM members, and as such are likely to only reflect business conditions in larger companies, with small- and medium-sized firms under-represented. In contrast, IHS Markit's survey includes an appropriate mix of companies of all sizes (based on official data showing the true composition of manufacturing output each year).
- Survey responses may relate to different markets: ISM also does not ask respondents to confine their reporting to US facilities/factories whereas IHS Markit specifies that all responses must relate only to business conditions at US factories. ISM data could therefore be more heavily influenced by conditions of US-owned factories in China, for example, than the IHS Markit data.

Put all of the above factors together and it becomes clearer as to why the ISM data may have exaggerated US manufacturing in 2017 and 2018, and why it is now possibly overstating the weakness. As chart 4 shows, global manufacturing growth outside of the US (as tracked by IHS Markit's other PMI surveys) accelerated sharply in 2017, and has since matched the pattern of growth shown by the ISM. More recently, note that global-ex-US growth has slowed sharply to show some of the weakest rates seen over the past ten years.

Chart 4: US surveys and correlation with global ex-US manufacturing growth



Sources: IHS Markit, ISM.

Global vs US

As the ISM data are seemingly more reflective of the performance of multinationals than the IHS Markit survey, we argue that it could be sending misleading signals regarding the health of the US economy. A more reliable picture of US manufacturing trends is offered by the IHS Markit survey. Moreover, given the greater volatility of the ISM data relative both the IHS Markit and official data, it is possible that the current steep decline signalled by the ISM represents another case of the survey exaggerating the rate of change.

Meanwhile, for those concerned that the ISM may be signalling a global manufacturing downturn, a better insight into global trends is provided by our global PMI, which is based on responses to monthly questionnaires sent to purchasing managers in survey panels in over 40 countries, totalling around 13,500 companies. Coverage includes all major developed and emerging markets which collectively account for 98% of global manufacturing value added.