Economic Research

9 December 2019

Week Ahead Economic Preview

Global overview

- **FOMC meeting including updated projections and interest rate 'dot plot'**
- **First ECB meeting with Lagarde at the helm**
- **UK election, EU leaders' summit**

After a week in which the business surveys provided key updates on the health of the global economy mid-way through the fourth quarter, the economic data take a back seat to policy and politics.

With the pace of global growth picking up to a four-month high in November according to PMI survey data, there are signs that the recent easing of monetary policy from many of the world's central banks has helped stem the slowdown, though the overall rate of expansion remains among the lowest since 2016. The coming week sees policy decisions from the FOMC and ECB, both of which have loosened policy this year to safeguard against the recent global headwinds and boost growth. Although both are expected to keep rates on hold, the economic projections and rhetoric will be scrutinised for clues as to future policy direction.

We see further stimulus from the ECB on the cards for early 2020, with Christine Lagarde having now taken over the helm, but the FOMC looks set to continue to sit on its hands for an extended period barring any material changes to the outlook (see page 3 for more US highlights).

Trade wars remain a key concern for the global outlook, and escalating tensions could set back the nascent improvement in the global growth trend. Developments in US trade with China, with new tariffs on Chinese goods set to kick-in on 15th December, will therefore be closely watched.

Brexit is also high on the list of global worries, and the upcoming UK general election on 12th December will be a key development in determining the outlook for the UK's departure from the EU. Polls are hinting at a Conservative party majority, which would lead to Brexit stepping up a gear. The EU Leaders' Summit will also be monitored for Brexit-related developments in particular (see page 4).

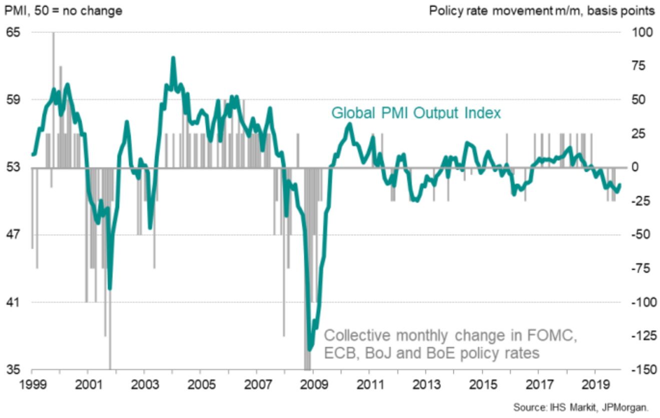
In Asia Pacific, a raft of data for China, Japan and Taiwan will be eyed for signs of economic trends. Policy action will come from the Philippines, while a speech from RBA governor Philip Lowe will be parsed for clues about future policy direction (see page 5).

Special reports

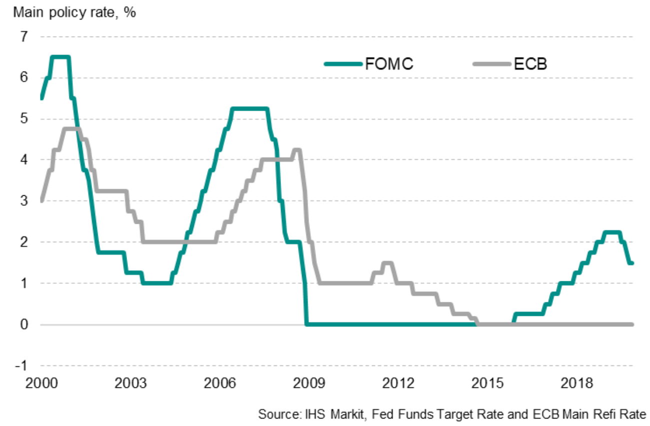
India: With GDP growth having slipped to a six-year low in the third quarter, we analyse the severity of India's economic slowdown, the policy response and the outlook (**page 6**).

United Kingdom: Ahead of the UK General Election on 12th December, we take a look at the likely impact of the Labour party's proposed fiscal plans (**page 8**)

Recent stimulus from some of the World's leading central banks appears to have helped halt the global slowdown, with the global PMI rising to a four-month high in November



Policymakers at the US FOMC and ECB meet to set monetary policy. Both are expected to keep rates on hold but will update on the outlook



Key diary events (UTC +8)

Monday 9 December
Japan GDP (Final, Q3)
Germany trade (Oct)
Taiwan trade (Nov)

Tuesday 10 December
RBA Governor Lowe speech
Australia business confidence (Nov), house price (Q3)
Philippines trade (Oct)
China inflation (Nov)
France and Italy industrial output (Oct)
UK GDP, trade balance, industrial output (Oct)
BoE financial stability report
Germany ZEW surveys (Dec)
Euro area ZEW economic sentiment index (Dec)
US nonfarm productivity, unit labour costs (Final, Q3)
Term of two members of WTO Appellate Body expires

Wednesday 11 December
South Korea unemployment rate (Nov)
Brazil retail sales (Oct)
US inflation (Nov)
FOMC and economic projections

Thursday 12 December
Japan machinery orders (Oct)
RBA Bulletin
Malaysia industrial output (Oct)
Singapore retail sales (Oct), jobless rate (Final, Q3)
Brazil and Philippines interest rate decision
India inflation (Nov), industrial output (Oct)
Germany and France inflation (Final, Oct)
Euro area industrial output (Oct)
ECB monetary policy meeting
UK general election

Friday 13 December
Australia consumer confidence (Dec)
Japan Tankan manufacturing index (Q4), industrial production (Final, Oct)
India WPI (Nov)
China FDI (YTD, Nov), total social financing, M2 (Nov)
US retail sales (Nov), business inventories (Oct)
EU leaders Summit

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Sat-Sun 14-15 December
14: US Baker Hughes oil rig count (13/Dec)
14: Malaysia unemployment rate (Oct)
15: US tariffs of 15% on $160 billion worth of Chinese imports take effect

Economic Research

9 December 2019

United States Week Ahead

FOMC meeting, inflation and retail sales

By Siân Jones

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The latest release calendar contains data that will help give a glimpse into the decisions of policymakers and into consumer well-being. Interest rates are expected to remain unchanged at the final FOMC meeting of 2019, amid solid labour market conditions and further increases in consumer spending. Retail sales data will give an insight into consumer resilience towards the end of the year.

FOMC meeting

The final Fed meeting of 2019 is not expected to yield any changes to the key rate, but analysts will be eager to see how the data-dependent FOMC policymakers have been assessing the recent US and global economic data flow.

Alongside the policy decision, the FOMC will publish their economic projections for GDP, unemployment and PCE inflation. These updates give key indications as to how policymakers see the economy progressing in the near- and longer-run. The projections will crucially also include the 'dot-plot' of the expected rate path.

Inflation

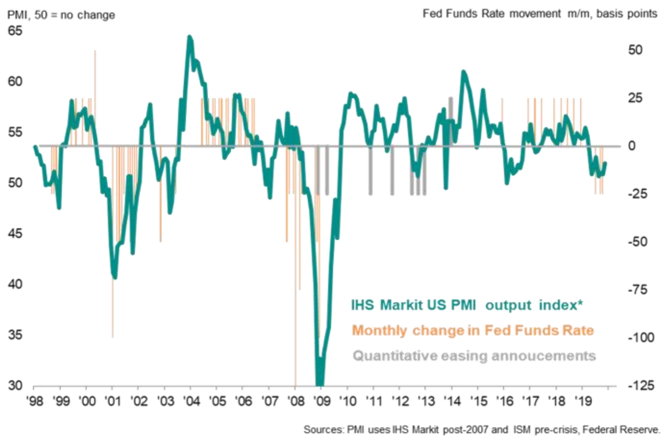
The rate of consumer price inflation is expected to pick up slightly in November, with core CPI (less food and energy) forecast to post above the target 2% once again. That said, the pace of increase remains historically muted, with private sector firms registering only marginal rises in cost burdens and selling prices midway through the fourth quarter, according to our latest PMI data.

Retail sales

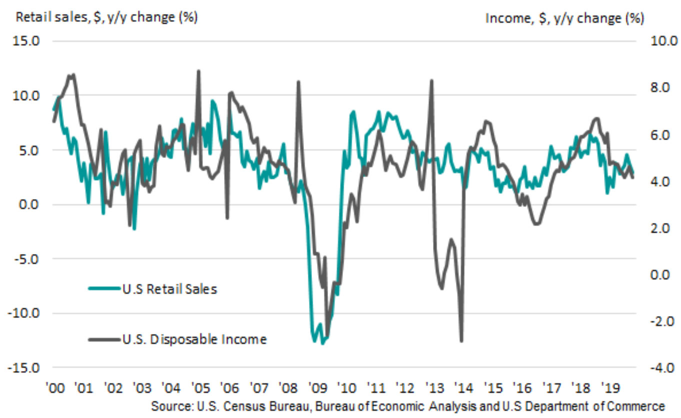
Retail spending is expected to pick-up further in November, following an uptick in retail sales in October which was partially driven by greater motor vehicle purchases. A further increase in disposable incomes and solid labour market conditions are widely expected to have helped boost sales.

Also released are updates to business inventories, productivity and unit labour costs.

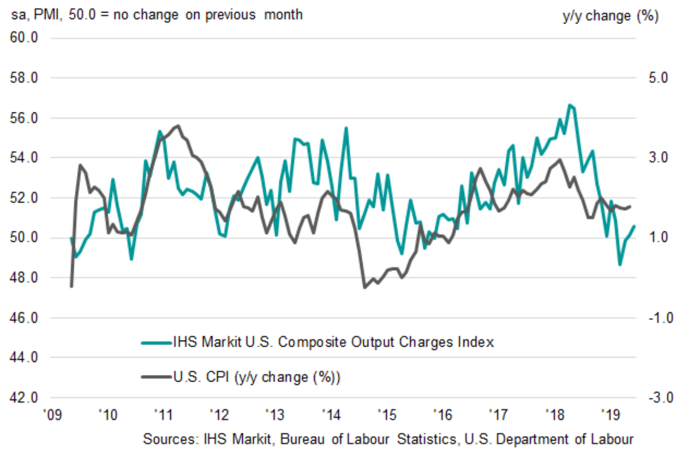
The FOMC is expected to hold rates steady in December



Stable rate of inflation forecast to continue



Further solid rise in consumer spending anticipated



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

Europe Week Ahead

UK general election, EU summit, Lagarde's first ECB meeting

By Joe Hayes

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Numerous high-profile events take place across Europe in the coming week, the most notable being the UK general election. EU leaders will also be meeting on 12th December, with a summit being held in Brussels. Meanwhile Christine Lagarde will chair her first monetary policy meeting at the European Central Bank, and important macroeconomic data come in the form of UK GDP and eurozone industrial production.

UK General Election & October GDP

Although October GDP data is set for release, the general election result is what will gather the most attention in the coming week in the UK. According to polls, both the Conservative and Labour parties have been gaining momentum, although the former looks set to clinch victory. Markets have started pricing in a Tory majority, with sterling making solid gains in recent days. That said, the EU summit, which is due to be held on the same day as the general election, could inject renewed uncertainty over Brexit and whether a trade deal can be negotiated next year.

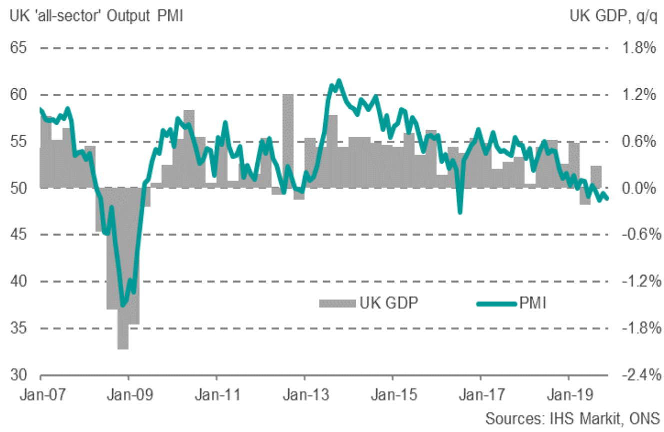
Politics aside, October GDP figures for the UK will provide the first insight into fourth quarter economic activity from a 'hard' data perspective. PMI numbers underwhelmed in October and November, with latest data showing "all-sector" output falling to the third-lowest since April 2009. Our nowcast model currently anticipates stagnation for the final quarter, but contraction risks have certainly been renewed.

European Central Bank

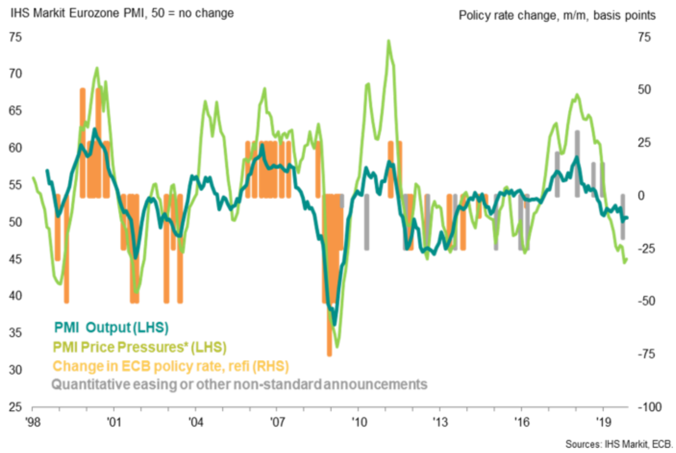
Christine Lagarde will chair her first monetary policy meeting as President of the ECB's Governing Council. However, there appears to be little appetite to take additional policy action so soon. This is partly due to the lagged effects of recently announced measures, and also as a result of the high-profile divisions within the Governing Council. Lagarde's first policy meeting press conference will nevertheless be eagerly scrutinised for any hints on the future direction of policy.

Eurozone industrial output data are also due, with the October print providing a crucial steer on fourth quarter GDP. PMIs suggest manufacturing remains deep in contraction, but the drag has diminished.

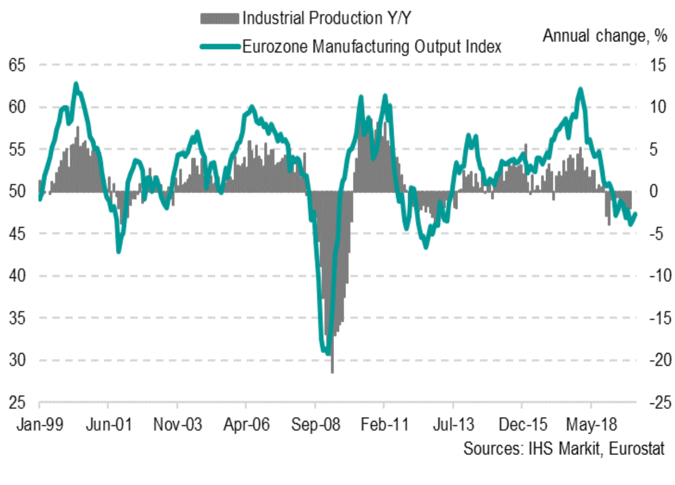
Economic contraction risks have risen in the UK



ECB meeting to pave the way for more monetary loosening in 2020?



PMI data suggest eurozone industrial slowdown could be bottoming out



Economic Research

9 December 2019

Asia Pacific Week Ahead

Japan GDP, Taiwan trade, China price and credit data, Philippines policy

By Bernard Aw

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The economic data releases in focus next week include Chinese inflation and credit data, plus Japan's GDP update and machinery orders. Taiwan's trade figures will also be closely watched for signs of Asian trade performance, while South Korea's unemployment data may garner some interest. Policy action will come from the Philippines, while a speech from RBA governor Philip Lowe would be parsed for clues about future policy direction. Asian investors will also scrutinise the policy meetings of the Fed and the ECB to assess the direction of monetary policy in 2020.

China inflation and credit

In the run-up to China's annual Central Economic Work Conference (CEWC), expected to take place before the end of the year, analysts will inspect forthcoming data for the likelihood of announcements of further stimulus measures at the meeting. The conference will set out China's economic policy for the next year. Core inflation is meanwhile likely to remain stable despite expectations of higher headline CPI due to rising pork prices. Data on new yuan loans, total social financing and foreign direct investment will also be important steers on the health of the Chinese economy. Both Caixin and the NBS PMI data pointed to output growth in November.

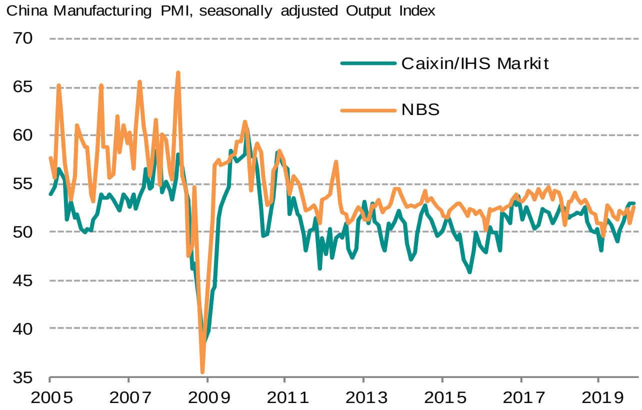
Japan GDP upgrade

The final estimate of Japan's third quarter GDP is expected to see a slight upward revision, according to IHS Markit estimates. However, latest PMI surveys point to a risk of economic decline in the fourth quarter as demand remained subdued following the sales tax hike and typhoon disruptions. Meanwhile, data on machinery orders and the quarterly Tankan surveys will be under scrutiny regarding the health of the Japanese economy.

Philippines and Australia central banks

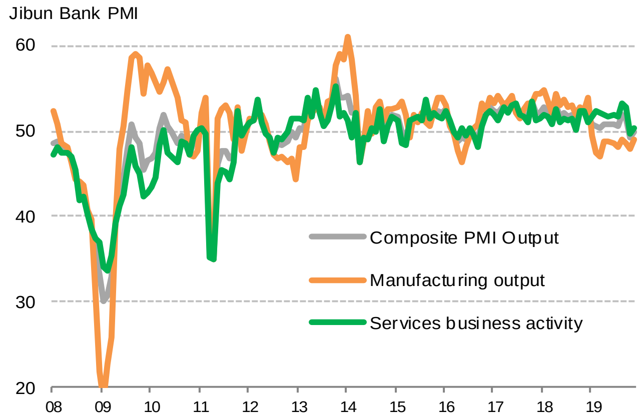
The Philippines central bank meets during the week to decide on monetary policy. Interest rates are expected to remain unchanged amid a faster rate of inflation in November. Meanwhile, the RBA governor's upcoming speech may contain information about the direction of Australia's monetary policy in 2020. Latest PMI data indicated a renewed decline in private sector activity.

Manufacturing PMI surveys for mainland China converged in November



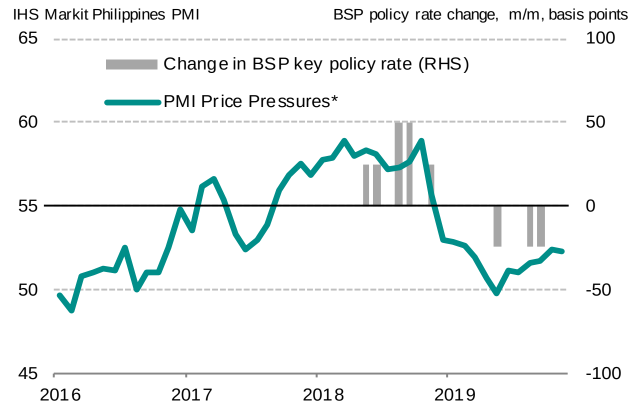
Sources: IHS Markit, Caixin, NBS

Recovery in Japan's services business activity is underwhelming



Sources: IHS Markit, Jibun Bank

Philippines PMI and monetary policy



Sources: IHS Markit, Bangko Sentral ng Pilipinas

*PMI Price Pressures is a blended index of input prices and suppliers' delivery times.

Asia Pacific Special Focus

How severe is India's economic slowdown?

By Rajiv Biswas

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Latest Indian GDP data for the July-September quarter showed a significant further moderation in the pace of economic growth, to a pace of 4.5% year-on-year (y/y). This was the weakest pace of growth recorded in six years, with a key contributory factor being a slump in manufacturing output.

Financial sector fragilities continue to weigh on India's economic growth momentum, with 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 (NBFCs) to the balance sheets of some commercial banks, which could further weigh on the overall pace of credit expansion.

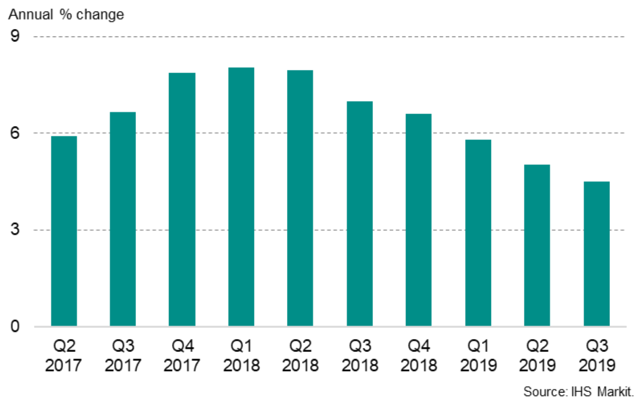
In response to the growth slowdown, the Reserve Bank of India (RBI) has eased policy rates significantly during 2019, with a series of rate cuts since February, while the Indian government announced a large reduction in corporate tax rates in September, in order to help boost new investment spending.

Indian economy continues to face headwinds

The pace of growth in the Indian economy continued to slow in the July–September (September) quarter of 2019, as GDP growth moderated to 4.5% y/y, compared with the 5.0% y/y growth rate registered in the previous quarter.

The slowdown in economic growth was particularly affected by a slump in manufacturing output, which contracted by 1.0% y/y. The pace of GDP growth was much weaker than the 7.0% y/y growth rate recorded a year ago, in the September quarter of 2018. For the first half of the 2019-2020 fiscal year, GDP growth slowed to a pace of 4.8% y/y, compared with the 7.5% y/y GDP growth rate recorded in the first half of the 2018-19 fiscal year.

Indian GDP growth rate



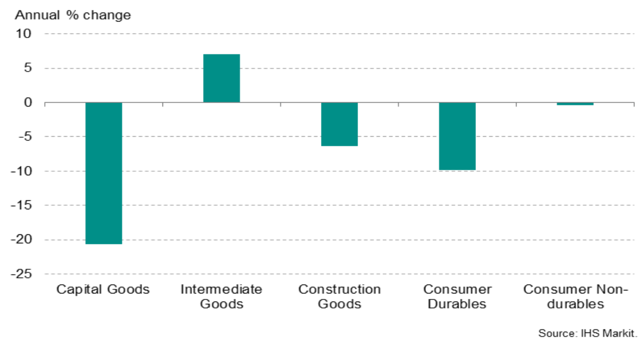
The significant weakening in India's economic growth momentum reflects the sharp slowdown in the manufacturing sector, which contracted by 1.0% y/y. During the first half of the 2019-2020 fiscal year, manufacturing output contracted by 0.2% y/y. Industrial production data for the month of September 2019 showed that 17 out of the 23 industry groups in the manufacturing sector recorded declines in output compared with a year ago.

The weakest sector has been auto manufacturing, with output in this sector down by 24.8% y/y in September. The Indian auto sector has slumped into a crisis, with hundreds of thousands of auto sector workers in the production and distribution segments having been laid off over the past 12 months.

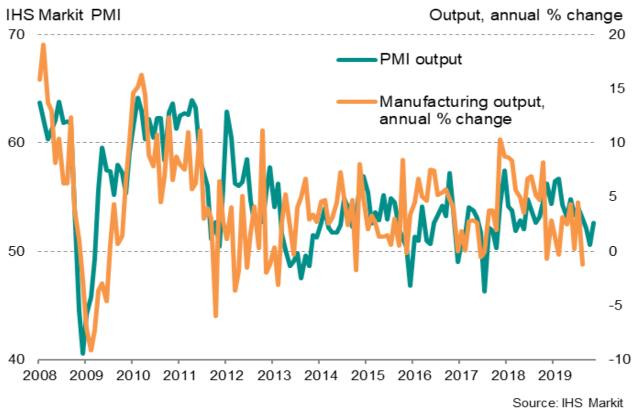
A key concern is also the sharp contraction in capital goods output, which was down 20.7% y/y in September 2019. This indicates that India's investment cycle is experiencing a severe cyclical slowdown, as reflected in the further slowing of fixed investment growth during the September quarter. The construction sector growth also slowed to a pace of 3.3% y/y in the September quarter, compared with growth of 5.7% y/y in the June quarter.

The latest headline seasonally adjusted IHS Markit India Manufacturing PMI® rose to 51.2 in November from 50.6 in October, when it had fallen to a two-year low. The latest reading was below the survey average (53.8) and indicated only a slight improvement in the health of Indian manufacturing sector. Consumer goods provided the main impetus to overall growth in November, while the intermediate goods category returned to expansion territory. Conversely, there was continued weakness in operating conditions at capital goods manufacturers.

Indian industrial production, September 2019



IHS Markit India PMI, manufacturing



Measuring GDP from the expenditure side, an important factor supporting GDP growth was public consumption, which rose by 15.6% y/y in the September quarter. Private consumption growth also picked up modestly versus the previous quarter, although it continues to expand at a much slower pace than in the past two financial years.

Macroeconomic policy responses

Faced with a softening economic growth outlook, the Indian central bank, the Reserve Bank of India (RBI), has eased monetary policy a number of times since February 2019, over concerns that growth momentum is slowing down and also in an effort to boost liquidity in the financial system.

The Indian government has also announced new fiscal policy measures to try to boost private sector investment. Finance Minister Nirmala Sitharaman announced on 20 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 are applicable 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%.

In November 2019, the Cabinet also approved the creation of a new fund that will provide debt finance for the completion of an estimated 1,600 stalled residential real estate projects for affordable and middle-income housing. The credit squeeze impacting on non-bank financial companies since the collapse of Infrastructure Leasing & Financial Services, one of India's largest NBFCs, in September 2018, has increased financing pressures for real estate developers.

Confronted with the sharp slowdown in economic growth momentum, the Indian government will face increasing pressure to roll out additional fiscal measures to bolster manufacturing output and kick-start an upturn in the investment cycle. Such measures could include accelerated government spending on infrastructure projects such as roads, railways, and ports, as well as urban infrastructure such as affordable housing and hospitals.

Indian economic outlook

Following the weak GDP outturn for the September quarter, Indian real GDP growth in FY 2019-20 is expected to be slightly below 5%, as it is anticipated that the impact of stimulus measures will take time to filter through to the real economy. The RBI also lowered its GDP growth forecast for 2019-20 from 6.1% to 5.0% on 5th December 2019, due to the weak September quarter GDP result.

Despite the policy measures implemented by the Indian government and the RBI so far this year, 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 crisis in NBFCs could also further impair the balance sheets of some public sector banks.

Although the RBI has also provided monetary policy stimulus through its monetary policy easing measures, the impact is likely to be more protracted, since monetary policy stimulus effects on the real economy generally act with long lags. Furthermore, the impaired balance sheets of many public sector banks and NBFCs also will dilute the flow-through of monetary policy easing to the economy.

Given that the process of strengthening bank balance sheets has been slow, taking a number of years already, India's financial sector problems are likely to remain a drag on the pace of economic growth over the medium-term outlook. Furthermore, any turnaround in the investment cycle could also be relatively protracted, depending on the ability of the government to accelerate its own infrastructure spending program.

Europe
Special Focus

Analysis of UK Labour party's fiscal plans

By Raj Badiani

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A Labour Party victory in the UK general election on December 12th is unlikely according to opinion polls. In the event of a shock outcome, financial market volatility would follow, with the party's manifesto representing a radical change for the corporate sector in particular. .

Recent opinion polls suggest the Conservatives will win a working majority in a general election to be held on 12 December 2019. The Conservatives are showing at around 40% share of the vote, while the reputable MMR poll for the Times newspaper estimate that the prime minister Boris Johnson will win 359 seats, implying an overall majority of 68. The Labour Party is expected to win 211 seats, a loss of 50 seats when compared to 2017. The MMR is seen as the authoritative poll after correctly predicting a hung parliament in 2017.

The Conservative's strong showing in the polls has provided further impetus to the pound which stands at its highest level against the USD since May 2019.

Chart 1: Sterling v US dollar

Source: IHS Markit

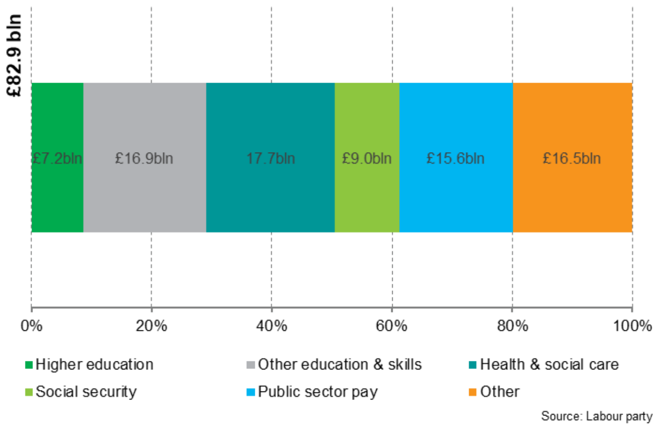
There is concern about a Labour victory potentially damaging UK financial and corporate assets, given the pledge "to rewrite the rules of the economy" including a greater role for the state and higher taxes.

The major day-to-day spending and revenue commitments from the Labour manifesto are:

It pledges an additional GBP83 billion (USD106.9 billion), or 10% higher than what is currently being planned, in day-to-day spending by 2023–24.

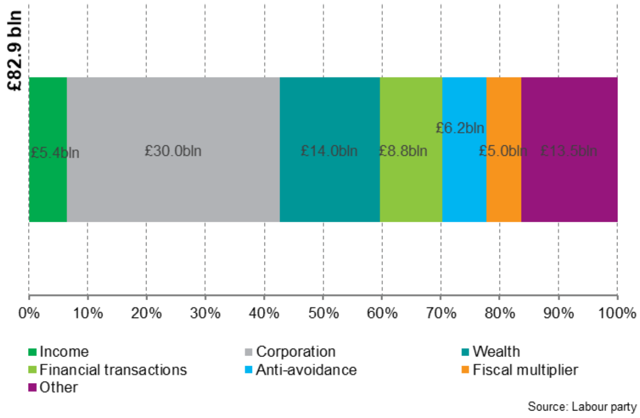
A key spending pledge is a 5% pay increase for public-sector workers, and to "restore public pay to at least pre-financial crisis levels" in real terms by above-inflation increases from April 2020. Labour plans a significant rise in funding for health and social care, education, and welfare provision.

Chart 2: Labour 's extra spending by 2023-24



Source: Labour party

Chart 3: Labour's extra tax revenues by 2023-24

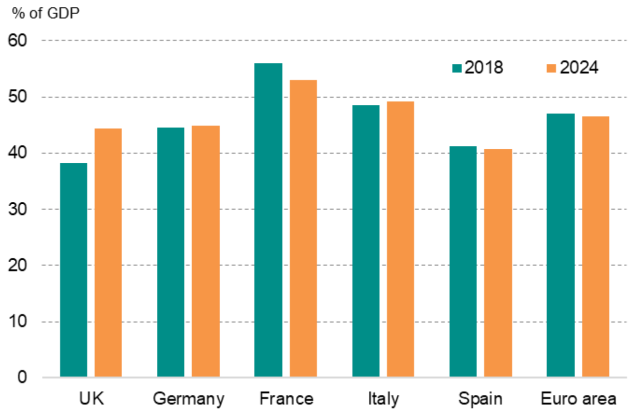


Source: Labour party

Annual capital spending would be raised from EUR47 billion (USD51.8 billion) in 2019–20 to EUR114 billion in 2023–24.

General government spending would increase to around 44% of GDP by 2023–24 from 37.8% proposed in the March Spring statement. Despite the large step-up, the UK expenditure-to-GDP ratio would be broadly aligned with its major European peers by 2023–24, according to the International Monetary Fund (IMF)–Financial Times calculations.

Chart 4: General government expenditure



Notes: UK includes 6.2% increase to reflect Labour's spending plans by 2024
Source: IFS, IHS Markit.

Meanwhile, the manifesto estimates tax regime changes would raise an additional GBP83 billion by 2023–24.

The UK corporate sector fears that the manifesto represents broad-based threats, namely higher corporate and wealth taxes, nationalisation, and mandatory employee ownership.

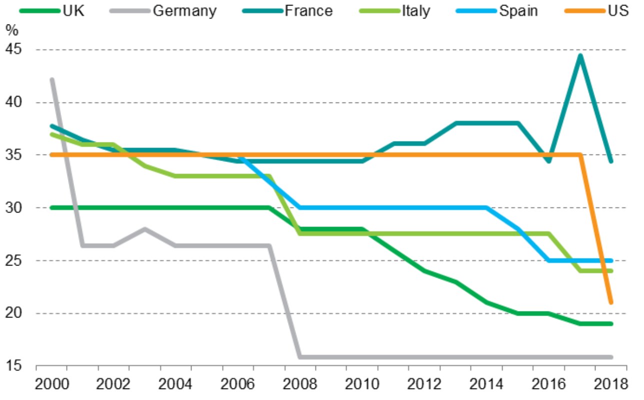
The Labour Party is proposing a programme of nationalisation to transfer essential sectors back to public ownership. Labour has not costed its nationalisation plan and has provided little detail on how it would occur, namely how the industries will be valued. But the Confederation of British industry (CBI) believes the party's nationalisation plan would cost GBP196 billion, or 9% of GDP, which is at the top end of a range of estimates, based on the upfront cost of purchasing the assets without considering any value or income flows from the new state industries. In addition, the CBI assumes in its calculations that the government would pay a 30% premium on the market value because they are relatively healthy companies (based on the prices of historical takeovers of utility companies by other companies).

The new government would issue bonds to fund its nationalisation plan and adjust fiscal targets to exclude debt used to finance state purchases of private companies.

The manifesto pledges higher corporate taxes and reform of the industrial landscape

The statutory corporate tax rate would be increased from 19% to 26%, the highest level since 2010 and the first rise since 1973. The UK would move up from one of the lowest headline rates in the OECD to above average.

Chart 5: Corporate tax rates



Source: OECD, IHS Markit.

It aims to reintroduce a small profits rate at 21% (a rise from 19%) for companies making less than GBP300,000 a year.

Overall, Labour hopes to raise additional corporate tax receipts totalling GBP27.3 billion by 2023–24.

A windfall tax on oil and gas companies would raise GBP11 billion to be used to finance its commitment to build a low-carbon economy in the next decade.

The minimum wage would rise to at least GBP10/hour for workers of all ages by 2020; it currently stands at a maximum of GBP8.21/hour for over 25s. This is expected to lift the wages of some 5.7 million workers.

Labour would repeal past laws restricting trade union activity and consider legislation to introduce a collective wage-bargaining process into parts of the economy.

Changes to Income and capital gains tax rates

The top income tax rate for those with incomes above GBP80,000 would rise, with the Institute of Fiscal Studies (IFS) estimating it will hit 1.6 million wage earners.

Higher rates of capital gains tax rates which is expected to generate GBP14 billion.

"Get Brexit sorted"

The Labour leader Jeremy Corbyn wants to renegotiate the exit deal within three months to ensure that the UK is closely aligned with the European Union on trade. The deal would then be put to a legally binding referendum, and a choice to remain in the EU could be included on the ballot paper. This whole process is targeted to be complete in six months, which is an ambitious timetable.

Nevertheless, Corbyn's goal of closer trade ties with EU is more growth-supportive than the Conservatives' apparent approach to deliver a limited trade deal in line with their insistence on UK regulatory independence.

A Labour victory would trigger financial market volatility

A Labour victory and its plan "to rewrite the rules of the economy" would likely trigger a period of financial volatility in the UK, with the exchange rate vulnerable given the recent appreciation and the persistent large trade and current account deficits. Key concerns include the new government's substantial borrowing and tax-and-spend pledges would be harmful to growth prospects, asset values and fiscal health.

Inflation would likely rise due to weaker sterling, a higher minimum wage, a more centralized wage bargaining process and above-inflation pay rises for 5.4 million public-sector workers. Above-target inflation suggest the Bank of England would be inclined towards a monetary tightening cycle.

The IFS believe Labour could struggle to generate the additional tax revenues it envisages. It warns that higher corporate tax rates will probably squeeze future profits and reinvestment funds, triggering an actual fall in corporation tax revenues. This alongside the possibility of other tax-raising disappointments would require additional general government borrowing to plug the fiscal gaps, and the temptation to target even higher corporate and income tax rates.

Poorer fiscal health in the UK would trigger a negative response from the major rating agencies. Moody's has already warned the main political parties against making broadly unfunded spending pledges ahead of election the rating agency notes that gross general government debt remains excessive when standing just below its recent peak of 86.9% of GDP in 2015. Furthermore, it expects the ratio to remain around 85% of GDP during the next 3–4 years.

Several rating downgrades could follow if a Labour government delivers in full its spending and nationalization pledges. The risk of tax-raising disappointments and the nationalisation price tag could lift the debt-to-GDP ratio to around 100%. This will trigger higher sovereign borrowing costs across the maturity range, with the UK Treasury having to higher to offer yields to attract nervous investors, adding to the accumulating fiscal tensions.

The UK has a buffer of a longer average rate of maturity on government debt of 14 years, higher than 5–9 years for most European countries. However, under the Labour manifesto, if implemented in full, probable below projected tax receipts alongside the inevitable overshoot on the current expenditure plans, and the nationalisation and pension commitments would fundamentally change the UK's debt dynamics.

Labour's election manifesto is a risk to supportive businesses conditions currently operating in the UK. Indeed, Forbes's Best Countries for Business places the UK as the most welcoming for capital investment for a second straight year in 2019. Furthermore, Moody's believes "the UK has a globalised economy that is more open than most across the world in terms of trade, investments, capital flows and, until recently, immigration". But this would all change should a Labour government deliver a higher corporate tax burden, alongside a more regulated labour market and wage-setting process.

A less vibrant corporate sector could make it harder for the UK to attract adequate foreign portfolio and foreign direct investment inflows to finance a sizable current-account deficit (at GBP92.5 billion or 4.3% of GDP in 2018). While the markets have taken a relatively calm view of the UK's elevated current account and trade deficits, it could become an increasing problem if the markets lose confidence in the UK as being a good place for business with the new Labour government leaning too heavily on private-sector activity.

The situation would be even more precarious with the UK's healthy services surplus with the EU under considerable threat once the UK leaves the EU. Indeed, Bank of England Governor Mark Carney has warned that the UK's dependence on around GBP100 billion a year of foreign financing has left it reliant "on the kindness of strangers".