Week Ahead Economic Preview

- **Worldwide manufacturing PMI surveys to reveal production momentum at tail end of 2019**
- **German inflation and labour market data**
- **Hong Kong SAR economic updates**

The coming week brings in the New Year, so we dedicate our special report this week to a summary of the main economic projections for the year ahead from our Chief Economist Nariman Behravesh.

Global recession risks have fallen in recent months with PMI surveys in particular sending encouraging signs of stabilisation. The headline global PMI hit a four-month high in November, with both manufacturing and services components lifting higher. The former, which led the 2018-19 slowdown, has now risen continually since mid-year. We will therefore get an updated insight into whether world economic growth momentum has continued to build heading into 2020 via the manufacturing PMI surveys for December during the coming week. The UK also sees the construction PMI released.

Other key data to watch for the US include pending home sales, inventories and the trade balance, while Europe sees German retail sales, labour market and inflation data, with the latter also updated for Spain, France and Italy. UK economy watches will also eye mortgage approvals numbers.

In Asia, insights into the resilience of the Hong Kong SAR in the face of trade wars and domestic unrest will be released via trade and retail sales data, while South Korea publishes industrial production, retail sales and trade numbers. Inflation data are meanwhile released for both Thailand and Indonesia.

For further information:

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Special reports

GLOBAL ECONOMIC OUTLOOK: A review of 2019 and a look at our forecasts for 2020, which sees recession risks having fallen and growth starting to trend higher as the year proceeds. (page 2).

Key diary events (UTC +8)

Monday 30 December

South Korea industrial output, retail sales (Nov)

Hong Kong SAR trade (Nov)

Germany retail sales (Nov)

IHS Markit Russia Manufacturing PMI (Dec)

Spain inflation (Prelim, Dec)

US goods trade balance (Nov), wholesale inventories (Adv, Nov), pending home sales (Nov)

US Chicago PMI, Dallas Fed manufacturing index (Dec)

Tuesday 31 December

IHS Markit Russia Services PMI (Dec)

Turkey trade (Nov)

Wednesday 1 January

South Korea trade (Dec)

Thursday 2 January

Worldwide release of IHS Markit Manufacturing PMI surveys (Dec)

Thailand and Indonesia inflation (Dec)

UK Nationwide housing prices (Dec)

Brazil trade (Dec)

Friday 3 January

Hong Kong SAR retail sales (Nov)

UK mortgage lending and approvals (Nov)

UK Construction PMI (Dec)

Germany jobless rate, unemployment change (Dec)

Germany, France and Italy inflation (Prelim, Dec)

US ISM manufacturing survey (Dec)

Global economic outlook

Global growth to lift from lows as 2020 proceeds

Global growth weakened considerably in 2019, falling to a rate of 2.6% from 3.2% in 2018. IHS Markit expects the pace of expansion to deteriorate marginally further to 2.5% in 2020, before edging up 2.7% in both 2021 and 2022. Some signs of stabilisation are already evident, and 'green shoots' of faster growth will become increasingly apparent in some markets early in the year, though the global economy remains vulnerable to various risks.

2019 review

Global economic growth peaked in early 2018 and by mid-2019 many parts of the world saw manufacturing either in, or close to, recession, as trade flows deteriorated. By mid-2019, the JPMorgan Global PMI, compiled by IHS Markit, was indicating the first falls in manufacturing output since 2012.

The slowing in part reflected cyclical factors, but 2019 also saw rising risk aversion as geopolitical uncertainty intensified (notably trade wars and Brexit), as well as a continuation of the longer-term trend of slowing of growth in China.

Trade woes were mitigated by resilient consumer spending in many markets, in particular the US, with consumers benefitting from decent income growth, low oil prices, low inflation and low interest rates. In addition, global financial conditions improved across the world, with rising markets creating a beneficial wealth effect. The global service sector, which tends to be more consumer-focused than manufacturing, consequently remained in expansion through 2019, but nevertheless had seen the pace of growth slow to the weakest since 2016 by the second half of the year.

In response to the growing signs of weakness, many central banks began to loosen monetary policy. The Fed lowered the federal funds rate three times in 2019, while the European Central Bank (ECB) began a renewed bond purchase program and made more interest rate cuts. Major emerging-market central banks also lowered their policy rates. Some countries (notably China and the US) provided additional stimulus via fiscal measures. Trade worries meanwhile showed signs of moderating.

By the end of the year, some of the IHS Markit PMIs had begun to stabilise. The headline PMI hit a four-month high in November, with both manufacturing and services lifting higher. The former has now risen continually since mid-year.

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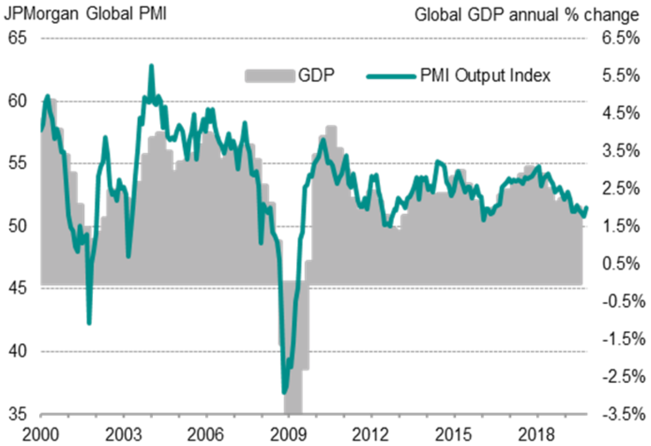
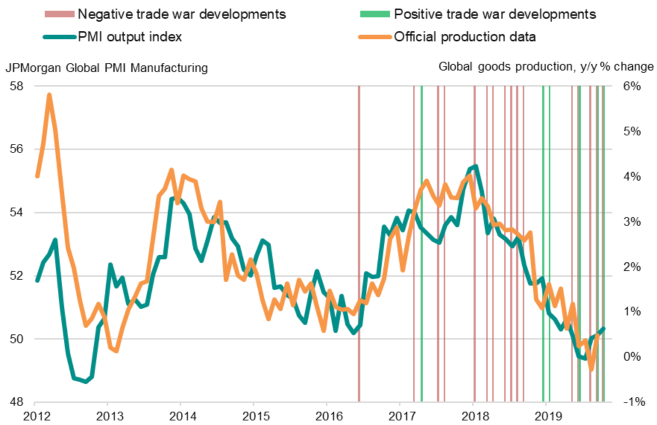
Global GDP and the PMI



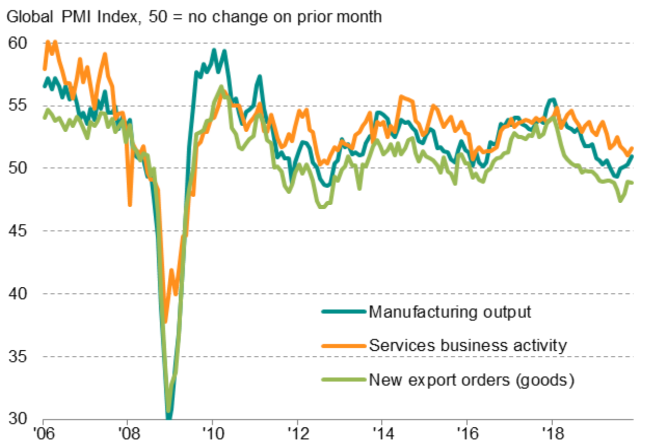
Source: IHS Markit.

Trade worries and global manufacturing



Sources: IHS Markit, JPMorgan.

Trade-led weakness offset by service sector resilience



Sources: IHS Markit, JPMorgan

2020 outlook

We therefore enter 2020 with signs that the slowdown is bottoming out, albeit with momentum remaining weak and vulnerable to downside risks. Notably, relatively low interest rates and sizable fiscal deficits in many countries leave little scope for policy stimulus in the event of recession risk.

We expect global growth to slow further from 2.6% in 2019 to 2.5% in 2020, but to have started to accelerate in late-2020 to then pick up marginally to 2.7% in the next two years.

- The US is set to grow 2.3% in 2019 and 2.1% next year, supported by good consumer finances and fiscal stimulus.
- Eurozone growth is settling near 1% as exports and investment remain weak. Political risks, including Brexit, are adding to caution. UK growth will slow to 0.5%.
- China's economic growth will continue to slow, as restraints from deleveraging and US trade restrictions are only partially offset by government stimulus.
- Asia-Pacific economies will sustain growth near 4% and account for over half of global real GDP growth.

The global monetary easing cycle will therefore likely come to an end. Signs of solid growth in the United States, including via IHS Markit's PMI surveys, mean the Fed may not need further "insurance" cuts. In fact, there is a better than 50/50 chance that the Fed will raise rates at the end of 2020 and again in 2021. While the challenges facing the ECB and Bank of England are more complex, the recent strong opposition to negative rates may imply that any easing will proceed cautiously.

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Despite historically high levels of policy uncertainty, recession risks have fallen. Recession fears rose in early-2019 as the economic data and risk outlook worsened. By summer, IHS Markit was assessing the risk of a recession at nearly 30%. However, with the data showing signs of stabilising, central banks around the world providing more liquidity, and financial conditions having eased considerably (both stock prices and bond yields have risen in key markets), we have consequently lowered the risk of US and world recessions to around 20%.

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- In the near term, the biggest threat is either an escalation of the US-China trade conflict or its spread to other parts of the world, notably Europe.
- Many governments (especially in the eurozone) may be reluctant to provide fiscal stimulus if growth falters further.
- High and rising corporate debt levels in both developed and emerging markets are a major threat to the current expansion, when (if) interest rates begin to rise.

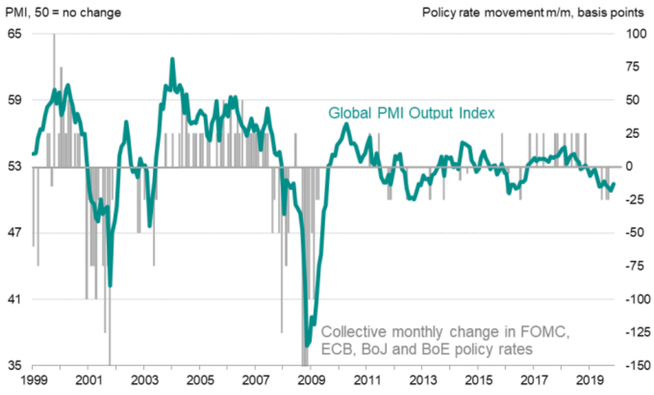
IHS Markit Global GDP forecast

Source: IHS Markit

IHS Markit GDP forecasts, annual % change

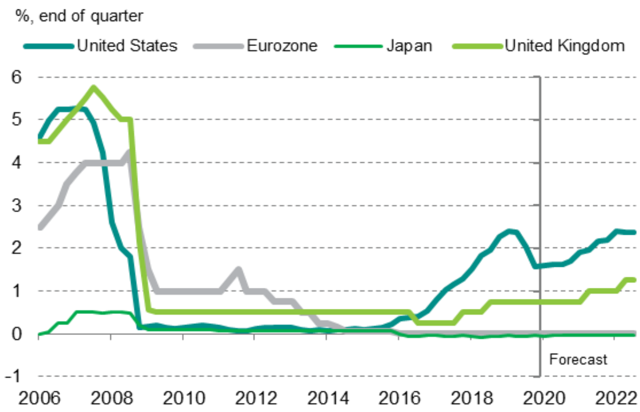
	2016	2017	2018	2019	2020	2021
World	2.8	3.4	3.2	2.6	2.5	2.7
United States	1.6	2.4	2.9	2.3	2.1	2.0
Canada	1.1	3.2	2.0	1.6	1.5	1.3
Eurozone	1.9	2.7	1.9	1.1	0.8	1.0
United Kingdom	1.8	1.9	1.4	1.3	0.5	0.7
China	6.7	6.7	6.6	6.2	5.7	5.6
Japan	0.6	2.2	0.3	1.1	0.3	0.5
India	8.1	7.1	6.8	4.8	5.5	6.2
Brazil	-3.3	1.3	1.3	1.1	1.6	1.7
Russia	0.3	1.7	2.2	1.1	1.6	1.6

Global PMI and G4 monetary policy



Source: IHS Markit, JPMorgan.

Policy rates

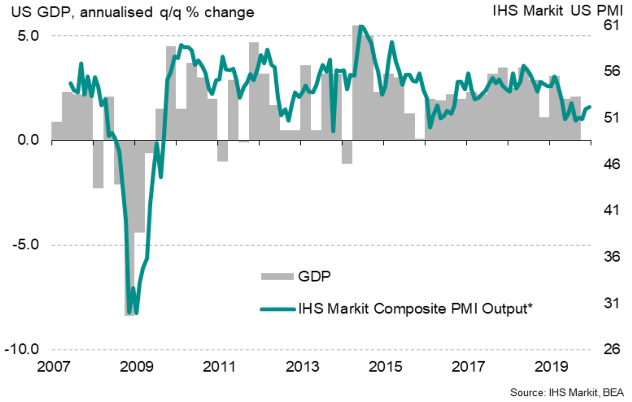


Source: IHS Markit

United States

The US economy will grow by around 2.0% in 2020, which we estimate to be the trend (or potential) growth rate. Real GDP growth averaged 2.5% in 2018 and 2019 thanks to fiscal stimulus but, with the effects of this stimulus wearing off, growth is returning to trend. That said, a rebound in production at General Motors is expected to buoy growth and the "phase one" trade deal with China will also help. Consumer spending (roughly 70% of the economy) will increase about 2.7% in 2020, putting a floor on growth in the broader economy. We look for real GDP to expand 2.1% next year, 2.0% in 2021, and an average 1.6% in 2022 and 2023 as fiscal stimulus wanes further, and financial conditions tighten. We note though that the run-up to the presidential election in 2020 could provide some policy surprises (both positive and negative), which could affect the outlook.

United States GDP and the PMI



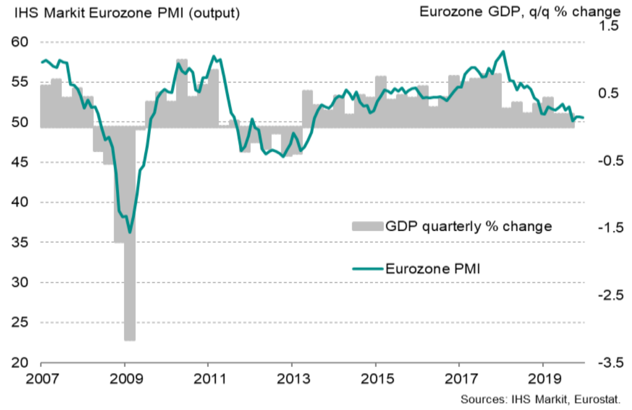
Europe's economy

The Eurozone economy is expected to start to recover a little as 2020 proceeds, but the UK looks set to weaken.

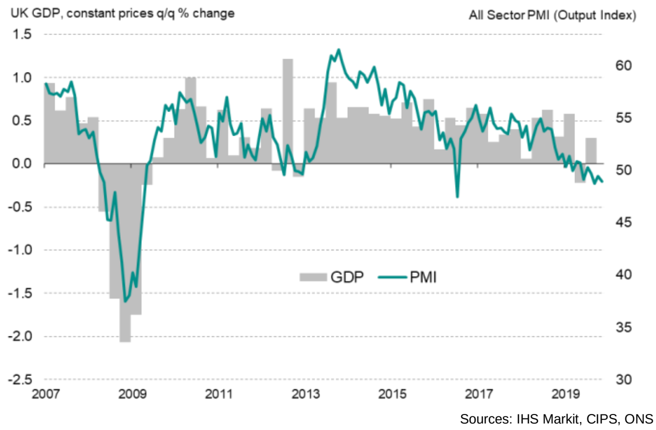
The slump in eurozone growth in 2019 (to 1.2%) compared with 2018 (1.9%) was alarming, with some large economies (notably Germany and Italy) flirting with recession. Nevertheless, there are some signs that the worst may be over. In particular, some of the IHS Markit PMIs for the eurozone have levelled off, after months of falling. Low inflation and easing financial conditions (including accelerating money-supply growth and a marked rise in equity prices) will continue to support consumer spending in the coming year. Consequently, IHS Markit expects eurozone growth to stabilize at around 0.9% in 2020, before picking up a little to 1.0% in 2021.

The results of the UK election meanwhile suggest that, while the worst of the Brexit uncertainty may be over, there is still a hard slog ahead, with growth dropping from 1.3% in 2019 to 0.5% in 2020, before recovering slightly to 0.7% in 2021.

Eurozone GDP and the PMI



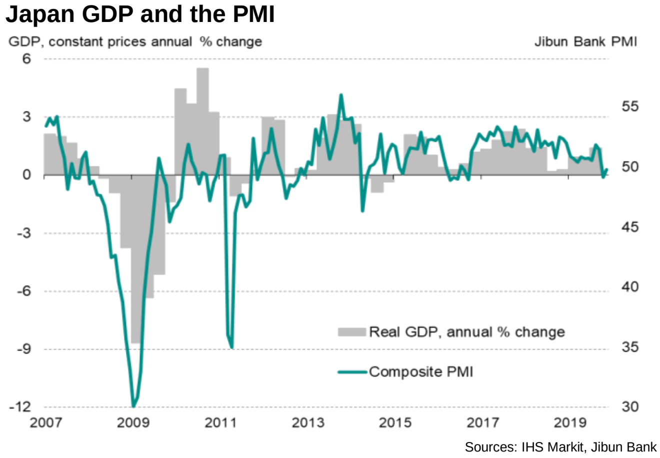
UK GDP and the PMI



Japan

Japan's post-tax-hike growth stumble will be cushioned by more stimulus. Japan's real GDP growth rate strengthened from 0.3% in 2018 to an estimated 1.1% in 2019. However, fourth-quarter growth is expected to turn negative as a result of the hike in the sales tax in October. The Abe government's announced new fiscal package—the first since 2016 and the largest since 2012 is intended to upgrade infrastructure, invest in new technologies, and repair typhoon damage. While it is unclear how much of this money is "new" and how much will actually be spent, it will neutralize much of the negative effects of the sales tax hike. The good news is that the increase in the sales tax will help to stabilize Japan's government debt ratio—the largest in the developed world. Furthermore, rising employment and low inflation will help consumer confidence. Consequently, after slowing to 0.3% in 2020, Japanese real GDP growth is projected to recover to 0.5% in 2021.

Japan GDP and the PMI



China

China's growth rate is forecast to fall below 6.0% in 2020, continuing the easing trend seen since the double-digit expansion of 2010. The expected 6.2% rate of expansion in 2019 will represent the slowest growth since 1990. While it is tempting to blame much of the recent slowdown on the US-China trade war, the decelerating trend is the result of both structural and cyclical factors. An aging population and a sharply lower productivity growth mean that potential growth in China is lower now than a decade ago, and will fall further.

The surge in China's debt from around 150% of GDP in 2009 to c.260% (mostly due to corporate borrowing and more recently an increase in household mortgage borrowing) has tied the hands of policymakers. Attempts to deleverage the economy by curbing shadow banks have only been partially successful and have subdued growth. Policymakers are in a balancing act: they would like to cut the debt ratio, while providing enough stimulus to keep growth from falling too fast. We predict that China's GDP growth will slide further to 5.7% in 2020 and 5.6% in 2021, unless the government puts in place a more aggressive stimulus program.

Emerging markets

Emerging markets will continue to tread water in 2020, as debt reaches new peaks. The past decade has seen emerging world growth fall from 7.3% in 2010 to 4.2%. While the long slide in China's growth rate will be a continued drag, emerging markets also face headwinds from lacklustre developed world demand, falling commodity prices and the trade war. More local concerns (e.g. unrest in Latin America and faltering growth in India) are also worrisome.

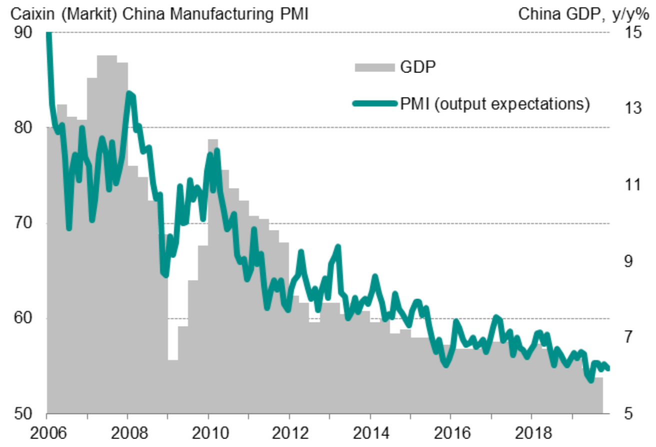
A growing concern is the record level of debt in the emerging world, encouraged by low global interest rates. This will only become a significant problem when interest rates begin to rise. In the meantime, central banks in the emerging world have more room to cut interest rates, if they need to.

Commodity prices

Commodity prices will trend down in 2020. The IHS Markit Materials Price Index (MPI) is predicted to decline by 3.0%-3.5% in 2020. More broadly, however, while the focus since early 2018 has been on slowing demand growth, production growth also slowed across 2019, with market conditions tightening in many industries. This improvement in fundamentals will gradually assert itself next year. Initial weakness in 2020 will be followed by prices stabilizing or even pushing slightly higher in the second half of 2020.

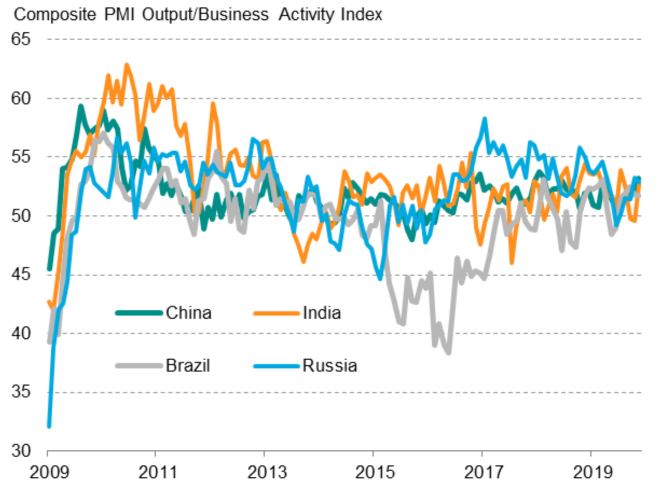
Crude oil prices are a case in point. Markets have been buffeted by news regarding weak global growth, OPEC production cuts, non-OPEC production increases, an attack on Saudi production facilities, and the trade wars. The net effect has been a drop in the price of Dated Brent to $64 per barrel in 2019, which we expect to weaken further to $57 in 2020, as growing non-OPEC production and sluggish liquids demand growth keep the oil market in surplus.

China GDP and PMI expectations



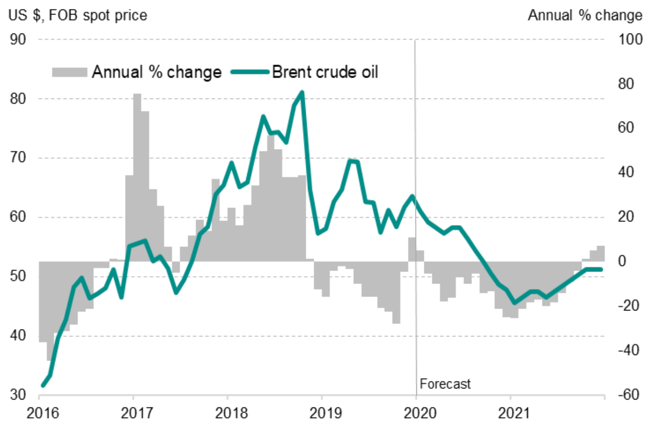
Sources: IHS Markit, Caixin

Emerging market PMIs



Sources: IHS Markit, Caixin

Oil prices



Source: IHS Markit

US dollar

The US dollar will appreciate a little further in 2020. In real effective terms (adjusted for inflation and trade-weighted), the US dollar has risen around 9% since the beginning of 2018. This is almost entirely due to economic fundamentals rather than currency "manipulation." The US economy has been growing faster than most other developed economies and interest-rate differentials between the US, on the one hand, and Europe and Japan, on the other, favour dollar-denominated assets.

The greenback also enjoys safe-haven status. Ironically, the escalation of the trade war has exacerbated this phenomenon—thus undermining attempts to improve the competitiveness of US companies by imposing tariffs on non-US suppliers. Going forward, these dynamics are likely to stay in place, but ease a little. IHS Markit expects that the US dollar will climb another 3% over the next two years, before beginning a long and gentle retreat. Growth in the US economy is likely to slow more, while growth elsewhere edges up. At the same time, we expect US interest-rate differentials to narrow with the rest of the world, and for the US current-account deficit and net external liabilities to keep worsening.

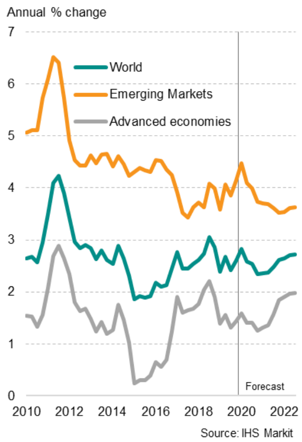
US dollar, real trade weighted index

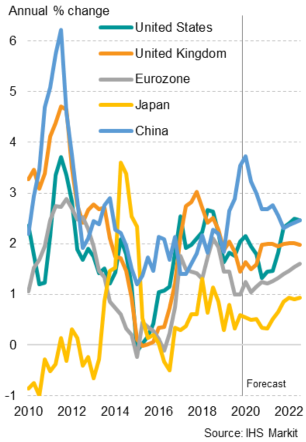
Inflation

Inflation will generally remain subdued. Global consumer price inflation rose to 2.9% in 2018, only to retreat to 2.6% in 2019. Most of the swings in world inflation were due to volatility in the rate of price increases in the developed world—inflation in the emerging world was more stable. Some of the inflation volatility was also a function of swings in the prices of oil and other commodities. There is early evidence that the underlying rates of price and wage inflation may be creeping up in the developed world, but the chances of a major "breakout" are remote—global inflation in 2020 is only expected to be 2.7%. While the pace of real GDP growth may have stopped decelerating, it will not accelerate much anytime soon. Similarly, sliding commodity prices will exert mild downward pressure on inflation. In the case of the US, a strong dollar will be an additional (albeit mild) disinflationary force. In emerging markets, subdued growth will also keep inflation in check—barring any sharp currency depreciation.

The one potential source of inflation is the US-China trade war. Tariffs can increase import prices and, if so, can raise the rate of inflation. However, importers have begun to source some of their purchases from countries that have not—yet—been subject to higher tariffs. Thus, the trade war impacts on inflation have so far been modest.

Consumer price inflation





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