

FIGURE
OF THE WEEK

49.3

China's official
manufacturing
PMI in October

In the Headlines



China: Policies aiming to lift spirits

Leading indicators suggest that the Chinese economy continued to be under pressure in October. The official manufacturing PMI declined to 49.3 points, slightly more than suggested by usual seasonal effects. Conversely, the Caixin manufacturing PMI increased, for the fourth month in a row. Details show however that business confidence remains weak on a historical comparison. In this context, recent media reports that there might be some rollback in tariffs as part of the “phase one” deal between the U.S. and China are encouraging. While it remains to be seen if and when the deal can be signed, markets reacted positively, with the renminbi appreciating and the USDCNY rate crossing below 7.00 for the first time since August. That may have created a window for the PBOC to continue easing the monetary policy, against market expectations. Indeed, on 5 November the MLF (medium-term lending facility) rate was cut by 5bp, to 3.25%. While this is a small move, in our opinion it sends a signal supporting our scenario for further prudent easing going forward. We expect further MLF rate cuts (and thus Loan Prime Rate cuts) in the coming quarters.



U.S.: Employment and services robust, manufacturing weak

The October employment report was expected to be weak at +90k jobs due to a General Motors strike. Instead the report was quite strong with job gains of +128k, and sharp upward revisions of +92k from the previous two months. Outside of manufacturing gains were widespread across industries. The labor force grew for the sixth consecutive month, driving the participation rate up +0.1 pp to 68.3%, the highest in over six years. The increase in participation did nudge the unemployment rate up to 3.6%, just above the 50-year record low of 3.5% set in September. The one slight drawback in the report was that wage growth remained unchanged at +3% y/y. In a separate report, the ISM services index, covering around 85% of the economy, rebounded +2.1 points in October to 54.7, well into expansionary territory. But manufacturing continues to struggle. Despite a small gain, the ISM manufacturing index remains in contraction at 48.3, and nine of the ten components are also in contraction.



UK: All sectors remain under pressure

Activity in the service sector remained subdued in October, reflected by the services PMI at 50 points (49.5 in September). Business levels were supported by existing contracts as the volume of new work declined further. The outlook improved slightly as a number of firms expected Brexit to be resolved early next year, reducing uncertainty, but the overall sentiment remained historically weak. Cost pressures continued to rise, due to wage growth but also higher prices for fuel, energy, food and imported items. Pricing power remained limited which suggests a further deterioration in company margins. In the construction sector, prospects were not better either with volumes of work falling for the sixth consecutive month across all three sub-sectors, with civil engineering being the worst performing. The index stood at 44.2 points, close to the 10-year low. Domestic political uncertainty weighs on demand in the sector. In the manufacturing sector, firms continued to report weaker new orders, notably from the domestic market. Growth in inventories of finished goods and purchases were at six-month highs. We expect GDP to fall by -0.1% q/q in Q4 2019 after an artificial rise of +0.4% in Q3.



Romania: New government approved

Romania has a new government after the parliament passed a vote of confidence in the cabinet of the new Prime Minister (PM) Ludovic Orban from the centrist National Liberal Party. This ended a political crisis that began in August when the center-right ALDE withdrew from the then governing coalition with the center-left PSD under former PM Dancila and culminated in the collapse of Dancila's government in October. Orban has announced to roll back some of the fiscal and judicial measures implemented under Dancila, for which Romania had been criticized by the EU and concerned investors. However, reigning in expansionary fiscal policies will not be easy until the next parliamentary elections, scheduled for end-2020, as Orban's minority government will need support from opposition MPs to push through bills. Meanwhile, the economy continues to weaken as industrial production contracted -6.6% y/y and nominal exports -2.5% y/y in August. Real GDP growth slowed from +5% y/y in Q1 to +4.4% in Q2 and we expected it to decelerate further, resulting in full-year growth of +4.2% in 2019 and +2.8% in 2020.

Countries in Focus

Americas



Brazil: Reforms, season 2

Amid slightly better economic data, Brazil's government is surfing the momentum of the pension reform approval, which could generate around USD200bn (-20% vs. the original bill) in public savings over the next 10 years. We expect a positive confidence shock to ignite a modest recovery of investment, hence explaining the growth acceleration in 2020 (+1.8% vs. +1% this year). Step 2 of the economic reforms includes freeing up more budget for discretionary spending (only 5-7% of the budget today), and would entail automatic austerity to comply with spending caps (e.g. reducing public sector salaries), improving fiscal management. Yet not only would such measures require significant political capital, but the window to pass them in 2020 is tight, as the local election campaign will start in May. Lastly, releasing Brazil's full growth potential and boosting its attractiveness would require an overhaul of the cumbersome and inefficient tax system; it would probably not be put forward before H2 2020.

Europe



Bulgaria: Growth is forecast to slow

Real GDP growth strengthened to an average +4.2% y/y in H1 2019 from +3.1% in full-year 2018. However, quarterly data already indicate a downtrend from +4.5% y/y in Q1 to +3.8% in Q2. The latter was primarily driven by a strong +7.4% increase in consumer spending, boosted by rapid wage growth and declining unemployment. Net exports also contributed +1.3pp to Q2 growth, but this was not a sign of economic strength but rather reflecting that real imports (-5.1% y/y) dropped more sharply than exports (-3%). Monthly data suggest that the downtrends in external trade have likely continued in Q3, reflecting the impact of weakening global and Eurozone demand, while the current account surplus surged to +7% of estimated GDP in August (from 5.4% in 2018 as a whole). Meanwhile, industrial production growth continued to weaken, from +3.5% y/y in Q1 to -0.1% in Q2 and an estimated -1.7% in July-August. Overall, we forecast full-year GDP growth of +3.5% in 2019 and +2.5% in 2020.

Africa & Middle East



Ethiopia: Deeds vs. Words

Ethiopia is regularly quoted as a model in Africa in terms of reforms and attractiveness, but the country has perhaps faced the largest number of concerns in the last few years. Among the main messages, reforms and foreign direct investment inflows have failed to nurture a real momentum for now. Reform is not only a word, and on many aspects Ethiopia did not make any improvement. The country is still 159th in the World Bank's Doing Business ranking, as it was two years ago. Moreover, manufacturing production such as textiles has failed to translate into significant export growth: the trade deficit is still high and foreign currency remains scarce. Politics and geopolitics are still tail risks in Ethiopia, with a divided society and violence inside the country as well as the potential for tense relationship with neighbors as a result of the Grand Renaissance Dam. With also an election in 2020, GDP growth should lose momentum (+5% next year), increasing again social frustration.

Asia Pacific



APAC: October PMIs reflect continued weakness in manufacturing

Most manufacturing PMIs in Asia declined in October. This reflects continued weakness across Asian manufacturing sectors, on the back of the ongoing global slowdown and trade tensions. Economies that had been holding up better, such as Thailand and Vietnam, are also starting to soften. Manufacturing PMIs in both countries declined to 50 points. In the case of Vietnam, this is the lowest level in nearly four years. The index in Taiwan fell back into contraction after a blip into expansion in September. PMIs in Hong Kong, Indonesia and Japan slid further into contraction. They rose in Malaysia, South Korea and Singapore, but are still in contraction territory. Looking at the breakdown, new export orders indices almost all declined, even for the economies that saw rises in their headline PMIs. In this context, policy support is likely to continue across the region. In October, central banks in Australia, China, India, South Korea and Singapore eased their monetary policies further.

What to watch

- November 7 – Philippines Q3 GDP
- November 7 – Germany Sept. industrial production
- November 7 – UK BoE meeting
- November 8 – China October trade
- November 8 – France Sept. industrial production
- November 8 – Canada October employment report
- November 8 – France September trade balance
- November 8 – U.S. October consumer sentiment
- November 8 – Germany Sept. foreign trade
- November 9 – China October inflation
- November 10 – Spain general elections
- November 11 – India Sept. industrial production
- November 11 – India October inflation
- November 11 – UK Q3 GDP
- November 12 – U.S. October National Federation of Independent business survey
- November 13 – Eurozone Sept. industrial production

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