MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 23 July 2018

Key Themes

Positive news on trade this week. The US and EC agreed to at least halt the threat of tariffs while they begin talks to reduce trade barriers. High level NAFTA meetings also recommenced – but with little detail/outcome.

The negotiation of the Brexit Withdrawal Agreement continued. Most of the agreement is in place but significant sticking points remain especially regarding frictionless trade borders. Key UK ministers, including PM May, have been meeting with EU members to try and build support. Meetings with the EC resume in mid-August.

The ECB kept rates on hold.

Core measures of Australian CPI growth continued to slow in Q2, edging down and out of the RBA target band of 2-3%. Its not likely that the RBA will start to cut rates based on slowing consumer prices at this stage.

US GDP growth didn't disappoint with Q2 real GDP growth at +4.1%. Consumption, investment and net exports all contributed to higher growth in the quarter. Other measures of the US economy remained positive – growth in Durable Goods in June after two weaker months prior and the Chicago Fed National Activity Index for June returned to a higher than average rate of growth. Early July data was a little mixed, showing expansion in regional manufacturing surveys and the composite PMI, but expanding at a slower pace.

Other global preliminary Composite PMI's for July were also mixed; slower expansion in the Eurozone (remaining near recent lows and downbeat commentary) and continued slower expansion in Japan. The German prelim composite PMI was stronger with expansion accelerating (led by manufacturing), continuing its rebound off recent lows.

Contents

US Data

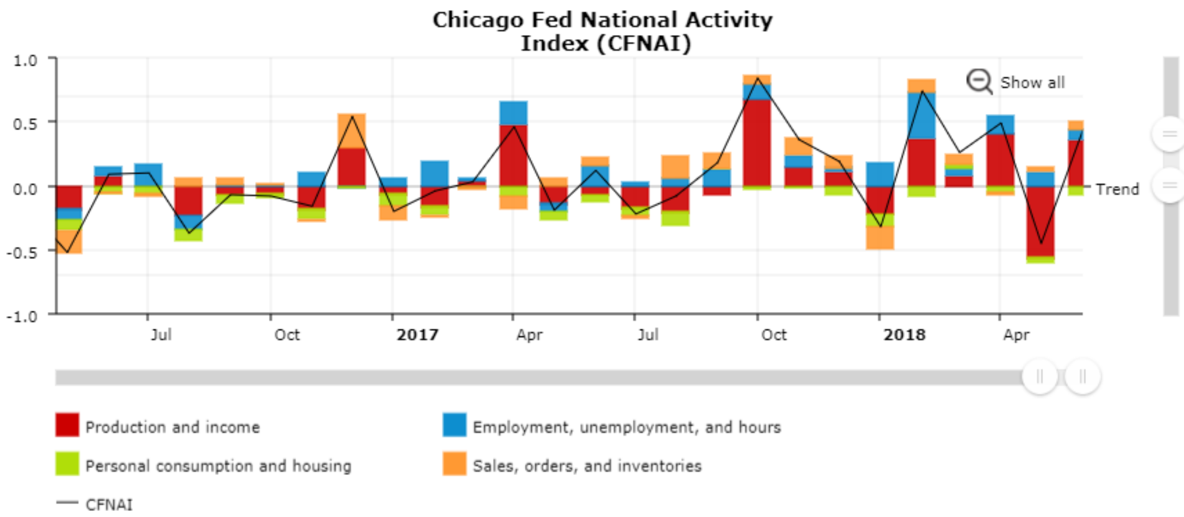
Chicago Fed National Activity Index (CFNAI) (June)

The June data shows a return to expansion above the historical average in June after a sharp fall in May;

Overall Index; June 0.43 versus May -0.45

The improvement in June was the result of improvement in the production & income sub-index;

Production and Income; June 0.36 versus May -0.56



The other elements of the activity index performed on par/were mostly unchanged compared with May;

Personal Consumption & Housing; June -0.06 versus May -0.04

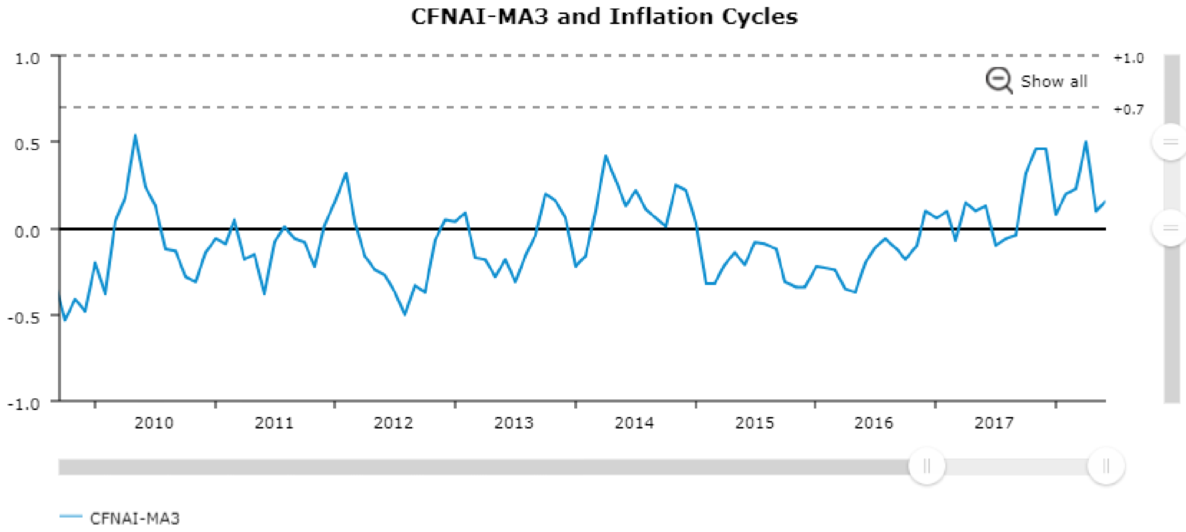
Employment, Unemployment and Hours; June 0.08 versus May 0.11

Sales, Orders and Inventories; June 0.06 versus May 0.03

The 3mth moving average for the activity index moved up slightly in the latest month but is well off the highs reached in April;

June 0.16 versus May 0.11

An increasing likelihood of a period of sustained increasing inflation has historically been associated with values of the CFNAI-MA3 above +0.70 more than two years into an economic expansion. The chart below highlights that the CFNAI has consistently fallen short of this level over the last 8 years;



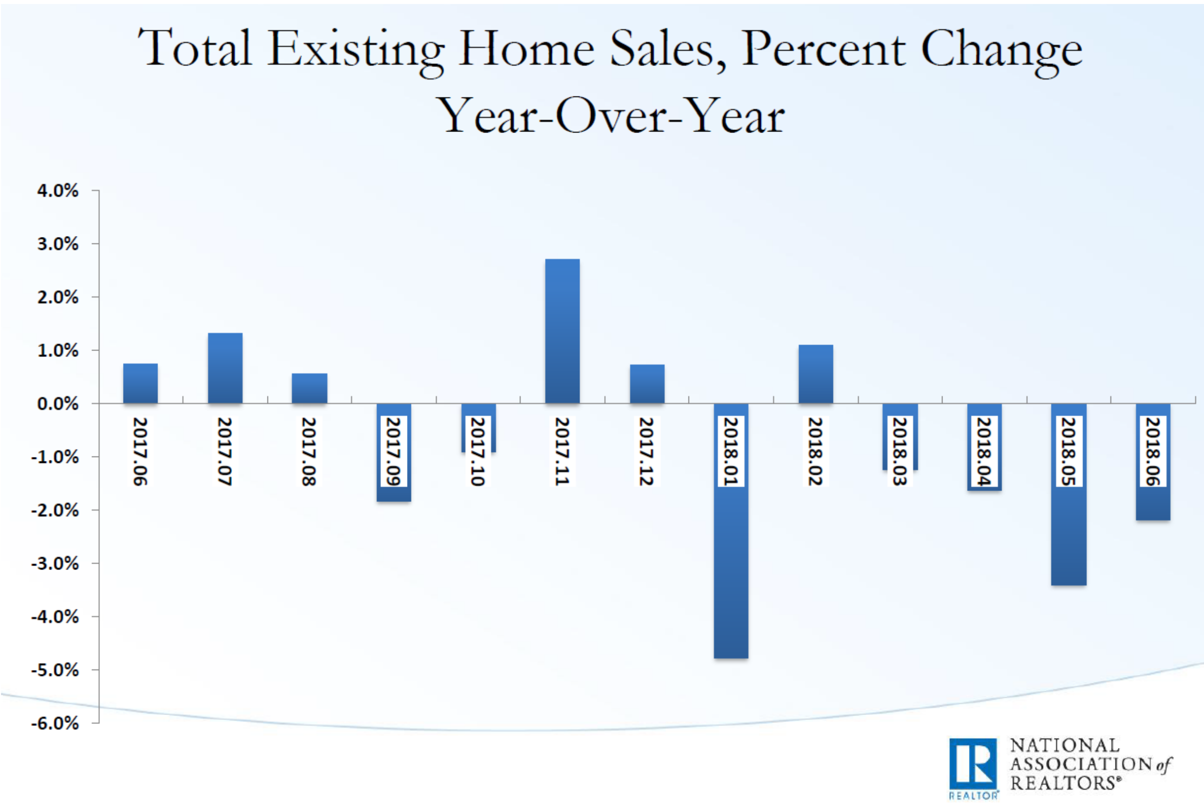
https://www.chicagofed.org/publications/cfnai/index

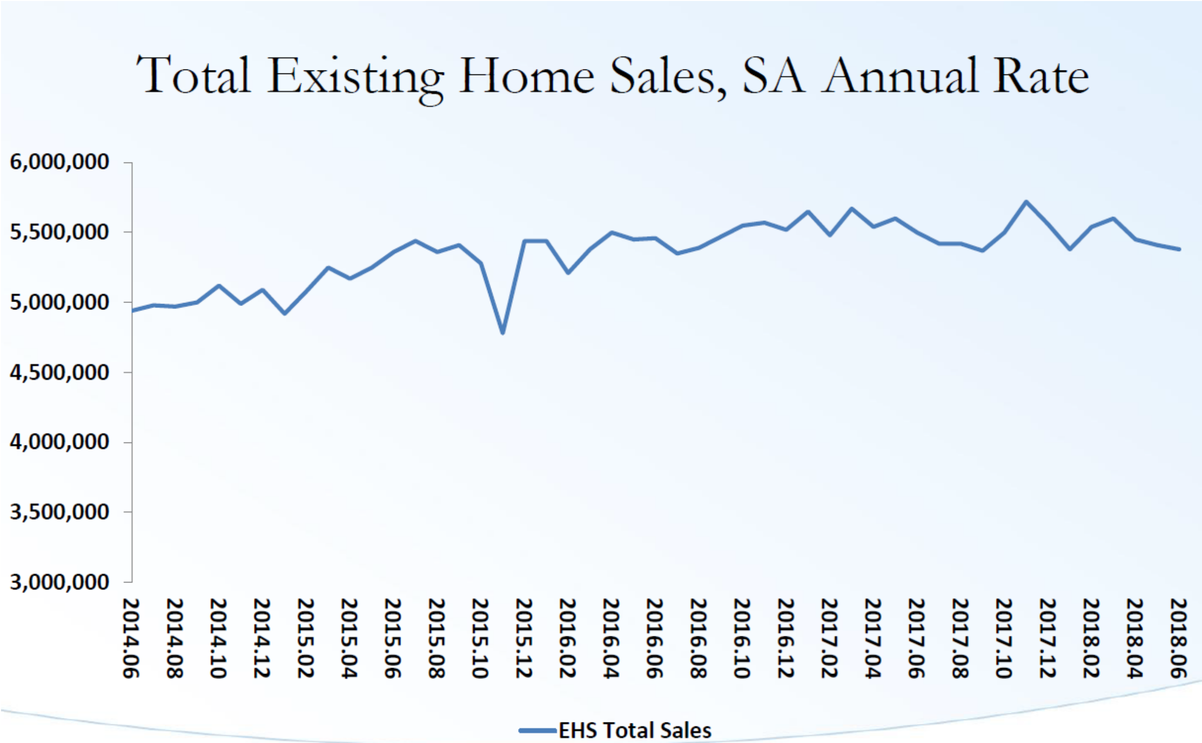
Existing Home Sales (June)

Existing home sales declined for the third month in a row.

June -0.6% and May revised lower from -0.4% to -0.7%

Annual change existing home sales -2.2% at June 2018





Bigger declines in the month for the South and West regions were offset by gains in the North East and Midwest. But on an annual basis, only the South has recorded a small gain in existing home sales;

Region	June – Mth Chg	June – Annual Chg
Total US	-0.6%	-2.2%
Northeast	5.9%	-4%
Midwest	+0.8%	-3.1%
South	-2.2%	+0.4%
West	-2.6%	-5%

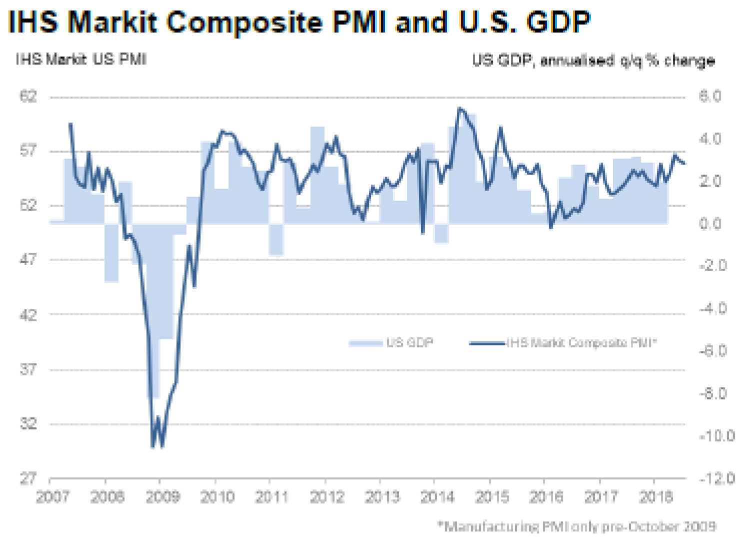
https://www.nar.realtor/sites/default/files/documents/ehs-06-2018-overview-2018-07-23.pdf

PMI Composite (Flash - July)

The US composite PMI (flash) highlighted that overall private sector expansion continued at a relatively constant pace in July, led by a small slow-down in services and little change in manufacturing;

Composite; July 55.9 versus June 56.2

Data collected July 12-23



Sources: IHS Markit, U.S. Bureau of Economic Analysis.

Overall, there was little change in the rate of services and manufacturing expansion;

Services Business Activity; July 56.2 versus June 56.5

Manufacturing PMI; July 55.5 versus June 55.4

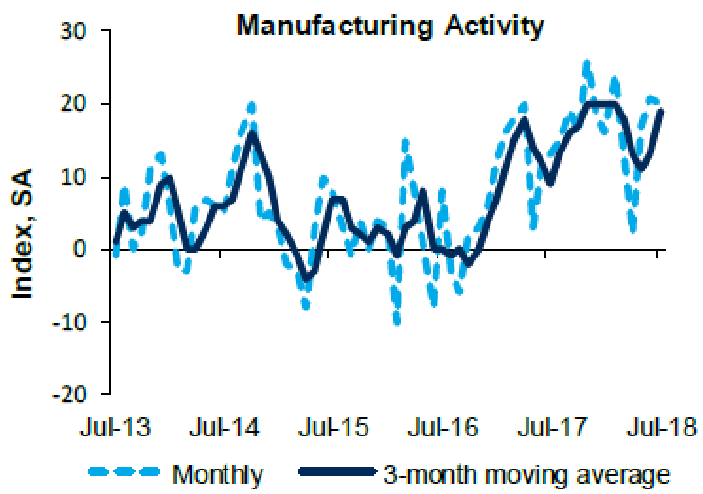
One highlight from the flash report was cost pressures – fuel, raw materials (via implementation of tariffs in July) and labour costs.

https://www.markiteconomics.com/Survey/PressRelease.mvc/a86344a03e0d48aeb7a2b2d8c7f9615f

Richmond Fed Manufacturing Index (July)

Manufacturing conditions remained virtually unchanged in the latest month, expanding at a similar pace in July v. June;

July 20 versus June 21



Shipments and new orders were mostly unchanged and continued to expand at a constant pace in July. It appears that part of this activity resulted in the large slow-down in the backlog of orders – order backlogs fell to 4 in July from 20 in June. Expansion in capacity utilization also slowed significantly. At the same time, there was a large increase in finished goods inventories in July, increasing to 10 from a reading of 2 in June.

Expansion in the number of employees remained unchanged (close to recent highs), but wages expanded a slower pace, falling to a reading of 22 in July from 27 in June. Yet, availability of skills needed, continued to fall deeper into contraction.

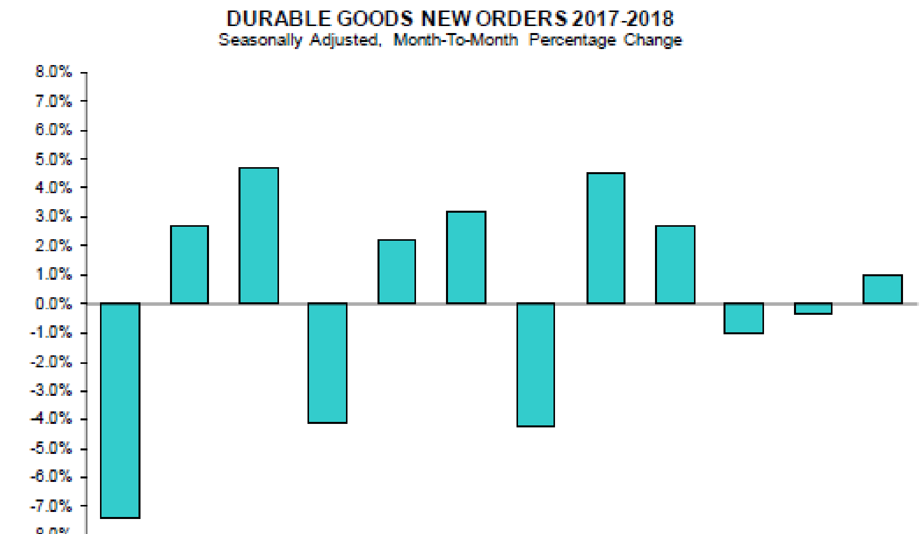
https://www.richmondfed.org/research/regional_economy/surveys_of_business_conditions/manufacturing/2018/mfg_07_24_18#tab-1

Durable Goods Orders (June)

A stronger end to the quarter after two weaker months;

New orders; June +1% versus May -0.3%

Shipments; June +1.7% versus May +0.2%



	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18
% Change	-7.4%	2.7%	4.7%	-4.1%	2.2%	3.2%	-4.2%	4.5%	2.7%	-1.0%	-0.3%	1.0%

Source: U.S. Census Bureau, Manufacturers' Shipments, Inventories, and Orders, July 26, 2018.

Excluding some of the larger value items such as transportation, headline numbers were a little lower in the latest month, but growth was consistent with the prior month, indicating a steady trend;

Ex-transportation New Orders; June +0.4% versus May +0.3%

Ex-transport Shipments; June +0.6% versus May +0.6%

As a measure of what is coming into the pipeline, new orders for two of the larger categories;

Non-Defence Capital Goods had a stronger month; June +2.3% versus May -2.2%

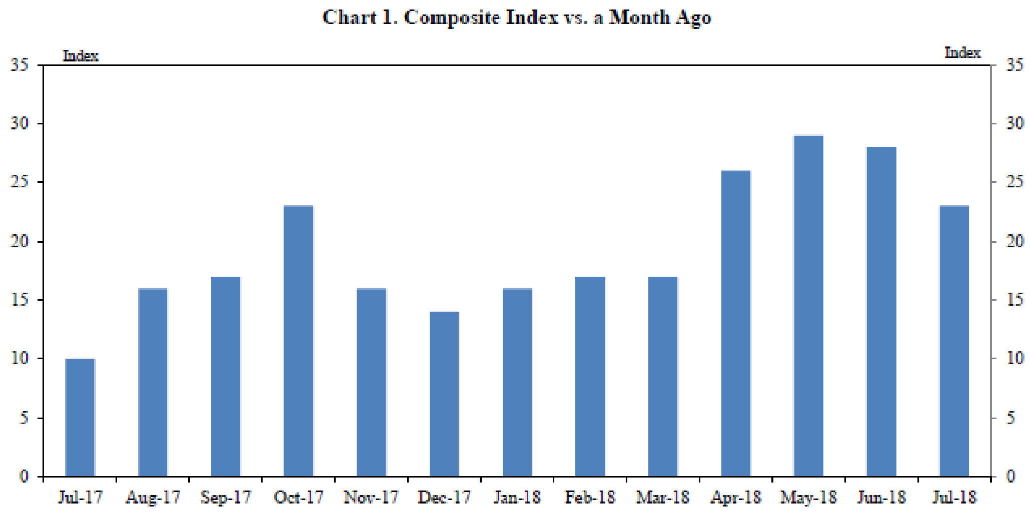
Manufacturing with unfilled orders slowed; June 0% versus May +0.9%

https://www.census.gov/manufacturing/m3/adv/pdf/durgd.pdf

Kansas City Fed Manufacturing Index (July)

The change in the headline composite index indicated manufacturing activity expanded, but at a slower pace in the latest month (but remains relatively high overall);

July 22 versus June 27



Whilst this wasn't a large change, there were some bigger shifts in the sub-indices;

Expansion in production and shipments slowed;

Production; July 22 versus June 38 (respondents shifted from increase to decrease)

Shipments; July 14 versus June 39

New orders also slowed; July 17 versus June 24 (less respondents recorded increasing new orders and shifted mostly into 'no change'). The backlog of orders also expanded at a slower pace.

The number of employees expanded at a similar pace, but the employee workweek expanded at a slower pace; July 11 versus June 28 (respondents shifting from increase to decrease)

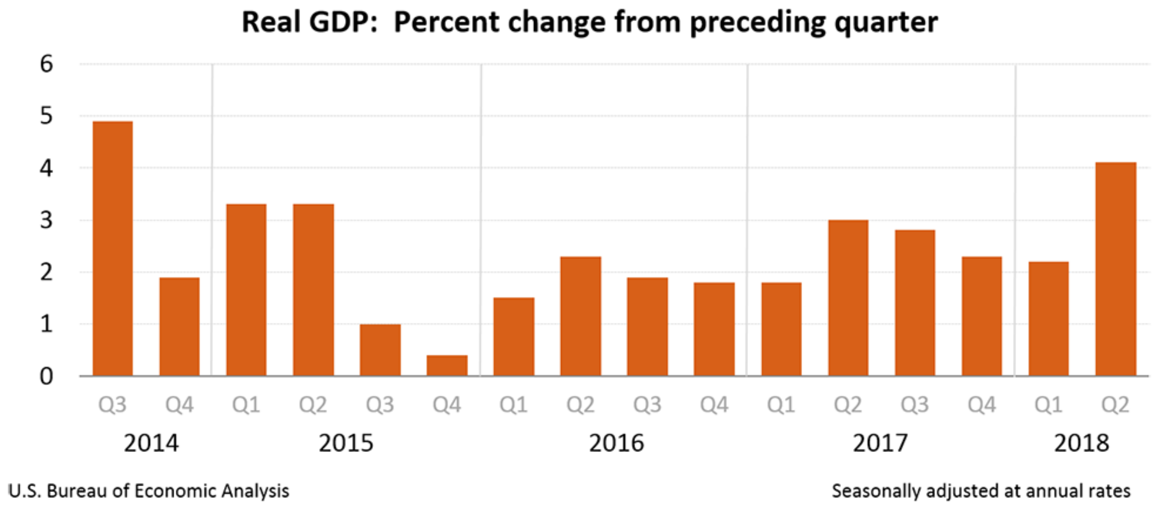
Prices paid for raw materials continued to increase, whilst prices received for finished goods remained unchanged.

Expectations for 6months time remain steady.

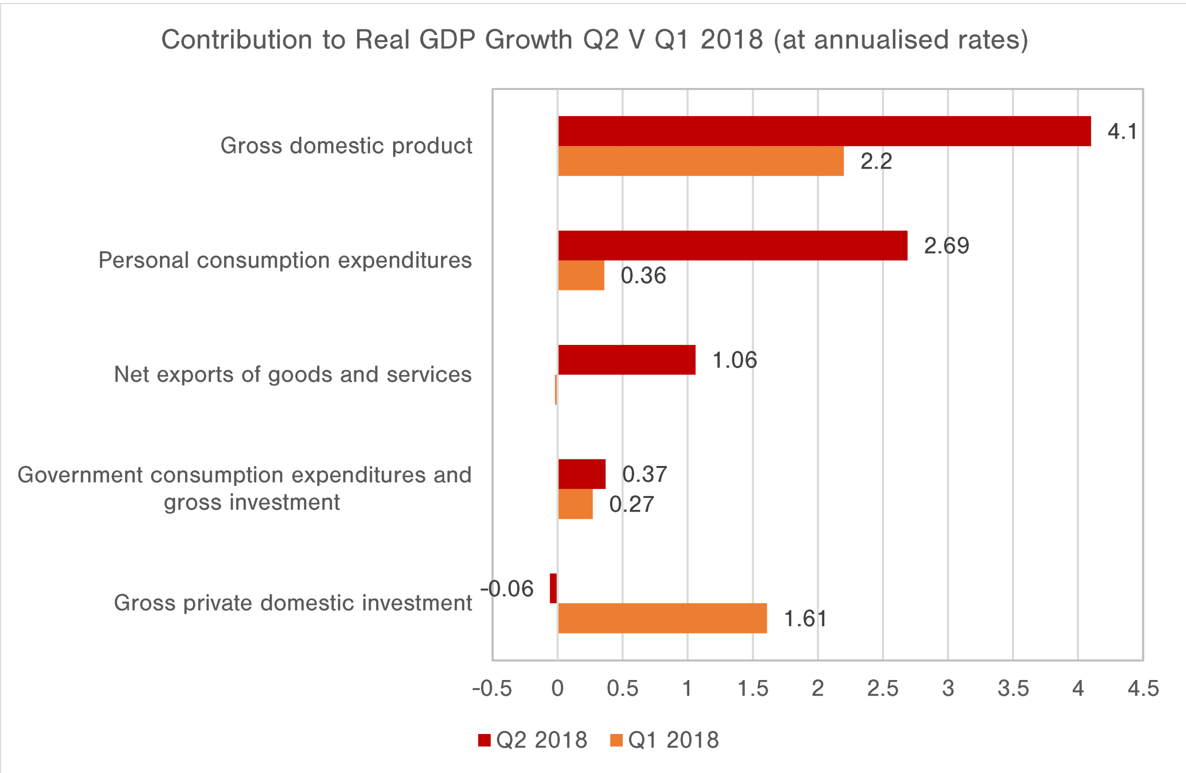
https://www.kansascityfed.org/~/media/files/publicat/research/indicatorsdata/mfg/2018/2018jul26mfg.pdf?la=en

US GDP Q2 2018

The advance estimate for Q2 GDP came in close to expectations +4.1% (annualised) for the quarter.



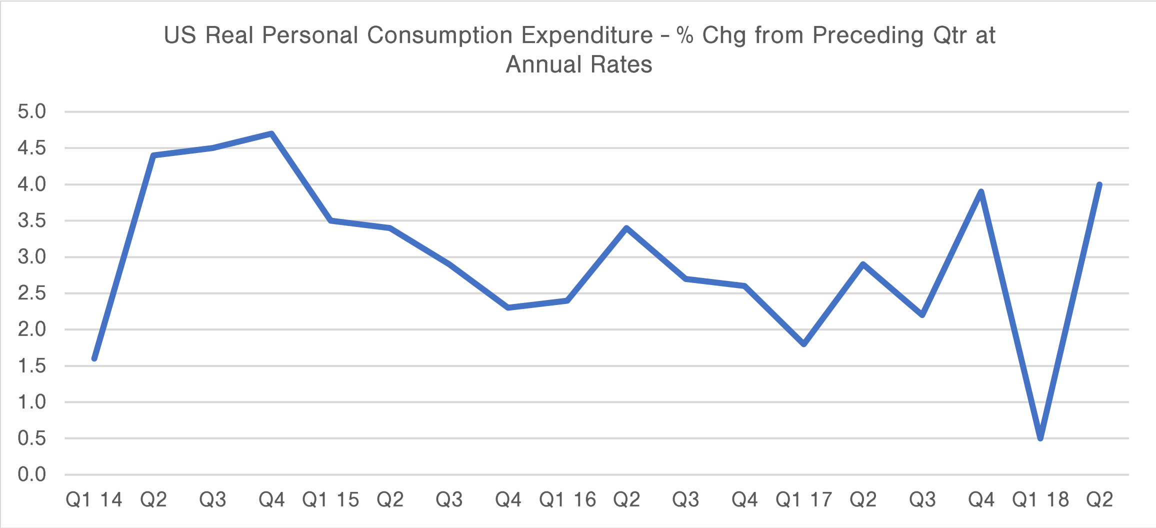
Most areas contributed to the higher rate of growth in the latest quarter;



The main contributor to the higher growth was personal consumption expenditure. Goods reversed the decline from the previous quarter and growth in Q2 was more in line with the higher growth recorded throughout 2017- led higher by durable and non-durable goods incl. clothing and footwear.

Services growth accelerated to new near-terms highs – led higher by household consumption expenditures on services including utilities and healthcare.

Overall, personal consumption growth was back to the higher level recorded in Q4 2017;

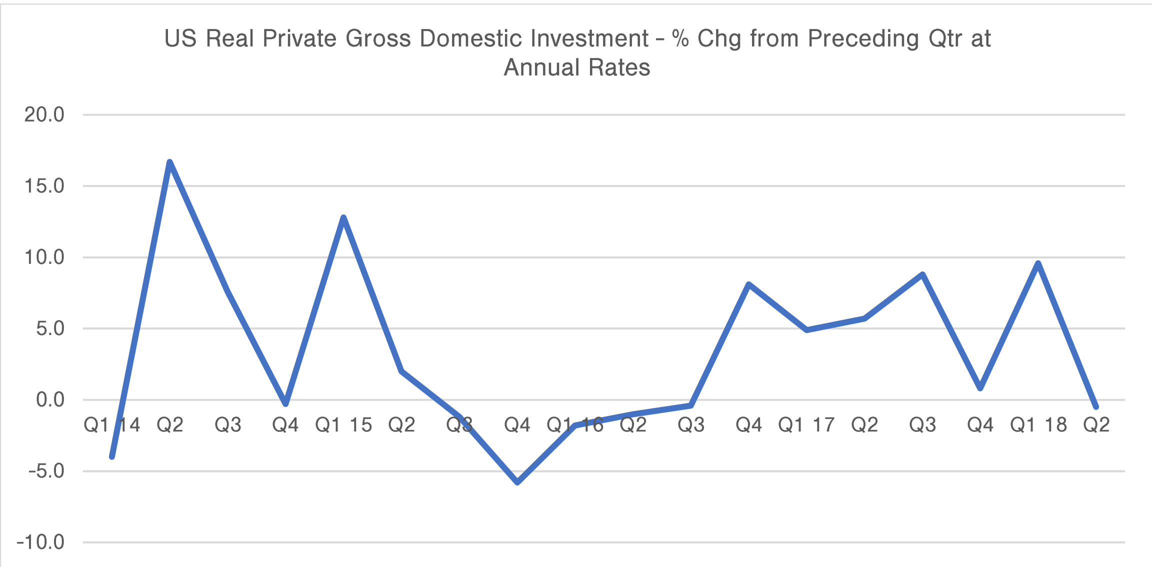


Net exports made a positive contribution to growth in Q2 – the result of stronger exports (+9.3% in Q2 v +3.6% Q1) and slowing growth in imports (+0.5% Q2 versus +3% Q1).

Government consumption expenditures have also continued to grow and has been growing at a consistent pace over the last three quarters.

Private investment detracted slightly from GDP growth in Q2 mostly the result of the change in private inventories, which detracted 1%pt from GDP in the latest quarter. Non-residential fixed investment and residential investment contributed a combined +0.9%pts.

Non-residential fixed investment continued to grow in the latest quarter, but at a slower rate +5.4% Q2 versus +8% Q1 (lower growth in equipment and intellectual property). Residential investment declined for the second quarter, albeit at a slower pace of decline (virtually flat).



https://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm

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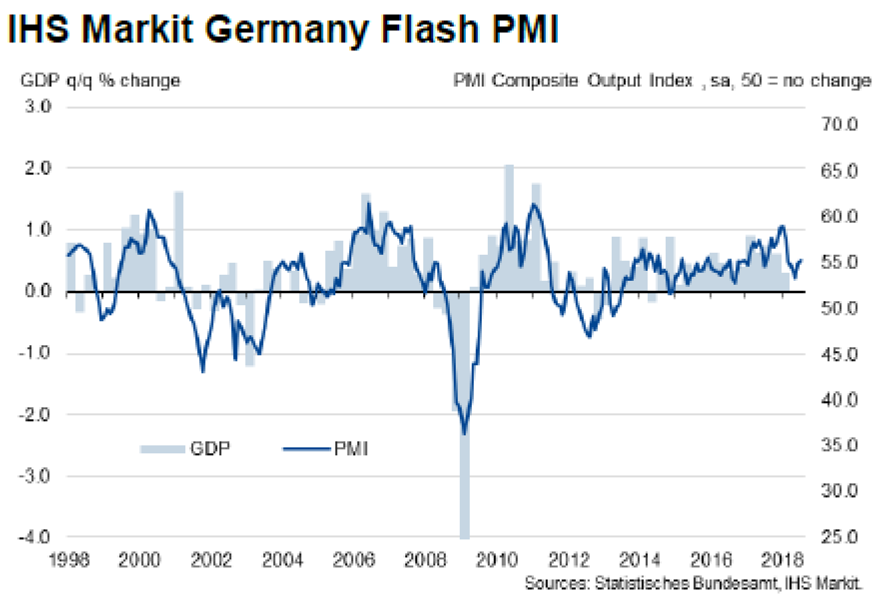
Europe

Germany Flash Composite PMI (July)

Overall private sector activity expanded at a slightly faster pace in July, led by manufacturing;

Composite PMI; July 55.2 versus June 54.8



Whilst the improvement is a good sign, the chart above highlights that expansion momentum is still well below the peak of 2017.

Manufacturing led the composite index higher in the latest month, whilst services expanded at a constant pace;

Services PMI Activity Index; July 54.4 versus June 54.5

Manufacturing PMI; July 57.3 versus June 55.9

The faster expansion in manufacturing was the result of increases in output, new orders, stocks of purchases and greater supply chain delays.

Job hiring expanded at a constant pace, unchanged from the previous month.

Input prices continued to rise – higher wages, fuel and increased steel prices (as well as shortages). Output price also continued to increase – at a rate just short of the all-time high from Sept 2000.

Business confidence slowed to its second lowest level in 20-months.

https://www.markiteconomics.com/Survey/PressRelease.mvc/4ea9b5268488427ebc111e2c907d8937

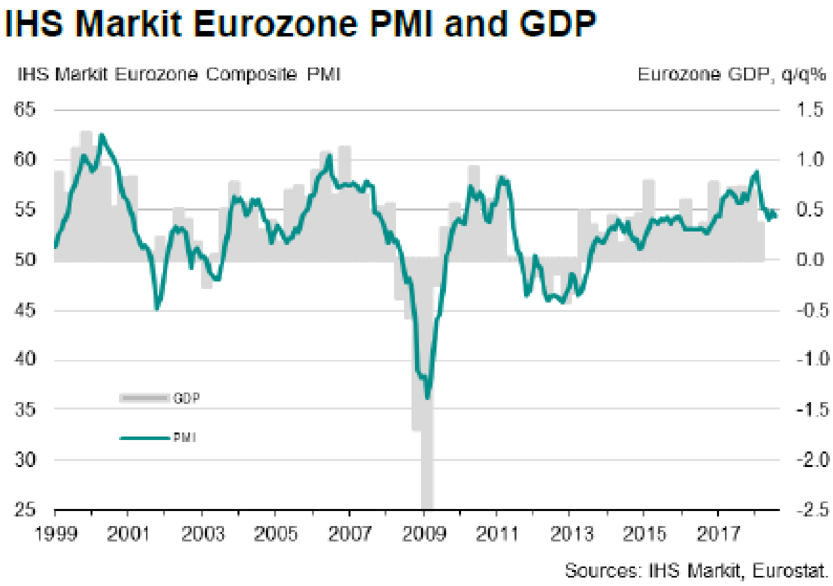
Eurozone Flash PMI (July)

Private sector activity in the Eurozone expanded at a slightly slower pace in the first month of the new quarter and remains near its recent low;

Flash Composite PMI; July 54.3 versus June 54.9

The July reading was the second weakest since November 2016 and only just above the recent low in May 2018.

This was led lower mostly by a slower expansion in Services.

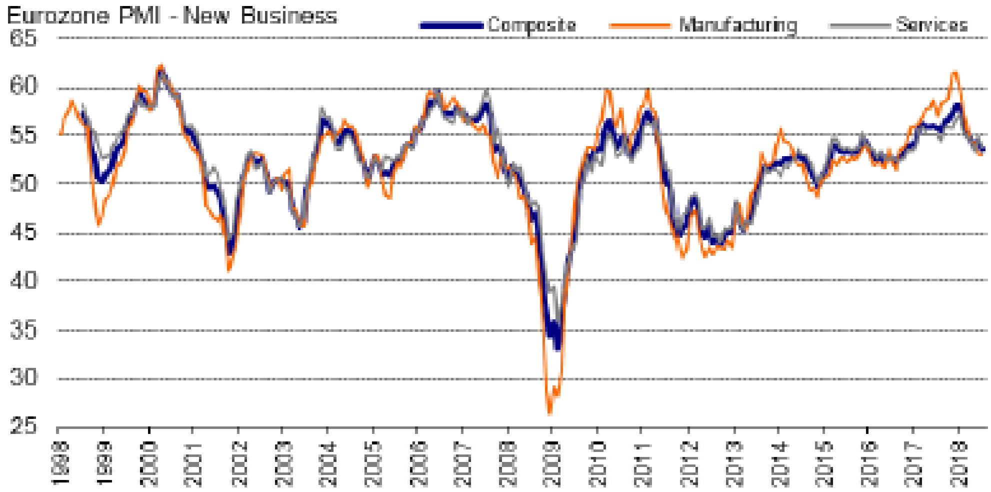


Expansion in Manufacturing output remained unchanged at the same pace as June; July 54.2 versus June 54.2

Services activity slowed; July 54.4 versus June 55.2

The key highlight of the report was the slowdown in new orders. The composite index for new orders slowed to a 21month low, led manufacturing.

New business



The slower rate of expansion in new orders resulted in a slower increase in backlogs, as firms worked through/completed order backlogs. This may also lead to slower output growth in future reports.

Future business expectations continued to slow across manufacturing and notably, services.

Employment indices continued to expand at a constant pace. Prices increased at a constant pace.

Commentary was downbeat for the Eurozone overall especially regarding new orders, production export orders. In contrast, the German Flash Composite was stronger in July.

https://www.markiteconomics.com/Survey/PressRelease.mvc/a47c2257ccb54d6c825fce1571f5c25a

Eurozone – ECB Rates Decision

Rates remain on hold.

Guidance - Rates to remain on hold through the summer of 2019 and for as long as necessary to achieve inflation that is close to 2% over the medium term. (The main change was to the wording which changed to ‘through the summer’).

Non-standard policy measures remain in place;

Asset Purchase Program - net purchases at the current monthly pace of €30 billion until the end of September 2018. After September 2018, subject to incoming data confirming our medium-term inflation outlook, we will reduce the monthly pace of the net asset purchases to €15 billion until the end of December 2018 and then end net purchases.

Reinvestment of principal payments from maturing securities purchased under the APP for an extended period of time after the end of our net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Growth – GDP had weakened in Q1 and has since stabilised throughout Q2. Risks are broadly balanced. Uncertainties remain with trade disputes (alleviated in the ST by the US-EC ongoing negotiations) and the risk of heightened financial market volatility.

Inflation – Higher headline inflation the result of higher energy and food prices. Underlying inflation remains 'muted', although there some domestic cost pressures have been increasing amid higher capacity utilisation and tightening labour markets.

"Ample degree of monetary accommodation is still necessary for the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term."

https://www.ecb.europa.eu/press/pressconf/2018/html/ecb.is180726.en.html

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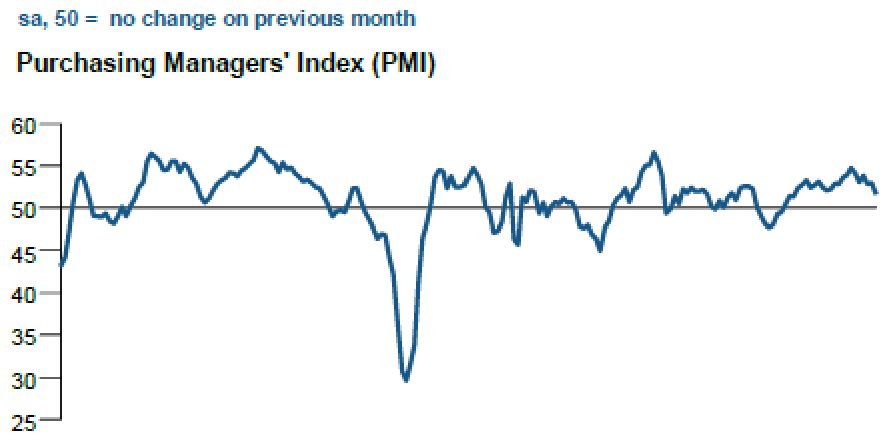
Japan

Nikkei Manufacturing PMI (prelim July)

The expansion in Japanese manufacturing continues to slow;

July 51.6 versus June 53



Demand conditions appear to have weakened with output and new orders expanding, but at a slower rate and new orders and new export orders declining;

The backlog of work is contracting and employment growth is expanding at a slower rate. Supplier delivery times continued to lengthen and input prices increased at a faster rate than output charges.

https://www.markiteconomics.com/Survey/PressRelease.mvc/962e44c819ce40ccb7e7d09456e23394

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Great Britain

Brexit

Latest polls highlight the ongoing division about the ‘right’ path for Brexit. There isn’t one course of action that has the support of even one third of the voters.

The UK government now goes into recess for the summer.

Another round of discussions took place last week. A summary of the key areas of agreement and disagreement (from an EC perspective) can be found here; http://europa.eu/rapid/press-release_SPEECH-18-4704_en.htm

According to the EC, approx. 80% of the details of the withdrawal agreement have been agreed upon. But there are significant points of disagreement, especially with regard to frictionless trade.

“Chequers was bound to be the beginning of the EU pushing the UK to the unacceptable combination of EEA and customs union membership,” Baker said. “On this road, eventually we will reach a fork between final capitulation or exit with no agreement.”

https://www.bbc.co.uk/news/uk-politics-44975696

The outstanding issues (outlined in the link above) will be reviewed and proposals tabled at the next round of meetings with the UK and EC will be mid-August.

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Australia

Australia CPI Q2

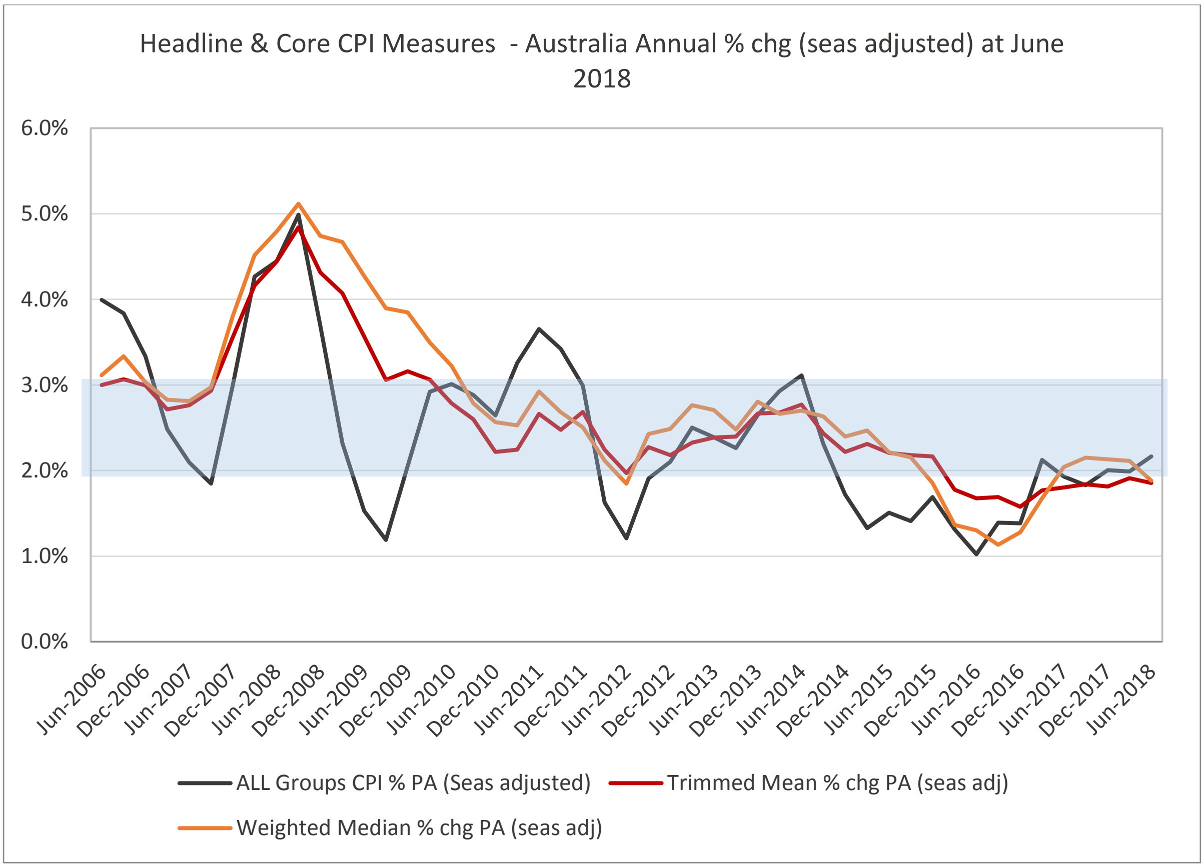
Headline consumer price growth continued to slow in Australia in the latest quarter – this report is in line with the continued low growth in CPI expected by the RBA.

Q2 headline CPI growth; +0.36% versus Q1 +0.45%

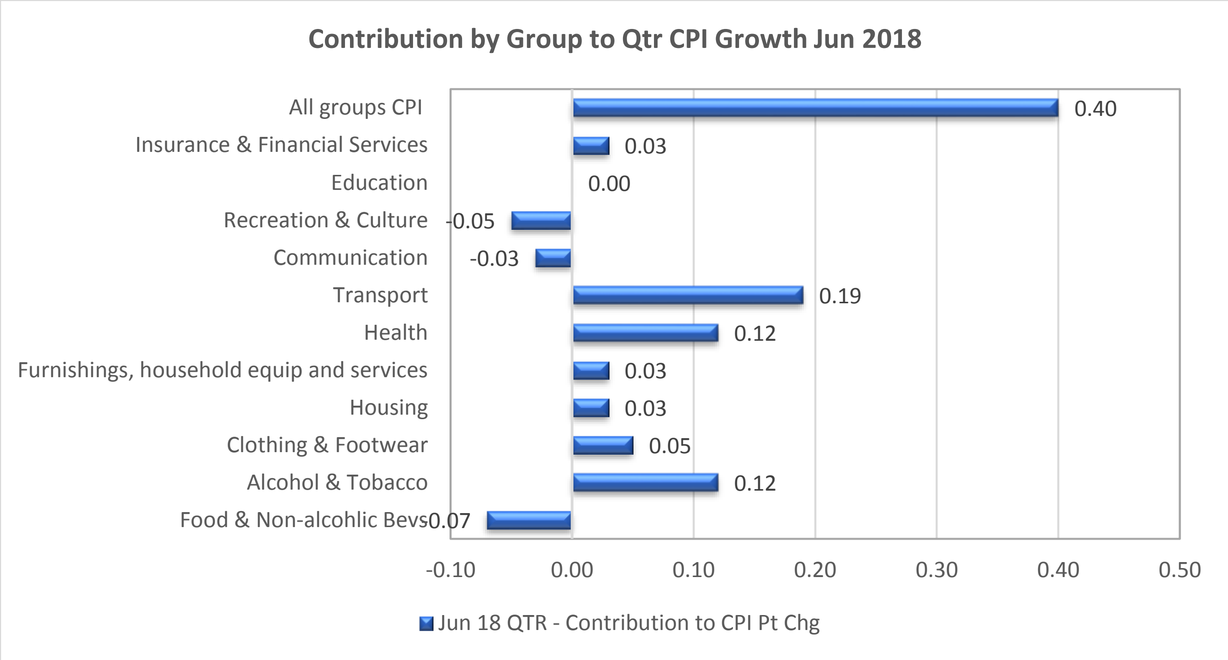
Despite the slight slow-down in quarterly CPI growth, the annual headline rate ticked up from +1.9% to 2.08%.

The numbers that matter to the RBA are the core measures of trimmed mean and weighted median CPI. The RBA target range is 2-3% and both core measures of CPI growth in Q2 have edged down and outside of the target range.

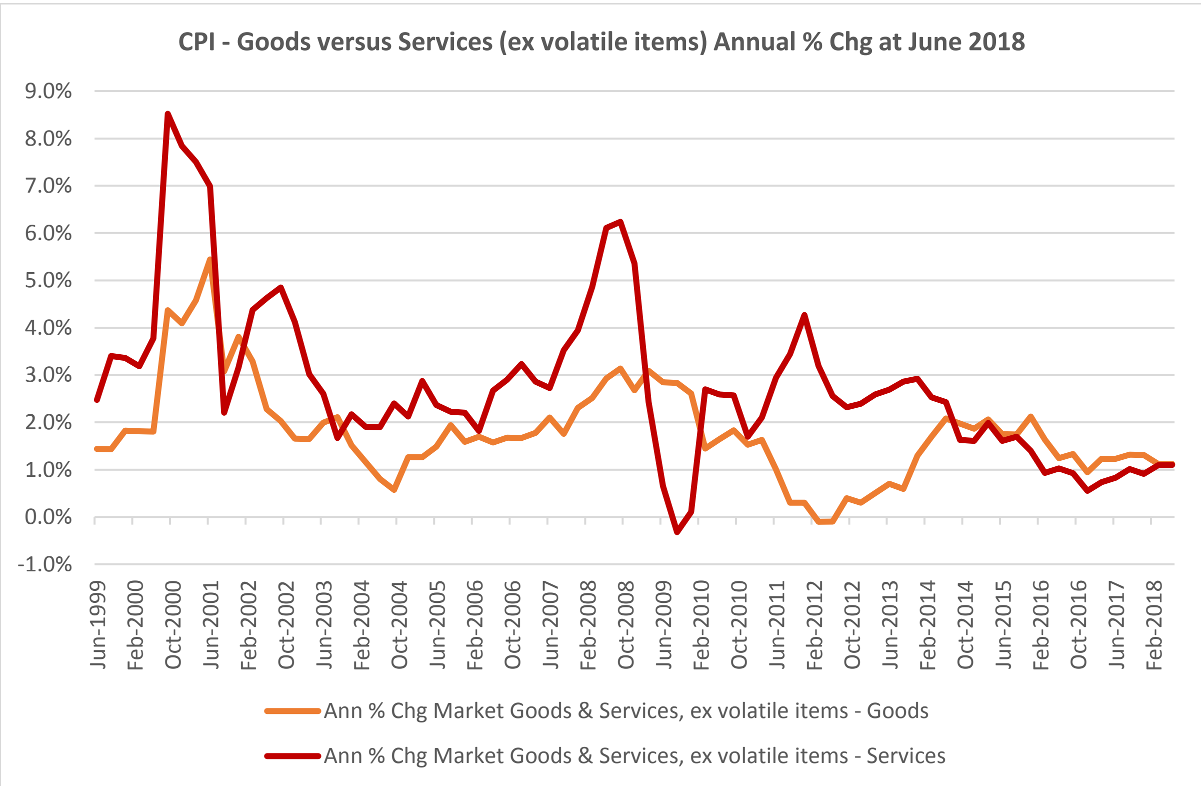
This highlights that underlying price pressures in Australia continue to ease.



From a category perspective, the major contributor to price increases in the latest quarter (headline) was transport, with automotive fuel jumping 7% in Q2 v Q1;



On a goods and services basis, the annual growth in prices is even lower. Total Goods & Services ex volatile items grew by only 0.18% in the latest quarter and +1.1% on an annual basis. Services ex volatile items fell -0.1% in Q2 v Q1 and Goods ex volatile items grew by +0.4% in Q2 v Q1.



Despite the low inflation read, its not likely that the RBA will commence a rate cutting cycle.

From the last minutes, the RBA Board highlighted that the strong GDP growth recorded in Q1 supported a further reduction in unemployment and helped to 'return inflation to target'. Progress to towards a lower unemployment rate and an inflation rate 'closer to the mid-point' of the target range was likely to be gradual.

In the past, Governor Lowe has indicated that, given strong employment growth, "it was not in the interest of the welfare of the nation to lower interest rates further, given such low embedded inflation, as this may not generate the inflationary pulse via wages but rather just boost credit growth and further lift asset prices".

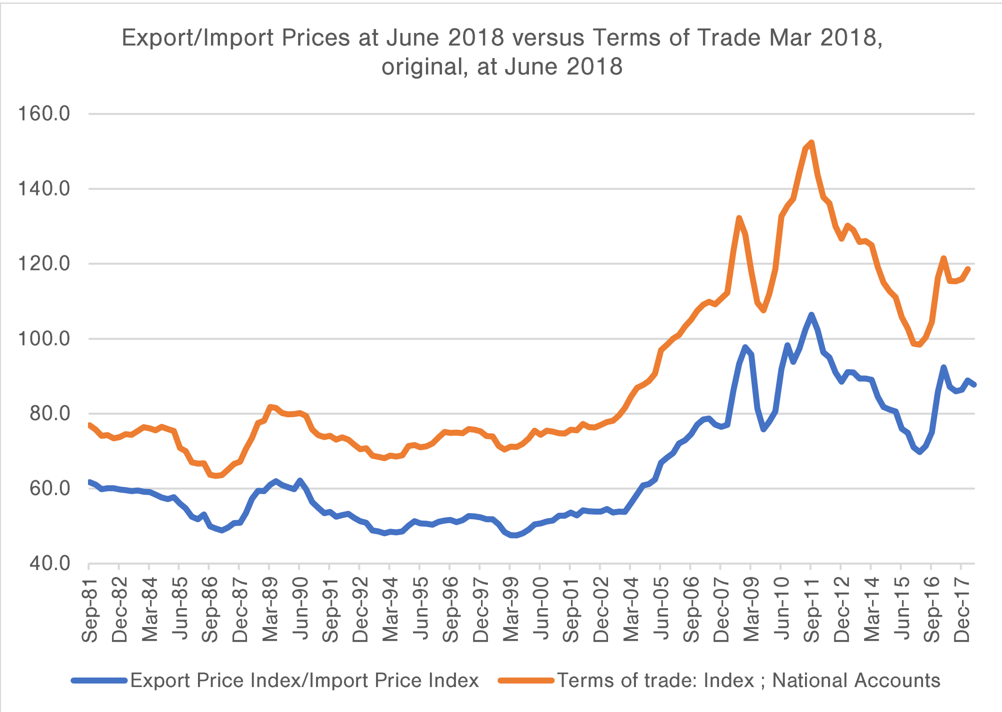
http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6401.0Main+Features1Jun%202018?OpenDocument

Australia – Export and Import Prices (Q2)

Both export and import prices increased in the latest quarter. On a quarter basis, export prices increased at a slower rate then import prices +1.9% and +3.2% respectively. This will likely have a small negative impact on the Terms of Trade Index and National Income calculations.

On an annual basis, export prices increased just slightly ahead of import prices; +6.6% versus +6% respectively. This will likely have a slightly positive impact on the Terms of Trade Index.

Below is a rough calculation of the export price index divided by the import price index. This yields a similar shape of prices compared to the Terms of Trade index (also charted to Mar 2018). The terms of trade index has been the major determinant of National Income (and government budget) results given the large impact of changes in commodity prices for Australia, especially since the mid 2000's.



http://www.abs.gov.au/AUSSTATS/abs@.nsf/productsbyCatalogue/AD48224A384AA1C3CA25765700161B6C?OpenDocument

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Trade

US-China Trade Negotiations

The Office of the U.S. Trade Representative (USTR) held public hearings July 24-25, 2018 regarding proposed tariffs on approximately $16 billion worth of Chinese products (this is the remaining $16b of the original $50b levied in response to unfair trade practices related to technology transfer, intellectual property, and innovation).

Awaiting outcomes of these hearings.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/july/public-hearings-proposed-section-301

Public hearings proposed for 20-23 August for a further investigation and proposal for the additional 10% tariff on $200b in trade value with China (announced 10 July).

NAFTA

High level talks recommenced last week to restart stalled NAFTA negotiations. Both Canadian and Mexican officials confirmed their support for the trilateral nature of the trade agreement.

Mexico's incoming NAFTA negotiator wants to accelerate talks to have an agreement in place within the next two months.

Last week, President Trump had stated that he was in discussions with incoming Mexican President Andres Manuel Lopez Obrador about doing something "very dramatic, very positive for both countries".

The key issues remain unresolved at this stage including automotive rules of origin, five-year sunset provision, and dispute settlement process. An upcoming ministerial meeting is planned.

US-Japan Trade Talks

US Trade Representative Lighthizer has told a senate hearing committee that the first meeting with Japan on a new trade dialogue will be in the next 30 days.

The United States "ought to be negotiating" a free trade agreement with Japan, Lighthizer said. The trade deficit with Japan was the third largest of all trading partners in 2017.

The trade deficit with Japan is "chronic," Lighthizer said. Particularly, he pointed to "unfair barriers" in the country's beef imports.

http://the-japan-news.com/news/article/0004616338

Previously, the Japanese Government has signalled that it would prefer that the US re-join the TPP (rather than negotiate a bilateral trade deal), which they claim is in the best interests of both countries.

https://www.bloomberg.com/news/articles/2018-07-22/abe-s-lieutenant-pours-cold-water-on-bilateral-japan-u-s-fta

Section 232 – Car and Truck Imports

Public hearing last week 19 July on proposed tariffs. Awaiting the outcome of the public hearings.

President Trump met with EC President Jean-Claude Juncker in Washington. For the moment, the threat of auto tariffs has been put on hold as both sides agree to start talks to reduce trade barriers related to all industrial goods other than cars. Steel and aluminium tariffs remain unresolved. President Trump claimed that the EU would “almost immediately” begin buying “a lot of” US soyabeans.

Joint statement; http://europa.eu/rapid/press-release_STATEMENT-18-4687_en.htm

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