MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 06 August 2018

Key Themes

Central banks – the RBA and RBNZ both kept rates on hold last week. The BoJ summary of opinions report highlighted little differences of opinion on recent MP implementation changes. One opinion stood out – "*Under the current policy, the possibility of the inflation rate increasing gradually toward 2 percent is low".*

US data continues to support Fed rate trajectory - CPI continued to grow with CPI ex fuel and food accelerating from 2.3% to 2.4% in June. Services growth (ex-energy services) remained at 3.1%. Consumer credit pulled back in the latest month but was higher overall in Q2 versus Q1. JOLTS, especially job openings, remain at historical highs.

Japan prelim Q2 GDP growth was stronger, driven higher in the quarter by private consumption. What stood out was the acceleration in the growth of compensation of employees in the quarter. Net exports detracted from growth on the back of slower exports.

UK prelim Q2 GDP was also stronger. From the expenditure perspective, a large adjustment was applied to changes in inventories, making investment look stronger. Services continued to grow and contributed most to overall GDP growth. Construction reversed last quarters decline but was offset by a decline in total production (incl manufacturing).

On the trade front, the USTR confirmed that tariffs on the remaining $16b of the original $50b of Chinese imports would go into effect from 23 August 2018.

Contents

US Data

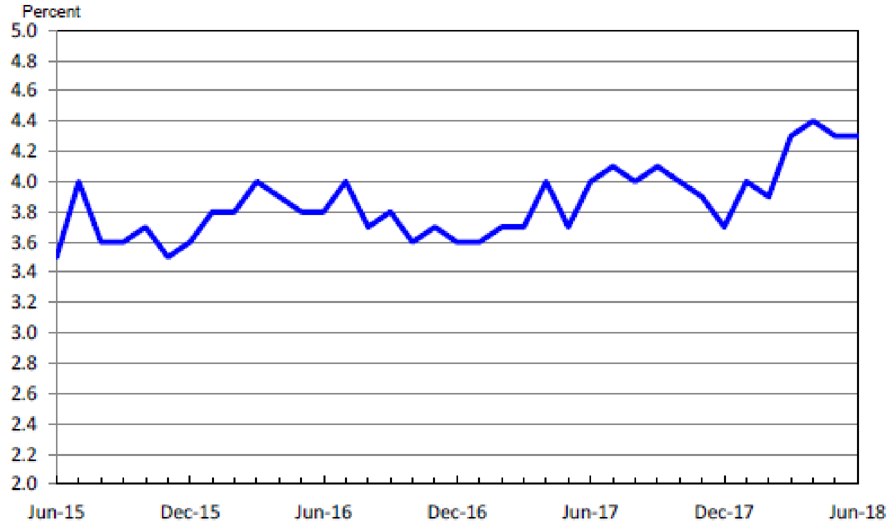
JOLTS (June)

Overall report is little changed from the prior month, remaining at historically high levels.

<u>Job Openings</u>; June 6.662m versus May 6.659

The job opening rate was unchanged at 4.3% (total) versus the month prior.

Chart 1. Job openings rate, seasonally adjusted, June 2015 - June 2018



On a regional basis, there was little change in the job openings rate between the two months. The job opening rate in the Midwest continues to be higher than the National average at 4.7% and the rate in Northeast is below the National average at 4%.

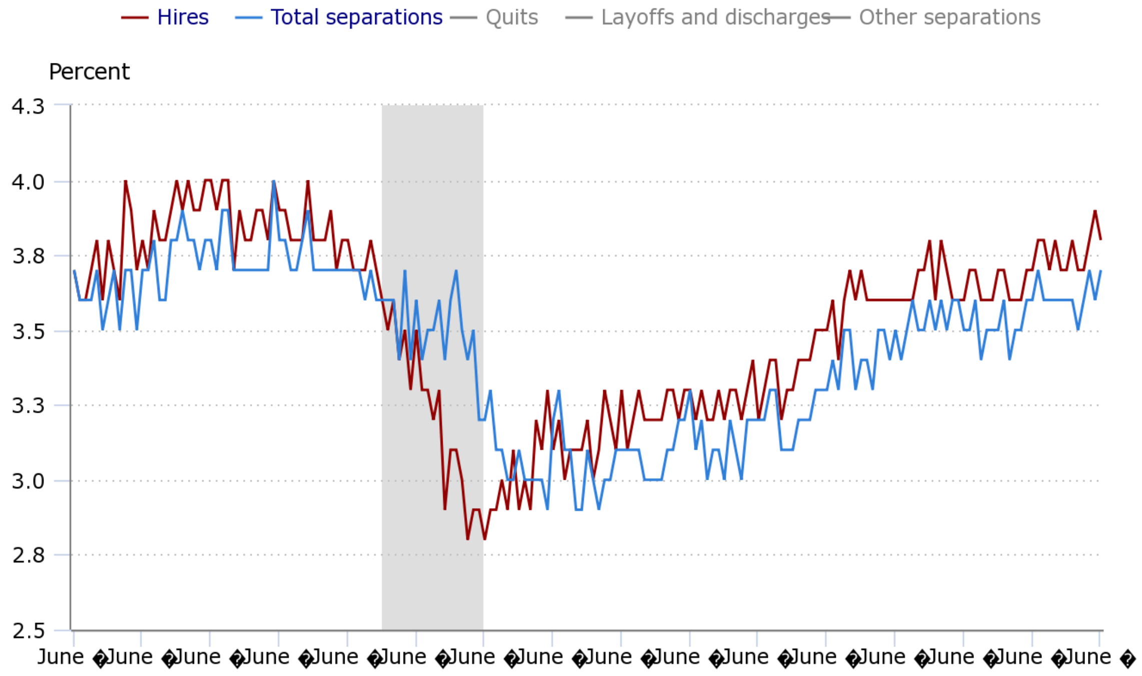
<u>Hires;</u> June 5.651m versus May 5.747

The hire rate fell to 3.8% in June from 3.9% in May

Despite the job opening rate at historically high levels (and exceeding previous highs), the hire rate is yet to exceed previous highs (prior to the GFC). A hire is defined as the total number of additions to the payroll (in the refence period).

Total nonfarm hires and separations rates, seasonally adjusted

Click and drag within the chart to zoom in on time periods



Hover over chart to view data.
Note: Shaded area represents recession, as determined by the National Bureau of Economic Research.
Source: U.S. Bureau of Labor Statistics.

Note: x-axis range for the chart above is June 2003 – June 2018

From a regional perspective, the South has the highest hire rate at 4.2% and well above the National average of 3.8%. The Northeast has the lowest hire rate at 3.3%. The West is also underperforming versus the National average with a hire rate of 3.6%.

<u>Separations;</u> June 5.502 versus May 5.419

The separations rate increased slightly in June to 3.7% versus 3.6% in May.

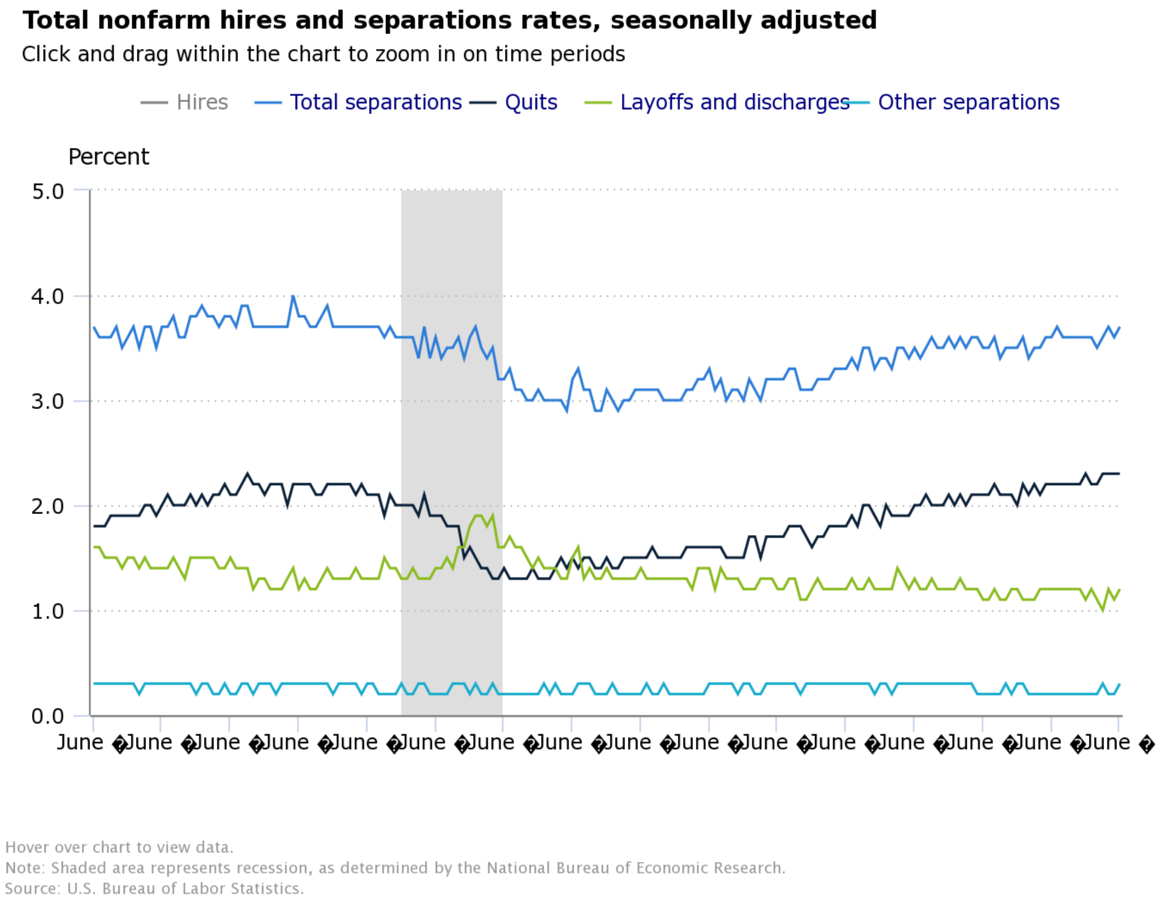
Separations overall have been led higher by quits, rather than layoffs. This was reversed in the latest month data with quits lower and layoffs slightly higher.

Quits; June 3.402m versus 3.480 May (rate unchanged at 2.3%)

- The quit rate was unchanged in the Midwest and all other regions the quit rate decreased.

Layoffs; June 1.723 versus May 1.681 (rate increased from 1.1% in May to 1.2% in June)

- The layoff rate increased in Northeast, South and notable in the West region and declined in the Midwest.



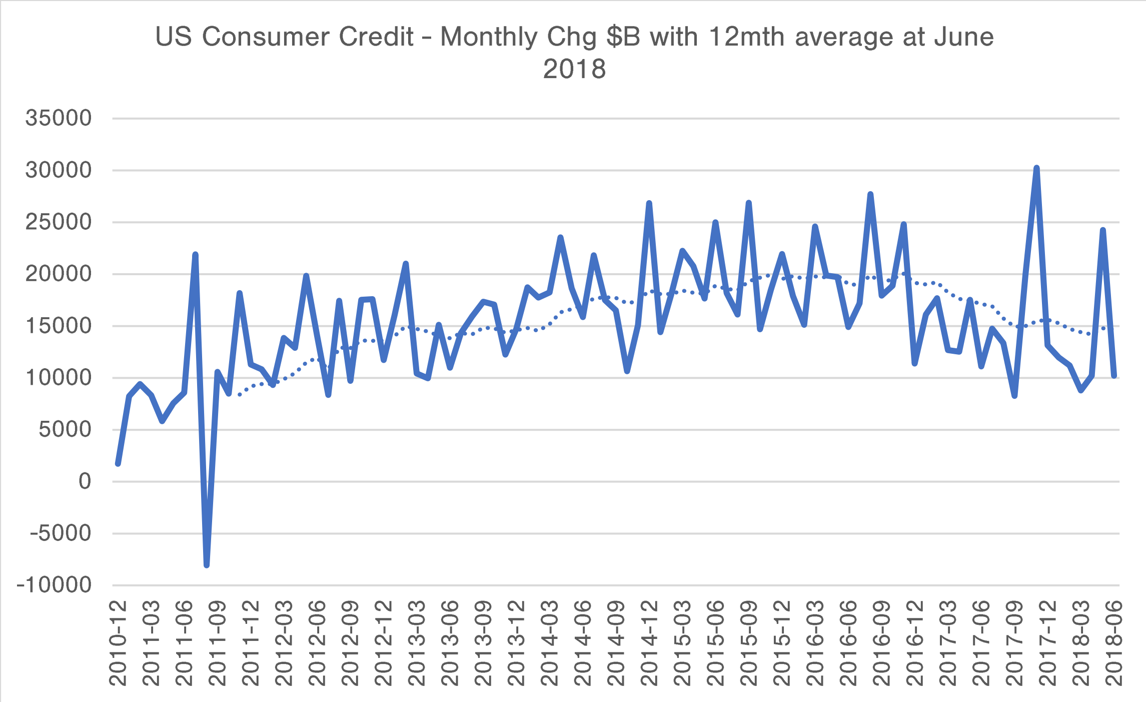
Note: x-axis range for the chart above is June 2003 – June 2018

https://www.bls.gov/news.release/jolts.nr0.htm

Consumer Credit (June) – US Fed G.19 Report

The growth in outstanding consumer credit slowed in the latest month; +$10.2b June versus +$24.2b in May (revised slightly lower).

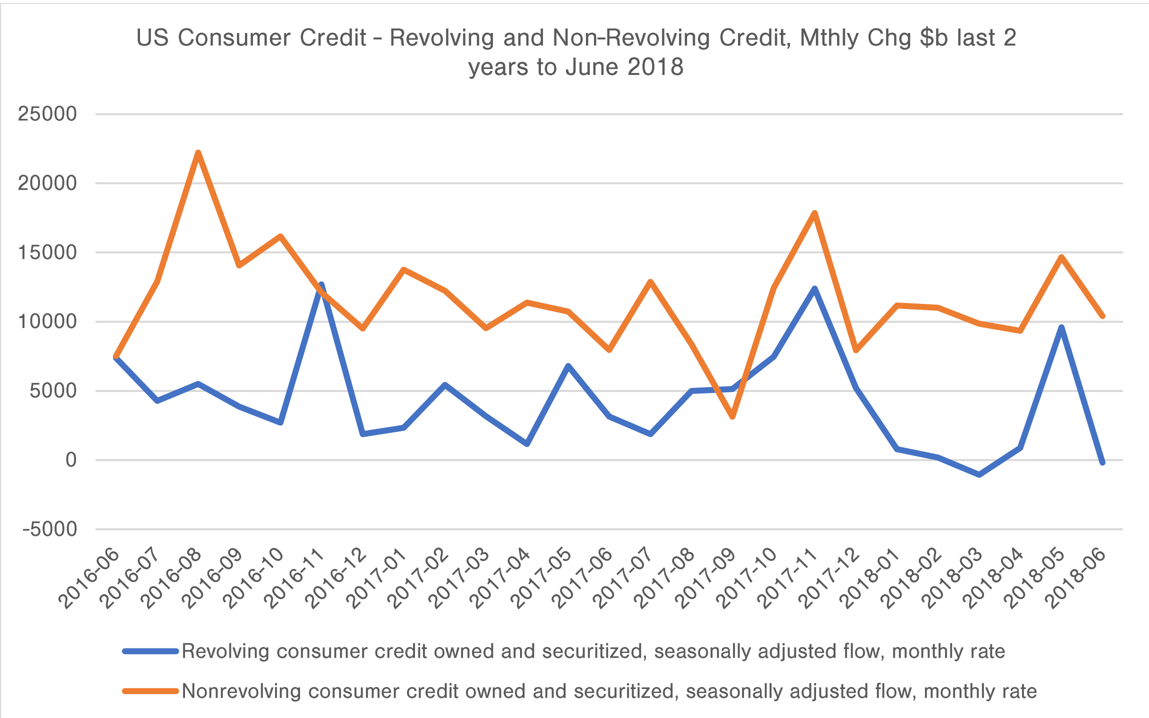
Despite the slower growth in the month, the Q2 total growth was +$44b versus +$32b in Q1 and +$63b in Q4 2017. The acceleration in credit growth in Q2 v Q1 helped both retail sales growth and household consumption growth in Q2 GDP.



In the latest month; The slow-down in growth was across both revolving and non-revolving credit;

Revolving credit declined slightly; -$0.2b June versus +$9.5b May

Non-revolving credit grew; +$10.4b June versus $14.7 May



A slow-down in credit growth is likely to result in more moderate consumption growth. But so far, the trend (12mth average) suggests that credit growth has stabilized since late 2017.

https://www.federalreserve.gov/releases/g19/current/

US Wholesale Sales and Inventories (June)

Monthly wholesale sales declined in the latest month;

June -0.1% versus +2.1% in May

Annual growth +10.2%

The decline in the month was the result of a decrease in non-durable wholesale sales, but growth in durable goods also slowed in June;

Durable Goods +0.2% June versus +1.4% May

Non-durable Goods -0.3% June versus +2.8% May

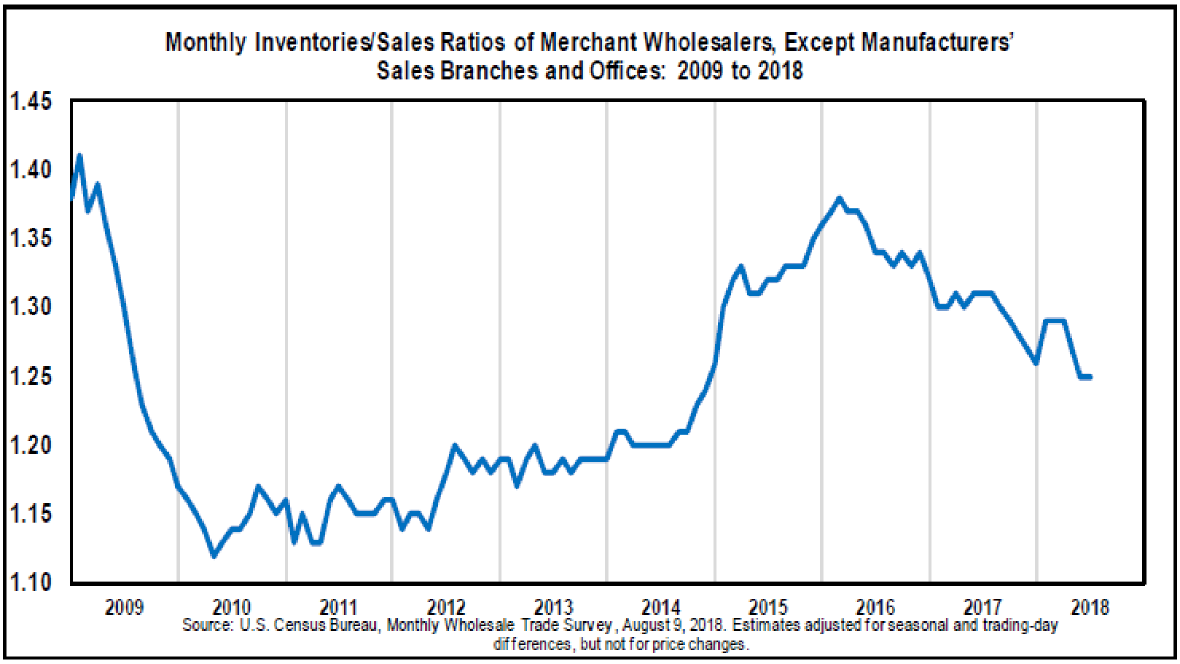
Misc non-durable was the major contributor to the decline in the latest month, but also professional and computer equipment.

Inventories increased slightly in the month, but slower than the month prior;

June +0.1% versus +0.3%

Again, non-durable goods inventories led the slowdown declining by -1% (versus +0.4% May). This was offset by the acceleration in growth of durable goods inventories (the larger of the two by value), growing by +0.8% June versus +0.3% May.

The sales to inventory ratio remained unchanged at a total level at 1.25

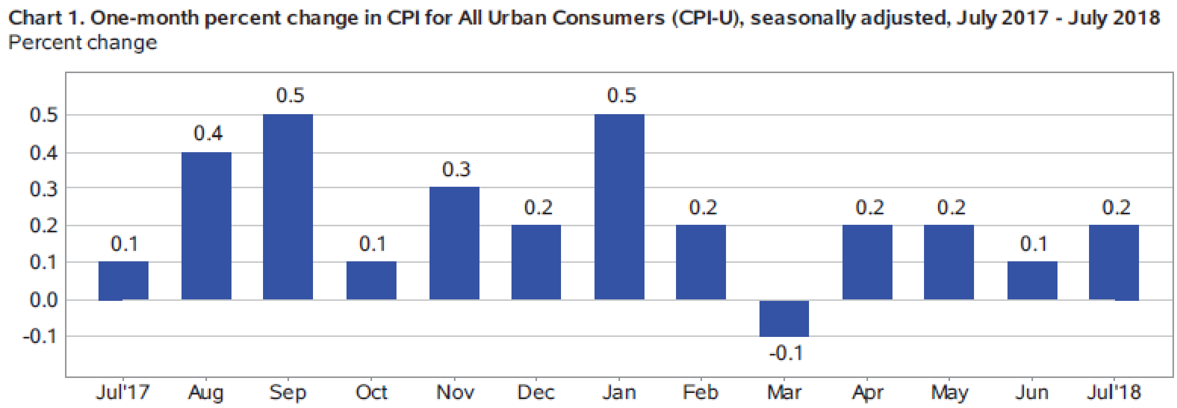


https://www.census.gov/wholesale/pdf/mwts/currentwhl.pdf

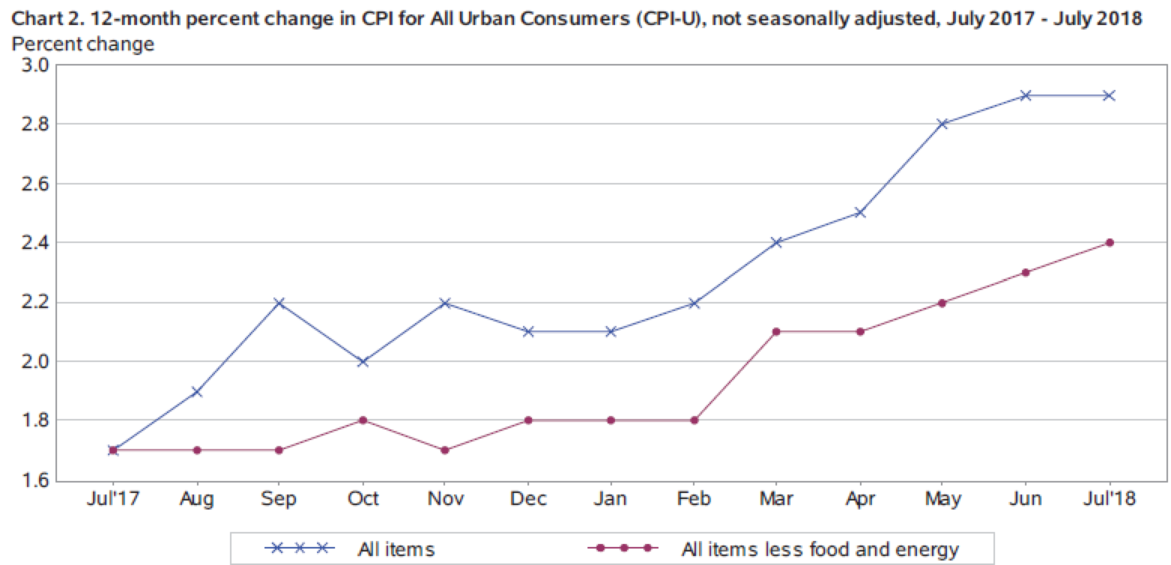
US – CPI (July)

Headline CPI in the US grew by +0.2% in the July. This was faster than the +0.1% growth recorded in June.

One of the larger items by weight in the index – Shelter, grew at +0.3% in July and accounted for approx. 60% of the seas adj index increase in headline CPI for the month.



<u>Annual CPI </u>grew by +2.9% in July – the same rate as in June;



The energy price index has been a large contributor to headline growth in CPI over the last year, growing at +12% year on year, but declined in July by -0.5%. On an annual basis, energy is approx 8% of the CPI weight but accounted for approx. 33% of the annual CPI change.

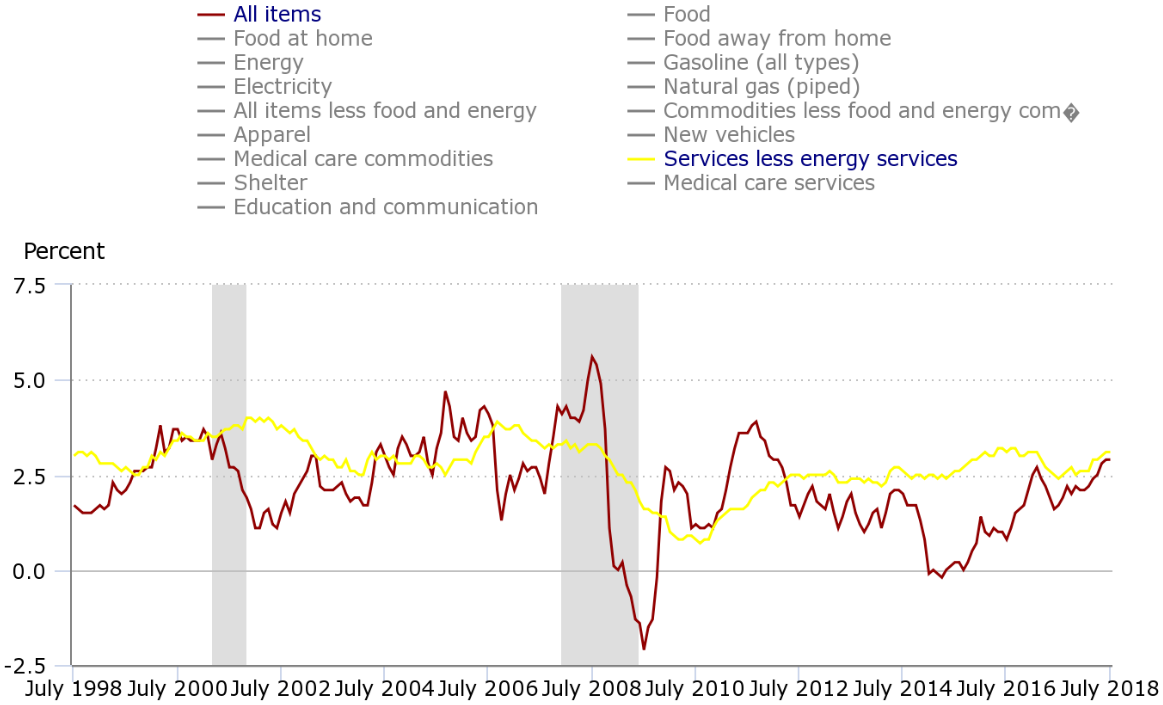
Food continues to grow at +1.4% annually, still below the headline rate. It accounts for 13% of the index and only 6% of the annual change in CPI.

<u>Annual CPI ex food and energy</u>; +2.4% in July, up from +2.3% in June

Services (less energy services) grew by +3.1% (annual) and accounts for approx. 62% of the change in CPI on an annual basis. Within this, Shelter is growing at 3.5% - it accounts for approx. 34% of the total CPI index by weight and accounted for approx. 40% of the annual change in CPI. Transportation services is also growing by 4% but accounts for a much smaller change in the CPI.

Services (less energy services) make up the majority of the CPI and provide a gauge of underlying price pressure. While Services have been growing at a steady pace since 2012, it has started to accelerate since the start of 2018. Headline CPI has been catching up recently.

12-month percentage change, Consumer Price Index, selected categories, not seasona adjusted



Hover over chart to view data.
Note: Shaded area represents recession, as determined by the National Bureau of Economic Research.
Source: U.S. Bureau of Labor Statistics.

Commodities less energy commodities continue to show little growth 0% annual growth at July. This group accounts for 19% of the total CPI index and accounted for -0.25% of the annual change in CPI.

https://www.bls.gov/news.release/pdf/cpi.pdf

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Europe

German New Factory Orders (June)

A large fall for manufacturing new orders in June;

June -4% versus May +2.6% and -0.8% versus June 2017

This is broadly consistent with the June PMI for manufacturing – when new order growth was at a 2yr low (which has improved slightly in July).

Demand weakness was across both domestic and foreign markets and different stages of the manufacturing process;

Domestic; June -2.8%

Foreign; June -4.7%

Manufacturers of Intermediate goods; June -2.3%

Manufacturers of capital goods; June -4.7%

Manufacturers of consumer goods; June -4.5%

The chart above shows that domestic demand has been a source of weakness recently and now non-domestic demand has also started rolling over.

On a more positive note, the German Manufacturing PMI in July showed improved demand, although still at lower levels.

https://www.destatis.de/EN/PressServices/Press/pr/2018/08/PE18_287_421.html

German Industrial Production (June)

Industrial production in June also slowed;

Production; June -0.9% versus May +2.4% and +2.5% versus June 2017

Production was lower across a range of industries, but energy production had increased;

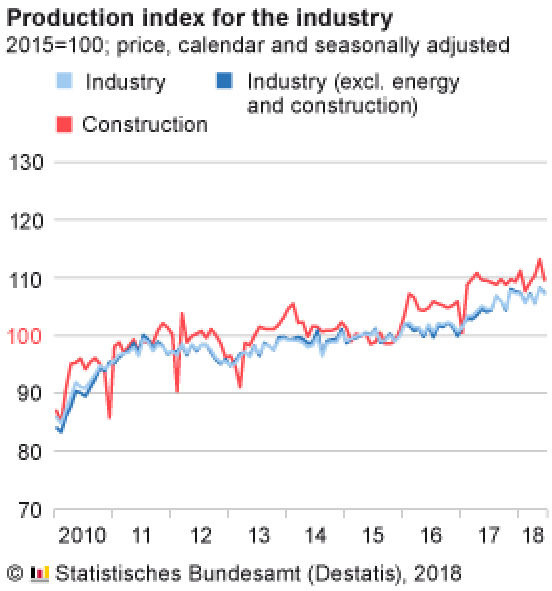
Production of capital goods; June -0.6%

Production of consumer goods; June -1.6%

Production of intermediate goods; June -0.8%.

Energy production; June +2.9% in June 2018

Production in construction; June -3.2%.



https://www.destatis.de/EN/PressServices/Press/pr/2018/08/PE18_289_421.html

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Japan

BoJ Summary Opinions Report – Meeting 30-31 July 2018

The points relating to the section "Opinions on Monetary Policy" were of most interest, given the changes made at the last meeting. Here were some of the common themes;

An undercurrent of recognising the 'consequences' of prolonged easy monetary policy. Likely referring to the smooth operation of JGB markets and 'other risks' related to the conduct of monetary policy (eg bank profitability).

There appeared to be a range of opinions for the range of JGB yield of between +/- 0.2%pts and +/- 0.25%pts.

Forward guidance – to build confidence in achieving the target and to stoke inflation expectations.

Looking for more easing, not just a stronger framework – so that monetary easing is not prolonged (too late).

A stronger more sustainable framework is required because the BoJ looks like continuing monetary easing for much longer (deflation mindset is well entrenched)

"Under the current policy, the possibility of the inflation rate increasing gradually toward 2 percent is low"

https://www.boj.or.jp/en/mopo/mpmsche_minu/opinion_2018/opi180731.pdf

Japan – Prelim Q2 GDP

GDP growth accelerated in Q2 (real GDP, Chained Yen basis, seasonally adj);

Quarterly growth; Q2 2018 +0.5% versus Q1 -0.2%. Q2 2017 growth: +0.5%

Annual basis (unadjusted); Q2 +1% versus Q1 +1%

In the latest quarter, overall GDP growth was driven predominantly by Private Consumption;

Domestic demand; contributed +0.6%pts to the quarter growth and grew by +0.6% versus the prior quarter. This is a large turnaround from the prior quarter result of -0.3% decline.

Public demand; made a <0.1%pt contribution to growth and grew by +0.2% over the quarter. Public investment continued to decline the in the latest quarter.

Net Exports; detracted from overall growth -0.1%pts. Exports grew by +0.2% - the lowest rate since Q2 2017. Imports grew by +1% over the quarter.

One point of note in the results was the acceleration in growth of Compensation of Employees (real); Q2 +1.9% versus Q1 +1.2%

http://www.esri.cao.go.jp/en/sna/data/sokuhou/files/2018/qe182/pdf/main_1e.pdf

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United Kingdom

BRC like for like Retail Sales (July)

On a like for like basis, retail sales grew by a modest +0.5% in July (versus July 2017), falling short of expectations.

Food categories were the strongest – mostly due to the world cup. Food recorded the 'best year on year uplift since 2013'.

https://brc.org.uk/retail-insight-analytics/retail-sales-reports/retail-sales-monitor/reports?id=28163

UK – Prelim Q2 GDP

GDP growth accelerated in the UK in Q2. There is however an important note on inventory adjustment from an expenditure perspective.

Quarterly growth; Q2 2018 +0.4% versus Q1 +0.2%

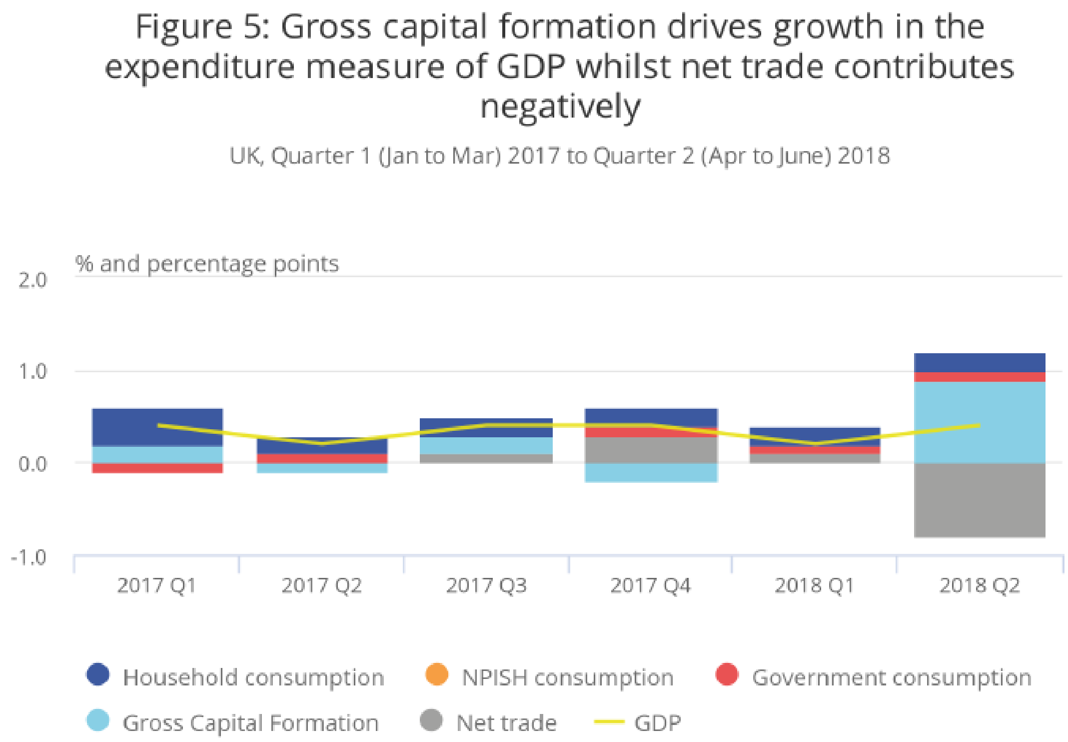
This lifted the annual rate of growth from +1.2% in Q1 to +1.3% in Q2

Expenditure Measures of GDP:

There were two main impacts in the Q2 GDP results.

There was a very large turnaround in gross capital formation (GCF) from 0%pt contribution to growth in Q1 to +0.9%pt contribution to growth in Q2. In growth terms; the total GCF grew by +5.2% in the latest quarter versus -0.2% in the Q1.

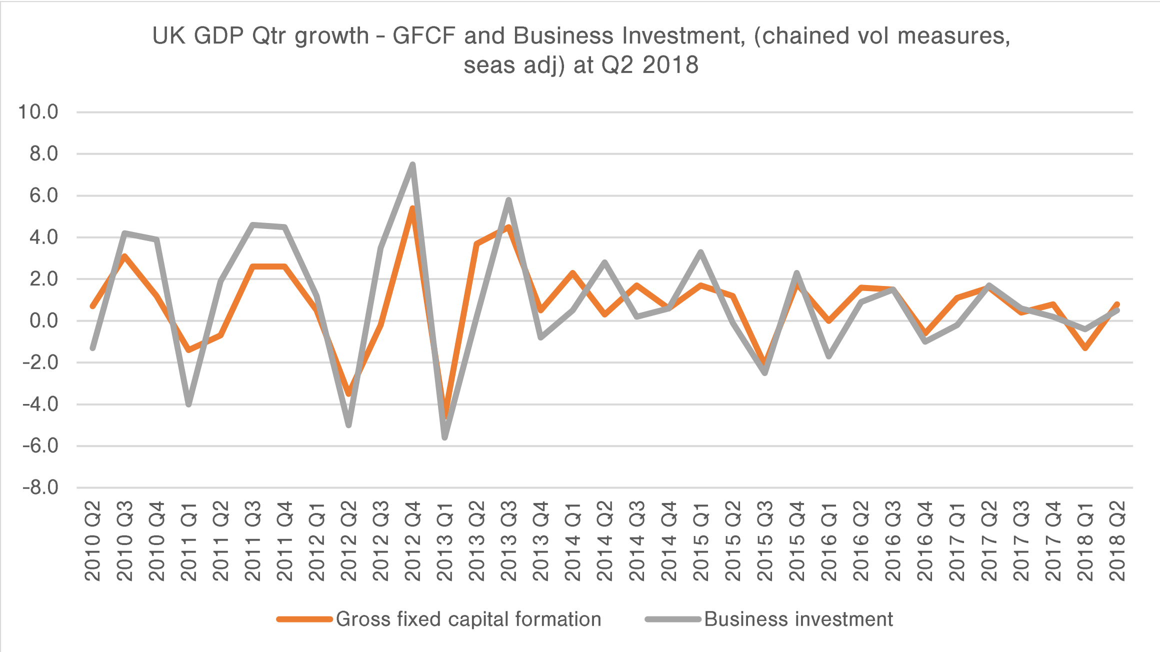
UK, Quarter 1 (Jan to Mar) 2017 to Quarter 2 (Apr to June) 2018



But that doesn't mean that investment has suddenly taken off in the UK. Total Gross Cap Formation is the sum of 1) Gross Fixed Cap Formation, which includes Bus Investment, 2) changes in inventories, 3) an alignment adjustment item and 4) acquisition less disposals of valuables.

In this quarter, the contribution of the Gross Fixed Capital Formation (GFCF) component was much smaller than total GCF suggests. Gross fixed capital formation contributed only +0.1%pts to GDP growth in the quarter and the Business Investment sub-component contributed < +0.1%pts. Importantly, both components still had modest turnarounds in the latest quarter; the GFCF component grew by +0.8% after -1.3% in Q1 and Business Investment grew by +0.5% in Q2 versus -0.4% in Q1.

The quarterly growth for both components has remained more subdued in recent quarters;



Two points from the ONS on the capital formation data this quarter;

"This notable difference is due mainly to a sharp rise in non-monetary gold (NMG) in the quarter, particularly in April and May. NMG is recorded within the national accounts as a change to valuables, within GCF. However, movements in NMG do not affect headline GDP as an equivalent impact is recorded in trade in goods and services."

"Users should be aware that **a number of adjustments have been applied to the change in inventories component in Quarter 2 2018** to help balance the different measurement approaches to GDP."

Data found at;
https://www.ons.gov.uk/economy/grossdomesticproductgdp/datasets/uksecondestimateofgdpdatatables

On the negative side, there was a large turnaround from the contribution of net exports, from +0.1%pts in Q1 to -0.8%pts in Q2.

The contribution of household and government consumption remained both remained unchanged in the latest quarter, each contributing +0.2%pts and +0.2%pts respectively to the overall +0.4% quarter growth.

Output Measures of GDP;

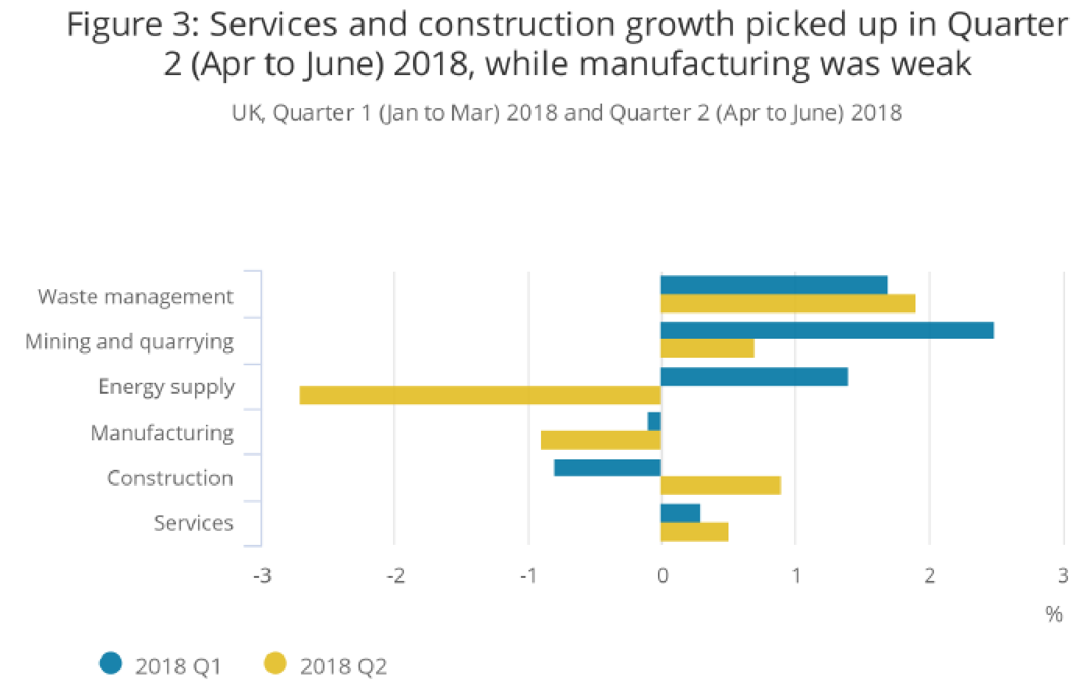
The biggest changes were;

Construction growth in Q2 +0.9% versus -0.8% in Q1. This contributed +0.1%pt to overall GDP growth in the quarter.

Services growth accelerated and added +0.4%pts to growth in the quarter.

Whereas Total Production (incl Manufacturing) declined by -0.8% in Q2 versus +0.4% in Q1 – most elements of total production contributed to the decline, except for Water Supply & Sewerage.

UK, Quarter 1 (Jan to Mar) 2018 and Quarter 2 (Apr to June) 2018



https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/apriltojune2018

Brexit

Some more positive news on the negotiation front with Ireland and Brussels prepared to compromise on the Northern Irish border backstop to secure a Brexit deal.

There will be another round of negotiations next week on 16 and 17 August – an agenda will be released shortly.

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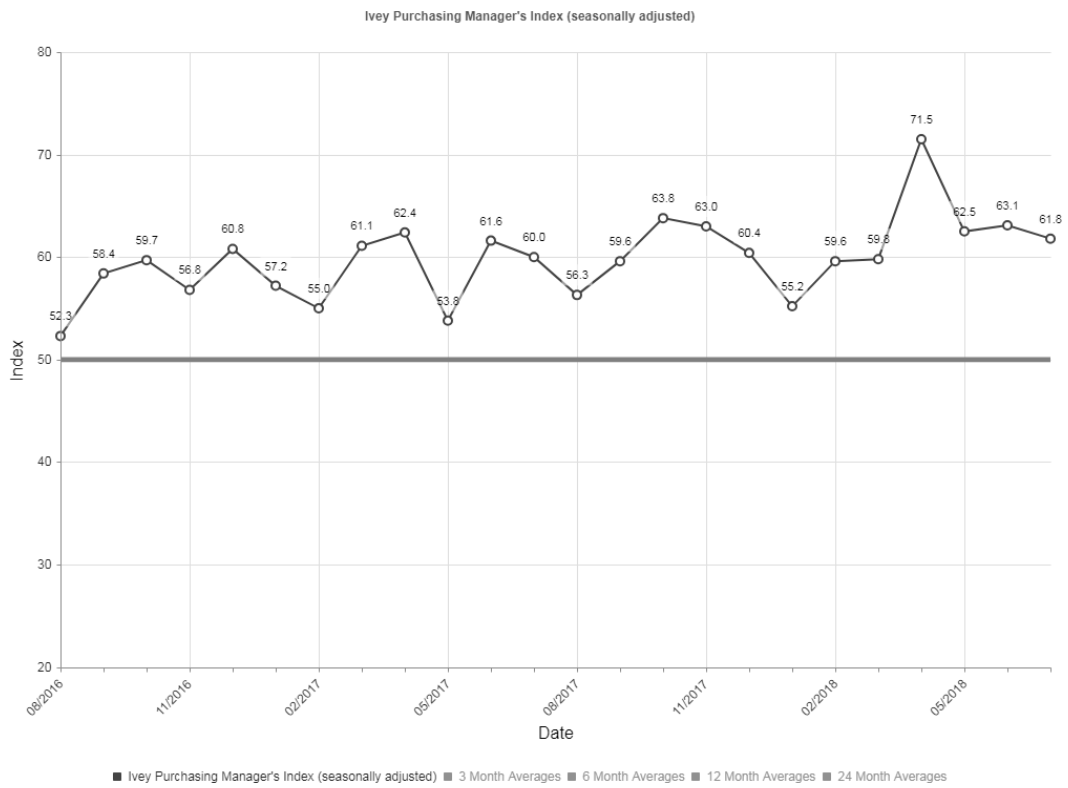
Canada

Ivey PMI (July)

Private sector activity continued to expand throughout Canada in the latest month, but the rate of expansion slowed;

July 61.8 versus June 63.1



Employment growth continues to slow, from 59.3 June to 55.3 July. The recent peak was 61.2 in May.

Growth in inventories picked up in July 56.2 versus 51.7 in June

While growth in prices slowed somewhat in July, it remains at near time high levels; July 71.1 versus Jun 74.3 (the two-year peak).

http://iveypmi.uwo.ca/

Canada – Employment (July)

Higher employment growth for July;

Employment growth was higher for the second month in a row; +54k persons (versus June +31.8). Like June, all the employment growth was PT employment; -28k FT employed and +82k PT employed.

The annual growth in employed persons grew at a faster pace; +245k persons versus +215k in June.

Total unemployed persons declined -34.9k persons in July (versus +43k in June). The decline in July represents half of the annual decline in total unemployed persons of 73.6k persons.

On annual basis, changes in participation are driving the declines in total unemployed persons;

	ANN at July 2018
Est of what underlying pop growth add to LF	261.7
Less annual employment growth	245.9
How many people left without employment?	15.8
Of the people that are left, how many left the LF in the yr to July 2018	-89.4
equals the ann chg in u/e persons	-73.6

On an annual basis, employment isn't growing as fast as the estimate of what underlying pop growth is adding to the labour force. If there had been no change in participation, then total unemployed persons would have increased. But in the latest year, the participation rate has declined by -0.3%pts or almost 90k persons had left the labour force. This resulted in a decline of 73.6k unemployed persons.

This is taken at a point in time, and the trend is important to ascertain whether this situation is improving or not.

To double check; The addition of the what the underlying population growth adds to the labour force and the change in participation is an alternative way to view changes in the total labour force. In this case, both equal the annual (official) change in the labour force of +172.3k persons. This is also the sum of the total annual change in employed persons and unemployed persons – which is the traditional definition of the labour force.

https://www150.statcan.gc.ca/n1/daily-quotidien/180810/t001a-eng.htm

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Australia

RBA – Rates Decision August

The RBA left the Official Cash Rate (OCR) on hold at 1.5%.

(The RBA target band for inflation (CPI) is 2-3% and the latest core CPI data highlighted that CPI growth has slowed down and is outside of this band. The current unemployment rate is 5.4%)

Guidance; Low rates continue to support the economy, holding rates will be consistent with achieving a reduction in unemployment (to 5%) and inflation back up and into the 2-3% range – this progress is likely to be gradual.

Growth forecast: average "a bit above 3%" in 2018-19 (current 3.1%)

Changes to the RBA statement comparing the last two statements;

- Shift in the view of China "growth has slowed a little and authorities easing policy" – in the prior month had stated that "Chinese economy continues to grow solidly".
- Higher money market rates. The RBA did not elaborate on the prior statement that "other factors were also at work' or any further details as to why these factors have persisted. The bank points to average mortgage rates being lower than a year ago.
- An expectation for a further reduction in spare capacity was mentioned for the first time – presumably linked to the expected reduction in unemployment. *(NOTE: based on the charts we shared a few weeks ago on the Aus labour market, the 'spare capacity' is most likely to be eroded once male participation starts to increase.)*
- Difficult drought conditions were mentioned in the latest statement – also presumably linked to risks regarding household consumption spending.
- The RBA looks to have established its forecast for unemployment target at 5%
- The RBA is expecting lower interim inflation, as one-off declines in administered prices will be reflected in the Sept qtr data.

August; https://www.rba.gov.au/media-releases/2018/mr-18-17.html

July: https://www.rba.gov.au/media-releases/2018/mr-18-16.html

Housing Lending (June)

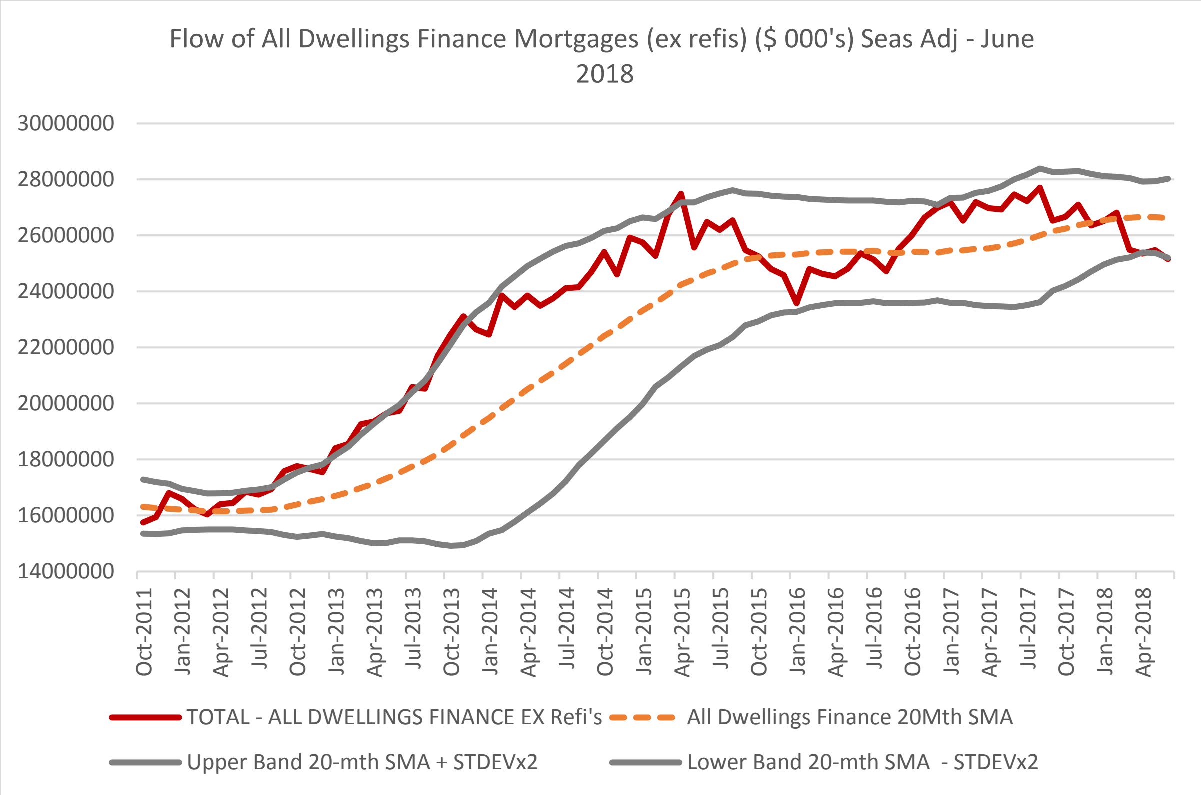
At the total level, the flow ($ value) of new housing lending commitments declined in the latest month;

Monthly change all dwellings finance (ex-refi's); June -1.2% versus May +0.5%

Annual change all dwellings finance (ex-refis) (current month versus same month prior year);

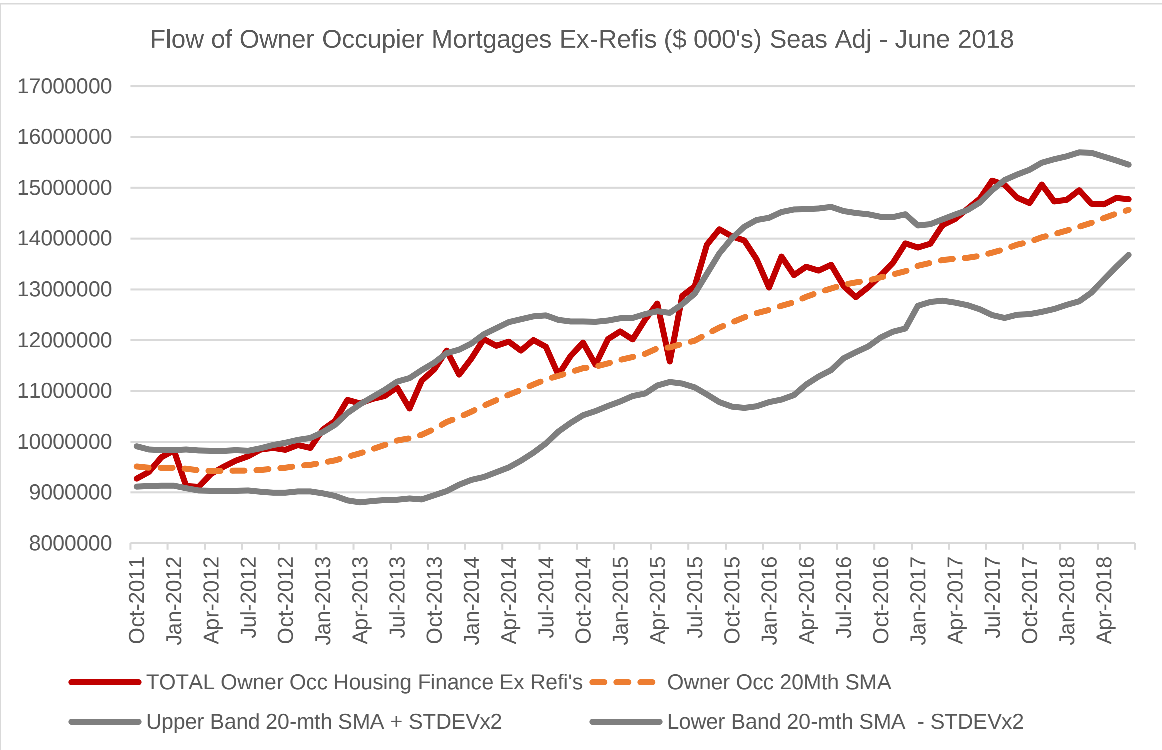
June -8.4% % versus May -5.4%.

These are important levels, as the total value of new housing finance commitments is sitting at -2 SD's of the 20month SMA.

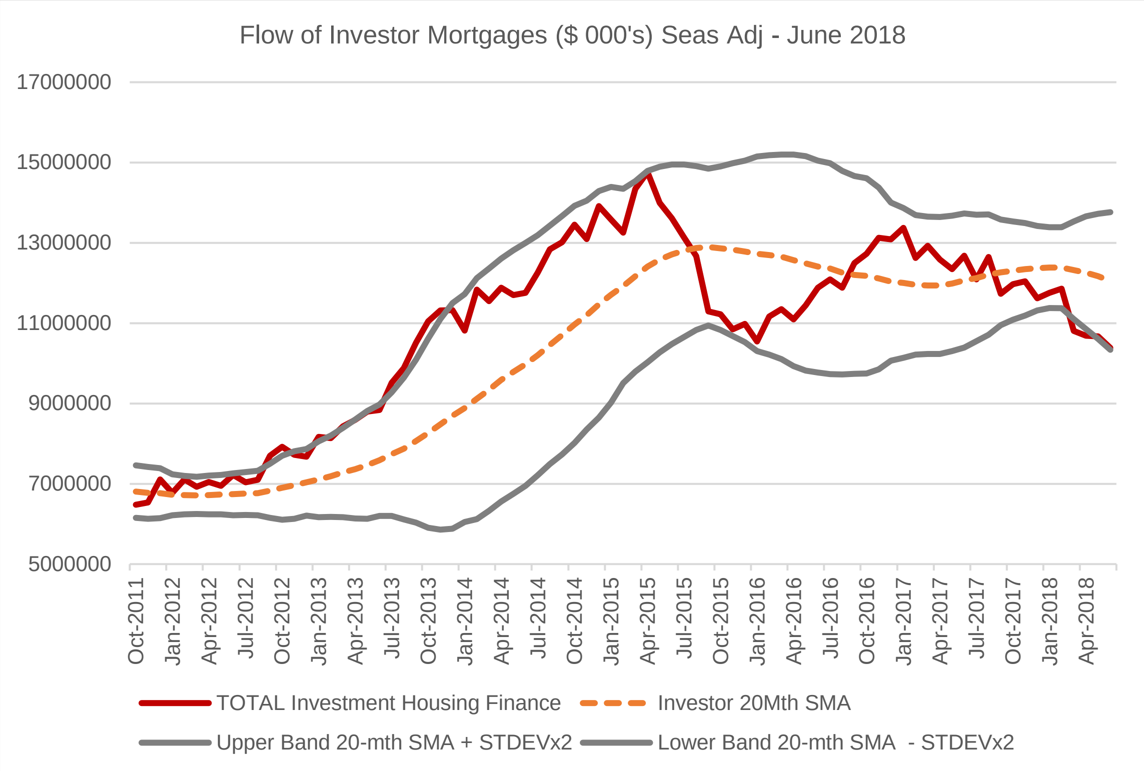


The total was lower mostly due to the decline in Investor housing commitments, while owner occupier housing lending was virtually flat.

Owner occupier housing commitments have slowed. The total is above the 20mth SMA, but still below 2017 peaks;



Investor lending housing commitments registered a large fall in the latest month, -18% versus June 2017.



The implications of the slowing/declining lending have been seen in slower growth and outright declines in house prices. The scale of the price declines is limited so far, but if they continue, it will make it difficult for those with little equity in their houses/apartments.

The RBA will keep rates on hold (cut likely if employment deteriorates). It will want to keep supporting the housing market, not to drive housing commitments to new highs, but to ensure household mortgage stress doesn't become widespread.

http://www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyCatalogue/05DBCE56402EC566CA25723D000F2999?OpenDocument

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Other

China – Trade data (July)

China's trade surplus narrowed.

Exports grew at a slightly slower than expected pace +6% (previous +3.1%)

Growth of imports accelerated +20.9% (versus previous 6%)

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Trade

US-China Trade

Public hearings were held 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). **The USTR has now finalised those details and has advised that "Customs and Border Protection will begin to collect the additional duties on the Chinese imports on August 23".** Full statement here; https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/august/ustr-finalizes-second-tranche

Tariffs initially announced on 10 July - 10% tariff on $200b in trade value - may be increased to 25%. In light of the possible increase of the additional duty rate to 25% the close of the written comment period has been extended from 30 August to 6 September. The due date for requests to appear at the public hearing have also been extended.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/august/statement-us-trade-representative

China reacted to the possible increase of the tariff rate to 25% by announcing an import tax on approx. $60b of US imports with the tax rate ranging from 5% - 25%.

US-Japan trade talks

Cabinet level talks went ahead during the week but have no confirmed outcomes after two days of negotiation. The Japanese negotiators requested that no additional car tariffs be imposed as negotiations continue, citing 'mutual trust'.

President Trump and Japanese PM Abe meet in late Sept 2018.

https://asia.nikkei.com/Economy/Trade-War/US-and-Japan-avoid-full-collision-in-trade-talks

Section 232 – Car and Truck Imports

Awaiting the outcome of the public hearings (19 July) and submissions.

https://www.federalregister.gov/documents/2018/05/30/2018-11708/notice-of-request-for-public-comments-and-public-hearing-on-section-232-national-security

NAFTA

Negotiations between US and Mexico continue. Key issues remain unresolved, but parties believe a deal is still possible by the end of August. Talks will resume this week.

Canada is yet to rejoin the negotiations. President Trump has again threatened tariffs on auto imports from Canada if a deal cannot be reached citing high tariff and trade barriers between the two countries.

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