Weekly Macro Review

w/c 20 August 2018

Key Themes

From Jackson Hole, the Fed Chairman reiterated his key principal that rate hikes that are too fast or too slow are undesirable. The path for interest rate increases will continue to be gradual and based on the incoming data. The data so far – good jobs and growth numbers and low inflation.

The FOMC minutes provided further insight, especially around yield curve inversion – and highlights the range of opinions that exist regarding how members view yield curve inversion. It's possible the yield curve could invert in the short-term (already flat) – it's not clear how the FOMC members will balance "good data" with possibly hiking into an inversion. The next FOMC meeting is 26 Sept and rates are expected to increase.

The RBA minutes continued to highlight that while the next move in rates is likely to be up, there was no strong case for move in the near-term.

US-Mexico trade talks appear to be making headway, especially on key issues regarding the easing of the sunset clause requirement. The Canadian Foreign Minister has stated that Canada will re-join NAFTA negotiations once the US-Mexico deal agreed.

US-China negotiations did not appear to produce any further progress on stalled talks.

Brexit talks last week also appeared to have made little headway. The EU and UK negotiators have now made negotiations ongoing to meet key deadlines. The UK parliament returns next week, and key trade and tax bills will be in focus.

Data across the board remains mostly good with a few pockets of weakness;

US flash PMI's highlighted that services and manufacturing continued to grow, but at a slightly slower pace in August, Durable Goods new orders and shipments declined in July.

Eurozone flash PMI's highlighted a consistent rate of growth in August – but with a gap between the faster growth of core nations and the slowing growth in the periphery nations.

Japan flash PMI for Manufacturing highlighted a slightly faster pace of expansion led by domestic demand. Export orders have declined for 3 months in a row. CPI increased in July and the core annual rate accelerated slightly.

Contents

US Data

US Fed – FOMC Meeting Minutes 31 Jul – 1 Aug

On current monetary policy;

If incoming data continues to support current economic outlook, "it would likely soon be appropriate to take another step in removing policy accommodation". Participants generally expected that further gradual increases in the target range for the federal funds rate would be consistent with a sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective over the medium term.

The current stance of monetary policy remained accommodative.

Statement that "the stance of monetary policy remains accommodative" would need to be replaced as federal funds rate moving closer to the range of estimates of its neutral level.

Economic outlook;

Real GDP to grow at a slightly slower pace in H2 v H1, but relative to the forecast in June, the projection for real GDP growth was revised up a little, primarily in response to stronger incoming data on household spending.

Overall a positive evaluation of current US economic conditions; stronger GDP growth in H1 2018, PCE price inflation remained at 2% and longer-term inflation expectations were little changed, non-farm payrolls continued to grow.

Operating framework;

The Chairman suggested that the Committee would likely resume a discussion of operating frameworks in the fall, including implications of changes in financial market regulations for the demand for reserves and for the size and composition of the Federal Reserve's balance sheet.

Other points of note;

Yield curve inversion was noted; there appears to be some range of opinions on what that means as an indicator. Inversions have often preceded recessions, keep an eye on slope of the yield curve, but "inferring economic causality from statistical correlations was not appropriate" an inversion of the yield curve might not have the significance that the historical record would suggest; the signal to be taken from the yield curve needed to be considered in the context.

[Given where spreads currently are, yield curve inversion is a distinct possibility in the near future. These latest minutes clearly highlight a range of views on the what it means for the inversion of the yield curve.

The path of 'gradual' rate increases has always been 'dependant on the incoming data'. No doubt the FOMC will be watching for an inversion and will decide, based on the data, whether to continue with hikes irrespective of inversion.]

Financial conditions remain accommodative - there were several reports of an easing of credit standards.

Given the increase that we saw in consumer credit growth in May and to a lesser extent in June - "A moderate net fraction of July SLOOS respondents reported easing standards on auto loans over the previous three months after several quarters in which banks had reported tightening standards. However, a significant net fraction of banks reportedly continued to tighten standards for credit card accounts."

Assessment of financial system vulnerabilities; moderate on balance, vulnerabilities associated with asset valuations pressures; elevated, financial sector leverage, maturity and liquidity transformation; low, household leverage; low to moderate, and vulnerabilities from leverage in the non-financial business sector; elevated.

Risks to the projections – tax cuts could provide more stimulus to household and business spending than forecast. On the downside, fiscal stimulus could provide less impact because of "current tightness" around resource utilization, trade policies could have a negative effect on growth, in the event of a major escalation in trade disputes, the complex nature of trade issues, including the entire range of their effects on output and inflation, presented a challenge in determining the appropriate monetary policy response.

https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20180801.pdf

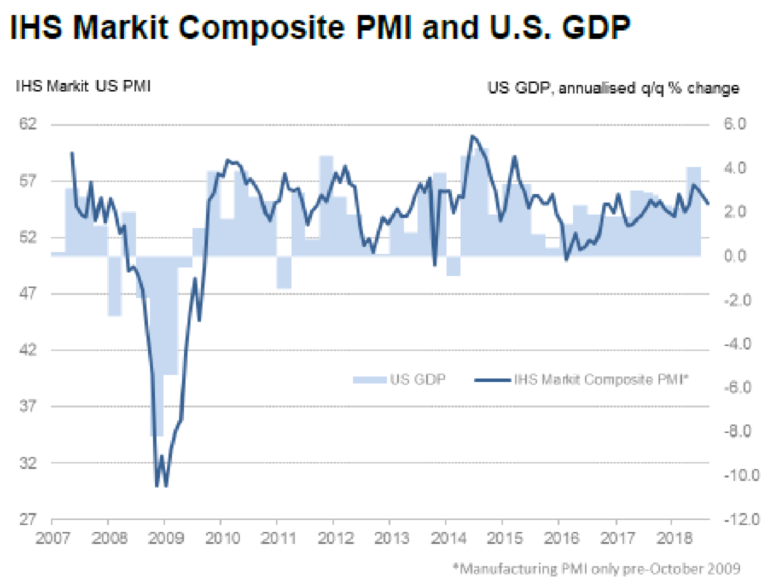
US Flash Composite PMI – Aug

The US composite PMI continued to expand at a slower rate in August – across both services and manufacturing.

Composite Output PMI; Aug 55 versus Jul 55.7

Services Activity PMI; Aug 55.2 versus Jul 56

Manufacturing PMI; Aug 54.5 versus Jul 55.3 (lowest reading since Nov 2017)



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

Services; measures of demand eased with new business volumes increasing at a slower rate, but still in line with LT averages. The backlog of work fell – the largest since Mar 2017.Slowest increase in payrolls for eight months. Growth of input costs moderated, but prices charged continued to grow.

Manufacturing; measure of demand also eased across manufacturing with lower rates of growth in output and new orders. Job creation slowed. Input costs continued to increase partly due to import tariffs and a corresponding increase in locally sourced inputs.

"Output, new orders and employment growth all moderated, adding to signs that the economy has cooled after strong growth in the second quarter. Backlogs of uncompleted work, a key indicator of future output and hiring, meanwhile fell for the first time for over a year, suggesting the slowing trend could persist into the fall"

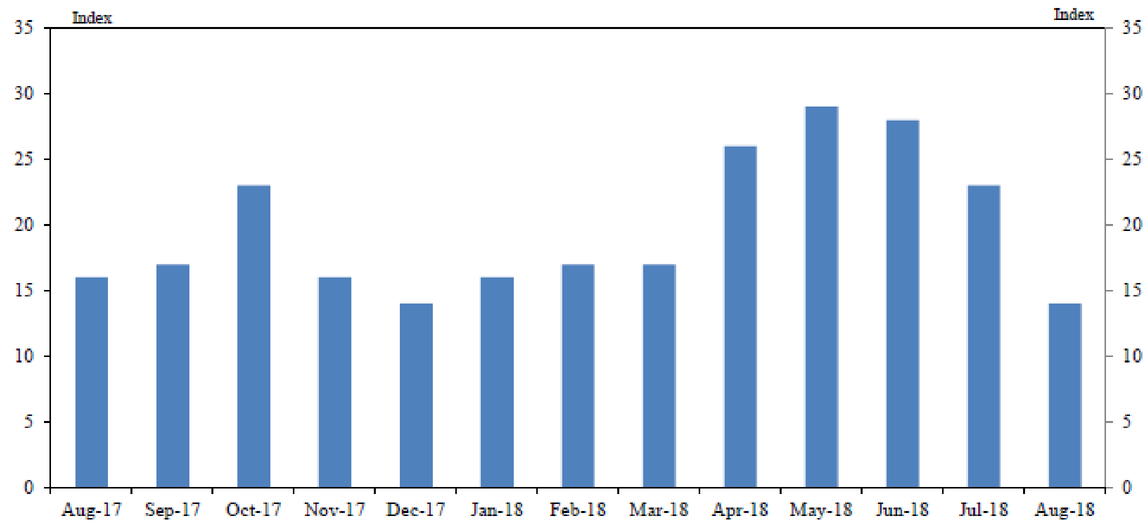
https://www.markiteconomics.com/Survey/PressRelease.mvc/0f72679b2374474da11f8160bfbf2dc0

Kansas City Fed Manufacturing Survey – Aug

Growth of the headline index of activity in the district slowed again in the latest month. Indicators highlighted that activity slowed across several important measures.

Headline composite index; Aug 14 versus Jul 23

Chart 1. Composite Index vs. a Month Ago



While production slowed, volume of shipments increased. The backlog of orders remained unchanged, well off the highs reached in April and growth in inventories of finished goods also slowed.

The volume of new orders slowed; Aug 9 versus Jul 21. The volume of new orders peaked in May at 38 and has slowed ever since. The index of New orders for exports fell into contraction, but was never particularly high, peaking at 9 in May and now -1 at Aug.

The number of employees also slowed; expanding at its recent peak of 26 in Jul fell back to 14 in Aug – coincidently the same reading at Aug 2017 (data is seasonally adjusted though).

The average employee workweek slowed to a point that suggested it was no longer expanding; Aug 1 versus Jul 14 (peaked in Jun at 25)

Prices received for finished goods remains elevated near recent highs; Aug 27 versus Jul 27 and growth in prices paid for inputs eased.

Given the somewhat downbeat results for Aug, expectations for overall activity in six months' time slowed only slightly; Aug 29 versus Jul 34. The current reading of 29 is well in line with the that of the last 12 months.

Expectations for capital expenditures for 6months time also slowed; Aug 28 versus Jul 38.

https://www.kansascityfed.org/~/media/files/publicat/research/indicatorsdata/mfg/2018/2018aug23mfg.pdf?la=en

Chairman Powell Speech – Jackson Hole

Chairman Powell continued to reiterate his key theme that rate hikes that were too fast or too slow were undesirable. This has been a clear and steady communication from the Fed Chairman.

Maintain the current path of gradual hikes, dependant on the incoming data – takes both risks seriously.

The economy is strong – unemployment remains below the longer-run level. No clear sign of an acceleration in inflation, so no clear risk of overheating the economy.

"As the most recent FOMC statement indicates, if the strong growth in income and jobs continues, further gradual increases in the target range for the federal funds rate will likely be appropriate."

https://www.federalreserve.gov/newsevents/speech/powell20180824a.htm

US Durable Goods Orders – July

Durable Goods new orders and shipments fell in July, New orders now down 3 of the last 4 months – potentially signalling slower production/shipments in coming months.

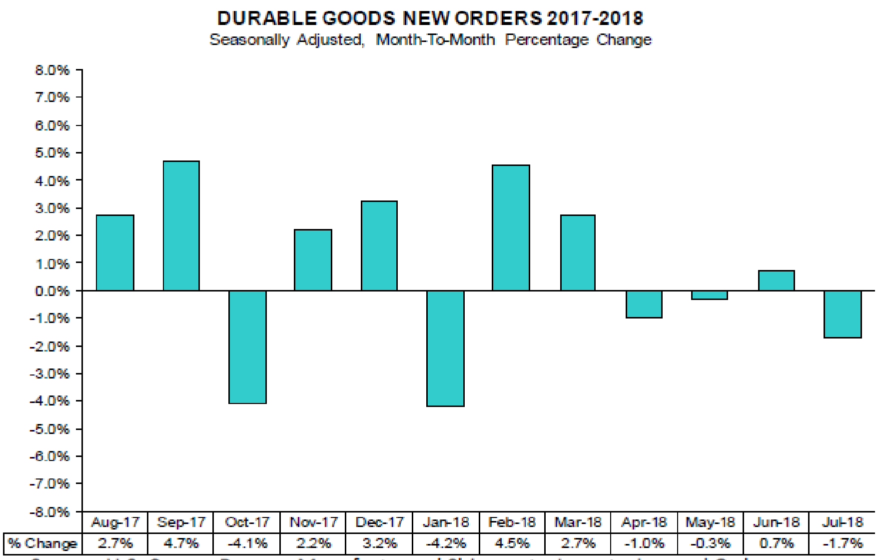
Despite the slowdown in the month, the YTD growth for shipments and new orders accelerated;

New Orders monthly growth; Jul -1.7% versus Jun +0.7%

YTD growth New Orders; Jul +8.6% versus Jun +8.4% (not seasonally adjusted)

Shipments monthly growth; Jul -0.2% versus Jun +1.6%

YTD growth Shipments; Jul +7.1% versus Jun +6.8% (not seas adjusted)



Source: U.S. Census Bureau, Manufacturers' Shipments, Inventories, and Orders, August 24, 2018.

In the latest month;

Excluding transport, shipments and new orders increased in Jul +0.6% and +0.2% respectively.

Excluding defence, shipments and new orders also decreased in Jul -0.3% and -1% respectively.

Durable Goods – Manufacturing with unfilled orders (approx. 68% of total Durable Goods orders and shipments) also fell. New orders; Jul -3.4% versus Jun -0.5% and shipments; Jul-1.3% versus Jun +0.8%. The YTD growth was mostly unchanged between the two months.

Capital Goods shipments and new orders also fell, led mostly by non-defense capital goods; Shipments; Jul -3.8% versus Jun +1.8% and new orders; Jul -5% versus Jun -0.2%.

Inventories – the largest jump in the last 3 months; Jul +1.3% versus Jun 0% versus May +0.3% (this is seasonally adjusted data). This was led by Manufacturing (with unfilled orders), transport and capital goods. The big jump in inventories especially for transport and capital goods (high value inputs) could be a sign of preparation for future production (rather than a slow down in demand).

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

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Europe

Eurozone – Flash Composite PMI – Aug

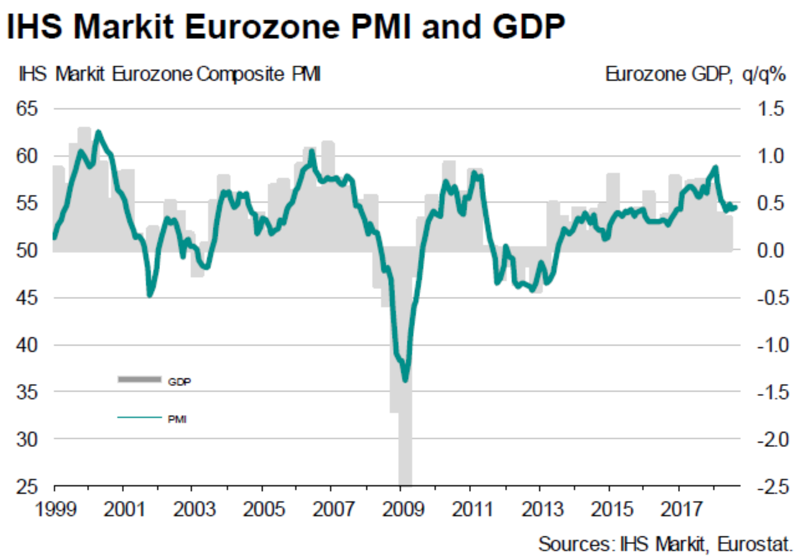
The Eurozone flash composite PMI was mostly unchanged in August – with services expanding at a similar pace the prior month and manufacturing expanding at a slightly slower pace as in July.

Underlying that result is the appearance of a division between the performance of the core and the performance of the periphery Eurozone member countries. Overall sentiment fell to the lowest in 2 years.

Composite output index; Aug 54.4 versus Jul 54.3

Services Activity PMI; Aug 54.4 versus Jul 54.2

Manufacturing PMI; Aug 54.6 versus Jul 55.1



While overall output continued to expand, it was the third weakest since Jan 2017.

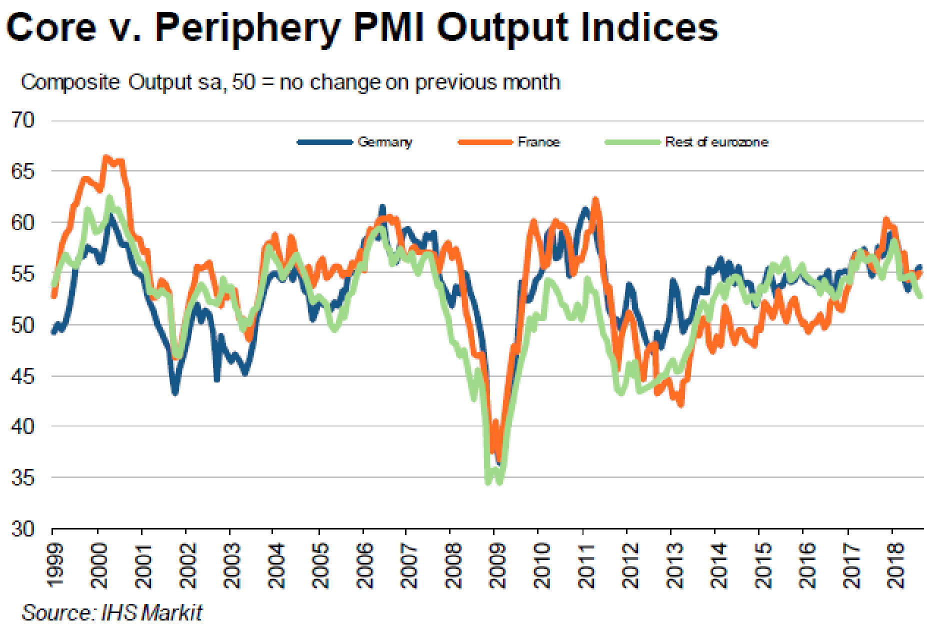
Measures of demand also showed weaker growth; new order growth remained subdued, new export orders in manufacturing recorded the smallest increase in 2 years, volume of orders received but yet completed increased at the slowest rate for 19 months, backlogs of orders esp in manufacturing grew at the slowest rate in 3 years.

Employment growth continued to grow reaching a 6mth high – led by services as factory payroll growth fell to a 17month low.

"Future expectations of business activity meanwhile deteriorated to a 23-month low, slumping to a 34- month low in manufacturing and a 21-month low in the service sector. Optimism was subdued by recent signs of cooling demand, higher prices and rising political concerns"

Periphery versus Core

Germany and France recorded better private sector expansion than the periphery - numbers for periphery not supplied, but chart shows a further weakening in the rest of the Eurozone;



Germany private sector continued to expand at a faster rate, drive by services. Manufacturing activity expansion remained constant – but new orders for goods slowed together with the smallest increase in new export orders for the last 2 years.

German Flash Composite PMI; Aug 55.7 versus Jul 55

German Flash Services PMI; Aug 55.2 versus Jul 54.1

German Flash Manufacturing PMI; Aug 56.1 versus Jul 56.9

France; private sector activity picked up, both in services and manufacturing. “However, although both sectors reported faster inflows of new business, growth rates remained well below peaks earlier in the year, notably for goods exports, and the third quarter is so far looking the weakest in terms of output growth since 2016”.

France Flash Composite PMI; Aug 55.1 versus Jul 54.4

France Flash Services PMI; Aug 55.7 versus Jul 54.9

France Flash Manufacturing PMI; Aug 53.7 versus Jul 53.3

Overall Eurozone - the current level of activity suggests growth will remain constant in Q3, but forward-looking indicators suggest slower growth is possible.

> “Warning lights are flashing. Analysis of past data indicates that demand needs to pick up to sustain current output and employment growth in coming months. Yet the risks seem tilted to the downside”

https://www.markiteconomics.com/Survey/PressRelease.mvc/5f841d9da516469d9ac922332ec49cc8

German GDP Q2 – Detailed release

The preliminary results released 14 Aug have been confirmed, with German GDP growing slightly faster in Q2 versus Q1;

Real GDP (seasonally and calendar adjusted); Q2 +0.5% versus Q1 +0.4%

The annual rate of growth slowed slightly; Q2 +2% versus Q1 +2.1%

Most areas of expenditure contributed to the result in the latest quarter;

Slightly slower household consumption growth +0.3% was offset by much higher Government consumption expenditure of +0.6%.

Gross Fixed Capital Formation slowed in the latest quarter from +1.4% in Q1 to +0.5% in Q2

Changes in inventories added to GDP growth from -0.1% in Q1 to +0.4% in Q2

Net exports detracted from GDP based on higher growth in imports of +1.7% versus +0.7% for exports.

https://www.destatis.de/EN/Publications/Specialized/Nationalaccounts/GermanEconomy.pdf?__blob=publicationFile

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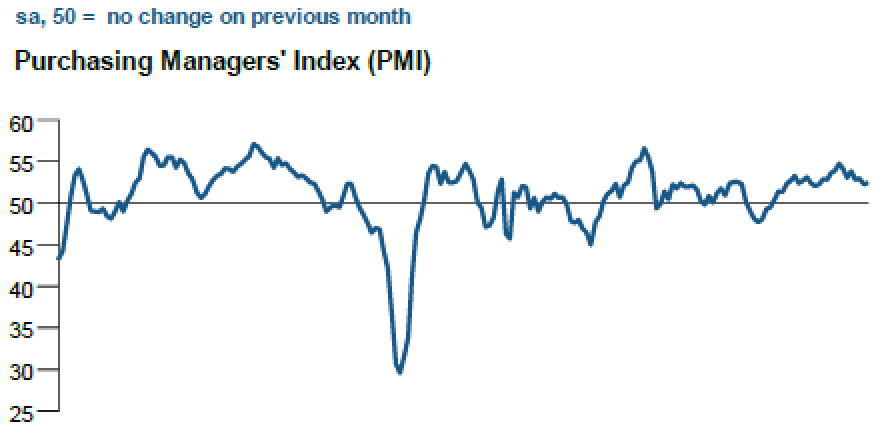
Japan

Nikkei Flash Manufacturing PMI – Aug

Manufacturing output in Japan continued to expand in the latest month, only slightly faster than in July;

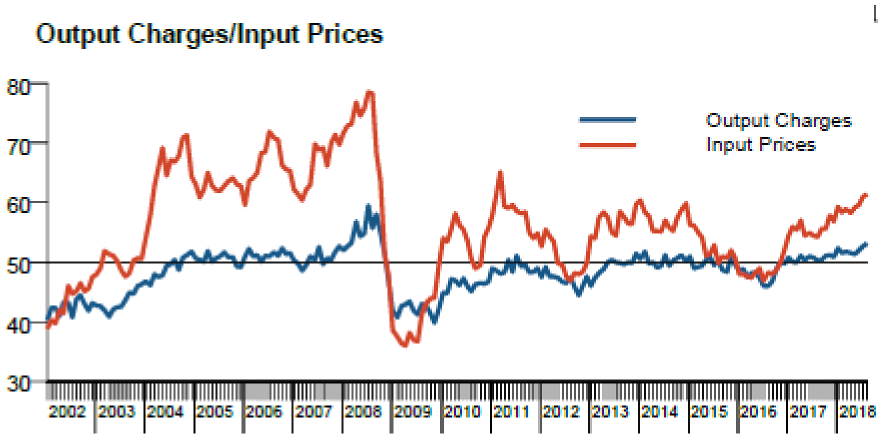
Aug 52.5 versus Jul 52.3



From a demand perspective, output and new orders grew at a faster pace, but export orders continued to decline.

Employment increased at a slower rate – and maintains a trend of slower expansion.

Input and output prices continued to increase at a faster rate;



Future expectations remained positive, but optimism was weaker.

https://www.markiteconomics.com/Survey/PressRelease.mvc/6ddff5bc2b2449439e1ee2ec9d5b2982

Japanese CPI – July

Headline CPI for Japan grew in the latest month;

Jul +0.3% versus Jun +0.1% (seas adj)

Annual headline CPI also accelerated slightly; Jul +0.9% versus Jun +0.7%

The more core measures of underlying CPI grew in the latest month;

All items less fresh food and energy; Jul +0.1% versus Jun -0.1%

Annual; Jul +0.3% versus Jun +0.2%

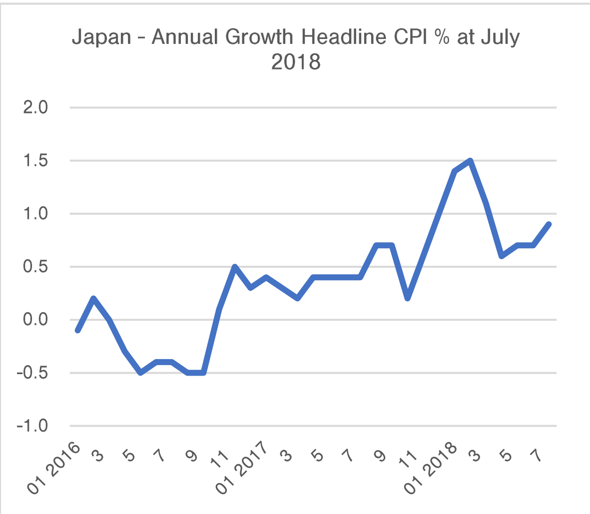
There was notable acceleration in the Food price index;

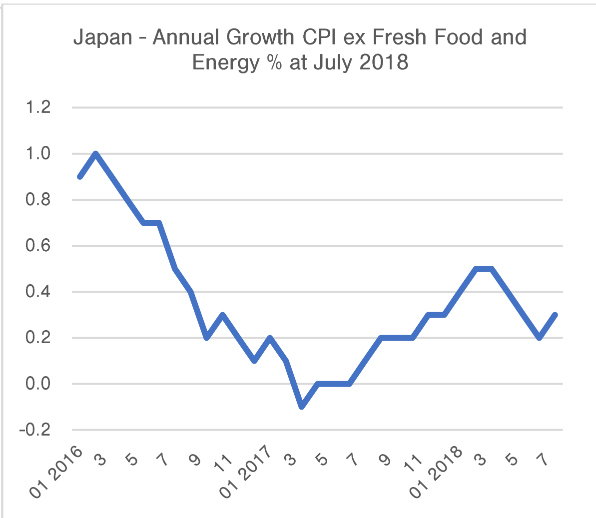
Food +0.6% Jul versus -0.4% Jun and accelerating from +0.4% in Jun to +1.4% in Jul.

Overall goods price index; Jul +0.1% (+1.7% ann)

Overall services price index; Jul +0.1% versus Jun-0.1% and annual slowed slightly; Jul +0.2% versus Jun +0.3%

Looking at the trend in headline CPI annual growth rates versus CPI ex fresh food and energy highlights the role of energy in driving the headline trend. Ex energy, CPI growth has been more subdued and drifted back somewhat over 2018 so far;





http://www.stat.go.jp/english/data/cpi/1581-z.html

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United Kingdom

BREXIT

Meeting agenda 21-22 August - https://ec.europa.eu/commission/publications/programme-eu-uk-article-50-negotiations-21-22-august-2018_en

A statement from Michel Barnier suggested that little headway was made on the key issues in the latest round of negotiations required to finalise the withdrawal agreement.

> "As I said in July, we are more, far more advanced in defining that common ground for foreign policy and security than for the economic relationship".

It has been agreed that negotiations will now be continuous between the UK and EU as the process to finalise the agreement moves into the final stages.

http://europa.eu/rapid/press-release_STATEMENT-18-5105_en.htm

The UK parliament will come back from summer recess on 4 September. Several pieces of legislation will be important; taxation bill 4 Sept and the trade bill 2nd reading on 11 Sept.

> "The Trade Bill will be "where all the action happens," a Labour source told BI. Anti-Brexit campaigners also believe this piece of legislation represents the best chance of forcing the government into a softer Brexit position"

https://www.businessinsider.com.au/house-of-lords-brexit-showdown-over-customs-union-2018-8?r=US&IR=T

There are many moving parts and many different interests within the UK parliament still trying to influence the outcome.

"Brexit crisis summit on 'no deal'" – 13 Sept. Senior frontbenchers will meet on 13 Sept to detail further contingency plans in case of 'no-deal' Brexit.

Timing - comments from Michel Barnier highlighted that the Oct 18 EU meeting was "no longer an absolute deadline", but that a deal should be finalised by the start of November. This initial timing was based on securing and agreement at the EU Council meeting and allowing enough time for both parliaments to approve the deal.

Key dates; 20 Sept - The informal meeting of heads of state or government (PM May had suggested the Salzburg meeting for further talks); Official EU council meeting Brussels 18 Oct – where it is hoped a deal can be struck/finalised; the next 'official' EU council meeting will be 13/14 Dec in Brussels. Scheduling an emergency meeting in November to finalise the agreement would be 'straightforward'.

https://www.theguardian.com/politics/2018/aug/24/october-no-longer-deadline-for-brexit-deal-david-lidington-finalising-agreement

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Canada

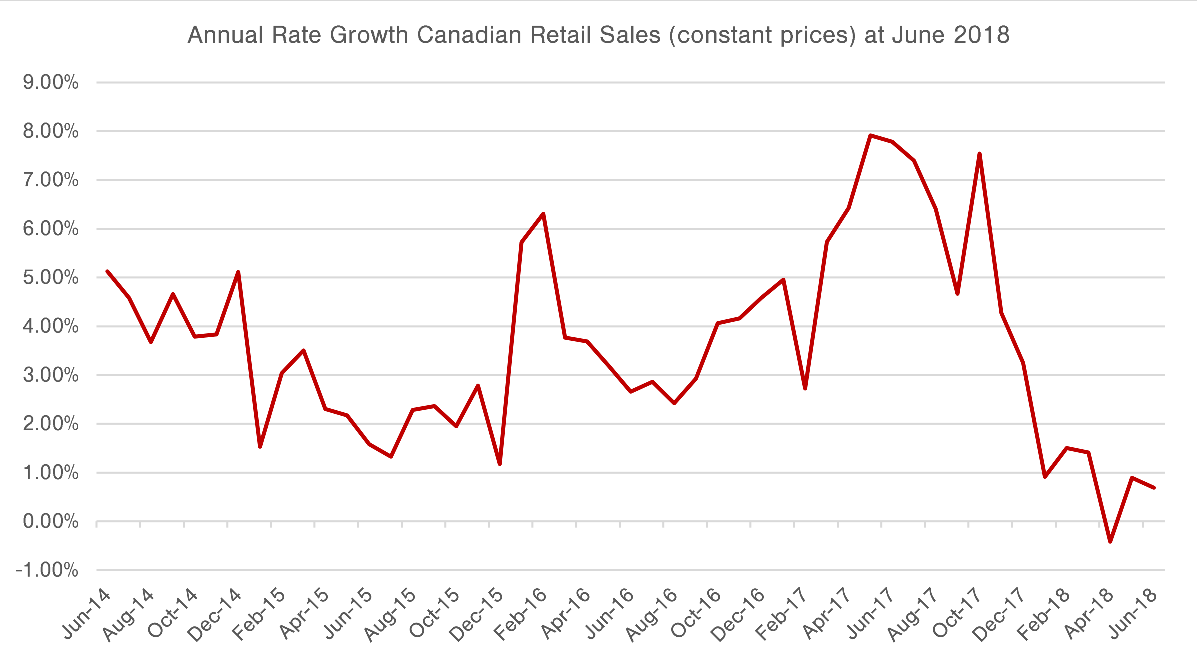
Retail Sales – Jun

In real terms, total retail sales declined in June after a stronger result in May;

Month on month; June -0.3% versus May +2.2%

Annual; June +0.7% versus May +0.9%

Total retail sales annual growth in real terms has continued to slow since late 2017 (latest month versus the same month prior year);



Source(s): Tables 20-10-0008-01 and 20-10-0078-01. https://www150.statcan.gc.ca/n1/daily-quotidien/180822/cg-a001-eng.htm

Motor Vehicle and Parts Dealers and gasoline stations have played a role in both months' results – adding to the May result and detracting from the June result.

Motor vehicle and parts dealers; June -1.2% versus May +4.1% (the single largest category)

The next largest category was food & beverage stores; June +0.7% versus May -1.4%

Performance of gasoline stations; June -4.9% versus May +4.1%

https://www150.statcan.gc.ca/n1/daily-quotidien/180822/t003a-eng.htm

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Australia

RBA Governor Philip Lowe speech – Opening remarks at launch of ASIC's National Financial Capability Strategy 2018

Governor Lowe uses this opportunity to deliver some very pointed advice - those with debt/mortgages should plan for a rainy day. If the economy continues to improve, then the next move in rates will be up.

'Many borrowers [in Australia] have not experienced a rate increase' – the last rate increase in Australia was eight years ago.

"This will not be welcomed by some, but it would be a sign that things are returning to normal. My advice here is to make sure your finances can withstand a lift in interest rates."

With house prices coming off the boil in key markets, Governor Lowe advises putting 'spare money into their offset accounts'.

https://www.rba.gov.au/speeches/2018/sp-gov-2018-08-21.html

RBA – Meeting Minutes 7 Aug 2018

Rates remained unchanged.

Current stance of monetary policy to continue to promote growth. Reduction in unemployment and shift of CPI to the middle of inflation band (2-3%) will be gradual.

Unemployment was expected to reach 5% target by the end of 2020 – impacting how long it will take for any wage pressures to emerge.

Inflation – headline inflation to average 1.75% over 2018, expecting a fall in Sept due to a range of new govt measures. Headline to increase to 2.25% in 2020.

Next move in rates likely to be up, but no strong case for a near term change/increase.

Considerations for monetary policy – previously Gov Lowe has expressed concern about the strength or, the increased possibility, of the US raising rates faster (because of adding fiscal stimulus at a time of 'tight' resource utilization. This was again featured in the minutes. Increasing rates in the US may have implications for rates here in Australia and our highly indebted households – a concern for the RBA.

Financial markets; some further discussion regarding the recent moves in AUD ST money market rates. The committee suggested that it was 'difficult to be definitive about the cause'. Similar situations had been experienced in other countries, portfolio reallocation had lowered demand for bank bills issued by major Australian banks, which had contributed to the increase in the bank bill swap rate.

Easing growth in house prices and drought conditions were also noted.

https://www.rba.gov.au/monetary-policy/rba-board-minutes/2018/2018-08-07.html

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Trade

US-China Trade Talks

The latest mid-level talks aimed at addressing the US trade deficit with China and technology transfer issues did not produce any developments towards resolution.

These talks were seen to start more higher-level talks in order to produce an agreement between US and China. Its been suggested that a deal would be completed after the Nov election by President Trump and Chinese leader Xi Jingping at an already planned multi-lateral summit (Source: WSJ link below).

Public hearings take place this week for the third tranche of tariffs on approx. $200b worth Chinese products. - https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/august/public-hearings-proposed-section-301

Based on the current timeline, its likely that these tariffs will go into effect sometime in Sept.

China has matched the US tariffs.

The WSJ reports;

> "On Friday representatives from the U.S., European Union and Japan will meet in Washington to continue talks about how to use the World Trade Organization and other means to pressure China. Those talks haven't gotten much attention but got a boost when the U.S. and EU in August agreed to a preliminary deal to reduce some tariffs and subsidies".

https://www.wsj.com/articles/u-s-china-trade-talks-end-with-no-sign-of-progress-1535065800

NAFTA

Talks between the US and Mexico continued this week – with the US apparently softening its stand on the sunset clause. It's likely to be replaced by periodic reviews of the agreement. President Trump has indicated that the US could reach 'a big trade agreement" with Mexico shortly.

Canada is yet to rejoin the talks and the Canadian Foreign Minister has stated that Canada will rejoin talks once the US and Mexico resolve bilateral issues.

US-Japan Trade Talks

Cabinet-level talks did not result any clear agreement between US and Japan. The Japanese negotiators requested no tariffs be implemented while talks are underway. President Trump and Japanese PM Abe will meet in late Sept.

Section 232 – Car and Truck Imports

Awaiting the outcome of the public hearings.

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