MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 7 January 2019

Key Themes

The stance of several key central banks has now shifted from removing policy accommodations to a 'wait and see' approach as growth concerns increase.

Fed speeches throughout the week and the FOMC minutes, continued to reinforce the key position of the Fed now; low inflation is providing room to 'wait and see', no set path for rates, won't hesitate to change course if policy or normalisation hinders achievement of dual mandate goals. The FOMC is likely to see how the data and risks to growth play out on the domestic front before hiking rates again.

The ECB minutes reflected 1) a shift in growth sentiment with the balance of risks now moving to the downside, although still assessed as 'broadly balanced', 2) rates "lift-off" likely pushed out to late 2019 and 3) the introduction of "chained guidance". This roughly translates into "removal of accommodation is on hold for now".

After raising the benchmark rate several times in 2018, the BoC kept rates on hold in Jan highlighting further growth concerns for the Canadian economy. Growth is expected to slow in Q4 and Q1 2019 as a result of lower oil prices. Rates likely to remain on hold until the impact of lower oil prices and global trade developments becomes apparent on inflation, spending and the housing market.

One central bank has been steadily increasing policy accommodations over the last year; the PBoC.

On the trade front; little news on the outcomes of the US-China trade talks during the week, but the meeting has likely set the foundations for higher-level negotiations in late Jan. Trade talks with Japan and the EU are likely to start within the next month as negotiating objectives have now been released by the USTR.

US data was limited due to the ongoing government shut down and we, unfortunately, missed a key indicator of manufacturing activity in Factory Orders. Headline CPI growth slowed to +1.9% on the back of lower energy prices, while growth in core CPI ex-food and energy remained unchanged at +2.2% - led by growth in services. Growth in the non-manufacturing PMI slowed but remains elevated. JOLTS data show openings and hires remain at high levels, but it appears that the strong upward momentum during 2018 has paused.

European industrial data was disappointing while consumer retail sales growth improved. The low-light of the week was the poor German manufacturing orders and industrial production data for Nov - confirming the recent weaker PMI reads and indicating further declines are likely. Of concern is that the decline in new orders and production was no longer limited to foreign markets and durable goods. German trade data showed both exports and imports declined in the month and the overall trade surplus is well below last year.

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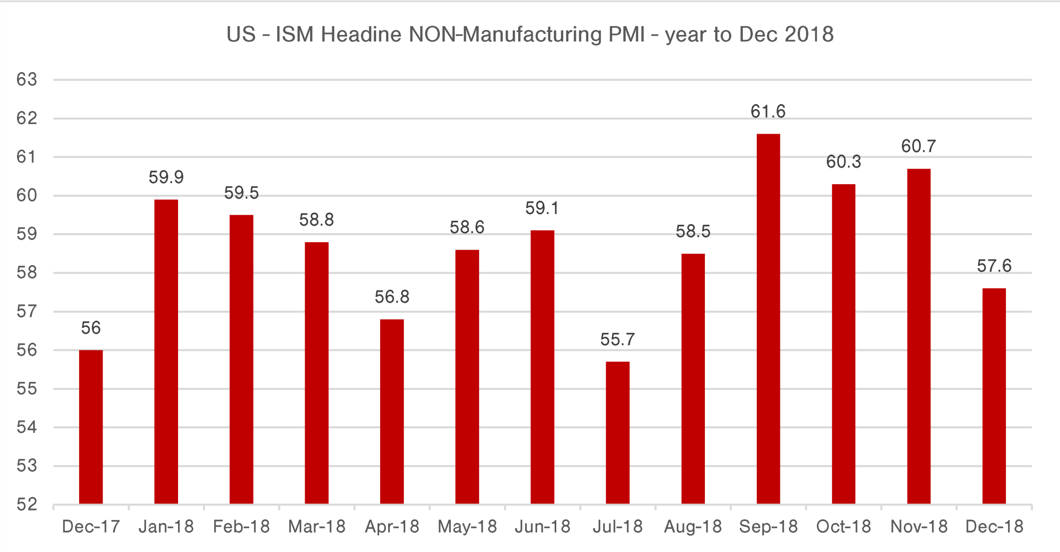
US Data

ISM Non-Manufacturing PMI (Dec)

The ISM non-manufacturing PMI indicated that growth slowed in the latest month but remains elevated. Slower growth was the result of slower growth in business activity, employment, inventories and prices. New orders growth remained steady.

Dec 57.6 versus Nov 60.7



Business activity/production slowed in the latest month, but growth remains elevated. The index fell by -5.3pts to 59.9. Underlying that, there were some negative shifts. The proportion of firms recording 'higher' levels of production/activity decreased by 8%pts and the proportion of firms that recorded 'lower' levels of activity increased by +7%pts. The proportion of firms recording 'higher' activity is still larger.

New orders were mostly unchanged, increasing by +0.2%pts.

Order backlogs decreased – a key feature of recent service and manufacturing PMI's. The index fell by 5pts to 50.5 in Dec – moving closer to the 50-neutral/no growth mark.

Employment growth slowed somewhat but remains positive.

Supplier deliveries have started to improve. The index fell by 5pts and is now at 51.5 (above 50 indicates slower deliveries). The proportion of firms recording 'faster' and 'slower' deliveries is now almost on par. A key feature of recent reports has been that suppliers have not be able to keep up with orders.

Inventory growth also slowed, with the index falling by 6pts to 51.5, edging closer to the neutral '50' mark. Firms shifted from 'higher' to 'lower' inventories, with both groups closer to the size. There is possibly some seasonal element to these inventory changes.

Input price growth also continued to grow, but at a slower pace. The index fell by 6.7pts. But underlying that, firms shifted from 'higher' prices to mostly "the same" level of prices. So far, there appears to be little downward pressure on prices.

https://www.instituteforsupplymanagement.org/ISMReport/NonMfgROB.cfm?SSO=1

JOLTS (Nov)

There was a pull-back in the level of hires, job openings and total separations in the latest month. The strong upward momentum of the last year appears to have slowed. The level of hires remains above the 12-mth average. Separations though, led by quits, has fallen for the last three months, now just below the 12-mth average, suggesting slightly less inclination to change jobs. Both quit and hire rates are on par with 12-mth averages. Layoffs and discharges have been edging up (no change this month though), now above the 12-mth average, but still historically low.

Job Openings

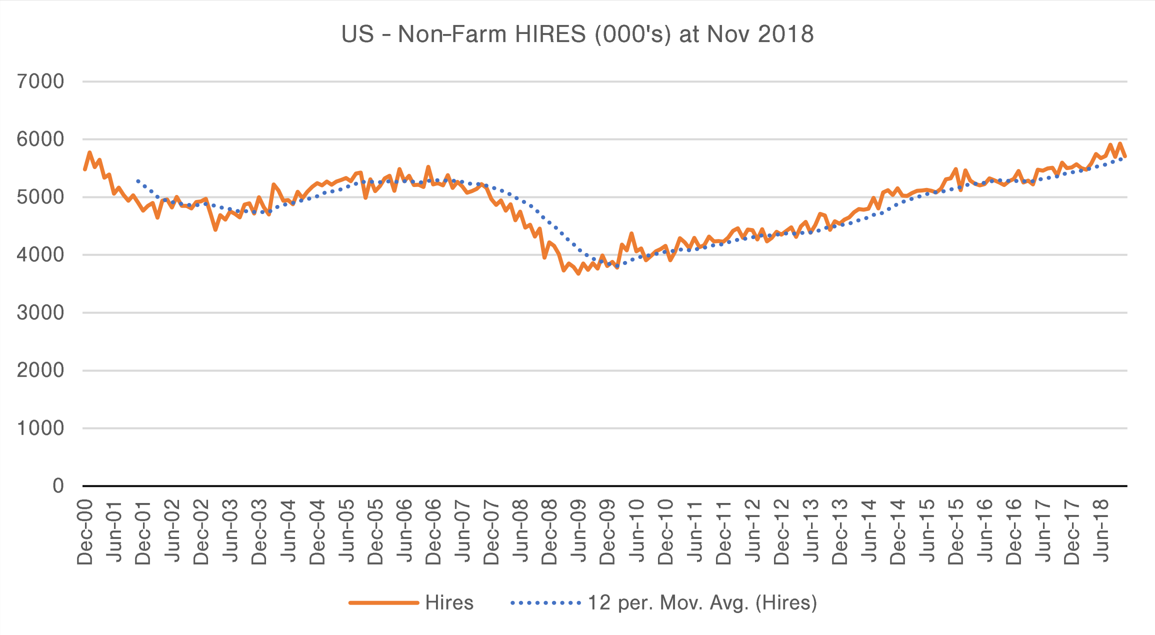
Nov 6.9m versus Oct 7.1m

The current level remains above the 12-mth average.

Hires

Nov 5.7m versus Oct 5.9m

The total number of hires in Nov remains just above the 12-mth average;

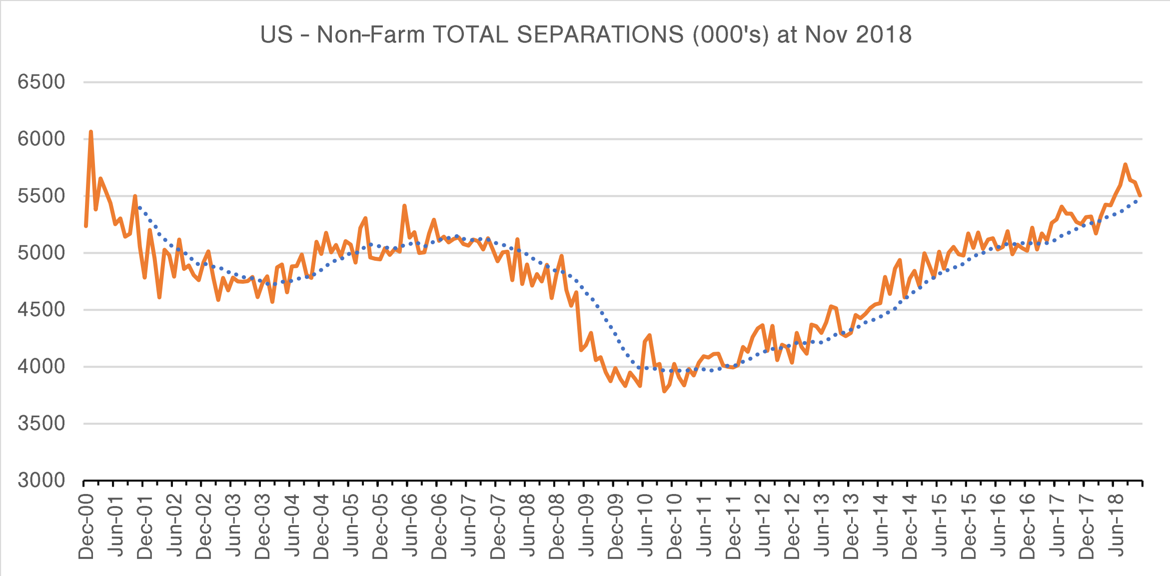


While the level of hires reached an all-time (since Dec 2000) peak in Oct 2018, the hire rate is still well below its historical peak of 4.4% reached in Jan 2001. The current hire rate slowed to 3.8 in Nov – which is on par with the 12-mth average.

Separations

Nov 5.5m versus Oct 5.6m

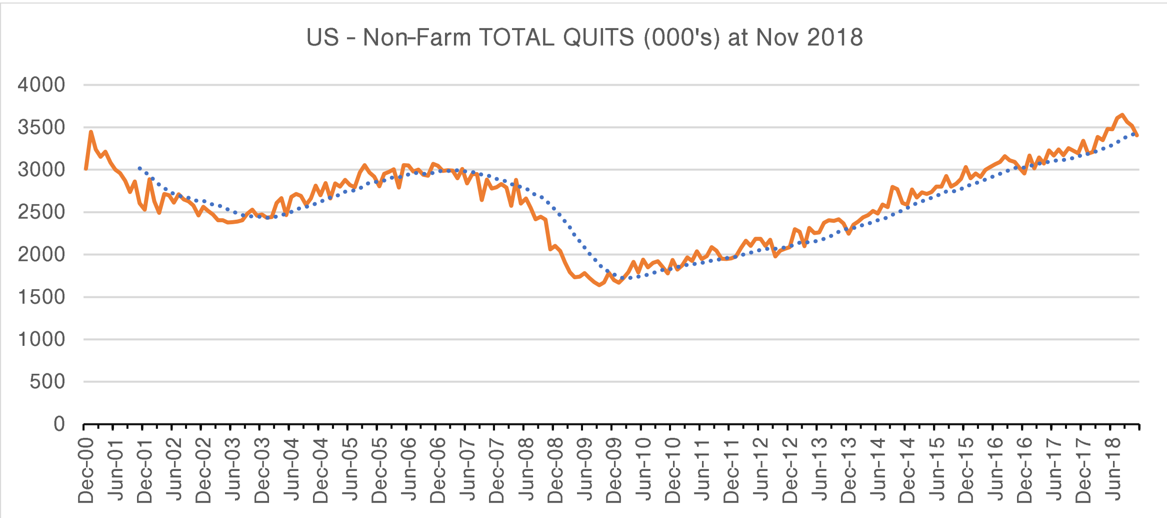
The level of total separations remains just above the 12-mth average.



The decline in separations in the month was the result of a decline in Quits (also the largest portion of Total Separations). There was no change in the level of Layoffs and Discharges and Other Separations.

<u>Quits:</u> Nov 3.4m versus Oct 3.5m

The level of quits is now slightly below the 12-mth average.



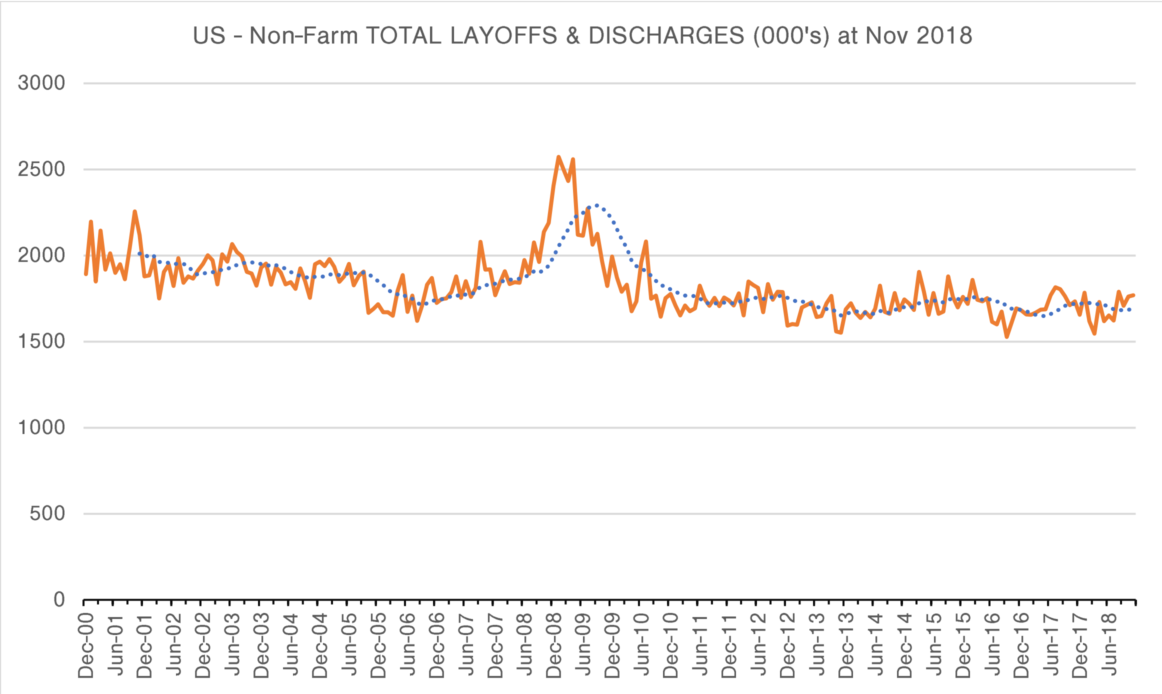
The trend suggests that quits (voluntary separations) increase as the job market is “strong” and people become less inclined to change jobs as the job market weakens (or perceptions of the job market change).

The new all-time high level of quits was reached recently in Aug 2018 and is currently 6% below that level.

The peak in the quit rate was 2.6% (dividing total number of quits by employment and multiplying by 100) back in Jan 2001. The current quit rate is 2.3% and is on par with the 12-mth average.

Layoffs and Discharges; Nov 1.7m versus Oct 1.7m

Although there was no change in the level of discharges in the latest month, the level has been edging up since Mar 2018 and is currently running 5% above the 12-mth average;

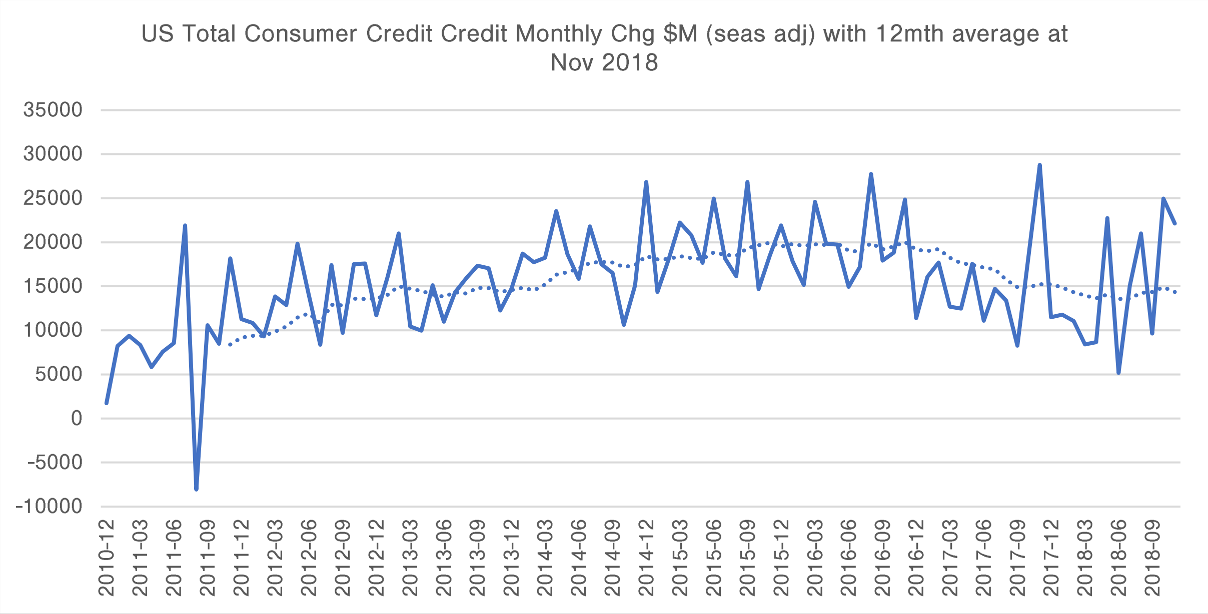


https://www.bls.gov/jlt/

Consumer Credit (Nov)

Consumer credit continued to grow in the latest month, but at a somewhat slower pace. This was the result of lower growth in revolving consumer credit.

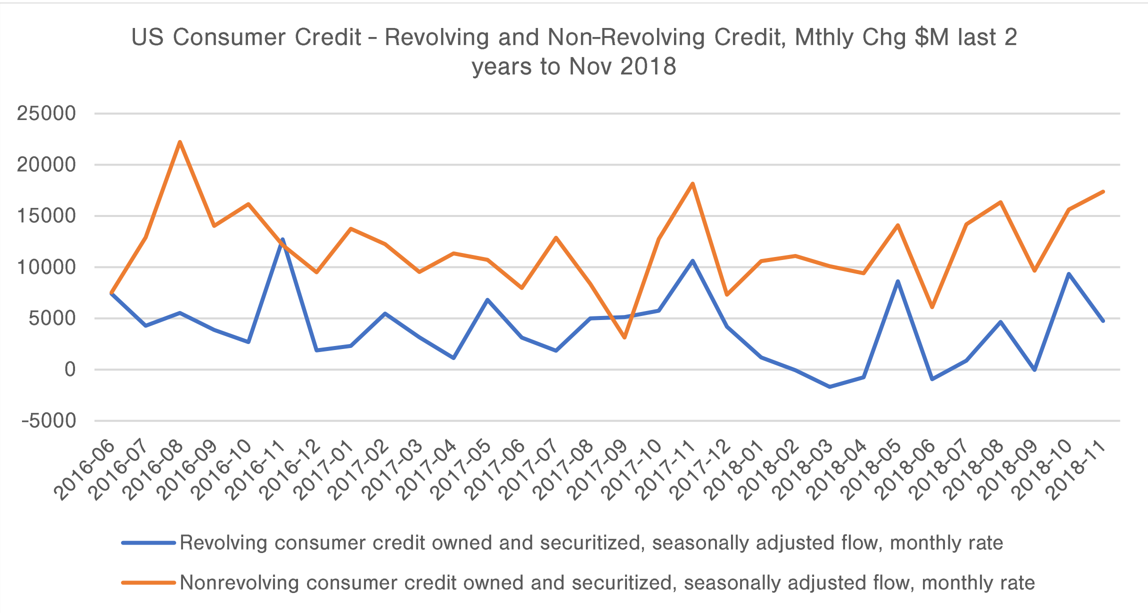
Monthly growth in total consumer credit: Nov $22.1b versus Oct $25b (revised from $25.4b)



The growth in the latest month was the result of slower growth in revolving credit and slightly higher growth in non-revolving credit.

Monthly growth in revolving consumer credit; Nov $4.76b versus Oct $9.34b

Monthly growth in non-revolving consumer credit; Nov $17.4b versus Oct $15.6b



Growth in nonrevolving credit (mostly student and auto loans) continues to increase at a faster pace. The quarterly breakdown of nonrevolving credit will be released next month.

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

CPI (Dec)

US CPI declined in Dec as a result of falling energy prices – mostly prices for fuel oil and motor fuel oil. Measures of underlying CPI growth remained stable though. There are pockets of higher price growth pressure in services less energy services, where shelter, medical and transportation services are all growing at higher rate than both headline and core measures of CPI.

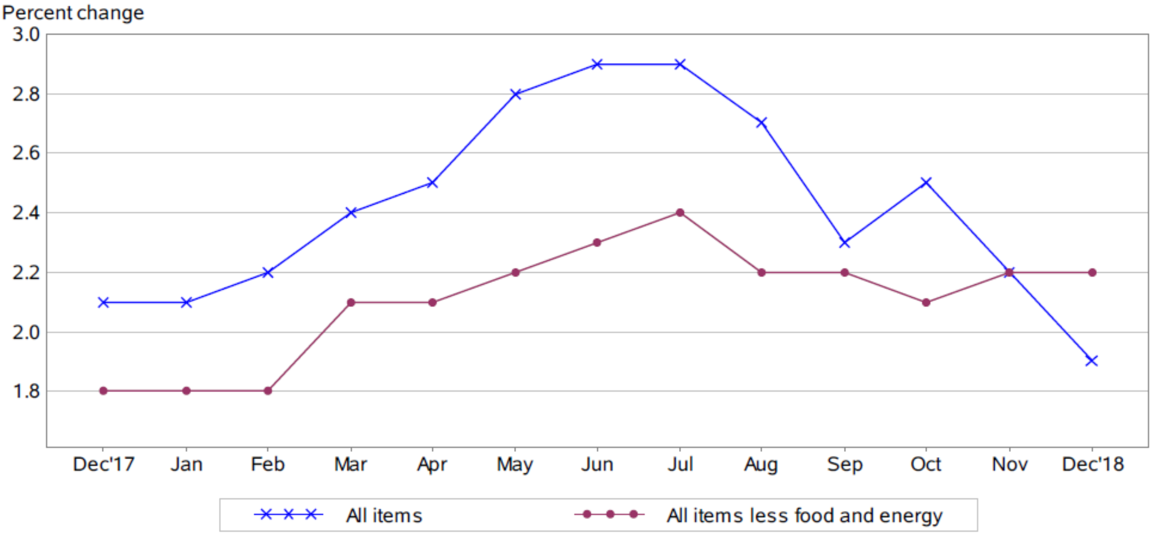
Headline All-Items CPI

The monthly CPI change and the change from a year ago declined and slowed in the latest month as a result of declining energy prices;

Monthly change; Dec -0.1% versus Nov 0%

Annual; Dec +1.9% slowing from Nov +2.2%

Chart 2. 12-month percent change in CPI for All Urban Consumers (CPI-U), not seasonally adjusted, Dec. 2017 - Dec. 2018



Energy Prices

In Dec, energy prices fell by -3.5% after declining by -2.2% in Nov. On an annual basis, energy prices declined by -0.3%.

The two main contributors to that decline were fuel oil (-11.4% in the month) and motor fuel (-7.4% in the month).

The decline in energy prices accounted for -1% of the change in the CPI – it accounts for 7.5% of the index weight.

Core CPI – Ex Food & Energy

One measure of underlying price growth is CPI ex-food and energy. Using this measure, growth has remained constant;

Monthly change; Dec +0.2% versus Nov +0.2%.

Annual change: Dec +2.2%, unchanged from Nov +2.2%.

All-items ex food and energy is made up of two main groups;

1. **Commodities, less food and energy commodities;** 19% of the CPI weight.

Dec annual growth; +0.1%

Includes new cars, used cars, apparel, alcoholic bevs, tobacco products.

Despite accounting for 19% of the index weight, only 1% of the change in the Dec index was due to the change in commodities prices.

2. **Services less energy services;** 59% of the index weight

Dec annual growth: +2.9%

90% of the change in the Dec index was due to the change in services prices.

Shelter is the largest share of weight in this group and rent is growing at +3.5% - well above the headline and core measures of CPI growth. Other areas of services are also growing at a faster annual rate: medical services +2.6% in Dec and transportation services +2.8% in Dec.

https://www.bls.gov/cpi/

FOMC Meeting Minutes Dec 2018

Recent volatility, the decline in risk sentiment and tightening in financial conditions were acknowledged in the meeting but on balance, the stronger economic data led the Fed to a further rate hike.

Overall, the minutes reflect that there has been an increase in downside risks. While current domestic conditions remained on track, the weakening of global/external activity could affect the domestic market. Based on these minutes, the FOMC is likely to want to see how the data and risk plays out before hiking rates again – inflation risk is low at this stage.

The minutes also deal with the shift in policy away from the 'gradual path' – despite still mentioning 'gradual path'. The implications of the Committee's statement changes were not clear at the time, and NY Fed President Williams gave an interview on CBNC shortly after the FOMC meeting to explain the shift in the statement wording, to clarify the Fed position on data-dependence and financial conditions and to 'walk-back' comments on 'auto-pilot' balance sheet normalization.

Key signalling statements from the minutes;

> "in an environment of muted inflation pressures, the Committee could afford to be patient about further policy firming."

> it was important for the Committee to assess factors such as how the risks that had become more pronounced in recent months might unfold and to what extent they would affect economic activity, and the effects of past actions to remove policy accommodation, which were likely still working their way through the economy.

Benchmark for a policy shift –

> If incoming information prompted meaningful reassessments of the economic outlook and attendant risks, either to the upside or the downside, their policy outlook would change.

Policy path -

> Participants emphasized that the Committee's approach to setting the stance of policy should be importantly guided by the implications of incoming data for the economic outlook. Monetary policy was not on a preset course; neither the pace nor the ultimate endpoint of future rate increases was known.

There were changes made to the statement that were discussed and considered during the meeting. The changes were (too) subtle and clearly had greater meaning intended;

> "Members agreed to modify the phrase "the Committee expects that further gradual increases" to read "the Committee judges that some further gradual increases". The use of the word "judges" in the revised phrase was intended to better convey the data-dependency of the Committee's decisions regarding the future stance of policy"

While the Fed was focused on 'judges' the rest of the market likely still saw 'further gradual'. This was more hawkish than expected and the addition of 'some' as a modifier to that statement was lost on most;

> "the reference to "some" further gradual increases was viewed as helping indicate that, based on current information, the Committee judged that a relatively limited amount of additional tightening likely would be appropriate."

The Fed added another statement to acknowledge/confirm that it is closely watching the impact of volatility and downside risks on markets and the economy – emphasis added – this statement will likely remain in the decision;

> "While members judged that the risks to the economic outlook were roughly balanced, they decided that recent developments warranted emphasizing that the Committee would **"continue to monitor global economic and financial developments and assess their implications for the economic outlook."**

Fed still see's risk from extended periods of low rates;

> Various factors, such as the recent tightening in financial conditions and risks to the global outlook, on the one hand, and further indicators of tightness in labor markets and possible risks to financial stability from a prolonged period of tight resource utilization, on the other hand, were noted in this context.

Discussion on the change in interest rate implementation continued;

Discussed issues related to the transition towards a regime with lower levels of excess reserves. In the transition to such a regime, there could be greater volatility in the FFR. New ceiling tools for controlling the policy rate were discussed and are to be presented/explored in later meetings.

Issues related to the long run composition of the SOMA portfolio – different portfolio maturity compositions could be advantageous. Holdings weighted towards shorter maturities would provide flexibility to lengthen maturity in a downturn. Some participated noted that a portfolio that "matched the outstanding Treasury market would have a more neutral effect on the market".

https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20181219.pdf

US Fed Speeches;

US Fed Reserve Chairman Powell – Interview at the Economic Club of Washington in Washington, DC.

Chairman Powell took the opportunity to continue to reinforce key positions of the Fed.

Balance the signals of the markets (slowing growth) with the signals of the data (growth still good) – with inflation low and under control, have the ability to be patient and watch patiently and carefully see how the econ evolves and see which one of these two narratives will be the story of 2019.

Waiting and watching.

No plan or pre-set path for interest rates – the dot plot is merely a summary of projections submitted by members four times a year. Two rate increases was the median of those projections.

Minutes; fair debate on raising rates – debate was more divided than the vote was? Vote for increase was unanimous.

Won't hesitate to change the path of monetary policy.

Nothing suggests the possibility of a recession in the near term is elevated in 2019. Out of control inflation or asset bubbles or excessive leverage have been major cause of recessions in the past.

Worried about? Global growth, slowing growth in Asia and Europe. Question will be – how much does that affect the US? Tightly integrated global markets and we will feel that.

Chinese growth is something we are watching. Showing up in consumer spending. Chinese authorities are doing repeated rounds of stimulus – baseline case of solid growth. No reason to think it will be worse.

https://www.economicclub.org/events/honorable-jerome-h-powell

Fed Reserve Vice Chairman Clarida - speech on economic outlook and monetary policy, NYU, New York.

Believes that the upper end of the current target range for the FFR 2.25 - 2.5% is now...

> "…equal to the lower end of the of the range of Committee participants' estimates of its longer-run equilibrium level, r*. One defines r* as the level of

the policy rate that, if sustained, would maintain full employment and price stability in the long run"

The speech reinforces key themes around: data dependence, the Fed looking at a wide range of data including financial conditions, no set path for rates, inflation is muted and can afford to be patient on how data evolves, will make changes if any part of policy or normalization is hindering achievement of dual-mandate goals.

References the work the FOMC/Federal Reserve is doing on evaluating changes to monetary policy implementation/interest rates. This is prompting the discussion/evaluation of the level of reserves in the banking system, weighing the costs and benefits of an implementation system with abundant reserves (as opposed to the pre-GFC regime where reserves were more limited).

The Federal Reserve is conducting a review into the Fed's monetary policy strategy, policy tools, and communication practices and will hold a research conference 4-5 June 2019. Outcomes to be announced in 2020.

https://www.federalreserve.gov/newsevents/speech/clarida20190110a.htm

Other Speeches;

US Fed speeches; Atlanta Fed President Bostic - economic outlook and monetary policy at the Rotary Club of Atlanta, in Atlanta GA, with audience Q&A.

Atlanta Fed President Bostic - speech to the Chattanooga Chamber of Commerce at their 2019 Economic Outlook Breakfast, in Chattanooga, TN, with audience Q&A.

Boston Fed President Rosengren - provide economic outlook to members of the Boston Economic Club as well as Boston Fed staff in Boston, Massachusetts.

Richmond Fed President Barkin - provide economic outlook to members of the Boston Economic Club as well as Boston Fed staff in Boston, Massachusetts

St. Louis Fed President Bullard (presentation on U.S. economic and monetary policy at the Little Rock Chamber of Commerce's Power Up Little Rock Event in Little Rock, AR, with audience Q&A)

Chicago Fed President Evans (speech and participate in a moderated Q&A session at the Milwaukee Business Journal Economic Forecast in Milwaukee, Wisconsin, with audience Q&A.),

Minneapolis Fed President Kashkari - speak about immigration and economic growth at the Jewish Community Relations Council Luncheon in Minneapolis, MN, with audience Q&A.

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Europe

Germany Factory Orders (Nov)

Manufacturing New Orders fell in Dec and the decline versus last year accelerated. Revisions to Oct data resulted in slightly lower growth in the month prior.

There is a confluence of events likely driving this month's result, including ongoing weaker Chinese demand. But what is standing out is the weakness from within Euro area countries, especially in Nov. While there is weakness across some of the larger economies (see Nov & Dec PMI's), one possible reason that stands out is the effect/interruption from protests in France (France PMI fell sharply in Dec, despite protests occurring on the weekends).

Overall, this month's data points to future weakness/declines in turnover and production. The Dec PMI's have highlighted further deterioration in Germany and across the Eurozone.

All data is based on the volume of new orders index.

Total Manufacturing New Orders Month on Month chg

Nov -1% versus Oct +0.2% (revised from +0.3%)

The decline in total manufacturing new orders for the month was the result of -11.6% decline in new orders from Euro area countries.

Main Groups;

The weakness in Intermediate Goods was evident in the domestic market (-2%), the Euro area market (-8.3%) and non-Euro area foreign markets (-5.3%).

Total Capital Goods new orders did not decline in the month but declined by -14.1% for Euro area countries.

Consumer Goods new orders declined in the month across domestic and foreign markets (-9.4% for Euro area countries).

Total Durable Goods new orders declined driven by falls foreign markets – both Euro area (-2.3%) and non-Euro area markets (-10.3%).

Total Non-Durable Goods new orders declined across both domestic (-1.8%) and foreign markets, with the foreign market decline driven entirely by a -12.3% decline in Euro area countries.

Total Manufacturing New Orders Annual % chg

Nov -4.3% versus Oct -3% (revised from -2.6%)

On an annual basis, new orders declined in both the domestic market (-3.6%) and foreign countries which was driven mostly by a -10% decline by Euro area countries.

New orders for Intermediate Goods is also an indicator of future production. The annual decline in Nov accelerated to -9.4%. Weakness was evident across all markets and hints at future weakness/declines in production.

New Orders for other major groups (% chg from same mth a year ago);

Capital goods annual decline -0.9%; across both domestic and foreign markets.

Consumer Goods annual decline -5.6%; across both domestic and foreign markets.

Durable Goods annual decline -7.2%; both domestic and foreign markets are in decline. The standout is the annual decline of -22.7% in new orders for non-euro area countries.

Non-Durable Goods annual decline -4.8%; both domestic and foreign markets are in decline.

https://www.destatis.de/EN/PressServices/Press/pr/2019/01/PE19_004_421.html

Germany Production Turnover (Nov)

The Production Turnover index (volume index) measures the total of final invoice amounts of the reference month.

The price adjusted turnover declined in Nov and fell versus a year ago. The monthly decline is widespread across major groups and markets.

Total Mining and Manufacturing Month on Month chg; Nov -2.4% versus Oct +0.5%

This was the result of declines in the month in the domestic market (-1.6%) and the euro area foreign market (-1.8%) and non-Euro area foreign markets (-4%).

Monthly chg across major groups;

Intermediate Goods; Nov -2.1% versus Oct -0.2%. The decline was experienced across turnover for both domestic and foreign markets.

Capital Goods; Nov -2.6% versus Oct +1.6%. The decline was experienced across production turnover for both domestic and foreign markets.

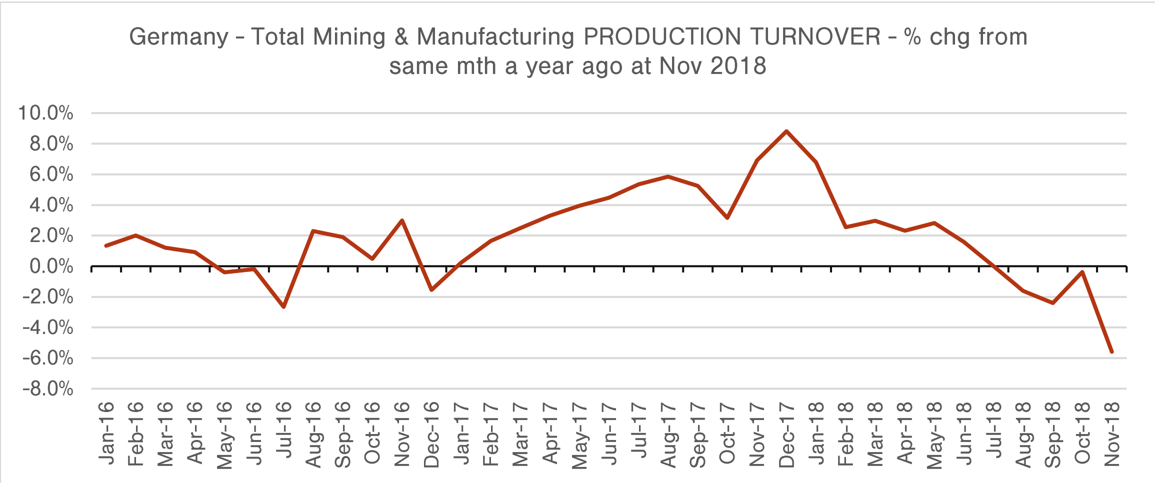
Consumer Goods; Nov -2.1% versus Oct +0.4%. The monthly decline was also evident across both domestic and foreign markets.

Durable Goods; Nov -1.5% versus Oct +0.3%. The monthly decline was led by foreign markets, bit Euro area and non-Euro area markets.

Non-Durable Goods; Nov -2.2% versus Oct +0.4%. The monthly decline in production turnover was also led by both domestic and foreign markets.

Total Mining and Manufacturing % chg from same mth a year ago; Nov -5.6% versus Oct -0.4%

On this annual basis, this decline was evident across both domestic markets (-4.3%), Euro area markets (-5.3%) and non-Euro area markets (-8%).



Production turnover is declining on an annual basis across all other major groups; Intermediate Goods -4.5%, Capital Goods -6.6% and Consumer Goods -4%.

Durable Goods -3.1% and Non-Durable Goods -4%.

https://www.destatis.de/EN/PressServices/Press/pr/2019/01/PE19_004_421.html

Germany Industrial Production (Nov)

Industrial production continued to decline in the latest month and versus a year ago. The prior month results were also revised lower.

Total Industry Production monthly change

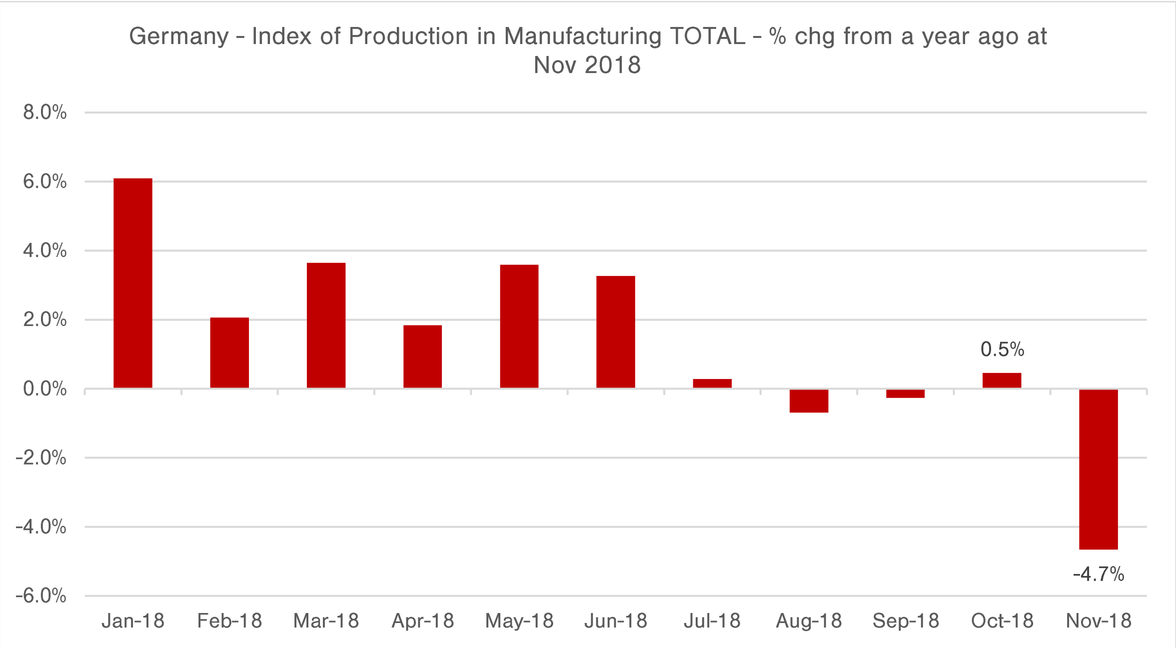
Nov -1.9% versus Oct -0.8% (Oct revised lower from -0.5%)

Major groups also recorded declines in the month; Intermediate Goods -1%, Capital Goods -1.8%, and Consumer Goods -4.1% (!).

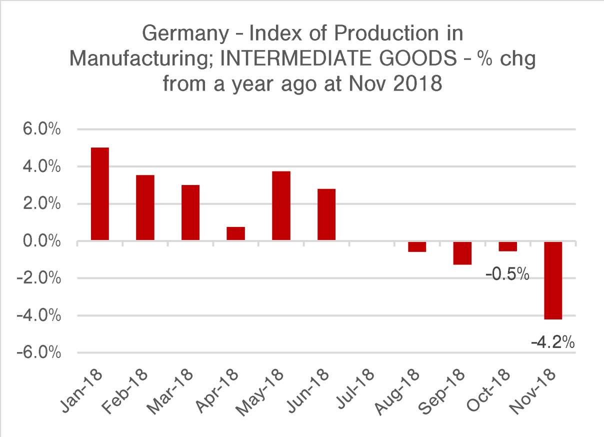
Durable Goods -2.5%, Non-Durable Goods -4.4%

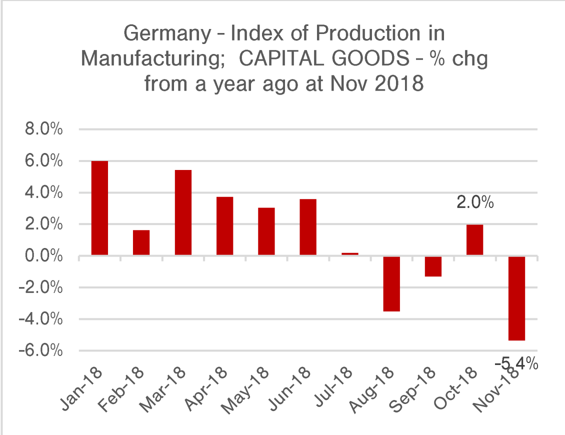
Total Industry Production % chg from a year ago

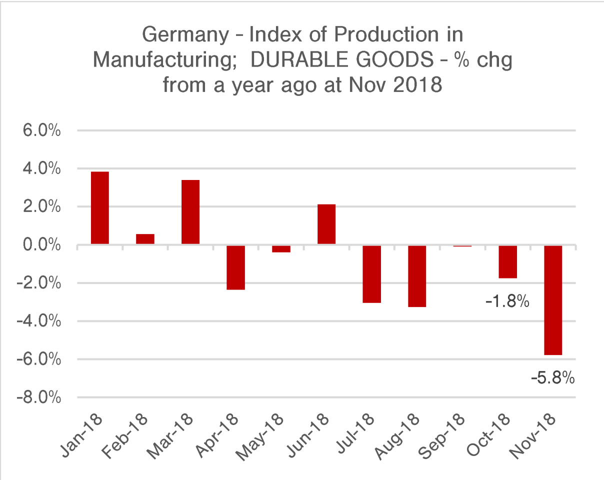
Nov -4.7% versus Oct +0.5%. Oct was revised much lower from +1.6%. Sep and Aug were also revised lower. This has substantially changed the 'shape' of the annual trend;



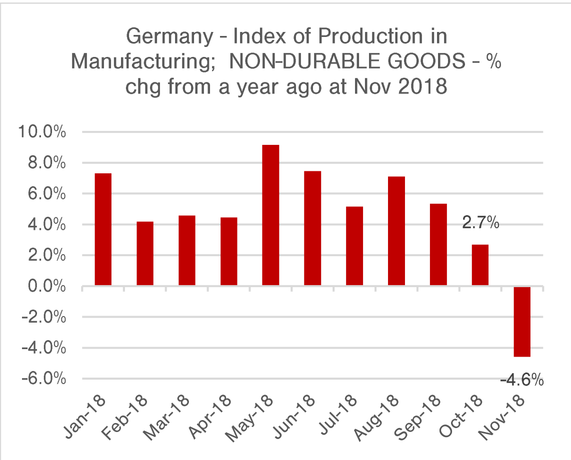
The annual decline accelerated in the latest month across the major groups – the continuing weakness in Intermediate Goods clear, but it appears as if there is a renewed weakness in Capital Goods:

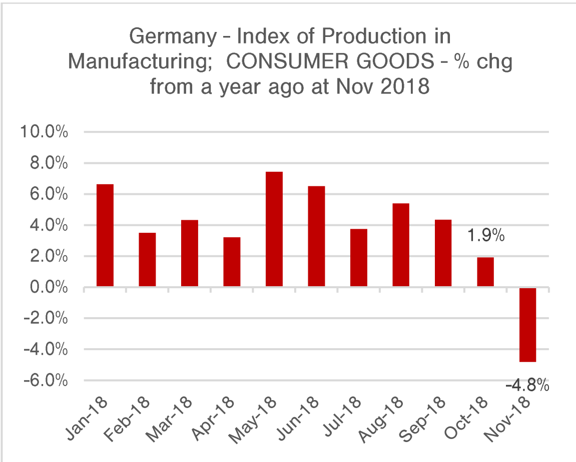






The latest Non-Durable and Consumer Goods production growth indicates that the weakness may no longer be contained to just Durables;





The monthly trend in the production index peaked in Nov 2017 but looking at the trend of the seasonally and calendar adjusted index suggests that production has started to roll over;

Given the declines in new orders, there is likely further slowing in production to come in the near term.

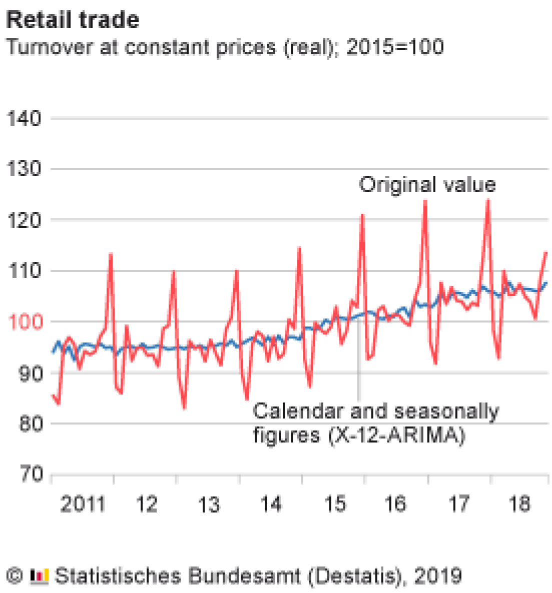
https://www.destatis.de/EN/PressServices/Press/pr/2019/01/PE19_007_421.html

Germany Prelim Retail Sales (Nov)

The prelim retail sales data shows that retail sales continued to grow in the latest month.

Retail sales month chg (real terms); Nov +1.4%

Retail sales % chg from a year ago (real terms); Nov +1.1%



https://www.destatis.de/EN/PressServices/Press/pr/2019/01/PE19_005_45212.html

Germany Trade Balance (Nov)

The German trade surplus increased slightly compared to the month prior. But underlying that, exports declined at a slightly slower pace than imports. In the YTD the German trade surplus is 7% below 2017. **All values in €.**

Current month – calendar & seas adj

Trade surplus; Nov 19bn versus Oct 17.9bn

Exports; Nov 110.6bn versus Oct 111bn (-0.4%)

Imports; Nov 91.6bn versus 93.1bn (-1.6%)

Current month % chg versus a year ago (original value)

Trade Surplus; -14%

Exports; 0%

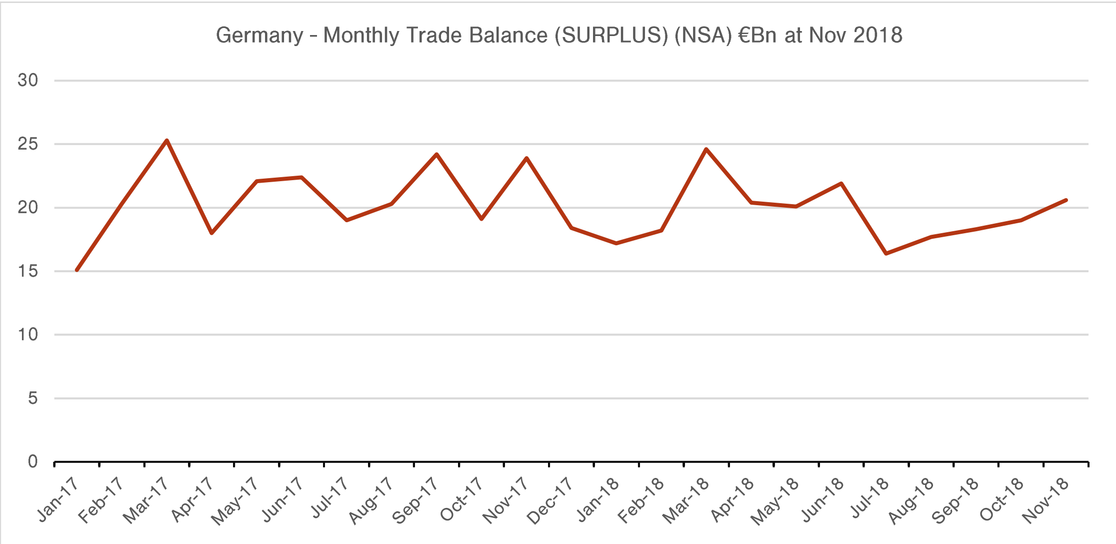
Imports; +3.6%

YTD 2018 versus YTD 2017 % chg (original value)

Trade Surplus; -7%

Exports; +4%

Imports +6%



Exports to key trading regions highlights that weakness within the Eurozone may be starting to show up in German exports. YTD growth in exports to Eurozone countries is stronger than growth in total exports, but have declined in the latest month;

Total exports YTD are growing at 3.7%. Of the EU member states, **exports to Eurozone members is growing at 5.2% (stronger than total export growth)**. Export growth to third countries is growing at +2.5%, below the rate of total export growth.

In the latest month, total export value is unchanged from a year ago (0% growth). Of the EU Member states, **exports to Eurozone members is down -0.4%** and exports to third countries is also down -0.4%. Growth of exports to non-Eurozone EU members is +1.3%.

https://www.destatis.de/EN/PressServices/Press/pr/2019/01/PE19_008_51.html;jsessionid=ED1AC8AA58FC64214C2AE7E7783C8E97.InternetLive2

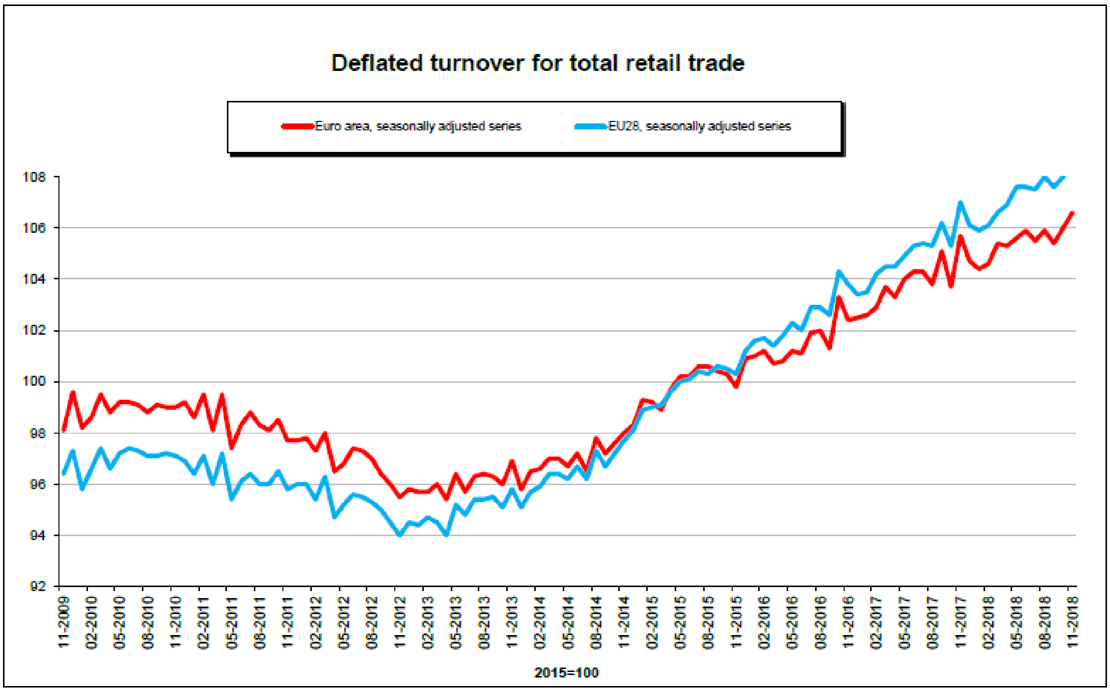
Eurozone Retail Sales (Nov)

Retail sales in the Euro area grew at a similar pace in the latest month, after Oct growth was revised higher. Total EU retail sales growth accelerated versus the month prior.

Monthly Growth – Volume of Retail Trade

Euro area; Nov +0.6% versus Oct +0.6% (Oct revised higher from +0.3%)

EU28 Group; Nov +0.7% versus Oct +0.4% (Oct revised higher from +0.1%) - the Nov result has been the strongest monthly growth of the last six months.



The stronger growth in retail sales in the Euro area and EU28 group in the latest month was mostly the result of acceleration in growth of sales of non-food products and auto fuel in specialised stores (volume). Food, drinks and tobacco declined in the month.

Annual Growth – Volume of Retail Trade

Euro area; Nov +1.1% versus Oct +2.3%

EU28 Group; Nov +2.1% versus Oct +2.4%

https://ec.europa.eu/eurostat/documents/2995521/9473138/4-07012019-AP-EN/edaca328-c96e-4d93-9330-1c46c0ec810f

ECB Monetary Policy Meeting Accounts/Minutes – 12-13 Dec 2018

The minutes reflect a shift in both growth sentiment and forward guidance/rates "lift-off". The minutes also introduced "chained guidance".

Sentiment

The ECB has shifted from "underlying strength of the economy continued to mitigate risks" (Oct minutes) to "the balance of risks now moving to the downside, although still assessed as 'broadly balanced'.

> "…owing to the persistent prominence of uncertainties related to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility"

> "Regarding the Eurosystem staff macroeconomic projections, it was noted that there had now been three successive downward revisions to the short-term euro area baseline growth outlook over the past half-year."

Rates "lift-off"

Although the statement still references "key ECB interest rates to remain at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels below, but close to, 2% over the medium term", the ECB now sees rates 'lift-off' moving out further;

> "Meanwhile, the expected timing of "lift-off" in key ECB interest rates had shifted out to around the end of 2019"

Introduction of "Chained Guidance" (emphasis added);

> Linking the reinvestment horizon to the interest rate "lift-off" signalled that the forward guidance on the key ECB interest rates was the Governing Council's primary tool for adjusting the monetary policy stance. This **"chained guidance" would strengthen the impact of rate guidance on financial conditions because market expectations for the reinvestment horizon would evolve in line with expectations for the date of a first interest rate rise.**

Oct statement without 'chained guidance'; The Governing Council intended to reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Dec statement with 'chained guidance'; Accordingly, the Governing Council intended to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time **past the date of a first rise in the key ECB interest rates,** and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

Conditions

Incoming data had been weaker than expected, but domestic demand continued to underpin Euro area expansion

Balance of risks moving to the downside

Governing Council still confident of sustained convergence of inflation

The forward guidance on the key ECB interest rates, reinforced by the reinvestments continued to provide the necessary degree of monetary accommodation

Governing Council expected the key ECB interest rates to remain at their present levels at least through the summer of 2019 (but noted that the expectations for 'lift-off" had shifted out to the end of 2019 at this stage)

Some possible upside from lower oil prices and fiscal measures;

> "As regards fiscal policy, the euro area general government deficit ratio was projected to increase over the period 2019-21, on account of a loosening fiscal stance – measured as the change in the cyclically adjusted primary balance – in both 2019 and 2020"

https://www.ecb.europa.eu/press/accounts/2019/html/ecb.mg190110.en.html

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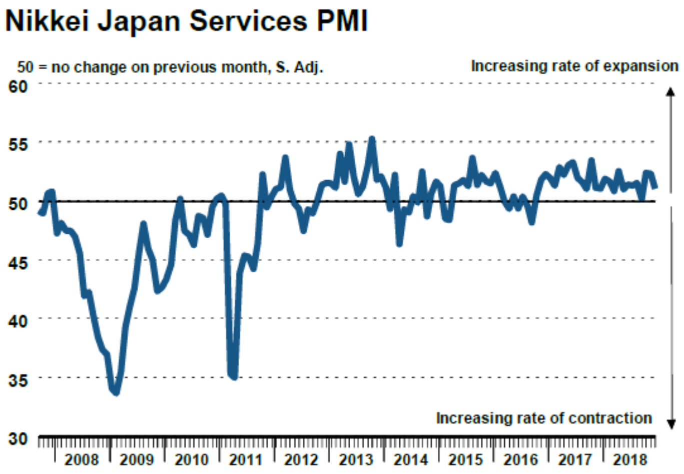
Japan

Services PMI (Dec)

Growth in the services PMI slowed further in the latest month. This was the result of slower growth in new business and output/activity. Despite that, employment grew at a faster pace.

Dec 51 versus Nov 52.3



Sources: Nikkei, IHS Markit

Output increased at the lowest level since mid-2018. New orders growth was weaker. New export orders grew at only a marginal pace.

Work backlogs increased 'fractionally'.

Employment growth was stronger, with growth accelerating for the second month in a row.

https://www.markiteconomics.com/Survey/PressRelease.mvc/1466e23666b2467794fc7d4b1391953b

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United Kingdom

Brexit

It is expected that the UK Parliament will vote on the Brexit agreement on 15 Jan 2019. It is also expected that the vote will not pass the Parliament but the margin for defeat is unclear.

PM May has been adamant that the referendum result to leave the EU will be implemented.

The EU is reportedly preparing for a delay to the 29 March Brexit date – possibly out to July.

https://www.theguardian.com/politics/2019/jan/13/eu-preparing-to-delay-brexit-until-at-least-july

https://www.theguardian.com/politics/2019/jan/13/may-makes-last-ditch-bid-to-win-over-commons-to-brexit-deal

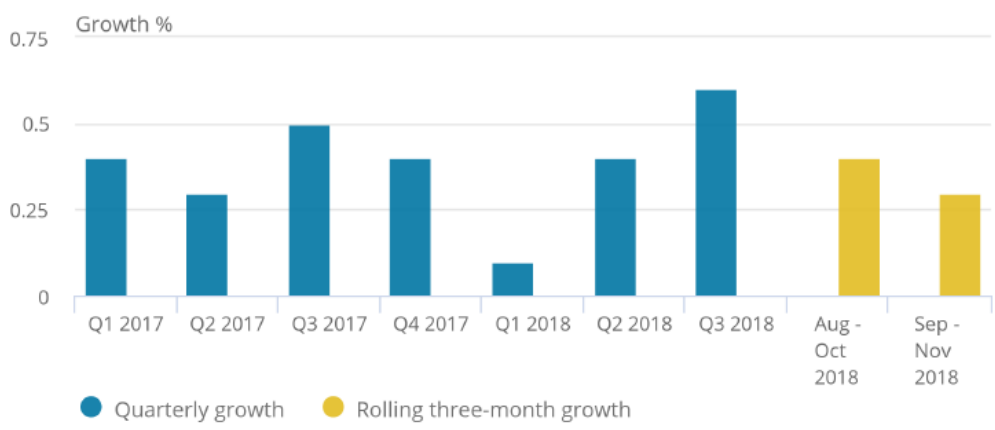
Monthly GDP (Nov)

The rolling 3-month GDP growth slowed in the Sep-Nov period. Services, construction and agriculture all contributed to growth, while production, led by manufacturing continued to decline. Given the latest improvement in the UK manufacturing PMI (based on Brexit preparations), we could expect manufacturing to improve in the next month.

Latest 3month rolling GDP growth; Sep-Nov +0.3% versus Aug-Oct +0.4%

Figure 1: Rolling three-month growth continued to slow after a peak in Quarter 3 (July to Sept) 2018

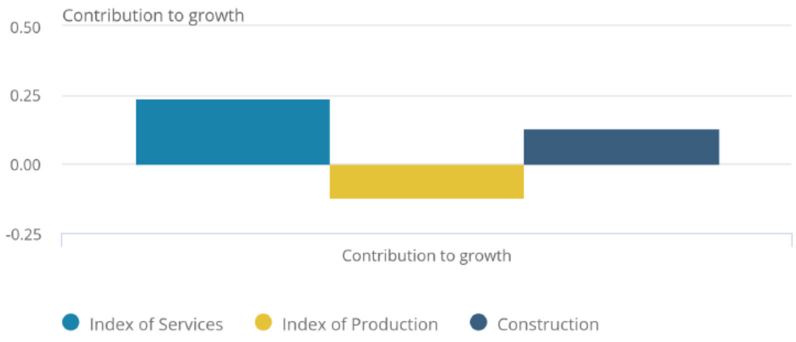
UK GDP growth, Quarter 1 (Jan to Mar) 2017 until September to November 2018



Services continued to make the larger contribution to growth in the month +0.24%pts. The decline in production (-0.12%pts) was off-set by the increase in construction (+0.13%pts);

Figure 2: The services sector was the largest contributor to growth, at 0.24 percentage points

Contribution to GDP growth, September to November 2018



While the monthly GDP growth can be volatile, the trend here suggests that within the latest rolling 3month, there has been some improved momentum, especially in services.

Table 1: Breakdown of GDP growth rates by month
UK, September, October and November 2018

	Sep-2018	**Oct-2018**	**Nov-2018**
GDP	0.0%	0.1%	0.2%
Index of Services	-0.1%	0.2%	0.3%
Index of Production	-0.5%	-0.5%	-0.4%
Manufacturing	-0.1%	-0.6%	-0.3%
Construction	1.9%	0.0%	0.6%
Agriculture	0.1%	0.2%	0.2%

Source: Office for National Statistics, GDP monthly estimate

https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/november2018

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Canada

BoC Rates Decision – 9 Jan 2019

The overnight target rate remained on hold at 1.75%

Lower growth expected in Q4 2018 and Q1 2019 and inflation pressure moderating on the back of lower oil prices. Likely rates remain on hold until the BoC see's how lower oil prices and global trade policy developments impact inflation, spending, the housing market and overall growth.

Key points;

The fall in oil prices has a material impact on the outlook for Canada – reducing the ToT and National Income;

> Global benchmark prices for oil have been about 25 per cent lower than assumed in the October *Monetary Policy Report* (MPR).

Consumption spending lower and housing investment weaker than expected. Spending curbs to be exacerbated in oil producing provinces.

Growth outlook for 2019 was revised lower to +1.7% which is 0.4%pts lower than the Oct outlook – expecting a temporary slowing in Q4 2018 and Q1 2019.

> This will open up a modest amount of excess capacity, primarily in oil-producing regions.

Inflation forecast;

> CPI inflation is projected to edge further down and be below 2 per cent through much of 2019, owing mainly to lower gasoline prices. On the other hand, the lower level of the Canadian dollar will exert some upward pressure on inflation. As these transitory effects unwind and excess capacity is absorbed, inflation will return to around the 2 per cent target by late 2019.

https://www.bankofcanada.ca/2019/01/fad-press-release-2019-01-09/

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Australia

Retail Sales (Nov)

Retail sales in Nov increased at only a slightly faster rate, despite promotional activity related to Black Friday and Cyber Monday sales events during the month.

The year on year data is also of interest as a gauge of how spending is evolving for this relatively new event in Australia – and this year, the year-on-year sales growth slowed. It's possible that factors such as the slowing housing market are starting to impact spending.

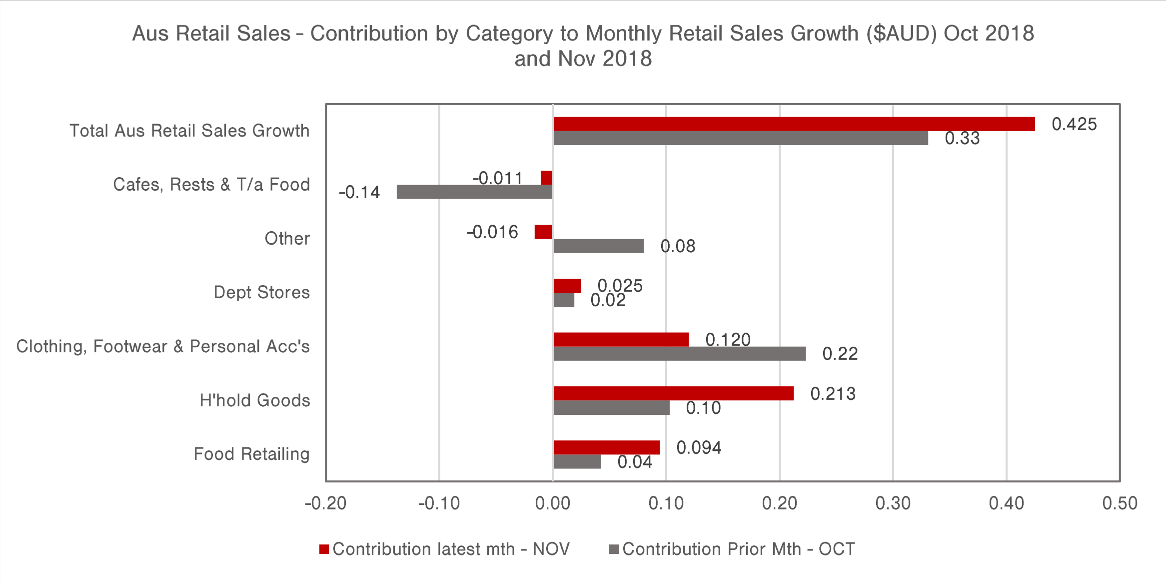
The Australian retail calendar has been shifting as local retailers adopt Black Friday and Cyber Monday promotions (as led by a more global push via online sales events). This tradition is starting to bring forward Christmas shopping.

Month growth – Retail Sales (value sales)

Nov +0.4% versus Oct +0.3%

This is a low level of acceleration between the two months given the scale of promotion activity in Nov. In 2017, Nov month retail sales increased by +1.2% versus Oct +0.4%.

From a category perspective, there was only a meaningful acceleration in sales month on month from Household Goods and Food Retailing, with both making a larger contribution to growth in the month.

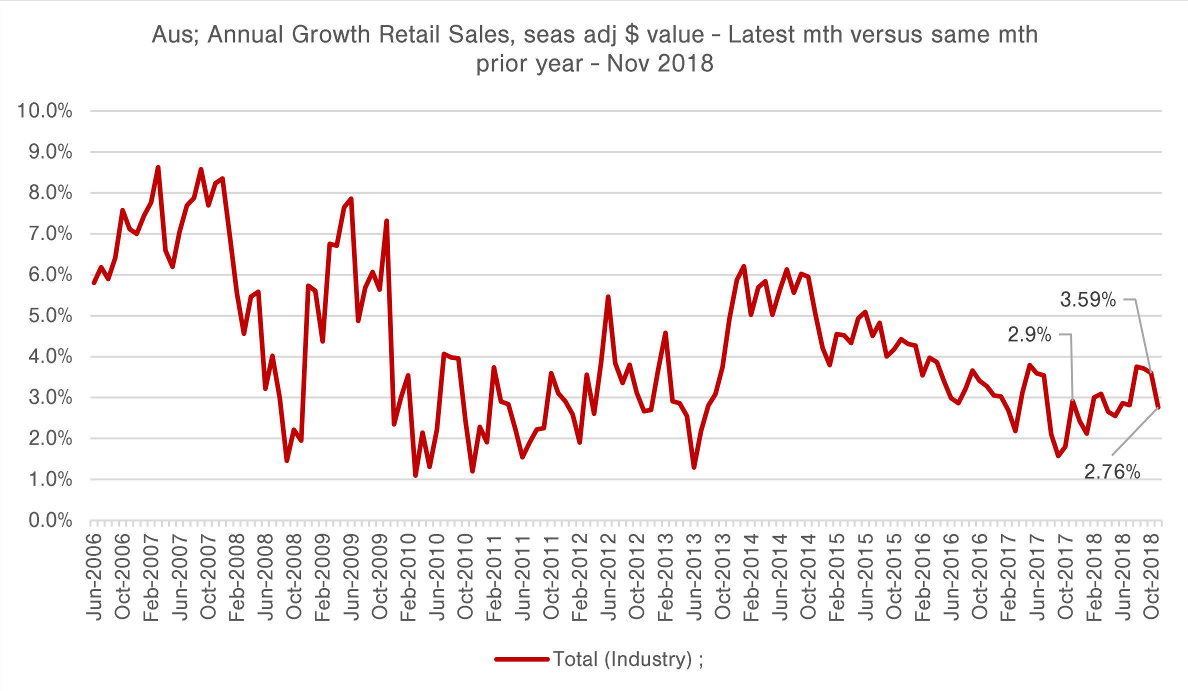


Spending in Cafes/Restaurants continued to decline. Other Retail declined. Growth in Clothing, Footwear and Personal halved month on month, but this was partly due to a much stronger Oct.

% chg from year ago – Retail Sales

Nov 2018 +2.8% versus Oct +3.6%

The Nov growth was slightly slower than the annual rate of growth recorded in Nov 2017 of +2.9%.



http://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/8501.0Main%20Features1Nov%202018?opendocument&tabname=Summary&prodno=8501.0&issue=Nov%202018&num=&view=

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China

China CPI (Dec)

Annual growth: Dec +1.9% versus Nov +2.2%

China PPI – (Dec)

Annual growth; Dec +0.9% versus Nov +2.7%

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Trade

US-China Trade Negotiations

The latest round of trade talks concluded during the week with an extra day added on.

The official statement by the USTR on the meeting outcome contained little detail on progress made. In most likelihood, this will lay the foundations for more the senior/high-level negotiations to come.

The USTR continued to reiterate key goals for the US administration (emphasis added);

> The meetings were held as part of the agreement reached by President Donald J. Trump and President Xi Jinping in Buenos Aires to engage in 90 days of negotiations **with a view to achieving needed structural changes in China with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft of trade secrets for commercial purposes, services, and agriculture**.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/january/statement-united-states-trade

It has now been announced that Premier Liu He will come back to Washington DC for talks on 30 and 31 January 2019 - could be as late as mid-Feb, although Chinese New Year celebrations will commence 5 Feb and continue for two weeks.

It is unclear whether this next meeting will be impacted by the ongoing government shutdown.

NEW – Special 2019 Section 301 Review

Posted on the Federal Register by the USTR is a request for comments and a notification of a public hearing for the annual special S.301 review;

> to identify countries that deny adequate and effective protection of intellectual property rights (IPR) or deny fair and equitable market access to U.S. persons who rely on intellectual property protection.

The special 301 subcommittee will hold a hearing on 27 Feb 2019.

On 26 Apr 2019, the USTR will publish the 2019 special 301 report within 30 days of the National Trade Estimate Report.

https://www.federalregister.gov/documents/2018/12/28/2018-28319/request-for-comments-and-notice-of-a-public-hearing-regarding-the-2019-special-301-review

NAFTA/USMCA

The government shutdown is reportedly halting further progress on the evaluation of the USMCA. The report by the US International Trade Commission on the economic impact of the new agreement has been delayed by the shutdown.

The report is due 15 March 2019 and will be used by member of Congress to inform their view of the agreement.

President Trump has already indicated that he will withdraw from NAFTA if there is any push to renegotiate the USMCA by the Democrats.

US-Japan Trade Talks

The summary of negotiating objectives for the US-Japan trade talks have been published;

https://ustr.gov/sites/default/files/2018.12.21_Summary_of_U.S.-Japan_Negotiating_Objectives.pdf

Awaiting details on when talks are to start, but likely to be late Jan/early Feb 2019.

Section 232 – Car and Truck Imports

The final report on the S232 has not yet been made public.

US-Europe Trade Talks

The summary of negotiating objectives for the US-EU trade talks have been published;

https://ustr.gov/sites/default/files/01.11.2019_Summary_of_U.S.-EU_Negotiating_Objectives.pdf

Awaiting further notice on the commencement of talks.

US-UK Trade Talks

A formal request has now been posted on the US Federal Register for comments on the negotiating objectives for a US-UK trade agreement. https://www.federalregister.gov/documents/2018/11/16/2018-24987/request-for-comments-on-negotiating-objectives-for-a-us-united-kingdom-trade-agreement

A public hearing has been scheduled for 29 Jan 2019 on the negotiating objectives for the US-UK trade talks.

As noted in the announcement, the USTR will publish objectives for the negotiations at least 30 days before negotiations begin. (https://ustr.gov/about-us/policy-offices/press-office/press-releases/2018/october/trump-administration-announces).

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