MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 4 February 2019

Key Themes

Growth downgrades were announced during the week by the EC, the BoE and the RBA.

The EC lowered growth forecasts for Euro area GDP; +1.3% in 2019 and 1.6% in 2020 (Autumn Forecast: 1.9% in 2019; 1.7% in 2020). Italy is already in recession and there is a risk of Germany also falling into recession. The EC maintains that "Europe's economic fundamentals remain solid".

The BoE kept rates on hold. Brexit remains the largest near-term risk with rising uncertainty about the form of Brexit. This is acting as a headwind to business decisions and the BoE has reduced growth forecasts. The UK services PMI reflects the impact of increasing uncertainty of Brexit on business decision making.

The RBA also kept rates on hold. Importantly, the RBA has shifted from its tightening bias ("next move in rates likely to be up") to a more neutral bias – "the next move could be up or down". This reflects concerns regarding the domestic housing market, consumption and global growth. The RBA downgraded economic growth from the "3.5% average" to 2.5% in June 2019 and then back up to +3% by the end of 2019. For the RBA, negative shifts in the labour market will likely be the key for rate cuts.

Comments by US San Francisco Fed President, Mary Daly, late in the week sparked the interest of the markets, saying that the US Fed balance sheet could be used to "generate more stimulus than it could achieve by just cutting rates" (rather than just using the balance sheet in emergency situations). This was broadly interpreted as "QE for ever".

US agencies are starting to catch up on the reporting backlogs. Factory orders, shipments and inventories were weak in Nov – driven by falls in non-durable goods (petroleum products) orders, shipments and inventories. International trade data also suggests that lower oil prices may have impacted the headline trade result. But the price-adjusted import data shows a broader slow-down (but not decline) of growth, especially since Oct. Both PMI reports into services for Jan indicated slower growth – which could be an effect from the partial government shutdown. The Jan motor vehicle sales data was very weak.

Weaker consumer data was recorded in the EU and Australia for Dec. EU retail sales (vol) fell in Dec across a broad range of categories, reversing the stronger gains in Oct and Nov. Aussie retail sales growth was marginal at best in vol terms and down in value terms. The shifting holiday retail calendar outside of the US has been bringing sales forward into Nov, but this was still a weak retail result for Australia. The Aus Services PMI also fell hard in Jan suggesting further weakness, especially in retail.

So far, much of the data around the 'growth slowdown' has been reflected in slower growth in production/manufacturing and exports, with weakness emanating mostly from Asia/China. PMI's throughout Asia and Europe have been indicating slower growth in output and new orders while backlogs decline. For the most part, this weakness has yet to be reflected in consumer-based data. Some retail reports are starting to weaken, and we'll get a better handle on that in the next few weeks. US data will be harder to evaluate given the possible impact of the partial govt shutdown. For example, US auto sales decline sharply in Jan during the shutdown. PMI's are just starting to hint at weaker growth in employment – but most labour market reports remain quite strong.

Contents

US Data

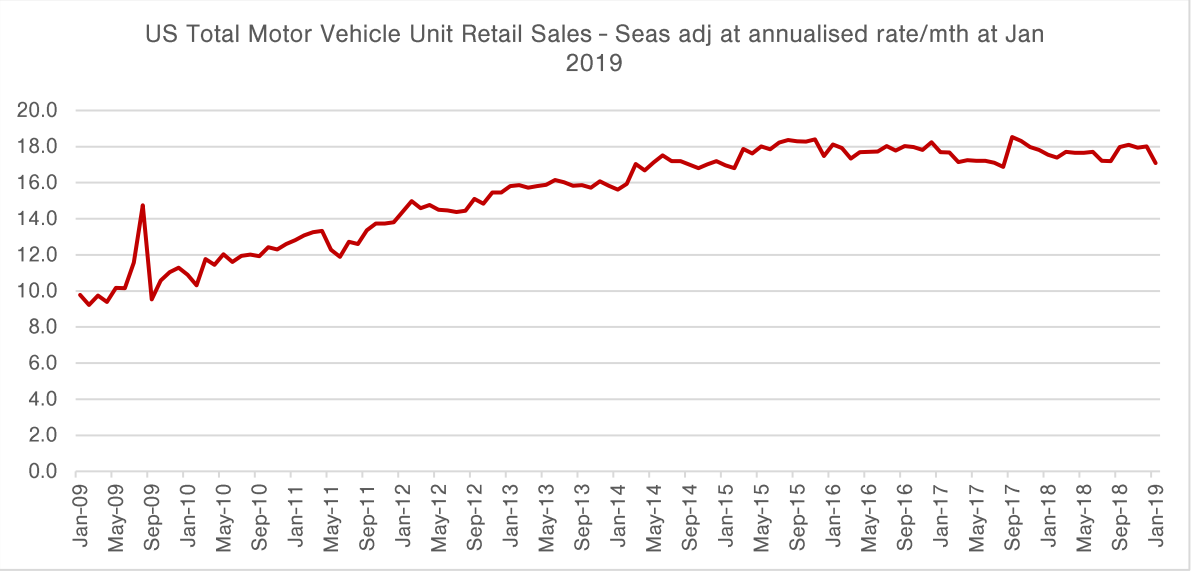
Motor Vehicle Sales (Jan)

The seasonally adjusted annual rate of total motor vehicle unit sales declined by 5% in Jan compared to Dec. The fall in the month was the result of a relatively large decline month on month decline in Light Truck/SUV sales of -7.8% while Car/Auto sales increased slightly, but not enough to offset the decline in Light Truck sales.

TOTAL Motor Vehicle Sales SAAR (mth % chg):

Jan 17.1m units (-5.1%) versus Dec 18m units (+0.4%) versus Nov 17.9m units (-0.9%)

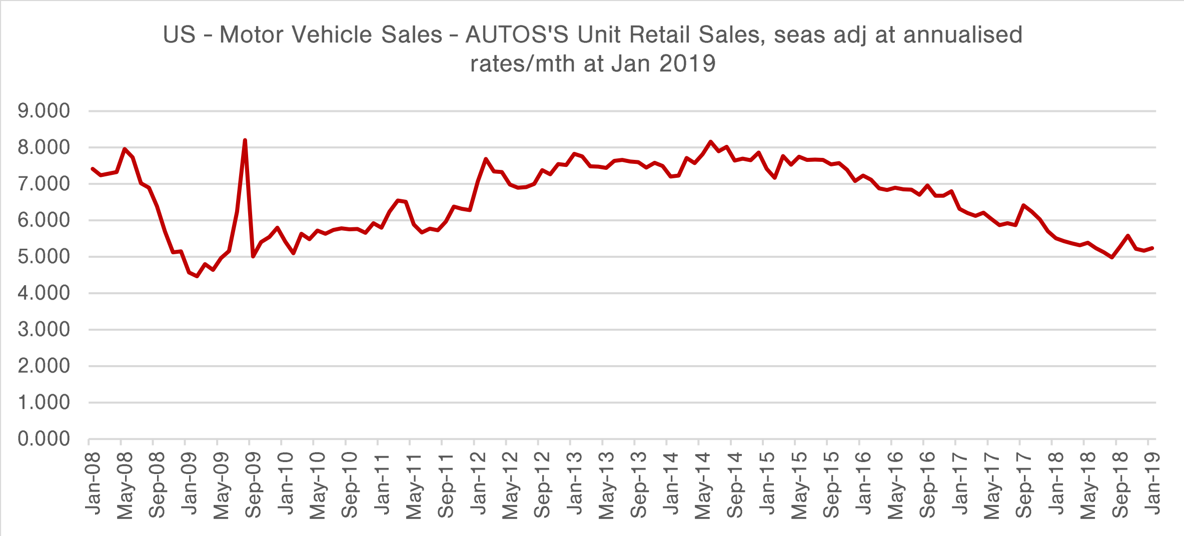
The annual % chg – Jan 2019 versus year ago (not seasonally adjusted): Jan -1.6%



Total motor vehicle sales remain 23% below the all-time high seas adjusted annual rate of unit sales of 22.06m units.

Car/Autos Sales SAAR (mth % chg): Jan 5.24m units (+1.3%) versus Dec 5.17m (-1.1%) versus Nov 5.22m (-6.4%)

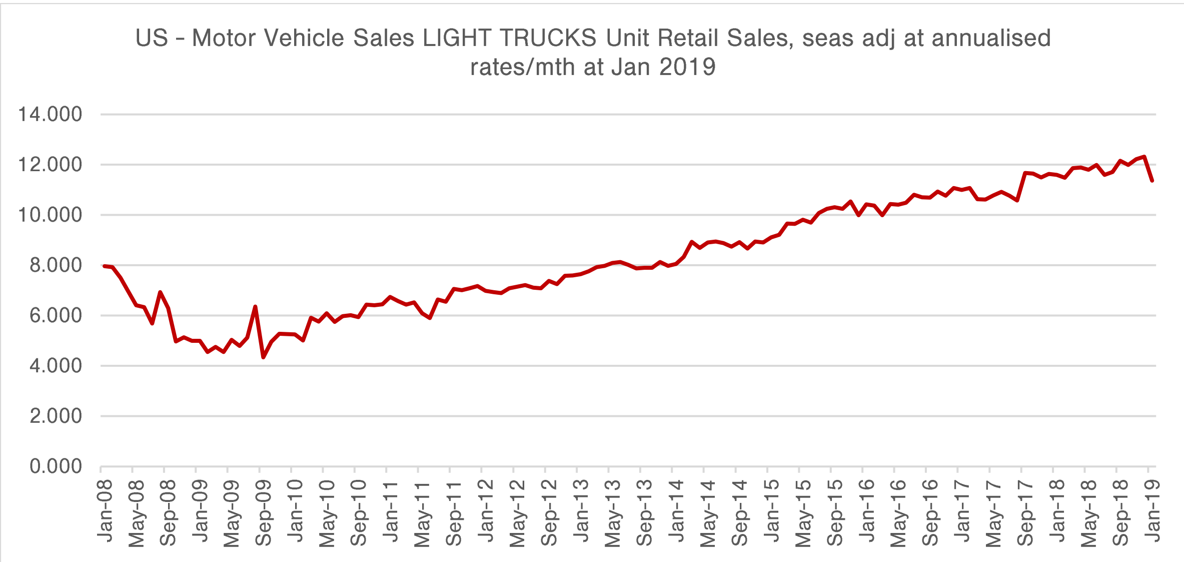
The annual % chg – same mth versus a year ago (not seasonally adjusted); Jan -5%



Car/Autos remain well below peak (SAAR) sales of 15.05m units and is now only 17% above the all time minimum seasonally adjusted annual rate of 4.46m.

Light Truck Sales SAAR (mth % chg); Jan 11.36m units (-7.8%) versus Dec 12.3m (+0.9%) versus Nov (12.2m (+1.9%)

The annual % chg – same month versus a year ago (not seasonally adjusted); Jan -1%



Sales of light trucks are now 10% below the all-time high seas adjusted annual rate of 12.59m units.

https://www.bea.gov/national/xls/gap_hist.xlsx

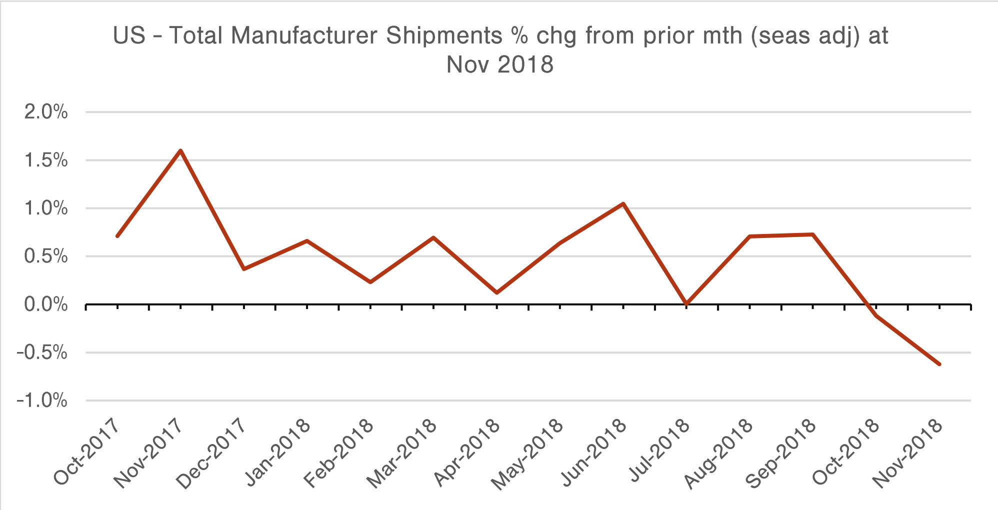
https://www.bea.gov/national/xls/gap_hist.xlsx

Factory Orders (Nov)

The decline in shipments, new orders and inventories this month can be clearly traced back to a decline in the value of shipments, new orders and inventories for non-durable goods (petroleum products).

<u>Shipments</u>

Shipments of manufactured goods (seas adj) mth % chg; Nov -0.6% (-$3.16bn) versus Oct -0.1%

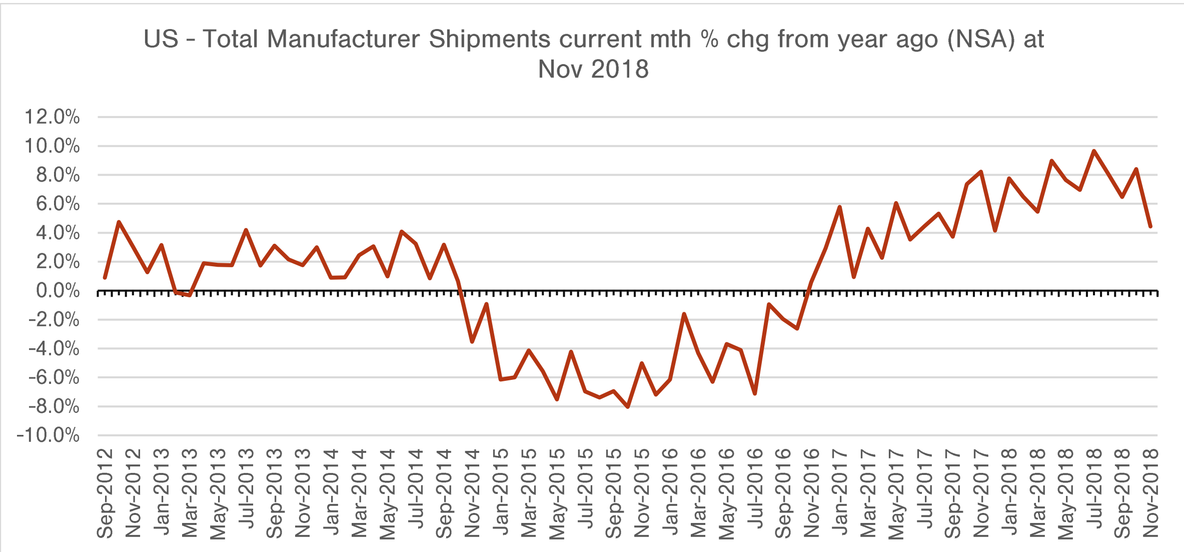


The decline in the latest month was the result of lower shipments of non-durable goods – namely petroleum and coal products.

Durable Goods; Nov +$1.7bn versus Oct -$0.87bn

Non-Durable Goods; Nov - $4.9bn versus Oct +0.27bn – shipments from petroleum refineries declined by -$5.5bn in Nov.

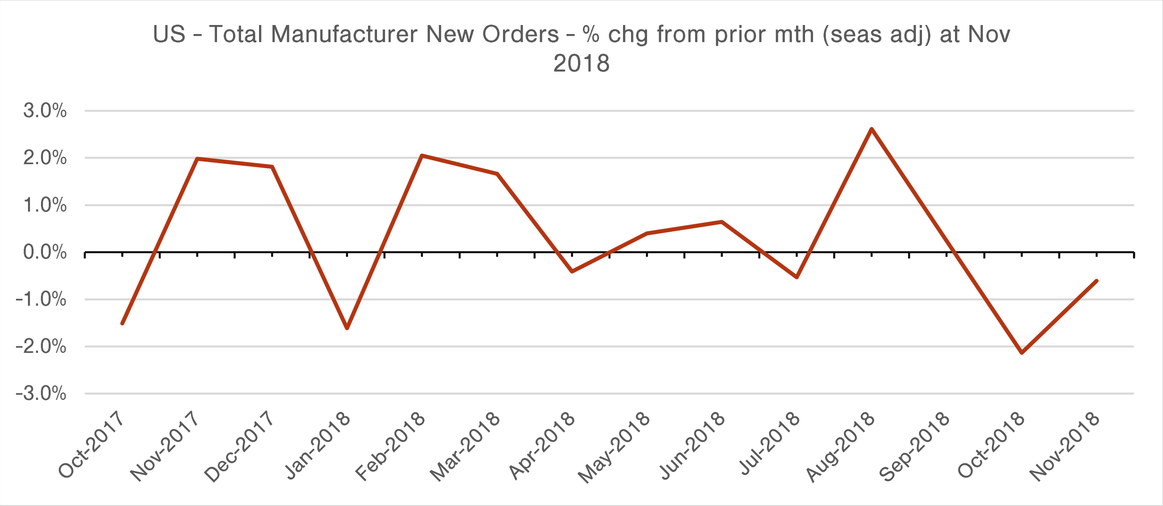
On an annual basis (NSA) growth in shipments has continued to slow; Nov +4.4% versus Oct +8.4%



New Orders

New orders of manufactured goods also declined further in the latest month (mth % chg);

Nov -0.6% (-$3.1bn) versus Oct -2.1%

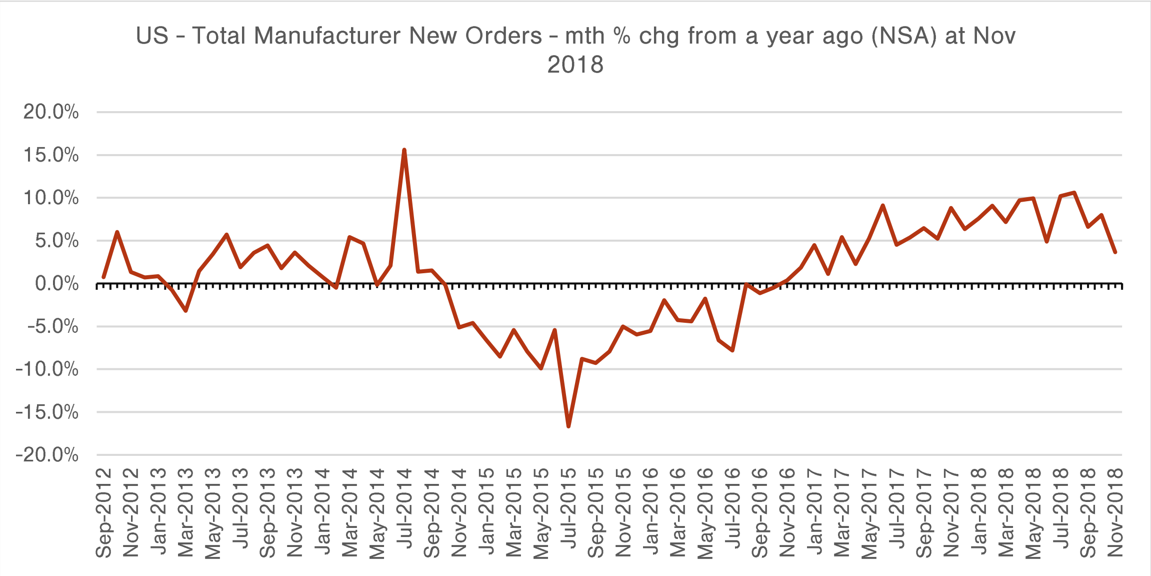


The decline in new orders for the month was also the result of lower new orders for non-durable goods;

Durable Goods; Nov +$1.8bn versus Oct -$11.2bn

Non-Durable Goods; Nov - $4.9bn versus Oct +0.27bn (the same values are provided for shipments and new orders for non-durable goods)

On an annual basis, growth in new orders has also continued to slow; Nov +3.7% versus Oct +8%



Inventory

The value of inventories declined in the latest month. Again, that decline was the result of lower petroleum inventories.

Total inventory (mth % chg); Nov -0.1% (-$1bn) versus Oct +0.2%

Durable Goods inventory (mth % chg); Nov +0.4% (+1.6bn) versus Oct +0.2%. There was no one industry driving the higher growth in durable goods inventories.

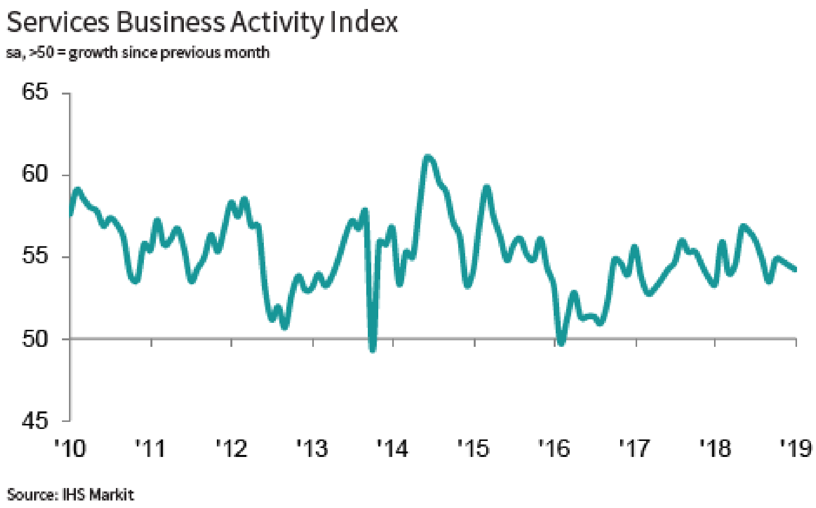
Non-Durable Goods inventory (mth % chg); Nov -1% (-$2.6bn) versus Oct +0.1%. Petroleum and coal products inventories declined by -$3.1bn in the month.

https://www.census.gov/manufacturing/m3/index.html

US Services PMI (Jan)

Private sector services activity continued to grow but at a slightly slower pace in the latest month (despite the partial government shutdown). Output, new orders and employment continued to grow, but was below the stronger momentum from early 2018.

Headline Services PMI; Jan 54.2 versus Dec 54.4



Output continued to grow but at the slowest pace in four months.

New business grew at a similar pace as in Dec with domestic demand offsetting a further decline in foreign/export new orders. Order backlogs increased.

Input price growth eased. Higher costs from raw materials and wages were offset by lower fuel prices. Output prices increased from the 12mth low recorded in Dec.

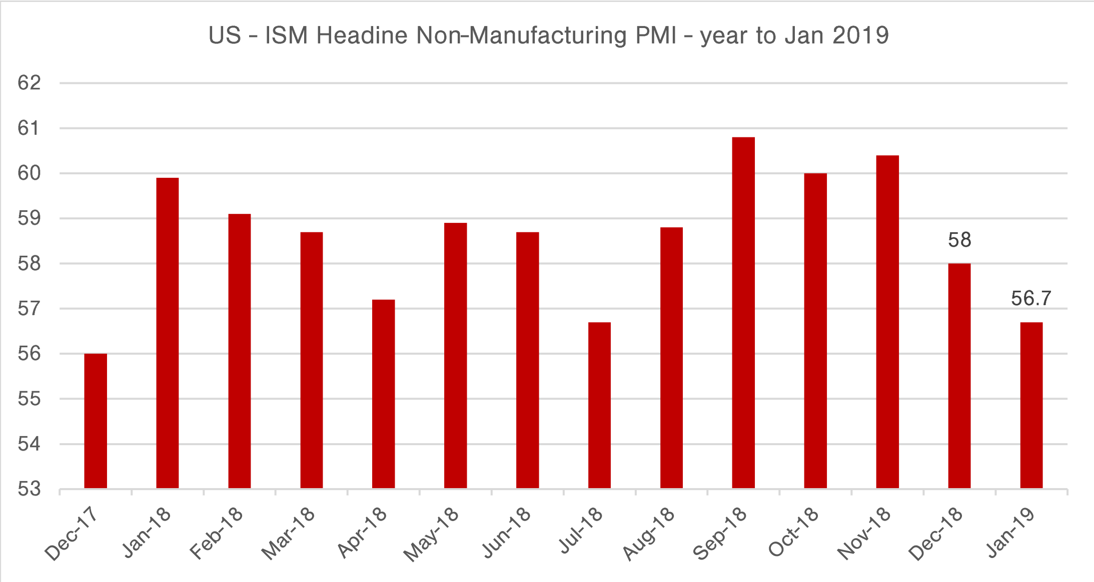
Employment growth eased to the second lowest rate of growth since mid-2017.

https://www.markiteconomics.com/Survey/PressRelease.mvc/6693d23aa79c43589e09bf02f28ce0ce

ISM Non-Manufacturing PMI (Jan)

The ISM also confirmed the somewhat slower pace of growth in private sector service activity – possibly impacted by the partial government shutdown. Service firm output grew at a slightly slower pace while new orders growth slowed (but off a high base). Like the PMI, new export orders recorded only marginal growth in the month – highlighting the ongoing weakness in external demand.

Headline ISM Non-Manufacturing PMI; Jan 56.7 versus Dec 58



Business output/activity grew at a slower pace. The underlying make-up of the index suggests that firms shifted from recording the 'same' level of activity to recording a 'lower' level of activity. In Jan, 24% of firms recorded 'lower' levels of activity, up from 11% in Nov. At the same time, 33% of firms recorded 'higher' levels of activity in Jan which was below the 40% recorded in Nov.

At the same time, order backlogs increased at a faster pace, picking up from the marginal growth recorded in Dec.

The new orders index slowed much faster. From 62.7 in Dec to 57.7 in Jan. It will be important to see whether this rebounds after the shutdown ended. New export orders slowed significantly recording only a marginal increase in Jan (64% of firms in this survey don't have international exposure or don't record export sales separately). The proportion of firms recording 'higher' and 'lower' levels of new orders is now on par.

Employment levels increased at a slightly faster pace.

Input prices also continued to increase at a slightly faster pace.

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

Mortgage Applications; 1 Feb 2019

Mortgage applications declined for the second week.

Mortgage applications declined by -2.5% in the latest week versus the week prior.

The seasonally adjusted purchase index declined by 5% versus the week prior and was 2% below the same week a year ago.

Mortgage rates declined in the latest week (-7bps on the 30year fixed to 4.69% - the lowest since early 2018).

https://www.mba.org/2019-press-releases/february/mortgage-applications-decrease-in-latest-mba-weekly-survey

International Trade (Nov)

In the latest month, the trade deficit improved but both imports and exports declined - where exports declined less than imports. This month on month decline in imports and exports highlights a shift in the underlying momentum (slower) of nominal export and import growth throughout 2018.

The YTD trade deficit became larger as import growth exceeded export growth.

Monthly Trade Balance (Deficit); Nov -$49.3bn versus Oct -$55.7bn

Exports; Nov -0.6%

Imports; Nov -2.9%

The decline in both imports and exports in the month was the result of lower trade in Goods;

The largest contributor the decline in Goods exports was Industrial Supplies (includes petroleum) (-2.9%), Consumer Goods (-5%) and Autos (-3%).

The decline in imports was led by a larger decline in Industrial Supplies (-6.9%) and Consumer Goods (-7.5%).

YTD Trade Balance (Deficit); YTD Nov 2018 -$552.3bn versus YTD Nov 2017 -$500.4bn

Exports; YTD Nov 2018 +7.3%

Imports; YTD Nov 2018 +7.9%

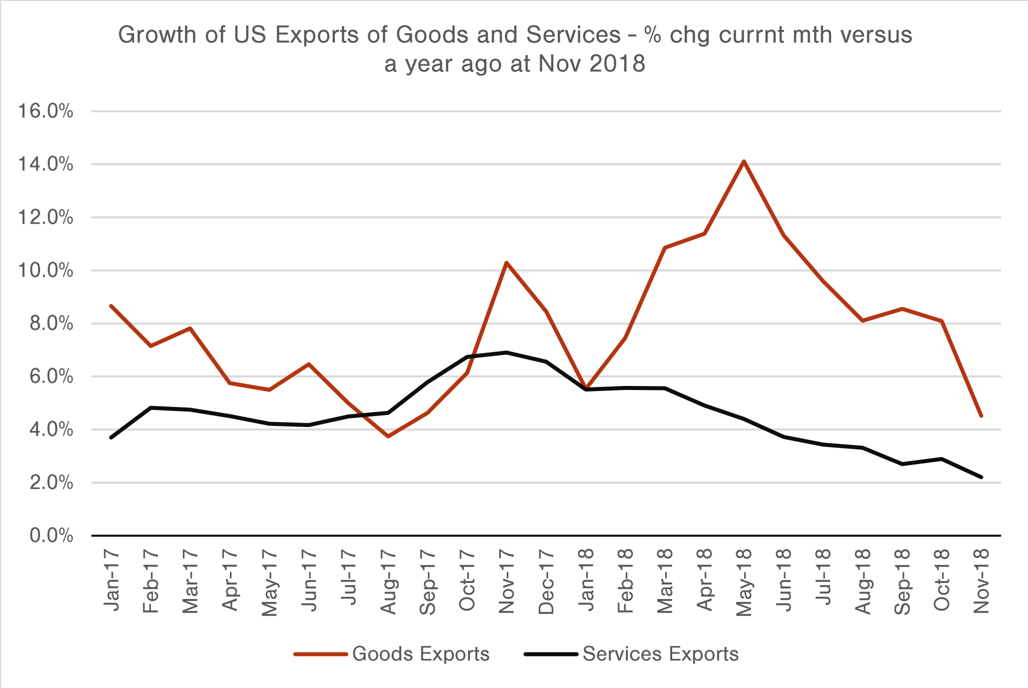
In the YTD, growth in Goods exports and imports is the main driver of total export and import growth.

YTD Goods imports has been led by higher growth in Industrial Supplies (+14.6%), but imports YTD have grown across most categories. The growth in imports of motor vehicles has underperformed growing at +3.6% (versus +9% growth in Total Goods imports YTD).

YTD Goods exports also grew by 9% YTD (but a lower $ value). Growth in Goods exports was led higher by Industrial Supplies (+17.4%). Similarly, the YTD growth in the export of motor vehicles underperformed growing YTD at +1.6%.

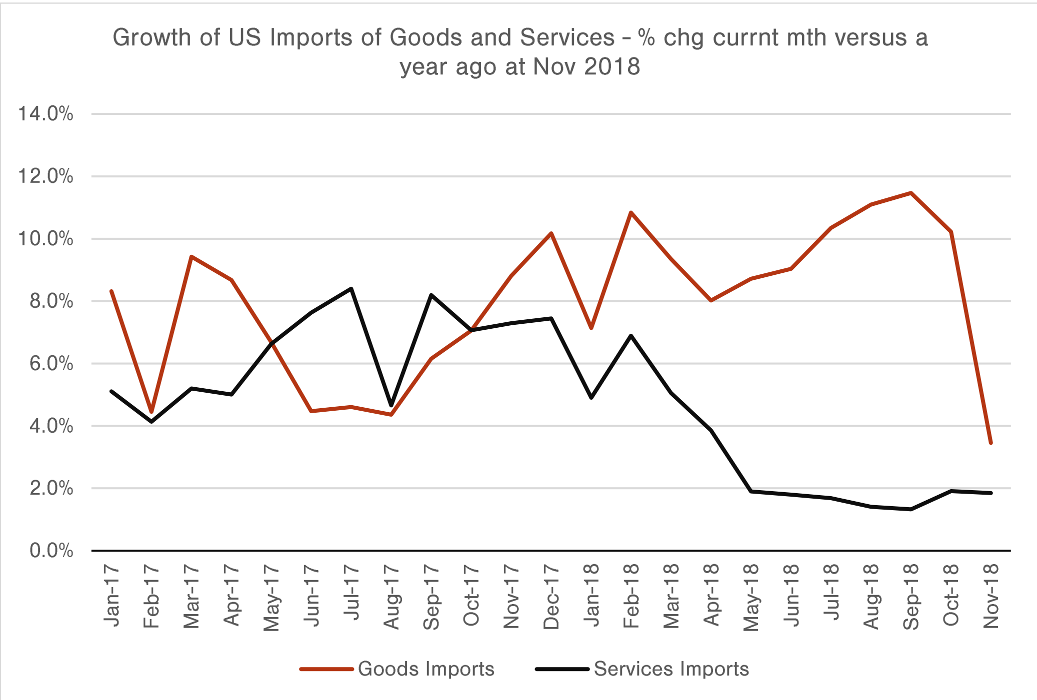
Growth in Exports and Imports versus a year ago

The latest month of trade data continues to highlight the underlying trend not yet evident in the YTD data; that export growth has been slowing. In fact, the growth in Goods and Services exports (in dollar value) has slowed throughout 2018 (slowed, not declined);



The growth in the value of imported Goods has slowed quickly from Oct. On a year ago basis, import of goods such as Industrial Supplies (possibly oil-price related) and Consumer Goods slowed very quickly. These two categories were the largest contributors to the Nov month decline in imports.

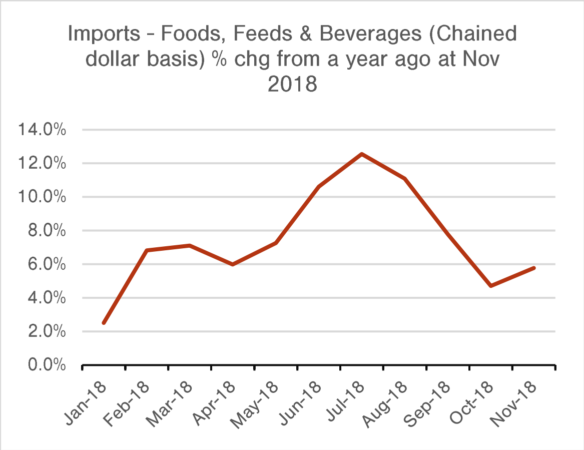
Growth in Service imports has remained lower throughout 2018;

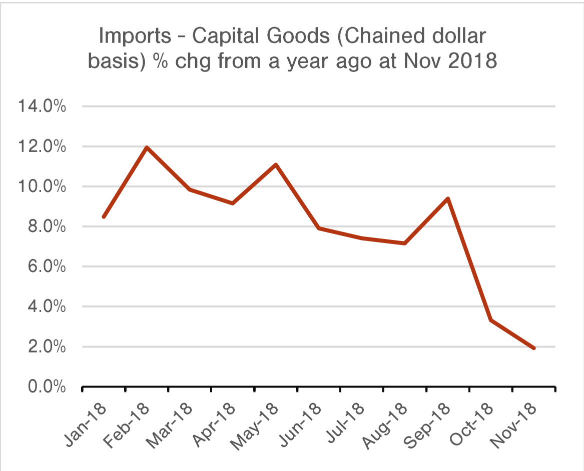


These same trends for Goods imports are also evident on a chained dollars basis (price deflated). Only Auto imports have continued to grow at a faster pace on a price deflated basis.

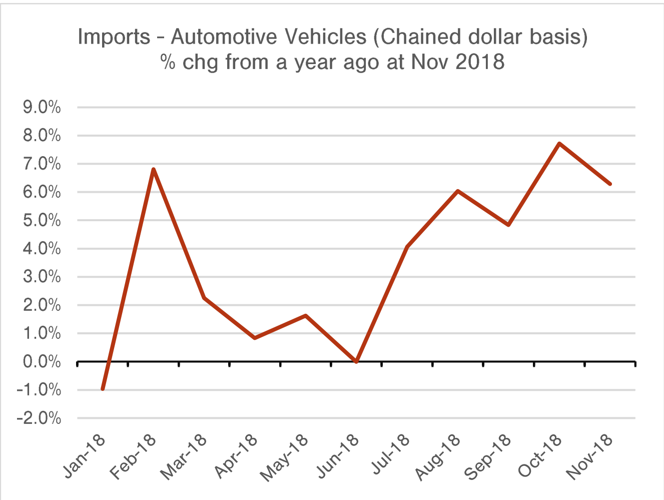
Is the slower growth in imports a reflection of a broader macro/demand slowdown? Here are a few charts of Principal End-Use Import Categories showing import growth slowing across Industrial Supplies, Capital Goods and Consumer Goods imports.

The slow-down in imports doesn't seem to be limited to just oil prices.





Bucking the trend is the import of Automotive Vehicles which has been growing at a faster pace throughout the latter part of 2018;



https://www.census.gov/foreign-trade/Press-Release/current_press_release/index.html#real

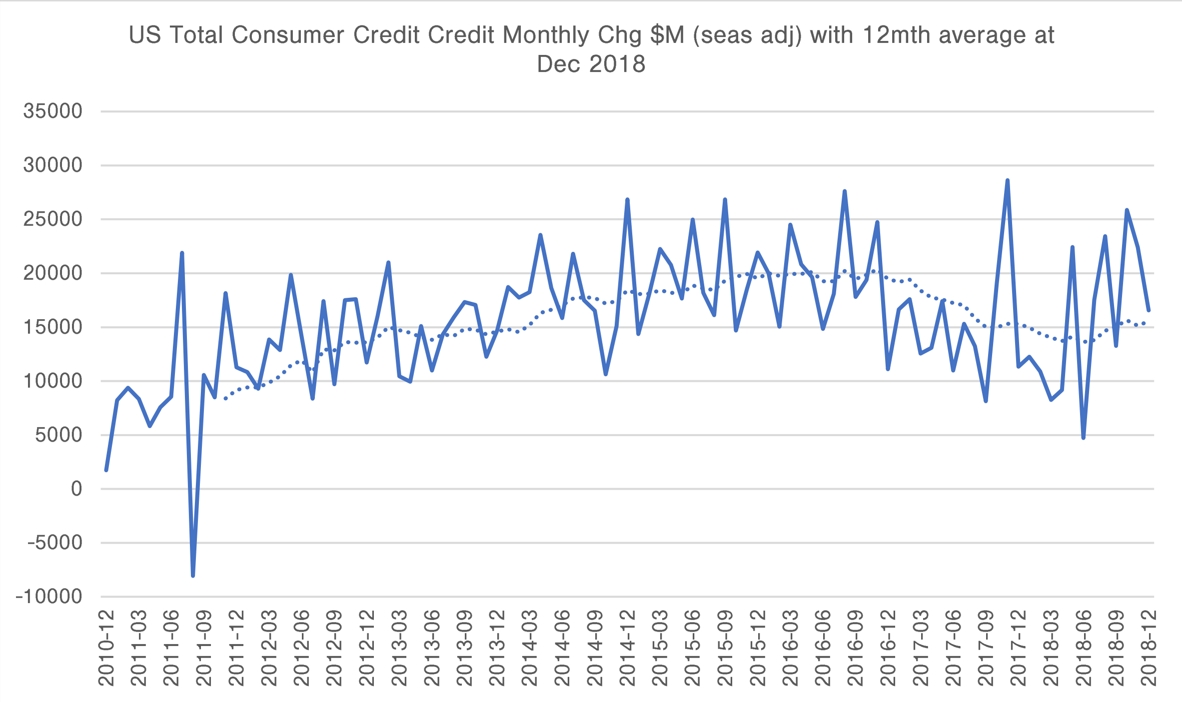
Consumer Credit (Dec)

US consumer credit grew at a slower pace in Dec. The two main components of consumer credit, revolving and non-revolving credit both grew at a slower pace in Dec.

<u>Total Consumer Credit $ Growth;</u> Dec +$16.5bn (+0.4%) versus Nov +$22.4bn (+0.6%)

The annual growth in total consumer credit outstanding increased by +4.7% in Dec.

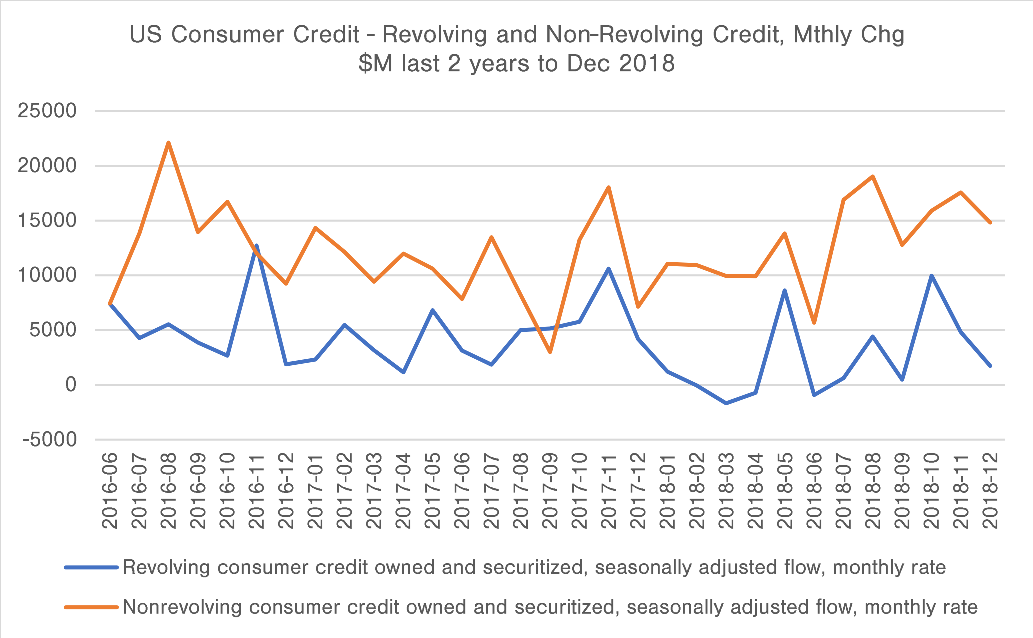
Total Q4 consumer credit grew by +1.6% over Q3



The two main components of consumer credit – revolving and non-revolving credit – both grew at a somewhat slower pace in Dec;

Revolving Credit $ Growth; Dec +$1.7bn (+0.2%) versus Nov +$4.8bn (+0.5%)

Non-revolving Credit $ Growth; Dec +$14.8bn (+0.5%) versus Nov +$17.6bn (+0.6%)



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

US Federal Reserve Speeches

US Fed Chairman Powell speech - Brief Opening Remarks at the Conversation with the Chairman: A Teacher Town Hall Meeting, Washington, D.C.

https://www.federalreserve.gov/newsevents/speech/powell20190206a.htm

San Francisco Fed President Mary Daly; participant in a moderated Q&A at the Bay Area Council Economic Institute's 12th Annual Economic Forecast Conference in San Francisco

> Comments from one Federal Reserve policymaker that further US interest rate rises seem less necessary now than a few months ago and that bond purchases by the central bank could be used as a policy tool not solely reserved as a last resort in a financial crisis, may have also helped the turn-around in stocks and a rally in Treasuries.
>
> Mary Daly, president of the San Francisco Fed, told reporters following a speech on Friday the tightening of financial conditions over recent months is doing some of the work the central bank would have otherwise had to have done by raising borrowing costs. Ms Daly also said she was open to the idea of "more readily" using bond purchases, and not simply waiting to deploy them as a policy tool only after the central bank had cut interest rates as much as it could.

https://www.ft.com/content/64438e60-2be4-11e9-88a4-c32129756dd8

Also; https://finance.yahoo.com/news/balance-sheet-could-fed-apos-202345378.html

More Fed speeches; https://www.stlouisfed.org/fomcspeak

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EUROPE

EC – Winter 2019 Economic Forecast; Growth moderates amid global uncertainties

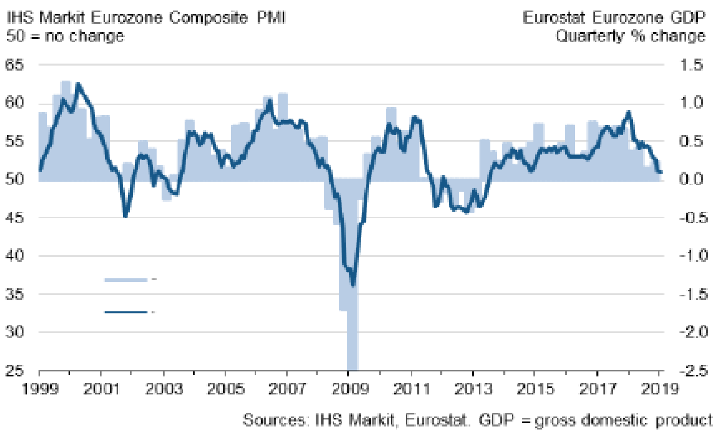
http://europa.eu/rapid/press-release_IP-19-850_en.htm

Eurozone Composite and Services PMI (Jan)

The headline Eurozone Composite PMI was little changed in Jan. Slower growth in manufacturing was somewhat offset by services activity that was mostly unchanged.

Composite PMI; Jan 51 versus Dec 51.1

IHS Markit Eurozone Composite PMI



Overall weaker activity was recorded in France and Italy – with total private sector output falling in both countries.

Employment growth remained the weakest in over two years. Backlogs of work declined for the second month in a row. Input prices continued to grow at a faster pace, although eased in the manufacturing sector (oil price -related).

Services PMI: Jan 51.2 versus Dec 51.2

Services output was mostly unchanged in Jan – at around a four-year low. Growth in new work was negligible.

Manufacturing PMI; Jan 50.5 versus Dec 51.4

Overall output growth in manufacturing was "sustained via the depletion of backlogs and stockpiling of finished goods (which rose at a series record rate)".

> "The eurozone has started 2019 on flat note, with growth close to stagnation amid falling demand for goods and services. The PMI indicates that GDP is growing at a quarterly rate of just 0.1%, setting the scene for the region's worst quarter since 2013"

https://www.markiteconomics.com/Survey/PressRelease.mvc/5e716ece4be24afaaae204ff6bfae4ee

Eurozone Retail Sales (Dec)

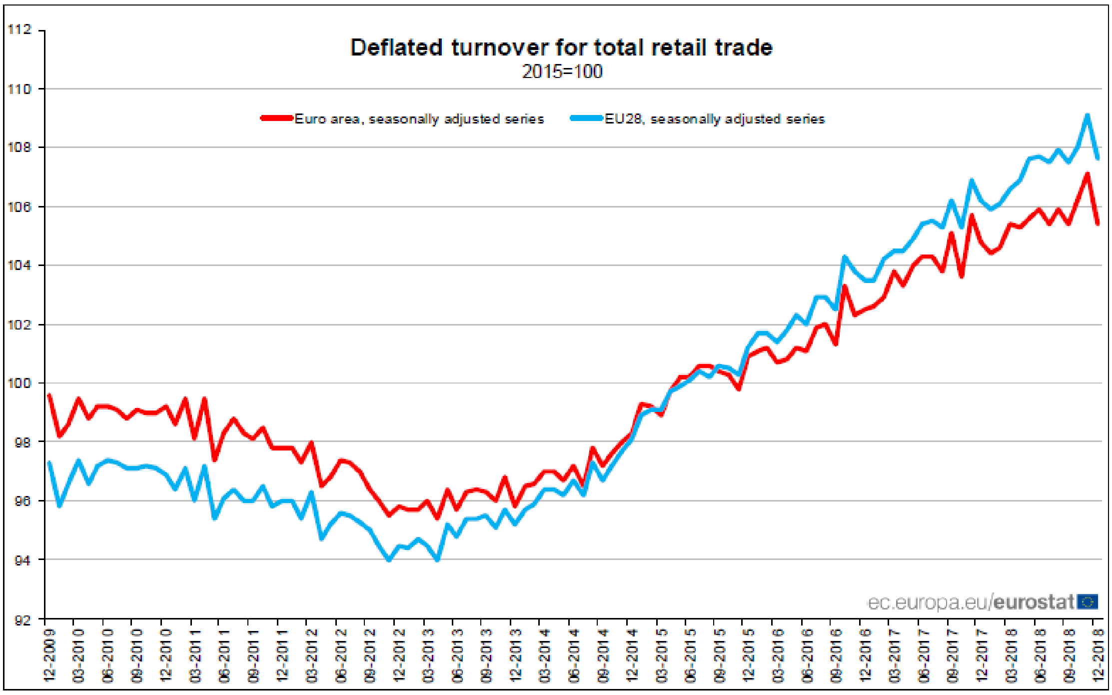
The volume of retail sales in the Euro area and broader EU group fell in the latest month compared to the month prior. Annual growth in retail sales volume halved in Dec.

Euro area Retail Sales – mth chg; Dec –1.6% versus Nov +0.8%

EU28 Group Retail Sales – mth chg; Dec -1.4% versus Nov +1%

The decline versus the month prior was the result of declines in sales across all categories except Automotive Fuel. Declines were recorded across Food, Drink and Tobacco but the more pronounced decline was across the Non-Food categories.

The decline in the month appears to have reversed the stronger growth recorded in Oct and Nov;



The annual growth in retail sales halved across the Eurozone in Dec;

Euro area; Dec +0.8% versus Nov +1.8%

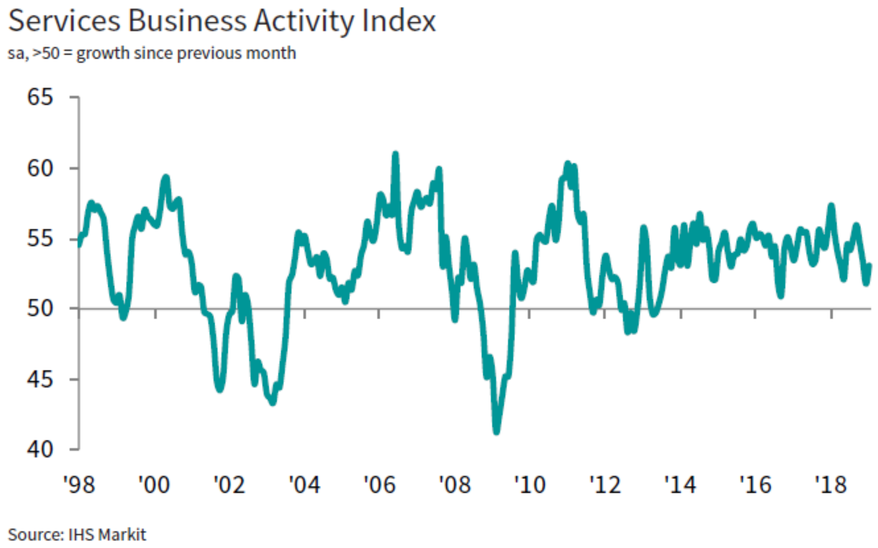
EU28 Group; Dec +1.2% versus Nov +2.5%

https://ec.europa.eu/eurostat/documents/2995521/9550051/4-05022019-AP-EN.pdf/712bc085-6408-4a5d-b88c-4c64d6436e99

Germany Services PMI (Jan)

The headline PMI indicated that private sector services activity grew at a faster pace in January. This was the first increase in four months. Underlying that result, new order growth remained marginal overall and firms continued to work through backlogs of orders.

Services PMI; Jan 53 versus Dec 51.8



Services output increased across a range of industries, but several industries such as Hotels & Restaurants, Transport & Storage and 'Other' Services – which includes health, education and recreational activities – fell into contraction.

Growth in new orders was marginal and slowed closer to stagnation. Somewhat stronger domestic demand was offset by an accelerated decline from new work from abroad. Order backlogs declined in the month for the second month in a row.

Employment growth continued to slow.

Growth in services charges increased at a faster rate in Jan.

Optimism was slightly stronger in Jan for the 12-month outlook but remains at relatively low levels. Firms cited slower growth, Brexit and lack of suitable candidate availability as key concerns.

https://www.markiteconomics.com/Survey/PressRelease.mvc/39b0607e0ae145159449ae012be81780

Germany Factory Orders Final Nov and prelim Dec

The more forward-looking factory orders data indicated a continued decline in manufacturing activity the latest month. New factory orders remain below last year which suggests future production weakness may persist. New orders from both domestic and foreign markets remain below levels recorded in the year prior. New orders for intermediate goods and capital goods remain below last year offsetting an improvement in new orders for consumer goods.

Total Manufacturing New Orders Month on Month % chg

Dec -1.6% versus Nov -0.2% (revised higher from -1%)

The decline new orders for the month was the result of declines from the domestic market (-0.6%) and foreign countries (-2.3%) led by Non-Euro countries. New orders from the Euro-area increased in the month by +3.2%, partially offsetting the -9.9% in the month prior.

The main groups that contributed to the monthly decline were;

Intermediate goods; Dec-1.2% versus Nov -3.6% (led by the domestic market and Non-Euro area exports)

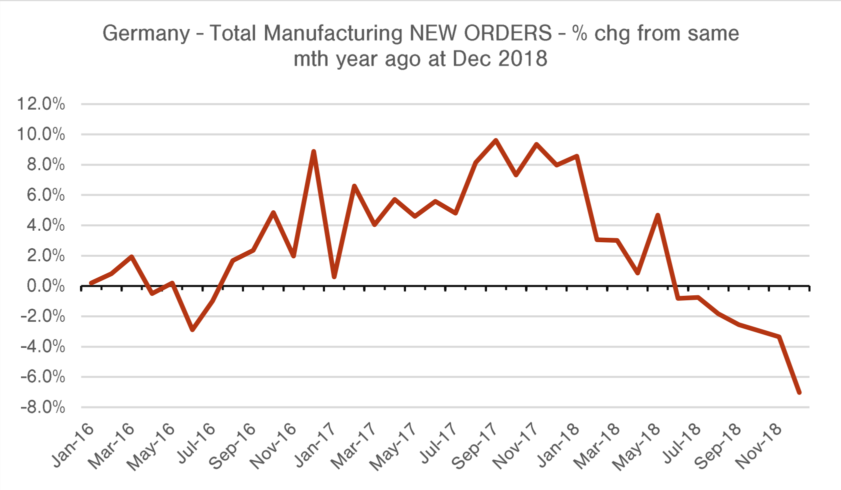
Capital goods; Dec -2.5% versus Nov +2.2% (Weakness persisted in foreign markets)

New orders for Consumer goods increased in the month by +4.2% after a -2.7% fall in the month prior. Both domestic and foreign markets recorded increases in the latest month.

Total Manufacturing New Orders – Annual % chg (NSA same mth a year ago)

On an annual basis, the decline in manufacturing new orders accelerated in Dec;

Dec -7% versus Nov -3.4%



On a year ago basis, declines were recorded for both domestic and foreign markets.

Domestic new orders; Dec annual -2.6%

Foreign new orders; Dec annual -9.7% (Euro area -11.6% & non-Euro area -8.5%)

The annual decline in intermediate goods new orders accelerated; Dec -9.6% versus Nov -8.6% (across both domestic and foreign markets)

New order for capital goods also fell below last year; Dec -6.7% versus Nov +0.1% (led by declines in export orders)

Consumer Goods new orders remain just above a year ago; Dec +1.6% versus Nov -5.5%

https://www.destatis.de/EN/PressServices/Press/pr/2019/02/PE19_042_421.html

Germany Industrial Production (Dec)

Industrial production continued to decline in the latest month, albeit at a slower pace than in the month prior. The continued falls in new orders suggests that production growth is likely to remain weaker.

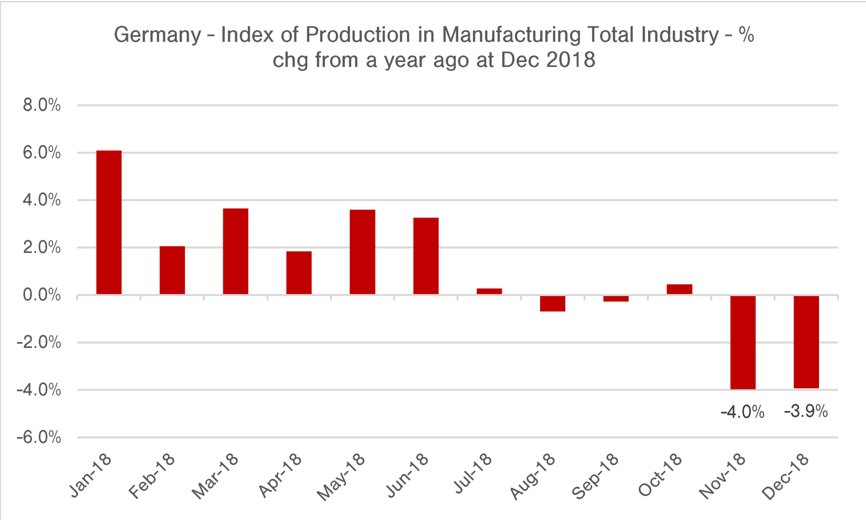
Total Industry Production – Mth % chg

Dec -0.4% versus Nov -1.3% (revised higher from -1.9% decline in the prelim Nov report)

Driving the month result was declines in production of intermediate goods -0.4% and consumer goods -0.5%. While production of capital goods increased +0.9% in Dec.

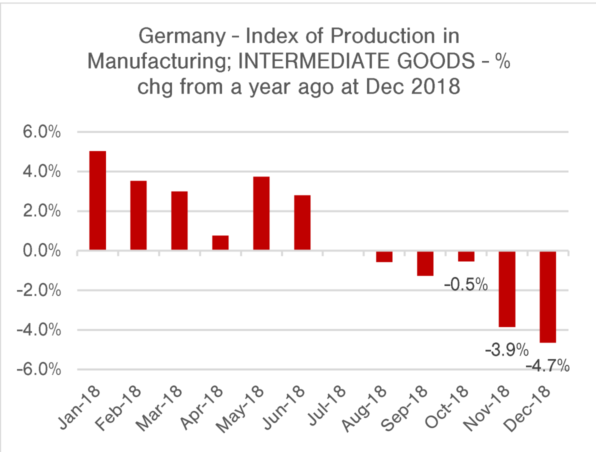
Total Industry Production - % chg from a year ago

Dec -3.9% versus Nov -4% (revised higher from -4.7% in the prelim Nov report)

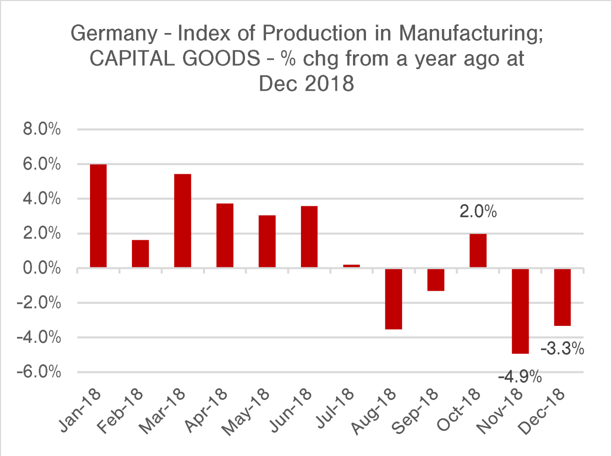


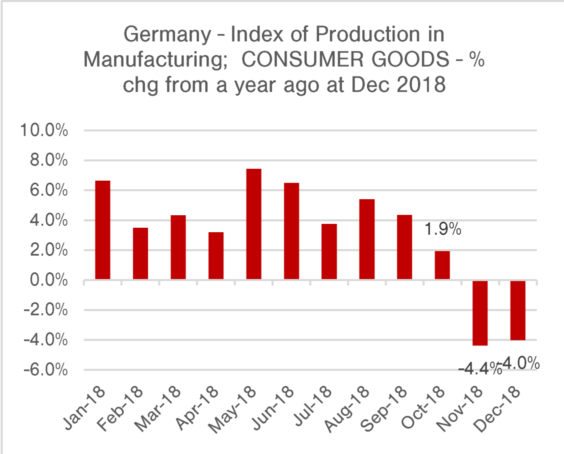
Across the major groups, industrial production remains below last year.

The decline in intermediate goods accelerated in Dec;



Production of capital goods and consumer goods continued to decline, but at a slower pace;





https://www.destatis.de/EN/PressServices/Press/pr/2019/02/PE19_044_421.html

Germany Trade Balance (Dec)

All values in €

The German trade balance (surplus) in Dec improved as exports grew at a slightly faster rate than imports compared to Nov (using seasonally adjusted data). Compared to the same month a year ago though (not seasonally adjusted), the trade balance (surplus) worsened as exports declined and import growth was zero. The full year result of a lower trade surplus highlights some of the slower momentum in export growth compared to imports.

Current month versus mth prior – calendar and seas adjusted

On a calendar and seasonally adjusted basis, the Dec trade surplus increased versus the month prior. This was the result of slightly faster growth in exports than in imports.

Trade Surplus; Dec 19.4bn versus Nov 18.9bn

Exports; Dec 112.3bn versus Nov 110.7bn (+1.5%)

Imports; Dec 92.9bn versus Nov 91.8bn (+1.2%)

The growth in Dec exports versus imports is likely to result in net exports for Q4 making a positive contribution to nominal GDP growth.

Current month versus a year ago

Comparing Dec 2018 to the same month a year ago on an unadjusted basis, the trade surplus was much lower. This was the result of a decline in exports while import growth was zero.

Trade Surplus Dec 2018 v Dec 2017; -24%

Exports; -4.5%. German exports in Dec to Eurozone, non-Eurozone and Third Countries were lower than in the same month a year ago.

Imports; 0%. Compared to the same month a year ago, the increase in imports from Eurozone countries was offset by declines in imports from non-eurozone and third countries.

Full Year 2018 versus 2017

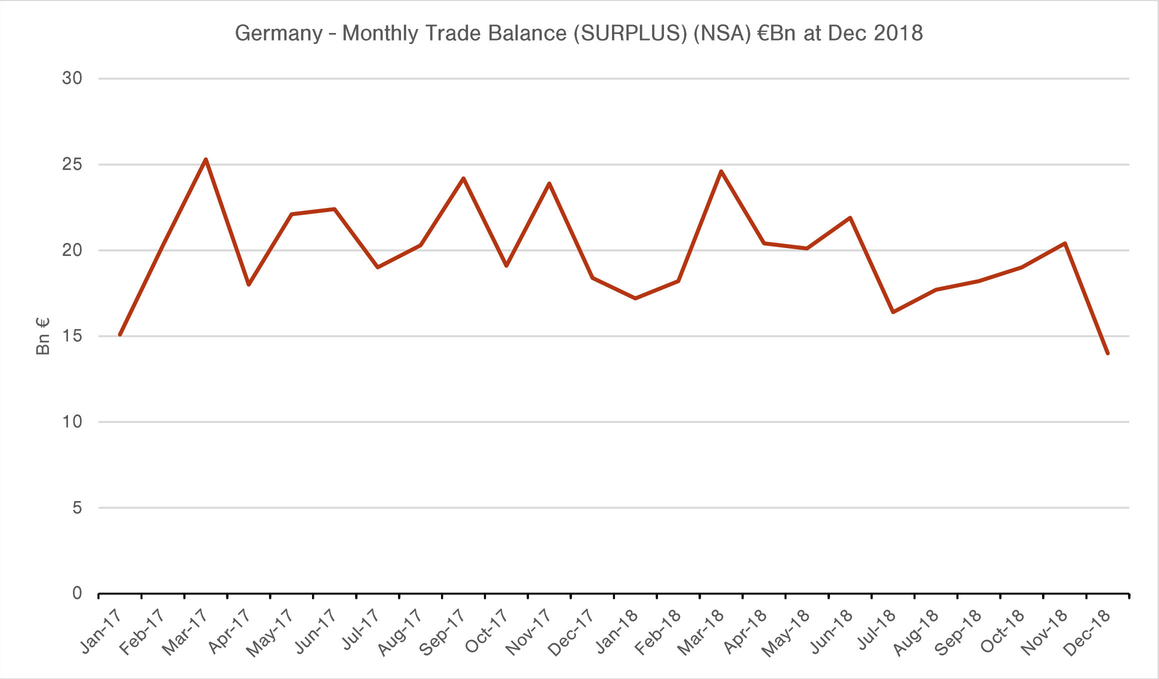
For the full year 2018 compared to 2017, the German trade balances was 8% lower. This was the result of imports growing faster than exports.

Trade Surplus; -8%

Exports +3%. The growth in exports to Eurozone countries (+4.5%) was well above the total rate of export growth, while growth of exports to non-eurozone (+2.8%) and third countries (+1.9%) was lower.

Imports +6%. Similarly, import growth was stronger from Eurozone countries. The growth in imports from non-eurozone and third countries was only slightly lower than total import growth of 6%.

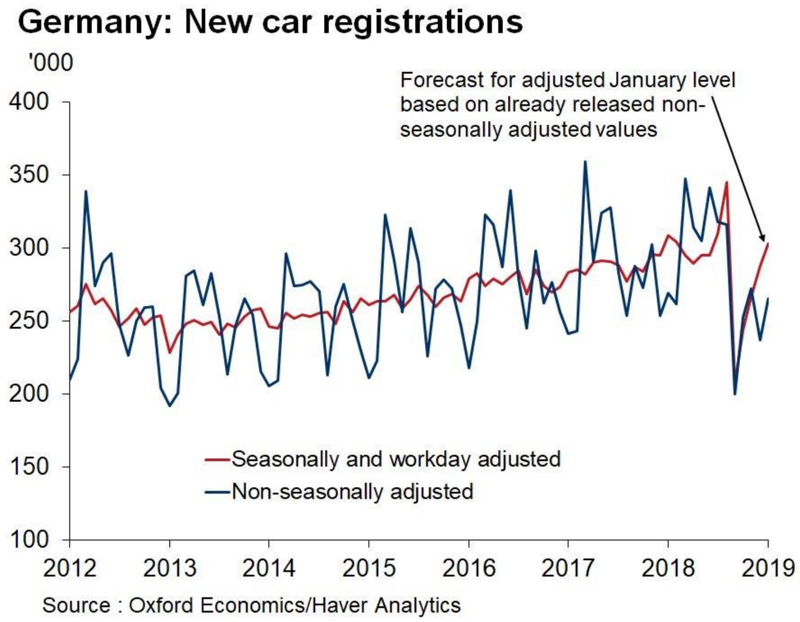
Trend of the monthly trade balance (NSA) for Germany



https://www.destatis.de/EN/PressServices/Press/pr/2019/02/PE19_047_51.html;jsessionid=BA74DE500F4C4F7DCEAA24694A44E62D.InternetLive2

Germany – New Car Registrations

The ongoing rebound in domestic car registrations in Germany may provide some support to the domestic economy. While inventories remain high, production of cars are expected to increase in Feb/Mar.



Source: @OliverRaku Via Twitter 5 Feb 2019

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United Kingdom

Brexit

After last week's vote in the UK parliament for the Brady amendment, PM May remains under pressure to develop alternative ideas to the current backstop agreement to remove the 'trap' of the current temporary customs arrangement from becoming an indefinite feature.

> The EU's view is that it's only indefinite so long as the future trade deal does not solve the border issue. Exiting the backstop is not time-driven, it's event-driven.
>
> The future relationship, which is supposed to give the UK a pathway out of the backstop, is delineated in the Political Declaration, which is *not* legally binding.

A meeting during the week between the EC president Donald Tusk and PM May produced no progress. The UK PM has been able to initiate talks again, but the messaging from the EU remains that the withdrawal agreement is not up for renegotiation.

> EU leaders have remained adamant that the withdrawal agreement cannot be reopened. "We will not gamble with peace; or put a sell-by date on reconciliation. And this is why we insist on the backstop," Donald Tusk, the president of the European Council, told reporters on Wednesday after meeting Ireland's Taoiseach, Leo Varadkar.

Further talks have been scheduled between the two lead negotiators for the EU and the UK. The EU negotiator, Michel Barnier has stated that while the EU will not reopen negotiation of the withdrawal agreement, the EU is open to reworking the Political Declaration. The Political Declaration outlines the plan for the post-Brexit relationship between the EU and the UK. It is not a legally binding agreement. On the clarity of the Political Declaration;

> "…EU diplomats, echoing the phrase used by the former Brexit secretary David Davis to describe his own negotiating style, admit the document's 8,192 words offer a great deal of "constructive ambiguity".

PM May is set to meet Jean-Claude Junker again before the end of February.

Despite news reports last week, EU ambassadors were told last week that PM May had no immediate plans to ask for an extension to Article 50.

https://www.buzzfeed.com/albertonardelli/theresa-may-backstop-solution-eu-buy-time

https://www.rte.ie/news/brexit/2019/0208/1028467-brexit-tony-connelly/

https://www.theguardian.com/politics/2018/nov/22/the-brexit-political-declaration-rated

BoE Interest Rate Decision (7 Feb 2019)

The MPC kept rates on hold with the current bank rate to remain at 0.75%.

The MPC also agreed to maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10 billion and the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435 billion.

Several areas of concern were highlighted in the statement;

Slower growth in the UK in late 2018 with a 'further weakening in early 2019", reflecting Brexit uncertainty and "softer" activity abroad.

Brexit is the more immediate issue for monetary policy;

> "The economic outlook will continue to depend significantly on the nature of EU withdrawal, in particular: the new trading arrangements between the European Union and the United Kingdom; whether the transition to them is abrupt or smooth; and how households, businesses and financial markets respond."

Slower global growth will remain expected to recover "by the more accommodative monetary policies in all major economic areas".

Inflation slowed late in 2018 as higher oil prices started to unwind. Some greater capacity/slack in the economy is expected in the near-term but inflation is expected to settle at a rate above the target.

The inflation report outlines several changes to the forecasts for the outlook;

1. Lower GDP growth – from +1.8% forecast in Nov 2018 to +1.5% as of Feb 2019.
2. CPI growth to slow to +1.8%

Table 5.B Forecast summary[(a)(b)]

	Projections			
	2019 Q1	2020 Q1	2021 Q1	2022 Q1
GDP[(c)]	1.5 (1.8)	1.3 (1.7)	1.7 (1.7)	2.0
CPI inflation[(d)]	1.8 (2.2)	2.3 (2.4)	2.1 (2.1)	2.1
LFS unemployment rate	3.9 (3.9)	4.1 (3.9)	4.1 (3.9)	3.8
Excess supply/Excess demand[(e)]	0 (0)	-¼ (+¼)	+¼ (+¼)	+¾
Bank Rate[(f)]	0.7 (0.8)	0.9 (1.1)	1.0 (1.3)	1.1

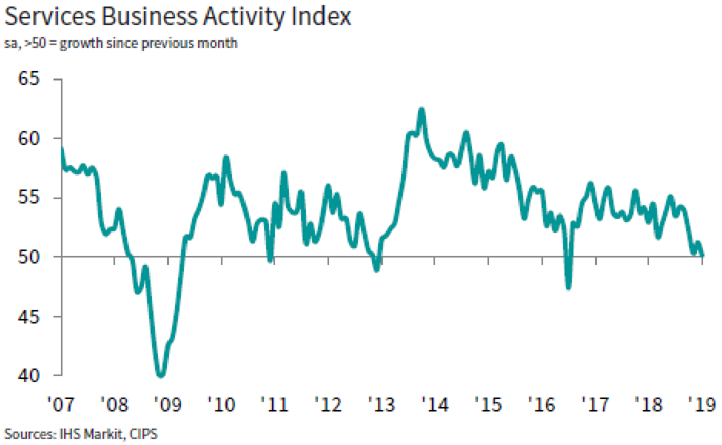
https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2019/february-2019

Inflation Report; https://www.bankofengland.co.uk/-/media/boe/files/inflation-report/2019/february/inflation-report-february-2019.pdf?la=en&hash=8487F69ED26692F4697D363A4E47111D1B0503D3

UK Services PMI (Jan)

The headline PMI highlighted that private sector services activity in the UK grew only marginally in Jan. Growth slowed on the back of a decline in new orders and the first decline in payroll numbers in over six years. Brexit uncertainty was cited as the key reason for work and projects to be delayed.

Services PMI: Jan 50.1 versus Dec 51.2



Output growth was mostly unchanged.

New business volumes fell into contraction in Jan. Firms remain cautious above moving ahead with new projects as the form of Brexit remained uncertain.

Work backlogs decreased for the fourth month. If new orders continue to contract, output is likely to decline in the coming months.

Employment growth declined for the first time since 2012. Firms opted not to replace 'voluntary leavers'.

Input costs grew for the third month in a row. Firms cited higher wages and some effect from a lower GBP. Growth in output charges remained subdued as firms continued to compete for new work.

"The latest PMI survey results indicate that the UK economy is at risk of stalling or worse as escalating Brexit uncertainty coincides with a wider slower slowdown in the global economy."

https://www.markiteconomics.com/Survey/PressRelease.mvc/601e7f3fa56a41dc92c77fae69e2e4b1

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CANADA

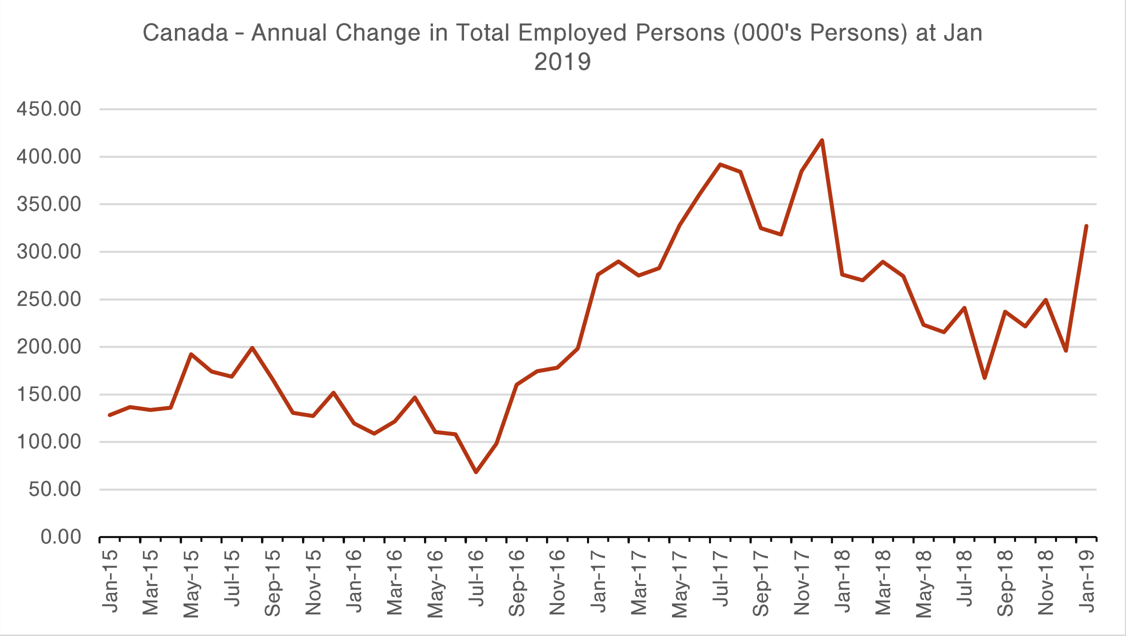
Labour Force Survey (Jan)

Annual employment growth accelerated in Jan and was high enough to absorb both population and new/returning persons into the labour force. As a result, there was little change in total unemployed persons on an annual basis. But the unemployment rate picked up in the month compared to the month prior because of the much larger increase in participation in Jan.

<u>Employment growth</u>

Annual employment growth increased at a faster pace in Jan;

Jan +327k persons versus Dec +195k persons



In the month of Jan, employment increased by +67k persons versus Dec +7.8k persons. The increase in employed persons in the latest month was the result of both FT and PT employment growth.

<u>Total Unemployed Persons</u>

The annual change in total unemployed persons was small; +3.8k persons.

In the latest month though, total unemployed persons increased by +37k persons.

The unemployment rate picked up from 5.6% in Dec to 5.8% in Jan. The unemployment rate from a year ago was 5.9%.

The main driver behind the increase in total unemployed persons was the increase in participation, especially in the latest month.

Changes in Participation

In the year to Jan, the change in participation was such that approx. +30k additional workers were in the labour force. Employment growth was high enough to absorb both population growth as well as the higher rate of participation.

In the latest month though, participation increased by a larger amount of +0.2%pts or approx. 77k more workers in the labour force. Even though employment growth was higher in Jan, it was not high enough to absorb both the increase in participation as well as population growth.

Below is summary of the broad labour market metrics for the month;

Month chg - 000's persons at Jan 2019	
Est of what underlying pop growth add to Labour Force (1)	27.1
How many jobs available? (Mth chg employment growth) (2)	66.8
Difference (if negative, employ is growing faster than what population adds to the Labour force) (3)	-39.7
Change labour force participation - people entering/returning to the labour force (4)	76.6
The remainder is the chg in total unemployed persons (declining if negative) (4) plus (3)	36.9
Double-check: Two views of mthly growth in the labour force;	
Total employed persons plus total unemployed persons	103.7
Est of what population adds to the labor force plus change in participation	103.7
Actual reported change in the size of the labor force	103.7

https://www150.statcan.gc.ca/n1/daily-quotidien/190208/dq190208a-eng.htm?HPA=1

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AUSTRALIA

Retail Sales (Dec)

The latest quarterly volume data has been released for retail sales this month. On a volume and seas adjusted basis, retail sales growth has slowed in the Dec quarter as well as on an annual basis. Growth has slowed across the two largest states, with retail sales declining the in the latest quarter in NSW, the largest state. On a category basis, retail sales declined in four of the six categories in the latest quarter.

It's also worth noting that on a value basis, retail sales declined by -0.4% in Dec (versus Nov).

Given that the labour market conditions haven't changed, lower spending in the Dec quarter is likely the result of lower growth in credit, especially in the housing market and heightened concern over house prices.

Retail Sales Volume – Qtr Growth

Dec +0.1% versus Sept +0.2%.

A year ago, the Dec 2017 qtr retail sales growth was +0.8%.

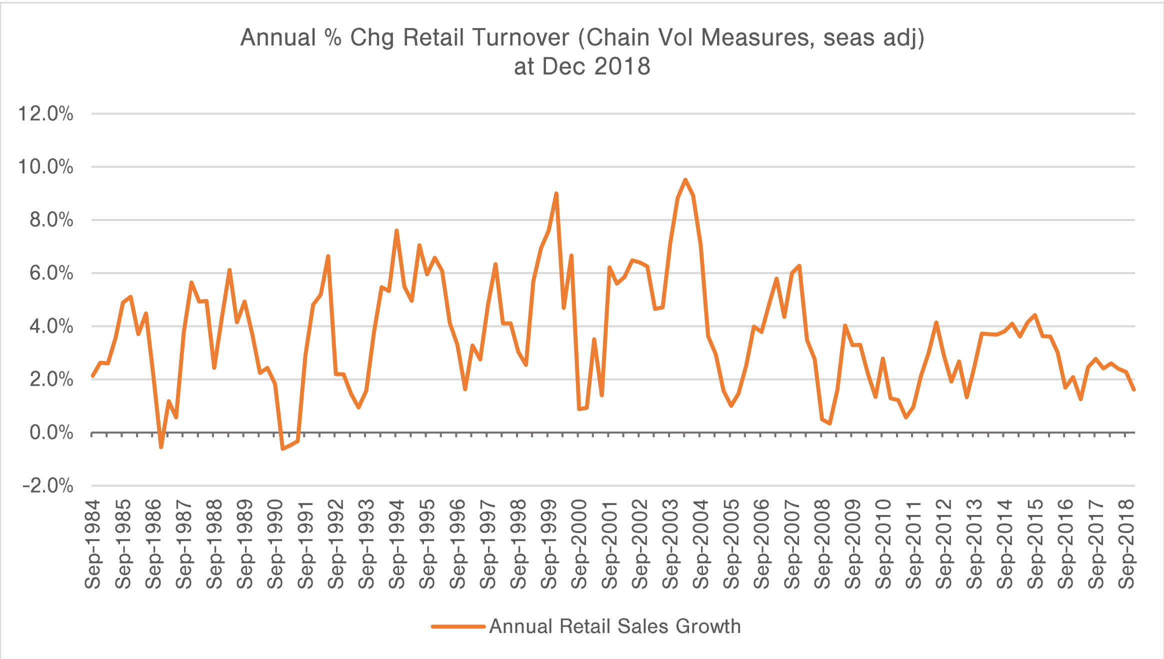
The very low growth in the Dec 2018 quarter suggests that retail sales will add little to Final Household Consumption Expenditure in the Dec qtr GDP.

This is consistent with the weaker results for retail in the Services PMI and the NAB Business Conditions report.

Retail Sales Volume – Annual % Chg (versus same qtr a year ago)

Dec 2018 +1.6% versus Sep +2.3%.

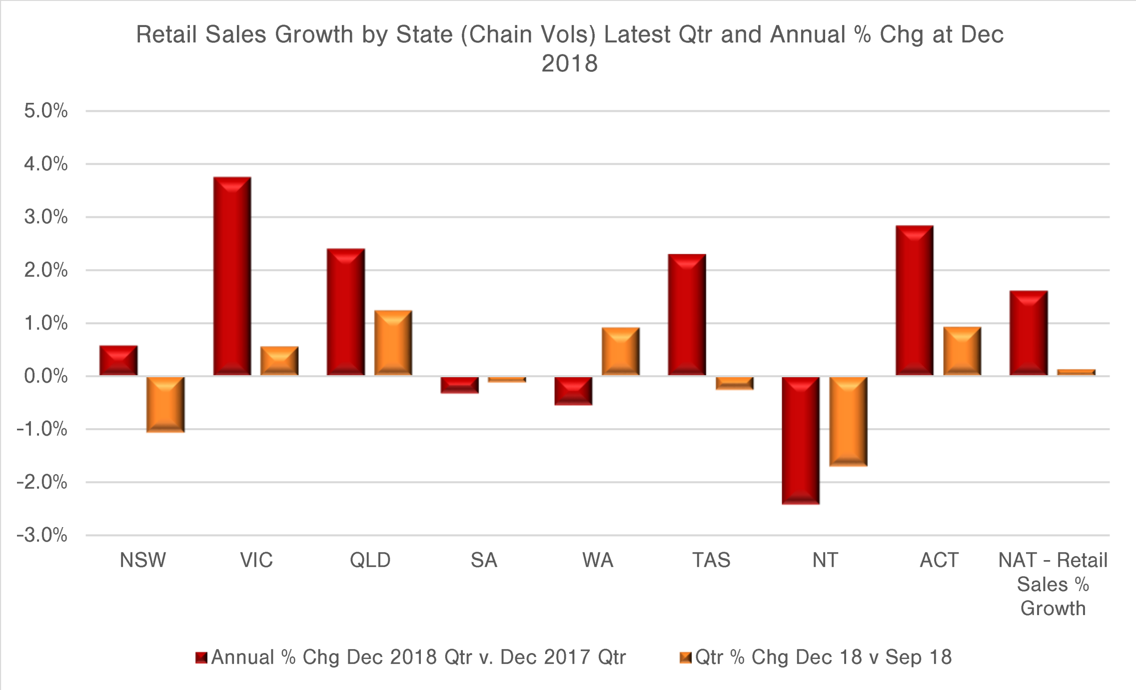
In Dec 2017, annual retail sales grew by +2.4%.



State Results

The slower growth in the latest quarter was mostly driven by the two biggest states; Vic and NSW. Retail sales declined in NSW in real terms in the final quarter of 2018.

The overall result was led higher by a much stronger result in QLD, which made the single largest contribution to retail sales growth in the quarter.



Category Results

The category results for the quarter show that retail sales in real terms increased only in Clothing, Footwear & Personal and Dept Store categories.

Clothing, Footwear and Personal is the only category where annual growth accelerated in the latest quarter.

	Food Retailing	H'hold Goods	Clothing, Footwear & Personal Acc's	Dept Stores	Other Retailing	Cafes, Rests & T/A Food	Total Retail Sales Qtr Growth
Annual % Chg Dec Qtr 2018 v Dec Qtr 2017	0.9%	1.5%	5.2%	2.1%	2.5%	0.0%	1.6%
Qtr % Chg Dec v Sep 2018	-0.21%	-0.28%	2.69%	0.66%	-0.54%	-0.54%	0.12%

In the latest quarter, retail sales declined in four of the six main categories.

<u>Retail Sales – Value</u>

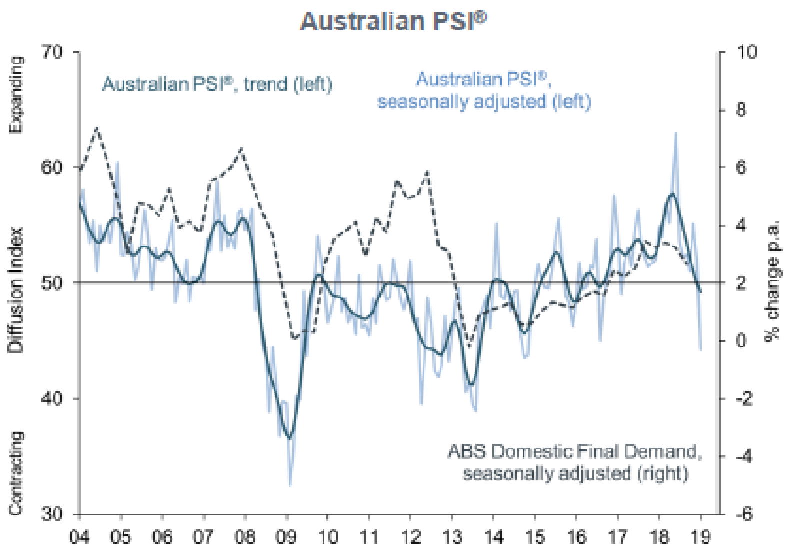
Also reported was the usual value of retail sales for Dec. Retail sales in value terms declined in Dec;

Dec -0.4% versus Nov +0.5%

But it's also worth noting that Dec 2017 retail sales value also declined by -0.4%.

The retail calendar in Australia has been shifting to bring forward some Christmas spending into late Nov. Considering that, we noted last month that Nov retail sales seemed soft considering that Nov 2017 month growth was +1.3% versus Nov 2018 +0.5%.

<u>Australia Services PMI Jan</u> – highlights that this retail weakness is likely to persist. The headline services PMI fell hard in Jan to 44.3 from Dec 52.1. One of the key drivers of that fall was a continued contraction in Retail Trade business;



Australian PSI® consumer-oriented services sectors

AUSTRALIAN PSI®	RETAIL TRADE	HOSPITALITY	HEALTH, EDUCATION & COMMUNITY	PERSONAL, RECREATION & OTHER
44.3	39.9	55.1	51.7	55.6
↓ 7.8 POINTS (seasonally adjusted)	↓ 5.2 POINTS (trend)	↓ 0.7 POINTS (trend)	↓ 1.8 POINTS (trend)	↑ 2.6 POINTS (trend)

Australian PSI® business-oriented services sectors

AUSTRALIAN PSI®	BUSINESS & PROPERTY SERVICES	WHOLESALE TRADE	FINANCE & INSURANCE	TRANSPORT & STORAGE
49.3	51.3	43.3	49.7	49.3
↓ 0.7 POINTS (trend)	↑ 0.2 POINTS (trend)	↓ 1.3 POINTS (trend)	↑ 0.7 POINTS (trend)	↑ 1.2 POINTS (trend)

http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8501.0Main+Features1Dec%202018?OpenDocument

https://cdn.aigroup.com.au/Economic_Indicators/PSI/2019/PSI_January_2019_73236z.pdf

RBA Interest Rate Decision (6 Feb 2019)

As widely expected, the RBA kept rates on hold – with the official cash rate (OCR) at 1.5%.

The statement indicated a downgrade in GDP growth for 2019. In the prior Dec statement, the central scenario for GDP growth was expected to average 3.5%. In the latest statement this week;

> The central scenario is for the Australian economy to grow by around 3 per cent this year and by a little less in 2020 due to slower growth in exports of resources.

The downgrade was the result of weaker growth in the Sep quarter, greater downside risks globally, the outlook for household spending and falling house prices.

The labour market (relatively low unemployment), rising terms of trade, business spending and public infrastructure spending continue to support growth.

Inflation remains low (and outside of the RBA target band) and underlying inflation is expected to pick up only gradually over the next couple of years.

> The low level of interest rates is continuing to support the Australian economy. Further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual. Taking account of the available information, the Board judged that holding the stance of monetary policy unchanged at this meeting would be consistent with sustainable growth in the economy and achieving the inflation target over time.

https://www.rba.gov.au/statistics/cash-rate/

RBA Governor Lowe speech – "The Year Ahead" address to the National Press Club of Australia – 6 Feb 2019

The overall flavour of the speech was to put a very optimistic spin on the key areas of concern in the global and domestic outlook. Despite that, the outlook for rates has now shifted to be balanced between 'could be up or could down' – whereas in the past the RBA kept the bias that the next move was likely to be up. It will be important to see how this view is incorporated into the RBA minutes.

Global growth – remains upbeat about growth, despite noting the 'change in momentum' within Europe and China. Surprised at the negative reaction to the lowering of growth targets by the IMF (global econ forecast to grow by 3.5% in 2019 and 3.6% in 2020).

Sees the downside risks globally as more political than economic; trade tensions, Brexit, rise of populism;

> the reduced support from the United States for the liberal order that has supported the international system and contributed to a broad-based rise in living standards. One could add to this list the adjustments in China as the authorities rein in shadow financing.

Domestic outlook – despite the downside risks, still sees growth at a reasonable pace over the next few years. The major domestic uncertainty is the strength of consumption and the housing market.

Growth forecasts have been cut for 2019 to 3% and 2.75% in 2020 (-0.25% pts);

> For 2018, the outcome is affected by the surprisingly soft GDP number in the September quarter and the ABS's downward revisions to estimates of growth earlier in the year. We are expecting a stronger GDP outcome in the December quarter, with other indicators of economic activity painting a stronger picture than suggested by the September quarter national accounts.

Expecting that with slower growth in 2019 and 2020, the economy will continue to reduce the unemployment rate from 5% to 4.75%, reduce spare capacity, see a lift in wage growth and inflation increase to 2.25% by 2020.

Supply of credit has been an uncertainty –

> Over recent years there has been a needed tightening of credit standards. But the right balance needs to be struck. As lenders have sought to find that balance, we have had some concerns that the pendulum may have swung too far the other way, especially for small business.

What effect will slower house price growth/declines have on spending (emphasis added)?

> At this point, though, what we are seeing looks to be a manageable adjustment in the housing market.
>
> A third and perhaps the most important consideration, is that household income growth **is expected to pick up** and income growth usually matters more for consumption than changes in wealth.

Outlook for rates (emphasis added);

> Looking forward, there are scenarios where the next move in the cash rate is up and other scenarios where it is down. Over the past year, the next-move-is-up scenarios were more likely than the next-move-is-down scenarios. **Today, the probabilities appear to be more evenly balanced.**

The bottom line is that rates will only move up when wage and inflation growth start to accelerate – which has fundamentally been the base case of 'seeing no near-term case for a change in rates'.

> Our expectation has been – and continues to be – that the tighter labour market and reduced spare capacity will see underlying inflation rise further towards the midpoint of the target range. Given this, we have maintained a steady setting of monetary policy while the labour market strengthens, and inflation increases.

https://www.rba.gov.au/speeches/2019/sp-gov-2019-02-06.html

RBA – Statement on Monetary Policy Feb 2019

The latest release of the Statement on Monetary Policy incorporated several changes to key economic forecasts with the RBA downgrading GDP growth and consumption growth.

Year-ended GDP growth is expected to be around 3% over 2019 and 2.75% over 2020 (as outlined in Governor Lowes speech above)

Consumption growth is now expected to be 2.75% over the forecast period, rather than the 3% medium term growth rate that has been expected.

Several reasons for the downgraded consumption growth; weaker than expected growth in the Sep 2018 qtr, the downward revision to the history of consumption by the Aus Bureau of Stats, recent declines in house prices and housing market activity are likely to weigh on spending. Growth in household disposable income has been weaker;

> "…due to subdued growth in non-labour income and strong growth in tax payments".

Table 5.1: Output Growth and Inflation Forecasts[a]
Per cent

	Year-ended					
	Dec 2018	June 2019	Dec 2019	June 2020	Dec 2020	June 2021
GDP growth	2¾	2½	3	2¾	2¾	2¾
(previous)	(3½)	(3¼)	(3¼)	(3¼)	(3)	(n/a)
Unemployment rate[b]	5.0	5	5	5	4¾	4¾
(previous)	(5)	(5)	(5)	(4¾)	(4¾)	(n/a)
CPI inflation	1.8	1¼	1¾	2	2¼	2¼
(previous)	(2)	(2)	(2¼)	(2¼)	(2¼)	(n/a)
Trimmed mean inflation	1.8	1¾	2	2	2¼	2¼
(previous)	(1¾)	(2)	(2¼)	(2¼)	(2¼)	(n/a)
	Year-average					
	2018	2018/19	2019	2019/20	2020	2020/21
GDP growth	3	2½	2¾	2¾	2¾	2¾
(previous)	(3½)	(3¼)	(3¼)	(3¼)	(3¼)	(n/a)

(a) Technical assumptions include TWI at 62, A$ at US$0.72 and Brent crude oil price at US$63 per barrel; shaded regions are historical data; figures in parentheses show the corresponding forecasts in the November 2018 *Statement*
(b) Average rate in the quarter
Sources: ABS; RBA

https://www.rba.gov.au/publications/smp/2019/feb/pdf/statement-on-monetary-policy-2019-02.pdf

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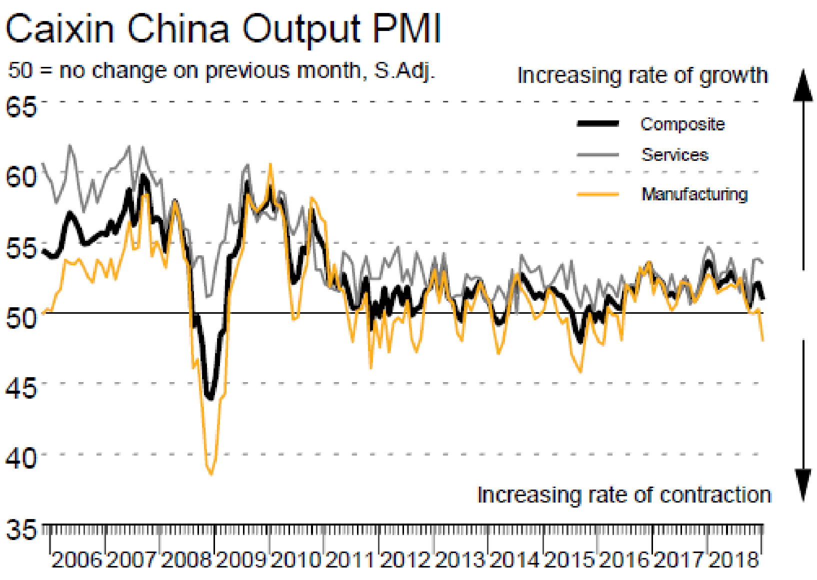
ASIA

China – Caixin Services PMI (Jan)

Overall services activity continued to growth in the latest month albeit at a slightly slower pace. While output and new orders both increased, firms continued to reduce backlogs of work.

Services PMI; Jan 53.6 versus Dec 53.9

The overall level of services activity remains elevated compared to the weaker manufacturing sector.



Sources: IHS Markit, Caixin.

Services firms recorded the fastest increase in new orders for seven months. New export orders continued to grow.

Backlogs of work in services firms declined in the month

Employment within the service sector continued to increase.

Input prices fell while output price growth was minimal.

https://www.markiteconomics.com/Survey/PressRelease.mvc/161419a830fa4925bcfc01aa89f0c85c

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TRADE

US-China Trade Negotiations

Further talks have now been scheduled for Treasury Secretary Mnuchin and USTR Lighthizer to travel to Beijing for talks on 14 and 15 Feb 2019.

The meeting between Presidents Trump and Xi are not likely to go ahead before the tariff deadline.

Reconfirming what a 'win' in the negotiations with China looks like – a statement of the key goals as outlined by the USTR (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

The final deadline for negotiations is 1 Mar 2019 before further tariffs and increased rates are imposed. From the USTR on the Federal Register in mid-Dec;

> As set out in this notice, the rate of additional duty for the products covered by the September 2018 action will increase to 25 percent on March 2, 2019.

https://www.federalregister.gov/documents/2018/12/19/2018-27458/notice-of-modification-of-section-301-action-chinas-acts-policies-and-practices-related-to

NEW – Special 2019 Section 301 Review

No further update on progress. 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 process to ratify the USMCA remains underway. The report outlining what needs to change in law to approve the USMCA has reached the Senate Finance Committee.

The report by the US International Trade Commission on the economic impact of the new agreement is likely to be delayed due to the shutdown. The report is due 15 Mar and will be used by members of Congress to inform their view of the agreement.

Reports continue to circulate that the new Congress will make it harder for the agreement to be ratified. While many believed that the agreement will end up being approved, some are calling for further changes on labour and environmental protections.

https://www.nytimes.com/2019/02/06/business/nafta-trump-deal.html

President Trump has previously indicated that he will withdraw from NAFTA if there is any push to renegotiate the USMCA by the Democrats. But it appears the Democrats aren't shying away from a fight.

Section 232 – Car and Truck Imports

The US Department of Commerce is expected to present the investigative report into the chapter 232 on 17 February. President Trump then has 90 days to make a final decision.

https://www.wiwo.de/politik/europa/plaene-des-us-handelsministeriums-diese-3-optionen-liegen-im-streit-um-autozoelle-auf-dem-tisch/23965242.html

https://fas.org/sgp/crs/misc/IF10971.pdf

US-Japan Trade Talks

The government shutdown and the looming deadline on the negotiations with China is hindering the progress on trade negotiations with Japan. It's now likely the negotiations with Japan will be postponed, possibly as late as April (if the US-China negotiations are extended).

President Trump is due to meet with Prime Minister Shinzo Abe at the Group of 20 summit in Osaka in June. https://asia.nikkei.com/Economy/Trade-War/US-Japan-trade-talks-face-delay-as-Trump-focuses-on-China

https://ustr.gov/countries-regions/japan-korea-apec/japan/us-japan-trade-agreement-negotiations

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

US-Europe Trade Talks

Awaiting further notice on the commencement of talks – likely to be delayed.

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

US-UK Trade Talks

A statement was released by the USTR last week confirming that the public hearing for negotiating objectives went ahead on 29 Jan.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/january/public-hearing-negotiating

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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