MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 22 April 2019

Key Themes

US GDP growth accelerated higher in Q1. The underlying drivers of growth provide a mixed message on economic activity. Growth was higher on the back of faster export growth, coupled with declining imports (higher net exports), and a continued increase in the change in inventory. Personal consumption growth and private fixed investment spending growth both halved.

The inventory build has been observed across several reports over the last few months especially within retail and wholesale channels, as sales growth slowed. An important point is that consumer retail sales, including motor vehicle sales, improved in Mar. If this higher growth in consumption can be maintained, then the inventory build may dissipate over the next few months. Growth in personal consumption expenditures, retail sales, and motor vehicle sales will be important data points to watch over the next few months.

One feature of the two regional surveys out this week for Apr was the weaker growth in employment and/or hours worked. The Richmond Fed manufacturing survey highlighted a weak rebound in activity – with a further notable increase in inventory for Apr and fall in the average work week – the largest decline since 2008.

US consumer sentiment for Apr continued the sideways move, but consumers remain upbeat about financial prospects in the year ahead.

The BoJ sounded an alarm on the economic outlook in Japan due to global uncertainties and the planned tax hike in Oct. The bank announced plans to expand the range of eligible collateral for lending and clarified its forward guidance that low rates will be maintained until at least Spring 2020. On cue, prelim industrial production declined sharply in Mar – in line with the weaker result indicated by the manufacturing PMI for Mar. Retail sales growth was stronger in Mar and recorded the first small acceleration in annual sales growth.

Australian CPI surprised to the downside with growth in the quarter at 0%. Annual price growth, including measures of core CPI, continue to trend further below the RBA target range. Both domestic and external factors are contributing to the lower price growth in the quarter and the year.

Contents

US Data

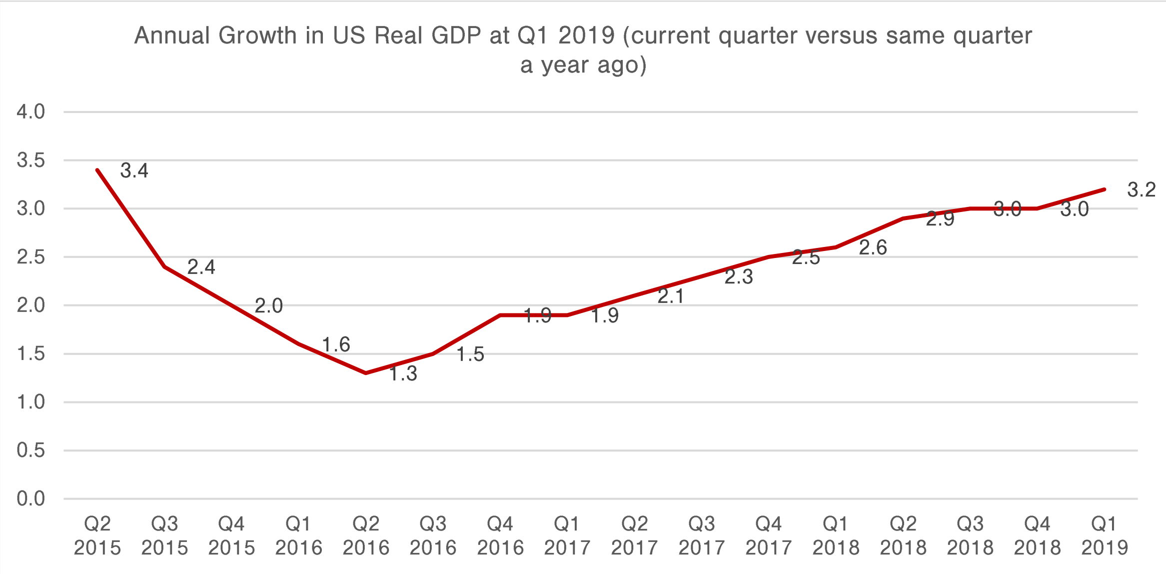
GDP Q1 (Prelim)

US GDP growth accelerated higher in the latest quarter (based on SAAR). This was the result of faster growth in inventories and government expenditures as well as an increase in net exports (exports grew faster while imports declined in the quarter). Personal consumption expenditure and fixed investment spending growth had halved from the quarter prior.

Annual growth GDP – Seas adj annual rate

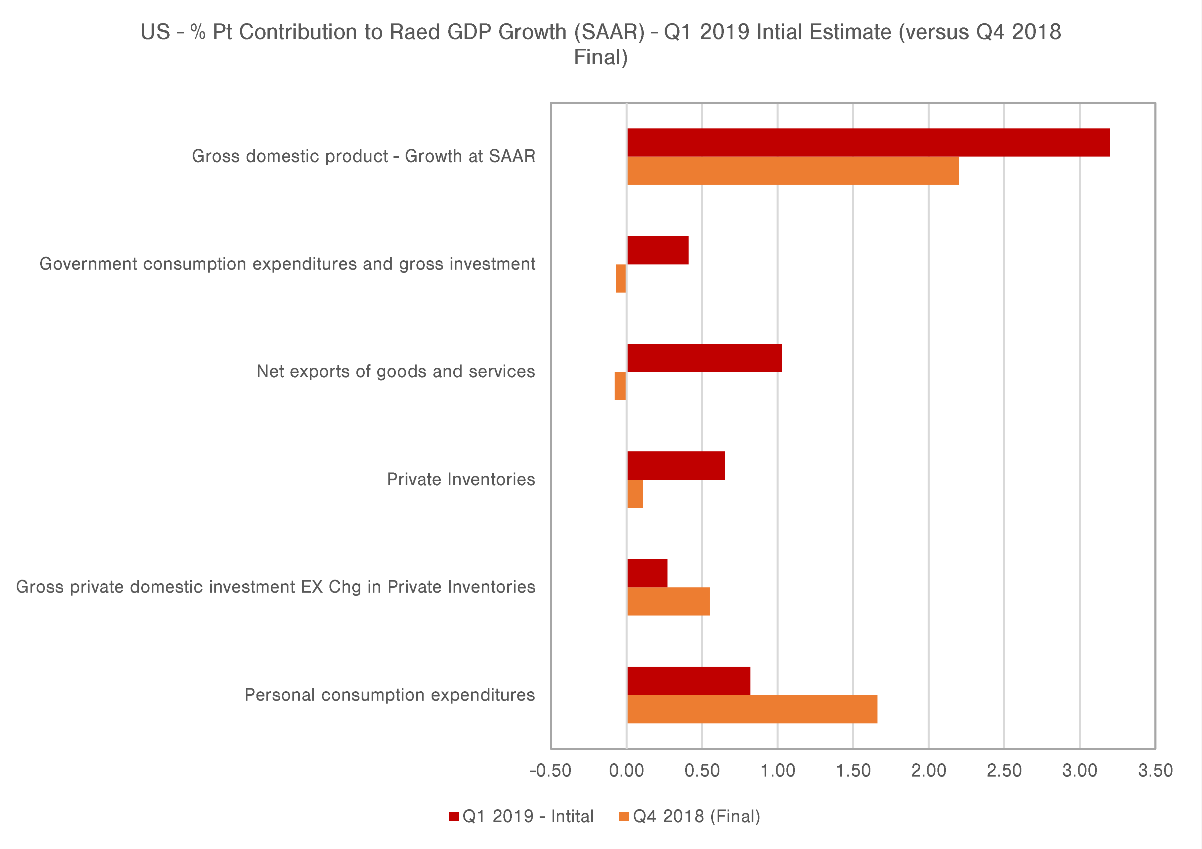
Q1 2019; +3.2% versus Q4 2018 +2.2%

On the basis of the current quarter versus the same quarter a year ago, growth also accelerated; Q1 2019 +3.2% versus Q4 2018: +3%. This view of GDP growth shows a consistently accelerating rate of growth over the last several years.



Q1 2019 – Contributions to Growth

There were large shifts in contribution to GDP growth in the latest quarter – with government expenditure, net exports and inventories making a larger contribution to growth in the latest quarter. The contribution from personal consumption expenditure and private fixed investment both halved from the quarter prior.



<u>Personal Consumption Expenditure</u>

Growth halved in the latest quarter versus the prior quarter and contribution fell from 1.66% pts in Q4 to +0.82% pts in Q1 2019.

The consumption of Goods declined, and this was offset somewhat by slower growth in the consumption of Services. The decline in consumption of goods was recorded across motor vehicles and parts, furnishings and durable household equipment, other durable goods, off-premise consumption of food and beverages and clothing & footwear.

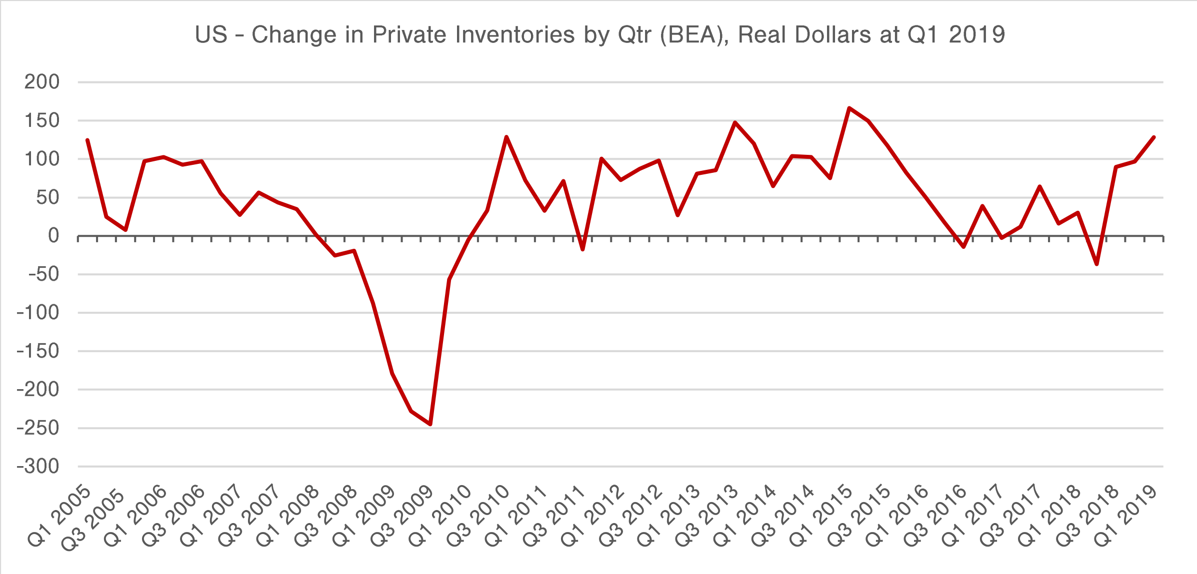
<u>Private Domestic Investment Excluding the Chg in Private Inventories (Fixed Investment)</u>

Growth in spending of the fixed investment component of private investment expenditure also halved in the latest quarter. Contribution to overall growth fell from +0.55% pts in Q4 to +0.27% pts in Q1 2019.

This was the result of much slower growth in non-residential investment (slowing from +1.3% growth in Q4 to +0.7% in Q1 2019) and a continued decline in residential investment expenditure (falling by -1.2% in Q4 and by -0.7% in Q1 2019).

<u>Inventories</u>

Further inventory build was a key feature of this report. The contribution from the change in inventories increased from +0.11% pts in Q4 to +0.65%pts in Q1 2019. This is the third quarter where the change in (real) private inventories has increased. This is consistent with the recent data on Wholesale and Business Inventories.



Net Exports

Net exports made a larger contribution to growth; from -0.08% pts in Q4 to adding +1.03% pts in Q1 2019. This larger contribution was the result of; faster growth in exports (SAAR) of +3.7% in Q1 versus +1.8% in Q4. At the same time, imports declined by -3.7% versus +2% growth in Q4.

Government Expenditure

There was a larger contribution from the government sector in Q1; Q1 +0.41% pts versus Q4 -0.07% pts. In real terms, the Federal government expenditure made 0% pt contribution to growth, while State and Local expenditure added +0.41% pts versus -0.14%pts in the quarter prior.

https://www.bea.gov/

Advance Durable Goods Orders & Shipments (Mar)

There was a solid rebound in the advance report for durable goods new orders versus the month prior. The faster growth in new orders was the result of faster growth across several categories but most notably Transport equipment, including motor vehicles and non-defense aircraft and parts.

The growth rate in shipments was unchanged from the month prior. The value of shipments was led higher mostly by shipments for Motor Vehicles and Parts – consistent with the stronger retail result in the month.

NEW ORDERS

Total New orders; Mar +2.7% **(+$6.7bn)** versus the month prior Feb -1.1%

New Orders ex Transportation; Mar +0.4% **(+$0.6bn)** versus the month prior Feb -0.2%

Growth in new orders across the major durable goods ex-transport categories was mixed;

Primary Metals and Fabricated Metal Product orders declined versus the month prior. Machinery and Computers and Electronic Product orders grew at a faster pace. Electrical Equipment and Appliance orders grew at a slower pace.

New Orders for Transportation Equipment

Increased at a much faster pace; Mar +7% **(+$6.1bn)** versus -2.9% in Feb. In value terms, this accounted for the bulk of the growth in durable goods new orders.

Despite this stronger monthly growth, new orders for transports in Mar was only +0.7% ahead of the same month a year ago (NSA) but +4.2% in the YTD.

Growth in new orders for transport was the result of;

Faster growth in Motor Vehicles and Parts orders; Mar +2.1% (+$1.3bn) versus Feb 0%.

Faster growth in Non-defense aircraft & parts orders; Mar +31.2% (+$3.4bn) versus Feb -25.4%. The value of new orders for non-defense aircraft and parts in Mar was -30% below the same month a year ago and -19% in the YTD.

Orders for Defense aircraft and parts also grew at a faster pace but represents a smaller portion of the total; Mar +17.7% (+$0.83bn) versus Feb +5%.

SHIPMENTS

Total Shipments; Mar +0.3% (+$0.87bn) versus Feb +0.3%

Shipments ex-Transports; Mar -0.1% (-$0.1bn) versus Feb +0.6%

Shipments for Transport Equipment;

Grew at a faster pace; Mar +1.1% (+$1bn) versus Feb -0.4%. The growth in transports shipments was due mostly to motor vehicles and parts of +$1.3bn in the month - which is consistent with the stronger sales for motor vehicles in the month. Shipments in non-defense aircraft and parts and defense aircraft and parts declined versus the month prior.

INVENTORIES

Total inventories increased at a slightly slower pace in Mar at a total level; Mar +0.3% (+$1.4bn) versus Feb +0.4%.

Inventories ex transports was the main driver of growth in inventory in the latest month; Mar +0.4% (+$1.2bn) versus Feb +0.1%.

Growth in transport inventories slowed; Mar +0.1% (+$0.2bn) versus Feb +1%

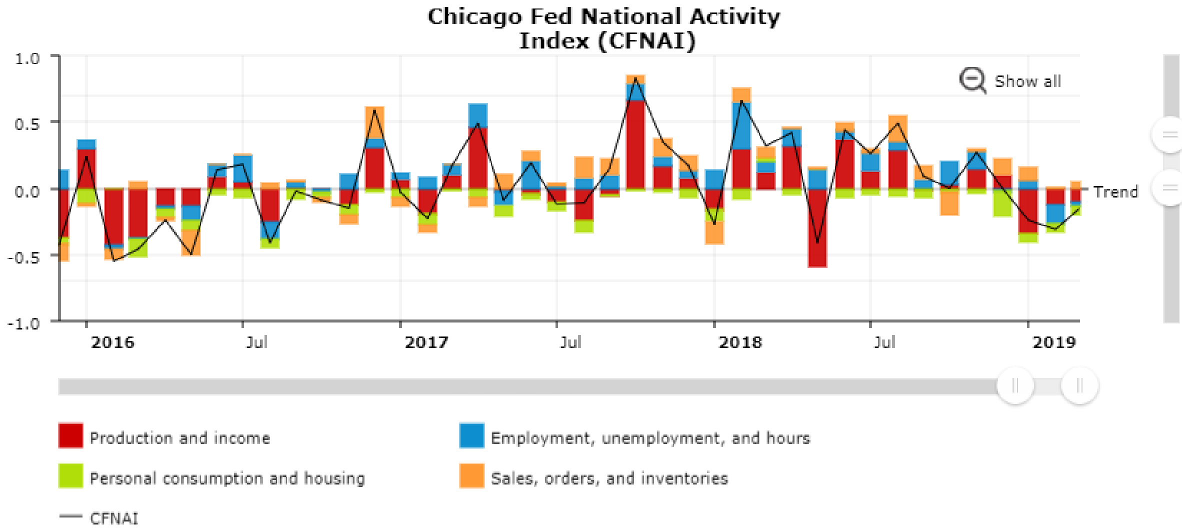
https://www.census.gov/manufacturing/m3/index.html

Chicago Fed National Activity Index (CFNAI) (Mar)

The headline index showed that economic activity expanded at a faster rate than in the month prior but is still growing at below the historical trend growth.

Headline CFNAI; Mar -0.15 versus Feb -0.34

Index reading of zero – the National economy is expanding a its historical trend/average rate of growth



Leading the improvement in the latest month was employment, unemployment and hours, which became less negative; Mar -0.03 versus Feb -0.15

Production and income were little changed and remained negative; Mar -0.1 versus Feb -0.12

Sales, orders and inventories improved; Mar +0.05 versus Feb +0.01

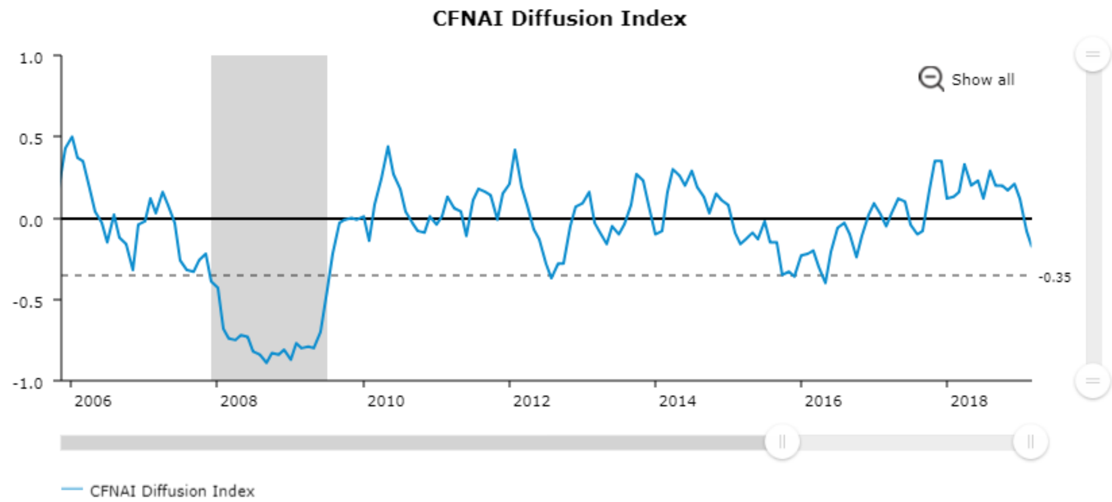
Personal consumption and housing were also little changed and remained negative; Mar -0.07 versus Feb -0.06

<u>The CFNAI Diffusion Index</u>

Mar -0.18 versus Feb -0.08

Periods of economic expansion have historically been associated with values of the CFNAI Diffusion Index above –0.35.

While the current diffusion index is still within the range of ‘economic expansion’ there has been a deterioration, most noticeably since Dec 2018. That slower expansion continued in Mar;

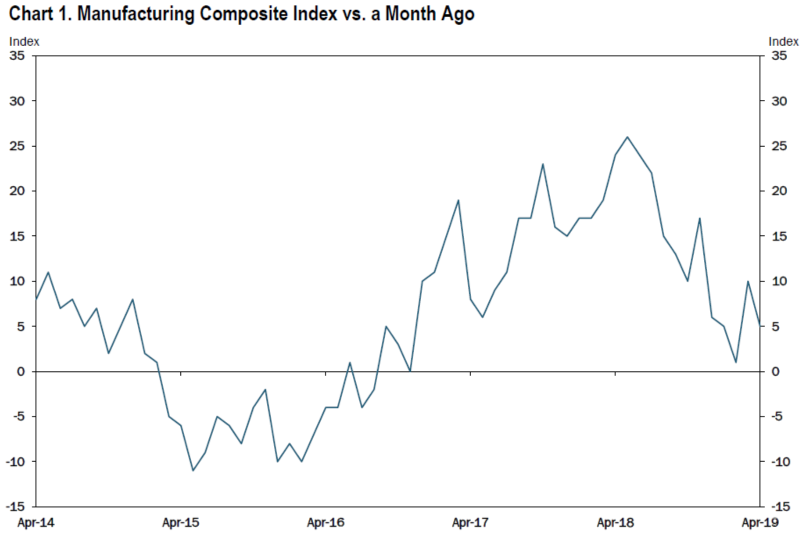


https://www.chicagofed.org/publications/cfnai/index

Kansas City Fed Manufacturing Index (Apr)

Overall manufacturing activity grew at a somewhat slower pace in Apr. The faster growth in new orders was offset by slower growth in production and shipments.

Manufacturing activity composite index; Apr 5 versus Mar 10



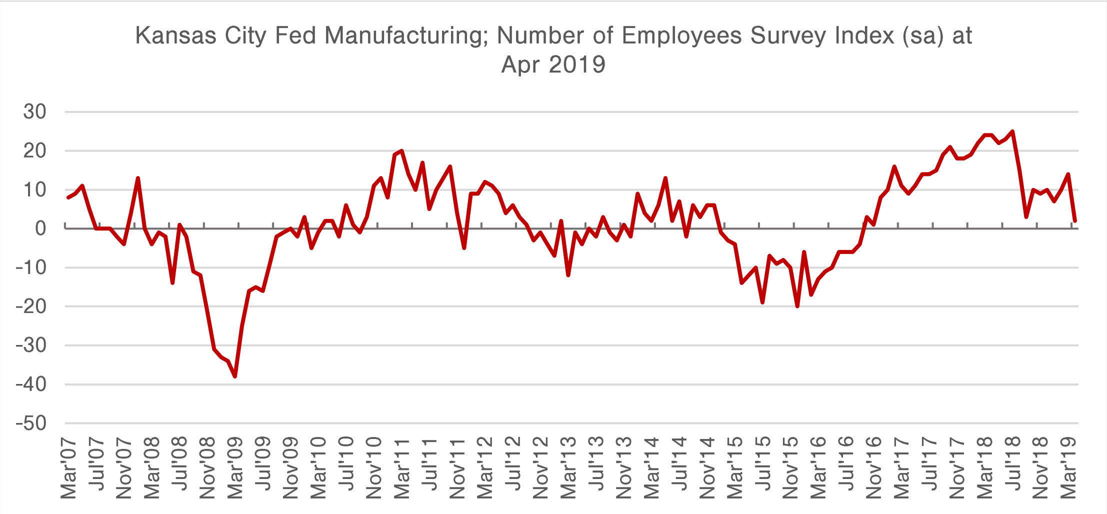
Production growth moderated in Apr - slowing from 17 in Mar to 12 in Apr but remained well above the recent low of -13 in Dec 2018.

Growth in the volume of shipments also slowed slightly to a reading of 9 in Apr and also remains well above the recent low of -14 in Feb.

The volume of new orders increased at a faster pace; from 4 in Mar to 10 in Apr, the second month in a row of faster growth after slowing throughout the last half of 2018.

Order backlogs fell back into contraction for the third month out of the last four.

After a period of sustained growth in employment in the first half of 2018 the weakening trend in employment growth persisted in Apr. Employment growth slowed from a reading of 14 to a reading of 2 in Apr;



The average employee workweek was unchanged, growing at the same pace in Apr as in Mar (14).

Inventories for materials fell into contraction while inventories of finished goods grew only marginally. Growth in both measures have moderated since Dec 2018.

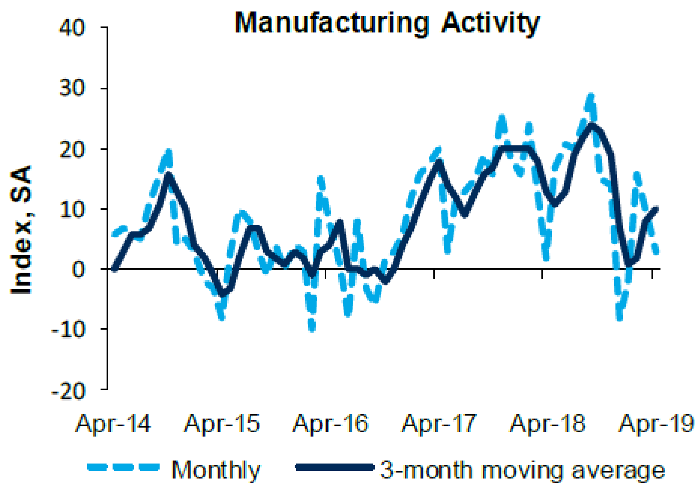
https://www.kansascityfed.org/~/media/files/publicat/research/indicatorsdata/mfg/2019/2019apr25mfg.pdf?la=en

Richmond Fed Manufacturing Index (Apr)

The headline index of manufacturing activity continued to moderate in the latest month suggesting that the manufacturing rebound in the region has been weak. The lower level of growth in the month was the result of new orders and shipments contracting slightly. Order backlogs continued to decline while inventory of finished goods increased at a faster pace.

Richmond Fed commentary was more upbeat on employment growth. The sharp decline in the workweek was attributed to an inability to find suitable candidates. The contraction in the workweek was the largest since 2008.

Manufacturing Index; Apr 3 versus Mar 10

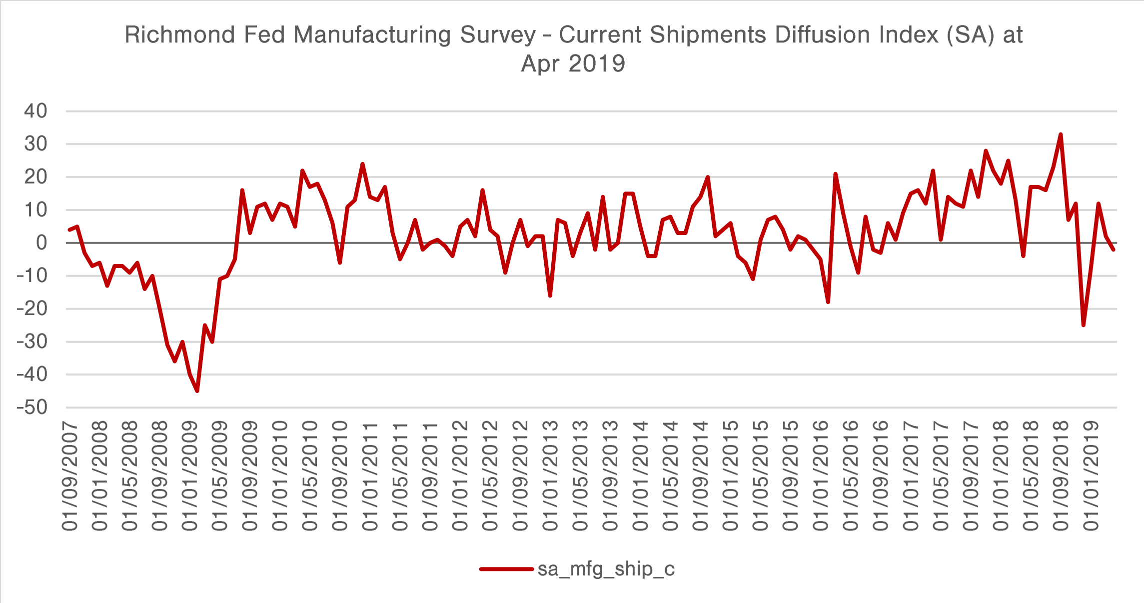


Measures of current and future demand weakened as both shipments and volume of new orders contracted slightly;

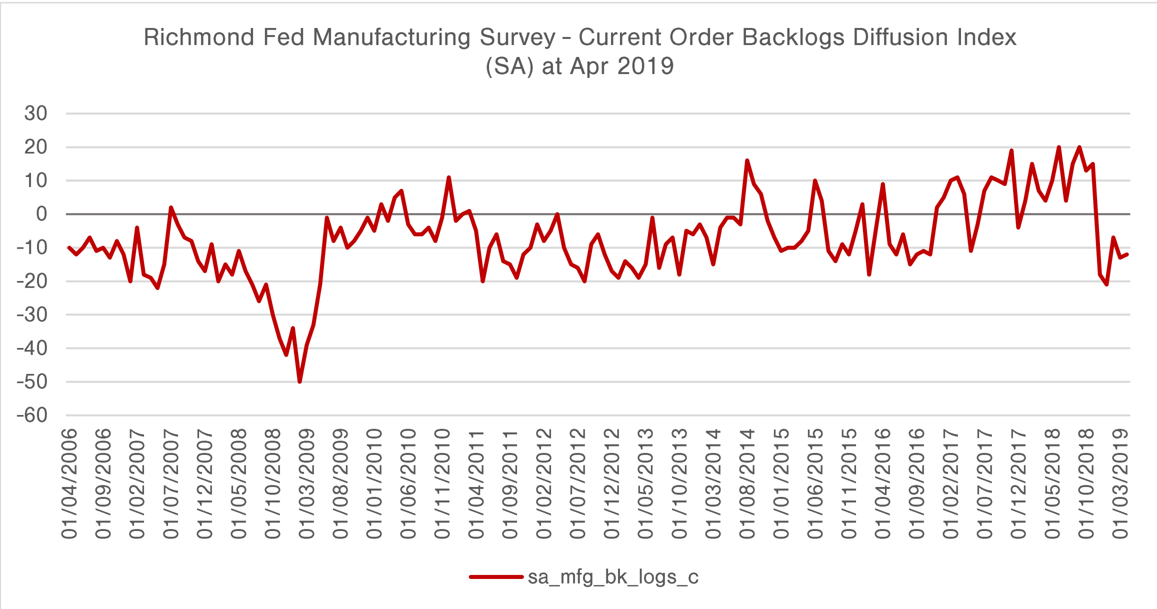
Volume of New Orders; Apr -2 versus Mar 9

Shipments; Apr -2 versus Mar 2

The growth rate in shipments peaked in Sep 2018 and the decline in Dec 2018 was the deepest since 2008. Growth in shipments has only rebounded modestly since then. This sets the scene for the rest of the data...

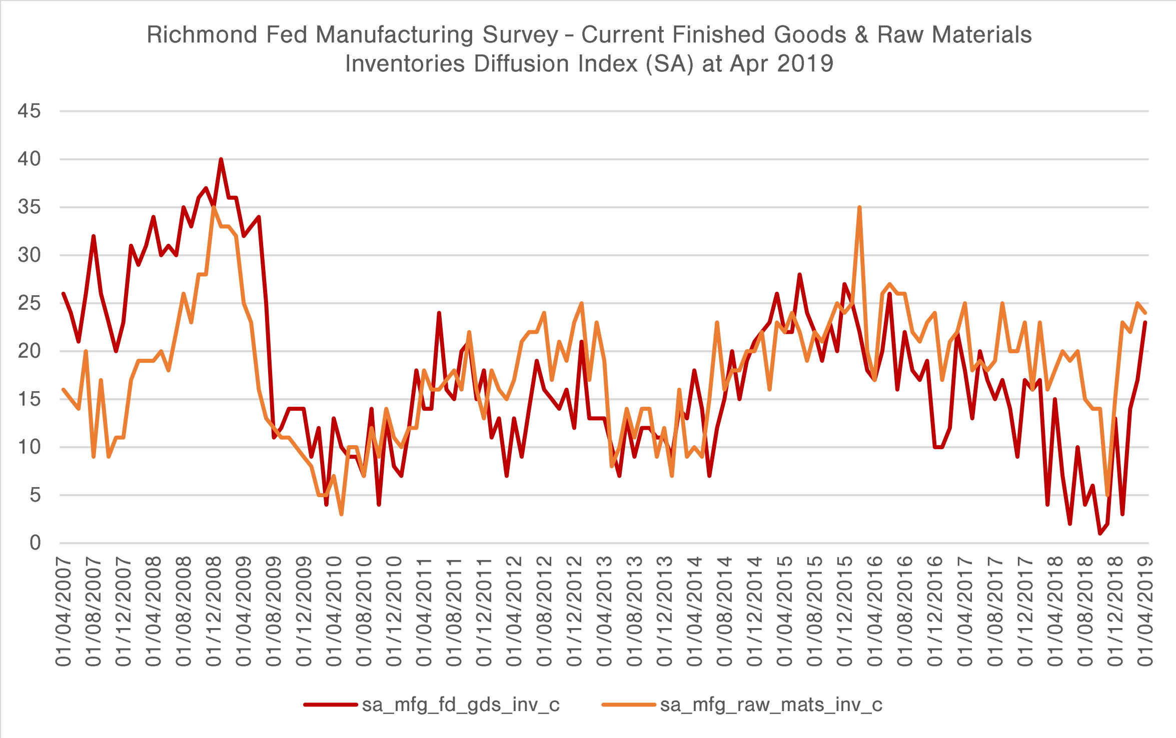


Firms continued to work through order backlogs in Apr and this measure continued to contract for the fifth month in a row. But it's the slowdown since Sept 2018 which is notable compared to the last ten years;



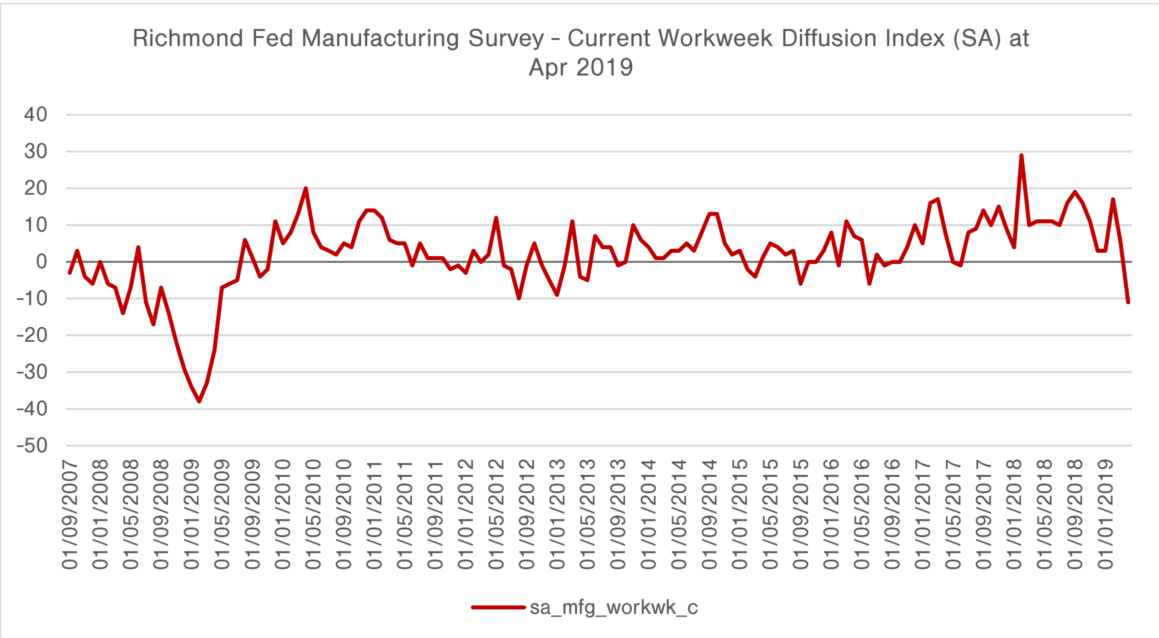
Inventories continued to grow in the latest month – this is a trend that started in Oct 2018 just as shipment growth started to slow. Compared to the history over the last ten years, the recent growth in inventories has been rapid. Raw material inventories could be the result of stockpiling due to tariffs.

Finished goods inventories increased at a faster pace in Apr, reaching a new near-term high. The more recent high was in 2015 at a reading of 28 – while the Apr reading reached 23. Growth in raw materials inventories in Apr was mostly unchanged and remains elevated;



At the same time, the report for Apr outlines ‘continued positive growth in employment and wages, although dropping slightly in April’.

Employment grew at a slower pace, moderating from a reading of 23 in Mar to a reading of 18 in Apr. The workweek however, shifted into contraction from a reading of 5 in Mar to -11 in Apr. This is an unusual move and the Apr reading is the lowest in the diffusion index since 2008 also;



The Richmond Fed commentary suggests that other reasons are at play for the decline in the average workweek;

"However, firms reported a decline in the average workweek as they continued to struggle to find workers with the necessary skills. Firms expected this difficulty to continue in the coming months."

The weakness in hours worked has been evident over the last two months.

This is only one small slice of the view of activity in the US economy. The trends however don't indicate a very strong rebound in manufacturing activity in the region.

https://www.richmondfed.org/research/regional_economy/surveys_of_business_conditions/manufacturing/2019/mfg_04_23_19

University of Michigan Consumer Sentiment – Final (Apr)

The final Apr result for consumer sentiment was little changed from the prelim result. The main headline indices are all mostly in-line with the respective 12-month average. Despite moving mostly sideways over the last few years, consumer sentiment has mostly remained favourable;

The last time consumer sentiment was as favorable for as long a period of time was during the late stages of the Clinton expansion.

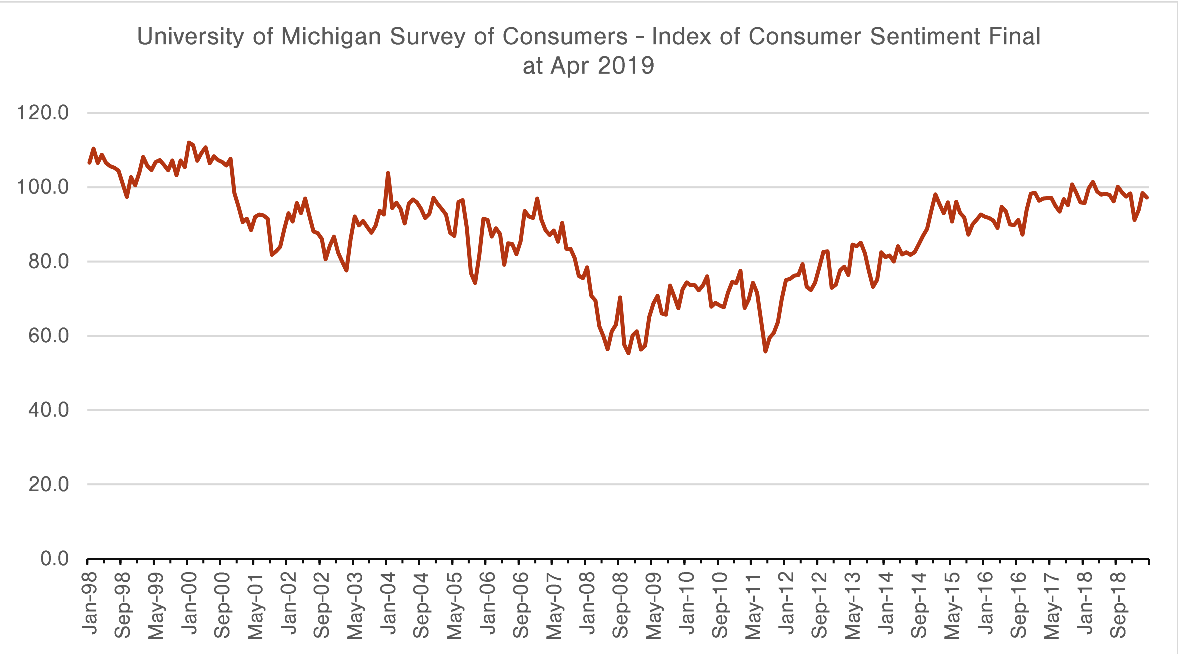
Consumer remain positive about future financial prospects;

"When asked about their financial prospects for the year ahead, 44% of consumers anticipated improvements compared with just 8% who expected worsening finances. This was the best overall reading since 2004."

<u>Index of Consumer Sentiment</u>

Apr 97.2 (revised higher from prelim 96.7) versus Mar 98.4

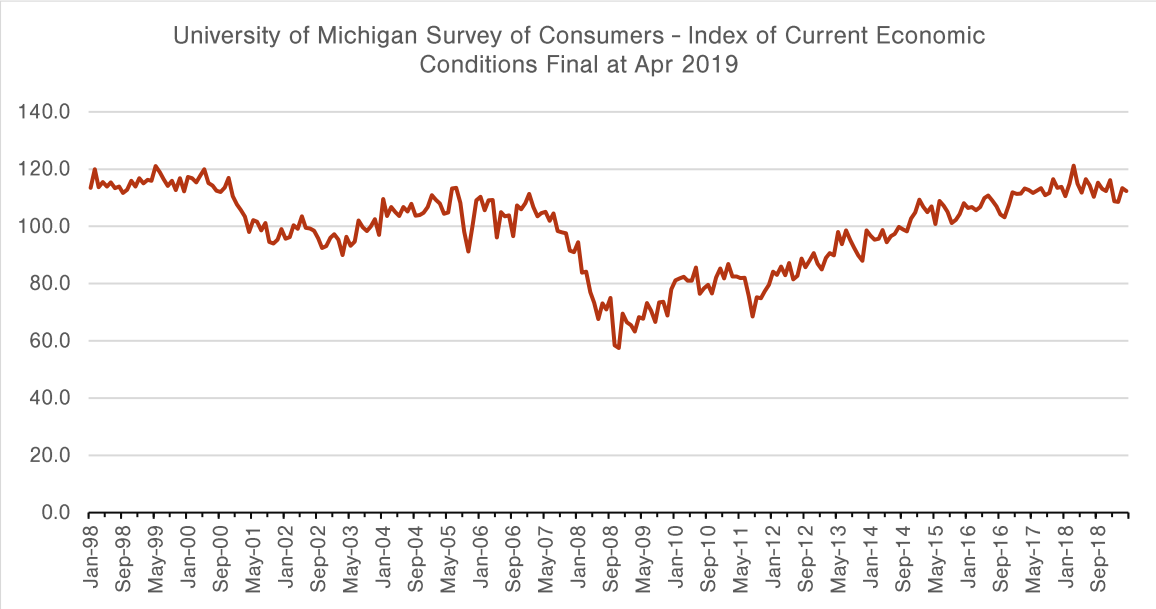
The current reading for Apr is in-line with the 12-month average and is only 1.6% below the reading for the same month a year ago;



Index of Current Economic Conditions

Apr 112.3 (revised lower from the prelim 114.2) versus Mar113.3

The current reading for Apr is also in line with the 12-month average and remains 2.3% below the reading for the same month a year ago.

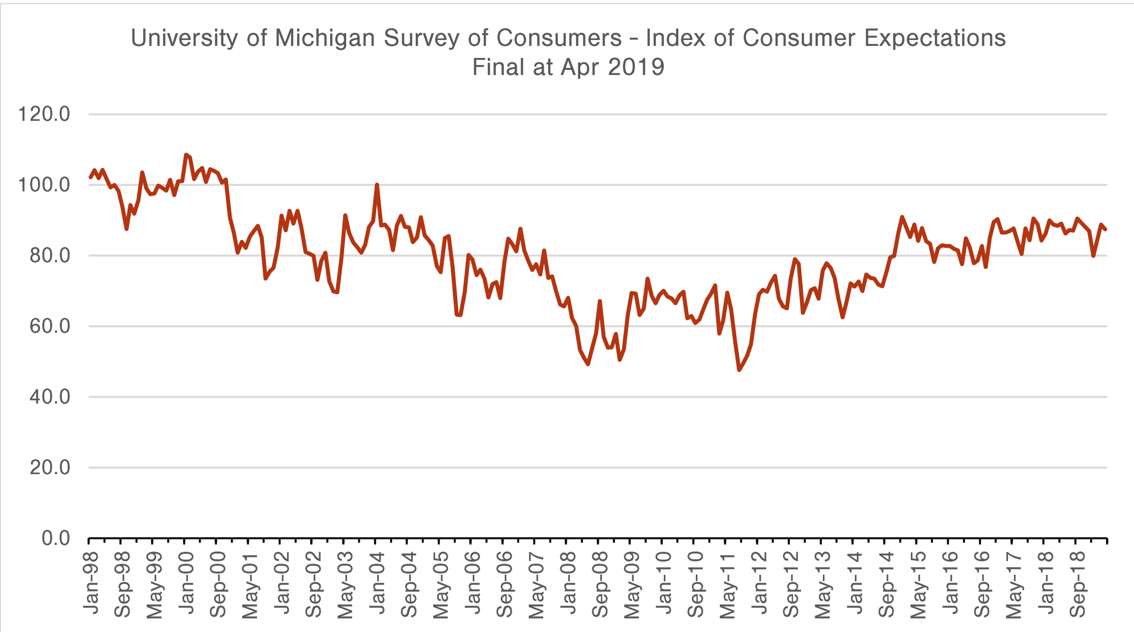


The index of current economic conditions peaked back in Mar 2018 at a reading of 121.2 and is 7% below that level.

Index of Consumer Expectations

Apr 87.4 (revised higher from the prelim 85.8) versus Mar 88.8

The Apr reading of expected conditions is slightly above the current 12-month average. And is only 1% below the reading for the same month a year ago;

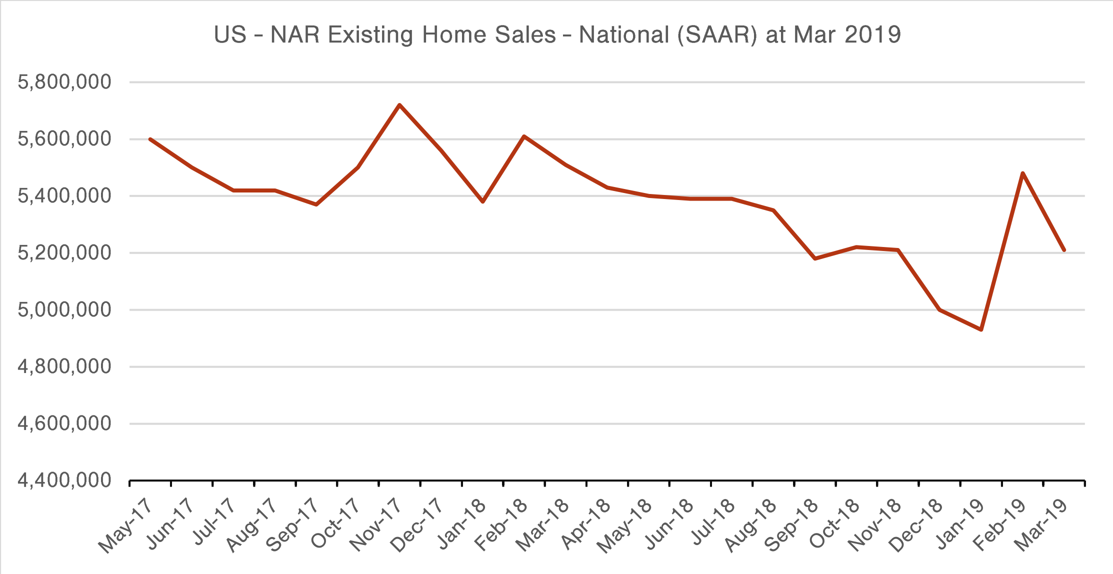


http://www.sca.isr.umich.edu/

Existing Home Sales (Mar)

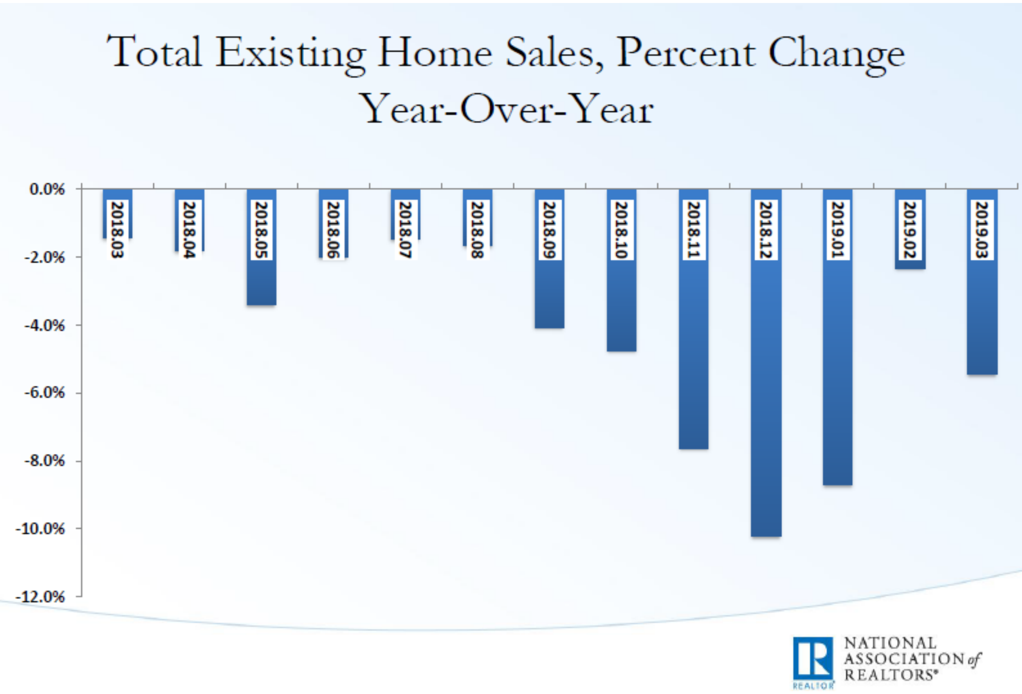
US existing home sales fell in the latest month after a stronger rebound in Feb. Declines were recorded across all regions, with the larger percentage falls recorded in the Midwest and West. Sales in the Midwest and Northeast markets remain weaker overall.

Existing Home Sales (SAAR); Mar 5.210m units (-5%) versus Feb 5.480m units



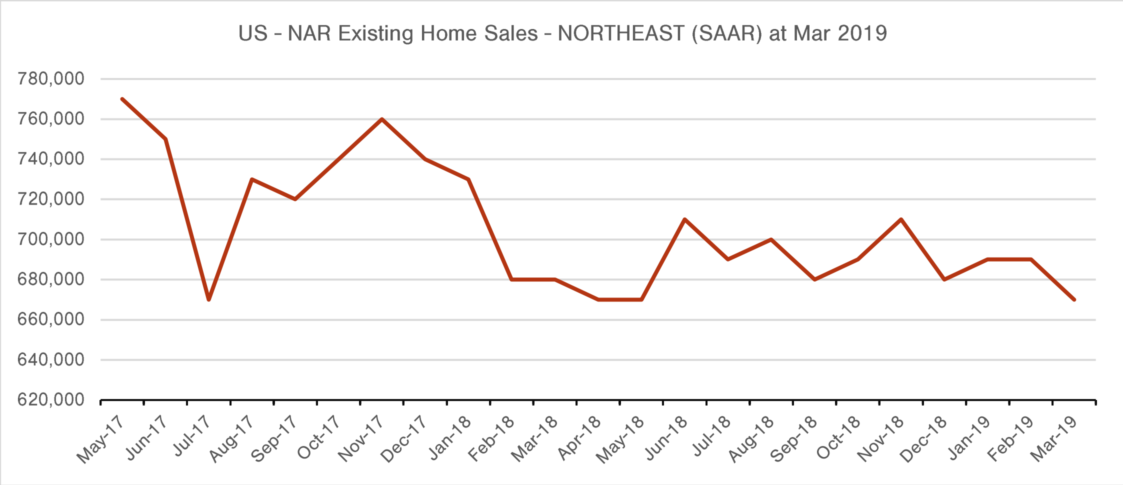
Despite the lower growth, the seas adj annual rate of home sales remains 6% above the Jan 2019 low – led predominantly by the South and the West.

The annual change in the annual rate of home sales accelerated lower in Mar and is 5.4% below the same time a year ago;



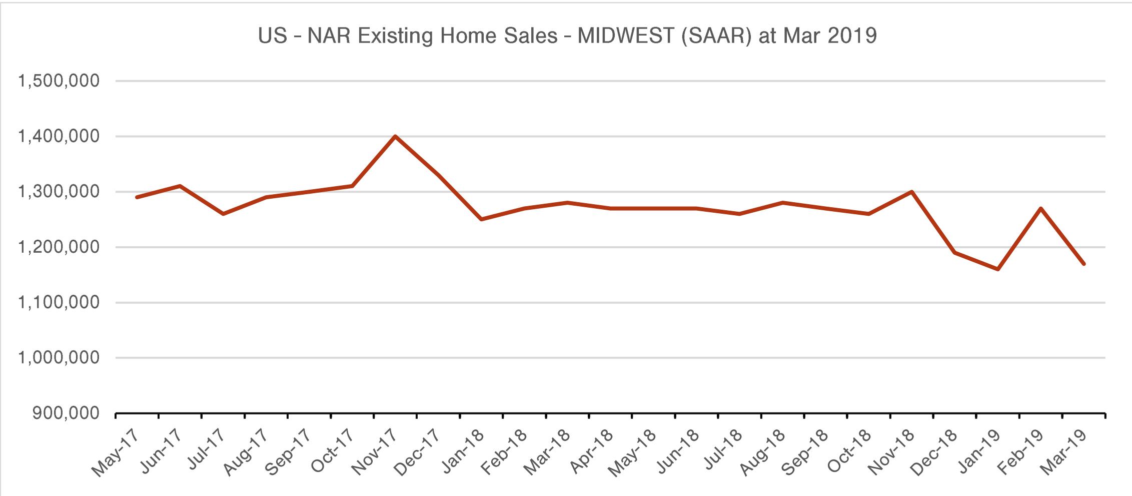
Regional Results

Northeast; -3% in the month and -1.5% below the same time last year. The SAAR of existing home sales remain on par with the recent lows of 670k units – there was no strong rebound in sales in Feb;



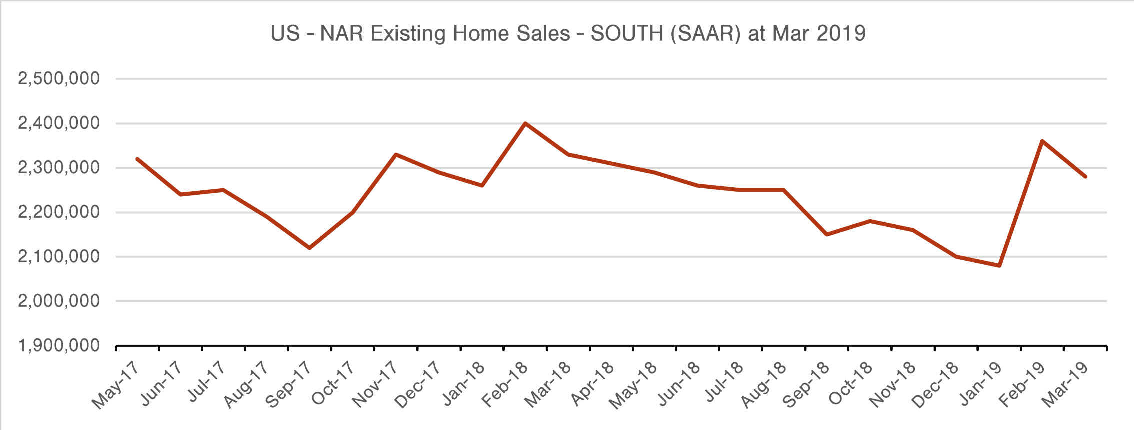
Midwest; sales fell harder here in Mar -8% versus the month prior and remain -9% below the same time last year. The fall in the month was 1.9SD's based on the last 20 months.

The fall in Mar brings the SAAR of unit sales almost down to the Jan 2019 low - +0.9% above the Jan 2019 low;

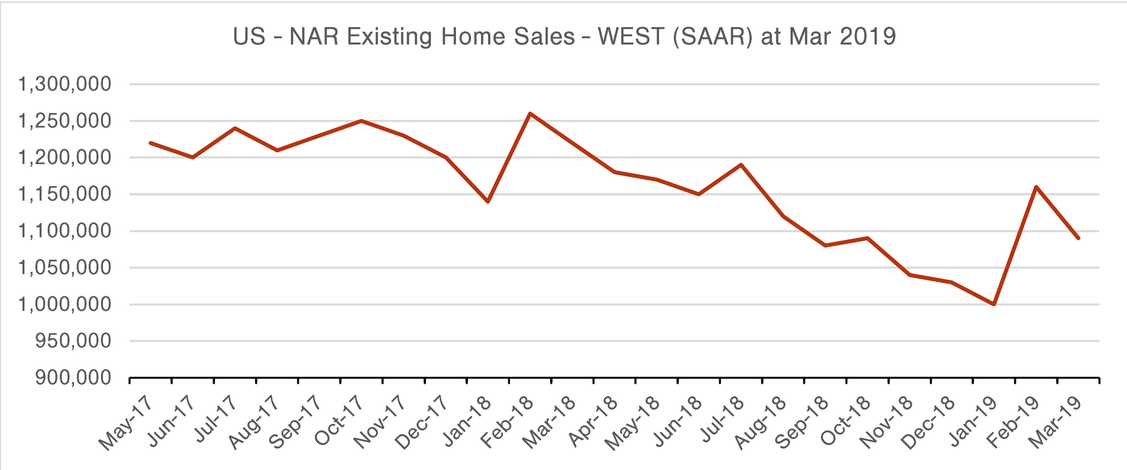


South; sales in this market remain firmer. Sales fell by 3% versus the month prior and are still 2% below the same time a year ago.

The current SAAR of home sales in Mar remains +10% above the Jan 2019 low;



West; Sales in the west fell by 6% in Mar versus the month prior and remain 11% below the same time a year ago. The current SAAR of existing home sales are still 9% above the Jan 2019 low;



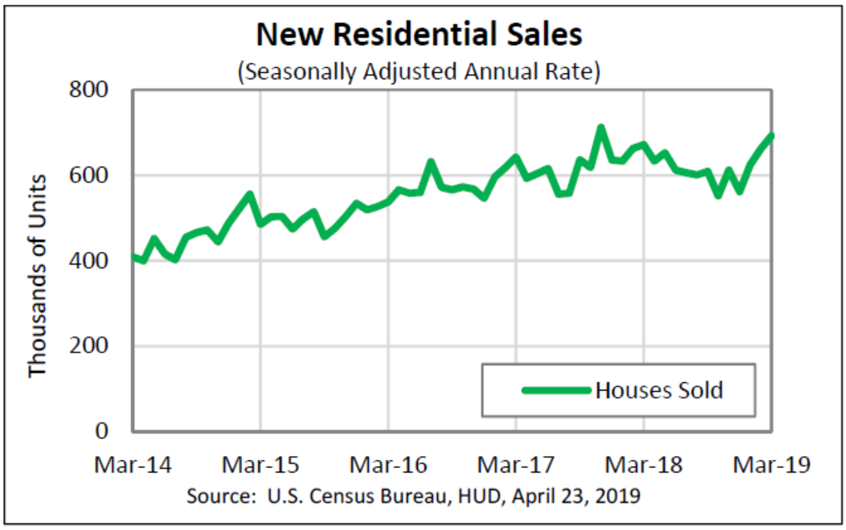
https://www.nar.realtor/research-and-statistics/housing-statistics/existing-home-sales

New Home Sales (Mar)

Data issues remain with this report at a National and regional level. In all cases, the 90% confidence interval around the monthly and annual changes all contain zero – meaning "there is insufficient statistical evidence to conclude that the actual change is different from zero." Sales could have increased or decreased.

At a National level, new home sales increased to a SAAR of sale of 692k units. Growth in Mar versus Feb was +4.5% - and the 90% confidence interval is +/- 17.6%. As this range contains zero, sales could have increased or decreased.

In Mar 2019 versus a year ago, new home sales grew by 3%. The 90% confidence interval for this statistic is +/- 11.4% - which again contains zero and means sales could have increased or decreased.



Regional Results

Similar issues exist for the sales results across the regions with the intervals all containing zero;

Northeast; monthly growth Mar -22.2% (+/- 29.9%)

Midwest; monthly growth Mar +17.6% (+/- 54.3%)

South; monthly growth Mar +3.6% (+/- 26.1%)

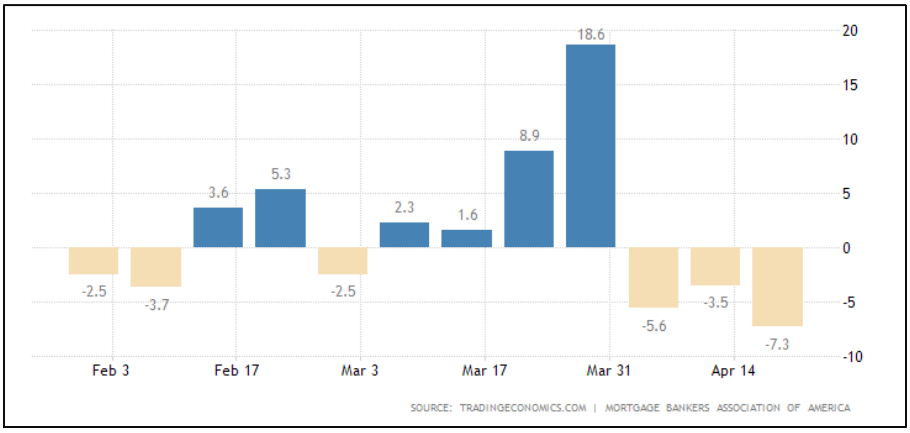
West; monthly growth Mar +6.7% (+/- 1.5%)

https://www.census.gov/construction/nrs/pdf/newressales.pdf

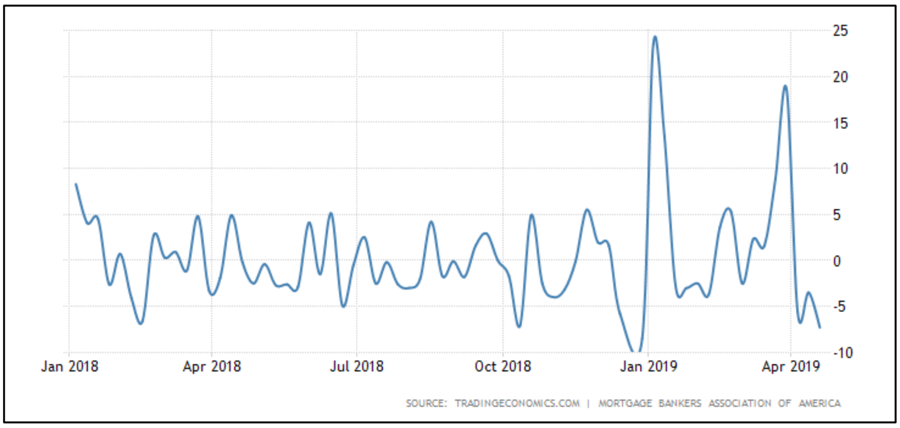
Mortgage Applications to 19 Apr

Mortgage applications declined by -7.3% in the latest week versus the week prior. This is the third week of falls;

Mortgage Applications - weekly % chg



Mortgage Applications - weekly % chg



Market Composite Index (mortgage loan application volume); -7.3% versus the week prior.

Refinance Index; -11% versus the week prior.

Purchase Index; -4% versus the week prior and +3% versus the same week a year ago.

> "The 30-year fixed mortgage rate has risen 10 basis points in three weeks, and is now at its highest level in over a month. Borrowers remain extremely sensitive to rate changes, which is why there has been a 28 percent drop in refinance applications over this three-week period. Purchase activity also declined, but remains almost 3 percent higher than a year ago," said Mike Fratantoni, MBA Senior Vice President and Chief Economist. "Borrowing costs have recently drifted higher because of ebbing geopolitical concerns, as well as signs of strengthening in the U.S. economy, including the recent data pointing to robust retail sales."

https://www.mba.org/2019-press-releases/april/mortgage-applications-decrease-in-latest-mba-weekly-survey-x251728

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Japan

BoJ Rates Decision – 25 Apr 2019

The BoJ kept rates on hold.

The Board clarified forward guidance for policy rates stating that "current extremely low levels of short and long-term rates will be maintained for an extended period of time at least through to spring 2020". This was in acknowledgement of uncertainties around economic activity and prices including developments in overseas economies as well as the effects of the planned consumption tax hike in Oct.

As a result, the bank also outlined new measures to expand eligible collateral for the provision of credit.

Monetary Policy - Yield Curve Control

ST interest rate; -0.1% policy rate Balances in current accounts held by financial institutions at the Bank.

LT interest rate; the BoJ will buy JGB's so that the 10yr JGB yield will remain at around zero %. Purchases will be conducted in a 'flexible manner' such that the amount outstanding will increase at a rate of 80bn Yen

Expansion of eligible collateral for the BoJ provision of credit

Asset Purchases

ETF's and J-REITs - amounts outstanding will increase at annual paces of about 6 trillion yen and about 90 billion yen, respectively

CP and corporate bonds - the Bank will maintain their amounts outstanding at about 2.2 trillion yen and about 3.2 trillion yen, respectively.

Current Conditions

Overall economy has been affected by the slow-down in overseas economies.

> "However, there are high uncertainties regarding the outlook for economic activity and prices. Including developments in overseas economies. In addition, it is likely to still take time to achieve the price stability target."

Given the high level of economic uncertainty, the BoJ "made clearer" its stance on monetary easing (no changes to rates until at least Spring 2020) as well as the expansion of eligible collateral for the BoKJ provision of credit.

> "…the Bank judged it appropriate to take such measures as the expansion of eligible collateral for the Bank's provision of credit, thereby contributing to smooth implementation of fund-provisioning and asset purchases as well as to securing market functioning."

Details are provided in the release document.

https://www.boj.or.jp/en/announcements/release_2019/k190425a.pdf

BoJ Q1 Outlook Report – 25 Apr 2019

> "Japan's economy is likely to continue on an expanding trend throughout the projection period -- that is, through fiscal 2021 -- despite being affected by the slowdown in overseas economies for the time being."

Outlook for Activity

Exports to show weakness and business fixed investment to slow – reflecting overseas weakness. Private consumption to continue growing supported by employment growth. Consumption tax hike likely to pull forward sales and consumption to also be supported by the Olympic games.

Outlook for Prices

CPI likely to increase gradually to 2% "on the back of the output gap remaining positive and medium- to long-term inflation expectations rising".

Risks

Developments in overseas economies have been clearly highlighted by the Bank this month. Other risks mentioned (as per previous announcements); protectionist moves, developments in emerging and commodity-exporting countries such as China, Brexit negotiations and geopolitical risks.

> "Such downside risks concerning overseas economies are likely to be significant, and it also is necessary to pay close attention to their impact on firms' and households' sentiment in Japan."

Domestic risks include the consumption tax hike.

Forecasts

Real GDP and CPI for fiscal year 2019 were revised slightly lower;

Real GDP; +0.7% - +0.9% (forecast in Jan 2019 was for +0.7% - +1% growth)

CPI – all items less fresh food; +0.9% - +1.2% (forecast made in Jan was for +1% - +1.3% growth)

https://www.boj.or.jp/en/mopo/outlook/gor1904b.pdf

Industrial Production – Prelim (Mar)

As suggested by the weaker manufacturing PMI reading for Mar (and Apr), the prelim result for industrial production was lower in the month and versus a year ago. Production & shipments declined in the month and accelerated lower versus a year ago.

Industrial Production (total Manufacturing & Mining) – Month (Seas Adj)

Production; Mar -0.9% versus Feb +0.7%. Production was notably lower in the month across several categories; Fabricated metals (-4.4%), Production machinery (-6.7%) and Transport equipment (-3.6%).

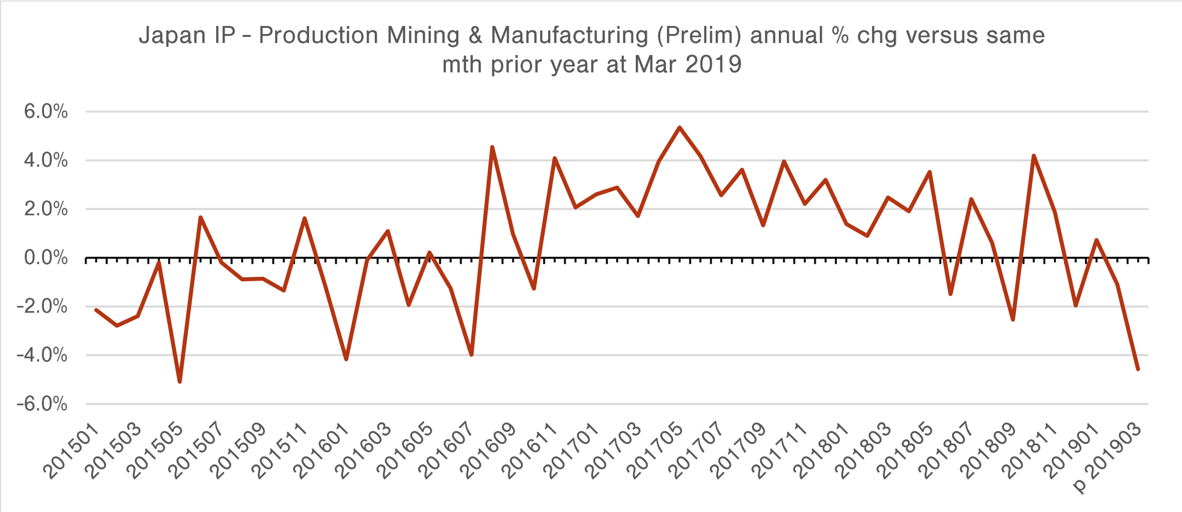
Shipments; Mar -0.6% versus Feb +1.6%

Inventory; Mar +1.6% versus Feb +0.4%

Inventory Ratio; Mar +1.7% versus Feb +0.5%

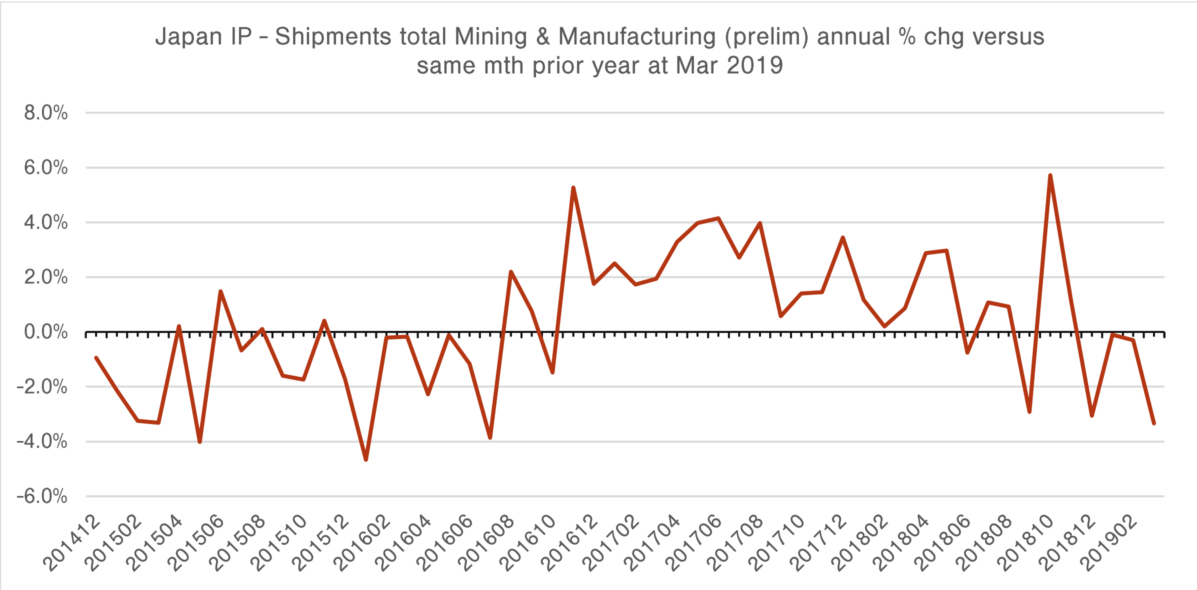
<u>Industrial Production (total Manufacturing & Mining) – Annual v. same mth a year ago (Orig)</u>

Production; Mar -4.6% versus Feb -1.1%



Production remains below a year ago across most categories (based on prelim data – not all categories included at prelim stage).

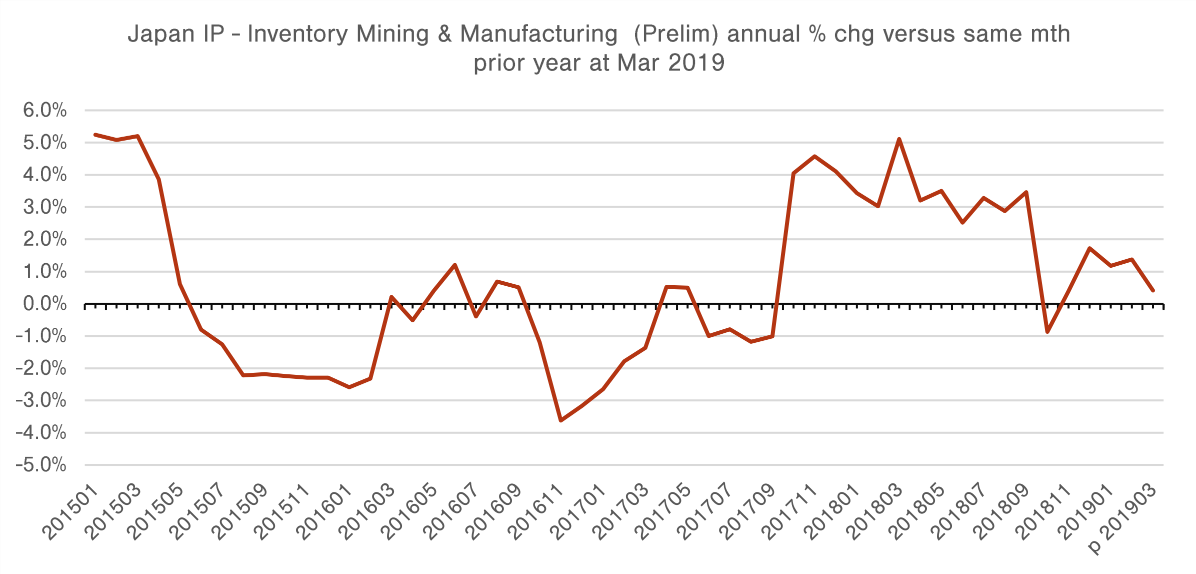
Shipments also remain under pressure; Mar -3.3% versus Feb -0.3%



Shipments remained below a year ago across most categories (based on prelim data).

Despite the declines in production and shipments, inventory has grown at a slower pace versus a year ago;

Mar +0.4% versus Feb +1.4%



The inventory ratio though increased at a faster pace versus a year ago.

<u>Survey of Production Forecast as of Apr</u>

April; production is forecast to increase by +2.7% for the month

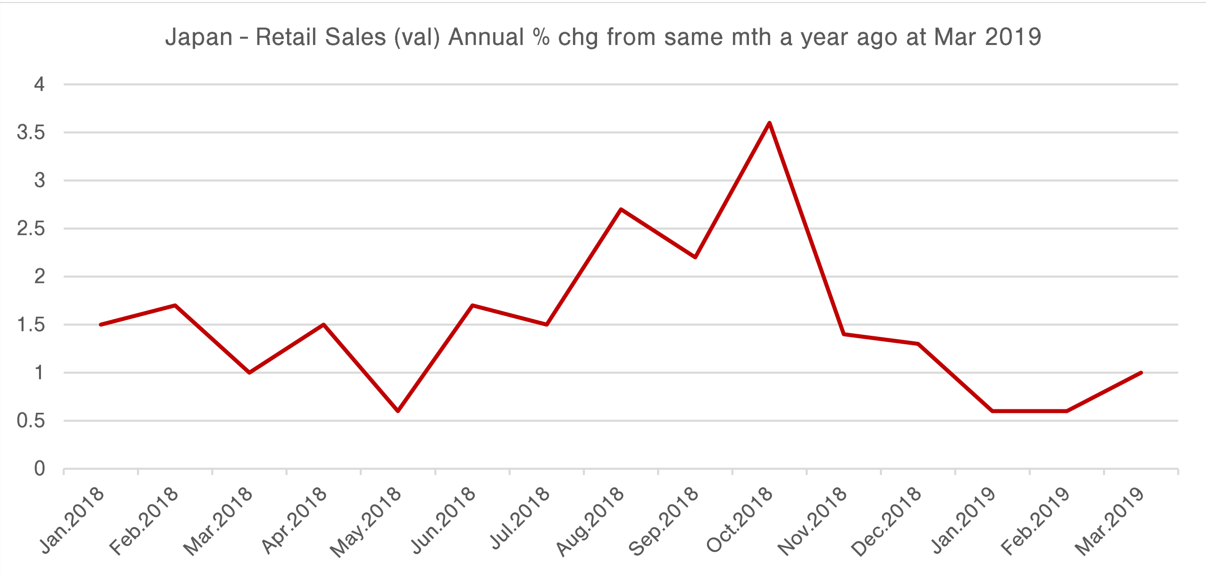
May; production is forecast to increase by +3.6% for the month

https://www.meti.go.jp/english/statistics/tyo/iip/index.html

Retail Trade (Mar)

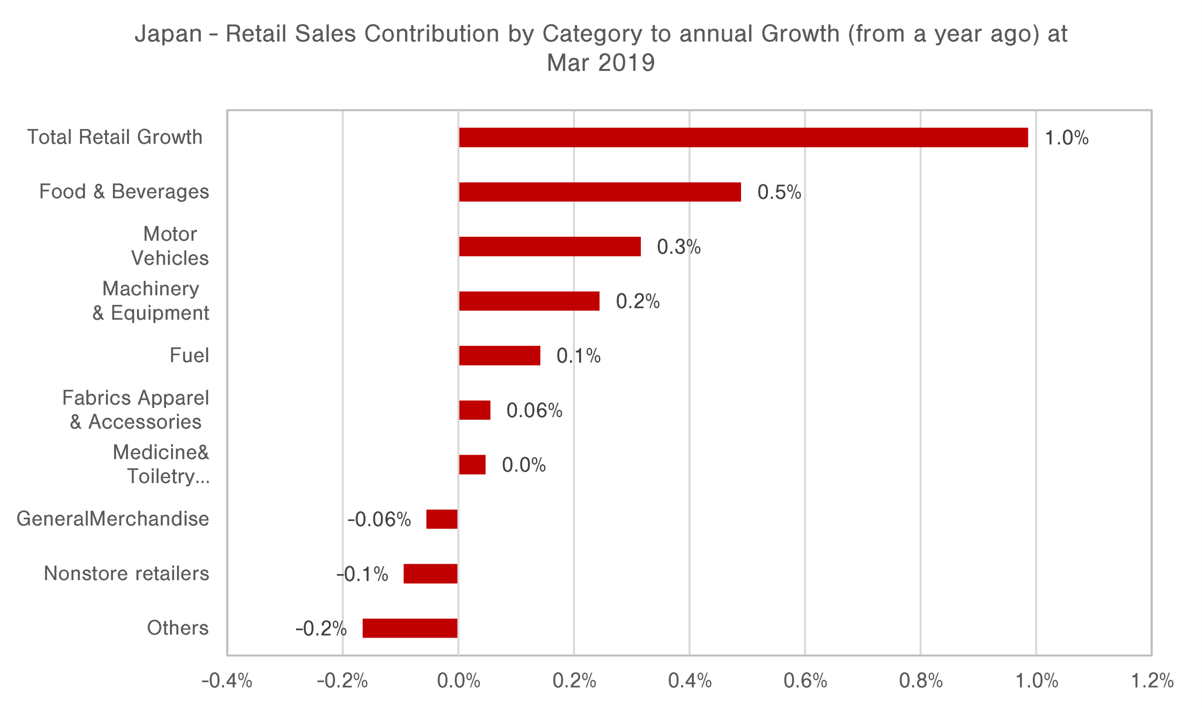
Retail sales increased by +0.2% in the latest month. The annual growth in retail sales (value) also increased at a slightly faster pace in Mar after slowing throughout late 2018.

Annual retail sales growth; Mar +1% versus Feb +0.6%



Retail Sales by Category

The largest contributor to growth in retail sales in the latest month versus a year ago was Food & Bev sales, followed by Motor Vehicles and then Machinery and Equipment.



https://www.meti.go.jp/english/statistics/tyo/syoudou/index.html

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United Kingdom

Brexit

Talks between UK government and the Labour party will recommence this coming week.

> "[PM] May herself has described the discussions as "difficult," while Labour officials say she has refused to compromise."
>
> "Labour wants May to guarantee the U.K. will join a post-Brexit customs union with the EU; May argues that would rule out pursuing free-trade deals with countries including the U.S."
>
> https://www.bloomberg.com/news/articles/2019-04-28/u-k-conservatives-still-seeking-brexit-deal-before-eu-election

To avoid participation in the EU elections, the UK government needs to approve the current Brexit deal by 23 May 2019. It appears unlikely that there will be another parliamentary vote in the coming week.

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Canada

BoC Rates Decision – 24 Apr 2019

The BoC left rates on hold at the latest meeting;

Overnight cash rate target; +1.75%

Bank rate target; 2%

Deposit rate target 1.5%

External Factors

Slower global growth since the Jan meeting and ongoing trade conflicts have maintained uncertainty and undermined activity and sentiment. Growth is expected to pick up though as 'temporary factors' fade.

Many central banks have now indicated a shift to a 'slower pace of monetary policy normalization'.

Domestic Outlook

In Canada, growth expected to pick up in Q2. Housing to stabilize due to population growth, fading policy changes and accommodative financial conditions. Consumption to be boosted by employment/income growth. Exports to expand on greater global demand.

Real GDP now forecast to growth +1.2% for full year 2019 (revised lower from the +1.7% forecast in Jan 2019).

CPI close to 2% but will dip in Q3 due to changes in gasoline prices.

Rates Signalling

Accommodative policy rates to remain.

Looking for signals that factors currently weighing on growth are starting to recede; household spending, oil markets, global trade policy.

https://www.bankofcanada.ca/2019/04/fad-press-release-2019-04-24/

Monetary Policy Report – Apr 2019

https://www.bankofcanada.ca/wp-content/uploads/2019/04/mpr-2019-04-24.pdf

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Australia

CPI (Q1)

The annual growth in the headline and core CPI measures slowed further in the latest quarter for Australia. All measures continue to trend further below the RBA target range of 2-3%. Both domestic and external factors are contributing to the lower price growth in the quarter and the year.

On a quarterly basis, CPI growth was 0%.

Changes in fuel prices continue to impact CPI growth. Although transport detracted from CPI growth in Q1, this could start to provide some upward pressure in the next quarter (if current oil prices continue to rise). This may offset some of the annual price resets for education and health – which have been the main positive contributors to CPI growth in the current quarter.

The latest RBA forecast for CPI growth for the year to June 2019 (next quarter) is +1.25% (Source: RBA Feb SMP https://www.rba.gov.au/publications/smp/2019/feb/economic-outlook.html).

Headline CPI

Annual change (original); Q1 +1.3% versus Q4 2018 +1.8%

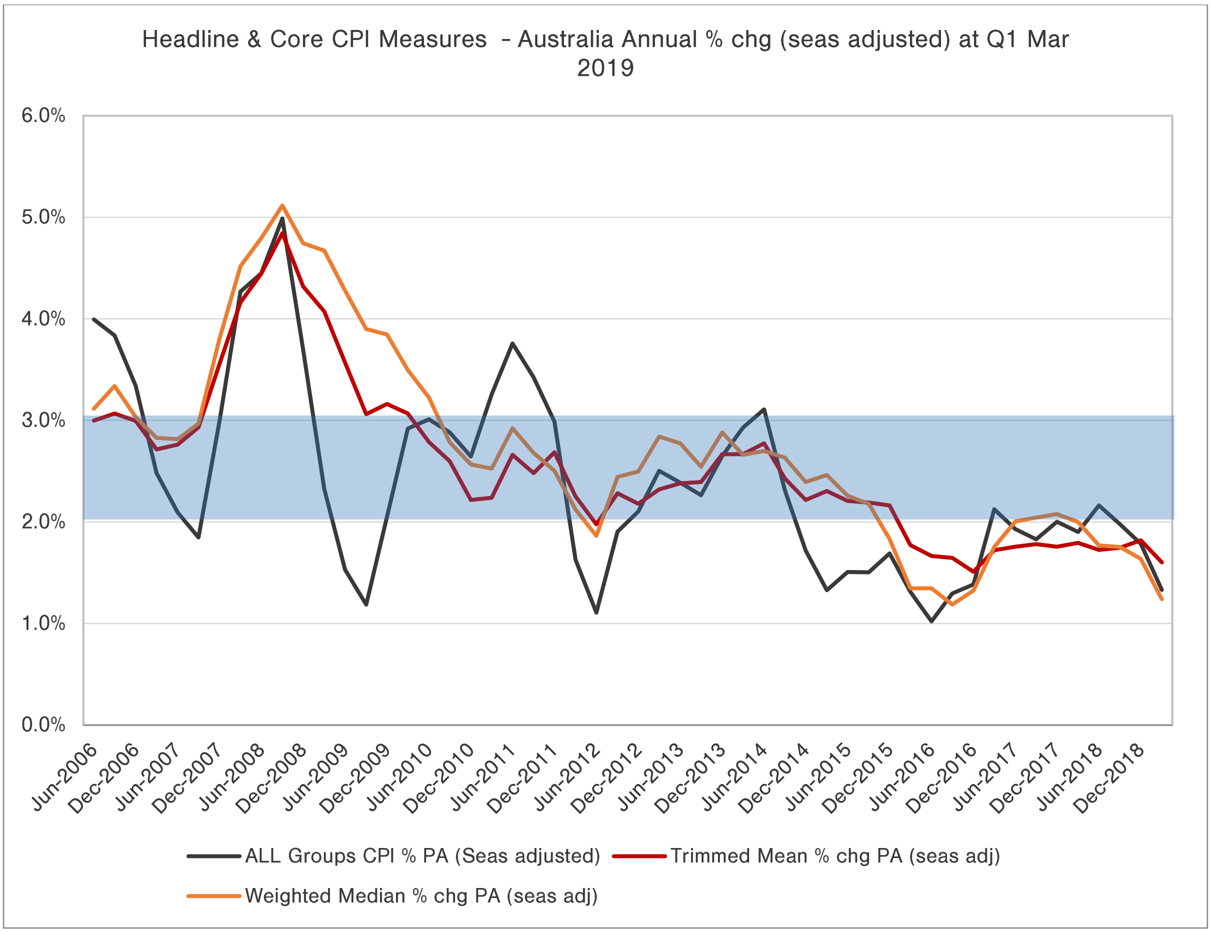
CPI Qtrly change (original); Q1 2019 +0.0% versus Q4 2019 +0.5%

Core CPI

Measures of core CPI/underlying price changes also slowed further in the latest quarter indicating that, even removing/accounting for extremes, price growth still slowed;

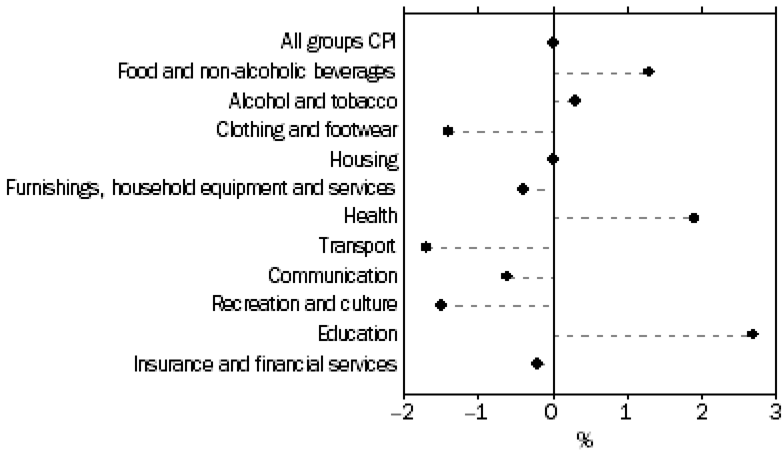
Trimmed Mean CPI – annual change (seas adj); Q1 2019 +1.6% versus Q4 2018 +1.8%

Weighted Median CPI – annual change (seas adj); Q1 2019 +1.2% versus Q4 2018 +1.6%



Contribution to CPI Growth

Weighted Avg of Eight Capital Cities (% chg from prev qtr)



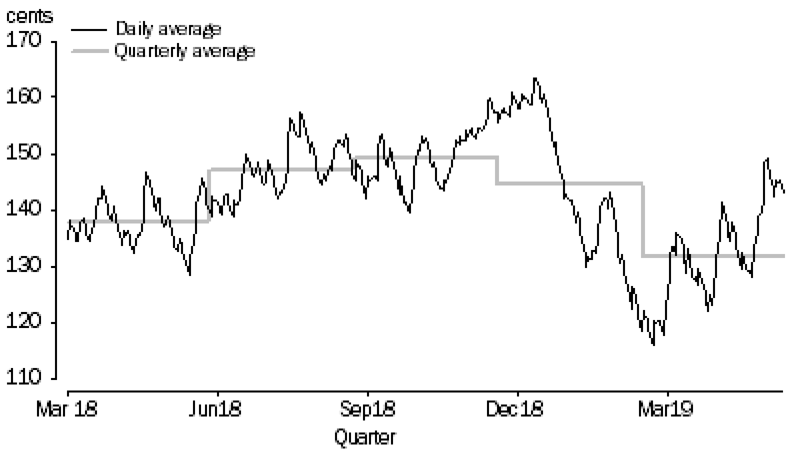
Food & bevs, Health and Education made the largest contributions to headline CPI growth over the last year.

The largest contributor in Food & Bev was vegetables (+7.7%) as drought conditions reduced supply. Education changes are the result of the start of the new school year. The rises in Health costs are driven by the cyclical reduction in the proportion of consumers that qualify for subsidies under the Medical Benefits Scheme. This is reset at Jan 1 each year. Some of these impacts should reverse in the next quarter.

Transport, Clothing and Recreation and Culture made the largest negative contribution to CPI over the last year.

Of note is transport. The fall was mostly the result of an 8.7% fall in automotive fuel over the year. Note though that fuel fell in Jan -6.1% but has increased in Feb (+4.2%) and Mar (+5.2%).

Avg Price of Unleaded Petrol (91 Octane) Cents/Ltr



Depending on what continues to happen with oil prices, there could be a shift to higher price pressure from this area in the next quarter.

While Housing doesn't appear to make any contribution to headline CPI in Q1, annual growth has halved between Q1 2019 +0.8% versus Q4 2018 +1.5%.

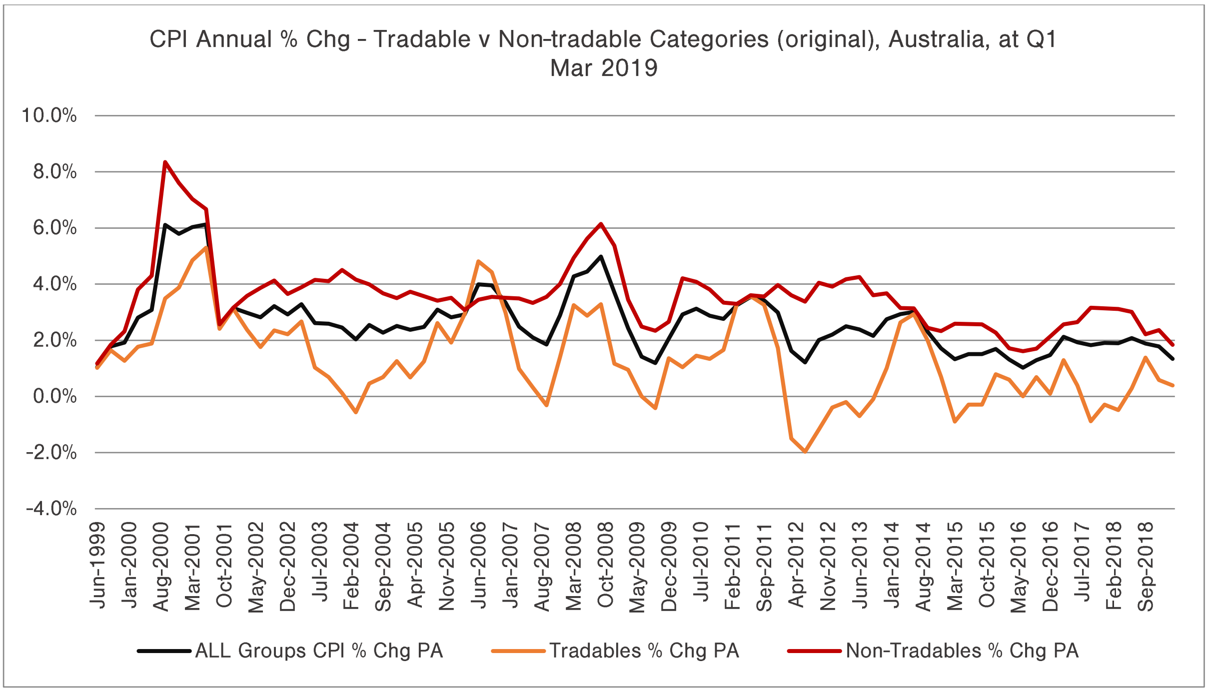
<u>Tradeable/Non-Tradable View of CPI</u>

This provides some insight as to the source of price pressures – domestic (non-tradable) or external (tradable – prices largely determined on the world market).

In Q1, falls in tradable prices and slower non-tradable price growth contributed to the zero growth in the CPI for the quarter. Both domestic and external factors are contributing to the lower price growth in the quarter and the year

In the latest quarter, **tradable inflation fell -0.6% after declining by -0.3% in Q4 2018**. This was mostly due to the fall in automotive fuel prices (-8.7%). The tradable services component fell 2.0% due to international holiday, travel and accommodation (-2.1%).

In the latest quarter, **non-tradable inflation increased by +0.3% after growing +0.9% in Q4 2018**. The domestic price pressures in Q1 were mostly the result of health and education price increases.



https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6401.0Main+Features1Mar%202019?OpenDocument

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Trade

US-China Trade Negotiations

USTR Lighthizer and Treasury Secretary Mnuchin will reportedly travel to China for further talks w/c 29 Apr with the aim of finalising details of the trade deal.

The following week (early May), Chinese Vice Premier Lui He is scheduled to travel to Washington;

> "The next week, Chinese Vice-Premier Liu He will go to Washington for talks, which officials hope will lead to the announcement of a deal and the details of a signing summit, probably for late May, according to the report."
> https://www.scmp.com/news/china/diplomacy/article/3006694/two-more-rounds-talks-set-may-amid-hope-us-china-trade-war

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

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 report by the ITC evaluating the USMCA was released last week – based on the implementation over the next six years;

> "We welcome the International Trade Commission's independent analysis of the USMCA. This report is an important step forward in gaining congressional approval of the USMCA. The ITC analysis shows that USMCA will increase U.S. employment by 176,000 jobs and is projected to increase GDP by 0.35%. This is more than double the 0.15% growth rate the ITC projected for the multilateral Trans-Pacific Partnership. These findings validate President Trump's action to withdraw from TPP and renegotiate the disastrous NAFTA. With USMCA, we will have stronger growth, more trade and more jobs – particularly in manufacturing. There can be no doubt that the USMCA is a big win for America's economy."

Links to the detail can be found in the USTR announcement; https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/april/statement-us-trade-representative

The focus now is to have the deal ratified by Congress before the summer.

> "Rep. Kevin Brady, ranking member on the House Ways and Means Committee, said U.S. Trade Representative Robert Lighthizer is ready to send legislation to lawmakers when House Speaker Nancy Pelosi "gives the green light." He called getting the deal to Trump's desk this summer "crucial."" https://www.cnbc.com/2019/03/29/trumps-nafta-usmca-trade-deal-faces-bipartisan-roadblock-in-congress.html

Link to the USITC report;
https://www.usitc.gov/press_room/news_release/2019/er0418ll1087.htm

Section 232 – Car and Truck Imports

The final report on the s.232 investigation was provided to President Trump on 17 Feb. The President has 90 days to make a final decision on the recommendations.

> "Some analysts have considered the secrecy around the U.S. report on Section 232 tariffs as leverage which Trump likely intends to use in the U.S. trade negotiations with the EU."

> "We're trying to make a deal. They are very tough to make a deal with," Trump told reporters at the White House on Wednesday. "If we don't make a deal, we'll do the tariffs." http://www.xinhuanet.com/english/2019-02/23/c_137845093.htm

US-Japan Trade Talks

Trade talks between the US and Japan commenced in the week prior. Details of the negotiations came to light during the week - Japan would not soften its stance on agriculture (import tariffs have been high);

> Donald Trump's hopes of completing a trade deal with Japan next month have been severely dented after he failed to persuade prime minister Shinzo Abe to give the US greater access to the country's agricultural market. https://www.ft.com/content/6ae28e80-698b-11e9-80c7-60ee53e6681d

> Japan wants to ensure it gets something in return for granting US farmers greater market access to its market, namely removing the threat of tariffs on car imports on the basis of US national security. https://www.ft.com/content/6ae28e80-698b-11e9-80c7-60ee53e6681d

A group of major US farm groups has lobbied USTR Lighthizer regarding the trade talks with Japan and access to the Japanese market (emphasis added);

> "In recent weeks, Japan cut tariffs for the second time on agricultural imports from the European Union and CPTPP member countries. **As a result, U.S. exporters of wheat, beef, pork, dairy, wine, potatoes, fruits and vegetables, and other products are facing collapse of their Japanese market share as these lucrative sales are handed over to their competitors."** https://www.hpj.com/ag_news/plenty-of-trade-action-on-several-fronts/article_6ac3fc7d-8eb4-5d6d-965d-602094ce6a66.html

The two representatives will 'meet again in the near future to continue talks'.

> "The United States and Japan discussed trade issues involving goods, including agriculture, as well as the need to establish high standards in the area of digital trade. In addition, the United States raised its very large trade deficit with Japan – $67.6 billion in goods in 2018." https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/april/statement-ustr-meetings-discuss

President Trump is due to meet with Prime Minister Shinzo Abe at the Group of 20 summit in Osaka in June – securing an agreement before then seems unlikely that this stage.

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

The summary of US 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

No further details on the commencement of trade talks between the US and EU.

Last week the EC authorised negotiations to commence between the EU and the US. Emphasis added;

> "Today's adoption of the EU negotiating directives gives a clear signal of the EU's commitment to a positive trade agenda with the US and the implementation of the strictly defined work programme agreed by Presidents Trump and Juncker on 25 July 2018. **But let me be clear: we will not speak about agriculture** or public procurement."

https://www.consilium.europa.eu/en/press/press-releases/2019/04/15/trade-with-the-united-states-council-authorises-negotiations-on-elimination-of-tariffs-for-industrial-goods-and-on-conformity-assessment/?utm_source=dsms-auto&utm_medium=email&utm_campaign=Trade+with+the+United+States%3a+Council+authorises+negotiations+on+elimination+of+tariffs+for+industrial+goods+and+on+conformity+assessment

Emphasis added;

> "[US President] Donald Trump reiterated his threat that trade talks with the EU must open up markets to farmers or he would impose tariffs on European car imports. **EU negotiating directives agreed Monday say agriculture must be excluded from planned negotiations**."

> "EU trade chief Cecilia Malmström held out hope Monday that a transatlantic trade deal could be done "quite quickly" if both sides could agree on a basis to start negotiations, but such an agreement appears difficult to reach amid the row over agriculture."

> "Brussels has said it would immediately suspend trade talks should Trump impose auto tariffs."

https://www.politico.eu/article/trump-to-eu-include-agriculture-in-us-trade-talks-or-face-tariffs/

A further escalation between the US and EU on aircraft subsidies. Last week, the USTR announced it will commence a process that will identify products of the EU that additional duties will be applied to in response to continued EU subsidies for Airbus. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/april/ustr-proposes-products-tariff

The USTR has launched an "investigation to enforce U.S. rights in the World Trade Organization (WTO) dispute against the European Union (EU) and certain EU member States addressed to EU subsidies on large civil aircraft."

> The Trade Representative proposes to take action in the form of additional duties on products of the EU or certain member States, to be drawn from the preliminary list annexed to this Notice.

Key dates for this investigation;

May 6, 2019: Due date for submission of requests to appear at the public hearing and summary of testimony.

May 15, 2019: The Section 301 Committee will convene a public hearing.

May 28, 2019: Due date for submission of written comments, including post-hearing rebuttal comments.

https://www.federalregister.gov/documents/2019/04/12/2019-07267/initiation-of-investigation-notice-of-hearing-and-request-for-public-comments-enforcement-of-us-wto

Last week the EC has identified approx. €20bn in US exports for tariffs;

> "The European Commission Wednesday said it wants to hit around €20 billion of U.S. exports with tariffs in retaliation for unlawful subsidies given by the U.S to American aircraft manufacturer Boeing." https://www.politico.eu/article/eu-prepares-e20b-retaliation-against-us-over-boeing-subsidies/

https://www.politico.eu/tag/eu-us-trade-talks/

The summary of US 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

The USTR has now published the summary of specific negotiating objectives for the US-UK trade negotiations; https://ustr.gov/sites/default/files/Summary_of_U.S.-UK_Negotiating_Objectives.pdf

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