Weekly Macro Review

w/c 17 June 2019

Key Themes

Central banks were the main focus during the week – mostly signalling that more policy accommodation is to be expected. The FOMC, RBA, and ECB indicated that further accommodations were required in order to reach inflation targets over the medium term.

From the FOMC this week, we expected to see a shift in the language, opening the door to greater accommodation. While rates remained on hold at this meeting, the decision signalled growing support among committee members for more policy accommodation. Downside risks for the domestic economy are on the radar – weakening business sentiment and investment, re-emergence of 'cross-currents' on trade and global growth. The concern for the FOMC has been muted domestic inflation – with downside risks seen as further slowing progress on bringing inflation back to the 2% (symmetrical) target. Key language changed; removing reference to a "patient approach". Forecasts were little revised except for PCE inflation which was revised lower for this year.

The two regional US manufacturing surveys indicated an abrupt loss of momentum in Jun. The prelim composite PMI for Jun indicated private sector activity stagnated – led by both manufacturing and services. At the same time, housing market conditions and existing home sales have stabilized since the start of the year.

ECB President Draghi also flagged further rate cuts and monetary stimulus were likely. This is in response to continued weakness across the Eurozone especially in manufacturing and exports. Downside risks pose a threat to the ECB reaching its 2% inflation target and ECB President Draghi reaffirmed the conviction of the Bank to meeting the 2% target.

Annual Eurozone CPI growth slowed further in May while the prelim PMI's indicated a slight improvement in momentum – led by services while manufacturing continued to contract.

The BoJ also kept rates on hold. There was little change here – with the Bank signalling policy accommodation to remain in place for an extended period, until at least Spring 2020. Inflation in Japan ex fresh food remained low in May with little sign of acceleration. The prelim manufacturing PMI indicated continued slight contraction in manufacturing activity. Exports and import declined in May.

The BoE kept rates on hold and has so far maintained its very slight tightening bias – which assumes a smooth Brexit. But the MPC has started to acknowledge downside risks are picking up with Brexit and political uncertainty partly fuelling underlying weaker growth in H1 relative to 2018. While stronger household consumption and weaker business investment patterns have persisted, retail sales (volumes) have declined/stalled for the last two months.

The RBA minutes also confirmed that further policy accommodation in Australia is likely. The case for rate cuts; to reduce spare capacity in the labour market in order for inflation to return to the 2-3% band (via an increase in wages growth). The return of inflation to the 2-3% range would be more gradual without further cuts given the current level of unemployment and underemployment.

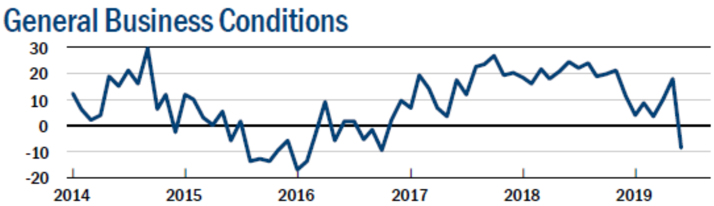
Contents

US Data

Empire State Manufacturing Survey (Jun)

The headline index of fell by 26.4 points in Jun – indicating an abrupt contraction/worsening in business conditions in the region. New orders declined while shipments growth slowed. Employment and hours worked also contracted in the month.

General Business Conditions; Jun -8.8 versus May 17.8



	Percent Reporting		
	Higher	Lower	Index
May	36.3	18.4	17.8
Jun	21.8	30.4	-8.6
Change			-26.4

Most concerning is that the proportion of firms recording better/worse conditions flipped in one month.

New orders fell by 21.7pts to a reading of -12 in Jun. The first fall in two years.

Shipments remained positive but growth slowed. Shipments were likely supported by firms working through order backlogs. In Jun firms recorded a large fall in unfilled orders, which fell by 17.9pts to a reading of -15.8.

Firms also continued to hold less inventory which declined at a slightly faster pace.

Prices paid for input increased at a slightly faster pace and, while not as high as the recent peak, remain elevated. Growth in the prices received index on the other hand, slowed quickly – suggesting little pricing power.

Measures of employment also declined this month. The number of employees fell firmly into contraction while the average workweek also declined, but to a slightly lesser degree.

https://www.newyorkfed.org/survey/empire/empiresurvey_overview.html#tabs-1

Philadelphia Fed Business Outlook Survey (Jun)

The fall in the headline index suggested that the level of general business activity in the region had slowed to virtually no growth in the month. Growth across most of the underlying indicators slowed but remained positive. The one area that stands out is the fall in the prices received index – a relatively large drop (not dis-similar to the Empire State survey).

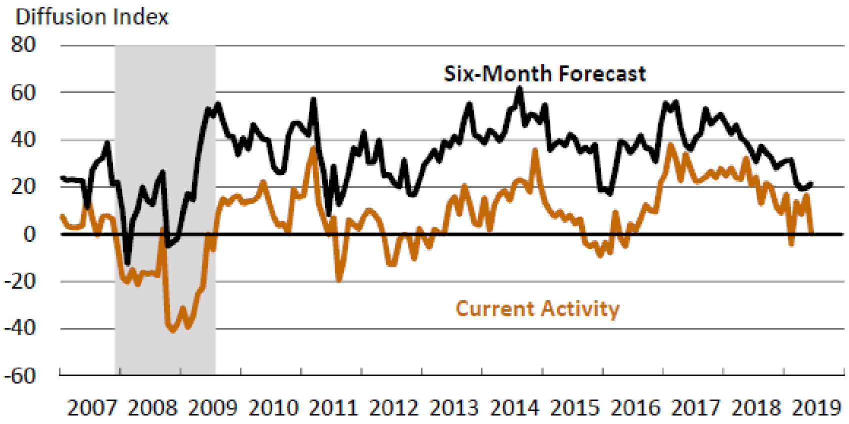
General Business Activity – Current; Jun 0.3 versus May 16.6

Its worth noting some recent volatility in this index over the last few months.

In the last month, there was a large shift in the proportion of firms that recorded a 'decrease' in activity; in May 8.8% of firms recorded 'decreasing' activity while in Jun this increased to 30% of firms reporting lower/decreasing activity.

The six-month forecast remains near its recent low – suggesting muted optimism.

Chart 1. Current and Future General Activity Indexes
January 2007 to June 2019



Note: The diffusion index is computed as the percentage of respondents indicating an increase minus the percentage indicating a decrease; the data are seasonally adjusted.

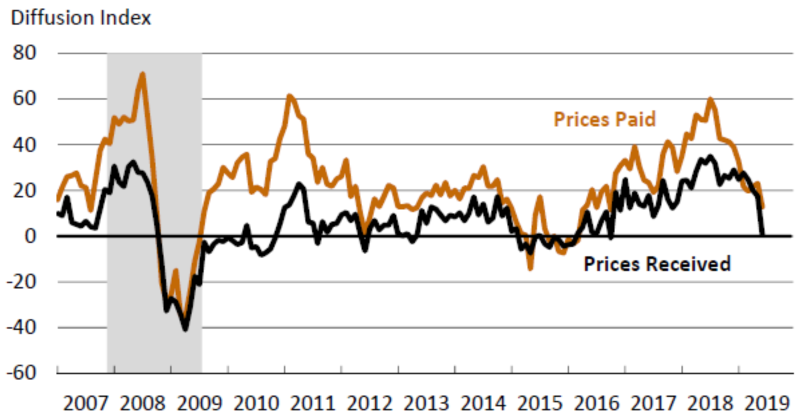
New orders grew at a slower pace; slowing from 11 in May to 8.3 in Jun. The underlying shift has been negative though – more firms shifted out of 'no change' to recording a decrease in new orders. There was also a small increase in the proportion of firms reporting 'increasing' new orders.

Shipments grew at a slower pace. At the same time, unfilled orders increased at a faster pace. Inventories shifted from declining to increasing.

The number of employees and average workweek both grew at a slower pace.

The prices paid index slowed quickly – from 23.1 in May to 12.9 in Jun (positive shift). But the prices received index fell very hard as well, from 17.5 in May to 0.6 in Jun;

Chart 2. Current Prices Paid and Prices Received Indexes
January 2007 to June 2019



Note: The diffusion index is computed as the percentage of respondents indicating an increase minus the percentage indicating a decrease; the data are seasonally adjusted.

https://www.philadelphiafed.org/-/media/research-and-data/regional-economy/business-outlook-survey/2019/bos0619.pdf?la=en

Prelim Manufacturing & Services PMI (Jun)

The prelim headline composite PMI indicated that private sector output growth continued to slow further in Jun. This was led by both manufacturing and services activity.

Composite PMI Output; Jun 50.6 versus May 50.9

Data collected June 12-20

IHS Markit Composite PMI and U.S. GDP

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

Manufacturing PMI; Jun 50.1 versus May 50.5

Services Business Activity Index; Jun 50.7 versus May 50.9

Manufacturing production output only increased at a marginal pace while services activity was the lowest in three years. New business increased at a slightly faster pace in Jun and there was a small increase in the backlog of work.

Employment growth was moderate in Jun but still the lowest rate of expansion since Apr 2017.

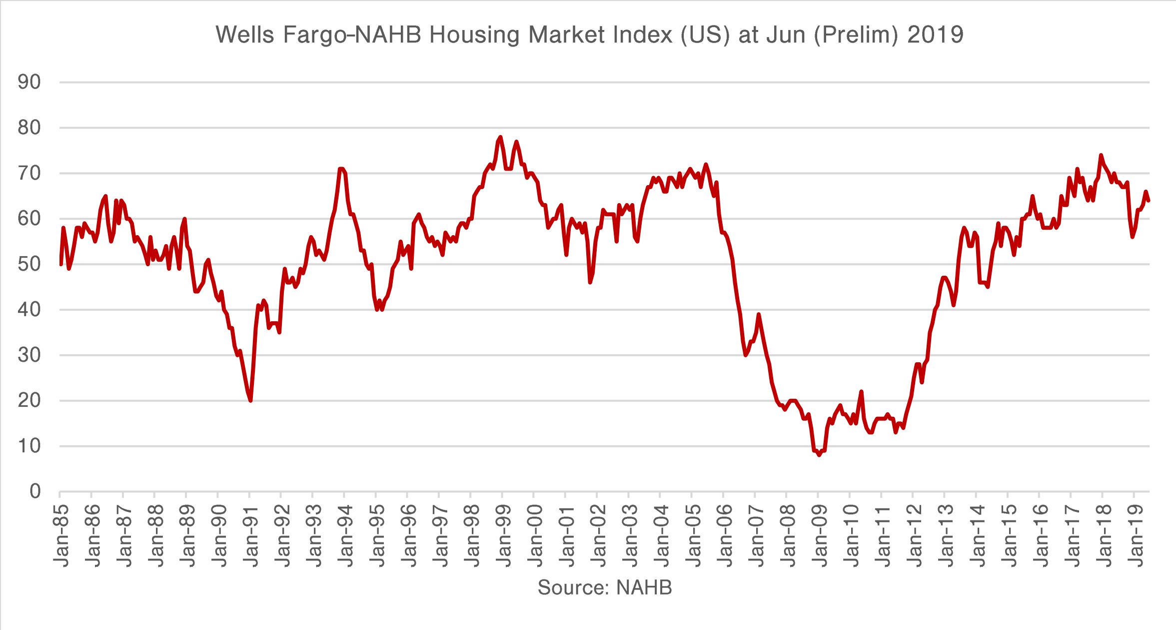
Optimism about the business outlook fell to the lowest point since Jul 2012 when this was first measured.

https://www.markiteconomics.com/Public/Home/PressRelease/1e3aca59a65d41e7bba25a391bd064f0

NAHB Housing Market Index (Jun)

The headline index of housing market conditions decreased slightly in the latest month. The component parts – single family sales current and 6 months head and traffic of prospective buyers all fell slightly (stalled). There were mixed results across all of the regions, but the weaker result was led mostly by a decline in conditions in the West and Northeast.

Housing Market Index; Jun 64 versus May 66



Housing Market Index Components

Single family sales; Jun 71 versus May 72

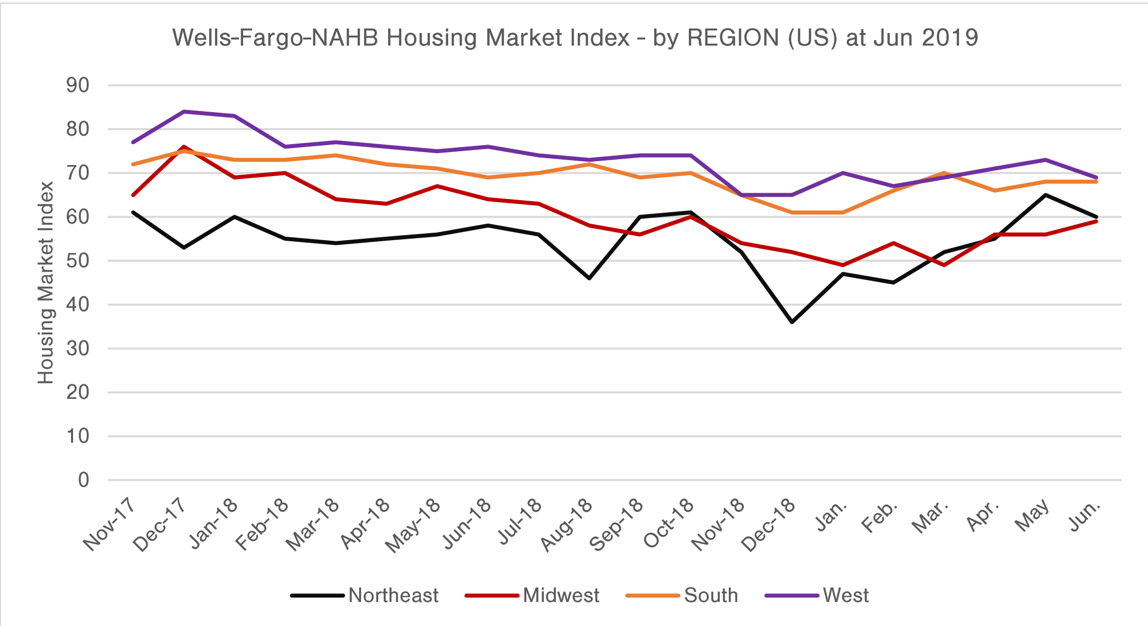
Single family sales – next 6-months; Jun 70 versus May 72

Traffic of prospective buyers; Jun 48 versus May 49

Housing Market Index - Regions

The results across the key regions were mixed;

The largest falls were recorded in the West (over a 1*SD decline in the HMI). The conditions index also fell in the Northeast. Conditions were unchanged in the South. Conditions continued to improve in the Midwest.



https://www.nahb.org/en/research/housing-economics/housing-indexes/housing-market-index.aspx

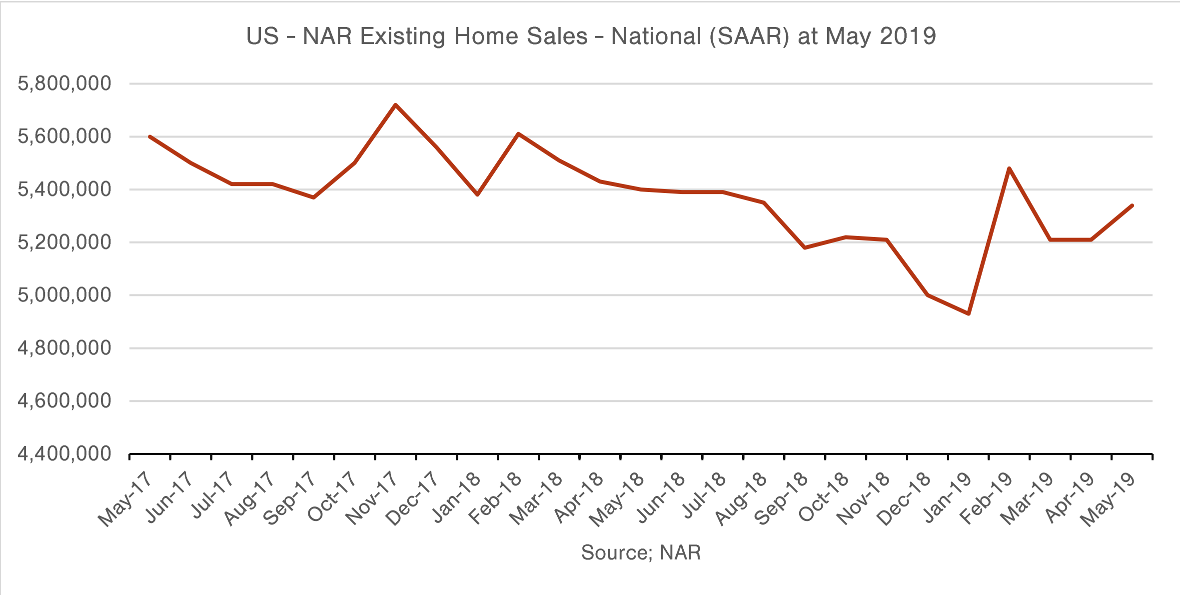
Existing Home Sales (May)

National existing home sales increased in May after no change in the month prior. The annualized rate of sale in May is now only 1.1% below the rate from the same time a year ago. Sales increased across all main market regions.

While sales increased in May, inventory and months of supply also continued to increase.

Existing Home Sales

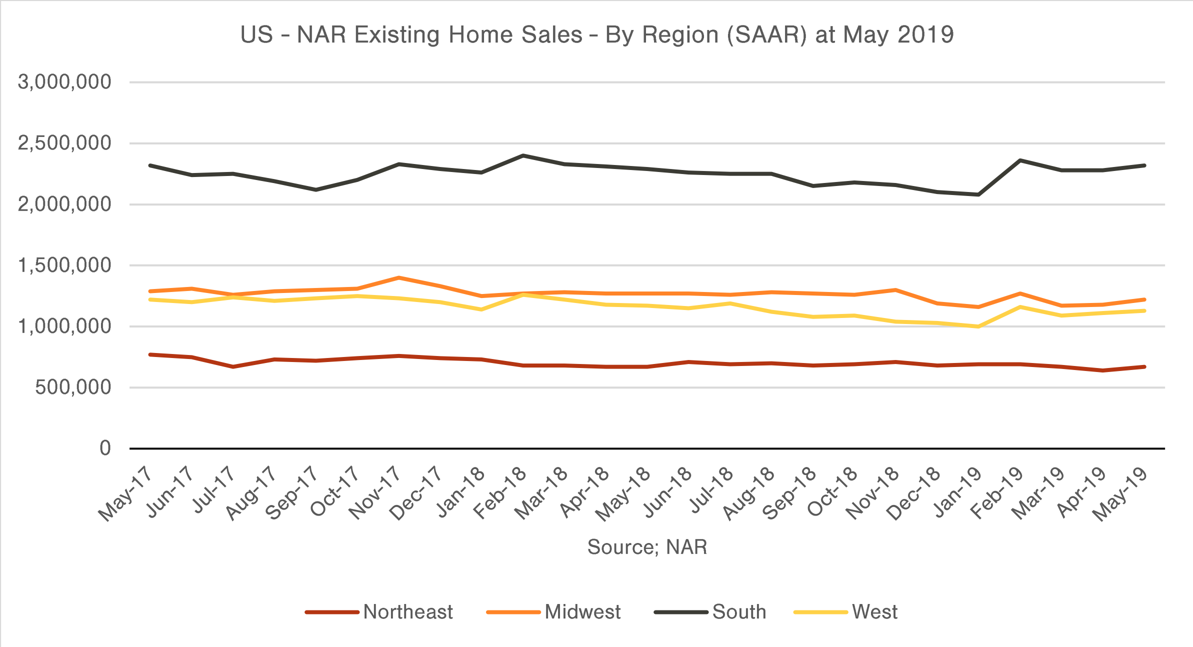
SAAR (seas adj ann rate); May 5.34m versus Apr 5.21m – a +2.5% increase versus the month prior. The May annualized rate of sale is now only -1.1% below May 2018.



Regional Sales

Sales of existing homes increased across all markets this month.

The largest increase (% chg) was recorded in the Northeast +4.7% versus the month prior and is now on par with the annualized rate of sale from a year ago.



Sales in the Midwest increased by +3.4% in May and current sales are now 4% below the same month a year ago.

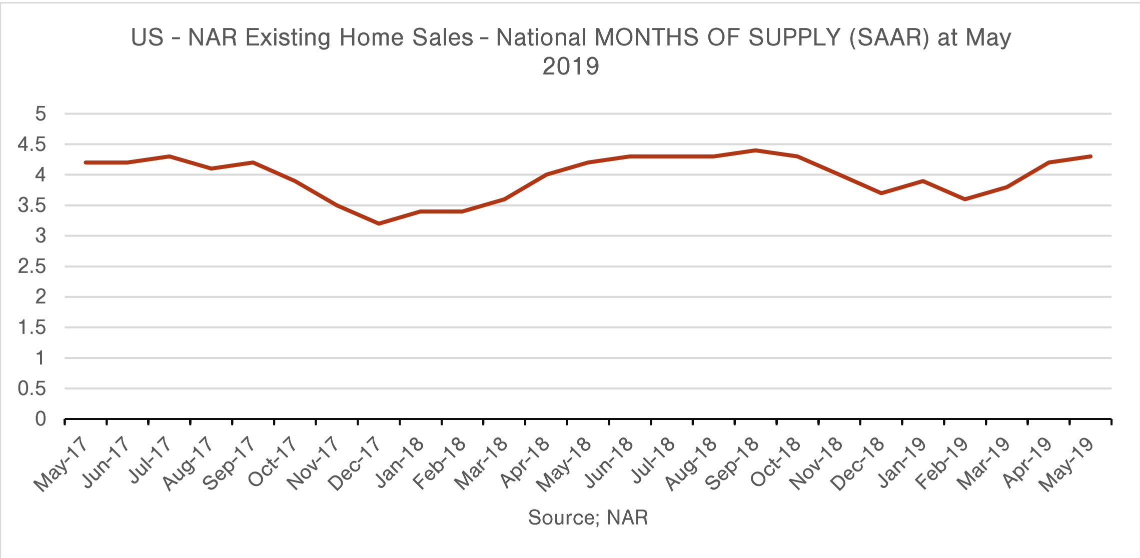
Sales in the South increased by +1.8% in May and sales are now running at 1.3% above a year ago.

Sales in the West also increased by +1.8% in May and are now running at -3.4% below a year ago.

Inventory

Even though sales increased in the latest month, inventory/months of supply continued to increase; May 4.3 months of supply versus Apr 4.2 months of supply.

Supply has continued to increase despite the rebound in sales since the Jan 2019 low;



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

FOMC Meeting – 18-19 Jun 2019

Summary; The FOMC has shifted to more active language on rate changes (supporting previous statements of 'doing whatever it takes'). There is now growing support among committee members for more policy accommodation - that downside risks for the domestic economy is now on the radar – weakening business sentiment and investment, re-emergence of 'cross currents' on trade and global growth and muted domestic inflation.

Statement

The FOMC kept rates on hold at the 2.25-2.5% range for the FFR.

> The Committee continues to view sustained expansion of economic activity, strong labor market conditions, and inflation near the Committee's symmetric 2 percent objective as the most likely outcomes, **but uncertainties about this outlook have increased**. In light of these uncertainties and muted inflation pressures, the Committee will closely monitor the implications of incoming information for the economic outlook and **will act as appropriate** to sustain the expansion, with a strong labor market and inflation near its symmetric 2 percent objective.

The FOMC notes that 'the most likely outcome is sustained expansion, strong labour market conditions and inflation near the 2% target'. This has not changed – the base case for the economy.

Previously, the FOMC has described issues/risks facing the economy and projections as – "In light of global economic and financial developments". This has now changed to "uncertainties about this outlook have increased", which now follows the base case for US domestic conditions. This suggests a shift in the focus of the downside risks – from external to domestic.

The FOMC removed 'patient' from the statement. Previously, the FOMC has signalled 'continued patience in assessing further adjustments in monetary policy'. Now, there seems to be more of a signal that the Fed will act quickly – "will act as appropriate to sustain the expansion".

'Muted inflation' remains in the statement. The FOMC acknowledges that inflation and core inflation are running below the 2%, which forms part of the risk to the domestic situation (and this hasn't changed).

Press Conference

Econ performing 'reasonably well', overall favourable.

Cross currents were moderating as of the previous meeting but have now re-emerged. Progress on trade turned to greater uncertainty.

Drop in business confidence and may be starting to show through in incoming data.

The case for more accommodative policy stance has strengthened – basis? U/e remaining low, growth projections remain above LR projections. But underlying drivers of growth are important – spending on consumption and business investment are more important indicators. Weaker consumption in Q1 but now growing at a solid pace (the Apr/May retail revisions must have been important), it's the weaker business sentiment and investment picture, together with the cross-currents, that has FOMC worried that the risk of less favourable outcomes has increased.

Inflation declined in Q1 but there has been some pick-up. FOMC concerned that the pace of the return of inflation to 2% target. Wages increasing but not increasing at a pace that would provide much impetus to inflation. Weaker global growth may also hold inflation down. The concern has shifted to a more 'sustained shortfall of inflation" and the broader implications of that.

On the case for policy accommodation – emphasis added;

> "Though some participants wrote down policy cuts and others did not, our deliberations made clear that a number of those who wrote down a flat rate path agree that the case for additional accommodation has strengthened since our May meeting. **This added accommodation would support economic activity and inflation's return to our objective**."

Projections

Projections were little changed except for inflation which was revised lower.

Real GDP growth was unchanged for 2019 at +2.1% and remains ahead of the longer run projection of +1.9%. The projection for 2020 was increased slightly.

Th u/e rate was revised lower; from 3.7% in Mar projections to 3.6% in the Jun projections.

PCE inflation for 2019 was revised much lower; from +1.8% in Mar projections to +1.5% in the Jun projections. Core PCE inflation for 2019 was also revised lower from the Mar projection of 2% to +1.8% in the Jun projections.

https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm

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Europe

Eurozone CPI (May)

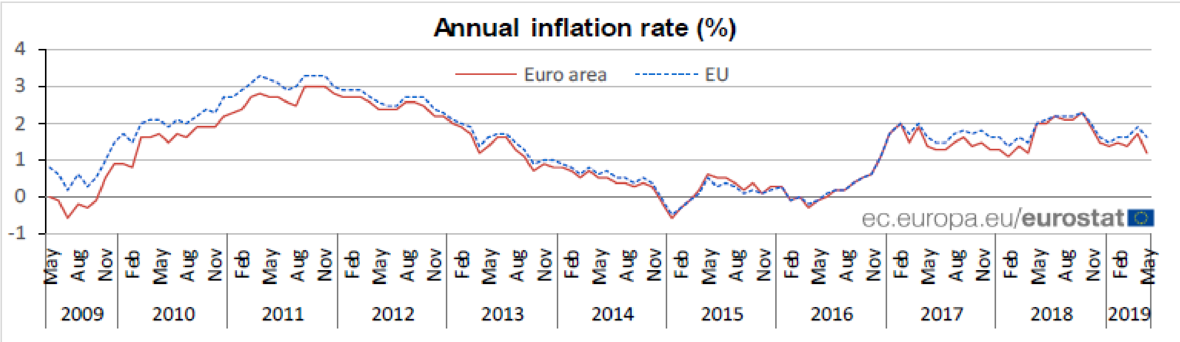
The annual growth in headline CPI continued to slow in the Euro Area and in the broader EU group.

Headline CPI – Annual Chg

Euro Area; May +1.2% versus Apr +1.7% (May 2018 ann CPI growth; +2%)

Euro Area Core CPI – ex energy, food, alcohol and tobacco grew by +0.8% in May. Note that although this is down from +1.3% in Apr, the May reading is “broadly” in-line with the Dec-18 Mar-19 readings.

EU28 Group; May +1.6% versus Apr +1.9%



Euro Area CPI – Detail

The main reason for the slower CPI growth between Apr and May was a much lower contribution from Services and Energy.

The contribution in % pts of Food, Alcohol and Tobacco was unchanged between Apr and May. The contribution of Energy fell from +0.51% pts to +0.38% pts. The contribution of Services also fell from +0.86% pts in Apr to +0.47% pts in May. The increases in Services CPI in May of 1% is reasonably low compared to recent growth rates.

https://ec.europa.eu/eurostat/documents/2995521/9832292/2-18062019-AP-EN.pdf/93899a92-e949-4fa7-9f48-de83607f1826

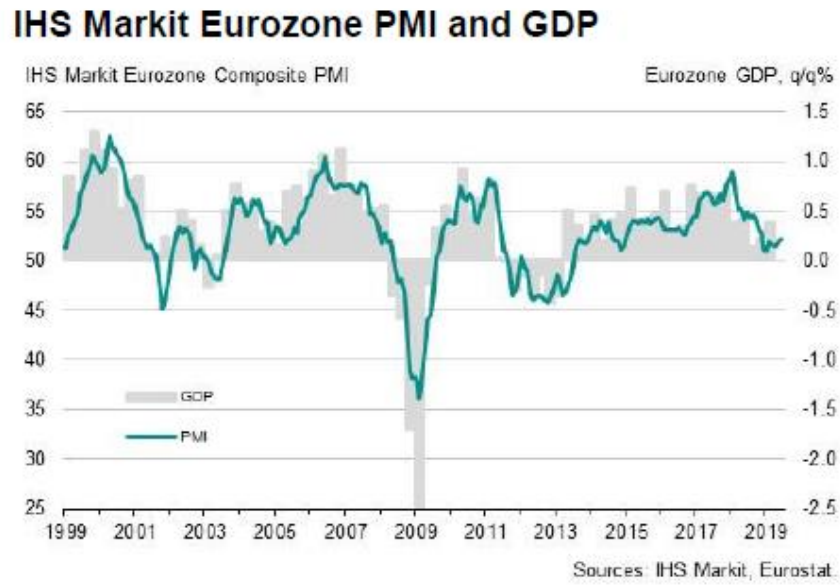
Eurozone Prelim Manufacturing and Services PMI (Jun)

The prelim Eurozone composite PMI indicated that, while output growth remained low, there has been some improvement in momentum. This has been led by somewhat faster growth in services activity while manufacturing activity continues to decline across key measures of demand.

Eurozone Composite PMI Output Index; Jun 52.1 versus May 51.8

The faster growth in services activity is now offsetting the continued decline in manufacturing. But despite the improvement in output and activity, overall optimism regarding the outlook for business conditions continued to fall, now reaching the lowest level since 2014.

> "Companies generally reported that a weaker economic outlook, uncertainty, geopolitical issues and intensifying competition would limit growth in coming months. Manufacturers reported particular concerns about slowing demand in export markets and the disruptive impact of trade wars."



Manufacturing PMI; Jun 47.8 versus May 47.7

Manufacturing output declined slightly faster in Jun but remains above recent lows. New orders continued to decline and also remains slightly above the recent lows. New export orders also declined. Order backlogs continued to decline. Employment growth increased marginally in Jun after declining in May for the first time since 2014.

Services PMI Business Activity Index; Jun 53.4 versus May 52.9

Output of service firms increased at a faster pace, the fastest since Nov 2018. This was supported by a large increase in new orders – but rates of which remain lower than 2018. Order backlogs increased at the fastest pace in over four months. Employment grew at a slightly slower pace.

https://www.markiteconomics.com/Public/Home/PressRelease/bd38336dd29248b39be4460e5bae7009

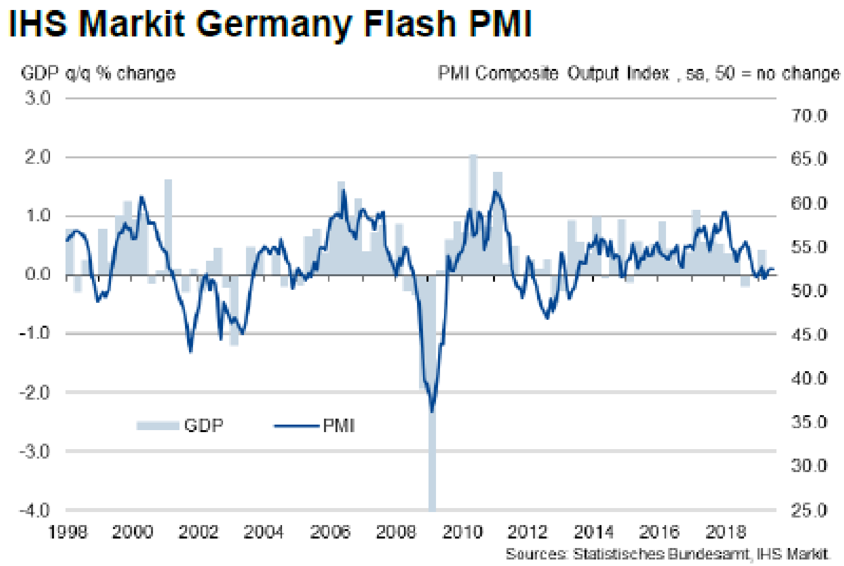
Germany Prelim Manufacturing & Services PMI (Jun)

The prelim composite PMI indicated that private sector activity in Germany continued to grow at a moderate pace in Jun. This was led by slightly faster growth in services activity as well as a slightly slower pace of decline in the headline manufacturing PMI. Growth in total output for the month was the result of faster growth in services output which offset further declines in manufacturing output.

Composite PMI Prelim Output Index; Jun 52.6 versus May 52.6

Firms overall remained downbeat on output growth over the next twelve months with sentiment reaching the lowest level since Oct 2014.

> "A number of firms reported that they expected a wider economic slowdown. Manufacturers were broadly neutral in their output growth expectations, representing a further relative improvement from the deep pessimism exhibited earlier in the year."



Manufacturing Prelim PMI; Jun 45.4 versus May 44.3

While the headline index improved, manufacturing output continued to decline at a faster pace in Jun (falling from 47.3 in May to 47 in Jun). New orders continued to decline, although at the slowest pace since Jan – linked to weaker export growth and autos. Manufacturing order backlogs declined further. Employment at manufacturing firms declined for the fourth month in a row, albeit at a slower pace than in May. Input price growth slowed (overall) to a thirty-four-month low. Output charges were cut for the first time since 2016.

Services prelim Business Activity Index; Jun 55.6 versus May 55.4

Output increased at the second fastest rate in over nine-months – which offset the further decline in manufacturing output at the composite level. New orders increased only for the second time in 2019 and growth remains weak. Outstanding business continued to increase. Employment continued to increase, but overall employment remained unchanged from May.

https://www.markiteconomics.com/Public/Home/PressRelease/9adb9b9a598b43e38723f6a6b0a262d4

ECB President Draghi speech – Twenty Years of the ECB's monetary policy, ECB Forum on Central Banking, Sintra, 18 June 2019

In this speech by ECB President Draghi, further rate cuts and monetary stimulus for the Eurozone were flagged. These were some of the important quotes towards the end of the speech;

Regarding the economy and reaching the 2% inflation target;

> "In the absence of improvement, such that the sustained return of inflation to our aim is threatened, additional stimulus will be required."

Signalling deliberations on further stimulus;

> "In the coming weeks, the Governing Council will deliberate how our instruments can be adapted commensurate to the severity of the risk to price stability."

> "Further cuts in policy interest rates and mitigating measures to contain any side effects remain part of our tools."

> "And the APP still has considerable headroom."

Regarding the mix between monetary and fiscal policy responses (emphasis added);

> "If the unbalanced macroeconomic policy-mix in the euro area in part explains the slide into disinflation, so a better policy mix can help bring it to a close. **Monetary policy can always achieve its objective alone**, but especially in Europe where public sectors are large, it can do so faster and with fewer side effects if fiscal policies are aligned with it."

https://www.ecb.europa.eu/press/key/date/2019/html/ecb.sp190618~ec4cd2443b.en.html

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Japan

Merchandise Trade Balance (May)

The provisional trade data indicated that the trade deficit worsened in May compared to the same month a year ago. This was the result a 7.8% decline in exports and a 1.5% decline in imports versus a year ago.

On a monthly basis, the seasonally adjusted trade figures indicated that export performance continued to deteriorate with a -5.3% fall in exports versus Apr and a +1.3% increase in imports versus Apr.

All figures in millions of ¥

TRADE BALANCE – DEFICIT (NSA)

May 2019; -967.1bn

May 2018; -577.4bn

EXPORTS

Headline exports; May 5,835.1bn or -7.8% below May 2018

On a seasonally adjusted basis, May 2019 exports were -5.2% below the month prior.

Exports to Main Trading Partners

Exports to most major areas declined in May except for the US/Nth America.

Exports to Asia declined at a faster pace (faster than the total -7.8% decline) across most key markets; -12.1%. Exports to China declined by -9.7% (the 2nd largest market for exports from Japan).

Exports to Nth America increased by +2.3%. The largest export market for Japan is the US and exports increased by +3.3% in May (versus a year ago).

Exports to Western Europe declined by -9.5%. Exports to Germany fell by 4.2% and exports to the UK fell by 15.8%.

Exports by Commodity

Exports of most commodities fell in May – except for transport equipment. The value of transport equipment exports increased by +1.2%. The volumes declined though.

The largest contributors to the overall decline in exports; Machinery (-13.1%), led by a 30% decline in semicon machinery, Electrical Machinery (-9.9%), Manufactured Goods (-10.1%), Chemicals (-5.2%) and Other (-14.5%).

IMPORTS

Headline imports; May 6,802.2bn or -1.5% below May 2018

On a seasonally adjusted basis, imports were +1.3% above the month prior.

Imports from Main Trading Partners

Imports from Asia declined by -3.3% with imports from China only down by -0.3%.

Imports from Nth America declined by -1.2% with imports from the US down by -1.6%.

Imports from Western Europe increased at a much faster rate +7% in the month. Imports from Germany were up by 8%.

Imports from the Middle East fell by -2.4%.

Imports by Commodity

The single largest contributor to the overall decline in imports compared to a year ago was Chemicals, falling -10.5%.

Other smaller contributors to the fall in imports; Food Stuffs (-4%), Mineral Fuels (-1.5%) and Manufactured Goods (-2.2%).

This was only partly offset by an increase in the value of imports for; Electrical Machinery (+3.3%), Transport Equipment (+10.2%) and Machinery (+0.9%).

http://www.customs.go.jp/toukei/shinbun/trade-st_e/2019/201905ce.xml

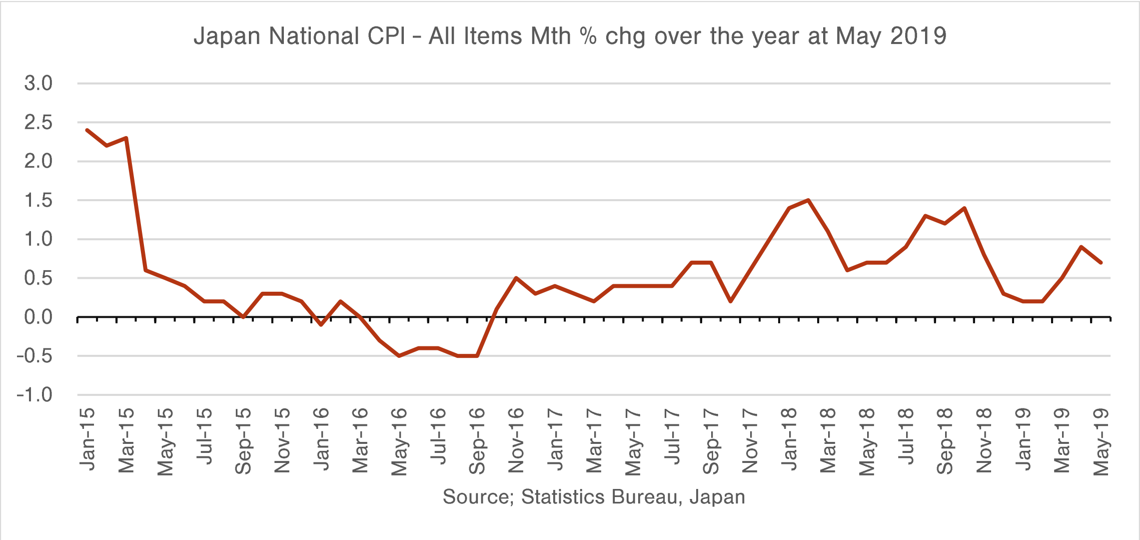
CPI (May)

The annual growth in the headline consumer price index increased at a slower pace in May, growing by +0.7%. The monthly change in consumer prices was zero.

The annual growth of underlying/core inflation (ex-fresh food) also grew at a slightly slower pace in May at +0.8%. Annual growth of core inflation has remained relatively constant and shows little/no sign of acceleration over the last year.

Headline CPI – All Items

Annual; May +0.7% versus Apr +0.9%

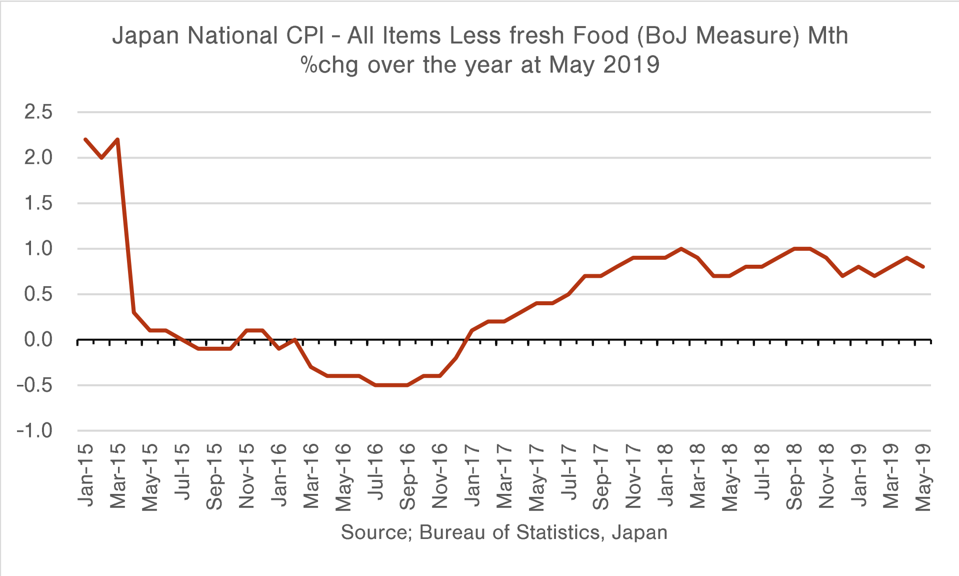


Core CPI – All items ex- Fresh Food

Annual; May +0.8% versus Apr +0.9%

The annual growth in the core CPI was higher than the headline because Fresh Food prices continued to fall on an annual basis (-0.1% in May versus -0.3% in Apr) – the recent decline in fresh food prices has been moderating (volatile). Fresh food accounts for 4% of the weight of the CPI.

This the BoJ preferred measure of CPI with a target of 2%. Growth has remained fairly constant since mid-2017;



One of the main drivers of CPI ex Fresh Food growth has been energy prices. Excluding fresh food and energy, annual CPI growth has been lower; May +0.5% versus Apr +0.6%.

On an annual basis, Goods prices have been growing faster than Services prices;

Goods; May +1.1%

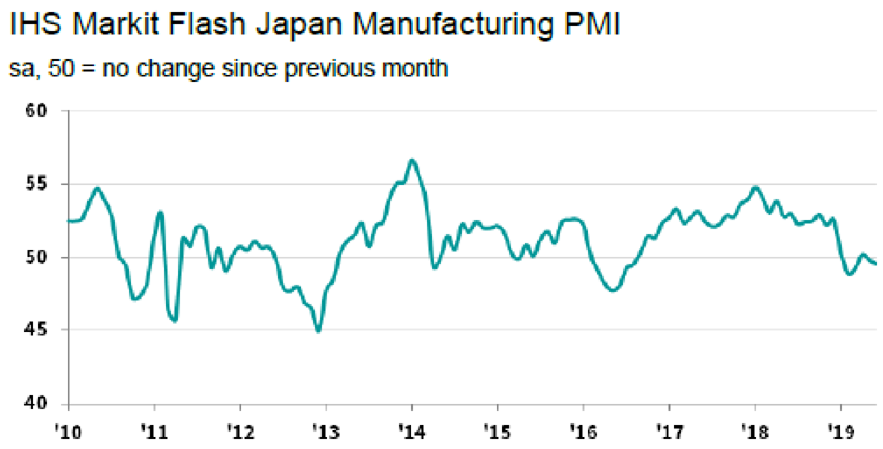
Services; May +0.3%

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

Prelim Manufacturing PMI (Jun)

The prelim PMI indicated that manufacturing activity in Japan continued to contract slightly in Jun. New orders and new export orders continued to decline at a faster pace. Output declined at a slower pace somewhat supported by a further decline in backlogs of work.

Headline Manufacturing PMI; Jun 49.5 versus May 49.8



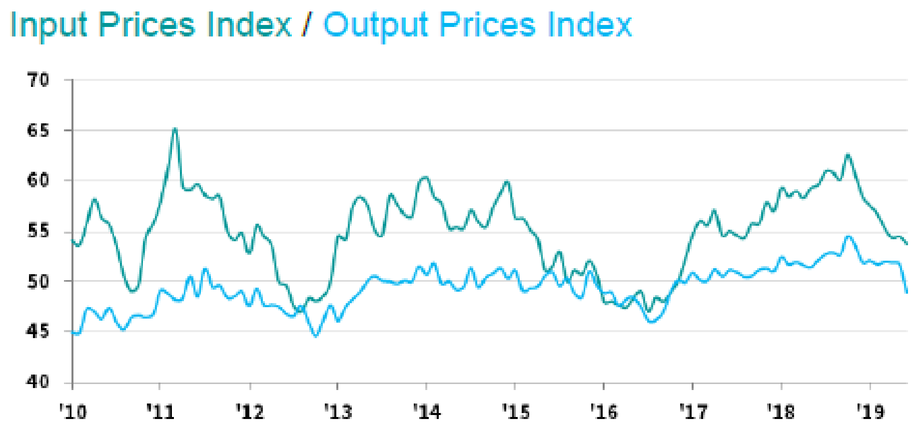
While output remained in contraction, the rate of decline has slowed. This is likely supported by further falls in the backlogs of orders – which declined at the fastest pace since 2013.

New orders and new export orders resumed respective declines (at a faster pace) in Jun.

Stocks of purchases declined, but the inventory of finished shifted back to increasing.

Employment growth increased at a slightly faster rate in the month but remains below the recent peak.

One of the more concerning trends has been the drop in output prices – which changed direction, indicating a decline in pricing power. Input prices continued to grow at a slower pace;



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BoJ Rates Decision – 19 Jun 2019

There was no change to policy settings at this meeting. Current policy will remain in place in order to achieve 2% CPI target and for as long as necessary to maintain that target "in a stable manner". Setting likely to remain in place for an extended period of time.

The BoJ acknowledged that weaker exports and domestic production will continue to impact the economy. Overall domestic conditions seen as expanding moderately. Risks were noted as external; US macro policy, protectionist moves, and a new addition regarding "global adjustments in IT-related production".

<u>Monetary Policy Settings/Guidelines</u>

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 80tn Yen

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.

<u>Current Conditions</u>

Moderate expansion in the economy. Domestic conditions supported by strong employment situation and financial conditions highly accommodative. Private investment mostly flat. Private consumption growth moderate but fluctuating.

Exports & production affected by the slowdown in o/s economies.

<u>Outlook</u>

Econ to continue moderate expansion but will remain affected by slow down in overseas economies.

Exports to show some weakness for the time being, but they are "expected to be on a moderate increasing trend on the back of overseas economies growing moderately on the whole".

CPI to "likely to increase gradually toward 2%".

<u>Risks</u>

> "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."

US macroeconomic policies and impact on global financial markets (rates or trade?)

Consequences of protectionist actions

(New) Developments in global adjustments in IT-related goods

Brexit

Policy Guidance

“The Bank will continue with "Quantitative and Qualitative Monetary Easing (QQE) with Yield Curve Control," aiming to achieve the price stability target of 2 percent, **as long as it is necessary for maintaining that target in a stable manner.** It will continue expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeds 2 percent and stays above the target in a stable manner.”

“As for policy rates, the Bank intends to maintain the current extremely low levels of short- and long-term interest rates **for an extended period of time, at least through around spring 2020**, taking into account uncertainties regarding economic activity and prices including developments in overseas economies and the effects of the scheduled consumption tax hike. “

http://www.boj.or.jp/en/announcements/release_2019/k190620a.pdf

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United Kingdom

BREXIT

The process to select a new leader of the Conservative Party is underway. Foreign Secretary Jeremy Hunt and Boris Johnston are the leading contenders for the leadership. Hunt voted to remain in the EU in 2016 and has now said he would vote for Brexit. Johnston supported the Brexit campaign.

During the week both made a pitch to Conservative Party members – these members will vote on the leadership.

"The result of the postal ballot will be announced in the week of July 22."
https://www.reuters.com/article/uk-britain-eu-leader/pm-favourite-johnson-reiterates-desire-for-october-31-brexit-idUSKCN1TN0MX

CPI (May)

The annual growth in the headline CPI-H continued to moderate somewhat in May. The main contributor to the lower growth in CPI-H was a lower annual contribution from transport prices between Apr and May. This more than offset smaller increases in prices across most other categories.

Headline CPI-H Growth

All Items CPI - H	Mth chg	May +0.3%	Apr +0.6%

All Items CPI – H	Ann chg	May +1.9%	Apr +2%

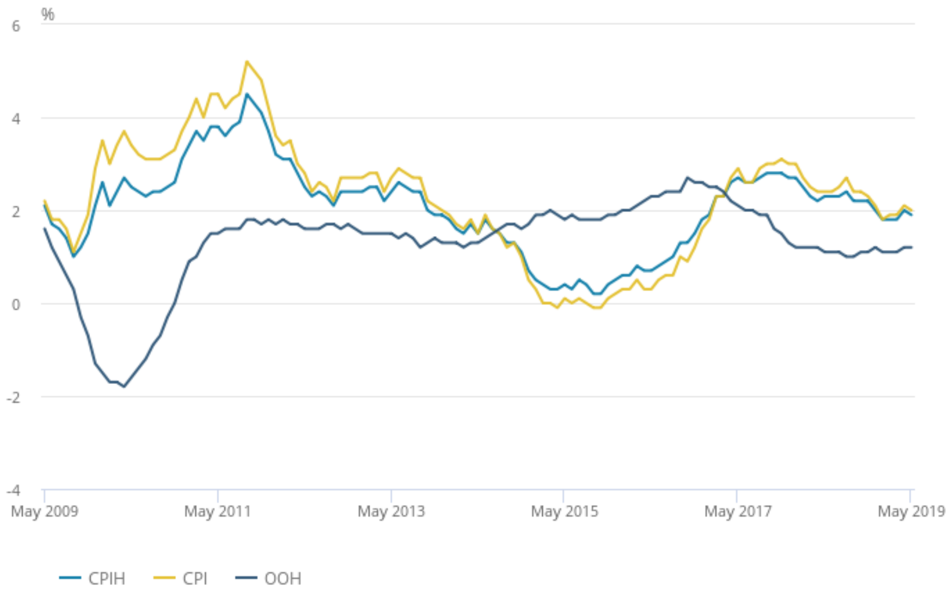
Services prices continues to grow at a faster pace for the year;

Goods; Annual chg at May +1.5%

Services; Annual chg at May +2.3%

Figure 1: CPIH and CPI 12-month inflation rates remain around 2%

CPIH, OOH component and CPI 12-month rates for the last 10 years, UK, May 2009 to May 2019



Source: Office for National Statistics – Consumer price inflation

Core CPI – H; excluding energy, food, beverages & tobacco grew at the same annual pace in May; +1.7% versus Apr +1.7%.

<u>Contribution by Category</u>

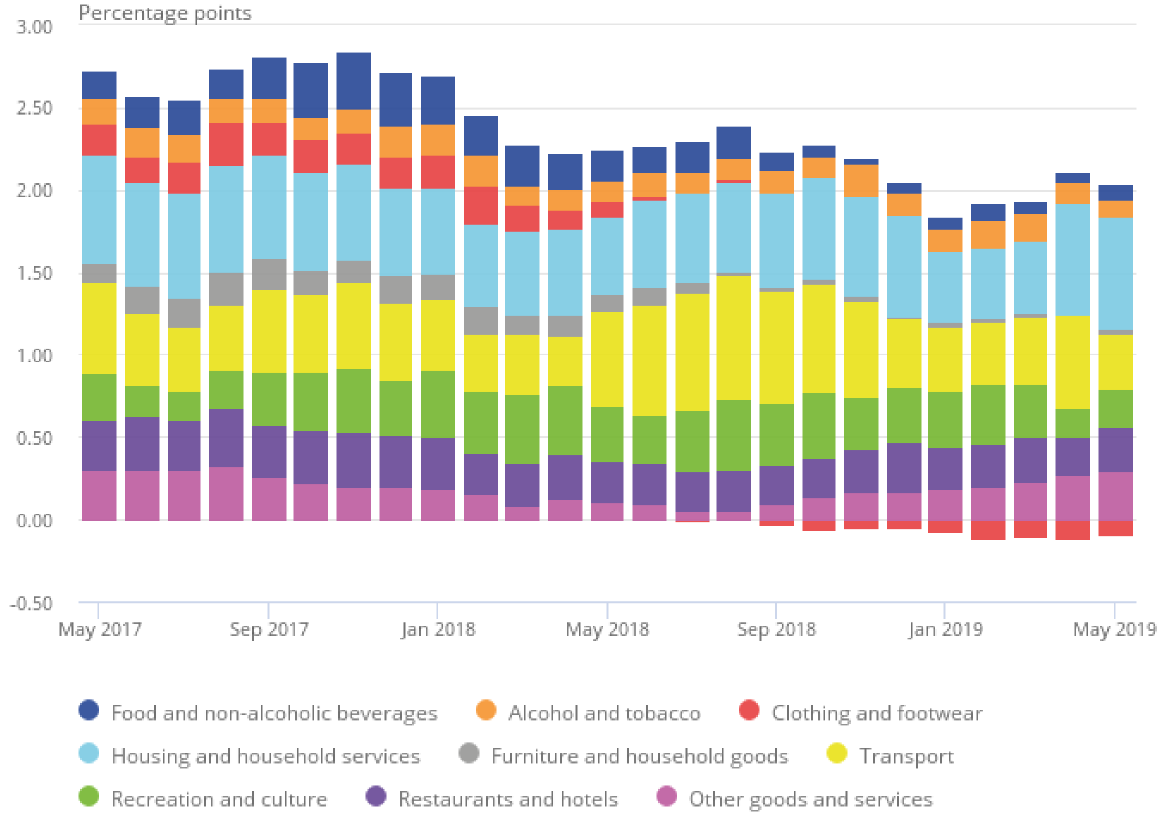
The largest contributor to the slower annual growth in May was transport.

The contribution from transport price growth slowed from +0.56% pts in Apr to +0.33% pts in May. This more than offset minor increases in contribution to CPI-H from food, alcoholic beverages & tobacco, clothing and footwear, recreation and culture, restaurants and hotels and other services.

Housing and household services continues to make the largest contribution to the CPI-H growth in prices, adding +0.68% pts in May (no change from Apr).

Figure 2: Largest contribution to inflation continues to come from housing and household services

Contributions to the CPIH 12-month rate, UK, May 2017 to May 2019



Source: Office for National Statistics – Consumer price inflation

https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/may2019

Retail Sales (May)

The volume of retail sales declined for the second month at a slightly faster pace. Declines in sales were recorded across many sectors.

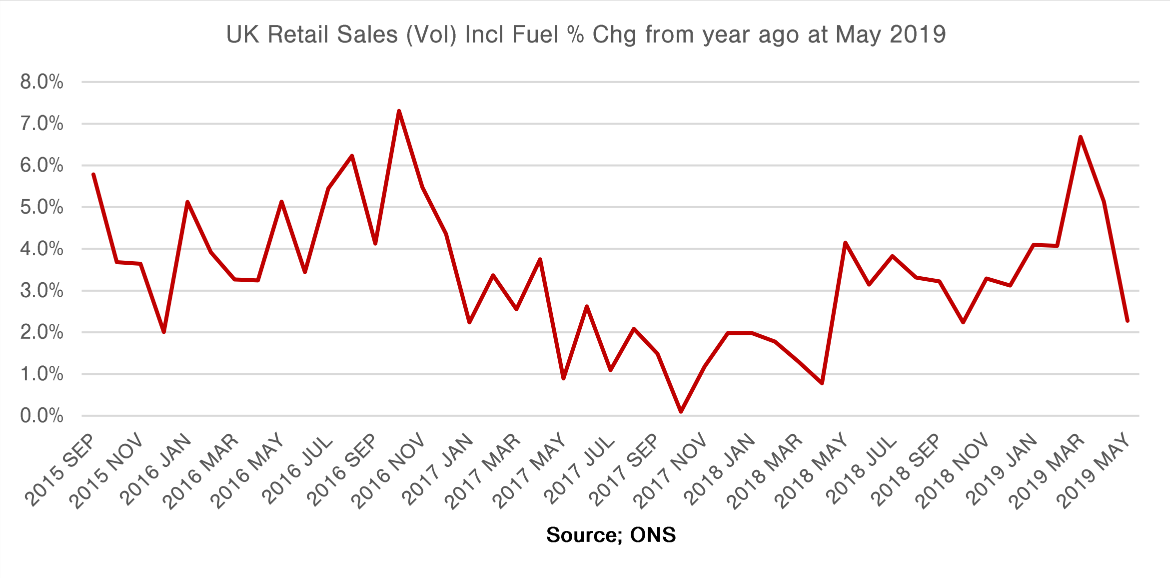
Total Retail Sales Incl Fuel

Total Retail Sales (Vol)	Mth chg	May; -0.6%	Apr; -0.1%

Total Retail Sales (Vol)	Ann chg	May; +2.3%	Apr +5.1%

Excluding fuel, the decline in retail sales was more consistent, falling by -0.3% in Apr and May.

The annual growth has slowed quickly over the last few months since Mar 2019;



Retail Sales by Category

Most of the main retail categories recorded a decline in sales in the latest month;

Food Stores; -0.1%

Non-Food Stores; -0.5%, including a -4.5% decline in textile clothing and footwear sales (annual sales slowed from 9.2% in Apr to +0.3% in May – which retailers blamed on adverse weather patterns), Dept stores -0.1%, Household Goods Stores and Other Stores sales increased by 2.2% and 1.3% respectively.

Non-Store Retailing; -0.2%

Fuel Stores; -2.3%

https://www.ons.gov.uk/businessindustryandtrade/retailindustry/bulletins/retailsales/may2019

BoE Rates Decision – 19 June 2019

There was no change to the stance of policy at this meeting and the BoE also maintained the slight tightening bias in its policy guidance (assuming a smooth Brexit) – and acknowledged that some downsides risks have started to pick up. The path of policy will continue to be influenced by the eventual timing and nature of the UK withdrawal from the EU.

Current policy settings

Bank Rate; +0.75%

Maintain the stock of sterling non-financial investment-grade corporate bond purchases, financed by the issuance of central bank reserves, at £10bn

Maintain the stock of UK government bond purchases, financed by the issuance of central bank reserves, at £435bn

Current Conditions

There has been a pick-up in downside risks to growth; 1) Intensifying trade tensions globally and 2) Perceived likelihood of a 'no-deal' Brexit has risen.

Domestic economy – now adjusting to the Brexit related effects of stock-piling in Q1. While Q1 GDP growth +0.5%, growth in Q2 expected to be flat. **Some underlying weaker growth in H1 relative to 2018 – stronger household consumption and weaker business investment patterns have persisted.**

Outlook

Forecasts are based on the assumption of a smooth Brexit. The outlook and path for policy will depend significantly on "the nature and timing of EU withdrawal".

CPI expected to fall below the 2% target due to recent falls in energy prices. Labour market remains tight.

Policy guidance (emphasis added);

> "The Committee continues to judge that, were the economy to develop broadly in line with its May Inflation Report projections that included an assumption of a smooth Brexit, **an ongoing tightening of monetary policy over the forecast period, at a gradual pace and to a limited extent**, would be appropriate to return inflation sustainably to the 2% target at a conventional horizon."

> "The monetary policy response to Brexit, whatever form it takes, will not be automatic and could be in either direction."

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

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Australia

House Price Index (Q1 2019)

House prices in Australia fell by 3% in Q1 2019 and the annual decline accelerated to 7.4%. Prices for both established houses and attached dwellings are contributing to the acceleration in the decline.

This is also the first quarter where the residential property price index has fallen across all capital cities (quarterly decline) – meaning that the weakness in housing has been spreading.

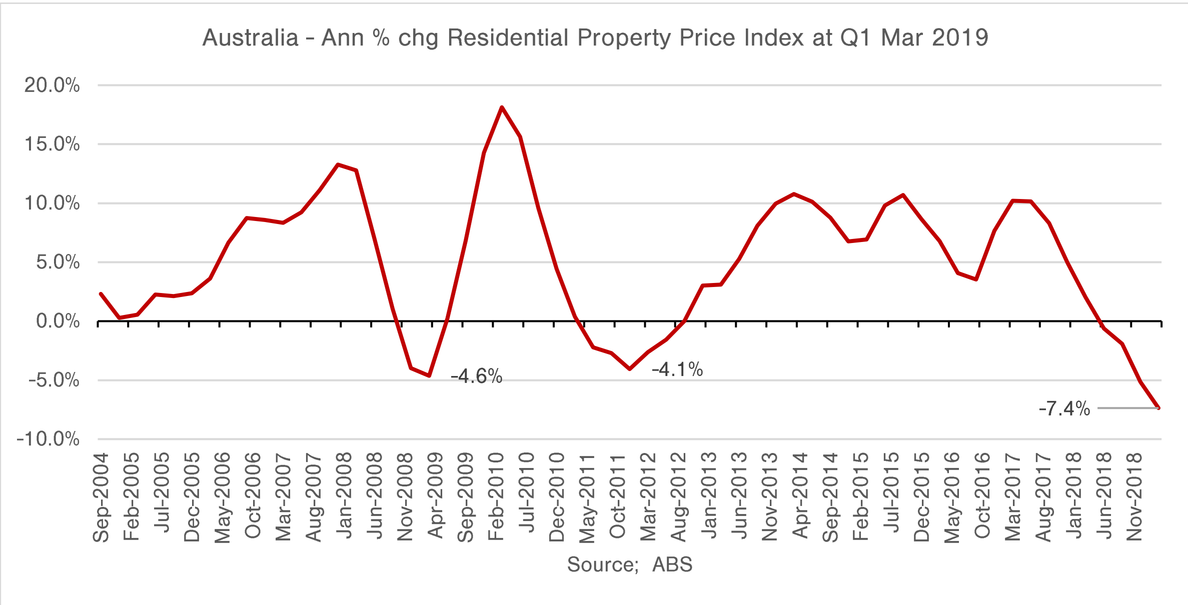
National House Prices

Residential Prop Price Index – Nat	Ann chg	Q1; -7.4%	Q4 2018; -5.1%

Residential Prop Price Index – Nat	Qtr Chg	Q1; -3%	Q4 2018; -2.4%

The decline in house prices has accelerated in the latest quarter and in the latest year.

The annual decline is now larger than the previous two most recent periods of weakness – although house prices are mostly much higher than during those two periods;



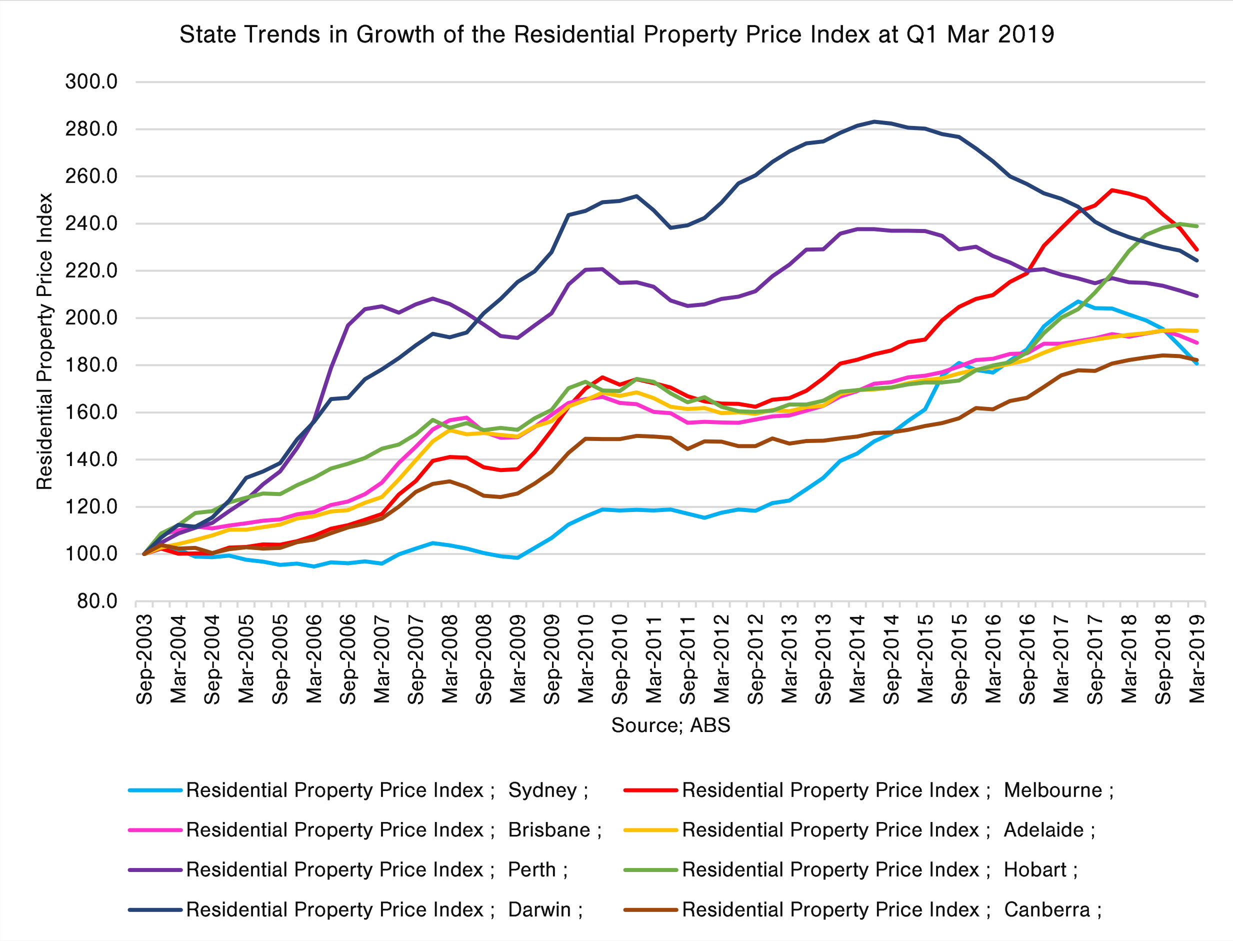
The decline has been driven by both established houses and attached dwellings – the annual decline for both continues to accelerate;

Established Houses – annual change; Q1 -7.7%

Attached Dwellings – annual change; Q1 -6.4%

<u>Capital City Results</u>

This has been the first quarter where house prices have declined in the quarter across all capital cities. Some markets had been more resilient – Brisbane and Adelaide among the larger markets and the much smaller markets of Hobart and Canberra.



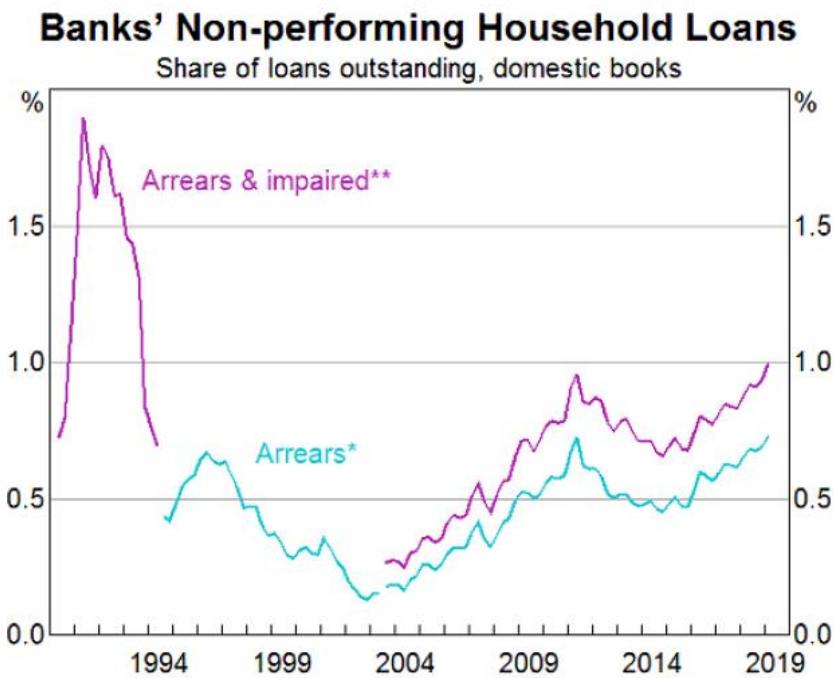
Annual declines have been recorded across Melbourne, Sydney, Brisbane Perth and Darwin. Canberra prices have stagnated over the last year and Hobart prices are still growing at +4.6% versus last year.

https://www.abs.gov.au/ausstats/abs@.nsf/latestProducts/6416.0Media%20Release1Mar%202019

RBA – Understanding Rising Housing Loan Arrears

An interesting speech was given by the RBA Head of Financial Stability Jonathan Kearns at the 2019 Property Leaders' Summit in Canberra.

Mortgage arrears are increasing and it's an important issue on several fronts – personal trauma for borrowers, the financial system and banks.



* Housing loans only; 90+ days past due and well-secured
** Housing and personal loans; 'impaired' loans are 90+ days past due and not well-secured or otherwise doubtful; non-performing loan rates before September 1994 are likely to be understated because the denominator includes lending by banks and non-banks, while the numerator is for banks only

Sources: APRA; RBA

While this is low compared to some other countries – the rate of housing only arrears are now on par with the GFC in 2008. One important point is the influence of the mining boom states of WA, NT, and some parts of QLD – that suffered larger declines in house prices after the investment phase of the mining boom ended.

The conclusion – in part (emphasis added);

> "To the extent that we can point to drivers of the rise in arrears, while the economic outlook remains reasonable and household income growth is expected to pick up, **the influence of at least some other drivers may not reverse course sharply in the near future, and so the arrears rate could continue to edge higher for a bit longer**. But with overall strong lending standards, **so long as unemployment remains low**, arrears rates should not rise to levels that pose a risk to the financial system or cause great harm to the household sector."

https://www.rba.gov.au/speeches/2019/sp-so-2019-06-18.html

RBA Meeting Minutes – 4 Jun 2019

At this meeting the RBA, the RBA decided to cut the overnight cash rate (OCR) by 25bps to 1.25%. The minutes make it very clear that further policy accommodation is likely.

The outlook – remained reasonable. The "expected" increase in household income, investment in infrastructure, renewed expansion of the resources sector and lowering of unemployment all predicated on “the assumption that the cash rate would follow the path implied by market pricing”.

The case to cut rates; reduce spare labour market capacity.

While the outlook remained ‘reasonable’, the RBA has noted little progress on reducing unemployment. Unemployment has ticked up slightly over the last few months and participation has also increased. This means that some level of ‘slack’ is to remain in the labour force. Wage growth will likely remain subdued in this situation, which means inflation returning to the 2-3% target range would take even longer.

> In these circumstances, members agreed that further improvement in the labour market would be required for wages growth and inflation to rise to levels consistent with the medium-term inflation target.

With regard to the current ‘adjustment’ underway in the housing market, a reduction in rates was not likely to encourage ‘a material pick-up in lending adding further risk to the economy’ – due mostly to the larger adjustment underway in lending practices (which were extremely laxed). [The lower rates will support households and household consumption, which has also been a key concern for the RBA].

Policy Guidance – provided some signal that further cuts are coming and that ‘other policy options’ would be explored (the assumption is that this would be not only fiscal stimulus, but also other monetary policy options);

> Given the amount of spare capacity in the labour market and the economy more broadly, members agreed **that it was more likely than not that a further easing in monetary policy would be appropriate in the period ahead**. They also recognised, however, that **lower interest rates were not the only policy option available to assist in lowering the rate of unemployment**, consistent with the medium-term inflation target.

https://www.rba.gov.au/monetary-policy/rba-board-minutes/2019/2019-06-04.html

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Trade

US-China Trade Negotiations

Speculation this week focused on talks between Presidents Trump and Xi at the upcoming G20 meeting in Japan.

> "My hope is we can get back on track," Lighthizer told lawmakers last week. "I think It's in our interest. I think it's in their interest. Hopefully the politics will line up over there to allow that to happen." https://www.agri-pulse.com/articles/12341-washington-week-ahead-trump-looks-to-jump-start-trade-agenda-in-japan

Another take on the G20 summit outcomes;

> "The G20 is a perfect venue for these gestures, with its traditionally grand shows of diplomatic pleasantries. **If Trump and Xi appear together, shake hands and smile, consider that a small victory.** If a process or road map is announced, then at least both sides can go back to their corners while negotiators search for compromises — not a terrible outcome considering the alternatives." https://www.scmp.com/comment/opinion/article/3015396/no-trade-war-breakthrough-no-problem-xi-and-trump-are-meeting-g20

The US is continuing the process of investigating imposing the next round of tariffs on the remaining $300bn of imports from China. Public hearings will continue this coming week on the proposed tariff list for the remaining $300bn of imports from China.

Key dates for the USTR investigation;

10 June – filing deadline for requests to appear at the public hearing

17 -25 June – public hearings in Washington https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/june/public-hearings-proposed-section-301

The main G20 Summit in Osaka will be in the coming week 28-29 Jun.

Background;

The USTR announced on 10 May that;

> "Earlier today, at the direction of the President, the United States increased the level of tariffs from 10 percent to 25 percent on approximately $200 billion worth of Chinese imports. **The President also ordered us to begin the process of raising tariffs on essentially all remaining imports from China, which are valued at approximately $300 billion."** https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/may/statement-us-trade-representative

These tariffs will go into effect from 15 June 2019; https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/may/notice-regarding-application-section

As expected, China announced retaliatory tariffs on $60 billion of U.S. goods.

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 notification on progress.

The USTR released its annual Special 301 Report on Intellectual Property Protection and Review of Notorious Markets for Piracy and Counterfeiting late last week.

> "Specifically, over the coming weeks, USTR will review the developments against the benchmarks established in the Special 301 action plans for countries that have been on the Priority Watch List for multiple years. For such countries that fail to address U.S. concerns, USTR will take appropriate actions, such as enforcement actions under Section 301 of the Trade Act or pursuant to World Trade Organization or other trade agreement dispute settlement procedures, necessary to combat unfair trade practices and to ensure that trading partners follow through with their international commitments."
> https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/april/ustr-releases-annual-special-301

The report prepared a 'priority watch list', a 'watch list' and a 'notorious markets list". The report highlighted;

"trading partners that do not adequately or effectively protect and enforce intellectual property (IP) rights or otherwise deny market access to U.S. innovators and creators that rely on protection of their IP rights.

Trading partners that currently present the most significant concerns regarding IP rights are placed on the Priority Watch List or Watch List. USTR identified 36 countries for these lists in the Special 301 Report:

Algeria, Argentina, Chile, China, India, Indonesia, Kuwait, Russia, Saudi Arabia, Ukraine and Venezuela are on the Priority Watch List.

Barbados, Bolivia, Brazil, Canada, Colombia, Costa Rica, Dominican Republic, Ecuador, Egypt, Greece, Guatemala, Jamaica, Lebanon, Mexico, Pakistan, Paraguay, Peru, Romania, Switzerland, Thailand, Turkey, Turkmenistan, the United Arab Emirates, Uzbekistan and Vietnam are on the Watch List."

Notorious Markets List

"The Notorious Markets List highlights 33 online markets and 25 physical markets that are reported to engage in and facilitate substantial copyright piracy and trademark counterfeiting" https://ustr.gov/sites/default/files/2018_Notorious_Markets_List.pdf

The link to the notorious markets reports is here; https://ustr.gov/sites/default/files/2018_Notorious_Markets_List.pdf

The first country on the list is China.

The full report; https://ustr.gov/sites/default/files/2019_Special_301_Report.pdf

NAFTA/USMCA

During the week, Mexico's Senate passed the USMCA – the first of the three parties to ratify the agreement.

"The move is welcome news for the Trump administration as it pushes for the U.S. Congress to approve the deal this summer. But Democrats have said they will not be rushed into passing the deal until the administration makes changes to the agreement's provisions on enforcement, labor, the environment and drug pricing."

"Canada, for its part, has already introduced an implementation bill in the country's Parliament. But Canadian officials have expressed a desire to approve the deal at roughly the same time as any final votes are held in the U.S. Congress."https://www.politico.com/story/2019/06/19/mexico-passes-usmca-1538543

On 30 May, USTR Lighthizer had submitted a 'statement of administrative action' letter to Congress, allowing the White House to submit the USMCA deal to Congress for vote within 30 days. House speaker Pelosi said;

"The Trump Administration's decision to send Congress a draft statement of administrative action before we have finished working with U.S. Trade Representative Lighthizer to ensure the USMCA benefits American workers and farmers is not a positive step," Pelosi said in a statement Thursday. "It indicates a lack of knowledge on the part of the Administration on the policy and process to pass a trade agreement." https://www.washingtonexaminer.com/policy/white-house-to-formally-submit-usmca-trade-deal

This action means that the House must vote on the deal within 60 days.

Section 232 – Car and Truck Imports

President Trump has agreed to delay the decision to impose tariffs on auto imports as a part of the s.232 investigation on car and truck imports on national security grounds. But he has

stated that he agrees with the conclusion of the Commerce Dept report that imports harmed national security by causing declining market share for US-owned carmakers.

> “"I concur in [Commerce Secretary Wilbur Ross'] finding that automobiles and certain automobile parts are being imported into the United States in such quantities and under such circumstances as to threaten to impair the national security of the United States," Trump said in a proclamation outlining his decision.” https://www.politico.com/story/2019/05/17/donald-trump-auto-tariffs-1330014

As a part of the announcement, US President Trump also…

> “directed U.S. Trade Representative Robert Lighthizer to pursue the negotiation of agreements with the EU, Japan and other countries that address the alleged national security threat posed by auto imports.
>
> Lighthizer was directed to update the president on the status of those talks within 180 days.” https://www.politico.com/story/2019/05/17/donald-trump-auto-tariffs-1330014

The tariffs remain as negotiating leverage between the US and Japan and the EU. The S.232 report has not been made public, but President Trump’s statement provided some insight as to how the Commerce Dept justified the ‘national security’ grounds;

> “The rapid application of commercial breakthroughs in automobile technology is necessary for the United States to retain competitive military advantage and meet new defense requirements,” the proclamation said.
>
> The proclamation added that the U.S. defense industrial base depends on the “American-owned automotive sector” for development of technologies essential to military superiority. Foreign imports have eroded the ability of U.S. companies to compete and research and develop new technologies, the proclamation said.
>
> “The lag in R&D expenditures by American-owned producers is weakening innovation and, accordingly, threatening to impair our national security,” the proclamation stated. https://www.politico.com/story/2019/05/17/donald-trump-auto-tariffs-1330014

US-Japan Trade Talks

Talks were held during the week in Washington in preparation for the G20 summit. ‘Working-level” negotiations focused on lifting or cutting tariffs in vehicles, industrial goods, electronics, chemical goods and textiles. https://www.japantimes.co.jp/news/2019/06/21/business/japan-u-s-seek-compromise-car-industrial-goods-tariffs-working-level-talks/#.XRBHE-szZhE

President Trump stated that August is the likely deadline for the two countries to announce a deal – after Jul elections. Importantly within the six-month window for auto-tariffs. https://asia.nikkei.com/Politics/International-relations/Trump-touts-August-trade-deal-with-Japan

Key issues for the US remain the trade deficit, access for agriculture and auto exports, as well as currency clauses to 'prevent competitive devaluations'. https://www.washingtonpost.com/business/whats-at-stakein-us-japan-trade-talks/2019/05/24/62d6104a-7e5d-11e9-b1f3-b233fe5811ef_story.html?utm_term=.776b6d909b48

Background;

Along with the postponement of the auto tariffs, USTR Lighthizer has also confirmed that the US will not push for import quotas as a part of the trade deal.

Agriculture as well as auto tariffs remain important to the negotiations. Representatives have previously stated that 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 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

There are several fronts to the talks between the US and the EU. The first is the current live investigation by the USTR into EU civil aircraft subsidies. The due date for the submission of written comments was 28 May – awaiting the outcome of that investigation (which should be completed shortly).

The second front is the main talks to negotiate a trade deal between the US and EU. The recent EU parliamentary elections will change the composition of the EU parliament – adding some complexity;

> "There very likely will be a whole new set of parties with whom to negotiate a transaction," said Ross. "So my guess is it's going to take a while to know whether there is any real prospect of a new agreement with the European Commission." https://www.theepochtimes.com/wilbur-ross-eu-trade-talks-are-far-more-complex-than-negotiating-with-china_2965690.html

It now seems likely that the US and EU will enter talks "on a limited trade agreement, which covers vehicles". https://menafn.com/1098537328/EU-set-for-talks-with-US-on-limited-trade-agreement

> "The EU indicated last month it is ready to start talks with the United States on only two areas: cutting tariffs on industrial goods and making it easier for companies to show products meet EU or US standards." https://www.bworldonline.com/eu-says-agriculture-not-on-agenda-for-us-talks/

Background – 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

US-EU civil aircraft subsidies; 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 now 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. Details; https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/may/public-hearing-proposed-countermeasures

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

During his visit to the UK, President Trump announced that the US would begin talks with the UK on a trade deal as soon as Brexit was completed.

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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