MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 5 August 2019

Key Themes

Tensions between the US and China escalated at the start of the week after the US announced plans to implement a further 10% tariff on imports from China. The USD/CNY moved above 7.00 for the first time in ten years – while no longer trading at its highs, the CNY fix remains above 7.00. A further round of trade talks between the US and China is scheduled for Sep after this next round of tariffs are implemented on 1 Sep.

This was the first of two weeks of economic data out of China and data continues to indicate weaker growth. Producer prices for the manufactured goods sector declined on an annual basis in Jul after slowing consistently through the last year. Manufacturing activity overall continued to contract, and services activity growth slowed. The Chinese trade surplus increased further in Jul – the result of continued moderate growth in exports and declining imports. The weaker import demand continues to hit trade partners. The next round of tariffs on 1 Sep – some front loading in the Aug data is possible.

US data this week also continued to indicate a slowing of activity. Services PMI's showed that activity continued to grow but the pace remained lower. Both ISM and Markit reports cited firms somewhat downbeat – with comments remaining mixed about business conditions and the overall economy.

The US PPI showed that broadly, growth in US producers' selling prices are continuing to slow – across both goods and services. Annual growth in the PPI has halved over the last year and the more underlying measure of producer prices (ex food, energy and trade) has also continued to slow also at a faster pace this month.

JOLTS data continued to deliver mixed results. The measures of job openings and hires are now declining on a year ago basis. Separations data is not so clear cut – firms were not reducing workforces, but workers were also less inclined to voluntarily leave their jobs.

Data confirmed weaker manufacturing activity continued in Germany. While factory orders were stronger overall in Germany in Jun, it was led by non-Eurozone foreign countries and capital goods orders. Orders from the domestic market and Euro-area countries declined in the month. Overall industrial production in Germany fell harder in Jun and declined at an accelerated pace versus a year ago. The decline in production was broad with manufacturing, mining, and utilities all declining the month. Construction activity stabilized after a larger decline in the month prior.

We continue to track the data flow on Australia after recent stimulus measures. The RBA kept rates on hold this month after cutting in the two months prior. Housing lending growth started to pick up in the Jun data – which incorporates the first of the two recent rate cuts. New lending for housing remains 18% below a year ago and 26% below the peak. There was little improvement across the AiG performance of industry indices for Jul though. Manufacturing activity rebounded to moderate growth in the month but services and construction activity both deteriorated markedly. Only the new orders growth in manufacturing provides some hope that production will lift in the near future. The ongoing contraction in new orders across services and construction suggest little chance for a rebound in the near term.

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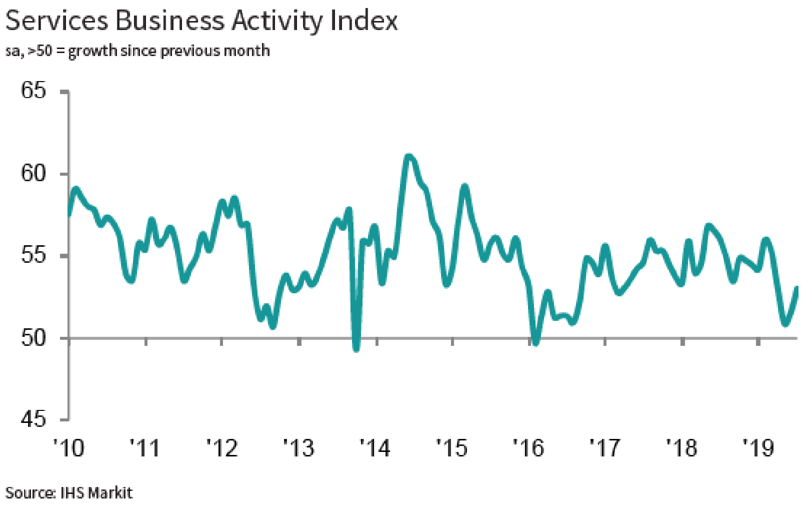
US Data

Markit Services PMI (Jul)

US private sector services activity increased at a faster pace in the latest month. This was led by faster growth in new orders and output. Similar to the month prior, despite the positive performance, sentiment continued to wane for the sixth month in row to a new series low. The weaker sentiment was the result of heightened economic uncertainty.

<u>Services Business Activity Index;</u> Jul 53 versus Jun 51.5



Output growth accelerated on the back of stronger growth in new orders. New orders increased from both domestic and foreign clients. The growth in outstanding business continued to increase for the seventh month.

Output charges increased at only slightly in Jul;

> "Panellists stated that the rate of charge inflation was historically muted amid promotional discounting to entice new customers."

Input costs increased at only a moderate pace.

The weaker overall sentiment continued to keep a lid on employment growth despite the faster growth in output. Employment growth was mostly unchanged from the pace of the last four months and growth was moderate.

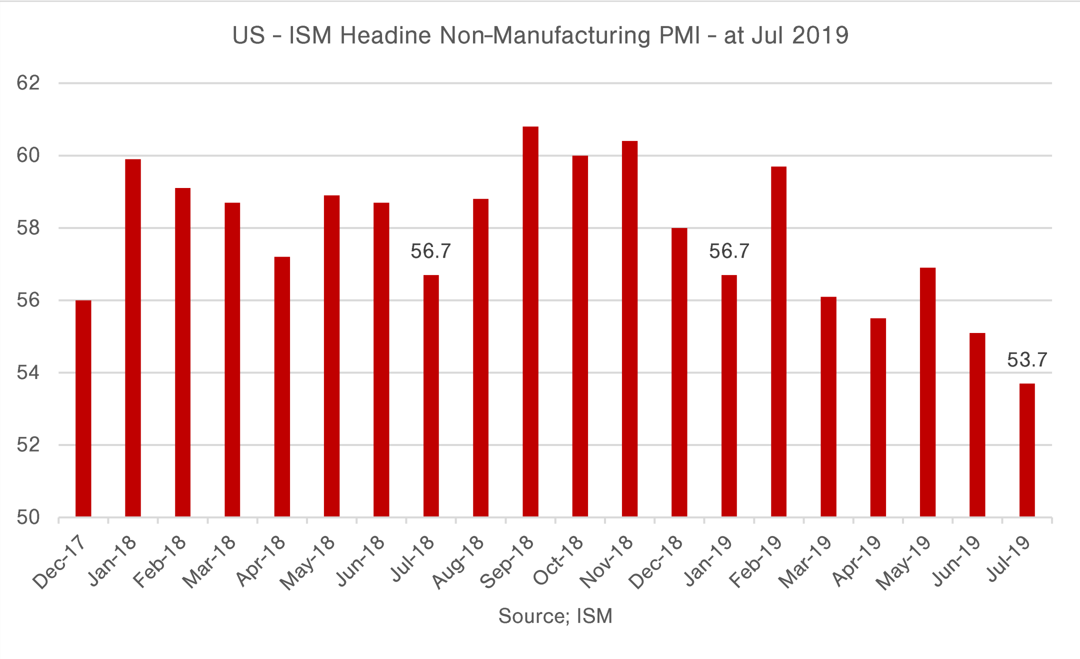
https://www.markiteconomics.com/Public/Home/PressRelease/a610f304a4604718b5384566e770e053

ISM Non-Manufacturing PMI (Jul)

The ISM non-manufacturing PMI indicated that business activity continued to grow but that growth has continued to slow. This was led by slower growth in production, new orders, inventories and order backlogs. Employment growth increased slightly.

"The non-manufacturing sector's rate of growth continued to cool off. Respondents indicated ongoing concerns related to tariffs and employment resources. Comments remained mixed about business conditions and the overall economy."

ISM Non-Manufacturing PMI; Jul 53.7 versus Jun 55.1



This month business activity/production slowed by 5pts falling to 53.1. The slowdown over the last few months has been relatively large with the production index at a high of 61.2 only back in May. Since May, the proportion of firms reporting 'lower' production has doubled from 8% to 17%. The proportion of firms reporting 'higher' production levels gas fallen from 33% to 23%.

New orders growth also slowed further. Similar to production levels, since May the proportion of firms reporting lower new orders has increased from 11% to 17%. The proportion of firms reporting 'higher' orders has fallen from 32% to 23%.

The increase in the backlog of orders slowed further. The biggest change was the decline in the proportion of firms reporting higher orders.

Despite the slower growth, firms increased employment levels. The increase was broad based across industries. That said, there was no change to the proportion of firms reporting 'higher' employment levels.

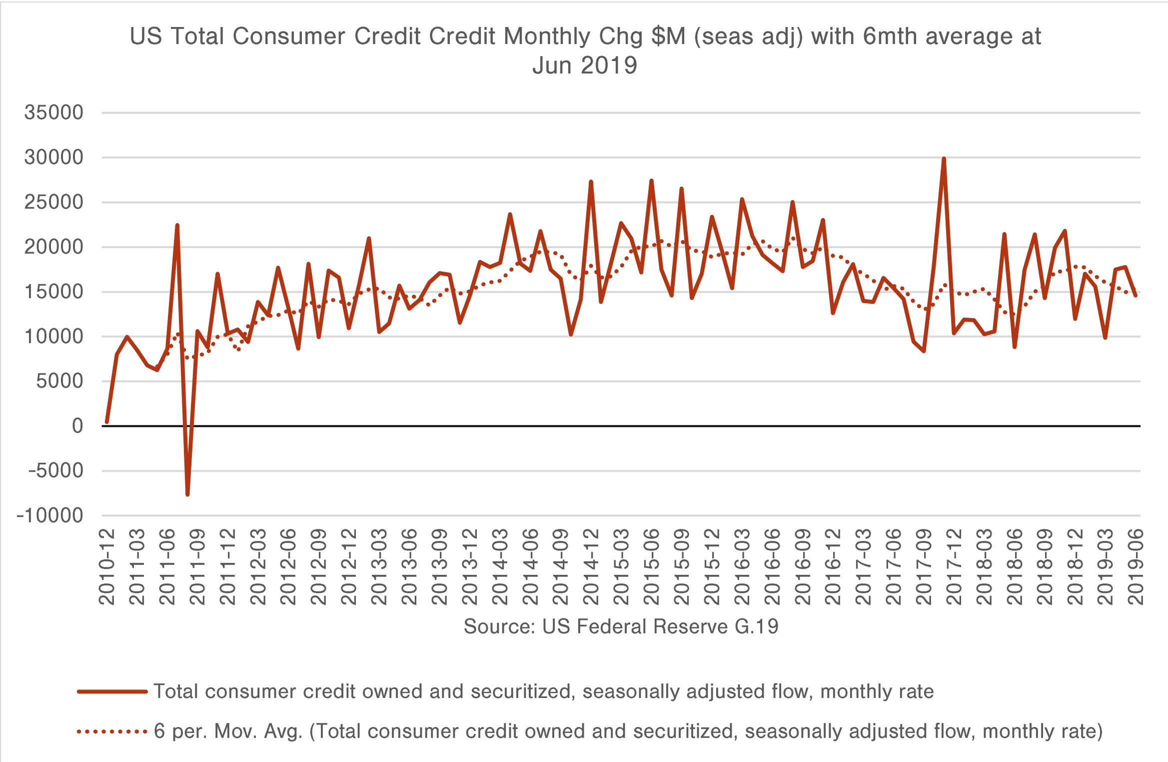
https://www.instituteforsupplymanagement.org/ISMReport/NonMfgROB.cfm?SSO=1

US Consumer Credit G.19 Report (Jun)

The growth of consumer credit slowed in the latest month – a small decline in revolving credit was offset by faster growth in non-revolving credit.

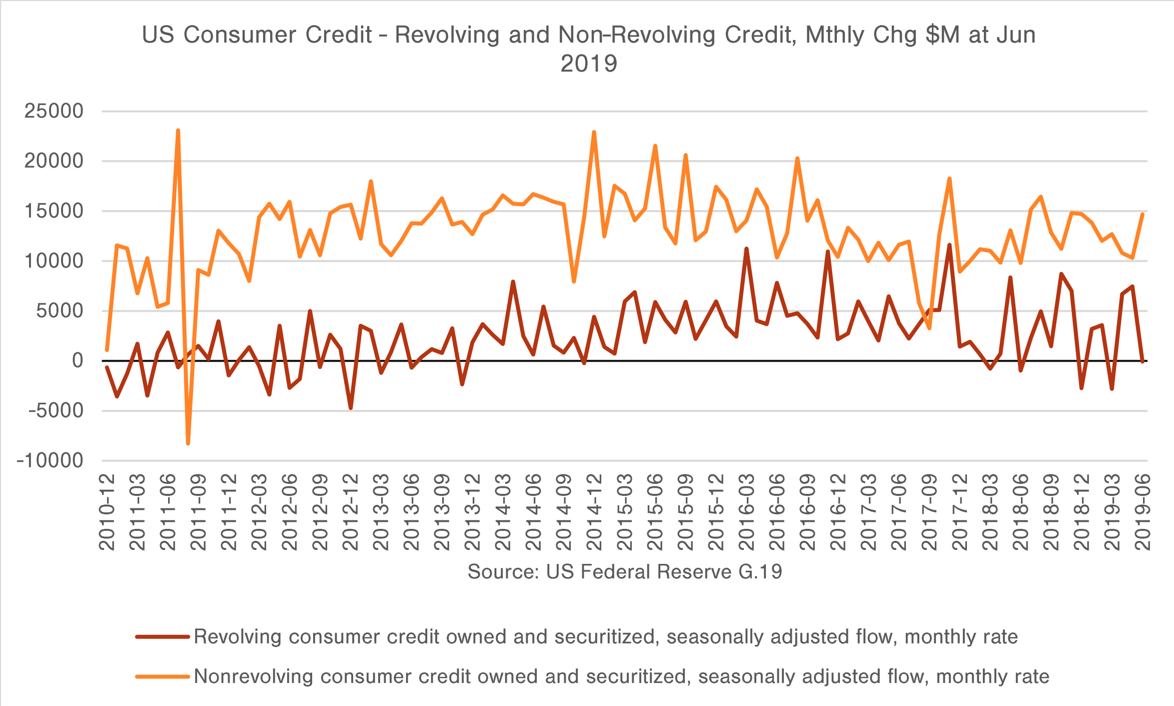
<u>Total Consumer Credit - month change;</u> Jun +$14.6bn versus May +$17.8bn

Annual growth increased to 5.3% (current month total outstanding versus same month a year ago). The latest 3-month annualized rate was slightly slower at 4.9%.



<u>Revolving versus Non-revolving Consumer Credit</u>

This slower growth in total consumer credit for the month was the result of a small decline in revolving credit while non-revolving credit increased at a faster pace.



<u>Revolving credit - month change;</u> Jun -$0.08bn versus May +$7.4bn

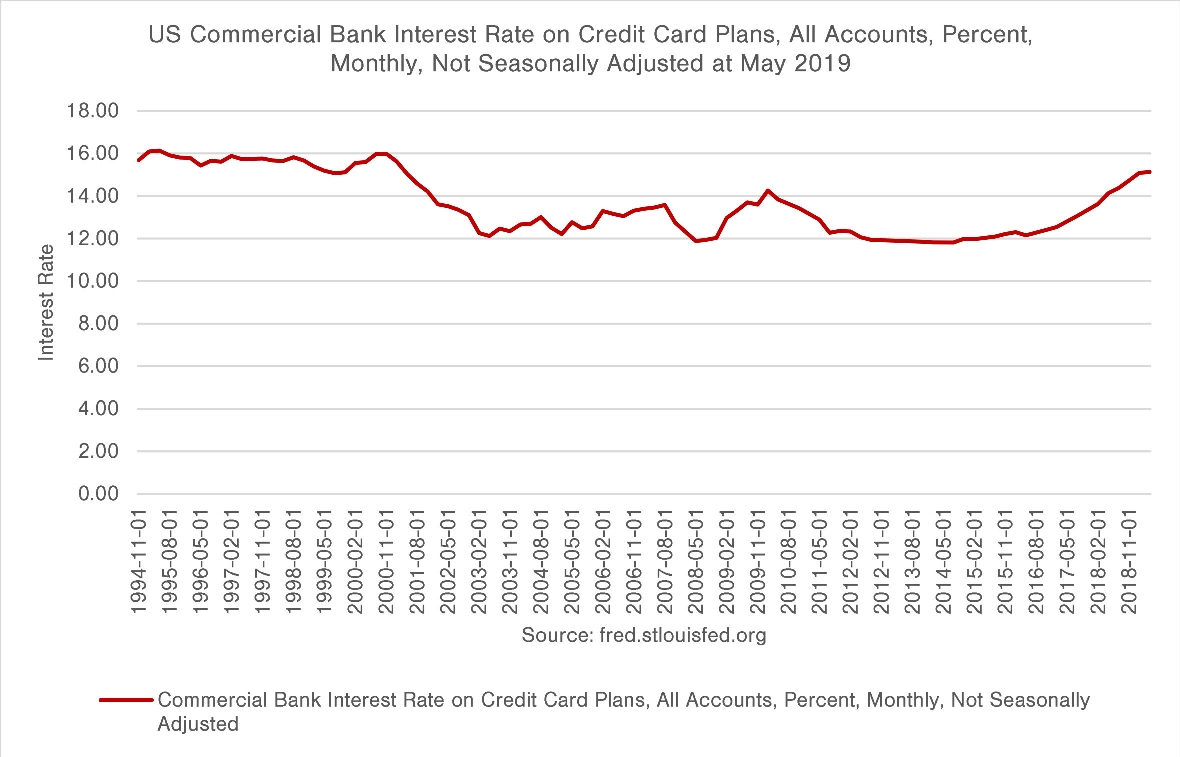
The annual growth in revolving credit was +4.6% in Jun. Despite the fall in the latest month, the 3-month annualized rate of growth was higher at 5.3%.

<u>Non-revolving credit – month change;</u> Jun +$14.7bn versus May +$10.3bn

The annual growth in non-revolving credit increased to 5.6%. Despite the increase in the latest month, the 3-month annualized pace was slower at +4.8%

<u>Consumer Credit Card - Interest Rates (to May 2019)</u>

Consumer credit card rates remained steady in May after consistently increasing throughout 2016-19.



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

JOLTS (Jun)

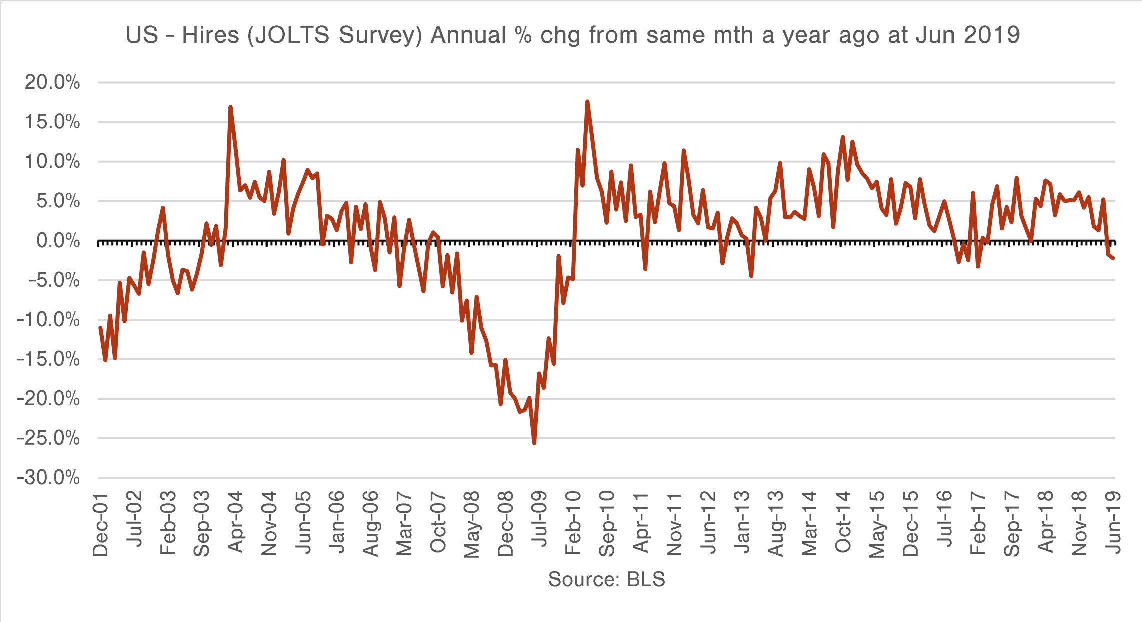
Growth in openings and hires continues to slow, especially on an annual basis. Separations show that firms are not reducing workforces but workers also somewhat less inclined to voluntarily leave their jobs.

<u>Job Hires</u>

The number of hires were lower for the second month in a row;

Jun 5.7m (-1%) versus May 5.76m (-4%)

On an annual basis, the number of hires is now 2.2% below the same month a year ago;



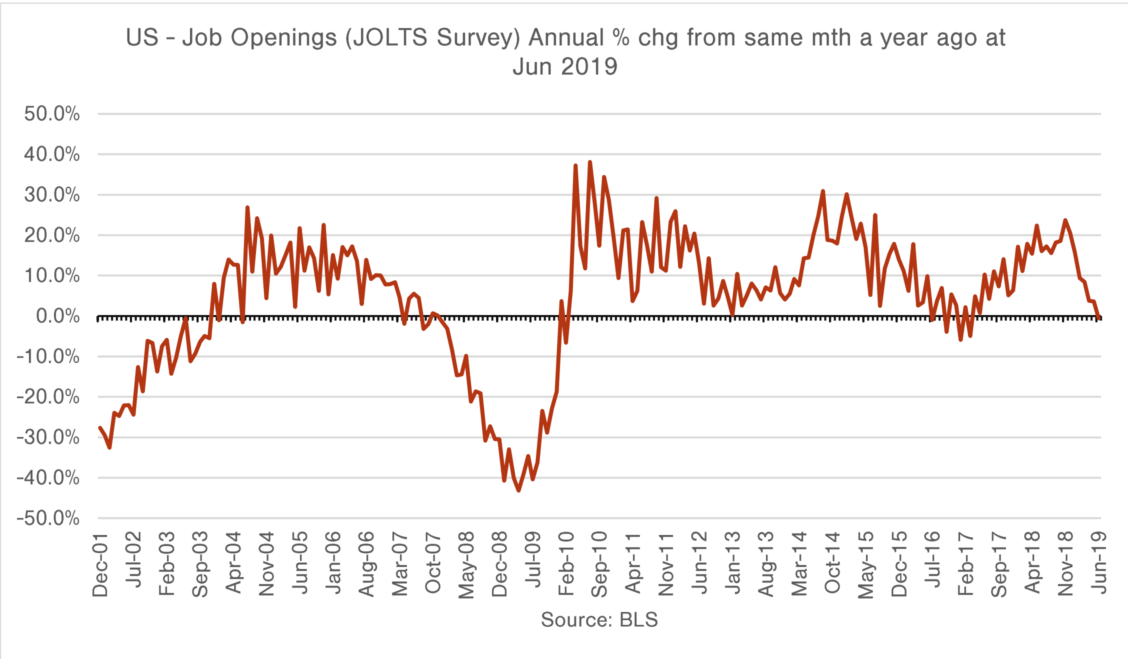
The hire rate was steady at 3.8% just below the 12-month average of 3.9%.

Job Openings

The number of job openings also slowed compared to the month prior;

Jun 7.34m (-0.5%) versus May 7.38m (+0.2%)

On an annual basis, the growth in the number of job openings has slowed consistently since the peak in Nov 2018. The number of openings is now -0.6% below the same month a year ago;



The job opening rate fell from 4.7% in May to 4.6% in Jun, just below the 12-month average of 4.7%.

Total Separations

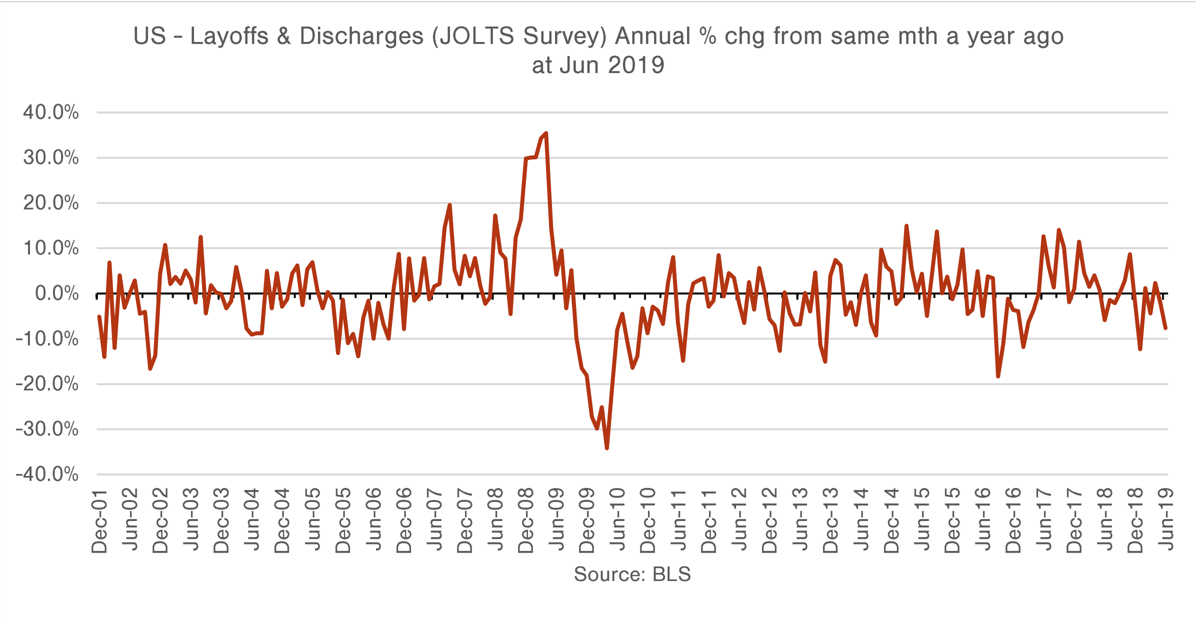
The number of separations declined versus the month prior. This was led not only by lower layoffs and discharges (involuntary separations) but also lower quits (voluntary separations). The story here is not as clear cut – firms not cutting as many workers but workers also less inclined to voluntarily leave their jobs.

Layoffs and Discharges

The number of layoffs and discharges declined for the second month;

Jun 1.7m (-4%) versus May 1.8m (-3%)

The number of layoffs and discharges in Jun was 7.7% below the same month a year ago – which paints a somewhat positive story about not cutting workforces;

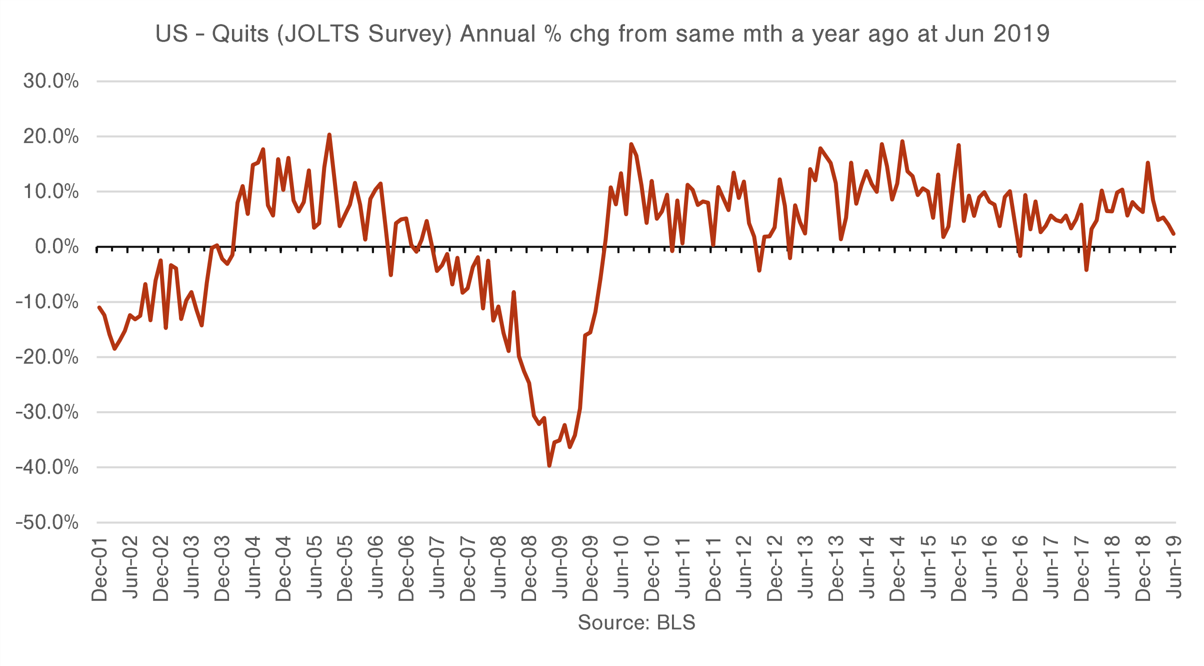


Quits

From a slightly different perspective, the number of quits also declined for the second month;

Jun 3.43m (-1%) versus May 3.48m (-1%)

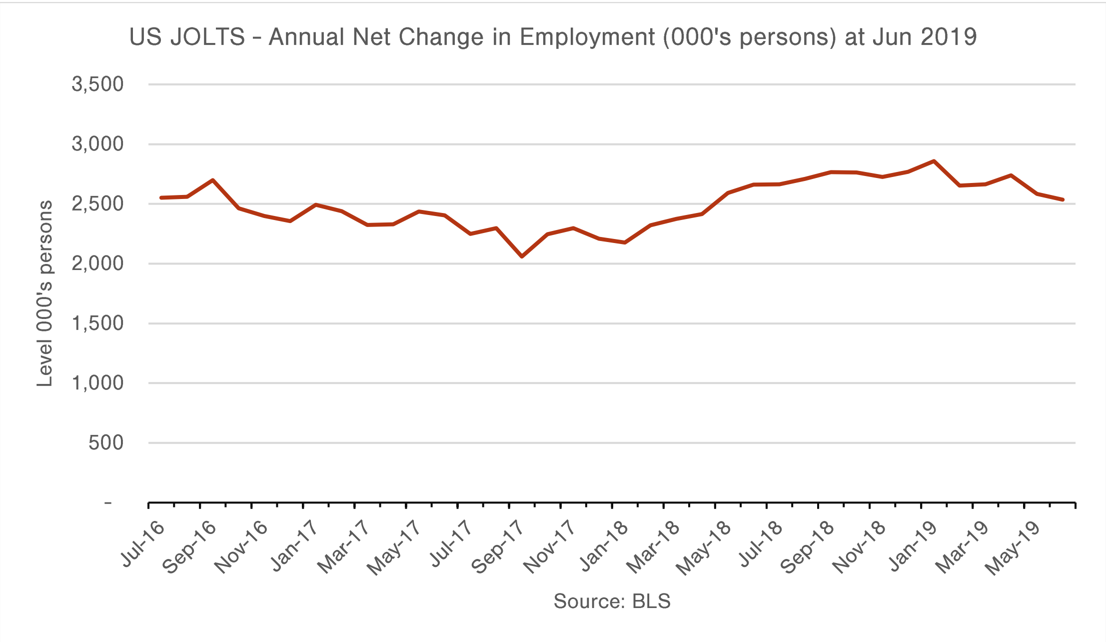
This suggests that in the last two months, workers have been less inclined to voluntarily leave their jobs. The quits data excludes retirements. On a 12-month basis, the growth in quits has also been slowing. The trend since Jan 2019 is especially of interest – with the growth in quits slowing consistently over the last 5 months. The number of quits remains 2.4% above the same month a year ago;



The quit rate has been unchanged at 2.3% for the last 13 months.

<u>Net change in employment</u>

The JOLTS data can be used to gauge the net employment change. When hires exceed separations, employment increases. Calculated over the last 12 months, the net change in employment is a gain of 2.5m in Jun;



The slow down in the growth of net employment since Jan 2019 is the result of slower annual growth in hires.

https://www.bls.gov/news.release/pdf/jolts.pdf

Wholesale Sales and Inventory (Jun)

The value of merchant wholesale sales declined for the second month, led mostly by a decline in the value of petroleum sales. Wholesaler inventory growth was zero – underlying that result was an increase in the value of durable goods inventories which was offset by a decline in non-durable goods inventory.

Wholesale Sales

Month change; Jun -0.3% versus May -0.6%

Annual change versus same month a year ago; Jun -0.2%

In Jun, durable goods wholesale sales increased at a faster pace; +0.2% versus 0% growth in May. The results were mixed with several larger categories recording declines in Jun; autos, computer equipment, electrical and machinery.

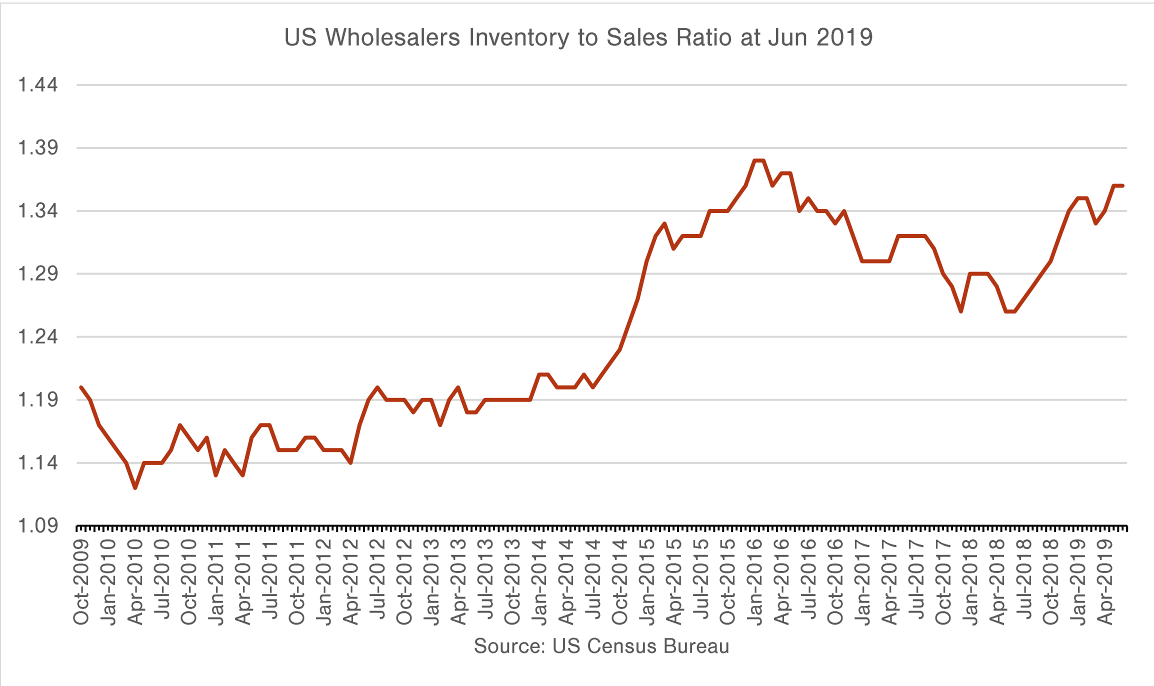
Non-durable goods wholesale sales declined by -0.7% in Jun after a -1.2% decline in May. Several non-durable categories declined but the largest contributor was the decline in the value of petroleum wholesale sales (-2.3% in Jun).

Inventories

Month change; Jun 0% versus May +0.4%

Annual change versus same month a year ago; Jun +7.6%

The inventory to sales ratio was unchanged at 1.36 and remains elevated;



Inventories in the latest month;

Durable goods; inventories increased at the same pace in Jun +0.3%.

Inventories for durable goods were higher across several of the categories that recorded sales declines in Jun; computer equipment, electrical and machinery. The inventory to sales ratio for durable goods increased in Jun from 1.75 in May to 1.76 in Jun.

Non-durable goods; inventories declined in Jun by -0.4% versus a +0.6% increase in May.

Despite the decline in the value of petroleum wholesale sales, inventory increased by +2.2% in Jun after a -2.5% decline in May. The main contributor to the decline in non-durable goods inventories was drugs, declining by -2.1% in Jun.

https://www.census.gov/wholesale/index.html

PPI (Jul)

Growth in the PPI increased in the latest month – with final demand goods prices increasing while services prices declined. On an annual basis, the growth in the PPI has been slowing over the last year and the more underlying measure of producer prices (ex food, energy and trade) has also continued to slow also at faster pace this month.

Broadly, this means that growth in US producers' selling prices are slowing – across both goods and importantly services.

From the BLS (emphasis added);

> The Producer Price Index is a family of indexes that measures the average change over time i**n the selling prices received by domestic producers of goods and services. PPIs measure price change from the perspective of the seller.** This contrasts with other measures, such as the Consumer Price Index (CPI), that measure price change from the purchaser's perspective.

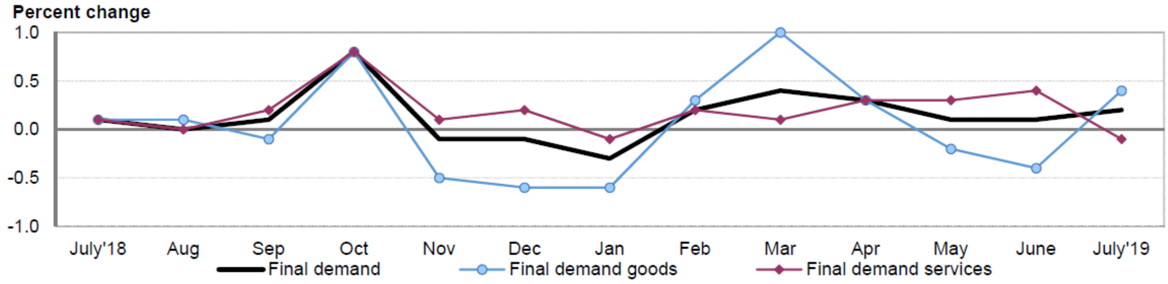
While not declining, the slower growth in selling prices impacts the pace of growth in business revenue/decisions on cost cutting/employment/hours over time.

The latest US PMI for services (Jul) hints at issues with demand with firms citing the 'rate of charge inflation was historically muted amid promotion discounting to entice new customers' (Source: Markit US PMI – Services Jul2019).

PPI Final Demand - Month Change; Jul +0.2% versus Jun +0.1%

The increase in the latest month was the result of faster growth in final demand goods prices while final demand services prices declined versus the month prior.

Chart 1. One-month percent changes in selected PPI final demand price indexes, seasonally adjusted



Final Demand Goods – month change; Jul +0.4% versus Jun -0.4%

The change in the month was the most the result of the faster growth in Energy prices, accelerating from -3.1% in Jun to +2.3% in Jul. Food prices grew at a slower pace.

> "Over half of the July rise in the index for final demand goods can be traced to prices for gasoline, which advanced 5.2 percent. The indexes for diesel fuel, electric power, corn, beef and veal, and tobacco products also advanced. Conversely, prices for jet fuel fell 3.5 percent."

Final Demand Services – month change; Jul -0.1% versus Jun +0.4%

Several areas contributed to the decline in the month; growth in trade and transport & warehousing prices slowed, other services prices shifted from zero growth to a decline of -0.3%.

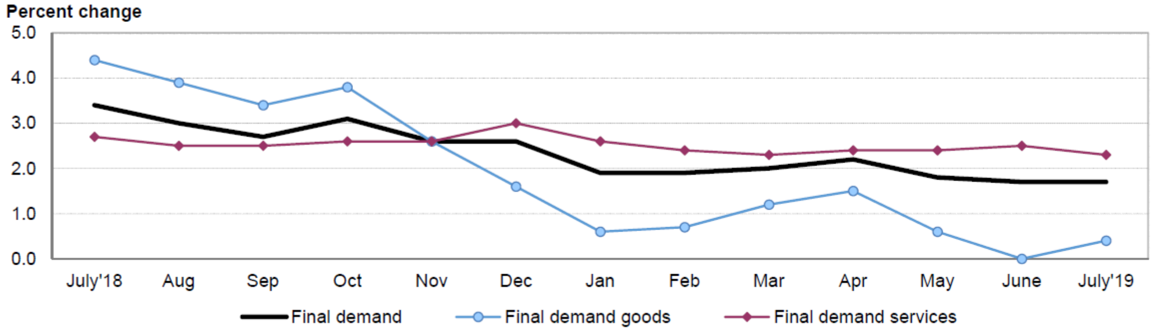
> "A major factor in the decline in prices for final demand services was the index for guestroom rental, which moved down 4.3 percent. The indexes for fuels and lubricants retailing, loan services (partial), machinery and equipment parts and supplies wholesaling, and truck transportation of freight also decreased."

PPI Final Demand – Annual Change; Jul +1.7% versus Jun +1.7%

A year ago, the headline index of producer prices was growing at +3.4% at Jul 2018 – growth in prices has halved in the last year.

Annual growth in PPI has been slowing consistently since mid-2018 as both goods and services prices have also slowed (general trend);

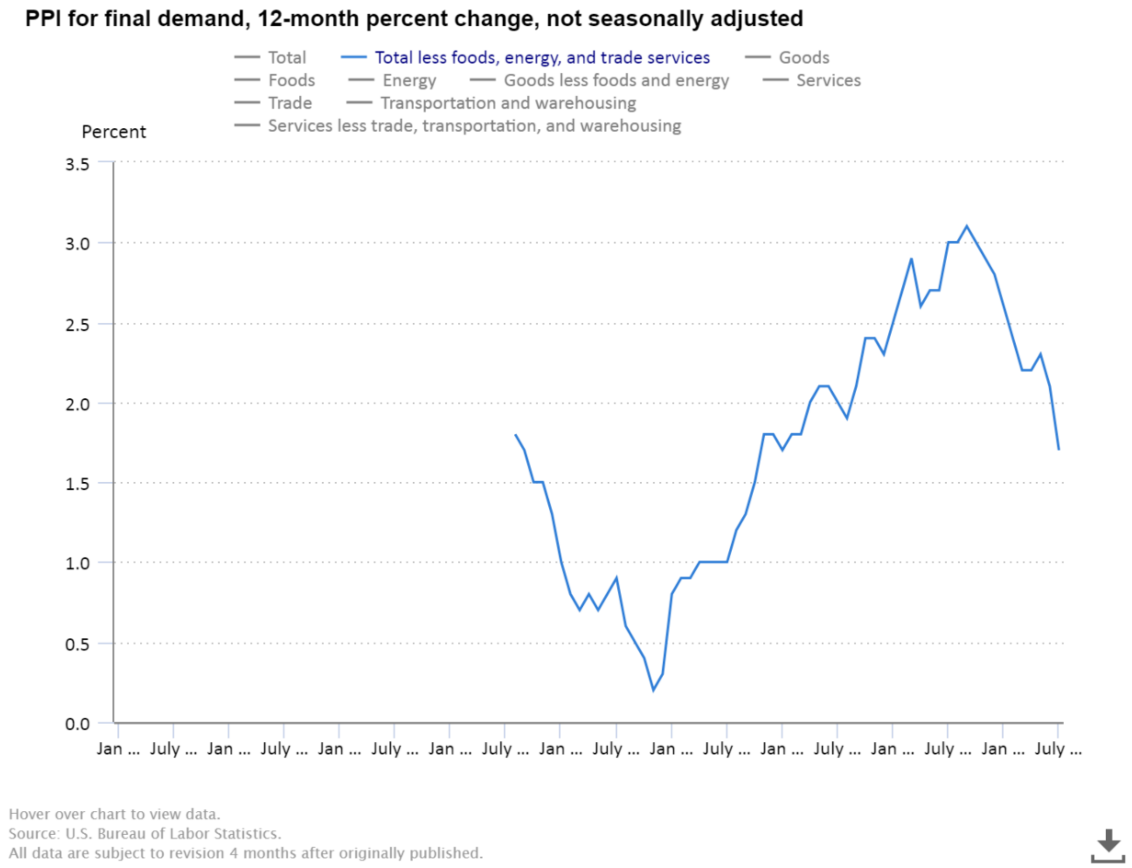
Chart 2. Twelve-month percent changes in selected PPI final demand price indexes, not seasonally adjusted



Even excluding more volatile food, energy and trade prices, the underlying trend in producer prices shows growth slowing;

PPI Final Demand Ex Food, Energy & Trade – annual change; Jul +1.7% versus Jun +2.1%. A year ago, this measure of underlying growth in the PPI was growing at +3%.

Chart – Annual Change PPI Ex food, energy and trade services;



One of the larger contributors to this slower growth in "core" producer prices growth is the much slower growth in transportation and warehousing prices; annual growth has slowed form +6.6% in Oct 2018 to 3% in Jul 2019. This slower growth is somewhat of a barometer for domestic trade and activity.

<u>Tariffs in the PPI</u>

Its important to note the impact of tariffs on producer prices – again from the BLS;

> "The Producer Price Index (PPI) measures the average change in prices U.S. producers receive for the sale of their products. Since tariffs and taxes are not retained by producers as revenue, they are explicitly excluded from the PPI. However, **pricing decisions producers make in reaction to tariffs are included in the PPI.** For example, if a domestic producer is manufacturing a product that is subject to import competition and tariffs are placed on those imports, the domestic producer may increase its own prices in order to maximize revenue. In this case, the price increase for the domestic producer would be included in the PPI. Similarly, if a domestic producer exports products to a foreign country that placed tariffs on U.S. products and the domestic producer lowered its prices either to better compete in the export market or to sell domestically excess inventory that resulted from those tariffs, those price decreases would also be reflected in the PPI."

https://www.bls.gov/news.release/ppi.nr0.htm

https://www.bls.gov/ppi/ppifaq.htm

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Europe

Markit Eurozone Services PMI (Jul)

Across the Eurozone, services activity continued to grow but at a slower pace. Across the major economies, growth slowed – Germany recorded the strongest growth. Growth in France, Spain and Italy slowed. Growth in services activity in Italy was the lowest of the four.

Business Activity Index; Jul 53.2 versus Jun 53.6

New work increased but also at a slower pace. Backlogs of work increased. Employment continued to grow, but the pace also slowed. Germany continued to lead the way on employment growth, but the pace slowed to a six-month low.

Overall business confidence increased to the highest level in three months. French service companies reported a notable increase in sentiment and Italian companies were the most optimistic overall. In Germany, service firms reported the lowest levels of confidence since the end of 2104.

"The service sector continued to sustain the expansion of the overall eurozone economy at the start of the third quarter, but there are signs that the scale of the manufacturing downturn is starting to overwhelm."

"While the service sector has helped offset the manufacturing downturn, growth also edged lower among service providers in July, meaning the overall pace of expansion of GDP signalled by the PMI has slipped closer to 0.1%."

https://www.markiteconomics.com/Public/Home/PressRelease/43fd7b59e09d433692a3bd82945deb98

Germany Factory Orders (Jun)

The volume of manufacturing new orders in Germany rebounded in the latest month. This rebound was led by an increase in orders from foreign non-Euro area countries – led by a larger increase in capital goods orders.

Orders from the domestic market and Euro-area countries declined in the month. There was a marked decline in consumer and durable goods orders in the domestic market for the month.

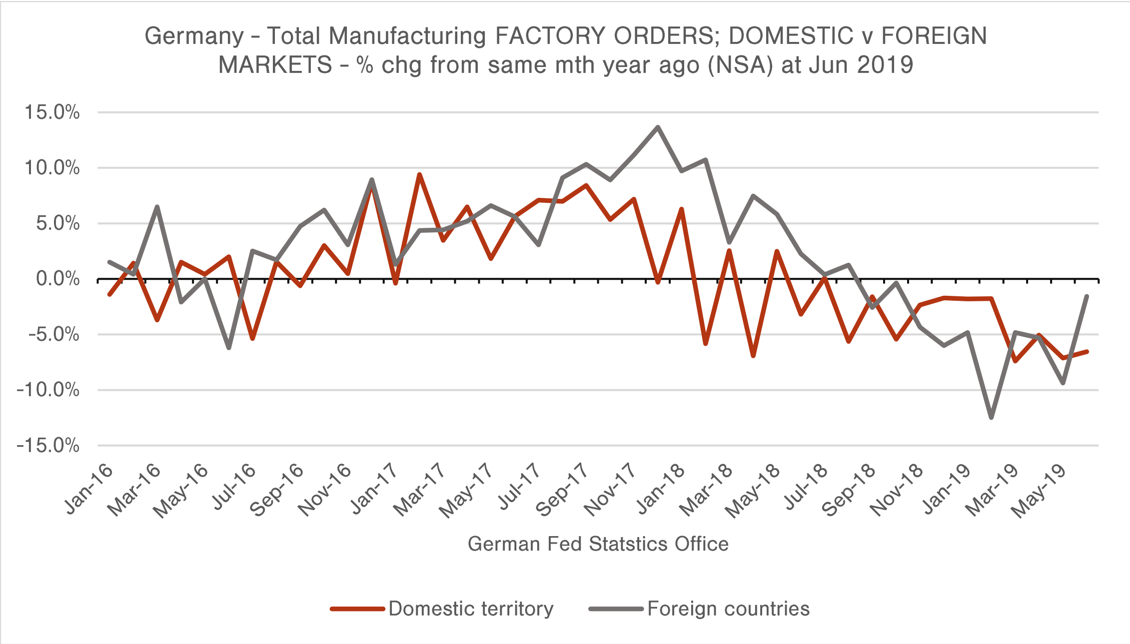
Total Manufacturing New Orders

Month change; Jun +2.5% versus May -2%

The increase in the latest month was due to a large increase in orders for non-Euro area countries; +8.6%. Orders for the domestic market declined by 1% and by -0.6% for Euro area countries.

On an annual basis, the volume of new orders was -3.6% below the same month a year ago, slightly less than the 8.4% decline in May.

The slower decline in foreign countries orders has been led by non-Euro area countries (now +3.9% versus a year ago) while orders from foreign countries in the Euro area remain -10.1% below the same month a year ago.



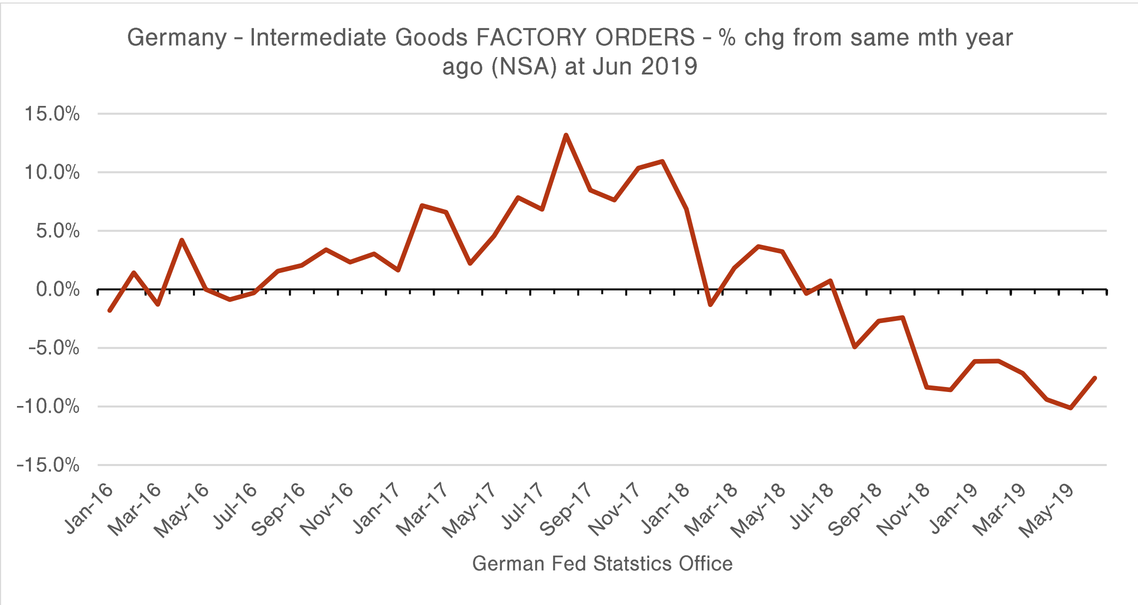
Intermediate Goods

Factory orders for intermediate goods increased in the latest month also after posting seven consecutive monthly declines.

Month change; Jun +1.3% versus May -1.5%

Orders for intermediate goods in the domestic market declined by -0.4% while orders for the Euro area countries increased by 6.1% in the month.

Annual change; Jun -7.6% versus May -10.1%



Capital Goods

Orders for capital goods increased at a faster pace in Jun – this was also led by a much stronger increase in orders for non-euro area foreign countries.

Month change; Jun +3.7% versus May -2.4%

In the domestic market, orders still declined by -1.4% and orders from Euro-area countries also declined by -4.9%. Capital goods orders from non-Euro-area countries increased by +12.3%.

Annual change; Jun -0.6% versus May -8.2%

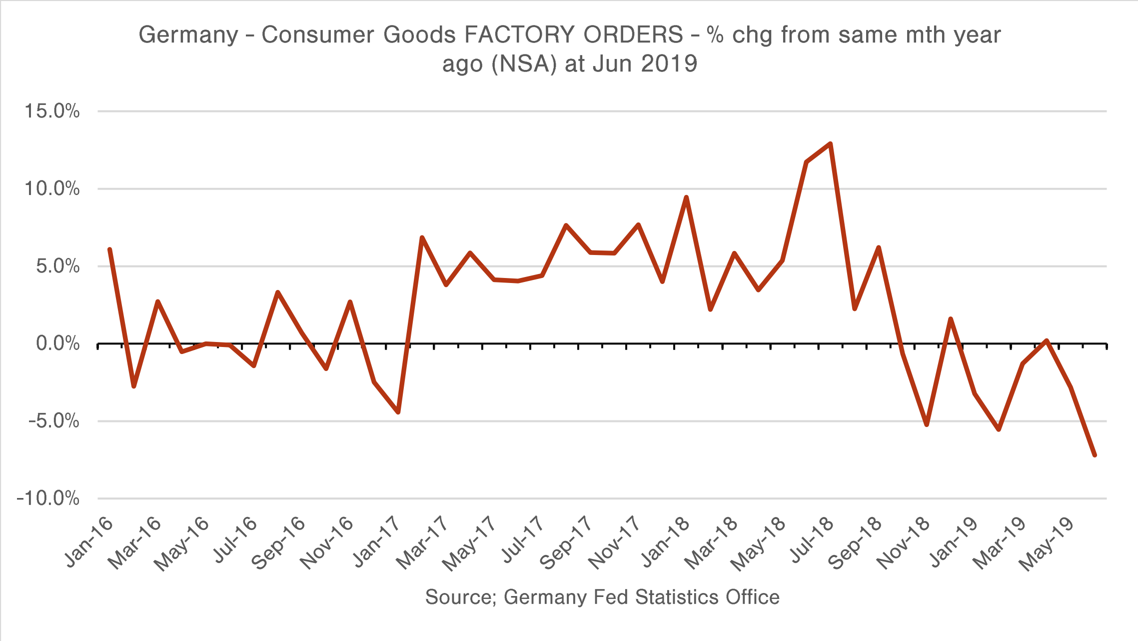
Consumer Goods

Orders for consumers goods declined in the month;

Month change; Jun -0.4% versus May -0.6%

Orders from the domestic market declined at a faster pace in Jun -2.1% and orders from Euro area countries also declined by -1.2%. Orders from non-euro area countries increased by 2.4%

Annual change; Jun -7.2% versus May 2.8%



Durable Goods

Orders for durable goods declined in Jun after a larger increase in the month prior;

Month change; Jun -0.4% versus May +2.8%

This month there was marked declined in durable goods orders in the domestic market, with orders falling 7.9%. Orders from Euro area countries also declined by -1.2%. Durable goods orders from non-Euro area countries increased by +10.2% in the month.

Annual change; Jun -0.7% versus May -6.6%

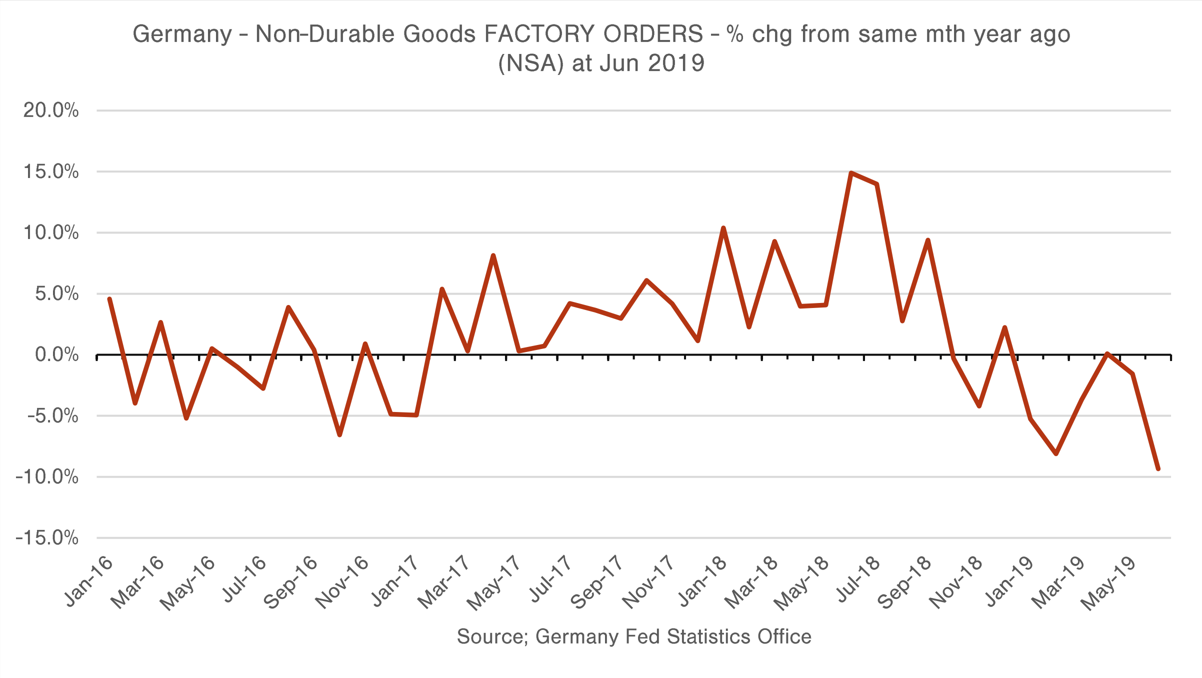
Non-Durable Goods

Orders for non-durable goods continued to decrease in the latest month;

Month change; Jun -0.2% versus May -1.9%

Orders from the domestic market increased slightly, while orders from foreign countries declined by -0.5%.

Annual change; Jun -9.3% versus May -1.6%



https://www.destatis.de/EN/Press/2019/08/PE19_293_421.html;jsessionid=93BF7696A3169C8628D7462D2FDD4451.internet732

Germany Industrial Production (Jun)

Overall industrial production fell harder in the latest month and declined at an accelerated pace versus a year ago.

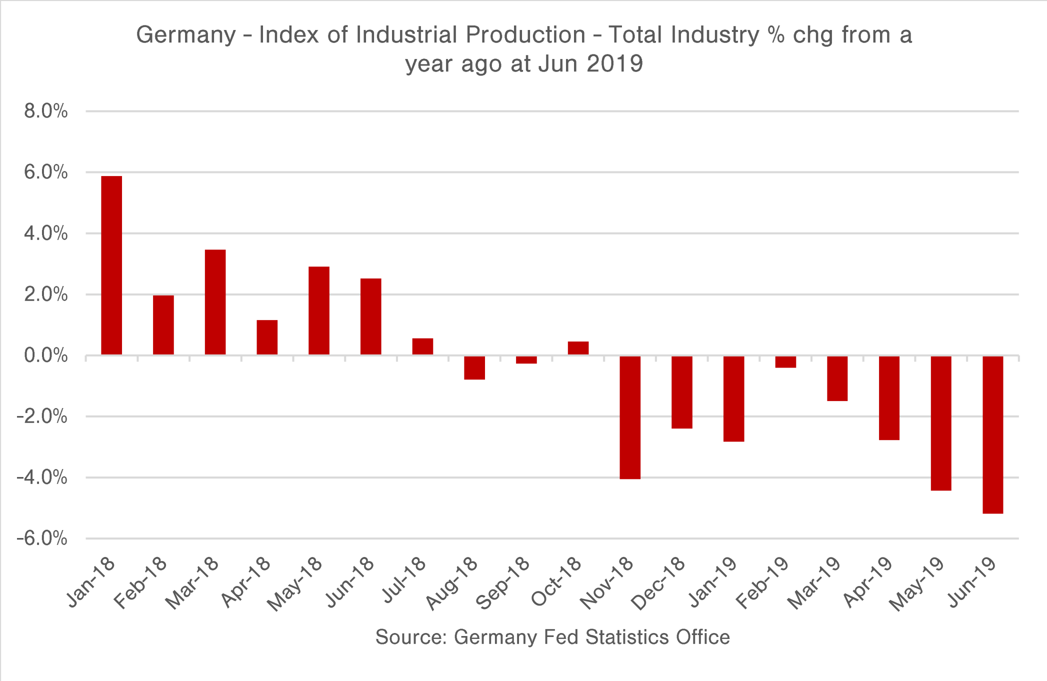
The decline in production was broad with manufacturing, mining and utilities all declining the month. Construction activity stabilized after a larger decline in the month prior.

Production – Total Industry

Month change; Jun -1.5% versus May +0.1%

Annual change; Jun -5.2% versus May -4.4%

The annual decline has been gathering pace over the last few months.



Total production in Jun is now 6% below the recent peak from Nov 2017.

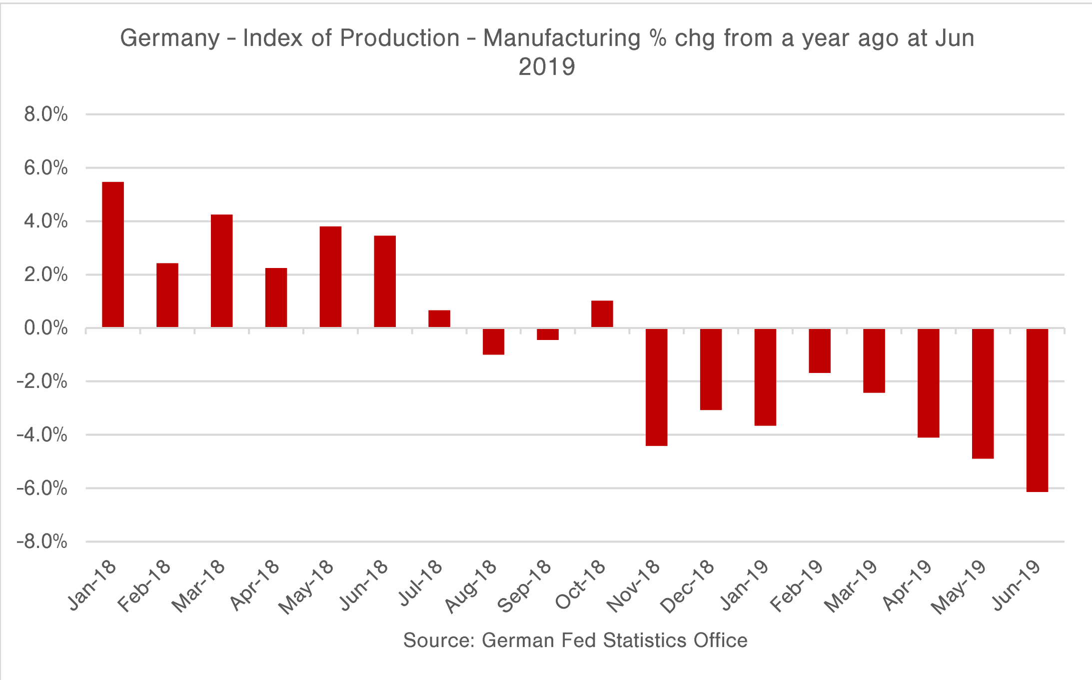
<u>Production in Manufacturing</u>

Month change; Jun -1.8% versus May +0.8%

Production of intermediate goods declined by 2% in Jun, capital goods production by -1.8%, durable goods by -2%, non-durable goods by -1.3% and the production of consumer goods declined by -1.4% in Jun.

Annual change; Jun -6.1% versus May -4.9%

Annual production in manufacturing has been declining on an annual basis for ten out of the last twelve months. The decline has been accelerating over the last four months;

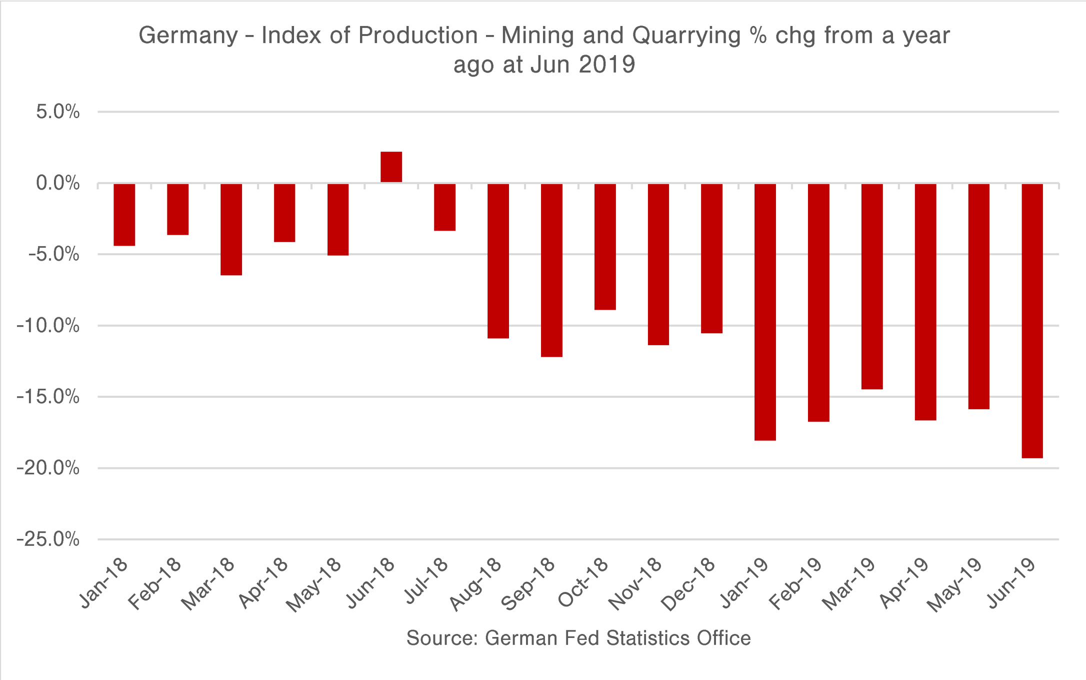


Production Mining and Quarrying

Month change; Jun -1% versus May +0.4%

Annual change; Jun -19.3% versus May -15.9%

Mining and quarrying production has continued to slow since mid-2018;

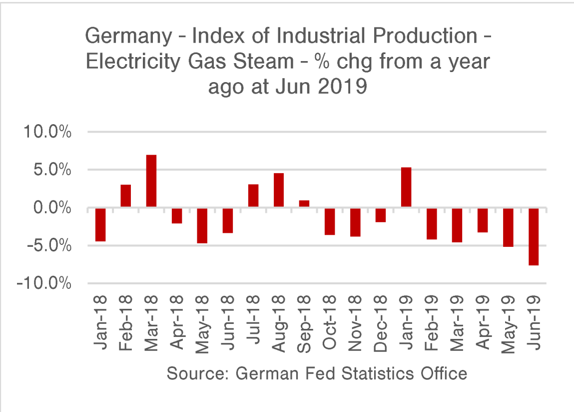


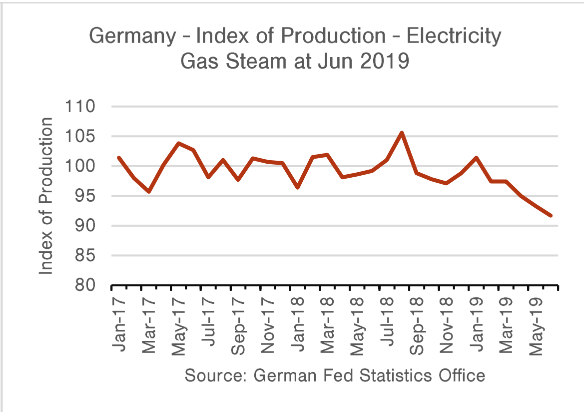
Production - Electricity, gas, steam, air conditioning supply

Month change; Jun -1.7% versus May -1.8%

Annual change; Jun -7.6% versus May -5.2%

The annual decline in utilities production has become more notable over the last three months – the index of production also highlights this slow down;



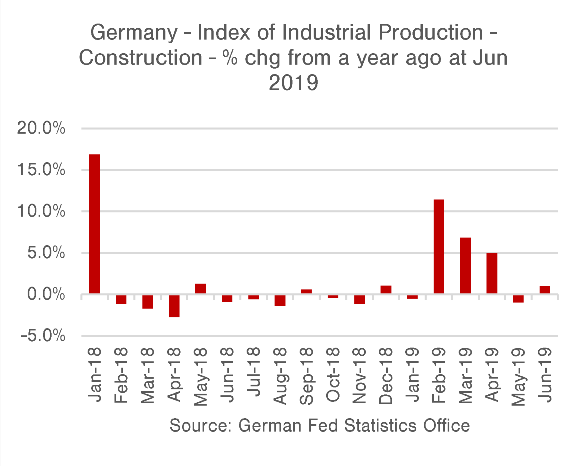


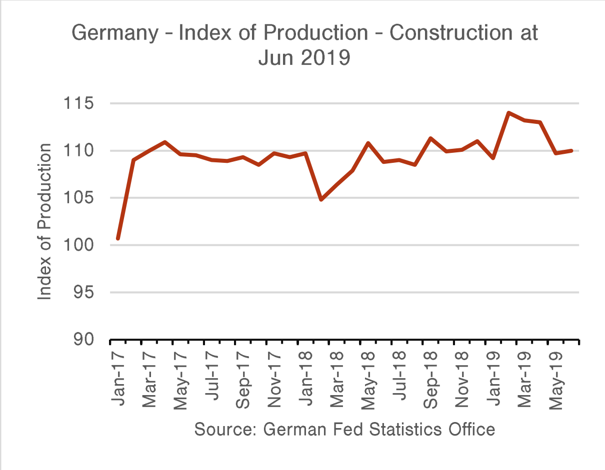
Production – Construction

Month change; Jun +0.3% versus May -2.9%

Annual change; Jun +1% versus May -1%

Construction activity has mostly stabilized around the late 2018 levels





https://www.destatis.de/EN/Press/2019/08/PE19_295_421.html;jsessionid=3966ACBA2DF0274D2AB33019E59F320A.internet711

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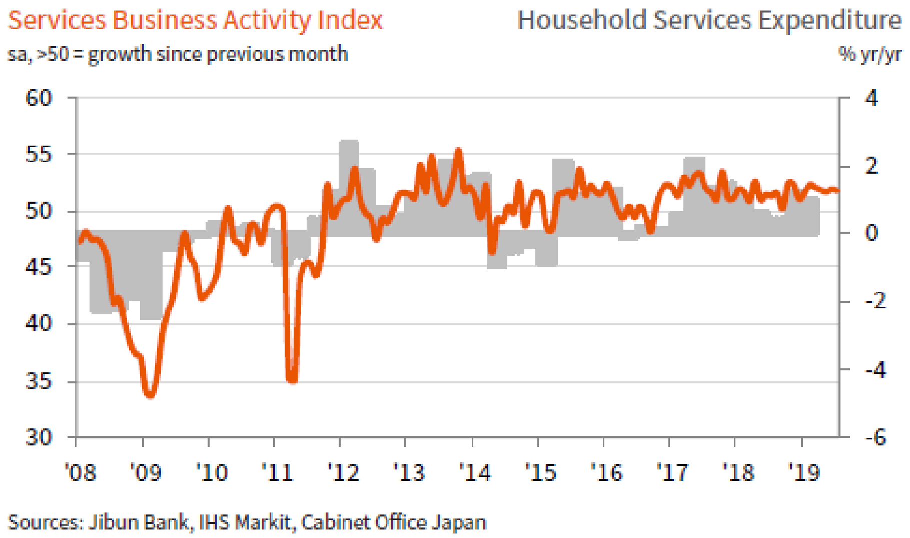
Japan

Markit Services PMI (Jul)

Activity of private sector services firms continued to expand in Jul. The pace of expansion was only slightly slower than in the month prior.

Services Activity Index; Jul 51.8 versus Jun 51.9



New orders continued to grow but the rate of growth slowed to a one-year low – firms reported 'subdued' sales. Orders from abroad recorded no growth in Jul after a notable decline in the month prior.

Backlogs of work were unchanged/no growth.

Employment growth was marginal.

Input prices increased at a slower pace and output charges also increased but was the lowest level in nine months.

Sentiment regarding the year ahead remained in positive territory but the degree of confidence 'eased to a near two-year low'.

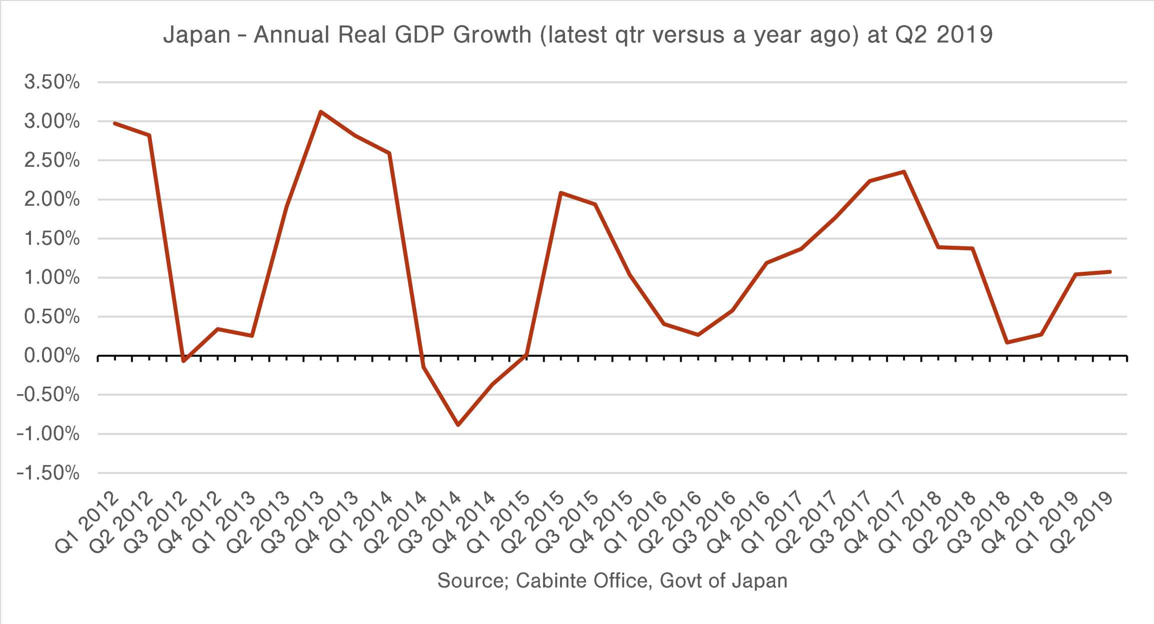
https://www.markiteconomics.com/Public/Home/PressRelease/acf45b0c90d94d31ba37b6fd76d41ace

Prelim GDP Q2

The prelim Q2 GDP growth slowed versus the prior quarter and the annual growth was little changed.

Quarter change; Q2 +0.4% versus Q1 +0.7%

Annual change (versus same quarter a year ago); Q2 +1.07% versus Q1 +1.04%



The slow down in growth for the quarter was mostly the result of net exports detracting from growth.

<u>Contribution to Growth in Q2 – Expenditure View</u>

Private Consumption made a larger contribution to growth in the quarter (+0.35% pts), led by faster growth in household consumption (+0.6% in Q2 versus +0.1% in Q1).

Private Residential Investment made a slightly smaller contribution (+0.01% pts) and grew at a slightly slower pace.

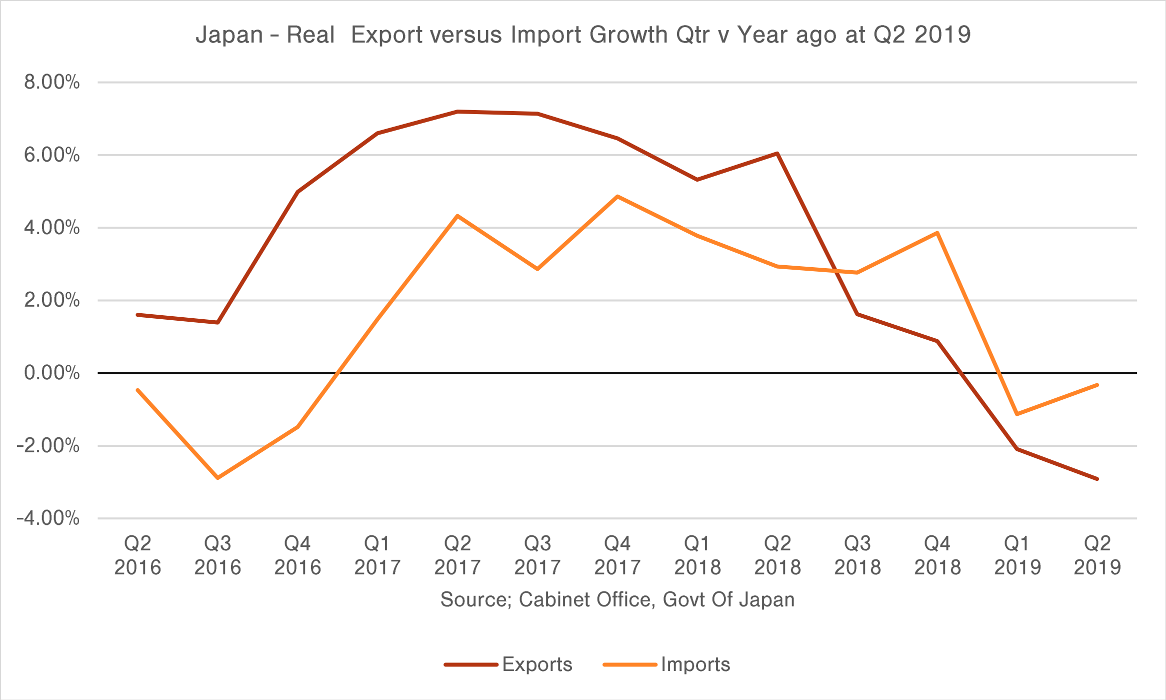
Private Non-Residential Investment made a larger contribution (+0.24% pts) grew at a much faster pace +1.5% in Q2 versus +0.4% in Q1.

The change in Inventories detracted from growth in Q2 (-0.09% pts) after adding to growth in Q1.

Govt Consumption expenditure made a larger contribution (+0.19% pts) after declining slightly in Q1.

The contribution from Public Investment spending (+0.05%pts) was little changed in Q2.

Net exports made the largest offsetting impact. After contributing +0.43%pts to growth in the prior quarter, net exports detracted -0.29%pts from the Q2 result. Real exports declined further, albeit slightly, in Q2 while imports increased. On an annual basis, real exports continue to decline;



https://www.esri.cao.go.jp/en/sna/data/sokuhou/files/2019/qe192/gdemenuea.html

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United Kingdom

BREXIT

With the conservative party leadership now resolved, focus shifts back to the Brexit deadline of 31 Oct.

The new UK Brexit secretary, Stephen Barclay called on his counterpart in the EU, Michel Barnier to request a new mandate for Brexit in order to avoid a 'no-deal' Brexit. But last week, the Irish Premier, Leo Varadkar, also confirmed that there would be no movement on the Irish border backstop;

> "Last week the Irish Taoiseach invited Mr Johnson to visit him in Dublin to discuss Brexit and other issues between the two countries, but last night Mr Varadkar's office insisted once again that there would be no movement on the Irish backstop – stating the point "has repeatedly been made clear".
>
> A spokesman added: "The withdrawal agreement and the backstop are not up for negotiation."" https://www.independent.co.uk/news/uk/politics/brexit-eu-uk-boris-johnson-leo-varadkar-irish-backstop-hard-border-a9052516.html

The UK PM Johnson and the Irish Premier will meet in Sept.

There are no details at this stage of a restarting of negotiations between the EU and UK on the withdrawal agreement.

The UK government has already announced new spending commitments in preparation for a no-deal Brexit. Details of the expenditure are yet to be released.

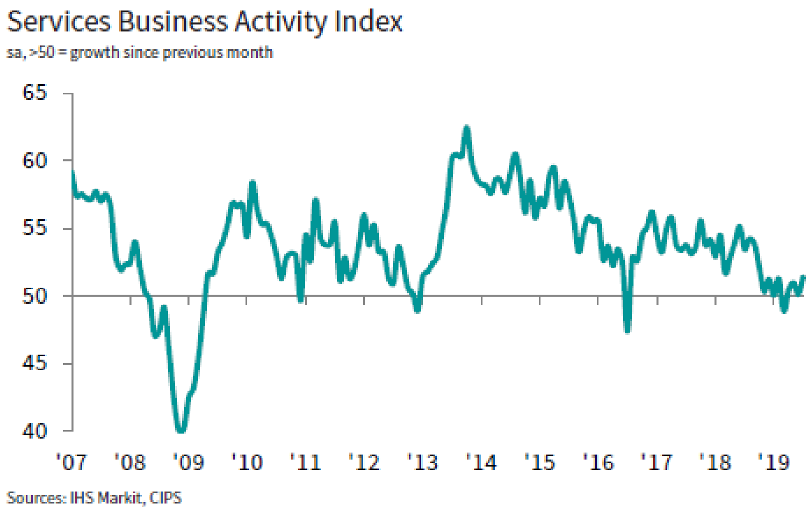
> "At the same time, Sajid Javid, the new chancellor, told the Sunday Telegraph there would be "significant extra funding" this week to get Britain "fully ready to leave" the EU on 31 October, with or without a deal."https://www.theguardian.com/politics/2019/jul/28/boris-johnson-turbo-charging-no-deal-brexit-plans-say-ministers

Markit Services PMI (Jul)

Services activity in the UK expanded at a faster pace in Jul. This increase in growth helped to offset the falls in manufacturing and construction activity in the month. The increase in service activity was led by faster growth in new orders.

Given that the leadership has been resolved, and the chance now of a no-deal Brexit, it will be likely that activity, especially services, will continue to expand in preparation for 31 Oct.

Business Activity Index: Jul 51.4 versus Jun 50.2



New orders rebounded in Jul – but firms continued to cite political uncertainty holding back decisions. New orders to external clients were aided by a weaker GBP.

Despite the increase in new business, order backlogs continued to decline for the tenth month in a row.

Employment growth continued to slow. Firms also cited increased payroll costs.

Input price growth was unchanged from Jun. Prices charged increased at only a modest pace.

Business optimism eased for the second month in a row.

> "Survey respondents continued to cite domestic political uncertainty and concerns about the global economic outlook, although some firms noted hopes of a boost from pent up demand following clarity about the path to Brexit."

https://www.markiteconomics.com/Public/Home/PressRelease/0cc0c4f6f7f14c65aaa27338a9abbfc5

UK Prelim GDP Q2

The prelim estimate indicates that GDP declined in Q2 after increasing in Q1. This is not unexpected given the volatility in activity as a result of Brexit preparations and inventory hangover.

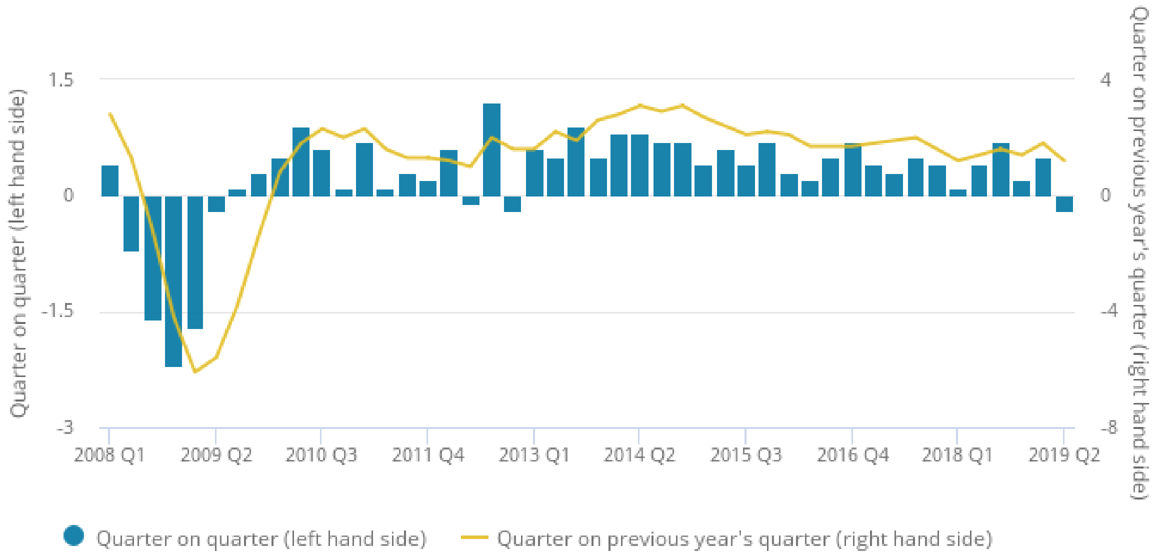
> "There is evidence that stockpiling was taking place in the first quarter of the year, which provided a boost to GDP, with the latest figures showing that these increased stock levels were partly run down in Quarter 2 2019."

Real GDP Growth – Quarter change; Q2 -0.2% versus Q1 +0.5%

Annual growth slowed to the second lowest rate since 2011; Q2 +1.2% versus Q1 +1.8%

Figure 1: Real GDP contracted by 0.2% in Quarter 2 2019, at a time of increased volatility around the UK's original planned exit date from the European Union in late March

UK, Quarter 1 (Jan to Mar) 2008 to Quarter 2 (Apr to June) 2019



Source: Office for National Statistics

Production View of GDP Components – Contribution to GDP Growth

The largest overall impact on GDP growth was the decline in production/manufacturing activity in Q2. The further fall in construction activity was offset by slower growth in services.

Production; in Q2 detracted -0.2%pts from the quarter GDP growth (after contributing +0.16%pts in the quarter prior). Manufacturing activity was bought forward ahead of the Mar Brexit date. The fall in manufacturing activity in Q2 reflected partial closures of car manufacturing factories, but commentary also hints at weaker demand (emphasis added);

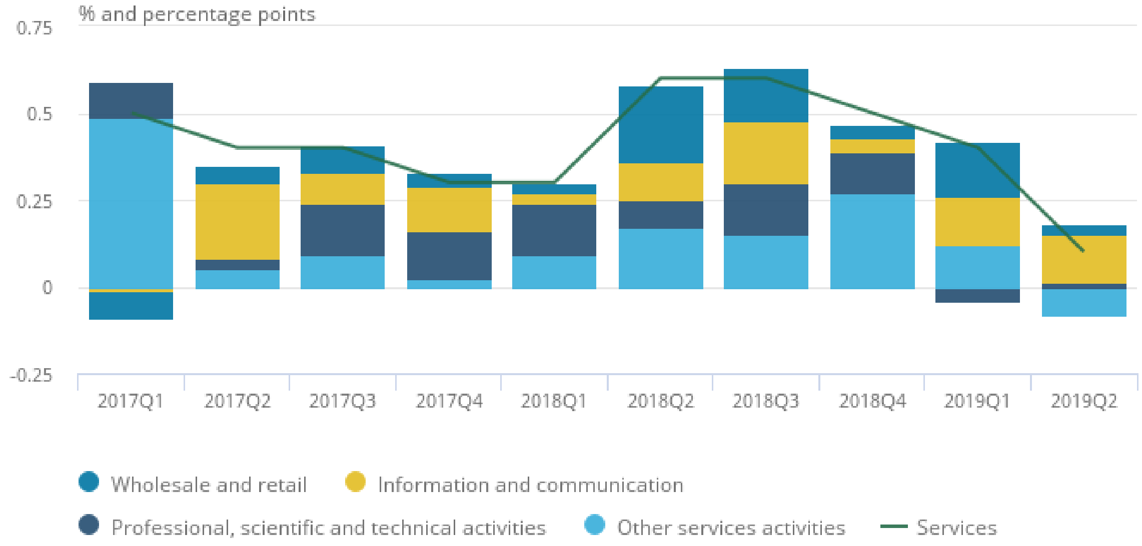
> The fall in transport equipment in Quarter 2 is also echoed in the recent Society of Motor Manufacturers and Traders survey, which reported that UK car production fell by 20% in the first six months of the year. **The fall in car production was attributed mainly to "falling demand in key markets, including the UK, exacerbated by factory shutdowns pulled forward in anticipation of the March Brexit deadline".** In addition, the recent CBI Industrial Trends Survey also recorded a fall in manufacturing output in the three months to June 2019. This was driven by the largest contraction in motor vehicle production since March 2009, due to the "bringing forward of planned seasonal plant closures to align with previous Brexit deadlines".

Construction; in Q2 detracted -0.08% pts from headline growth after adding +0.09% pts to headline growth in Q1.

Services; activity slowed in Q2 from adding +0.3% pts in Q1 to +0.08%pts in Q2. There has been a general slowing in services momentum over the YTD.

Figure 6: The recent decline in momentum in the services industry continues in the second quarter of 2019

UK, Quarter 1 (Jan to Mar) 2017 to Quarter 2 (Apr to Jun) 2019



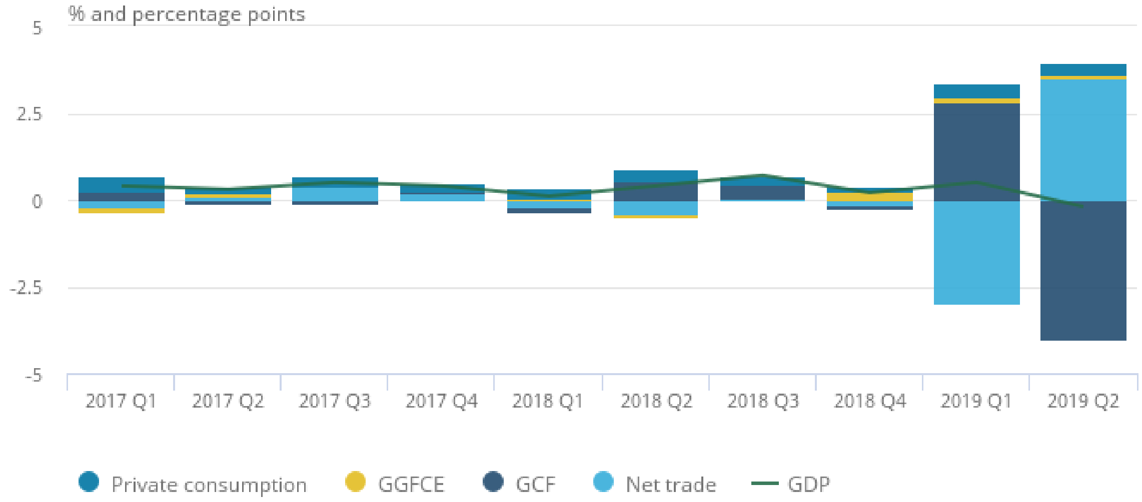
Source: Office for National Statistics

Expenditure View

In the expenditure view there were some larger offsetting performances in Q2 versus Q1. The largest impacts were from changes in gross capital formation and net trade.

Figure 7: There have been large movements in net trade and GCF for the second consecutive quarter

UK, Quarter 1 (Jan to Mar) 2018 to Quarter 2 (Apr to June) 2019



Source: Office for National Statistics

Private consumption made a slightly smaller contribution to growth +0.32%pts in Q2 versus +0.37% pts in Q1.

Government consumption expenditure made a similar contribution to growth; +0.12%pts in Q2

Gross capital formation detracted -4.0%pts in Q2. Just over half of this 2.24%pts was attributed to the fall back in inventories that had been accumulated in Q1 in preparation for Brexit.

The shifts in trade flows highlight activity bought forward in preparation for Brexit (goods stockpiling). Net trade detracted -3%pts in Q1 versus adding +3.5%pts in Q2. Both imports and exports declined in Q2.

https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/apriltojune2019

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Australia

AiG – Industry Performance Indexes (Jul)

While we don't usually follow these indices, we will continue to track them in the ST to gauge the response to the various stimulus that has been implemented for the Australian economy - rate cuts, tax cuts and changes in bank lending restrictions.

This July data incorporates both rate cuts and easier credit/lending conditions for housing/owner occupier mortgages.

While there was some pick up in manufacturing activity, services and construction activity both deteriorated markedly. Across reports, sales remained in contraction. Only the new orders growth in manufacturing provides some hope that production will lift in the near future. New orders in services and construction suggest little chance for a rebound in the near term.

Manufacturing; Jul 51.3 versus Jun 49.4

The headline index rebounded from contraction in the prior month. **Production remained in contraction** while new orders increased. **Sales contracted at a faster pace dropping 8pts** – while exports continued to expand. Employment growth increased at a faster pace. Selling prices declined while input prices increased at a slower pace.

Three of the six main sectors expanded in July - building materials, wood, furniture & other manufacturers, the large food & beverages sector and the chemicals sector. Contracting industries - machinery & equipment sector contracted but at a slower pace in July, while the metal products and the small TCF, paper & printing products fell deeper into contraction.

Services; Jul 43.8 versus Jun 52.1 (-8.3pts in the month)

The headline index fell back into contraction after growing in the month prior. Most sub-indices are now in contraction. Of most concern is the 12pt decline in new orders which fell to 44.1 in Jul. Only input prices and wages remained in positive territory. Sales declined markedly also.

Four of the eight sectors expanded in the month; hospitality, health & education, wholesale trade and a marginal expansion in finance and insurance. Retail, personal & recreation, business & property services and transport & storage all remained in contraction.

Construction; Jul 39.1 versus Jun 43 (-3.9pts in the month)

The headline index indicated that construction conditions continued to deteriorate in Jul.

Every sector remained firmly in contraction this month – house building activity increased by 0.6pts to 38.3 and commercial activity increased by 0.4pts to 46.9. Apartment activity and engineering activity continued to contract.

Most of the activity sub-indices declined in the month except for selling prices. Employment was hit hard again falling 7.7pts to 35.9pts and new orders also declined by 5.5pts to 36pts. Selling prices increased by 5pts but remained firmly in contraction at 36.6pts. Input prices continued to expand, albeit at a slower pace.

https://www.aigroup.com.au/policy-and-research/economics/economicindicators/

Housing Lending (Jun)

Total lending for housing increased at a faster pace in Jun. This was led by a larger increase in the value of lending for owner-occupier housing – although the number of owner occupier housing commitments increased by a smaller degree. The value of lending for investment housing also increased but by a smaller degree.

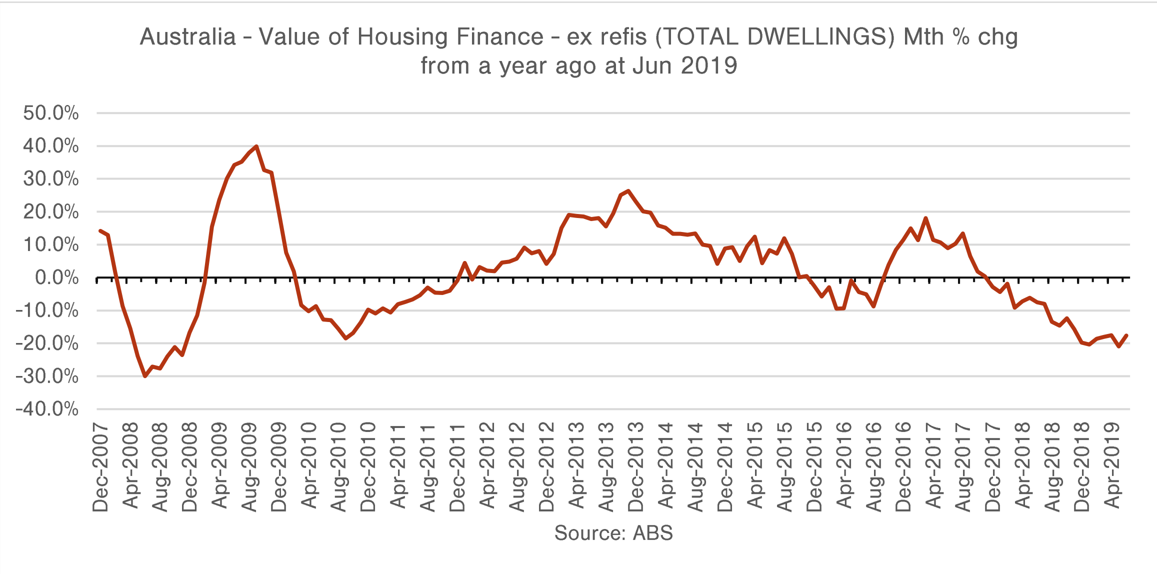
This is the first full month after the federal election - the incumbent party was returned to government meaning that reform to tax rules on investment lending would not be implemented. This month also captures the first of the two rates cuts by the RBA and some softening of lending criteria by the prudential authority APRA. APRA has now reduced the tolerance for assessing serviceability of new mortgages - it was increased to a 7% i/r buffer now its +2.5%pts above the current variable rate - this will help increase loan sizes. But banks will now have to use a more comprehensive (or realistic!) household expenditure measure (HEM), which will likely offset some of the lower i/r benchmarks.

<u>Total Lending for Housing</u>

The value of total lending for housing ex refis increased at a faster pace in the latest month;

Month change; Jun +1.9% versus May -2.7%

On an annual basis, lending in Jun remained 18% below the same month a year ago. The value of lending in Jun was 26% below the peak in lending;



Lending for both owner occupier and investment housing contributed to the increase in the latest month.

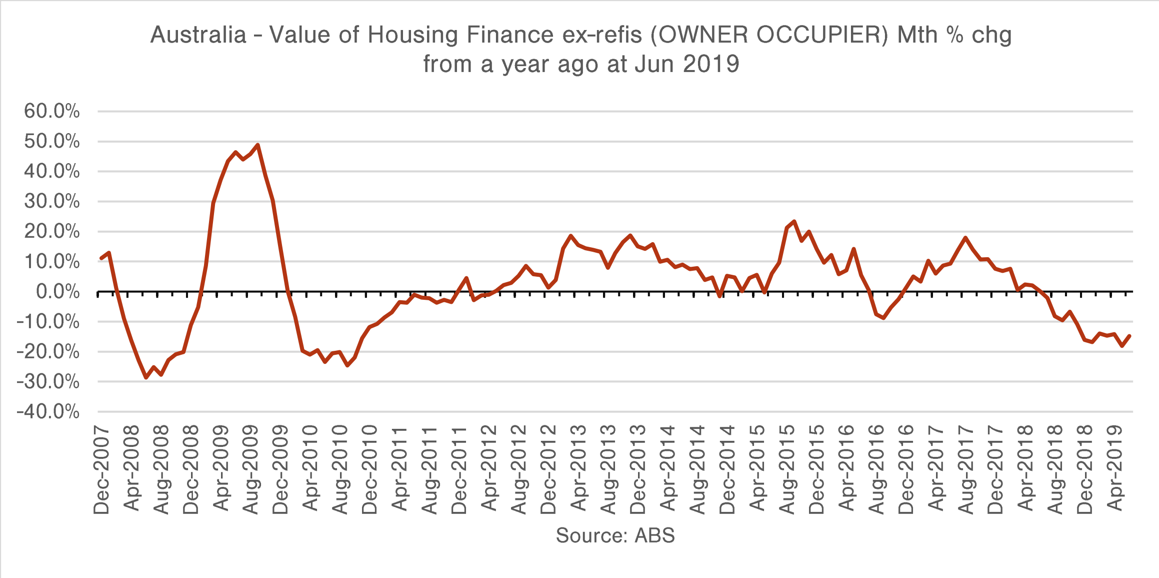
<u>Lending for Owner Occupier Housing</u>

The value of lending for owner occupier housing ex refi's increased at a much faster pace in the latest month;

Month change; Jun +2.4% versus May -3%

This month there was a larger increase in lending for the purchase of established dwellings while the value of lending for construction and purchase of new dwellings for owner occupiers declined in the month.

On an annual basis, the value of lending for owner occupiers was 15% below the same month a year ago, improving slightly from the -18% decline in the month prior;



While the value of owner occupier lending (ex refis) increased by +2.4% in Jun, the NUMBER of housing commitments grew by only +0.4% versus the month prior.

Across the states; the number of commitments in NSW, QLD, SA, WA and TAS all increased in the month and declined in VIC, NT and the ACT.

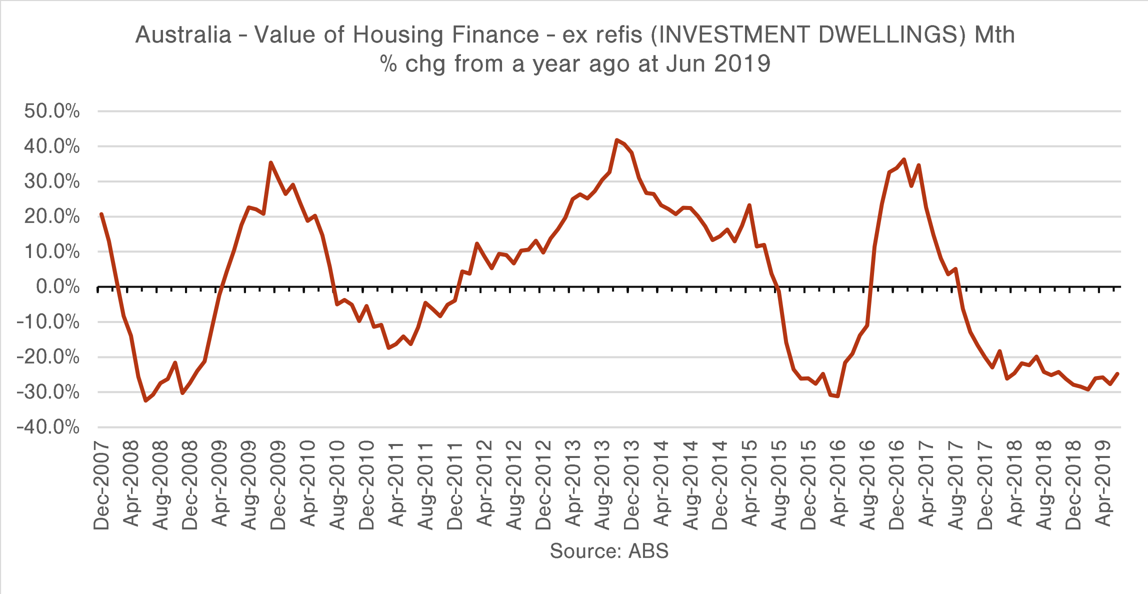
The number of commitments remains 14% below the same month a year ago.

Lending for Investment Housing

The value of lending for investment properties (ex refi's) increased slightly in the month after declining in the month prior;

Month change; Jun +0.5% versus May -1.9%

The value of lending in Jun was 25% below the same month a year ago, still slightly better than the -28% recorded in May;



https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/CD780691805A926CCA25839E001987B5?OpenDocument

RBA Cash Rate Decision – 6 Aug 2019

The RBA left rates on hold – the overnight cash rate remains at 1%.

Since the last meeting there were several changes. Most recently was the escalation in the trade dispute between the US and China resulting in a further increase in business uncertainty. Risks to growth are tilted to downside.

Rates have been reduced by the FOMC and QT has ended. The ECB has signalled that lower rates are possible, if not likely at upcoming meetings. Yields on government bonds across the world have fallen to near-term lows. Financial conditions remain accommodative and there is more of an easing bias across CB's.

Domestic data; employment growth/unemployment rate – remains little changed. The increase in participation over recent years has resulted in little to no reduction in the unemployment level. Some housing data points to stabilisation in prices in key markets, but it's too early to tell.

Q2 CPI last week showed that price growth remains subdued and underlying CPI continued slow. The return to the 2-3% band is likely to take longer than earlier expected. Wages growth remains subdued – demand for labour is being met with excess supply. The comment by the RBA is interesting, suggesting that wage growth is not 'expected' – "a further gradual lift in wages growth would be a welcome development."

Uncertainty regarding consumption expenditure remains. Recent policy measures – rate cuts, tax cuts and government are yet to be fully reflected in data.

Guidance; rates likely to remain low for an extended period. The RBA wants to see more certain progress towards lowering unemployment and wages growth such that the inflation rate returns to the 2-3% band.

Data points for upcoming decisions; **The only point mentioned by the RBA was labour market developments.** Wages, employment, income and spending outcomes will stem from developments in the labour market herein. The RBA has been explicit that should there be a deterioration in labour market conditions, the bank will continue to ease policy further.

https://www.rba.gov.au/media-releases/2019/mr-19-20.html

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China

Caixin Manufacturing PMI (Jul)

Manufacturing activity continued to contract slightly in Jul with the headline PMI sitting just below the 50-neutral mark. Output and new orders increased slightly. Firms reduced selling prices for the first time since Jan 'in an effort to boost customer demand' and continued to reduced employment. Firms remained cautious regarding inventories with inputs and finished goods inventories declining in Jul.

Manufacturing PMI; Jul 49.9 versus Jun 49.4

Output shifted to growth in Jul after contracting slightly in Jun. Firms cited some 'firmer' demand conditions. New orders also increased slightly led by domestic demand while new export orders continued to decline. Growth in order backlogs was modest.

Firms reduced employment in Jul for the fourth month.

Inventories of inputs and finished goods declined.

Firms cut selling prices for the first time since Jan 'in an effort to stimulate customer demand and boost new order intakes'.

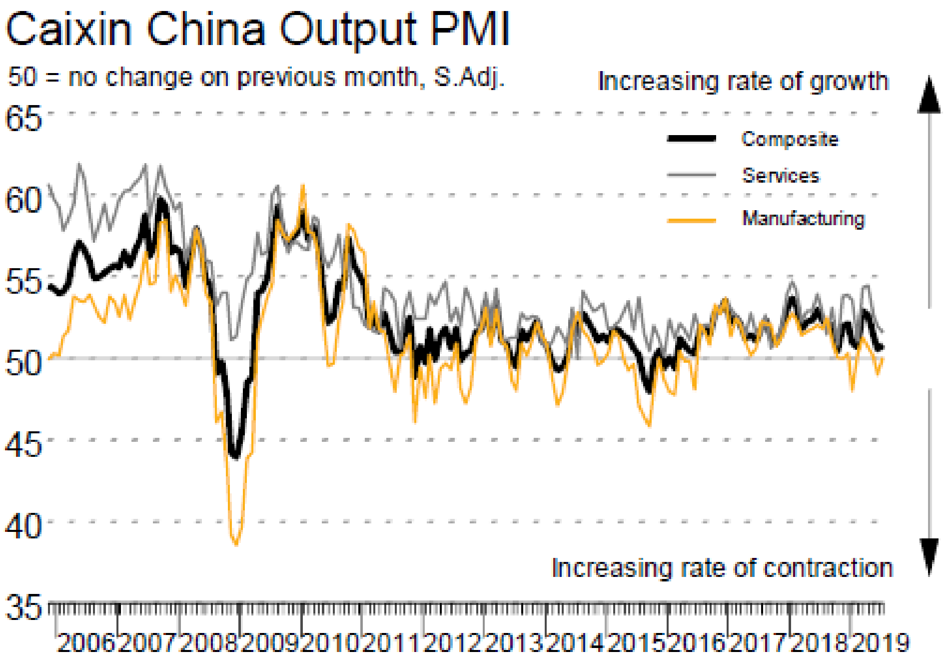
Sentiment was improved – based on some improvement in conditions. Concern regarding trade negotiations with the US continued to weigh.

https://www.markiteconomics.com/Public/Home/PressRelease/c777ba6bdb9249529adea78034658761

Services PMI (Jul)

The headline services index increased at a slower pace in Jul.

Services Activity Index; Jul 51.6 versus Jun 52



Sources: IHS Markit, Caixin.

New orders continued to increase albeit at a slower pace. There was a 'solid rebound' in new export orders from abroad.

Employment growth remained marginal – emphasis added;

> Meanwhile, job creation at services companies remained marginal in July, as **softer business activity growth and efforts to contain costs** weighed on hiring decisions.

Output prices increased only marginally with firms citing increased competitive pressures had 'restricted pricing power'. Output prices declined at the composite level.

The level of optimism remained unchanged from Jun.

https://www.markiteconomics.com/Public/Home/PressRelease/28a5e6c5a60d4b369793a4a9c3d10dac

CPI and PPI (Jul)

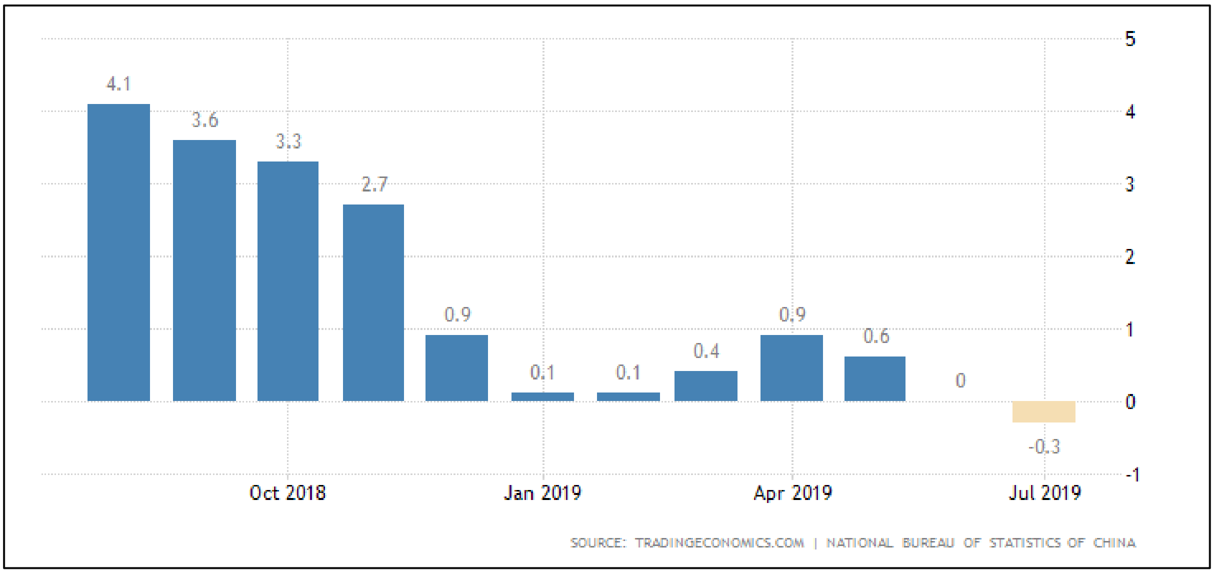
Data not yet updated on the NBS website for Jul.

Headline PPI – annual change; Jul -0.3% versus Jun 0%

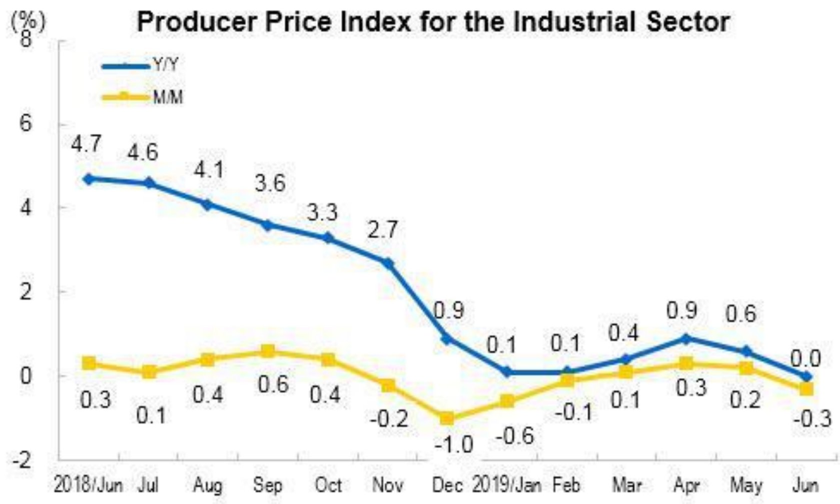
The trend of slower growth in producer selling prices continued this month with the annual PPI declining in Jul.

On a month basis, the PPI declined by -0.2% in Jul versus -0.3% decline in Jun.

Chart; China PPI Annual % Chg – to Jul 2019



The chart below is the JUNE trend of PPI – the China NBS has yet to update with the latest data for Jul. But the trend, especially for the annual growth in producer prices for the manufactured goods sector has been clearly slowing over the last year – and likely impacting profitability now that prices are falling at an annual pace as of Jul;



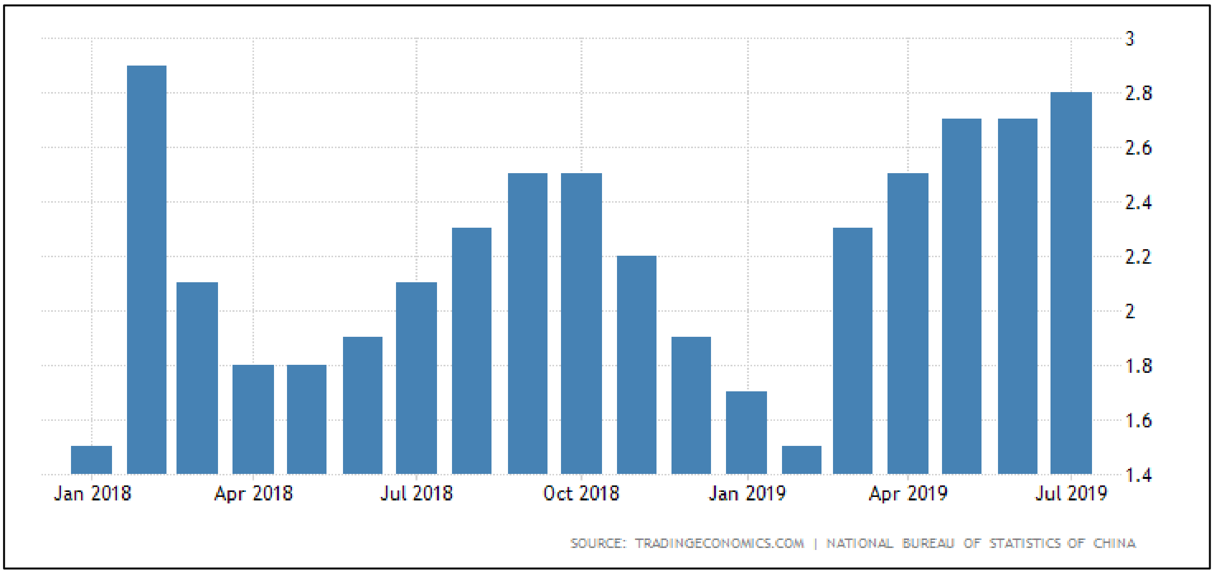
https://tradingeconomics.com/china/producer-prices-change

http://www.stats.gov.cn/english/PressRelease/201907/t20190710_1675305.html

Headline CPI – annual change; Jul +2.8% versus Jun +2.7%

The annual growth in consumer prices continued to accelerate, led by an acceleration in food prices due to pork prices.

Chart; China CPI Annual % Chg



https://tradingeconomics.com/china/inflation-cpi

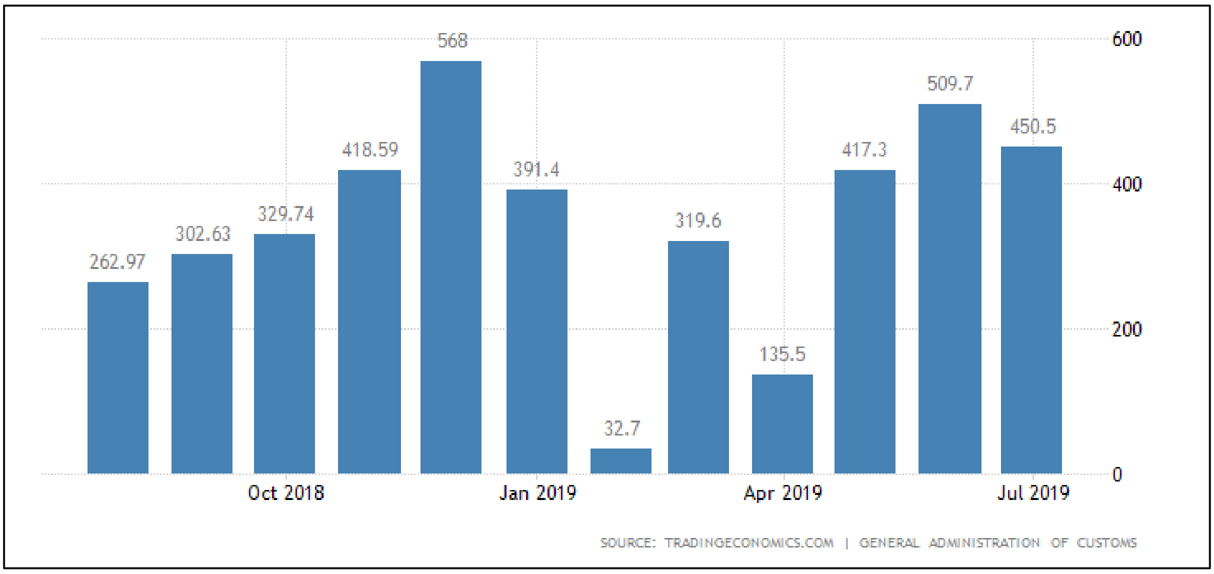
Trade/Exports/Imports (Jul)

China's trade balance dipped slightly compared to the month prior but remained well above a year ago.

With the next round of tariffs to be applied from 1 Sep, the next round of trade data may reflect higher growth in exports from China to front load any increase in price. This will also depend on what impact the weaker CNY will have on production costs and export/import prices.

Trade balance USD; Jul 45bn (versus $26bn Jul 2018 a year ago)

Chart: China Trade Balance USD's



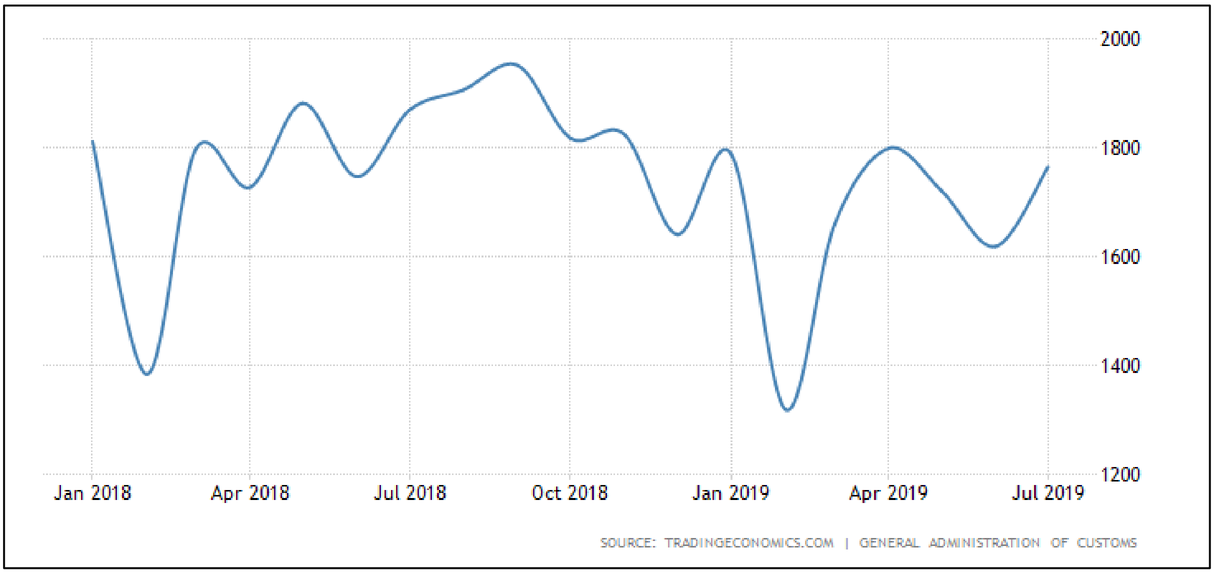
This continued growth in the trade surplus comes from moderate growth in exports but mostly from declining imports/relatively lower import growth.

Exports increased by +3.3% versus a year ago in Jul

Chart; China's Exports USD

Imports declined by -5.6% versus a year ago in Jul

Chart; China's Imports USD



https://tradingeconomics.com/china/balance-of-trade

https://tradingeconomics.com/china/exports https://tradingeconomics.com/china/imports

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Trade

US-China Trade Negotiations

After the weakening of the CNY last week, breaking 7.00 USD/CNY, the US officially labelled China a 'currency manipulator'.

China denied that it was using the currency to respond to the tariffs. A press release from the Chinese State Administration of Foreign Exchange (SAFE);

> Reporter: Why is the RMB exchange rate " breaking 7" ?
>
> A: Affected by unilateralism and trade protectionism measures and the imposition of tariff increases on China, the RMB has depreciated against the US dollar today, breaking through 7 yuan, but the renminbi continues to be stable and strong against a basket of currencies. This is the market. Supply and demand and the reflection of fluctuations in the international currency market. http://www.safe.gov.cn/safe/2019/0805/13792.html

There were also reports that Chinese state buyers were asked to halt US agricultural imports.

Last week, the US announced a new round of tariffs on imports from China. The new tariffs will come into effect on 1 Sep; 10% on $300bn (the value of the remaining imports from China).

Despite the announcement of the new round of tariffs, China has committed to further talks in Washington in Sep. Source: https://www.scmp.com/news/china/diplomacy/article/3021316/chinese-state-media-questions-whether-us-trade-talks-should

We previously noted that the progress of talks likely hinges on whether the US and China can move forward on the Huawei/agriculture compromise. https://www.reuters.com/article/us-huawei-tech-usa-blacklist-exclusive/exclusive-u-s-firms-may-get-nod-to-restart-huawei-sales-in-2-4-weeks-official-idUSKCN1U90ON

The lack of progress on agriculture purchases remained an issue for the US. Notes from the prior week suggest that China was not likely to move too much on the issue either;

> "The new purchase of American farm products has shown that China is honouring its commitment and also a response to the recent signals of goodwill by the US side," the Xinhua commentary said.
>
> But it also said China had diversified its imports to include agricultural products from countries such as Brazil and Australia, and to uphold the spirit of self-reliance and ensure a firm grip of its own "rice bowl", meaning it would rely on domestic output for its food supply.
>
> "No matter how much uncertainty lies ahead of us, China will continue its own path, do its own thing and to strengthen its ability in handling risks and challenges." https://www.scmp.com/news/china/diplomacy/article/3019558/china-us-trade-talks-could-resume-soon-washingtons-tariffs

The threat of talks stalling is likely still high – nothing has really changed;

> "There have been no signs either side is willing to back down from their red lines, which begs the question: if one side must back down, which will it be? Surely, whether a deal can be made will depend on how much Beijing agrees to Washington's terms, rather than vice versa. Trump has repeated often that China should be ready to strike a deal or tariffs will rise "very, very substantially"." https://www.scmp.com/week-asia/opinion/article/3017495/us-china-trade-war-ignore-hype-trump-and-xi-are-no-closer-deal

> "China and the United States remain divided over which negotiating text to base their revived trade talks on, with Washington demanding a longer document be used that lists earlier promises made by Beijing, according to observers." https://www.scmp.com/news/china/diplomacy/article/3019373/china-us-said-be-wrangling-over-text-trade-talks-can-resume

The issue of intellectual property remains a key obstacle to the deal;

> "Indeed, China's Vice Premier Liu He has only reiterated Beijing's position that a deal must be balanced and "expressed in terms that are acceptable to the Chinese people and do not undermine the sovereignty and dignity of the country." https://www.cnbc.com/2019/06/29/g20-summit-trump-and-xi-agree-to-talks-but-offer-no-clear-path-to-end-the-trade-war.html

Reconfirming what a 'win' in the negotiations with China looks like – a statement of the key negotiating 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

US-Japan Trade Talks

Working-level talks will be held next week (Tue/Wed) in Washington. This is in preparation for the next round of ministerial-level negotiations later in Aug.

As previously, noted, the US and Japan will target Sep to agree a 'broad trade deal'.

> "…both sides hope to have a broad trade deal in place by the time Japanese Prime Minister Shinzo Abe meets U.S. President Donald Trump on the sidelines of United Nations' general assembly scheduled for later in September in New York." https://www.reuters.com/article/us-usa-japan-trade/japan-us-target-broad-bilateral-trade-deal-by-september-nikkei-idUSKCN1UU01X

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

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 US-Europe trade talks; the outstanding dispute and pending WTO decision on airline subsidies, the main trade negotiation and the special trade channel (Instex) set up to bypass the US sanctions on Iran to enable trade between Europe and Iran.

Last week, the US and the EU announced a 'breakthrough' agreement on US beefs exports to the EU – nearly tripling annual duty-free exports of beef to the EU. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/august/united-states-and-european-union

Airline Subsidies

It is now expected that the WTO will rule in favour of the US over illegal European subsidies to Airbus. The EU also has a similar case pending related to Boeing. Both sides have already identified potential areas for further sanctions if matters escalate and the US has already instigated a second process to identify further targets for tariffs.

> "An arbitrator for the WTO is expected to decide in September what level of sanctions Washington can impose after winning a case before the WTO about European subsidies to Airbus, with the EU likely to get a decision in its favor several months later." https://www.reuters.com/article/us-usa-trade-eu/eu-redoubles-threat-to-retaliate-if-u-s-raises-auto-tariffs-idUSKCN1UH1N5?il=0

> In addition to helicopters and aircraft parts, the U.S. tariffs may also be aimed at goods such as cheese, olives and pasta, along with some types of whiskey in **what the officials see as an effort to gain concessions from EU members to the American agricultural sector.** bloomberg.com/news/articles/2019-07-15/europe-braces-for-7-billion-u-s-tariff-hit-over-airbus-dispute

The USTR has commenced another review; "Additional Products for Tariff Countermeasures in Response to Harm Caused by EU Aircraft Subsidies" (1 Jul 2019) https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/july/ustr-proposes-additional-products#

The US is considering more products for tariffs thereby reinstating the threat of tariffs in the EU.

Among other things, this announcement builds on the current 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."

[As outlined previously…key dates for that 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]

According to the Federal Register announcement during the week;

> "A number of public comments submitted in response to the April 12 notice requested that the U.S. Trade Representative consider additional products that were not included in the April 12 list for possible inclusion on the final list of products to be subject to additional duties."
> https://ustr.gov/sites/default/files/enforcement/301Investigations/Notice_for_Additional_Products.pdf

The dates for this latest review;

July 24, 2019: Due date for submission of requests to appear at the public hearing and summary of testimony.

August 5, 2019: Due date for submission of written comments.

August 5, 2019: The Section 301 Committee will convene a public hearing in the Main Hearing Room of the U.S. International Trade Commission. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/august/public-hearing-additional-products

August 12, 2019: Due date for submission of post-hearing rebuttal comments.

Also, from the USTR announcement this week, if there is a decision on the case before the end of the public comment phase, then additional duties could be imposed before that process is complete;

> "In the event the Arbitrator issues its decision prior to completion of the public comment process on the supplemental list, the USTR may immediately impose increased duties on the products included in the initial list, and take further possible actions with respect to products on the supplemental list."

Also hanging over the negotiations are the US threats of tariffs on auto imports from Europe.

Trade Negotiations

One of the main issues standing in the way of a trade deal is that agriculture has been exempt from the negotiations by the EU.

The key sticking point remains agriculture. The EC authorised negotiations to commence between the EU and the US – but excluding agriculture. 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

> ""I do not think we will reach an agreement if agriculture is not included," McKinney told reporters on a teleconference during his visit to Brussels, citing concerns raised by U.S. lawmakers and Trump." https://www.reuters.com/article/us-usa-trade-eu/no-u-s-eu-trade-deal-without-agriculture-u-s-official-idUSKCN1TS2SH

Instex

The EU confirmed that Britain, France and Germany had established a special trade channel (Instex) that would enable trade with Iran that circumvents the US sanctions. It was announced last year that the EU would work on developing the channel. https://www.reuters.com/article/us-iran-nuclear-talks-statement/europe-says-iran-trade-channel-operational-statement-idUSKCN1TT2RL

President Trump made some mention of this development at the G-20;

> "President Donald Trump said there was "absolutely no time pressure" in dealing with Iran as European nations pushed to salvage what remains of the 2015 nuclear accord and avert a slide toward war." https://finance.yahoo.com/news/trump-chats-putin-shakes-hands-081017994.html

The Instex system enables trade with Iran without the use of U.S. dollars or US banks. The US has previously stated opposition to this;

> "According to Bloomberg, the Treasury Department's undersecretary for terrorism and financial intelligence, Sigal Mandelker, sent a letter on May 7 warning that Instex, the European SPV to sustain trade with Tehran, and anyone associated with it could be barred from the U.S. financial system if it goes into effect."

> "Separately, during a visit to London on May 8, Mike Pompeo also warned that there was no need for Instex because the U.S. allows for humanitarian and medical products to get into Iran without sanction."

> ""When transactions move beyond that, it doesn't matter what vehicle's out there, if the transaction is sanctionable, we will evaluate it, review it, and if appropriate, levy sanctions against those that were involved in that transaction," Pompeo said. "It's very straightforward.""

Digital Services

Undeterred by the USTR investigation into the digital services tax to be approved by the Govt of France, the EU has opened its own investigation into possible anti-competitive conduct of Amazon;

“The European Commission has opened a formal antitrust investigation to assess whether Amazon's use of sensitive data from independent retailers who sell on its marketplace is in breach of EU competition rules.” https://ec.europa.eu/commission/presscorner/detail/en/ip_19_4291

Last week the USTR opened a S.301 investigation into the digital services tax approved by the French government;

“The services covered are ones where U.S. firms are global leaders. The structure of the proposed new tax as well as statements by officials suggest that France is unfairly targeting the tax at certain U.S.-based technology companies.” https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/july/ustr-announces-initiation-section-301

On Wednesday trade representative Robert Lighthizer said an investigation would "determine whether it is discriminatory or unreasonable and burdens or restricts United States commerce". https://www.bbc.com/news/world-europe-48947922

Background

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

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

NAFTA/USMCA

The Democrats continue to work with USTR Lighthizer on changes required to the USMCA before the deal can go to Congress for approval. Lawmakers have indicated that they will continue to work on the revisions throughout the recess in August.

> Republican President Donald Trump views ratification of the trade deal as a top priority, but Democrats say they will not move forward until their concerns over labor, environmental issues and access to medicine have been addressed.
>
> Officials on both sides now say the deal could move forward in September after lawmakers return from the August recess. https://www.reuters.com/article/us-usa-trade-usmca/democrat-calls-for-good-faith-talks-with-ustr-on-trade-deal-idUSKCN1UL2A3

Once the US approves/ratifies the USMCA, Canada will take steps to approve the USMCA in parliament.

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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

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

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