Weekly Macro Review

w/c 21 October 2019

MARS CAPITAL PARTNERS

Key Themes

The prelim PMI's this week indicated that private sector activity was weaker, or little changed at lower levels in Oct.

In the US, the advance durable goods report provided more insight behind the weaker US manufacturing activity in Sep and Oct.

Recap of recent US manufacturing data; Sep ISM PMI fell further into contraction (across a broader range of industries) while the Sep Markit PMI was mostly stable after slowing markedly in Aug. Industrial production for manufacturing was weaker in Sep – with the GM strike affecting auto production – but that was not the only driver of the weaker durable goods result.

The Sep advance durable goods orders reflected this weakness in autos but also highlighted further weaker manufacturing results for non-defense aircraft. At the total durable goods level, the monthly decline in new orders and shipments, together with no change in order backlogs, made the inventory growth a standout in both the month and on an annual basis. This was led by non-defense aircraft and motor vehicles.

The US Oct prelim PMI indicated some small rebound in growth for manufacturing. Manufacturing recorded a small increase in the pace of growth, but growth remained moderate. That said demand, output and employment increased at a faster pace. There was also some improvement in the outlook. The services view of the PMI indicated that activity was little changed, but the sub-indices indicated weakening demand and declining employment.

The PMI's were little changed for Germany and across the Eurozone. The composite PMI for Germany indicated continued contraction in manufacturing activity which offset the slightly slower growth in services. Across both reports – demand was weaker and order backlogs continued to decline. Sentiment shifted increasingly negative for the outlook. The German PPI, excluding energy prices, continued to slow, indicating that selling price growth remains under pressure. The recent peak in the PPI ex energy was in early 2017 at around 3% - and this has slowed consistently to +0.5% growth in producer selling prices as of Sep.

The broader Eurozone PMI was little changed at the composite level, with the index slowing to virtually no growth in Oct compared to Sep. While there was a slight improvement in the headline services activity index, growth in demand and employment slowed. Manufacturing broadly across the Eurozone remained in contraction, at the same level as the month prior. There was a faster decline in new manufacturing orders and employment declined – "with the steepest job cuts since Jan 2013".

The ECB kept rates on hold. The outgoing President of the ECB, Mario Draghi, noted that since the last meeting, data had confirmed that the euro area growth remains in a period of protracted weakness. No further change was made to policy settings with several of the measures announced last month yet to be implemented. Outgoing President Draghi called on euro area countries to implement structural changes and fiscal response where possible.

The composite PMI for Japan slipped into contraction for the month. This was partly due to the implementation of the consumption tax increase as well as the major typhoon – but manufacturing firms cited weaker demand conditions generally. The manufacturing outlook shifted from net positive to net negative. Services activity slowed to zero growth.

The prelim Aus PMI indicated that growth of manufacturing and services activity slowed in Oct. Demand was weaker across both services and manufacturing with new manufacturing orders declining for the first time in the series history.

Contents

US Data

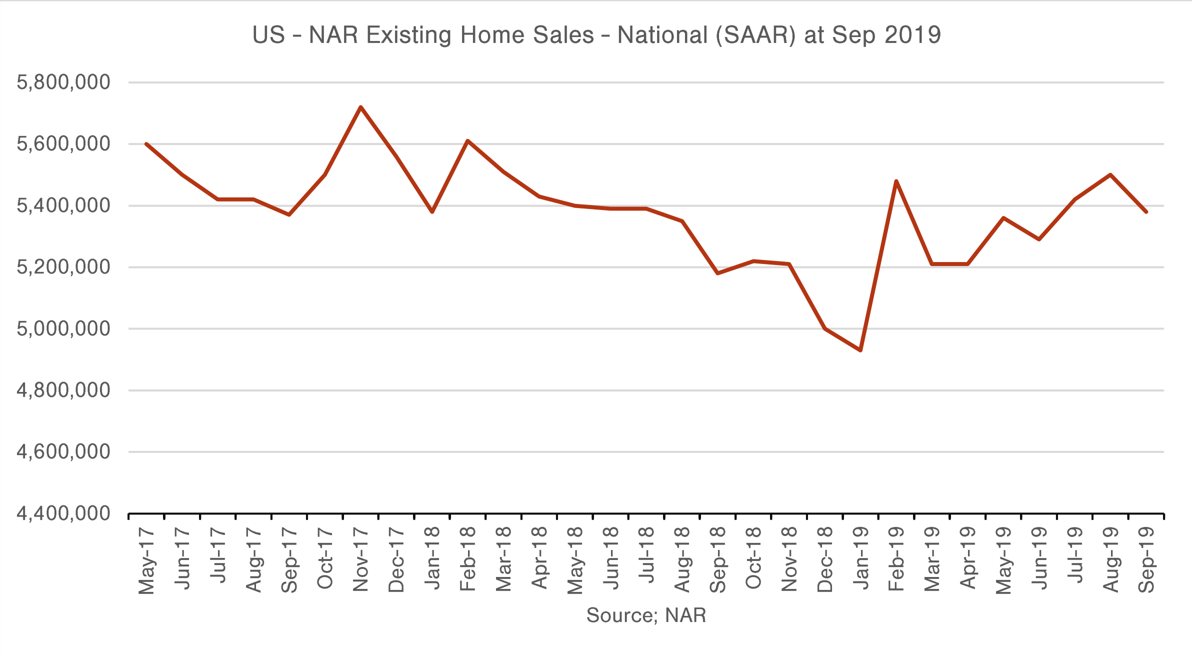
Existing Home Sales (Sep)

Existing home sales declined in Sep – the first monthly decline since Jun. Existing home sales declined across all regions with the larger declines recorded in the Northeast and Midwest.

The seas adj annual pace remains 4% above the same time a year ago.

Existing Home Sales – month change (SAAR); Sep 5.38m versus Aug 5.5m

This was a 2.2% decline versus the month prior and represented only a -0.7 SD decline.



The annual pace of growth in existing home sales is +3.9%

On a regional basis, sales in all markets declined in the month.

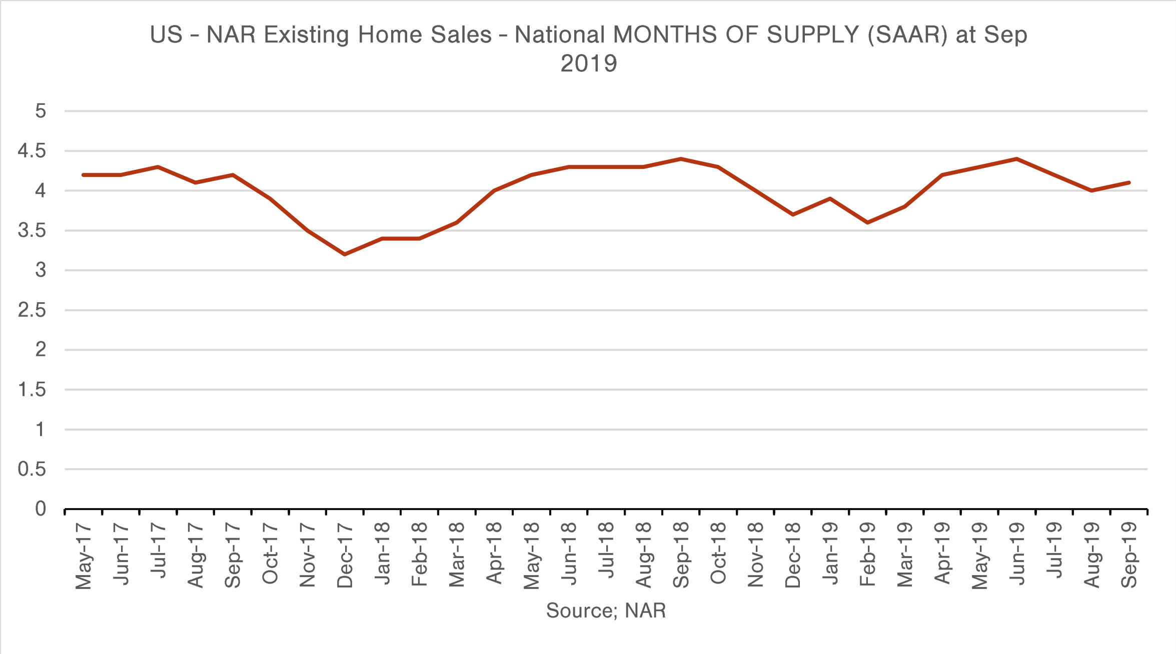
Midwest; sales declined by 3.1% in the month, which was a 0.94 SD decline. Sales are flat to last year.

Northeast; sales declined by 2.8% in the month, which was a 1.14 SD decline (the largest of all markets). Sales remain 1.5% ahead of last year.

South; sales declined by 2.1% in the month, which was a 0.6 SD decline. Sales remain 6% ahead of last year.

West; sales declined by 0.9% in the month, which was a 0.15 SD decline. Sales remain 5.6% ahead of last year.

The month supply increased slightly to 4.1 in Sep from 4 in Aug.



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

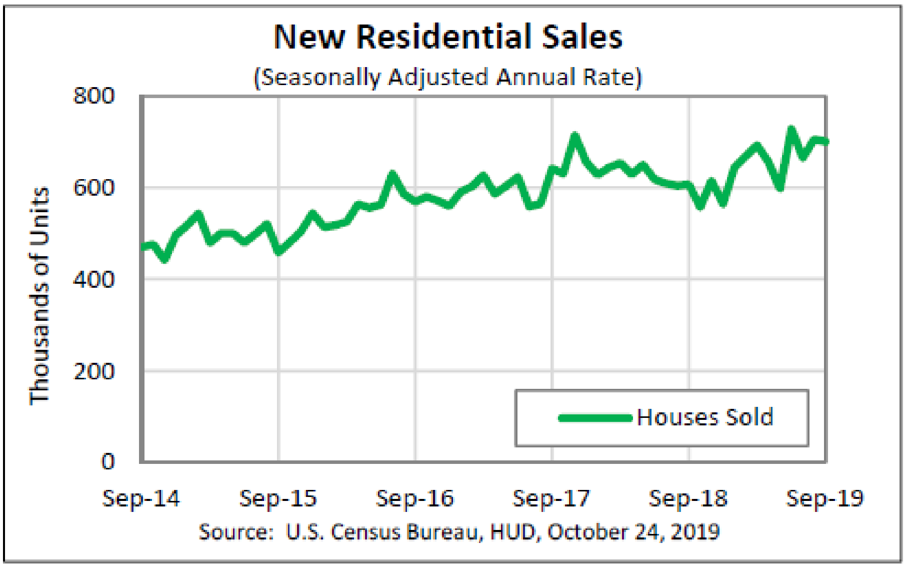
New Home Sales (Sep)

New home sales recorded a slight fall in the seasonally adjusted annual rate in Sep. The 90% confidence interval for the 0.7% decline includes zero though, so it is uncertain whether there was an increase or a decrease in the SAAR in Sep.

National – New Home Units Sold (SAAR); Sep 701k versus Aug 706k

The increased month to month was +0.7% with a 90% confidence interval of +/- 16.1%. As this interval around the -0.7% includes zero, it is uncertain whether the pace of new home sales increased or decreased. This is also evident in the annual rate of growth and in the monthly changes across the regions.

It takes approx. four months of the sampling data to establish a trend. So far that means that there has been a lift in the pace of sales over the first half of 2019, especially compared to the slower pace throughout late 2017 and 2018;

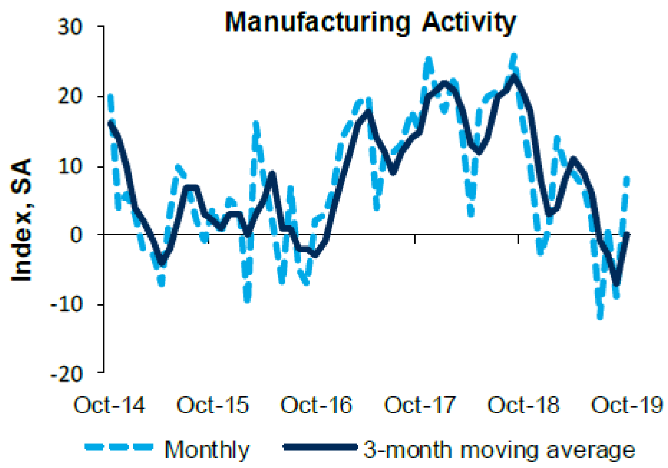


https://www.census.gov/construction/nrs/pdf/newressales.pdf

Richmond Fed Manufacturing Index (Oct)

The headline index of manufacturing conditions shifted from contraction to expansion in the latest month. This was led by a recovery in shipments, new orders, order backlogs, number of employees and the average workweek.

Headline Manufacturing Index; Oct 8 versus Sep -9

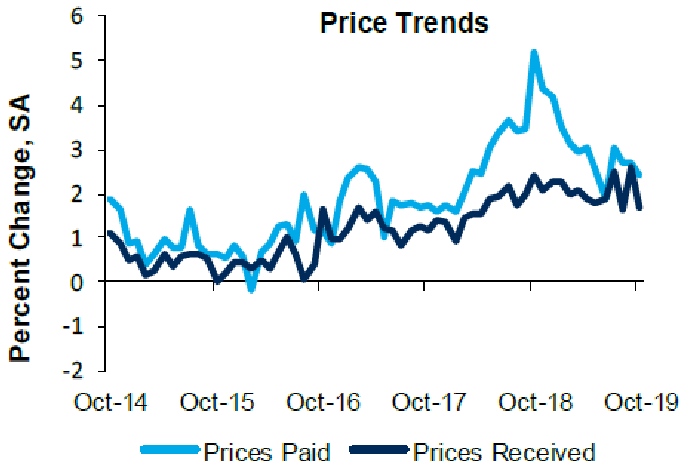


Shipments, the volume of new orders and order backlogs shifted from contraction in the month prior to expansion in the latest month.

Finished goods and raw materials inventories grew at a slower pace.

Employment indictors were mostly stronger. The number of employees increased at a faster pace, but wages grew at a slower pace. The average workweek also shifted from contraction to expansion in the latest month.

Despite the stronger demand indicators, pieces received declined versus the month prior. Prices paid continues to drift lower;

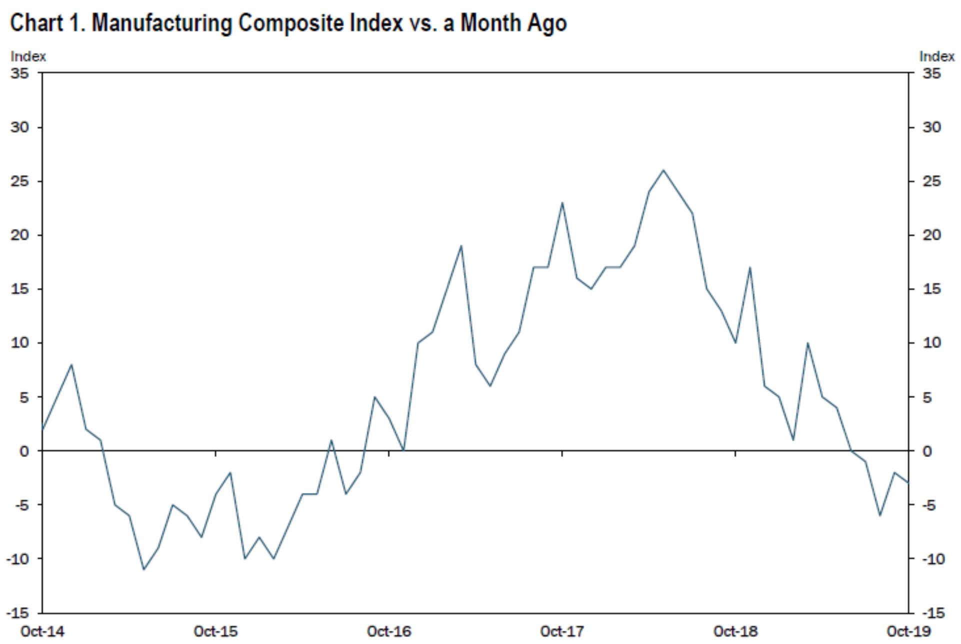


https://www.richmondfed.org/-/media/richmondfedorg/research/regional_economy/surveys_of_business_conditions/manufacturing/2019/pdf/mfg_10_22_19.pdf

Kansas City Fed Manufacturing Index (Oct)

The headline composite index declined at a slightly faster pace again in Oct- the level of decline remains moderate. The further weakening in conditions was led by a faster decline in new orders and a slow-down in shipment and production growth.

Headline Composite Manufacturing Index; Oct -3 versus Sep -2



Production growth slowed, but remained positive. While the volume of shipments slowed to no growth. Demand weakened further as the volume of new orders declined at a faster pace. New export orders also declined at a faster pace in Oct.

Firms continued to support production and shipments by a further decline in order backlogs.

Firms continued to reduce the number of employees (albeit at a slower pace) and the average workweek grew at a slower pace.

Prices received for finished goods increased at a slightly faster pace while input prices declined.

Inventories of materials declined, and inventories of finished goods were unchanged.

One of the weaker parts of the survey this month was the expected manufacturing conditions in six-months-time

https://www.kansascityfed.org/~/media/files/publicat/research/indicatorsdata/mfg/2019/2019oct24.pdf?la=en

Advance Durable Goods Orders (Sep)

The advance durable goods report for Sep provided some insight into the underlying weaker manufacturing conditions reported in Sep.

Manufacturing recap; In Sep the ISM manufacturing PMI fell further into contraction (headline PMI of 47). The Markit PMI for manufacturing was slightly stronger in the month (headline 51.1), but growth remained more moderate. Several regional manufacturing surveys had also indicated weaker conditions.

With the monthly decline in new orders and shipments, together with no change in order backlogs, the acceleration in inventory growth was a standout both in the month and on an annual basis.

In this durable goods report, transport equipment – namely both motor vehicles and non-defense aircraft, remained a key weakness for orders, shipments, unfilled orders and inventory growth.

<u>NEW ORDERS</u>

<u>Total durable goods new orders - month change</u>; Sep -1.1% (-$2.9bn) versus Aug +0.3%

The decline in new orders for transport equipment was the single largest contributor to the overall decline at -$2.3bn. The decline in transport orders was spread across motor vehicles and parts and non-defense aircraft. Orders for defense aircraft and parts increased slightly +$0.3bn.

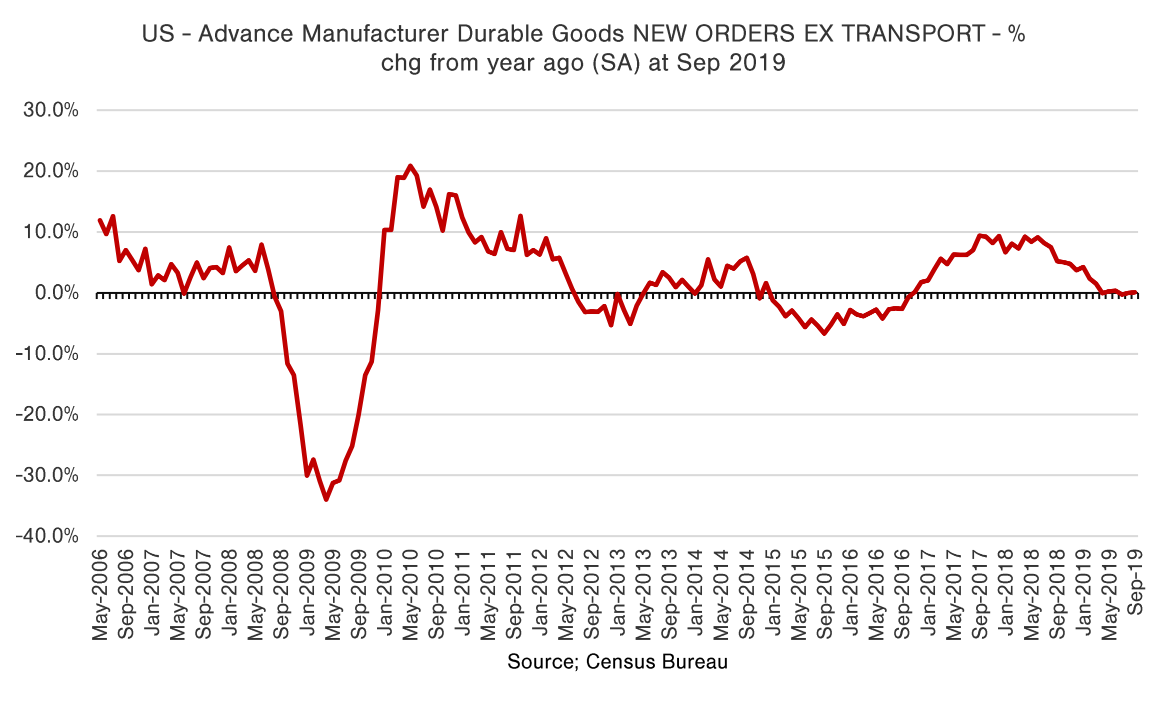
But even excluding transports, new orders growth deteriorated slightly in the month.

Total durable goods new orders ex transports – month change; Sep -0.3% (-$0.5bn) versus Aug +0.3%

The decline in 'core' orders was led by fabricated metals and computer/electronic products.

The annual growth in new orders has slowed further this month and is 5.4% below the same time a year ago. Again, transportation equipment is the main driver of this weakness – new orders for transport equipment is 14% below a year ago.

The annual change for new orders of durable goods ex transports is flat to a year ago;



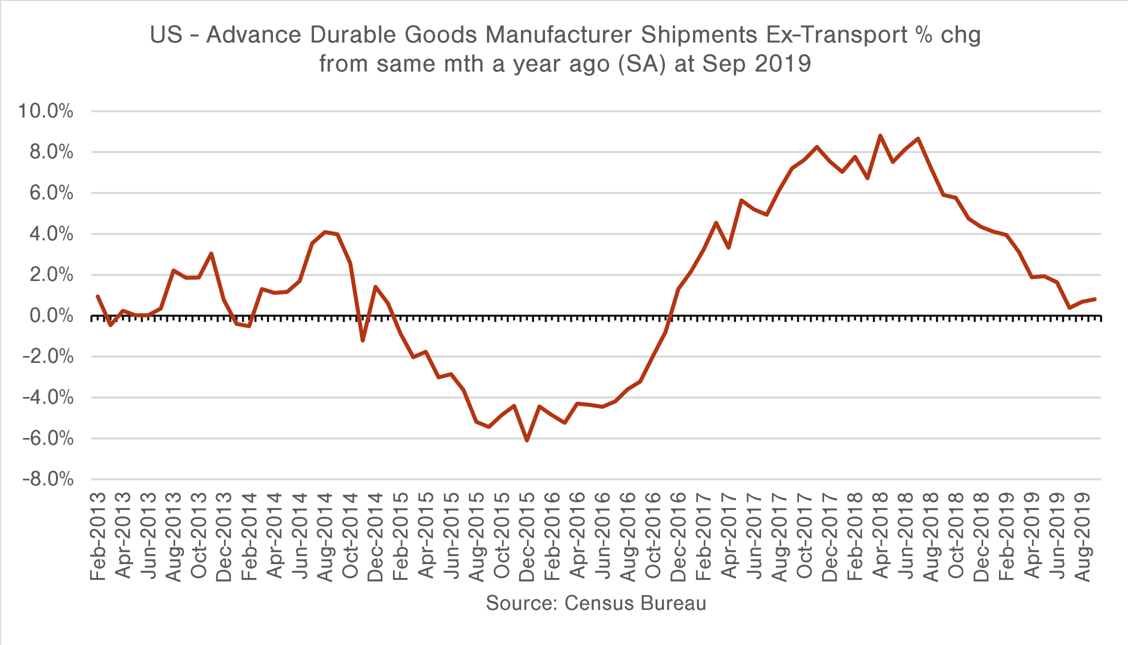
SHIPMENTS

Total durable goods shipments – month change; Sep -0.4% (-$1bn) versus Aug -0.1%

The weaker monthly shipment data continued this month. The faster decline in Sep was led by transport equipment (motor vehicles -$1bn), machinery and computer and electronic products. Excluding transport equipment, the declines in machinery and computer & electronic products were offset by increases in shipments across most other non-transport categories;

Durable goods shipments ex transports – month change; Sep 0% versus Aug +0.4%

On an annual basis, total shipments of durable goods are -1% below Sep a year ago. Excluding transports though, shipment growth lifted slightly; Sep +0.8% versus Aug +0.7%.



Shipments of transport equipment has continued to decline on an annual basis and is 4.4% below a year ago.

UNFILLED ORDERS

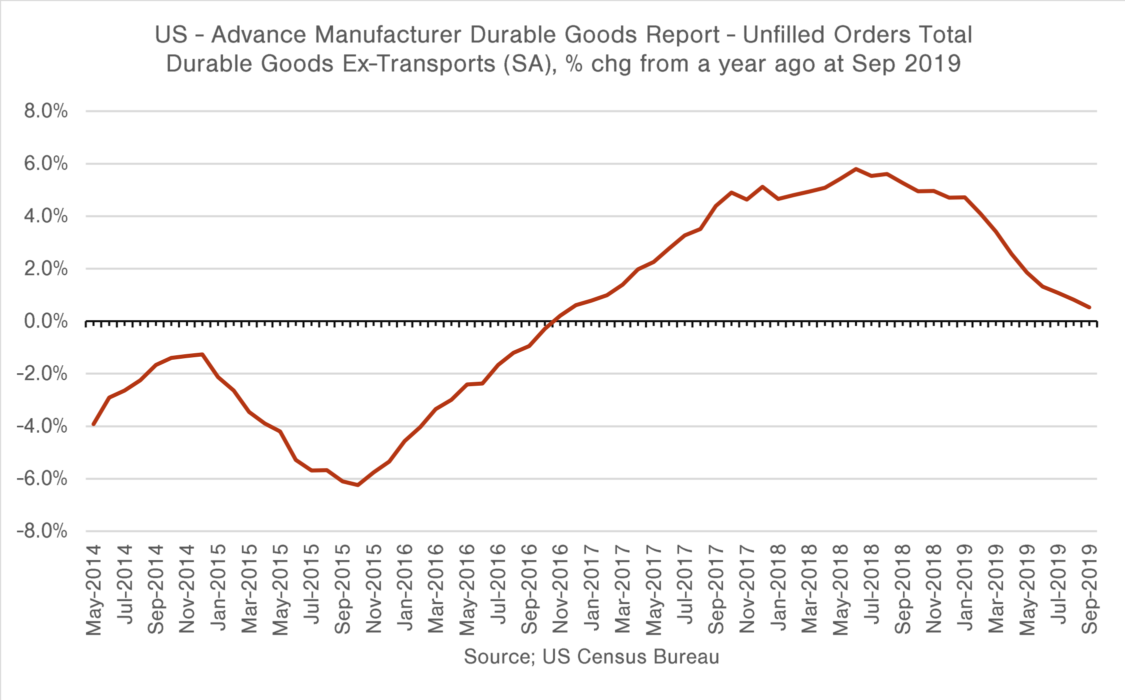
Total unfilled orders were unchanged in the month after increasing at a faster pace in the month prior;

Durable goods unfilled orders – month change; Sep 0% versus Aug +0.2%

Overall transport equipment unfilled orders were unchanged in Sep at 0%, but underlying that, unfilled orders declined across motor vehicles, and non-defense aircraft (as new orders slowed, firms were able to work through order backlogs, likely helping to support growth in shipments across both categories). This was offset by an increase in defense aircraft unfilled orders.

Excluding transportation, order backlogs were unchanged in the latest month; Sep 0% versus Aug -0.3%

On an annual basis, unfilled orders declined at a faster pace in Sep by 1.8%. Excluding transports, the growth in unfilled orders remains higher, but has also continued to slow;



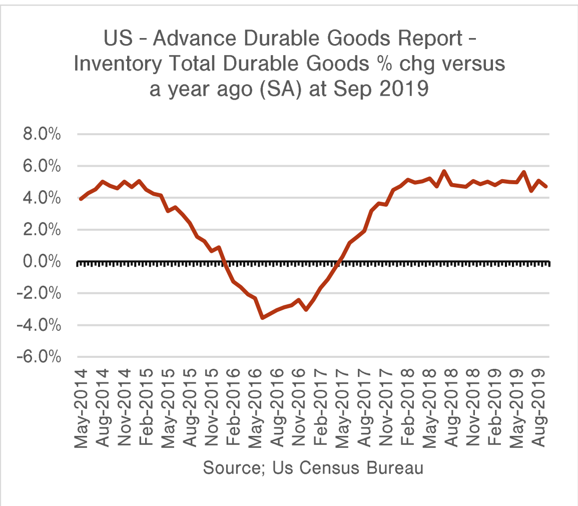
<u>INVENTORY</u>

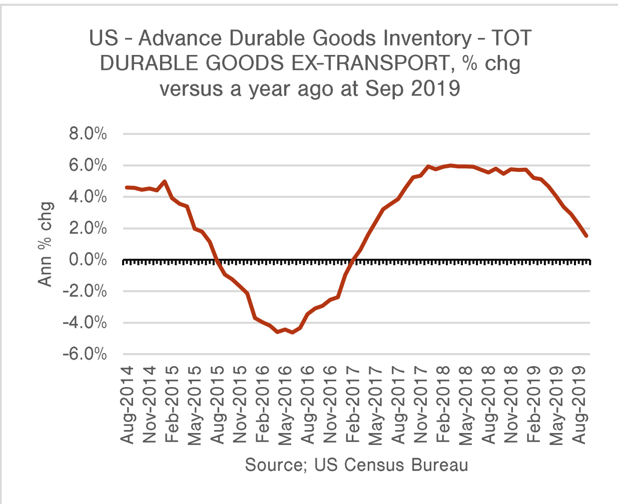
Inventory growth has come back to the forefront this month, especially for motor vehicles and non-defense aircraft and parts.

<u>Durable goods total inventory – month change</u>; Sep +0.5% (+$2.1bn) versus Aug +0.2%

Most of the increase was transport equipment. Motor vehicle inventory growth was constant at +0.4% and non-defense aircraft inventory increased at +2.1% (slightly slower than in Aug, but accounting for most of the value increase at +$2bn).

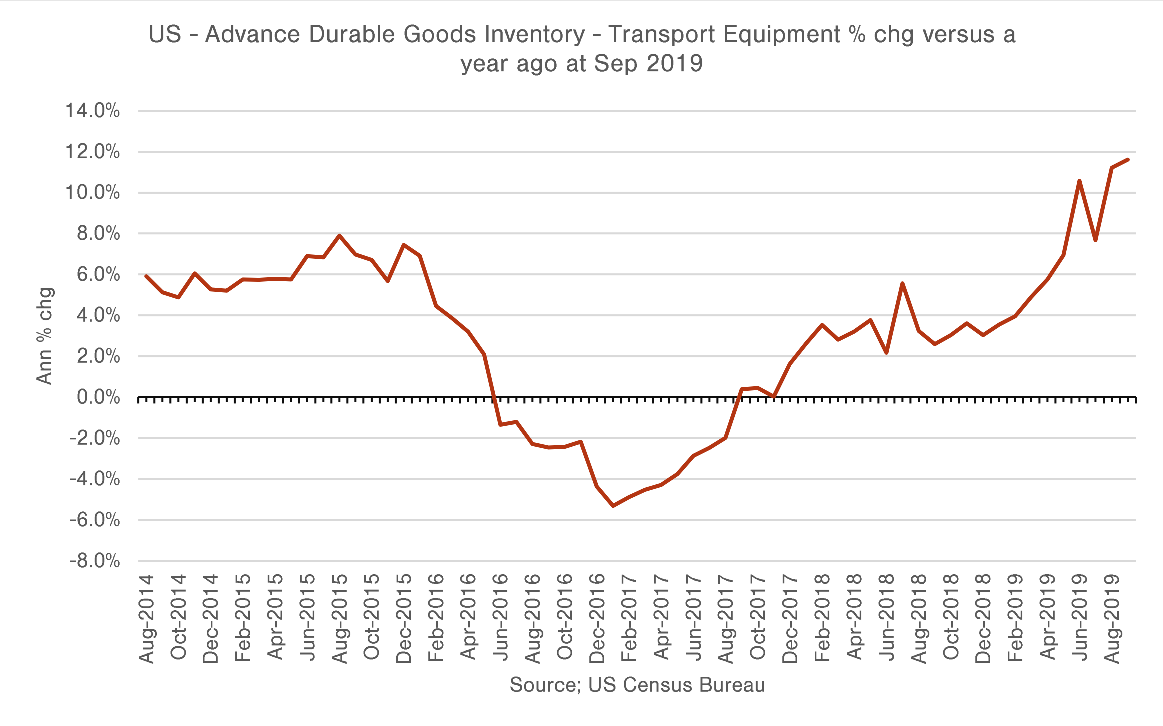
<u>On an annual basis, transport equipment is driving the increase in inventory growth.</u> The difference between total durable goods (incl transports) and durable goods excluding transports is obvious;





The growth of inventory ex transports has been slowing – and is now only +1.5% on an annual basis. This seems in line with the zero growth in new orders and the slowing growth of order backlogs now down to +0.5% on an annual basis.

On the other hand, transport equipment inventory growth is +11.6%.



Most of that inventory growth has been for non-defense aircraft and parts – with inventory growth accelerating to +16%. This seems at odds with the flat growth in unfilled orders (although the value of outstanding orders remains elevated), and the annual decline in new orders of 42% for non-defense aircraft.

Inventory growth for motor vehicles has also accelerated on an annual basis to +6.5%, still below recent peaks of inventory growth rates – but the value of inventory (not in real terms) remains at historically high levels. This is amid virtually no annual growth in new orders for vehicles and declining order backlogs of 3% below a year ago.

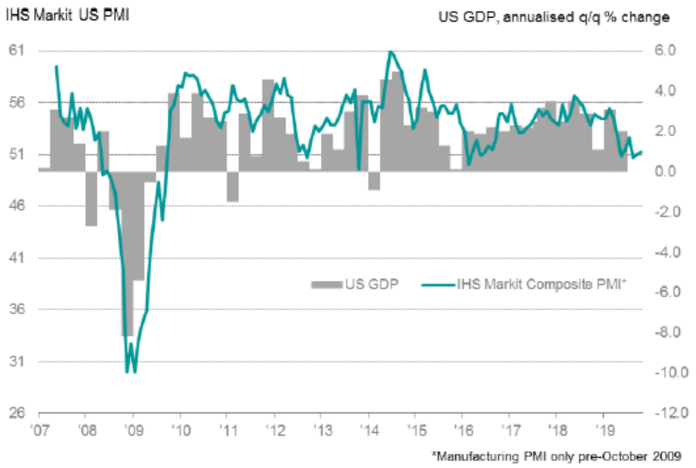
https://www.census.gov/manufacturing/m3/index.html

US Composite PMI - Prelim (Oct)

There was little change in the headline composite index of manufacturing and services activity in Oct. Both services and manufacturing activity increased at only a slightly faster pace compared to Sep. The underlying changes in services activity indicated slightly weaker demand, while manufacturing orders, output and employment increased at a faster pace.

Composite PMI – prelim; Oct 51.2 versus Sep 51

IHS Markit Composite PMI and U.S. GDP



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

Services Activity Index – Prelim; Oct 51 versus Sep 50.9

New business growth slowed to a near neutral level in Oct. Some firms cited subdued demand conditions and weaker investment spending.

Employed decreased for the second month in a row. Operating expenses increased at a faster pace in Oct – firms cited tariffs had led to price increases among suppliers.

Manufacturing PMI – Prelim; Oct 51.5 versus Sep 51.1

This small increased was the result of faster growth in new orders, output and employment. New export orders increased for the first time in four months. Inventory continued to decline but at a slower pace.

Output charges declined for the first time since Sep 2016 – as firms looked to discounting to increase sales.

Manufacturing confidence increased in Oct;

> A number of firms cited stronger order books and hopes of a recovery in global trade conditions. **Comments from manufacturers in the automotive sector were the main exception,** with respondents often noting concerns about the demand outlook in domestic and export markets.

https://www.markiteconomics.com/Public/Home/PressRelease/17224686923f4925928f9b4d5ba5c17b

Consumer Sentiment – Final (Oct)

There was little change in sentiment levels in the final data release for Oct, with measures continuing to rebound after the fall in Aug.

> The overall level of consumer confidence has remained quite favorable and largely unchanged during the past few years.

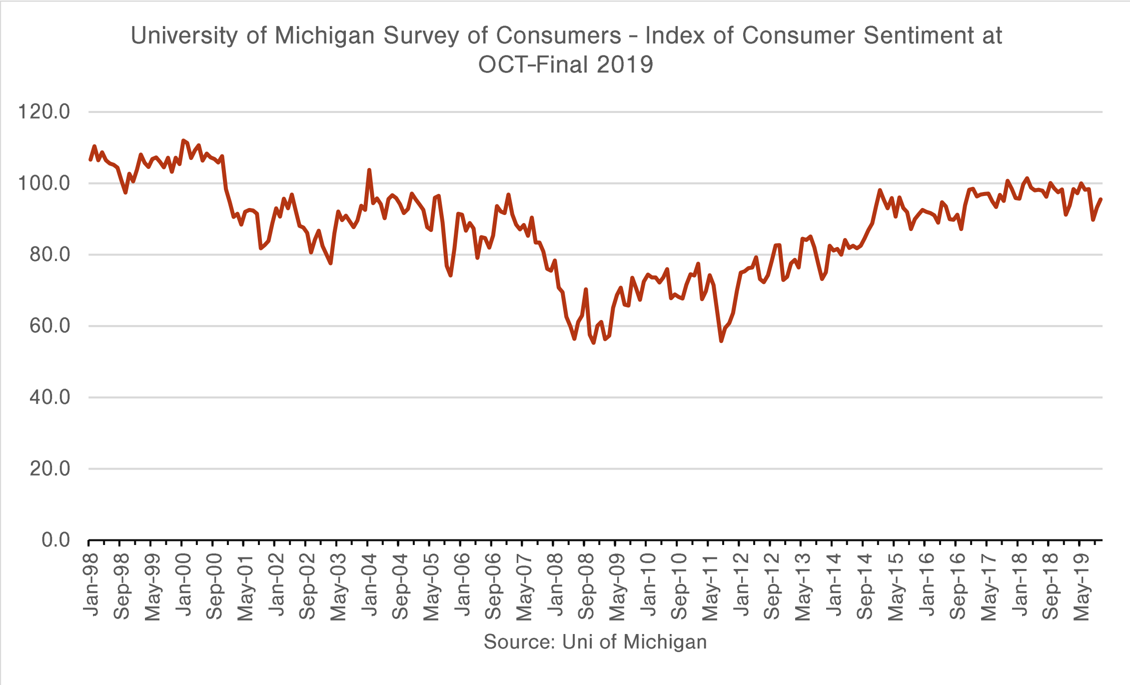
The focus of consumers has been on income and job growth, while largely ignoring other news.

The spontaneous references to negative news, especially tariffs, continue to abate; mentions of negative tariff impacts in Oct fell to 27% after reaching 36% in Sep, negative mentions of the impeachment inquiry totalled 2%, and under 5% mentioned negative news from the GM strike.

<u>Index of Consumer Sentiment</u>

Oct 95.5 (revised lower from 96) versus Sep 93.2

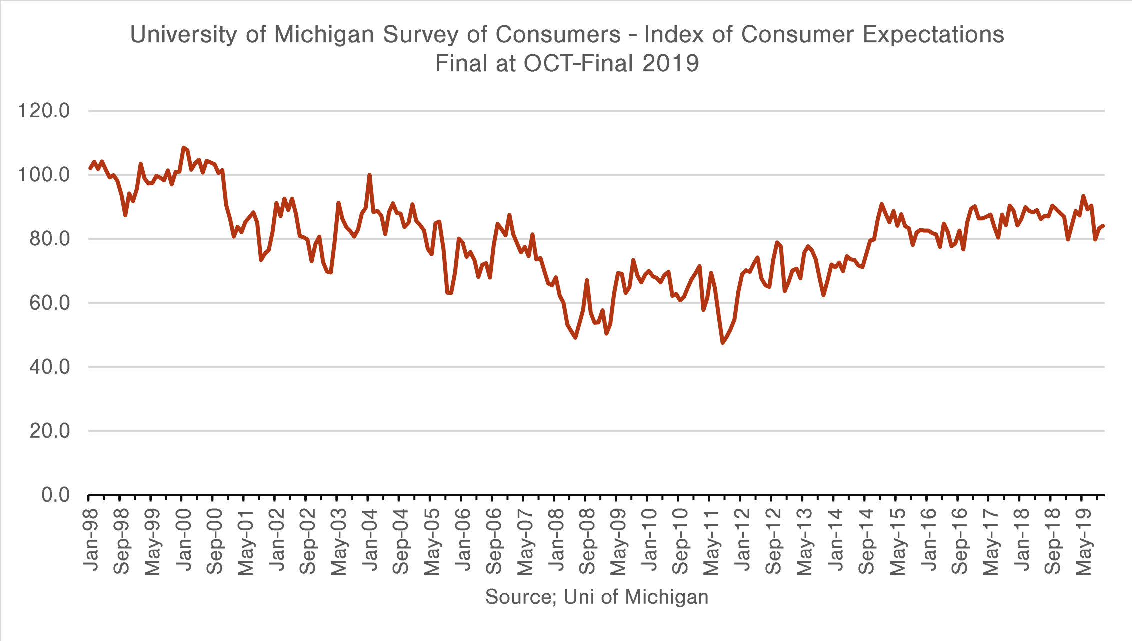
While not at its highest level, sentiment continues to rebound after falling in Aug. The index is 3% below the same month a year ago.



<u>Index of Consumer Expectations</u>

Oct 84.2 (revised lower from 84.8) versus Sep 83.4

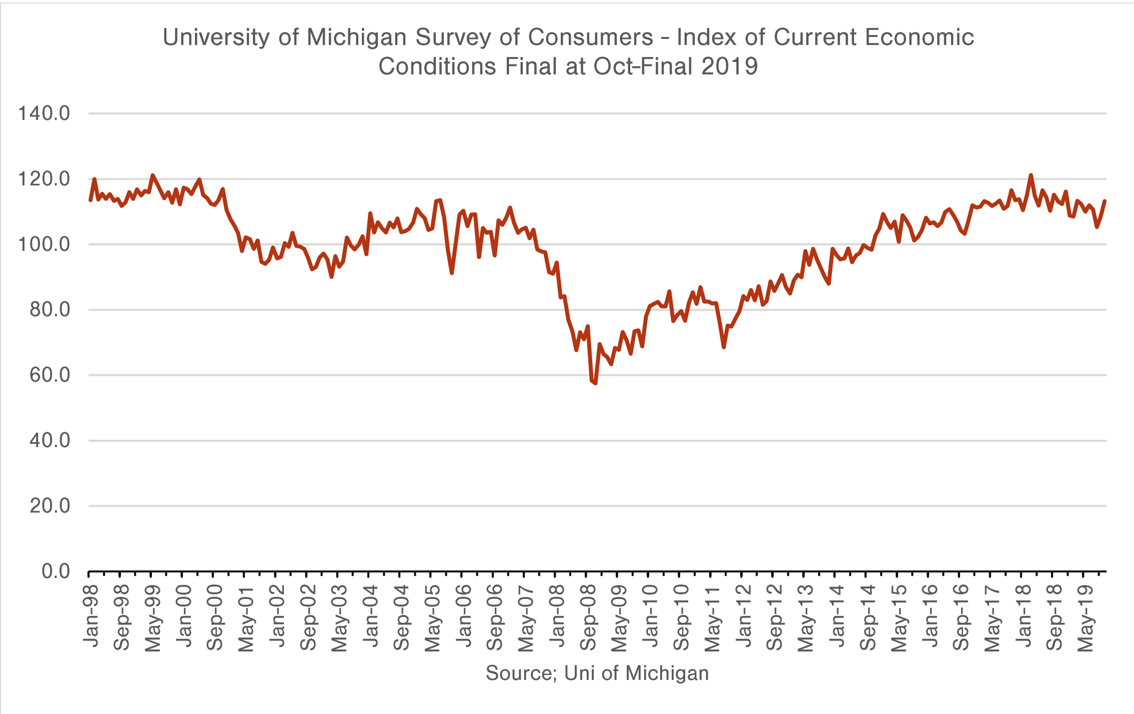
Consumer expectations fell much harder in Aug and the rebound has been more subdued so far. The index of consumer expectations is 6% below the same month a year ago.



<u>Index of Current Economic Conditions</u>

Oct 113.2 (revised slightly lower from 113.4) versus Sep 108.5

The index of current conditions had generally lagged sentiment and expectations. The index of current conditions peaked back in Mar 2018. Since the decline in Aug, the index of current economic conditions has rebounded to at least the highest level of 2019 so far. The index is now only 7% below the same month a year ago.



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

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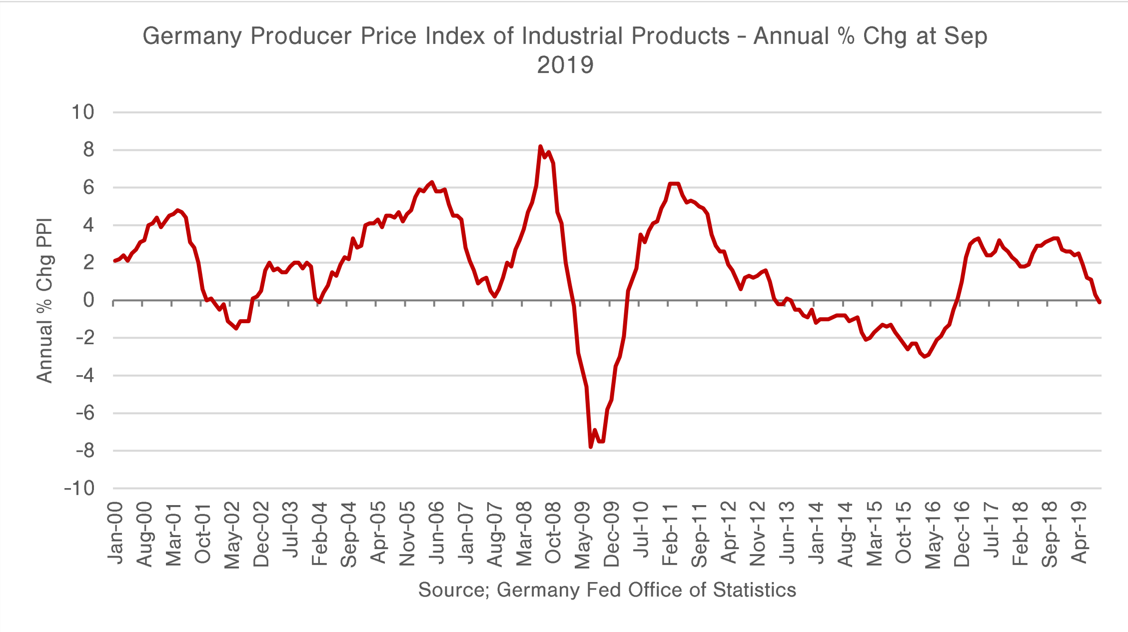
Europe

Germany PPI (Sep)

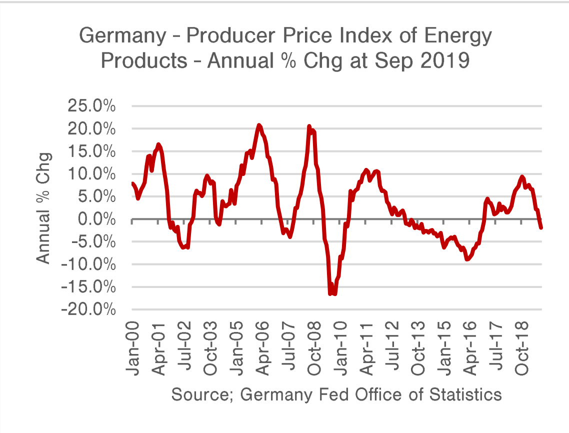
On an annual basis, producer prices declined by -0.1% at Sep. Excluding the decline in energy prices, the producer price index increased by +0.5% on an annual basis.

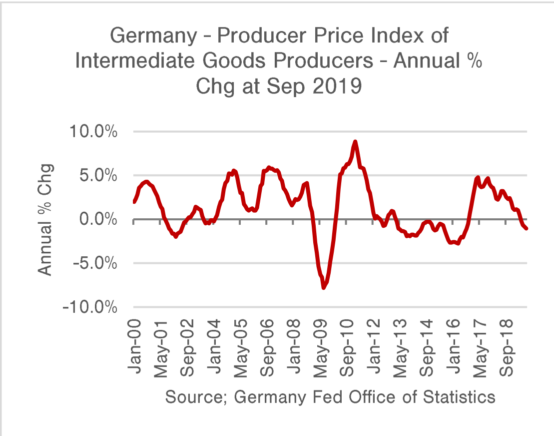
PPI – Month change; Sep +0.1% versus Aug -0.5%

PPI – annual change; Sep -0.1% versus Aug +0.3%

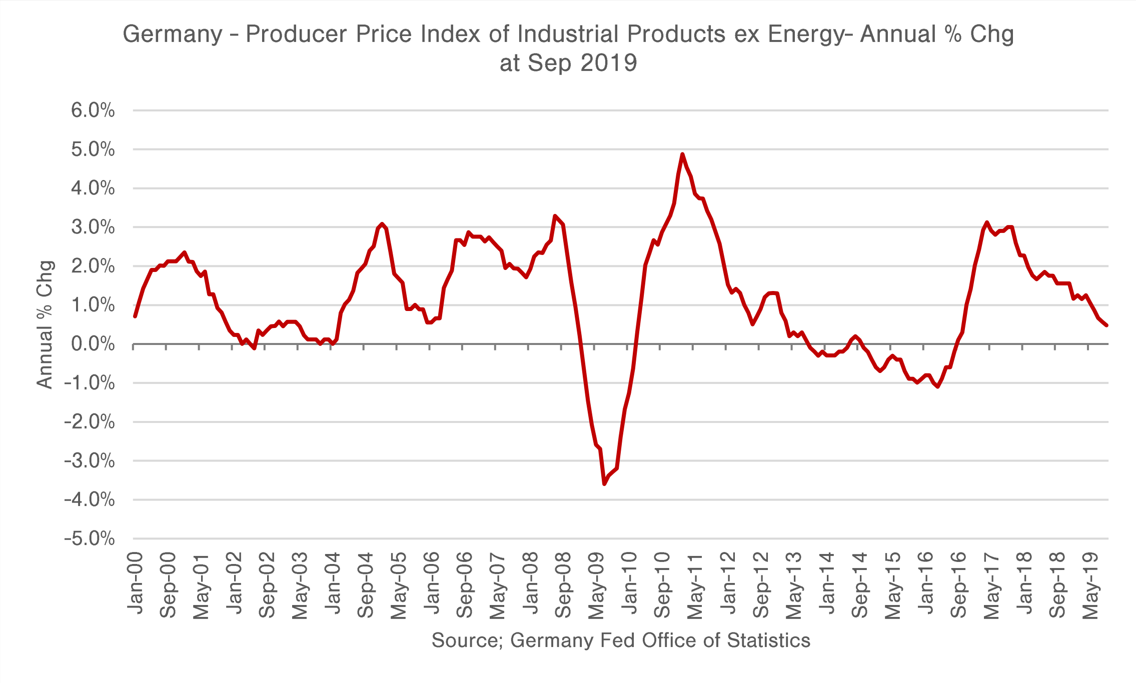


The main contributors to the decline on an annual basis were; energy prices -1.9% and intermediate goods prices -1%. Growth in energy prices has been slowing since Nov 2018. Growth in intermediate goods prices have been slowing since Apr 2017;





Excluding energy prices, the producer price index for industrial products increased by +0.5% in Sep versus the same month a year ago. This was slightly slower than the +0.6% annual pace in Aug;



Energy prices increased by +0.4% in Sep versus Aug, while intermediate goods prices continued to decline by -0.3% in Sep versus Aug.

Capital goods prices increased by +1.5% on an annual basis and were unchanged in the Sep month.

Prices for consumer durable goods increased by +1.4% versus a year ago and were up +0.1% in Sep versus Aug.

Prices for non-durable consumer goods increased by +1.8% versus a year ago and were also up +0.2% in Sep versus Aug.

https://www.destatis.de/EN/Press/2019/10/PE19_410_61241.html;jsessionid=C78901567040FB79A8CD7B32FF6AB93F.internet742

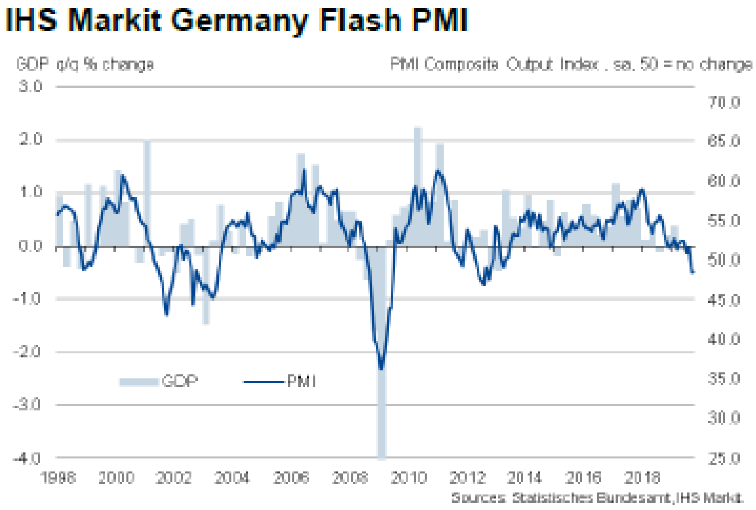
Germany Composite PMI – Prelim (Oct)

The headline composite index increased at only a slightly faster pace with private sector activity continuing to decline in the month. Output, new orders and employment continued to decline into Oct with only a slight easing in the pace of decline.

> "Manufacturing remains the main weak link, though here there are some signs of encouragement with rates of decline in production and new orders easing and business confidence improving to a four-month high.

"Perhaps most concerning are the signs of increasing strain on the domestic economy, with growth of service sector activity slowing to the weakest since September 2016 and employment now in decline for the first time in six years."

Composite PMI – Prelim; Oct 48.6 versus Sep 48.5



Services Activity Index – Prelim; Oct 51.2 versus Sep 51.4

Overall output growth in the service sector remained modest, slowing though to the lowest level in three-years. Future growth in output is likely to remain low as new orders declined for the second month – new export work also declined at a fastest pace since the data was collected. Employment growth slowed to the lowest in three and a half years.

Manufacturing PMI – Prelim; Oct 41.9 versus Sep 41.7

Manufacturing output continued to decline, only at a slightly slower pace. New orders declined at a slightly slower pace. New export orders continued to decline – with the pace of decline also easing slightly. Employment growth in manufacturing declined – as firms reduced both temporary and contract workers.

Overall – with the decline in new orders firms continued to reduce order backlogs – reaching the fastest pace of decline in seven years.

Business sentiment shifted increasingly negative – future business expectations fell to the lowest level since 2012.

Driving this was a marked deterioration in confidence across the service sector, where for the first time in almost seven years the number of firms expecting activity to fall over the coming year exceeded those anticipating an increase. Manufacturers remained strongly pessimistic about the outlook, though expectations rebounded further from August's record low to the highest since June.

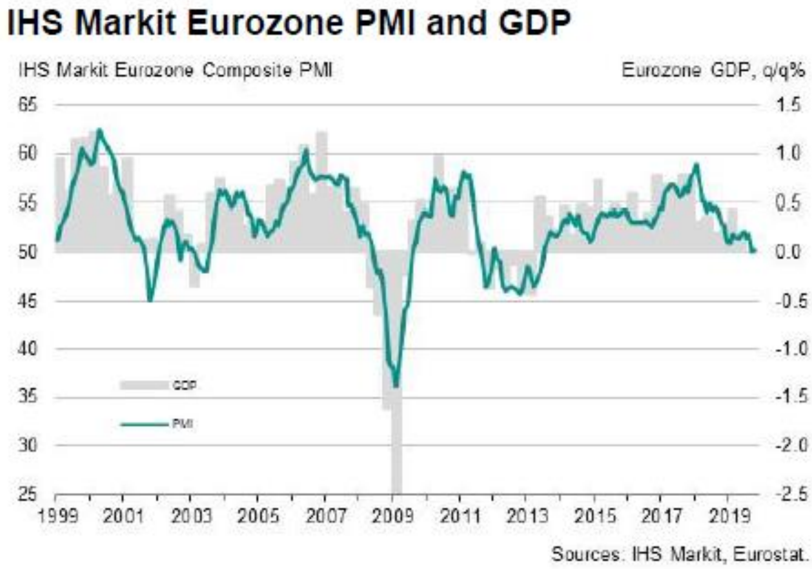
https://www.markiteconomics.com/Public/Home/PressRelease/644e5c6de3254a518b8a0791b1506f9e

Eurozone Composite PMI – Prelim (Oct)

The headline composite PMI was little changed in Oct with the index remaining close to stagnation. Services activity continued to expand at a slightly faster pace, and this was offset by the continued decline in manufacturing activity.

> "The Eurozone economy remained close to stagnation at the start of the fourth quarter, according to the latest flash PMI data, with demand for goods and services falling for a second successive month. A further steep decline in manufacturing output was accompanied by one of the weakest service sector expansions since 2014. Future expectations sank to the gloomiest since 2013 and jobs growth hit the lowest since 2014."

Composite PMI – Prelim; Oct 50.2 versus Sep 50.1



Services Activity Index – Prelim; Oct 51.8 versus Sep 51.6

New orders growth slowed, indicating likely further weaker output growth. Current low output growth was supported by a slightly decline in order backlogs.

Firms continued to expand employment but at a slower pace.

Input prices increased at a faster pace while output prices increased at the slowest pace in over 2-years.

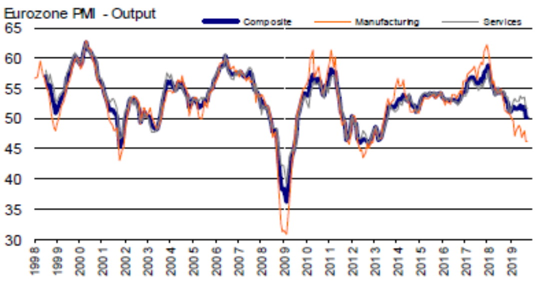
Manufacturing PMI – Prelim; Oct 45.7 versus Sep 45.7

New orders declined at a faster pace also indicating continued weakness in future output. Output continued to decline in the month supported by a further fall in order backlogs.

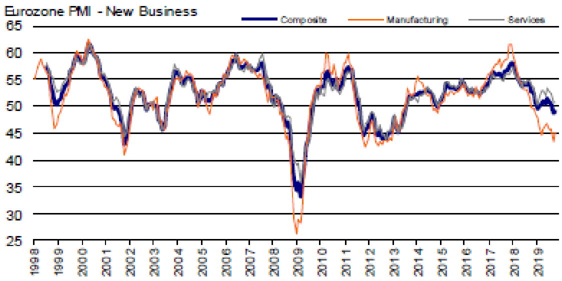
Firms reduced employment – "with the steepest job cuts since Jan 2013".

Input prices declined at the fastest pace in nearly four years. Firms reduced output prices.

Output



New business



https://www.markiteconomics.com/Public/Home/PressRelease/0d41ffba58df4fafa8e3d8fdfdf40730

ECB Rates Decision – 24 October 2019

Decision; there was no change to the monetary policy setting at this meeting.

Rates remain unchanged; rates on the main refinancing operations, the marginal lending facility and the deposit facility remain 0.00%, 0.25% and -0.50% respectively.

Guidance; rates will stay at these present levels, OR LOWER, until inflation reaches close to but below 2% (and reaches this level consistently).

> "In any case, the Governing Council continues to stand ready to adjust all of its instruments, as appropriate, to ensure that inflation moves towards its aim in a sustained manner, in line with its commitment to symmetry."

Some changes to policy settings made at the prior meeting are still to be implemented;

Net asset purchases will restart on 1 Nov at 20bn Euro a month. This will run "as long as necessary" to reinforce the accommodative stance on rates. Maturing securities will continue to be reinvested in full.

Since the last meeting, data confirmed economic growth remains in a period of protracted weakness due to international trade issues, persistent global uncertainties and muted inflation pressure. The economy remained somewhat resilient in this environment due to employment growth and increasing wages.

> "The risks surrounding the euro area growth outlook remain on the downside. In particular, these risks pertain to the prolonged presence of uncertainties, related to geopolitical factors, rising protectionism and vulnerabilities in emerging markets."

> "The implementation of structural policies in euro area countries needs to be substantially stepped up to boost euro area productivity and growth potential, reduce structural unemployment and increase resilience."

https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp191024~438769bd4f.en.html

https://www.ecb.europa.eu/press/pressconf/2019/html/ecb.is191024~78a5550bc1.en.html

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Japan

Merchandise Trade (Sep)

On a non-seasonally adjusted basis, both exports and imports declined versus a year ago. The decline in exports was reasonably broad – with all major commodity groups contributing to the lower value of exports versus a year ago. Exports to the two largest customers – the US and China declined by a faster pace than total exports. The decline in exports to the US appears mostly linked to weaker car exports (other categories contributed to the weakness but to a lesser degree) and exports to China were lower across most categories, but notably machinery and transport equipment.

Imports were also lower than in the year prior, but this possibly does not reflect lower domestic demand. The decline looks more linked to the value of lower mineral fuel/petroleum imports (single largest import category by value). The value of imports increased across most other categories, but not enough to offset the decline in mineral fuel imports (value).

All values quoted in ¥.

TRADE BALANCE

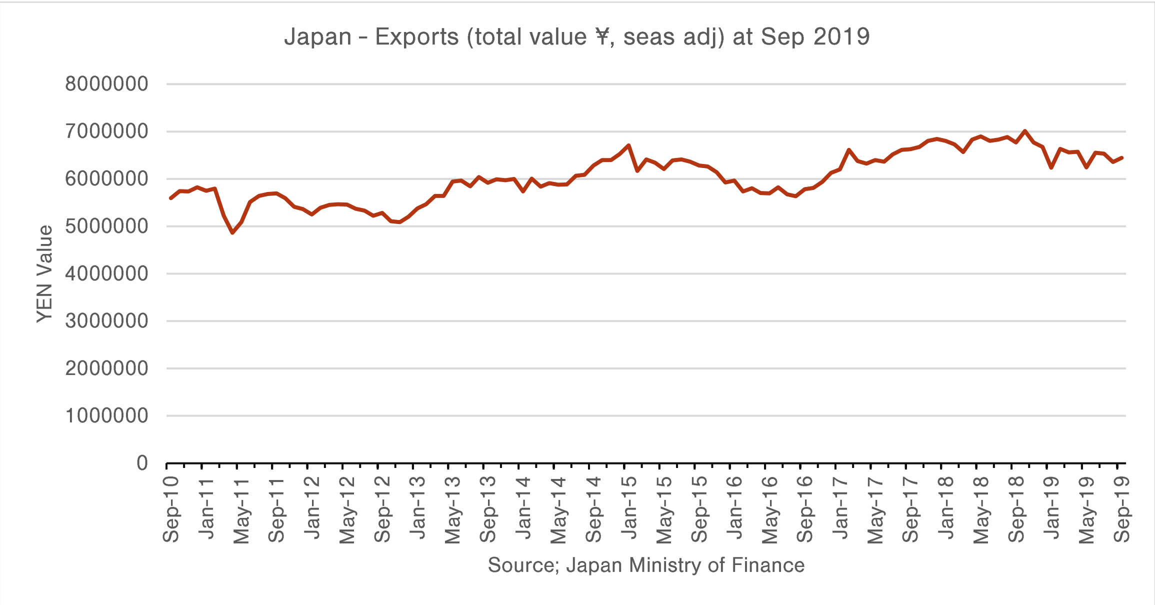
The trade balance shifted from a surplus of 124bn in 2018 to a deficit of 122bn in 2019 – due the value of exports declining faster than imports.

Exports - annual change (NSA); Sep 2019 -5.2%

Imports – annual change (NSA); Sep 2019 -1.5%

EXPORTS

On a seasonally adjusted basis, the value of Japanese exports remains 8% below the recent peak in Oct 2018. Growth remains subdued on a monthly basis;



Exports – Regional Performance

Exports to the two largest export markets for Japan – the US and China, both declined faster than the total decline in exports. Exports to China declined by 6.7% and exports to the US also declined by 7.9%.

Asia is the single largest export market for Japan. Exports to the Asian region fell by 7.8% in Sep - faster than the total decline of -5.2%. Exports to most Asian markets were lower than a year ago. The largest declines were recorded for China, Hong Kong, Korea, Singapore, Thailand and Indonesia.

Exports to North America were 7.8% below a year ago. Exports to the US, Canada and Mexico declined.

Exports to Europe increased by 3.4% overall. Underlying that though, exports to Germany fell 1.5% and exports to the UK fell by 15%.

Exports to the Middle East increased by 8.5%.

Exports – Commodity Performance

Exports across all categories declined versus a year ago. By commodity, the largest contributors to the decline in the value of exports were;

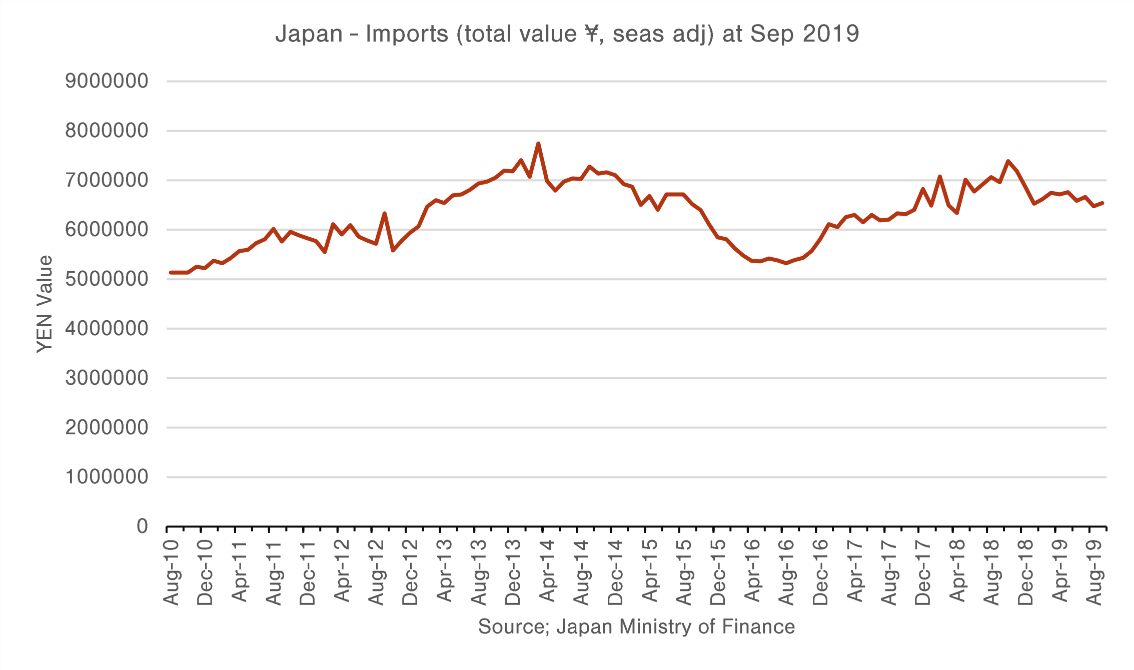
Machinery – contributing -2.2% pts to the 5.2% pt decline

Electrical Machinery – contributing -0.8% pts. The value of semiconductor exports increased by 9.1%

Transport Equipment – contributing -0.6% pts (the value of car exports declined by 1.8% but the volume increased by 3.4%). Note that exports of motor vehicles to the US were down 15% in value and 9% in volume versus a year ago.

IMPORTS

On a seasonally adjusted basis, imports are 11% below the recent peak of Oct 2018. While there was a small month on month increase in imports, growth also remains subdued;



<u>Imports – Regional Performance</u>

Total imports into Japan declined by 1.5% versus a year ago.

Imports from Asia were up +0.3% versus a year ago. But within that, imports from China, Hong Kong, Korea, Singapore and Indonesia were lower. Imports from China were down 1% - the single largest import market. Imports from Vietnam and Thailand increased by 17 and 11% respectively – possibly a sign of shifting supply chains out of China.

Imports from Western Europe were up 12%.

Imports from North America were down 7.8%. This was led by an 11.6% decline in imports from the US.

Imports from the Middle East were down 13.6% - declines were recorded across most markets. This was mostly due to the fall in the value of imports of mineral fuels which contributed 12.9%pts to the 13.6% decline. While the value of petroleum imports was down by 8.3%, the volume of imports increased by 9.7%.

<u>Imports – Commodity Performance</u>

The single largest negative contributor to the decline in imports in Sep (versus a year ago) was Mineral Fuels – contributing -4.6%pts. The value of petroleum imports contributed -1.8% pts to the overall decline in imports – but the volume of petroleum imports was still 3.4% ahead of the year ago.

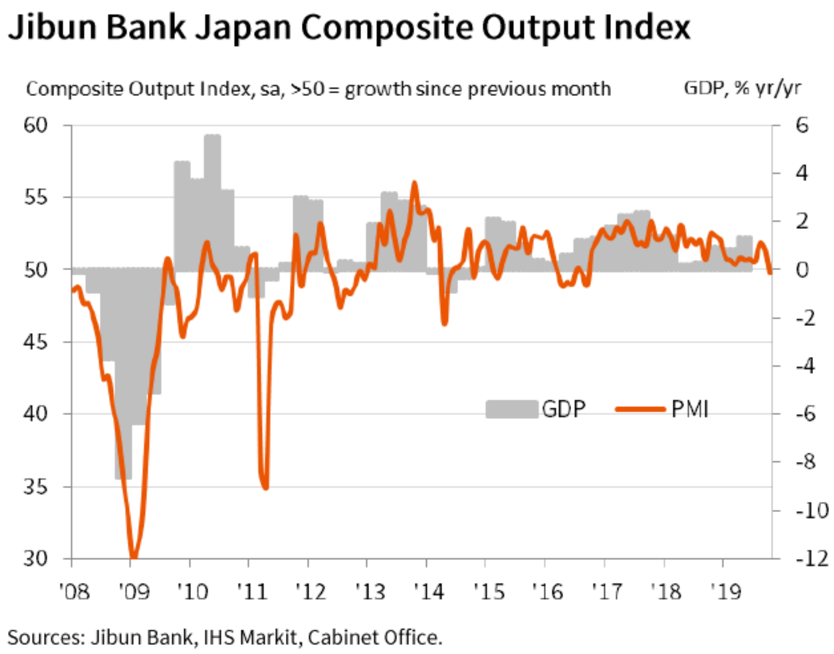
Partly offsetting this decline, was an increase in the value of imports from Other, Electrical Machinery, Chemicals and Food Stuffs.

http://www.customs.go.jp/toukei/shinbun/trade-st_e/2019/201909ce.xml

Composite PMI – Prelim (Oct)

The prelim composite reading of private sector activity fell into contraction in Oct. This was led by much slower growth in services (which remained above 50) but a slightly faster decline in manufacturing activity. Despite the increase in the consumption tax and disruption from the typhoon, services activity remained resilient. Manufacturing firms, however, cited weaker demand conditions for the slightly faster decline in activity.

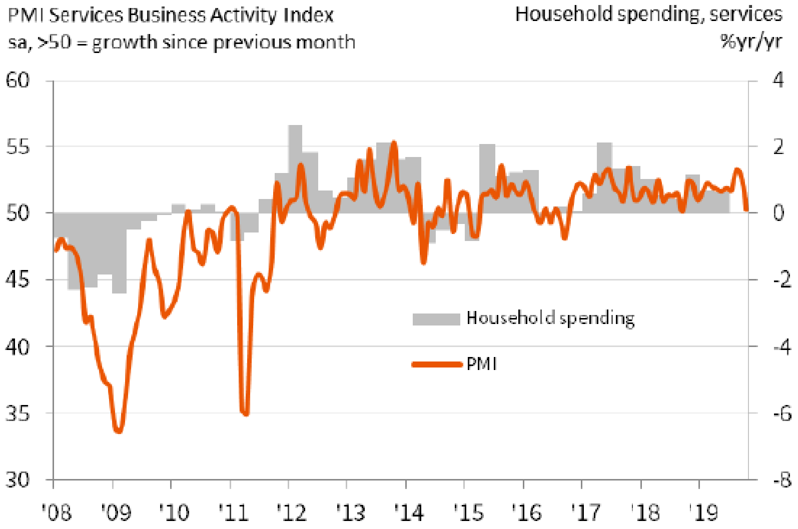
<u>Composite PMI – Prelim</u>; Oct 49.8 versus Sep 51.5



<u>Services Activity Index – Prelim</u>; Oct 50.3 versus Sep 52.8

Importantly, new orders growth increased at a faster pace (the fastest in four months) – which should support output growth. New export orders recorded weaker growth though. Backlogs of work declined in Oct, likely supporting the (weaker) growth in activity/output. Employment grew at a slower pace. Both input and output prices increased at a faster pace as a result of the consumption tax increase. Firms cited weaker expectations for the 6-month outlook.

Services business activity



Sources: Jibun Bank, IHS Markit, Cabinet Office.

<u>Manufacturing PMI – Prelim</u>; Oct 48.5 versus Sep 48.9

Overall manufacturing activity declined/contracted at a slightly faster pace in Oct. This was the lowest reading since Jun 2016.

New orders declined at a faster pace and new export orders declined but at a slower pace.

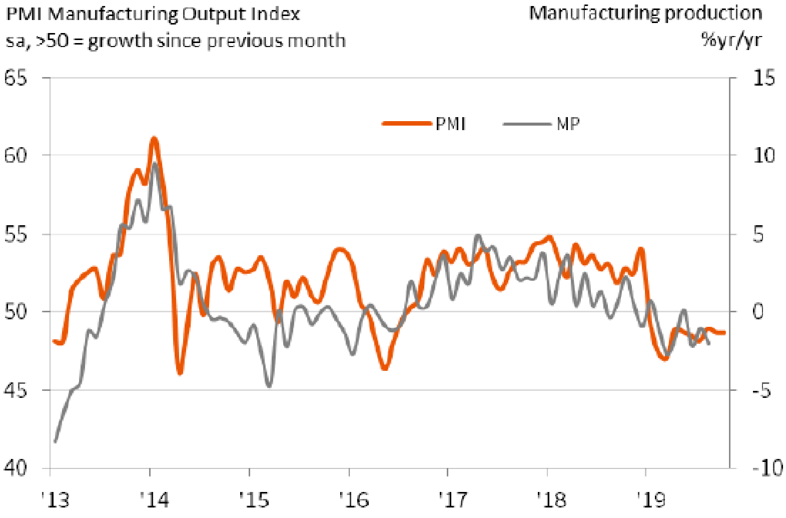
> "New orders declined at the sharpest pace since Dec 2012, as firms indicated that weak global trade conditions and weaker key export markets restricted demand"

Output activity was supported by a further decline in backlogs of work.

Output prices declined and input prices increased at a slower pace.

The outlook for manufacturing firms shifted from positive to negative in the prelim Oct report.

Manufacturing output



Sources: Jibun Bank, IHS Markit, METI.

https://www.markiteconomics.com/Public/Home/PressRelease/ddfd100b9b404ca994338a9d25cf0280

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United Kingdom

Brexit

Uncertainty remains elevated regarding the timetable and process for Brexit coming into the final days before the 31 Oct deadline.

The UK Parliament voted down the programme motion – the timetable for the bill, giving PM Johnson no choice but to pause the progress of the Withdrawal Agreement legislation through Parliament. It now seems possible that there will be a general election called (likely early-mid Dec). This will be PM Johnsons third attempt at forcing an election – there will likely be a vote on an election on Monday. Labour needs to approve the move;

> Corbyn replied he would wait to see what the EU does on a Brexit delay before deciding which way to vote, repeating that he could only back an election when the risk of a no-deal Brexit was off the table.

While the EU has now agreed to the Brexit extension, it has not decided yet on how long of an extension to grant.

> The EU envoys had been due to discuss the length of a third delay to Brexit but diplomats decided to hold off to let events play out in London.
>
> "Everyone wanted a decision today. But France had a problem with that and wanted to wait until Monday/Tuesday to see what happens in London," the diplomat said.

At this stage, a date for the extension is still up for debate by the EU – with a likely response early next week.

https://www.theguardian.com/commentisfree/2019/oct/24/election-boris-johnson-deal-12-december-brexit-withdrawal-bill

https://edition.cnn.com/2019/10/21/uk/brexit-boris-johnson-monday-explainer-intl-gbr/index.html

https://brexitcentral.com/mps-back-johnsons-brexit-deal-at-second-reading-but-defeat-programme-motion-how-every-mp-voted/

https://www.apnews.com/f1a602a355dc46e78ef31366845796a7

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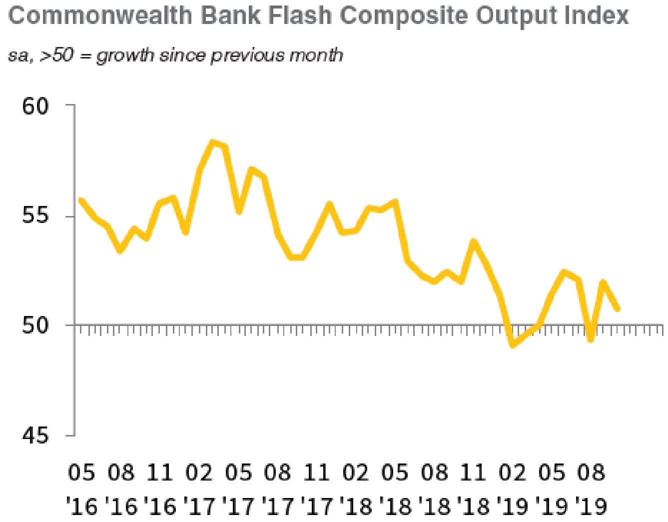
Australia

CBA Composite PMI – Prelim (Oct)

The prelim headline composite index indicated that both service and manufacturing activity/growth slowed in Oct. Services recorded the larger slowdown with growth slowing to a low level. The growth in manufacturing activity also slowed slightly, close to the neutral/no growth level.

One common theme across both services and manufacturing was that new orders growth was weaker. Growth in new orders slowed for services and declined for the first time in the series history for manufacturing. This indicates potentially weaker output growth in the future.

Composite PMI – Prelim; Oct 50.7 versus Sep 52



Services Business Activity Index – Prelim; Oct 50.8 versus Sep 52.4

The driver of the slower growth in services business activity was slower expansion in output, new orders and employment. Business confidence slowed to a seven-month low. Input prices increased at a faster pace and output prices continued to grow at a faster pace.

Manufacturing PMI – Prelim; Oct 50.1 versus Sep 50.3

Conditions continued to indicate that growth remains low, with the PMI falling to its lowest reading the three-and-a-half-year history. Output growth rebounded to stable/neutral after declining in the month prior. New orders declined for the first time since the data series started – "panellists reported weak market demand". Firms reduced pre and post-production inventories. Input prices increased at a faster pace – reflecting currency weakness. Employment continued to grow.

https://www.markiteconomics.com/Public/Home/PressRelease/8a2e4469694a4e079d6a5d35ed0d0ef2

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China

PBoC Rates Decision

The one-year Loan Prime Rate (LPR) remained at 4.20%, steady from the previous monthly fixing.

> "Economists and China observers say a recent bath of weak data showing a further loss of momentum in the world's second-biggest economy underlined the need for further monetary policy support."

> "Beijing has leaned more heavily on fiscal stimulus to address the current downturn, announcing trillions of yuan in tax cuts and special local government bonds to finance infrastructure projects."

https://www.reuters.com/article/us-china-economy-rates/china-unexpectedly-keeps-lpr-lending-benchmark-unchanged-but-outlook-for-rates-down-idUSKBN1X003B

https://tradingeconomics.com/china/interest-rate

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Trade

US-China Trade Talks

Both the US and China indicated that 'good progress' was being made on negotiations for the first phase of the trade deal.

So far, China has agreed to purchase more agricultural products (was this going to happen anyway?) in exchange for suspending a tariff increase on the 15 Oct. There is, however, a further tariff increase scheduled for 15 Dec. Its unclear what the hurdle will be to have that tariff increase suspended.

Emphasis added;

> "**Hopes are rising** that a deal will be ready for President Xi Jinping and President Donald Trump to sign when they meet on the sidelines of the Asia-Pacific Economic Cooperation summit in Chile on November 16-17."
> https://www.politico.com/news/2019/10/26/china-trade-war-058425

With the details yet to be put into writing and fully agreed to (we were here back in May), the situation will likely remain tenuous. The purchase of agriculture has been a key part of this phase (China agreeing to purchase $40-$50bn of US agriculture). Last week, and previously, China has stated that it would **make such purchases only according to market need**. It's not clear how the deal can resolve this.

The APEC summit in Chile 16-17 Nov remains the likely place where both Presidents Trump & Xi will sign the phase one agreement.

The more difficult issues of the negotiations have been reserved for the next phase of the negotiations. This stage of the negotiation will commence after the first deal is signed.

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

On the sidelines of the UN General Assembly last month, the US and Japan signed a limited trade deal that will precede a more comprehensive deal/negotiation to commence next year.

The Japanese Cabinet has approved a bill to ratify this trade pact. The bill will now be up for debate in the extraordinary session of Parliament. This session ends on 9 Dec, in time to have

pact ratified for the Jan 2020 deadline.
https://mainichi.jp/english/articles/20191015/p2g/00m/0bu/046000c

The US Congress does not need to ratify this first more limited deal.

Details from the Congressional Research Service;
https://crsreports.congress.gov/product/pdf/IF/IF11120#targetText=Japan's%20Diet%2C%20however%2C%20will%20have,effect%20on%20January%201%2C%202020.

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

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

US-Europe Trade Talks

On 1 Nov, the new EU commissioners take up office. Phil Hogan takes over as EU Trade Commissioner – a key role in the negotiation with the US. Once the new commissioners are in place, there will likely be further progress on the US-EU trade negotiations, as well as Brexit/EU-UK trade deal negotiations.

https://www.ft.com/content/d5d1e928-e9c6-11e9-a240-3b065ef5fc55

There are several fronts to the US-EU trade discussions.

Airline Subsidies

From 18 Oct, the US has implemented tariffs on some EU imports as a part of the WTO ruling on the Airbus case. This was announced during the week on the US Federal Register; https://www.federalregister.gov/documents/2019/10/18/2019-22902/technical-adjustments-to-section-301-action-enforcement-of-us-wto-rights-in-large-civil-aircraft

> "The tariffs will be applied to a range of imports from EU Member States, with the bulk of the tariffs being applied to imports from France, Germany, Spain, and the United Kingdom – the four countries responsible for the illegal subsidies. Although USTR has the authority to apply a 100 percent tariff on affected products, at this time the tariff increases will be limited to **10 percent on large civil aircraft and 25 percent on agricultural and other products**. The U.S. has the authority to increase the tariffs at any time, or change the products affected." https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/october/us-wins-75-billion-award-airbus

The counter-case where the EU is pursuing tariffs against US support for Boeing is running approx. six-months behind.

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

Trade Negotiations

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

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

Further to the USTR S.301 investigation into the digital services tax approved by the French government, a public hearing on the tax implications has been held in the US;

> "The French DST law imposes a 3% tax on annual revenues generated by some companies that provide certain digital services to, or aimed at, French users. The tax applies only to companies with annual revenues from the covered services of at least €750 million globally and €25 million in France. The services covered are ones where U.S. firms are global leaders."
> https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/august/public-hearing-section-301

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

Late last week, a Mexican official said that the USMCA was “at the threshold” of its final ratification;

"The end of this complex story is approaching, and we will soon see the United States starting the formal process for the approval of the treaty," said Jesus Seade, undersecretary for North America of the Mexican Ministry of Foreign Affairs, during President Andres Manuel Lopez Obrador's daily press conference. http://www.xinhuanet.com/english/2019-10/26/c_138504592.htm

This mirrors comments made by US House Speaker Pelosi that the Republicans and Democrats were getting closer to ‘wrapping up’ changes to the USMCA.

Democrats moved at least one step forward in their ongoing negotiations on Thursday when they received a letter from Mexican President Andrés Manuel López Obrador pledging to fully implement sweeping labor forms required under the new agreement.

"There is still fluidity on the labor stuff and enforcement," Neal told reporters. "So we're looking for more assurances.
https://www.politico.com/news/2019/10/17/pelosi-democrats-trump-administration-usmca-050128

At this stage, there is some sign that both sides want to finalise changes by Thanksgiving. As always though "there is still a ways to go".

Canada has yet to approve the deal. It has been reported that Canada will wait to approve the deal until after 21 Oct elections. It was originally reported that Canada would not take steps to approve the deal until the US had ratified the deal. (Source;
https://www.reuters.com/article/us-usa-trade-usmca/pence-upbeat-that-congress-will-pass-usmca-trade-deal-this-year-idUSKBN1W22FF)

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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