MARS
CAPITAL PARTNERS

Weekly Macro Review

w/c 18 November 2019

Key Themes

The FOMC minutes confirmed a more “wait and see” mode, allowing some time for policy rate changes to flow through to the economy. Guidance was also changed to reflect more focus on incoming data. It was noted in the minutes that the rate cut in Oct was an insurance against ongoing, downsides risks. In particular, the FOMC is concerned that weakness across manufacturing, energy, agriculture and weaker external growth could spill over into the labour market.

Other points of interest from the FOMC minutes;

Still seeing pressure in the repo market for year end. There have already been several announcements since the meeting – mostly to increase size of the Fed repo facility. Still possible that further measures will be taken to cope with year-end pressure.

The minutes also included a discussion of policy options in the case of rates reaching the effective lower bound. Negative rates were discussed at length as a part of the policy options;

> “…participants did not rule out the possibility that circumstances could arise in which it might be appropriate to reassess the potential role of negative interest rates as a policy tool.”

The PMI’s at a composite level – overall better view of US activity in Nov with output growth increasing. Eurozone output growth was stagnant in Nov. Output growth in Germany was still declining. Japan output growth was stagnant in Nov. UK output declined in Nov. Australian output shifted into decline in Nov.

US – While the PMI’s were somewhat improved, optimism regarding output growth in the next 12-months across both services and manufacturing was lower. Manufacturing activity improved in the Philly Fed report, but Kansas City Fed manufacturing activity remained in contraction.

US existing home sales are still improving but are yet to exceed the late-2017 cycle highs. Growth in housing permits likely positive for future construction activity.

The prelim PMI’s across the Eurozone remained weak. The manufacturing decline abated slightly, but services activity slowed further.

In Germany, the composite index of output indicated a weaker pace of decline in Nov. Services output growth continued to slow while the decline in manufacturing output also slowed. Despite most measures remaining weaker, optimism lifted for the first time in four months.

Japan PMI's rebounded slightly – remaining mostly stagnant at the composite level. Services activity rebounded slightly, and optimism lifted. Manufacturing activity declined at a slower pace, but measures of demand continued to decline. Sentiment lifted.

The Japanese trade data for Oct was weak and the underlying detail was negative. Declines in exports and imports in value terms were matched by declines in volume terms (where that detail is provided) and declines were recorded across key customers/markets. A large portion of the decline in imports versus a year ago is related to petroleum, but again, other key imports were down in value and volume terms.

Core CPI growth in Japan accelerated slightly in Oct as the increase in the consumption tax was implemented.

UK PMIs continue to be heavily influenced by the Brexit process. At the composite level private sector output declined at the fastest pace since Jul 2016 – led by declines in services and manufacturing output.

Australian PMIs deteriorated with both services and manufacturing output shifting into contraction. Underlying detail on demand was also negative. Bus sentiment declined.

RBA minutes highlighted that consideration had been given to a further cut in rates at the Nov meeting. Instead, the RBA had opted to 'wait and assess' based on having "already delivered sizeable monetary stimulus over the last several months". The overall assessment of the economy was downbeat.

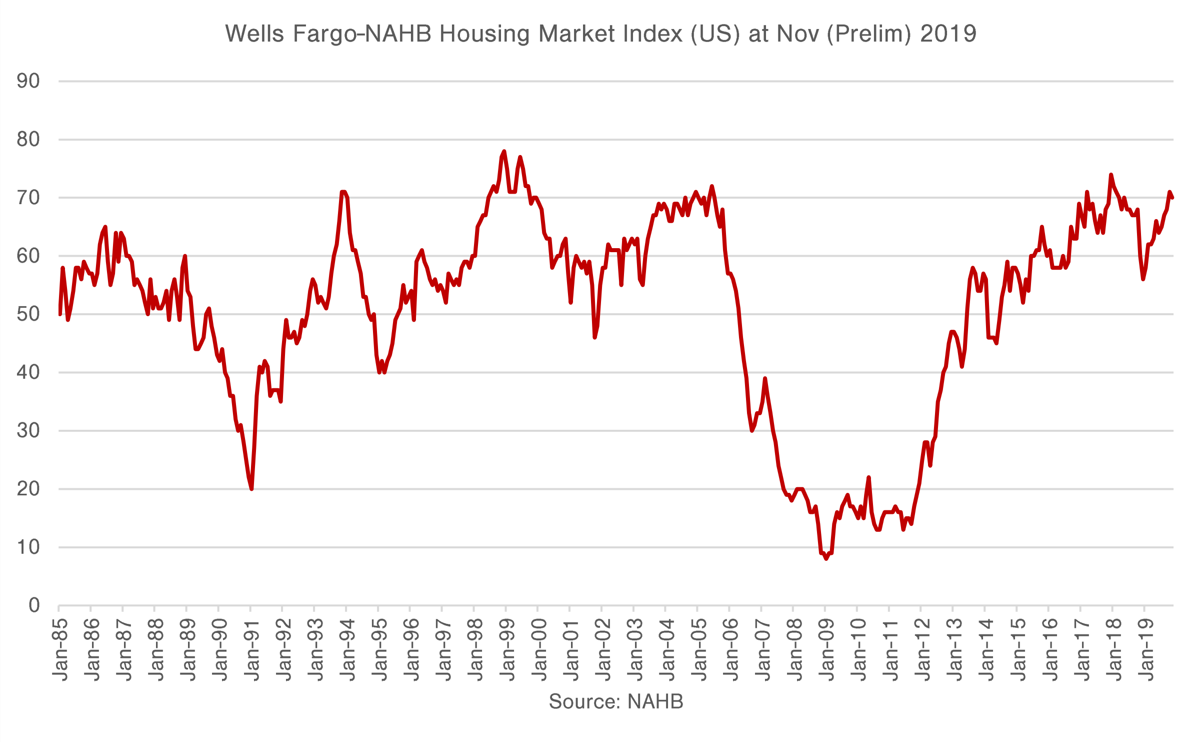
Contents

US Data

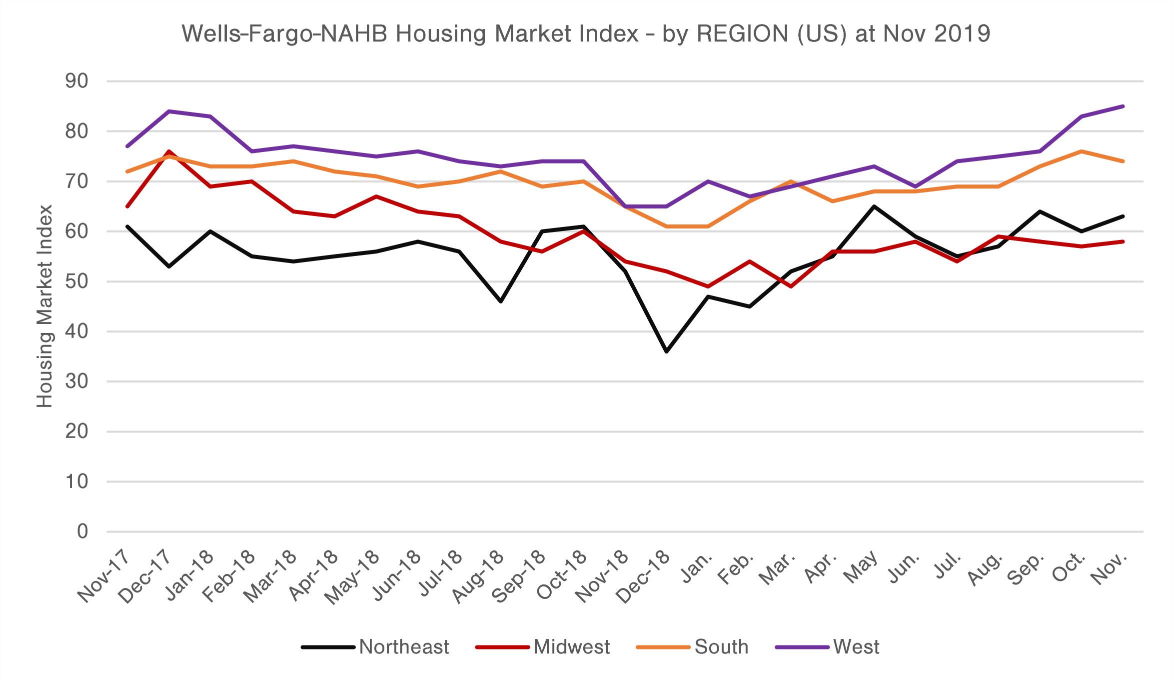
NAHB Housing Market Index (Nov)

Housing market conditions were little changed in Nov – remaining around the near-term peak of the recovery so far in 2019.

<u>Headline Housing Market Index</u>; Nov 70 versus Oct 71



Conditions remained elevated across most of the regions in Nov. There was a slight pull-back in conditions in the South;



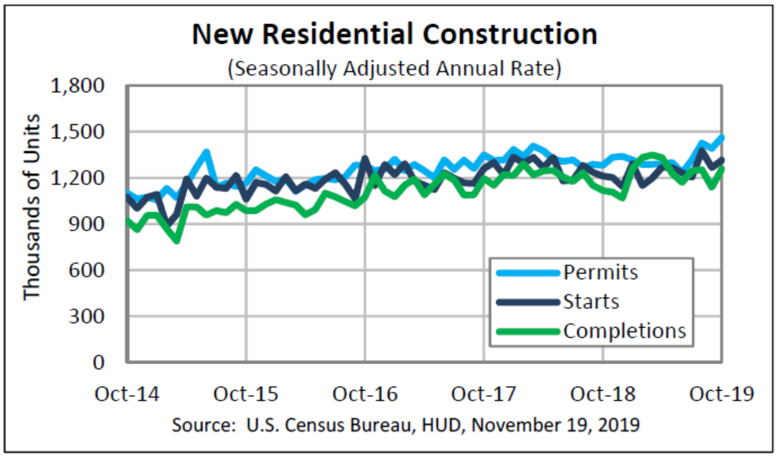
https://www.nahb.org/research/housing-economics/housing-indexes/housing-market-index.aspx

Housing Permits (Oct)

Housing permits in the US continued to increase in Oct and remain well up on a year ago.

Total Permits US – month change; Oct 1.46m units (5% versus the month prior. The 90% confidence interval is +/- 1.7% pts, which means that total permits likely increased in Oct).

On an annual basis, housing unit starts are +14% in Oct. Again the 90% confidence interval is +/- 2.1% pts, so it is likely that the pace of annual growth was around this level.



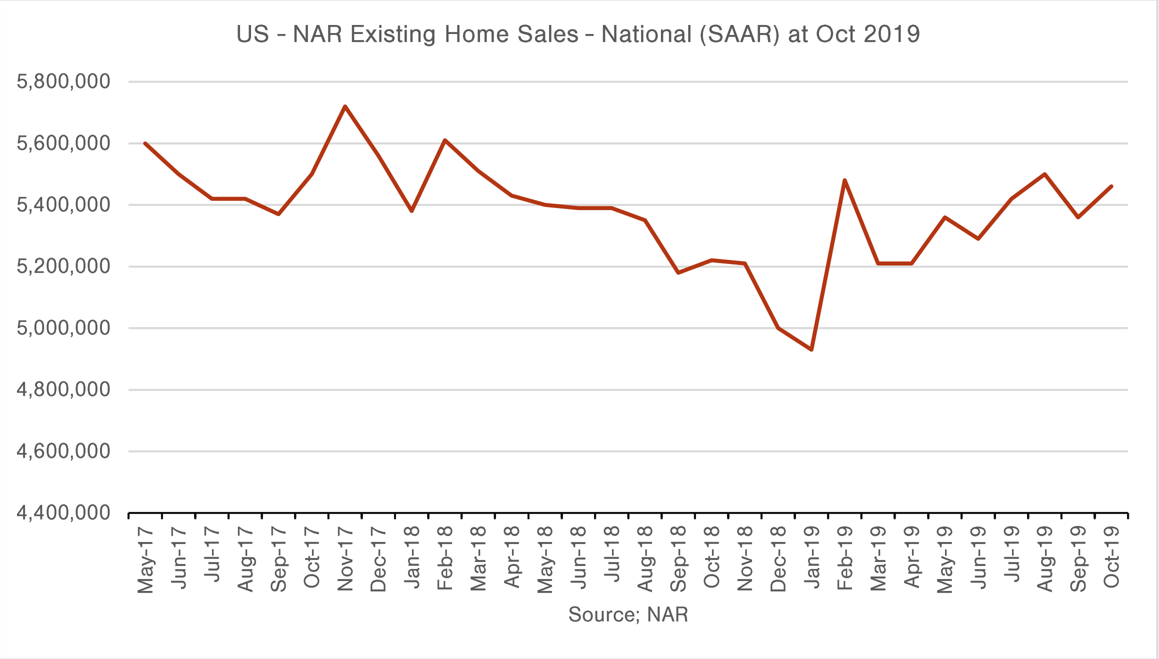
Growth in permits was recorded across all regions. But only in the Northeast (+19%) and the South (+5.6%) was growth likely (the 90% confidence interval did not contain zero).

https://www.census.gov/construction/nrc/index.html

Existing Home Sales (Oct)

Existing home sales increased in Oct. The SAAR in Oct is now on par with the two prior highpoints in this recovery since Jan 2019. The increase in the month was led by stronger growth in the South. Sales increased more moderately in the Midwest and declined in the Northeast and West.

<u>Existing Home Sales – National (SSAR)</u>; Oct 5.460m units (+1.9%) versus Sep 5.36m units (-2.5%)



Inventory declined in the month by 3% and the months' supply of inventory fell from 4.1 in Sep to 3.9 in Oct.

<u>Regional Performance</u>

The National sales result was led by an increase in sales in the South.

South; Oct +4.4% versus Sep. Based on the SAAR, sales are +8% ahead of a year ago.

Midwest; Oct +1.6% versus Sep. Sales are also up +2.4% on a year ago.

West; Oct -0.9% versus Sep. Sales still remain +4% up on a year ago.

Northeast; Oct -1.4% versus Sep. This remains the weakest market with sales on par (no growth) with a year ago.

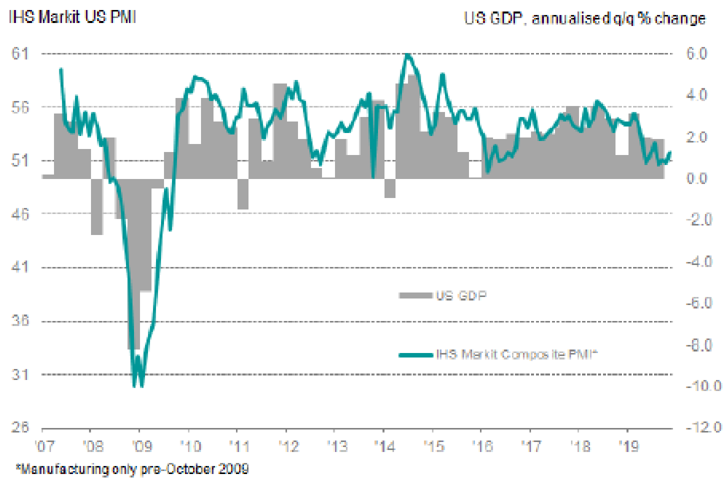
https://www.nar.realtor/research-and-statistics/housing-statistics/existing-home-sales

US Prelim Composite PMI (Nov)

The headline composite index indicated that manufacturing and services output expended at a faster pace in Nov. Both manufacturing and services output expanded at a faster pace.

Headline Composite Output; Nov 51.9 versus Oct 50.9

IHS Markit Composite PMI and U.S. GDP



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

Services Activity Index; Nov 51.6 versus oct 50.6

While demand increased, there was only a muted lift in new business. The pace of growth remained historically low. Firm increased employment for the first time since Aug – the growth also “fractional”. Optimism continued to dip “amid reports of less favourable demand conditions”.

Manufacturing PMI; Nov 52.2 versus Oct 51.3

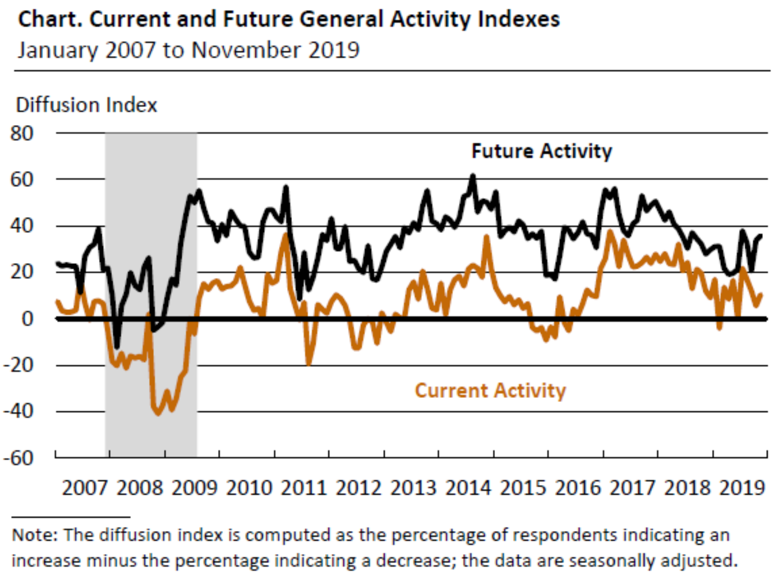
Output and new orders expanded at a faster pace. Production growth reached a ten-month high. Backlogs recorded the first increase since Jun. Employment also increased at a faster pace in response. Despite the stronger performance in the month, optimism was lower among goods producers for the next twelve months. Firms cited ongoing economic uncertainty.

https://www.markiteconomics.com/Public/Home/PressRelease/72e0447602a446eab3dc4b42e9db5585

Philadelphia Fed Business Outlook (Nov)

The headline index of business activity increased at a faster pace in Nov but growth remained low. Despite the increase in overall activity, the underlying indicators of demand indicated much slower growth in the month. This was experienced across most measures.

General Business Activity Index; Nov 10.4 versus Oct 5.6



This month, the growth in new orders slowed from 26.2 in Oct to 8.4in Nov. The index of shipments also indicated slower growth in Nov falling by 9pts to 9.8 in Nov. The growth in unfilled orders also slowed by 12.2pts to 6.0 in Nov – likely helping to support growth in shipments.

Inventories shifted into contraction.

Growth in input prices slowed and there was also slightly slower growth in prices received.

There was still fairly high growth in the number of employees, but growth slowed from Oct to Nov. Growth in the average employee workweek also slowed.

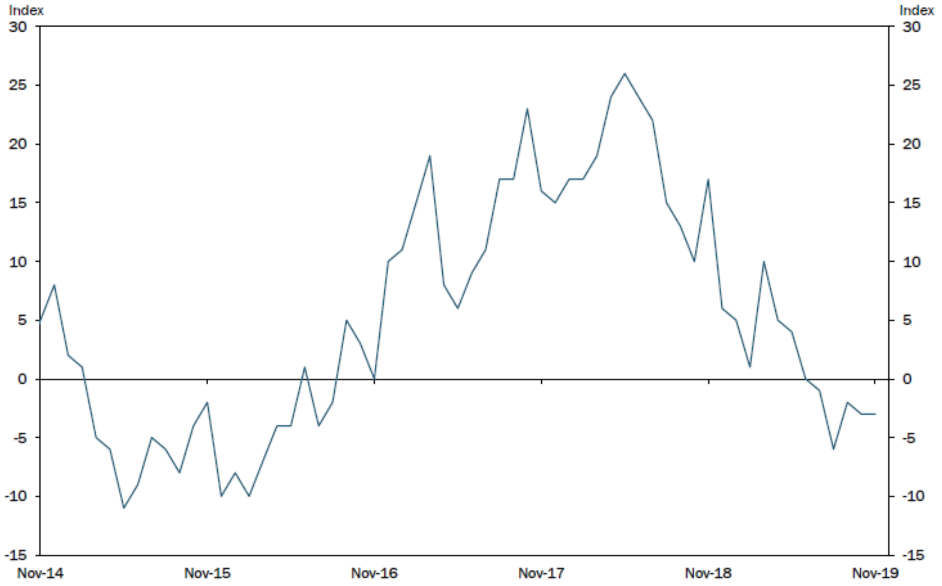
https://www.philadelphiafed.org/-/media/research-and-data/regional-economy/business-outlook-survey/2019/bos1119.pdf?la=en

Kansas City Fed Manufacturing Index (Nov)

The headline composite manufacturing index remained in contraction and declined at the same pace overall versus the month prior. Production shifted back into contraction, while the volume of shipments growth was supported by a further decline in order backlogs. The volume of new orders continued to decline, albeit at a slower pace. Overall manufacturing activity remained weak this month.

Composite Manufacturing Index; Nov -3 versus Sep -3.

Chart 1. Manufacturing Composite Index vs. a Month Ago



"The decline in district manufacturing activity continued to be driven by slower activity at durable goods plants, especially from decreases in primary metal, fabricated metal products, machinery, and computer and electronic products manufacturing."

https://www.kansascityfed.org/~/media/files/publicat/research/indicatorsdata/mfg/2019/2019nov22.pdf?la=en

Uni of Michigan Consumer Sentiment – Final (Nov)

The final report for Nov indicates that readings across current sentiment, expectations and current conditions were revised higher. The current conditions index declined versus the month prior despite being revised higher. All indices remain marginally below the same month a year ago.

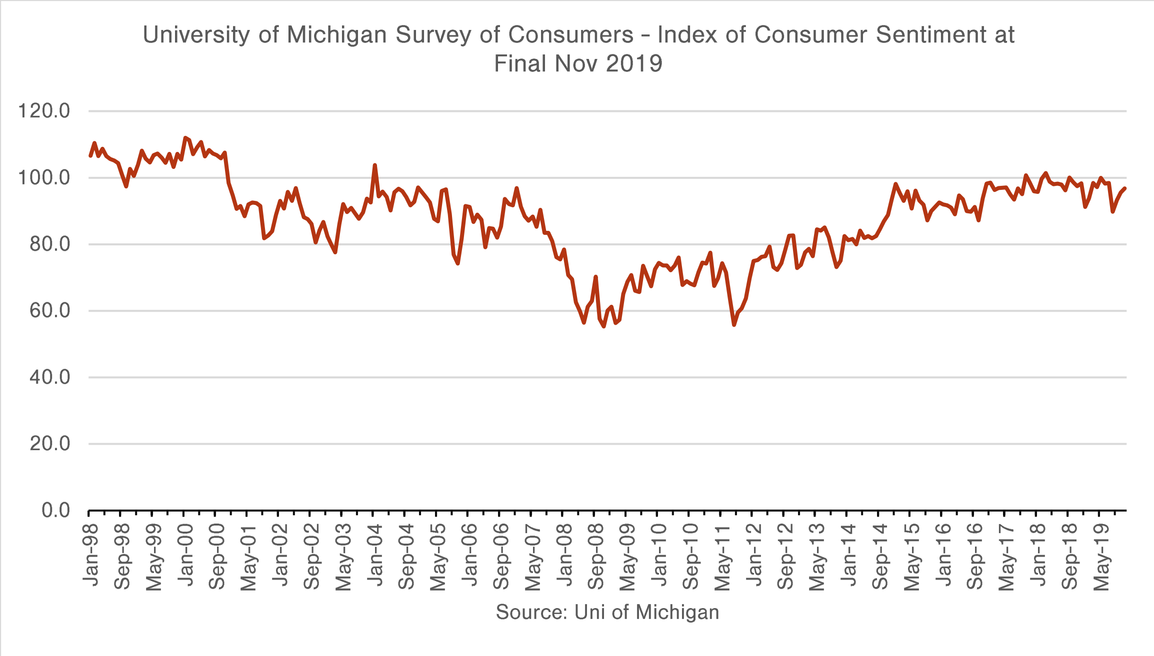
Personal spending will be energized by record favorable evaluations by consumers of their personal financial situation, with gains expected across the entire income distribution, net increases in household wealth, the renewed appeal of price discounting, and reduced mortgage rates.

INDEX OF CONSUMER SENTIMENT

Was revised higher than the prelim reading and is now only slightly below the reading for the same month a year ago.

Consumer Sentiment; Nov 96.8 (prelim 95.7) versus Oct 95.5

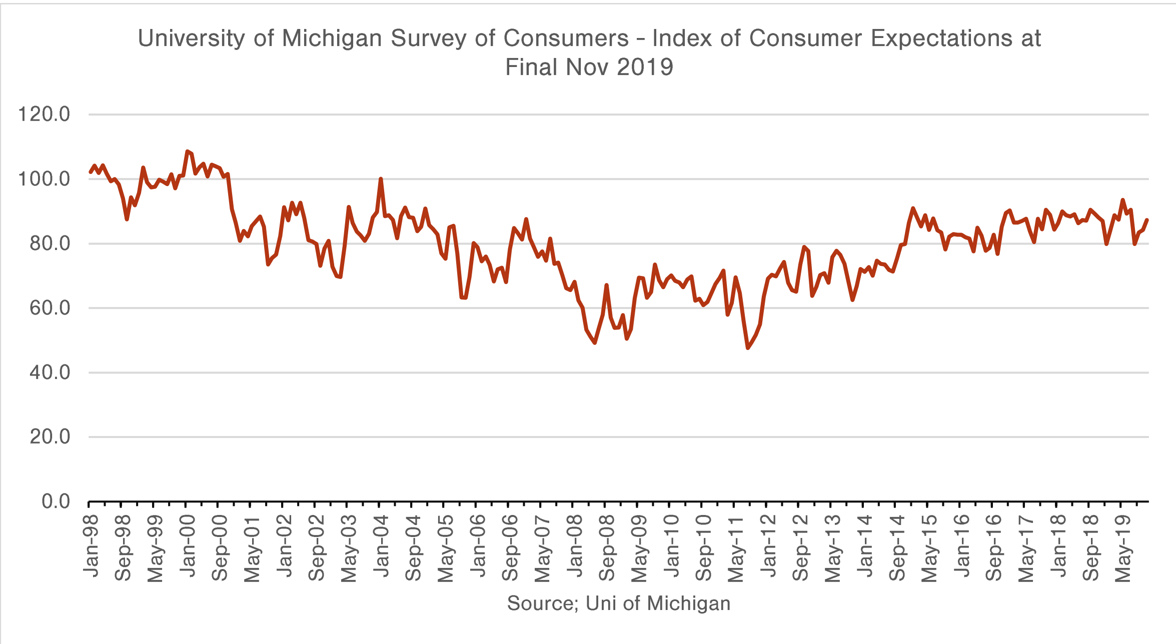
Current sentiment remains -0.7% below the same month a year ago.



INDEX OF CONSUMER EXPECTATIONS

Expectations were revised higher in the final report. The increase in the month bring the index into line with the 12-month average and remains -0.9% below the same month a year ago.

Consumer Expectations Index; Nov 87.3 (prelim 85.9) versus Oct 84.2

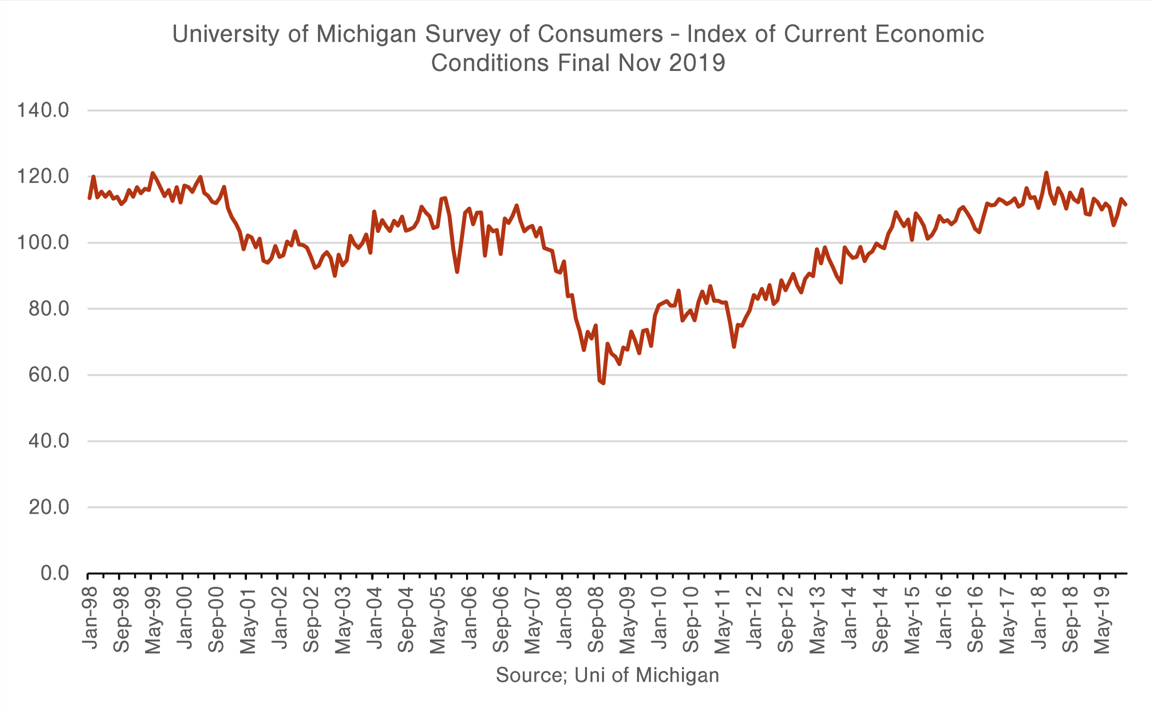


INDEX OF CURRENT CONDITIONS

The index of current conditions was also revised slightly higher than the prelim reading but still fell versus the month prior.

<u>Current Conditions Index</u>; Nov 111.6 (prelim 110.9) versus Oct 113.2

Current conditions also remain -0.6% below the same month a year ago.



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

FOMC Minutes – Meeting 29-30 Oct 2019

At this meeting, the FOMC reduced the FFR target range to 1.5% - 1.75%. At the time of the announcement, it was noted that there had been no material worsening in conditions, but that the rate cut was more of an insurance against ongoing, downsides risks. In particular, the FOMC is concerned that weakness across manufacturing, energy, agriculture and weaker external growth could spill over into the labour market.

From the announcement, we also noted that there was a more 'wait and see' approach now, allowing some time for policy rate changes to flow through to the economy.

There were several highlights in the minutes.

<u>Review of Monetary Policy Strategy, Tools, and Communication Practices</u>

Staff briefed the Committee on options for monetary policy tools where the policy rate would be constrained by the effective (zero) lower bound. There were three forms of forward guidance discussed; qualitative, date/time-based and outcome-based.

Negative rates were discussed as a policy option – some evidence that this tool had provided some accommodation where implemented but also signs of adverse policy effects. Emphasis added;

> Moreover, differences between the U.S. financial system and the financial systems of those jurisdictions suggested that the foreign experience may not

> provide a useful guide in assessing whether negative rates would be effective in the United States
>
> Participants noted that negative interest rates would entail risks of introducing significant complexity or distortions to the financial system.
>
> Notwithstanding these considerations, **participants did not rule out the possibility that circumstances could arise in which it might be appropriate to reassess the potential role of negative interest rates** as a policy tool.

Balance sheet tools – benefits had been significant in the post crisis period and the potential costs either did not materialize or materialized to a smaller degree than had been feared.

Repo and Year End Funding

In early Oct, the Committee announced that it would maintain reserves at, or above, the levels of early Sep through the announcement of the Reserve Management Program – buying $60bn of US Treasury BILLS through at least to early 2020. As well, the Committee announced a ST program of repo operations to provide additional liquidity to maintain the FFR within the target range – also through to early 2020.

It was noted that there was still a diminished willingness of some dealers to intermediate across money markets ahead of year end – adding further upward pressure on ST money rates.

> Forward measures of market pricing continued to indicate expectations for such pressures around the year-end.

This next quote is particularly important. In a Bloomberg Odd-Lots interview, Zoltan Pozar indicated that further issues could remain in the repo market especially leading into year-end due to balance sheet constraints. The point is that balance sheet constraints due partly to year-end regulatory requirements could be such that banks may not be able to take the liquidity on offer by the Fed. Here, the Committee has been advised of such a constraint;

> The Desk planned to continue its close monitoring of reserves and money market conditions, as well as dealer participation in repo operations, particularly given balance sheet constraints heading into year-end.

[As a result, we will be looking for announcements regarding financial regulation (Quarles speeches) and/or US Treasury regulation changes helping to alleviate issues leading into the year-end turn.]

The Committee then goes onto discuss the potential role of these repo operations in the monetary policy framework over the longer-run. There is lengthy presentation of different options. Committee participants noted that once reserves are back up to a more ‘ample' level there may be little need for a standing repo facility or more frequent operations.

> Participants made no decisions at this meeting on the longer-run role of repo operations in the ample-reserves regime or on an approach for conducting repo operations over the longer run.

Views on Current Conditions

The Committee participants viewed the outlook as positive and views had changed little from the Sep meeting.

> Uncertainties associated with trade tensions as well as geopolitical risks had eased somewhat, though they remained elevated. In addition, inflation pressures remained muted. The risk that a global growth slowdown would further weigh on the domestic economy remained prominent.

Yet;

> Many participants continued to view the **downside risks surrounding the economic outlook as elevated**, further underscoring the case for a rate cut at this meeting

Consumer spending was increasing at a strong pace, measures of confidence remained high.

Trade tensions and lower global growth were weighing on business investment decisions and exports. Several areas were highlighted;

Manufacturing production remained weak. GM strike and issues at Boeing were either disrupting or slowing output.

Activity in the energy sector was weak due to lower petroleum prices.

Agriculture – lower crop yields, tariffs, weak export demand and "the difficult financial position for many farmers".

Labour market remained strong, but inflation continued to run at below the 2% objective.

Policy Decision

> In their consideration of the monetary policy options at this meeting, most participants believed that a reduction of 25 basis points in the target range for the federal funds rate would be appropriate. In discussing the reasons for such a decision, these participants continued to point to global developments weighing on the economic outlook, **the need to provide insurance against potential downside risks to the economic outlook,** and **the importance of returning inflation to the Committee's symmetric 2 percent objective** on a sustained basis.

> Many participants continued to view **the downside risks surrounding the economic outlook as elevated**, further underscoring the case for a rate cut at this meeting.

Most participants were concerned that the weakness in several of the industries noted and other global factors, could spill over into negative developments in the labour market.

There were some participants, although voting for the rate cut, that still viewed it as a "close call". Two Committee members voted to keep the policy rate unchanged.

Guidance

The minutes noted the change in the post meeting statement to remove "act as appropriate" and instead emphasize that the Committee would continue to monitor incoming information. This change was viewed as a suitable change given;

> "…the current stance of monetary policy was likely to remain appropriate as long **as the economy performed broadly in line with the Committee's**

expectations and that policy was not on a preset course and could change if developments emerged that led to **a material reassessment of the economic outlook**."

[The guidance, and press conference statement, was broadly interpreted as the Committee shifting to a more 'wait and see' stance on the path of rates, unless there was a material deterioration.]

https://www.federalreserve.gov/monetarypolicy/fomcminutes20191030.htm

Return to top

Europe

Germany PPI (Oct)

On an annual basis, producer prices for industrial products declined at an accelerated pace in Oct. This was partly the result of the decline in energy prices. The PPI excluding energy still grew at a slower annual pace in Oct though, led by continued weakness in intermediate goods – consistent with weaker demand.

Headline PPI – annual change; Oct -0.6% versus Sep -0.1% (revised lower from +0.1%)

In the year to Oct, intermediate goods prices declined by -1.7%, accelerating from the -1% reported in Sep. In the month, intermediate goods prices declined by -0.7%.

Prices for capital goods increased at the same annual pace of +1.5%.

Consumer durable goods prices also increased at the same pace of +1.4%.

Price growth of non-durable consumer goods increased at a faster annual pace of +2.3% versus +1.8% reported in Sep.

Energy prices declined by 3.1% in Oct versus a year ago (versus the -1.9% reported decline in Sep).

PPI Ex Energy – annual change; Oct +0.3% versus Sep +0.5%

https://www.destatis.de/EN/Press/2019/11/PE19_445_61241.html;jsessionid=59E26474A45254B7AA175711FDAA4D1B.internet731

Germany GDP (detail) Q3

There were no revisions to the Q3 pace of real GDP growth. In Q3, GDP increased by +0.1% after declining by -0.2% in Q2. The underlying detail indicates that that activity in the domestic economy was mixed – while consumption expenditure increased, the decline in private capital investment more than offset this growth. While most of this decline in Gross fixed capital formation was a negative contribution from the change in inventories, other areas of investment remained weak. The external sector made a positive contribution in the quarter.

Headline Real GDP – quarter change; Q3 +0.1% versus Q2 -0.2%

Contribution to GDP Growth in Q3

Consumption expenditure added +0.4%pts to headline growth. Both households and government consumption expenditure increased in Q3 versus Q2.

Gross Capital Formation declined and detracted -0.8%pts from the quarter growth. While expenditure in construction rebounded slightly (+0.1% pts), expenditure in equipment declined (-0.2%pts) and there was no change in the 'other' category. The change in inventories made the larger contribution (-0.7%pts).

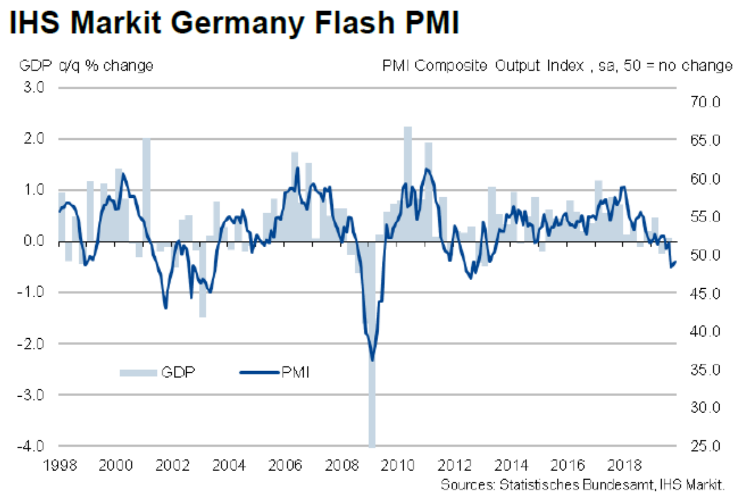
Net exports contributed +0.5% pts – offsetting the decline in the domestic market. Export growth rebounded and increased at a faster pace than imports.

https://www.destatis.de/EN/Press/2019/11/PE19_448_811.html;jsessionid=91DCFFF3C5653104A4FCCF1E9A384052.internet731

Germany Prelim Composite PMI (Nov)

The headline composite index of output indicated a weaker pace of decline in Nov. Services output growth continued to slow while the decline in manufacturing output also slowed.

Composite PMI Output Index; Nov 49.2 versus Oct 48.9



Services Output Index; Nov 51.3 versus Oct 51.6

Output growth slowed further and remained the weakest reading since Sep 2016. New orders declined although the pace eased.

Manufacturing PMI; Nov 43.8 versus Oct 45.2

Production in manufacturing continued to decline, albeit at a slower pace. New orders and new export orders declined but at a slower pace.

Overall order backlogs declined for the thirteenth month and was the second fastest pace of the last seven years - no doubt helping to lift output growth.

There was no change in private sector job growth.

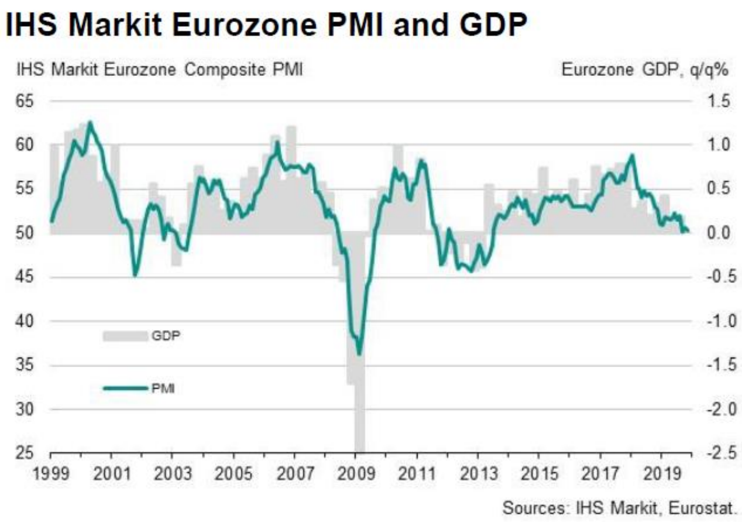
Overall optimism turned positive for the first time in four months.

https://www.markiteconomics.com/Public/Home/PressRelease/d4e03a5eed9f4321bf36091cbf917881

Eurozone Prelim Composite PMI (Nov)

The headline composite index indicated that growth continued to slow/stagnate at the broader Eurozone level. Services activity slowed further, while the decline in manufacturing abated slightly.

Composite PMI Output Index; Nov 50.3 versus Oct 50.6



Eurozone Services PMI Activity Index; Nov 51.5 versus Oct 52.2

Eurozone Manufacturing PMI; Nov 46.6 versus Oct 45.9

Output overall expanded at the slowest pace since Jul 2013. New orders declined for the third month in a row. Employment growth slowed to the slowest pace in five years as firms remained cautious. Order/work backlogs continued to decline, and at the fastest pace in the last five years also. Weaker demand resulted in much slower growth in output charges – the increase in prices charged by firms was the joint lowest in three years.

https://www.markiteconomics.com/Public/Home/PressRelease/91044e6e6026458b9728162fbcd59345

Return to top

Japan

Merchandise Trade (Oct)

While the trade balance improved between Oct 2018 and Oct 2019, the underlying growth in exports and imports had deteriorated. In Yen value terms, export growth declined by 9% while import growth also declined by 14%.

The underlying detail of the trade report was negative. In most cases, declines in exports and imports in value terms were matched by declines in volume terms (where that detail is provided). A large portion of the decline in imports versus a year ago is related to petroleum, but again, import growth was down in value and volume terms.

The overall picture of trade suggest that it may not be just a currency/price effect, but could indicate weaker domestic and global demand.

All values quoted in ¥.

BALANCE OF TRADE – OCT

The actual balance of trade was in surplus in Oct 2019 versus a larger deficit in Oct 2018;

Surplus Oct 2019; 17bn (a year ago Oct 2018; 456bn deficit)

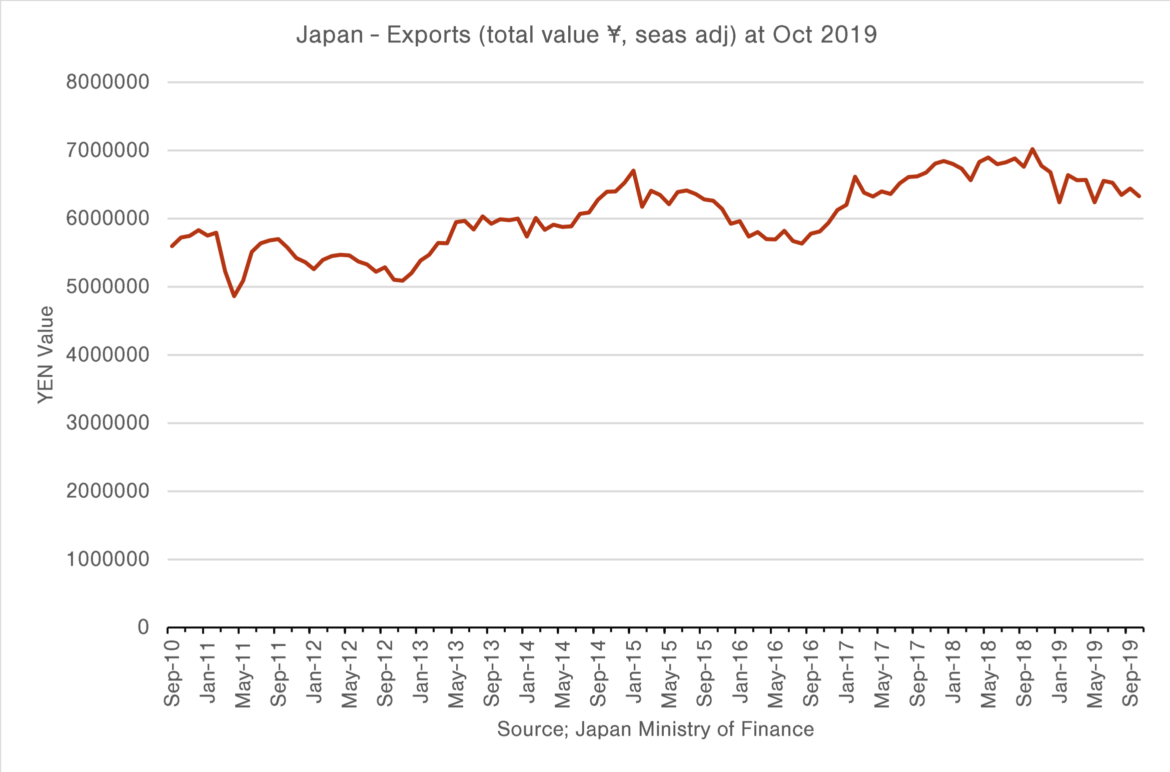
Exports – annual change (NSA); Oct 2019 -9.2%

Imports – annual change (NSA); Oct 2019 -14.8%

EXPORTS

On a seasonally adjusted basis, exports declined by 9.8% versus a year ago and 2% versus the month prior.

The severity of the annual decline is partly a base effect. In this most recent cycle, the value of total exports peaked back in Oct 2018 – seasonally adjusted exports increased +4% in that month versus Sep. But exports have drifted off since then anyway.



<u>Exports by Region</u>

Exports to most trading partners declined in Oct. Exports to the two largest customers, China and the US declined at rates above the total decline in exports;

Exports to China -10.3% versus a year ago – across all commodity categories. Exports to Asia broadly were down over 11% versus a year ago – also across all commodity categories. Exports to Korea were down 23%, Singapore -14%. Exports to Taiwan were up +1.4%.

Exports to the US declined by 11.4%. There was a large decline in the value and volume of exports of transport equipment (contributing over half of the overall decline). Declines in exports were recorded across all categories.

Exports to Western Europe declined by 6.3% (less than total), but there was a notable 19% decline in exports to Germany. Across the EU, the declines in exports were led by machinery and electrical machinery (value and volume). Export of transport equipment was up in total, but motor vehicle parts exports declined in value and volume terms versus a year ago.

Exports to the Middle East increased by 3.6% versus a year ago.

<u>Exports by Commodity</u>

Exports by commodity highlight weakness across most groups. In order of the largest contribution to the 9.2% decline in exports;

Machinery contributed -2.5% pts to the decline or -13% decline in Yen terms. Volume declines were recorded across power generating machinery, computer parts and semi's (only detail provided).

Transport equipment contributed -1.7%pts to the decline, or -7.4% decline in value terms. Declines across motor vehicles (cars and buses & trucks) and parts exports were also recorded in volume terms.

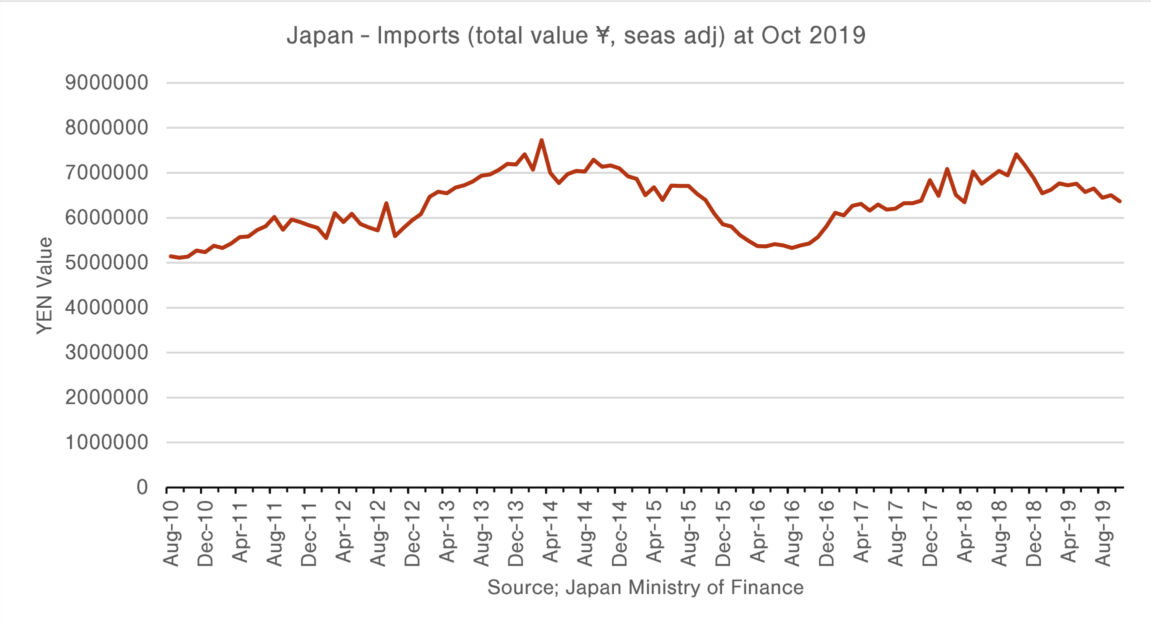
Electrical machinery and manufactured goods both contributed -1.5%pts (each) to the decline.

Chemicals, raw materials and other all contributed to the decline versus a year ago.

<u>IMPORTS</u>

On a non-seasonally adjusted basis, imports fell by 14.8%. On a seasonally adjusted basis, imports declined by 14.2% versus a year ago and 2.2% versus the month prior. A significant portion of the decline in imports is attributed to the lower value of petroleum imports. The value of imports of petroleum declined by 22% versus a year ago while volume declined by -1.3%.

Similarly, the scale of the decline is somewhat exacerbated by a base effect. In Oct 2018, the value of imports peaked. In seasonally adjusted terms, imports in Oct 2018 increased by 7% (the clear peak in this cycle visible in the chart below). Total imports have drifted off since then.



<u>Imports by Country</u>

The value of imports was lower across most trading partners. In descending order of the largest import markets;

China; imports declined by 15% versus a year ago. The largest declines were recorded for electrical machinery -16%, other -16% and manufactured goods -15%. Declines were recorded across all other categories in value terms.

Across all of Asia, the value of imports declined across all of the major trading partners in Oct (versus a year ago).

Imports from the US declined by 17% - led by foodstuffs, chemicals, machinery and mineral fuels (-36% - the largest, but not only, contributor the headline decline in imports). The import of transport equipment was up 30% versus a year ago – most of which was aircraft.

Imports from Europe were down 10%. Led by Germany -13%, but imports from most countries in Europe declined versus a year ago.

Imports from the Middle East were down 30%. The decline in mineral fuel imports (value) accounted for all of that decline.

Imports by Commodity

The value of imports declined across all commodity groups in Oct versus a year ago. The exception was transport equipment which made 0% contribution to growth/decline. While the import of motor vehicles increased by 10% in value terms, the volume declined by 5%.

The single biggest contributor to the decline was mineral fuels, contributing -5.5%pts to the decline in Oct. The volume of petroleum also declined.

Electrical machinery contributed -2.1%pts to the decline, other -2%pts, chemicals -1.9%pts, manufactured goods -1.5%pts, food -0.6%pts and raw materials -0.2%.

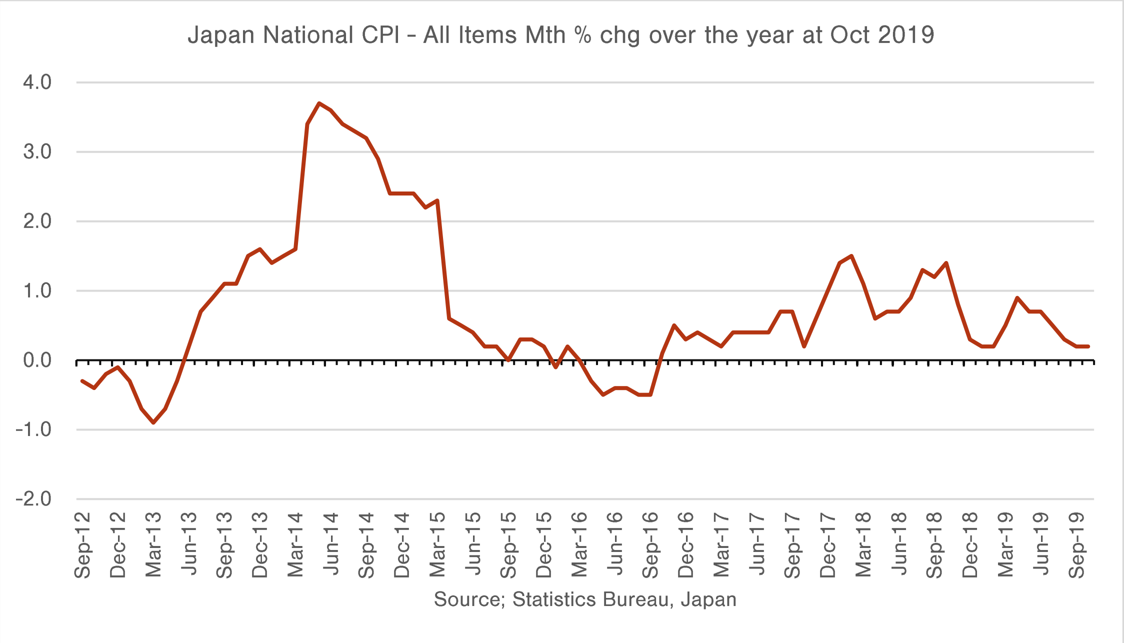
http://www.customs.go.jp/toukei/latest/index_e.htm

Japan CPI (Oct)

The Oct CPI data reflects part of the first month of the increase in the sales/consumption tax. There was no change in the pace of headline CPI growth. While food prices increased at a faster annual pace, there was an accelerated decline in fresh food prices. A further fall in energy prices also offset some of the effect of the tax increase.

Headline CPI – annual change; Oct +0.2% versus Sep +0.2%

Annual CPI charts have been posted with a longer history to include the last increase in consumption tax in Apr 2014. The increase in Oct 2019 to 10% was delayed several years;



There was a small acceleration in headline CPI growth in the month though, with CPI growing at +0.4% in Oct versus +0.1% in Sep.

How price have changed over the month;

Increases/acceleration was recorded across several categories. The Sep month price growth that is quoted below is representative of the pace of growth prior to the Oct hike.

Food prices increased at a faster annual pace in Oct of +0.9% versus +0.5% in Sep. Food prices overall increased at a slower pace in the month due to a decline in fresh food prices (what the BoJ measures). Fresh food prices only account for 4% of the index weight, but declined by 1.6% in Oct. The annual decline in fresh food prices continued at -3.5% in Oct versus -2.2% in Sep.

Housing price growth accelerated – most notably in the month growing at +0.5% in Oct after recording 0% each month since 2015. This represents 21% of the index weight.

Furniture and household utensils price growth increased at a much faster pace in Oct +2.5% versus +0.3% in Sep.

Medical care prices increased to +0.9% growth in Oct after declining -0.1% in Sep.

Transport & comms prices jumped +1.1% in Oct from -0.7% in Sep.

Culture and recreation prices also jumped +2.2% in Oct from -1.9% in Sep. The +2.2% jump in the month is not unusual.

Energy prices overall increased in the month by +0.8% after recording four consecutive monthly declines prior to that.

These increases in the month have been offset by weaker/declines in the monthly price across several categories;

Fuel, light and water charges continued to decline month on month.

Clothing and footwear prices increased at a slower pace in Oct +1.6% versus +4% in Sep.

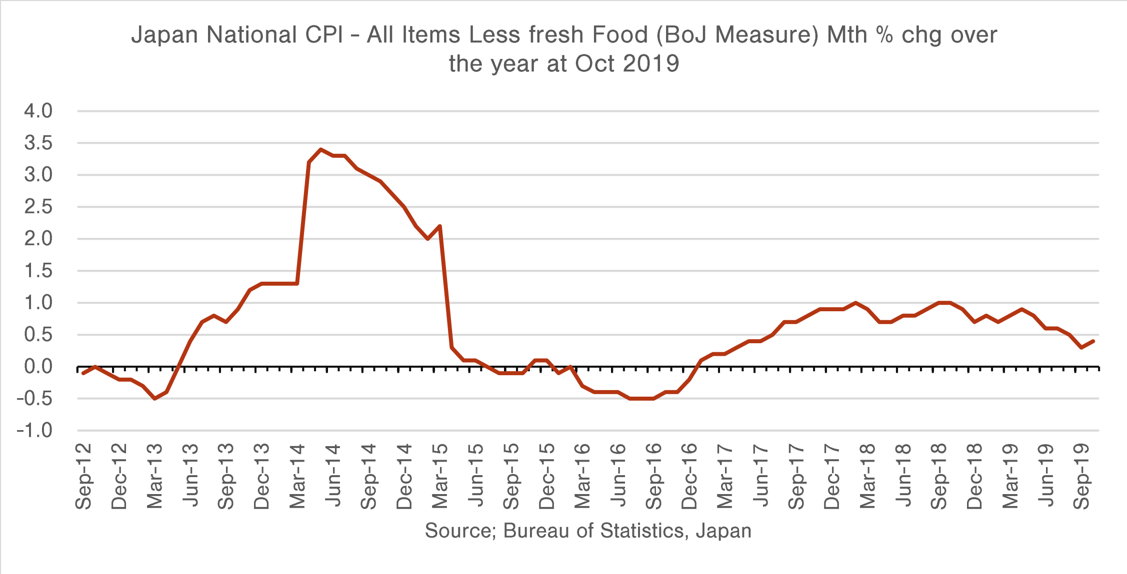
Education prices declined by 8.4% in Oct after posting low monthly growth over the last few years. Sep was 0% growth. Education represents 3% of the index weight.

Misc prices declined by -3.1% in Oct (approx. 6% of the index weight).

CPI Ex Fresh Food

The measure of CPI followed by the BoJ is CPI less fresh food;

CPI ex Fresh Food – annual change; Oct +0.4% versus Sep +0.3%



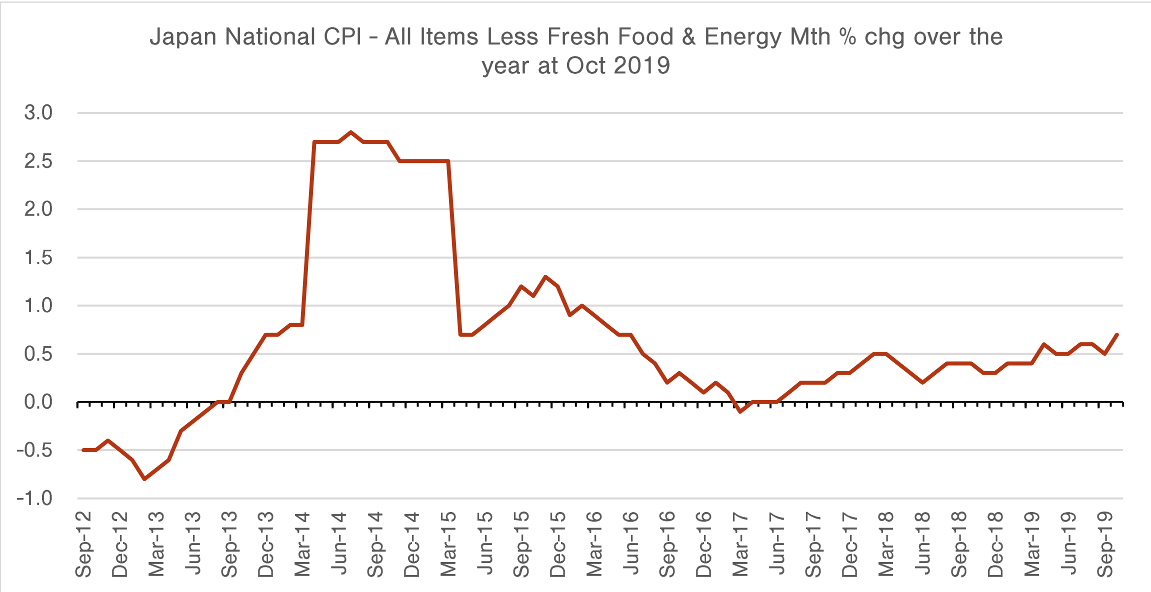
In the month, CPI ex fresh food increased by +0.4% in Oct versus a -0.1% decline in Sep.

<u>Core CPI – All items ex fresh food and energy</u>

It's difficult to ignore the impact that changes in energy prices are having on the headline CPI.

Energy prices declined at an accelerated annual pace of -2.7% in Oct after declining by -1.9% annual pace in Sep. So excluding energy and fresh food, underlying consumer prices show more of an acceleration in growth;

<u>Core CPI ex fresh food and energy – annual change</u>; Oct +0.9% versus Sep +0.5%

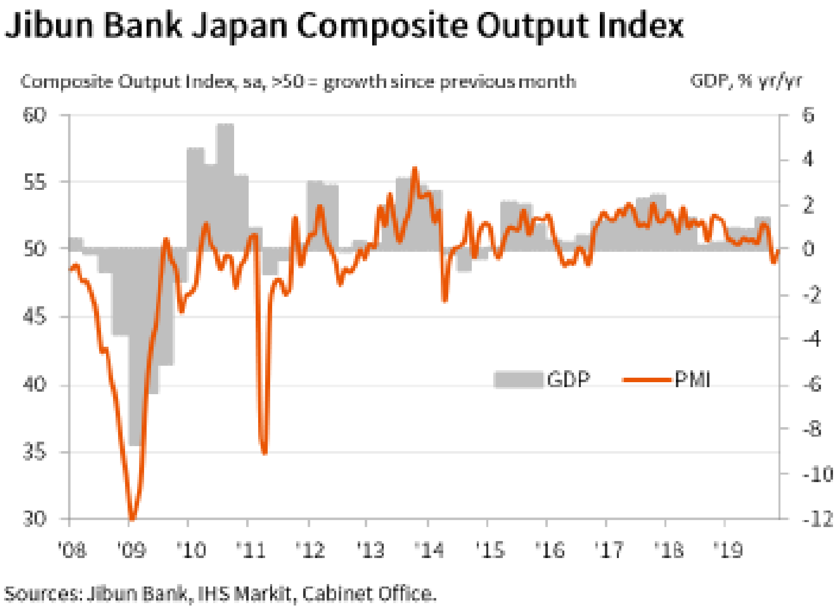


https://www.stat.go.jp/english/data/cpi/1581-z.html

Japan Prelim Composite PMI (Nov)

The index of private sector services and manufacturing activity indicated that growth was stagnant in Nov. While services activity shifted from slight contraction to marginal growth, manufacturing activity continued to decline.

Headline Composite Index; Nov 49.9 versus Oct 49.1



Services Activity Index; Nov 50.4 versus Oct 49.7

Output growth rebounded marginally. New orders recorded stronger growth, but new export order growth slowed. Slower growth in order backlogs helped to support output growth. Employment increased at a slower pace. Output prices increased at a slower pace. Yet the outlook improved with a stronger positive sentiment reading for future output.

Manufacturing PMI; Nov 48.6 versus Oct 48.4

Output and new orders continued to decline albeit at a slower pace. New export orders also declined further, but at a slower pace. Further declines in order backlogs helped to support the small improvement in output. Despite the weaker demand and production conditions, employment increased at a faster pace. Firms reduced output prices amid the weaker demand conditions. Firms continued to manage inventories with a faster decline in purchase quantities and stocks of purchases.

Despite the gloomier results, business sentiment recorded a stronger positive outlook for future growth.

https://www.markiteconomics.com/Public/Home/PressRelease/35433956b8214428ae3da6673ee04217

Return to top

United Kingdom

Brexit

The UK has now had a further Brexit extension approved – until 31 Jan 2020. This will allow time for the general election to be held on 12 Dec 2019.

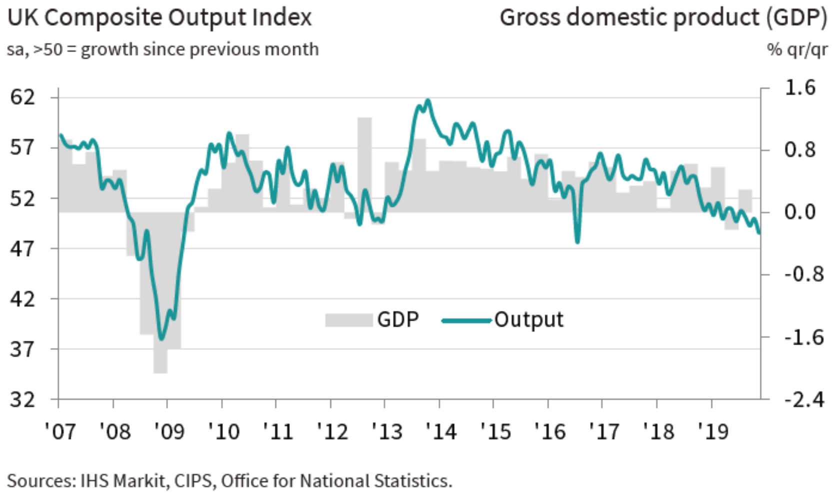
> Despite doing the seemingly impossible and getting a new deal from the EU, he [PM Johnson] simply doesn't have the numbers in Parliament to pass the legislation required to deliver Brexit. Holding an election in which he secures a fresh majority was his only real option.
> https://edition.cnn.com/2019/11/02/uk/boris-johnson-brexit-risk-intl-gbr/index.html

UK Composite PMI – Prelim (Nov)

The prelim UK composite PMI indicated private sector output fell into contraction and declined at the fastest pace since Jul 2016. Services output declined after stagnating in Oct and manufacturing output declined at a faster pace.

> Reports from survey respondents largely attributed weaker domestic economic conditions to a lack of clarity in relation to Brexit, alongside a fresh injection of business uncertainty from the forthcoming general election.

Composite Output Index; Nov 48.5 versus Oct 50



Services Business Activity Index; Nov 48.5 versus Oct 50

Weaker output was linked to the political uncertainty but some firms also cited weaker consumer demand in Nov. New business declined for the third month led by sharper falls in demand from overseas clients.

Manufacturing PMI; Nov 48.3 versus Oct 49.6

Output, new orders and employment all declined in Nov. Production falls were the result of both global economic and local political uncertainty. The decline in employment was the largest since 2012. Stocks of finished goods declined at the fastest pace in over two years as firms reverse the stock piling efforts prior to the 31 Oct deadline.

https://www.markiteconomics.com/Public/Home/PressRelease/9a06ecc699294f8cb13d26c3aff7b651

Return to top

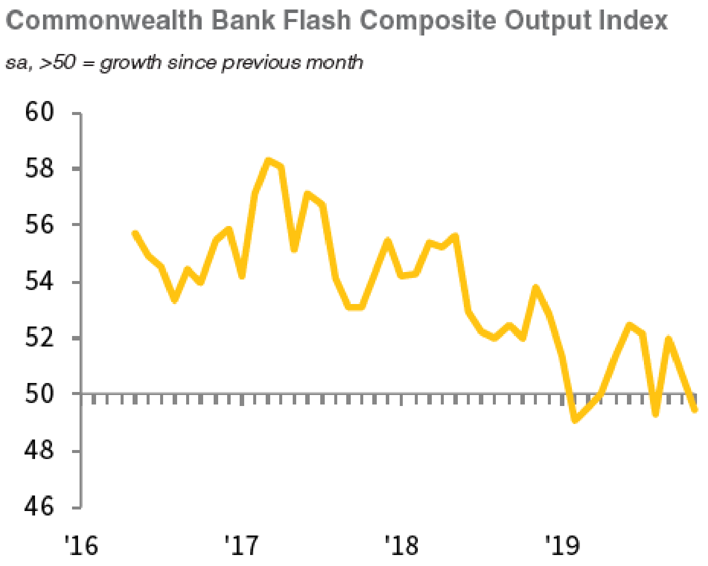
Australia

CBA Prelim Composite PMI (Nov)

The composite index of private sector manufacturing and services activity contracted in Nov. Both services and manufacturing activity shifted from no change in Oct to a small contraction in activity in Nov.

> Activity in the key manufacturing and services sectors continues to bounce around the 50 line that separates expansion from contraction. This is a **particularly disappointing result when benchmarked against interest rate cuts, tax cuts,** rising house prices and a still solid labour market"

Headline Composite Index; Nov 49.5 versus Oct 50



Services Business Activity Index; Nov 49.5 versus Oct 50.1

While business activity declined in the month, there was still marginal growth in new orders. Employment growth was also recorded at a marginal pace. Input prices increased at a faster pace, but firms reduced selling prices in order to stimulate demand. The fall in selling prices was the first since Jun 2016.

Manufacturing PMI; Nov 49.9 versus Oct 50

Output declined for the third month in a row – at a similar pace as the month prior. But new orders declined at a faster pace – the fastest pace in the (short 43- month) history of the series so far. There was a renewed decline in new export orders.

Employment levels declined slightly.

Business sentiment declined to a 41-month low.

https://www.markiteconomics.com/Public/Home/PressRelease/5c6a886e4e934d7b90939757001dc6af

RBA Minutes – Meeting 5 November 2019

Rates were kept on hold at this meeting, but there was consideration given to the case for further easing at this meeting;

> The Board agreed that a case could be made to ease monetary policy at this meeting, but that the most appropriate approach would be to maintain the current stance of monetary policy and to make another full assessment once more evidence of the effects of the earlier monetary easing had become available.

Given the assessment of the economy and the progress that had been made so far towards achieving the RBA goals (little, if any movement on wages growth, inflation and unemployment), it was deemed that there could be a case for easing at this meeting.

On balance, it was decided to keep rates on hold to allow for more time to make another full assessment. The Board noted that financial markets were signalling a decline in pessimism which could lead to "better than expected outcomes for the global economy".

> Having already delivered a substantial monetary stimulus in recent months, there was a case to wait and assess the effects of this stimulus, especially given the long and variable lags.

The minutes highlight the risks that exist in the economy and how growth overall had underwhelmed. The downturn in housing was noted as having a much larger negative spill-over effect than anticipated;

> Members considered a detailed review of how the economy had evolved over the preceding year relative to the Bank's forecasts for GDP growth, unemployment and inflation. **Over the year since the November 2018 forecasts, GDP growth had been much weaker than expected**. Inflation had also been lower than forecast. The extent and breadth of the spillovers from the housing downturn – particularly for consumption, household income, dwelling investment and inflation – had been an important driver of these outcomes. These spillovers had mostly been identified at the time as downside risks to the forecasts, but **their extent had been considerably larger than expected**.

The assessment was somewhat downbeat and, after the minutes were released, the probability of a further rate cut at the next meeting increased from 22% to 31% (19 Nov).

<u>Assessment</u>

Growth was expected to pick up to 2.75% due to accommodative monetary policy, recent tax cuts, expenditure on infrastructure and the "upswing in housing prices" across some markets as well as a pick-up in mining investment.

Yet, wages growth remains low and is expected to remain low for some time.

> Members agreed that a further gradual lift in wages growth would be a welcome development and was needed for inflation to be sustainably within the 2–3 per cent target range.

There is little evidence yet of translation of accommodative policies and tax concession into consumption expenditure growth. Accommodative policies were expected to support household income growth, but even then, that growth has been revised lower due to the effects of the drought and the downturn in housing construction on related businesses.

> Retail sales volumes had declined in the September quarter, which suggested that consumption growth was likely to have remained subdued in recent months despite the tax offset payments and the reductions in interest rates.
>
> Consumer sentiment had fallen to below-average levels over recent months.

In fact, the Board also identifies the possibility that consumer sentiment could be adversely affected by further cuts in interest rates (emphasis added);

> While members judged that lower interest rates were supporting the economy through the usual transmission channels (including a lower exchange rate, higher asset prices and higher cash flows for borrowers), they recognised the negative **effects of lower interest rates on savers and confidence**. They also discussed the possibility that **a further reduction in interest rates could have a different effect on confidence than in the past, when interest rates were at higher levels**.

The downturn in housing construction was identified as a risk. **By the Banks' own admission, this has been an under-appreciated area of weakness in the economy.** The downturn in the housing market has not only been driven by the tighter lending conditions leading up to and during the Banking Royal Commission, but also by to the difficulties now being faced by Body Corporates and high-rise developers due to structural defects in newly completed buildings (insurance costs). Lending practices have also changed since the Royal Commission such that there is a difference in interest rates charged for lending for investment properties – both are factors that are contributing to the lack of recovery in the growth of lending for investment purposes. It's likely that the prior loose lending practices for investment lending was a key driver of the construction boom. So far, the Board has indicated that there has been little impact (yet) from lower rates on development activity.

> Despite the stronger-than-expected pick-up in established housing markets, there had been little evidence of a lift in the early stages of residential development activity.
>
> A larger-than-expected contraction in dwelling investment could delay the gradual improvement in GDP growth.
>
> One near-term downside risk to the Australian economy could be a larger-than-expected contraction in housing construction activity.

The Board mentions infrastructure spending as a source of stimulus. There is no detail provided about the size/scope and the degree to which that this government spending will be incremental to the fall in housing construction. So far, the government has announced approx. $3.8bn in infrastructure spending.

The Board also mentions investment expenditure on mining as a source of growth in the forward assessment. Again, the Boards' own forecast was for lower terms of trade, because global demand for bulk commodities was expected to ease. Export performance of key commodities such as iron ore to be determined by demand out of China. Slowing growth in China is yet to impact export performance;

> Members noted that the implications of slower global growth for the Australian economy would depend on its composition; over the previous year or so, strength in steel-intensive activity in China had supported demand for Australian exports **despite Chinese growth slowing overall**.

Inflation figures indicated price growth remained subdued – but with higher prices across tradables (pass through of weaker currency into higher retail prices) offset by lower housing related consumer prices.

> Trimmed mean inflation had been low and steady at 1.6 per cent in year-ended terms, which was consistent with slow output growth, continued spare capacity in the labour market and weak housing market conditions weighing on housing-related prices.

https://www.rba.gov.au/monetary-policy/rba-board-minutes/2019/2019-11-05.html

Return to top

Trade

US-China Trade Talks

Headline risk remains very high around the trade talks and the phase-one deal details.

Chinese Vice Premier Lui He has invited the US trade delegation for further talks in Beijing in Dec.

While some reports are mixed, there are indications that the US will most likely postpone the tariffs scheduled to increase on 15 Dec. Nothing is confirmed and will likely depend on the outcome of talks in Beijing.

It's possible a more detailed trade deal could be negotiated – and the deadline for this phase of the deal could move further out into 2020. Requests from China to roll back tariffs may require more concessions;

> China's commerce ministry said this month that removing tariffs imposed during the trade war is an important condition to any deal. The demand has U.S. officials wondering if higher Chinese purchases of U.S. farm goods, promises of improved access to China's financial services industry, and pledges to protect intellectual property are enough to ask in return.
>
> whether Trump will agree to remove existing tariffs depends largely on whether he believes it will benefit his re-election chances. Some White House advisers would like to see China agree to large, specific agricultural purchases, while the U.S. maintains existing tariffs for future leverage.
> https://uk.reuters.com/article/uk-usa-trade-china/beijing-tariff-demands-may-expand-u-s-china-phase-one-trade-deal-significantly-idUKKBN1XU0DH

https://uk.reuters.com/article/us-usa-trade-china-phasetwo/no-phase-two-u-s-china-deal-on-the-horizon-officials-say-idUKKBN1XZ00H

The situation is likely to remain tenuous. The purchase of a specific quantity of agriculture has been a key sticking point for China.

> "Beijing, for its part, is hesitant to include a specific amount of agricultural purchases in a deal, The Wall Street Journal reported. Trump has claimed Beijing agreed to purchase up to $50 billion in U.S. farm goods."
> https://www.cnbc.com/2019/11/17/china-and-us-had-constructive-discussions-about-phase-one-trade-deal.html

The other issue at hand is that of Hong Kong. The US Hong Kong Democracy bill has two versions – one approved by the House of Representatives and one approved by the Senate. Both versions need to be reconciled before being signed into law by President Trump. On the passing of the Bill by the Senate;

> Beijing hit back instantly at the passage of the bill, summoning a senior US diplomat and telling the US to keep its hands off China's internal affairs, warning of retaliation if Trump gives it the green light. Hong Kong commerce

> minister Edward Yau Tang-wah called it “unwarranted and unnecessary”, saying the bill “adds fuel to the fire”.
>
> https://www.scmp.com/news/hong-kong/politics/article/3038671/hong-kong-democracy-bill-passed-us-senate-spells-hope

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

This week, the lower house of Japan’s parliament approved the phase one of the limited trade deal with the US;

> The government’s proposal to ratify the trade deal will next be brought to the upper house for a vote but its passage in the powerful lower house increases the chances it will come into force in January.

The focus then moves to phase two negotiations;

> After the deal is ratified, Japan and the United States have four months to consult on further talks, and Trump has said he wants more trade talks with Japan after the initial deal.
>
> But Japanese government sources familiar with the talks say the momentum to negotiate a deeper deal appears to have waned for now with Washington preoccupied with talks with Beijing.

The issue for phase two talks is auto tariffs;

> Japan has said it has received U.S. assurance that it would scrap tariffs on Japanese cars and car parts, and that the only remaining issue was the timing. But Washington has not confirmed that.
>
> https://www.reuters.com/article/us-usa-trade-japan/japan-lower-house-passes-u-s-trade-deal-auto-tariffs-still-in-question-idUSKBN1XT0IK

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

The threat of auto tariffs also remains an issue, despite the US missing the S.232 deadline of 14 Nov. After postponing a decision on auto tariffs (based on National security issues) back in May, US President Trump may decide on 14 Nov (or around this time).
https://www.cnbc.com/2019/11/08/trump-wont-impose-tariffs-on-european-cars-eu-juncker-says.html

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

Back in May, 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. A Reuters article during the week reported that President Trump may no longer be able to impose tariffs under this S.232 investigation because of the missed announcement deadline. Source: https://www.reuters.com/article/us-usa-trade-autos/trump-can-no-longer-impose-section-232-auto-tariffs-after-missing-deadline-experts-idUSKBN1XT0TK

> The 1962 act is clear about the time limits that a president has for invoking tariffs to protect U.S. national security.

The article outlines other recent cases where the increase in tariffs have been challenged due to missed deadlines (Turkey and the increase in steel tariffs in 2018).

The article outlines the "escape hatch" for President Trump;

> A clause in the 1962 law may offer an escape hatch for Trump. If an agreement is not reached within 180 days or proves ineffective, "the President shall take such other actions as the President deems necessary to adjust the imports of such article so that such imports will not threaten to impair the national security." It adds that Trump would be required to publish these actions in the Federal Register, but does not specify a time frame.

For the moment, there have been no announcements made by the USTR or by the USTR on the Federal Register.

The threat of auto tariffs is likely to 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. There are other avenues for how these tariffs may be implemented.

NAFTA/USMCA

No final agreement was reached last week on the USMCA, frustrating hopes of a vote prior to Thanksgiving.

> Leaving a meeting with House Speaker Nancy Pelosi and U.S. Trade Representative Robert Lighthizer, House Ways and Means Committee Chairman Richard Neal said the sides made progress but did not strike a final agreement, his office confirmed. https://www.cnbc.com/2019/11/21/pelosi-neal-and-lighthizer-do-not-reach-deal-on-trump-uscma-agreement.html

"Work will continue" to narrow differences between the two sides and it's unclear whether a vote will take place this year.

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

Return to top