

Key Themes

A busy week ahead with both data and events;

US Congress – possible votes on USMCA, Government funding bills ahead of the Friday deadline and impeachment this week.

Central bank decisions – BoJ and BoE. The BoJ will be interesting in light of the weaker data post-consumption tax. Changes in guidance from the BoE will be important now after the general election result.

Data highlights this week;

Prelim PMI's for Dec across the US, Europe, Japan, UK and Australia.

US – Personal income, outlays and the PCE price index for Nov, industrial production, JOLTS, final consumer sentiment for Dec and regional manufacturing surveys.

UK data – Q3 GDP, employment and retail sales.

Japan – CPI for Nov, the second read after the consumption tax increase and trade (Oct trade data was disappointing, so looking for a rebound post weather and consumption tax disruptions).

The Australian government released its mid-year economic and financial outlook (a mid-year budget statement). Overall, expected/forecast surplus was lower due to the slowing economy. No further expenditure measures for the economy were announced.

This week, the RBA will be focused on the employment data for Nov.

US Treasury supply will be heavier. The US Treasury will settle \$231bn in ST Bills, Notes and Bonds this week, raising approx. \$39bn in new money. Reserve management operations for this week will see the Fed purchase approx. \$30bn in treasury bills. Also, the Fed will reinvest approx. \$6.9bn in maturing securities.

The Fed has announced additional term repo operations and also increased offering amounts further in the lead up to year end.

Friday is also Quadruple Witching.

US Treasury Issuance & Settlements

The supply of US Treasuries settling this week will be heavier this week. The US Treasury will settle \$231bn in ST Bills, Notes and Bonds this week, raising approx. \$39bn in new money.

The US Treasury will also auction the 2yr FRN this week that will settle next week, raising approx. \$18bn in new money.

| WEEK | Auction Date | Settlement Date | Marketable Securities | Auction Amount \$B (TBAC) | Amount Maturing \$B | New Money \$B | |
|-----------|--------------|-----------------|--|---------------------------|---------------------|---------------|-----------|
| 16-20 Dec | 12-Dec | 17-Dec | 4 week bill | 40 | | | Completed |
| | 12-Dec | 17-Dec | 8 week bill | 35 | | | Completed |
| | | | | 75 | 87 | -12 | |
| | 16-Dec | 19-Dec | 13 week bill | 42 | | | Announced |
| | 16-Dec | 19-Dec | 26 week bill | 36 | | | Announced |
| | | | | 78 | 81 | -3 | |
| | 09-Dec | 16-Dec | 3yr Note | 38 | | | Completed |
| | 10-Dec | 16-Dec | 10yr Note | 24 | | | Completed |
| | 12-Dec | 16-Dec | 30yr Bond | 16 | | | Completed |
| | | | | 78 | 24 | 54 | |
| | | | Total - securities settling this week | 231 | 192 | 39 | |
| | | | Fed SOMA - Face Value of SOMA securities maturing | \$B | | | |
| | | 17-Dec | Tbills | 8.1 | | | |
| | | 19-Dec | Tbills | 0.07 | | | |
| | | | | 8.17 | | | |
| | | | Reserve Management Purchase Operations - Treasury Bills | \$B | | | |
| | | 16-Dec | Tbills | 7.525 | | | |
| | | 18-Dec | Tbills | 7.525 | | | |
| | | 19-Dec | Tbills | 7.525 | | | |
| | | 20-Dec | Tbills | 7.525 | | | |
| | | | | 30.100 | | | |
| | | | Reinvestment Purchases - Treasury Coupons | \$B | | | |
| | | 17-Dec | Coupons | 1.625 | | | |
| | | 18-Dec | Coupons | 1.825 | | | |
| | | 19-Dec | Coupons | 1.825 | | | |
| | | 20-Dec | Coupons | 1.625 | | | |
| | | | | 6.900 | | | |

New reserve management operations and reinvestment purchases for mid-Dec to mid-Jan were announced. Operations for this week will see the Fed purchase approx. \$30bn in treasury bills. Also, approx. \$6.9bn in maturing securities on the Fed balance sheet will be reinvested.

The FOMC also announced at its meeting in July that reductions of its securities holdings in the SOMA will conclude in Aug rather than at the end of Sep. Principal payments from maturing securities will be reinvested;

“...Beginning in August 2019, principal payments received from agency debt and agency MBS up to \$20 billion per month will be reinvested in Treasury securities to roughly match the maturity composition of Treasury securities outstanding; principal payments in excess of \$20 billion per month will

continue to be reinvested in agency MBS. **Also beginning in August, all maturing Treasury securities in the SOMA portfolio will be rolled over at Treasury auctions following usual practices.**

<https://www.federalreserve.gov/monetarypolicy/policy-normalization.htm>

WEEK OF 16 December 2019

MONDAY 16 DECEMBER (US Eastern Time)

| | |
|--------|---|
| US | Empire State Manufacturing Index (Dec), US Composite PMI Prelim (Dec), Housing Market Index (Dec) |
| Aus | Composite PMI Prelim (Dec), MYEFO released |
| Japan | Composite PMI Prelim (Dec) |
| China | Fixed Asset Investment, Industrial Production, Retail Sales (Nov) |
| Europe | Eurozone & Germany Composite PMI Prelim (Dec) |
| UK | Manufacturing & Services PMI Prelim (Dec) |

TUESDAY 17 DECEMBER

| | |
|-------|--|
| US | Housing Starts & Permits (Nov), Industrial Production (Nov), JOLTS (Oct). US Fed speeches; Kaplan, Rosengren, Williams |
| Aus | Housing Finance (Oct), RBA Minutes |
| UK | Employment Survey (Aug-Oct) |
| Japan | Merchandise Trade (Nov) |

WEDNESDAY 18 DECEMBER

| | |
|--------|----------------------------------|
| US | US Fed speeches; Evans, Brainard |
| Europe | CPI (Nov) |

THURSDAY 19 DECEMBER

| | |
|-------|---|
| US | Philadelphia Fed Business Outlook Survey (Dec), Existing Home Sales (Nov) |
| Aus | New Home Sales (Nov), Labour Market Survey (Nov) |
| Japan | BoJ Rates Decision, CPI (Nov) |
| UK | Retail Sales (Nov), BoE Rates Decision |

FRIDAY 20 DECEMBER

| | |
|----|--|
| US | GDP (third Est) Q3, Personal Income, Outlays and PCE Price Index (Nov), Consumer Sentiment – Final (Dec), Kansas City Fed Manufacturing Survey (Dec) |
| UK | GDP Q3 |

Trade & Brexit

US-China Trade Talks

The news late in the week was that the US and China had reached a deal on phase one of the trade deal. The good news for the markets is that, there is at least no further deterioration in the relationship and to tariff hikes.

The increase in the tariff rate scheduled for 15 Dec for Chinese imports did not go ahead. China also announced that it would temporarily suspend scheduled tariff increases that were expected to take effect on 15 Dec.

The USTR made a statement and outlined some 'details' regarding the agreement. It is expected that the agreement, after it is put into writing, will be signed in the first week of 2020.

The United States and China have reached an historic and enforceable agreement on a Phase One trade deal that requires structural reforms and other changes to China's economic and trade regime in the areas of intellectual property, technology transfer, agriculture, financial services, and currency and foreign exchange. The Phase One agreement also includes a commitment by China that it will make substantial additional purchases of U.S. goods and services in the coming years. Importantly, the agreement establishes a strong dispute resolution system that ensures prompt and effective implementation and enforcement. The United States has agreed to modify its Section 301 tariff actions in a significant way. <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/united-states-and-china-reach>

The USTR announced that the US will maintain a 25% tariff on approx. \$250bn of Chinese imports as well as the Sep 15% tariff cut to 7.5% on approx. \$120bn of imports.

As a part of this statement, the USTR provided a fact sheet (<https://ustr.gov/sites/default/files/US-China-Agreement-Fact-Sheet.pdf>) with some 'details' of the agreement. One of the key issues had been around intellectual property. The fact sheet relays ambiguous wording around 'addressing numerous long-standing concerns'.

The technology transfer chapter indicates that (emphasis added);

For the first time in any trade agreement, **China has agreed to end its long-standing practice of forcing or pressuring foreign companies to transfer their technology to Chinese companies as a condition for obtaining market access**, administrative approvals, or receiving advantages from the government. China also commits to provide transparency, fairness, and due process in administrative proceedings and to have technology transfer and licensing take place on market terms. Separately, China further commits to refrain from directing or supporting outbound investments aimed at acquiring foreign technology pursuant to industrial plans that create distortion. <https://ustr.gov/sites/default/files/US-China-Agreement-Fact-Sheet.pdf>

The expanding trade chapter;

The Expanding Trade chapter includes commitments from China to import various U.S. goods and services over the next two years in a total amount that exceeds China's annual level of imports for those goods and services in 2017 by no less than \$200 billion. <https://ustr.gov/sites/default/files/US-China-Agreement-Fact-Sheet.pdf>

There are still many conflicting stories regarding the details of the agreement (initial quantities of goods purchases announced the President were then revised lower), what will be and won't be made public and what benchmarks will be placed in writing. Some reports indicate that China only agreed to existing WTO rules on trade. Still expect some headline risk.

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

Last week, the Upper House of the Japanese Parliament approved phase one of the trade deal. The US Congress does not need to approve the deal, so phase one will come into force in early 2020.

The focus in early 2020 will be on phase two of the deal;

After the deal enters into force, the countries have agreed to conclude consultations for further trade talks within four months. Then discussions between their lead negotiators, Foreign Minister Toshimitsu Motegi and U.S. Trade Representative Robert Lighthizer, will start again in earnest.

The United States is seeking a full-fledged free trade agreement that covers areas including services and investment.

<https://www.japantimes.co.jp/news/2019/12/04/business/economy-business/upper-house-approves-united-states-japan-trade-deal/#.Xe3HTegzaUk>

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>

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.

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. <https://www.cnbc.com/2019/11/08/trump-wont-impose-tariffs-on-european-cars-eu-juncker-says.html>

Digital Services

The USTR S.301 investigation into the digital services tax approved by the French government has been completed and released its report on 2 Dec 2019;

“USTR’s decision today sends a clear signal that the United States will take action against digital tax regimes that discriminate or otherwise impose undue burdens on U.S. companies,” Ambassador Robert Lighthizer said. **“Indeed, USTR is exploring whether to open Section 301 investigations into the digital services taxes of Austria, Italy, and Turkey.** The USTR is focused on countering the growing protectionism of EU member states, which unfairly targets U.S. companies, whether through digital services taxes or other efforts that target leading U.S. digital services companies.” <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/december/conclusion-ustr%E2%80%99s-investigation>

The proposed action includes up to 100% duties on certain French products imported into the US. The USTR is now inviting comments on the proposed action at a public hearing in Washington on 6 Jan 2020. <https://www.federalregister.gov/documents/2019/12/06/2019-26325/notice-of-determination-and-request-for-comments-concerning-action-pursuant-to-section-301-frances>

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

An agreement on the USMCA has been reached in the US among Republicans and Democrats. Legislation is likely to be introduced to Congress this week that will result in ratifying the new trade deal. The deal is likely to be voted on later in the week.

It has been reported that the USMCA will not go to the Senate this year.

Canada has yet to approve the deal – this is likely to happen once 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

The UK election now decided and Brexit likely to happen by the end of Jan 2020. The US President reconfirmed his eagerness to begin talks with the UK on a trade deal, once 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

BREXIT

The UK general election delivered a clear majority to the Conservative party. This most likely means that Brexit legislation will be introduced (and approved) in the UK parliament in time for the 31 Jan separation date. The UK and the EU will enter a transition period in which a new trade agreement will be negotiated. This can be extended to 2022, but the Conservative party has indicated that it would not extend that period beyond 2020.

The focus now shifts to the negotiation of the trade deal between the UK and the EU.

EU leaders will discuss on Friday a mandate for the European Commission to negotiate the future relationship with Britain after Brexit now expected at the end of January, with a transition period until the end of 2020.

<https://www.reuters.com/article/us-britain-election-eu-reaction/eu-welcomes-brexit-clarity-from-uk-conservative-victory-idUSKBN1YG2S7>

There is little detail at this stage as to how Brexit will be handled after 31 Jan and during the transition period. For now, there is at least some uncertainty removed regarding Brexit and that it will be an orderly exit. We expect that there will be some rebound in activity as firms commence preparations for 31 Jan 2020.

President Trump was quick to congratulate the UK and indicate he was ready to start negotiations on a trade deal. It's unclear whether or not the UK will commence negotiations with the US on a new trade deal before or after the EU negotiations are completed.

Current Brexit documents:

Announcement; http://europa.eu/rapid/press-release_IP-18-6424_en.htm

Comprehensive factsheet; http://europa.eu/rapid/press-release_MEMO-18-6422_en.htm

Q&A Protocol on Ireland and Northern Ireland; http://europa.eu/rapid/press-release_MEMO-18-6423_en.htm