MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 25 November 2019

Key Themes

US data this week continued to highlight generally weaker manufacturing activity across the three regional reports for Nov.

The advance Durable Goods report for Oct was mixed. Orders rebounded across most categories, but was led mostly by defence aircraft orders. Shipments remained weak with no growth in the month. Unfilled orders increased due to defense aircraft orders. Inventory still increased this month, albeit at a slower pace. The single largest contributor to inventory growth was non-defense aircraft.

We continue to track weakness in several categories – non-defense aircraft and motor vehicles. The annual increase in inventory for non-defense aircraft continued to accelerate and is now at +18%, compared to the 25% and 24% respective annual *declines* for orders and shipments. Motor vehicles was also weak; inventory is growing at an annual pace of 6% (consistently) while orders are down -4% and shipments are down -3% (both slowing). While there may some GM effect in this month's data, the slowing growth trend was established before that.

It's important to note that last week's US prelim manufacturing PMI continued to build on the improvement seen in Oct, so it's possible that there will be an improvement in manufacturing activity in the following months.

The second estimate for US GDP was revised higher to +2.1% from +1.9%. This was mostly the result of a shift in the change in inventories from a -0.4% decline to a +10% increase in Q3. This revision is not surprising given the higher levels of inventories recorded across several categories and seen across several different reports during Q3. As noted in the wholesale sales and inventory report for Sep, the inventory to sales ratio remains elevated – with inventory rising faster than sales.

The annual change in the headline PCE price index was unchanged in the month, but growth slowed further for the core measure of PCE price growth. Core PCE price growth slowed to 1.6% in Oct after approaching +1.8% in Aug. This will continue to reinforce the 'muted inflation pressure' view of the Fed.

House prices in the US increased at a faster pace in Sep, after a long period of decelerating growth.

Retail and industrial production data for Japan was volatile, reflecting the first month of the consumption tax increase. Retail sales declined in the month (and on an annual basis) reversing the gains in the two prior months which were likely due to stockpiling before the tax increase. The stockpiling effect will continue to unwind enabling us to evaluate the impact of the consumption tax on demand.

Japanese industrial production and shipments also fell hard with production down 4% in Oct. There was some typhoon related disruption in Oct and likely an impact from stockpiling prior to the increase in the consumption tax in Oct.

The value of Australian construction and private capex continued to decline in real terms in Q3 and will likely detracting from GDP growth in Q3. Growth in the value of outstanding private credit continued to slow – led this month by a notable slowdown in the growth of outstanding business credit.

The RBA Governor's speech this week reflected on the policy options available if/when the OCR reaches the effective lower bound – which has been confirmed as 0.25%. Governor Lowe goes out of his way to downplay any risk in the Australian economy and yet here we are, two 25bps cuts away from a scenario where the RBA would consider a QE program in Australia;

> "There may come a point where QE could help promote our collective welfare, but we are not at that point **and I don't expect us to get there**."

Contents

US Data

Chicago Fed National Activity Index (Oct)

There was a further deterioration in the Oct reading of the Chicago Fed National Activity Index. A reading below zero indicates below trend growth. This month, the headline index fell back to -0.7. This is a borderline reading for economic contraction. So far, its just one month at this level. The 3mth moving average (the preferred measure) remains at below trend growth, but still above this -0.7 threshold.

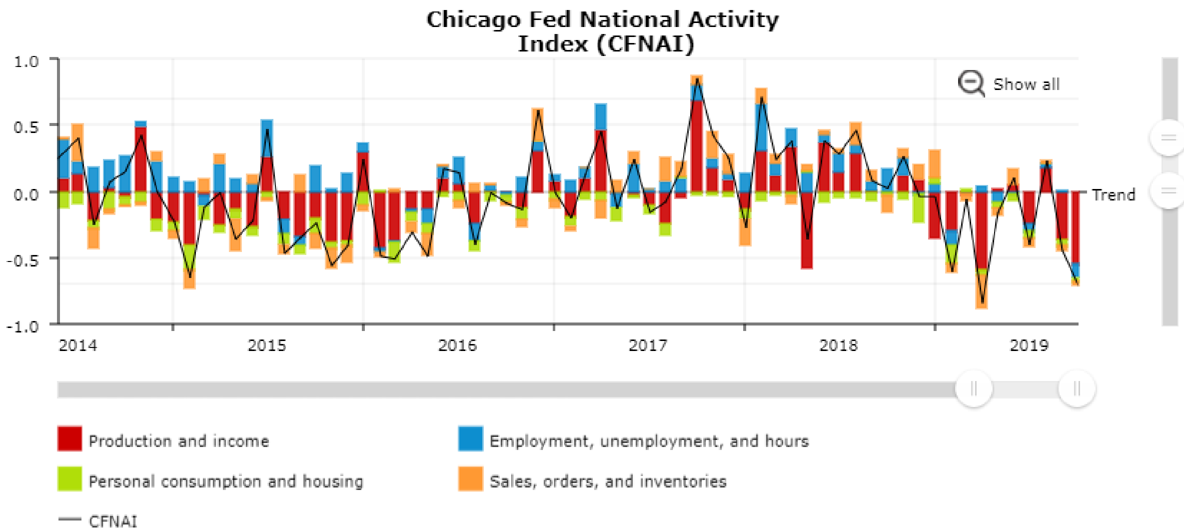
From the Chicago Fed (emphasis added);

> Following a period of economic expansion, an increasing likelihood of a recession has historically been associated with a **CFNAI-MA3** value below –0.70.

This month all sub-indices recorded below average growth with production and income the main contributor to the fall in the index. This is fairly consistent with the weaker manufacturing data recorded Sep-Oct.

Headline Index; Oct -0.7 versus Sep -0.45

The current 3mth moving average also weakened further; Oct -0.31 versus Sep -0.21.



Performance by Sub-Index

Production and Income; Oct -0.55 versus Sep -0.36. These have been the two worst performing months since Apr 2019. This is fairly consistent with the weaker manufacturing data during that time (includes GM strike). The Oct PMI for Manufacturing started to show some improvement and Nov improved further – so could indicate that this weakness abates coming into year end.

Personal Consumption and Housing; Oct -0.03 versus Sep -0.05

Employment, Unemployment and Hours; Oct -0.1 versus Sep +0.01. This is on par with the weakest reading of the YTD.

Sales, Orders and Inventory; Oct -0.03 versus Sep -0.04

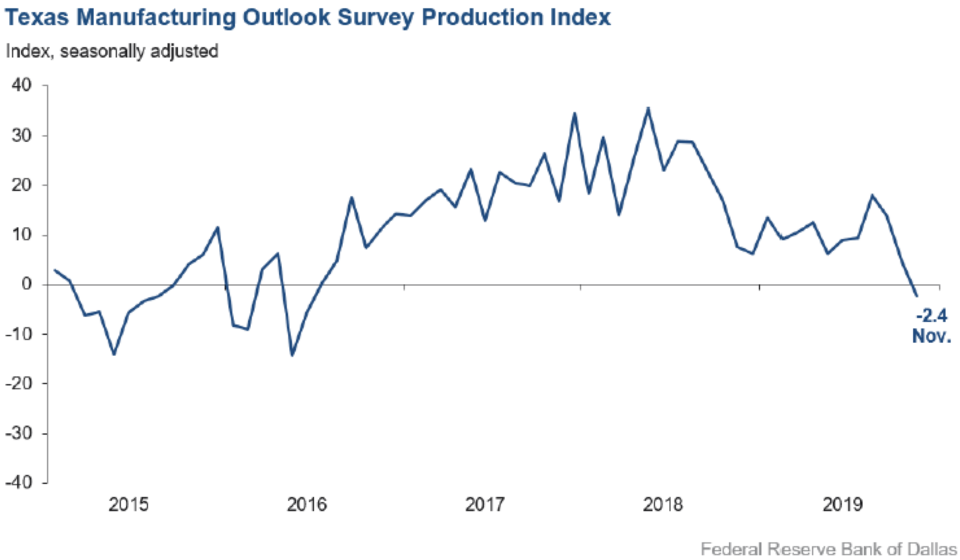
https://www.chicagofed.org/publications/cfnai/index

Dallas Fed Manufacturing Survey (Nov)

There was a general deterioration across most of the measures of the Texas manufacturing and outlook survey in Nov. The index general level of business activity remained in contraction but the pace of decline did slow somewhat. Key measures of production, new orders and the growth rate of new orders remained in contraction.

General Business Activity; Nov -1.3 versus Oct -5.1

Production Index; Nov -2.4 versus Oct 4.5



New orders remained in contraction and the growth rate of new orders declined at a faster pace. Unfilled orders also continued to decline, albeit at a slower pace.

Shipments shifted into decline after increasing in the month prior. Inventories declined at a faster pace.

The growth in prices paid for raw materials slowed and remains elevated. The growth in prices received for finished goods slowed to just above zero (+1.9).

Employment growth slowed to virtually no change and hours worked shifted into decline.

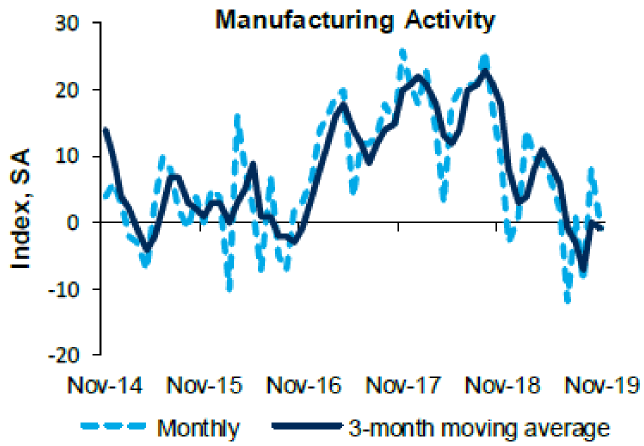
Company outlook shifted from a positive 8.8 in Oct to -2.1 in Nov. Outlook uncertainty increased at a faster pace, from 12.1 in Oct to 17.1 in Nov.

https://www.dallasfed.org/-/media/Documents/research/surveys/tmos/2019/1911/tmos1911.pdf

Richmond Fed Manufacturing Survey (Nov)

The headline index of manufacturing activity shifted back into slight contraction for Nov. This was led by shift into decline across shipments, new orders and order backlogs.

Headline index of Manufacturing Activity; Nov -1 versus Oct 8



Shipments and the volume of new orders shifted back into a slight decline after the rebound in the month prior. Order backlogs shifted back into decline – likely supporting already lower shipments.

Finished goods inventories increased at a faster pace (Nov 15 versus Oct 5). Raw material inventory remains elevated.

The growth in the number of employees slowed, but remained positive. Wages growth increased at a faster pace. The growth of the average workweek slowed to a low level.

Growth slowed in prices paid for materials. Growth in prices received increased at a faster pace.

Capex growth was little changed at a neutral level.

https://www.richmondfed.org/-/media/richmondfedorg/research/regional_economy/surveys_of_business_conditions/manufacturing/2019/pdf/mfg_11_26_19.pdf

Chicago PMI (Nov)

The barometer of business activity in Chicago remained in contraction this month. The pace of decline abated somewhat. The most notable change was the improvement in new orders, increasing to the neutral level.

Headline Chicago Business Barometer; Nov 46.3 versus Oct 43.2

This month, production declined further, falling to 42.3. New orders though, increased by 12pts to recover to a neutral level.

There was, though, anecdotal evidence of firms being concerned about the outlook due to wider economic issues.

Order backlogs declined but at a much slower pace (likely the result of the large improvement in orders). Inventories continued to decline. Employment demand continued to decline slightly. Prices received continued to grow, but at a slower pace.

https://s3.amazonaws.com/images.chaptermanager.com/chapters/b742ccc3-ff70-8eca-4cf5-ab93a6c8ab97/files/mni-chicago-press-release-2019-11-1574866416579.pdf

Advance - Durable Goods Orders (Oct)

Orders rebounded this month – led by growth across most categories. Stronger growth was recorded across defense and non-defense aircraft orders (defence aircraft orders made up the bulk of the total increase) and fabricated metal products. Orders for motor vehicles continued to decline.

The annual decline in orders slowed notably due in part to a lower base in Oct 2018.

Shipments remained weak with no growth in the month.

Unfilled orders increased by +$1.3bn, led mostly by the +$3bn increase in unfilled defense aircraft orders.

Inventory still increased this month, albeit at a slower pace. The single largest contributor to inventory growth was non-defense aircraft.

The annual increase in inventory for non-defense aircraft continued to accelerate and is now at +18%, compared to the 25% and 24% respective annual *declines* for orders and shipments. Motor vehicles are also still weak; inventory is growing at an annual pace of 6% (consistently) while orders are down -4% and shipments are down -3% (both slowing).

NEW ORDERS

The value of new orders increased in Oct after a larger decline in Sep. This should provide some further support for growth in shipments in the near-term – and also provides more insight behind the improvement indicated by the Oct Manufacturing PMI (and now the Nov prelim PMI). Orders were higher across most areas in the month. Defense and non-defense aircraft orders were the main contributors to the growth, which was partly offset by further declines in orders for motor vehicles.

The value of Sep orders was revised lower.

Durable Goods Orders – month change; Oct +0.6% (+$1.5bn) versus Sep -1.4% (-$3.5bn)

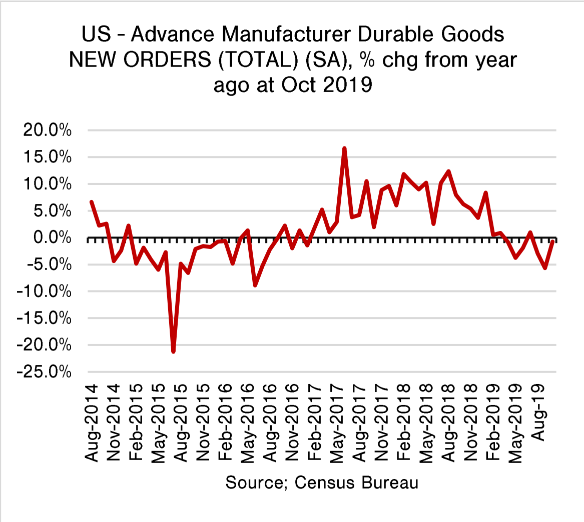
One of the larger contributors to the growth in new orders this month was fabricated metal products (+$0.6bn). Machinery orders also made a larger contribution +$0.4bn.

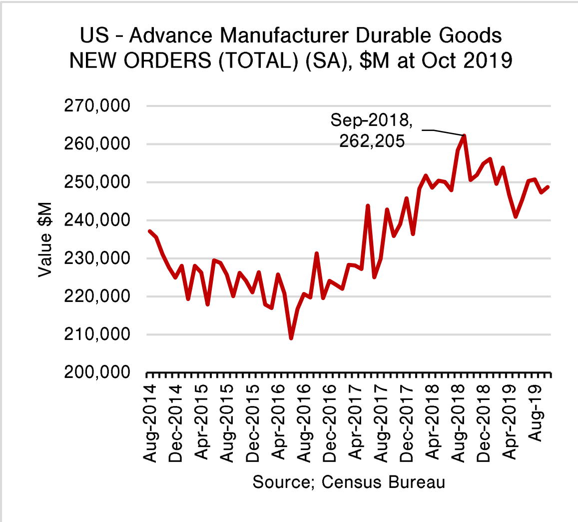
The largest category – transport equipment – recorded a mixed result. Overall, transport equipment contributed +$0.56bn to the growth in new orders.

We've been tracking some weakness in motor vehicles and non-defense aircraft for some time now.

This month, motor vehicle orders declined a further -$1.2bn (-1.9% in Oct after a -3% decline in Sep). This is Oct data and possibly still influenced by the GM strike. Non-defense aircraft orders increased by +$0.8bn after declining by -$1.7bn in the month prior. Defense aircraft orders increased by +$1.2bn for the month.

There was a larger improvement in the annual pace of decline in new orders. This was partly due to a base effect. New orders in Oct 2018 declined by -4.4% (versus Sep 18) – which is a relatively large decline in a month. The value of durable goods orders in Oct 2019 is still -0.7% below that of Oct 2018 (seasonally adjusted);





Excluding transports, annual growth in durable goods new orders continued to decline slightly; Oct -0.4% versus Sep -0.3%.

On an annual basis (NSA) several pockets of weakness in new orders still exist; primary metals orders -9% on a year ago, machinery -2% on a year ago, computers -0.7% on a year ago, total transport equipment -2% on a year ago (motor vehicles -5%, non-defense aircraft -25% - but offset by a 65% increase in defense aircraft orders).

SHIPMENTS

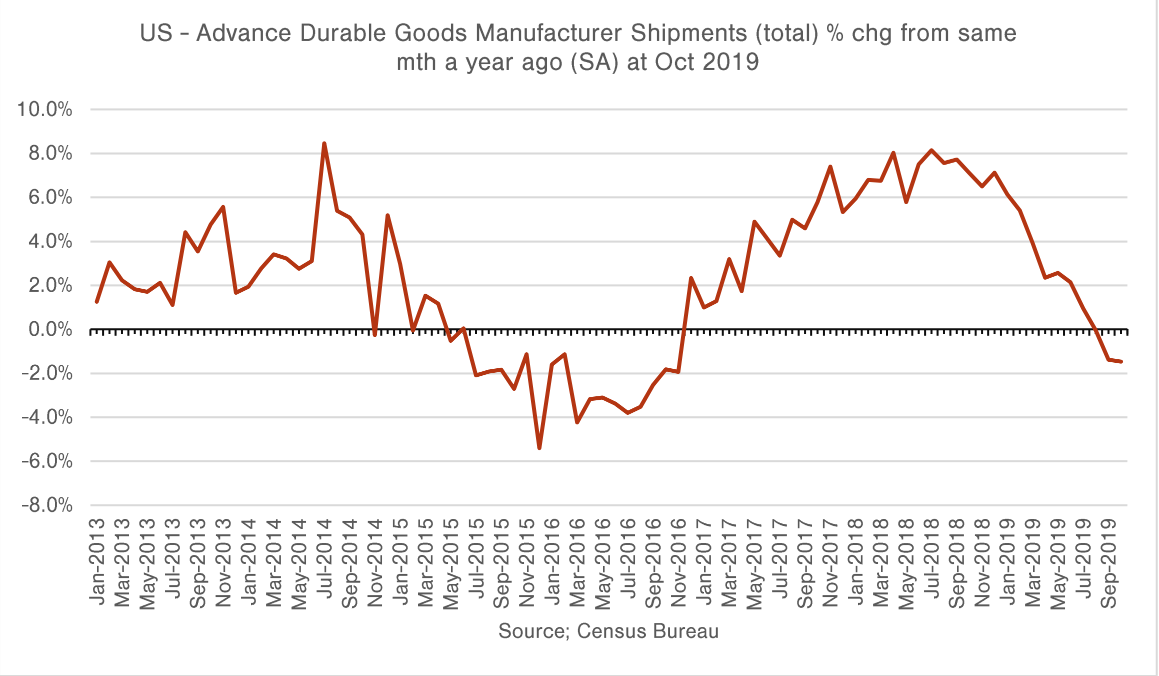
Shipments were flat this month after declining in the two months prior.

Durable Goods Shipments – month change; Oct 0% versus Sep -0.7%

The largest contributor to the result in shipments was machinery +$0.3bn. Increases were also recorded across fabricated metals and computers.

Shipments of transport equipment declined by -$0.3bn or -0.4% after declining by -1.8% in Sep. The decline in shipments of motor vehicles of -$1.2bn in the month was partly offset by a +$0.7bn increase in non-defense aircraft shipments.

Versus a year ago, shipments of durable goods declined at a slightly faster pace; Oct -1.5% versus -1.4% Sep;



Excluding transports, annual growth in durable goods shipments slowed to +0.3% in Oct (+0.6% in Sep).

UNFILLED ORDERS

The value of unfilled orders increased at a slightly faster pace – this is the result of a $3bn increase in unfilled orders for defense aircraft.

Durable Goods – unfilled orders; Oct +$1.3bn (+0.1%) versus Sep 0%

Most of the increase in unfilled orders was the result of a +$0.9bn increase in transport equipment unfilled orders – most of which was defense orders +$3bn. The decline in unfilled orders for non-defense aircraft (-$2bn) helped to support the growth in shipments of non-defense aircraft for the month. Motor vehicle unfilled orders also declined by -$0.3bn.

On an annual basis, the value of unfilled orders remains below the same month a year ago; Oct -1.6% versus Sep -1.8%.

The decline is driven mostly by transport equipment. Excluding transport, durable goods unfilled orders were still ahead of last year, but growing at a slower pace; Oct +0.2% versus Sep +0.5%;

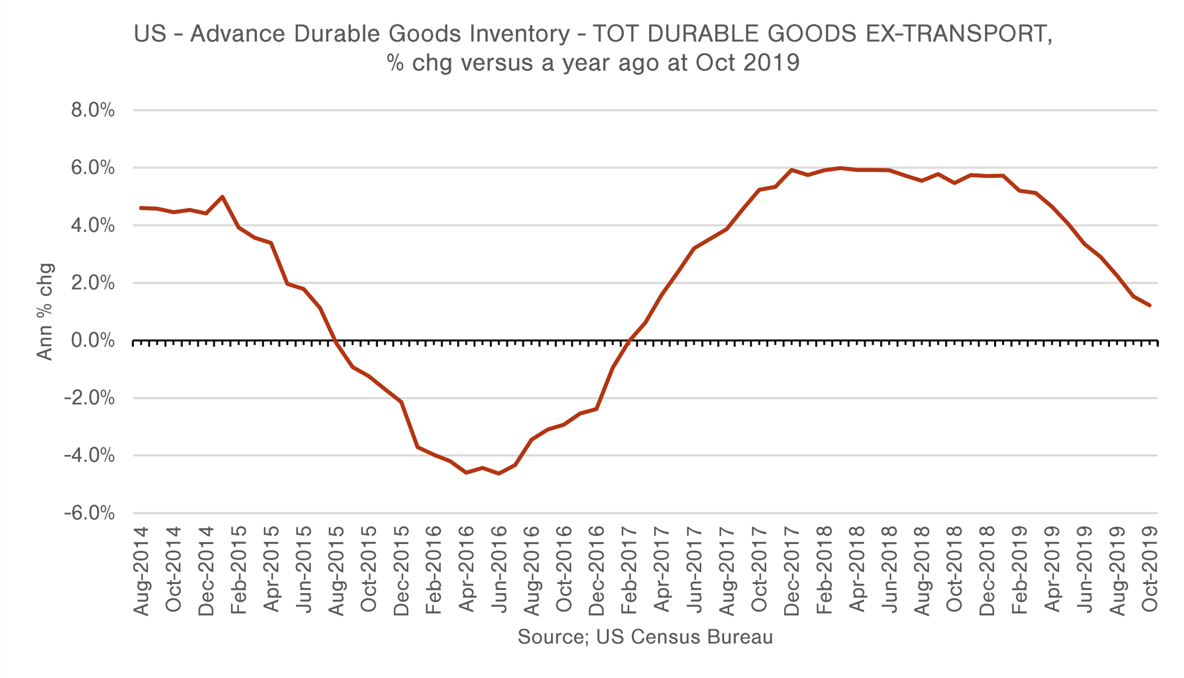
INVENTORY

The value of inventory increased at a slower pace this month. The value of non-defense aircraft inventory continued to increase and was offset by declines across most other categories.

Durable Goods Inventory – month change; Oct +$1.4bn (+0.3%) versus Sep +$2.2bn (+0.5%)

The main contributor to higher inventories this month was again another increase in non-defense aircraft inventory of +2% or +$1.5bn. The annual growth in non-defense inventory is accelerating and is now growing at +18%. Note that orders are tracking at -25% below a year ago and shipments are -25% versus a year ago.

On an annual basis, total durable goods inventory growth remained unchanged at +4.8%. Excluding the value of transport inventory, the annual growth is much lower and the trend has been slowing; Oct +1.2% versus Sep +1.6%.



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

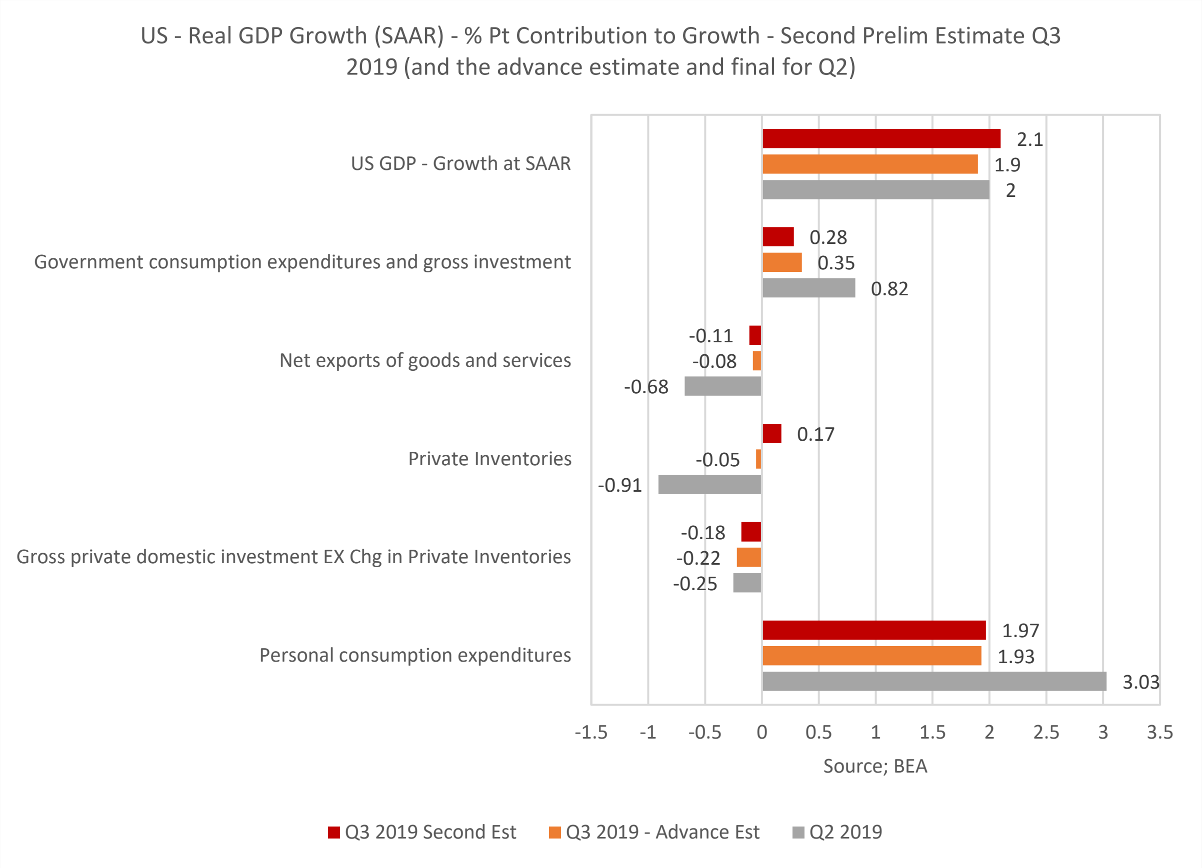
GDP Second Prelim Estimate Q3 2019

The second estimate for Q3 GDP was revised higher from +1.9% to +2.1% (seasonally adjusted annual rate). The increase was mostly the result of a higher contribution from the change in inventories – the value of inventory changed from a -0.4% decline to a +10% increase in Q3. This revision is not surprising given the higher levels of inventories recorded across several categories and seen across several different reports during Q3. As noted in the wholesale sales and inventory report for Sep, the inventory to sales ratio remains elevated – with inventory rising faster than sales. This is not a positive revision.

Offsetting *small* increases for personal consumption expenditures and fixed investment was net exports that detracted further from growth and a lower, still positive, contribution from government expenditure.

Real GDP (SAAR) second estimate – quarter change; Q3 +2.1% versus Q2 +1.9%

Q3 GDP was reported as +1.9% in the advance estimate.



<u>Changes in the Second Estimate</u>

GDP growth was revised +0.2%pts higher in this second estimate and there were revisions across several of the GDP components. The single largest revision was to the change in inventories.

Change in inventory – shifted from detracting -0.05% pts to adding +0.17%, **a change of +0.22% pts** (which is most of the change). Underlying this, the value of inventory was revised higher in both Q2 and Q3. The result was the value of inventory in real terms shifting from a -0.4% decline to a +10% increase between the two estimates for Q3. This is more consistent with various reports of the elevated inventory to sales ratio reported throughout the quarter.

Personal Consumption Expenditure – **increased by +0.04%pts**. This was led mostly by an increase in goods (durable goods) and a smaller increase in services expenditure.

Fixed Investment – continued to detract from growth in the quarter but by a smaller degree and **improving by +0.04% pts**. This was led by an improvement in non-residential fixed investment. Residential fixed investment was unchanged.

Net exports – detracted from headline growth by **a further -0.03%pts**. While there was an improvement in the contribution from exports, there was a larger increase in imports – which detracts from GDP. Export growth increased from +4.7% to +5.7%. Import growth increased from +10.3% to +13.3%.

Government consumption and gross investment – made a smaller contribution to growth, reducing the contribution by -0.07%pts.

https://www.bea.gov/news/2019/gross-domestic-product-third-quarter-2019-second-estimate-corporate-profits-third-quarter

Personal Income and Outlays and PCE Price Index (Oct)

While total personal income recorded no growth in Oct, employee compensation growth remained robust. Personal consumption expenditure growth remained consistent. As a result, there was a larger decline in personal savings for the month.

PERSONAL INCOME

Total personal income growth slowed to zero this month;

Total Personal Income – month change; Oct 0% versus Sep +0.3%

Fortunately, employee compensation grew at a faster pace which helped to offset declines across other forms of income;

Employee compensation growth accelerated +0.4% in Oct after +0.1% growth in Sep.

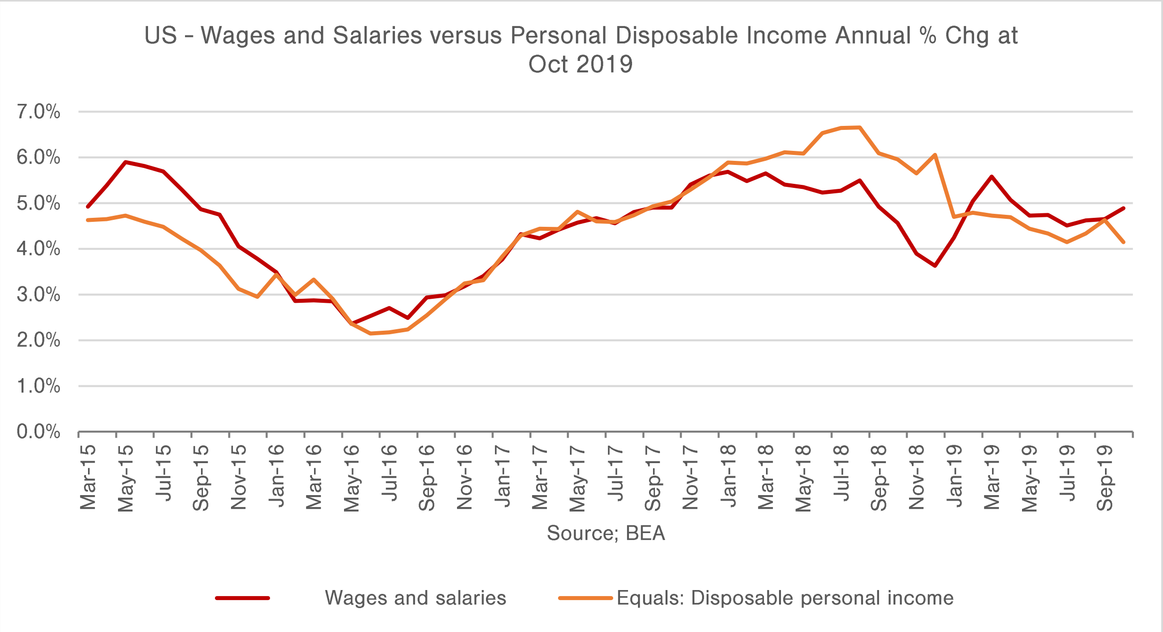
> BEA adjusted October wages and salaries upward by $7.2 billion (at an annual rate) to account for strike pay and payments associated with contract ratification for members of the United Automobile Workers.

Offsetting this growth was; a 1% decline in proprietors' income and a 1% decline in personal income receipts (both interest and dividend income).

Personal current taxes increased in Oct by +0.7% versus -0.2% in Sep.

This resulted in an overall decline in personal disposable income for the month of -0.1% (versus +0.3% in Sep).

On an annual basis, the pace of wage and salary growth has lifted to 4.9% while personal disposable income growth slowed to +4.1%.



In real terms, annual personal disposable income growth slowed to +2.8% in Oct.

PERSONAL EXPENDITURE AND OUTLAYS

Consumption expenditure was little changed from the month prior;

Personal Consumption Expenditure – month change; Oct +0.3% versus Sep +0.2%

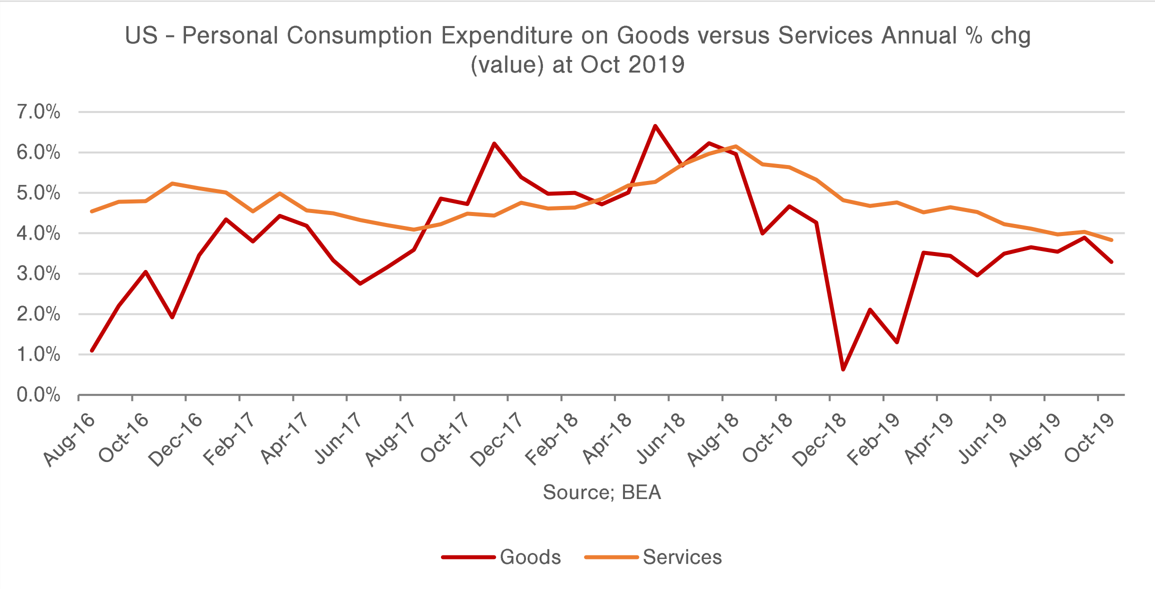
A decline in durable goods expenditure (-0.7%) was offset by an increase in non-durable goods expenditure (+0.6%). Growth in services was unchanged from the month prior (+0.3%).

The detail provided by the BEA is interesting. The BEA cites the decline in motor vehicle sales as the leading contributor to the decline in durable goods sales for the month – yet Oct retail sales recorded +0.5% growth in motor vehicle sales. Likely to be some revisions? Emphasis added;

> The $11.3 billion increase in real PCE in October reflected a $16.4 billion increase in spending for services that was partially offset by a $7.4 billion decrease in spending for goods (table 7). Within services, the largest contributor to the increase was spending for household electricity and gas. Within goods, **new motor vehicles was the leading contributor to the decrease**.

On an annual basis, personal consumption expenditure growth continued to slow.

Growth in goods expenditure slowed to 3.3% in Oct from 4% in Sep. Growth in services slowed to 3.8% in Oct from 4% in Sep;



SAVINGS

Given the fall in personal disposable income and the slight lift in personal consumption expenditure, personal savings declined by 4.1% in Oct. The saving rate as a % of personal disposable income fell to 7.8%.

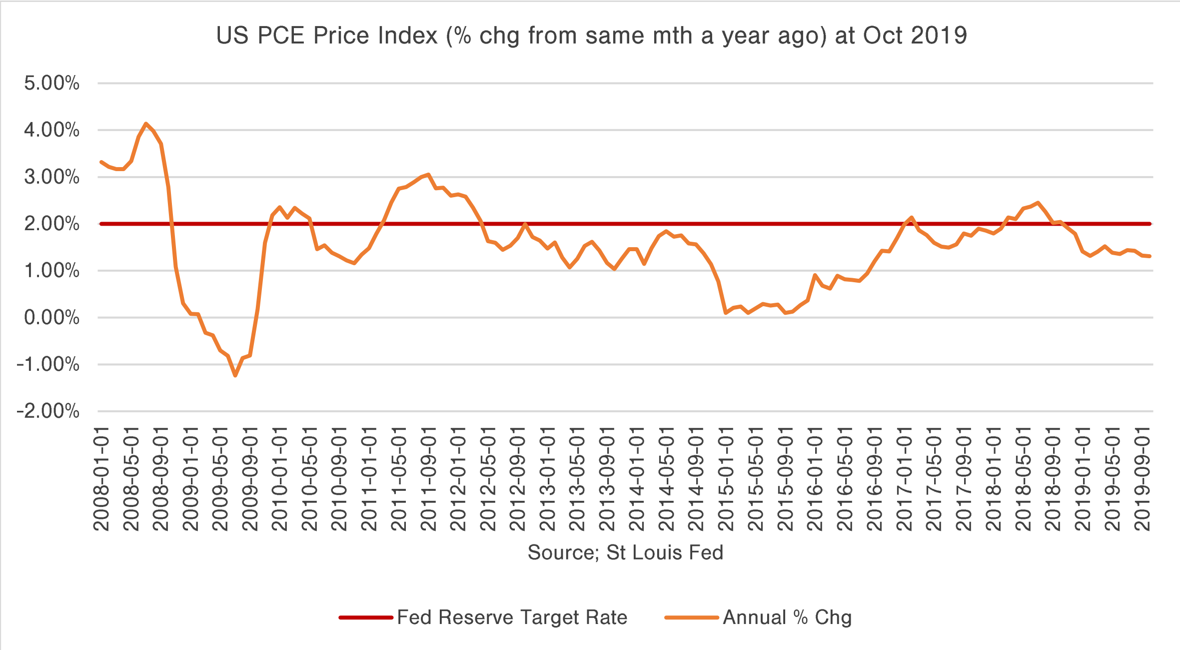
PRICE INDEX – PERSONAL CONSUMPTION EXPENDITURE

This is the US Fed preferred measure of consumer price inflation.

There was little change in the annual pace of growth in the headline PCE price index. Removing the effects of more volatile food and energy prices, indicated a further slow down in the growth of consumer prices. Core PCE growth has slowed further over the last two months.

Both measures remain well below the Fed symmetric target of 2%.

<u>Headline PCE Price Index – annual change</u>; Oct +1.3% versus Sep +1.3%

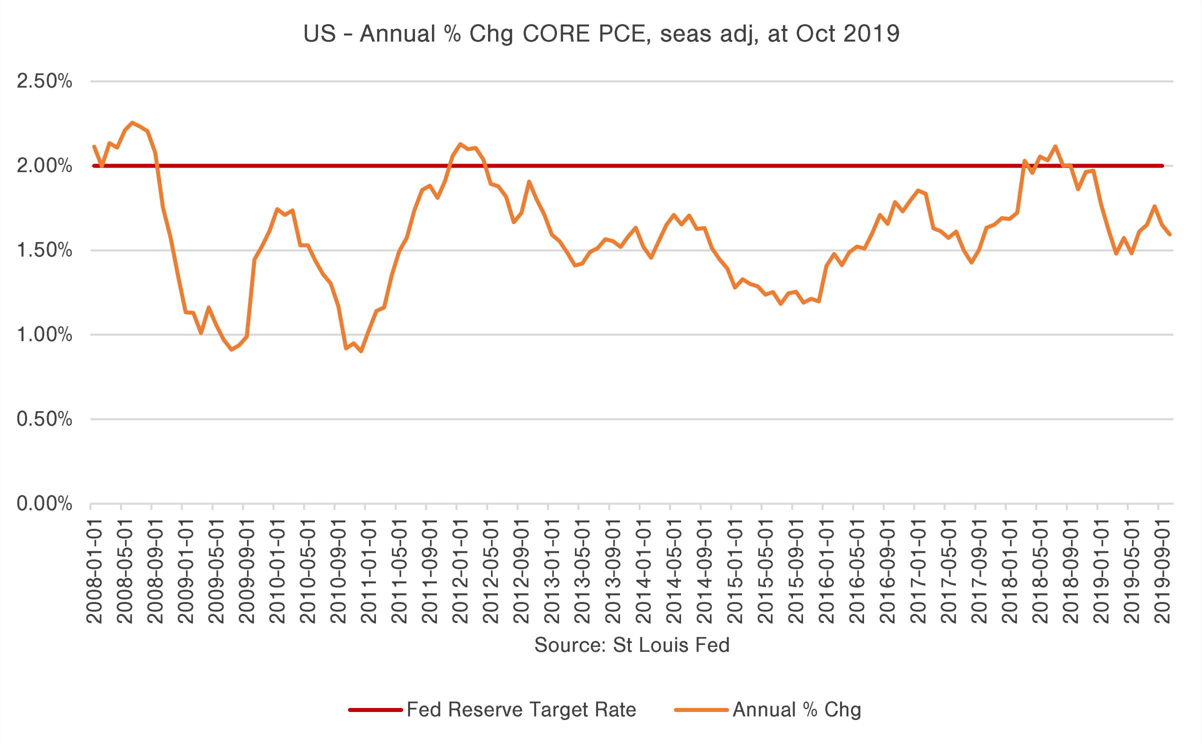


Goods prices declined at an annual pace of -0.6% in Oct. Durable goods prices declined by -1% and non-durable goods prices declined by -0.4%.

Food and energy prices declined at a slower pace; Oct -0.9% versus Sep -1.3%. Food prices increased at a faster pace of +1.1% in Oct from +0.8% in Sep. Energy prices continued to decline on an annual basis by 7.3% in Oct, at a slightly slower pace from -8% in Sep.

Services prices increased at a constant pace of +2.2% in Oct.

<u>Core PCE Price Index Ex Food & Energy – annual change</u>; Oct +1.6% versus Sep +1.65%



The further slow-down was the result of goods ex food and energy prices declining a further -0.3% in Oct (-0.4% in Sep).

Services ex energy prices also slowed to +2.2% in Oct from +2.3% in Sep.

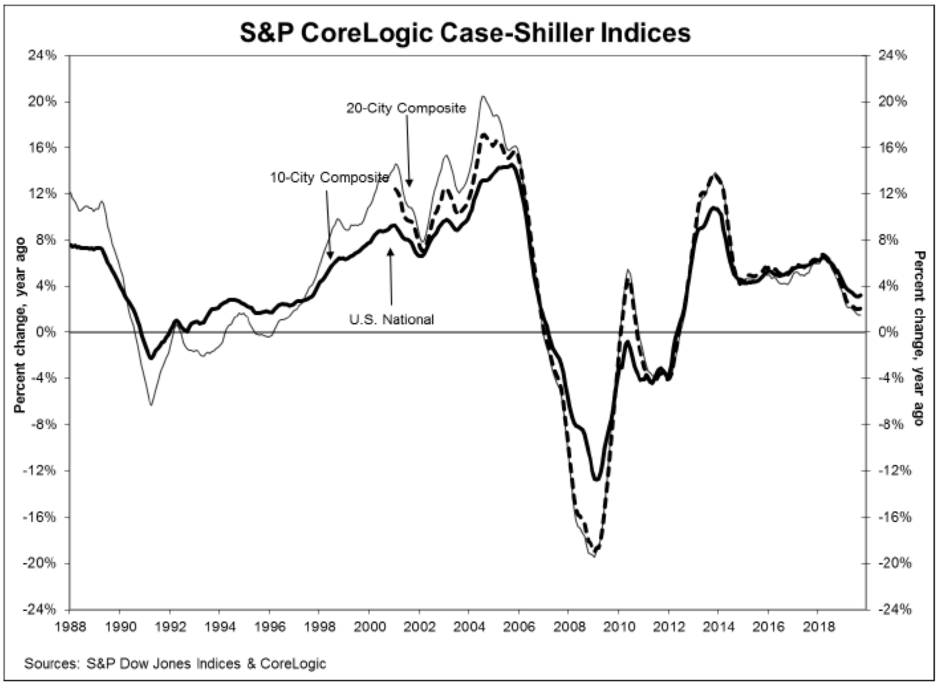
https://www.bea.gov/data/income-saving/personal-income

CoreLogic House Price Index (Sep)

The National house price index of annual house price growth increased at a slightly faster pace in Sep. The 10-City composite was unchanged and the 20-city composite also increased at a faster pace.

National House Price Index – annual change; Sep +3.2% versus Aug +3.1%

> "After a long period of decelerating price increases, it's notable that in September both the national and 20-city composite indices rose at a higher rate than in August, while the 10-city index's September rise matched its August performance. It is, of course, too soon to say whether this month marks an end to the deceleration or is merely a pause in the longer-term trend.



In the month, the National house price index increased by +0.4% after increasing by +0.3% in Aug (seas adj basis).

10-City Composite House Prices Index – annual change; Sep +1.5% versus Aug +1.5%

Price growth accelerated slightly in the latest month +0.2% in Sep versus +0.1% in Aug (seas adj basis).

20-City Composite House Price Index – annual change; Sep +2.1% versus Aug 2%

There was a more notable acceleration in prices this month; Sep +0.4% versus Aug +0.2% (seas adj basis).

https://au.spindices.com/index-family/real-estate/sp-corelogic-case-shiller

US Fed Speeches

US Fed Chairman Powell - Building on the Gains from the Long Expansion

https://www.federalreserve.gov/newsevents/speech/powell20191125a.htm

Governor Lael Brainard - Federal Reserve Review of Monetary Policy Strategy, Tools, and Communications: Some Preliminary Views

Some key points here related to policy at the ELB – this is an ongoing discussion point in the Fed minutes also.

> the Committee will actively employ its full toolkit so that the ELB is not an impediment to providing accommodation in the face of significant economic disruptions

https://www.federalreserve.gov/newsevents/speech/brainard20191126a.htm

Return to top

Europe

Germany CPI – Prelim (Nov)

The prelim release of the Nov CPI shows that the annual change in consumer prices is expected to stay broadly unchanged at 1.1%.

Headline CPI - month change; Nov is expected to be -0.8%

Headline CPI – annual change; Nov +1.1% versus Oct +1.1%

Goods prices continued to grow at a much slower annual pace – slowing from +1.3% in Aug to now only +0.1% in Nov. This is led by further declines in energy prices (declining by -3.7% in Nov versus -2.1% in Oct). Food prices had been slowing between Aug and Oct, but growth in food prices increased at a faster pace in Nov +1.8% versus +1.1% in Oct.

Services prices increased at a slightly faster pace; Nov +1.8% versus Oct +1.7%. There has been little change in the annual change in services prices over the last four months.

Final results will be released 12 Dec 2019.

https://www.destatis.de/EN/Press/2019/11/PE19_454_611.html;jsessionid=198AA7359FB51970E2FF806560CAA74F.internet731

Eurozone CPI – prelim (Nov)

The headline annual Euro area CPI rate is expected to increase to 1% in Nov up from +0.7% in Oct.

The monthly change in the Euro area CPI in Nov versus Oct is expected to be -0.3%.

Euro area headline CPI – annual change; Nov +1% versus Oct +0.7%

The lift in the annual CPI rate was the result of;

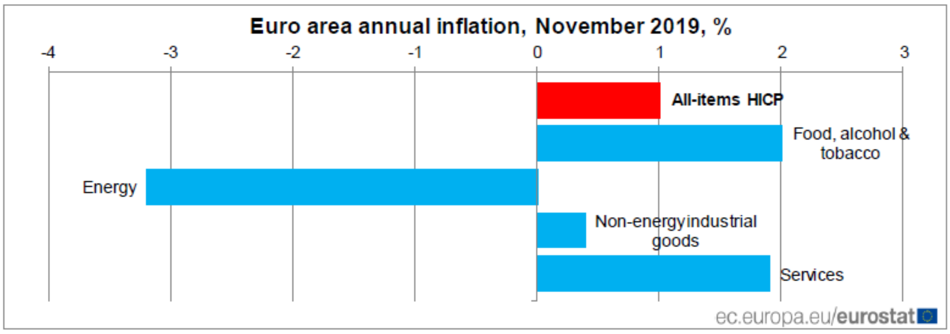
Much faster growth in food, alcohol and tobacco prices; Nov +2% versus Oct +1.5%. **Unprocessed food prices jumped from +0.7% annual growth in Oct to +1.8% in Nov.** Processed food, alcohol and tobacco prices also increased at a faster pace; Nov +2.1% versus Oct +1.8%.

Much faster growth in services prices; Nov +1.9% versus Oct +1.5%.

A consistent decline in energy prices of -3.2% in Oct and Nov.

Little change in non-energy industrial goods prices of +0.4% in Nov.

Core CPI ex food, energy, alcohol and tobacco increased at a faster pace from +1.1% in Oct to +1.3% in Nov, likely as a result of services prices.



It's worth noting that the monthly change in the Euro area CPI was negative for Nov; -0.3%. While food prices increased by +0.4% and energy prices were unchanged, services prices declined by 1% in Nov.

https://ec.europa.eu/eurostat/documents/2995521/10075427/2-29112019-AP-EN.PDF/734bb605-7201-a8d3-c6ad-c30119c6a638

Return to top

Japan

Retail Trade (Oct)

The value of retail sales reversed the prior month gains as the consumption tax went into effect.

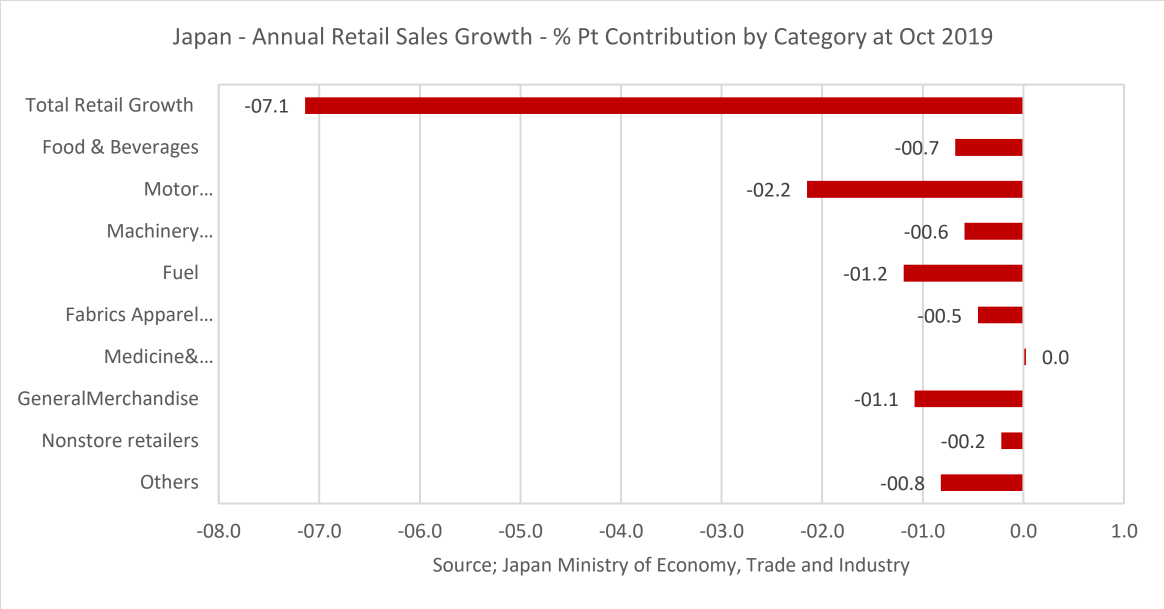
Retail sales in the two prior months of Aug-Sep had accelerated, likely due to stockpiling prior to the consumption tax increase in Oct. Retail sales in Oct reversed those gains. The reversal was not unexpected and now we'll need to see how consumer demand responds to the increase in consumption tax.

Retail Sales (value) – month change; Oct -14.4% versus Sep +7.2%

Sales also declined on an annual basis;

Retail Sales (value) – annual change; Oct -7.1% versus Sep +9.2%

Most categories contributed to the decline this month – the exception was medicine and toiletry store sales. The decline in motor vehicle sales made the largest contribution to the decline on an annual basis.



https://www.meti.go.jp/english/statistics/tyo/syoudou/index.html

Industrial Production – prelim (Oct)

Several factors are likely affecting the much weaker industrial production and shipments for Oct. There is likely an impact from stockpiling prior to the increase in the consumption tax in Oct and there is also likely an impact/disruption from Typhoon Hagibis also in Oct. It will be difficult to separate the effects of either event.

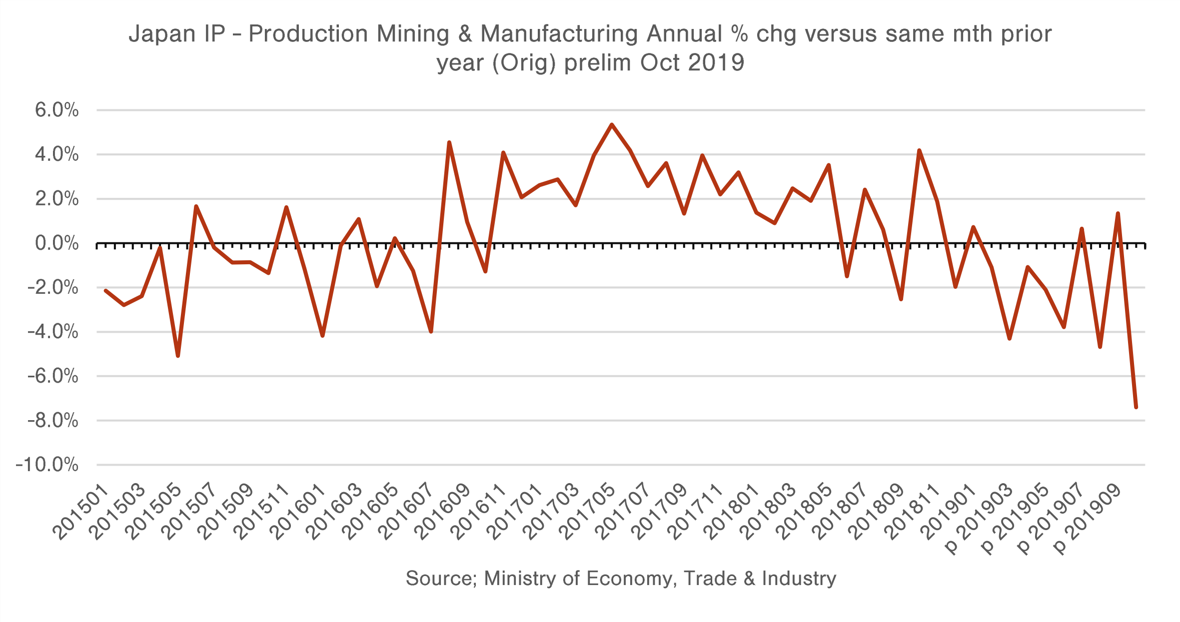
The weaker industrial production and shipments data is consistent with the much weaker export and import data report several weeks ago for Oct.

<u>PRODUCTION</u>

<u>Month change</u>; Oct -4.2% versus Sep +1.7%

Production declined in the month across most categories. The top three largest weight categories in the index contributed most to the decline in production for the month; transport equipment -7.7% (production of passenger cars was down 9%, which has been consistently slowing over the last few months), electrical machinery -4.6% and general purpose and business-oriented machinery -13%. Data for food and chemicals are yet to be updated.

<u>Annual change</u>; Oct -7.4% versus Sep +1.3%



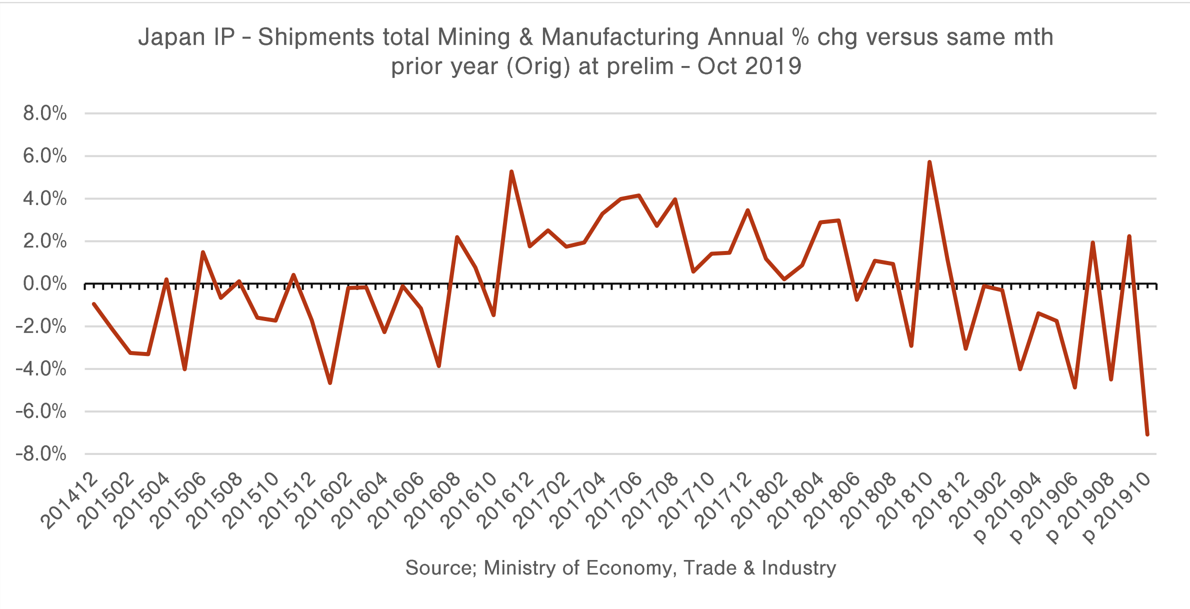
<u>SHIPMENTS</u>

<u>Month change</u>; Oct -4.3% versus Sep +1.5%

Shipments were similarly down across most categories (food and chemicals yet to be reported). The top three weighted categories that contributed to the decline in shipments for the month were;

Transport equipment – although down by only 2.5%, there was a large contribution from the decline in motor vehicle shipments of -6.7% which was partly offset by stronger shipments of ships. Iron, steel and non-ferrous metal shipments declined by 4.6%. Electrical machinery shipments declined by 6.3%.

<u>Annual change</u>; Oct -7.1% versus Sep +2.2%



INVENTORY

Month change; Oct +1.2% versus Sep -1.4%

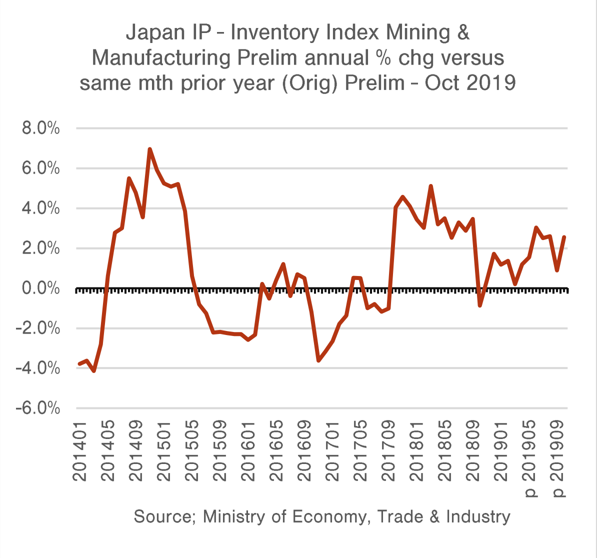
Given the large falls in production and shipments, there was a relatively small increase in the value of inventories (likely planned for the consumption tax increase). But when measured as the inventory to shipment ratio, the increases were more pronounced; +4.7% in Oct after a -1.9% in Sep.

Inventory declined for some of the larger categories; iron, steel and nonferrous metal inventories increased by only +0.1% (the single largest weight category in the inventory index), transport equipment inventory declined by 6% (motor vehicles declined by 5%) and electrical machinery inventory increased by 4.4%.

Petroleum and coal product inventories increased by +11%.

Annual change; Oct +2.5% versus Sep +0.9%

The original index remains below the recent peak;



https://www.meti.go.jp/english/statistics/tyo/iip/index.html

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

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

Return to top

Australia

Construction Work Done (Q3)

Construction has been a key industry in the current downturn in Australia's growth. This has been led in part by the residential market and the tightening of credit standards around the banking royal commission.

The construction data is broken down in two broad areas – building work and engineering construction. Building work is then broke down further into residential and non-residential.

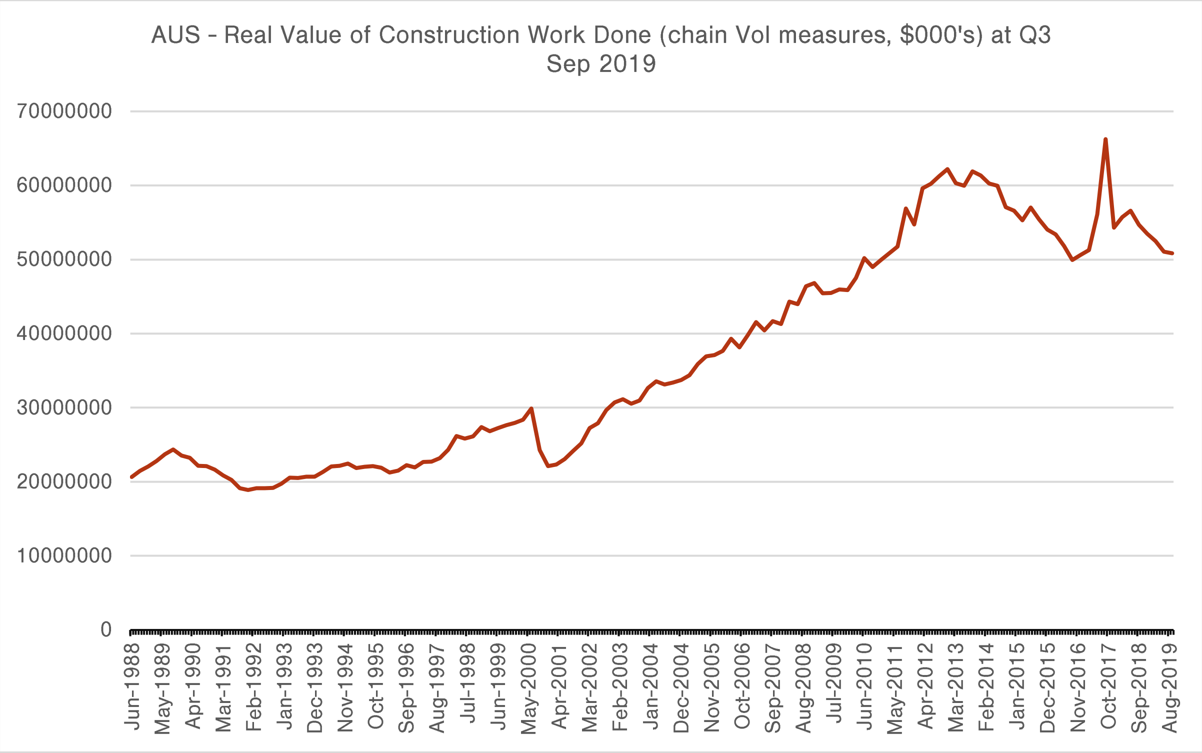
There is evidence in this release to suggest some lift in public sector expenditure is helping to offset ongoing weakness in private engineering construction and residential construction.

In real terms, overall construction work done declined at a slower pace in the Sep quarter;

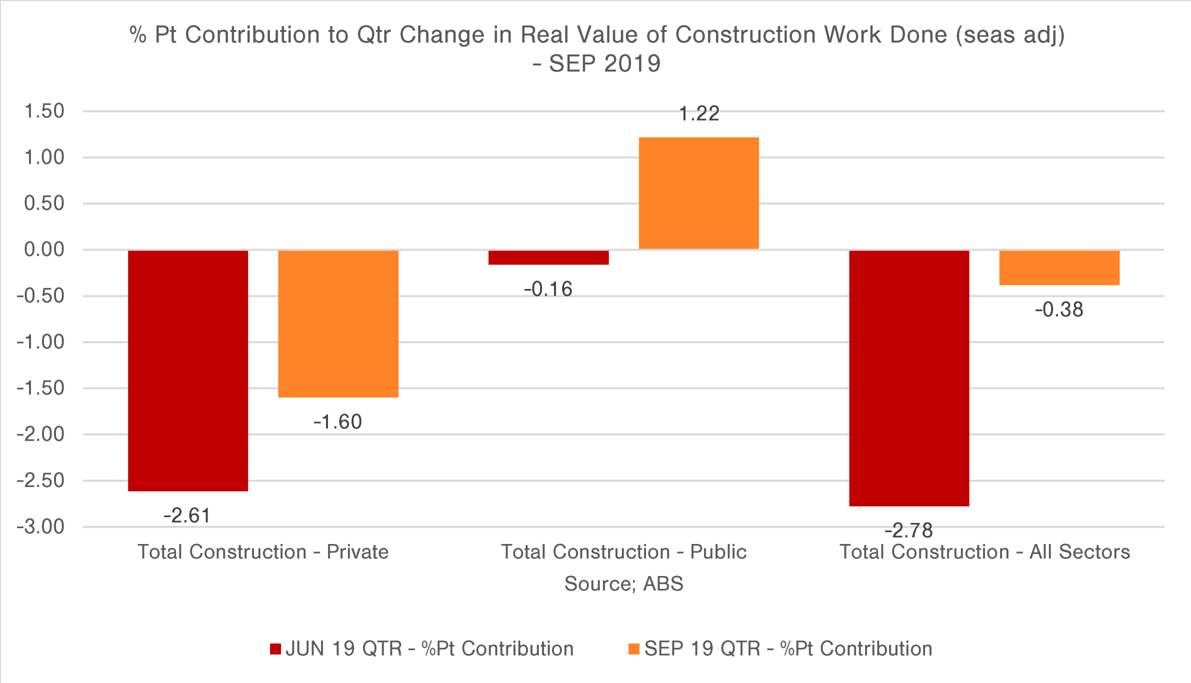
Construction work done (all sectors) – Qtr Chg; Q3 -0.4% versus Q2 -2.8%

The value of construction work done (real terms) has fallen to be on par with the Sep 2016 low. The gap between the Sep 2017 peak and Sep 2019 is approx. $15bn.

Versus a year ago, total construction work done is down 7% in real terms;



In Q3 2019, there was a positive contribution from public sector construction which helped to offset some of the decline in private sector construction.



The two main areas making up construction work are engineering construction and building construction.

Engineering Construction (total sectors) – qtr chg; Q3 -0.2% versus Q2 -0.6%

The decline in private sector engineering accelerated to -4.6% and was partly offset by public works this quarter (+6.4%).

The slightly larger contributor to the overall decline in construction was Building Construction;

Building Construction (total sectors) – qtr chg; Q3 -0.5% versus Q2 -4.3%

Private sector building - still declined by -0.9% in Q3 while public sector building increased by +2.6%.

New residential building construction declined by -3.5% in Q3 – led by both houses and multi-dwelling units.

Non-residential building increased by 4% in Q3 after declining by -5% in Q2.

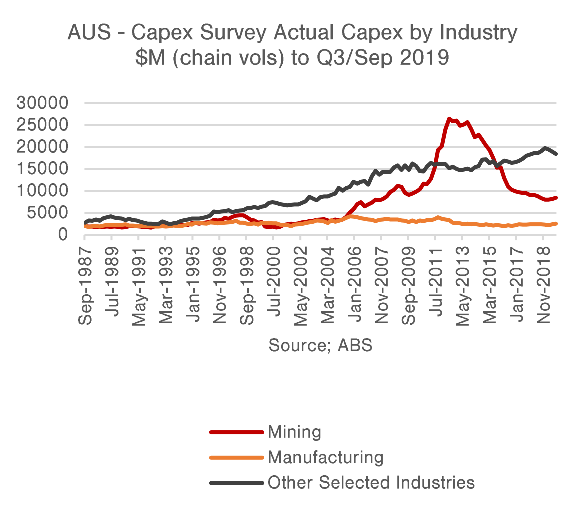
https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/8755.0Main+Features1Sep%202019?OpenDocument

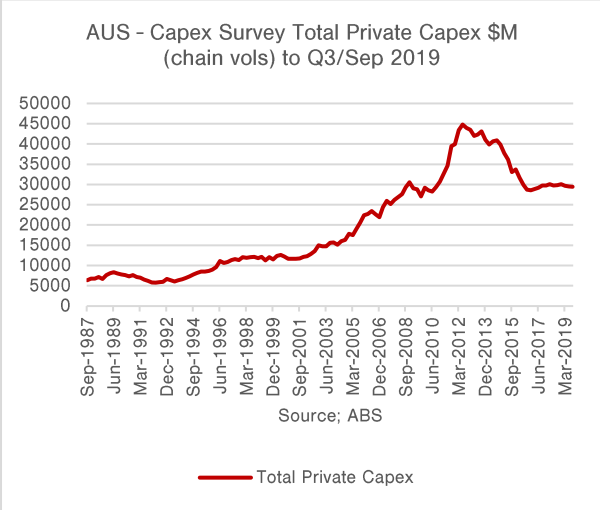
Private Capex (Q3)

Private sector capex declined in the quarter and on a year ago basis in real terms. In the latest quarter and on a year ago basis, growth in mining and manufacturing capex was more than offset by a decline in 'other selected industries'. Other selected industries include mostly services and now represents the largest proportion of capex – so it's concerning to see a decline in investment. Overall capex has been flat in real terms over the last year.

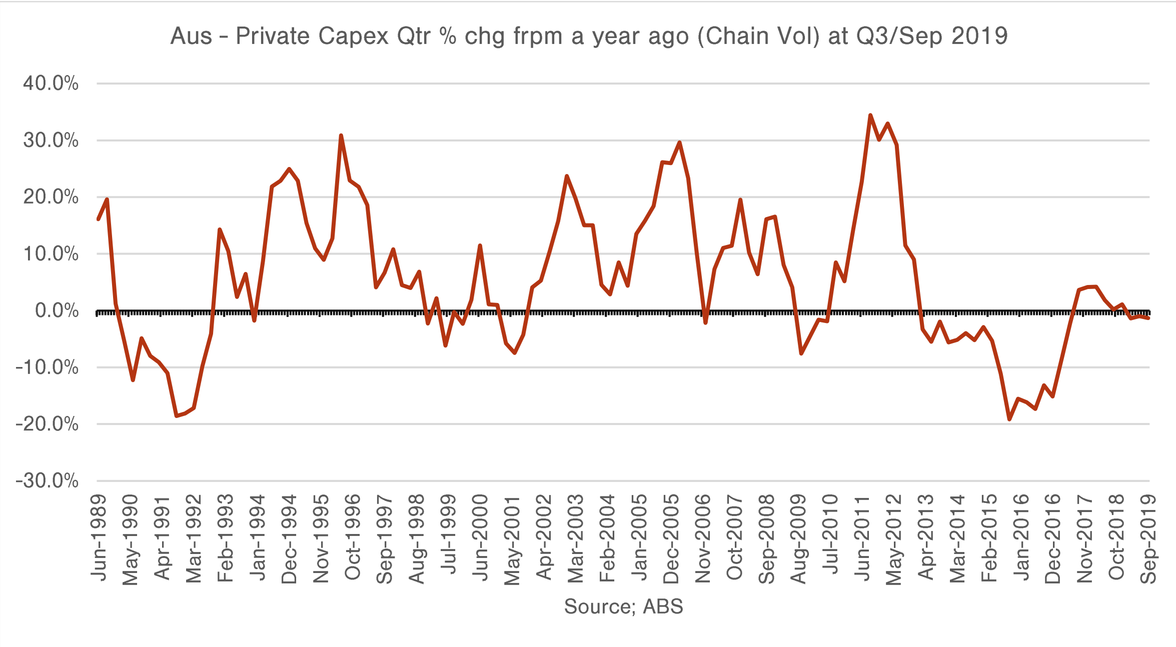
Total Private Capex – quarter change; Q3 -0.2% versus Q2 -0.6%

The underlying result was mixed; mining capex increased by 4% and manufacturing capex also increased by 5.5%. This was offset by a 3% decline in capex for other selected industries. The value of capex for other selected industries now makes up the majority of total private capex – especially since the end of the mining investment boom;





<u>Total Private Capex – annual change</u>; Q3 -1.3% versus Q2 -1%



Similarly, the underlying results were mixed. Small growth in mining (+1.2%) and manufacturing (+3%) capex were more than offset by a 3% decline in capex for other selected industries.

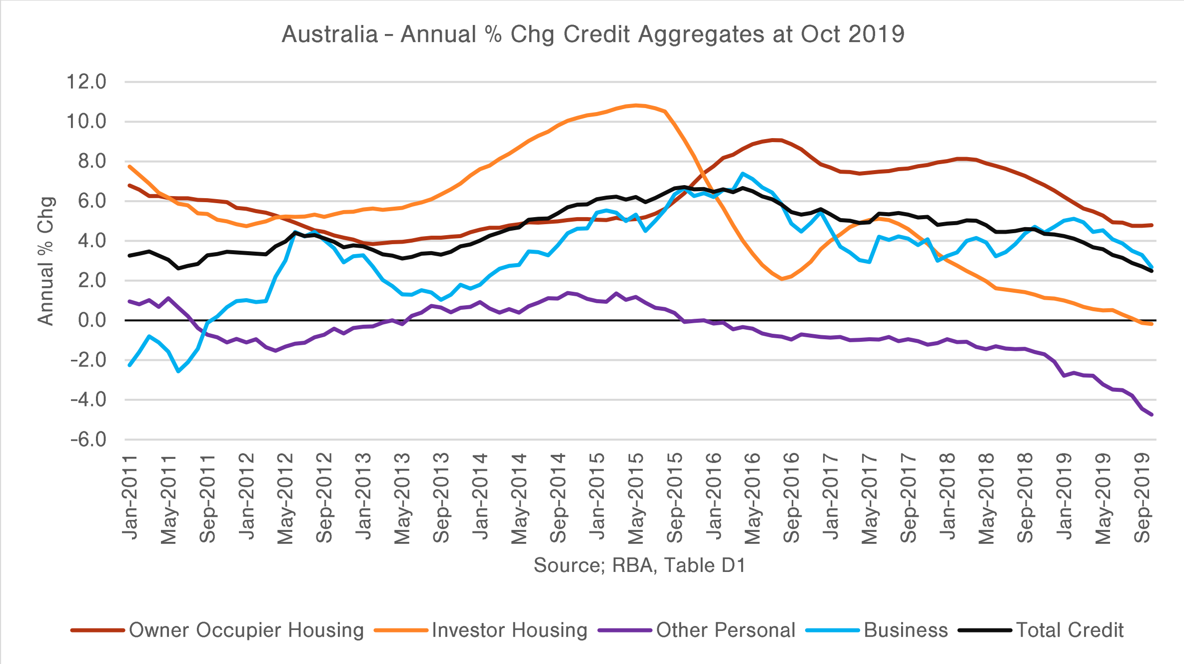
https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5625.0Main+Features1Sep%202019?OpenDocument

Credit and Lending Aggregates (Oct)

The growth in total credit outstanding slowed further this month. There was a notable slow down in the growth of outstanding business credit – this was the most concerning element of the report.

Growth in total housing credit outstanding also continues to slow – led by no further acceleration in owner occupier credit (growth was constant) and a further decline in outstanding housing investor credit.

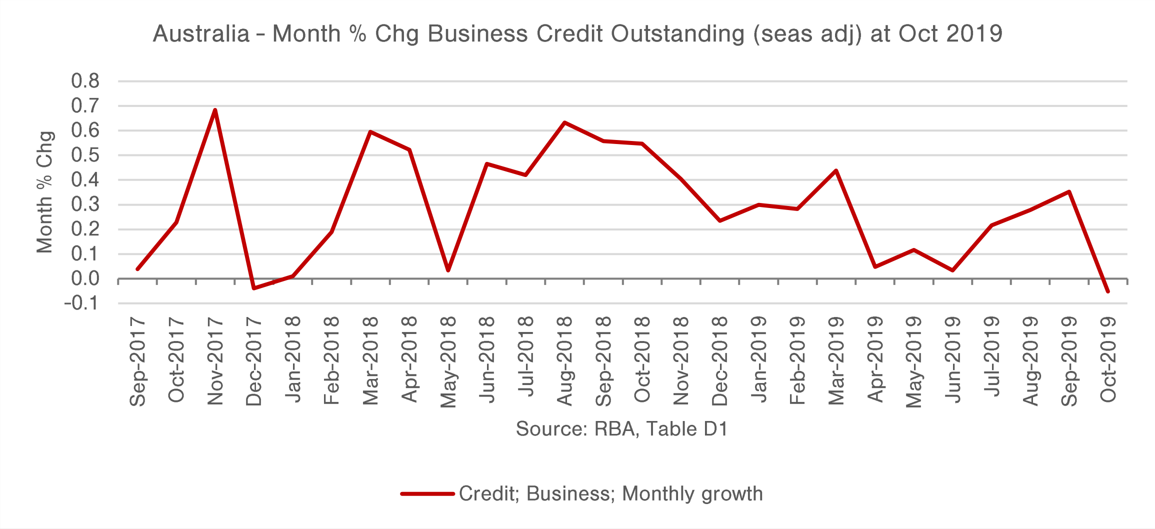
Total Private Credit Outstanding – annual change; Oct +2.5% versus Sep +2.7%



Components of Total Outstanding Credit

Business credit outstanding – annual change; Oct +2.7% versus Sep +3.3%. Growth is now only marginally above that of total credit.

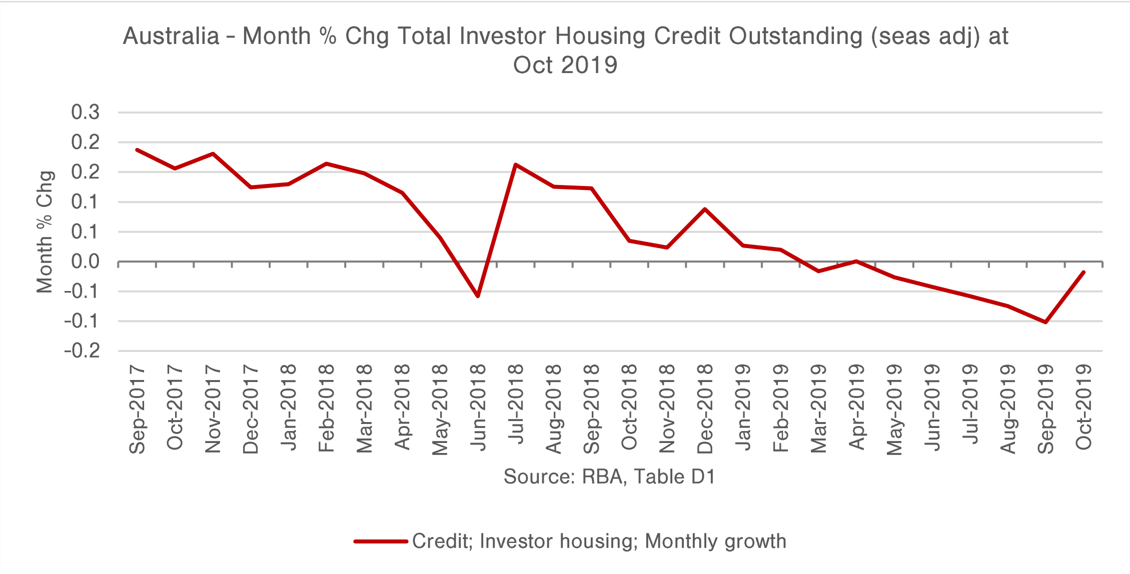
The month change was showed that outstanding business credit declined versus the month prior;



This is the most concerning change this month. Slower growth in business credit could lead to contraction in business growth and employment. This will be important to watch.

Owner Occupier housing credit outstanding – annual change; Oct +4.8% versus Sep +4.8%. There was also no change – or importantly, acceleration, in the growth of outstanding credit for Oct.

Investor housing credit outstanding – annual change; Oct -0.2% versus Sep -0.1%. Although outstanding credit declined at an accelerated pace on an annual basis, there is some evidence of stabilizing on a monthly basis;



Other personal credit outstanding – annual change; Oct -4.7% versus Sep -4.5%.

https://www.rba.gov.au/statistics/frequency/fin-agg/2019/fin-agg-1019.html

RBA Governor Lowe Speech; Unconventional Monetary Policy: Some Lessons From Overseas – 26 Nov 2019

This speech coincides with interest rates in Australia approaching the zero-lower bound – the official cash rate (OCR) is at 0.75%. After this speech, and despite weak economic data this week, the expectations for another interest rate cut at the 3 Dec RBA meeting almost halved (from a low 22% to 13%).

The speech reflects on the policy options available if/when the OCR reaches the effective lower bound. In giving this speech, Governor Lowe is also employing several tools of the CB toolkit – signalling and projecting confidence (no matter how real the threat of a weakening economy really is).

The speech does not acknowledge any level of risk that exists in the economy – and in fact Governor Lowe goes out of his way to downplay any risk. Yet here we are, two 25bps cuts away from a scenario where QE could be considered in Australia.

> "There may come a point where QE could help promote our collective welfare, but we are not at that point **and I don't expect us to get there**."

In this speech, while some unconventional policy options are ruled 'not likely', **they are not ruled out**. There is no doubt whatsoever that the "lessons from overseas" will be implemented here – if the economy weakens to the point of a threat of a recession, then RBA will do "whatever it takes", which is more than what is outlined here in this speech.

Four (4) "unconventional tools" were discussed in the first part of the speech – this is based on a BIS paper released last month 'Unconventional Monetary Policy Tools: A Cross-country Analysis'. But it's the discussion on unconventional policy related to Australia that is of interest;

The RBA remains committed to providing liquidity operations if and when needed.

> "…if markets were to become dysfunctional, you can be reassured by the fact that we have both the capacity and willingness to respond. **But this is not the situation we are currently in**. Things are operating normally."

Negative interest rates in Australia are "extraordinarily unlikely".

> Our growth prospects are stronger, our banking system is in much better shape, our demographic profile is better and **we have not had a period of deflation. So we are in a much stronger position**.

No deflation in Australia? The 10yr yield as of 30 Nov was 1.042%. The current annual pace of CPI growth is 1.67% - which makes our real 10yr yield already negative.

The Governor goes onto say that Australia is a fair way off what is called the "reversal rate" - the interest rate at which lower rates become contractionary, rather than expansionary. Conventional policy is still providing a boost via the exchange rate, to asset prices and to aggregate household disposable income. I've highlighted 'aggregate' because it's worthwhile noting that, so far, conventional policy it is benefitting the household income of those with mortgages.

Asset purchases - the RBA has “no appetite” to purchase outright private sector assets as a part of a QE program. The comments here are mostly made to signal that the RBA does not see a case for QE at this stage;

> The first is that there is **no sign of dysfunction in our capital markets** that would warrant the Reserve Bank stepping in.
>
> The second is that the purchase of private assets by the central bank, financed through money creation, represents a significant intervention by a public sector entity into private markets. It comes with a whole range of complicated governance issues and would insert the Reserve Bank very directly into decisions about resource allocation in the economy. **While there are some scenarios where such intervention might be considered, those scenarios are not on our radar screen.**

QE becomes an option at a cash rate of 0.25% (two cuts away). At this OCR, the banks surplus balances at the RBA would already be paid 0% given the use of the corridor system of setting rates – so it is effectively the zero-lower bound.

> My fifth, and final, point is that **the threshold for undertaking QE in Australia has not been reached, and I don't expect it to be reached in the near future**.

So when would QE be considered?

> It is difficult to be precise, but QE would be considered if there were an accumulation of evidence that, over the medium term, we were unlikely to achieve our objectives. [unemployment and inflation]

What form would QE take?

> My fourth point is that if – **and it is important to emphasise the word if** – the Reserve Bank were to undertake a program of quantitative easing, we would purchase government bonds, and we would do so in the secondary market.

The rationale for the purchase of government bonds is that reduction in the risk-free rate would flow through to all sectors, rather than just a limited market. But again, if issues were to arise, mortgage debt is likely to be the main problem. It’s difficult to see how the RBA wouldn’t step in to help ease mortgage stress for the banks.

If the RBA starts to cut again next year, it most likely will be based on rising unemployment and inflation/wages either stagnant of falling. Based on the Bank focus on supporting aggregate disposable income via lower rates, a deterioration in the labour market would be a direct threat to the transmission mechanism of conventional policy. If the OCR goes down to 0.25%, then we will likely start talking QE, if not, a suite of unconventional policy approaches.

At this point Governor Lowe reiterates the guidance provided by the bank – “on hold” in order to assess the effects of recent cuts;

> Given the significant reductions in interest rates over the past six months and the long and variable lags, the Board has seen it as appropriate to hold the cash rate steady as it assesses the growth momentum both here and elsewhere around the world.

Rates will likely be revisited by the RBA early next year.

The RBA Governor makes it very clear that he does not expect to reach the performance threshold that would trigger a further fall in rates leading to a QE program to continue to provide further accommodation. Recall that the RBA minutes stated that Australia had likely reached a 'gentle turning point'.

https://www.rba.gov.au/speeches/2019/sp-gov-2019-11-26.html

Return to top

Trade

US-China Trade Talks

Headline risk remains very high around the trade talks and the phase-one deal details. An important milestone is approaching - the 15 Dec schedule increase in tariff rates on Chinese imports into the US.

The current points of contention are; the US support of the HK Democracy Bill, China requesting a rollback of all tariffs as a part of the phase one deal (not just a postponement of upcoming tariff increase) and the quantity of purchases of US agriculture products. Talks continued by phone during the week and there is not yet confirmation of a date for further talks in Beijing in Dec.

> U.S. Senate Finance Committee Chairman Chuck Grassley told reporters on Tuesday that Beijing invited U.S. Trade Representative Robert Lighthizer and Treasury Secretary Steven Mnuchin for in-person talks in Beijing. Grassley said Lighthizer and Mnuchin were willing to go if they saw "a real chance of getting a final agreement." https://www.cnbc.com/2019/12/01/china-wants-tariffs-rollback-in-phase-one-trade-deal-with-us-says-chinese-media.html

Chinese Foreign Ministry officials responded to the signing of the HK Bill in the US (emphasis added);

> "China firmly opposes Hong Kong Act. We have made stern representations & strong protests to U.S.," Geng Shuang, a spokesman for the Chinese Foreign Ministry, said in a briefing Friday. "It is a stark hegemonic practice & a severe interference in Hong Kong affairs, which are China's internal affairs. **China will take strong counter-measures**." https://www.cnbc.com/2019/11/29/china-threatens-strong-counter-measures-after-hong-kong-bill-signings.html

While some reports are mixed, there are indications that the US will 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."

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;

Japanese 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.

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 will release its report on 2 Dec 2019. The USTR will announce any proposed action at that time.

> "The two houses of the French parliament passed a final DST bill on July 4 and 16, and President Emmanuel Macron signed the bill into law on July 24. The DST imposes a 3 percent levy on gross revenues generated from providing two categories of digital services—"digital interface" services and "targeted advertising" services—to, or aimed at, persons in France. The DST applies only to companies that generate, from providing the taxable services, €750 million globally and €25 million for services provided to, or aimed at, persons in France." https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/november/united-states-trade-representative

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

"Work continues" on negotiating changes to the USMCA regarding pharmaceutical provisions and enforcement of Mexican labour reforms.

Comments from the Mexican Undersecretary for North America were positive during the week;

> "United States Trade Representative Robert Lighthizer must satisfy Democrat concerns while holding on to the support of Mexico and Canada, as well as Senate Republicans. "If the amendments suggested are fine, are acceptable, are improvements, then there's no reason why we should not be shaking hands next week," Seade told reporters at the Mexican Embassy."

> Crucially, the trade deal has also faced resistance from labour group leaders, including Richard Trumka, president of the powerful AFL-CIO union, who last month warned that the agreement "would be defeated" if Congress voted before the U.S. Thanksgiving. American unions — who believe the original NAFTA did little to stop the flow of U.S. jobs to Mexico — are emphatic about the need to ensure labour reforms are fully carried out this time.

https://business.financialpost.com/news/economy/usmca-ratification-is-getting-there-but-difficult-issues-remain

The likelihood of the US ratifying the deal this year appears to be diminishing;

> Pelosi has insisted the Democrats are working hard, to “get to yes” on the deal, though she recently suggested a vote is unlikely in 2019. Pushing the deal into 2020 raises the risks of it languishing amid the runup to the U.S. presidential election, analysts have warned.
> https://business.financialpost.com/news/economy/usmca-ratification-is-getting-there-but-difficult-issues-remain

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