MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 9 December 2019

Key Themes

Several of the larger uncertainties for the global economy are now poised to be resolved positively. There were several major developments during the week.

Firstly, the US and China have agreed on a phase one trade deal. While details are still emerging, there is at least no further deterioration in the trade relationship.

The UK election resulted in an increased majority for the UK Conservative Party. Brexit now looks likely to go ahead by the end of Jan 2020. We expect that there will be some rebound in activity as firms commence preparations for 31 Jan 2020.

Finally, the US Democrats also appear to have made an agreement with the White House on changes to the USMCA/NAFTA. This legislation is now expected to go to Congress before the end of the year as part of the process to ratify the deal.

The US FOMC kept rates on hold. Given the cuts already implemented over the last three (3) meetings, the Fed guidance has shifted to monitoring the implications of incoming information for the outlook, global developments and muted inflation pressure. Most FOMC members don't see, given the current data and projections, a case for hikes in 2020.

US retail sales were softer in Nov, despite post-holiday promotions in Thanksgiving – although some of those holiday sales will be reported in Dec. Producer prices continue to highlight weakness across growth in service segments of trade margins and transport and warehousing prices in Nov.

Annual growth in consumer prices accelerated, as energy prices made a less negative contribution to price growth. Core CPI remains elevated at +2.3% - led predominantly by services prices.

The business inventories report for Oct highlighted weaker sales through the distributive trade channels while inventory continued to grow.

The ECB also kept rates on hold and made no change policy. This was the first meeting for the new ECB President Christine Lagarde.

In Japan, the second estimate for Q3 real GDP growth was revised higher – due mostly to upward revisions in household consumption (possibly stockpiling ahead of the consumption tax increase in Oct (Q4)) and private investment spending. The weaker industrial production data for Oct was also revised further lower in the final release.

House prices in Australia increased in Q3 but prices across most states remains below a year ago. This was in line with the growth in new credit since Jun 2019. In Nov, business conditions were unchanged and business confidence declined again – so far indicating little improvement in the economy in Q4. Consumer sentiment also declined in again in Dec, although remains above the recent low. The report suggests that rate cuts are not instilling confidence (as in 2011) and consumers are likely to keep a tight rein on spending during the holidays.

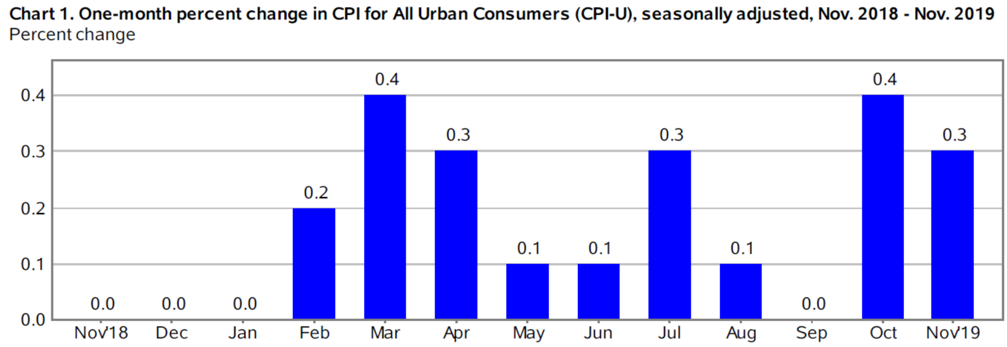
Contents

US Data

CPI (Nov)

US CPI increased at a slightly slower pace in the month, but the annual pace of inflation accelerated from +1.8% in Oct to +2.1% in Nov. The single largest change was energy prices making a much smaller negative contribution to annual headline price growth.

All Items CPI – month change; Nov +0.3% versus Oct +0.4%

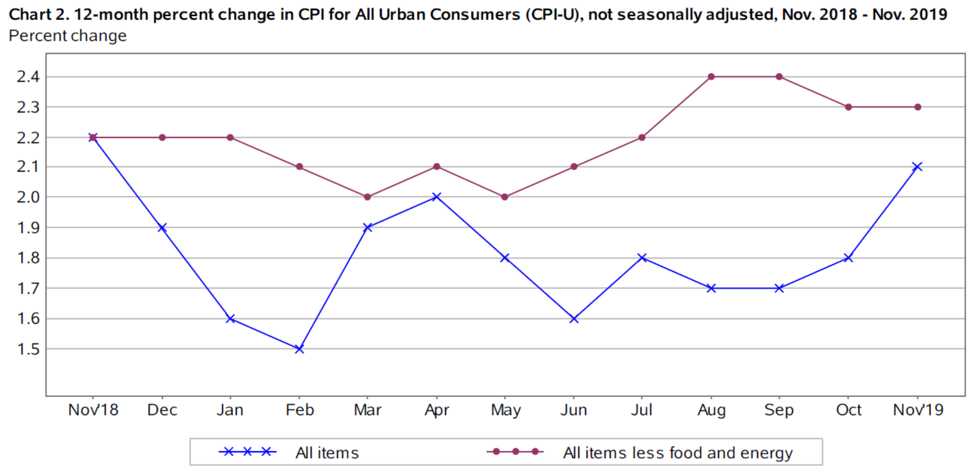


In the month, food prices increased at a slower pace (Nov +0.1% versus Oct +0.2%). Energy prices also increased at a much slower pace (+0.8% in Nov versus +2.7% in Oct).

Core CPI in the month was unchanged at +0.2% growth.

On an annual basis, consumer prices increased at an accelerated pace;

All Items CPI – annual change; Nov +2.1% versus Oct +1.8%



The main driver behind the acceleration in the annual growth in all item's CPI was a less negative contribution from energy prices.

In Nov, energy prices detracted from growth by -0.044% pts. In Oct, the decline in energy prices detracted -0.314% pts from headline growth. Energy represented approx. 7.4% of the index weight in Nov.

The annual growth in food prices made a slightly smaller contribution to headline growth in Nov of +0.265% pts.

All items excluding food and energy (core CPI) represents the largest part of the index (approx. 81% of the weight).

Core CPI ex Food and Energy – annual change; Nov +2.3% versus Oct +2.3%

Overall core CPI made a slightly larger contribution to headline CPI growth, with the contribution adding +1.837% pts in Nov (versus +1.833% pts in Oct).

Commodities, less food and energy commodities (20% of the weight in the all items index) made a smaller contribution to growth in Nov (+0.024% pts) versus Oct. Apparel, new vehicles and used car and truck prices all subtracted from annual headline price growth in Nov.

Services less energy services makes up the largest weight of the CPI index approx. 60%. Annual growth in core services prices was unchanged at +3% in Nov (+3% in Oct also). Well above the Fed target range. Core services also made a somewhat larger contribution to headline CPI growth in Nov, adding +1.825% pts (which is +0.0405% pts higher than in Oct).

Shelter prices continue to grow at an elevated pace +3.3%, but made a slightly lower contribution to annual growth in Nov. Medical services prices also increased at the same pace in Nov as in Oct, at +5.1%.

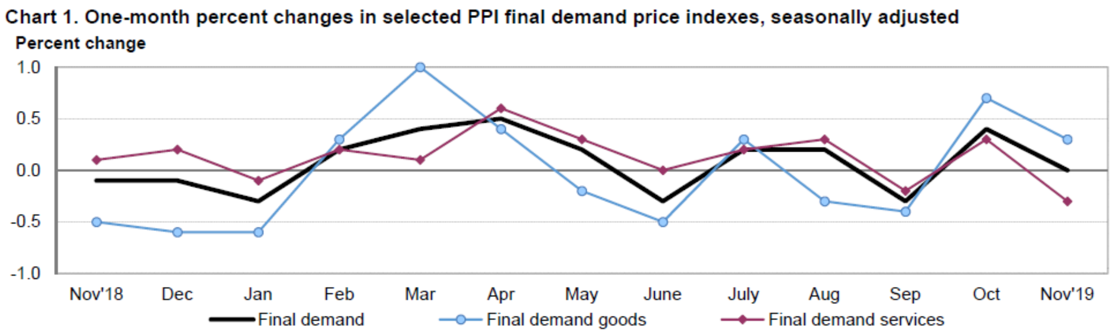
https://www.bls.gov/cpi/home.htm

PPI (Nov)

Producer selling prices recorded no change (0% growth) in the month of Nov. A gain in final demand goods prices was offset by a decline in final demand services prices for the month. Declines in margins for trade services led the decline in services prices.

The annual pace of PPI final demand price growth was unchanged at +1.1%. Slower annual growth in services prices was offset by an acceleration in annual goods prices.

PPI Final Demand – month change; Nov 0% versus Oct +0.4%



Growth in final demand goods and services prices slowed in the month.

Final demand goods – month change; Nov +0.3% versus Oct +0.7%. There was a slow-down in growth across both food and mostly energy (energy Nov +0.6% versus Oct +2.8%). The monthly price change of goods less food and energy accelerated slightly from 0% in Oct to +0.2% in Nov.

"Half of the broad-based rise in November is attributable to a 1.1-percent advance in prices for final demand foods. The indexes for final demand energy and for final demand goods less foods and energy moved up 0.6 percent and 0.2 percent, respectively."

Final demand services – month change; Nov -0.3% versus Oct +0.3%. The decline in the month was led by trade, transportation and other prices. The decline in prices was led by reduced margins for trade services.

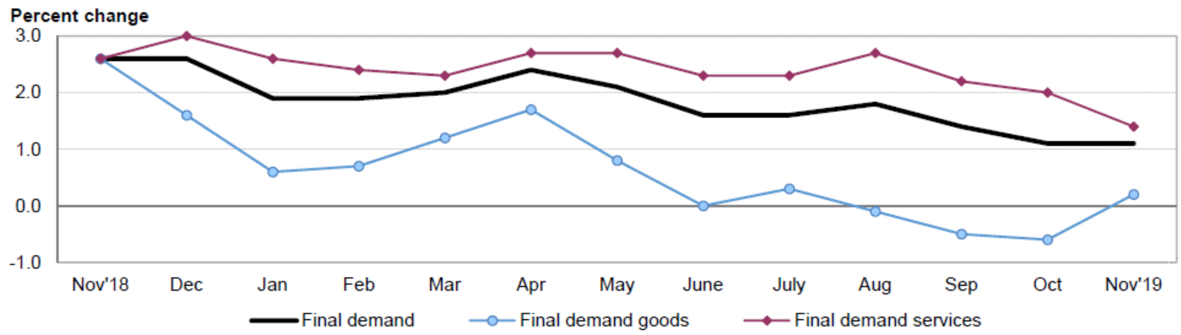
Over two-thirds of the broad-based decline in November can be traced to margins for final demand trade services, which decreased 0.6 percent. (Trade indexes measure changes in margins received by wholesalers and retailers.) Prices for final demand services less trade, transportation, and warehousing and for final demand transportation and warehousing services fell 0.1 percent and 0.3 percent, respectively.

The slowdown in the annual price change of producer selling prices eased this month;

<u>PPI Final Demand – annual change</u>; Nov +1.1% versus Oct +1.1%.

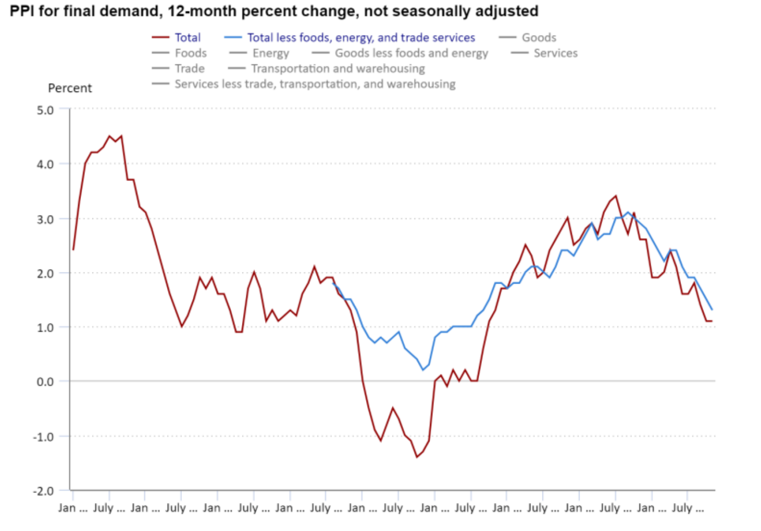
A year ago, the annual change in final demand producers selling prices was +2.6%.

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



The slowdown in annual price growth is not just a function of energy prices. Excluding food, energy and trade services, the PPI for final demand also slowed from +1.5% in Oct to +1.3% in Nov – and has been slowing since Sep 2018;

PPI for final demand, 12-month percent change, not seasonally adjusted

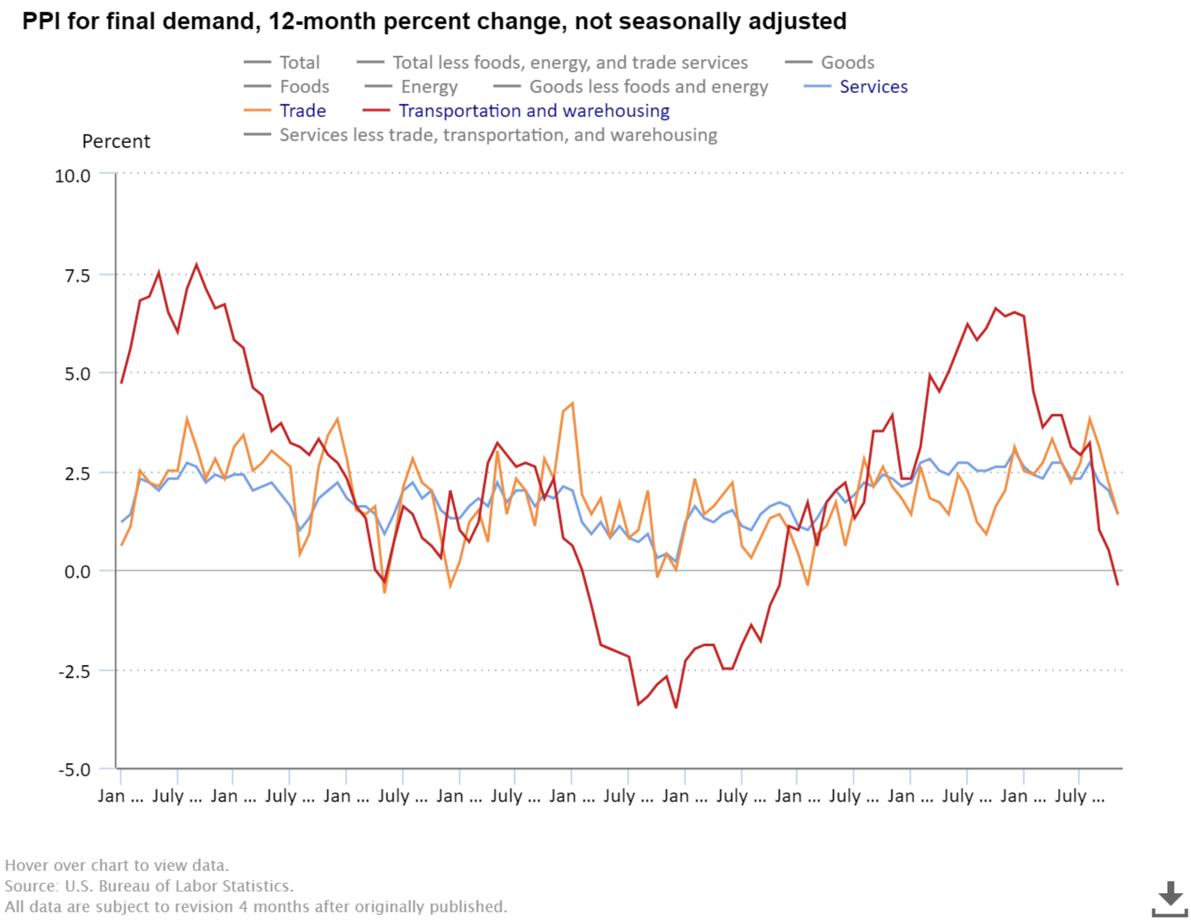


Hover over chart to view data.
Source: U.S. Bureau of Labor Statistics.
All data are subject to revision 4 months after originally published.

But over the latest month, the annual change in goods prices shifted to an increase (due to energy and food prices) while annual services price growth slowed further.

Focusing in on the annual growth in services, there are two key areas driving this trend.

1) There has been a larger slowdown in trade margins growth since Aug 2019 from +3.8% to +1.4% in Nov.
2) Transportation and warehousing prices are now declining on an annual basis. In Nov 2018, transportation and warehousing prices were growing at +6.4% (close to the peak growth in this cycle) and in Nov 2019, prices are now declining by -0.4% on an annual basis.



What each measures in the PPI -final demand for services;

The final demand trade services index measures changes in margins received for the retailing and wholesaling of merchandise sold to final demand, generally without transformation. (Trade indexes measure changes in margins received by wholesalers and retailers.)

The final demand transportation and warehousing services index tracks price change for transportation of passengers, as well as, transportation of cargo sold to final demand, and also includes prices for warehousing and storage of goods sold to final demand.

The final demand services less trade, transportation, and warehousing index measures price change for all services other than trade and transportation sold to final demand. Publishing, banking, lodging, and health care are examples of these services. https://www.bls.gov/ppi/fdidsummary.htm

This price data indicates some weakness in retail and wholesale (margins falling in the month and slowing more pronounced on an annual basis over the last 3 months).

On an intermediate basis, prices for warehousing and transport are also slowing, but remain positive. The annual change in trade services margins remain elevated, but have slowed somewhat since Sep 2019. The intermediate prices reflect demand by firms as an input to production.

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

Retail Sales (Nov)

The nominal value of US retail sales grew at a slower pace in Nov compared to Oct. This was somewhat of a disappointing result due to post-Thanksgiving sales.

Some of the data from the holiday retail period will likely also be reflected in Dec retail sales due to timing of cyber Monday sales (2 Dec). Next month we will look at the combination of Nov + Dec retail sales.

Total Retail Sales – month change; Nov +0.2% (+$1bn) versus Oct +0.4% (+$2.3bn). The Oct result was revised higher but the Sep result was revised lower.

The Nov result was mixed from a category perspective. Best performing categories (in order of the size of contribution to headline growth) were;

Non-Store Retailers – made the largest contribution to overall sales growth in the month. Growth also accelerated from +0.6% in Oct to +0.8% in Nov.

Motor Vehicles – but sales slowed from +1% growth in Oct to +0.5% growth in Nov.

Gasoline stations – but sales slowed from +1.7% in Oct to +0.7% in Nov.

Food and Bev Stores – the pace of growth increased from +0.2% in Oct to +0.3% in Nov.

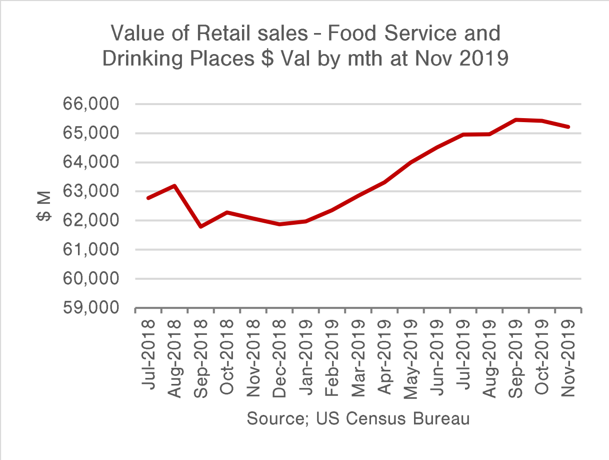
Sales were lower across several categories;

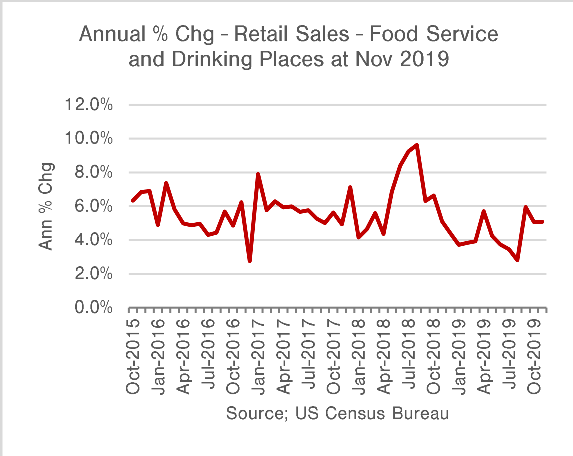
The largest contributor was a decline in health and personal care store sales (-0.3% in Oct versus -0.6% in Nov).

Clothing sales declined at a faster pace (-0.6% in Nov versus-0.3% in Oct) – recall from the CPI report (earlier in this section) that apparel prices declined in Nov.

The third largest contributor to the weaker sales was food services and drinking places (out of home food consumption); declined by -0.3% in Nov versus -0.1% in Oct, the second month of decline/plateau.

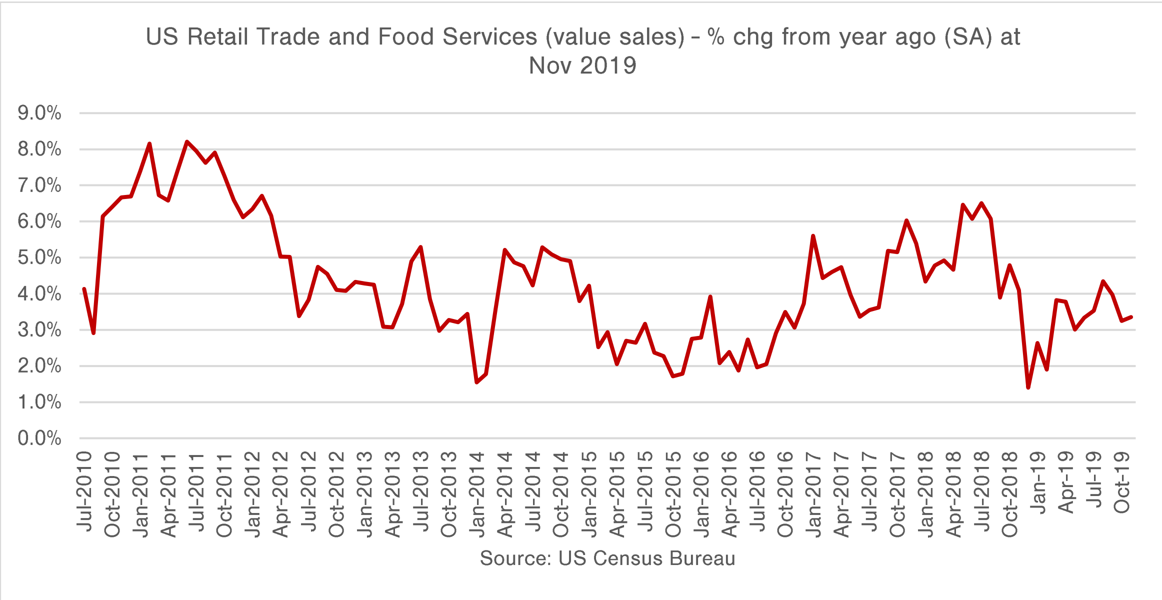
The annual growth looks somewhat more impressive, but the recent spike higher in growth in Sep was partly due to base effects (Sep v Aug 2018 sales declined by 2.2% in the month). Food service sales are sometimes used as a bell-weather for discretionary expenditure;





The annual change in retail sales at Nov was little changed;

Total Retail Sales – annual change; Nov +3.3% versus Oct +3.2%



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

Business Inventories (Oct)

The distributive trade sales and manufacturer shipments declined further in the latest month and declined versus a year ago. At the same time, the value of inventory increased in the month. On a seasonally adjusted basis, the inventory to sales ratio held steady at 1.4, up from 1.36 a year ago.

Sales Total Distributive Trade – month change; Oct -0.1% (-$1.1bn) versus Sep -0.2% (-$3.2bn)

Leading the decline this month was merchant wholesalers (-$3.6bn), while retailer sales increased (+$2.4bn) and manufacturer shipments were unchanged ($0).

Inventory Total Distributive Trade – month change; Oct +0.2% (+$3.8bn) versus Sep +0.05% (+$1bn)

The increase in inventory for the month was the result of increases across all channels.

Manufacturer inventory increased by +0.1% (+$0.9bn). The inventory to sales ratio was unchanged between Oct and Sep at 1.4.

Retailer inventory increased by +0.3% in Oct (+$2.2bn). The inventory to sales ratio was also unchanged at 1.45.

Merchant wholesaler inventory increased slightly by +0.1% (+$0.7bn). The inventory to sales ratio increased slightly to 1.37 as a result of the weaker sales in the month.

On an annual basis, the increase in the value of inventory remains much higher than sales;

Sales Total Distributive Trade – annual change; Oct -0.1% (-$1.3bn) versus Sep +0.5%

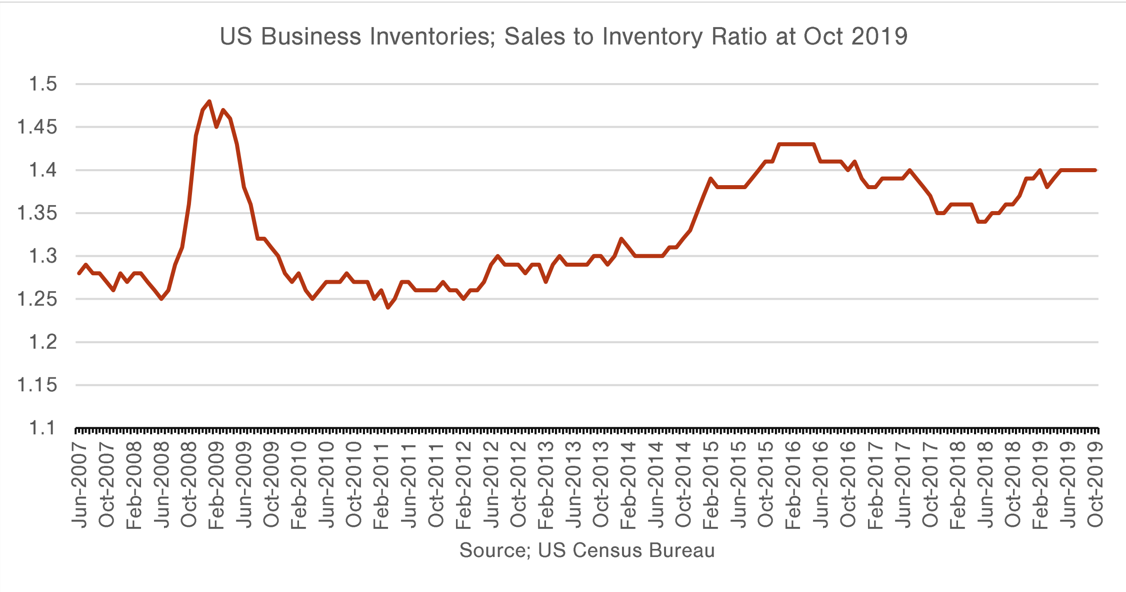
Sales are down on a year ago across manufacturer shipments (-$7.8bn) and merchant wholesalers (-$6.9bn). This was mostly offset by retail sales growth of +$13.4bn.

The value of inventory is increasing on an annual basis at much faster pace, but did slow over the last month;

Inventory Total Distributive Trade – annual change; Oct +3.1% (+$61.3bn) versus Sep +3.7%

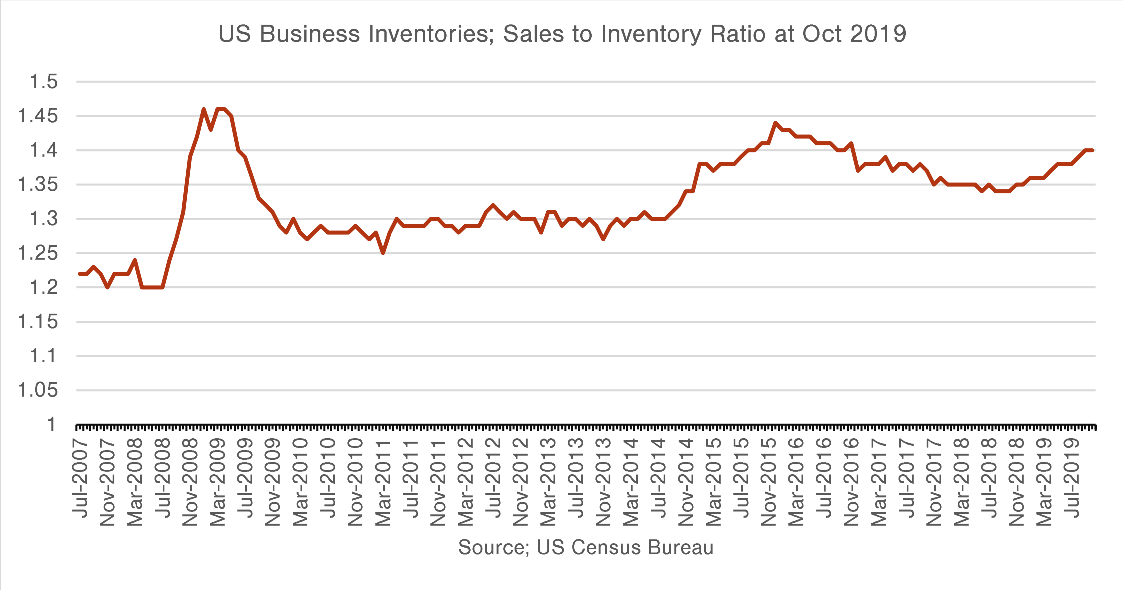
All channels recorded higher growth in inventory in the latest year.

The total business inventory to sales ratio remains elevated but has not changed from 1.4 since May;

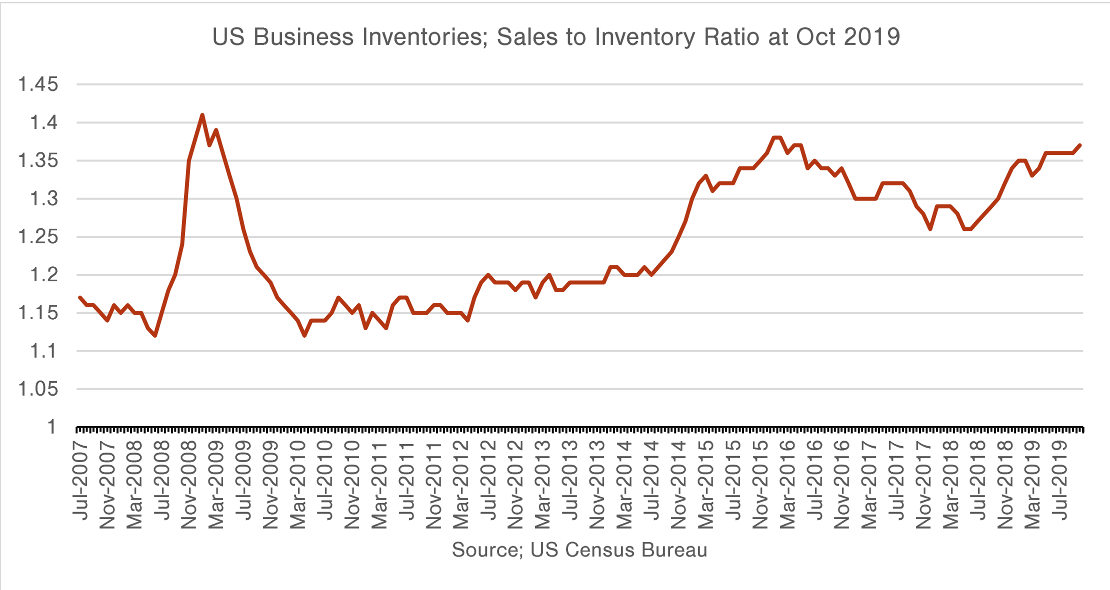


The retail channel is the only channel where the inventory to sales ratio has remained fairly steady at 1.45 across the last year. Given the slowdown in sales in Nov, it will be interesting to see how the inventory situation evolves.

The manufacturer inventory to sales ratio is 1.4 in Oct, up from 1.34 a year ago;



The merchant wholesaler inventory to sales ratio has increased from 1.3 a year ago to 1.37 in Oct and remains elevated compared to recent periods of weakness;



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

FOMC Rates Decision – 11 Dec 2019

As expected, rates remained on hold in the meeting; FFR 1.5% - 1.75%. The fed has cut rates at the three prior meetings.

There was no change to the reinvestment policy or to the purchase of T-bills.

There were several changes made to the statement – the biggest change being the removal of 'uncertainties about this outlook remain' – in relation to the current stance of policy to support the expansion, labour market and inflation.

Guidance on the appropriate path for policy remains focused on monitoring the implications of incoming information for the outlook, global developments and muted inflation pressure.

https://www.federalreserve.gov/newsevents/pressreleases/monetary20191211a.htm

Projections

Projections on growth were unchanged at this meeting, the unemployment rate was revised lower (compared to Sep projections). Core PCE inflation was revised lower for 2019.

Percent

Variable	Median[1]				
	2019	2020	2021	2022	Longer run
Change in real GDP	2.2	2.0	1.9	1.8	1.9
September projection	2.2	2.0	1.9	1.8	1.9
Unemployment rate	3.6	3.5	3.6	3.7	4.1
September projection	3.7	3.7	3.8	3.9	4.2
PCE inflation	1.5	1.9	2.0	2.0	2.0
September projection	1.5	1.9	2.0	2.0	2.0
Core PCE inflation[4]	1.6	1.9	2.0	2.0	
September projection	1.8	1.9	2.0	2.0	
Memo: Projected appropriate policy path					
Federal funds rate	1.6	1.6	1.9	2.1	2.5
September projection	1.9	1.9	2.1	2.4	2.5

Given these projections, the appropriate policy path has the potential for a rate hike from 2021. Most FOMC members don't see, given the current data and projections, a case for hikes in 2020.

https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20191211.pdf

Press Conference

> Our economic outlook remains a favorable one despite global developments and ongoing risks

With regard to repo coming into the year end, the Chairman signalled that the Fed would be ready to respond to any repo/rates pressure (emphasis added);

> We stand **ready to adjust** the details of our operations as appropriate to keep the federal funds rate in the target range.

https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20191211.pdf

Further Support for Liquidity via Repo Operations into the Year End

The NY Fed announced on the 12 Dec further liquidity support for the year-end turn;

In addition to the term repo operations already conducted, the Fed will conduct further two-week term repo operations, twice a week, four of which will cover the end of year. Another longer-term operation will be conducted (up to $50bn in this operation) in the lead up to the year end and will also span year end.

Overnight operations will continue each day. The operations for 31 Dec and 2 Jan, operations will increase to $150bn. Another operation will be offered on 31 Dec fat $75bn that will mature on 2 Jan.

https://www.newyorkfed.org/markets/opolicy/operating_policy_191212

Return to top

Europe

Eurozone Industrial Production (Oct)

Industrial production across the Eurozone declined in the month of Oct. Both the Euro area and the EU28 recorded declines in production across energy and capital goods.

Euro area Industrial Production – month change; Oct -0.5% versus Sep -0.1%

The decline in production in the month was led by another fall in energy production (-0.7% in Oct versus -1% in Sep) but was led mostly by a 2% decline in capital goods production (after +0.7% growth in Sep).

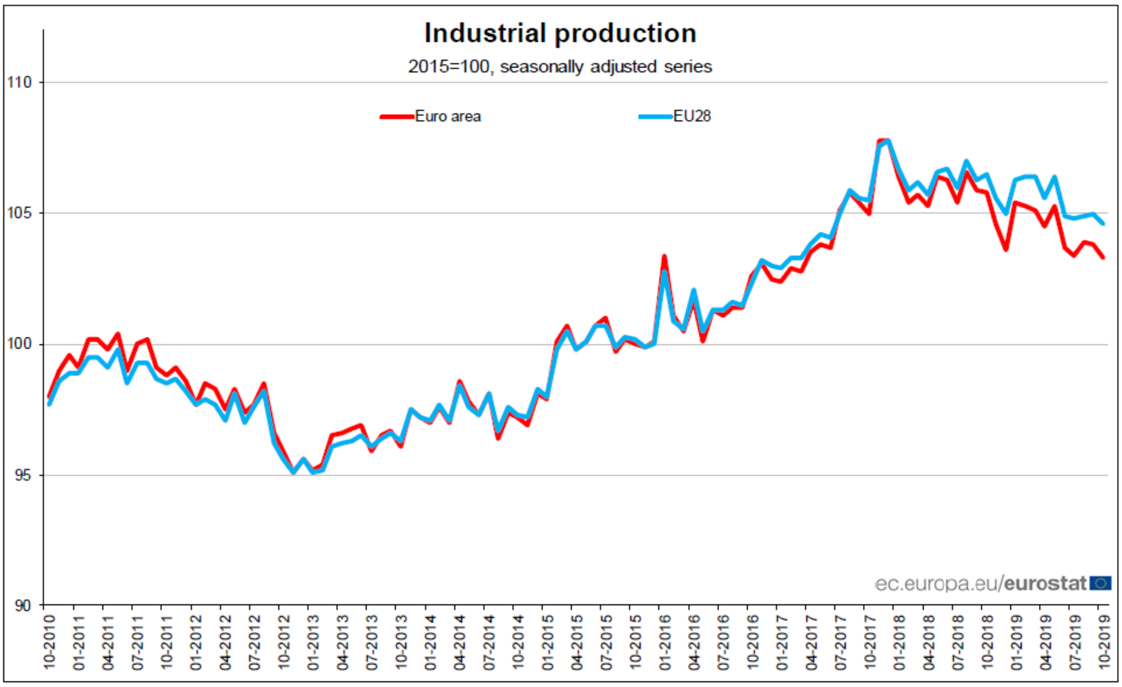
The production of non-durable consumer goods slowed, but remained positive.

Growth in durable goods production accelerated from a -0.5% decline in Sep to +1.9% increase in Oct.

The results were similar across the EU28 group. Leading the declines in the month were Sweden (-1.5%), Greece (-2.6%), Ireland (-0.2%), Germany (-1.5%), Spain (-0.4%) and Denmark (-2.6%).

Euro area Industrial Production – annual change; Oct -2.2% versus Sep -1.8%

Production remains below a year ago across intermediate goods, energy and capital goods. Durable consumer goods shifted to slightly growth versus a year ago in Nov. Growth in non-durable consumer goods accelerated higher from +1.5% in Sep to +2.7% in Nov.



On an annual basis;

> "…the largest decreases in industrial production were registered in **Germany** (-6.3%), **Estonia**, **Romania** and **Slovakia** (all -3.9%). The highest increases were observed in **Hungary** (+6.5%), **Ireland** (+5.9%) and **Poland** (+3.4%). "

https://ec.europa.eu/eurostat/documents/2995521/10081956/4-12122019-AP-EN.PDF/2f7cb7ba-ac94-105f-a34c-bc331c5ccedb

Germany CPI (Nov)

Consumer prices in Germany declined in the month and growth was unchanged on an annual basis. The European version of the harmonised CPI increased at a faster pace in Nov.

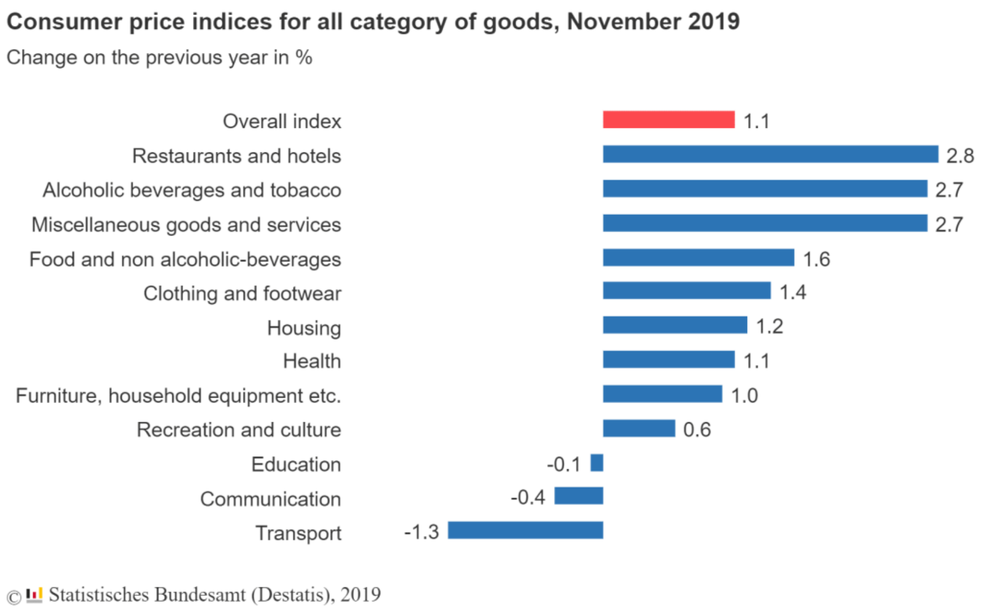
Germany CPI – month change; Nov -0.8% versus Oct +0.1%

The decline in the month was led mostly by a decline in services prices of -1.5%. Services ex net rent declined by -2.5% - led by a 28% decline in package holiday prices.

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

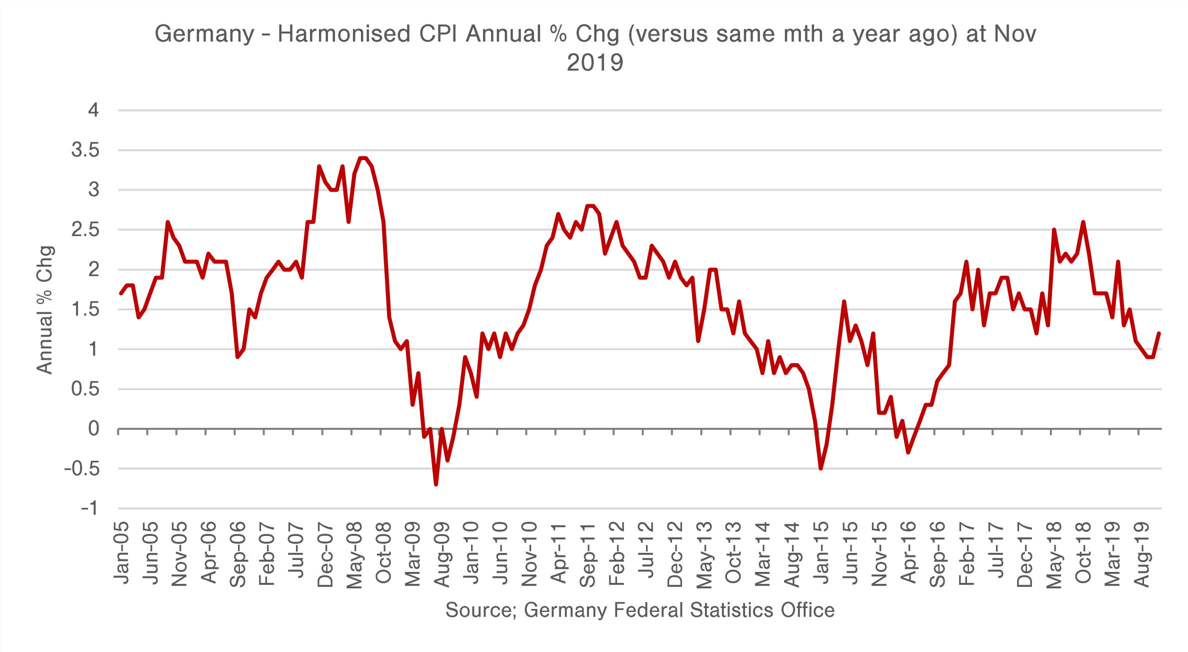
The annual growth in goods prices slowed from +0.4% in Oct to +0.1% in Nov. Energy prices were -3.7% lower in Nov versus a year ago.

Services prices increased at a similar pace; Nov +1.8% versus Oct +1.7%



Annual core CPI growth also lighted slightly; Nov +1.6% versus Oct +1.5%

The harmonised version of annual CPI growth increased from +0.9% in Oct to +1.2% in Nov;



https://www.destatis.de/EN/Press/2019/12/PE19_477_611.html

ECB Rates Decision – 12 Dec 2019

This was Christine Lagarde's first meeting as ECB President and no change to policy was expected.

Rates remained on hold at this meeting and no changes were made to the QE program.

Rates guidance remained unchanged; rates to remain at present **or lower levels** until inflation "robustly converges at a level close to but below 2%" and that such convergence has been consistently reflected in underlying inflation dynamics.

QE guidance – the ECB will continue to the APP for as long as necessary to maintain accommodative policy stance. Will stop QE shortly before raising rates. Reinvestment of maturing securities will continue for an extended period of time, past the date when it starts raising the key ECB policy rates.

In the press conference, ECB President Lagarde announced a year-long review of the ECB – similar to that currently underway in the US.

There was a more upbeat tone on the state of the Eurozone economy;

> With the euro zone economy barely expanding, the former IMF chief firmly embraced the ECB's easy money policy but suggested that the worst of the bloc's slowdown may now over and an often-discussed but elusive recovery could now begin. https://www.reuters.com/article/us-ecb-policy/lagarde-pledges-own-style-as-she-unveils-broad-ecb-review-idUSKBN1YF2TQ

https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.mp191212~06d84240ae.en.html

Return to top

Japan

Q3 GDP Second Est

The second estimate for Q3 real GDP growth was revised higher – due mostly to upward revisions in household consumption (possibly stockpiling ahead of the consumption tax increase) and private investment spending.

The prelim estimate for Q3 GDP growth was revised from +0.1% to +0.45% growth.

Growth in Q2 was also revised higher from +0.4% to +0.5% growth.

The main revisions to Q3 growth were;

Private consumption growth was revised higher from +0.4% to +0.5% growth – private consumption adding +0.3%pts to headline growth (from +0.2% pts).

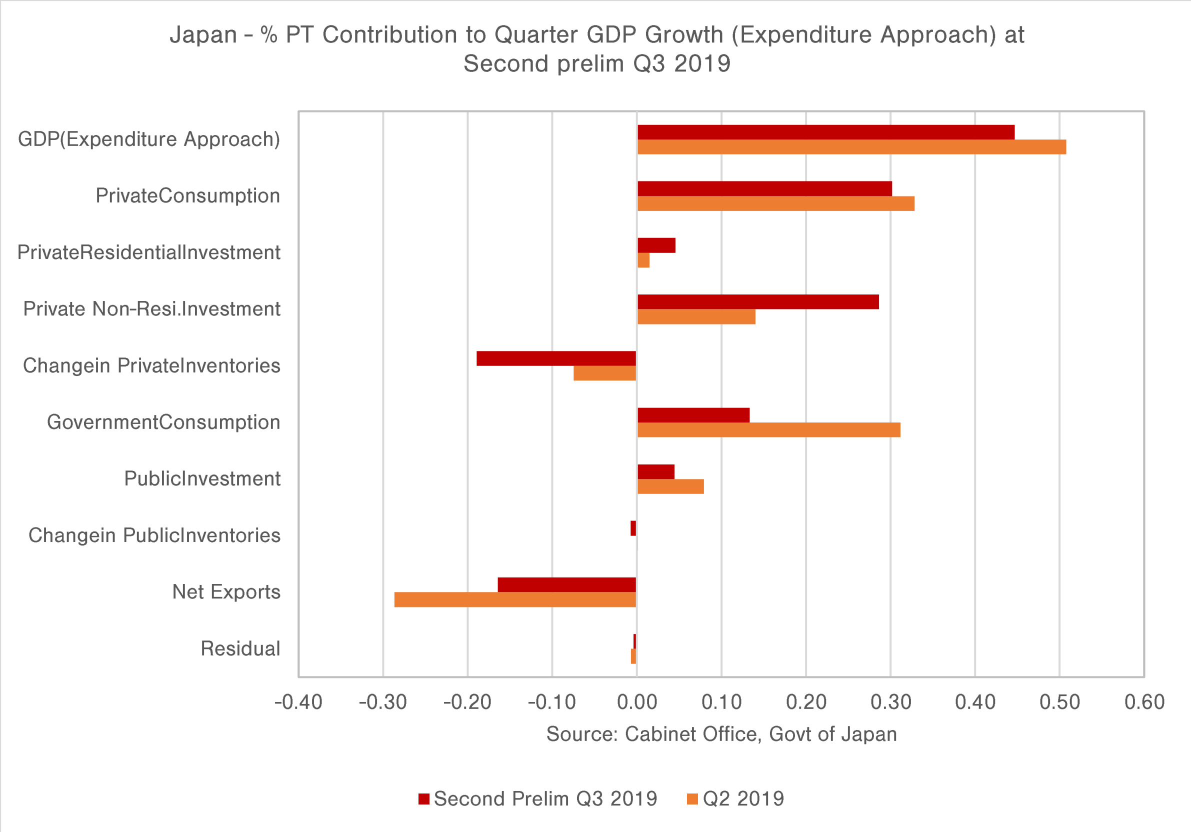
Private residential investment was revised only slightly higher.

Private non-residential investment was revised notably higher. Growth was revised from +0.9% to +1.8%. The contribution increased from +0.1% pt to +0.3% pts.

The change in private inventories made a smaller negative contribution (revised from -0.3% pts to -0.2% pts)

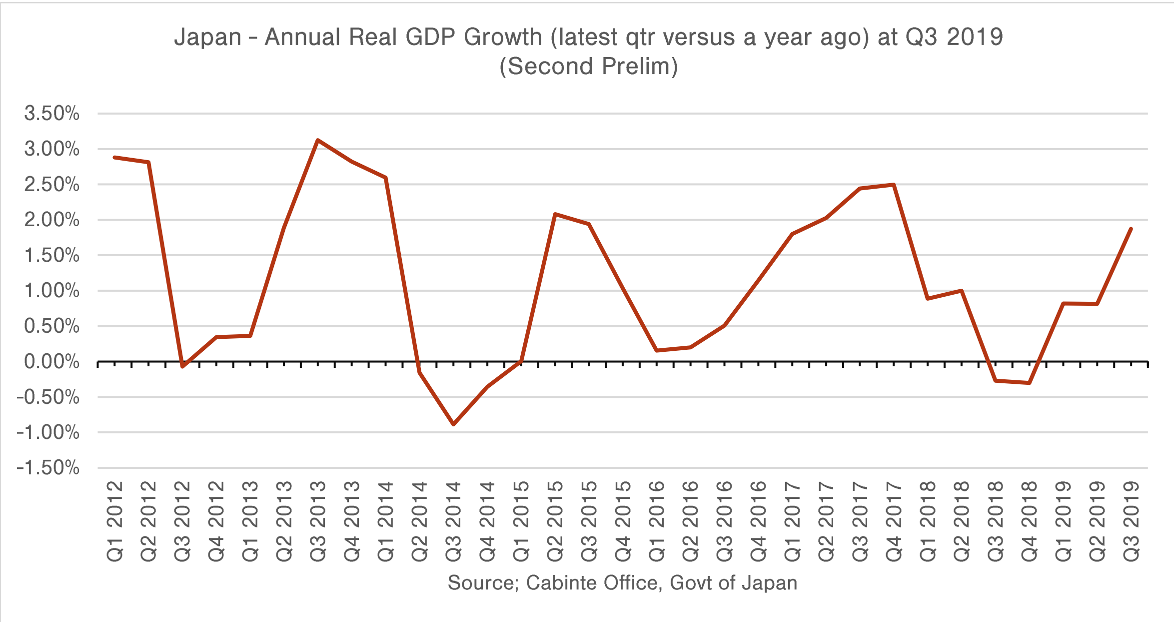
Government consumption and public investment were little changed.

The contribution from net exports was also unchanged at -0.2%pts in Q3.



As a result of the revisions, annual real GDP growth was also revised higher, due mostly to household consumption and private investment spending.

Real GDP growth – annual change; Q3 +1.87% (revised higher from +1.4%) versus Q2 +0.8%



https://www.esri.cao.go.jp/en/sna/data/sokuhou/files/2019/qe193_2/gdemenuea.html

Industrial Production (Final) Oct

Industrial production and shipments for Oct were revised lower in the final report. This is likely partly, but not entirely, due to stockpiling prior to the Oct increase in the consumption tax in Oct. Weather related disruptions also likely influenced the final result for the month.

PRODUCTION

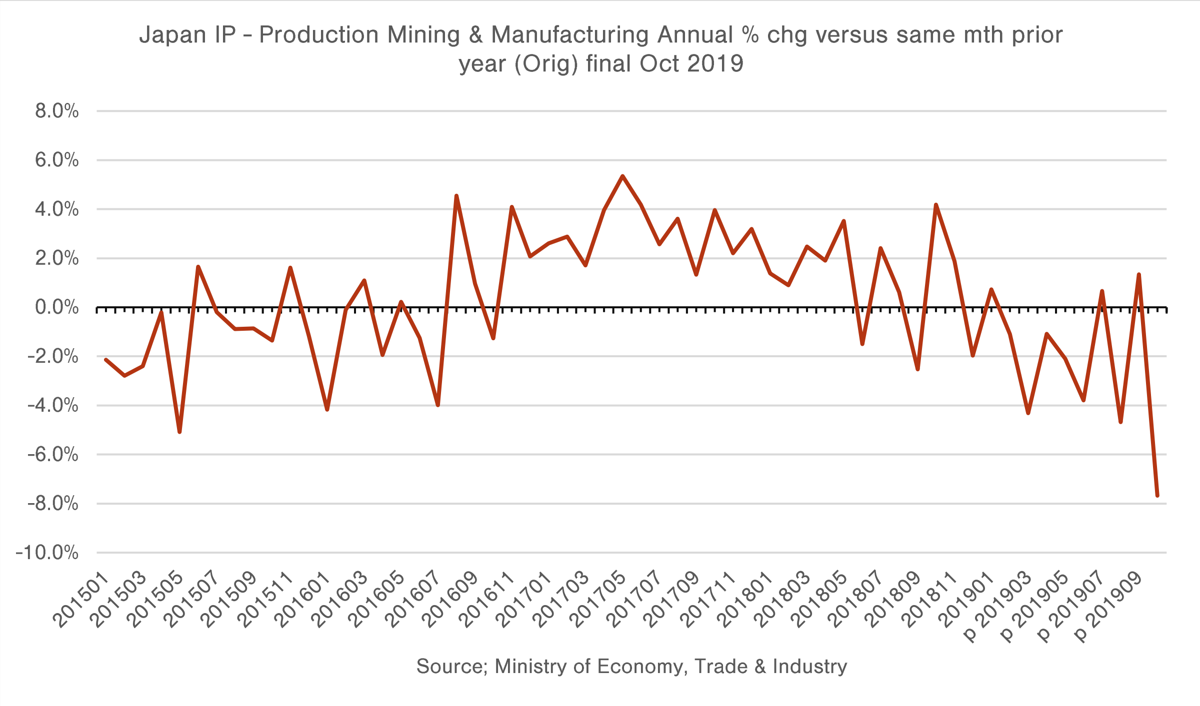
Month change; Oct -4.5% (revised from -4.2%) versus Sep +1.7%

While the larger decline in the month was likely due mostly to weather and consumption tax disruptions, the production index had already been trending somewhat sideways since the start of 2018.

Production in the month was notably lower across (in order of the largest weight categories); Transport equipment (-7.8%), foods and tobacco (-5.1%), general purpose and business-oriented machinery (-13%) and production machinery (-6.4%).

Production increased in the month for electronic parts and devices (+0.9%) and chemicals (+0.7%).

Annual change; Oct -7.7% (revised from -7.4%) versus Sep +1.3%

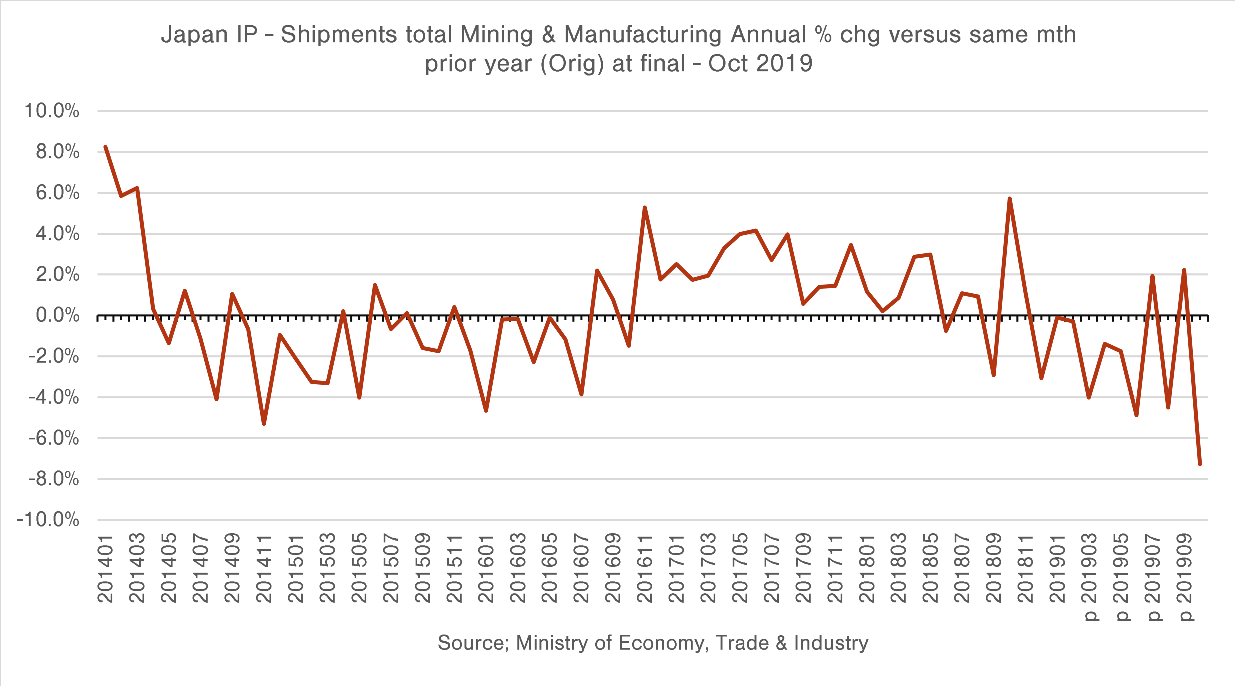


SHIPMENTS

Month change; Oct -4.5% (was -4.3%) versus Sep +1.5%

Shipments were lower across; food and tobacco (-4.8%), transport equipment (-2.2%, but lifted by a +55% increase in shipments of ships/ship engines), electrical machinery -6.3%, general purpose and business-oriented machinery (-12.5%) and production machinery (-7.9%).

Annual change; Oct -7.3% (prior -7.1%) versus Sep +2.2%



<u>INVENTORY and INVENTORY RATIO</u>

<u>Month change</u>; Oct +1.3% (prior +1.2%) versus Sep -1.4%

The index of seasonally adjusted inventory in Oct is only 0.5pts below the peak reached in Jul 2019 (the peak of 104.7 in Jul 2019 was the highest in the data series which only goes back to the start of 2013)

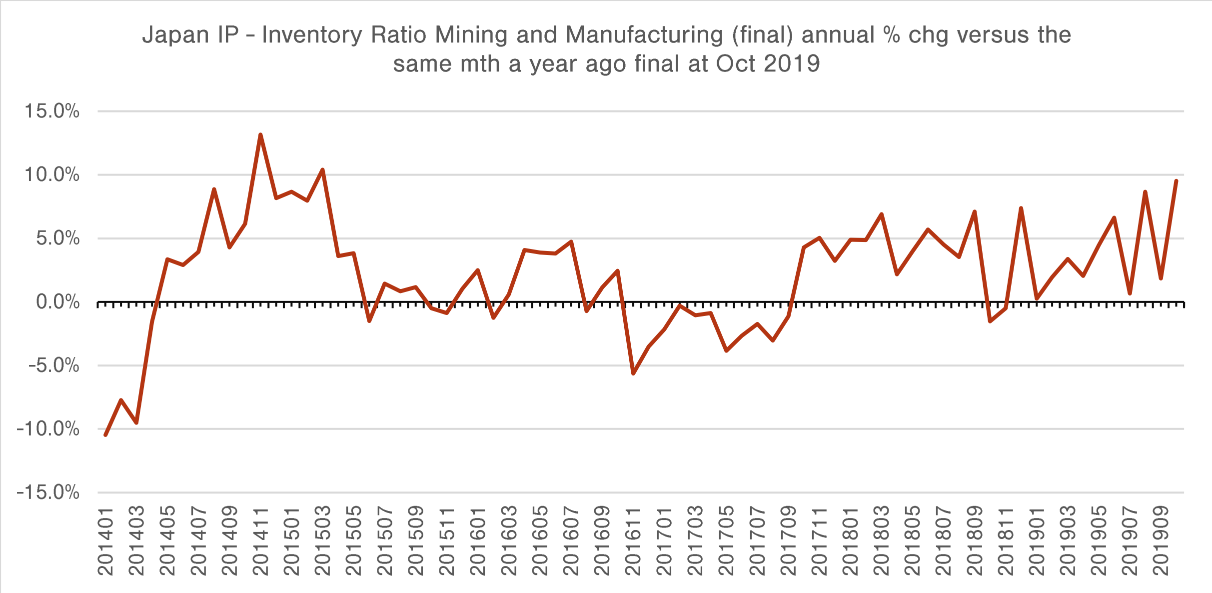
Inventory growth in the month was higher across several categories; electronic parts and devices (+8.8%), electrical machinery (+4.1%), petroleum (+10.8%) and food and tobacco (+2.4%).

Inventory declined across some of the larger categories such as transport equipment (-5.8%), chemicals (-0.6%), production machinery (0%).

The single largest category by weight in the inventory index (SA) is iron and steel – and inventory grew by only +0.2%.

The inventory ratio increased at a much faster pace though; Oct; +4.6% versus Sep -1.9%

<u>On a year ago basis</u>, the inventory ratio increased by +9.5% in Oct (versus +1.9%) in Sep).



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

Return to top

United Kingdom

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.

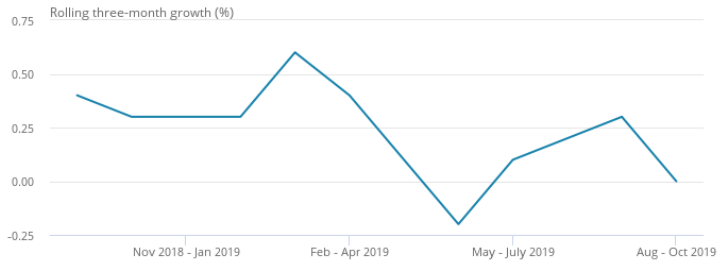
GDP Month (Oct)

UK GDP in the three months to Oct recorded no growth versus the prior quarter. This reflected slower growth in services activity which still helped to offset declines in production and construction over the 3-months to Oct.

GDP Growth; Aug-Oct 0% versus Jul-Sep +0.3%

Figure 2: Rolling three-month growth was flat in the three months to October 2019, following growth of 0.3% in Quarter 3 (July to Sept) 2019

Growth, three-months on previous three-months, September to November 2018 until August to October 2019



Source: Office for National Statistics – GDP monthly estimate

Services increased by +0.2% in the 3-month period, adding +0.17%pts to headline growth

Production activity declined by -0.7% and detracted -0.1%pts from growth

Construction also declined by -0.3% detracting -0.02%pts

By month, growth across some sectors appears to have stabilized in Oct except for construction. Construction recorded its lowest level of output since Jan 2018;

Table 2: Breakdown of GDP and its components' growth rates by month

	August 2019	September 2019	October 2019
GDP	-0.2	-0.1	0.0
Index of Services	-0.1	0	0.2
Index of Production	-0.7	-0.3	0.1
Manufacturing	-0.7	-0.4	0.2
Construction	0.1	-0.2	-2.3
Agriculture	-0.1	-0.2	0.1
Source:	Office for National Statistics - GDP monthly estimate		

The pick-up in manufacturing in Oct was likely led by stockpiling as per results in Mar;

> Manufacturing also grew by 0.2% on the month, with the largest positive contributions coming from pharmaceuticals and food production. These industries were also the main contributors to growth in March 2019 ahead of the UK's original planned date to exit the European Union.

The decline in construction in Oct of -2.3% was led by shifts in activity for infrastructure;

> This decrease was driven by private new housing and infrastructure, which fell by 4.7% and 6.3%, respectively. The fall in infrastructure is as a result of several

large businesses changing the timing of some of their regular activity from July to October.

https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/october2019

Return to top

Australia

House Price Index Q3

In line with the improvement in the flow of new housing credit since Jun, the residential property price index increased on a National basis in the latest quarter. This was led by an increase in prices across both houses and attached dwellings. The largest % gains in prices were recorded in Melbourne and Sydney,

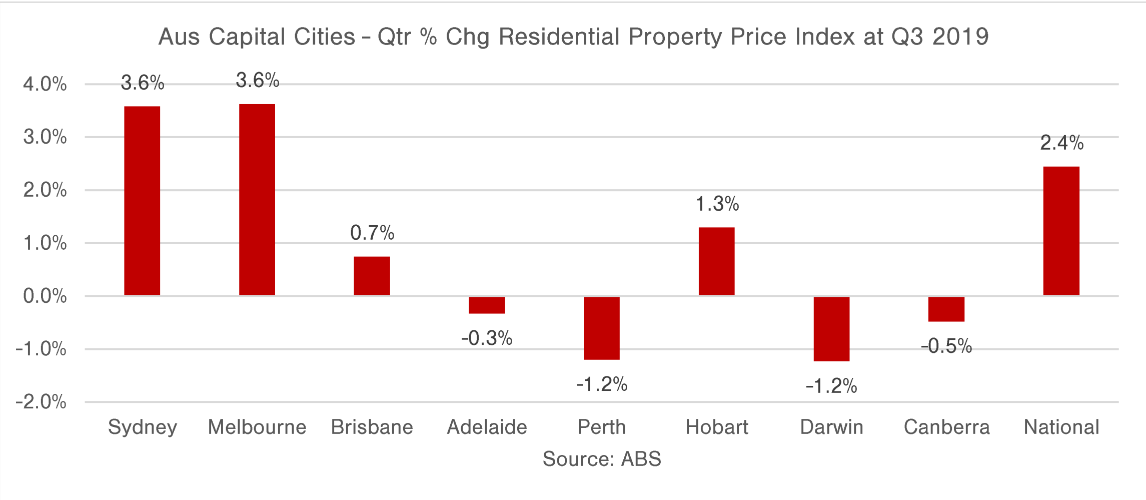
On an annual basis, prices remain below a year ago across most markets, except Hobart (one of the smallest states).

So far, the trough in prices was recorded in Q2 2019 (the prior quarter) – this represented a 9% declined from the peak in Dec 2017. In this quarter, prices remain 6% below that peak in Dec 2017.

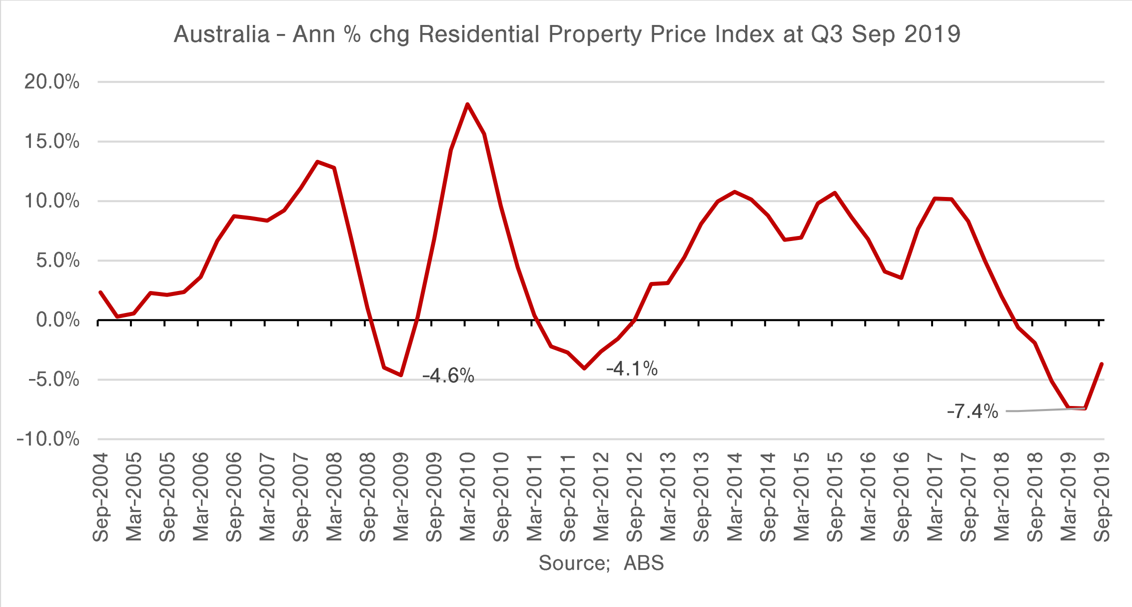
<u>National Residential Property Price Index – quarter change</u>; Q3 +2.4% versus Q2 -0.7%

Both established houses and attached dwellings contributed to the increase in the quarter. Established dwellings increased by +2.5% in Q3 and attached dwellings also increased by +2.5%.

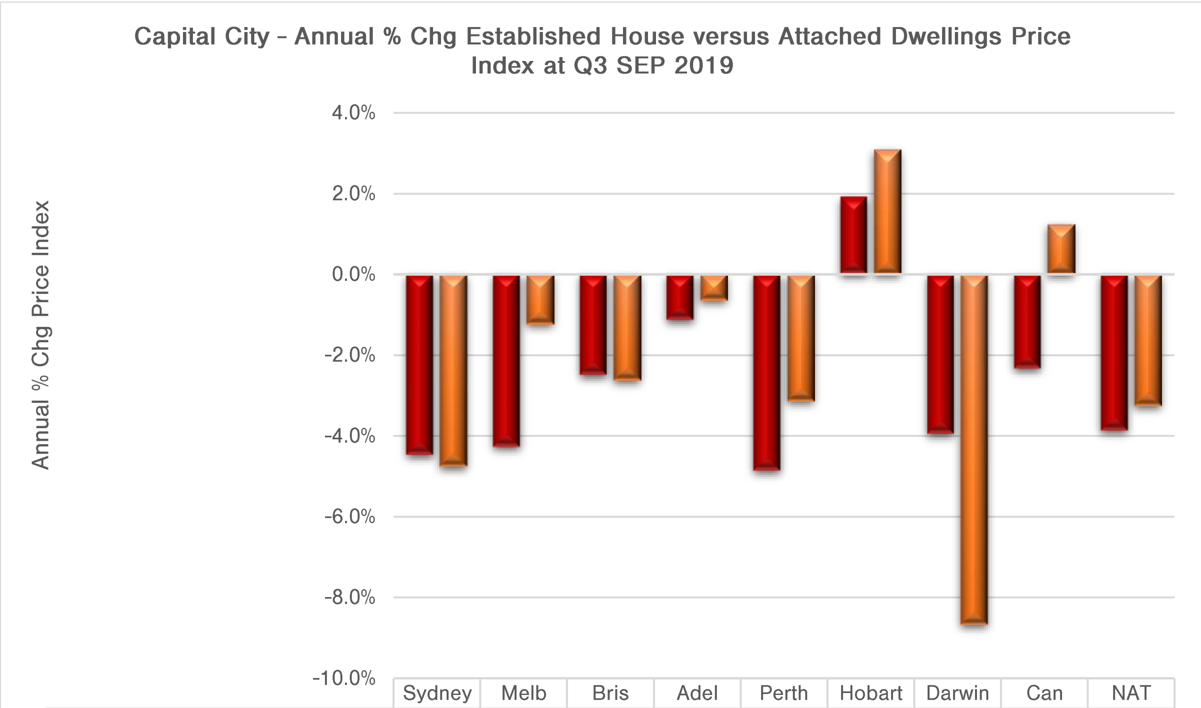
The gains in the quarter were led mostly by Sydney and Melbourne;



<u>National Residential Property Price Index – annual change</u>; Q3 -3.7% versus Q2 -7.4%



On an annual basis, both established dwellings and attached dwellings (apartments) remain below a year ago across most markets;



	Sydney	Melb	Bris	Adel	Perth	Hobart	Darwin	Can	NAT
% Chg Est House Price Index	-4.5%	-4.3%	-2.5%	-1.1%	-4.9%	1.9%	-4.0%	-2.3%	-3.9%
% Chg Attach Dwelling Price Index	-4.8%	-1.2%	-2.6%	-0.6%	-3.1%	3.1%	-8.7%	1.2%	-3.2%

Source; ABS

https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6416.0Main+Features1Sep%202019?OpenDocument

NAB Business Conditions and Confidence (Nov)

This month, business confidence fell back to the zero 'no change/neutral' level, while there was no change in the level of business conditions between Oct and Nov. Conditions have at least stabilized at a low level, but the forward-looking indicators weakened (emphasis added);

> "Overall, the business survey is consistent with ongoing weakness in GDP growth (especially private demand) and **suggests there has been little improvement in Q4 for GDP**. With conditions below average and confidence also weak, there is a risk that employment growth slows and that investment will remain weak despite spill-over demand from public sector spending and a stabilisation in mining."

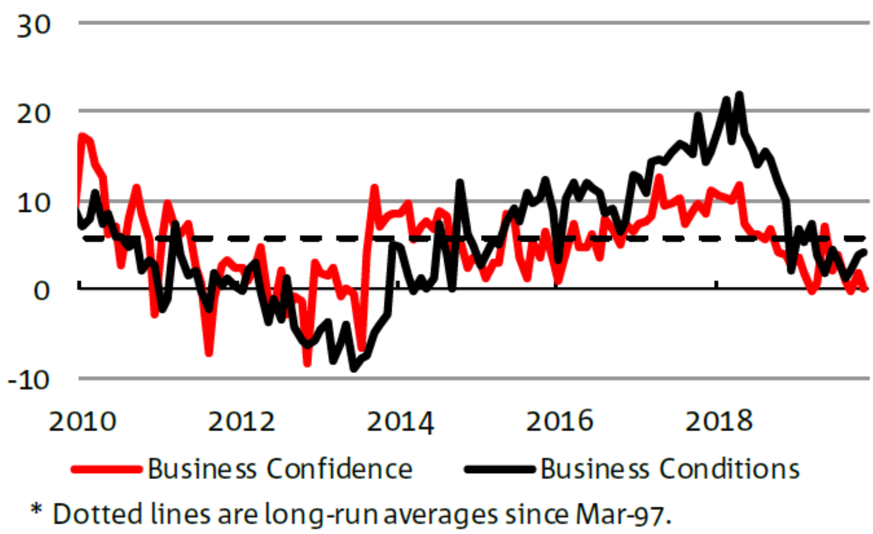
Headline Business Conditions; Nov 4 versus Oct 4

Trading conditions fell slightly in the month, while profitability improved. Employment growth was unchanged. All three elements remain well below the early 2018 peaks.

Headline Business Confidence; Nov 0 versus Oct 2

Both conditions and confidence remain below the long-run average;

CHART 1: CONDITIONS STABILISING

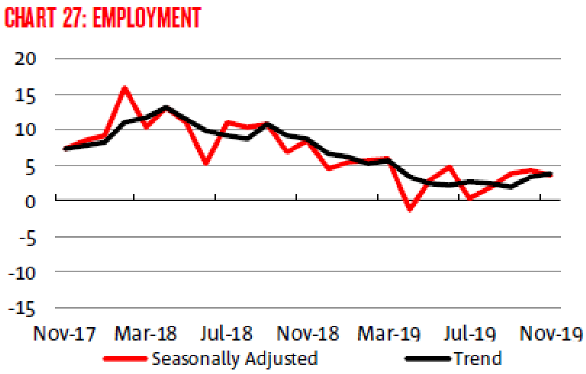


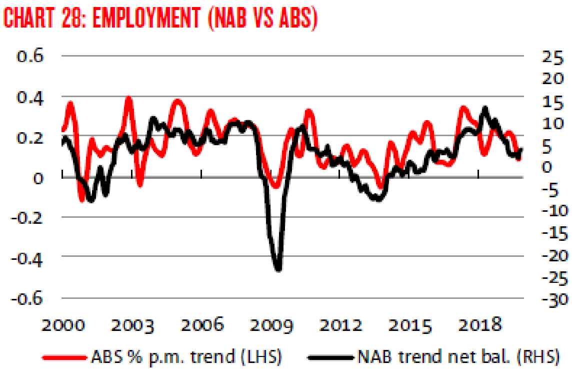
Concerning is that forward orders fell back into decline; Nov -2 versus Oct 3. Stocks also increased from 1 in Oct to 3 in Nov. Export growth fell back to zero in Nov from 1 in Oct. Capacity utilization is now back down to its long run average.

Labour Market Indicators

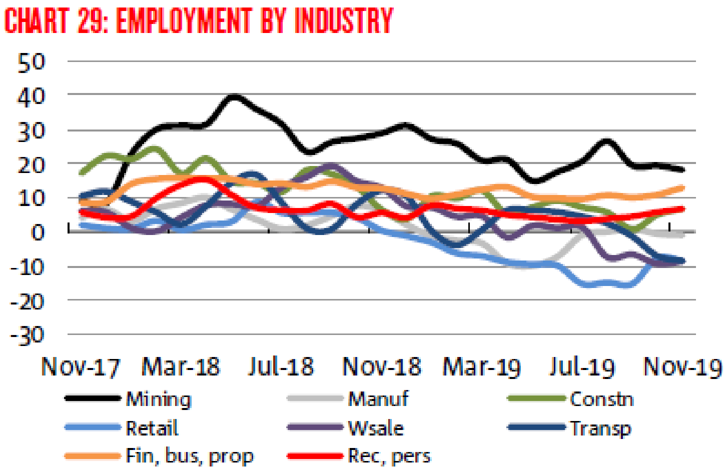
Given the importance of the labour market conditions to the RBA and the economy generally, it's worth looking at some of the employment measures in more detail.

The NAB report shows that the slow-down in employment growth has stabilized and that employment growth remains low;





By industry, employment continues to decline in retail (despite less negative confidence), wholesale and transport. Manufacturing employment growth remains flat. There has been some improvement in financial/business/property and recreation employment.



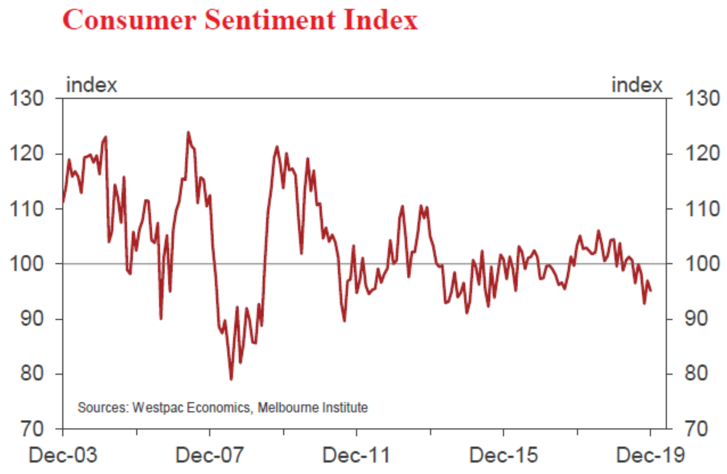
https://business.nab.com.au/wp-content/uploads/2019/12/NAB-Monthly-Business-Survey-%E2%80%93-November-2019.pdf

Westpac Consumer Sentiment (Dec)

Consumer sentiment fell again this month after rebounding slightly in the month prior. The index of consumer sentiment remains below the 100 level – indicating pessimists out-weigh optimists. The key message in this report is that rate cuts in this cycle (as opposed to the 2011 cycle) are having a far lower impact on consumers. The Dec report suggests that consumers will continue to keep a tight rein on spending. Despite house price expectations increasing, consumers are also expecting higher unemployment.

Headline index of Consumer Sentiment; Dec 95.1 versus Nov 97

The index reading is 9% below a year ago;



All index components recorded declines versus the month prior and all remain below readings from a year ago.

> The 'finances vs a year ago' sub-index fell 3.6% in December and the 'finances, next 12 months' sub-index slipped 0.5%.These components are down by 9.5% and 7.0% respectively on a year ago. Readings continue to disappoint given interest rate cuts, the $7.7bn in personal income tax relief rolled out since July and the turnaround in house prices in most markets.

Other important sentiment indices;

Time to buy a dwelling; the index declined in the month by 5.6%, but still remains positive versus a year ago.

The index of house price expectations continued to increase in the month, up +3.2% in Dec versus Nov. The index is 40% above a year ago.

The unemployment expectations index has been increasing – indicating consumers expect an increase in job losses. The index increased by 1% in Dec and is +14% above the reading from a year ago.

https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/economics-research/er20191211BullConsumerSentiment.pdf

Return to top

China

Trade Balance/Exports/Imports (Nov)

Trade Balance (USD) - Surplus; Nov 38.7bn versus Oct 42.5bn

The decline in the surplus was the result of a decline in exports and a year on year increase in imports for the first time in seven months. The lift in imports was mostly focused on copper, crude oil, iron ore and soya beans.

The improvement in imports, and the composition, is consistent with the improvement in the manufacturing PMI activity in Nov, following on from an improvement in Oct. This lift in activity is something to watch.

Exports (USD) – annual change; Nov -1.1% versus Oct -0.9%

Chart; China Exports (USD)

Exports by Commodity;

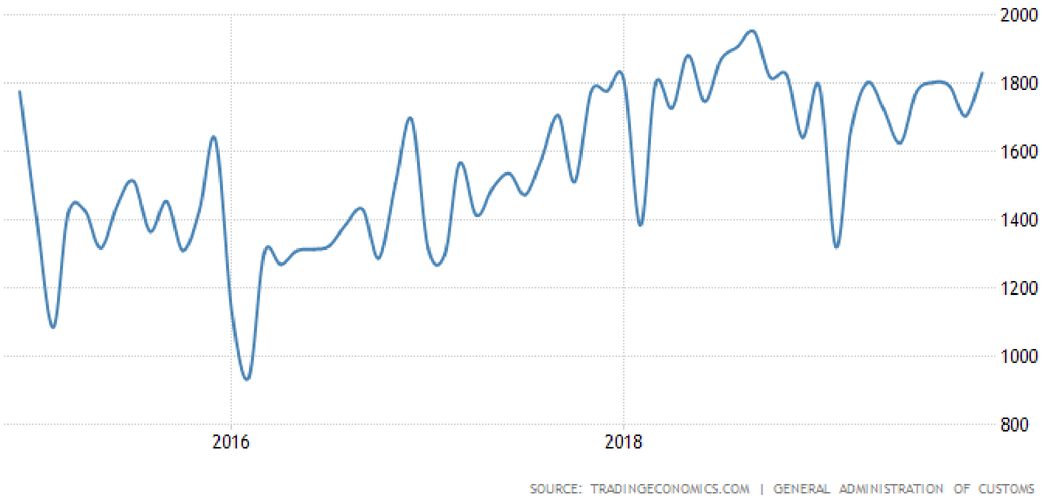
This was the fourth straight month of yearly decline in overseas sales, amid weakening global demand and ongoing trade tensions with the US. Sales declined for crude oil (-79.4 percent), unwrought aluminium and products (-15.7 percent), coke & semi-coke (-63.1 percent), steel products (-13.6 percent), and rice (-47.4 percent).

Exports by Market;

Among major trade partners, exports fell to the US (-23.0 percent), the EU (-3.8 percent), Japan (-7.8 percent) and Australia (-0.1 percent); but rose to ASEAN (18.0 percent), Taiwan (6.5 percent) and South Korea (0.5 percent)

Imports (USD) – annual change; Nov +0.3% versus Oct -6.4%

Chart; China Imports (USD)



Imports by Commodity;

> This marked the first year-on-year import growth since April, as unwrought copper purchases were the highest since September 2018 (5.9% to 483,000 tonnes). Imports also advanced for crude oil (6.7%), natural gas (3.3%), copper ores & concentrates (27.0%), coal (8.5%), iron ore (5.1%), soybeans (53.8%) and edible vegetable oil (70.3%).

Imports by Market;

> Imports increased from the US (2.9%), the EU (2.7%), ASEAN (11.1%) and Taiwan (2.0%). On the other hand, purchases from Japan were unchanged, while those from Australia and South Korea dropped 9.3 percent and 7.1 percent respectively.

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

China PPI for the Industrial Sector (Nov)

Producer prices for the industrial sector (manufactured goods) declined slightly in the month, while the annual decline eased only slightly. Prices for the means of subsistence (consumer goods) are growing at an accelerated pace due to higher food prices. The decline in consumer durable goods prices likely reflects the ongoing weaker demand. Prices for the means of production are declining on an annual (and monthly) basis across all sectors of mining, raw materials and processing.

So far, the Oct & Nov lift in manufacturing activity (PMI's) has occurred as industrial prices continue to fall.

Some definitions from the NBS:

Producer Price Index for manufactured goods consists of producer price index and purchaser price index.

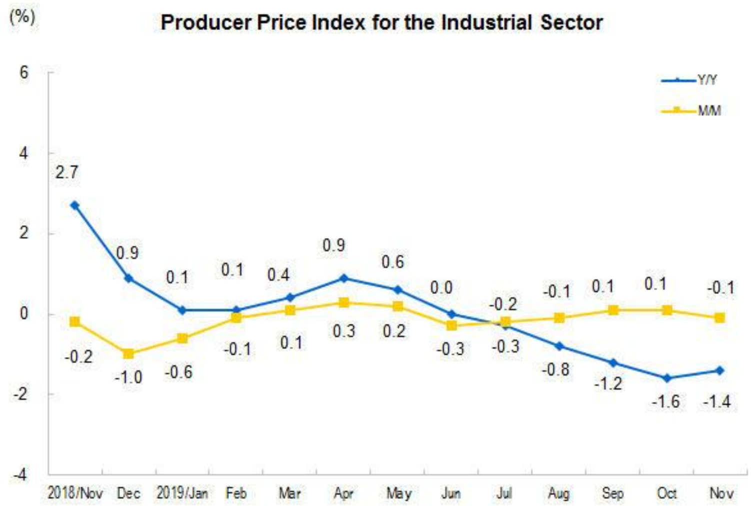
The industrial producer price index reflects the trend and level of prices change when the products are sold for the first time.

The industrial purchaser price index reflects the trend and level of prices change for the products purchased by the industrial enterprises as intermediate inputs.

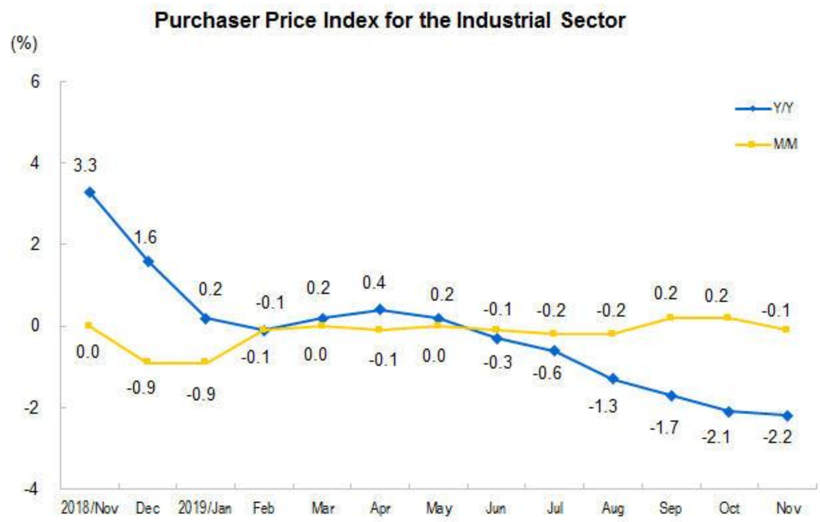
The overall producer price index for manufactured goods includes the producer and purchaser price index.

PPI Industrial sector – month change; Nov -0.1%

PPI Industrial sector – annual change; Nov -1.4%



The purchase price index also recorded a decline in the month and an accelerated decline in the year;



Prices for consumer goods (means of subsistence) continue to accelerate higher (+1.6% in the year to Nov). This has been led higher predominantly by higher food prices (+5.4% up on the year), clothing and articles for daily use are up +0.3% and +0.1% year on year respectively. Consumer durable goods prices are down by -2.1% year on year.

Prices for the means of production continue to decline (-2.5% versus a year ago). Means of production prices for all areas are below that of a year ago; mining and quarrying (-1.4%) raw materials (-5%) and processing (-1.6%).

http://www.stats.gov.cn/english/PressRelease/201912/t20191211_1716924.html

China CPI (Nov)

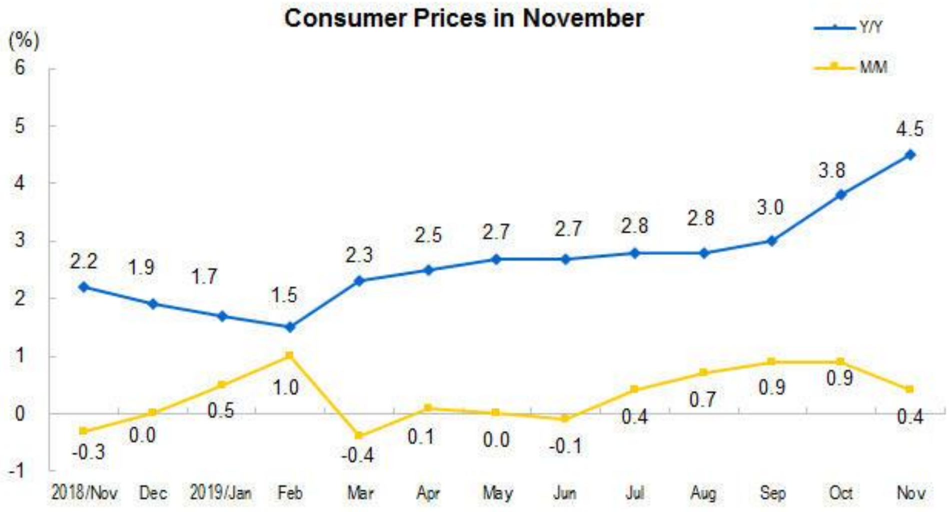
Consumer price growth continues to accelerate on an annual basis due higher food prices. This is likely having an impact on consumer shopping behaviour and contributing to lower growth in retail sales.

All items CPI – month change; Nov +0.4% versus Oct +0.9%

In the month, excluding food and energy, consumer prices declined by -0.1% in Nov versus Oct. Food prices were up +1.5% in the month, still well above that of the next faster increase – clothing +0.3%.

All items CPI – annual change; Nov +4.5% versus Oct +3.8%

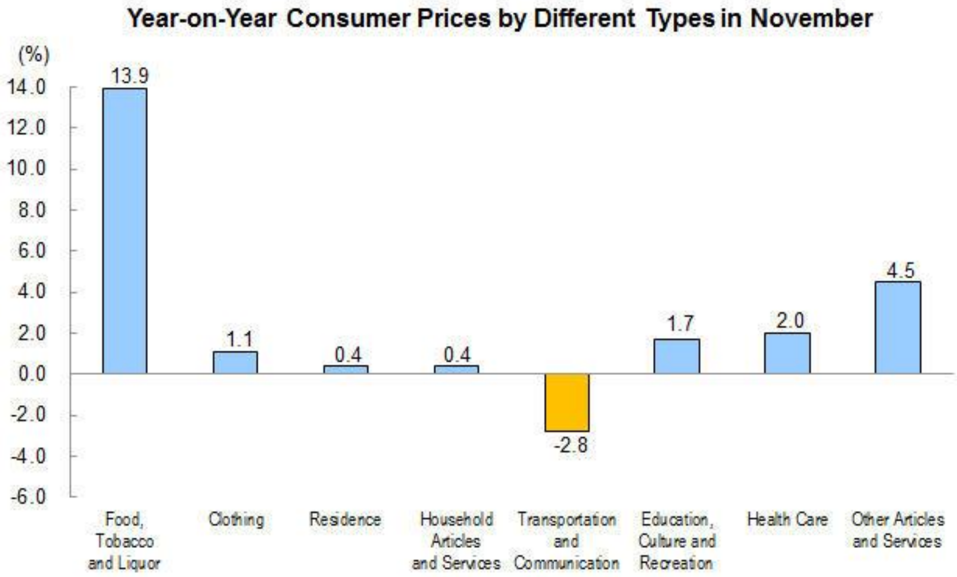
Excluding food and energy, the annual growth in consumer prices was a mere +1.4%.



Annual change by Category

The single largest area contributing to the higher growth in prices is food, up +14% on a year ago;

> Of which, livestock meat price went up by 74.5 percent, affecting nearly 3.27 percentage points increase in the CPI (price of pork was up by 110.2 percent, affecting nearly 2.64 percentage points increase in the CPI).



Fuel prices are down -10.6% on a year ago and up +0.3% on the prior month.

Other articles and services (+4.5% on a year ago) is not broken out.

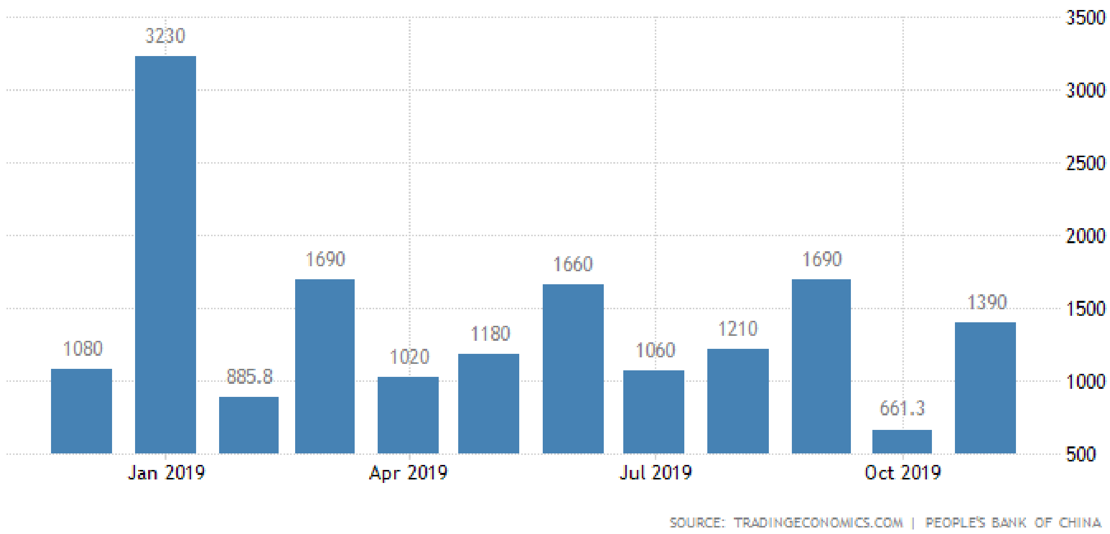
http://www.stats.gov.cn/english/PressRelease/201912/t20191211_1716908.html

China New Loans (Nov)

The value of new loans in CNY increased (doubled) in Nov after a much weaker Oct. The largest increase in lending was for corporate loans.

> "Figures beat expectations of CNY 1200 billion and last year's reading of CNY 1250 billion as the PBoC has lowered several key interest rates in November …"
>
> Bank lending in China usually increases in November after a decline in October when a week-long National Day holiday falls**.**

Chart; China New Loans (CNY)



The benchmark interest rate has fallen from approx. 4.3% in Aug to 4.15% in Nov (an all-time low).

Household loans, mostly mortgages; Nov +683bn CNY versus Oct +421bn CNY

Corporate loans; Nov +679.4bn CNY versus Oct +126bn CNY

Total social financing (broad measure of credit and liquidity); Nov +1750bn CNY versus Oct +619bn CNY (Oct was the lowest since Jul 2016).

Outstanding yuan loans grew at an annual pace of 12.4%, the same as the month prior.

Chart; China Outstanding Loan Growth (CNY)

https://tradingeconomics.com/china/banks-balance-sheet

Return to top

Trade

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 wont 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 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

Return to top