MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 6 January 2020

Key Themes

Our w/c 6 Jan 2020 macro review includes several of the larger releases from the last two weeks, focusing mainly on private sector manufacturing and services output.

US manufacturing weakness was evident in the data out over the last few weeks. Factory orders data continues to show that declines in non-defense aircraft production, shipments and (rising) inventory is one of the larger issues affecting the data. Excluding transport equipment, the value of US factory orders and shipments is just slightly below a year ago. This is also reflected in the mixed results across regional manufacturing reports. The ISM manufacturing PMI for Dec reported a further contraction in activity, while the Markit manufacturing PMI was positive, albeit reflecting low growth.

The labour market report for Dec highlighted that overtime hours of US durable goods manufacturing continued to contract at around 9% in Dec. This is broadly in line with the weaker growth/conditions. Overall average weekly hours growth was also still below that of a year ago.

US employment growth (non-farm payrolls) slowed in Dec – and was lower than the 12-month average which has now slowed back down to 184k. The unemployment rate remained broadly unchanged. The labour market performance remains good - from the household survey, the acceleration in employment growth together with lower/no growth in what participation added to the labour force, resulted in a larger decline in total unemployed persons (in the month and on an annual basis).

Global PMI's – manufacturing remained in contraction across Europe incl Germany, Japan, UK and Australia at the end of 2019. Despite these weaker readings, firms expressed optimism for 12-months ahead, likely due to greater Brexit certainty and the phase one trade deal between US-China in early Dec (reflecting at least no further worsening in trade relations).

Germany recorded one of the weaker manufacturing PMI results in the Eurozone for Dec. Factory orders declined for Nov. The data indicates that the declines since late 2017 appear to have at least stabilized at a lower level but are yet to recover the respective peaks. Similarly, industrial production was stronger in Nov, but at best, declines in output (for manufacturing especially) may have stabilized – too early to tell.

Services PMI's were generally stronger, except for Australia and Japan, which remained in contraction. The UK services PMI recovered to the 50/neutral level.

CPI's for Dec are worth noting. China CPI growth remained elevated at 4.5%, likely adding further pressure in a lower growth environment for consumers. Also, some signs of higher CPI growth across the Eurozone too in the Dec prelim CPI.

There was little rebound in data out of Japan for Nov. Retail sales increased in the month but remained below a year ago across most categories (likely due to stockpiling prior to the Oct sales tax increase). There was no rebound (overall) in industrial production and shipments for Nov. The Dec PMI's indicate that there is likely more weakness in activity to come as both manufacturing and services PMI's for Dec contracted at a faster pace.

Contents

US Data

Factory Orders – Final (Nov)

Total US manufacturing factory orders declined in Nov, led by the larger decline in durable goods orders, the result of a decline in defense aircraft orders versus the month prior. Excluding transports, new orders versus a year ago actually increased for the first time in six months, but growth remains low.

The value of shipments increased at a slightly faster pace and this was led by accelerated growth in non-durable goods shipments (mostly petroleum – which could be due to a price effect). Shipments of durable goods were flat to the month prior, despite supported by the decline in unfilled orders for the month.

Inventory growth accelerated in the month, led by transport equipment (namely by non-defense aircraft).

<u>New Orders</u>

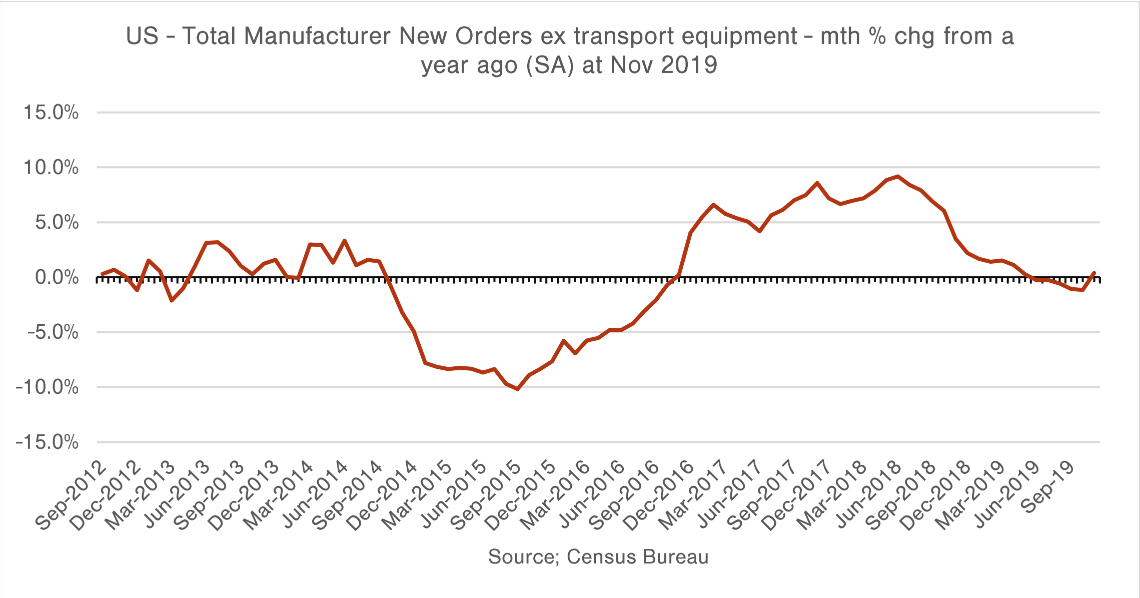
<u>New orders – month change</u>; Nov -0.7% (-$3.6bn) versus Oct +0.2%

The new orders for durable goods declined by -2.1% in Nov (-$5.2bn) – this was led by a $5.2bn decline in defense aircraft orders versus the month prior.

Orders declined for other transport equipment categories such as non-defense aircraft and ships & boats. Orders for motor vehicles & parts increased after declines in the two months prior.

Primary metals and machinery orders also declined in the month and were offset by increases across the other categories.

On an annual basis, total manufacturing new orders declined by 1.5% versus a year ago. Excluding the effect of transports, new manufacturing orders increased by +0.4% in Nov versus a year ago;



Shipments

Manufacturing Shipments – month change; Nov +0.3% (+$1.7bn) versus Oct +0.1%

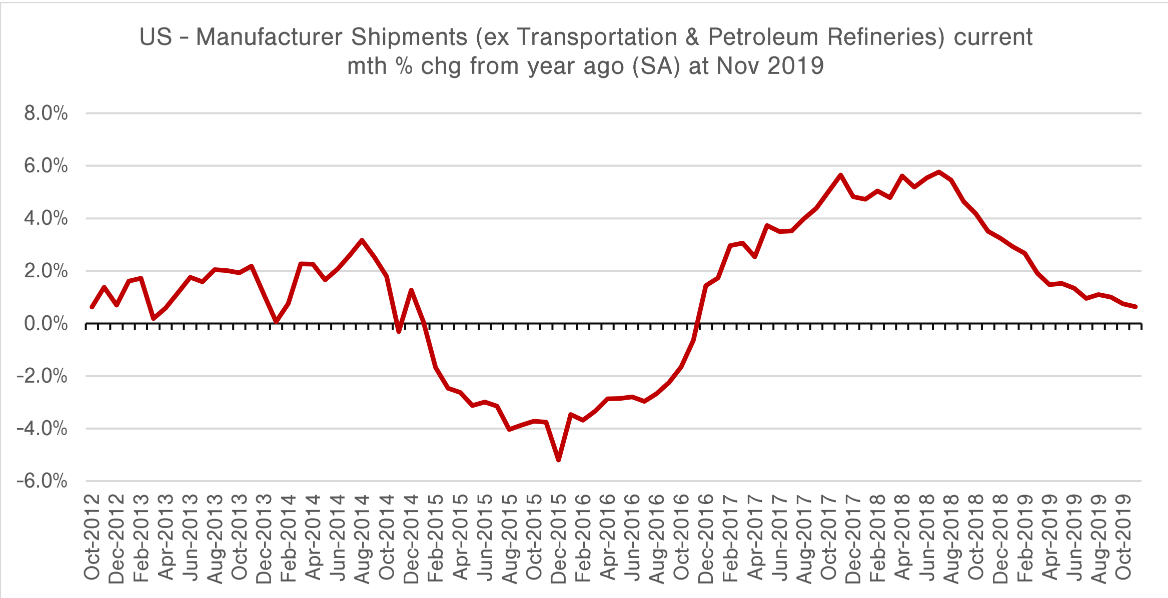
The increase in shipments for the month was mostly the result growth in non-durable goods shipments, namely an increase of $1.2bn in petroleum products – which could be linked to higher prices. Overall non-durable goods shipments increased by +$1.6bn in the month.

Durable goods shipment growth was 0% in Nov versus declines in the two months prior. Shipments for the largest group – transport equipment – increased marginally by +0.1% or +$0.07bn. Auto, SUV & motor vehicle bodies & parts all increased, while shipments of heavy-duty trucks declined. Shipments of defense and non-defense aircraft both declined in Nov, reversing gains from the month prior.

On an annual basis, total manufacturing shipments declined at a slower pace of -0.8% in Nov (slower than the -1.5% in Oct).

Given the impact of petroleum over the last few months; manufacturing shipments excluding petroleum actually declined at a faster pace than in the month prior, indicating some underlying weakness in shipments ex-petroleum. This weakness can be narrowed down to transport equipment. Transport equipment shipments were down -7.2% in Nov versus a year ago. **Non-defense aircraft is a major contributor to this weakness.**

Excluding both petroleum and transport equipment indicates that manufacturing shipment growth remains broadly positive, but does continue to slow;



Unfilled Orders

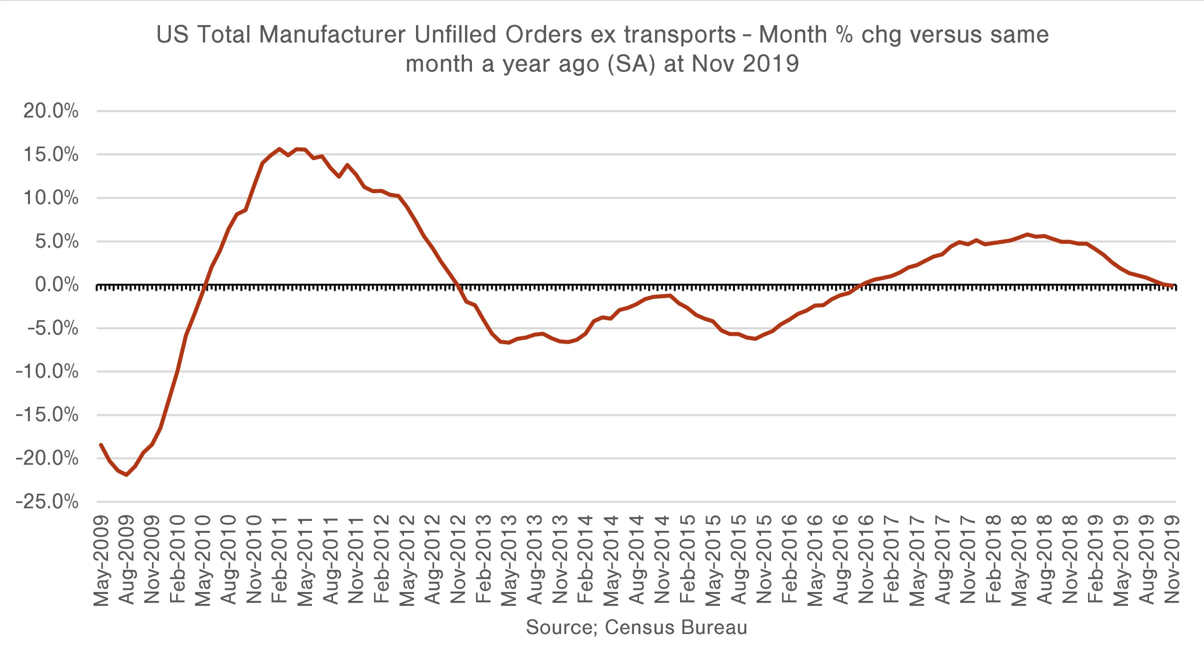
Manufacturer unfilled orders – month change; Nov -0.4% (-$4.9bn) versus Oct 0%

The bulk of the decline in unfilled orders for the month was due to transport equipment – back orders declined by -$4.7bn. In the absence of growth in new orders for defense and non-defense aircraft, firms worked through order backlogs. Note that shipments in both categories continued to decline.

Machinery and fabricated metals unfilled orders also declined in the month.

Versus a year ago, total manufacturer unfilled orders declined at a faster pace, indicating that firms were working through order backlogs in the absence of faster growth in orders.

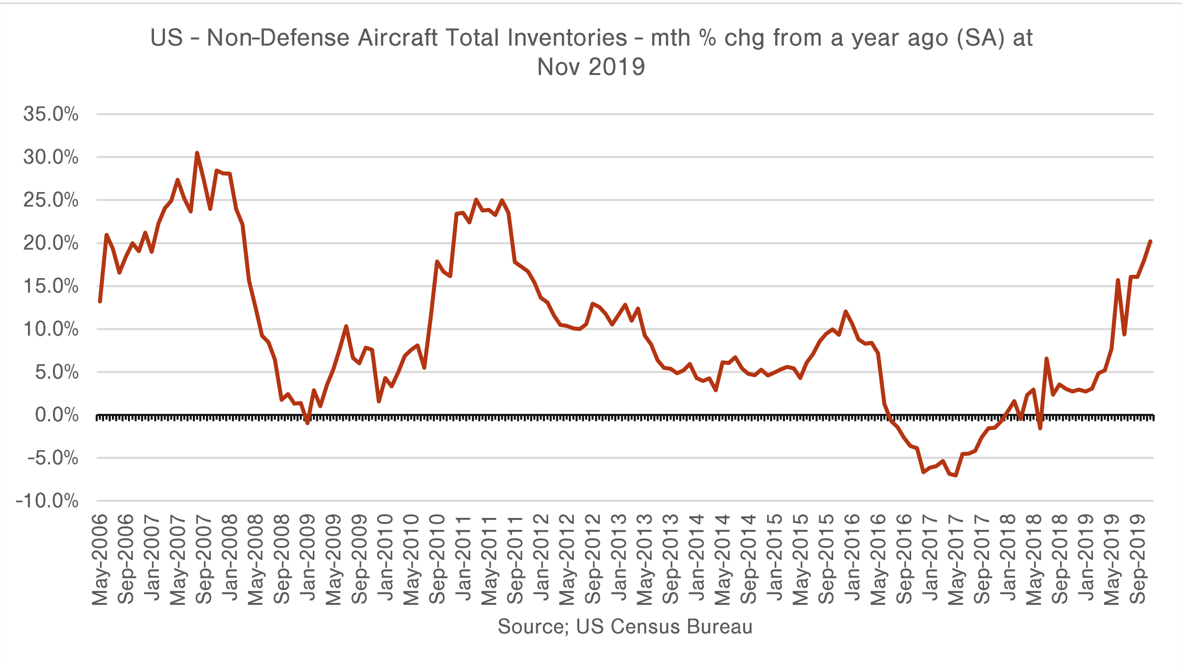
Even excluding transport, unfilled orders declined on an annual basis slightly (-0.1%) for the first time since late 2016;



<u>Inventory</u>

Manufacturer Inventory – month change; Nov +0.3% (+$2bn) versus Oct +0.2%

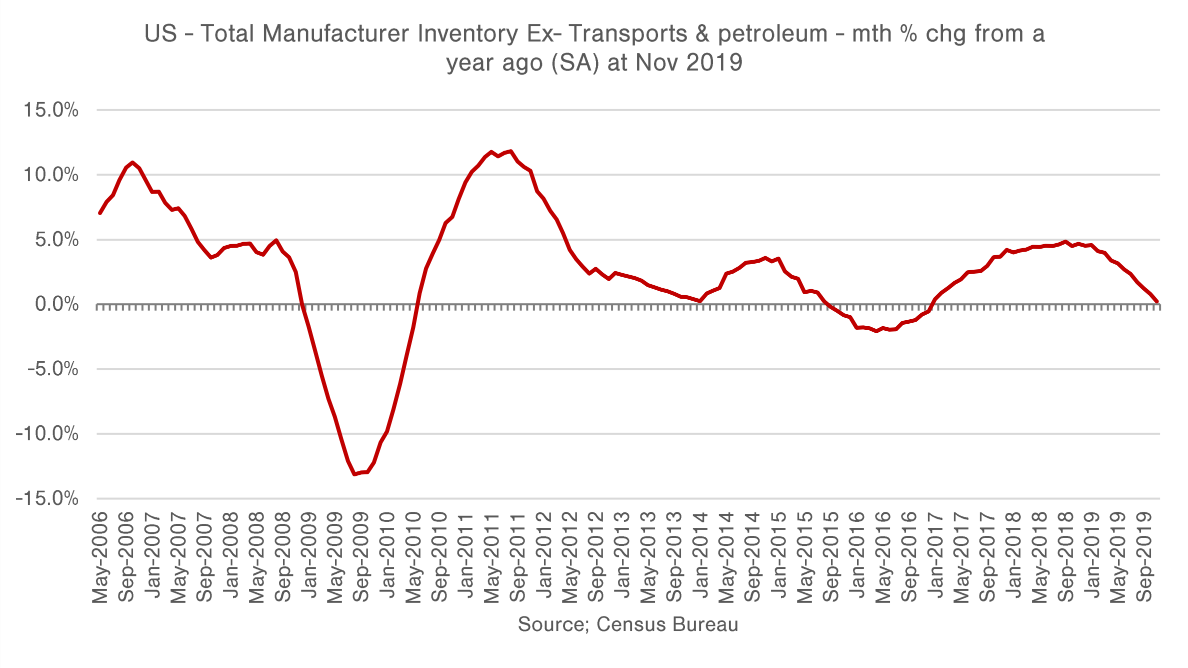
The increase in inventory for the month was led by a further +$1.5bn increase in non-defense aircraft inventory. On an annual basis, inventory for non-defense aircraft increased by 20% in Nov;



This is the main, but not only driver, of the value of annual inventory growth for transport equipment.

The value of petroleum inventory also added +$0.7bn for the month – again, this could be a price effect.

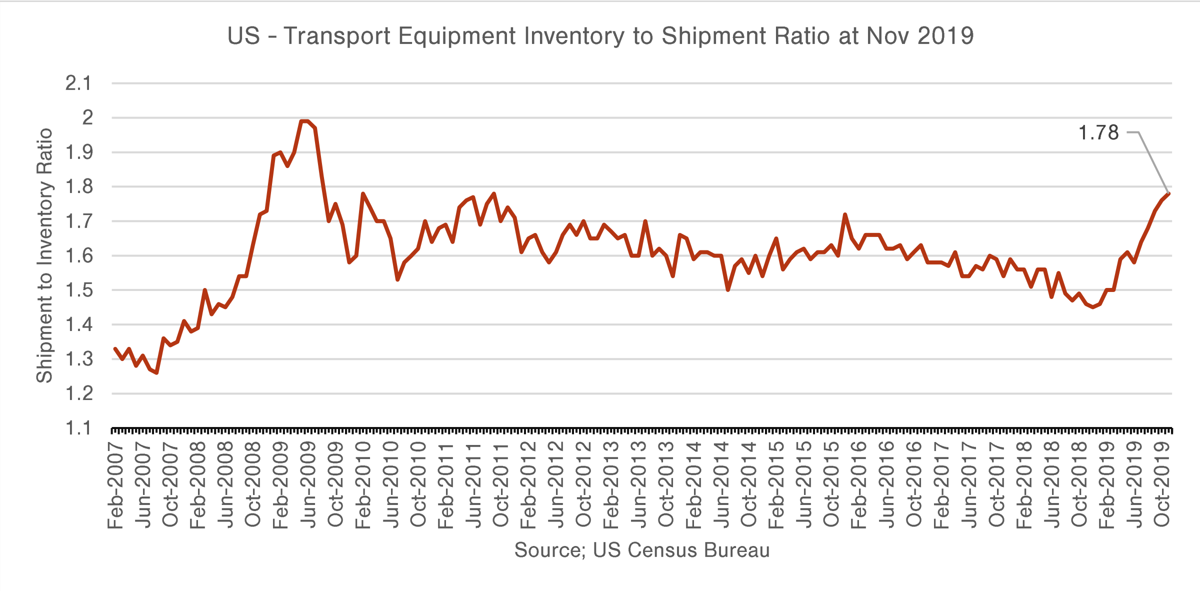
Excluding both petroleum and transports, underlying inventory growth compared to a year ago continued to slow in Nov +0.2% versus +0.8% in Oct.



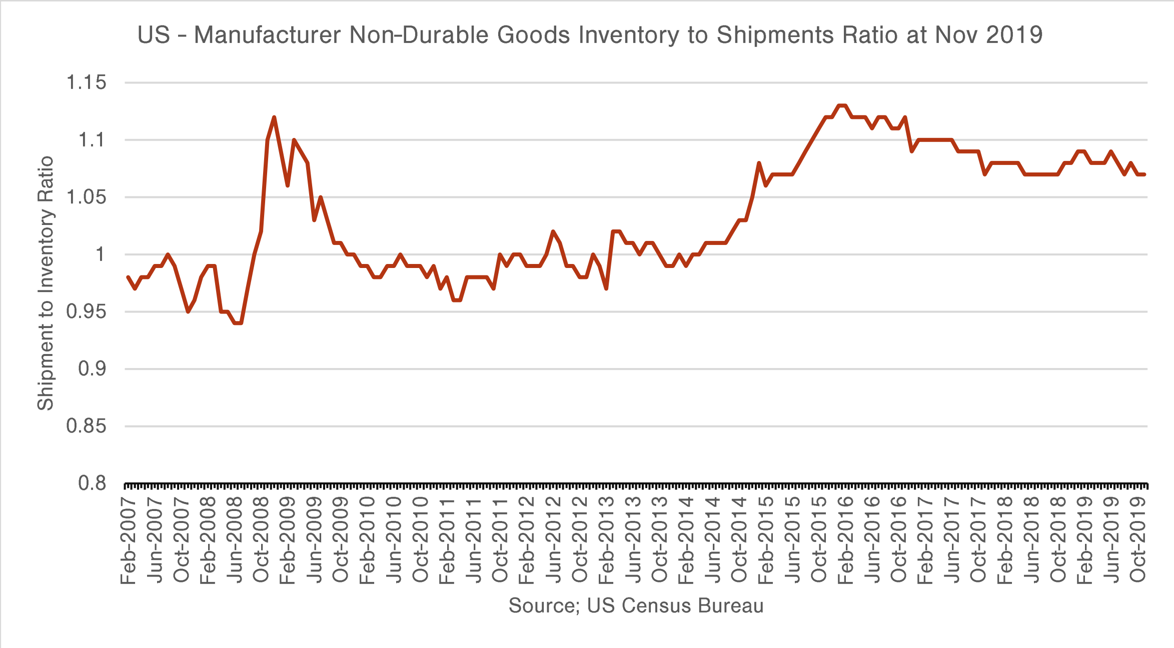
Inventory to Shipment Ratio

This provides some further insight into issues with weaker shipments/rising inventories – durable goods, namely transport equipment.

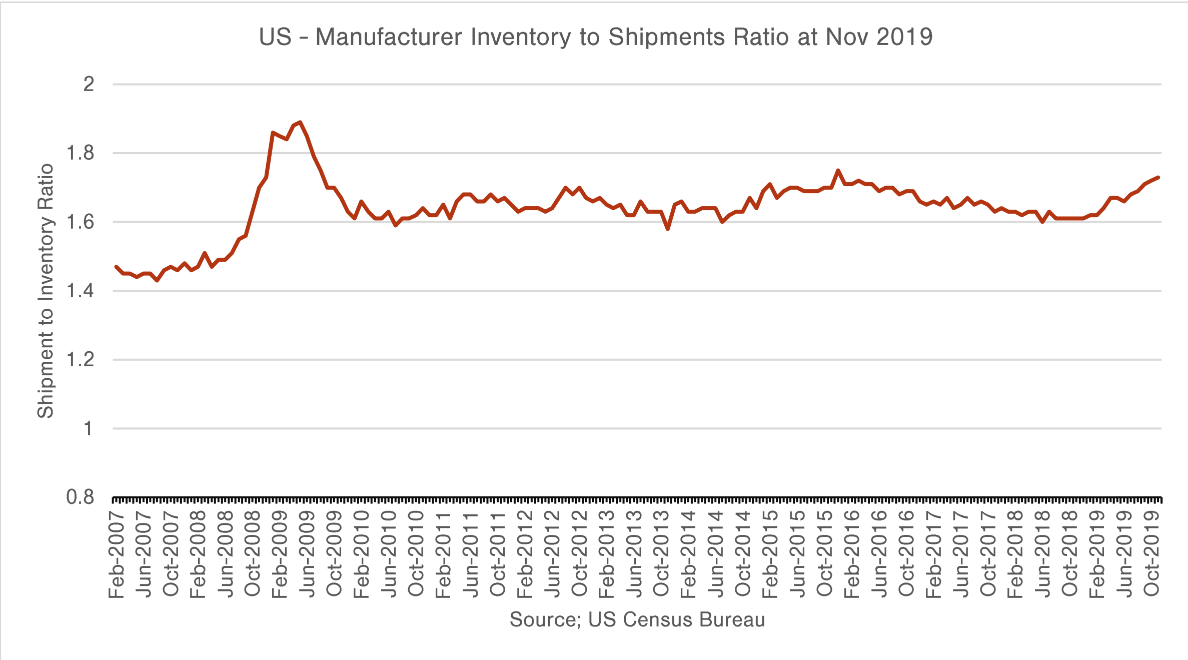
The inventory to shipment ratio of transport equipment continues to increase;



Non-durable inventory to shipments ratio remains somewhat elevated, but has been slowing recently;



Total Manufacturer inventory to shipments ratio is increasing on the back of weakening transports (aircraft);



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

ISM Manufacturing PMI (Dec)

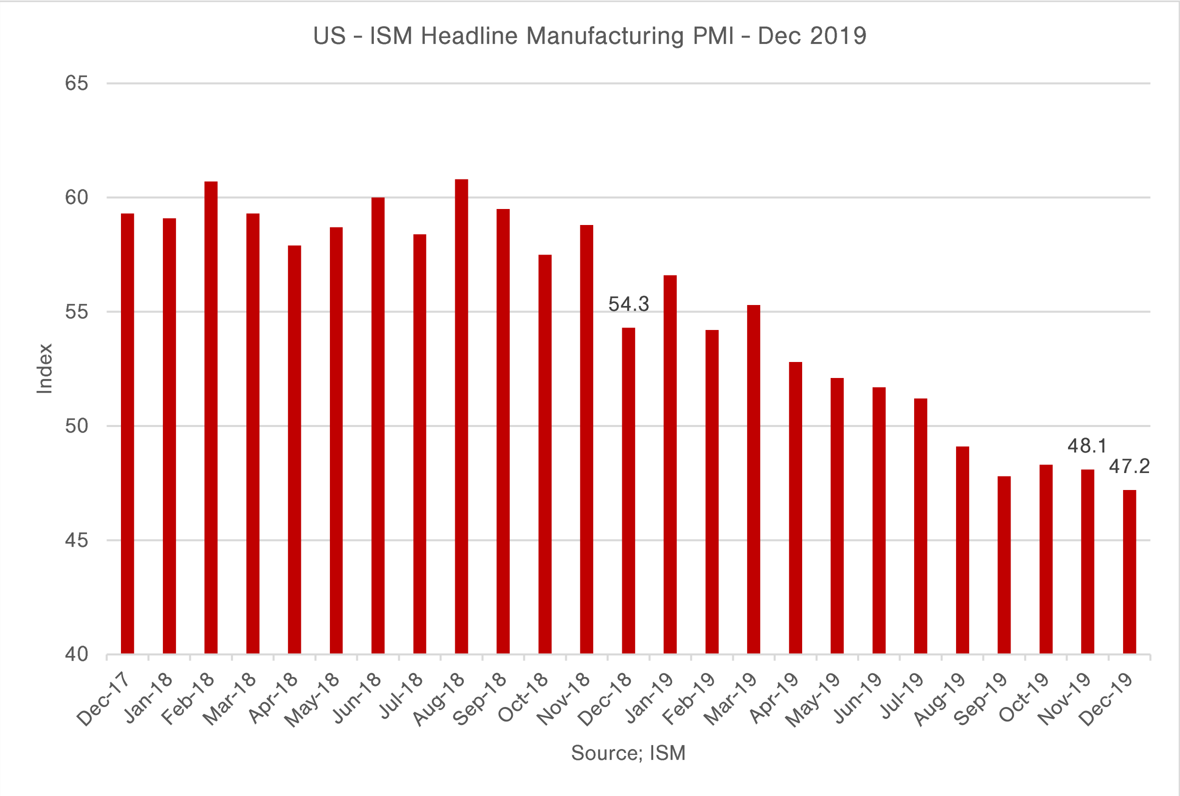
The ISM manufacturing PMI indicated that manufacturing activity continued to contract into Dec. While orders, production and employment all continued to contract, there was some sense of increased optimism;

> Global trade remains the most significant cross-industry issue, but there are signs that several industry sectors will improve as a result of the phase-one trade agreement between the U.S. and China.

The breadth of decline across manufacturing industries remains unchanged.

> Of the 18 manufacturing industries, three reported growth in December: Food, Beverage & Tobacco Products; Miscellaneous Manufacturing; and Computer & Electronic Products. The 15 industries reporting contraction in December — listed in order — are: Apparel, Leather & Allied Products; Wood Products; Printing & Related Support Activities; Furniture & Related Products; Transportation Equipment; Nonmetallic Mineral Products; Paper Products; Fabricated Metal Products; Petroleum & Coal Products; Electrical Equipment, Appliances & Components; Textile Mills; Primary Metals; Chemical Products; Plastics & Rubber Products; and Machinery.

<u>Headline PMI</u>; Dec 47.2 versus Nov 48.1



New orders continued to contract at a faster pace – but led by more firms reporting ‘unchanged’ levels of new orders. Less firms reported increasing new orders and less firms also reported declining new orders. New export orders declined at a faster pace.

Production growth declined at a much faster pace with the index down to 43.2 (-5.9pts).

The larger decline in production was still recorded despite a further decline in backlogs. Firms continued to work through order backlogs and the backlog index remained at 43.3.

Employment growth contracted at a faster pace – the underlying shifts were less positive as a larger proportion of firms reported lower levels of employment and a smaller proportion of firms reported higher levels of employment.

Inventories remained in contraction, but declined at a slower pace.

Imports continued to decline, but at a slightly slower pace of contraction.

Raw materials prices jumped from contraction in Nov 46.7 to 51.7 in Dec;

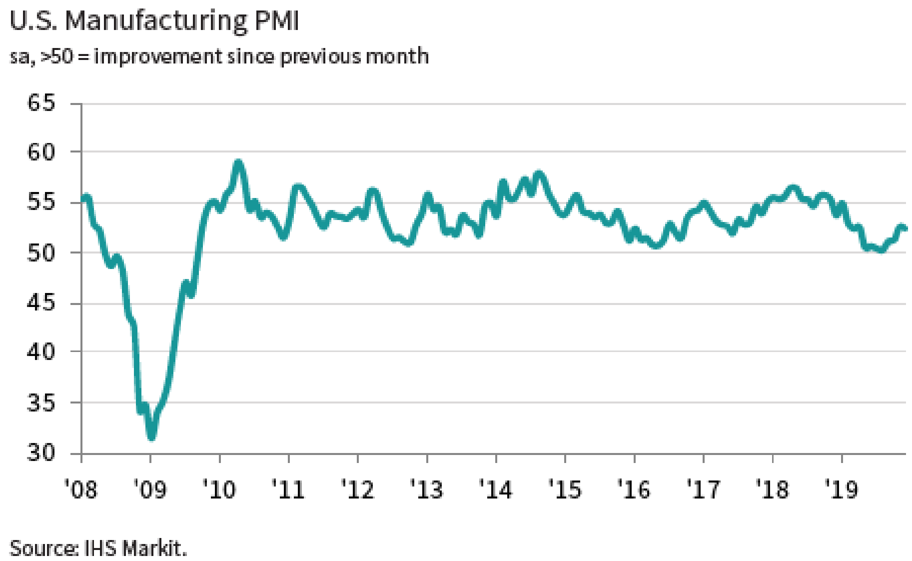
> "Prices increased in December, supported by steel, copper and aluminium price growth, as manufacturers placed orders for 2020 demand. Prices registered their highest level since May 2019, when the index recorded 53.2 percent,"

https://www.instituteforsupplymanagement.org/ISMReport/MfgROB.cfm?SSO=1

Markit Manufacturing PMI Final (Dec)

The Markit manufacturing PMI report for Dec presented a different picture of US manufacturing. While the pace of growth slowed slightly in Dec, growth remained positive and moderate. While production growth slowed, growth in new orders accelerated including a further expansion in export orders.

Headline Manufacturing PMI; Dec 52.4 versus Nov 52.6



Output growth slowed in Dec, but remained moderate. Output expectations for the next twelve months remained muted. New orders increased at a “solid” pace supported by a further increase in new export orders.

Order backlogs increased, but eased from the larger increase reported in the month prior.

Employment continued to increase at the second fastest pace since May.

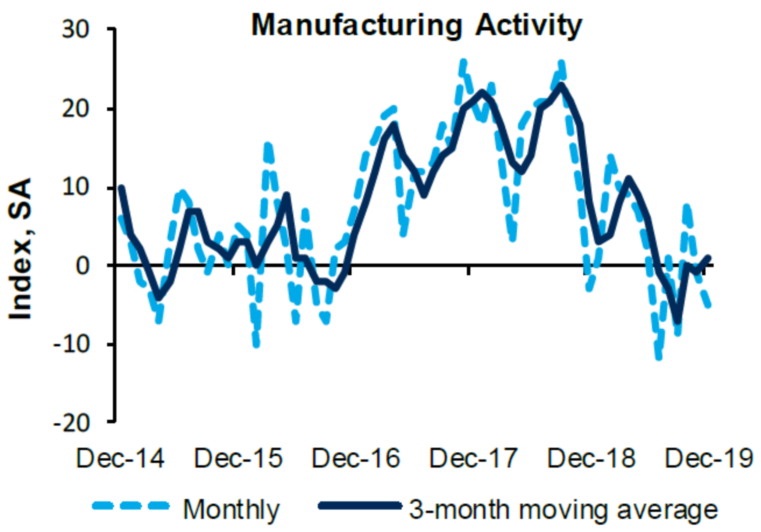
Firms continued to increase output charges amid higher input prices.

https://www.markiteconomics.com/Public/Home/PressRelease/c582d7ce96cd4577aec39d8732716a53

Richmond Fed Manufacturing Index (Dec)

The index of manufacturing activity fell at a faster pace in Dec led by a further contraction in shipments and new orders (especially). While employment growth accelerated slightly from a lower level, the average workweek contracted at the fastest pace since 2009.

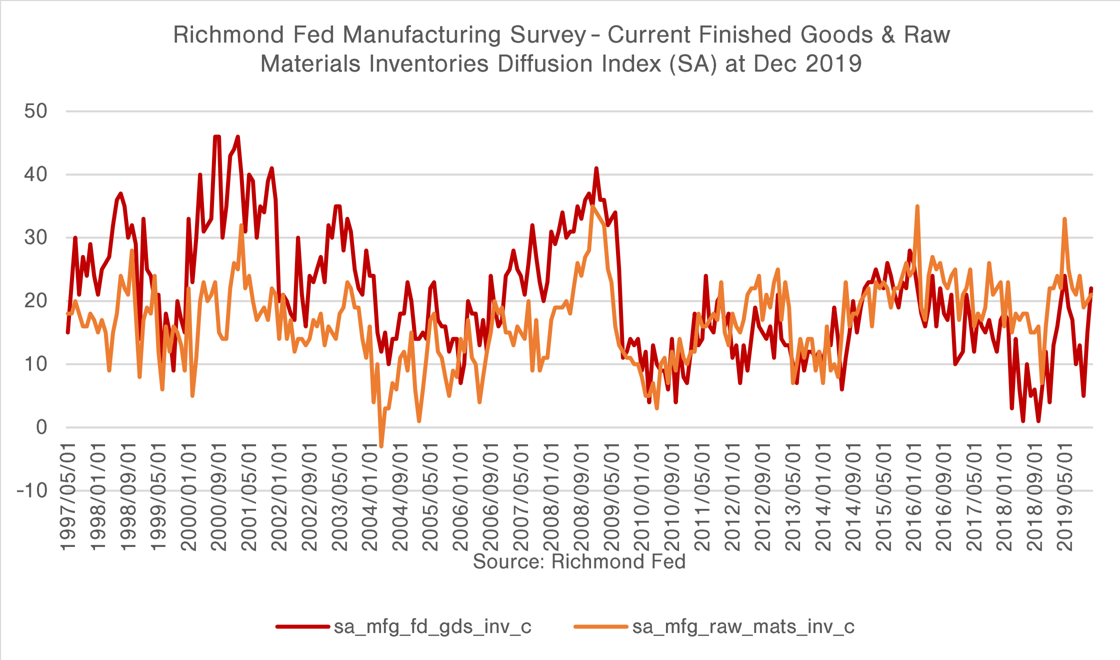
Headline Manufacturing Index; Dec -5 versus Nov -1



Shipments contracted at a faster pace. The volume of new orders also contracted at a much faster pace (-13 in Dec versus -3 in Nov) and remains close to the weakest levels in the post-GFC period. Expectations for shipment and new order growth remain elevated. Expectations for shipment growth in the next six months have lifted consistently since Sep.

Firms continued to work through order backlogs which continued to contract at a similar pace as the month prior. Despite working through the backlogs, capacity utilization fell into contraction.

Finished goods inventories increased at a faster pace – again close to the recent peak reached in mid-2019. While raw materials inventories were little changed, the index indicates levels remain somewhat elevated;



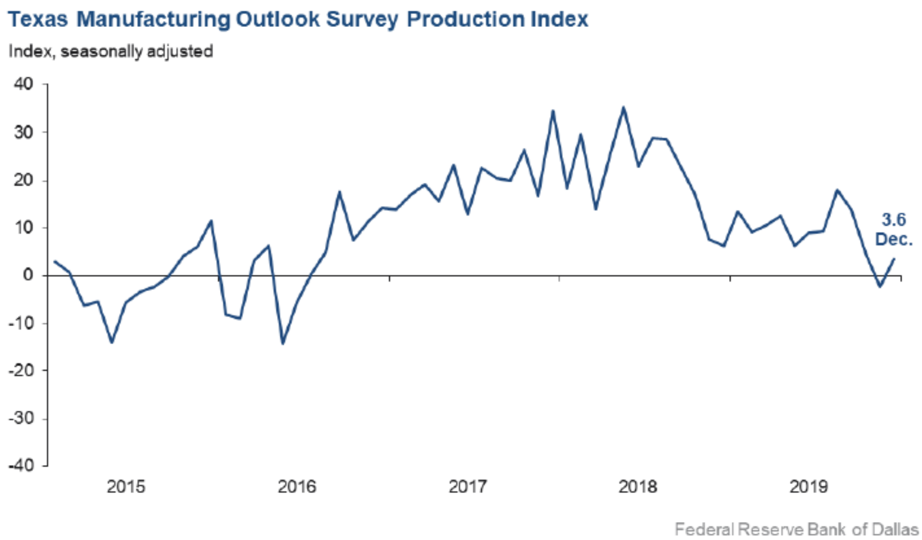
While the number of employees increased at a faster pace (still only moderate growth), the average workweek contracted at a much faster pace – the fastest decline since 2009.

https://www.richmondfed.org/-/media/richmondfedorg/research/regional_economy/surveys_of_business_conditions/manufacturing/2019/pdf/mfg_12_24_19.pdf

Dallas Fed Manufacturing Index (Dec)

There was a rebound in activity in Dec. Production, new orders and shipments all recorded growth in Dec after contracting in Nov. Similarly, there was growth in employment and hours worked.

Headline Production Index; Dec 3.6 versus Nov -2.4



The production index increased by 6pts, rebounding back into expansion for the month. While new orders also increased and recorded marginal growth in the month, the growth rate of new orders remained in contraction.

Shipments increased by 7.5pts also rebounding back into at least marginal growth for the month. At the same time, unfilled orders continued to contract as firms supported growth by working through order backlogs. As well, finished goods inventories declined at a faster pace.

Prices paid for raw materials continued to grow, albeit at a slightly slower pace. Prices received for finished goods increased at only a marginal pace.

Employment grew at a faster pace and hours worked also shifted back into expansion for the month.

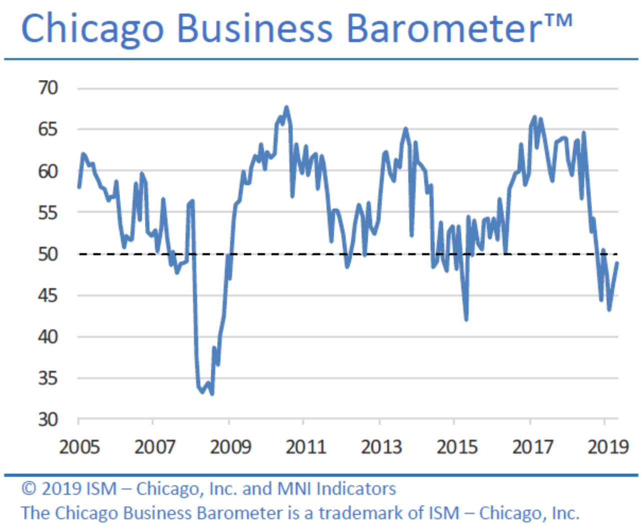
The outlook uncertainty fell, likely as a result of the truce negotiated in the US-China trade deal.

https://www.dallasfed.org/research/surveys/tmos/2019/1912.aspx

Chicago PMI (Dec)

The headline business barometer indicated that activity continued to contract in Dec, albeit at a slower pace of decline.

Headline PMI; Dec 48.9 versus Nov 46.3



Interestingly, supplier deliveries continued to expand at a faster pace with the index now at 55.4. New orders remained in slight contraction at 49.1. Production also remained more firmly in contraction at 47.2 (which is still the highest level of the index since Aug).

Firms continue to work order backlogs in lieu of new order growth. Backlogs continued to decline in Dec, albeit at a slower pace of 46.2.

Employment growth remains in contraction at 47.4.

https://s3.amazonaws.com/images.chaptermanager.com/chapters/b742ccc3-ff70-8eca-4cf5-ab93a6c8ab97/files/mni-chicago-press-release-2019-12.pdf

S&P/Case Shiller House Price Index (Oct)

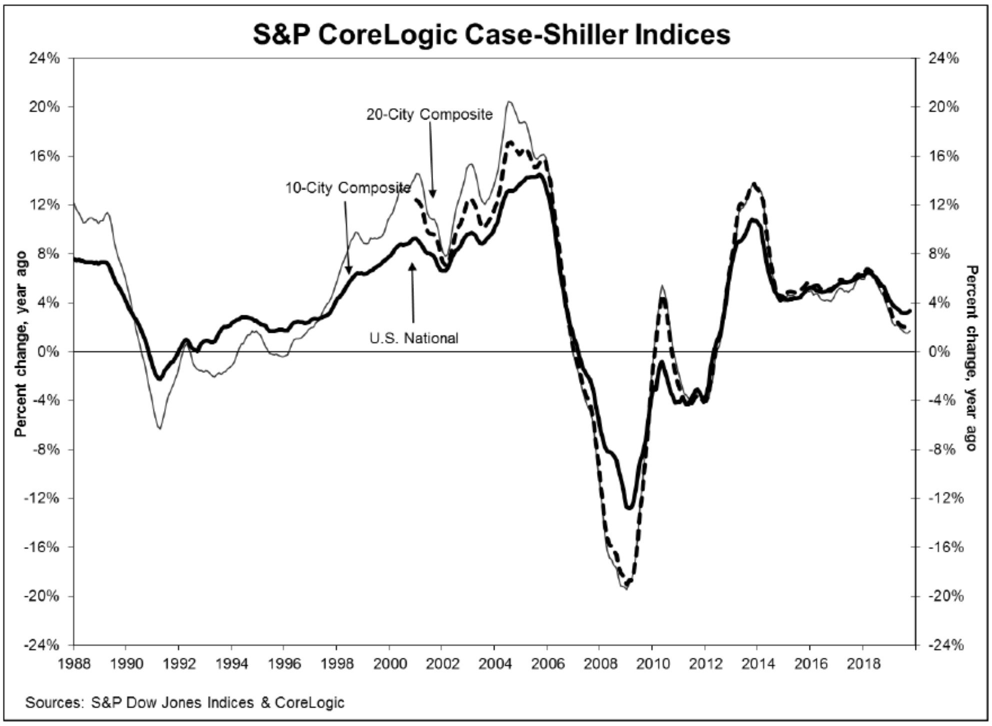
The pace of growth in house prices continued to lift in Oct;

> "As was the case last month, after a long period of decelerating price increases, the national, 10-city, and 20-city composites all rose at a modestly faster rate in October compared to September. This stability was broad-based, reflecting data in 12 of 20 cities. It is, of course, still too soon to say whether this marks an end to the deceleration or is merely a pause in the longer-term trend."

National House Price Index – annual change; Oct +3.3% versus Sep +3.2%

10-City Composite Index – annual change; Oct +1.7% versus Sep +1.5%

20-City Composite Index – annual change; Oct +2.2% versus Sep +2.1%

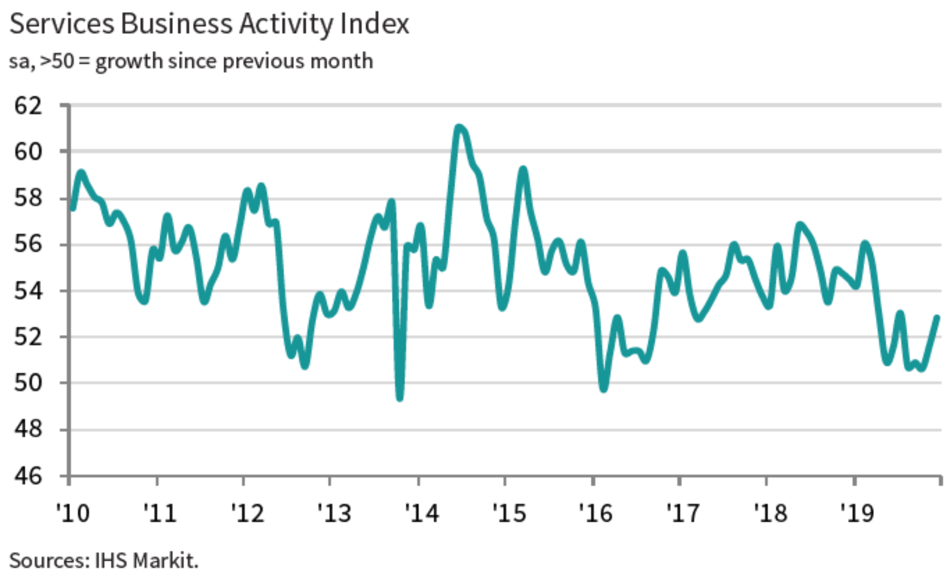


https://au.spindices.com/index-family/real-estate/sp-corelogic-case-shiller

Services PMI Final (Dec)

The market Services PMI indicated that services activity continued to expand at a faster pace in Dec.

Headline Services Activity Index; Dec 52.8 versus Nov 51.6



The increase in output for the month was linked to improved demand conditions. New orders increased at the fastest pace in five months, recording positive growth for the second month in a row. Despite the lift, growth remains low/marginal.

Employment increased marginally for the second month in a row – linked to the increase in new orders.

Backlogs were unchanged, signalling little capacity pressure.

Firms increased selling prices at a slightly faster pace, in an effort to passing rising input prices from supplier and wage costs.

While business expectations improved in Dec for the year ahead, confidence remains well below the series average. Firms continue to question the stability of client demand.

https://www.markiteconomics.com/Public/Home/PressRelease/86baf86493b14968842191443ec38487

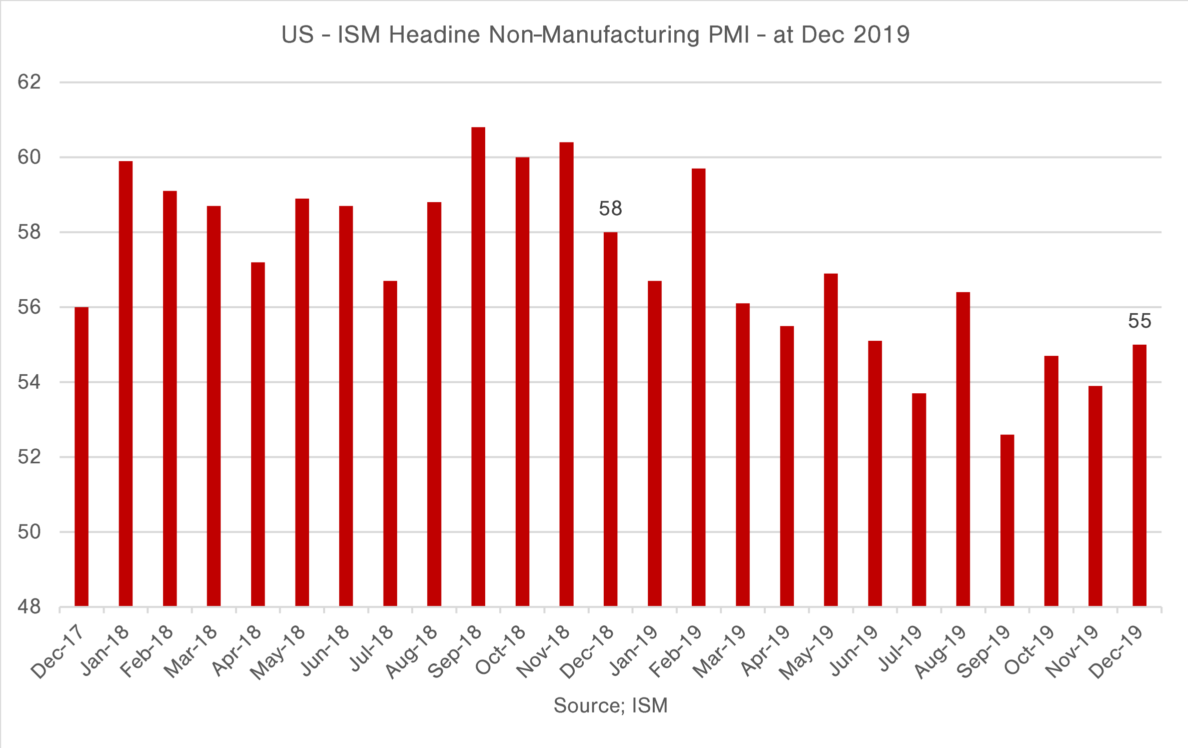
ISM Non-Manufacturing PMI (Dec)

The ISM non-manufacturing PMI for Dec indicated similar conditions to the Markit services PMI. The ISM non-manufacturing PMI continued to expand at a faster pace in Dec, with the headline index now just below the 12-month average. The underlying movement in new orders indicates some weakening in demand though.

Headline ISM Non-Manufacturing PMI; Dec 55 versus Nov 53.9

Of the seventeen (17) industries covered in the report, eleven (11) reported growth in Dec; Retail Trade; Arts, Entertainment & Recreation; Management of Companies & Support Services; Health Care & Social Assistance; Utilities; Accommodation & Food Services; Information; Transportation & Warehousing; Professional, Scientific & Technical Services; Other Services; and Finance & Insurance.

The six (6) industries that reported decreases in Dec were; Educational Services; Real Estate, Rental & Leasing; Wholesale Trade; Public Administration; Mining; and Construction.



Overall business activity index increased by +5.6pts. There was an increase in firms reporting both higher and lower activity. A lower proportion of firms reported 'the same' level of activity.

New orders continued to increase, but at a slower pace in Dec. Interestingly, the proportion of firms reporting 'lower' new orders increased from 15 to 20%, while the proportion of firms reporting higher new orders declined from 28% to 25%. New export orders slowed, with the index at 51 indicating only marginal growth. Firms cited the holiday season for the slowdown in overall new orders.

Order backlogs continued to decline, and at a slightly faster pace. It is likely that firms continuing to work through backlogs has supported more output growth.

The employment growth index was little changed at 55.2.

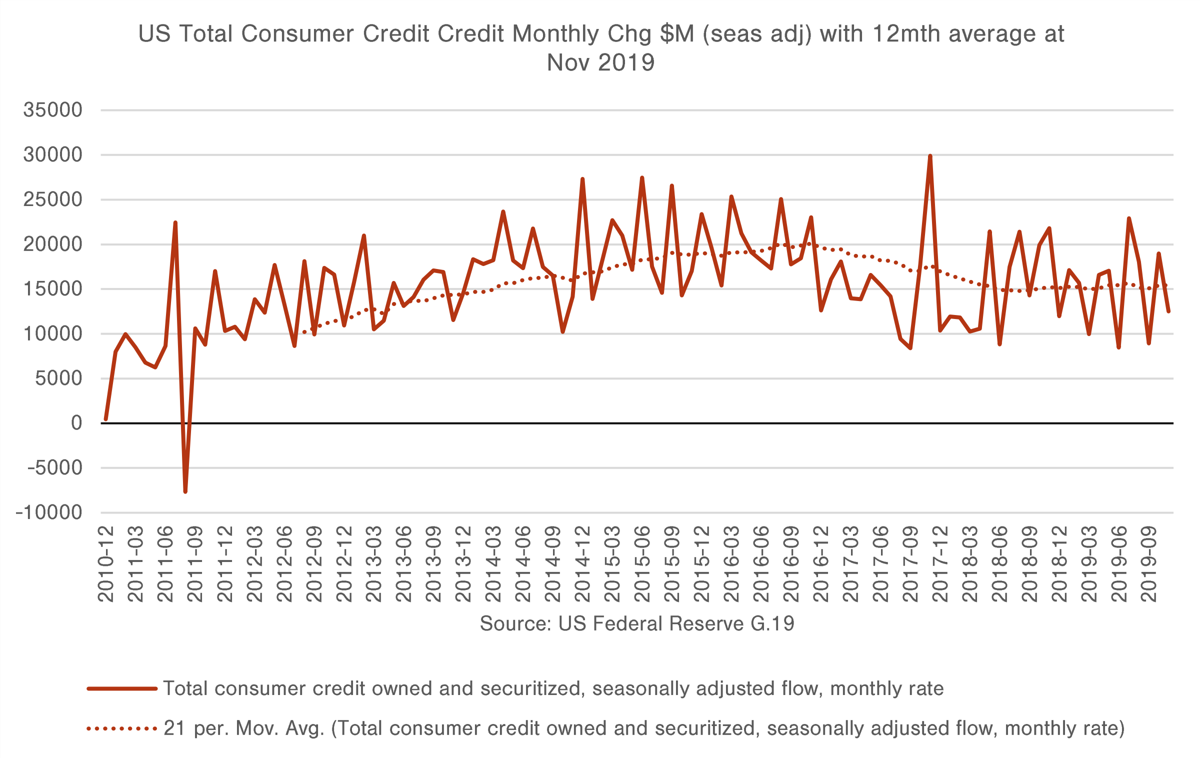
https://www.instituteforsupplymanagement.org/ISMReport/NonMfgROB.cfm?SSO=1

Consumer Credit (Nov)

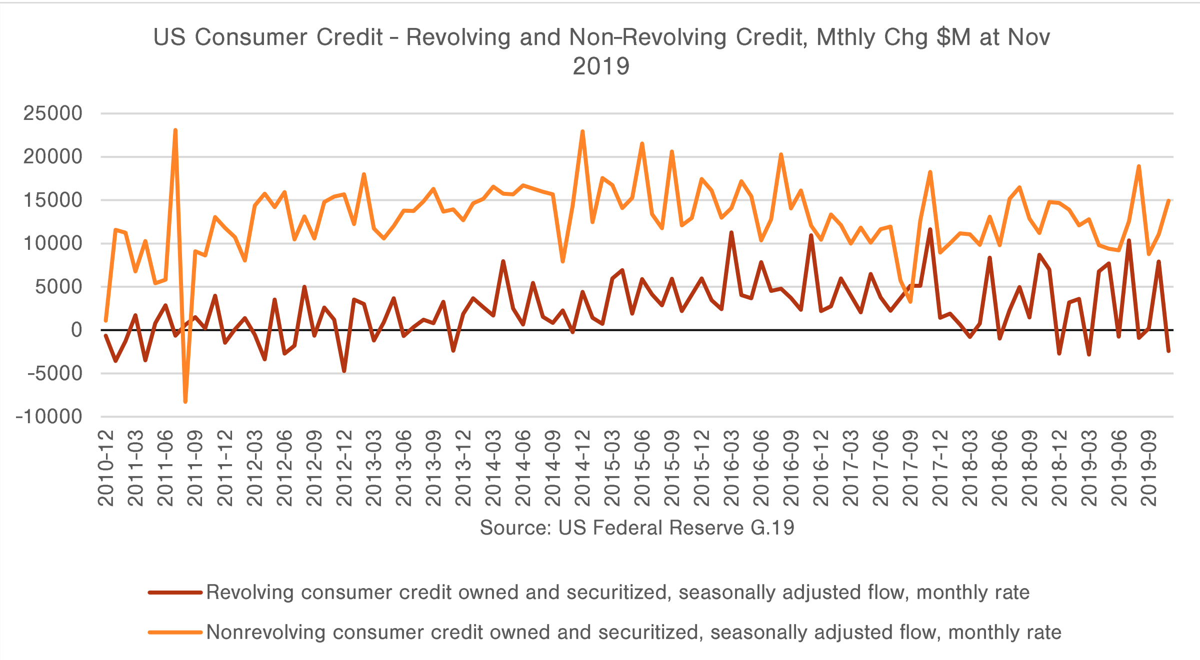
US consumer credit growth slowed in Nov. This was the result of a month on month decline in revolving credit, while non-revolving credit continued to grow at a faster pace.

Total Consumer Credit – month change; Nov $12.5bn versus Oct +$19bn

The month growth of the pace of total outstanding consumer credit, at an annualised pace, remains lower at +3.6% than the actual annual growth of +4.5%



The two components of consumer credit are revolving (credit card) credit and non-revolving credit. This month, the value of outstanding revolving credit declined while non-revolving credit continued to increase at a faster pace.



<u>Revolving Credit – month change</u>; Nov -$2.4bn versus Oct +$7.9bn

The annualised pace of growth slipped to -2.7% in Nov compared to the +2.9% actual annual pace of growth for consumer revolving credit.

Non-Revolving Credit – month change; Nov +$14.9bn versus Oct +$11.1bn

The annualised pace of non-revolving consumer credit accelerated to +5.8% in Nov compared to the actual annual pace of growth at 5%.

https://www.federalreserve.gov/releases/g19/current/

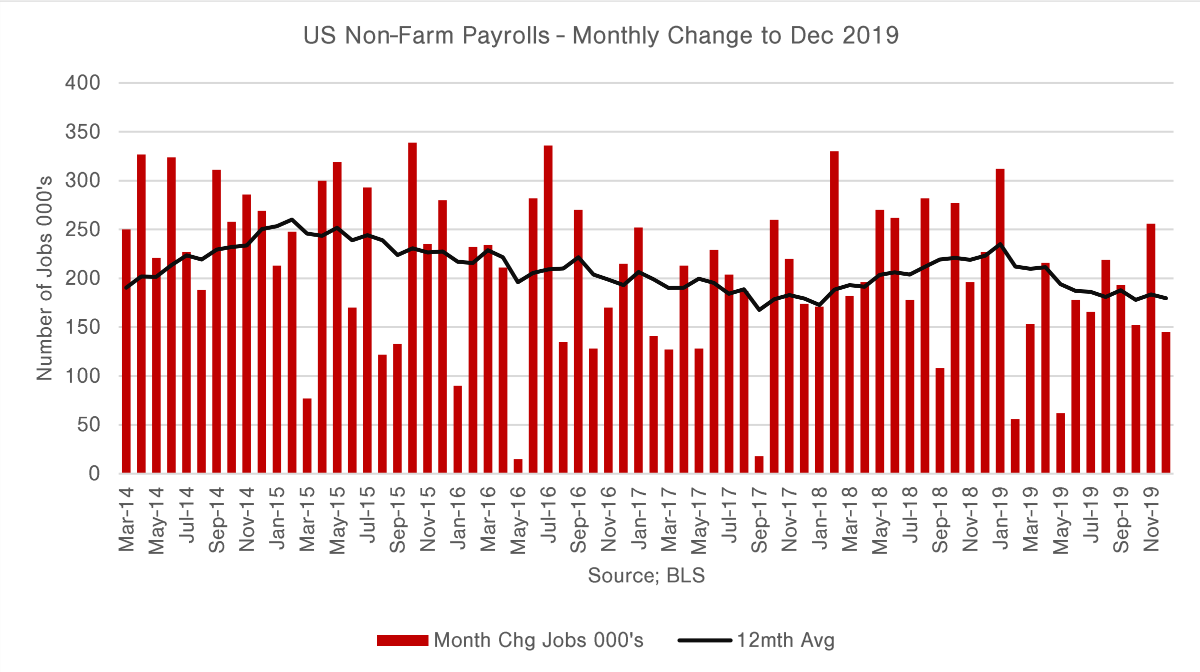
Non-Farm Payrolls and Household Employment Survey (Dec)

NON-FARM PAYROLLS (ESTABLISHMENT SURVEY)

The monthly growth in non-farm payrolls slowed in Dec and Sep and Oct growth was revised slightly lower.

Non-Farm Payrolls – month change; Dec 145k versus Nov 256k (revised lower from 266k)

The monthly growth in Dec is still lower than the 12-month average which has now slowed back down to 180k. The Dec growth in non-farm payrolls is -0.5SD from the 12-month average.



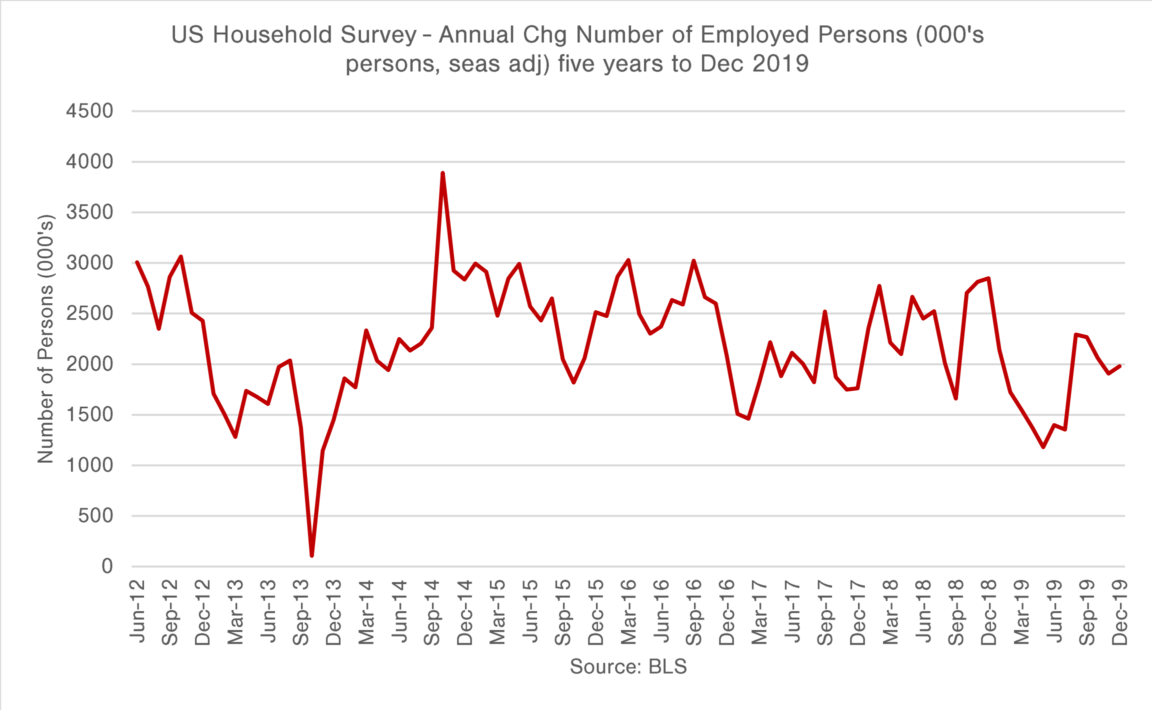
HOUSEHOLD EMPLOYMENT SURVEY

There was an acceleration in employment growth on an annual and monthly basis. This, together with lower/no growth in what participation added to the labour force, resulted in a larger decline in total unemployed persons.

Employment

Growth in employment increased on both an annual and monthly basis.

Employment – annual change (persons); Dec 1.98m versus Nov 1.9m



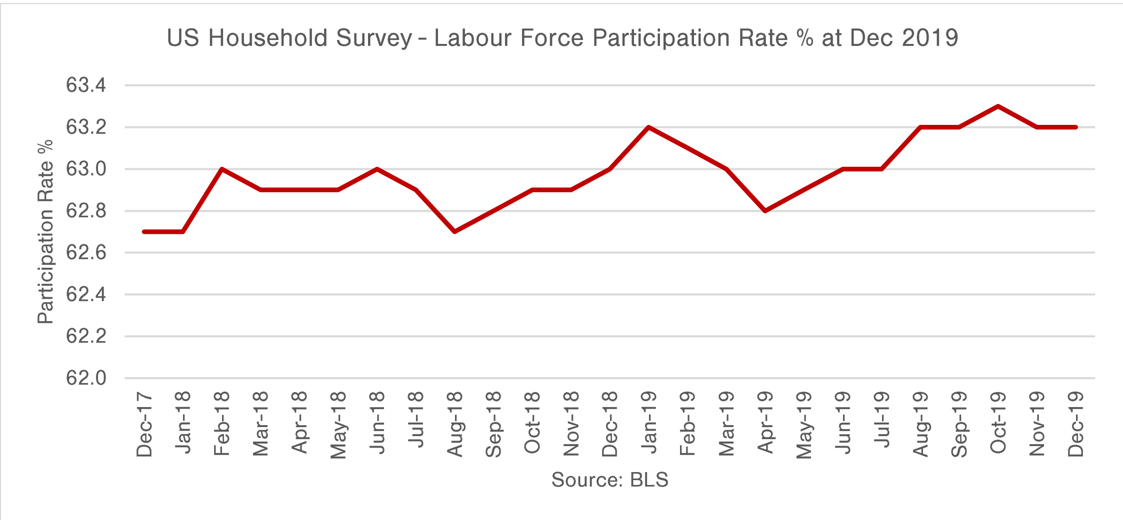
On a monthly basis, employment growth increased from a small decline of -8k persons in Nov to +267k persons in Dec.

<u>Labour Force</u>

Importantly, employment growth remained higher than what the estimated change in population added to the labour force – on both an annual and monthly basis.

The slow down this month was in participation *growth*.

On an annual basis, participation increased by +0.2%pts in Dec versus the +0.3% pts recorded at Nov.



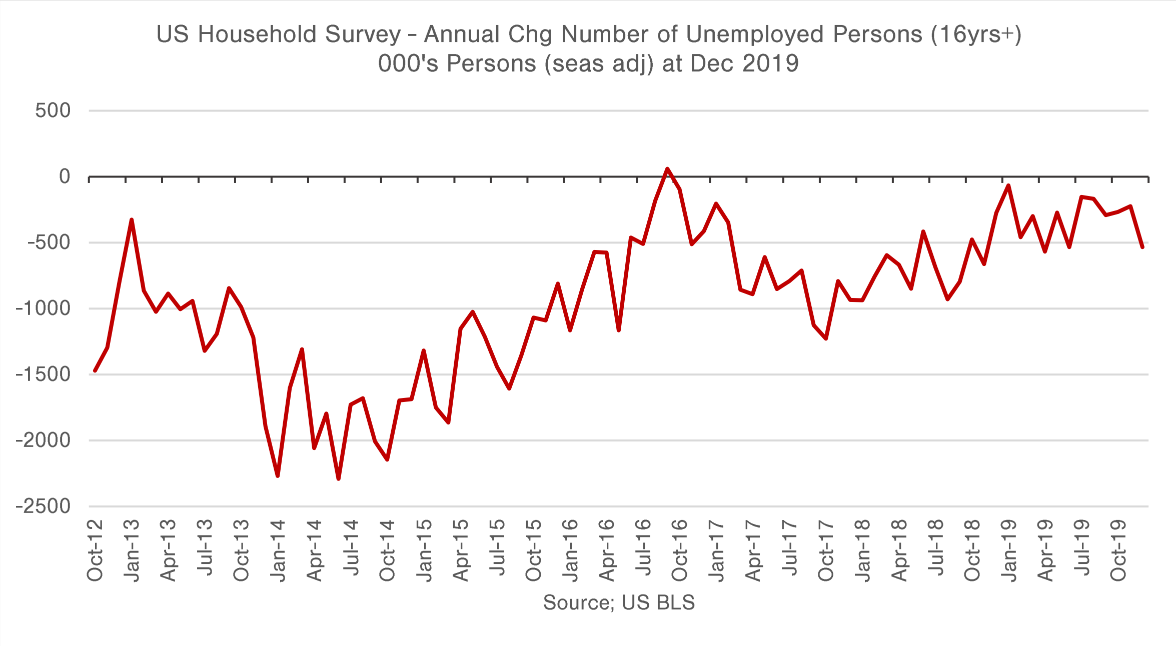
This meant that there was lower growth in persons added to the labour force due to participation change.

On a monthly basis, the participation rate was unchanged between Nov and Dec – meaning that participation added no further persons to the labour force in Dec.

This then translated directly into employment growth reducing total unemployed persons instead.

<u>Unemployed Persons</u>

<u>Total unemployed persons – annual change</u>; Dec -533k persons versus Nov -223k persons



On a monthly basis, total unemployed persons declined by 58k persons in Dec versus the decline of -46k persons in Nov.

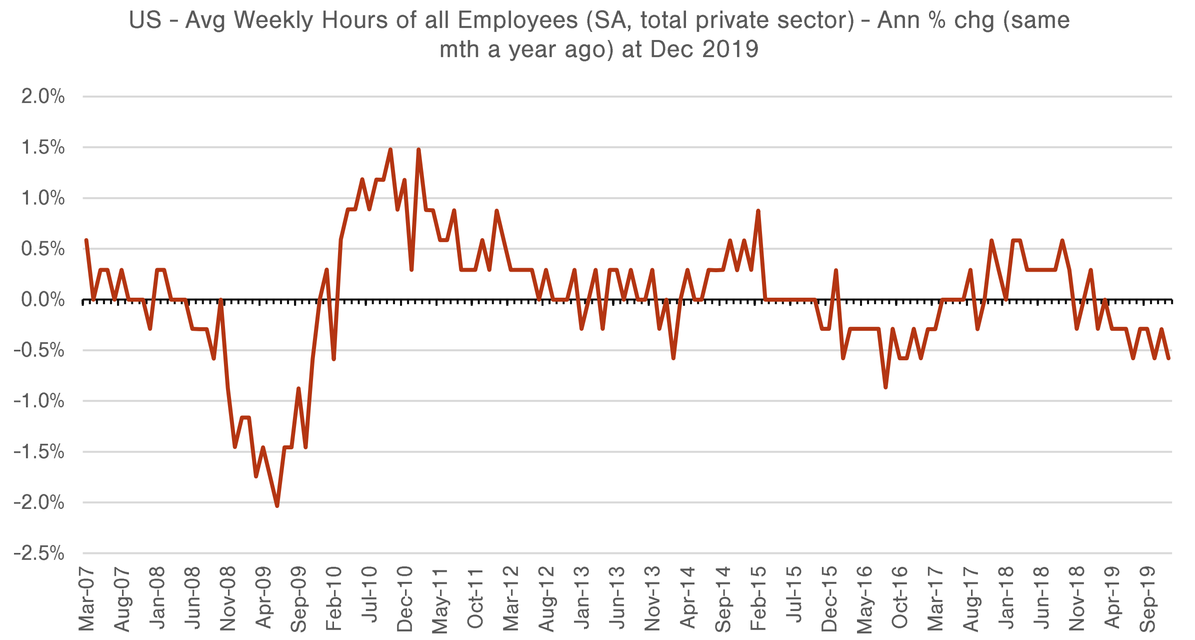
The unemployment rate in the month was 3.50% (down very slightly from 3.54% in Nov).

Summary of Key Labour Market Variables

000's people (16yrs+)	Annual chg - DEC 2019	Monthly Chg - DEC
The estimated change in the Labour Force due to pop growth (1)	924	209
How many jobs available for them? (employment growth) (2)	1,978	267
Difference (if negative, then employment growing faster than what pop adds to the labour force) (3)	- 1,054	-58
Change labour force participation - (if positive, people entering/returning to the labour force) (4)	521	0
The remainder is the chg in total unemployed persons (declining if negative) (4) plus (3)	- 533	-58
Two views of annual growth in the labour force;		
Total employed persons plus total unemployed persons	1,445	209
Est of what population adds to the labor force plus change in participation	1,445	209
BLS reported change in the size of the labour force	1,445	209

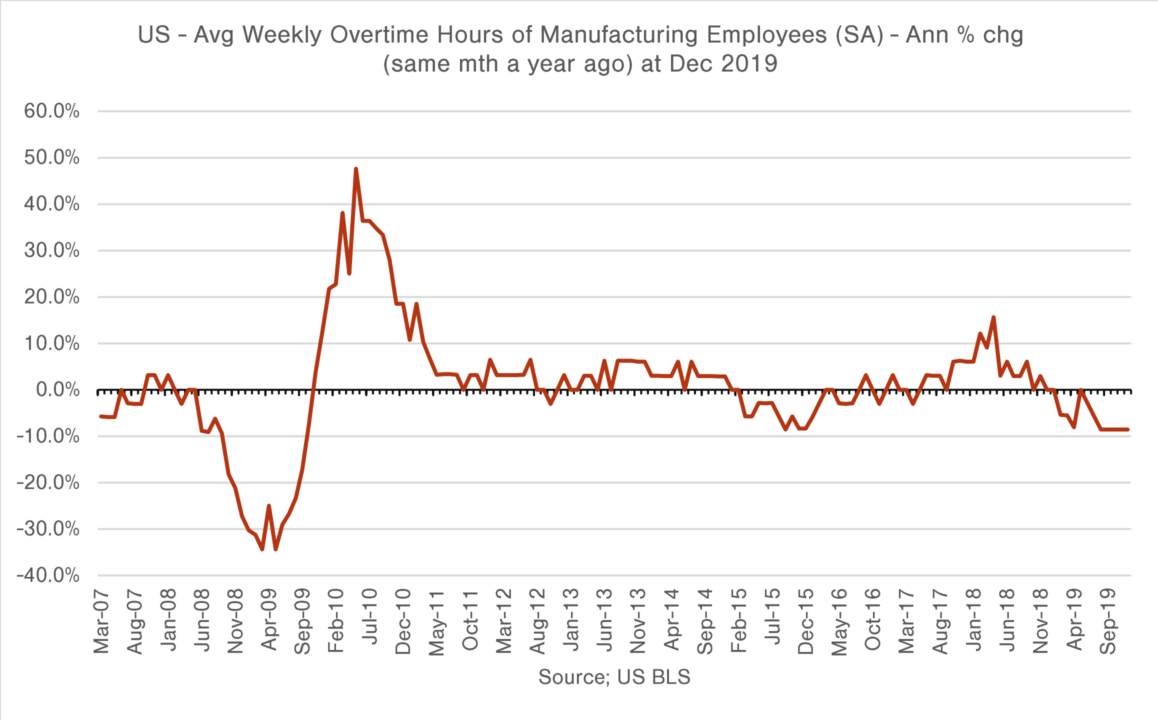
Average Weekly Hours

The annual growth in average weekly hours of all employees remained below a year ago (-0.6%) and recorded no growth in Dec versus Nov;



Source; US BLS

The average weekly overtime hours of all employees in manufacturing sectors also remains well below a year ago; Dec -8.6% annual decline. Average weekly overtime hours recorded zero growth on a monthly basis;



https://www.bls.gov/ces/

Speech - Vice Chair Richard H. Clarida – 9 Jan 2020 - U.S. Economic Outlook and Monetary Policy

This is a very short speech. One important point he makes in the speech is in relation to the current FOMC repo operations over the year end turn. Reading into the language suggests that the Fed is rethinking the timing of ending the repo operations (system reserves still not rising as fast as FOMC purchases of Treasury Bills). Repo operations were initially intended only to support the maintenance of the FFR through the year end turn. I've highlighted two points below which highlight that repo operations may now be ongoing;

> As we enter 2020, let me emphasize that we stand ready to adjust the details of this program as appropriate and in line with our goal, which is to keep the federal funds rate in the target range desired by the FOMC. As the minutes of the December FOMC meeting suggest, **it may be appropriate to gradually transition away from active repo operations this year** as Treasury bill purchases supply a larger base of reserves, **though some repo might be needed at least through April,** when tax payments will sharply reduce reserve levels.

https://www.federalreserve.gov/newsevents/speech/clarida20200109a.htm

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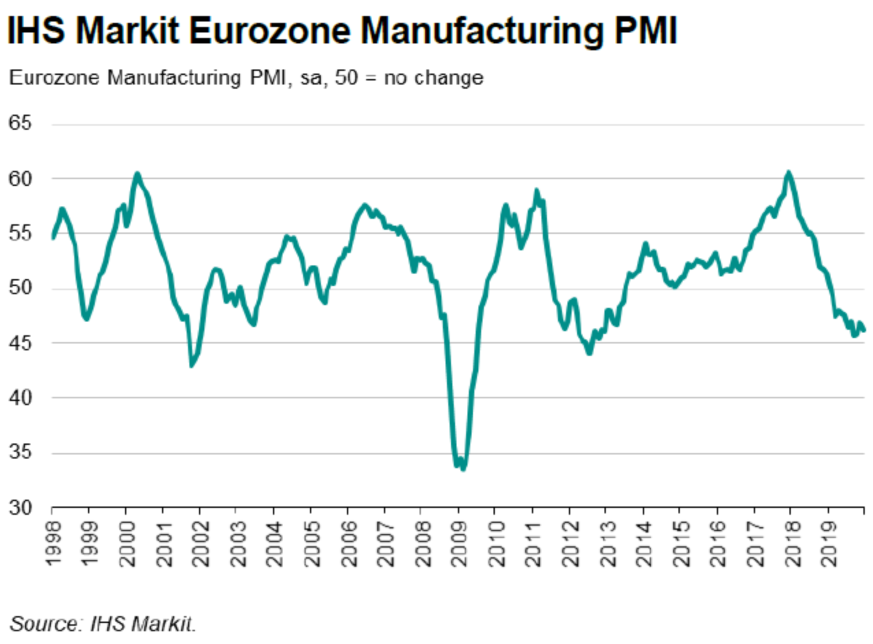
Europe

Eurozone Manufacturing PMI Final (Dec)

It was a weaker end to the year for manufacturing across the Eurozone with the PMI indicating manufacturing activity continued to decline at a slightly faster pace in Dec.

Manufacturing activity in Ireland, Netherlands, Spain, Italy, Austria and Germany remained in contraction. Manufacturing growth in France was at a neutral/no growth level.

Headline Manufacturing PMI; Dec 46.3 versus Nov 46.9



Production and new orders continued to decline in Dec. Firms were able to continue to reduce order backlogs. This still created spare capacity and firms reduced employment further.

> Moreover, the rate of job losses was the sharpest recorded by the survey since the start of 2013. In line with recent trends, job shedding remained centred on Germany. Greece, in contrast, saw strong employment growth, with France the only other country not to record lower employment during the month.

Despite the weakening in conditions, optimism about the future continued to improve. The survey was taken between 5-16 Dec, so possibly the trade truce between the US and China had a positive impact on expectations.

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Eurozone Services PMI Final (Dec)

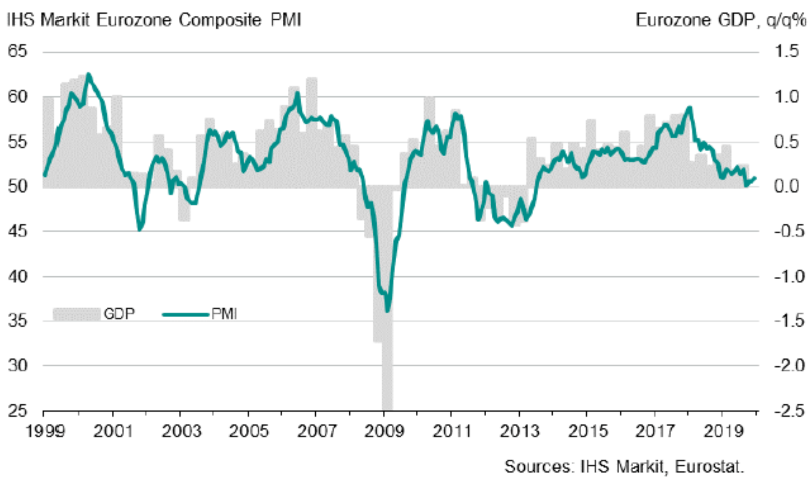
There was a much larger improvement in services activity across the Eurozone in Dec, with activity expanding at a faster pace.

All countries in the services survey recorded growth in services output/activity in Dec.

Services Activity Index; Dec 52.8 versus Nov 51.9

The composite PMI indicated that broadly, growth in activity remained low, but increased slightly from 50.6 in Nov to 50.9 in Dec.

IHS Markit Eurozone Composite PMI



New services orders continued to grow, while new export work continued to decline.

Backlogs of work increased for the first time in five months and employment increased. The pace of employment growth was the lowest since the start of 2019.

Input prices increased while output charges only increased modestly.

Business confidence increased to the highest level since mid-2019 – led mostly by Germany.

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Eurozone Retail Sales (Nov)

The volume of retail sales in the Eurozone increased in Nov after declining in the two months prior. Growth was recorded across most categories with the exception of auto fuel.

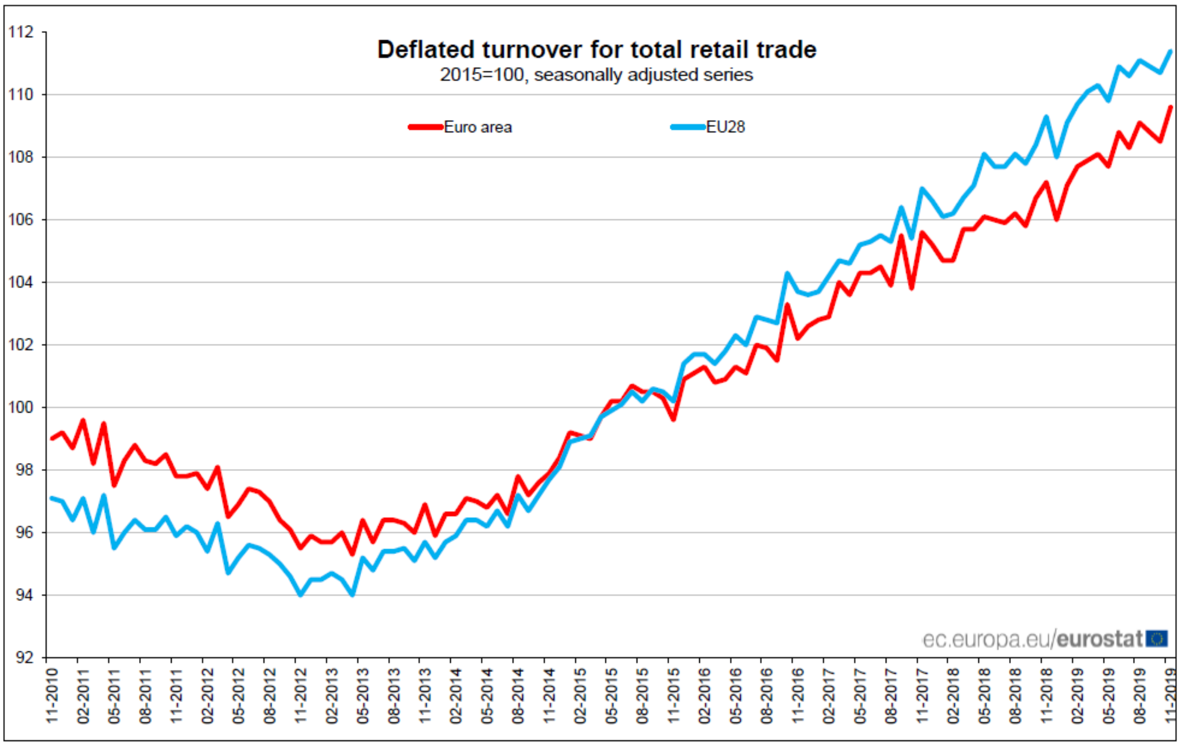
EU28 Group Retail Sales (vol) – month change; Nov +0.6% versus Oct -0.2%

Sales growth accelerated across food, alcohol and tobacco. While growth across non-food categories increased after declines recorded in the prior month. Auto fuel sales (vol) declined by -0.8% in Nov compared to Oct.

In the month, Poland (+3.3%), Belgium (+2.7%) and Latvia (+2.6%) recorded the largest increase in retail sales. The largest decreases were recorded by the UK (-1.7%), Ireland (-0.9%) and Finland (-0.5%).

On an annual basis, broader EU retail sales growth increased at a slightly slower pace; Nov +1.9% versus Oct 2.1%.

The annual growth in food, alcohol & tobacco was higher. But annual growth across non-food categories slowed further. Textile, clothing and footwear sales declined slightly versus a year ago (-0.5%). Auto fuel sales were also -0.9% below a year ago.



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Eurozone CPI Prelim (Dec)

The prelim CPI for the Euro area in Dec indicated that consumer price growth accelerated on an annual basis. There are signs that inflation is starting to lift across the Euro area – this is even without an acceleration in energy prices.

Prelim Euro area CPI – annual change; Dec +1.3% versus Nov 1%

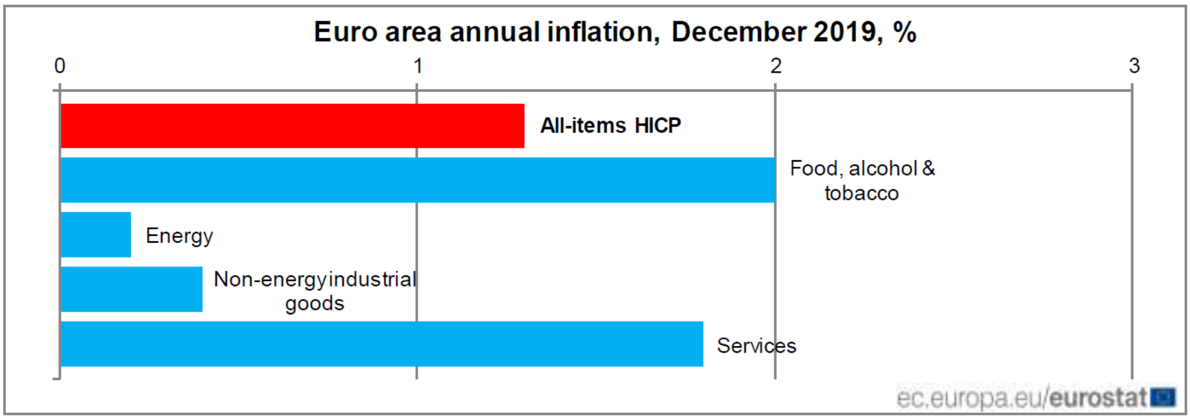
The main contributors to the increase in CPI growth were;

Food, alcohol & tobacco – annual growth in prices lifted from +1.9% in Nov to 2% in Dec (both unprocessed and processed food/alcohol/tobacco)

Energy prices – the annual decline in energy prices in Nov of -3.2% shifted to +0.2% in Dec

Core CPI (ex-energy and food/alcohol/tobacco) remained elevated at +1.3% annual growth but the pace of growth remained unchanged from Nov. A year ago, annual core inflation was lower at +0.9%.

Growth in services prices slowed slightly from +1.9% in Nov to +1.8% in Dec, but remain well above the growth recorded in Dec 2018 of +1.3%.



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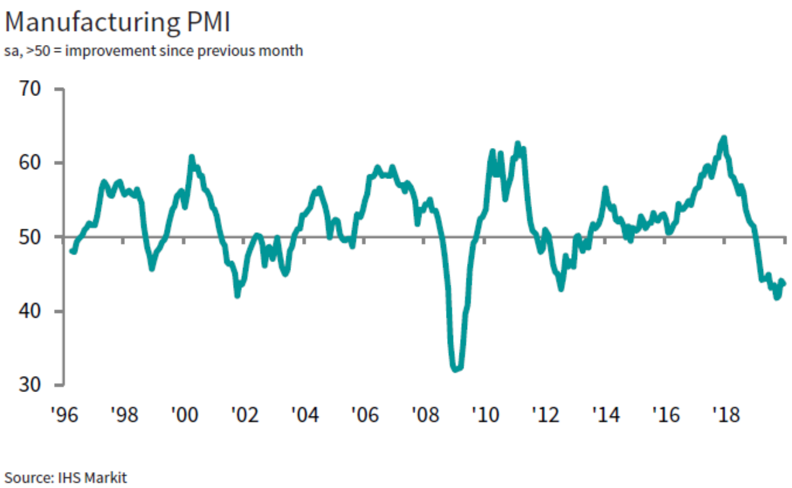
Germany Manufacturing PMI Final (Dec)

The headline manufacturing PMI continued to contract in Dec – led by declines in output and employment. All three main industrial groups recorded a decline in conditions.

Headline Manufacturing PMI; Dec 43.7 versus Nov 44.1



The decline in output accelerated in Dec. New orders also continued to decline, but at much slower pace compared to the rest of the year – this may be positive for future output. Business confidence improved.

Order backlogs continued to contract and firms continued to reduce employment. The pace of decline in employment "was among the quickest over the past ten years".

Firms continued to reduce output charges in order to remain competitive.

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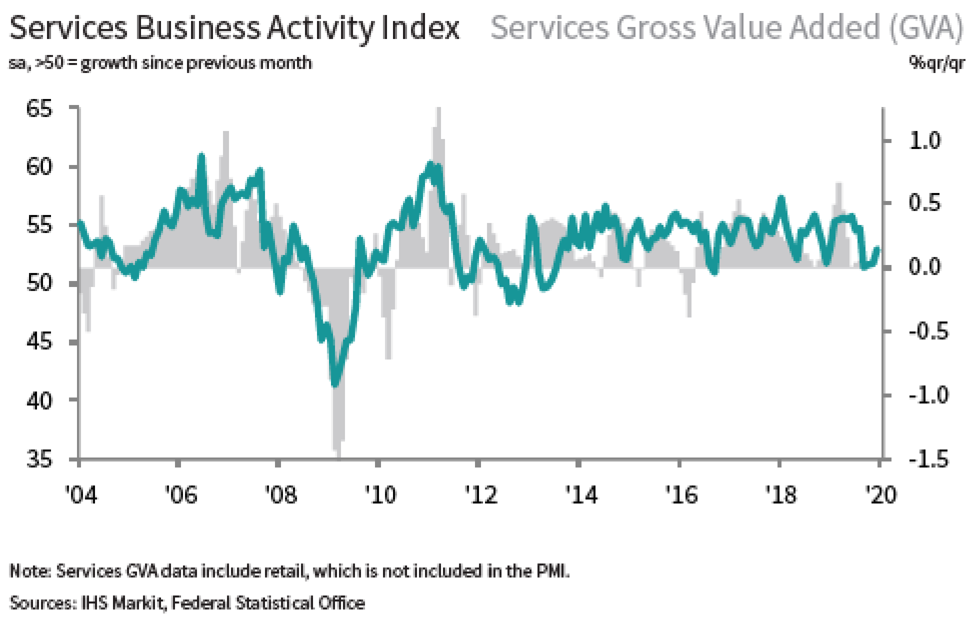
Germany Services PMI Final (Dec)

Service activity, on the other hand, improved at a faster pace, despite growth remaining more moderate. This was led by an improvement in new orders, although new export work continued to decline, business optimism and employment. Growth in output charges was small as firms continued to compete for new work.

Services activity index; Dec 52.9 versus Nov 51.7



Confidence was at its highest overall level since April and back above the long-run average (since 1997), with a number of firms highlighting expectations for new projects and company expansions in 2020.

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Germany Factory Orders (Nov)

Germany factory orders declined in the month of Nov after recording growth in the two months prior. The decline in the month was the result of lower orders from foreign countries – both Euro area and non-Euro area countries. Domestic orders increased in Nov.

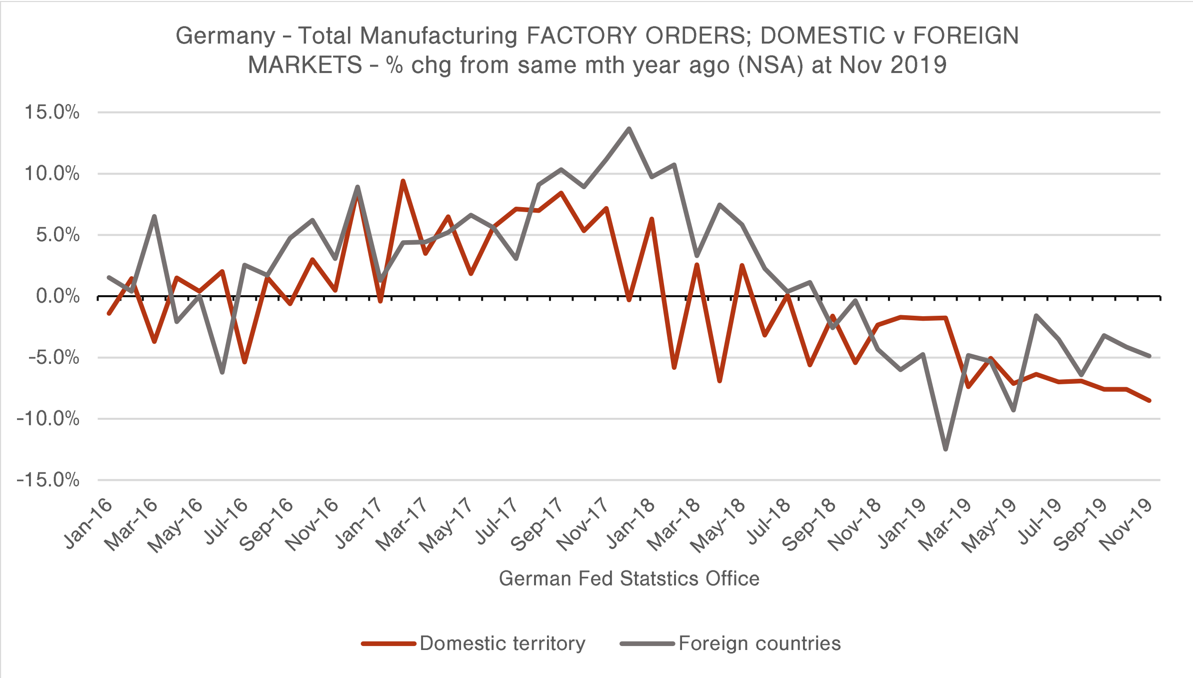
Across many industry groups, it appears as if annual growth in orders is starting to improve. But in the case of intermediate goods, capital goods, consumer goods and non-durable goods, orders remain below the respective peaks in the orders index. At best, the decline in orders across these categories has stabilized.

Total factory orders – month change; Nov -1.3% versus Oct +0.2%

Orders from the domestic market increased by +1.6% in Nov while foreign orders declined by 3.1%. Euro area orders declined by 3.3% in Nov after a much stronger +12.4% increase in Oct. Non-Euro area orders declined by 2.8% in Nov after a 3.8% decline in Oct.

Total factory orders declined on an annual basis at a faster pace; Nov -6.5% versus Oct -5.6%.

Declines in both domestic and foreign orders contributed to the overall decline in the last year;



<u>Orders by Industry Group</u>

<u>Intermediate Goods – month change</u>; Nov +0.2% versus Oct +0.7%

Domestic orders for intermediate goods increased at a faster pace in Nov (+2.4%), but foreign orders declined by 1.8% led by a 4.5% decline in foreign orders from non-Euro area countries.

On an annual basis, the decline in orders for intermediate goods is becoming smaller. **But this is more of a reflection of the period of time over which orders for intermediate goods have declined.** I have posted both the annual decline in orders as well as the seasonally adjusted index of factory orders. Orders for intermediate goods remains 13% BELOW the peak of Nov 2017. For the moment, the decline in orders for intermediate goods has stabilized.

<u>Capital Goods – month change</u>; Nov -2.1% versus Oct -0.3%

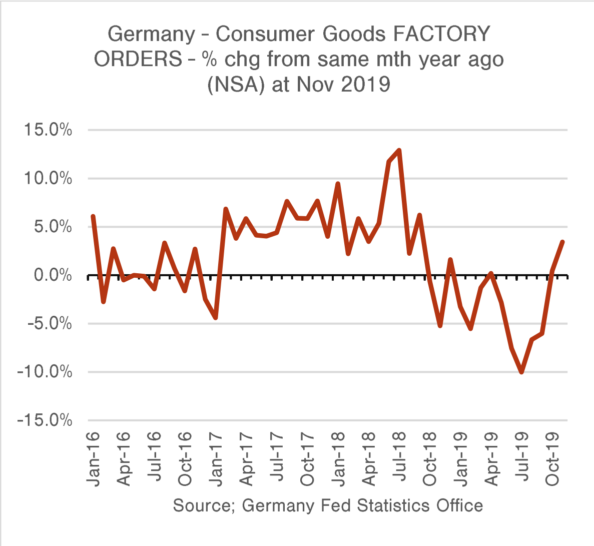
There was a further deterioration in capital goods orders this month. This was led by foreign orders – both non-Euro area and Euro area countries. Domestic orders increased for Nov.

On an annual basis, the decline in orders for capital gods accelerated to -8.3% below a year ago. Similarly, capital goods orders remain 12% below the peak of Dec 2017.

<u>Consumer Goods – month change</u>; Nov 0% versus Oct +0.9%

The change in the month was the result of +0.7% growth in consumer goods orders from the domestic market, which was offset by a decline in foreign orders (Euro area orders).

On an annual basis, orders for consumer goods are +3.4% ahead of a year ago. But consumer goods orders are yet to recover the peak of Jun/Jul 2018 and are still 8% below that level. The index of orders continues to trend mostly sideways;



<u>Durable Goods – month change</u>; Nov +7.6% versus Oct -10.4%

Durable goods orders were stronger across all markets this month.

On an annual basis durable goods orders are 6% ahead of a year ago. Orders continue to trend higher and reached a near-term peak only in Sep 2019.

<u>Non-Durable Goods – month change</u>; Nov -2.7% versus Oct +5.4%

Orders in Nov were stronger in the domestic market +0.1% but were offset by declines in foreign orders for non-durable goods (-4.5%).

On an annual basis, orders for non-durable goods are now positive +2.4% ahead of a year ago. Domestic and Euro-are orders remain below a year ago. Annual growth is higher due to non-Euro Area orders for non-durable goods.

Overall non-durable goods orders remain 11% below the peak of Jun 2018.

https://www.destatis.de/EN/Press/2020/01/PE20_007_421.html;jsessionid=3051DF838CBCAB5245EF0232307ECACC.internet721

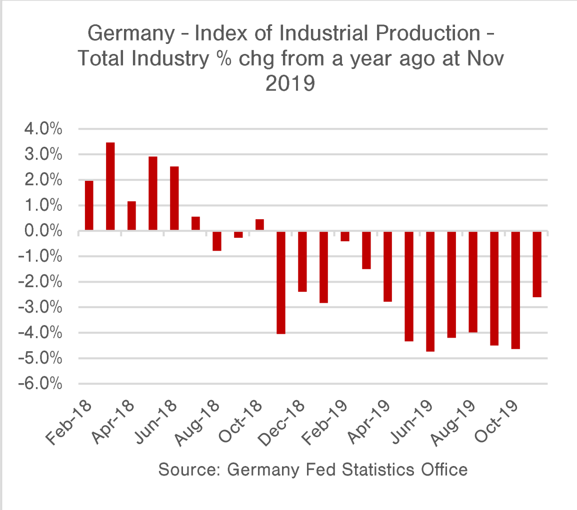
Germany Industrial Production (Nov)

Total industrial production increased in Nov. This was led by growth in construction and manufacturing. Mining and quarrying recorded zero growth in the month. Production of utilities declined slightly.

While the annual decline in industrial production has become smaller, this is not necessarily a reflection of improved conditions as production remains 6.3% below the Nov 2017 peak (at its worst level, production was 7.3% below that peak – this was recorded last month Oct 2019)

<u>Total Industrial Production – month change</u>; Nov +1.1% versus Oct -1%

On an annual basis, production is 2.6% below a year ago but remains 6.3% below the peak of Nov 2017 (two years ago). Both the index of production and the annual growth are posted below;

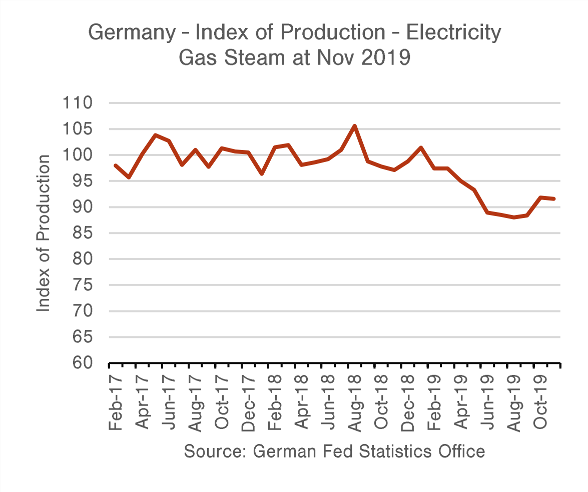


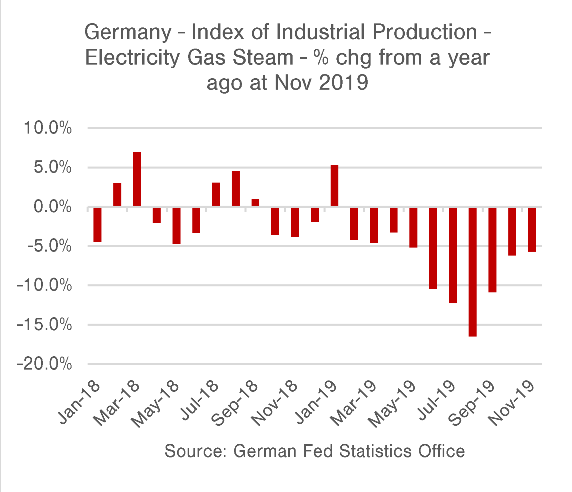
<u>Total Manufacturing Production – month change</u>; Nov +0.9% versus Oct -1.3%

On an annual basis, the decline in manufacturing production slowed in Nov to -4%. Manufacturing production remains 8% below the peak of Nov 2017;

Utilities Production – month change; Nov -0.2% versus Oct +3.8%

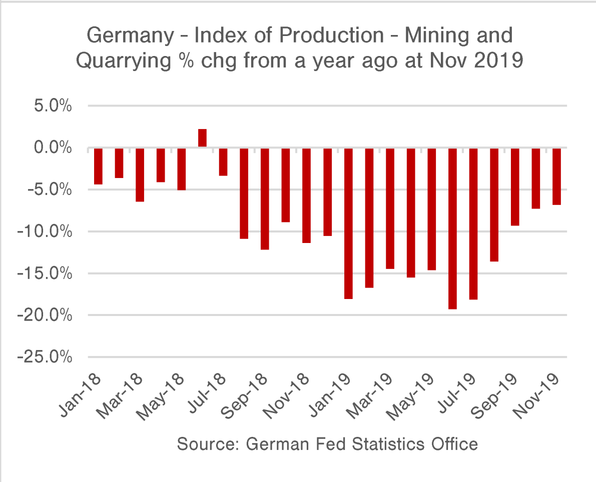
On an annual basis, production remains 5.7% below a year ago. Production of utilities is also 13.3% below the peak reached in Aug 2018;





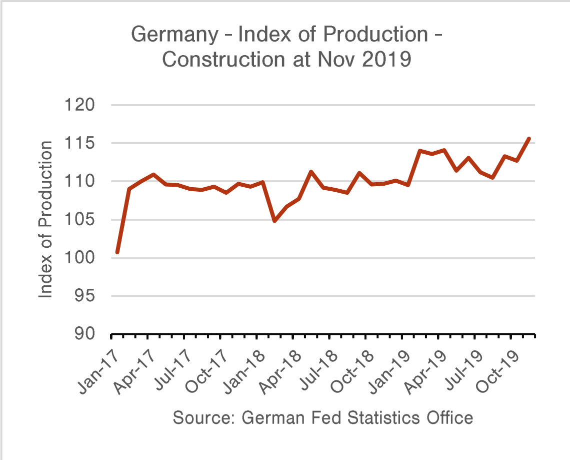
Mining and Quarrying – month change; Nov 0% versus Oct +2%

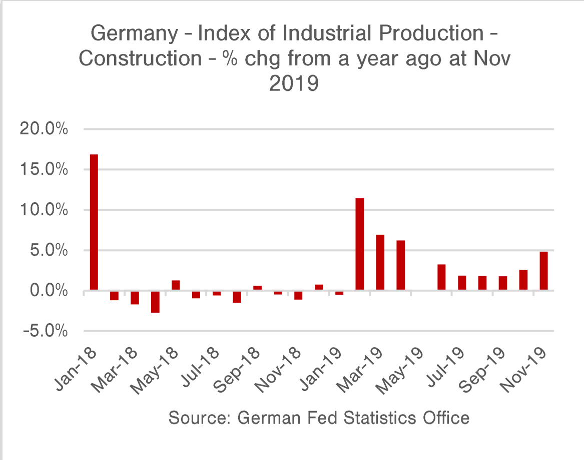
On an annual basis, mining and quarrying is 7% below a year ago – and that decline has become smaller over the last five months. But production remains well below the May 2017 peak – and is 20.5% below that peak. There are signs that the decline has stabilized over the last three months;



Construction – month change; Nov +2.6% versus Oct -0.5%

Annual growth in construction accelerated in Nov to +4.8% and is the only area recording continued growth in activity;





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Japan

Retail Trade (Nov)

The value of retail trade rebounded in the month of Nov after a much larger fall in Oct as the sales tax increase was implemented. On an annual basis though, the value of retail sales remains below that of a year ago – led by motor vehicle sales, fuel and general merchandise categories.

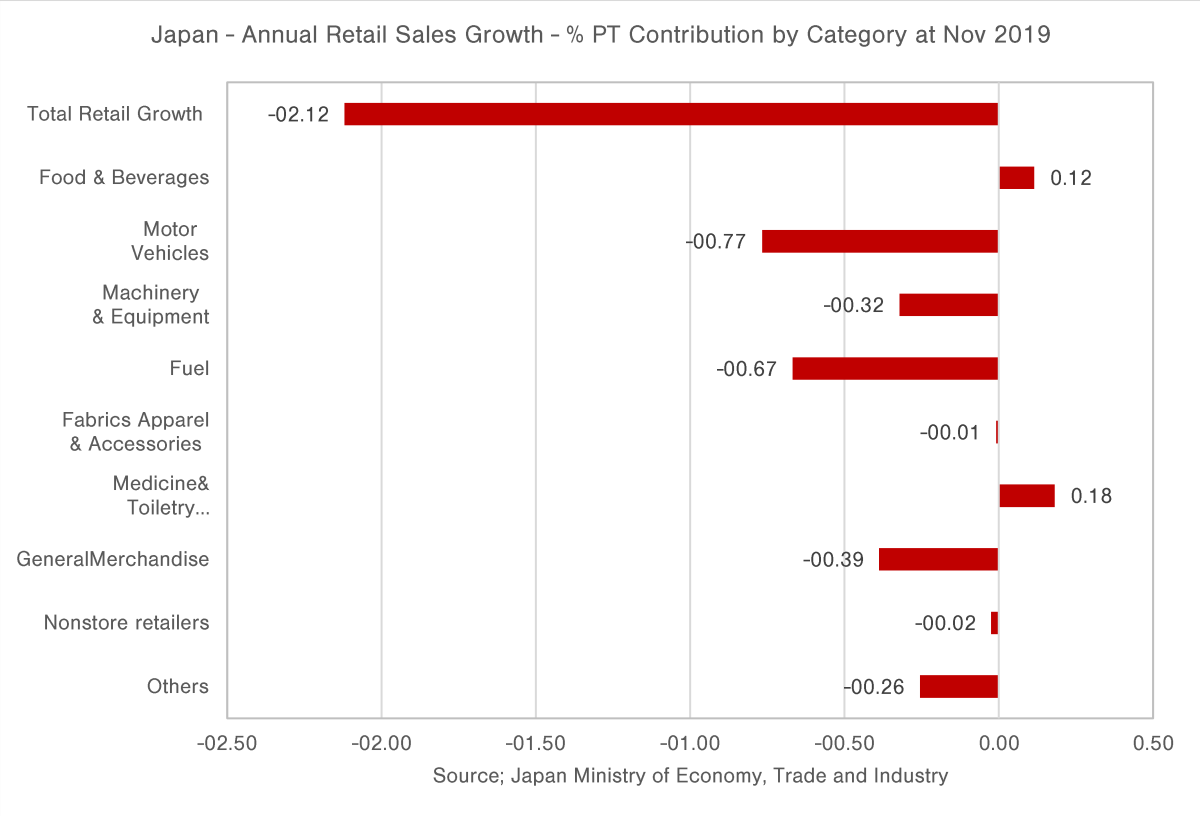
<u>Japan nominal retail sales – month change</u>; Nov +4.5% versus Oct -14.2%

The slump in Oct was preceded by stronger retail sales growth in Sep as consumer likely stockpiled prior to the implementation of the sales tax.

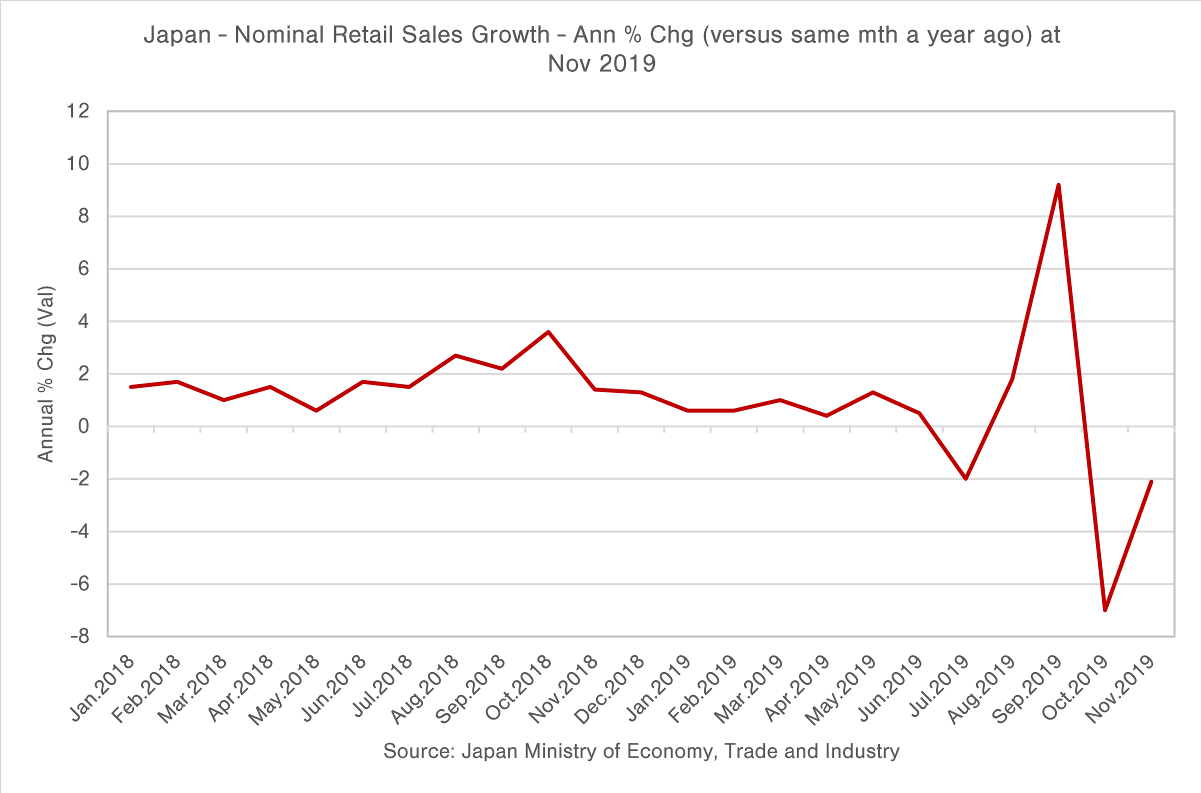
Japan nominal retail sales – annual change; Nov -2.1% versus Oct -7%

Most categories contributed to the annual decline in Nov. The largest contributors were motor vehicle sales, fuel and general merchandise.

Only food & bev and medicines/toiletries categories grew in nominal terms versus a year ago;



The trend in the annual growth is clearly impacted by the implementation of the sales tax increase in Oct 2019. For the moment, sales growth continues to trend below a year ago;



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

Industrial Production – Prelim (Nov)

Industrial production and shipments declined again in Nov after the larger decline in Oct (weather disruption and possibly related to the sales tax increase). The value of producers' inventory of finished goods declined in the month, but the ratio of inventory to shipments reached another near term high.

Industrial production and shipments continue to fall further behind the levels from a year ago.

Forecast for the months ahead; the Dec survey contains a more upbeat forecast of +2.8% growth in production for Dec and a +2.5% growth in production for Jan.

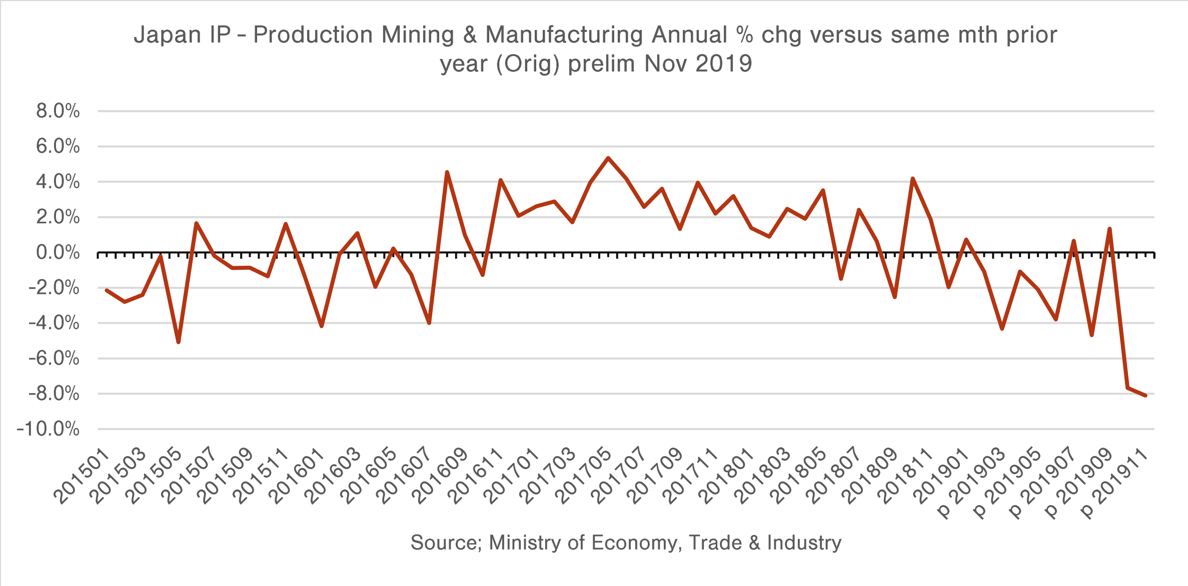
PRODUCTION

Month change; Nov -0.9% versus Oct -4.5%

Several categories contributed to the decline in the month; iron and steel, fabricated metals, production machinery (a further -8.9% decline in the month) and electronic machinery.

Transport equipment production increased by +4.1% in the month after declining by 7.8% in the month prior.

Annual change; Nov -8.1% versus Oct -7.7%

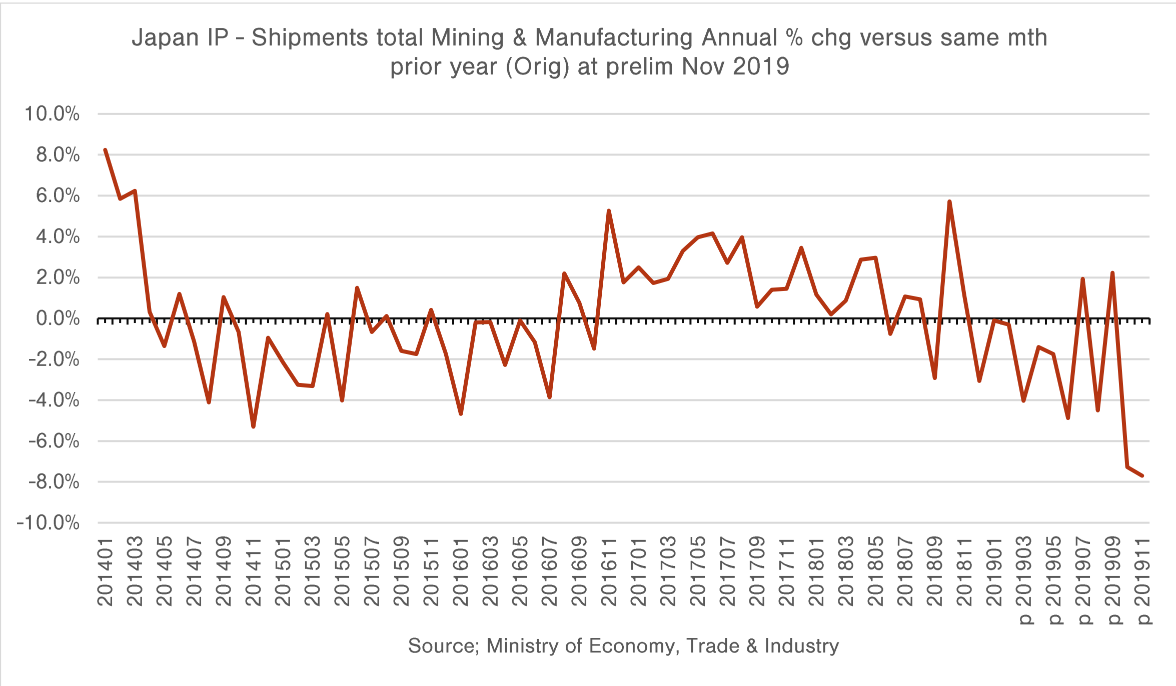


SHIPMENTS

Month change; Nov -1.7% versus Oct -4.5%

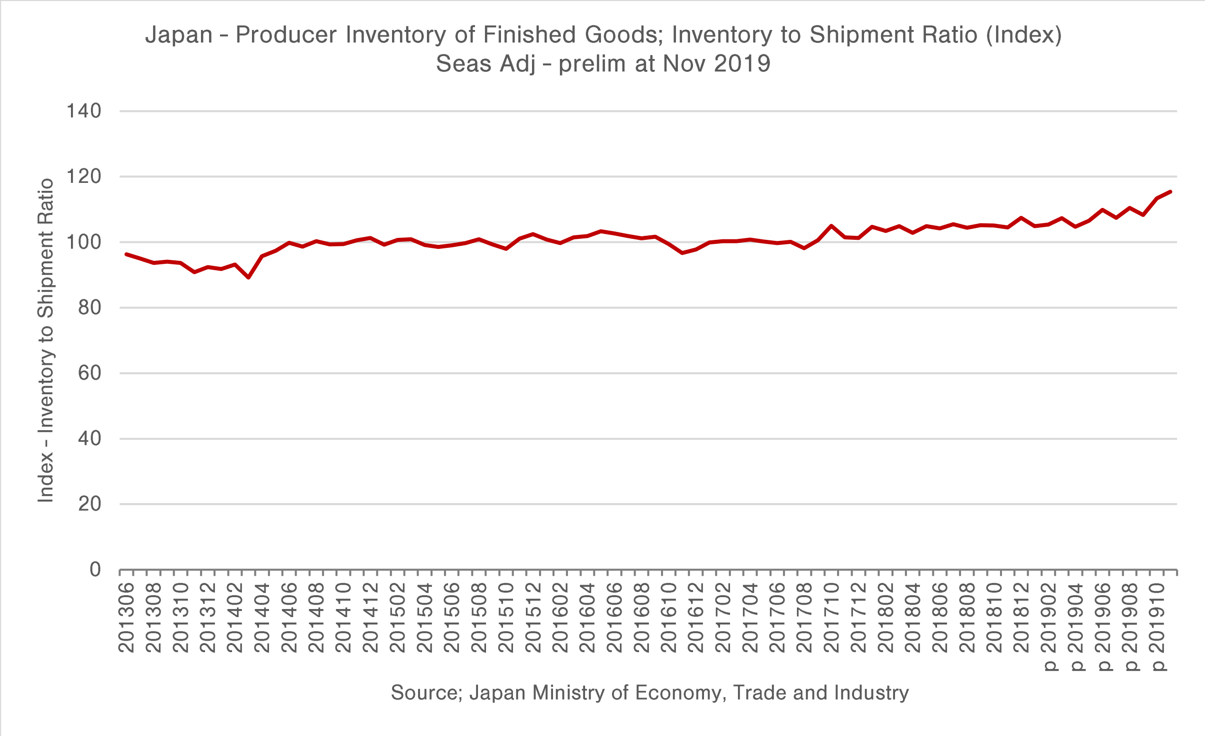
Shipments were lower across several of the larger categories this month; production machinery (-10% in the month), electrical machinery and transport equipment (-2.5% in the month).

Annual change; Nov -7.7% versus Oct -7.3%



PRODUCER INVENTORY OF FINISHED GOODS INVENTORY TO SHIPMENT RATIO

Month change; Nov +1.8% versus Oct +4.5%



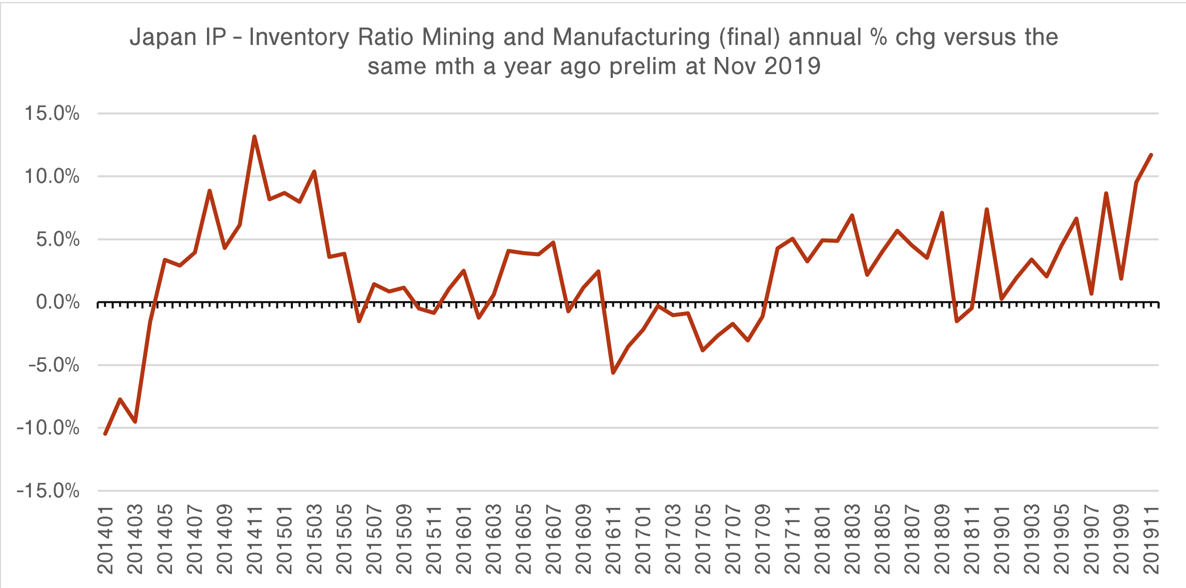
The index weights are quite different for inventory versus production/shipments.

The largest weight group in the inventory to shipment ratio is for iron, steel and non-ferrous metals. The inventory shipment ratio increased another 3% in the month and is elevated

Inventory to shipment ratio for production machinery is similarly elevated.

Transport equipment is one of the few areas where the inventory to shipment ratio is trending lower – and declined by 10% in the month.

Annual change; Nov +11.7% versus Oct +9.5%

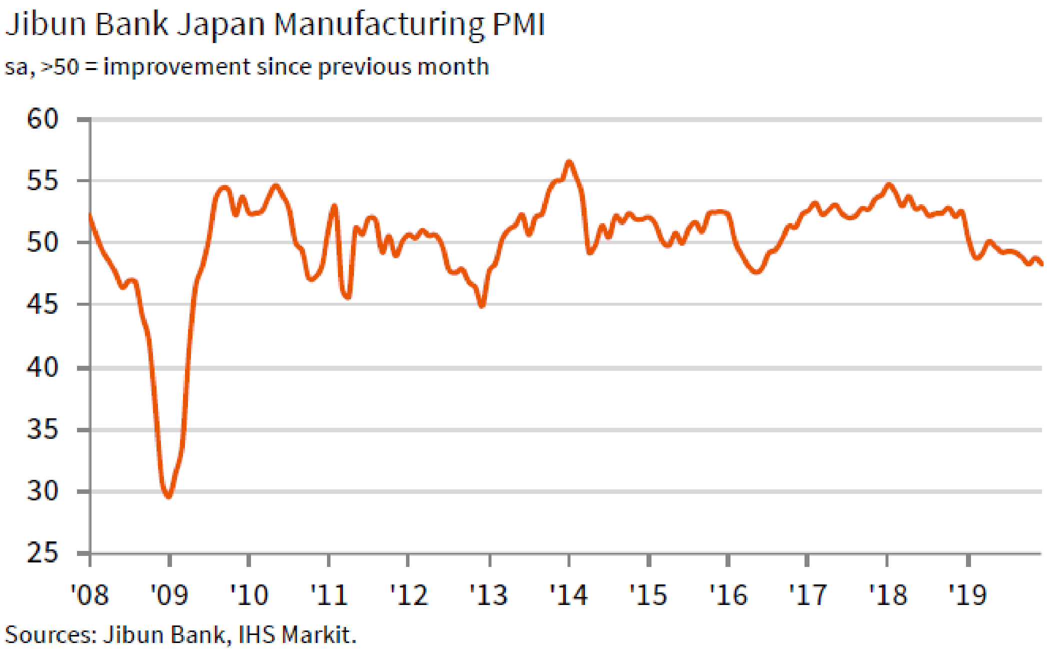


https://www.meti.go.jp/english/statistics/tyo/iip/index.html

Manufacturing PMI Final (Dec)

Manufacturing activity continued to contract in Dec. Output and orders continued to decline – somewhat at odds with the more robust forecast based on the industrial production survey. Regarding the weaker conditions in Dec, firms cited "global trade conflicts and lower demand from China".

Headline Manufacturing PMI; Dec 48.4 versus Nov 48.9



Contributing to the weaker conditions in the month was a further decline in output and new orders. New export orders also continued to decline.

> "…unfavourable demand conditions and economic fragility had prompted production cutbacks."

In the absence of new order growth, firms continued to work through order backlogs. This, and depletion of finished goods inventory, helped to keep shipments more buoyant. Purchase of stocks were reduced in Dec, given the lower order/production requirements.

Despite the weaker conditions, employment continued to grow. This was linked to somewhat improved optimism for output and recovery in the sector in 2020. Confidence levels remain weaker relative to the series average.

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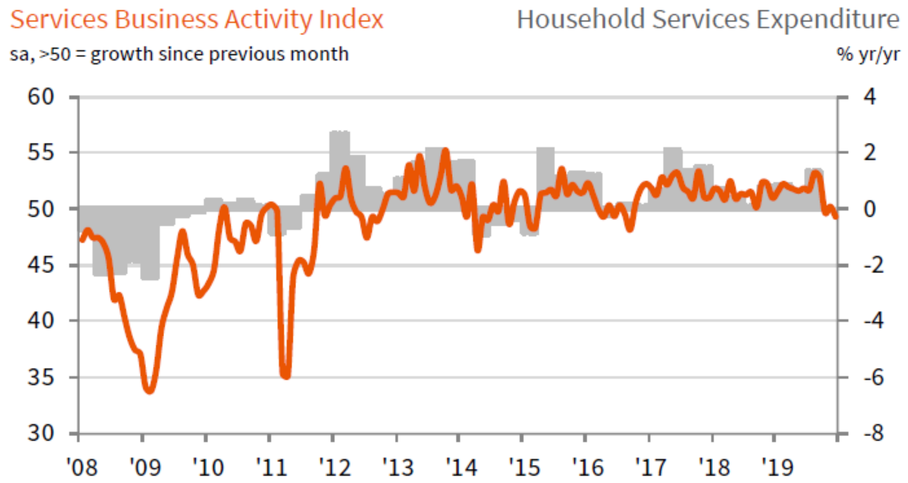
Services PMI Final (Dec)

There was a further weakening in the services sector in Dec with business activity contracting slightly.

> Furthermore, the decline was the strongest in over three years, subsequently rounding off the worst quarterly economic performance since the third quarter of 2016.

Headline Services Activity Index; Dec 49.4 versus Nov 50.3



Sources: Jibun Bank, IHS Markit, Cabinet Office Japan

Firms cited weaker underlying demand conditions as weighing on activity. Growth in orders remained subdued and export orders declined for the first time since Jun 2019. As a result, order backlogs declined at the fastest in over 18-months.

Firms continued to increase employment at a marginal pace.

Firms remained optimistic about future conditions but levels were lower than in the month prior.

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United Kingdom

Brexit

The passage of the Brexit Withdrawal Agreement bill through the House of Commons has been completed.

The House of Lords will continue to debate areas of the bill early this week. The bill will enter the committee stage on 14,15 & 16 Jan this week. The report stage is scheduled for 20 and 21 Jan. The third reading will then take place once the report stage is completed.

> Following completion of third reading, the bill may pass to the Commons for consideration of any Lords amendments. House of Lords consideration of Commons amendments is scheduled to take place on Wednesday 22 January.
> https://www.parliament.uk/business/news/2020/january/lords-debates-european-union-withdrawal-agreement-ill/

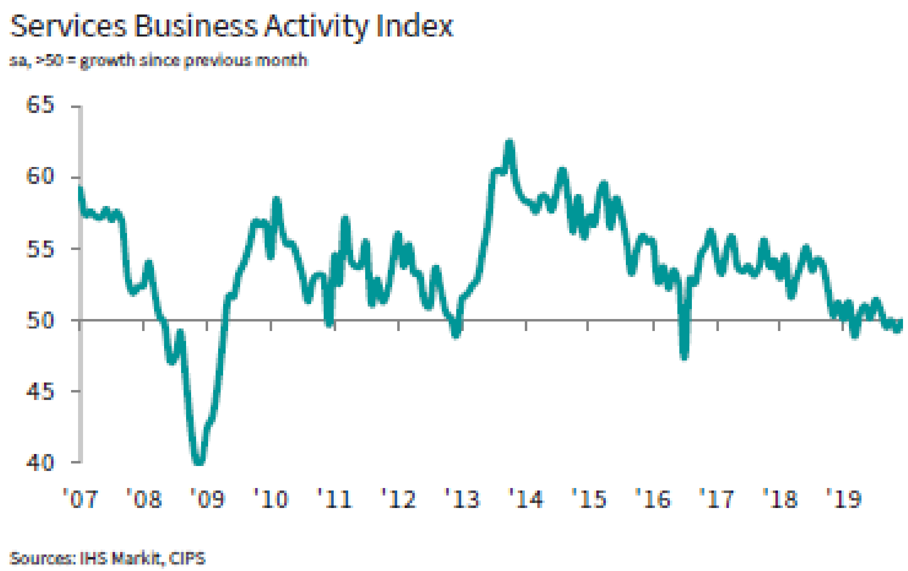
Once this first stage of Brexit is completed on 31 Jan 2020, The UK will enter a transition period with the EU and commence negotiations of a trade agreement. The negotiations can only commence after 31 Jan 2020. The UK PM has enshrined in law that the UK will only have until 31 Dec 2020 to complete trade negotiations with the EU.

UK Services PMI Final (Dec)

Private sector services activity improved slightly in Dec, rebounding from contraction in Nov to a neutral/no growth reading in Dec. Emphasis added;

> There were signs that service providers have become hopeful that a more stable political backdrop will help to support business conditions over the course of 2020. This was highlighted by a rebound in business optimism to its highest since September 2018, with a number of **survey respondents predicting a short-term boost to business activity** when the first stage of Brexit is resolved.

Headline Services Business Activity Index; Dec 50 versus Nov 49.3



New work increased moderately for the first time in three months. But within that, new export orders continued to decline and firms cited ongoing uncertainty regarding Brexit. Firms continued to work through order backlogs, with the index of backlogs declining for the fifteenth month.

While output and orders increased, employment recovered to record marginal growth.

Output prices charged by service firms increased only slightly in Dec.

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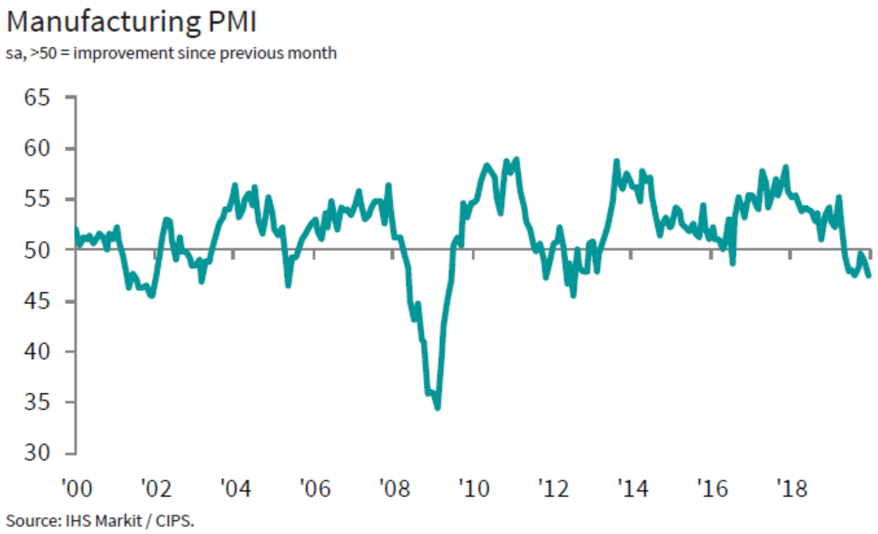
UK Manufacturing PMI Final (Dec)

While service activity stabilized in Dec, manufacturing activity continued to contract. The faster decline in Dec was the result of a fall in new orders from domestic and export markets and declines in output were linked to efforts to reduce Brexit inventory stockpiles.

Headline Manufacturing PMI; Dec 47.5 versus Nov 48.9



Production and new orders both declined at the fastest pace “in almost seven and a half years”. The declines in production and new orders were led by intermediate and capital goods. Activity in consumer goods remained more robust with marginal growth in orders and production recorded in Dec.

While firms remained positive about future conditions, that level of optimism was lower than in Nov.

As a result of weaker conditions, employment declined for the ninth month in a row.

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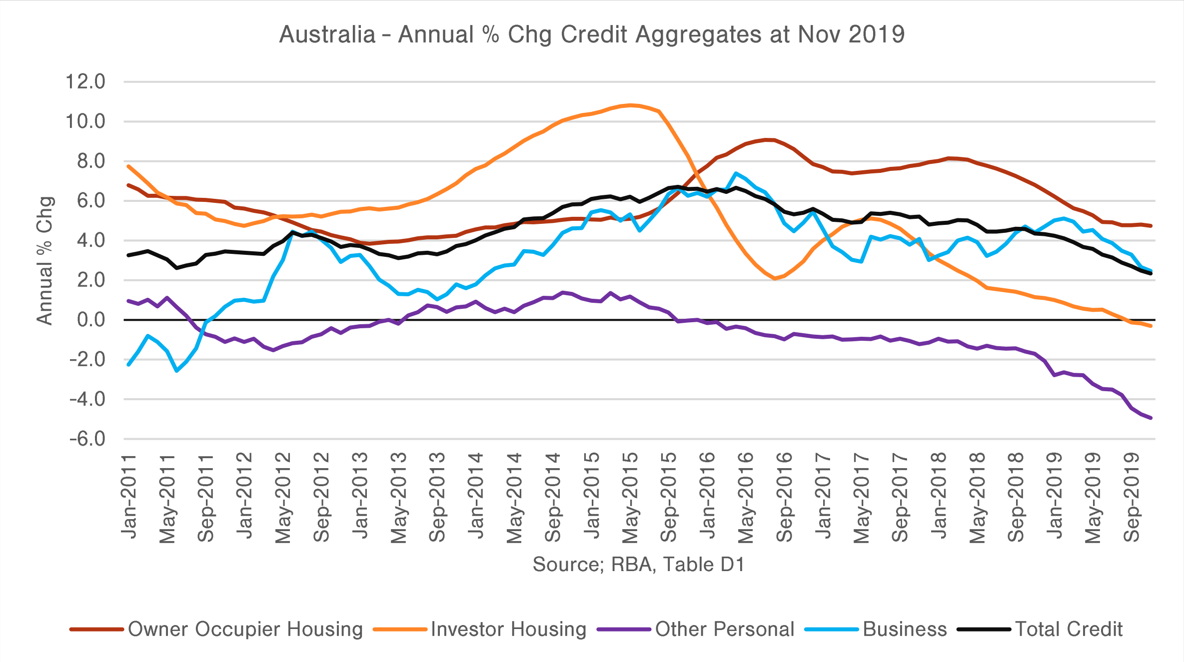
Australia

Private Sector Credit (Nov)

The annual growth in private sector credit outstanding continued to slow in Nov, with all sectors recording slower growth. Total outstanding credit increased at a faster pace on a monthly basis led only by faster growth in total business credit outstanding.

The data measures the value in total outstanding credit and as such should reflect the changes in the flow of new credit as well as any debt paydowns.

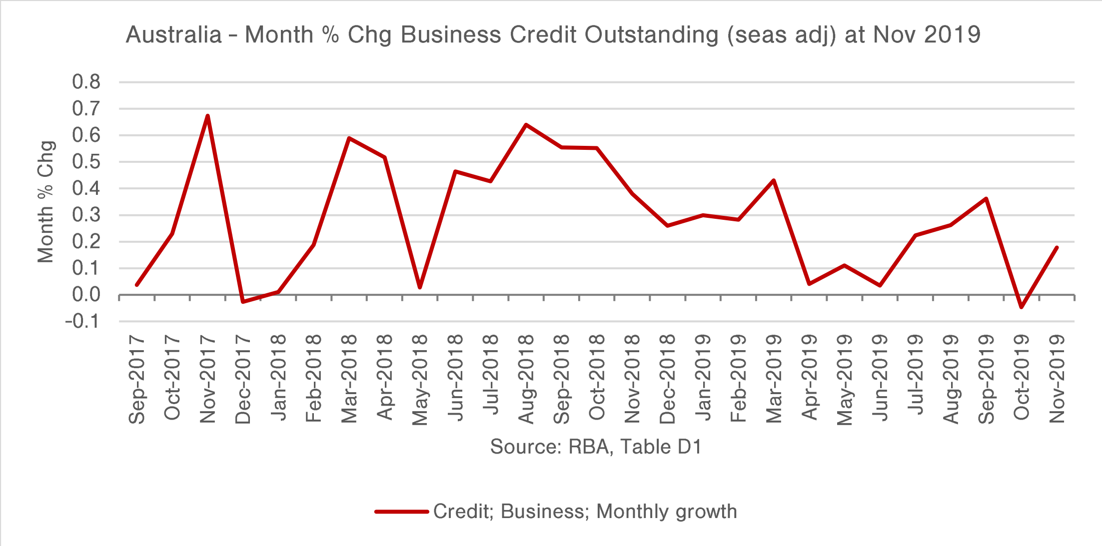
<u>Total private sector credit outstanding – annual change</u>; Nov +2.3% versus Oct +2.5%



Slower annual growth in outstanding credit was recorded across all sectors;

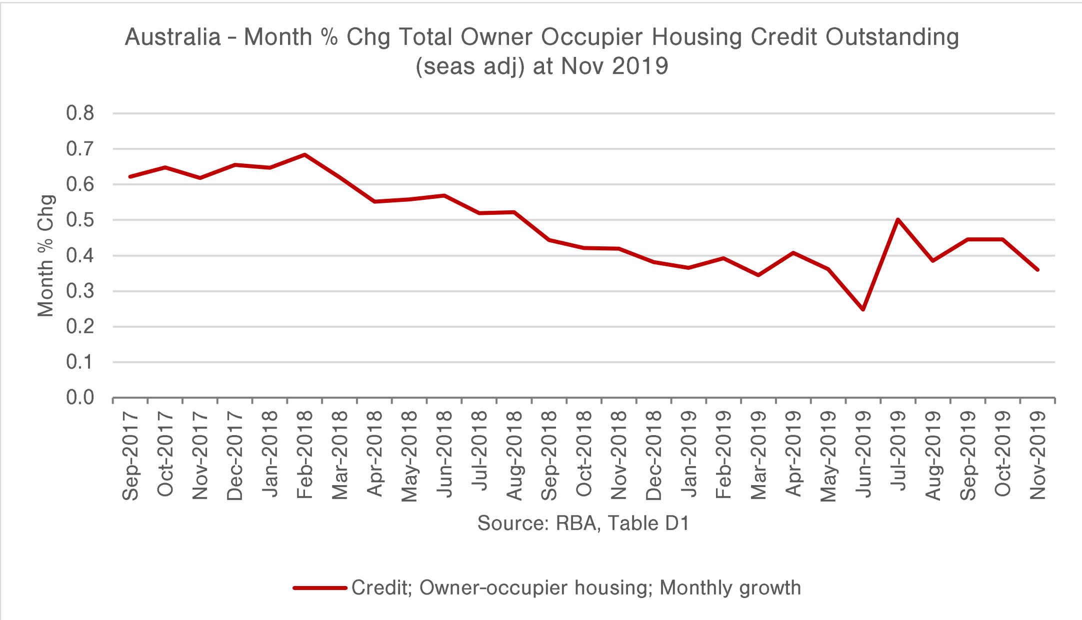
<u>Total business credit outstanding – annual change</u>; Nov +2.5% versus Oct +2.7%

The monthly change of business credit outstanding rebounded in the month after virtually no growth in the month prior, but remains lower than throughout 2018;



<u>Total owner occupier housing credit outstanding – annual change</u>; Nov +4.7% versus Oct +4.8%

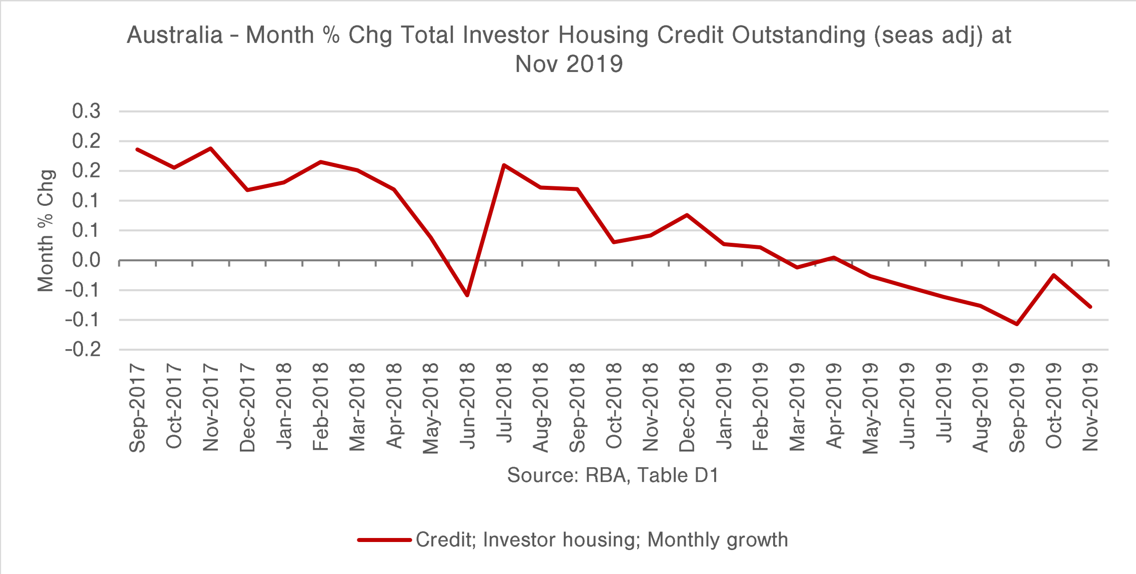
This is essentially the main part of credit growth in Australia and is the driver of house price growth at the moment. While the rate cuts arrested the slow down in the monthly credit growth for owner occupier housing credit, that rebound has not accelerated and monthly growth appears to have slowed again. While that impulse is low, house price growth will also likely remain low.



<u>Total investor housing credit outstanding – annual change</u>; Nov -0.3% versus Oct -0.2%

This was previously one of the key areas of housing credit growth (up to half of the monthly value of new commitments at the peak). Even after rate cuts in 2019, this part of the market is yet to rebound. The annual decline in outstanding investor housing credit indicates one of several possible scenarios (or a combo); the flow of new investor credit has not been higher than the paydowns in debt and, investors could be switching loan types/refinancing to principal and interest loans.

The continued to decline in monthly credit growth indicates continued weaker overall growth for housing.

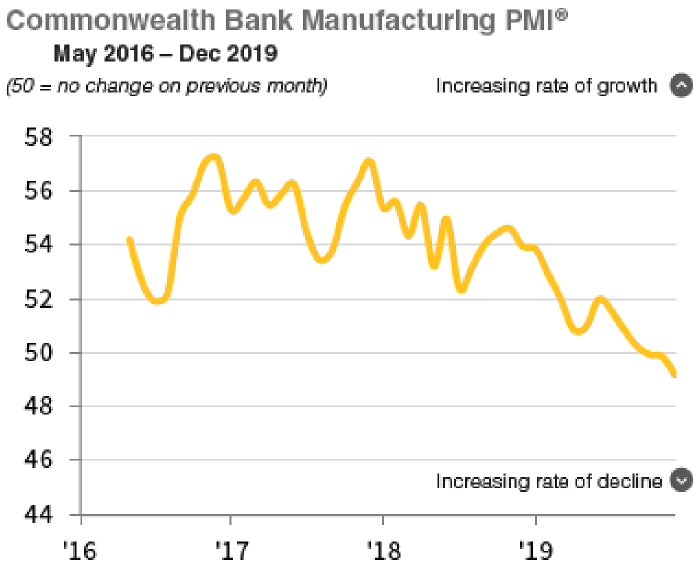


https://www.rba.gov.au/statistics/frequency/fin-agg/2019/fin-agg-1119.html

CBA Manufacturing PMI Final (Dec)

Manufacturing conditions continued to deteriorate in Dec with the PMI falling further into contraction. Record low readings (note the very short history though) were also recorded for output and new order growth.

Headline Manufacturing PMI; Dec 49.2 versus Nov 49.9



Underlying demand deteriorated with new orders and output declining. Firms reduced inventory and purchasing in light of weaker demand conditions. As a result employment was also reduced.

Confidence and expectations remained up-beat;

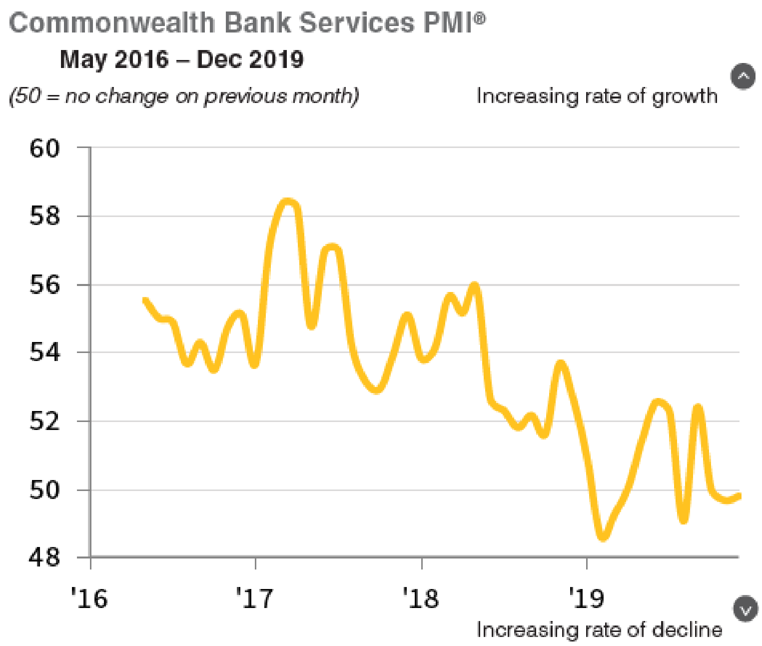
> "Despite signs of weakening conditions, goods producers were at their most upbeat for five months regarding output in the year ahead. Expectations of improved economic conditions, higher sales projections and marketing activities were cited as factors driving growth"

https://www.markiteconomics.com/Public/Home/PressRelease/c2a2668a15994498b5125bbe23cbef20

CBA Services PMI Final (Dec)

The headline index indicated that service activity continued to contract in Dec, albeit at a slightly slower pace of decline.

Headline Business Services Index; Dec 49.8 versus Nov 49.7



The reports cites 'drought related disruptions' and subdued sales growth as reasons for the weaker overall activity.

The weaker activity was the main reason behind the decline in employment in Dec. Firms cited restores and layoffs.

Despite the weaker output, orders continued to increase.

> "Total new business intakes rose at the fastest rate for three months, supported by a recovery in export orders."

Optimism was also more robust – just over 50% of respondents expect higher activity over the next 12-months.

"Optimism was mainly connected to expectations of an improved economic environment, new product launches, marketing strategies, planned business expansions and better weather conditions"

https://www.markiteconomics.com/Public/Home/PressRelease/69c0cdd7c01b4acab4ef638678ddc980

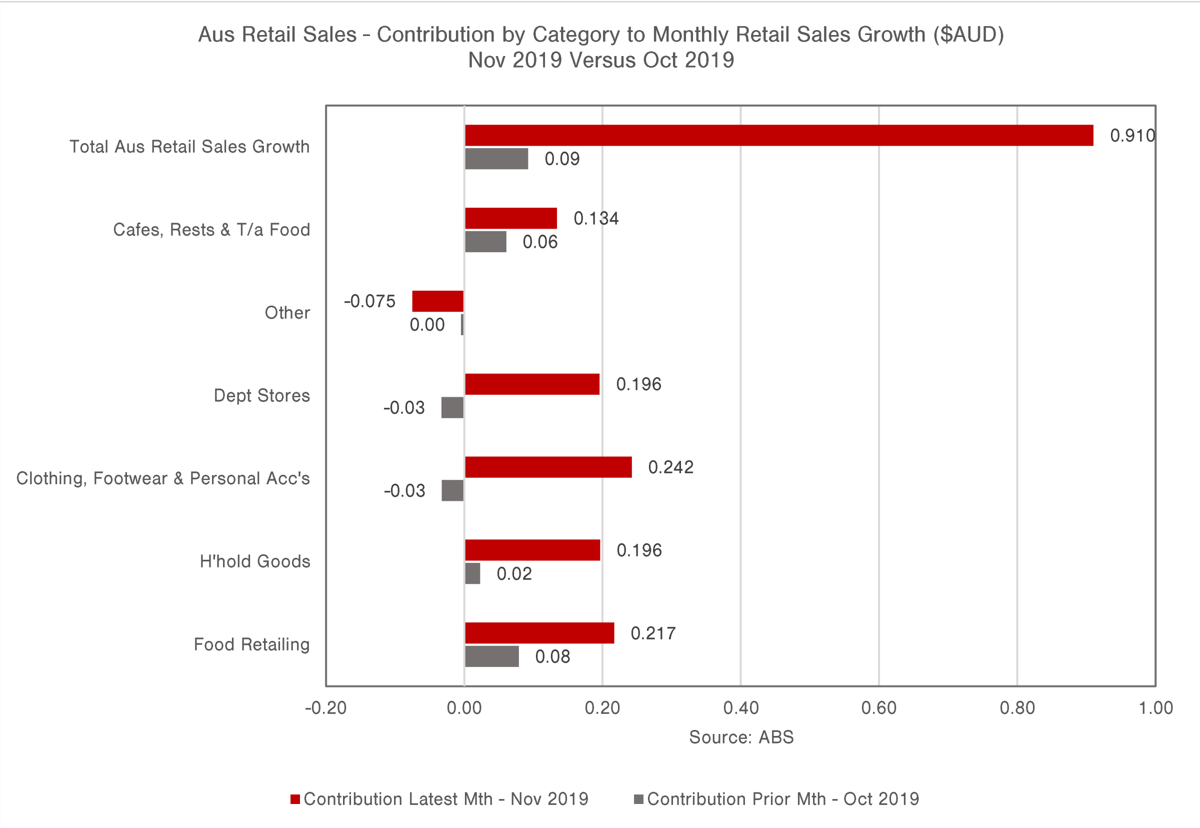
Aus Retail Sales (Nov)

Aus retail sales growth was much stronger in Nov mostly on the back of 'Black Friday' promotions (a relatively new concept in Aus). Growth in sales was stronger across the categories with the only exception, 'Other'. The overall stronger result for Nov comes on the back of weak Oct result. The Dec retail sales data will be important to gauge whether or not this strong Nov has brought forward holiday shopping patterns. But note that so far, Oct and Nov retail sales growth has been stronger than that of the respective months in 2018.

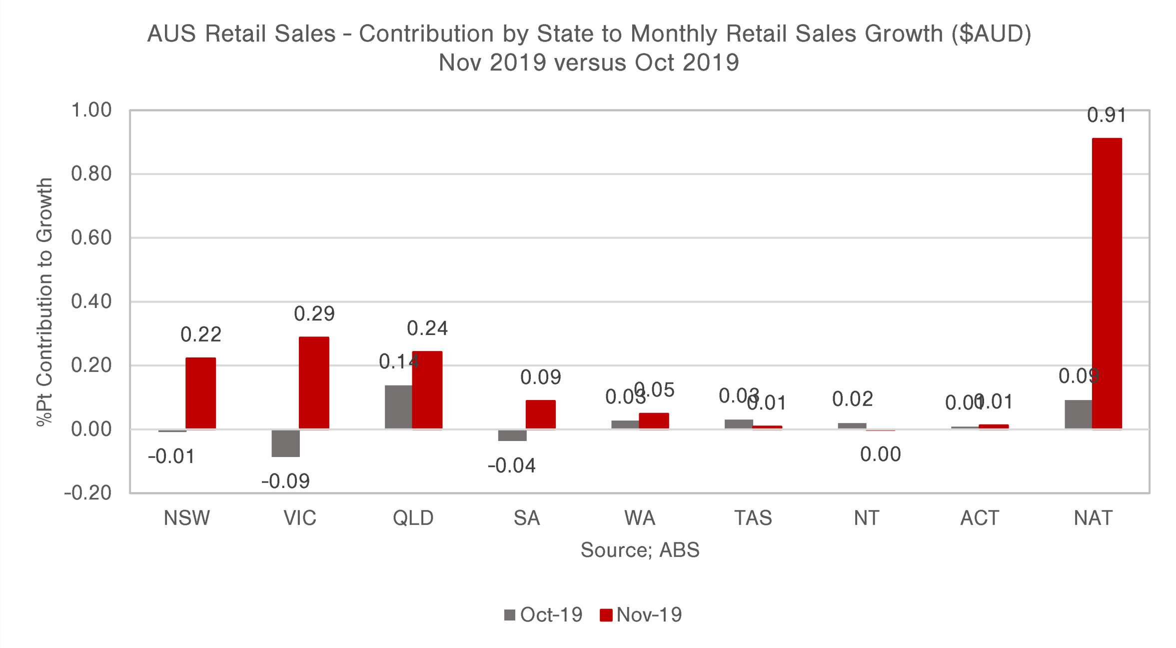
Retail sales (value) – month change; Nov +0.9% versus Oct +0.1%

In the year prior (Nov 2018), retail sales growth was much weaker, recording zero growth on a monthly basis.

Retail sales growth was much stronger this month across most categories;

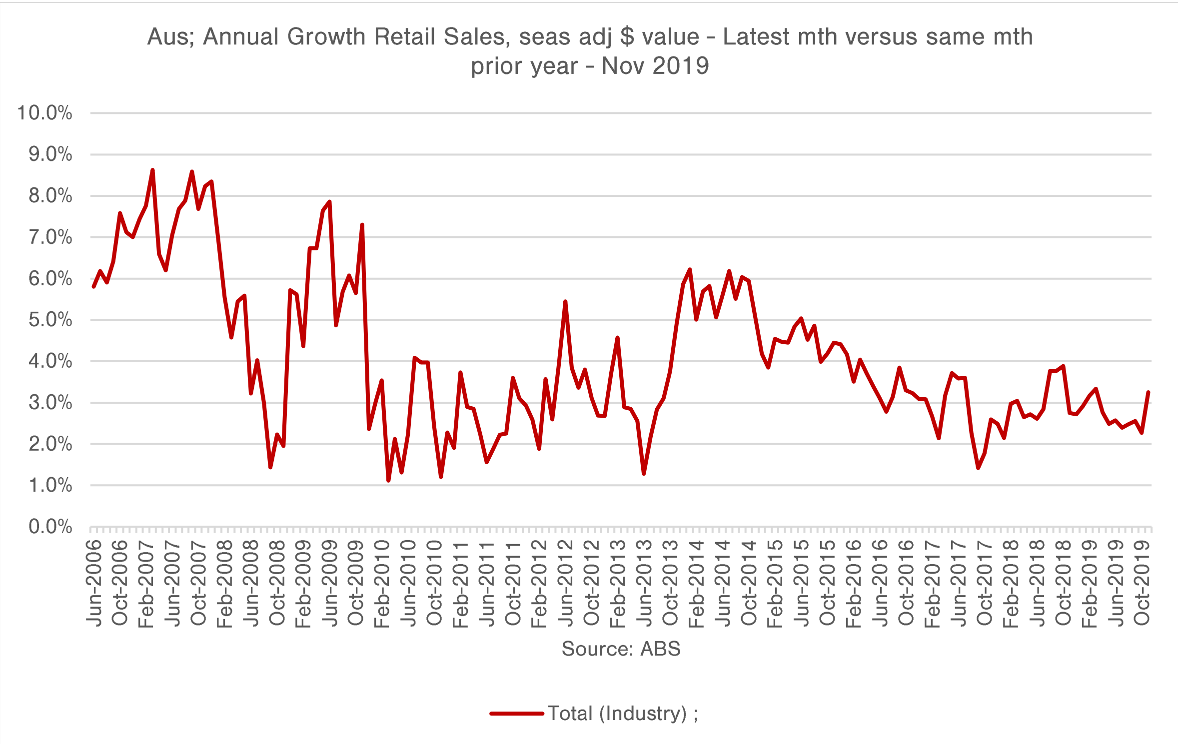


Similarly, on a state basis retail sales performance was stronger across most states. Sales still declined in the Northern Territory. Growth was higher than the National average across Vic, QLD and SA.



Retail sales (value) – annual change; Nov +3.2% versus Oct +2.3%

The annual growth in retail sales jumped in Nov;



https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/79EACA2718D0318ACA2581AF001493AA?OpenDocument

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NBS Manufacturing PMI (Dec)

There was little change in the pace of manufacturing activity growth in Dec. The headline PMI continued to indicate marginal growth in overall manufacturing activity. An improvement in activity for medium sized firms helped to offset a further decline in manufacturing activity for smaller firms. Manufacturing activity grew at a slower, more marginal pace for the largest firms.

Headline Manufacturing PMI; Dec 50.2 versus Nov 50.2

Production increased at a faster pace. This was likely aided by further growth in new orders (albeit at a slightly slower pace) and a further decline in open orders. Inventory of finished goods continued to decline at a faster pace.

New export orders posted the first marginal increase of the last twelve months.

The import index also continued to improve (now just under the neutral/no growth level) – possibly reflecting improved demand conditions.

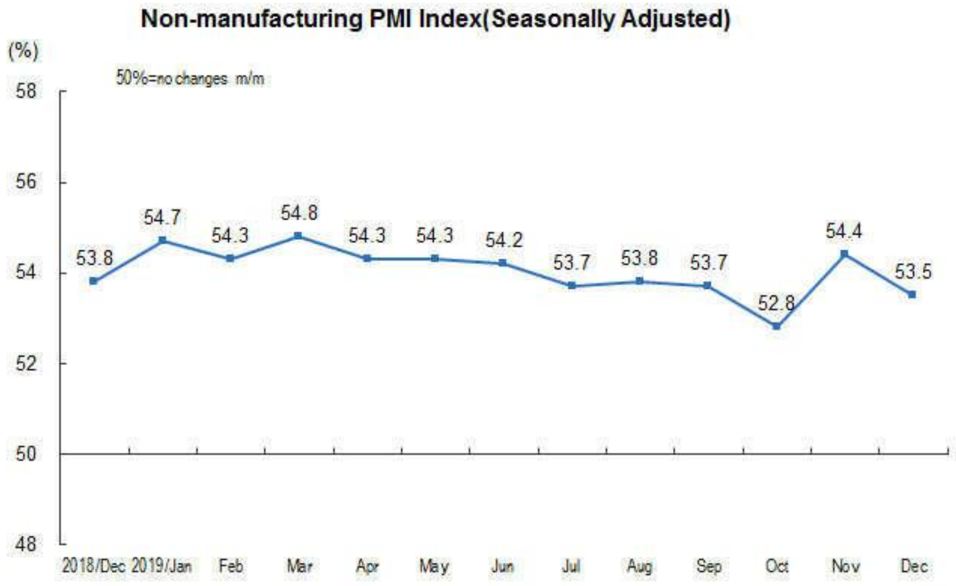
Despite the improvement in activity, employment continued to decline, recording the same pace of decline in Dec as in Nov and Oct.

http://www.stats.gov.cn/english/PressRelease/202001/t20200102_1720899.html

NBS Non-Manufacturing PMI (Dec)

The NBS Non-manufacturing PMI indicated that while activity continued to expand, the pace of growth slowed. That pace of growth in Dec was more in line with the prior twelve-month average.

Headline Non-Manufacturing PMI; Dec 53.6 versus Nov 54.4



From an industry perspective -

> Non-manufacturing business activity index of service industry was 53.0 percent, lower 0.5 percent point than last month. Of which, the indices of railway transportation, accommodation, telecommunication, broadcast, television and satellite transmission services, internet software and information technology services, financial intermediation, leasing and business services were more than 55.0 percent, and the business activities were more active; that of wholesale, real estate and other industries were in the contraction range.
>
> The business activity index of the construction industry was 56.7 percent, down by 2.9 percentage points from the previous month, maintaining a high level of prosperity.

This month, the slower growth was the result of slower growth in new orders, new foreign orders and employment. New orders slowed to record only marginal growth. New export work and employment contracted at a faster pace.

Output growth was likely aided by a further decline in unfilled orders.

Input price growth also slowed.

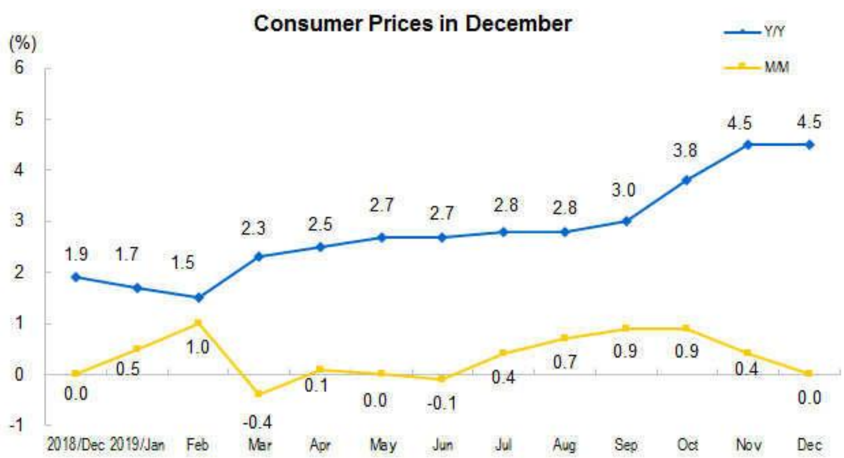
The only subindex that was higher than the headline non-manufacturing PMI was business activities expectation index – which registered 59.1 in Dec, somewhat lower than the 61 reading of Nov. All of the other index components of the non-manufacturing PMI were below the headline 53.5 in Dec.

http://www.stats.gov.cn/english/PressRelease/202001/t20200102_1720899.html

China CPI (Dec)

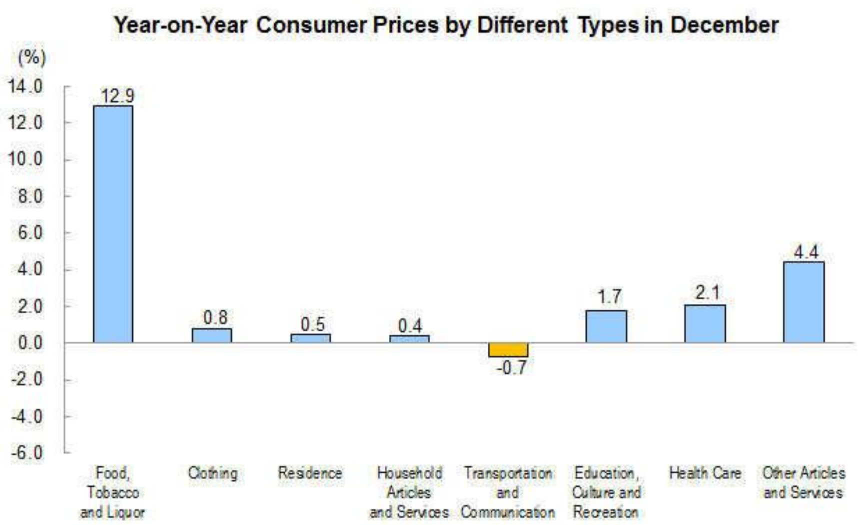
On an annual basis, consumer price growth was unchanged from the month prior. On a monthly basis, consumer price growth was flat. Over half of the annual increase can still be attributed to the acceleration in meat prices. But on a monthly basis, meat prices declined (including a 5.6% decline in pork prices for the month).

Consumer Prices – annual change; Dec +4.5% versus Nov +4.5%



Annual change in consumer prices by category

The 66% increase in meat and livestock prices contributed approx. 2.94% pts to the headline 4.5% annual growth in consumer prices.



http://www.stats.gov.cn/english/PressRelease/202001/t20200110_1722189.html

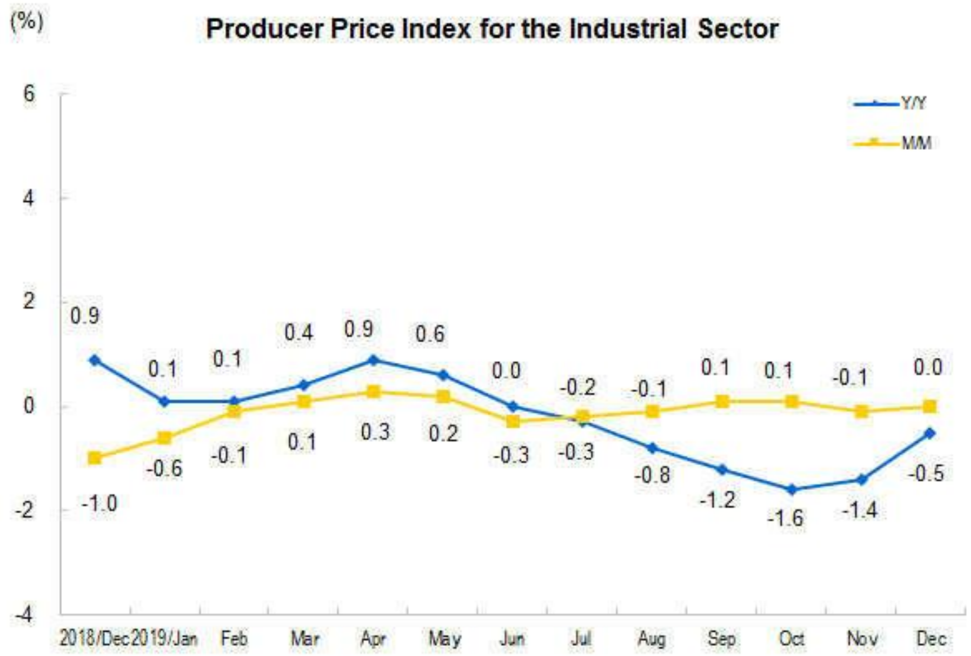
China PPI (Dec)

Producer prices continued to decline on an annual basis, but the pace of decline slowed notably. Producer prices continued to decline for the means of production on an annual basis, but were unchanged in the month. Producer prices for consumer goods continued to increase, but at a slower pace on an annual basis, but declined on a monthly basis.

Input prices continued to decline across abroad range of inputs on an annual basis.

Producer Price Index for Manufactured Goods – annual change; Dec -0.5% versus Nov -1.4%

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



On an annual basis, prices for the means of production declined by 1.2% after declining by 2.5% in Nov. This was led by a decline in prices for raw materials and processing. On a monthly basis, prices were unchanged.

The means of subsistence (producer prices for consumer goods) prices increased by +1.3%, slowing from +1.6% in Nov. Food prices increased, but prices declined across clothing, articles for daily use and durable consumer goods. On a monthly basis, the producer prices for consumer goods declined across all four groups.

Producer Prices by Industry

On an industry basis, producer prices declined across the manufacture of textiles, mining & washing of coal, manufacture of chemical raw materials, processing of petroleum and manufacture of chemical fibers. Producer prices continued to decline across manufacture of motor vehicles (-0.8%) as well as communication/computer equipment (-2.6%).

Purchaser Prices

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

Purchaser prices also continued to decline at a total level and on an annual basis. Prices were unchanged on a monthly basis. The annual decline was led by declines in fuel and power prices, non-ferrous metal materials, chemical raw materials, wood & pulp and textile materials.

http://www.stats.gov.cn/english/PressRelease/202001/t20200110_1722193.html

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Trade

US-China Trade Talks

It is expected that the phase one of the trade agreement will be signed on 15 Jan this coming week. Text for the agreement (English version) will also be released by US officials.

> White House officials had said as late as Friday that the final Chinese text was not yet completed, even as invitations went out to more than 200 people for a Jan. 15 signing event at the White House.
>
> Asked if he still expected China to purchase $40 billion to $50 billion in U.S. farm products under the deal, Mnuchin said: "I do. Let me just say, it is $200 billion of additional products across the board over the next two years, and, specifically in agriculture, $40 billion to $50 billion."
>
> Thus far**, Beijing has not confirmed those purchase commitments, and recent government actions here in the agriculture industry have raised questions over the $40 billion to $50 billion target** cited repeatedly by Trump administration officials.
> https://mobile.reuters.com/article/amp/idUSKBN1ZB0LU?__twitter_impression=true

Decisions regarding the commencement of phase two negotiations will likely be made by/before the implementation of the first phase of the deal. Phase two is expected to deal with the existing tariffs, as well as restrictions on digital trade, subsidies for Chinese-state owned companies and cyber-security.

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

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

New EU commissioners are now in place and there will likely be progress on the US-EU trade negotiations, as well as Brexit/EU-UK trade deal negotiations.

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 6-8 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

and

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/january/public-hearing-proposed-action-frances-digital-services-tax-0

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

The revised draft USMCA agreement was approved in the House prior to the holiday break. The agreement was expected to be voted on in the Senate early in Jan 2020, but it is likely that a Senate vote will not occur for another week;

> The Senate is unlikely to vote on the U.S.-Mexico-Canada Agreement next week because several committees have yet to review the deal, Senate Finance Chairman Chuck Grassley (R-IA) said on Thursday. The USMCA implementing bill, approved earlier this week by the Senate Finance Committee, has also been sent to the Health, Education, Labor and Pensions; Environment and Public Works; Appropriations; Foreign Relations; Commerce, Science and Transportation; and Budget committees. https://insidetrade.com/daily-news/grassley-full-senate-usmca-vote-unlikely-next-week-due-committee-markups?utm_source=dlvr.it&utm_medium=twitter

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 has now been decided and Brexit is 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

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