MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 18 May 2020

Key Themes

The prelim PMI's for May suggest that the pace of the falls in output may have started to abate across the US, Eurozone, and UK. The 'slower pace of decline' in this case means that more firms are starting to record increases in output (from a low base) and less firms are recording declines in output. But for the moment, the firms reporting declines still outnumber the firms reporting increases. Those declines are also on top of the severe Apr declines.

In the US, output across services declined at a slightly slower pace than in manufacturing. The weekly initial claims data is yet to show any recovery. The initial claims for wk ending 15 May remained extremely elevated with 2.4m new initial claims recorded. There was a similarly large increase in the number of continuing claims for the prior week. While existing home sales fell sharply in Apr, housing market conditions, and mortgage applications data suggests that the market likely stabilized in May.

This "improvement" in the PMI's in the form of a slower pace of decline was far less pronounced in Japan and Australia.

The prelim Japanese PMI for May indicated that activity continued to decline at a similar severe pace as in Apr. The services output index remained in the 20's, indicating that services activity continues to contract at an extremely sharp pace. Manufacturing output continued to decline at an accelerated pace. The decline in Q1 GDP indicates that in all likelihood, Japan is already in a recession. So far Q2 performance appears to be worse. Exports declined by over 20% in Apr (value). The PMI's for Apr and May indicate an even more severe contraction in output. The National emergency was issued in Apr and it's likely that this will end by early Jun. Stimulus payments were approved in Apr and its likely that a further round of support will be announced shortly.

The prelim PMI for Australia was also concerning with the composite output index remaining in the 20's. Services output recorded a slightly slower pace of decline, from a low output index level of 19 in Apr. But manufacturing output continued to decline at an accelerated pace. High frequency payrolls data indicates that employment declined at a slightly faster pace in the first week of May. The prelim Apr retail turnover shifted sharply negative in the month with retail sales likely declining across most segments. Quarantine restrictions continue to be eased across the country in late May and are planned to ease further from early Jun.

A further blow to the Aus economy will the exports impacted by measures recently announced by China on barley tariffs, beef export restrictions, and slower thermal coal exports. This week the Aus government also announced that benefits of the JobKeeper program had been significantly overstated – more like 3.5m rather than 6m recipients or a $60bn spend rather than a $130m spend. Whilst that might reflect a "saving" to the budget, it also means less people receiving support during a significant economic downturn.

Since the GFC especially, spending by China had been an important driver of global growth. At the National People's Congress over the weekend, and for the first time since 1994, the growth target was omitted. In a speech, Premier Li Keqiang explained why;

> "because our country will face some factors that are difficult to predict," pointing to the coronavirus and uncertainties around trade. But Mr. Li said the lack of a target "will enable all of us to concentrate on ensuring stability…and security."

This comes at a time when China has been increasingly singled out for its role in the spread of Covid-19, as well as now for the renewed security crackdown on Hong Kong.

Contents

US Data

Initial and Continuing Jobless Claims wk. ending 15 May

The increase in initial unemployment claims continues to be measured by the millions. Quarantine restrictions are just starting to be eased across most states.

Advance Claims wk ending 15 May 2020 (SA); 2,438,000 people

Advance claims from the week prior were revised lower by 294k claims to 2,687,000 claims.

The total number of new claims made over the last nine (9) weeks is now 38,636,000.

The increase in continuing claims (insured unemployment) was larger this week.

Advance Claims for Insured Unemployment at wk ending 9 May 2020 (SA); 25,073,000

This is a 2,525,000 increase in continuing claims in the week. The insured unemployment rate increased to 17.2%.

> The highest insured unemployment rates in the week ending May 2 were in Nevada (23.5), Michigan (22.6), Washington (22.1), Rhode Island (19.9), New York (19.6), Connecticut (19.3), Puerto Rico (19.2), Mississippi (18.8), Vermont (18.8), and Georgia (18.5).

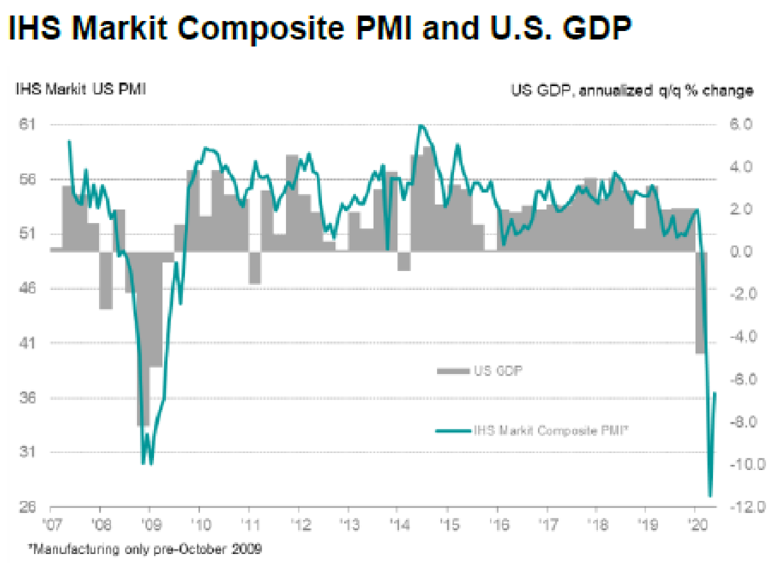
https://www.dol.gov/ui/data.pdf

Markit Prelim Manufacturing & Services PMI (May)

The prelim composite output index indicated that output likely continued to decline in May across private sector services and manufacturing firms. The pace of decline in May did moderate, but still indicated another notable contraction in activity. Both services and manufacturing output contracted at this slower, but yet still steep pace.

The reference week for data collection was 12-20 May.

Headline composite output index; May 36.4 versus Apr 27



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

Services Business Activity Index; May 36.9 versus Apr 26.7

The decline in services output in May was not as steep as in Apr, but it was still a severe decline, nonetheless. Total sales declined sharply based on weaker domestic and foreign demand. Firms continued to place workers on furlough or reduced workforces at another marked pace. Firms continued to cut output charges.

Manufacturing PMI; May 39.8 versus Apr 36.1

The manufacturing output index also recorded a further decline, albeit at a slightly slower pace; May 34.1 versus Apr 28.8. This was still a substantial pace of decline. New orders also continued to decline. Backlogs of work continued to fall. Firms also reduced employment (furlough, lay-offs, and decreased hours) at a "historically sharp pace". Output charges and input costs both continued to decline.

https://www.markiteconomics.com/Public/Home/PressRelease/3ea9e157cc5d447c9ecbb1ad5037cbf6

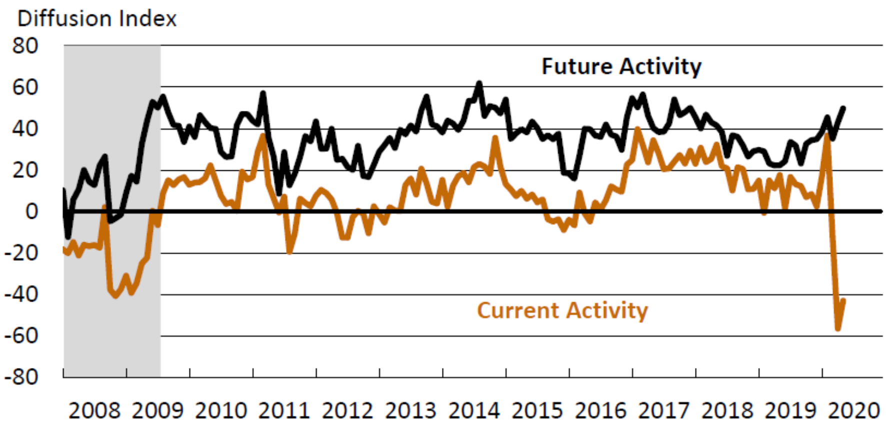
Philly Fed Manufacturing Survey (May)

The pace of decline in manufacturing activity moderated in May after the very sharp decline in Apr. Shipments and new orders both continued to decline at a relatively steep pace, but not as fast as in Apr. On a positive note, the expectation for future activity continued to indicate that firms expect activity to be higher in six months' time.

General Business Activity; May -43.1 versus Apr -56.6

The vast majority of firms (58%) still reported decreases in activity again this month (last month it was 60%). There was a larger number of firms reporting increases in activity this month, increasing from 3.5% last month to 15% this month.

Current and Future General Activity Indexes
January 2008 to May 2020



Note: The diffusion index is computed as the percentage of respondents indicating an increase minus the percentage indicating a decrease; the data are seasonally adjusted.

The main indictors of activity and demand still declined in May, but at a slower pace.

New orders shifted from a historic decline of -70.9 in Apr to -25.7 in May. Again, the majority of firms still reported decreases in new orders (but improving from 70% of firms in Apr to 50.9% of firms in May). In Apr 0% of firms had recorded an increase in new orders – this has now shifted back to up to 25% of firms reporting an increase in orders in May.

The results were similar for shipments. Whilst still declining, the pace of decline slowed.

Unfilled orders continued to decline at a similar pace in May. Delivery times also shifted back into decline.

Inventories increased as more firms reported an increase in inventories.

After falling in the month prior, prices paid for raw materials increased in May. Prices received continued to contract, albeit at a slower pace.

Employment declined at a slower pace. Last month, 0% of firms reported any increase in the number of employees. This month, at least 8.5% of firms reported an increase in employees. Last month 46% of firms reported a decrease in the number of employees and in May, this was lower at only 23% of firms reporting a lower number of employees. The majority of firms (64%) now report no change to employment levels – after the large decline in the month prior.

This is a similar result for hours worked. The number of hours still declined, but at a slower pace than in Apr. More firms reported higher hours and less firms reported lower hours. But the majority of firms (61%) report no change in hours after the prior months decline.

In terms of outlook, more firms (62%) expect an increase in activity in six months' time. This is up slightly from 53% of firms in Apr.

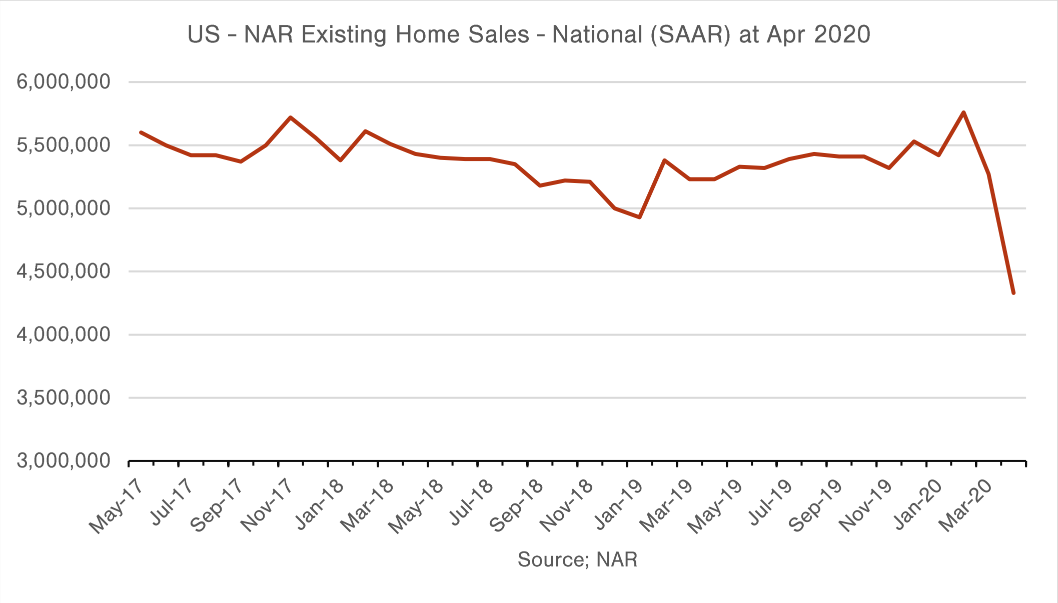
https://www.philadelphiafed.org/-/media/research-and-data/regional-economy/business-outlook-survey/2020/bos0520.pdf?la=en

Existing Home Sales (Apr)

Existing home sales declined sharply in Apr (SAAR basis). The monthly decline was strongest in the West and the South.

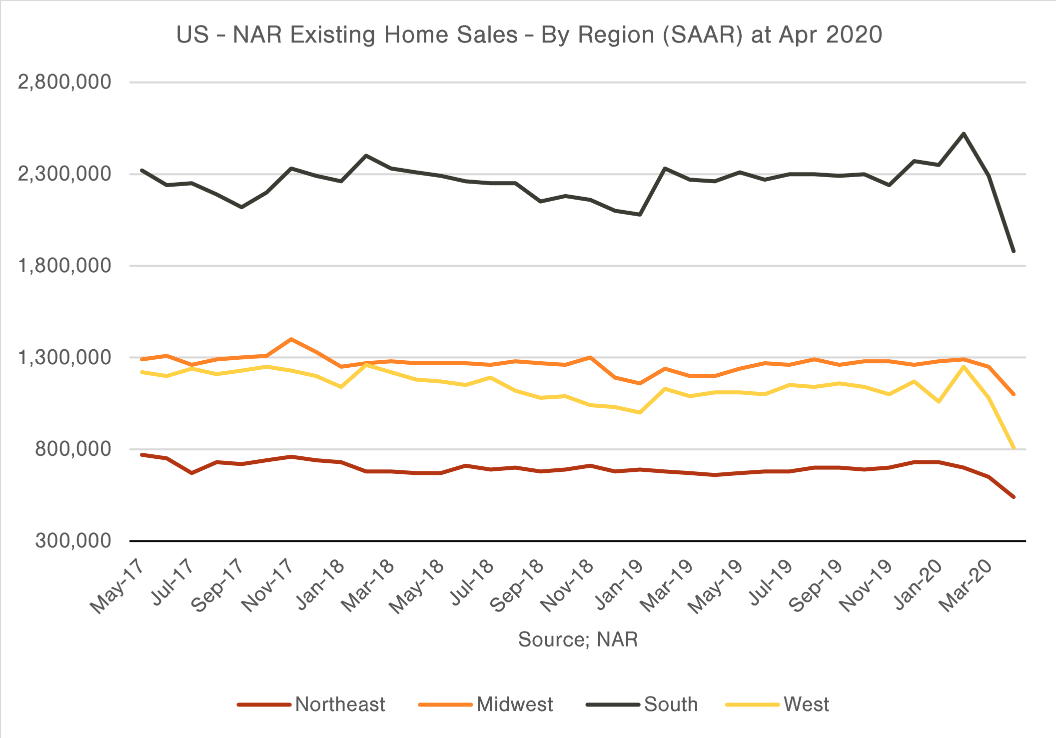
Existing Home Sales – SAAR; Apr 4.33m (-17.8%) versus Mar 5.27m

The seas adj annual pace of sales in Apr fell to -17.2% below the same month a year ago;



On a regional basis, the largest decline in existing home sales was recorded in the South with sales declining by -410k (-17.9%) versus the month prior. Sales in the West declined by -25% or -270k on a SAAR basis.

Declines in the North East and Midwest were -16.9% and -12% respectively;



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

Weekly Mortgage Applications wk. ending 15 May

The number of mortgage applications declined in the latest week. Refi activity also slowed. Emphasis added;

> Despite mortgage rates remaining close to record-lows, refinance activity slid to its lowest level in over a month. The average loan amount for refinances fell to its lowest level since January - **potentially a sign that part of the drop was attributable to a retreat in cash-out refinance lending as credit conditions tighten**. We still expect a strong pace of refinancing for the remainder of the year because of low mortgage rates. With many homeowners still facing economic and employment uncertainty, these refinance opportunities will allow them to save money on their monthly payments, which can then be used to help other areas of their budgets."

Mortgage market composite index (loan application volume) wk ending 15 May; -2.6% versus the week prior.

Refi index declined by 6% versus the week prior. The refi index remains +160% above the same week a year ago. The share of refis within mortgage activity fell to 64.3% from 67% a week ago.

The purchase index (the measure of the number of loans finalised and a leading indicator of home sales) increased by 6% versus the week prior (after increasing by 11% last week).

> Applications for home purchases continue to recover from April's sizeable drop and have now increased for five consecutive weeks. Purchase activity - which

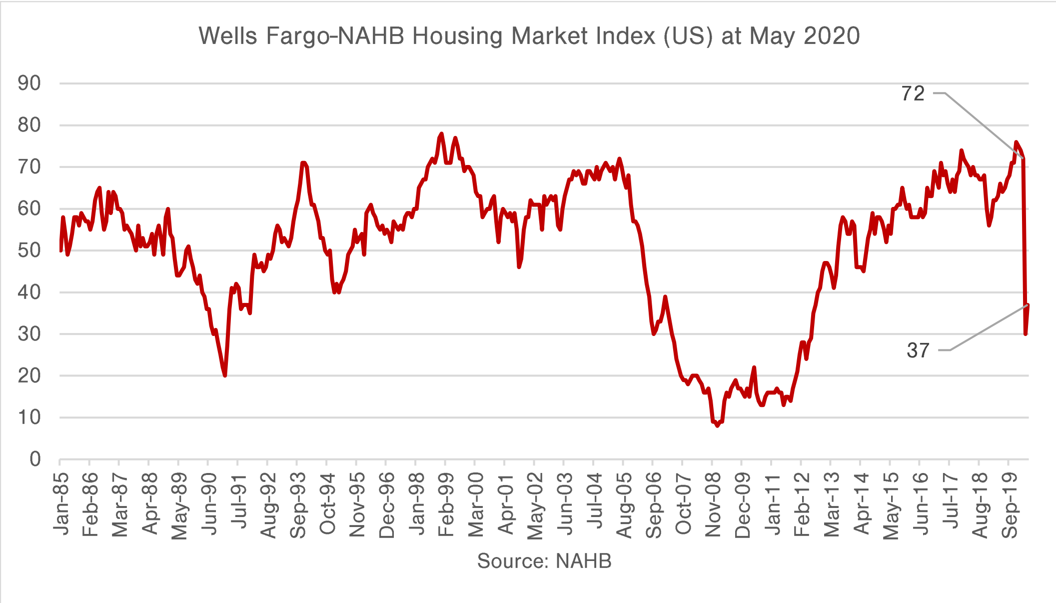
was 35 percent below year-ago levels six weeks ago - increased across all loan types and was only 1.5 percent lower than last year,"

https://www.mba.org/2020-press-releases/may/mortgage-applications-decrease-in-latest-mba-weekly-survey

NAHB Housing Market Conditions (May)

As indicated by the improvement in mortgage application data over the last few weeks, the housing market conditions index also improved. While the levels remain low, all index components contributed to the improvement in the month. Regional conditions were somewhat mixed though – conditions in the North East continued to deteriorate, while conditions in the West improved by a greater degree. Conditions in the Midwest and South improved in line with the headline index;

Headline Housing Market Index – month; May 37 (+23%) versus Apr 30



Performance of Index Components;

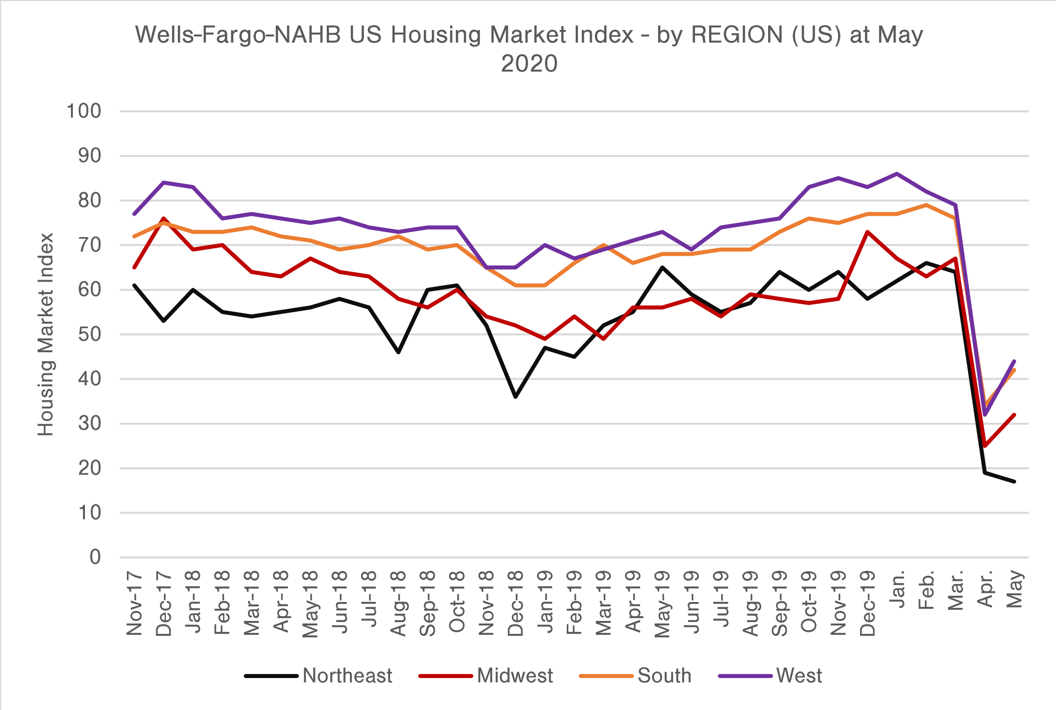
The index of conditions for single-family home sales increased less than the growth in the headline index; May 42 (+17%) versus Apr 36

Expectations for the next six months – single family home sales; May 46 (+28%) versus Apr 36

Traffic of Prospective Buyers – the increase in percentage terms was much larger, but coming from a low base; May 21 (+62%) versus Apr 13. The traffic of prospective buyer's index reached a near-term peak of 58 back in Jan 2020.

Regional Performance;

Regional conditions were somewhat mixed though. Conditions in the North East continued to deteriorate, while conditions in the West improved by a greater degree. Conditions in the Mid-west and South improved in line with the headline index.



https://www.nahb.org/News-and-Economics/Housing-Economics/Indices/Housing-Market-Index

Housing Starts (Apr)

Prelim Apr data for new housing permits and housing starts declined at an accelerated pace.

The results this month were notable (unusual) in that the 90% confidence intervals (at a National and most regional levels) did NOT include zero, indicating that there was likely enough evidence to suggest that the change was different to zero i.e. confirming the decline.

<u>New Housing Permits – month (at a seas adj ann rate):</u> Apr 1.07m versus Mar 1.36m

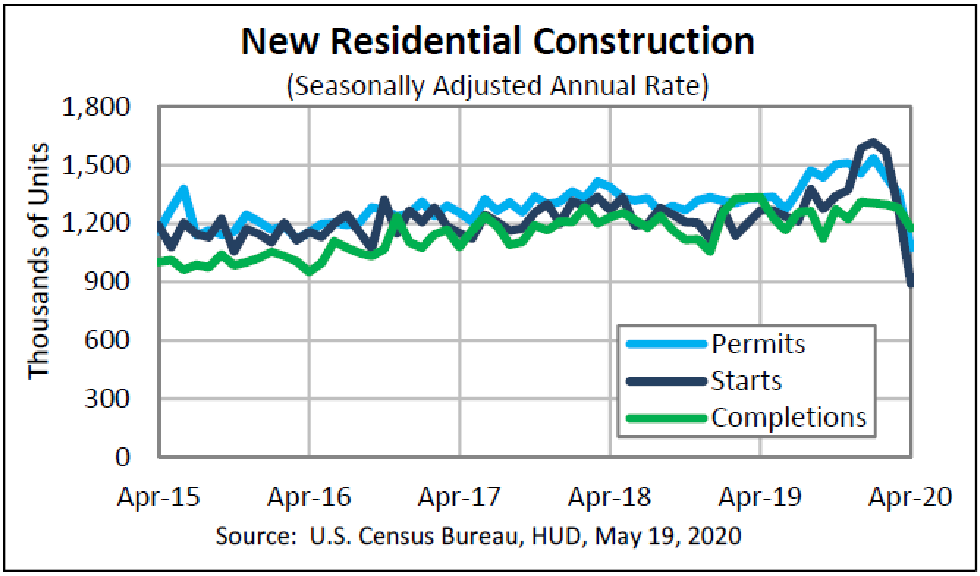
The fall in permits between Apr and May was -20.8% and the 90% confidence interval was +/- 0.9% pts.

Declines were recorded across all regions.

<u>Housing Starts – month (at a seas adj ann rate):</u> Apr 891k versus Mar 1.276m

The fall between Apr and Mar was -30.2% and the 90% confidence interval was +/- 11% pts.

Declines were recorded across all regions.



https://www.census.gov/construction/nrc/pdf/newresconst.pdf

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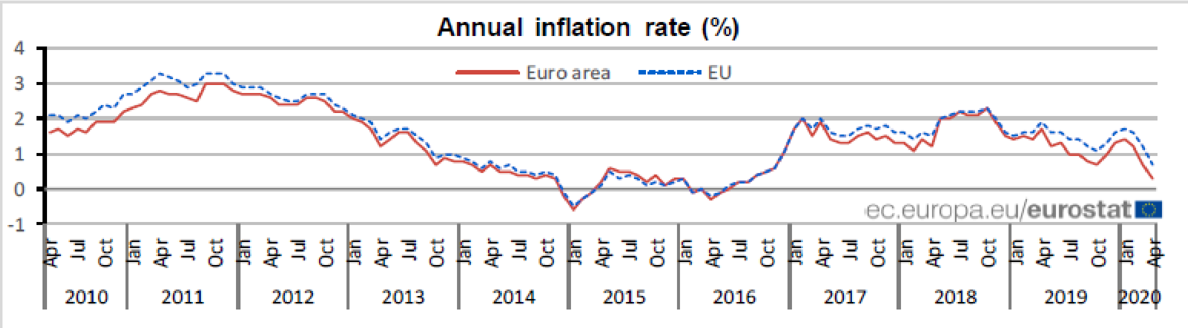
Europe

Eurozone CPI (Apr)

The annual growth in consumer prices slowed further across the Euro area. The largest downward contribution was from the fall in energy prices. Food, alcohol, and tobacco prices, including unprocessed food, continues to grow at an accelerated annual pace – and was the largest contributor to the headline pace of inflation.

<u>Euro area CPI – annual change;</u> Apr +0.3% versus Mar +0.7%



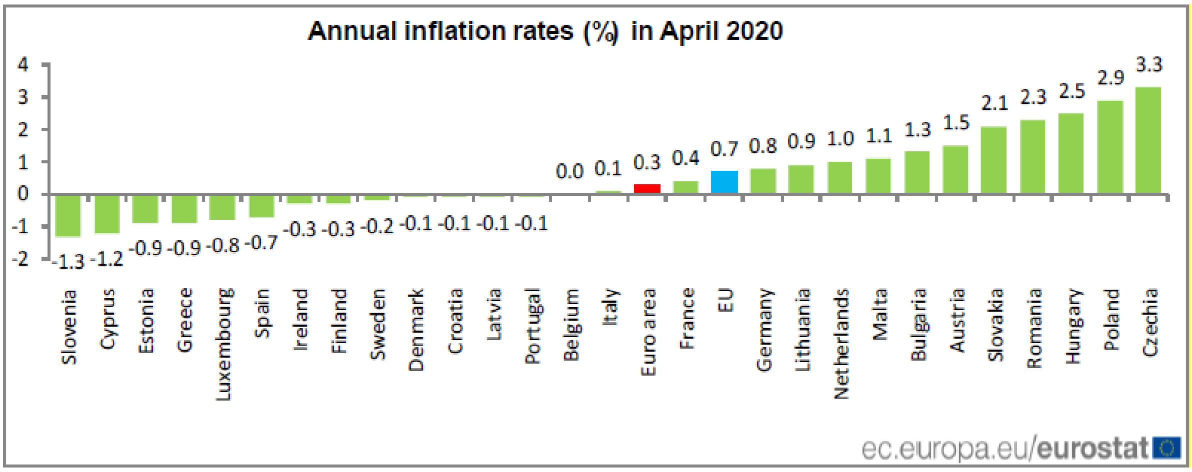
Food, alcohol, and tobacco prices increased at an accelerated annual pace in Apr of +3.6% versus +2.4% in Mar. Included in this is unprocessed food prices growing at an annual pace of +7.6% in Apr. Food, alcohol and tobacco prices made the single largest positive contribution to headline CPI growth, adding +0.67%pts.

This was offset by a 9.7% annual decline in energy prices. Energy prices detracted -0.97%pts from headline CPI.

Growth in services prices continued to slow in Apr to +1.2% versus Mar +1.3%. This is the largest weight of the CPI. The contribution to the headline CPI growth was lower at +0.52% pts.

<u>Member Country CPI</u>

Annual CPI growth in Apr by EU member;



https://ec.europa.eu/eurostat/documents/2995521/10294852/2-20052020-AP-EN.pdf/4d69f01b-fe9a-c248-2627-cc2059ca2f31

Eurozone Prelim Manufacturing and Services PMI (May)

The composite output index for the broader Eurozone indicated that output continued to decline, but at a slower pace. Both manufacturing and services output continued to decline, but that pace of decline eased across both sectors, especially across manufacturing.

Composite Output Index; May 30.5 versus Apr 13.6

New orders across both sectors contracted at a slower pace, but the pace of decline remained steep. Firms continued to reduce employment, but where possible, took advantage of furlough schemes. Expectations for activity in the next 12-months increased further, but pessimists continued to exceed optimists.

Services Business Activity Index; May 28.7 versus Apr 12

This was the slowest pace of decline in three months. Firms in industries such hospitality and consumer facing businesses continued to be hit the hardest.

Manufacturing PMI; May 39.5 versus Apr 33.4

Manufacturing output contracted at a slower pace this month with the output index rising to 35.4 in May from 18.1 in Apr. This is still a rapid pace of decline, but at least not as fast as the prior month as some firms recommence operations.

https://www.markiteconomics.com/Public/Home/PressRelease/7b038676295949b78d6114bb6005c368

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Japan

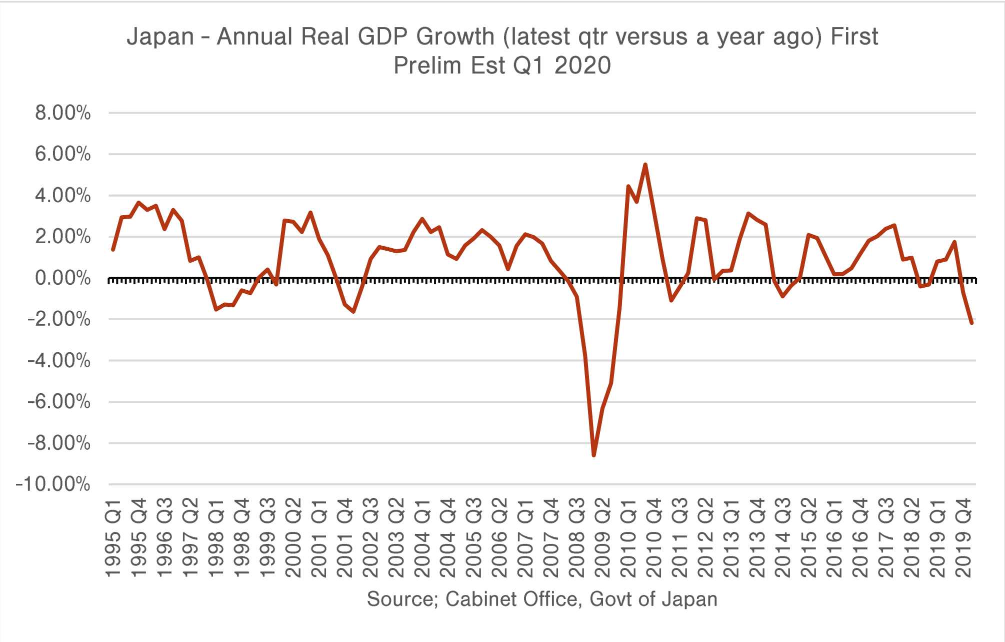
Japan GDP First Prelim Estimate - Q1 2020

Japanese GDP declined in the first prelim estimate for Q1. This means that the Japanese economy is now likely in a recession as this is the second consecutive quarter where GDP has declined.

The % decline in Q4 2019 was larger, driven in part by the increase in consumption tax. The effect is notable on private consumption. In Q1 2020 though, most areas of expenditure experienced a further decline, including net trade this time. Most social distancing restrictions were implemented late in the quarter, but external trade was impacted via quarantine restrictions undertaken by foreign trading partners.

<u>Real GDP – Quarter Change;</u> Q1 -0.9% versus Q4 2019 -1.9%

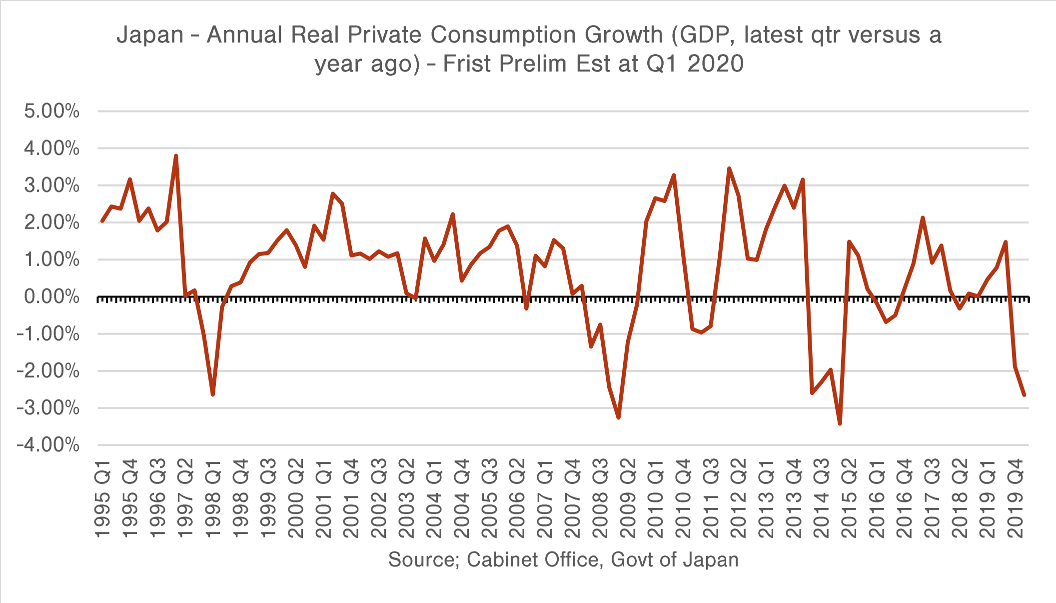
<u>Real GDP – Annual change</u>; Q1 -2.2% versus Q4 2019 -0.7%



<u>Q1 2020 – Expenditure Perspective</u>

<u>Private Consumption</u> – declined by -0.7% in Q1 (versus -3% in Q4). The decline was mostly all the result of a further decline in household consumption for the quarter.

Private/household consumption is still the largest component of GDP. On an annual basis (versus the same quarter a year ago), private consumptions declined by 2.6%.

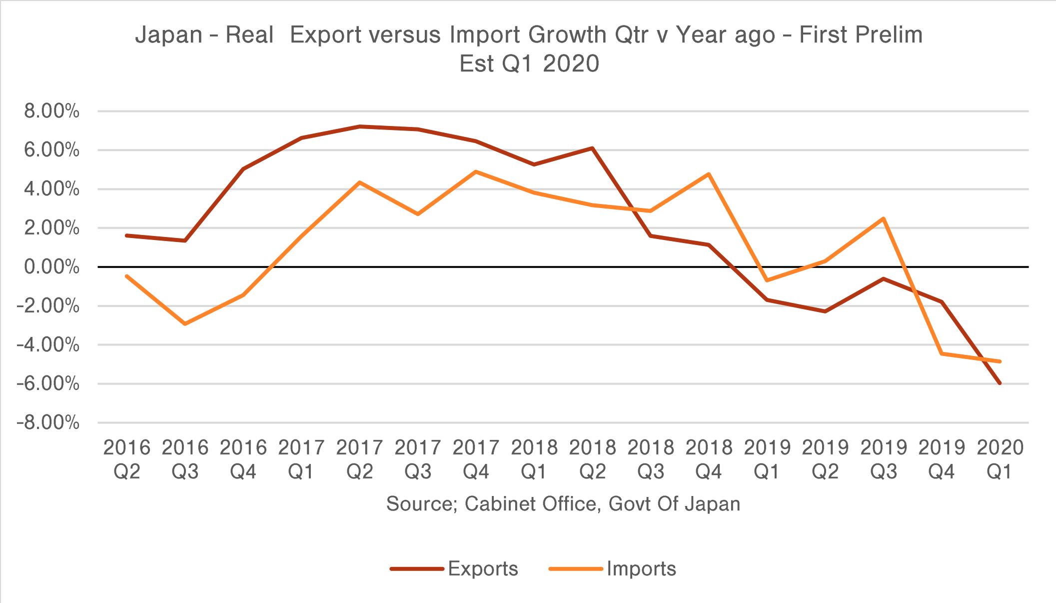


Investment Expenditure - private residential investment declined at a faster pace in Q1 by -4.5% versus -2.5% in Q4 2019. Private non-residential expenditure also declined in Q1 by -0.5%, a slower pace than -4.8% in Q4 2019. The change in private inventories was also a drag on Q1 growth, detracting -0.04%pts from GDP.

Government consumption expenditure increased slightly by +0.1% in Q1. Growth in Q4 2019 was higher at +0.2% growth. Government investment expenditure declined in Q1 by -0.4% after increasing by +0.5% in Q4.

Net Exports – The contribution from net exports shifted from positive in Q4 to negative in Q1. The impact in Q1 was the result of a larger decline in exports of -6% in real terms versus the +0.4% growth in the quarter prior. Major trading partners, such as China, were heavily impacted by Covid-19 restrictions from early in Q1. But imports into Japan also declined at a faster pace in Q1 by -5% versus -2.4% in Q4 2019 – likely due to a combination of disruptions to supply chains and lower demand throughout shutdowns.

The annual change in exports has been declining over the last five quarters and imports over the last two quarters;



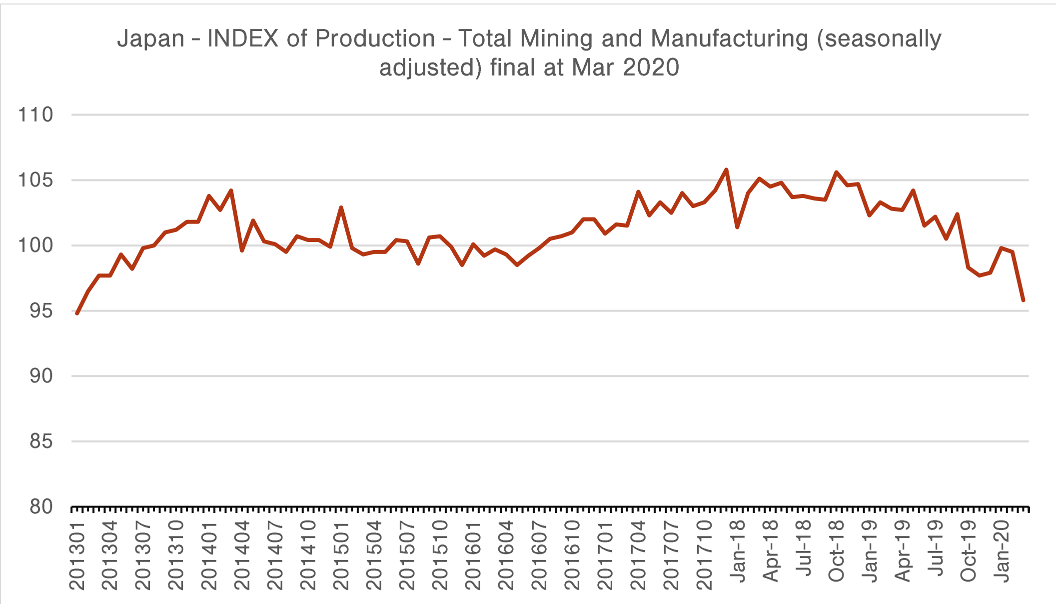
https://www.esri.cao.go.jp/en/sna/data/sokuhou/files/2020/qe201/gdemenuea.html

Japan Industrial Production Final (Mar)

The final industrial production report for Mar confirmed the decline in production and shipments through Mar. Production levels as of Mar declined to be back on par with levels recorded in 2013. The PMI's indicate that Apr production and shipments are likely to be worse.

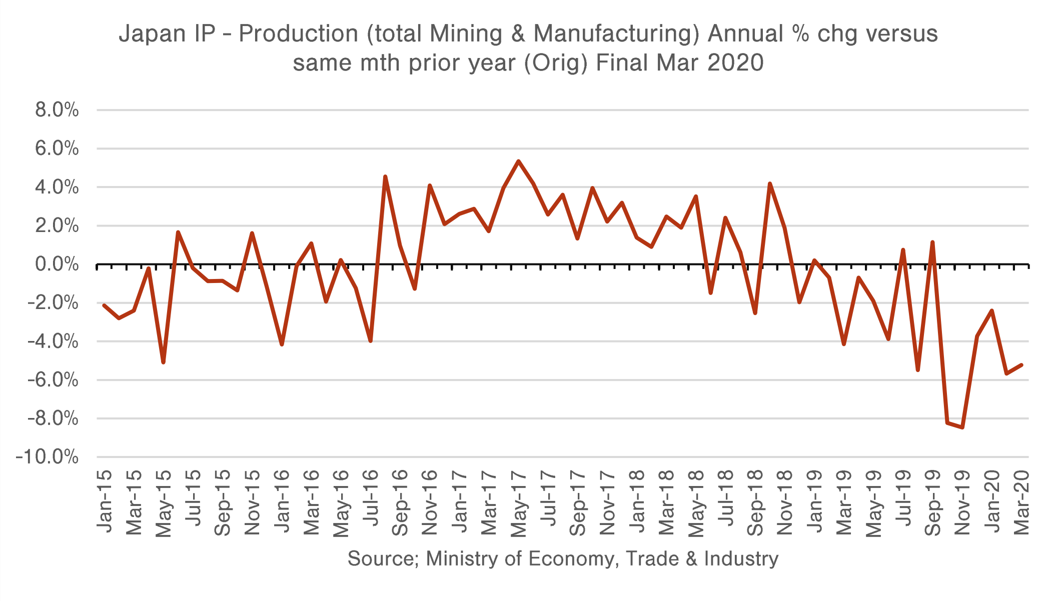
Total Industrial Production – month change; Mar -3.7% versus Feb -0.3%

The index of production had already been weakening since late 2018. Production levels as of Mar are back on par with 2013. The PMI's indicate that Apr will likely be worse.



Production was lower across all industry groups this month, including food and tobacco production which was down -0.3% (one of the largest weights in the index). The larger declines were recorded across iron and steel production, fabricated metals, production machinery (-10%), transport equipment (-4.3%, the largest weight group).

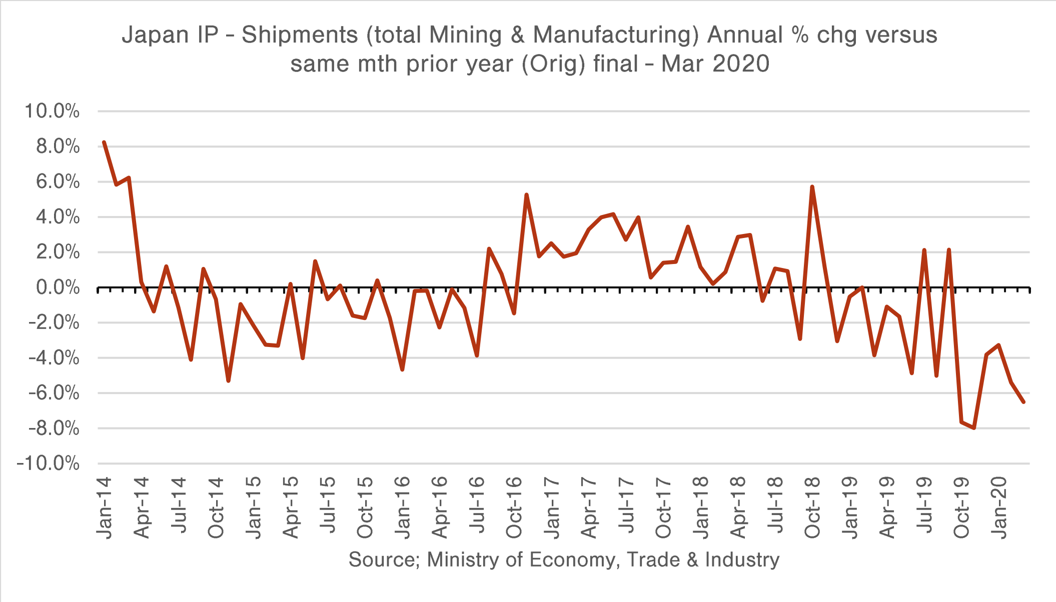
On an annual basis, production was -5.2% below a year ago as of Mar. In Feb, production was -5.7% below a year ago.



<u>Total Shipments – month change</u>; Mar -5.8% versus Feb +1%

Shipments also turned sharply negative in Mar with most industry groups recording lower shipments in the month. Shipments of production machinery (-13%) and transport equipment (-9%) were the main drivers. Petroleum shipments were also down by 7% and food and tobacco shipments down by -2.6%.

On an annual basis, total shipments declined at a faster pace of -6.5% in Mar versus -5.4% in Feb.



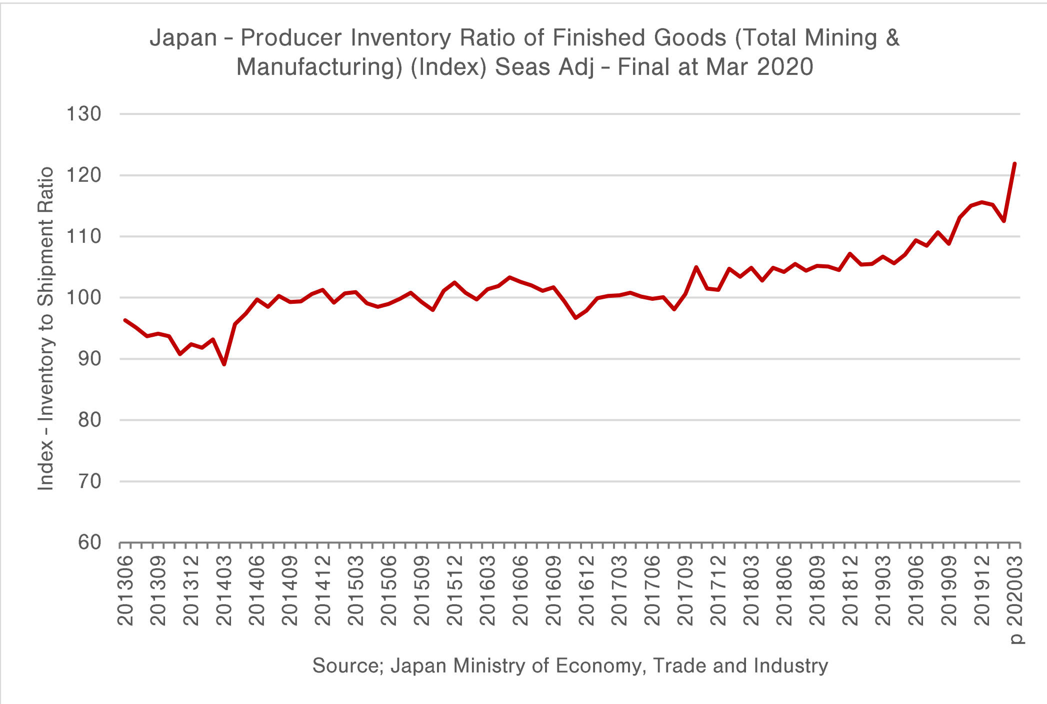
<u>Total IP Inventory – month change</u>; Mar +1.9% versus Feb -1.7%

Inventory was higher across most industry groups this month but not all groups. The most notable increase was transport equipment inventory +11.5%.

The largest industry weight for the inventory index is iron and steel and inventory growth was 1.8%, in line with the total. Similarly chemicals are the second largest weight item in the inventory index and inventory growth was lower at +0.6%.

The ratio of producer inventory of finished goods to shipments accelerated in Mar due to the decline in shipments and increase in inventory.

The finished goods inventory to shipment ratio reached a new near term high again in Mar;



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

Japan Merchandise Trade (Apr)

The goods trade balance shifted from a small surplus in Apr 2019 to a 900bn Yen trade deficit in May 2020. This was the result of a sharper fall in the value of exports versus a year ago – led by declines in machinery, transport equipment and electrical machinery exports to the US and Europe (especially). Both markets remained under various levels of quarantine in Apr.

Imports also declined versus a year ago, but by a smaller degree – the single largest (main) contributor to the decline in imports was mineral fuels (including petroleum). Imports from China actually increased by 11% versus a year ago as the country started to come out from quarantine.

All values in ¥.

Merchandise Trade Balance; Apr 2020 deficit 930bn versus a year ago Apr 2019 surplus 59bn

Underlying this shift into deficit (versus same time a year ago);

Exports – annual change at Apr 2020; -21.9% versus the same month a year ago

Imports – annual change at Apr 2020; -7.2% versus the same month a year ago

On a monthly, seas adjusted basis, exports declined by 10% in Apr versus Mar and imports were mostly flat month-on-month, up just +0.2%

EXPORTS

The value of Japanese exports declined by 21.7% versus a year ago.

Export Performance by Region

The top two export markets are the US and China. Exports to China started to recover as the Chinese economy started to ease quarantine restrictions – exports to China were down by -4% versus a year ago. Performance throughout Asia was mixed but overall down only -11% (a smaller decline than the total).

Exports to the US fell sharply versus a year ago – given that the economy remained mostly under quarantine restriction in Apr. Exports to the US declined by -37.8% in Apr versus a year ago.

Similarly, exports to Western Europe were down by -30.4% in Apr versus a year ago. Declines were larger across the UK, France, Italy, Sweden, and Spain. Exports to Germany were down by 22% - in line with the total decline in exports.

Exports to the Middle East did not decline by the same degree, falling by -6.2% versus a year ago.

Exports to Australia and NZ fell by 47% as both countries were under broad quarantine.

Export Performance by Commodity

Export of most commodity classifications declined in Apr versus a year ago.

The largest contributors to the decline were;

Transport Equipment – contributing -10.8% pts to the headline decline of 21.7% in exports. This equates to a 45% decline in transport equipment exports in Apr versus a year ago. Within transport equipment, motor vehicles were the single largest contributor to the decline with exports declining by over 50% versus a year ago.

Machinery – contributed -4.7%pts to the headline decline. Machinery exports declined by 23% versus a year ago.

Electrical machinery contributed -1.5% pts to the overall decline. Within electrical machinery, the export of semi-conductors continued to increase and were up +4.3% versus a year ago. This was offset by declines across other electrical exports.

Manufactured goods contributed -1.6% pts to the headline decline, as iron, steel, textile, paper, and rubber manufacture exports declined by 14.5% versus a year ago.

IMPORTS

The decline in imports was less severe than exports, falling by -7.2% versus a year ago. This may partly be the result of China production coming back online.

Import Performance by Region

Imports from China increased by +11.7% versus a year ago – and China is the single largest import market for Japan. Imports from Asia more broadly were up by +2.2%.

Imports from the US were up by 1.6%.

Imports from Western Europe were down by 11.5%.

Imports from the Middle East were down by 40% - most of which was a decline in the value of Mineral Fuel (incl petroleum) imports.

Import Performance by Commodity

The largest contributor the decline in imports in the month was the fall in value of mineral fuel (petroleum) imports. This contributed -7.3% pts to the headline 7.2% decline in imports. The value of mineral fuel imports declined by 33% versus a year ago.

Smaller declines were recorded across food stuffs, raw materials, machinery, transport equipment and other. These were offset by increases in imports of chemicals, manufactured goods, and electrical machinery.

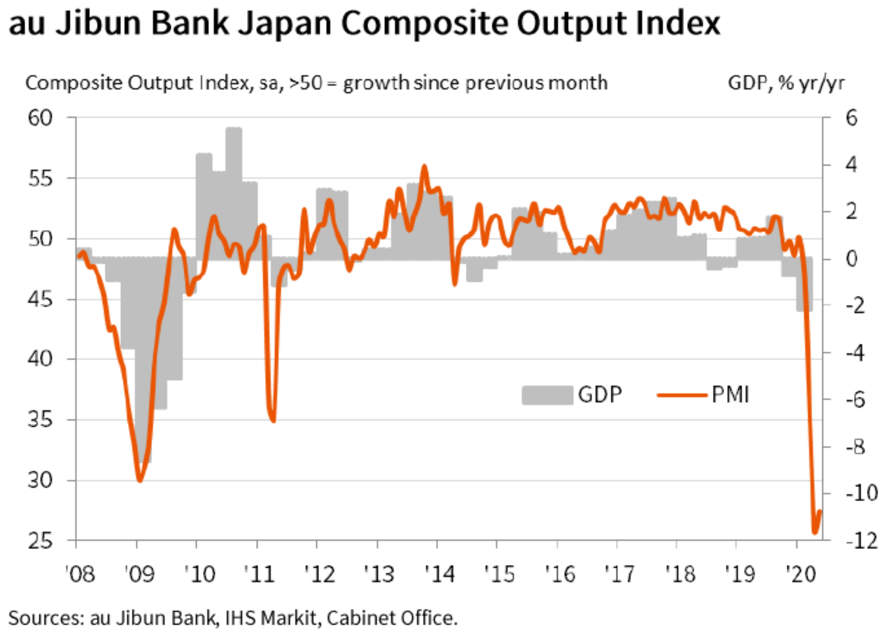
https://www.customs.go.jp/toukei/latest/index_e.htm

Japan Jibun Bank Composite PMI Prelim (May)

The prelim composite output index for Japan indicated that private sector activity continued to decline at a sharp pace in May. There was a small slow down in the pace of the decline, but the pace of output contraction remained in the 20's. Manufacturing output continued to decline at an accelerated pace while there was a small slowdown in the pace of the decline in services activity. Across both services and manufacturing, the outlook remained negative, but improved from the month prior.

The Japanese government is now starting to ease its quarantine measures, meaning that there should be some improvement in services activity, especially, over the next few months.

Composite Output Index; May 27.4 versus Apr 25.8

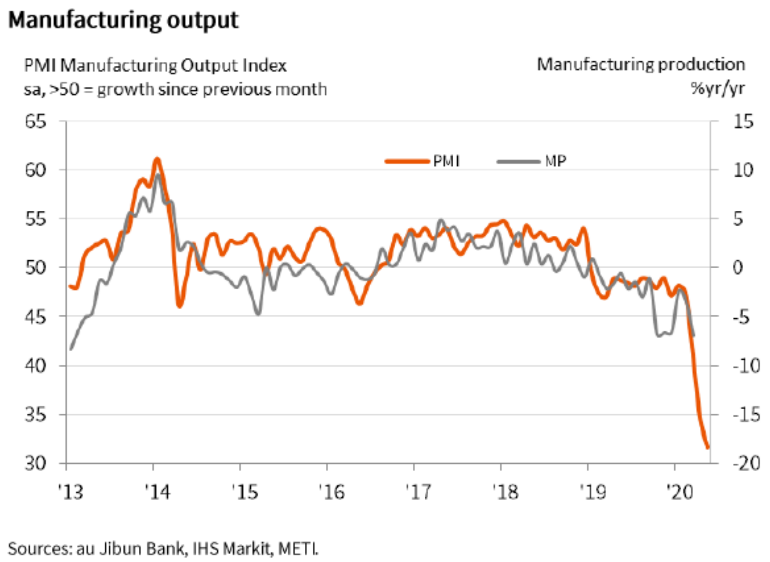


Services Business Activity Index; May 25.3 versus Apr 21.5

The index remaining in the 20's indicates that services activity continues to contract at an extremely sharp pace, just slightly slower than in the month prior. Services recorded a weaker decline across output, new business, and backlogs of work. Firms though continued to reduced employment at a faster pace.

Manufacturing PMI; May 38.4 versus Apr 41.9

The output index fell to the sharpest extent in over eleven-years.



Performance of the sub-indexes was weaker; production and new orders and new export orders all declined at a faster pace in May. Order backlogs also declined at a faster pace. Manufacturing employment was unchanged in May after declining in Apr.

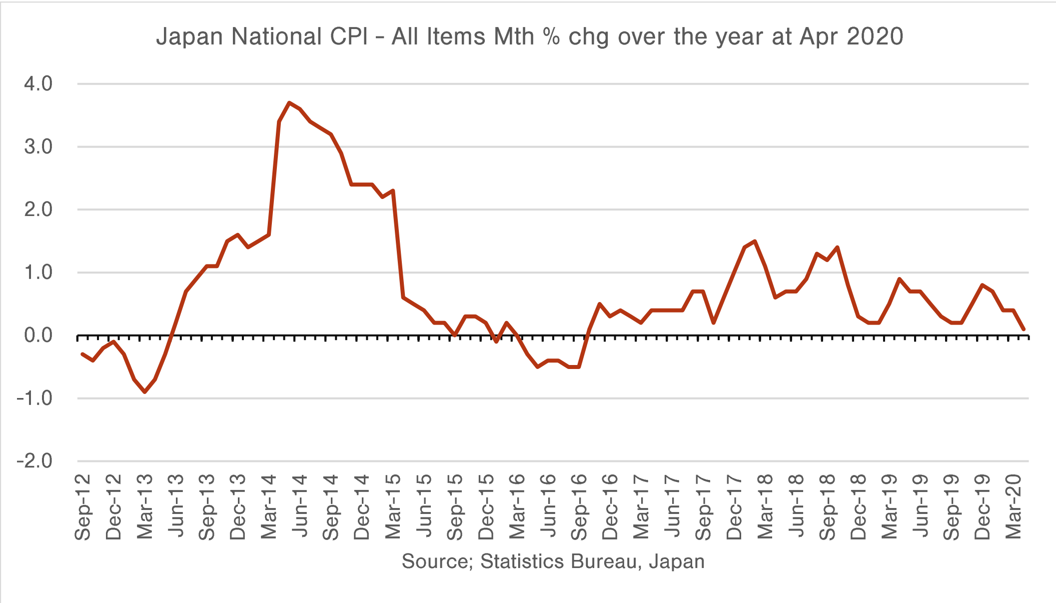
Stocks of purchases and quantities of purchases declined at a faster pace and stocks of finished goods also shifted into a decline (after growing in the month prior).

https://www.markiteconomics.com/Public/Home/PressRelease/4a9ae69be6ab45ecbe7ad505e022abc6

Japan National CPI (Apr)

The headline all-items CPI growth slowed further on an annual basis. Energy prices continued to have a larger downward impact and this offset an acceleration in fresh food prices. The BoJ preferred measure of underlying annual CPI growth is all-items CPI less fresh food – and in Apr, this became negative. CPI growth continues to fall well short of the 2% BoJ target growth.

All-Items CPI – annual change; Apr +0.1% versus Mar +0.4%



Annual growth in food prices accelerated this month, including a +6.7% growth in fresh food prices.

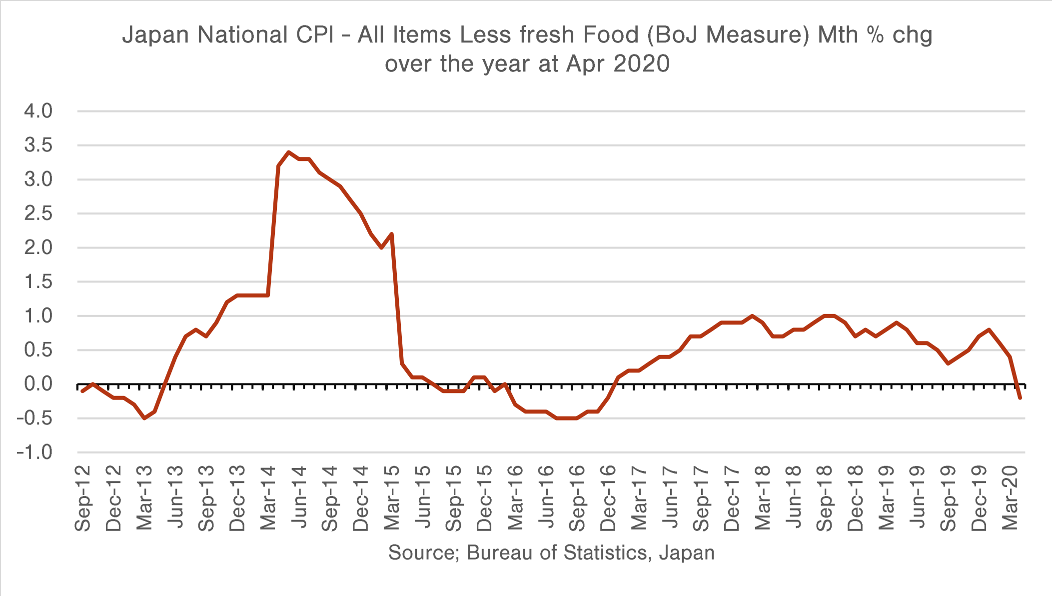
Fuel, light, and water charges as well as transport and comms, and education prices, declined at a faster annual pace in Apr.

Culture and recreation prices increased at a much slower pace.

Misc prices and energy prices both declined at an accelerated pace in Apr.

The BoJ preferred measure of underlying consumer price inflation is all items ex fresh food – and this month that measure shifted back into decline reflecting the broader declines in prices versus a year ago.

All-items less fresh food – annual change; Apr -0.2% versus Mar +0.4%



The fall in energy prices continued to have a large impact in Apr. CPI less fresh food and energy prices increased by +0.2%, but still slowed from +0.6% annual growth in Mar.

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

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United Kingdom

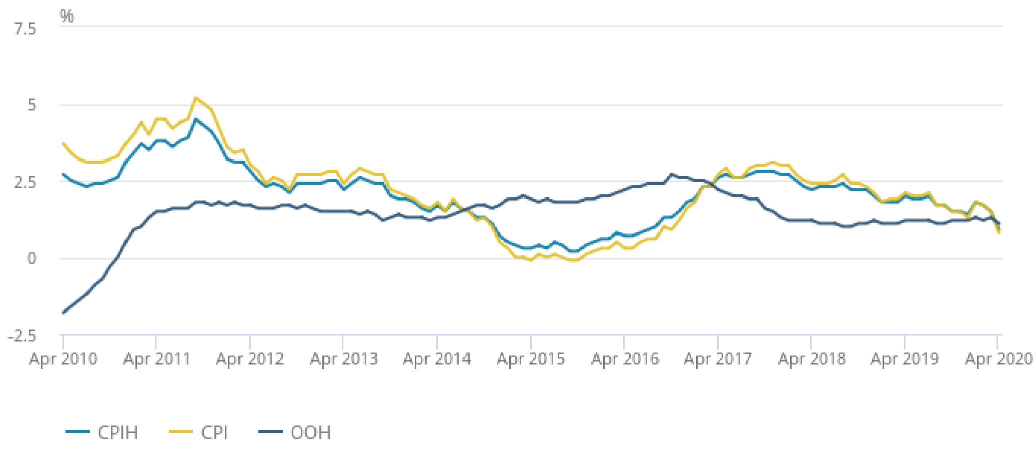
UK CPI (Apr)

The annual pace of CPI (incl housing) growth slowed in Apr. The slow down between the two annual rates was the result of slower growth in housing and household services prices and declines clothing and transport prices.

CPI-H – annual change; Apr +0.9% versus Mar +1.5%

Figure 1: CPIH and CPI 12-month inflation rates ease further in April 2020

CPIH, OOH component and CPI 12-month rates for the last 10 years, UK, April 2010 to April 2020



Source: Office for National Statistics – Consumer price inflation

Contribution to annual CPIH Growth

The slow down in the annual pace of CPIH growth between Mar and Apr was led by several expenditure areas;

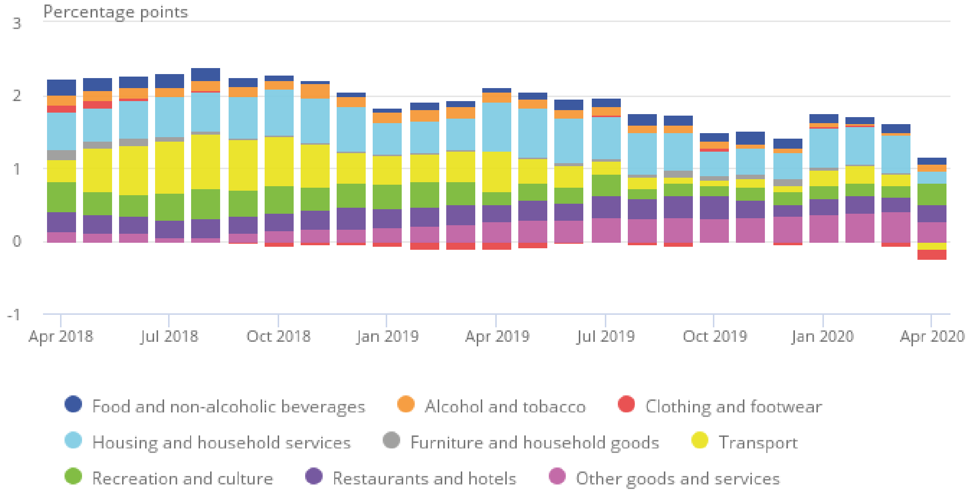
The largest downward contribution was from Housing and Household Services (prices still increased, but at a slower pace) – the result of lower housing utilities price growth (mostly gas) in Apr than in Mar.

Transport prices – which was the result a fall in fuel prices as well as a fall in transport services prices.

Clothing and footwear prices declined in Apr versus a small increase in the annual rate in Mar. There were a greater number of items discounted this year versus last year.

Figure 2: Contributions from housing services and transport eased in April 2020

Contributions to the CPIH 12-month rate, UK, April 2018 to April 2020



Source: Office for National Statistics – Consumer price inflation

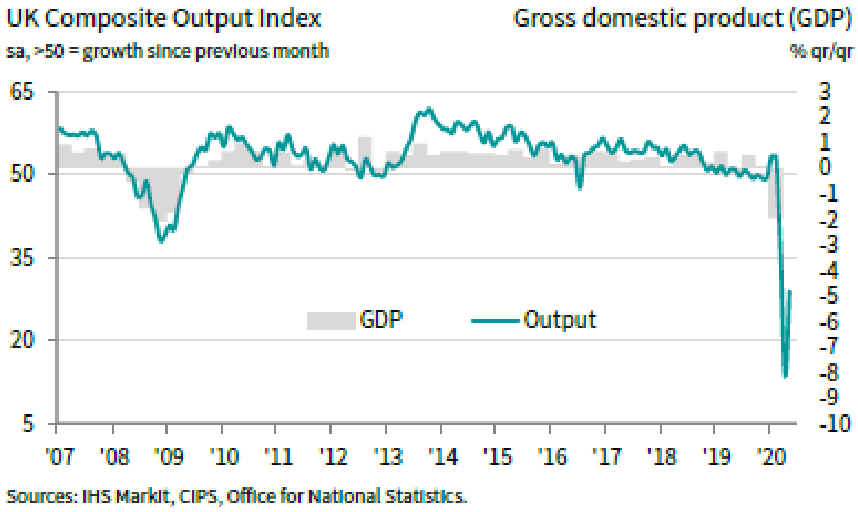
https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/april2020

Markit Manufacturing and Services PMI Prelim (May)

The composite index indicated that output continued to contract a steep pace. The pace of decline was not quite as steep as the prior month. Both services and manufacturing output continued to decline, but at a slower pace.

Composite Output Index; May 28.9 versus Apr 13.8

The pace of decline remains steeper than that of the depths of the GFC and the fall in May is still one of the fastest declines recorded in the series history;



Services Business Activity Index: May 27.8 versus Apr 13.4

Business activity continued to decline in May. Sectors such as travel, tourism and leisure often cited that business had fallen to zero. Clients across other industries continued to reduce spending and cut back orders. Only 12% of firms reported an increase in output in May.

> Those indicating a rise in business activity mainly linked this to greater demand for some technology services, as well as online sales initiatives and a boost from the reopening of business operations in other parts of the domestic economy.

Employment across the services sector continued to decline with the pace of that decline easing only slightly.

Manufacturing PMI: May 40.6 versus Apr 32.6

The headline PMI indicated a slower pace of contraction overall. The decline in output remained steep with the output index in May at 34.9. The pace of output decline was at least slower than the low of 16.3 in Apr. Approx. 24% of firms reported an increase in output in May – linked to healthcare and initiatives to reopen shutdown factories. Approx. 54% of firms reported a further fall in output – linked to a 'severe drop in client demand in May, especially across the automotive chain'.

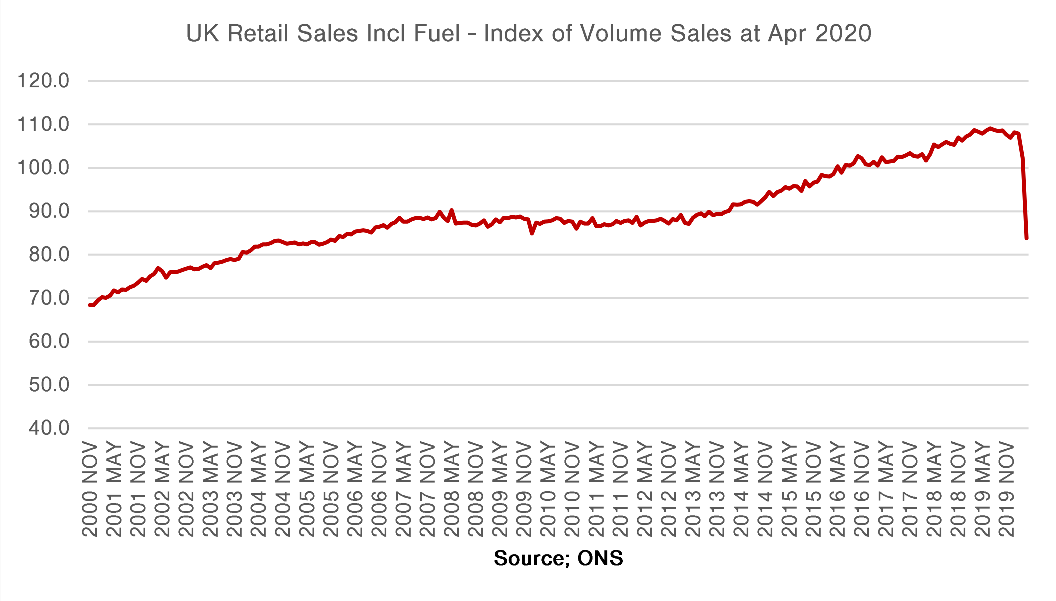
https://www.markiteconomics.com/Public/Home/PressRelease/c2c5efa8283e40a4b780ff8f45d9c9e2

Retail Sales (Apr)

As was the case across most countries in Apr, retail sales declined at an accelerated pace. The index of retail sales volume fell back to a level not recorded since Dec 2005. Approx. 14% of retail stores recorded zero turnover in Apr. Declines were severe across most categories in the month. The exception was alcohol and tobacco sales and non-store retailing. The decline across supermarket stores was also less severe.

<u>Retail Sales (Vol) – month change</u>; Apr -18.1% versus Mar -5.2%

The decline in the month was so severe that the retail sales volume index fell back to a level not recorded since Dec 2005;



<u>Retail Sales by Category</u>

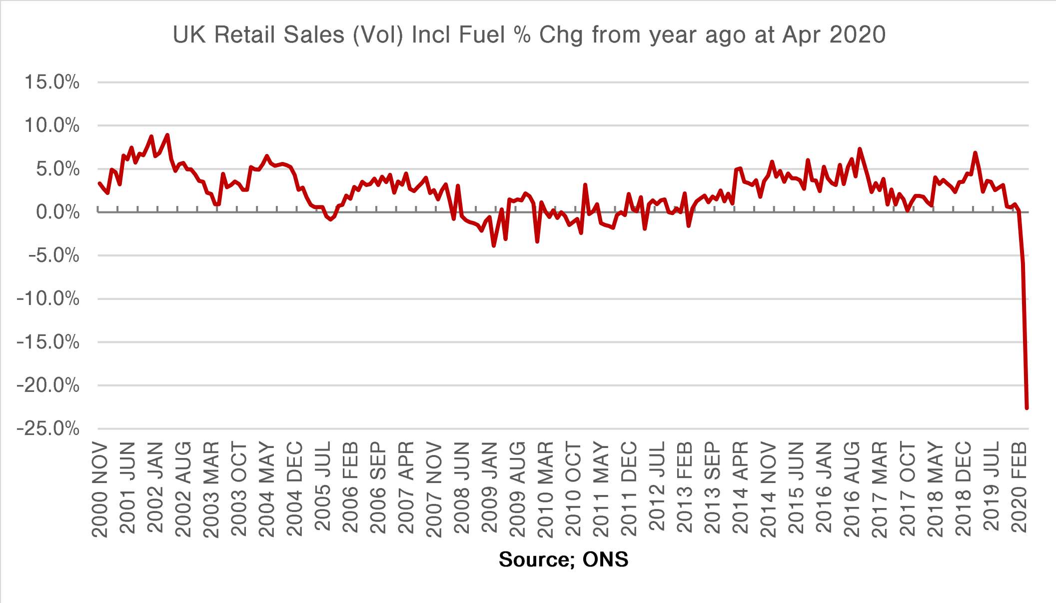
The decline across food stores was less severe, with sales only falling by 4.1%. Sales of alcohol and tobacco increased by 2.3% in the month.

Sales across non-food stores declined by 41.7% in Apr. This included a 50% decline in clothing and footwear sales.

Non-store retailing increased by 18% in the month.

Sales across fuel stores (volume) declined by 52%.

<u>Retail Sales (volume Index) – annual change;</u> Apr -22.6% versus Mar -5.9%



https://www.ons.gov.uk/businessindustryandtrade/retailindustry/bulletins/retailsales/april2020

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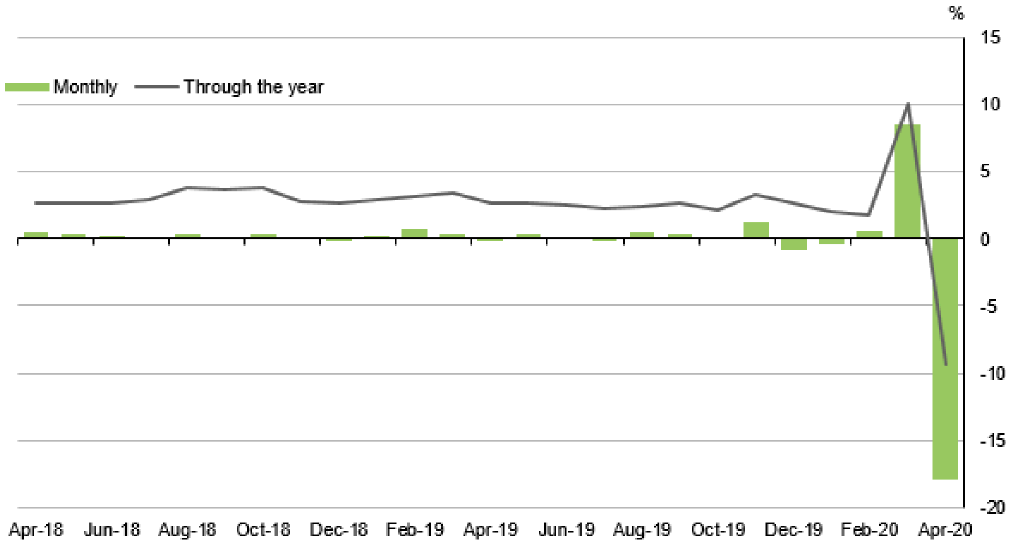
Australia

Aus Preliminary Retail Turnover (Apr)

After a stronger result in Mar, when households were likely in food/grocery stockpiling mode, Apr retail sales declined at the fastest monthly pace in the history of the retail sales history.

<u>Retail Turnover – month change:</u> Apr – prelim -17.9% (-$5.4bn) versus Mar +8.5%

On an annual basis, sales likely declined by -9.4% versus turnover in the same month a year ago.



Food retailing declined by -17.1% (-$2,444.3m) in Apr, after a 24.1% increase in Mar.

> Analysis of supermarket and grocery store scanner data shows that monthly retail turnover fell in original terms for Non-Perishable Goods, Perishable Goods and All Other Products by 23.7%, 15.3% and 24.5% respectively in April 2020 compared to March 2020. These falls follow significant unprecedented demand in March 2020 where Non-Perishable Goods rose 39.0%, Perishable Goods rose 21.6% and All Other Products rose 30.5%.

Sales of cafes, restaurants and takeaway food services and clothing, footwear and personal accessories retailing all continued to decline at an accelerated pace.

> Businesses reported that regulations regarding social distancing measures limited their ability to trade as normal for the entire month. Turnover in Clothing, footwear and personal accessories, and Cafes, restaurants and takeaways in April 2020 is around half the level of April 2019.

Online retailing likely accounted for approx. 10% of total retail turnover in Apr.

https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/2927B2B34EA54818CA25852E0079A627?OpenDocument

Aus Weekly Payrolls - wk ending 2 May

Weekly payrolls as of the wk ending 2 May continued to decline.

National Payrolls - weekly change to 2 May; -1.1% decline in payroll jobs. This was slightly faster than last weeks' decline in payrolls of -0.9%.

The larger states of NSW and Vic continue to record higher-than-National payroll declines at -1.8% and -1.9% respectively. Payrolls in QLD, Tas, and NT increased slightly in the latest week.

Since restrictions were first implemented on 14 Mar, total employee jobs have declined by -7.3%. All states have recorded declines. Again, the larger states of NSW and Vic have recorded the largest % declines of -7.7% and -8.4% respectively.

https://www.abs.gov.au/ausstats/abs%40.nsf/mediareleasesbyCatalogue/400084FDCC1353C9CA2585500026370F?OpenDocument

Aus CBA Manufacturing and Services PMI Prelim (May)

The headline composite measure of output in the May release indicated that activity continued to decline sharply. Its concerning that May has not reflected at least some moderation in the declines in output, orders, and employment. The outlook has started to improve as firms look towards further easing of restrictions.

> "Another incredibly weak result that indicates the contraction in activity observed in April intensified over May. Two consecutive reads in the 20s is simply astonishing as well as concerning."

Continued sharp declines in output were reported across both services and manufacturing. The decline in services was only slightly slower in May.

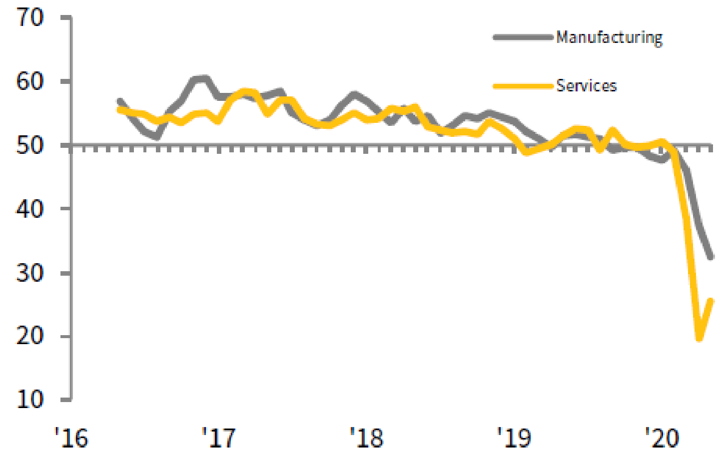
The first phase easing restrictions were announced early May. The second phase will begin early Jun and will include regional travel. An important milestone will be the impact on tourism (hospitality and services generally) around the Queens Birthday long weekend in early Jun. The second milestone will be school holidays in early Jul – especially for domestic tourism.

Headline Composite Output Index; May 26.4 versus Apr 21.7

The output index remained in the 20's – an extremely low reading. The May decline was only slightly slower than Apr due to a slower pace of decline in services output.

Services Business Activity vs Manufacturing Output

sa, >50 = growth since previous month



Services Business Activity Index; May 25.5 versus Apr 19.5

Output across the service sector continued to decline at a sharp pace, somewhat slower than in Apr. Other components also continued to experience sharp declines, albeit slightly slower than in Apr including new orders, export orders and employment. Input costs and output prices continued to decline. Business confidence increased.

Manufacturing PMI; May 42.8 versus Apr 44.1

Unfortunately, manufacturing activity overall contracted at a faster pace. This was led by an accelerated decline in output (chart above) and new orders. As a result, employment and purchasing activity also continued to decline. Input costs continued to increase due to weaker currency and higher freight charges. Margins will likely come under further pressure as manufacturers reduced selling prices for the first time in the 3-year series history. There was no mention of any improvement in business confidence among manufacturers.

https://www.markiteconomics.com/Public/Home/PressRelease/710d43c43a31410cb691519abb43995c

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China

National People's Congress - Annual

At the National People's Congress over the weekend, one of the important outcomes was that China "omitted" a growth target for the first time since 1994.

> The unusual move—it's the first time a formal target has been omitted since the practice began in 1994—suggests Beijing's leaders aren't eager to unleash a large-scale stimulus after China's sharpest contraction in four decades. It foreshadows more economic pain for a world that has become increasingly reliant on China as an engine of growth.
>
> Mr. Li said the decision to scrap an explicit numerical forecast was made "because our country will face some factors that are difficult to predict," pointing to the coronavirus and uncertainties around trade. But Mr. Li said the lack of a target "will enable all of us to concentrate on ensuring stability…and security."

https://www.wsj.com/articles/china-scraps-gdp-target-for-2020-11590111014

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Trade

US-China Trade Talks

Tensions between the two countries continue to simmer amid accusations and posturing regarding China's role in the spread of the Covid-19 virus. The delicate trade truce between the two countries remains at risk as both sides threaten renewed trade restrictions.

Last week though the USTR released a statement outlining the progress made so far on Chinese purchases of US agriculture exports; https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/usda-and-ustr-announce-continued-progress-implementation-us-china-phase-one-agreement

The US continues to focus on strengthening and/or returning to more local supply chains. There are reports that the US is planning to actively promote a return to local supply chains;

> The Trump administration is "turbocharging" an initiative to remove global industrial supply chains from China as it weighs new tariffs to punish Beijing for its handling of the coronavirus outbreak, according to officials familiar with U.S. planning.
>
> "I think it is essential to understand where the critical areas are and where critical bottlenecks exist," Krach said, adding that the matter was key to U.S. security and one the government could announce new action on soon. https://www.reuters.com/article/us-health-coronavirus-usa-china-idUSKBN22G0BZ

Reconfirming what a 'win' in the negotiations with China looks like – a statement of the key negotiating goals as outlined by the USTR from the initial USTR objectives (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 – originally planned to begin from April or May this year;

> 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

There are several fronts to the US-EU trade discussions.

Airline Subsidies

The US has officially notified the WTO that it has complied with the dispute raised by the EU on US subsidies to Boeing. The US has now enacted the Senate Bill that eliminates the preferential tax treatment for aerospace manufacturing.

The removal of the subsidy fully implements the WTO's recommendation to the United States, bringing an end to this long-running dispute.
https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/us-notifies-full-compliance-wto-aircraft-dispute

From 18 Oct, the US had implemented tariffs on some EU imports as a part of the WTO ruling on the Airbus case. This week, the USTR announced a further increase in the tariff rate in aircraft imported from the EU into the US from 10% to 15% - effected from 18 Mar 2020.
https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/february/ustr-revises-75-billion-award-implementation-against-eu-airbus-case

Trade Deal 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

> France on Monday agreed to suspend a 3% digital tax on U.S. tech companies in exchange for Washington holding off on a threat to impose tariffs of up to 100% on a $2.4 billion list of French imports, a French diplomatic source said. **https://www.reuters.com/article/us-usa-trade-deals/after-china-trade-deal-europe-and-uk-next-on-trumps-to-do-list-idUSKBN1ZL2TJ**

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 2019, 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

Last week the USTR notified the US Congress that both Mexico and Canada taken the measures required to comply with new USMCA and that the agreement would enter into force on 1 Jul 2020.

A quote from the release highlights further focus on manufacturing in the US, especially in the post-pandemic world;

"The crisis and recovery from the Covid-19 pandemic demonstrates that now, more than ever, **the United States should strive to increase manufacturing capacity and investment in North America**. The USMCA's entry into force is a landmark achievement in that effort. Under President Trump's leadership, USTR will continue working to ensure a smooth implementation of the USMCA so that American workers and businesses can enjoy the benefits of the new agreement," said Ambassador Robert Lighthizer. https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/april/usmca-enter-force-july-1-after-united-states-takes-final-procedural-steps-implementation

US-UK Trade Talks

There has been no further update on the first round of trade negotiations between the UK and the US at this stage. Trade negotiations commenced w/c 4 May and were expected to run in parallel with the EU Brexit/trade negotiations.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/statement-ustr-robert-lighthizer-launch-us-uk-trade-negotiations

The USTR has published the summary of specific negotiating objectives for the US-UK trade negotiations; https://ustr.gov/sites/default/files/Summary_of_U.S.-UK_Negotiating_Objectives.pdf

BREXIT

Negotiations are set to resume on 1 Jun ahead of the EU summit later next month.

With a trade deal of huge complexity to negotiate, for the moment taking place over video links, the European Union and the U.K. have yet to agree even on the basic elements of an accord—including whether there should be a single overarching agreement with one set of rules and oversight or multiple smaller ones. https://www.wsj.com/articles/brexit-talks-go-nowhere-adding-new-european-economic-headache-11589559642?mod=searchresults&page=1&pos=2

The deadline for extending the negotiations is approaching at the end of June 2020. The UK maintains that an extension will not be requested.

"Transition ends on 31 December this year," Frost said on Twitter last week. "We will not ask to extend it. If the EU asks, we will say no."

If the two sides can't reach a deal, the UK would default to trading on terms set by the World Trade Organisation, meaning the return of tariffs and quotas where there are none today. https://www.straitstimes.com/world/europe/brexit-talks-resume-with-time-for-a-deal-running-out

Link to the EU draft is embedded in the release;
https://ec.europa.eu/commission/presscorner/detail/en/IP_20_447

The UK negotiating objectives;
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/868874/The_Future_Relationship_with_the_EU.pdf

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