MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 4 May 2020

Key Themes

Even though it was expected, the extremely large decline in employment and increase in unemployment in the US jobs report was still alarming. The initial and continuing unemployment claims data indicate that this is likely to continue.

The detail on unemployment is important. While unemployment increased substantially, the vast majority (87%) of those people identified as having lost jobs this month, were classified as “on temporary layoff” and expecting to be recalled to their jobs once restrictions are lifted. The pace of permanent job losses has so far been much smaller and is tracking well below that of the GFC levels. The dynamic between temporary and permanent layoff is one of the more important datapoints to watch in order to see if/when these jobs come back and how future employment expectations are changing.

Consumers remained more cautious regarding expenditure on larger items such as vehicles. Retail sales of vehicles in Apr (on a SAAR basis) continued to fall to new lows. Consumer credit also declined in Mar, led by a decline in revolving credit (credit cards). This fits with the income and outlays report from the prior week – while income declined as a result of job losses, the value of expenditure declined by a greater degree. Stimulus checks around mid-Apr are likely to show up as higher expenditure but it will worth noting the impact on “saving” (as measured by the income/expenditure report), and/or outstanding consumer credit.

The weaker demand in areas such as vehicles impacted factory orders and shipments in Mar. The overall decline in US factory shipments and orders was in line with the weaker PMI data from Mar. The decline in shipments and orders was led by transport equipment, as well as petroleum shipments. The largest impact on new orders was the -$16bn print in total orders for non-defense aircraft for the month (not the change, the total value) – which indicates that orders may have been cancelled. There were modest declines in orders and shipments across other industries, the exception was food manufacturing shipments.

Germany industrial production for Mar declined severely – led by manufacturing. The index of manufacturing production fell back to 2010 levels. This is consistent with the weak Mar PMI report. Only construction activity continued to grow. The Apr manufacturing PMI has indicated that manufacturing output in Germany has declined even further.

This week, the view of Apr activity was completed with the release of the services PMIs. The countries/regions covered here all recorded faster declines in activity in Apr. In many cases, the business activity index reached all-time lows. The exception was China. The China Caixin services activity index still indicated that activity contracted in Apr, but at a similar pace as in Mar. Underlying conditions appear mixed with new work declining and employment declining at an accelerated pace but some small improvements were recorded in the outlook.

There appears to be more news of various restrictions starting to be lifted as of early May. This could start to be reflected as improvements in activity levels next month (depending on the reference week for surveys).

Contents

US Data

Initial Jobless Claims wk ending 2 May

New jobless claims made by workers continued to increase by a significant number for the seventh week in a row.

Advance Claims wk ending 2 May 2020 (SA); 3,169,000 new claims made by people.

The advance claims for the prior week were revised slightly higher to 3,846,000 people.

The total number of new unemployment claims made by people over the last seven weeks now totals; 33,483,000 new claims.

The level of continuing claims (insured unemployment) continues to rise as a result. The advance (SA) number for insured unemployment has now reached 22,647,000 people (wk ending 25 Apr 2020). This is an insured unemployment rate of 15.5%.

There are now five (5) states where continuing claims exceed 1,000,000 as of 25 Apr;

California; 4.8m

Michigan (state est); 1.04m

New York; 1.75m

Pennsylvania (state est); 1.25m

Texas; 1.15m

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

Non-Farm Payrolls & Labour Force Report (Apr)

The change in non-farm payrolls, employment and unemployment was as dire as expected.

If there is any hope in this report, it's that the majority of those people who have lost their jobs are classified as on temporary layoff with the expectation that they will be recalled to their jobs as restrictions are lifted. So far, the scale of permanent layoffs has been much smaller.

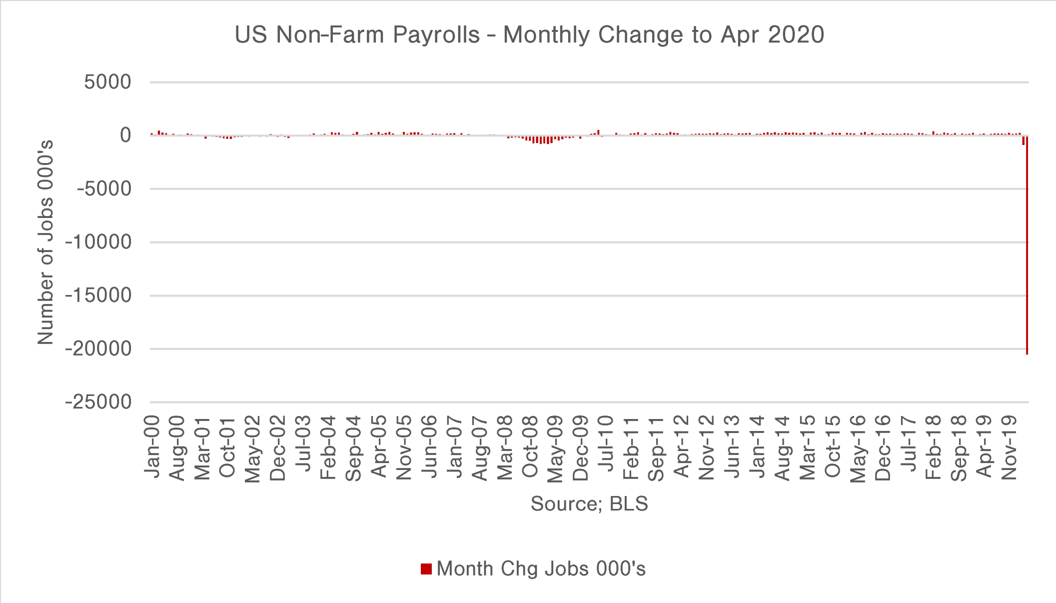
As restrictions are lifted, we should start to see the "on temporary layoff" expectations evolve – and this will provide some insight into the recovery process.

The reference week for the survey was 12-18 Apr.

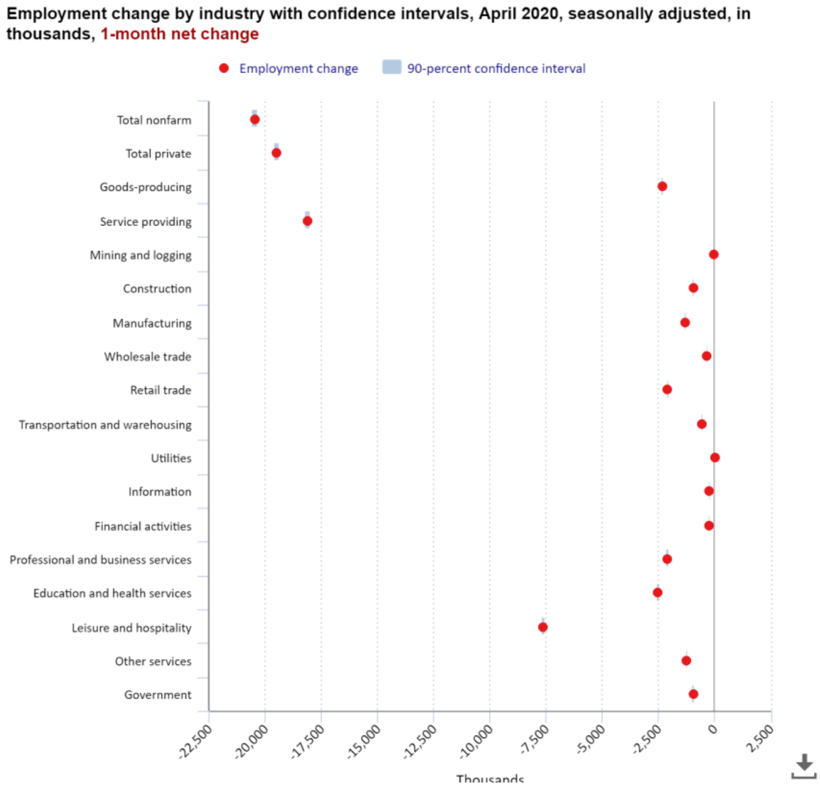
NON-FARM PAYROLLS – Establishment Survey

The non-farm payrolls declined by the most in the series history this month and the Mar result was also revised lower. The establishment survey covers wage and salary employees on the payrolls on non-farm establishments. It can reflect multiple job holders.

Non-Farm Payrolls – month change; Apr -20.5m versus Mar -881 (revised lower by 108k persons)



Declines in payrolls were recorded across all industries this month. Goods producing industries recorded a monthly decline of -2.4m payrolls jobs. Services providing industries recorded -18.1m payroll jobs. The smallest decline in payrolls for the month was -3.3k recorded in Utilities.



HOUSEHOLD EMPLOYMENT SURVEY

The household survey differs to the establishment survey in that it identifies the work status of the population without duplication – each person is classified as either employed, unemployed or not in the labour force.

In context of the current situation, one of the more important points coming out of this survey is the unemployment classification. The BLS advised this month that (emphasis added);

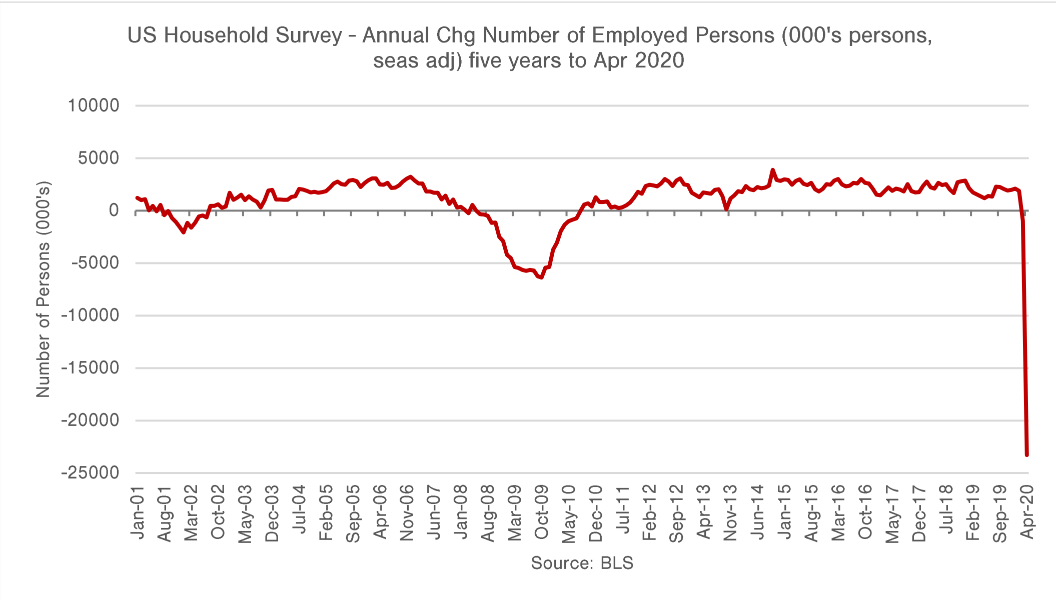
> Workers who indicate they were not working during the entire survey reference week **and expect to be recalled to their jobs** should be classified as unemployed on temporary layoff.

This means it will be crucial going forward to monitor the reasons for unemployment and the shift between "on temporary layoff" and "not on temporary layoff (which includes permanent job losers)" within the labour market dynamics.

The vast majority of those people identified as having lost their jobs this month, were classified as "on temporary layoff". At this stage, restrictions on trade, due to social distancing, make it difficult for some businesses to open. As those restrictions are lifted, we should start to see the expectations for "on temporary layoff" change – and this will provide some insight into the recovery process.

Employment

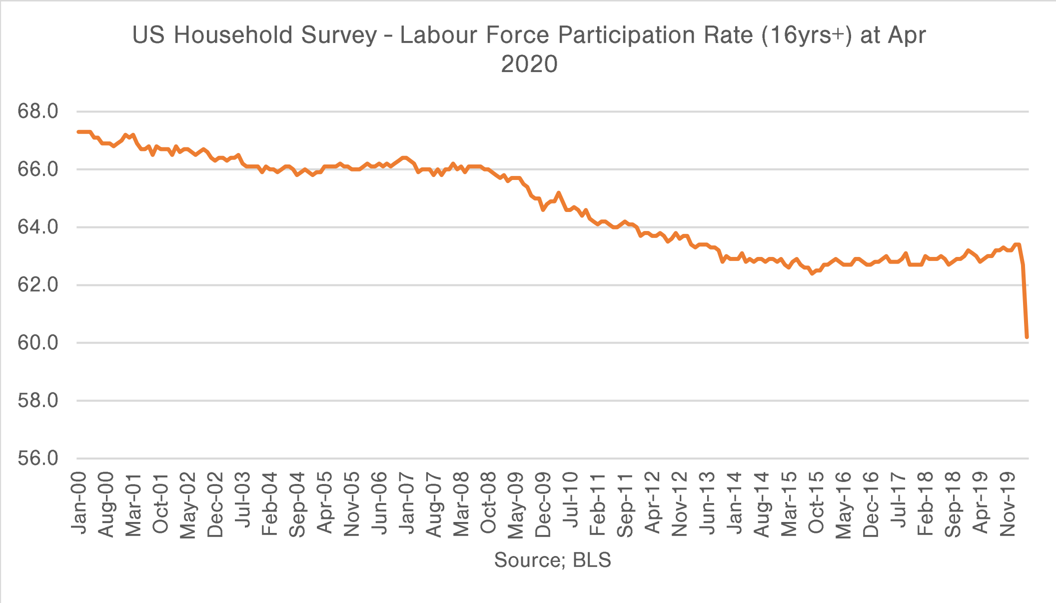
This month (versus the month prior), total employed persons declined by over 22m. On an annual basis, the decline was similar with over 23m less total employed persons versus the same month a year ago.



Total Labour Force

This month (versus the month prior) the total size of the labour force declined by -6.4m people. While there was a slight slowdown in the estimate of underlying population growth, the majority of the decline in the labour force was due to the decline in participation.

The participation rate in Apr fell to 60.2% from 62.7% in Mar and 62.8% a year ago. On a monthly basis, this equates to approx. 6.5m people leaving the labour force.

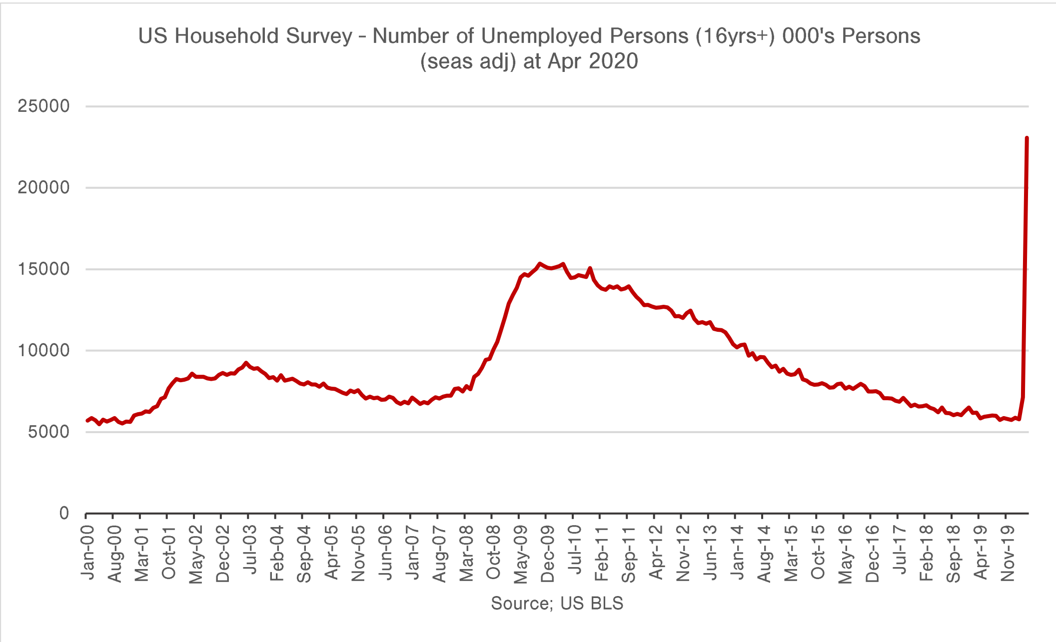


Given that the decline in the total labour force was smaller than the decline in employment (on a monthly and annual basis), the total number of unemployed persons increased.

<u>Total Unemployment</u>

The total number of unemployed persons increased by +16m (versus the month prior) to reach a total of 23.1m unemployed people in Apr.

The total unemployment rate increased to 14.75% (from 4.38% in Mar).

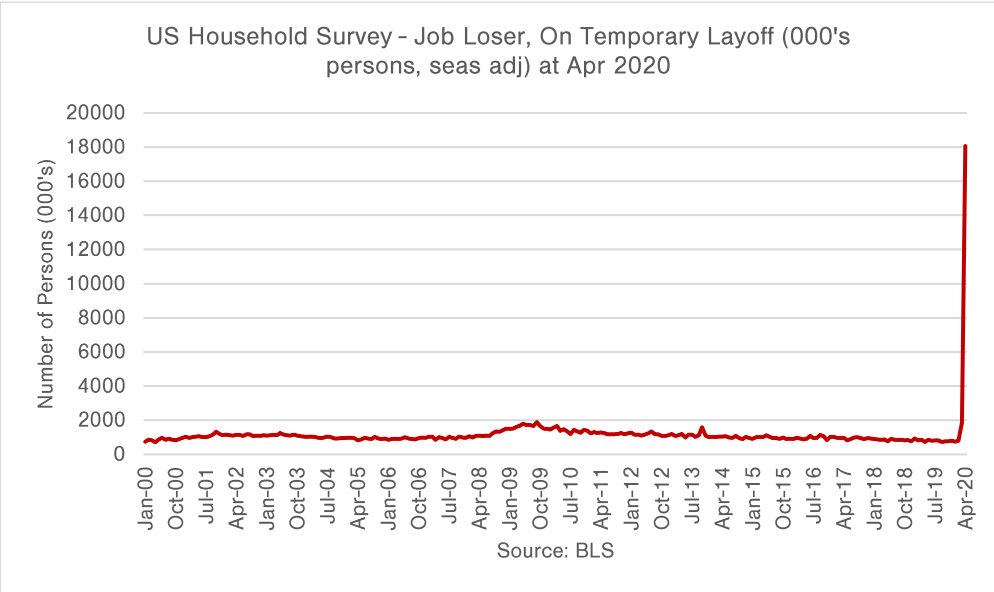


The change this month dwarfs anything that occurred during the GFC. The unemployment rate and the increase in total unemployed persons this month were the largest recorded in the history of the data (seas adj back to Jan 1948).

Unemployment Detail

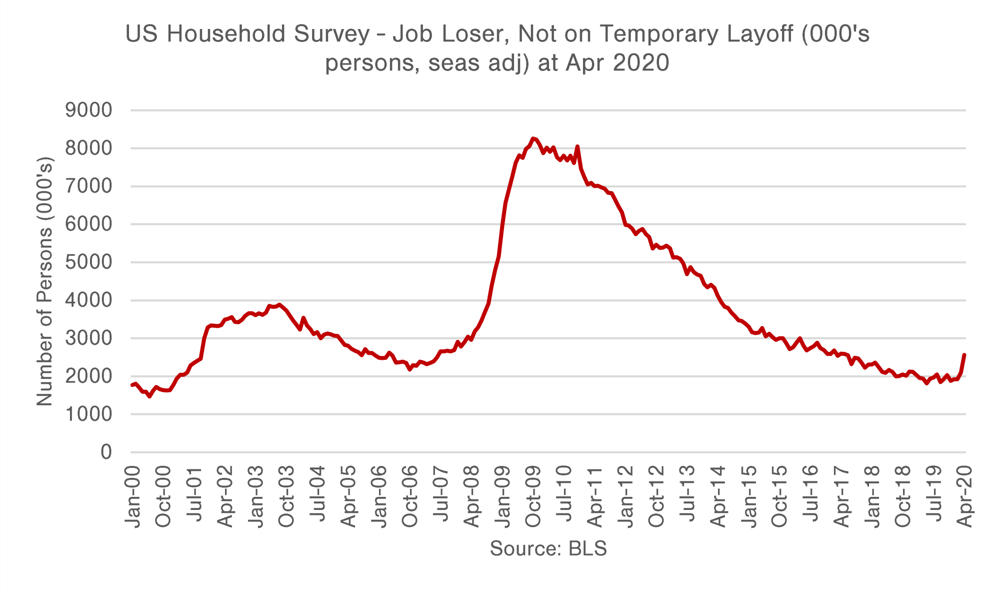
The numbers of people cited in this section will not add up to the previous section on total unemployment as the seasonal adjustment is done independently.

The total number of "job losers" this month totalled 20.6m people. The vast majority of those were identified as on "temporary layoff". In Apr that was 18.1m people, up from 1.8m people in Mar.



The BLS advised that anyone who was laid off but expected to be recalled to their jobs, would be classified as on temporary layoff. As the economy re-opens, the test will be whether these people are recalled.

Those not on temporary layoff, increased further this month to 2.5m people. This is what makes the current situation different to the GFC – the majority of the current extremely high unemployment is so far NOT permanent.



But that said, there was a marked increase in those classified as "permanent job losers" this month; from 1.4m in Mar to 2m people in Apr.

This is one of the more important datapoints to watch in order to see if/when these jobs come back and how expectations are changing.

<u>Summary of main labour market dynamics this month;</u>

000's people (16yrs+)	Annual chg - APR 2020	Monthly Chg - Apr
The estimated change in the Labour Force due to pop growth (1)	693	64
How many jobs available for them? (employment growth) (2)	- 23,293	-22369
Difference (if negative, then employment growing faster than what pop adds to the labour force) (3)	23,986	22433
Change labour force participation - (if positive, people entering/returning to the labour force) (4)	- 6,758	-6498
The remainder is the chg in total unemployed persons (declining if negative) (4) plus (3)	17,228	15934
Two views of annual growth in the labour force;		
Total employed persons plus total unemployed persons	- 6,065	-6435
Est of what population adds to the labor force plus change in participation	- 6,065	-6435
BLS reported change in the size of the labour force	- 6,065	-6432

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

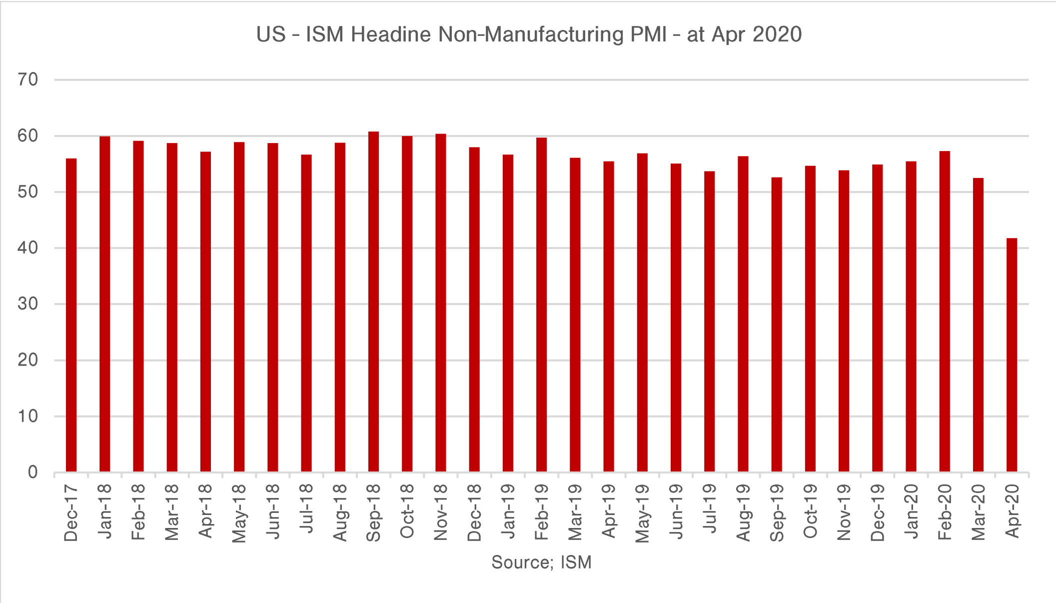
ISM Non-Manufacturing PMI (Apr)

The headline PMI indicated that non-manufacturing activity contracted further in the latest month. This headline index is also influenced by lengthening supplier delivery times – usually a sign of improving activity, but not in the current context. The business activity index at 26 in Apr (the output equivalent) highlights the extent to which non-manufacturing activity has declined this month.

Similar to the manufacturing PMI report, the breadth of growth across industries has become extremely narrow. This month only two non-manufacturing industries recorded growth; public administration and finance and insurance.

> The 16 industries reporting a decrease in April — listed in order — are: Arts, Entertainment & Recreation; Agriculture, Forestry, Fishing & Hunting; Retail Trade; Other Services; Wholesale Trade; Construction; Transportation & Warehousing; Mining; Professional, Scientific & Technical Services; Information; Accommodation & Food Services; Management of Companies & Support Services; Educational Services; Real Estate, Rental & Leasing; Utilities; and Health Care & Social Assistance.

<u>Headline Non-Manufacturing PMI;</u> Apr 41.8 versus Mar 52.5



The output/business activity index fell to 26 in Apr (from 48 in Mar). Back in Jan 2020, the index reading was 60.9. The large shift this month was that 64% of firms reported lower business activity (up from 30.6% of firms in Mar). Just over 20% of firms still reported higher business activity. Only one industry overall reported higher business activity – finance and insurance.

New orders fell firmly into contraction this month. The new orders index in Apr was 32.9 versus Mar 52.9. Over half of the firms reports lower new orders. Only two industries reported higher new orders; public administration and finance and insurance.

New export orders (services to be provided outside of the US) contracted at a faster pace. There was a much larger increase in the proportion of firms reporting lower new export orders (now up to 45% of firms from 15% in Mar). But there was also an increase in the number of firms reporting an increase in new export orders – from 7.8% in Mar to 18.1% in Apr. There were three industries overall reporting an increase in new export orders - Arts, Entertainment & Recreation; Health Care & Social Assistance; and Public Administration.

Employment contracted at an even faster pace this month with the index falling to 30 in Apr from 47 in Mar. There was a large decline in the proportion of firms reporting unchanged employment levels – falling from 76% of firms in Mar to 47% in Apr. There was a large corresponding shift by firms to reduce employment instead – 46% of firms reported lower employment (up from only 14% of firms in Mar).

Supplier deliveries continue to increase. The index is now at 78.3 up from 62.1 in Mar. This is the single highest reading since the series commenced in 1997.

> "Supplier deliveries are being affected by the COVID-19 crisis. Deliveries are slipping due to slower production windows" and "Increased demand on delivery resources."

Inventories continued to decline, albeit at a slower pace. Firms cited shifting to only ordering on demand and working through excess stock.

Material input prices continued to increase in the latest month. The index increased to 55 in Apr up from 50 in Mar. There were ten (10) industries reporting higher prices in Apr;

> Health Care & Social Assistance; Public Administration; Educational Services; Utilities; Other Services; Transportation & Warehousing; Real Estate, Rental & Leasing; Information; Finance & Insurance; and Wholesale Trade.

There were four (4) industries reporting lower prices;

> Agriculture, Forestry, Fishing & Hunting; Mining; Construction; and Accommodation & Food Services.

One of the comments in the report relates to agricultural commodity prices;

> "The COVID-19 situation has created significant challenges for the agricultural sectors. Milk prices have declined 29 percent in a few weeks. Milk is being dumped on farms because of the loss of markets. Cattle prices are down 28 percent, pork prices down 24 percent, [and] all agriculture sectors are facing significant price declines. Our agriculture economy is challenged, with poultry, pork, and beef processing plants closed due to COVID-19 cases or impaired due to employees afraid to work side-by-side with other employees. Farmers cannot sell fat cattle locally due to processing plant shutdowns." (Agriculture, Forestry, Fishing & Hunting)

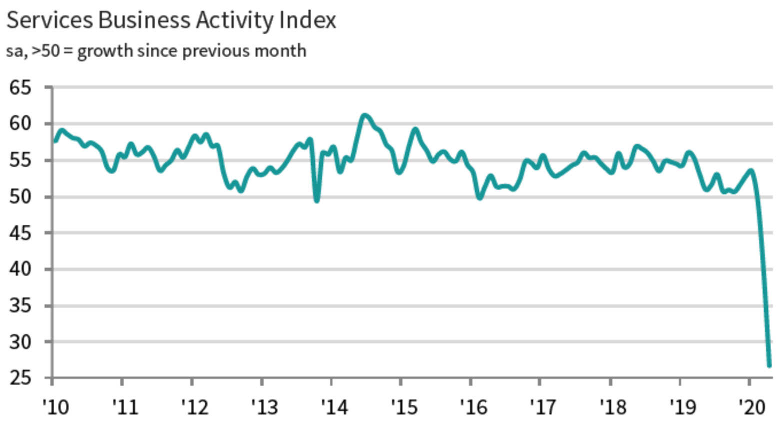
While the comment highlights falling prices due to weaker demand (due to on-premise), there also appears to be a processing bottleneck causing supply shortages at the same time.

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

Markit Services PMI – Final (Apr)

Private sector services activity contracted at a faster pace in Apr. Business activity declined severely as firms restricted trade or closed temporarily amid social distancing measures.

Services Business Activity Index; Apr 26.7 versus Mar 39.8



Sources: IHS Markit.

New orders declined as clients either postponed or cancelled work.

Despite increasing talk of lifting restrictions, expectations for activity over the coming 12-months declined to the most pessimistic reading since that series began.

> "With hope, infections rates have peaked and the economic downturn should start to ease as virus-related restrictions are lifted. However, while manufacturing may see a rebound in production as increasing numbers of factories are allowed to re-open, prospects look bleaker for many parts of the services economy, especially where businesses rely on travel, social gatherings or close contact with customers. Businesses such as airlines, bars, restaurants, cinemas, sports arenas and other recreational activities will likely be at the back of the line in terms of being able to re-open to anything like previous capacity levels, meaning the recovery will be long and slow."

As a result, firms reduced employment at a faster pace.

https://www.markiteconomics.com/Public/Home/PressRelease/8a0d42c3414d40808c6301d28b928364

Factory Orders – Final (Mar)

The larger impact on factory orders and shipments continues to be led by transport equipment. Shipments declined across most industries this month, with transport and petroleum the two main drivers. Orders also declined at a faster pace this month, linked mostly to the -$16bn in non-defense aircraft orders Mar (this is the month total, not the change). New orders were weak across most durable goods industries though.

Shipments – month change; Mar -5.2% (-$26.2bn) versus Feb -0.3% (-1.4bn)

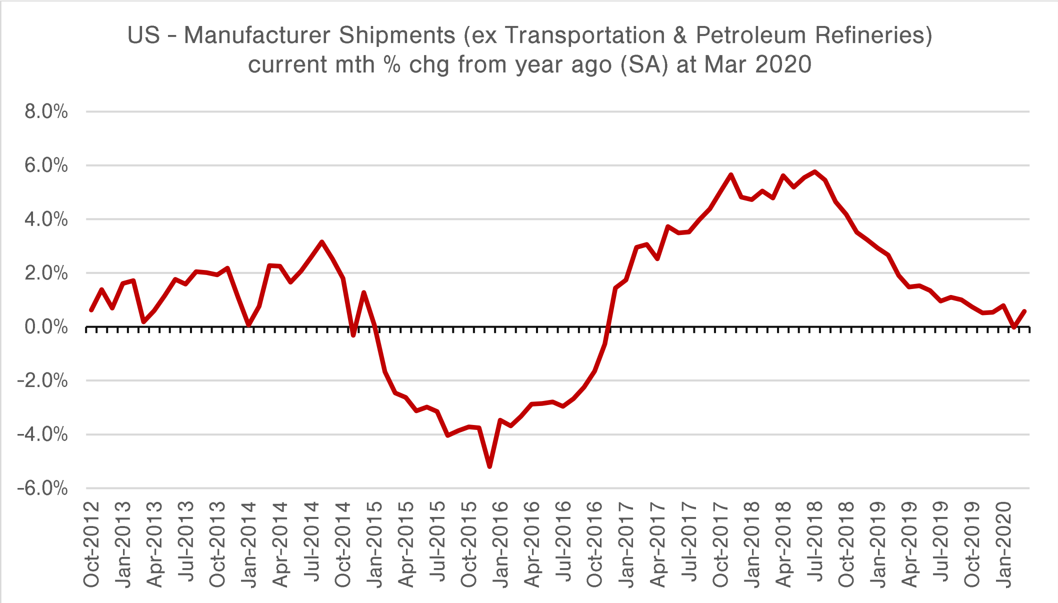
The decline in shipments was similar across both durable and non-durable goods industries.

Durable goods shipments declined by 4.7% (-$11.8bn) in Mar. Shipments declined across most, but not all, industries. Most of the decline in durable goods shipments was transport equipment (-$11.1bn) - led by autos and light trucks. Non-defense aircraft and parts shipments increased in the month.

Non-durable goods shipments declined by 5.8% (-$14.4bn) in Mar. The -$15.4bn decline in the value of petroleum shipments was only partly offset by increases in shipments for food (+$0.9bn) and beverage and tobacco products (+$0.3bn).

The value of total manufacturing shipments declined by 6.5% in Mar versus the same month a year ago.

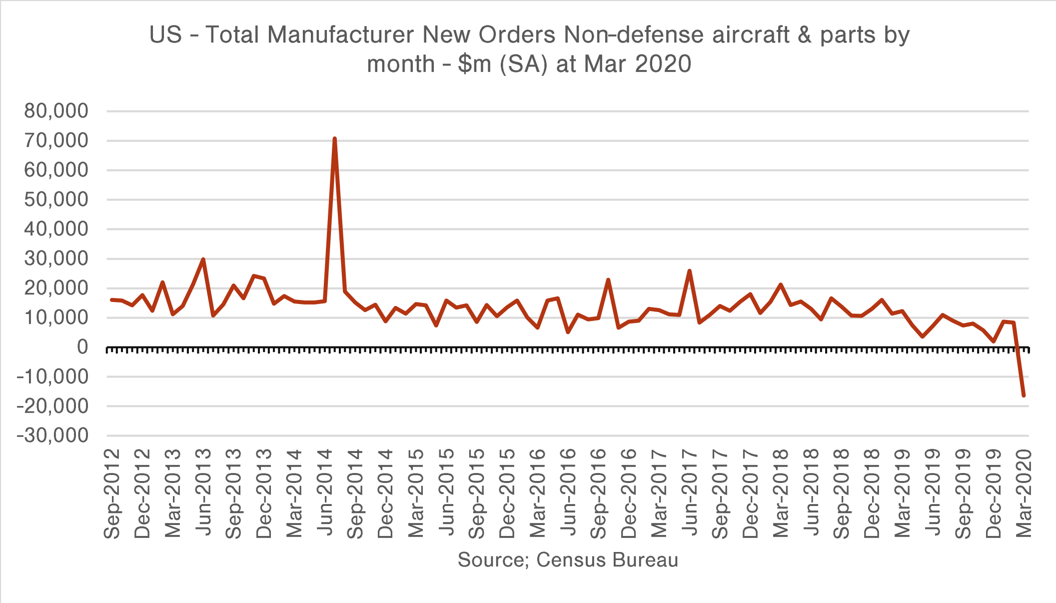
Excluding the, so far, severe impact from declines in petroleum (-39% versus a year ago) and transport equipment (-17% versus a year ago), the total of all other shipments versus a year ago increased by +0.6%;



<u>New Orders (Durable Goods only) – month change;</u> Mar -14.7% (-$36bn) versus Feb +1.1% (+2.6bn)

The majority of the decline in orders for the month was transport equipment; -41.3% (-$35.9bn).

Within that, the main, but not only, contributor to the decline in orders was the 300% decline in non-defense aircraft orders (-$24.7bn). In Mar, the total print for non-defense aircraft orders was -$16bn – likely to be the result of order cancellations, but there is no official note on this.



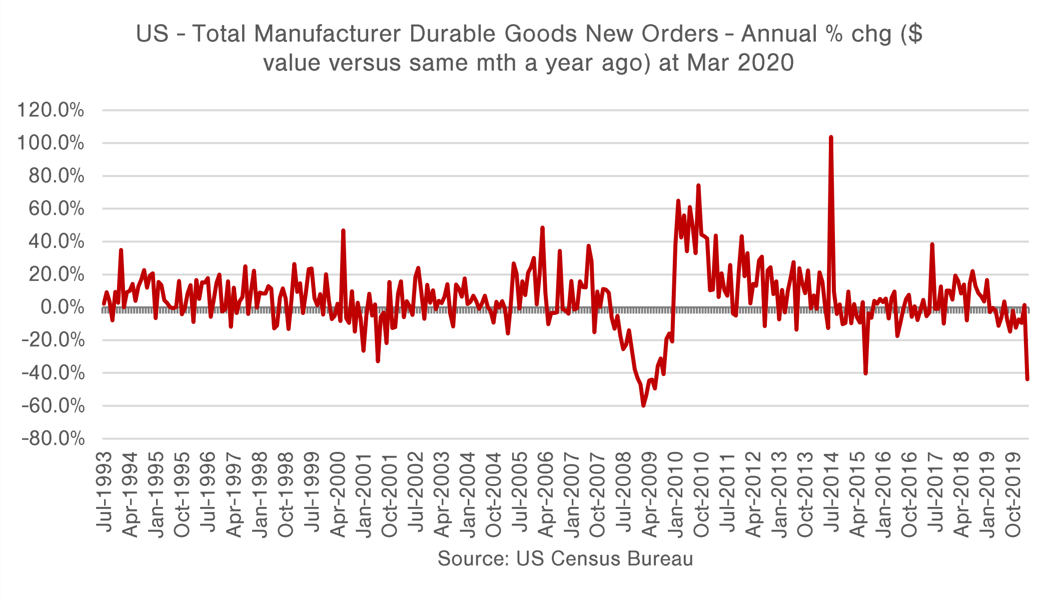
This is unchanged from the advance durable goods report from two weeks ago.

Orders for motor vehicles declined for the second month; Mar -6.7% (-$1.9bn). The decline in orders for ships and boats was more substantial; -65% or -$3.3bn. Defense aircraft orders increased by 63% or +$2.4bn.

New orders across most other durable goods industries declined this month. The only two industries where orders did not decline were; electrical equipment and appliances (+0.8%) and computers and electronic products (flat to last month).

Orders for non-durable goods is the same as the shipments data – and is excluded in this analysis.

Versus a year ago, total durable goods manufacturing new orders declined by 16.7%. So far, the decline is on par with the weaker manufacturing conditions from back in 2015;

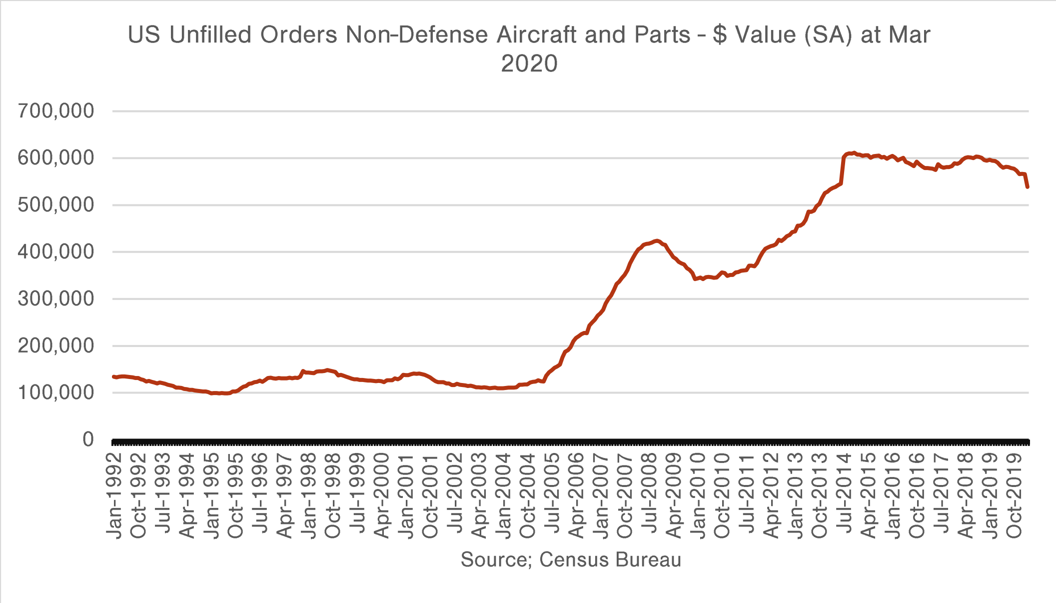


The annual decline in transport orders accelerated to -44% in Mar. The annual change in durable goods orders excluding transport remained unchanged at -0.9% in Mar;

<u>Unfilled Orders – month change</u>; Mar -2% (-$23.6bn) versus Feb +0.1% (+$1.3bn)

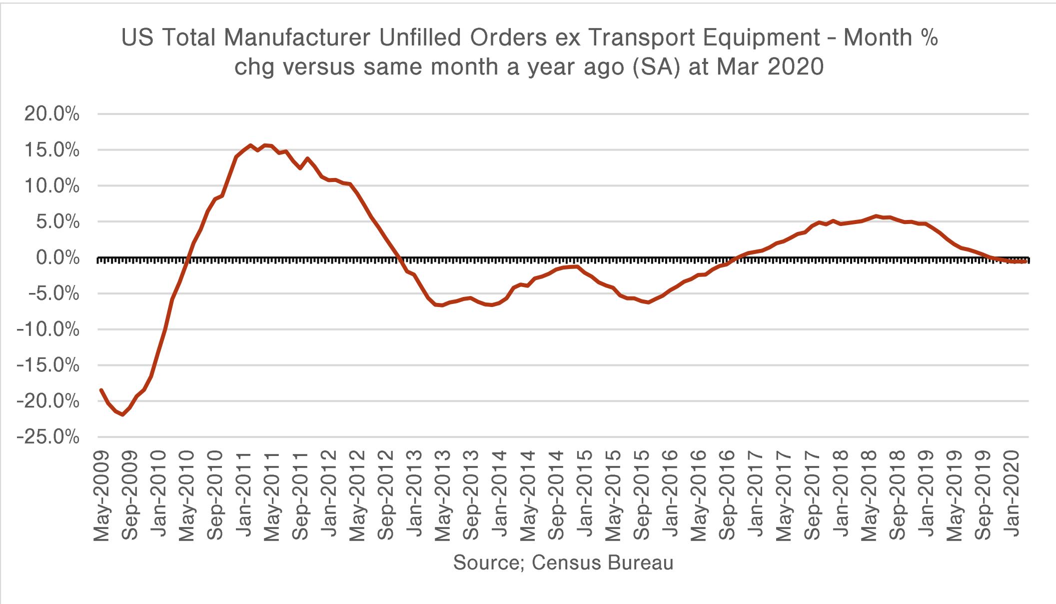
All of the decline in Mar was attributed to the 4.7% decline (-$26.8bn) in non-defense aircraft unfilled orders (likely as a result of order cancellations). Excluding transportation equipment, unfilled orders declined by only -0.2% (-$0.6bn).

The value of unfilled orders for non-defense aircraft remains high. On an annual basis, unfilled orders are only 9.2% below a year ago (given where things are at now). The following chart is the just the outstanding value of unfilled orders (but not deflated for time);



Non-defense aircraft accounts for nearly half of all outstanding/unfilled orders. The question is whether more orders can or will be cancelled over the coming months.

At a total level, the value of unfilled orders is -3.8% below the same month a year ago. This is the tenth consecutive month where unfilled orders have declined. Even excluding transport equipment, orders remain -0.5% below a year ago;

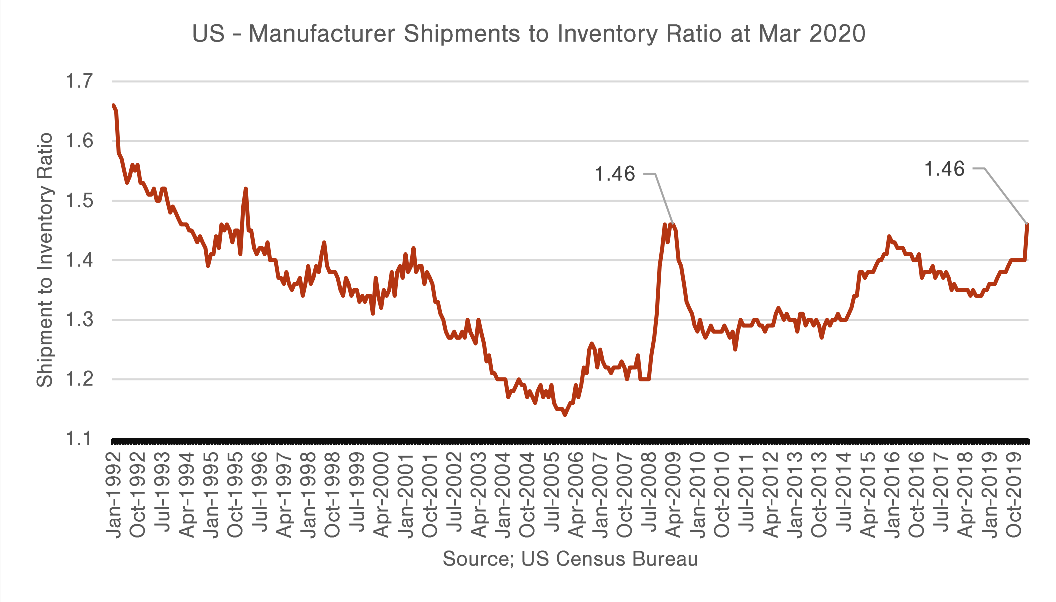


<u>Inventory – month change</u>; Mar -0.8% (-$5.3bn) versus Feb -0.4% (-$2.7%)

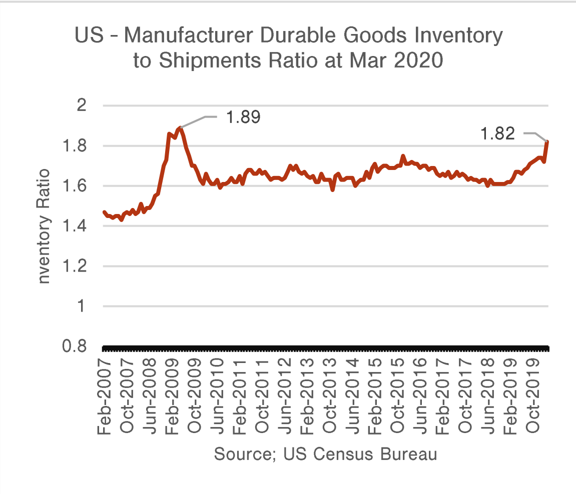
This month, there was actually an increase in the value of inventory for durable goods +0.6% (+$2.7bn). This was led by an increase in transport equipment inventory, but values increased across all durable goods manufacturing industries this month.

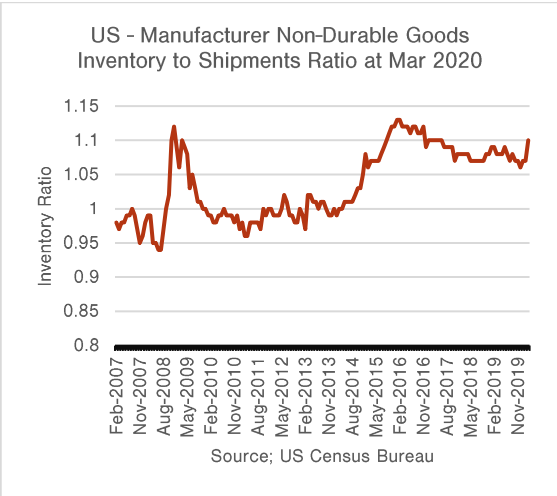
The value of inventory for non-durable goods declined by -3.2% (-$8.5bn) in Mar. This is likely linked to the lower value for petroleum – petroleum inventory declined by -$7.6bn

The inventory to shipment ratios all increased this month. Total manufacturing inventory to shipment ratio increased to 1.46 – on par with the GFC;



Both durable goods and non-durable goods recorded higher inventory to shipment ratios;





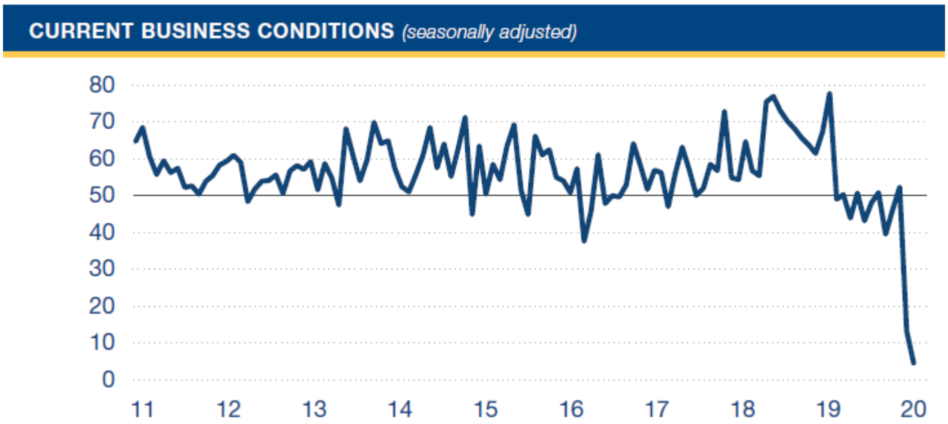
https://www.census.gov/manufacturing/m3/index.html

ISM NY Business Conditions (Apr)

The ISM report on business conditions in NY painted a fairly grim picture of current and expected conditions as of Apr.

The index of current conditions fell to the lowest reading on record this month – indicating that activity continued to contract after an already extremely low reading in the prior month.

Current business conditions for the NY metro area – month; Apr 4.3 versus Mar 12.9



The index of the six-month outlook also fell to the lowest reading on record; Apr 26.4 versus Mar 37.9.

The employment index for the area continued to fall in Apr – but so far remains above the lows of the GFC (26.3). The index in Apr fell to 29.2.

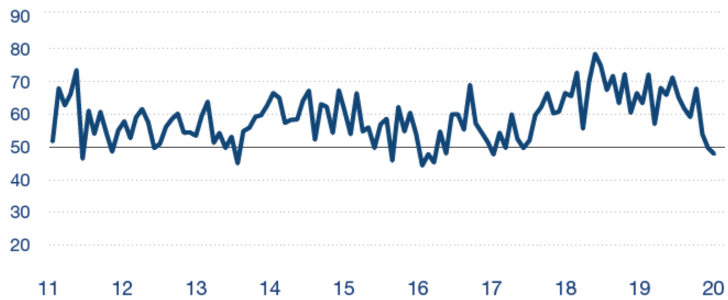
Current and expected revenues (top-line and forward revenue guidance) both contracted to new series lows in the month.

At the same time, prices paid has remained more resilient and has only just moved into contraction in Apr;

PRICES PAID

The current month's price levels paid for goods and services purchased from suppliers vs. the previous month.

Apr	Mar	Feb	Jan	Dec	Nov	Year Ago Apr
48.2	50.0	54.2	68.1	59.4	62.0	63.6



http://www.ismny.com/wp-content/uploads/2020/05/2020_ISM-New-York_April-ROB_v01.pdf

Mortgage applications wk ending 1 May

There was a slight increase in mortgage applications in the latest week. The purchase index is showing some sign of improvement.

Mortgage market composite index (loan application volume); +0.1% from the week prior.

"Mortgage application volume was unchanged last week, even as the 30-year fixed rate mortgage declined to 3.40 percent - a new record in MBA's survey"

The refi index decreased by 2% in the latest week, but remains +210% ahead of the same week a year ago. The drop in refi's is attributed to the shift in rates with lower rates being offered now for new loans than for refi's.

"Despite lower rates, refinance applications dropped, as many lenders are offering higher rates for refinances than for purchase loans, and others are suspending the availability of cash-out refinance loans because of their inability to sell them to Fannie Mae and Freddie Mac."

The purchase index, a measure of the number of loans finalised and a leading measure of home sales, increased another 6% in the latest week after increasing by 12% in the week prior. The purchase index remains 19% below a year ago.

The week over week change for some of the most affected states indicates that the pace of applications slowed in the latest week versus the week prior. The application volumes remain well below a year ago in these states;

	Week-Over-Week Change		Year-Over-Year Change	
State	% Change: Week Ending 5/1/2020	% Change: Week Ending 4/24/2020	% Change: Week Ending 5/1/2020	% Change: Week Ending 4/24/2020
CA	10.1	17.2	(30.9)	(34.1)
NY	8.8	13.7	(50.5)	(49.9)
WA	2.9	16.1	(37.5)	(36.9)

NOTE: Not seasonally adjusted, home purchase applications only

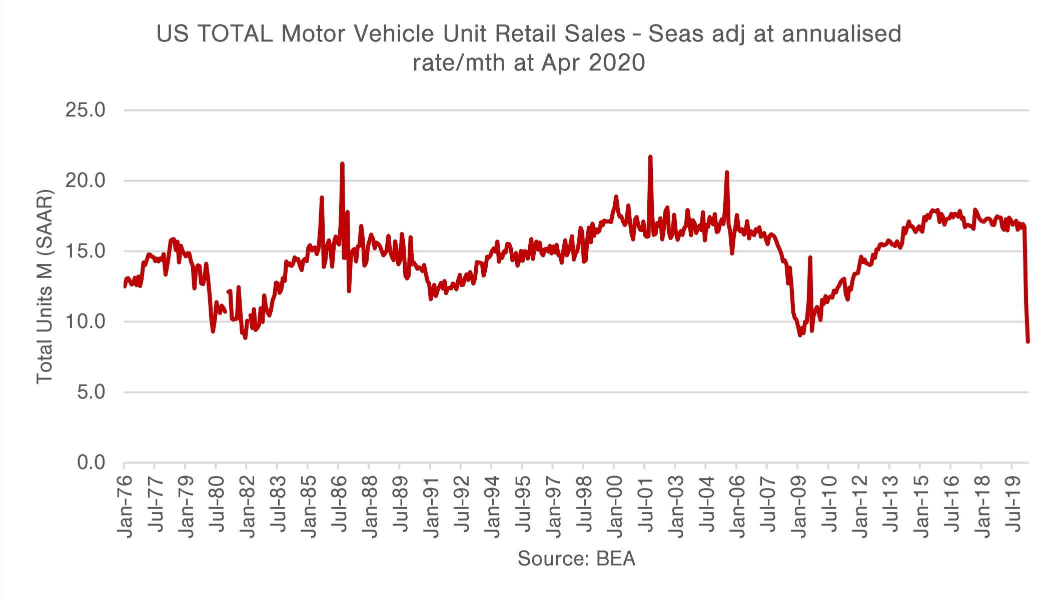
Source: Mortgage Bankers Association Weekly Applications Survey

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

Motor Vehicle Sales (Apr)

US Motor Vehicle sales continued to decline sharply in Apr, reaching a new series low on a SAAR basis. Sales continued to be restricted (physical dealer closures in many cases, online only) at the dealer level with strong sales incentives in place. Both Autos and Light Trucks/SUV's contributed to the decline. The sale of Auto's has reached a new all-time series low. The sale of light trucks/SUV's remains above the lows reached in the GFC.

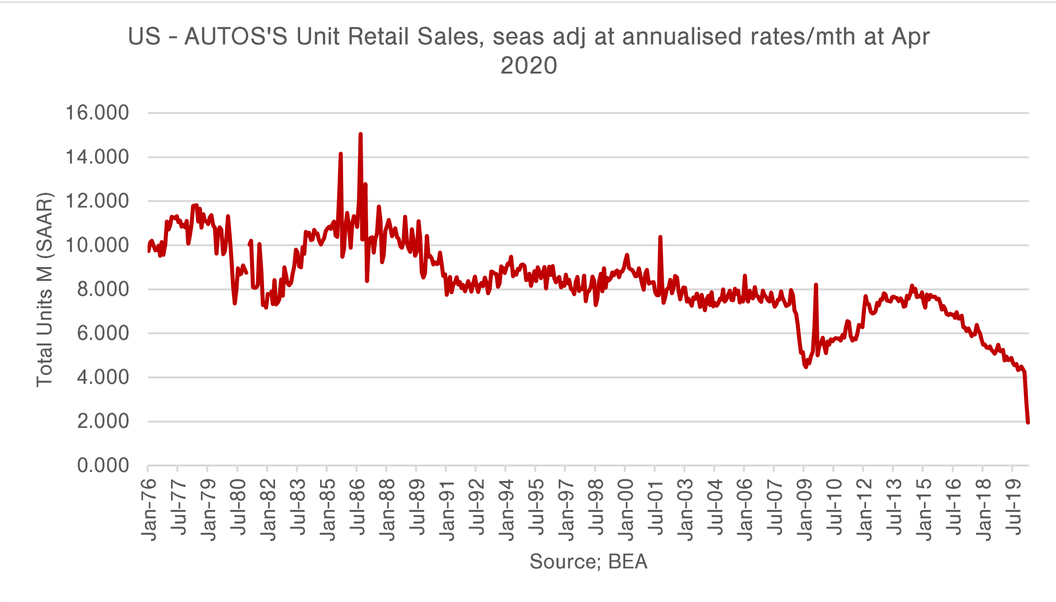
Total Motor Vehicle Sales – SAAR at the latest month; Apr 8.58m versus Mar 11.36m units



On an annual basis, the Apr SAAR of 8.58m in motor vehicle retail sales was 48% below a year ago. This is the single largest decline in sales in the series history (back to the late 70's).

The two main vehicle types in this series are Autos and Light Trucks/SUV's.

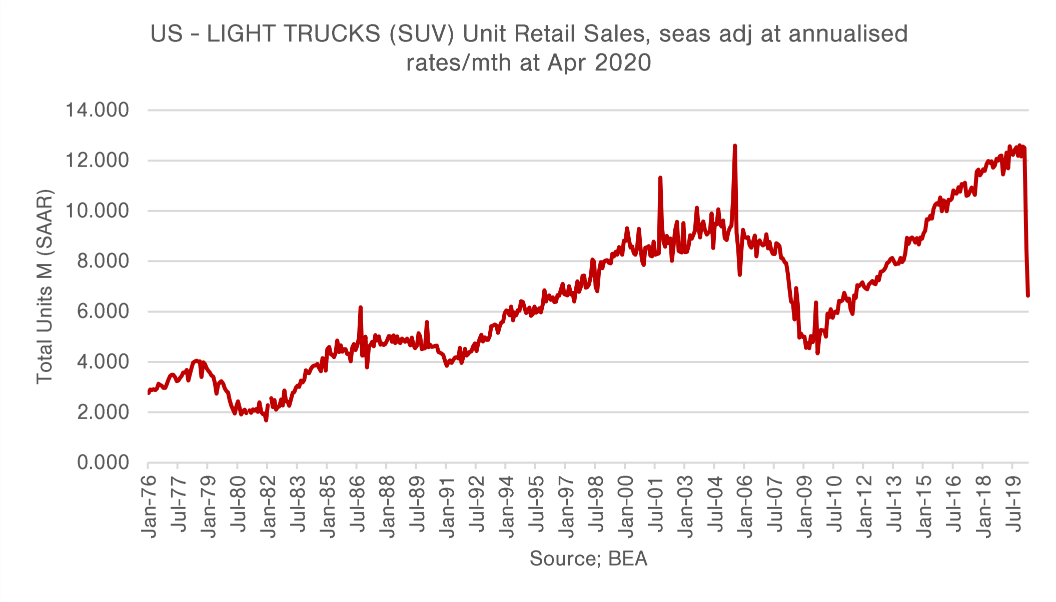
Auto Sales – SAAR at the latest month; Apr 1.95m versus Mar 2.85m units



The Apr SAAR of Auto sales is now 60% below a year ago.

Light Truck/SUV Sales – SAAR at the latest month; Apr 6.63m versus Mar 8.50m units

Note that the all-time HIGH SAAR of Light Truck sales was reached just six months ago in Nov 2019 which was 12.609m units. The SAAR of sale has almost halved since then.

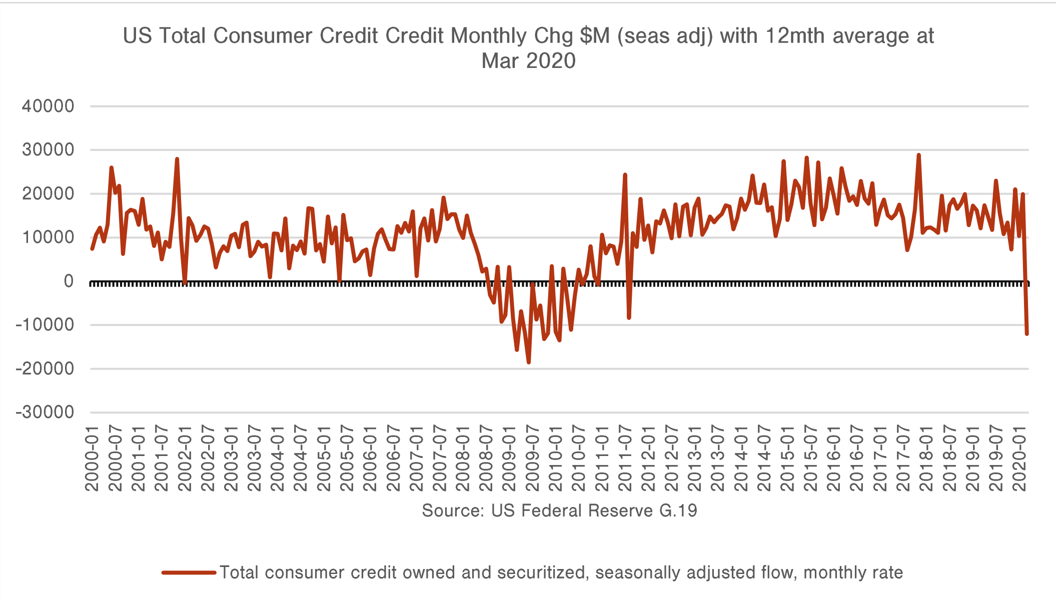


https://www.bea.gov/data/consumer-spending/main

Consumer Credit (Mar)

The total of outstanding consumer credit contracted sharply in Mar. The decline in outstanding revolving credit (credit card) more than offset continued growth in non-revolving credit.

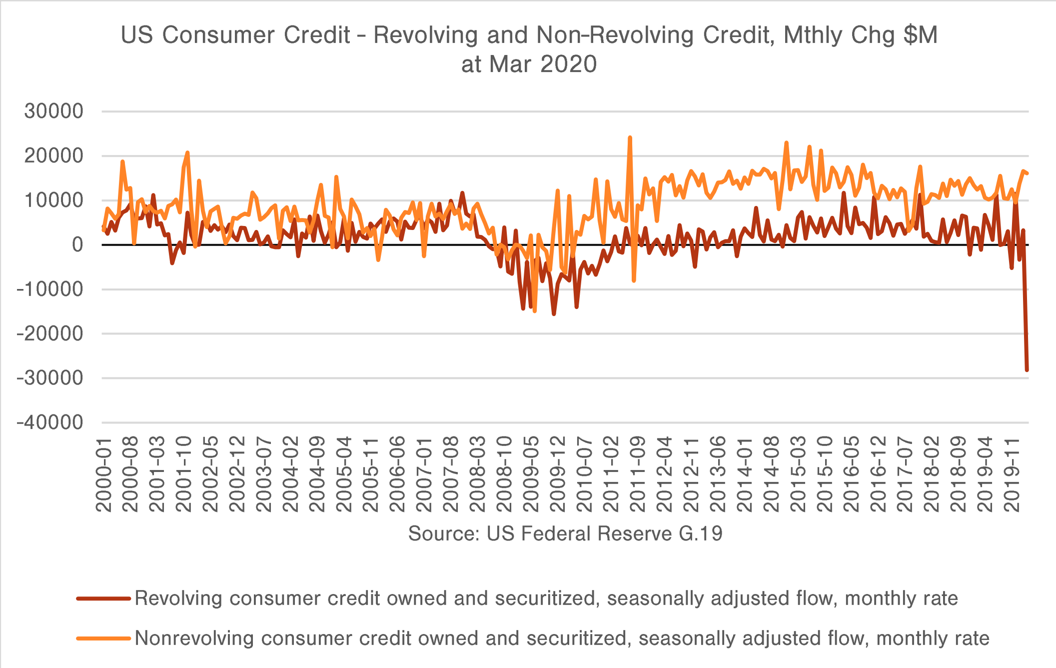
<u>Total Consumer Credit Outstanding – month change</u>; Mar -$12bn versus Feb +$20bn



The decline in the month is attributed to a large decline in revolving credit.

Revolving Credit Outstanding – month change; Mar -$28.2bn versus Feb +$3.3bn

The decline in Mar was larger than any single month of deleveraging during the GFC. Stimulus checks did not go out until mid Apr, so it's not likely that they were used to reduced credit card debt.

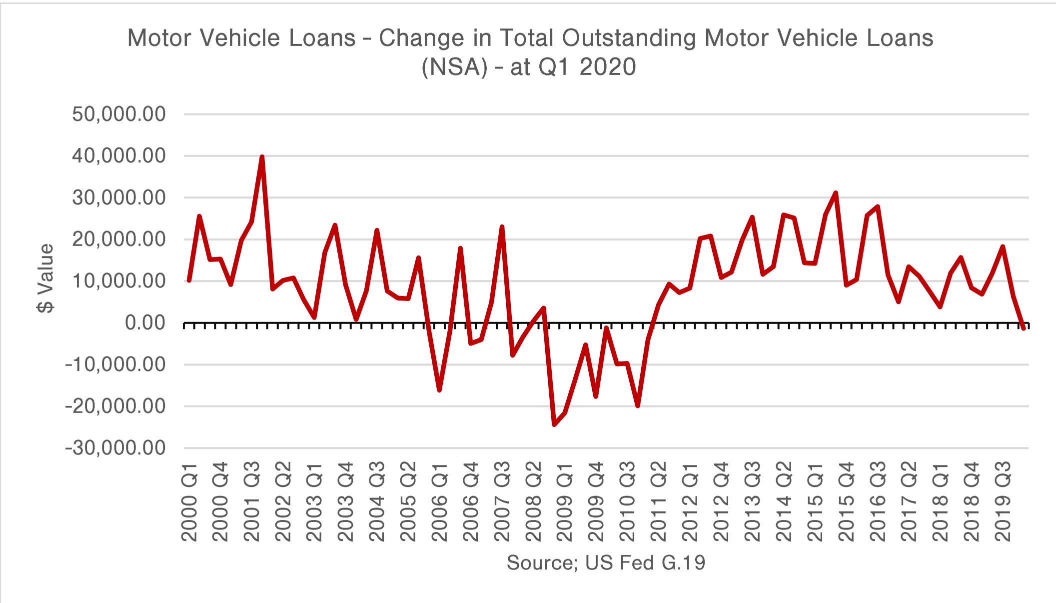


Non-revolving credit increased at a consistent pace;

Non-Revolving Credit Outstanding – month change; Mar +$16.1bn versus Feb +$16.6bn

As this is quarter end, the student and auto loan detail of non-revolving credit outstanding were released.

This is not seasonally adjusted data. In Q1, motor vehicle loans outstanding declined by -$1.3bn in Q1.



Student loans increased by +$41bn for Q1. There is a strong seasonal element to this series, but the Q1 result for 2020 was virtually the equal largest quarterly increase (Q1 2011 student loans increased by $41bn also).

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

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Europe

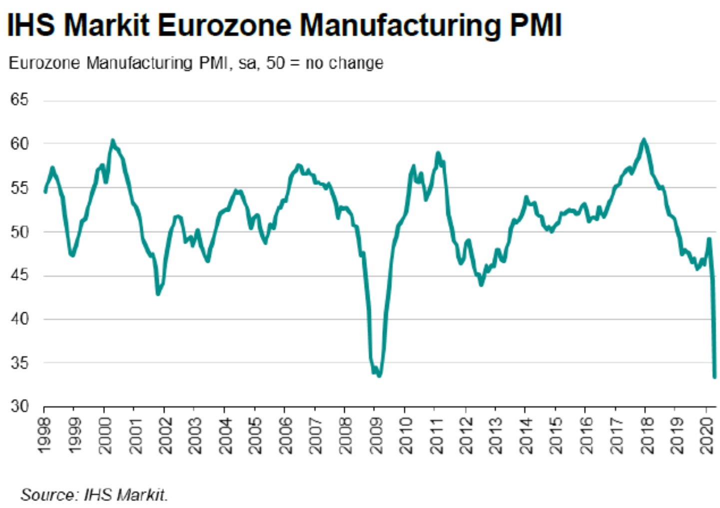
Markit Manufacturing PMI Final (Apr)

The final PMI reading indicated that manufacturing activity across the Eurozone did decline at a record pace in Apr. New series lows in the headline PMI were recorded across Austria, France, Italy, and Greece. The manufacturing PMI in Germany fell to an eleven-year low.

> Restrictions on non-essential economic activities and associated social-distancing measures were widely reported to have led to a broad-based pause for demand and production.

Headline Manufacturing PMI; Apr 33.4 versus Mar 44.5

The pace of decline in Apr was the lowest recorded since the series commenced in Jun 1997.



The decline in output reached a new record low across the entire Eurozone this month. All categories recorded declines this month, with the decline across investment goods particularly sharp. Similarly, new orders and new export orders also declined at a record pace.

Delivery times continued to lengthen due to transport delays and challenges in sourcing materials. Non-essential input purchases were reduced and firms worked through existing inventories.

Backlogs of work declined in the absence of growth in new orders. Employment levels were also reduced at the fastest pace since Apr 2009.

Both input costs and output charges declined at a faster pace.

With regard to the outlook, firms remained "extremely downbeat". Sentiment fell to a new low in Apr amid concerns about future output. The most pessimistic member states were Spain, Germany, and Austria.

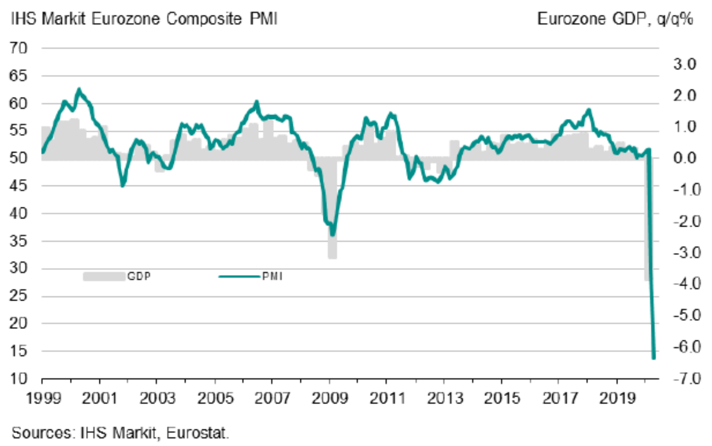
https://www.markiteconomics.com/Public/Home/PressRelease/d9c45c2e3a1b4b45a4b68fbc0389385c

Eurozone Composite and Services PMI (Apr)

The Eurozone services business activity index fell at an accelerated pace in Apr, even after a record fall in Mar. This led the entire composite output index for the Eurozone to a new series low.

The headline composite output index; Apr 13.6 versus Mar 29.7

IHS Markit Eurozone Composite PMI



New survey lows were recorded across major Eurozone members – Germany (17.4), Ireland (17.3), France (11.1), Italy (10.9) and Spain (9.2).

Services business activity index fell to 12 in Apr from 26.4 in Mar.

New work contracted at a record pace. Firms worked through order backlogs resulting in the fastest decline in backlogs in the series history. Employment declined at the fastest pace in the series history also.

Business confidence remained at extremely low levels.

https://www.markiteconomics.com/Public/Home/PressRelease/90fd4f17d89e410f9925c283a97e25ca

Germany Industrial Production (Mar)

The PMI's have been the leading indicator for the pace of decline in activity around the globe. There has been a 'shock factor' in these PMI's as production declines reach new series lows, especially throughout Europe. Reviewing industrial production will help to put some substance behind the PMI's which indicate the direction and pace of change, not the level of activity.

Germany industrial production was impacted by the shut-down of activity due to Covid-19 in Mar. While manufacturing, mining and utilities production all declined in Mar, construction continued to grow. Overall industrial and manufacturing production levels fell back to levels last recorded in 2010.

Total Industrial Production – month change; Mar -9.2% versus Feb +0.3%

The decline in Mar ended what appeared to be the start of a small rebound in industrial production over the two prior months. Overall, production had peaked back in late 2017 and had drifted off ever since. By Feb 2020, production appeared to 'rebound' such that it was only 5% below that late 2017 peak.

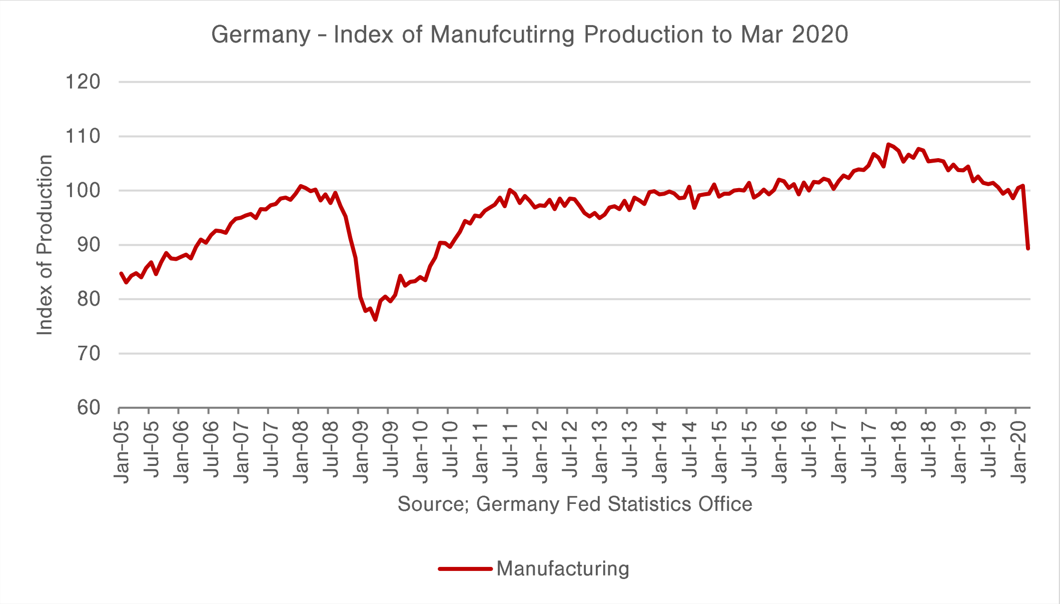
As of Mar 2020, production levels have fallen back down to levels recorded in 2010;

Overall industrial production declined by 11.6% versus the same month a year ago. Production levels are now 13.6% below the Nov 2017 peak.

There are four main areas of industrial production; manufacturing, mining & quarrying, utilities, and construction.

<u>Manufacturing Production – month change</u>; Mar -11.5% versus Feb +0.4%

The severe decline in Mar resulted in production levels falling back down to 2010 levels also;



Total Manufacturing production is now 17% below the Nov 2017 peak and is 14% below the same month a year ago.

All areas of manufacturing production declined sharply in the month.

Intermediate goods – month change; Mar -7.4% versus Feb +1.8%

Again, there had been some sign of a rebound in activity over Jan and Feb 2020. The manufacture of intermediate goods is now 7.8% below the same month a year ago.

Capital goods – month change; Mar -16.5% versus Feb -1.2%

Production of capital goods had remained weak and Mar was a further blow to production levels. Production is now 21.8% below a year ago and 25% below the Nov 2017 peak.

Durable goods – month change; Mar -10.9% versus Feb -1.2%

Similarly, growth in durable goods production had remained fairly weak leading up to Mar. Production levels are now 14% below a year ago.

Non-durable goods – month change; Mar -6.8% versus Feb +2.5%

Production of non-durable goods had at least stabilised over the last few months. But as of Mar, production levels have also fallen to -6.8% below a year ago and 14% below the May 18 peak.

Consumer goods – month change; Mar -7.5% versus Feb +1.8%

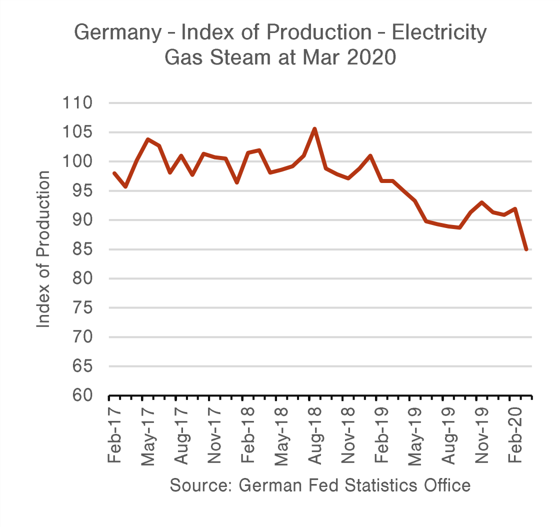
Similarly, production of consumer goods had been more stable over the last 12 months. But as of Mar, levels have fallen to 8.3% below a year ago and 14.5% below the May 2018 peak.

<u>Mining and quarrying – month change</u>; Mar -3.7% versus Feb -3.6%

Mining and quarrying production activity has been declining since mid-2017. The decline in Mar was in line with recent falls. The annual decline in Mar accelerated slightly from -8.2% in Feb to -9.1% in Mar;

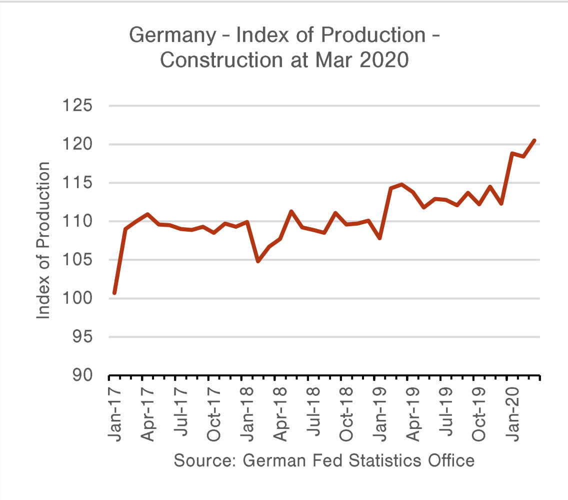
<u>Utilities – month change</u>; Mar -7.5% versus Feb +1.1%

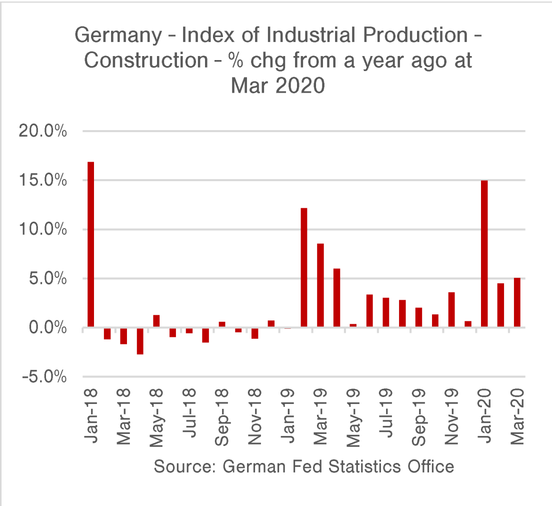
The production of utilities continued to fall in the latest month. Production levels are now 12% below a year ago and 19.5% below the Aug 2018 peak.



<u>Construction – month change</u>; Mar +1.8% versus Feb -0.3%

Construction remains the one bright spot in the industrial production landscape for Germany. Construction activity is now +5.1% ahead of a year ago and growing at constant pace;





https://www.destatis.de/EN/Press/2020/05/PE20_156_421.html

Eurozone PPI (Mar)

Industrial producer prices declined at an accelerated pace in Mar, led by an accelerated decline in energy prices

The index of producer prices shows (in the national currency of the country concerned) changes in the **ex-works sale prices of all products sold on the domestic market**, excluding imports.

This provides some insight into demand conditions for firms within the supply chain. While selling price growth across most categories (ex-energy) are starting slow on a monthly basis, annual growth remains more robust.

<u>Euro area PPI – month change</u>; Mar -1.5% versus Feb -0.7%

The further decline in prices in Mar was mostly led by a 5.5% decline in energy prices.

Excluding energy, producer prices declined more modestly; Mar -0.2% versus Feb 0%

There was an accelerated decline in prices in the month for intermediate goods (-0.5% in Mar). Capital goods prices and non-durable consumer goods prices slowed to zero. Prices of durable consumer goods increased at the same pace (+0.1%).

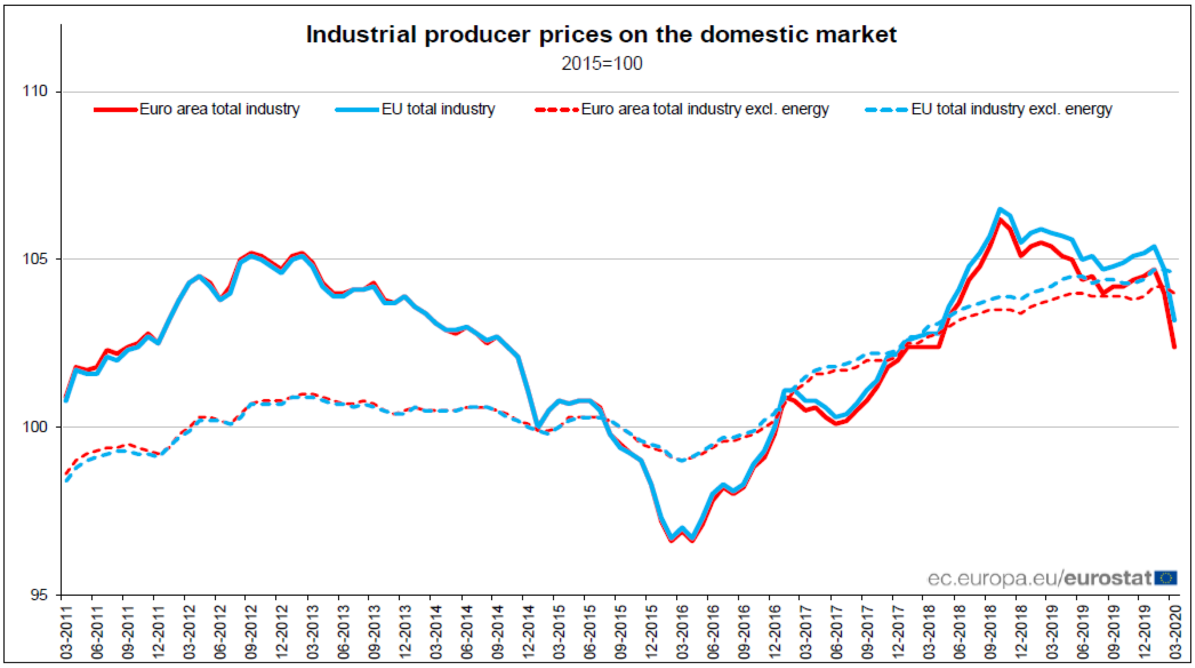
There were few markets that did not record a decline in producer prices in Mar; Malta, Latvia, and Cyprus.

<u>Euro area PPI - annual change</u>; Mar -2.8% versus Feb -1.4%

Accounting for most of this acceleration in the decline of the PPI was an 11.3% annual decline in energy prices.

Excluding energy prices, the annual change in the Euro area PPI slowed; Mar +0.2% versus Feb +0.5%. This is still the lowest growth of the last six months.

Prices for intermediate goods declined by -1.8% versus a year ago. Prices for capital and durable consumer goods also slowed, but remained firmly positive. Prices for non-durable consumer goods remained unchanged at +2.4% versus a year ago.



https://ec.europa.eu/eurostat/documents/2995521/10294828/4-05052020-AP-EN.pdf/94512e4d-f51d-3170-2916-690a5709a256

Eurozone Retail Sales (Mar)

Across the Eurozone, the volume of retail sales declined by over 10% in Mar. This reflects the broad implementation of Covid-19 containment strategies across member countries.

Severe declines in sales were recorded across most categories and were only partly offset by stronger growth in food, drinks, and tobacco. Sales via mail order and internet increased but at a slower pace.

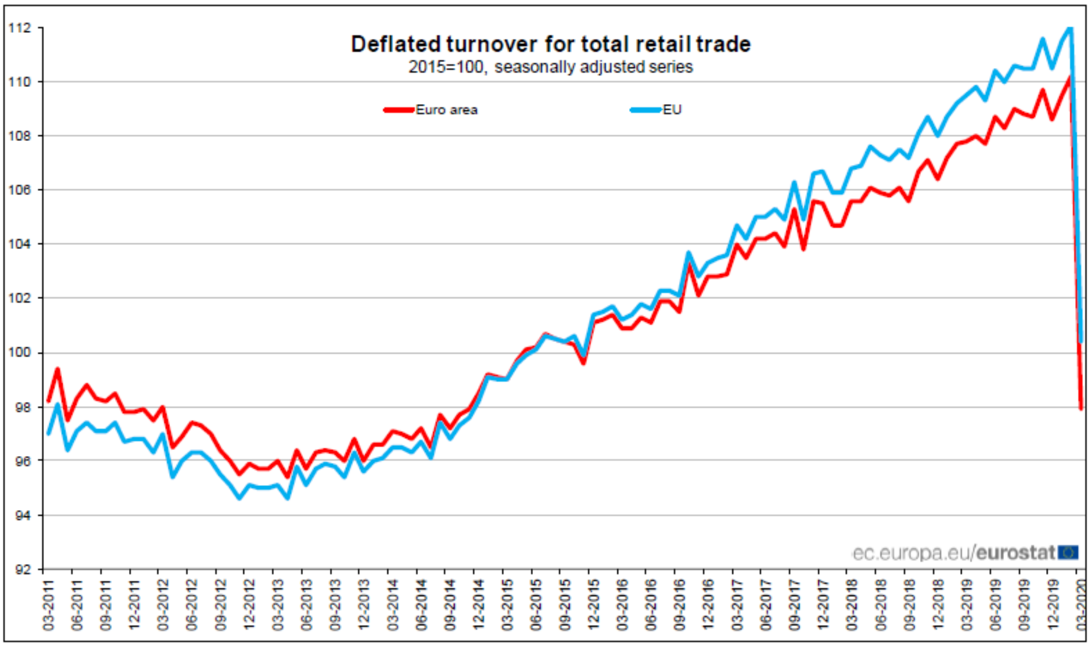
EU Retail Sales Volume Index – month change; Mar -10.4% versus Feb +0.5%

Across the EU, food, drink, and tobacco sales increased at a faster pace of +4.7% in Mar. Retail sales of pharmaceuticals and sales via mail or internet also increased in Mar, but at a slower pace of +0.2% and +2.2% respectively.

This was more than offset by a decline across non-food products of -21.3% versus the month prior. Clothing/footwear sales declined by 40% in Mar and electrical goods and computer equipment sales both declined by -16% in Mar.

Auto fuel sales declined by 19% in Mar.

On an annual basis, retail sales across the EU declined by 8.2% in Mar (versus the same month a year ago).



https://ec.europa.eu/eurostat/documents/2995521/10294820/4-06052020-AP-EN.pdf/f1cfda40-fe3f-4d21-e8ae-e8821001f3fb

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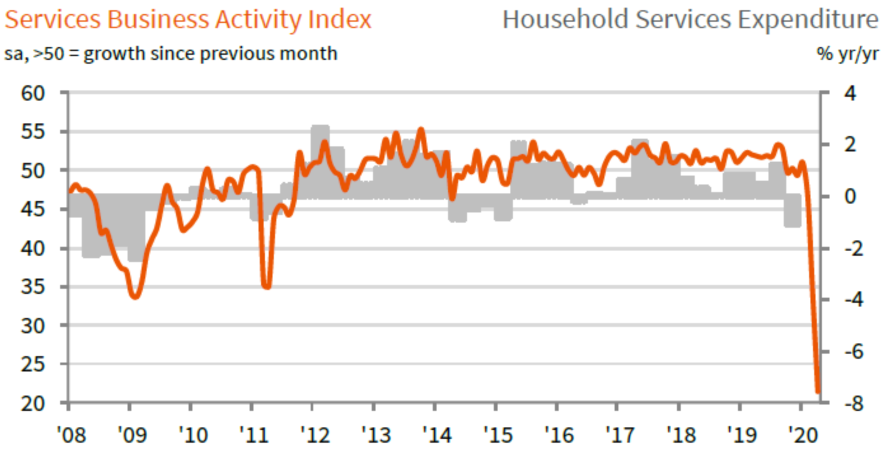
Japan

Services PMI Final (Apr)

The final reading for the Services PMI in Japan confirmed the very sharp fall in activity in Apr. The decline in activity was the largest in the series history. The sharp fall in activity was the result of ongoing measures to slow the spread of Covid-19.

Services Business Activity Index; Apr 21.5 versus Mar 33.8



Sources: au Jibun Bank, IHS Markit, Cabinet Office Japan

New business orders declined at the fastest pace on record in Apr. Clients either closed businesses or cancelled orders amid restricted trade.

Overall business confidence declined to the lowest level since 2009. Firms expect that activity will decline over the next 12-months.

Despite the sharp decline in demand and outlook, employment declines were not as severe. The report noted that approx. 83% of firms left employment unchanged from the month prior.

Input costs declined for the first time since 2012, due to somewhat lower employment as well as lower fuel costs.

Firms continued to discount, with selling charges falling at the fastest pace since Jun 2011.

https://www.markiteconomics.com/Public/Home/PressRelease/b6241ffc6ae34198afd8072e0e10d692

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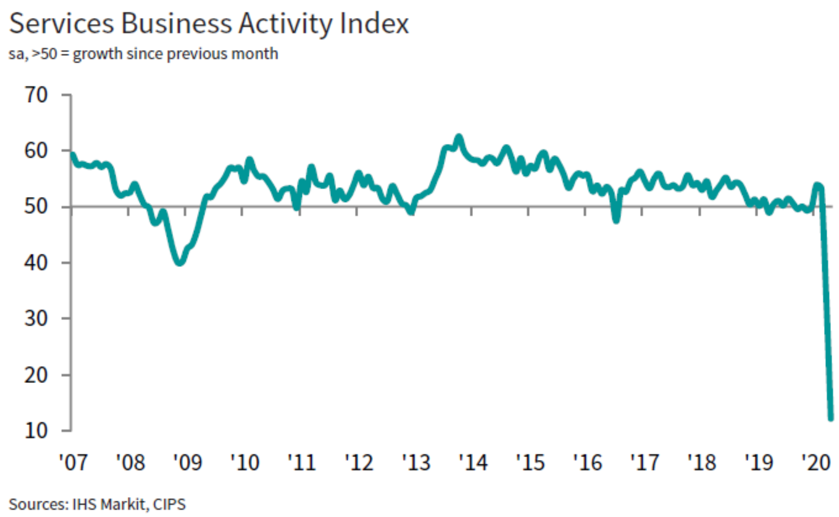
United Kingdom

Markit Services PMI Final (Apr)

Services activity declined in Apr at the fastest pace in the history of the survey (going to back to 1996). The decline in activity was extremely severe with the headline business activity index falling into the teens. In Apr, 79% of firms reported a decline in business activity compared to 43% firms in Mar.

<u>Business Activity Index;</u> Apr 13.4 versus Mar 34.5



New orders and employment declined at 'record-levels' in Apr. There was a small number of firms reporting increased, or at least resilient levels of, new work/orders – online shopping, public sector work, services related to remote working and financial services.

There was a small lift in business expectations for the next twelve months, but most firms expected that activity would take a long time to return to normal.

https://www.markiteconomics.com/Public/Home/PressRelease/429ff7c4e6724cf1a2e354b690c728f0

BoE Rates Decision – 7 May 2020

Current settings were left unchanged at the latest meeting, although there were several members of the MPC that voted to increase bond purchases as a part of the QE program.

<u>Current Settings</u>

Bank rate; +0.1%

Maintain £200bn of UK government bond and sterling non-financial investment-grade corporate bond purchases. Two members voted to increase the target for the total stock of these purchases (currently £645bn) by an additional £100bn. At the current pace of purchases, the stock of outstanding securities will reach the target of £645bn by the start of Jul.

Current Conditions

Economic activity has fallen since the start of the year. Some signs of stabilization at low levels. Household consumption has declined by approx. 30%. Consumer confidence has declined and housing activity has "practically ceased".

Widespread take-up of the job retention scheme, but still a "pronounced" increase in unemployment has been recorded.

Annual CPI growth has slowed to 1.5% and is expected to slow further to below 1% in the coming months – mostly as a result of weaker energy prices.

Outlook

Remains highly uncertain. It will depend on household, business, and government response. The most likely scenario;

> a very sharp fall in UK GDP in 2020 H1 and a substantial increase in unemployment in addition to those workers who are furloughed currently.
>
> Given the assumed path for the relaxation of social distancing measures, the fall in GDP should be temporary and activity should pick up relatively rapidly.
>
> a degree of precautionary behaviour by households and businesses is assumed to persist, the economy takes some time to recover towards its previous path.
>
> CPI inflation is expected to fall further below the 2% target during the second half of this year, largely reflecting the weakness of demand.

The MPC also notes that in the illustrative scenario, activity rebounds relatively quickly;

> In the illustrative scenario, the recovery in economic activity is relatively rapid and inflation rises to around the 2% target, conditional on the scenario assumptions that include a gradual easing in social distancing, and supported by the very significant monetary and fiscal stimulus.

The MPC also notes that the balance of risks remains to the downside at this stage.

Forward Guidance

Current policy settings are appropriate. Further action will be taken as necessary in order to ensure a "sustained return of inflation to the 2% target".

https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/may-2020

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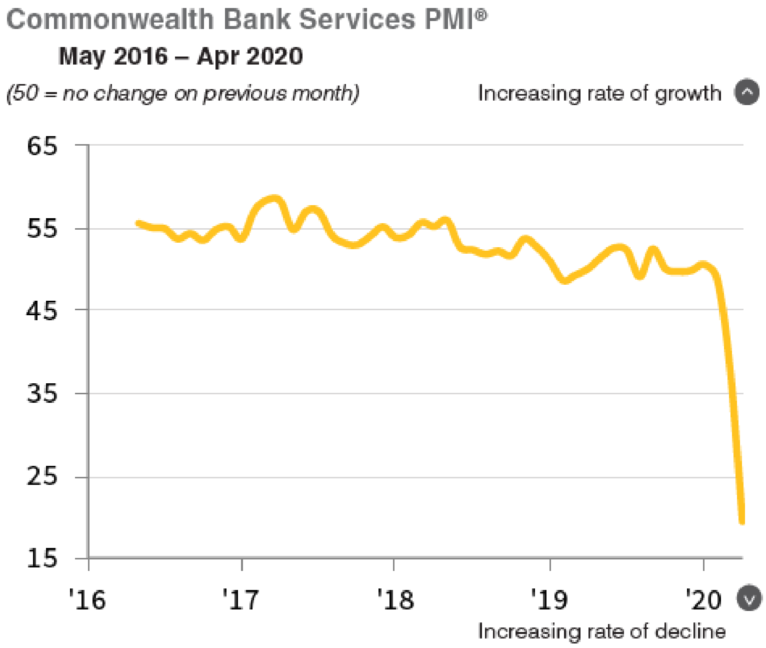
Australia

CBA/Markit Services PMI Final (Apr)

Growth in services business activity continued to slow to new lows in Apr. This Apr report reflects the first full month of social distancing restrictions in Australia. At the time of writing, some of these restrictions are now to be slowly lifted – which means we should start to see an improvement in activity levels from next month. But with ongoing travel restrictions, upside will be limited.

Services Business Activity Index – month; Apr 19.5 versus Mar 38.5



Demand for services declined sharply, especially across restaurant and travel sectors. New business continued to decline led by both domestic and foreign demand for services.

Business confidence remained 'subdued' with expectations for future output only improving marginally.

Firms continued to reduced workforce numbers, with reports of forced redundancies.

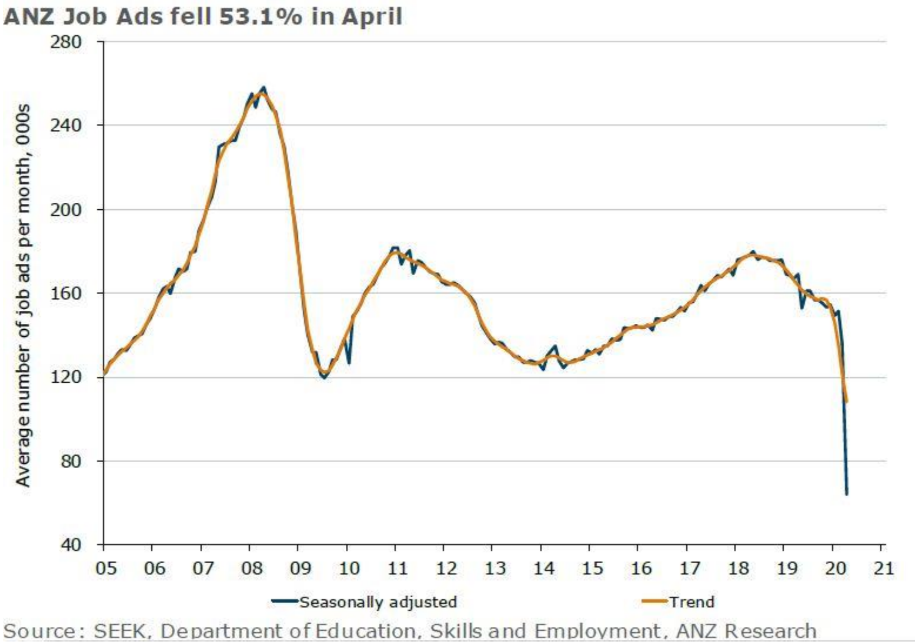
Input prices declined for the first time in the four-year series history – due to lower fuel charges, pay cuts and rental relief. Selling prices also declined markedly in the month in an effort to retain customers.

https://www.markiteconomics.com/Public/Home/PressRelease/d162c4e866c84b4496fc867b4941a24b

ANZ Job Ads (Apr)

The ANZ bank job ads series indicated that adverts fell sharply in Apr. The demand for labour was impacted by restrictions on trade for non-essential services/business.

Total Jobs Ads – month; Apr 63,806 which was 53% below the month prior.



Job ads fell progressively over the month, adding to the evidence that the downturn in activity is impacting businesses and the labour market at an unprecedented speed.

The job-keeper allowance is expected to reduce the peak in total unemployment in Australia, but unemployment is still expected to increase to 9.5% in Q2.

https://media.anz.com/posts/2020/05/job-ads-halve-in-april?adobe_mc=MCMID%3D62542987290149514063282464170528242039%7CMCAID%3D2F4B2A450515A543-60000A1929B2F4C0%7CMCORGID%3D67A216D751E567B20A490D4C%2540AdobeOrg%7CTS%3D1588914592

Retail Sales (Mar)

As outlined by the prelim report, retail sales growth accelerated considerably in Mar. This represents 1) households stockpiling essential items and 2) shifting consumption patterns based on uncertainty, lower income, and/or physical restriction of activity.

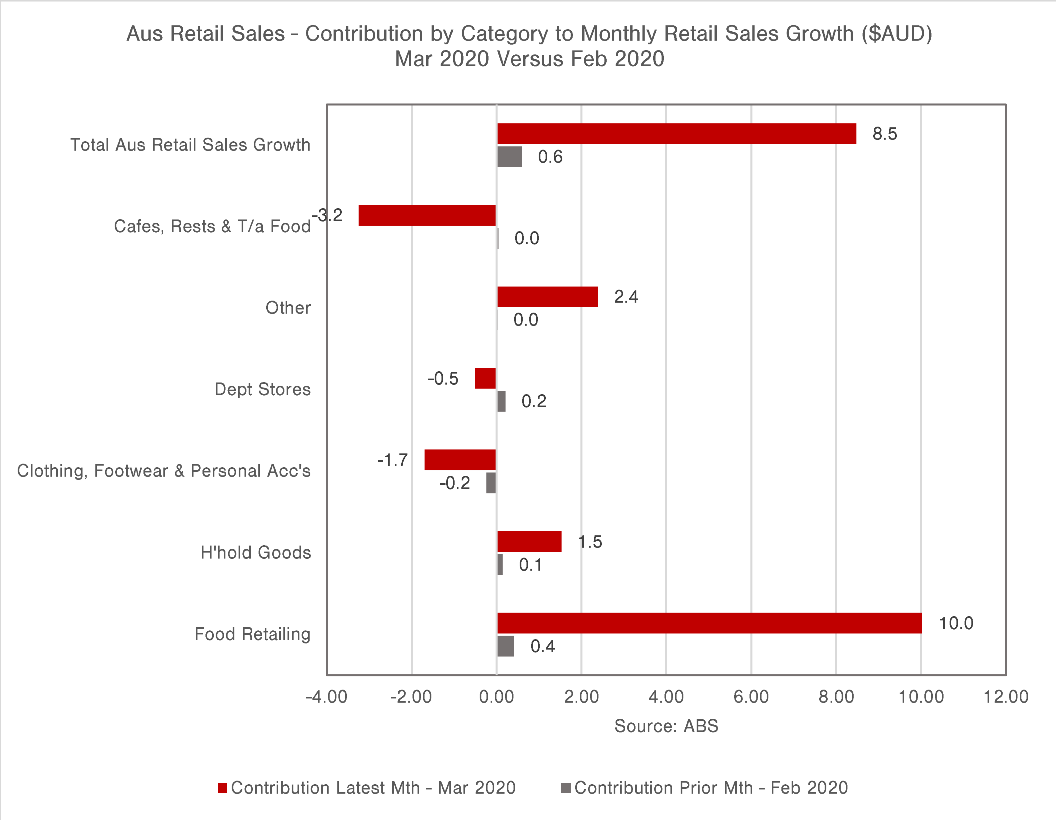
In the timeline of activity, Mar represents the implementation of physical distancing containment strategies, resulting in the shutdown or restricted trade of on-premise food and liquor and some retail.

Retail Sales Value – month change; Mar +8.5% versus Feb +0.6%

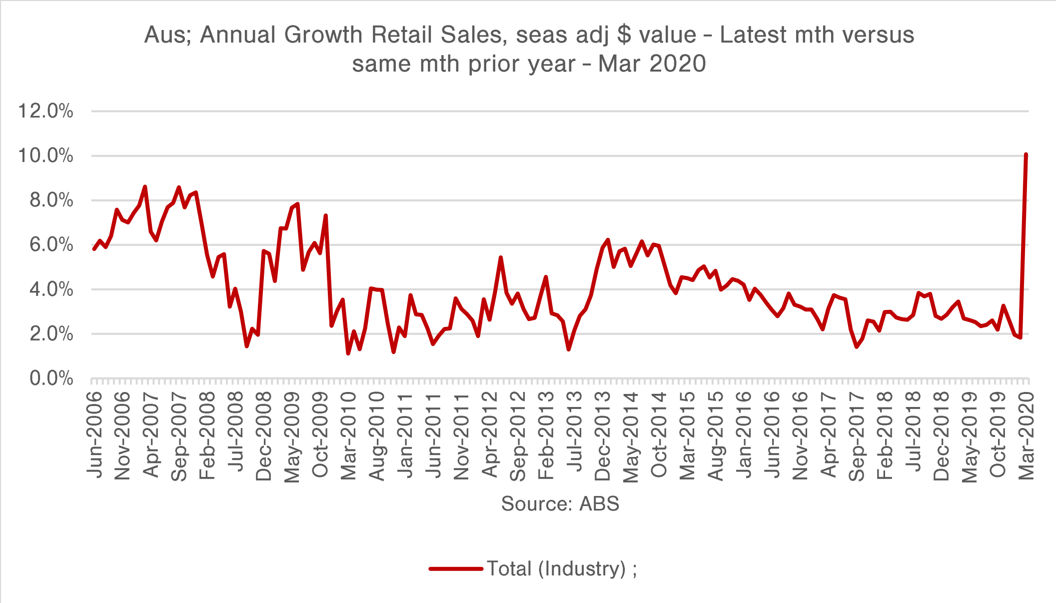
The extremely strong result was led almost entirely by sales in the grocery retail channel, which *increased by 24% in the month*. This growth may have been higher were it not for the considerable out-of-stocks on shelves.

Food retailing overall contributed 10% pts to the headline 8.5% growth in the month. Which means that all other retail sales excluding grocery, declined in the month.

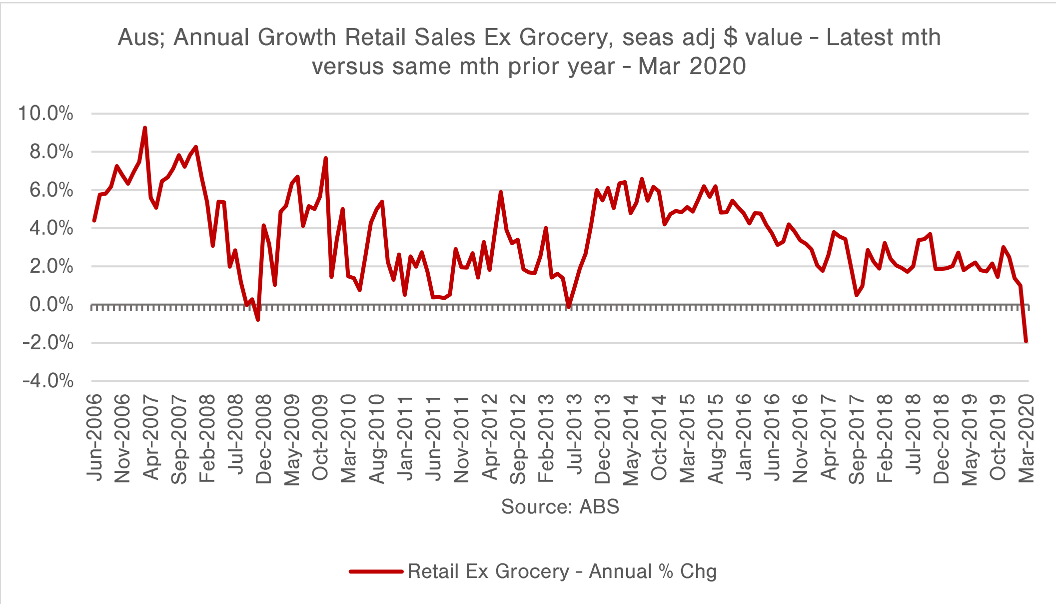
Excluding grocery, retail sales value declined by 2.7% in the month. There were mixed results underlying this; sales declined in cafes, restaurants, and takeaway food services, clothing, and department stores. Other and household goods retail sales increased in the month;



The annual change in retail sales value sales (versus the same month a year ago) increased to +10.1% versus +1.8% in Feb;



Excluding grocery sales, retail sales declined by -1.9% versus the same month a year ago;



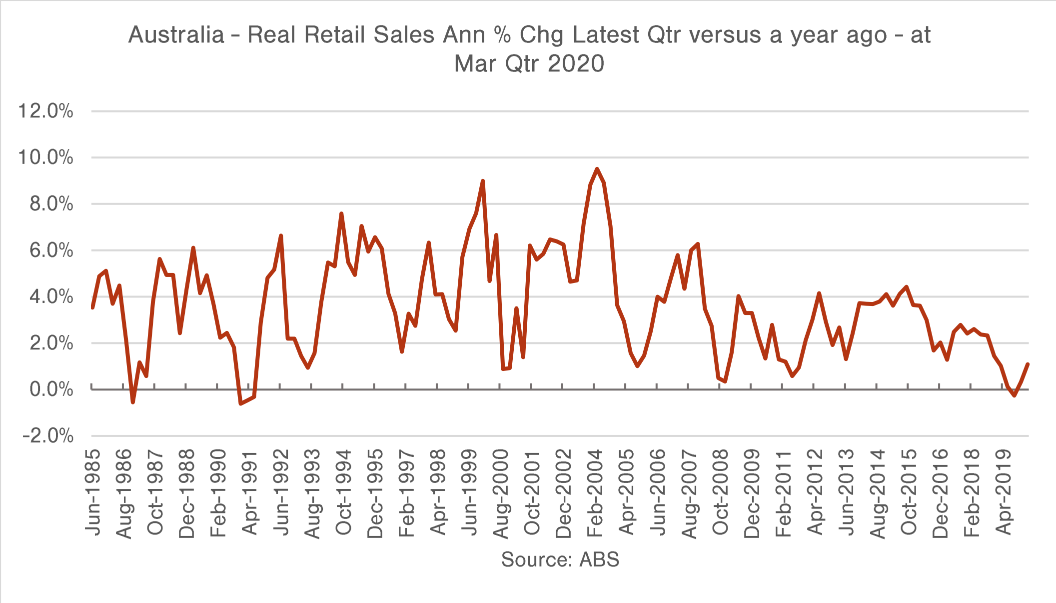
<u>Retail Sales Volume</u>

The ABS released the retail trade volume index for Q1. There was some acceleration in retail sales for the Mar quarter;

<u>Retail Sales Volume – quarter change</u>; Mar +0.7% versus Dec +0.5%

The sales volumes reflected an identical trend to sales value; food retail volumes growth led total sales higher and mostly offset declines in sales volumes across clothing, department stores and cafes/restaurants and take-away.

On an annual basis, retail sales volume growth accelerated to +1.1% versus the same quarter a year ago;



https://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/8501.0Main%20Features1Mar%202020?opendocument&tabname=Summary&prodno=8501.0&issue=Mar%202020&num=&view=

New Housing Finance Lending Commitments (Mar)

While this is the housing finance report for Mar, the commitments reported in Mar "largely reflected loan applications submitted in February or the first half of March before major restrictions were introduced". There are two effects to consider in the future reports 1) physical restriction of sales and 2) the impact of lost income on loan demand.

All values quoted are AUD and excluding refi's.

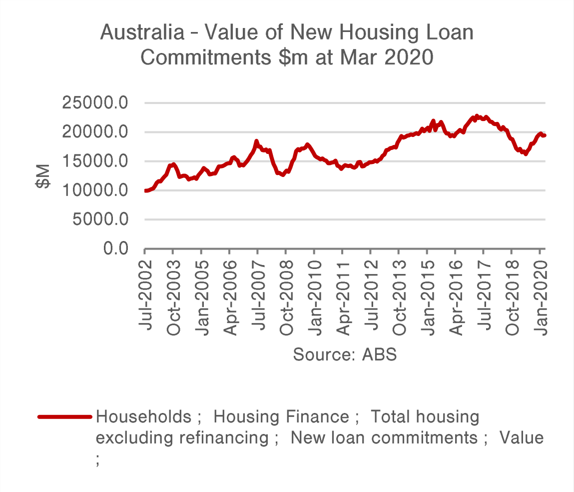
Loan growth for housing was subdued for Mar after declining in Feb. Of the three main segments, the main driver of growth was loans for first home buyers. Loans for other owner occupiers increased at a slower pace. New commitments for investors continued to decline on a monthly basis.

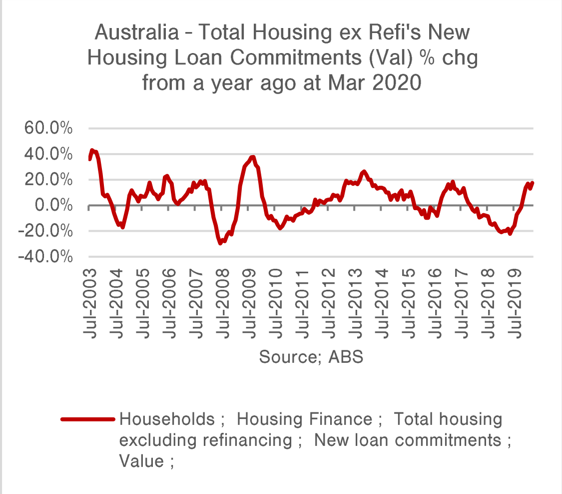
It's important to underline the weakness in the 'recovery' of the investor housing market since May 2019 and now leading into the pandemic. Rental income for investors has been severely curbed by travel restrictions and investors are now looking for longer-term rental agreements in order to fill the income gap, creating more rental supply on the market. According to CoreLogic, the value of rents in Apr just declined at the fastest pace since the series was started in 2005.

<u>Total Housing Finance New Loan Commitments (val) – month change</u>; Mar +0.2% (+$35.4m) versus Feb -1.8%.

The value of new lending commitments remains below the 2017 peak. On an annual basis though, total value is still cycling over the trough from early 2019 - the minimum was reached in May 2019. This was partly the reason behind the acceleration in annual growth this month, despite the virtually flat growth.

Total housing finance new loan commitments (ex-refis) increased by 17% versus a year ago in Mar versus +13% in Feb.





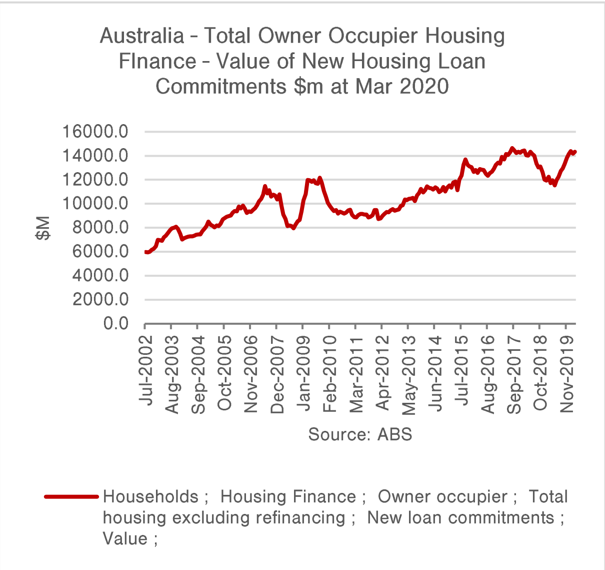
Owner occupiers are the largest segment of this lending market, made up first home buyers (FHB's) and all other owner occupiers. The FHB segment has been the driver of growth over this period of recovery since May 2019.

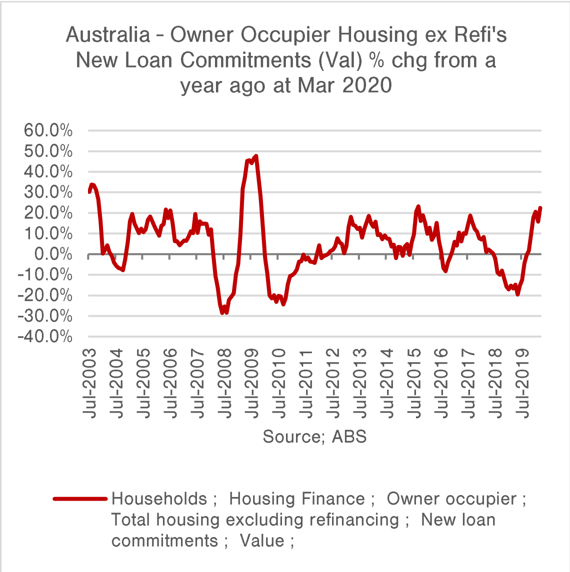
<u>Owner occupier lending new finance commtiments – month change</u>; Mar +1.2% (+$165m) versus Feb -1.5%.

In Mar, FHB housing finance commitments increased by +2.5% or +$102m – making up the majority of growth this month again.

All other owner occupier housing finance commitments increased by +0.6% or +$62m.

Overall owner occupier housing lending increased by 22% versus a year ago. Growth in FHB lending commitments increased by 39% versus a year ago and all other owner occupiers lending increased by 17%.



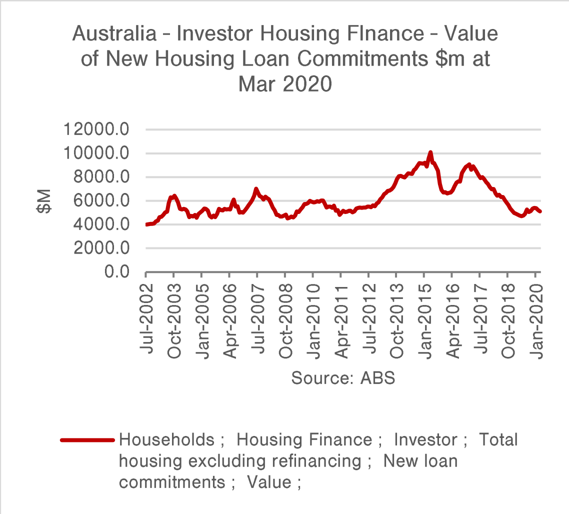


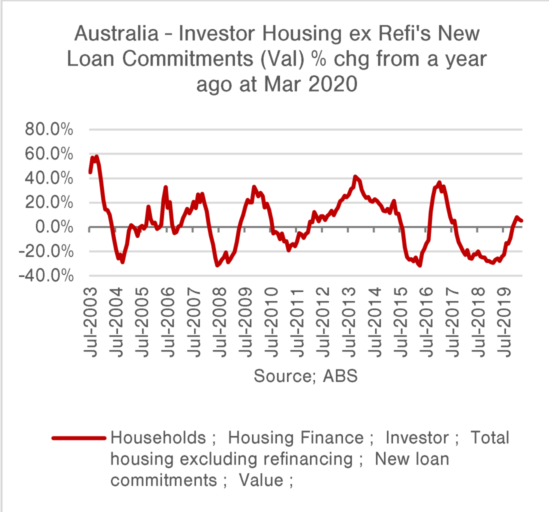
This month, lending for investors remained a drag on growth.

<u>Investor housing new finance commitments – month change;</u> Mar -2.5% (-$130m) versus Feb - 2.6%

Note that investor lending has severely lagged in this recovery since May 2019. The monthly value of lending is only +8.5% higher than the trough in May 2019. Compared to total owner occupiers, where the monthly loan value is now +25% higher than the May 2019 trough.

The value of lending for investors is only +5.3% ahead of a year ago;

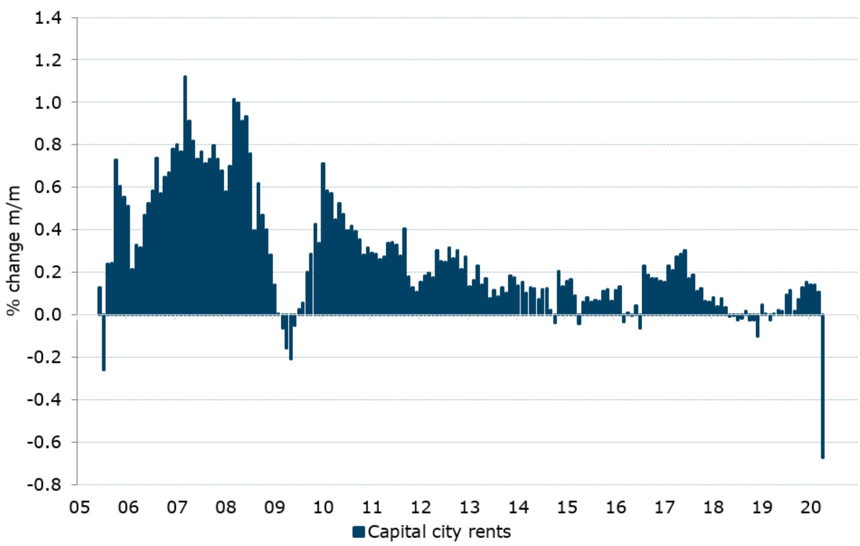




It's important to note the existing weakness in the 'recovery' of the investor housing market segment since May 2019 and now leading into the pandemic.

Demand for investor lending is likely to keep falling, especially as the income from short-term rentals, such as Air BnB, has declined significantly due to travel restrictions. This form of rental income has underpinned some investor loans. Investors using short-term rental sites are now looking to longer-term leases in order to recover income. This increase in supply has already started to flow into declines in rents – according to ANZ and CoreLogic, rents for new and established homes (all capital cities) have fallen by -0.8% in Apr. This is the single largest monthly decline since the series started in 2005.

Chart; CoreLogic Month Change in Capital City Rents



Source: CoreLogic, ANZ Research

https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/5601.0Main+Features1Mar%202020?OpenDocument

RBA Rates Decision – 5 May 2020

The RBA Board kept policy settings unchanged. The overnight cash rate and the target rate for the 3yr yield were also unchanged at 0.25%.

Current Conditions

Conditions remain challenging as restrictions are still in place and uncertainty in the outlook remains extremely high.

Overall improvement in the functioning of financial markets amid unprecedented liquidity injections over the last two months.

Output is expected to fall by 10% over the first half of 2020 and by 6% overall in the full year. Growth is expected to bounce back to +6% in 2021.

Domestic demand conditions will remain weak during restrictions, but are supported by a strong commitment of fiscal and monetary support.

Outlook

The outlook is dependent on the pace at which restrictions can be lifted. Any delays to lifting restrictions is likely to have a greater negative impact on already subdued business sentiment.

Unemployment is expected to peak at around 10%, despite the job-keeper allowance. The unemployment rate is expected to remain above 7% by the end of the year.

CPI growth was somewhat stronger in Q1, but is expected to turn negative in Q2 due to the child-care relief, lower oil prices, and deferrals in other price increases.

The aim is to keep funding costs low to support incomes, jobs, and business through this period.

Forward Guidance

> The Board will not increase the cash rate target until progress is being made towards full employment and it is confident that inflation will be sustainably within the 2–3 per cent target band.

https://www.rba.gov.au/media-releases/2020/mr-20-13.html

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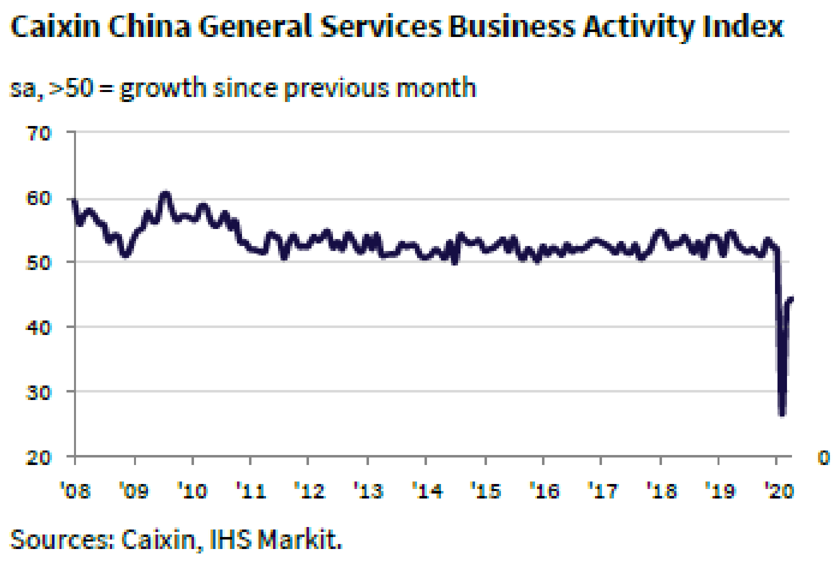
China

Caixin Services PMI Final (Apr)

Services activity continued to decline in Apr, at a similar pace as Mar. The decline in business activity was the result of continued disruption to local and foreign demand as a result of the pandemic.

Services Business Activity Index; Apr 44.4 versus Mar 43



New business continued to fall for the third month in a row. The pace of decline has slowed since Feb though. Orders remained lower due to weaker local and foreign demand. New export orders continued to decline sharply, falling at the second fastest pace since the series began in 2014.

Employment started to fall at faster rate – now the fastest on record since 2005. Despite the fall in employment, backlogs continued to decline amid declining new work.

Despite the current conditions, optimism regarding future output increased to a 3-month high.

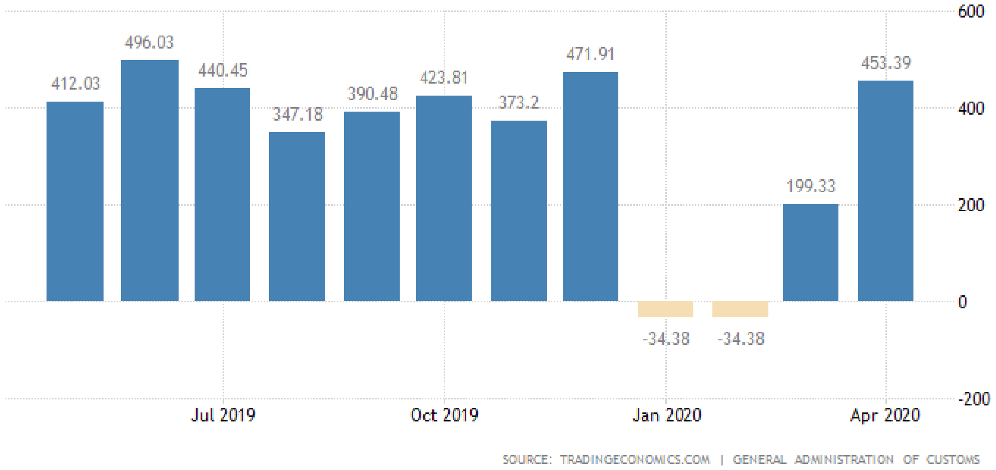
https://www.markiteconomics.com/Public/Home/PressRelease/62c70775a2b74fce87c79598d4907fd9

Trade Balance, Imports and Exports (Apr)

The Chinese trade balance increased more than expected this month as exports increased while and imports declined. The increase in exports was linked to medical equipment. The decline in the value of imports was partly linked to weaker domestic demand as well as weaker commodity prices.

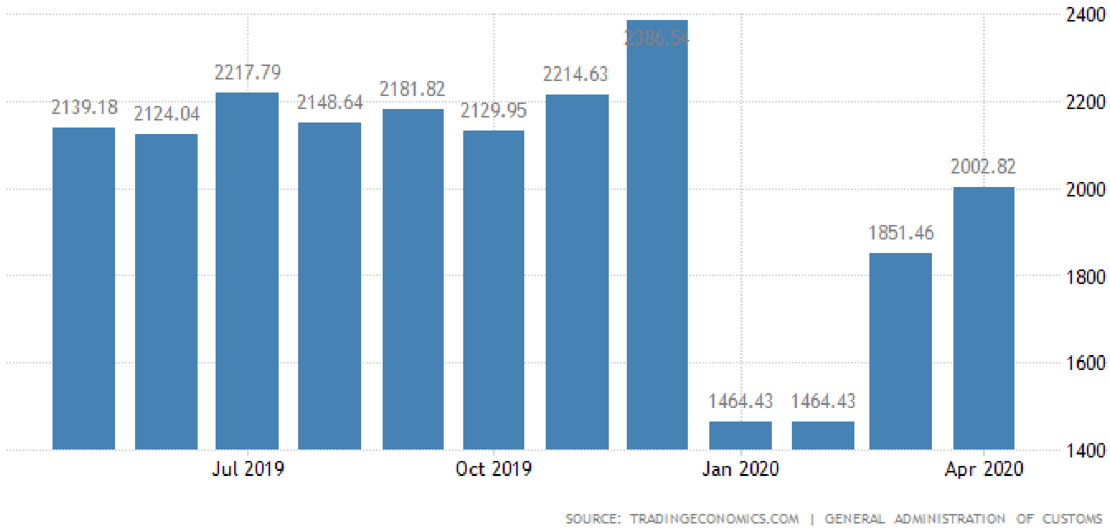
Trade Balance; increased to $45bn USD in Apr from $19.9bn in Mar. The trade balance a year ago was 13bn USD.

Chart: China Trade Balance USD 12mths to Apr 2020



Exports increased at a faster pace versus the month prior at +8.2% and by +3.5% versus a year ago.

Chart: China Exports USD at Apr 2020

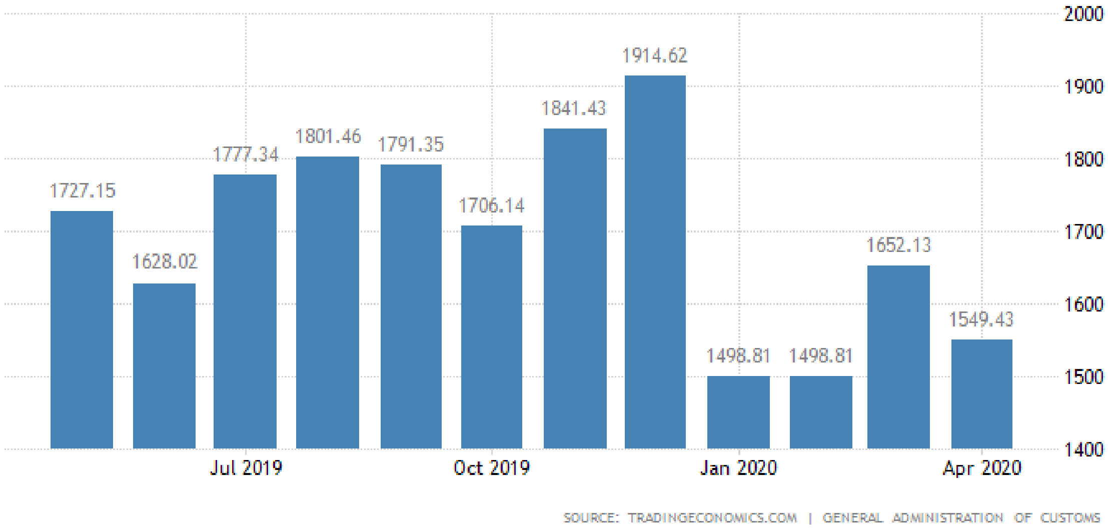


There was an increase in sales of medical equipment, traditional Chinese medicine and textiles, which include masks.

Imports on the other hand declined more than expected.

Imports declined by 6.3% versus the month prior, and 14.2% versus the same month a year ago.

Chart: Chinese Imports USD at Apr 2020



"…due to deteriorating domestic demand and lower commodity prices. There were declines in imports of crude oil (-7.5 percent), refined products (-28.8 percent), rare earths (-0.3 percent), soybeans (-12.1 percent) and rubber (-10.4 percent). Still, there were increases in demand from the previous month, with crude imports climbing to 10.42 million barrels day (bpd) in April from 9.68 million bpd in March."

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

http://english.customs.gov.cn/statics/report/preliminary.html

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Trade

US-China Trade Talks

With indications of renewed tension between the US and China, the USTR and the US Treasury released a joint statement outlining the details of a call with Chinese counterparts. The release of the statement was likely aimed at reducing speculation regarding the state of relations between the two countries.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/may/ustr-and-treasury-statement-call-china

As noted in the USMCA announcement several weeks ago, there is some focus on strengthening/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

Timing for the 'official' commencement of the second phase of the deal remains unclear amid the global pandemic.

The USTR has confirmed progress on the implementation of phase one of the trade deal.

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/march/usda-and-ustr-announce-continued-progress-implementation-us-china-phase-one-agreement

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

Trade negotiations between the UK and the US commenced last week (w/c 4 May). These negotiations will 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

Initial talks will be held via videoconference and are expected to run for two weeks.

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

The next round of official talks will commence this week via videoconference.

> Both sides have emphasised the need to make as much progress as possible in the future relationship talks ahead of an EU-UK summit in June but positions remain far apart, with a matter of months left to conclude a deal. https://www.ft.com/content/12e40098-cf26-46dc-ac7b-cfd6a238718f

Previous rounds of talks have yet to result in any substantial progress on bringing both parties closer to an agreement.

> After five days of videoconference talks, involving a total of 100 officials, the prospects of an agreement by the end of the year seemed remote as the two sides emerged from the negotiations to attack each other.

Barnier appeared exasperated by the British team, led by David Frost, who has said the UK will leave the single market and customs union with or without a deal by the end of the year. https://www.theguardian.com/politics/2020/apr/24/britain-running-down-the-clock-in-brexit-talks-says-michel-barnier-eu

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

At this stage, both sides have shared draft legal agreements;

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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