MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 8 June 2020

Key Themes

There were no changes made to US monetary policy settings this week. The FOMC statement and press conference were more downbeat in the current assessment of conditions, but did note some positive developments as the economy starts to open up.

While the FOMC kept policy settings on hold, the US Fed announced enhancements to crisis lending programs, enabling a broader scope of eligibility as well as easing the terms of the Main Street Lending Program.

Fed Chairman Powell noted in his press conference;

> The extent of the downturn and the pace of recovery remain extraordinarily uncertain and will depend in large part on our success in containing the virus. We all want to get back to normal, but **a full recovery is unlikely to occur until people are confident that it is safe to reengage in a broad range of activities**.

This sentiment was also reflected in the prelim consumer confidence numbers this week. Measures of sentiment, current conditions and expected conditions all improved in the prelim report. While expectations are high that the jobless rate will fall, there are lower expectations that favourable economic conditions will be re-established – consumers remain concerned about ongoing high unemployment and a resurgence in the spread of Covid-19;

> Bad times financially in the economy as a whole during the year ahead were still expected by two-thirds of all consumers, and a renewed downturn was anticipated by nearly half over the longer term.

News of increasing cases of Covid-19 are starting to emerge across the US and Beijing has entered a fresh lock-down to control a local outbreak.

US CPI was little changed in the month and on an annual basis. The PPI indicated that selling prices increased at a faster rate. In both reports, food price inflation was higher and the reversal of energy price declines also impacted prices. Prices for shelter and medical services continues to grow at a higher pace.

Initial unemployment claims continued to increase in the latest week – over the last 12 weeks, a total of 44m claims have been made by people. Continuing claims have remained extremely elevated and consistently around 20-21m mark. JOLTS data for Apr highlighted decreasing job openings, hires, and quits. At the same time, the level of layoffs and discharges remained extremely elevated after likely peaking in Mar.

Industrial production in Germany (and the broader EU group) and Japan declined notably in Apr. More recent PMI's indicate that Apr 2020 may have been the "peak" of these declines (not for Japan though). While the lifting of domestic restrictions will help, global export demand will be an important driver of production growth for these countries. The production of motor vehicles remains a key component of this growth.

This month, the Chinese trade surplus increased notably due to a decline in exports and a larger decline in imports. While some of the import decline is linked to lower oil prices, there were still substantial declines in imports from the larger industrial exporters such as Europe (especially Germany), the US, and Japan. This is partly a reflection of these countries remaining under some restrictions as well as some Chinese domestic demand weakness (likely, demand for both final and intermediate goods). Imports from other key markets such as Vietnam and South Korea were higher while imports from Australia were lower.

Contents

US Data

Initial and Continuing Jobless Claims wk ending 6 Jun

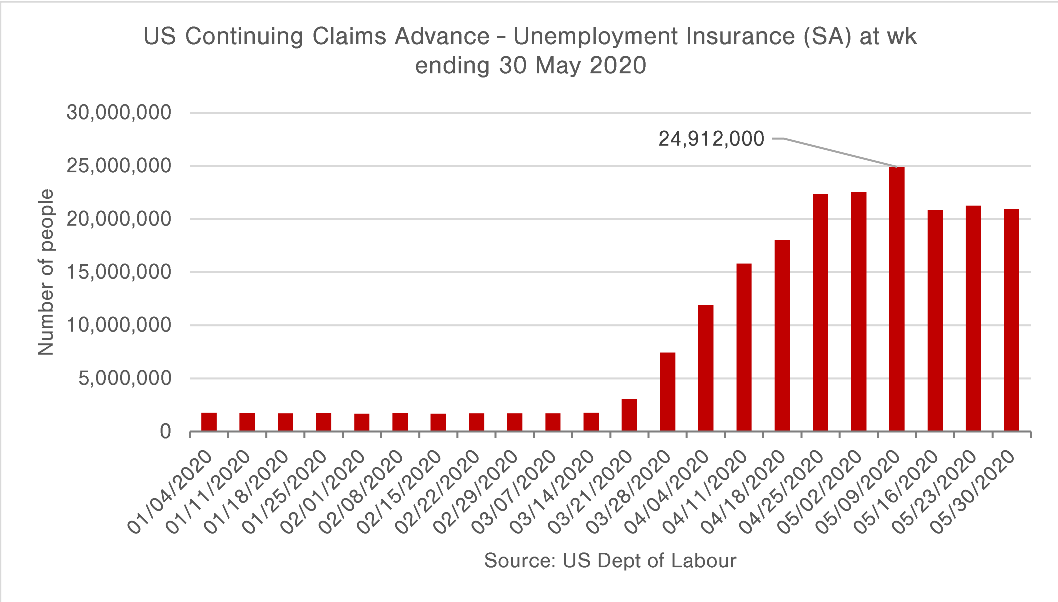
There was another historically large increase in initial unemployment claims this week. The total number of new claims made by people over the last twelve weeks is now 44m. The level of continuing claims remains extremely high but did fall a little from the week prior.

Advance Initial Jobless Claims wk ending 6 Jun 2020; 1,542,000 people

The advance claims from the week prior was revised higher by 20,000 people.

The advance report for continuing claims (insured unemployment) was lower than in the week prior but the level remains extremely high.

Advance Continuing claims wk ending 30 May 2020; 20,929,000 people.



The insured unemployment rate for wk ending 30 May was 14.4%.

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

University of Michigan Consumer Sentiment Survey Prelim (Jun)

Consumer sentiment improved further in the prelim Jun survey. The improvement has been led by gains in employment as restrictions begin to be lifted.

But while expectations are high that the jobless rate will fall, there are lower expectations that favourable economic conditions will be re-established.

> Bad times financially in the economy as a whole during the year ahead were still expected by two-thirds of all consumers, and a renewed downturn was anticipated by nearly half over the longer term.

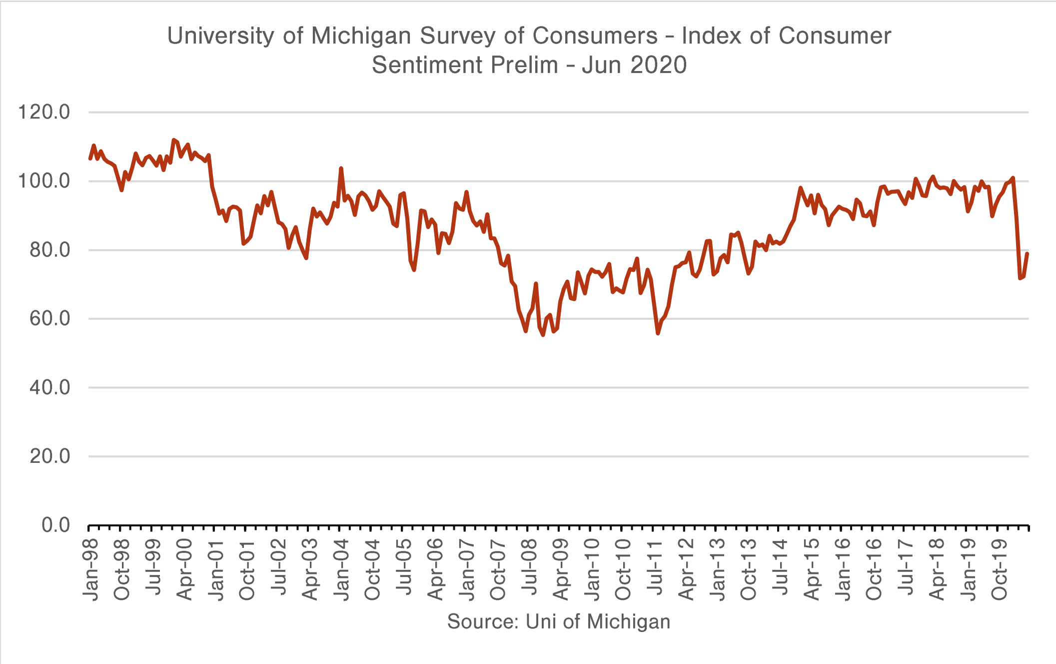
Consumers cite two important issues (emphasis added);

> The most often cited cause of a renewed downturn is **a resurgence in the spread of the coronavirus**, and the most often cited cause of a slow economic recovery is the financial damage from **persistently high unemployment**.

This has created income uncertainty, which is likely to impact discretionary spending.

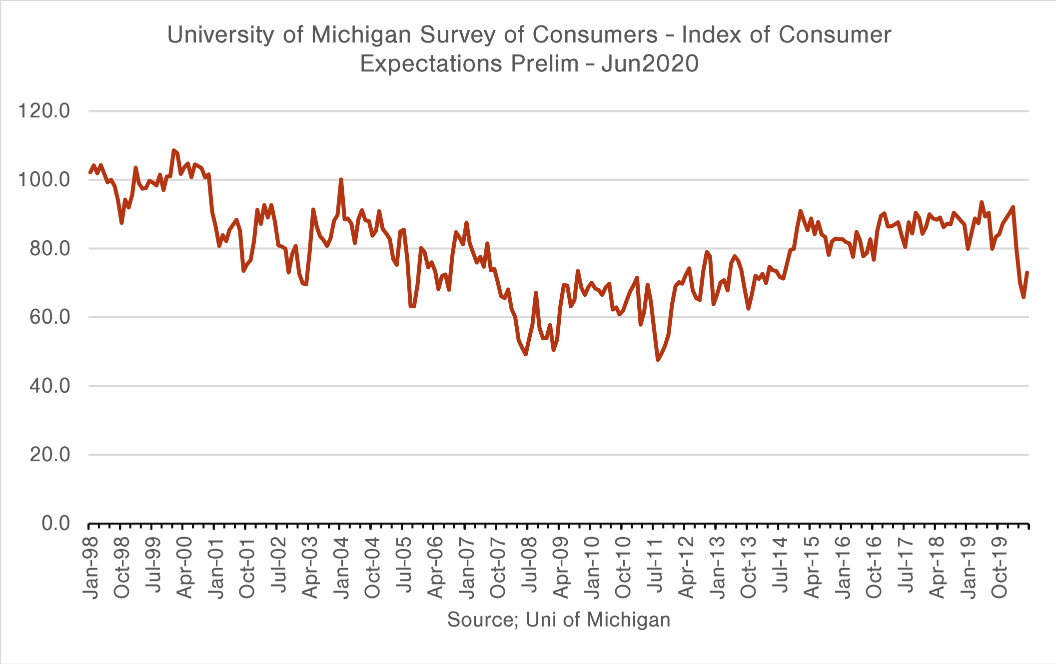
CONSUMER SENTIMENT

Index of Consumer Sentiment – month; Jun 78.9 versus May 72.3



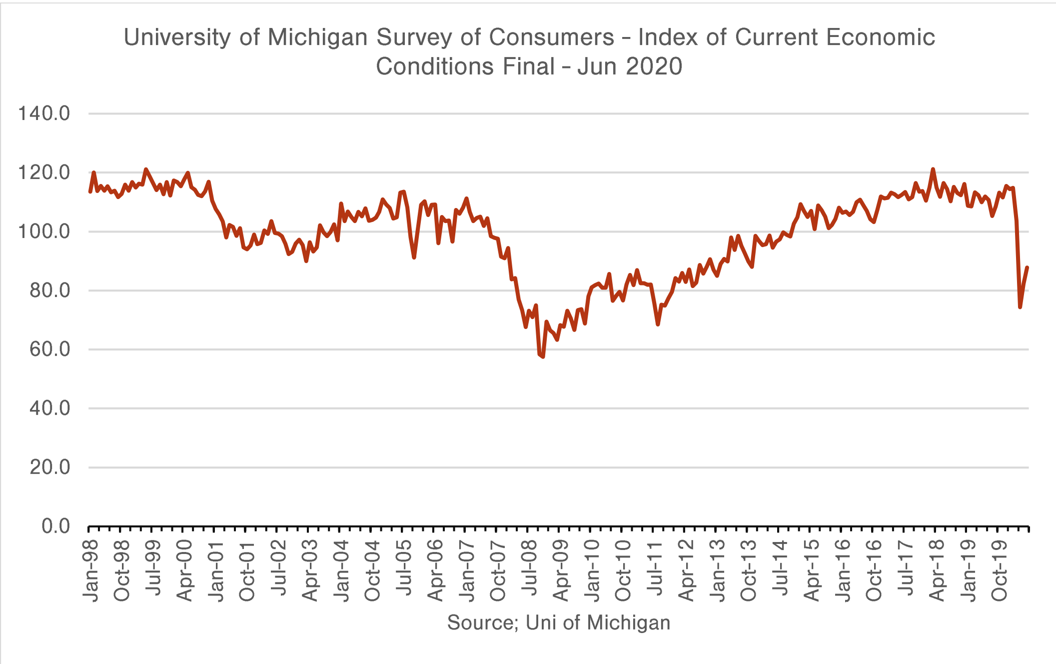
EXPECTED CONDITIONS

Index of Consumer Expectations – month; Jun 73.1 versus May 65.9



CURRENT CONDITIONS

Index of Current Economic Conditions – month; Jun 87.8 versus May 82.3



http://www.sca.isr.umich.edu/

JOLTS (Apr)

The JOLTS report for Apr is as of the last business day in Apr.

There is usually an estimation process that aligns the JOLTS data with the Current Employment Statistics. This process was been suspended in Apr due to differing reference periods that would have altered the results;

> BLS modified the JOLTS estimates for April to better reflect the impact of the coronavirus (COVID-19) pandemic. The estimation process usually includes an alignment of monthly hires minus separations to the over-the-month change in the Current Employment Statistics (CES) employment estimates. For April estimates, however, BLS suspended the alignment process because the differing reference periods for the CES employment estimates (pay period including the 12th of the month) and the JOLTS hires and separations estimates (the entire reference month) led to substantially different measurement outcomes. **Hires and separations during the latter half of April were not included in the CES employment change for April, but were included in the JOLTS data for the month.**

This suggests that the Apr JOLTS results, reflecting the last business day in Apr, were quite different to the mid-Apr labour market situation. As the month progressed, it's likely that there was a shift from the depths of the shut-down process.

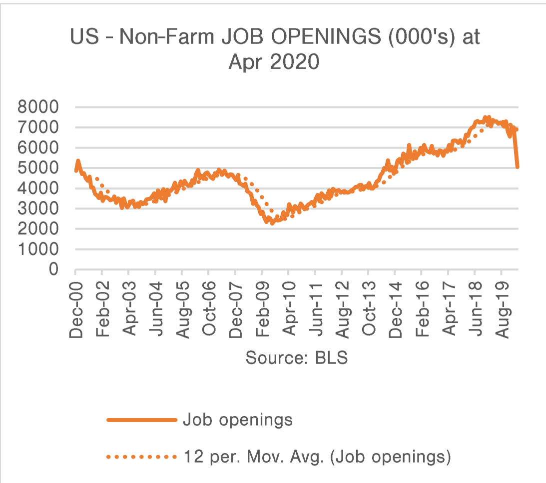
The data for the month still represents decreasing job openings, hires, and quits. At the same time, the level of layoffs and discharges remains extremely elevated after likely peaking in Mar.

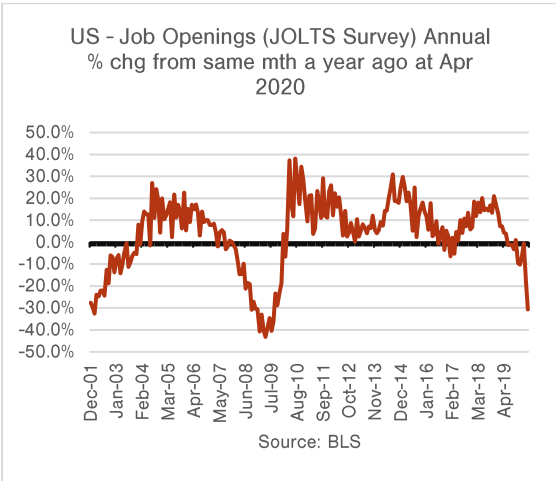
<u>JOB OPENINGS</u>

The level of job openings fell notably for the second month in a row with the pace of decline accelerating slightly.

<u>Job openings – month</u>; Apr 5m (-16%) versus Mar 6m (-14%)

The pace of decline in openings appears to somewhat more muted that the decline in hires. The rate of job openings has fallen from 4.4 in Jan 2020 to 3.7 in Apr. Still well below the 12-mth average of 4.3, but well above the all-time minimum of 1.7.





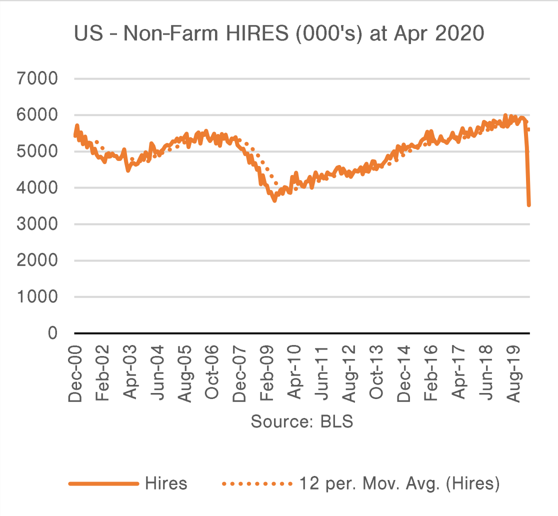
NEW HIRES

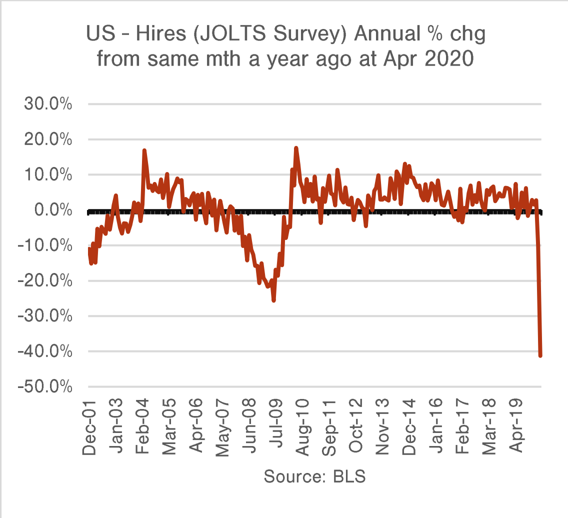
The number of hires has declined harder in Apr. The level of hire in Apr reached a new low going back to the start of 2000.

New hires – month; Apr 3.5m (-31%) versus Mar 5.1m (-13%)

The hire rate also fell substantially and was the lowest going back to the start of 2000 also. The hire rate fell from 3.4 in Mar to 2.7 in Apr.

The level of hire in Apr was 41% below the same month a year ago.





TOTAL SEPARATIONS

The two main elements in the separations data are Layoffs and Discharges & Quits.

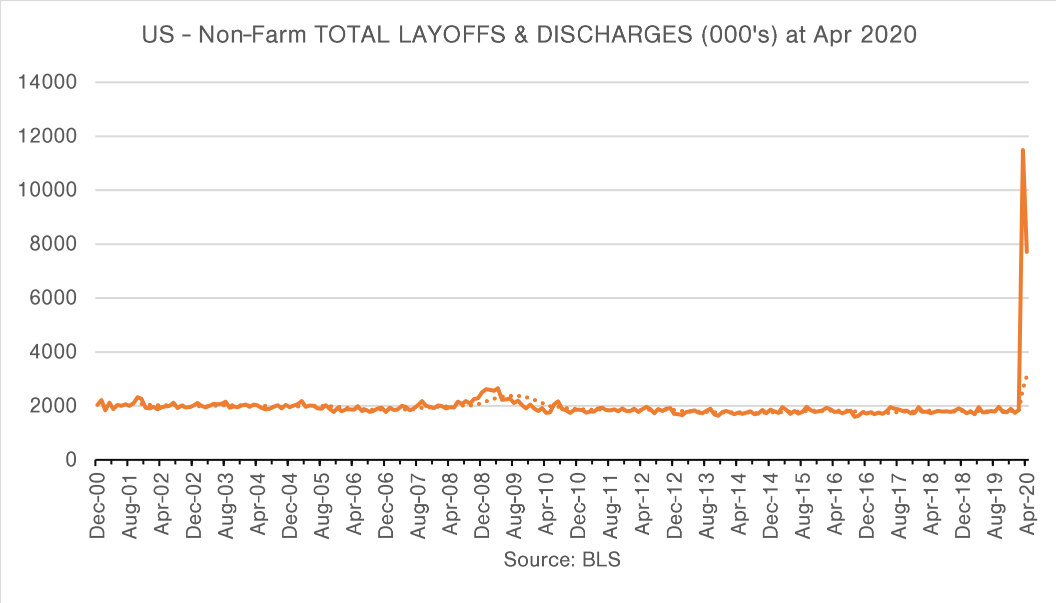
Layoffs and Discharges

There was a difference here compared to the hires. The (likely) worst of the layoffs were recorded in Mar with the increase in layoffs and discharges reaching a new high in Mar. While number came down somewhat in Apr, the levels remained highly elevated..

Layoffs and discharges – month; Apr 7.7m (-33%) versus Mar 11.5m (+522%)

The layoff and discharge rate reached a new high in Mar also at 7.6. This has lowered somewhat to 5.9 in Apr – but remains well above the layoff and discharge rate of Jan 2020 which was 1.1.

The level of layoffs and discharges in Apr is +295% ahead of the same month a year ago. The chart of the level of layoffs provides enough context for the size of the move;



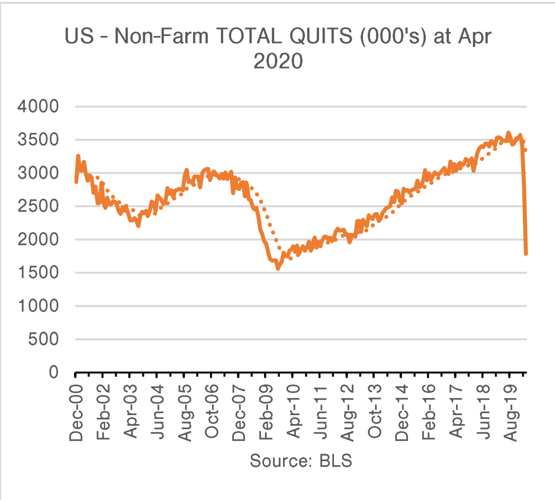
Quits

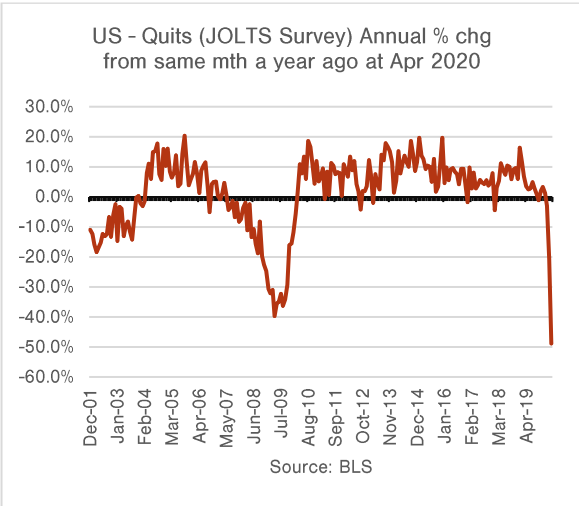
The level of quits has declined in Apr also. The level of quits is now only 14% above the minimum reached during the GFC (Aug ‘09).

Quits – month; Apr 1.8m (-36%) versus Mar 2.8m (-19%)

The quit rate fell to 1.4 in Apr – which is just above the all-time low of 1.2. The quit rate in Jan 2020 was 2.3.

The level of quits in Apr 2020 was 49% below the same month a year ago;





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

US CPI (May)

The monthly CPI continued to decline, albeit at a slower pace. The slower decline in energy prices helped at least to offset to still relatively fast growth in food prices. Core CPI in the month was unchanged from the month prior - declines in motor vehicle insurance and airline fares were offset by higher medical services and shelter prices.

On an annual basis, the decline in energy prices again helped to offset higher food prices. Core CPI growth slowed, but remained positive (and higher than headline CPI) as shelter and medical services price growth remained elevated. Partly offsetting the growth in prices in these two expenditure categories were core commodities and other services such as motor vehicle insurance.

<u>Headline All-Items CPI – month change</u>; May -0.1% versus Apr -0.8%

The major CPI groups all contributed to the smaller decline in CPI this month.

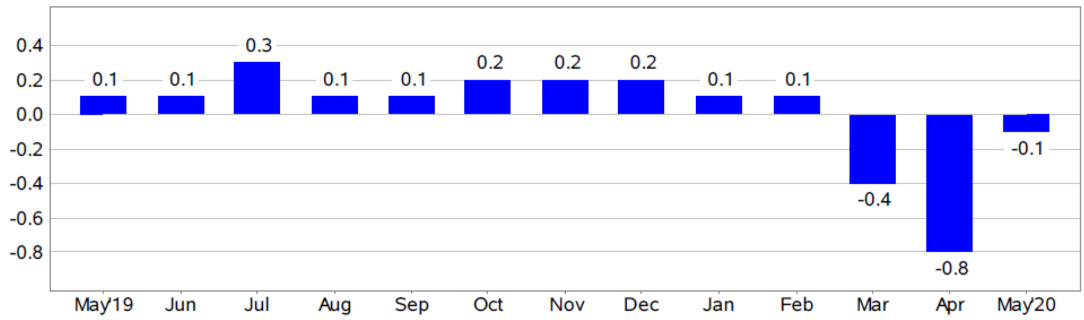
Food – the month change in food items prices slowed from +1.5% in Apr to +0.7% in May. This is still a relatively fast pace of monthly growth.

Energy – the monthly decline in energy prices also slowed notably from -10% in Apr to -1.8% in May.

Core CPI All-items less food and energy prices declined at a slower pace in May by -0.1% compared to -0.4% in Apr.

Core services price change was zero % in May after declining by -0.4% in Apr. The decline in motor vehicle insurance and airline fares were offset by higher medical services and shelter prices.

Chart 1. One-month percent change in CPI for All Urban Consumers (CPI-U), seasonally adjusted, May 2019 - May 2020
Percent change



<u>Headline All-Items CPI – annual change</u>; May +0.1% versus Apr +0.3%

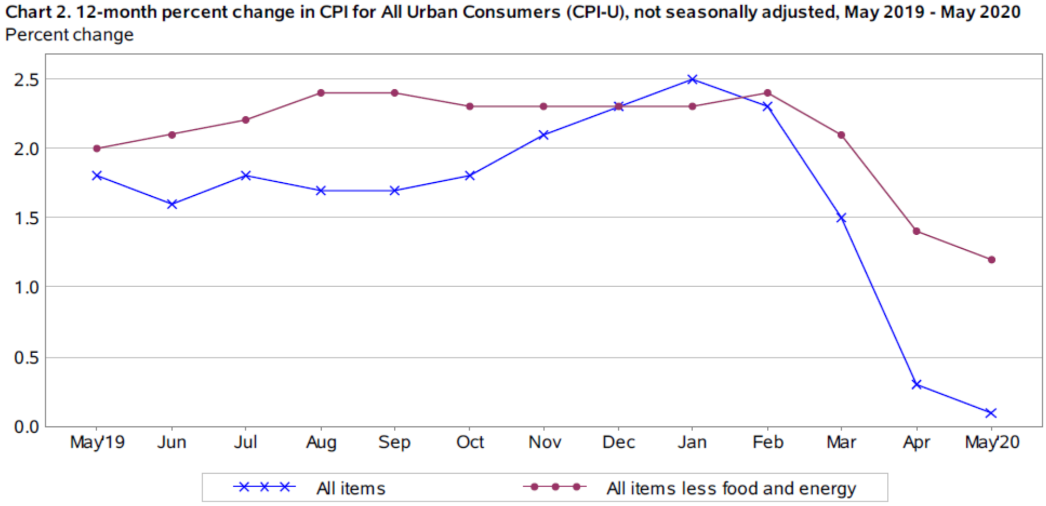
There were several offsetting changes regarding the contribution to headline growth among the main groups.

Food prices – increased at a faster annual pace in May by 4%, making a slightly larger contribution to the headline CPI change.

Energy prices – declined at a slightly faster annual pace of -18% and accounted for most of the slow down in price growth.

Core CPI All-items ex Food and Energy – the annual change in prices slowed further in May to +1.2%. The core commodities prices (less food & energy commodities) continued to decline at a similar pace (-1%) which was offset by slower, yet positive, growth in core services prices of

+2%. Growth in shelter and medical prices remain much higher (and little changed) at +2.5% and +5.9% respectively. The decline motor vehicle insurance of -14% and airline fares of -29% were offsetting factors in the index. Airline fares have a small weight in the index.

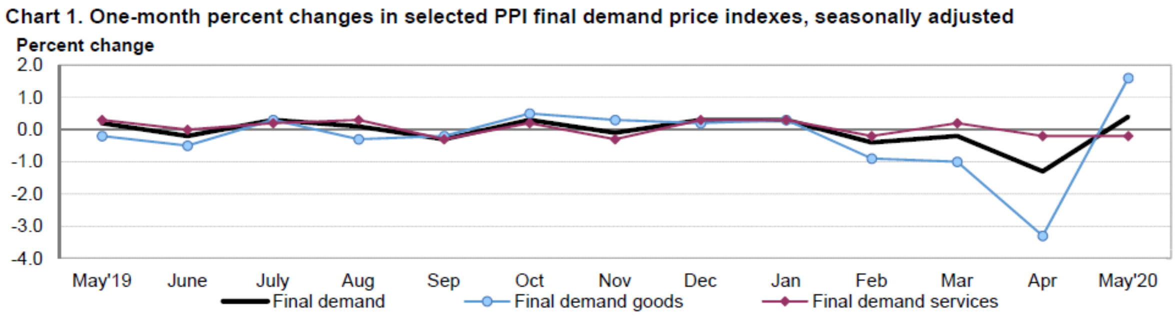


https://www.bls.gov/news.release/cpi.nr0.htm

US PPI (May)

There was a larger rebound in the monthly change in the PPI with price growth accelerating. This was due to an increase in final demand goods prices – led by a sharp increase in food prices in May and by an increase in energy prices (after three months of larger falls). Final demand services prices continued to decline as falling trade prices helped to offset a rise in transportation and warehousing prices.

PPI Final Demand – month change; May +0.4% versus Apr -1.3%



The acceleration in prices in the month was due to final demand goods prices.

Final demand goods prices increased by +1.6% in May compared to the -3.3% decline in Apr. The increase in May was the result of two changes. One, a large increase in food prices jumping from -0.5% in Apr to +6% in May;

Two-thirds of the May increase in the index for final demand goods is attributable to a 40.4 percent jump in meat prices.

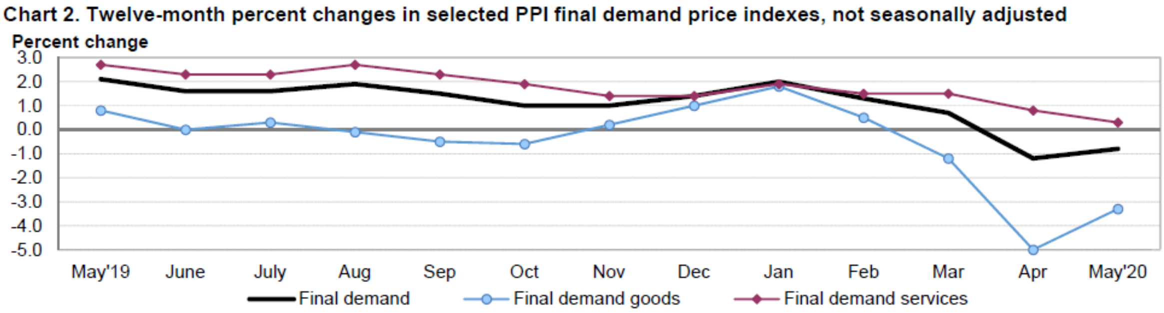
The second was a rebound in energy prices. In Apr energy prices declined by -19% and this was partly reversed in May with a +4.5% increase in the month.

Excluding food and energy, final demand goods prices were unchanged in May (0%) after falling by -0.4% in Apr.

Final demand services prices declined at the same pace in May as in Apr by -0.2%. Trade prices declined by -0.8% which helped to offset a stronger rebound in transportation prices, increased by +1.5% in May (after declining by -3.5% in Apr).

PPI Final Demand – annual change; May -0.8% versus Apr -1.2%

The slower annual decline in final goods prices helped to offset slower growth in services prices. The PPI still declined on an annual basis, but the pace of the decline eased.



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

Mortgage Applications wk ending 5 Jun

Mortgage applications increased further in the latest week.

The mortgage composite index (mortgage loan applications volume) increased in the wk ending 5 Jun by 9.3%.

The refi index was much stronger this week, increasing by 11% and is now +80% ahead of a year ago. Th share of refis increased from 59.5% in the prior week to 61.3% in the latest week.

> "Refinances moved higher for the first time in nearly two months, with both conventional and government applications rising and the overall index coming in 80 percent above year-ago levels."

The purchase index (the measure of the number of loans finalised and a leading indicator of housing sales) increased by 5% versus the week prior.

> "The recovery in the purchase market continues to gain steam, with the seasonally adjusted index rising to its highest level since January. Purchase activity increased for the eighth straight week and was a notable 13 percent higher than a year ago,"

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

FOMC Rates Decision – 10 Jun 2020

The FOMC made no changes to the current policy settings at the latest meeting.

But note that the US Fed has made announcements outside of the standard policy meetings to adjust the crisis lending programs. For example, early in the week, the US Fed announced enhancements to the Main Street Lending Program to widen the scope of eligibility as well as reducing/easing the terms of the program. (Source: https://www.federalreserve.gov/newsevents/pressreleases/monetary20200608a.htm)

Current Settings

The FFR remains at 0-0.25%.

The FOMC confirmed that it will maintain the current pace of purchases of Treasury securities, and agency, residential, and commercial mortgage-backed securities to:

> "sustain smooth market functioning, thereby fostering effective transmission of monetary policy to broader financial conditions"

The large scale overnight and term repo operations will also be maintained.

Recent Developments and Outlook

Recent developments noted were the very sharp declines in economic activity and the "surge" in job losses.

The FOMC made no attempt to 'talk up' current conditions in the statement, but noted some of the positive developments in the press conference instead. The statement noted the improvement in financial conditions (reduced tightening) enabling the transmission of credit.

The FOMC instead opted for a downbeat outlook with risks skewed to downside;

> The ongoing public health crisis will weigh heavily on economic activity, employment, and inflation in the near term, and poses considerable risks to the economic outlook over the medium term.

In the press conference, Chairman Powell noted the highly uncertain outlook and the role that the success in containing the virus would have on confidence;

> The extent of the downturn and the pace of recovery remain extraordinarily uncertain and will depend in large part on our success in containing the virus. We all want to get back to normal, but **a full recovery is unlikely to occur until people are confident that it is safe to reengage in a broad range of activities**. The severity of the downturn will also depend on the policy actions taken at all levels of government to provide relief and to support the recovery when the public health crisis passes.

Forward Guidance

Current policy settings will remain in place (barring any further deterioration in conditions) until the FOMC is confident that the US economy has weathered the recent events and is on track to achieve maximum employment and price stability goals.

> In determining the timing and size of future adjustments to the stance of monetary policy, the Committee will assess realized and expected economic

> conditions relative to its maximum employment objective and its symmetric 2 percent inflation objective.

The FOMC will take into account a wide range of measures in assessing future changes to monetary policy; labour market, inflation, inflation expectations, and readings on financial and international developments.

Through the statement and the press conference, the FOMC reinforced that it would continue to do whatever it takes;

> The Committee will closely monitor developments and is prepared to adjust its plans as appropriate.
>
> We are committed to using our full range of tools to support the economy in this challenging time.
>
> We have also been taking broad and forceful actions to support the flow of credit in the economy.
>
> We are deploying these lending powers to an unprecedented extent, enabled in large part by financial backing and support from Congress and from the Treasury. We will continue to use these powers forcefully, proactively, and aggressively until we are confident that we are solidly on the road to recovery

https://www.federalreserve.gov/monetarypolicy/files/monetary20200610a1.pdf

https://www.federalreserve.gov/monetarypolicy/fomcpresconf20200610.htm

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Europe

Germany Industrial Production (Apr)

Industrial production in Germany is an important barometer of global production and trade, as one of the top 3 global exporters (just behind the US) and behind China.

Total industrial production fell further in Apr amid weaker local and global demand.

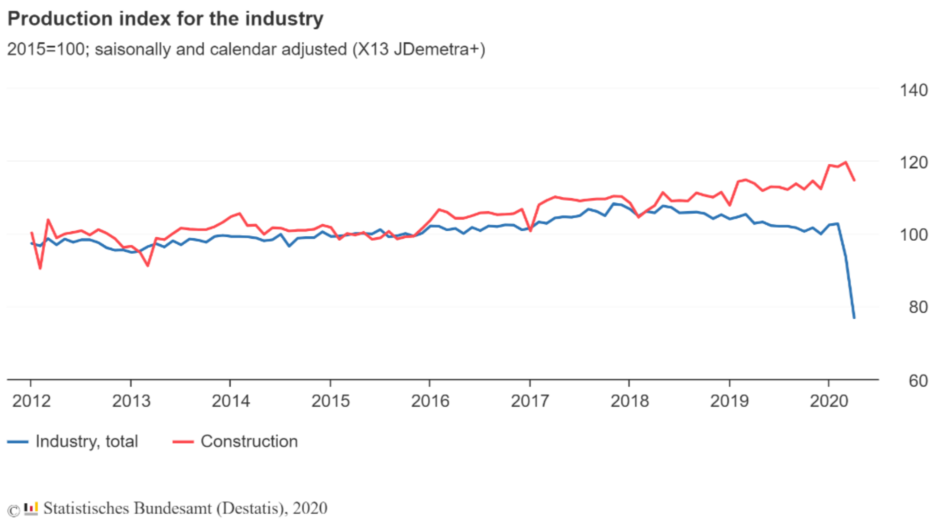
As we've noted over the last year, German production in manufacturing had peaked back in Nov 2017 and has slowed ever since. While there was a small rebound in early 2020, production levels have now fallen significantly as a result of global policies to slow the spread of the pandemic.

More recent PMI's indicate that Apr 2020 may have been the "peak" of the decline. While the lifting of domestic restrictions will help, global export demand will be the more important driver of production growth in the future. The production of motor vehicles remains a key component of this growth.

TOTAL INDUSTRIAL PRODUCTION (VOL INDEX) – month change; Apr -17.9% versus Mar -9%

This is the largest decline since the beginning of the time series in January 1991.

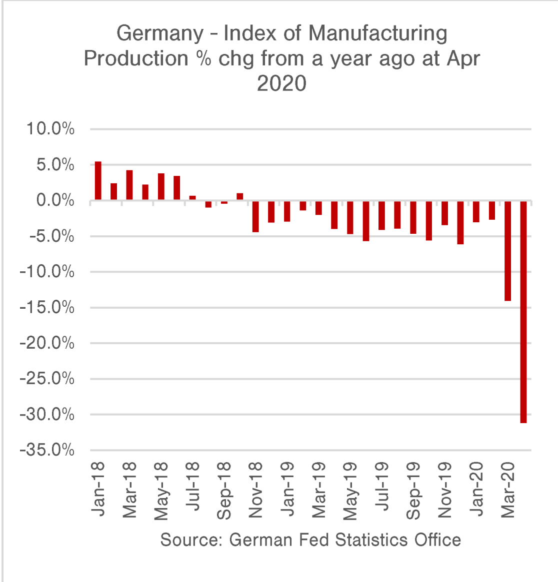
Production levels have fallen significantly over the last two months and levels are now 29% below the Nov 2017 peak and are 25% below the same month a year ago.



Most of this decline has been the result of falls in manufacturing. The fall in mining and quarrying appears to be mostly consistent with the existing trend. The fall in utilities production accelerated. The one area that has remained stronger is construction. While there was a fall this month, construction activity is at least on par with a year ago.

Manufacturing Production – month change; Apr -22% versus Mar -11%

Manufacturing production is now 31% below a year ago and is 35% below the Nov 2017 peak.



Production across most areas of manufacturing were impacted, with the capital goods industries leading the decline;

Capital goods production declined by -35.3% in Apr after a -15.6% decline in Mar. Production is now 50% below a year ago and the Nov 2017 peak.

A sharp drop was recorded by the automotive industry (-74.6%).

Intermediate goods production declined by -13.8% in Apr versus Mar -7.2%. On a year ago basis, is -19.1% below the same month a year ago.

Durable goods production declined by -17.1% in Apr compared to -10.4% in Mar.

The decline in non-durable goods production was -7.1% in Apr compared to -6.6% in Mar.

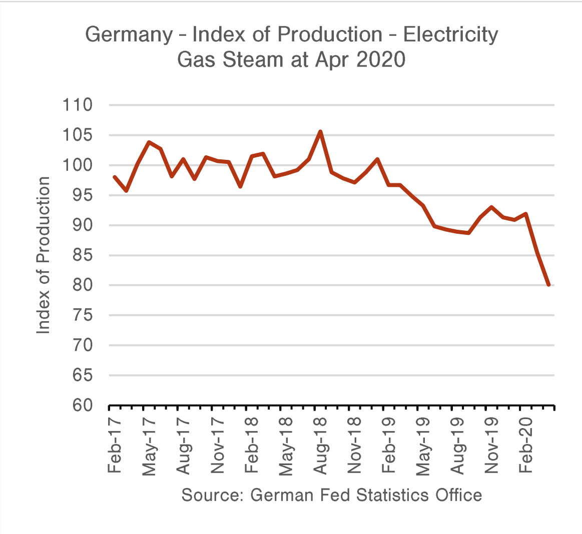
Similarly, consumer goods production fell by -8.7% in Apr compared to -7.3% in Mar.

Mining and Quarrying Production – month change; Apr -5% versus Apr -2.2%

The decline in mining and quarrying appears to be consistent with the pre-existing trend, but the decline in the last three months is still relatively large. Production is now down 12% versus a year ago and 30% below the May 2017 peak;

Utilities Production – month change; Apr -6.2% versus Mar -7.1%

Production of electricity, gas, steam, air conditioning supply has fallen notably over the last two months. Production is now 15% below a year ago.



Construction Production – month change; Apr -4.1% versus Mar +1%

Construction was impacted this month, but production remains +0.9% ahead of the same month a year ago.

https://www.destatis.de/EN/Press/2020/06/PE20_204_421.html

Eurozone Industrial Production (Apr)

Across the broader Euro Area and EU group, industrial production declined at a sharper and accelerated pace in Apr. All member states (for which data is available) recorded declines in production for the month. Declines in production were recorded across all industry groups for the month. Declines in production across energy remain more moderate.

As mentioned above, the more recent PMI's indicate that Apr is likely to have been the 'peak' in the decline of production.

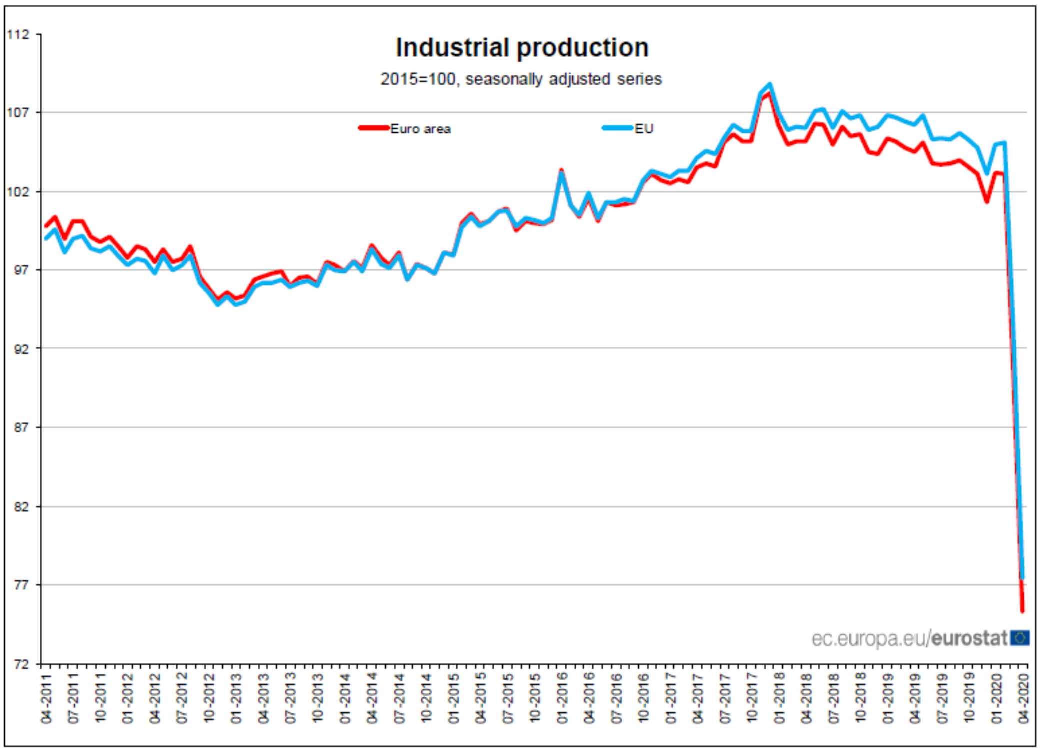
Euro Area Industrial Production – month change; Apr -17.1% versus Mar -11.9%

Leading the decline in the month were extremely sharp declines in production of capital goods (-27%) and durable consumer goods (-29%). Production also declined across intermediate goods (-15.6%), non-durable consumer goods (-11.9%), and energy (-4.8%).

EU Industrial Production – month change; Apr -17.3% versus Mar -10.9%

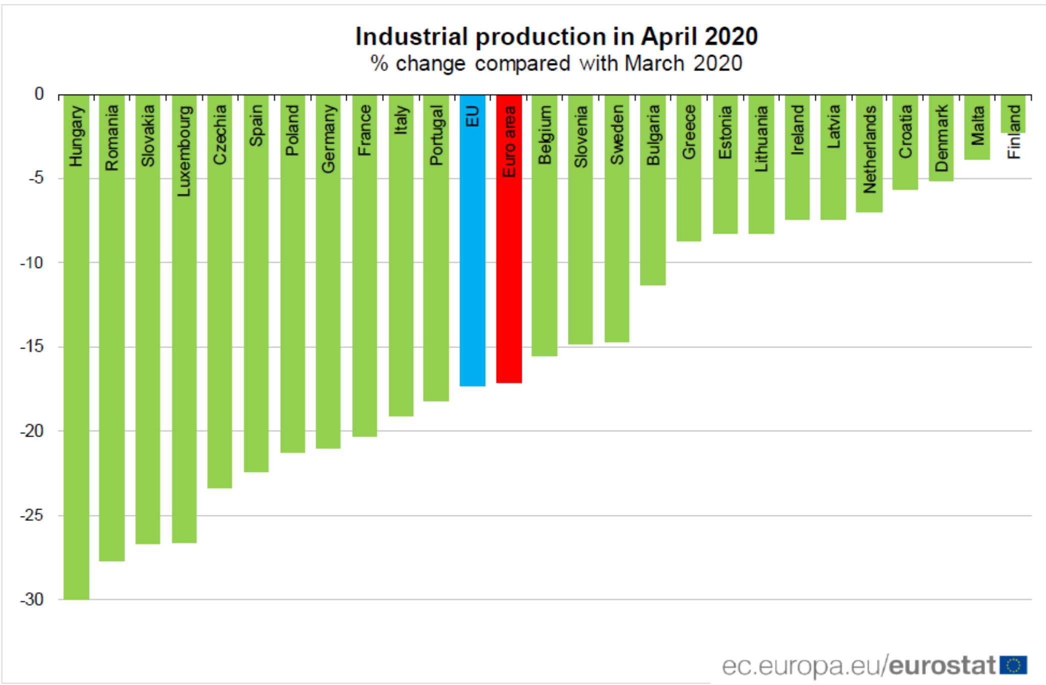
Similar sharp declines were recorded across the EU with falls in production across capital goods (-27.3%) and durable consumer goods (-27.8%). Production also declined across intermediate goods (-15%), non-durable consumer goods (-10.7%), and energy (-5%).

On an annual basis, production levels in the Euro Area in Apr were 28% below a year ago and across the broader EU, production levels were -27% below the same month a year ago.



<u>Performance by Member State</u>

Most markets recorded declines in production this month;



https://ec.europa.eu/eurostat/documents/2995521/10294900/4-12062020-AP-EN.pdf/93c51a4c-e401-a66d-3ab3-6ecd51a1651f

Eurozone GDP Q1 (detailed)

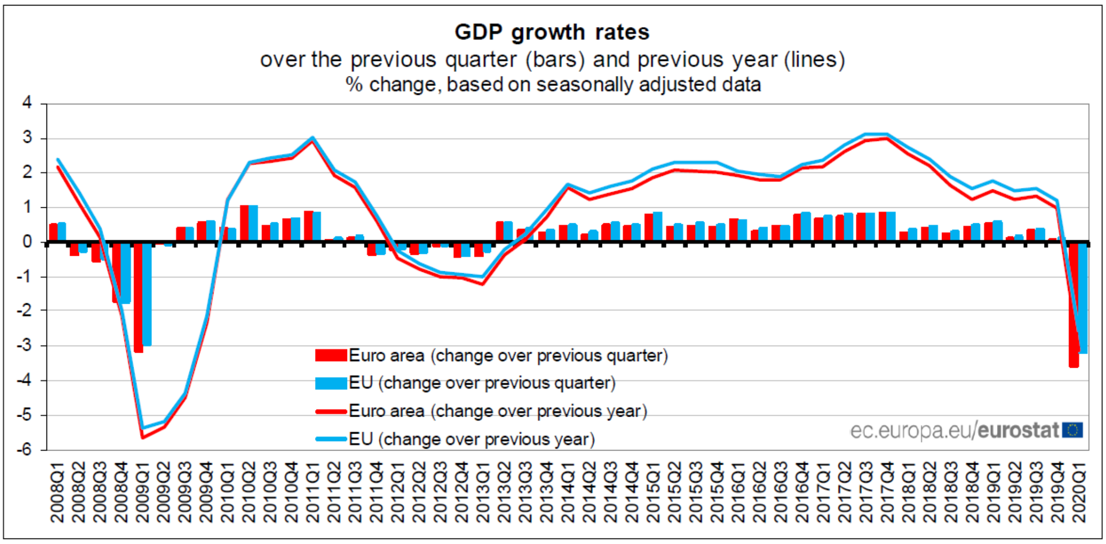
The final estimate for real GDP growth was revised slower higher (lower pace of decline) for the broader EU. The pace of decline remained one of the sharpest declines in total output and expenditure since the broader Eurozone timeseries started in 1995.

Euro Area Real GDP – quarter change; Q1 -3.6% (revised 'higher' from -3.8%)

On an annual basis, real GDP growth in the Euro Area (EA19) declined by -3.1% in Q1 2020 compared to the same quarter a year ago.

EU Real GDP – quarter change; Q1 -3.2% (revised 'higher' from -3.3%)

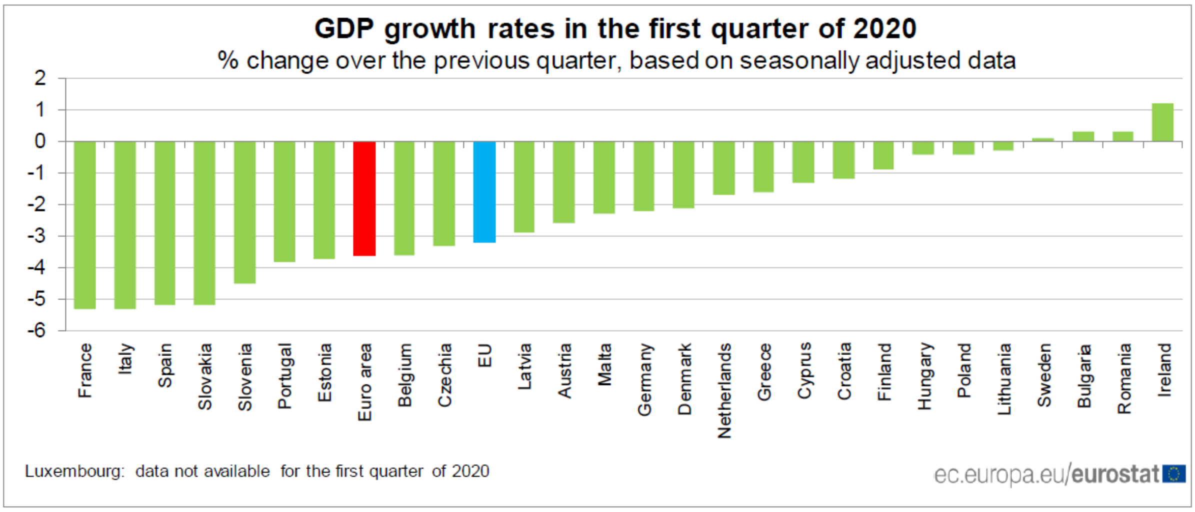
On an annual basis, the broader EU real GDP growth declined by -3.1% compared to the same quarter a year ago



GDP Growth by Member States

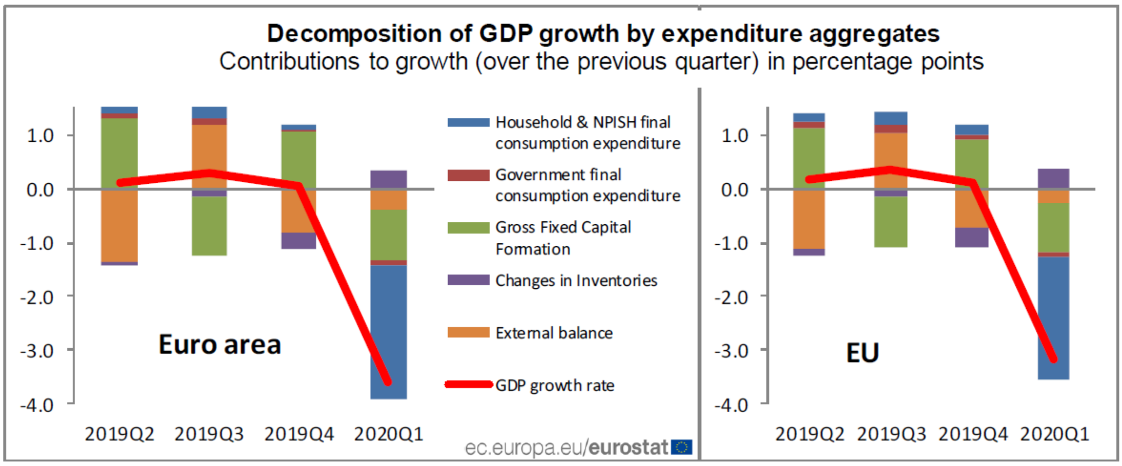
Only four member states recorded positive GDP growth in Q1 – Sweden (+0.1%), Bulgaria, Romania, and Ireland.

Several of the larger economies in the EU recorded the steepest falls in GDP growth including France, Italy, and Spain.



Expenditure View of GDP Growth

Across both the broader EU and the Euro Area, real GDP growth declined as a result of a larger declines across most areas of GDP expenditure. This includes declines in household consumption expenditure, investment (gross fixed capital expenditure), net exports, and government expenditure. The only positive contribution to GDP growth was from the change in inventories.



https://ec.europa.eu/eurostat/documents/2995521/10294996/2-09062020-AP-EN.pdf/8a68ea5e-5189-5b09-24de-ea057adeee15

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Japan

GDP Q1 (2nd Prelim Est)

The decline in Japanese GDP was revised slightly lower in the second prelim estimate. Private investment (mostly non-residential) was revised higher helping to offset the decline in private consumption.

Real GDP – qtr change; Q1 2020 -0.6% (prev -0.9%) versus Q4 2019 -1.9%

From an expenditure view, the following revisions were made;

Private consumption; the decline in private consumption was revised higher from -0.7% in the first est to -0.8% in the second est.

Private residential investment; the decline in private residential investment was revised lower (smaller) to -4.2%

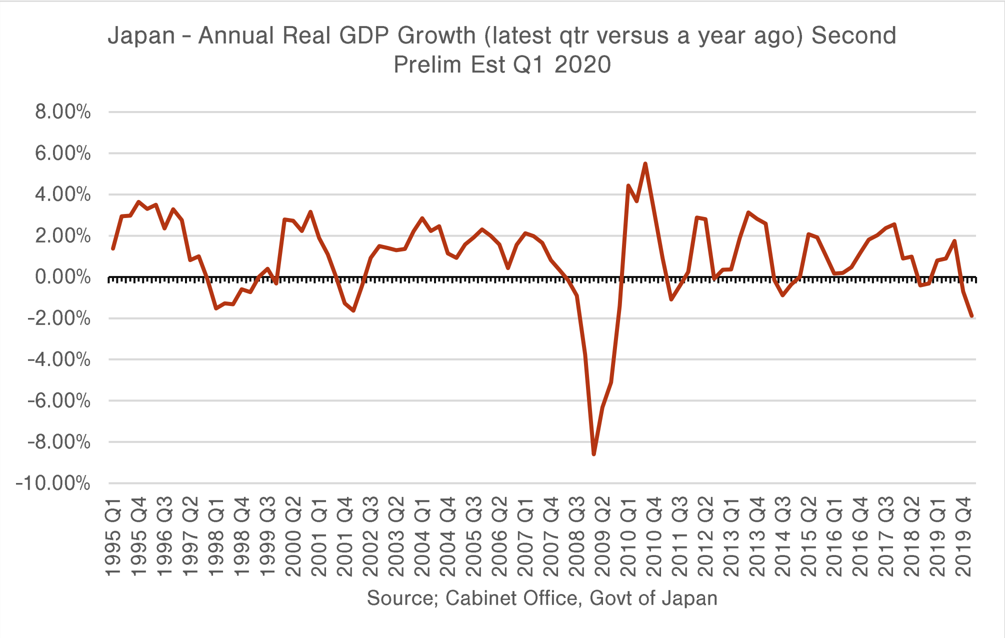
Private non-residential investment; the decline of -0.5% in the first est was revised to a +1.9% growth in the second estimate.

The change in private inventories made a slightly larger contribution to the decline, detracting -0.1% pts in the second est.

Government consumption and investment; consumption was revised higher from 0% to +0.1% and public investment expenditure was revised lower from -0.4% to -0.6% in the second est.

Net exports were unchanged. The decline in exports for the quarter was confirmed at -6% and the decline in imports was confirmed at -4.9%.

The year on year decline in real GDP growth was revised lower (smaller), -2.2% to -1.9%.



https://www.esri.cao.go.jp/en/sna/data/sokuhou/files/2020/qe201_2/gdemenuea.html

Industrial Production Final (Apr)

The final (complete) report on industrial production for Apr confirmed a slightly faster pace of decline in production and shipments for Apr.

Industrial Production – month change; Apr -9.8% (perv -9.1%) versus Mar -3.7%

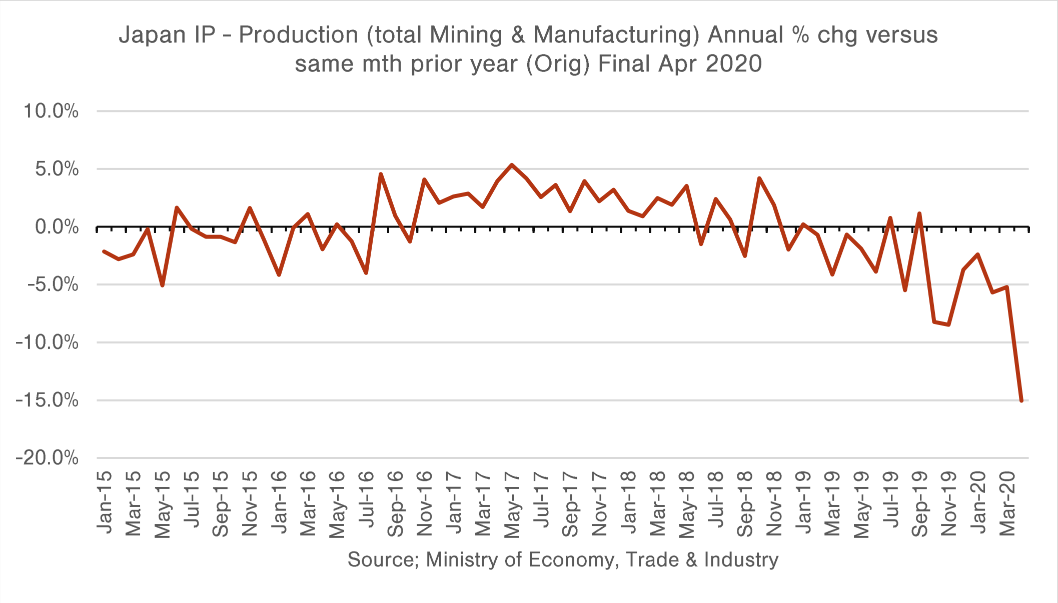
Similar to the prelim report, not all sectors recorded declines in the month. Output of production machinery increased by 4% - but within that production only increased in the semiconductor and flat-panel display manufacturing equipment subsector (+42%).

Chemicals production (large weight in the index) increased by +1.6%.

Declines across some of the larger groups led the overall decline; transport equipment (-34.8%), iron and steel (-15%), fabricated metals (-6.1%), and general-purpose machinery (-7.4%).

Food production (second largest weight in the production index_ declined by -3.1% in the month.

On an annual basis, production declined at an accelerated pace of -15% below the same month a year ago (versus -5.2% in Mar);



The most notable decline on an annual basis was the 50% decrease in passenger car production in Apr compared to a year ago.

Shipments – month change; Apr -9.5% (prev -8.8%) versus Mar -5.8%

The decline in shipments was revised to a faster pace of decline in the month.

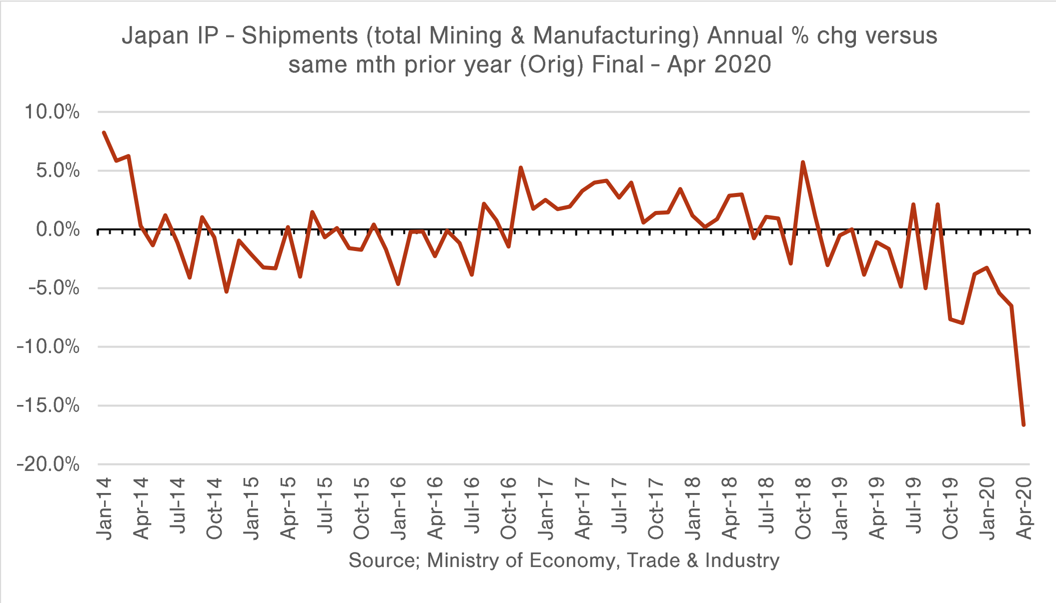
Shipments of transport equipment declined at a faster pace (-32.6%), this included passenger car shipments down -41% for the month.

Shipments also declined notably across iron and steel (-9.4%), fabricated metals (-7.5%), general purpose business machinery (-11%), electrical machinery (-5.4%), and petroleum shipments were down -8.1%.

Shipments of food and tobacco (second largest weight) declined by -2.2%.

Categories that recorded higher shipments in the month were chemicals (+1.1%) and production machinery (+6%, which again was semiconductor and flat panel display manufacture).

Shipments declined at an accelerated pace on an annual basis; -16.6% in Apr versus –6.5% in Mar;



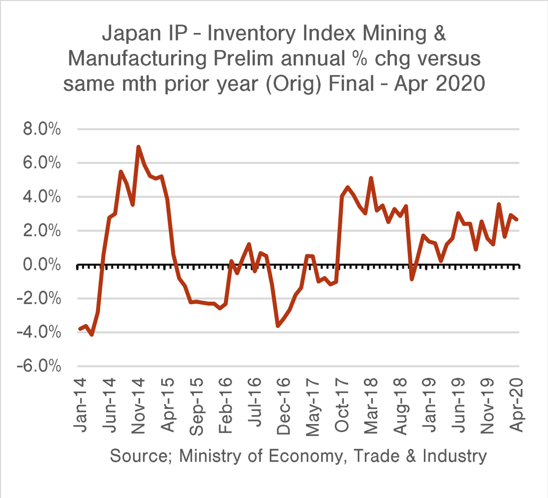
<u>Inventory – month change</u>; Apr -0.3% (no revision) versus Mar +1.9%

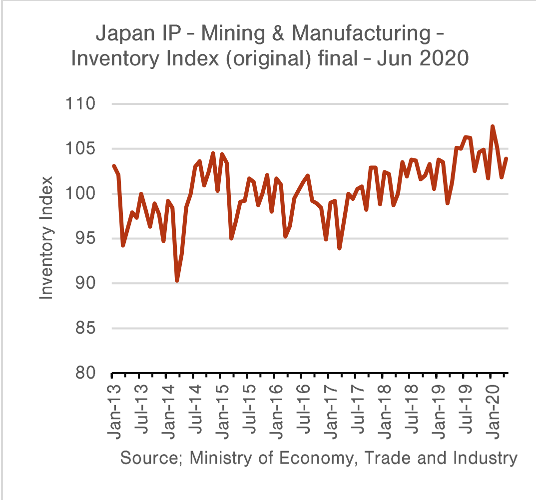
There was little change to the inventory view of industrial production in the final release. The overall decline in inventory was led by the largest weight group in the index; iron, steel, and non-ferrous metals which producer's inventory of finished goods fell by -5.6%.

Inventory of finished goods also declined across; fabricated metals (-0.3%) and production machinery (-2.1%).

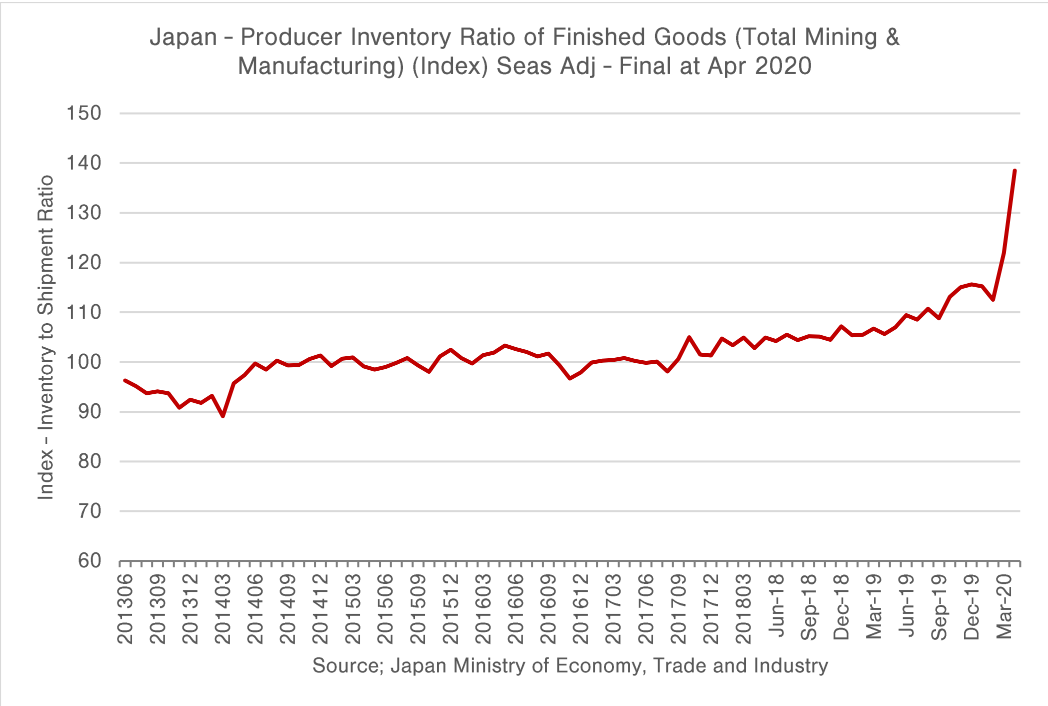
Producers inventory of finished goods increased across transport equipment (+9.5%), electrical machinery (+4.7%), electronic parts and devices (+5%), and general purpose and business equipment (+2.8%).

On an annual basis, the value of inventory increased by +2.7% versus a year ago. The annual pace of change has been consistent over the last two years; The index shows that inventory levels have rising since early 2017;





But the producers inventory ratio remains extremely elevated given the sharp decline in shipments. The index increased by 13.8% in Apr and is +30% ahead of a year ago.



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

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Australia

NAB Business Conditions and Confidence (May)

There was a notable improvement in business confidence and a smaller improvement in business conditions. Both indicators remain firmly negative though and at levels not seen since the last Aussie recession in the early 90's.

Business Confidence – month change; May -20 versus Apr -45

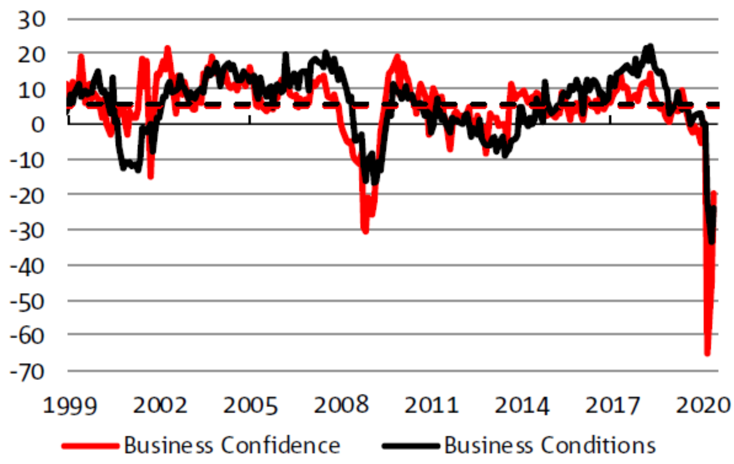
The increase in confidence was also broad-based across the economy but all industries continue to expect a deterioration in conditions.

Business Conditions – month change; May -24 versus Apr -34

The lift in the month was evident across trading (-18) and profitability (-19). But the improvement in employment was smaller, increasing from -34 in Apr to -31 in May. Concerns regarding returning to full capacity continue to weigh on firms.

Forward orders are still firmly negative, but improved from -35 in Apr to -29 in May. The decline in exports accelerated slightly.

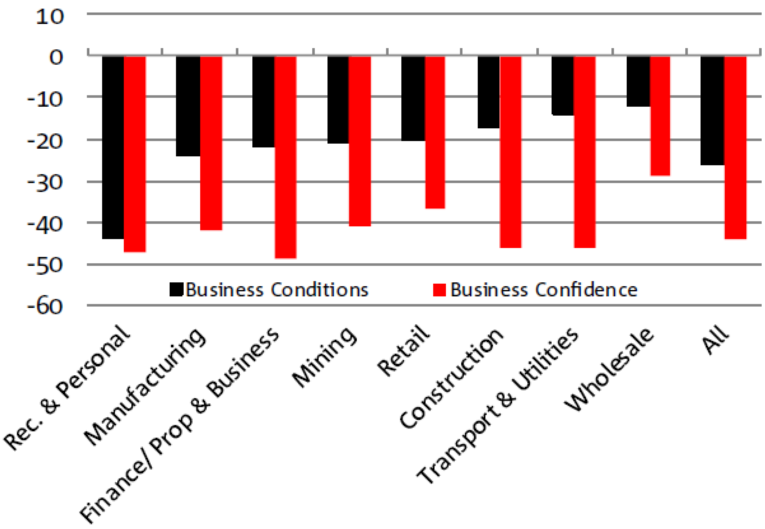
CHART 8: BUSINESS CONDITIONS AND BUSINESS CONFIDENCE



* Dotted lines are long-run averages since Mar-97.

Conditions and confidence remained native this month across all industries, with hospitality the most negative;

CHART 9: BUSINESS CONDITIONS BY INDUSTRY, LATEST MONTH (TREND)



https://business.nab.com.au/wp-content/uploads/2020/06/nab-monthly-business-survey-may-2020.pdf

ANZ Job Ads (May)

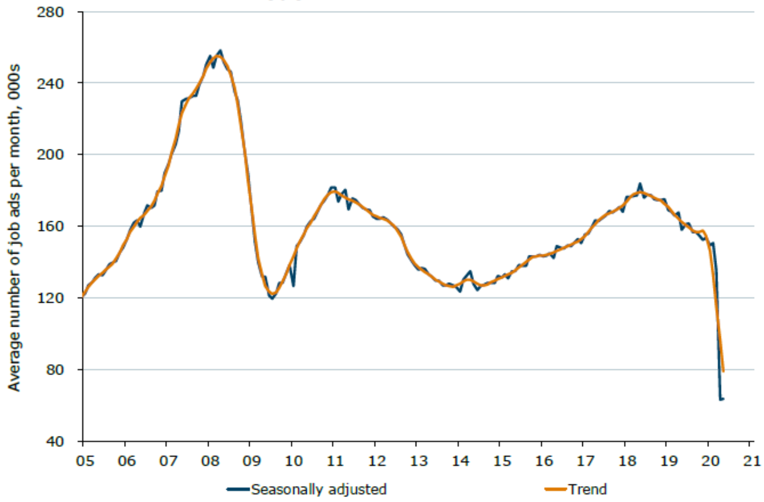
The decline jobs ads eased in May. This is positive in that it suggests that the recent falls in job ads may have at least subsided – and is consistent with the Covid-19 restrictions starting to be reduced.

There was only a small increase in the number of ads in May compared to Apr.

Job Ads – month (SA): May 63,428 jobs ads versus Apr 63,112 job ads

The number of job ads remain almost down 60% compared to a year ago;

ANZ Job Ads down 60% y/y



Source: SEEK; Department of Education, Skills and Employment; ANZ Research

https://media.anz.com/content/dam/mediacentre/pdfs/jobads/2020/June/ANZ%20Job%20Ads%20May%2020.pdf

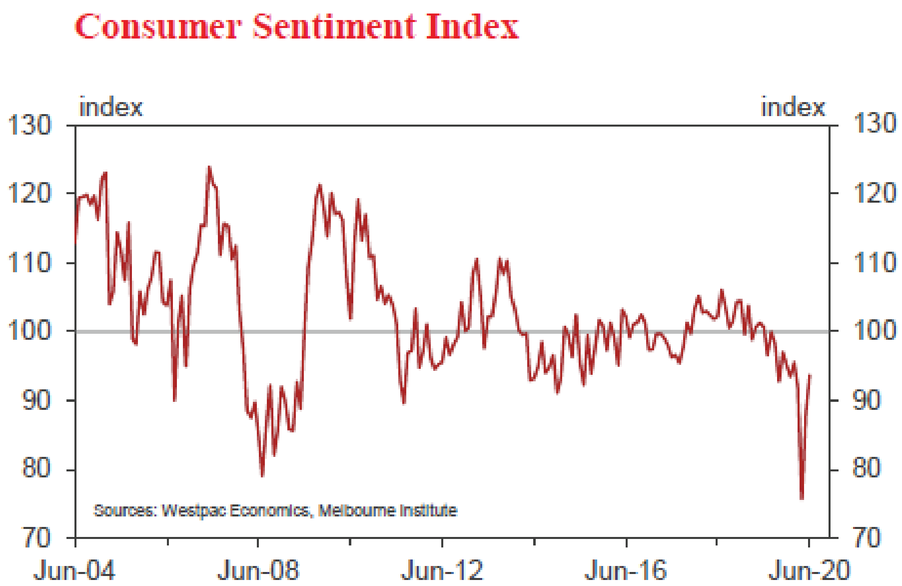
Westpac Australian Consumer Sentiment (Jun)

Consumer sentiment in Australia has rebounded strongly again in Jun and is now just below the pre-pandemic levels. But note that consumer sentiment in Australia had been slowly shifting lower even prior to the pandemic and shutdowns (sentiment in Mar and Apr 2020 plummeted). General sentiment has likely been buoyed for many by the apparent success in substantially lowering the impact of the virus during the lock-down. Expectations for the easing of lock-down restrictions were set for Jun/Jul, so the commencement of easing during May was a good boost for sentiment.

<u>Consumer Sentiment – month</u>; Jun 93.7 versus May 88.1

The index remains 7% down on a year ago and pessimists still out-number optimists.

The Index is now only 2% below the average in the preceding September to February period. Note that sentiment was already on the weak side prior to the COVID shock with the Index through this earlier period showing a persistent excess of pessimists over optimists.



Sentiment measures have improved among states as different states have started winding back restrictions.

Views of the economy and finances have also improved, but more moderately;

The economy next year and next five years have both rebounded by 8% and 6% respectively, but from extremely low levels. The near-term expectations index is at 77.2 and, excluding Mar and Apr, this is still the lowest reading since the GFC. This is consistent with the expectation of only a gradual improvement in the economy.

The index of the economy next five years is at 102.4 – an 18-month high.

Improvement in family finances were more muted. Current assessment of family finances remains low with the index at 77 in Jun, up from the Apr low of 70.

A reading of 77 is consistent with intense pressures on household budgets.

But the forward view of family finances is now net optimistic with the index moving up to 105.3 in Jun.

Westpac notes the very delicate balance between consumer sentiment and the shift in policy – noting that for the moment, many programs to support finances remain in place.

> This improvement will need to be firmly in place before key supports to household finances such as JobKeeper, JobSeeker and home loan repayment holidays can be withdrawn.

Further improvements in “time to buy” indexes suggest some near-term support for retail sales.

One area that did not improve was time to buy a dwelling. The index fell further to 107.6 and is 8% below a year ago and is 10% below the average. House price expectations improved, but the index remains at <100 at 80.6. The index average is 125.6.

> With the unemployment rate set to remain elevated; extensive restrictions staying in place and the economy facing permanent structural change it would be surprising if the recent upward momentum continues and is able to sustain a stable level of confidence which is above that previous period.

https://www.westpac.com.au/content/dam/public/wbc/documents/pdf/aw/economics-research/er20200610BullConsumerSentiment.pdf

Aus Housing Loan Commitments (Apr)

Housing lending declined notably in the latest month, likely posing further challenges for house prices. Lending by owner occupiers declined the most, led by non-first home buyers. The decline in lending for first home buyers was less steep.

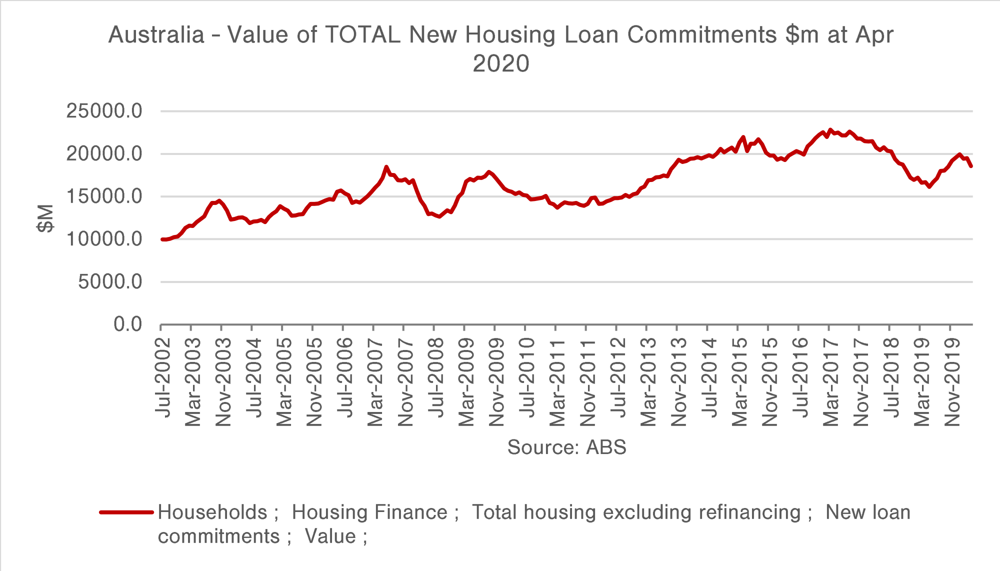
Lending for investors remains under pressure with the decline in lending for the month accelerating compared to the month prior. The value of lending for investors is now only +2.4% ahead of a year ago – which was close to the pre-election low. This is (was) a large segment of the market that is currently underperforming.

The concern over the slow-down in housing generally, has resulted in a raft of home-buying and home-building grants/incentives since the onset of Covid-19 restrictions.

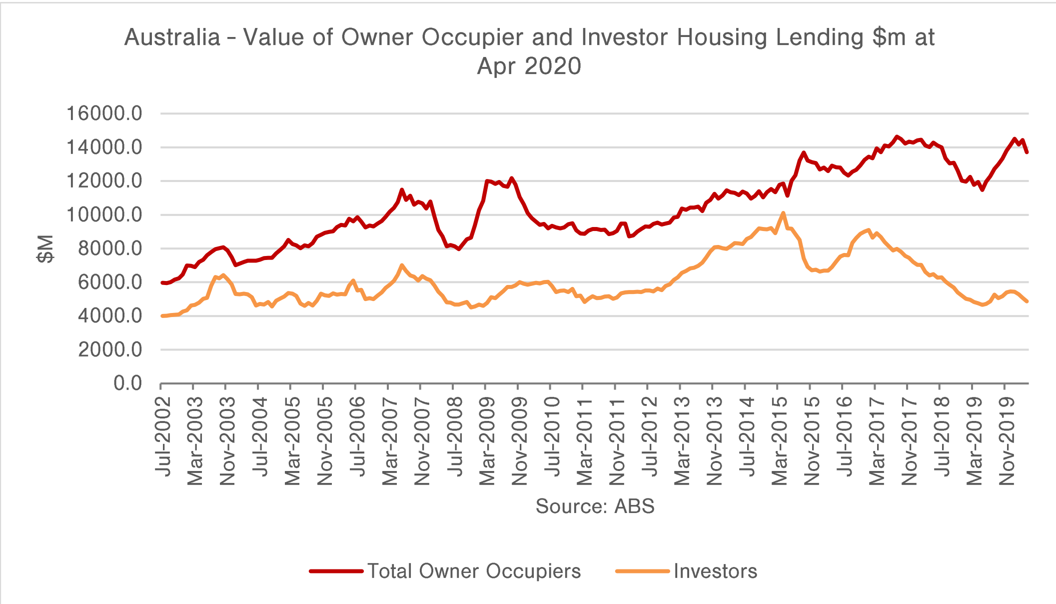
Banks have also deferred 429,000 mortgages for six months during Covid-19 – which is roughly one in fourteen mortgages in Australia. Interest payments deferred are added to the outstanding balance owed. (Source: https://www.ausbanking.org.au/banks-have-now-deferred-more-than-400000-mortgages/)

Total Housing Finance ($ val) ex refis – month change; Apr -4.8% versus Mar +0.3%

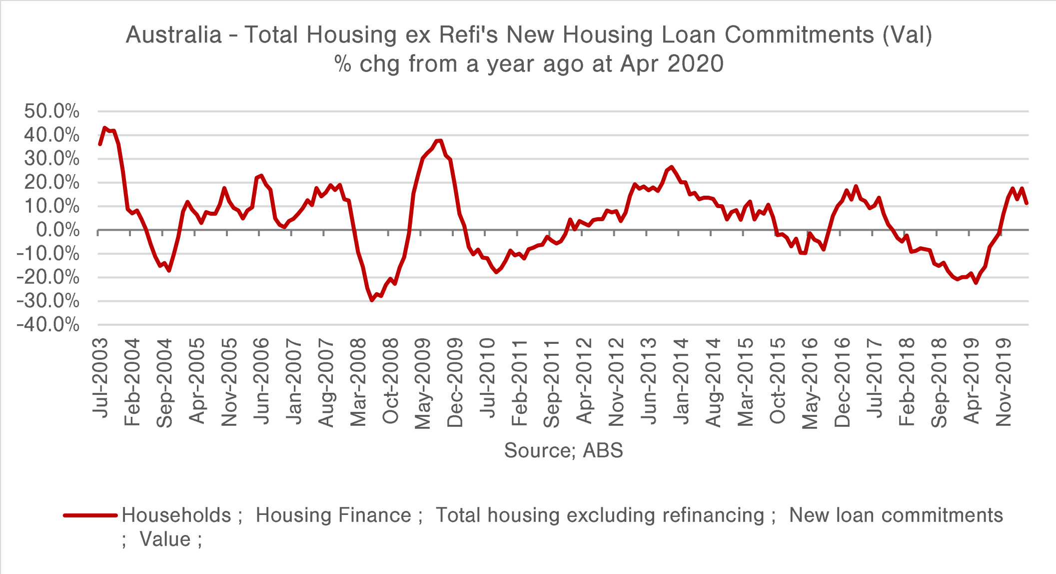
The fall in the month is on the back of lending that was already weakening as of Jan 2020. Total lending remains well below the 2016 peak;



The weaker recovery since May 2019 has so far been the result of a very weak rebound in investor lending – which has turned lower again now. First home buyers have stepped up to help lift owner occupier lending;



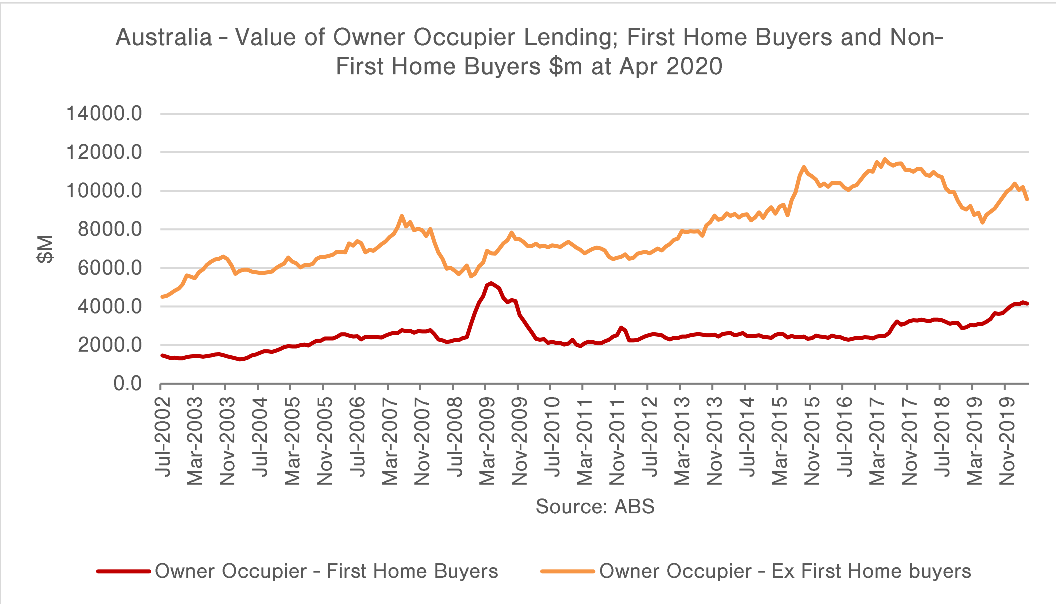
On an annual basis, the growth in total housing lending slowed from the near-term peak of 17.2% to 11.2%.



The two main segments making up total housing lending are owner-occupiers and investors.

<u>Owner Occupier Housing Finance ($ val) ex refis – month change</u>; Apr -5% versus Mar +1.8%

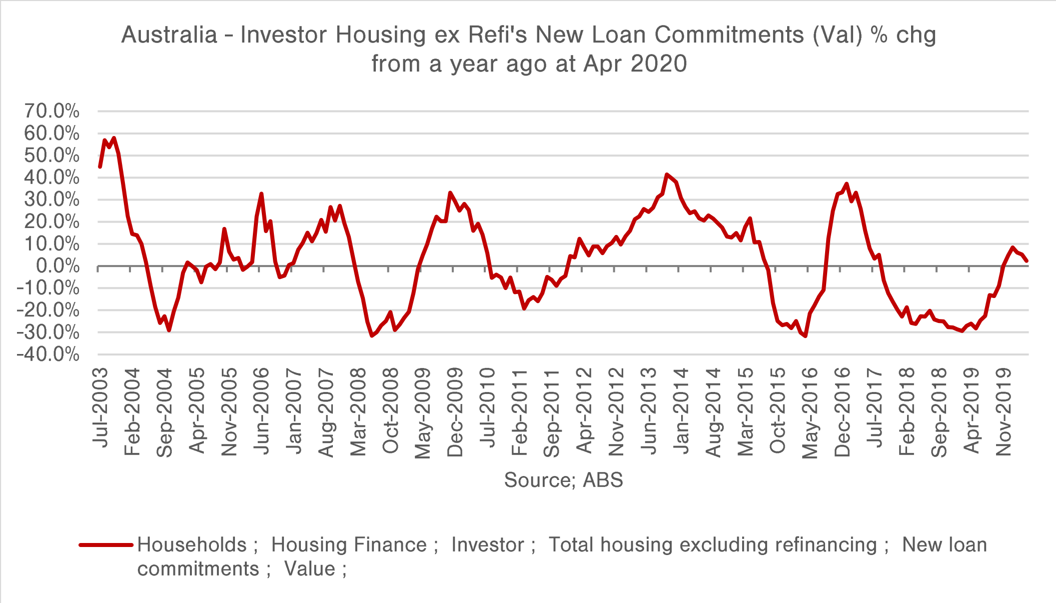
The decline this month in owner occupier lending was the result of a 6% decline in non-first-home-buyer lending. Lending for first home buyers declined by -1.9%.



Annual growth in total owner-occupier housing lending has slowed from the near-term peak of 22.5% in Mar to +14.8% in Apr.

<u>Investor Housing Finance ($ val) ex refis – month change</u>; Apr -4.2% versus Mar -3.9%

The value of lending for investors has declined in each of the last four months. The decline has been such that the value of investor lending in Apr was only +2.4% ahead of that a year ago;



https://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/5601.0Main%20Features2Apr%202020?opendocument&tabname=Summary&prodno=5601.0&issue=Apr%202020&num=&view=

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China

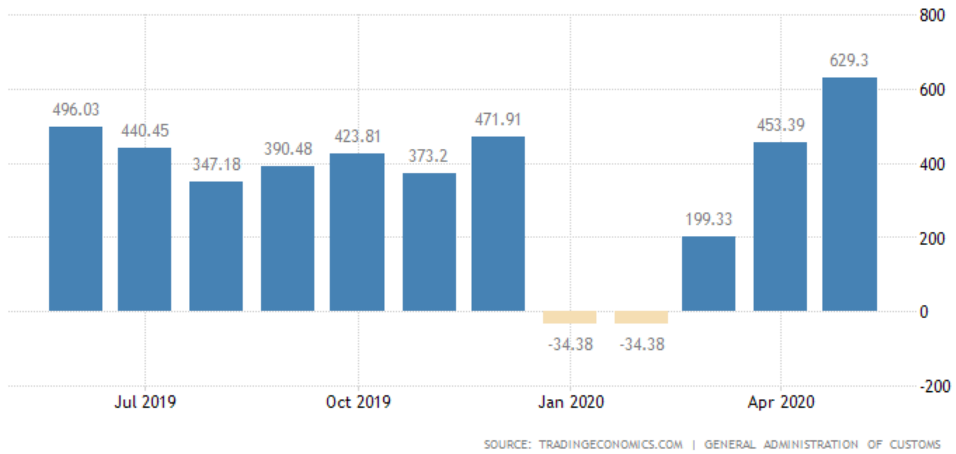
Trade Balance, Exports, and Imports (May)

The trade surplus increased notably this month compared to a year ago. This was the result of a decline in exports but also a larger decline in imports. One large factor in the decline in imports is the fall in oil prices, but imports are also down across key regions such as the EU, the US, and Japan. This also connects back to the weaker European (and German), US and Japanese production data. It's unclear the extent to which weaker imports are the result of these supply issues and/or weaker domestic demand.

Values USD

China Trade Surplus; May 2020 62.9bn versus May 2019 41.2bn

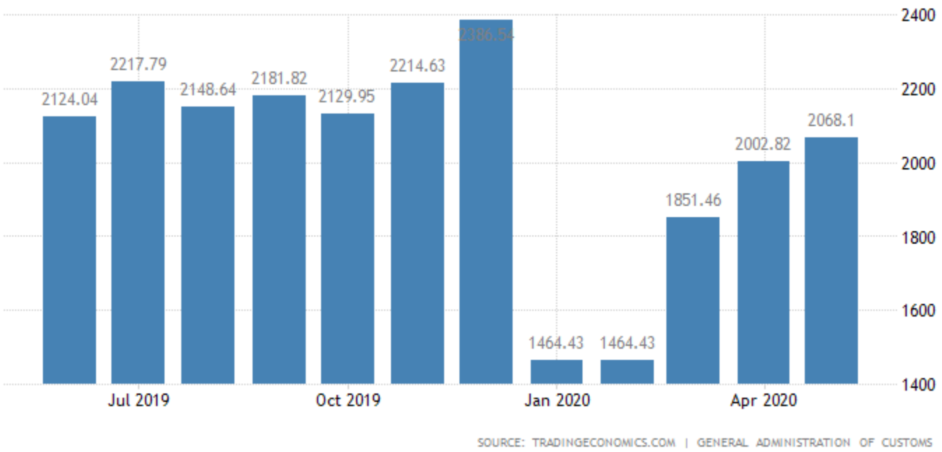
Chart; China Trade Balances last 12 months USD



Exports; May 2020 206.8bn versus May 2019 213.9bn

Exports in May were down -3.3% versus a year ago.

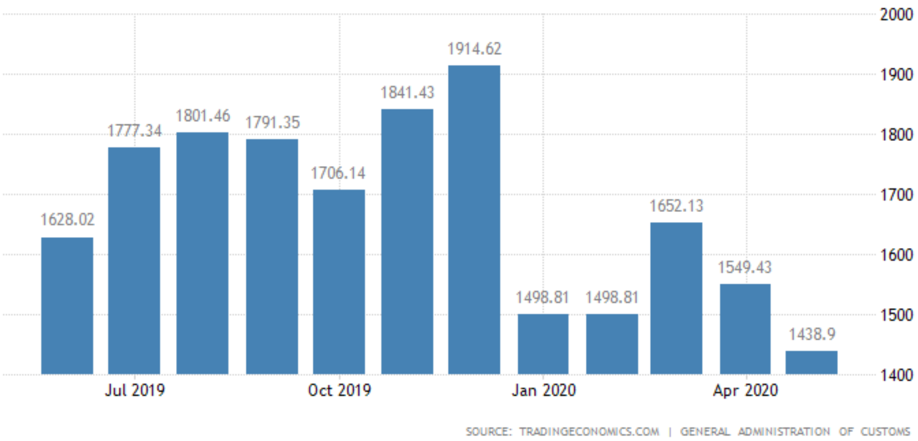
Chart; China Exports last 12 months USD



Imports; May 143.8bn versus May 2019 172.7bn

Imports were down much harder this month declining by -16.7% versus a year ago.

Lower commodity prices, esp oil, accounts for some of this weakness. But imports from markets such as EU and the US remain firmly down (est -22% and -5% year on year respectively). Japan is also a large import market for China and imports from Japan were down an estimates 43% compared to a year ago. Imports from Japan were down 34% for the first five months of the year. This is partly a reflection of these countries remaining under some restrictions as well as some Chinese domestic demand weakness (likely both final and intermediate goods).

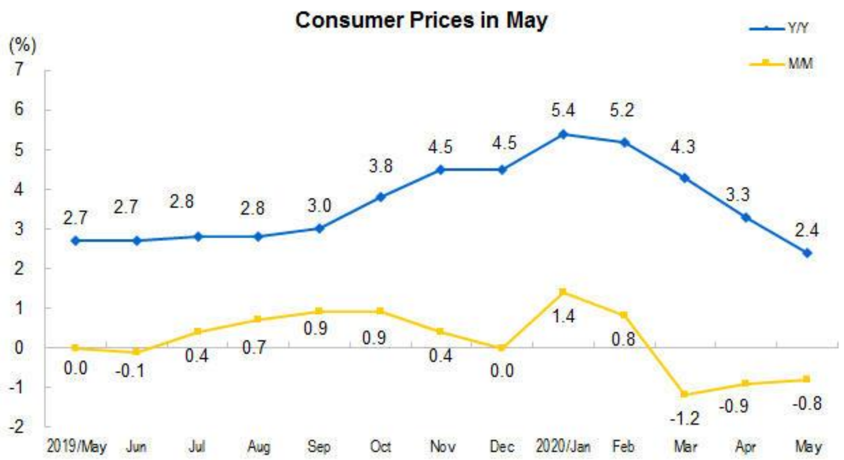


http://english.customs.gov.cn/Statics/90b65d80-9f97-49b2-afa7-f16853e88ebe.html

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

CPI (May)

Consumer prices continued to decline month on month in May and slowed further on an annual basis.



The largest contributor to the falls in the month were food, tobacco, and liquor prices, declining by -2.4% in compared to Apr. Most food prices declined;

> In which, fresh vegetable prices went down by 12.5 percent, affecting CPI down by 0.33 percentage point; livestock meat prices dropped by 5.7 percent, affecting nearly 0.41 percentage point decrease in the CPI (price of pork was down by 8.1 percent, affecting nearly 0.37 percentage point decrease in the CPI); egg prices dropped by 4.1 percent, affecting CPI down by 0.02 percentage point; fresh fruits prices fell by 0.8 percent, affecting CPI down by 0.01 percentage point; aquatic products prices increased by 1.3 percent, affecting CPI up by 0.02 percentage point; the price of grain rose by 0.3 percent, affecting CPI up by 0.01 percentage point.

On an annual basis though, food price growth remains elevated at +8.5% (due to livestock meat prices).

Clothing and other articles recorded only slight increases in prices for the month of +0.2% and +0.5% respectively.

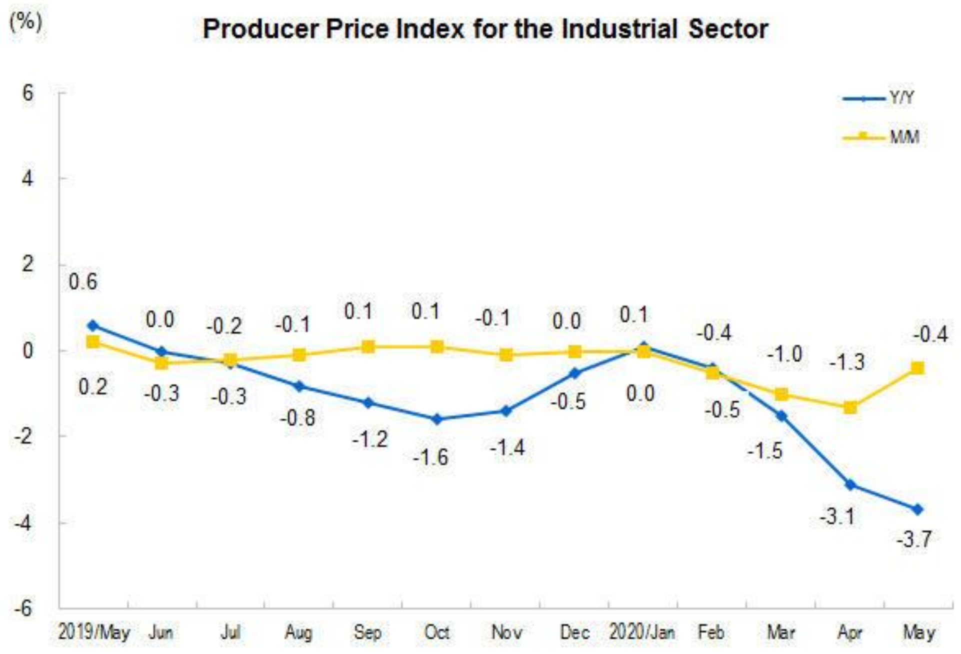
On an annual basis growth in prices continues to slow as food prices growth slows and transportation prices decline (-5.1% versus a year ago). Growth in education and healthcare remains positive. Prices for other articles is elevated at +5.3%.

http://www.stats.gov.cn/english/PressRelease/202006/t20200611_1755740.html

PPI (May)

Headline producer prices declined at a slower pace in May, but continued to accelerate lower on an annual basis. This measures the prices of products sold for the first time – so indicates that producers are likely continuing to reduce prices in order to remain competitive.

This has been aided somewhat by falling input prices. The purchase prices index also fell at a faster pace on an annual basis which measures the purchase price of intermediate inputs. So while producers were reducing prices, input prices were also falling, led mostly by falling fuel and power prices.



<u>PPI Industrial sector – month change</u>; May -0.4% versus Apr -1.3%

Prices for the mean of production and the consumer goods declined in the month – across all subcategories.

On an annual basis, the producer price index declined at an accelerated pace of -3.7%.

For the means of production, prices for raw materials and mining and quarrying remain well below a year ago at -9.9% and -14.8% respectively.

The largest changes year on year are;

Extraction of petroleum and nat gas -57.6%

Processing of petroleum -24.4%

Processing of agriculture products for food +5.1% (but manufacturer of food only up +0.4%)

<u>Purchase Price Index – month</u>; May -1.2% versus Apr -2.3%

Purchase prices declined by -1.2% in the month, led by larger falls in fuel and power prices in the month of -4.2% and -15% versus a year ago. In fact, most purchase prices declined in the month and remain lower than a year ago.

http://www.stats.gov.cn/english/PressRelease/202006/t20200611_1755743.html

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Trade

US-China Trade Talks

Tensions between the two countries continue to simmer. The delicate trade truce between the two countries remains at risk. As a part of the push to localise production, President Trump is looking at a phase 4 stimulus package of around $2trillion for manufacturing. This could have far wider effects than just the impact on Chinese manufacturing. Emphasis added;

> "Put simply, we need to create more manufacturing jobs," Navarro said. "Manufacturing jobs not only provide good wages but also create more jobs both up- and downstream through multiplier effects."
>
> Navarro said House Speaker Nancy Pelosi would like a $3 trillion dollar package, Senate Majority Leader Mitch McConnell would like a $1 trillion dollar package, but President Donald Trump would like a package of "at least $2 trillion dollars that is strategically focused around the President's two simple rules -- Buy American, Hire American -- **along with incentives for American companies to bring offshored jobs back home**."

https://edition.cnn.com/2020/06/13/politics/navarro-white-house-coronavirus-stimulus/index.html

Stage two of trade negotiations were planned to follow on from last years' agreement – but there has been no further progress. 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. There is no indication of timing for the start of phase two at this stage.

> 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 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.

NEW – S.301 Investigation of Digital Services Taxes

It was announced this week that the USTR would commence an investigation into various digital services taxes that have been implemented of considered for implementation on US firms.

> "President Trump is concerned that many of our trading partners are adopting tax schemes designed to unfairly target our companies," said USTR Robert

Lighthizer. "We are prepared to take all appropriate action to defend our businesses and workers against any such discrimination."

https://ustr.gov/about-us/policy-offices/press-office/press-releases/2020/june/ustr-initiates-section-301-investigations-digital-services-taxes

NAFTA/USMCA

The new USMCA will 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 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.

A deal is not likely to be finalised until the completion of the UK-EU post-Brexit trade deal. https://www.washingtonpost.com/business/what-trump-johnson-want-from-us-uk-trade-deal/2020/06/10/e116d732-ab75-11ea-a43b-be9f6494a87d_story.html

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

The actual details of the negotiations are largely unknown and causing concern in the UK;

> "The precise details of any UK-US Free Trade Agreement are a matter for formal negotiations, and we would not seek to pre-empt these discussions.
>
> "The Government is clear that when negotiating FTAs we will continue to protect our right to regulate in the public interest where we deem fit." https://www.express.co.uk/news/world/1288548/uk-government-brexit-trade-deal-chlorinated-chicken-farmers-us-trade-liz-truss

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 fourth round of negotiations took place last week. Little progress has been made in previous rounds of talks and, over the last week, further issues arose especially in regard to an agreement on fisheries. Both parties remain far apart on key negotiating objectives (https://audiovisual.ec.europa.eu/en/video/I-191665).

This week, UK PM Johnson will take part in the online negotiations.

> "So far we haven't had actual negotiations, just an exchange of views," an EU diplomat told AFP. "It's a battle of strategies at this point." https://au.news.yahoo.com/britains-johnson-eu-chiefs-seek-brexit-talks-reboot-025450148--spt.html

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

The overall deal needs to be struck by the end of Oct in order to have deal ratified by the EU members. Work will continue throughout the summer to come to an agreement.

> On Friday, the UK said that whatever the outcome of the talks, British customs officers would not be ready to deal with new rules at their ports or borders on January 1.https://au.news.yahoo.com/britains-johnson-eu-chiefs-seek-brexit-talks-reboot-025450148--spt.html

> 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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