MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 15 June 2020

Key Themes

The current trend of initial and continuing claims indicates little progress into reducing unemployment via reopening so far. Granted, its early days in the reopening process, but this is the second week of Jun data for initial claims and continuing claims reflect first week of Jun data. Both remain extremely high. Yet, activity has been clearly picking up – as evidenced by the strong rebound in retail sales last month (May).

The regional manufacturing surveys and industrial production data also indicate a lift in activity. The regional survey results were positive in terms of recording a lift in activity in the first week of Jun. They also provide some insight into the impact on employment so far. T**he average workweek probably says the most about current working conditions**. Despite the improvements in orders and shipments this month, firms continued to cut the average workweek on net (most firms kept the workweek unchanged compared to May) – both surveys were consistent on this. Demand growth is likely such that firms are not yet in a position, on net, to expand operations significantly compared to May. The change in unfilled orders also hint at this. Industrial production, esp manufacturing improved in May, but the scale of the rebound so far is such that levels of production remain low. Next month data should start to see a larger improvement, but so far, employment appears to be lagging.

One data point that stands out this week is the Japanese merchandise trade for May. There were quite severe declines in exports and imports this month compared to a year ago. Exports declined across all regions, with the most notable, a 50% decline in exports to the US (compared to the same month a year ago) – including transport equipment exports down 80%. Exports to China, the largest export market were down only slightly – likely indicating the more advanced state of the recovery in China. Japan's imports were also down. Last month, the fall in imports were linked mostly to the fall in the value of petroleum imports. This month declines in imports were more widespread. China is the single largest import market (1.5t in May) for Japan. While imports from China were down by only 2% compared to a year ago – the underlying performance of imports was mixed. Imports of manufactured goods from China was up by 46% (the largest positive contribution, but only one subsector led this growth – textiles, yarn, fabrics) and machinery +6%. This was offset by declines in imports from China across transport equip (-39%), electrical machinery (-10%), others (-16%), raw materials (-19%), and foodstuffs (-19%).

The BoJ kept policy unchanged, aside from upwardly revising the value of loans it could potentially back under a pre-existing scheme. Instead, the BoJ confirmed its dedication to QQE and YYC as the Japanese government has approved further stimulus to support the weaker economy. There was little change in the Japanese CPI growth this month (well below the 2% target). Japan has already experienced two consecutive quarters of GDP decline, as well as ongoing weakness in trade.

The weaker Japanese trade data (imports) also connects back to the weakness in Chinese exports reported last week (as well as lower Chinese exports to Europe and the US). But while

Chinese exports declined, Chinese imports declined by a larger degree. This is somewhat consistent with this month's Chinese industrial production data. The decline in exports has been more moderate – supported by the restart of local production.

The Aus Labour Force report for May highlights the extent to which fairly significant damage has been done the labour market. In May, employment declined, unemployment increased and underemployment also increased. The increase in these measures has reached historical extremes. The employment to population ratio was 58.4% in May. The last time the employment to population ratio was at least this low was in Jun 1999.

The one positive was hours worked. This month, hours worked declined by a much smaller number, possibly indicating that the peak falls in activity were in Apr.

With the lifting of more restrictions in Aus, there will hopefully be a rebound in employment growth next month. But the mutual obligation requirement of looking for work on JobSeeker has also been reinstated as of early Jun, so we'll possibly see an increase in the participation rate, leading to an increase in 'official' unemployment numbers next month. There also appears to be some new Covid case activity – something to watch.

Contents

US Data

Initial and Continuing Jobless Claims wk ending 12 Jun

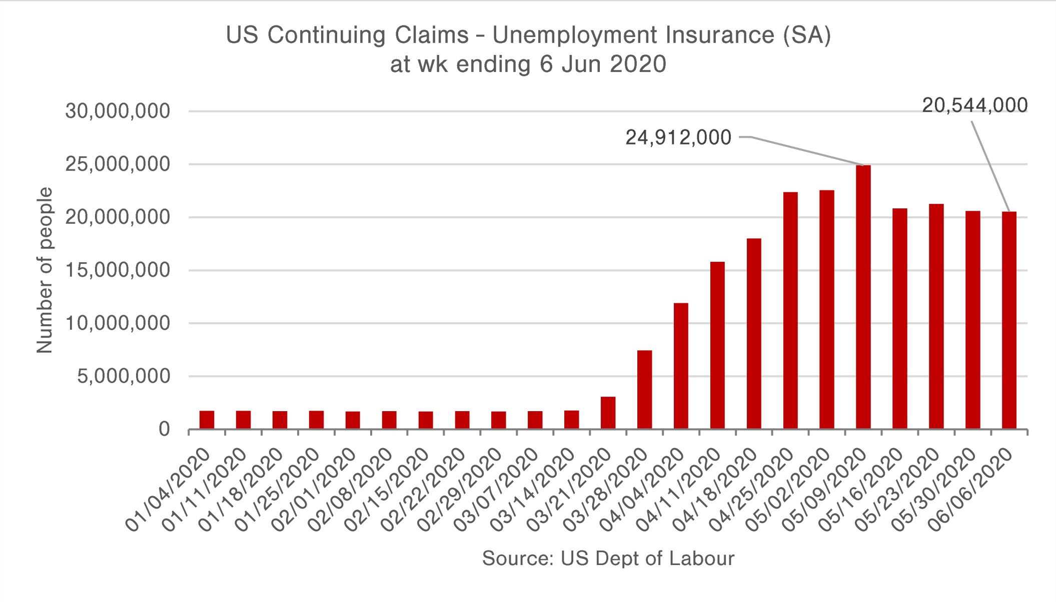
Growth of initial jobless claims remain extremely high, running at approx. twice the pace of the worst month of the GFC. Continuing claims also remain extremely high, with little change in the level of ongoing claims this week.

Advance Initial Jobless Claims – wk ending 13 Jun 2020; 1,508,000 claims made by people

The level of new claims remains highly elevated. Prior week claims were revised slightly higher and remained well above 1.5m people. For comparison, the peak of initial claims in the GFC was 665,000 people (which also took longer in weeks to reach).

Advance Continuing Insured Unemployment Claims – wk ending 6 Jun 2020; 20,544,000 claims.

Insured claims were little changed from the week prior level of 20,606,000 claims. **Little inroads appear to have been made into reducing unemployment via reopening so far**;



Insured unemployment rates are highest among some of the largest states for the wk ending 30 May;

> The highest insured unemployment rates in the week ending May 30 were in Nevada (24.2), Puerto Rico (21.1), Hawaii (20.2), New York (18.0), Michigan (17.6), Connecticut (16.3), California (16.2), Rhode Island (16.2), Louisiana (16.1), and Massachusetts (16.1).

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

US Retail Sales (May)

US retail sales rebounded in May after two extremely weak months in Mar and Apr. The growth in May, in dollar terms, offset the decline in Apr. All categories contributed to the growth this month. Growth in some categories is coming off an extremely low base of sales from Apr.

The other factor to consider in the pace of retail sales growth in the next few months is the impact of out-of-stocks. Anecdotally, this is still an issue (maybe not a large issue) across some categories/stores as supply chains start to come back online.

The rebound coincides with the very weak consumer credit report for May, and was after the (first) round of CARES Act payments.

<u>Total Retail Sales ($Val) – month change</u>; May +17.7% (+$73bn) versus Apr -14.7% (-$71.3bn)

The largest contributor to growth in the month, in dollar value, was the sale of motor vehicles. Motor vehicle sales increased by +44% ($30bn) after declining by 12.3% in the month prior. Seasonally adjusted sales of motor vehicles are now 4% below the same month a year ago.

<u>Other contributors to growth this month were</u>;

Food service and drinking places; May +29% (+$8.7bn) – and sales remain 40% below a year ago.

Non-store retailers; May +9% (+$7.1bn) – and sales are +30% ahead of the same month a year ago.

Clothing stores; May +188% (+$5.2bn) – this is after sales in this category fell to an extremely low level in Apr of a mere $2.8bn (for the total category). Sales remain 63% below a year ago.

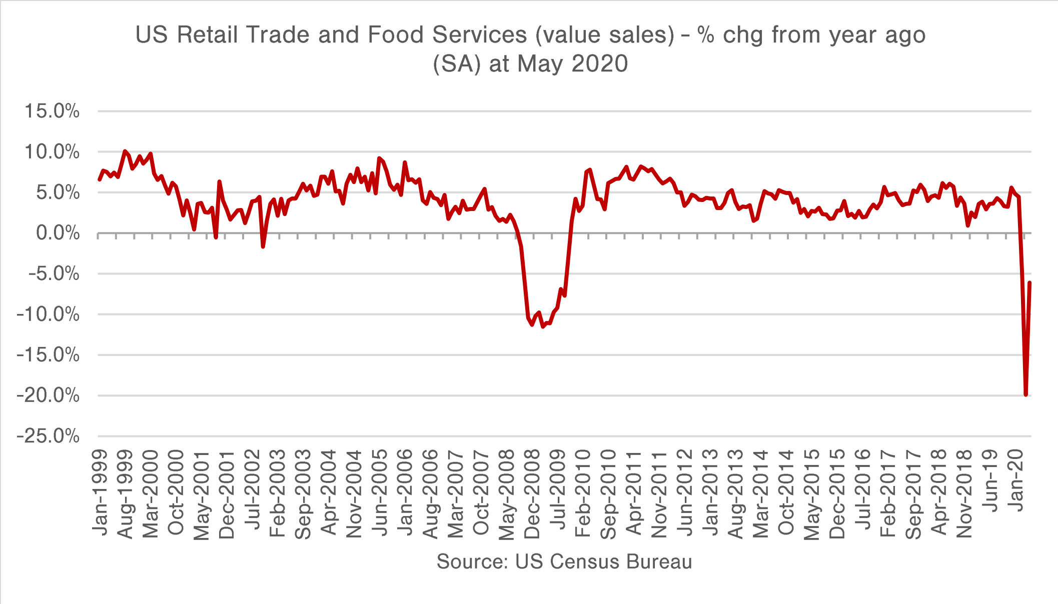
<u>Other strong performing categories on a year ago basis</u>;

Grocery; May +2% (+$1.5bn), sales growth was not as strong as the headline this month after a -12% decline in the month prior. Sales are 14.5% ahead of a year ago.

Building materials; May +11% (+$3.6bn). Sales of building materials are up 16% versus the same month a year ago.

Sporting goods; May +6% ($+3.3bn) after a 14% decline in the month prior. Sales are 5% above a year ago.

<u>Total Retail Sales ($Val, SA) – annual change</u>; May -6.1% versus Apr -19.9%



The annual growth chart above does provide a fairly accurate view of the current level of retail sales – still well below the peak of Jan 2020;

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

NY Empire State Manufacturing Index (Jun)

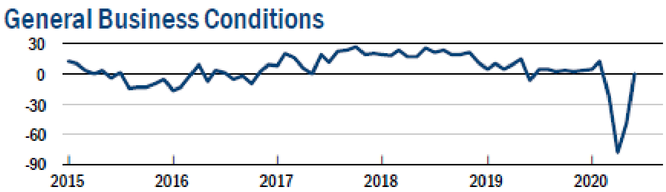
The reference week for the survey was 2-9 Jun.

This month, manufacturing firms noted, on net, that business activity was steady so far in Jun compared to the severe falls of Apr and May. The continued decline in unfilled orders indicates that new order growth likely remains too low. Firms, on net, continued to reduce hours worked (and the number of employees) and most firms have made no changes to the average workweek compared to the month prior despite some small growth in shipments. Margins look to be squeezed this month with an acceleration in input costs and a further slight decline in output prices.

Despite this, the vast majority of firms expect better conditions in six months' time.

<u>Headline Business Activity Index – month</u>; Jun -0.2pts versus Mar -48.5

The underlying result was that 36.1% of firms reported higher/improve conditions in Jun and 36.3% of firms reported that activity had worsened in Jun. Both results are a vast improvement on the last two months.



	Percent Reporting		
	Higher	Lower	Index
May	14.5	63.1	-48.5
Jun	36.1	36.3	-0.2
Change			48.3

The improvement in new orders and shipments followed a similar pattern.

The new orders index improved from -42.4 in May to -0.6 in Jun indicating, on net, steady new orders conditions compared to the month prior. Similarly, 35.3% of firms reported improved/higher new orders at the start of Jun and 36% of firms still reported worse/lower new orders than in the month prior.

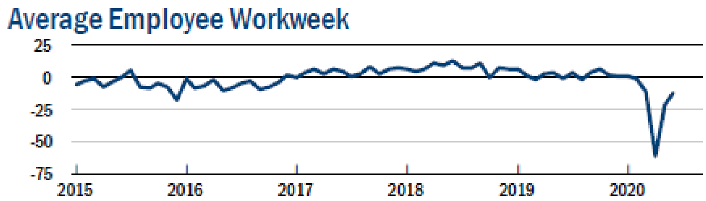
The shipments index improved more positively. The index shifted from -39% in May to +3.3% in Jun. This indicates that there was on net, firms recorded an improvement in shipments. This still represents only slight growth on the prior month.

Unfilled orders declined at a slower pace increasing from -20.3 in May to -12.5 in Jun. While there was a larger decrease in the firms reporting lower unfilled orders (from 34.5% of firms in May to 27.5% of firms in Jun), there was little change in the proportion of firms reporting an increase in unfilled orders, lifting from 14.2% of firms in May to 15% of firms in Jun. In other words, most firms were reporting no change in unfilled orders. This indicates that there was likely still enough spare capacity for firms to work through existing orders before any growth in new orders resulted in increasing backlogs.

Inventories declined at a slight pace, indicating little change from the month prior.

The number of employees continued to decline, but at a slower pace. The number of employee's index improved from -6.1 in May to -3.5 in Jun. The underlying shifts were somewhat mixed. There was actually <u>an increase in the proportion of firms reporting a lower number of employees, 21.9% of firms reported a lower number of employees in Jun versus 20.8% of firms in May</u>. There was a larger increase in the number of firms reporting higher employment increasing from 14.7% of firms in May to 18.4% of firms in Jun.

The average workweek probably says the most about current working conditions. The average workweek continued to decline but also at a slower pace. While less firms reported reductions in the average workweek, there was a slightly lower proportion of firms, less firms, reporting an increase in the average workweek. Most firms (63.8%) reported no change in the average workweek versus the month prior. Demand growth is likely such that firms are not yet in a position, on net, to expand operations significantly compared to May. Most firms will likely do what they can with current staffing and operation levels until demand growth picks up.



	Percent Reporting		
	Higher	Lower	Index
May	12.8	34.4	-21.6
Jun	12.1	24.1	-12.0
Change			9.6

On the prices front, prices paid for inputs start to increase at an accelerated pace. The index increased from 4.1 in May to 16.9 in Jun. At the same time, prices received were little changed, declining at a slower pace; May index -7.4 versus Jun -0.6. In effect, this results in a squeeze in margins and firms will likely continue to keep a tight rein on costs.

The most positive point in this report was the forward view of business conditions in six months' time. The index of expectations increased significantly from 29.1 in May to 56.5 in Jun. Most firms, 68.6% of firms, expect conditions to be better in six months' time.

https://www.newyorkfed.org/medialibrary/media/survey/empire/empire2020/esms_2020_6_survey.pdf?la=en

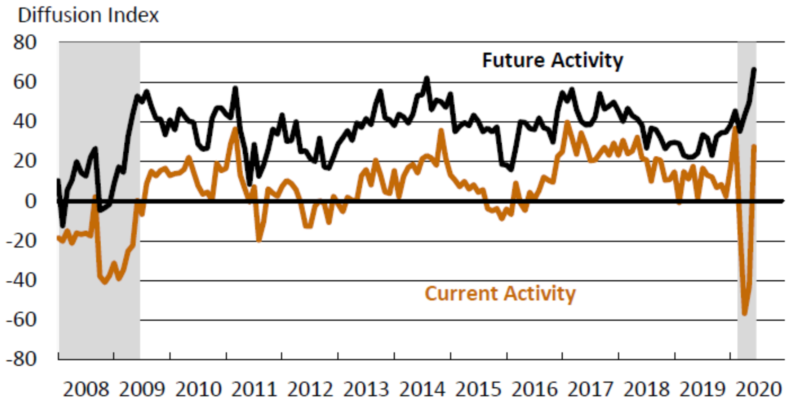
Philadelphia Fed Manufacturing Survey (Jun)

There was improvement in the Philadelphia regional manufacturing conditions this month after three months of severe declines. There was an obvious improvement in demand with more firms reporting growth in new orders and shipments. At the same time, employment and the average workweek continued to decline.

Future business conditions were expected to improve by 75% of firms in the survey. Future business expectations did not actually decline during the pandemic shutdown.

Headline General Business Activity Index; Jun 27.5 versus May -43.1

Chart 1. Current and Future General Activity Indexes
January 2008 to June 2020



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

Demand was stronger this month with new orders increasing from -25.7 in May to 16.7 in Jun. The proportion of firms reporting growth in new orders increased (from 25% to 41.5%) and the proportion of firms reporting lower new orders declined (from 50.9% of firms to 24.8% of firms).

Similarly, growth in shipments also accelerated with the index increasing from -30.3 in May to 25.3 in Jun.

Unfilled orders were unchanged in Jun (-0.1) after declining in May (-13.3). Most firms though (49.2% of firms) reported no changes in unfilled orders compare to the prior month when orders declined. This suggests the improvement in new orders is at least resulting in steady unfilled orders.

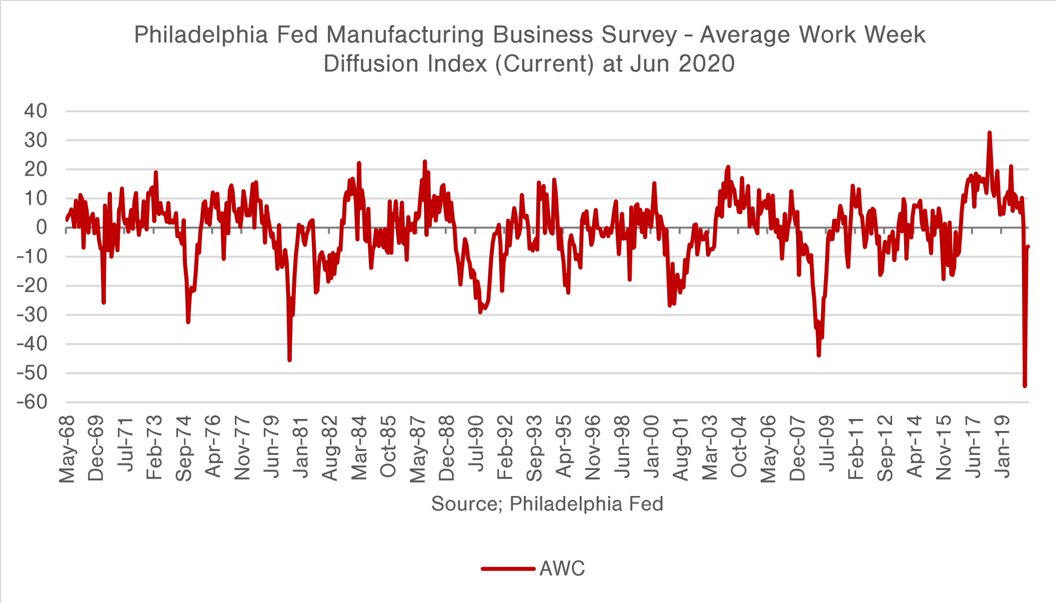
Inventories were unchanged this month after declining in the month prior.

Input prices accelerated, but the vast majority of firms (78.5% of firms) reported no change in input prices from the month prior. Only 16% of firms reported higher input prices this month – which was exactly the same as in the month prior.

The prices received index also increased this month from -3.3 in May to 11 in Jun. Again, most firms, 84% of firms, reported no change in prices received compared to the decline in the month prior. There was an increase in the proportion of firms reporting higher prices received, increasing from 6.4% in May to 13.2% of firms in June.

Employment improvement appears to be lagging somewhat. The employment index continued to decline, albeit at a slower pace this month; Jun -4.3 versus May -15.3. There was a small improvement in the proportion of firms reporting an increase in employees, lifting from 8.5% of firms in May to 11.8% of firms in Jun. Less firms reported declines in the number of employees (16% of firms). But the vast majority of firms, 72%, reported no change in the number of employees.

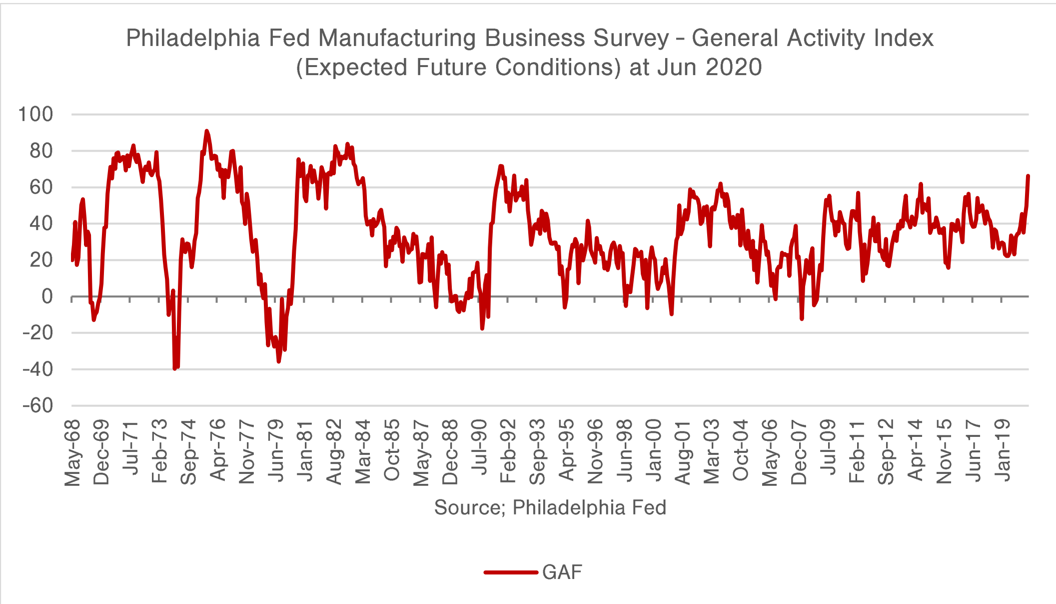
Despite the improvements in orders and shipments this month, firms continued to cut the average workweek. While the average workweek declined at a slower rate than the month prior, consider that this is on the back of a severe decline in Apr (the largest in the series) – with further declines in May (-7.1) and now Jun (-6.5);



Underlying the workweek changes, less firms this month (12% compared to 15% in May) reported an increase in this average workweek. More firms (most firms – 69% in Jun) reported no change to the average workweek.

The outlook for conditions continued to improve in Jun. The expected business activity for six months' time improved from 49.7 in May to 66.3 in Jun.

What is interesting about the future business activity reading is that it did not fall to a new low during the pandemic shutdown. The near-term low of 23.1 was recorded back in Sep 2019.



In the current month, 75.3% of firms expect to see an improvement in six months' time.

https://www.philadelphiafed.org/-/media/research-and-data/regional-economy/business-outlook-survey/2020/bos0620.pdf?la=en

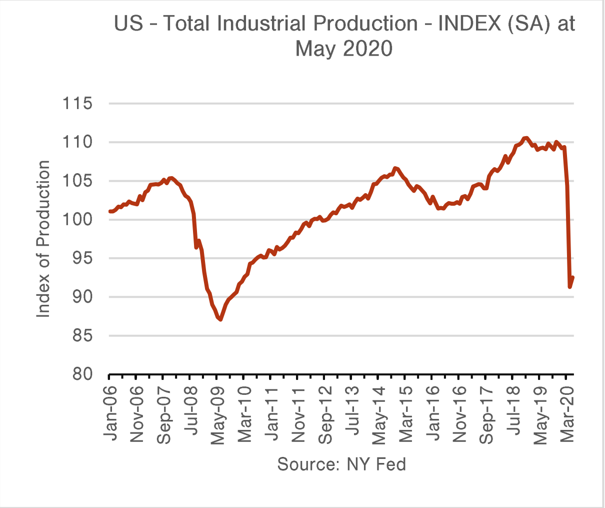
Industrial Production (May)

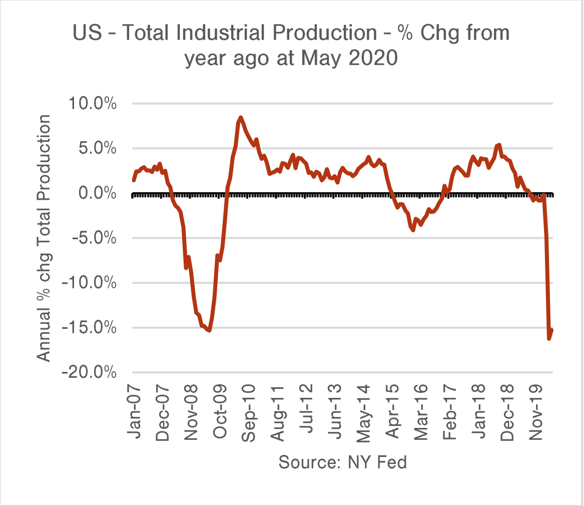
The rebound in production commenced in May. Increased production was recorded across manufacturing, including both durable and non-durable goods. While the % increases are impressive, levels remain low for the moment. Production across mining and utilities continued to decline this month.

Overall capacity utilization increased in-line with headline production growth rates.

<u>Total US Industrial Production – month change</u>; May +1.4% versus Apr -12.5%

The level of production in May remained 15% below a year ago.



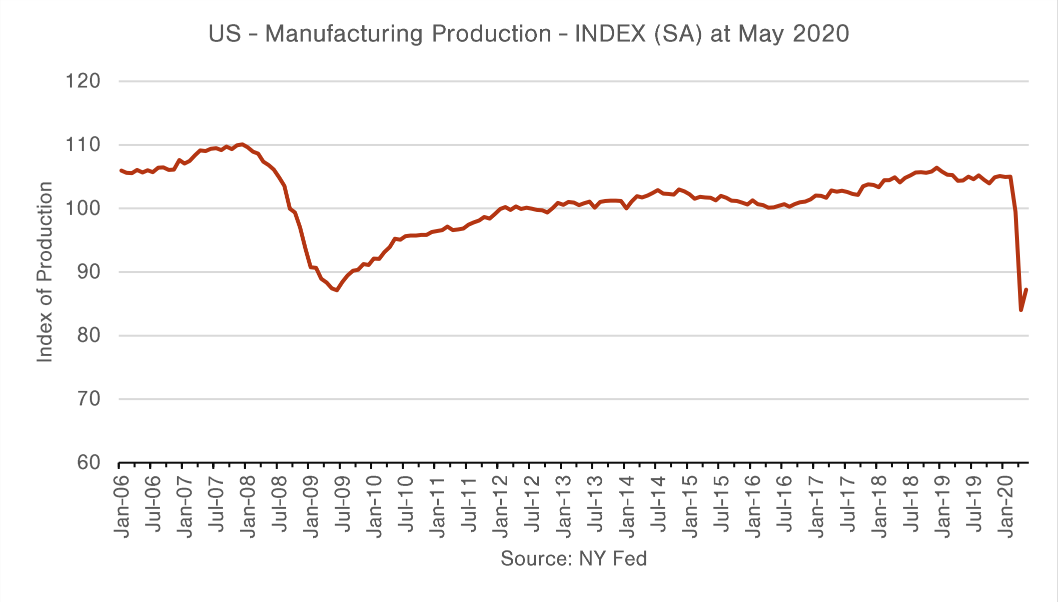


Overall this was only a small rebound in growth – with some manufacturing growth helping to offset declines in mining and utilities.

<u>MANUFACTURING PRODUCTION – month change</u>; May +3.8% versus Apr -15.5%

The index of production highlights the scale of rebound so far. Its early days.

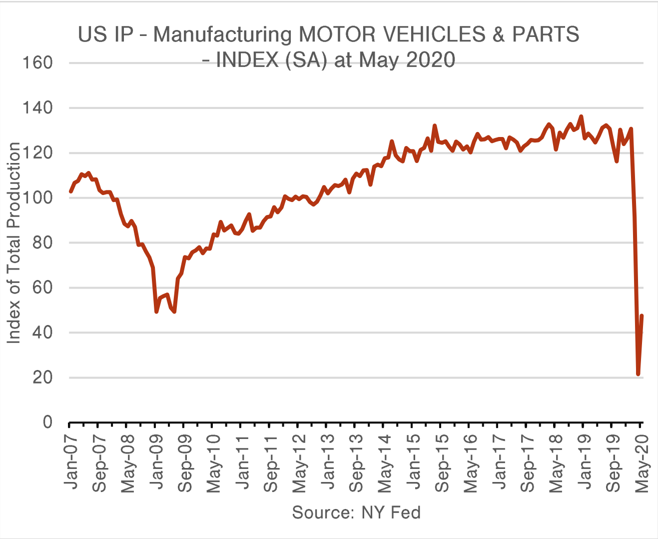
Manufacturing production levels are still 16.5% below the same month a year ago;



Production increased across both durable and non-durable goods. The breadth of growth across the sectors improved too.

<u>Durable goods;</u> May +5.8% after declining by -21% in Apr. Six out of eleven sectors recorded growth this month.

This included motor vehicle production. The month on month growth was 121%, but this comes off an extremely low base;



In May, the index of motor vehicle production doubled compared to Apr, increasing to 47. The May level is still 36% below the peak in Feb 2020.

Motor vehicle capacity utilization only increased to 28% (from 12% in Apr). It will likely take some time to restart this supply chain globally.

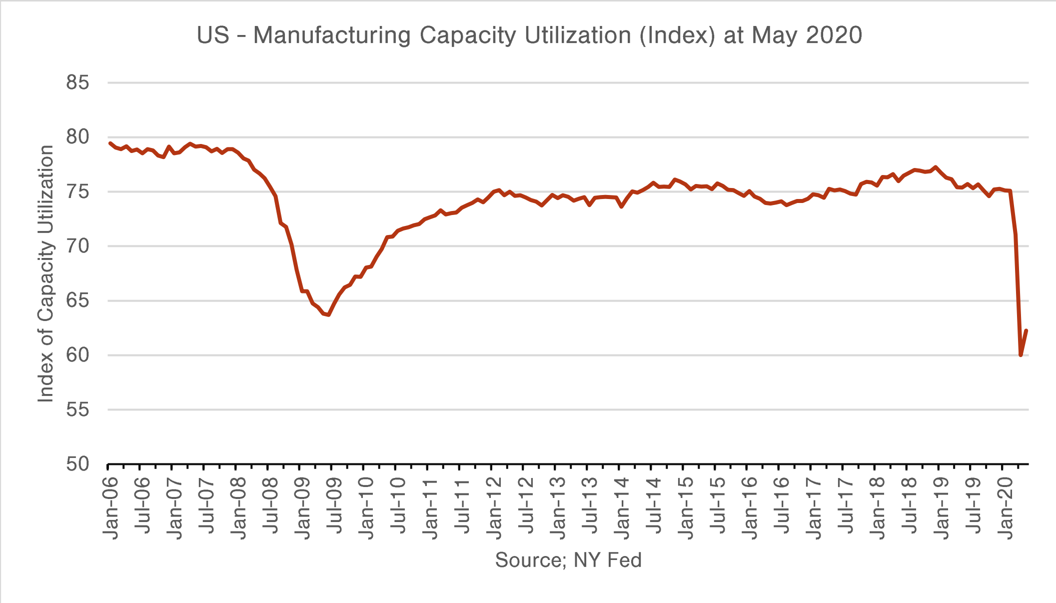
Production across several durable goods categories continued to decline; primary metals, machinery, computer and electronic products, and electrical equipment.

<u>Production across non-durable goods</u> also increased by +2.1% in May after a 9.6% decline in Apr. The breadth of growth was better with only one non-durable goods sector recording a decline in the month (paper products).

Food and bev production increased by +1.4% and production remains 10% below the Dec 19 peak and 7% below the same month a year ago.

Production of petroleum and coal products also increased slightly this month by +2.1% after a 17% decline in Apr. Production remains well below a year ago at -20%. This will likely improve along with prices.

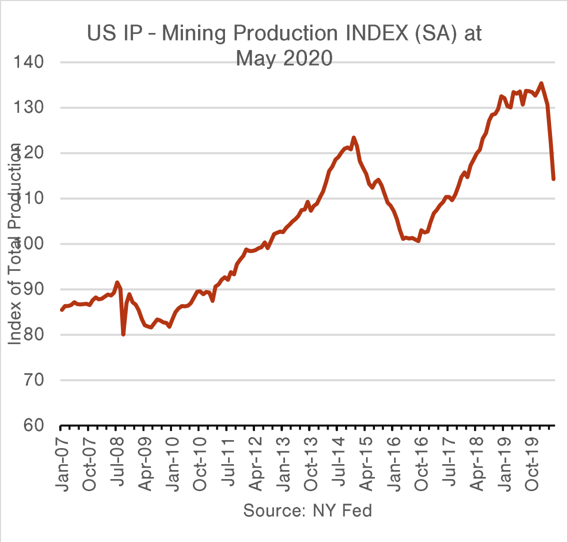
<u>Manufacturing Capacity Utilization</u> – this increased by 3.7% in the month with utilization increasing from 60.3% to 62.2%. The recent peak was Dec 2018 at 77%;

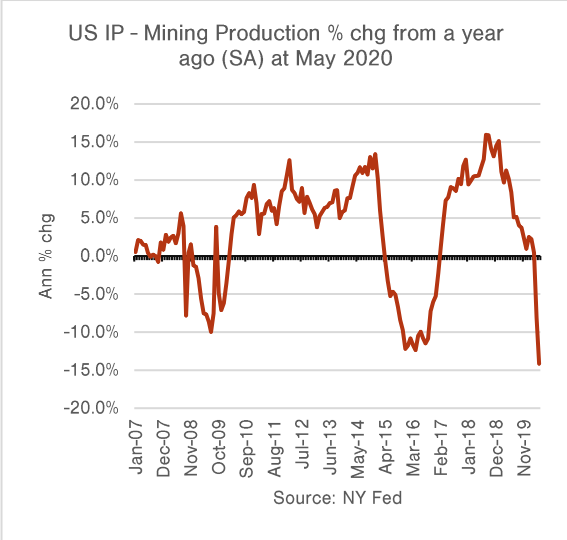


<u>MINING PRODUCTION – month change</u>; May -6.8% versus Apr -6.1%

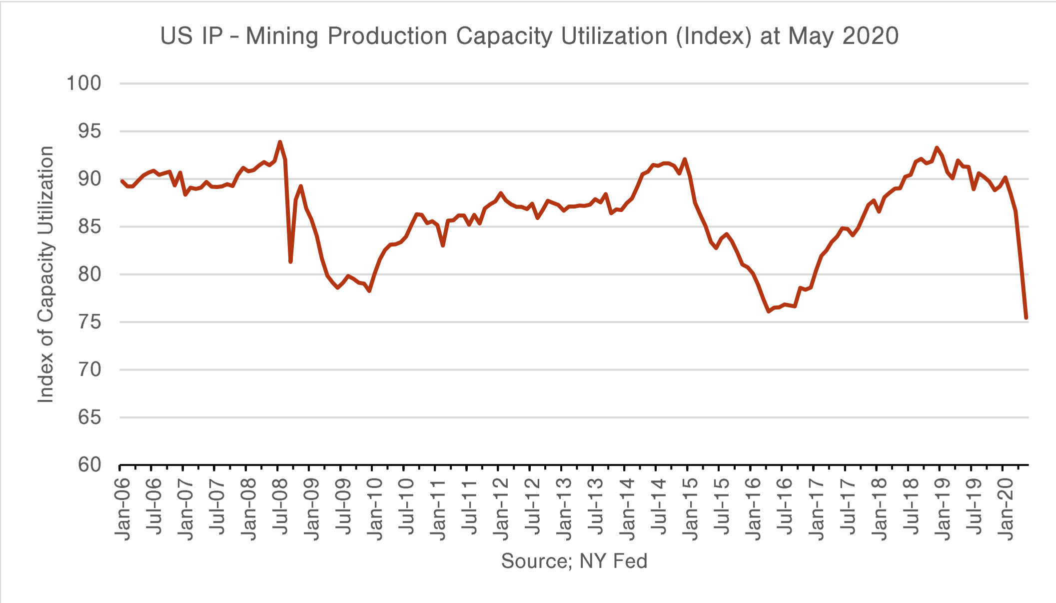
> Mining output dropped 6.8 percent, with declines in nearly all categories. After falling nearly 28 percent in April, the index for oil and gas well drilling declined almost 37 percent further in May and was more than 63 percent below its year-earlier level. In addition, the index for crude oil extraction has fallen about 5 percent in each of the past two months.

Mining production overall remains 14% below the same month a year ago;





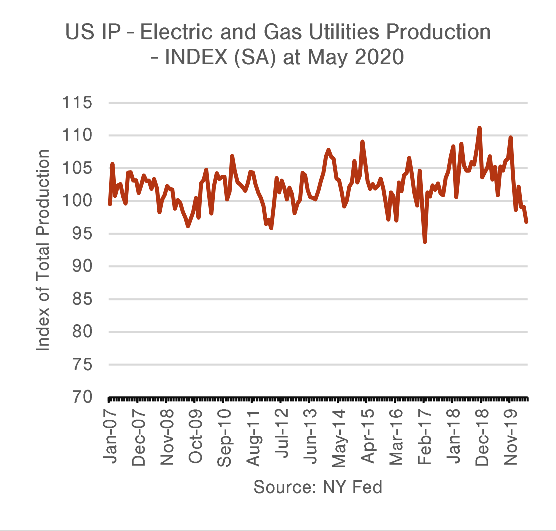
Mining capacity utilization fell to the lowest level in recent years, falling to 75%;

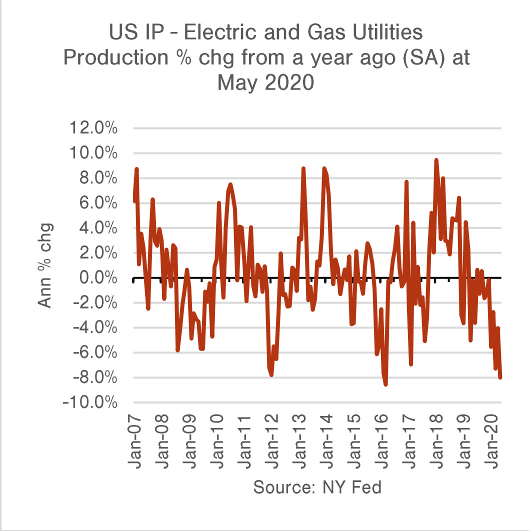


<u>ELECTRIC AND GAS UTILITIES PRODUCTION – month change</u>; May -2.3% versus Apr -0.6%

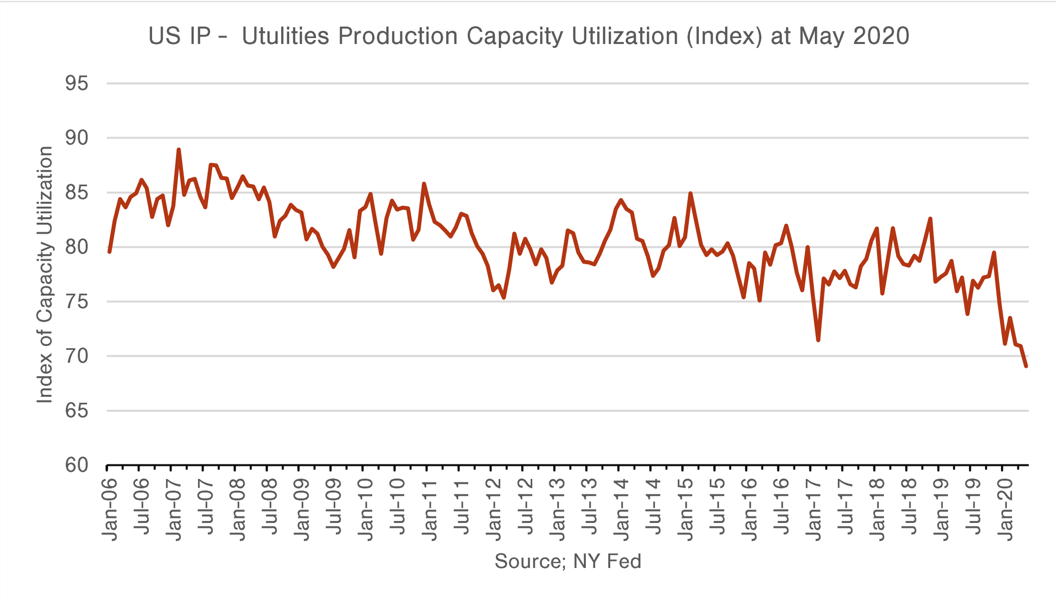
The output of utilities fell 2.3 percent in May, as both gas and electric utilities posted losses.

On an annual basis utilities production declined at an accelerated pace and is now down by 8% compared to a year ago;





Electricity and gas utilities capacity utilization also fell further to 69%. Again, this is one of the lowest levels in recent years;



https://www.federalreserve.gov/releases/G17/Current/g17.pdf

Weekly Mortgage Applications wk ending 12 Jun

Mortgage applications continued to increase in the latest week, led by both refi activity and purchases.

Market Composite Index (mortgage loan application volume) wk ending 12 Jun; +8% versus the week prior.

Refinance applications increased by 10% versus the week prior and was +106% ahead of the same week a year ago.

Refi's continued to increase again. As a proportion of total mortgage applications, refis increased from 61.3% last week to 63.2% this week.

The purchase index (the measure of the number of loans finalised and a leading indicator of housing sales), increased by 4% compared to the week prior.

> "Purchase applications increased to the highest level in over 11 years and for the ninth consecutive week. The housing market continues to experience the release of unrealized pent-up demand from earlier this spring, as well as a gradual improvement in consumer confidence," said Joel Kan, MBA's Associate Vice President of Economic and Industry Forecasting. **"Mortgage rates dropped to another record low in MBA's survey, leading to a 10 percent surge in refinance applications**. Refinancing continues to support households' finances, as homeowners who refinance are able to gain savings on their monthly mortgage payments in a still-uncertain period of the economic recovery."

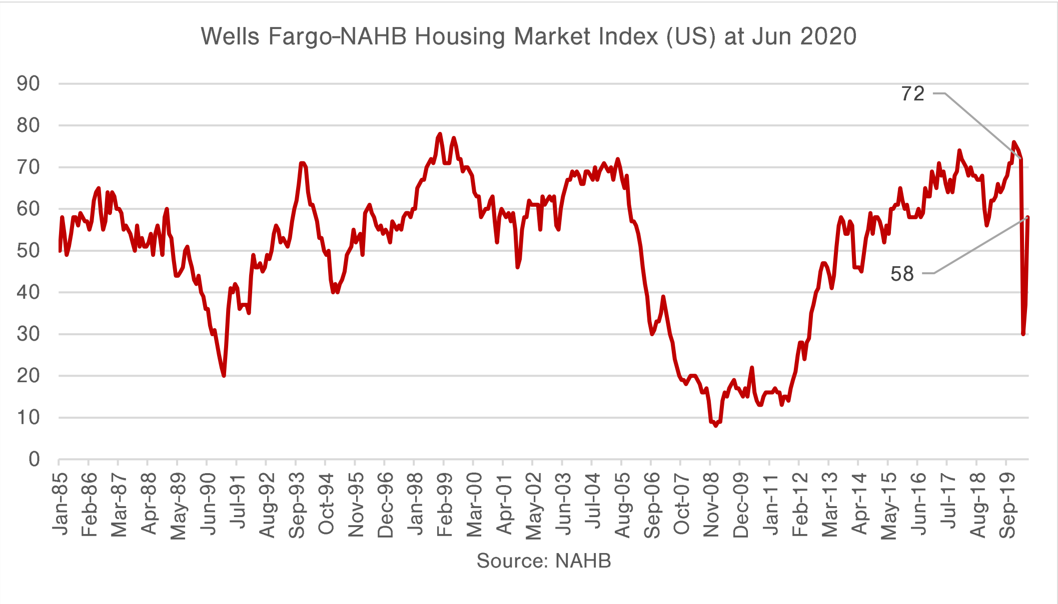
https://www.mba.org/2020-press-releases/june/mortgage-applications-increase-in-latest-mba-weekly-survey-x264417

NAHB Housing Market Index (Jun)

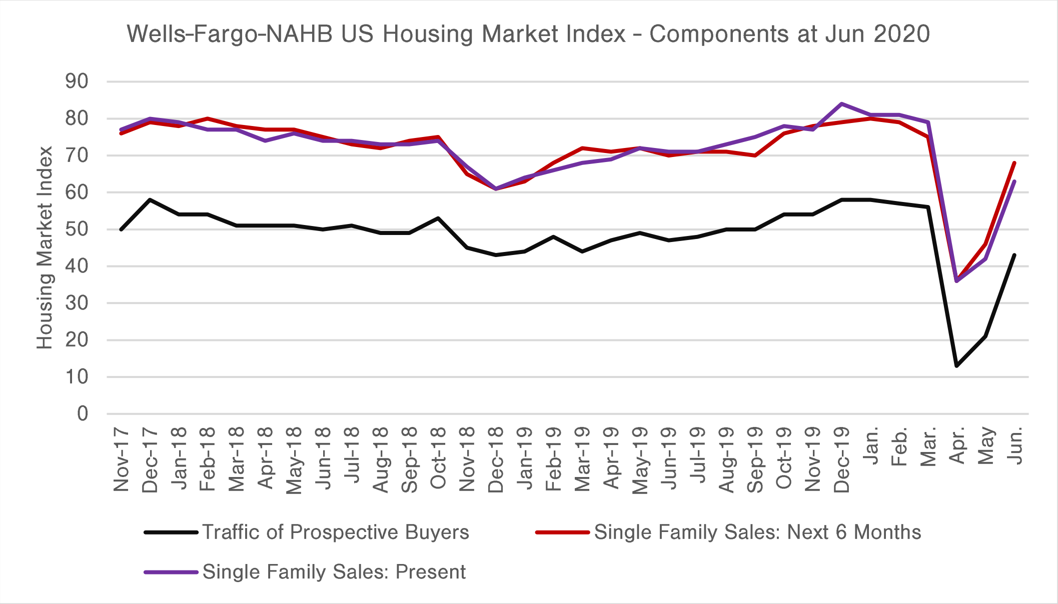
Housing market conditions rebounded at a stronger pace in Jun – this is in-line with the improvement in weekly mortgage applications.

Stabilization in the mortgage market and improvement in conditions is within the broader context of 'crisis' level measures in place such as the temporary break on mortgage repayments. The average rate on the 30-year fixed mortgage fell to a new all-time low in the latest week of 3.13%.

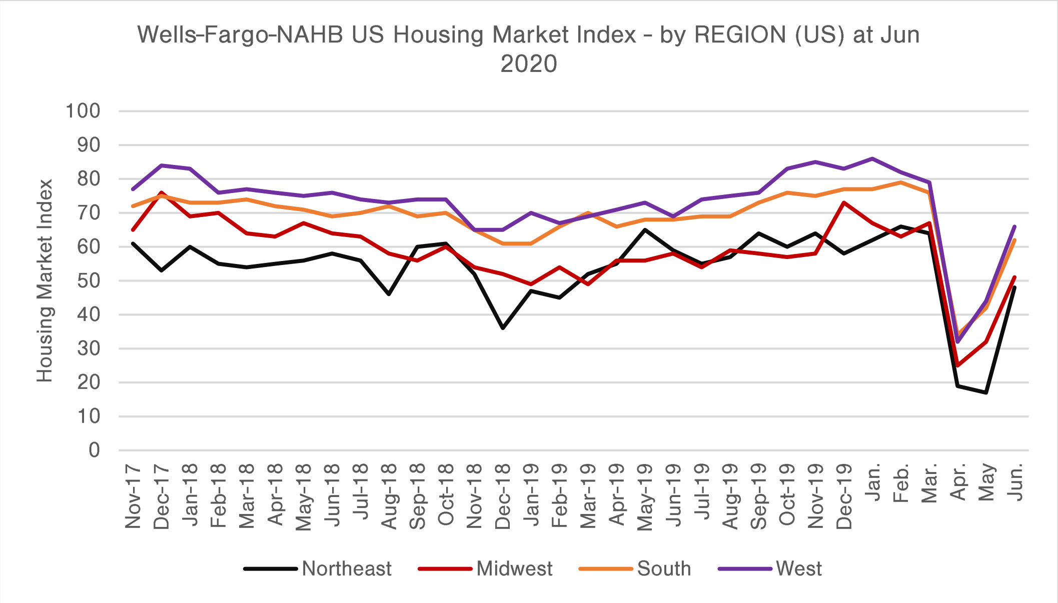
NAHB Housing Market Conditions Index; Jun 58 versus May 37



All of the underlying components of the HMI improved in Jun – especially the traffic of prospective buyers, which had lagged notably.



There was an improvement in housing market conditions across all regions. The largest percentage again was the improvement in conditions in the Northeast (+182% versus May).



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

Housing Permits & Starts (May)

New housing permits increased in the latest month. The growth in permits across the regions was more robust as well, as confidence intervals were 'statistically significant' (did not contain zero). Growth in housing starts was also positive at a National level, but the level remains well below a year ago. New starts survey data across the regions did not yield statistically significant results across the Northeast or the Midwest (confidence intervals included zero).

National Housing Permits - SAAR; May 1.220k versus Apr 1.066k

The increase in the month was +14.4% (+/- 1.1% pt) – meaning that it is likely that new housing permits issued increased in May.

The pace of new housing permits issued remained 8.8% below a year ago (90% confidence interval is also +/- 1% pt).

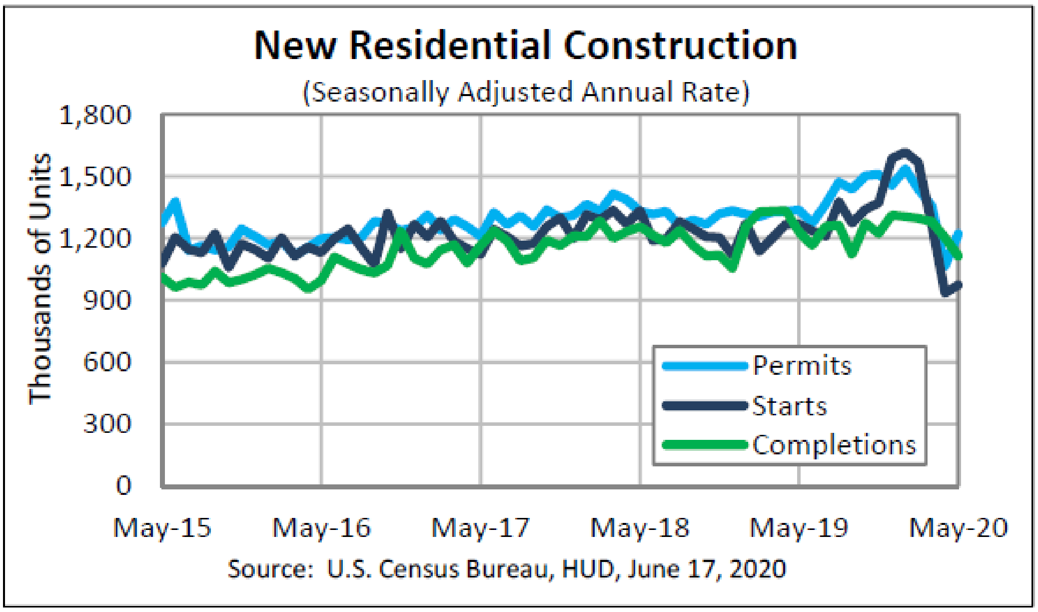
Across the regions, permits increased in the Northeast (+82%), the Midwest (+18.4%), South (+7.7%) and West (+12.3%). All regional results in the month were statistically significant – meaning that it is likely that permits increased in the month.

National Housing Starts – SAAR; May 974k versus Apr 934k

The increase in housing starts for the month was lower than permits at +4.3% and was also not a statistically significant result (+/- 15% pts) – so the number could have increased or decreased.

The pace of housing starts in May was 23.2% below a year ago (+/- 6.2% pts).

The lower trend for new starts is possibly the result of pandemic-related restrictions.



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

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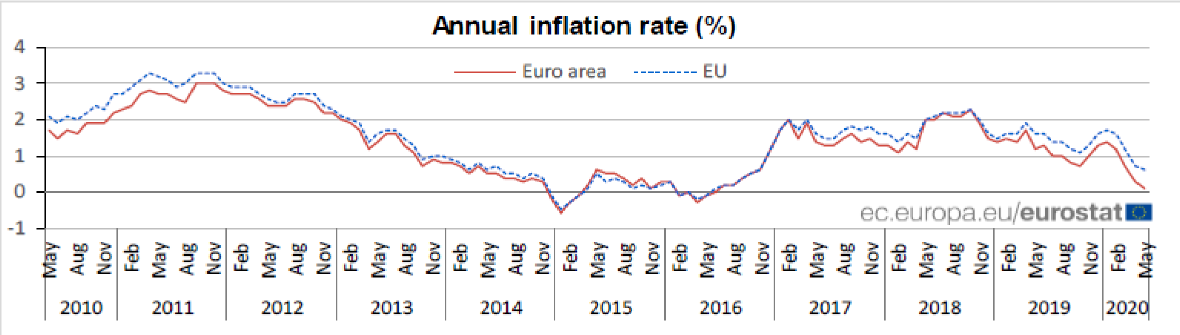
Europe

Eurozone CPI (May)

Annual growth in consumer prices slowed to +0.1% in May across the Euro Area (broader EU +0.6%). In the Euro Area, food, alcohol, and tobacco prices and services prices continued to make the largest contributions to headline CPI growth. This was offset by larger declines in energy prices.

Euro Area Headline CPI – annual change; May +0.1% versus Apr +0.3%

A year ago, Euro Area CPI growth was +1.2%.



Annual headline CPI growth slowed in May as a result of an 11.9% decline in energy prices. In the month, energy prices declined by -1.7%. The annual decline in energy prices detracted -1.2%pts from the headline CPI growth rate.

Food, alcohol, and tobacco prices continued to grow at a faster pace, although slightly slower than in Apr; +3.4% in May versus +3.6% in Apr. Growth in unprocessed food prices was the largest contributor, growing at an annual pace of +6.7% (and +0.3% in the month). Food, alcohol, and tobacco prices contributed +0.64% pts to annual headline CPI growth.

Excluding these two results, core CPI growth was higher; May +0.9% versus Apr +0.9%

The largest weight category in the index is services prices. Services prices grew at a slightly accelerated pace in May of +1.3% compared to +1.2% in Apr. Services contributed +0.59% pts to headline CPI growth.

https://ec.europa.eu/eurostat/documents/2995521/10294984/2-17062020-AP-EN.pdf/27a39aa1-8a45-10f9-dc06-71d41f235e03

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Japan

Merchandise Trade (May)

The Japanese trade deficit was slightly smaller in May compared to a year ago. But this was the result of a severe decline in both exports and imports versus a year ago.

Exports declined across all regions, with the most notable a 50% decline in exports to the US (compared to the same month a year ago). Exports to China, the largest export market were down only slightly – likely indicating the more advanced state of the recovery in China. Imports for Japan were also down. Last month, the fall in imports were linked mostly to the fall in the value of petroleum imports. This month declines in imports were more widespread.

All values in YEN.

Japanese trade balance (NSA); May 2020 - deficit 833bn versus May 2019 – deficit 956bn

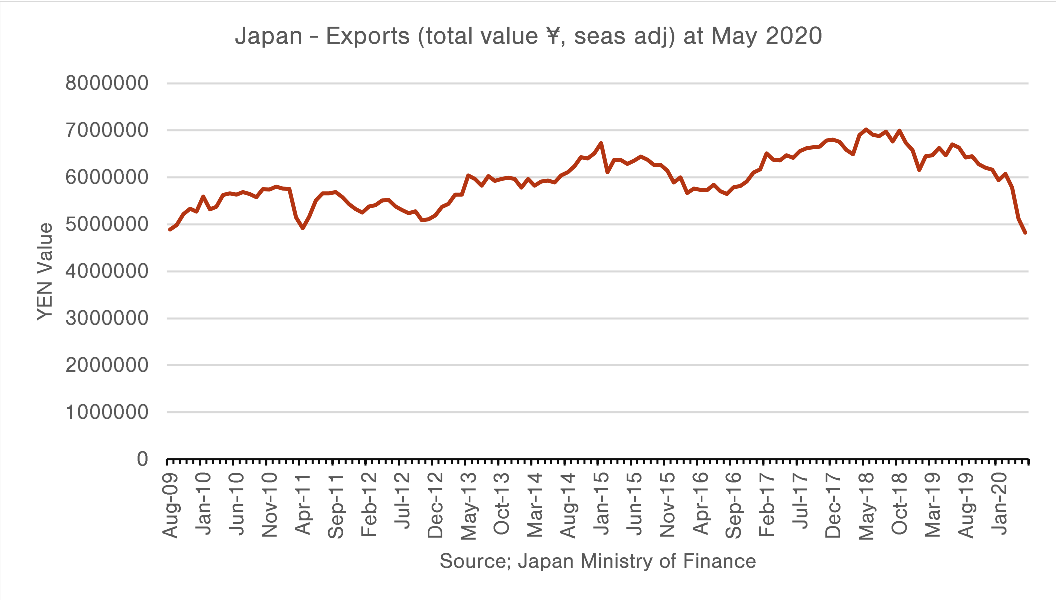
The trade deficit was also smaller on a seasonally adjusted basis, falling from 1trillion deficit In Apr to a 600bn deficit in May.

Both were the result of a larger annual decline in exports compared to the decline in imports.

EXPORTS

Exports (NSA) – annual change; **May 2020 -28.3%** compared to Apr 2020 -21.9%

On a seasonally adjusted basis, Japanese exports also declined by 25% versus a year ago and were -6% below the value of merchandise exports in Apr.



Exports by Region

There were some significant shifts in exports among the key markets. In prior analysis, exports to both China and the US have been of a similar value and both were either the largest or second largest export market for Japan.

This month though, there was a significant fall in the value of exports to the US, falling by 50.6% versus the same month a year ago. The fall in exports of transport equipment contributed half of that decline (mostly finished goods of passenger vehicles). Motor vehicle exports were down by 80% versus a year ago. Exports to the US of machinery and electrical machinery were also down by 40% and 42% respectively versus a year ago. Given the time lags for export delivery, and with production only just starting to come back online, it will likely take quite a few months before supply chains are fully back (especially in the US).

The largest market for Japanese merchandise exports in May was China (1.13tr). Exports to China were down by -1.2% compared to a year ago. Throughout Asia, exports were down by -12% compared to a year ago.

Exports to Western Europe were down by 35% compared to a year ago. Exports to the larger industrial markets in the region were down between 20 and 54% compared to a year ago. Exports to Germany (largest Euro area market) were down by 35%.

Exports to the Middle East and Australia were both down by roughly 50% compared to a year ago.

<u>Exports by Commodity</u>

Declines in exports were reported across most categories with the exception of foodstuffs, which contributed +0.1% to the headline growth.

The largest contributors to the decline in exports were;

Transport equipment – exports were 60% below a year ago. Cars, parts, aircraft, and ships all contributed to the decline. Overall, the decline in transport exports contributed -14.4% pts to the annual export decline (approx. half of the decline).

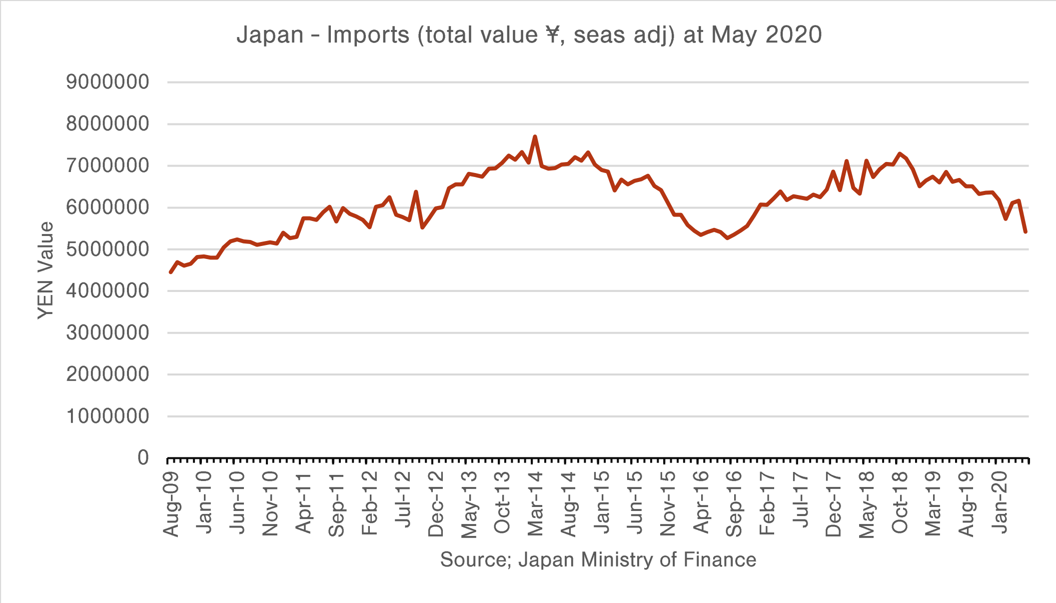
Machinery – contributed -4.5% pts to the decline in exports. Machinery exports declined by 23% and declines were recorded across most sectors. The only sector where exports increased was semiconductor machinery (+12.4% - and this links back to the Japanese IP data for the month too). The increase in semicon machinery exports was recorded in Non-China Asia (+24% ahead of a year ago).

Electrical machinery – contributed -2.3% pts to the headline decline exports. Electrical machinery exports were 13.7% below the same month a year ago.

<u>IMPORTS</u>

<u>Imports (NSA) – annual change</u>; **May 2020 -26.2%** compared to Apr 2020 -7.2%

On a seasonally adjusted basis, imports into Japan also declined by -20.8% in May versus the same month a year ago and declined by -12% compared to Apr;



<u>Imports by Region</u>

This month, the falls in imports are less clear cut. Last month, the falls were linked mostly to the fall in the value of petroleum imports. This month declines in imports were more widespread.

The largest import market for Japan is Asia. Imports from Asia were down by 11%. China is the single largest import market (1.5t in May) for Japan. While imports from China were down by only 2% compared to a year ago – the underlying performance of imports was mixed though. Imports of manufactured goods from China was up by 46% (the largest positive contribution, but only one subsector led this growth – textiles, yarn, fabrics) and machinery +6%. This was offset by declines across transport equip (-39%), electrical machinery (-10%), others (-16%), raw materials (-19%), and foodstuffs (-19%).

Imports from the US were down by 27.5% - this is either a Japanese demand issue or a US supply side issue. Either way this is still a large loss of export income for the US (Japan being fourth or fifth largest export market for the US). Imports from the US were down mostly due to transport equipment (-75%), machinery (-28%), electrical machinery (-30%), mineral fuels (-34%), others (-30%), raw materials (-10%), and foodstuffs (-8.2%).

Imports from Western Europe were down 30.2% compared to a year ago. This was linked to falls in imports of transport equipment, machinery, electrical machinery, chemicals, manufactured goods, and others.

Imports from the Middle East were down by 72% compared to a year ago. Again, that was all related to the value of petroleum imports.

<u>Imports by Commodity</u>

Imports in total were down across all sectors.

The largest contribution from the decline was still petroleum imports (accounting for less than half of the decline -12.3% pts of the decline).

Imports declined notably across; foodstuffs (-12.3%), raw materials (-25.8%), machinery (-12.6%), electrical machinery (-17.2%), transport equipment (-56.3%), and others (-25%).

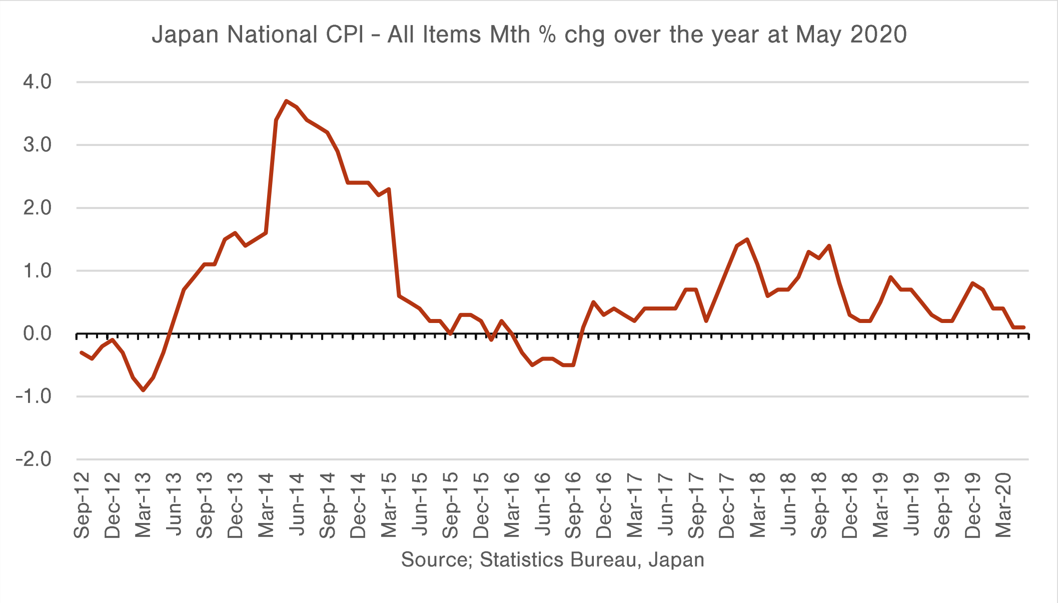
Declines in imports were moderate across; imports of manufactured goods (-3.7%) in May and chemicals (-6.1%).

https://www.customs.go.jp/toukei/shinbun/trade-st_e/2020/202005ce.xml

Japan National CPI (May)

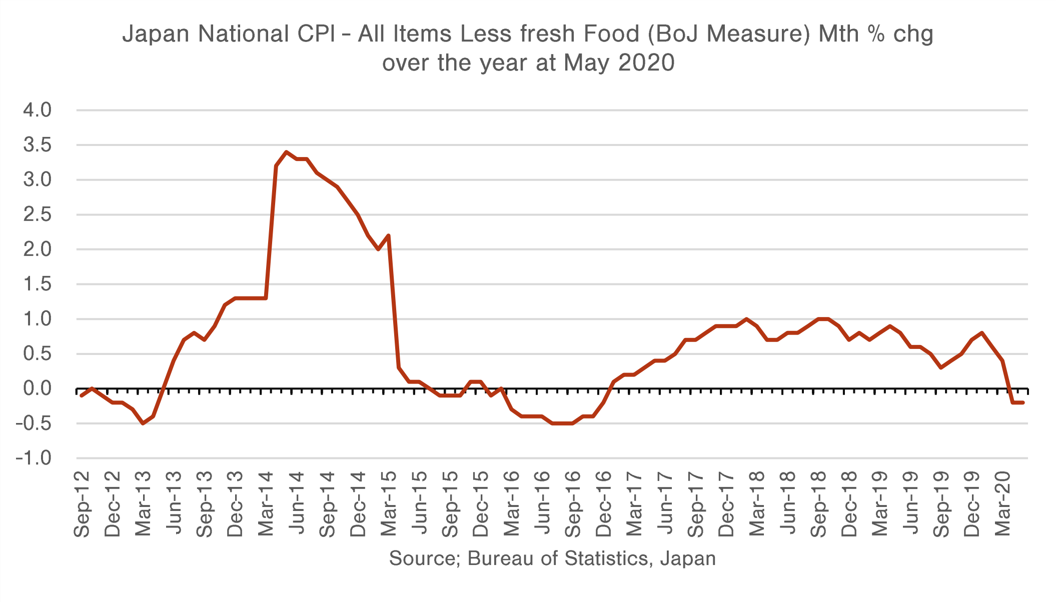
There was no change in the annual pace of CPI growth in May. The BoJ preferred measure of core CPI was also unchanged at -0.2% annual decline. But the underlying CPI excluding fresh food and energy indicated that there was a slight acceleration in the annual pace of CPI growth in May.

Headline CPI All-Items – annual change; May +0.1% versus Apr +0.1%



Food prices have the largest weight in the CPI index (26%) and the annual pace of food prices was +2.1% in May (unch from Apr). Fresh food prices continued to grow, albeit at a slower pace; May +5.8% versus Apr +6.7%. Fresh food prices account for 4% of the CPI weight.

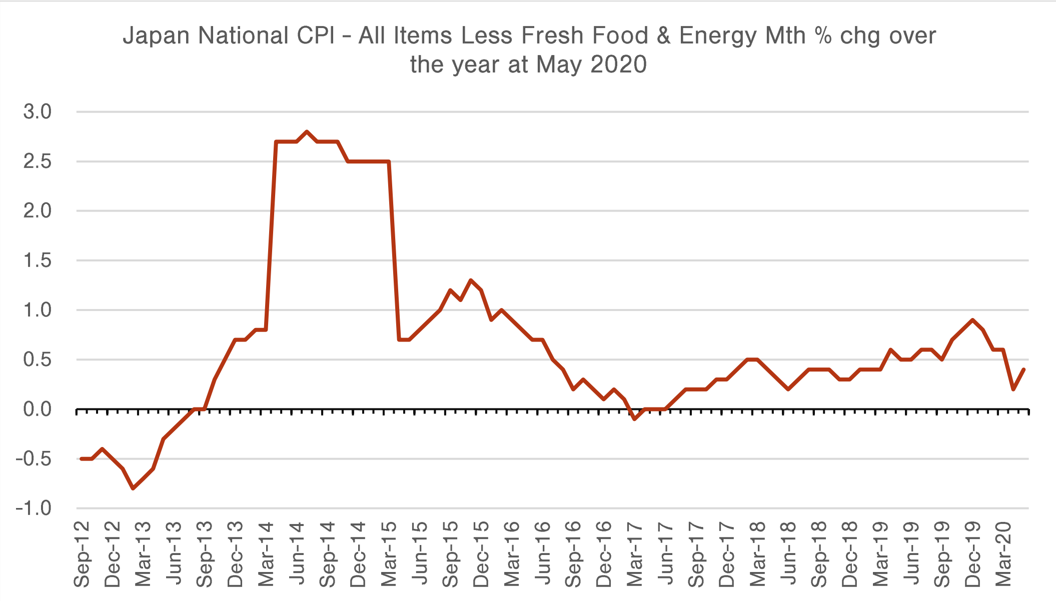
The BoJ preferred measure of underlying CPI is All-items ex fresh food. In May, this measure of underlying CPI declined by -0.2% (in Apr also -0.2%).



The decline in this measure of core CPI was led by falling energy prices, which declined by -6.7% in May (compared to -4.7% in Apr).

Removing the effect of lower energy prices and accelerating fresh food prices (volatile items), indicates that there was a slight accelerating in underlying CPI;

Core CPI – All-Items ex fresh food and energy – annual change; May +0.4% versus Apr +0.2%



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

BoJ Rates Decision – 16 Jun 2020

<u>Current policy settings</u>

Yield Curve Control

St Rates; -0.1% Policy-Rate balances in current accounts held by financial institutions at the BoJ

LT Rates; 10yr Yield to remain around zero – the BoJ will purchase JGB's in quantities necessary to achieve this

Asset Purchases

Purchase of ETF's – purchase at rates such that amounts outstanding increase by 12 trillion Yen p.a

Purchase of J-Reits – at rates such that amounts outstanding increase by about 180bn Yen p.a

Commercial Paper and Corporate Bonds – purchase in quantities such that the BoJ will maintain amounts outstanding at 2 and 3 trillion Yen p.a. BUT;

> In addition, until the end of March 2021, it will conduct additional purchases with the upper limit of the amounts outstanding of 7.5 trillion yen for each asset.

<u>Outlook</u>

While the current conditions remain severe for the Japanese economy, once the impact of Covid-19 subsides, the economy will likely improve.

> Thereafter, as the impact of COVID-19 subsides, the economy is likely to improve, supported by accommodative financial conditions and the government's economic measures, as well as through the expected materialization of pent-up demand and a projected recovery in production from the decline brought about by COVID-19.

<u>Forward Guidance</u>

The BoJ plans to maintain QQE with YCC in order to achieve the price stability target of 2%, and for as long as necessary for maintaining that price growth at the target in a stable manner.

> The Bank will continue to support financing mainly of firms and maintain stability in financial markets through (1) the Special Program to Support Financing in Response to the Novel Coronavirus (COVID-19), (2) an ample provision of yen and foreign currency funds without setting upper limits mainly by purchasing JGBs and conducting the U.S. dollar funds-supplying operations, and (3) active purchases of ETFs and J-REITs.

https://www.boj.or.jp/en/announcements/release_2020/k200616a.pdf

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United Kingdom

UK CPI (May)

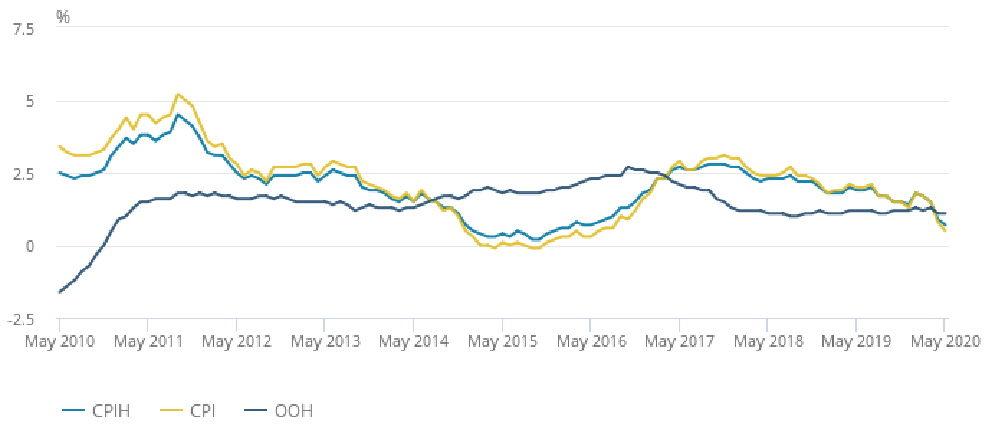
Annual growth in UK consumer prices continued to slow in May. Slower growth, or declines, in prices across most categories contributed to the result.

UK CPI-H All Items – annual change; May +0.7% versus Apr +0.9%

The annual rate of CPI-H growth in May 2019 was +1.9%

Figure 1: CPIH and CPI 12-month inflation rates ease for fourth consecutive month

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



Source: Office for National Statistics – Consumer price inflation

Most categories contributed to the slower annual growth in CPI this month;

Transport prices continued to decline to at a faster pace.

Clothing and footwear prices also continued to decline.

Furniture and household goods prices declined slightly.

Growth in prices for recreation and culture slowed notably.

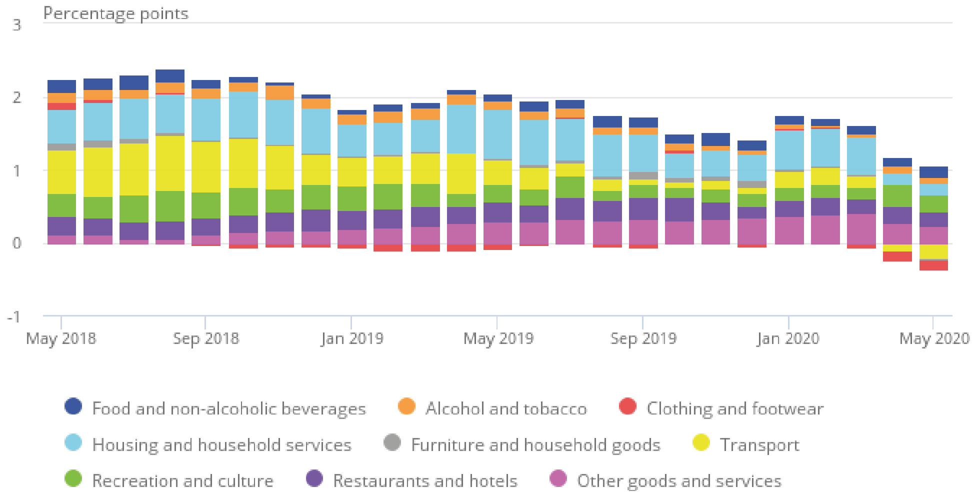
Price growth across restaurants and hotels, and other also slowed.

There was no change in alcohol and tobacco prices.

Food and non-alcoholic beverages were the only category where the price growth made a larger contribution to headline CPI growth.

Figure 2: Contributions from most broad groups eased in May 2020

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



Source: Office for National Statistics – Consumer price inflation

https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/may2020

UK Retail Sales (May)

The volume of retail sales rebounded in the latest month compared to the severe decline in the month prior. The level of sales remains well below a year ago and below the Jul 2019 near term peak.

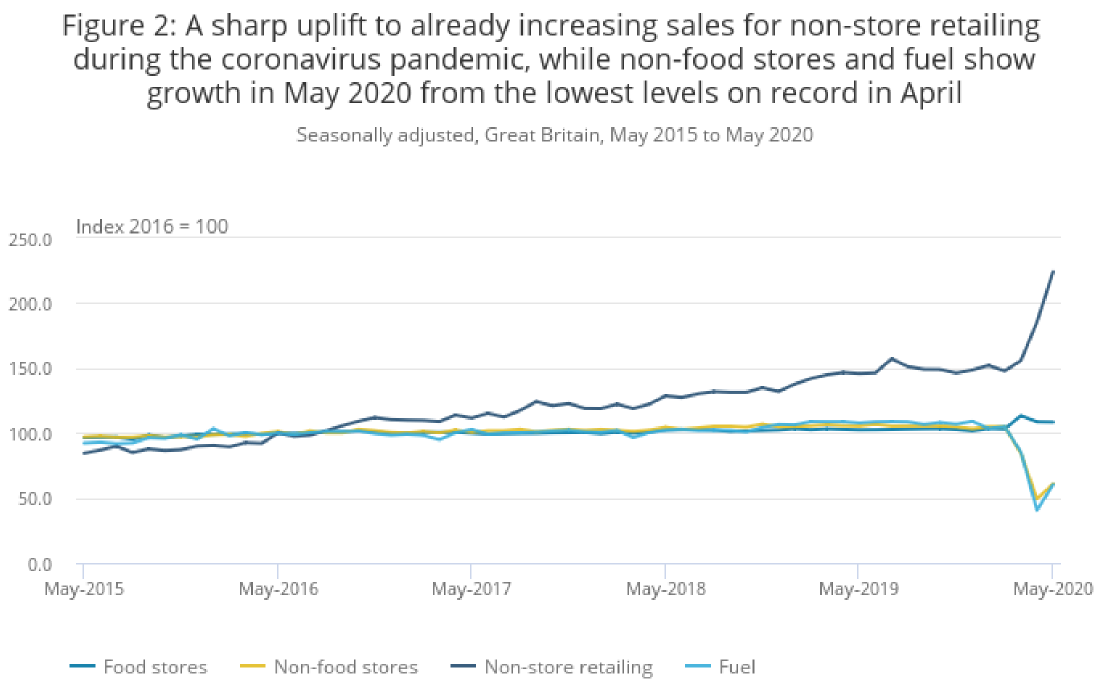
Retail Sales Vol – month change; May +12% versus Apr -18%

The growth in the month was result of higher sales across non-store retailing.

The proportion spent online soared to the highest proportion on record in May 2020 at 33.4%, which compares with the 30.8% reported in April 2020.

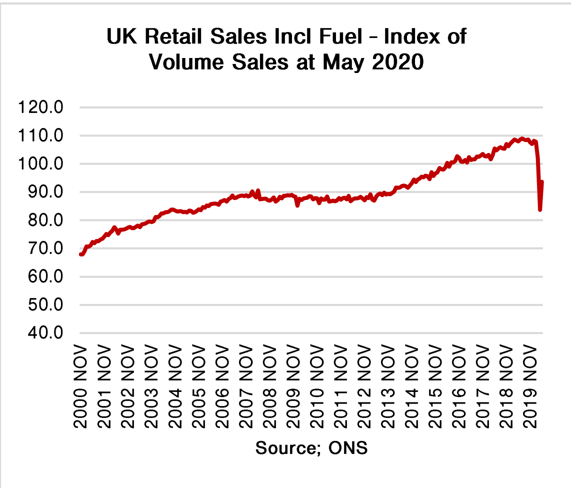
Sales across fuel and non-food stores rebounded, but have not fully recovered from the Mar and Apr declines.

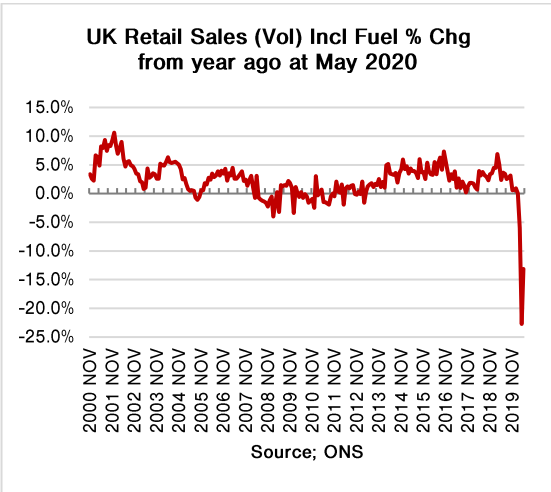
Food store sales were little changed.



Source: Office for National Statistics – Monthly Business Survey – Retail Sales Enquiry

Retail Sales (vol) – annual change; May -13.2% versus Apr -22.7%





https://www.ons.gov.uk/businessindustryandtrade/retailindustry/bulletins/retailsales/may2020

BoE Rates Decision – 18 Jun 2020

At this meeting, the Monetary Policy Committee (MPC) decided to keep the Bank Rate unchanged at 0.1%.

The majority of the MPC voted to also increase the stock of UK government bond purchases by £100bn;

> At this meeting, the MPC judges that **a further easing of monetary policy** is warranted to meet its statutory objectives. The Committee agreed to increase the target stock of purchased UK government bonds by an additional £100 billion in order to meet the inflation target in the medium term. The Committee expects that programme to be completed, and the total stock of asset purchases to reach £745 billion, around the turn of the year.

Outlook

The Q2 decline in GDP is likely to be less severe as initially anticipated. The pace of recovery though is unclear;

> Even with the relaxation of some Covid-related restrictions on economic activity, a degree of precautionary behaviour by households and businesses is likely to persist.

Both employment and CPI will take some time to recover. The pace of CPI growth is well below the MPC target of 2%. This is expected to fall further in the coming quarters 'largely reflecting weakness in demand'.

> The sharp drop in domestic activity is also adding to downward pressure on inflation through increased spare capacity in most sectors of the economy.

Forward Guidance

There is less overt communication about the future path of monetary policy – likely reflecting the high degree of uncertainty. The key reference remains 'supporting the economy and ensure a sustained return of inflation to the 2% target'.

> The MPC will continue to monitor the situation closely and, consistent with its remit, stands ready to take further action as necessary to support the economy and ensure a sustained return of inflation to the 2% target. The Committee will keep the asset purchase programme under review.

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

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Australia

Labour Market Survey (May)

Making sense of the labour market report this month requires a quick review of the job schemes as well as the classification approach of the Aus Bureau of Statistics (ABS). The key issue is how people are classified (employed, unemployed or not in the labour force) during the period of enforced shutdowns.

The JobKeeper scheme – if someone is paid through the JobKeeper scheme, no matter the number of hours worked, or not, are classified as employed. The job attachment is maintained.

The JobSeeker scheme – if someone is paid via the JobSeeker scheme, they are not automatically classified as unemployed;

> Recent changes to the JobSeeker program related to COVID-19 also meant that recipients did not have to meet the usual mutual obligation requirements, such as looking for work. Some of these obligations are gradually being reinstated **from June onwards, and changes may lead to increases in active job search and an increase in the number of people classified as unemployed in future months**.
>
> To be classified as unemployed in Labour Force statistics, a person must: have actively looked for full-time or part-time work in the last four weeks; and be available for work in the reference week.

People not working any hours, including those who were stood down: it depends on their job attachment and pay, and potentially other labour market activity. In this scenario;

A person will be classified as employed if; they have taken any leave, were away from their job (including being stood down temporarily, or on JobKeeper) and were paid for any part of the last four weeks, or were away from their job during the last four weeks without pay, but believe they have a job to go back to.

Employment declined by another significant number of people this month – despite the existence of the JobKeeper scheme. Part of the fall this month is explained by;

> People stood down without pay from late March through to early May were away from their job for four weeks or more and therefore were no longer considered employed in May.

This possibly represents a shift from a temporary layoff to a permanent layoff.

A person will be classified as unemployed if;

> If a person is away from their job for four weeks or more without pay, or they believe they no longer have a job to be absent from, they will be classified as:
>
> unemployed - if they have actively looked for work, and are available to start work; or not in the labour force - if they have not looked for work and/or are not available to start work.

The Labour Force report highlights the extent to which fairly significant damage has been done the labour market. The levels of unemployment and underemployment are quite alarming. In May, employment declined, unemployment increased and underemployment also increased. Measures have reached historical extremes.

While Aus has been relatively successful at reducing infection case rates, there is a long way to go before the working environment is 'back to normal'. The reference week was back in early May and more restrictions have been lifted since then.

With the lifting of more restrictions, there will hopefully be a rebound in employment growth next month – the question is how strong the rebound will be. This month, hours worked declined by a much smaller number, hopefully indicating that the peak falls in activity were in Apr. But the mutual obligation requirement of looking for work on JobSeeker has also been reinstated as of early Jun, so we'll possibly see an increase in the participation rate, leading to an increase in 'official' unemployment numbers next month.

Employment

The annual and monthly change in employed persons remained firmly negative this month – this is despite those workers retained on JobKeeper as classified as employed.

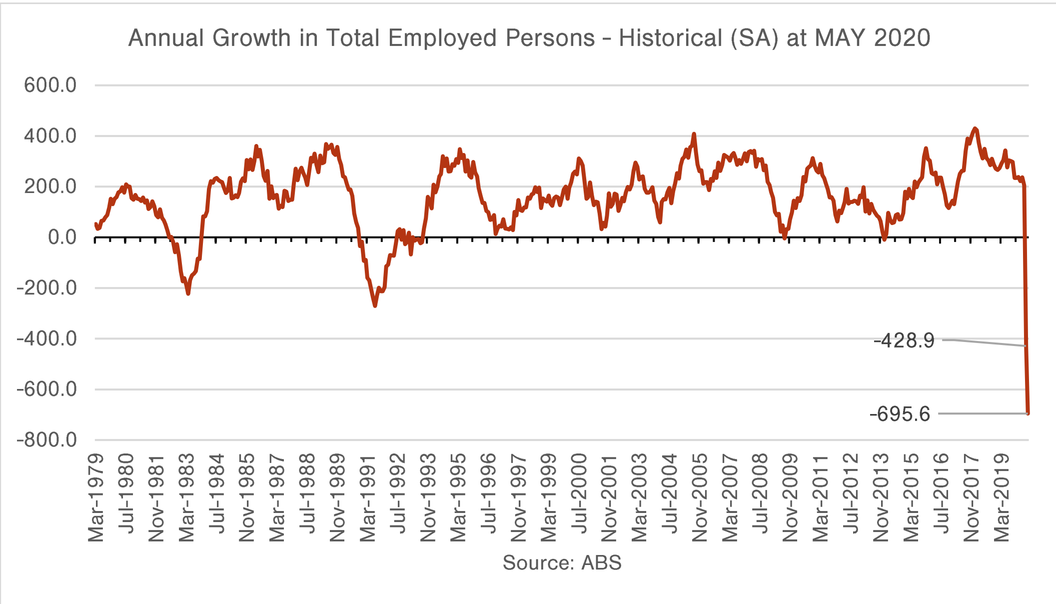
Employed persons – month change; May -227k persons versus Apr -607k persons

Part of the monthly decline in employment represents a shift in classification, with some people who were stood down in late Mar without pay and away from their jobs for four weeks or more, now classified as not employed.

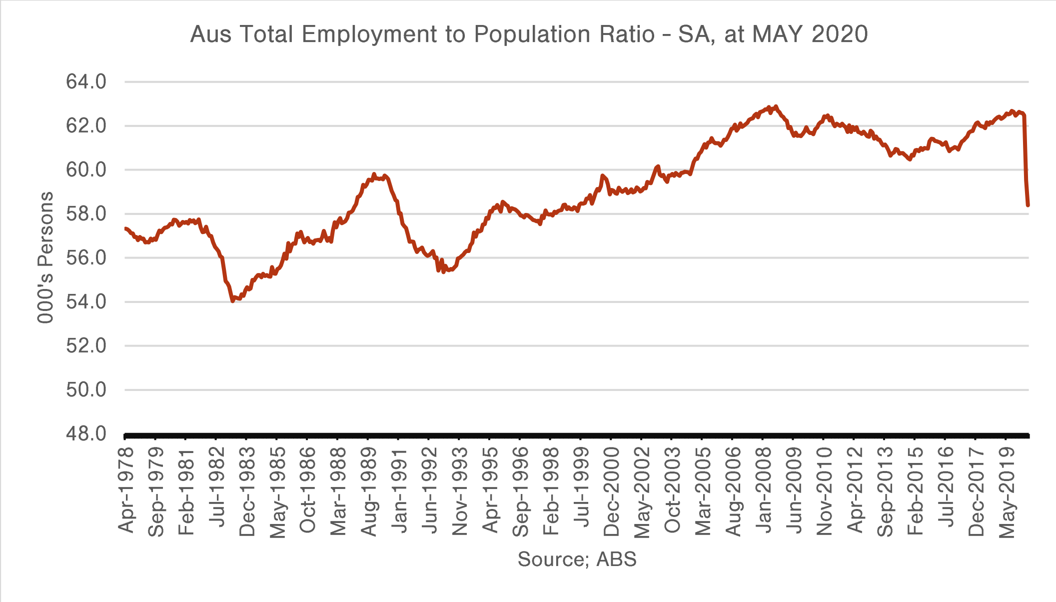
The decline in employment this month was almost equally both full and part-time employed persons.

The decline in employed persons accelerated on an annual basis;

Employed persons - annual change; May -695k persons versus Ape -428k persons



The employment to population ratio continues to drop and was at 58.4% in May. The last time that the employment to population ratio was at least this low was in Jun 1999.



<u>Labour Force</u>

The size of the labour force continued to decline in May, although by a smaller number of people.

<u>Labour Force – month change</u>; May -142k persons versus Apr -481k persons

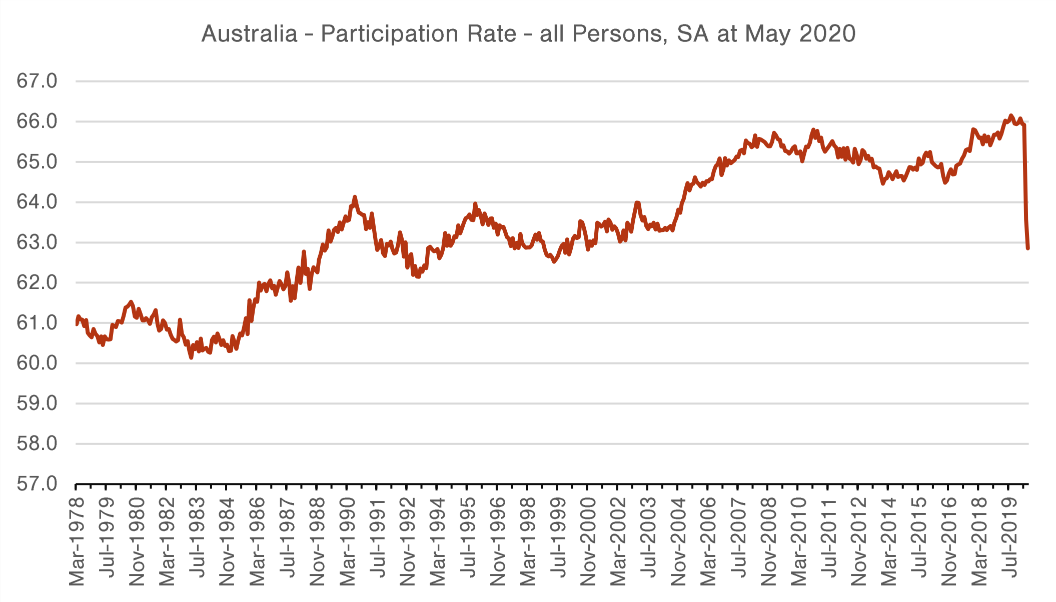
While there has been a slow-down in the estimate of what population growth added to the labour force, most of the decline is attributed to the fall in participation. The decline in participation is likely related more to the suspension of the mutual obligation requirement of the JobSeeker program to look for work during the height of the lockdowns. This has now been reinstated as of early Jun. The effect will likely be an increase in the participation rate and a jump in the unemployment rate.

To some degree, this decline in the size of the labour force has been keeping the published unemployment rate lower.

<u>Participation rate – month</u>; May 62.9% versus Apr 63.6%

The decline in participation for the month was the equivalent of 150k persons leaving the labour force. This is following the -488k decline in Apr. Compared to a year ago, the fall in participation represents approx. 658k persons leaving the labour force.

Female participation has been hit the hardest.



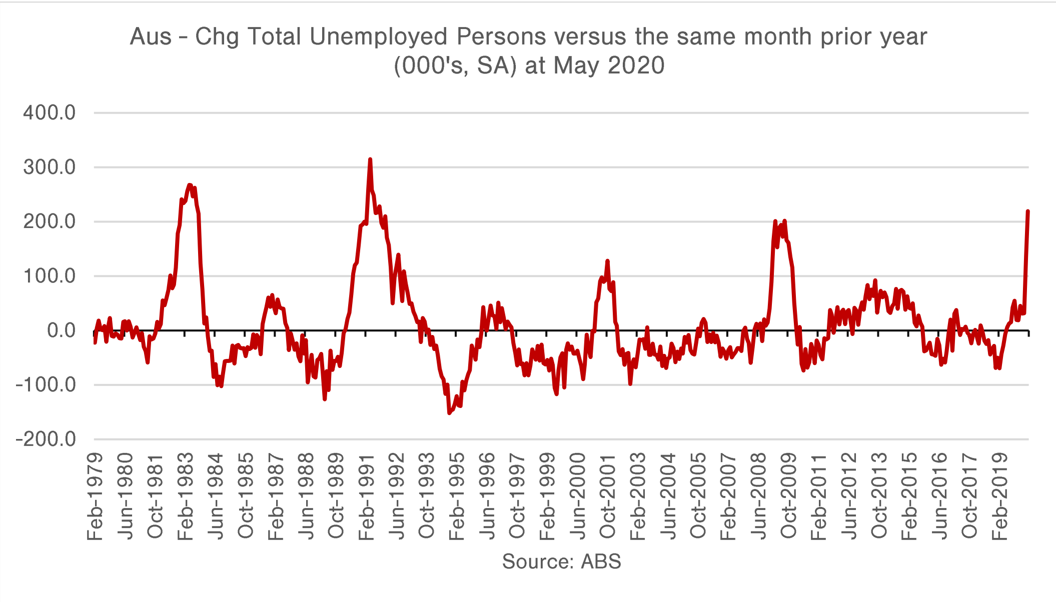
Total Unemployed Persons

The number of unemployed persons increased further this month. The monthly increase in unemployed persons in Apr and May were the largest monthly increases on record, going back to May 1978.

Total unemployed persons – month change; May +85k versus Apr +125k

This is considering that the large decline in participation and various classification nuances are likely hiding the real number of unemployed persons.

The annual pace of growth in total number of unemployed persons has now reached +219k. The all-time max growth was +314k persons back in the early 90's recession (and obviously based on a smaller population).



The unemployment rate increased this month from 6.4% in Apr to 7.1% in May.

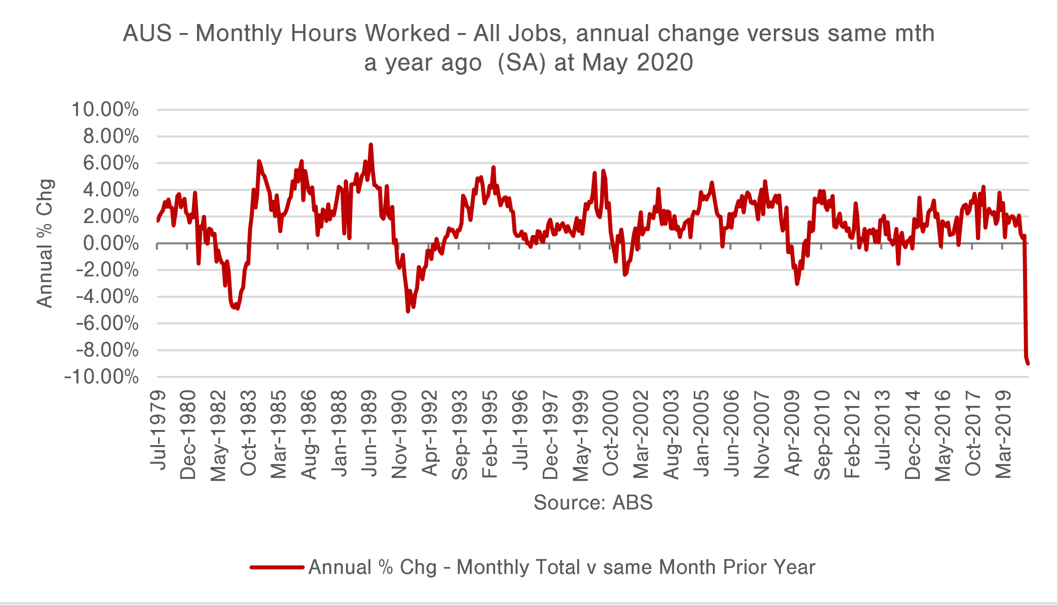
If participation had stayed unchanged, then the total number of unemployed persons would be higher.

<u>Hours Worked</u>

The number of hours worked continued to fall in the month of May, but not to the same degree as in Apr. This indicates some possible stabilization in the decline of activity.

<u>Monthly Hours Worked in All Jobs – month change</u>; May -0.75% versus Apr -9.5%

Versus a year ago, the hours worked in all jobs in May was 9% below the same month a year ago – an historical low;



What is interesting to note is that growth in hours worked had already been slowing since peaking around the start of 2019.

Summary of Key Labour Market Indicators

In May, there was 227k fewer jobs, while the estimate of population increased. The decline in participation of 148k persons helped to offset the fall in employment, resulting in a smaller increase in total unemployed persons. If participation had remained unchanged, the increase in total unemployed persons in May would have been higher.

	000's Persons	
	Annual Chg - MAY	Month Chg - MAY
The estimated change in the Labour Force due to pop growth	182.512	6.695
How many jobs available for them? (employment growth)	-695.602	-227.714
Difference (if positive, employment growing faster than pop est)	-878.115	-234.408
Change in labour force due to the change in participation	-658.906	-148.820
The reminder is the change in total unemployed persons	219.208	85.588
Double Check - Reported chg in size of the Labour Force	-476.394	-142.050
Two views of the size of the Labour Force:		
Underlying population growth plus changes in participation	-476.394	-142.126
Total employed persons plus total unemployed persons	-476.394	-142.126

https://www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/6202.0Main%20Features1May%202020?opendocument&tabname=Summary&prodno=6202.0&issue=May%202020&num=&view=

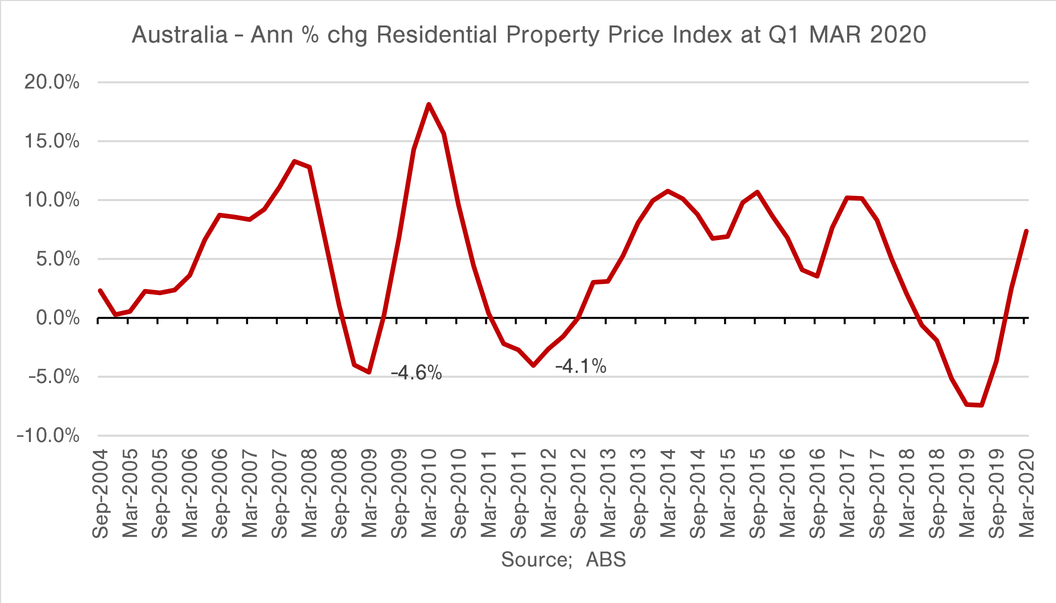
House Price Index Q1

The National house price index indicated that the housing market recovery continued into Q1, albeit at a slower quarterly pace than in Q4. Most of the pandemic-related restrictions were installed late in Q1. We expect that this price growth may slow further given the slowdown in housing finance so far.

The residential property price index (weighted avg 8 cap city) – qtr chg; Q1 +1.6% versus Q4 +3.9%

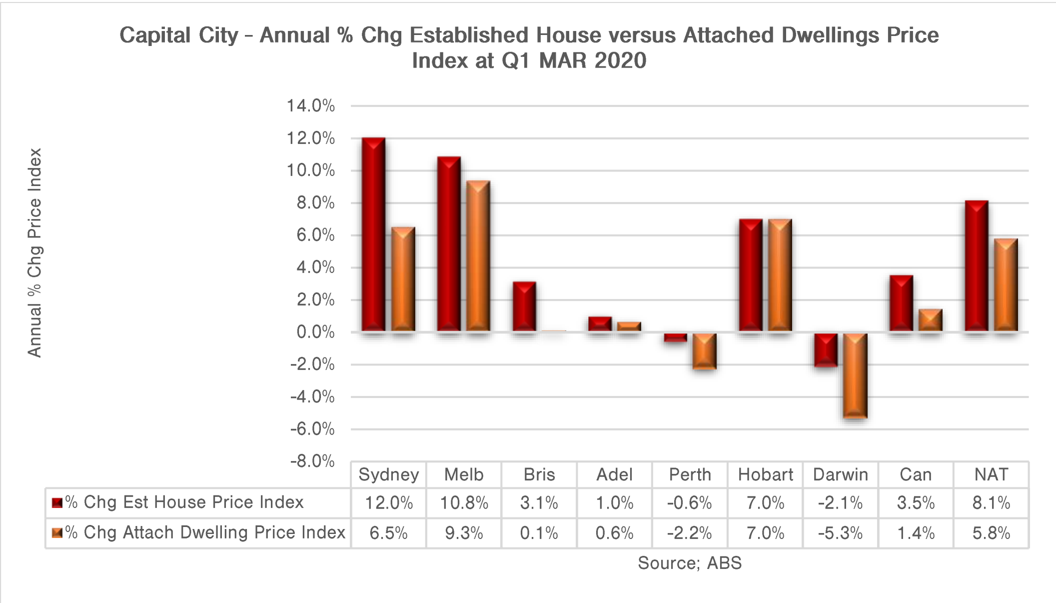
Q1 prices were led higher across Syd and Melb markets. Hobart recorded the highest % growth, but is a smaller weight of the index. Growth was lower across Brisbane, Adelaide, Perth, and Canberra.

The annual growth accelerated partly due to the lower base in the prior year (falls in the housing market due to the Federal election and the Royal Commission into Lending) – annual change at Q1 2020 +7.4%.



Leading the market higher on an annual basis was mainly growth in established house prices (as opposed to attached dwellings). This has been confirmed by a much weaker ‘recovery’ in lending for investment properties (many of which would be apartments).

Growth in prices has been led by only two markets – Syd and Melb (the two largest markets);



https://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6416.0Main+Features1Mar%202020?OpenDocument

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China

Fixed Asset Investment (May)

The annual pace of growth in fixed asset investment in China continued to decline (based on Jan-May 2020 versus a year ago), despite the growth in new lending during that period. The month on month lending in May increased though;

> From January to May, China's fixed asset investment (excluding rural households) was 19,919.4 billion yuan, down 6.3 percent year on year, 4.0 percentage points lower than that from January to April.
>
> Among them, private fixed asset investment was 11,223.2 billion yuan, down 9.6 percent, narrowed 3.7 percentage points of decline.
>
> In May, fixed asset investment (excluding rural households) increased by 5.87 percent in terms of the month on month speed.

Fixed Asset Investment Jan-May 2020 – annual change; -6.3%

Weaker investment was recorded across all types of industry; primary (0%), secondary (-11.8%), and tertiary (-3.9%).

Investment across most industrial sectors also declined. Of note was the 14.8% decline in investment in manufacturing. The manufacture of medicines and telecom equipment were the only sectors where investment had increased, both by 6.9% for the first five months (compared to a year ago).

http://www.stats.gov.cn/english/PressRelease/202006/t20200616_1760436.html

Industrial Production (May)

Growth in industrial production in May continued to accelerate. Growth in manufacturing activity led production higher.

There has been some advantage for China in reopening before other markets. For example, looking at the Japanese merchandise trade this month, imports from China (Japan's largest import market) were only down by 2% versus a year ago, while Japan's imports from the US were down by 27% versus a year ago.

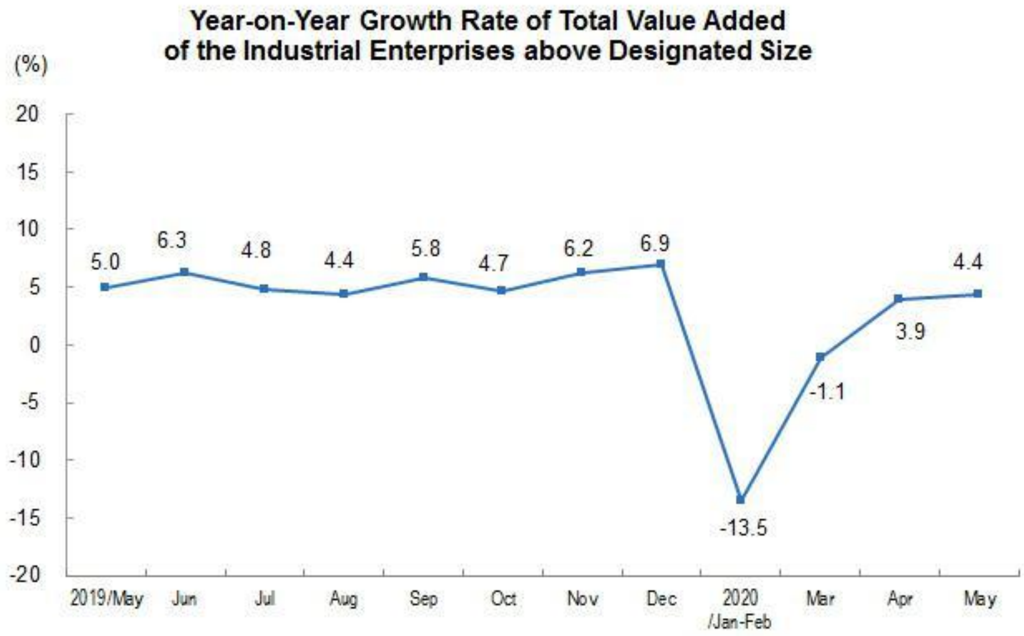
The Chinese trade figures last week also confirm a similar scenario – where imports were down much more (not just oil price related) across key markets such as Japan, US, and Europe (esp Germany) – key markets where industrial production remains well down (indicating the issue is partly supply and not just domestic Chinese demand). The decline in exports has been more moderate – supported by the restart of local production.

Industrial Production – annual change; May +4.4% versus Apr +3.9%

In terms of three categories, in May, the value added of the mining industry increased by 1.1 percent year-on-year, up 0.8 percentage point over last month;

that of the manufacturing industry increased by 5.2 percent, 0.2 percentage point of increase over last month;

that of the production and distribution of electricity, heating, gas and water increased by 3.6 percent, 3.4 percentage points of higher over last month.



http://www.stats.gov.cn/english/PressRelease/202006/t20200616_1760429.html

Retail Sales (May)

Retail sales in May continued to decline, albeit at a slower pace. This is now the fourth month of annual decline in a row.

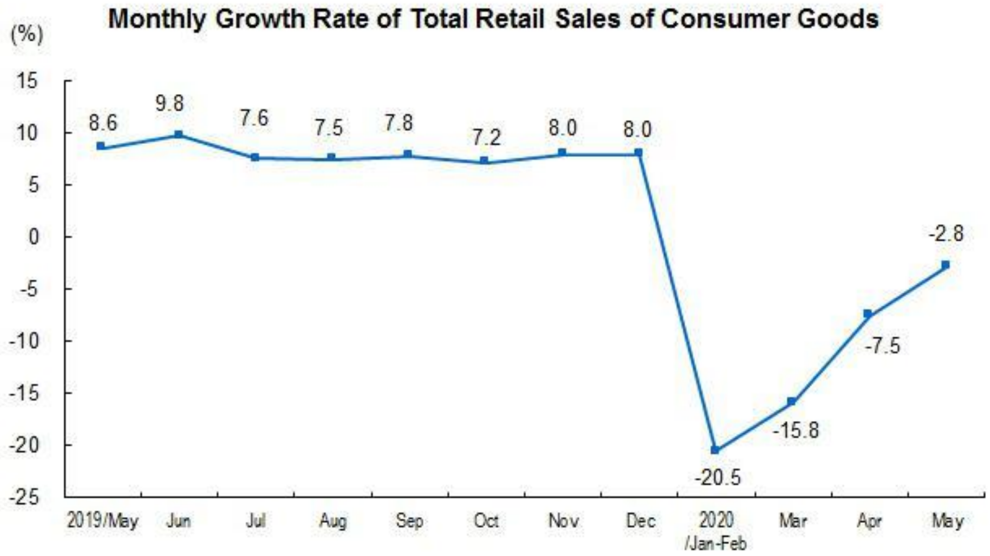
Annual growth in May appears to have mostly recovered versus a year ago, with the overall decline led by a small number of categories; sales of petroleum continues to lag (value) by -14% as well as catering services down -19%. Sales of gold, silver, and jewellery, and garments were also down slightly versus a year ago.

But sales for the first 5-months Jan-May are still well down on a year ago -13.5% and this is true of most categories. This suggests that there is still long way for the retail sales recovery to go.

Sales also declined by 4.7% versus the prior month.

Retail Sales – annual change; May -2.8% versus Apr -7.5%

Retail sales are down 13.5% for the Jan-May period versus a year ago.



While sales in May versus a year ago are somewhat more positive across the various categories, the Jan-May 2020 growth rates remain lower across most categories.

For example, sales of autos in May were +3.5% on May a year ago. But sales for Jan-May compared to a year ago were down -17%. So while sales have improved this month, there is still a way to go before most categories recover the lost sales of the start of the year.

http://www.stats.gov.cn/english/PressRelease/202006/t20200616_1760480.html

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Trade

US-China Trade Talks

Tensions between the two countries continue to simmer amid accusations and posturing regarding China's role in the spread of the Covid-19 virus. The delicate trade truce between the two countries remains at risk. As a part of the push to localise production, President Trump is looking at a phase 4 of the stimulus package 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. The phase two of the negotiation was noted recently in USTR Lighthizer's testimony to the House Ways and Means Committee (emphasis added);

> The President directly confronted China's abusive trade practices through substantial tariffs, resulting in the groundbreaking Phase One trade agreement signed on January 15 of this year. The agreement secured enforceable commitments from China to cease its abusive trade practices – including intellectual property theft, forced technology transfer, discriminatory regulations, and currency manipulation. It also committed China to significantly increase its purchases of U.S. goods and services by at least $200 billion over 2017 purchase levels.
>
> By establishing a strong dispute resolution system and maintaining tariffs on approximately $370 billion in goods from China, **the Administration has maintained the authority and leverage to enforce China's compliance with the agreement while pursuing additional reforms under a future Phase Two agreement**.
>
> With China, "Phase Two" will focus on issues of overcapacity, subsidization, disciplines on China's state-owned enterprises, and cyber theft.
>
> https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/HWMCTestimonyon2020TradeAgenda-Final.pdf

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

In his testimony last week, USTR Lighthizer referred to the second phase deal with Japan;

> Last year, the United States also entered into two agreements with Japan that established preferred or zero-rate tariffs on more than 90 percent of U.S. food and agricultural products imported into Japan and enhanced the existing $40 billion in digital trade between our countries.
>
> In the case of Japan, the two countries intend to enter into further negotiations on customs duties, barriers to trade in services and investment, and other trade restrictions.
> https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/HWMCTestimonyon2020TradeAgenda-Final.pdf

Phase two of the deal was 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

USTR Lighthizer also noted in his testimony last week of the intention to continue to pursue negotiations with the EU;

> The United States also seeks to rebalance our trade relationship with the European Union. For many years, U.S. businesses have been at a disadvantage in doing business in the EU. Both tariff and non-tariff barriers in the EU have led to increasing and unsustainable trade deficits with the EU – reaching $179 billion in 2019. With recent changes in EU leadership, the United States is hopeful for more progress in the coming year. https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/HWMCTestimonyon2020TradeAgenda-Final.pdf

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.

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

USTR Lighthizer also noted in his testimony last week of the US intention to continue to pursue a trade agreement with the UK;

> The Trump Administration has taken numerous steps to pave the way for negotiating a trade agreement with the UK, including a review of public comments, a public hearing, and extensive consultations with congressional and trade advisory committees. USTR published detailed negotiating

objectives on February 28, 2019, and aims to reach an agreement with substantive results for U.S. consumers, businesses, farmers, ranchers, and workers as soon as possible. https://waysandmeans.house.gov/sites/democrats.waysandmeans.house.gov/files/documents/HWMCTestimonyon2020TradeAgenda-Final.pdf

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

While a high-level round of talks took place during the week, mostly in the hopes of injecting some 'positivity' into the direction of talks, there is little to suggest that any breakthrough was made;

European Council President Charles Michel, European Commission President Ursula von der Leyen and European Parliament President David Sassoli, along with the UK Prime Minister, acknowledged the need for increased momentum in future talks. Negotiations, they said, must intensify in July in order "to create the most conducive conditions for concluding and ratifying a deal before the end of 2020". While the overall exchange appears to have been positive, there is no indication that any of the ongoing issues, in particular how to deliver on the commitment of a regulatory "level playing field", have been resolved. https://www.natlawreview.com/article/transatlantic-trade-us-and-european-trade-talk-update-june-19-2020

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 reach 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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