MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 22 June 2020

Key Themes

Global prelim PMI's for Jun showed some further improvement since countries started to lift restrictions related to the pandemic. This month, there was a continued 'slower pace of decline'. This means that the number of firms reporting a decrease in activity still outnumber the firms reporting an increase in activity, but by a much smaller degree than in the month prior. This was a consistent result across the US, EU, UK, Japan, and Australia.

Some highlights from the prelim reports; France and UK manufacturing sectors recorded at least small growth in Jun compared to May, and the Aus services sector also recorded growth in Jun compared to May. Japan's manufacturing sector remained weak with the PMI and output indicating declines accelerated in Jun.

The US prelim composite PMI for Jun indicated a slower pace of decline in activity. What these PMI's don't show, is the degree to which activity/output/orders is growing. The advance durable goods report for May recorded stronger headline growth in orders of over 15%. Half of this increase was the result of a shift in new orders for non-defense aircraft from a total of -$8.6bn in orders (i.e. net cancelled orders) last month to total orders in May of +$3.1bn. That said, most other categories reported a rebound in orders – but excluding transportation (and the aircraft effect), growth in orders was more moderate at +4%. Shipments growth was also more moderate.

The three US regional manufacturing reports for Jun reflected further stabilization in conditions in Jun. Within these reports, employment continued to decline, but at a slower pace, with the majority of firms reporting 'no change' in employment levels from the month prior.

This has also been reflected in the weekly initial and continuing claims. The weekly growth in initial claims remains extremely elevated – and, adding in the Pandemic Unemployment Assistance (PUA), initial claims were more like 2.18m for the week. Continuing claims also remain elevated at 19.5m people, but there was a more substantial 767k reduction in total claims wk ending 13 Jun. As of 6 Jun, there were 11m continuing PUA claims (NSA).

In May, there was a month on month decline in personal income/personal disposable income compared to Apr (due to one-off stimulus payments made in Apr). But the level of personal disposable income remains above the pre-pandemic trend due to the growth in government social payments. Wages and salaries grew in the month, but remain well below a year ago. Consumption expenditures grew in May, but remain approx. 10% below a year ago. So the savings rate (surplus % of disposable income), although lower than the month prior, remains extremely elevated.

Is the saving a function of fear (remaining unemployed, laid-off, lower future income etc) or still a function of less opportunity to spend due to restrictions? It's likely a combination of both. Recall that the May consumer credit report recorded a relatively large decrease in outstanding revolving consumer credit.

Consumer sentiment slipped slightly in the final half of Jun compared to the first half of Jun. The Jun result was still an increase on the month prior. While all regions experienced the fall in sentiment as a result of the Covid-19 shutdowns, the Northeast fared the worst due the high number of infections. The improvement/decline in cases in the Northeast – likely as a result of a longer shutdown, has resulted in a much stronger rebound in sentiment in the region this month. Growth in sentiment in the South has been weaker – and this is likely to worsen as Covid cases have started to increase. There is likely to be some worsening in sentiment across other regions as the number of US cases reaches new highs.

While most consumers believe that economic conditions could hardly worsen from the recent shutdown of the national economy, **prospective growth in the economy is more closely tied to progress against the coronavirus**.

Contents

US Data

Initial Claims (to 20 Jun), Continuing Jobless Claims (to 13 Jun) and Pandemic Unemployment Assistance (PUA) Claims

initial unemployment claims continued to increase in the latest week. This week we have included the number of people applying for Pandemic Unemployment Assistance (PUA). The number of continuing claims remains extremely high, but at least there was further decline in the number of ongoing claims.

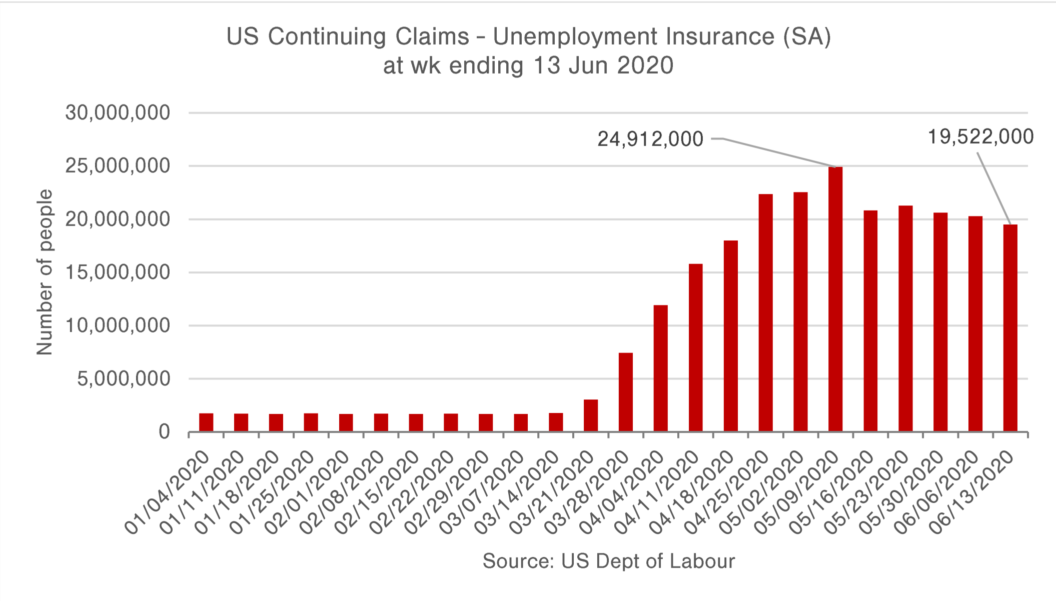
Advance initial jobless claims wk ending 20 Jun (SA); 1,480,000 people

The prior week initial claims were revised higher by 60,000 claims to 1,540,000 claims by people.

Advance insured unemployment claims wk ending 13 Jun (SA); 19,522,000 people

The advance claims from the week prior were revised lower to 20,289,000 people.

At least in the wk ending 13 Jun, there was a more substantial reduction in the number of continuing claims which was lower by 767,000 claims;



The insured unemployment rate slowed to 13.4%, excluding additional programs.

Pandemic Unemployment Assistance (PUA)

In Mar 2020, the CARES Act provided funding to enable states to expand unemployment insurance for workers, especially workers not ordinarily eligible for unemployment benefits.

States are permitted to provide Pandemic Unemployment Assistance (PUA) to individuals who are self-employed, seeking part-time employment, or who otherwise would not qualify for regular

> unemployment compensation. To qualify for PUA benefits, you must not be eligible for regular unemployment benefits and be unemployed, partially unemployed, or unable or unavailable to work because of certain health or economic consequences of the COVID-19 pandemic. https://www.dol.gov/coronavirus/unemployment-insurance#fact-sheets

Advance PUA Initial Claims wk ending 20 Jun (NSA); 728,120 claims

The prior week claims were 770,920.

On a NSA basis, *total initial claims for wk ending 20 Jun was more likely around 2.18m*.

The number of PUA continuing claims NSA at wk ending 6 Jun was 11,046,401 people. This is not included in the weekly continuing claims data. Note that there is a possibility of some level of duplication.

Pandemic Emergency Unemployment Compensation benefits

Under the CARES Act, the states can elect to extend unemployment benefits by 13 weeks under the PEUC program.

> The program covers most individuals who have exhausted all rights to regular unemployment compensation under state or federal law and who are able to work, available for work, and actively seeking work as defined by state law. https://www.dol.gov/coronavirus/unemployment-insurance#fact-sheets

PEUC Claims wk ending 6 Jun; 851,983 claims

> During the week ending Jun 6, 46 states reported 11,046,401 individuals claiming Pandemic Unemployment Assistance benefits and 38 states reported 851,983 individuals claiming Pandemic Emergency Unemployment Compensation benefits. https://www.dol.gov/ui/data.pdf

All Programs

> The total number of people claiming benefits in all programs for the week ending June 6 was 30,553,817, an increase of 1,294,309 from the previous week. There were 1,546,208 persons claiming benefits in all programs in the comparable week in 2019. https://www.dol.gov/ui/data.pdf

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

Details of Pandemic Insurance Programs;
https://wdr.doleta.gov/directives/corr_doc.cfm?DOCN=4628

https://www.dol.gov/coronavirus/unemployment-insurance#fact-sheets

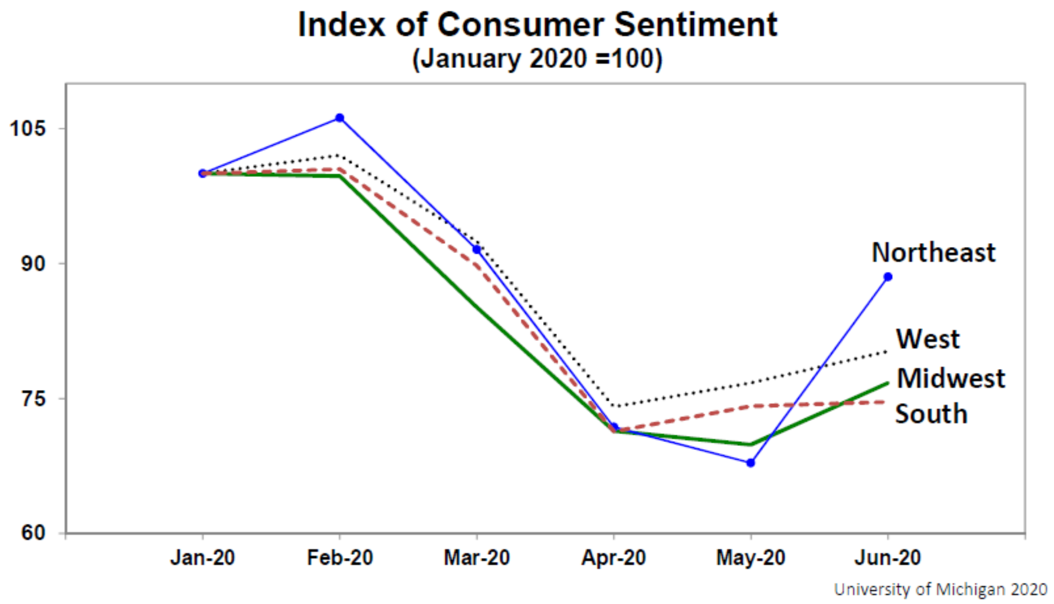
University of Michigan Consumer Sentiment – Final (Jun)

Consumer sentiment slipped slightly in the final half of Jun – compared to the first half of Jun. The Jun result was still an increase on the month prior.

> While most consumers believe that economic conditions could hardly worsen from the recent shutdown of the national economy, **prospective growth in the economy is more closely tied to progress against the coronavirus**.

The underlying shifts in regional sentiment are insightful. While all regions experienced the fall in sentiment as a result of the Covid-19 shutdowns, the Northeast fared the worst due the high number of infections. The improvement in infections in the Northeast – likely as a result of a longer shutdown, has resulted in a much stronger rebound in sentiment. Growth in sentiment in the South has been weaker – and this is likely to worsen as Covid cases have started to increase. There is likely to be some worsening in sentiment across other regions as the US case tally reaches new highs.

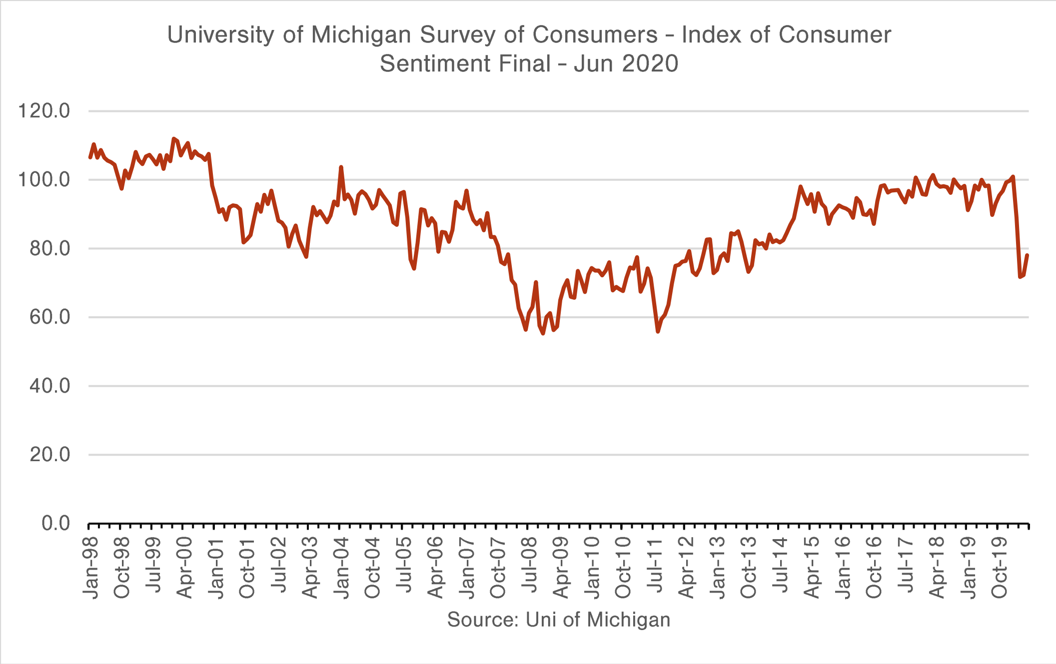
> The resurgence of the virus will be accompanied by weaker consumer demand among residents of the Southern and Western regions and may even temper the reactions of consumers in the Northeast.



<u>CONSUMER SENTIMENT</u>

<u>Index of Consumer Sentiment;</u> Jun final 78.1 (revised from 78.9) versus May 72.3

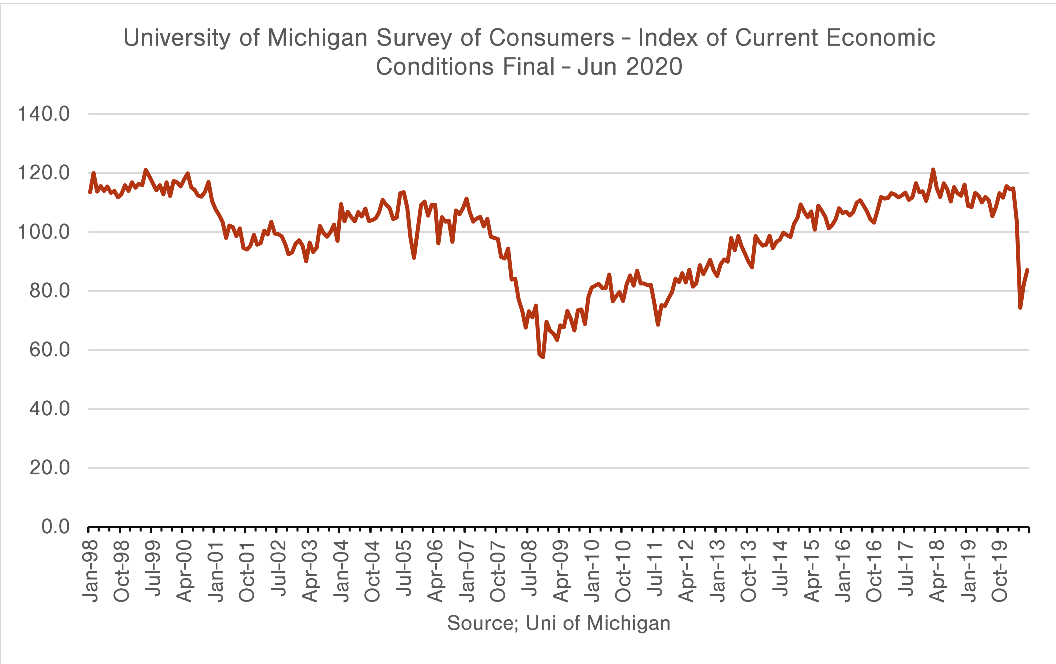
The sentiment reading remains 20% below a year ago;



CURRENT CONDITIONS

Sentiment of Current Conditions Index; Jun final 87.1 (revised rom 87.8) versus May 82.3

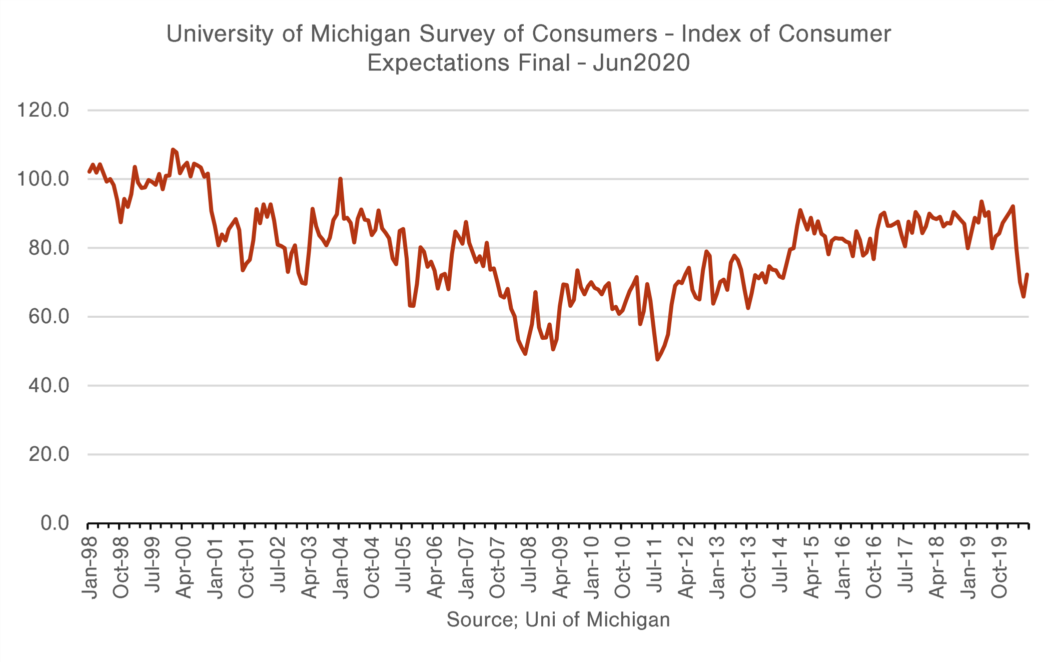
The index of sentiment regarding current economic conditions is 21% below a year ago;



Expected Conditions

Sentiment of Expected Conditions Index; Jun final 72.3 (revised from 73.1) versus May 65.9

The index of expected economic conditions is 19% below the same month a year ago;



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

US Markit Manufacturing and Services PMI Prelim (Jun)

Note that the methodology to calculate the PMI's in the Markit report is different to the US Fed regional surveys;

> For each variable, the index is the sum of the percentage of 'higher' responses and half the percentage of 'no change' responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease.

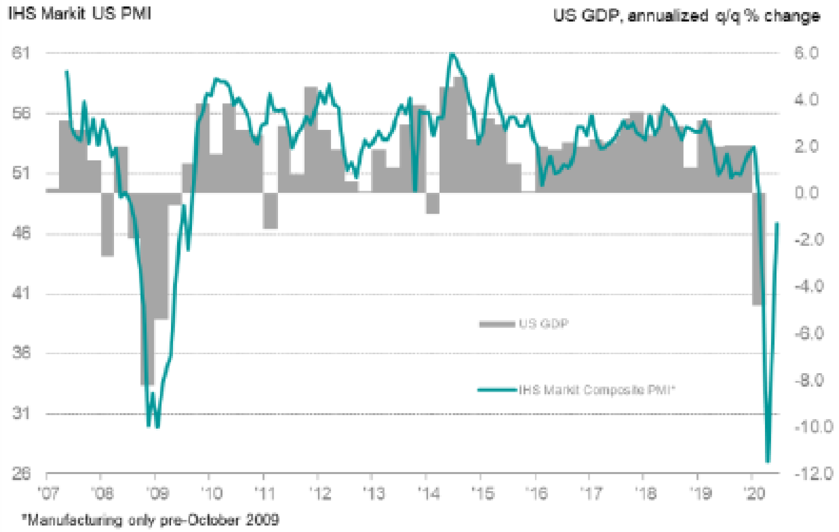
This month the composite output measure across services and manufacturing showed that output continued to contract in Jun, but a slower pace. Both services and manufacturing output declined at a slower pace in Jun.

Composite Output Index – month; Jun 46.8 versus May 37

> Expectations of a rise in activity over the coming year contrasted with negative sentiment seen in April and May. The reopening of states and reports of client interest reportedly sparked the return to optimism.

Data collected June 12-22

IHS Markit Composite PMI and U.S. GDP



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

<u>Services Business Activity Index – month</u>; Jun 46.7 versus May 37.5

The pace of activity improved slightly, but it is still most likely that the proportion of firms recording worsening activity outnumber the number of firms reporting improving activity.

New orders on net continued to decline compared to the prior month, but by a lesser degree. The decline in domestic and foreign orders eased this month.

<u>Manufacturing PMI – month</u>; Jun 49.6 versus May 39.8

The manufacturing output index improved from 34.4 in May to 47.8 in Jun, still noting that more firms, on net, were reporting lower levels of output. Obviously that margin is becoming smaller.

The decline in new orders also slowed notably. But backlogs continued to be ‘reduced sharply’ in June, highlighting that level of space capacity that still exists.

<u>Employment across both sectors continues to lag</u>;

> The June survey meanwhile signalled further cuts to workforce numbers across the private sector, albeit at only a modest rate. Where an increase was noted, **some businesses reported the return of furloughed staff**. That said, **hiring freezes and relatively weak demand** led many other companies to shed employees in an effort to cut costs.

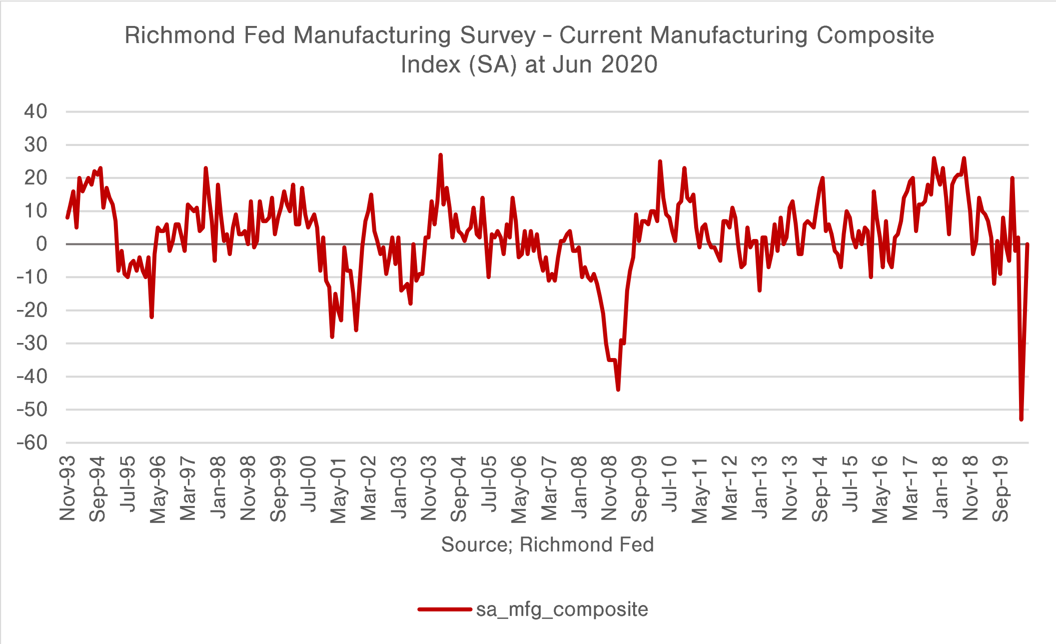
The return of furloughed workers will be one important note to watch in the upcoming employment report – especially the impact on those on temporary layoff. The BLS has noted that some of these people have also been misclassified as employed but not at work.

https://www.markiteconomics.com/Public/Home/PressRelease/bc642a4d5ff34fe4b8e7c0c8fe017b8e

Richmond Fed Manufacturing Index (Jun)

The headline manufacturing index increased to zero in Jun. This means that an equal number firms in the region recorded worsening conditions as well as improving conditions compared to the month prior. This was an improvement compared to May where the number of firms reporting worse conditions clearly outnumbered the number of firms reporting improved conditions. What these indices don't say, is how many firms reported no change from the month prior, and there is no sense of whether this 'no change' group is getting larger or not. These surveys also don't indicate the level of improvement.

Headline Manufacturing Index – month; Jun 0 versus May -27



Some improvement was recorded across demand this month. The shipments index continued to decline but only slightly, compared to the month prior. Slightly more firms reported worsening shipments than the number of firms reporting improving shipments.

The volume of new orders index shifted to a positive reading of 5 in Jun after two months of extremely negative readings. This means that the number of firms reporting improving orders outnumbered the number of firms reporting worsening volume of new orders in Jun (not by a large margin though).

The backlog of orders continued to decline, albeit at a slower pace than the month prior. This likely suggests that the growth in new orders remains low – such that firms are still able to reduce backlogs.

The employment index continued to indicate that firms on net, continued to reduce employment. In May the employment index was -16 and in Jun the reading was -5.

The average workweek indicates that the number of firms increasing the average workweek is basically on par with the number firms reducing the average workweek. This is still an improvement on the prior month (Jun 1 versus May -24).

There was a larger increase in prices paid this month compared to a much smaller increase in prices received.

Firms also expected that local business conditions would improve in six months' time. The expected local conditions index for six months' time improved from 4 in May to 55 in Jun. This is the highest reading for this index in the series – likely reflecting the unique nature of the shutdown and expected improvement from reopening and 'getting back to normal'.

https://www.richmondfed.org/-/media/richmondfedorg/research/regional_economy/surveys_of_business_conditions/manufacturing/2020/pdf/mfg_06_23_20.pdf

Kansas City Fed Manufacturing (Jun)

In Jun, there was a small expansion in activity compared to the month prior. This at least indicates some stabilisation after three consecutive months of severe declines.

> The improvement in activity was driven by non-durable goods plants, while durable goods factories, especially nonmetallic mineral products, primary metals, fabricated metals, and computer and electronics plants continued to decline

The support for manufacturing firms in the region has been extensive. The special questions this month were related to the use of lending assistance programs in the region. Approx. 76% of the survey respondents applied for the SBA PPP since 13 Mar – and 97% of those applying, received loans.

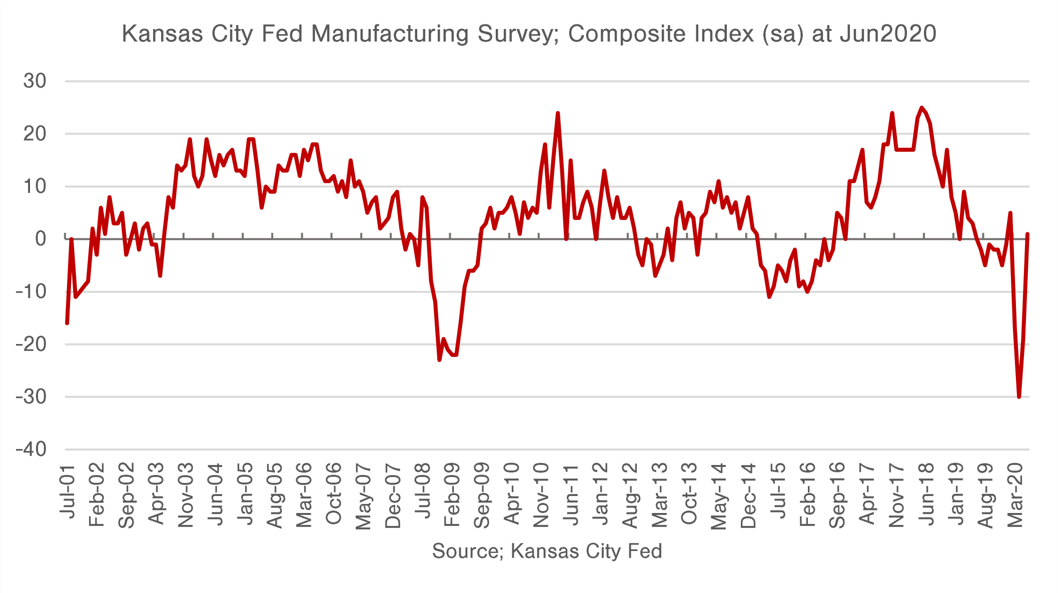
> "PPP loan was a life line for us. Plus our bank has deferred loan payments."

> "We have used all of the PPP funding. If revenues do not start increasing soon, we will have to start furloughing employees."

Composite Manufacturing Index; Jun 1 versus May -19

The index reading of one (1) in Jun indicates that the number of firms reporting improved/higher activity slightly outnumbered those firms still reporting continued worsening/declines in activity for the month.

The composite index compared to a year ago remains firmly in contraction at -29.



This month, the volume of shipments increased slightly compared to the month prior – indicating at least some stabilization in activity. More firms reported an increase in production and less firms reported a decline. The number of firms reporting 'no change' in production compared to the month prior was unchanged in Jun at 33% of firms. The production index versus a year ago in Jun indicated that most firms (68%) still reported a decrease in production versus a year ago. The year ago index remained firmly in contraction territory.

The volume of shipments improved from -22 in May to +8 in Jun. This was a more positive improvement with more firms reporting increases in shipments than decreases compared to the month prior. Most firms still reported that shipments were worse than a year ago.

"Our business should return to normal when commercial flights return to pre-Covid-19 status."

The index of the volume of new orders indicated some growth compared to the month prior, improving from -25 in May to +7 in Jun. More firms reported an increase in orders than those reporting a further decrease compared to the month prior. The number of firms though reporting 'no change' in the volume of new orders compared to the prior month, also increased slightly to 29%. Most firms (70%) reported that orders in Jun declined versus a year ago.

"We expect most of our customers to be back at full capacity in a few months. We are already seeing increased orders in that regard."

New export orders continued to decline on net, but note that the vast majority of firms reported no change in new exports orders this month – 75% of firms. There were 9% of firms that reported higher new export orders and 16% of firms reporting lower new export orders.

The backlog of orders index indicated that most firms continued to record declines in order backlogs. This indicates that the growth in new orders likely remains too low.

The number of employees continued to decline for the fifth month in a row. Most firms though (62%) reported no change in the number of employees this month (little changed from the May result).

For firms that received an SBA loan, 86% reported that it prevented layoffs and/or furloughs.

The decline in the average employee workweek shifted to more stable conditions; the larger contraction in May (-20) improved to 'no change' in Jun. This month, 19% of firms reported higher hours (last month 11%), but the vast majority of firms reported no change in the workweek – this increased from 60% of firms in May to 65% of firms in Jun. The number of firms reporting ongoing reductions in the workweek declined from 29% of firms in May to 16% of firms in Jun. On a year ago basis, the average employee workweek remained firmly in contraction (below that of a year ago).

Inventories of finished goods and materials both continued to decline this month.

https://www.kansascityfed.org/~/media/files/publicat/research/indicatorsdata/mfg/2020/mfgsurvey-kcfed-2020-june25.pdf?la=en

Advance Durable Goods Orders (May)

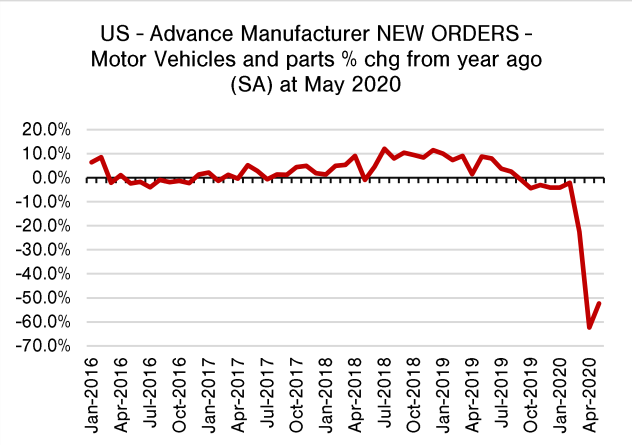
There was a stronger rebound in durable goods new orders this month of +$26.6bn (or +15.8%). Half of this monthly increase was the result of a shift in new orders for non-defense aircraft from a total of -$8.6bn (i.e. cancelled orders) last month to total orders in May of +$3.1bn. Interestingly, the NSA total for new orders for non-defense aircraft in May was still negative -$0.9bn. That said, most other categories reported a rebound in orders – but excluding transportation (and the aircraft effect), growth in orders was more moderate at +4%.

Growth in shipments was less pronounced – both including and excluding transportation.

The scale of the rebound is consistent with the PMI's for May and industrial production data – a restart of production, but activity levels remained low. Much of this is being driven by the slower rebound so far in motor vehicle and transportation production, especially non-defense aircraft – which is not limited to the US.

Durable Goods – New Orders; May +15.8% (+$26.6bn) versus Apr -18.1% (-$37.2bn)

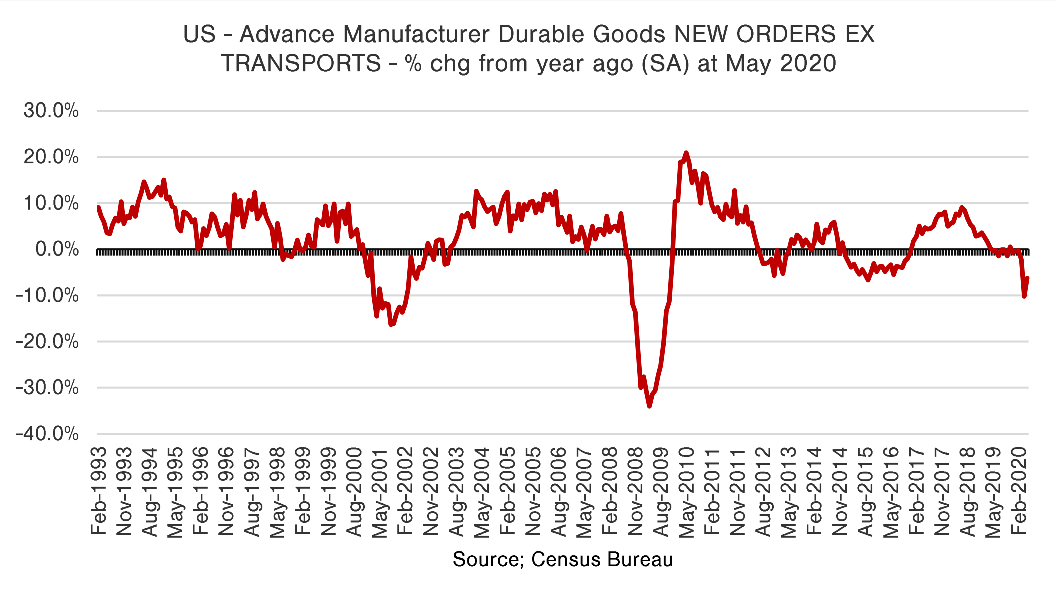
The main contributor to the growth in orders this month was non-defense aircraft orders. The increase in aircraft orders was the result of total orders in Apr of -$8.6bn (cancelled orders likely) shifting to a low level of positive orders in May of +$3.1bn. On net contributing +$11bn to the change between the two months (close to half of the growth in May). Whilst its positive that further orders weren't cancelled, the level remains extremely low. The NSA total for aircraft orders was actually still negative -$0.9bn in May.



The other large contributor to orders growth was growth in orders of motor vehicles and parts +27.5% - this is coming off a low base of orders. This level of % change only contributed +$6.1bn to the growth in total durable goods orders this month. For context, the May orders for motor vehicles was still 54% below the same month a year ago.

Excluding transportation equipment, new orders for durable goods was lower at +4% (+$5.6bn growth) compared to the -8.2% in Apr.

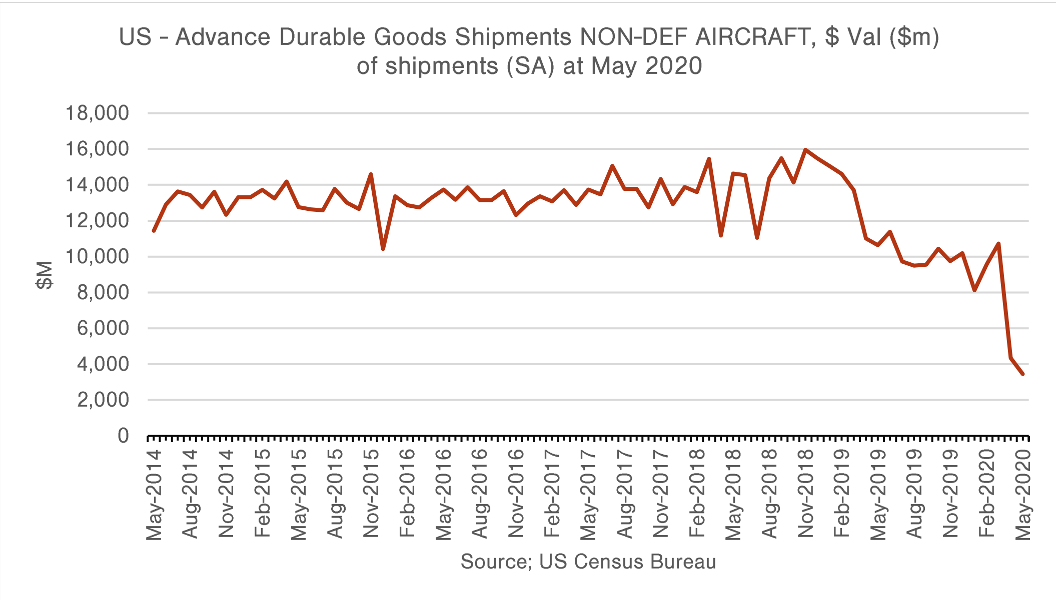
On an annual basis, total durable goods orders in May were down -18% (SA). Excluding transports, the pace of the decline remains smaller at -6.3%.



<u>Durable Goods - Shipments</u>; May +4.4% (+$8.4bn) versus Apr -18.6% (-$43.5bn)

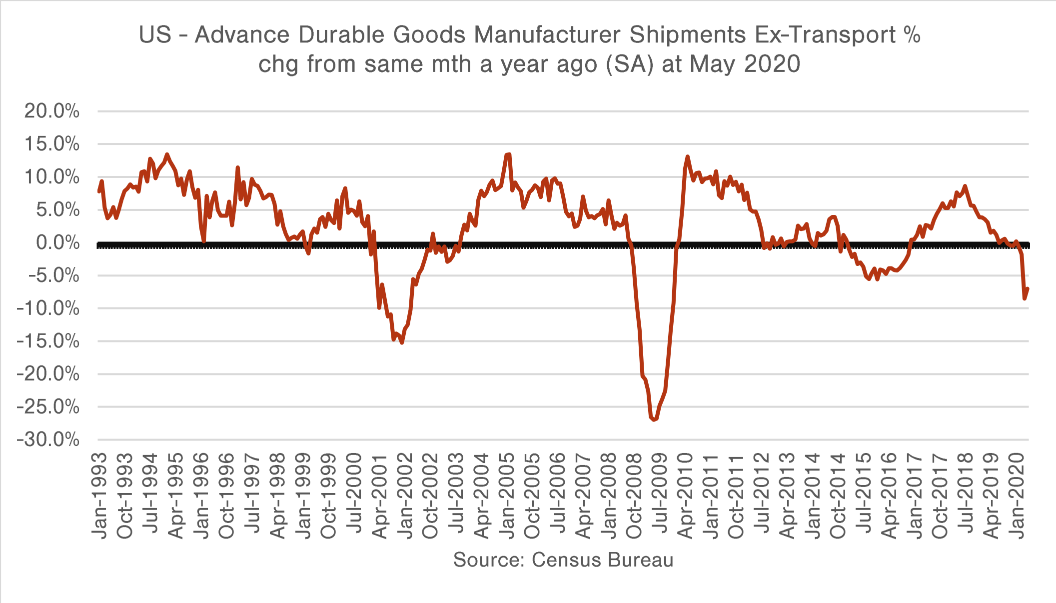
Most of the increase in shipments this month was due to the growth in motor vehicles and parts shipments; +26.7% or +$6bn (compared to the -53% in Apr or -$25.6bn).

Non-defense aircraft and parts shipments declined further this month by -20% or -$0.9bn compared to shipments in Apr (which was down -60% on the month prior to that). Shipments of aircraft have been slowing since the end of 2018 when shipments peaked at $16bn/mth and that decline has accelerated since Mar 2020;



Shipments of ‘all other durable goods’ added +$1.3bn to the growth in shipments for the month. The growth in shipments of fabricated metals also added +$0.8bn to the growth in total shipments in May.

On an annual basis, total shipments of durable goods declined by -20% in May. Excluding transport equipment, shipments were down -7% compared to the same month a year ago;



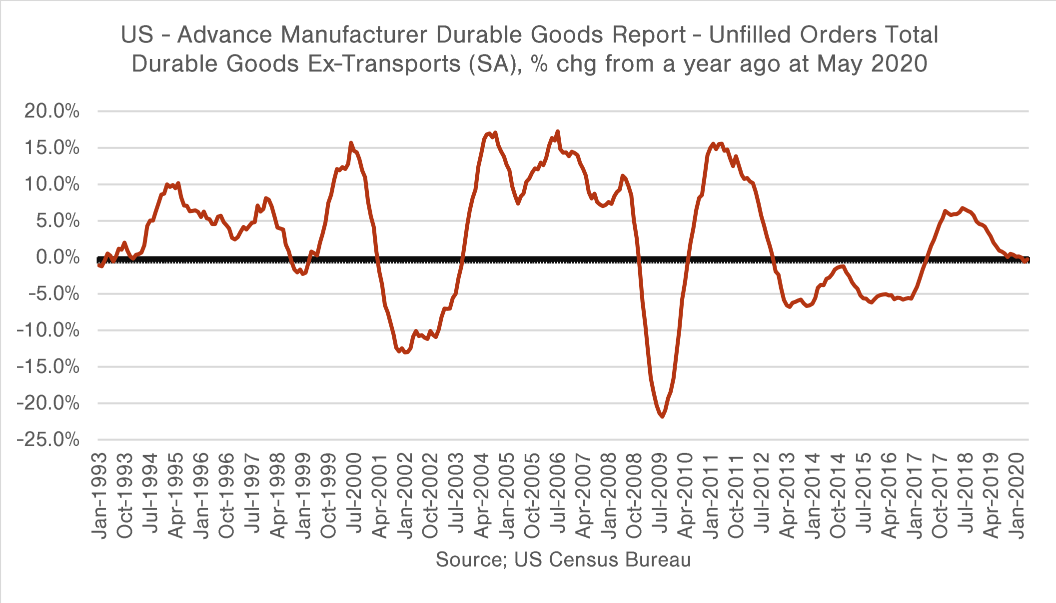
<u>Durable Goods – Unfilled Orders</u>; May +0.1% (+$0.8bn) versus Apr -1.5%

Unfilled orders were little changed in the latest month. There was no one category that stood out with regard to an increase in unfilled orders. Even excluding transportation, unfilled orders increased by +0.1% in May.

The largest contributions were transportation equipment (+$0.3bn), electrical equipment (+$0.2bn) and, fabricated metals productions (+$0.3bn)

Last month there was a larger decline in unfilled orders as a result of non-defense aircraft (likely linked back to the cancelled orders). Nondefense aircraft accounts for 47% of total unfilled orders. Backorders for non-defense aircraft continued to fall slightly this month by -$0.4bn.

On an annual basis, unfilled orders for total durable goods remains 4% below a year ago. Excluding transport equipment, unfilled orders are only slightly below a year ago at -0.3%;



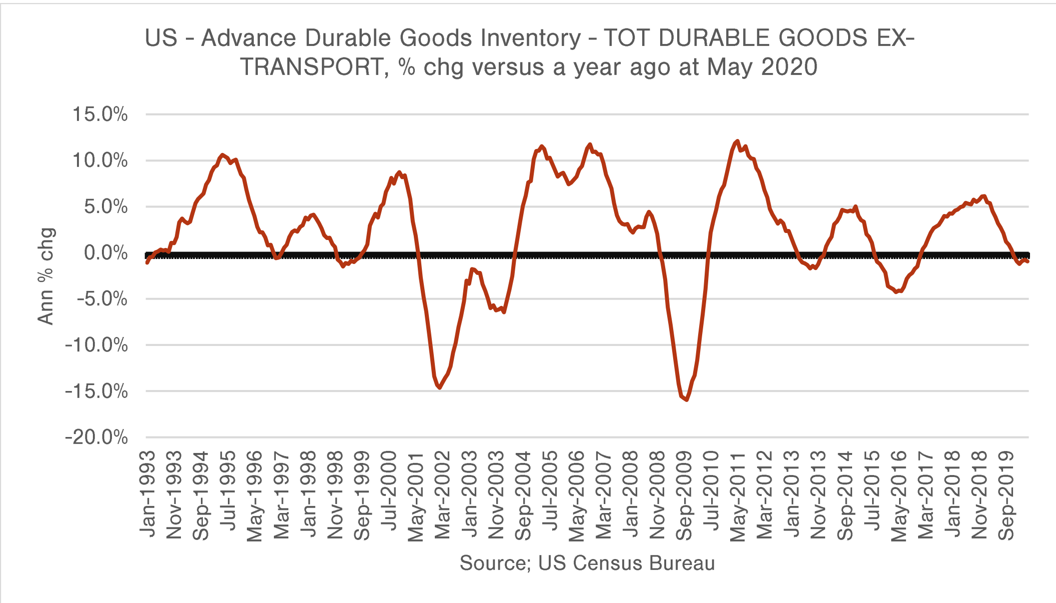
<u>Durable Goods – Inventory</u>; May +0.1% (+$0.25bn) versus Apr 0%

Despite little change at a total level, there were several changes this month.

The value of inventory for transport equipment increased by $1.3bn in May. This was led by an increase in non-defense aircraft inventory of +1.6% or +$1.1bn.

This was offset by a larger decline in primary metals inventory of -$0.7bn.

On an annual basis, growth in inventory of durable goods continues to slow, now at +2.7% compared to a year ago. Excluding transport equipment, inventory declined at a faster pace of -1%;



https://www.census.gov/manufacturing/m3/adv/pdf/durgd.pdf

Personal Income, Consumption expenditure and PCE Price Index (May)

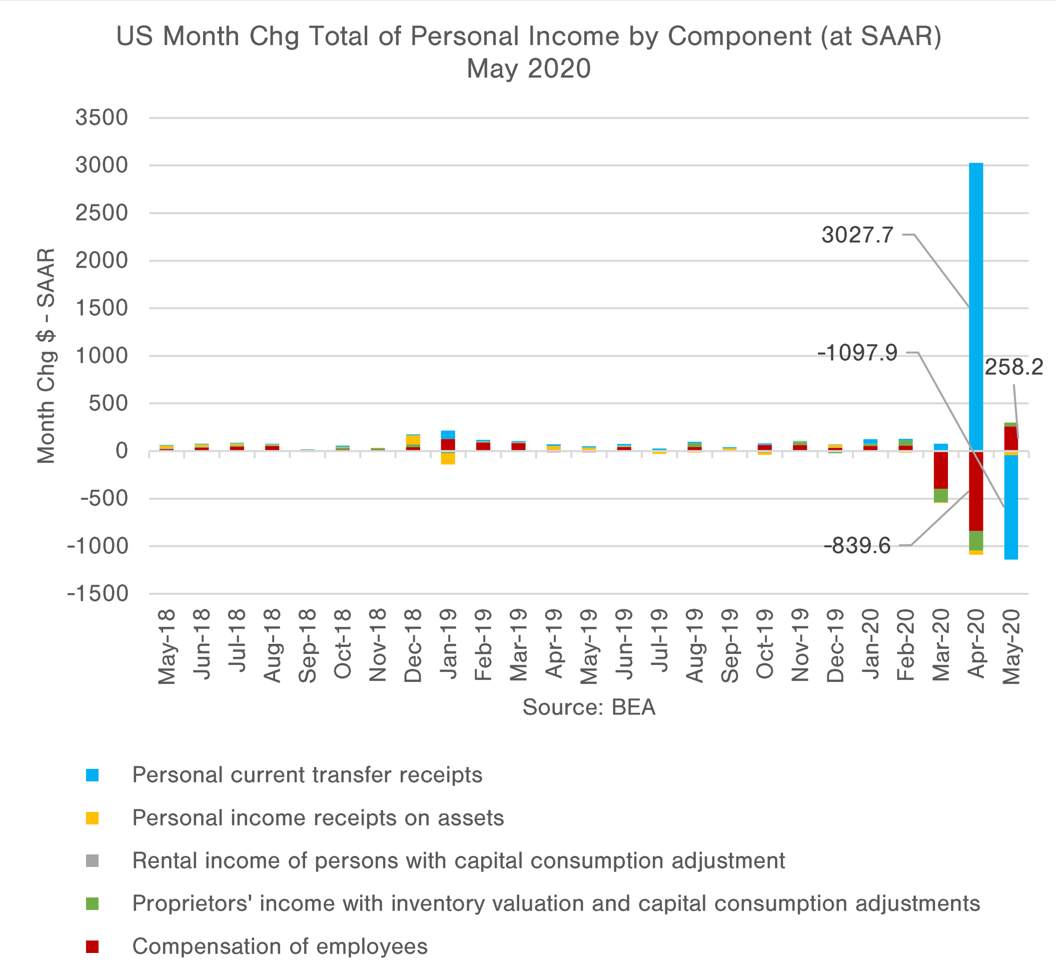
Despite the month on month decline in personal income/personal disposable income compared to Apr (due to one-off payments), the level of personal disposable income remains above the pre-pandemic trend due to the growth in government social benefits payments. Consumption expenditures grew in May, but remain approx. 10% below a year ago. So the savings rate (% of disposable income), although lower than the month prior, remains extremely elevated.

Is the saving a function of fear (remaining unemployed, laid-off, lower future income etc) or still a function of less opportunity to spend due to restrictions? It's likely a combination of both.

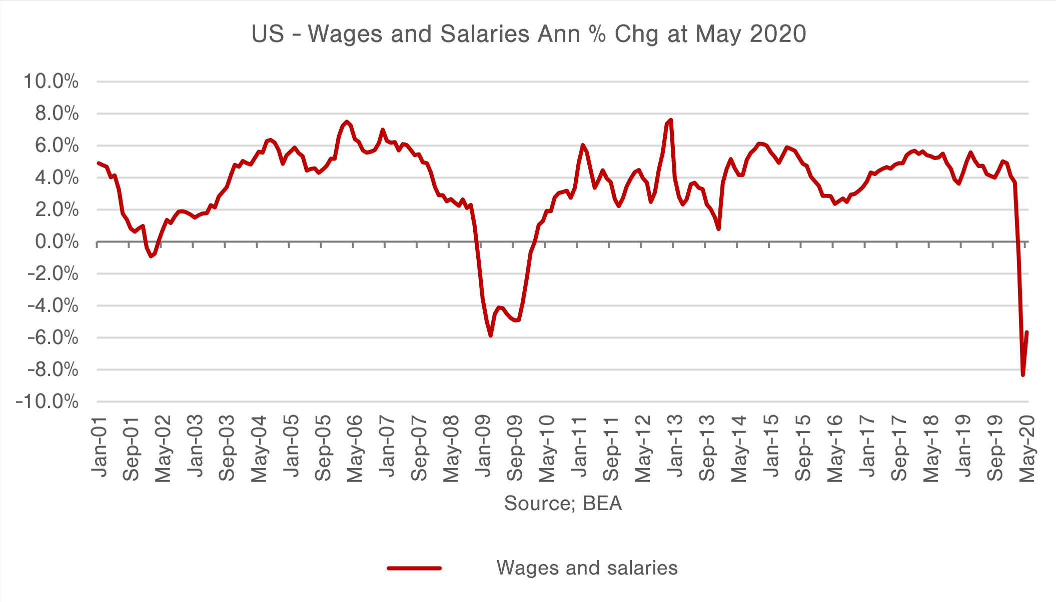
PERSONAL INCOME

Total Personal Income – month change; May -4.2% (-$874bn) versus Apr +10.8%

Overall, employee compensation rebounded slightly this month via wages and salaries. The decline in the month was led by personal current transfers – due mostly to the bulk of the one-off CARES Act payments made last month (blue bars below).



The largest part of personal income is wages and salaries. In May total wages and salaries were $8.7 trillion. This month, there was a rebound in wages growth of +2.7% (+$233bn) compared to -$700bn decline in the month prior. On an annual basis, the decline in wages and salaries remains severe, falling to -5.7% below a year ago – whereas growth had been tracking around +4-6% annual growth. This is obviously still an area of concern;



The bulk of the income change this month was the decline in personal current transfers. Total government social benefits; May -17% (-$1.1trillion) compared to +91% in Apr (+$3 trillion)

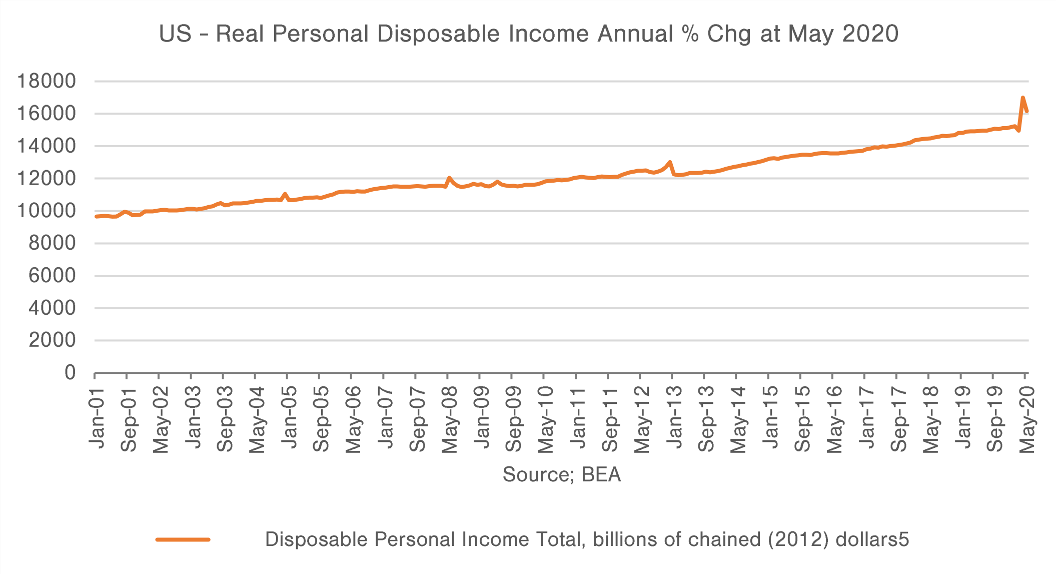
In Apr, there was a significant +$3 trillion in one-time payments made via the CARES Act. Part of these payments extended in May with a further $1.2 trillion in payments recorded in May, but the month change was a decline.

The growth in unemployment insurance payments increased this month. In May, unemployment insurance payments increased by 182% (+$825bn) versus Apr. Nearly $1.3 trillion in unemployment benefits were paid in May compared to $452bn in Apr. Prior to Mar, unemployment insurance had been tracking along at approx. $25bn/month.

The overall result was a 5% decline in personal disposable income for the month (or -$911bn compared to the month prior – when personal disposable income increased by $2.2trillion).

Total personal disposable income in May was $17.8 trillion.

In real terms, personal disposable income is +8% ahead of a year ago – due to government social benefits;



PERSONAL OUTLAYS

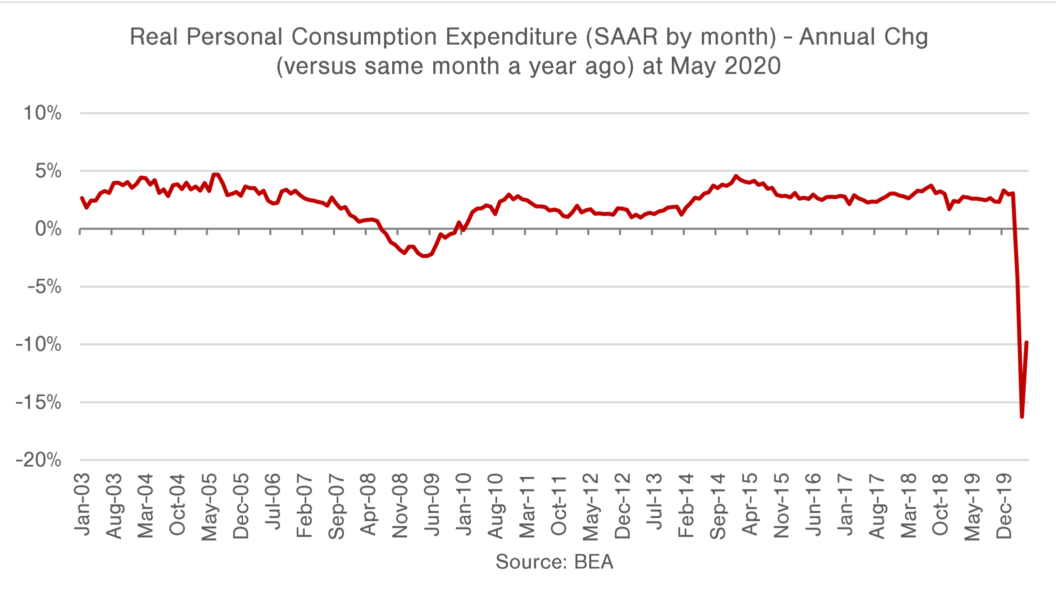
As foretold by retail sales, there was a large rebound in retail sales this month – partly due to the lifting of restrictions and partly the result of the boost to personal income (despite the month decline).

Personal Consumption Expenditures – month change; May +8% (+$1trillion) versus Apr -12.6%

Increased expenditure was recorded across both goods (+14%) and services (+5%).

> Within goods, spending on motor vehicles and parts as well as recreational goods and vehicles were the leading contributors to the increase. Within services, the largest contributors to the increase were spending for health care as well as food services and accommodations.

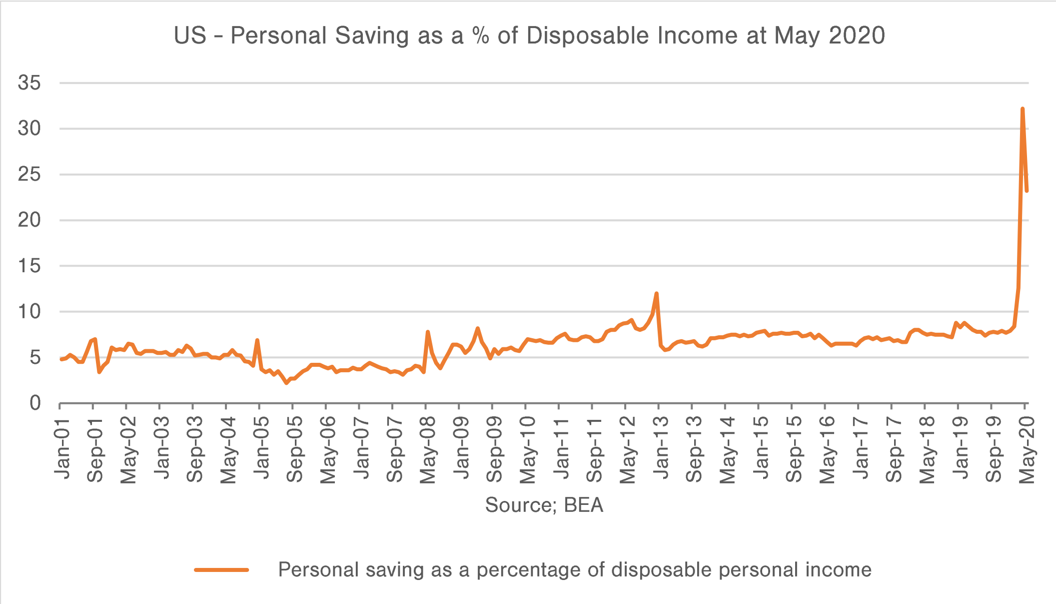
In real terms, personal consumption expenditure remains 10% below a year ago (-9.3% in nominal terms too).



PERSONAL SAVINGS

This month, the rate of personal saving (as a % of disposable personal income) remains extremely elevated.

Personal saving as a % of disp Income – month; May 23.2 versus Apr 32



So despite the rebound in outlays sales this month, personal saving remains elevated, partly due to the higher level of disposable income (due to government payments not wages and salaries).

The savings 'surplus' (disposable income less outlays) was still at $4trillion in May, despite the fall in disposable income compared to the month prior. In Apr that surplus was $6 trillion.

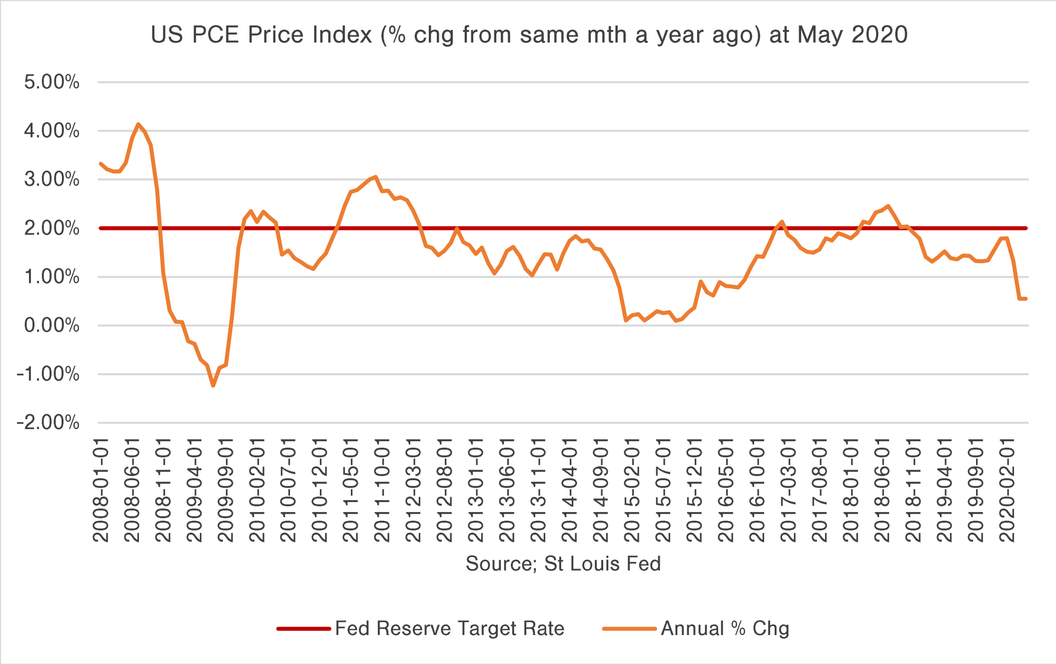
https://www.bea.gov/news/2020/personal-income-and-outlays-may-2020

Personal Consumption Expenditures – Price Index (May)

In May, the annual growth in the headline PCE price index was unchanged at +0.55% - remaining well below the FOMC 2% 'symmetrical' target for prices.

Headline PCE Price Index – annual change; May +0.55% versus Apr +0.55%

On a monthly basis, prices were little changed, increasing by +0.1% after a larger -0.46% decline in the month prior.

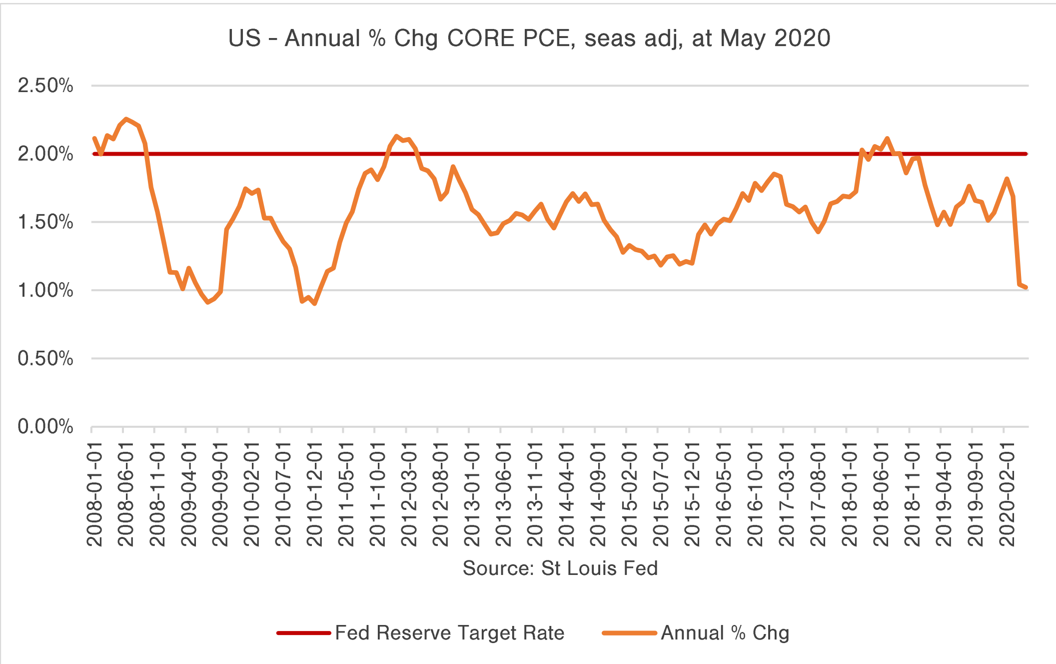


The decline in energy prices has had the largest impact on the PCE price index. Just excluding energy prices, the headline PCE price index grew by +1.4% compared to a year ago. In the month, gasoline and other energy goods prices continued to decline by -3.6% in May (v -19% in Apr). and are still 33% below a year ago.

Food and non-alcoholic bevs (for off-premise consumption) price growth remains elevated, but only partly offsetting the significant fall in energy prices. In May, prices increased by 1% and are +5% ahead of a year ago.

The growth in core PCE remains higher (than the headline growth) due to the fall in consumer energy prices;

<u>PCE Ex Food and Energy – annual change</u>; May +1% versus Apr +1%



Within the core prices, the annual decline in core goods prices (-1.6%) continues to be offset by growth in core services prices (+1.9%).

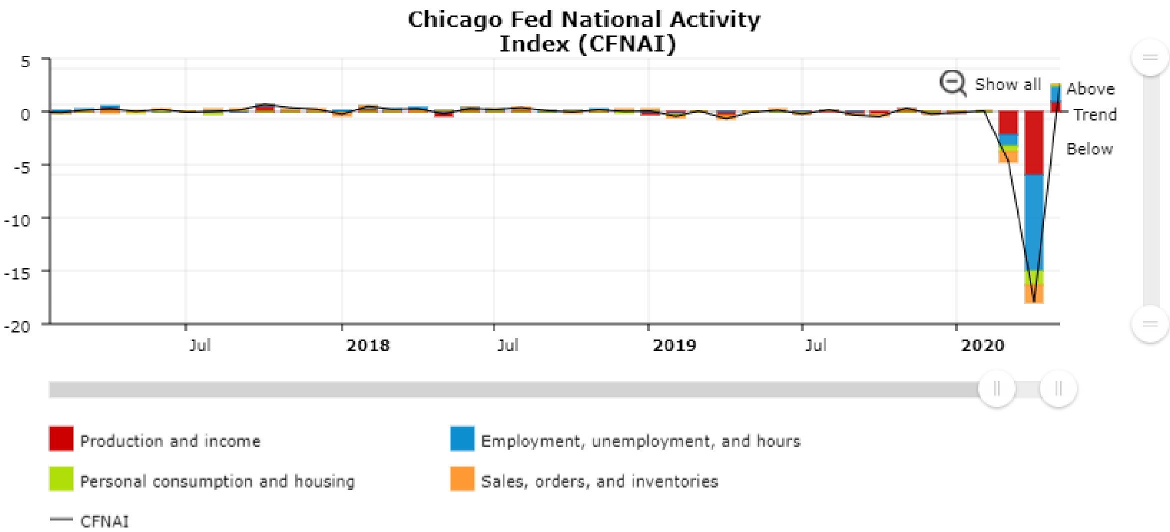
https://fred.stlouisfed.org/series/PCEPILFE#0

https://apps.bea.gov/iTable/iTable.cfm?reqid=19&step=2#reqid=19&step=2&isuri=1&1921=underlying

Chicago Fed National Activity Index (CFNAI) (May)

The headline National activity index indicated that activity increased at an-above-average pace in May after two months of severe declines.

Headline CFNAI – month; May 2.61 versus Apr -17.89



All of the key sectors returned to growth this month.

Employment, unemployment, and hours; May +1.53 versus Apr -9.06

Production and income; May +0.89 versus Apr -5.94

Personal consumptions, and housing; May +0.17 versus Apr -1.3

Sales, orders, and inventories; May +0.02 versus Apr -1.59

https://www.chicagofed.org/research/data/cfnai/current-data

US Q1 GDP – Third Estimate

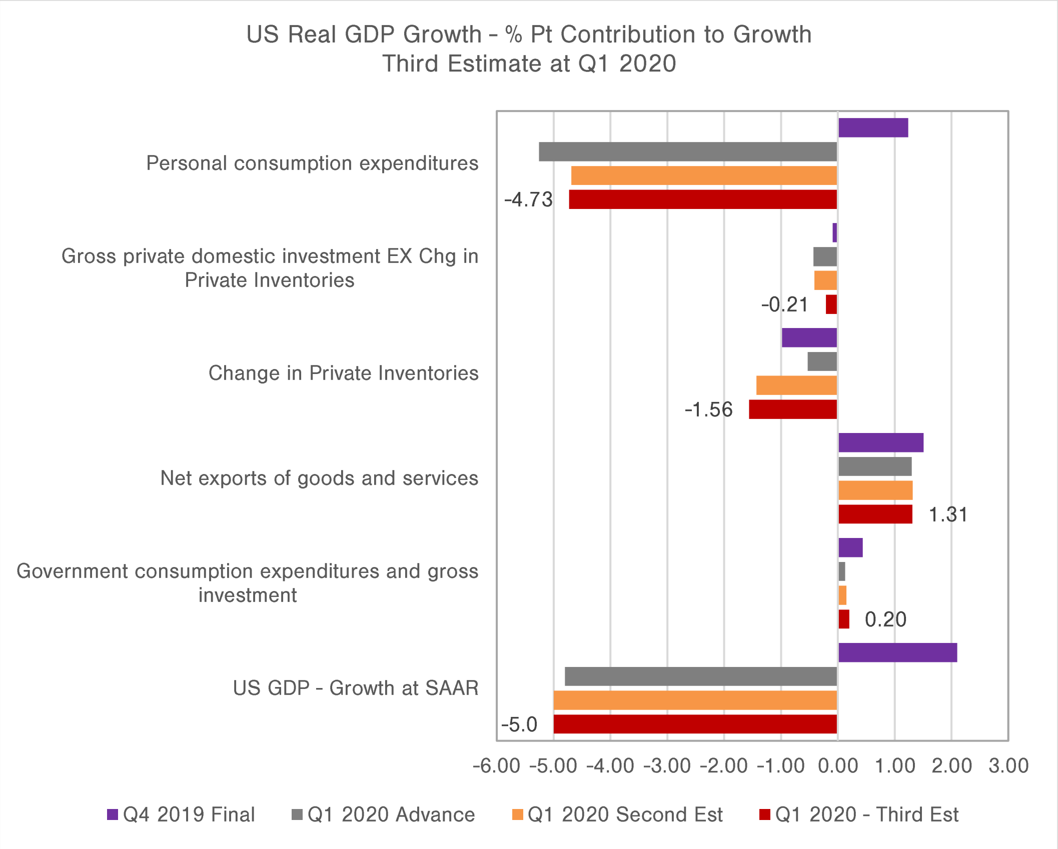
The was little change in the third estimate of Q1 GDP growth. The SAAR of decline in US GDP was confirmed at -5% in Q1.

The decline in personal consumption expenditures made a slightly larger contribution to the headline decline.

Fixed investment expenditure 'improved', making a smaller contribution to the decline. But this was offset by the change in inventories making a larger contribution to the decline in GDP.

The contribution of net exports was little changed.

There was a larger positive contribution from government consumption and investment expenditures.



https://www.bea.gov/data/gdp/gross-domestic-product

Weekly Mortgage Applications wk ending 19 Jun

This week there was a decline in mortgage applications, refis and purchases compared to a week ago.

Mortgage Composite Index (mortgage loan application volume); -8.7% versus a week ago.

Refi's -12% versus a week ago and remain +76% ahead of the same week a year ago. The share of refis in mortgage activity fell to 61.3% from 63.2 versus a week ago.

The purchase index, the leading indicator of sales, declined by 3% versus a week ago. The purchase index remains 18% ahead of the same week a year ago.

> One factor that may potentially crimp growth in the months ahead is that the release of pent-up demand from earlier this spring is clashing with **the tight supply of new and existing homes** on the market. Additional housing inventory is needed to give buyers more options and to keep home prices from rising too fast.

The May existing home sales data (next section) indicates that months of supply in May actually increased (to a near term high). Inventory increased by 6% but remained 19% below the same month a year ago.

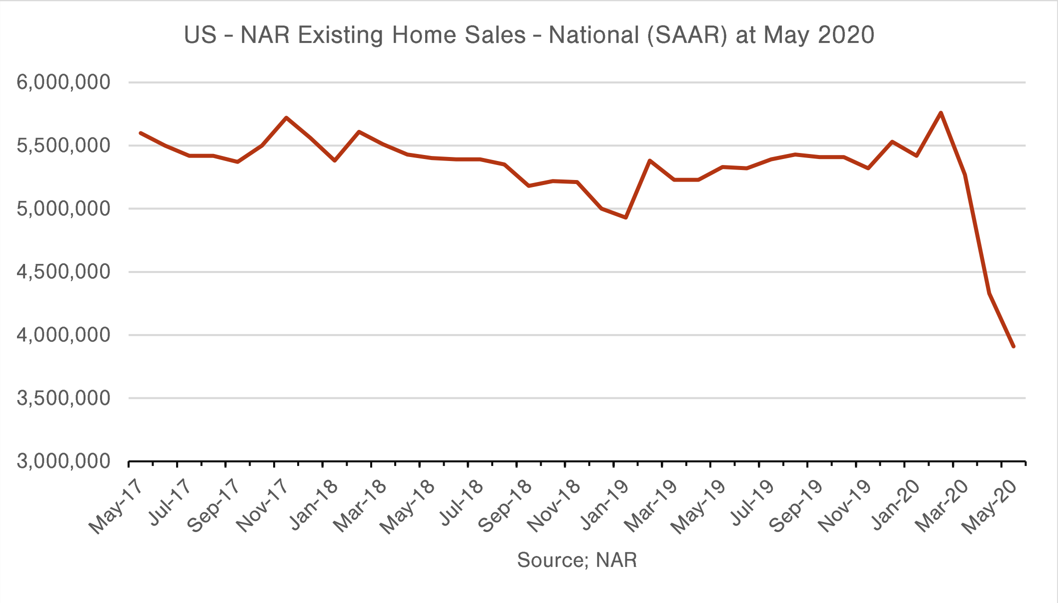
https://www.mba.org/2020-press-releases/june/mortgage-applications-decrease-in-latest-mba-weekly-survey-x270845

Existing Home Sales (May)

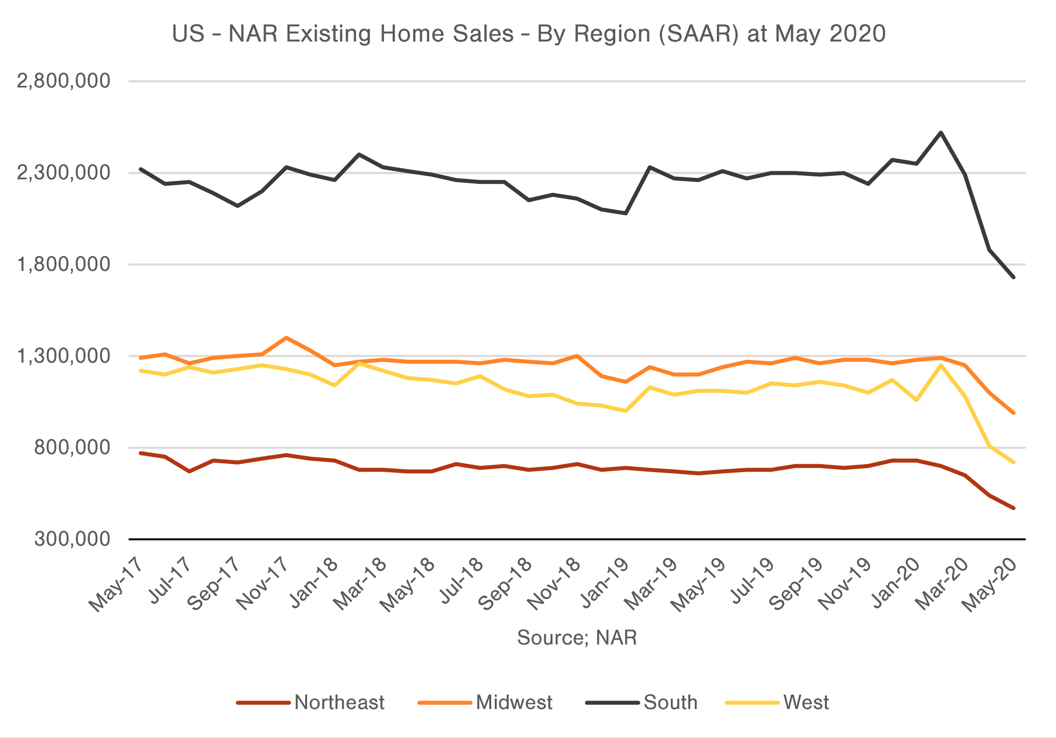
Existing home sales declined further again in May after falls in the two months prior. The falls were large across all regions. Given the ongoing improvement in purchase applications since early May, there should be some stabilization in sales in the next month (it's a 4-6-week leading indicator of home sales).

National Existing Home Sales – SAAR; May 3.91m (-9.7%) versus Apr 4.33m (-17.8%)

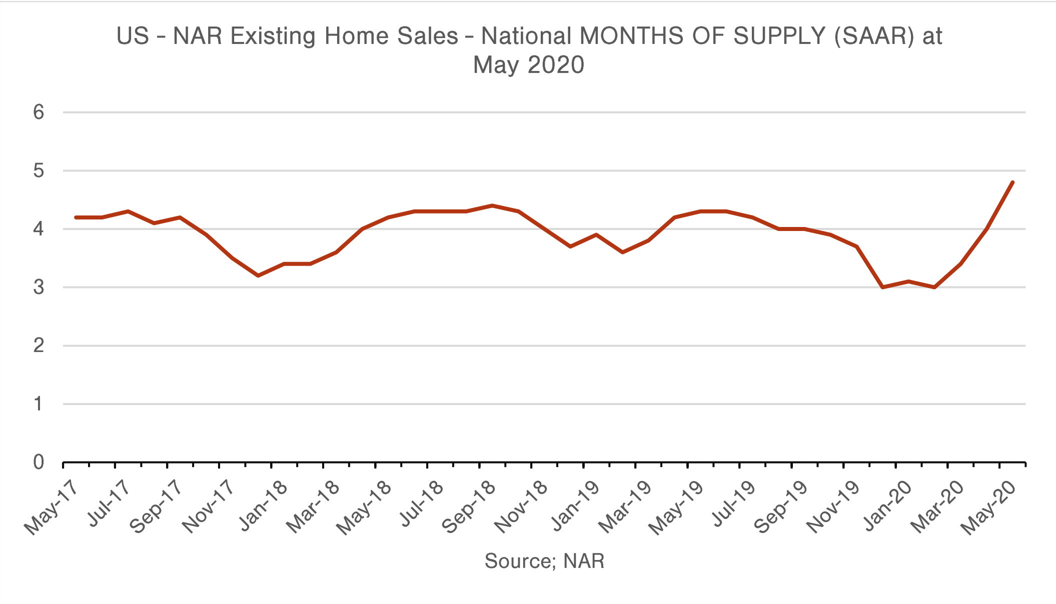
The decline in the month is such that the existing home sales (SAAR basis) in may were 26.6% below the same month a year ago.



All of the main regions recorded further declines this month. The largest contributor to the decline was the South (-8%) followed by the Midwest (-10%), the West (-11.1%) and the Northeast (-13%).



The volume of inventory increased by 6% in the month, but remains 19% below the same month a year ago. The Months of Supply of homes for sales increased from 4 to 4.8;



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

New Home Sales (May)

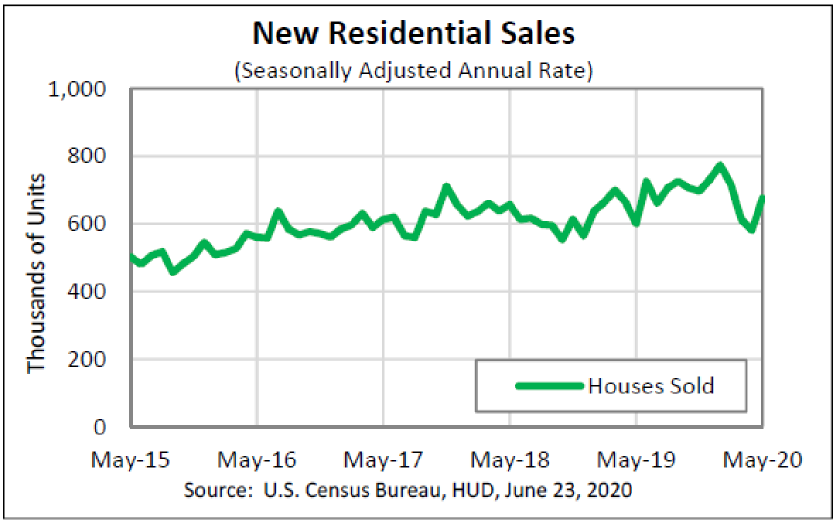
Despite the drop in existing home sales in for the month, new home sales increased in May, but only after the Apr sales result was revised notably lower. The 90% confidence at the

National level does not include zero (just), so is likely that there was an increase. The regional data is not statistically significant this month, except for the West.

New Home Sales – SAAR basis; May 676k versus Apr 580k (revised lower from 623k originally reported in Apr)

The growth in the month was +16.6% with the 90% confidence interval +/- 15.5% pts – so it is likely that new home sales increased in the month.

This is still higher than that of a year ago too – May 2019 sales (SAAR basis) were 600k.



https://www.census.gov/construction/nrs/pdf/newressales.pdf

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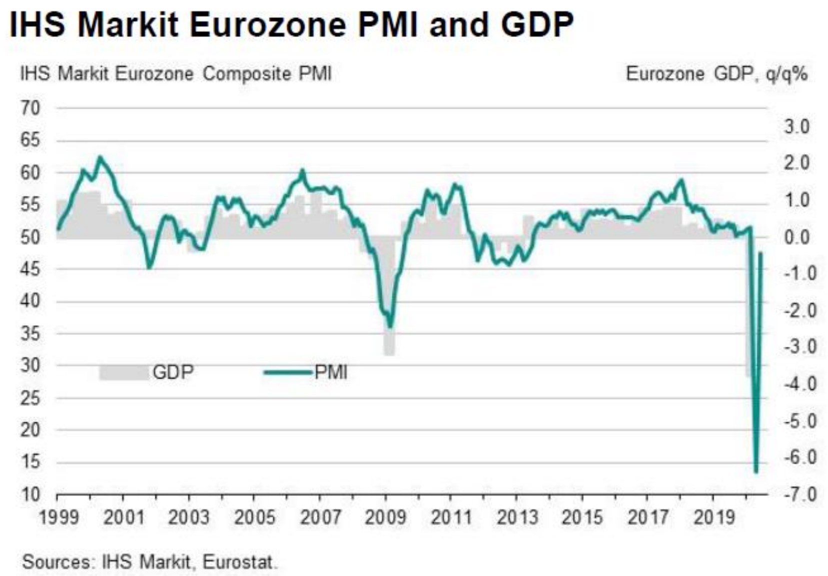
Europe

Markit Eurozone Manufacturing and Services PMI Prelim (Jun)

The broad Eurozone composite output PMI continued to decline in the latest month, but at slower pace. This means that the number of firms reporting a decrease in output still continued to outnumber the number of firms reporting an increase in output, but less so than in the month prior. Both services and manufacturing sector output contributed to the 'weaker decline' improvement. This was also supported by an improvement in expected business conditions for the next twelve months.

Composite Output Index – month; Jun 47.5 versus May 31.9



Services Business Activity Index – month; Jun 47.3 versus May 30.5

Output declined at a slower pace, continuing the improvement since Apr. The decline in output was still linked to a weaker decline in new orders. Unfilled orders also continued to decline – but at a slower pace also. This likely indicates that demand growth remains weaker.

Manufacturing PMI – month; Jun 46.9 versus May 39.4

The manufacturing output index also declined, but at a slower pace this month. Improvement was led by France reporting month on month growth in output for the first time in four months. Germany on the other hand continued to record a weaker decline in output.

Overall, employment continued to decline.

> While rates of job losses moderated in both sectors for a second month in a row, taking the rate of job shedding to its lowest in the current sequence, factory headcounts continued to be reduced at an especially marked rate as producers scaled-back operating capacity.

Overall, the easing of restrictions across the Eurozone during the month resulted in more firms reopening. Plans for further easing of restrictions helped to improve business sentiment – with the number of optimists outnumbering the number of pessimists for the first time in four months.

Firms across both sectors continued to reduced prices charged – discounting in order increase sales. But the fall in prices was the smallest pace of decline in the last four months.

https://www.markiteconomics.com/Public/Home/PressRelease/fe2b26799d8e4589811762831b509fbd

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Japan

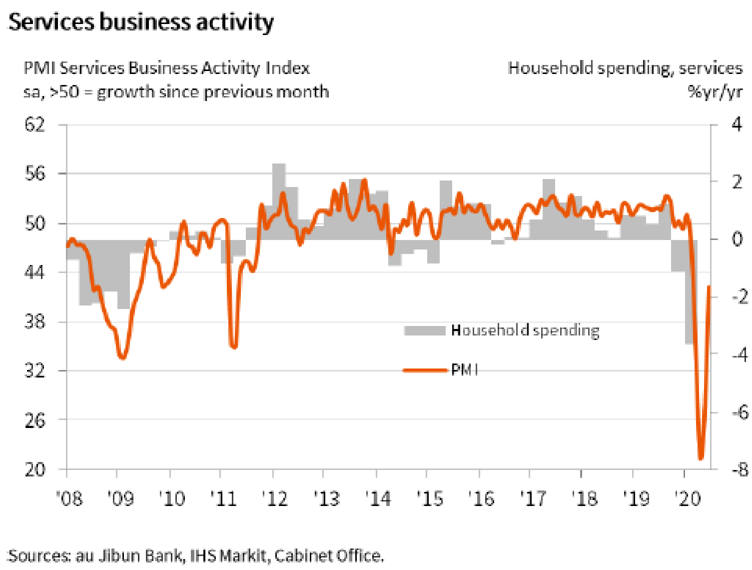
Markit Manufacturing & Services PMI Prelim (Jun)

The composite output index indicated that output continued to decline in Jun. The pace of decline in services output eased from extremely low levels in May. But in the manufacturing sector, output actually declined at an accelerated pace. The outlook of firms across both service and manufacturing sectors remains negative, albeit, less negative than in the prior month.

Composite Output Index – month; Jun 37.9 versus May 27.8

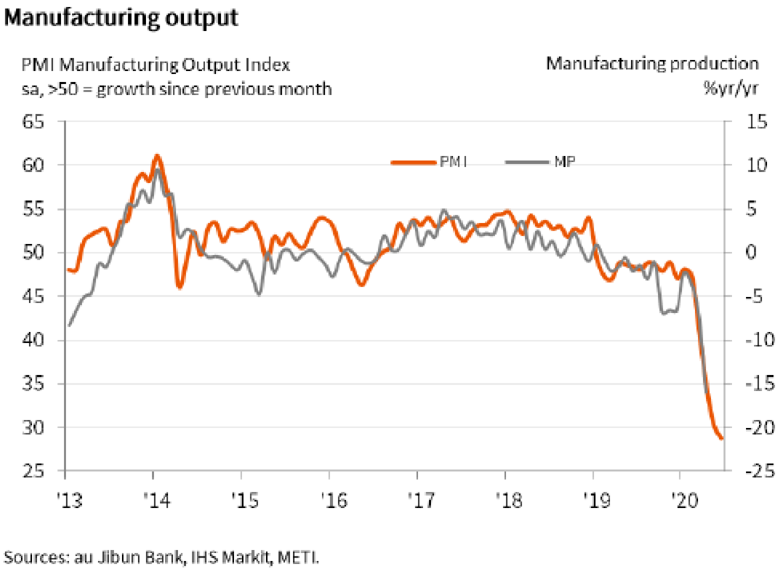
This month services output declined at a slower pace but manufacturing output declined at an accelerated pace.

Services Business Activity Index – month; Jun 42.3 versus May 26.5



Output continued to decline, on net, across services firms in Jun. Similarly, new business also continued to decline, albeit at a slower pace. Employment was unchanged from the month prior, after three consecutive months of declines. Output prices continued to decline, also at a slower pace.

Manufacturing Output Index – month; Jun 28.9 versus May 30.3



The continued pace of decline in manufacturing activity is concerning. The overall Manufacturing PMI also declined at a slightly faster pace in Jun, indicating that manufacturing conditions likely continued to deteriorate in Jun.

Production/output declined at a faster pace, already after several months of steep declines. The decline in new orders was less severe than in the month prior – hopefully indicating some change in trend. Order backlogs though continued to decline at a faster pace.

Given the weaker demand conditions, employment also declined at an accelerated pace.

Output prices continued to decline while input price growth accelerated, likely squeezing margins.

Firms continued to reduce purchases and inventory also declined at a faster pace.

https://www.markiteconomics.com/Public/Home/PressRelease/3ca7b5553f49415caa0b00fd651136d4

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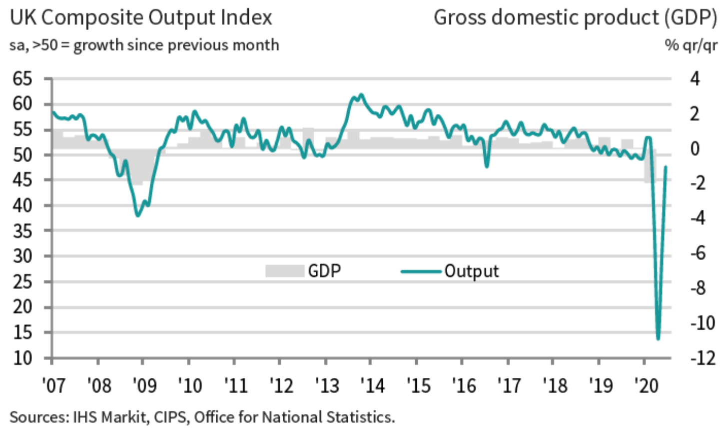
United Kingdom

Markit Manufacturing and Services PMI Prelim (Jun)

The headline composite output index indicated that output continued to decline, but also at a slower pace. This month, manufacturing output increased slightly compared to the decline in the month prior – this indicates that there was likely an equal number of firms reporting increases as there were reporting decreases in manufacturing output this month. The service sector recorded a much slower pace of decline in output.

A further easing of restrictions in Jul is likely to lead to additional output growth in the coming month.

Composite Output Index – month; Jun 47.6 versus May 30



Services Business Activity Index – month; Jun 47 versus May 29

This month, 33% of firms reported a decline in activity in Jun, still outnumbering the proportion of firms reporting an increase (28% of firms). The downturn in Jun was mostly the result of closures of cafes/restaurants/catering firms – but many of the restrictions will be lifted as of early Jul for these firms. Business to business services providers recorded "another steep downturn".

Firms still reported further declines in employment – citing reduced workloads/demand.

Manufacturing PMI – month; Jun 50.1 versus May 40.7

Higher output was linked back to reopening of plants. New orders though continued to decline. Firms cited a lack of new sales to replace completed order backlogs.

Survey respondents cited particularly weak demand across the automotive and aviation sectors in June.

Despite the current conditions, there was an improvement in the outlook for output growth over the next twelve months.

https://www.markiteconomics.com/Public/Home/PressRelease/31975bdd766349268b37c9856621dcea

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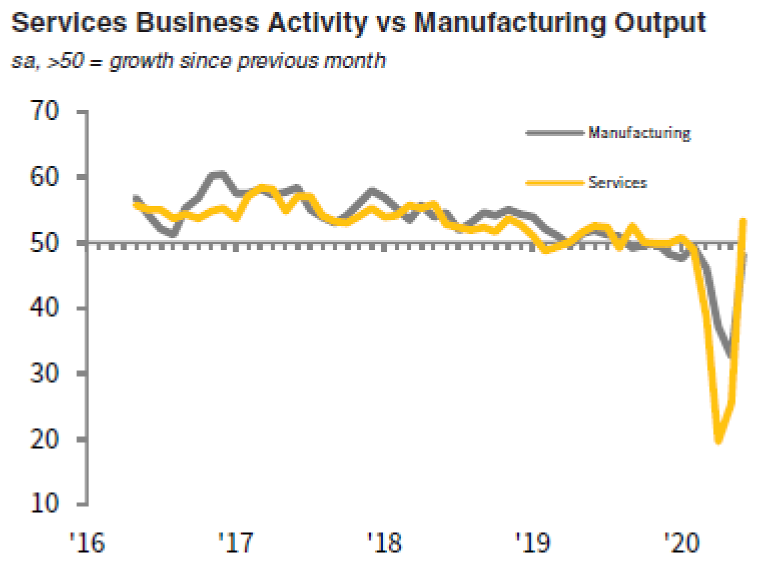
Australia

CBA Manufacturing and Services PMI Prelim (Jun)

The headline composite output index shifted into expansion this month, indicating that output across private sector firms increased on net compared to the month prior. This is in-line with the further easing of stay at home restrictions, which resulted in services output increasing after several months of decline. Some restrictions remain in place, limiting many firms from operating at full capacity i.e., cafes/restaurants. Output of manufacturing continued to decline, but at slower pace than in the month prior.

> Optimism that the worst of the disruption from the pandemic has passed and that operating conditions will gradually return to normal led to increased confidence in the 12-month outlook for activity.

Composite Output Index – month; Jun 52.6 versus May 28.1



Services Business Activity Index – month; Jun 53.2 versus May 26.9

Business activity increased for the first time in months. New business also increased 'marginally', but new export orders continued to decline. Employment growth though continued to decline, albeit at a slower pace. Both input and output costs increased for the first time in three months.

Manufacturing PMI – month; Jun 49.8 versus May 44

Note that this is the headline PMI, not the output index. Both output and new orders continued to decline, but at a slower pace. New export orders also continued to decline.

Employment continued to decline, 'as firms operated below capacity'.

Input costs continued to increase at the fastest pace since May 2018 and output prices increased slightly this month.

https://www.markiteconomics.com/Public/Home/PressRelease/ab14ecc1601b4273885dc0f098b76262

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Trade & Brexit

US-China Trade Talks

A comment by White House adviser Navarro, stating that the US-China trade deal was off, was quickly walked back by President Trump during the week. Some of President Trump's re-election bid will rest on the 'success' of striking a deal with China and taking a continued hard line against the trade deficit with China.

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 - this coming week.

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

A round of 'intensive' negotiations between the EU and UK is set to commence this week. They will be the first face-to-face meetings since the beginning of the global pandemic. The talks will alternate between Brussels and London for five weeks through Jul and Aug.

> Without a new agreement, the two sides would see ties reduced to minimum standards set by the World Trade Organization, with high tariffs and serious disruptions to business.
>
> London wants to agree on at least the bare bones of a trade deal this summer — at least politically, if not legally — in order to offer businesses clarity well before the end of the year.
>
> The EU is less pressed for time, and believes that the necessary ratification by the European Parliament and others would require a deal by late October. https://www.japantimes.co.jp/news/2020/06/29/world/eu-uk-brexit/#.Xvlra5MzY_U

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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