



MORNING BRIEFING

March 19, 2018

Fair Is Foul, and Foul Is Fair

(1) Meet Ambassador Lighthizer, the US trade czar. (2) USTR's report card on China's trade fairness likely to show lots of "F"s. (3) Section 301 making a comeback as US weapon in trade negotiations, or trade war if deals aren't made. (4) China's government has big ambitions for state-run economy by 2025. (5) Imposing a price on trade theft. (6) WTO benefits China more than US! (7) Trump's "America First" puts multilateral trade organizations second. (8) National security becomes a trade issue under Trump, or at least a negotiating position. (9) Steel tariffs may be a sideshow compared to trade conflict with China over technology and intellectual property. (10) Reagan's team of supply-siders is back.

US Trade I: China Doesn't Play Fair. Last August, the Office of the US Trade Representative (USTR) initiated an investigation into China's unfair trade practices. It was announced in a USTR [memo](#) titled "Initiation of Section 301 Investigation; Hearing; and Request for Public Comments: China's Acts, Policies, and Practices Related to Technology Transfer, Intellectual Property, and Innovation."

According to a 12/5 [article](#) in *POLITICO Morning Trade* ("A daily speed read on global trade"), the USTR completed a draft report late last year. Melissa and I expect that it may be publicly released shortly along with recommendations for retaliation.

We aren't fans of tariffs or trade wars. But our take is that China certainly seems to be engaged in lots of corrupt trade practices. The question is how to deal with them. While we wait on the USTR's findings and recommendations, here is the general background:

(1) *Meet Robert Lighthizer.* Robert E. Lighthizer was sworn in as the 18th USTR on May 15, 2017. Prior to his appointment by President Donald Trump, Ambassador Lighthizer was a partner at the high-powered law firm Skadden, Arps, Slate, Meagher & Flom LLP, where he practiced international trade law for over 30 years, according to his [bio](#). He has been around the trade block a few times: Before joining Skadden, he served as Deputy USTR for President Ronald Reagan, negotiating over two dozen bilateral international agreements, including agreements on steel, automobiles, and agricultural products.

(2) *Section 301.* Lighthizer is leading the China trade investigation. It is being conducted under Section 301 of America's Trade Act of 1974. Such investigations—which are initiated without using a dispute settlement mechanism under a trade agreement—must be completed within one year or less. According to [Mayer Brown](#), a global legal services provider, "Section 301 gives USTR broad authority to respond to a foreign country's unfair trade practices. If USTR makes an affirmative determination of actionable conduct, it has the power to take all appropriate and reasonable action to obtain the elimination of the act, policy or practice, subject to the direction of the president, if any."

However, Mayer Brown points out that using the Section 301 authority isn't commonplace these days: "...Section 301 has not been used in a unilateral manner in recent years, except when a country is designated as a priority foreign country in the annual Special Section 301 Report. That is not the case with the new investigation regarding China. ... Section 301 investigations were conducted more frequently during the Reagan administration, before the United States agreed in the mid-1990s to settle disputes through the WTO [World Trade Organization] dispute settlement system."

(3) *Made in China 2025*. Many policy wonks have questioned the Trump administration's recent broad, sweeping approach to tariffs on aluminum and steel. Gary Cohn, the former National Economic Council director, resigned from the administration over this issue. However, he supported stricter trade policies specifically targeted at China, a long-suspected manipulator of global trade. The USTR's investigation memo specifically calls out China's "Made in China 2025" industrial plan.

China's overriding goal for "Made in China 2025" is to become a leader in advanced-technology industries, including in defensive ones like aerospace. At the cornerstone of this initiative, the USTR contends, are the unfair "acts, policies, and practices of the Government of China directed at the transfer of U.S. and other foreign technologies and intellectual property." (See page 3 under section I.B. of the USTR's memo for the four specific types of conduct under investigation.)

(4) *Tariff on theft*. China requires US companies to establish joint ventures with Chinese partners in order to gain access to certain Chinese markets, a mechanism that naturally encourages intellectual property theft. To penalize China's "theft of American intellectual property," Trump and his trade advisers are readying actions, including tariffs, on at least \$30 billion of annual Chinese imports, [reported](#) the 3/15 *NYT*.

That equals the cost that "Chinese policies aimed at acquiring American technology impose on American companies annually," Lighthizer's office estimates. Separately, an 8/15/17 *NYT* [op-ed](#) coauthored by Dennis C. Blair and Keith Alexander, both former national intelligence directors, pinned the value of Chinese intellectual property theft at up to \$600 billion.

Section 301 requires that the US consult with external trade partners before imposing punitive measures, [according](#) to an article in the 3/2 issue of *Forbes*. Recently, the US has asked the Chinese government to propose a plan that would reduce its \$300 billion plus trade surplus with the US by \$100 billion.

(5) *WTO ineffective*. China wants the US to handle the dispute through the World Trade Organization (WTO), reports *Forbes*, which makes sense given that the WTO has been largely ineffective at enforcing actions against China's state-led regime. "The Chinese are protectionists dressed in free market clothing," US Secretary of Commerce Wilbur Ross has said.

With the creation of the WTO, it was expected that members would embrace open-market policies, strictly adhere to agreed rules, and observe in good faith the organization's fundamental principles, stated the [2017 USTR Report to Congress on China's WTO Compliance](#) dated January 2018. WTO agreements do include a dispute mechanism. But "this mechanism is not designed to address a situation in which a WTO member has opted for a state-led trade regime that prevails over market forces and pursues policies guided by mercantilism rather than global economic cooperation."

According to the report, China repeatedly has acted in conflict with its WTO obligations and has failed to embrace the WTO's ideals. "No amount of enforcement activities by other WTO members would be sufficient to remedy" such behavior.

(6) *Reforming the system*. By the way, we skimmed the Trump administration's [2018 Trade Policy Agenda and 2017 Annual Report](#), just released by the USTR. One agenda item, "reforming the multilateral trading system," doesn't seem to have been widely covered by the media yet, but caught our eye since the global trade system exists under the WTO. While the agenda is written to avoid sounding anti-WTO, it explicitly states that the US will not bend to the WTO, especially on China.

Specifically, the agenda says (our italics for emphasis): “The Trump Administration wants to help build a better multilateral trading system and will remain active in the World Trade Organization (WTO). At the same time, we recognize that the WTO has not always worked as expected. Instead of serving as a negotiating forum where countries can develop new and better rules, it has sometimes been dominated by a dispute settlement system where activist ‘judges’ try to impose their own policy preferences on Member States.

“Instead of constraining market distorting countries like China, the WTO has in some cases given them an unfair advantage over the United States and other market based economies. Instead of promoting more efficient markets, the WTO has been used by some Members as a bulwark in defense of market access barriers, dumping, subsidies, and other market distorting practices. *The United States will not allow the WTO—or any other multilateral organization—to prevent us from taking actions that are essential to the economic well-being of the American people.* At the same time, as we showed in last year’s WTO Ministerial, we remain eager to work with like-minded countries to build a global economic system that will lead to higher living standards here and around the world.”

US Trade II: The National Security Card. A 1/11 [report](#) from the Commerce Department is titled “The Effect of Imports of Steel on the National Security: An Investigation Conducted Under the Section 232 of the Trade Expansion Act of 1962, as Amended.” On the grounds of national security, Section 232 grants the President the authority to impose tariffs on US trade partners. President Trump invoked Section 232 on March 1, when he announced broad global tariffs on aluminum and steel imports to the US at 10% and 25%, respectively, [reported](#) the *Washington Post*. Many interpreted the act as a provocation of China, primarily to combat its overproduction of steel.

But the broad nature of the tariffs and the fact that China is not a major exporter of steel to the US suggest otherwise. It seems to us that the steel tariffs aren’t aimed at China. Rather, the tariff threats either are sincerely poised to address national security issues or, more likely, are simply a negotiation tactic to be used at the trade table with Canada and Europe. Consider the following with a focus on steel:

(1) *Allied threat.* How on earth can the administration justify a national security threat from trade with our Canadian and European allies? According to the report from Wilbur Ross’ Commerce Department, the regions are contributing to the crumbling of the US steel and aluminum industry. The report insists that the US government needs to have supply chains related to the production of these materials stateside.

The rationale is that in a time of war, the US will need access to these industries for purposes of defense. Maybe there are some grounds to the argument, but it falls apart when considering that Canada shares our borders and has a long-time history as a US ally. Canada would more than likely continue to supply the US with steel even in a time of global war.

(2) *Canada largest exporter to US.* By far, the biggest exporter of steel to the US is Canada, which supplied 16% of US steel imports, measured in metric tons, in 2017. By contrast, China is the 11th highest exporter, totaled only 2% of US steel imports for 2017. By the way, Germany is ahead of China as the eighth largest exporter of steel to the US. (See page 28 of the Department of Commerce’s Section 232 report on steel.)

(3) *US largest exporter to Canada.* Interestingly, the US also happens to be the [largest](#) exporter of steel to Canada, accounting for 59% of Canada’s steel imports, measured in metric tons, for 2016. Although China is the second-largest exporter of steel to Canada, China’s steel exports compose just 9% of Canada’s steel imports. That’s according to a *Global Trade Monitor* [posted](#) by the International Trade

Administration to the www.trade.gov website.

(4) *Made in China?* But is it possible that China is indirectly sourcing steel to the US through its other Asian trading partners? Yes, but if so, the numbers probably aren't significant. According to the Commerce report, the largest share of China's steel exports are indeed sent to its neighbors in Asia. "Roughly 40 percent of those 2016 steel exports went to South Korea, Vietnam, Philippines, India, and Thailand. An unknown portion of these are further processed in those countries and eventually shipped to the United States."

US imports of steel from South Korea, Vietnam, India, and Thailand totaled just under 16% of all US steel imports for 2017. (That excludes the Philippines, absent from the Commerce Department's chart because it isn't one of the top 20 steel exporters to the US.) It seems unlikely that all of it was originally sourced from China, so any throughput would probably be less than that. Canada's imports from other top Asian steel exporters besides China (and excluding Japan) totaled approximately less than 10% of Canada's steel imports.

(5) *Warning to China.* Inklings in the media suggest that US trade negotiations with Justin Trudeau, Canada's prime minister, aren't going very well for Canada. The country has gained temporary relief from the tariffs, but according to incoming White House economic adviser Larry Kudlow, Trudeau has been making concessions "hand over fist" to keep NAFTA alive, [reported](#) Bloomberg. The US is also working on fairer trade agreements with European nations. Given these factors and Trump's affinity for the "art of the deal," it isn't too farfetched to think that the steel tariffs were intended primarily as a negotiation tactic from the outset. The tariffs were probably deemed a national security issue to qualify as Section 232 appropriate. Why else would the US impose such a tariff on its allies?

The effects of the steel tariffs will likely be minimal for China based on the data noted above. But the action could still be interpreted as a warning signal to China. The timing of the announcement of the global tariffs seemed artfully planned, i.e., just *before* specifically targeting China and intellectual property theft, which arguably is a much bigger threat to national security. Is the Trump administration sending a message? If the US is not afraid of drawing a hardline when it comes to trade with its allies, what might be its stance with nations that it openly mistrusts?

US Trade III: Reagan's Gang Reunites. President Trump has selected Larry Kudlow to replace Gary Cohn as the director of the US National Economic Council. Actually, Kudlow comes as a package deal. The Wall Street commentator is a member of the Committee to Unleash Prosperity (CUP). The other three influential founders of the group are Steve Moore, Arthur Laffer, and Steve Forbes, according to the CUP's [website](#). Its mission is to "unleash an era of immense prosperity for all Americans" under the "right set of policies" that will "double" our economy's weak growth rates.

Free trade happens to be one of the core principals of the CUP. "Idyllic" is the best way to describe the Committee's [depiction](#) of free trade on its website. Will the preexisting members of the Trump trade cabinet, including Robert E. Lighthizer and Peter Navarro, butt heads with Kudlow given his CUP ideals? We think that they'll meet somewhere in the middle of free and protectionist trade. It's called "fair trade," and we are all for it if the alternative is a trade war. Consider the following:

(1) *Tough response.* Last week, Melissa and I reviewed the protectionist tendencies of Peter Navarro, the director of the White House National Trade Council. Navarro himself would probably prefer to characterize his tendencies as promoting "fair" trade rather than "protectionist." Kudlow has been painted as a pure free-trade advocate, especially based on his association with the CUP.

Kudlow recently [said](#) on CNBC's *Closing Bell*: "I must say as somebody who doesn't like tariffs, I think

China has earned a tough response not only from the United States.” So Kudlow may be more of a realist on trade than his underlying principals might suggest. He might also have caught up on his reading about China’s unfair trade practices.

(2) *Tariffs are taxes.* Even so, Kudlow co-authored an [article](#) with Laffer and Moore against Trump’s recent steel and aluminum tariffs for the 3/3 *National Review*. It stated: “Steel and aluminum may win in the short term, but steel-and-aluminum users and consumers lose. Tariffs are really tax hikes. Since so many of the things American consumers buy today are made of steel or aluminum, a 25 percent tariff on these commodities may get passed on to consumers at the cash register.” The three concluded: “In the early 1980s President Ronald Reagan invoked anti-dumping provisions against Japanese steel. It was one of the few decisions he later confessed he wished he hadn’t made. Trump will come to learn the same thing.”

Trump has intentionally surrounded himself with smart people who have diverse opinions. Navarro diplomatically made this point in a CNBC [appearance](#) on Thursday. Navarro said that he has an amicable history with Kudlow and indicated that he is looking forward to working with the new NEC director, who has been nothing but “warm.” That suggests a staunchly different relationship than Navarro had with his previous boss, Cohn, with whom he reportedly had many closed-door disagreements.

(3) *Art of the deal.* In a 3/12 [interview](#) with Fox Business, Laffer said that he was in “awe” of the President. The former Reagan adviser gushed over Trump, calling him the most successful president ever in the first four years of office. Laffer thinks the Trump tariffs on steel and aluminum are a negotiation tactic, particularly with NAFTA and Europe. Laffer said that these tariffs are Trump’s “ace in the hole” to make trade a fairer playing field for the US. Laffer is a self-proclaimed advocate of free trade, but doesn’t mind seeing tariff threats used at the negotiating table.

(4) *Getting things done.* Upon the release of Trump’s 2018 Trade Policy Agenda, the President already can check off several of his trade agenda items. Can you just hear him saying to himself, “Section 301 China investigation, check; Section 232 steel and aluminum tariffs, check; solar panel and washing machine tariffs, check”?

It’s doubtful that Trump will allow anyone to slow down his agenda. Jim Cramer told CNBC last Thursday, appearing on the same *Closing Bell* segment linked above, that there is “no distance” between Trump and Kudlow on China trade. Cramer also indicated that Kudlow might have less of an influence on Trump’s trade policies and more of an influence on a possible phase two of tax reform. Either way, Kudlow’s newfound influence is more likely to be bullish for markets than not.

CALENDARS

US. **Mon:** Bostic. **Tues:** FOMC Meeting Begins. (*Wall Street Journal* estimates)

Global. **Mon:** Eurozone Trade Balance €22.3b. **Tues:** Eurozone ZEW Economic Sentiment Survey, Eurozone Consumer Confidence 0, Germany ZEW Survey Expectations 13, UK Headline & Core CPI 2.8%/2.5% y/y, Japan Leading & Coincident Indexes, RBA March Meeting Minutes. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance ([link](#)): The US MSCI index fell 1.2% last week, ranking 34th out of the 49 markets in a week when 17 countries rose in US dollar terms and the AC World ex-US index rose 0.2%. That compares to a 3.6% surge a week earlier, which ranked 11th as 38 markets rose and

the AC World ex-US index gained 1.9%. Most regions fell w/w last week, but EM Asia gained 1.8%, beating BRIC's advance (0.5). The underperforming regions were EM Latin America (-2.9), EM Eastern Europe (-2.6), EMEA (-1.8), EMU (-0.3), and EAFE (0.1). Taiwan was the best-performing country as it rose 2.4%, followed by China (2.3), Korea (2.1), Japan (2.1), Thailand (2.0), and Portugal (2.0). Of the 33 countries that underperformed the AC World ex-US MSCI last week, South Africa fared the worst, falling 4.4%, followed by Poland (-3.7), Greece (-3.5), and Brazil (-3.2). On a ytd basis, the US MSCI fell w/w to a 3.1% gain from 4.4%, and dropped in the performance ranking to 23/33 from 19/33. The US MSCI continues to lead the AC World ex-US (1.5) in the ytd period, however. Most regions and 33/49 countries are in positive territory ytd. EM Latin America has risen 7.4% ytd and leads BRIC (6.9), EM Eastern Europe (5.4), EM Asia (4.9), EMEA (3.0), and EMU (1.2). EAFE (-0.4) is the only laggard relative to the AC World ex-US's performance.

S&P 1500/500/400/600 Performance ([link](#)): All three market-cap indexes fell last week as SmallCap performed best with a drop of just 0.1%, ahead of the decreases for MidCap (-0.7%) and LargeCap (-1.2). LargeCap is now down 4.2% from its record high on January 26, worse than the declines of MidCap (-3.0) and SmallCap (-1.0) since then. Just nine sectors rose in the latest week, down from all 33 rising in the prior week. The biggest gains in the latest week were recorded by SmallCap Utilities (3.5), MidCap Utilities (2.6), LargeCap Utilities (2.6), LargeCap Real Estate (1.3), and MidCap Real Estate (1.1). The biggest underperformers for the week: LargeCap Materials (-3.2), LargeCap Financials (-2.4), LargeCap Consumer Staples (-2.1), MidCap Materials (-2.1), and SmallCap Telecom (-2.1). Despite the recent and short-lived correction, LargeCap is still up 2.9% so far in 2018. That's behind the gain for SmallCap (3.5) and ahead of MidCap (1.8). Sixteen sectors are positive to date in 2018, up from just three in early February. The best-performing sectors ytd: SmallCap Health Care (16.4), LargeCap Tech (10.1), MidCap Tech (9.1), MidCap Health Care (8.4), and SmallCap Tech (7.2). The worst performers ytd: SmallCap Real Estate (-10.9), MidCap Energy (-8.5), SmallCap Utilities (-7.1), LargeCap Energy (-6.7), and LargeCap Consumer Staples (-6.6).

S&P 500 Sectors and Industries Performance ([link](#)): Just two sectors rose last week as seven outperformed the S&P 500's 1.2% decline. That compares to all 11 rising a week earlier, when five outperformed the S&P 500's 3.5% rise. Utilities was the best-performing sector with a gain of 2.6%, ahead of Real Estate (1.3%), Telecom (-0.7), Consumer Discretionary (-0.7), Energy (-0.8), Health Care (-0.9), and Tech (-1.0). Materials (-3.2) was the biggest underperformer, followed by Financials (-2.4), Consumer Staples (-2.1), and Industrials (-2.0). Five sectors are in the plus column so far in 2018, down from nine a week ago and up from just one a month earlier. These four sectors are ahead of the S&P 500's 2.9% ytd gain: Tech (10.1), Consumer Discretionary (6.7), Financials (3.5), and Health Care (3.5). The seven sectors that are underperforming the S&P 500 ytd: Energy (-6.7), Consumer Staples (-6.6), Telecom (-6.1), Real Estate (-5.1), Utilities (-4.5), Materials (-2.1), and Industrials (1.1).

Commodities Performance ([link](#)): The commodities markets lost some steam last week: Nine of the 24 commodities we follow moved higher for the week as the S&P GSCI commodities index edged up 0.1%. That compares to a 0.6% gain in the prior week, when 14/24 commodities rose. Last week's strongest performers: Lean Hogs (7.3%), Unleaded Gasoline (2.3), Cocoa (2.3), Heating Oil (1.5), Brent Crude (1.1), and Soybeans (1.0). Last week's biggest decliners: Live Cattle (-5.2), Wheat (-4.4), Kansas Wheat (-4.0), and Feeder Cattle (-2.2). The S&P GSCI commodities index is now up 0.5% ytd, but that's down from its peak 4.7% ytd gain on January 26. The best performers so far in 2018: Cocoa (33.3), Kansas Wheat (16.9), Lean Hogs (10.2), Wheat (9.5), Soybeans (9.1), and Corn (9.1). The biggest laggards of 2018 to date: Sugar (-16.6), Aluminum (-8.3), Live Cattle (-8.1), Natural Gas (-8.0), and Heating Oil (-7.3).

Assets Sorted by Spread w/ 200-dmas ([link](#)): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 8/24 commodities, 4/9 global stock indexes, and 8/33 US stock indexes,

compared to 13/24 commodities, 7/9 global stock indexes, and 33/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to 5.1% from 6.0%. Sixteen commodities trade above their 200-dmas, down from 17 a week earlier. Cocoa leads all commodities and all assets at 24.7% above its 200-dma, but Lean Hogs (14.6%) rose 7.9ppts w/w for the best performance of all commodities and all assets. Sugar trades at 10.0% below its 200-dma, the lowest of all commodities and indeed all assets. Kansas Wheat (8.8) and Wheat (3.0) each fell 5.0ppts w/w for the worst performance among all commodities and all assets. The global indexes trade at an average of 2.7% above their 200-dmas, down from 3.3% in the prior week. Seven of the nine global indexes trade above their 200-dmas, up from six a week earlier. Brazil (14.5) still leads the global indexes, but dropped 2.9ppts w/w for the worst performance among global indexes. South Korea (2.2) rose 1.3ppts w/w for the best performance among global indexes. The UK (-3.6) trades the lowest among global assets. The US indexes trade at an average of 3.4% above their 200-dmas, with 21 of the 33 sectors above, down from 4.2% a week earlier, when 23 sectors were above. SmallCap Health Care (20.5) still leads all US stock indexes relative to their 200 dmas, followed by LargeCap Tech (13.9). SmallCap Utilities (-4.9) rose 3.3ppts for the best performance among US stock indexes. SmallCap Real Estate (-9.5) trades the lowest among all assets, but LargeCap Materials (2.2) fell 3.7ppts w/w for the worst performance among US stock indexes.

S&P 500 Technical Indicators ([link](#)): The S&P 500 price index weakened relative to its short-term 50-dma and long-term 200-dma trend lines last week. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 98th straight week (after 17 weeks in a Death Cross), yet the index's 50-day moving average (50-dma) relative to its 200-dma dropped for a sixth week to an eight-week low of 6.3% from 6.5%, and is down from a 55-month high of 7.2% in early February. This Golden Cross reading compares to a four-year low of -4.5% in March 2016. The S&P 500's 50-dma rose w/w for a fourth week after falling in early February for the first time since mid-August. The 200-dma continued to rise, as it has done since May 2016. The index dropped to 0.1% above its rising 50-dma from 1.5% above a week earlier, which compares to a two-year low of 3.8% below its falling 50-dma in early February and a two-year high of 6.2% on January 29. The S&P 500 fell to 6.4% above its rising 200-dma from 8.1%, which is up from 2.9% in early February (the lowest since the election). However, it's still down from a seven-year high of 13.5% on January 29. That compares to a prior post-election low of 3.0% in mid-August and a four-year low of -10.1% in August 2015.

S&P 500 Sectors Technical Indicators ([link](#)): Last week saw most sectors weaken relative to their 50-dmas and 200-dmas. At the week's end, four sectors traded above their 50-dma, down from five a week earlier. Real Estate and Utilities turned positive w/w, but these three turned negative: Financials, Health Care, and Industrials. Utilities was above its 50-dma for the first time in 14 weeks, and Real Estate was above for the first time in 13 weeks. The longer-term picture—i.e., relative to 200-dmas—shows six sectors trading above, down from eight a week earlier, as Energy and Telecom reversed course again and turned negative w/w. Consumer Staples was below for a fourth week, Real Estate below for an 11th week, and Utilities below for a 13th week. All 11 sectors had been above both their 50-dmas and 200-dmas briefly in mid-December for the first time since July 2016. Nine sectors are in a Golden Cross (50-dmas higher than 200-dmas), unchanged from a week earlier. All 11 had been in a Golden Cross in mid-January for the first time since a 26-week streak ended in October 2016. Real Estate was out of the Golden Cross club last week for a sixth week and the first time since last April, and Utilities was out for an eighth week and for the first time since last March. Only four sectors have rising 50-dmas, down from six a week earlier, as Industrials and Materials turned lower w/w. The low number of sectors with a rising 50-dma matches early February's reading, which was the lowest since February 2017. Real Estate fell for the 11th time in 13 weeks, and Utilities moved lower for a ninth straight week. Other sectors with a falling 50-dma include Consumer Staples, Energy, and Telecom. Seven sectors have rising 200-dmas, unchanged from a week earlier. That's also up from six in early February, which was the lowest since May 2017. The 200-dmas for Real Estate and Utilities fell for a

tenth week, and Consumer Staples and Telecom dropped for a fourth week.

US ECONOMIC INDICATORS

Industrial Production ([link](#)): US factories were humming last month, with factory output jumping to a new cyclical high. Headline production rebounded 1.1% in February, its fifth gain in six months, for a total jump of 3.4%, to a new record high—with manufacturing output up 1.2% and 2.8% over the comparable periods. Over the six-month period, consumer goods production accelerated 2.0% to a new cyclical high as consumer durable and nondurable goods production expanded 5.2% and 1.2%, respectively. Production of business equipment reached a new cyclical high, jumping 1.0% in February and 3.2% over the past six months—with information processing (1.3% and 3.6%, respectively), industrial (0.4, 3.5), and transit (1.9, 2.4) equipment output all expanding solidly. Information processing output made a new record high. Also boosting headline output last month was a 4.3% advance in mining—on an 11.6% jump in oil & gas well drilling—and a weather-related 2.3% increase in construction output. Utilities was the one outlier, dropping 4.7%, as warmer-than-expected weather cut usage.

Capacity Utilization ([link](#)): The headline capacity utilization rate in February jumped from 77.4% to 78.1%—the highest reading since January 2015. Still, it's 1.7ppts below its long-run (1972-2017) average, but closing the gap. Manufacturing's capacity utilization rate rebounded from 76.0% to 76.9%, its highest reading since April 2008, 1.4ppts below its long-run average. The operating rate for mines rebounded to a three-year high of 87.6%, after sliding from 86.2% to 84.3% in January, to within 0.6ppt of its long-run average. Meanwhile, the rate for utilities sank 3.9ppts to a five-month low of 76.9% as warmer-than-normal temperatures reduced demand for heating.

Regional M-PMIs ([link](#)): Two Fed districts have reported on manufacturing activity for March—New York and Philadelphia—and they show growth in the sector remains vibrant. We average the composite, orders, and employment measures as data become available. The composite index accelerated (to 22.4 from 19.5) this month, not too far from its recent high of 28.5 in October—which was the highest reading since July 2004. The New York (22.5 from 13.1) region showed faster growth, while Philadelphia's (22.3 from 25.8) showed an easing in growth, though it was still robust. The new orders gauge (26.3 from 19.0) improved markedly, driven by an acceleration in orders in both the Philly (35.7 from 24.5) and New York (16.8 from 13.5) regions, with the former recording its fastest rate in a year. The employment measure (17.5 from 18.1) was little changed; manufacturers in both the Philadelphia (25.6 from 25.2) and New York (9.4 from 10.9) regions added to their payrolls at about the same pace as last month, though Philadelphia's manufacturers are hiring at a considerably faster rate than New York's.

Consumer Sentiment Index ([link](#)): A record-high reading in the University of Michigan's present situation component in mid-March pushed the overall Consumer Sentiment Index (CSI) to its highest reading since January 2004. The CSI rose for the second month, from 95.7 in January to 102.0 this month. All of this month's increase was driven by households with incomes in the bottom third (+15.7) of the distribution, while the top third (-7.3) posted a significant decline. The present situation component climbed from 114.9 in February to 122.8 this month—the highest reading in the history of the series going back to the 1950s. The expectations component of the CSI eased from 90.0 to 88.6, fluctuating around recent highs. The University of Michigan reported the one-year expected inflation rate jumped to a three-year high of 2.9% this month, while interest rates were expected to increase by the largest proportion since 2004. The survey also noted, "Favorable mentions of the tax reform legislation were offset by unfavorable references to the tariffs on steel and aluminum—each was spontaneously cited by one-in-five consumers."

Housing Starts & Building Permits ([link](#)): Housing starts cooled in February from January's blistering pace, on a drop in multi-family starts. Overall housing starts slumped 7.0% to 1.236 mu (saar), following an upwardly revised 10.0% surge in January, as volatile multi-family starts tumbled 26.1%, to 334,000 units (saar), after a 25.6% spurt in January. Meanwhile, builders broke ground on more single-family homes for the second month, rising 6.5% during the two months through February to 902,000 units (saar); it was the fourth gain in five months, for a total advance of 8.4%. Building permits sank 5.7% to 1.298mu (saar) after jumping 5.9% in January to its highest level since June 2007. Multi-family permits plunged 14.8% to 426,000 units (saar) after rebounding 19.3% in January. Single-family permits fell fractionally for the second month, down 1.0% over the two-month period, to 872,000 units (saar), after soaring 13.1% the prior seven months to 881,000 units—which was the highest level since August 2007. Meanwhile, March builder confidence remained on solid footing, though eased for the third month. The NAHB Housing Market Index declined from an 18-year high of 74 in December to 70 in March, as builders remained hampered by a shortage of buildable lots. Of the three components: 1) the measure for current sales conditions remained at 77, just below December's cyclical high of 80; 2) sales expectations over the next six months ticked down 2 points to 78, after reaching a post-recession high of 80 in February; and 3) the index measuring buyer traffic dropped to 51 from 54 the prior two months.

Import Prices ([link](#)): Import prices in February accelerated 3.5% y/y, trending higher since reaching a recent low of 1.2% last July. The rate was at a five-year high of 4.7% during February 2017. Prices for nonpetroleum products advanced 2.1% in the 12 months through February, which is the fastest pace since January 2012; the yearly rate had turned positive in December 2016 (0.3% y/y) for the first time since November 2014. The yearly rate for petroleum prices was in double digits for the fourth month at 18.3% y/y, slowing from 26.8% in November; it was at a recent low of 3.2% last June. February's rate is considerably below February 2017's seven-year high of 74.1%. Monthly data show total import prices increased for the seventh straight month, up 0.4% m/m and 3.9% over the period; nonpetroleum import prices rose at an 18-month high of 0.5% for the second consecutive month, after showing no gain the last three months of 2017.

GLOBAL ECONOMIC INDICATORS

European Car Sales ([link](#)): In February, EU passenger car registrations (a proxy for sales) rose 4.3% y/y totaling 1.125mu; in volume terms, it was the best February result since 2008. Three of the five largest markets performed well, led by Spain (13.0% y/y), which continued its double-digit pace, followed by Germany (7.4) and France (4.3). Car sales in the UK (-2.8) fell for the 11th straight month, while Italy's (-1.4) growth has been fluctuating around zero in recent months. Car sales during the first two months of 2018 were 5.8% above the comparable 2017 period, continuing to grow in Spain (16.4), Germany (9.5), and France (3.4), while momentum began to slow in certain markets, especially the UK (-5.1).

Eurozone CPI ([link](#)): February's CPI slowed to a 14-month low of 1.1% y/y (below the flash estimate of 1.2%), slowing steadily from November's 1.5%. February's rate remained considerably below the ECB's goal of just under 2.0%. Looking at the main components, rates for energy (to 2.1% from 2.2% y/y) and food, alcohol, and tobacco (1.0 from 1.9) once again slowed. Meanwhile, the rate for non-energy industrial goods (0.6) was unchanged at its highest rate since February 2016, while services inflation ticked up to 1.3% from 1.2% the prior four months. The core rate—which excludes energy, food, alcohol, and tobacco—remained at 1.0%. Of the top four Eurozone economies, inflation rates in France (1.3% y/y), Germany (1.2), and Spain (1.2) were above the Eurozone's 1.1%, while Italy's (0.5) was below. Along with Italy, Ireland (0.7) and Portugal (0.7) had among the region's lowest rates.

Contact us by [email](#) or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor & Webmaster, 570-775-6823

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