MORNING BRIEFING
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Trade Talk

See the collection of the individual charts linked below.

(1) China's IDAR approach is major source of trade tensions. (2) Protectionism is mostly talk for now. (3) China and US have plenty of time to negotiate trade deal. (4) Keeping a timeline on trade developments. (5) China offering some concessions already, but they don't add up to much. (6) Often it helps to have a Chinese partner in China. (7) Mexico's production stalls at record high awaiting NAFTA outcome and mounting political risk from a leftist presidential candidate called "AMLO." (8) Other than NAFTA talks, Canadians face challenges, with an inflated housing market and uncertainty about commodity prices and currency value. (9) Movie review: "A Quiet Place" (- -).

Trade I: US-China Negotiations Underway. Lots of new developments have occurred since the US released its Section 301 report on China's unfair trade practices on March 22. Melissa and I covered the 215-page report in detail in our 3/26, 3/27, 3/29, and 4/5 *Morning Briefings*. Previously, we discussed China's overt strategic plans for global technology dominance through its IDAR approach: introduce, digest, assimilate, and re-innovate.

The US Trade Representative (USTR) paints the IDAR approach as a means for China to steal intellectual property from abroad, asserting that the Chinese government does so by crafting unfair policies. These policies, the USTR argues, create an uneven playing field for foreign entities, which must choose to comply or forgo access to one of the largest markets in the world.

Keeping track of who-said-what-from-where following the release of the USTR's report is enough to make your head spin. For now, the most important thing to keep in mind is that the latest developments are mostly talk. While both the US and China has threatened significant tariffs on goods imported from the other, neither has taken significant action at this point. The questions are when and where—in terms of tariff levels—will the trade dispute end?

Still, there is plenty of time for negotiation. The US has 180 days following the comment period on the Section 301 report to decide whether it will follow through on the actions proposed. Even if the US or China proceeds with announced retaliatory measures, the measures may not make much of a dent in either economy. In any event, investors need to keep track of what's been said to assess what might be done in the future. I asked Melissa to keep a timeline of the developments since the release of the USTR's 3/22 report. Here is the latest:

(1) *Tit-for-tat*. On April 5, President Trump warned that he might impose $100 billion in tariffs on imports to the US from China. That was incremental to the targeted 25% levies across 1,300 categories of Chinese goods amounting to $50 billion announced on April 3, reported the 4/3 *WSJ*. In response, China proposed incremental 25% retaliatory duties on up to $50 billion of US goods, including aircraft and soybeans. So far, none of these proposals have been implemented.

Last month, the US imposed a 25% tariff on worldwide imports of steel and a 10% tariff on imported aluminum. Some nations have negotiated temporary exemptions from the aluminum and steel tariffs, but not China. That action has been put into place. In response, on April 1, China announced new tariffs of up to 25% on $3 billion worth of over 128 kinds of US agricultural goods, effective April 2.

(2) *Fender-bender*. Neither of those tit-for-tat measures initially implemented is expected to make a real dent in either economy, assuming that the tariff spat will be solved amicably, as we expect. For comparison to the $3 billion in Chinese tariffs on agricultural goods, the US exported $140.5 billion of agricultural goods last year, according to the US Department of Agriculture. The US annually sends $14 billion worth of soybeans to China alone.

For a sense of scope on aluminum and steel, only about 2% of US steel exports are sourced from China. More broadly, in 2017 the US ran a $375 billion trade deficit with China, which the President aims to reduce by $100 billion.

For perspective on the GDP impacts of the total potential tariffs imposed, Mike Bell, a global market strategist at JPMorgan Asset Management, figures that "25% of $150 billion is about $37.5 billion. That seems like a large number, but when you put it in perspective, it's about 0.3% of Chinese GDP. That same $37.5 billion is about 0.2% of US GDP," reported Business Insider.

Another estimate for the impact on China's economy was reported by Bloomberg: "A simulation by Oxford Economics suggests a 25 percent U.S. tariff on $60 billion worth of Chinese exports, with comparable retaliation, would reduce China's growth by about 0.1 percentage point this year and a little less next year, chief Asia economist Louis Kuijs in Hong Kong said in a recent note."

(3) *Deal in the making.* As noted above, most of the proposed US-China tariffs have yet to be enacted. On May 15, the USTR will hold a public hearing on the tariffs proposed against China. After that, according to the *WSJ*, the US has at least 180 days to further contemplate the decision, leaving lots of time for negotiations. On April 6, Larry Kudlow, director of the National Economic Council, confirmed that the US and China were involved in "back channel" negotiations on trade.

On April 21, US Treasury Secretary Steven Mnuchin told reporters at the International Monetary Fund's spring meeting that a trip to China is "under consideration." He's involved in a "dialogue" with the Chinese government over the trade dispute, he said, adding, "We're cautiously optimistic to see if we can try to reach an agreement." On April 24, President Trump told reporters: "China's very serious, and we're very serious." The President added: "We've got a very good chance at making a deal."

Up for discussion, according to the 4/3 *WSJ*, are changes to the existing Chinese 25% tariffs on imported cars, as we discuss below. Also under negotiation is an easing of regulations pertaining to foreign investors in Chinese financial markets, which would create more open Chinese financial markets. Further, the *WSJ* listed, China will consider buying semiconductors from the US rather than other countries.

Trade II: Dog & Pony Show? So far, there seems to have been at least one substantial outcome of the US-China trade spat: China's concession to US policymakers to lift ownership rules that limit foreign investment in Chinese carmakers. Is it a YUGE deal? Or just a dog-and-pony show? It may turn out to be the latter. After all, 2018 is the Chinese Year of the Dog. Consider the following:

(1) *Concession stand*. On April 17, the Chinese government promised to end foreign ownership caps on electric vehicle, shipping, and aircraft manufacturing, reported the *FT*. Specifically, ownership restrictions currently require 50-50 joint ventures with a Chinese partner in order to manufacture autos on Chinese soil without facing the 25% tariff. That restriction would be eliminated by 2020 for

commercial vehicles and for all vehicles by 2022. The rules were originally enacted in the 1990s to help Chinese carmakers to "learn from" (or, depending on your perspective, steal intellectual property from) foreign market leaders.

However, the concession was accompanied by a 178% duty placed on US sorghum crops, a grain used to feed livestock. During 2014, China started buying larger amounts of US sorghum after "inflated grain prices set by Beijing made US imports relatively cheaper." Last year, China imported almost $1.0 billion of US sorghum. The USTR is reportedly considering taking the sorghum tariffs up with the World Trade Organization.

(2) *Symbolic victory*. Robert Zoellick, chairman of AllianceBernstein, told the *WSJ* that even if China were to lower car import tariffs from 25% to closer to the US's 2.5%, the US victory would be only a symbolic one, because it most likely would help only German car makers that export to China from their plants in the US. That is "because the U.S. producers are Ford and GM, and they've got their plants in China, so what difference is it going to make? It would make a difference for BMW, and BMW in South Carolina exporting and so on and so forth," he said.

(3) *Complex gift*. A 4/17 *WSJ* article said it would be costly and complicated for foreign car makers to extricate themselves from any pre-existing Chinese partnerships. "Reaching an agreement on the venture's valuation would likely be one obstacle. And foreign car companies might not be able to afford to buy out their Chinese partners, said Janet Lewis, Macquarie Capital Research's managing director of equity research."

A person familiar with GM's strategy said the prospect of reaping 100% of the profits may be enticing, "but you'd also get 100% of the cost and complexity." Partnerships help, according to this person, in terms of "working with regulators, developing a manufacturing footprint and managing supply chains and retail networks."

(4) *Good for China*. Michael Laske, president of Austrian powertrain supplier AVL GmbH's China operations, told the *WSJ* that the move would be most beneficial for China: "Lifting limits on electric-car makers by the end of this year would encourage foreign investments from Tesla and others, helping China become the world's factory for electric vehicles."

Laske further observed that China wouldn't have lifted the ownership restrictions unless "they felt they were ready to compete." That jibes with what we've previously written about China's foreign investment catalogue, i.e., the Chinese government lifts investment restrictions on domestic industries when it benefits China to do so.

Mexico: Arriba! Arriba! Last Thursday, Sandy Ward, our contributing editor, and I noted that unlike trade negotiations with China, there is a need for haste in concluding NAFTA talks. Today, let's briefly review a few of the key economic and financial indicators first for Mexico, and then Canada:

(1) *Stock prices.* The MSCI Mexico Share Price Index has rallied 5.0% (local currency) in April through Friday on hopes that a NAFTA agreement will emerge (*Fig. 1*). That compares with a gain of 5.2% for the EM Latin America Share Price Index and 1.1% for the S&P 500 month-to-date. The year-to-date picture is quite the opposite, with the MSCI Mexico Share Price Index off 1.4% and the EM Latin America Share Price Index up 7.7%. The S&P 500 fell 0.1% through Friday ytd.

(2) *Interest rates.* Banxico, Mexico's central bank, left rates unchanged at 7.50% when its governing board met on April 12, citing tamer inflation, according to a 4/12 Reuters piece. The bank also noted that the probability of the NAFTA talks foundering "have reduced recently." The move to keep rates

steady followed two consecutive hikes previously. The CPI inflation rate fell from a recent peak of 6.8% during December to 5.0% in March (*Fig. 2* and *Fig. 3*).

(3) *Manufacturing.* Mexico's industrial production index is up only 0.7% y/y through February, having stalled at a record high over the past year (*Fig. 4*). The seasonally adjusted IHS Markit Manufacturing PMI rose to 52.4 in March from 51.6 the previous month, as new order growth hit a four-month high and demand strengthened domestically and abroad (*Fig. 5*).

(4) *Valuation.* With a forward P/E of 16.2 and long-term consensus earnings growth expectations of 15.6%, Mexico's stock market continues to look attractive (*Fig. 6*).

(5) *Political risks*. An investment in Mexico, however, comes with some political risk, as we discussed last week. The frontrunner heading into Mexico's July 1 presidential election, Andres Manuel Lopez Obrador (commonly referred to as "AMLO"), is a fiery leftist populist candidate running on an anti-corruption and anti-establishment platform. He has advocated for suspending NAFTA talks until after the election and has said he would renegotiate any deal that is seen as hurting Mexico's interests. He has been critical of energy reforms that have opened up the sector to private and foreign investment.

Just this past week, the *WSJ* reported in a 4/27 article that AMLO vowed to cancel the $13.3 billion new airport project mid-construction, alarming business interests. About 70% of the contracts associated with the project have been awarded, and private investors, nearly half from the US, have bought $6 billion in bonds. Mexico's taxpayers are on the hook for $1.2 billion so far, and billionaire Carlos Slim is an investor.

Even if negotiators succeed in agreeing to a new NAFTA deal in a timely fashion, an AMLO victory could cast a cloud over Mexico's economic outlook.

Canada Isn't All About NAFTA. Trade with the US is obviously very important to the Canadian economy. So is the domestic housing market, which has been in a multi-year bull market. More volatile, but also important for Canada's economy, are commodity prices. Consider the following:

(1) *Stock prices*. The MSCI Canada Share Price Index is down 3.2% ytd through Friday, and up 2.0% mtd (*Fig. 7*). While uncertainties about the outcome of NAFTA negotiations have weighed on shares, broader issues such as inflation pressures and the impact of rising rates on debt-burdened consumers are concerns.

(2) *Interest rates.* The Bank of Canada (BoC) left overnight rates unchanged at 1.25% when it met April 18, given weaker-than-expected growth and a continued cooldown in the housing sector. The BoC suggested, however, that future rate hikes were likely as a means to control inflation (*Fig. 8* and *Fig. 9*).

(3) *Earnings.* Consensus forward revenues and earnings for Canada's MSCI stock price index have been rising since early 2016 (*Fig. 10* and *Fig. 11*). Its forward P/E dropped from 15.9 at the start of the year to 14.1 in mid-April (*Fig. 12*). Earnings are projected to increase 10.1% this year and 10.0% next year. If the uptrend in commodity prices continues, then lots of Canadian commodity producers would benefit. However, rising commodity prices would also boost the foreign exchange value of the Canadian dollar (*Fig. 13* and *Fig. 14*).

A quick and successful end to the latest round of NAFTA negotiations would certainly be beneficial for both Canada and Mexico. However, they both face homegrown challenges.

Movie. "A Quiet Place" (- -) (*link*) is a very odd film combining aspects of a sci-fi thriller and a horror movie. It is neither thrilling nor horrifying. Aliens invade our planet and devour any human that makes a noise. They have a great sense of hearing, but are blind as bats. It would be great if every movie theater had one of these aliens to terminate anyone talking during the movie.

CALENDARS

US. Mon: Personal Income & Outlays 0.4%/0.4%, Headline & Core PCED 2.0%/2.0% y/y, Pending Home Sales 1.0%, Dallas Fed General Activity Index 18.0, Chicago PMI 57.8. **Tues:** Total & Domestic Motor Vehicle Sales 17.2mu/13.0mu, Construction Spending 0.5%, ISM & IHS Markit M-PMIs 58.7/56.5, FOMC Begins. (*Wall Street Journal* estimates)

Global. Mon: Germany CPI -0.1%m/m/1.5%y/y, Germany Retail Sales 0.8%m/m/1.2%y/y, China M-PMI & NM-PMI 51.3/54.5. **Tues:** UK M-PMI 54.8, Canada GDP 0.3%m/m, Canada M-PMI, RBA Cash Rate Target 1.50%, Poloz. (DailyFX estimates)

STRATEGY INDICATORS

Global Stock Markets Performance (*link*): The US MSCI index edge down 0.1% last week, ranking 17th out of the 49 markets in a week when 15 countries rose in US dollar terms and the AC World ex-US index dropped 0.5%. That compares to the index's 0.6% gain a week earlier, which ranked 19th as 30 markets rose and the AC World ex-US index gained 0.3%. EM Eastern Europe performed the best last week with a gain of 0.4%, ahead of BRIC (-0.2%), EMEA (-0.2), and EAFE (-0.4). The underperforming regions were EM Asia (-1.0), EMU (-0.9), and EM Latin America (-0.6). Jordan was the best-performing country as it surged 7.2%, followed by Egypt (4.2), Russia (2.2), and Finland (1.1). Of the 26 countries that underperformed the AC World ex-US MSCI last week, Indonesia fared the worst as it fell 8.0%, followed by Argentina (-4.1), South Africa (-3.4), Poland (-3.2), and Taiwan (-2.7). On a ytd basis, the US MSCI edged down w/w to a flat performance from a 0.1% gain a week ago, but improved in the performance ranking to 27/49 from 29/49. The US MSCI is now ahead of the AC World ex-US (-0.7) in the ytd period. Most of the regions and 22/49 countries are in negative territory ytd. EM Latin America has risen 6.5% ytd and leads EMU (1.6), BRIC (0.8), EM Eastern Europe (-0.3), EAFE (-0.4), and EM Asia (-0.5). EMEA (-1.9) is the only laggard relative to the AC World ex-US's performance. The best country performers ytd: Colombia (14.8), Peru (13.0), Egypt (12.8), Italy (10.6), and Finland (10.5). The worst-performing countries ytd: the Philippines (-14.4), Turkey (-14.0), Indonesia (-13.2), Argentina (-12.2), and Poland (-7.0).

S&P 1500/500/400/600 Performance (*link*): All three market-cap indexes failed to rise last week as LargeCap performed best with a flat performance, ahead of MidCap (-0.4%) and SmallCap (-0.6). LargeCap is now down 7.1% from its record high on January 26, steeper than the declines of MidCap (-5.2) and SmallCap (-2.4) since then. Eighteen of the 33 sectors rose in the latest week, down from 22 rising a week earlier. The best performers in the latest week: MidCap Utilities (3.8), SmallCap Energy (3.1), MidCap Real Estate (3.0), LargeCap Utilities (2.8), LargeCap Real Estate (2.6), and SmallCap Utilities (2.2). The biggest underperformers for the week: MidCap Industrials (-3.5), SmallCap Materials (-3.2), LargeCap Industrials (-3.1), and SmallCap Tech (-3.1). Fifteen sectors are now positive to date in 2018, up from just three in early February. The best-performing sectors ytd: SmallCap Health Care (17.2), MidCap Health Care (8.0), LargeCap Consumer Discretionary (5.5), SmallCap Energy (5.3), and MidCap Energy (4.5). The worst performers ytd: SmallCap Real Estate (-11.5), LargeCap Consumer Staples (-11.4), LargeCap Telecom (-8.3), LargeCap Real Estate (-6.2), and MidCap Real Estate (-5.7).

S&P 500 Sectors and Industries Performance (*link*): Seven sectors rose last week as seven outperformed the S&P 500's flat performance. That compares to seven rising a week earlier, when six outperformed the S&P 500's 0.5% gain. Utilities was the best-performing sector with a 2.8% gain, ahead of Real Estate (2.6%), Health Care (1.8), Telecom (1.5), Consumer Discretionary (1.1), Energy (0.6), and Consumer Staples (0.5). Industrials was the biggest underperformer with a drop of 3.1%, followed by Materials (-2.1), Financials (-0.7), and Tech (-0.6). Four sectors are in the plus column so far in 2018, up from three a week earlier and down from nine in early March. These four sectors are ahead of the S&P 500's 0.1% ytd decline: Consumer Discretionary (5.5), Tech (3.8), Energy (2.1), and Health Care (1.1). The seven ytd underperformers: Consumer Staples (-11.4), Telecom (-8.3), Real Estate (-6.2), Materials (-4.6), Industrials (-3.5), Utilities (-2.0), and Financials (-0.9).

Commodities Performance (*link*): The S&P GSCI index fell 0.1% w/w as 12 of the 24 commodities we follow moved higher. That compares to a 1.2% gain in the prior week when 15/24 commodities rose. Last week's strongest performers: Kansas Wheat (5.7%), Wheat (4.5), Coffee (4.0), Cocoa (3.7), and Corn (3.4). Last week's biggest decliners: Aluminum (-10.3), Nickel (-6.4), Lean Hogs (-6.4), Silver (-4.2), and Zinc (-3.5). The S&P GSCI commodities index is up 6.9% ytd and near its highest level since December 2014. The best performers so far in 2018: Cocoa (49.6), Kansas Wheat (24.2), Unleaded Gasoline (18.5), Wheat (16.7), and Corn (13.6). The biggest laggards of 2018 to date: Sugar (-24.0), Live Cattle (-12.0), Copper (-6.2), Natural Gas (-6.2), and Zinc (-6.1).

Assets Sorted by Spread w/ 200-dmas (*link*): Spreads between prices and 200-day moving averages (200-dmas) rose last week for 12/24 commodities, 6/9 global stock indexes, and 18/33 US stock indexes, compared to 14/24 commodities, 8/9 global stock indexes, and 21/33 US stock indexes rising a week earlier. Commodities' average spread fell w/w to 6.6% from 7.3%. Sixteen commodities trade above their 200-dmas, down from 18 a week earlier. Cocoa leads all commodities and all assets at 33.1% above its 200-dma, but Kansas Wheat (16.1%) rose 6.1ppts w/w for the best performance of all commodities and all assets. Sugar trades at 16.7% below its 200-dma, the lowest of all assets. Aluminum (4.7) tumbled 12.5ppts w/w for the worst performances among all commodities. The global indexes trade at an average of 1.6% above their 200-dmas, down from 1.8% in the prior week. Six of the nine global indexes trade above their 200-dmas, up from five a week earlier. Brazil (11.6) still leads the global indexes, but the UK (1.5) rose 1.8ppts w/w for the best performance among the global indexes. China (-5.2) trades at the lowest among global assets, but Indonesia (-3.7) tumbled 6.9ppts w/w for the worst performance among global assets. The US indexes trade at an average of 2.2% above their 200-dmas, with 21 of the 33 sectors above, unchanged from 2.2% a week earlier, when 22 sectors were above. SmallCap Health Care (16.5) still leads all US stock indexes relative to their 200 dmas, but MidCap Utilities (1.6) rose 3.6ppts for the biggest gain among US stock indexes last week. SmallCap Real Estate (-8.4) trades the lowest among all US stock indexes, but MidCap Industrials (-0.5) fell 3.8ppts for the worst performance among US stock indexes and all assets.

S&P 500 Technical Indicators (*link*): The S&P 500 price index was unchanged last week and improved relative to its short-term 50-dma trend line, but weakened relative to its long-term 200-dma. The index remained in a Golden Cross (50-dma higher than 200-dma) for a 104th 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 12th week to a 70-week low of 2.6% from 2.9%, 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 for a second week following four weekly declines, ending its worst performance since it fell for seven weeks before the 2016 election. The 200-dma continued to rise, as it has done since May 2016, but near the slowest pace since October 2011. The index improved to 0.6% below its now-rising 50-dma from 0.8% below its falling 50-dma a week earlier, which compares to a 25-month low of 5.6% below its falling 50-dma near the end of March and a two-year high of 6.2% above its rising 50-dma on January 29. The S&P 500 appears to have successfully tested its 200-dma again recently, but dropped to 2.0% above its rising 200-dma from 2.2% above its rising 200-dma a week earlier and from 0.6% below on April 3, which was the lowest reading since June 2016. That compares to a seven-year high of 13.5% on January 29 and a four-year low of -10.1% in August 2015.

S&P 500 Sectors Technical Indicators (*link*): Last week saw three sectors improve relative to their 50-dmas and one rise relative to its 200-dma, while two sectors weakened relative to both measures. At the week's end, five of the 11 sectors traded above their 50-dmas (Consumer Discretionary, Energy, Health Care, Real Estate, and Utilities). That compares to all 11 below at the end of March, which was the first time that has occurred since February 2016. Utilities was positive for a fifth week, and Energy was positive for a third week. The longer-term picture—i.e., relative to 200-dmas—shows 5/11 sectors trading above, which matches the lowest count since January 2016 and is down from 6/11 above a week earlier. Health Care moved above its 200-dma in the latest week, but Industrials and Materials moved below. Also trading above their 200-dmas: Tech (above 200-dma for 95 straight weeks), Consumer Discretionary (77 straight weeks), Financials (33 weeks), and Energy (3 weeks). On the other hand, Consumer Staples was below for a tenth week, Real Estate below for a 17th week, and Utilities below for a 19th 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. However, seven sectors are in a Golden Cross (50-dmas higher than 200-dmas), up from six a week earlier as Energy rejoined the club after being out for two weeks. All 11 had been in a Golden Cross in mid-January for the first time since a 26-week streak ended in October 2016. Telecom was out for a fourth week, Consumer Staples for a sixth, Real Estate for a 12th, and Utilities for a 14th. Three sectors have rising 50-dmas now, up from two a week earlier as Real Estate turned higher for the first time in 16 weeks and joined Consumer Staples and Telecom. That's a sharp turnaround from early April, when all 11 sectors had falling 50-dmas in the worst count since before the election in November 2016. Consumer Staples' 50-dma fell for a 12th straight week and Telecom's for an 11th week. Eight sectors have rising 200-dmas, unchanged from a week earlier. That's up from six in early February, which was the lowest since May 2017. The 200-dmas for Real Estate and Utilities fell for a 16th week, and Consumer Staples' dropped for a tenth week.

US ECONOMIC INDICATORS

GDP (*link*): Real GDP growth was higher than expected last quarter, according to preliminary estimates, but still lagged behind growth posted during most of last year. Real GDP expanded 2.3% (saar) during Q1 (vs a 2.1% consensus estimate), after averaging 3.0% growth over the final three quarters of 2017. (GDP growth during Q1 has tended to be weaker than the other quarters' figures since 2010.) Real consumer spending grew only 1.1% (saar) last quarter—the weakest since Q2-2013—as goods consumption (-1.1%, saar) contracted for the first time since Q2-2011, driven by a sharp drop in durable goods (-3.3) spending, mainly motor vehicles & parts; nondurable goods (0.1) consumption was flat. Meanwhile, services consumption increased 2.1% (saar), in line with recent readings. Real nonresidential fixed investment expanded 6.1% (saar) during Q1, matching its y/y percent change. Last quarter's gain was widespread, led by a double-digit jump in structures (12.3%) investment, which was twice Q4's pace; spending on equipment (to 4.7 from 10.8) and intellectual property products (3.6 from 5.2) slowed from their respective Q4 rates. Inventory investment climbed to $33.1 billion (saar) during Q1, after falling to $15.6 billion during Q4—which was less than half Q3's $38.5 billion pace. Trade contributed positively to GDP growth last quarter—after being a big drag during Q4—as exports (4.8) rose at roughly double the pace of imports (2.6). Real government spending (1.2) advanced for the third consecutive quarter as both federal (1.7) and state & local (0.8) expenditures expanded, though at slower paces than Q4. Real residential investment was flat last quarter after soaring 12.8% (saar) during Q4, following declines of 4.7% and 7.3% the prior two quarters. On the inflation front, the deflator for personal consumption expenditures, excluding food & energy, rose 2.5% (saar)—its strongest quarterly gain in nearly seven years.

Contributions to GDP (*link*): Real business investment was the number-one contributor to real GDP growth last quarter, followed closely by consumer spending. (1) Nonresidential fixed investment accounted for 0.76ppt of Q1's increase, with investment in structures (0.34ppt), equipment (0.27), and intellectual property products (0.14) all contributing positively. (2) Real consumer spending accounted for 0.73ppt of real GDP growth—all services-related (0.97); goods (-0.24) consumption subtracted from growth for the first time since Q2-2011, all durable (-0.25) goods. (3) Inventory investment (0.43), which was the biggest negative contributor to Q4 GDP growth, was the number three contributor to growth during Q1—all nonfarm (0.45). (4) Trade (0.20) was a positive contributor to GDP growth again last quarter—after subtracting from growth during Q4 for the first time in a year—as a positive contribution from exports (0.59) more than offset a negative contribution from imports (-0.39). (5) Real government spending (0.20) matched trade's contribution to growth last quarter, with federal (0.11) and state & local (0.09) government spending complementing one another. (6) Residential investment (0.00) was neutral last quarter after contributing positively during Q4 for the first time in three quarters.

Durable Goods Orders & Shipments (*link*): Core capital goods shipments and orders both took a step back in March after posting strong gains in February; growth in both has slowed sharply since late last year. Nondefense capital goods orders ex aircraft (a proxy for future business investment) ticked down 0.1% in March, after a 0.9% gain in February (half the preliminary 1.8% preliminary estimate), which followed a two-month decline of 0.8%. Meanwhile, the comparable shipments measure (used in calculating GDP) fell for the first time in 14 months, by 0.7% in March, after a 13-month surge of 9.9%. Core capital goods orders were fractionally negative—contracting 0.2% (saar)—during the three months through March, based on the three-month average, slowing sharply from double-digit gains from September through December; the comparable shipments measured grew 4.1% (saar), slowing steadily from its recent peak of 14.1% recorded in the three months through October. Headline durable goods orders expanded for the fourth time in five months, by 2.6%m/m and 7.0% over the period, reflecting a surge in commercial aircraft orders in recent months. Excluding transportation, March orders were unchanged at February's cyclical high, following a 0.9% gain and a 0.3% loss the prior two months. These orders soared 5.6% the last six months of 2017.

Regional M-PMIs (*link*): So far, four Fed districts have reported on manufacturing activity for April—New York, Philadelphia, Richmond, and Kansas City—with two outliers. Growth in the Kansas City region showed a sharp acceleration this month, while Richmond's showed a sharp deterioration. We average the composite, orders, and employment measures as data become available. The composite index (to 15.5 from 19.2) showed activity continued to expand at a solid pace, though down from October's 22.7—which was the strongest rate since May 2004. The Philadelphia (23.3 from 22.3) region is showing steady growth through the first four months of this year, with April's reading virtually matching the four-month average, while New York's (15.8 from 22.5) growth is easing. Meanwhile, Richmond's (-3 from 15) gauge contracted for the first time since June 2016, while Kansas City's (26 from 17) was the highest in the history of its series going back to July 2001. The new orders gauge (13.9 from 17.1) continued to ease, as orders growth in the Richmond (-9 from 17) region turned negative after 17 months in positive territory, while orders growth slowed in both the Philly (18.4 from 35.7) and New York (9.0 from 16.8) regions—though Philly orders expanded at double the pace of New York's. Meanwhile, Kansas City (37 from -1) manufacturers recorded their best orders growth since December 2003, after a slight contraction in March. The employment measure (17.8 from 18.0) was little changed this month, though hirings by manufacturers in the Philly (27.1 from 25.6) and Kansas City (unchanged at 26) regions continued to grow at a much faster pace than the Richmond and New York regions. Richmond (12 from 11) manufacturers hired at half the pace recorded earlier this year, while New York (6.0 from 9.4) factories hired at less than a third of the pace recorded at the end of last year.

Employment Cost Index (*link*): Labor costs in the private sector accelerated during Q1, with the quarterly gain at a 14-year high and yearly growth the highest in nearly 10 years. Private industry compensation climbed 1.0% last quarter—double Q4's 0.5% gain—pushing the yearly rate up to 2.8% y/y, the highest since Q3-2008. Wages & salaries followed a similar script, climbing 1.0% q/q, after a

0.5% gain during Q4, with the yearly rate accelerating 2.9%, also the highest since Q3-2008. Benefits' costs rose 0.8% during Q1, double Q4's 0.4% gain, pushing the yearly rate to a three-year high of 2.5%. (Note: Some of Q1's gain may have been influenced by one-time payouts made by companies in response to the Republican-backed tax cuts enacted in December.)

Consumer Sentiment (*link*): Consumer sentiment dipped in April after reaching its highest reading since January 2004 in March. The Consumer Sentiment Index (CSI) fell to 98.8 this month (slightly higher than the 97.8 mid-month reading) after rising from 95.7 to 101.4 the prior two months. According to the University of Michigan, many survey respondents offered their views on tax reform and trade policies without even being asked, reflecting the prominence these issues have taken in the political debate over the U.S. economy. The present situation index slipped from a record high of 121.2 in March to 114.9 in April, while the expectations component edged lower for the second month from 90.0 in February to 88.4 this month (which was above the 86.8 initial estimate). The survey notes, "The difference in the Expectation Index was striking: positive views on tax reform had Index values 28 points higher than those who made no mention of the tax reform legislation, and negative views on tariffs had Index values that were 28 points lower than those who didn't spontaneously mention trade."

GLOBAL ECONOMIC INDICATORS

Eurozone Economic Sentiment Indicators (*link*): April's Economic Sentiment Index (ESI) for the Eurozone (at 112.7) was unchanged from the March level, while the EU's (-0.3 points to 112.3) was relatively stable. Both remain at elevated levels, below their December 17-year highs of 115.3 and 115.2, respectively. This month, ESIs among the Eurozone's five largest economies were mixed, though all remained at comparatively high levels. The ESIs for both Spain (+1.6 to 110.6) and France (+1.1 to 110.3) were up markedly, while the Netherlands' (-2.3 to 110.5) was down sharply; Germany's (112.2) was unchanged, while Italy's (-0.4 to 109.4) was negligibly lower. At the sector level, while all ESIs also remained at relatively high levels, April's performance was mixed, with consumer (+0.3 to 0.4) and industry (+0.1 to 7.1) confidence slightly higher, and retail trade (-1.3 to -0.6), services (-1.0 to 14.9), and construction (-0.7 to 4.5) confidence lower.

UK GDP (*link*): The UK economy barely budged last quarter, posting its weakest quarterly growth rate since 2012, according to preliminary estimates. Real GDP eked out only a 0.1% (not annualized) increase last quarter, slowing from 0.4% and 0.5% the prior two quarters. While the UK was hit by severe weather last quarter, the Office for National Statistics noted weather had a "relatively small" impact on Q1's performance. Of the four industry groupings, construction (-3.3%) and agriculture (-1.4) both contracted for the second quarter, with the former the weakest since Q2-2012. Meanwhile, services, which accounts for 80% of the UK economy, rose 0.3% last quarter—in line with 2017 increases—but half the average quarterly gain of 0.6% posted during 2016. The production group, which includes manufacturing and mining, advanced 0.7% during Q1 after advances of 0.5% and 1.0% the prior two quarters. Manufacturing activity inched up only 0.2% last quarter after gains above 1.0% in each of the prior two quarters; mining output, which tends to be volatile, rebounded 3.5% after contracting 4.9% during Q4. (The second release of GDP data, due May 30, will show the expenditure breakdown.)

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, 570-775-6823