July 6, 2020

Weekly Macro & Markets View

Highlights and View

- **The Global PMIs show that economic activity improved further in June, though conditions remain depressed**

  The next stage of the recovery will be more challenging as pent-up demand is likely to fade while COVID concerns are intensifying.

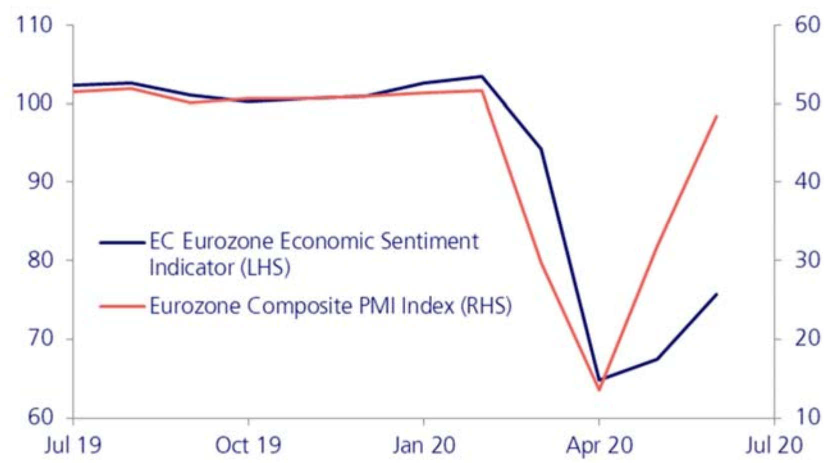
- **Eurozone PMIs rebound sharply in June**

  While some data such as the PMIs point to a V shaped recovery in the Eurozone, overall economic activity will likely still remain below pre COVID-19 levels for some time.

- **US Nonfarm payrolls soar by 4.8 million in June, lifting the 2-month total to 7.5m**

  The labour market is healing from its worst downturn in decades, though with roughly one third of lost jobs regained there is still a long way to go.

Impressive EU policy response and recovery in some Eurozone data



Source: Bloomberg

The policy environment in the Eurozone continues to be constructive. Gradual progress is being made on the EU's proposed EUR 750 bn recovery fund as negotiations continue, with an in person EU leaders summit scheduled for July 17-18 likely to see the broad outline of a deal. Separately, last week the German parliament voted in favour of a motion stating that the ECB has demonstrated the proportionality of its QE programme. This followed the release of internal documents by the ECB and a long reference justifying QE in the minutes to its most recent monetary policy meeting held on June 4. This reduces the risk that the Bundesbank will have to stop participating in QE asset purchases because of the recent German Constitutional Court ruling and is in-line with what we expected. Meanwhile, economic data continue to rebound sharply. The final June Eurozone Composite PMI was revised up relative to the flash estimate, while retail sales in Germany jumped by 13.9% MoM in May. However, the rebound in the European Commission's economic sentiment indicator was less strong and economic activity is still some way below pre COVID-19 levels. Overall, there has been an impressive economic and health policy response in the Eurozone that should support risk assets in the region, though uncertainty is still high given the virus containment difficulties in other regions.

US: Nonfarm employment rises by 4.8 million jobs

The S&P 500 gained 4% ahead of the long weekend as investors continue to look through the acceleration of new COVID-19 cases in the US. It is reassuring that the fatality rate has not been rising in proportion with new infections though there will be headwinds for the economy as more and more states slow down their plans to reopen the economy. So far, this has not shown up in the data, which remain in line with our base case of a solid rebound. Nonfarm payrolls soared by 4.8m in June, bringing the 2-month total to 7.5m. This underlines the strong rehiring following the massive downturn, though with roughly one third of the lost jobs being brought back there is still a long way to a full recovery. The ISM Manufacturing survey rose to 52.6 in June with new orders jumping to 56.4, the highest since January 2019. Finally, the latest Fed minutes reveal a preference for sticking with forward guidance rather than switching to direct yield curve control. One reason to opt against yield curve control is the concern that restraint over the size of the balance sheet could be lost.

Switzerland: Activity rebounds, but the next stage will be more challenging

Retail sales rose sharply in May as lockdowns eased, with non-food, ex-fuel sales up by 60% compared to April, leaving it at a level similar to pre COVID. Borders were still closed in May and we suspect this helped the rebound as cross border shopping was decimated.

The Services PMI also rose sharply and approached 50 in June, meaning that half of businesses surveyed saw activity improve in June compared to May.

Other indicators were less upbeat, however, including the Manufacturing PMI, which edged lower, with employment plans falling precipitously. The environment is also deeply deflationary, as consumer prices are now falling at a pace of -1.3% YoY, amplifying downward pressure on margins and wages. Looking forward, while it is encouraging that economic activity has improved, the base was low and with new COVID cases rising and employment weakening, the next stage of the recovery will be more challenging.

Asian PMIs: The worst seems to be over

Asian Manufacturing PMIs improved further in June, with India and ASEAN experiencing strong rebounds to 47.2 and 43.7 respectively. An early success in flattening the infection curve led to less stringent restriction measures in Taiwan and Korea, which explains a less severe plunge in their May and April Manufacturing PMIs. Coming from a less depressed level, the two countries only saw a moderate pickup in June PMI readings.

Overall, the latest Manufacturing PMIs suggested the worst seems to be over for Asia, with readings for China, Australia, Malaysia and Vietnam crossing into expansionary territory with PMIs above 50. While headline PMIs were encouraging, the recovery in New Export Order PMIs was somewhat underwhelming, even for China. While it will take time for manufacturing output to normalise, the recovery appears well on track for the region, in line with early signs of a pickup in global demand.

China: Strong June PMIs while Beijing successfully contains the virus

Both sets of China's official NBS as well as Caixin PMIs for June have come in strong, exceeding expectations. PMIs for Manufacturing, Services and Construction were clearly above the boom/bust line of 50. Even though the New Export Order PMI improved as well, it remains below 50, and businesses still seem to be cautious in hiring and restocking. Indeed, Employment PMIs below 50 indicate that the labour market remains in a difficult shape. Some SMEs keep struggling and need further public support. The Caixin Services PMI surged to 58.3, the highest level in over a decade, as the upbeat mood in the services sector was not even hampered by the renewed outbreak of the coronavirus in Beijing. The virus seems to be contained, as new infection cases have fallen close to a standstill, with the new cumulative case count, including neighbouring provinces, remaining below 400. More than eight million tests have been conducted. Torrential rain caused severe flooding in China's Southern provinces, with 12 million people affected, but it seems the economic impact is manageable.

Japan: Bad times

Japan was rattled by heavy flooding in Kyushu over the weekend, causing mudslides and severe casualties. There was also no cheer when looking at the latest economic indicators for May. Industrial production deteriorated more than consensus had expected, down 8.4% MoM and 25.9% YoY in May, while housing starts were down 12.3% YoY. We also note first scars in the so far resilient labour market, with the unemployment rate creeping higher to 2.9% and the job-to-applicant ratio falling to levels last seen five years ago. The focus, however, was on the Tankan, the quarterly corporate business survey conducted by the Bank of Japan. The headline diffusion index for large manufacturing companies fell more than consensus had expected from -8 to -34 in Q2. The non-manufacturing index fell from positive territory to -17. However, forward looking indications suggest we have seen the worst. Unfortunately, this not true for small companies, which are suffering the most from the COVID-19 crisis. This is a worry, as they are the backbone of Japan's labour market.

What to Watch

- In the US, the ISM Non-Manufacturing survey will reveal whether the service sector is recovering in line with other parts of the economy while producer prices are expected to show limited price pressure.
- In the Eurozone, various industrial data will likely confirm a rebound in activity, while the European Commission is expected to release further details on the proposed EU recovery fund.
- In APAC, we expect the central bank of Malaysia to deliver a 25bps policy rate cut while Australia's RBA is likely to keep policy rates unchanged. Australia's home loan statistics for May will also be released this week. In Japan, the focus will be on the Eco Watchers Survey for June as well as machinery orders and real household spending data for May. China will release inflation, credit and monetary data for June. Taiwan's exports are likely to have fallen only marginally in June.

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