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ZURICH

# Weekly Macro & Markets View

## Highlights and View

- **China equities rally**

  There is more upside potential, as euphoria is not yet at the levels of 2015 and valuations are still acceptable, but we expect the government to intervene were a speculative frenzy to emerge.

- **UK Chancellor Sunak announces further fiscal spending and a temporary VAT cut on certain activities**

  The fiscal support is welcome but given that a number of earlier measures will run out in H2 there will still be a fiscal drag on the economy later this year.

- **The Eurozone sees an uneven rebound in industrial production**

  This reflects in part the different timing and severity of lockdowns in the region. Overall the Eurozone is coping with the virus as well as could be hoped for from an economic and health perspective.

## China equities rally

Source: Bloomberg

Both the MSCI China and domestic 'A'-shares surged 7½% last week, outperforming lacklustre global equities, and extended gains today. The rally is being driven by domestic retail investors, but foreign investors have also started to show more appetite for Chinese stocks. The domestic 'A'-share rally was broad-based, with various sectors contributing, led by securities stocks. The ChiNext index, featuring innovative venture companies, even rallied nearly 13%. Meanwhile, the MSCI China was driven by internet and technology stocks, in tandem with the tech-heavy US Nasdaq Index. We note that the top six internet stocks combined have an index weight of 42%, with Alibaba and Tencent already making up one third of the MSCI China. The top four financial stocks follow with a weight of only 8%. The rally in the CSI300, representing domestic 'A'-shares, resembles the surges seen in 2014 and 2018. Fears are emerging that this is the beginning of a bull market similar to that of 2014/2015, which ended in tears, as the chart above shows. However, we believe that the current surge in equities is not (yet) showing the same signs of exuberance. Both turnover and the margin trading balance have risen, but not to the lofty levels seen at the peak in 2015. We believe that while authorities continue to provide ample liquidity, with aggregate financing to the economy accelerating to 12.8% YoY in June, they are likely to take measures at one point to curb any kind of speculation.

## US: Daily infections hit a new record

Despite a further acceleration in new COVID-19 cases to the highest daily rate since the beginning of the pandemic the mortality rate still lags the increase in new infections. The S&P 500 managed to climb 1.8% last week as positive economic data helped to lift investors' spirits. The ISM Non-Manufacturing survey shows a much bigger improvement than expected by consensus, rising to 57.1 in June from 45.4 in May. New orders jumped almost 20 points to 61.6, signalling strong momentum. The employment component improved as well, though it remains relatively modest, indicating some caution among service providers. Continuing jobless claims fell further to 18.1m at the end of June, the lowest since mid-April. Initial jobless claims also fell but remain high at more than 1.3m. It remains to be seen how the latest steps to slow down or even partially reverse the reopening of the economy will affect the rehiring process. Producer prices dipped into negative territory in June, underlining the deflationary impact of the pandemic, at least in the short term.

msme@zurich.com

## Eurozone: Uneven bounce back in industrial production

Data for May released last week showed an uneven rebound in industrial production across the Eurozone, increasing by 9.7%, 19.6% and 42.1% MoM in Germany, France and Italy respectively. However, this reflected in part the different timing and severity of lockdowns. Overall, industrial output is still well below pre COVID-19 levels in the Eurozone, given that output fell around 27% in March and April combined. What's more, German factory order data for May, often seen as a leading indicator for the sector, were disappointing, rebounding less than expected. In contrast, retail sales have bounced back more strongly and levels of spending in the Eurozone overall are 'only' down around -5% on a YoY basis. Taking all the data together it still appears to be the case that the region has coped with the virus as well as could be hoped for from a health and economic perspective. Eurozone equity markets were flat over the week, while periphery spreads remained well contained, only slightly above pre COVID-19 ranges.

## UK: Another round of fiscal stimulus

Chancellor Sunak announced further fiscal measures to support the economy. One of the key elements is a job retention scheme where employers receive a GBP 1'000 bonus payment for every furloughed employee that is retained and remains in employment until at least January 2021. Depending on how many furloughed employees will be retained, the program could cost more than GBP 9bn. Other support measures include a temporary 9-month VAT cut from 20% to 5% for hospitality, accommodation and attractions, as well as a temporary Stamp Duty cut, with the latter intended to support the housing market. A relatively small but attention-grabbing measure is the "Eat Out to Help Out" scheme whereby people can get a 50% discount of up to GBP10 per head when eating out. Overall, the latest round of fiscal measures amounts to roughly 1% of GDP, which is a welcome support for the economy. However, as a number of earlier measures amounting to several percentage points of GDP will run out in the second half of the year, there will still be a fiscal drag in H2.

## Japan: A glimpse of hope in a difficult environment

Even after the state of emergency was lifted in May, Japan's economy remained in a tailspin. Most economic indicators for May disappointed, both in the manufacturing sector and in terms of private consumption, while labour market conditions deteriorated. Finally, a glimpse of hope has emerged as the Eco Watchers survey diffusion index for June recovered in a V-shaped manner from 15.5 to 38.8, with the outlook moving even higher to 44. The consumer related Eco Watchers survey also covers businesses close to the consumer. However, we are concerned that consumer sentiment may suffer again, as daily infections in Tokyo exceeded 200 for a fourth day in a row, with the latest flare-up spreading beyond nightclubs. Even though new infections remain miniscule compared to other big countries, citizens are on high alert. Heavy flooding and mudslides that caused fatalities in western and central Japan are also having an impact on overall sentiment. In a brighter spot, following a phase of trading sideways, Japanese equities gained more than 2% this morning, responding to the surge in Chinese equities and rising US index futures.

## Credit: Resilient as rating trends improve

Credit markets were largely resilient last week despite news of rising coronavirus infections in the US and emerging markets. While cash credit spreads generally tightened, CDS indices were marginally softer, underperforming equities, especially in the US. A notable development within credit markets has been the marked reduction in the pace of rating downgrades, causing some brokers to revise down their estimates of fallen angel volumes. That said, we think the situation remains dire for the weakest borrowers. Bankruptcies continue, with the consumer discretionary sector, which includes retailers, accounting for around 40% of bankruptcies in the US so far. Technicals, especially for the investment grade credit markets remain robust. Issuance has slowed down as we had expected, although some of the current slowdown is due to the 'blackout' ahead of earnings. Inflows remain solid, although new issue concessions in primary markets have risen recently while oversubscription levels have moderated. Some European bank issuers have now also started issuing subordinated green bonds.

## What to Watch

- While the ECB meeting is unlikely to see any more changes in policy announced, the EU summit to be held at the end of this week will be a crucial one, with more progress expected on the details of the recovery fund.
- In the US, small business optimism and retail sales are expected to have further improved in June, but investors will focus on the beginning of the Q2 earnings season.
- In Asia, we expect both the Bank of Japan and the Bank of Korea to keep policy rates unchanged, while Bank Indonesia is expected to cut its policy rate by another 25bps. China will announce GDP Q2 statistics and various relevant economic indicators for June. Singapore will also report GDP Q2 data as well as June exports.

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Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

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