July 27, 2020

Weekly Macro & Markets View

Highlights and View

- **The EU summit finally sees an agreement on the EUR 750bn recovery package and EU budget for the next seven years**

  The agreement marks an important step forward for Europe, and in particular the sharing of fiscal burdens will help make the Eurozone economically more resilient to shocks.

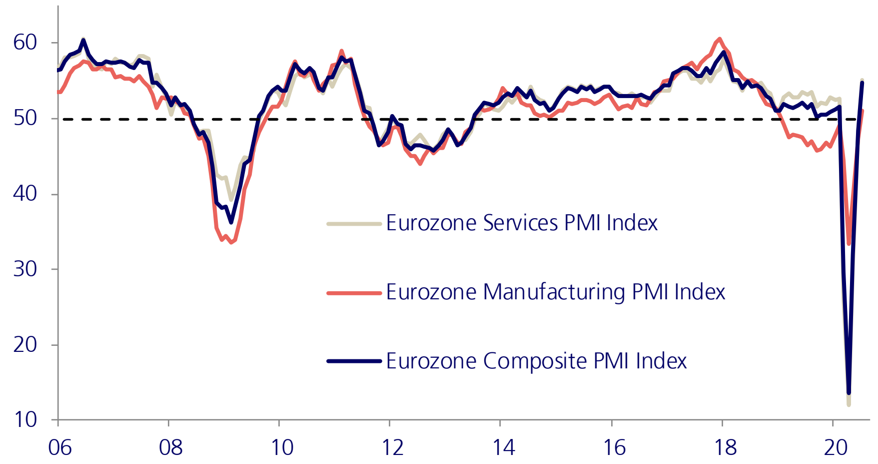
- **The US stock market takes a pause as headwinds mount**

  Mixed economic data, rising US-China tensions and Intel's announcement that its next-generation chips will be delayed led to some profit taking, particularly in tech stocks.

- **Australia's government extends the JobKeeper and JobSeeker programs**

  The extension of these programs will give the labour market more time to heal post-crisis, addressing concerns over a premature withdrawal of fiscal support.

Eurozone becomes more resilient with EU summit agreement



Source: Bloomberg

Last week's agreement at the marathon EU summit on the EUR 750bn recovery package was an important step forward for Europe. The leaders finally agreed as to the division of grants (EUR 390bn) and loans (EUR 360bn) in the package, and the allocation key for the disbursement of these funds to each country. The spending will be front-loaded, with 70% spent or at least committed to specific projects over 2021-22. To finance the spending the EU will borrow large amounts, effectively mutualising some European debt. What's more, the way the allocation of spending will be determined means that there will effectively be a fiscal transfer of tens of billions of euros for the next few years from the richer Northern European countries to the less well off Southern and CEE countries. Such fiscal transfers and debt mutualisation are an important part of making the Eurozone more resilient to future shocks. There are still some approval and implementation risks as the agreement needs to be ratified by national parliaments and the European parliament, but we expect it to be operational from early next year more or less as planned. Elsewhere, data in the Eurozone continued to confirm a strong rebound due to a constructive health and economic policy response to the COVID-19 crisis. The Eurozone Flash Composite PMI jumped by a greater than expected 6.3 points to 54.8 in July, a 25-month high, supported by strong gains in services confidence in particular.

US: Intel's stock hammered as new chips are delayed

The S&P 500 Index ended its three-week winning streak with a small weekly loss of -0.3%, after a good start initially lifted the market to the highest level since February. With continuously high numbers of new infections, rising tensions between the US and China, as well as a set of mixed economic data there were enough reasons for some investors to take profit. The Nasdaq has now fallen (and underperformed the S&P 500) for two weeks in a row, indicating potential headwinds for tech stocks going forward. Tech sentiment was not helped by Intel's announcement on Thursday that the release of its next-generation chip will be delayed by six months, sending its stock down by almost 16% over the week. Economic data provided further headwinds to the market with initial jobless claims rising for the first time since March. On a more positive note, though lagging by one week, continuing claims dropped by more than a million to 16.2 million in mid-July. The housing market saw another boost with new home sales rising 13.8% MoM in June following May's rise of 19.4%.

UK: Service sector sentiment reaches a five-year high

Business conditions have significantly improved in July with the Composite PMI jumping almost ten points to 57.1, the highest level in five years. Both manufacturing and services improved, but the recovery was more pronounced in the latter, which was also more affected by lockdown measures. While this is reassuring, weak spots remain and particularly staffing levels are relatively low in both sectors as redundancies continue to weigh on the outlook. On a more positive note, retail sales continued to soar, growing by 13.5% MoM in June after rising 10.6% the month before. Overall, retail sales levels are now slightly higher than a year ago, showing an impressive rebound from depressed levels. Meanwhile, the latest round of Brexit talks ended without notable progress. Both sides acknowledged significant gaps between the two parties' positions. Nevertheless, they also signal a willingness to continue negotiating, leaving the door open for a narrow trade agreement later this year.

Japan: The economic recovery so far pales in an international comparison

Most economic indicators continue to show that Japan's economic recovery remains sluggish. The Manufacturing PMI for June showed only a patchy recovery of 2½ points to 42.6, remaining in contractionary territory, while the Services PMI inched up only marginally to 45.2. These numbers pale next to those of the US, Europe and China. While the manufacturing output component rose more convincingly, the new order and new export order indices recovered only in a lacklustre manner, reflecting weakness in the auto and machinery segments, which make up a major part of Japan's exports. June export statistics confirm this sluggishness, as export volumes were down 27.7% YoY, not indicating a recovery. Exports to the US and Europe remained particularly weak, while those to China were down only slightly. Today's final release of the MoF Q1 Corporate Survey confirmed our suspicion that the low survey collection rate had distorted numbers to the upside. Indeed, both sales and capex components were revised down significantly from the preliminary release.

Taiwan & Korea: Taiwan's economy fares well, Korea's exports dragged down by autos

Taiwan's economy continues to shine. June industrial production, up 7.3% YoY, and export orders, up 6.5%, were both much stronger than consensus had expected. The resilient tech sector, a prime beneficiary of the global semiconductor cycle, is the main pillar behind the stellar performance of Taiwan's economy. Exports are benefiting from strong global 'home office' demand for desktop and notebook PCs. In addition, we are seeing rush demand from Huawei before US export restrictions begin to bite. Taiwan is also benefitting from the swift recovery in China. In addition, domestic demand has been resilient, as Taiwan has handled the COVID-19 crisis well. Out of a total of 458 infections, only 11 are active, and the death toll, at 7, is low. Meanwhile, South Korea's economic downswing accelerated in Q2 to -3.3% QoQ, down 2.9% YoY, worse than consensus had expected. Weak exports were the main cause, showing the steepest quarterly decline since 1963, driven by weak auto exports, while domestic consumption held up well. Exports have been falling at a slower speed in July, with brisk demand from China and the US.

Australia: More green shoots

Australia's government extended the JobSeeker and JobKeeper programs from September 2020 to December 2020 and March 2021 respectively. However, the subsidies and unemployment benefits will be tapered off gradually. We believe this is a sensible move, as fiscal support remains crucial in the early phase of recovery. As a result, the budget deficit is expected to widen from 0% to 4.3% and 9.7% of GDP in the fiscal years of 2019/2020 and 2020/2021 according to the latest budget update by the government. While public debt is expected to rise considerably, it remains relatively low compared to other developed markets. Elsewhere, data showed more green shoots despite worries over the infection resurgence in Victoria. The July Flash Composite PMI jumped from 52.7 to 57.9 with the services sector leading the way. June preliminary retail sales rose by 2.4% MoM, supported by a pickup in dining out and food services. So far, the recovery in activity remains well on track although the economy is still at a vulnerable juncture.

What to Watch

- In the US, the first estimate of Q2 GDP will shed more light on the pandemic's impact on the economy. In addition, consumer sentiment is expected to have deteriorated somewhat given the marked increase in new infections.
- In the Eurozone, Q2 GDP data are likely to show a record contraction in the economy, from which it is now bouncing back.
- In APAC, the focus will be on Japan's June economic indicators to be published at the end of the week. China's NBS Manufacturing PMI for July will probably inch higher again. Australia's CPI is expected to be negative in Q2. Exports in South Korea and Malaysia will potentially show some signs of a rebound but will still be down significantly in YoY terms.

Disclaimer and cautionary statement

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