Weekly Macro & Markets View

Highlights and View

- **China's economic recovery is slowing**

  We believe policy support will remain targeted towards SMEs, consumers, migrant workers and unemployed youth.

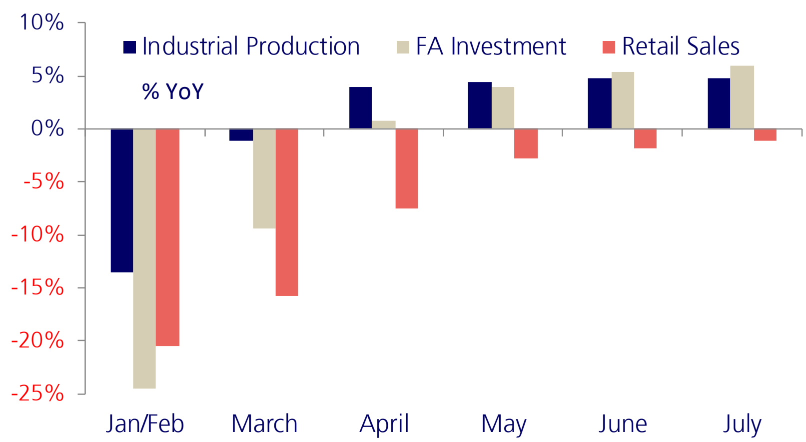
- **The UK economy suffers its worst drawdown in the post-war period as GDP contracts by 20.4% in Q2**

  The UK was harder hit than most other major economies, though a strong pickup in monthly GDP data at the end of the quarter points to a solid rebound after the collapse.

- **Government bond yields rebound from historical lows, helped by rising inflation expectations and heavy US debt issuance**

  We had expected yields to rise but futher upside looks limited given economic vulnerabilities and ongoing central bank support.

China's economic recovery remains solid, but is losing some steam



Source: Bloomberg

Some observers characterised China's economic data set for July as underwhelming. We would not go that far, but we acknowledge that the recovery seems now to be switching from full throttle to auto-pilot following the emergency brake in Q1. Infrastructure investment remains the driving force, even though growth slowed somewhat, which may have been impacted by severe flooding along the Yangtse River. State owned companies continue to give the major boost. While manufacturing investment is still down compared to last year, property investment has been booming, up nearly 12% YoY, as new home sales surged more than 16% YoY in value terms. Industrial production was up less than 5% YoY, disappointing consensus expectations, even though slower electricity consumption growth had already given us an indication. Despite strong auto and online sales, retail sales remained below last year's level, dragged down by lacklustre expenses for dining and entertainment. Aggregate financing inched higher, up 12.9% YoY, a two-year high, despite lower than expected bank lending, as both direct financing and shadow banking activities picked up steam. Meanwhile, tensions with the US remain high. Talks regarding the 'phase one' trade deal scheduled for the weekend have been postponed, while the US is increasing pressure on China in a series of other issues. We do not expect any substantial progress in the runup to the US presidential election.

US: Consumer sentiment remains weak

The S&P 500 came within a hair's breadth of closing at a new record high before levelling off in the second half of the week. In the end, the index was still up by 0.6% over the full week despite receding hopes regarding an agreement between Democrats and Republicans on further fiscal support measures. Meanwhile, economic data point to a continuation of the recovery at a more moderate pace. Retail sales rose by 1.2% MoM in July after (an upwardly revised) 8.4% in June. The University of Michigan's consumer sentiment survey was also not helped by the expected expiration of fiscal stimulus measures and remained close to its multi-year low with expectations improving only slightly. Small business optimism receded in July after the big surge in the two months before, though important components like hiring and capex plans ticked up, reflecting an improving outlook. Finally, inflation rates accelerated in July, showing the biggest monthly pickup in more than a decade. That still leaves the annual rate at only 1.0%, though Core CPI rose to 1.6% YoY, significantly higher than consensus expected.

Eurozone: German ZEW survey points to further gains in industrial production

The German ZEW expectations survey of analyst sentiment, which is also a useful leading indicator of industrial production, increased more than expected, to 71.5 in August from 59.3 in July. This points to further strong gains in industrial production after the latest data show output rose 10.8% MoM in Germany and 9.1% for the Eurozone as a whole in June, suggesting that the economy is continuing to bounce back sharply from the worst recession on record. Admittedly, new virus cases have picked up, in Spain and France in particular, with the seven-day average of new cases at 1,502 and 2,364 respectively. Authorities are acting quickly, however, with localised lockdowns and obligatory face-mask measures, but with the risk of a second wave of infections developing the situation needs careful monitoring. Eurozone equity markets had another good week last week, up around 1.6% for the Euro Stoxx 50, while periphery bond spreads continued to gradually tighten, especially those of Italian bonds

UK: Economic activity collapses in Q2

The UK economy suffered its biggest drawdown in the post-war period with GDP contracting by 20.4% in Q2. The drop is larger than the ones in the US and major European countries including Germany, Italy and France. The contraction was broad based with both consumption and investment falling by more than 20%, and the service sector hit particularly hard by the lockdown measures. Despite the record fall in economic activity the unemployment rate has hardly moved away from its multi-decade low, remaining at 3.9% in June. However, this figure is severely distorted by the large number of furloughed workers who are still classified as employed. The true unemployment rate would be several percentage points higher. Other labour market data reveal the weakness more clearly with the numbers of hours worked plunging to the lowest level since 1994. On a more positive note, industrial production rebounded by 9.3% MoM in June after rising 6.2% in May. The monthly GDP measure picked up 8.7% in June pointing to a solid rebound at the end of the quarter.

Japan: Q2 brings biggest post-war GDP contraction

Japan's economy contracted even more in Q2 than consensus had expected. Real GDP fell 7.8% QoQ and was down nearly 10% YoY, mainly driven by a significant drop in private service consumption and net exports, while business investment remained rather resilient. Looking forward, we think that Q3 GDP will get a boost for purely statistical reasons, as the carryover effect from the strong rebound in consumption in June should have an impact. Japan's Eco Watcher Survey was the first economic indicator to show the V-shaped surge in economic activity in June following a release of pent-up demand paired with cash handouts by the government. Unfortunately, the party already seems to be over, as improvement in July was marginal, with the diffusion index up only 1.3 points to 41.1, following June's surge of 23.3 points. Indeed, the household diffusion index even remained flat, while the corporate index improved by 7.4 points, driven by both manufacturing and services. However, conditions remain severe for dining and travel related SMEs. Households suffered from a new surge in COVID infections and the rainy season.

Credit: Resilient, but US supply causes some softening

Credit markets were broadly resilient last week, although US credit markets underperformed marginally due to a pickup in supply. August is shaping up to be a strong month in the US primary market, with Apple selling over USD 5.5bn of debt last week, following other technology companies such as Amazon and Google also locking in low borrowing costs. While some tick up in supply in August was expected after the end of the earnings blackout period, September may see even heavier issuance. That said, our view remains that issuance on average in 2H 2020 is likely to be muted versus what was seen in 1H 2020 as companies are generally flush with liquidity. In contrast to the US, the European primary credit market was practically dead as the summer lull continues. The technical picture in credit remains constructive with inflows continuing across most segments of the market. Rising Treasury yields and steepening bond curves also weighed on credit last week, as total return-oriented investors retreated, but the relative allure of credit to government bonds remains intact in our view.

What to Watch

- The G3 Flash PMIs will reveal if the global economy has maintained momentum after the initial post-lockdown bounce.
- In the Eurozone, the Flash PMI survey should indicate that growth remains strong as the economy continues to rebound from the coronavirus induced recession.
- In Asia Pacific, we believe the central banks of Indonesia and the Philippines will keep at least a dovish tone, if not even cutting policy rates by another 25bps. Export data for July will be released in Japan, Taiwan, Indonesia and Singapore, while July CPI data will be reported in Japan, Hong Kong and Malaysia. In Australia, the focus will be on August PMIs.

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