September 7, 2020

Weekly Macro & Markets View

Highlights and View

- **After a volatile week, the S&P 500 loses 2.3%, driven by the tech sector**

  The setback in the tech sector is a healthy correction in a market that was showing signs of overheating.

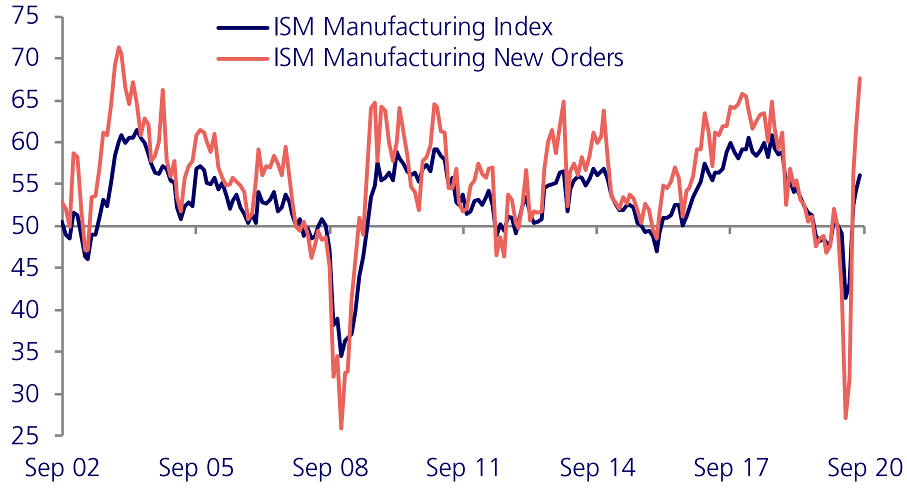
- **The Global Composite PMI rose further in August on broad-based improvements across sectors and regions**

  While global growth continues to pick up, labour markets are frail, showing that the recovery remains vulnerable and dependent on ongoing policy support.

- **Indonesia's parliament will discuss a panel proposal to change the central bank law**

  Bank Indonesia's independence is at risk and debt monetisation cannot be ruled out, as the Ministry of Finance could intervene in monetary policy according to a draft bill. Developments need to be watched carefully.

Manufacturing new orders soar to a 16-year high



Source: Bloomberg

The S&P 500 suffered its worst week since the end of June, losing 2.3%, though that number hides a more significant 6.7% peak-to-trough move over just two trading days. The correction was driven by the tech sector, reflected in the Nasdaq Composite shedding 3.3% over the week, with an intra-week peak-to-trough drawdown of almost 10%. The setback in the tech sector is a healthy correction in a market that showed signs of overheating and still leaves the index up by more than 26% since the beginning of the year. Meanwhile, economic data continue to reflect a solid recovery. The ISM Manufacturing Index rose to 56.0 in August with new orders soaring to the highest level in more than 16 years. The ISM Service Index ticked down to a still decent 56.9. More positive news was provided by the latest batch of labour market data. Another 1.4mn jobs were brought back in August, helped by a 238'000 increase in temporary Census workers. The unemployment rate fell more than expected, to 8.4%, even as the participation rate recovered to 61.7%. The broader underemployment rate fell more than two percentage points to 14.2%. These strong gains in employment combined with a tick higher in average weekly hours provide a boost to household income and spending, supporting economic momentum in the second half of the year.

Credit: Resilient corporate bonds despite the stock tumble

Equities had been outperforming credit markets and the relative performance was expected to take a breather at some stage. This breather came last week and it is unsurprising that after a very strong run, equity markets corrected sharply on Thursday and remained weak on Friday. While spreads of CDS indices widened during the stock sell-off, corporate bonds were resilient and in fact most corporate bond segments saw spreads tighten over the week, with the exception of US high yield. We believe that corporate bonds are likely to remain bolstered, unless the economic outlook deteriorates drastically. The support for credit comes not only from central banks and conservative capital management by companies, but also from strong supply/demand technicals. Last week saw record inflows into US investment grade credit, while the primary market showed very strong demand, at least in the first half of the week as US debt deals were on average around eight times oversubscribed. Notably, many companies are using debt proceeds to pay down existing debt, which implies net supply should remain low.

Global PMIs: Global activity improves further, but not all is clear

Macro data show that growth remained strong through August, despite a resurgence in COVID-19 cases and reduced fiscal support. The Global Composite PMI rose to 52.4 — the highest level since early 2019 and consistent with growth above trend. The recovery has broadened out with a majority of countries, as well as both manufacturing and services, on an improving growth trajectory. New orders are strong, suggesting the recovery has further to run, and manufacturing new export orders rebounded to the highest level since 2018, prior to the US-China trade dispute.

That said, in APAC, which tends to lead the global trade cycle, new export orders remain weak outside of China, Taiwan and Australia, posing a vulnerability to the ongoing recovery. Labour markets are also frail, with global employment still in contraction. This poses a risk to the recovery and demands that monetary and fiscal support measures remain in place for now, despite gains in activity.

Eurozone: Core inflation falls to a record low adding pressure on the ECB

Core inflation fell to an all-time low of just 0.4% YoY in August, well below expectations. Headline inflation actually turned negative, falling to -0.2% YoY in August from 0.4% YoY in July. Inflation data has been volatile recently because of the late start in summer sales. In addition, a temporary German VAT cut has also pushed inflation down. Nevertheless, the data suggest that underlying inflationary pressures are muted for now. Meanwhile, retail sales in the Eurozone fell 1.3% MoM in July, but this followed gains of 20.3% and 5.3% in May and June respectively. Finally, the PMIs show some diverging trends at the country level. While the overall Eurozone Composite PMI for August was revised up slightly to 51.9 from the flash estimate of 51.6, Spain saw both its manufacturing and services indices fall back below 50 in August. This may reflect the impact of the pickup in new virus cases and weakness in the tourism sector over the summer. However, the PMI survey for the Eurozone overall is still consistent with the recovery continuing.

Australia: The first recession in nearly 30 years, but turnaround is likely in H2

Australia experienced its first recession in nearly 30 years, as real GDP fell for the second quarter in a row in Q2 by 7% QoQ and 6.3% YoY, worse than consensus had anticipated. A slump in private consumption, particularly service consumption, was the driving force. Dwelling construction took a beating, while rising mining investment was not able to lift overall investments. Public demand and net exports contributed positively, but the latter only because imports fell stronger than exports. Despite the lockdown in Victoria, we believe a recovery in the rest of Australia may contribute to slightly positive GDP growth in Q3. CoreLogic house prices for eight capital cities continued to fall for the fourth month in a row in August, driven by Melbourne and Sydney. With that, house prices remain unchanged on a YoY basis nationwide, but are still up 10% in Sydney. Meanwhile, the RBA left policy rates unchanged as expected, but expanded the size of its Term Funding Facility, enabling higher money supply growth for longer, while a bond yield target beyond three years remains an option.

LatAm: The worst of the crisis seems to be behind us, but the recovery will be slow and heterogonous among countries

In Chile, economic activity has been above market expectations, and the Central Bank revised the economic outlook for this year upwards. In Brazil, although 2Q GDP was -9.7% QoQ, below market expectations, industrial production and PMIs surprised positively, and the economic forecast has been revised upwards. Uncertainty about fiscal spending should continue to affect the financial market's volatility. The government has extended the emergency aid program until the end of the year, but by half of the previous amount (BRL 300 per month until year end). The budget bill for 2021 was sent to Congress, but it did not include the new social program, as it is not clear how the government will fund it without affecting spending rules. The government has delivered the administrative reform to Congress, which would not affect current civil servants. The reform aims for lower cost and greater efficiency and transparency in the public sector. It is part of the Government's austerity plan, but the approval process will be slow.

What to Watch

- In the US, inflation numbers are expected to show that prices have further recovered from the weakness induced by last quarter's economic contraction.
- In APAC, we believe Bank Negara Malaysia will keep policy rates unchanged at 1.75% amid a more balanced risk outlook. We will focus on Japan's Eco Watchers Survey for August and the Q3 BSI Survey, a leading indicator for the Tankan. In China, CPI inflation and PPI deflation are likely to have eased further. In Australia, business and consumer confidence are likely to have improved, but remain negative. In India and Malaysia, the V-shaped industrial production recovery may have continued in July, but production remains depressed in India.
- The main event this week in the Eurozone is the ECB meeting. No change in policy is expected, but it is likely that the tone will be dovish.

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