Investment Insight

September 2020

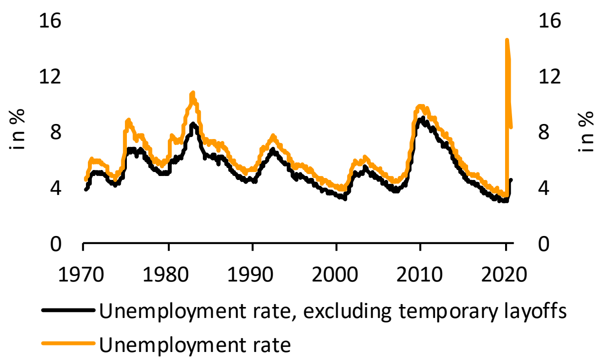
Upswing in sight

Economic data in the USA, China and Europe is surprisingly positive despite rising numbers of infections. The prospect of a sustained economic recovery is buoying risk assets on the financial markets.

The Chinese purchasing managers' indicators from August clearly point to continued recovery. Markit's manufacturing index increased further, from 52.8 to 53.1 points, reaching a 9½-year high. The Bureau of Statistics' PMI for the service sector was surprisingly positive, climbing from 54.2 to 55.2 points – a 2½-year high. The surveys confirm the picture painted by the high-frequency activity data, which shows the domestic economy continuing to pick up speed. The PMIs also indicate that the outlook for foreign trade is brightening, with the manufacturing surveys showing a continued recovery of the sub-indices on foreign orders. Strong GDP growth is therefore becoming increasingly clear for China. After a year-on-year increase of 3.2% in the second quarter, we consider an acceleration towards +5.0% possible in Q3. This would take the growth rate of the Chinese economy in large strides towards the pre-crisis level of around 6.0%.

In the USA, labour market figures reflect a continuation of the upturn. For example, the number of people in work rose by a further 1.37 million in August. Around half of the 22 million jobs lost in March and April have now been recovered. The unemployment rate actually fell unexpectedly sharply from 10.2% to 8.4%. This decline is likely to exaggerate the extent of the recovery, although the over-arching downward trend appears stable. One indication of this is the large number of US citizens who responded in the survey that they were only temporarily laid off. This figure is currently 6.2 million; at the peak of the 2009 recession, it was »only« 1.9 million. The majority of temporarily laid-off workers are likely to find work again quickly as the economy recovers. Excluding them from the unemployment rate puts it at just 4.6%, significantly below the rate seen in previous recessions (see figure below).

USA: Unemployment rate only temporarily high

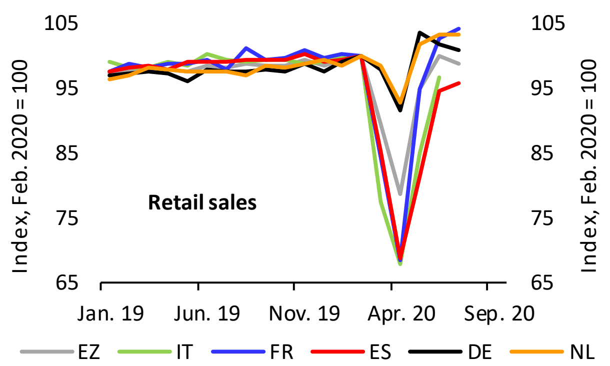


Sources: BLS, BANTLEON

In addition, recent developments in the coronavirus pandemic provide a positive outlook. If new infections continue to decline over the next few months, and hospitali-sations and death rates remain low, distancing restrictions will likely be eased further, which in turn will also cause employment figures to continue to rise. The unemployment rate will therefore likely move back towards the pre-crisis level much more quickly this time than in »normal« recessions.

In the Eurozone, the latest economic data confirmed our view that the coronavirus infection figures, which have increased sharply until recently, have had little impact on economic recovery so far. For example, although retail sales were down 1.3% month on month in July, they were only 1.2% below February's pre-crisis level following the dramatic increase of May and June (see figure below). The effects of the pandemic on the labour market are limited. The Eurozone unemployment rate rose only slightly again, in July, to 7.9%. This means the rate has only increased by 0.7 percentage points since the coronavirus crisis began. Given the severity of the economic downturn, a double-digit increase was likely. However, apart from difficulties in collecting figures, it was primarily the various furlough wage-subsidy schemes that helped to limit unemployment.

Eurozone: Retail sales recovering well



Sources: Eurostat, BANTLEON

In German industry, the signs also continue to point towards recovery. June's breathtaking 28.8% month-on-month increase in order intake was followed by a rise of 2.8% in July. Order intake has now made up 78% of the slump suffered in March and April. While it was primarily domestic orders that increased in May and June, foreign orders were responsible for the rise in orders in July. Given the encouraging economic development in Germany and at global level, the German government has revised its GDP forecast for 2020 upwards, from -6.3% to -5.8%. We are more confident, and expect a drop in economic output of »only« around 5%, which would be less dramatic than during the global financial crisis of 2009 (-5.6%). At around 7%, our predicted drop for the Eurozone is also clearly above the consensus estimate (-8.1%), but well below the decline of 2009 (-4.5%).

Our relatively optimistic economic outlook is also due to the fact that the sharp rise in the number of infections in many Eurozone countries has not caused an economic collapse and is also unlikely to do so in the future. The current second wave of infection is fundamentally different from the first wave seen in March and April. The recent increase in case numbers is due to the hugely expanded testing, and primarily relates to people experiencing relatively mild symptoms. The »soft« containment measures taken, along with the end of the summer holiday period, are likely to be enough to send the number of new infections back down. A vaccine could be available from early 2021 and pave the way for further economic revival.

Increased risk appetite on the bond markets

The stock markets recently took a breather, particularly concerning US technology equities. However, the uptrend in equities is set to continue in light of the economic recovery, even if numerous disruption factors are potential fuel for setbacks. The succession of positive surprises in economic data have boosted not only equities in recent weeks, but all other risk assets too. Risk appetite has increased on the bond markets. Corporate bonds have shown virtually textbook-like outperformance compared to German government bonds.

Commodities are traditionally a winner in upswing periods, and have indeed also experienced a marked recovery since March/ April. This was driven not only by crude oil and gold, but also by traditional, cyclically sensitive industrial metals. Copper, zinc and nickel, for example, have also each increased by more than 40% since March. Going forward, we expect both the uptrend in commodity prices and the narrowing of risk premiums on the bond markets to continue.

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