Investment Insight

October 2020

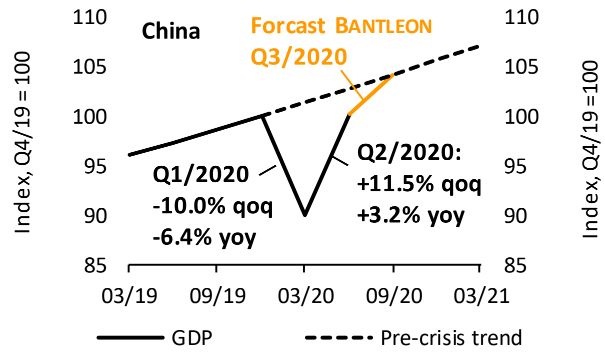
Positive news

The Chinese economy has shifted back into forward gear. Signs also point to recovery in the USA and Europe. Inflation is likely to rise again too by the start of next year.

In China, the economic recovery after the coronavirus outbreak at the beginning of the year continued in September. China's National Bureau of Statistics (NBS) reported a rise in the purchasing managers' indices (PMIs) for manufacturing and the service sector (from 51.0 to 51.5, and 55.2 to 55.9 points, respectively). The composite index for the two sectors even hit a three-year high of 55.1, up from 54.5 points. Tailwind is largely generated by foreign trade. But the domestic economic situation is also improving. The sub-indices on employment increased in all PMIs. Markit reported a gain in manufacturing from 49.8 to 50.1 points. That does not seem much in absolute terms, however, there have been only slightly higher values in two months during the past seven years. This shows that the job market is benefitting more and more from the upturn, which will likely also boost private consumption.

Overall, China's economic rebound clearly remains on track. The robust September PMI figures therefore provide further evidence of our expectation of another strong boost to GDP in Q3. China's economy is thus likely to return to its former growth path much more quickly than expected at the beginning of the crisis (see figure right).

China: Swift return to earlier growth path



Sources: NBS, BANTLEON

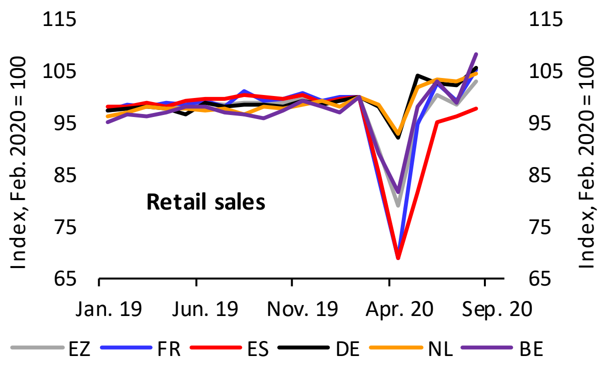
The Chinese job market is just starting to pick up, but signs of fatigue are already becoming apparent in the USA. Although the jobless rate there fell for the fifth consecutive time to 7.9%, the participation rate slipped at the same time from 61.7% to 61.4% due to a retreat by some discouraged job seekers. The number of new jobs also indicates that the US labour market recovery has been flagging in recent months. Of the 22 million workers who lost their jobs at the peak of the crisis, around 50% are still without work. This puts the labour market clearly behind other areas in the return to normality. Retail sales, for example, have already exceeded pre-crisis levels.

Nonetheless, the US economic recovery is not jeopardized by below-average job market trends. Americans have been able to put enough aside to get by in the coming months thanks to extensive federal aid. The latest consumer confidence surveys confirm our optimistic assessment of the consumer situation. For instance, the University of Michigan Index of Consumer Sentiment climbed just as noticeably (from 74.1 to 80.3 points) as its counterpart published by the Conference Board (from 86.3 to 101.8 points). Given this environment, we do not regard the latest drop in the ISM Purchasing Managers' Index for manufacturing from 56.0 to 55.4 points in September as problematic.

In the Eurozone, the decline in September's inflation rate to -0.3% and at core rate level to +0.2% seems worrying at first glance. At present, however, inflation is clearly distorted downwards due to a number of extraordinary effects. In addition to decreasing clothing prices, the lull in tourism demand and VAT rate cuts in many Eurozone countries have temporarily put a damper on inflation. Moreover, inflation development will depend heavily on the price of oil until the end of the year. If the oil price does not rise, the inflation rate will likely remain in negative terrain. Regardless of this, however, inflation will noticeably increase step by step at the beginning of next year and exceed the 2% mark for a time. The core inflation rate is also projected to move towards 2% in 2021.

Aside from inflation figures, economic data has recently delivered positive surprises, including retail sales in numerous Eurozone countries. In Germany, retailers sold 3.1% more in real terms in August than in July, meaning an almost 6% increase over pre-crisis levels. The figures in France were similar. August sales increased by 6.2% compared to July and by 5.5% compared to February. The Netherlands, Belgium, Ireland and Finland also exceeded pre-crisis levels (see figure below). Q3 retail sales can therefore be expected to increase by 10% quarter on quarter in the Eurozone. Automotive sales are even likely to almost double based on new registrations for July and August. This should largely compensate for the persistent weakness in some service sectors such as tourism, hospitality, and arts and culture. We thus expect a very sizable quarter-on-quarter increase in private consumption of 12% to 14% in Q3.

Eurozone: Retail sales exceed pre-crisis levels



Sources: Eurostat, BANTLEON

It still looks like a »V« for Eurozone industry. The recovery in industrial production, the near V-shaped recovery in construction, and the greater than expected retail sales rebound could result in a double-digit GDP growth rate for Q3. Our forecast of an average 7% decline in GDP for this year might therefore prove overly cautious. The prospects remain favourable for the current fourth quarter, particularly as the number of new infections in the Eurozone seems to indicate a turnaround and the healthcare system is coping well with the current burden of COVID-19 patients.

Government bond yields set to climb moderately by the end of the year

Although the risk appetite for equities has recently returned, government bonds have continued to hold their own. German bunds and their counterparts from the other

Eurozone countries benefited from the zone's weak inflation data, which in turn dampened inflation expectations. Moreover, ECB president Christine Lagarde implied acquiescence to the Fed's actions. This means that after a period of too low inflation, the ECB could also tolerate inflation overshooting its target for a while. This ultimately amounts to an even longer period of ultra-expansionary monetary policy, which tends to counteract a rise in yields on Eurozone government bonds.

We expect inflation rates to move up again slightly in the coming months. If the economic recovery continues, economic output would likely achieve pre-COVID levels as early as next year. This is already the case in some areas, such as retail sales. These positive reports are currently not getting through because of the high number of new infections in Europe. However, we believe that this will change in the next few months. Government bond yields are therefore set to climb moderately by the end of the year.

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