Investment Insight

July 2020

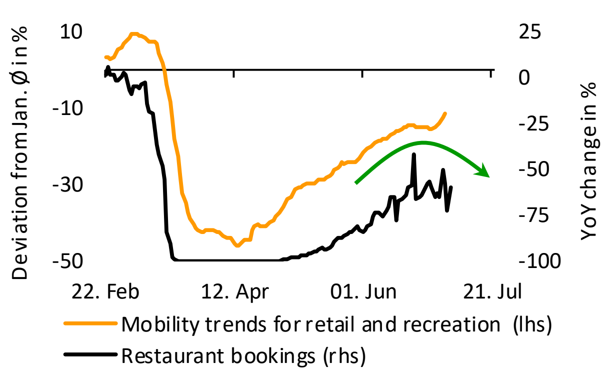
Improved economic data

Economic indicators around the world have recently pointed to an end of the economic downturn. However, the return of the pandemic in the USA is having a renewed negative impact. The recently so stable stock markets face a temporary setback.

US economic data has recently been surprising in a positive way. Preliminary contracts for home purchases were up by 44% in May, making up for around three-quarters of the previous losses. Following that, consumer confidence caused a stir in June with an unexpectedly sharp increase from 85.9 to 98.1 points. Even more surprising was the ISM Purchasing Managers' Index for manufacturing, which climbed to 52.6 points with the largest monthly increase in 40 years (+9.5 points). The sub-index for new orders jumped by as much as 24.6 points to 56.4 points, the most dramatic growth since 1947. The data series was topped off by the labour market report for June. With 4.8 million new hires, job growth was about twice as high as in the preceding month and also noticeably exceeded consensus expectations. The unemployment rate fell from 13.3% to 11.1%.

Taken together, the data shows how quickly the US economy has started to recover from the coronavirus crash. However, these statistics do not show the latest developments. The economy has slowed again for the past two weeks or so due to the major resurgence in coronavirus infections. Around 40% of the US population is now affected by new lockdown measures. Daily activity figures such as table reservations in restaurants already reflect this slowdown (see figure below).

USA: USA: Signs of slowdown in shops and restaurants

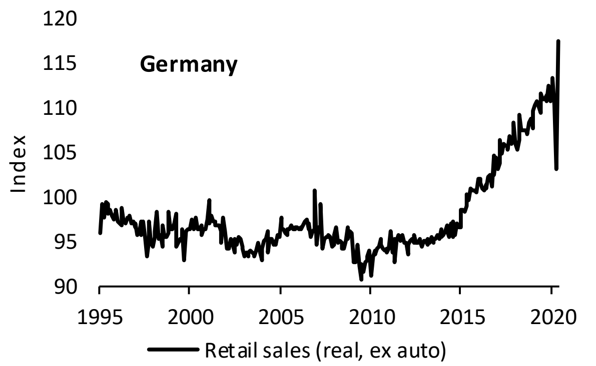


Sources: OpenTable, Google, BANTLEON

It should currently be assumed that the trends of rising new infections and increased lockdown measures will continue for the time being. The outlook for July's economic data is accordingly bleak. The stricter the distancing restrictions become, the greater the braking effects on the economy will be. However, monetary and fiscal policy will likely cushion the economic slowdown effects of additional lockdown measures. Among other things, we expect a new round of stimulus cheques for US citizens and an extension of unemployment benefits.

While the accelerated spread of the coronavirus in the USA is weighing on the short-term economic outlook, China appears to be keeping the pandemic under control. The new infection numbers show a downward trend at a low level while the purchasing managers' indices signal a continued recovery. For instance, Markit's Services PMI unexpectedly registered a strong movement from 55.0 to a 10-year high of 58.4 points, and its Manufacturing PMI improved from 50.7 to 51.2 points. The purchasing managers' indicators collected by China's National Bureau of Statistics are pointing in the same direction. The message of the first Chinese economic indicators for June is clear – the economy remains on the road to recovery.

German retail at full speed out of the crisis



Sources: Eurostat, BANTLEON

The strong economic recovery we expected in Europe in Q3 is taking greater shape. Retail sales for May were up throughout Europe – by between 2.7% in Finland and 25.6% in France. In some countries, particularly Germany, sales were even higher than before the crisis began (see figure above). It would appear that consumers are not that unsettled. Instead of going on holiday, they are buying new furniture and TVs. The outlook for June is also extremely positive. Sales in the Eurozone are likely to be only slightly below the pre-crisis level of February. Data on restaurant visits suggests that the recovery in the Eurozone service sector is similarly dynamic to that in the retail sector. If a second wave of infection and the associated large-scale lockdown can still be prevented, the signs for a strong countermovement in private consumer spending from July to September are very good. The decline of around 15% expected for Q2 could be almost completely compensated for in Q3. This would also pave the way for a similar development in GDP.

At any rate, European businesses are increasingly positive. The final results of the purchasing managers' indices (PMI) in June were considerably better than the preliminary figures. The Eurozone manufacturing PMI was revised from 46.9 to 47.4 points, with an even larger correction for the services PMI (from 47.3 to 48.3). This difference is attributable to the responses of only 10% to 15% of the total number of companies surveyed. These »late responders« must therefore have provided considerably better sentiment data in June than the companies included in the preliminary publication. According to our calculations, the late-submitted survey results correspond to a manufacturing PMI of 51 points and a services PMI of 55 points. The upward revision of the PMI figures for the Eurozone is largely due to the German results. The positive assessment from the end of June will carry over into July. We consider the values of the »lagging PMIs« as the lower threshold for the July figures. The lifting of travel restrictions within the EU from 1 July points to an even greater increase in the service sector.

The impact of the coronavirus pandemic on inflation remains manageable. Price dampening effects (hotels and advance sales) and price driving effects (restaurants and services) are more or less balanced. However, price increases are more likely to be sustained in the future. Although core inflation will fall again in July due to the German VAT cut, the increase will be all the stronger from the beginning of 2021. The inflation rate will follow the movement of the core inflation rate even more due to the easing of dampening base effects in energy prices.

The risk of setbacks for risk assets is increasing

The positive economic data recently continued to drive up share prices, and spreads on the bond markets also narrowed. However, the euphoria has been dampened by the sharp increase in new coronavirus infections in the USA. There are many indications that the trends of rising numbers of cases and increasing lockdown measures will continue for days to come. The current positive economic picture is therefore likely to show some cracks, which means increasing risks of setbacks for risk assets. On the other hand, the short-term outlook for safe havens remains favourable.

The headwind for the financial markets is not likely to ease until we see evidence that the distancing and other restrictions do actually slow the spread of the virus. Meanwhile, the central banks continue to provide support. There are discussions in the USA, for instance, about not raising interest rates until inflation runs above the 2% target rate. Since this has only been achieved for nine months over the past twelve years, this would actually be tantamount to fixing yields at the short end.

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