

ECONOMICS & MARKETS

Market Update 25 September 2020

28 Sep, 2020



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Data/Event	Movement	
	LATEST	PREVIOUS
US – Existing Home Sales (MoM) (Aug)	6 Million	5.86 Million
Australia – Retail Sales (MoM) (Aug)	-4.2%	+3.2%
US – Markit Manufacturing PMI (Sep)	53.5	53.1

Financial markets

Indicator	Sunday 27 September 2020	Sunday 20 September 2020	Weekly Change %	27 September 2019	12-month Change %
S&P/ASX 200 Index	5,964.9	5,864.5	+1.7	6,716.1	-11.2
S&P/ASX 200 A-REIT	1,307.2	1,300.2	+0.5	1,618.0	-19.2
US S&P 500	3,298.5	3,319.5	-0.6	2,961.8	+11.4
Dow Jones EURO STOXX	347.4	362.5	-4.2	382.3	-9.1
UK FTSE 100	5,842.7	6,007.1	-2.7	7,426.2	-21.3
Japan Nikkei 225	23,204.6	23,360.3	-0.7	21,878.9	+6.1
CHINA – CSI 300	4,570.0	4,737.1	-3.5	3,852.7	+18.6
MSCI (ex-Aust/in LC)	1,795.9	1,816.8	-1.1	1,694.6	+6.0
Australian 90-day bank bill yield	0.08	0.09	-1.00 bps	0.960	-88 bps
Australian 10-year bond yield	0.80	0.89	-8.90 bps	0.946	-15 bps
US 10-year bond yield	0.66	0.69	-3.03 bps	1.675	-102 bps
Oil – West Texas Crude	37.59	38.59	-2.590	82.420	-54.4
A\$ in US dollars	0.70	0.73	-3.969	0.677	+3.6
A\$ trade-weighted index (TWI)	60.4	62.0	-2.6	59.3	+1.9

Major upcoming global economic releases and events

Date	Data/Event	FORECAST	PREVIOUS
30 September	China – Non-Manufacturing PMI (Sep)	52.1	55.2
30 September	US – Gross Domestic Product Annualised (Q2)	-31.7%	-31.7%
30 September	US – ADP Employment Change (Sep)	650K	428K

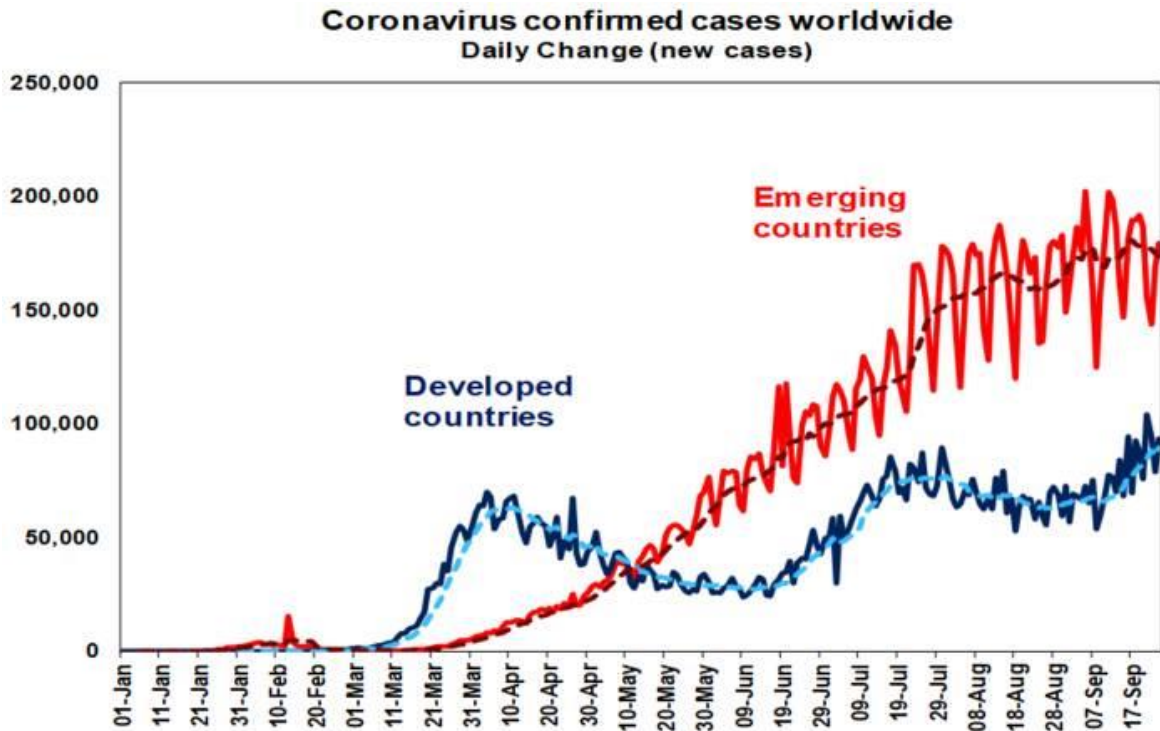
Source: Bloomberg, FXStreet, AMP Capital

Investment markets and key developments over the past week

Global share markets fell again over the last week on concerns about rising coronavirus cases, tightening social distancing restrictions in Europe and the lack of progress towards additional fiscal stimulus in the US. Despite a rally late in the week, US shares fell 0.6%, eurozone shares lost 4.2%, Japanese shares fell 0.7% and Chinese shares fell 3.5%. Australian shares however managed a decent gain of 1.7% through the week, with banks boosted by the Government moving to relax the responsible lending laws and strong gains in health, utility, industrial and consumer shares. Reflecting the risk-off tone globally, bond yields, commodity prices and the A\$ fell as the US\$ rose.

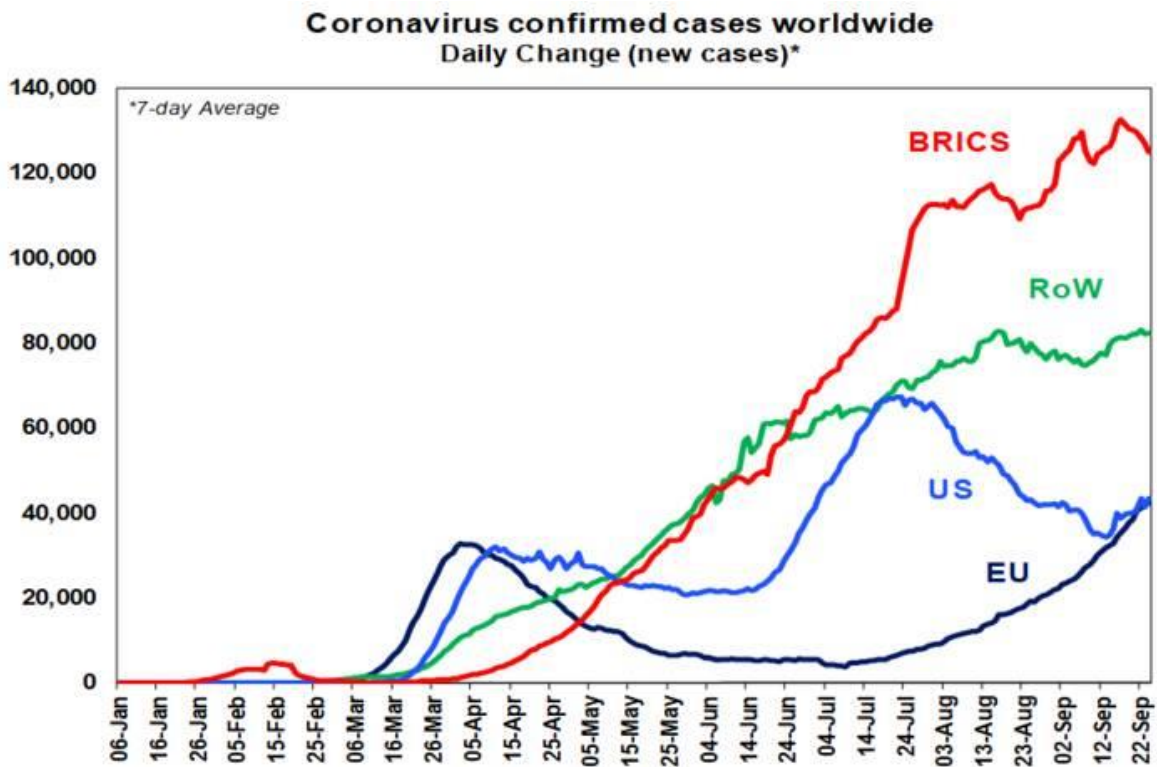
The correction in equity markets has now seen US shares fall 10% from their high and the tech heavy Nasdaq pull back 12%. Eurozone and Australian shares meanwhile have seen about a 6% decline to their lows. We remain of the view that this is just a correction after an excessive run up in US shares rather than the start of a renewed bear market, and that a continued but gradual and messy recovery, along with ultra-easy monetary policy will likely underpin a rising trend in shares on a 6-12 month horizon, providing Coronavirus is controlled. It however remains too early to say the correction is over; seasonal weakness often continues into October, Coronavirus could worsen into the northern winter, the next round of US fiscal stimulus remains uncertain and the US election is likely to add to volatility.

The past week or so has seen the trend in new Coronavirus cases continue to rise, particularly in developed countries.



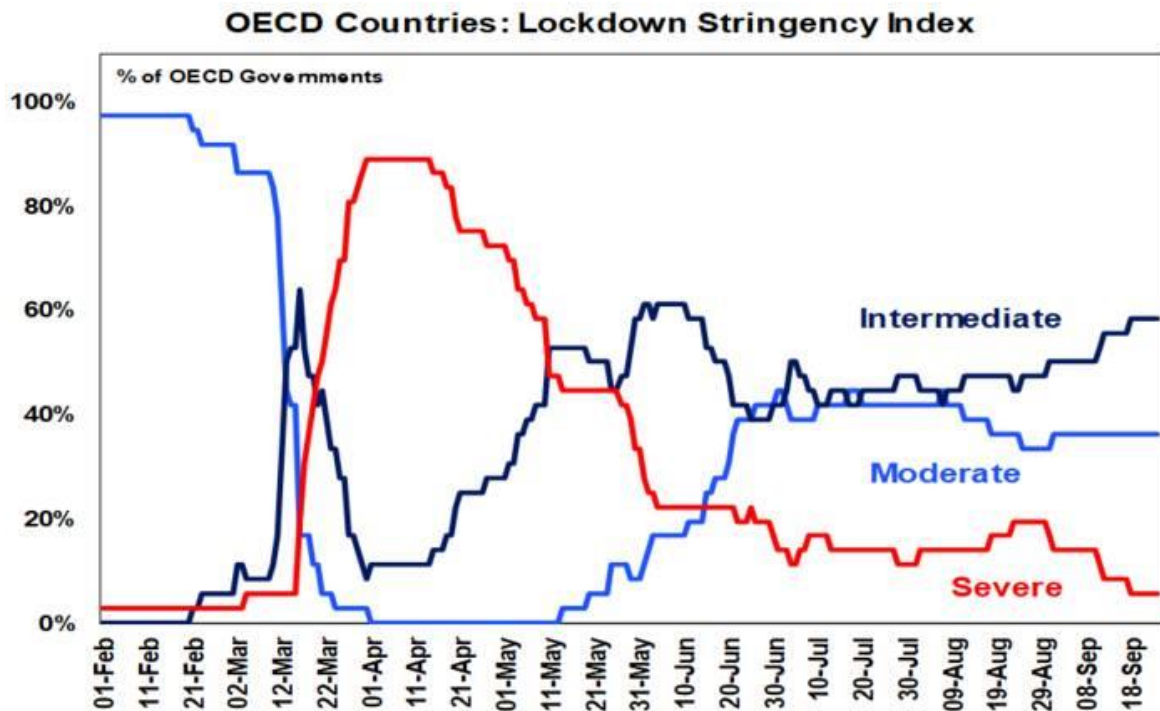
Source: ourworldindata.org, AMP Capital

A continuing strong surge in Europe is the main driver, but the UK and Canada are also rising solidly, while the US has hooked back up (particularly in the south).



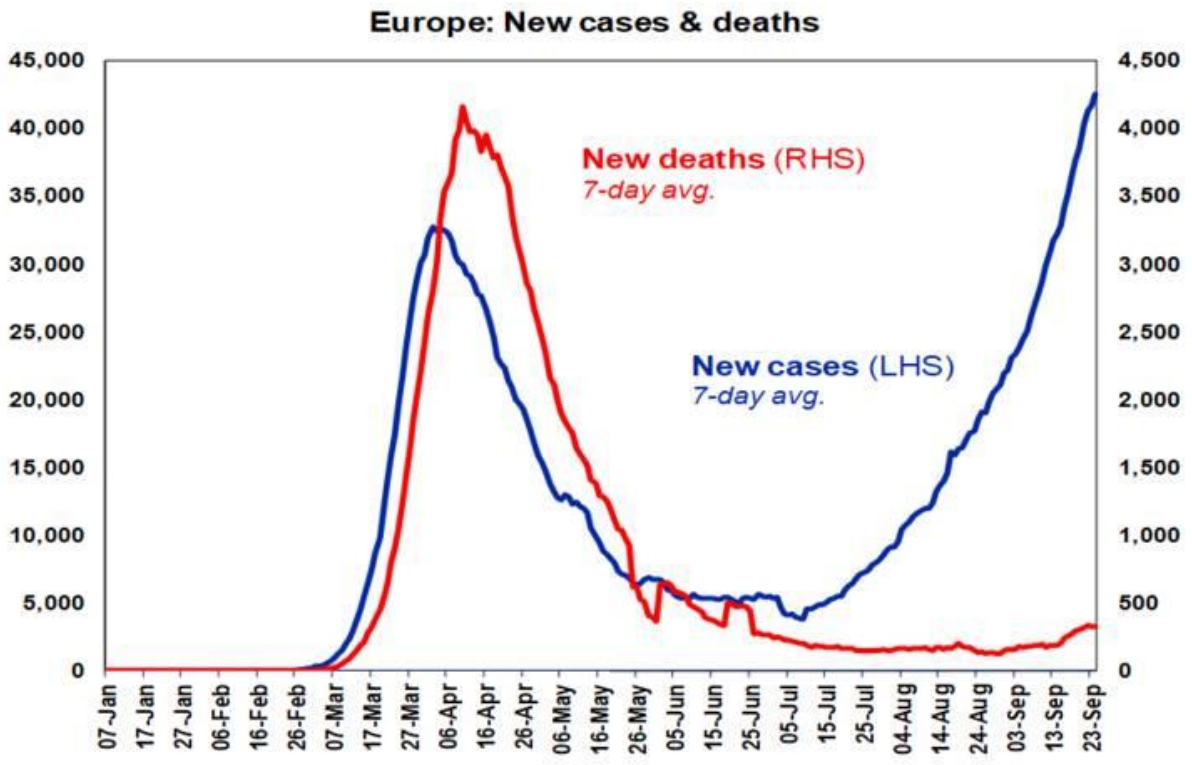
Source: ourworldindata.org, AMP Capital

This has seen various countries (e.g., the UK and France) - tighten some restrictions around bars, restaurants and public gatherings, resulting in a rising proportion of countries in “intermediate lockdowns”. See the next chart.



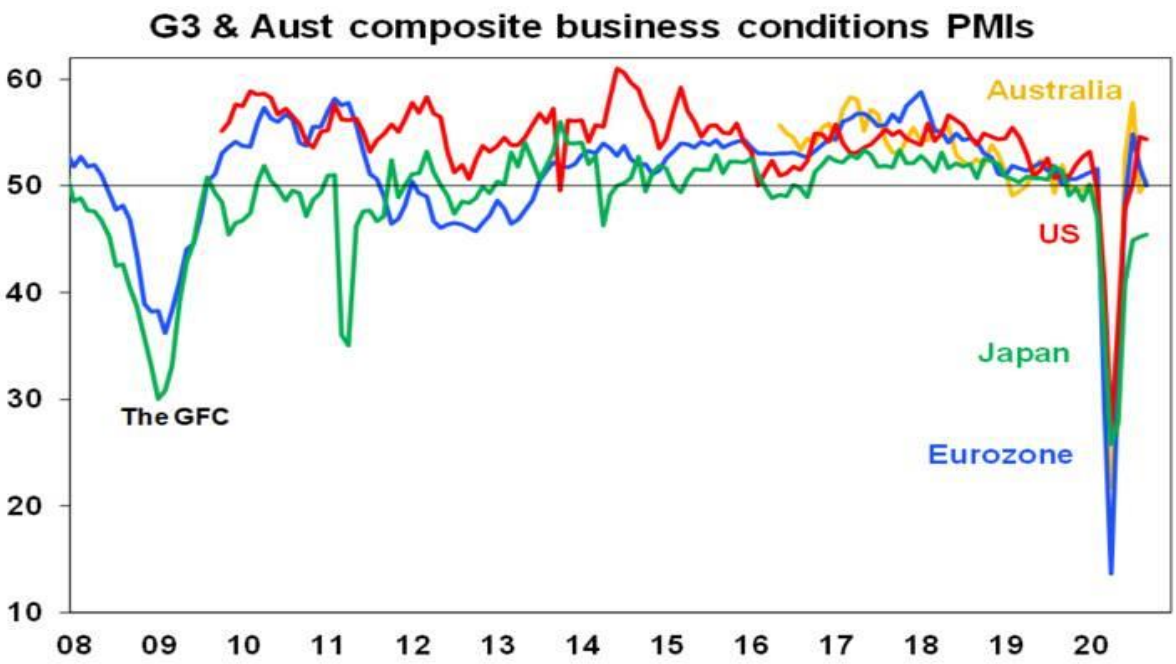
Source: University of Oxford, AMP Capital

Fortunately, the number of deaths remains well down on what was seen earlier this year across developed countries. (See the next chart for Europe.) This in turn should hopefully help avoid a return to generalised lockdowns in most countries – in favour of targeted measures – and help confidence hold up. Of course, the risk is high going into the northern winter.



Source: ourworldindata.org, AMP Capital

Business conditions PMIs provided a mixed picture in September, but generally remain ok. They fell again in Europe and the UK on the back of rising new Coronavirus cases and renewed shutdown fears, while they rose slightly in Japan and Australia and held solid in the US.



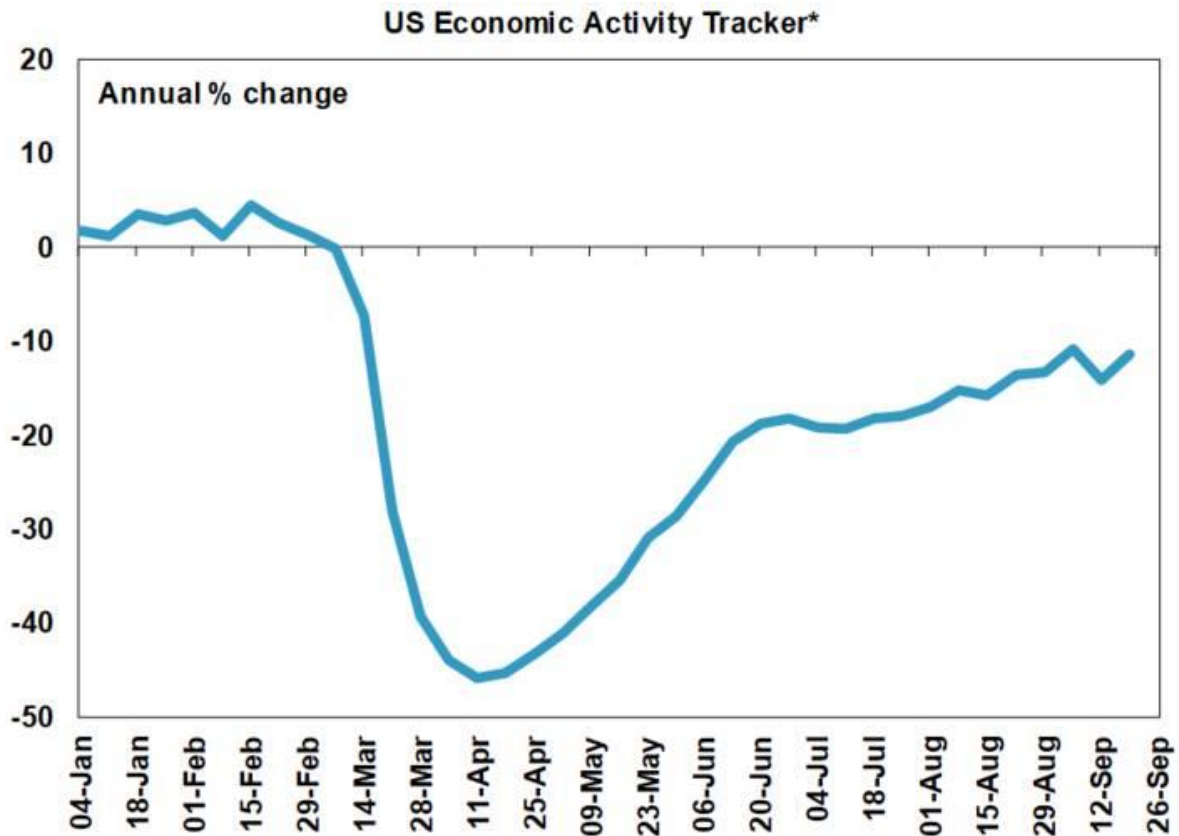
Source: Markit, Bloomberg, AMP Capital

Critically, they remain well up from April lows and suggest that the full country global PMI will remain at levels consistent with a continuing recovery, when it's released in the week ahead.



Source: Markit, Bloomberg, AMP Capital

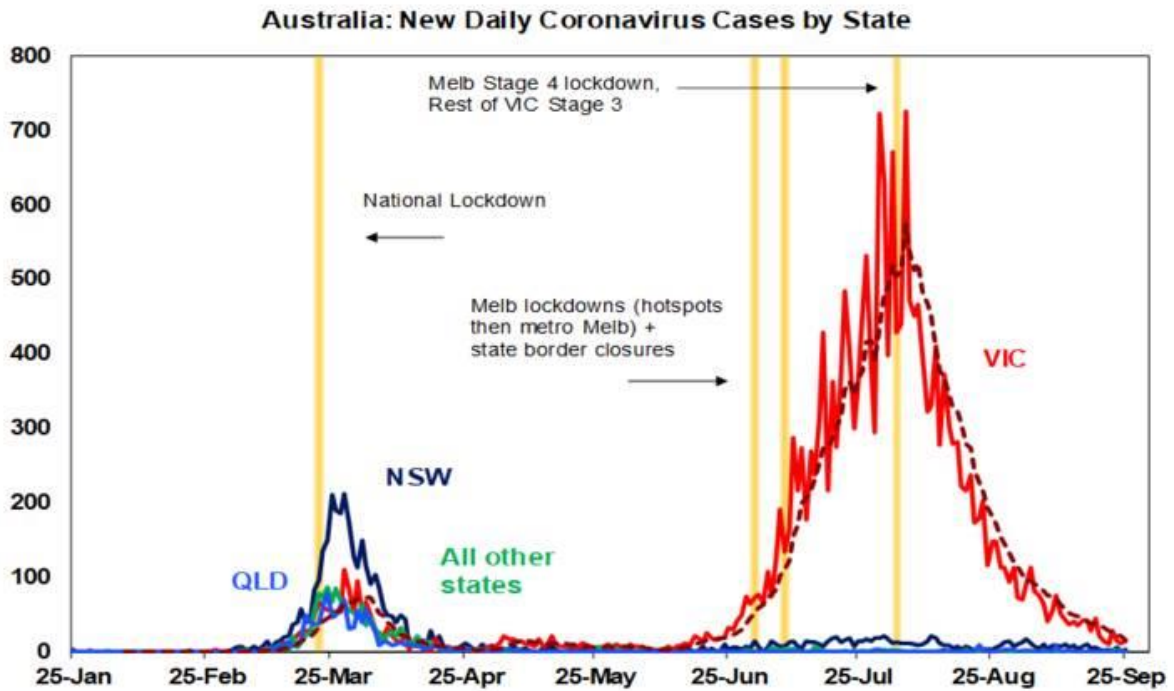
Our US Economic Activity Tracker picked up again over the last week, with gains in most components while it continues to trace out a gradual recovery, after the initial reopening-driven rebound in May.



* Components of the tracker include: Consumer spending, Restaurant performance, Consumer Confidence, Jobless Claims, Hours worked, Small business revenue, Rail Freight Loads, Retail Sales, Retail Foot Traffic, Apple & Google Mobility Indices, Mortgage applications, Hotel bookings and Job Ads.

Source: AMP Capital

Australia is continuing to see better news on Coronavirus, with new cases in Victoria plunging below levels set as necessary for Melbourne’s ‘Step Two’ reopening in the week ahead, pointing at the prospect of a somewhat faster reopening. NSW also relaxed some distancing restrictions, while various border restrictions were relaxed or removed.



Source: Covid19data.com.au, AMP Capital

Despite the second wave in Victoria, Australia ranks only behind New Zealand in terms of virus control as measured across deaths, new cases, total cases and tests per capita. Which should help Australia's recovery and Australian asset classes.

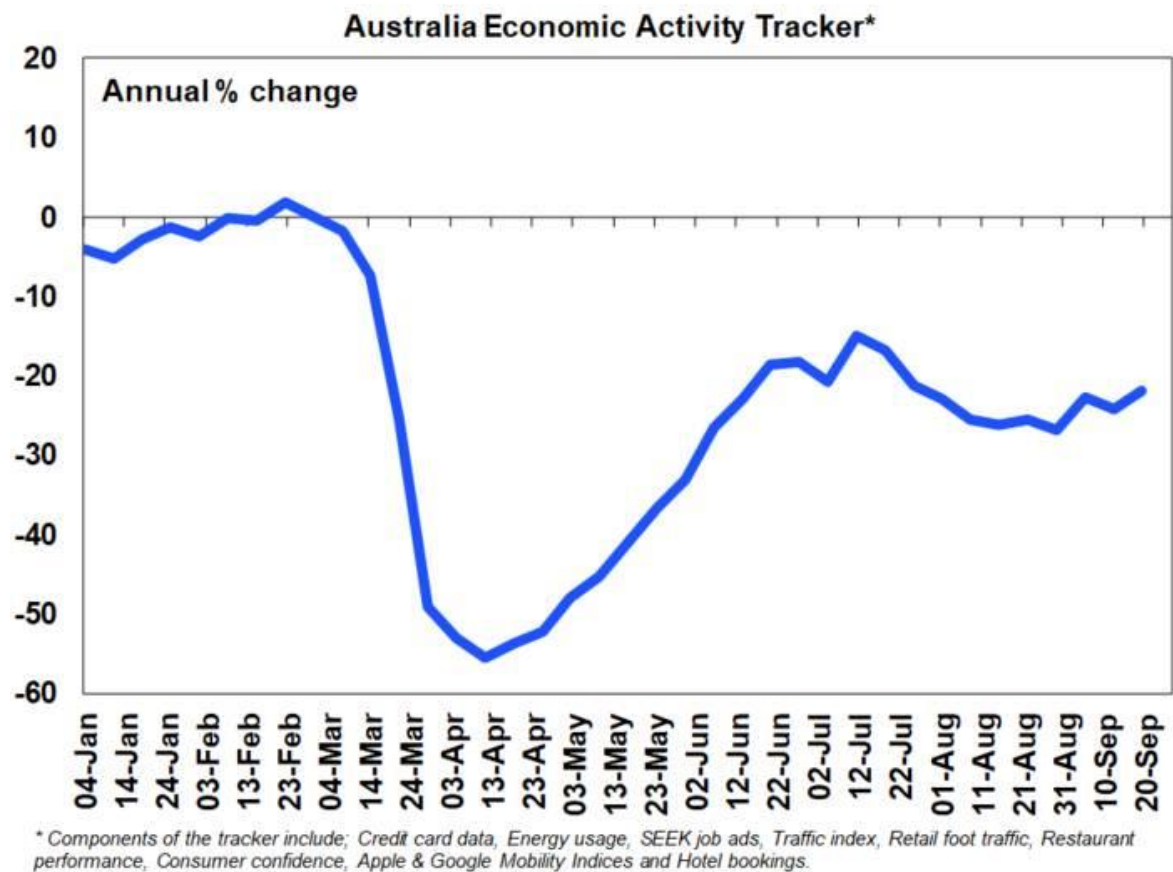
Rank*	Country**	Total Cases	New cases (7-day Avg.) / Population (mil.)	Deaths/Population (mil.)	(Total cases/Pop. mil.) / Days	Tests/Population (mil.)
1	New Zealand	1,471	0.4	5	1	179,267
2	Australia	28,003	1.0	34	5	275,142
3	Latvia	1,572	6.4	19	4	148,509
4	Lithuania	3,932	25.1	31	7	255,491
5	South Korea	23,341	1.9	8	2	41,419
6	Iceland	2,476	116.0	28	34	282,514
7	Japan	80,041	3.4	12	3	13,567
8	Finland	9,288	13.9	62	7	146,555
9	Greece	16,286	29.9	33	7	108,018
10	Slovakia	7,269	37.0	8	7	70,426
11	Estonia	3,033	30.0	48	11	130,307
12	Norway	13,152	20.4	50	12	154,623
13	Denmark	24,357	93.3	111	20	488,674
14	Germany	278,070	21.0	114	14	160,368
15	Poland	81,673	22.3	62	11	75,662
16	Canada	147,753	30.9	249	16	163,066
17	Slovenia	4,694	50.7	64	11	88,013
18	Turkey	308,069	20.3	94	19	101,016
19	Austria	40,558	82.5	88	22	150,050
20	Luxembourg	8,090	163.6	204	64	646,616
21	Czech Republic	55,464	194.0	52	25	99,210
22	Portugal	70,465	67.2	188	33	216,781
23	Ireland	33,675	55.2	370	33	194,739
24	United Kingdom	409,729	67.7	630	26	237,838
25	Hungary	21,200	88.2	73	11	56,852
26	Switzerland	50,984	47.5	208	28	137,132
27	Italy	302,537	26.2	592	21	97,985
28	Sweden	90,000	27.9	577	37	59,197
29	Israel	204,690	529.4	149	106	309,441
30	Netherlands	100,493	118.2	365	28	106,943
31	Belgium	106,793	89.7	872	40	226,754
32	United States	6,934,204	132.4	617	85	262,294
33	Mexico	710,049	33.0	594	27	10,897
34	France	481,141	162.6	470	29	12,734
35	Spain	704,209	240.2	666	63	159,172
36	Chile	449,903	81.0	659	117	147,944
37	Colombia	784,268	137.8	498	78	56,934

* Sample of OECD countries

** Rank determined by New cases (7-day Avg.)/Population (mil.), Total Deaths/Population (mil.), (Total Cases/Population (mil.))/Days, & Testing/Population (mil.)

Source: ourworldindata.org, AMP Capital

The decline in new cases has seen our **Australian Economic Activity Tracker** **hook up from August lows**. Expect a rising trend to continue as Victoria moves to a gradual reopening and other states continue to recover.



Source: AMP Capital

There are mixed signals regarding the next round of US fiscal stimulus, with the political fight over the replacement of Supreme Court justice Ruth Bader Ginsberg adding to the divide but stimulus package talks starting up again between Treasury Secretary Mnuchin and House Speaker Pelosi. The gap between both sides has narrowed to \$1.5trn from Trump and \$2.4trn from the Democrats and Trump would be mad not to agree to something, as not getting it done will hurt him more than the Democrats. Ultimately, we think they will get there, but it's a close call.

On the central bank front, there was lots of dovish news over the last week:

- Comments by European Central Bank (ECB) President Lagarde were dovish and consistent with an increase in quantitative easing in the months ahead;
- While repeated calls from US Federal Reserve (Fed) officials for more fiscal policy stimulus may be adding to market nervousness, Fed Chair Powell also said more is required from monetary policy. While some seem to want more clarity in terms of what the Fed plans to do, this seems to be asking too much given the current uncertainty. The key is that it is very dovish and stands ready to do more;
- The Reserve Bank of New Zealand (RBNZ) indicated that a cheap bank-funding for lending program is set to be introduced soon and reiterated the possibility of a move to negative interest rates;
- Reserve Bank of Australia (RBA) Deputy Governor Debelle provided confirmation that the RBA is considering options for more easing, given that the outlook is not consistent with its objectives. His list of options was not new, with negative interest rates and foreign exchange intervention remaining out of favour, but a rate cut to 0.1% and more bond buying looking more likely.

We continue to expect further easing by the RBA, probably at its October meeting so as to present a united “Team Australia” front with the Federal Government, as it’s the same day as the Budget. This is likely to involve cutting the cash rate, the three year bond yield target and the Term Funding Facility rate to 0.1%, tweaking forward guidance to not raise the cash rate until full employment is reached and inflation is sustainably within the 2-3% target band and adopting a more traditional quantitative easing program, although this may not come all at once.

Meanwhile, the Australian Government announced several measures to further boost growth, with the National Broadband Network (NBN) to spend \$4.5bn on fibre connections for nearly 10 million homes, thereby upgrading the NBN towards what it was originally supposed to be; a relaxation of insolvency rules for small businesses; and the responsible lending laws for banks to be rolled back.

The relaxation of the Australian responsible lending laws is a big move. The 2009 responsible lending laws were reinforced by the Royal Commission and had shifted the focus in lending decisions from “borrower beware” to “lender beware”. Many, including the RBA, have argued the banks had become too conservative and it was taking too long to get loans as banks checked everything borrowers said down to how much they spend on coffee. This move will shift the onus back to the borrower and may speed up the flow of lending to home buyers and small businesses. APRA’s prudential lending standards will remain and the change will not offset the near term drags from high unemployment and reduced immigration, but it may help the recovery at the margin. The risk is that it just helps pump up the property market again down the track, pushing already high household debt levels even higher and opens the door again to “liar loans”. It’s not an issue now, but could be several years ahead, once economic conditions are stronger.

It was a tough ending for The Bachelor this year – I reckon Irena was the right choice, but I felt really sad for Bella (and Locky). Pity Osher couldn’t make it. But back to music. I am a bit of an album person, because they represent a body of work by the artist. The good ones have a common theme running through them and they are often a counter reaction to the artist’s last album (e.g., contrast the indie folk of Taylor Swift’s Folklore with the full on pop of Lover or the Pet Shop Boy’s Very with Behaviour). One of my favourite albums of all time is The Beach Boys’ Sunflower. It

was their first album with Reprise/Warner Records after they left Capitol. While Brian Wilson is clearly evident, it had brilliant contributions by all band members such that every song is a classic. Dennis Wilson's Forever is up there with the best Beach Boys' songs, as is Mike and Brian's dream pop (before dream pop) All I Wanna Do. Unfortunately, the album wasn't a big commercial success, but I reckon I have played it over several hundred times.

Major global economic events and implications

US data was generally strong, with further strength in home sales, strong gains in house prices, a continuing recovery in underlying capital goods orders and business conditions PMIs remaining solid for September. That said, the decline in initial jobless claims looks to have stalled.

The eurozone's composite business conditions PMI fell further, driven by services in September, although they remain around pre-Coronavirus levels. Against this, the German IFO and French INSEE business surveys showed further small improvement. Meanwhile, Italy's governing coalition parties received good support in electoral tests, with constitutional reform which was supported by the Five Star Movement getting strong support in a referendum and the Democratic Party doing well in regional elections. Not so good for the Northern League.

Japan's business conditions PMI's rose slightly in September. While still soft, at least they are well up from their April low.

Australian economic events and implications

Australian data was mixed over the last week, with business conditions PMIs up but payroll jobs down (though they tend to underestimate jobs growth) and retail sales down. The latter fell 4.2% in August, as the surge in spending in previous months had brought spending forward and Victorian retail sales fell sharply. Retail

sales remain well above trend, but this partly reflects the switch in spending from services to goods, and retail sales look likely to be up this quarter despite Victoria.



Source: ABS, AMP Capital

Population growth slowed to 1.4% year-on-year in the March quarter, but the hit to immigration will see it fall to around 0.6% this financial year, its lowest since 1917. This will mean that underlying demand for dwellings will be around 80,000 less than the norm of around 175,000 pa, which in turn will keep rental vacancy rates up, put downwards pressure on prices and mean less housing construction (although HomeBuilder will provide an offset).

What to watch over the next week?

In the US, September jobs data to be released Friday are likely to be the main focus. Payrolls are expected to continue to recover but the pace of gains is likely to slow to around 850,000, with the unemployment rate falling to 8.2% after the surprisingly sharp fall seen in August. In other data, expect gains in consumer confidence (Tuesday) and pending home sales (Wednesday), another solid rise in personal spending (Thursday) despite a fall in personal income on reduced

unemployment benefits and continued strength in the manufacturing conditions ISM for September (also Thursday). Meanwhile, core personal consumption deflator inflation for August (Thursday) is expected to rise slightly to 1.5% year-on-year. Eurozone core CPI inflation for September (Wednesday) is expected to remain low, at around 0.4% year-on-year, with unemployment (Thursday) rising slightly. Japan's September quarter Tankan business conditions survey (Thursday) is expected to show an improvement, but August jobs data (Friday) is likely to soften slightly.

China's September business conditions PMIs (Wednesday) are expected to remain around reasonable levels.

In Australia, expect August credit growth to remain soft (Tuesday), August building approvals (also Tuesday) to rise slightly after a big rise in July, CoreLogic September home price data (Wednesday) to show a 0.2% fall led by Melbourne, ABS job vacancies for the three months to August (also Wednesday) to show a solid rise and August retail sales (Friday) to confirm a 4.2% decline.

Australian budget preview - the delayed Federal 2020-21 budget (6th October) is expected to be big on spending and economic reforms, all designed to spur demand and jobs. Reflecting another hit to revenue assumptions along with an extra \$30bn in stimulus, the projected deficit for this year is likely to be around \$230bn (up from \$184.5bn back in July). The key fiscal measures are expected to be a bring-forward of the July 2022 tax cuts to July 2021 (at a cost of around \$15bn), an investment tax break for companies, an extra \$10bn in infrastructure spending, a new wage subsidy tied to employment, more support for home building, more health spending and possible stimulus payments for welfare recipients. More details around how the Government proposes to further its reform agenda around training and

education, deregulation and industrial relations are also likely. The Government has also committed to not commence budget-repair until unemployment is comfortably below 6%; and it has committed not to raise taxes when it does so.

Outlook for investment markets

Shares remain vulnerable to short term setbacks given uncertainties around Coronavirus, economic recovery, the US election and US/China tensions. But on a 6 to 12-month view, shares are expected to see good total returns, helped by a pick-up in economic activity and stimulus.

Low starting point yields are likely to result in low returns from bonds once the dust settles from Coronavirus.

Unlisted commercial property and infrastructure are ultimately likely to continue benefitting from a resumption of the search for yield, but the hit to economic activity and hence rents from the virus will weigh heavily on near-term returns.

Australian home prices at present are being protected by income support measures and bank payment holidays, but higher unemployment, a stop to immigration and rent holidays will push prices lower into next year. Home prices are expected to fall by around 10%-15% from their April high. Melbourne is particularly at risk on this front, as its "Stage 4" lockdown has pushed more businesses and households to the brink.

Cash and bank deposits are likely to provide very poor returns, given the ultra-low cash rate of just 0.25%.

Although the A\$ is vulnerable to bouts of uncertainty about Coronavirus, the economic recovery and US/China tensions, a continuing rising trend is likely to around \$US0.80 over the next 6-12 months, helped by rising commodity prices, the

return of a positive bond yield differential versus the US and a cyclical decline in the US dollar.

Important notes

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