Market Watch

July Review 2020

INSIDE THIS ISSUE

Over July, varying economic results were reported throughout the world. While the hunt for a successful COVID-19 vaccine continues, Governments and central banks are focusing on new and additional forms of stimulus and relief, to the support the dire economic state of many nations at present.

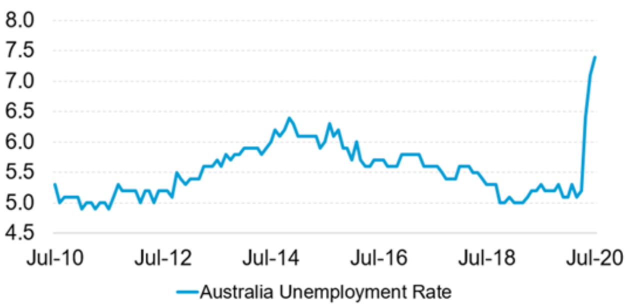
Development in Global Economy

Australia

The Westpac-Melbourne Institute Consumer Sentiment Index fell 6.1% to a reading of 87.9 in July, the first decline after rising for two straight months. While July's reading was 16.2% higher than the record low in April, the index remains 8.0% lower than pre-pandemic levels. Concerns over rising cases of COVID-19 in Victoria were largely behind the deterioration in overall sentiment. With daily infections surpassing 700, Victorian state borders were closed with Greater Melbourne finding itself facing Stage-4 restrictions. Meanwhile, NSW is implementing softer restrictions for weddings, funerals and venues as well as strongly encouraging the voluntary use of masks when in public.

Wage data is expected to show a 0.4% increase in the June quarter and annual growth is predicted to slow from 2.1% to 2.0%. Furthermore, labour force data is likely to reveal a 40,000 increase in employment throughout the month of July, following the 210,800 surge in June. The increase in employment failed to prevent the unemployment rate rising from 7.1% in May to 7.4% in June, the highest since November 1998. The lift was a result of a large proportion of people returning to the workforce. The participation rate jumped from 62.7% in May to 64.0% in June. Consensus is that the July unemployment rate is expected to reach 7.8%, propped up by an increase in the participation rate to 64.4%.

Chart 1: Australian Unemployment Annualised



Source: BTIS/Bloomberg

The government provided an update to budget expectations during July - Some 'eyewatering figures' (as Treasurer Josh Frydenberg appropriately labelled them). At the time of the December 2019 Mid-Year Economic and Fiscal Outlook, the government forecasted a AU$5 billion surplus for 2019-20 and a $6.1bn surplus for 2020-21. The deterioration has been sharp and fast. The Federal Government have announced an underlying cash deficit of -AU$85.8 billion (4.3% of GDP) for 2019-20. The fiscal deficit is expected to rise to -AU$184.5 billion in 2020-21 (9.7% of GDP). The 2020-21 deficit will be the largest on record, with records starting in 1970.

The forecast for Australia's economic contraction in 2020 has been upgraded from 4.0% to 4.2%. The extensive policy measures to support the economy through the impact of this pandemic have accounted for the bulk of the deficit.

Additionally, a heavy decline in economic activity and subsequent loss of employment have resulted in less tax revenue and higher levels of required welfare payments.

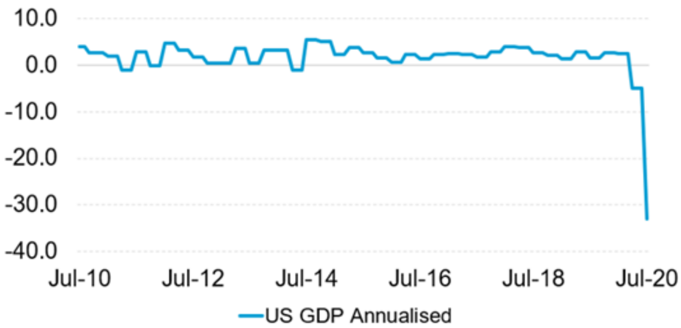
The Federal government also announced the extension of both the Job Keeper and Job Seeker programs over July. Job Keeper has been extended to the end of March, with companies needing to reapply and meet the revenue test every quarter. The new model adds a tiered payment approach, with provisions made for full-time and part-time (less than 20 hours weekly) workers. The new payments are $1,200/$750 and $1000/$650 for the December and March quarter, respectively. The renamed 'Job Keeper 2.0' that will come into effect at the end of September will cost an additional AU$16 billion. Additionally, 'Job Seeker 2.0' will reduce the coronavirus unemployment supplement from $550 to $250 per fortnight. There is also a mutual obligation to accept jobs when offered a position. This extension comes at a cost of AU$3.8 billion. Other support packages were announced over July with the Australian Banking industry announcing that loan deferrals could be extended for up to four months for eligible borrowers. Additionally, the stamp duty exemption in NSW for first home buyers was relaxed, with an increase in the threshold from $650,000 to $800,000. Victoria's premier also announced a AU$534 million Business Support package, which includes a $5,000 grant to support more than 80,000 eligible businesses in response to the stage 4 lockdowns.

While foreign policy has not been a focus of Australia during the past few months, the Foreign and Defence Ministers have travelled to Washington D.C for national security discussions at the AUSMIN summit. Discussions included Australia's response to the growing threat of China's foreign interference and treatment of Hong Kong citizens.

United States

The US economy over July found itself caught between opposing forces. Consumer sentiment is slowing but still strong, aided by the past two months of resurgent job growth. However, the threat posed by COVID–19 continues to increase, and support from existing fiscal stimulus is beginning to dwindle.

Chart 2: US GDP (Annualised)



Source: BTIS/Bloomberg

The Philadelphia Fed Business Outlook survey fell to 24.1 in July from 24.7 in June. The fall was driven by a decline in the six-month outlook which fell to 36.0 from the December 2019 outlook of 66.3 as COVID-19 concerns soured sentiment. Similarly, the University of Michigan's consumer sentiment index fell to 73.2 in July, from 78.1 in June. US chief medical advisor Fauci said that the final stage of several COVID-19 vaccine trials were commencing, and the earliest confirmation of effectiveness would be November. However, even with the end in sight, the effects of this pandemic remain.

A United Nations (UN) study estimates that global tourism revenues will fall by up to US$3.3 trillion due to COVID-19 restrictions with the US standing to be impacted the most. GDP fell at an annualised rate of 32.9% in Q2. It was the worst outcome since GDP was first recorded and follows a 5.0% contraction in Q1. A big drop in consumer spending played a large role in the collapse in economic activity. Declines in business investment, inventories and exports also contributed to the decline in GDP.

On the data front, the July Empire State manufacturing survey rose above expectations to +17.2 (est. +10) from -0.2 in June with the NY Fed citing positive new orders, employment and less negative work hours as lifting in business conditions to their first positive read since February. Although forward conditions slipped from 56.5 to 38.5, this was still a positive read from the extreme rebounds over the past 3 months. The US services sector contracted in July with the PMI services reading registering at 49.6, despite improving slightly from June's reading of 47.9. Readings below 50.0 signals a contraction in activity. The manufacturing PMI, however, rose from 49.8 in June to 51.3 in July. The recent labour market improvement has also come undone. Initial jobless claims for the week ending July 25 rose to 1.43 million, from a revised 1.42 million, with continuing claims also increasing to 17.0 million from 16.2 million. This data suggests the number of people laid off may be starting to rise again.

US lawmakers have been seeking an agreement on a further stimulus package to replace the assistance package due to expire. Senate Majority Leader Mitch McConnell said Republicans were about to unveil a new coronavirus bill worth more than US$1 trillion. That bill is set to include $105 billion for schools and small businesses, as well as direct payments to households and funding for health costs.

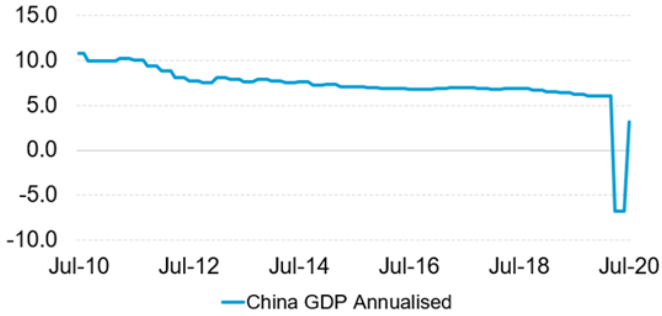
Democrats are proposing US$175 billion to be spent on schools to help them cope through the pandemic amid an increasing likelihood of further lockdowns in some States. US Treasury secretary Steven Mnuchin said Republicans would consider extending some emergency jobless benefits as data for the number of Americans filing for initial unemployment benefits showed the labour market's recovery may be stalling.

Also, in July, the US formally quit the World Health Organisation (WHO), providing the United Nations with the required one year's notice period. More tensions became evident with the US-China relationship over the month. The House of Representatives passed a bill imposing sanctions on China in retaliation to its new national security law which they say diminishes the freedoms of Hong Kong. Sanctions have been applied to banks who do business with officials involved in cracking down on pro-democracy protestors in Hong Kong. The bill was approved unanimously in a vote. Additionally, the US have accused China of directing years of espionage from its Houston consulate in defending the decision to shut it down. US administration officials characterised those transgressions as the 'tip of the iceberg,' hours after Beijing ordered the American consulate in the city of Chengdu closed in retaliation.

Asia

In China, second quarter results were surprisingly stronger than expected. GDP bounced back 11.5% in Q2 following a 10% plunge in Q1. On an annual basis, economic activity returned to growth, increasing by 3.2% in the second quarter following a 6.8% contraction in Q1. This rapid recovery reflects China's successful containment of COVID-19 as well as their ability to return output back to capacity. Industrial production levels rose 4.8% in June, increasing from a 4.4% gain in May. The Caixin manufacturing purchasing manager's index (PMI) rose from 50.7 in May to 51.2 in June. This is the highest level in six months, boosted by domestic demand (notwithstanding weakening export orders). However, not all economic news has been good for China this month. There has been a concerning reduction in retail spending. This might demonstrate the fact that consumer spending may be far slower to recover than the remainder of the economy. Retail sales fell a further 1.8% in June following a 2.8% decrease in May. China's continued economic recovery is still threatened by severely reduced global demand given the multiple second waves that are making their way across the globe.

Chart 3: China GDP (Annualised)



Source: BTIS/Bloomberg

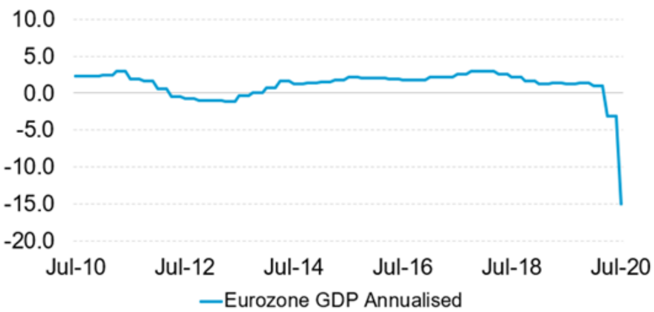
In Japan, economic activity is showing signs of revival after a pandemic induced state of emergency. The rate of national inflation was unchanged at an annual rate of 0.1% in June, representing the first time that prices did not decline on an annual basis in three months. This provides some degree of reassurance that Japan is not beginning a period of deflation.

India's services PMI increased to 34.2 this month after a result of 33.7 in June. This demonstrates a continuation in the reduction of activity. Unfortunately for India, with the highest daily COVID infection and death rate in the world, there is no immediate economic recovery in sight. Continual lockdowns, virus fears, low output and drastically reduced employment are all roadblocks in the path of improvement.

Europe

Harsh restrictions against COVID–19 across the continent have done their job, materially curbing the spread of the virus. Attention is now turning to recovery. Data suggests it is already underway, albeit heavily skewed towards Germany. With respect to the virus and policy, there is a need for a concerted approach that drives the region forward together. Recent forecasts outline that the Italian economy will suffer the largest contraction out of all 27 European Union members. Italy's is expected to contract by 11.2%, with Spain and France also estimated to contract by 10.9% and 10.6% respectively.

Chart 4: Eurozone GDP



Source: BTIS/Bloomberg

In terms of stimulus, the European Central Bank (ECB) have retained their commitment to purchase €1.35 trillion worth of bonds every month. Furthermore, after a four-day EU leader summit, a huge €750 billion recovery package was announced. This includes €390 billion in grants to worst hit member states. Additionally, low-interest rate loans worth €360 billion will also be offered.

In the United Kingdom, planned reduction of restrictions has been delayed by the ongoing infection rate throughout the country. With the 3-month unemployment rate reaching 3.9% in May, a furlough scheme (like JobKeeper) has been established to prevent a further rise in unemployment. Jobless claims were over 28,000 in June after a half million increase in May. The furlough scheme is expected to have helped over 9.5 million employees. The government have borrowed extensively to fund these job-support programs, reaching a record £128 billion in the first three months of FY 20/21.

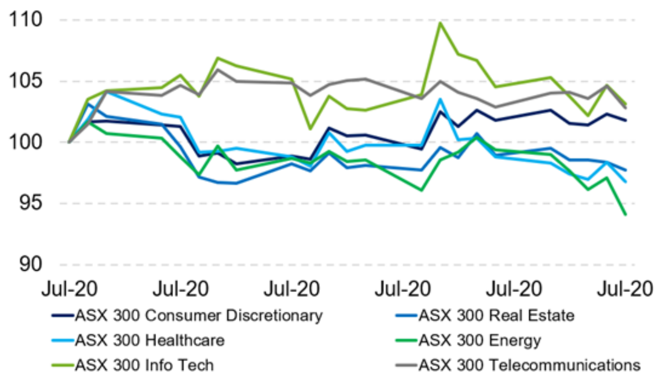
July also saw Britain's National Cyber Security Centre claim that Russian state intelligence have almost certainly hacked COVID vaccine development organizations in multiple countries.

Development in Financial Markets

Australian shares

The Australian share market (ASX300) experienced a modest increase, posting a +0.60% gain for the month of July. This was led by materials, +7.65% and Information Technology, +7.38%. Some losses were seen this month through Healthcare (-3.93%) and Energy (-2.22%). Over the last 3 months, Information Tech and Materials remain up +29.95% and +20.82% respectively, while healthcare is down (-6.82%).

Chart 5: Australian shares (rebased to 100)



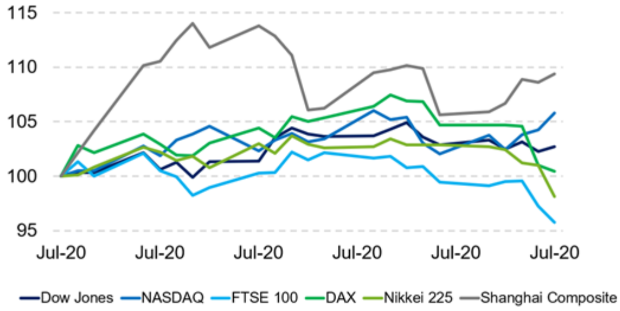
Source: BTIS/Bloomberg

International shares

Global equities experienced a continued increase from last month. The Dow Jones was up by +2.51%, the S&P 500 by +5.6% and the Nasdaq once again leading the way with a rise of +6.85%. European shares performed poorly throughout July. The strongest index result was the German Dax, which rose only +0.02%. Meanwhile, both the European STOXX and UK FTSE fell by -1.1% and (-4.41%) respectively.

In Asia, markets experienced varying results across the continent. After a positive result in June, the Japanese Nikkei decreased by -2.6% this month. The Korean KOSPI had another strong month, finishing up with an index increase of +6.69%. Chinese and Hong Kong markets continued with their positive results from last month. The Hang Seng increased by +0.69% and the Shanghai Composite, by +10.9%.

Chart 6: Major Market Indices (rebased to 100)



Source: BTIS/Bloomberg

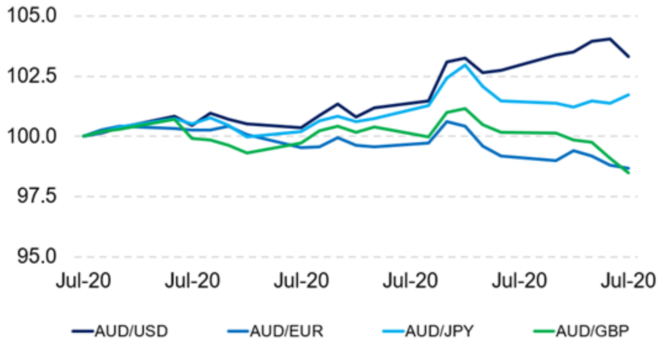
Fixed interest

Throughout the month of July, bond yields traded range bound. After a tightening last month, the US and Australia 10-year bond yield spread widened from +23bps to +30bps.

While the Australian 10-year Treasury bond saw some early increases, the latter part of the month saw a substantial drop to 0.83%. The Australian Commonwealth Government Bonds (ACGB) yield finished higher at 0.30% and the 20-year yield ended the month lower at 1.41%.

Over in Europe, the 10-year bond yields saw decreases throughout July. The Italian 10-year bond yield dropped substantially for a second month in a row, falling by 24bps to 1.01%. Meanwhile, the UK 10-year gilt yields were down 7bps to 0.10%.

Chart 7: Major Currencies (rebased to 100)



Source: BTIS/Bloomberg

Currencies

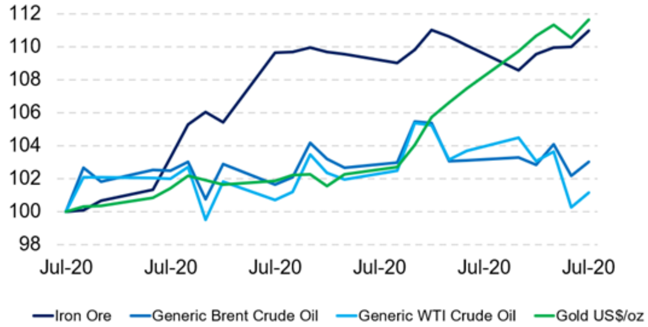
After an increase over the last couple of months, the AUD/USD has continued to increase throughout July. Finishing at 0.7143, the AUD/USD experienced a +3.48% increase this month. The Euro has once again performed well against the USD, with a +4.84% rise to 1.1778. Moreover, the GBP similarly strengthened against the USD again, increasing by +5.52% to 1.3085.

Commodities

Commodities once again performed strongly throughout July with Chinese stimulus supporting the strong Iron Ore prices. Leading the way this month was Iron Ore, which increased +11.47% to a month end price of US$109.25. Gold prices exceeded their performance from last month, rising +10.94% to US$1975.86.

Oil was also up although not to the extent of last month's stellar performance. Brent Crude Oil was up +5.22% to US$43.3 while WTI Oil increased +2.55% to US$40.27. These results were reflected in the Bloomberg Commodity Index which increased +5.70% to 68.6767.

Chart 8: Major Commodities (rebased to 100)



Source: BTIS/Bloomberg

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