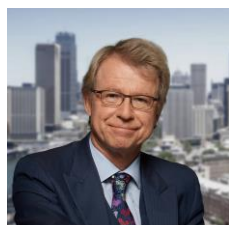


COMMUNICATION

Market Update 19 June 2020

22 Jun, 2020



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Data/Event	Movement	
	LATEST	PREVIOUS
China – Industrial Production (YoY)(May)	+4.4%	3.9%
China - Retail Sales (YoY)(May)	-2.8%	-7.5%
US – Retail Sales (MoM)(May)	+17.7%	-14.7%

Financial markets

Indicator	Friday 19 June 2020	Friday 12 June 2020	Weekly change	19 June 2019	12-month change
S&P/ASX 200 Index	5,942.6	5,847.8	1.6%	6,648.1	-10.6%
S&P/ASX 200 A-REIT	1,275.8	1,252.7	1.8%	1,642.9	-22.3%
US S&P 500	3,097.7	3,041.3	1.9%	2,926.5	5.9%
Dow Jones EURO STOXX	355.8	345.1	3.1%	374.8	-5.1%
UK FTSE 100	6,292.6	6,105.2	3.1%	7,403.5	-15.0%
Japan Nikkei 225	22,478.8	22,305.5	0.8%	21,333.9	5.4%
CHINA – CSI 300	4,098.7	4,003.1	2.4%	3,715.9	10.3%
MSCI (ex-Aust/in LC)	1,717.9	1,681.5	2.2%	1,676.7	2.5%
Australian 90-day bank bill yield	0.11	0.10	+0.13 bps	1.26	-116 bps
Australian 10-year bond yield	0.86	0.91	-4.80 bps	1.34	-48 bps
US 10-year bond yield	0.68	0.70	-1.46 bps	2.02	-134 bps
Oil – West Texas Crude	37.82	34.83	8.56%	79.23	-52.27%
A\$ in US dollars	0.69	0.68	0.31%	0.69	-0.11%
A\$ trade-weighted index (TWI)	60.0	59.9	0.2%	59.5	0.8%

Major upcoming global economic releases and events

Date	Data/Event	FORECAST	PREVIOUS
22 June	Australia – CBA – Manufacturing PMI (Jun)	49.3	44.0
23 June	Europe – Markit Manufacturing PMI (Jun)	43.8	39.4
23 June	US – Markit Manufacturing PMI (Jun)	44	39.8

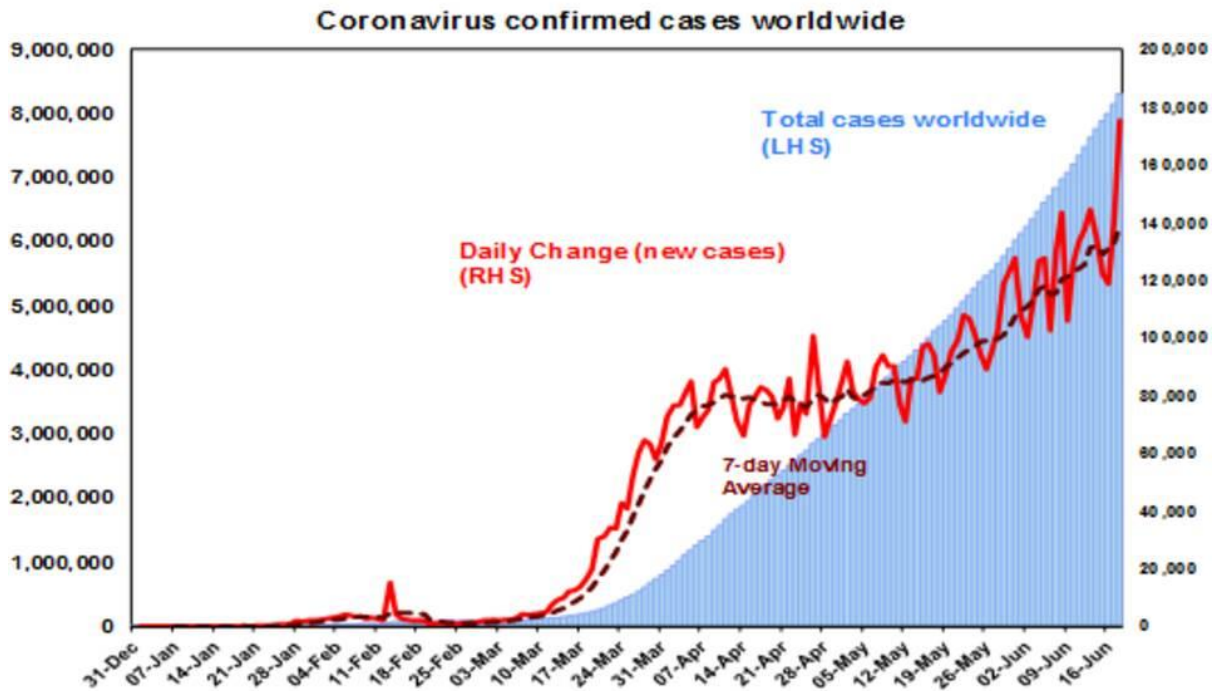
Source: Bloomberg, FXStreet, AMP Capital

Investment markets and key developments over the past week

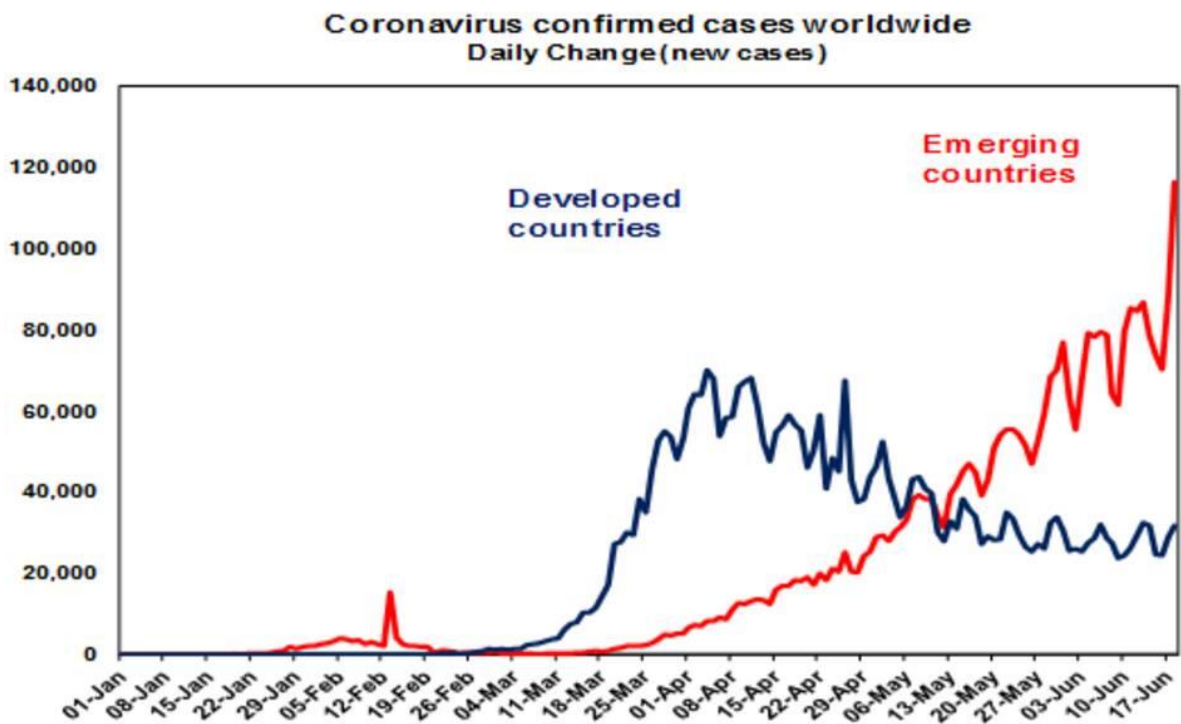
Share markets rose over the last week as ongoing signs of economic recovery and stimulus measures helped offset concerns about a “second wave” of coronavirus cases. US shares gained 1.9%, Eurozone shares rose 3.1%, Japanese shares rose 0.8% and Chinese shares rose 2.4%. Australian shares also gained 1.6% helped by the positive global lead with strong gains in IT, energy, telco and consumer discretionary stocks. The rally came after a 6% to 7% pullback in share markets and still leaves them below their recent highs. Bond yields were little changed in the US, Germany and Japan but fell in Australia. Oil prices and metal prices rose but the iron ore price fell as did the Australian dollar.

Shares remain technically overbought and vulnerable to a further correction or period of consolidation, but we continue to see it as a pause in a rising trend. So far, the pullback has been just 6% to 7% before markets bounced up again in the last week on ongoing stimulus measures. Risks around the growth outlook flowing from second wave worries remain significant and could drive a further correction. However, contrarian support for shares remains from a record amount of cash sitting in US money market funds, surging bank deposits (including in Australia) and investor sentiment remaining relatively cautious. The three big risks are: a second wave of coronavirus cases (which is a big risk in the US as noted below); collateral damage from the shutdowns resulting in a delayed or very slow recovery if bankruptcies surge and unemployment goes higher; and the US presidential election with President Trump likely to try and appeal to his base by ramping up tensions with China (and maybe even Europe), particularly if his approval rating continues to slide.

The big picture globally has not changed on coronavirus. The trend in new cases remains up, driven by a rising trend in emerging countries with big problems continuing in Brazil, India, Pakistan, Mexico, Saudi Arabia, Bangladesh & Indonesia and South Africa. The spike in the last observation in the next two charts reflects an additional 31,000 cases in Chile dating back to March that had not been previously included in official reports.

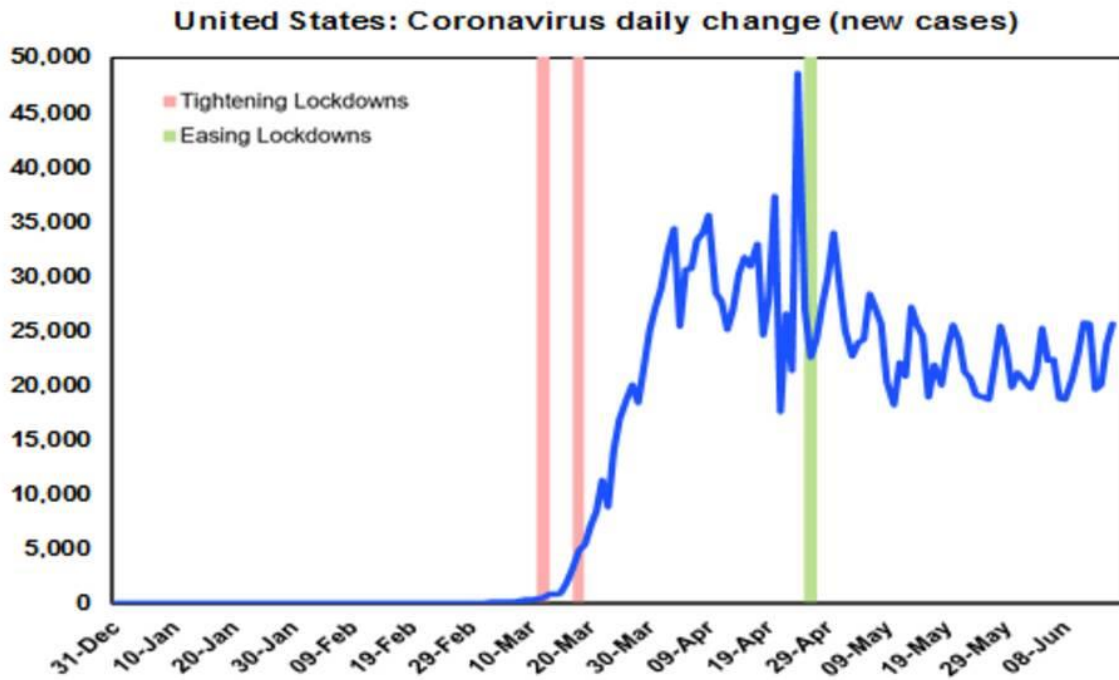


Source: ourworldindata.org, AMP Capital



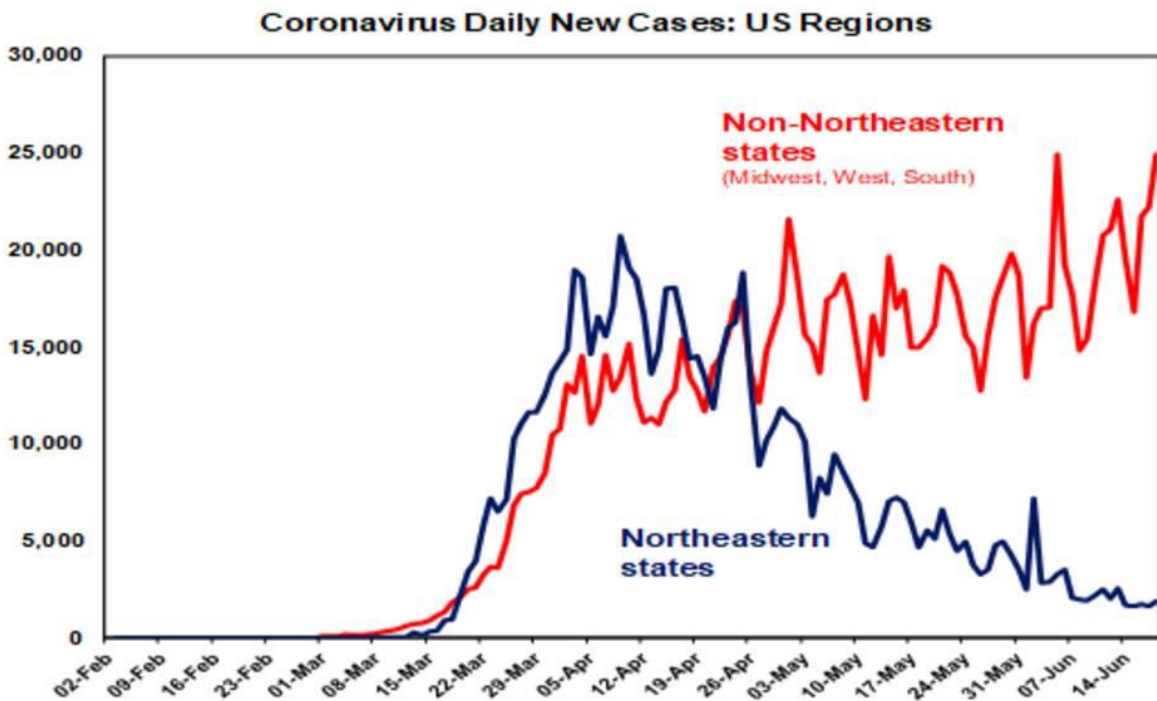
Source: ourworldindata.org, AMP Capital

Fear about a second wave of coronavirus cases continues as several US states are seeing rising trends/second waves. Several points are worth noting in relation to the US: **First the broad trend in new cases in the US remains flattish, although it may be starting to edge up.**



Source: ourworldindata.org, AMP Capital

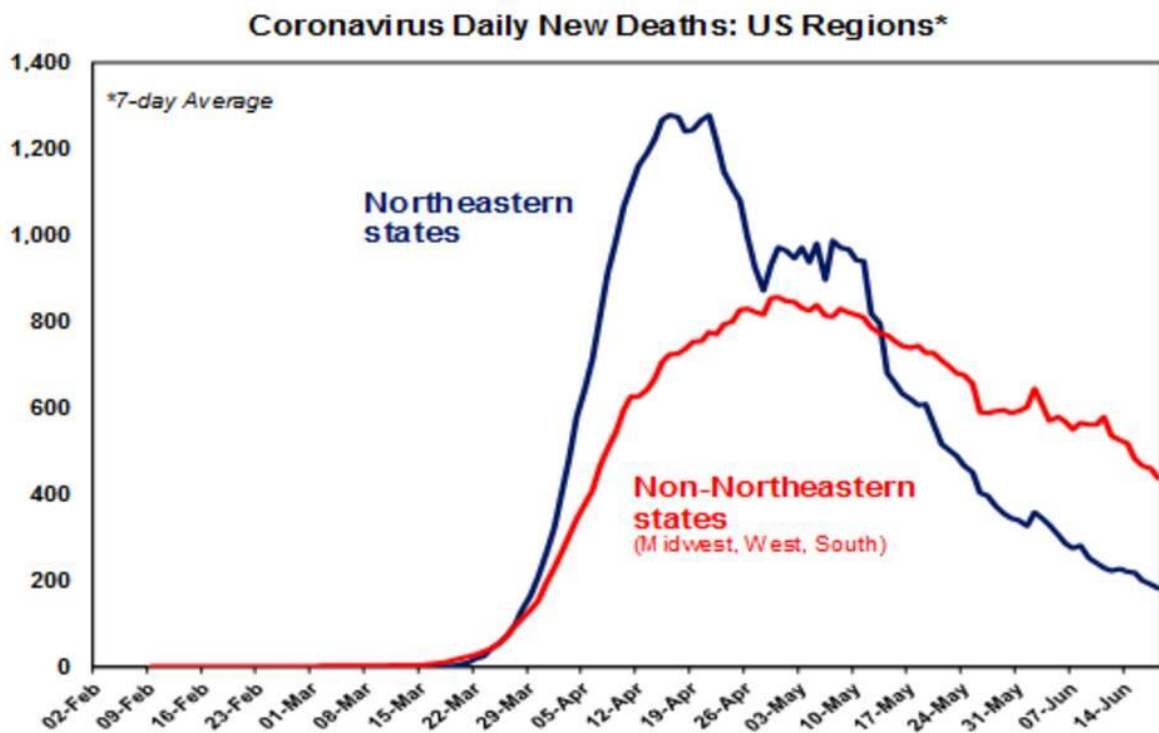
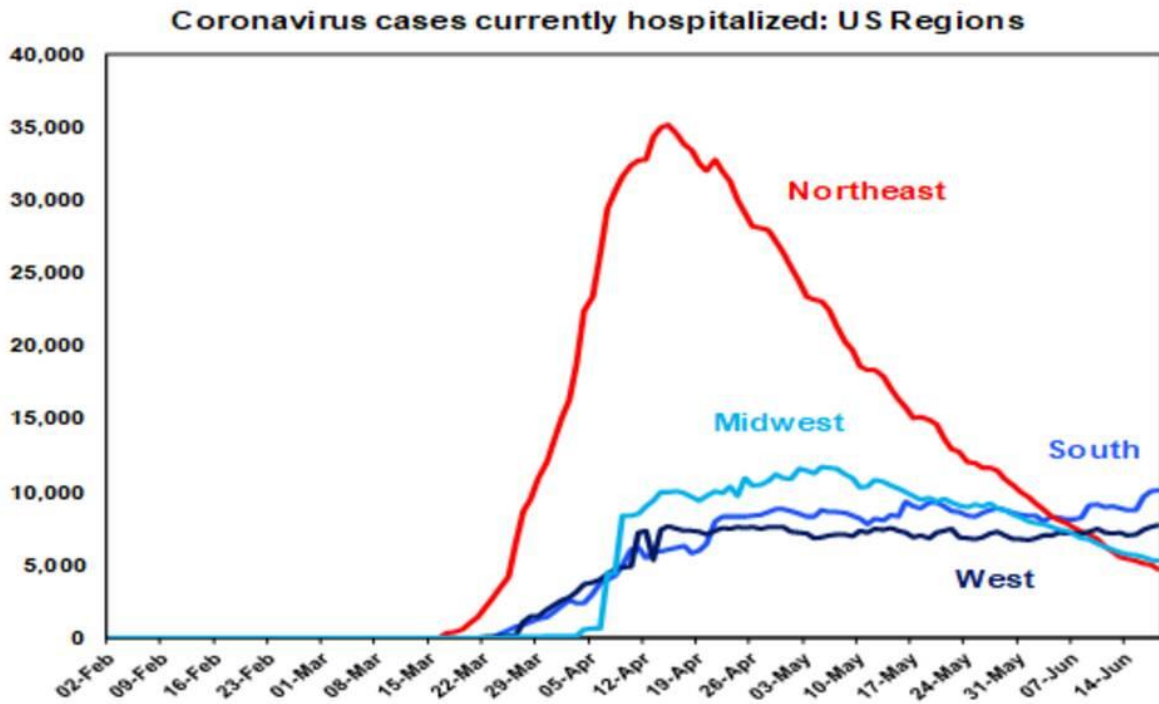
Second, this reflects a declining trend in north eastern states (led by NY) and the mid-west offset by a rising trend elsewhere (notably in Texas, Arizona, Florida and California). It was always inevitable that some states would have ongoing problems and flare ups.



Source: The COVID Tracking Project, AMP Capital

Third, this partly reflects increased testing in the south and west with the overall positive testing rate remaining stable to slightly down (although it's up in some states – notably Texas and Arizona).

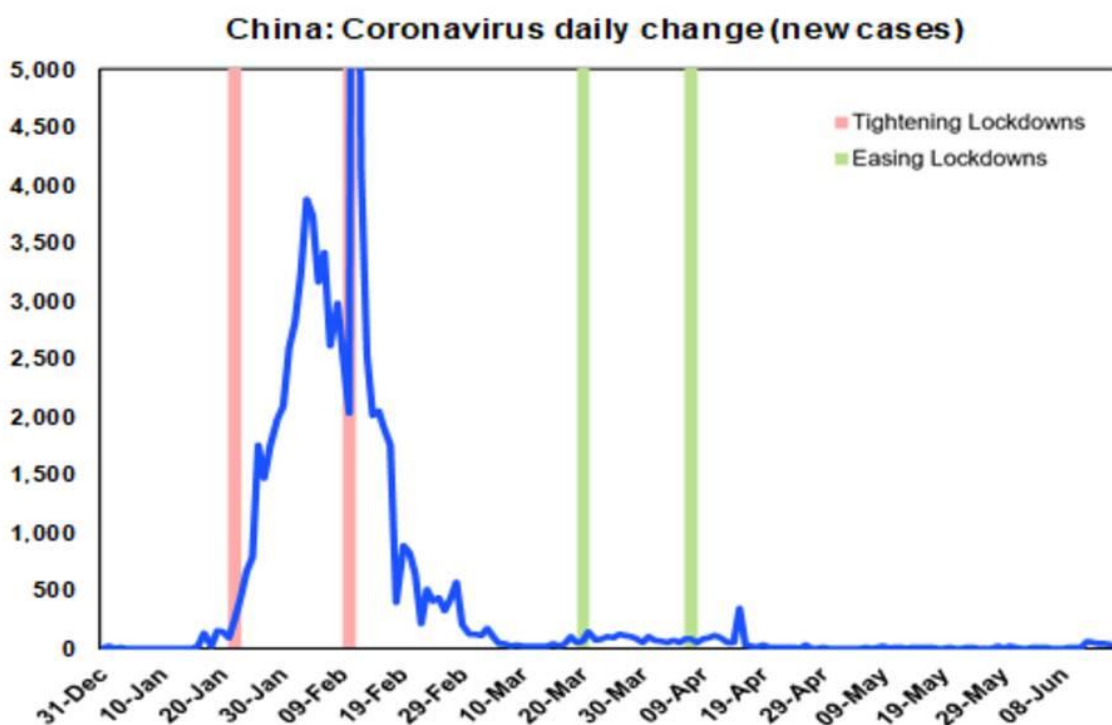
Fourth, hospitalisations and deaths overall have been trending down – although there has been a bit of an increase in hospitalisations in the south. The relatively lower level of hospitalisations and deaths may reflect more young people being affected, better protections for older people and better management of new cases.



Source: The COVID Tracking Project, AMP Capital

Finally, as long as new hospitalisations and deaths remain down a renewed broad-based shutdown of the US economy is unlikely. So, keep an eye on the overall strain on the medical system.

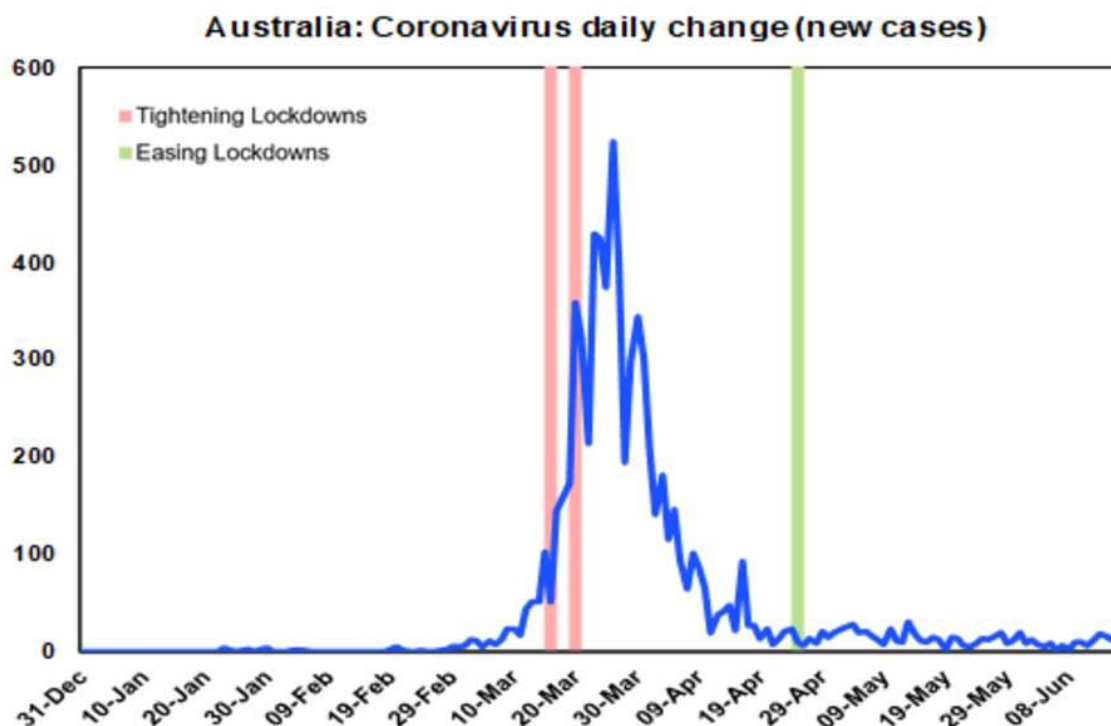
What about China? Beijing (which accounts for about 3.5% of Chinese GDP) has announced a return to some lockdown controls after an outbreak around a market. So far, the number of cases is limited, and new cases have fallen back over the last few days. My base case is that it will be controlled by rigorous testing, tracing, quarantining and some mobility restrictions. But it's a risk worth watching. And its puts paid to the nonsense theory that China unleashed coronavirus on the world but forgot to inoculate the people of Wuhan in advance!



Source: ourworldindata.org, AMP Capital

While Australia is continuing to see a low number of new cases, it has risen to its highest in over a month – mainly due to various clusters in Victoria with many of the new cases connected to family gatherings and returned travellers. So far, the Victorian Government has responded by restricting the number of visitors allowed in homes, the size of gatherings outside homes and by slowing the reopening. Fingers crossed the Victorian outbreaks are brought under control with lots of testing, tracking and quarantining and a renewed emphasis on social distancing. A renewed severe lockdown would be bad news for the Victorian economy and Australia, but we are hopefully a long way from that, and the authorities had anticipated a pickup in cases as the lockdown

is eased. I do wonder whether we have all become a bit too relaxed too quickly though – maybe the mandatory use of face masks in public should be considered!

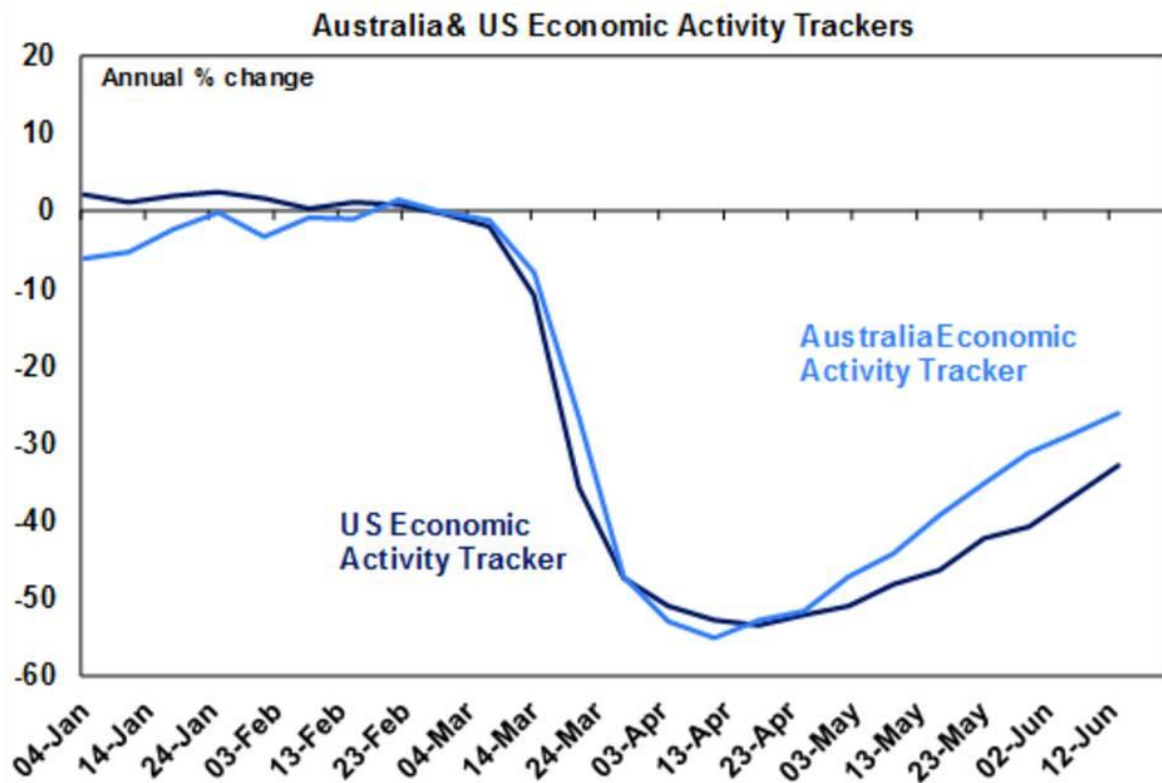


Some positive news on the medical front – with a cheap steroid being shown to reduce the risk of death from coronavirus among the severely ill.

Central bank easing is continuing to roll out with the Fed moving to the direct purchase of corporate bonds, the Bank of Japan increasing its estimate of low cost bank funding, the Bank of England boosting its QE program by £100bn (albeit it expects to slow it by year end), the ECB seeing a record take-up of €1.3trn in funding for banks at a -1% interest rate and the Bank of Indonesia cutting rates again. Meanwhile President Trump floated another US\$1trn infrastructure spending plan, which looks unlikely to make it through Congress but another general stimulus package of US\$1-1.5trn still looks to be on the way. Meanwhile, the message from Fed Chair Powell was a bit more upbeat on the economy in the short term but with uncertainty remaining about the medium term with an ongoing call for more fiscal support. The message from the RBA's latest minutes was pretty much the same.

Deep V rules (for now). The past week has seen an avalanche of data showing a strong rebound in economic activity in May/June after the huge shutdown related hit to data in April. The past week has seen very strong gains in a whole range of data including US regional business conditions surveys, the Eurozone ZEW expectations index, US retail sales and home builder conditions and in Australian

retail sales which are now higher than they were before coronavirus. This is all directionally consistent with high frequency data that has been showing that April was the low and since then things have started to recover. Our weekly economic activity trackers for the US and Australia based on high frequency data for things like restaurant bookings, confidence, retail foot traffic, box office takings, hotel bookings, credit card data, mobility indexes & jobs data are continuing to rise. The Australian Economic Activity Tracker has now risen for nine weeks in a row.



Source: AMP Capital

What about conflict between India and China and North Korea's latest tantrums? The border conflict between India and China has been going on for decades and the violence in the past week involved knives, stones and throwing each other off cliffs (as soldiers on both sides don't carry guns). An escalation is a risk but unlikely to come to much and if it does it may actually reduce bigger risks in the South China Sea. North Korea's latest tantrum may cause a few jitters but Kim Jong Un is unlikely to push things so far that it threatens his regime's existence.

Major global economic events and implications

US data showed an impressive rebound in economic activity. Retail sales surged a record 17.7% in May, permits to build new homes rose 14.4%, home builder conditions continue to recover, auto sales have rebounded by over 49% and business conditions in the New York and Philadelphia region

improved sharply in June. On top of this, jobless claims continued to fall, albeit only slowly.

Eurozone auto sales also roughly doubled in May.

Japanese inflation remained at 0.1% year on year in May, but with core inflation rising to a still very weak 0.4%.

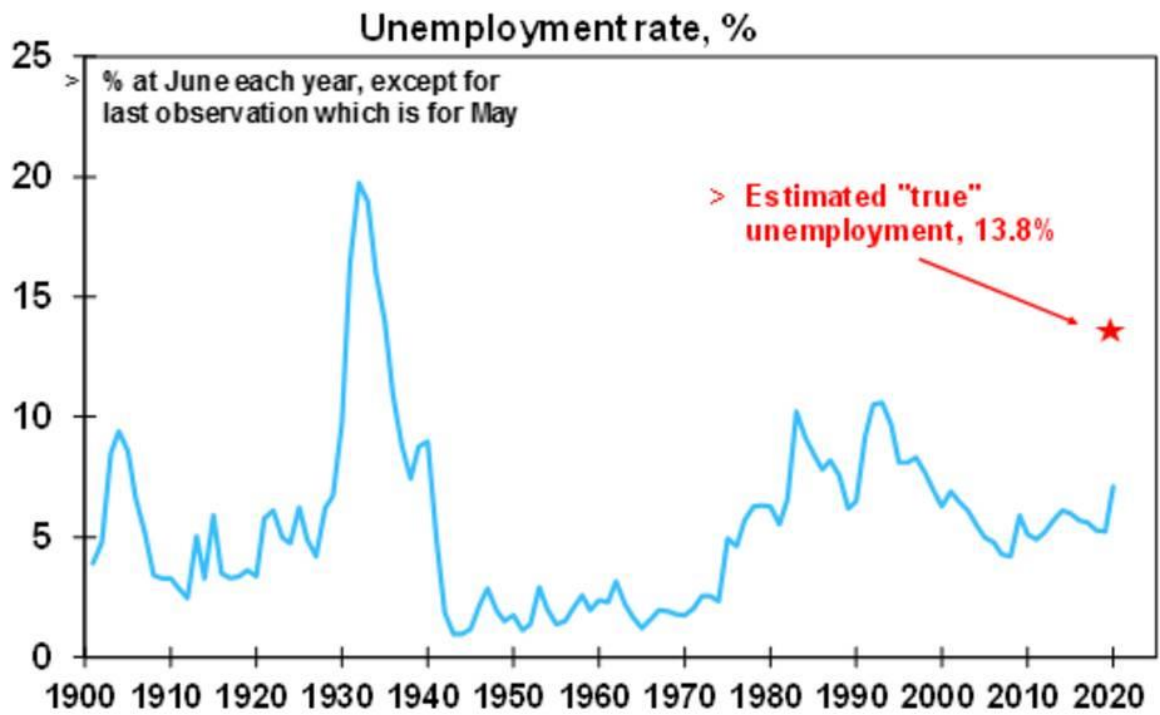
Chinese May economic activity data for industrial production, retail sales and investment

continued to rebound consistent with a solid return to growth this quarter. Home price growth also continued to edge higher. The coronavirus outbreak in Beijing clearly poses a risk if it's not brought swiftly under control, but China's experience shows that much economic activity can bounce back relatively quickly after a lockdown.

Australian economic events and implications

Mostly bad news, but also some good news, on the jobs market. ABS labour force data showed a further sharp deterioration in the Australian labour market into mid-May with employment falling another 228,000 and unemployment rising to 7.1%. This is worse than economists including ourselves expected but still far better than we expected a month or two ago when we saw unemployment going rapidly up to just below 10% this quarter. Whatever it is it's a devastating outcome for those impacted.

The bad news is that the "true" unemployment rate is probably a lot higher than 7.1%. The change to JobSeeker that allows people to receive it and not have to look for work has contributed to a 3% decline in the participation rate (from 65.9% to 62.9%) since March. If the participation rate had only fallen by around 1% as occurred in the early 1990s recession unemployment would have risen to 10%. Furthermore, JobKeeper covering 3 to 3.5million jobs has prevented an even steeper fall in employment – a rough guesstimate of which is around 500,000 jobs. If this is also allowed for it would take the "true" unemployment rate up to around 13.8% which would be the highest since 1935.

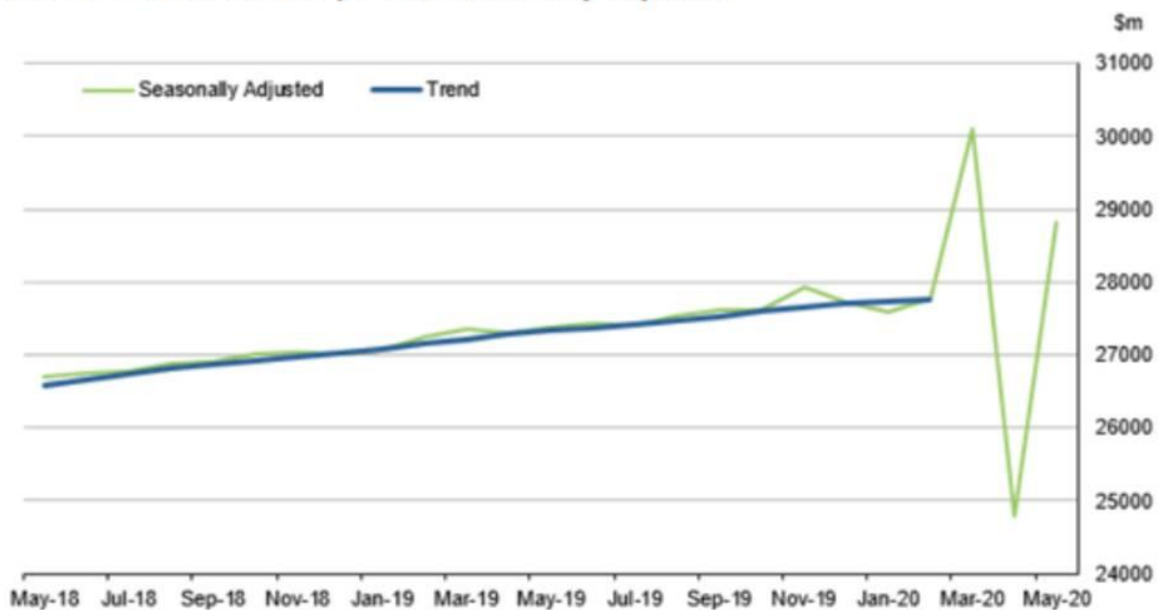


Source: Westpac/MI, NAB, AMP Capital

The good news is that employment should improve over the next few months consistent with the reopening of the economy that has been underway since mid-May (which was too late for the May labour force survey that covered the first half of May) and has seen a significant return of economic activity. This was evident in an improvement in the ABS's payroll jobs data through the second half of May and also in a huge rebound in preliminary retail sales for May.

Retail sales surged a record 16.3% in May. Of course this followed a record fall of 17.7% for retail sales in April but it does seem that the reopening of the economy that was seen from mid-May has unleashed a lot of demand that had been pent up through the lockdown and got Australians back into the shops again. Interestingly over the last 3 months retail sales averaged \$28bn a month which is what they were pre-coronavirus. Of course, consumer services were a lot harder hit and parts of retailing (clothing and restaurants/cafes are down 20 to 30% on a year ago). But it does suggest upside risks to our forecasts for June quarter GDP to contract by 8% quarter on quarter.

Retail turnover, current prices, seasonally adjusted



Source: ABS

The real test will come once JobKeeper ends in September and JobSeeker reverts to requiring recipients to be in the labour market looking for jobs. This is likely to see the unemployment rate head higher, particularly after September. While we expect the “true” unemployment rate to have fallen back by then it’s still likely to be high at around 8%, so our view remains that the measured unemployment rate will peak at around 8% and will remain elevated well into next year. Ideally the Government will utilise some of its \$60bn savings on JobKeeper and possible savings to be had by taking it away from those who no longer need it, to support those parts of the economy (and exposed workers) that will see a slower recovery – notably in tourism, education and parts of retailing.

Australia’s minimum wage to rise 1.75% taking it to \$19.84/hr. The risk is that it prices lower skilled/younger workers out at a time of reduced demand. However, it’s a marginal risk as the increase is small, its well below the 3-3.5% increases of the last 3 years, its phased in and its consistent with a broader slowing in average wage growth in response to the coronavirus hit to the economy.

Australia’s population growth slowed slightly to 1.4% year on year in the December quarter last year, but with immigration grinding to a halt its likely on its way to around 0.4% with obvious big implications for dwelling demand. Our rough estimate is that underlying demand for housing will be reduced by around 80,000 dwellings a year unless a way is quickly found to allow immigrants to

return. This should be feasible with a regime of testing and quarantining – but it may be politically difficult given the weak jobs market.

What to watch over the next week?

Trends in new coronavirus cases will continue to be watched closely, particularly in US states which are seeing rising trends, along with the recent increase in China and Victoria.

On the economic front the big focus in the week ahead will be preliminary business conditions PMIs for June to be released in the US, Europe, Japan and Australia on Tuesday. All are expected to show a continuation of the rebound seen in May consistent with economic activity recovering as economies are reopened.

In the US, expect to see gains in May data for existing home sales (Monday), new home sales (Tuesday), durable goods orders (Thursday) and personal spending (Friday). The record 17.7% surge in retail sales seen in May points to a strong rise in personal spending as consumers start to run down the record 33% saving rate seen in April. Meanwhile, CPI data points to a further fall in core personal consumption deflator inflation for May to just 0.8% year on year.

The RBNZ on Wednesday is not expected to make any major changes to monetary policy.

In Australia, RBA Governor Lowe's comments in a panel discussion (Monday) will be watched for any new clues on how the RBA sees the outlook. It's hard to see him offering much that is new beyond recent observations around the economy recovering earlier but medium-term challenges remaining high. On the data front expect preliminary goods trade data for May (Tuesday) to be consistent with an ongoing trade surplus, ABS job vacancies data for the three months to May (Thursday) are likely to show a sharp fall in catch up to more timely vacancy data but skilled vacancy data for the month of May (Wednesday) is likely to show a rise.

Outlook for investment markets

After a strong rally from March lows shares are vulnerable to short term setbacks given uncertainties around coronavirus, economic recovery and US/China tensions. But on a 6 to 12-month horizon shares are expected to see good total returns helped by a pick-up in economic activity and massive policy 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.

The Australian housing market has slowed in response to coronavirus. Home prices are starting to fall and a sharp fall in employment, a stop to immigration and rent holidays poses a major threat to property prices into next year. While government policies to support jobs and incomes and the bank payment holiday out to September have headed off the risk of a 20% plus fall in prices, they are still expected to fall by around 5 to 10% into next year.

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

Although the Australian dollar is vulnerable to bouts of uncertainty about the global recovery and US/China tensions, a continuing rising trend is likely if as we expect the threat from coronavirus continues to recede. Particularly with the US expanding its money supply far more than Australia is via quantitative easing and with China's earlier recovery likely to boost demand for Australian raw materials (assuming political tensions between Australia and China are kept to a minimum).

Important notes

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