BARINGS INVESTMENT INSTITUTE

July 2020

The Four Rs: Reopening, Reclosing, Risk & Recovery

MONTHLY MACRO DASHBOARD

BARINGS

20-1275052

Key Themes

1. A Bearish Recovery

- Much of the macroeconomic data confirms that the rebound has begun but faces persistent headwinds from faltering consumer confidence, elevated personal savings rates and global uncertainty around COVID-19 and trade.

2. The Dreaded Second Wave

- A recovery in consumer confidence depends heavily on coronavirus containment. Infection rate flare-ups in certain pockets of the world mean new rounds of distancing restrictions and more cautious consumers.

3. Crucial Policy Support

- Policy support through enhanced jobless benefits remains crucial to supporting demand, especially as job separations are elevated. While global fiscal stimulus measures have been exceptional and coordinated, policymakers seem to understand that more will be needed.

4. Asset Markets Hesitate

- Risk assets are in limbo after a strong bullish bounce from the bottom. They remain elevated but volatile and still below pre-crisis highs. With the worst seemingly over, investors have focused their attention on the durability of the earnings recovery next year.

5. Geopolitics Return

- Geopolitical tensions are heating up again in the background of the COVID crisis. While the polls are not yet meaningful for the U.S. presidential election, it is an uphill battle for the incumbent. Meanwhile, rising global tensions with China—both in the U.S. and Europe—are leading to renewed uncertainty about future trading and economic relationships.

6. Weakening Dollar

- After a sharp strengthening during the crisis as global investors flocked to safer U.S. assets, the dollar has begun to weaken, driven by expectations of lower U.S. rates, a search for yield in risky assets, and a diversification of safe assets in the face of uncertainty.

Outlook Summary

The global economic recovery remains intact due to massive fiscal and monetary stimulus measures. However, rising COVID-19 cases and geopolitical tensions are weighing on consumer spending and the outlook. Infection rates are rising in parts of the United States, Europe and even Hong Kong, leading to the reintroduction of containment measures and greater concerns among consumers. Retail sales are weak in Europe and much of Asia, while high-frequency data show the pace of consumer spending in the U.S. moderated in July. Manufacturing is improving, though industrial production remains well below pre-crisis levels. Income replacement in the U.S. has been massive and key to the spending rebound, while effective furlough schemes in Europe have kept unemployment rates and bankruptcies low. Policymakers are readying new spending plans, such as the EU Recovery plan, the fourth U.S. fiscal spending bill and China's infrastructure spending. Meanwhile, geopolitical risks have returned as the U.S. election approaches and tensions with China worsen.

In the U.S., after a quicker-than-anticipated rebound in consumer spending in May and June, rising COVID-19 cases and uncertainty over a fourth fiscal spending bill have led consumers to slow the pace of spending and activities. However, other sectors such as autos, housing, and manufacturing continue to improve. While the labor market could weaken temporarily over the summer, fiscal stimulus should be enough to support incomes and drive overall spending higher if Congress delivers as expected. Industries such as energy and financials, and services-oriented sectors such as leisure, hospitality, entertainment, bars, and travel, may take longer to recover. New growth drivers should keep the U.S. economic recovery intact—even if it is a wavy path forward.

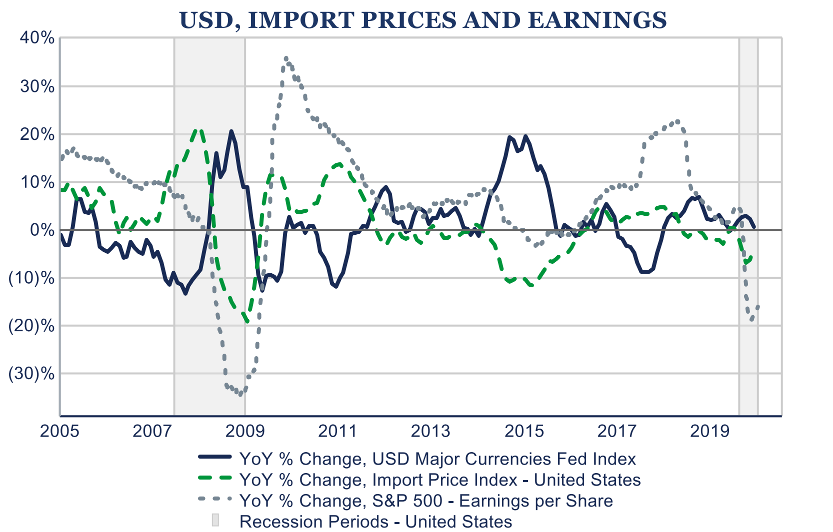
European authorities' response to the pandemic has been fast, appropriate and effective. In stark contrast to what happened after 2008, monetary and fiscal policy have been extremely accommodative and well transmitted in all parts of the euro area, hence preventing the credit crunch that pushed EU economies into deep recessions a decade ago from materializing. Still, consumer confidence and retail sales remain close to their lows in Europe. This is a rational reaction to the unprecedented level of uncertainty prevailing on the EU outlook. Policymakers and laymen know very well that policy support remains crucial. The Recovery Fund has been approved and will provide a crucial respite for beleaguered EU economies. However, government support in the form of job retention schemes, loan guarantees and payment holidays, to name a few, will be gradually withdrawn, starting in the fall. The impact on unemployment and firms' viability can likely only be negative; the question of "how negative?" lingers, and the economies remain in limbo.

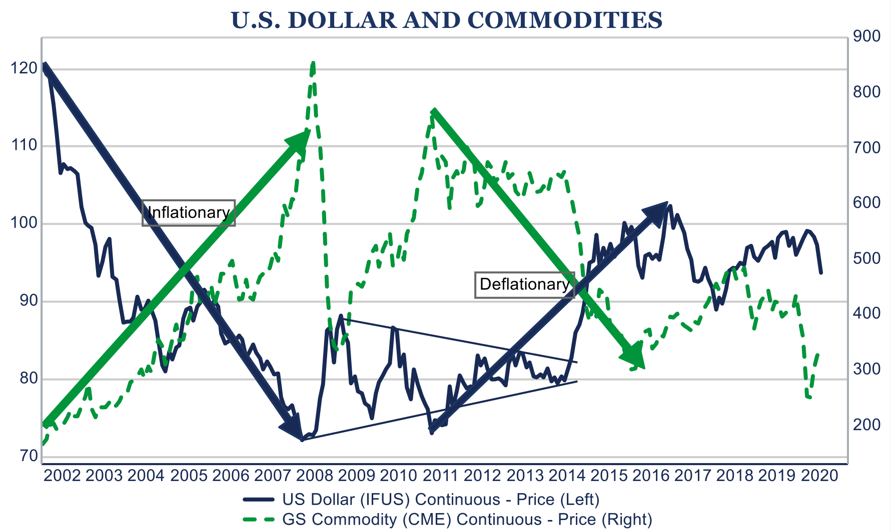
China's economy recovered faster than expected in the second quarter, largely supported by robust credit expansion and government spending. Consumer spending, on the other hand, lagged. High-frequency data in China was more mixed in June than in previous months, but the economy continues to lead the global recovery. **Japan, which saw a later entry into the crisis, has begun a more modest recovery aided by massive fiscal support.** Government stimulus checks to individuals helped boost spending, while weak global demand together with elevated precautionary savings is weighing on the manufacturing sector. Bankruptcies in the region appear limited for now, but concerns of rising COVID-19 cases in areas such as Tokyo and Hong Kong, floods, a potential income cliff in the fall and rising geopolitical tensions keep uncertainty over the outlook elevated.

UPSIDE/DOWNSIDE RISKS TO THE OUTLOOK

Upside	Downside
Vaccine is widely available by year-end	Disappointing U.S. fiscal stimulus
Medical breakthrough	Intensification of trade war
	Another severe COVID-19 outbreak

Continued weakness in the U.S. dollar will likely drive important cyclical shifts





Continued weakness in the U.S. dollar will likely drive important cyclical shifts. Strong U.S. growth tends to lead to a weaker USD—as growth improves, import demand increases, which leads to growth in Emerging Markets and export countries. Since currencies are relative—or a zero-sum game—improving global growth leads to a weaker USD. A weaker USD leads to import price inflation and tends to provide a tailwind for S&P 500 earnings (40% of revenues outside the U.S.).

The U.S. dollar and commodity prices are negatively correlated—dollar cycles tend to play out over a number of years, with a weaker USD driving higher commodity prices. Current drivers of weaker USD demand are the rapid recovery from the economic shutdown, reduced safe haven demand and a sharp rise in the U.S. fiscal deficit. Various markets are exhibiting this change in USD direction—industrials and materials sectors are outperforming in the S&P 500, precious metals and copper are rising, the euro is catching a bid, and foreign equity markets (such as the DAX and BOVESPA) are hitting new recovery highs. It remains to be seen if recent USD weakness develops into a longer-term trend that may have more lasting implications for inflation, or if it is more of a short-term cyclical adjustment as we bounce back from recession.

Source: FactSet. As of 07/24/2020.

Global

OUTLOOK

The global economic recovery remains intact due to massive fiscal and monetary stimulus measures. However, rising COVID-19 cases and geopolitical tensions are weighing on consumer spending and the outlook. Infection rates are rising in parts of the United States, Europe and even Hong Kong, leading to the reintroduction of containment measures and greater concerns among consumers. Retail sales are weak in Europe and much of Asia, while high-frequency data show the pace of consumer spending in the U.S. moderated in July. Manufacturing is improving, though industrial production remains well below pre-crisis levels. Income replacement in the U.S. has been massive and key to the spending rebound, while effective furlough schemes in Europe have kept unemployment rates and bankruptcies low. Policymakers are readying new spending plans, such as the EU Recovery plan, the fourth U.S. fiscal spending bill and China's infrastructure spending. Meanwhile, geopolitical risks have returned as the U.S. election approaches and tensions with China worsen.

Economic Activity	2017	2018	2019	2020 (E)	2021 (E)	2022 (E)
Real GDP (Y/Y %)	3.9	3.6	2.9	-3.7 --	5.1 ▼	3.4 ▲
CPI (Y/Y %)	3.2	3.6	3.6	2.2 ▲	2.5 ▲	2.8 ▼
Trade Volume (Y/Y%)	5.7	3.8	1.0	-11.9	8.0	8.0
Inter-Bank Rates						
3-Month USD Libor	1.69	2.81	1.91	0.34 ▼	0.45 ▼	0.75 --
3-Month Euribor	-0.33	-0.31	-0.39	-0.40 ▼	-0.37 ▼	-0.32 --
3-Month GBP Libor	0.52	0.91	0.79	0.17 ▼	0.21 ▼	0.39 --
3-Month JPY Libor	-0.02	-0.07	-0.05	-0.08 ▼	-0.08 ▼	-0.03 --

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg and IMF as of 07/27/2020. (E)—Bloomberg private market consensus estimates for GDP, CPI and rates. Trade volume data is a projected figure from the IMF.

CENTRAL BANKS have taken a step back to assess the efficacy of recent fiscal policy, though additional monetary accommodation is not hard to imagine.

Economy	Policy Rate (%)	Next CB Meeting	Implied Policy Rate (%) 3M	6M	1Y
U.S.	0.13	07/29/2020	0.09	0.07	0.04
Eurozone	-0.50	09/10/2020	-0.51	-0.53	-0.55
U.K.	0.10	08/06/2020	0.08	0.03	-0.03
Japan	-0.04	09/17/2020	-0.05	-0.07	-0.06
China	2.20	—	2.04	2.11	2.18

- The **FOMC** is expected to remain at the zero-lower bound for several years, although markets are pricing in slight odds of rates going even lower. While the Fed will likely take a back seat to fiscal policy in the near-term, it has signaled that more explicit forward guidance such as yield curve control may be forthcoming.
- The **ECB** has kept its primary policy settings unchanged as it feels it is in a good place at the moment. Experience with a two-tier system also seems to be working as intended. A second virus wave appears to be a concern, though the baseline forecast accommodates this.
- The **BoE** is choosing to maintain its easing bias, citing it as appropriate, but has recently cautioned on the endurance of the recovery. Negative rates continue to be an open question.
- The **BOJ** is holding steady and continues to focus on support for companies and employment rather than inflation in the near-term.
- The **PBOC** has shifted to a slightly less dovish stance amid solid credit growth in the economy, tolerating gradual increases in key benchmark rates, including the 7-day repo, 1-month SHIBOR and 7-day swap.

Source: Bloomberg and FactSet. As of 07/27/2020.

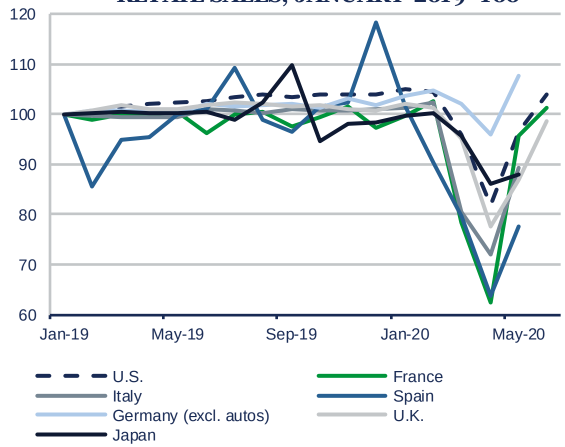
Global

RETAIL SALES are weaker in much of Asia and Europe but rebounded strongly in the U.S. amid greater income replacement.

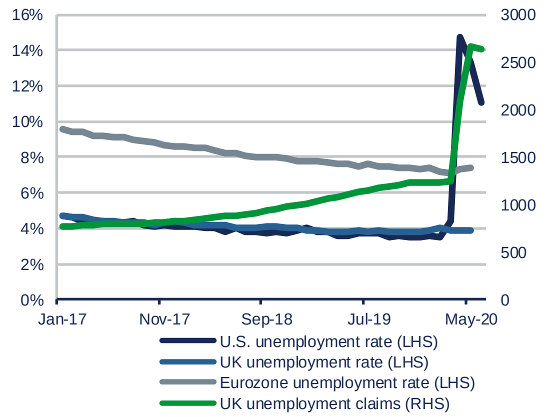
LABOR MARKETS are being aided by unprecedented levels of fiscal stimulus, but the recovery hinges on further aid.

DECLINING REAL YIELDS are consistent with a state of excess savings and is a tailwind for assets like gold.

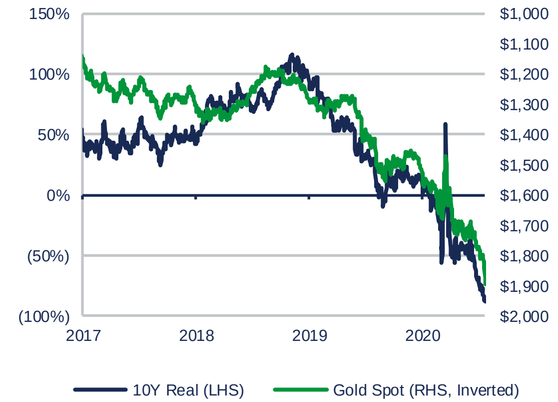
RETAIL SALES, JANUARY 2019=100



UNEMPLOYMENT



U.S. REAL YIELD VS. GOLD



- Retails sales are experiencing a slower recovery in much of Asia and Europe amid cautious consumers and fiscal stimulus that replaces only a portion of lost income for those who lose their jobs or working hours.
- Meanwhile, retail sales in the U.S. are roughly back to pre-crisis levels, as stimulus checks and additional unemployment insurance benefits left many individuals with greater incomes than prior to the pandemic.
- Consumer spending varies by sector, and spending on service activities such as leisure, hospitality and travel are set to be laggards in this recovery across the globe.

- Effective furlough schemes in Europe have kept unemployment rates in the single digits, as they keep employees connected with employers and replace a large portion of income. However, job losses—as seen in claimant counts—have jumped, suggesting many countries will need to extend schemes or risk a delayed jump in unemployment rates and lost income.
- The unemployment rate in the U.S., by contrast, jumped in April but has begun to trend south. While the pace of improvement is set to slow and may be a bumpy road, fiscal stimulus has more than made up for lost income. But more is needed soon as stimulus checks have been largely spent and the additional $600/week UI benefit expires on July 31.

- Real yields continue to grind lower amid concerns about the growth outlook and increased supply of global savings. It's a trend that has continued since 2018 but has recently come into focus amid perceived inflationary risks due to the fiscal-stimulus fueled debt binge in the current crisis.
- Fears of future inflation may not be the full story, however, especially as the stock of negative yielding debt has also started increasing recently. With real yields, rather than breakeven inflation, also being a larger driver of nominal yields in the U.S., the price action may be less about inflation hedging and more about the fundamental uncertainty around the growth outlook.

Source: Bloomberg. As of 07/24/2020.

OUTLOOK

In the U.S., after a quicker-than-anticipated rebound in consumer spending in May and June, rising COVID-19 cases and uncertainty over a fourth fiscal spending bill have led consumers to slow the pace of spending and activities. However, other sectors such as autos, housing, and manufacturing continue to improve. While the labor market could weaken temporarily over the summer, fiscal stimulus should be enough to support incomes and drive overall spending higher if Congress delivers as expected. Industries such as energy and financials, and services-oriented sectors such as leisure, hospitality, entertainment, bars, and travel, may take longer to recover. New growth drivers should keep the U.S. economic recovery intact—even if it is a wavy path forward.

Economic Growth	7/27/2020	12/31/2018	12/31/2019	2020 (E)	2021 (E)	2022 (E)
Real GDP (Y/Y %)	0.3	2.9	2.3	-5.5 ▲	3.9 ▼	2.9 ▲
Inflation						
CPI (Y/Y %)	0.6	2.5	1.8	0.9 ▲	1.6 ▼	2.0 --
Core PCE (Y/Y %)	1.0	2.0	1.6	1.1 ▲	1.3 --	1.8 ▲
Labor Market						
Unemployment (%)	11.1	3.9	3.7	9.1 ▼	7.5 --	6.0 ▲
Rates						
Fed Funds	0.13	2.38	1.63	0.25 --	0.35 --	0.55 --
2Y Treasury	0.15	2.52	1.57	0.29 ▼	0.54 ▼	0.92 --
10Y Treasury	0.61	2.72	1.92	0.87 ▼	1.23 ▼	1.64 --

Arrows indicate consensus estimate change compared to one month ago

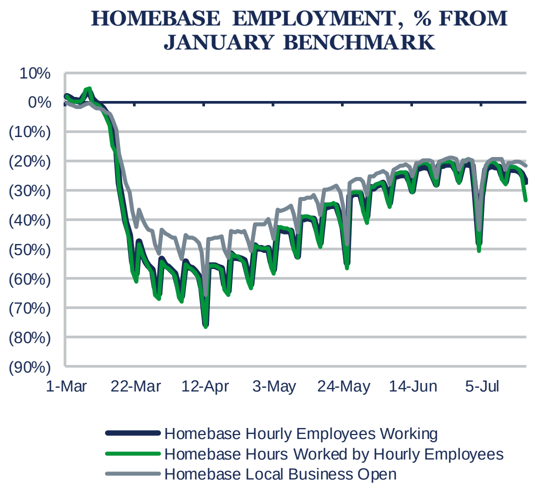
Source: Bloomberg. As of 07/27/2020. (E)—Bloomberg private market consensus estimates.

U.S.

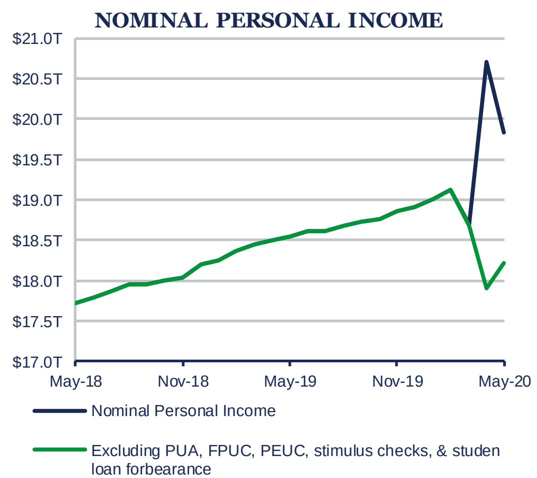
After improving in May and June, the **LABOR MARKET** is set for a more modest and bumpy recovery amid uncertainty.

FISCAL SUPPORT has been key for the sharp rebound, but more is needed in the immediate near-term to sustain growth.

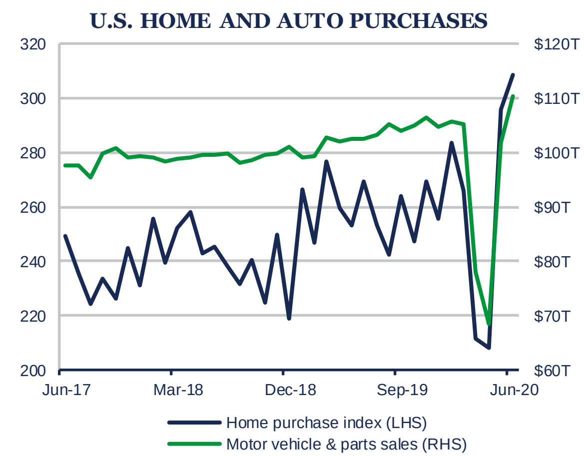
The **AUTO AND HOUSING SECTORS** are rebounding strongly and are set to be growth drivers of the recovery.



- After losing over 22 million jobs in March and April, employment rebounded in May, rising by almost 7.5 million jobs in May and June.
- However, after record monthly job gains, employment trends have eased in July amid rising COVID-19 cases and uncertainty around future fiscal stimulus—and therefore future financial conditions.
- Employment is set for a bumpy road and could take a temporary step back over the summer, but if fiscal policies continue to be supportive, employment should improve throughout the recovery.



- U.S. fiscal stimulus has been key to a rebound in consumer spending as, despite health concerns and mass job losses, income soared above pre-pandemic levels.
- Without further fiscal stimulus, combined with concerns amid rising COVID-19 cases, the U.S. could face a double-dip recession, as income would collapse with a still-elevated unemployment rate.
- However, if adequate fiscal stimulus is passed—as expected—the recovery should remain intact.



- While consumer spending has eased in July, the housing market and auto sector have rebounded beyond pre-crisis levels and will help drive growth this recovery.
- Record-low mortgage rates and pent-up demand have led weekly home purchase applications to exceed January levels, and both consumers and home builders remain optimistic on the outlook.
- Auto sales have reached new highs, as the pandemic has boosted demand given rising concerns surrounding public transit use, which has led those who did not previously need a car to take the plunge.

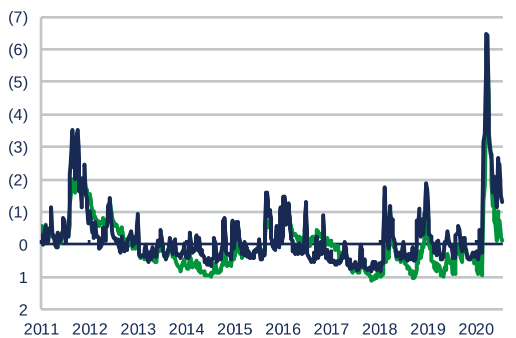
Source: Bloomberg and Bureau of Economic Analysis. As of 07/24/2020.

Fed liquidity has gone a long way to calm financial conditions, but MARKETS REMAIN HESITANT.

NO SIGNS OF SCARRING YET as most default and bankruptcy activity is likely centered on reorgs rather than liquidation.

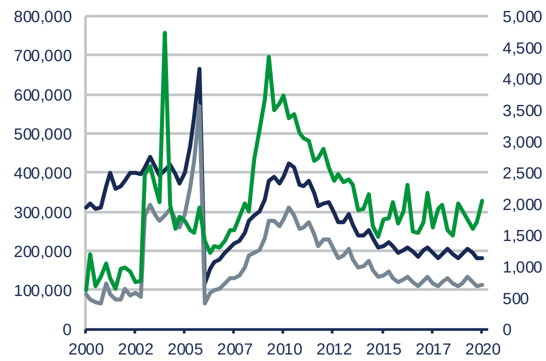
The worst may be over, but a complete RECOVERY IN EARNINGS isn't expected to come until late next year.

IMPLIED VOLATILITY & FINANCIAL CONDITIONS



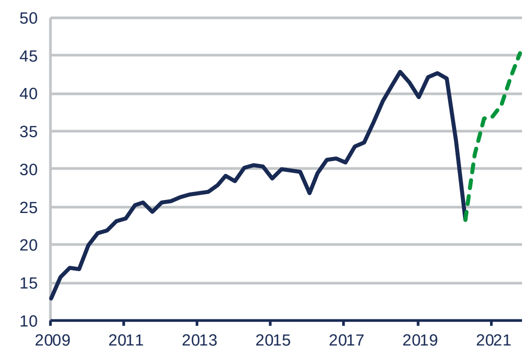
- Ultra-accommodative policy from the Federal Reserve has caused financial conditions to quickly revert back to neutral conditions, preventing capital markets from completely seizing up.
- Nevertheless, some pockets of concern remain as implied equity volatility, while off their highs, continue to remain elevated. The same dynamic is also true of credit spreads and CDS spreads, which remain above pre-crisis tights.
- Despite the optimism around the stunning rally in markets, it may very well be built on shaky ground, especially as both risk and haven assets rally here.

U.S. BANKRUPTCY FILINGS



- Markets appear to be cautious about the potential for permanent scarring caused by business liquidation and closure. So far, evidence of this impact appears limited, as U.S. aggregate bankruptcies remain stable.
- Most of the stress so far has been in the form of Chapter 11 bankruptcies, which are arguably more strategic in nature rather than true business liquidation.
- Fiscal relief has been instrumental in keeping solvency risks minimal but risks of an income cliff remain, especially as we approach fall.

S&P 500 INDEX ADJUSTED EARNINGS PER SHARE



- Forward earnings growth expectations have stabilized out at these low levels as the economy goes down the path of gradual reopening. Still, questions remain about the speed and endurance of the recovery, especially as risks remain tilted to the downside.
- A return to pre-crisis earnings for the S&P 500 as a whole is expected by Q3 2021 but is more varied on an industry basis. Recovery time should be quickest for Health Care and Materials, with expectations calling for a complete recovery this year. Energy and Financials appear to be the laggards, with earnings not expected to return to normal until after 2021.

Source: Bloomberg. As of 07/24/2020.

OUTLOOK

European authorities' response to the pandemic has been fast, appropriate and effective. In stark contrast to what happened after 2008, monetary and fiscal policy have been extremely accommodative and well transmitted in all parts of the euro area, hence preventing the credit crunch that pushed EU economies into deep recessions a decade ago from materializing. Still, consumer confidence and retail sales remain close to their lows in Europe. This is a rational reaction to the unprecedented level of uncertainty prevailing on the EU outlook. Policymakers and laymen know very well that policy support remains crucial. The Recovery Fund has been approved and will provide a crucial respite for beleaguered EU economies. However, government support in the form of job retention schemes, loan guarantees and payment holidays, to name a few, will be gradually withdrawn, starting in the fall. The impact on unemployment and firms' viability can likely only be negative; the question of "how negative?" lingers, and the economies remain in limbo.

Economic Growth	7/27/2020	12/31/2018	12/31/2019	2020 (E)	2021 (E)	2022 (E)
EZ Real GDP (Y/Y %)	-3.1	1.9	1.3	-8.1 ▼	5.5 ▲	2.2 ▲
U.K. Real GDP (Y/Y %)	-1.7	1.4	1.5	-8.9 ▼	6.0 ▲	2.6 ▼
Inflation						
EZ CPI (Y/Y %)	0.3	1.8	1.2	0.4 --	1.1 --	1.3 --
U.K. CPI (Y/Y %)	0.6	2.5	1.8	0.8 ▼	1.4 ▼	1.8 ▲
Labor Market						
EZ Unemployment (%)	7.4	8.2	7.6	8.9 ▼	9.4 ▼	8.7 ▼
U.K. Unemployment (%)	3.9	4.1	3.8	6.1 ▼	6.8 ▲	5.6 ▼
Rates						
EZ Central Bank	0.00	0.00	0.00	0.00 --	0.00 --	0.00 --
EZ 2Y Note	-0.67	-0.62	-0.61	-0.60 ▲	-0.46 ▲	-0.34 --
EZ 10Y Bond	-0.49	0.24	-0.19	-0.37 ▲	-0.14 --	0.13 --
U.K. Central Bank	0.10	0.75	0.75	0.05 --	0.15 ▼	0.55 --
U.K. 2Y Gilts	-0.11	0.74	0.53	0.03 ▼	0.27 ▼	0.26 --
U.K. 10Y Gilts	0.11	1.27	0.82	0.33 ▼	0.63 ▼	0.82 --
Currencies						
EUR/USD	1.18	1.14	1.12	1.14 ▲	1.17 ▲	1.20 --
GBP/USD	1.29	1.27	1.33	1.27 --	1.32 --	1.37 ▲

Arrows indicate consensus estimate change compared to one month ago

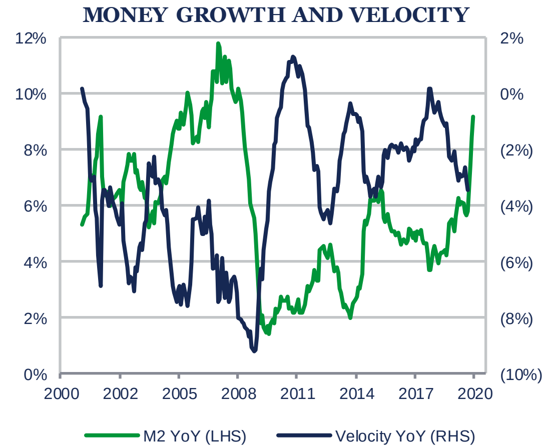
Source: Bloomberg. As of 07/27/2020. (E)—Bloomberg private market consensus estimates.

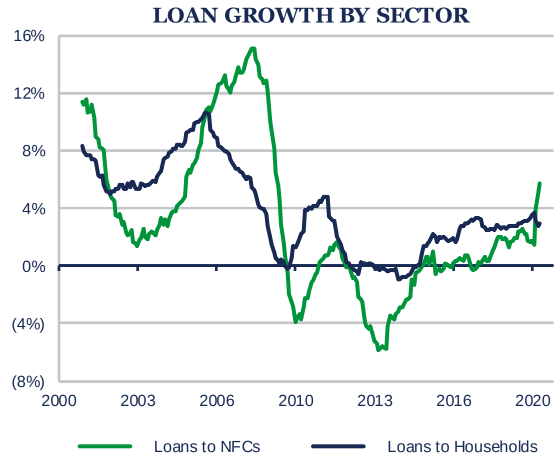
Europe

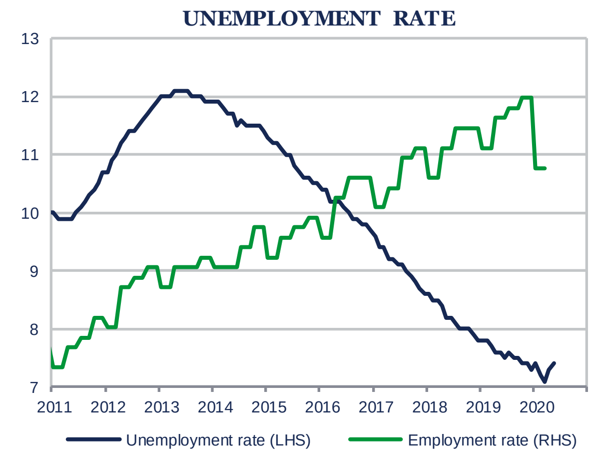
NO POLICY MISHAP THIS TIME AROUND – ECB to the rescue.

…AND IT IS PAYING OFF as a credit crunch is avoided.

FISCAL POLICY ALSO SUPPORTED LABOR MARKETS which are scarcely touched (for now).







- Contrary to the Global Financial Crisis (GFC), the COVID shock has been followed by an immediate and extensive monetary policy response.
- While a monetary contraction took place after 2008 (money growth declined) and velocity (the propensity of people to spend and invest) also declined, a substantial monetary expansion is taking place this time around and velocity does seems to have remained stable so far.
- The ECB has managed to make money cheaper and more available, to contrast the effects of the pandemic.

- After 2008, credit to non-financial corporations collapsed and credit to households continued its long-standing deceleration.
- This credit crunch magnified the impact of the 2008 crisis on EU economies, triggering one of the worst recessions post-WWII.
- Credit to firms has even accelerated this time, thanks to the ECB monetary expansion, combined with loan guarantee schemes set up by national governments, while household credit has also remained stable.
- This provides support to businesses and families that would have otherwise fallen in arrears with loans, mortgage and other payments.

- Notwithstanding the unprecedented drops in economic activity due to lockdowns, unemployment remained stable since the outbreak of the pandemic (in some EU countries it even declined).
- Few workers stopped looking for jobs and left the labor force: employment declined only slightly.
- Furlough schemes have obviously limited unemployment surges, but the question is what will happen once they are phased out?

Source: Bloomberg and Haver. 06/30/2020.

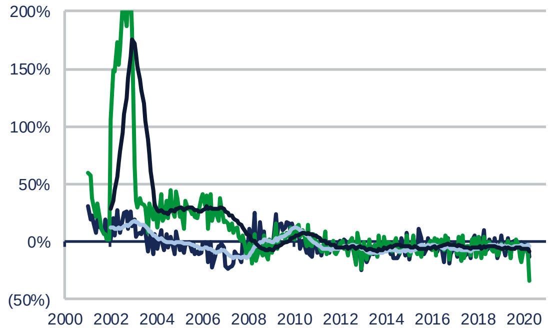
Europe

DELAYING THE RECKONING? The support had oxymoronic effects.

A RETURN TO NORMAL INSOLVENCIES would imply a 30% jump in bankruptcies.

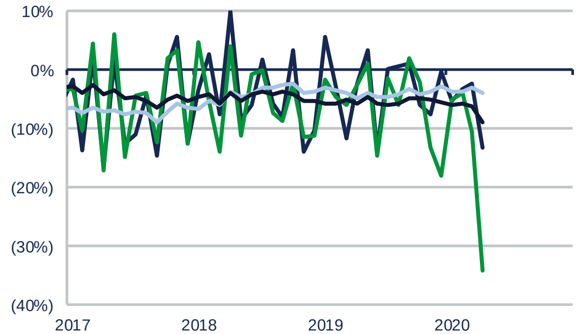
WORRIES ABOUT THE FUTURE to restrain consumption and investment bounce-backs.

INSOLVENCIES



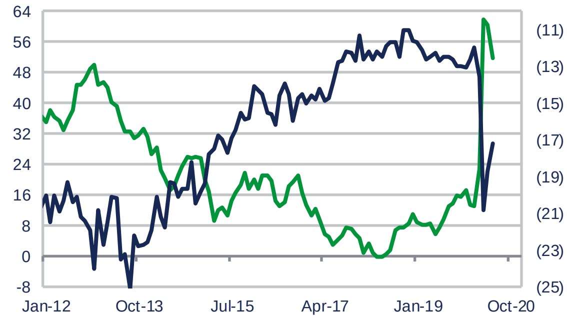
- Policy responses were fast and effective, but did they postpone the reckoning?
- German firms' insolvencies are at the lowest ever recorded, and French data shows a similar pattern.
- In the context of the sharpest slowdown in economic activity and widespread reduction in firms' revenues, this can only be explained by the fact that the wall of liquidity and job retention schemes have been a tide that floats all boats, including those that can't float normally.

INSOLVENCIES



- Job retention schemes, the loan guarantee schemes, the payment holidays and several other supportive measures will have to be phased out in fall (given their cost to the public purse).
- Once the support is gone, an increase in insolvencies and unemployment is unavoidable.
- The question is thus, how big will these increases be? A return to normal insolvency levels in Germany would imply a nearly 30% jump.
- Many estimates for the unemployment rates in France, Italy, Spain and the U.K. have it jumping to 2009 peaks.

CONSUMER CONFIDENCE



- Expectedly, the EU consumer survey shows evidence of fear about the future.
- The expected increase in the unemployment rate is close to its highest levels during the GFC, and the number of households expecting to buy major ticket items has dropped during lockdowns and recovered only slightly since; this is consistent with the observed jump in EU savings rate.
- EU economies are in limbo: the shock to labor markets and firms' solvency is still to come. People know this and consumption and investment should therefore remain subdued as we move into fall.

Source: Bloomberg and Haver. As of 06/30/2020.

OUTLOOK

China's economy recovered faster than expected in the second quarter, largely supported by robust credit expansion and government spending. Consumer spending, on the other hand, lagged. High-frequency data in China was more mixed in June than in previous months, but the economy continues to lead the global recovery. Japan, which saw a later entry into the crisis, has begun a more modest recovery aided by massive fiscal support. Government stimulus checks to individuals helped boost spending, while weak global demand together with elevated precautionary savings is weighing on the manufacturing sector. Bankruptcies in the region appear limited for now, but concerns of rising COVID-19 cases in areas such as Tokyo and Hong Kong, floods, a potential income cliff in the fall and rising geopolitical tensions keep uncertainty over the outlook elevated.

Economic Growth	7/27/2020	12/31/2018	12/31/2019	2020 (E)	2021 (E)	2022 (E)
Japan Real GDP (Y/Y %)	-1.7	0.3	0.7	-4.9 --	2.5 --	1.2 ▲
China Real GDP (Y/Y %)	3.2	6.7	6.1	2.0 ▲	8.0 --	5.5 ▲
Inflation						
Japan CPI (Y/Y %)	0.1	1.0	0.5	-0.1 --	0.2 --	0.7 ▼
China CPI (Y/Y %)	2.5	2.1	2.9	2.7 ▼	2.2 ▲	2.3 --
Labor Market						
Japan Unemployment (%)	2.9	2.4	2.4	3.0 --	3.2 ▲	2.7 ▲
China Unemployment (%)	3.7	3.8	3.6	4.2 ▼	4.1 --	4.0 --
Rates						
Japan Central Bank	-0.10	-0.10	-0.10	-0.10 --	-0.10 ▼	0.00 --
Japan 2Y Note	-0.14	-0.15	100.46	-0.14 ▲	-0.12 --	-0.04 --
Japan. 10Y Bond	0.02	-0.01	100.82	-0.01 ▲	0.02 --	0.11 --
China Central Bank	4.35	4.35	4.35	4.30 ▲	4.30 ▲	4.15 --
China 2Y Note	2.32	2.75	99.81	1.96 ▲	2.03 ▲	1.55 --
China 10Y Bond	2.88	3.30	98.34	2.73 ▲	2.93 ▲	2.97 --
Currencies						
USD/JPY	105.36	110.27	105.36	107.50 ▲	107.50 ▼	105.00 --
USD/CNY	7.00	6.86	7.00	7.07 ▲	6.90 --	6.80 ▲

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg. As of 07/27/2020. (E)—Bloomberg private market consensus estimates.

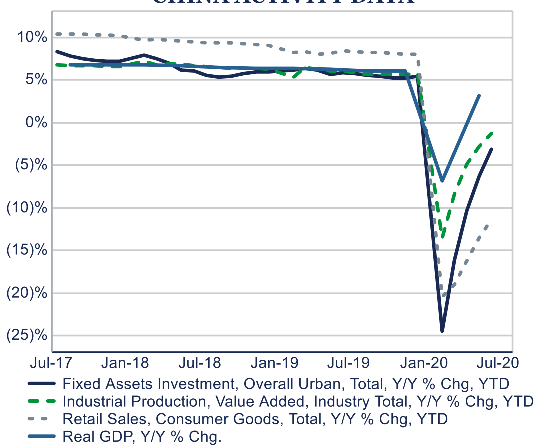
Asia Pacific

CHINA RECOVERED faster than expected in Q2, led by construction and production, while spending is lagging.

JAPAN CONSUMER SPENDING is showing signs of moderate improvement as the economy begins its recovery.

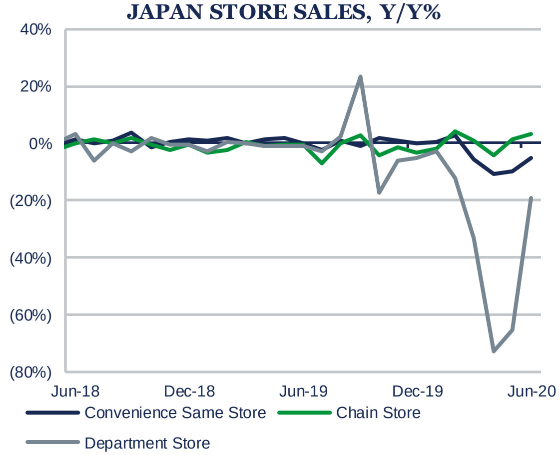
MANFUFACTURING SENTIMENT IN JAPAN is recovering more slowly than services.

CHINA ACTIVITY DATA



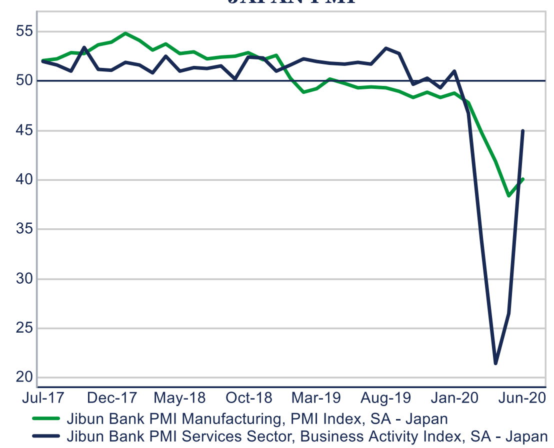
- China's economy recovered faster than expected in the second quarter, rising 3.2% Y/Y. Growth was led by construction and production, which were both aided by government spending and projects. Meanwhile, consumer spending—as seen in retail sales—is lagging, still down 11.4% YTD Y/Y in June.
- High-frequency data was more of a mixed bag in June, and concerns are rising about COVID-19 cases around the world, international tensions, and floods in China.
- However, the recovery in China remains intact and is poised to continue and lead the pack in Q3.

JAPAN STORE SALES, Y/Y%



- Consumer spending in Japan has begun to show signs of improving. Though department store and convenience same store sales remain below levels from a year ago, the trend has improved in June compared with April and May as Japan embarks on its path to recovery.
- Consumer spending has been aided by fiscal policy, such as government payments to individuals.
- However, uncertainty on the outlook is elevated amid rising COVID-19 cases in Tokyo and the end of government payments.

JAPAN PMI



- Differentiation is a key theme for the recovery; while services are improving, manufacturing sentiment in Japan is lagging. Weak global demand is set to keep a lid on the recovery in Japan.
- The Jibun Bank Manufacturing PMI remained firmly in contractionary territory in June, staying near its May lows.
- While Japan has joined other major economies on the path to recovery, it's pace is more moderate than other areas, such as China and the U.S.

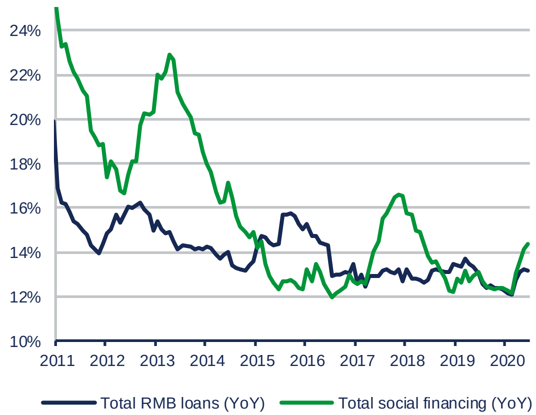
Source: Bloomberg and FactSet. As of 07/27/2020.

CREDIT SUPPORT for the Chinese economy has been large and strong, despite a less dovish stance on rates.

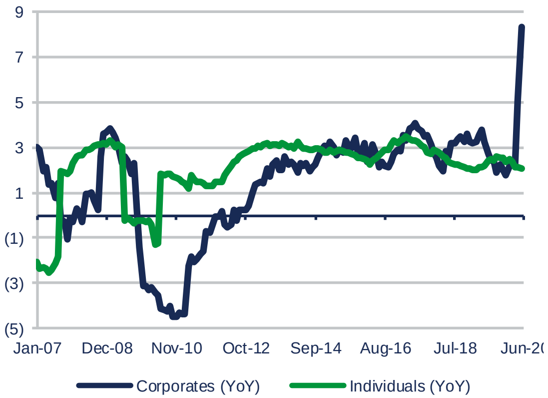
Japan's stimulus efforts are working as intended amid robust CORPORATE SECTOR CREDIT GROWTH.

BANKRUPTCIES in the region appear to be contained, especially relative to past crises.

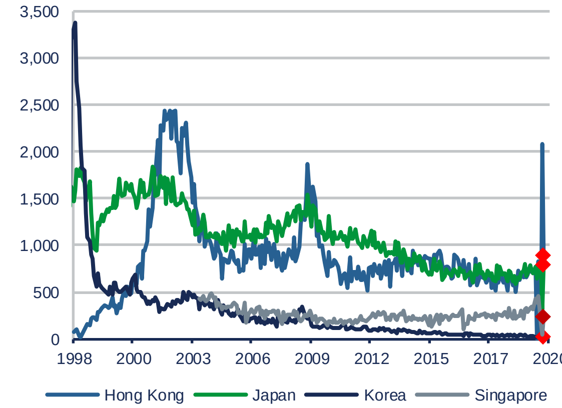
CHINA CREDIT GROWTH



JAPAN LOAN Y/Y GROWTH RATE BY SECTOR



ASIA BANKRUPTCY FILINGS



- While the pace of growth in credit has yet to match the same rate in past crises, the robust growth in credit comes amid only modest on-balance fiscal support from the central government, with June fiscal spending actually coming substantially lower compared to a year ago.
- However, as credit grows, the PBOC has also been more lenient in letting benchmark rates increase, with the 7-day repo, 1-month SHIBOR and 7-day swap all rising since the lows of April.
- Given its demand economy, China is in a unique position where it can control both the price and stock of credit, with inflation the only offset.

- With much of the focus on maintaining corporate balance sheet liquidity rather than market liquidity, it appears the transmission mechanism by which the BoJ is impacting the real economy is working as intended.
- Despite this, business bank deposits have also increased significantly. The ¥70 trillion expansion in the BoJ's balance sheet was met with a ¥39 trillion increase in corporate demand deposits, suggesting a rise in precautionary savings among businesses.
- Both household and corporate savings will likely remain elevated amid a still uncertain outlook.

- Signs of permanent scarring appear limited for now as bankruptcies seem manageable amid massive stimulus efforts in the region. The recent volatility in this measure can be largely attributed to courts being closed amid the COVID-19 lockdowns.
- Credit market spreads, while gradually grinding together since the peak in April, are still elevated compared to pre-crisis tights, suggesting lingering caution remains.
- There are also concerns about a potential income cliff in the fall if government support measures are lifted before a recovery can take hold, especially in developed Asia.

Source: Bloomberg. As of 07/24/2020.

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