BARINGS INVESTMENT INSTITUTE

August 2020

The Glass Is Still Half Full (For Now)

MONTHLY MACRO DASHBOARD

BARINGS

20-1312102

Key Themes

1. **Stronger-Than-Expected Rebound**
   - World economies have rebounded out of lockdowns faster and stronger than expected: June and July economic data widely surprised to the upside, supported by unexpected policy measures. But scars from the shock remain and the longer-term damage to potential growth is unclear.

2. **The Risk is Around Silent Spreaders**
   - This high-stake summer saw contagion spread. More tests, prevention, a better understanding of the symptoms, and border management helped protect populations at risk, but the virus-resilient youth decided to enjoy social life. This second wave of cases was less deadly—as we exit the summer, there is no second wave in terms of hospitalizations. Yet, risks ahead have not abated. As schools reopen, indoor family contamination can pick up. Aware of this, consumers continue to carry a heavy weight of worry.

3. **Employment is at Stake**
   - Uncertainty about the resilience of demand is resulting in fragile business confidence and low job vacancy. In the U.S., 3 million people have permanently lost work. In Europe, unemployment has only started to rise as furloughed workers remain supported by government programs. In China, concerns linger about the impoverishment of unemployed migrant workers, without access to unemployment benefits. How much unemployment can revert will be key for the resilience of the recovery.

4. **Policy Support May Start to Fade**
   - Monetary and fiscal stimulus have been crucial in supporting demand. In the U.S., the size and scope of a much-needed support package is still being negotiated, and the lack of agreement is weighing on consumer confidence. The still-anticipated but delayed bill will hardly be followed by similarly sized packages next year. In Europe, national governments are getting reading to announce new measures and approve the European recovery plan that becomes active next year. The question remains whether governments will be able to do more if needed.

5. **Bullish Markets In Spite of Rising Uncertainty**
   - The recovery in the real economy contrasts with bullish financial markets. Stock market capitalization is exploding but earnings are down Y/Y. Only a handful of tech stocks are driving the performance. Is there a risk this bubble bursts? Or are tech stocks a new “safe asset,” perceived to protect investment value and transfer it into the future?

Outlook Summary

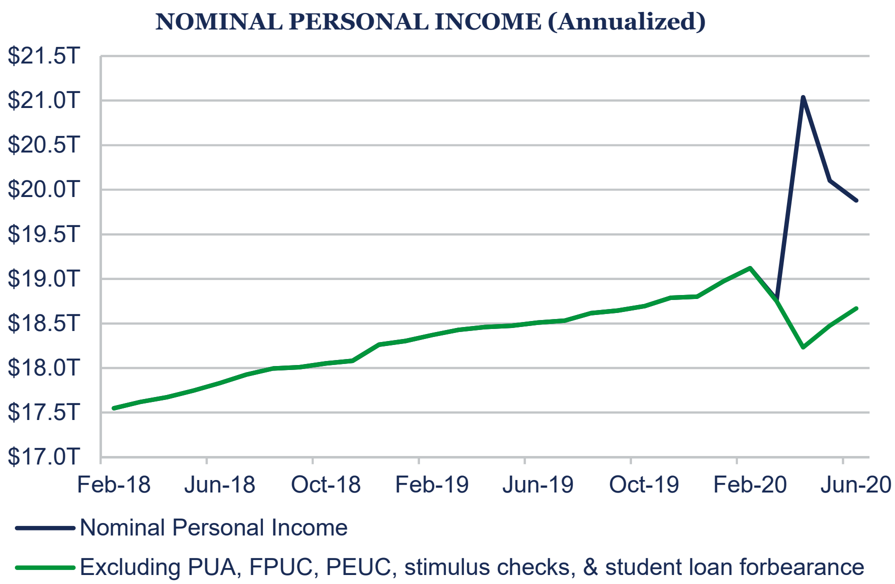
The global economy continues to improve, with economic data still exceeding expectations amid massive fiscal and monetary stimulus measures, but the risks may be rising that momentum will slow. Retail sales have rebounded strongly across the globe, and industrial production has turned higher. Flooded with liquidity, risk assets march higher, with Q2 marking the trough in earnings. While supportive policies have been key to the solid rebound, uncertainty about additional fiscal support is mounting as economies try to find the balance between stimulus and growth. The viral path also adds to this uncertainty, with a resurgence of new cases in Europe and Asia. While it is still too soon to tell the extent of permanent scarring, we are watching the labor market as the duration of layoffs lengthens, business balance sheets even though bankruptcies remain relatively low, and consumer confidence, particularly where it affects the return to many in-person activities.

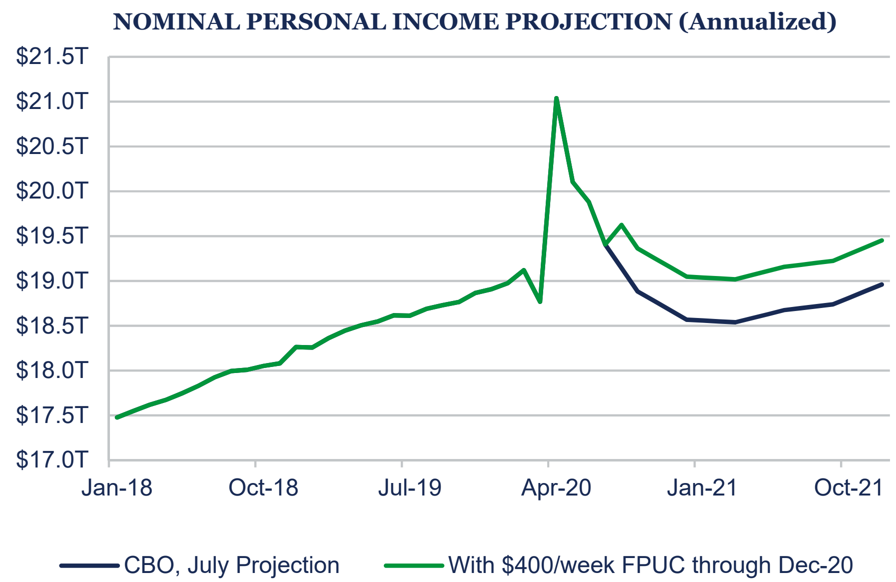
In the U.S., economic data continue to surprise to the upside. Manufacturing, housing, and autos continue to drive impressive growth. A relatively weaker USD is a boon to the manufacturing rebound, while industrial production is being aided by continued reopening, lean inventories and strengthening global demand. Low mortgage rates have also supported the continued strength in the housing market. Meanwhile, uncertainty over additional fiscal support and lingering COVID-19 cases means the road ahead for the services sector will likely be longer. While the economy is not yet in the clear, additional policy support should aid the recovery until uncertainty eases. Overall, markets continue to anticipate a substantial earnings recovery in 2021 and the implicit “Fed put” also keeps a lid on credit risks. Investor positioning still biased towards cash could provide further upside in risk assets.

In Europe, the bounce-back is underway: industrial production and economic activity surveys such as the PMIs all signal a solid pickup in activity. Most sectors of the European economy look set to show a rebound in Q3. Clearly, the authorities’ response to the pandemic has been effective in avoiding a meltdown and the reopening of shops and plants was meant to create growth. While the return towards normality has been faster and stronger than expected, not all is well in Europe. Uncertainty about the health of labor markets and SME balance sheets abound, as unprecedented policy support clouds the signals normally provided by unemployment rates and bankruptcy numbers. Nevertheless, governments around continental Europe have signaled intent to extend most of income-support measures, boosting sentiment that a steep income cliff by the fall may be avoided. In total, for consumption and investment to rebound sustainably and the recovery to have legs, such uncertainty must dissipate... second waves permitting.

In Asia, while parts of the region successfully conquered the first wave of the virus, signs are mixed about how long the rebound can endure. After a strong initial bounce in China, growth in activity data underwhelmed in July. Supply has snapped back, but the return of demand is weaker amid elevated domestic and global uncertainty. In Japan, 2Q GDP collapsed, though to a lesser extent than in the U.S. and Europe. The decline was led by consumption and weak global demand, while capex and residential investment held up better. High-frequency data points to a solid bounce back in Q3, though concerns of a second wave weigh on the outlook. Finally, liquidity and credit growth have aided the rebound in the region, but while they remain broadly robust in North Asia, there are signs they may be weakening in India, Indonesia and the Philippines.

U.S. fiscal stimulus has been key to supporting personal income and spending, but more is needed in the near-term.





Unprecedented levels of fiscal stimulus boosted personal income well above pre-crisis levels. Despite a near-record collapse in U.S. GDP and a still-elevated unemployment rate, massive income replacement has aided a ‘V’-shaped rebound in retail sales. Without the additional unemployment insurance benefits, stimulus checks, and student loan forbearance, personal income would be 2.4% below February levels in June, compared with up 4%. With employment down almost 13 million from February, continued income replacement is needed to support spending and confidence in the near-term. While a fourth stimulus bill is still being discussed, and uncertainty could lead spending to take more of a wavy path to recovery, overall consumer spending is set to be buoyed if and when it is passed.

The Congressional Budget Office’s July nominal personal income projections include fiscal stimulus through the CARES Act. Without further stimulus, the data shows that it would take until the end of 2021 for personal income to return to pre-crisis levels. However, if a $400/week unemployment insurance benefit is distributed through the end of 2020—less than the original $600/week benefit—this would be enough to keep income above pre-pandemic levels, even as the disbursement of stimulus checks comes to an end, which would aid the consumer spending recovery.

Source: Bureau of Economic Analysis, Congressional Budget Office, and Bloomberg. As of August 21, 2020.

OUTLOOK

The global economy continues to improve, with economic data still exceeding expectations amid massive fiscal and monetary stimulus measures, but the risks may be rising that momentum will slow. Retail sales have rebounded strongly across the globe, and industrial production has turned higher. Flooded with liquidity, risk assets march higher, with Q2 marking the trough in earnings. While supportive policies have been key to the solid rebound, uncertainty about additional fiscal support is mounting as economies try to find the balance between stimulus and growth. The viral path also adds to this uncertainty, with a resurgence of new cases in Europe and Asia. While it is still too soon to tell the extent of permanent scarring, we are watching the labor market as the duration of layoffs lengthens, business balance sheets even though bankruptcies remain relatively low, and consumer confidence particularly where it affects the return to many in-person activities.

Economic Activity	2017	2018	2019	2020 (E)	2021 (E)	2022 (E)
Real GDP (Y/Y %)	3.9	3.6	2.9	-3.9 ▼	5.1 ▲	3.5 ▲
CPI (Y/Y %)	3.2	3.6	3.6	2.3 ▲	2.6 ▲	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	0.31 ▼	0.48 ▲	0.80 ▲
3-Month Euribor	-0.33	-0.31	-0.39	-0.43 ▼	-0.41 ▼	-0.35 ▼
3-Month GBP Libor	0.52	0.91	0.79	0.11 ▼	0.19 ▼	0.32 ▼
3-Month JPY Libor	-0.02	-0.07	-0.05	-0.09 ▼	-0.07 ▲	-0.03 --

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg and IMF as of August 21, 2020. (E)—Bloomberg private market consensus estimates for GDP, CPI and rates. Trade volume data is a projected figure from the IMF.

UPSIDE/DOWNSIDE RISKS TO THE OUTLOOK

Upside	Downside
COVID fears recede faster-than-expected	Higher contagion and death rates lead to worse sentiment
Larger-than-forecasted fiscal support	U.S. fiscal stimulus underwhelms or fails to pass
	Intensification of trade war
	Contested U.S. presidential election

CENTRAL BANKS remain on the sidelines as the burden of the recovery shifts firmly towards fiscal policy.

Economy	Policy Rate (%)	Next CB Meeting	Implied Policy Rate (%)		
			3M	6M	1Y
U.S.	0.13	09/16/2020	0.10	0.08	0.07
Eurozone	-0.50	09/10/2020	-0.51	-0.53	-0.58
U.K.	0.10	09/17/2020	0.09	0.06	-0.02
Japan	-0.04	09/17/2020	-0.05	-0.07	-0.06
China	2.20	—	2.13	2.20	2.22

- The **FOMC** has extended several of its domestic and international credit and liquidity facilities through next year. While still expressing concern about the outlook, they've largely held steady but have emphasized their September meeting as the timeline for rolling out long-awaited framework changes.
- 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** has opted for a wait-and-see approach with a surprisingly upbeat outlook. The option exists to cut the policy rate into negative territory, but the benefits are unclear. They may choose to use this extra policy space only if necessary, and with more data in hand.
- The **BOJ** is holding steady and continues to focus on support for companies and employment rather than inflation in the near-term.
- The **PBOC** continues to shift to a more neutral stance with respect to rates. But still healthy credit and money supply growth suggest a more targeted and flexible approach to monetary policy as a whole. There has also been emphasis on fiscal policy as needing to be more proactive in this stage of the recovery.

Source: Bloomberg As of August 21, 2020.

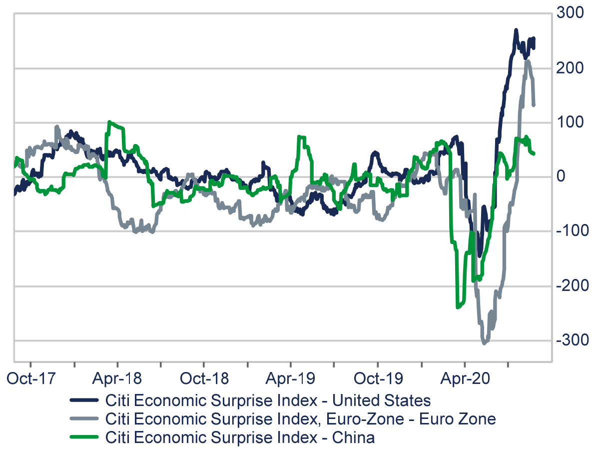
Global

THE GLOBAL RECOVERY is continuing at an impressive rate, with economic data largely surprising to the upside.

FISCAL AND MONETARY STIMULUS have been key to the recovery but further measures are less clear.

Flooded with liquidity, risk assets march higher, with the second quarter marking the TROUGH IN EARNINGS.

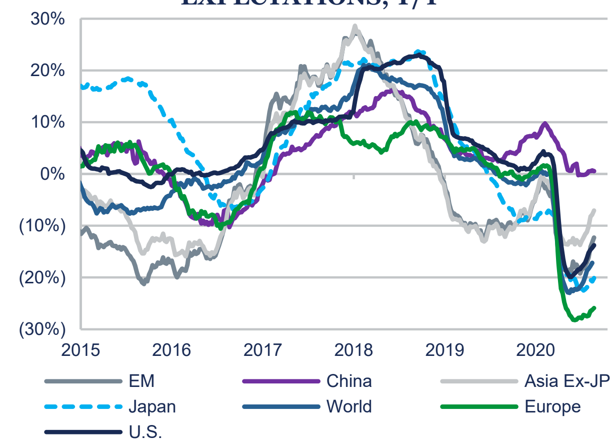
Citi Economic Surprise Index



POTENTIAL FISCAL STIMULUS

	$ Trillion	% of GDP
U.S.	$3.3	15.4%
Eurozone	$4.13	31.0%
U.K.	$0.19	6.0%
Japan	$2.08	40.3%
China	$1.22	8.4%

NEXT-12-MONTHS EARNINGS EXPECTATIONS, Y/Y



- The global recovery is happening at a more rapid speed than many expected, with economic data surprising greatly to the upside over the past two months.
- The Citi Economic Surprise Index has reached new highs as massive fiscal and monetary stimulus have proven very effective tools to boost spending and production.
- While uncertainty remains elevated and risks to the outlook are tilted to the downside, the global economy is positioned well to continue its recovery, pending any policy missteps.

- In the U.S., further fiscal stimulus is needed in the immediate term, but details are still under negotiation. More will likely be needed in 2021, while the details will largely depend on the political landscape in Washington, the dollar amount is set to be lower than what was seen in 2020.
- In Europe, the European Recovery Fund will likely be sufficient through year-end, and more will likely be needed in 2021, but additional support is set to be much smaller next year.
- In China, while it has been more of a ‘wait-and-see’ environment, underwhelming activity data suggests further accommodative monetary policy may be warranted before year-end.

- The second quarter earnings season has proved to be generally better than expected across the U.S., Europe and Japan. It appears that the worst is over as the change in consensus expectations of next-12-months earnings have bottomed in most markets, and have started moving higher.
- The sustained nature of economic surprises into mid-August suggest further scope for earnings outperformance into the third quarter.
- Nevertheless, monetary stimulus will likely continue to be a far more dominant driver of price action over the near-term. Markets appear to have written 2020 off, instead looking towards next year where expectations of the earnings rebound remain robust.

Source: Bloomberg, FactSet, and Cornerstone Macro. As of August 21, 2020.

OUTLOOK

In the U.S., economic data continue to surprise to the upside. Manufacturing, housing and autos continue to drive impressive growth. A relatively weaker USD is a boon to the manufacturing rebound, while industrial production is being aided by continued reopening, lean inventories and strengthening global demand. Low mortgage rates have also supported the continued strength in the housing market. Meanwhile, uncertainty over additional fiscal support and lingering COVID-19 cases means the road ahead for the services sector will likely be longer. While the economy is not yet in the clear, additional policy support should aid the recovery until uncertainty eases. Overall, markets continue to anticipate a substantial earnings recovery in 2021, and the implicit “Fed put” also keeps a lid on credit risks. Investor positioning still biased toward cash could provide further upside in risk assets.

Economic Growth	8/21/2020	12/31/2018	12/31/2019	2020 (E)	2021 (E)	2022 (E)
Real GDP (Y/Y %)	-9.5	3.0	2.2	-5.0 ▲	3.7 ▼	2.8 ▼
Inflation						
CPI (Y/Y %)	1.0	2.5	1.8	1.0 ▲	1.7 ▲	2.0 ▼
Core PCE (Y/Y %)	0.9	2.0	1.7	1.1 --	1.3 --	1.7 ▼
Labor Market						
Unemployment (%)	10.2	3.9	3.7	9.0 ▼	7.5 ▼	6.0 --
Rates						
Fed Funds	0.13	2.38	1.63	0.25 --	0.30 ▼	0.55 --
2Y Treasury	0.14	2.52	1.57	0.22 ▼	0.50 ▼	0.85 ▼
10Y Treasury	0.64	2.72	1.92	0.76 ▼	1.19 ▼	1.58 ▼

Arrows indicate consensus estimate change compared to one month ago

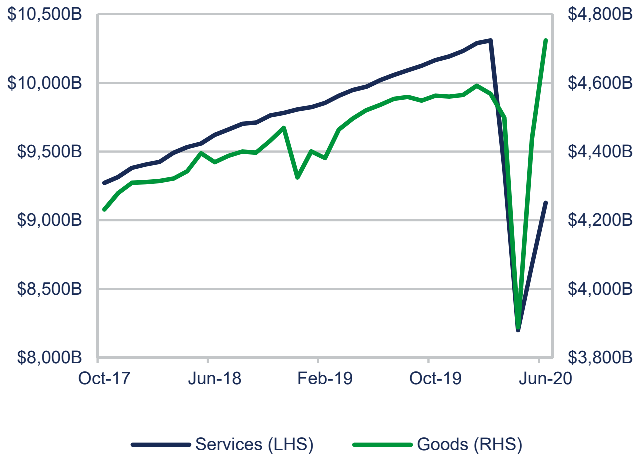
Source: Bloomberg. As of August 21, 2020. (E)—Bloomberg private market consensus estimates.

CONSUMER SPENDING is rebounding, but there is much differentiation by sector, and lack of stimulus may be a near-term weight.

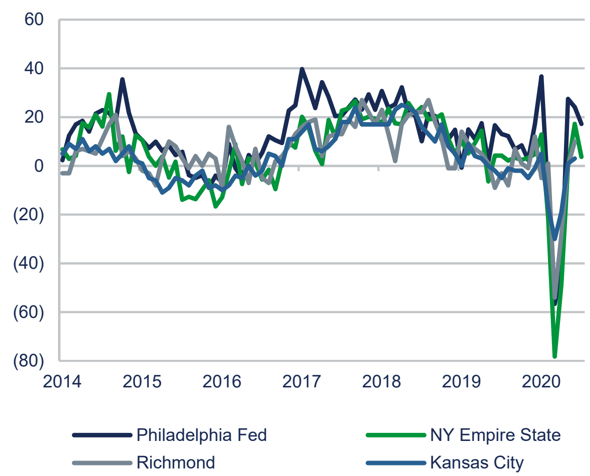
MANUFACTURING is bouncing back and will be a boon to the recovery.

The HOUSING SECTOR continues to drive growth amid record-low mortgage rates and pent-up demand.

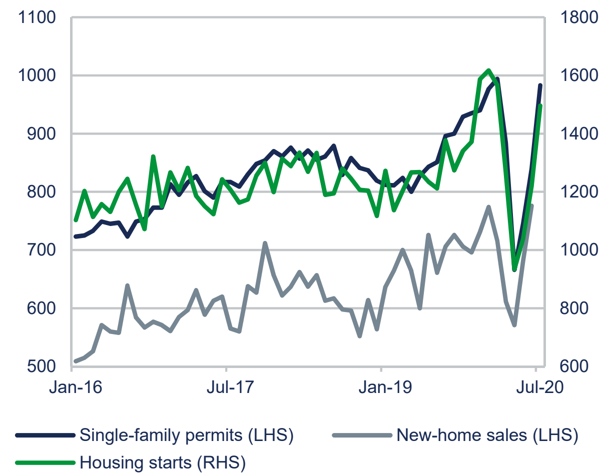
PERSONAL SPENDING (SAAR)



REGIONAL MANUFACTURING PMIS



U.S. HOUSING MARKET



- Consumer spending has rebounded strongly and was about 7% below pre-crisis levels in June. However, spending trends have shifted materially compared with prior to the pandemic.
- Consumer spending on goods has exceeded pre-crisis levels and has been particularly robust among durable goods—notably furniture and motor vehicles. All major categories of goods other than clothing, gasoline, and other durable goods have exceeded pre-pandemic levels.
- On the other hand, services spending is down 11.5% from February. While the bounce in spending on goods will boost 3Q consumption and GDP from record lows, the road to recovery for many services industries will be tougher and longer.

- While consumer spending could take a more wavy path in the months ahead, the manufacturing recovery is shaping up to be strong.
- Industrial production has improved for three-consecutive months, regional manufacturing PMIs are showing signs of strength amid reopening, and the August manufacturing Markit flash PMI beat expectations, with new orders rising further into expansionary territory.
- A relatively weaker USD will be a boon for the U.S. manufacturing sector, and industrial production is set to be aided by continued reopening, lean inventories and strengthening global demand.

- Housing market leading indicators quickly snapped back to pre-pandemic levels as mortgage rates remain near record lows, pent-up demand is being released, and millennials are entering into homeownership.
- The pandemic has disproportionally hit the lower-income cohort, which are generally more likely to rent than own, while higher-wage employment has held up better, which contributes to the boom despite a double-digit unemployment rate.
- Remote work and school arrangements as well as the anecdotal shift to suburban areas would be a boon to the housing market, as it is set to remain a growth driver during this recovery.

Source: Bloomberg. As of August 21, 2020.

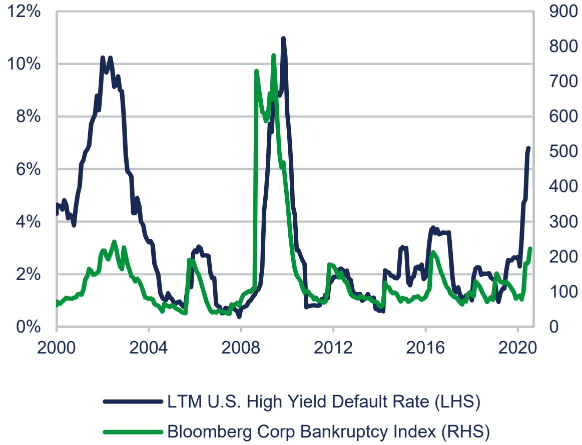
U.S.

SIGNS OF PERMANENT SCARRING appear surprisingly limited so far, but most of the visible damage is in larger companies.

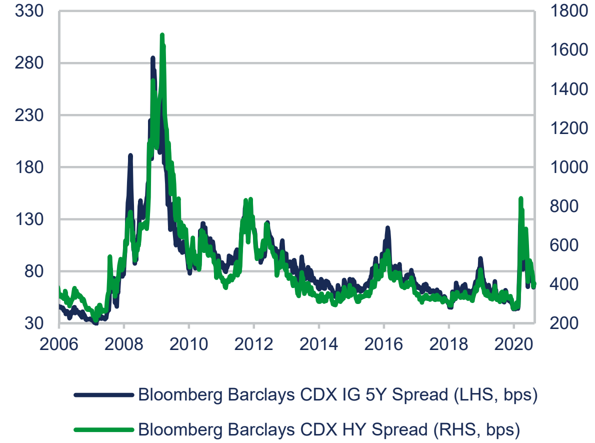
Extraordinary easy monetary policy conditions, together with an implicit "Fed put," is keeping a lid on CREDIT RISKS.

The TECHNOLOGY SECTOR has been leading the rebound as investors continue to remain biased toward cash.

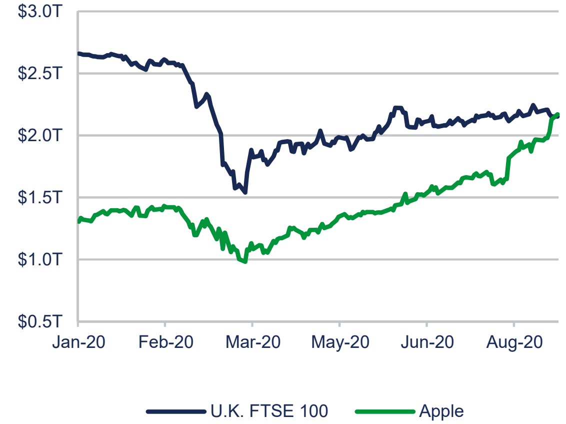
U.S. HIGH YIELD DEFAULTS AND CORPORATE BANKRUPTCIES



U.S. CORPORATE IG AND HY INDEX CDS SPREAD



APPLE AND U.K. FTSE 100 MARKET CAPITALIZATION



- Despite business bankruptcy filings remaining subdued, measures focused on larger companies appear to be deteriorating. High yield defaults and bankruptcies of corporates with at least $50 million in liabilities have been steadily ticking higher.
- A possible explanation behind this divergence is that while aggregate economy-wide debt is large, it is not evenly distributed. Larger companies that are able to access capital markets tend to have larger debt stocks compared to ultra-small business.
- It is also worth noting that much of the defaults and bankruptcies so far have been strategic in nature, rather than liquidation.

- While there is deterioration in default and bankruptcy measures, it has yet to impact the gradual improvement of investment grade and high yield CDS spreads, which have continued to grind tighter.
- Federal Reserve intervention is clearly a dominant driver of these developments, but mostly by acting as a backstop, rather than by directly flooding credit markets. This is as evident by low take-up in its emergency credit facilities and only modest ramp-up of its corporate asset purchase programs.
- Easy credit conditions meant that corporate balance sheet cash levels have risen markedly, pointing to a build-up of precautionary liquidity.

- Since the broad equity market bottom in April, the technology sector has led the rally in U.S. equities. One such name, Apple, has been so well bid that on a market-cap basis it is larger than the entirety of the U.K. FTSE 100.
- Price action has been very narrow; the percentage of equities trading at 52-week highs across major geographies ranges around 5%, compared to 20-25% at the start of the year.
- Despite this significant run-up, there remains a massive amount of cash sitting in the sidelines–mostly parked in money market fund assets–which could provide a positive tailwind to risk assets.

Source: Bloomberg and JPMorgan. As of August 21, 2020.

Europe

OUTLOOK

In Europe, the bounce-back is underway: industrial production and economic activity surveys such as the PMIs all signal a solid pick-up in activity. Most sectors of the European economy look set to show a rebound in Q3. Clearly, authorities' response to the pandemic has been effective in avoiding a meltdown, and the reopening of shops and plants was meant to create growth. While the return towards normality has been faster and stronger than expected, not all is well in Europe. Uncertainty about the health of labor markets and SME balance sheets abound, as unprecedented policy support clouds the signals normally provided by unemployment rates and bankruptcy numbers. Nevertheless, governments around continental Europe have signaled to extend most of income support measures, boosting sentiment that a steep income cliff by the fall may be avoided. In total, for consumption and investment to rebound sustainably and the recovery to have legs, such uncertainty must dissipate... second waves permitting.

Economic Growth	8/21/2020	12/31/2018	12/31/2019	2020 (E)	2021 (E)	2022 (E)
EZ Real GDP (Y/Y %)	-15.0	1.9	1.3	-8.1 --	5.7 ▲	2.3 ▲
U.K. Real GDP (Y/Y %)	-21.7	1.4	1.5	-9.7 ▼	6.4 ▲	2.8 ▲
Inflation						
EZ CPI (Y/Y %)	0.4	1.8	1.2	0.4 --	1.0 ▼	1.4 ▲
U.K. CPI (Y/Y %)	1.0	2.5	1.8	0.8 --	1.4 --	1.8 --
Labor Market						
EZ Unemployment (%)	7.8	8.2	7.6	8.5 ▼	9.5 ▲	8.6 ▼
U.K. Unemployment (%)	3.9	4.1	3.8	5.8 ▼	6.9 ▲	5.8 ▲
Rates						
EZ Central Bank	0.00	0.00	0.00	0.00 --	0.00 --	0.05 ▲
EZ 2Y Note	-0.69	-0.62	-0.61	-0.62 ▼	-0.48 ▼	-0.41 ▼
EZ 10Y Bond	-0.51	0.24	-0.19	-0.38 ▼	-0.15 ▼	0.10 ▼
U.K. Central Bank	0.10	0.75	0.75	0.10 --	0.10 ▼	0.25 ▼
U.K. 2Y Gilts	-0.05	0.74	0.53	0.00 ▼	0.21 ▼	0.18 ▼
U.K. 10Y Gilts	0.20	1.27	0.82	0.24 ▼	0.53 ▼	0.76 ▼
Currencies						
EUR/USD	1.18	1.14	1.12	1.18 ▲	1.22 ▲	1.22 ▲
GBP/USD	1.31	1.27	1.33	1.28 ▲	1.33 ▲	1.35 ▼

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg. As of August 21, 2020. (E)—Bloomberg private market consensus estimates.

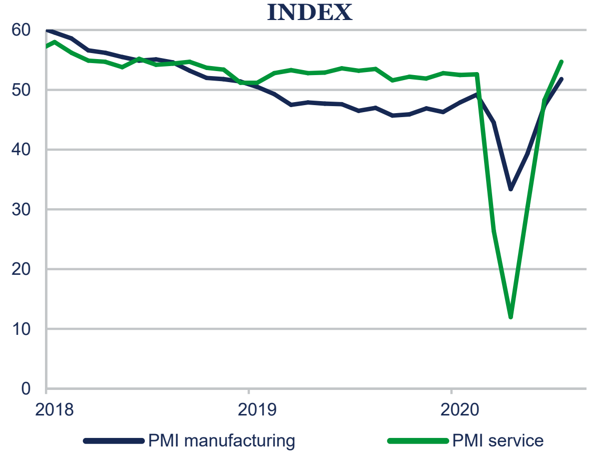
Europe

THE BOUNCEBACK IS HAPPENING – Survey data point in that direction…

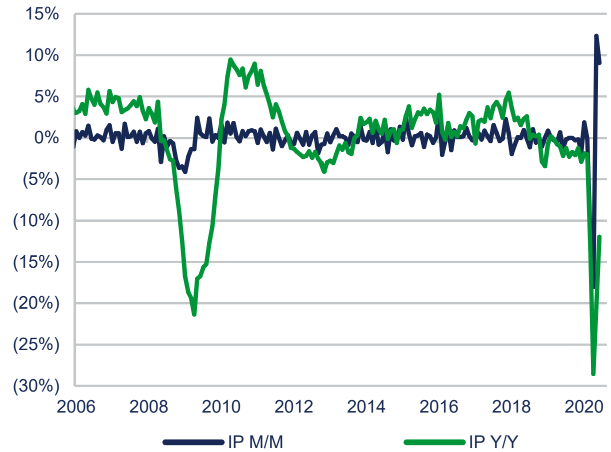
…IT HAS ALREADY STARTED: hard data is going in the same direction.

CONSUMER SPENDING HAS HELD UP as household income support was effective.

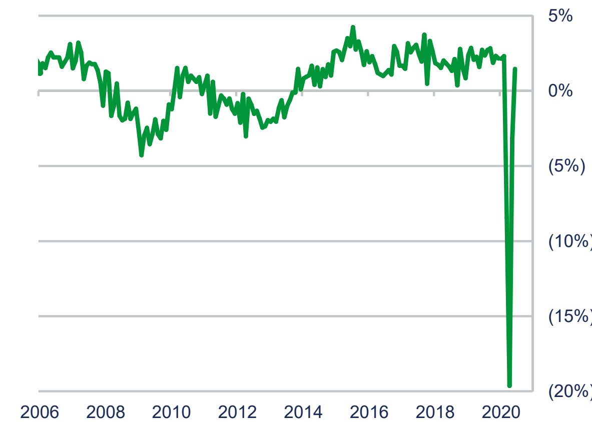
EURO AREA PURCHASING MANAGER INDEX



INDUSTRIAL PRODUCITON



RETAIL SALES Y/Y



- Purchasing manager indexes, a good gauge for the change in economic activity, point toward a solid rebound after the Q2 collapse.
- With both the manufacturing and the services indexes moving neatly above 50 in July, Q3 is posited to show a broad-based recovery as European economies exit lockdowns.
- The recovery has been faster and stronger than expected, but now PMIs need to remain at these elevated levels to show that this is not just a technical rebound but a sustainable recovery instead.

- Hard data such a industrial production has confirmed the PMI signal, rebounding faster and stronger than expected.
- Industrial production posted two months of record growth in May and June and PMIs point to continuing growth in July.
- Year-on-Year, industrial production is still 12% lower, close to the trough touched in the 2009 recession.
- July should however show strong growth and industrial production should continue moving back towards pre-COVID levels in the coming months, albeit at a slower pace possibly.

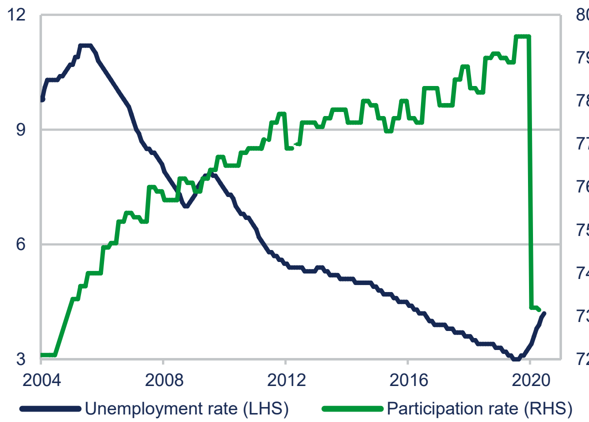
- After experiencing the biggest drop since record keeping began, euro area retail sales recovered fully, hovering at 1.5% Y/Y in June.
- This is a testimony to the effectiveness of the policy response in protecting household income.
- Compared to 2008, when retail sales contracted continuously for two years, the balance sheet of European households looks considerably healthier.

Source: Bloomberg. Haver. As of August 23, 2020.

Europe

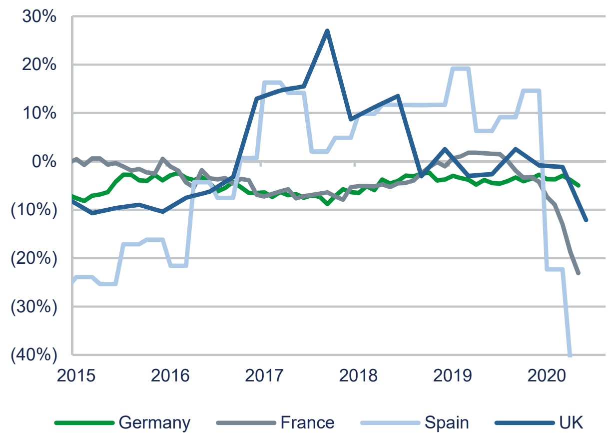
LABOR MARKETS ARE SUFFERING as unemployment is misleading.	**AN ECONOMY ON HOLD,** as companies are kept afloat by huge public support.	**WORRIES ABOUT THE FUTURE** remain substantial.

LABOR MARKET RATES



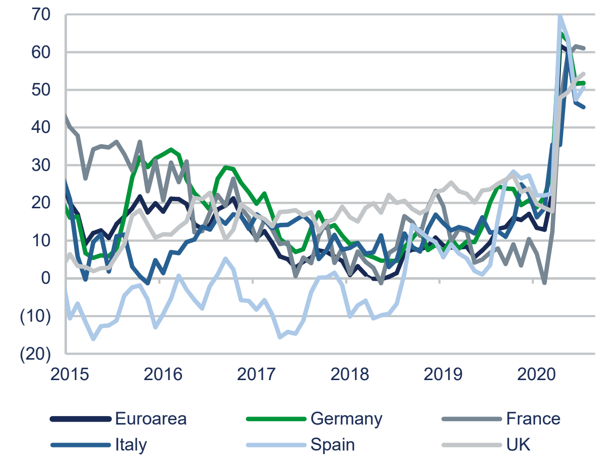
- The rebound is happening, but not all is well in Europe: labor markets are in a more fragile state than suggested by unemployment rates.
- These have moved very little, because those who lost jobs did not start looking for new ones, thereby being registered as ‘inactive.’
- Focusing on the participation rate (the % of people in working age with a job) one can see the damage already caused by COVID.
- In Germany, the EU country arguably least affected by the virus, the drop in participation has been considerable.
- What will happen when the job retention schemes are phased out?

BANKRUPTCIES Y/Y



- Another testimony to the effectiveness of policies is the number of bankruptcies, at its lowest levels in all major EU economies.
- While this is obviously welcome, it suggests caution in interpreting the rebound in activity as a sustainable recovery.
- We simply do not know the state of European SMEs, as the wall of liquidity injected by central banks, coupled with loan guarantees and job retention schemes created by governments, have suppressed the signal normally given by business bankruptcies.
- Similar dynamics are seen in the U.S., suggesting the same caution about U.S. SMEs.

UNEMPLOYMENT EXPECTATIONS



- Such caution is shared by European households, which show fear of job loss.
- The expected increase in unemployment in the next 12 months, while moderating from levels reached in April, remains close to its GFC peak in all major EU economies. This is consistent with the observed jump in EU savings rate.
- Uncertainty about the future remains elevated: the worst seems to be over, the economy is recovering but the shock to labor markets and firms’ solvency has yet to show its effects. For consumption and investment to rebound sustainably, such uncertainty must dissipate.

Source: Bloomberg. Haver. As of August 23, 2020.

OUTLOOK

In Asia, while parts of the region successfully conquered the first wave of the virus, signs are mixed about how long the rebound can endure. After a strong initial bounce in China, growth in activity data underwhelmed in July. Supply has snapped back, but the return of demand is weaker amid elevated domestic and global uncertainty. In Japan, 2Q GDP collapsed, though to a lesser extent than in the U.S. and Europe. The decline was led by consumption and weak global demand, while capex and residential investment held up better. High-frequency data points to a solid bounce back in Q3, though concerns of a second wave weigh on the outlook. Finally, liquidity and credit growth have aided the rebound in the region, but while they remain broadly robust in North Asia, there are signs they may be weakening in India, Indonesia and the Philippines.

Economic Growth	8/21/2020	12/31/2018	12/31/2019	2020 (E)	2021 (E)	2022 (E)
Japan Real GDP (Y/Y %)	-9.9	0.3	0.7	-5.2 ▼	2.5 --	1.3 ▲
China Real GDP (Y/Y %)	3.2	6.7	6.1	2.0 ▲	8.0 --	5.5 ▲
Inflation						
Japan CPI (Y/Y %)	0.3	1.0	0.5	0.0 ▲	0.2 --	0.7 --
China CPI (Y/Y %)	2.7	2.1	2.9	2.7 ▼	2.2 --	2.2 ▼
Labor Market						
Japan Unemployment (%)	2.8	2.4	2.4	3.0 --	3.2 --	2.8 ▲
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 --	0.00 ▲	0.00 --
Japan 2Y Note	-0.12	-0.15	100.42	-0.13 ▲	-0.08 ▲	-0.07 ▼
Japan. 10Y Bond	0.03	-0.01	100.71	-0.01 --	0.04 ▲	0.09 ▼
China Central Bank	4.35	4.35	4.35	4.30 ▲	4.30 ▲	4.15 --
China 2Y Note	2.52	2.75	99.50	1.96 ▲	2.03 ▲	1.55 --
China 10Y Bond	2.99	3.30	97.50	2.73 ▲	2.93 ▲	2.97 --
Currencies						
USD/JPY	105.84	110.27	105.84	106.00 ▼	107.50 --	107.00 ▲
USD/CNY	6.91	6.86	6.91	7.00 ▼	6.81 ▼	6.60 ▼

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg. As of August 21, 2020. (E)—Bloomberg private market consensus estimates.

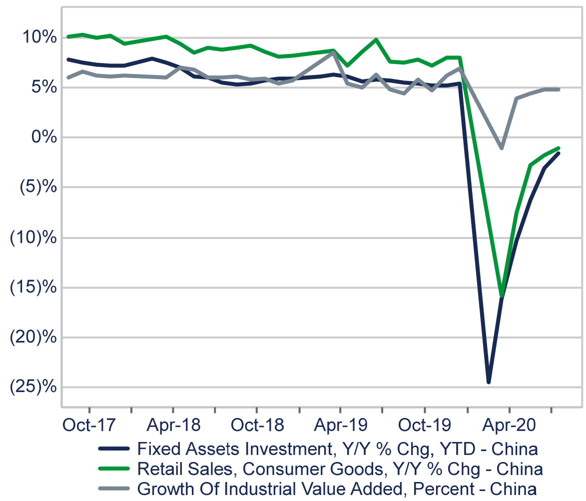
Asia Pacific

After a quick rebound, CHINA ACTIVITY DATA underwhelmed in July, suggesting further stimulus may be warranted.

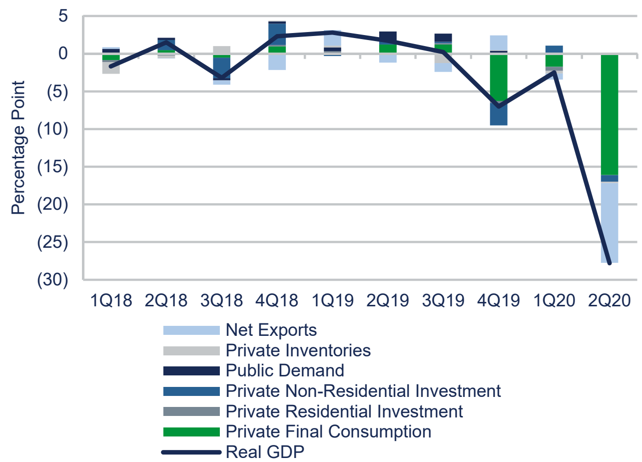
JAPAN GDP collapsed in the second quarter, led by consumption and trade, but this likely marks the trough.

High-frequency data points to a 3Q rebound in JAPAN, but rising COVID-19 cases weigh on the outlook.

CHINA ACTIVITY DATA



CONTRIBUTIONS TO JAPAN REAL GDP, Q/Q SAAR



JAPAN ECONOMY WATCHERS SURVEY EXPECTATIONS

- After a fast snap-back in much of China's economic activity data, the pace of recovery eased in July, underperforming expectations.
- While supply has had a swift return, the weaker-than-expected data, particularly in retail sales, suggest demand is not yet fully back.
- More accommodative policy may be needed in the near-term to help boost demand, as uncertainty weighs on the domestic and global recovery.

- Japan's economy shrank 27.8% Q/Q, annualized in the second quarter. While this is less than the U.S. and Eurozone economies fell by, it marks the third consecutive quarterly contraction.
- The decline was led by private consumption and net exports, as lockdowns in Japan weighed on domestic demand and weak global demand weighed on exports.
- On the other hand, capex and residential investment held up better.

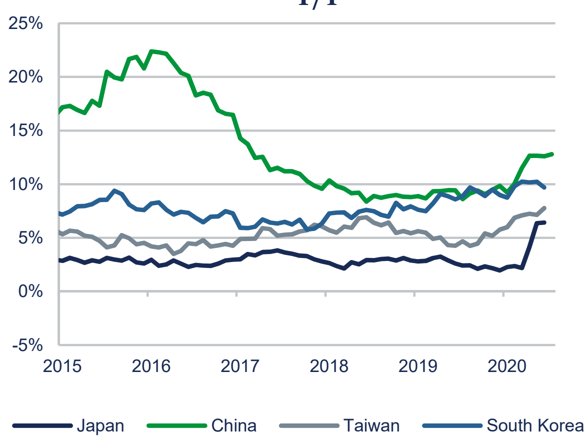
- Improvement in high-frequency data has pointed to a solid rebound for Japan's economy in the third quarter as restrictions and lockdowns were lifted.
- However, rising COVID-19 cases and regional States of Emergency are weighing on mobility data and the outlook, with expectations taking a step back in July.
- Japan's August flash PMIs eased, suggesting that Japan's recovery is in a more precarious position than other major economies during the month.

Source: Bloomberg and FactSet. As of August 21, 2020.

Asia Pacific

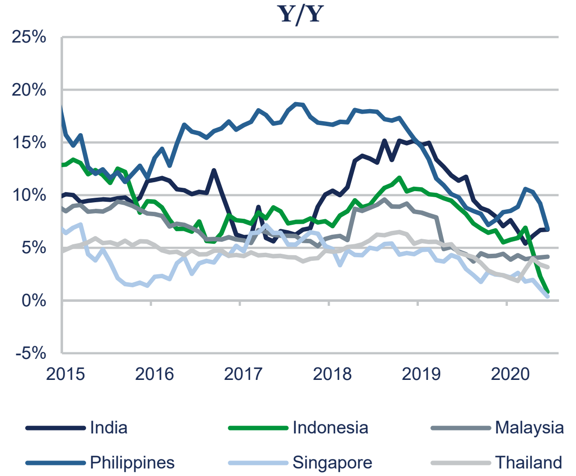
Liquidity and credit growth have aided the rebound in the region, but while they remain broadly robust in NORTH ASIA…	…they appear less evident and even show signs of weakening in SOUTH ASIA.	Certain MOBILITY MEASURES suggest lingering signs of economic slack remaining on the sidelines.

PRIVATE SECTOR CREDIT GROWTH Y/Y



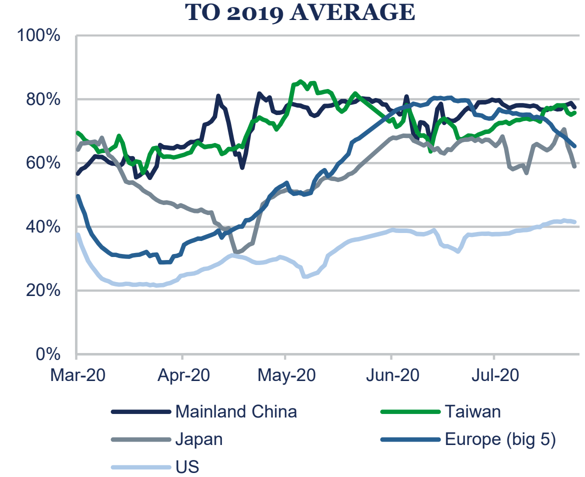
- Bank credit growth in Northern Asia remain broadly supportive. Senior loan officer surveys also show expectations of robust credit with credit standards easing.
- In Japan, most of the easing is focused in small-to-large firms, with households seeing mostly credit standards unchanged amid declining credit demand.
- China continues to see robust credit growth and money supply measures continue to be strong, though still lower compared to pre-2016, suggesting a more measured and targeted approach in terms of monetary stimulus.

PRIVATE SECTOR CREDIT GROWTH Y/Y



- In South Asia, there are signs commercial bank credit availability may be weakening; loan officer surveys in Thailand and the Philippines are deteriorating and private credit growth is slowing in India, Vietnam and Indonesia.
- This has also been noticeable via a rise in savings and deposits. Given South Asia's reliance on banks as a source of credit, this suggests most injected central bank liquidity is being un-lent.
- While these trends are supportive of bank financial stability in a time where risks are elevated, it could pose issues to the speed and intensity of the recovery, especially if access to credit is impaired.

TRAFFIC CONGESTION RELATIVE TO 2019 AVERAGE



- Outside the near-term resurgence of COVID-19 in the region, effective containment of the pandemic early in the crisis has indeed translated into a recovery in most mobility measures.
- Nonetheless, it is still an open question as to whether activity will stay at current levels of about 70 to 80%, or return to levels over 100% of those seen a year ago–implying a recovery of lost output.
- While it is particularly though to disentangle the effect of permanent economic damage and human behavioral changes on the slack implied by mobility, both are nevertheless significant factors clouding the recovery.

Source: Bloomberg, Haver and UBS. As of August 21, 2020.

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