Markets in a Minute

28 July 2020

Equity markets lose ground as investors seek safe havens

Global share markets struggled to hold on to recent gains over the past week as tensions between the US and China escalated, with tit-for-tat consulate closures in Houston and Chengdu. There were also signs that the rebound in the US economy was waning, with initial jobless claims rising for the first time since March. Increasing coronavirus cases in numerous countries added to worries.

Bond yields fell, the gold price hit a record high as investors looked for safe havens and the US dollar fell to its lowest level for two years when compared to a basket of other currencies.

Last week's markets performance*

- FTSE100: -2.64%
- Dow Jones: -0.75%
- S&P500: -0.3%
- Dax: -0.63%
- Hang Seng: -1.5%
- Shanghai Composite: -0.54%

**Data for the week to close of business on Friday 24 July.*

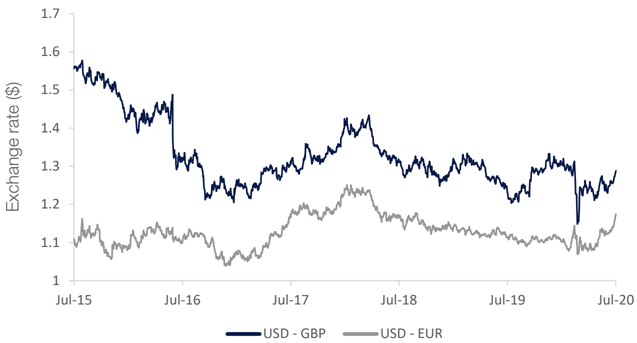
Holiday chaos

Markets started the week cautiously yesterday. Asian shares were mixed, the US rose, but equities in the UK and Europe lost ground. The FTSE100 closed down by 0.3%, and the Eurostoxx600 index also fell by 0.3%. Travel stocks shouldered the worst of the losses on the back of the government decision to impose a two-week quarantine on travellers returning from Spain. It had a knock-on effect as many travellers to other destinations cancelled their holidays fearing a similar last-minute change to the rules. But the UK was not alone; France also warned against citizens travelling to Catalonia, and said those returning from a list of 16 countries outside the EU would be subject to mandatory testing at the border on arrival.

Dollar woes

We have been calling a decline in the dollar for some time now and it has fallen against virtually everything over the past week, especially when compared to the euro which is continuing its strong run. Recent data suggests that the European economy is performing better than the US, and given European interest rates are negative, while they are still (just) in positive territory in America, investors perceive US rates have further to fall, putting downwards pressure on the dollar. The euro gained 0.95c yesterday to $1.17.81, above the $1.17 level for the first time since late 2018. The pound also strengthened 0.7% to $1.29.01.

Dollar exchange rates



Source: Datastream – Exchange rates July 2020

Virus news

While global case numbers continue to rise, driven largely by emerging economies, there have been renewed spikes in numerous locations including Japan, Hong Kong, France, Canada, Germany and, of course, Spain. However, it is the progress of the virus and policy response in the US that will have the greatest impact on the global economy.

In that sense at least, there were hopeful signs in the US that new infections were peaking, and there are several factors which suggest that the economic impact of the virus in the coming months won't be as severe as it has been in the past.

Firstly, the rise in cases is partly explained by the increase in testing. That means the headline case number is less worrying and it also means more people who know they are infected can self-isolate and be treated.

Hospitalisation rates have been lower and are falling. That means more minor cases are being identified and people are self-isolating, and it also suggests that high-risk groups are isolating to keep out of harm's way. Additionally, those who are hospitalised are getting better faster. Treatments have improved and the ICU mortality rate has declined. All these factors suggest that repeating the total lockdowns seen earlier in the year is not a viable option.

Stimulus deadlock

While the EU eventually approved its €750bn recovery package after a marathon summit early last week, US Congress is still debating how to proceed. The Democrats approved a bill for $3trn in additional stimulus two months ago, including a proposal to keep paying the $600-a-week in extra unemployment benefits until the end of the year. The payments are due to expire this week.

Yesterday, however, the Republican-controlled Senate unveiled a $1trn plan that involves cutting the $600-a-week benefits to $200 in September, then setting unemployment benefits at a maximum of 70% of the claimants' most recent salary. The idea is to make sure that nobody earns more for staying at home than they would going to work.

However, the Democrats said the plan fell far short of what was needed to ensure the US recovery stayed on track, and said the cut to benefits was a "slap in the face" for the 30m Americans relying on unemployment payments. The two parties are now negotiating a compromise.

Road to recovery

While recent economic data has generally been better than expected, that trend has been less pronounced in the UK than other regions. Although the initial purchasing managers' indices for July show activity is improving, the data is only relative to the previous month and so does not really tell us a great deal other than things aren't quite as bad as they were in June.

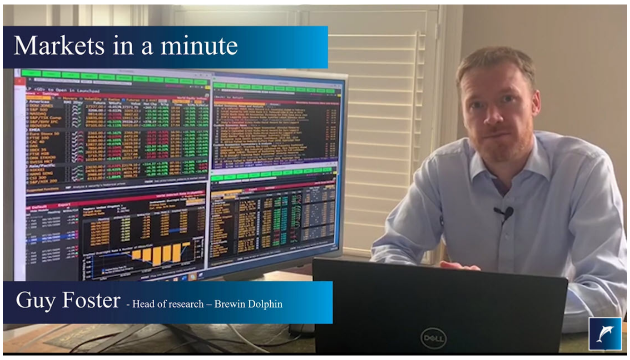
While the direction of travel is welcome, there's every reason to expect the UK recovery to be slow as the job retention scheme is unwound over the coming months.

We compared the Office of Budgetary Responsibility (OBR) and US Congressional Budget Office (CBO) forecasts for UK and US GDP respectively. They anticipated that the US will reach its pre-COVID level of activity in 2021, a year ahead of the UK.

Brexit and trade deals

The current state of Brexit negotiations also implies a slower trajectory for the UK. Whilst opinions differ, the market views any frictions between the UK and EU as inhibiting UK economic activity. Last week the Telegraph reported that government insiders are resigned to the fact that they may be trading with the EU on WTO terms in 2021. The FT reported that the government are equally resigned to the fact that a trade deal with the US will not happen ahead of the US elections this year (and therefore will be pushed back to the next congressional session starting in the new year).

The first of these stories is presumably part of the bargaining strategy and doesn't necessarily change our view that a thin trade deal can be achieved later in the year, but will likely still mean some economic disruption. The second weakens the UK hand in further negotiations but is not a surprise given that the US has typically been a tough partner for smaller countries to negotiate with. Both scenarios present some headwinds which could add to volatility.



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