Economic data shows improvement, but infection rates prove difficult to control

Weekly Market Compass: Evaluating the positive and negative signs over the past week

June 22, 2020 | Kristina Hooper, Chief Global Market Strategist

Two weeks ago, I wrote about some burgeoning "green shoots" that offered early, encouraging signs of economic recovery around the world. I'm pleased to see that more green shoots are sprouting – we continue to receive positive economic news as developed world economies progress in their re-openings. However, I'm also keeping an eye on some negative signs that could cause disruption.

Positive signs

Last week we learned that in the US, May retail sales rose a whopping 17.7% from the previous month.[1] This was the biggest increase on record and far exceeded expectations – a very substantial rebound after an abysmal April. US industrial production also improved in May, although it rose less than expected.

China's industrial production for May rose 4.4% year-over-year, which was less than expected but an improvement over April.[2] China's retail sales declined 2.8% year-over-year after a 7.5% drop in April.[2] Fixed asset investment fell 6.3% for the first five months of the year, which was an improvement over the bigger drop from January through April.[2]

Other good news from last week came from the talks between the US and China that were held in Hawaii. China reaffirmed its commitment to step up its purchases of agriculture from the US, as first agreed to in January's "Phase 1" trade deal. It seems that, despite increasingly antagonistic rhetoric from the US, hostilities are unlikely to escalate – at least for the moment. I do remain concerned that an escalation in tensions between the US and China – including a re-ignition of the tariff wars – is a distinct possibility as we near the November election in the US, although that's not my base case.

We also learned that the Trump administration is proposing a major infrastructure plan, which is extremely welcome news. Infrastructure spending has a high multiplier effect; what's more, the United States is desperately in need of a major investment in infrastructure. However, it's unlikely to have a material impact on the economy this year. The concept of "shovel ready" projects is a myth – infrastructure takes time. The plan also needs to be structured properly – we have to look to models of success from America's history, such as the Work Projects Administration, in order to have the greatest impact for every dollar spent. However, this is very needed, in my view – and should be a positive for the US economy over the longer term.

We even got good news on the medical front – about an inexpensive steroid therapy called dexamethasone. The UK is using the drug to treat COVID-19 patients, and it has improved outcomes among seriously ill patients. It was reported that a preliminary study in the UK found that the steroid, which is already widely prescribed to help reduce inflammation for those with allergies, reduces the risk of dying from COVID-19 by one-third for patients on ventilators, and by one-fifth for those receiving oxygen.[3] This news is very promising, especially given that dexamethasone is widely available.

Negative signs

However, the news has not been all good. Europe, the US and the UK are all in the process of reopening their respective economies, but the latter two are doing this despite still experiencing robust infection rates. In fact, this past Friday and Saturday, the US experienced two straight days of more than 30,000 coronavirus cases – which is the highest number since May 1.[4]
I expect the re-openings to certainly contribute to improved economic data, but also to increase the chances that the US and UK will not be able to control the spread of the virus, especially given that many Americans have been very lax in employing simple but effective measures such as wearing face masks. The overall infection rate in the US has risen modestly, but that belies a significant rise in infection rates in a number of US states – including Arizona and Florida. In other states that maintained lockdowns for longer, the infection rates have fallen. It is going to be a lot harder to get back to normal if the US can't even control the first wave of the novel coronavirus. And China, which had been very successful tamping down the virus, has now experienced a resurgence of COVID-19 in Beijing. The good news is that, given a strong contact tracing infrastructure and a quick reaction, there have only been 137 confirmed cases as of June 17.[5] But it has caused this major city to lock down neighborhoods, cancel flights and close schools.

It's also clear that the US Congress will not consider more fiscal stimulus until after the July 4 holiday recess. Additional fiscal stimulus is critically important, as Federal Reserve (Fed) Chair Jay Powell reiterated in his testimony before Congress last week. For example, the US has lost over 1 million government jobs in the last two months[6] – without state and local government funding, that number could increase significantly. Similarly, I believe we need to see ongoing payments to households because of the financial fragility of a large cohort of Americans. And I'd like to see funding for contact tracing.

There was also some geopolitical risk last week, as tensions rose between North Korea and South Korea. North Korea blew up an inter-Korea liaison building built by South Korea near the border of North Korea as a vehicle to help improve relations between the two countries. The action was in retaliation for some anti-North Korea leaflets that were dropped in North Korea. Kim Jong Un's sister was behind the decision to bomb the building, suggesting she is taking on a bigger role in government affairs – and raising questions about her brother's whereabouts. It seems that North Korea is very frustrated with a lack of progress in its negotiations with the US and is probably under increased economic pressure given the pandemic. North Korea seems interested in provoking the US into re-entering negotiations, although that doesn't seem to be at the top of the US' priority list. What we do know is that North Korean troops have been moved back to the demilitarized zone, in contravention of a 2018 demilitarization accord between the two countries.

Looking ahead

As we look to the coming week, I expect more of the same: economic data indicating signs of improvement, but infection rates that are worse than we would like to see. We will be getting Purchasing Managers' Index data for Europe and the US that will probably provide reasons for the stock market to celebrate. However, we will also likely be getting a continued rise in infection rates in certain states in the US, which is going to exert downward pressure on stocks. Improving economic data and rising infections is not an ideal scenario, and I am not sure it's sustainable for very long. But in the short term, this scenario suggests significant volatility for stocks – although I believe the bias remains upward given the massive stimulus that the Fed and other central banks have provided.

Source

[1]Source: US Census Bureau, US Commerce Department, June 16, 2020

[2]Source: China's National Bureau of Statistics

[3]Source: New Scientist, "Covid-19 news archive: UK using dexamethasone to treat patients," June 17, 2020

[4]Source: US Centers for Disease Control and Prevention

[5]Source: Science Magazine, "Source of Beijing's big new COVID-19 outbreak is still a mystery," June 17, 2020

[6]Source: Bureau of Labor Statistics, June 5, 2020

Important information

Purchasing Managers Indexes are based on monthly surveys of companies worldwide, and gauge business conditions within the manufacturing and services sectors.

The opinions referenced above are those of the author as of **June 22, 2020.** These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.