

Rising China Tensions Add to Policymakers' To-Do Lists

IN REVIEW

- **Conference Board consumer confidence** rose modestly from 85.7 to 86.6 in May, as expectations rose amid reopening measures. An elevated unemployment rate kept a lid on improvements. The present situations index fell to 71.1.
- **Initial claims** slid 323,000 to 2.123 million in W/E May 23. Continuing claims fell 3.86 million to 21.052 million in W/E May 16.
- **U.S. weekly home purchase applications** rose for the sixth-consecutive week, up 8.6% in W/E May 22—the highest since January.
- **New home sales** surprised to the upside in April, rising 0.6% M/M after falling 13.7% in March. **FHFA house price index** remained strong in March, rising 0.1% M/M and 5.9% Y/Y. Limited inventories kept a floor under prices.
- **German IFO business climate index** rose 5.3 points to 79.5 in May, as business confidence improves modestly amid reopening. The rise was led by a 10.7-point rise in expectations, while current conditions took another step back.
- **U.K. retail sales** fell a record 15.2% M/M in April amid lockdowns. Predominantly non-food store sales sank 41.7% M/M, while non-store retailing rose 18.1% M/M.
- **Japan all industry activity index** fell 3.8% in March suggesting a decline in economic activity amid global lockdowns.
- **China industrial profits** improved from -34.9% Y/Y in March to -4.3% Y/Y in April, amid recovery in industrial production.

WATCH LIST

Date		Consensus		Previous
U.S.				
Mon 6/1	ISM Manufacturing	43.5	▲	41.5
Tue 6/2	Vehicle Sales	11.20m	▲	8.58m
Wed 6/3	MBA Mortgage Applications			2.7%
Wed 6/3	ISM Non-Manufacturing	44.4	▲	41.8
Thu 6/4	Trade Balance	-\$41.5b	▲	-\$44.4b
Thu 6/4	Initial Claims			2123k
Fri 6/5	Change in Nonfarm Payrolls	-8500k	▲	-20537k
Fri 6/5	Unemployment Rate	19.5%	▲	14.7%
Fri 6/5	Average Hourly Earnings	1.0% M/M	▼	4.7% M/M
Europe				
Wed 6/3	EZ Producer Price Index			-1.5% M/M
Wed 6/3	EZ Unemployment Rate	7.9%	▲	7.4%
Thu 6/4	EZ Retail Sales	-18.0% M/M	▼	-11.2% M/M
Thu 6/4	ECB Monetary Policy Meeting	0.0%	-	0.0%
Fri 6/5	Germany Factory Orders	-15.0% M/M	▲	-15.6% M/M
Asia Pacific				
Sun 5/31	China Official Manufacturing PMI	51.0	▲	50.8
Sun 5/31	China Official Non-Manufacturing PMI	53.5	▲	53.2
Wed 6/3	Caixin China Manufacturing PMI	49.7	▲	49.4
Wed 6/3	Caixin China Services PMI	47.8	▲	44.4
Fri 6/5	Japan Household Spending	-12.7% Y/Y	▼	-6.0% Y/Y

Arrows indicate consensus forecast compared to the previous period. Local dates of release.

U.S.

- The May **employment report** is due on Friday, June 5 and is expected to show continued deterioration in labor market conditions, albeit at a more modest pace than in April. Initial claims rose a cumulative 16.6 million between the April and May payroll reference weeks, suggesting a sizeable decline in overall employment, while the unemployment rate is expected to rise further before beginning its long descent.

Europe

- **The ECB Governing Council is meeting** next week. At the current pace of purchase, the latest pandemic asset purchase program (PEPP) will be exhausted by September—or later as the ECB needs less activism now that EU fiscal policy is taking much of the burden. Italian spreads have tightened 40 bps in a week. A rise in the PEPP would just be for insurance.

Asia Pacific

- **China PMIs** are expected to show modest improvement in May, compared to April, across both manufacturing and services, as the economy continues to recover with improving domestic demand.
- Meanwhile, **household spending in Japan** is expected to plummet in April amid states of emergency and other restrictive measures in place during the month.

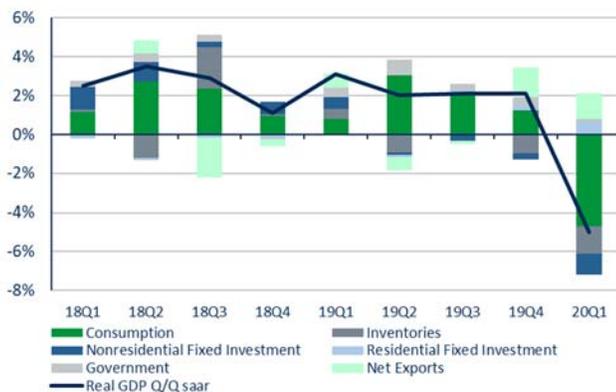
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THE HIGHLIGHTS

U.S. GDP Worse Than Expected

U.S. first quarter GDP was worse than initially thought and will likely fall further in Q2 before rebounding in the second half of the year. GDP contracted 5% annualized in the first quarter, according to the second estimate—downwardly revised from the 4.8% annualized contraction in the advanced estimate due to private inventory investment, which was offset by upward revisions to personal consumption and nonresidential fixed investment.

CONTRIBUTIONS TO PERCENT CHANGE IN U.S. GDP



Source: Bloomberg. As of May 28, 2020.

Consumer spending contracted the most since 1980 and is set to worsen in the next quarter amid lockdowns and job losses. Despite net exports contributing to the headline, trade activity collapsed in Q1, and high frequency data points to further deterioration in Q2. While residential investment contributed positively in Q1, it will likely weigh on Q2 growth as lockdowns wiped out housing demand. Current consensus is for a 34.2% annualized contraction in Q2 before rebounding in the second half of the year.

This release also included preliminary estimates of corporate profits, which fell 13.9% in Q1 after rising 2.6% in 4Q19. Profits for financial corporations fell 16.6% in Q1 while profits for nonfinancial corporations were down 14.3%.

Policy

National People's Congress: The NPC government work report appears less aggressive than the support package implemented after the GFC in 2008 with a smaller fiscal response of 4.5% of GDP. The NPC meetings also announced no specific economic growth target for 2020, although one can be backed up from its inflation and fiscal targets to reach just 1.8%. Monetary policy remains prudent and flexible and more could be done if necessary.

Hong Kong: As the NPC announced its national security law for Hong Kong, the U.S. State Department recommended that Hong Kong be treated at parity with China and is no longer autonomous under U.S. law, a crucial step in whether the city continues to receive preferential economic and trade treatment. Further measures that could now affect Hong Kong include higher

trade tariffs, tougher investment rules, asset freezes and more onerous visa rules. However, tariffs would not matter much as most HK exports are re-exports from China and already taxed in China. The key effect may be on investors' sentiment. Rating agencies may downgrade Hong Kong to join the Mainland, and Hong Kong may join the rest of China in the MSCI emerging markets index. Should Hong Kong be reclassified as an emerging market, a large share of foreign capital invested in the Hong Kong market may leave. The E.U.'s top diplomats will hold a video call today to discuss relations with China amid increasing unease in the region over Beijing's recent moves.

Global Stimulus: Japan is expected to pass a 117 trillion yen (\$1.1 trillion) or 19% of GDP virus-stimulus package. The measure includes financing help for struggling companies, subsidies to help firms pay rent and several trillion yen for health care assistance and support to local economies. The spending will be funded by a second supplementary budget, and the new measures would match the overall size of April's 117 trillion package, bringing the total of the two packages to just under 234 trillion yen. The package may also support loans and investment through government-backed lenders by 39 trillion yen to a record 62.8 trillion yen in the current fiscal year. The EU commission proposed a Next Generation EU spending package with 500 billion euros in grants and 250 billion euros in loans to member states. The total size of the pandemic-related new spending package is 750 billion (5.25% of GDP). The proposal will be discussed at the June 11 Eurogroup before being voted by Parliaments of all 27 EU nations. **France** unveiled a roughly 8 billion euros (\$9 billion) package aimed at reviving its struggling car industry. The plan includes incentives for the purchase of electric cars, cash-for-clunkers to encourage consumers to trade in older, more polluting cars and subsidies for struggling car-parts makers. The package also includes state-backed loans for French car manufacturers.

Social Media: The Trump administration is preparing an executive order to reduce the legal protections that shield social media companies from liability for material on their platforms. The order would push the Federal Communications Commission to issue rules clarifying the issue, potentially allowing users to sue over takedowns if inconsistent with companies' terms of service, but did not provide enough notice or meet other suggested criteria.

Himalayan Conflict: India and China have moved 5,000 soldiers along its shared Himalayan border as it prepares for an extended conflict over border disputes. Diplomats in New Delhi and Beijing launched talks after failed negotiations on May 22 between Indian and Chinese military officials. The moves add geopolitical tension between the world's two most-populated countries.

England Reopening: England's outdoor markets and car showrooms can reopen June 1, and all other non-essential retail outlets are expected to be able to reopen June 15 if the government continues to control the spread of the virus. Scotland, Wales and Northern Ireland have different timetables to ease out of lockdown, as determined by their local administrations.

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KEY FINANCIAL INDICATORS

Rates	Yield	1 W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
Fed Funds	0.25%	0 bps	0 bps	-150 bps	-150 bps	-225 bps	-150 bps
U.S. SOFR	0.06%	5 bps	3 bps	-152 bps	-149 bps	-231 bps	-149 bps
3 Month USD Libor	0.36%	0 bps	-48 bps	-122 bps	-155 bps	-216 bps	-155 bps
3 Month Euribor	-0.28%	0 bps	-6 bps	15 bps	12 bps	3 bps	10 bps
3 Month U.S. T-Bill	0.15%	3 bps	4 bps	-127 bps	-145 bps	-219 bps	-140 bps
2-Year U.S. Treasury	0.17%	1 bps	-5 bps	-93 bps	-145 bps	-199 bps	-140 bps
10-Year U.S. Treasury	0.67%	-1 bps	2 bps	-62 bps	-109 bps	-165 bps	-125 bps
10-Year German Bund	-0.41%	6 bps	4 bps	15 bps	-4 bps	-32 bps	-22 bps
10-Year U.K. Gilt	0.20%	-3 bps	-11 bps	-23 bps	-47 bps	-83 bps	-63 bps
10-Year JGB	0.00%	0 bps	4 bps	12 bps	12 bps	8 bps	2 bps
Fixed Income	Yield	OAS	1W Return	1M Return	3M Return	12M Return	YTD Return
Barclays Capital U.S. Government-Treasury	0.53%	N/A	-0.1%	-0.3%	4.1%	12.5%	8.4%
Barclays Capital U.S. TIPS	0.74%	N/A	-0.3%	-0.3%	1.6%	9.1%	4.6%
Barclays Capital U.S. Aggregate	1.39%	77	0.1%	0.5%	2.1%	10.2%	5.2%
Barclays Capital Global Aggregate	1.04%	66	0.0%	0.7%	0.1%	5.5%	1.5%
Barclays Capital U.S. ABS	1.37%	115	0.2%	1.2%	0.5%	4.3%	2.1%
Barclays Capital U.S. MBS	1.45%	73	-0.1%	0.4%	2.2%	7.1%	3.5%
Barclays Capital U.S. Corporate Investment Grade	2.46%	178	0.5%	1.5%	-0.6%	10.6%	2.5%
BAML Euro Corporate Investment Grade	1.17%	170	0.8%	0.8%	-3.9%	-0.4%	-2.8%
Barclays Capital U.S. Corporate High Yield	7.07%	643	1.9%	4.9%	-4.4%	0.3%	-5.2%
BAML European Currency High Yield Non-Financial	5.61%	605	2.1%	3.0%	-6.9%	-2.7%	-7.1%
CS U.S. Leveraged Loans	7.87%	756	1.5%	3.4%	-6.9%	-4.2%	-6.7%
CS Western European Leveraged Loans Non-USD	6.97%	688	0.9%	2.9%	-6.5%	-4.4%	-6.1%
JPM CEMBI Broad Diversified	5.48%	491	1.1%	4.3%	-5.2%	3.0%	-3.1%
JPM EMBI Global Diversified	6.00%	521	1.0%	7.9%	-7.6%	0.7%	-5.8%
JPM GBI-EM Global Diversified	4.55%	N/A	1.7%	7.7%	-5.7%	2.2%	-7.9%
Equities	Price	Div Yield	1W Return	1M Return	3M Return	12M Return	YTD Return
S&P 500	3,036.13	1.90%	2.2%	5.7%	2.5%	9.6%	-5.3%
Euro STOXX 600 (Local)	349.75	2.30%	2.0%	4.3%	-10.2%	-7.2%	-15.9%
U.K. FTSE 100 (Local)	6,144.25	4.91%	1.3%	5.1%	-9.6%	-15.6%	-18.5%
Japan Nikkei 225 (Local)	21,419.23	2.22%	4.0%	8.3%	-2.4%	1.1%	-9.5%
China Shanghai Composite (Local)	2,836.80	2.36%	-1.6%	0.8%	-5.2%	-1.9%	-7.0%
MSCI AC World (Local)	506.98	2.48%	1.9%	7.2%	-5.0%	4.7%	-8.0%
MSCI Emerging Markets (Local)	927.36	3.01%	-0.7%	4.3%	-7.9%	0.3%	-11.7%
Commodities/Currencies	Price	1W Change	1M Change	3M Change	6M Change	12M Change	YTD Change
S&P GS Commodity Index	297.30	-1.4%	29.0%	-19.2%	-29.3%	-30.4%	-31.8%
WTI Crude (\$/bbl)	32.80	-2.1%	169.5%	-30.5%	-43.6%	-43.8%	-46.4%
Copper (\$/lb)	2.40	-2.6%	0.9%	-6.6%	-10.2%	-11.2%	-14.0%
Gold (\$/oz)	1,694.60	-3.1%	-1.2%	2.6%	16.5%	32.1%	11.9%
U.S. Dollar Index	99.06	-0.1%	-1.0%	0.6%	0.7%	1.5%	2.8%
Euro (USD/EUR)	1.10	-0.2%	1.2%	-0.1%	-0.2%	-2.0%	-2.2%
British Pound (USD/GBP)	1.22	-0.5%	-1.6%	-5.1%	-5.2%	-3.7%	-7.8%
Japanese Yen (Yen/USD)	107.84	0.4%	0.6%	-2.0%	-1.4%	-1.6%	-0.8%
Chinese Yuan (CNY/USD)	7.15	0.7%	1.0%	2.0%	1.8%	3.7%	2.7%

Source: FactSet and Bloomberg. As of May 27, 2020.

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