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# Market Update: 3rd September 2020

**Stimulus Hopes Rise as Eurozone Recovery Loses Steam**

Over the week, various data releases shed some light on the economic situation in different aspects of the Eurozone economy as it recovers from the pandemic-induced economic recession. While it is widely accepted that the Eurozone recovery remains intact, recent data paints a picture of a recovery which is starting to run out of steam moving through the third quarter of the year. As the health situation continues to deteriorate in several countries across the bloc, there is a risk that the recovery could stall in the coming months, or that activity could continue to be weighed down by uncertainty before a vaccine is found. Against this backdrop and helped by recent comments on the strength of the currency, markets are becoming increasingly optimistic over the potential for further stimulus from governments and the European Central Bank to secure the recovery.

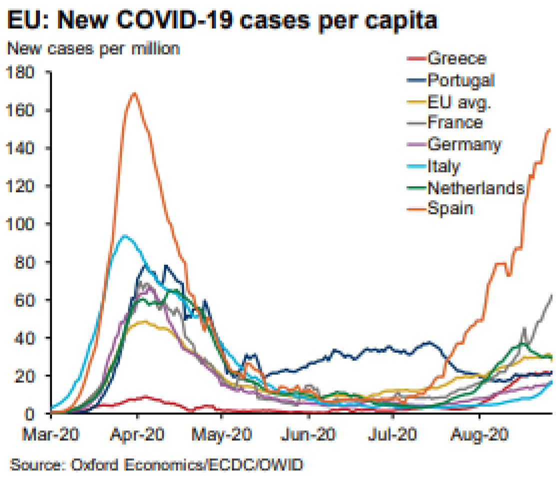
***Consumer Sentiment Wanes***

Last week, sentiment indicators showed that the recovery in the economy continues, yet the pace of recovery is slowing while virus concerns continue to weigh on consumer sentiment. The figures showed an improvement compared with the negative sentiment survey numbers for August, however more generally, survey data continues to suggest that the recovery is slowing, with national indices reflecting different conditions at the country level. For instance, while German data still shows a generally positive trend, this month's European Sentiment Indicator figures show that activity in Spain deteriorated in August compared with July as the country continues to suffer some of the worst numbers of Covid-19 infections in the continent.

On a sector level, the data shows that while the recovery in services and industrial sentiment continues, the rise in consumer confidence has stalled, and figures remain broadly unchanged since June. Despite the strong levels of public support and generous employment support schemes put in place by most European governments, consumers remain worried about their financial situation and the state of the economy next year, and they still anticipate sharply higher unemployment in most countries.

***The Evolving Health Situation***

The evolution of the health situation continues to dominate the short-term outlook for the Eurozone economy. The number of cases has risen strongly in several countries as shown in the following chart, feeding concerns that the recovery could stall over the coming months. With schools re-opening across the continent and containment measures only partially effective, there is a risk that European countries could see an increase in local restrictive measures which could restrain growth.




Fortunately, the health situation is far better than it was during the worst months of the spring in terms of the real number of cases and the severity of the outbreak, with a much lower number of deaths and hospitalisations. With limited risks of health systems being overwhelmed for the time being, the risk of a re-imposition of nationwide lockdowns is relatively low, given the colossal damage this would cause to already battered European economies. A more likely risk is weaker economic growth over the coming quarters until a vaccine is available as businesses and consumers remain cautious given current uncertainty. This feeds into our expectation that the recovery will become more gradual in the fourth quarter as uncertainty remains.

***Manufacturing and Services Data***

The final services PMIs for August added to the evidence of a slowing recovery. While manufacturing output rose markedly in August, the services sector saw only marginal growth over the month. While the overall eurozone PMI remained in expansionary territory at 50.5, it still fell sharply from July's figure of 54.7, reinforcing our expectations for a strong mechanical bounce back in GDP in Q3, before growth slows markedly in Q4. The PMIs also suggested that the recovery is diverging across countries, as activity in tourism-oriented Italy and Spain dropped back into contractionary territory, while activity in Germany and France continued to expand over the month.

Adding to evidence of the recovery running out of steam, Eurozone retail sales dropped 1.3% month on month in July following two months of strong increases. Sales are still up over the year, however the rebound in overall household consumption is likely to be more subdued due to weaker spending on services. This effect was expected as retail sales in previous months reflected pent up demand as lockdown restrictions were eased, before returning to a more accurate level.

***Calls for Stimulus***

While its not yet clear whether the ECB will boost stimulus again just yet, the Governing Council may indicate next week that downside risks have intensified, signalling more easing could be done before the end of the year. ECB officials have also recently expressed concerns that the strength of the Euro may weigh on exports and bring down prices, spurring speculation that they may consider easing monetary policy further. So far, the central bank has been reluctant to lower rates further into negative territory, but they could find themselves under increasing pressure to cut rates again on a stronger Euro and fading recovery.

Governments are also attempting to support the recovery along with more stimulus spending. This week, France unveiled details of a 100 billion Euro stimulus plan, and German Chancellor Angela Merkel's parliamentary caucus backed plans allowing for further extraordinary deficit spending next year, paving the way for more stimulus.

***Market Movements***

Around the world, the equities rally appears to be gaining fresh momentum. European shares jumped to the highest in more than a month earlier today after France introduced new stimulus measures to drive the economy and spur job creation. The Euro weakened on expectation for more stimulus, while commodities slumped. The S&P 500 jumped 1.5% yesterday to hit another record, and Japanese stocks are trading at the highest since February. The rotation away from technology giants such as Apple, Tesla and Zoom in yesterday's trading session was taken as another bullish sign amid hopes for a coronavirus vaccine.

***Our Outlook***

Overall, the Eurozone rebound appears to have lost momentum, however the autumn is likely to still see the economy rebounding from spring lows. Essentially, the data released this week highlights how policymakers will need to remain focused firmly on sustaining the recovery, suggesting that conditions are likely to remain supportive for European risk assets moving forward.