MARS CAPITAL PARTNERS

Weekly Macro Review

w/c 2 November 2020

Key Themes

US data this week continued to indicate improvement in the economy. Jobs growth improved – but there is still a long way before there is a full recovery of the jobs lost in Mar and Apr. The non-farm payrolls continue to rebound – and have now recovered just over 50% of the jobs lost in Mar and Apr. Unemployment continued to fall – aided by a slower recovery in labour market participation. Initial jobless claims continue to slow. Some of the slowdown in state-based programs is being offset by increases in federal support programs.

The US congress will return next week in a lame duck session. There is some evidence that Governors may begin to implement measures to reduce the spread of Covid in their states – especially where cases are placing pressure on hospital capacity. President-elect Biden will announce a task force this week – it is unclear how much impact he can have prior to taking office though. The holiday season will place pressure on infection rates, which are already well above 100k a day now. Any restrictions implemented during this period may not be supported by another round of fiscal support, although there remains some positive signs for some agreement on stimulus support during the lame duck session – and there is still a very high level of cash in the Government Treasury General Account. The FOMC left policy unchanged this month – further support for the economy in the face of restrictions, may be a priority for the FOMC over the next few months.

US business activity continued to rebound, but is uneven. Manufacturing recorded stronger growth in Oct, in line with the improved regional reports. The Sep factory orders continue to show weakness in airline and petroleum industries. Motor vehicle orders and shipments are now back above that of a year ago. Other industries continued to rebound. Services growth was consistent this month, but there was no acceleration in activity after the stronger result in Sep. There was some caution regarding hiring.

Activity in Europe and the UK is about to be impacted by further social restrictions to curb the spread of Covid. Eurozone manufacturing was stronger in Oct due mostly to activity in Germany. Services output across the Eurozone fell back into contraction – the first sign of weakness re-emerging.

In the UK there was a notable slowdown in services growth, while manufacturing growth remained consistent. The BoE stepped up asset purchases by an additional £150bn. The BoE remains cautious about the uncertainty of the Brexit trade deal as well as the impact of the reimposition of social restrictions.

Australia is now coming out on the other side of restrictions. The PMI's noted large improvements in business sentiment as case counts decline, as trading and travel restrictions are lifted, and as state border restrictions begin to lift. The PMI's indicated moderate improvement in activity, especially in services. But both manufacturing and services reports noted declines in employment. The RBA used this opportunity to "gain more traction" with monetary stimulus by easing further this month. A large suite of easing measures was introduced this week, including QE, and the reduction of the OCR down to +0.1%.

Aus mortgage finance data confirmed that housing remains well supported. Retail sales are recovering with a strong Q3 result (in real terms) – even the weakness in Vic was offset by stronger growth in other states. But the retail sectors contributing to the growth are *generally* not discretionary in nature. Food grocery has been strong. Household Goods was also strong – led by some shift to work-from-home requirements. Retail sales have been boosted by the strong fiscal and monetary stimulus, rent and mortgage payment moratoriums, early tax-free access to retirement savings, and improvements in employment. Some of the fiscal measures have started to unwind now.

Contents

US Data

Non-Farm Payrolls & Employment Report (Oct)

One of the key take-aways this month is that the jobs market continues to improve. While there is still a significant number of payrolls jobs to recover, growth has thankfully remained consistent. The concern now is that the significant increase in Covid cases may lead to some shutdowns or reintroduction of restrictions – which would likely severely curtail some of this recovery.

There was a similar story with the household employment survey – and it was positive this month. There were strong gains in employment this month – with an even split between FT and PT employment gains. The employment gains were higher than the slight increase in participation, so there was a larger reduction in total unemployed persons.

The direction of the changes this month were encouraging. The levels though indicate that there is still a substantial deficit in employment to recover and high levels of unemployment.

US NON-FARM PAYROLLS

There was a further increase in non-farm payrolls this month, mostly on par with the increase in the month prior. The growth in private non-farm payrolls remained elevated, but was offset by a decline in government payrolls.

Non-Farm Payrolls – month change: Oct +638k employees versus Sep +672k

Since the -22.16m decline in non-farm payrolls in Mar and Apr, approx. 12.07m jobs have been recovered in the six months since Apr. This still leaves a deficit of 10m jobs just to make up for the Mar/Apr loss.

The gain this month was in private non-farm payrolls of +906k employees, which was offset by a decline of -268k in government jobs:

> A decrease of 138,000 in federal government was driven by a loss of 147,000 temporary 2020 Census workers. Job losses also occurred in local government education and state government education (-98,000 and -61,000, respectively).

Within the private non-farm sector, most of the payroll gains were in service providing industries of +783k jobs. The main service job gains were in leisure and hospitality (+271k jobs this month versus +406k jobs in the prior month) and professional and business services (+208k jobs versus +122k prior month). Retail trade jobs also increased notably +123k jobs in Oct versus +23k in Sep.

Goods producing jobs increased by +123k jobs (manufacturing jobs +38k and construction +84k jobs).

US EMPLOYMENT (HOUSEHOLD SURVEY)

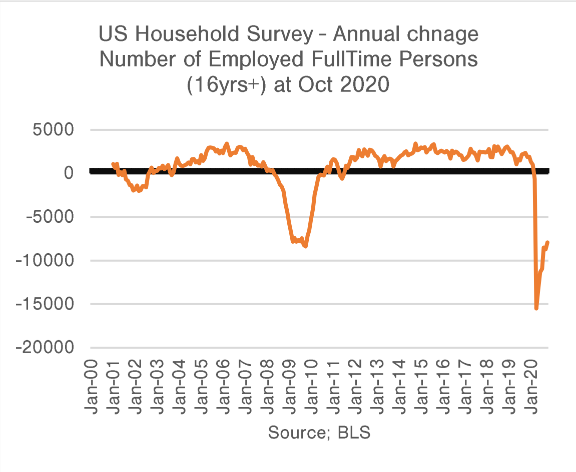
The underlying changes in the labour market were encouraging this month. Employment growth was strong and this more than offset the increase in the size of the labour force due to participation. As a result of the stronger employment growth, there was a corresponding and notable pick-up in the reduction of total unemployed persons.

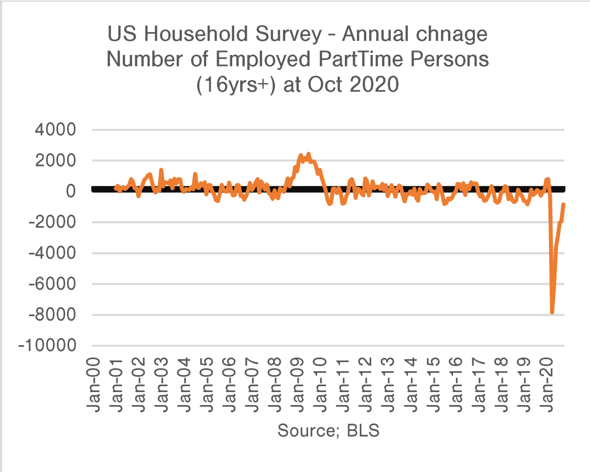
The direction of the improvement in the labour market is reassuring. The levels though remain well below a year ago and there remains a large employment deficit versus a year ago. The continued low level of the employment to population ratio is strong indicator that much more needs to be done to stimulate growth. The slower improvement in the participation ais also contributing to the reduction of total unemployment.

Total Employed – month change: Oct +2.2m versus Sep +275k

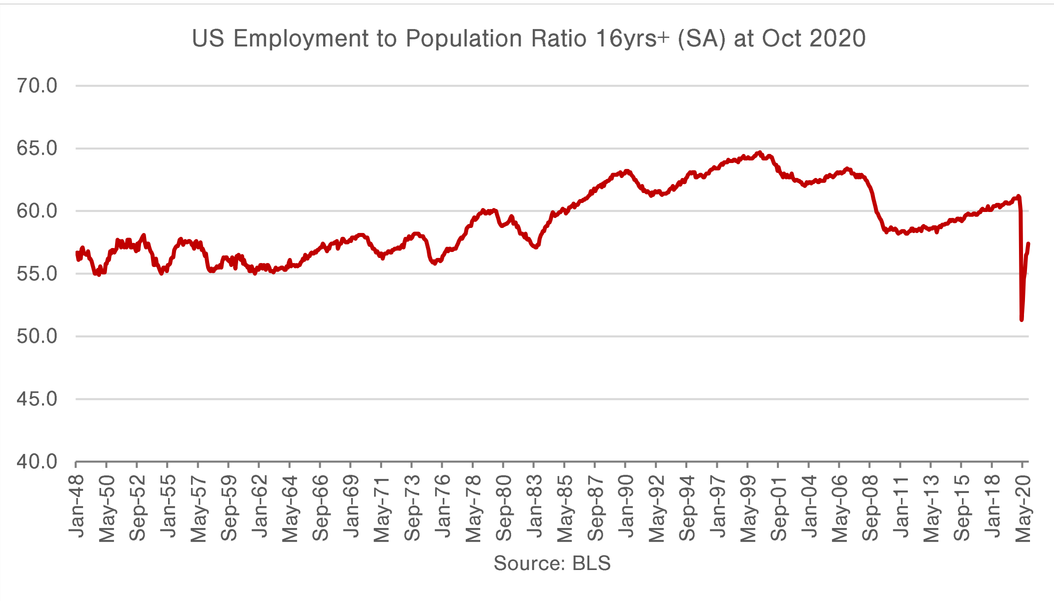
This was a significant improvement in the employment gain this month. Even more encouraging was that more than half the gains this month were in FT employment (+1.2m) this month. Last month, FT employment increased by a mere 54k jobs.

The current level of employment, although improved, remains 8.7m below the same month a year ago. Most of the decline versus a year ago is in FT employed persons (-8m FT employed persons. There are now only 800k fewer PT employed persons compared to a year ago.





The employment to population ratio improved again this month, but still remains at low levels. The employment to population ratio increased from 56.6 in Sep to 57.4 in Oct. The last time the ratio was this low (aside from the prior six months), was May 1983.

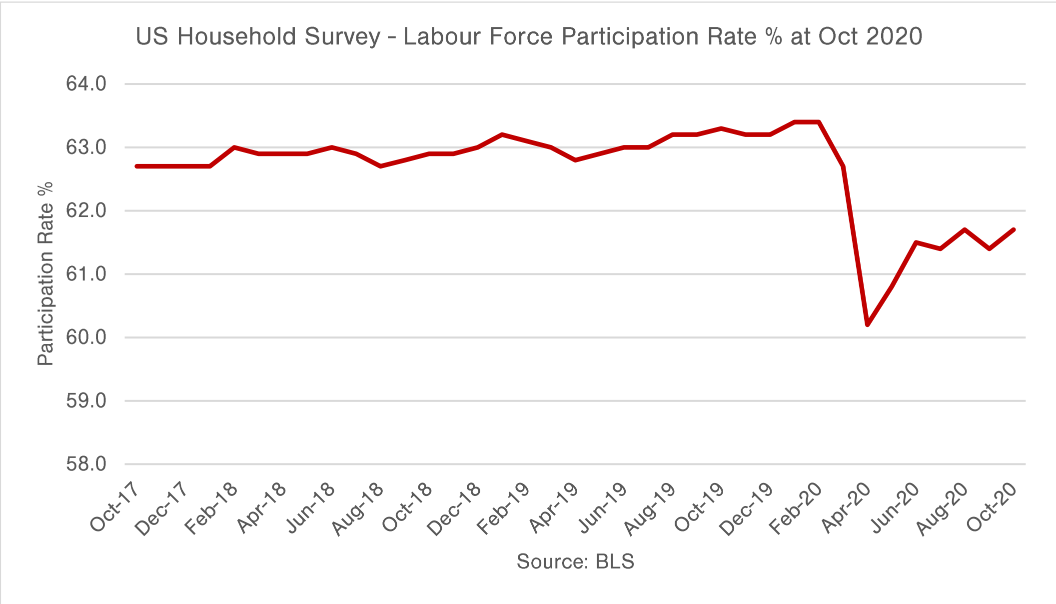


<u>Labour Force – month change</u>: Oct +724k persons versus Sep -695k persons

Most of the increase in the labour force this month was due to the increase in the labour force participation rate.

The increase in participation from 61.4% in Sep to 61.7% in Oct added approx. 782k persons to the labour force. This was significantly lower than the increase in employment, so most of the employment gain resulted in a decline in total unemployed persons.

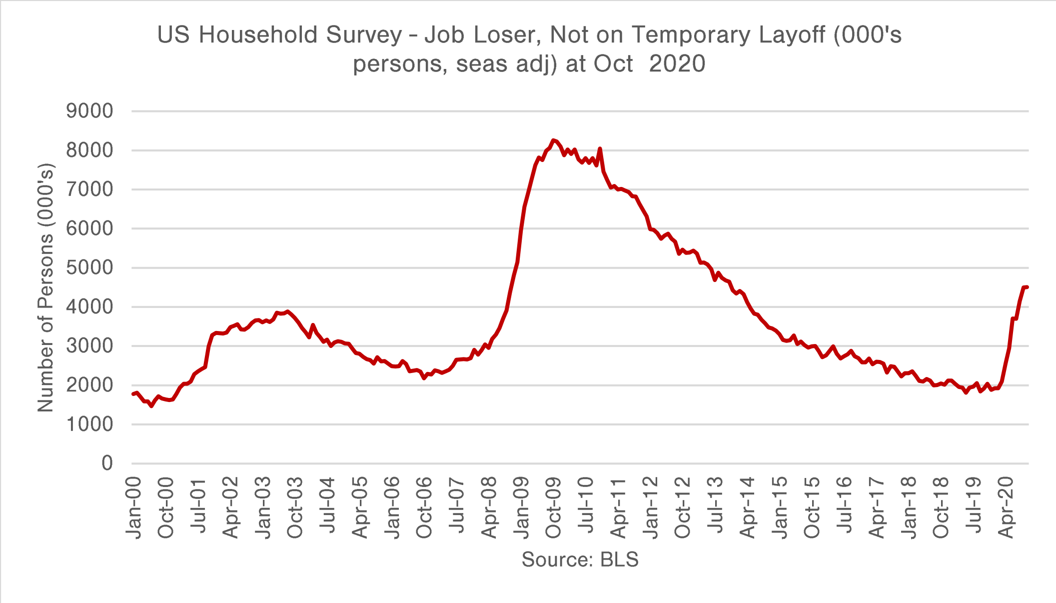
The total labour force size remains -3.5m people below the same month a year ago. After some early gains, growth has stalled. This is due to the limited improvement in participation within the 16yrs+ group. Since the improvement in participation in Jun (61.5%), there has been little gain made:



<u>Total Unemployment – month change</u>: Oct -1.5m persons versus Sep -970k persons

The level of total unemployed persons remains +5.2m above the same month a year ago.

The job losers series (independently adjusted from the unemployment series) highlights that most of the decline in total unemployed persons was people on temporary layoff (-1.4m persons). The number of people on permanent layoff was unchanged at 4.5m. This is still below the levels reached during the GFC.



The unemployment rate has fallen to 6.9% in Oct from 7.9% in Sep.

Summary of Main Employment Indicators

000's people (16yrs+)	Annual chg - OCT 2020	Monthly Chg - OCT
The estimated change in the Labour Force due to pop growth (1)	638	- 58
How many jobs available for them? (employment growth) (2)	- 8,738	2243
Difference (if negative, then employment growing faster than what pop adds to the labour force) (3)	9,376	-2301
Change labour force participation - (if positive, people entering/returning to the labour force) (4)	- 4,172	782
The remainder is the chg in total unemployed persons (declining if negative) (4) plus (3)	5,204	-1519
Two views of annual growth in the labour force;		
Total employed persons plus total unemployed persons	- 3,534	724
Est of what population adds to the labor force plus change in participation	- 3,534	724
BLS reported change in the size of the labour force	- 3,534	724

https://www.bls.gov/news.release/empsit.nr0.htm

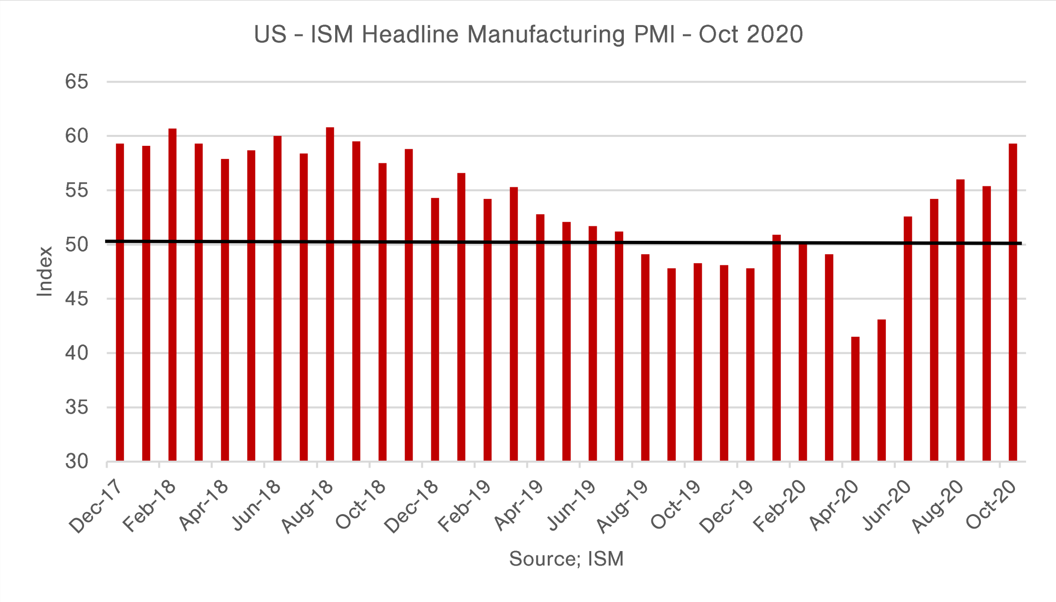
ISM Manufacturing PMI (Oct)

The headline manufacturing PMI indicated that more firms experienced faster expansion in Oct compared to Sep. This is in-line with the stronger regional surveys for Oct reported over the last few weeks. The stronger result in new orders indicates further support for higher production and overall activity in the short-term. The improvements in demand were widespread among industries. The employment index indicates further hiring momentum among firms.

> "Among the six biggest manufacturing industries, five (Fabricated Metal Products; Food, Beverage & Tobacco Products; Chemical Products; Computer & Electronic Products; and Transportation Equipment) registered strong growth."

Headline Manufacturing PMI: Sep 59.3 versus Sep 55.4

Most industries reported growth in manufacturing activity this month (fifteen). Only two industries reported contraction: Textile Mills; and Printing & Related Support Activities.



The new orders index jumped notably from 60.2 in Sep to 67.9 in Oct. This was due to more firms reporting higher new orders. There was a corresponding larger decrease in the proportion of firms reporting lower orders, falling from 18.9% of firms in Sep to 10.5% in Oct. Only one industry reported a decline in new orders – Textile Mills.

The new export orders index was also slightly higher this month: Oct 55.7 versus Sep 54.3. The increase was the result of less firms reporting a decrease in new export orders (11% in Sep versus only 7% of firms in Oct). More firms reported the same level of new export orders and there was only a slight decline in the proportion of firms reporting higher export orders.

The production index increased from 61 in Sep to 63 in Oct. There were more firms reporting higher production and less firms reporting lower or declining production. Again, Textile Mills was the only industry to report lower production.

Backlogs of orders continued to increase at a similar pace. The index was only slightly higher at 55.7 in Oct.

The employment index shifted into expansion this month from 49.6 in Sep to 53.2 in Oct. The underlying shift was positive. There was an increase in the proportion of firms reporting higher employment and a decrease in the proportion of firms reporting reduced employment. Despite the improvement, there were still five industries reporting a decrease in employment in Oct:

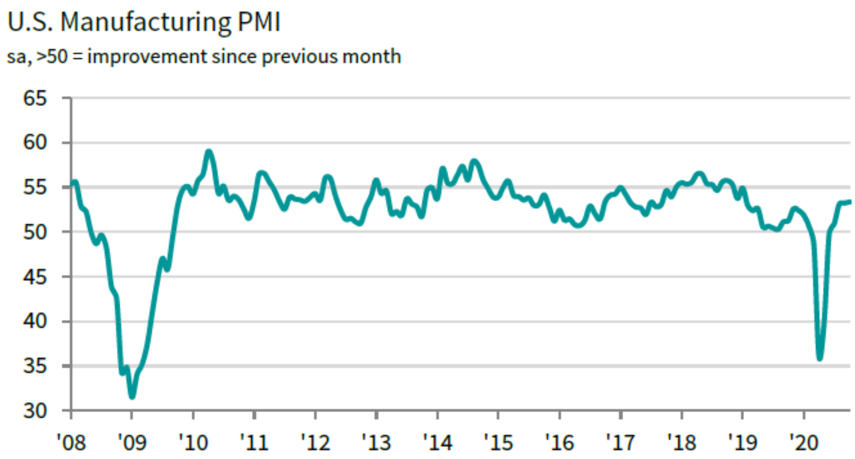
Printing & Related Support Activities; Petroleum & Coal Products; Paper Products; Miscellaneous Manufacturing; and Electrical Equipment, Appliances & Components.

https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/october/

Markit Manufacturing PMI Final (Oct)

There was only a marginal improvement in the pace of growth in overall manufacturing activity in Oct versus Sep.

<u>Manufacturing PMI:</u> Oct 53.4 versus Sep 53.2



Source: IHS Markit.

Production output increased at a faster pace. New orders increased at a slower pace, but firms noted "larger volumes of orders". Growth in orders was led by domestic orders contracted for the first time since Jul. Order backlogs were little changed. Employment increased at a slower pace.

> Business expectations remained positive in October, improving on September's four-month low, as firms foresee a rise in output over the coming year. The degree of confidence was historically muted, however, as fears regarding the pandemic weighed on optimism.

https://www.markiteconomics.com/Public/Home/PressRelease/201875b465134d98b50ea92ea8be6811

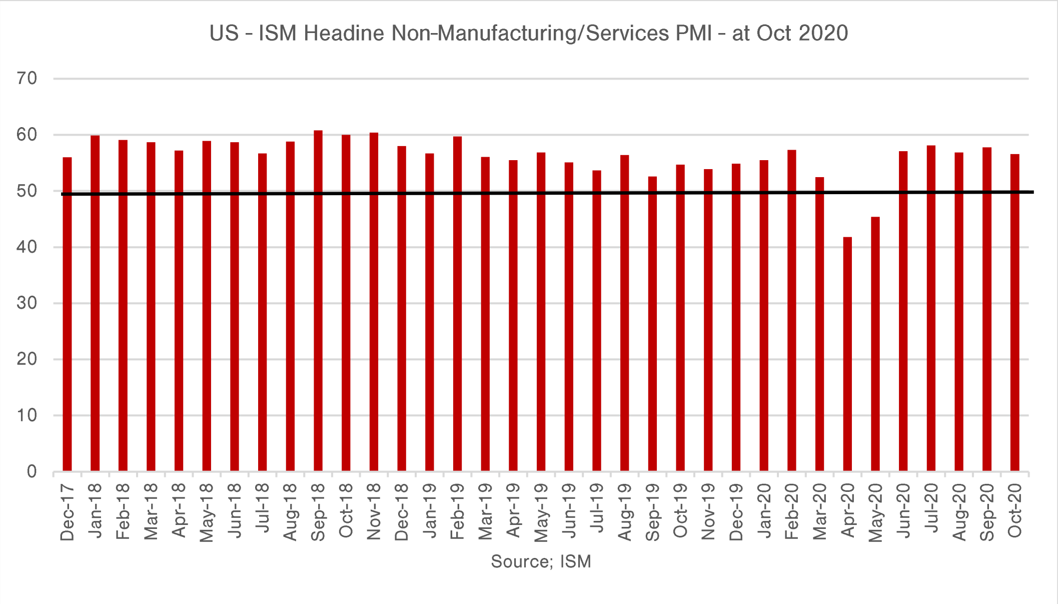
ISM Services PMI (Oct)

This is a broadly upbeat report on services activity and growth in Oct. While the monthly pace of growth slowed, this is still the fourth month-on-month growth in services activity. Indexes across most measures fell back slightly this month after a stronger Sep – but index levels remain in line with activity levels from Jul/Aug. Anecdotes from business are mostly positive.

“Respondents’ comments are cautiously optimistic about business conditions and the economy. There is a degree of uncertainty due to the pandemic, capacity constraints, logistics and the elections”

Of the industries covered in the report, sixteen recorded growth in Oct and “only” two industries recorded a decline. One was the Arts, Entertainment, and Recreation – which has been hit hardest by restrictions on social gatherings. The other was Public Administration.

<u>Headline Services PMI</u>: Oct 56.6 versus Sep 57.8



The business activity/output index fell slightly from 63 in Sep to 61.2 in Oct – but remains elevated. The underlying dynamic was mixed. There was an improvement (increase) in the proportion of firms recording higher output, but there was a larger increase in firms reporting lower output this mong from 7.8% of firms in Sep to 15.1% in Oct (and is now in line with levels back in Jul and Aug). Only one industry recorded a decline in output in Oct – Public Administration.

“We continue to be cautiously optimistic that the rebound in business that began in July continues to sustain.” (Retail Trade)

“Business continues to gain as people are travelling and businesses are opening up to consumers.” (Wholesale Trade)

The new orders index also fell back slightly from 61.5 in Sep to 58.8 in Oct. The underlying shift was not positive – less firms reported higher orders (37.2% in Sep versus 32.3% in Oct) and more firms reported declining orders (12% in Sep versus 18% in Oct) – compared to the month prior. The levels in Oct are not dissimilar to that of Aug, so the stronger Sep data may have been the anomaly. Only Public Administration reported a decline in orders in Oct.

The proportion of firms reporting growth in new export orders was little changed

The backlog of orders index increased to 54.4 in Oct after no change in Sep. More firms reported higher backlogs and less firms reported either no change or declines in backlogs. That said, there were still six industries recording a decline in backlogs in Oct: Other

Services; Mining; Retail Trade; Public Administration; Educational Services; and Utilities. This suggests still some spare capacity.

The employment index eased from 51.8 in Sep to essentially no change in Oct 50.1. There was a slightly higher proportion of firms reporting higher employment (19.5% in Oct versus 17.1% in Sep), but there was a much larger increase in the proportion of firms reporting lower/declining employment from 14.9% in Sep to 18.1% in Oct. Eight industries reported further declines in employment this month: Arts, Entertainment & Recreation; Other Services; Mining; Information; Public Administration; Utilities; Educational Services; and Professional, Scientific & Technical Services.

The inventory index increased this month from 48.8 to 53.1 after several months of decline. In some cases, there has been a deliberate effort to reduce inventories and in other cases to stockpile to offset delay and supply issues.

> Comments from respondents include: "We have made a concerted effort to reduce our inventory levels in a cost saving effort across the company" and "Supplier allocations impacting inventory quantities."
>
> "Business has improved, but greatly reliant on COVID-19-related restrictions. Supplier's inventories and lead times are longer and spotty with outages due to keeping lead times lean as a cash flow measure, but putting consistent supply at risk." (Accommodation & Food Services)

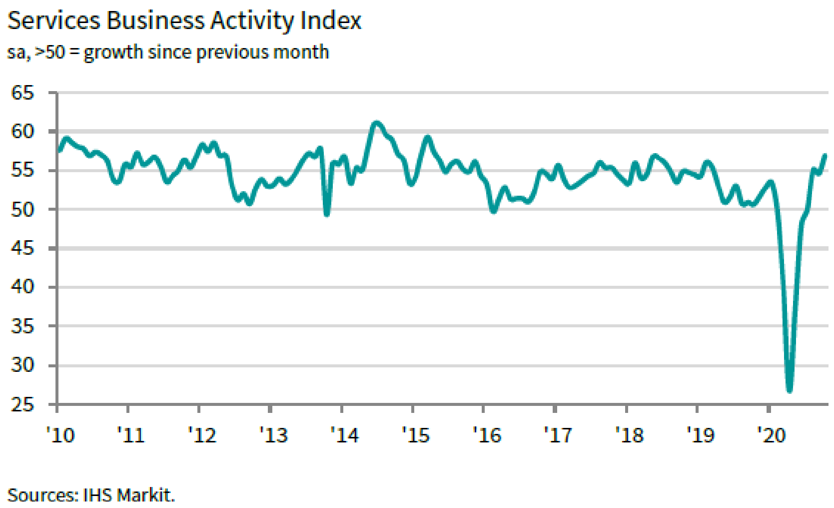
https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/services/october/

Markit Services PMI Final (Oct)

The Markit Services Business Activity index recorded a stronger pace of expansion in Oct compared to Sep. Growth in new orders was also notable in the month. Optimism continued to improve:

> The record survey improvement in optimism took confidence to the highest since April 2018, which reportedly stemmed from hopes of notably looser virus-related restrictions in one year's time and additional stimulus.

Headline Services Business Activity Index: Oct 56.9 versus Sep 54.6



Services output increased at a faster pace this month. This was supported by an acceleration in the growth of new orders. New export orders softened as key export markets reimposed some lock-down measures. Backlogs of work eased to the slowest level in four months. Employment growth also slowed as firms reported some excess capacity.

https://www.markiteconomics.com/Public/Home/PressRelease/3f1d6083970b4795afc5e988a4c34698

US Factory Orders (Sep)

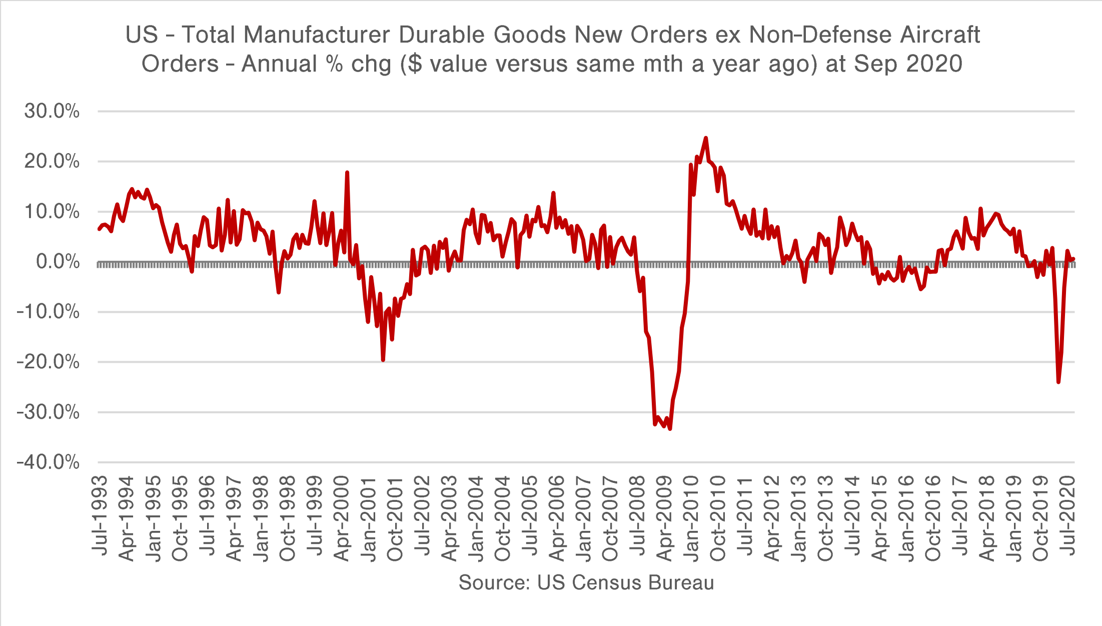
New Orders (Durable Goods) $ Val – month change: Sep +1.9% (+$4.4bn) versus Aug +0.4% (+$1bn)

The single largest contribution to the growth in orders this month was non-defense aircraft orders. These aircraft orders in Aug recorded a decline of -$3.2bn in Aug (cancelled orders) which shifted to a positive value of orders recorded in Sep of +$1.8bn. The effect was to “add” +$5bn to the month on month growth of durable goods. The level of orders and shipments of non-defense aircraft remain in trouble.

Excluding the impact of commercial aircraft, durable goods orders actually declined slightly by -0.3% in Sep compared to Aug (-0.7%).

Primary metals, fabricated metals, and motor vehicle orders increased at a faster pace this month. But this was offset by declines in machinery, electrical equipment, defense transport, ships & boats, and furniture orders.

On an annual basis, total durable goods orders are -1.8% below a year ago. Again, the large decline in commercial aircraft orders masks the underlying growth across durable goods orders and durable goods orders excluding commercial aircraft is +0.6% ahead of a year ago.



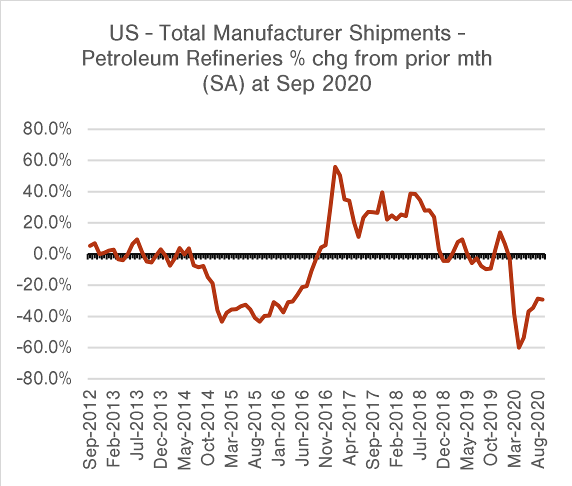
<u>**Total Manufacturer Shipments – month change**</u>: Sep +0.3% (+$1.6bn) versus Aug +0.3% (+$1.3bn)

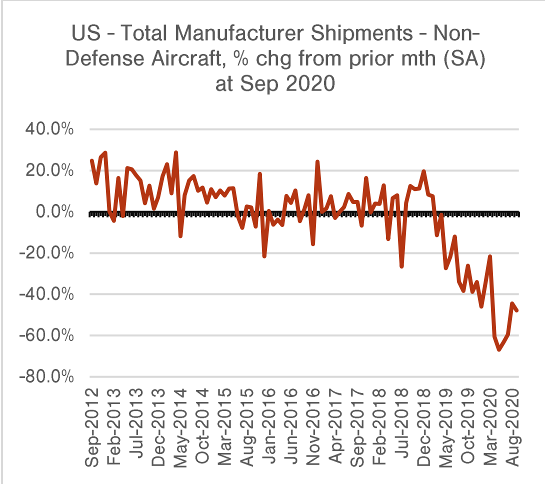
Both durable goods and non-durable goods shipments contributed to the growth this month.

Durable goods shipments increased by +0.4% (+$0.9bn) after declining in the prior month. Shipments were higher across wood products, fabricated metals, computers, autos, and misc. Shipments declined across light truck/SUV's, defense and non-defense aircraft, electrical equipment, machinery, and primary metals.

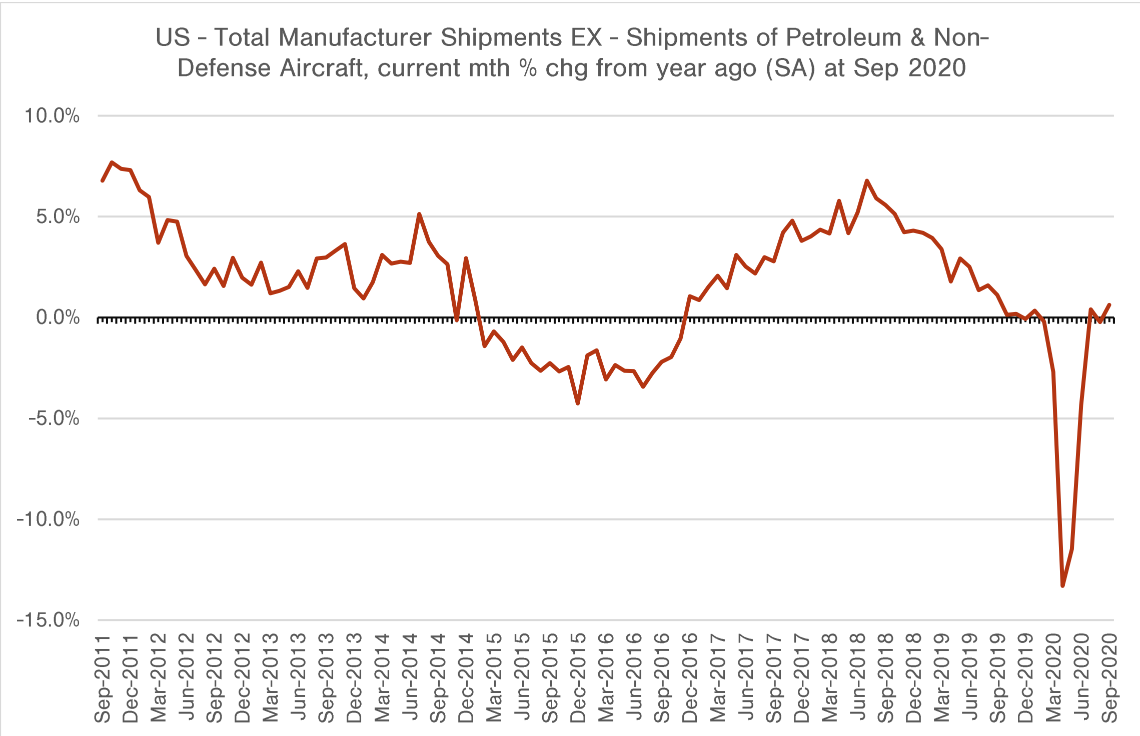
Non-durable goods shipments slowed in Sep, but remained positive: Sep +0.3% (+$0.7bn) versus Aug +0.8% (+$1.8bn). The large increase in the month prior was the result of a higher value of petroleum shipments. This month, the value of petroleum shipments declined slightly (compared to the month prior). More than offsetting this decline was an increase in food, beverage, chemicals, and paper product shipments.

Again, there are two key industries where large fluctuations in demand and price are masking the underlying performance of shipments growth. The two industries are petroleum and commercial airline shipments. The severe decline in the price of oil back in Mar and Apr has resulted in the value of oil shipments remaining 29% below the same month a year ago in Sep 2020. The demand shock from the Covid shutdown, although there were issues for Boeing prior to Covid, has also resulted in commercial airline shipments down -48% from the same month a year ago:





The value of total manufacturer shipments is still -3.3% below the same month a year ago. This has steadily rebounded since the -19% decline in Apr 2020. Excluding the value of petroleum and airlines, total shipments actually shifted from a -0.2% decline in Aug to +0.6% growth in Sep.



https://www.census.gov/manufacturing/m3/index.html

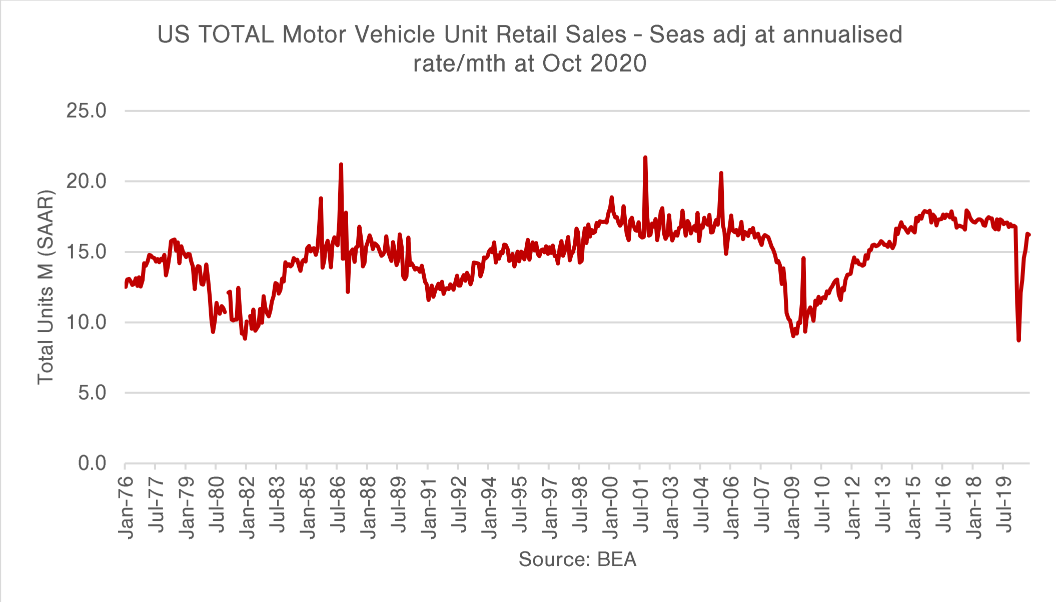
Motor Vehicle Sales (Oct)

Total motor vehicle sales were slightly lower in Oct compared to Sep. This was due to a fall in sales of Light Trucks/SUV's which offset a small increase of sales of Auto's. Auto sales remain 13% below a year ago while Light Truck sales are just back on par with a year ago.

The pace of growth has not accelerated beyond the year ago level (at this stage) to recover the gap in lost sales. Production and supply chains are coming back online, but some demand for motor vehicles has spilled over into the used car market instead – and used car prices have increased notably.

Total Motor Vehicle Sales – SAAR: Oct 16.2m (-0.5%) versus Sep 16.3m

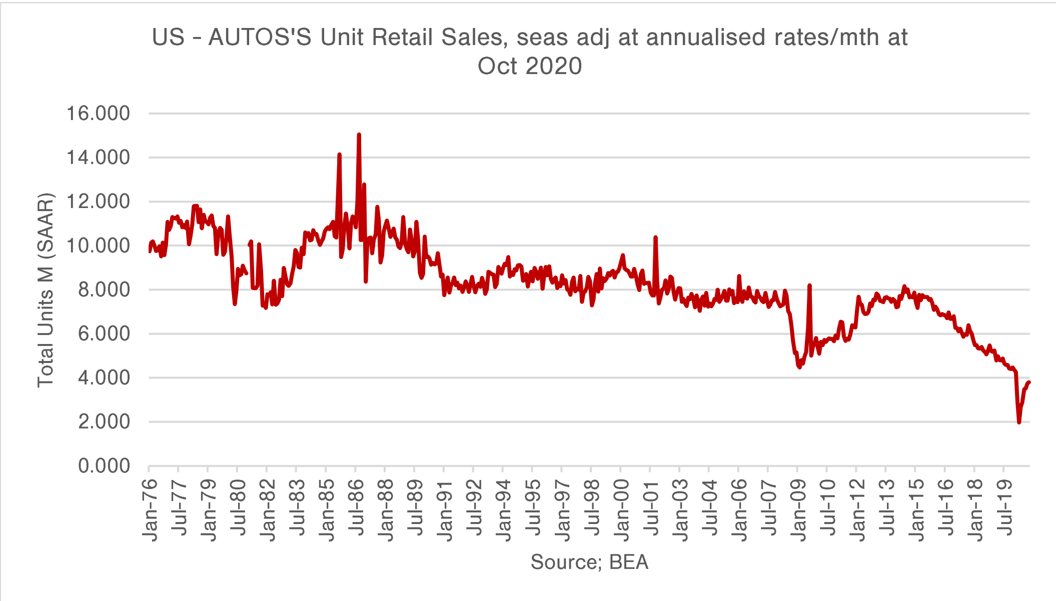
The current pace of total motor vehicle sales is 3.3% below the same month a year ago.



The recovery in Light Truck sales has been offset by the continued weakness in Auto sales.

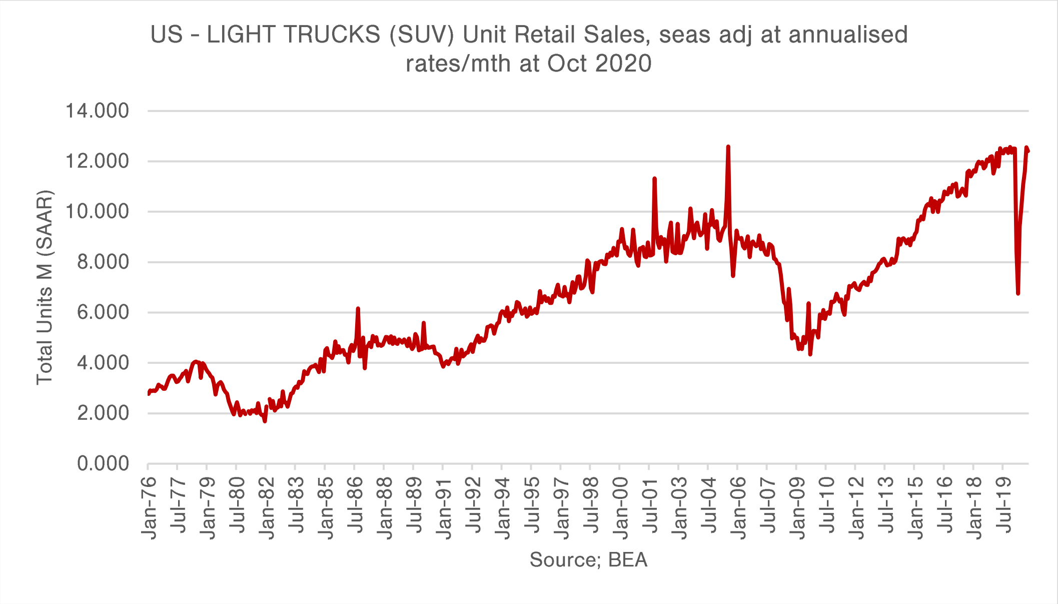
Auto sales were already in decline prior to the mandated shutdowns – and while there has been a recovery, the underlying trend decline remains in place. Auto sales are -13.9% below the same month a year ago.

Auto Sales – SAAR: Oct 3.8m (+1.7%) versus Sep 3.7m



Light Truck/SUV's – SAAR: Oct 12.4m (-1.2%) versus Sep 12.5m

The annual pace of Light Truck sales has rebounded back to +0.6% above the same month a year ago.

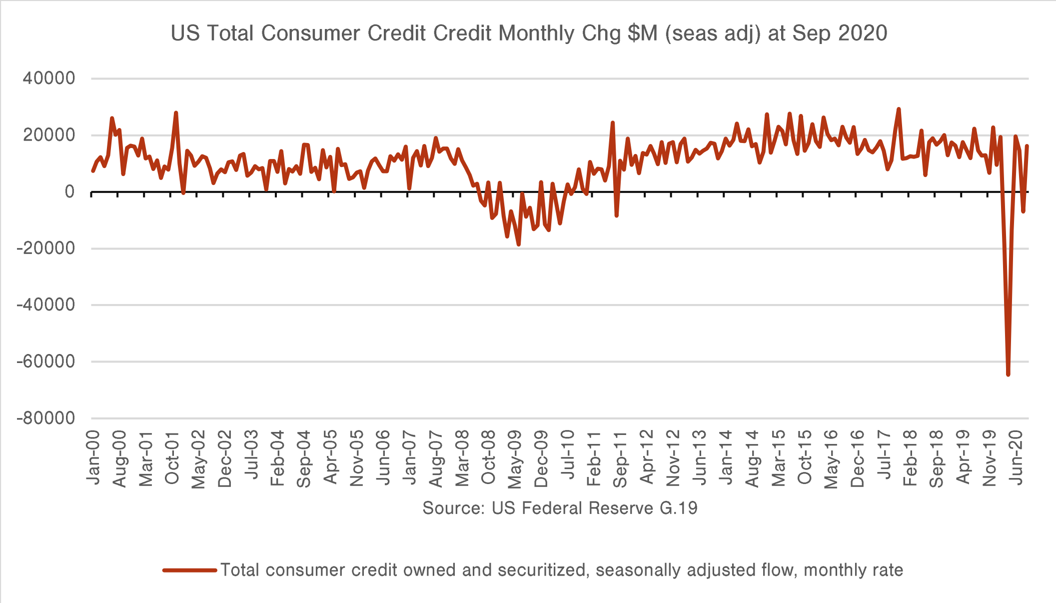


https://www.bea.gov/data/consumer-spending/main

Consumer Credit (Fed Reserve G.19) (Sep)

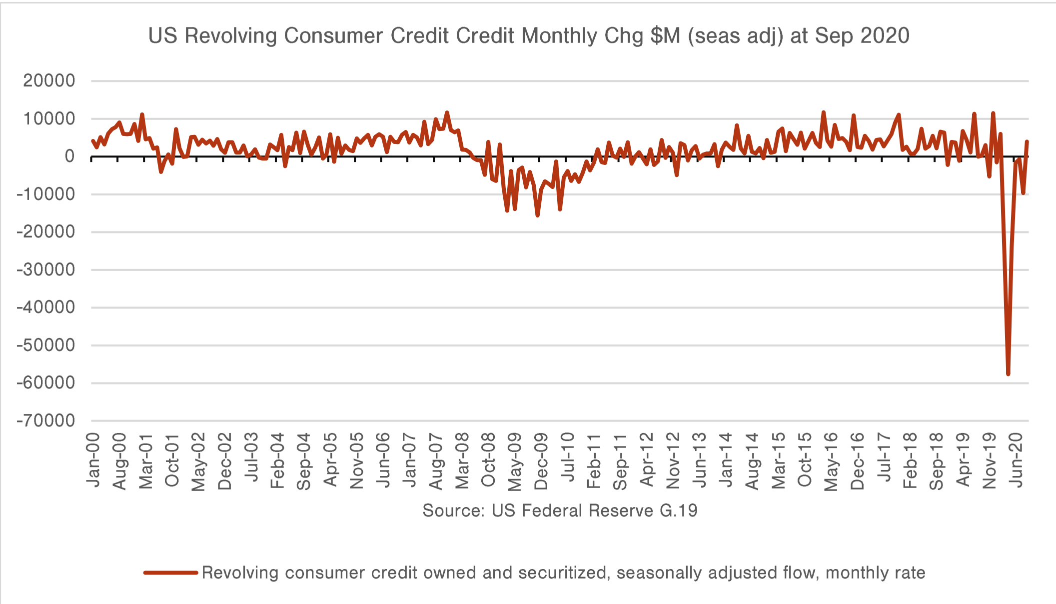
There was a stronger rebound in consumer credit growth this month. Revolving credit increased in Sep after a solid decline in Aug and non-revolving credit growth increased at a faster pace.

Total Consumer Credit – month change: Sep +$16.2bn versus Aug -$6.9bn



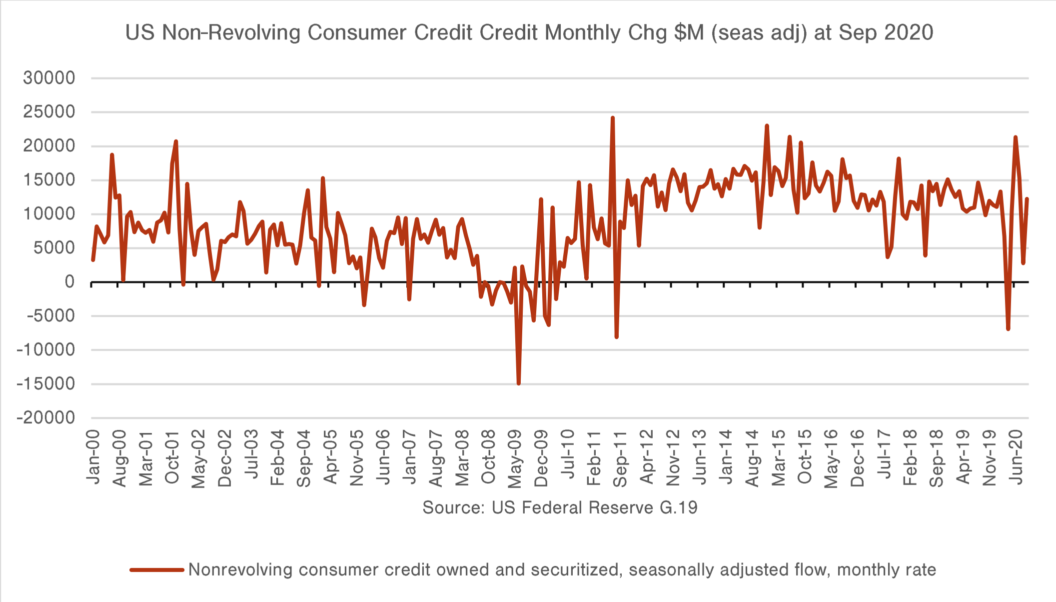
Both revolving and non-revolving credit contributed to the increase this month.

<u>Revolving Credit (Credit Card) – month change</u>: Sep +$4bn versus Aug -$9.7bn



The current value of outstanding consumer credit is now -8.9% below the same month a year ago.

<u>Non-Revolving Credit – month change</u>: Sep +$12.2bn versus Aug +$2.8bn



The current value of outstanding non-revolving consumer credit is +4% above the same month a year ago.

https://www.federalreserve.gov/releases/G19/current/

Mortgage Applications wk ending 30 Oct

Mortgage application growth was stronger in the latest week, led higher by refinance applications. Purchase applications declined again after a brief respite in the week prior.

<u>Market Composite Index (mortgage loan volume) – wk ending 30 Oct</u>: +3.8%

Growth in the prior week was +1.7%

The stronger growth in the latest week was due to the increase in refinance applications as mortgage rates remain near new lows.

<u>Refi Index wk ending 30 Oct</u>: +6%

Currently, the refi index is +88% ahead of a year ago. And refi activity is approx. 68% of all mortgage applications this week.

Refi applications last week increased by +3%.

> "Mortgage rates continue to hover at record lows this fall. The 30-year fixed mortgage rate remained essentially unchanged at 3.01 percent last week, but rates for 15-year fixed-rate loans, FHA loans and jumbo loans all fell to new MBA survey lows,"

> "The drop in rates spurred an uptick in demand for refinances. Activity increased over 6 percent, with borrowers notably seeking conventional and government loans.

The purchase index declined this week for the fifth time in six weeks – indicating some likely weakness in sales data in the next month.

Purchase Index – wk ending 30 Oct: -1%.

The purchase index is still +25% ahead of the same week a year ago.

Purchases last week increased marginally by +0.2%

The commentary last week highlighted that much of the purchase activity remains at the higher end of prices in the housing market:

> "…and the average loan size reached another record high at $372,600. These results highlight just how strong the upper end of the market is right now, with outsized growth rates in the higher loan size categories. Furthermore, housing inventory shortages have pushed national home prices considerably higher on an annual basis,"

https://www.mba.org/2020-press-releases/november/mortgage-applications-increase-in-latest-mba-weekly-survey

https://www.mba.org/2020-press-releases/october/mortgage-applications-increase-in-latest-mba-weekly-survey-x273545

Initial Jobless Claims (wk ending 31 Oct), Continuing Unemployment Claims (wk ending 24 Oct), and PUA Claims

Initial and continuing claims within regular state programs continue to trend lower – but remain elevated. Continuing claims within federal programs are now larger than the state programs and the continuing claims for the Pandemic Emergency Unemployment Compensation (PEUC) program continue to increase.

For the latest week of data for wk ending 17 Oct, there were 1.13m initial claims across regular state and federal programs.

For the wk ending 17 Oct, continuing claims across both state and federal programs totalled 21.5m people. This was a -1.15m decline versus the week prior (NSA).

STATE PROGRAMS

Initial Claims wk ending 31 Oct (NSA): 738,166 new claims.

This was 7k claims lower than in the week prior. The state program initial claims continue to trend lower. The same week in the prior year, initial claims totalled 205k claims.

Continuing Claims wk ending 24 Oct (NSA): 6,951,731 ongoing claims. This was lower by 537k people versus the week prior. The state program unemployment rate was 4.7%.

The state unemployment rate for wk ending 17 Oct was 5.1% (NSA).

FEDERAL PROGRAMS

Initial Claims for the PUA program for wk ending 31 Oct (NSA): 362,883 new claims

This was approx. 4k higher than in the week prior.

PUA Continuing Claims for wk ending 17 Oct (NSA): 9,332,610 claims, which was 1m claims lower than in the week prior.

PEUC Continuing Claims wk ending 17 Oct (NSA): 3,961,060 claims, which was +277k higher than in the week prior.

https://www.dol.gov/ui/data.pdf

FOMC – Rates and Policy Decision and Press Conference – 5 Nov 2020

As broadly expected, there was no change to the policy stance of the FOMC.

Current Settings

No change to target FFR of 0-0.25%

No change to the current pace of bond buying programs. At the Sep meeting (https://www.newyorkfed.org/markets/opolicy/operating_policy_200916) the pace of the increase in SOMA holdings of US Treasury Securities was confirmed at approx. $80bn per month and MBS holdings at $40bn a month. (Note: the current pace of *purchases* of US Treasuries is at about $20bn/week and MBS purchases are currently running at a higher pace of >$20bn/week).

Policy Goals

Maximum employment and inflation of 2% over the longer run.

The inflation objective was recently adjusted to reflect the target of an average of 2% inflation over time:

> With inflation running persistently below this longer-run goal, the Committee will aim to achieve inflation moderately above 2 percent for some time so that inflation averages 2 percent over time and longer-term inflation expectations remain well anchored at 2 percent.

Forward Guidance

The accommodated stance of policy will not change until inflation averages 2% for some time and full employment is achieved.

https://www.federalreserve.gov/newsevents/pressreleases/monetary20201105a.htm

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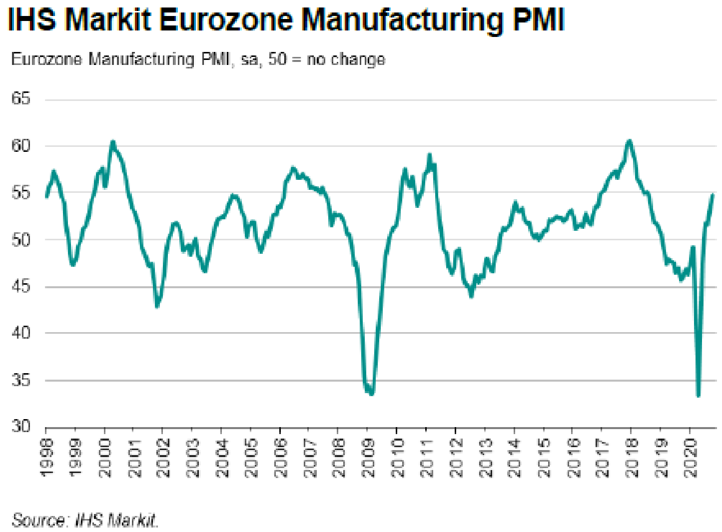
Europe

Markit Eurozone Manufacturing PMI Final (Oct)

The increase in the headline manufacturing PMI for Oct indicates that activity continued to expand at a somewhat faster pace in Oct compared to Sep. Overall output and new order growth was led higher by stronger growth in Germany. Activity continued to expand in Italy and Spain and more moderately in France.

Eurozone Manufacturing PMI: Oct 54.8 versus Sep 53.7



On a regional basis, Germany contributed the most to the growth momentum. Both Austria and Italy also recorded acceleration in growth. Activity expanded in Spain, but growth was marginal in France, Netherlands, and Ireland.

Growth in output and new orders at the total Eurozone level accelerated in Oct – Germany was the main contributor to the acceleration. Order backlogs increased for the third month. Despite the improvement in output, firms on net continued to reduce employment in Oct compared to Sep. This is now eighteen months of month-on-month declines in employment in firms across the Eurozone.

Purchasing activity increased and resulted in suppliers lengthening lead-times. This also resulted in a further notable decline in finished goods inventories.

https://www.markiteconomics.com/Public/Home/PressRelease/f8cad52b35e94cb397f6804d6c5b006e

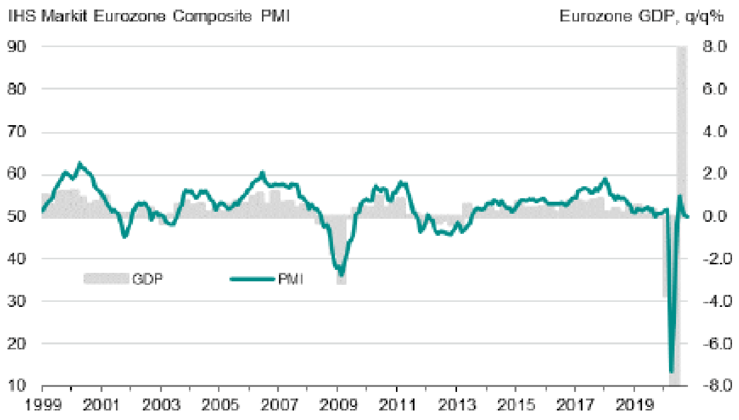
Markit Eurozone Composite and Services PMI Final (Oct)

There was a slightly faster pace of contraction across the private sector services industry in Oct. With the reintroduction of restrictions due to rising Covid infections, services conditions especially, are likely to deteriorate further over the coming month. Given the weakening environment amid the restrictions, business sentiment fell to a five-month low.

Eurozone Business Services Index: Oct 46.9 versus Sep 48

The overall composite output index (services and manufacturing combined) recorded no net change at 50 in Oct compared to Sep. The Sep composite index for the Eurozone was also little changed in Sep at 50.4. The growth in manufacturing output (at an aggregate Eurozone level) is offsetting the contraction in services output.

IHS Markit Eurozone Composite PMI



Sources: IHS Markit, Eurostat.

At a regional level, Germany was the only member to record a net increase in output in Oct – as services output in Germany declined and was offset by the increase in manufacturing output. All other member states recorded net declines in output led by Spain and France. Marginal declines were recorded in Italy and Ireland.

As output started to contract, firms also noted the accelerated decline in new business – the fastest now in five months. Both domestic and export orders declined. Services employment was reduced through the Eurozone at a more modest pace.

Firms margins remained under pressure as input costs increased and firms continued to reduce selling prices in order to remain competitive.

Unsurprisingly, business optimism fell to a five-month low.

Sentiment deteriorated most notably since September in Italy, whilst French service providers where the least optimistic overall.

https://www.markiteconomics.com/Public/Home/PressRelease/e5d2a2d403ee4d25beae55f453310778

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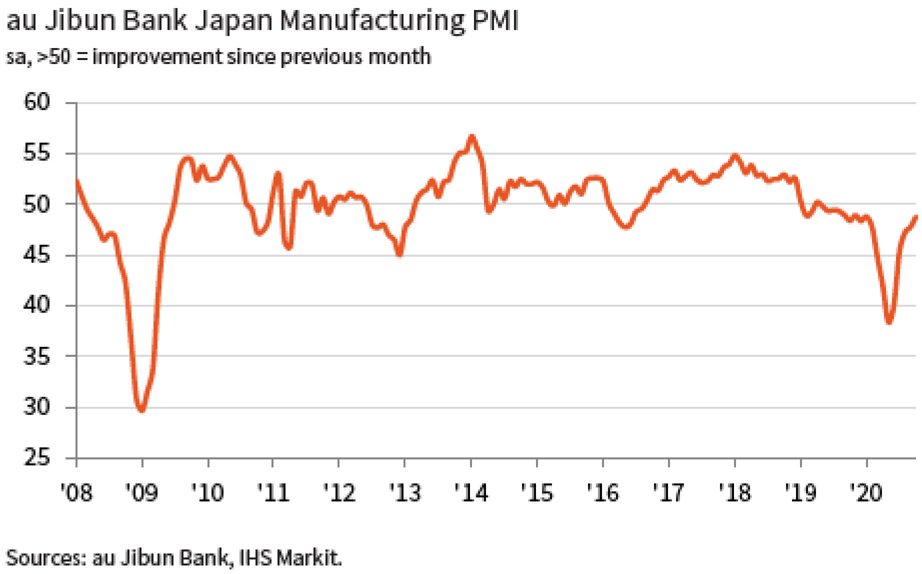
Japan

Markit Manufacturing PMI Final (Oct)

The final manufacturing PMI indicated that, on net, the number of firms continued to report weaker conditions, but less so than in Sep.

Headline Manufacturing PMI: Oct 48.7 versus Sep 47.7



The PMI indicates that output and new orders declined at a slower pace. But industrial production output for manufacturing industries has been increasing over the last few months. New export orders increased for the first time in two years – which is more in line with both export data and industrial production data. Orders backlogs continued to fall – indicating that despite improvements in orders and production, spare capacity exists. The employment index indicated that more firms were reducing employment in Oct compared to Sep.

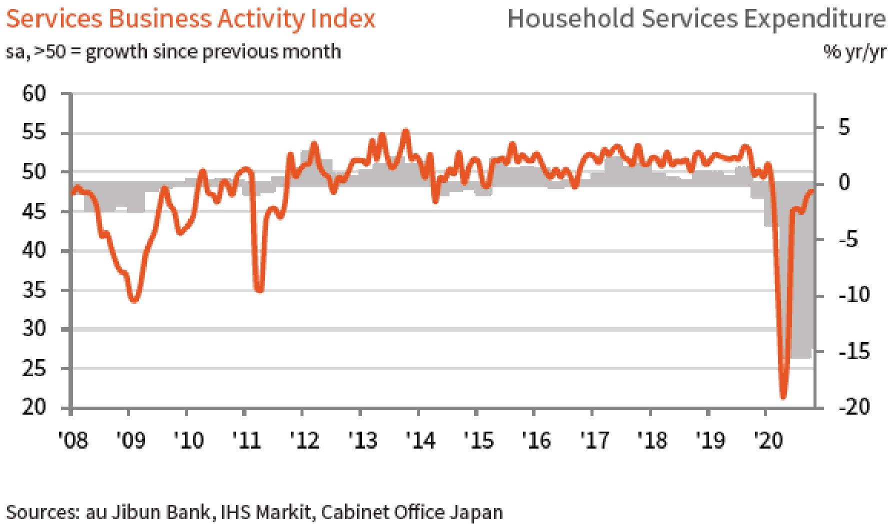
> Business confidence regarding activity over the next 12 months improved again in October. Expectations for output were at their highest since July 2017, reflecting hopes of a return to pre-crisis demand conditions once the virus subsides.

https://www.markiteconomics.com/Public/Home/PressRelease/2c93560405b047dca3c3858ac6cc9dc5

Markit Japan Services PMI Final (Oct)

The Japanese business services activity index indicated that firms on net recorded a contraction in output in Oct. The pace of contraction was moderate and eased slightly compared to Sep.

<u>Headline Business Services Activity Index</u>: Oct 47.7 versus Sep 46.9



Firms also noted that new business continued to contract in Oct. The fall remained modest but still highlighted weak demand conditions. New export work remained weaker amid global restrictions and a larger wave of infections in key client markets.

Employment levels remained unchanged.

Margins remained under pressure as input costs increased while firms discounted selling prices for the eighth month in a row.

Firms also recorded the highest level of business optimism since the start of 2018 – pinning hopes of output growth and a return to normal business conditions "once the virus spread is controlled".

https://www.markiteconomics.com/Public/Home/PressRelease/fd0a1919946e4c12bc0ff9b28f8d0e98

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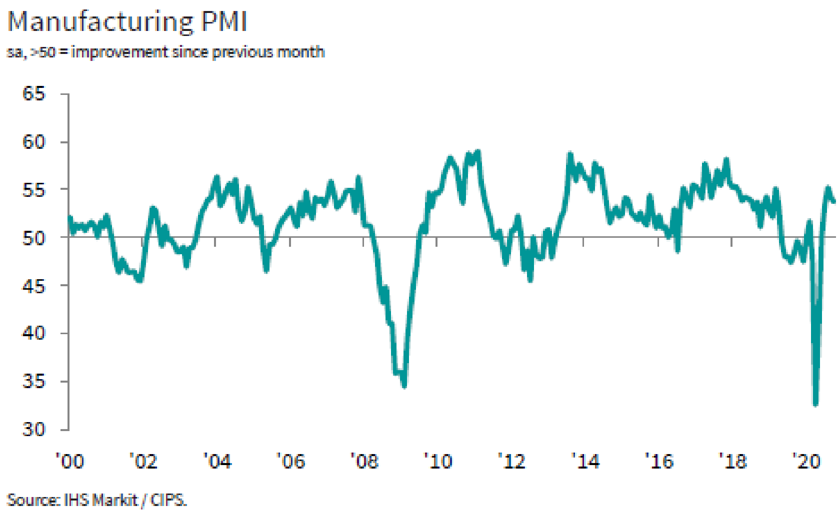
United Kingdom

UK Markit Manufacturing PMI Final (Oct)

Manufacturing activity continued to expand in Oct compared to Sep, but at a slower pace.

Manufacturing PMI: Oct 53.7 versus Sep 54.1



Output growth slowed while orders continued to increase. Some boost to new exports from the US, China, and clients preparing for the final Brexit date. Order backlogs continued to decline.

Similar to the Eurozone, demand for consumer goods weakened while growth strengthened for investment and intermediate goods. Consumer goods and investment goods manufacturers recorded stronger declines in employment in Oct.

> Manufacturers maintained a positive outlook in October. Over 60% of companies expect output to rise over the coming year, compared to only 10% forecasting a decline.

It appears survey data was collected prior to the shut-down announcement – this may impact manufacturer sentiment.

https://www.markiteconomics.com/Public/Home/PressRelease/25b1c1de1611467f8315f2ba442c09c2

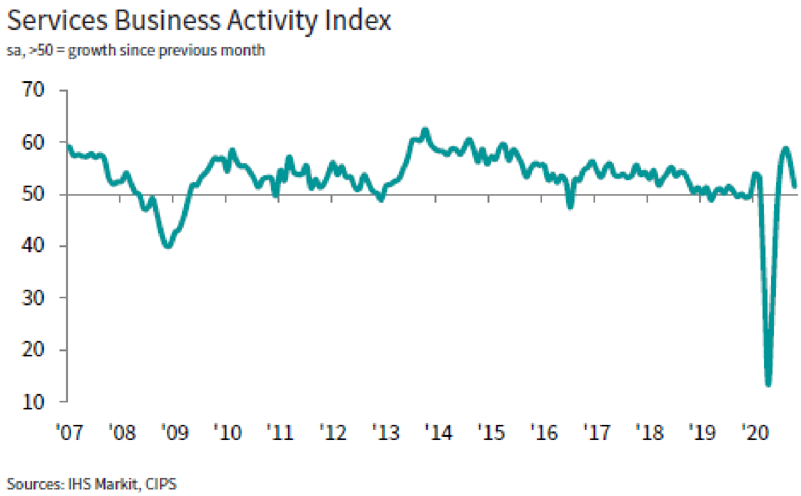
Markit UK Services PMI Final (Oct)

The headline services business activity index recorded a notable slowdown in output growth in Oct. Towards the end of the month, restrictions were reintroduced to combat the rising Covid infections.

> "Ongoing lockdown measures and covid disruption knocked the wind out of the sector's sails last month, with the deepest fall in new orders since June. The

> return to uncertainty and curbs on free movement have started to wipe out the gains of the summer, and consumer-facing businesses were the hardest hit.

Business Services Activity Index: Oct51.4 versus Sep 56.1



The rebound in the months prior had been relatively strong after the severe contraction from the Q2 lockdowns. Growth in output has now slowed again and new orders declined for the first time since Jun.

> Survey respondents overwhelmingly attributed lower new business to the impact of COVID-19 restrictions on trade during October and a subsequent lack of demand for hospitality and leisure services.

Firms continued to reduce staff numbers:

> More than twice as many survey respondents (26%) reported a drop in employment as those that indicated a rise (12%). This signalled a sharp downturn in staffing numbers, although the overall rate of job shedding was the slowest since March.

https://www.markiteconomics.com/Public/Home/PressRelease/62305cbfddf147f4b57125c2999cbe32

BoE Rates and Policy Decision

The BoE MPC statement reflected the challenge faced by policy makers in the face of the "rapid rise in rates of Covid infections".

> The Bank of England's Monetary Policy Committee (MPC) sets monetary policy to meet the 2% inflation target, and in a way that helps to sustain growth and employment. In that context, its challenge at present is to respond to the economic and financial impact of the Covid pandemic.

All restrictions announced up to and including 31 October have been reflected in the Committee's judgements.

The MPC kept the Bank rate unchanged at +0.1% and unanimously voted, not only to maintain the current program of UK government bond purchases, but also to increase the target stock of purchased bonds by an additional £150bn – taking the total stock of bonds purchases to £875bn.

Brexit remains a key issue for the MPC and there is no ratified agreement at this stage:

The outlook for the economy remains unusually uncertain. It depends on the evolution of the pandemic and measures taken to protect public health, as well as the nature of, and transition to, the new trading arrangements between the European Union and the United Kingdom. It also depends on the responses of households, businesses and financial markets to these developments.

Forward Guidance

The MPC will maintain the accommodative stance of monetary policy until there is clear evidence that progress has been made to reduce spare capacity in the economy and the 2% inflation target is achieved on a "sustainable" basis.

https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2020/november-2020

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Australia

RBA Rates and Policy Decision – 3 Nov 2020

As expected, there was further easing announced by the RBA, including the introduction of QE. This was the first time that the RBA held a press conference to explain the measures that were announced today – which underlines the importance of this meeting.

One thing that has changed over the last two meetings is the focus on the labour market. This has always been a priority for the RBA, but it is now central to the policy outcomes. The Board has acknowledged in the last minutes (6 Oct meeting minutes) that "achieving inflation consistent with the target is likely to require a return to a tight labour market".

From the press conference today:

> To be clear, the inflation target remains the cornerstone of Australia's monetary framework. Even so, the priority over the next couple of years is jobs, with inflation risks remaining low.

Changes to Current Settings

The transmission mechanisms targeted in this package are lower borrowing costs, lower exchange rate, and lower funding costs for banks.

> The package combines the price-based target at the shorter part of the yield curve that has been in place since March with a quantity target at the longer part of the yield curve. **In doing so, it will lower the whole structure of interest rates in Australia.**

> This lower structure of interest rates will work to support the economy through the normal transmission mechanisms, including **lower borrowing costs, a lower exchange rate than otherwise and higher asset prices**.

Overnight Cash Rate (OCR): +0.1%, target on the 3yr AGB yield of +0.1%

QE: $100bn of Bond purchases over the next six months covering Bonds issued by the Australian Government, states, and territories. Purchases will be made in the secondary market. The pace of purchases is approx. $5bn a week.

> We will focus on buying bonds with maturities of around five to 10 years, but may also buy bonds outside this range, depending upon market conditions.

> We will be purchasing fixed-rate nominal bonds only, as these are the benchmark fixed-income securities in Australia and they underpin the pricing of many other assets.

This program is separate from the 3yr AGB buying program.

Term Funding Facility (TFF); With the decline in the OCR, the RBA has reduced the price it charges banks to access credit in the TFF – further reducing banks wholesale cost of funding for new lending (preserving some margin for the banks as lending rates are reduced). The price for new drawings on the TFF has been reduced from 25bps to 10bps.

> To date, authorised deposit-taking institutions have drawn $83 billion under this facility and have access to a further $104 billion.

It is possible that the RBA will continue to extend the use of this program (it was launched as 'temporary').

Policy Rate on Exchange Settlement Accounts – Banks will no longer receive interest on excess balances in the RBA's Exchange Settlement Account. A rate of remuneration of 10bps was introduced in Mar (19 Mar announcement) and this has now been reduced to zero. The remuneration was put in place to ensure ample liquidity during the period of market disruption at the time. Surplus balances are now about half of what they were at the peak at the start of Apr, but remain elevated compared to history. This is also a way to 'free up' the surplus ES balances for lending growth.

Forward Guidance

This was an important policy announcement today. The introduction of QE is expected to lower the "whole structure of interest rates in Australia".

These new lower rates will be in place for an "extended period".

The cash rate will not be increased until ACTUAL (emphasis added) inflation is sustainably within the target range. The Board acknowledges that actual inflation will be within the range until wages move "materially higher" and for that to happen, there needs to be significant gains in employment and a return to a "tight labour market".

> Given the outlook, the Board is not expecting to increase the cash rate for at least three years.

https://www.rba.gov.au/media-releases/2020/mr-20-28.html

Speech: https://www.rba.gov.au/speeches/2020/sp-gov-2020-11-03.html

Housing Finance (Sep)

The monthly value of new housing finance commitments in Australia continued to grow in Sep. While the growth slowed compared to Aug, the pace of growth remains quite elevated.

An increase in the value of new housing finance commitments for the month was recorded across all three of the main buyer types, but growth was led mostly by owner occupiers (non-first home buyers FHB's).

There is still some effect in the data from the Covid-19 restrictions. The strong result in Aug was the result of clearing backlogs, as noted by the ABS last month. This month, there is more of an impact from the Vic shut-down – and yet growth in commitments remains strong. From the ABS:

> The value of owner occupier home loan commitments rose in all states except Victoria and Tasmania. Victorian owner occupier home loan commitments fell 8.8 per cent in seasonally adjusted terms reflecting decreased housing market activity in July and August when COVID-19 related stage 3 and stage 4 restrictions were imposed.

At a National level, the housing market remains well supported. The weaker recovery in investor lending has been more than offset by growth in FHB lending.

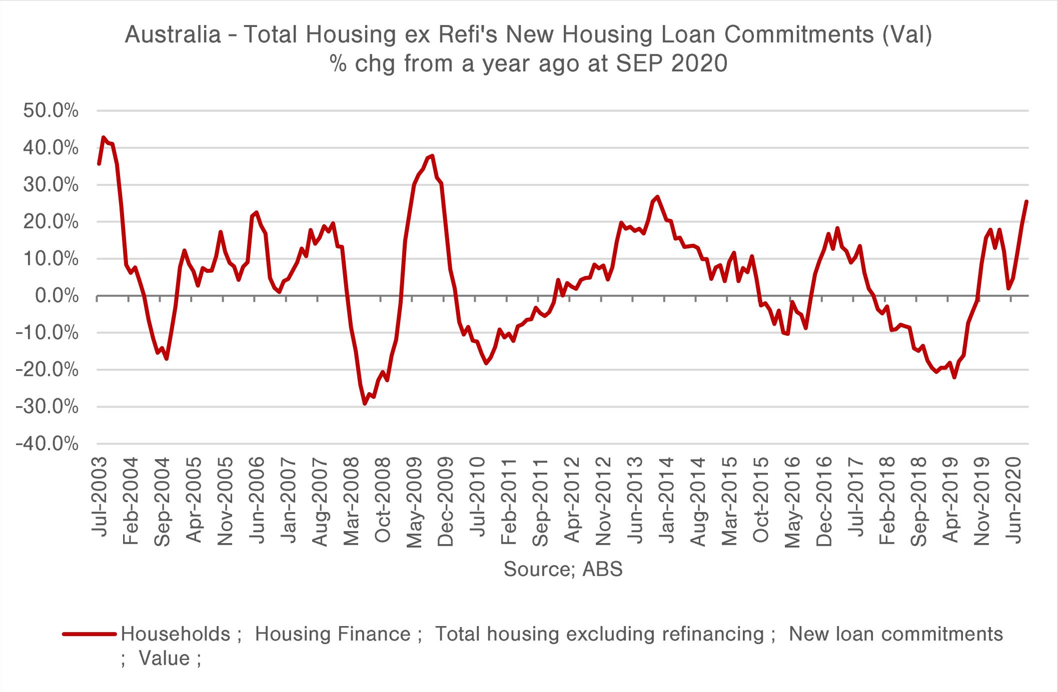
On a year ago basis, the number of new housing finance commitments for owner occupiers in Sep was led instead by FHB's (owner occupiers).

All data are excluding refi's.

New Housing Finance Commitments $ Val – month change: Sep +6% (+$1.24bn) versus Aug +12.6% (+$2.4bn)

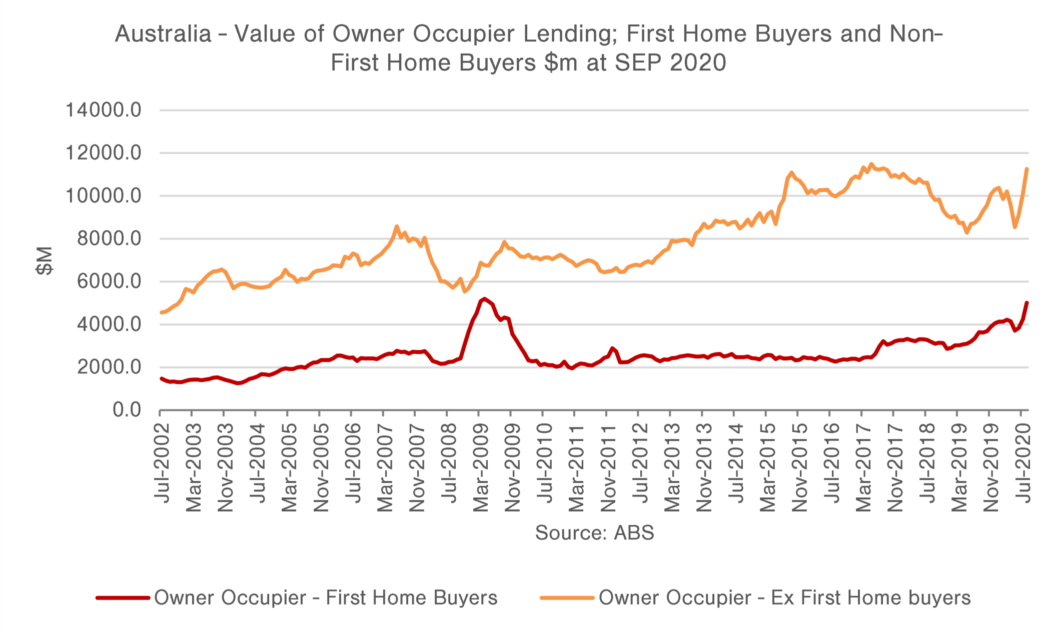
All buyer segments contributed to growth this month. The largest contributor was owner occupiers ex FHB's +$0.7bn, then FHB's +$0.28bn, and then investors +$0.26bn.

The value of total housing finance commitments in Sep was +25% ahead of the same month a year ago:



Owner Occupiers New Housing Finance Commitments $ Val – month chg: Sep +6% (+$0.98bn) versus Aug +13.7% (+$1.9bn)

Within this group, owner occupiers excluding FHB's accounted for most of the value increase in Sep of +$0.7bn whereas FHB's accounted for +$0.28bn of the increase.



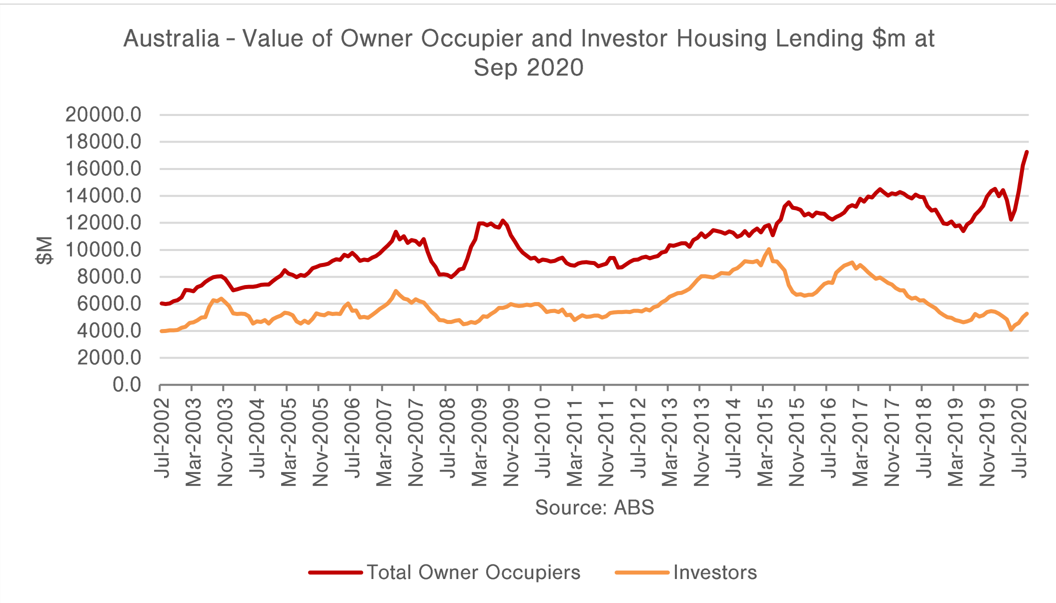
On a year ago basis, new owner occupier housing commitments were +34% ahead of the same month a year ago. The pace of growth is the strongest since the GFC.

The increase in the NUMBER of housing finance commitments for owner occupiers was led higher by non-FHB's in the month. The number of owner occupier commitments increased by 2.3k in Sep, of which non-FHB's was +1.6k of the increase and FHB's were +0.7k of the increase.

But on a year ago basis in Sep, the total number of new owner occupier commitments was higher by +6.5k and FHB's accounted for +4.1k of that increase.

Investor New Housing Finance Commitments $ Val – month change: Sep +5.2% (+$0.62bn) versus Aug +9.3% (+$0.43bn)

Investor activity continues to lag the rest of the market and the monthly value of new commitments remains close to the May 2020 lows:



The value of new investor lending commitments in Sep was +4% higher than in the same month a year ago.

https://www.abs.gov.au/statistics/economy/finance/lending-indicators/sep-2020#data-download

Retail Sales (Sep)

The Sep release includes the Q3 real retail sales estimates.

The value of retail sales declined for the second month in Sep. On a category basis: on-premise food consumption increased, which only partly offset declines across most other categories. Despite a further monthly fall in retail sales, the value of sales in Sep was still +5.6% ahead of the same month a year ago. In real terms, retail sales are +4.2% ahead of the same quarter a year ago.

Are retail sales that buoyant?

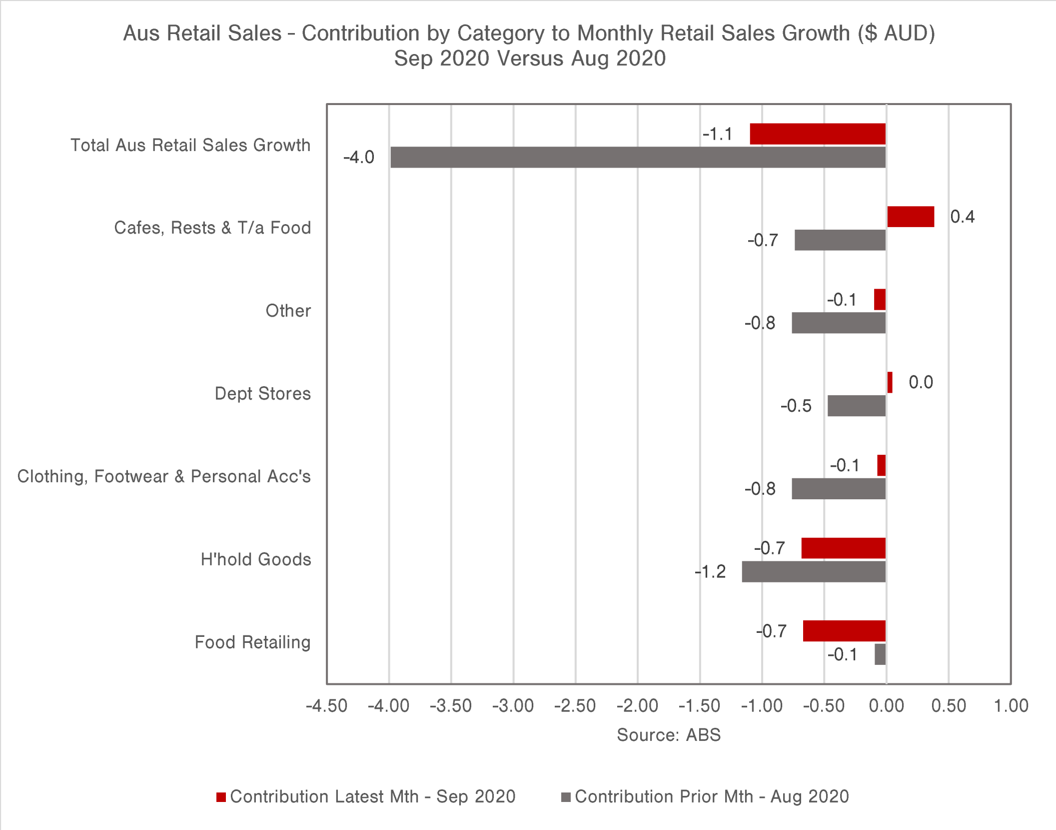
The nature of the pandemic and mandated shutdowns resulted in shifts in consumer behaviour – from on-premise food consumption to home-based consumption. As well, work from home has boosted sales of appliances (coffee machines, desks/equipment, computer equipment, as well as household appliances such as freezers etc). Categories such as Food and household goods retailing have recorded strong annual growth. Other categories, including more discretionary spending, such as clothing and on-premise have been hit the hardest by mandated shutdowns of venues, malls, and other places of public gatherings.

On a value basis, Food retail (Grocery and off-premise beverages) sales have been the single largest contributor to annual retail growth – contributing 5.0%pts to the overall annual retail growth of 5.6%. In real terms though, it is both food and household goods sales that have made the largest contributions to overall annual real retail sales growth. Increased spending in both of these categories have helped to offset weakness elsewhere.

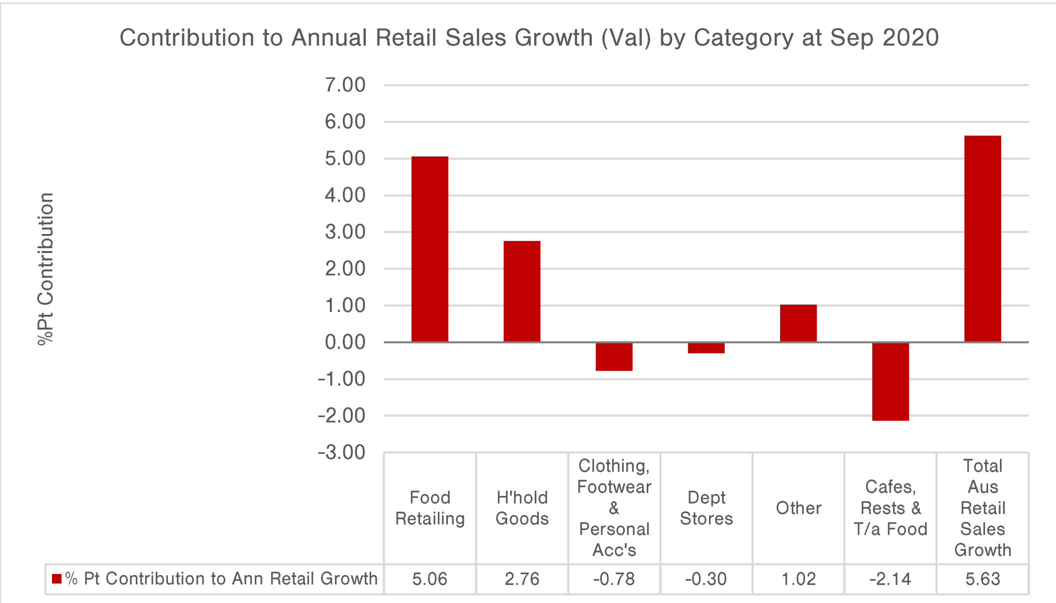
Across the states, the recovery in real retail sales is evident in Q3 compared to Q2. The expected impact from Vic and the shutdowns was more than offset by stronger growth across most other states.

Retail Sales $ Value – month change: Sep -1.1% versus Aug -4%

There was still a large drag on monthly retail sales from Food Retailing and Household Goods sales in the month. But sales in these two categories are still 12% and 16% above a year ago, respectively.



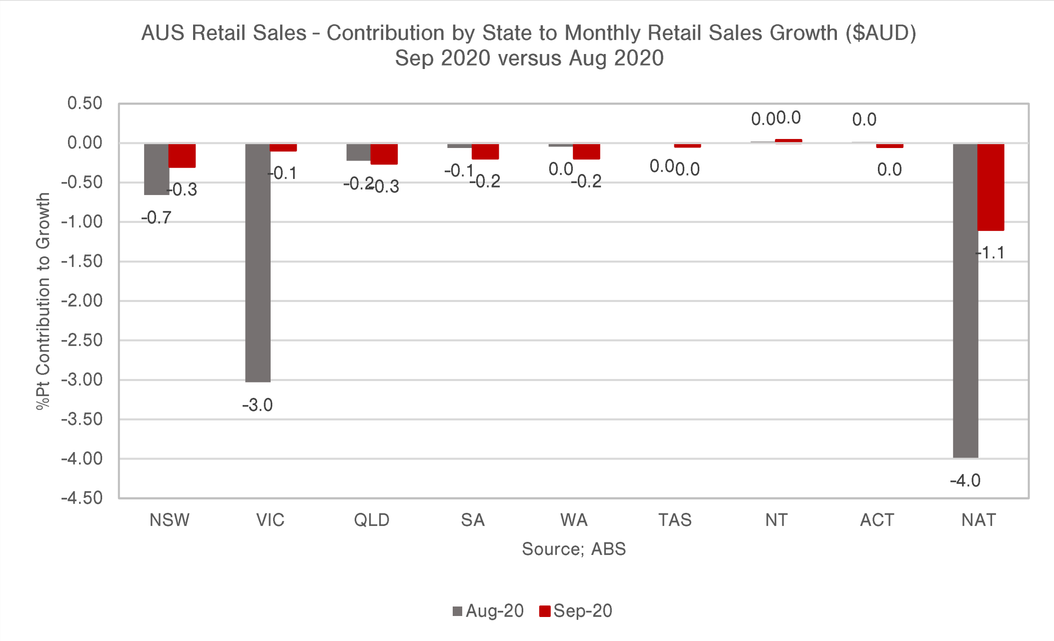
On a value basis, Food Retail accounted for most of the annual growth in total retail sales (Sep 2020 v Sep 2019). The positive contribution from household goods was offset by declines across clothing, dept stores and on-premise food:



This is slightly different in real terms with both food and household goods making an equal contribution to overall retail growth. This reflects some higher prices in grocery (delays/shortages ultimately leading to fewer discounts and some higher fresh food prices) and likely, some discounting across household goods retailers in the latest quarter to boost sales.

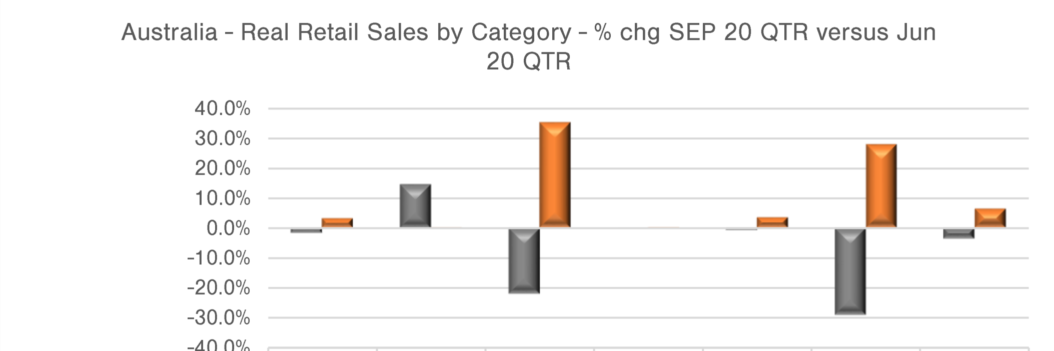
Retail Sales (Value) by State

On a state basis, only the Northern Territory (NT) recorded an increase in retail sales. Sales across all other states declined this month – the largest contributors to the decline this month were NSW and QLD:



Quarterly Real Retail Sales (Chain Vol Measures)

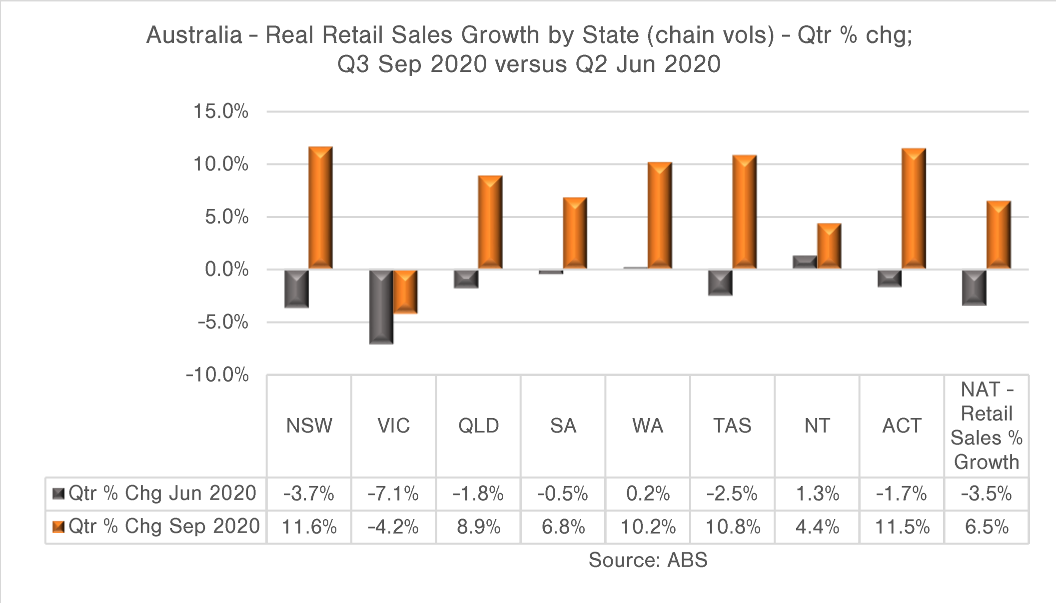
On a quarterly basis, real retail sales increased by 6.5% after declining by -3.5% in Q2. There was a larger contribution from clothing and on-premise food consumption to the growth in the quarter. This is mostly a function of reopening of shopping malls and lifting of on-premise restrictions.



	Food Retailing	H'hold Goods	Clothing, Footwear & Personal Acc's	Dept Stores	Other Retailing	Cafes, Rests & T/A Food	Total Retail Sales Qtr Growth
Qtr % Chg JUN 2020	-1.6%	14.7%	-22.0%	0.1%	-0.6%	-29.0%	-3.5%
Qtr % Chg SEP 2020	3.2%	-0.2%	35.5%	0.2%	3.5%	28.1%	6.5%

Source: ABS

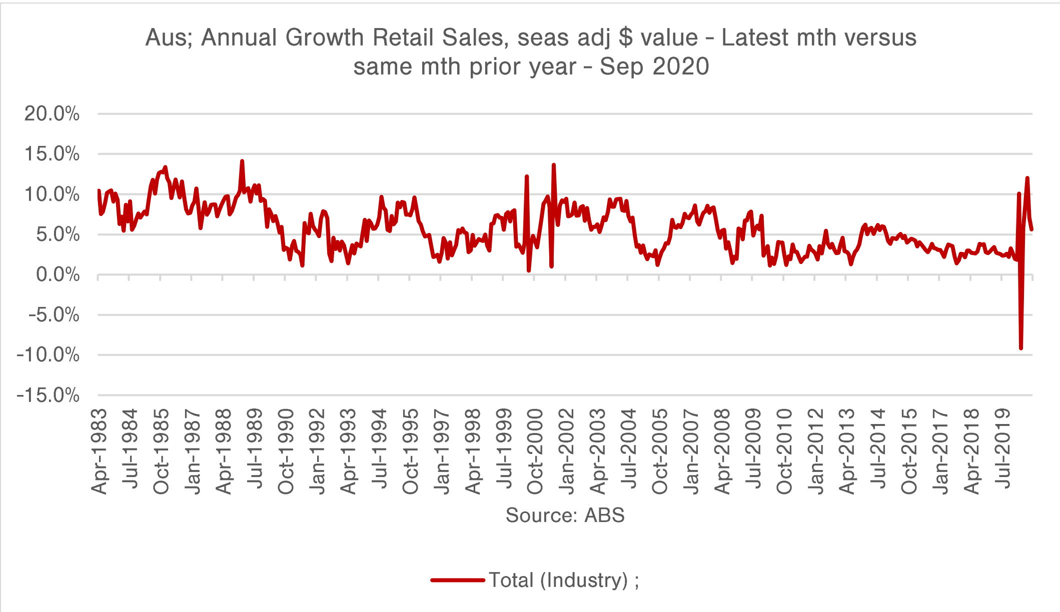
In real terms, there is clearly an impact from the extended shut-down in Vic. The further decline in real retail sales in Vic in Q3 is more than offset by the growth in other states.



	NSW	VIC	QLD	SA	WA	TAS	NT	ACT	NAT - Retail Sales % Growth
Qtr % Chg Jun 2020	-3.7%	-7.1%	-1.8%	-0.5%	0.2%	-2.5%	1.3%	-1.7%	-3.5%
Qtr % Chg Sep 2020	11.6%	-4.2%	8.9%	6.8%	10.2%	10.8%	4.4%	11.5%	6.5%

Annual Retail Sales

On an annual basis, the value of retail sales slowed to +5.6% versus the same month a year ago. Excluding grocery, the value of annual sales growth slowed to 1%.



The stronger growth in the last three months is also reflected in higher real retail sales growth of +4.2% in Q3 versus -2.1% in Q2 (Q2 was affected by the National mandated shut-down).

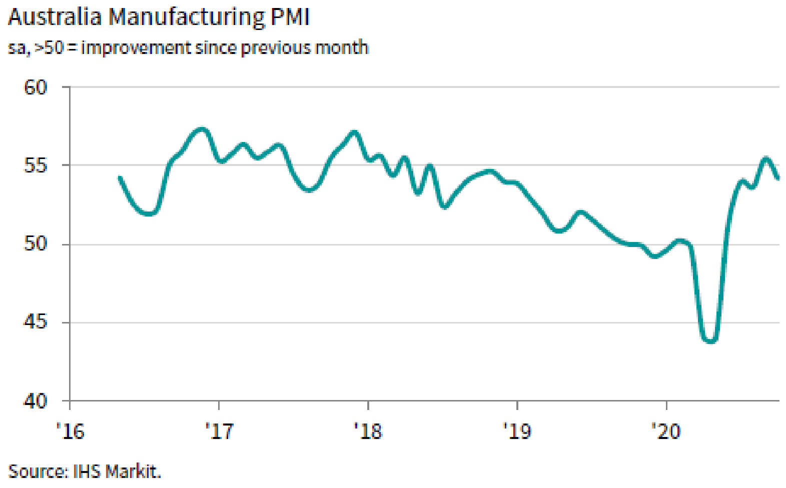
https://www.abs.gov.au/statistics/industry/retail-and-wholesale-trade/retail-trade-australia/sep-2020#key-statistics

Markit Manufacturing PMI Final (Oct)

The headline manufacturing PMI indicated a somewhat slower pace of expansion in activity in Oct compared to Sep. Again, the "substantial lengthening" of supplier lead times is likely influencing the headline PMI – it is usually a sign of increasing demand when supplier deliveries lengthen. Throughout this pandemic though, it has been more of a reflection of supply chain disruptions due to restrictions on activity.

> "…business sentiment about the year-ahead outlook strengthened further in October, to its strongest since February 2019 during October. Firms that anticipated a rise in output over the coming year highlighted expectations that market conditions will return to normal, a further easing of COVID-19 restrictions, and government's stimulus spending on infrastructure."

Manufacturing PMI: Oct 54.2 versus Sep 55.4



Firms still reported a net increase in output and new orders this month, albeit at lower pace in Oct compared to Sep. New export orders declined slightly. Order backlogs increased "marginally", and the employment index shifted back into contraction. Firms reported delays in sourcing materials. Post-production inventories declined notably in Oct.

https://www.markiteconomics.com/Public/Home/PressRelease/364ec930f38e42608e76577ee8b6864a

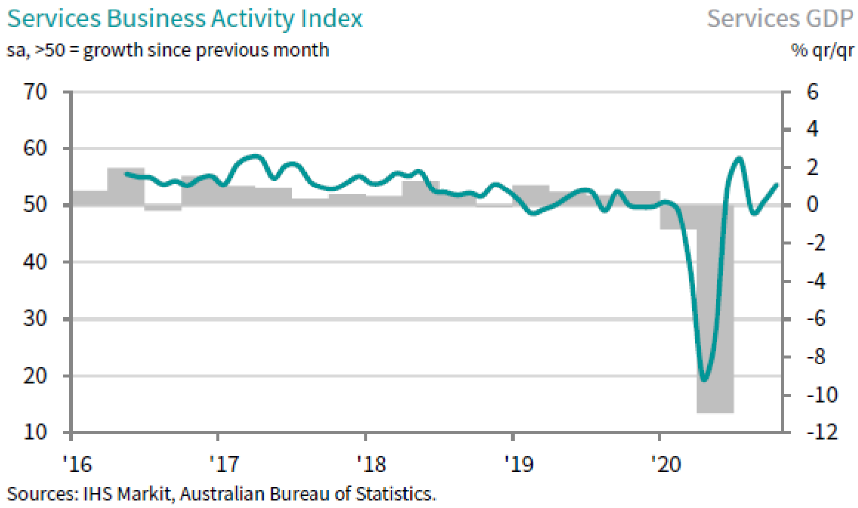
Markit Services PMI Final (Oct)

The headline service PMI increased in Oct indicating that more firms reported improving business activity compared to Sep.

> Finally, business confidence for the year-ahead outlook rose to the highest for just over two years as a smaller proportion of panel members expect a decline in output over the next 12 months. Optimism was generally linked to

expectations of a further easing of containment measures, improvement in consumer demand, and relaxation of border restrictions.

<u>**Services Business Activity Index**</u>: Oct 53.7 versus Sep 50.8



Output was boosted by a further easing of restrictions. But new orders growth did match the growth in output. Backlogs continued to decline for the third month, indicating spare capacity remains an issue. Employment declined for the ninth month in a row.

The reduction of government wage subsidies and forced redundancies were reasons cited for the drop in staff numbers.

As a result of lower subsidies, wage costs increased adding pressure to input costs for firms. Competitive pressure resulted in firms cutting selling prices in Oct.

https://www.markiteconomics.com/Public/Home/PressRelease/576d5054dcab4aca80b7f5d70e10bcc4

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