UOB Investment Insights

The Journey Ahead

7 September 2020

This is produced by UOB Global Economics & Markets Research
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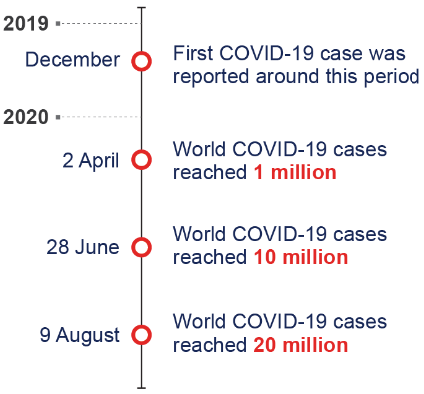
WHAT DOES 2020 HOLD FOR THE WORLD'S BIGGEST ECONOMY?

The negative impact of COVID-19 on US economy has been swift and dramatic. The country continues to lead the world in total COVID-19 cases at 5.4 million - about a quarter of the world total confirmed cases.

21.7 million
World COVID-19 Cases
(Figure as of 17 August 2020)

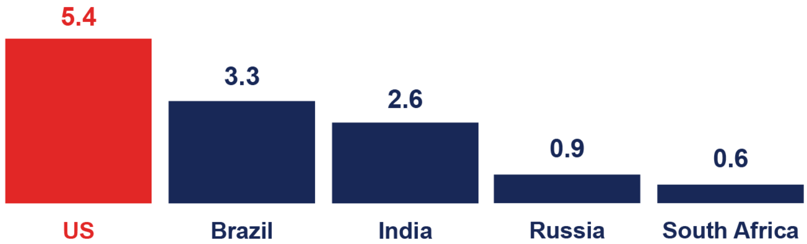
It took about 6 months for the world to reach 10 million cases but just 6 weeks to double the figure to more than 20 million.



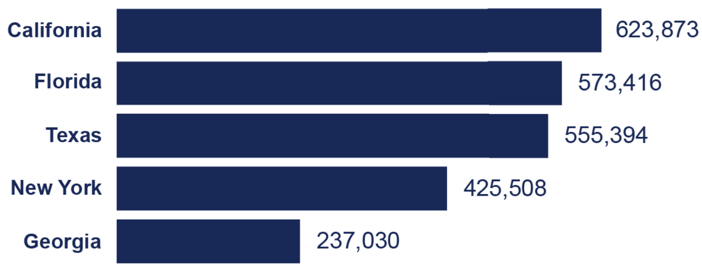
Governments are still divided in their responses given a resurgence in cases in some countries while some has eased lockdowns.

The vaccine race has more than 150 candidates being developed and tested around the world with 25 in human clinical trials (as of 14 August 2020), according to the World Health Organisation.

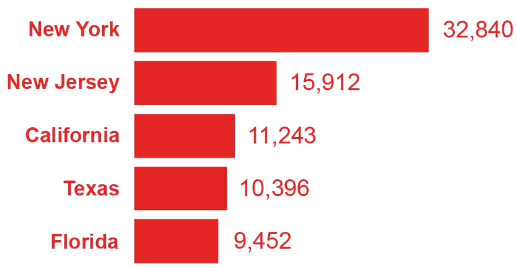
5 Countries With The Highest COVID-19 Cases (million)
Figure as of 17 August 2020



5 States In The US With The Highest COVID-19 Cases
Figure as of 17 August 2020



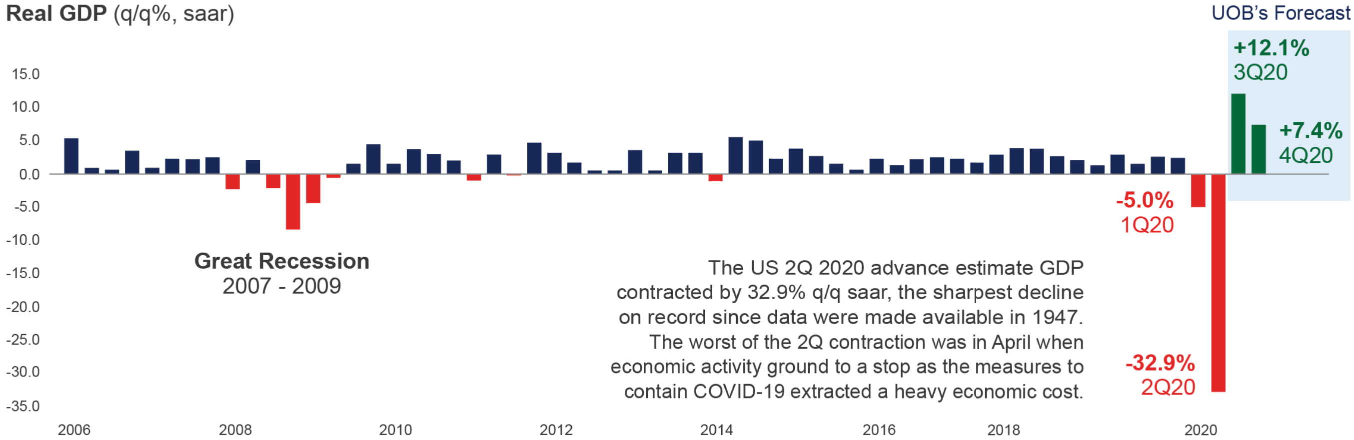
5 States In The US With The Highest COVID-19 Deaths
Figure as of 17 August 2020



Source: CNN, Media reports, UOB Global Economics & Markets Research

A DEEPER CONTRACTION IN 2Q 2020

Real GDP (q/q%, saar)



What Do We Think?

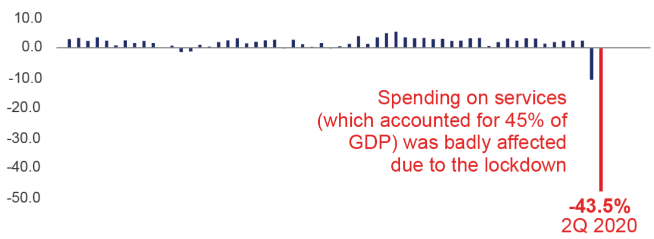
Now that the unprecedented 2Q GDP has come to pass, we expect a resumption of q/q growth in 2H 2020 (3Q: +12.1% and 4Q: +7.4%) but the rebound in 2H will not offset the 1H contraction. For full year 2020 GDP, we project a contraction of 5.8% from +2.2% in 2019.

A Drastic Change In Spending Pattern

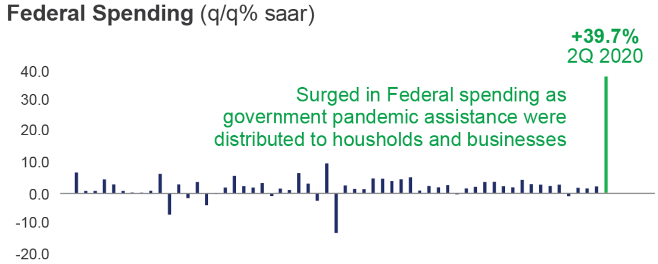
Private Consumption (q/q% saar)

Business Investment (q/q% saar)

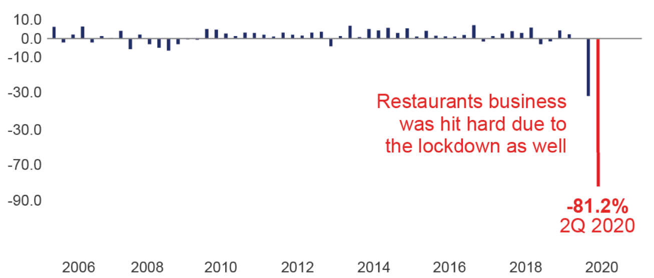
Services (q/q% saar)



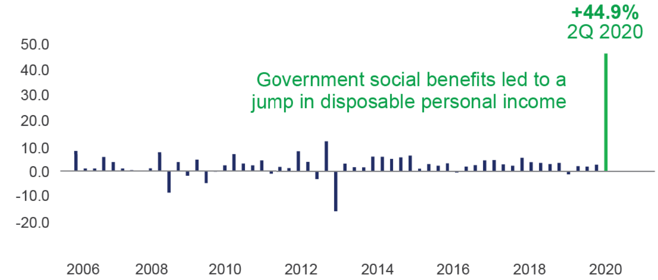
Federal Spending (q/q% saar)



Food Services & Accommodation (q/q% saar)

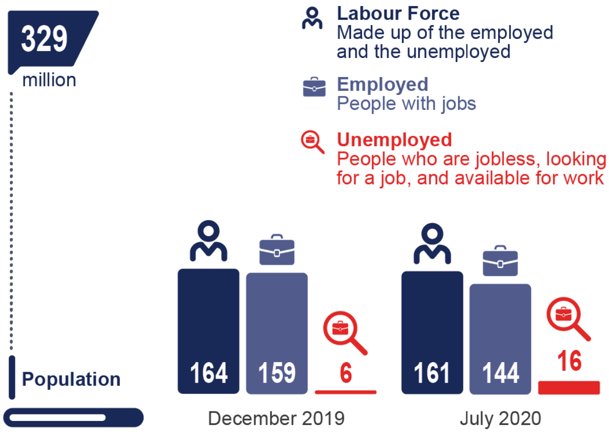


Disposable Personal Income (q/q% saar)

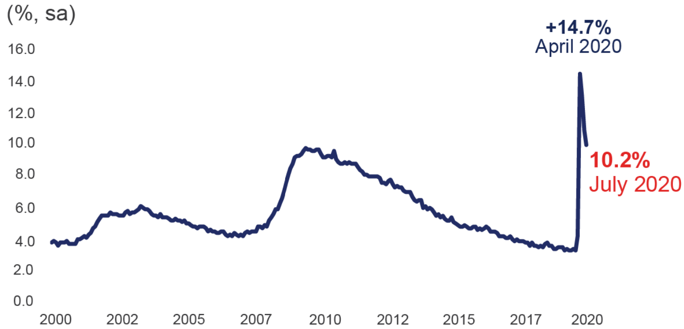


Source: CEIC, Macrobond, BLS, UOB Global Economics & Markets Research

JOB LOSSES REFLECT THE MAGNITUDE OF THE PANDEMIC IMPACT

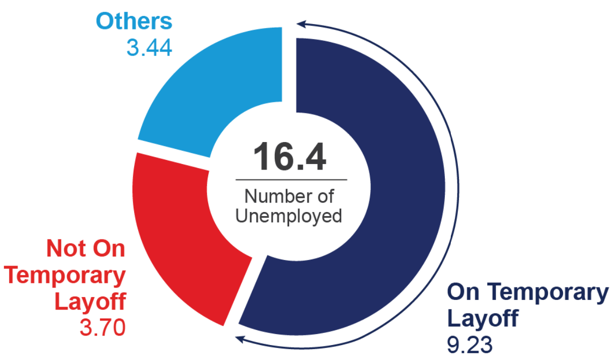


Unemployment Rate
(%, sa)



Unemployment rate has eased to 10.2% from April's record high but is still significantly above the low of 3.5% in February.

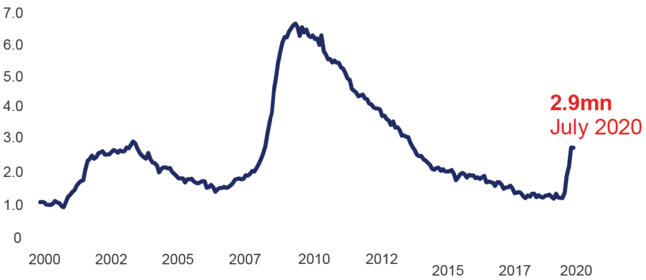
Unemployed By Reason For Unemployment (July)
(persons million, sa)



There are concerns temporary layoffs could become permanent if the waves of COVID-19 cases continue to grow.

* To be classified as unemployed on temporary layoff, a person has either been given a date to return to work by their employer or expects to be recalled to their job within 6 months.

Permanent Job Losers
(billion, sa)



The number of permanent job losers rose to 2.9 million from 1.3 million in February. This suggests that some of the furloughs has turned into permanent layoffs.

Unemployment Claims

28.3 million

The total number of people claiming unemployment insurance benefits in all programs (unadjusted) for the week ending 25 July, a decrease from 31.3 million the previous week - according to the Labour Department.

This is more than 17% of the Labour Force.

What Do We Think?

The significant COVID-19 impact on economic activities has translated into a sharp spike in US job losses in recent months. While the employment situation has improved post-April, jobs recovery momentum is clearly derailed in face of the COVID-19 resurgence.

We continue to expect US unemployment rate to end the year at 9.5%, implying some improvement still in the employment front in 2H, but the pace of improvement is unlikely to match what was experienced in May-July period.

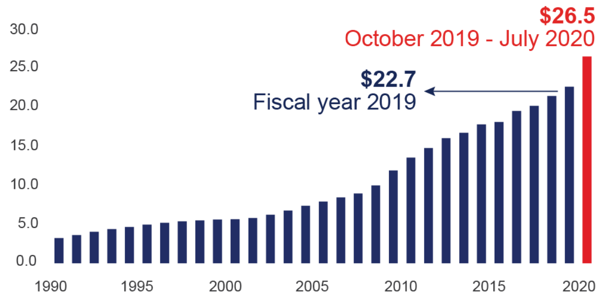
Source: CEIC, Macrobond, BLS, Media reports, UOB Global Economics & Markets Research

IS THE RISING FEDERAL DEBT A CONCERN?

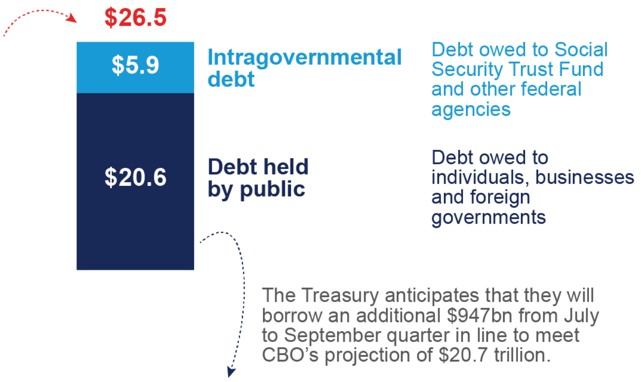
US Federal Debt

The total federal financial obligation owed to the public and intragovernmental departments.

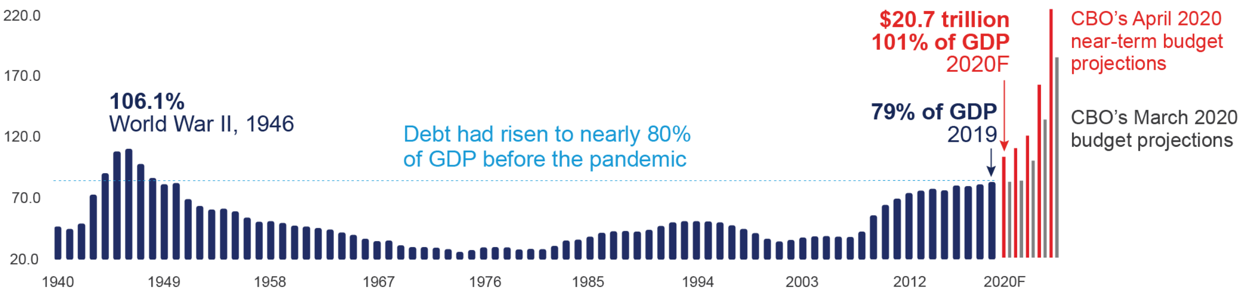
Federal Debt (USD trillion)
Date as of the end of each fiscal year - 30 September



Components of Federal Debt (USD trillion)
Data as of July 2020



Debt Held By The Public (% of GDP)
Consists of US Treasury bills, notes and bonds



Debt Projected To Continue Rising

In the face of the pandemic, it was an essential move by the government to provide support for affected households and businesses.

The measures taken have pushed the ballooning debt to greater heights. Fortunately, the government was able to borrow at low interest rates.

The CBO now expects the debt held by public to rise to 101% of GDP in 2020 compared to 81% projection in March.

What Do We Think?

US is able to shoulder a heavier debt in a low interest rates environment.

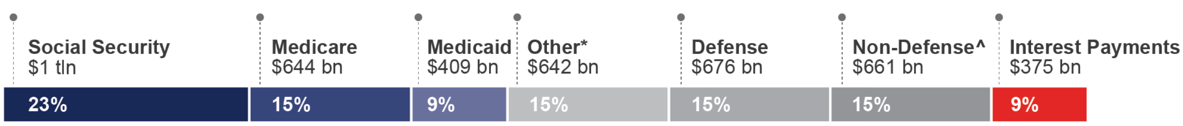
However, when the economy picks up, any rate hikes that result in higher interest payments will further weigh on the government spending. This will in turn contribute to a wider budget deficit.

Interest On Debt And Its Impact On Budget

Interest payment was already one of the growing expense in the federal spending even before the crisis.

When the crisis is over and the economy recovers, the government needs to focus on balancing its fiscal position before it becomes a fiscal crisis.

Federal Spending In 2019 (USD)
* Includes unemployment benefits, food and income support, anti-poverty tax credits, federal pensions and crop insurance
^ Includes spending on education, transportation, health, housing, social services, veterans' benefits and int'l affairs programs

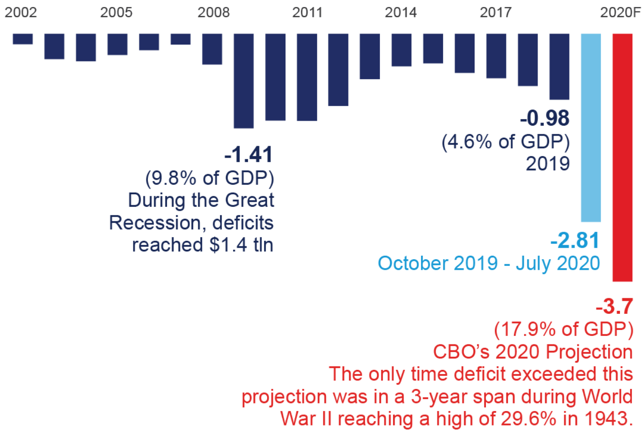


Source: CBO, CRFB Calculations, The Balance,CEIC, Macrobond, UOB Global Economics & Markets Research

DEFICIT PROJECTED TO GROW TO UNPRECEDENTED LEVEL

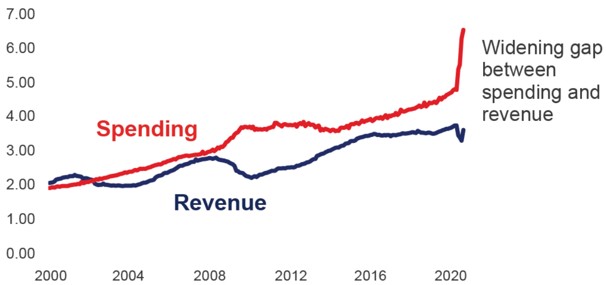
US Budget Deficit
The difference between the flow of government spending and revenues.

Budget Deficit (USD trillion)
Fiscal Year 2002-2021F



The deficit is large by historical standards as deficits in the last 10 years averaged $829 billion. In just the first ten months of fiscal year 2020, it has surpassed the previous annual record of $1.4 trillion set in 2009.

Federal Spending & Revenue (USD trillion)
12-month moving totals



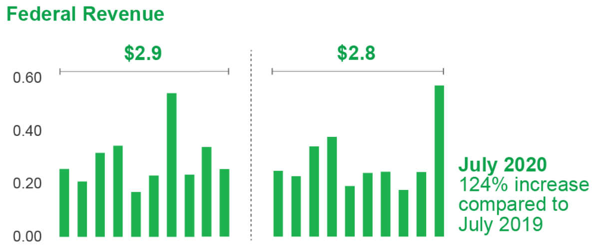
The higher deficit was mostly driven by the goverment relief programmes that include the Paycheck Protection Program for businesses as well as unemployment insurance and Economic Impact Payments for individual households.

This coupled with a drop in revenue due to an extended deadlines for income and payroll taxes, will bring the deficit to a new record level.

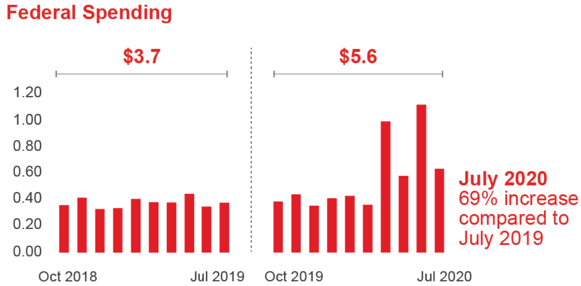
What Do We Think?

While the stimulus spending is necessary to cushion the economy in order to nurse it back to health, (and more may be needed in the near term), it is important for the government to review and cut back on spending as the economy recovers. Bearing in mind that it is a vicious cycle, as a huge deficit will bring about huge debts.

Federal Spending/Revenue (USD trillion)
First 10 Months of Fiscal Year 2019 and 2020



The jumped in July's Revenue was due to the deferment of individual and corporate income taxes from April to July this year. Before the crisis, this spike can be seen in April 2019 as shown above.



Spending in the first 10 months of FY2020 surged 51% compared to the same period in FY2019. Mainly driven by the government response to the pandemic and economic fallout such as the Small Business Administration which rose to $26 billion in July from $103 million in July 2019.

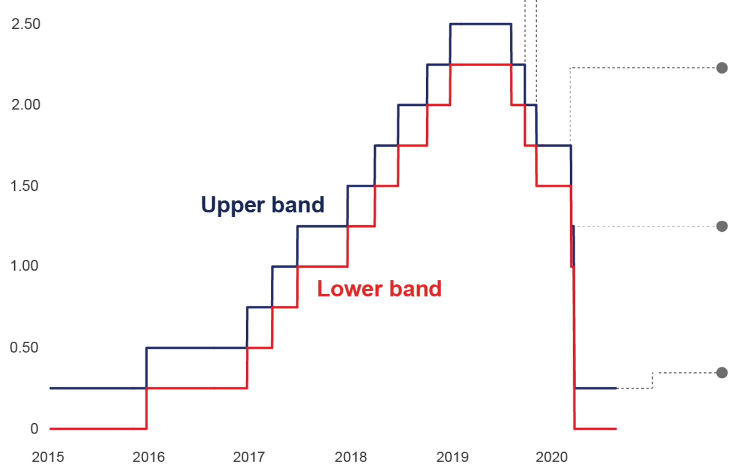
Source: CBO, CRFB Calculations, CEIC, Macrobond, UOB Global Economics & Markets Research

WHAT CAN WE EXPECT ON THE MONETARY POLICY FRONT?

US Fed Funds Target Rate (%)

In its latest July FOMC meeting, the Federal Reserve kept its policy Fed Funds Target Rate (FFTR) in the range of 0.00-0.25%.

The Fed also kept its pledge "*to maintain this target range until it is confident that the economy has weathered recent events and is on track to achieve its maximum employment and price stability goal.*"



31 July 2019
25bps cut to 2.00-2.25%
The key reason for the Fed rate cut was "*In light of the implications of global developments for the economic outlook as well as muted inflation pressures*" even with the view that US domestic conditions remain robust.

18 September 2019
25bps cut to 1.75-2.00%
FOMC Chair Powell said the Fed lowered interest rates to keep economy strong, provide insurance against risks.

30 October 2019
25bps cut to 1.50-1.75%
The Fed said it "*will continue to monitor the implications of incoming information for the economic outlook as it assesses the appropriate path of the target range for the federal funds rate.*"

3 March 2020
50bps cut to 1.00-1.50%
The Fed announced a 50bps emergency rate cut. The surprise decision was meant to address the uncertainty surrounding the COVID-19 outbreak.

15 March 2020
100bps cut to 0.00-0.25%
In an unscheduled meeting, the Fed announced a 100bps rate cut. The Fed also re-started its quantitative easing (QE) program.

What Do We Think?

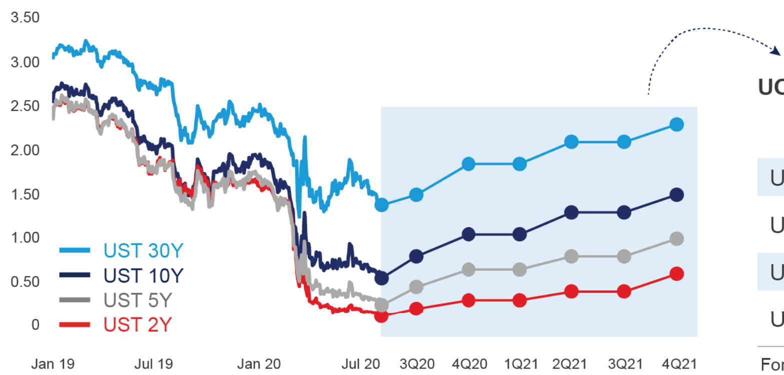
The message from the latest FOMC remains clear that the Fed is committed to do whatever it takes to maintain financial market stability, and safe-guard the economic recovery. We expect the Fed to keep its near zero percent policy rate until at least 2022.

We remain in the camp that does not see the Fed resorting to negative interest rates (NIRP). We see Yield Curve Control (YCC) as a more palatable policy option should the economy require more assistance.

As it stands, the YCC option should be preserved for a later time given that the longer term US Treasury yields (10Y and beyond) are stuck at the lower end of their ranges.

We expect the Fed to implement YCC as an additional tool to make monetary policy even more accommodative, to be announced possibly by the next FOMC meeting on 15-16 September.

US Treasuries Yield (%)



UOB's Forecast (%)

	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
UST 2Y	0.20	0.30	0.30	0.40	0.40	0.60
UST 5Y	0.45	0.65	0.65	0.80	0.80	1.00
UST 10Y	0.80	1.05	1.05	1.30	1.30	1.50
UST 30Y	1.50	1.85	1.85	2.10	2.10	2.30

Forecast as of 18 August 2020

Source: Bloomberg, Macrobond, UOB Global Economics & Markets Research

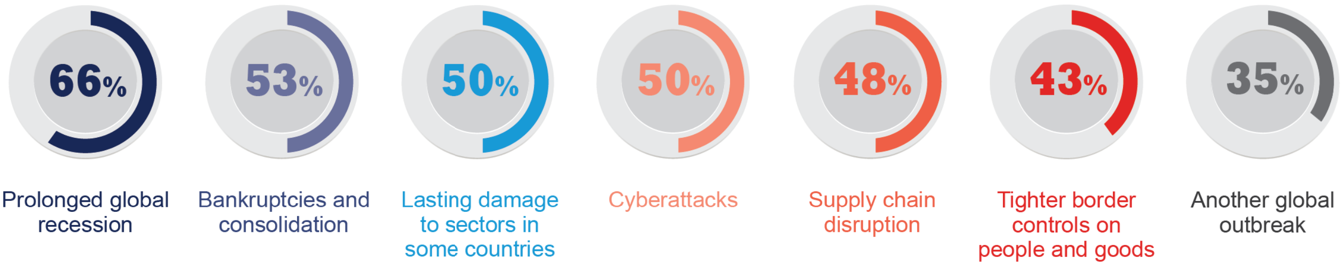
WHAT ARE BUSINESSES CONCERNS AND PRIORITIES NOW?

Survey by World Economic Forum

This COVID-19 Risks Perception Survey by the World Economic Forum, taps into the views of nearly 350 senior risk professionals from large companies around the world.

Respondents were asked to take a view on 31 risks that they considered to be the most worrisome for their companies from the COVID-19 crisis over the next 18 months. The survey was conducted from 1-13 April 2020.

350 Risk Professionals At Large Corporations Ranked These As Most Worrisome For Their Companies
Two-thirds of respondents identified a prolonged global recession as a top concern for business

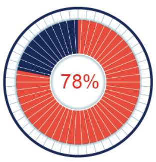


PwC's CEO Panel Survey

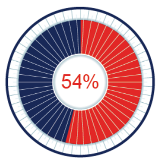
PwC surveyed 699 CEOs online in 67 countries/regions in June and July 2020. The surveyed CEOs are leaders of private businesses and public companies, of small firms and US$1bn-plus enterprises, and they represent a diverse cross section of industries, countries and regions.

The survey reflects the views of 699 CEOs on emerging business models and key trends resulting from the COVID-19 pandemic. We extracted some information to share here, for the full report, please refer to PwC website.

Transforming the workforce
Two questions have loomed large for CEOs since the pandemic took hold: where will work happen, and how will it happen?



CEOs surveyed said the shift towards remote collaboration is enduring, a nod to the momentum building around flexibility.

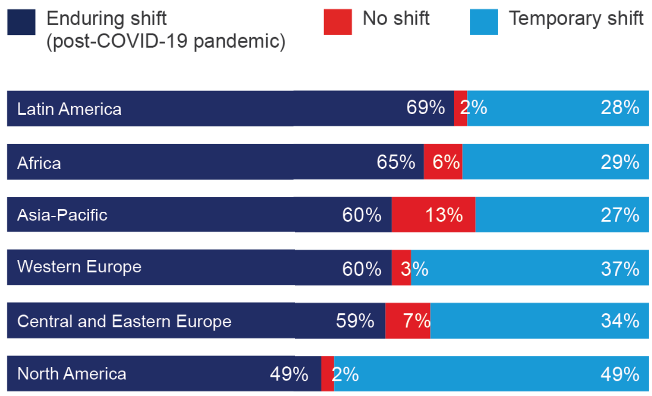


More than half believe the trend away from traditional employment and towards the gig economy is here to stay.

"As a result of the need to cut back in order to reduce losses, we have been able to understand those processes that are most critical to the well-being of employees and the business versus those that have become accepted over time and add less value. The crisis has also pulled teams together in tackling a common adversary."

- Hospitality & leisure CEO, UK

In most regions, CEOs view low-density workplaces as a lasting change
Question: The shift towards low-density workplaces (away from high-density workplaces) will be a/an ...



"[The] greater emphasis on remote work [is] enabling a significant reduction in real estate footprint and cost - allowing those savings to be returned to the workforce via increased benefits."

- Asset & wealth management CEO, US

Learning from the crisis
Two key themes emerged among the respondents, when asked about their priorities

CEOs plan to make their companies more digital and virtual

CEOs plan to develop a more flexible and employee-oriented workforce

Source: WEO, PwC, UOB Global Economics & Markets Research

IT IS A TOUGH FIGHT AGAINST COVID-19, SO IS THE ROAD TO RECOVERY

SUMMARY OF OUR KEY VIEWS

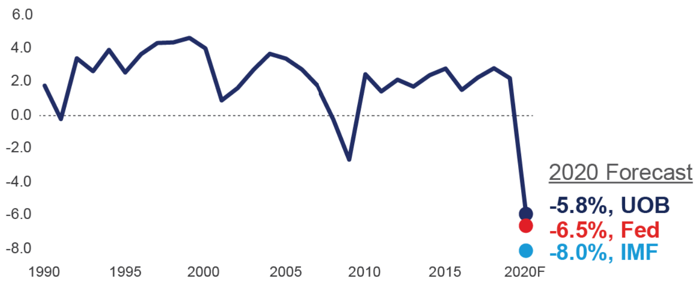
2H 2020 Recovery Far From Certain

The US GDP contracted by 32.9% q/q saar in 2Q 2020 (from -5.0% in 1Q), the sharpest decline on record since data were made available in 1947. The earlier optimism of a robust recovery has now given way to a stalling one given the resurgence in COVID-19 infections across the US which could derail the job market recovery.

We still project a resumption of q/q growth in 2H 2020 (3Q: +12.1% and 4Q: +7.4%) but the rebound in 2H will not offset the 1H contraction. This leads to our full year GDP projection of -5.8% y/y in 2020.

Annual GDP (Y/Y %)

The last annual contraction was in 2009 at -2.5%



Monetary Policy To Remain Accommodative

The message from the latest FOMC remains clear that the Fed is committed to do whatever it takes to maintain financial market stability, and safe-guard the economic recovery. We expect the Fed to keep its near zero percent policy rate until at least 2022. This should help to keep the economy supported and low interest rates will help the government to finance its high debt.

Consumer Spending Is Crucial To Economy Rebound

For the economy to rebound sustainably, people must feel safe to engage in a broad range of economic activities. This includes people being able to return to their jobs, shops to re-open and stay open, and most importantly for consumers to start spending given that US economy is largely powered by consumers. However, people are cautious with spending as they are apprehensive about the future.

Labour Market Recovery May Take Some Time

The unemployment rate has started to ease from April's high of 14.7% as well as the number of unemployed people on temporary layoff. However, the number of permanently unemployed has risen since the start of the year. This suggests that some of the furloughs has turned into permanent layoffs.

Investment Recommendation by UOB Wealth Advisory

Despite the ongoing uncertainties, the US economy is expected to gradually recover with both monetary and fiscal support in place. However, we remain concerned over the high valuations in the US equity market and the low US Treasury yields. Investors can consider our other tactical calls that have more attractive valuations, such as Global Healthcare equities and Asia ex-Japan equities.

Source: Macrobond, UOB Global Economics & Markets Research
Data and forecasts are as of 18 August 2020.

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