Focus on America amid Trump's coronavirus bombshell

On the day President Trump and his wife tested positive for Covid-19, we look at just how important the economy is shaping up in terms of his reelection plans; today's job numbers weren't great. Elsewhere, we cover the latest Brexit developments, the Swiss move deeper into FX 'manipulator' territory and we analyse the prospects for the ECB's digital euro

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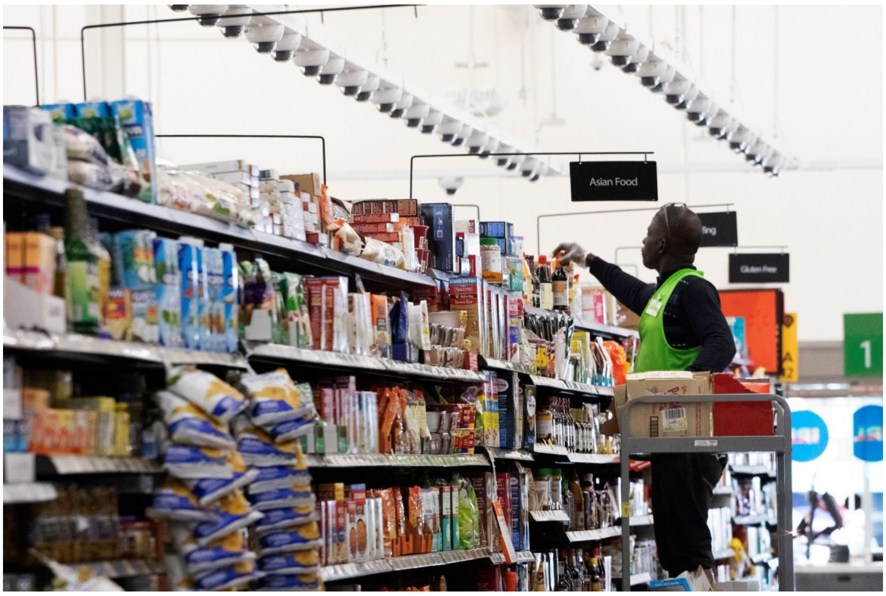
Article | 2 October 2020

US: Jobs report adds to Trump's woes

The market importance of today's jobs report has been diminished by the news surrounding President Trump, but the information remains highly...



661,000 Rise in US payrolls in September

Payrolls overshadowed by Trump's Covid test

The final jobs report ahead of the 3 November presidential election has been overshadowed by the news that President Donald Trump has tested positive for Covid-19.

Betting odds signal a diminished chance he will win re-election and a much higher probability of a Democrat clean sweep. Markets are of the same view with steep equity future falls presumably on fears that such an election outcome will heighten the chances of more taxes and regulation that will hurt corporate profitability.

However, we would argue that this scenario would offer a greater chance of a swift agreement on a meaningful fiscal stimulus early next year that could boost the outlook for US growth. This would keep the fiscal deficit wider, which could add to upside pressure on

Treasury yields over the medium term. We also would doubt that regulations and taxes would be hiked immediately given the challenge this would pose for corporate America at a time of immense Covid-19 stress – which would be detrimental for jobs.

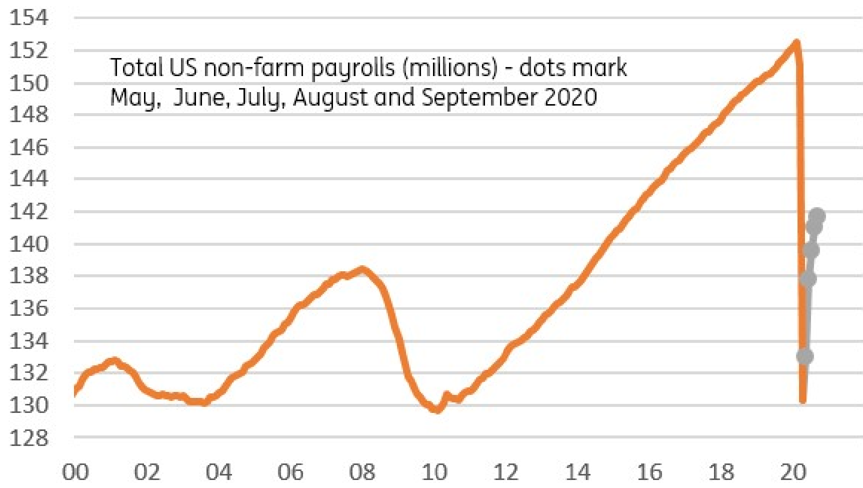
We see this more as a 2022/23 story, so in an environment of stronger fiscal stimulus fueled growth over the next couple of years, this may not necessarily be such a negative environment for risk assets over the medium term.

Jobs disappoint with momentum fading

US non-farm payrolls rose 661k in September versus the 859k consensus and while there has been a net upward revision of 145k to the previous two months of data, it doesn't change the narrative of stalling momentum in the jobs market.

May saw a 2.7mn gain, June a 4.8mn gain, July a 1.8mn gain and August a 1.5mn gain, but employment overall remains 10.7mn below the level of February so there is a long way to go still on the recovery path.

Non-farm payrolls (millions)



Source: www.tracktherecovery.org

A long, long way from full employment

The details show private payrolls up 877k (consensus 850k) with goods up 93k and services up 784k. Government employment fell 216k, highlighting the strains on state and local government due to the pandemic having hurt tax revenues and contributing to a significant increase in expenditure. Given most have to balance their books this is why we are hearing many calls for more federal financial support. Federal government employment fell 34k on some of the temporary census hiring being laid off.

Government employment fell 216k, highlighting the strains on *state and local government due to the pandemic*

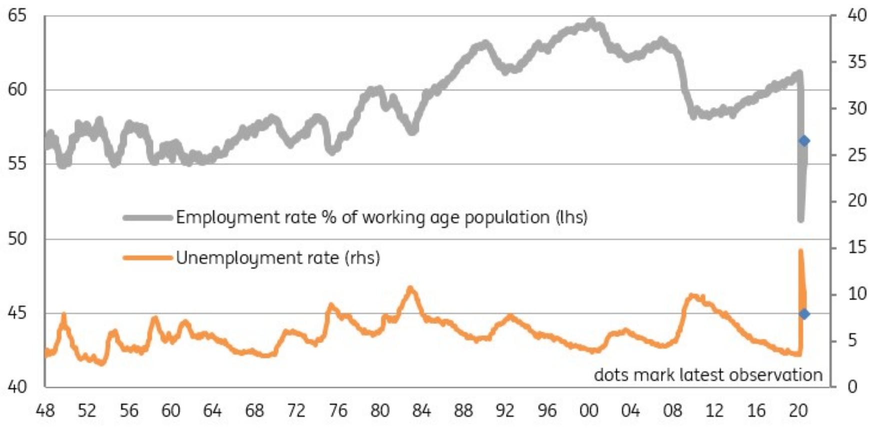
The unemployment rate fell further to 7.9% from 8.4%, but much of this was due to a fall in the participation rate (to 61.4% from 61.7%) - another bad sign as it typically indicates people are being discouraged from looking for work. The participation rate was up at 63.4% in February.

"Officially" unemployment is now 12.58mn, but this only reflects people who are actively looking for work. Many people who were employed in sectors that have been heavily impacted by the pandemic, such as leisure and hospitality, are not actively looking for work as there isn't much out there, yet they can continue to claim benefits under the current rules. The total number of people claiming unemployment benefits was 26.5mn as of 12 September according to the Department of Labour data.

The unemployment rate fell further to 7.9% from 8.4%, but much of this was due to a fall in the participation rate

Consequently, employment as a percentage of the working-age population gives us a clearer picture of the US labour market – see chart below. It is at 56.6%, which is where we were back in the mid-1960s when female participation was far lower than it ordinarily is today.

Employment and unemployment rates



Source: Macrobond, ING

Wage growth is at 4.7% year-on-year, but this figure is distorted by the fact that most of the jobs lost since February have been concentrated in low paying sectors. This means that the dollar wage of those in work is going to be "on average" much higher in September 2020 than in September 2019. There is very little evidence of actual wage growth outside of sectors such as grocery and we expect this to remain the case given the slack in the jobs market.

Job gains set to continue slowing

The economy has bounced strongly since the re-opening as a combination of pent up demand and generous unemployment support programs fueled growth. In fact, based on the latest data flow we should be expecting 3Q GDP growth of the order of 35% annualised.

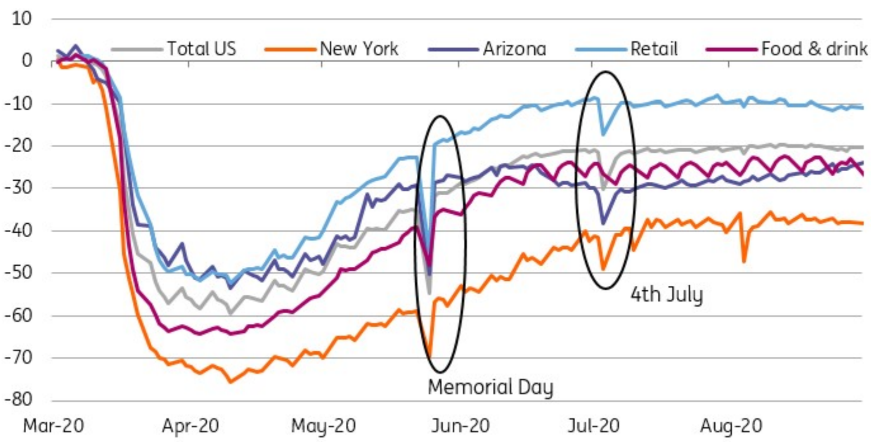
> *We are currently forecasting 4Q GDP growth of 4.5% annualised, which would leave 2020 output around 2.2 percentage points below 4Q19 levels*

However, there is a long way to go before all the output lost through the first half of the year is fully recovered, underlined by the fact that employment is still 10.7mn lower than February. Covid-19 will continue to present challenges for the economy for many more months, while election tensions could also weigh on sentiment.

High-frequency daily data from payroll tracking firm Homebase already suggest the improvements in the labour market are plateauing while yesterday's ISM manufacturing employment index remained in contraction territory. Consequently, further job gains are likely to be tougher to come by, especially if the rising number of Covid-19 cases leads to renewed containment measures, as we are seeing in Europe right now.

We are currently forecasting 4Q GDP growth of 4.5% annualised, which would leave 2020 output around 2.2 percentage points below 4Q19 levels.

Homebase payrolls tracking suggest a plateau (% deviation in employment from January)



Source: Homebase

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Article | 2 October 2020 Video

Watch: US jobs, the economy and Trump's reelection hopes

As we wait for today's big US jobs report numbers, just how vital is the economy to Donald Trump's reelection chances? Despite being in the...

US jobs, the economy and Trump's reelection hopes

If it's 'the economy, stupid', then what are Donald Trump's chances of reelection in November? Over the past 80 years or so, only two incumbents have been defeated when America has been mired in recession; Jimmy Carter and George Bush Senior. Right now, the US is experiencing its deepest recession since World War Two.

But even Mr Trump's fiercest critics wouldn't put all the blame on him given the global coronavirus pandemic. He can also point to both the labour and equity markets which are performing relatively well. ING's James Knightley in New York says if the president loses the election, it wouldn't necessarily be the economy's fault this time.

Watch video

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Article | 1 October 2020 United Kingdom

Brexit: Optimism returns, but is it justified?

There are a growing number of reasons to be cautiously optimistic about UK-EU talks. Negotiations seem to be heading slowly in the right direction, while...

Things are starting to look a little brighter

It's now three weeks since the UK unveiled its controversial Internal Markets Bill (IMB), legislation that would grant powers to override parts of the withdrawal agreement agreed just last year between the UK and EU. The fireworks created by this move led many, ourselves included, to conclude that the chances of a deal were slipping. We wrote at the time that we thought the odds of a deal were at best 50:50.

But as another round of trade negotiations draw to a close, there is a renewed sense of optimism that a deal might still be on the cards after all.

The first piece of good news is that despite the bill having gone through the House of Commons this week, Brussels has not shut down trade talks - wary perhaps of avoiding the blame if both sides were to fall back on WTO trade terms next year. Instead, the EU has signalled it is pursuing legal action against London, but this will take time and doesn't preclude a deal being done in the meantime.

And in light of the critical global reaction to the bill - including from Joe Biden - the UK government appears to be taking a more conciliatory approach. It has, for instance, offered Parliament a veto over the controversial powers in the IMB. While this in itself will do little to dampen concerns in Brussels, it does signal flexibility from ministers.

Importantly, the bill will also reportedly not go to the House of Lords until much later in the year, and that too has helped take some of the immediate heat out of the situation.

The Internal Markets Bill isn't necessarily a barrier to a deal

Now, clearly the EU won't ratify a trade deal with the UK while the threat of overriding the withdrawal agreement remains. And equally the UK won't want to be seen to be climbing down over the bill as talks enter their final stages.

There's no clean way out of this impasse. But there's a growing expectation that Brussels will require the bill to be adapted as the price of a deal and at that point, with some careful political manoeuvering, the UK could find an off-ramp. The UK government could for instance publicly claim that the tactic was successful in securing an agreement, and that the 'safety net' provided by the bill would no longer be required.

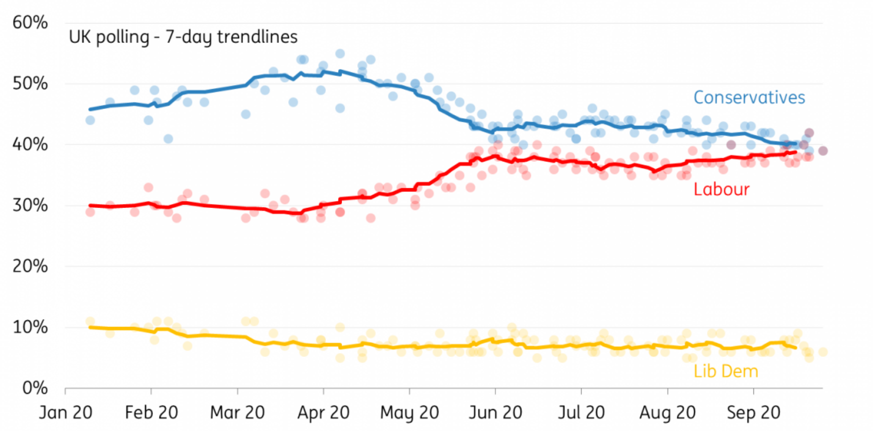
In short, the IMB is not necessarily a barrier to a deal being done, and encouragingly there have been signs that negotiations have taken a more positive turn.

The UK this week reportedly put forward a range of papers on different issues, including on state aid and fishing. So far there has been no breakthrough, but the fact that Britain is putting forward new proposals is undoubtedly a step forward compared to the previous past few rounds.

The fact that Britain is putting forward new proposals is undoubtedly a step forward

All of this comes as pressure grows on the UK government to avoid 'no deal'. The return of Covid-19 risks a volatile winter for the economy, and a chaotic start to 2021 would only add further challenges. The Conservatives have also now slipped below Labour in the polls for the first time since 2019, according to an Opinium poll over the weekend. We know too that support for Scottish independence is rising, and it's widely believed that a 'no deal' scenario could add further impetus to the campaign.

The Conservatives are now neck-and-neck in the polls with Labour



Source: Various polling agencies via Wikipedia

Individual dots represent polling from YouGov, SavantaComres, Deltapoll, Opinium, Redfield & Wilton Strategies, Kantar, Ipsos MORI, Survation, Number Cruncher Politics, BMG

A deal would still require big compromises from the UK

Putting all of that together, there does appear to be a case for some cautious optimism. But it's not all positive - and there are still a few key ways that it could all go wrong.

Firstly, none of what we discussed above changes the fact that the UK is going to have to make some serious compromises if it wants a deal - chiefly on state aid. The EU will, at the very least, want Britain to create an independent regulator to police the government's state support policies. So far, the UK has been very reticent to do this, instead signalling that it wants greater scope to support industry in the post-Covid era.

> *The UK is going to have to make some serious compromises if it wants a deal*

But even if PM Johnson is willing to accept these choices, there will undoubtedly be dissent among some Conservative MPs in Parliament. And while the government does have a strong majority in the House of Commons, recent experience with coronavirus legislation has shown that ministers increasingly need to strike compromises with MPs to secure ongoing support.

That potentially opens the door to an alternative scenario, where no agreement is reached this year, and instead UK negotiators return to the table in 2021 to chart a course towards an even more distant agreement (e.g. one that waives some but not all tariffs), involving fewer so-called 'level-playing field' commitments. Whether or not this is realistic is, of course, the subject of plenty of debate. At the very least it would take a while, and in the meantime, there would still be all of the initial disruption expected in a' no trade deal' scenario.

Returning to the original question, have the chances of a deal gone up? Well the answer seems to be yes, but even so, the risk of there being no deal is still pretty high - and indeed much higher than we always felt the risk of 'no deal' was back in 2019 surrounding the original Brexit deadlines.

For more on what all of this means for the economy, read our recent piece

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Article | 30 September 2020

FX | Switzerland

Switzerland: Deep into FX 'manipulator' territory

The Swiss National Bank unveiled CHF 90bn of FX intervention in 1H20, worth more than 13% of GDP. Switzerland now clearly meets all three criteria to be...

This publication is being re-sent to correct a calculation error.

We previously reported interventions as being at 50% of GDP, but this referred to quarterly GDP. When corrected for annual GDP, FX interventions by the SNB are worth 13% of GDP. With the US Treasury's "manipulator" threshold still at 2% of annual GDP, our conclusions about the risk of the US labelling Switzerland as such remain the same.

The original article was published on 30 September.

SNB interventions confirm Switzerland could be named FX manipulator

Despite normally disclosing the size of currency interventions once a year in the Annual Report, the Swiss national bank announced today that it engaged in currency interventions worth CHF 90bn in the first half of 2020. This narrowly exceeds 13% of Switzerland's GDP.

The figure is a mere confirmation of the large deployment of the FX intervention tool by the SNB to curb the strong appreciation pressures on the franc as the Covid-19 pandemic erupted. Still, a key issue is whether this will cause Switzerland to be labelled a currency manipulator by the US Treasury. Speculation about possible labelling generated upward pressure on the franc back in January when the US Treasury put Switzerland on its watchlist as it met two of the three criteria to receive the manipulator label. These criteria, and the quantitative thresholds, are reported in the table below.

Criteria	Benchmark	Threshold
Significant Bilateral Trade Surplus with the United States	Goods Surplus with the United States	$20 billion
Material Current Account Surplus	Current Account Balance	2% of GDP
Persistent One-Sided Intervention in Foreign Exchange Markets	Net FX Purchases	2% of GDP
	Persistence of Net FX Purchases (months)	6 of 12 months

Source: US Treasury, ING

In our latest preview of the US Treasury Semi-Annual FX report – which was due in May, but hasn't been published yet – we highlighted how Switzerland was already meeting the first two criteria (trade surplus with the US and current account surplus) in the period covered by the report (Jan-Dec 2019) and was very close to the 2% threshold on the third (FX intervention) - which we estimated at 1.9% of GDP in that period.

FX intervention has now been revealed to be around 13% of GDP in 1H20, and a look at the SNB FX reserves leaves little doubt that the Bank has engaged in net purchases for at least 6 of the 12 months (we count at least 8) ending June 2020. The period July 2019 – June 2020 will be covered in the autumn edition of the Treasury FX report, which is usually published in October, but given the spring report is still to be published, it may not be drafted before the end of the year.

Still, we estimate that Switzerland has continued to exceed the trade surplus and current account surplus thresholds in the period July 2019 – June 2020, and would therefore meet all criteria to receive the FX manipulator designation (table below).

	Bilateral Trade*	**Current Account***	**Foreign Exchange Intervention***	
	Goods Surplus with US (USD bn)	Balance (% of GDP)	Net Purchases (% of GDP, Trailing 4Q)	Net Purchases (6 of 12 Months)
Switzerland	47	8.9	13%	Yes

*Data for July 2019 - June 2020
Values in red exceed the thresholds
Source: ING, US Census, IMF, SNB

Does the US have an interest in labelling Switzerland?

With the US Treasury FX report having adopted strong political overtones since trade disputes took centre stage, the decision to label any country a currency manipulator will likely have to fit in the

US trade/geopolitical agenda. A testament to this is the fact that the only country to receive the label in recent years was China, in August 2018, despite the country only meeting one of the three criteria.

While we have previously noted how Vietnam, Taiwan and Thailand all exceeded the three thresholds in the 2019 calendar year, we suspected that geopolitical implications with relation to China may still spare them the unwanted label.

For Switzerland, geopolitics aren't playing a key role but there are other factors at work. The report covering July 2019 – June 2020 is unlikely to be published before the US election, and a potential change in the presidency may also imply a more light-handed approach to trade relationships. Even if President Trump stays in power, we cannot exclude that a free pass would be granted due to the extraordinary environment caused by the pandemic.

At the same time, there is a chance the Treasury decides to make an impromptu statement (like it did when labelling China) and declaring Switzerland a manipulator without publishing the full report.

Implications may be limited, but CHF speculative buying may emerge

Assuming that Switzerland is designated a currency manipulator, the implications for the country (and for trade relations with the US) would not be immediate. The Treasury provides for a period of negotiations with the monetary authority of the designated country to establish different FX intervention practices. Only if negotiations fail are more drastic measures, such as tariffs, recommended.

> The implications could, however, be more significant from a market perspective, as many investors may suspect that the SNB will be forced to review the upper-bound of its tolerance band for CHF, allowing the currency to appreciate more freely. This may generate intense speculative bullish bets on CHF, putting the SNB in the uneasy position of having to increase its FX intervention despite having received the manipulation label.

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Snap | 29 September 2020 Germany

Germany: Disinflation for now but deflation risk increases

The September fall in German inflation is mainly the result of low energy prices and the VAT reduction. However, disinflation can easily turn into deflation

Source: Shutterstock

Based on the inflation outcomes in several regional states, German inflation came in at -0.2% year-on-year in September, from 0.0% YoY in August.

The lowest reading since January 2015. The harmonised index, relevant for ECB policymaking, dropped to -0.4% YoY, from -0.1% in August.

The regional data paint a picture of diverging inflationary trends in the German economy.

The negative base effect from low energy prices is keeping headline inflation low but there is more: the VAT cut of July is most visible in prices for food, clothing, other consumer goods and increasingly also for other leisure activities and packaged holidays. At the same time, the fact that the increase in hotel and restaurant prices is still very much in line with the trend seen prior to the VAT cut suggests that lower taxes are also used to support businesses and are not necessarily entirely passed on to consumers.

For the time being for Germany, the conclusion is crystal clear, the current crisis is disinflationary

Looking ahead, German headline inflation should first fall further before gradually rebounding next year; at least if the German government sticks to the plan of reversing the VAT reduction in January. In July 2009, headline inflation came in at -0.7% YoY; a record which could be broken in October or November.

At the start of the crisis, there had been speculation about whether this current crisis would be an inflationary or deflationary event. For the time being for Germany, the conclusion is crystal clear: it is disinflationary. Since the VAT reduction, around 50% of the top 100 components of the inflation measure have recorded negative inflation rates.

During the last fears of deflation in 2014 and 2015, this was never more than 30%.

Almost needless to say that the ECB hardly ever reacts to actual inflation developments but to inflation expectations and forecasts. Many aspects of the recent drop in inflation can be explained rationally: VAT reduction, social distancing, devastating summer for tourism in many countries. Also, in a positive scenario with a vaccine coming to the rescue, some of these trends could be reversed next year.

However, it would not be the first time that falling prices, driven by one-off factors, combined with economic uncertainty and increasing unemployment could develop into a deflationary spiral.

Latest speeches, comments and leaks from ECB officials show that balancing between this 'rather act now to prevent worse from happening' and 'it is temporary and all will be fine next year' is anything but easy.

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ECB: Moving towards a digital euro

After months of academic debate, the ECB has finally published its first report on a digital euro, thereby leaving the door open for further...

Source: Shutterstock

The ECB issues its first report on a digital euro...

Although the ECB Governing Council has not made an official decision on issuing a digital currency just yet, the central bank today published its first report discussing different alternative scenarios that may facilitate the issuance and the adoption of a digital euro. Unsurprisingly, the rapid digitalisation of the economy, fast-changing consumer attitudes towards digital payments, as well as the emergence of crypto currencies, are key drivers behind the possible issuance of a digital euro in the future.

As we've argued before, this makes a lot of sense: although cash still remains a dominant means of payment across the eurozone (and many other countries across the world, including the US), the Covid-19 crisis has encouraged consumers to change their payment habits and rely more on contactless payments and e-commerce more broadly. We see this as a developing trend even after the current pandemic ends. Although other key drivers such as cyber-security, natural disasters, pandemics and other extreme events have been mentioned, crucially we think that the most interesting one relates to the international role of the euro.

Indeed, the potential launch of a digital euro is seen as a deterrent against the development of other CBDCs around the world. This is also seen in the context of Article 127 of the Treaty on the Functioning of the European Union (TFEU), which describes price stability as one of the key objectives for the ECB. The report also states that the digital euro should potentially be accessible to non-euro area residents, and this could potentially stimulate demand for the euro by foreign investors.

...but a lot of questions are still unanswered

Obviously, there are still many unanswered questions. Just think of privacy issues or how retail and wholesale customers are supposed to get access to the digital euro. Also, if customers were allowed to directly open a digital account at the ECB, would this then be an interest rate free bank account or would the ECB's deposit rate apply. Many questions will have a direct impact of how the ECB conducts monetary policy. Currently, the main transmission channel is through commercial banks. A digital currency could bypass these commercial banks, not only affecting their business models but also the way the ECB's monetary policy affects the economy. In a distant future, a digital euro could actually also be an enabler of helicopter money as it could give the ECB direct access to economic actors.

It is remarkable that the ECB is finally going digital. Several ECB officials have given insights into the ongoing strategy review in recent days and today's announcement should add a very interesting chapter to this review.

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