4Q 2020 Outlook

4Q 2020 PART 1: What to watch out for going into the last stretch of 2020

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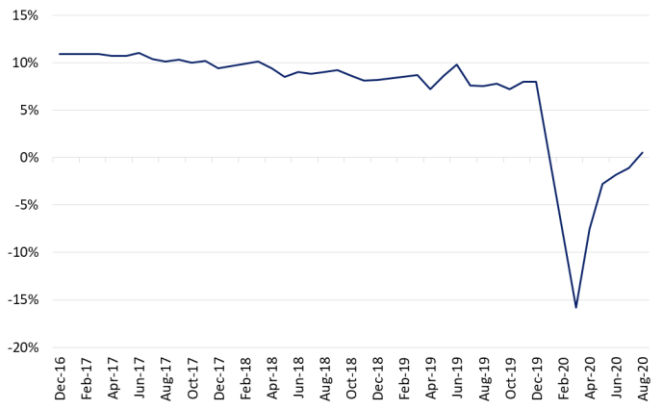
Going into the last stretch of 2020, the US presidential elections scheduled for 3rd November is the biggest uncertainty. In this report, we highlight key policy differences, as well as our recommendations in subsequent reports.

In the immediate term, we expect a high likelihood for an October surprise that could cause more volatility in financial markets.

Recovery amid G2 tension. It has been more than six months since the global outbreak of the COVID-19 pandemic. As of 20th September, the total number of infected and death cases totalled 30.8mn and 957k, according to the World Health Organization. Most countries where the epicentres are located have yet to contain the virus, especially in America and Europe. The direct economic impact due to the adoption of containment measures have led to a global recession. However, this could be the shortest recession in history as the disruption on the economic and financial systems have been met with an unprecedented reaction by governments and central banks.

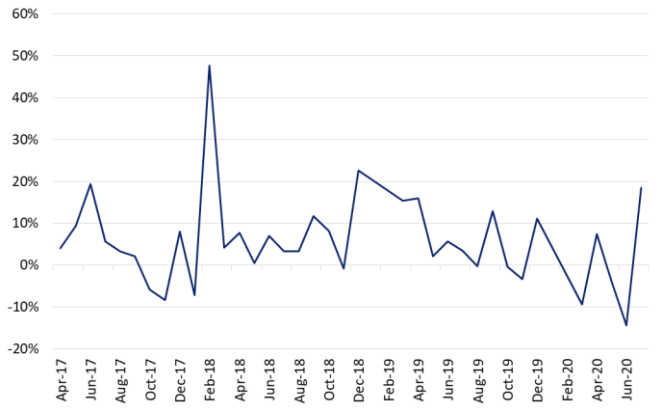
China contained COVID-19 and resumes growth. Among the major economies, China is taking the lead on the recovery of the economy. As the earliest epicentre of the COVID-19 outbreak, China managed to contain the spread within two months and normalised growth since May. Overall economic conditions have been improving since the full-blown nationwide lockdown in February and March. Consumption which accounted for 57.8% of 2019 GDP rebounded from the dip in March. Retail sales growth in August increased by 0.5% YoY, the first month of positive growth in 2020. Both fixed asset investment and foreign direct investments continued to improve with slightly negative YTD growths. Government spending substantially expanded by 18% YoY in July, the highest growth since December 2018. Net export value remarkably surged by 69% YoY in August, following 40% YoY growth in July. China's overall economy is walking out of the woods and is back on the path of normalised growth.

Figure 1: Retail sales growth YoY in China



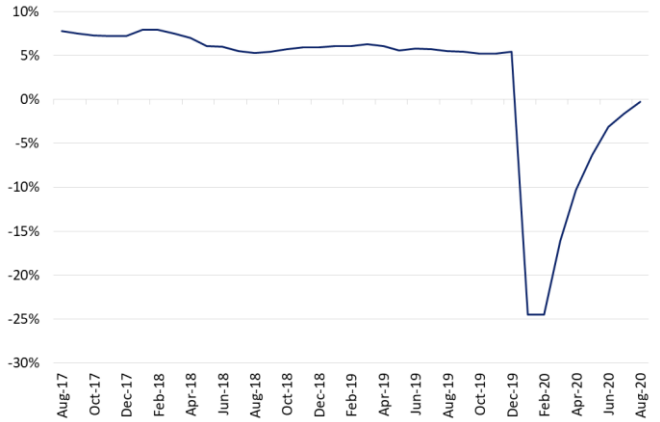
Source: CEIC, KGI Research

Figure 2: Government expenditure growth YoY in China



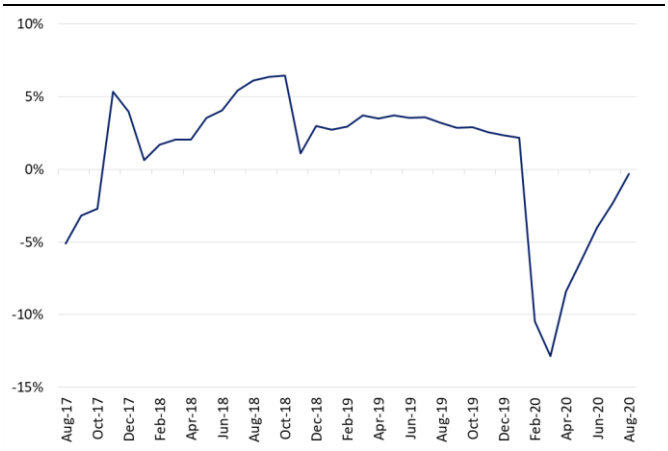
Source: CEIC, KGI Research

Figure 3: Fixed asset investment growth YTD in China



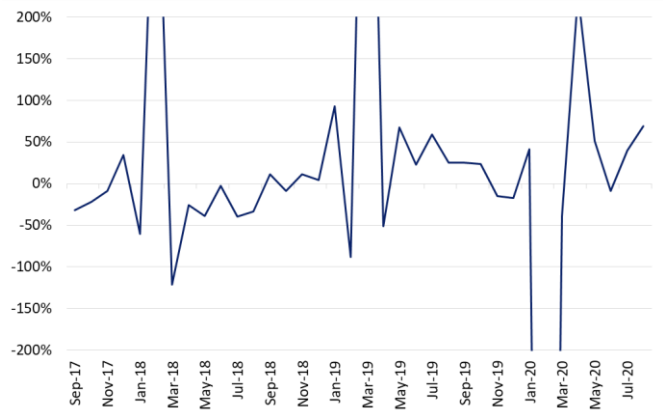
Source: CEIC, KGI Research

Figure 4: Foreign direct investment growth YTD



Source: CEIC, KGI Research

Figure 5: Net export growth YoY in China



Source: CEIC, KGI Research

Modification of growth pattern under the tensions between China, the western world and neighbouring countries. Investors have probably acclimatised to the tensions between China and US over the past two years. In recent months, another new tension has emerged, which is the border skirmishes between China and India. India has had border conflicts with China since 1962, and is currently on a campaign to boycott China products. Meanwhile, the European Union, which is standing on the sidelines of the China-US trade tension and has overtaken the US to become the largest trading partner to China, plans to reduce its economic dependence on China. ASEAN, the second largest trading partner to China, has resumed the dispute over South China Sea with China recently. In a nutshell, China is facing significant diplomatic and external economic pressure and challenges at the moment.

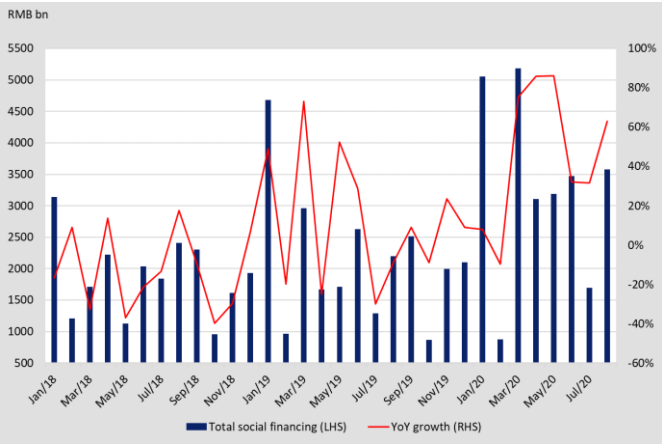
Confronting these headwinds, China initiated a "dual circulation" growth model in May, namely the internal and international circulation. Internal circulation involves expanding domestic demand and establishing a complete supply chain, together with an increase in import substitution. International circulation is to proactively participate in both supply and demand side of the global supply chain. The former is the main body that takes a leading role while the latter is an extension and supplement.

Near-term growth driver is infrastructure expansion. To support the economy during the COVID-19 pandemic period, China adopted expansionary fiscal and monetary policies. The credit impulse growth continues the uptrend cycle started in early 2019. To be more specific, total financing monthly growth averaged 62% YoY this year. In 1H20, the total issuance of urban construction bond grew by 60% YoY to RMB24.7tn, and net financing of which totalled at RMB15tn, surpassing the full amount in 2019. All these indicate that government-led infrastructure expansion will remain the main driver of economic growth in the near term in China, which is proven by the abovementioned jump in government expenditure in July.

Figure 6: China credit impulse growth YoY

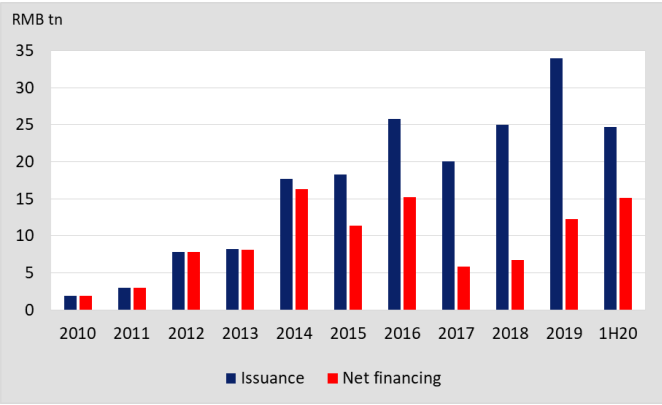
Source: Bloomberg, KGI Research

Figure 7: China total social financing and growth YoY



Source: Bloomberg, KGI Research

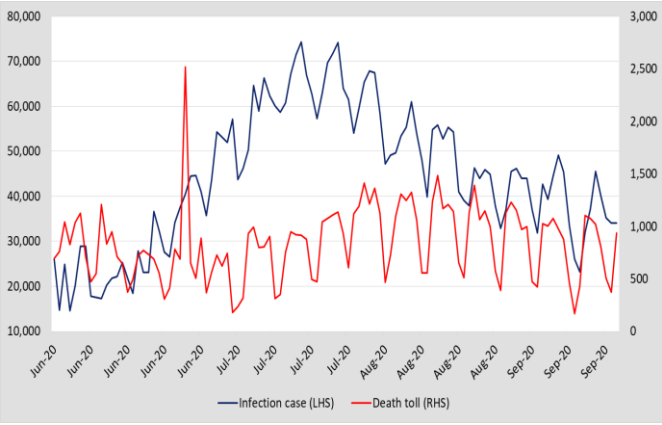
Figure 8: China urban construction bond issuance and net financing



Source: Wind, KGI Research

US has yet to fully contain COVID-19 but is slowly walking out of the woods. The daily incremental infection cases have topped out and have been trending down since July, but the daily incremental death toll seems to range between 500 and 1,000. To completely contain the pandemic, it is likely the US can only rely on vaccines which are expected to be out by the end of this year.

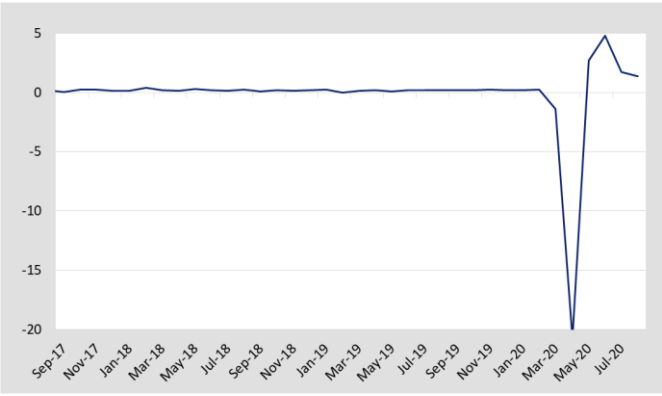
Figure 9: COVID-19 daily incremental infection and death in US



Source: WHO, KGI Research

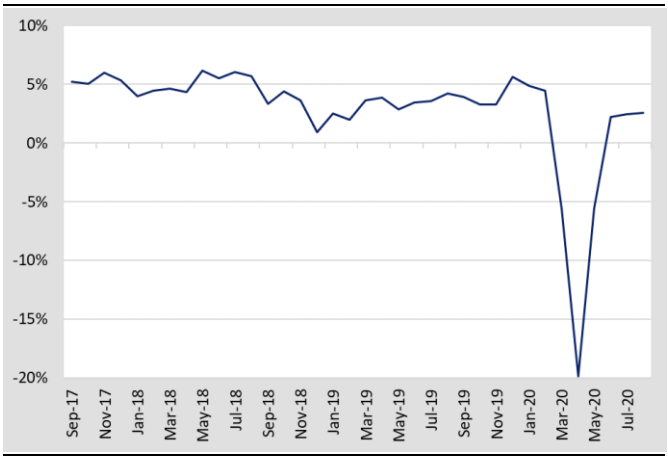
The US economy also embraced a V-shaped rebound but has yet to recover to pre-COVID levels. Non-farm payroll bottomed at -20.8mn in April, and the job creation in the following four months totalled 10.6mn. However, the recovery of the job market slowed down in July and August, indicating that permanent job losses are expanding. Retail sales are resilient, back to positive growth YoY since 2Q20. The manufacturing sector remains soft since industrial production growth YoY stayed at negative zone in the high single digit. Housing market has seen a real V-shaped recovery, which is counterintuitive. Working from home and social distancing has driven the demand for houses, especially in the suburban areas. The overall US economic conditions are still weak at the moment.

Figure 10: Non farm payroll



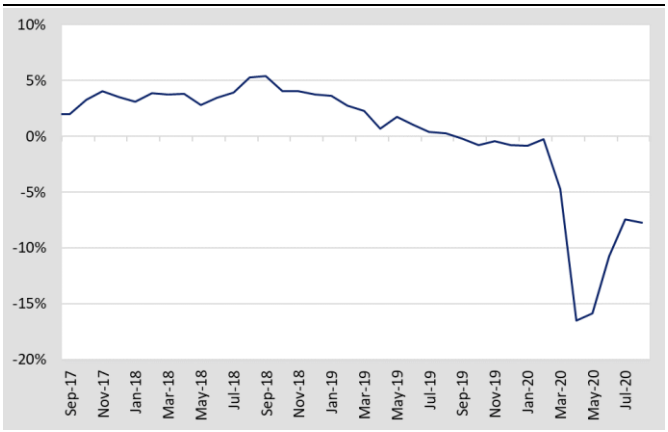
Source: Bloomberg, KGI Research

Figure 11: Retail sales growth YoY



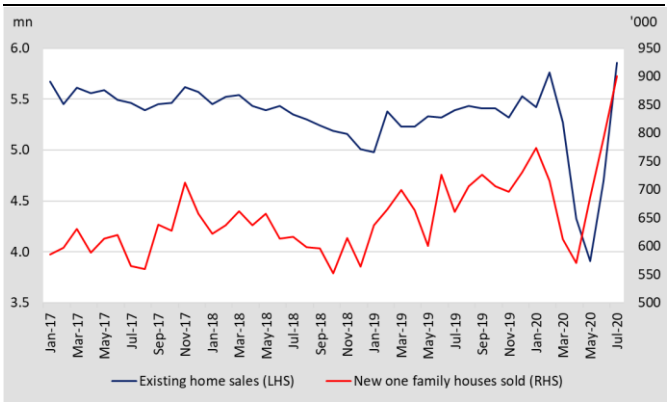
Source: Bloomberg, KGI Research

Figure 12: Industrial production growth YoY



Source: Bloomberg, KGI Research

Figure 13: Existing and new home sales



Source: Bloomberg, KGI Research

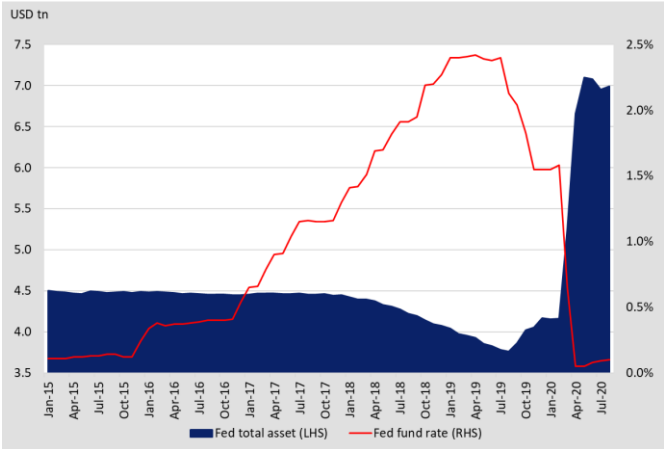
Nonetheless, there is a huge deviation between the economy and financial market. US equities markets broke new highs in August but corrected about 10% at the moment. Views on the outlook are also divided. Some think the overall economy is on track of V-shaped recovery, and companies' earnings will catch up and justify the price performance. Some think the market is euphoric and frothy and that improving fundamentals cannot uphold the current levels. Only time will tell which camp is correct, but these polarised views share a common ground which is that the financial market is a not a reflection or barometer of the economy, at least at the

moment. The Federal Reserve's massive liquidity injection (US$3tn increase in the Fed's total asset since March) and asset purchases over the past few months is a key reason for the sharp jump from the bottom in asset prices.

The Fed's dilemma. To bail out the financial market and uphold the economy, the Fed has to maintain the expansionary monetary measures by keeping asset purchases (mainly bonds) to prevent widespread credit losses due to the crash in the real economy. It has been effective in the short run but is also creating long-term consequences. Apart from asset price distortion, the potential reflation and dollar weakness could do more harm to the economy subsequently.

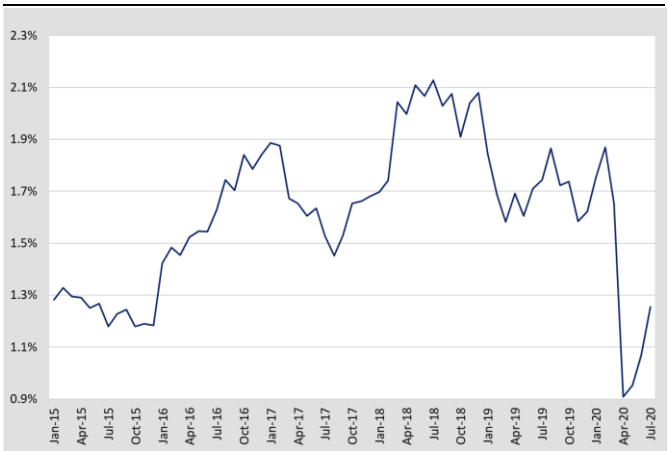
In the previous FOMC meeting, the Fed relaxed the inflation target of 2%, bringing up more concerns of a sharp jump in inflation and ensuing hike in interest rates. The expectation of which is strengthened by ongoing weakness of the US dollar. The dollar index is approaching the lows of 2018 after the reversal of the uptrend in June. The low interest rate will be maintained at least till 2023, according to the latest FOMC minutes. The unlimited QE to support the recovery has cast doubts. After all, its effectiveness could be reduced by the abundance of US dollars.

Figure 14: Fed total assets and Fed fund rate



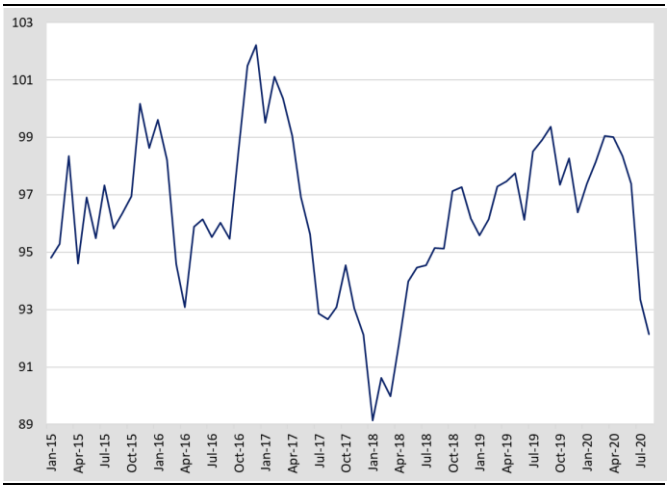
Source: Bloomberg, KGI Research

Figure 15: PCE core inflation



Source: Bloomberg, KGI Research

Figure 16: US Dollar index



Source: Bloomberg, KGI Research

US elections is the biggest uncertainty. The US presidential elections could be the trigger that causes instability in the global economy and financial markets going into the last stretch of 2020. The two main political parties have never been more polarised in terms of diplomatic, economic, environmental and other aspects of policies. Below, we compare proposals of policies in several key fields.

To summarise, if elected, Trump could continue his "America First" proposal that focuses on the recovery of the domestic economy by adopting more dovish measures. But he is more prone to deglobalisation and decoupling from China. On the other hand, Biden proposes to roll back most of the incumbent president's policies. He is more focused on social welfare enhancement and is more supportive of globalisation. Regarding the China-US tension, he suggests to restore the G2 relations and resume talks instead of the acceleration of tensions which could potentially lead to a new Cold War.

However, it does not mean that the overall confrontational policy towards China will be fundamentally reversed. Overall, we believe that the outlook of global economic development and international relationships will be substantially diverse depending on who is elected the next US president.

Figure 17: Proposals of policies

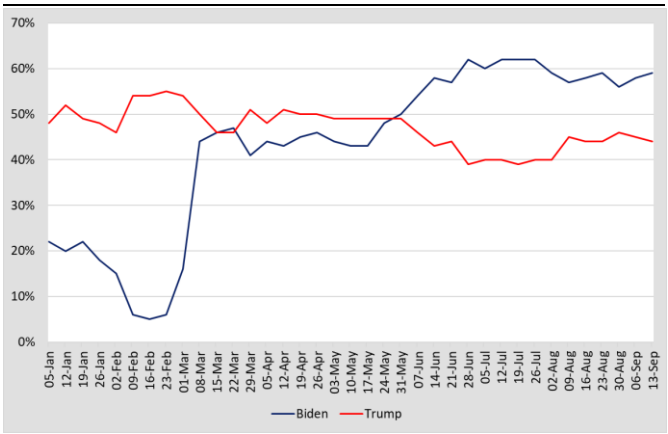
	Biden	Trump
Corporate tax	Increase corporate tax rate to 28%; minimum tax rate of 15% on book income	Decrease corporate tax rate to 21%
Personal income tax	Restore top rate to 39.6%; increase capital gain tax	Lower federal tax rates
Energy	Support green energy and carbon tax; end fossil fuel subsidies; Ban new leases for drilling	Support traditional energy
Financial and monetary	Support financial transactions tax	Support low rate and credit expansion
Immagration	Reinstate DACA; restore asylum system and support alternatives to immigrant detention; end family separation	Boarder wall; tighen boarder and interior enforcement; restrict asylum; roll back DACA; cancel refugee visas
Healthcare	Enhance Affordable Care Act; Medicare to negotiate to negotiate drug prices; Match domestic drug prices with overseas ones	Lower drug prices; terminate Affordable Care Act
Trade	Support free trade; Erase tariffs on China imported goods; Resume talks with China	Support China-US decoupling; Ongoing sanction and restiction on China tech companies;
Tech	Support anti-trust investigation	No priorities
Other	Increase minimum wage to $15/hour	Unchanged minimum wage at $7.25/hour

Source: Open sources, KGI Research

As of mid-September, the probability of Biden winning the 2020 US presidential elections was reported at 59%, 15ppts higher than Trump according to Bloomberg. However, this may not indicate the final results accurately. The poll survey could be viewed as a reference for the two candidates, especially for the one lagging behind to adjust the campaign strategy in the last month before elections.

In other words, Trump could place more effort in the swing states. We believe three big factors could affect general voters' final decision: restoration of social order, recovery of the economy and job creation, and the containment of COVID-19 pandemic and the release of a vaccine. The upcoming presidential debates scheduled on 29th September, 15th October, and 22nd October will show how the two candidates will address these issues.

Figure 18: Probability of winning the 2020 US presidential elections



Source: Bloomberg, KGI Research

October surprise. Last but not least, there could be an October surprise this time given more potential risks and instability in various vital situations domestically and globally, including:

1. **Public health:** New wave of COVID-19 infections
2. **Economy and market:** Disappointed economic recovery or employment; Stock market crash
3. **Diplomacy:** Escalation of China-US tension; Skirmish at South China Sea
4. **Society:** Ongoing social and political protests and disruption of social order
5. **Environment and climate:** West coast wild fire, hurricane

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