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Weekly Macro & Markets View

Highlights and View

- **Oil prices plunge in one of the sharpest moves on record, as OPEC talks collapse and Saudi Arabia vows to cut prices and raise production**

  Disruption is likely to be severe, especially in the credit markets, for the many vulnerable companies exposed to oil, while a deflationary impulse will be exerted on the world economy.

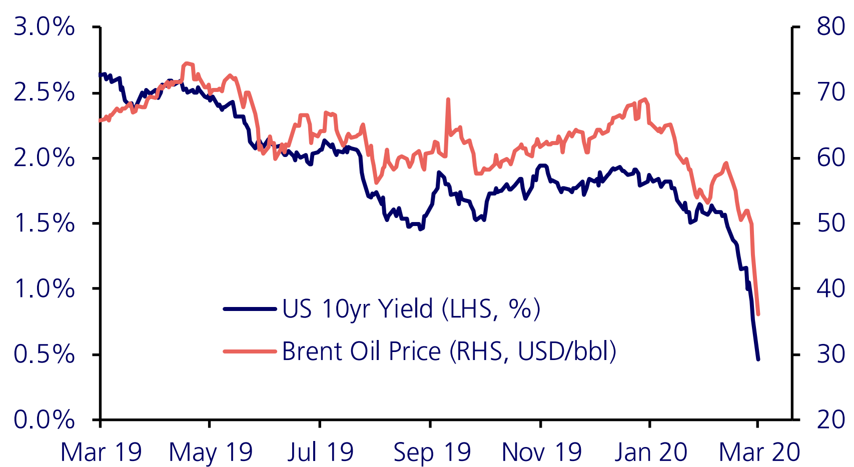
- **Global bond yields fall to new lows as recession fears intensify and oil prices collapse**

  Central bank actions have failed to calm investors, and a more coordinated policy response is now needed to put a floor under financial markets and the economic outlook.

- **COVID-19 infections are rising at a faster pace outside of China**

  We expect China's business activity to pick up speed again in Q2, while the global situation remains vulnerable.

Bond yields plummet as fears intensify



Source: Bloomberg

Global bond yields have fallen dramatically along with stocks and oil prices. The Fed cut rates by 50bps in an unscheduled meeting on Tuesday, but this was not enough to calm investors and trigger a rebound in risk assets and bond yields. The breakdown in OPEC talks over the weekend was unexpected and amplifies the slump in yields, as the oil price collapse triggers deflationary fears and disrupts the global economy. Treasury yields have fallen the most and, for the first time in history, the whole curve is now trading below 1% with another 100bps of policy easing priced in by year end. This has left the 10yr yield below 0.5%, down from 1.9% in the beginning of the year. Elsewhere, yields have been more resilient, as central banks have less room to cut rates. Bund yields have fallen to new lows though and further ECB rate cuts are priced in, along with cuts from most other major central banks. We had expected global growth to slow and bond yields to revisit their lows over the course of 2020, but the moves we have seen have by far outpaced our expectations. A globally coordinated policy response — involving both fiscal and monetary support — is now needed to put a floor under sentiment and prevent a further deterioration in the economic outlook.

US: Stocks fail to respond to rate cut or better data, as virus uncertainty spooks investors

Investors were tossed around like a boat in a storm last week as the S&P 500 lurched up and down in each of the five trading sessions by more than 3%, yet closed only a fraction higher on the week. Economic data were modestly encouraging, with the major caveat being that they precede the impact from COVID-19. The ISM Non-manufacturing for February jumped to 57.3 from 55.5, though the ISM Manufacturing ticked lower to 50.1, while the jobs data proved robust. Payrolls surpassed expectations by a wide margin at 273k, with upward revisions to prior data, while the unemployment rate ticked down to 3.5%, with hours worked and the participation rate both decent. Unfortunately, the economy is still losing steam and is yet to face the COVID-19 impact. Further rate cuts and modest fiscal initiatives will help to some degree and, despite current market gyrations, are likely to provide some support for stocks in the weeks ahead, provided infection rates remain relatively contained. In the meantime, despite stocks becoming oversold, caution is warranted until a bottoming process becomes more apparent.

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COVID-19: The focus continues to shift from Chinese to global infections

As global coronavirus cases increase above the 100,000 mark and keep rising, we note that infections are stabilising in China while the situation is rapidly deteriorating outside of China. South Korea, Iran and Italy make up nearly three quarters of the cases outside of China. Other European countries and the US are also moving into focus. While most observers are concentrating on new and total cases of infections, we note that nearly three quarters out of 80,739 infected Chinese citizens have already recovered, bringing the number of active cases to 18,898, with about a quarter of them in serious condition, while the mortality rate has increased to 3.9% with 3,120 death reported. Work resumption is speeding up, particularly in the infrastructure segment. Having tumbled, retail sales are also picking up again in China. As many migrant workers are returning to their factories, there are concerns that a second wave of infections may occur, but we believe that the worst will soon be over in China, while, unfortunately, the rest of the world will have to cope with further deterioration.

Eurozone: The ECB prepares to act, governments also announce fiscal stimulus

The Italian, French and German governments have announced various fiscal stimulus measures in response to the coronavirus outbreak. While these will help, the impact of the virus and associated disruption to economic activity will be substantial, likely pushing the region into at least one or two quarters of contraction, hence the negative reaction from financial markets. The Euro Stoxx fell 3% last week (and is down around nearly 7% at this point), while periphery spreads widened substantially. Admittedly, the February Eurozone Composite PMI was confirmed at 51.6, the highest since August. However, beneath the surface there were already signs of disruption to activity, with new export orders falling and manufacturing supplier delivery times lengthening. We expect business confidence to fall sharply in the coming months. The ECB said last week that it stood ready "to take appropriate and targeted measures". We expect it will increase the size of monthly QE asset purchases and announce extra liquidity measures to support the financial sector and SMEs.

Switzerland: The SNB is caught between a rock and a hard place

The Swiss franc remains a safe haven and has surged against both the euro and the dollar. The dollar has slumped as a result of Fed policy easing and expectations are now for the ECB to follow, potentially with rate cuts along with increased QE purchases. This puts the SNB in a difficult position, as policy space is limited. A combination of FX interventions and, potentially, a small rate cut, is the most likely response from the SNB, should further policy easing materialise in the Eurozone. Macro data show that the economy held up well in 2019, with GDP up 0.9% on the prior year, and we had anticipated growth to hold up at around this level in 2020. The strong currency in combination with coronavirus related business disruptions put that view at risk, however. Inflation, by contrast, is notably weak. Consumer prices are falling again and the deflationary impulse will intensify over the coming months, given currency strength and the collapse in oil prices.

Credit: Notably underperforms equities

Credit underperformed equity markets significantly last week, lagging during equity rallies and selling off aggressively during equity selloffs. This morning, the plunge in oil prices after the breakdown of talks between OPEC and Russia are again sending stocks and credit lower. US shale producers will struggle to remain profitable, with the US high yield energy credit spreads already soaring to 1,080 basis points on Friday, with indications that further stress will be experienced today. With corporate leverage at a record high the fundamental risks, exacerbated by the coronavirus fallout, had been trumped by liquidity so far. However, this may be changing as last week marked a sharp acceleration of outflows for high yield funds, with investment grade funds also suffering their first week of outflows in 2020. Despite high volatility, issuers made a tentative return to the primary bond market, but volumes remained low and activity is limited to the safest borrowers, with covered bonds dominating European financial issuance.

What to Watch

- In a fairly light week for US data, inflation data and consumer sentiment for March will be the main events, with the former expected to show CPI broadly unchanged, while a sharp decline in sentiment seems likely.
- The ECB is likely to announce a range of measures to support the economy at its meeting this Thursday, such as increasing the size of QE and extra liquidity measures. There is also a chance that it will announce a cut to the deposit rate further into negative territory, though we think this would be a mistake.
- In Asia, the focus will be on monetary and credit data as well as CPI and PPI for February in China. Taiwan will release foreign trade data for February, with our focus more on how non-China exports have fared. In Australia, we expect business and consumer confidence to have deteriorated in February.

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