ZURICH

Weekly Macro & Markets View

Highlights and View

- **Global equity markets fall decisively into bear market territory, with most down close to 30% from recent record highs**

  As global infection rates of COVID-19 continue to rise and governments lock down many regions, evidence of a peak in infection rates will likely be required to rebuild confidence.

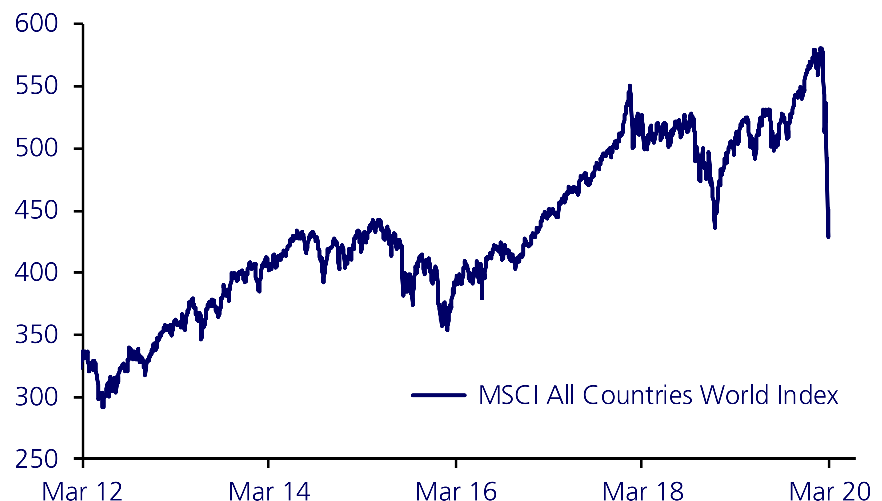
- **Dramatic intervention by the Fed includes slashing rates to the zero bound and boosting asset purchases, along with additional liquidity provisioning**

  The Sunday action by the Fed was much needed and showed a degree of coordination with government bodies to provide a united response to COVID-19.

- **The ECB announces more QE and cheaper liquidity for banks**

  While the ECB announced a range of measures, the increase in size of QE was disappointing and the messaging at the press conference confusing.

The death of the bull



Source: Bloomberg

The longest US bull market on record finally ended last week. Stocks joined most other global equity markets in entering the jaws of a bear market, loosely defined as falling by more than 20% from the peak. The S&P 500 recorded its sharpest drop on Thursday since Black Monday back in 1987, helping to pull the index down 27% from last month's record high. Despite a 9% bounce on Friday, events over the weekend are pushing global markets significantly lower and will likely have further to run. The locking down of many European boarders and the imposition of home confinement, with the US now also closing schools and limiting activity, will have a profound impact on economic activity as data from China now forebodes. An already faltering global economy was ill equipped to absorb the impact of COVID-19 and is now almost certain to enter recession in the first half of this year. A lack of coordination and force on the policy front up until now has not helped and, as we have frequently pointed out, such market declines are not unusual in recessionary periods. Despite the dramatic intervention by the US Federal Reserve over the weekend, which is detailed below, it may take a bit longer for a bottom to be put in place for stocks. Clear evidence of a peak in global infection rates and tangible government backstops for ailing economies will be required to allow confidence to rebuild.

Eurozone: An underwhelming response from the ECB as the region goes into lockdown

The ECB announced extra QE and cheaper liquidity conditions for banks last week, but investors were left underwhelmed especially as the messaging at the press conference was somewhat confusing. The ECB announced extra QE asset purchases of EUR 120bn for the remainder of this year, which amounts to an additional EUR 12bn per month on top of the existing EUR 20bn. However, in the past the ECB has bought far more on a monthly basis. Somewhat disconcertingly, President Lagarde seemed to indicate that it was not the ECB's responsibility to help tighten periphery spreads. These remarks were quickly rolled back in a subsequent TV interview and ECB blog. President Lagarde did correctly identify the need for fiscal policy to do more, and various initiatives have been announced recently. Meanwhile the region is increasingly going into lockdown, with borders being gradually closed except for essential travel and goods transit, and in many countries domestic activity also being severely curtailed. The hope is that these are just temporary measures lasting a few weeks, but they will still have a severe impact on activity.

UK: The BoE cuts rates as the budget offers support to the economy

Last week, the Bank of England (BoE) cut interest rates by 50bps to 0.25% in an emergency meeting in order to support the UK economy in the face of the COVID-19 outbreak. The BoE also announced a liquidity facility of around GBP 100bn for banks as an incentive to support SMEs with loans, as well as a cut in the countercyclical capital buffer from 1% to 0% to support lending when economic conditions deteriorate and banks natural reaction is to tighten credit availability. The move was coordinated with the UK Treasury, as it came on the day of Chancellor Rishi Sunak's budget statement. Chancellor Sunak delivered a fiscal stimulus to the economy of around 1% of GDP in 2020 in his budget, with various spending measures, including virus related spending and extra public investment. While all these measures and the coordinated way in which they were taken is impressive, the bigger picture is that the economy will still be heavily exposed to the global slowdown now taking place because of the COVID-19 outbreak, while also having to deal with the severe impact domestically.

North Asia: Latest data confirm economic slump, urging central bank support

China's activity data for January/February have revealed a record slump in economic activity. Industrial production fell 13.5%, fixed asset investment was down 24.5% and retail sales tumbled 20.5% YoY, while unemployment jumped by a percentage point to 6.2%. Although manufacturing activity may fully recover by the end of Q1, it's expected that services will only reach the pre-crisis level by mid Q2, suggesting that GDP may contract by more than -10% YoY in Q1. Aggregate financing has benefitted from strong government lending support and RMB 550bn of fresh liquidity provisions by the PBoC, while weaker shadow banking suggests that SMEs are suffering. The PBoC also cut its RRR for large and mid-sized banks at an equivalent of 35bps as of today. Meanwhile, the severe slump in Japan's Eco Watcher index in February and the weak BSI business survey for Q1 suggest that a recession is unavoidable. Among other measures, the Bank of Japan doubled its ETF purchase target in an emergency meeting today, but left policy rates unchanged. The Bank of Korea cut its policy rate by 50bps to a record low 0.75%.

Australia: Fiscal stimulus comes to the rescue

With the COVID-19 outbreak intensifying globally, Australian equities experienced one of their sharpest drops ever within a few trading days. The oil price shock, owing to the disagreement between OPEC and Russia on an output cut last week, has added further headwinds to Australia's energy sector, weighing on investor confidence. Following a 25bps policy rate cut by the RBA, the government announced a sizable stimulus package of AUD 17.6bn, equivalent to 0.9% GDP. Together with tax cuts and wage subsidies, the largest portion of the package is a one-off payment of 2.5k to 25k to companies with less than 50mn in revenue, aiming to help firms survive through an extended period of business shutdowns and to avoid a substantial drop in corporate profits. On top of that, the government plans to hand out AUD 760 to 6.5mn low-income earners and to provide additional funding to certain affected regions. As risks of a technical recession become imminent, we believe the current coordination between fiscal and monetary policies is what Australia's economy needs at this juncture.

Credit: Lines are drawn amid primary freeze and volatility

The rapid spread of COVID 19 and drastic action by governments led some equity indices to the largest daily moves on record, which filtered to credit. ECB actions underwhelmed investors, while Fed actions over the weekend are also causing risk assets to decline this morning. Amid these large whipsaws, credit's relative performance to equities has also been highly volatile. More important, however, is the underlying deterioration in credit conditions. The primary market is largely frozen. Technicals have also deteriorated, with both US and European investment grade credit funds seeing record outflows. Perhaps most concerning is the reported drawdown of credit facilities by some companies. US banks had $2.5 trillion unused credit commitments at year end 2019, as per the Federal Deposit Insurance Corp, with 64% of it coming from the big four US banks, JPMorgan Chase & Co., Bank of America Corp., Citigroup Inc. and Wells Fargo & Co. In a highly leveraged corporate world it is increasingly urgent that policy measures are seen as credible in order to avoid the unravelling of credit markets.

What to Watch

- US retail sales and housing market data will be points of interest, though the weekly initial jobless claims data are now highly relevant for gauging the impact from the virus. The FOMC meeting will no longer take place following the policy action at the weekend.
- While a range of emergency measures are being taken by the SNB, a rate cut is less likely in this week's policy meeting.
- In Asia, we expect policy rate cuts by Taiwan's CBC, Philippine's BSP and Bank Indonesia, with the latter being a close call. China's 1yr loan prime rate LPR is likely to be cut by 10bps. We will also watch export related data in Japan, Taiwan, Indonesia and Singapore. In Australia, labour market data for February and house price data for Q4 will be released.

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