March 30, 2020

Weekly Macro & Markets View

Highlights and View

- **Jobless claims jump to unprecedented levels as the US economy comes to a halt**

  Unfortunately, this is just the beginning, but swift actions by Congress and the Fed will help to mitigate the impact.

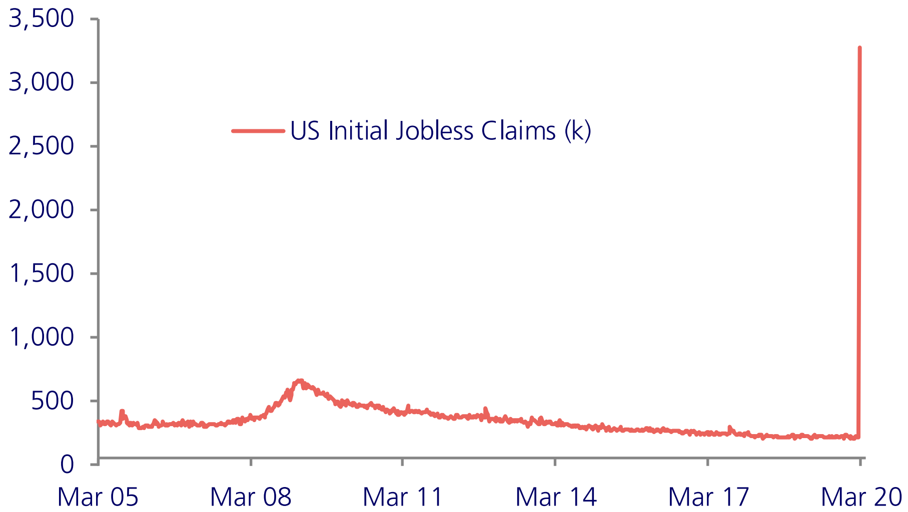
- **Equity and credit markets bounce sharply, as the unprecedented global monetary and fiscal measures lure bargain hunters**

  The much needed policy moves, if fully implemented, could put a floor under risk assets, though a sustainable and broad-based rally will require further signs of COVID-19 containment.

- **Germany embraces deficit spending and the ECB waives the 33% issuer limit on asset purchases**

  While the increased Eurozone monetary and fiscal stimulus is a welcome development, even more needs to be done, especially on the fiscal side.

Initial jobless claims soar as corona wave hits the US



Source: Bloomberg

Few indicators demonstrate the massive headwinds that the US, as well as the global economy, faces like the unprecedented jump in initial jobless claims last week. Claims soared to 3’283’000, reflecting tremendous job losses as the economy screeches to a halt. And this is likely to be just the beginning as the wave of coronavirus infections will only hit the US with its full force in the days and weeks ahead. Business activity took a hit in March with the Markit Flash Composite PMI falling to 40.5 from an already modest 49.6 in February. Not surprisingly given the effects of social distancing and travel restrictions the service sector was hit particularly hard with the Services PMI falling to 39.1. Manufacturing also contracted but the pace has so far been more muted than in services with the Manufacturing PMI dropping to 49.2. However, a steep fall in new orders indicates that worse is to come. Economic activity will remain under pressure, but markets have rebounded from recent lows as aggressive monetary and fiscal responses have been put in place to mitigate the impact of the partial lockdown of large parts of the economy. Congress passed a USD 2tn rescue package to support companies and households with loans and direct payments while the Fed basically announced unlimited support to keep markets liquid and put an implicit lid on yields as the fiscal deficit will soar.

Equities: Stocks spring back from the sharpest fall on record

Having experienced the worst few weeks since at least the 1930s, stocks rebounded sharply last week, with the MSCI World Index up 11%. In what has been a truly remarkable period the S&P 500 rallied by just over 20% from Monday’s low to the intra-week high on Thursday. While some may cite this as a definition of a bull market, coming just 16 days after the 20% drop which defined the start of the bear, we would reserve judgement – at least for now. There is no question that the unlimited asset purchases being undertaken by some central banks and the wave of fiscal initiatives being pledged is reason to be optimistic, with perhaps a bottoming phase now underway, but until there is clear evidence of containment of the dreaded virus, some caution is still warranted. While the plunge in prices left P/E valuation measures optically attractive, the earnings part of that ratio is likely to be slashed. Price to book values for the S&P 500 did fall to 2.4 from February’s high of 3.7, but at best offer fair value rather than a bargain, having hit 1.5 back in 2008.

Credit: Back from the brink... for now

Credit markets saw a sharp relief rally after weeks of substantial price drops, spurred by decisive policy action on both monetary and fiscal fronts to combat the economic downside from the COVID-19 virus outbreak. The Fed has announced a number of credit market facilities, which is a significantly positive development as, at the very least, it provides a much-needed liquidity backstop to the market. US credit rallied more than European credit, after selling off more aggressively as well. Supply picked up in both the US and Europe with the US seeing a record week for supply. All is not rosy yet though, as weak fundamentals start to become reflected in rating downgrades. Outflows continued at a record pace in US investment grade funds, while most other sectors also continued to see outflows. Companies continue drawing on credit facilities, spurring US banks to issue paper. In summary, while cash credit spreads may seem attractive and the rally could continue for some time, longer-term prospects hinge on limiting downside from the COVID-19 outbreak and accompanying lockdowns.

Bonds: Yields fall back despite unprecedented stimulus

Core government bond yields edged lower last week, along with volatility. The US 10yr yield closed at 0.67% on Friday, down 18bps on the week, while the 10yr Bund yield slipped back towards the -0.5% level. Inflation breakevens rebounded from historical lows, though, as unprecedented monetary and fiscal measures were announced. Indeed, we suspect that core yields may be past their cycle lows, as stimulus reduces downside risk to the outlook. Signs of containment of the virus are, however, likely to be needed before financial markets can move forward and start to price in a recovery, especially given the severity of global lockdowns, which will result in negative global growth in Q2. Deflationary pressure will also be intense near term, following the collapses in oil prices and global demand, which should cap yields. Elsewhere, the ECB confirmed that it would waive its 33% issuer limit for the Pandemic Emergency Purchase Programme (PEPP), giving it more power and credibility. Periphery spreads were generally tighter after the announcement.

Eurozone: Germany embraces fiscal stimulus

Last week saw further significant policy developments in the Eurozone. On Wednesday, Germany's parliament approved an exception to its constitutionally enshrined debt brake limit (that the structural federal deficit should not exceed 0.35% in any one year) and announced a supplementary budget of around 4.5% of GDP, including around 2% of discretionary fiscal spending. This is a positive development given Germany's previous reluctance to embrace deficit spending. However, given the size of the shock to the Eurozone economy, even more government spending will be needed. Unfortunately, Eurozone finance ministers and leaders were unable to agree on how to unlock European Stability Mechanism funds, with the topic of joint Eurobond (so-called "Coronabonds") issuance still divisive. The Flash Eurozone PMIs showed the first hints of the damage being caused to the economy by the COVID-19 pandemic. The Composite PMI fell by 20 points to its lowest level since the series began, driven by a collapse in services confidence to levels well below those seen during the Global Financial Crisis.

Asia: Good and bad news on the COVID-19 front

Tokyo's 2020 Olympics fell victim to COVID-19 and have been postponed until summer next year, while novel coronavirus fears are gaining momentum in Japan, threatening a lockdown of its capital Tokyo. On an even bigger scale, the whole of India has been put on lockdown despite less than 0.01% of its population of 1.37bn having been infected so far. Australia and Malaysia are examples of other APAC countries with rising infection rates. Following the 'first in, first out' theorem, China's active COVID-19 cases have fallen by about 95%, enabling the government to release its most affected province, Hubei, from quarantine. Business is gradually normalising, with migrant workers returning to their factories. Various industries have resumed activity levels at 50-90% of capacity, but we believe it will take more time for the services sector to recover. As the threat of a second wave of infections lingers, several Asian countries have announced fiscal packages. Australia's and Singapore's are impressive in terms of their size relative to GDP. Japan and China also announced packages over the weekend.

What to Watch

- The ISM surveys, consumer confidence and labour market data will reflect the massive hit to the US economy caused by the corona crisis.
- On Wednesday, it's time again for Japan's quarterly Tankan corporate business survey. We expect a severe deterioration in all components. We will also watch February data for industrial production, retail sales, housing starts and the labour market. In China, we expect a strong rebound of the Manufacturing PMI in March from its record low of 35.7 in February, while Hong Kong's retail sales will likely have plunged further in February. South Korea's exports will probably have weakened further in March. Australia will report housing related data. Finally, we expect India's BI to cut its repurchase and its reverse repo rate by another 50bps.

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