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Weekly Macro & Markets View

Highlights and View

- **The Fed unveiled a USD 2.3 trillion credit package, leading to a sharp credit and equity rally**

  While this will support risk assets, it largely addresses liquidity, not solvency concerns amid high leverage. Cash credit spreads are wide, but recovery is likely to be bumpy amid rising default rates.

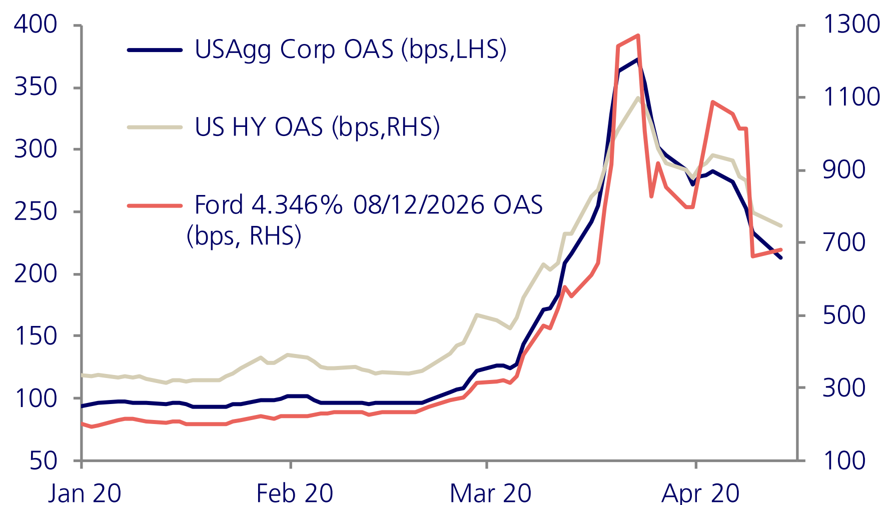
- **Japan announces huge fiscal package following state of emergency declaration**

  We now expect GDP to contract by 4.5% this year, as the impact of fiscal measures is less impressive than the headline number suggests.

- **Eurogroup finance ministers agree to more than EUR 500bn in plans to support the European economy**

  While the plans will help, they still need to be signed-off on by the EU heads of government, and the lack of agreement on common bond issuance is disappointing.

The Fed unveils its credit bazooka



Source: Bloomberg

The Fed unveiled a USD 2.3 trillion package last week for private sector borrowers, a development we were broadly expecting. The new facilities provide banks funding for small businesses under the USD 350bn Paycheck Protection Program, as well as up to USD 600bn in funding for small and mid-sized businesses and up to USD 500bn in short-term funding to eligible US municipal borrowers such as cities, counties and states. The Fed also upsized the existing primary and secondary market facilities for large investment grade companies from USD 200bn to USD 750bn, while announcing it could buy some high yield ETFs. Moreover, Fed purchases can now include so called 'fallen angels', i.e. bonds downgraded to high yield, provided they were investment grade rated on 22 March 2020 and remain within the BB rated bucket of high yield. Lastly, the Fed expanded eligible collateral for the USD 100bn Term Asset-Backed Securities Loan Facility (TALF) to AAA rated commercial mortgage backed securities and collateralised loan obligations. Credit markets rallied sharply, with recent and potential 'fallen angels' along with high yield rallying the hardest. While Fed actions are a positive development, they address liquidity but not solvency in a leveraged corporate world and we expect default rates to still pick up. Long-term prospects of cash credit appear reasonable, but incoming earnings and economic data will dictate whether it is a smooth or a bumpy path to recovery.

Equities: The bull is back… and charging

Last week saw the return of the equity bull market, loosely defined as a 20%+ rally from the lows. Indeed, following the sharpest bear market on record, the week saw further chunky gains across regions, with many markets, including the MSCI World Index, jumping by more than 10%. Investors are prepared to look through the health and economic catastrophes and are buoyed by the liquidity wave being provided by global central banks. Certainly, we concur that the scale of stimulus and asset purchases is truly remarkable and may well be sufficient to keep the newly regained momentum in place. However, earnings season kicks off in earnest this week and we suspect a grim prognosis, with little in the way of positive guidance. Consequently, as we pointed out a couple of weeks ago, market valuations, at least on a P/E basis are rich and likely to become even richer as analyst forecasts for the year are slashed further. That noted, stocks seem poised to move higher, as liquidity once again trumps fundamentals and a dangerous gap opens between asset prices and the real economy.

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COVID-19: A tale of rising and falling infection curves

As the number of total global confirmed cases of infection approaches the 2mn mark and nearly 120'000 fatalities have been reported, there are signs of hope on the COVID-19 front. The number of new cases in Italy and Spain, the two countries with most infection cases behind the US, is starting to slow. A peak in new cases is also expected in heavily affected New York this week, while other parts of the US are still seeing rising rates of new infections. Meanwhile, the high level of new cases remains a concern in the UK, France, the Netherlands and Belgium. Countries like Turkey and Ecuador are also moving into focus as infections are accelerating. While lockdowns are introduced and extended in some countries, other countries are announcing measures to relax restrictions, and public and private discussions are heating up as to how to slowly normalise economic activities once the worst is over. In Germany, for example, local states and German government officials will convene this Wednesday to discuss such options, using academic studies about the impact of current restrictions on society and the economy.

Eurozone: The Eurogroup agrees to more support, but common bonds still missing

After much discussion, the Eurogroup was finally able to reach agreement on a broad range of further support measures along the lines we had mentioned last week. Countries will be able to apply to the European Stability Mechanism for funds worth up to 2% of their respective GDP with minimal conditionality initially. The EIB will provide a new credit guarantee facility of up to EUR 200bn aimed specifically at SMEs. The EC proposal for a EUR 100bn fund to provide funding for EU wide temporary unemployment insurance and short-time work schemes will also be adopted. The schemes mentioned above could total more than EUR 500bn, providing an important backstop to the economy. However, disappointingly, discussion around debt mutualisation and common bond issuance has been pushed back with a vague reference to a 'Future Recovery Fund' that could be based on 'innovative financial instruments', with details to be discussed later. We believe a commitment to some form of common bond issuance would have made the Eurozone more resilient to this and future shocks.

Japan: Record high fiscal package follows state of emergency declaration

PM Abe officially announced a state of emergency for seven prefectures including the two major cities Tokyo and Osaka. While Japan has 47 prefectures, these seven make up about half of its GDP. Local governments are now able to impose partial lockdowns, urging people to stay home at least until May 6, the end of the 'Golden Week'. We expect a severe impact on Japan's economy and have cut our GDP forecast for this year to -4.5%. The latest Eco Watchers Survey for March has already confirmed a steep slowdown, with the overall diffusion index (DI) tumbling to a record low of 14.2 from an already low 27.4. The March DI was even lower than the trough after the Global Financial Crisis (GFC). Meanwhile, the government has announced a record JPY 108tn stimulus package, about 20% of GDP and double the size of the GFC package. However, the 'clear water' ('mamizu') impact is far lower at JPY 19.1tn, or 3.4% of GDP, and the direct boost to GDP is about only JPY 14tn, mainly in the form of cash handouts to individuals and SMEs as well as measures to prevent the spread of COVID-19 and to support the accommodation sector.

Australia: Under stress

The Services PMI plunged from 47 to 38.7 while job advertisements dipped by 10.3% MoM in March, showing how severely the COVID-19 pandemic is weighing on the economy. On a brighter note, the number of new cases of infection receded over the past week. Meanwhile, equities bounced back strongly, although market volatility remains high. We have witnessed an unprecedented level of both fiscal and monetary stimulus. Within a month or so, the Reserve Bank of Australia (RBA) delivered two policy rate cuts and launched quantitative easing while the government announced three rounds of fiscal stimulus, worth about AUD 194bn in total, equivalent to nearly 10% of GDP. In our view, both the RBA and the government have acted decisively in response to the pandemic, and we believe these measures will be effective in mitigating potential downside risks. However, we still expect unemployment to rise amid business and production shutdowns while households continue to be under stress given their high debt to income levels.

What to Watch

- In the US, retail sales and industrial production are expected to have fallen in March while housing market data are likely to reveal weakness as well. The Q1 earnings season will be kicked off by a number of banks with investors focusing more on the outlook rather than reported earnings.
- In Asia, following today's decision by Bank Indonesia to leave its policy rate unchanged while cutting its reserve ratio for banks, the focus will be on China's GDP Q1 release as well as major economic indicators for March. Credit and export data for March have already come in better than consensus had expected. In Japan, we will keep an eye on the Reuters Tankan for April. March export data will be released in Singapore and Indonesia. Australia will publish labour market as well as consumer and business confidence data.

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