April 20, 2020

# Weekly Macro & Markets View

## Highlights and View

- **China's economy contracted 6.8% YoY in Q1**

  We believe strong policy actions targeting households, SMEs and infrastructure investment are in the offing

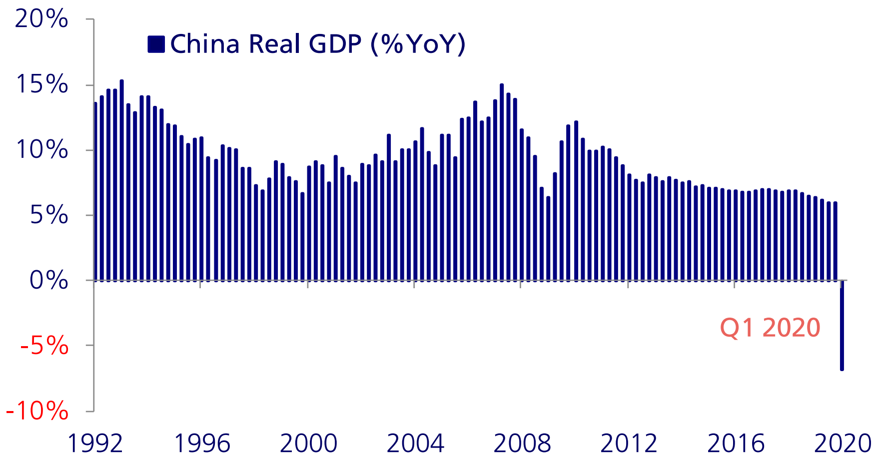
- **Germany announces gradual easing of lockdown restrictions**

  While it is encouraging that Germany has apparently been able to contain the virus and will ease its lockdown restrictions, the risk of a second wave of infections remains as economic activity resumes.

- **The US earnings season is picking up steam with headwinds for bank stocks**

  Bank stocks came under pressure as provisions for credit losses cut deep into their profitability, investors remain more optimistic with regard to healthcare and tech stocks.

## China's growth shock will spur significant policy response




Source: NBS, Bloomberg

The odds at a London bookmaker would have been high at the start of the year when betting that China's GDP growth would fall below +5%. But who would have believed that China would report negative growth of -6.8% YoY in Q1, or -39% on an annualised sequential basis? This shocking number, the first negative rate since quarterly statistics were published in 1992, offers a glimpse of what is currently happening around the world, as China was the first country affected by COVID-19. Meanwhile, economic statistics released for March reveal a recovery from the February lockdown lows, but still show that China's economy remains in dire straits. The contraction of industrial production narrowed more than consensus had expected, down only marginally YoY, as workers returned to their factories and a heavy export order backlog had to be filled. However, we have some concerns that this was just a blip, as exports are expected to suffer from the global lockdowns in major export markets in Q2. The drop in infrastructure investment narrowed, while property investment even showed growth. Retail sales were still down 19% in Q1, despite an acceleration of online sales growth, while nearly half a million companies went bankrupt. Following remarks by China's Politburo on Friday we expect a major fiscal and monetary boost ahead, focussing on the labour market, household income, SMEs and infrastructure.

## US: More than 22 million initial jobless claims in four weeks

The S&P 500 gained 3% last week after a trading range of almost 6% and changing signs several times over the course of the week. This was the first time we saw back-to-back weekly gains since mid-February. Investors are looking through economic data that increasingly reveal the devastating impact of COVID-19 and the lockdown on the economy. Retail sales fell by 8.7% MoM in March, although excluding cars and gas the drop was a more modest 3.1%. This is important as spending on big-ticket items like cars is likely to be postponed rather than completely forgone and is expected to rebound after the crisis. Not surprisingly given the lockdown and the impact on the labour market, housing market data show a severe slowdown for March and April. Another 5.2mn people filed for jobless claims, lifting the 4-week total to more than 22mn, a huge number but at least the latest print was the lowest in three weeks. A number of major banks opened the Q1 earnings reporting season with bank stocks being among the worst performers as provisions for credit losses cut deep into profitability.

## Credit: Sentiment improves, but further signs emerge of rising defaults

Global economic data continue to be dire, which has led to weak US bank earnings reports for Q1, as provisions to weather expected loan losses jumped. We think the read-across to European banks is noteworthy, especially as they seem more vulnerable and the European economy is likely to weaken more than the US. Indeed, bank stock indices in both regions have significantly underperformed broader stock indices. Investor focus is likely to remain on Q1 earnings in the coming weeks to gauge the deterioration of corporate fundamentals.

Defaults are likely to continue rising, with more leveraged borrowers skipping interest payments and filing or preparing to file for bankruptcy. Stimulus actions are, however, having a positive impact on investor sentiment with more credit sectors seeing a thaw in primary markets and flows. JP Morgan issued USD 10bn in bank debt, the largest ever, while cash credit markets rallied along with equities last week. Credit derivative indices notably lagged though, as further upside seems limited at current levels given the uncertainty and deteriorating fundamentals.

## Bonds: Core bond yields slip as macro data reveal the severity of the crisis

Global bond yields fell back last week, led by abhorrent macro data and a further fall in oil prices. The US 10yr yield retraced 8bps, ending the week at 0.64%, still above the historical low of 0.54% reached in early March (when it dipped to 0.31% intraday). The decline in yields came as the Fed scaled back average daily Treasury purchases from USD 50bn to 30bn and announced planned daily purchases at USD 15bn for the coming week. Looking forward, the case for an economic rebound in the second half of the year is strengthening, as the pace of infection is flattening in many regions and policy actions have helped to contain financial stress. This supports our view that core bond yields are likely to have seen their lows. However, upside potential for yields is likely to remain limited given ongoing disinflationary pressures in the recessionary environment and strong central bank demand. For now, this is likely to offset any upward pressure on core yields due to increased debt issuance.

## Eurozone: Some countries ease lockdown, budget deficits set to soar

Germany has announced a gradual easing of lockdown restrictions with some shops allowed to reopen as of April 20, schools gradually reopening in May and some factories set to resume production in the next few weeks. In Spain, some non-essential shops were allowed to reopen last week. However, easing of restrictions will be a gradual process and will need to be monitored carefully to see if a second wave of infections develops. The severe hit to economic activity this year and extra government spending announced will lead to record budget deficits across the Eurozone. The French finance ministry said its budget deficit for 2020 could be 9% of GDP, a post-1945 record and an Italian government official was reported as saying Italy's could be around 10%. Pressure is mounting for common bond issuance in the Eurozone to support the fiscally weaker nations in the face of this unprecedented shock. Indeed, Italian BTPs came under pressure last week in periphery bond markets, with 10yr yields rising 20bps despite substantial buying by the ECB.

## ASEAN: Walking a narrow path

The COVID-19 infection curves seem to be flattening for several countries while most governments announced lockdown extensions at least until the end of April. However, a higher-than-average mortality rate, particularly in Indonesia and the Philippines, raised concerns over testing inadequacy, which means many cases might have gone unreported. The central bank of the Philippines delivered a 50bps emergency policy rate cut to 2.75% while Bank Indonesia kept its policy rate unchanged given a steep fall in the rupiah in March. Risk-off mood among investors led to massive capital outflows from emerging markets in Q1, which can be observed in Indonesia, Malaysia and Thailand in particular. Credit rating agencies revised their economic outlook from 'stable' to 'negative' for Malaysia and Indonesia, voicing their concerns over widening budget deficits following the announcement of large fiscal packages to cushion their economies from the economic shocks. We expect economic fallouts to be quite severe for the region at least in the first half of the year.

## What to Watch

- The G3 flash PMIs will likely show a further decline in activity in April, given the severity of the lockdown.
- This week's EU leaders summit meeting will be a crucial one to see whether agreement can be reached on some form of common bond issuance or not.
- In Asia, economic releases for March will be in focus. Japan, Taiwan and Thailand will report export data, while industrial production statistics will be published in Taiwan, Thailand and Singapore. CPI data will be released in Japan, Hong Kong, Singapore and Malaysia. In Australia it will be interesting to listen to RBA Governor Lowe's statement on the economy and monetary policy. In Japan, we will closely monitor the impact of a nationwide extension of the COVID-19 state of emergency measures.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

ZURICH®