April 27, 2020

ZURICH®

Weekly Macro & Markets View

Highlights and View

- **Flash PMIs show the global economy has plunged deeper into contraction in April**

  Economic activity should rebound in the second half of the year, but risks are high and recovery hinges on lockdowns being eased over the coming weeks.

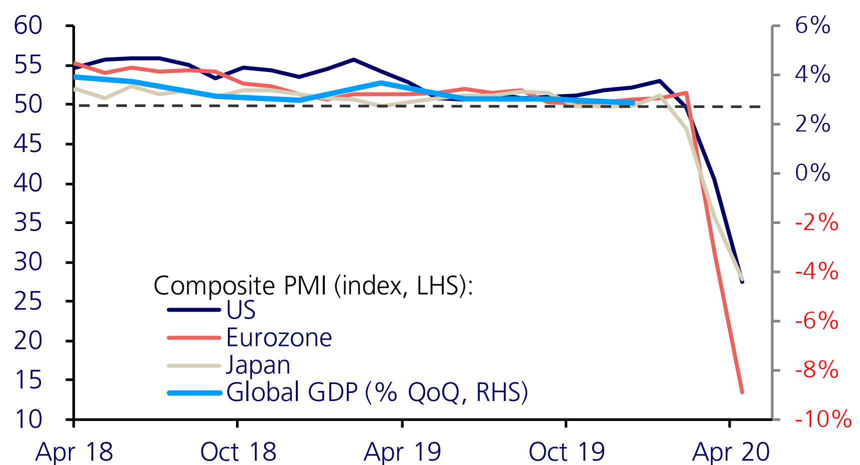
- **EU leaders agree on a European recovery fund initiative at summit, but the details are unclear**

  While some progress was made, it was disappointing that EU leaders did not come up with more concrete proposals on fiscal burden-sharing.

- **Oil prices saw dramatic price swings, with front end WTI future prices touching USD -38 per barrel**

  With oil demand likely to remain muted and storage facilities near capacity, oil price volatility can persist, but energy credit was underpinned by optimism around support from the US administration.

Lockdown cripples the global economy



Source: Markit, Bloomberg

The flash composite PMIs for the G3 economies slumped to the lowest levels ever recorded in April, as the COVID-19 lockdown crippled the global economy. The service sector suffered an unprecedented decline in activity due to restrictions on mobility and gatherings. Manufacturing fared slight better, but a plunge in new orders and a sharp rise in suppliers delivery times show that the collapse in business confidence and the breakdown in supply chains will be damaging, also for those businesses that stay open. While lockdowns appear to have been effective in flattening the COVID-19 infection curve, the economic cost of fighting the virus has been huge. It is likely that the world economy will slump into the deepest recession since the Great Depression this year, exceeding the downturn seen during the Global Financial Crisis. Looking forward, however, policy support, both on the fiscal and on the monetary side, has been remarkable and should help to bridge the collapse in output and shortfall in earnings that have been suffered. We therefore expect the recession to be short-lived, with a rebound in growth in the second half of the year. Risks are high though and hinge crucially on lockdowns being eased over the coming weeks.

EU Summit: Leaders deliver the minimum needed to assuage bond markets

The EU summit was disappointing relative to hopes that a commitment to common bond issuance would be made. However, there was at least agreement on previous proposals by the Eurogroup, for example regarding using the ESM with credit lines and minimum conditionality. In addition, some progress was made on the European recovery fund initiative. This would be attached to the EU budget, with the EU borrowing to finance extra spending of around EUR one trillion over the next few years to stimulate the economy. However, various details, such as the mix of loans versus grants and how much each country will contribute to the fund, remain unclear. Chancellor Angela Merkel did say that Germany would make a substantial contribution, but overall it was disappointing that the summit did not come up with more concrete proposals. This job has been pushed back to the European Commission, which is expected to report again in early May. Nevertheless, periphery spreads narrowed after the meeting, suggesting that it did the minimum necessary to keep bond market investors more relaxed for now.

msme@zurich.com

Eurozone: April PMIs are the lowest ever, but a rebound in May is likely

The Eurozone Flash PMIs for April (the worst of the lockdown period) were horrific, with the Composite Index falling to 13.5 from a previous record low of 29.7 in March. By sector, services were again the weakest falling to 11.7. However, manufacturing confidence also fell to close to its lowest point reached during the 2008/09 Global Financial Crisis (GFC). Given a gradual easing of lockdown restrictions in many countries starting in late April/early May, we expect activity and business confidence will rebound over the next few months, especially as the survey can hardly get worse. However, the severe hit to the economy in Q2 will lead to an overall contraction in Eurozone GDP in 2020 much worse than during the GFC. Despite the fact that S&P announced after the market close on Friday that it would maintain Italy's credit rating at BBB (with a negative outlook), government finances will come under massive strain because of the economic contraction, emphasising the need for coordination and burden sharing at a Eurozone level if the region is to get through this crisis intact.

US: Congress approves almost USD 500bn in additional support for the economy

The S&P 500 ended last week with a small loss of 1.3% after gaining more than 15% over the two previous weeks. The Q1 earnings season is now well under way with roughly a quarter of the companies having reported so far. Although COVID-19 and the lockdown hit the US only in the last few weeks of March the economic damage is already clearly visible in a steep fall in profitability. Earnings are almost 18% lower than in Q1 last year with the energy, industrial and banking sector in particular under pressure. Banks' profits were decimated by large provisions for credit losses. Initial jobless claims remain very high at 4.4m last week. Nevertheless, it is the lowest number in four weeks and raises hopes that the worst is now behind us. As the labour market remains under pressure and the Paycheck Protection Program's (PPP) initial funding of USD 349bn has already been exhausted, Congress approved an additional USD 310bn for PPP and some more support for SMEs last week. In addition, a further USD 100bn was provided to the healthcare sector lifting total fiscal support to more than USD 2.7 trillion.

Australia: The labour market is under pressure

The Australia Bureau of Statistics (ABS) released its new 'Weekly Payroll Jobs and Wages Report' last week, surveying 99% of large firms and 71% of small firms between March 14 and April 4. It estimated a fall in employment of about 6%, equivalent to 700k-800k job losses within three weeks. However, it should be noted that the 'JobKeeper' program announced on March 30, which provides wage subsidies to affected firms to encourage them to retain their staff, had not yet kicked in during the survey period. While emphasising the importance of this program in preserving jobs, RBA Governor Lowe mentioned in his latest speech that the unemployment rate could rise to 10% by June. The RBA also projected national output to fall by 10% over the first half of the year, followed by a gradual recovery in Q3 and a stronger rebound in Q4. Job losses are certainly putting financial stress on households, which are already indebted. However, we believe decisive fiscal and monetary action is already in place and should mitigate systemic default risks among households and businesses.

Credit: Negative oil prices do little damage to credit

Oil prices saw dramatic swings at the beginning of last week, while recovering somewhat later on. WTI futures for May touched nearly USD -38 a barrel on Monday, driven by traders avoiding physical delivery, as current storage capacity is reaching limits. Tuesday saw further brutal price falls in other WTI future contracts and Brent oil benchmarks, as the demand is likely to remain muted for some time. While energy credit spreads widened, the widening was muted relative to not only the oil price moves but also to the rally since March, with the sector being one of the best performers this month. The US administration is keen to support energy companies, as President Trump and Treasury Secretary Mnuchin indicated. Even beyond oil, credit fundamentals are undoubtedly deteriorating, but central banks are providing a backstop, which has boosted credit investor sentiment. Indeed, this morning, the BoJ has substantially upsized its commercial paper and commercial banks purchases from JPY 5tn to JPY 20tn, in addition to widening the collateral in its emergency funding facility.

What to Watch

- The US earnings season is in full swing with more than a quarter of S&P 500 companies reporting. The first estimate of Q1 GDP is expected to show a severe impact due to the lockdown and the following rise in unemployment.
- Some observers expect the ECB to announce an increase in QE at its meeting this week. It may be too early for this, but the ECB will stress its readiness to act as needed. Meanwhile, Eurozone GDP is expected to have fallen around 4% QoQ in Q1.
- In Japan, many of the most relevant economic indicators for March are expected to show a deterioration. In China, the NBS PMIs for April will be in focus. Taiwan will report Q1 GDP data, while Korea will release March industrial production and April export statistics. For Australia, Q1 inflation is likely to be weak given lower oil prices and lacklustre final demand while April house prices will probably show some signs of fatigue.

Disclaimer and cautionary statement

This publication has been prepared by Zurich Insurance Group Ltd and the opinions expressed therein are those of Zurich Insurance Group Ltd as of the date of writing and are subject to change without notice.

This publication has been produced solely for informational purposes. The analysis contained and opinions expressed herein are based on numerous assumptions concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies. Different assumptions could result in materially different conclusions. All information contained in this publication have been compiled and obtained from sources believed to be reliable and credible but no representation or warranty, express or implied, is made by Zurich Insurance Group Ltd or any of its subsidiaries (the 'Group') as to their accuracy or completeness.

Opinions expressed and analyses contained herein might differ from or be contrary to those expressed by other Group functions or contained in other documents of the Group, as a result of using different assumptions and/or criteria.

The Group may buy, sell, cover or otherwise change the nature, form or amount of its investments, including any investments identified in this publication, without further notice for any reason.

This publication is not intended to be legal, underwriting, financial investment or any other type of professional advice. No content in this publication constitutes a recommendation that any particular investment, security, transaction or investment strategy is suitable for any specific person. The content in this publication is not designed to meet any one's personal situation. The Group hereby disclaims any duty to update any information in this publication.

Persons requiring advice should consult an independent adviser (the Group does not provide investment or personalized advice).

The Group disclaims any and all liability whatsoever resulting from the use of or reliance upon publication. Certain statements in this publication are forward-looking statements, including, but not limited to, statements that are predictions of or indicate future events, trends, plans, developments or objectives. Undue reliance should not be placed on such statements because, by their nature, they are subject to known and unknown risks and uncertainties and can be affected by other factors that could cause actual results, developments and plans and objectives to differ materially from those expressed or implied in the forward-looking statements.

The subject matter of this publication is also not tied to any specific insurance product nor will it ensure coverage under any insurance policy.

This publication may not be reproduced either in whole, or in part, without prior written permission of Zurich Insurance Group Ltd, Mythenquai 2, 8002 Zurich, Switzerland. Neither Zurich Insurance Group Ltd nor any of its subsidiaries accept liability for any loss arising from the use or distribution of publication. This publication is for distribution only under such circumstances as may be permitted by applicable law and regulations. This publication does not constitute an offer or an invitation for the sale or purchase of securities in any jurisdiction.

Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

ZURICH®