May 11, 2020

Weekly Macro & Markets View

Highlights and View

- **The global PMIs show the extent of the depressionary collapse in economic activity in April**

  April is likely to mark a nadir as lockdown measures are now being eased, but risks around a more sustainable recovery remain high.

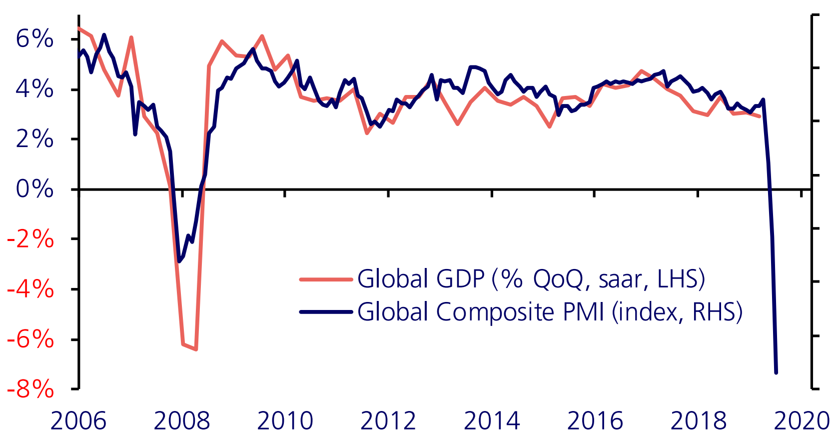
- **The German Constitutional Court finds that the ECB has not justified its original QE programme**

  The court gave the ECB three months to justify QE before it will halt Bundesbank participation. We think the justification will be provided and do not expect QE to end soon.

- **The US unemployment rate soars to 14.7% while payrolls plunge by more than 20 million**

  Grim as it is, the true picture is even worse as the participation rate tumbled as well. The broader underemployment rate shows almost one in four Americans being either unemployed or forced to work less than desired.

Economic conditions are gruesome, but April may mark a nadir



Source: Bloomberg

The global PMIs fell at the sharpest pace on record in April, confirming that the Q2 contraction is likely to be the worst since the Great Depression. This unprecedented plunge in activity primarily reflects the unique collapse in the services sector, while the decline in manufacturing activity is, albeit grim, still comparable with the outturns during the great financial crisis. While the speed and the cost of this economic collapse is unprecedented, with job losses surging in many regions, April is likely to mark the worst month. As steps are taken to ease lockdowns in some regions, some businesses will be able to open again, with activity likely to start improving in May. This is broadly the pattern that has been observed in China, which was the first country to enter – and emerge from – a lockdown. That said, risks are high and the next few weeks will be critical, with the pace of new infections remaining decisive for the outlook. Prospects for a more sustainable recovery also hinge crucially on businesses being able to survive this extraordinary episode. With business and consumer sentiment remaining extremely fragile, and unemployment at depressionary levels in some parts of the world, it will be critical that policy support is not removed prematurely over the coming weeks and months.

APAC: Most PMIs tumbled, many to record lows

April PMIs plunged across the board in the APAC region, except for China where the trough was marked in February as it was the first country to be hit by COVID-19. China's April Manufacturing PMIs marked another slight improvement following the spike in March, while new export orders and the service sector experienced another setback. The Construction PMI even surged close to 60 on public infrastructure spending. Manufacturing PMIs in Asia's electronics hubs, Korea, Taiwan and Singapore, as well as in Australia, deteriorated, but only to the low forty levels, while those for the other ASEAN countries and India fell significantly. India's Manufacturing PMI tumbled from 54.5 two months ago to only 27.4, while its Services PMI, impacted by the nationwide lockdown, tumbled from 49.3 to 5.4, the lowest PMI we have ever seen. New export orders fell across the board, with Indonesia's plunge to only 8.5 being the most dramatic. The dismal external outlook was confirmed by South Korea's exports in the first ten days of May, which fell 30% YoY on a working day adjusted basis.

US: Payrolls plunge and unemployment soars

After a modest start, the S&P 500 rose 3.5% over the course of the week. The move higher came despite another set of weak economic data. The unemployment rate jumped to 14.7% in April, the worst since the Great Depression. And yet it understates the true impact of COVID-19 and the lockdown. The unemployment rate was flattered by a 2.5 percentage point drop in the participation rate. The broader underemployment rate soared to 22.8%, indicating that almost one in four Americans is either unemployed or forced to work less than desired. Payrolls data show that more than 20 million jobs disappeared in April, though this didn't come as a surprise given the recent explosion in initial jobless claims. The fact that growth in average weekly earnings soared to 7.9% YoY from 3.3% the month before underlines that low-wage jobs have been hit much more severely by the lockdown. The ISM Non-Manufacturing Index fell to 41.8. The actual contraction is even more severe, though, as lockdown-related longer delivery times distort the survey to the upside.

Eurozone: The German constitutional court verdict could prompt the ECB to increase PEPP

European equities opened lower last Monday but moved higher during the week as further easing of lockdown restrictions were announced and US equities powered higher. Periphery bonds were volatile however, as the German Constitutional Court's verdict on the ECB's original QE programme (the PSPP) prompted some uncertainty in investors' minds. The judgment found, amongst other things, that the ECB had not sufficiently justified the PSPP and would need to do so in the next three months for the Bundesbank to be allowed to continue to participate. We expect either the ECB or the Bundesbank directly, to provide the required justification and think it unlikely that QE will end soon. In fact, the ECB's EUR 750bn Pandemic Emergency Purchase Programme (PEPP) may even be increased in size when it meets in June as a way to demonstrate its independence. After markets closed on Friday, the rating agency Moody's left Italy's credit rating unchanged with a neutral outlook, on the lowest rung on the investment grade ladder, helping reduce risks for periphery bonds in the near term.

Australia: Resilient March data, but a collapse in employment is a worry

March data released last week came in more robust that the consensus had expected. Retail sales spiked by 8.5% MoM and 10% YoY, the strongest since 2001 on the back of panic buys. Home loans and building approvals showed resilience. Exports rose by 15% MoM after having fallen 5% in February, driven by commodity shipments supported by stronger demand from China. While March data were buoyant, we expect Q2 figures to show severe contractions with exports likely to be an exception. The main concern is the job market. Job advertisements, a leading indicator for job growth, dropped by 53% MoM in April. The RBA projected an unemployment rate of around 10% in the June quarter, already netting off the job saving impact of the 'Jobkeeper' program, which provides fortnightly wage subsidies of AUD 1.5k per employee to encourage employers to retain their workforce. As Australia starts to reopen from its lockdown in May, we expect to see a slow economic recovery in Q3 and more visibly in Q4, assuming no second wave of COVID-19 arises.

Credit: Spreads widen despite the cheer in stocks

Credit markets were soft last week across cash and CDS, despite the upbeat mood in equities that led the MSCI World Equities Index to rise by nearly 3%. A number of factors are behind credit market weakness, most notable the continued heavy supply. Indeed, with last week's issuance, US credit markets have now seen over USD 600bn of investment grade debt supply since March. The pace of supply is set to continue if the drawn down revolvers are refinanced with bonds. Fundamental and economic news continues to be dire, as bankruptcy filings continue to climb while companies are on the verge of bankruptcy. The Fed's latest lending standards survey shows a tightening in lending standards for companies and is consistent with our forecast of a 10% default rate in high yield this year. Optimism around central banks, crucial to the credit market recovery, was also dampened marginally. Further details on the Fed's credit programs were somewhat disappointing, while the German constitutional court ruling on the ECB dented sentiment.

What to Watch

- In the US, the NFIB Small Business Survey will give an indication as to the current mood of the crucial SME sector while retail sales are expected to have plunged in April. Consumer sentiment for May will show whether households' expectations are recovering.
- In the Eurozone, industrial production data, the second estimate of Eurozone Q1 GDP and first estimate of German Q1 GDP are likely to confirm the sudden stop to economic activity that took place.
- In China, most of the relevant economic indicators for April will be released. In ASEAN, Malaysia's Q1 GDP and March exports as well as Indonesia's trade data are key indicators to watch this week. Australia's unemployment rate is likely to rise sharply on the back of business shutdowns in March and April, but we will also watch Q1 wage data as well as the latest business and consumer sentiment surveys.

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