June 8, 2020

Weekly Macro & Markets View

Highlights and View

- **US May nonfarm payrolls beat all expectations, soaring by 2.5mn**

  These numbers are always volatile, but they point to a solid rebound in economic activity with the private sector adding more than 3mn jobs.

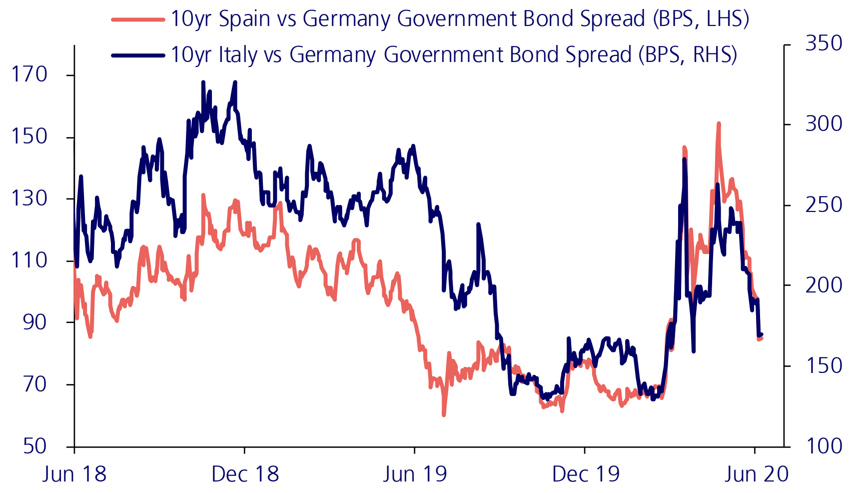
- **ECB increases PEPP by EUR 600bn, German government announces another fiscal stimulus package**

  The further policy support is a welcome development that should help buoy risk assets in the region and reduce downside risks to the economy.

- **Stock and credit markets surge, as skeptical investors now buy into the rally**

  A potent combination of further asset purchases, additional fiscal measures and less bad economic data powered risk assets higher globally. Momentum likely has further to run, but fundamentals are woeful.

ECB adds more PEPP to the Eurozone



Source: Bloomberg

The economic policy response to the COVID-19 epidemic took another step forward last week in the Eurozone. On the monetary side, the ECB increased the size of its Pandemic Emergency Purchase Programme (PEPP) by a larger than expected EUR 600bn, bringing the total size of planned asset purchases to EUR 1.35tn. ECB President Christine Lagarde stated that the PEPP would run at least until mid-2021, rather than ending in December 2020 as originally planned, and indicated flexibility with respect to the capital key. She also said that the ECB would reinvest coupons and securities as they matured. Indeed, for once the ECB over-delivered relative to market expectations leading to a sharp tightening in periphery government bond spreads. On the fiscal side last week, the German government announced another stimulus package of around EUR 130bn (approximately 4% of GDP), with some of the measures kicking in almost immediately. For example, as of July VAT will be reduced until the year's end and households will receive a one-off 300 EUR payment per child. Other measures include extra incentives for the purchase of electric vehicles. Overall, the further monetary and fiscal stimulus being provided to the Eurozone is a welcome development that should help support risk assets in the region. However, continued progress in containing the epidemic is another important and necessary condition for a sustained economic recovery.

US: Nonfarm payrolls soar by 2.5mn, pointing to massive rehiring

The S&P 500 gained 4.9% last week with a substantial boost provided by positive labour market data published on Friday. Payroll numbers beat even the most optimistic expectations by a large margin as nonfarm employment increased by 2.5mn in May compared to consensus expectations of -7.5mn. It's promising that more than 3mn new jobs were provided by the private sector with some of the most affected sectors like leisure and hospitality showing the biggest gains. While these numbers are always very volatile, the huge pickup in employment points to a solid rebound in business activity as the economy reopens. The unemployment rate fell to 13.3% from 14.7%. With the broader underemployment rate receding to 21.2% from 22.8% there are more signs that the worst of the crisis in economic terms seems to be behind us, but there is still a long way to go. The ISM Non-Manufacturing survey improved to 45.4 from 41.8, indicating that activity in the service sector is stabilising. Finally, a strong rebound in vehicle sales also points to a solid growth reacceleration as pent-up demand comes back to the market.

msme@zurich.com

Australia: Signs of recovery

Australia's real GDP declined by 0.3% QoQ in Q1, dragged by business investment and private consumption. April retail sales plunged by almost 18% MoM given stringent containment measures. Home prices were also on a downward trajectory, but the latest auction clearing rate showed some improvement, implying that home sales will probably recover following the reopening of the economy post COVID-19. To support the property market and the construction sector, the government announced a cash payment of AUD 25k for new home purchases and renovation work. This might help property sales and construction activity a little. However, it is unlikely that the program will spur home demand significantly as lacklustre wage growth and high unemployment are still a challenge after the lockdowns. While past data show clear weakness, some leading indicators pointed to a potential recovery in economic activity. In particular, the May Manufacturing and Services PMIs have rebounded while consumer and business confidence indices also picked up meaningfully.

Equities: The planets align

A remarkable week saw equity markets power higher, with the Eurostoxx 600 up over 7% and the MSCI World stock index now over 40% above March lows. A number of factors played a part in the move, with a lightly positioned and rather sceptical investor base apparently feeling compelled to buy into the rally. News on policy initiatives dominated most of the week, with the German fiscal stimulus package and hike in the ECB's asset purchase programme warmly received, along with signs of further fiscal initiatives in the US. Even on the US-China trade front there were some constructive comments from US Trade Representative Lighthizer. However, it was the surprisingly good US payroll data on Friday that provided the extra adrenalin shot to investors. Sector rotation has been evident, with the more cyclical sectors back in favour, while leadership from technology has eased somewhat. We continue to believe that the wave of liquidity can drive markets higher, but the shift in sentiment and signs of capitulation by the bears leave stocks more vulnerable to any disappointment.

Credit: Spreads rip tighter as inflows hit another record

Credit spreads ripped tighter last week, supported by positive sentiment throughout the week, which got a shot in the arm by the surprisingly strong US nonfarm payrolls on Friday. A scramble was evident in the primary markets throughout the week as new issue concessions turned negative and order books ballooned. Further signs emerged that issuance volumes are likely to be slowing down from the heady days of the last three months. Amid the liquidity glut created by central banks, inflows into US credit markets across investment grade, high yield and leveraged loans set another record for the second week in a row, with inflows of USD 15.6bn after last week's USD 13.8bn. Oil prices climbed sharply driven by optimism around a recovery, while OPEC+ extended supply cuts. Energy spreads have been the best performing sector within credit since March, but spreads may have tightened excessively now as fundamentals still look weak. Lastly, while credit derivative spreads tightened, they underperformed both equities and cash credit and show little upside now.

Bonds: Closing the gap

Government bond yields snapped higher last week, responding to positive news on ECB stimulus, German fiscal spending, a bottoming out in the macro data, and a faster than expected recovery in US payrolls, with virus data also contained. Bond yields have been trading within tight ranges close to historical lows since mid-April despite risk assets rallying, and the move above key resistance levels is encouraging, as this provides a missing signal that the global economy is likely to be past the worst. Last week's selloff took the US 10yr yield to 0.9%, up almost 25bps from a week ago, with 10yr yields rising slightly less in other core markets. This mainly reflected a steeper curve along with higher inflation expectations, while yields at the shorter end of the curve remain anchored by 'low for longer' policy expectations. This explains why further upside to yields is likely to be limited near term, with the fragile but improving economic outlook now appearing to be broadly fairly priced.

What to Watch

- In the US, small business optimism and consumer sentiment are expected to recover. The Fed is likely to keep signalling its ongoing support for the economy and financial markets.
- In the Eurozone, industrial production data is likely to show a record fall in output in April, but this should represent the low point in terms of economic activity.
- In Japan wages and machinery order data for April will be published. Money, credit data and the CPI for May will be released in China. We expect China's CPI to fall further. Industrial production for Malaysia and home loans for Australia will also be published this week.

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Zurich Insurance Company Ltd
Investment Management
Mythenquai 2
8002 Zurich

173001566 (01/16) TCL

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