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Weekly Macro & Markets View

Highlights and View

- **The Fed will buy corporate bonds without company certifications in its secondary market program**

  This unshackles the Fed from being restricted to ETF purchases and significantly increases the probability that it will achieve its purchase targets, which some had begun to doubt.

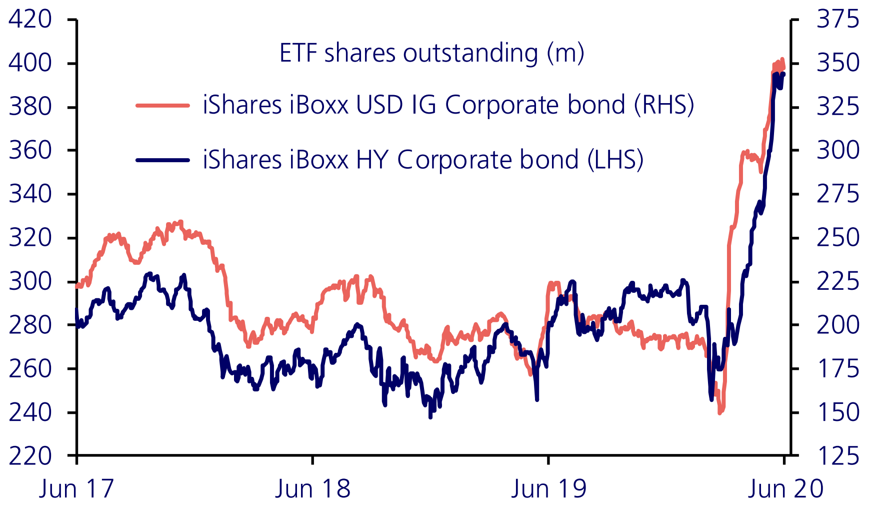
- **US retail sales rebound as lockdown measures ease**

  Pent-up demand lifts sales, particularly in the auto sector. The recovery is on track, but there is still a long way to go as retail sales are still well below the level of a year ago.

- **European banks borrow EUR 1.3tn from the ECB's TLTRO III operation, the largest amount ever**

  European banks' profitability is likely to benefit from this low cost funding with Spanish and Italian banks capitalising on the cheap loans, although fragilities still remain in the sector.

The Fed injects a credit boost into markets



Source: Bloomberg

In a significant development last week that bolstered risk assets, which had suffered sharp declines during the prior week, the Fed announced a new mode of corporate bond purchases. The Fed will now buy corporate bonds according to a broad index of corporate securities in its USD 250bn Secondary Market Corporate Credit Facility without needing certifications from companies. These certifications have been a stumbling block so far for both the USD 250bn secondary market facility and the USD 500bn primary market facility. This change unshackles the Fed from being restricted to ETF purchases in absence of certifications and significantly increases the probability that the Fed will achieve its purchase targets, which some investors had begun to doubt. Indeed, ETF inflows have ballooned since the Fed announced its purchases back in April. We think similar changes may also be made to the USD 500bn primary corporate credit program, which has not seen much action so far. Furthermore, as we had outlined in The credit cycle ends and a new one is born, since companies have raised a lot of liquidity already, some of the primary market facility's size could be reallocated to the secondary facility. The Fed has also eased the terms of its Main Street Lending Program targeted at smaller borrowers, many of which are in the high yield and leveraged loan universe. We believe these developments will further benefit credit markets, with a spillover likely into broader risk assets.

US: May retail sales soar by the biggest increase on record

Last week, the S&P 500 partially recovered from its sell-off the week before, rising 1.9%, shrugging off worries around reaccelerating infection rates in a number of US states. The Fed's announcement on credit purchases (see main section) helped to boost investor confidence, but better than expected economic data added further support. Retail sales jumped by almost 18% MoM in May after April's 15% fall. It is a promising signal that households will quickly return to spending as the economy opens up again. Nevertheless, sales are still 6% lower than a year ago and the road to recovery remains long. The manufacturing sector is showing signs of life, too, with the Philly Fed Business Outlook soaring back into positive territory in June. The housing market recovery was a bit more subdued with housing starts rising only 4.3% MoM in May after a 26.4% drop in April. However, growth in building permits in May and a substantial improvement in home builder sentiment in June point to a more substantial recovery underway.

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Eurozone: Recovery fund discussions continue, ECB faces a fresh legal complaint

While data was thin in the Eurozone last week, there were some further developments on the policy and legal front. Discussions on the EU recovery fund at Friday's virtual EU summit saw negotiation between countries over the size of the fund, the division between loans and grants, which countries would benefit the most and how this would all tie in with the EU's traditional seven-year budget deal. While there was no agreement, the fact that discussions are continuing is encouraging. We expect that progress will continue and a deal will be made within the next few months. Separately, a complaint has now been put to the German Constitutional Court (GCC) regarding the ECB's EUR 750bn PEPP that began earlier this year. This is in addition to the existing complaint regarding the ECB's original QE programme that began in 2015, on which the GCC recently ruled that the ECB had three months to justify it or the Bundesbank would have to stop participating. However, this fresh complaint regarding the PEPP is likely to take some time (probably years) before a verdict is reached.

UK: The Bank of England expands its QE programme

Despite the massive fall in economic activity caused by the lockdown, the official unemployment rate remained at 3.9% in May, the same as the month before. However, the stable headline number underestimates the true impact of the economic downturn, which can be seen in the fall in the labour market participation rate as well as in a significant reduction in total hours worked. Nevertheless, the better than expected unemployment rate also reflects the success of the government's job retention scheme. Consumer confidence and retail sales show that the economy is healing, but the way to a full recovery remains long. As expected, the Bank of England announced that it will expand its asset purchases by GBP 100bn to a target of 745bn. The BoE wants to reach that target by the end of the year, which implies that they intend to slow the pace of their asset purchases, providing a small headwind to gilts. The BoE acknowledged that GDP is likely to fall less than initially forecast, but the Bank is likely to reaccelerate its purchases should the situation deteriorate again.

Switzerland: Deflation and negative rates here to stay

The SNB kept policy unchanged last week, as expected, but cut the inflation forecast to -0.7% in 2020 and -0.2% in 2021. Given deep deflation, negative rates are set to remain in place long after the COVID-19 crisis, with implications for financial stability and the housing market. The financial stability report showed that take-up of the SNB's COVID-19 refinancing facility, under which it lends to banks at -0.75% for 100% guaranteed loans to SMEs, has underwhelmed, with only CHF 13.5bn in loans provided — well below the 40bn limit to the facility. Most of the funding was in place already by mid-April, however, and provided aid to businesses that lacked an existing relationship with a bank, so support still appears to have been timely and effective. Exports were unchanged in May after a 10% slump in April while imports surged by 13%. This confirms that while activity is resuming, conditions are fragile, and it will remain critical that support is not withdrawn prematurely.

North Asia: Focus on monetary policy

Market participants largely shrugged off tensions on the Korean peninsula and between India and China. The focus was rather on economic data and policy action. The Bank of Japan left policy rates unchanged but expanded its scope of support for corporate funding, while Taiwan's CBC refrained from cutting its policy rate as consensus had expected, painting a rather upbeat picture about the country's economy. However, it left options open for more accommodation should risks increase. China's senior government officials gathered at the Lujiazui Forum in Shanghai to discuss monetary, financial and regulatory policy issues, while the State Council urged financial institutions to use RMB 1.5tn of profits to support the economy, particularly SME's, by cutting lending rates and reducing fees. Banks were asked to cap their earnings growth below 10% YoY, a request that raised some eyebrows. On the economic data front, the outlook component in Japan's June Reuters Tankan survey improved significantly for the 400 companies that had been surveyed, even though it remains in deeply negative territory.

What to Watch

- The G3 Flash PMIs will show if global activity has continued to normalise in June.
- In the Eurozone, various business confidence surveys for June are likely to show a further bounce back in sentiment.
- We expect the Philippine's central bank, BSP, to cut its policy rate by 25bps amid the impact of the lockdown on the economy and as inflation is within its target range, while the Bank of Thailand is expected to keep its policy rate unchanged for now.
- Japan's Manufacturing PMI for June will be released tomorrow. Taiwan's industrial production statistics for May should show resilience, while Singapore's production is expected to have taken a hit in May. Finally, CPI data will be released for Tokyo, Hong Kong, Singapore and Malaysia. In China, markets will be closed on Thursday and Friday, while Hong Kong's market will be closed only on Thursday.

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