

# Covid-19: Every angle to the global response

A roundup of the main developments in the fight against the coronavirus from ING Research's global network of economists and strategists

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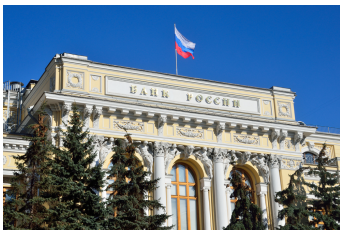


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# China: Terrible GDP contraction means a fat U recovery

China's GDP went into deep contraction in 1Q20, and signs of a recovery in activity are mixed. As long as strict social distancing measures are in place, we think China will struggle to recover quickly



## Economy contraction worse than 1967

GDP contracted 6.8% year-on-year in 1Q20, the last time we saw such a big contraction was back in 1967 when China saw the economy shrink -5.8% during the Cultural Revolution, [according to data from the World Bank](#). The contraction this time is a result of city lockdowns and strict social distancing measures but the comparison provides us with a sense of how big an impact Covid-19 has had.

## Investment was up in March it can't be described as a recovery

Fixed asset investments contracted 16.1%YoY in 1Q20 but rose 6.05%MoM in March.

According to the National Bureau of Statistics, there were many items that experienced a slower contraction in Jan-Mar compared to in Jan-Feb. That means there are signs of some growth in investment in March. But it is still too soon to gauge the effectiveness of stimulus measures on investment.

The central government is now pushing the "New infra" plan, which currently consists of 5G

infrastructure, big-data centres, AI, Industrial internet of things, ultra-high voltage connectors and e-vehicle chargers. The contents of the plan are quite fluid and more items have been added to it since January.

But we believe the speed of putting money into projects and turning this into measurable production will take much longer than it would do without social distancing in place. In short, recovery will be a long road.

## Factories were the least affected

Industrial production shrank 8.4%YoY in 1Q20 but shows signs of heading back to recovery in March as the shrinkage narrowed to 1.1%YoY during that month.

Automobiles and related parts were heavily impacted by the lockdown. Automobile production shrank 43%YoY and new energy cars fell 43.9%YoY.

This positive note was mainly a result of the need to fight against Covid-19, e.g. non-woven textiles (masks and protective wear) +6.1%YoY, medicines +4.5%YoY. Other positive notes include the push for the “New Infra” projects by the central government. Computation and telecommunication rose 9.9%YoY and robot production also increased at 12.9%YoY in March.

Exports are expected to be dismal due to the Covid-19 situation in Europe and the US. This could last until June-July.

## Retail sales were the most hit

Retail sales in March fell 15.8%YoY after falling 19.0%YoY in Jan-Feb. Retail sales show some improvement in terms of the variety of spending. It was not just food and medicine as in Jan-Feb, but also telecommunication equipment (+6.5%YoY), which is most likely purchases of smartphones.

But there was still a deep contraction in many retail sales items, e.g. clothing (-34.8%YoY), furniture (-22.7%YoY) and automobiles (-18.4%YoY).

As mentioned earlier, as long as there are strict social distancing measures, the recovery of activity will be very slow, and this will be reflected in consumption.

## Policy expectation

Monetary easing and fiscal stimulus will certainly continue.

We expect a 20bp cut in the 1Y Loan Prime Rate on 20 April. Apart from that, there will be more targeted RRR cuts, which should focus on inclusive finance so that SMEs, which are employers of many workers, can get loans from banks.

Another policy expectation is the combination of monetary and fiscal policy of government guarantee loans for SMEs if banks continue to be reluctant to lend to SMEs.

To further stabilise the jobs market, the central government will push harder on the “New infra” plan, to make sure that the local government special bonds issued so far this year at CNY1.1 trillion can be put into projects as soon as possible. But the difficulty is still that even getting enough

capital, the projects need to run smoothly without strict social distancing measures, which we don't think will be relaxed any time soon.

## Revision of GDP forecasts

We have downgraded China' GDP growth further to -3.1%YoY in 2Q20, -0.5%YoY in 3Q20 and 4.5%YoY in 4Q20. 2020 full-year growth is projected at -1.5%.

USD/CNY has been affected by the changes of cases and death tolls of Covid-19 globally. We are revising the yuan to depreciate less than in our previous forecasts to USD/CNY at 7.15, 7.0 and 6.9 by end of 2Q, 3Q and 4Q20, respectively.

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## Watch: A glimmer of hope for the oil market

Warren Patterson on what next for the oil market after the demand destruction we've seen from Covid-19 and OPEC's response



### Oil: A tiny light at the end of the tunnel

The latest OPEC deal to cut oil production was 'too little, too late', according to ING's Head of Commodity Strategy, Warren Patterson. And while he says the cuts were big, they're not necessarily enough to offset the demand destruction we're seeing from the effects of Covid-19. However, he believes there is light at the end of the tunnel for crude in the second half of the year but it depends on how quickly the world can recover from the coronavirus.

[Watch video](#)

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# The Covid-19 drop in world trade, and what's on the other side

In our baseline scenario, world trade falls 9% this year, but in a 'worst case' scenario, the fall is 34%. Maintaining global value chains is likely to become more challenging and costly as protectionism increases, but is also a way of managing risks



Source: Shutterstock

## The hit to world trade

World trade is falling sharply as Covid-19 puts investment and consumer spending on hold as well as disrupting production and credit markets. China's exports fell 6.6% year-on-year [in March](#) and may get worse in April and May. Global port throughput was down 10% on the month in [February](#), mainly due to lower activity at Chinese ports. Services trade is also showing sharp falls, with the distances travelled by air passengers falling 15% in [February](#). The goods that are still moving are facing higher frictions. Europe and the US are experiencing shortages of empty containers, having received fewer shipments from China. Ports worldwide are enforcing delays before ships from China are unloaded.

In the global financial crisis, the total fall in world trade in goods and services was roughly four times that in GDP. The collapse in trade was mostly due to falling demand for durable goods, with major purchases and investments being put off when economies slowed. This stopped the many cross-border flows of durable intermediate goods within global value chains. Supply side effects due to credit constraints for producers, and disruptions to trade finance, also played a role.

## Scenarios

World trade is likely to fall by more than GDP again in the wake of Covid-19. In our base-case scenario, countries experience a more severe contraction of economic activity than during the financial crisis. This time, supply chains may be disrupted by production outages and workforce absences, as well as the knock-on effects of lower demand for durable goods. Lockdown measures in many countries are sharply reducing services activity, including travel and tourism, but also non-traded services, so the falls in trade and GDP – while drastic – may be more evenly matched than in 2008-09.

In our base case [scenario](#), lockdown measures begin to be relaxed across all countries toward the end of this quarter. If policy measures to support business have been effective, production and investment resumes, and there is a 'U shaped' recovery. In another scenario where lockdowns resume this winter, the hit to demand lasts through 2Q 2021, and recovery to pre-crisis levels of activity takes a further year. A 'best case' scenario sees lockdown measures lifted for good by the end of this quarter, allowing activity to bounce back strongly. A 'worst case' scenario involves a deeper recession this year and recovery taking until 2023.

## Percentage annual growth in GDP and world trade under ING scenarios

	GDP		Total trade	
	2020	2021	2020	2021
<b>Base case</b>	-3.6	3.7	-9.0	9.2
<b>Winter lockdown</b>	-5.1	1.8	-15.4	5.5
<b>'Best' case</b>	-1.2	3.6	-3.1	9.1
<b>'Worst' case</b>	-11.3	1.8	-33.9	5.4

In the scenarios where the recovery is delayed until 2022 or beyond, investment is likely to suffer and with it, demand for durable goods. Trade policy may also become less supportive of globalisation, with longer term implications for trend growth in world trade. Export restrictions on medical supplies may be extended to other goods, and, once the crisis has passed, there may be a lack of political will to pursue trade liberalisation. Trade negotiations may be halted indefinitely, including EU and China efforts to stave off further increases in US import tariffs.

## Protectionism doesn't protect

Covid-19 has made it clearer than ever that global value chains make production and livelihoods in one country vulnerable to shocks in others. Increasing protectionism was already a threat to global value chains before the Covid-19 outbreak, and countries' responses to the virus have included protectionist actions. Some US-China trade war tariffs have been lifted, but only as part of the same rush to secure supplies of medical products that has seen many countries implement export [restrictions](#), which are allowed within the WTO rules.

Countries are exposed to value chains to different [degrees](#), but vulnerability follows from how readily available substitutes are – whether for an imported component or a buyer for a product. To manage the risks, firms could hold larger inventories to help them bridge disruptions to the supply of their inputs. They could also source from multiple suppliers (and sell to multiple markets), decreasing the chances of suppliers (markets) all facing shocks at the same time.



Holding more inventories and finding backup suppliers will push costs up for firms, and beyond a temporary effect from building up inventories, will not provide any boost to world trade. Trade costs will also go up if protectionism persists, whether in the form of increased frictions, export controls, or damaged relations between countries. Higher costs erode the efficiency of global value chains and with it, the benefits to consumers of international trade.

There are profound challenges ahead for global value chains and world trade as Covid-19 hits the world economy and seems likely to leave an increase in protectionism behind. The spread of the virus has made it is clearer than ever that global value chains make production and livelihoods in one country vulnerable to shocks in others. But managing these risks does not have to involve abandoning globalisation.

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Snap | 16 April 2020

## US: Labour pains continue

Jobless claims show the rate of increase in lay-offs is slowing, but they remain quite bad. Meanwhile, the manufacturing plunge adds to fears unemployment will only fall slowly



**22.034m** The number of jobs lost in the past four weeks

### Nearly all the jobs gained since the Great Financial Crisis are now lost

Jobless claims came in a touch lower than expected at 5.245 million (consensus 5.5m), but it is still a terrible outcome for those impacted. This brings the number of jobs lost over the past four weeks to just over 22 million. It is probable that some of those who have lost jobs, which we assume primarily impacts people in retail, entertainment and at bars and restaurants, have subsequently found work at grocery stores, logistics and delivery, but the overwhelming majority will not.

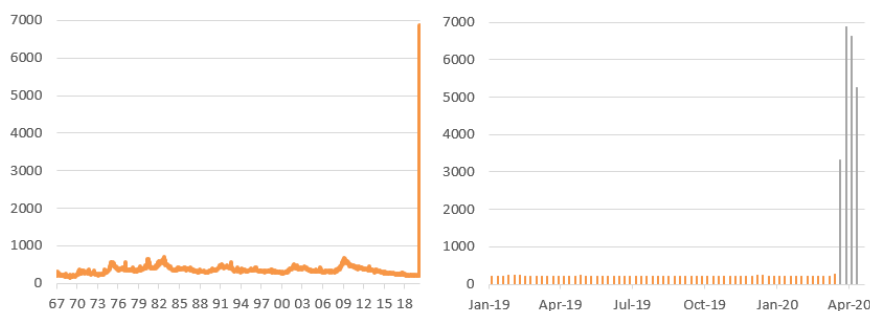
Note here that continuing claims are at just under 12 million versus around 1.7 million in February, but we need to remember that there is an extra week of lag here – the latest number is only for the week of 3 April – so ancient history, given what has been going on. Moreover, the numbers will understate the true picture given they won't include undocumented migrant labour, which will be

very vulnerable to firings in the current environment.

The week of 12 April was also when the data for the US jobs report is collected. The fact that we have seen more than 22 million people fired or furloughed since the data collection week for the March jobs report suggests that we are going to break the record of 1.959m jobs lost in September 1945. That was the result of military demobilisation in Europe in the wake of the ending of World War II to give you some context.

Given some people will have found work and the fact there will need to be some working day and seasonal adjustment to the raw figures we tentatively estimate payrolls will fall by around 15 million with the unemployment rate hitting 14%. This would mean all the jobs gained since 2009 have been lost in the best part of a month!

## Initial jobless claims (000s)

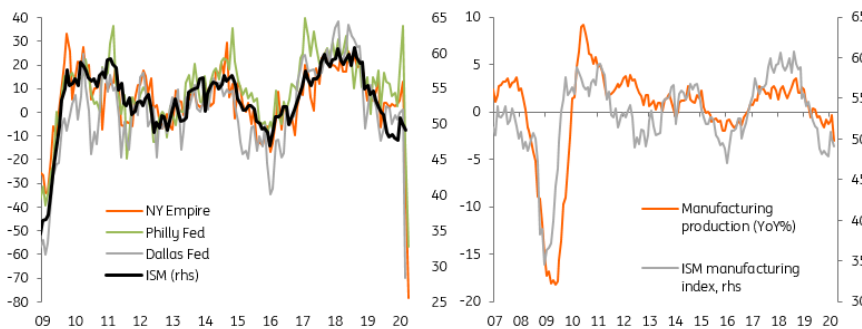


Source: Bloomberg, ING

## Manufacturing woes add to job fears

Today's Philadelphia Fed index, like yesterday's NY Empire survey has hit new record lows - the Richmond Fed manufacturing survey got there last month. As the chart below shows it is consistent with the headline ISM manufacturing index falling to the 25-35 region - it fell to 34.5 in December 2008. In turn, this suggests we could see manufacturing output fall by more than the -18% year on year seen at the depth of that crisis. The worry here is that business will end up cutting costs despite government and Federal Reserve support programmes - this is bad news for capex and also jobs meaning that awful labour market data will subside only slowly.

## Regional PMIs point to horrible ISM and manufacturing output



Source: Bloomberg, ING

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## France: Longer lockdown to slash growth and intensify calls for Eurogroup action

As strict lockdown measures are set to remain in place until 11 May in France and won't completely end after that, 2Q20 GDP could fall by 10% to 15% on the quarter. This calls for bold recovery actions. This morning, President Emmanuel Macron reiterated in a Financial Times interview that Europe needs “financial transfers and solidarity”



In France, the decision to remain under strict lockdown until 11 May will add three weeks of subdued economic activity to what was expected: with the economy currently running at around 65% of capacity, these three weeks will cut GDP by another two percentage points. While the IMF was pointing to a 7.2% GDP contraction this week for 2020, the government is now expecting -8%. Government forecasts are currently running ahead in terms of pessimism. It could be to avoid large future downward revisions, but also to warn European peers of what lies ahead (see below).

The decision to lengthen the lockdown calls for a bigger budget, which was announced this week, not least to fund the temporary unemployment scheme (a bill now expected at €24 billion or 1% of GDP). This should allow for a limited increase in the unemployment rate this year, which we think should be close to, but not much above the 10% threshold, instead of the 8.5% measured in 4Q19.

Previously announced measures were reinforced (as the compensation period has increased by

several weeks) but it also appears that France is also ready for more intervention, with a special €20 billion fund for participation in strategic companies. The word “nationalisation” has not been verbalised per se, but more intervention is clearly in the cards, which – at current market values – could come at a final limited cost once the economy recovers.

## Pressure on eurozone peers is up

Intervention is not limited to France. In his public address on Monday, President Macron said that Europe was “at a moment of refoundation”. In a [Financial Times interview this morning](#), he repeated that, “We are at a moment of truth, which is to decide whether the European Union is a political project or just a market project. I think it’s a political project. We need financial transfers and solidarity, if only so that Europe holds on”. Finance Minister Bruno Lemaire also stepped forward yesterday with proposals of new ways to share the debt burden. This all means that the pressure is still on for the next EU Council meeting next week and that the debate on debt mutualisation is far from dead.

## What about an exit ?

It is still early to talk about an exit from the current lockdown. After 11 May, some sectors will be able to increase activity again, gradually and depending on the availability of tests and masks for those who have to return to work. The intention (already under much heated debate) is to reopen schools and nurseries to “free” parents of kids and younger teens after 11 May. However, there is no plan yet for the backbone of the French hospitality industry. Bars, restaurants, cafés, hotels, cinemas, theatres, concert halls and museums will remain closed after 11 May for an indefinite period. Festivals and other events with large crowds will not be able to take place until mid-July. Finally, restrictions on long-distance travel are likely throughout summer. More details will be unveiled in early May, but it all means that the French economy could see a 10% to 15% (quarter-on-quarter non-annualised) contraction in 2Q20, a figure that certainly calls for bold recovery actions.

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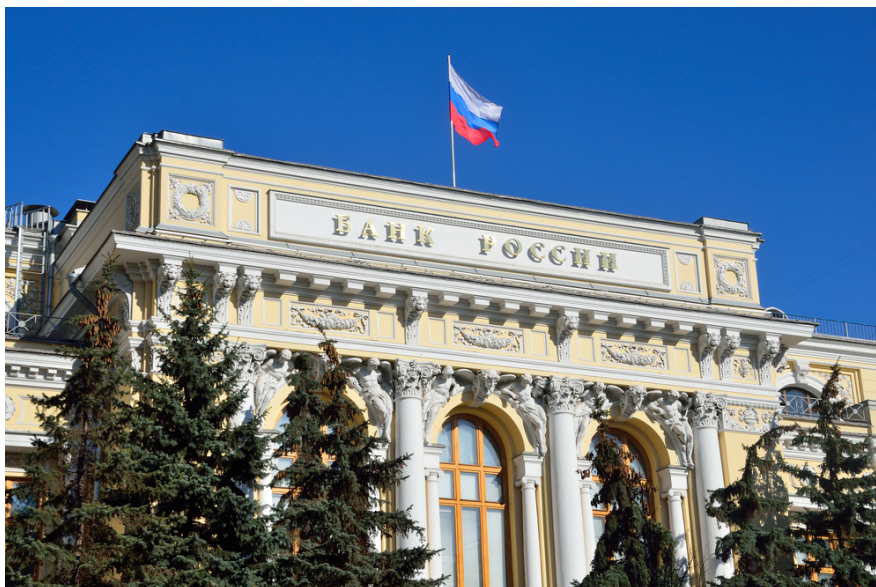
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## Bank of Russia: Rate cut inevitable

The Bank of Russia has guided for a cut in its 6.0% key rate, with a magnitude likely exceeding the standard 25 basis points. This is a reaction to more stable financial markets, a darkening outlook for local activity and so far, modest fiscal stimulus. Based on cross-country experience, we estimate the near-term downside to the key rate at 50-100bp



Central Bank of Russia, Moscow

# 5.50%

Our CBR key rate expectation for 24 April

down from previous 6.0%

### Russian central bank makes another dovish shift

The CBR made a [dovish shift](#) in its communication on 17 April, the last day before the self-imposed media blackout period ahead of the 24 April meeting, strongly suggesting that a cut is not only the primary option but that it may exceed the standard 25bp. This comes despite the acknowledgment of accelerating CPI (from 2.3% year-on-year in February to 2.9% YoY currently) and deteriorating inflationary expectations amid panic buying of some consumer

products, growing global agro prices and the recent USD/RUB depreciation. We believe this shift was triggered by a combination of factors, including:

- **Stabilisation in global markets** in recent weeks, which helped to assure a 2% recovery in USD/RUB and an almost 140bp drop in local 10-year state bond (OFZ) yields in the last 30 days. Stabilisation on the local FX market has also been assured by the CBR's FX sales amounting to \$175-200 million per day, reflecting both the fiscal rule (as the actual Urals price is below the \$42.4/bbl cutoff level) and extra sales, related to the handover of a 50% equity stake in Sberbank, Russia's largest lender, from CBR to Minfin. The deal was valued at \$26-28 billion, and the FX sales are likely to continue going forward, helping to smooth out rouble volatility.
- **Experience of other emerging market central banks** which according to the IIF, cut policy rates by 25-300bp in March-April, with the Russian central bank standing out as the only monetary authority which had refrained from a cut in the last two months.
- **Deterioration of Russian GDP growth expectations.** Russia has been in a Covid-19-related quarantine since the end of March, and the lockdown will be in place at least until the end of April. Assuming this one month of quarantine, Russian GDP could drop by 2.5% this year, but if the lockdown is extended into May, which given the progression of Covid-19 is becoming increasingly likely - then our outlook could be downgraded by another 2.5 percentage points to a total of 5%. Put simply, based on preliminary activity estimates, each month of quarantine may cost 20-30% of monthly GDP.
- **Very modest fiscal support** in the face of Covid-19 challenges. So far, the announced fiscal stimulus is 2.8% of GDP, out of which up to 1ppt represents the redistribution of previously announced spending plans and up to 0.5ppt is in state guarantees. The support is also quite targeted, focusing mainly on low income households, the unemployed, those on sick leave, and SMEs. Assuming some recovery in oil prices in 2H20, and the 1.5% GDP proceeds from the Sberbank sale are returned from the CBR to the government, the Russian budget will be in a 3.5% of GDP deficit this year, which appears controllable given Russia's 10%+ GDP liquid fiscal savings and small public debt of below 15% of GDP. It appears that the stringent fiscal approach allows, and in a way may be pushing the CBR to step up from the monetary side.

## Near-term downside for the key rate is 50-100bp, based on cross-country real rates

The scope of a potential cut remains highly uncertain, with market expectations ranging from 25 to 100bp at this point. We believe the best way of looking at the potential room for a key rate cut is by looking at real rates from a cross-country perspective.

- Based on expected Russian CPI in 12 months, which is 4-5%, according to the Bloomberg consensus range, the real key rate in Russia is currently at 1-2%.
- Based on the cross-country 12 month CPI expectations, the real rates in Russia's direct EM/commodity peers are ranging from c.-0.5% in Saudi Arabia and South Africa to c.0.5% in Brazil and Colombia, and to c.+1.0% in Malaysia and Indonesia). There are indeed more extreme cases such as Turkey (c.-2%) and Mexico (c.+3%), however we treat these as more country-specific.

Given this comparison and the CBR's historic preference to remain in the upper half of the real rate range, we estimate the near-term downside to the nominal key rate at 50-100bp. We believe that the [near-term risks to the rouble](#) and recent retail deposit outflows amounting to 0.6% of

GDP from Russian banks suggest that the CBR will still opt against moves that would be seen as too aggressive. Our base case scenario for 24 April is for a 50bp cut to 5.5%.

## Real key rate by country

	Russia	S. Arabia	Mexico	S. Africa	Malaysia	Indonesia	Thailand	Turkey	Brazil	Colombia
Current key rate (%)	6.00	1.00	6.50	4.25	2.50	4.50	0.75	9.75	3.75	3.75
Latest CPI reading (% YoY)	2.5	1.2	3.3	4.6	1.0	3.0	-0.5	11.9	3.3	3.9
CPI BBG consensus for 1Q21 (% YoY)	4.9	1.4	3.3	4.5	1.6	3.2	1.1	11.6	3.5	3.5
Expected change in CPI in 12M, pp	2.4	0.2	0.0	-0.1	0.6	0.2	1.6	-0.3	0.2	-0.4
Real key rate, % ex-ante (based on CPI expected at 1Q21)	1.1	-0.4	3.2	-0.3	0.9	1.3	-0.4	-1.9	0.3	0.3

Source: Bloomberg, ING

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Podcast | 16 April 2020

## Listen: The future of the euro project

European finance ministers have agreed on a €540 billion package of support for the eurozone, as it continues to battle the coronavirus. But the thorny issue of debt sharing remains unresolved. Can the euro project survive without it? In this podcast, ING's Carsten Brzeski, shares his thoughts



### Saving the Eurozone

European finance ministers have agreed on a joint fiscal response to the Covid-19 outbreak. But the 16 hours of negotiations exposed deep rifts between member states over the issue of coronabonds. [In this podcast](#), ING's Senior Editor Rebecca Byrne asks Carsten Brzeski, Global Head of Macro and Chief Economist of the Eurozone, whether the support provided is enough to save the euro area from fragmentation.

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# The Fed fuels fallen angels: Forecasting credit spreads on ING's Covid-19 scenarios

Late last week the US Fed went where no central bank has gone before, indicating that fallen angels (downgraded from investment grade to high yield) would be part of their purchasing plans and no less significantly indicating it will also buy High Yield ETFs



## A clear message to the ECB

Besides fuelling a relief rally in riskier parts of the credit spectrum, the message to the ECB is now clear –you're up next. Indeed, the 7 April commentary opened this window, and we expect the ECB to follow suit, but only in part. This activity has given more comfort to our view on credit spreads if the base case ING economic scenario holds. The action has reduced the tail risk of a credit crunch but not evaporated it. Any scenario whereby lockdowns continue for longer will, in our view, see a rating migration and defaults approach and subsequently exceed Global Financial Crisis numbers, and spreads and funding levels alike will spiral.

## A wise move

Late last week the Fed announced that non-financial corporates rated investment grade on 22

March 2020 will be included in their primary purchasing programme (PMCCF) and secondary market facility (Facility), as long as the rating (from at least two agencies) remains BB- or higher. Subsequently, they also indicated that they will expand their exchange-traded funds (ETF) purchasing to include not just Investment-grade corporate bond funds but also US high-yield corporate funds.

The move to some comes as no surprise given the market's discomfort in the BBB universe at large along with the higher level of leverage in the US credit markets, where the weight of the potential fallen angel universe made the issue particularly acute. The downgrade by S&P on Ford on 25 March might well have been the catalyst, as the name now benefits from the Fed's Primary Market Corporate Credit Facility and secondary facility.

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### *Buying ETFs is far more contentious*

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So, what about the European Central Bank? On 7 April the ECB, on announcing its package of temporary collateral easing measures, added in the last paragraph that it mandated Eurosystem committees to assess measures to mitigate collateral availability from rating downgrades, hence opening the door to a similar move in terms of allowing fallen angels to be part of the CSPP or PEPP environment. We believe the move by the Fed ensures that the ECB will take this course of action. However, buying ETFs is far more contentious. The ECB already buys most of the underlying bonds directly, and by including fallen angels expands that universe, making it less necessary to take the ETF route.

As a reminder, for the Fed programmes, the facility can purchase corporate bonds that at the time of purchase has a remaining maturity of less than 5 years and the Facility and PMCCF will carry limits per names (10% of the maximum of what was outstanding per issuer for the calendar year up to 22 March 2020).

We believe this is a wise move given the scenario where no less than 10% of current BBB rated debt in the US and in our estimation 7% European BBB rated debt could fall into the fallen angel bucket in the next 12 months. We must not forget about speculative-grade issuers (pre-22 March) for whom the current purchasing from the Fed and the expected purchasing from the ECB will do little in terms of their funding conundrum. They still often fall between a rock and a hard place in terms of financing possibilities as in terms of the cost of debt and the whether the market is open, they struggle but also the ECB's Corporate Sector Purchase Programme and the Fed's SMCCF are not accessible for them, similarly leveraged loan market for use of CLOs has stalled and the bank loan market will come at a steep cost. Thus, the tail risk of a full credit crunch has therefore only been reduced but has not evaporated. At the end of the day, the situation is most acute for true high yield players and apart from pricing stabilisation through ETF purchasing, it won't really improve financing opportunities.

**Fig 1 - Credit Forecasts**

<b>Euro Base Case</b>	<b>1Q20</b>	<b>2Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>FY20</b>
BBB Spreads (bp)	225	200	175	150	150
BBB Curve (bp)	-10	10	20	30	30
Supply (€bn)	113	140	90	60	403
Fallen Angel Amount (€bn)	6	11	15	13	45
<b>Euro Prolonged Lockdown</b>	<b>1Q20</b>	<b>2Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>FY20</b>
BBB Spreads (bp)	225	350	400	375	375
BBB Curve (bp)	-10	-10	10	10	15
Supply (€bn)	113	110	80	50	353
Fallen Angel Amount (€bn)	6	30	30	25	91
<b>USD Base Case</b>	<b>1Q20</b>	<b>2Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>FY20</b>
BBB Spreads (bp)	450	350	300	250	250
BBB Curve (bp)	-15	80	140	160	160
Supply (€bn)	293	360	80	70	803
Fallen Angel Amount (€bn)	18	22	35	30	105
<b>USD Prolonged Lockdown</b>	<b>1Q20</b>	<b>2Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>FY20</b>
BBB Spreads (bp)	450	600	700	650	650
BBB Curve (bp)	-15	20	40	50	50
Supply (€bn)	293	220	100	80	693
Fallen Angel Amount (€bn)	18	47	80	75	220

Source: ING

From a broader perspective, credit forecasts based on ING's base case scenario and the scenario of a prolonged downturn, for the European and US markets we identify some potential forecasts for the upcoming year. At present, credit markets are showing various positive nodes, and on top of mutual fund inflows in Euro and US Investment Grade and High Yield, we are also seeing a tightening in spreads, particularly in QE eligible debt. This is occurring despite the substantial supply coming to the market, as many corporates are front-loading their refinancing needs and shoring up liquidity.

As per the forecasts in Figure 1, we estimate spread levels of BBB non-financials, the curve shape on BBB credit, the supply levels for investment-grade corporates and finally the level of fallen angels from investment grade to high yield.

**Fig 2 - ING GDP Scenarios (%)**

<b>EUR</b>	<b>1Q20</b>	<b>2Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>FY20</b>	<b>1Q21</b>	<b>2Q21</b>	<b>3Q21</b>	<b>4Q21</b>	<b>FY21</b>
Base Case	-15.2	-16	13	7.5	-5	2.5	2	2	2	3.2
Winter lockdowns	-15.2	-16	13	-6	-5.8	1	5.5	2.5	2.5	0.5
Best Case	-15.2	-4.5	10	4	-3.2	2.5	2	2	2	3.1
Worst Case	-15.2	-50	-8	0	-16.1	4	30	20	10	3.3
<b>USD</b>	<b>1Q20</b>	<b>2Q20</b>	<b>3Q20</b>	<b>4Q20</b>	<b>FY20</b>	<b>1Q21</b>	<b>2Q21</b>	<b>3Q21</b>	<b>4Q21</b>	<b>FY21</b>
Base Case	-6	-40	22	10	-7	5	4	3.5	3	3.4
Winter lockdowns	-6	-40	22	-9.5	-8.1	1	9	13.5	9	1.2
Best Case	-6	-24	15	6.5	-3.6	4.5	3	3	2.5	3.4
Worst Case	-6	-55	-10	0	-14.9	3	23	21	9	1.2

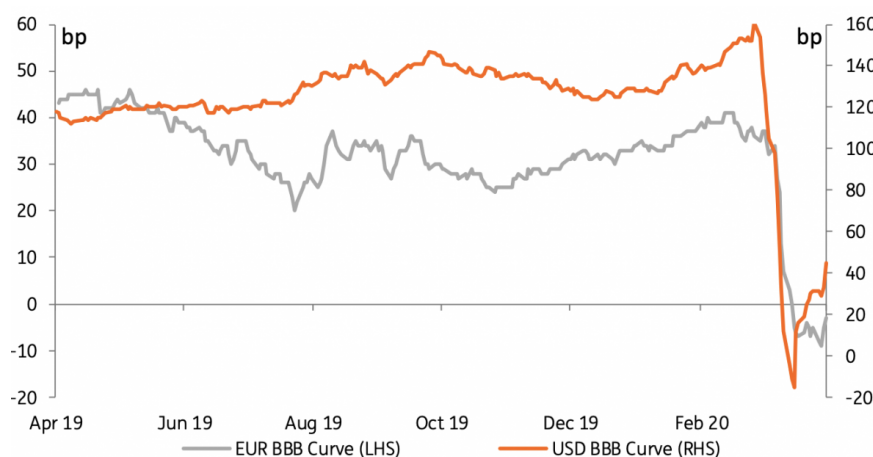
Source: ING

For reference, Figure 2 illustrates ING GDP scenarios. As mentioned, we use the base case scenario

and a prolonged downturn, which falls between the worst-case scenario and the winter lockdown scenario, as a proxy. In the base case scenario, we expect default rates to fall between 7% to 10%. However, in the case of a prolonged lockdown we expect default rates to reach up to the levels of the 2008 Global Financial Crisis of around 13%.

Using BBB non-financial spreads, we identify the wide spread of 225bp in 1Q in Euro and 450bp in 1Q in USD. We expect them to gradually tighten over the coming year under the base case and with that we expect the curve to steepen considerably from the inverted points of 1Q. As illustrated in Figure 3, both Euro and USD had inverted curves, however, with the considerable short end financing stimulus we will likely see a sharp steepening of the curves.

**Fig 3 - BBB Curves in Euro and USD**



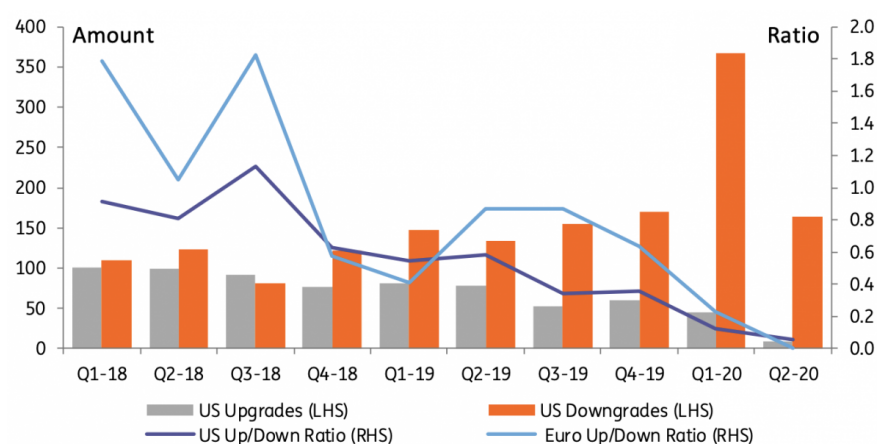
Source: ING, ICE, Curve based on 11yr duration minus 4yr duration

## Another record-breaking year

Initially, we had forecast a 2020 corporate supply of €340bn, however, now we estimate around the €400bn to mark another record-breaking year. This is despite the expectation of considerably less reverse Yankee supply. The majority of the supply has and will come in the first half of the year as many corporates are refinancing and front loading. The significant liquidity financing paired with the reduced earnings will be detrimental to leverage ratios, which will, in turn, lead to a higher level of downgrades.

We believe many corporates will happily take the risk of a downgrade in return for shoring up liquidity to ensure long-term survival. Therefore, we forecast fallen angels to increase, and be about 10% of the BBB universe. The same story can be said for the Base Case in the US. There was already some reason for concern in the US high yield and leveraged loan space, which is certainly evident now in times of crisis because the US entered this crisis with significantly more leverage. Additionally, there has already been a significant rise in downgrades over the past two years. Therefore, we are likely to see a higher negative rating migration, and continued downgrade dominance.

**Fig 4 - US Rating Migrations and US & Europe Up/Down ratio**



Source: ING, Bloomberg

In the alternative scenario of a prolonged lockdown, which will result in a 2008 Global Financial Crisis style default rates (or higher) and increased spreads, up to 400bp in Euro and 700bp in USD. If so, we expect fallen angels to be about 20% of the BBB universe in both Euro and USD, as there will be considerably more downgrades across the board. Rating transition is the name of the game with manageable default rates under the base case; prolonged lockdowns change that game from a focus on transition to widespread defaults.

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