

Covid-19: The shocking numbers are in

This week's global growth numbers show the impact of the coronavirus crisis in the starkest way. We've looked at the figures and are trying to forecast what a recovery will look like. The Fed didn't move on Wednesday; we're expecting a policy shift in September. And, as our podcast highlights, negative rates are still on the table

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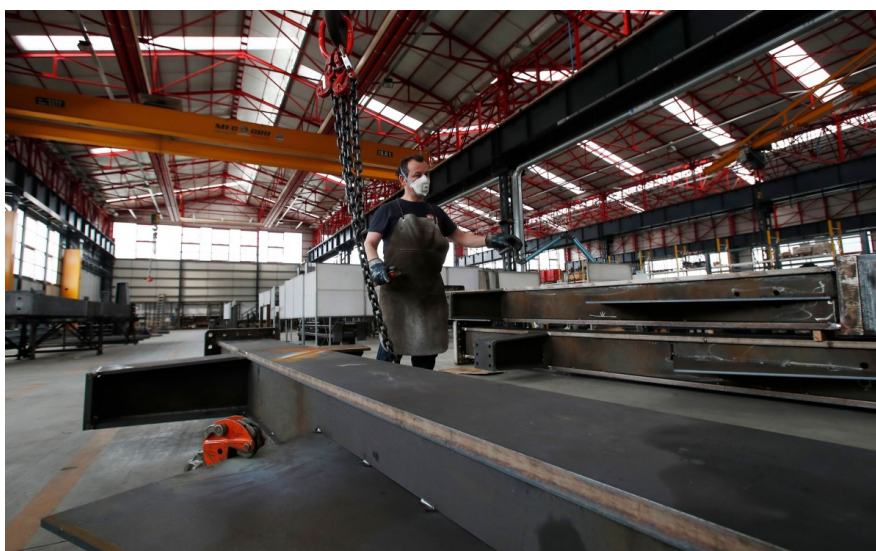
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The largest quarterly decline in Eurozone GDP on record

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A man wears a mask at a steel factory in Milan

-12.1% Eurozone GDP
Second quarter

Some records are never to be beaten. Think of Alan Shearer's Premier League goals, Wilt Chamberlain's 100 point basketball game, Eddy Merckx's victories in cycling. The second quarter eurozone GDP figure should probably go on that list as well; it would be great if it were never to be beaten.

The -12.1% Q-o-Q growth rate is the worst ever recorded and a pretty difficult one to interpret. It is a shocking drop, but completely understandable as the economy was shut for a considerable period during the quarter. It, therefore, doesn't tell us all that much about the general state of the economy, which is usually why one would look at GDP figures in the first place. Still, the deeper the lockdown, the higher the chance of more significant lasting damage to the economy and therefore

the extent of the decline is still relevant.

That decline has been relatively similar between countries with Germany, France and Italy all showing between 10 and 14% GDP declines. There is one worrying outlier though, which is Spain. Spain lagged Italy and France in its recovery of nowcast data during 2Q, but the difference is larger than expected and with reopening measures being locally reversed for 3Q, Spain looks set for a prolonged slump. Outside of Spain, the divergence between countries has been smaller than expected. This is a cautious positive sign for further Eurozone divergence in the recovery phase.

The hard part of this recovery is set to start about now

Looking forward, this recession is not like any other precisely because it has been caused by a lockdown of the economy. Judging from nowcast data, the eurozone economy started to grow again around the end of April, early May. Monthly figures have suggested a considerable bounce back in retail sales and industrial production, but that is largely just a mechanical improvement thanks to the reopening of shops and factories.

The hard part of this recovery is set to start about now. First of all, slightly higher trending new Covid-19 cases increase the risk of reversed reopenings, and we're already seeing local signs of that. Secondly, from this point on, cautious increases in unemployment and bankruptcies and weak investment will bring to light more characteristics of a general economic slump. These factors are likely to drag on for some time, making a swift recovery to pre-corona levels of GDP out of the question.

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Snap | 30 July 2020

Germany: The crisis finally has a number

The worst ever quarterly performance of the German economy finally has a number -10.1%. This is the size of the contraction in the second quarter



Source: Shutterstock

The numbers

Finally, it's out. The German economy recorded the worst quarterly performance ever, dropping by 10.1% quarter-on-quarter. The last record holder was the first quarter of 2009, with a drop of 4.7% QoQ. On the year, the German economy contracted by 11.7%. Over the last three quarters, the economy lost more than 12%.

For the statistical aficionados, with today's data release, Germany finally caught up with the rest of Europe, at least when it comes to the timing of GDP data releases. Up to now, the German statistical office took some 45 days after the end of the quarter to come up with a first estimate for GDP growth. This is much later than most other European countries. Today's release is the first one to come out after 30 days. A very timely statistical innovation.

Still, as the Covid-19 crisis is so unprecedented, even the earlier release is nothing more than a look in the rear-view mirror. This picture shows the deepest but also the shortest recession ever. All monthly indicators since May have already pointed to a strong rebound of economic activity in the course of what has been the worst quarterly performance ever.

What's next

Looking ahead, we still expect a strong rebound of the entire economy in the third quarter. The worst quarter ever could be followed by the best quarter ever. However, the rebound will be uneven. The domestic economy should benefit from fiscal stimulus in general and the VAT reduction in particular, thriving services and construction, as well as summer vacations at home instead of abroad. At the same time, however, the manufacturing sector will take much longer to recover, given the disruption of global supply chains, economic weakness in major trading partners and continuing structural change, which had already hampered production prior to Covid-19.

A good reminder that the recovery in the second half of the year is anything but a sure shot, notwithstanding a second wave, is the labour market. Formerly known as the stronghold of the economy, the labour market has become a good indicator of the economic damage. Unemployment in July was almost 28% higher than in July 2019. Since March, more than 500,000 people have lost their jobs. The only good news is that the July increase was mainly driven by seasonal factors and was no longer Covid-related. In addition, some 6.7 million employees are currently working in short-time work schemes.

All in all, today's GDP data marks the trough of the crisis. As with any horrible ride, there is a strong feeling of relief that the worst is over. Compared with the last few months, the coming weeks could actually feel like a joy ride. However, this crisis will have longer-term implications and potentially some surprises up its sleeve. It's going to be a long ride.

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US GDP: Hopes for a 'V' are misplaced

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-32.9% Annualised 2Q 2020 GDP contraction

The largest decline on record

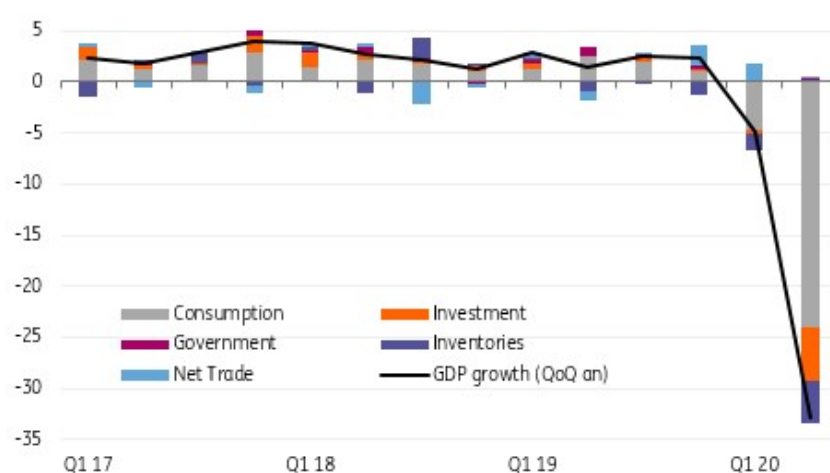
US GDP declined at an annualised rate of 32.9% in 2Q 2020, not quite as bad as feared (consensus -34.5%), but this is still the biggest decline on record. For those who prefer non-annualised numbers, it was a 9.5% quarter-on-quarter drop. The details show that consumer spending was the main drag, falling 34.6% annualised, while fixed investment fell by 29.9%, led by a 38.7% plunge in residential investment. Inventory drawdowns meant this component subtracted 4 percentage points from headline GDP. On the positive side, government spending rose 2.7%,

while net exports were a net positive contributor, adding a rather paltry 0.7 percentage points to headline GDP.

When combined with the 5% annualised fall in 1Q GDP it means the US economy contracted 10.6% peak-to-trough in the first half of the year. The true decline between mid-March and the end of April when the lockdowns were at their most intense was likely much greater, possibly even double the 10.6% figure, given evidence of a sharp bounce-back in consumer activity through May and June.

By way of international comparison, the 10.6% peak-to-trough fall in US GDP since 4Q 2019 is less bad than the European numbers we had earlier in the day. Germany saw an 11.9% decline in output with Austria experiencing a 12.8% fall and Belgium a 15.3% decline over the same period.

Contributions to US annualised GDP growth



Source: Macrobond, ING

Tougher times ahead

So we now know how deep the deepest ever contraction in US economic activity was, but this is old news given financial markets are priced for a very vigorous recovery. However, Covid-19 is far from beaten and while there is optimism about a vaccine, the timing and its efficacy are still unknown.

Meanwhile, a renewed spike in cases is forcing state Governors to backtrack on reopening plans, which is closing businesses, with workers losing their jobs. At the same time, the US\$600 a week unemployment benefit boost to 30 million plus claimants has effectively ended and will likely be replaced with something much smaller in size.

With virus fears on the rise, jobs being lost and incomes squeezed, we feel the recovery could be much bumpier than markets seemingly do, and think we are in for some data disappointment over the next couple of months – starting with next week’s payrolls number.

Job worries mount

With regards to the labour market, the other major report today showed initial jobless claims rose for the second week in a row to 1.434 million while continuing jobless claims rose by 900k. The total number of US unemployment benefit claimants did drop to 30.2mn from 31.8mn, but we

must remember this is for the week of 11 July as it lags two weeks behind initial claims (25 July) and one week behind continuing claims (18 July). Given both the latter two are on the rise again, we should expect total unemployment benefit claimants to rise next Thursday.

This reinforces our nervousness that the Covid 19 fear factor, states reversing course on reopenings (leading to job losses) and the likelihood of a significant cut to the level of unemployment benefits means that the upcoming data flow may not point to as vigorous recovery as markets are pricing.

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Article | 29 July 2020

Federal Reserve: Dovish dose of reality

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Source: Shutterstock

Fed funds target rate stays at 0-0.25%, QE stance unchanged

With markets functioning well, bond yields at such low levels, the Fed yesterday extending emergency lending programmes and the focus currently on another round of fiscal stimulus, we weren't going to see a major policy move today. Officials unanimously decided to leave the Fed funds target rate unchanged at 0-0.25% with no change to their quantitative easing stance, which has seen Treasury and mortgage-backed security purchases slow sharply since the peak of the crisis in March. The only other announcement was an extension of dollar repo and swap lines through to 31 March in another sign it is looking to ensure market functioning continues without stress.

The accompanying statement repeats the line that the Fed remains committed to keeping the Fed funds rate at the 0-0.25% level "until it is confident that the economy has weathered recent events and is on track to achieve our maximum-employment and price-stability goals". Given the Fed's dot diagram from June, which showed just two FOMC members expecting the Fed to announce any increase in the policy rate before the end of 2022, there is little need to be any more explicit with their policy guidance at this stage.

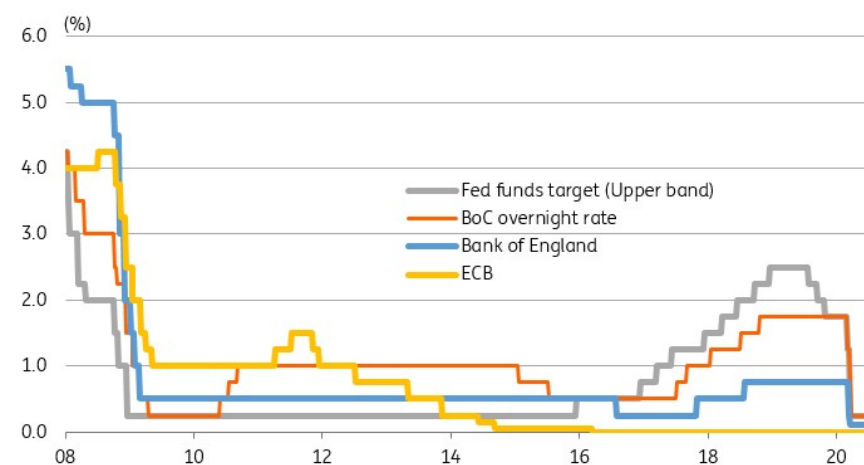
The Fed's dose of realism

The only major statement change is that at the beginning of the second paragraph it adds an explicit warning that “the path of the economy will depend significantly on the course of the virus”. It seems to be yet another effort to try to provide a dose of realism in contrast to what appears to be equity market optimism that recovery is plain sailing from here. In the press conference, Fed Chair Jay Powell expressed the same view as at last month's testimony to Congress that “until the public is confident that the disease is contained, a full recovery is unlikely”.

We agree completely. Covid-19 is far from beaten and while there is optimism about a vaccine that can allow a return to “normality”, the timing and its efficacy are still unknown. Meanwhile, a renewed spike in cases is forcing state Governors to backtrack on reopening plans, which is shuttering businesses with workers losing their jobs. At the same time the US\$600 a week benefit boost to 31.8 million claimants has effectively ended and will be replaced with something much smaller in size. With virus fears on the rise, jobs being lost and incomes being squeezed, we feel the recovery could be much bumpier than what is currently priced.

In this regard Fed Chair Powell emphasised how "critical" fiscal support has been to the recovery so far in a plea for an agreement between the Republicans and Democrats on another fiscal package. Pretty obviously, interest rates are not going anywhere for a very long time and the bond markets and dollar are reflecting this.

Central bank policy rates



Source: Macrobond, ING

A change of strategy is coming...

They also indicated that markets should prepare for a potential change in strategy "in the near future" regarding the way they ensure their dual goal of price stability and maximum employment. It seems probable that the Fed's long running review of its policy setting framework will be announced in September and it will involve a shift away from a policy of pre-emptively raising interest rates before inflation reaches the 2% target.

Instead, they are seemingly moving towards a policy of targeting 2% inflation over a period of time – thereby tolerating bouts of above 2% inflation to make up for long periods of sub-target inflation. This would clearly imply looser monetary policy for longer and help reinforce the message from

the dot diagram that a rate hike remains at least another two and a half years away.

Additional policy options downplayed... for now...

Financial markets continue to price in the possibility of negative interest rates, but officials have been dismissive of this and within the press conference Jay Powell again hinted they are not an attractive option. For example, there is little evidence to suggest it has boosted inflation in the eurozone or Japan while the Fed is of the view that such a move “could have more significant adverse effects on market functioning and financial stability here than abroad”. It also acts as a disincentive for businesses to maintain cash buffers to deal with future financial stress. Instead, the negative interest rate pricing behaviour is more likely to be some traders hedging positions rather than a conviction the Fed will take this step.

Another option that continues to be discussed as a potential future policy tool is yield curve control – using QE to target specific yields to prevent borrowing costs rising too far too quickly. However, with the US 10Y Treasury yielding less than 60 basis points and the 30Y a mere 1.25% there is no pressing need to do anything. If yields start to rise on economic optimism and the perception that inflation is rising, the Fed is unlikely to stand meaningfully in the way. However, if it is more a fear of a demand/supply mismatch, as Treasury issuance rises to fund a fiscal deficit we think could hit 20% of GDP this year, then they will be far more willing to prevent rising borrowing costs from threatening the recovery.

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Listen: Stocks vs bonds - who's right?

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The Federal Reserve left monetary policy on hold this week as expected but said the economic outlook is "extraordinarily uncertain," in what looked to be a shot across the bow to the ebullient stock market. The optimism priced into stocks stands in stark contrast to the much more negative sentiment reflected in the bond market, where Treasury yields are close to record lows. [In this podcast](#), Padhraic Garvey, ING's Regional Head of Research in the Americas, tells Senior Editor Rebecca Byrne which market has got it right and what more the Fed could do to support the recovery, following the sharpest drop in US GDP on record in the second quarter.

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Article | 30 July 2020

Record highs for gold, but where next?

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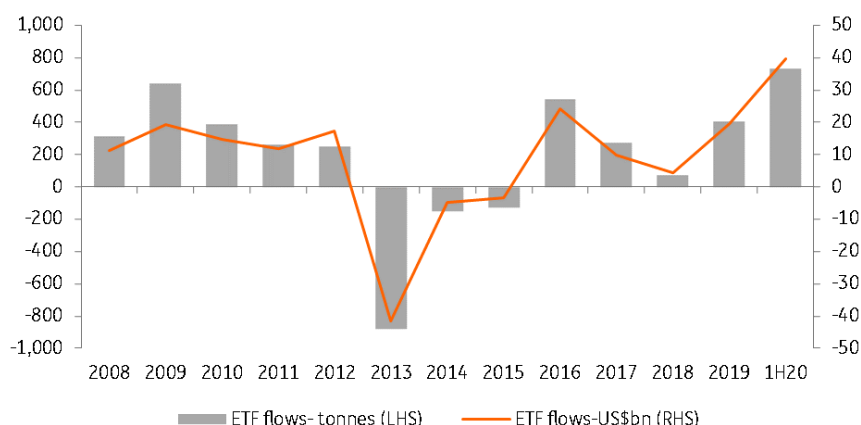
Saf haven appeal

Given the current environment, and the uncertainty over the path towards recovery following the Covid-19 outbreak, we have seen significant inflows into gold ETFs over the course of the year. Meanwhile a recent ratcheting up in tensions between the US and China continues to support these inflows.

World Gold Council (WGC) data shows that ETF inflows over the first half of this year totalled 734t, a record increase, and in fact exceeds the annual record of 646t seen in 2009. This buying into gold ETFs appears to have only continued over the course of July, with Bloomberg data showing that total known holdings over the month increased by around another 4moz or basically 120t.

As golds record prices grab headlines, we wouldn't be surprised to see some further momentum buying from retail investors, providing some additional upside to the market.

Gold ETF inflows hit record levels



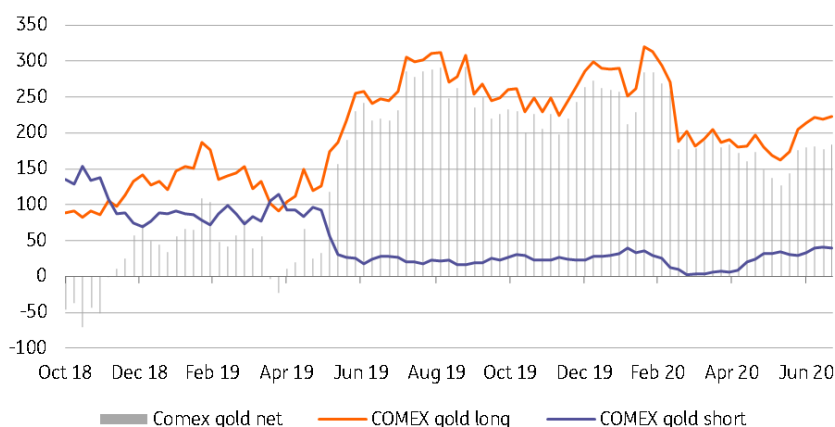
Source: WGC, ING Research

Speculators yet to jump fully onboard

Interestingly, speculators have not been as active in COMEX gold futures, with the speculative net long position still some distance away from the record levels seen over the course of last year. This suggests, particularly in the current environment, that speculators have quite some room to increase buying in gold futures, and in doing so providing further upside for gold prices. The speculative net long peaked at around 292k lots in September last year, whilst at the moment, they are holding a position of around 184k lots. This data is lagged, and so the actual current position is likely somewhat higher given the more the recent rally we have seen in the market

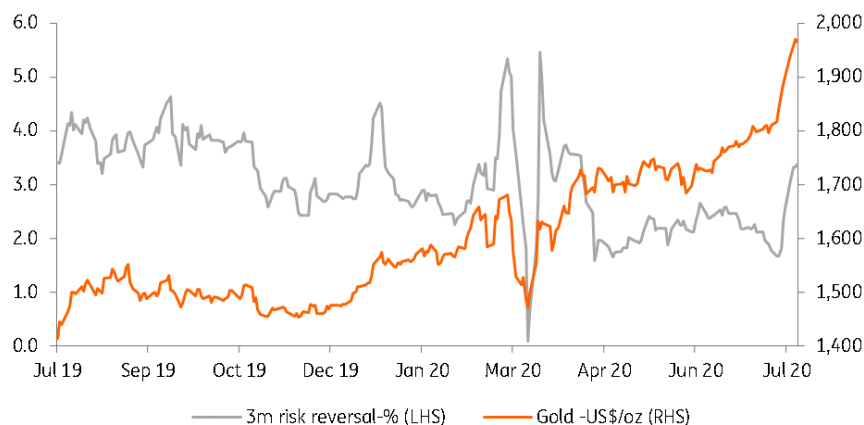
Meanwhile, if we look at the 3-month risk reversal for gold, it suggests that the demand for call options continues to outweigh the demand for put options, and has in fact picked up in recent days, with the rally in gold, suggesting that investors are positioning for further upside in gold prices.

Comex gold managed money position (000 lots)



Source: CFTC, ING Research

Gold 3 month 25 delta risk reversal (25 delta calls minus 25 delta puts)



Source: Bloomberg, ING Research

USD weakness

The USD has not had the strongest relationship with gold for much of the year, with both gold and the USD serving as a haven over parts of the year so far.

However, the USD weakness over the last month or so has been another bullish factor, with the inverse correlation between the two having strengthened.

Our house view on the USD is for more weakness over the remainder of the year, and so this is one factor which shouldn't provide too much resistance to potentially higher prices.

Central bank easing

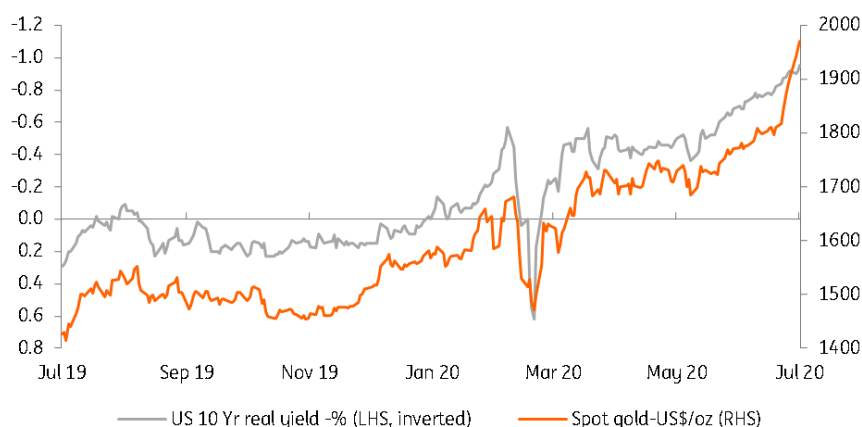
Globally, central banks have eased this year, lowering policy rates in an attempt to help weather the impact from Covid-19. It also does seem in the absence of a pickup in the recovery, the environment of zero to near-zero policy rates will continue for the foreseeable future.

This, along with quantitative easing, has seen longer-term yields coming under significant pressure, with the 10 year US treasury yield remaining below 60bps, having entered the year at around 190bps. Given that QE is likely to continue for some time, yields are likely to remain under pressure. Meanwhile, real yields, which factor in inflation, are firmly in negative territory, increasing the attractiveness of non-yielding assets, such as gold.

Meanwhile, money supply has grown at unprecedented levels over the last few months. US Fed data shows that over June, M2 money supply grew by 22.9% YoY, this far exceeds the 10% YoY growth that we saw over stages of 2011 when spot gold hit the previous record high.

In the Eurozone, we have also seen significant growth in money supply, with M2 supply growing by 9.1% YoY in May, levels last seen in 2008.

US real yields vs. gold



Source: FRED St Louis Fed, Bloomberg, ING Research

US M2 money supply growth (% YoY)



Source: US Fed, ING Research

Inflation expectations

Growing money supply and significant stimulus from governments logically leads to the view that we will see a pick-up in inflation moving forward.

While we are likely to see some level of inflation as we move through the recovery, significant levels of inflation are not a given. Whilst money supply has grown substantially thanks to QE, the velocity of money has slowed significantly. Latest data from the St Louis Fed through until the end of 1Q20 shows money velocity is at the lowest levels going as far back as 1960, and given that 2Q20 was the peak of lockdowns, it's likely that this has only fallen further in recent months.

However regardless of whether we see a significant rise in inflation or not, there clearly is a large portion of the market who holds the view that inflation will pick up, and as a result, are looking at gold as a long term hedge.

Quarterly velocity of US M2 money stock



Source: FRED St Louis Fed, ING Research

Physical demand remains weak

Latest numbers from the WGC show that global gold demand over 1H20 was down 6% YoY, whilst jewellery demand over the same period was down 46% YoY. Gold demand from the two largest consumers, India and China has been weak as a result of Covid-19 lockdowns. China's jewellery consumption over 1H20 was down 52% YoY to total a little over 152t, the lowest demand number since 1H07. Meanwhile, for India, jewellery consumption totalled just 117.8t, down 60% YoY, and an all-time low according to WGC data.

The stronger prices we are now seeing will also do little to support demand in the months ahead. But as we know, it really is financial flows which drive the market but continued weak physical demand can always start to drag on sentiment, particularly if gold-backed ETFs buying starts to slow in the months ahead.

What are the downside risks?

Whilst we believe there is further upside to the market, there are a number of risks which could stand in the way of this.

Firstly, a swift rolling out of a Covid-19 vaccine, which sees economies around the world re-opening at a quicker pace, and returning to a form of normality, would likely provide a boost to risk assets, and as a result, weigh on havens, such as gold.

Secondly, a swift turnaround in the USD would likely weigh on gold prices.

Thirdly, as we hit record levels, investors will become increasingly tempted to take profits, which could not only cap the market but possibly put downward pressure on it. The market for the moment is clearly in overbought territory, given the scale of the move we have seen recently.

Finally, while a renewed sell-off in risk assets should provide upside to gold, there is the potential that we see a repeat of March, where a selloff in other asset classes, saw investors liquidating gold positions in order to meet margin calls.

What does this all mean for price?

Clearly the bulk of drivers are telling us that there is further upside to the market, and we believe it is only a matter of time before the market breaks through the US\$2,000/oz level.

We expect prices to face some resistance as it approaches this level like we saw earlier this week. Meanwhile, by year-end we expect prices to trade up towards US\$2,100/oz.

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Article | 28 July 2020

How green is the EU budget and recovery deal?

Climate expenditures have been increased and this gives a clear signal to the private sector: the green transition is here to stay. It remains to be seen,...



There is a deal

After long and difficult negotiations, EU leaders [secured a deal](#) on the multi-annual budget and recovery plan. The multiannual budget is worth €1.074 trillion for 2021-2027, while the recovery fund, the Next Generation EU, remained at €750 billion (in 2018 prices) for 2021-2024.

The deal is, however, not completely final, as the European parliament has to approve the multiannual budget. Some members of parliament, such as Manfred Weber, the leader of the centre-right People's party, already said the deal lacks ambition and does not deliver on its priorities. Negotiations will be held over the summer.

As for the Next Generation EU, parliament has no veto but some Members of Parliament have demanded a role in the governance of it. This could be seen as the price for approving the budget deal.

The final deal should generate more green expenditures than the initial proposal and previous budgets

The main sticking point in the negotiations was the proposal for the EU to borrow money directly on financial markets which would then be handed to member states. Climate action was not one of the more controversial themes. Compared to the European Commission's proposal, some green programmes were reduced, but the money that should flow to the green transition has actually increased.

A simple calculation shows that the final deal should generate more green expenditure than the proposal from the European Commission. In the proposal, the spending target for climate action was 25%. In the final deal, this rose to at least 30%. So the final deal should generate about €547 billion of green expenditure (30% of €1.824), while in the proposal this was *only* €463 billion (25% of €1.850). This implies €85 billion of extra green expenditure.

In the new budget and recovery plan, spending on green projects is three times higher than it was under the previous multiannual budget (2014-2020). The EU planned to spend 20% of its last budget on green expenditures, or about €182 billion (20% of €908 billion) and according to the Commission, it is on track to reach 19.7% of that target.

A measurement issue

There is, however, [evidence](#) that the existing methodology to track climate spending overstates it. In particular, spending related to the Common Agricultural Programme. But the Commission is aware of this and has pledged to develop an effective methodology for monitoring climate spending and its performance. They will also report on climate expenditures on an annual basis.

As the climate target is now much higher than before and the measurement should also be more stringent, reaching the target will be difficult. It remains to be seen exactly how Europe will reach this objective.

Private sector investment is crucial

Currently, the EU wants to reduce greenhouse gas emissions by 40% by 2030 compared to 1990 levels. And to reach this target, there is a lot of investment needed. In the green deal, published at the end of 2019, the European Commission assumed there was an investment gap of €260 billion per year by 2030. Government action alone is therefore not enough and attracting the private sector is crucial.

Moreover, the target of a 40% reduction is likely to increase. President Ursula von der Leyen already said she wanted to raise it to 50%-55%, while German Chancellor Angela Merkel has stated she wants to build a consensus on this target revision during the German EU presidency. Increasing the target obviously implies that the investment gap is even larger than earlier estimates.

Compared to the proposal, we see two opposing developments in the final deal related to attracting private funds. On the one hand, the InvestEU programme gets less funding in the final deal (from €30.3 billion in the proposal to €5.6 billion in the final deal). As the InvestEU programme is designed to attract private money, this is not good news for the green agenda.

On the other hand, the final agreement states that the European Investment Bank (EIB) should

have enough capital to implement EU policies. There will be a review of the capital adequacy of the EIB and on how the EIB can support the digitalisation and the fight against climate change. The review should be completed by the end of 2020. The higher capital would, in turn, allow for more risk taking and for more crowding in of private money.

Other tools

Apart from money that flows into green projects, taxes can also be used to further the green agenda. The final deal makes plans to introduce new taxes at the EU level more concrete and some of them will indeed push companies to pursue less carbon intensive production processes. The Commission will work on a revised proposal on the Emission Trading Scheme, possibly extending to aviation and maritime. The proposal on a carbon border adjustment mechanism should be made public in the first half of 2021.

Tax matters, however, need [unanimous approval](#) and so the actual implementation remains uncertain although some leaders, such as the French Finance Minister Bruno Le Maire, are openly supporting a shift towards [qualified majority](#).

Conclusion

The Covid-19 crisis triggered a number of initiatives to kickstart and support the economic recovery. On top of this goal, we continue to see a willingness to support the green transition in Europe. Indeed, the European Council's deal targets a larger amount for green projects compared to the proposal of the European Commission and larger than the previous multiannual budgets. On top of that, Europe is also pursuing new taxes at the European level that would adjust the incentives of companies and consumers towards greener decisions.

In order to reach the European emissions reduction target, the proposed public expenditure is, however, not enough. There remains a lot of uncertainty around how much private investment can be attracted due to the EU initiatives. Developments surrounding the European Investment Bank will play a crucial role in this.

European oil and gas majors: The road to a green business model

European energy companies have announced new strategies which include a shift towards greener business models. In this report, we look at some of the...



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