

## Covid-19: What you need to know

It's been another week of dreadful economic numbers, but as far as Covid-19 is concerned, there's hope things are slowly improving. Here are the main stories from ING Economics from the past seven days

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## Watch: Which market is getting it right?

Different markets are telling us different things about how they see the coronavirus recovery shaping up. So who's right?



### Watch: Which market is getting it right?

Different markets are telling us different things about how they see the recovery from the coronavirus crisis panning out. US Treasuries are performing very well and are priced for a long slowdown. Equity and credit markets suggest that we could be in for a swifter bounceback. The story from currency markets is 'watch out'! So who's got it right? ING's Chris Turner has been looking at the numbers.

[Watch video](#)

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Article | 13 May 2020

# Lockdowns lifted, what does this mean for the eurozone economy?

While economic data will continue to look very bleak for some time, make no mistake the bottom of economic activity is already behind us, bar any new lockdown measures



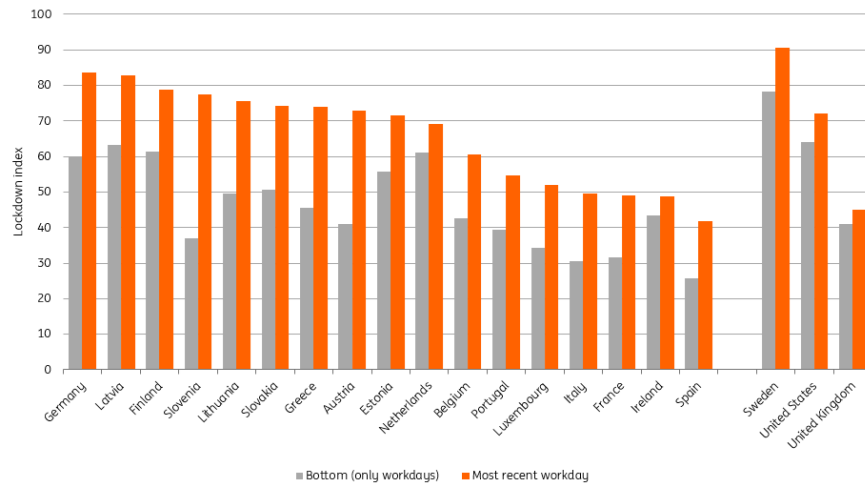
## Lockdowns are gradually lifted and activity is increasing

Across the eurozone, lockdowns are now being gradually lifted as new coronavirus cases have been retreating in recent weeks. The easing of measures started in Austria and briefly afterwards in Germany, and has been quickly following by other countries. Even in the European countries most severely affected by Covid-19, like Italy and Spain, measures have now been eased, marking the start to a slow return to normalcy in daily life. We use our mobility index based on the Google COVID-19 Community Mobility Reports to track activity at retail stores, grocery shops and pharmacies and workplaces, to get an indication of the impact of the restrictive measures on the economy. These indexes indeed show that the lifting of measures has resulted in more activity over recent weeks, suggesting that the bottom in economic activity is already behind us, if lockdowns do not return.

The eurozone countries now closest to “normal” mobility levels are Germany at 84% of January levels, Latvia at 82% and Finland at 78%. Austria, Greece, Slovenia, Slovakia and the other Baltic countries have seen their activity levels return to more than 70% of their respective January levels. The Netherlands was among the countries with the highest mobility levels during lockdown, but

has only recovered mildly in recent weeks to 70% of normal activity. Spain, France and Italy are still below 50%.

## The worst of the lockdown is already behind us



Source: ING Research, Google COVID-19 Community Mobility Reports

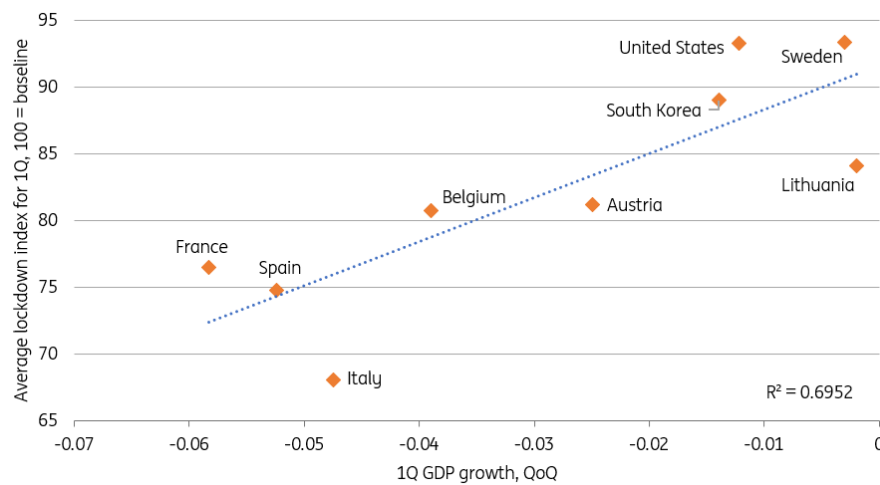
*Note: index of activity since 15 Feb for retail & recreation, groceries & pharmacies and workplaces using Google COVID-19 Community Mobility Reports with data through 2 May. 100=baseline of activity between 3 Jan and 9 Feb.*

## So what can we expect for 1Q and 2Q GDP growth in different countries?

While there are usually many different variables that drive GDP growth, there is only one factor that dominates all for 1Q growth: the depth of the lockdown. As chart 2 shows, there has been a wide range of GDP estimates already released for many OECD countries, with France contracting by as much as 5.7% quarter-on-quarter and just -0.2% QoQ in Lithuania. The chart shows our index based on the Google mobility data on the vertical axis, which serves as a strong predictor for 1Q growth with an  $r^2$  of 0.7 for the nine countries with data released so far.



## So far, GDP declines for 1Q are strongly correlated to the severity of lockdowns



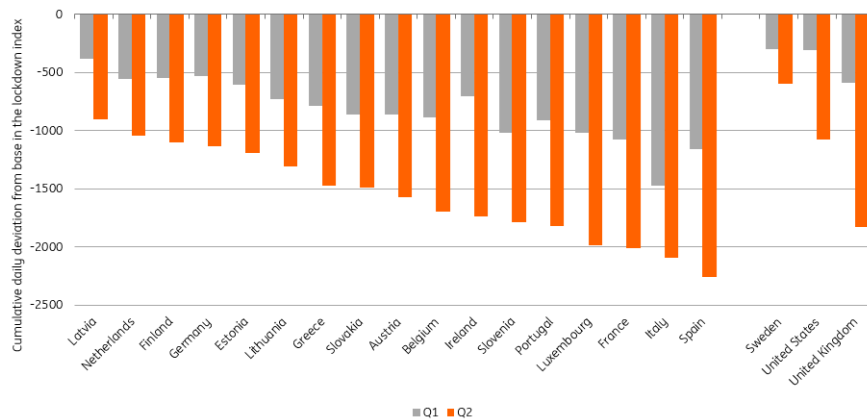
Source: ING Research, Google COVID-19 Community Mobility Reports, OECD

*Note: vertical axis represents the average for the lockdown index of activity between 15 Feb and 31 Mar for retail & recreation, groceries & pharmacies and workplaces using Google COVID-19 Community Mobility Reports. 100=baseline of activity between 3 Jan and 9 Feb.*

The index can therefore serve as a good predictor of the range of 1Q GDP growth for the countries that have yet to release their GDP figures. The Netherlands, Finland, UK and Germany for example saw an average lockdown index of around 88 for the 1Q period, which means that they are expected to have experienced a milder than average GDP contraction. Greece, Portugal and Ireland have seen values of between 80 and 85, which means that the traditional core vs. periphery distinction in 1Q GDP data will prevail as lockdowns in the South of Europe will have had a more severe impact on the economy than in the North.

While the 1Q GDP figures have so far been historically bad, with a contraction in eurozone GDP that has never been as deep in one quarter, 2Q will be worse still. Looking at the lockdown data that is already available for 2Q, we find that the length and depth has been significantly worse than in 1Q. To get a sense of how much deeper GDP growth could be in 2Q using already available data, we take the cumulative daily deviation from the base period in January and February. The resulting number is not meaningful as an absolute figure, but provides meaningful insights relative to other quarters and other countries.

## The impact for 2Q is already much more severe than for 1Q, indicating a larger decline in GDP



Source: ING Research, Google COVID-19 Community Mobility Reports

Chart 3 shows that even though we only have data for roughly one third of the quarter and economic activity will not immediately return to normal, the impact is already about twice as strong in most countries for 2Q than in 1Q. In some advanced economies outside the eurozone it's even worse than that, look at the US, UK and Australia, for example. That means that the decline in the second quarter will definitely be more severe as the return to normalcy will remain very gradual over the coming months, meaning that the impact will only increase as the weeks go by. Just to give an example, Germany would have to see its mobility surge to more than 10% above the pre-lockdown levels for May and June to see 2Q activity return to its 1Q level. That is out of the question for the moment. All of this means that the unprecedented crisis is currently showing another unprecedented face: the inflow of dreadful traditional macro data will continue, while more experimental and real-time data suggests that the worst is already behind.

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Snap | 15 May 2020

## Germany: And this is just the beginning

The worst contraction of the German economy since 2009 is not where the current crisis will end. The second quarter will be more dreadful



Source: Shutterstock

The German economy shrank by 2.2% quarter-on-quarter in the first quarter, the sharpest drop since the first quarter of 2009, when the economy contracted by 4.7% QoQ. On the year, the German economy contracted by 2.3%. GDP components will only be released at the end of the month but according to available monthly data and the press release of the German statistical office, the construction sector and government consumption were the only growth drivers. Private consumption, investments and exports all were a drag on the economy.

Today's number does not come as a real surprise. Industrial data for March and earlier GDP reports from other eurozone countries as well as the first estimate for the eurozone as a whole (-3.8% QoQ) already indicated the potential size of the German slowdown. The fact that the German slowdown is less accentuated than in most other eurozone countries provides very little comfort. Two weeks of lockdown as well as supply chain disruptions on the back of lockdown measures elsewhere brought the German economy to its knees.

### Data will get worse even if the worst might already be behind us

Looking ahead, things will get worse before they get better. To be more precise, incoming data will be worse, even though the worst might already be behind us. If today's data are the result of two weeks of lockdown, three more weeks of lockdown and a very gradual lifting of some measures do not bode well for the second quarter. However, more real-time data, such as Google mobility data,

shows that activity had already accelerated by mid-May. While (social and economic) activity slowed down to 60% of its January level during the peak of the lockdown, it has now returned to more than 80%. The timing of the lifting of the lockdown measures as well as the huge fiscal support by the German government (more than 30% of GDP) support the view that the German economy could leave the crisis earlier and stronger than most other countries. Still, there is no reason for complacency or hubris.

## More differences than similarities with 2008/9

Contrary to the 2008/9 crisis, out of which Germany emerged faster and stronger, the economy entered the current crisis with more structural weakness. In 2008/9, Germany had just implemented structural reforms and was just at the start of a positive cycle. This time, it was at the end of a very mature cycle and in need of investments and new reforms. Also, back then, the Asian countries, which were hardly hit by the financial crisis, rebounded quickly and helped Germany's export-led recovery. There won't be any sugar daddy this time around. Consequently, the destiny of the German economy and its recovery depends more than ever on fiscal policy. Up to now, the government's fiscal reaction has been much faster and stronger than in 2008/9. To ensure a lasting recovery, however, more stimulus will be needed. In this regard, the current discussion in Berlin about a new stimulus package is good news. For the time being, things will get worse before they get better. Once they get better, the German economy is likely to move faster and stronger out of the starting blocks than the rest. However, a fast start alone will not win the marathon.

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## The Netherlands: A relatively mild decline in GDP so far

Dutch GDP fell by -1.7% QoQ in 1Q20, suggesting that the economic impact of the coronavirus was mild, at least in international comparison. The “intelligent lockdown” as it has been dubbed by PM Rutte has paid off economically thus far, although the second quarter is likely to be much worse



Dutch Prime Minister, Mark Rutte

**-1.7%** GDP growth rate  
1Q20 (QoQ)

As expected

### Intelligent lockdown is a relatively mild lockdown

The decrease in GDP in the first quarter came nowhere near the decline of -3.6% QoQ in 1Q09 during the global financial crisis and was smaller than the eurozone average of -3.8%. Given the Dutch economy's high degree of openness and the fact that Dutch expenditure data for January

and February was disappointing, the small GDP decline might be a bit surprising. What stands out as more important, however, is the relative mildness of the Dutch lockdown compared to many European peers. Google Covid-19 Community Mobility Reports already showed visits to 'grocery stores', 'workplace' and 'retail shops' [fell less in the Netherlands than elsewhere](#). Even though bars, restaurants and hairdressers were also forced to close in the Netherlands, this observation is in line with the fact that the Dutch have been able to shop, didn't require licenses to travel and could operate their factories throughout the so-called "intelligent lockdown".

## Both domestic spending and expenditures abroad declined

On the expenditures side, exports (-3.0% QoQ), household consumption (-2.7%) and government consumption (-1.4%) declined most. Also, investment (-1.1%) fell. This was counterbalanced by imports development of -3.5%: the net effect of trade was close to 0.

## Manufacturing decline not at all in double digits yet

From an industry perspective, there was one clear positive note: construction expanded by 5.5% QoQ. Also, agriculture and fishery increased its value-added. The large "commercial service sector" declined by -1.6% QoQ, non-commercial services by -3.3% and gas and oil by -8.8%. The retail component of commercial services (excluding fuel and pharmacies and including webshops), however, managed to increase volumes by 0.7%, illustrating that consumers continued some of their purchases; there was a shift from non-food (-1.8%) to food (+3.0%).

Manufacturing declined only by a limited -1.7% QoQ, much less than in other European economies. Looking ahead, while the composite manufacturing NEVI PMI (purchasing managers' index) did not hit a record low in April, expectations for order books, production and delivery times have never been more pessimistic. This suggests that a manufacturing slump will mainly show in figures for the second quarter. An unprecedented decline in consumer confidence suggests that retail may also see worse numbers in the current quarter, even though the lockdown will be eased gradually in the second.

## 2020 worse than 2009

Making economic forecasts is extremely difficult in the current uncertain environment. Therefore, ING Research is working with different scenarios to look at possible GDP growth outcomes. Our base case contains a fall of GDP for the year 2020 of -6% to -8%. Despite today's mild 1Q figure, we believe that this is an outcome that might still be on the cards. Google Mobility data showed that while travel initially fell less in the Netherlands than in many other countries, more recent data shows that activity has also [increased less than elsewhere during 2Q](#). So the Dutch economy is bracing itself for a larger full lockdown fallout in 2Q. Such an outcome would imply a bigger annual decline in GDP than the of -3.7% of 2009 during the global financial crisis.

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Article | 14 May 2020

## Trade war: Where is Trump heading?

President Trump has threatened to rip apart the US-China trade deal and has not ruled out tariff hikes, if non-Chinese experts are unable to participate in the search for the origin of Covid-19. Although we think that Trump prefers verbal pressure for now, the risk of new measures is definitely rising



Source: Shutterstock

US President Donald Trump and Chinese President Xi Jinping

### Return of the threats

The possibility of another trade war is back. President Trump has said he will terminate the phase one deal if China does not live up to the goal of increasing imports from the US by a total of US\$200 billion the end of 2021. Once again we have witnessed that Trump is willing to apply tariff hikes (or at least threaten their use) to other policy areas than just trade. He called tariff hikes 'the ultimate punishment' if China does not allow non-Chinese experts to be involved in the search for the origin of Covid-19.

Trade secretary Wilbur Ross has also ramped up trade tensions by initiating a national security section 232 investigation into imports of (parts of) transformers and transformer regulators.

### Non-tariff measures

As well as tariffs, the US government is eyeing other ways of piling on the pressure. The latest idea

at Capitol Hill is to hurt China by ordering the main US federal pension fund not to invest in China's financial assets. Last year a similar idea was floated when the US government threatened to close US financial markets to Chinese companies to complicate their funding.

Incentives to discourage American companies from making direct investments in China and restrictions on Chinese direct investments in the US are other options to put economic pressure on China.

The 'nuclear' option of defaulting on US government debt, of which China is the world's largest holder, is sometimes brought up in the public discussion as well. This seems unlikely because it could have significant repercussions for the credit rating of the US and thereby the funding costs of its increasing government debt.

## Bark or bite as well?

The million dollar question is whether President Trump will stick to verbal pressure or follow up and hike tariffs again or effectuate alternative protectionist measures.

Regarding Chinese compliance with the phase one deal, we don't expect the President to move in the short run. Although the call for a renegotiation of the trade deal is apparent in Chinese newspapers, so far the Chinese government has not asked for this. After a call last week between Vice Premier Liu He and the US trade representative Robert Lighthizer, the Chinese Ministry of Commerce confirmed it is continuing to work on implementing the deal.

Chinese imports from the US (and other countries) have crashed this year as a consequence of plunging Chinese demand due to the Covid-19 pandemic (see chart 1). The crisis seems to qualify for calling upon the clause in the phase one deal that states, 'in the event that a natural disaster or other unforeseeable event outside the control of parties, delays a party from timely complying with its obligations...the parties shall consult with each other'.

The fact that Chinese authorities have not brought up this point to publicly pressure the US to renegotiate could be seen as a sign of good intentions. Together with the positive tone from US negotiators Lighthizer and Treasury Secretary Steven Mnuchin after their call with Liu He, there is no indication that China is deliberately trying to shy away from the deal.

Having said that, it is clear that it is simply unrealistic to expect, in the midst of the deepest recession since the 1930s, that China could prop up its imports by \$US200 billion in two years. So, it would be no more than reasonable for the US to give China some leeway, for example by lowering the target for this year (\$US76 bn) and agreeing that the cumulative target of \$US200 bn of extra imports from the US can be reached at a later point in time.

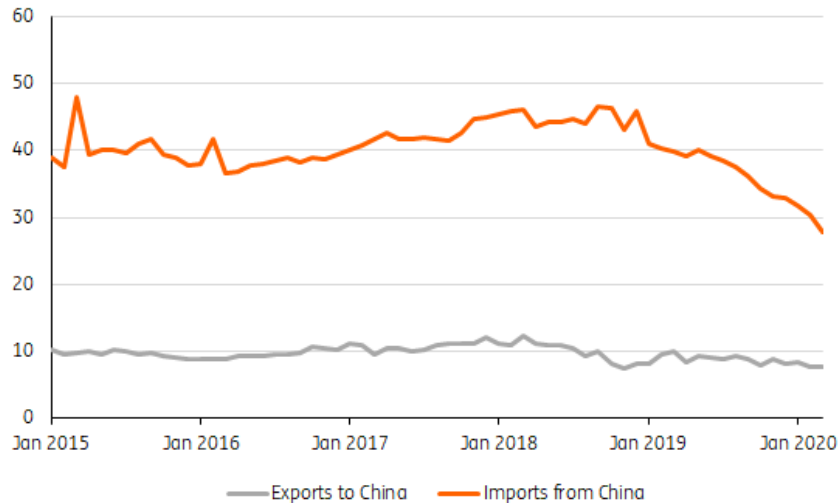
Besides, while China is not importing as much from the US as originally targeted, China is not exporting anywhere near as much to the US given that the year to date goods deficit with China is 33% lower than in 2019. This has caused a further significant decline in the bilateral trade deficit of the US with China. The improvement in the bilateral trade balance already started last year before the pandemic hit the world economy. It is partly the result of Trump's tariffs. So he can use that to claim that his war on trade with China has been successful, which should give him some space not to demand the impossible in these extraordinary times.

Last Wednesday, however, Trump said he is not 'interested in renegotiating' the deal. Does that



mean that a tariff hike or other measures to inflict pain on China are in the offing? Not immediately, in our view.

## Chart 1: US - China - Bilateral trade USD, bn per month



Source: US Census Bureau

Adjusted for seasonality and the Chinese new years holiday

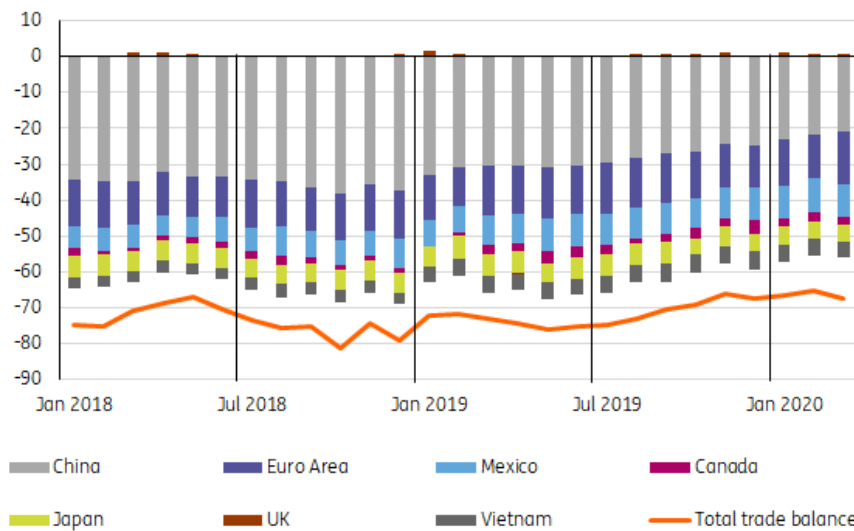
## Blame for the economic crisis

Last year, Trump could shrug off critics who said his tariff hikes hurt the stock market and caused a recession in manufacturing by pointing to all time highs for stock market indices and record low unemployment rates. But this time, the overall economy is in a devastated state.

So from an economic point of view, it would be very risky for Trump to take measures that are not welcomed by most American businesses and consumers. He would have little defence if he were to be accused of driving the economy into an even deeper hole.

We therefore expect Trump to wait a little more to see whether his verbal pressure on China works so that he can continue to claim he has cut a 'fantastic deal' with China.

**Chart 2: Selected bilateral trade balances and total US trade deficit USD, bn per month**



Source: US Census Bureau

Adjusted for seasonality and the Chinese new years holiday

## Other reasons for hiking tariffs

Nevertheless, the risk of Trump taking new protectionist measures has definitely increased. Trump is currently not doing very well in the polls. As the economy is in a terrible state and will still be far from healthy at election day, Trump could give preference to non- economic considerations.

If the President thinks that China offers a scapegoat for the current crisis and could potentially boost his re-election chances, an announcement of new protectionist measures is a serious option, particularly if the conflict with China about the search for the origin of the Covid-19 virus escalates. If Trump feels a sense of injustice in China's behaviour and can bring other countries on board to take action, he might well go for another round of tariff hikes. Trump could then portray himself as a global leader.

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## US: jobless claims slow crawl lower

US initial jobless claims dropped for the sixth straight week, but remain painfully high at 2.98 million. As the economy gradually re-opens this decline will continue, but with social distancing constraints, consumer anxiety relating to the virus and household incomes feeling the strain, unemployment will not drop anywhere as quickly as it spiked



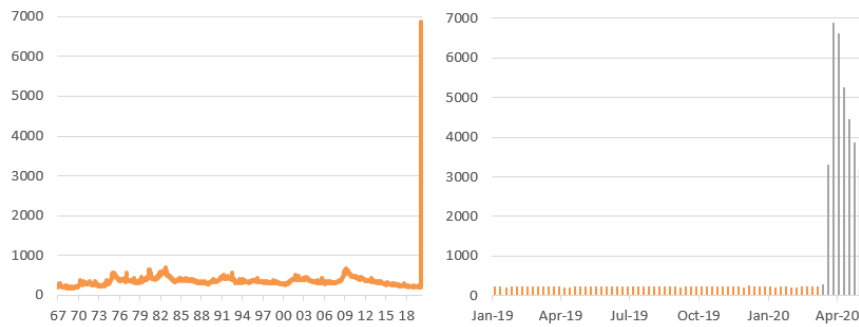
36.76

Cumulative new jobless claims over past 8 weeks

million

Initial jobless claims for the week of 9 May didn't slow as quickly as hoped at 2.981 million (versus consensus forecast of 2.5 million and only 195,000 below the previous week) bringing the 8-week running total to 36.76 million. The data shows a huge spike in claimants in Connecticut – 298,680 versus 36,138 the previous week – while Florida and Georgia, which are supposedly more advance in the re-opening process, also saw fairly sizeable increases on the previous week of 47,045 and 13,035 respectively. Most other states saw a slowing in new jobless claims with California seeing 102,299 fewer and Texas 102,263 fewer than the week of 2 May. Nonetheless, these are still astonishingly huge numbers that underline the economic pain caused by Covid-19 containment measures.

## Initial jobless claims (000s)



Source: Macrobond, ING

Continuing claims are not climbing as quickly though, rising to "only" 22.8 million from 22.4 million. There is an extra week lag in the data (week of 2 May, rather than the 9th), but the gap between the two series is somewhat strange. Obviously not everyone will qualify for unemployment benefits and there may well be the case of double counting on initial claims as people try to register both online and by phone. There could also be issue with backlogs between filing and receiving benefits and then being classified as a continuing claimant.

As such the "true" figure of the number of people out of work right now is somewhere in between and our best guess is that after payrolls fell 20.5 million in April we will see another 11-12 million decline for May. After all, we have to remember the initial jobless claims data only reflect the debit side, there will be some job creation coming through as the different states start to re-open their economies.

Nonetheless, social distancing constraints, consumer anxiety relating to the virus and household incomes feeling the strain with tens of millions of Americans out of work, unemployment will not drop anywhere as quickly as it spiked. We look for it to rise to around 22-23% and with a third of working age Americans not included within the labour force (students, early retirement, sick, homemakers, carers) we will have less than half of 16-65 year-olds earning a wage this month.

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## Fed Chair Powell's dose of reality

Fed Chair Jerome Powell doesn't pull his punches in his latest economic update. Monetary policy and negative interest rates can't magic up spending; government needs to do more



Fed Chair, Jerome Powell

### More needs to be done...

Fed Chair Jerome Powell's webcast titled "Current Economic Issue", underscores the Fed's concern about the current situation and its medium to longer term implications for the US economy.

He acknowledges that "the scope and speed of the downturn are without modern precedent" and that a clear risk is that "the passage of time can turn liquidity problems into solvency problems".

As such he believes more action is likely required to support the US economy through the crisis. Unfortunately, as he himself acknowledges in the webcast "the Fed has lending powers, not spending powers" – its policy focus is more on ensuring lending and credit markets are functioning fully and that there is enough liquidity that financial system strains don't start to feed back negatively on the economy.

### It's up to government

Powell therefore, somewhat cautiously, makes the case for more government support, arguing that "additional fiscal support could be costly, but worth it if it helps avoid long-term economic damages and leaves us with a stronger recovery". Powell himself highlights the fact that the crisis

is driving inequality by citing that the Fed's own analysis shows nearly 40% of households making less than \$40,000 per year had lost a job in March. We (ING) are projecting another 12 million decline in payrolls in May so we wouldn't be surprised to see this figure move close to 60% by the end of this month. Given this backdrop we strongly suspect there will be another round of major fiscal stimulus that receives broad support in Congress.

## No to negative rates

With regard to future Fed policy there is no discussion about the possibility of negative interest rates in the text, with the Q&A revealing that it isn't something they are currently looking at. In any case, plenty of his Fed colleagues had dismissed the idea over the past 48 hours to suggest there is little prospect of it happening despite President Trump's keen interest. The evidence of success in Europe is very limited while domestic considerations, such as "breaking the buck" in money market funds, make it more challenging.

Instead, his discussion is more focused on emphasising the importance of the unprecedented action of zero interest rates, "unlimited" QE, liquidity and funding measures. These support mechanisms, coupled with measures to support the flow of credit to households, business and state and local governments together with measures to allow banks to increase the size of their balance sheets, would remain in place until "the economic recovery is well underway". Nonetheless, they will not be permanent and "when the crisis is behind us, we will put these emergency tools away".

## But little prospect of a policy reversal anytime soon

He doesn't try to gauge when that timing may be. We know that the Global Financial Crisis saw GDP fall 4% peak to trough and it took 14 quarters to recoup that lost output. Today we are forecasting a 13% peak-to-trough fall in GDP through 1H20. While we acknowledge that the scale and speed of the fiscal and monetary support has been more impressive in the current crisis versus the GFC, the fact is we don't know how long social distancing, travel restrictions and consumer angst about catching the virus will last. There is also clear concern that with tens of millions of Americans having lost their job, consumer demand may not come back as rapidly as in the GFC.

This suggests to us the Fed's stimulus will remain in play for many more months with very little prospect of a rate hike away from the emergency lower bound within the next year and a half.

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# Hong Kong quarterly: which industries will survive the deep recession?

Trade war. Social unrest. Covid-19. These three hits to Hong Kong's economy have resulted in a difficult recovery path. Now, Covid-19 has subsided but social unrest has returned, and there may still be a trade war with the US. Here, we look at which industries have been hurt the most and which ones will hold up better



Source: Shutterstock

## Hong Kong has had difficulty coming out recession

The economy has been in recession since 3Q19, and fell by -8.9%YoY in 1Q20, which is the deepest contraction since 1974 when the data was first compiled.

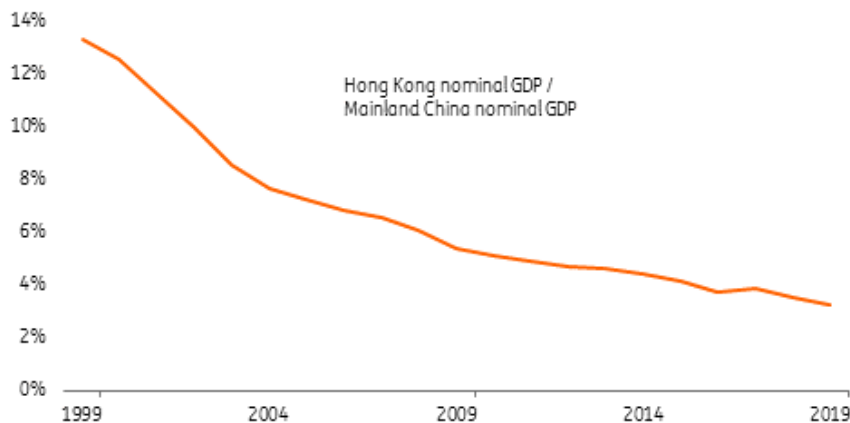
The trade war clearly hurt economic growth in 2019, with GDP growth of just 0.7%YoY and 0.4%YoY in the first two quarters of 2019, respectively.

The arrival of social unrest, together with the trade war, brought the economy into recession, with drops of -2.8%YoY and -3.0%YoY in the third and fourth quarters of 2019.

Then came Covid-19.

But just as the pandemic seems to be subsiding in Hong Kong, social unrest is returning. We expect full year GDP growth at -4.1%. This is based on the assumption that there will be no material trade war between China and the US.

## Hong Kong's importance to Mainland China in terms of GDP



Source: ING, National Statistic Bureau (Mainland China), Census and Statistics Department (Hong Kong)

## Who's been hurt most?

Looking at the damage to industry, we believe that a better gauge would be employment data. In Hong Kong, redundancy costs are not as high as in Europe. So when businesses expect a long term downturn, they hire fewer people or even lay off staff.

## Industries affected by the trade war

Hong Kong has only a tiny manufacturing sector, so essentially we can describe Hong Kong as not having factories. It provides services to merchandise trade, e.g. sourcing, shipping, port service, freights and trade finance. The number of companies in import/export trade and wholesale fell 2.8% in 2019 compared to 2018. This does not sound a lot. But the number of people employed in this industry **fell 7.3%**, (around 39,000 people).

The impact of the trade war is therefore large. It's still uncertain whether there will be a new round of tariffs between China and the US. If that happens, it will be the fourth hit to Hong Kong's economy.

## Industries affected by social unrest and Covid-19

Attracting Mainland tourists to shop in Hong Kong was a comparative advantage over many other economies in the world due to the lower travel costs, a high standard of restaurants, good services, and no value-added tax. This made Hong Kong appealing to Mainland tourists who want a luxurious shopping experience.

But with social unrest increasing from the second half of 2019, this advantage has gone. While Hong Kong and Mainland China may relax quarantine measures and travel restrictions for each other fairly soon, Mainland tourists are unlikely to visit Hong Kong if the threat to personal security persists.

Social unrest in Hong Kong has been rare in the past. Even the 2014 Occupy Central protest was a very peaceful one. But since 2019, demonstrations have become increasingly violent. Many shops and restaurants closed early to avoid damage. The unemployment rate in the category of retail, accommodation and food services increased from 3.6% at the beginning of 2019 to 6.1% at the

end of the year.

Covid-19 further hit the tourism industry and local retail and catering businesses. Unemployment in this category rose further, to **6.8%** by the end of March 2020, which was higher than the headline unemployment rate of 4.2%.

As such, airlines, retail and catering will continue to be hit. These industries rely on domestic demand, which is under threat due to high unemployment.

## Which industry stands out?

Hong Kong should continue to leverage its financial and legal system to serve the offshore financial needs of Mainland companies. This will continue unless Mainland China's financial system matures, e.g. via interest rate liberalisation. Hong Kong could have another 10 years to enjoy this privilege.

Businesses of residential property developers should be fairly stable because the unemployed are mostly in the low-income group, which could not afford to buy a private flat even before the triple hits to the economy. But property investors of commercial and retail could stay on the sidelines as they wait for the social unrest to fade and to see how the trade conflict pans out.

While there are policies to encourage the development of technology as an industry in Hong Kong, Shenzhen is located very nearby, and there is already a cluster of well-established tech companies here, as well as a pool of talent from other cities in Mainland China and from the rest of the world, including Hong Kong. As such, Hong Kong can't really compete on this one.

Hong Kong	1Q19	2Q19	3Q19	4Q19	1Q20F	2Q20F	3Q20F	4Q20F
Real GDP (YoY%, period average)	0.6	0.5	-2.9	-2.9	-8.9	-8.0	-0.7	1.4
CPI (%YoY, period average)	2.2	3.0	3.3	3.0	2.0	-0.5	0.0	0.5
HIBOR 3M (% period end)	1.76	2.46	2.26	2.43	1.93	0.90	1.00	1.10
10Y government bond yield (% period end)	1.47	1.51	1.56	1.76	0.78	0.55	0.60	1.00
USDHKD exchange rate	7.850	7.812	7.838	7.791	7.751	7.752	7.760	7.765

Source: ING, Census and Statistics Department of Hong Kong SAR

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Article | 11 May 2020

## China signals more aggressive monetary stimulus

China's credit growth slowed in April but the central bank, the People's Bank of China, has signalled more aggressive monetary stimulus. We expect there will be more focused credit injections to SMEs, which should help employment



Leading members of the People's Bank of China, including Governor, Yi Gang (waving)

### Starting with slower credit growth in April

Combining all the data, we get the impression that corporates continued to issue bonds as an alternative to bank loans.

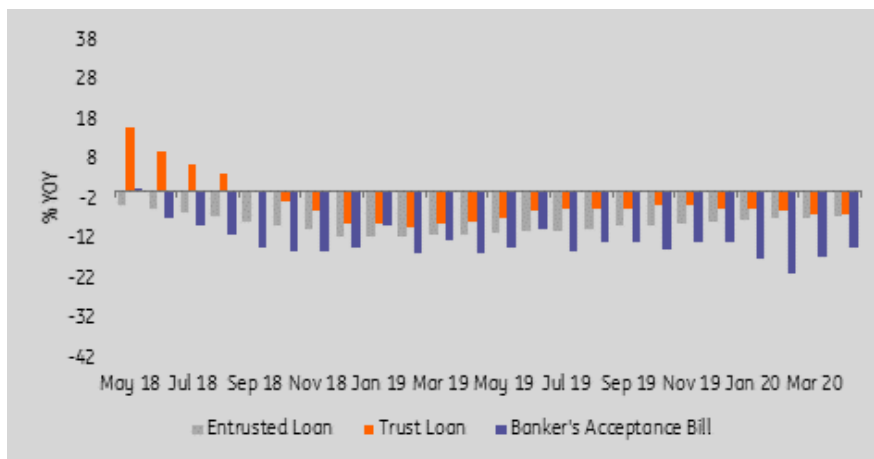
But the money raised seems to have been deposited in banks, which pushed up the M2 growth rate significantly, to 11.1%. Yuan deposit growth only rose 9.9%, and most of this increase came from corporate savings, which makes us curious about whether some funds raised in the bond market, in anticipation of projects beginning, have been parked in longer-term savings products, e.g. structured deposits, for interest income.

For individuals, we see a fall in household deposits and an increase in short term loans to individuals. This could reflect rising unemployment resulting from Covid-19.

Here is the data summary:

- Aggregate finance grew only CNY3.09 trillion in April after growing CNY5.15 trillion a month ago. Loan growth was a mere CNY1.7 trillion after CNY2.85 trillion in March.
- Among other categories in aggregate finance, the net issuance of corporate bonds fell the least, at CNY902 billion in April similar to CNY982 billion in March.
- In contrast, government bond issuance, including local government special bond issuance, increased at a slower pace of CNY336 billion in April from an increase of CNY634 billion in March.
- Most shadow banking items increased at a slower pace in April even as the PBoC continued to ease.
- But the M2 growth rate surged to 11.1% year-on-year in April from 10.1% a month ago, compared to yuan deposit growth of 9.9% YoY in April.

## China's shadow banking keeps shrinking even as the PBoC eases



Source: ING, CEIC

*"...we see a fall in household deposits and an increase in short term loans to individuals. This could reflect rising unemployment resulting from Covid-19. "*

## PBoC change to aggressive monetary easing

In its first-quarter report, the central bank deleted the prudency wording describing its monetary stance. This is a big change and means the PBoC is going to inject a lot of liquidity into the financial system.

The easing policy should focus on SMEs as they will be hit hardest by the Covid-19 crisis, and a possible coming trade war. They employ a lot of workers, mostly lower income groups.

We believe the easing will be in the form of targeted RRR cuts or broad-based RRR cuts for all banks.

- In previous RRR cuts, the central bank excluded big banks, which limited the injection of

liquidity. From now on, this may change as more liquidity will be released if the RRR applies to all banks. This could help the economy recover from Covid-19.

- There should be an additional mechanism to encourage banks to lend to SMEs, which usually have weak credit profiles. Without this mechanism, mere RRR cuts will not help SMEs.
- A government-guaranteed SME programme could also be a solution as this will shift the credit burden from banks to the government, which is not desirable for lending to healthy corporates but is necessary to help SMEs and to stabilise employment so that households don't use up their savings or indeed need to borrow for a living.

After injecting liquidity from RRR cuts, there will also be interest rate cuts from the 7D reverse repo to the 1Y Medium Lending Facility and 1Y Loan Prime Rate. Money market rates should fall accordingly.

## Forecast of monetary policies

We expect the RRR for big banks to be cut from 12.5% to 9.5% by the end of 2020. This is the most aggressive easing policy as it will inject a lot of liquidity into the system.

The 7D reverse repo rate should be cut from 2.2% to 1.5% and the LPR should be cut from 3.85% to 3.35%.

## USD/CNY forecast

Though we expect a lot of liquidity injections from the PBoC, which could push down interest rates, we do not expect such moves to put depreciation pressure on the yuan. Instead, we are closely monitoring news on the trade and technology war, which are more likely to move the yuan in the coming months.

We forecast USD/CNY at 7.15 by the end of 2Q20 and 6.90 by the end of 2020. But we may revise the year end forecast if there is more negative news about US tariffs on China.

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# Listen: Are digital currencies a “total scam” or moving into the mainstream?

The Covid-19 crisis and its impact on currencies in some emerging markets has fuelled distrust in governments and central banks, and ignited interest in digital alternatives. In this podcast, ING economist Carlo Cocuzzo discusses whether the current pandemic could accelerate the adoption of digital currencies around the world



## Algorithms vs politicians

Lebanese protestors held a mock funeral for their local currency earlier this month after a financial crisis, exacerbated by the coronavirus, sent it into a tailspin. With other emerging markets also feeling the pain of a strong dollar, proponents of digital currencies are touting the benefits of a system run by algorithms rather than politicians and central banks. [In this podcast](#), ING's Senior Editor Rebecca Byrne asks Digital Finance Economist Carlo Cocuzzo whether the economic damage caused by Covid-19 could speed up the adoption of digital currencies, or whether Nouriel Roubini, who called bitcoin a "total scam", is right to be sceptical.

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