

# Covid spikes threaten the recovery

A resurgence in Covid cases around the world and new lockdown measures to halt the spread of the virus, are raising questions about the economic recovery, the outlook for financial markets and the response from policy makers. ING's economists and analysts share their thoughts on what might happen next

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Podcast | 25 September 2020

## Listen: What the Covid resurgence means for oil

A recent upswing in Covid-19 cases and new lockdown measures to stem the spread of the virus have sparked concern that demand for oil could be hit at a time when supply is picking up. In this podcast, ING's Warren Patterson discusses the outlook for oil prices, what OPEC+ may do and how the US presidential election may play a role



Invoking Clint Eastwood's Dirty Harry, Saudi Energy Minister Prince Abdulaziz bin Salman warned short sellers in the oil market to 'make my day'. But it may take more than a Hollywood catchphrase to calm traders in this market. [In our latest podcast](#), ING's Head of Commodities Strategy Warren Patterson tells Senior Editor Rebecca Byrne what OPEC+ may have to do if a recent resurgence in the pandemic hits demand.

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Article | 24 September 2020

## Eurozone: Hangover in the making while the party's in full swing

Third quarter growth will likely be stronger in the countries hardest hit by the lockdowns earlier this year, but worries about a double dip recession, thanks to higher trending Covid infections, should be a large warning sign against complacency for policy makers



Source: Shutterstock

A view of a deserted beach in Benidorm, Spain, one of Spain's hotspots for tourism.

### The last shall be first, judging from mobility data

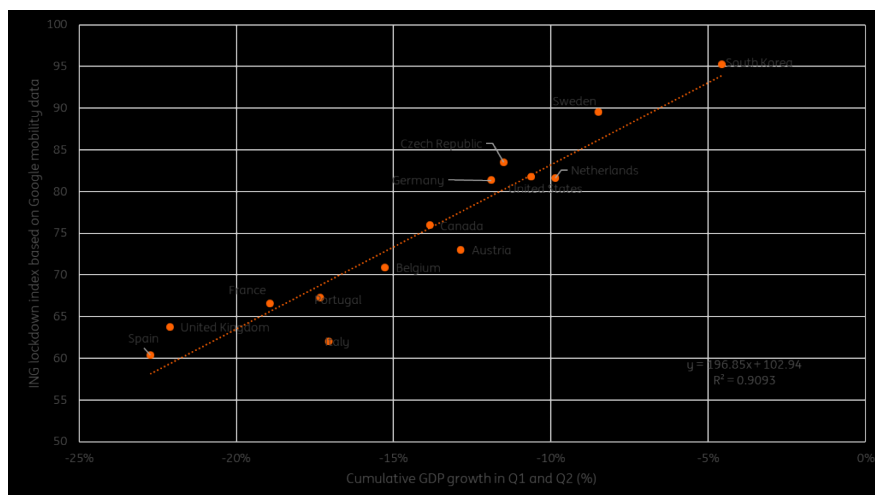
It feels a bit like being in the twilight zone. While incoming hard (and lagging) economic data for the eurozone is still painting a picture of the size of the rebound in the third quarter, soft and other leading indicators are providing a first glance of the shape of the subsequent recovery. As the third quarter of the year is coming to a close, we have a first look at what the latest data is telling us about both.

Up to now, hard economic data for the third quarter has been limited to the month of July. Thanks to base effects from the rebound in May, June and July, third quarter growth in industrial production, retail sales, new car registrations and exports will be massive. Taking available data for July and leaving that stable for the rest of the quarter yields quarterly growth of 7.1% for retail sales, 14.6% for industrial production, 16.7% for exports in goods and a whopping 106.9% for new car registrations. Our expectations for 3Q GDP growth are therefore around 10%.

Turning to more experimental data, our favourite, Google Mobility data, gave a good proxy of

1Q and 2Q GDP growth for most advanced economies. In the third quarter, however, seasonal factors could undermine the predictive power of the Google Mobility data. The mobility data measures movement, which was very useful to gauge the dip when activity was restricted by the virus. Now that mobility data is closer to “normal levels”, seasonal movements like people going on holidays distort the impact on GDP, which filters out seasonal trends.

## The decline in GDP has been very well correlated to Google mobility data in advanced economies

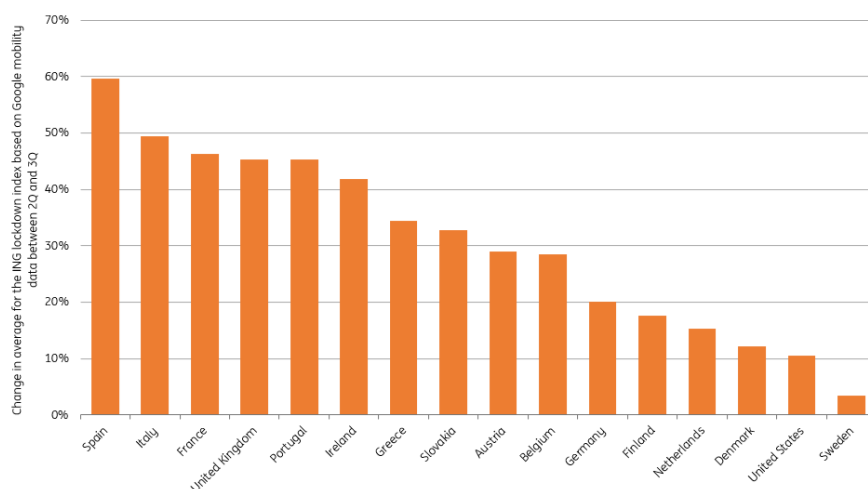


Source: ING Research, Google COVID-19 Community Mobility Reports

Note: index of activity since 15 Feb for retail & recreation, groceries & pharmacies and workplaces using Google Covid19 Community Mobility Reports with data through 30 June. 100=baseline of activity between 3 Jan and 9 Feb

Nevertheless and notwithstanding the above mentioned caveats, Google Mobility data points to a strong economic recovery in the third quarter. The countries with the largest improvements are also the ones which experienced the deepest declines in March and April, indicating that the mechanical rebound effects are strongest in the countries with the larger economic fallout. That is encouraging, as it means that the third quarter numbers will show a bit of a reduction in GDP divergence between countries. Still, we do expect output gaps to remain a lot larger in the countries hardest hit in the first half of the year.

## Countries with deeper GDP declines in the first half have also seen a stronger recovery in mobility data in 3Q



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 Covid19 Community Mobility Reports with data through 11 September. 100=baseline of activity between 3 Jan and 9 Feb

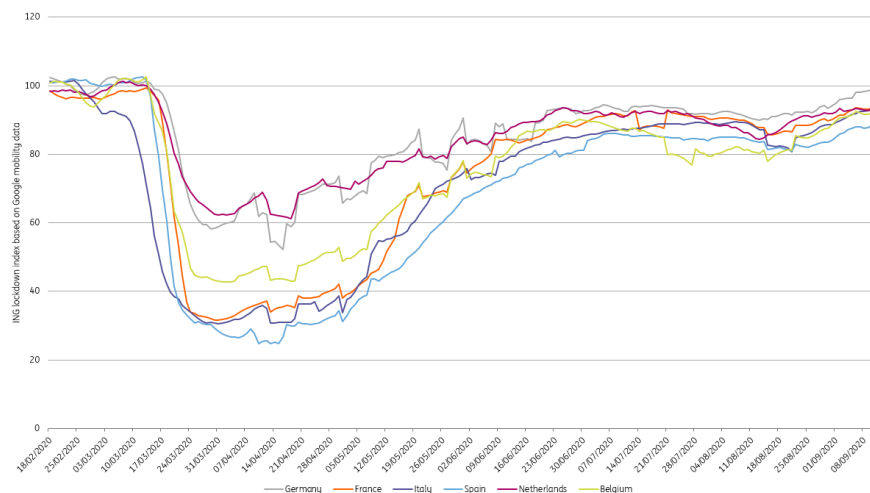
### Brightest before dusk?

Looking beyond the third quarter, this week's traditional confidence indicators have fuelled fears of a double dip. The eurozone services PMI even dropped below 50, indicating that the sector is experiencing a contraction in activity. According to the survey, the decline was related to the surge in Covid-19 cases impacting business. Also, in our view, the drop in the services PMI could reflect the notion that longer-lasting social distancing measures will have a more structural impact on some sectors. It therefore does not only come as an early warning for policy makers that second wave concerns are developing but also that the structural impact from the crisis could gain traction. While the reversal of reopening measures has been very limited so far, it is concerning to hear that businesses are already noticing a decline in activity thanks to the resurgence of the virus.

The latest Google mobility data does not yet indicate significant declines in activity again though. Data through 11 September indicates an improvement from the end of summer onwards, consistent with people returning from summer holidays and increasing activity. This means that perhaps the increase in Covid cases may be impacting a limited or specific number of businesses at the moment, we're unsure. We do know that the concerns in the services sector indicated in the PMI are a wake-up call for policy makers that it's not necessarily smooth sailing from here.

When celebrating third quarter GDP data one should remember that the hangover will not be far away.

## Most recent mobility data does not yet point to a large shift in behaviour as new Covid cases are increasing again



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 Covid19 Community Mobility Reports with data through 11 September. 100=baseline of activity between 3 Jan and 9 Feb

The boost of reopening has already determined that GDP growth in the third quarter will be massive, but this could mask another dip or at least a slowing of economic activity. It is a reminder that as second round effects from lockdowns are gaining traction and new – for now just – local lockdowns are popping up, there is a chance that the eurozone recovery could come to an abrupt stop. A vaccine will be needed before the recovery can be sustainable, as recent developments show. And even then, the longer-term impact from social distancing, as well as the structural transition in some sectors which was not started but accelerated by Covid-19, should continue to weigh on growth in 2021 and beyond.

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# UK economy heading for October contraction as Covid-19 returns

The UK recovery is set to stall through the autumn and winter as the 'reopening phase' ends and new Covid-19 restrictions are brought in. As the Chancellor announces fresh stimulus, we've taken a look at what new virus measures could mean for the economy. A decline in October's GDP data looks likely



Source: Shutterstock

Britain's Chancellor of the Exchequer Rishi Sunak (C) and Dame Carolyn Julie Fairbairn, Director General of the CBI (R) and Frances O'Grady, General Secretary of the TUC, (L) stand outside 11 Downing Street, London

## The UK is seeing early signs of a renewed spike in Covid-19 transmission

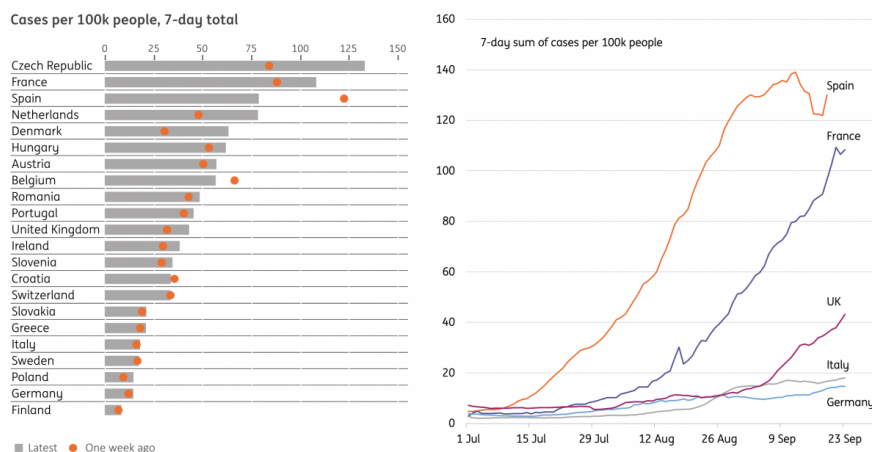
UK Chancellor Rishi Sunak has announced fresh economic support today, with a new wage-subsidy scheme designed to top-up the pay-packets of employees working reduced hours.

This comes amid a fresh spike in Covid-19 cases in the UK. So far the viral spread is at a less advanced stage than in other parts of Europe - the UK has recorded around 40 cases per 100,000 people over the past week, compared to over 100 in both France and Spain. But concerns that this could soon translate into a rise in hospitalisations have triggered a fresh round of restrictions

across the UK.

So what's the scale of the economic challenge that Sunak is facing as he unveils his 'winter economic plan'?

## Coronavirus compared: UK cases rising, albeit not yet as fast as elsewhere in Europe



Source: Macroond, UN, ING calculations

Note: Due to lags in reporting Spanish cases suggest the latest figures, we've removed the past few observations from the line chart for comparison purposes. Rate per 100k people is calculated as the seven-day sum of reported cases, adjusted by UN population data

Well firstly, it's worth remembering that the recovery was always likely to stall during the fourth quarter, now that the 'reopening phase' is over. And so far, the restrictions that have been announced over the past few days are unlikely to make a huge dent on GDP. The new rules, including covering those areas with higher levels of the virus, are predominantly focussed on limiting social gatherings rather than outright closure of certain economic sectors.

But there's still a clear risk that further measures could be on their way if the rate of case growth doesn't slow. A number of recent headlines have indicated the government may be mulling a [two-week 'circuit-breaker'](#) mini-lockdown.

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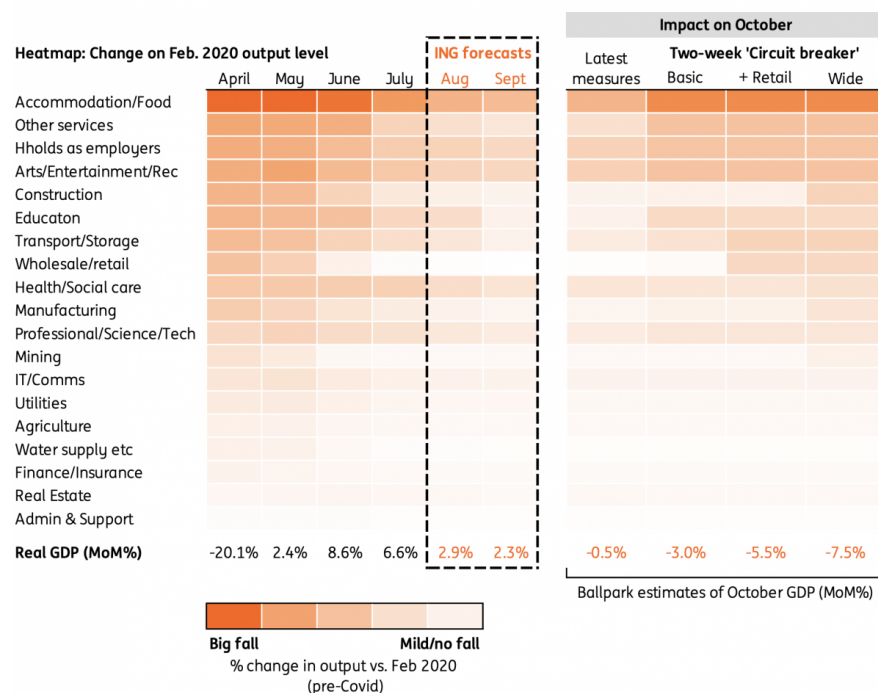
*We think that a two-week 'circuit-break' involving closure of hospitality and schools could see October GDP fall by around 3%. If these measures also involved shop closures, then that decline could rise to 5-6%*

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What might that involve? Well, the key point is that this appears very unlikely to involve the severity of restrictions imposed back in March. Reports suggest this kind of scenario could see pubs and restaurants asked to close for a two-week period, as well as potentially schools.

We've done some 'back of the envelope' calculations to see what this might mean for October's GDP figures, based on some assumptions on the impact at a sector-level. The heatmap shows the worst affected sectors during the initial lockdown (measured by the change on pre-virus levels), how they've recovered since, and how that might change under different 'circuit breaker' scenarios.

## Four indicative scenarios for UK October GDP depending on Covid-19 restrictions



Source: Macrobond, ING calculations/forecasts

'Circuit-breaker' estimates assume schools are re-closed to most children for two weeks

In short, we reckon that a two-week 'circuit-break' involving the closure of the hospitality sector and schools could see October GDP fall by around 3%. If these measures also involved shop closures, then that decline could rise to 5-6%, and if a wider range of sectors were included (e.g. parts of manufacturing/construction), then perhaps we'd be looking at a 7-8% contraction.

All of this is, of course, fairly rough-and-ready, and there are a few key ways in which the impact could vary.

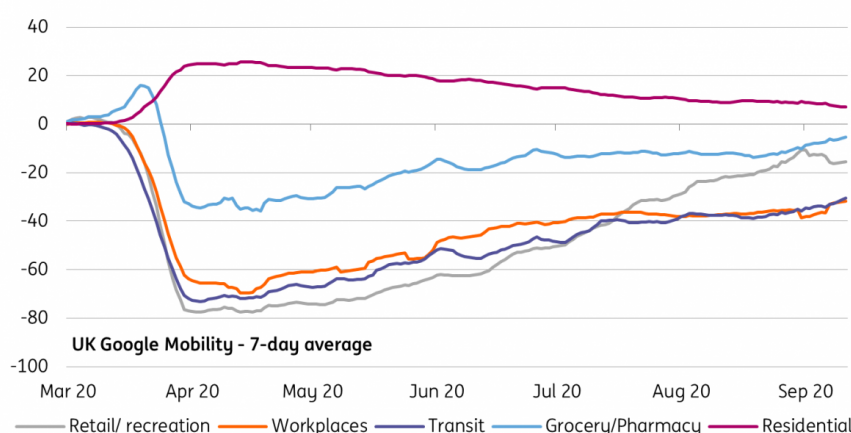
The most obvious variable is the length of any such restrictions - would they really last two-weeks? The above estimates assume they do, but the question is whether ministers would have enough data after 14-days of closures to conclude that the virus spread has sufficiently slowed? While the bar for schools to stay shut for any longer appears high, it's not inconceivable that the likes of pubs/restaurants could stay closed for longer in this kind of scenario. The effect would be to drag overall fourth-quarter GDP lower (see box below).

## Will the public 'act with their feet'

Secondly, how will the public react? Evidence from the first round of lockdowns suggests that, regardless of the measures that were imposed, consumers often 'acted with their feet' and voluntarily restricted their movements given safety concerns.

So far, and perhaps not surprisingly, we've not seen much evidence of this during this second spike. While both restaurant bookings and retail footfall have leveled off over the past couple of weeks, neither dataset suggests consumers are meaningfully changing their habits again in response to virus fears. So far this is consistent with what we've seen in other European hotspots, at least according to Google Mobility data.

## The UK's Google Mobility data



Source: Macrobond, ING

## Fresh uncertainty poses additional challenge for jobs market

However, as [our Eurozone team](#) have highlighted, business surveys including the latest Europe PMIs, are beginning to air some fresh concerns about damage from the second wave. This brings us onto a third factor - uncertainty.

With the exception of some local lockdowns, the operating environment has been kept relatively stable over the summer as Covid-19 prevalence has stayed low. But the imposition of new restrictions will raise fresh questions about what the winter will bring for businesses - and it will inevitably see firms ramp-up plans for a return to full lockdown, even if in reality that currently appears a fairly low-probability event.

The primary impact is likely to be on jobs. There are already early signs in the latest data that the unemployment rate starting to rise, and we have thought it could hit 9% by the end of the year or early next.

The Chancellor's [new wage subsidy scheme](#), which will subsidise a portion of an employee's salary if they are able to work at least a third of their normal hours, should help head-off some of the redundancies that may have otherwise occurred with the closure of existing Job Retention scheme in October.

However, inevitably this leaves some concerns about what will happen in sectors still effectively

closed (e.g. events), where labour demand may be insufficient for firms to justify bringing staff back on a part-time basis, and where the jobs will eventually be viable again once restrictions ease.

## Further Bank of England action likely in November

The threat of a challenging fourth quarter suggests that the Bank of England will also inject fresh stimulus in November. The question now is what this might involve. Despite all the hype over negative rates, it's clear from recent comments from Governor Andrew Bailey that quantitative easing remains the favoured tool. He also noted this week that negative rates, whilst in the toolkit, are unlikely to become a reality this year.

### A side-note about fourth quarter GDP

Although, we've focussed on what possible restrictions might mean for October GDP, but what will the impact be on the full fourth-quarter figures?

Well, we know that third-quarter GDP is likely to come in at a blockbuster 16-17% QoQ, although this is of course because you are comparing it to a three-month period where the economy was essentially shut.

We're likely to see a similar, albeit smaller effect in the fourth quarter too. The economy was still getting back on its feet through July and August. So even if hypothetically the monthly level of GDP stays unchanged at September's forecasted level through October-December, then overall fourth-quarter GDP will still be around 2-3% higher than the overall GDP in the third.

The implication is that under the two-week 'basic' circuit-breaker scenario detailed above, we could still see overall quarterly GDP come in flat or even slightly positive for the fourth quarter as a whole. It all really depends on how all-encompassing the restrictions are on different sectors, and more importantly how long they end up lasting.

A wider 'circuit-break', or one that lasts longer than two weeks, would almost certainly drag fourth-quarter GDP below zero, even with the favourable 'base effect'.

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# European Banks: Do they have what it takes?

European banks have so far drawn €1,699bn funding from the ECB TLTRO-III operations. We examine whether banks are likely to reach the lending thresholds that would allow them to benefit from the lowest available funding rates



Source: Shutterstock

European banks drew €174.5bn from the fifth tranche of the ECB funding programme TLTRO-III yesterday, substantially down from the €1,308bn drawn from the fourth tranche. The total size of the TLTRO-III programme stands at a substantial €1,699bn.

Motivation to participate in the fifth tranche could have been driven by a growing understanding of bank loan demand in the Covid-19 environment, a possible access to funds at the -1% level until June 2021, the consideration of no stigma or reputational risk left after the significant June take-up, and removal of a possible leverage ratio constraint.

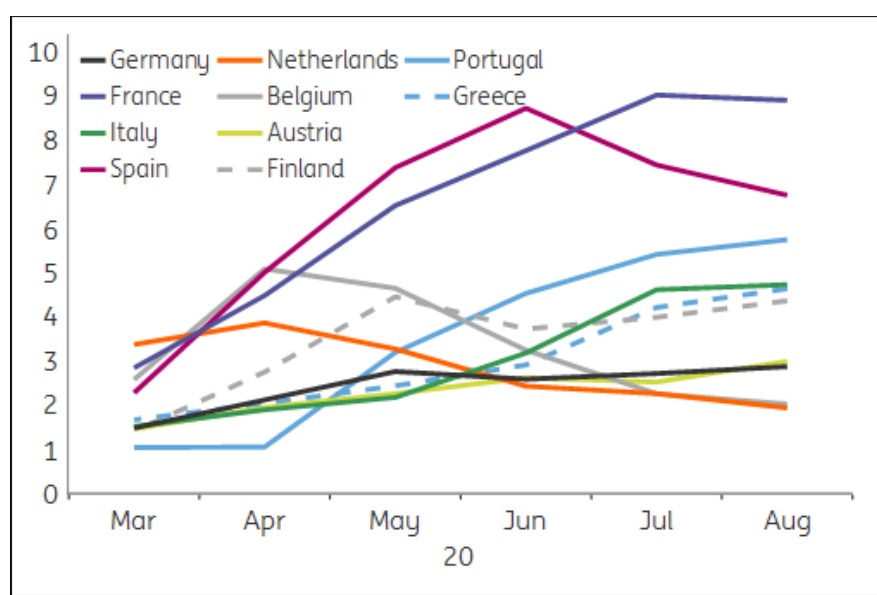
The interest rate in the ECB TLTRO-III operation is tied to lending development. If banks meet the set lending criteria, they can obtain the TLTRO funding at a rate as low as -1% for one year and at -0.50% for the rest of the time. In our view, banks are in general well positioned to meet the benchmark with their eligible net lending growth on a country basis by March 2021. Yet there are clear country differences.

Countries where initial liquidity needs were mostly met by bank loans and, in turn, backed by government guarantees, are comfortably above the benchmark. This applies to Spain, Italy, Portugal, but also France.

At the other end of the spectrum are countries where more of the support was provided by governments directly to businesses and households, mainly via tax deferrals and temporary wage support schemes. This is the case in, for example, Germany and the Netherlands.

Despite the fact that the latter group of countries has less leeway above the benchmark, we think all countries presented here are in a good position to meet or exceed the net lending benchmark. Countries are also generally on track to meet or exceed the benchmark in the second reference period.

### Cumulative eligible net lending since March 2020 (%)



Source: Lending to businesses and non-mortgage lending to households. Compared to country net lending benchmark as defined by ECB. Corrected for sale/securitisation where applicable. Source: ING-calculations based on ECB-data.

French and Italian banks were the largest users of the ECB's longer-term refinancing operations in July, drawing €350bn and €345bn, respectively, followed by German and Spanish banks, at €284bn and €257bn, respectively. This is not surprising taking into account the lending developments and the bond market pricing. The banking sectors of France, Spain and Italy are among those showing the strongest lending growth in the special reference period. Among them, Italy and Spain in particular, but also to a lesser extent France, stand to benefit from the attractive funding levels of the TLTRO programme as compared to funding via bond markets.

From a funding cost angle, it would currently make sense for banks across the Eurozone to draw funds from the TLTRO-III, especially if they were to meet the special reference period lending benchmark and thus realise the attractive -1% rate for one year and a rate of -0.5% for the rest of the operation. The TLTRO-III tranches I-V have the first repayment opportunity in September 2021.

Thus, banks can enjoy the special interest rate period, and only then consider whether to repay the funds early or keep them to maturity. The willingness to repay early is likely to be driven by lending

development, bond market trading levels, tiering effects and the economic outlook.

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## Swiss central bank: Wait, see and hope

No change in monetary policy for the SNB, which still seems to be waiting to see what happens. But the bank will now publish data on the volume of its foreign exchange market interventions on a quarterly basis instead of just annually



Source: Shutterstock

### The intervention continues

The Swiss central bank didn't change its monetary policy today and the key rate is still at -0.75% and the franc is still described as "highly valued".

Since the June meeting, the Swiss franc has depreciated against the euro but appreciated against the dollar. The central bank, therefore, remains in the same position, indicating that it "remains willing to intervene more strongly in the foreign exchange market". This implies that it still intends to use foreign exchange market intervention as the primary instrument of its monetary policy in the coming months.

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*Interestingly, the central bank announced it will now publish data on the volume of its foreign exchange market interventions on a quarterly basis instead of just annually*

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Interestingly, the central bank announced it will now publish data on the volume of its foreign exchange market interventions on a quarterly basis instead of just annually. This will therefore provide a clearer picture of the situation. It cannot be ruled out that this decision is linked to the fact that Switzerland is on the US authorities watch list for currency manipulation, and this additional transparency is intended to allay US fears.

## Technical revision of the outlook

The interesting element of the September meeting is the upward revision of the outlook for GDP and inflation; although this was clearly expected.

The SNB now believes GDP will contract by around 5% in 2020, compared to -6% at the June meeting, due to the smaller than expected contraction in GDP figures in the second quarter of 2020. It, therefore, seems that it has not changed its scenario or its assumptions and that the change in forecasts is purely technical.

For inflation, the SNB is revising its outlook slightly upwards by forecasting -0.6% for 2020, 0.1% for 2021 and 0.2% for 2022 (compared with -0.7%, -0.2% and 0.2% respectively in June). One might be tempted to see a “less dovish” sign of these upward revisions, but that would probably be a mistake. Anticipating 0.2% inflation by 2022 is low, very low, and implicitly implies that the SNB is aware that it has difficulty in keeping inflation in positive territory on a long-term basis.

In view of the fact that inflation has been negative over seven of the last 20 years (including 2020) and that, with inflation forecasts of 0.1 and 0.2% for 2021 and 2022, the risk of another year of deflation is substantial, achieving its monetary policy goal has become very complicated for the SNB. The risk is, of course, that the inflation target will become less and less credible. In the meantime, the SNB seems to be waiting and keeping its fingers crossed that a better economic situation will one day lead to higher inflation. For the time being, it is clear that such forecasts imply that absolutely no rate increases are expected.

It should be noted that a rate cut is also difficult to envisage at the moment. The ECB would probably have to lower its own rates to see a rate cut in Switzerland, and again, this would depend on the appreciation of the franc that would result from such a decision by the ECB.

### No revision of monetary policy in sight

It is also interesting to note that the Swiss central bank does not even communicate about a possible revision of its monetary policy strategy like the Federal Reserve has done, which is now targeting an average inflation rate of 2%, or as the ECB, whose revision is in progress.

Clearly, the SNB is not there yet or does not wish to communicate about this (let's not forget that the SNB has always preferred surprise decisions in the past). Nevertheless, it is possible that the SNB may have to undertake such an exercise in the coming years. For now, it may wish to wait and see what emerges from the ECB's monetary policy review.

Ultimately, as it has done for some time now, the SNB seems to be waiting for better times to see what should be done.

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# Norges Bank: No helping hand to the battered NOK

The Norges Bank struck a cautious tone today. Given the global uncertainty, it verbally delayed the prospect of policy normalisation. This is clearly not positive for Norway's krone, which is already under heavy pressure and set to remain the most vulnerable G10 currency in falling markets



## No change over the next couple of years

The NB struck a cautious tone today. While the interest forecast still points towards tightening (NB modestly upgraded the interest rate path for end 2022, showing interest rates at 0.21% vs 0.16% previously), the verbal forward guidance was more cautious, with the NB saying rates will stay "at the current level over the next couple of years." This is a more forceful message compared to the previous statement where rates were supposed to stay unchanged for "some time ahead".

This rhetoric is justified, in our view, given the rising Covid-19 related uncertainties, the re-rating of global growth prospects by the market and the subsequent limited upside to oil prices. With such risks rising, the change in the NB's bias (back towards more hawkish / constructive) is unlikely to happen anytime soon.

## NOK remains vulnerable

The NB has been widely considered to be the most hike-prone central bank in the G10 FX space, and the dovish/cautious bias presented in the NB statement today pours cold water on such expectations (of earlier hikes). With NOK already struggling heavily during the recent fall in risk assets, the NB has clearly not provided a helping hand (rather the opposite) and NOK continues its decline as well as its underperformance vs G10 peers. In the current fragile markets, we see the low liquidity krone (which is the least liquid currency in the G10 FX space) as the most vulnerable G10 currency - as was the case during the peak of the Covid-19 crisis this spring and during the market sell-off this week.

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## Sweden's Riksbank upgrades growth assessment but signals ongoing caution

The latest Riksbank announcement signals that rates are going nowhere fast - and importantly that means a return to negative rates looks unlikely. The fact that the central bank is no longer a dovish outlier in the G10 space suggests the krona could continue to outperform high beta peers in periods of market stress



Source: Shutterstock

### Swedish interest rates going nowhere fast

On the face of it, there's not much to get excited about in the latest Riksbank summary. Despite some better consumer spending data, which has driven the central bank to revise up its expectations for 2020 GDP (to -3.6% from -4.5% in July), the myriad of uncertainty facing the global economy this winter means that policymakers have unsurprisingly kept their interest rate projection flat over coming years.

And while the situation in the jobs market has now stabilised (new redundancy notices have fallen back to normal levels after a spike in the spring), the subdued outlook for wages has contributed to a marginal reduction in the Riksbank's CPIF forecasts for the next couple of years.

Still, what all of this does at least signal is that further easing, at least in the form of a return to negative interest rates, is unlikely. We also know that, despite the gradual appreciation in SEK over

recent months, policymakers are much more relaxed about the currency than they were in times gone by.

All in all, rates are unlikely to move in either direction for quite some time.

## SEK impact: Riksbank neither a help nor a hindrance for the currency

The SEK reaction to the Riksbank meeting has been muted, given the upward revision to the 2020/21 GDP outlook was not matched by even a modest upward revision to the interest rate forecast (which remained flat at 0% over the entire forecast horizon). That differs from the stance taken by Norges Bank, which has pencilled a modest amount of tightening into their profile in future years.

While Sweden is a small open economy levered to global growth - which is currently an undesirable attribute given the downside risk from rising Covid-19 cases - and the central bank has not signalled it will tighten policy any time soon, SEK is still set to outperform Norway's krone in the current risk-challenging environment given its lower beta to risk (NOK currently exerts the highest beta to risk in the G10 FX space).

Sweden's central bank is no longer a dovish outlier in the G10 FX space as nominal and real rates no longer stand out as particularly negative in relative terms vs its peers, and it is not actively leaning against currency strength, which suggests that the outlook for SEK is not negative and the currency will likely continue to outperform its high beta G10 peers in times of stress.

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Article | 23 September 2020

## Oil demand uncertainties linger

Price action in oil had been largely rangebound over the summer months. However a slower than expected demand recovery and returning supply has seen prices wobble more recently. While we still see prices moving higher from current levels, we have revised lower our price expectations due to the demand picture



A worker inspects oil pipeline equipment in northeast China

### Demand taking longer than expected to come back

Demand is the key uncertainty for the global oil market, and it is set to remain so, as long as Covid-19 disrupts our everyday life.

It has become clear that the recovery in oil demand from the peak lockdown period over 2Q20 is taking longer than many had initially anticipated. A resurgence in Covid-19 cases, continued remote working, and the fact that international travel remains heavily restricted is weighing on the recovery.

At the peak of the lockdown, global oil demand was estimated to have been down a little over 23MMbbls/d year-on-year in April according to Rystad Energy, while currently it is estimated to be down in the region of 8MMbbls/d YoY.

For full-year 2020, Rystad Energy is expecting demand to be down a little over 10MMbbls/d YoY. Then, as we move into 2021, demand is estimated to grow by almost 6.8MMbbls/d YoY, however, this still leaves it below 2019 demand levels. Over 2021, it continues to be the aviation industry

that largely weighs on demand, with international air travel unlikely to return to anywhere near normal levels until there is a Covid-19 vaccine commercially available.

## Chinese buyers take a step back

One of the key drivers behind the recovery in oil prices from their April lows was strong Chinese buying.

Imports in June hit an all-time high of just below 13MMbbls/d, up 34% YoY. Since then imports have eased, but we have still seen strong YoY growth. These imports do not reflect real consumption, instead, China has taken advantage of lower prices to stock up. The peak was in June, where the country appears to have added around 2.8MMbbls to inventories every day. Looking at the latest available data, in August, China added 1.1MMbbls/d to inventories.

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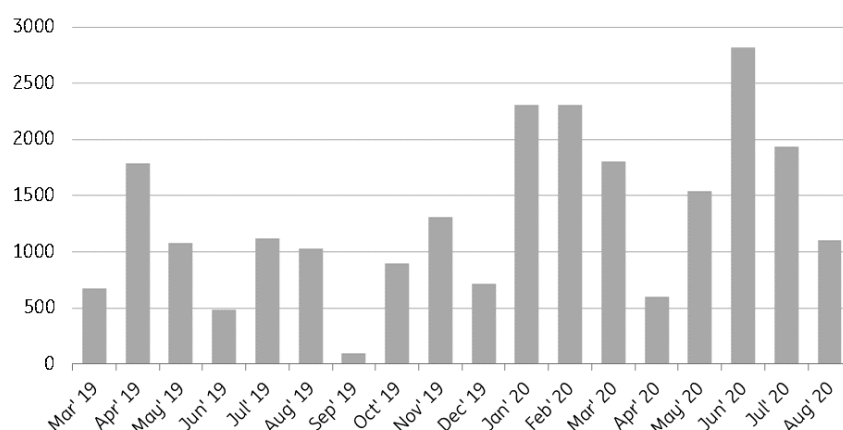
*One of the key drivers behind the recovery in oil prices from their April lows was strong Chinese buying, as they took advantage of lower prices to stock up*

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This should slow in the months ahead, with Chinese buyers noticeably quieter in the physical market, having stocked up already, as well as running low on available import quotas.

This has hit the physical market, with differentials weaker, and with a number of unsold cargoes from West Africa. There have been reports more recently that independent refiners in China are requesting for further import quotas to be issued for 4Q20, which if occurs could provide some needed support to the physical market.

## China has built significant crude oil inventories in 2020 (Mbbbls/d)



Source: NBS, China Customs, ING Research

## Refinery margins not providing much incentive

Another factor which has not been supportive for crude oil demand are weak refinery margins.

Globally refiners remain under pressure, with poor products demand, large product inventories and weak product cracks. As a result, there is little incentive for refiners to increase utilisation rates. According to IHS Markit, global refinery utilisation rates are below 75% currently, which compares to around 85% at the same stage last year.

While recent hurricane activity in the US Gulf hasn't helped, with some refiners in the region sustaining damages resulting in lower run rates. In addition, with refinery maintenance season approaching, this will likely weigh on crude demand further in the weeks ahead.

## OPEC+ easing

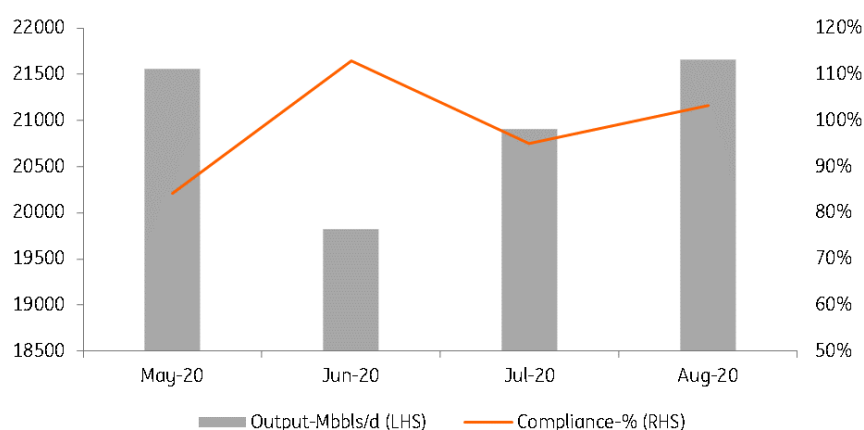
The wobble in prices that we have seen more recently will be a concern for OPEC+, although they decided against recommending or taking any further action when the Joint Ministerial Monitoring Committee (JMMC) met on the 17 September.

The issue for OPEC+ is that as the demand recovery has slowed, and Chinese buying has disappeared while the group has eased output cuts. Between May and July, under the deal they agreed to cut by 9.7MMbbls/d (while for June, Saudi, the UAE and Kuwait decided voluntarily to cut by an additional 1.2MMbbls/d), and this was eased to 7.7MMbbls/d from 1 August.

Meanwhile, and unsurprisingly there is always the issue of compliance, and at every OPEC+ JMMC, there is pressure on those producing above their quota to comply. The group have gone a step further this time, pushing those who have fallen short, to compensate for the lack of their compliance. While Iraq and Nigeria produced above their quota in the first few months of the deal, they do seem to be hitting compliance now, although will need to compensate for their previous poor performance in the months ahead. While more recently, the UAE has also started to slip with its compliance. However, according to the committee, compliance for the full group still came in at 102% in August.

More recently, OPEC member, Libya (which is exempt from the output cut deal, and has been suffering from near zero production due to an export blockade since the start of the year) looks set to see output return. Libya's National Oil Corporation has lifted force majeure for a number of ports and facilities, whilst the East Libyan commander Khalifa Haftar has said that he will lift the export blockade from the country. This does suggest that in the coming months we could see Libyan supply increase from a little over 100Mbbls/d towards 1MMbbls/d. Libya's NOC has said that output from the country is expected to reach 260Mbbls/d by next week. However as we have become accustomed to, it is safe to assume that Libyan supply will remain volatile moving forward.

## OPEC-10 compliance (%)



Source: OPEC, ING Research

## Non-OPEC+ supply also returns

It is not just OPEC+ where we have seen supply come back to the market. The fairly strong and quick recovery we saw in prices from the April lows means that producers who had closed production, have brought it back fairly quickly.

This is most evident in the US, where producers have been very quick to bring back this production. US crude oil output bottomed out at a little over 10MMbbls/d in May, around 2MMbbls/d lower from the month before. But since May, output is estimated to be back in the region of 11MMbbls/d, although a fairly active hurricane season has meant that we have seen quite a bit in the way of supply disruptions in offshore US Gulf of Mexico.

While we have seen a short term bounce in US output, it is unlikely that output will continue to grow. Rig activity in the US has basically come to a standstill, and so it will be difficult to sustain current production levels, never mind grow it, unless we see a pickup in drilling. The industry will likely turn to completing drilled but uncompleted wells (DUCs), in an attempt to maintain output, and this is something we saw over August, with US DUC inventories edging lower.

## Plenty of demand uncertainty, but market still set to move higher

Clearly how demand evolves is the big unknown, and so it is the key risk for the oil market. Further waves of Covid-19 and restrained air travel is a downside risk for demand and as a result prices.

However assuming that demand continues its gradual recovery, we believe that stocks will decline over 4Q20 and 2021, which should see prices trending higher from current levels. We do not believe that further waves of Covid-19 will lead to full lockdowns, instead, governments are likely to take a more targeted and localised approach. However we have revised lower our forecast for ICE Brent, and now expect prices to average US\$47/bbl over 4Q20, this compares to our previous forecast of US\$50/bbl. Meanwhile, for 2021, we have made some minor revisions, although the average for the year remains at US\$58/bbl.

*We have revised lower our forecast for ICE Brent, and now expect prices to average US\$47/bbl over 4Q20*

Apart from Covid-19 related demand risks, there are several other downside risks to our view. Firstly, is the OPEC+ deal, which is currently set to run all the way through 2021 and into 2022. If for some reason the deal was to fall apart, this would mean 5.8MMbbls/d additional supply coming onto the market in 2021, and this would be enough to push the market back to building inventories.

The second risk is related to US elections. The Trump administration has had a very hawkish stance with Iran, which saw the US re-implement sanctions against the country. If we were to see a Joe Biden victory, one would have to consider the possibility of the US lifting sanctions and rejoining the Joint Comprehensive Plan of Action. If this were to happen, we would likely see Iranian oil output recovering, leading to potentially more than 1.5MMbbls/d of supply returning to the market over time.

## ING oil forecasts

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
ICE Brent (US\$/bbl)	51	33	43	47	50	58	60	62
NYMEX WTI (US\$/bbl)	46	28	41	44	46	53	55	57

Source: ING Research

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# CAD: Uncertain path, but the best choice in the \$-bloc

A resurgence of lockdown-related risks and choppy risk environment highlight more limited downside potential for USD/CAD. Still, a well-paced economic recovery in Canada, no further stimulus from the central bank, a still positive oil outlook and lingering CAD short positioning should favour CAD's outperformance vs AUD and NZD



Source: pexels

The current re-pricing of the global economic recovery, as new virus waves and restrictions loom, has inevitably hit the pro-cyclical Canadian dollar, which is back at the 1.34 level last seen in July. Recent developments are forcing us to slightly revise our views on the loonie, although we continue to identify some factors that suggest CAD may not stand out as an underperformer among the pool of activity currencies. We see four key factors at work:

## 1 Bank of Canada unlikely to add more stimulus

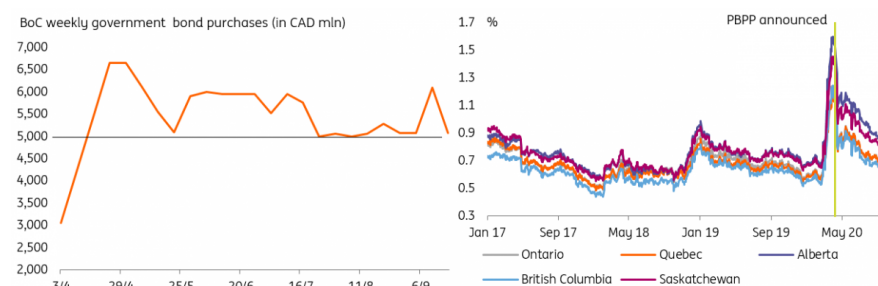
The Bank of Canada has so far broadly followed the Federal Reserve in enacting emergency policy measures to counter the effects of the pandemic: cutting the policy rate to 0.25% and starting quantitative easing.

The BoC has not touched its QE programme (neither quantitatively nor qualitatively) since it

introduced facilities to purchase provincial and corporate bonds to accompany its bond-buying scheme in April. For now, the new Governor, Tiff Macklem, has not seen enough reasons to add stimulus to the already large monetary package: the pace of purchases under the Government of Canada Bond Purchase Program (GBPP) has not been increased, as most weekly purchases were slightly above or at the minimum CAD 5bn amount set by the BoC (Figure 1). This may signal a relatively low interest to increase the minimum amount of weekly bond purchases anytime soon.

Looking at the provincial spreads, they have been tightening (Figure 2) at a constant pace since the introduction of the Provincial Bond Purchase Program (PBPP), easing the Bank's concerns.

### Figure 1 & 2 - BoC QE and provincial spreads



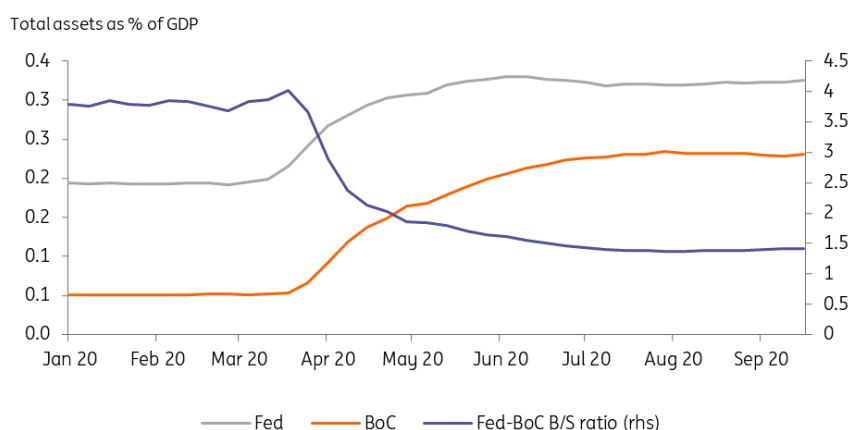
Source: Bank of Canada, Bloomberg, ING

Accordingly, the sharp rise in the BoC's balance sheet, also compared to the Fed's (Figure 3), has been followed by some stabilisation in late summer. From a currency perspective, a slower rise in the balance sheet suggests less negative implications for CAD.

All in all, we see the current amount of monetary stimulus provided by the BoC as adequate to support the recovery and do not expect any increase in the size or spectrum of asset purchases and – even less so – any rate cut in the foreseeable future.

This could create some monetary policy divergence within the G10 commodity space, considering that the Reserve Bank of New Zealand is openly planning to embark on negative interest rates early next year, and speculation around a possible cut in Australia has also risen.

### Figure 3 - BoC balance sheet



Source: Bloomberg, ING

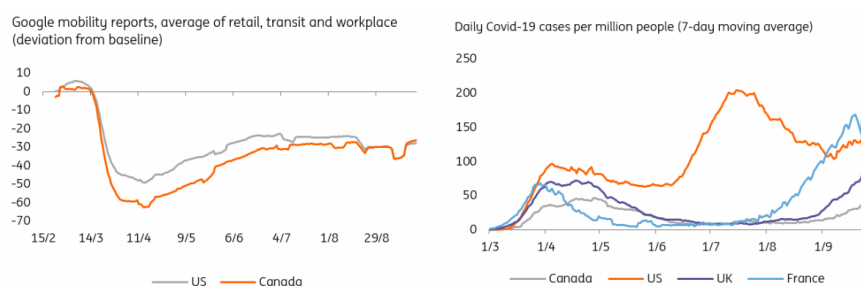
## 2 Canadian economic recovery set to continue

The Canadian economy contracted by 38.7% quarter-on-quarter (annualised) in the second quarter, displaying a worse slump than the US (31.7%), which is understandable considering the stricter containment measures in Canada and the higher exposure to the swings in global trade and commodity prices.

The Canadian economic recovery has been helped by a well-sized fiscal stimulus (already worth around 15% of GDP, waiting for a next round of spending) and monetary accommodation and it has kept pace with the US recovery. The unemployment rate contracted to 10.2% in September after having peaked at 13.7% in May- broadly following the dynamics in the US jobs market. Google mobility data shows that the impact of restrictions in Canada has definitely started to fade and the divergence with the US (which had looser restrictions) has been erased from the mobility point of view (Figure 4).

The Canadian economy has likely digested the slump in oil prices earlier this year, and signs of recovery in global trade have likely fuelled a solid rebound in the third quarter. While the risk of new lockdowns worldwide obviously poses the risk of a slower global recovery, we do not see enough factors to suggest the Canadian economy will lag other major economies.

### Figure 4 & 5 - Canada's virus situation is not too alarming



Source: Bloomberg, ING

If anything, the virus situation appears more under control in Canada compared to other regions, as shown in Figure 5. While Canada will remain very exposed to new contagion waves and lockdown measures in the US, this may suggest a more limited need for more restrictive measures in Canada compared to other countries, which bodes well for the economic recovery.

Finally, political turmoil appears to be easing in Canada following a complicated summer where another scandal caused the resignation of Finance Minister Bill Morneau. It appears now that the Trudeau administration has made it through the worst, and can still count on a high approval rate for its Covid-19 policy response.

## 3 More support for oil is not off the charts

Demand is indeed the key question mark for the crude oil price outlook. The recovery in demand is proving slower than previously expected and a key driver of such recovery – Chinese buying – appears to be drying up. Meanwhile, weak refinery margins are failing to provide much incentive to increase utilisation rates.

On the supply side, OPEC+ is refusing to agree on more output cuts for now, but it is still making steps forward in terms of compliance, by asking those who fell short of their commitments to compensate for their previous poor performance.

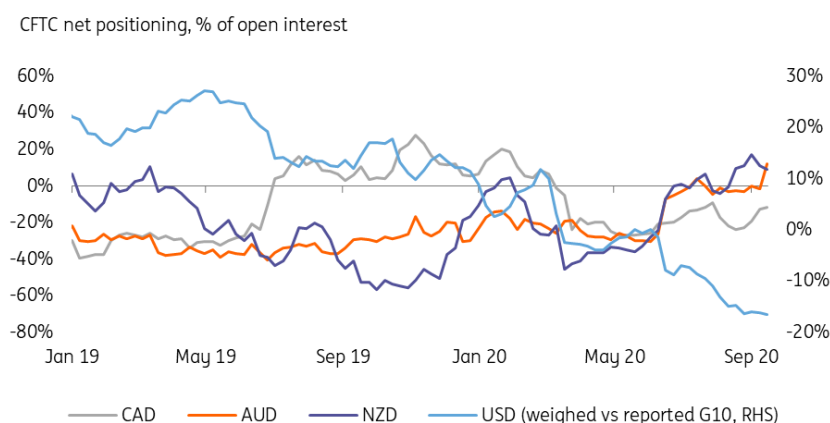
While there is plenty of uncertainty around the oil outlook, our commodities team [remains of the view](#) that a gradual (albeit slower) recovery in global crude demand should still allow oil prices to stay supported in 4Q, where we expect an average 47\$/bbl for Brent and 44\$/bbl for WTI. For more details on our oil view, see our commodities team’s update: [“Oil demand uncertainties linger”](#).

## 4 Linger short positioning signals less downside risk

In our [latest CFTC positioning review piece](#), we highlighted how all reported G10 currencies except the Canadian dollar had a net-long positioning vs the oversold USD. While this past week’s market movements have likely generated some USD short-squeeze and possibly sent some currencies back into net-short territory, the resilience of CAD’s shorts compared to its pro-cyclical peers has been evident for a few months now (Figure 6).

Should new swings in global risk appetite generate some dollar short-squeezing events, the CAD should be more protected than its peers AUD and NZD.

Figure 6 - CAD's positioning



Source: CFTC, Macrobond, ING

### CAD outlook: uncertain vs USD, but we see value vs other procyclicals

All the points mentioned above aim to highlight how the Canadian dollar still presents relatively solid fundamentals. But the recent setback in risk sentiment and the rise in Covid cases worldwide do highlight a non-negligible downside risk for activity currencies as we head into the US elections in November. In turn, we now see the USD/CAD outlook as more uncertain compared to a few weeks ago, its downside potential as somewhat more limited, and we are inclined to see the pair staying above the 1.30 mark in 4Q.

Still, we believe that a combination of monetary policy divergence (BoC to stand pat, RBNZ and RBA increasingly dovish), a well-paced economic recovery in Canada, a still optimistic oil outlook and lingering CAD short positioning, all point to better resilience from CAD compared

to AUD and NZD in the currently unstable global risk environment.

We see room for the recent downtrends in AUD/CAD and NZD/CAD to extend towards the 0.92 and 0.85 marks, respectively.

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## Mexico: Cutting short the easing cycle

Mexican policymakers seem ready to conclude the monetary easing cycle, even though the country's monetary stimulus remains unusually modest, when compared to its regional peers. The expected 25bp rate cut at this week's meeting, to 4.25%, should be the last of the current cycle



### A hesitant Banxico

The balance of risks for Mexico's post-pandemic outlook for economic activity remains skewed to the downside, with consensus expectations consolidating at a 2020 GDP contraction of -10%, among the worst in LATAM.

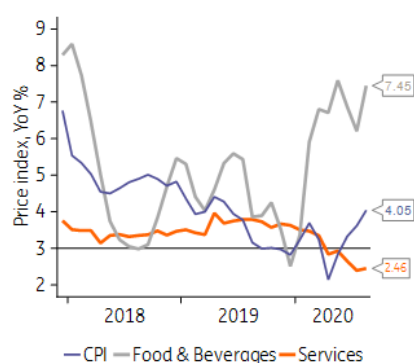
Despite this grim outlook and the rising output gap, central bank officials have refrained from replicating the aggressive rate-cutting cycle seen throughout LATAM in recent months. Moreover, the hawkish dissent seen at the last policy meeting, when one board-member (Irene Espinosa) called for a smaller rate cut of 25bp, presaged a growing discomfort with the consequences of the easing cycle.

Mexican policymakers appear more concerned than their LATAM peers about the incipient rise in food prices, which helped push headline inflation slightly above the targeted range in August (4.05% YoY).

Rising food prices was seen across the region, but it was generally downplayed by local

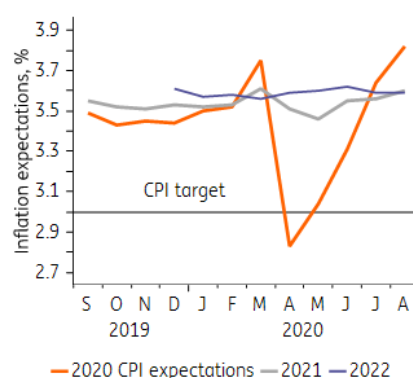
policymakers, who tended to view the fact as the result of pandemic-related temporary supply constraints and changes in consumption patterns, with limited potential for lasting damage to inflation dynamics.

Food prices surged in recent months



Source: Macrobond, ING

Inflation expectations have also risen



Source: Macrobond, ING

The rise in inflation expectations towards the upper-bound of the targeted range is more concerning, as it calls into question the credibility of the inflation targeting regime.

But, ultimately, Banxico's enduring concerns regarding the impact of rate cuts over local market stability, which could be compromised if capital outflows surge, suggest that tolerance for additional cuts is likely very close to its limit. The assumption is that a sufficiently large Mexico/US rate differential is crucial to anchor local markets.

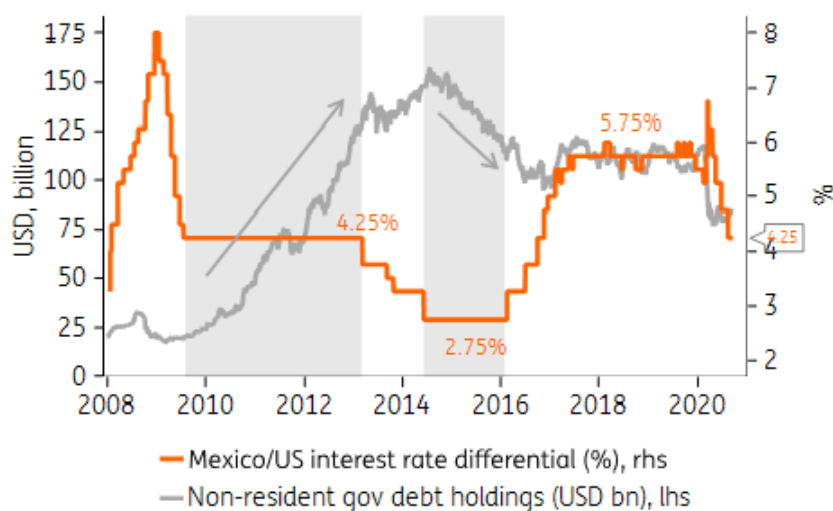
These factors suggest that this Thursday's monetary policy meeting should conclude with policymakers slowing down the pace of rate cuts, to 25bp from 50bp, and emphasizing the reduced room for additional easing, when considering the rising price pressures seen in recent months.

We suspect officials will not explicitly signal the end of the cycle. But, at 4.25%, the tolerance for additional rate cuts would be considerably lower and would likely require significant improvements in the outlook for inflation and a stronger MXN. We now expect the cycle to end after this week's rate cut, with the benchmark rate at 4.25%, instead of our previous call of 4.0%.

## A cloudier near-term outlook for EM assets

As we've discussed before, Banxico often cites Mexico/US interest rate differential as an important input in its reaction function, given its perceived impact over FX flows. As seen in the chart below, that differential should drop to 4.0% this week, or 175bp below the level prevailing in the recent 2017-20 period, which was marked by broad stability in non-resident holdings in the local government debt market.

### Falling Mexico/US rate differential could jeopardize FX flows

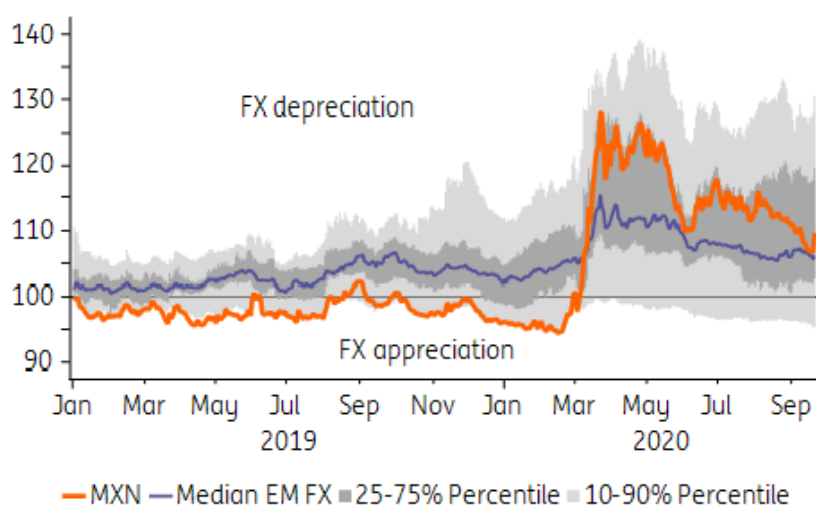


Source: Macrobond, ING

Apart from the uncertainties generated by this narrowing rate differential, greater caution by central bank officials could also be justified by the recent rise in market volatility.

Even though the Mexican peso has been a clear outperformer over the past couple of months, the outlook for EM currencies appears cloudier now, amid heightened uncertainties regarding the global outlook for Covid-19 and economic activity, along with lingering concerns regarding the US fiscal stimulus and the November Presidential election.

### The MXN's recent outperformance stood out across the EM space



Source: Macrobond, ING

### A winning short-term strategy (for fixed income assets)

Judging by the relative performance of local fixed-income assets and the MXN, the current

economic policy strategy, marked by a relatively hawkish fiscal and monetary policy stance, has proved successful at boosting appetite for some local assets.

The unusually modest policy stimulus is not without risks, however, as it should deepen the recession and delay the recovery, likely causing deeper permanent damage to economic activity and the country's long-term trajectory.

But, in the shorter-term, it should continue to be seen as a safer path, when compared to regional peers. As seen in the brewing fiscal concerns in Brazil and other large LATAM countries that stretched the limits of what EM economies can do in terms of fiscal stimulus, investor concerns over fiscal sustainability may take longer to dissipate.

Overall, the recent rise in volatility could reduce the appeal of the carry trade but Mexico's stronger-credit rating suggests that, in the shorter-term, the country's local fixed-income assets should remain the asset-of-choice to boost LATAM/EM exposure in the context of a weakening USD and low rates.

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