In case you missed it: Global flight to safety

The Fed has leapt into action, treasury yields are plummeting, Libor is spiking and central banks around the world have begun to cut rates. As the virus crosses 100,000 confirmed cases, the global flight to safety continues, and the 'whatever it takes' sentiment returns. All eyes on the ECB next week but the real question is how low can the Fed really go?

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By James Knightley, Padhraic Garvey, CFA and Chris Turner

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The Fed largely delivered on expectations with an emergency 50bp rate cut this Tuesday. The dollar was initially weaker across the board, with high yield...

By Chris Turner

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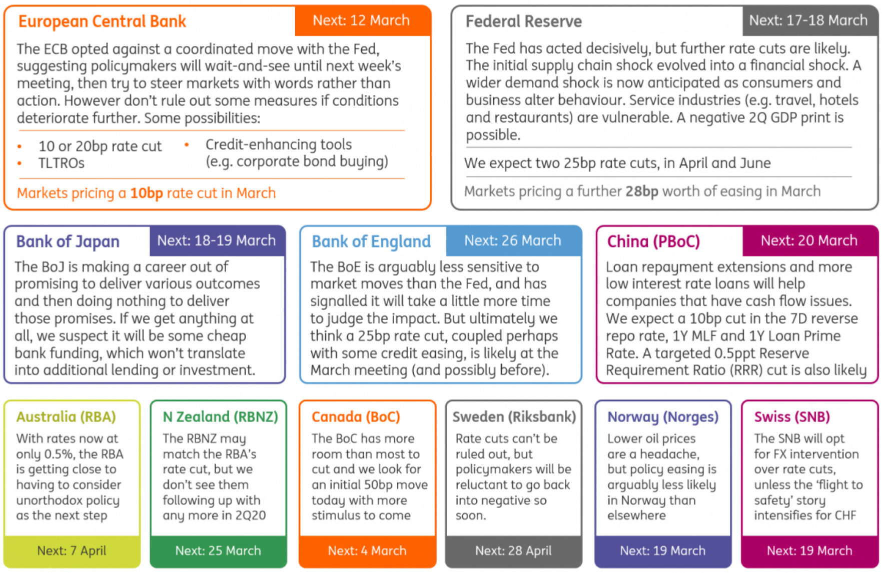
By Timothy Rahill and Jeroen van den Broek

Article | 4 March 2020

Central banks: Who will be next to cut interest rates?

Global central banks decided against joining the Federal Reserve's rate cut this week, but it is only a matter of time before policymakers elsewhere...

Who will be next to cut interest rates?



Source: ING, Bloomberg (for market pricing)

The Federal Reserve has cut by 50bp – who will be next?

The Federal Reserve has delivered a punchy 50 basis point emergency rate cut, and we suspect there could be more to come.

What started out as a supply chain shock for the US has morphed into a financial shock, as markets recognise that the coronavirus will have a much broader impact on the global economy. The concern now is that the fear factor surrounding the outbreak will change corporate and consumer behaviour, prompting a wider demand shock too. This is most likely through the service sector of the economy with travel, hotel accommodation, restaurants and leisure-related sectors looking vulnerable. Add in the prospect of significantly weaker export performance and a negative second quarter GDP print is looking a distinct possibility.

While we doubt rate cuts will make a meaningful boost to aggregate demand, they may help to mitigate some potential strains in the financial system and lift sentiment. We're pencilling in two further 25bp rate cuts for the second quarter, giving a total of 100bp worth of easing in the US.

There had been hopes among investors that the Fed's bold move would be accompanied by wider coordinated action. That hasn't happened yet, with some of the other major central banks signalling a preference to wait a little longer to gauge the fallout.

But further action is inevitable from central banks, and here we take a look at who might be next in line to cut rates.

The Federal Reserve is covered by James Knightley

European Central Bank (ECB)

Under the leadership of ECB President Christine Lagarde, the bank looked less sensitive to financial market developments than it did under her predecessor Mario Draghi. There has been a growing awareness of the adverse effects of the ECB's unconventional measures, lowering the likelihood of, or at least the willingness for, additional monetary policy easing.

The ECB opted against a coordinated move with the Fed, signalling that policymakers would prefer to wait-and-see until next week's official meeting, and then try to steer markets with words rather than action. It is currently hard to tell whether words will really be enough or whether the ECB feels forced into some action. A lot will depend on how the virus and financial markets evolve in the coming days.

The ECB is facing a challenging situation in which the staff projections, which are based on the no-policy-change assumption, and the still relatively benign macro data (cut-off date for the projections was last week), will be more optimistic than the gut feeling of many ECB officials about the possible economic impact of the coronavirus. This combination of fear and uncertainty, and the root problem originating clearly outside of the ECB's reach, once again illustrates the ECB's dilemma: it has run out of ammunition.

Still, we shouldn't rule out some moves if the situation deteriorates. A 10 or 20bp rate cut is possible, combined with a tweaked tiering facility, some new (or adapted) Targeted Longer-Term Refinancing Operations, a new credit enhancing instrument for SMEs or a shift of quantitative easing purchases towards corporate bonds.

The European Central bank is covered by Carsten Brzeski

People's Bank of China (PBoC)

Loan repayment extensions and more low interest rate loans will help companies that have cash flow issues from Covid-19. Easing via a rate cut and targeted reserve requirement ratio (RRR) cut will help the economy, but only slightly. A broad-based RRR cut, for now, won't help affected companies sufficiently.

We're expecting a 10bp cut in the 7-day reverse repo rate, 1-year medium-lending facility and 1-year loan prime rate. We are also pencilling in a targeted 0.5 percentage point cut in the reserve requirement ratio (RRR) for affected companies.

People's Bank of China is covered by Iris Pang

Bank of England (BoE)

The rise in sentiment after December's election was enough to convince the Monetary Policy Committee not to lower interest rates in January. Policymakers had been looking for a modest growth rebound in the first half of this year. But if the coronavirus were to create a broader demand shock in the UK, that could change. Comments from outgoing Governor Mark Carney indicate the committee wants to wait for more data before deciding how to act.

Like the ECB, policymakers are arguably less sensitive to financial market moves than the Fed, and will be listening closely with their agents to gauge the extent of the fallout. However, with the UK government warning that the number of cases is likely to rise, we think policymakers will ultimately cut interest rates to 0.5% later in March, and like the ECB, may also look towards credit easing measures. A negative second quarter growth figure now looks like a possibility.

The Bank of England is covered by James Smith

Bank of Japan (BoJ)

The BoJ is making a career out of promising to deliver various outcomes and then doing nothing to deliver those promises. We put recent comments related to the coronavirus by central bank Governor Haruhiko Kuroda into that category. If we get anything at all, we suspect it will be some cheap bank funding, which won't translate into additional lending or investment.

The Bank of Japan is covered by Rob Carnell

Bank of Canada (BoC)

We had been looking for a 25bp cut by the BoC this week as coronavirus worries increasingly weigh on the economic outlook, but with the Fed having moved more aggressively, the pressure is on the BoC to follow suit. The BoC has more room than most central banks to provide support to the economy and financial markets (the Overnight Lending Rate is at 1.75%) and in the past hasn't been afraid to take bold steps. We expect an additional 50bp of rate cuts in subsequent months.

The Bank of Canada is covered by James Knightley

Riksbank

Sweden's open economy is vulnerable to the wider supply chain disruption. Even so, policy easing is not necessarily inevitable. A rate cut is possible, but it would come only weeks after policymakers lifted the deposit rate to get out of negative territory. The Riksbank will be reluctant to go back there so soon, and don't forget the next meeting isn't until late-April, by which time there may be light at the end of the tunnel.

The Riksbank is covered by James Smith

Norges Bank

Lower oil prices are a headache for the Norges Bank, although don't forget that breakeven prices in the oil industry are still lower than current market pricing, according to the central bank. Like everywhere else monetary easing is possible although barring a sharp appreciation in the krone, it's too early to conclude a rate cut is likely at the 19 March meeting. Don't forget the Norges Bank has been a standout hawk in the G10 space over the last 12 months.

Norges Bank is covered by James Smith

Swiss National Bank

The appreciating Swiss franc is a problem for the Swiss National Bank, which finds itself forced to intervene in FX markets to avoid deflation. The question is what can policymakers do if the flight-to-safety persists? If pressure becomes too great such that invention runs out of road, the SNB could lower its rate to -1% if it has to. This, however, is not our base case, and we think policymakers will want to avoid that.

The Swiss National Bank is covered by Charlotte de Montpellier

Reserve Bank of Australia (RBA)

Australia cut rates this month, a big turnaround from its upbeat assessment in February. With rates now at only 0.5%, the Bank is getting close to having to consider unorthodox policy as the next step.

The Reserve Bank of Australia is covered by Rob Carnell

Reserve Bank of New Zealand (RBNZ)

The Reserve Bank of New Zealand may match Australia's rate cut this month, but we don't see it following up with any more in the second quarter, as inflation and growth remain reasonable.

The Reserve Bank of New Zealand is covered by Rob Carnell

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Article | 6 March 2020

That sinking feeling as Libor spikes

When Libor spikes, we need to sit up and pay attention. Why? It's telling us that the financial system is feeling real stress. Stress that goes beyond...

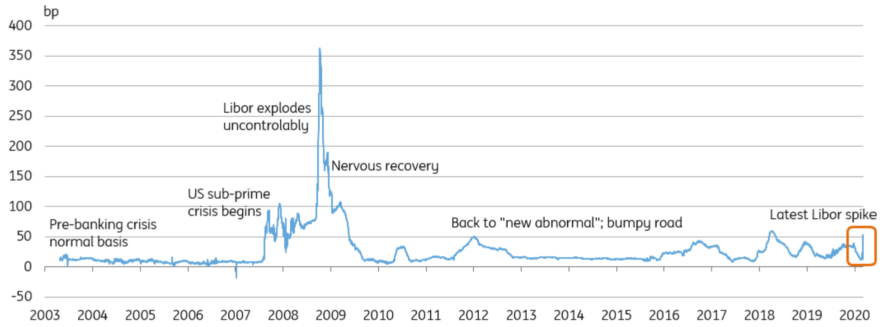
Source: Shutterstock

A financial crisis reminder?

Few spend time looking at Libor. We don't blame you.

It's old-school, and it will be replaced by new risk-free rates after 2021. Also, Libor is more about where banks can print commercial paper these days than a measure of risk attached to interbank lending (as there is virtually no volume there). But when it spikes, as it has been doing in the past couple of days, we need to sit up and take attention. This is, in fact, reminiscent of the beginnings of the extremes we saw during the financial crisis.

> *"This is in fact reminiscent of the beginnings of extremes we saw during the financial crisis"*



This is a measure of credit risk, the spread of Libor above the risk free rate as set by the Federal Reserve

Why we shouldn't necessarily panic, but then again ...

We are not necessarily expecting to see those extremes ahead; we view the financial system as better capitalised with access to exceptional liquidity provision. The Federal Reserve has been rebuilding its balance sheet through T-bill purchases and has also been making liquidity available to the street through repo operations.

Providing liquidity is one thing, but getting access to it is another. One of the risks we are running is a scenario where some e.g. high yield players flip from running in the black to the red, requiring then a stop-gap, but finding that access to credit is not easy. Access to the bond market for stressed players would prove tricky as the primary market stalls. And as default risks rise, discussions with banks for lines of credit could prove difficult, especially as rating agencies are already making noises on heightened credit risk.

> *"This is part of a scenario that could result in a credit crunch should conditions continue to deteriorate"*

Flight to safety: 2-year eyeing zero

This is part of a scenario that could result in a credit crunch if conditions continue to deteriorate. A de-rating in credit conditions generally is a backdrop that requires help from the Fed. The first step was an emergency 50bp cut earlier this week. Those that doubted the wisdom of that move should factor in the high-risk scenario that we are encountering.

The spike in Libor is a credit event and will see echoes in more traditional credit spreads right out the yield curve, with high yield under particular pressure. At the same time, core rates continue to gap lower (amplifying the wider credit spreads story). The bond market is leading the process here. The 2-year is now below 50bp and will see zero as an extreme but natural target. The 10-year is now below 75bp and will be dragged ever lower by the flight into the front end.

> *"Pressure for another 50bp Fed rate cut is now extreme"*

The Fed needs to deliver more than just a cut

Pressure for another 50bp rate cut from the Federal Reserve is now extreme. It needs to come with a more rounded policy response though. Ideally, measures that provide a comfort blanket for credit providers so that lending can continue.

Resumed quantitative easing is also on this list of remedies, as the Fed risks running out of rate cut bullets. And don't forget that in the extreme QE, does not have to be all about bonds, any risk asset could be on that list (even equities!).

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Article | 3 March 2020 FX

Can the ECB deliver, and what are the implications for EUR markets?

The European Central Bank is at an impasse having nearly exhausted its easing options. We see more downside to core rates regardless of ECB action, but we...

Source: Shutterstock

ECB action: mostly words, for now

Last night, the ECB finally joined other major central banks' communication efforts to calm financial markets, stating that it stood ready to take "appropriate and targeted measures". The "targeted" in this statement could be key in predicting the ECB's next steps.

Under the leadership of ECB President Christine Lagarde, the bank looked less sensitive to financial market developments than it did under her predecessor Mario Draghi. Judging by recent statements, there has been a growing awareness of the adverse effects of the ECB's unconventional measures, lowering the likelihood of, or at least the willingness for, additional monetary policy easing. In our view, the ECB would still prefer to stick to its wait-and-see policy until next week's official policy meeting and then try to steer markets with words rather than action.

Out of ammo and ineffective tools

The ECB is facing a challenging situation in which the staff projections, which are based on the no-policy-change assumption, and the still relatively benign macro data (cut-off date for the projections was last week), will be more optimistic than the gut feeling of many ECB officials about the possible economic impact of the coronavirus. This combination of fear and uncertainty, and the root problem originating clearly outside of the ECB's reach, once again illustrates the ECB's dilemma: it has run out of ammunition.

The coronavirus and its impact on the economy, in our view, call for fiscal rather than monetary policy. Think of state guarantees, bridge loans or temporary tax relief. There is very little the ECB can do, besides calming financial markets. To be blunt, at the current juncture a vaccine would definitely help more than another rate cut.

Still, coordinated action from central banks and governments would likely involve the ECB, if only for the sake of emphasising the so-called "mutual brotherhood of central banks" and to avoid an unwarranted appreciation of the euro. This could mean a 10 or 20 basis point rate cut, combined with some tweaking of the tiering facility and some new or tweaked Targeted Longer-Term Refinancing Operations.

EUR rates: lower... or lower?

Even with 10Y Bund yields trading around -0.60%, we continue to see downside to core EUR interest rates. Barring a sudden stop in the spread of the coronavirus, the reaction of EUR interest rates appears asymmetric to us: they are heading lower either on an easing package or on the ensuing disappointment. A risk to this view is if we see a strong fiscal policy response that boosts both the issuance of government bonds and growth expectations. We judge this unlikely. As a result, look for 10Y Bund yields to breach their all time low from September 2019, and rally to -0.75%.

Taking into account our expectation of an underwhelming ECB response, we think long-end interest rates are poised to outperform shorter ones. Even in a scenario where the ECB comes around to the idea of cutting rates, the limited space to lower the deposit rate further means the long-end would be more likely to reflect a deterioration in risk sentiment. Our curve flattening view might seem surprising in light of the strength of front-end EUR bonds of late but we attribute episodes of curve steepening to the steepening of the USD curve, reflecting the possibility of 100 basis points of Federal Reserve rate cuts in the first half of the year.

EUR risk assets: no support

EUR risk assets, in particular peripheral sovereign bonds, appear at risk of a further correction. Clearly, the ECB adopting a more reserved tone than its peers is not going to reflect well on risk appetite in EUR financial markets. While the threat to the monetary policy transmission mechanism is a concern, the central bank is ill-equipped to ease the blow to consumers and small businesses. If the situation deteriorates further, it is possible that financial markets will price in a probability of larger asset purchases, but this means that things need to get worse before they get better. More generous TLTROs aimed at SMEs are possible but there is already ample liquidity.

Due to the lack of specific response in EUR markets, the improvement in sentiment caused by Fed easing might be short-lived. Additional TLTRO liquidity injections might help short-end credit but we doubt their effectiveness in suppressing spreads for longer tenors. The current level in Italian spreads, in particular, appears incongruous relative to the correction in other risk markets. The 10Y Italy-Germany spread has reached our near-term target of 175bp. We see potential for a widening to 200bp in short order to reflect the risk of an economic slowdown affecting the eurozone's weakest member disproportionately.

EUR/USD set to move higher

That the ECB has far less room than the Fed to lower the short-term policy rate is obvious. US short term rates therefore look to converge on those in Europe, which we think is enough to briefly push EUR/USD to 1.15 in the second quarter.

Also important in the EUR space will be what happens to eurozone peripheral debt. A fresh spread widening stands to keep EUR/CHF under pressure at 1.06 and raises questions over the magnitude of the Swiss National Bank's FX intervention now that Switzerland is on the US Treasury's Monitoring List for currency manipulation. 1.05 beckons on EUR/CHF, while USD/CHF could trade down to 0.92.

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Article | 2 March 2020 FX

US asset markets: What Fed cuts mean for US Treasuries and the dollar

G7 Finance Ministers and central bankers hold a conference call on the impact of the coronavirus this Tuesday. We think this could ultimately lead to the...

A negative print for 2Q20 US GDP and a 100bp Fed easing cycle

The US economy appears to have started 2020 on a strong footing with consumer confidence close to record highs, business surveys bouncing back as trade tensions eased and residential investment a key source of strength. However, it is increasingly apparent that the US faces a significant economic drag relating to the coronavirus. There was already a (relatively modest) supply shock as supply chains faced disruption due to factory closures in China and other parts of Asia, but over the past couple of weeks this has increasingly turned into a financial shock as bond yields and equities plunge. The concern is that the fear factor surrounding Covid-19 will change corporate and consumer behaviour and lead to a demand shock as well. This is most likely through the service sector of the economy with travel, hotel accommodation, restaurants and leisure-related sectors looking vulnerable. A negative second quarter GDP print is a clear possibility.

Fed Chair Powell released a statement Friday afternoon saying the Federal Reserve is “closely monitoring” developments and stands ready to “use our tools and act as appropriate to support the economy”. This clearly hints that the Fed is poised to implement rate cuts at any point – the Fed knew full well that making such a statement would only fuel expectations of action - and we now expect a 50bp rate cut imminently. The next scheduled meeting is 18 March, but given financial market volatility/tensions this could certainly happen much sooner. We doubt it will trigger a meaningful boost to aggregate demand, but implementing rate cuts should help to mitigate some of the strains in the financial system, particularly if it is accompanied by additional liquidity/credit measures. We are also pencilling in two further 25bp rates cuts for 2Q giving a total of 100bp of easing.

US Treasury Yields: How low can they go?

The US yield curve had been flattening as the bond market front-ran the Fed. That has morphed into re-steepening as the market now discounts a more imminent move from the Fed. That discount is quite pronounced now, with the 2yr at c.75bp. At that level the front end is comfortably discounting 100bp in rate cuts. That said, part of this move on the front end is also the outcome of risk asset players parking some of their liquidated product on the front of the Treasury curve, and in bills. Typically this can see the 2yr overshoot to the downside during times like these.

The 10yr is now homing in on 1%, and in all probability will breach below that level in the coming weeks. There are two routes to consider. One is where the Fed holds off on cutting rates, and there is a flight into bonds which pushes the curve further down. The second is where the Fed gets in early with a cut, averting near-term damage. Here, the 10yr could well back up as equity markets briefly rally. But the subsequent reaction is still likely to be biased towards a re-test lower in equities, along with a push lower in the 10yr yield. We'd view a 50bp 2yr and a 75bp 10yr as entirely conceivable here.

The reaction function further out the credit curve is important too. Fed cuts would likely be accompanied by extra liquidity provision to the banking system, and the re-ignition of some QE would make imminent sense. Banks should be under far less pressure during this crisis than the last one. They have been building liquidity buckets, that have performed as rates have fallen. They are better capitalized. Still vulnerable to a wider slowdown, but not a massive point of concern for the Fed. A bigger concern is the functioning of the wider financial system.

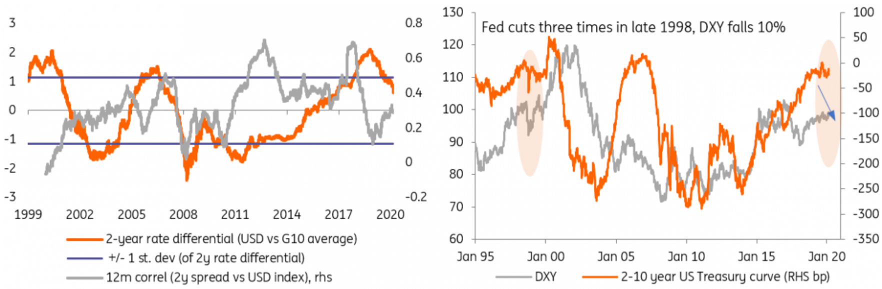
The sell-off last week was as orderly as one could hope for given the size of the fall. That's good. But another week like that and price discovery could well become more opaque. That would not be good. High yield has been under particular pressure. The focus here is on a likely elevation in default risk. The good news is that investment grade corporates are long cash. They have not been over-investing and have been paying off debt in fact. An associated risk though is a closing of the primary market. Against that backdrop the Fed will be eager to ensure that there is easy access to liquidity for the wider economy.

US Dollar: A 5-10% correction

The US S&P 500 at one stage last week was off 15% from its mid-February highs. Typically, high beta/high yield currencies are hit most during episodes like this, whilst the dollar enjoys some safe-haven properties on the back of the liquidity and yield advantages. What has changed over the last week is that the market is now convinced – helped in part by the Fed statement late Friday – that the Fed is set to imminently embark on a series of emergency rate cuts.

That flip to bullish steepening from bullish flattening in the US 2-10 year yield curve has seen the dollar fall across the board – even against the low-yielding EUR and JPY. With the ECB and the BoJ far more constrained in what they can deliver in terms of rate cuts, the US yield advantage is therefore narrowed sharply. Over the last couple of years yield differentials have not had much say in dollar pricing – but we have argued that those differentials have been too wide to make a difference. These differentials have now narrowed back inside historical norms (+/- one standard deviations) and should have a bigger say in dollar pricing going forward.

As James notes above, we see scope for the Fed to deliver as much as a 100bp easing cycle over coming months. That should temporarily hit the dollar – just as the 75bp Fed easing cycle interrupted the dollar bull trend in 1998. That cycle was worth a 10% correction in the DXY. So far we've seen a 2.5% correction in DXY from last month's highs. With equities set to stay fragile over coming months, we certainly think DXY can fall another 3% (5% from the highs) from current levels. We therefore seeing EUR/$ correcting to the 1.15 area in 2Q20, before dropping back to 1.10 towards year-end. Equally USD/JPY looks set to press strong support at 105 over coming quarters.



Source: Bloomberg, ING

	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
EUR/USD	**1.12**	**1.15**	**1.12**	**1.10**	**1.10**	**1.10**	**1.10**	**1.10**
Prior*	1.10	1.11	1.12	1.13	1.14	1.15	1.18	1.20
USD/JPY	**107.0**	**105.0**	**107.0**	**108.0**	**109.0**	**110.0**	**110.0**	**110.0**
Prior*	108.0	108.0	108.0	108.0	107.0	106.0	105.0	100.0

Source: Source: ING, Prior: 'Monthly Economic Update: Feb 7th, 2020'

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Article | 6 March 2020 FX

Tin hat time in FX markets

Continued pressure in global equity markets sees an on-going flight to safety in the FX world. What's different this time is that the market may be...

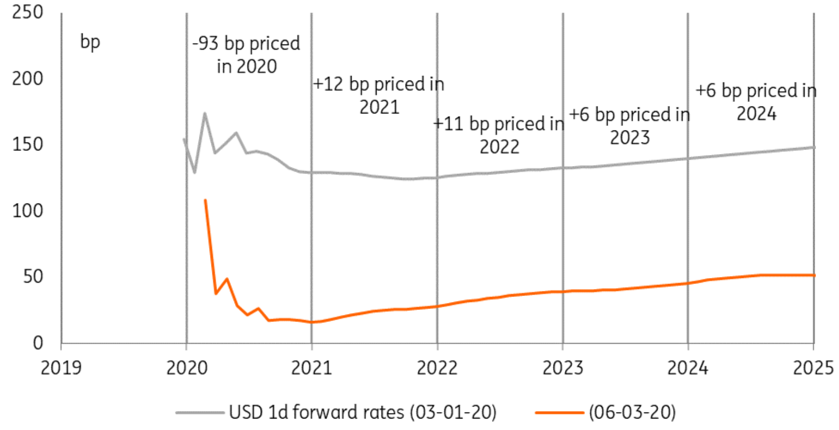
Currency traders in South Korea

Market moves to price a Fed Funds rate at 0.25%

Continued pressure in global equities sees investors rotate into safe-haven assets, particularly in high-quality sovereign bonds, and price an aggressive policy response from central bankers with room to cut.

As you can see in the chart below, our Rates Strategy team highlights how the market has shifted to price the Fed Funds rate at 0.20% later this year – effectively the zero lower bound. Markets are now asking what next from the Fed? Another QE programme? Certainly, the Federal Reserve has room on its balance sheet to resume QE should it so choose, given that its balance sheet is now just 19% of GDP versus the 26% peak in 2014.

Markets shift to pricing the Fed Funds rate at 0.20% within six months



Source: ING Rates Strategy Team

Fed QE would be a game changer for the dollar

QE programmes have been some of the biggest drivers in FX regime shifts over the last decade. The Fed enjoyed first-mover advantage in 2009, with their initial programmes sending EUR/$ to 1.50. As conviction grew of the ECB belatedly starting a QE programme, EUR/$ fell 20 cents in 2014.

The spread of Covid-19, its economic impact and the policy response remain highly uncertain, but it seems as though the FX markets are starting to price in the Fed's money printing presses being properly fired up again.

If the Fed were to restart QE, we would expect the dollar to undertake a much deeper decline than the one we currently pencil in (e.g. EUR/$ to 1.15 in 2Q20). This would really be the US monetary story converging on the zero rates and QE underway among major trading partners.

ECB and BoJ would struggle to resist EUR and JPY strength

In an environment where the Fed re-starts QE, the White House would elevate its Currency Manipulation framework – expecting other trading partners to allow the dollar to adjust to the new environment. This goes to the heart of the US currency manipulation debate – namely that over previous decades trading partners of the US have not allowed their currencies to fully appreciate as part of an orderly adjustment of global imbalances.

> *This makes currency intervention to limit local currency strength very difficult indeed*

This makes currency intervention to limit local currency strength very difficult indeed. Historically known for their FX intervention, Japanese authorities are unlikely to undertake intervention in USD/JPY before 100. Instead, the expectation is that the semi-official sector, e.g. GPIF, would see good value in $/JPY at 105 to increase US Treasury purchases. But 105 would remain under heavy pressure were the Fed to consider QE.

Switzerland has recently been elevated to Washington's currency manipulation Monitoring List and will find it hard to undertake the typical amounts of FX buying seen through prior crises. USD/CHF could, therefore, be embarking on something much more than a trip to 0.91/92.

And for EUR/USD. The ECB cannot match the Fed in terms of rate cuts, nor does it appear to have the appetite for dramatically increasing its APP programmes. Today's move in EUR/$ suggests investors are just starting to consider this outcome. EUR/$ is well on the way towards our target in 2Q20. But were the Fed to be called into more drastic action – e.g. starting with a 50bp rate cut at the March 18th meeting and bringing QE a little nearer – then the temporary EUR/USD rally we see could be longer and draw in a discussion of 1.20.

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Report | 6 March 2020

March Economic Update - Coronavirus: The unknown and unprecedented risk

The virus, along with its impact on economies and markets, is posing an unknown and unprecedented risk. Economic forecasts are surrounded by even more...

Source: Shutterstock

Financial markets and the global economy are still in the stranglehold of a real global shock that doesn't stop at borders and can't be tamed by words or negotiations: Covid-19. The outbreak of the new coronavirus comes at a time when the global economy was about to gain traction again on the back of the Phase One Deal between the US and China, a turning inventory cycle and a bottoming out of global manufacturing. Instead, the virus, along with its impact on economies and markets, is posing an unknown and unprecedented risk. Economic forecasts are surrounded by even more uncertainty than normal, including our own.

Inside this edition:

Coronavirus: The unknown and unprecedented risk
Financial markets and the global economy are still in the stranglehold of a real global shock that

doesn’t stop at borders and can't be tamed by words or negotiations: Covid-19

US: Hope for the best, prepare for the worst

Coronavirus concerns are gripping the nation as an initial supply shock morphs into a financial shock and now a demand shock. The Federal Reserve has leapt to action, but we are still in the early phase. The economic disruption will likely intensify in the coming weeks.

Eurozone: Just when things were looking up

The eurozone economy started the year on a stronger footing. But the coronavirus disruption is likely to become a major drag that might only peter out in the course of the second quarter. Negative GDP growth in the first half of the year now looks likely

UK: Rate cut coming as consumption risks build

Like elsewhere, there is a rising risk that the Covid-19 demand shock will cause a decrease in GDP in the second quarter. We expect the Bank of England to cut interest rates later this month, although the bigger focus for markets should be the forthcoming budget, which arguably offers greater scope to tackle the virus impact

China: The supply chain is still broken

The spread of the coronavirus in China seems to be slowing down, but the global supply chain remains broken. As a result, we've revised our growth forecast to 4.4% YoY in 1Q20 and 5.2% for this year

Japan: in search of a paddle

Last month, we pre-emptively took an axe to our growth forecasts - looking back on it, we may still have work to do

FX: The dollar deflates

Given the US dependency on the capital markets for financing, the Fed looks set to be at the forefront of the monetary response to the Covid-19 crisis. The end of US ‘exceptionalism’ in terms of growth and interest rates means that we should now be looking at a temporary 5-10% correction in the dollar. We revise our 2Q20 EUR/USD forecast up to 1.15

Rates: Getting dumped

Risk assets were the darlings of 2019. Tainted now with virus risks, they are seriously stressed. Core bond markets are the ultimate safe haven. Even 3-month German bills at -0.7% are deemed an acceptable alternative versus the bigger risk implied in equity markets. It's

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Singapore: Recession looms

A recession in Singapore seems inevitable. That's why we've cut our forecast for annual growth to 0.3% from 1.0%. Hopes are pinned on stimulatory...

0.3% **2020 GDP growth**

Revised down from 1%

Weakening demand

Singapore's recent activity indicators continue to reinforce a weak backdrop for the economy that's bracing for a beating as Covid-19 goes global. Trade and tourism are the sectors most affected, as they are largely dependent on strong demand from China.

Retail sales for January contracted by 5.3% year-on-year - the steepest fall in almost a year following December's 3.4% fall. As expected, weak automobile sales were the main drag, posting a 34% YoY plunge on top of the 24% fall in December. Sales ex-autos just about scraped 0.6% growth.

The yearly fall may have been inflated by the Lunar New Year holiday, which last year was in February. As a result, we anticipate a much bigger plunge in sales as the epidemic spreads, which will not only dent tourist spending but also weigh down domestic consumer shopping.

Among other things, rising unemployment is also depressing consumption.

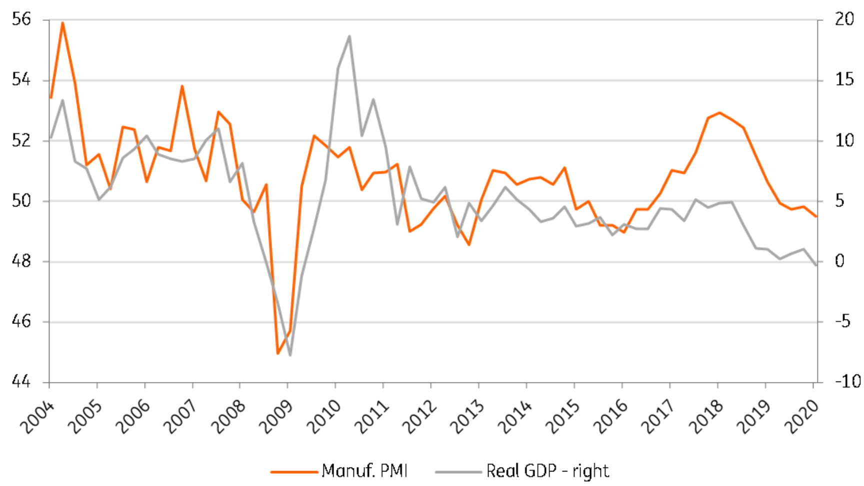
PMI points to negative GDP growth

January non-oil domestic exports and industrial production were a mixed bag as the former continued to fall and yet the latter rose. But, like retail sales, these were distorted by the new year holiday and are likely to dip further in February and the months ahead.

Manufacturing purchasing managers index is foreshadowing a clear oncoming trend, as it dipped to 48.7 in February from 50.3 in the previous month - a big single-month fall in over five years while the electronics sector PMI fell to 47.6 from 50.1.

The headline index is correlated with year-on-year GDP growth, not a perfect fit though fairly close as the chart below shows. And, it's pointing to steady downward grind in GDP growth, more likely into the negative territory.

GDP growth headed into negative territory



Source: Bloomberg, CEIC, ING

ING's GDP growth forecast for 1Q20.

Recession seems inevitable

In light of the evolving Covid-19 situation, especially the rapid spread of the epidemic beyond Asia, Singapore's small open economy is among the most vulnerable. Having grown by only 0.7% in 2019, negative GDP growth doesn't look too far-fetched.

Consistent with initial indications from the PMI data, we think a couple of quarters of GDP contraction, both on a yearly and quarterly basis, now look inevitable. Accordingly, we see -0.3% YoY and -0.5% GDP fall in the first and second quarters respectively, both also implying a quarterly contraction tantamount to a technical recession.

2020 growth forecast downgrade

Hopes remain pinned on the record fiscal stimulus and possible policy easing by the central bank to help revive demand, though that's probably something for the second half of the year. We do anticipate a return to positive GDP growth in the third and fourth quarters at 0.8% and 1.2% respectively.

> *Our full-year growth forecast for 2020 now stands at 0.3%, a sharp downgrade from 1.0% earlier*

Our full-year growth forecast for 2020 now stands at 0.3%, a sharp downgrade from 1.0% earlier. This is even lower than the official baseline of 0.5% growth this year, or the mid-point of -0.5% to 1.5% forecast range announced by the trade and industry ministry last month. We also revise our inflation view for this year to 0.2% from 0.8% as weak demand will continue to dampen price pressures.

With the risk of a recession looming large, we believe the central bank is on course to join the global easing bandwagon at the next meeting in April.

Article | 3 March 2020 FX

Fed and the FX markets: Tainted carry

The Fed largely delivered on expectations with an emergency 50bp rate cut this Tuesday. The dollar was initially weaker across the board, with high yield...

US Fed Chairman, Jerome Powell, announcing a cut in US rates

Fed largely delivers in Round One

The Fed has acted reasonably quickly in cutting rates 50bp. As James Knightley writes, this may well be the first of perhaps a three-stage easing cycle that will ultimately be worth 100bp. The DXY had already fallen 2.5% over recent days and today we did not see that much follow-through selling of dollar against the EUR and the JPY.

The larger dollar selling in the G10 space came against the activity currencies of AUD and SEK on the view that reflationary Fed policy (steeper yield curves) would kick start an economic recovery. That view looks premature, however. It is very unclear how far Covid-19 will spread and its impact on activity – proving both a supply and demand shock.

Our team is very cautious on risk assets

And like most financial products, the FX market is wary that the Fed's medicine will only provide temporary relief to global equity markets. Our team is very cautious on risk assets and believe the

Fed will be called again into action over coming quarters. We see EUR/$ moving to 1.15 and $/JPY to 105 over coming months, with volatility staying high.

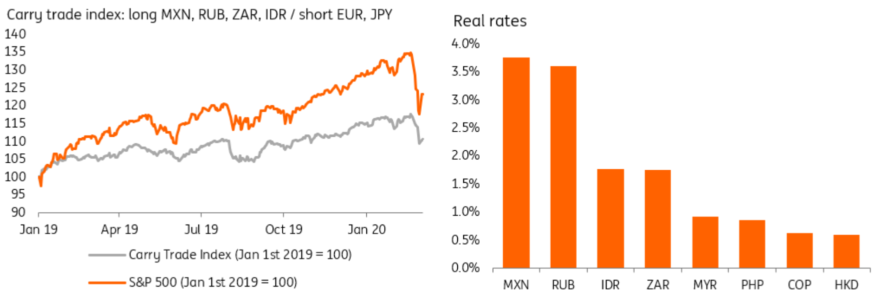
Too early to re-enter the carry trade

The bigger FX moves on today's Fed cut came in the high yield EM space. The Mexican peso, the darling of the EM high yield world, briefly enjoyed a 2% rally against the dollar, with other high yielders, such as RUB and ZAR, following suit. As we highlighted last week, these are the currencies with the highest real rates in the EM universe and have been very popular with carry trade strategies.

However, the carry trade is a low volatility strategy designed to pick up yield (and hopefully some nominal FX appreciation) in a benign market environment. As we highlight below, the pick-up in volatility emerging from the equity market has triggered huge draw-downs in carry trade strategies (we look at a basket equally invested in MXN, RUB, ZAR and IDR, funded equally out of EUR and JPY).

Unless one believes that policymakers with their actions so far have put a floor under risk assets and volatility drops substantially – (highly unlikely in our opinion) – it looks premature to be buying the dip in high yield FX.

Carry trade and real rates



Source: Bloomberg, ING

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Article | 3 March 2020 Credit

Credit markets and the coronavirus threat

We take a look at what it could mean for EUR and USD in Investment Grade and High Yield

Source: Shutterstock

Some sectors more exposed to coronavirus

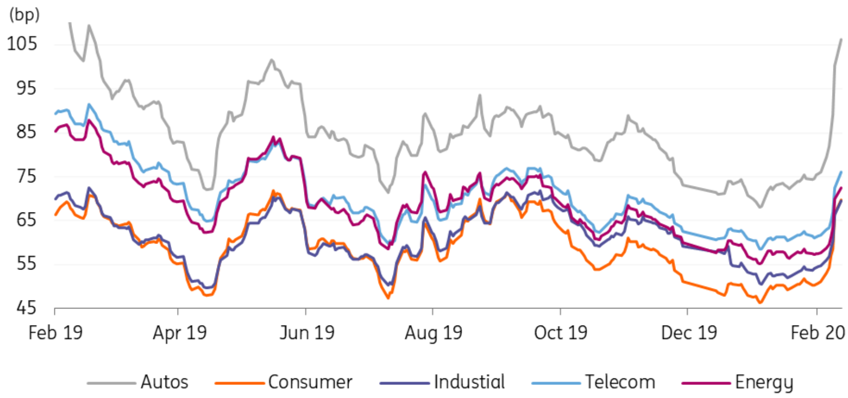
The Euro and USD credit markets are seeing the repercussions of the spread of coronavirus. We have already seen widening in credit spreads, but these events have highlighted the weakness due to leverage in higher beta credit, high yield and leveraged loans. All sectors have seen widening spreads and steepening curves, but there are some sectors that are more exposed to Covid-19. Consumer goods, Autos, Chemicals, Food & Beverages, Oil & Gas and Travel have been the biggest underperformers.

Performance (bp)

	Current	1Week
Main	64	21
SenFin	76	27
Crossover	303	84
CDX IG	66	20
Autos	100	24
Consumers	67	15
Industrials	66	11
TMT	72	11
Energy	70	12
Hybrids	205	62
Bank Sen	65	18
Bank Sub	128	32
Euro STOXX	3,329	-12%
Dow Jones	25,409	-12%

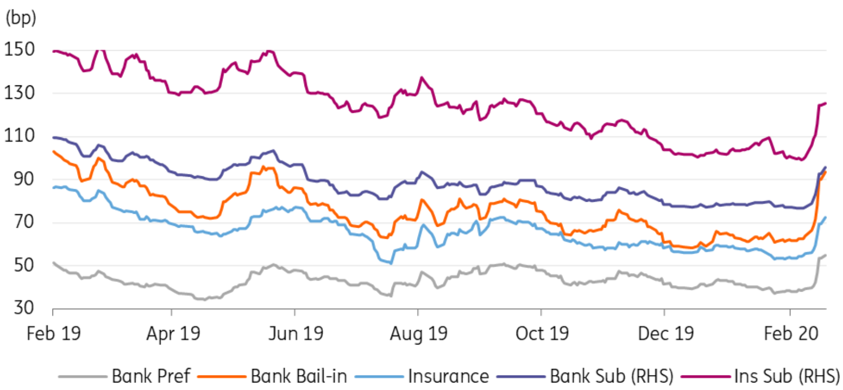
Source: Bloomberg

Corporate spread developments



Source: ING

Financial spread developments

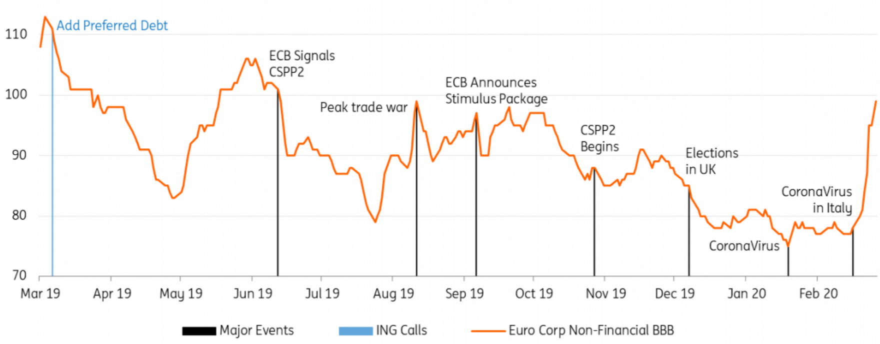


Source: ING

Credit curves steepened considerably at the start of last week, but as the week progressed the short end began to underperform, particularly in BBB, causing slight flattening of the curve. This is due to potential rate cuts being priced in, despite the ECB having limited room to cut further. This will result in widening on the short end because credit will struggle to go further into negative yields.

Using the ICE BofA Euro Corp Non-Financial BBB indices as a proxy, spreads widened 21bp last week. This is a substantial widening. Interestingly, according to the relative value heat maps, the 1-3yr maturity bucket of Energy, TMT and Covered bonds still look statistically expensive.

Major events

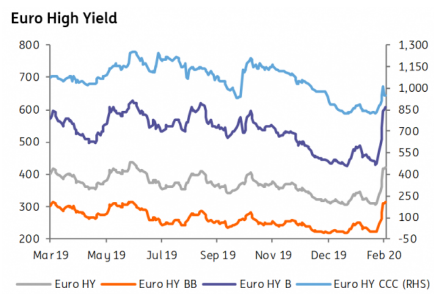


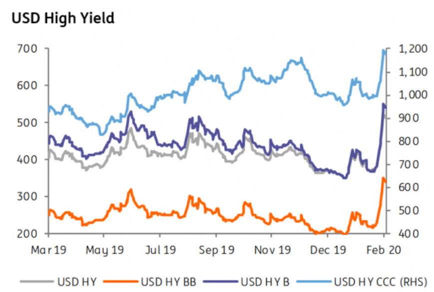
Source: ING, ICE

A push for higher quality should fears continue

High Yield credit has largely underperformed, with over a 100bp widening in the ICE BofA Euro High Yield index. Although single B spreads underperformed the most in Euro high yield with a widening of 174bp. Some B rated names may be on the verge of being downgraded to CCC. Last week saw mutual fund outflows in Euro high yield of 0.29% of assets under management, but interestingly, Euro investment grade funds remained inflowing at 0.11% of assets under management.

If the Covid-19 fears continue, we are likely to see similar trends of a push for higher quality, resulting in more underperformance of higher beta names and long end of curves.

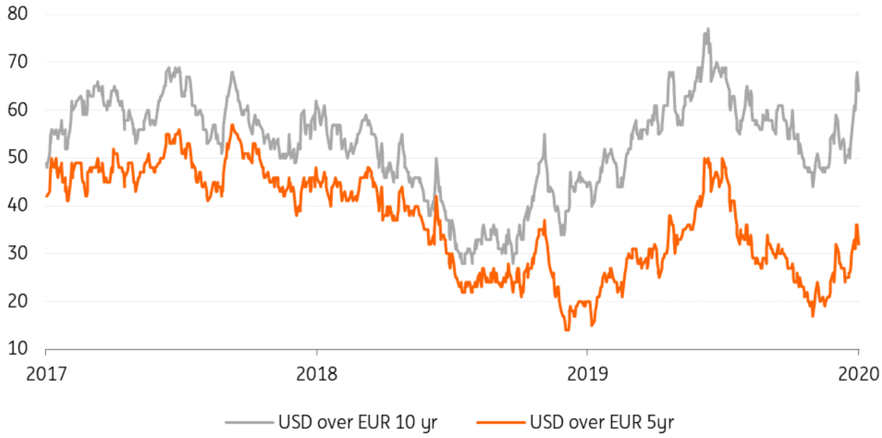




Source: ING, ICE

USD spreads have also widened considerably, underperforming against the Euro spreads. Figure 4 illustrates the growing differential between USD spreads and Euro spreads. This is particularly so on the long end of the curve. Much like in Euro, USD investment grade mutual funds remained inflowing at 0.12% of assets under management, whereas USD high yield has flipped to outflows of 1.99% of assets under management.

USD credit spreads over EUR spreads



Source: ING, ICE

A potential warning for credit markets at large

One swallow does not make a summer but outflows in USD high yield mutual funds over the past week at almost 2% of assets under management should be seen as a warning for credit markets at large.

> *Outflows in USD high yield mutual funds should be seen as a warning*

We have often been at pains to stress that one of the biggest risks for credit spreads is the leveraged part of the credit spectrum in the US where investor protection has fallen whilst leverage and debt levels have risen substantially. Expectations on default rates are still very benign and the downturn in economic activity could trigger an uptick, expectations of which will lead to investors in the higher yield space and the leveraged loan space to reduce holdings at an aggressive pace, liquidity in these parts is limited and as such could lead to capitulation trades. And a serious repricing.

The leveraged loan price index has fallen from 98bp to below 96bp; the last time we were at these levels was at the end of 2018. This large pressure build up in the leveraged loan space, may result in an increase in the default rate.

Leveraged loan price index (bp)

Source: ING, Bloomberg

Concerns about a significant credit market correction

Credit markets might have seen a serious widening in credit spreads but from a yield perspective, in investment grade USD and EUR at least, the effect has been far more benign. Nonetheless, the events have highlighted the weakness due to leverage in higher beta credit, high yield and leveraged loans. Our rates strategists and economists, earlier today, emphasised their expectation that coordinated action from central banks is likely and the ECB will participate. These measures could include a 10 or 20 basis point rate cut, combined with tweaking of tiering and TLTROS. From a credit market perspective that leaves tweaking of the corporate sector purchasing programme on the cards at a later stage, in this instance we would be looking at a possible increase of (the share of) CSPP to €10bn a month and, even more speculatively, the addition of purchasing preferred bank debt comes back into the mix.

The longer the credit market fall-out continues, the more the aforementioned risk scenario comes into play and a significant credit market correction becomes a possibility. Given ECB QE, the Euro-denominated market is better protected as is the lower leveraged investment grade arena.

Worst performers in February (%)

Name	Coupon	Maturity	Total Return
Fluor Corporation	1.75	Mar 23	-8.8
Unibail-Rodamco-Westfield	1.75	Jul 49	-6.9
Carnival Plc	1	Oct 29	-5.3
Petroleos Mexicanos	4.75	Feb 29	-4.8
Petroleos Mexicanos	2.75	Apr 27	-4.8
Tesco plc	5.125	Apr 47	-4.6
Petroleos Mexicanos	4.875	Feb 28	-4.3
Volkswagen International Finance N.V.	3.5	Mar 30	-3.8
Daimler AG	2.125	Jul 37	-3.7
Petroleos Mexicanos	5.5	Feb 25	-3.6
Anheuser-Busch InBev N.V./S.A.	2.75	Mar 36	-3.5
Basf Se	1.625	Nov 37	-3.5
AbbVie Inc.	1.25	Nov 31	-3.4
Petroleos Mexicanos	3.75	Apr 26	-3.3
Compagnie Generale des Etablis Michelin	2.5	Sep 38	-3.3
Volkswagen International Finance N.V.	3.875	Jun 27	-3.2
RCI Banque S.A.	1.625	May 26	-3.1
ZF Europe Finance B.V.	3	Oct 29	-3.0
Accor	1.75	Feb 26	-3.0
Volkswagen International Finance N.V.	4.625	Jun 27	-3.0

Source: ING, ICE

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