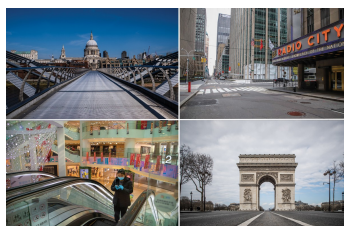


# In case you missed it: Undone by a pandemic

As a decade of job growth in the US comes to an end, a recession is not the correct word of what we are currently witnessing. It is an abrupt stop of economic activity, from 100 to zero in just a few days or weeks. A virus-driven ice age. There's no point pretending we know exactly how the economy will evolve in the next 18 months, but we've developed some scenarios

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Our April Economic Update brings you economic truths of the Covid-19 crisis, our scenarios for the future and the reality of living in what sounds like...

By Carsten Brzeski



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### **Eurozone: GDP contraction to rival great recession**

With most eurozone countries in partial or full lockdown, GDP contraction this year is likely to rival the Great Recession. While the European Central...

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The past few weeks have seen a flurry of proposals for EU members to jointly finance the coronavirus-related fiscal costs. We look at the latest...



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China's central bank plans to cut the targeted Required Reserve Ratio again, but this time only for smaller banks. We look at how effective this...



### **Central and Eastern Europe FX: Negative growth, more easing ahead**

All CEE countries should experience negative growth in 2020, with 2Q20 constituting the bottom. All banks in the region are in full easing mode. We expect...



### **Thailand**

#### **Thailand: It's going to be the worst since the 1998 Asian crisis**

We cut our forecast of Thailand's GDP growth in 2020 to -4.3% from -0.8%, the worst year for the economy since the 1998 Asian economic crisis. We...

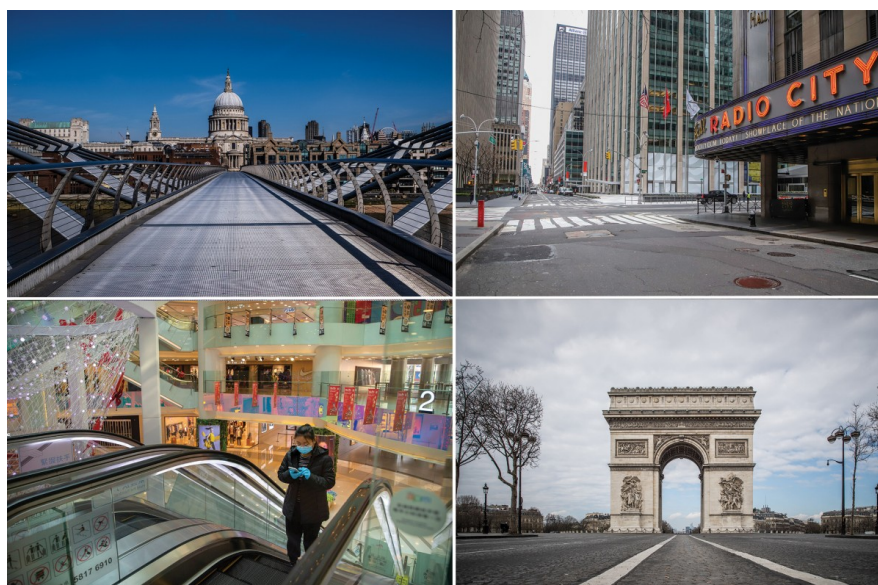
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Report | 2 April 2020

# Covid-19: The scenarios, the lockdown, the reaction, the recovery

Our April Economic Update brings you economic truths of the Covid-19 crisis, our scenarios for the future and the reality of living in what sounds like the script of a Hollywood movie



Source: ING

It's often said that economists live in ivory towers, taking a macro, holistic or sometimes nerdy view on things without really knowing what it is all about.

I will not even try to debunk these myths but the truth is that right now we're all in the same boat. The outbreak of Covid-19 affects everyone. A virus doesn't stop at borders, a virus does not distinguish between jobs, lockdowns, social distancing, empty shelves in supermarkets, death tolls, reinventing the work-life balance in times of home office and many more. What sounded like the script from a Hollywood movie (I can recommend the 2011 movie "Contagion") at the start of the year has become a reality.

A reality with unprecedented economic consequences.

---

*It is an abrupt stop of economic activity... a virus-driven ice age*

---

It started as a supply-side shock, on the back of supply chain disruptions in China, which then turned into a demand-side shock, with first China going into lockdown and then other countries following and has now transformed into a standstill of many sectors of the economy. Recession is not the correct description of what we are currently witnessing. It is an abrupt stop of economic activity, from 100 to zero in just a few days or weeks. A virus-driven ice age.

Governments across the world have to balance health care issues with economic interests. The lockdowns could be compared to a medically induced coma to 'flatten the curve'. The enormous rescue packages from both governments and central banks are the vital lifelines to make sure the patient is still in good health once brought back to life.

In these times, it's more difficult than ever to come up with adequate economic forecasts. The best we can do is to describe several possible outcomes, based on different scenarios regarding the length of the lockdown and the spread of the virus. As a result, we would like to present four scenarios in this Monthly Update.

Our base case scenario assumes a U-shaped recovery with a wide bottom, as social distancing and travel restrictions are likely to stick, even beyond the lockdowns. After a severe contraction of most economies in the first half of 2020, a subdued recovery would follow, with most economies returning to their pre-crisis levels in 2022. In more adverse scenarios, the return to pre-crisis levels could take until 2023 or even later.

While the different scenarios give some guidance on the economic impact of Covid-19, there are currently many other important issues. Do central banks still have any ammunition left? What is the endgame for fiscal policies? Which eurozone countries are the most vulnerable? Is this the time for a Eurobond? And what could an exit from the lockdown measures look like? Also, at some point in time, the crisis will be over. How will the world look then?

Our Research Team provides some food for thought in this edition of our Economic Monthly Update.

In the meantime, stay healthy.

## ING's new base case forecasts

	2020F					2021F				
	1Q	2Q	3Q	4Q	FY	1Q	2Q	3Q	4Q	FY
<b>United States</b>										
GDP (QoQ%, ann)	-6.0	-40.0	22.0	10.0	-7.0	5.0	4.0	3.5	3.0	3.4
CPI headline (YoY%)	1.9	-0.9	-1.3	-1.3	-0.4	-0.9	1.5	1.8	1.8	1.0
Federal funds (% eop)1	0.25	0.25	0.25	0.25		0.25	0.25	0.50	0.75	
3-month interest rate (% eop)	1.45	0.85	0.75	0.60		0.55	0.50	0.75	0.95	
10-year interest rate (% eop)	0.65	0.50	0.75	0.75		1.00	1.00	1.25	1.50	
<b>Eurozone</b>										
GDP (QoQ%, ann)	-15.2	-16.0	13.0	7.5	-5.0	2.5	2.0	2.0	2.0	3.2
CPI headline (YoY%)	1.1	0.6	0.8	1.0	0.9	1.3	1.4	1.4	1.4	1.4
Refi minimum bid rate (% eop)	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.0	
3-month interest rate (% eop)	-0.34	-0.35	-0.35	-0.40		-0.40	-0.40	-0.40	-0.40	
10-year interest rate (% eop)	-0.47	-0.50	-0.40	-0.35		-0.25	-0.20	-0.20	-0.15	
<b>Japan</b>										
GDP (QoQ%, ann)	-1.0	-27	18	1.8	-5.0	0.5	0.9	0.9	0.9	0.9
CPI headline (YoY%)	0.5	-0.1	0.5	0.3	0.3	0.7	1.2	0.9	0.7	0.9
Excess reserve rate (%)	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	-0.1	-0.1	
3-month interest rate (% eop)	0.00	0.05	-0.05	-0.10		-0.05	-0.05	-0.05	-0.05	
10-year interest rate (% eop)	0.00	-0.20	-0.10	0.00		0.00	0.00	0.00	0.00	
<b>China</b>										
GDP (YoY%)	3.6	3.9	4.0	4.5	4.0	5.8	5.9	5.6	5.7	5.8
CPI headline (YoY%)	5.0	4.5	3.5	2.4	3.9	2.0	2.2	2.5	2.5	2.3
PBOC 7-day reverse repo rate (% eop)	2.2	2.0	2.0	2.0		2.0	2.0	2.0	2.0	
10-year T-bond yield (% eop)	2.60	2.45	2.50	2.60		2.70	2.80	2.90	3.00	
<b>UK</b>										
GDP (QoQ%, ann)	-5.5	-35.0	20.0	8.0	-6.1	3.5	2.4	1.5	0.5	2.6
CPI headline (YoY%)	1.7	0.8	0.8	1.2	1.1	1.4	1.9	1.9	1.8	1.8
BoE official bank rate (% eop)	0.10	0.10	0.10	0.10		0.10	0.10	0.25	0.25	
3-month interest rate (% eop)	0.6	0.3	0.3	0.3		0.3	0.4	0.4	0.4	
10-year interest rate (% eop)	0.35	0.2	0.4	0.5		0.8	0.9	1.1	1.3	
EUR/USD (eop)	1.10	1.12	1.15	1.20		1.18	1.15	1.12	1.10	
USD/JPY (eop)	108	105	100	100		102	105	108	110	
USD/CNY (eop)	7.20	7.25	7.00	6.90		6.80	6.70	6.60	6.50	
EUR/GBP (eop)	0.89	0.89	0.88	0.85		0.85	0.85	0.85	0.85	
Brent Crude (US\$/bbl, avg)	53	20	35	45	38	50	60	60	63	58

Source: ING, Bloomberg

GDP forecasts are rounded to the nearest whole/half number, given the large magnitude and uncertainty surrounding our estimates

### Author

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## US jobs report - how bad could it get?

Today's US employment report broke the run of 113 consecutive monthly job gains, but the timing of collection meant it missed the carnage of the past two weeks. Covid-19 containment measures means shuttered businesses and an unemployment rate could easily hit 15% by May



Source: Shutterstock

**-701k** The first monthly drop in employment since September 2010

This is just the start...

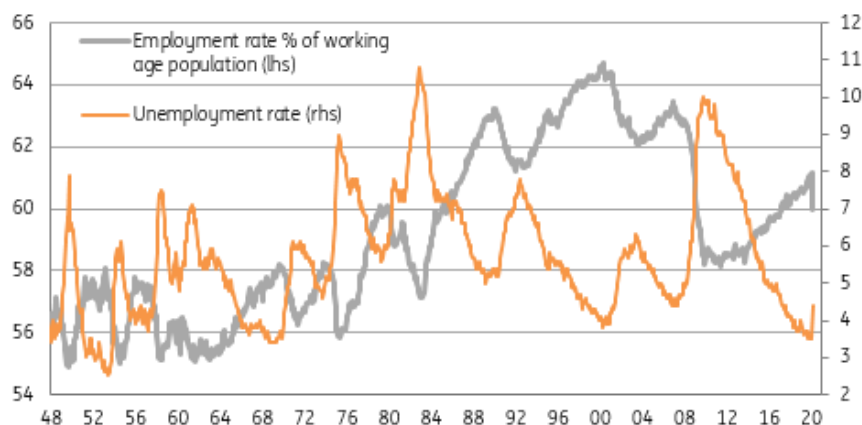
The US lost 701,000 jobs in March, far worse than expected, but it will be ignored. It merely appears that the lay-offs started a little earlier than thought as Covid-19 containment measures led businesses to close, particularly bars and restaurants, with staff laid off. This is just the start and it will get much, much worse. The cut-off for this report was the week of 12 March and we know from initial claims data that around 10 million people have registered for unemployment benefits in the last two weeks of the month.

Within the details a net 459,000 people in leisure and hospitality lost their jobs, which reflects the orders for restaurants and bars to close while temporary help fell 50,000. It is less clear why 76,000

people lost their job in education and healthcare – presumably support staff who are required to be at the buildings as remote learning increasingly kicked in.

We saw the unemployment rate rise to 4.4% while wages surged 0.4%, which could reflect a computational issue – low income workers predominantly being fired and therefore the average wage of those in employment being skewed higher.

## Unemployment and employment ratios



Source: Macrobond, ING

In terms of where we could get to, Treasury Secretary Mnuchin warned of a 20% unemployment rate, which President Trump later clarified as a worst-case scenario. But with at least 10 million people having lost their job over the past couple of weeks and more job losses likely in the next few weeks as the Covid-19 containment measures spread and intensify – we could see a further 8-10 million job losses in the subsequent two weeks – we should be braced for a 10-11% reading for April unemployment rate with 15% conceivable for May. To put this in context the Global Financial Crisis saw unemployment peak at 10%, while the post-war high was 10.8% in 1982.

We also have to remember the data won't pick up undocumented workers who are paid in cash and cannot claim benefits. The Department for Homeland Security estimates that 3% of the population are undocumented migrants so around 11-12 million. If we then make an assumption that two-thirds of those are working in some way – the rest either being children or caring for children that would imply around 8 million workers. You would have to assume they are going to be incredibly vulnerable to losing their jobs.

When we finally get through the crisis and we can head on the path towards “normality”, unemployment will not fall as rapidly as it spiked. There is likely to be a rolling withdrawal of the restrictions, meaning a slow return to business as usual. Many companies will not make it through the crisis due to the plunge in demand and others will restructure and come out requiring a smaller workforce. In this regard we worry about physical retail stores and by extension commercial real estate. Furthermore, with businesses now knowing that remote working and meetings can be done, it could have longer term implications for business travel, hotels and hospitality. As such the prospect of additional fiscal support for affected households and businesses appears a virtually

certainty.

## Author

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Article | 2 April 2020

# Four scenarios for the global economy after Covid-19

We map out the hit to the global economy and possible path for recovery under four different coronavirus scenarios



In this fast-moving environment, we need to think in scenarios, rather than pretending to know how the economy will evolve over the next 1 ½ years.

We've developed four scenarios of how the virus, the lockdown measures and consequently the different economies could evolve. Needless to say, even these scenarios cannot try to fully predict reality, but we hope they can provide a benchmark for both the extremes and the middle-ground. In each case, we've laid out some possible health factors that may be driving the scenarios - although we'd emphasise these are not meant to be interpreted as forecasts.

## Scenario 1: Our base case

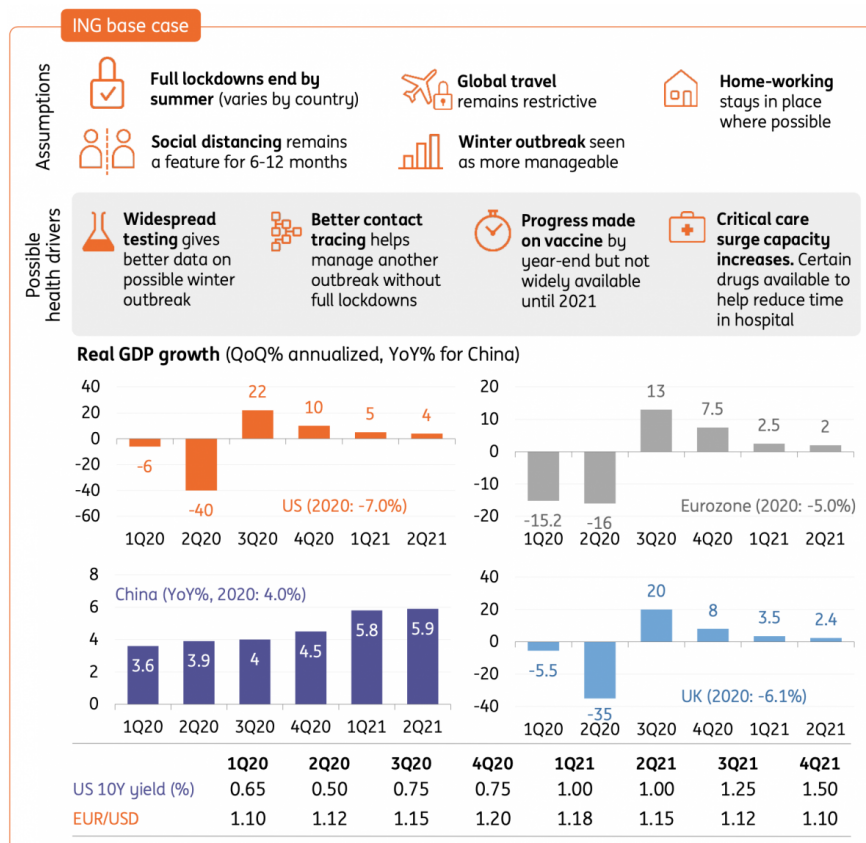
We've discussed our base case, and what that means for the major economies, in other parts of our latest monthly update.

It assumes that the lockdowns eventually manage to flatten the curve, although not entirely. Given socio-economic tensions and the significant economic fallout, the first European governments decide to begin relaxing the lockdown measures at the end of April. Others will follow in May. The return to normality is gradual, and social distancing continues for at least the entire summer.

A proportion of those who can work from home continue to do so for the foreseeable future. Meanwhile, places, where you can socialise (pubs, cinemas etc), begin to open with strict distancing rules in place. Global travel remains restrictive, but a combination of vaccine development, more widespread testing capacity and higher surge capacity within critical healthcare services, means full lockdowns can be largely avoided if the virus spreads again as we approach the northern winter.

As a result, the economic recovery will be u-shaped. Still, most countries will experience a more severe contraction of economic activity than during the financial crisis.

## Our base case at a glance



Source: ING

## Scenario 2: Winter lockdowns return

This is a slight variation of our base case scenario.

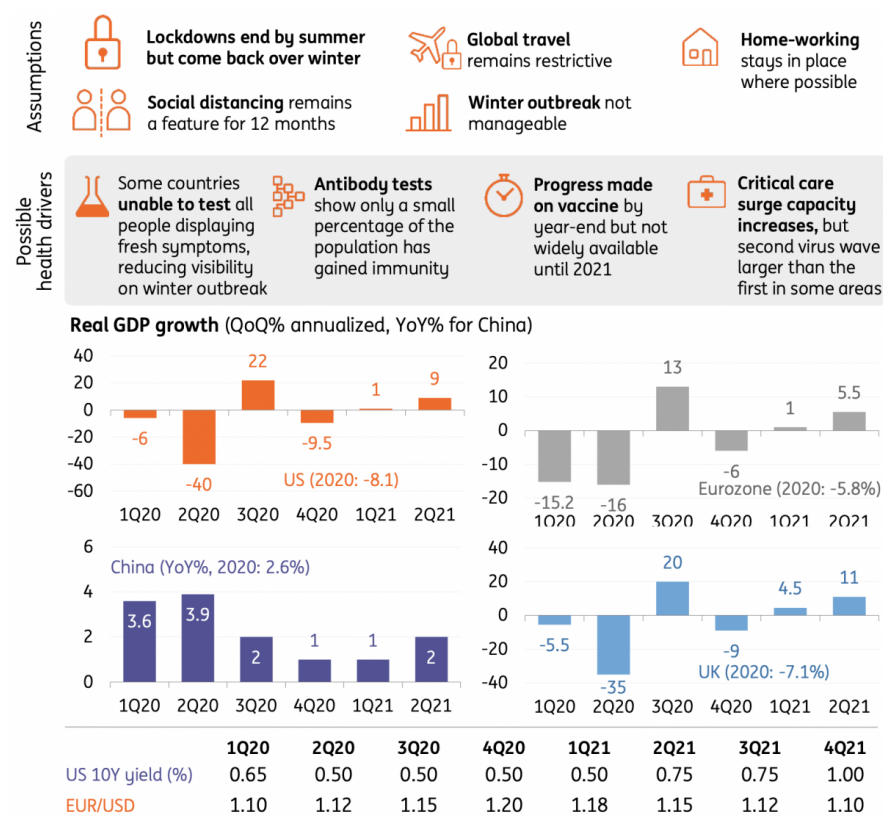
It starts off in much the same way, with a gradual easing of lockdown measures in May and June. However, in this scenario, the virus returns in the autumn and despite more widespread testing

efforts and contact tracing, the new spread pushes most economies back into lockdown.

Crisis management is more experienced than in Spring 2020 and containment measures could be more tailor-made, keeping some regions and sectors up and running. For indicative purposes, we're assuming it will take until April 2021 before the virus is back under control and economies, as well as societies, begin to return to normality. This is a 'W-shaped recovery'.

GDP growth would be lower in 2020 but higher in 2021 than in our base case scenario. However, it may well take until late-2022 before most economies have returned to their pre-crisis levels.

## Scenario two at a glance



Source: ING

## Scenario 3: The 'best' case

In our 'best' case scenario, the Western world follows in the footsteps of China by ending the lockdowns as soon as the curve of new infections has been flattened.

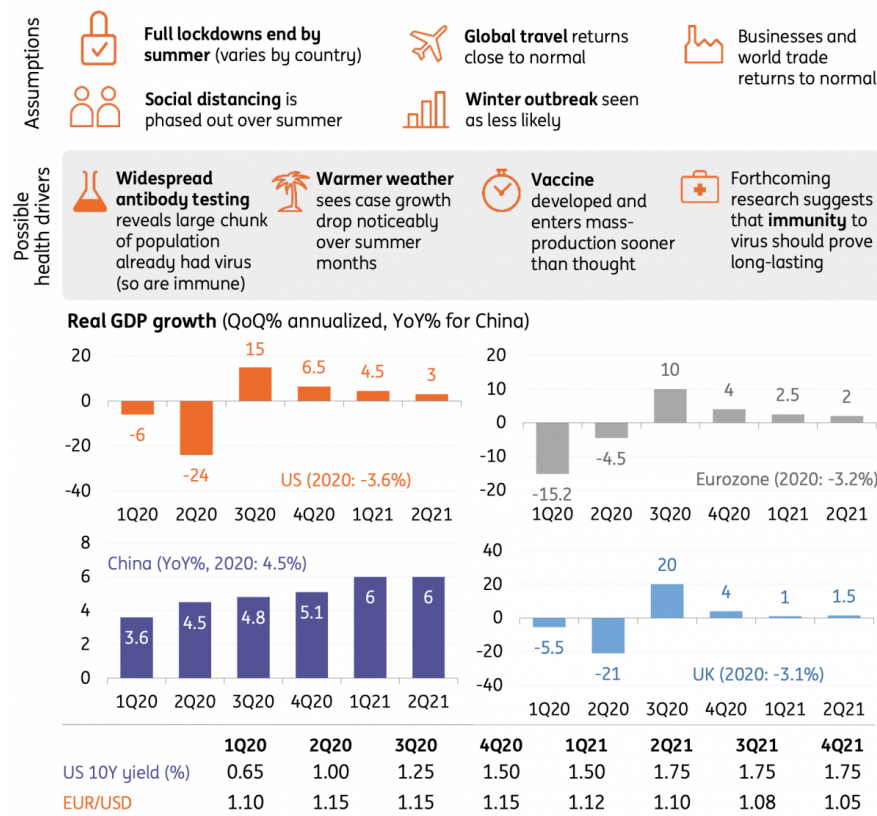
A quick return to normality is assumed to materialise towards the end of April. This scenario also assumes that the virus doesn't come back again in the winter, either because a larger-than-expected proportion of people have already had the virus and built immunity, or because control measures become much more effective.

Even so, some economic losses would not be offset immediately. But government measures like guarantees, liquidity support and short-time work schemes foster a quick and strong rebound,

notwithstanding some differences across countries depending on when the lockdown measures end. This is effectively a 'v-shaped' recovery scenario.

In this scenario, most economies would experience a mild recession of some 2-3% year-on-year but growth in 2021 would accelerate, returning most economies to their pre-crisis levels.

## Scenario 3 at a glance



Source: ING

## Scenario 4: The 'worst' case

To give a sense of how the worst-case scenario for the global economy might look, we assume here that the lockdown measures last until the end of the year.

We're assuming that things return to normal from 2Q21, perhaps if a vaccine is developed and able to be deployed over the winter months. The recovery here may be a little faster and stronger than in the other scenarios, as the virus is assumed to be completely under control. This is an 'L-shaped' recovery. Needless to say, this is an extreme scenario with lots of economic, social and political turmoil, and one that looks pretty unlikely at this stage.

In this scenario, most economies would experience an unprecedented and almost unimaginable contraction in 2Q20 of around 50% quarter-on-quarter annualised. The year 2020 would go down in the history books as the year with the most severe recession on record, seeing most economies shrinking at double-digit rates for the year as a whole.

The rebound in 2021 would be relatively muted and it would take until 2023 before most economies have returned to their pre-crisis levels.

## Scenario 4 at a glance

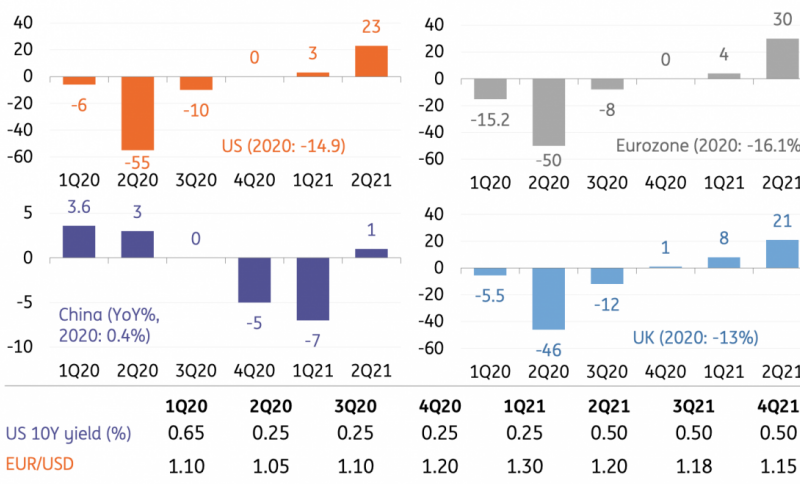
**Assumptions**

- Lockdowns remain largely in place until year-end**
- Global travel remains restrictive**
- Home-working stays in place where possible**
- Social distancing remains a feature for 12-18 months**
- Winter outbreak not manageable**

**Possible health drivers**

- Countries unable to test all people displaying Covid-19 symptoms**
- Antibody testing not rolled out to masses. Limited visibility on % of population that is now immune**
- Vaccine unavailable to the masses for 12-18 months**
- Immunity is found to be short-lived and/or virus shows signs of mutating**

Real GDP growth (QoQ% annualized, YoY% for China)



Source: ING

Real GDP growth (QonQ% annualised unless otherwise stated) and market forecasts

Scenario 1 – Base case										
	1Q	2Q	3Q	4Q	2020 FY	1Q	2Q	3Q	4Q	2021 FY
United States	-6.0	-40	22	10	-7.0	5.0	4.0	3.5	3.0	3.4
Eurozone	-15.2	-16	13	7.5	-5.0	2.5	2.0	2.0	2.0	3.2
China (YoY%)	3.6	3.9	4.0	4.5	4.0	5.8	5.9	5.6	5.7	5.8
Japan	-1	-26	18	2.0	-4.9	0.5	0.9	0.9	0.9	0.9
United Kingdom	-5.5	-35	20	8.0	-6.1	3.5	2.4	1.5	0.5	2.6
EUR/USD	1.10	1.12	1.15	1.20		1.18	1.15	1.12	1.10	
USD/JPY	107	105	100	100		102	105	108	110	
US 10-year yield (%)	0.65	0.50	0.75	0.75		1.00	1.00	1.25	1.50	

Scenario 2 – Winter lockdowns return										
	1Q	2Q	3Q	4Q	2020 FY	1Q	2Q	3Q	4Q	2021 FY
United States	-6.0	-40	22	-9.5	-8.1	1.0	9.0	13.5	9.0	1.2
Eurozone	-15.2	-16	13	-6.0	-5.8	1.0	5.5	2.5	2.5	0.5
China (YoY%)	3.6	3.9	2.0	1.0	2.6	1.0	2.0	4.0	5.0	3.0
Japan	-1.0	-44	17	-22	-11	29	15	15	6.0	5.0
United Kingdom	-5.5	-35	20	-9.0	-7.1	4.5	11	5.5	3.0	1.8
EUR/USD	1.10	1.12	1.15	1.20		1.18	1.15	1.12	1.10	
USD/JPY	107	105	100	100		102	105	108	110	
US 10-year yield (%)	0.65	0.50	0.50	0.50		0.50	0.75	0.75	1.00	

Scenario 3 – 'Best case'										
	1Q	2Q	3Q	4Q	2020 FY	1Q	2Q	3Q	4Q	2021 FY
United States	-6.0	-24	15	6.5	-3.6	4.5	3.0	3.0	2.5	3.4
Eurozone	-15.2	-4.5	10	4.0	-3.2	2.5	2.0	2.0	2.0	3.1
China (YoY%)	3.6	4.5	4.8	5.1	4.5	6.0	6.0	5.8	5.9	5.9
Japan	1.7	0.4	0.9	0.9	-0.6	0.9	0.9	0.9	0.9	0.9
United Kingdom	-5.5	-21	20	4.0	-3.1	1.0	1.5	1.0	1.0	2.1
EUR/USD	1.10	1.15	1.15	1.15		1.12	1.10	1.08	1.05	
USD/JPY	107	105	105	105		108	110	110	112	
US 10-year yield (%)	0.65	1.00	1.25	1.50		1.50	1.75	1.75	1.75	

Scenario 4 – 'Worst case'										
	1Q	2Q	3Q	4Q	2020 FY	1Q	2Q	3Q	4Q	2021 FY
United States	-6.0	-55	-10	0.0	-14.9	3.0	23	21	9.0	1.2
Eurozone	-15.2	-50	-8.0	0.0	-16.1	4.0	30	20	10	3.3
China (YoY%)	3.6	3.0	0.0	-5.0	0.4	-7.0	1.0	4.0	6.0	1.0
Japan	-1.0	-47	-11	-19	-14	27	21	14	6.0	2.0
United Kingdom	-5.5	-46	-12	1.0	-13.1	8.0	21	17	6.5	2.3
EUR/USD	1.10	1.05	1.10	1.20		1.30	1.20	1.18	1.15	
USD/JPY	107	110	100	90		95	100	102	105	
US 10-year yield (%)	0.65	0.25	0.25	0.25		0.25	0.50	0.50	0.50	

Source: ING

Note most growth forecasts rounded to nearest whole or half number

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Article | 1 April 2020

# Metals: Bumpy road in search for the bottom

Metals will be seeking to rebalance after the shocks from both the supply and demand-side. They are likely to be on a bumpy road while searching for the bottom over 2Q20 provided that the Covid-19 outbreak in the world follow a similar pattern to the outbreak in China. However, things are likely to get worse before they get better



## 1 China returns to normality?

China's March manufacturing PMI reading surprised the market with a V turn, but perhaps it just telling us that things are not as dreadful as they were in February as Beijing took the draconian approach to combat Covid-19. Some positive signs have begun to emerge from China's metals market including tightened nearby spreads across the Shanghai Futures Exchange (ShFE) base metals and inventory drawdown. But what is behind the repricing in ShFE that caused the nearby contracts into a backwardation?

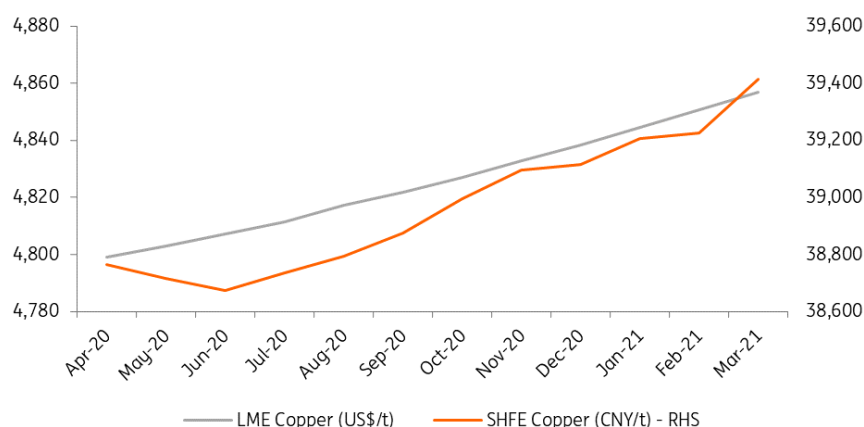
There has been some anticipation of a tax cut to be introduced in 1H20, which began with a rumour that Beijing will restart its Two sessions on 18 April as policies are usually introduced and passed at the conference.

Many measures have been brought forward to stimulate the economy during this pandemic such as rate cuts and fiscal stimulus, but now the market is looking for a VAT tax cut.

Given that, ShFE prices are tax inclusive currently at 13% VAT, last week the nearby contract (cu 2004) had begun to price in a premium at the highest of RMB200/t over the cu 2005 contract. Meanwhile, there has been a similar move across other base metals in Shanghai.

Fig.1 ShFE front-month contract in backwardation

Bloomberg, ING (as of March 30th )



## 2 Inventories peaked?

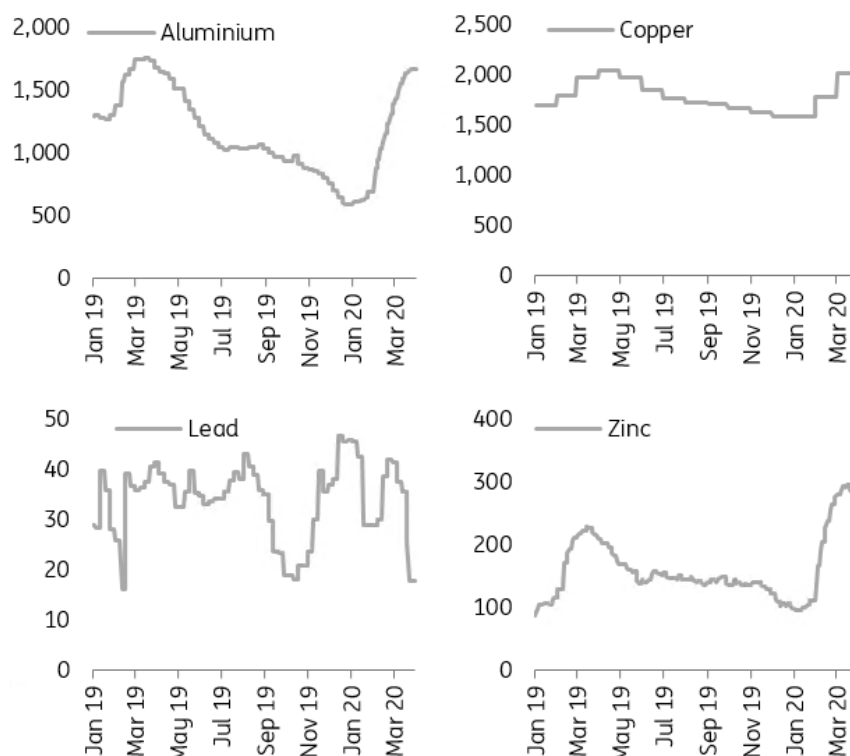
Inventory building in the Chinese market has levelled off and some metals have shown a small decline which provides some sense of relief. This coincides with their traditional seasonal pattern where inventories tend to climb ahead of the Chinese New Year and decline around March at downstream ramp up. While this year a slight delay seems not too bad, but could a recovery at this time compare to the dead first half of February?

There are two aspects to understanding the inventory pattern. Firstly, the exodus of inventory by smelters to ship metals to warehouses have now returned to normality. The second is as China gradually removes lockdowns and people are able to move within the country, business is slowly ramping up at physical trading houses and downstream fabricators and end-users. This could see some metal inventories to decline due to the physical stock replenish.

However, it the extent of all of this is questionable. Export market slump impacts may have just started to negative feedback into the demand. Anecdotal reports showed that zinc alloys and galvanised products have already started to report orders being cancelled. Given more countries have started lockdowns since mid-March, most of the export market problems will only become apparent in April.

Fig. 2 Some metals inventories in China have started to turn

Bloomberg, ING



### 3 Increasing supply risks

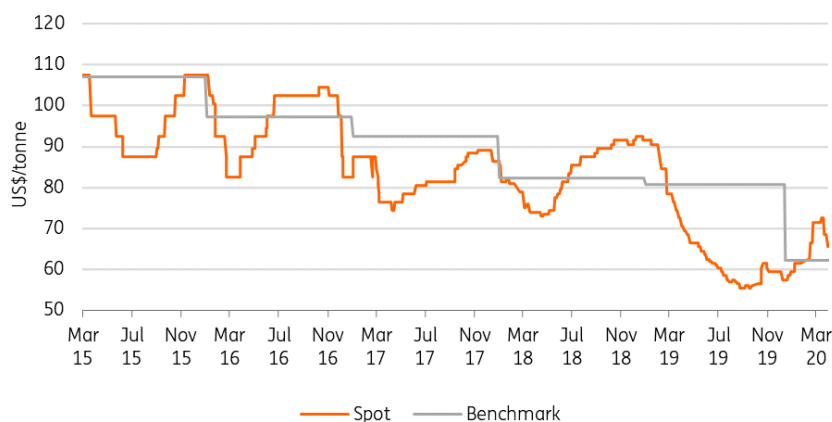
As more countries are enforcing lockdowns, some miners and refined metal producers have announced to temporarily suspend operations.

Mine disruptions keep climbing in major mining countries including those from Americas and China. The spot treatment charges (TCs) have started to decline primarily on the expectation of shipment disruptions to come. Both copper and zinc TCs in the import concentrate market have decreased. Meanwhile, low prices saw an increased risk of price-related cuts from smelters. By the end of March, around half of Chinese aluminium smelters are in cash negative and small cutbacks (or in bringing forward maintenance) have begun to emerge. Others had struggled raw materials such as waste lead-acid battery as major feeding to secondary lead producers. The secondary lead production is approximately 45% of total lead production in China. Meanwhile, with some major lead-zinc polymetallic mines announced suspensions and wider lockdowns, the risk is also rising from mine supply which they may face with concentrate shipment disruptions.

If we assume a turning tide in the number of cases in late April and early May and lockdowns gradually removed thereafter, base metals demand could fall by an average of 5.5% YoY in 2020. Based on assessing potential production loss from already announced production disruptions, they have yet to offset the demand loss over the period which an average 25% drop in average demand over 1Q20. As a result, there are swelled surplus built in the market and could continue to grow if lockdowns to prolong.

Fig. 3 Spot TCs have declined

Bloomberg, ING



#### 4 A bumpy road in search of the bottom

Things are likely to get worse before they get better, and the same applies to the industrials metals market.

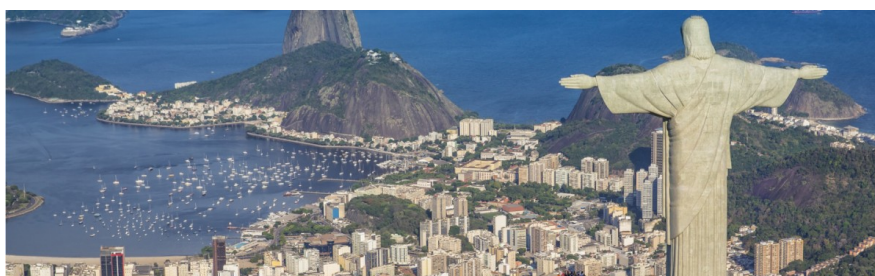
As for copper, the pessimism saw even the long-dated contracts shift lower along the curve. Some have more drastic moves towards the front end such as lead, the historical steep backwardation saw during last month has eased and contango. Back in mid-March, when things were not as bad as what they are looking today and we were still able to work in offices, the market hadn't been price in what could coming later at that time copper was holding around US\$5,300/tonne before it crashed to US\$4,371/tonne on 19 March - the lowest since 2016.

We are still not out of woods. In the extreme case, copper might go even lower from what we have just seen two weeks ago. The main risk to the upside is on the supply side at major mine producing countries disruptions. Covid-19 is still the main uncertainty, with some medical experts now predicting a second wave in China around October this year. That could result in another round of lockdowns, however, will the situation be less extreme as what we have seen during the first outbreak? Unfortunately, there is no easy answer to this.

We have cut our 2Q20 copper forecast significantly to an average of US\$4,680/tonne and expect gradual recovery mostly during 2H to see full-year price average at US\$5,030/tonne.

## EM Sovereigns: Covid-19 to leave behind a legacy of debt distress

While the past week has seen some recovery across risk assets on the back of global fiscal and monetary policy stimulus, permanent damage remains for several emerging market sovereign debt issuers. The amount of US\$-denominated bonds in emerging markets with a yield above 10% has more than doubled from US\$90bn in January to US\$190bn



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Podcast | 3 April 2020

## Listen: Covid-19 - The lockdown, the recession, the recovery

In this podcast, ING's chief international economist James Knightley discusses the potential hit to growth and possible path for recovery under four coronavirus scenarios



### Four scenarios

President Trump extends social distancing in the US until the end of April. But like other countries around the globe, the move to limit the spread of the virus will come at a severe economic cost. In this podcast, ING's chief international economist James Knightley discusses the potential hit to growth and possible path for recovery under four coronavirus scenarios.

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Article | 2 April 2020

## Eurozone: GDP contraction to rival great recession

With most eurozone countries in partial or full lockdown, GDP contraction this year is likely to rival the Great Recession. While the European Central Bank has ultimately put a big monetary package on the table, a common European fiscal approach still seems far away



### Lockdown idles a large part of the economy

While the sentiment indicators for March were bad, they probably can be thrown in the bin immediately. After four months of increases, economic sentiment nosedived in March.

Although the decline was historically large, it probably still understates the actual fall in sentiment, as the survey was conducted between 26 February and 23 March and fieldwork was hindered by containment measures.

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*The OECD placed the loss of added value for most eurozone member states at around 25% per month of lockdown*

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We have more faith in the French statistical office INSEE's analysis that estimated the loss of activity by sector during the first week of the lockdown, as well as the loss of demand for each sector. Both the production and expenditure approach point to an economy operating at 65% of capacity. The OECD, using a similar methodology, placed the loss of added value for most eurozone member states at around 25% per month of lockdown.

## Consumer confidence crashed in May



Source: Refinitiv Datastream

## A better second half won't prevent significant GDP contraction

In our base case, the lockdown will be gradually lifted by the end of April, setting the scene for a recovery in May. However, there will be some negative second-round effects from higher (temporary) unemployment and rising bankruptcies, implying a very negative second quarter.

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*We now pencil in a GDP contraction of 5% in 2020, followed by a 3.2% expansion in 2021*

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While the rebound in the second half of the year is likely to be strong, it might take until the summer of 2022 before we catch up with the pre-crisis production levels. We now pencil in a GDP contraction of 5% in 2020, followed by a 3.2% expansion in 2021.

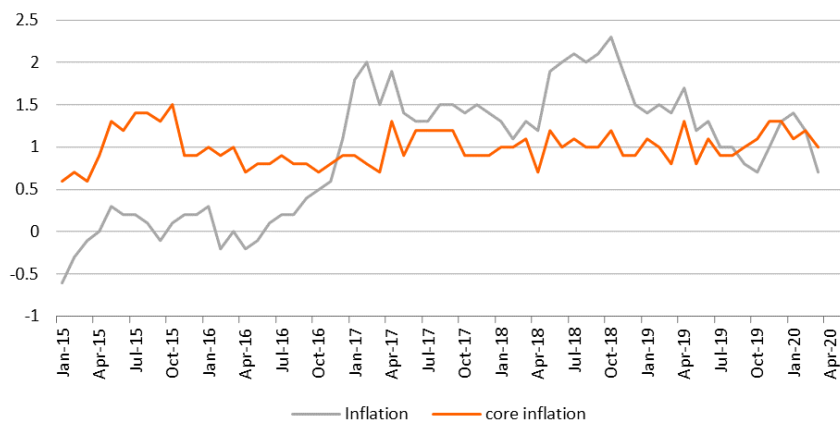
While some think that the supply shock might push inflation higher, we believe that falling demand will keep inflation at bay.

## No unity on a common approach

The reaction of authorities has been rather swift. The general escape clause of the European Union's fiscal framework was activated to allow member states to disregard fiscal constraints to be able to fully respond to the economic challenges. On average about 2% of GDP stimulus has already been decided upon.

Whether this will be sufficient to compensate for the economic fallout remains doubtful, but European leaders have thus far failed to come up with a common European approach. The bone of contention remains a common debt instrument, a formal proposal by nine member states.

## Inflation comes down again



Source: Refinitiv Datastream

### 'Crossing the Rubicon' moment

Meanwhile, the ECB has morphed back into “whatever it takes” mode.

In the first instance, the central bank came up with a thoughtful response, loosening the conditions for banks to get ultra-cheap funding (even below the deposit rate) through the TLTRO III, to avoid a credit crunch. As markets' reaction was lukewarm, the ECB decided in an emergency meeting to put in place the Pandemic Emergency Purchase Programme, allowing the bank to purchase for €750 billionworth of sovereign and corporate bonds. Greek bonds will now also be included as well as commercial paper.

*If the ECB buys according to capital keys, it might temporarily pass the issuers limit for Germany but since the German government has decided to go big on fiscal expansion, the ECB's holdings of German debt are likely to fall below 33% again in 2021*

With the PEPP (even though it allows some flexibility), together with the existing programmes, the ECB is now likely to buy more than €100bn a month in assets for the remainder of the year. The ECB will continue to use the capital key for the ultimate distribution of the purchases, although it decided to junk the issuer's limit, something that might trigger new complaints at the constitutional court in Karlsruhe.

While some saw this as a “crossing the Rubicon” moment, the reality is more prosaic. If the ECB buys according to the capital keys, it might temporarily pass the issuers limit for Germany. However, as the German government has decided on a big fiscal expansion, the ECB's holdings of German debt are likely to fall below 33% again in 2021.

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Article | 2 April 2020

# European rescue alphabet soup and market impact

The past few weeks have seen a flurry of proposals for EU members to jointly finance the coronavirus-related fiscal costs. We look at the latest proposals, how they compare, and how they would be received by EUR rates markets



Source: Shutterstock

## An attempt at taxonomy

Given the number of unknowns and lack of political agreement, it is pointless to go into too much detail about each of them. It is worth having a general taxonomy in mind, however. The proposals can be categorised along two axes. Firstly, how much of a fiscal transfer do they amount to (in €), and secondly for how long. The holy grail in terms of supporting the more vulnerable member states is of course a large package of help with permanent transfers.

## SURE but not very significant

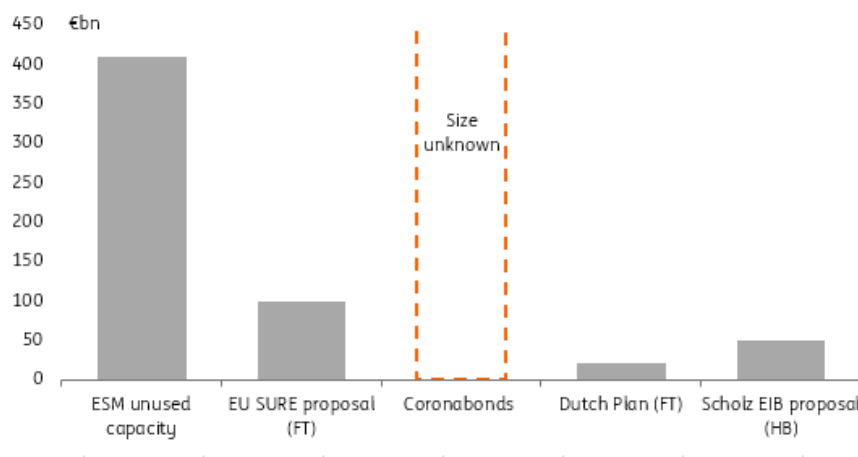
The EU's SURE proposal floated in the FT yesterday, from what we can tell, doesn't rank very highly on either axis. To be sure, €100bn of loans (with the largest three recipients unable to borrow more than €60bn together) is a step in the right direction, but it compares with the European Stability

Mechanism's firepower of over €400bn. Similarly, the length of the loans is unknown but each member state's exposure would presumably be limited to the amount of guarantees provided. According to the same source, they should total €25bn and would be weighted by the size of each country's economy.

## Rescue measures: the patchwork approach

This is perhaps the greatest advantage to this proposal. Its limited size and (apparently) lack of conditionality make it a more likely tool to be implemented. We see no reason to think this could not be used in addition to other measures, such as the ESM's Enhanced Conditions Credit Lines (ECCL) or European Investment Bank loans in principle. Indeed, according to Handelsblatt, German Finance Minister Olaf Scholz is open to combining SURE bond issues with additional EIB and ESM loans. It is likely that contributing member states would look at their total additional liabilities under all the proposals on the table however.

## The options on the table



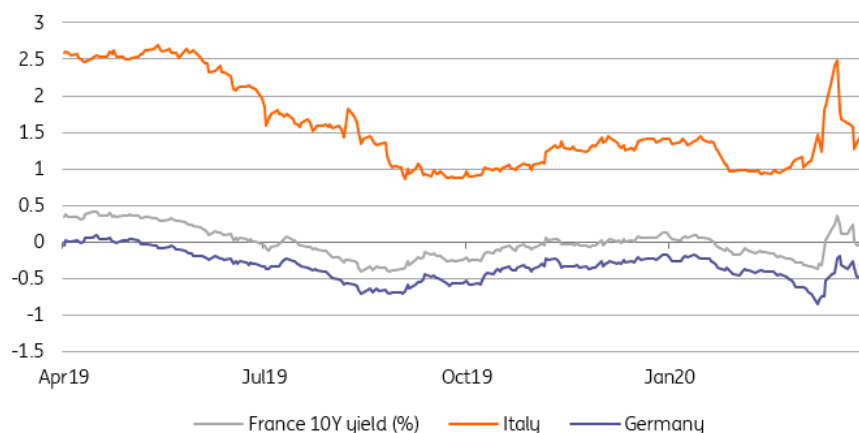
Source: FT, HB, ESM, ING

## Alphabet soup and market impact

Market reaction to the proposal has been positive but we warn against overstating its significance. Granted, even an additional €20bn loan each to Italy and Spain would be a step in the right direction but this compares to what our economics team estimates will be €70bn of additional financing needs for 2020 alone in Italy. Note also that this option is inferior to the ESM ECCL in one additional respect: it is not a pre-condition for the European Central Bank to start the Outright Monetary Transactions.

We argue that €20bn less BTP issuance alone would be of no great relevance for Italian yields, and that additional Germany guarantees to the EU and EIB would fail to move Bund yields. Add some ESM loans to these figures and one starts to have a decent budget relief for affected countries in the near term, but their liabilities would remain their own.

## Fiscal transfer would reverse the divergence in borrowing costs



Source: Bloomberg, ING

Interestingly, semi-core sovereign primary markets stand to be most affected from the plan. If the ESM borrowing is any guide, and we think it is, the markets most likely to be 'crowded out' are existing 'E-names' (EU, EIB, EFSF, ESM), and France. With respect to ECB purchases, what would be spent on SURE bonds would not be spent on other supranational, agencies or sovereign bonds.

This seems like an ever more distant prospect now but any progress on an instrument with more explicit fiscal transfers, even if capped and limited in time, would be a lot more significant for European yield. In addition to the direct substitution of liabilities between member states, it would encourage hope, or fear depending of where you stand, of greater fiscal and economic coordination in the future, thus chipping away at the very reason why borrowing costs differ from one member state to the next.

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# China's central bank to cut the targeted RRR again and again

China's central bank plans to cut the targeted Required Reserve Ratio again, but this time only for smaller banks. We look at how effective this policy will be, and what the People's Bank of China could do next



Source: istock

## Targeted RRR cut but on a smaller scale

China's central bank, the PBoC, announced it will cut the targeted RRR by 0.5 percentage points on 15 April and again on 15 May, amounting to a full 1 percentage point cut. This time, the RRR cut is only targeting smaller banks, so it will release a smaller amount of liquidity than the previous cut of CNY 500 billion. The PBoC estimated that each targeted RRR cut could release CNY 400 billion.

The PBoC also announced that it will lower the interest rate paid for excess reserves from 0.72% to 0.35%.

## Effectiveness at helping SMEs is in question

The cut suggests that damages from the coronavirus outbreak globally could linger at least until May. So the effectiveness of policy is highly important to gauge the speed of the economic recovery.

Just how effective this targeted RRR cut will be, however, is questionable.

After this move, some of the small banks face a reserve ratio of only 6%. This is indeed very low. But even without these two targeted RRR cuts, the reserve ratio for these banks is just 7%, which is already low.

The cuts are aimed at smaller banks to encourage them to lend to SMEs. But banks have been reluctant to lend to SMEs that are facing difficulty in this pandemic. This could be especially true for exporters who are facing order withdrawals from the west. The Easter holiday is an important export season for China. With the lockdown and increased social distancing in Europe and the US, sales in western markets are expected to be dismal.

Are banks willing to take high credit risk to lend to SMEs that are facing a cash flow problem? This may be unlikely.

## Effectiveness at pushing down interest rates is high

Frequent targeted RRR cuts that release long term liquidity to the market mean that longer-term interest rates should fall, if global risks do not increase suddenly.

Though this would not benefit SMEs, which are the most in need, it will ease the interest costs of other corporates that could contribute to the recovery of the economy, even if liquidity is already ample.

This lower interest rate effect should have a short-term impact on the yuan. We expect the USD/CNY to go from 7.10 to 7.20 by early May and to 7.25 by the end of June, as the recovery should be slow and the market is looking at the chance of the second wave of coronavirus infections.

## Further easing is certain but how?

The central bank may find it difficult to encourage banks to lend to those most in need without government loan guarantees.

Even though we expect there to be more targeted RRR cuts for smaller banks, and rate cuts on the 7D, 1Y Medium Lending Facility (MLF) and 1Y Loan Prime Rate (LPR), these policies would be more beneficial to solid companies, as their credit profiles are much better than small manufacturers, service providers and exporters. These weak credit profile borrowers could be supported by fiscal stimulus including tax and fee cuts.

A combination of monetary policy and fiscal policy is necessary at this time.

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Article | 2 April 2020

## Central and Eastern Europe FX: Negative growth, more easing ahead

All CEE countries should experience negative growth in 2020, with 2Q20 constituting the bottom. All banks in the region are in full easing mode. We expect more cuts from the Czech Republic and QE from Hungary. The pace of the CEE FX sell off should ease as FX interventions loom. The already tightly-managed Romanian leu remains one of the global winners

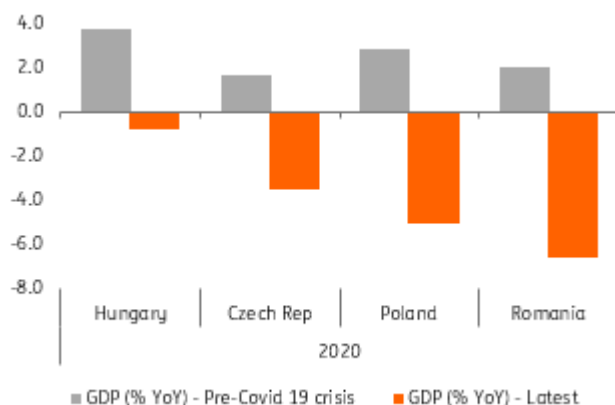


Source: Shutterstock

### CEE growth: 2Q20 should constitute the bottom

As small open economies, the CEE countries are feeling the heat of the Covid-19 crisis via collapsing demand both domestically and globally. With world trade coming to a halt, weaker domestic exchange rates no longer act as an offsetting factor to weaker domestic growth. We expect all CEE countries to show negative growth in 2020 (Figure 1), with fiscal stimulus (in Poland worth as much as 9% of GDP for example) only softening the blow. Hungary is expected to experience the least negative growth (-0.8% year-on-year) among CEE countries in 2020, while Romania will feel the biggest hit (-6.6% YoY). As for the growth trajectory, 2Q20 should constitute the bottom, with some modest rebound in the second half of this year.

Figure 1: Downgrading CEE growth significantly



### CEE central banks: Shaking up the status quo

For the CEE central banks, the Covid-19 crisis heavily altered the status quo in terms of their reaction functions. The Czech National Bank, arguably one of the most hawkish central banks globally, has already slashed interest rates by 1.25% and is contemplating a soft version of quantitative easing. In contrast, one of the most dovish central banks globally up until now, the National Bank of Hungary, has lagged its CEE peers, refraining from rate cuts and QE and only providing targeted lending - perhaps due to the currency consideration. We expect the NBH to join the chorus of global central banks and eventually embark on QE, thus supporting the local bond market. In contrast, a lot seems to be already discounted in Czech and Poland (with the National Bank of Poland already embarking on aggressive purchases of domestic bonds), with the market looking for further cuts, in excess of 50bp. The CNB is likely to deliver more cuts while for the NBP, the bar to cut rates is higher.

Figure 2: CNB benefits from vast FX reserves



Source: CEE Central Banks

## CEE FX: Entering the second (and more moderate) phase of the sell-off

As for FX, we see the CEE currencies entering a second (and more moderate) phase of the sell off, with local central banks contemplating FX interventions. The National Bank of Romania is already in full intervention mode, the CNB delivered a verbal intervention, while the NBP is likely to step into the market too, should it be necessary. In contrast, we see a high bar for NBH FX purchases, suggesting that the Hungarian forint could be relatively more vulnerable in falling markets (particularly if the NBH may yet embark on QE). In contrast, the CNB's large scale firepower in the form of its huge FX reserves (Figure 2) should now stop the koruna's underperformance vs its free floating CEE FX peers. In falling markets, the tightly managed RON should continue to be a CEE winner and one of the global outperformers.

# Thailand: It's going to be the worst since the 1998 Asian crisis

We cut our forecast of Thailand's GDP growth in 2020 to -4.3% from -0.8%, the worst year for the economy since the 1998 Asian economic crisis. We add 50 basis points in rate cuts to our central bank policy forecast and see the THB weakening to 35 against the USD by end-2Q20



Source: Shutterstock

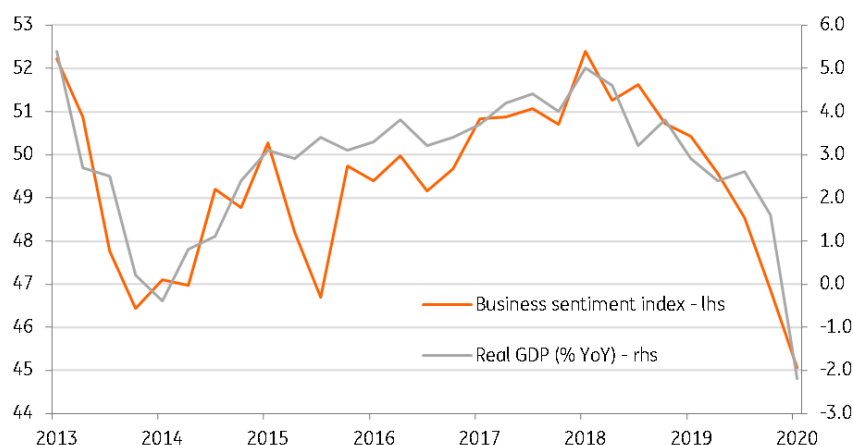
**-4.3%** ING's 2020 GDP growth forecast

## Sentiment indicator points to worse

Yesterday's release of an all-time low manufacturing Purchasing Manager Index (PMI) of 46.7 in March and the third consecutive month of it staying under 50, implying contraction, foreshadowed a negative GDP growth in the first quarter of the year. The subsequent data yesterday on Business Sentiment Index (BSI) in March informed about the extent of the GDP fall in the last quarter.

In fact, BSI is a better lead indicator of GDP growth than PMI as the chart below plotting the quarterly average of the index against the year-on-year real GDP growth shows. Unlike PMI, which compares sentiment relative to the previous month ([read our Asian PMI note for more](#)), the BSI is the diffusion index with a reading below 50 implying negative responses outweighing positive ones, and vice-versa for that above a 50 reading. The BSI reading for March was 42.6, the lowest since November 2011 and under 50 where it's been since mid-2019 (44.1 in February 2020).

## One way down and deeper - BSI and real GDP growth



Source: Bloomberg, CEIC, ING

## The worst since the Asian crisis, if not more

Covid-19 spreading around the world suggests that 2020 is shaping to be worst for the Thai economy since the 1998 Asian financial crisis, of which Thailand was the epicentre with over a 7.8% plunge in the country's GDP in that year. Blame it on the economy's greater reliance on tourism and trade as both these sectors are going to taking a significant hit from the global spread of the disease.

Following a three-week partial lockdown in Bangkok (started last week) and Phuket island now shut for the entire month of April, there will be a big slump in tourism. Moreover, the lockdown will inflict significant damage to consumer spending. As elsewhere in Asia, private consumption forms a significant chunk of GDP on the expenditure side; in the case of Thailand, it's 52% in 2019. If so, no prizes for guessing that we should see GDP growth moving into negative territory in the first quarter and staying there for the rest of 2020.

We anticipate at least about a 2% year-on-year GDP fall in the first quarter, just as what the BSI indicates. But with a full blow of disease spread in the current quarter, it's going to be ugly. We see GDP plunging as much as 7.7% in this quarter, followed by a not so worse 4.8% and 2.6% declines in the third and fourth quarters respectively. This brings our full-year growth forecast to -4.3%, a downgrade from -0.8% earlier. If true, 2020 will go into history as the worst year for the economy since the Asian crisis.

Not just us. But, the Bank of Thailand also thinks so. Rather far worse. Just a week ago the central bank slashed its growth forecast for 2020 to -5.3% from +2.8%.

## How's the policy response?

The authorities are doing what they can. The government has already announced two stimulus packages worth THB400 billion and THB117 billion in the last month, for a total thrust of about 3% of GDP. However, the real boost from measures such as cash hand-outs and tax cuts amounts to only about half of that. The government is preparing the third package of THB500 billion to be unveiled this month.

We also expect the BoT to continue to ease monetary policy by cutting interest rates further in the current quarter. The off-cycle BoT rate cut of 25 basis point on 20 March was too little too late, while the central bank refrained from doing more at the regular meeting just a week later. At 0.75% currently, the policy rate is the lowest ever, which probably underlies the BoT's reluctance to ease further. However, we don't see this as a constraint. Not particularly amid persistently low inflation, or even negative inflation this year on the back of plunging consumption.

Yes, we are also cutting our consumer price inflation forecast for the year to -0.8% from +0.6%.

### More central bank easing, weaker currency

We are adding 50bp in rate cuts to our BoT policy forecast and expect this to occur in the current quarter. There are two meetings in this quarter, on 20 May and 24 June, and a 25bp cut at each won't be an overkill given the current situation. Lower interest rates together with a narrowing current account surplus should sustain the THB as an Asian underperformer in the rest of the year, adding on to the 8.6% depreciation against the USD in the first quarter.

We see the USD/THB exchange rate hitting 35 by end-2Q20, a level not seen in the last three years (spot 33.05).

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