

Covid-19: The world's slow, uneven recovery

What does the European leaders' agreement mean in practice for the continent's Covid-19 recovery? And what next for America as a Republican stimulus packed is delayed? The Fed meets next week as housing in the States rebounds. Here's our roundup of the top stories from ING Research

In this bundle



EU summit: A historic deal reached

A marathon negotiation has resulted in an agreement on the EU budget and recovery fund. It is a significant step of solidarity and integration, but the...

By Bert Colijn and Carsten Brzeski



The economic impact of Europe's audacious recovery plan

The EU's Recovery and Resilience Fund is no game-changer for economic growth, but it's no paper tiger either. It will nudge the recovery in the...

By Bert Colijn



FX

FX implications of the EU Summit

With plenty of good news priced into euro ahead of the EU summit, the reaction to the agreement today was limited. Yet, we don't expect a...



Czech Republic | Hungary...

CEE implications from the EU recovery fund

EU recovery fund and the EU budget is positive for the CEE region with the EU transfers into CEE in the 2021-27 period rising vs the prior budget. As the...

By Leszek Kasek, Valentin Tataru and Peter Virovacz

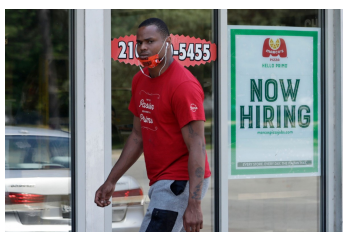


United States

US housing market bounces with a capital "V"

As the debate goes on about the shape of the overall US economic recovery, in the housing market there is little doubt it is a "V". This has...

By James Knightley



United States

US: Labour market strains intensify

A pick-up in jobless claims underlines the economic pain from renewed Covid containment measures in many states. A more pressing issue is what will happen...

By James Knightley



Credit | Romania...

EM sovereign debt: No time to be complacent on fallen angel risks

Amid the pandemic and oil price collapse, fundamentals of emerging market sovereigns have come under pressure across the board, resulting in a peak of 28...

By Valentin Tataru



Commodities, Food & Agri | Energy | Sustainability

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

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

By Nadège Tillier

Article | 21 July 2020

EU summit: A historic deal reached

A marathon negotiation has resulted in an agreement on the EU budget and recovery fund. It is a significant step of solidarity and integration, but the hard-fought negotiations show that this provides no guarantee of unity moving forward and it is unclear how much political porcelain has been smashed for good



European Council President Charles Michel (R) and EC President Ursula von der Leyen at the end of the EU summit

They got it done at last. The agreement on the Multi-annual Financial Framework (MFF) and the Next Generation EU recovery effort, including the Recovery and Resilience Fund (RRF) is a milestone for the EU as it tries to battle the economic impact of the corona crisis. This crisis has already seen quite a few sacred European cows toppled and this latest agreement marks the most significant one. The EU has already allowed countries to overrun the maximum allowed budget deficit, and borrowing can be done for short-time work schemes (SURE) and from the European Stability Mechanism without conditionality for coronavirus-related spending. The European Central Bank pulled out all the stops, allowing full flexibility in asset purchases, but that was all just a lead-up to the real game changer: the EU will now borrow in the market for grants to individual member states.

What's been agreed?

A deal worth €1.824 trillion in total, including €1.074 trillion for the multi-annual budget for 2021-2027, including sizable increases in rebates for the Netherlands, Austria, Denmark and Sweden and an upheld rebate for Germany. The total size of the Next Generation EU recovery effort has been upheld at €750 billion (in 2018 prices) and the EU will borrow up to that amount on capital markets until 2026. The specific recovery and resilience fund receives €672.5bn, more than in the initial proposal, as a mix of €312.5bn in grants and €360bn in loans. The other programmes under Next Generation EU, including spending on innovation and greening, have all seen cuts compared to the initial proposal.

The allocation of the Recovery and Resilience Facility grants is upheld from last week's Council proposal. That means that 70% gets disbursed in the first two years (2021-2022) according to a set key. Some 30% will be disbursed in 2023, depending on the depth of the recession in 2020 and cumulative GDP performance in 2020 and 2021. That amount will therefore only be calculated in 2022. Payment of grants will be conditional on progress made on national recovery and resilience plans that the countries have to submit, focusing mainly on the Commission's country specific recommendations for reform and a jobs and growth agenda. The Commission will monitor progress and member states can escalate issues with other countries' progress to the Council.

Is this the most effective recovery fund and budget possible? No, it isn't. In terms of size, the fund is still relatively small given the severity of the economic crisis. Also, the fund will only become effective on 1 January, with the first money probably reaching the real economy not much before mid-2021. On top of that, there have been cuts to the original proposal on long-term investment funding such as research and development, digitization, greening and health. Still, given that more than a year ago a meagre eurozone budget was almost impossible and given how far apart member states had been at the start of the discussion, this morning's outcome is still remarkable. Even if it is what a soccer player might call a "dirty victory". It is not the result of unity and solidarity but rather a hard-fought compromise, and only time will tell how much of the drama has been for the voters at home and how much political porcelain has been smashed.

What does it mean for the economy and markets?

According to our preliminary calculations for the first two years, the maximum amount of grants disbursed from the RRF will be 1.6% of EU GDP at €218.75bn with large differences among countries. More vulnerable countries like Italy and Spain can receive grants for around 2.5% and 3.5% of GDP, while France, Germany and the Netherlands have maximum allotments of 0.9%, 0.4% and 0.5% of GDP over those two years, respectively. Especially for the countries that were more vulnerable going into the coronavirus crisis, this will provide a decent amount of stimulus to their economies. Many of those are also the ones with sharper economic downturns due to stricter lockdowns to curb the virus. However, don't forget that the fund will only become effective next year and that 30% of it won't be disbursed until 2023. To tackle the economic impact of the virus now, the countries in need will and should lean on the options offered by the ESM, looser fiscal rules and the SURE (Support to mitigate Unemployment Risks in an Emergency) programme.

With hindsight, it might have been a better idea to actually separate the negotiations on the RRF and the MFF. The link was made in order to construct the issuance of a temporary common bond, without having to give it this name. Maybe the RRF should have been a eurozone project, rather

than a EU-wide project.

The negotiations on the RRF have always had a pure economic dimension and a symbolic dimension. The fact that there will now be grants is an enormous step towards solidarity in Europe. The fact that there will be something like a common bond is an important step towards further integration, even if the impact should not be overestimated. It is still a one-time fund exceptionally created for the coronavirus crisis and the bitter fights at the Council show that it is not a given that future crises will receive a similar response.

Whether these significant steps, however, will have the maximum symbolic impact remains to be seen. From a positive perspective, the fact that government leaders negotiated to the bitter end to find a deal and did not simply decide to postpone the decision shows that all of them saw the sense of urgency. Also, the fact that Germany and France have been working closely together on all of this should have strengthened the markets' belief in more integration. From a more negative perspective, the hard-fought compromise has not sent a signal of strong unity. Only time will tell which of these two perspectives will become the dominant narrative in financial markets.

One thing is for sure, while the ECB was the only game in town for quite some time now, it looks like a second team has entered the game. That should take some of the pressure off of the central bank in the aftermath of this historic crisis. And probably even more if the second team improves its team play.

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The economic impact of Europe's audacious recovery plan

The EU's Recovery and Resilience Fund is no game-changer for economic growth, but it's no paper tiger either. It will nudge the recovery in the right direction, especially for those countries which are particularly vulnerable



European Commission President Ursula von der Leyen

□ Numbers at a glance

The agreement between EU leaders on a recovery fund can be considered a new milestone in terms of European solidarity and opens the door towards more integration. The most notable part of the agreement is that the EU will borrow from capital markets for subsidies to countries for the first time. Now that this is sinking in, the question is whether the impact of the fund will be largely symbolic or whether it actually will have a significant economic impact? So I've been crunching the numbers.

- The size of the Next Generation EU recovery effort is significant at €750bn.
- It will make the EU the third-largest borrower after Germany, France and Italy by 2021
- It is split between 390bn euro in grants and 360bn euro in loans.

Out of that, the specific tool meant to boost economic recovery is the Recovery and Resilience

Fund (RRF).

- This gets 312.5bn euro in grants and 360bn euro in loans.
- Of the grants, 70% will be disbursed in 2021 and 2022 and the last 30% will only be available in 2023.
- They are conditional on progress made regarding a recovery and resilience plan, to be submitted to the European Commission.

? Who gets what?

For the first two years and 70% of the RRF grants, the allocation key has already been determined. This depends on:

- The population of the country in 2019,
- GDP per capita in 2019 and unemployment between 2015 and 2019.

That means that 70% of the grants are disbursed based on economic performance going into the crisis, not during the crisis itself. The 30% disbursed in 2023 replaces the unemployment component by GDP growth during the coronavirus crisis in the calculation, making it more dependent on the Covid-19 impact itself.

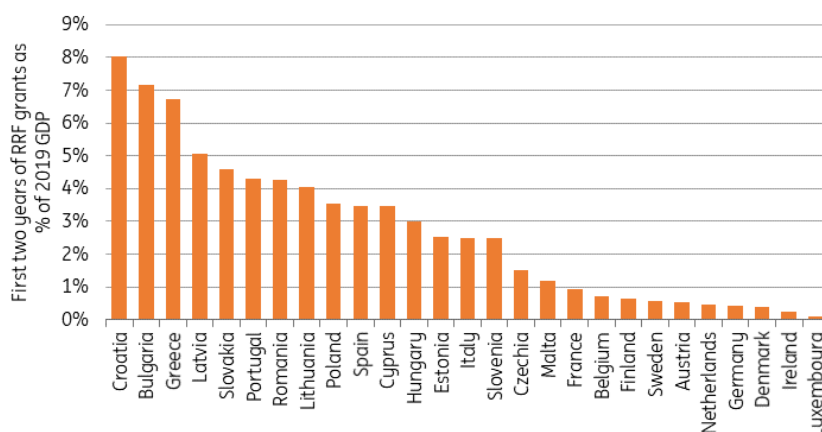
So here's what I'm looking at. I'll focus on the maximum grants for 2021 and 2022 by country, as those are already set and because they are most relevant for the recovery in terms of timing. Regarding loans, the eligibility is not yet determined and the take-up on them will be doubtful, meaning I'll stick to grants here.

Central-eastern and southern European economies stand to gain the most

The chart below shows that there are large differences between countries in terms of potential stimulus for their economies. Mind you, this is stimulus as a share of 2019 GDP and given that GDP will likely still be below 2019 levels in 2021 and 2022, the impact will still be somewhat higher depending on the severity of the crisis of course.

Overall, central-eastern and southern European economies stand to gain the most from the fund. Croatia, Bulgaria and Greece lead the pack with stimulus potentially north of 6% over two years. Of the larger economies, Spain and Poland get around 3.5% of GDP, Italy around 2.5% and France, Germany and Netherlands under 1% of GDP over those two years.

Maximum grants differ significantly between countries

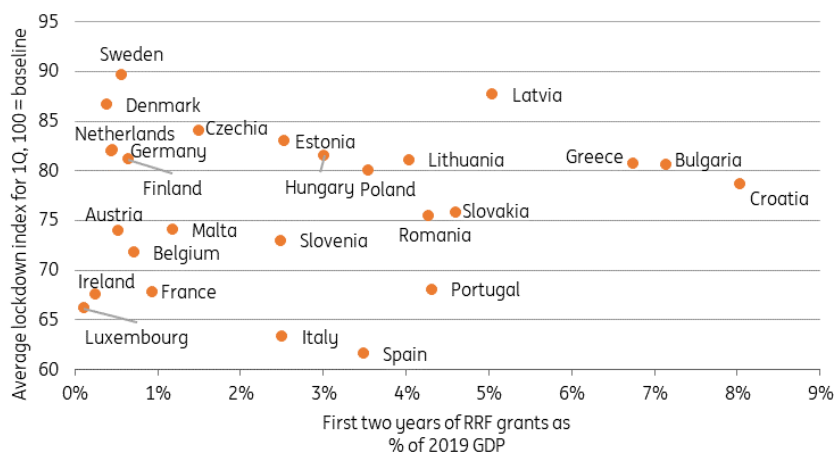


Source: ING Research, Google COVID-19 Community Mobility Reports

? Do the more vulnerable countries stand to benefit most?

As the purpose of the recovery fund is to provide relief for the hardest-hit economies, the question is whether the predetermined method actually benefits the countries most affected by the coronavirus crisis. One way of assessing this is by looking at the depth and length of the lockdowns in different countries, as this has proven to be a key determinant of the economic crisis. The chart below shows there is little relationship between the severity of the lockdown and the maximum grants for the first two years.

Grants are not strongly related to the severity of the lockdown



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

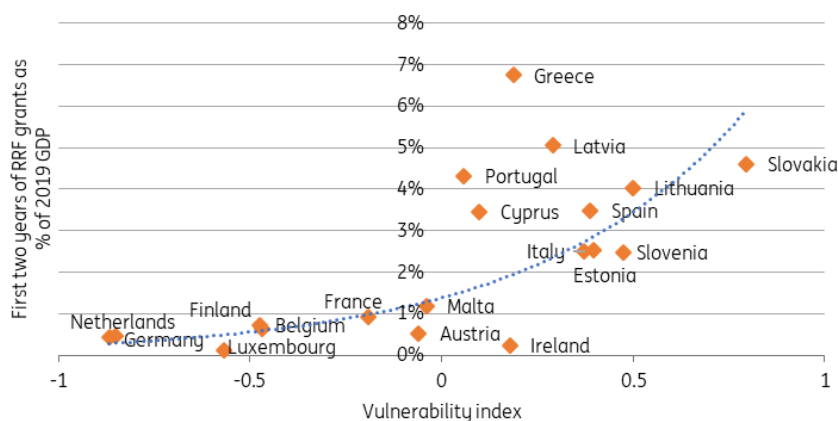
Note: index of activity since Feb 15 for retail & recreation, groceries & pharmacies and workplaces using Google Covid19 Community Mobility Reports with data through June 23. 100=baseline of activity between Jan 3 and Feb 9

□ It's all in the bounce

The question is of course not necessarily just how deep the recession is now, but also how quickly an economy can bounce back from it. That is something that we have focused on looking at just eurozone countries in a previous note. For that, we created a vulnerability index that captures the likelihood of an economy experiencing a prolonged slump due to the Covid-19 crisis. As you can see below, the relationship between the maximum grants as a % of GDP and the vulnerability index is a lot stronger, which shows that the money could well end up where it is most needed on average.

Countries that stand to gain more than the vulnerability index would suggest are Greece and Portugal for example, countries which are slightly more vulnerable than the eurozone average to a weak recovery but receive among the highest RRF payouts. Ireland has a similar risk to a weak recovery but receives a smaller share of GDP from the RRF than even the Netherlands and Germany.

Countries more vulnerable to a longer economic slump stand to gain more from the RRF grants



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

Note: vulnerability index comprises an average of normalised indicators: automatic stabilisers, emergency fiscal spending as a percentage of GDP, percentage employment of small enterprises (under 10 employees), average of the three financial conditions factors mentioned in the text, liquid household assets as a percentage of GDP, sectoral composition and the average for our lockdown index.

? Will it have a meaningful impact on the recovery?

The big question is whether the fund will really make a difference or largely serve an important role through symbolism as the first mechanism through which the EU borrowed in the markets for subsidies to member states? This depends on the timing and the size. As mentioned above, the size is significant for a few of the CEE and southern eurozone economies, but definitely not all. But also for those countries which get more than 1% of 2019 GDP, the amount of stimulus provided through

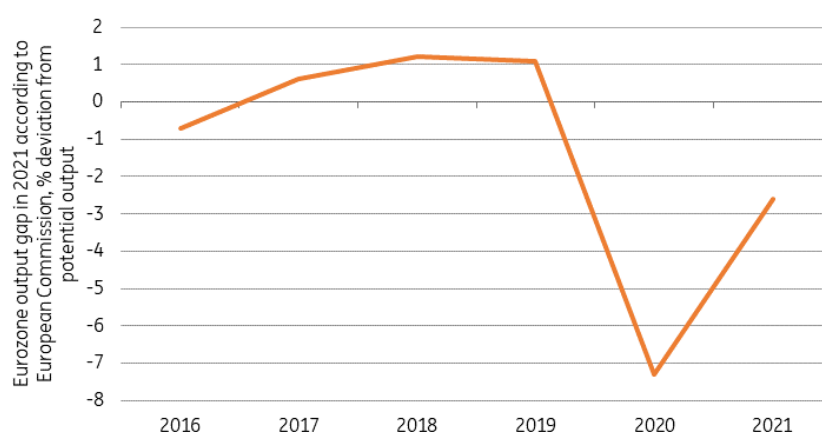
the RRF is significantly smaller than what national governments are providing in terms of fiscal injections. According to Bruegel estimates of the immediate fiscal impulse, only Greece would receive more from the RRF than from national fiscal injections, while most other economies receive far less than what they already commit to themselves.

The timing of the fund is not ideal for it to have a maximum positive impact

The timing of the fund is not ideal for it to have a maximum positive impact on the economic recovery, and that's also important. Most national stimulus measures are aimed at stimulating the economy now, but as the RRF only starts to disburse in 2021, it does not help stability in the depth of the crisis itself. It does boost the economy in the recovery phase, but the positive effects through multipliers would likely be stronger the sooner the money is sent out. It is important to note that the European Fiscal Board has already warned against too tight budgetary stances in 2021 though, so the RRF grants are also useful to counter effects on unwinding stimulus. All of this is conditional of a second wave not causing new lockdowns and lengthening the period of economic fallout.

Output gaps suggest that stimulus in 2021 is still useful, but not as effective as in 2020

Source: European Commission Spring Forecast, ING Research



Source: European Commission Spring Forecast, ING Research

□ Significant output gaps to remain

Looking at expectations of output gaps by the European Commission in late April, we see they expect significant gaps still to exist in 2021. The output gap means that the economy performs below potential, making fiscal stimulus meaningful. Those output gaps are expected to be far larger in 2020 though, -7.3% in 2020 versus -2.6% in 2021. This shows that any stimulus is expected to be more helpful now than next year. No estimates exist for 2022 and 2023, but the gap would only become smaller if not closed in those years if the recovery continues as the EC

expects it to.

All in all, despite the EU recovery fund being a truly historic milestone in terms of solidarity and integration, the RRF is unlikely to be a real game-changer for the economic recovery for most economies. Don't underestimate the impact either though; it is definitely helpful in the recovery phase, but smaller in size than most national fiscal emergency spending plans and quite late in terms of disbursement to make it a real turning point as far as the growth picture is concerned.

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FX implications of the EU Summit

With plenty of good news priced into euro ahead of the EU summit, the reaction to the agreement today was limited. Yet, we don't expect a "sell the fact" response, look for stable EUR/USD this week and more gains to 1.20 later this year as USD weakness kicks in. European FX to benefit. We like Scandinavian currencies and expect GBP to remain the laggard



EUR: Good news priced in but no reason to "sell the fact"

The euro's reaction to the agreement on the EU recovery fund and the EU budget ([see EU Summit for details](#)) was quite muted overnight and this morning largely because optimism about a deal had been priced into the euro since the start of the last week. While we don't think the currency reaction will fully reflect "buy the rumour, sell the fact" mechanics, its near term upside above 1.15 is likely to be limited as good news has been priced in already. But equally, the agreement is significant enough (the emergence of grants points to solidarity; the emergence of common bonds points to integration) not to prompt investors to exit their long EUR positions (particularly against USD, where the outlook for the remainder of the year looks bleak).

With the EUR-specific good news now being largely in the price, we expect the next leg of the EUR/USD upside to come from the dollar side, with the US currency's downtrend caused by a combination of loose monetary policy from the Federal Reserve (note the dollar lost its key

advantage which has kept it supported in prior years - the meaningful interest rate differential), the twin deficit and the US Presidential election uncertainty. We see EUR/USD moving to 1.20 by year-end.

Scandinavia FX benefiting

With EUR/USD rising ahead of the summit and the EU deal (both on the recovery fund and EU budget) reducing downside risk to the eurozone's economic outlook and compressing the region's fiscal risk premium, this is a positive for other European currencies such as Norway's krone and Sweden's krona. The two cyclical currencies are set to feel a positive spillover from higher EUR/USD and improved risk sentiment while both still screen as undervalued vs the euro based on our medium-term BEER valuation framework. We expect both EUR/SEK and EUR/NOK to reach the 10.00 level by the year-end and NOK/SEK to move to parity.

Limited gains for sterling

Although sterling reacted positively yesterday, we see limited scope for EUR/GBP to persistently break below the 0.90 level this summer. Sterling should remain a laggard among European FX, with the UK-EU trade negotiations overhang being the key obstacle for persistent GBP gains this summer. Note that we don't expect any real progress in negotiations this summer and look for the process to drag on into the late third quarter and early fourth quarter of this year. Also, as discussed previously, GBP sensitivity to risk appetite has changed since the Brexit referendum, with sterling suffering disproportionately more in falling markets than it benefits from rising markets (see [GBP: The ongoing disappointment](#))

CEE implications from the EU recovery fund

EU recovery fund and the EU budget is positive for the CEE region with the EU transfers into CEE in the 2021-27 period rising vs the prior budget. As the new EU wide funding means lower downside risks to the CEE key export market and higher odds of a synchronised EU recovery, this is clearly a positive for CEE FX. CZK remains our top pick and we look for lower PLN/HUF



The Next Generation EU fund was approved on Monday with a total EUR 750 bn budget allocated to fight the negative economic consequences of Covid-19 outbreak.

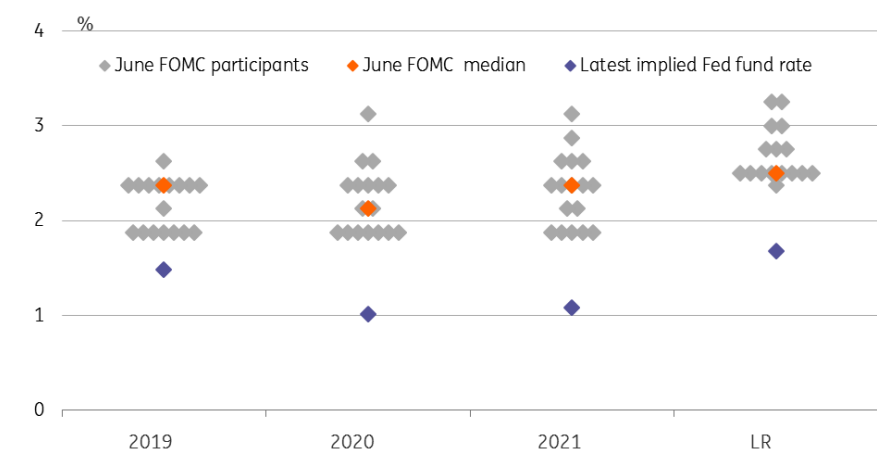
Although the total part allocated for grants was reduced from the initially planned EUR 500bn, individual CEE countries will receive from this extraordinary source between 4% to 8% of its 2018 GDP. Apart from that, loans might be tapped with allocation between 6% to 8% GDP, with conditions more likely favourable than would be the case if available on the national level. Taking the grants and loans together, the support from the New Generation budget in a 3-year horizon ranges from 11 to 16% of GDP for the CEE region including Slovakia.

The total amount of grants for the CEE region (including Slovakia) equals more than 72 EUR bn, which represents 18.5% of total EU grant allocation of EUR 390 bn. As the CEE GDP represents just

8.4% of EU27 GDP in 2018, this means that the CEE region will be the net beneficiary of the grant distributions among EU countries. The current proposal expects that 70% of funds will be distributed in 2021-2022, with the remaining 30% later based on real GDP decline during the 2020-21 period. Funds should be repaid by 2058.

Regarding the EU budget in the new multiannual financial framework 2021-2027, it should apply the general assumption that CEE countries will receive fewer funds mainly from the cohesion funds due to its convergence. As some CEE countries cross the 75% of GDP per capita of the EU average threshold, this makes them less eligible for EU funds (see [Directional Economics from November 2018](#)). Although the final numbers on EU budget are not officially published yet, based on our initial estimates and media reports, the overall transfers to the CEE in the 2021-2027 budget period will be eventually larger (vs the current budget) when accounting for new grants (and of course even larger when accounting for loans).

EU summit: A historic deal reached



Source: Macrobond

Czech Republic

Czech economy should receive 8.7 EUR bn in form of grants (2.2% of total EU grant allocation) and EUR 15.4 bn loans (4.3% of total EU loans allocation) from the new the Next Generation EU recovery fund. This represents more than 4% of Czech GDP in terms of grants and more than 7% of GDP for loans, totalling more than 11% of GDP.

The Czech Republic negotiated a possibility to shift around 25% of allocation across structural funds according to its particular needs. This compares to the 20% threshold for other countries. The Cohesion fund was increased by 1.55 EUR bn vs. the previous estimate, although almost EUR 2 bn funds were lost from the Just Transition funds compared to earlier assumptions. However, total income from the Recovery fund was slightly higher than expected despite lowering the total amount of EU-grant allocation as unemployment criterion (unfavourable for CZ) changed for GDP for 2023.

Hungary

The previously rumoured figures have not been updated yet, but Hungary should receive 8 EUR bn in form of grants (2% of total EU grant allocation and EUR 7 bn loans (2% of total EU loans allocation) from the new the Next Generation EU recovery fund. This represents around 6% of Hungarian GDP in terms of grants and 5.2% of GDP for loans, totalling more than 11% of GDP. Not much change expected when it comes to the final figures, so still, a nice amount to have.

The outcome regarding the new EU budget 2021-2027, however, is a really positive one. The previous MFF budget for Hungary was EUR 32 bn but based on the recent rumours, it will be around EUR 35bn for the upcoming seven-year period. The caveat here is that these numbers include the co-financing from the Hungarian state.

In the previous period, the co-financing was 15 cent on one EUR, while in the next MFF it will be 30 cents. It is still around 26.9bn (2021-2027) vs the previous 27.1bn (2014-2020) in “pure transfer”. On top of this with the EUR 15bn Recovery fund share, the EUR 50bn EU money for Hungary equals 37% of the GDP.

Poland

Poland should get around 29.5 EUR bn in form of grants (7.6% of total EU grant allocation) and 30.6 EUR bn loans (8.5% of total EU loans allocation) from the new EU Recovery fund and Just Transition Fund. Poland is to be the biggest beneficiary and will receive 3.5 EUR bn from the latter fund aimed at supporting the low-carbon transition in coal-dependent regions. Grants represent 5.9% of GDP and loans 6.1% of GDP, totalling 12.1% of GDP.

We have some doubts in effective absorption capacity of new grants in Poland starting as early as 2021 given the complex bureaucratic procedure imposed at the EU level, and lengthy preparations of new investments locally. The summit conclusion says that 70% of new grants should be used in 2021-22, and the remaining 30% in 2023. We see this distribution over time in Poland rather 20%-50%-30% in 2021-23. This would translate in additional transfers of EU funds to Poland of about 1.1%-2.8%-1.7% of GDP in 2021-23, respectively. Nonetheless, the Minister for EU Funds and Regional policy has already announced a first draft of the National Recovery plan to be ready in late summer.

From the “traditional” EU budget (cohesion funds and payments from the Common Agricultural Policy), Poland should get around 95 EUR bn in 2021-27, which is an equivalent of 19.2% of GDP (2.7% of GDP per year if distributed equally over the 7 years).

Thanks to the new grants from the Recovery fund, in the new EU’s financial perspective, Poland will benefit from an increase in the EU subsidies by 7% compared to the budget envelope in the current EU budget. The country will remain the biggest beneficiary from the cohesion funds. Without the new grants, the country would suffer around 18% decline as the total EU budget was supposed to shrink due to Brexit and other factors. Thanks to the EU deal, Poland gets a strong and timely instrument to support the economic recovery starting 2021 as the measures from the generous domestic anti-crisis shield are to expire.

Romania

Romania is to receive EUR 33.5bn from the Next Generation fund, split into EUR 16.8bn grants and EUR 16.7bn loans. Their own contribution is EUR 12bn so on net we're looking at EUR21.5bn or around 9.5% of GDP over the next four years

From 2021-2027 EU budget (the "traditional" EU funds) is to obtain EUR 46.3bn, which in line with expectations. We would expect a low absorption rate in the initial years as most efforts/projects will be channelled on getting the grants from the Next Generation fund.

CEE FX: A big short term positive

CEE currencies have benefited from the EU summit outcome and turned into the top EM performers yesterday, benefiting from (a) the sizeable EU recovery fund grants, loans and the EU budget distributions; (b) reduced downside risk to EZ growth (its main export market) and further compression in the EUR risk premium; and (c) the accompanying rise of EUR/USD (with CEE FX being the only EM region directly benefiting from higher EUR/USD).

While we think it is premature to reach a conclusion about the impact of the EU budget and EU recovery fund on CEE currencies BEER fair values if the latest EU measures mean faster and a more synchronised EU recovery, this will be a positive for currencies of export-oriented CEE countries.

Among the individual CEE crosses, CZK remains our top pick for the remainder of the year (we see EUR/CZK at 26.00) given its solid fiscal position and our view that the CNB won't fight the currency appreciation (given no deflation risk and still well above target CPI).

In the relative value space, we like short PLN/HUF (targeting 78.0) largely due to the more dovish NBP stance. EUR/RON should remain tightly managed from the NBR, with the cross expected to modestly rise later this year, yet not enough to outperform FX forwards. Given our year-end 1.20 EUR/USD target, more gains in CEE FX vs USD are expected.

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US housing market bounces with a capital “V”

As the debate goes on about the shape of the overall US economic recovery, in the housing market there is little doubt it is a “V”. This has positive consequences more broadly, but there are threats to its durability as key parts of the CARES Act expire and renewed shutdowns make work harder to come by



Source: Shutterstock

Covid-19 dealt a massive blow to the housing market

The housing market started the year in great shape thanks to record employment, rising wages and low mortgage rates, but the Covid-19 pandemic soon sent the sector crashing. As the gravity of the situation became apparent, the fear for health and jobs and the turbulence in financial markets saw even seasoned buyers take flight with transactions pulled in significant numbers.

Existing home sales fell 32% between February and May, taking them towards the lows experienced in the global financial crisis while new home sales proved to be only marginally more resilient, falling 25% between January and April. Housing starts – a measure of construction activity – fell 42% between January and April with the construction sector losing 1.1 million jobs

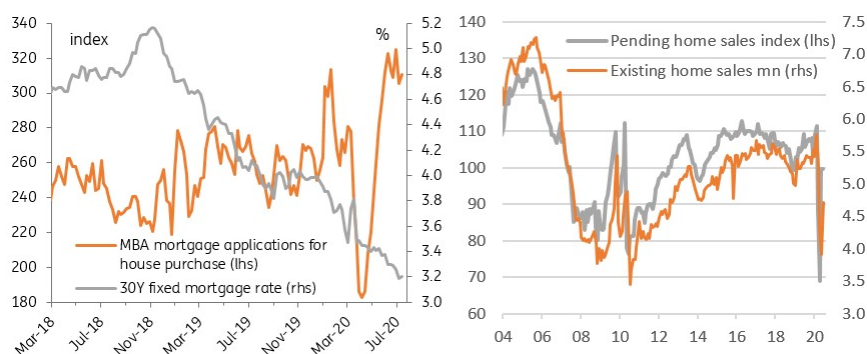
through March and April as State Governors shut down building sites.

Fed action has prompted a sharp recovery

However, the news is already turning for the better with lead indicators pointing to a vigorous recovery in housing activity. The Federal Reserve's aggressive liquidity injections, interest rate cuts and asset purchases have calmed market nerves and kept credit flowing to the extent that mortgage rates are now at historical lows. A resurgent equity market is also a positive through lifting sentiment, particularly for those first-time buyers who kept their deposit invested there.

The result has been that mortgage applications for a home purchase surged to an 11-year high, which is remarkable given 32 million people, or nearly 20% of the labour force, are claiming some form of unemployment benefit. Record low mortgage rates have improved affordability while significant pent-up demand following weeks of lockdowns are also leading to a major bounceback.

Mortgage applications and new home sales at multi-year highs!



Source: Macrobond, ING

Another important factor explaining the vigour of the recovery is that the average age for a home buyer is 47, according to the National Association of Realtors. This demographic is less likely to have been impacted by unemployment, will be more financially secure and have a better credit history versus younger members of the population who are more likely to work on lower wages in retail and hospitality. Older home buyers are also more likely to be looking for an investment property or a vacation home.

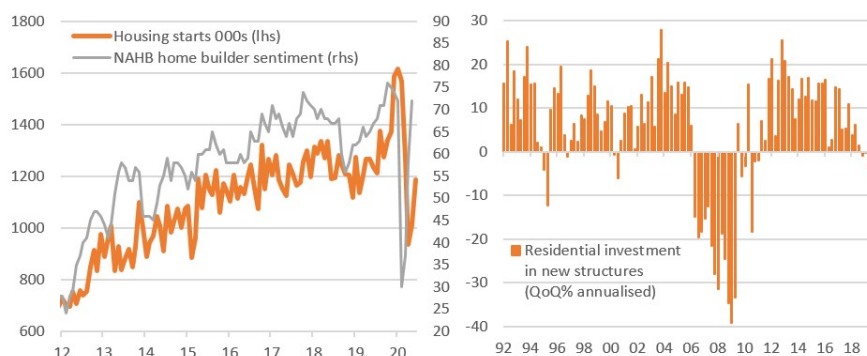
The surge in mortgage applications already triggered a 44.3% jump in pending home sales in May while new home sales recorded a 19.4% bounce May and an 13.8% gain in June to leave the level at 776,000 – the highest since 2007! Both new home sales and pending home sales are recorded at the point buyers sign the contracts – right at the beginning of the transaction process. Existing home sales are recorded as transactions when contracts are closed, which can take a couple of months and explains why they continued to fall in May. However, they rose in June, with the strength in pending home sales suggesting we should be back up to the 5-5.5mn range next month (see right hand chart above).

Housing to be a major GDP growth driver in 3Q

The recovery on housing demand is also prompting a rapid revival in construction with the National Association of Home Builders sentiment having fully reversed its post-Covid losses. Construction employment has risen by 611,000 in the past two months, while housing starts have risen a cumulative 27% during the same period. Based on the recovery in sentiment further strong gains in jobs and construction are likely over the next couple of months, which will support 3Q GDP growth.

A strong housing market boosts demand elsewhere in the economy. Housing transactions are strongly correlated to retail sales – as people move to a new home they typically spend money on new furniture and home furnishings, garden equipment and building supplies such as a new paint job and a bit of home improvement. It also results in demand for moving services while generating legal and mortgage fees within the service sector, which should also all help boost 3Q GDP.

Construction activity bouncing back after shutdowns



Source: Macrobond, ING

CARES Act expiry and Covid spikes could limit further upside

However, there are some issues brewing for the residential property sector. The reintroduction of containment measures in the wake of a renewed flare up in Covid-19 cases means more business closures and rising joblessness that could threaten the broader economic recovery. While not necessarily directly impacting the home buyer demographic right now it could make potential purchasers more wary. In this regard, the average age of a first-time buyer is 33 and any economic uncertainty and potential fear over employment prospects mean that this first part of a housing market transaction chain remains the weakest link.

Another, potentially more significant issue is that the enhanced unemployment benefit within the CARES Act, providing an extra US\$600 per week to 32 million people, and the federal eviction protection, both end this Saturday (25 July). Talks are ongoing about another round of stimulus, but we are likely as a minimum see the US\$600/week tapered to something closer to US\$200-450 per week with the protracted nature of the discussion possibly meaning a payment pause for a week or two.

In an extreme case this additional payment could disappear completely. Either way incomes will be falling for those 32 million people at a time when job opportunities are increasingly scarce due to renewed Covid lockdowns. This means a growing chance of missed rent or mortgage payments at a time when protection from eviction is ending – note several states such as California and New York have extended their own state legislation, but the majority of others have not. A rising number of mortgage defaults and foreclosures could undermine the recovery in the property market with our base case being a gradual moderation in housing market activity as we approach 4Q20.

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US: Labour market strains intensify

A pick-up in jobless claims underlines the economic pain from renewed Covid containment measures in many states. A more pressing issue is what will happen to spending if 31.8mn unemployment benefit recipients see their incomes drop US\$600/week from Saturday. We should be braced for a period of worsening economic news



Renewed containment measures bring more jobs stress

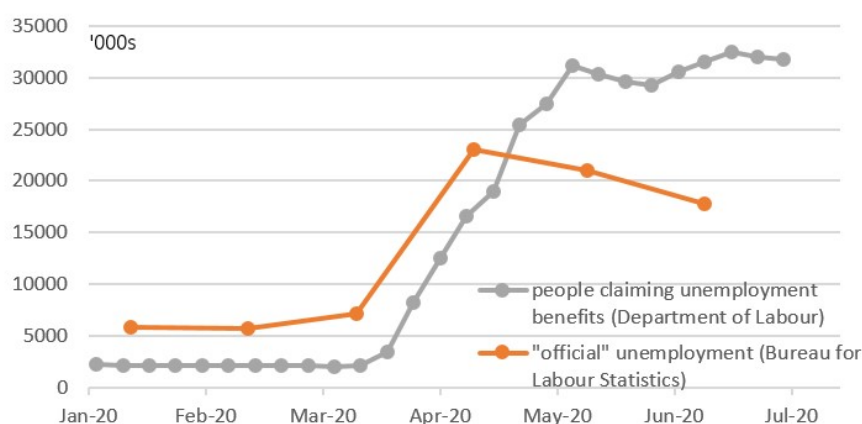
Today's initial jobless claims data have shown another 1.416mn people lodging a new unemployment benefit claim the week of 18 July versus the consensus forecast of 1.3mn. We sensed the risks were skewed to the upside given the reintroduction of Covid containment measures in a number of states following a spike in cases. This has led to renewed shuttering of businesses in the hospitality industry with high frequency jobs data from Homebase (an employee scheduling software provider for small businesses) suggesting employment peaked in late June and has been drifting lower nationally ever since. This is the 18th consecutive week of a reading at or above 1.3mn, underlying the stressed situation in the labour market.

Continuing claims dropped from 17.3mn to 16.2mn, which is a little more encouraging, but it comes with a week lag on the initial claims numbers and could certainly rise again. That said, for us, the key figure to watch is the number of people claiming benefits under ALL programs, which is up at 31.8mn as of the week of 4 July versus 32mn the week of 27 June (it comes with an additional week lag on continuing claims data). That is because an additional 14mn people receive

benefits under the Pandemic Unemployment Assistance and PEUC programs that don't qualify for state unemployment insurance benefits (only 17.2mn do) – people that left their last job voluntarily, students looking for a first job or people who didn't work enough time or earn the minimum earnings to be eligible.

Given the lags versus initial claims and the renewed containment measures and the data from Homebase we could certainly see the total number of benefits claims increase again in the next couple of weeks.

The number of people claiming benefits vastly exceeds "official" unemployment



Source: Bloomberg, ING

Support for impacted households remains key to economic outlook

The federal CARES Act has provided a huge support to the households impacted by joblessness, through extending unemployment insurance benefits by 13 weeks, but more substantially through the extra US\$600 per week it has been providing in benefits to all 31.8 million. This means, according to the [University of Chicago's Becker Friedman Institute](#), that 68% of claimants are actually on higher incomes today than when they were working with the median uplift to that income being about a third.

This has massively benefited the economy with low income households driving the recovery in retail sales based on data from www.tracktherecovery.org. The challenge is that this expires on 25 July. Talks are ongoing about another round of stimulus and we could see a temporary bridge until the new package is agreed, but we are likely as a minimum see the US\$600/week tapered to something closer to US\$200-450 per week given Republican concerns about the cost and whether it is actually creating a disincentive to finding work. In an extreme case where the Republicans, the Democrats and the President fail to reach an agreement before recess, this additional payment could disappear completely.

Either way incomes will be falling significantly for those 32 million people at a time when job

opportunities are increasingly scarce due to renewed Covid lockdowns – JOLTS data suggests there are four unemployed people for every job opening. We are already concerned that we could see both retail sales and employment post declines in July and if this US\$20bn per week in income support (the cost of the US\$600/week benefit) is cut too quickly too soon, we should be braced for the prospect of more bad economic news in 2H20.

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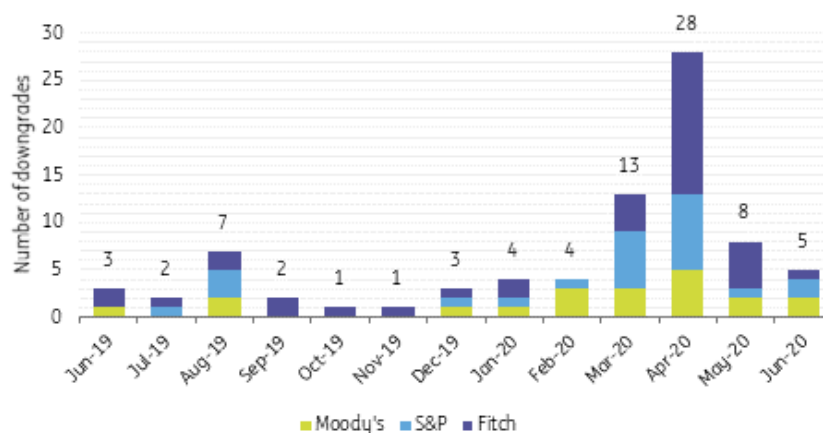
EM sovereign debt: No time to be complacent on fallen angel risks

Amid the pandemic and oil price collapse, fundamentals of emerging market sovereigns have come under pressure across the board, resulting in a peak of 28 downgrades in April 2020 - out of 82 in total over the last year



Source: Shutterstock

Pandemic and oil price collapse led to a surge in rating downgrades for EM sovereigns



Source: Moody's, S&P, Fitch, Bloomberg, ING

Since then, the number of downgrades has dropped substantially, but it's not the time to become complacent. While the stabilising external backdrop has helped to cushion the fall, the fundamental deterioration is slow to materialise, and there is no guarantee that 2021 will bring a much-needed rebound. As another warning sign, 54 sovereign ratings have been placed on a negative outlook since March (vs 29 to stable and 1 to positive).

This sets the context for a handful of 'BBB' rated sovereigns which face the risk of losing investment-grade status in the foreseeable future. Among the sovereigns we cover in this note, this is especially true for **Colombia, India, Morocco** and **Romania** which are one or two downgrades away from becoming fallen angels, further exacerbated by negative rating outlooks. It's however, not set in stone as investors and rating agencies alike are trying to look through the cycle and assess the post-pandemic outlook. For India and Morocco, lifting growth to potential will be essential alongside structural reforms. For Colombia and Romania, downgrade risks are linked to restoring fiscal credibility.

Meanwhile, **Mexico** remains some distance away from losing investment-grade status. Still, the combination of persistently weak growth, faltering business confidence and PEMEX-related financial troubles will become more evident in 2021. **Indonesia** is in the most favourable position here with limited downgrade risks in the near-term. However, should the pandemic and economic slump turn out more severe, this would weigh on the debt outlook and external sentiment (already being tested by fiscal monetisation and the suspension of the fiscal rule), and ultimately on ratings.

We also scrutinise rating relevance for EM debt funds and look at bond performance around the time of losing investment-grade status for some issuers.

We conclude that concerns of such a rating event have resulted in underperformance ahead of actual downgrades, but prospects diverge afterwards (most ratings have fallen further). Finally, yet importantly, forecasting the timing of a downgrade remains a science of its own.

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

European energy companies have announced new strategies which include a shift towards greener business models. In this report, we look at some of the sustainability plans in detail and the role that hydrogen will play in achieving carbon neutrality by 2050



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