

This cruel summer

With GDP down in double digits in virtually all global economies, ING's Carsten Brzeski reflects that this truly is a 'cruel summer'. It's also the headline of our August Economic Update. We look too at who's most effective in the credit markets, the Fed or the ECB. And why is our man in New York so worried?

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'A cruel summer' was a big hit back in 1984. 36 years later, it could be the soundtrack of 2020 as the impact of the Covid-19 crisis is revealed globally. Key now: Will the rebound translate into a sustained recovery?



Watch: A cruel summer

With GDP down in double digits in virtually all global economies, ING's Carsten Brzeski reflects that this truly is a 'cruel summer'. The only good thing, he says, is that the worst is hopefully behind us. It's true that there's been an almost mechanical v-shaped rebound in the past couple of months. However, we'll only know whether this is a sustainable recovery after the summer. And it all depends on there not being a second wave of Covid-19 which would lead to another round of lockdowns.

[Watch video](#)

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Report | 6 August 2020

August Economic Update: A cruel summer

We've seen historic dismal numbers this quarter, but they are painful illustrations of the costs of a lockdown. In the second half of the year, the shape of the rebound will depend on authorities withstanding local curfews rather than larger-scale lockdowns. Nonetheless, the jury is still out on the long-term and permanent costs of this crisis



Source: Shutterstock

It's a cruel summer.

Back in 1984, Bananarama were singing about hot summer streets, unsuccessful attempts to smile and being left on their own.

A feeling many will have these days when wanderlust has to be subdued and the nearby lake has to make up for a sandy coastal beach. The summer is also cruel as it finally added numbers to the Covid-19 crisis. For most economies, the GDP data for the second quarter followed the pattern of 'worst quarter since x years for country y'. We only had to fill in the numbers.

In all honesty, as severe as these GDP readings were, they are yesterday's story. In fact, they are a painful illustration of the costs of a lockdown. The longer and the stricter a lockdown, the more severe was the impact on the economy. This pattern nicely explains the differences across the Eurozone. The (too) early lifting of lockdown measures in the US is also the main reason why the contraction was somewhat less severe than in the Eurozone. At the same time, China's recovery

continued. The fact that Chinese exports in June surprised to the upside could be another sign that the Eurozone and the US are recovering.

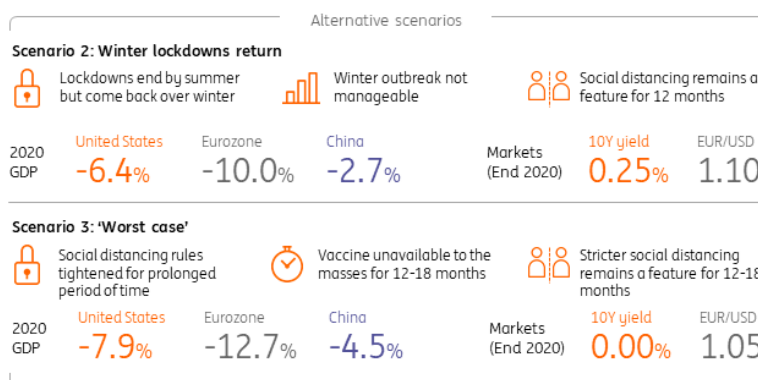
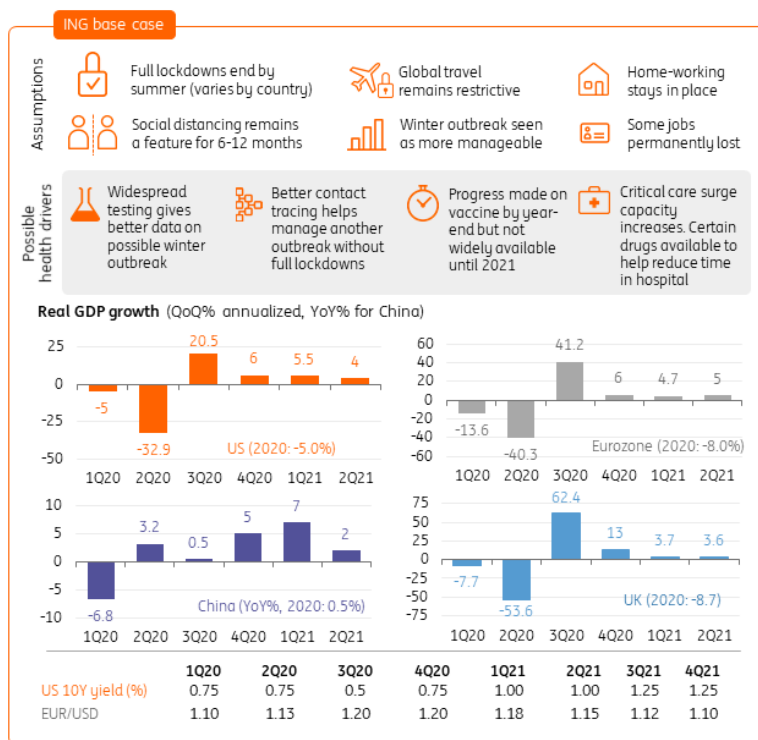
Monthly data since May have kept hopes for a v-shaped recovery alive

Looking ahead, monthly data since May have kept hopes for a v-shaped recovery alive. Or let's better call this a v-shaped rebound. Whether it is the traditional macro indicators or the more experimental data, they have all surged until July. It is now up to the hard data to follow suit. It will take until the hard July data before we really know whether the initial and more mechanical rebound after lifted lockdown measures, will turn into a strong and sustainable recovery or rather a quick flattening out.

Several factors will determine the shape of the recovery in the second half of the year. The experiences of many Asian countries and first European countries show that new outbreaks of the virus cannot be prevented. The only question is whether authorities can withstand local curfews rather than larger-scale lockdowns. Also, the permanent damage of the crisis is still hard to gauge but it is hard to believe that sectors like retail, leisure or tourism have already seen the full and final impact from the crisis on employment. 'High uncertainty' will be the key phrase for all forecasters and policymakers. It will take until September before the global economy will get new guidance from macro data, policymakers and politics.

With regards to politics, now that European leaders have shown solidarity and agreed on a historic deal (which will have stronger symbolic than economic impact), financial markets' focus will probably shift to the US presidential elections. Given the experiences of the last few years, the election campaign alone has the potential of sending some shock waves to the global economy.

Looks as if all of us better fill up the tank to prepare for an action-loaded autumn season. Happy staycation.



Source: ING

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US: Forget the “V”

With virus fears on the rise, jobs being lost and incomes squeezed, we feel the second phase of the recovery will be much more challenging, especially in the absence of a new broad and substantial fiscal package. And all of this suggests, financial markets optimism on a 'v' - shaped rebound could be severely tested in the next couple of months



Source: Shutterstock

Movement of people wearing a protective mask and maintaining social distance, Domino Park, Brooklyn

US economic output plunged 10.6% through the first half of the year. Yet as containment measures were eased through May and June the economy has bounced back strongly, led by the US consumer. There was certainly plenty of pent-up demand as we escaped the confines of our homes, but substantial stimulus from both the Federal Reserve and the Federal government undoubtedly fueled the recovery story.

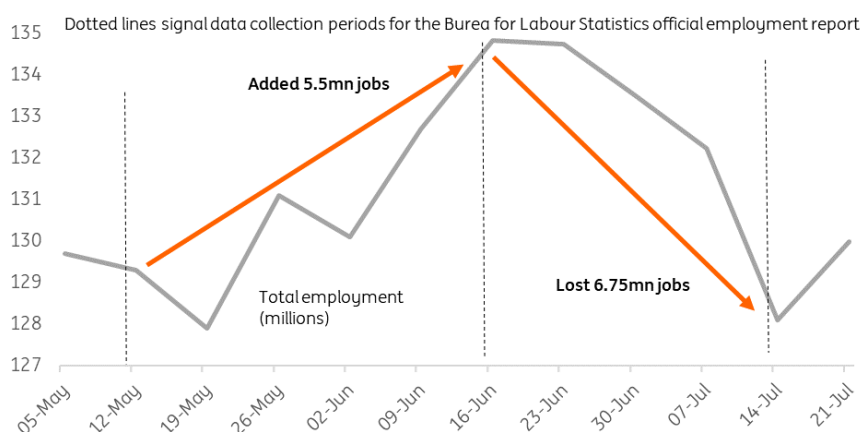
Aggressive central bank action lowered borrowing costs, kept credit flowing and supported confidence and asset prices. Meanwhile, a \$2+ trillion fiscal package provided a critical lifeline to households and businesses. Unfortunately, there are growing challenges to the recovery story.

Firstly, the recent spike in Covid-19 cases is hurting confidence. It is also leading many State

Governors to reverse course on their re-opening plans as they worry about strains on their healthcare systems if rising infection rates are left unchecked. The result is that businesses that had re-opened are being forced to close again with workers losing their jobs.

The Census Bureau's new Household Pulse survey suggests that employment may have reversed much of its gains since May. Perhaps most critically for near-term consumer spending the US\$600/week unemployment benefit boost given to 30 million claimants ended in July. Talks on another fiscal stimulus are dragging but in all likelihood, it might be replaced with something much smaller in size.

Census Bureau Household pulse - employment millions



So, with virus fears on the rise, jobs being lost and incomes squeezed, the second phase of the recovery will be more challenging. In the absence of a timely and substantial fiscal package we should be braced for the threat of weaker employment and spending numbers, which will provide a major test for financial market optimism on the “V” shaped recovery.

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Eurozone: Better, but the fear factor remains

After the historic GDP contraction in 2Q, Eurozone economic figures have improved, though the flare-up of Covid-19 infections has placed a burden on the recovery



Source: Shutterstock

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

Historic GDP contraction

So we now have official figures that we can in the future refer to as the worst in history.

In the second quarter of 2020, Eurozone GDP contracted by 12.1%, with Spain even printing an 18.5% contraction. The good news is that as lockdown measures are eased, the European Commission's economic sentiment indicator has now risen three months in a row, with July's 87 point level firmly above the second quarter's average of 71.1.

We maintain our -8.0% GDP forecast for this year, while slightly lifting our 2021 outlook to 4.8%

While for the third quarter, the v-shaped recovery is still in place, the flaring up of Covid-19 infections clearly signals that until an effective vaccine is available, life will not return to normal.

The disappointing Spanish tourism season shows how vulnerable a great number of service sectors remain to the pandemic's vagaries. The health risk and targeted confinement measures are keeping consumers hesitant, leading to a higher propensity to save. On the plus side, the European Union has now decided on a recovery fund, which will provide about 0.8% of GDP fiscal stimulus, both in 2021 and 2022. We maintain our -8.0% GDP forecast for this year, while slightly lifting our 2021 outlook to 4.8%.

Inflation quirk

Notwithstanding the VAT rate cut in Germany, eurozone core inflation actually increased from 0.8% to 1.2% in July.

However, this is probably a statistical quirk, since the sales period has been delayed until August in a number of countries, rendering the year-on-year comparison less favourable in July. That said, 2021 could see somewhat higher inflation as the German VAT rate will increase again and energy price inflation becomes positive.

But even then, we are only pencilling in 1.4% headline inflation.

Euro trouble

Meanwhile, the euro's effective exchange rate has gained around 6% since February and it is not that far away from an all-time high.

While it might be too soon for the European Central Bank to counteract, it is definitely a factor that will contribute to low inflation, soliciting dovish comments from the ECB. And even if the tightening of spreads on sovereign bond yields could incite the central bank to slow down its bond purchases, the stronger common currency leads us to believe that an additional €400bn of PEPP (Pandemic Emergency Purchase Programme) remains feasible.

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China's tech war with the US has made us revise our yuan forecast

The persistence of the technology war is hurting long term Chinese growth and the yuan's strength. Although we're revising our yuan forecast, it isn't much stronger from the current spot



Source: Shutterstock

In this photo illustration, a TikTok logo is seen displayed on a smartphone with the Chinese and American flag in the background

New challenges to economic growth

The Chinese economy is recovering. GDP grew by 3.2% year-on-year in 2Q20 but there are new challenges ahead.

- The first-in-first-out from Covid-19 has been China's advantage compared to other economies. There have been some small clusters recently, but the government has acted swiftly to impose very tight social distancing measures, limiting the impact on the economy.
- There has been widespread flooding affecting agriculture as well as infrastructure construction. The typhoon season has also arrived, bringing more uncertainty to the flood damage.

These two challenges hurt short-term economic growth, and the government has offered help to offset some of the damage, so we are not too worried that these will hit GDP growth significantly in

2H20.

The longer-term challenge to the economy is the US becoming increasingly aggressive towards Chinese tech companies. US companies are banned from doing business with more Chinese companies and there were renewed threats on Huawei in May. Recently, the US administration has forced TikTok, whose parent company is a Chinese corporate, to be sold to US companies or stop operating in the US.

This hurts China's long term growth in technology exports.

The yuan strengthens but only slightly

This technology war has put yuan strength at risk.

Even though China has fought against Covid-19 quite successfully, the yuan depreciated against the dollar to 7.1680 per dollar in May, which was the peak in 2020, as a result of the renewed threats to Chinese telecommunications group Huawei.

But in June, economic indicators improved and since then the Chinese economy has started to recover. From its peak, USD/CNY at 7.1680 to 6.9809 on 3 August, the yuan has appreciated by 2.61%.

If we measure the yuan's performance from the beginning of 2020, then it is still 0.25% weaker against the USD. This is in contrast with the dollar index's 2.95% depreciation over the same period. Some of the yuan appreciation that should have reflected in the USD/CNY exchange rate has been offset by the technology war.

We expect the technology war to persist for the rest of the year, which will continue to affect the yuan's performance.

We have revised our USD/CNY forecast to 6.97 from the previous 7.05 by the end of 2020.

We expect a stronger yuan from the previous forecast but the strength of the yuan from now to the end of 2020 is likely to be hit by negative news from the tech war.

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FX: King dollar loses its crown

The dollar's four percent decline in July marked its largest monthly drop since 2010. Driving this decline is both a re-rating of the European project, but also the dollar's loss of its growth and yield advantage. The latter leaves the dollar vulnerable into November's contentious presidential elections



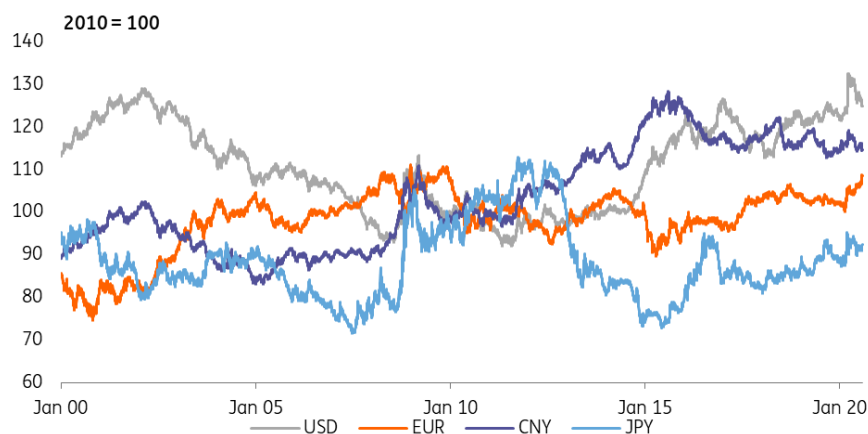
Dollar: We don't need you any more

The myriad of factors which propelled the dollar around eighteen percent higher between March 2018 and March 2020 have faded. The dollar rally in 2018 and 2019 was all about large US fiscal stimulus and then US protectionism. These drove a growth and interest rate wedge between the US and the beleaguered overseas economies.

The dollar rally in March 2020 was all about liquidity needs. The fact that foreign central banks are now only drawing down around US\$100bn from the Fed's dollar swap lines – versus a peak of US\$450bn in May – suggests the need for emergency dollar liquidity or [hoarding](#) has reversed.

In other words, dollar demand from both the investor and commercial community is in decline and the dollar is no longer the only game in town.

Trade weighted exchange rate indices: USD retreats from highs



Source: BIS

Euro: A reluctant alternative

Progress on the EU recovery fund has prompted a re-assessment of the European project and the euro. Investor surveys show the fund management community are still overweight US equities but inclined to move into Europe. Depending on the path and handling of Covid-19 second wave, a re-allocation of funds towards Europe should be the theme for 2H20.

We expect EUR/USD to maintain its bullish momentum into an uncertain US presidential election in November. That means pressing 1.20, with outside risk to 1.25. This environment should also favour the liquid, defensive currencies of JPY and CHF – as the market seeks dollar alternatives.

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Credit: Why the Fed's loaded gun appears more powerful than the ECB's fired bullet

USD credit spreads are clearly outperforming EUR credit despite the fact that the (relative) volume of purchases by the ECB through PEPP and CSPP is far more significant. So why does the Fed seem to be pressing the right buttons?



The ECB's Christine Lagarde and the Fed's Jerome Powell in 2018

The snapshot

- Sometimes carrying the ammunition is more effective than the bullet itself, as the Fed has a huge arsenal which is predominately left in the warehouse, whilst the ECB has been extremely active in credit markets but the effect has been dissimilar.
- We find that USD credit spreads have outperformed over the past few months despite a more concerning Covid-19 trend.
- We estimate that three factors are driving this outperformance.
 - Firstly, the novelty of the Fed's involvement in credit markets (CSPP - and APP as a whole - has not really stopped since early 2016).

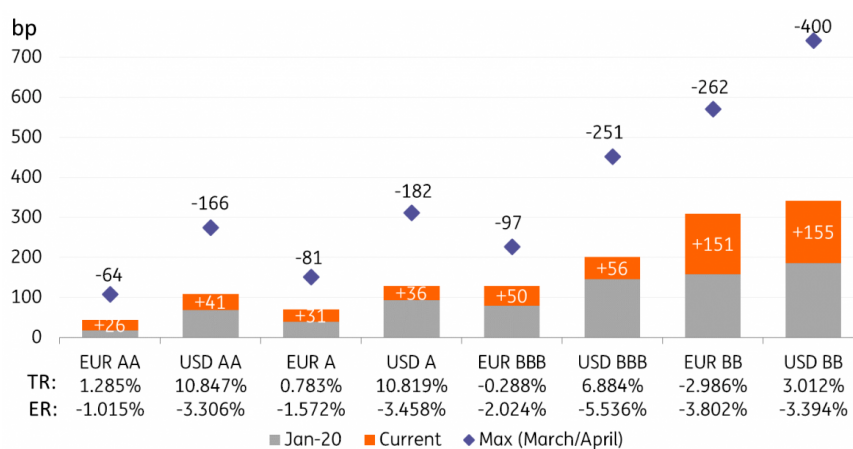
- Secondly, we believe the presence of the Fed in the ETF space is a key difference between the two markets.
- Lastly, the ECB has not added fallen angels to its programmes whilst the Fed has indicated it is part of their ammunition.
- Yield is also a crucial driver in this development, as we note that the chase for yield in the USD market is something of a novelty and reminds us of the same in EUR when rates first targeted near zero levels a few years ago; this element of the demand for yield drives credit spreads tighter in USD.
- On the other hand, the supply equation works in favour of the EUR market with both gross and net supply not hitting the same excesses as USD markets in 2020.
- When we look at AUM for mutual funds developments we see that the ETF route really influences the outperformance as inflows into USD HY are now in positive territory whilst EUR HY has only just turned to inflows YTD. The confidence the Fed has given default sensitive investors by targeting IG and HY ETFs is the backbone to this development.
- We do believe that given the possibility of a second wave of Covid-19 related lockdowns and that given recent performance and massive supply YTD that USD debt is more sensitive now to re-pricing, particularly as supply starts to rear its sizeable head after the summer recess.

ECB's QE vs Fed's QE

(€/\$bn)		Holdings	Avg monthly purchases
Corporate sector	ECB	242	10
	Fed	44	4
Public sector	ECB	2,643	100
	Fed	16	2
Commercial paper	ECB	35	18
	Fed	10	2
Covered bond	ECB	287	3
	Fed	0	0
Asset backed securities	ECB	30	1
	Fed	1,933	100

Source: ING

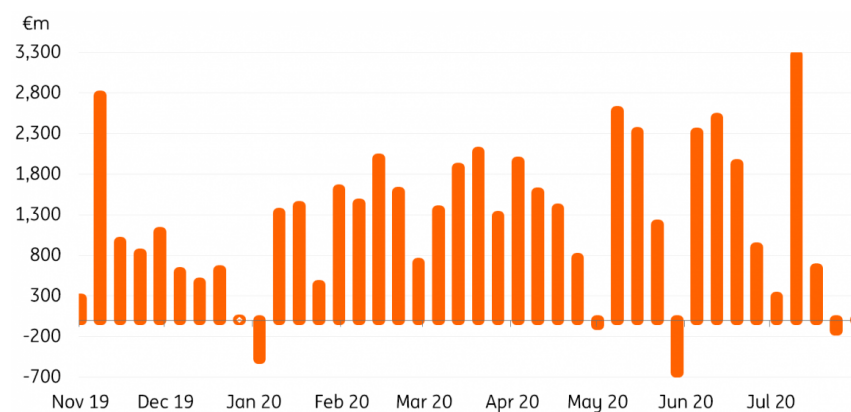
USD & EUR Spread movements & Total return



Source: ING, ICE

The ECB has been particularly active in corporate purchasing during the crisis. Initially introducing an additional €120bn envelope into APP, of which a portion has been utilised under the Corporate Sector Purchasing Programme (CSPP) and then introducing the Pandemic Emergency Purchasing Programme (PEPP) of €750bn, which further was expanded by an additional €600bn. PEPP includes corporate purchases which run at roughly 5%, accounting for around €5bn per month, matching that of the average CSPP net purchases per month.

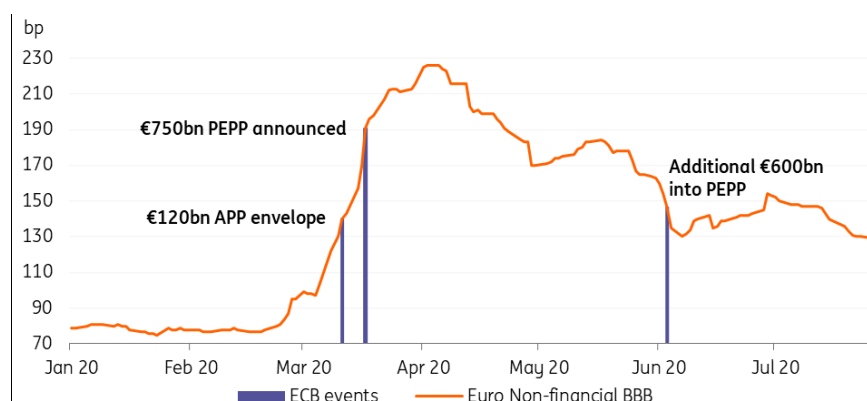
ECB's CSPP net purchases on a weekly basis



Source: ING, ECB

In addition to corporate purchases, the ECB is very supportive of Banks via the TLTRO programme and the purchases of covered bonds under CBPP3. The purchase of public sector debt is a favourite of the ECB in terms of volumes under PSPP and PEPP. Finally, the ECB supports asset-backed securities (under ABSPP) and commercial paper (under PEPP).

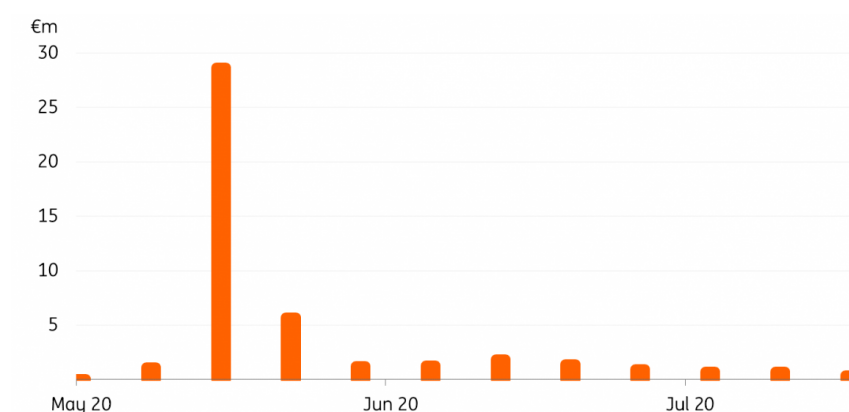
ECB events over EUR non-financial BBB spreads



Source: ING, ICE

Similar to the ECB, the Fed has also introduced effective supportive programmes, namely its corporate credit facility in which the two components are primary market and secondary market purchasing. However, both programmes are limited to the short end of the curve, 4yr and 5yr maturities and less, respectively. Additionally, the Fed purchases under a commercial paper facility and a municipal facility.

Fed's corporate credit facility net purchases



Source: ING, Fed

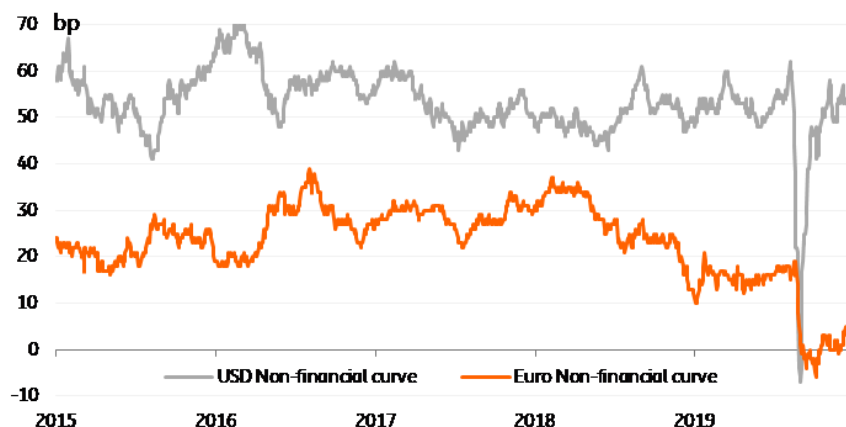
A significant difference

Both the ECB and the Fed include only domestic debt for their purchasing eligibility. A significant difference in terms of corporate purchasing between the two central banks is the approach to primary market purchasing. The ECB has been considerably active in 'hoovering up' nearly every eligible new issue. Since the recommencement of CSPP in November and the introduction of PEPP, primary market purchases have accounted for roughly 65% of the new bonds added. The Fed's primary market corporate credit facility, on the other hand, acts more so as a lender of last resort. Whereby, the Fed will purchase qualifying bonds directly off the issuer as a sole investor or a portion (up to 25%) of the bond at issuance. The bond must have a maturity of 4 years or less and there will be an additional 'Commitment Fee' of 100bp.

Within the support for corporates, the Fed is limited to the short end but the ECB can purchase across the curve, in theory offering more support and keeping curves relatively flat. Indeed the USD curves are somewhat steeper but this is subdued by the hope of further Fed stimulus, although the ETF purchases are a principal component of the Fed's programme. According to figures as of the end of 16 June, ETF purchases under the secondary market corporate credit facility amounted to \$5.3bn (market value of \$6.8bn). This is conservative relative to the roughly \$900bn eligible ETF universe. Of the ETF purchases, around 17% were high yield. This is a very significant difference between the ECB and the Fed, the ECB offers no direct support to the high yield market.

Furthermore, the Fed includes 'fallen angels' in its purchasing of bonds, those which have seen a drop in their investment-grade rating, whereas the ECB has only included those fallen angels in their collateral eligibility. As a result, we see Euro high yield more exposed to volatility.

USD & EUR non-financial curves



Source: ING, ICE

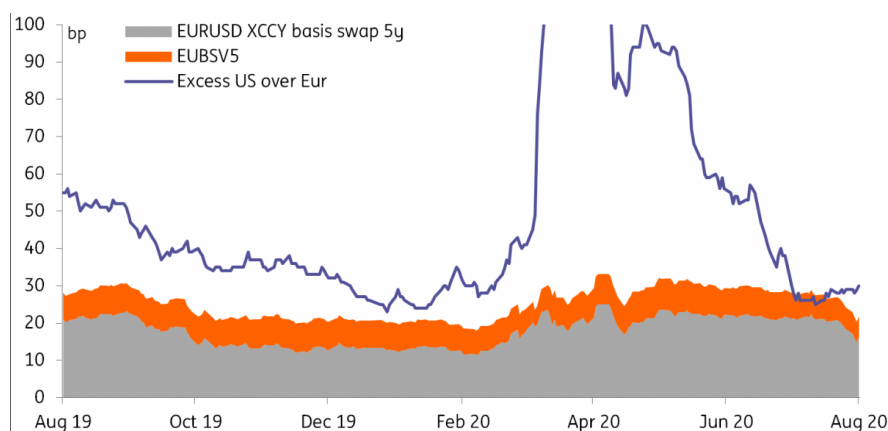
Broader versus targeted

Overall the Fed seems to have hit the nail on the head with their broader approach compared with the more targeted ECB, as the large variance in Fed support has indeed pulled USD spreads tighter and are clearly outperforming EUR spreads, particularly on the short end of the curve. This is clearly identified by the larger total return YTD. As well as seen in the shape of the curve, as the USD curve quickly bounced back to the steep levels of pre-Covid-19, whereas the EUR curve remains relatively flat.

Implications for reverse Yankee & Yankee supply

USD EUR spread differentials play a substantial factor, amongst others, in the level debt issued by US corporates in Euro (reverse Yankee) and debt issued by European corporates in USD (Yankee). Now that USD spreads are outperforming EUR spreads and the differential is relatively tight, there is less of a cost advantage for reverse Yankee supply. Of course, the opposite can be said for Yankee supply, particularly if the cross-currency basis swap remains somewhat wide.

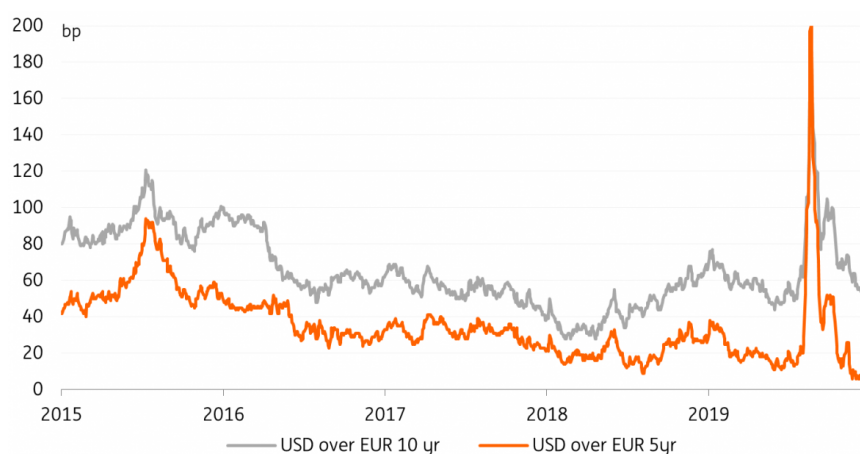
Cross currency basis swap & USD EUR spread differential



Source: ING, ICE

As mentioned, due to the short end limitations self-imposed on the Fed purchasing, the short end is outperforming in USD spreads, as well as the USD curve being significantly steeper than the EUR curve. This has led to the majority of the USD over EUR outperformance to fall in the short end. As illustrated in Figure 8, the 3-5yr area of USD EUR differential is hitting historic lows. Although the 10yr area of the USD curve still remains relatively tight but not near the lows of 2018, meaning the reverse Yankee attraction in the long end remains limited.

USD EUR Spread differential at 5yr & 10yr



Source: ING, ICE

The outlook for the rest of the year

Across the curve, these tight levels do suggest there should be significantly less reverse Yankee supply, but YTD this year we pencil in €50bn in reverse Yankee supply, compared to the €56bn supplied in 2019 YTD, which went on to become a record-breaking year. However, taking into account the sheer size of supply in USD thus far this year (\$812bn), reverse Yankee only accounts for 6% of US corporate funding. A very different story to the 15% seen last year on a YTD basis. Therefore we do expect reverse Yankee debt to continue to be supplied over the second half of 2020 and reach up to a full-year estimate of €80bn, down from last year's FY figure of €99bn. Of course, this will likely be concentrated over the longer end of the curve.

Another potential outcome is an uptick in yankee supply on the short end. There will be a particular cost advantage to do so if the cross currency basis swap falls further negative. Although in any case, a major factor against swapping is the lack of QE eligibility, as ECB only buy European corporate debt and the Fed only buy US corporate debt.

If there is an uptick in either reverse Yankee or Yankee supply, there will be a supporting factor for spreads of the home currency. As such, if European corporates issue in USD, there will be less supply in EUR which will alleviate any supply pressure on spreads. Additionally, with less eligible debt being issued, the current eligible debt will become more supported under QE resulting in further outperformance of eligible spreads.

In conclusion, it seems the Fed's loaded gun is more powerful than the ECB's fired bullet. The USD spread performance, relative to EUR, illustrates the Fed's substantial 'arsenal' and is certainly an effective method in supporting spreads. Despite the fact that the ECB has been considerably more active in purchasing, particularly when it comes to corporate purchases.

We estimate that three factors are driving this outperformance

1. The novelty of the Fed's involvement in credit markets
2. The presence of the Fed in the ETF space
3. The ECB has not added fallen angels to its programmes whilst the Fed has.

We do believe that given the possibility of a second wave of Covid-19 related lockdowns that USD debt is more sensitive now to a re-pricing, particularly due to the record-breaking supply.

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James Knightley: Why I am getting nervous

There's a threefold threat to America's economic recovery, says ING's James Knightley in New York. And that's why he's getting increasingly worried



Re-opening triggered a rapid recovery

'We will come back strong!'. So said Donald Trump in a recent tweet. I'm not so sure. After last week's GDP number, we know that US economic output plunged 10.6% through the first half of the year – the worst downturn since the end of the Second World War.

It's true: as containment measures were eased throughout May and June the economy has bounced back strongly, led by the US consumer. There was certainly plenty of pent-up demand as we escaped the confines of our homes, but substantial stimulus from both the Federal Reserve and the Federal government undoubtedly fueled the recovery story. On the monetary policy front, early and aggressive interest rate cuts, credit easing measures, liquidity injections and quantitative easing lowered borrowing costs, kept credit flowing and supported confidence and asset prices.

And on the fiscal side, we saw a \$2+ trillion support package for both households and businesses including \$1200 cheques and financial incentives for keeping staff on payrolls. Another key plank was the Federal government's decision to expand the number of people eligible to receive unemployment benefits and then additionally boost weekly payments by \$600.

Given the scale of the economic hit, unemployment was surging and this was a key way to protect incomes and support consumer activity, which makes up nearly 70% of total economic output. In fact, it was such a generous scheme a [University of Chicago paper](#) estimated that 69% of benefit recipients were now earning more money than when they were working with the median uplift in incomes put at around a third. With upwards of 30 million people having received these additional payments we believe this has been critical to the recovery. Daily data from www.tracktherecovery.org based on daily debit and credit card transactions suggests it has been lower-income households that have led the recovery in consumer spending.

Spending breakdown by income



Source: www.tracktherecovery.org

It is higher-income households that are holding back, largely because they spend proportionately more on “experiences” such as eating out, going to the cinema or travelling, which people have been much less able or willing to do over the past few months.

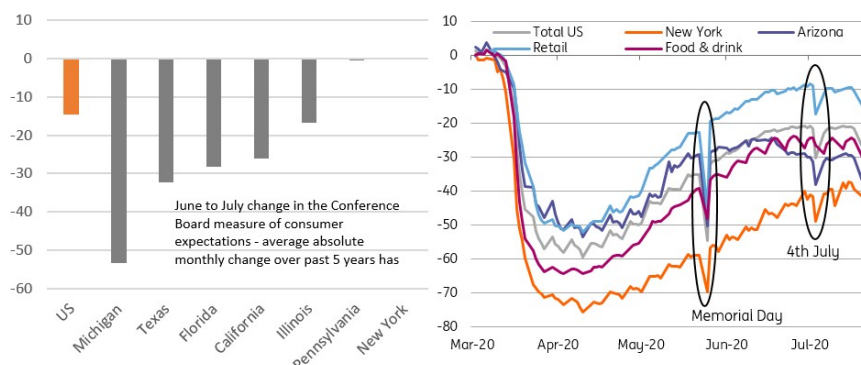
1 Covid 19: A halt to re-openings

However, there is now a threefold threat to this recovery. Firstly, Covid-19 is far from beaten with the recent spike in cases disrupting the economy once again. Fear of catching the virus is on the rise which is hurting confidence and leading many State Governors to reverse course on their re-opening plans as they worry about the potential strains on their healthcare systems if rising infection rates are left unchecked.

Given this experience we suggest governors will tread more carefully on a second wave of re-openings in coming months, particularly given the experiences of southern hemisphere nations, which are finding containing the virus is even more challenging once colder weather returns.

Renewed shutdowns take their toll on confidence and jobs

Homebase data for over 60,000 businesses and 1 million hourly employees active in the US in January 2020. All the rates compare employment that day vs. the median for that day of the week for the period Jan 4, 2020 – Jan 31, 2020.



Source: Bloomberg, Macrobond, ING

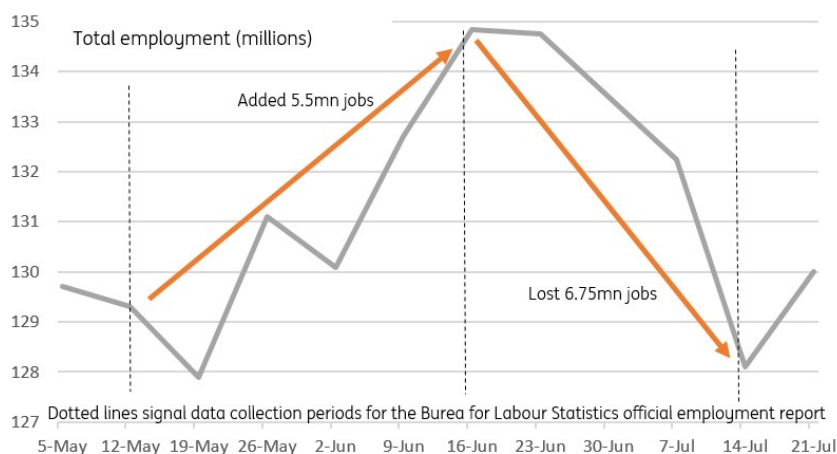
2 Jobs: the second big concern

The result is that businesses that had re-opened are being forced to close again with workers losing their jobs – the second major worry for the economic outlook. Data from Homebase, a payroll scheduling and tracking company, suggests employment in the small business sector has been falling through July. Meanwhile the Census Bureau has recently been publishing data from its new Household Pulse survey, which suggests that after 5.5 million job gains from mid-May to mid-June there were 6.75mn jobs lost between mid-June and mid-July.

Admittedly, both data series are new and we don't have enough history to comment on their long-run predictive accuracy, but even the ISM manufacturing and non-manufacturing employment component, which have decades of history, are indicating companies are shedding workers right now. At a minimum, it suggests there is downside risk to expectations for [Friday's non-farm payrolls](#) which has a consensus forecast of a 1.5 million gain in employment. We increasingly expect to see an outright fall in employment in August.

Employment has plunged lower again

Derived from experimental data produced by the Census Bureau. *"The new experimental Household Pulse Survey is designed to quickly and efficiently deploy data collected on how people's lives have been impacted by the COVID-19 pandemic"*. <https://www.census.gov/programs-surveys/household-pulse-survey/data.html>



Source: Census Bureau, ING

3 Stimulus: Talks are dragging on

Then, thirdly, the US\$600 a week unemployment benefit-boost given to 30 million or so claimants ended last week. Talks on another fiscal stimulus are dragging given the broad differences between the Republicans' proposed \$1 trillion stimulus and the Democrats' \$3.5 trillion plan. In all likelihood the \$600/week will be replaced with something much smaller in size – Republicans are talking of a transition period where it is cut to just \$200/week until systems are put in place when the benefit can be adjusted to maybe 60% or 70% of pre-Covid employment income.

Moreover, with only slow progress being made, we recognise the prospect that tens of millions of workers receive only the basic state benefits for a few weeks at a time when job opportunities have been severely restricted by the return of Covid containment measures.

So, with virus fears on the rise, jobs being lost and incomes squeezed, we feel the second phase of the recovery will be much more challenging. We should be braced for weaker employment and spending numbers in the absence of a new broad and substantial fiscal package. This suggests financial market optimism on a "V"-shaped rebound could be severely tested over the next couple of months.

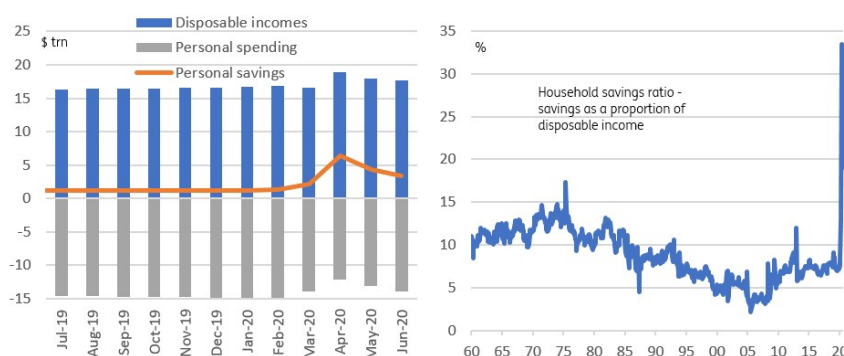
✓ The potential upside

We acknowledge that there is optimism about a vaccine and that could be a game-changer, but its timing and efficacy are unknown. Moreover, implementing a plan to get the world inoculated could take many months meaning restrictions of movement and behaviour remain in place well into 2021 even if a vaccine is found this year.

Nonetheless, an announcement on a vaccine would undoubtedly boost consumer and business sentiment and be a trigger for new highs in stock prices. It would also likely

incentivise the restart of corporate investment plans that had been put on hold and could prompt preparatory hiring, particularly in travel and hospitality, as businesses see the light at the end of the tunnel.

Savings boosted by unemployment benefit income and lower spending



Source: Macrobond, ING

✓ A consumer spending buffer

Many analysts have also noted that the household savings ratio has surged and this creates a buffer that can be drawn on to keep consumer spending robust until we get to the point of a vaccination program. However, our caution regarding this assessment centres on where the savings are located. In the absence of such specific data, we surmise it is concentrated in middle and higher-income households that are involuntarily saving given they are effectively prevented from spending to the degree that they normally would on entertainment, travel and hospitality services.

Unemployed and lower-income households, which appear to have led the recovery in consumer spending, may have saved a few hundred dollars from the extra \$600/week, but financial fears for the future mean they will be more cautious as unemployment benefits are scaled back. Further protection against foreclosure and eviction in addition to an extension of a generously sized unemployment benefit extension would be a must within the new financial package to reassure us that this demographic is not going to cut back their spending significantly.

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