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20 million reasons for caution

As Asia trades ahead of today's US jobs report, the idea of perhaps more than 20 million new jobless being priced into markets seems hard to accept

Go figure

I've long given up thinking that in some way, equity markets provide an insight into the economic future. Liquidity is the ultimate drug for equities, and the outlook for earnings seems to be of little real merit as a predictor.

But less than 24 hours ahead of what will probably rank as the "worst economic report in the history of the world" I find it puzzling that equity futures are hovering in slightly positive ground. Check out this from James Knightley for more on the US jobs market.

The usual excuse for this sort of thing is that all the bad news is already priced in. But if so, when did that happen? Recent equity market performance has been steady to slightly higher. And I don't believe that this point occurred the minute the S&P500 hit its 23 March bottom. Investors

were still talking about V-shaped recoveries back then (economists have been pretty clear - for once - that this was not on the cards from the word go - despite what you read in some sections of the media).

Could it in some way be a positive reaction to the fact that December Fed funds futures are now pointing to negative US policy rates? If so, they haven't been paying attention, because if this happens, the liquidity role played by US money markets would likely make financial conditions far tighter, rather than looser. And even in Europe, where liquidity is more of a bank function, negative rates have clearly not provided much help, and there is a good argument to suggest that they've done active harm.

Jerome Powell and his colleagues are smart and I don't think official Fed policy will ever go negative for these reasons. I don't rule this out for market rates further along the curve, however. But in short, the Fed has done practically everything of substance that you could have asked of them, so you can't reasonably put equity optimism down to stimulus expectations.

We'll see. For such a well-flagged car crash, the market reaction to this in either direction will be very interesting.

More trade worries next week

I read on the newswires that US and China trade negotiators will meet next week to see how China has been living up to the commitments that it made to secure last year's trade truce.

Very obviously, on a month by month basis, they will have fallen far short, thanks to the pandemic. But will the US make allowances for this? Reasonableness would argue, "yes". But the politics of this is not so clear. While there is little to be gained economically or in terms of market action from ripping the scab off this old wound, with the economic data flying off the charts in the wrong direction, it could make a useful diversion for the spin-doctors. Next week could also be quite "interesting" as a result.

Let inflation rise to 4%? What do you mean, let?

I skimmed over an article today that suggested that letting US inflation rise to 4% for a decade could help to wipe off the debt accumulated during the pandemic.

I'm sorry. "Let inflation rise to 4%?" Despite what were some of the tightest labour markets on record, and some of the correspondingly most accommodative monetary and fiscal policies on record, including trillions of dollars of quantitative easing, the US was barely able to hit its more modest 2% PCE inflation target for more than a few months in 2011, 2017 and 2018.

It's one thing to play with spreadsheets and "what if" scenarios. But this idea belongs in the trash can, along with the growing number of articles on stagflation I'm reading.

I'll be writing a longer, and most probably quite a ranty piece on why this is nonsense as soon as time allows. But the short version of the note would simply say - there is no mechanism for supply shortages to generate a cost-push inflation spiral any more. Growing alternatives to wage-labour (AI, automation), much larger service sector, decreased unionisation and collective bargaining, all mean that at worst, supply constraints lift the relative prices of a number of goods and services for a time. But it fails to generate the subsequent rounds that would cause this to stick, or to grow, irrespective of central bank accommodation.

No mechanism = no stagflation. Which is a pity, as in my view, as a bit of "flation" of any sort really would be quite useful. It's wishful thinking though. Debt write-downs are much more likely in my view.

Today in Asia

It is a quiet one today in Asia. Prakash Sakpal writes this on Malaysian industrial production and what it means for next week's GDP release: " March industrial production (IP) data today is the last element in our 1Q20 GDP estimate. We expect a 4.9% YoY IP fall, a negative swing from 5.8% growth in February as the Covid-19 lockdown starting in mid-March dented activity. This result would still deliver slightly positive quarterly IP growth. Both exports and manufacturing held their ground in 1Q, but were outweighed by a sharp slump in services due to stalled tourism and movement restrictions. We expect a 4.2% YoY GDP fall in 1Q20 (data is due next week, 13 May").

Author

Olivia Grace
Editor
olivia.grace@ing.com

Julian Geib
Junior Economist, Global Trade
julian.geib@ing.de

Zoltán Homolya
Economic research trainee
zoltan.homolya@ing.com

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz
Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@ing.com

Michiel Tukker
Senior UK & Eurozone Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Senior Economist, Healthcare & Technology
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Deputy Global Head of Editorial and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier
Head of Corporate Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com