

Markets catch a bad case of reality

It is not possible to say that this retracement won't be wiped out in the coming days by bargain hunters, but perhaps markets will be a bit more cautious from here on?



Source: Shutterstock

Plausible direction, but will it last or get worse?

Recent experience suggests that it would be wrong to get too smug about a stock market decline of this size, which finally seems to reflect some of the growing weight of bad news in the global economy. Critics are quick to criticize the US Federal Reserve. Although in their defence, they have not done anything wrong except to point out what we already knew - that the US/global economy was in a bad place and that there would be no quick bounce even with recent more optimistic signs from the US labour market, auto and housing markets. There is no point in shooting the messenger. US policy rates are already at virtually zero, backed up with QE. What more could the equity bulls really expect? What more would yield curve control have delivered? Probably very little is the answer that springs to my mind. And the same goes for negative rates (despite what Kenneth Rogoff writes).

The other factor mentioned in the ex-post rationalization of why stocks fell so much in one day was the virus. We have been tracking this closely since I first starting writing about it on around 23 Jan this year. And yes, some of the data from the states do look bad and suggest a second wave following premature re-opening. This was evident more than a week ago. We have been noting it

in these notes from time to time.

We hear from various politicians overnight that the US will not shut down again. Maybe not. But the Mayor of Houston, one of the more affected areas in the resurgence of infections in Texas, is reported to be considering issuing stay home notices again. So some more surgically applied shut-downs can't be ruled out in infection hotspots. That isn't to say these will be adhered to.

But really, stocks probably fell so much simply because they had gone up too much. The simplest explanations are often the best. Some investor fingers will have been burned. But others will see this as a buying opportunity. After today's adjustment, there is no telling which way markets will go.

In the meantime, in our part of the world here in Asia, the currencies that saw the fastest month-to-date increases, the IDR and KRW, are top of our list for seeing selling pressure today. The AUD and NZD have already tumbled sharply. They will not be alone.

Other G-7 news

It's pretty quiet across the G-7 today, though we read that UK Cabinet Office Minister, Michael Gove, will formally rule out an extension of the EU transition period today. The transition period is due to end at the end of this year, and the UK had until the end of this month to ask for an extension. The move comes against rumours that the EU may be softening its stance on some of the UK's red lines, including fishing and state aid. The UK for its part seems to be firming up the only card it has in its hand, namely the threat of hard Brexit. Rising hard Brexit fears won't be good news for either the EUR or GBP, though probably worse for the GBP.

The only US release today of any note is the University of Michigan consumer sentiment index. Buried within the detail of this survey are some interesting indices looking at households expectations for losing their job over the coming 12 months, and house and auto buying intentions. These will be interesting given the recent resilience shown by these sectors. But probably not market moving.

And In Asia...

It is also pretty quiet in Asia today. Prakash Sakpal has picked up on some looming releases from India, writing, "May CPI inflation and April industrial production (IP) releases today should reinforce the ugly state of the Indian economy. A 60% YoY plunge in exports and 38% fall in key infrastructure industries' output in April tells you what to expect from the IP data (ING forecast is -33% YoY). Inflation should stay close to the last published reading of 5.8% in March (there was no April data due to the lockdown and we aren't sure if we will get one for May either). The continuing rapid rise of Covid-19 infections in India suggests the economy is poised to be much worse before it shows any signs of improvement. And that won't be anytime soon. India is now the fourth worst-affected country in the world. We now see a steeper 2.1% GDP fall in FY2020, revised down from -1.2% a month ago".

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

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