27 March 2020
Bundle

Covid-19 crisis: What you need to know

The Covid-19 crisis is tightening its grip on global markets around the world. These are ING's key thoughts and reactions to this week's extraordinary developments, from the dollar to jobs, from central banks to market rates

25 March 2020
Article

US fiscal package: Signed, sealed, delivered?

A $2 trillion fiscal package has been agreed and will be voted on today. A clear positive development that the economy desperately needs, but with recession unavoidable the US fiscal position will deteriorate markedly. A deficit well in excess of 10% of GDP is inevitable this year... 20% is possible

Deal done

A deal has been reached between President Trump's administration and Congress on a $2 trillion fiscal package. Equivalent to just under 10% of GDP, it dwarfs the Global Financial Crisis plan, which amounted to around $800bn. While final drafting is ongoing, a vote is expected today.

It contains measures that offer direct support to both households and businesses – focusing on efforts to incentivise businesses to keep workers on their payrolls and for those employees that do lose their job or have had hours cut, it provides better financial support. Unemployment insurance has been extended by 13 weeks that include four months of enhanced benefits with more workers covered.

Another major thrust is a cheque of $1200 for low and middle-income households. Anyone earning below $75,000 gets the full amount before it is phased out to zero for those earning more than $99,000. Families receiving this money would also qualify for an extra $500 per child.

Concessions were key

The main sticking point to getting a deal had been Democrats insisting on greater oversight as to who benefits and by how much and on what terms from the hundreds of billions of dollars available for loans and bailouts. There will now be an inspector general with a five-person Congress-appointed panel with rules stating that companies receiving support cannot implement any share buybacks during the period they benefit from government assistance. There would also be limits on executive remuneration during the period with steps needing to be taken to limit lay-offs while companies owned or run by the families of Donald Trump and Vice President Mike Pence would be barred from receiving support.

On top of this there would be another $130bn for hospitals and $150bn extra for state and local governments to help them deal with the healthcare crisis. There is also $350bn to fund a lending programme for small businesses set up in a way to incentivise keeping workers on the payroll.

Getting House approval

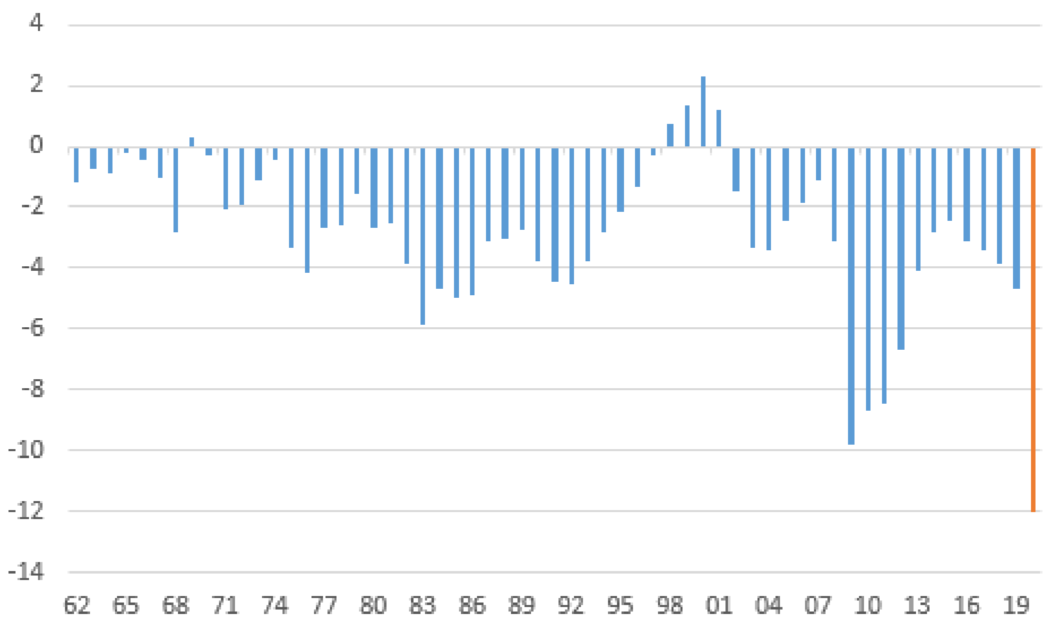
Unlike the Senate, the House is not in session and therefore a large proportion of members are not in Washington to participate in a vote. One option being considered is passing by “unanimous consent” whereby, assuming no objections, it would be written into law. However, that runs the clear risk that just one person could be unhappy with one small aspect of the bill and reject it, bringing down the entire legislation. Nonetheless with all sides, the White House, the Senate and the Democrat leadership in the House all happy, we expect it to pass.

Astonishing numbers

The economic data underlines the need for dramatic support for the economy. We know tomorrow’s initial jobless claims will be truly awful given the scale of lay-offs in the wake of city and state lockdowns that have shuttered countless businesses. We are forecasting a figure of two million people, but even this probably underrepresents the true picture given anecdotal news of jammed phone lines and crashed websites as people registered. Millions more will file in coming weeks.

Over the past 24 hours, we have seen business surveys collapse and mortgage applications plunge, which points to a sharp fall in housing activity in the months ahead. As such, not only is government spending surging, but tax revenues are plummeting and will continue to fall relative to the budget.

The US fiscal deficit and where we could be in 2020 (% of GDP)



Source: Macrobond, ING

The US fiscal deficit was already on course to top $1 trillion this year. We will be publishing updated global economic forecasts that will include different scenarios next week, but even in a best-case situation where President Trump gets his wish and we start to see the economy tentatively re-opening at some point in 2Q 2020, we will still likely have some form of social distancing and restrictions. Either way this means the economy still contracts sharply this year and implies a possible deficit in excess of $2.5 trillion.

In arguably the most benign case whereby the economy contracts around 3%, that still implies a fiscal deficit of around 12% of GDP. A deeper, more prolonged economic dislocation that requires significantly more fiscal support can quickly get you up to a fiscal deficit well in excess of 20% of GDP.

This truly is comparable with wartime. Unfortunately, the demographic situation will make lowering deficits and debt levels much more challenging relative to post World War 2, which raises questions as to what happens to all this debt? That is obviously not the focus while fires are being fought, but we will be addressing this in upcoming notes.

James Knightley
Chief International Economist
+1 646 424 8618
james.knightley@ing.com

26 March 2020

Snap

US: unemployment surge is just the first wave

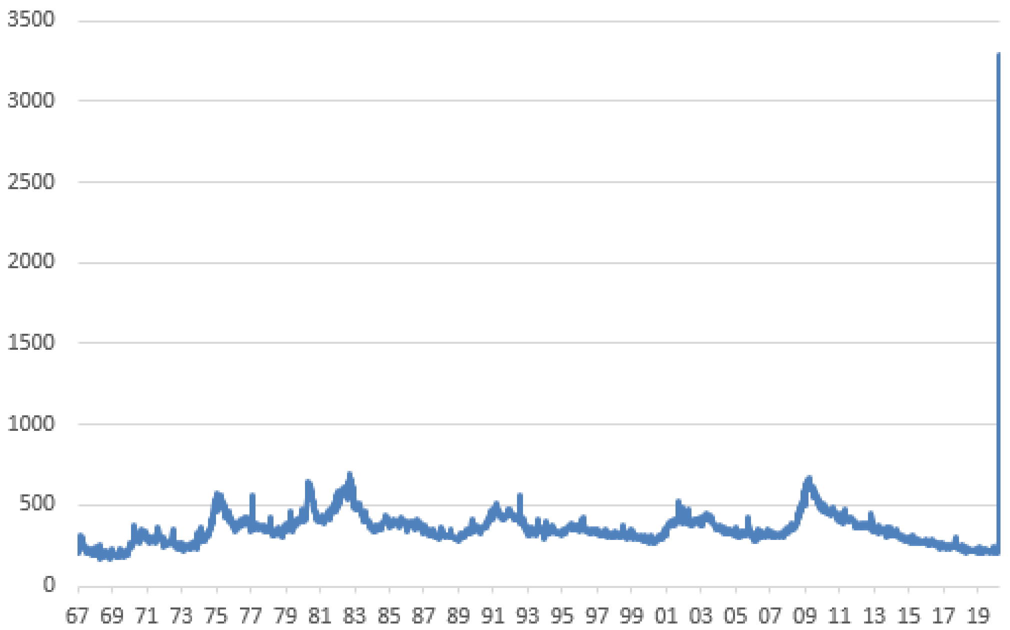
Even in the knowledge that tens of thousands of businesses shuttered in response to Covid-19 containment measures, the 3.3 million spike in initial claims is still shocking. Soberingly, given jammed phone lines and crashed government websites this figure understates the economic cost of the crisis so far

We knew that today's figure was going to be bad, just not quite this bad. There were 3.283 million initial jobless claims for the week ended March 21st – up 1064.2% on the week before and the highest on record by a factor of nearly 5. We were expecting something a little north of 2 million while the consensus was at 1.7 million.

This is obviously the result of the city and state lockdowns that have been spreading across the US as a response to try to contain Covid-19. Pennsylvania reported the highest number of claims (378,900), with Ohio reporting 187,800, Illinois 114,700, California 186,800 and New York 80,300.

The latter two states seem low given anecdotal evidence, which may indeed reflect issues with websites crashing and phone lines jammed and a general reluctance of people to stand in line with lots of other claimants in the current environment. We would expect numbers from these states and others to climb in coming weeks, particularly with the number of lockdowns increasing across the US.

Weekly initial jobless claims 1967-2020 (000s)



Source: Bloomberg, ING

The longer the crisis lasts the more likely that even good quality businesses will fail and unemployment will climb higher – hence the importance of the agreement on the fiscal package that can provide support for key industries and small businesses. Without it, Treasury Secretary Steven Mnuchin mentioned the possibility of a 20% unemployment rate, which would imply unemployment rising from just under 6 million as of February to 33 million in just a matter of a few months. St Louis Fed President, James Bullard, has talked of the possibility of a 30% unemployment rate, which would suggest nearly 50 million out of work in the US.

The path of the coronavirus and the government's response will be the key determinant of what happens to the labour market. Nonetheless, if firms can get financial support from the Federal Reserve and from government and there is the inkling of a roadmap out of the situation, involving testing and a gradual reopening of the economy later this year, firms are more likely to keep workers on their payroll. As such, we remain hopeful that these doomsday type estimates for unemployment will be avoided

James Knightley
Chief International Economist
+1 646 424 8618
james.knightley@ing.com

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Article

Watch: The European coronavirus response; is it enough?

Expect more spending commitments to be promised by eurozone governments in the coming weeks. That's Bert Colijn's prediction as he compares what individual countries are already pledging amid the Covid-19 pandemic

The European response: Is it enough?

European governments are spending billions of euros trying to shore up their economies amid the coronavirus crisis. ING's Bert Colijn says although there's little coordination between eurozone member states, the plans are similar and it's likely we'll see yet more financial pledges before this is over.

Bert Colijn
Senior Economist, Eurozone
+31 20 563 4926
bert.colijn@ing.com

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Article

Global FX: Glimmers of hope

Measures taken on both the fiscal and monetary front and signs of reducing USD funding squeeze suggest that global FX markets may be about to exit the period of profound, indiscriminative moves, where the USD appreciates abruptly. This should be particularly helpful for NOK and GBP, which have been vulnerable during periods of the USD funding squeeze

Tentative signs of improvement …

Although the rally in risk assets stalled overnight and today (equities are down, many EM currencies lower vs USD), the fairly well-behaved price action in FX markets (the decline in selected EM currencies appears modest in the context of heightened volatility which we observed in the past few days and weeks, while G10 FX is up vs USD) suggests things may be tentatively improving.

This is not to say that the downside risks have faded (if anything, the US fiscal stimulus seems to be fully priced in, while there are concerns about the US government having to do even more), but as global governments and central banks have already taken steps in the right direction on the (1) fiscal front; (2) monetary front, and (3) very importantly for FX markets, the USD funding squeeze seems to be easing, the currency market should be about to exit the period of profound, indiscriminative moves, where USD either appreciates or depreciates abruptly.

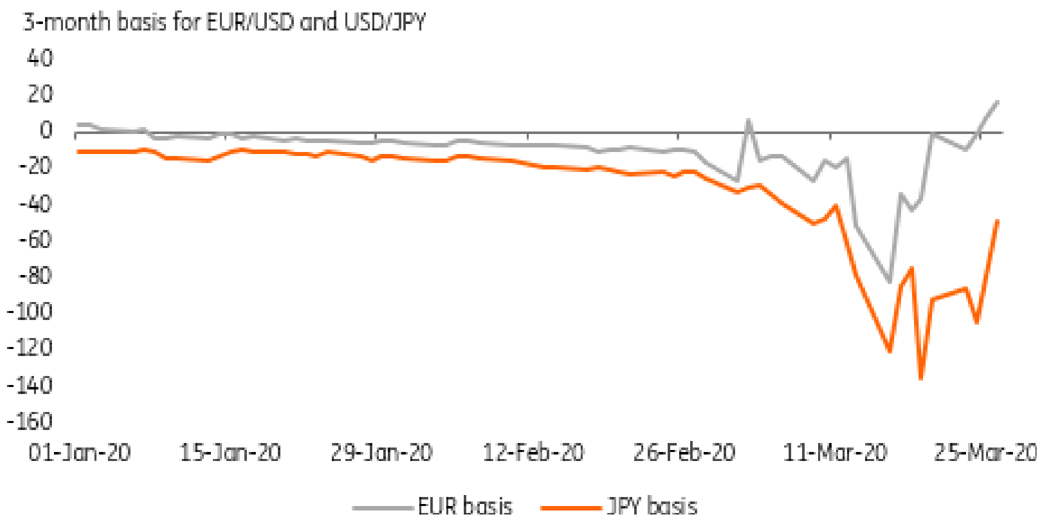
… as the USD pressure appears to ease

As Fig 1 shows, the EUR/USD basis (the gauge for the USD funding squeeze) has now fully recovered and following the Federal Reserve's measures (the central bank offering USD liquidity via the FX swap programme) the EUR/USD basis is back above the pre-USD funding squeeze levels.

A similar trend is seen in USD/JPY basis, which has also largely recovered (also Fig 1). As we argued previously, this was a crucial factor that was exaggerating the currency moves and, if corrected for, should allow for more EUR/USD gains as the unlimited Fed quantitative easing will be allowed to take a toll on the dollar in a better functioning market environment.

> Read our latest FX Talking: I need a dollar

Figure 1: EUR and JPY basis have been correcting



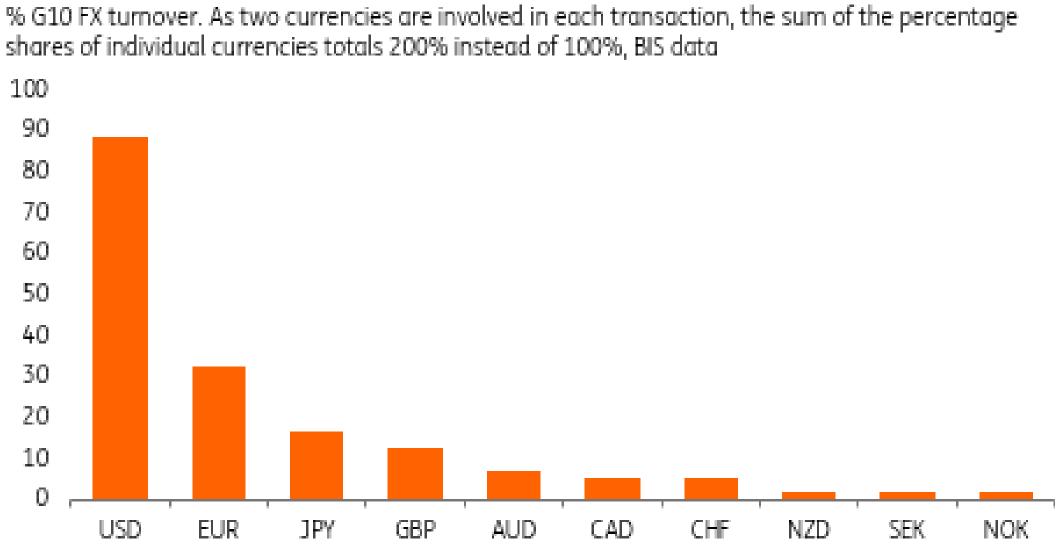
Source: ING, Bloomberg

Excessive FX volatility may decline

To be clear, we fully recognise the uncertainty about the persistency and durability of the impact of the Covid-19 crisis on the global economy. But given the measures already taken and USD funding situation improving, we may now move away from the abrupt, many times seemingly irrational FX moves, whereby global currencies depreciated or appreciated abruptly vs USD.

In other words, the currently excessive FX volatility may decline from exaggerated levels. Still, currencies may fall further vs USD, but the fall may be more well-behaved from here vs the abrupt price action so far.

Figure 2: Low liquidity has been an issue for NOK



Source: BIS

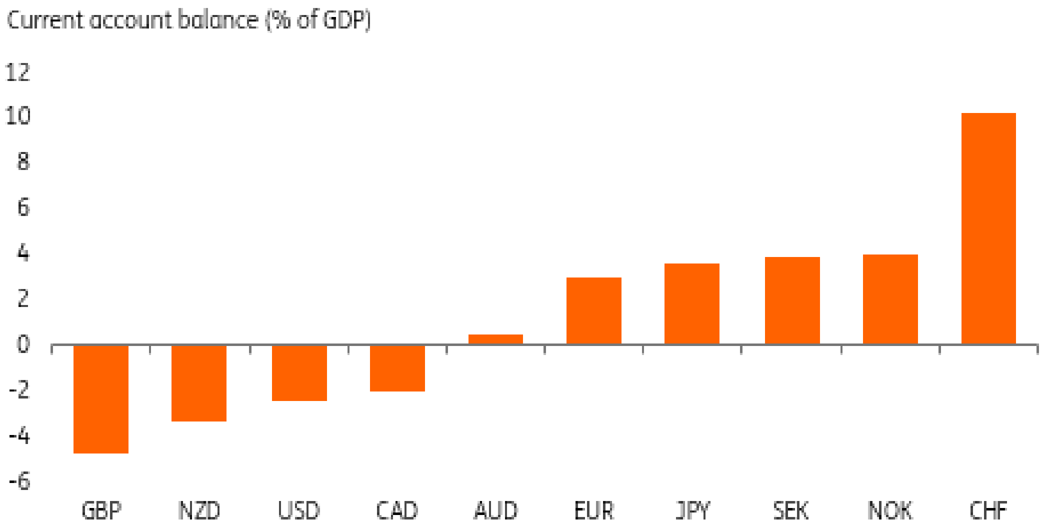
NOK and GBP might get some breathing room

Should the USD funding squeeze pressure start to fade, this should partly benefit NOK and GBP.

NOK has been the key victim of the latest market rout as the krone low liquidity (Fig 2) h eavily exaggerated the currency downfall. As for GBP, the currency suffers from the worst current account position in the G10 FX space (Fig 3), and the external funding needs make sterling vulnerable. Both currencies may still decline further vs USD, but the tentative signs of an improvement on the USD funding front suggest a reducing risk of GBP and NOK meltdown during risk-off days.

For NOK, our view that oil prices will remain depressed for some time suggests that a meaningful NOK rally is unlikely. Rather its downside should be limited from here and NOK should be experiencing less abrupt moves.

Figure 3: GBP has the worst current account position in G10 FX space



Source: ING, Bloomberg

Petr Krpata, CFA
Chief EMEA FX and IR Strategist
+44 20 7767 6561
petr.krpata@ing.com

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Article

Mexico: A “perfect storm” scenario sets in

Mexico may witness the largest economic contraction among its LATAM peers in 2020. A large GDP contraction, together with the financial difficulties faced by the state-owned oil company, PEMEX, would both elevate the risk of adverse credit rating actions, as already seen last night with S&P, and narrow the scope for counter-cyclical policies

Recession should deepen given the narrow scope for policy stimulus

Mexico stands out for its relatively mild policy response to the virus outbreak seen so far, which contrasts with our assessment that the Mexican economy is among the LATAM economies likely to be most affected by the ongoing crisis.

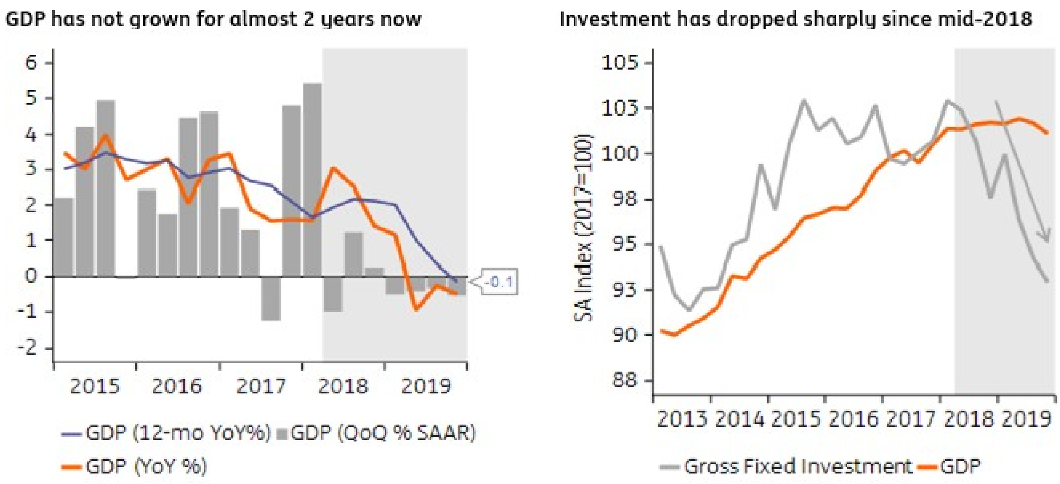
A high degree of uncertainty prevails, and much should depend on the duration of the crisis and how broadly the virus will spread and trigger lockdowns in the local economy. But judging by the contraction seen elsewhere, unless the coronavirus-related disruption in domestic activity is substantially lower in Mexico, the GDP contraction should draw parallels to the 5.3% drop seen in 2009, after the global financial crisis.

Among the factors that should contribute to a deeper contraction in Mexico are:

- The weaker starting point, with GDP in broad stagnation for almost two years now (see chart below),
- The most integrated manufacturing supply chain in LATAM, with the largest share of imports from China, and the stronger dependence on manufacturing exports, heavily concentrated on the US, implies greater vulnerability amid trade flow disruptions and a US recession. The rise in unemployment in the US is also contributing to lower income in Mexico as it reduces workers’ remittances, while travel restrictions could cause considerable damage to the service sector, especially tourism
- A relatively narrower scope to implement fiscal stimulus was made worse by the collapse in oil prices, which, despite the existing oil hedges, should place further stress on fiscal accounts and call into question the government’s PEMEX-centered growth strategy

- The tighter financial conditions and resistance of monetary authorities to shift monetary policy towards an expansionary stance
- As seen in the just-announced cancellation of a partly-built brewery, following another poorly-attended "public consultation", the government continues to undermine business confidence and is being seen as adopting an adversarial attitude towards the private sector, adding further downside to capital investment that has already collapsed since it took office (see chart)

GDP growth and investment



Source: Macrobond, ING

Source: Macrobond, ING

Risk of further credit rating downgrades has increased sharply

All these factors add to a "perfect storm"-type scenario that is still hard to quantify, but that should have deep implications for Mexico's macro outlook. Uncertainties involving eventual domestic policy responses to the crisis remain especially acute, but if recent signalling is any indication, Mexico's policy stance should continue to stand out for being especially contractionary, when compared to its EM peers.

Overall, assuming that economic activity should be severely affected over the next two months, Mexico's GDP should drop by 3-4% of GDP in 2020, down from -0.1% last year. Such a contraction, together with the financial difficulties faced by oil company PEMEX, would both elevate the risk of adverse credit rating actions and narrow the scope for counter-cyclical policies.

This reflects the fact that any effort to "rescue" PEMEX through tax cuts or cash injections would reduce the scope for other types of fiscal transfers. In addition, a credit rating downgrade would increase the risk of financial instability and increase the reluctance by monetary authorities to lower the policy rate, which is seen as an anchor for steady FX flows.

> A downgrade by Moody's seems like just a matter of time

Citing the twin shocks represented by the impact of the coronavirus on economic activity both in Mexico and in the US, and the collapse in oil prices, S&P already downgraded the sovereign and PEMEX yesterday, by one notch to BBB. S&P also maintained the negative outlook, citing economic policy uncertainty and the potential for PEMEX-related contingent liabilities.

A downgrade by Moody's seems like just a matter of time and that would be especially consequential. Given that Fitch already ranks PEMEX below investment grade, in contrast to S&P's BBB, PEMEX would lose its investment-grade if Moody's announces a one-notch downgrade. This would inevitably add to the company's financing difficulties and trigger some forced selling by investors who cannot hold junk-rated assets.

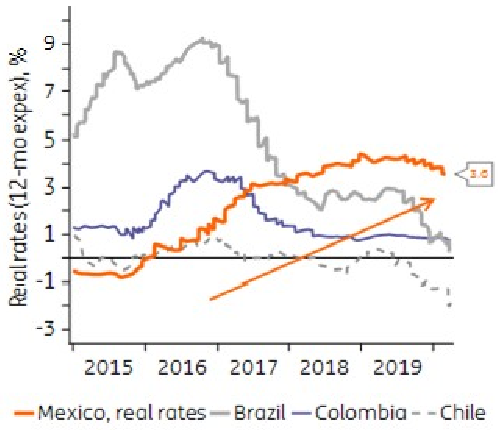
Risk of FX outflows to limit room for monetary stimulus

The Mexican central bank (Banxico) advanced its policy meeting by one week and cut the policy rate by 50bp last Friday, to 6.5%. Despite the ahead-of-schedule announcement, the decision was broadly in line with expectations.

Still, the decision and the policy statement that followed can easily be characterized as hesitant when compared to the stance adopted by other central banks in the region, especially given that one of the five board members voted for a smaller 25bp cut. The notably cautious monetary policy guidance contrasts with Mexico's relatively high level of interest rates (see chart below), the sharp deterioration in the outlook for economic activity and the fact that the US Fed, which is an important reference point for Banxico, was considerably more aggressive by cutting the overnight rate by 150bp in March (see chart).

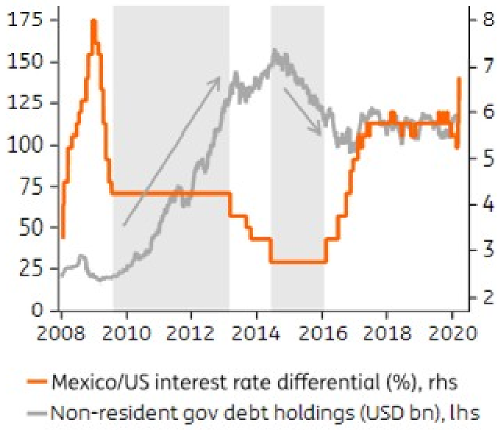
Mexico's high rates

Mexico's high rates should continue to stand out in LATAM



Source: Macrobond, ING

At 6.25%, the rate differential with the US remains exceedingly high



Source: Macrobond, ING

Banxico Governor Alejandro Diaz de Leon was quoted justifying the caution by citing financial stability considerations, stating that Mexico was experiencing a currency shock and that the country is especially vulnerable to FX outflows. As seen in the chart above, non-resident holdings have been largely stable in Mexico over the past couple of years, which likely reflects the attractive rate differential offered by local bonds.

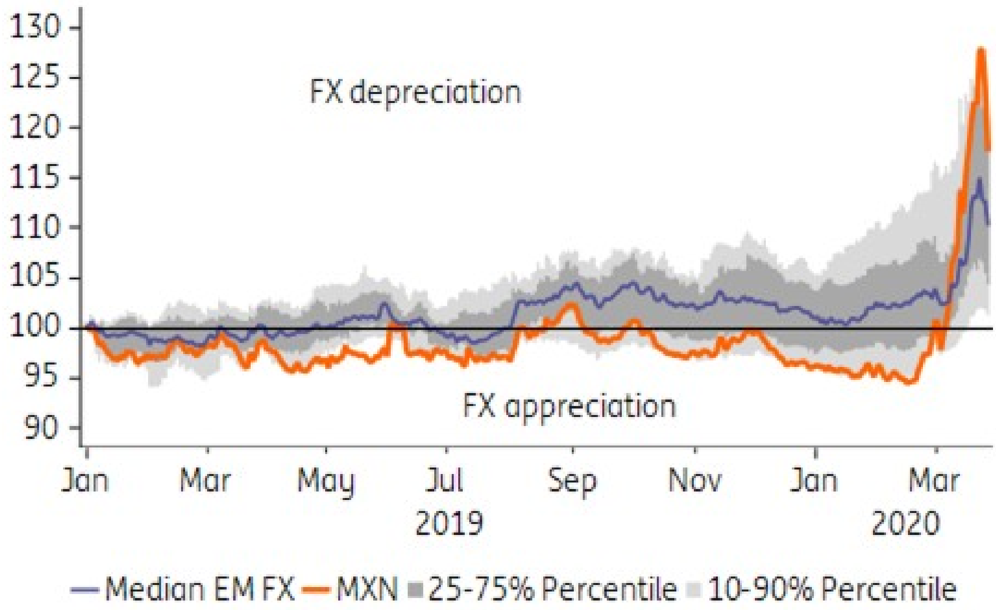
In our view, even if the currency's performance improves in the near future, Banxico should stick to its play-it-safe strategy. In practice, we believe the bank should be a follower, and not attempt to surprise the market in its rate decisions.

In our view, market consensus should gradually consolidate around a terminal level for the policy rate in the 5-5.5% range, implying at least 100bp in additional rate cuts, that could be implemented in a relatively front-loaded fashion (i.e. starting with a 50bp cut in May, followed by 2-to-4 25bp adjustments in subsequent meetings).

Assuming that the US Fed keeps its overnight rate stable in the foreseeable future, this would imply a rate differential relative to the US in the 4.75-5.25% range, which lower than the 5.75% that prevailed in recent years but still high, especially when compared to its LATAM peers.

Weakness in Mexican peso

After outperforming EX FX for several quarters, the MXN weakened sharply in recent weeks



Source: Macrobond, ING

Monetary policy caution suggests that the MXN could, once again, outperform when risk appetite stabilises

We continue to be less sanguine about the peso's medium-term outlook, given the ongoing deterioration in the macro outlook. But high rates could, once again, become an effective short-term anchor for the currency,

Overweight portfolio positioning was likely the chief factor behind the MXN's extreme sell-off seen in recent weeks. And given that investor positioning is probably much better adjusted by now, we do not discard a relatively quick reversal of the flight-to-quality shift that roiled the currency in recent weeks. That, of course, would depend on how fast global risk aversion abates.

In that case, the MXN could experience a relatively quick rally towards the 21-22 range.

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

What the Kiwi 'bazooka' means for NZD

The Reserve Bank of New Zealand has joined major central banks in starting quantitative easing and will buy NZD 30bn (around 10% of GDP) worth of New Zealand government bonds over the next 12 months. With the central bank not bucking the ultra-dovish trend, the pro-cyclical NZD is left without any solid floor and may converge lower in the next few weeks

New Zealand's central bank goes big

After an initial sanguine reaction to the Covid-19 outbreak, the Reserve Bank of New Zealand delivered an emergency 75 basis point rate cut on 16 March.

On 23 March, as the Monetary Policy Committee of the RBNZ acknowledged how downside risks to the economy had highly intensified, it announced a Large Scale Asset Purchase Program (LSAP). Over the next 12-months, the Bank will buy up to NZD 30bn of New Zealand government bonds in the secondary market across different maturities to "provide further support to the economy, build confidence, and keep interest rates on government bonds low". The statement highlights the possibility of further adjustments to the programme if necessary.

> The RBNZ's asset purchase programme is worth around 10% of New Zealand's GDP

This move by the central bank is in line with the jump into unorthodox monetary policy in many developed countries and, in particular, by the two key reference central banks, namely the Reserve Bank of Australia and the Federal Reserve. While RBNZ LSAP is largely similar to "standard" quantitative easing implemented by the Fed (although the latter recently made it practically unlimited), it differs quite significantly from the Australian case. The RBA opted for a Japanese-style yield-curve control scheme, aiming at keeping the 3-year yield at 0.25% (which equals the Cash Rate). On the contrary, the LSAP is mostly aimed at keeping the long-end of the curve pressured.

In terms of the size of the purchase scheme, the RBNZ has surely gone big: the asset purchase programme is worth around 10% of New Zealand's GDP. The Fed's initial announcement on QE – before announcing a practically unlimited scheme – was worth only around 2% of domestic GDP, the ECB's EUR 750 bn new bond-buying was roughly 6% of the Euro Area GDP, while the Bank of England's GBP 200 bn scheme equals approximately 9% of GDP.

Full lockdown warrants extra stimulus

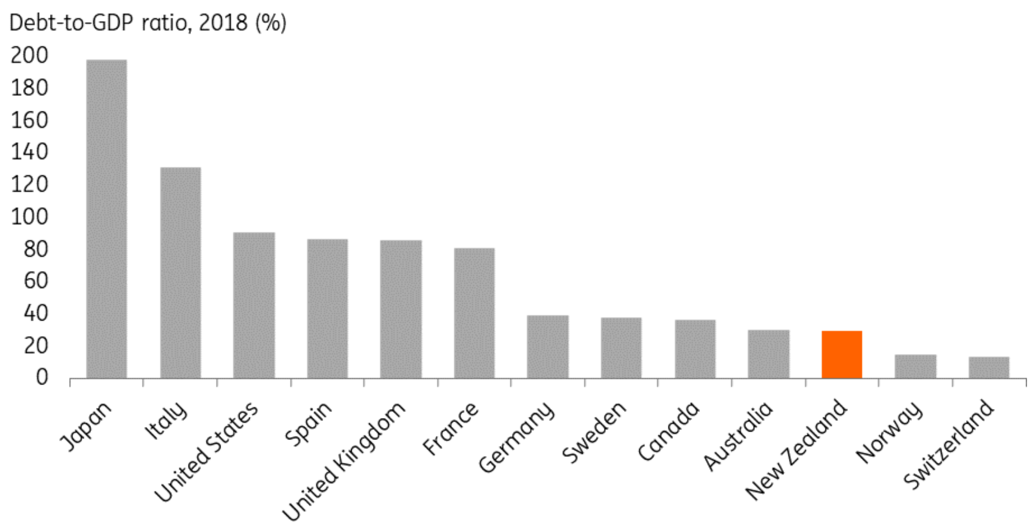
Assessing the impact of Covid-19 on the New Zealand economy has mostly been concentrated on external factors: above all, a slowdown in Chinese demand along with shrinking global trade flows and a fall in tourism. However, the impact is now obviously seen covering a wider share of economic activity and, like in other countries, private consumption – that makes some 57% of NZ GDP – is what concerns authorities the most.

The good news for New Zealand is that it has ample room for additional spending, given its small debt-to-GDP ratio (around 29%) compared to other developed economies

New Zealand has just entered a full lockdown phase, that will last at least four weeks. People have been asked to stay at home and all non-necessary businesses, schools and universities have been closed. So far, there are 338 confirmed cases in New Zealand, although authorities expect the number to increase sharply in the next few days.

On the fiscal side, the government announced a NZD 12.1 bn (4% of GDP) stimulus last week, with 5 bn for wage subsidies for businesses, 2.8 bn for income support, the same amount as tax relief and around 600 m to help the airline industry. All in all, the fiscal stimulus package seems quite heavy, although more may well be required to offset the dramatic consequences of Covid-19.

In this context, the good news for New Zealand is that it has ample room for additional spending, given its small debt-to-GDP ratio (around 29%) compared to other developed economies (as shown in the chart below).



Source: IMF, ING

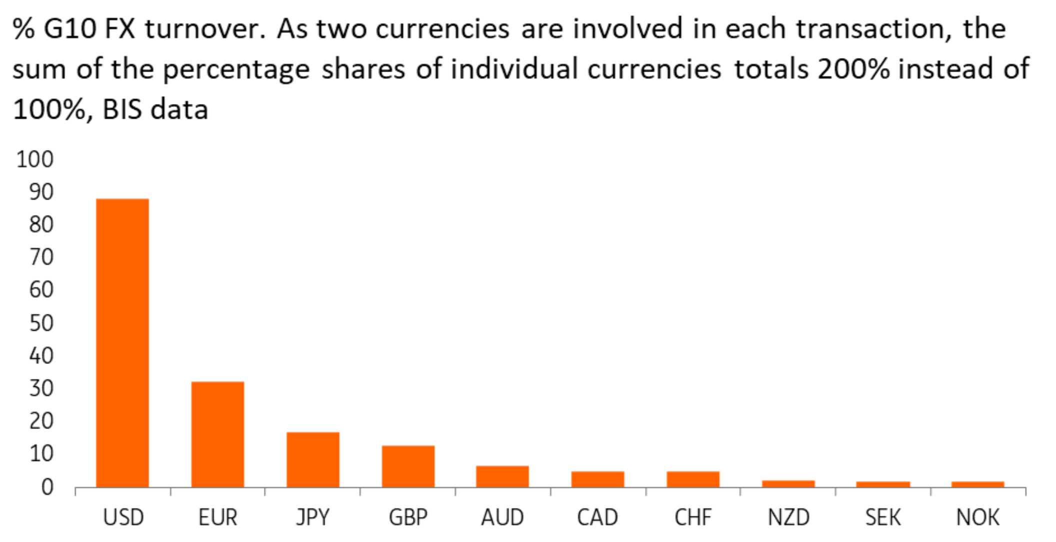
NZD: A fragile recovery

The Kiwi dollar is, indeed, part of the equation. Like in Australia, the pro-cyclical nature of the currency makes it a natural shock-absorber in times of economic downturns, given the exportoriented nature of the economy.

It's worth highlighting that NZD is one of the least liquid currencies in G10, and another liquidity drop in the markets bears the risk of NZD underperforming most of its G10 peers

The recent price action in NZD/USD has, however, followed mostly those of the USD (strictly linked to USD funding fears), and almost no mark of the RBNZ bazooka was left in the FX market. The easing of USD funding concerns may mean, however, that the period of large indiscriminate moves may be over, leaving more space to fundamentals. Naturally, this is also translating into USD weakness and a more sanguine global risk sentiment, all to the benefit of NZD/USD upside.

However, we suspect that the RBNZ's quite aggressive dovish stance makes the recovery in NZD hardly sustainable in the next few weeks, especially in the crosses. Also, it is worth highlighting that NZD is one of the least liquid currencies in G10, and another liquidity drop in the markets bears the risk of NZD underperforming most of its G10 peers (as shown in the chart below).



Source: BIS, ING

Looking at the AUD/NZD case, the QE in New Zealand appears substantially deeper than in Australia for now (in relative terms).

If nothing else, this represents an obstacle for AUD/NZD to trade sustainably at parity. The key notion that likely allowed the pair to briefly touch 1.00 earlier in March was that the RBNZ was lagging the RBA in terms of easing. Clearly, this is not the case anymore. Even if the RBA ramps up its QE scheme, exceeding the RBNZ LSAP in terms of relative size will be quite hard, and we need to bear in mind that the RBNZ has also left the door open for additional QE.

We expect the pair to stabilize around the 1.02/1.03 area in the next quarter.

Any additional NZD weakness may also be channelled against safe-havens such as the yen. As highlighted in a recent publication, we think the yen could face recovery in the next months ahead as a deep global recession unfolds. This could mean that NZD/JPY could re-approach the 62 low.

Looking at NZD/USD, we could see some additional support from USD weakening in the very short term, but we suspect the pair may be close to the bottom of the range. Looking beyond the near-term, the pro-cyclical nature of NZD in a global recessionary environment and the ultra-dovish stance by the RBNZ should prevent any sustained recovery above 0.60 before 2Q20.

Any possibility of additional fiscal stimulus by the Kiwi government may bode well for the economy but may only have time-limited impact on the currency, given the highly unsupportive rate environment.

Francesco Pesole
FX Strategist
+44 207 767 6405
francesco.pesole@ing.com

27 March 2020
Snap

China: Worst-ever profit data for factories

Industrial profits fell sharply in China's state-owned and privately-owned enterprises in January and February. What can we expect for March and April?

-38.3%

The worst industrial profits on record

YoY YTD in February

Profits of factories plunged in the first two months

Industrial profits fell 38.3% year-on-year, year-to-date in February from -3.30% YoY YTD in December. This is the worst data on record.

The plunge spanned state-owned (-32.9%YoYYTD) and privately-owned (-36.6% YoY YTD) manufacturers. But manufacturers in Mainland China who are funded by Hong Kong, Macau and Taiwan suffered the most serious falls in profits, at 53.6% YoY YTD.

Credit should deteriorate as account receivables lengthen

There is a risk that the profit squeeze leads to a credit event, especially among smaller manufacturers, as the number of days of account receivables has increased to 71.3 days from December's 53.7 days. Again, Hong Kong, Macau and Taiwan-funded factories are at a higher risk. The number of days of account receivables they faced is 89.4.

When account receivables lengthen, the risk of a cash flow problem is higher. The risk of being unable to pay an invoice then goes up, which can turn a liquidity risk into a credit risk.

Some manufacturers are also suppliers. If their upstream manufacturers cannot pay them back in time, they will have difficulty paying their downstream suppliers. The chain effect has been seen in previous difficult times. This is no different.

71.3

Account receivable days

Chinese manufacturers

So far no sign of stress in the market

The good news is that the market in Mainland China so far has not seen any sign of a liquidity crunch or credit crunch. Interbank interest rates have been low, and we have not seen any spikes-that is there is no stress in the market in general. 7D to 3M interest rates have been below 2%, while the People's Bank of China 7D policy rate is currently at 2.4%.

But small manufacturers‘ problems may not be reflected in the interbank market as they have difficulty borrowing from banks.

According to the PBoC website, the central bank's re-lending programme to support the resumption of SME operations has released CNY130 billion, which is only a fraction of the CNY500 billion re-lending programme.

It is expected that some SMEs may close their businesses, which will affect the stability of the job market, and therefore will slow down the recovery of domestic consumption. This will put further pressure on SMEs.

Iris Pang
Chief Economist, Greater China
+85 22 848 8071
iris.pang@asia.ing.com

25 March 2020
Opinion

Buy or sell the rally

What you need to consider now is, are the stimulus measures in place sufficient to justify buying risk assets against the moving target of the spread of this pandemic? And the answer that you have to come up with is, I don't know...

Round and round and round she goes, where she stops, nobody knows

We are long past the point where I update and show you coronavirus charts in this note, though maybe I'll knock some together for Friday's note.

The salient facts are these:

1. Total Global confirmed cases, 468,127 (up about 300 since I opened my computer this morning).
2. New cases in the last 24 hours 45,553
3. Of these, the largest single contributor is the US with more than 10,000
4. Total deaths from the virus in Spain now exceed those in China (where new cases continue to rise)
5. New case numbers in Italy, Germany and France have begun to respond to lockdowns and are now slowing.
6. Not so the UK, where the recent lockdown has yet to bite and new cases topped 1450 overnight.

All in all, the pandemic still looks to be on a runaway path, though there are some signs that some of the European hotspots are cooling very slightly. But with the piecemeal containment measures undertaken in the US unlikely to be effective except locally, and their large population with its challenging health and age characteristics coupled with variable health care coverage, I think that the prospects of a real problem for the US still exist.

So in my summary, I take the somewhat cowardly approach of saying that it is impossible to look at the (still unpassed) stimulus bill in the US and conclude that the time is ripe for piling into risk assets, simply because the other unknown, the virus, is still accelerating, with no prospect of guessing how much damage it will deliver.

Reallty though, I think it is still far too early to buy, but I concede that the turn, when it comes, might be sharp and that there is a danger of missing out on a chunk of the upswing when it comes. The US though, even if it isn't the centre of global GDP growth anymore, is still where the market cycle starts and ends. So what happens with the virus in the US is critical.

Singapore shows the way

Singapore's preliminary 1Q20 GDP figure is one of the first regionally, indeed, globally, and it is mainly for that reason that it is important as it is about the first piece of hard evidence of what is facing countries across the world.

At -10.6% (annualized QoQ%), the 1Q20 GDP result was a little worse than consensus, but the consensus really hadn't any clue, with a low of about -18 and a high of about -2, so the deviation from the median is not significant in my view.

Singapore, of course, was one of the first countries globally to be affected by the coronavirus as Chinese tourism with the island was strong before the outbreak, and that could have weighed more on these numbers than elsewhere. More importantly, in our view, are the containment measures undertaken, that have meant the island state still operates close to normality except for international travel and tourism, unlike many European countries. A lockdown may yet come, but the measures that have been taken have massively alleviated the economic burden on Singapore. It really is the role model to follow.

So when thinking about the GDP numbers elsewhere, in Europe and the US, you'd have to think that they would be lucky to see only a 10% annualised downturn in activity. And the actual figures could be magnitudes worse.

The limited detail we have on these numbers so far shows us that the people-intensive sectors of services (-15.9%QoQ) and construction (-22.9%QoQ) are the biggest victims of the virus. Manufacturing was actually up on the quarter (+4.2%). I don't expect that to last though, so a figure as bad or worse probably looms for 2Q20.

These numbers cement our expectation for some remedial action from the MAS this month (not waiting until their scheduled April meeting). Prakash Sakpal expects the MAS to re-centre the currency NEER close to current levels and remove the appreciation slope.

China rumours of rate cuts

Apart from the Singapore data, its very quiet in Asia today, though Iris Pang draws our attention to a story running in the FT. She writes, "The FT reported rumours that the PBoC is going to cut the benchmark deposit rate (1Ynow at 1.5%) to beef up banks' net interest margins. The rate is considered a backward tool as it is a retail interest rate, which, banks have the freedom to post any rate for deposits based on market conditions. We believe that if the central bank wants to incentivise banks to lend more to inclusive finance, which is the group that needs cash from the damage of Covid-19, then the regulator is expected to link the capital or liquidity requirements with the loan amount for inclusive finance".

Robert Carnell
Regional Head of Research, Asia-Pacific
+65 6232 6020
robert.carnell@asia.ing.com

26 March 2020
Snap

Czech National Bank Review: The big winner is the koruna

The Czech National Bank cut rates by 75bp today but the total package of measures disappointed. After the latest MinFin comments, the CNB planning on quantitative easing appeared as a done deal. But the CNB indicated it is not on the table now. All this is positive for the koruna but less positive for Czech Government bonds

Given the high market expectations, the CNB's unwillingness to embark on quantitative easing (QE) delivered a disappointment. Even more, the CNB interprets the current law as allowing it to do full QE (though limited via commercial banks), so the latest trouble to act by the CNB, which was not approved on Thusday, was not the obstacle.

Our understanding from the press conference is that the CNB Board sees QE as a financial stability tool which would be in place to provide liquidity when markets are broken and thus prevent spread widening (ie, a “soft” QE), but not as a big scale measure to support the economy or government via bond issuance, at this point.

Given the reluctance to do QE now, it is likely the CNB will continue cutting rates aggressively, but this is already reflected in the market (the policy rate priced in is around 0.25% in 3 months). However, it was mentioned during the press conference, that it is premature to assess, whether rates will return to zero now.

1.0% Main CNB rate

0.75 % lower today

Lower than expected

Counter-cyclical capital buffer also lowered

Apart from lowering the main interest rate, the CNB reduced further the countercyclical capital buffer (CCyB) rate from 1.75% to 1%, which is effective from April. This should support lending activity of the Czech banking sector to the real economy. The CNB is ready to further reduce the CCyB rate if the banking sector experiences losses. Apart from that, the CNB enlarged its recommendation to postpone dividend payments from banks, and also to insurance companies and pension funds.

The CNB ready to support CZK, if needed

The limited prospects of imminent QE, and if QE then "soft" QE (with a focus on financial stability goals) is supportive for CZK as the liquidity increase is unlikely to be material. Moreover, with the CNB standing ready to intervene in EUR/CZK (and having a credible firepower to do so), the previous CZK underperformance vs its CEE peers should stop. Indeed, the mix of a low CNB bar for FX interventions but and high bar for the full-scale QE is positive for the koruna vs CEE peers.

Jakub Seidler
Chief Economist, Czech Republic
+420 257 47 4432
jakub.seidler@ing.com

Petr Krpata, CFA
Chief EMEA FX and IR Strategist
+44 20 7767 6561
petr.krpata@ing.com

26 March 2020
Article

Dutch debit card transactions decline sharply due to Covid-19

Covid-19 is beginning to hit the Dutch economy, and the confinement measures to halt the spread of the virus are affecting the way consumers spend money. An analysis of ING debit card transaction data shows a 24% decline, year-on-year, for last Friday

The largest year-on-year decline in debit card transactions is in recreational venues, such as cinemas, sport clubs, and restaurants (-83%). This is followed by clothing stores and shoe retailers, which show a decline of 72%. Since people are staying home, spending on transport is also taking a big hit (-46%).

In other places we see an increase in debit card transactions. In particular, toy retailers are benefiting from children having to stay home. Parents are likely resorting to toys to keep children busy, with debit card transactions at these retailers showing a 10% year-on-year increase. Other shops where we see a larger number of debit card transactions are supermarkets (+5%) and DIY shops (+2%).

Where we see fewer or greater debit card transactions

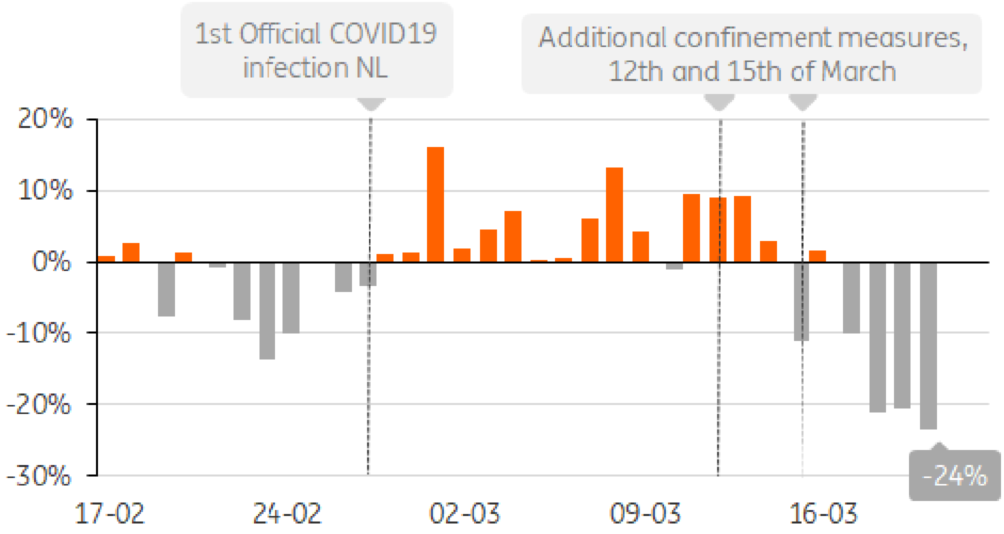
Type of pin location	Growth YoY
Total	**-24%**
'Essentials'	**+2%**
Supermarkets	+5%
Other food stores	-7%
Health (pharmacy, drugstores)	+2%
Appearance	**-68%**
Clothing and shoe shops, jeweler	-72%
Personal care (e.g. hairdresser, perfumery)	-59%
Leisure (goods)	**-12%**
Toy and game shops	+10%
Book and music shops	-4%
Sports shops	-33%
Electronics shops	-3%
Do-It-Yourself (incl. furniture stores)	**+2%**
Other non-food stores	**+11%**
'Going out'	**-83%**
Bars & Restaurants	-81%
Leisure locations (cinema, funfair, hotels, etc.)	-95%
Transport	**-46%**
Petrol stations & parking	-39%
Public transport	-76%

Source: ING

Overall, we see a sharp decline in debit card transactions. Last Friday, they were down 24% from a year before. This is primarily driven by the closure of public places such as restaurants, cafés, cinemas and sport clubs.

Prior to the extra confinement measures, we saw an increase of 10%. This was mostly driven by extra consumer spending in supermarkets.

24% fewer debit card transactions on Friday, 20th March



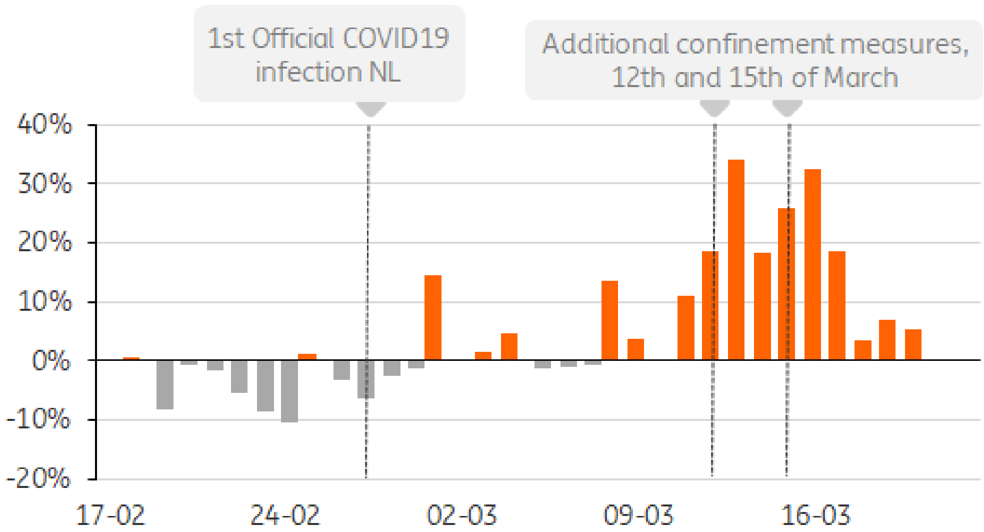
Source: ING, last observation: Friday 20th of March

More debit card transactions in supermarkets

We saw a significant increase in debit card transactions in supermarkets in the past two weeks, peaking at 30% YoY.

Over the last week this has been decreasing. Friday 20th of March showed 5% more debit card transactions than a year earlier.

More debit card transactions in supermarkets



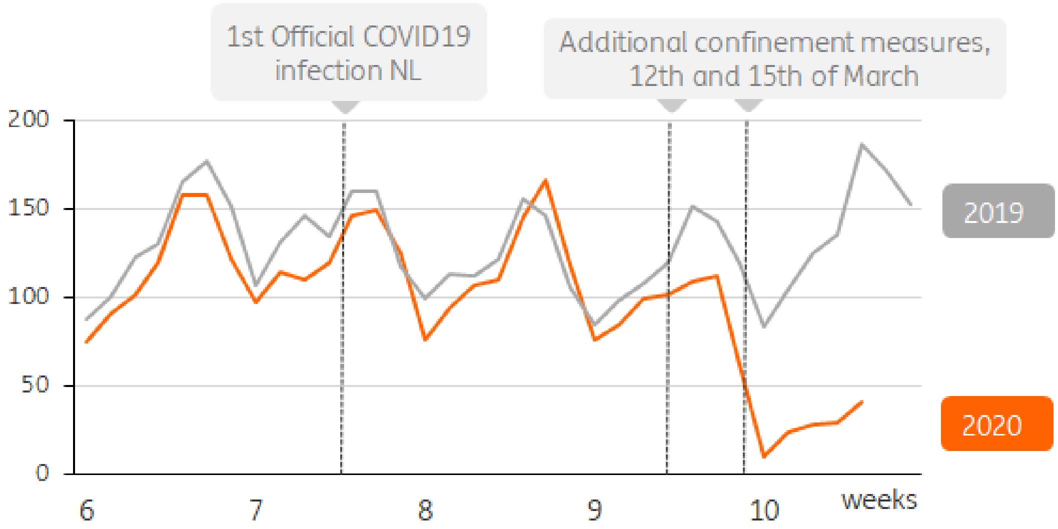
Source: ING, last observation: Friday 20th of March

Cafés and restaurants show a decline of c.80%

Covid-19 measures have particularly hit businesses in the leisure industry. We observed an 81% decrease YoY for pin transactions in restaurants and cafés last Friday. Currently, it is just the takeaway and delivery caterers that are keeping debit card transactions above zero.

We observed even larger declines in recreational venues such as cinemas, sport clubs and amusement parks. In particular, last Friday we saw a drop of 95% compared to last year.

Huge decline in debit card transactions in pubs and restaurants



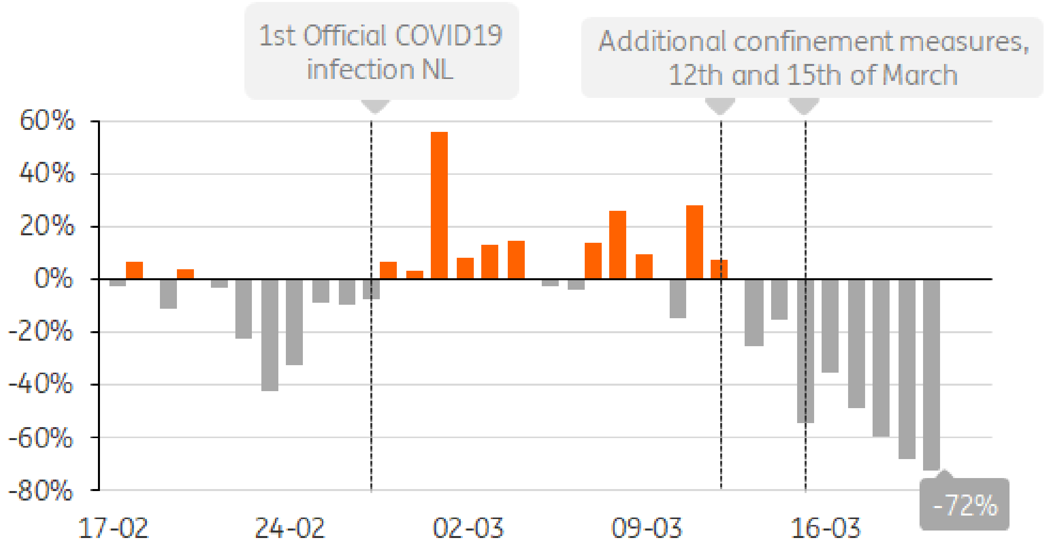
Source: ING, last observation: Friday 20th of March

72% fewer transactions in fashion retailers

Since the government rolled out the new Covid-19 measures, the number of transactions has decreased drastically at fashion retailers. Last Friday, these transactions were 72% below the number observed the same day in the previous year.

Businesses in the personal care and wellness sectors such as hairdressers, beauty salons, and pedicure studios saw a 60% decline in the number of pin transactions in comparison to last year. Since then, the government has forbidden professions that require physical contact to be open until 6 April. As such, we expect to see a further decline in debit card transactions for these types of businesses this week.

72% fewer debit card transactions in fashion stores



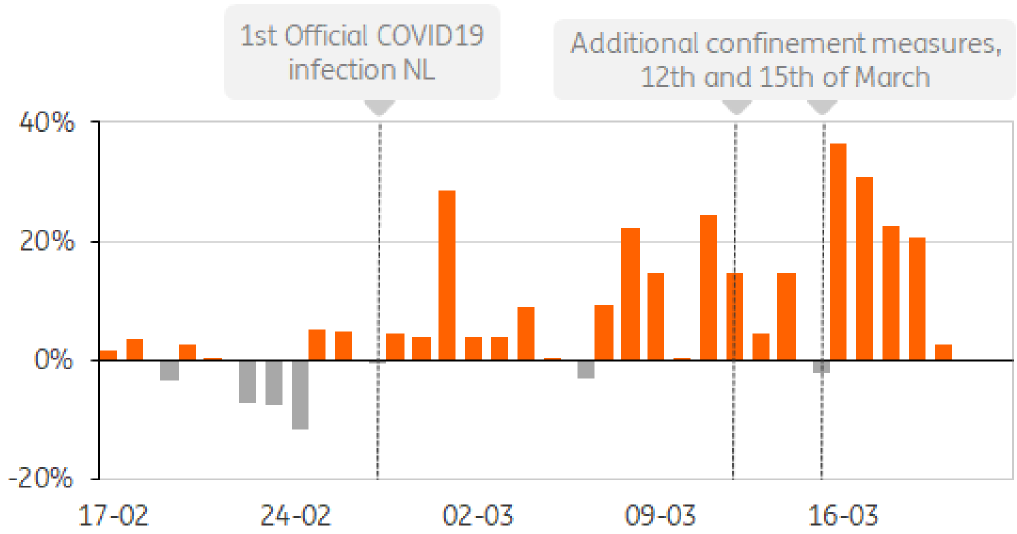
Source: ING, last obsercation: Friday, 20th of March

DIY shops peak with 40% more debit card transactions

DIY shops, furniture stores, and gardening centres show a strong increase in debit card transactions, peaking at almost 40% higher than a year ago. The spring-like weather conditions and the limited possibilities for leisure activities have seemingly fuelled an increase in gardening and house chores.

In the last couple of days, we have observed a smaller increase in debit card transactions in these types of shops. On Friday, 20 March we saw just 2% more transactions than in the year before. This does fit with the declining short-term trend. However, this number may also be biased downwards due to extra demand last year as the weather was even better back then.

Debit card transactions at DIY shops up by almost 40%



Source: ING, last observation: Friday 20th of March

Marten van Garderen
Senior Economist
+31 63 020 1203
marten.van.garderen@ing.com

26 March 2020
Article

Why Spain's economy is more sensitive to the Covid-19 shock

For a country that was already slowing down and had more than three million people unemployed before the coronavirus crisis hit, Spain's economy is acutely sensitive to the fallout. We explain why

Spain hit hard by Covid-19

In Spain, the first case of coronavirus was confirmed on 1 February, but the number of new infections started to accelerate in early March.

The country went into lockdown on 14 March. Only essential shops and pharmacies are open while schools, museums, libraries, hotels and restaurants have been closed and sporting and cultural events are prohibited. Initially, these measures were taken for 15 days, but have now been extended to at least until 12 April.

The longer a lockdown is necessary to combat the spreading of the virus, the harsher the economic downturn will be.

The economy is sensitive to the Covid-19 shock

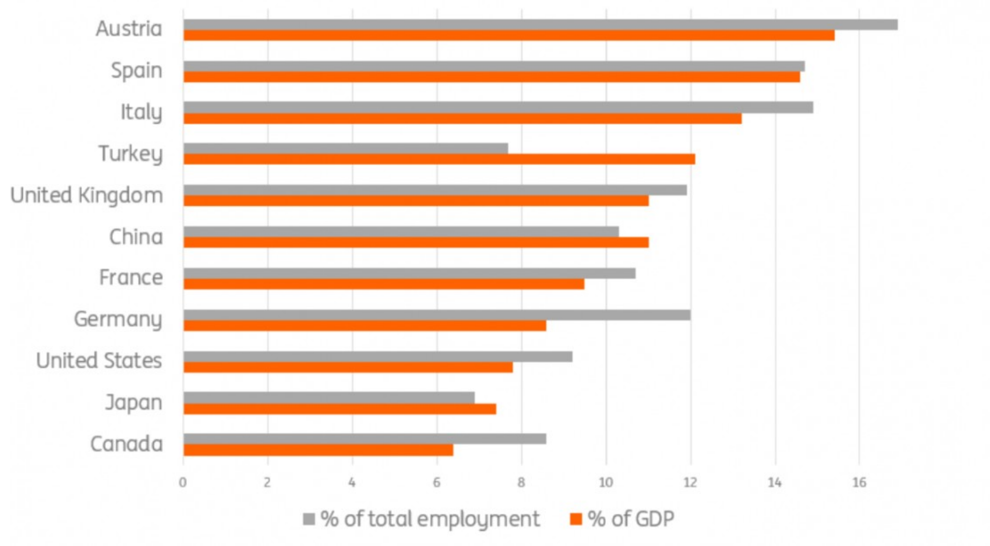
For the duration of the lockdown, the Spanish economy is more sensitive to its effects compared to other countries as it has a number of vulnerabilities:

- The economy slowed already in 2019 and was expected to slow further
- A high unemployment rate (13.8%) High government debt (close to 100% of GDP)
- A high structural deficit
- A minority central government and regional tensions.

But some other structural characteristics make it even more sensitive.

Tourism will be hit hard

Tourism and travel account for 15% of Spain's GDP and it looks like this sector will be hard hit. We already see that prices for flights to Spain and hotel prices for the Easter period have dropped significantly, implying a sharp fall in demand.



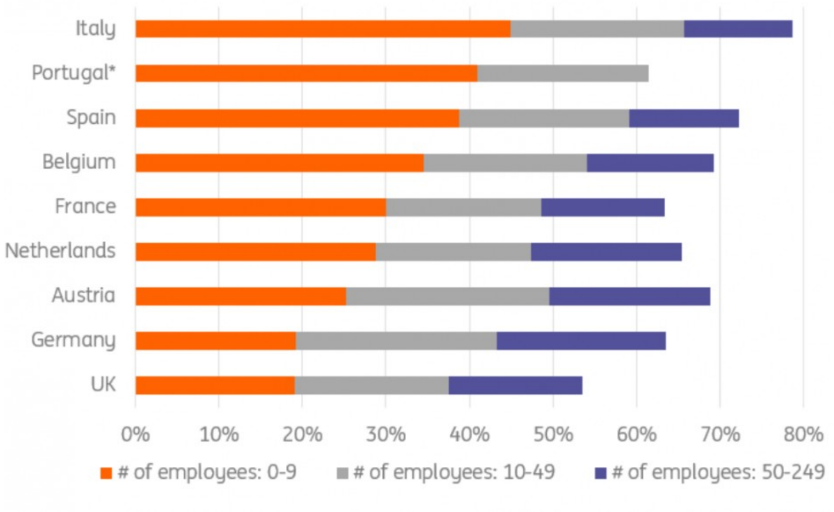
Source: World travel and tourism council, 2018

SME’s are important and more vulnerable

Academic research shows that small and informal enterprises are more vulnerable to exogenous shocks.

They have limited financial, managerial and technological resources. This is why, for example, it is more difficult for small firms to respond to the crisis with technological solutions such as telework.

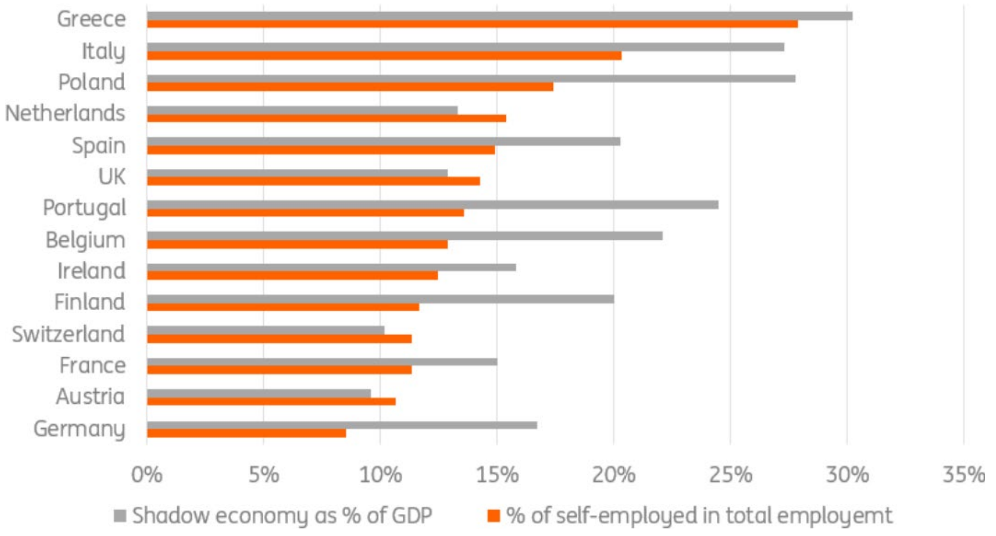
> How Firms Respond to Business Cycles: The Role of Firm Age and Firm Size



*Source: Eurostat 2016 * Figures for companies with 50-249 employees are not available*

Relatively high share of vulnerable workers

Workers in the informal sector have no social protection and are more difficult to reach with targeted measures while self-employed workers generally have lower social protection too.



Source: Data on informal economy are from Kelmanson et al. (2019). Data on self-employment are ING calculations based on Eurostat data for the year 2019.

Steven Trypsteen
Economist, Spain and Portugal
+32 2 547 33 79
steven.trypsteen@ing.com

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Article

France: An economy in shock

Based on innovative methods, INSEE has managed to estimate that the French economy was only operating at two-thirds of its capacity during the first week of lockdown

The slump set in very quickly

In France, INSEE published a first estimate of current activity across various sectors, together with its monthly business climate survey. The monthly survey ended on 23 March but the institute points out that the last week was poorly represented in the total sample, with only a few responses via the internet. Many respondents were already unavailable. The survey figures are therefore partial, and biased towards the first two weeks of March, so we will have to wait for the April results to have a more precise idea of the fall in economic sentiment during the crisis.

INSEE has therefore, for the first time, used new methods, many of them qualitative, to estimate the loss of activity by sector during the first week of lockdown, as well as the loss of demand by sector of activity. Both approaches (production and expenditure approaches) point to an economy operating at 65% of capacity.

They may be partial, but these are awful figures nevertheless. Business climate collapsed by 10 points in March, the largest drop since the survey was first conducted in 1980, and one point more than at the start of the financial crisis in October 2008. The declines are stronger in services and retail sales than in industry (where the impact still seems limited - Chart 1). Similarly, in the building sector, which has since come to a virtual standstill, the indicator has remained above its long-term average, reflecting the situation at the beginning of March. In services, the drop in business confidence reflects the message given earlier this week by the PMI indicators, where the services index fell to an all-time low of 29 (Graph 2).

The fall in industrial activity is still partial

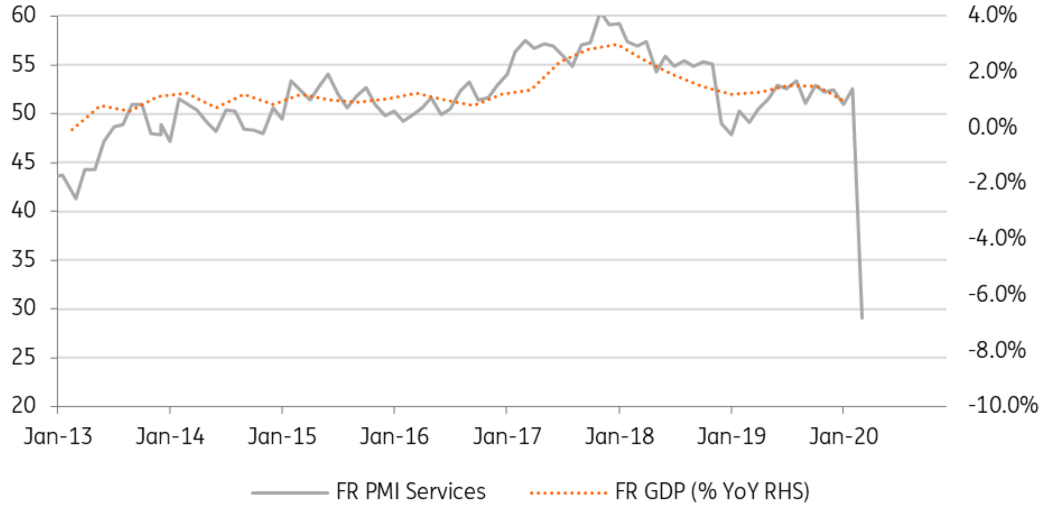
Source: Refinitiv Datastream

A shock differentiated by sector

According to INSEE, which used various new and often qualitative methods for its estimation, not all sectors were affected in the same way. It is obvious that this estimate is bound to evolve over time, but it nevertheless already offers more precise information on what is happening (an extraordinary light in the thick economic fog in which we must have the honesty to admit we are all immersed). INSEE uses two of the approaches used to compute GDP to present its main result: that only 65% of the French economy was operating during the first week of confinement.

According to the "production" approach (which considers the value-added of each sector to calculate GDP), the loss of value-added compared to a normal week ranges from 36% in market services to 52% in industry and nearly 90% in construction (Chart 3). The weighted average (by weight of these sectors in value-added) shows a drop of about 35%. Similarly, according to the "expenditure" approach (where GDP is considered as the sum of the different demands), the loss in consumption is estimated at 60% for industry (excluding food processing), 56% for market services (excluding real estate) and 90% for construction. The increase in activity in the agro-food industry, and the smallest loss in non-market and real estate services allows INSEE to obtain a weighted average of (again close to) 35%.

PMI services pointed to a strong contraction

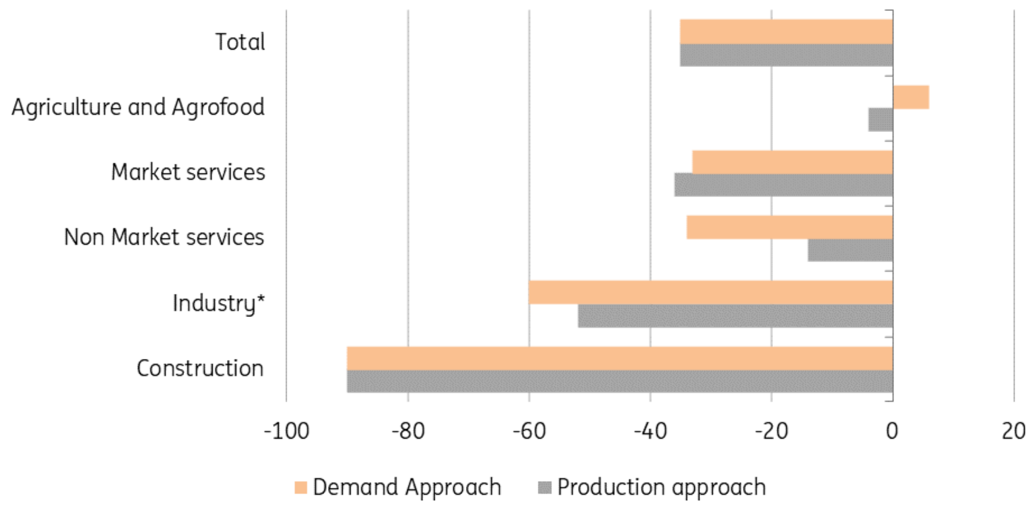


Source: Refinitiv Datastream

The economy is in shock

Both business cycle indicators and these initial signs of a decline in activity point to a sharp contraction in GDP. INSEE refused to quantify this in its publication but indicated that a fall of three percentage points (in GDP growth over the year 2020) per month of lockdown is a reasonable estimate of the shock. The way in which this shock will mark total growth in 2020 will depend essentially on the shape of the recovery and the length of the lockdown, two components for which only assumptions are possible at this stage. However, it is already clear that the first estimates of the recession (-1% in 2020) have quickly become outdated and will have to be revised downwards again very soon.

First estimates of activity losses per sector during the French lockdown



*Industry excluding construction and agrofood

Source: Refinitiv Datastream

Julien Manceaux
Senior Economist
+32 2547 3350
julien.manceaux@ing.com

27 March 2020
Article

Rates Daily: All PEPPed up

The US crisis response has been huge. The Eurozone is right up there too; the ECB showed its determination to support bond markets by ditching the issuer limit for the PEPP, another "whatever it takes" moment. A tip of the hat from markets was overdue. We are not there yet and expect rates to test lower again, with US cases having overtaken China's yesterday.

Market rates to continue to test lower

On a number of fronts the market place is in better shape. The primary market has been active again in recent days as the credit stress implied in spreads and CDS eased off the highs, across both the corporate and sovereign landscapes. Safety nets that have been built by the official sector, practically on a global scale, have been given a deserved tip of the hat by financial markets.

But evidence of stress remains. One measure of this comes from the $Libor curve. As practically every other measure of credit stress has eased, Libor in fact edged even higher, widening the spread to the risk free rate to 115bp. Part of the issue here is continued implied pressure on banks as the various rescue mechanisms take time to take-off.

But it is not just that. Behind the scenes there is ongoing default event risk spanning the financial and corporate world that will likely be uncovered in due course. In addition, even in a scenario where economies re-open by the summer, there will be some severe collateral damage left in its wake. Some of this is currently being masked by rescue mechanisms.

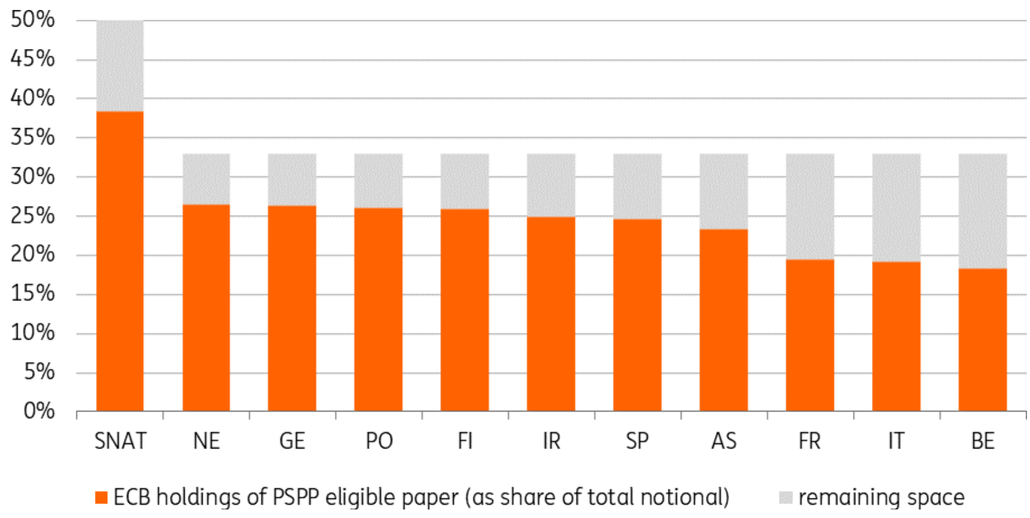
These have been a welcome few days, but the risks remain elevated. We still look for lower market rates and yield in the near term. Eventually we will have a big supply-driven curve steepening process, but we are not ready to make that switch just yet. We still think the US 2yr yield can hit zero by the summer.

The ECB shows determination

Eurozone government bond markets rallied across the board yesterday, 10Y German bond yields falling by 10bp to -0.36%. The spread of Italian bonds over Bunds tightened by more than 20bp. We agree with the move lower in EGB yields but, pending more steps towards common fiscal risksharing, we think the risk-reward in core bonds is more palatable.

The ECB had greeted markets with new details regarding its Pandemic Emergency Purchase Programme (PEPP) which we believe has been rightly touted as a game changer. The official legal decision, the publication of which kick-started the new facility yesterday, laid out a flexibility going well beyond what was initially announced.

ECB holdings as share of the outstanding PSPP eligible bond markets



Most importantly the ECB has decided not to apply the issue limits to PEPP purchases. This is crucial for countries where the Public Sector Purchase Programme (PSPP) has already approached the 33% share limit of what the central bank allowed itself to hold. According to our estimates these countries are Germany, the Netherlands and Finland, but also Portugal and Ireland where more substantial purchases should now be possible under the €750bn envelope. That does not mean Italy is left out in the cold. While the ECB's capital subscription key remains the guiding principle for the cumulative distribution of purchases among jurisdictions, the PEPP explicitly allows for flexibility "over time, across asset classes and among jurisdictions."

Additionally the ECB will allow PEPP to buy public sector paper with maturities as short as 70 days. Making shorter dated public sector paper eligible for the PEPP means that the ECB could potentially buy treasury bills from 3 month maturity onwards. This matches the strategy of debt agencies ramping up bills supply to cover their immediate funding needs. And it would be consistent with the nature of the crisis which constitutes a short term emergency. However, as a result the duration impact of PEPP purchases could be substantially smaller if the ECB picks up a larger part of what could be a substantial increase in money market issuance in coming months. In combination with the relaxed issue limits this will have contributed to yesterday's remarkable 6bp steeping of the German 10Y-30Y bond curve.

A final thought: There has been no mention of reinvestments of PEPP holdings. While the €120bn envelope was added to the existing APP and thus falls under its respective communication regarding reinvestments, the PEPP has been set up as a separate programme. There may still be a decision towards the end of the year on the matter, but again the short term nature of the crisis suggests that initially it may have been intended to let the portfolio run-off after 2020 when purchases have concluded. This potentially being the trade-off for allowing the PEPP to go beyond the limits that constrain the PSPP.

Let these be tomorrow's worries, however. For now we would take the ECB's decisions as testament to its determination in supporting bond markets, opening the door to lower rates and further spread tightening. This is just as well as yesterday's EU Council ended with little agreement on a way forward to tackle the impending economic crisis. The call of 9 member states to issue joint debt instruments (coronabonds) was reportedly rebuffed by the Netherlands and Germany.

Padhraic Garvey, CFA
Regional Head of Research, Americas
1 646 424 7837
padhraic.garvey@ing.com

Benjamin Schroeder
Senior Rates Strategist
+31 20 563 8955
benjamin.schroder@ing.com

Antoine Bouvet
Senior Rates Strategist
+44 20 7767 6279
antoine.bouvet@ing.com

25 March 2020
Article

India: Complete lockdown to break Covid-19

The three-week nationwide lockdown will significantly dent India's GDP growth, making this an even worse year for the economy than the 2008 Global financial crisis. This demands a stronger policy response. Until then, the looming economic misery is poised to push USD/INR above 80 in the coming days

Breaking the Covid-19 chain

Prime Minister Narendra Modi has announced the complete lockdown of the country for three weeks to break the Covid-19 transmission cycle as confirmed infections crossed the 500 mark. Starting today, 25 March, the lockdown imposes a total ban on all non-essential businesses and prevents people from stepping out of homes, with anyone flouting rules facing fines and even jail. The government also has allocated $2 billion for the healthcare sector in this emergency.

This follows lockdowns in a number of Indian states already underway, while the authorities have also restricted international arrivals into the country and suspended domestic air and other modes of transport.

The economic impact

The Prime Minister warned the crisis risked pushing the country 21 years backwards if people failed to comply with the restrictions during the lockdown.

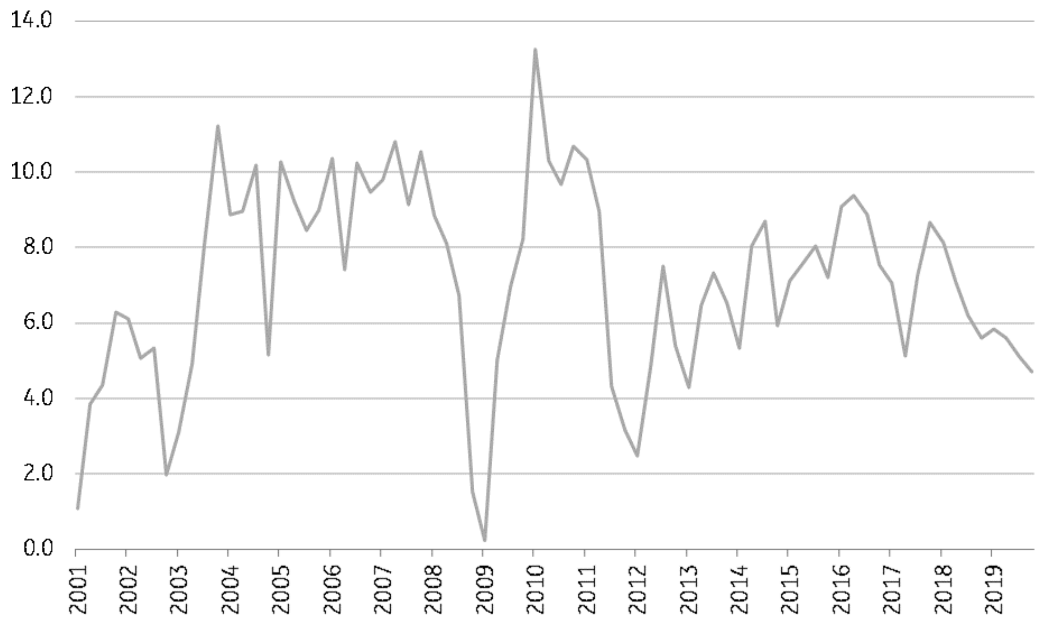
Just as everywhere else in the world, the Indian economy is bracing for the fallout of this unprecedented event. We expect the lockdown to dramatically reduce GDP in the current and subsequent quarters, while there will be prolonged economic gloom throughout the rest of the year.

> If we are not able to manage this pandemic in the next 21 days, the country and your family will be setback by 21 years. – Prime Minister Narendra Modi

The biggest whammy will be to private consumption, which accounts for 57% of India's GDP. With all non-essential consumption dropping virtually to zero for a week in the current quarter means year-on-year GDP growth plunges to just about 1%, and with two weeks of a hit in the next quarter could push it to about -5%. We would anticipate at least one more quarter of drag keeping growth in negative territory, beyond which the policy support and favourable base effects should drive recovery back to positive growth.

While this shaves a full percentage point from the yearly growth in the current fiscal year (ends on 31 March 2020) to our estimated 4.0%, we have revised our forecast for the next financial year to 0.5% from 4.8%. This is a far cry from the government's expectation of over 6% growth outlined in the FY2020-21 budget, which will surely be scaled back significantly as the Finance Ministry prepares fresh stimulus to stem the crisis. However, citing significant policy support, the official growth outlook may not be as bearish as ours, though we note that official growth tends to be overestimated by about 2%.

Real GDP growth (% year-on-year, quarterly data)



Source: Bloomberg, ING

More policy support on the way

Finance Minister, Nirmala Sitharaman, has announced a series of support measures, though these only included waivers and relaxations of tax and bankruptcy codes, no material stimulus which still seems to be in the making. The talk on the street is of about $20 billion (1% of GDP) stimulus. But given the enormity of the crisis, it could be bigger than that.

This also raises the chance of the Reserve Bank of India cutting its policy rates by more than our 50bp forecast at the meeting next week (3 April). The lockdown will be associated with a significant drying of financial system liquidity in coming weeks. However, the RBI has been pumping cash into the system through repo auctions and will be prepared to do more to support any surge in liquidity demand post-lockdown.

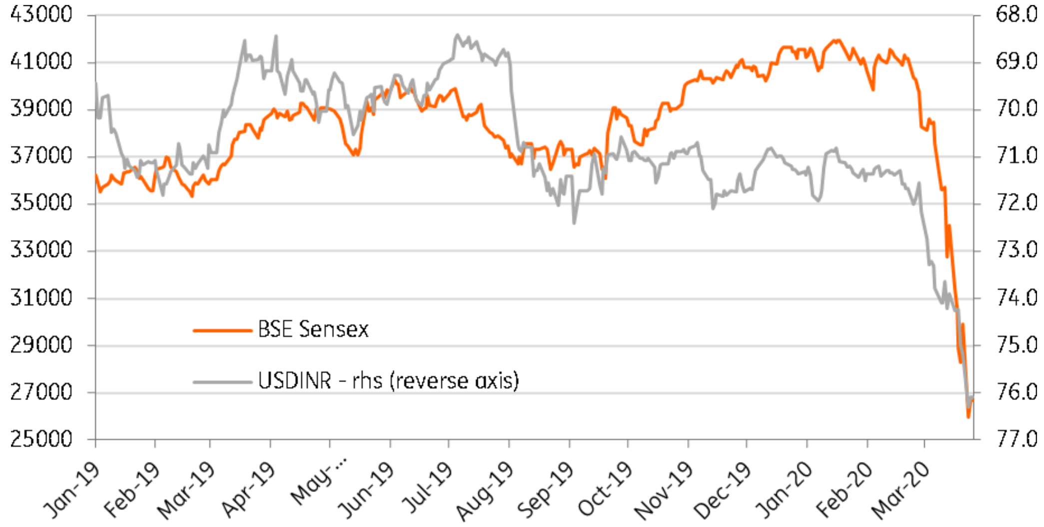
Market pricing for the worst

Markets are pricing in a massive economic impact of this health crisis. The BSE Sensex suffered its steepest-ever single-day plunge by 13% on Monday, a day after a nationwide lockdown on Sunday. It recovered on Tuesday. But this new and longer lockdown will likely push it deeper into negative territory today. The stock market remains open for trading during the lockdown.

Government bond yields remain under upward pressure with the 10-year bond up now 30bp to yield 6.3% from over a decade low hit earlier this month. And, the Indian rupee (INR) continues on a steady depreciation path, trading above 76 against the US dollar. We see no end to these market trends until we have signs of Covid-19 coming under control.

For now, we see the USD/INR rate trading past 80 USD within days.

Markets - one way down



Source: Bloomberg, ING

Prakash Sakpal
Economist, Asia
+65 6232 6181
prakash.sakpal@asia.ing.com

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