Monthly Economic Update
Entering the next phase

Three scenarios for the global economy and markets as the long road to recovery is laid bare

THINK Economic and Financial Analysis

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US: the long road home

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Eurozone: this is big

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China: challenges shift from supply chain to global demand

- *China's economy is recovering from the damage caused by Covid-19. The broken supply chain is not the top issue anymore. Weak global demand is. As a result, companies within China may focus more on the domestic market given stimulus from the "New Infra" scheme. But the risk of a new trade and technology war is returning*

Asia: Lockdowns work, they also hurt

- *There is a really wide spectrum of experience for Asia in terms of the Covid-19 outbreak, the responses, the state of the economy and the proximity to a reopening of the economy where it has been closed*

Central and Eastern Europe's fiscal and monetary response to Covid-19

- *What is behind the magic of high numbers of anti-crisis programmes to combat the economic fallout from Covid-19? Some CEE countries can afford policy responses like developed markets as their central banks kickstart QE support programmes*

Rates: Taming the supply monster

- *The size of government deficits built to finance the Covid-19 induced lockdown are nothing short of staggering. Now they must be financed. That means lots more government bond issuance. Had it not been for central bank buying, the impact would be for much higher rates. We should see curves steepen. But market rates will not be let rocket higher*

Asset Markets: Which asset class has got it right?

- *Equity markets have retraced around 50% of their Q120 sell-off and are focusing on the recovery. Credit markets are also performing well. However, sovereign debt, commodities and to some degree FX markets are still pricing recessionary levels. Which asset class has got it right?*

Negative oil prices may be behind us

- *Oil markets made history in April, with NYMEX WTI trading into negative territory for the first time. While much of this was technical in the lead up to the 20 May contract expiry, it also reflected the state of the physical oil market, where we have seen significant demand destruction. But we think the worst is behind us now*

Mapping the global lockdown

- *An index based on Google mobility data indicates which economies have so far been more or less affected by the lockdown. While differences are large, one thing stands out: this is truly a global symmetric shock like no other*

Asia: What can we learn from Asia's pandemic?

- *Asia is really diverse, so it will come as no surprise that we have learned very different things from different economies during the Covid-19 pandemic*

US versus eurozone: 'I did it my way'

- *In this article, we compare the US and eurozone policy response and explore potential differences in the recovery phase*

The rising risk of an asymmetric eurozone recovery

- *Judging from mobility data, the lockdown measures in the eurozone seem to have different impacts across countries. With some countries easing the lockdown measures, while others remain locked down for longer, the risk of an asymmetric recovery increases*

Will the eurozone survive this crisis?

- *The highly emotional debate on coronabonds, the discussion on a pan-European fiscal response and the cumbersome negotiations on a recovery fund has brought back speculation about a return of the euro crisis and a potential break-up of the eurozone*

Carsten Brzeski
Rafal Benecki
Rob Carnell
Bert Colijn
Dmitry Dolgin
Padhraic Garvey
Leszek Kasek
James Knightley
Warren Patterson
Iris Pang
Jakub Seidler
James Smith
Valentin Tataru
Steven Trypsteen
Chris Turner
Peter Vanden Houte
Peter Virovacz

Entering the next phase

This is still the mother of all fast-moving environments. While the latest economic data paints an even clearer picture of the depth of the crisis across the world, some European countries have already entered the next phase of the Covid-19 pandemic: the gradual easing of lockdown measures. Other countries, including the US, are likely to follow in the coming weeks. This loosening of restrictions is taking somewhat longer than initially expected and is also more gradual. It is too soon to expect a smooth transition back to normal life and a temporary, partial return to lockdown measures cannot be ruled out.

Plans to reopen suggest that the worst of the economic downswing might be behind us. However, available data shows that the damage from the crisis has been even worse than expected. Most Western countries will see the sharpest contractions in their economies since the 1930s. With the latest information, we expect declines of more than 10% in the developed world and have consequently had to revise down our estimates for GDP growth in 2020.

In the traditional alphabet soup of expectations, the recovery will still be U-shaped. However, with the more gradual easing of lockdown measures and much uncertainty about the permanent damage that Covid-19 has inflicted on the global economy, there could be innovative additions to this recipe. Think of a cursive ‘r’, a capital ‘G’ or the swoosh of a well-known American athletic shoe and apparel retailer.

As we enter the next phase of the crisis, the focus will shift from imminent firefighting to structural changes and the nature of the recovery. In this regard, policymakers in the developed world might want to look at possible lessons from the Asian experience. My colleague Rob Carnell has already done some work for them and you can find his analysis in our Monthly Update. James Knightley and Peter Vanden Houte have compared the US and eurozone recoveries, and to give you a sneak peak, faster does not necessarily mean stronger. And Bert Colijn shows that Google mobility data gives an almost real time picture of the impact of the lockdown and current easing. Finally, there is a high risk that the recovery will lead to new divergence in the eurozone,, which eventually could lead to new political tensions which some believe could put the survival of the entire monetary union at risk. Read about this and much more in our new Monthly Economic Update.

Our six key views this month

1 Sharp decline in second-quarter GDP globally
Expect 10%+ quarterly declines in developed world

2 Economic recovery to be very gradual
Major economies unlikely to hit pre-virus size until 2022 or later

3 Inflationary pressures unlikely to return quickly
Despite huge stimulus, spike in unemployment to keep inflation muted

4 Supply chains to take time to recover
Some specific key prices could temporarily spike in areas of shortage

5 The worst is past for the oil market
ICE Brent unlikely to go negative. USD/bbl 45 possible in 2H20

6 Risk assets already well priced
Equity and credit markets will struggle to extend recent rally

Source: ING

Carsten Brzeski, Frankfurt +49 69 27 222 64455

ING's three scenarios for the global economy and markets

ING base case

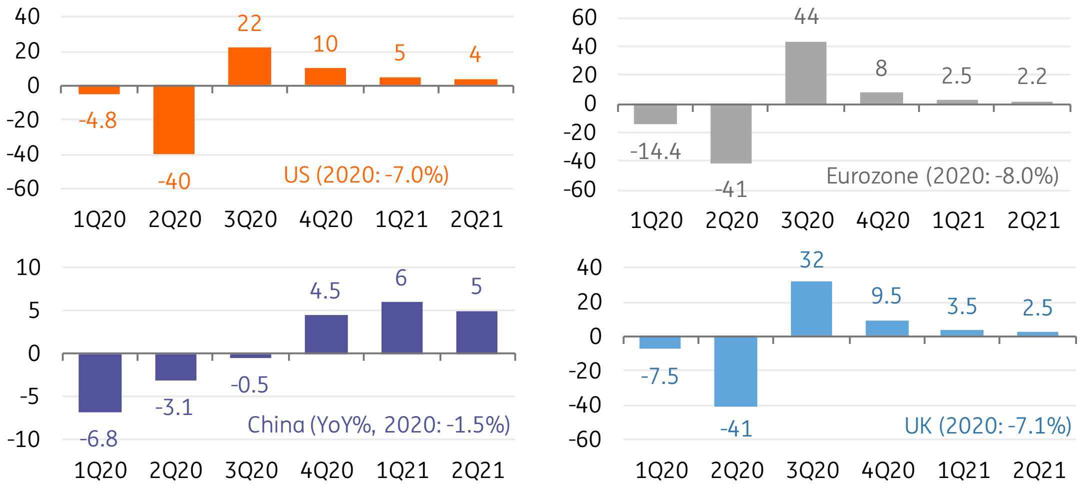
Assumptions

- Full lockdowns end by summer (varies by country)
- Global travel remains restrictive
- Home-working stays in place where possible
- Social distancing remains a feature for 6-12 months
- Winter outbreak seen as more manageable

Possible health drivers

- Widespread testing gives better data on possible winter outbreak
- Better contact tracing helps manage another outbreak without full lockdowns
- Progress made on vaccine by year-end but not widely available until 2021
- Critical care surge capacity increases. Certain drugs available to help reduce time in hospital

Real GDP growth (QoQ% annualized, YoY% for China)



	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21
US 10Y yield (%)	0.65	0.50	0.75	0.75	1.00	1.00	1.25	1.50
EUR/USD	1.10	1.10	1.15	1.20	1.18	1.15	1.12	1.10

Alternative scenarios

Scenario 2: Winter lockdowns return

- Lockdowns end by summer but come back over winter
- Winter outbreak not manageable
- Social distancing remains a feature for 12 months

2020 GDP	United States	Eurozone	China	Markets (End 2020)	10Y yield	EUR/USD
	-8.0%	-10.1%	-2.7%		0.50%	1.12

Scenario 3: 'Worst case'

- Lockdowns remain largely in place until early-2021
- Vaccine unavailable to the masses for 12-18 months
- Social distancing remains a feature for 12-18 months

2020 GDP	United States	Eurozone	China	Markets (End 2020)	10Y yield	EUR/USD
	-14.7%	-18.5%	-4.5%		0.25%	1.20

Note: GDP forecasts have been rounded to nearest whole or half number
Source: ING

US: the long road home

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

While there are glimmers of hope as a re-opening tentatively gets underway, the damage wreaked on the economy will take a long time to repair

People walk on Brooklyn Bridge Park's rebuilt Squibb Bridge in New York. Source: Shutterstock

The economic newsflow over the past month has been grim with activity and employment both collapsing. The running total for new unemployment benefit claims since the initiation of lockdowns is in excess of 30 million. The majority of those impacted were employed in retail, travel and hospitality, but unemployment is spreading to other sectors.

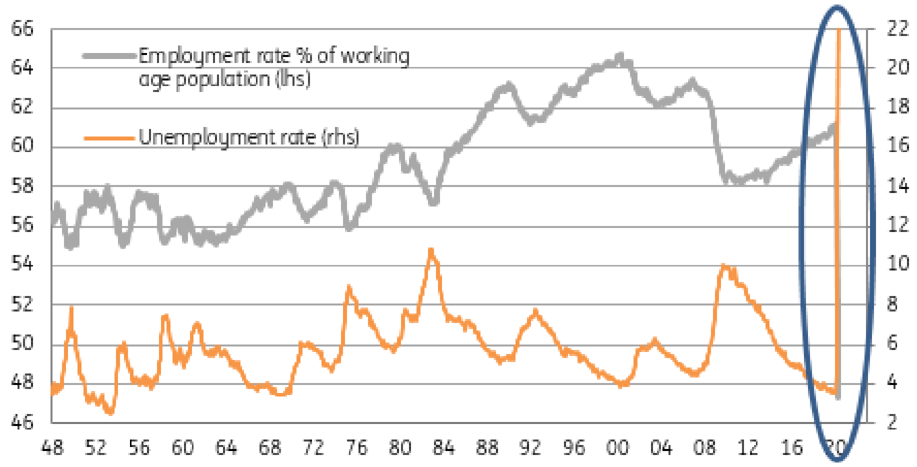
The latest ISM manufacturing production index hit an all-time low while its employment component is the weakest since 1949, suggesting significant job losses are coming in this sector. Business services will not be immune while the devastation in the oil and gas industry is plain for all to see. We expect unemployment to breach the 20% level in May with a clear risk it gets close the 1933 peak of 24.9%.

We must also remember that one third of Americans aged 16-65 are not classified as economically active – they are students, retirees, homemakers, carers or sick. This leads us to yet another sobering statistic – that less than half of working age Americans will be earning a wage this month. In an election year, the call for politicians to re-open the economy is only going to get louder, irrespective of the health advice.

Some states have started the process, most notably Georgia, Tennessee and South Carolina. However, even here we are a long way away from "normal". Social distancing requirements mean restaurants can only open with much reduced capacity to the extent that it simply isn't economically viable for many to do so. At the same time, there is consumer caution about going to shops and restaurants. This is likely to be repeated elsewhere as other states start easing restrictions. With numerous businesses likely to fail as the lockdowns take their toll, unemployment is unlikely to fall quickly – 8-10% would be a good outcome for end 2020.

After contracting 1.2% in 1Q 2020 (4.8% annualised), we expect the economy to experience a peak to trough decline in excess of 13% by the end of 2Q 2020. Given ongoing social distancing for several more months, lingering consumer caution and the legacy of nearly 40 million jobs lost, we see little prospect of a V-shaped recovery. Even with additional fiscal support, the lost economic output may not be recouped until early 2023.

Fig 1 How bad could it get? Unemployment & employment 1948-2020 with ING's forecast for May

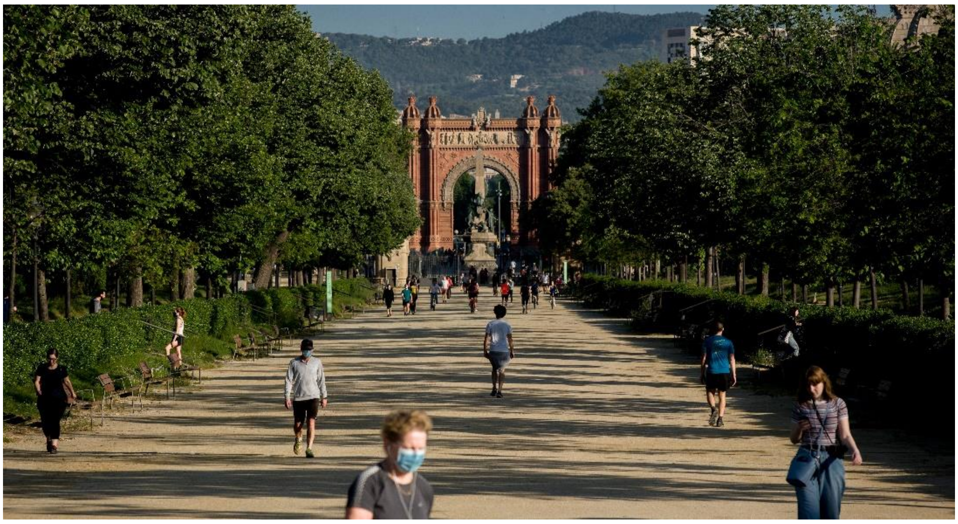


Source: Macrobond, ING

Eurozone: this is big

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg
Brussels +32 2 547 8009
peter.vandenhoute@ing.com

With the lockdown measures lengthened and only phased out very gradually, the eurozone economy is likely to shrink by around 8% this year. The European Central Bank will continue to do the heavy lifting in terms of measures to soften the blow, though the verdict of the German Constitutional Court, questioning the legality of QE, certainly doesn't help



People walk along the main avenue the Ciutadella Park in Barcelona. Source: Shutterstock

The big one

It is now very clear that the economic shock caused by Covid-19 is big. Very big. In the first quarter, eurozone GDP shrank by a non-annualised 3.8% on the back of a two week lockdown in most member states. Given the fact that the confinement lasted, on average, more than a month in the second quarter and that the relaxation of the lockdown measures will only be very gradual, the contraction in the second quarter is likely to be between 10 and 15% quarter-on-quarter non-annualised. The good news is that the number of new infections is now clearly on a downward path, meaning that the epidemic is under control. However, as long as an effective cure and vaccine remain unavailable, economic and social life will not return to normal, and the need for social distancing will continue. This means that even after the most severe lockdown measures have ended, production is still going to remain below capacity for quite some time.

Fig 2 Unemployment likely to rise significantly

Source: Refinitiv Datastream

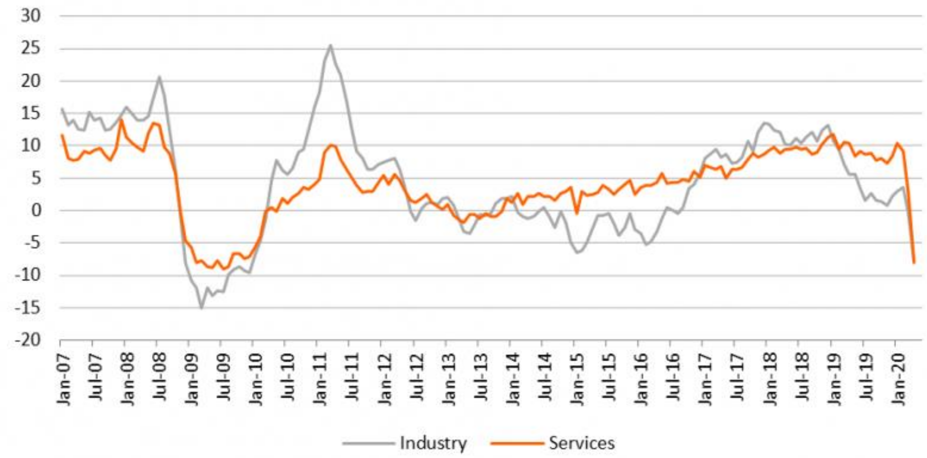
Second round effects

On top of that, we also have to pencil in some negative demand effects. Even with the temporary unemployment schemes, trying to preserve as many jobs as possible, a number of companies are likely to fail or restructure, transforming some of the temporary unemployment into permanent job losses. We also expect business investment to take a hit, as collapsing demand and balance sheet problems will lead to delays or the cancelling of investment plans. Given the longer than expected lockdown, we had to cut our growth forecast in our base case to an 8% fall in GDP this year, which places us near the middle of the possible range of outcomes that the ECB put forward (between 5% and 12% GDP contraction). For next year, we expect a rebound of 4.0%, although for this to happen, we have to assume that we don't see a repeat of the mistakes after the financial crisis and that budgetary policy remains relatively expansionary. However, we remain doubtful that much stimulus will come from a European programme, as the size of the Recovery Fund that the European Commission has been mandated to put in place, will remain limited.

Deflationary forces

With the crash in oil prices, headline inflation is going to be significantly lower this year. April already saw HICP inflation falling to a mere 0.4%. Core inflation declined to 0.9%. With the negative output gap widening rapidly, core inflation will remain under downward pressure. That said, in the course of 2021 a slightly higher core inflation rate might be observed, though more a kind of normalisation than a trend. Oil prices are expected to regain some lost ground, but even then we see headline inflation at only 0.5% this year and 1.4% next year.

Fig 3 Expected selling prices survey



Source: Refinitiv Datastream

The ECB versus the German Constitutional Court

The ECB keeps adding to its pandemic fighting measures, with a further easing of collateral rules (now also including 'fallen angels' corporate bonds), new liquidity lines and an even more generous pricing of the Targeted Longer-Term Refinancing Operations (TLTRO III). During the press conference after the meeting of the Governing Council, ECB President Christine Lagarde repeated several times that the ECB stands ready to use all available tools and deploy full flexibility in fighting the crisis. In a blog post, ECB Chief Economist Philip Lane added that non-fundamental volatility in spreads in government bond markets impairs the smooth transmission of monetary policy across countries and that the central bank should counter this. In that regard, we deem it likely that in the course of this year, the size of the Pandemic Emergency Purchase Programme will be substantially increased to further support the bond markets of the weaker countries. However, the verdict of the German Constitutional Court, questioning the legality of the Public Sector Purchase Programme, will force the ECB to tread carefully in this regard

China: challenges shift from supply chain to global demand

Iris Pang
Economist, Greater China
Hong Kong +852 2848 8071
iris.pang@asia.ing.com

China's economy is recovering from the damage caused by Covid-19. The broken supply chain is not the top issue anymore. Weak global demand is. As a result, companies within China may focus more on the domestic market given stimulus from the "New Infra" scheme. But the risk of a new trade and technology war is returning

https://think.ing.com/downloads/newsletter-selligent/article/china-challenges-shift-from-supply-chain-to-global-demand/
Source: Shutterstock

Broken supply chain no longer an issue if there is little demand

Back in February, city lockdowns kept Chinese workers away from factories. This created a sharp disruption in the global supply chain.

By mid-March however, many of these workers were finally able to leave their home towns and go back to work. But at the same time, buyers in the US and Europe were withdrawing orders. With no clear indication as to when global demand would recover, many Chinese factories were forced to lay off the workers they had just hired.

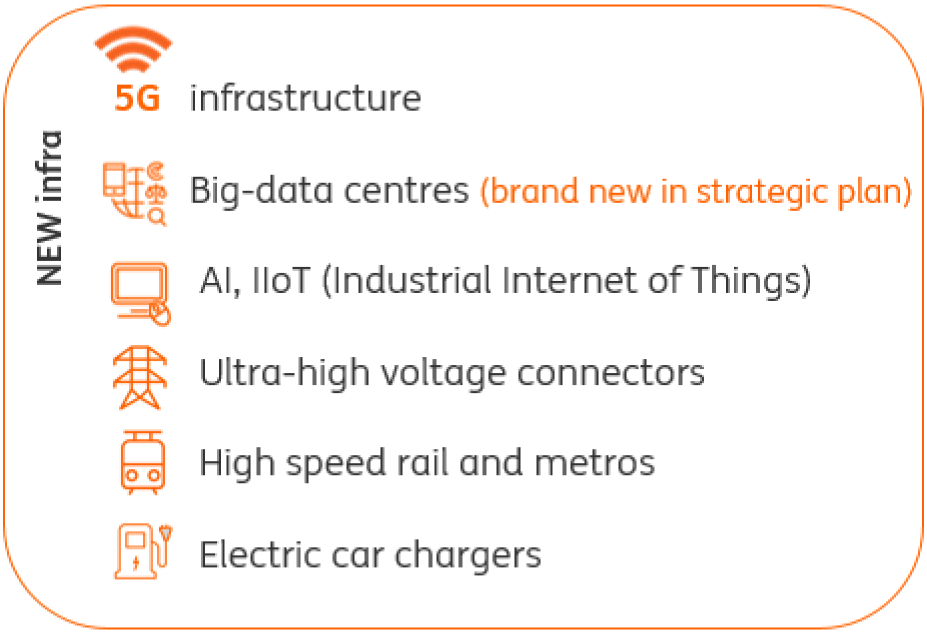
This has yet to be fully reflected in the GDP contraction of 6.8% year-on-year in the first quarter. More of this will be seen in the coming quarters as unemployment rates are high in buyers' markets.

Manufacturers turn to the Chinese market

Factories are now turning to the domestic market. The moderate recovery of inbound tourism during the May Golden Week holiday, even with strict social distancing measures imposed, has given some hope to retailers and manufacturers.

Together with the new infrastructure plan, which is worth CNY8 trillion in 2020, China may be a more promising market for retailers and digital services.

Fig 4 New infrastructure plan



Source: ING

The "New Infra" plan to support the economy

The Chinese government has created a theme of stimulus for the recovery, dubbed "New Infra". It's 'new' because it has a lot of digitalisation elements compared to the 'old' infrastructure, which is largely bricks and mortar.

5G, a big-data centre, AI & Industrial Internet of Things (IIoT), ultra-high voltage connections, high-speed rails and metro networks, and electric-car chargers, are the major elements in the scheme. The plan consists of 22,000 projects, which is worth a total of CNY49.6 trillion over several years, of which 8 trillion yuan will be invested in 2020. Most of this is private investment, combined with government strategic planning.

Frankly, elements in the "New Infra' scheme are not brand new, with the exception of the big-data centre project. The big-data centre idea seems to have emerged from the Covid-19 crisis, with many office workers forced to work from home, while factories have tried to control operation lines remotely without enough workers. These activities have increased the flow of data quite suddenly. The project could allow China to become the champion of remote working in the next decade and also more prepared for an aging population.

Recovery depends on trade and technology wars

Even with a well-planned stimulus scheme, a trade and technology war with the US would make China's road to recovery more difficult.
Our GDP forecast of -1.5% for the whole of 2020 is based on the assumption that trade and technology wars won't intensify. We may downgrade our GDP forecast if this assumption is wrong.

Asia: Lockdowns work, they also hurt

Rob Carnell
Regional Head of Research, Asia-Pacific
Singapore   +65 6232 6020
rob.carnell@ing.com

There is a really wide spectrum of experience for Asia in terms of the Covid-19 outbreak, the responses, the state of the economy and the proximity to a reopening of the economy where it has been closed

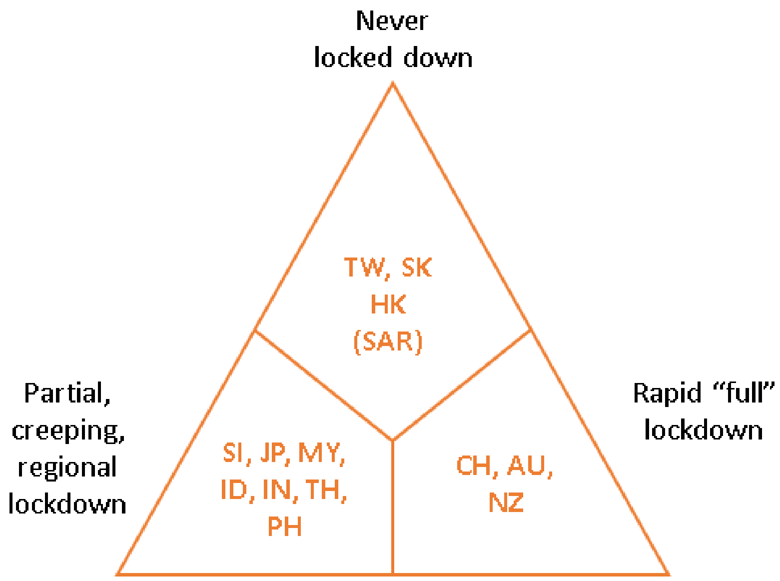
Workers produce protective masks at a factory. Source: Shutterstock

Asia can be split into three groups

In terms of the pandemic, the response, and the state of the economy, you can split Asia into three main groups. :

1) Didn't go into complete lockdown – South Korea, and Taiwan
2) Locked down quickly, and with vigour – (China), Australia, New Zealand
3) Gradually locked down, partial lockdowns, or late lockdowns – everyone else

Fig 5 Asia Pacific and the pandemic



Source: ING

No lockdown sees the smallest GDP loss

Both Taiwan and Korea are not far from a domestic "business as usual" setting, except for the fact that they are "islands" in a world where almost everyone else is locked down.

But both are seeing some mixed signs in manufacturing, though the true magnitude is only likely to be evident with the release of April data. Trade figures have been extremely weak. But domestic demand, though depressed, is beginning to come back.

> *"Economic recovery will only come with an end to lockdowns and a moderation in the local aspects of the pandemic"*

In the vigorous lockdown group, these counties are already largely out of the most severe forms of lockdown, and phasing to less restrictive forms, with greater freedom of movement and more retail opportunities. Both Australia and New Zealand, like China, show very low daily new Covid-19 case. Further opening of the economy will likely be phased, and quickly reversible. Policy measures have largely been taken and whilst reversal is not on even the medium term calendar, it is hard to see further substantive monetary or fiscal easing. Nonetheless, recovery is likely to be slow. Forget V-shaped.

The final group includes the late/partial/incremental lock-downers, into which you can put most of the ASEAN, including Singapore, as well as Japan (though not technically a lockdown in either).

In some cases, progress with the outbreak is being made, with daily new cases numbers trending lower. In others (Japan) the trends are upwards. But a lack of reliable testing makes it impossible to generalise about this group or make coherent comparisons. Many lockdowns are being extended into May. Singapore and Japan will probably be in lockdown until early June. Indonesia may have to adopt tougher measures after the end of Ramadan. Also in this group is India, where easing restrictions seems premature given the Covid-19 backdrop.

Lockdowns work, they also hurt

While lockdowns remain in place, the economies of these countries will continue to suffer extreme stress in terms of business failure, household spending and employment shocks. Fiscal measures have already been implemented on a large scale where possible, and monetary policy likewise (though with less direct impact).

Some modest further easing is likely on an ongoing basis where available, but in a few cases will this be substantial or definitive. Economic recovery will only come with an end to lockdowns and a moderation in the local aspects of the pandemic.

In time, global pick up also lends a hand.

Central and Eastern Europe's fiscal and monetary response to Covid-19

Rafal Benecki
Chief Economist, Poland
Warsaw +48 22 820 4696
rafal.benecki@ingbank.pl

Leszel Kasek
Senior Economist
Poland +48 22 820 5075
leszek.kasek@ingbank.pl

Peter Virovacz
Senior Economist, Hungary
Budapest +36 1 235 8757
peter.virovacz@ing.com

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

Valentin Tataru
Economist
Bucharest +40 31 406 8991
valentin.tataru@ing.ro

Dmitry Dolgin
Chief Economist, Russia and CIS
Moscow +7 495 771 79 94
dmitry.dolgin@ingbank.com

What is behind the magic of high numbers of anti-crisis programs to combat the economic fallout from Covid-19? Some CEE countries can afford policy responses like developed markets as their central banks kickstart QE support programs

Above-and below-the-line rescue measures

Central and Eastern Europe countries are part of a select emerging market group, which can afford developed markets-like policy responses to Covid-19 recession: large fiscal stimulus backed by central bank asset purchases on the secondary market to prevent side-effects of higher public borrowing needs i.e. mitigate tightening of financial conditions, which would limit the positive impact of fiscal impulse.

The discretionary policy response to the pandemic can be split into:

1) **Above-the-line measures**: direct support for companies and households through new spending, cuts in tax or social security contributions moratoria - they impact budgets and debt immediately.

2) **Below-the-line measures**: public loans and capital injections and guarantees to firms in troubles. They affect fiscal accounts indirectly and partially.

Hungary: Biggest anti-crisis response package

Hungary announced the biggest anti-crisis response package of 13.6% of GDP, of which 60% is liquidity support, and the remaining 40% is direct fiscal support (the highest relaxation of tax burdens in CEE).

The National Bank of Hungary is starting QE with Govies purchases on 5 May. In 2020, QE may reach up to 3.2% of GDP and cover 16% of gross public borrowing needs. In the past, mortgage and corporate bonds were already on the list of eligible assets purchased by the central bank, and these programmes are likely to be extended.

Czech Republic: Guarantees-based package and the most conservative central bank

The Czech Republic pledged to deliver the second biggest anti-crisis programme in the region of 12.3% of GDP.

It seems to be high, but it requires much red tape, so it starts slowly and doesn't serve as fast as expected. Also, public guarantees constitute 70% of the programme, while direct fiscal support amounts to just 3.2% of GDP. The programme does not benefit from support from the central bank in terms of QE.

The Czech national bank remains the most conservative in the region as it cut interest rates but claims that QE is the last resort measure, which can be deployed in the case of a prolonged recession, the threat of deflation or financial stability risk.

Poland: Largest QE-based fiscal shield in the region

Poland ranks third in this comparison with the announced measures totalling 11.3% of GDP.

But the fiscal component encompassing direct support is the most generous in the region. The Polish government took the boldest redistributive measures, with additional discretionary spending on protecting jobs, sustaining incomes for households, and supporting firms. Overall, above- the- line fiscal measures should reach 6.5% of GDP. In relation to GDP, this is the highest fiscal stimulus not only in CEE but in Europe.

Such a fiscal shield would not be possible without a large central bank programme of asset purchases, which may reach 8.4-10.4% of GDP according to our estimates and should be the highest in the region. So far, a large expansion of central bank balance sheet has not affected the currency. We explain it by a strict liquidity control - money printed is tightly managed by the state-owned bank BGK so shorting PLN isn't easy. NBP cut interest rates aggressively and frontloaded aggressive POLGBs purchases, which led to a drop in T-bond yields.

More than half of the projected net public borrowing needs in 2020 should be satisfied by other bonds aside from Polish government bonds, issued by BGK and the Polish development fund. They should be bought by local banks, and then to a large extent purchased by the central bank, and foreign investors looking for extra spread vs expensive POLGBs. Strong central bank support for the government bonds market also prevents adverse currency reaction to high QE.

Romania: Moderate fiscal stimulus with first-ever but modest QE

Romania's anti-crisis programme of 3.2% of GDP, of which 2% of GDP are public guarantees is relatively small. The direct support is just 1.2% of GDP because the government conducted procyclical policy in the past and brought the deficit to a high level. It could only add a small fiscal stimulus now.

The National bank of Romania has started its first-ever QE programme in April, but its scale is limited due to worries about RON fragility.

Russia: Modest anti-crisis response with no QE in sight

The Russian anti-crisis response has been modest so far, just 3% of GDP.

In this package, 2% of GDP is spending (of which only 1% of GDP are new outlays), another 0.5% of GDP are tax breaks. The public guarantee programme is just 0.5%of GDP. The public support is targeted - only the most affected individuals and businesses are eligible. We expect a new wave of support measures to be announced soon totalling around 1% of GDP, evenly split between state guarantees and public spending.

Quantitative easing doesn't seem to be on the cards in Russia, but the central bank is likely to continue easing monetary policy from the current 5.5% to 4.5-5.0%. Also, it is ready to provide refinancing loans to banks if required.

Fig 6 CEE's anti-crisis response, as % of projected GDP in 2020, unless otherwise indicated

	Poland	Czech	Hungary	Romania	Russia
TOTAL anti-crisis package (A+B)	**11.3**	**12.4**	**13.6**	**3.2**	**3.0**
A. Total above-the line measures	**6.5**	**3.3**	**5.5**	**1.2**	**2.5**
Revenue measures	2.1	1.8	4.0	0.0	0.5
Expenditure measures	4.4	1.5	1.5	1.2	2.0
B. Total below-the-line measures and guarantees	**4.8**	**9.1**	**8.1**	**2.0**	**0.5**
Loans and equity injections (below-the-line)	1.8	0.1	3.6	0.0	0.0
Public guarantees	3.0	9.0	4.5	2.0	0.5
Key macro-fiscal indicators					
Real GDP growth (ING forecast), YoY, in percent	-4.5	-6.5	-3.2	-6.6	-2.5
Official fiscal balance forecast 2020 (ESA2010)	-8.4	-5.1	-2.7	-6.7	n/a
Fiscal balance (ING forecast)	-11-(-8.4)	-5.8	-6.0-(-4.5)	-7.9	-3.5
Public debt-to-GDP ratio at end 2019 (ESA2010)	46.0	30.8	66.3	35.4	13.8
QE program of central banks	**Yes**	**No**	**Yes**	**Yes**	**No**
Share of QE in gross public financing acc. to ING	44%-55%	-	15.8%	18%	-
Launch date	19 March 2020	-	5 May 2020	1 April 2020	-
Timeframe	not specified	-	not specified	n/a	-
Amount	not specified	-	technical review at HUF 1,000bn	n/a	-
Amount estimated by ING	8.4-10.4	-	3.2	1.5	-
Progress through end-April, as % of ING's estimates	30-36%	-	0%	10%	-
Eligible securities to be purchased by central banks		-			-
T-bonds	Yes	-	Yes	Yes	-
T-bills	Yes	-	No	Yes	-
Debt instruments with T-guarantee	Yes	-	No	No	-
Corporate papers (A investment grade)	No	-	Yes	No	-
Maturities of FI securities at auctions, in years	2-10Y	-	3-15Y	all maturities	-

Source: ING estimates

Rates: Taming the supply monster

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

The size of government deficits built to finance the Covid-19 induced lockdown are nothing short of staggering. Now they must be financed. That means lots more government bond issuance. Had it not been for central bank buying, the impact would be for much higher rates. We should see curves steepen. But market rates will not be let rocket higher

View of Federal Reserve Bank of New York during COVID-19 pandemic Source: Shutterstock

Why market rates must remain relatively low

These are strange times for market rates. On the one hand, there are mega buyers in play, in the guise of central banks; persistent sentiment-immune players on the bid side of the market. On the other hand, there are huge gaps to fill as governments rack up massive deficit obligations that need to be financed on the debt market.

So far central bank buying is dominating, containing the potential impact from the heavy supply. This is a good thing. In fact, it is necessary.

The Fed's corporate bond buying programme lite - there just in case

Market rates need to be kept as low as possible, to help provide as much support as possible, all the way from consumer mortgages to corporate borrowing to government financing needs, and all things in between. Central bank buying of government bonds is an important aspect to this but by no means the only one.

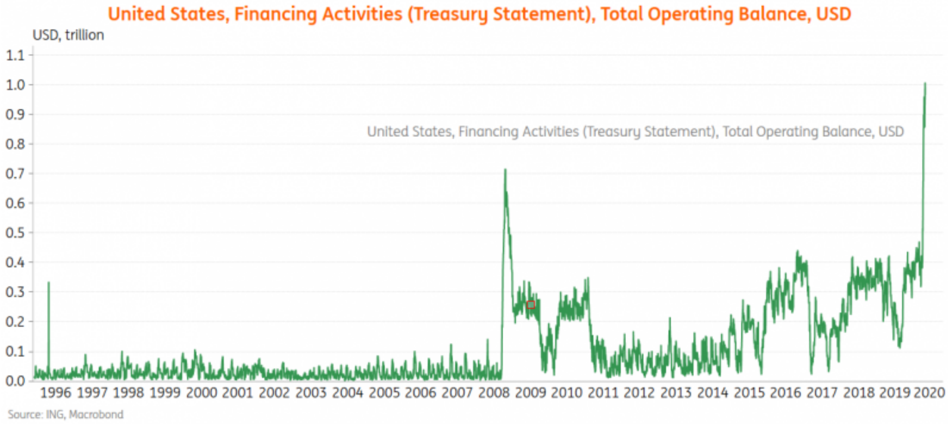
The European central bank has been buying corporate bonds for some time now, including participation in primary issuance books, and more recently has extended its influence to include fallen angels.

"Market rates need to be kept as low as possible, to help provide as large a support as possible, all the way from consumer mortgages to corporate borrowing to government financing needs, and all things in between"

The Federal Reserve has taken a slightly different approach. The capacity to buy corporate bonds is more novel and is not technically quantitative easing.

It is more of an equity-financed SPV with a capacity to buy corporates and exchange-traded funds, and we see ETF buying as a more plausible entry point. Here also the Fed's SPV can buy high yield, albeit on lower leverage to equity relative to investment-grade buying. There are other supportive facilities in a similar vein to aid other types of issuance, from commercial paper to municipal bonds.

Fig 7 Cash balance at the US Treasury (recently added to through bills issuance)



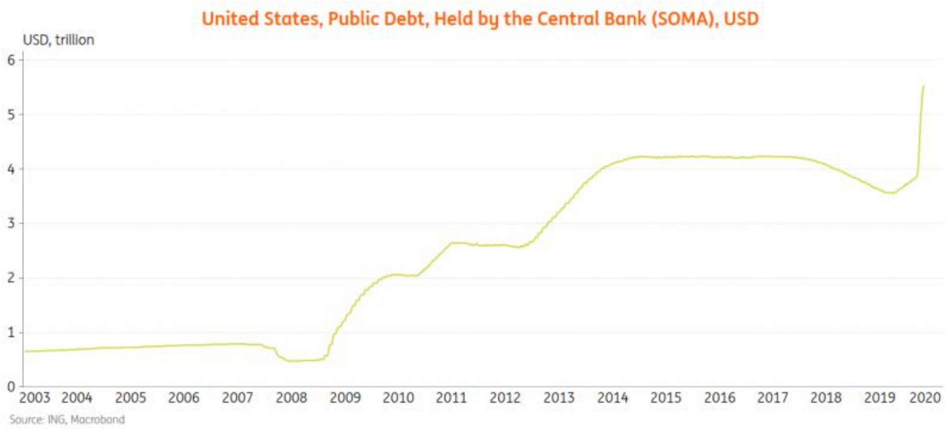
Source: ING, Macrobond

Big bills issuance has managed to keep supply pressure under wraps

Many of these facilities make less sense if market rates were to rise. Put better, maintenance of low market rates pushes in the same direction as the help that these facilities provide. In consequence, it is important that extra government bond supply does not force up market rates, as it would likely push up the cost of funding for all players, right out the credit curve.

There are a couple of factors that are helping to mute the impact of extra government issuance. First, the big push towards extra issuance has been in bills, to begin with. The good news is there is ample of demand for bills, as cash gets parked on front ends of curves. The US Treasury, in fact, managed to push its cash balance up to $1trn, driven primarily by additional bills issuance. Eurozone issuers have adopted a similar strategy. However, this will have to morph into longer duration issuance ahead.

Fig 8 Bonds bought and held by the Federal Reserve (including recent big buying)



Source: ING, Macrobond

Heavy bond issuance coming, but big buying support there too

The US is instructive, as it is an all-in estimate. And the US curve is the global benchmark curve.

The re-funding estimates for the US in the coming quarter pitches issuance at $3trn, in tune with the congressional budgetary office fiscal deficit estimate of some $3.7trn for the full fiscal year. Normally, these numbers would place material upward pressure on yields.

Offset against that are two factors. First, the Fed has bought an additional $1.9bn of bonds over the past couple of months. On top of that, it now holds $5.5trn, which equates to over a quarter of the total US public debt. The equivalents on the eurozone countries are much higher, in the area of a third for many issuers. Both the stock and flow are important here. The stock effect crowds out available bonds for investors, while the flow maintains a strong residual demand.

All things considered, government bond issuance increases are staggering, and there is more to come. But there is also an important off-set in place in the guise of central bank mega buyers (flow), and mega holders (stock). This is helping to keep market rates and yields low.

Expect creeping steepening pressure though, as longer maturities will have to discount the rolling nature of this well into the future. So while we see the US 2-year heading towards zero, the 30-year should be eyeing a break back above 1.5%.

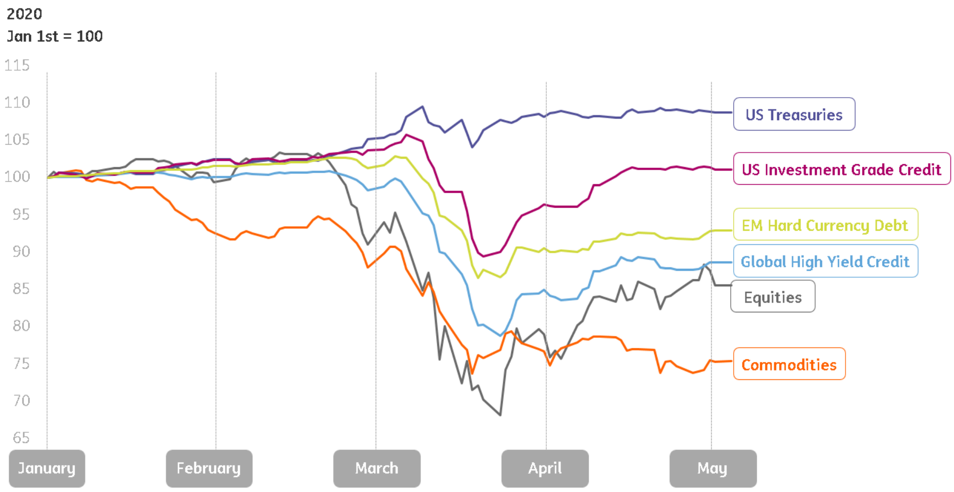
Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
London +44 20 7767 1610
chris.turner@ing.com

Asset Markets: Which asset class has got it right?

Equity markets have retraced around 50% of their Q120 sell-off and are focusing on the recovery. Credit markets are also performing well. However, sovereign debt, commodities and to some degree FX markets are still pricing recessionary levels. Which asset class has got it right?

People wearing medical masks in front of the Wall Street stock exchange in the financial district of New York City
Source: Shutterstock

Fig 9 Total Return Indices by Asset Class: US Treasuries bid, Commodities offered, Equities and Credit recover



Source: ING, Equities: MSCI World (USD)

Equity markets: powerful recovery, but questions still need to be answered

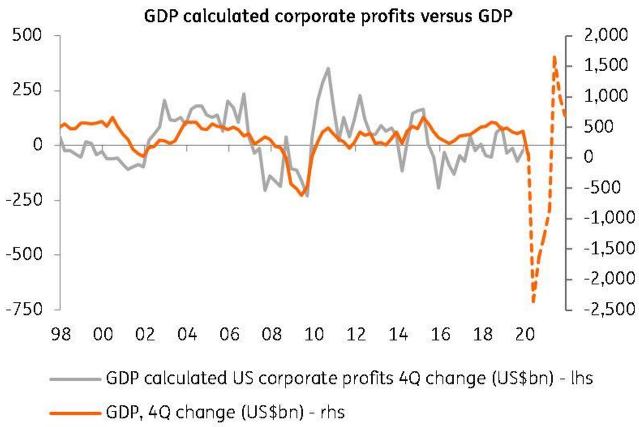
The MSCI World Equity Index has recovered more than half the losses it suffered between February and March. The quicker reaction from central bankers and especially politicians compared to events in 2008/2009 has certainly been appreciated by investors. That 2008/2009 playbook of aggressive liquidity provisions has again been seen as a move by central bankers to push investors out along the credit curve and into equity markets. So far, so good.

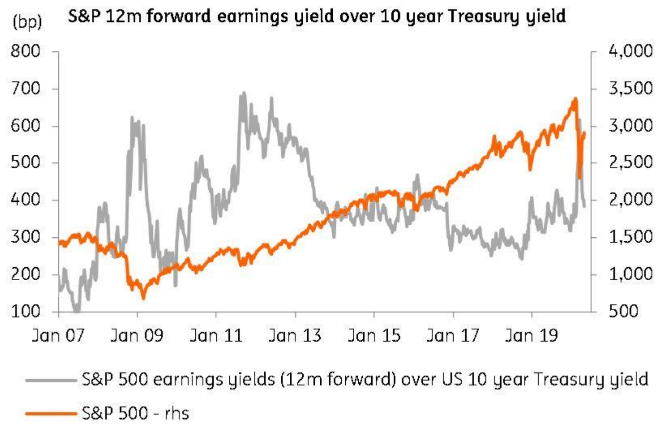
The narrative in equity markets seems to be that: i) given the prospect of another Fed-fuelled rally in financial asset prices and ii) such a paltry risk-free rate that iii) investors are prepared to look through the 2020 slowdown and attach more weight to the 2021 recovery. For reference, investors currently price a 20% fall in S&P 500 earnings in 2020, followed by a 25% recovery next year.

Our concern here is that the consensus 20% decline in 2020 US corporate earnings is too optimistic. James Knightley's 2020 US GDP forecast for a contraction of 7% is well below the consensus of -4%. If he is right, the 2020 drop in US corporate profits looks set to dwarf the US$200-230 billion rolling four quarter losses seen during the GFC crisis.

Equally, the poor transparency for corporate profits – where even Amazon and Apple are struggling for guidance – suggests investors will need some strong compensation for holding equities. Given the recent 35% rally off the lows and the expansion in P/E multiples, the 12-month forward earnings yield on the S&P 500 now offers less than a 400 basis point pick-up over the long end of the US Treasury market. In uncertain times like these, higher earnings expectations or lower valuations may be needed to keep equity markets supported. We err towards the latter.

Fig 10 US corporate profits look set to fall heavily, earnings yields may not be attractive enough





Source: ING calculations, Macrobond, Bloomberg

Credit markets: Under-pricing default rates

Credit spreads have shown much the same picture as equity markets with about half of the spread widening being retraced from roughly a month ago. At that time, we had a look at these valuations and concluded that credit markets were pricing in potentially too much economic fallout and consequent rise in default rates. Looking at that same valuation now, by calculating expected default rates from the prevalent credit spreads in investment grade and high yield, we think that markets are taking a rather benign view of future default rates. Framing credit spreads at times of turmoil is never an easy exercise but looking back at default rate levels, the depth of the economic downturn and the accompanying spreads will give us some guidance where spreads could or should be trending from here. This is highlighted in the figure below and backed up by the theoretical compensation for these spreads based on loss, given default calculations assuming 40% recovery rates (i.e. how high should credit spreads be to compensate for certain cumulative or annual default rates).

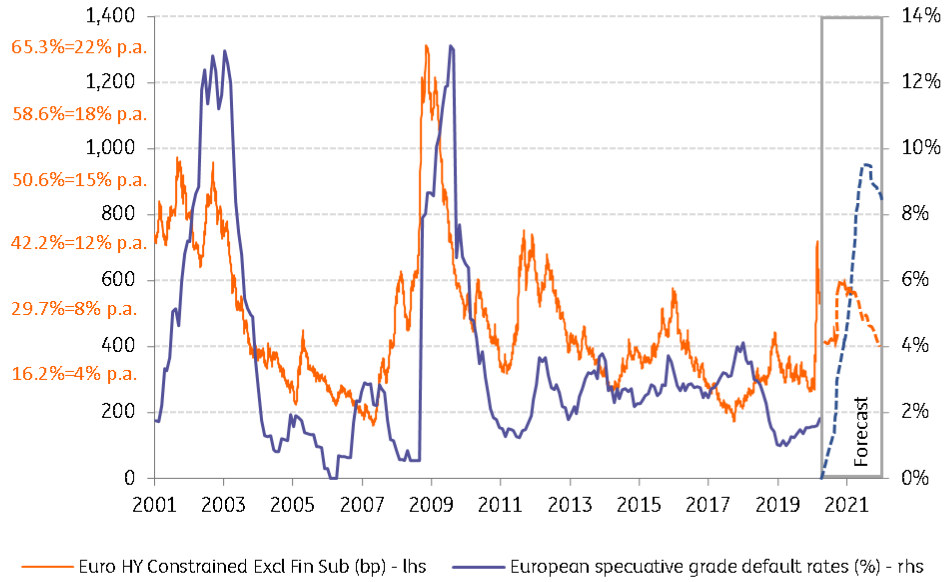
The graph; the index and the accompanying 1yr default rate that is being priced into spreads (LHS axis) currently shows that after the sharp rally, we are now looking at a scenario where default rates are expected to approach levels seen during the recession in the early 2000s (dot-com bubble) and will stay below those seen during the global financial crisis some 10 years ago. However, the 7% GDP contraction for 2020 in the US indicates that close to GFC style default rates are far more likely.

To back that up, Moody's said it expects a speculative-grade 6.8% default rate in 12 months for "a short, sharp downturn" and 16.1% for a "GFC-style" crisis (to compare, default rates peaked at 13.4% in 2008-2009). Hence it is clear that markets are expecting a V-shaped recovery.

Looking at ING scenarios and/or recessionary environments and accompanying default rates, it is safe to say that a 7% annual default rate is a given. The truth might well lie in between the elevated levels of the Global Financial Crisis and that most "optimistic" scenario. This, however, at least for the time being is not a systemic crisis but one that will lead to higher corporate leverage and pressure speculative-grade issuers, as such default rates might well hit 10%, but the GFC peak at c. 13% should be avoided, unless we see winter lockdowns.

Importantly, this crisis has one big difference in terms of financing - markets are not closed. Bank balance sheets too are stronger and will be able to absorb more, and let's not forget government support measures (not just QE) are also different to the GFC and offer some bankruptcy protection. Hence as stated before, we feel comfortable with default rates approaching 10% but not reaching GFC levels. But that still means credit spreads could widen.

Fig 11 European High Yield credit spreads versus speculative grade defaults



Source: NG Credit Strategy

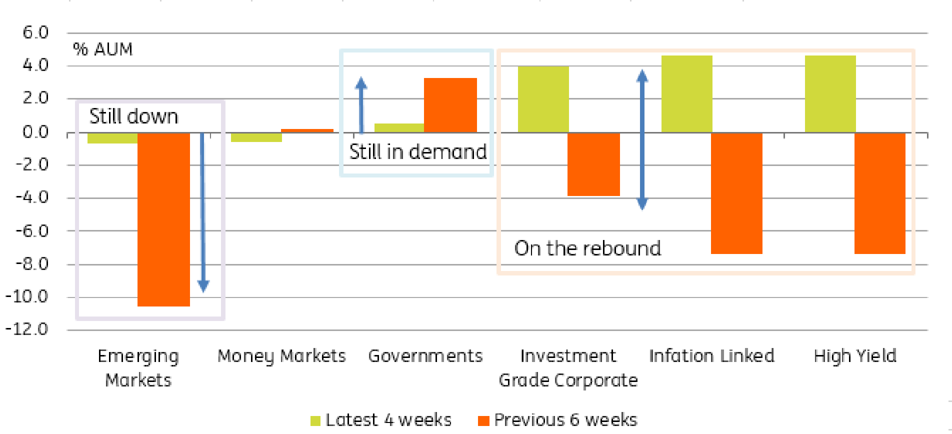
Bond Markets: Follow the flows, as that is where the money goes to work

The Covid-induced lockdown saw significant outflows from risk assets, especially emerging markets and high yield, but also investment grade corporates. In more recent weeks, flows have gone back into corporates, including high yield. But despite the prior outsized outflow from emerging markets, there have not been marked reverse flows back in. Part of this reflects the contrast with big support put in place for developed market-based corporates through the various support facilities, but part also reflects a residual fear factor that a second wave of negativity has yet to hit emerging markets.

Mild aggregate flows in the money market masks some massive movements. US corporates initially liquidated money market holdings significantly to get access to quick liquidity. But then, the Fed's Money Market Facility was fast-tracked into place as a viable backstop. In the meantime, primary markets had reopened, allowing corporates to have a more traditional route to liquidity and taking pressure of the money market funds.

Meanwhile, in government bonds there was an initial inflow, and that has been sustained, even as rates collapsed to new historic lows (or deeper into negative turf in many regimes).

Fig 12 Bond flows as % of total assets under management



Source: EPFR Global, ING estimates

Bottom line, the support being provided by central banks and governments has calmed the pain in the corporate space. There it still some vulnerability attached to high yield though.

Bigger residual angst is in emerging markets (higher beta). Here, the support comes mostly in the guise of supra-national support, which comes with ratings and default risks as typical riders. Meanwhile, government bonds and money markets remain recipients of residual cash.

Worth also taking note of the cash going back into inflation-linked funds. This is supposed to be a dis-inflationary environment, but with some obvious upside risks to prices in an environment where scarcity does breed spikes in prices in some places.

Flows show the glass as being half full, with stressed scenarios waiting in the wings.

FX Markets: More inclined towards a slowdown

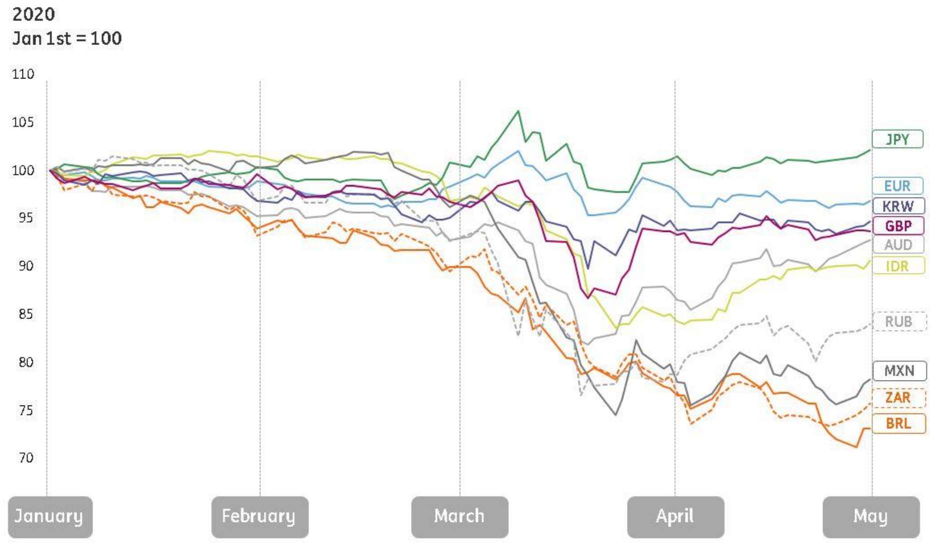
Our generally bearish view on the dollar, particularly in the second half of 2020, is premised on: a) broader signs of the recovery coming through, which will b) allow dollar liquidity to be put to work in higher-yielding and perhaps faster-growing economies.

The signs of that theme already emerging are patchy at best. High beta FX continues to trade not far from its lows and roughly 25% down on the dollar since the start of the year. And it is only the safe-haven Japanese yen, which is firmer against the dollar this year.

Until clearer and more confident signs of a recovery emerge, we think we will see a much more differentiated recovery coming through in FX markets. Based on our FX scorecards, we tend to favour the Swedish krona and Australian dollar in the G10 space, and North Asia in the emerging market FX world (as long as a new trade US-China trade war does not erupt).

Our view of a gently higher EUR/USD this year, culminating in an end-year target of 1.20, again is premised on the global recovery story, but also eurozone fiscal premia being contained largely through ECB actions. Were the latter not the case, the global recovery story would also be challenged (as it was in 2012) and EUR/USD would be ending the year under 1.10.

Fig 13 Year-to-date performance against the dollar of selected G20 currencies



Source: ING

Negative oil prices may be behind us

Warren Patterson
Head of Commodities Strategy
Singapore +65 6232 6011
warren.patterson@asia.ing.com

Oil markets made history in April, with NYMEX WTI trading into negative territory for the first time. While much of this was technical in the lead up to the 20 May contract expiry, it also reflected the state of the physical oil market, where we have seen significant demand destruction. But we think the worst is behind us now

Xx Source: Shutterstock

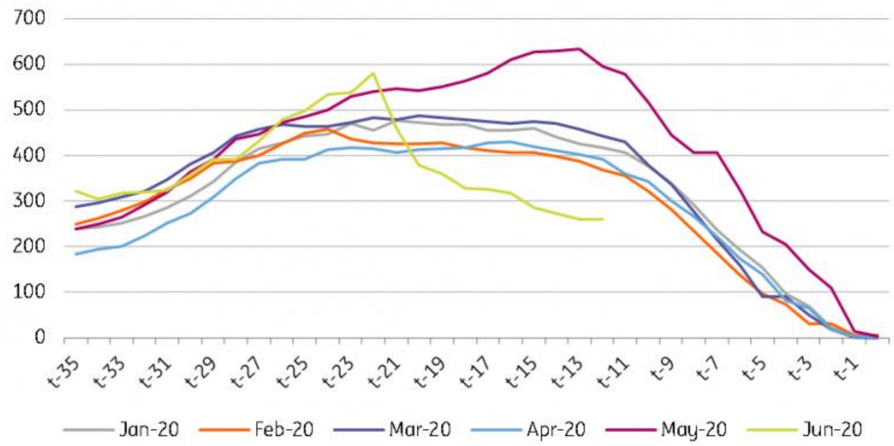
The month oil prices went into the red

April will be remembered as the month where WTI oil prices traded into negative territory, with the May contract trading at a low of -US$40.32/bbl, a day before the contract expiry.

Much of this extreme weakness had to do with the expiry of the May contract, with longs desperate to close out their position or face having to take physical delivery of oil at Cushing, the WTI delivery hub. Looking at the open interest in the May contract, going into the penultimate trading day, open interest was still significant, and hence the need for these positions to be closed out ahead of expiry.

However the fact that prices had to trade down to these levels to find a buyer clearly highlighted the oversupplied environment, and concerns over storage. At the time, storage at Cushing was around 79% full, but clearly less was available, with space booked up in anticipation of large stock builds in the future.

Fig 14 WTI contract open interest (000 lots)



Source: Bloomberg, ING Research

Could we see a repeat?

Having now seen negative prices, the question is whether we could see a repeat this month for the June contract. While it initially appeared we could, with storage expected to be an even bigger issue, dynamics have changed somewhat. The scale of stock builds at Cushing has slowed down more recently, while we are seeing some early signs that demand is starting to recover. This is evident with a pick-up in refinery run rates in the US, along with a modest increase in gasoline demand.

Meanwhile, on the supply side, a number of US oil producers have announced production shut-ins, with some of these reductions starting in May already. The gradual demand recovery, along with falling US supply should slow the rate of inventory builds from the US in the weeks and months ahead, reducing the prospect of negative WTI prices.

Furthermore, market players have been very cautious about holding a position in the WTI June contract, which will expire later this month, fearing that we could see a repeat of the May 20 expiry. Open interest has fallen significantly in recent weeks, with positions rolled further down the board, this should mean market participants who do not have the capability to take physical delivery will likely not hold their position in the final days of the contract's life.

Fig 15 Global crude oil floating storage (MMbbls)

Source: Bloomberg, ING Research

What about negative prices for Brent?

There has also been growing interest over the prospects of negative prices for ICE Brent. While this is possible, we believe that this is unlikely. Firstly, ICE Brent is cash-settled, and so the urgency to close a position ahead of expiry is not as strong, given there is no risk of having to take physical delivery, unlike the WTI contract. Secondly, Brent is a seaborne market, and so does not suffer from the same capacity constraints as the WTI landlocked contract.

Meanwhile, from a fundamentals perspective, it seems that there has been a shift in at least global floating storage for crude oil, with total floating storage having fallen for the first time since March. Although admittedly it still remains near recent record levels, and we would need to see several weeks of consecutive declines to confirm a change in the trend.

Fig 16 US oil rig count

Source: Baker Hughes

Outlook for the rest of the year

We believe that the worst is behind the market now. The main driver behind this assumption is that we should see a gradual recovery in demand over the course of the year. Although saying that, we are unlikely to see demand back at pre-Covid-19 levels in 2020. This is something that we are more likely to see happen in 2021. Clearly, the key risk is if we do see a second wave of Covid-19, which leads to a tightening in restrictions once again.

"We believe that the worst is behind the market now"

Supply will also contribute to a more constructive outlook. OPEC+ production cuts got underway on 1 May, which will see 9.7MMbbls/d of supply taken off the market for the next two months, while we are still set to see sizeable cuts of 7.7MMbbls/d over the second half of this year.

Meanwhile, we are also set to see sizeable reductions from producers outside of OPEC+. The bulk of these reductions will take the form of market-driven declines, with current prices just too low, while there will be some producers who follow mandated cuts. Recently, Norway announced that it will be cutting output in an effort to stabilise the oil market.

However clearly, the focus is on the US. It is looking less likely that we see mandated cuts from producers there, with the Texas Railroad Commission at least saying the idea of pro-rationing is "dead" for producers in the state. But the US will still see significant market-driven production declines. US oil rig activity has fallen by more than 50% since mid-March, whilst some producers have gone even further and announced plans to shut in existing production from this month. This suggests that US output by the end of this year could be between 2-3MMbbls/d lower than current levels.

When taking into consideration the demand recovery and fall in supply, the market should transition from surplus to deficit over the second half of this year, allowing it to start drawing down the significant inventory build from the first half of this year. While the scale of stock means prices are unlikely to trade back to pre Covid-19 levels this year, we think ICE Brent will average almost US$45/bbl over the second half of the year.

Mapping the global lockdown

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

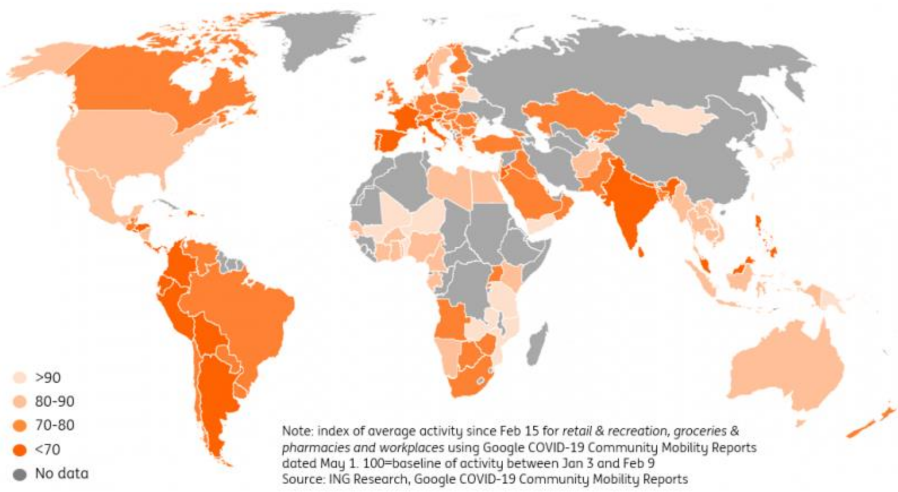
An index based on Google mobility data indicates which economies have so far been more or less affected by the lockdown. While differences are large, one thing stands out: this is truly a global symmetric shock like no other

Woman wearing surgical mask going through crosswalk in Midtown Manhattan Source: Shutterstock

In 2008, it was China and other emerging markets that bucked the trend of the global recession. During the dotcom crisis many European economies didn't even officially go into recession. This time, it's very different as it seems unlikely that more than perhaps a handful of countries have a fighting chance of avoiding a 2020 downturn.

To get a sense of how much the lockdowns are affecting economies, we use Google's mobility data. The reports show data as the percentage change in visits to certain places like grocery stores, workplaces, and retail shops compared to a baseline (ie. the average of visits for the same day of the week between 3 January and 6 February). We have created indexes combining the three categories mentioned above and look at the average activity since 15 February to get a sense of the cumulative impact of Covid-19 on economies over time. While there are some challenges in comparing the countries, the data does provide an interesting first peek at how significant public lives have been affected by the softer and harder lockdowns.

Fig 17 Global map



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

Figure 17 shows that daily life has been interrupted very significantly across the globe. The countries with the most significant impact so far on retail, grocery stores and workplace visits have seen average activity drop by almost 50% since the beginning of the time series in February, which is well before most countries started their lockdowns. The most affected countries so far for which there is data available are Italy, Ecuador, Bolivia, Spain and Peru.

The limitations on daily life have been quite severe in many European countries, but the different approaches have resulted in a heterogenous decline in daily visits to retail, grocery stores and the workplace. Belarus has barely seen an impact and does not have a lockdown in place, countries like the Netherlands and Sweden have had relatively mild lockdowns, while France, Spain and Italy for example have seen full lockdowns for a significant period that are now very gradually being eased.

Fig 18 The lockdown has been very different over time for major economies

Note: index of average activity since Feb 15 for retail & recreation, groceries & pharmacies and workplaces using Google COVID-19 Community Mobility Reports dated May 1. 100=baseline of activity between Jan 3 and Feb 9
Source: ING Research, Google COVID-19 Community Mobility Reports

In North America, lockdowns seem to have had a milder impact on economic activity while daily life in Latin America has been significantly interrupted across the board. Brazil has had one of the milder impacts on the economy so far according to the index, in part due to the different approach taken by President Jair Bolsonaro.

Asia has seen a very different pattern to Latin America with some countries like India among the most severely hit according to the Google mobility data, while others like Korea, Taiwan and Japan rank among the most unscathed. The spread of the virus has been relatively contained in countries like Korea and Taiwan, while in Japan new cases have been on the rise recently. This has resulted in more disruptions to daily life in Japan as activity has been declining, as opposed to cautiously rising as in most advanced economies in recent weeks. Korea has actually seen cautiously increasing activity since the end of February and is almost back to activity levels seen in January. Australia started its restrictive measures relatively late, but has seen daily life about as impaired as it is in the US at the moment.

Rob Carnell
Regional Head of Research, Asia-Pacific
Singapore +65 6232 6020
rob.carnell@ing.com

Asia: What can we learn from Asia's pandemic?

Asia is really diverse, so it will come as no surprise that we have learned very different things from different economies during the Covid-19 pandemic

Asian class Source: Shutterstock

First: Chuck out all the wrong ideas

Before considering learning points from Asia's pandemic, there are firstly some "false truths" to be dispelled. The main one of these is that as Asia was first in (to the outbreak), so it will be first out.

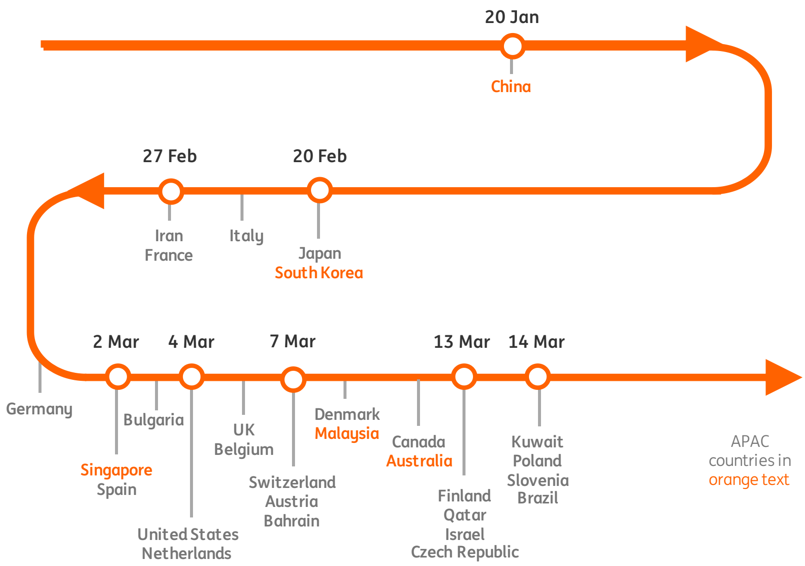
This is wrong on two levels:

3) China, South Korea and Japan may have been the first three countries to register 100 confirmed cases, but the first 20 countries to reach 100 confirmed cases are dominated by Europe (see chart).

4) Of the early Covid-19 movers, some (Singapore and Japan), are still only mid-way through their own outbreak.

This note updates and draws on a larger piece published recently

Fig 19 100-up: Timeline of countries reaching 100 confirmed Covid-19 cases



Source: WHO, ING

Three learning points

More importantly, what we have learned can be summarised by the three statements below. These are generalisations, and there are exceptions. But they are good working rules and most likely hold true for other parts of the world too:

1) Lockdowns work
2) Lockdowns hurt
3) There was an alternative

There was an alternative

Neither South Korea nor Taiwan endured a mandatory lockdown (Hong Kong too, though it has other problems). Taiwan was quick to close its borders and impose quarantine. Together with tech-based tracing and extensive testing, kept the outbreak from ever gaining a serious foothold.

> *"There was an alternative for almost any developed economy with a sufficiently advanced biotech industry and access to social distancing and tracing apps"*

South Korea was a little slower off the mark, but it too responded to its outbreak with aggressive testing, tracing and isolation. Korea quickly ramped up its testing capacity to front-run the virus, not just to respond to outbreaks.

So, there was an alternative for almost any developed economy with a sufficiently advanced biotech industry and access to social distancing and tracing apps. But it had to be employed very early. Instead, most economies outside Asia assumed Covid-19 was an Asia-only disease until it clearly wasn't.

So our learning point, that there was an alternative seems to be overtaken by the more realistic learning point that, "given the opportunity to procrastinate, most countries will do so".

Lockdowns work

Practically all of Asia is under some form of lockdown now or has been under some form of lockdown. What we observe is that countries that implemented their lockdowns early, and fully, saw their new case counts peak quickly, and were able to begin the process of reopening more quickly. In this group, we would place Australia and New Zealand alongside China.

All three countries have now eased movement restrictions and we are seeing a slow resumption of economic activity.

In Asia, lockdowns seemed to work most effectively when they were implemented rigorously and in the early stages of an outbreak. When implemented gradually, they simply chased the outbreak higher, or if regionally, chased it geographically, taking longer to bring outbreaks under control.

Fig 20 Table of Asia Pacific lockdowns, extensions, easing

Country	Date of "lockdowns" or equivalent	Scope of lockdown or alternatives	Start of easing/ extensions
Japan	7-Apr	No Lockdown as such due to constitutional issues. But Schools closed on Feb 27. State of emergency declared on 7 April for 7 prefectures including Tokyo and Osaka, but still essentially voluntary. Sports venues and Karaoke bars shut, but restaurants open, public transport still	State of Emergency extended until 30 May
Mainland China	23-Jan	Wuhan forcibly locked down, Hubei province on lockdown soon after. Parts of Guangdong also put under lockdown. Partial lockdown in Wenzhou in Zheijang, on 2 Feb, followed by some other cities in Zheizhang. No lockdown in Beijing or Shanghai.	Wuhan lockdown ends 8 April. Elsewhere, restrictions being gradually relaxed. Some further restrictions (lockdowns) imposed in smaller cities close to Russian border to contain local outbreak.
Hong Kong (SAR)	No lockdown, but strict social distancing since 28 March	No groups of 4 or more allowed to meet in public places subject to fines or imprisonment. Self isolation / working from home being practiced. 1.5m distancing rule practiced.	From 3 April, pubs, nighclubs, Karaoke closed. Restaurants can operate at 50% capacity. Restrictions due to be relaxed from 8 May
China (Taiwan)	No lockdowns but social distancing measures introduced	1m outdoor social distancing rule proposed (1.5m indoor). Fines for non-wearing of masks on public transport	No end date specified
South Korea	N/a	Spike in cases in Southern City of Daegu in late Feb. No mandatory lockdown, voluntary restraint used. Backed up with huge scale testing and isolation of positive cases. Case tracking. Use of technology to aid social distancing	
Singapore	7-Apr	Circuit-breaker notionally until May 4.	Extended in 2nd week of circuit breaker until 1 June. Some very limited easing from 5 May and further easing 12 May. No extension anticipated.
Philippines	15-Mar	Enhanced community quarantine for Island of Luzon. Also Lockdowns in Cebu, Davao, and Soccsksargen. Stricly enforced curfews. Essential services only	Initially until 15 April, extended until 30 April, and then again in capital region and neighbouring provinces until 15 May. Expected to be eased then.
Malaysia	18-Mar	Movement control order: Originally for two weeks	Extended in three phases until 12 May, some minor relaxations on 4 May
Indonesia	10-Apr	Partial lockdown initially only in Jakarta and in Tegal. Social distancing measures enhanced. But substantial movement still allowed.	Measures tightened and expended on 15 April. Initial lockdown then extended to 22 May. We anticipate further tightening or extensions posssible.
Thailand	26-Mar	State of Emmergency: coming in stages starting with shutdown of non-essential establishments in Bangkok since the state of emergency on 26 March, following by Phuket shutdown starting 30 March, and Koh Samui from 7 April, etc.	Easing of restrictions started 3 May. No further extensions anticipated.
India	25-Mar	Nationwide lockdown for 3 weeks. Migrant workers fleeing back to native homes from big cities has significantly blunted the impact of the nationwide lockdown that might well be extended in the hotspots like	Lockdown extended until 3May, with further extension in hotspots until 17 May with tighter restricitons. Further extensions possible given low recovery rate.
Australia	23-Mar	National Lockdown but brought in at State level so rules vary – but generally entail strict limits on reasons for leaving accommodation, including exercise and grocery shopping. Enforced by police. Internal quarantine between States.	Victoria still in lockdown, but some easing of movement, visiting restrictions in other States from 2 May
New Zealand	26-Mar	4-week national lockdown - all non essential services closed. People to stay in homes except for good reasons including supermarket shopping, exercise.	27 April, Travel to work allowed, restrictions on outside time eased and takeaway food orders resume

Source: ING

Lockdowns hurt

Although we can't really make any qualitative assessment just yet, mainly due to the different timing of different country's outbreaks and lockdowns within 1Q20 and 2Q20, there are a few observations that we can make.

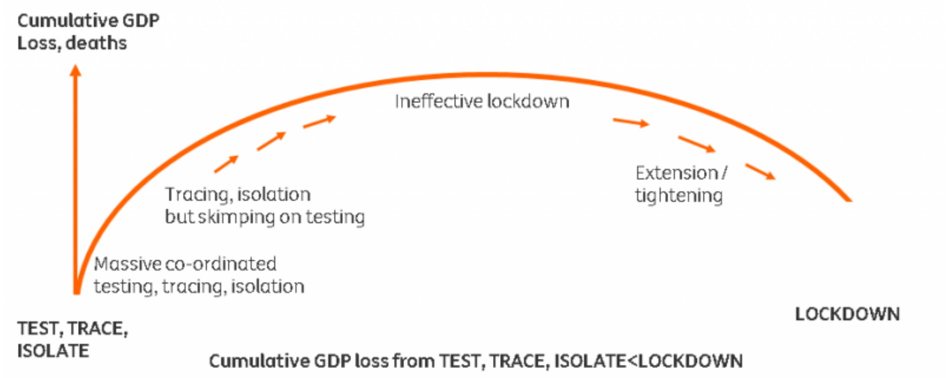
Quarter-on-quarter seasonally adjusted GDP growth for China, Korea and Taiwan was all negative. For Korea, it fell 1.4%, Taiwan fell 1.5%, China fell 9.8%. That's quite a difference. We also have preliminary GDP for Singapore, which was down 2.2%, though, in 1Q20, Singapore only had soft social distancing.

Cumulatively, once we add in the big losses for 2Q20, the losses in this group are likely to be more than those for China (and of course Australia and New Zealand) although the pain has been spread over several quarters.

So refining our earlier learning points:

- Lockdowns work, but result in a smaller cumulative loss of output if done early and fully
- There is an alternative, but only if you are quick

Fig 21 The cost of dithering



Source: ING

And finally, on policy responses/stimulus

There are also some policy learning points from Asia.

"The dangers of doing too much of either policy are probably believed to be dwarfed by the dangers of doing too little. That is probably correct in our view"

In a pandemic, countries will spend on fiscal support what they can afford (more if richer, less if poorer), or whatever they can get away with (Japan is already so indebted that a little more can't hurt), or whatever they need to (less for Korea and Taiwan as both avoided lockdowns). Though as this spending is only ever buying an option on the eventual recovery, the question, "Is it enough?" is not relevant.

Where there are more fiscal constraints, fiscal packages will be fluffed up with off-budget measures to inflate headline support (Malaysia, Japan). More constraints, more fluff.

All central banks will do whatever they can, knowing that it won't make much difference to the economic outcome, but in the knowledge that the more important fiscal policy response may face considerable constraints.

The dangers of doing too much of either policy are probably believed to be dwarfed by the dangers of doing too little. That is probably correct in our view.

US versus eurozone: 'I did it my way'

In this article, we compare the US and eurozone policy response and explore potential differences in the recovery phase

Carsten Brzeski
Chief Economist, Eurozone and Global Head of Macro
Frankfurt +49 69 27 222 64455
carsten.brzeski@ing.de

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

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg
Brussels +32 2 547 8009
peter.vandenhoute@ing.com

Harder, Better, Faster, Stronger

The monetary and fiscal response to the Global Financial Crisis more than a decade ago was unprecedented, but the scale of intervention in the current crisis and the speed with which it has happened is even more impressive. Within a month, trillions of dollars and euros have been provided in direct payments, asset purchases, liquidity injections, loans and guarantees. This aggressive response offers hope that while this recession will be far deeper than the GFC, the lost output might be recovered more quickly.

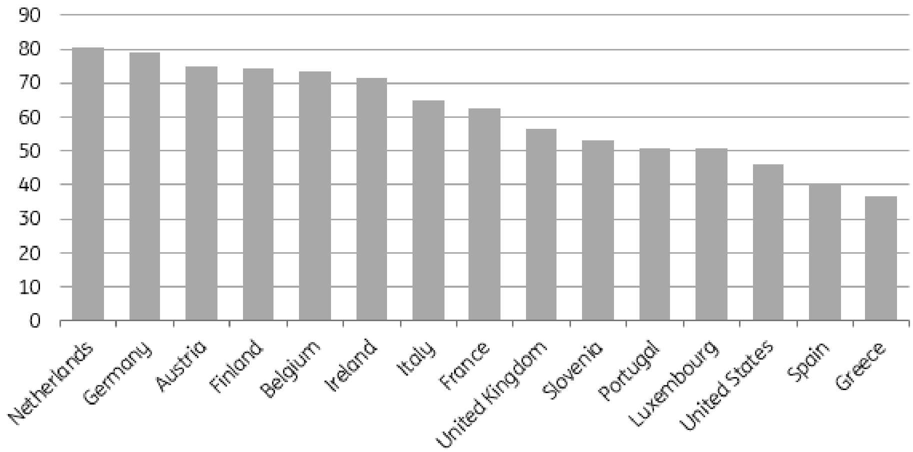
Back in the GFC, the policy reaction in the US was much swifter and stronger than in Europe. In the current crisis, European policymakers seem to have learned their lesson and reacted quickly, even though some still criticise the lack of a strong pan-European fiscal answer. Will the US economy again emerge faster and stronger from this crisis than the eurozone?

Hey Big Spenders

The US fiscal package amounts to around 15% of GDP (half direct spending, half loans and guarantees) while the Federal Reserve has expanded its balance sheet by $2.4 trillion since early March. The Fed's response has succeeded in calming financial market tensions which is critical given the US corporate sector is more orientated to obtaining financing through credit markets and we are currently seeing record debt issuance.

Eurozone governments have not been thrifty, either. On average, national governments have announced fiscal stimulus of some 3% of GDP and liquidity support of some 16% of GDP. The ECB has increased its balance sheet by 13% since early March. While the total numbers look similar, the eurozone's disadvantage is that fiscal packages differ significantly across countries, ranging from more than 30% of GDP in Germany to some 4% in Greece. Also, the share of direct 'cash-out' fiscal stimulus is relatively small in most eurozone countries. To be sure, the automatic stabilisers are on average more important in Europe than in the US. However, this seems especially the case in the core countries and much less so in the South.

Fig 22 The importance of automatic stabilisers



Note: The percentage share shows by how much the income decline is offset by automatic stabilisers one year after the shock
Source: OECD, ING

Working Man Blues

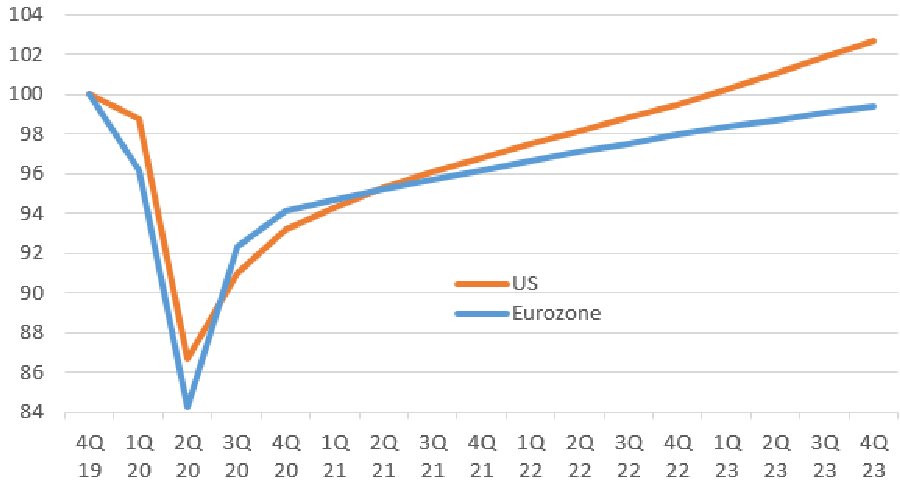
Direct payments to households and improved unemployment benefits should help to tide US households over until the economy reopens and jobs return. However, the US isn't in pole position for everything. Europe's furloughing schemes will ensure more workers keep their jobs and incomes, which could translate into a better environment for growth as lockdowns end and people return to their places of employment.

Much higher US unemployment means more household anxiety and may contribute to a slower rebound in spending initially. European short-term work schemes have an enormous cushioning effect, at least if the crisis doesn't last too long and demand picks up quickly afterwards. That said, the longer the crisis lasts, the higher the chances are that short-term work schemes are just a waiting room for unemployment.

The fact that consumer services and the energy sector are far more important to the US economy could also hinder the initial recovery path relative to Europe. Restaurants, bars and travel, for example, are likely to be far more restricted by social distancing constraints than other parts of the economy, limiting the scope for a sharp recovery. At the same time the oil glut and plunging prices will limit investment and jobs in a sector that was worth 2.5% of the US economy in 2019.

But while the eurozone on average might be less dependent on consumer services, that is not the case for every member state. In the South, tourism is a large chunk of the economy, a sector which is especially vulnerable to the Covid-19 fallout. Also, the eurozone is much more exposed to international trade, an activity also hampered by the pandemic. While we see international trade recovering in 2021, which is likely to give the eurozone a temporary lift, it could take much longer before things get back to normal, as the deglobalisation forces will most probably have been bolstered by the current crisis.

Fig 23 US versus eurozone GDP profile (4Q 2019 = 100)



Source: ING

It's a marathon, not a sprint

The Covid-19 crisis has hit the US economy where it is arguably most susceptible: health, where the most vulnerable workers are the most exposed. It also seems as if the crisis has hit the richer and economically stronger states the most, contrary to what is happening in Europe. With an easing of the lockdown measures having started earlier in some countries, the eurozone could emerge from the crisis faster and possibly even stronger than the US. However, it would only be a sprint start in what will be a long marathon.

As the initial hit to the economy was likely bigger in Europe than in the US, in a first instance, the phasing out of the lockdown measures will automatically lead to optically stronger growth in Europe. In 2021 however, higher potential growth in the US should also lead to more dynamic growth than in the eurozone. Let’s not forget that the eurozone was already struggling with a structural growth problem before the Covid-19 crisis erupted, because of its less favourable demographics and dwindling productivity growth. Those problems could even be exacerbated by the current crisis as investment is likely to take a big hit.

On top of that the eurozone’s problem will once again be the significant divergence across countries. History could repeat. After the GFC, the US economy had returned to its pre-crisis level after 14 quarters, while it took the eurozone 29 quarters. However, the eurozone number masks that Belgium, France and Germany were faster than the US, while for e.g. Spain it took 35 quarters to regain its pre-crisis production level and today Italy still has lower GDP than it did in 2007!

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

Carsten Brzeski
Chief Economist, Eurozone and Global Head of Macro
Frankfurt +49 69 27 222 64455
carsten.brzeski@ing.de

The rising risk of an asymmetric eurozone recovery

Judging from mobility data, the lockdown measures in the eurozone seem to have different impacts across countries. With some countries easing the lockdown measures, while others remain locked down for longer, the risk of an asymmetric recovery increases

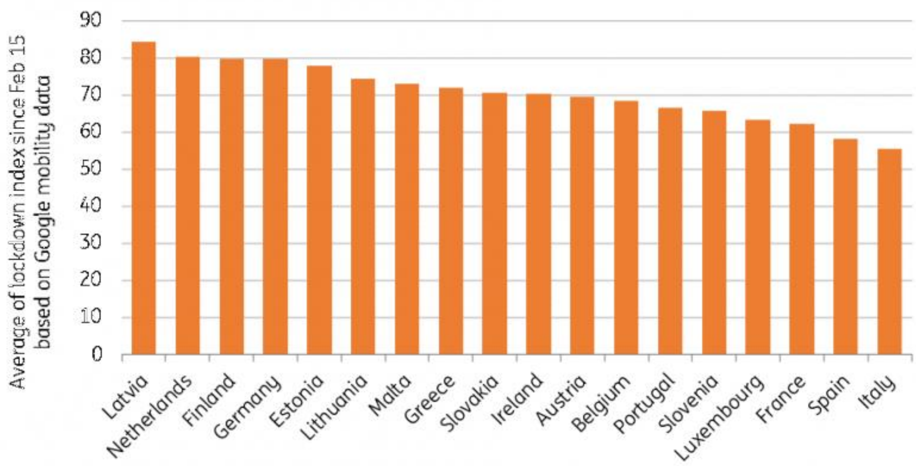
Woman with a protective mask, walking with her dog according to the rules, Chartres, France

Source: Shutterstock

Eurozone lockdowns are not all alike

While the French need to do paperwork to walk their dog, the Dutch have been able to do some shopping throughout the lockdown. The lockdown measures in the eurozone are similar but definitely not the same. Countries did not only react differently in terms of the timing of the lockdown measures, but also in terms of their strictness.

Fig 24 Differences of lockdown impact between eurozone economies has been large



Note: index of average activity since Feb 15 for retail & recreation, groceries & pharmacies and workplaces using Google COVID-19 Community Mobility Reports dated May 1. 100=baseline of activity between Jan 3 and Feb 9
Source: ING Research, Google COVID-19 Community Mobility Report

As Italy was the first severely affected country in Europe, it also started the lockdown measures earlier than the rest. Most other countries followed in the second half of March. However, the announced measures differed significantly in terms of the strictness and scope. Some started off with prohibiting public gatherings, others immediately decided on a shutdown. The countries which started off relatively mildly often stepped up the measures quickly afterwards so that by end-March almost all eurozone countries were in a de facto full lockdown.

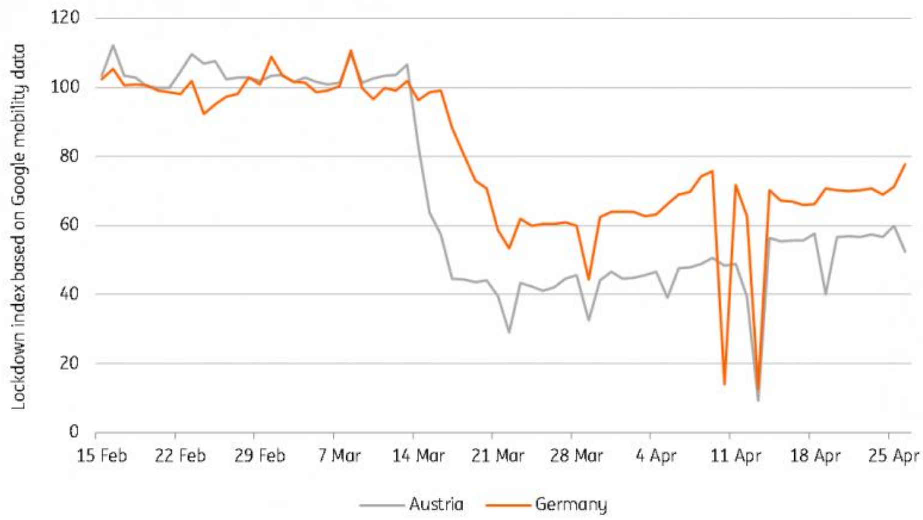
The cumulative deviation from the baseline for an average of the Google categories 'grocery stores', 'workplace' and 'retail shops' shows that Italy saw a much quicker deviation from base than other countries and has the largest cumulative impact at the moment. Spain has been closing in though and France ranks third in terms of restricted activity. The Netherlands, Finland and Germany are near the bottom of the list in terms of the severity of the lockdown in practice. Greece, Belgium, Austria and Ireland are in the middle of the pack. This suggests that the direct economic impact is likely larger in the Southern eurozone economies and France than in the Northern countries where the lockdown has been lighter.

Is the gradual lifting of measures having an impact on activity?

Now that the new number of Covid-19 cases is dropping across the eurozone, the first plans for exits from the lockdown have been put into place. One overarching theme is clear: there is no sudden return to pre-Covid 19 daily life. A gradual return to normalcy is par for the course as concerns about a quick return of the virus and another spike in hospital admissions leads governments to be very cautious about the endgame.

Austria leads the way here as small businesses, DIY stores and garden centres have been allowed to reopen after Easter. Austria had one of the stricter lockdowns in place from a retail perspective and is now trying to alleviate the impact a little as progress has been made in containing the virus. In Germany, something similar has been announced, with smaller retail businesses open as of 20 April and schools opening gradually. What we see is a cautious return to normalcy, which is backed up by the mobility data. The data shows an ever so slight improvement in activity over the first days for which the measures have been lifted. This suggests that it's not just regulation playing a role, but that behaviour is also affected by confidence, and its further early evidence that a V-shaped recovery is not in the making.

Fig 25 Austria and Germany have taken the first cautious steps to reopen



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

Lockdown and exit measures likely to increase divergence

Covid-19 is often labelled as a symmetric shock hitting the eurozone economy. While this is correct regarding the nature of the shock, differences in the length and depth of the lockdown measures seem to have had a rather asymmetric impact on the eurozone economy. Currently, a pattern seems to be emerging that the eurozone countries which experienced the sharpest impact on public (and economic) life will be the countries exiting the lockdown measures last. Germany and Austria have been among the first to lift measures while most Southern European countries have only just started to lift some of the strictest measures.

On top of that, most southern European economies have structural characteristics that make them more vulnerable to this specific shock. The chart below shows the relationship between a quick and dirty vulnerability index of the different eurozone economies and the announced emergency fiscal spending. The factors taken into account are, sectoral vulnerability based on the ECB Economic Bulletin of 1 May, fiscal automatic stabilisers, the average of the lockdown index, the share of solo self-employed and temp workers and the dependency on foreign inputs for production. This gives an indication of which countries are set to have the quickest bounce back in economic activity after the crisis. While the relationship is weak, the countries that are set for a stronger recovery are also the ones with the largest fiscal response. Divergence is therefore set to continue in the aftermath of the crisis, putting even more pressure on European leaders to come to a swift agreement on a recovery fund.

Fig 26 Eurozone fiscal response is stronger from countries with a higher likelihood of a better recovery

Source: ING Research

Carsten Brzeski
Chief Economist, Eurozone and Global Head of Macro
Frankfurt +49 69 27 222 64455
carsten.brzeski@ing.de

Will the eurozone survive this crisis?

The highly emotional debate on coronabonds, the discussion on a pan-European fiscal response and the cumbersome negotiations on a recovery fund has brought back speculation about a return of the euro crisis and a potential break-up of the eurozone

Coronavirus emergency - first day of phase 2, people in the centre. Galleria Vittorio Emanuele
Source: Shutterstock

ECB to the rescue

Even though Covid-19 is a so-called symmetric shock, its economic impact is asymmetric.

This is not just because of differences in the total number of infections or death tolls but also because of the sectors hardest hit by the crisis. The share of tourism or small and medium-sized enterprises in total economic activity varies from country to country and there has been huge disparity across the region in terms of the fiscal response. The fear of government debt increasing beyond levels that are sustainable seems to have discouraged several governments in Southern Europe from announcing bigger stimulus packages. This is despite the fact that there is a waiver for the fiscal rules, that interest rates are low due to European central bank's government bond-buying and that it is possible to get a cheap credit line with hardly any conditions attached via the European Stability Mechanism.

> *"Even after Covid-19, the Italian government's finances will not automatically become unsustainable and there is no guarantee that the euro debt crisis will return"*

We have previously argued that a coronabond is not the silver bullet to all eurozone problems. There are sufficient instruments in place to tackle possible liquidity issues and a surge in debt would be better solved by debt monetisation or debt write-offs than with debt mutualisation, though a coronabond would obviously be the ultimate symbol of solidarity.

As long as the ECB keeps on purchasing bonds, even a sharp increase in government debt is manageable. Take the example of Italy, which has been running primary fiscal surpluses almost continuously since the early 1990s. Currently, the Italian government uses some 7% of its revenues for interest rate payments. With low-interest rates, a surge in debt would probably increase interest rate payments to 9% or 10% of total revenues. In the 1990s, Italy used more than 30% of its revenues for interest payments.

So even after Covid-19, the government's finances will not automatically become unsustainable and there is no guarantee that the euro debt crisis will return.

Is this the time for a (euro) Coronabond?

'Muddling through' put to the test

This does not mean that everything is all well and good.

Covid-19 will lead to further widening of economic discrepancies, at least in the first phase of the recovery. Any growing divergence bears the risk of new tensions between eurozone member states and increases the likelihood that Europe, and the euro, could once again be used as a political scapegoat. These tensions could come either from Southern European countries, which feel abandoned by their Northern peers or from Northern European countries, which want to return to normality and blame the ECB, low-interest rates and Southern Europe for undermining savings, the pension system and the financial sector.

> *"Covid-19 will lead to further widening of economic discrepancies, at least in the first phase of the recovery"*

There is clearly a risk of strengthening centrifugal forces both in the Northern and Southern eurozone countries in the aftermath of Covid-19. This is probably the strongest argument in favour of some symbolic act of solidarity, as the ECB's debt monetisation by stealth has now been thrown into question by the German constitutional court.

The potential for the rift to widen was foreseeable given the lack of meaningful progress on deepening the monetary union's integration in the years after the financial crisis, despite numerous attempts. The right balance between the eurozone and national sovereignty, transfers and loans hasn't been found, yet.

In the end, the eurozone is a political project. The economics and the economic risks of a possible break-up can always be tackled as long as there is the political will to do so.

However, the tried and tested practice of 'muddling through' will be challenged in the coming years.

Covid-19 will be an enhancer, not a gamechanger in this debate.

Fig 27 ING global forecasts

	2020F 1Q	2Q	3Q	4Q	FY	2021F 1Q	2Q	3Q	4Q	FY
United States										
GDP (QoQ%, ann)	-6.0	-40.0	22.0	10.0	-7.0	5.0	4.0	3.5	3.0	3.4
CPI headline (YoY%)	2.1	-0.4	-1.6	-1.6	-0.4	-1.1	1.2	2.5	2.5	1.3
Federal funds (%, eop)	0.25	0.25	0.25	0.25		0.25	0.25	0.25	0.50	
3-month interest rate (%, eop)	1.45	0.45	0.40	0.40		0.40	0.40	0.45	0.55	
10-year interest rate (%, eop)	0.75	0.50	0.75	0.75		1.00	1.00	1.25	1.50	
Eurozone										
GDP (QoQ%, ann)	-14.4	-41.0	44.0	8.0	-8.0	2.5	2.2	2.0	2.0	4.0
CPI headline (YoY%)	1.1	0.3	0.2	0.5	0.5	1.3	1.4	1.5	1.5	1.4
Refi minimum bid rate (%, eop)	0.00	0.00	0.00	0.00		0.00	0.00	0.00	0.00	
3-month interest rate (%, eop)	-0.40	-0.20	-0.30	-0.30		-0.30	-0.35	-0.35	-0.35	
10-year interest rate (%, eop)	-0.47	-0.50	-0.40	-0.35		-0.25	-0.20	-0.20	-0.15	
Japan										
GDP (QoQ%, ann)	-1.4	-26.5	18.1	1.8	-4.9	0.5	0.9	0.9	0.9	0.9
CPI headline (YoY%)	0.5	-0.1	0.5	0.3	0.3	0.7	1.2	0.9	0.7	0.9
Excess reserve rate (%)	-0.1	-0.1	-0.1	-0.1		-0.1	-0.1	-0.1	-0.1	
3-month interest rate (%, eop)	0.00	0.05	-0.05	-0.10		-0.05	-0.05	-0.05	-0.05	
10-year interest rate (%, eop)	0.00	-0.20	-0.10	0.00		0.00	0.00	0.00	0.00	
China										
GDP (YoY%)	-6.8	-3.1	-0.5	4.5	-1.5	6.0	5.0	4.0	2.0	4.3
CPI headline (YoY%)	5.0	4.5	3.5	2.4	3.9	2.0	2.2	2.5	2.5	2.3
PBOC 7-day reverse repo rate (% eop)	2.20	2.00	1.70	1.50		1.50	1.50	1.50	1.50	
10-year T-bond yield (%, eop)	2.60	2.45	2.50	2.60		2.70	2.80	2.90	3.00	
UK										
GDP (QoQ%, ann)	-7.5	-40.7	31.9	9.4	-7.1	3.5	2.4	3.0	3.0	3.7
CPI headline (YoY%)	1.7	0.4	0.2	0.6	0.7	0.7	1.6	1.7	1.7	1.4
BoE official bank rate (%, eop)	0.10	0.10	0.10	0.10		0.10	0.10	0.10	0.10	
3-month interest rate (%, eop)	0.60	0.30	0.30	0.30		0.30	0.30	0.30	0.40	
10-year interest rate (%, eop)	0.30	0.20	0.40	0.50		0.70	0.80	0.90	0.90	
EUR/USD (eop)	1.10	1.10	1.15	1.20		1.18	1.15	1.12	1.10	
USD/JPY (eop)	108	105	100	100		102	105	108	110	
USD/CNY (eop)	7.20	7.20	7.00	6.90		6.80	6.70	6.60	6.50	
EUR/GBP (eop)	0.89	0.88	0.86	0.85		0.85	0.85	0.85	0.85	
Brent Crude (US$/bbl, avg)	51	25	37	50	41	50	60	60	63	58

GDP forecasts are rounded to the nearest whole/half number, given the large magnitude and uncertainty surrounding our estimates
Source: ING forecasts

Real GDP growth (QoQ% annualised unless otherwise state) and market forecasts

Scenario 1 – Base case

	2020 1Q	2020 2Q	2020 3Q	2020 4Q	2020 FY	2021 1Q	2021 2Q	2021 3Q	2021 4Q	2021 FY
United States	-4.8	-40	22	10	-7.0	5.0	4.0	3.5	3.0	3.5
Eurozone	-14.4	-41	44	8	-8.0	2.5	2.0	2.0	2.0	4.0
China (YoY%)	-6.8	-3.1	-0.5	4.5	-1.5	6.0	5.0	4.0	2.0	4.3
Japan	-1.6	-28	18	1.6	-4.9	0.5	1.0	1.0	1.0	0.9
United Kingdom	-7.5	-41	32	9.5	-7.1	3.5	2.5	3.0	3.0	3.7
EUR/USD	1.10	1.10	1.15	1.20		1.18	1.15	1.12	1.10	
USD/JPY	107	105	100	100		102	105	108	110	
US 10-year yield (%)	0.65	0.50	0.75	0.75		1.00	1.00	1.25	1.50	

Scenario 2 – Winter lockdowns return

	2020 1Q	2020 2Q	2020 3Q	2020 4Q	2020 FY	2021 1Q	2021 2Q	2021 3Q	2021 4Q	2021 FY
United States	-4.8	-40	22	-10	-8.0	1.0	9.0	14	9.0	1.1
Eurozone	-14.4	-41	44	-25	-10.1	20	10	2.5	2.0	2.5
China (YoY%)	-6.8	-3.1	-2.0	1.0	-2.7	4.0	3.0	2.0	2.0	2.8
Japan	-1.6	-45	17	-22	-11.2	30	15	15	6.0	4.8
United Kingdom	-7.5	-41	32	-20	-8.9	2.0	19	6.0	4.0	0.7
EUR/USD	1.10	1.10	1.12	1.12		1.15	1.20	1.15	1.10	
USD/JPY	107	105	100	100		100	103	105	107	
US 10-year yield (%)	0.65	0.50	0.50	0.50		0.50	0.75	0.75	1.00	

Scenario 4 – 'Worst case'

	2020 1Q	2020 2Q	2020 3Q	2020 4Q	2020 FY	2021 1Q	2021 2Q	2021 3Q	2021 4Q	2021 FY
United States	-4.8	-55	-10	0.0	-14.7	5.0	24	22	10	1.6
Eurozone	-14.4	-55	-15	-5.0	-18.5	25	50	15	10	7.5
China (YoY%)	-6.8	-5.0	-4.0	-2.0	-4.5	0.0	3.0	3.5	4.0	2.6
Japan	-1.6	-47	-11	-19	-14.5	27	22	14	5.5	2.2
United Kingdom	-7.5	-49	-14	-5.0	-14.9	6.0	31.0	12.5	5.5	1.1
EUR/USD	1.10	1.05	1.10	1.20		1.30	1.20	1.18	1.15	
USD/JPY	107	110	100	90		95	100	102	105	
US 10-year yield (%)	0.65	0.25	0.25	0.25		0.25	0.25	0.25	0.50	

Source: ING (Note most growth forecasts rounded to nearest whole or half number)

Disclaimer