What to focus on in Global Macro for the week of April 6th, 2020

Macro Themes on the Radar:

Eight years ago, at the height of the euro crisis, German Chancellor Angela Merkel assured her constituents that Eurobonds will not exist "for as long as I live."

Last week, during the video summit of European Union leaders, southern EU member states, with the backing of France, received a similar message when the idea of Eurobonds was once again raised as a way of shielding their economies from the impact of the corona pandemic. German Economics Minister Peter Altmaier said it was a "phantom debate."

With Italy and Spain facing both a financial and healthcare meltdown something will have to be done to backstop them or the growing antipathy and distrust along the old north /south divide may well come to a head. As I indicated last week, such a showdown could be existential for the Eurozone.

As one op-ed rant in Der Spiegel described it... "if the Europeans don't immediately signal that they are working together to counter this crisis, it will be a feast for populists, for enemies of the EU and for hedge funds in London and New York. Just like when Greece teetered at the edge of the abyss during the euro and debt crisis, they would bet on the entire Eurozone going bust. And this time they would win." 😊

Ok, so what are the options:

- **Eurobonds** – So far it doesn't seem like this is going to work with Germany, Netherlands, Austria et al digging in their heels. At least not yet.
- **Coronabonds** – The northern countries might give in eventually but would have to be a one-off with limited size and maturity. Clearly the fear of setting a precedent is a major obstacle here. Once you have said yes, how can you say no next time, and does it inevitably result in full Eurobonds and a common budget and Treasury down the road?
- **Current ESM credit lines** – Germany has suggested using the existing European Stability Mechanism as a way of "bailing out" Spain and Italy. The ESM was set up in reaction to the 2011 European debt crises as a standing facility for supporting member states in financial need. The ESM is seen as having a stigma attached to it and came

with imposed austerity and fiscal constraint. As such this idea is very unpopular with those that would need to utilize its Eur410B capacity.

- **Increased ESM** – An expanded ESM without stigma might be a solution that would take advantage of an already existing infrastructure. (The ESM already employs 200 people in Luxemburg.)

- **Status Quo** – A significant increase in national borrowing, which is now unconstrained by EU fiscal rules, supported by massive ECB QE. On March 18th, the ECB announced the Pandemic Emergency Purchasing Programme (PEPP) which in effect gets targeted QE going. Spreads came in quickly. It is potentially unlimited and fits with the "whatever it takes" mantra at the ECB. However, if done in large enough size this becomes a backdoor to mutualization of debt and I would expect it to be challenged.

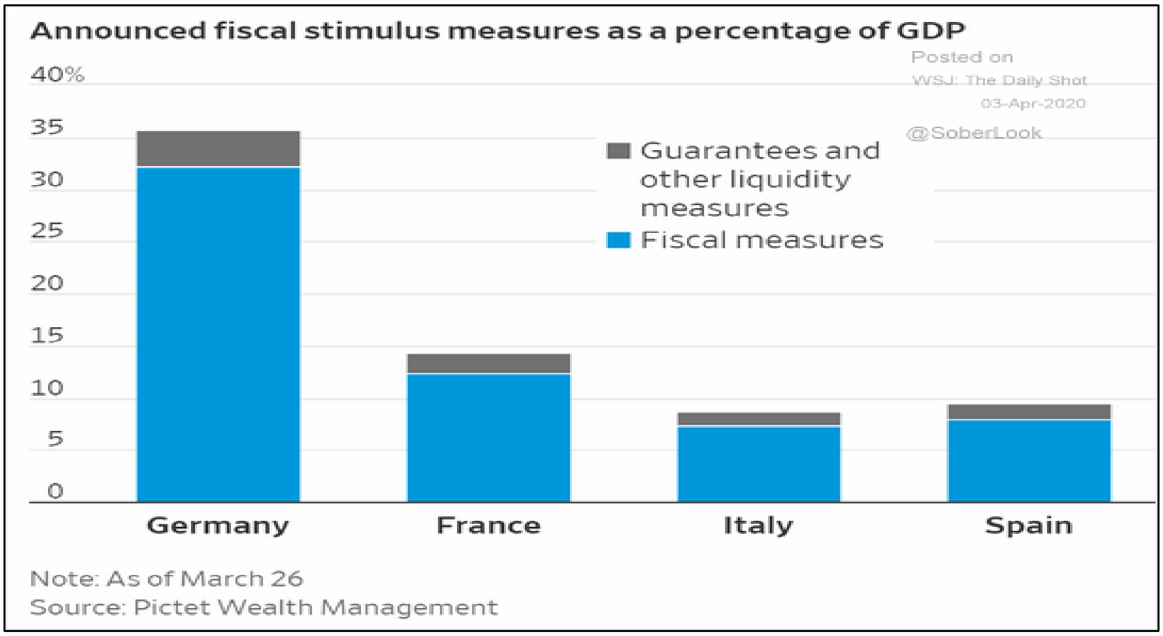
Germany & Co. will have to decide to what extent they are willing to bend. What form of mutualization will they be willing to accept and in what size? The Eurozone has a prohibition against Monetary Financing. In the past Germany has argued that some of the ECB actions violate this prohibition in principal. Will they stick to their guns, or turn a blind eye now?

On Sunday, the Spanish PM, Pedro Sanchez turned up the heat with an op-ed piece published in The Guardian and nine newspapers across the continent:

"The circumstances are exceptional and call for unwavering positions: either we rise to this challenge or we will fail as a union. We have reached a critical juncture at which even the most fervently pro-European countries and governments, as is Spain's case, need real proof of commitment. We need unwavering solidarity… Europe must build a wartime economy and promote European resistance, reconstruction and recovery. It must start doing so as soon as possible with measures to support the public debt that many states, including Spain, are taking on. And it must continue to do so when this health emergency is over, to rebuild the continent's economies by mobilizing significant resources through a plan we are calling the new Marshall plan, and which will require the backing of all of the EU's common institutions."

So far those that can, do…

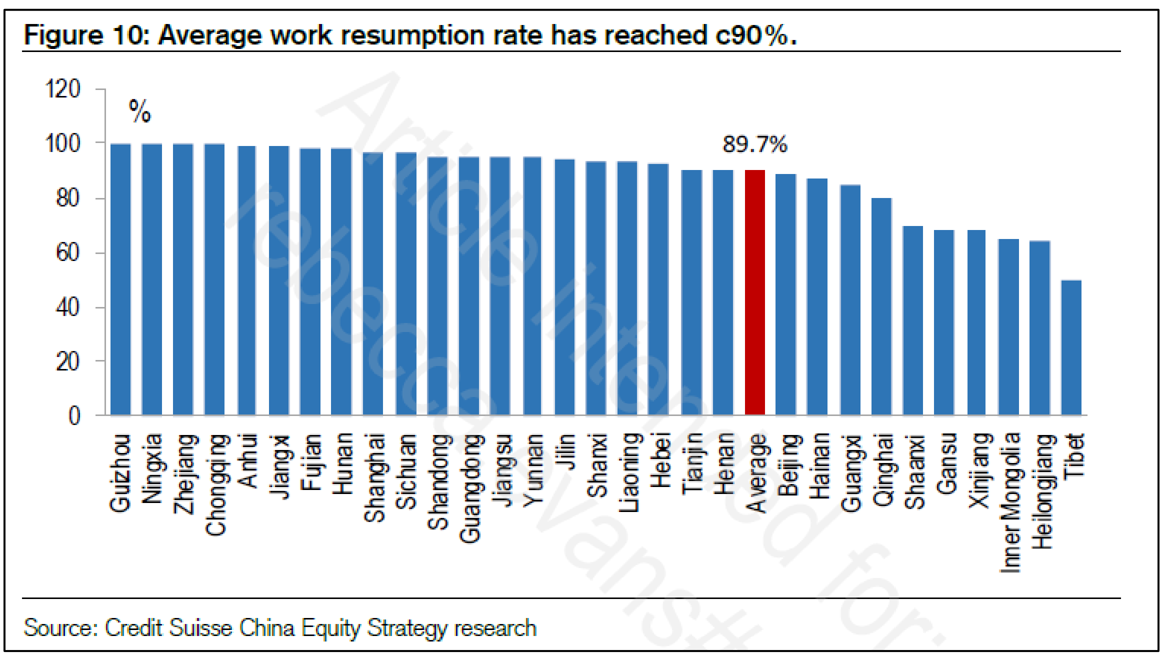
Stargazer
Asset Management



<u>**What to Focus on Now:**</u>

China/Asia Rebound

As the lockdowns are being slowly loosened, economic activity is starting to normalize in parts of Asia. In China 95% of large enterprises and 72% of SMEs are up and running.

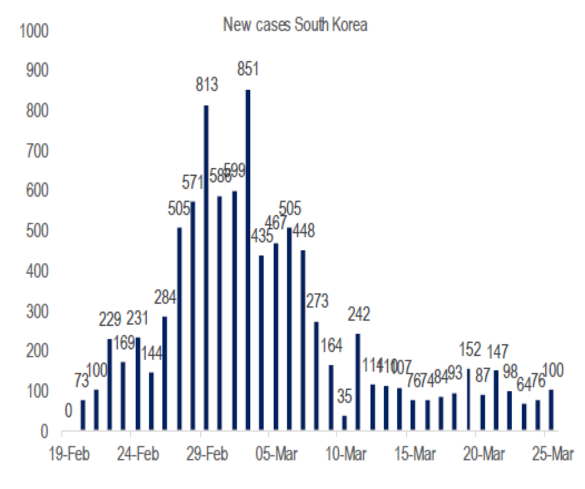


In Korea automobile companies are back at full capacity. In Japan, Prime Minister Abe has indicated he is planning to reopen the schools in April.

- In spite of the return to work there is hardly a pick up in the infection rate.

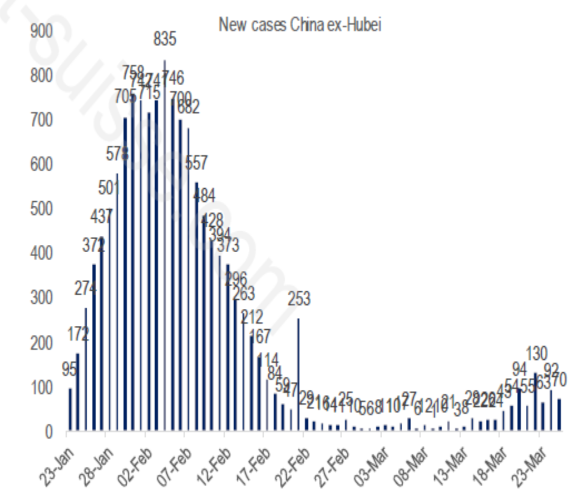
This obviously suggest that the resumption in work can be more sustainable.

Figure 11: Korea new daily cases

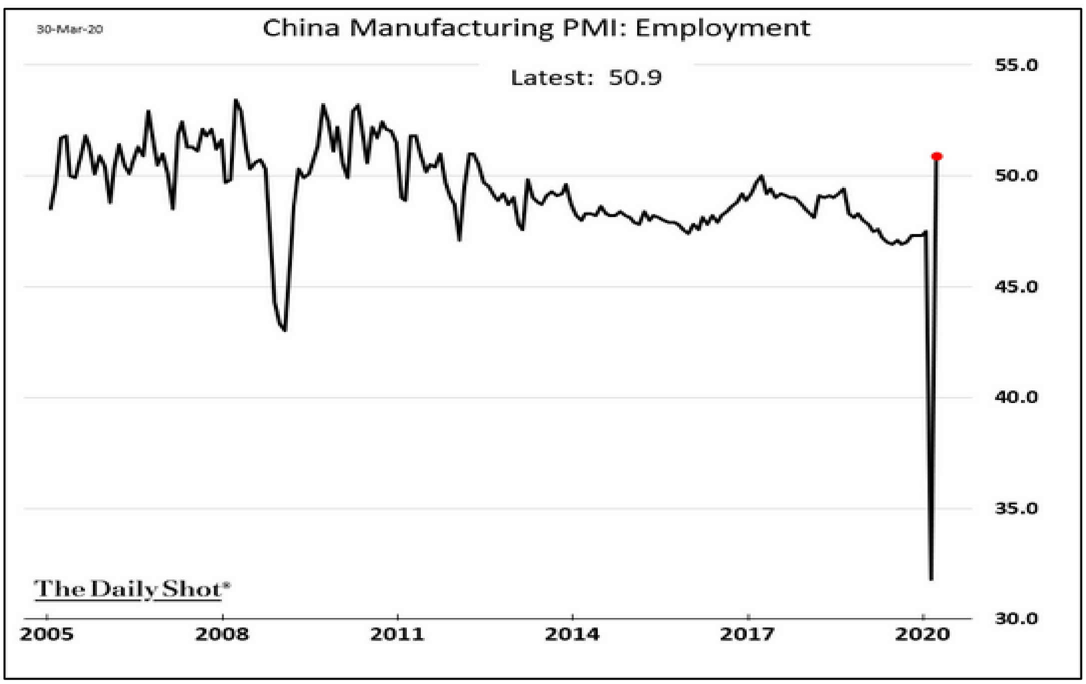


Source: JHU

Figure 12: China new daily cases

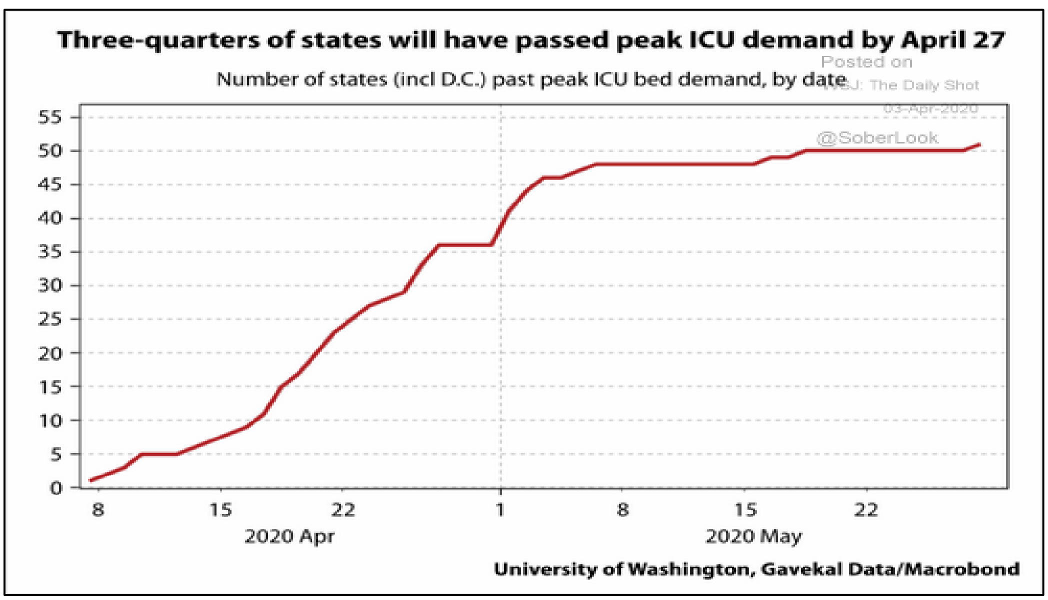


Source: China CDC

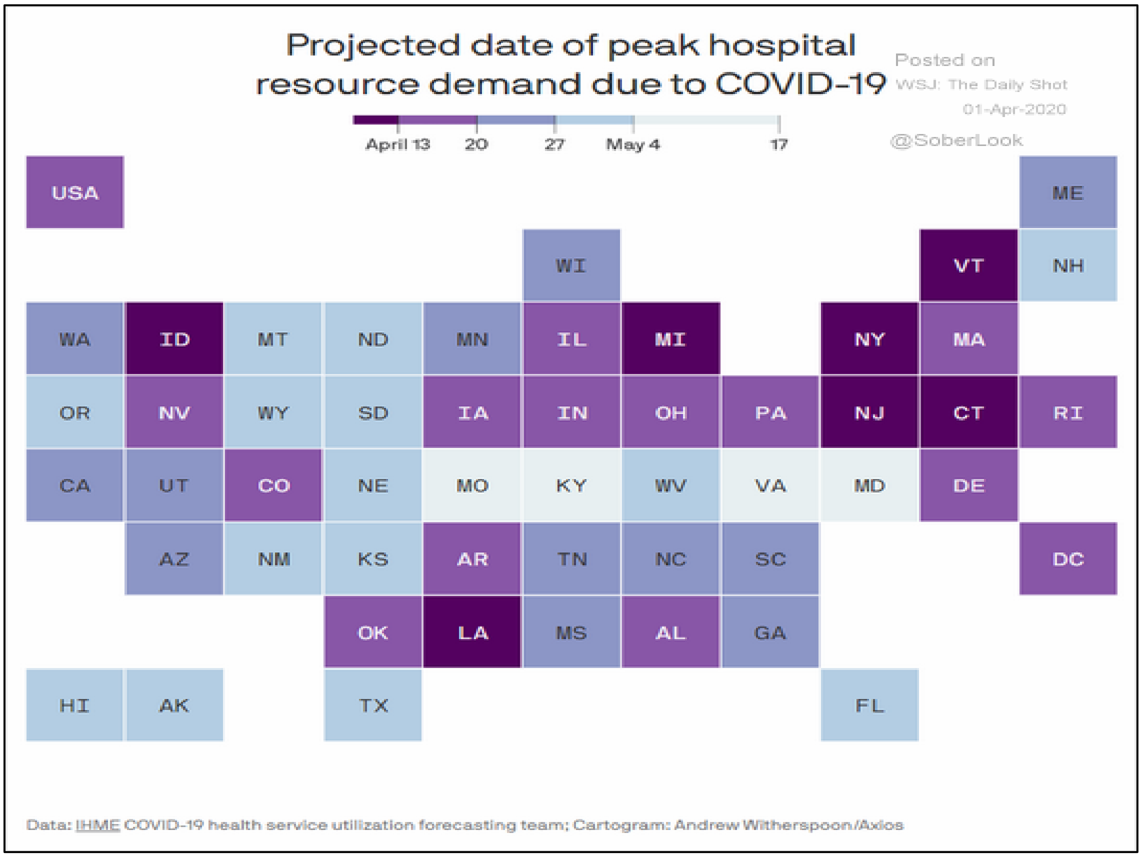


Having said the above, China reported over the weekend that it is seeing a renewed rise in local transmissions. On Sunday, Japan reported that Tokyo saw more than 130 new coronavirus cases, the largest jump in one day. Is this the template for Europe and the US? Outbreak followed by lockdown, followed by re-opening and then lower intensity but persistent continued cases?

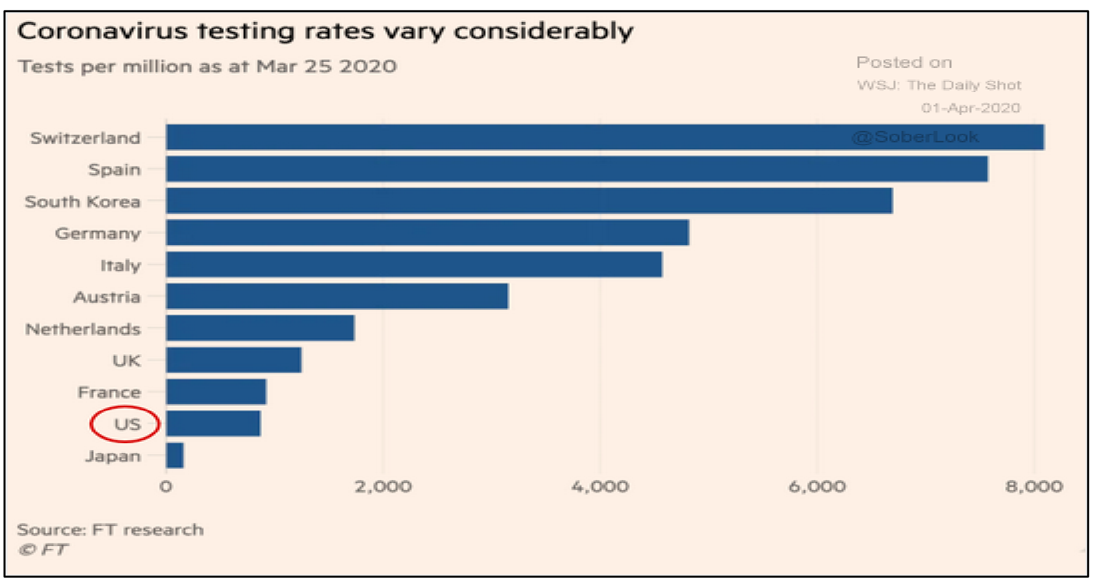
Corona in the US – Some good news



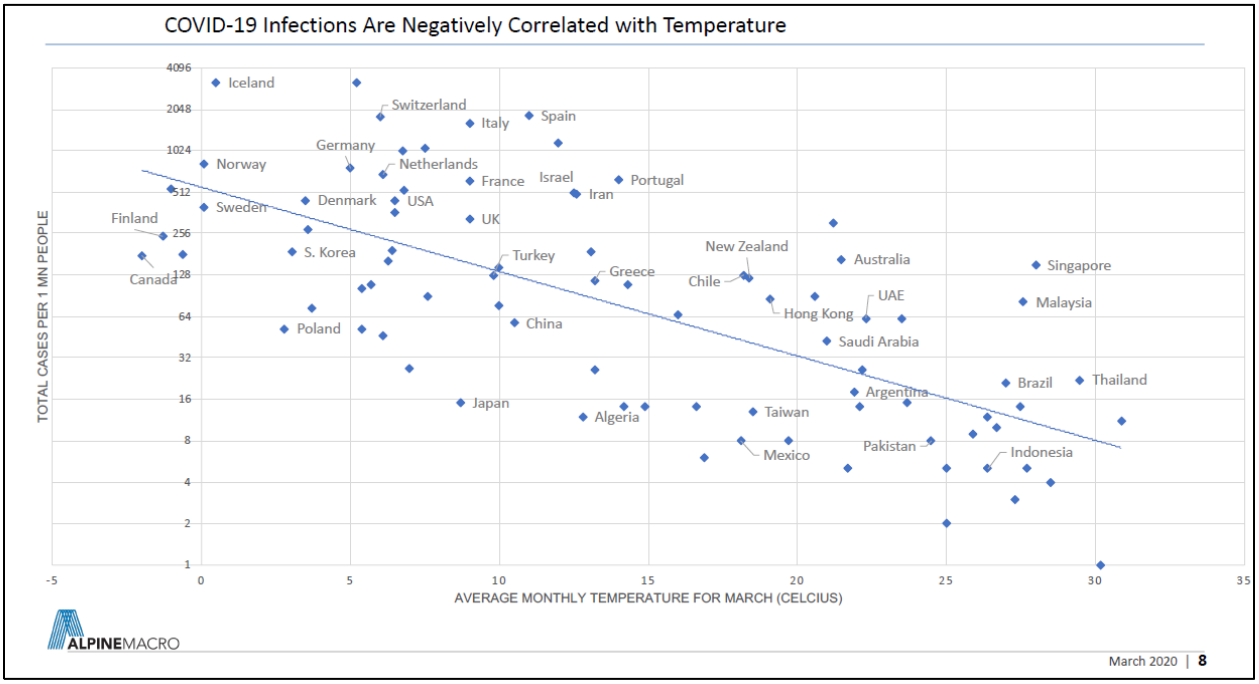
Seen another way…

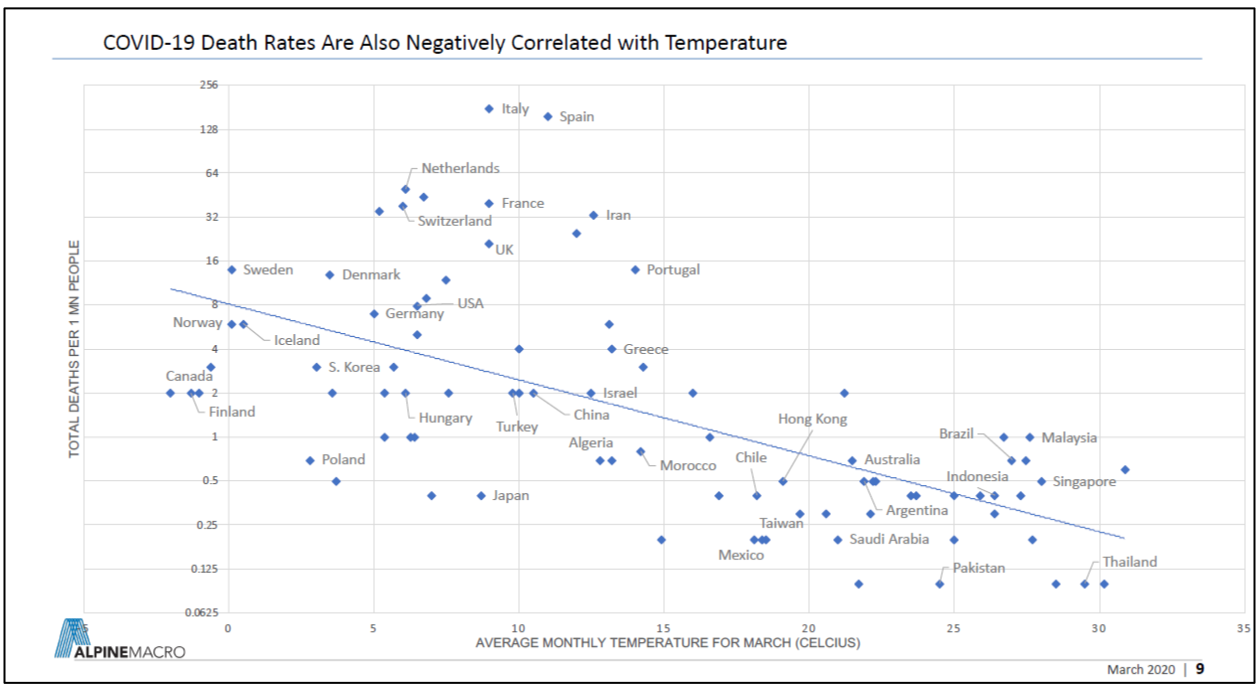


Testing remains variable and is increasingly focused on those with severe symptoms.



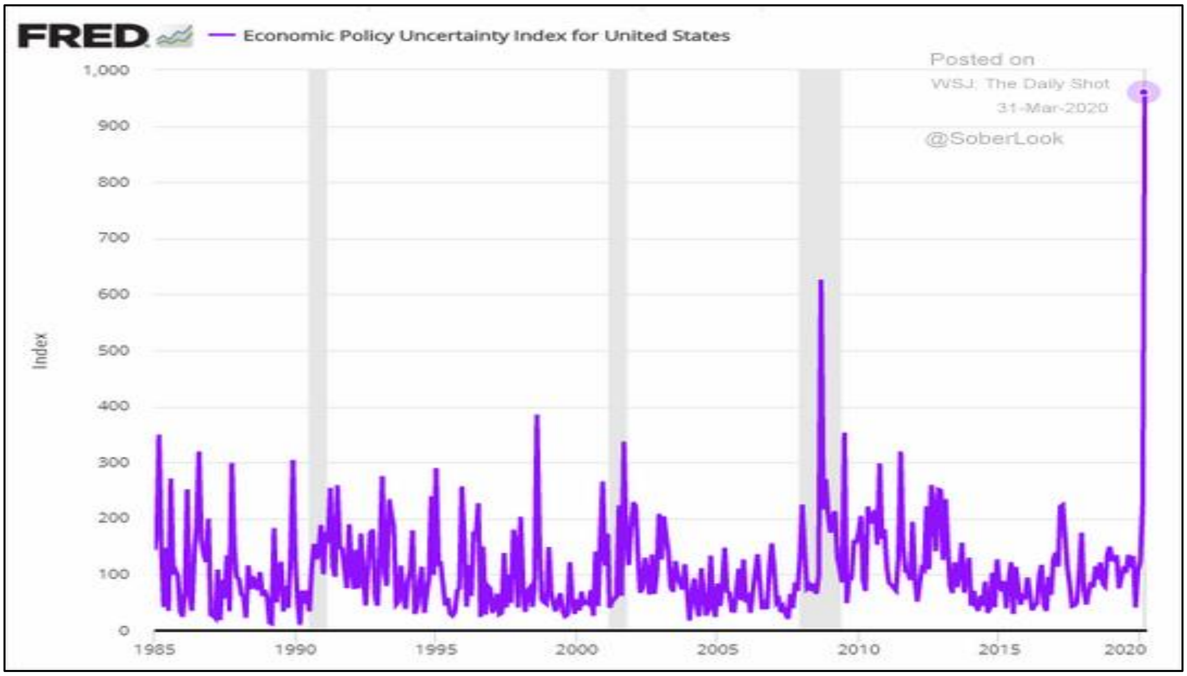
<u>Antibody testing is likely to be the path forward</u>… meantime some good news as the weather warms in Europe and the US.



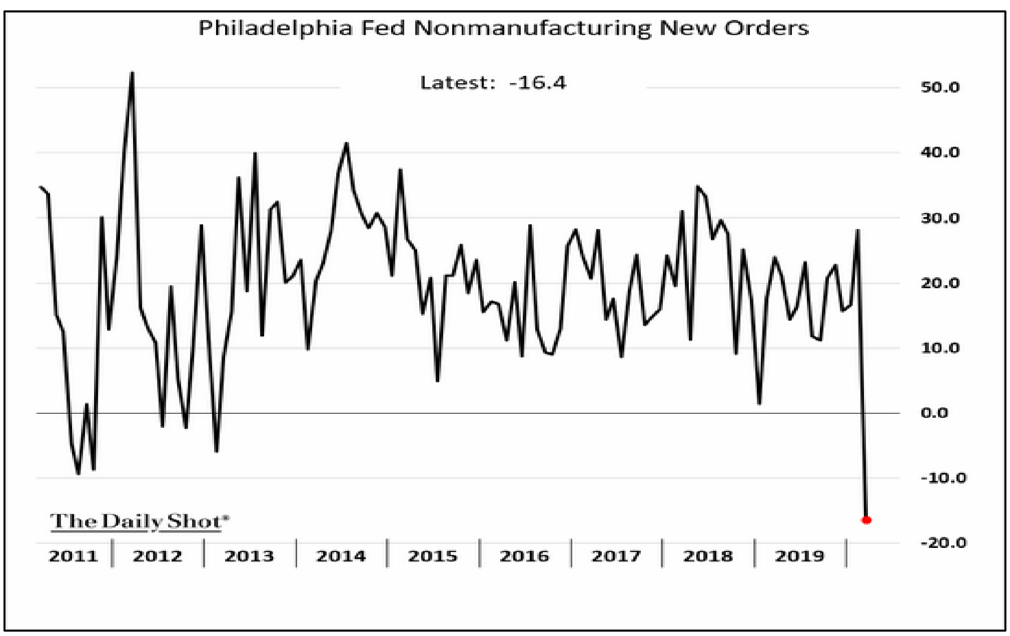


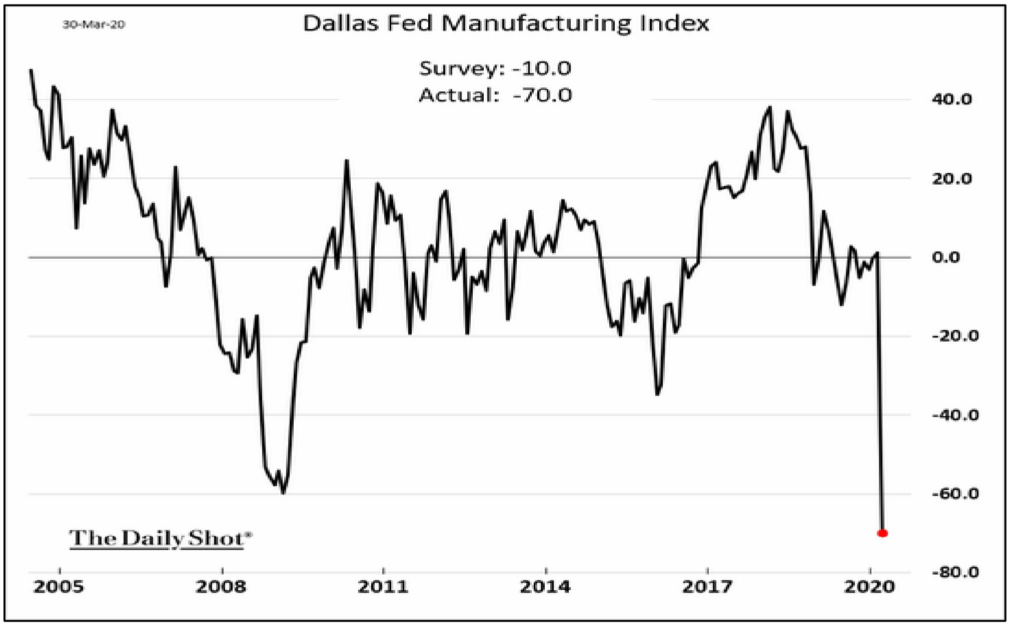
Historic Extremes

This crisis has brought a bull market in, straight-line, never seen before, historic moves.

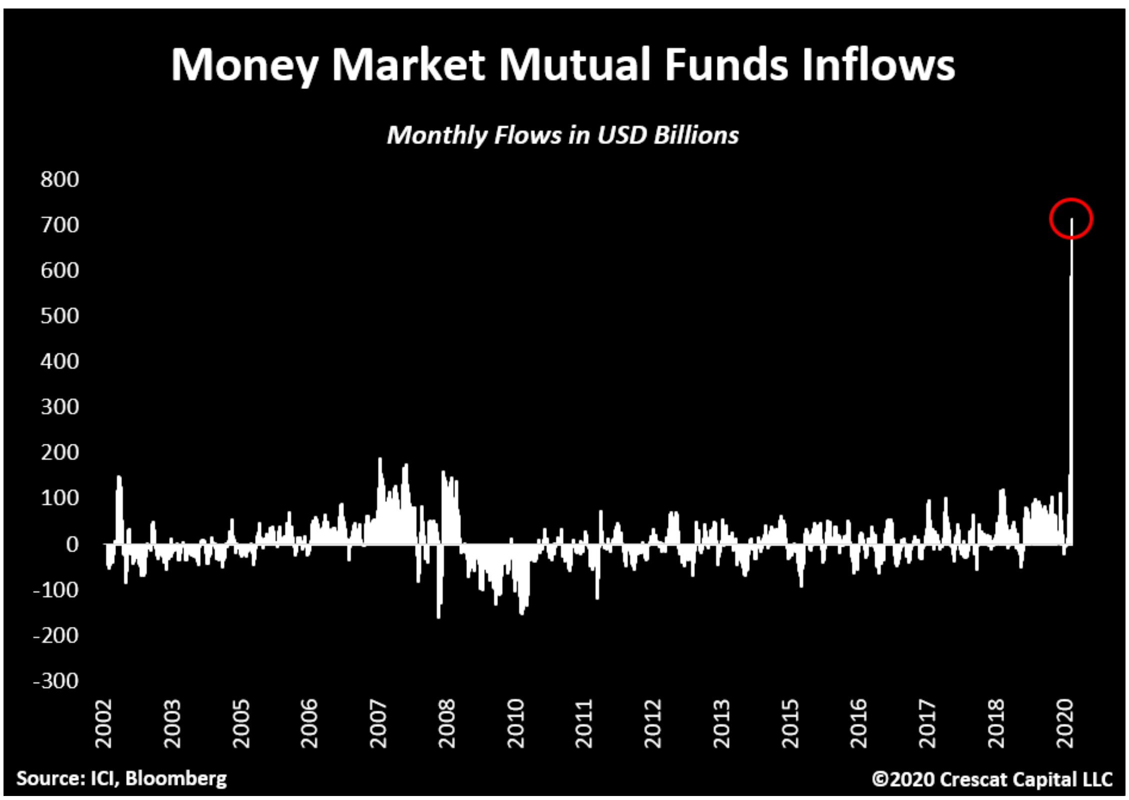


We are seeing these moves in the economic data, like the 10m rise in Initial Claims over a two-week period, all the way down to more regional indicators…

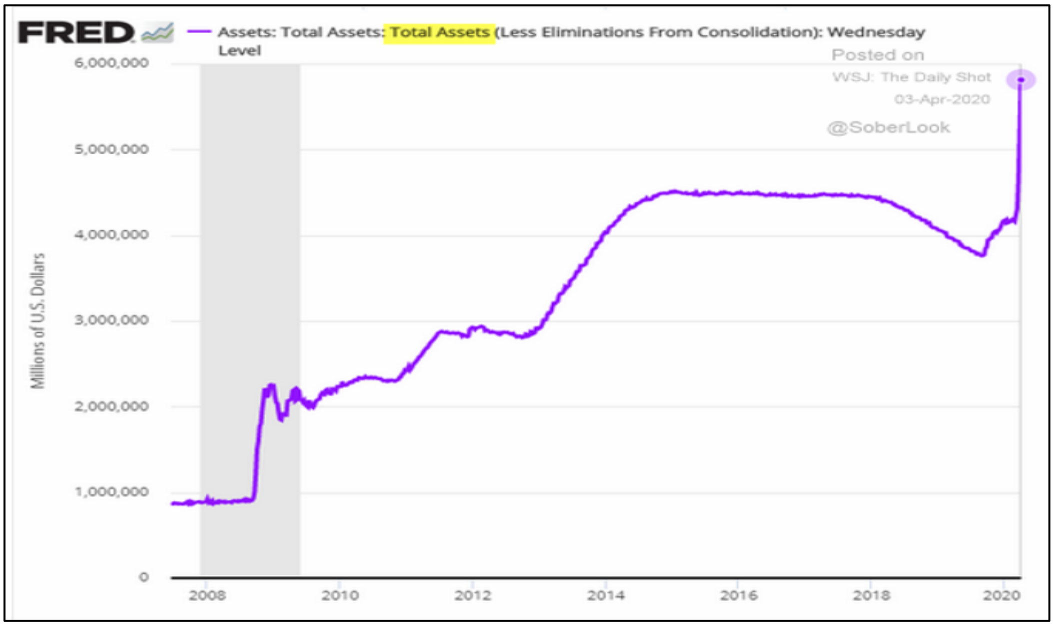




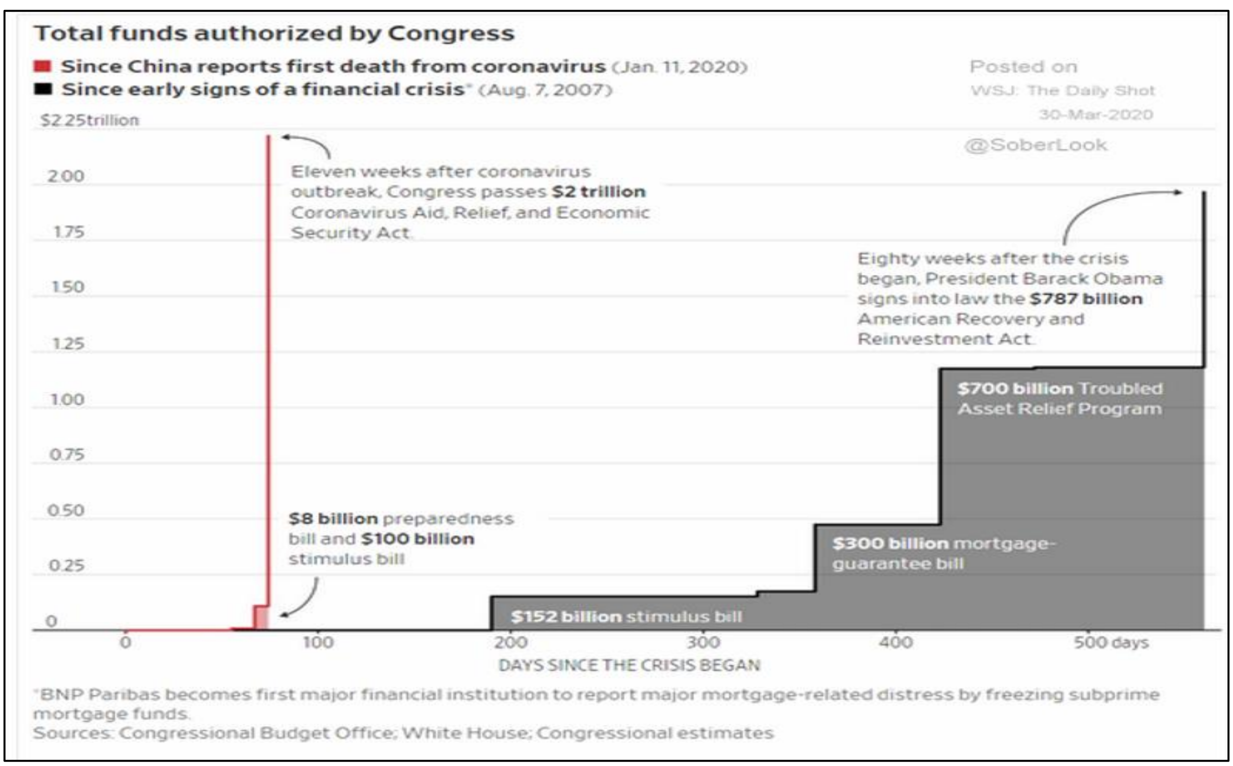
But also in flows… as liquidiation in its many forms has washed thru the market.



Of course, the Fed has joined in with the lightning fast rate cuts and a large jump in QE.



The Federal Government has also acted **quickly** and in **size** never seen before, with massive fiscal spending.



My point is that with all precedents busted both in terms of the type of productivity shock we have seen and the response to it, forecasting the way forward is very hard. The debate on V, U or L recovery is raging. The unknows however are many.

- A big chunk of cash flow is gone… can governments do enough to fill that void?
- Is the damage done going to be economically fatal for some, like HY?
- A lot will depend on SMEs ability to recover. How many survive/fail.
- A lot of the assistance is in the form of loan… some will need to be repaid.
- The above will have a big impact on how quickly employment recovers.
- This crisis brings debt on top of debt. Will this impair growth going forward?
- Effective therapeutics, a vaccine or meaningful herd immunity could bring a “sudden start”… when?

USD

The market is very split on the USD. The wide open G7 FX Swap Lines, goosed US QE and unprecedented fiscal spending, are convincing market participants that the dollar should weaken. JPY and EUR are still seen as eventually benefiting. I’m not so sure. So far it isn’t happening. Were the dollar to rally as last man standing and not just because of funding needs, there wouldn’t be much the Fed or anyone could do about it. USD as safe haven.

Fig. 2 - A dislocation between the dollar and its positioning gauge

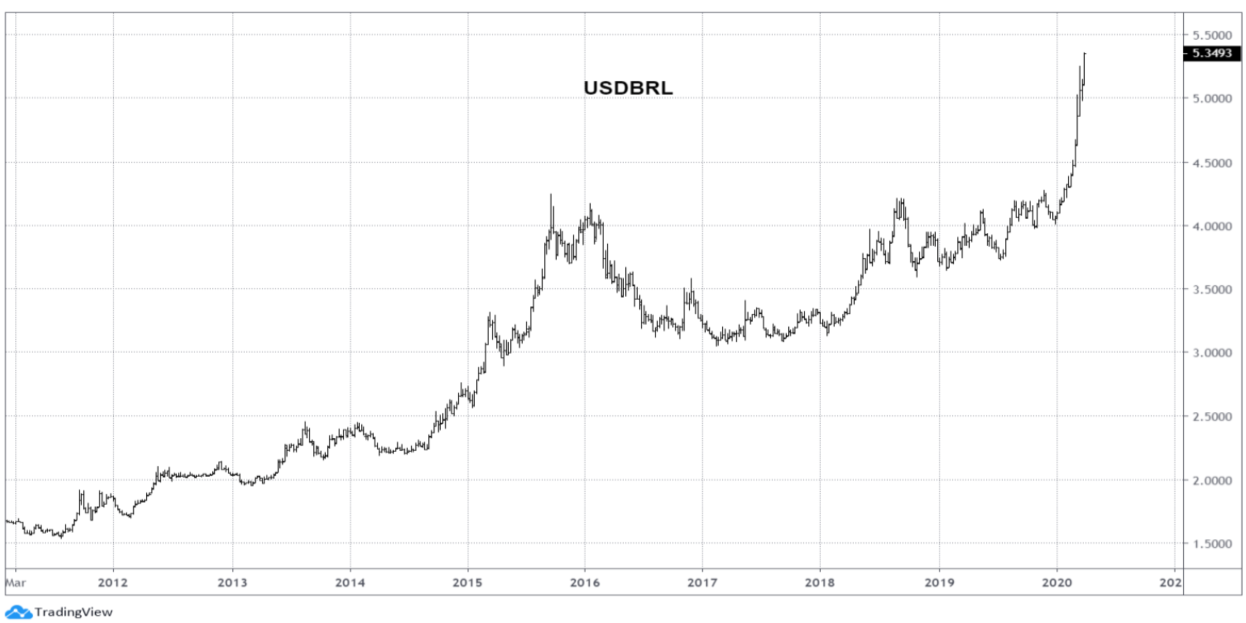
Source: Bloomberg, ING

As noted last week the basis swaps have come zooming back as the FX swap lines had the taps opened. The USD funding issues as seen via FX forwards seem to have been drowned.

Yet the EUR isn't exactly perky… I'm thinking par is still in the cards.

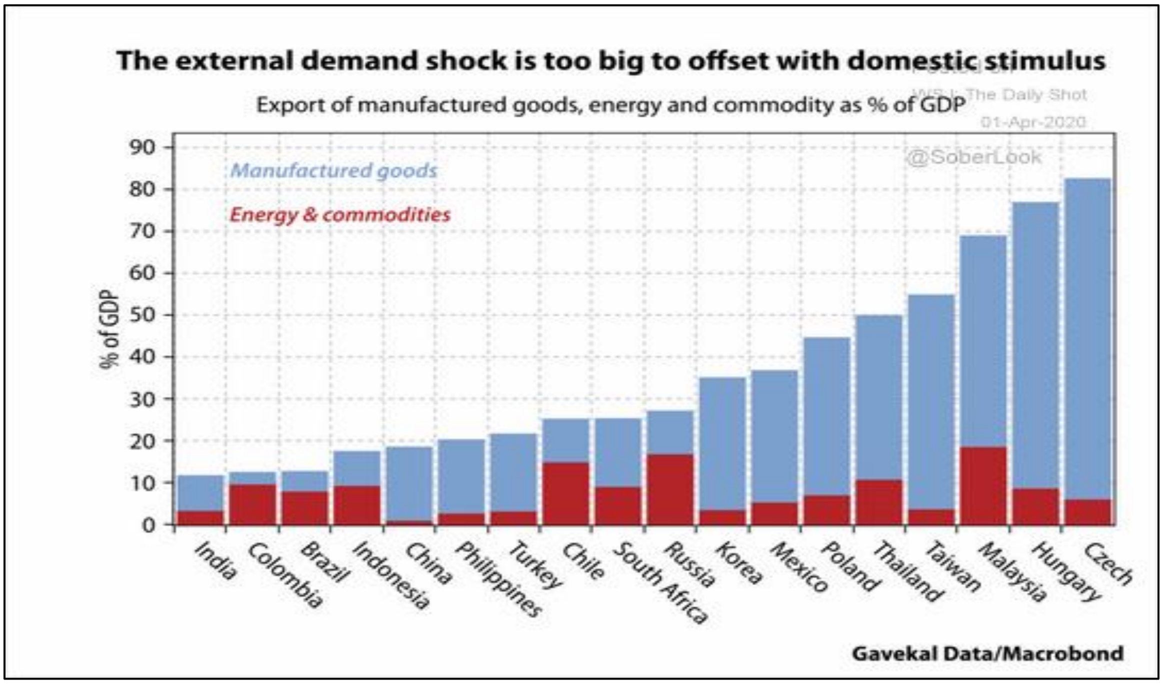
Like Repo, Swap Lines can add USD but do they get to the right buckets? They are effectively only aimed at G7 counterparts. The Fed has added a special temporary repo facility for international and monetary authorities (FIMA) to try and further address the issue.

EM in particular is having a hard time.

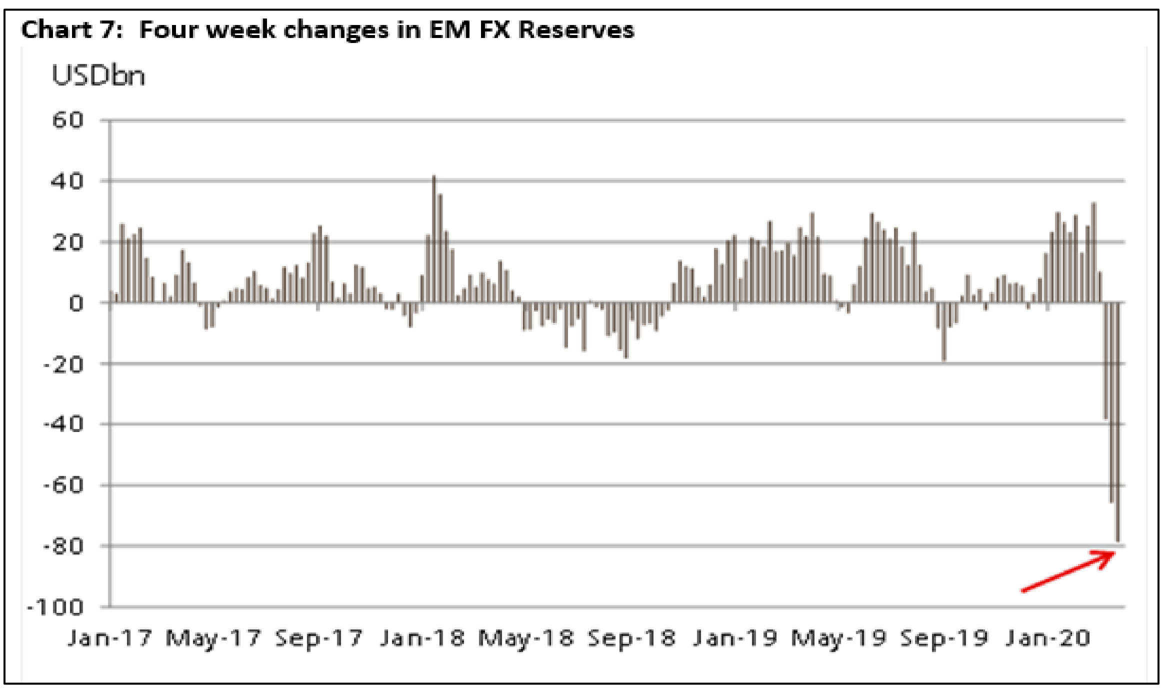


Stargazer
Asset Management

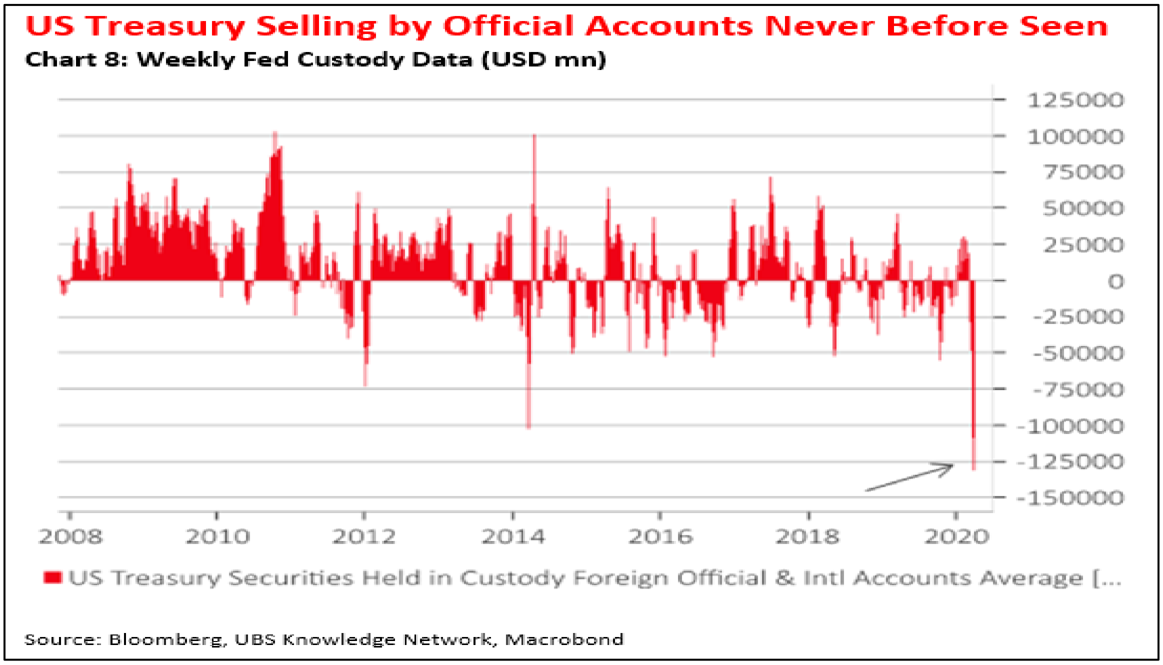
For export and commodity dependent economies, this is an especially painful crisis.



It is no surprise that EM currency reserves are falling…

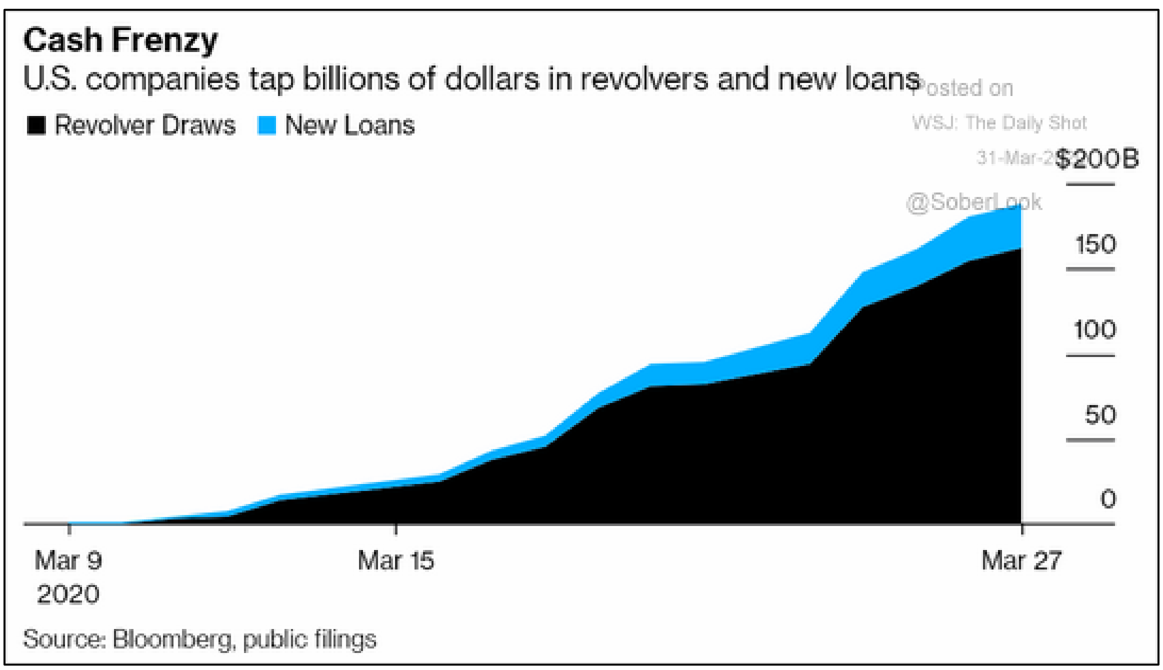


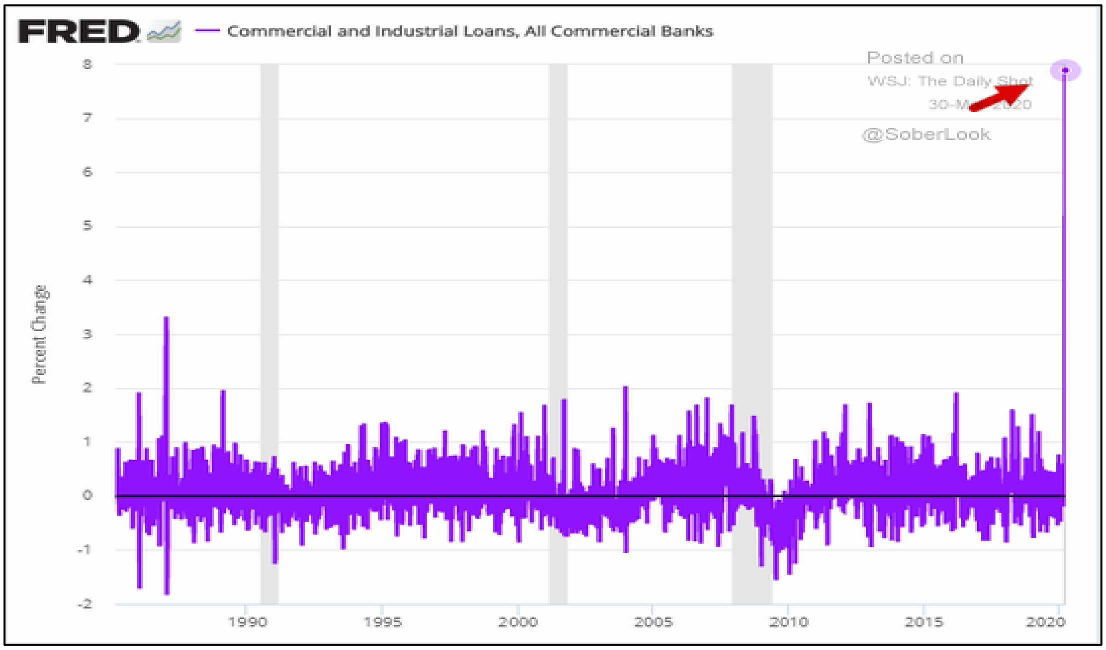
Some of this can be seen as they dump US Treasury holdings to raise liquidity. There has been lots of talk about Middle East sellers given the happenings in Oil.



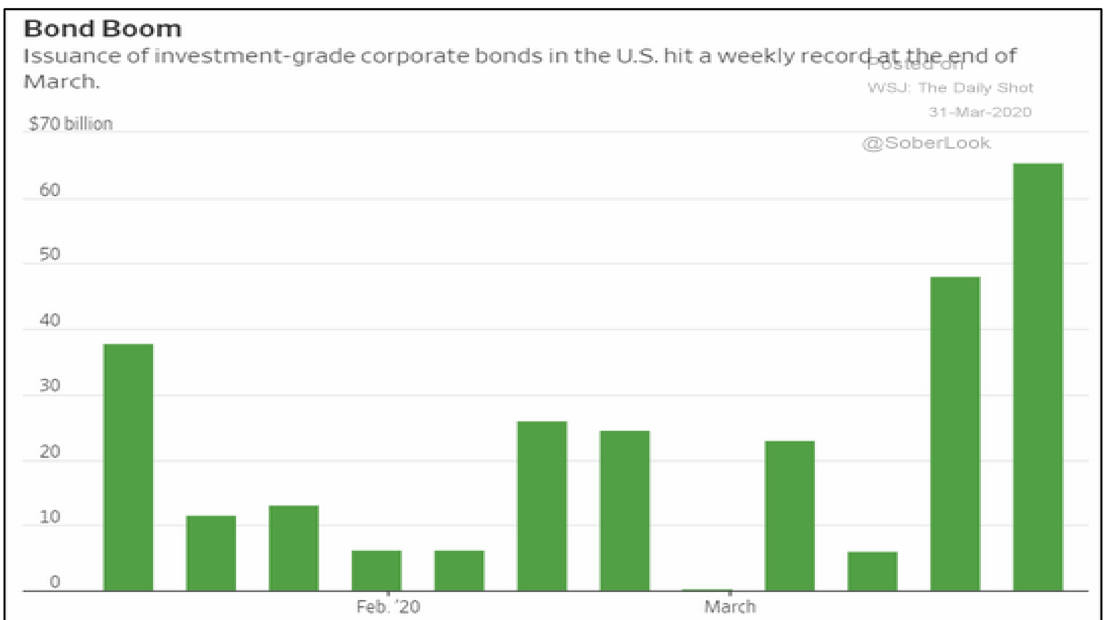
Credit

As the cash flow slows or stops, credit is required to bridge the gap.



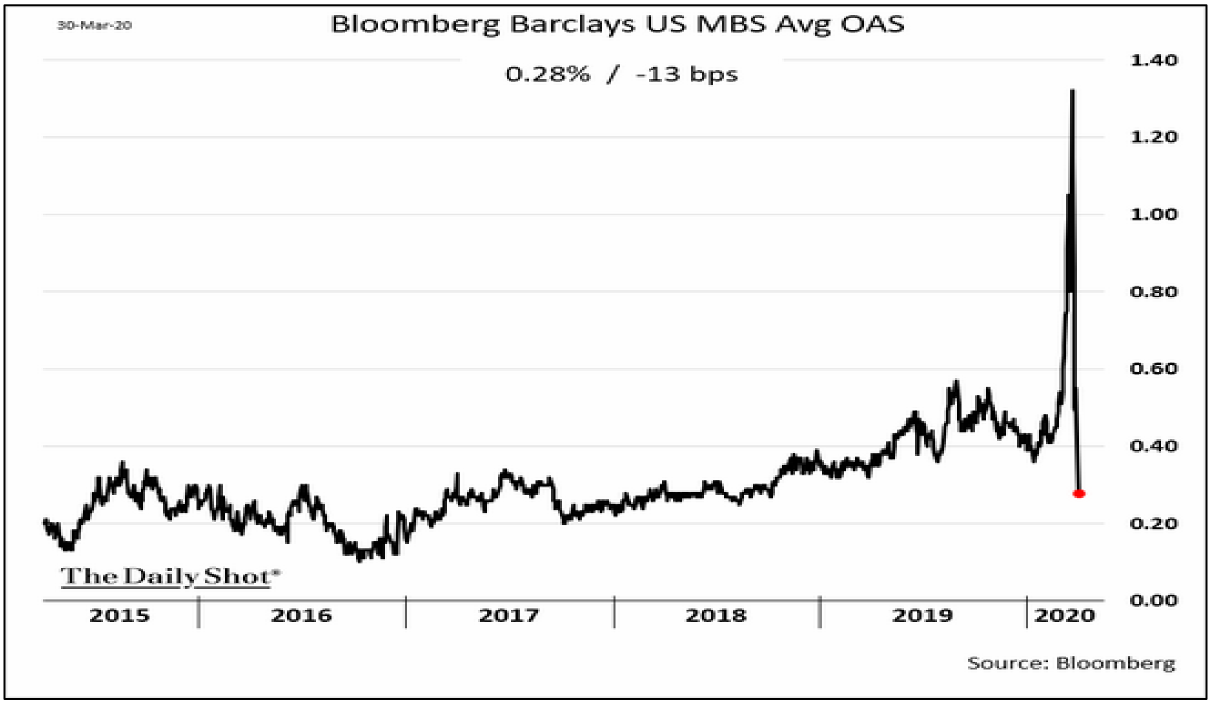


With liquidation having washed through the market and the Fed now buying corporate bonds both directly and indirectly, the market is open again.

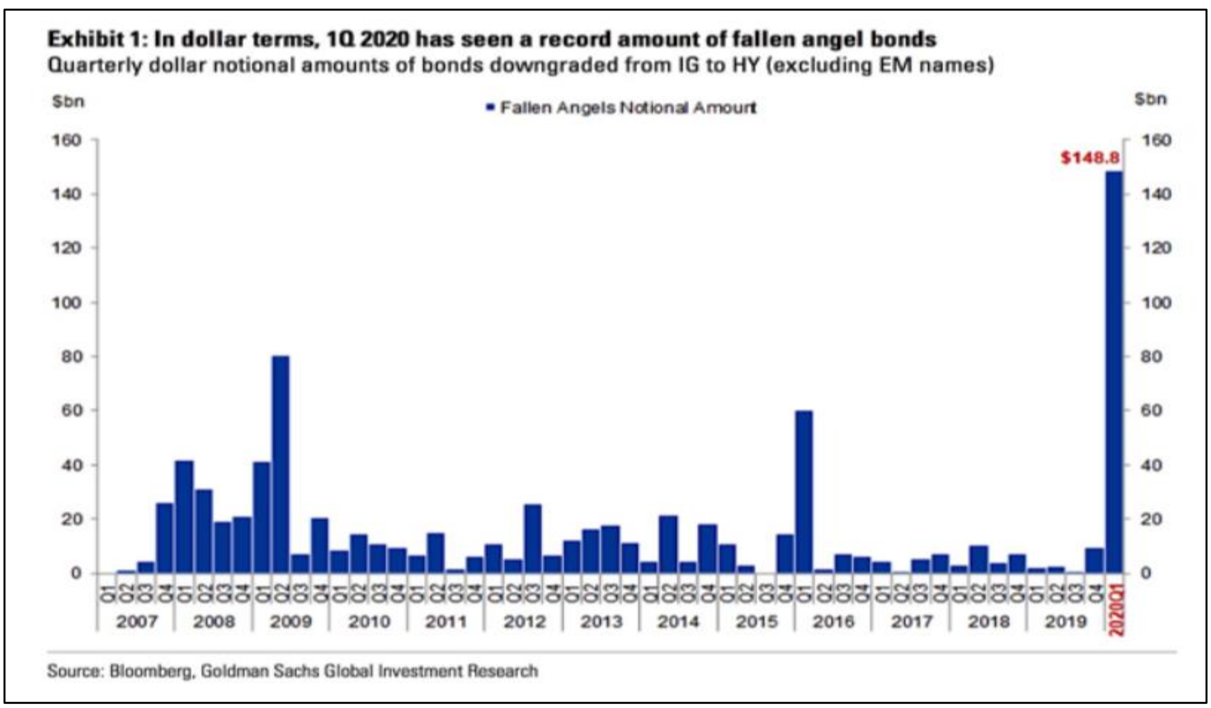


Source: Dealogic

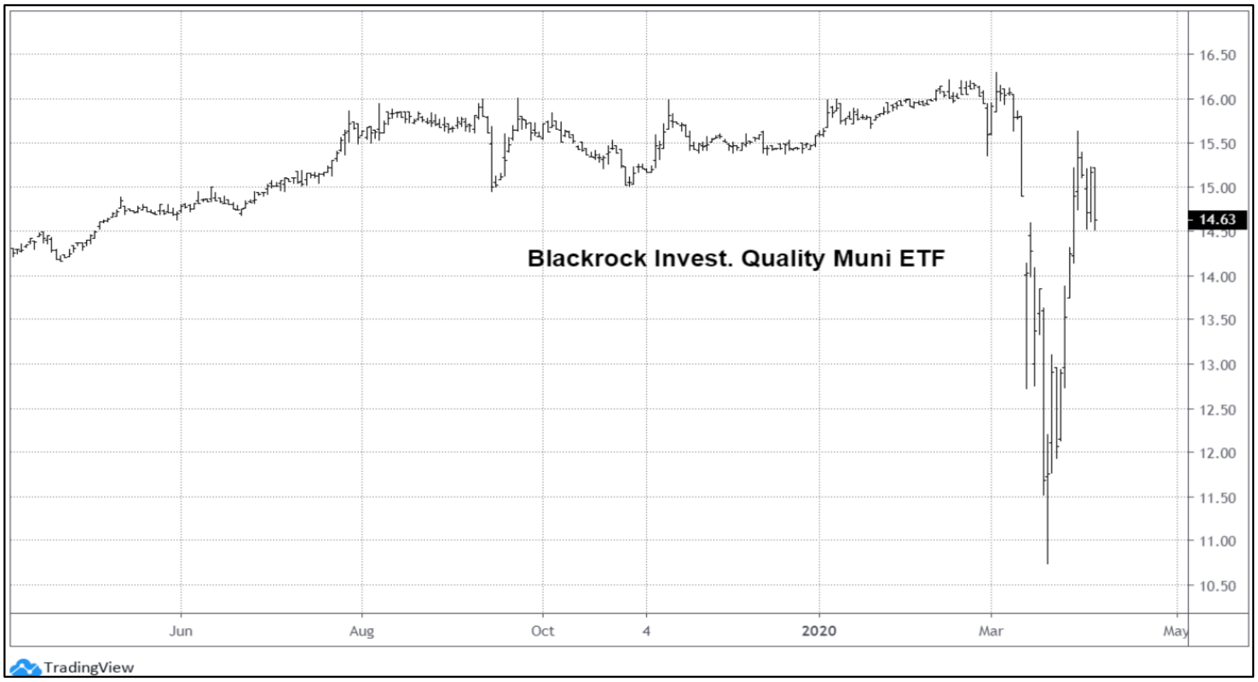
Their presence in the mortgage market is being felt as well, as spreads collapse after the spike.



However, as quality deteriorates with cash flow the downgrades have started.



Municipal Bonds also got caught up in the liquidation with the added threat of increased outlays and falling revenues. Here too the Fed has now stepped in and prices have come back.



It will be interesting to see what level of support will come from the Federal government and whether these long-held relationships vs. corporate bonds are maintained. Traditionally, lower rated Muni's were able to maintain default rates only seen with the highest quality corporate bonds.

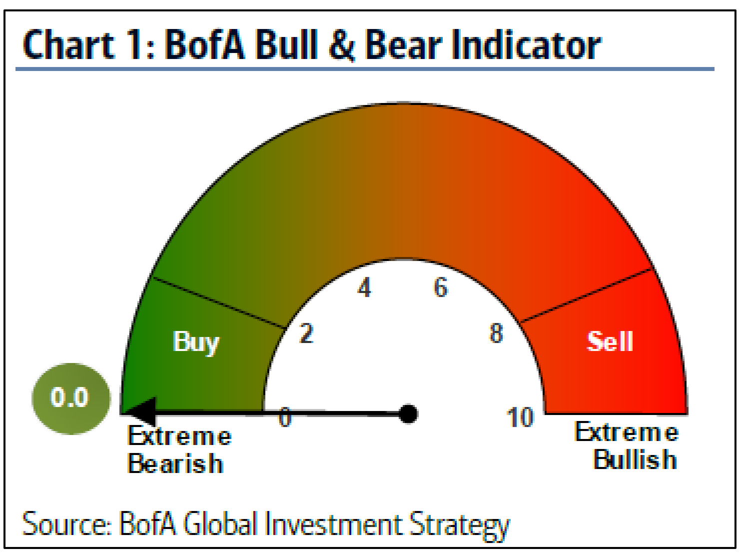
Credit Quality[5]	Municipal (%)	Global Corporate (%)
AAA	0.00%	1.16%
AA	0.06%	1.45%
A	0.16%	2.71%
BBB	1.03%	5.98%
BB	5.04%	17.96%
B	11.69%	29.97%
CCC/C[6]	42.78%	58.88%
Investment Grade	0.28%	3.61%
Speculate Grade	9.61%	26.96%

Source: Russell Investments; **Read full article**

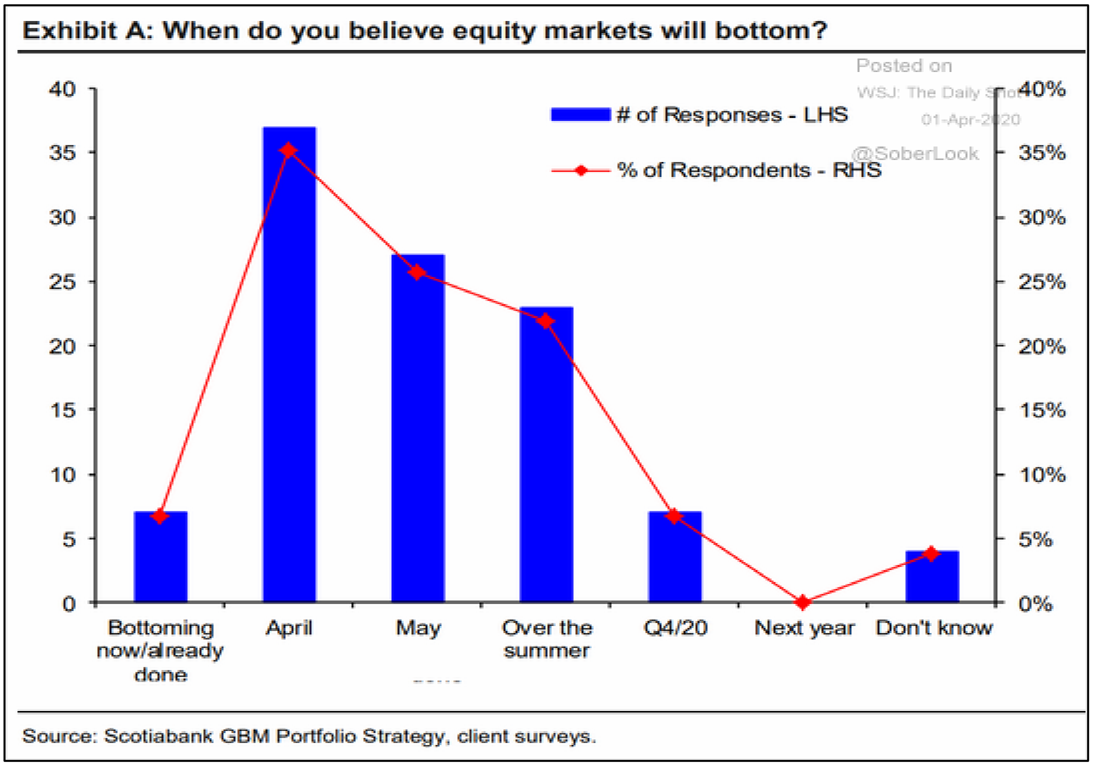
Equities

As with the USD, Equities have lots of bulls and bears at these levels.

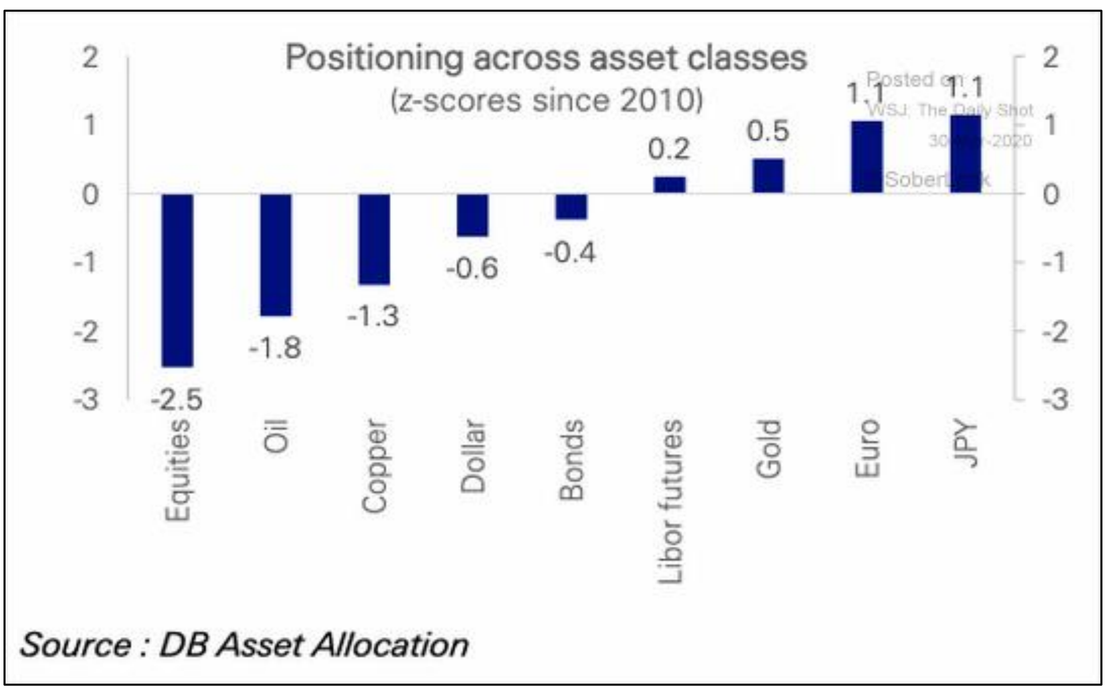
BoA/ML points out that their market indicator is now at maximum bearish. The wave of liquidation we have seen across markets will be driving this extreme print. They are thinking that we hold 2150 on the S&P.



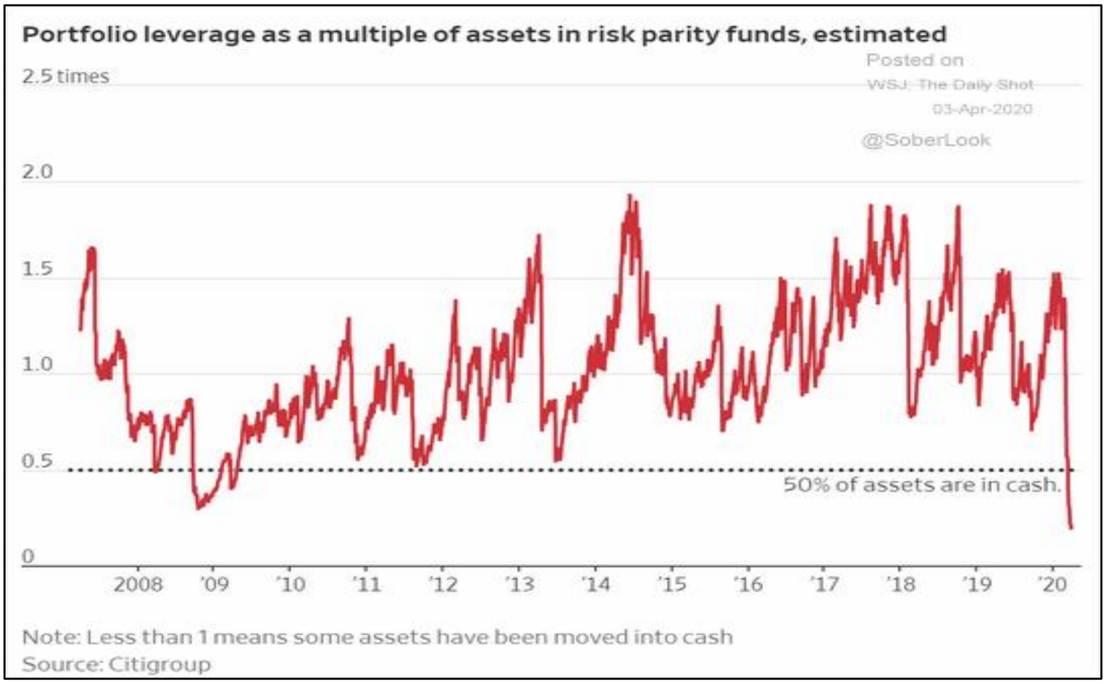
Market participants in various surveys seem to think we are also close to a low, coinciding with an expected peak in the infection curve.



However, positioning still looks very bearish.



And at least for the moment, liquidation seems to have run its course.



That begs the question. What is the path of most pain for the market from here? With many positioned to buy further weakness now and then looking for a rally, is the maximum pain extracted if you get the opposite?

Econ Data

At this point some sort of peak in the infection curve is inevitable. The question is, what happens then.

Again, the very unusual speed and depth of the virus induced halt to commerce has produced consequences that are almost literally off the charts outside of World Wars and the Great Depression.

This is true in the US …

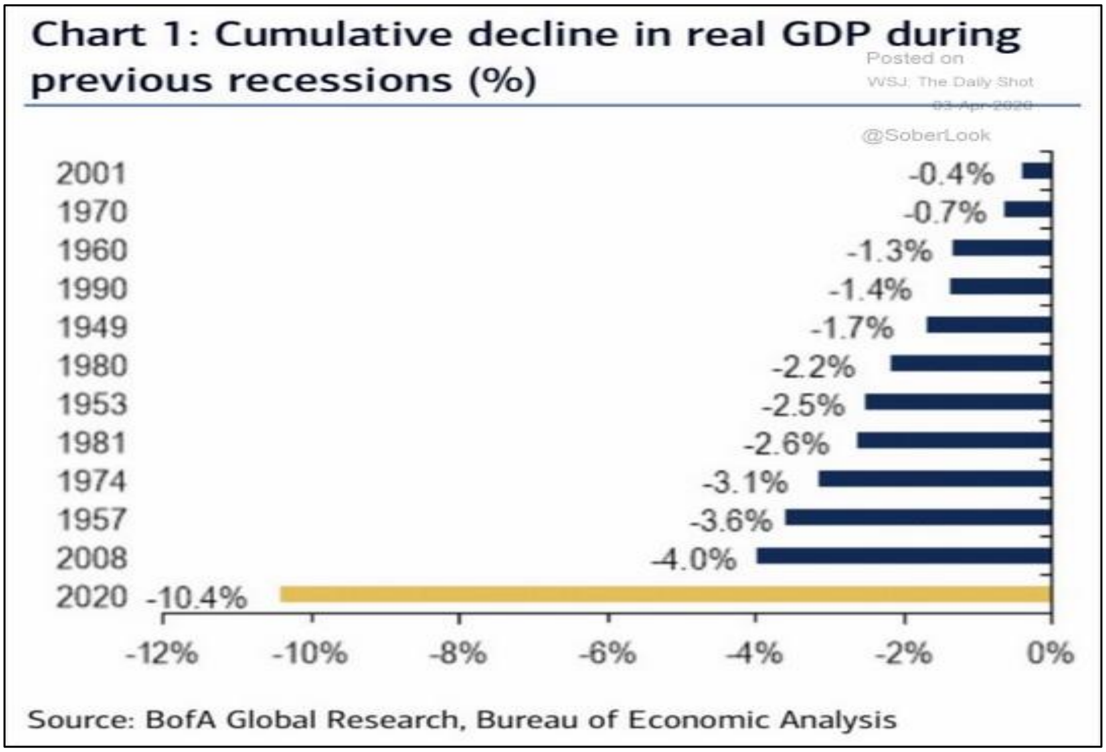


Chart 1: Cumulative decline in real GDP during previous recessions (%)

Source: BofA Global Research, Bureau of Economic Analysis

And globally…

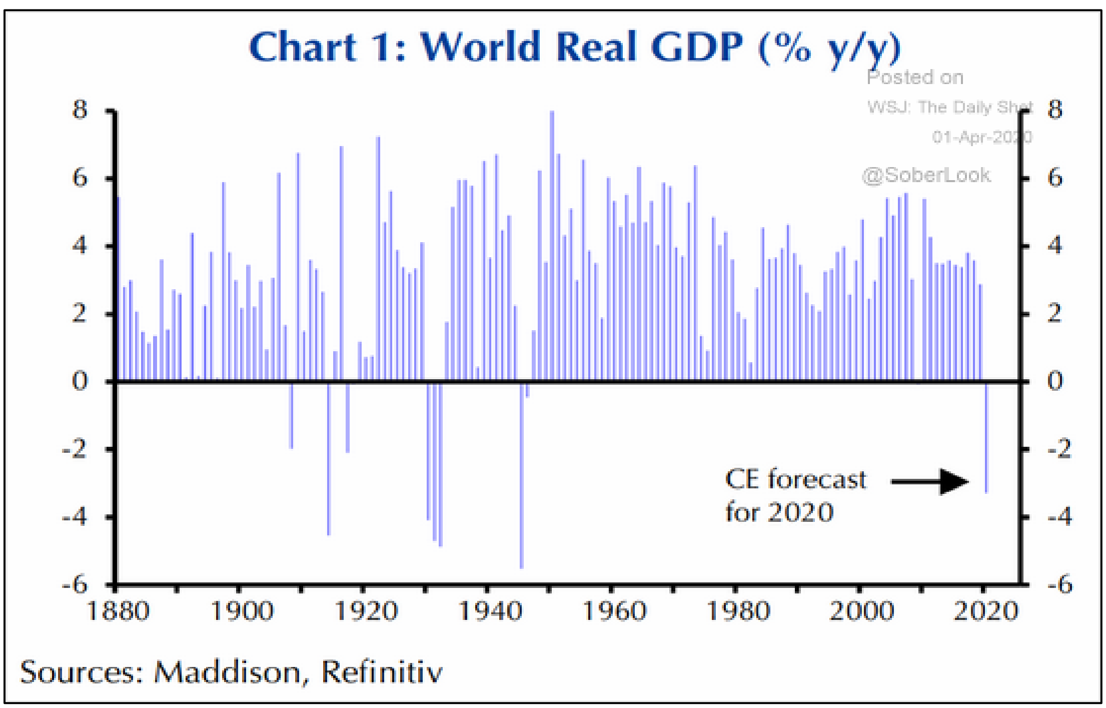
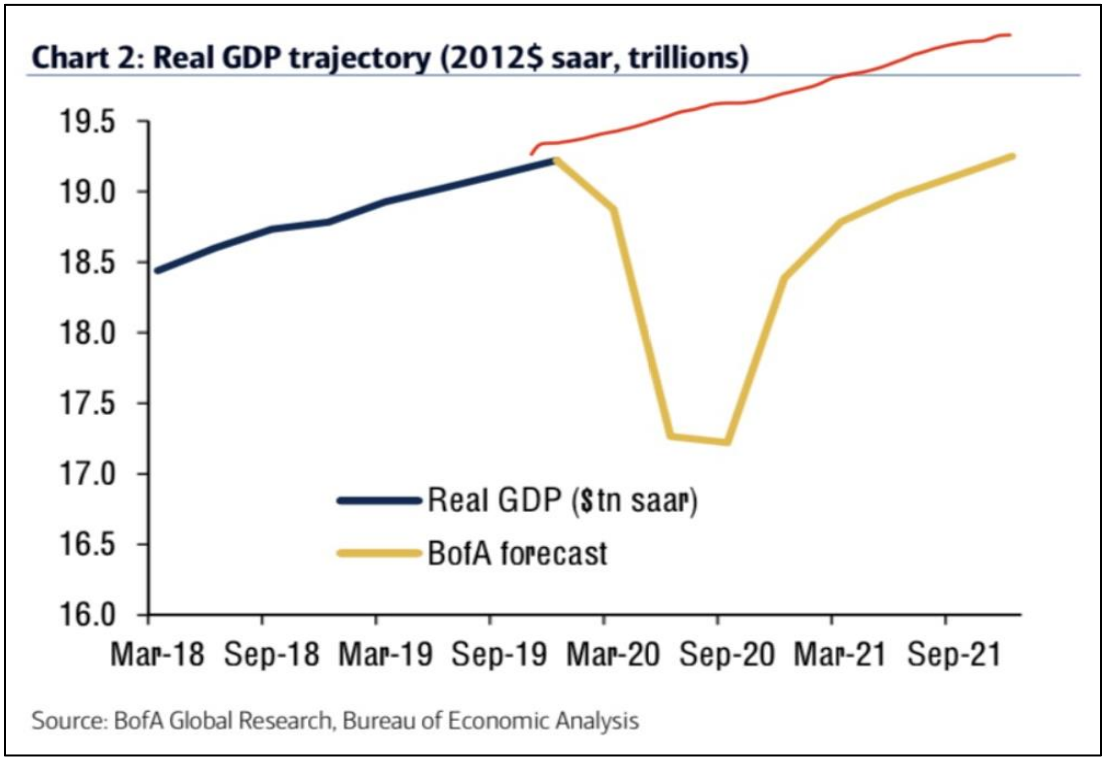


Chart 1: World Real GDP (% y/y)

Sources: Maddison, Refinitiv

Lots of things to watch for the final verdict on what shape that yellow line will take… V,U or L.



Important Macro Data Releases and Events for the Week

Monday
4/6/2020

OPEC Meeting (**Now moved to Thursday**)

Factory Orders MoM (Feb) Forecast: -2%, Prior: 5.5%

Tuesday
4/7/2020

Eurogroup Meeting

Industrial Production MoM (Feb) Forecast: -1%, Prior: 3%

Ivey Purchasing Manager's Index (Mar) Forecast: - , Prior 54.1

Machinery Orders MoM (Feb) Forecast, -3%, Prior 2.9%

Wednesday 4/8/2020

FOMC Minutes

Thursday 4/9/2020

BoJ's Governor Kuroda SPEECH

ECB Policy Meeting Accounts

Initial Jobless Claims Forecast: - , Prior: 6.648m

Initial Jobless Claims 4-week ave. Forecast: - , Prior: 2.612m

Continuing Claims Forecast: - , Prior: 3.029m

Unemployment Rate (Mar) Forecast: - , Prior: 5.6%

Michigan Consumer Sentiment Index (Apr) Forecast: 75, Prior: 89.1

Friday 4/10/2020

CPI and PPI

CPI MoM (Mar) Forecast: -0.2%, Prior: 0.1%

CPI Ex- Food & Energy MoM (Mar) Forecast: 0.1%, Prior: 0.2%

CPI Ex- Food & Energy YoY (Mar) Forecast: 2.3%, Prior: 2.4%

Fed's Mester SPEECH

Monthly Budget Statement (Mar) Forecast: - , Prior: $-235B

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