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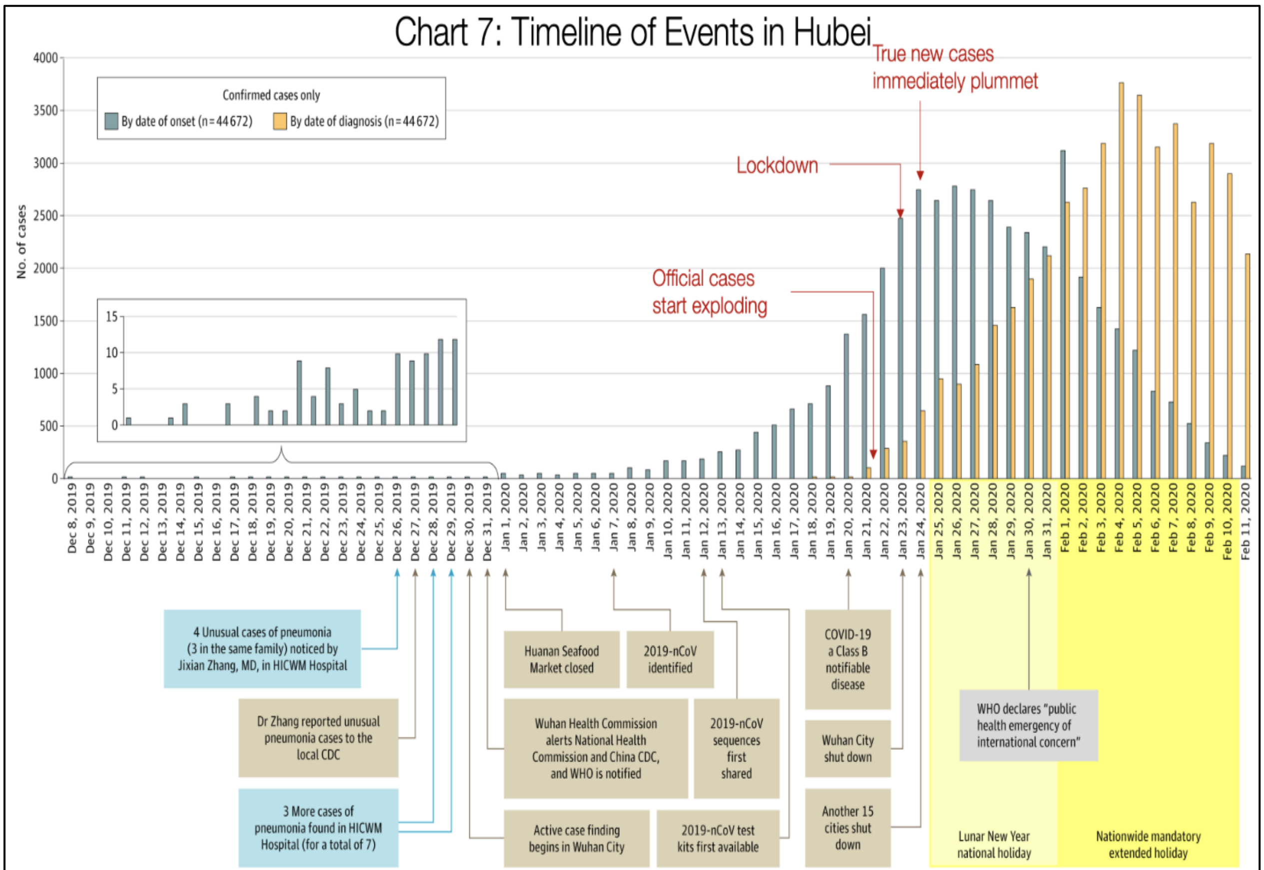
What to focus on in Global Macro for the week of March 16th, 2020

Macro Themes on the Radar:

Lockdowns work

Here are some excerpts from an interesting [piece]() by Tomas Pueyo on the effectiveness of lockdowns.

"This chart shows in orange bars the daily official number of cases in the Hubei province: How many people were diagnosed that day. The grey bars show the ***true*** *daily coronavirus cases. The Chinese CDC found these by asking patients during the diagnostic when their symptoms started. Crucially, these true cases weren't known at the time. We can only figure them out looking backwards: The authorities don't know that somebody just started having symptoms. They know when somebody goes to the doctor and gets diagnosed."*



Source: Tomas Pueyo analysis over chart from the Journal of the American Medical Association, based on raw case data from the Chinese Center for Disease Control and Prevention

"What this means is that the orange bars show you what authorities knew, and the grey ones what was really happening.

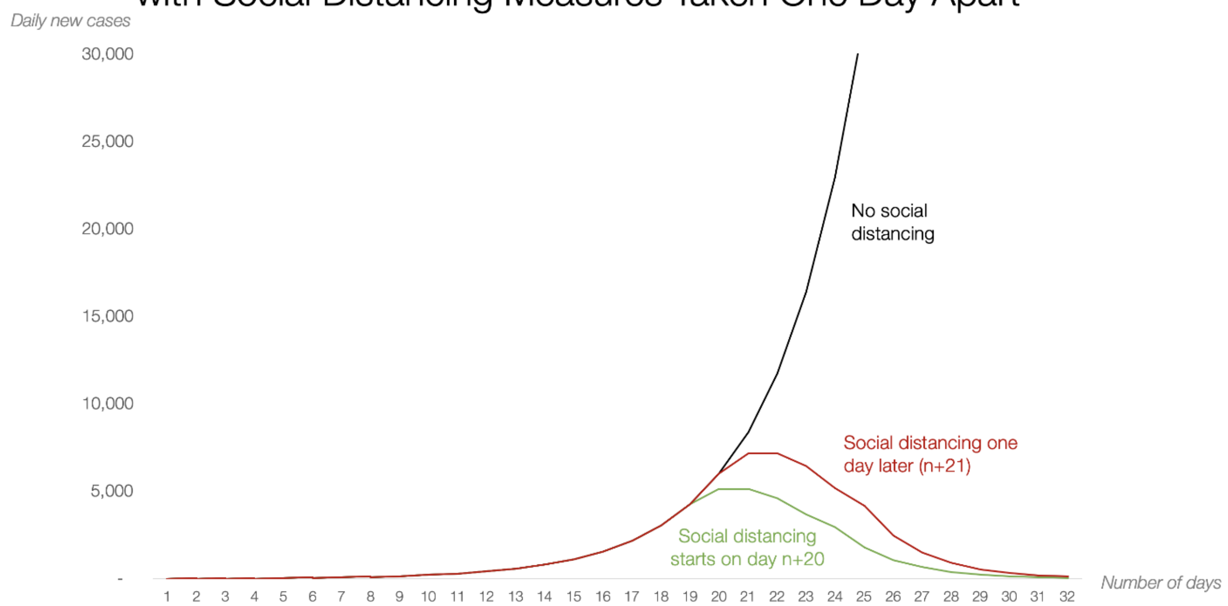
This is what you can conclude:

- *Excluding these, countries that are prepared will see a fatality rate of ~0.5% (South Korea) to 0.9% (rest of China).*
- *Countries that are overwhelmed will have a fatality rate between ~3%-5%*

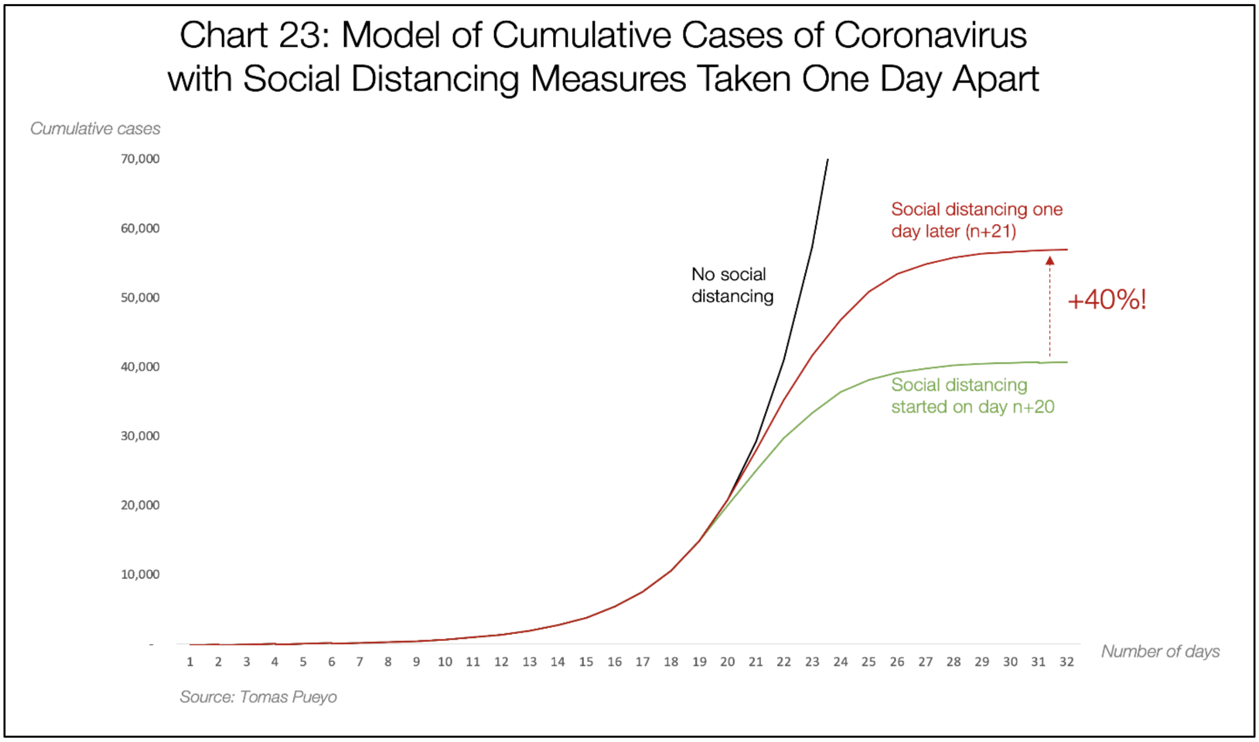
  Put in another way: Countries that act fast can reduce the number of deaths by a factor of ten. And that's just counting the fatality rate. Acting fast also drastically reduces the cases, making this even more of a no-brainer."

The charts they present on the effects of timely social distancing are eye-opening.

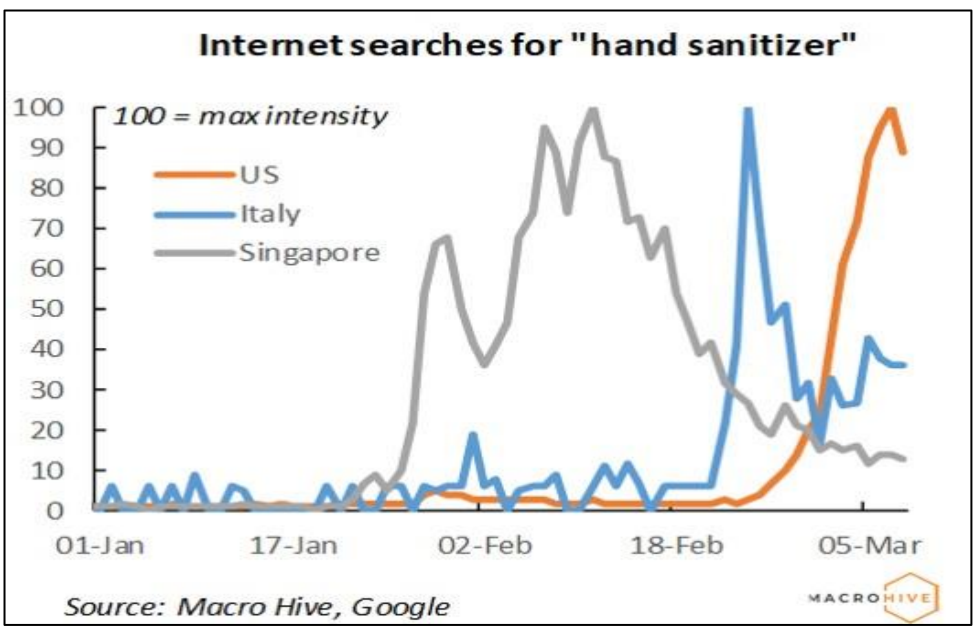
Chart 22: Model of Daily New Cases of Coronavirus with Social Distancing Measures Taken One Day Apart



Source: Tomas Pueyo



Europe seems to be embracing the lessons learned in Asia now. Over the weekend, a number of new lockdown measures were announced. For example, Denmark closed its borders as of mid-day Saturday. On Sunday, Austria's Tirol region was put under 24-hour curfew, with a EUR 2000 fine if you are caught outside your house. Better late than never as it rolls west.



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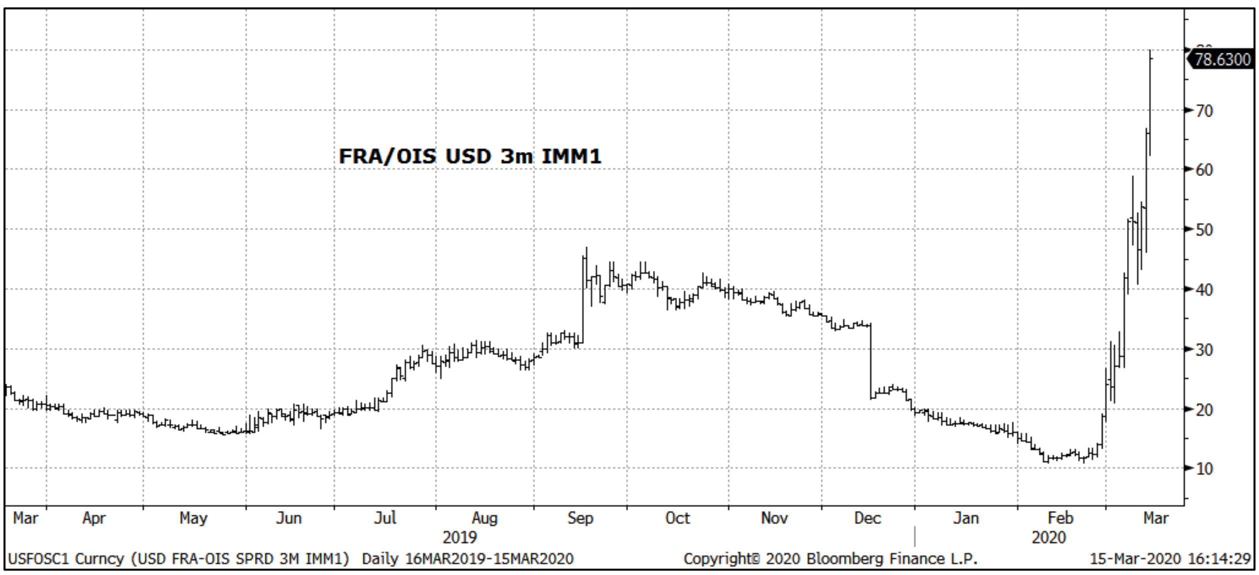
Central Banks

Left with few policy options the Central Banks are focused on providing large amounts of liquidity in an effort to ensure the continued functioning of credit and capital markets. At the same time global governments are starting to roll out meaningful fiscal spending. The final form and size of this support is still unknown. Assistance to small businesses is becoming especially critical with the expanding lockdowns.

Fed

The blowing out of spreads that led to the initial repo operations and balance sheet expansion that started last September has taken another leg wider.



The Fed has been providing liquidity via hugely expanded overnight and term-repo operations committing to an additional $175bln in overnight and $1.5trl in term-repo. They also shifted from buying $60bln a month in T-bills to now buying Treasuries along the entire curve. By the Fed's own definition (buying the long end), it is increasingly hard to categorize this as anything other than QE4.

The shift away from T-bills by the Fed is occurring because they found themselves competing with market participants for the high-quality collateral (T-bills) needed for repo.

A big problem they have been facing is that both cash and collateral are needed for the repo intervention to effectively reach those who need it.

As liquidity has tightened, it has left those most in need having a hard time accessing it. The lack of access to liquidity and the VaR shock we have seen from the explosion in volatility has turned the bull market in everything into everything going down together by the end of last week.

ECB

Last Thursday's ECB Press Conference and policy adjustments left the market disappointed. Lagarde shocked markets with her statement that, *"We are not here to close spreads, there are other tools and other actors to deal with these issues."* She subsequently tried to walk back her comment.

But the damage had been done. Italian bond yields spiked...

Although the ECB left the deposit rate and the main refinancing rate unchanged, in actuality, the ECB announced quite a lot in terms of temporary measure.

Until June 2021, TLTRO liquidity will be provided to banks at 25bps below the main refinancing rate. If they actually lend the money out, they can receive a rebate to 25bps below the deposit rate. Effectively this is a 25bps real cut for the banks. In addition, the ECB announced EUR 120bln in additional asset purchases to be completed by year-end. They can do these in government, corporate, asset-backed and covered bonds as needed by market conditions. In addition, the ECB will offer weekly long-term refinancing operations at the deposit rate. Essentially banks can have as much liquidity as they want assuming they have the appropriate collateral.

At the same time the Single Supervisory Mechanism also adopted new easing measures on bank regulatory capital that apparently amounts to a huge EUR800bln! With these policies the SSM is delivering massive capital relief.

Lagarde made it very clear that the EU governments now need to take action. She repeatedly warned against complacency and inaction. *"The response should be fiscal, first and foremost. I don't think anybody should expect any central bank to be the first line of response."*

With Italy under extreme pressure now and lockdowns spreading across Europe the response will need to come soon or risk permanent economic damage. The big question is whether this is the crisis that finally brings European governments together eventually forging a unified treasury and mutualized debt or results in a final fracturing of the union.

The Eurozone is potentially facing an existential threat.

What to Focus on Now:

The 30% drop in equities has priced an average recession at this point.

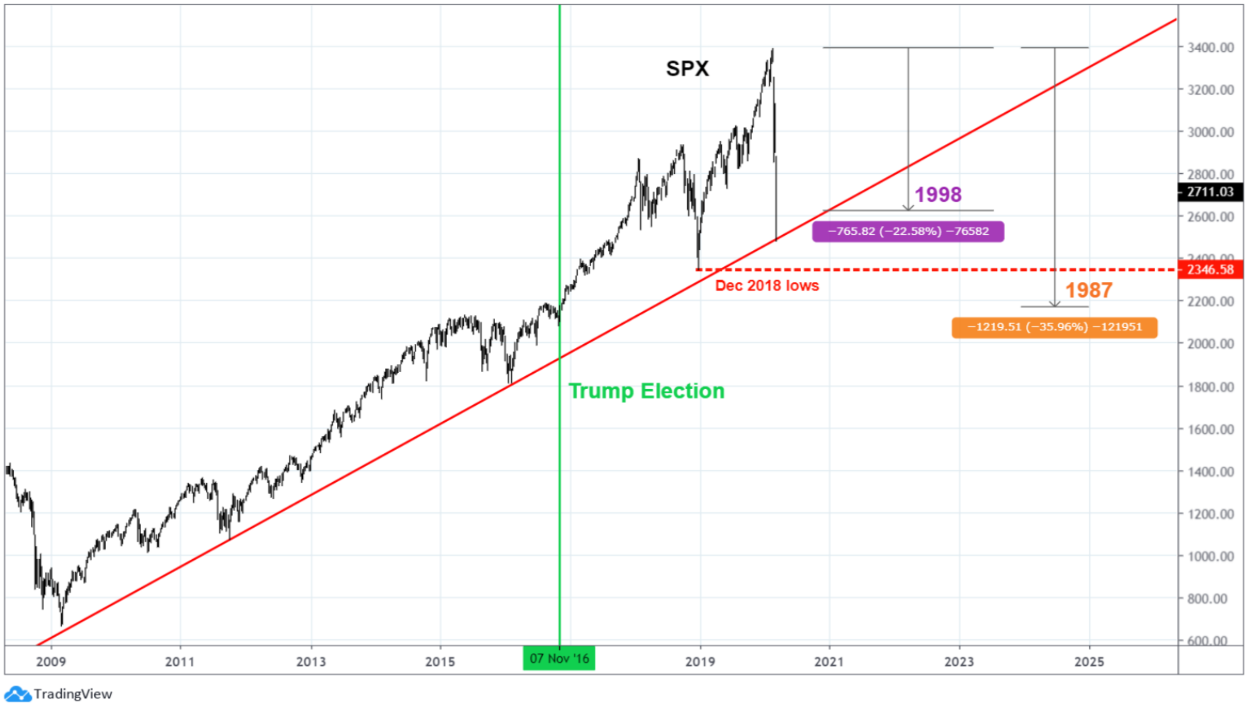
Chart 8: S&P500 holding 2400 consistent with typical "recession" level EPS downgrades

S&P 500 12m fwd EPS

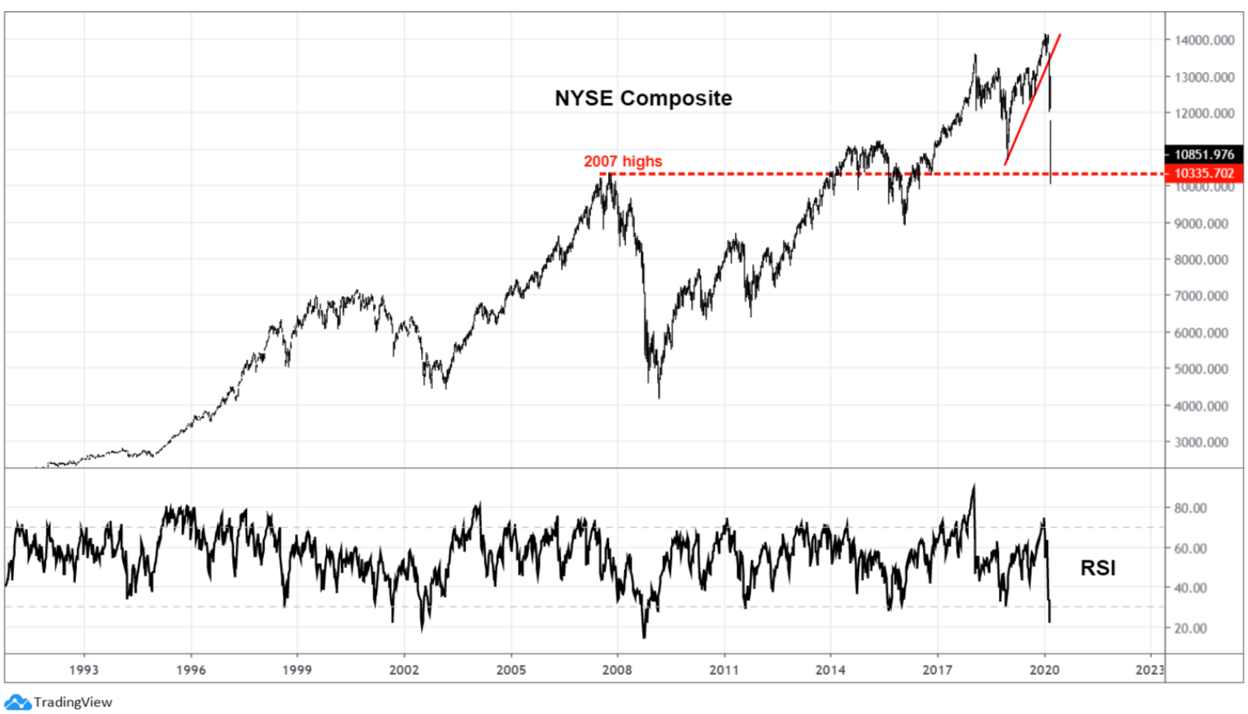
P/E multiple	130	150	177	185	195
	-25% EPS	-15% EPS	+0% EPS	+6% EPS	+12% EPS
10.0	1300	1500	1770	1850	1950
12.0	1560	1800	2124	2220	2340
14.0	1820	2100	2478	2590	2730
16.0	2080	2400 Hold	2832	2960	3120
18.0	2340	2700	3186	3330	3510

Source: BofA Global Investment Strategy, Bloomberg, Datastream, IBES

Here is an S&P chart for some context on where we are, including '87 and '98 declines.



The NYSE Composite got back to the 2007 highs.



The fall in equities has been deep and fast… and has been a rout for global stocks.

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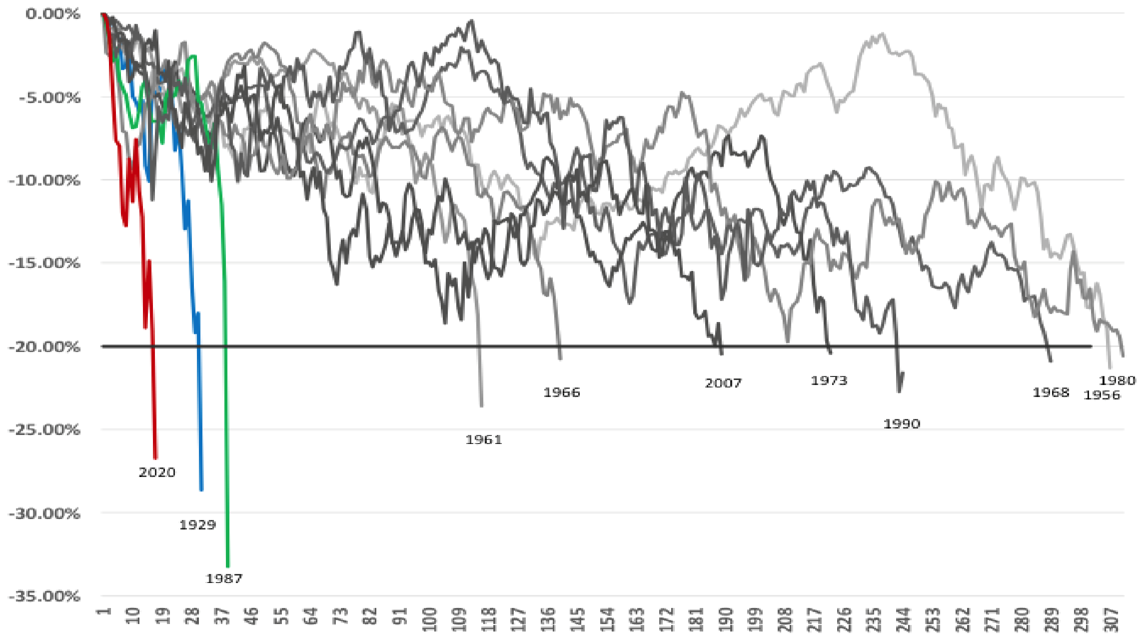
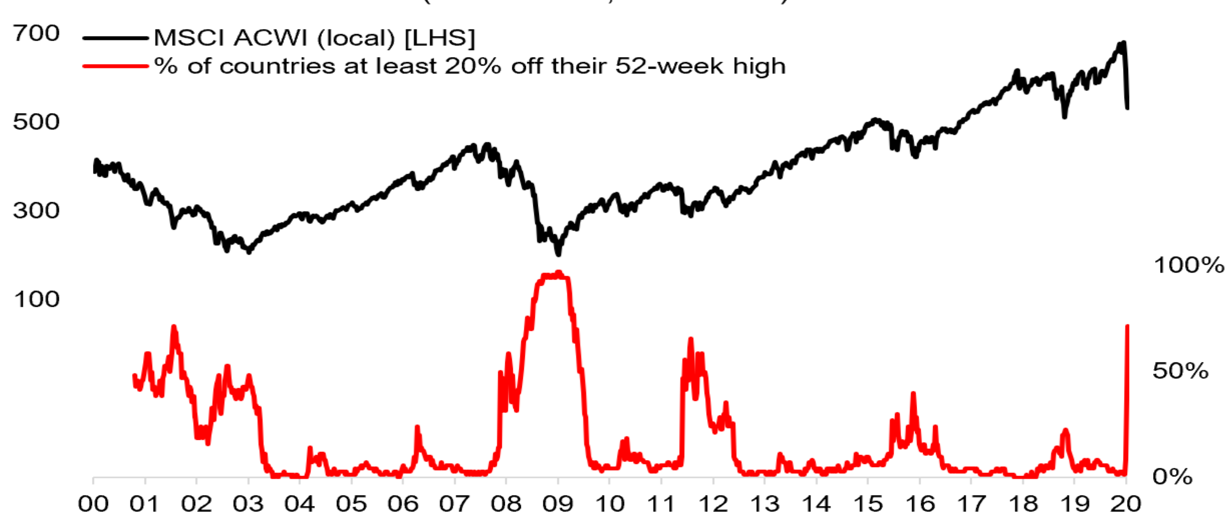
Exhibit 1: The S&P500 has dropped 20% from peak faster than in any other stock market crash before

Performance until the day it surpassed the -20% threshold (vertical axis); Trading days from peak (horizontal axis)



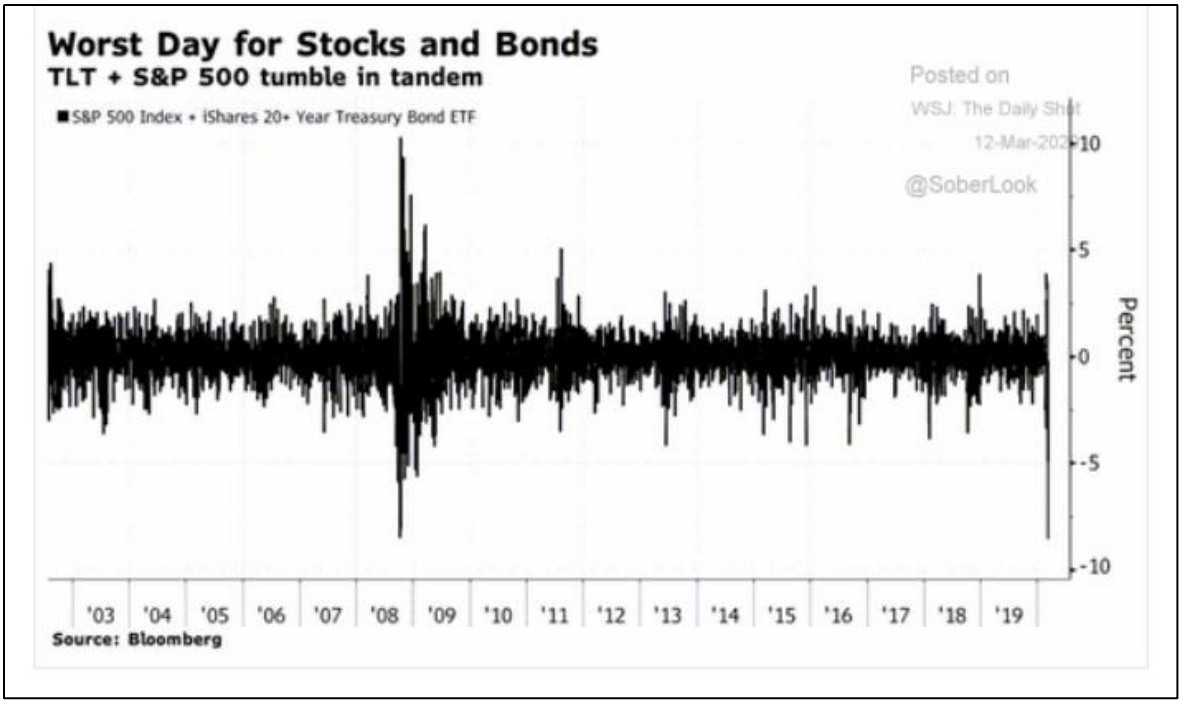
Source: Bloomberg, Goldmoney Research

Global Equities: Those down 20% from 52wk High
(70 countries, main index)

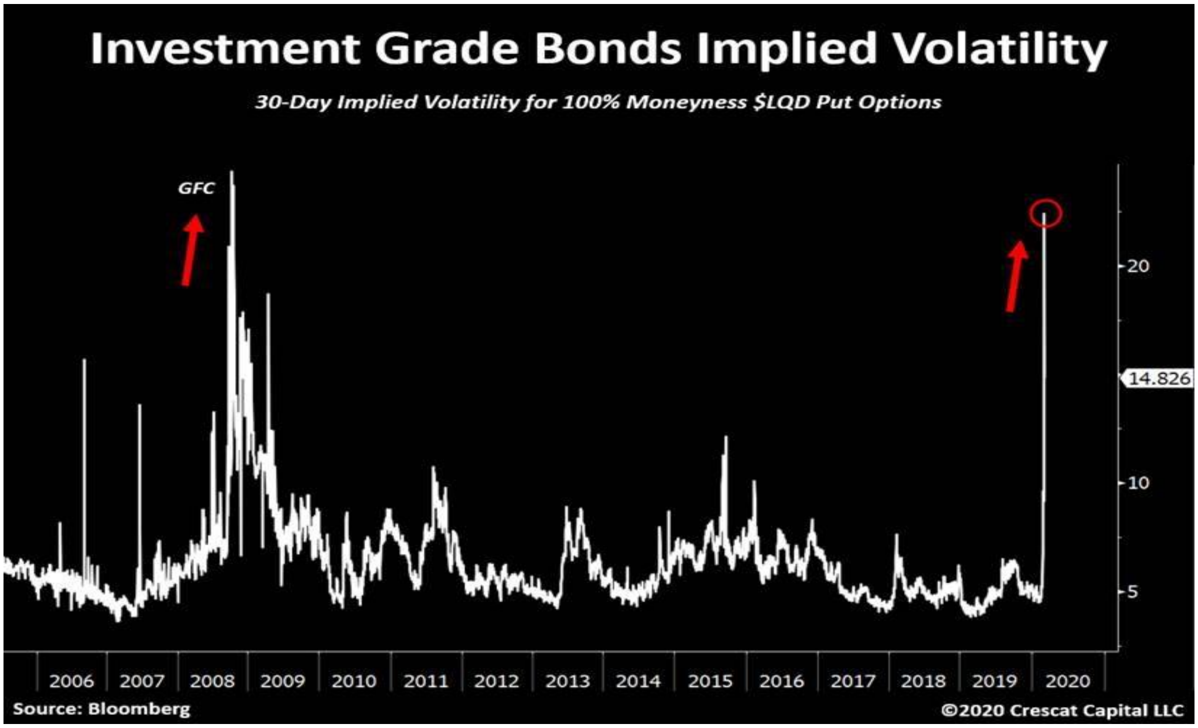


Source: Topdown Charts, Refinitiv Datastream
topdowncharts.com

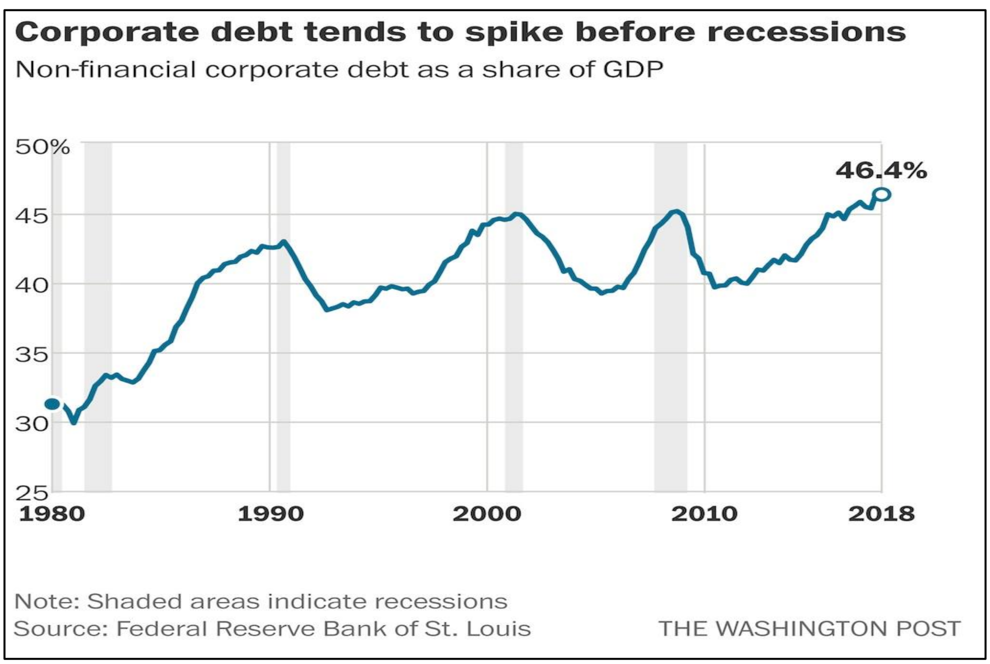
Not only have equities been hit hard, but the sell-off has increasingly rolled across asset classes as a lack of liquidity and VaR shocks hit. Last week, 60/40 and Risk Parity strategies suffered as bonds and stocks went down together.



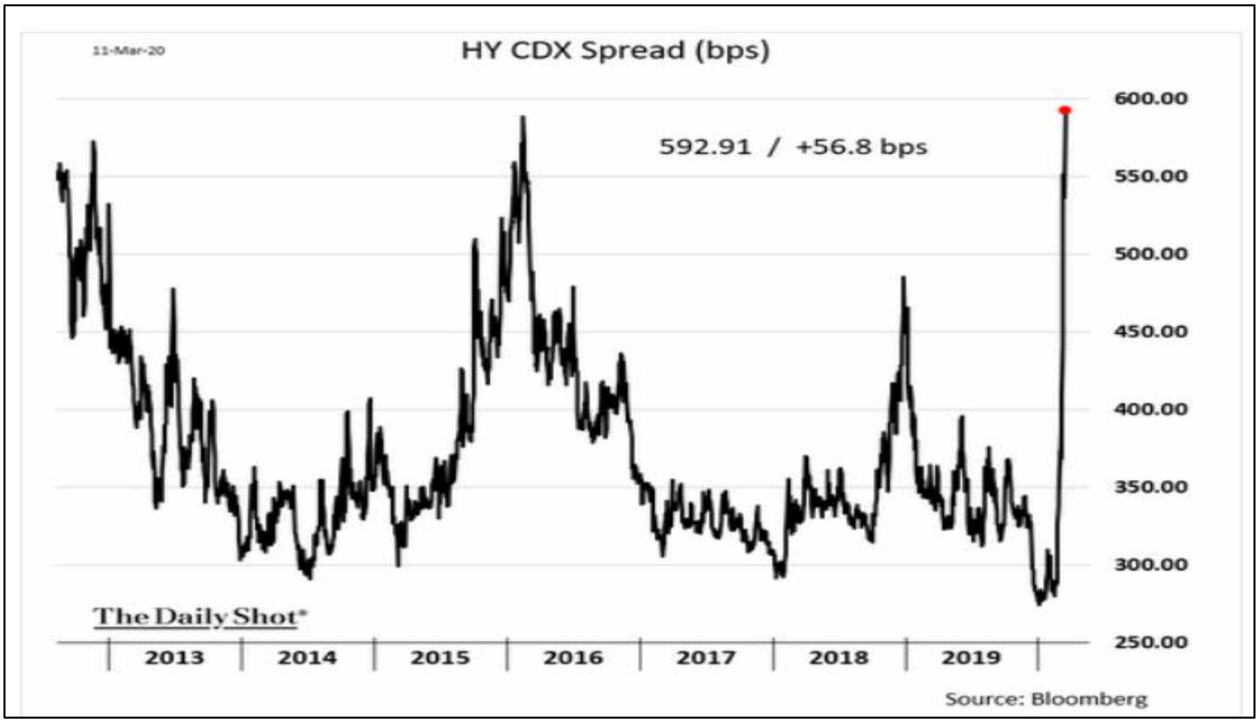
While the VIX hit 77.6 last week, it isn't just equity volatility that has exploded.



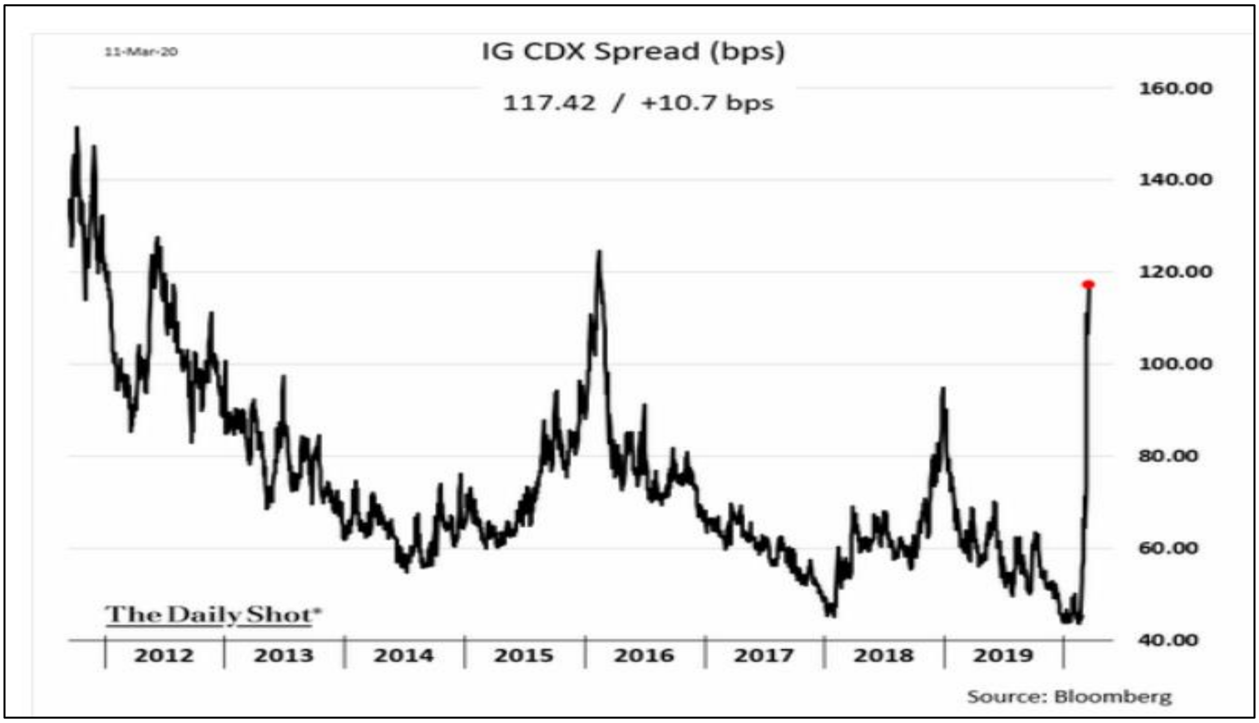
With corporate debt now much more of a potential issue than consumer debt, markets are nervous. Close to $900bln in BBB or lower debt needs to be rolled this year.



With higher exposure to energy and the importance of cash flow, High Yield has been hit hard already. CDS has popped and High Yield Bond ETF's have been smashed.



However, Investment Grade Bonds are also under pressure as the length of this still growing supply / demand shock is unknown.



At this point it is critical that credit markets continue to function, and that spread widening doesn't get out of control. Clearly this is also at the front of the Fed's mind and their massive liquidity provisions are an attempt to keep these markets as liquid and functioning as possible. It is one thing for markets to reprice based on new economic expectations, it is another when forced selling creates panic selling and dislocations. Not so different from the idea of "flattening the curve" when talking about virus infection rates. The system can otherwise be overwhelmed.

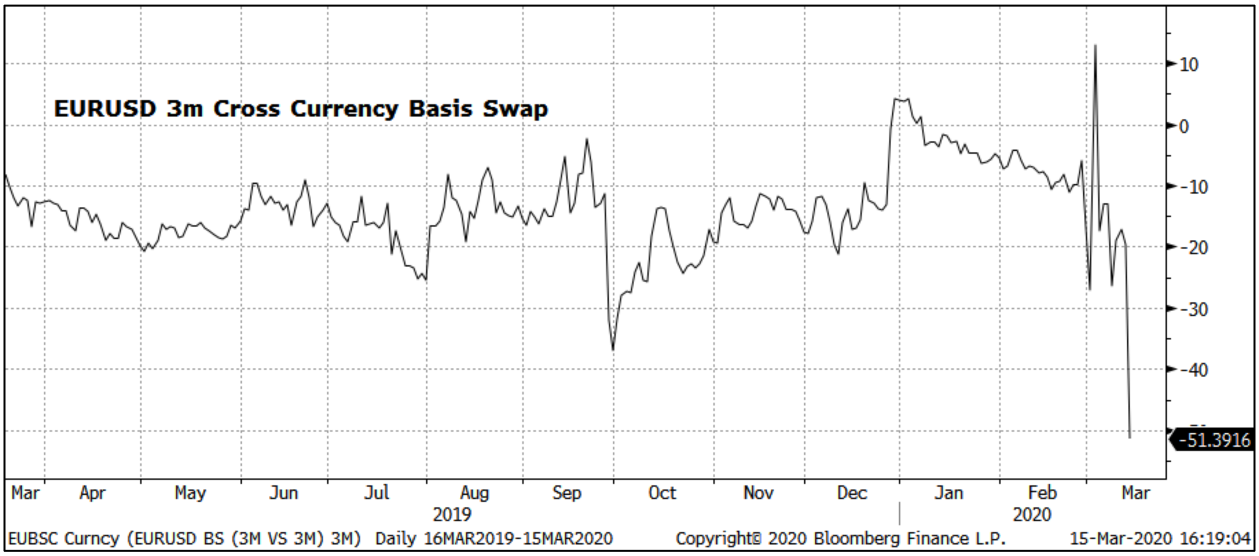
USD

Closely related to the global credit markets is the USD. Last week saw a large jump in USD vs. Developed Markets. In a time of crisis this is not a good sign. In can represents a scramble for dollar funding that can quickly become toxic.

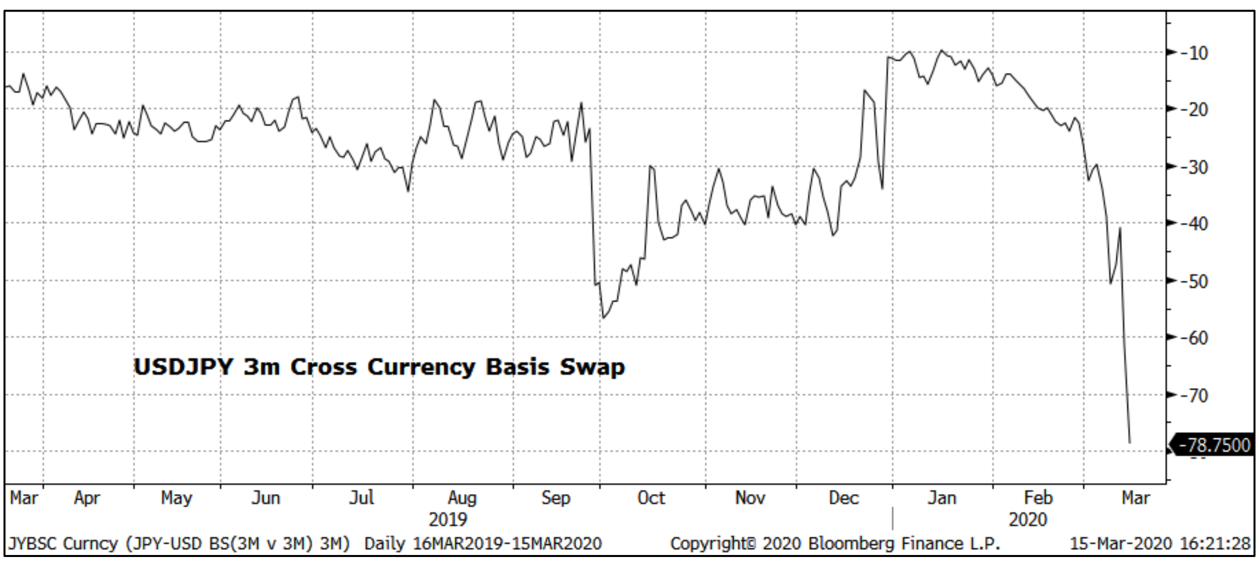
The dollar is often a safe haven vs. EM during troubled times, but last week we saw the dollar rally against currencies like CHF, JPY, GBP and EUR

This is particularly worrying in light of how FX swap basis is starting to blow out. This is an indication of USD funding stress and that people are paying up for dollars.

EUR Basis



JPY Basis



We have seen a big USD whipsaw over the last few weeks as negative yielding currencies like EUR, JPY and CHF initially rallied as people were forced to unwind structural positions using these currencies as a cheap funding source. Last week however the USD shortfall suddenly hit home and the dollar took off.

If we go through the top of this range at 100 in the DXY there is going to be trouble.

The Fed is of course aware of both the credit and USD issues, and that they are linked on a global scale via the dollar's global reserve currency status. No doubt they will try and control the situation, but this may be hard to do on an ongoing basis. As Central Banks try and control Fixed Income markets and Finance Ministers attempt to act in their individual countries best interest, the currency markets will remain one of the few functioning pressure release valves.

A dollar spike now would cause chaos, so I would expect an announcement soon that USD swap lines are open and flowing between G7 Central Banks. Will that do the trick or is it another repo-like situation where the liquidity may not get to the ones most in need of it?

USDJPY

USDJPY is potentially a very interesting contrarian trade. While everyone was looking for continued Yen safe haven flows, it in fact fell meaningfully last week. If USDJPY continues higher from here, the 112.40 level will act as a powerful magnet for the market. A break of that level will potentially signal a new and powerful uptrend for the dollar.

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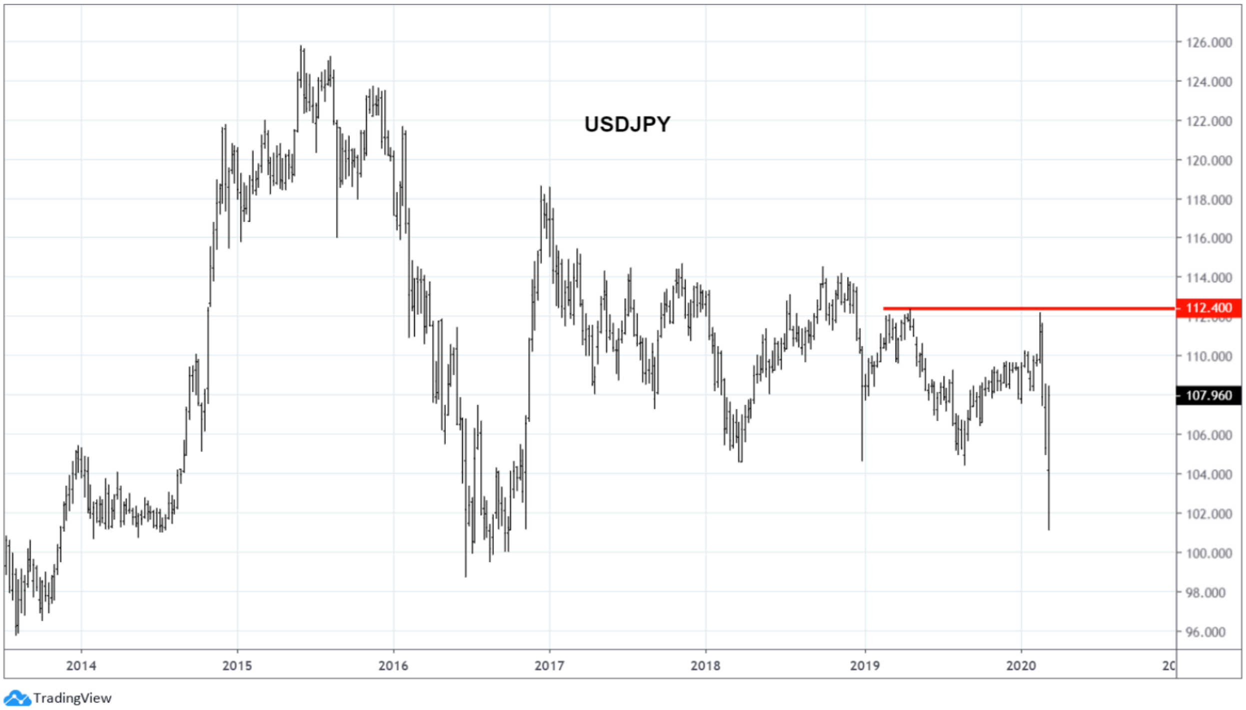

Gold, which also suffered from position liquidation at the end of last week, is rapidly approaching the buy zone below 1500.

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The data is of marginal value currently as lockdowns and social distancing are only increasing in magnitude. What does matter is what the Central Banks and Finance Ministers are doing. G7 leaders will meet via video link on Monday. Eurozone Finance Ministers on Tuesday. The Fed, BoJ, PBoC and SNB are all on the docket as well. This week's Eco data calendar is slimmed down.

Important Macro Data Releases and Events for the Week

Monday 3/16/2020

- Eurogroup Meeting

Tuesday 3/17/2020

- **EcoFin Meeting**
- ZEW Economic Sentiment (Mar) Forecast: -23.4, Prior: 8.7
- FOMC start of two-day policy meeting

Wednesday 3/18/2020

- **FOMC Interest Rate Decision and Press Conference**

Thursday 3/19/2020

- **BoJ Interest Rate Decision and Monetary Policy Statement**
- **SNB Interest Rate Decision and Monetary Policy Statement**
- Continuing Jobless Claims (Oct 25) Forecast: 1.722m , Prior: 1.722m
- Initial Jobless Claims 4-week ave. Forecast: 216.41, Prior: 214k
- Initial Jobless Claims Forecast: - , Prior: 211k

Friday 3/20/2020

- **PBoC Interest Rate Decision**

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