WEEKLY UPDATE

Beware of Greeks bearing (bond) gifts

Greek government bond (GGB) yields fell this week below 1%, reaching the lowest level on record. Only eight years ago, on February 14th 2012, GGBs yielded 33%. However, Greek government debt remains an enormous burden on the economy – at 180% of gross domestic product (GDP), its debt is three times larger than the maximum enshrined in the Maastricht Treaty. What caused the collapse in yields? And what are the implications for the euro zone?

In the aftermath of the financial crisis of 2007-2008 and the euro zone sovereign debt crisis in 2010-2012, Greece's mishandling of the economy and misreporting of its deficits led to reform, austerity and a severe recession which shrunk GDP by over one quarter. The collapse in GDP pushed debt-to GDP ratios from 127% in 2009 to current levels while Greece sought bail-outs from the International Monetary Fund, the Eurogroup and the European Central Bank (ECB).

Greece underwent three successive economic adjustment programmes overseen by these three institutions (known as the *troika*), meeting a number of commitments, albeit with extreme difficulty, before finally exiting the bailouts on August 20th 2018. The final agreement extended maturities on around one-third of Greek debt by ten years and instituted a ten-year grace period for interest and amortisation payments on those loans, providing much-needed relief to the government's debt-service burden.

Under troika guidance, Greece's government finances began to come under control. Expenditure was slashed and tax-collection systems improved, enabling Greece to promise to achieve a primary budget surplus (i.e., before the cost of servicing its debt) of 3.5% of GDP each year until 2022, continuing the run of surpluses each year since 2015 (see chart). And thanks to the partial grace period on interest, the overall budget balance is now back in surplus too.

Although much of the implementation of the bailout plan was carried out by the radical-left Syriza government, July 2019's election saw the centre-right New Democracy party back in power. The return of a more business-friendly government was well received, with manufacturing PMI confidence up to 54.4, the second-highest level in the world, and consumer confidence at a two-decade high (see chart).

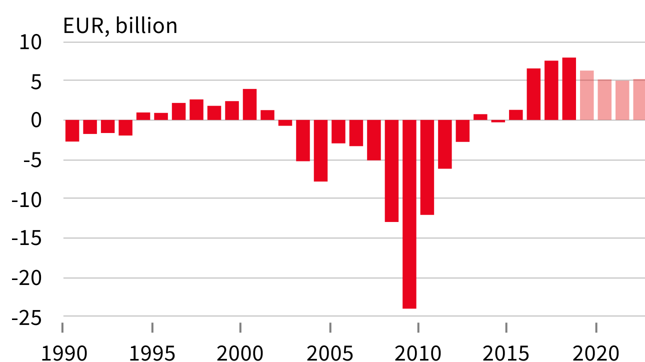
The better economic performance has encouraged rating agencies to take a more positive view on GGBs. Recently, Fitch lifted Greece's credit rating to BB and the other agencies have their ratings on positive outlook. However, Fitch still rates Greece two levels below the investment grade level which would qualify GGBs for the ECB's asset purchase programme.

Nonetheless, Greece still faces enormous challenges in addition to its debt burden. Foremost amongst these is the ratio of non-performing loans (NPLs) on bank balance sheets, which stood at 37.4% at end Q3 on ECB data, over twice as high as Cyprus at 17.5% followed by Portugal at 10% and Italy at 7%. Greece recently gained approval for its Hercules programme to transfer EUR30bn of NPLs to a special-purpose vehicle for securitisation and sale. However, completion of this scheme would still leave the NPL ratio around 25%, far too high for comfort.

Bottom line. GGBs have benefited from a combination of factors – improved public finances, better economic performance and their positive yields in a region dominated by negative-yielding bonds. However, Greece remains an economy in convalescence for which the return to a sustainable level of public debt will take decades. Moreover, as underlined recently by Christine Lagarde, the euro zone still needs to complete its Economic and Monetary Union to provide a supportive framework for its weakest members such as Greece. We would caution against chasing GGBs at such low levels of yield.

Greece in budget surplus since 2015

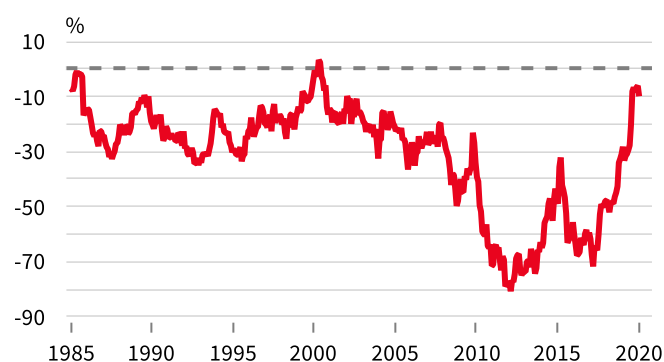
Greece: Primary balance since 1990 (in billion EUR)



Sources: SGPB, Macrobond, data as of 14/02/2020

Consumer confidence has picked up since 2017

Greece: Consumer Confidence Index (European Commission)



Sources: SGPB, Macrobond, data as of 14/02/2020

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OUR MACRO COMMENTS

This week and next

EUROZONE

- The Sentix gauge of investor confidence dropped to 5.2 in February, from 7.6 in January amid growing coronavirus-related concerns.
- Industrial production decreased 4.1% YoY in December after -1.7% in November, depressed by a 6.8% drop in Germany.
- Germany registered no growth in Q4, narrowly avoiding slipping back into contraction and taking full-year 2019 GDP growth to 0.6%.
- In Germany, the final inflation rate came in at 1.7% YoY in January, unchanged from first estimates and still below the ECB target.

Next week's key events		Per.	Prev.	Cons.
21 Feb	Markit Mfg Flash PMI	Feb	47.9	47.5
21 Feb	Inflation rate YoY	Jan	1.4%	1.4%

UNITED KINGDOM

- Britain's GDP growth was flat QoQ in the last quarter of 2019, hit by uncertainty over Brexit.
- Industrial production fell 1.8% YoY in December, after -2.5% November, while rising 0.1% on the month.
- At the same time, manufacturing production dropped 2.5% YoY in December, from -3.3% the previous month.
- Business investment fell 1.0% QoQ in Q4, worse than expectations.

Next week's key events		Per.	Prev.	Cons.
18 Feb	Unemployment rate	Dec	3.8%	3.8%
19 Feb	Inflation rate YoY	Jan	1.3%	1.7%

UNITED STATES

- Over the last 12 months, headline inflation increased 2.5%, the highest reading since October 2018, while core inflation was stable at 2.3%
- The JOLTS survey of job openings fell by 364,000 to 6,423,000 in December, well below market expectations.
- The NFIB index of small business optimism rose to 104.3 in January, from 102.7 in December.

Next week's key events		Per.	Prev.	Cons.
18 Feb	NAHB Housing Market Index	Feb	75	74
21 Feb	Markit Mfg PMI	Feb	51.9	51.5

ASIA & EMERGING

- In China, inflation came in at 5.4% YoY in January, the highest since October 2011, driven up by food and energy while core inflation edged up to 1.5% YoY. Passenger car sales fell -20.1% YoY in January, from -0.9% YoY in December on coronavirus fears.
- Indian inflation rose 7.6% YoY in January, from 7.4% the previous month.
- South Africa's manufacturing production fell -5.9% YoY in December, from -3.2% in November.

Next week's key events		Per.	Prev.	Cons.
17 Feb	Japan: GDP growth QoQ	Q4	0.4%	-0.9%
20 Feb	Japan: inflation rate YoY	Jan	0.8%	0.7%

Sources: DataStream, Bloomberg, 14 February 2020. Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, PMI = Purchasing Manager's Index.

Our 3-month targets for currencies and commodities

	Thursday close	3mth target
EUR/USD	1.08	1.11
GBP/USD	1.30	1.31
EUR/CHF	1.06	1.10
USD/JPY	109.8	108
Brent	$56.2	$65
Gold (oz.)	$1575	$1500

No changes made to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

THIS WEEK'S Q&A

Oil Prices Outlook

As the Covid-19 coronavirus outbreak takes its toll on the Chinese economy, investor expectations for lower oil demand have driven energy prices down – Brent crude oil has fallen 15% since the beginning of the year, reaching $56.3 per barrel. However, we expect oil prices to bounce back once the disease comes under control.

Why have prices dropped?

Oil prices have registered their worst monthly performance since last May as investors start to realise just how hard the world's largest oil importer's demand for oil might be hit. Travel restrictions and production halts in China have weighed on both market sentiment and economic activity.

According to the International Energy Agency (IEA), this quarter's global oil demand is set to fall (for the first time since the financial crisis) by 435,000 barrels per day (bpd) compared to last year. Moreover, the agency has reduced its global demand growth forecast for 2020 by 365,000 bpd to 825,000 bpd, as has OPEC which now forecasts demand growth of 990,000 bpd, down 230,000 bpd from its previous estimate. Furthermore, US oil output has continued to rise since year-end, reaching an all-time high of 13 million bpd and ensuring plentiful supply.

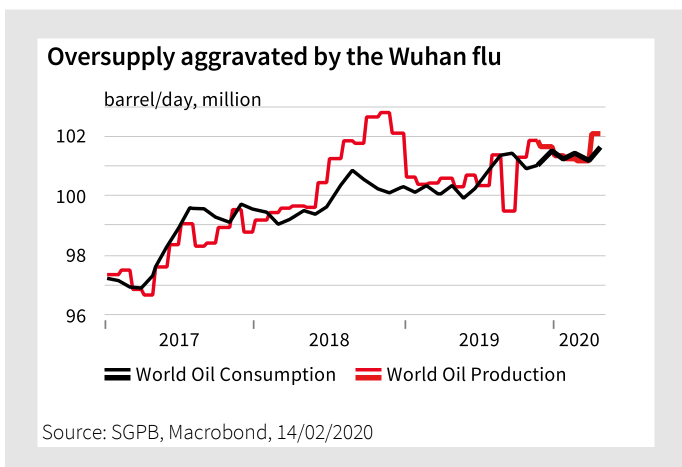
Could prices remain low for an extended period?

Our central view is that oil prices are unlikely to stay at such low levels in the medium/long term for several reasons. Chinese oil demand should recover quickly once Covid-19 starts to come under control and people return to work after the extended lunar new year holiday. If for example the virus were to be contained by early March, oil demand could return close to pre-epidemic projections as soon as the second quarter.

Moreover, oil prices have already begun to stabilize this week on optimism that OPEC and its allies (OPEC+) are considering further measures to restrict output. According to OPEC+ officials, production could be cut by more than a million barrels per day if necessary. The surge in US oil production and the slowdown in the world economy kept the market in oversupply for most of 2018 and 2019. However, the latest data published by IEA suggest that OPEC+ production cuts have begun to offset US production increases with oil supply and demand in equilibrium at 102 million bpd at end 2019. Once the outbreak is contained, demand should return to those pre-epidemic levels.

Finally, Chinese authorities have ample margin to support economic activity – the People's Bank of China has already cut interbank rates and required reserve ratios and has injected $174 billion worth of liquidity into the markets via reverse repo operations.

Bottom line. In the short run, the Wuhan flu will continue to weigh on Chinese economy and energy prices. But given economic support from Chinese authorities and likely OPEC+ production cuts, any further downward pressure on oil prices should be short-lived. We expect Brent prices to be back in a $60 and $70 per barrel range by year-end.



Source: SGPB, Macrobond, 14/02/2020

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MARKET PERFORMANCE

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-0,46 %	-1 bp	➡	-1 bp	-10 bp	-9 bp
3mth Euribor (EUR)	-0,41 %	-1 bp	⬇	-1 bp	-10 bp	-10 bp
3mth Libor (USD)	1,69 %	-4 bp	⬇	-22 bp	-112 bp	-99 bp
3mth Libor (GBP)	0,75 %	0 bp	➡	-4 bp	-16 bp	-12 bp
10-year US Treasury bond	1,62 %	-3 bp	⬇	-25 bp	-107 bp	-109 bp
10-year German bond	-0,39 %	-2 bp	⬇	-9 bp	-63 bp	-51 bp
10-year French bond	-0,15 %	-3 bp	⬇	-15 bp	-86 bp	-70 bp
10-year UK bond	0,65 %	7 bp	⬆	-11 bp	-62 bp	-53 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0,1%	⬆	1,1 %	7,4 %	5,8 %
BAML EURO Corp HY	0,3%	⬆	2,7 %	12,5 %	9,5 %
BAML GBP Corp IG	-0,2%	⬇	3,1 %	14,2 %	11,4 %
BAML US IG	0,3%	⬆	3,7 %	16,9 %	14,3 %
BAML US HY	0,5%	⬆	3,4 %	15,7 %	9,8 %
BAML Global EM Sov. External Plus	-0,1%	⬇	4,1 %	14,2 %	9,8 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,08	-1,3 %	⬇	-1,5 %	-5,5 %	-3,8%
EUR/CHF	1,06	-0,8 %	⬇	-2,6 %	-5,7 %	-6,6%
GBP/USD	1,30	0,9 %	⬆	1,5 %	2,2 %	1,6%
USD/JPY	109,8	-0,2 %	⬇	0,9 %	0,2 %	-1,1%
USD/BRL	4,35	1,6 %	⬆	4,3 %	12,1 %	15,9%
USD/CNY	6,98	0,1 %	➡	-0,7 %	1,4 %	3,2%
USD/RUB	63,7	0,5 %	⬆	-1,1 %	-8,7 %	-4,3%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0,1 %	⬆	1,5 %	1,3 %	7,0 %
United Kingdom (3-7yr)	-0,3 %	⬇	0,2 %	0,6 %	2,0 %
Germany (3-7yr)	0,1 %	⬆	0,1 %	0,6 %	0,6 %
Japan (3-7yr)	0,1 %	➡	-0,2 %	0,1 %	-0,3 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	580	0,6 %	⬆	7,5 %	2,7 %	20,0 %
Eurostoxx 50	3 847	1,1 %	⬆	4,4 %	3,0 %	24,5 %
DAX	13 745	1,3 %	⬆	3,9 %	3,8 %	23,1 %
CAC 40	6 093	0,9 %	⬆	3,5 %	2,1 %	24,1 %
S&P 500	3 374	0,9 %	⬆	9,6 %	4,7 %	25,0 %
FTSE 100	7 452	-0,5 %	⬇	2,1 %	-0,9 %	8,7 %
SMI	11 092	0,7 %	⬆	7,7 %	4,5 %	25,1 %
Topix	1 713	-1,4 %	⬇	0,9 %	-0,5 %	10,5 %
IBOV Brazil	115 662	0,4 %	⬆	9,1 %	0,0 %	20,7 %
MICEX Russia *	3 110	0,4 %	⬆	6,0 %	31,9 %	25,1 %
MSCI EM	1 106	0,4 %	⬆	6,4 %	-0,7 %	9,3 %
SENSEX 30 India	41 460	0,4 %	⬆	3,4 %	0,5 %	16,3 %
Hang Seng (H-K)	27 730	0,9 %	⬆	4,5 %	-1,6 %	0,9 %
Shanghaï Composite	2 906	1,4 %	⬆	0,0 %	16,5 %	6,8 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$56,2	2,0 %	⬆	-9,8 %	5,9 %	-11,8 %
Gold	$1 576	0,8 %	⬆	7,6 %	23,0 %	20,0 %
Copper	$5 772	0,9 %	⬆	-0,7 %	-3,0 %	-5,7 %

Source: DataStream, on 14 February 2020.

1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets. * Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7-year returns. Figures are rounded.

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