# WEEKLY UPDATE

## Three Steps Forward, One Step Back

After rising 12.9% over the previous three weeks, the MSCI World index of global equities has shed -5.0% since Monday. This has come amidst gloomy projections from the Organisation of Economic Cooperation and Development (OECD) and the US Federal Reserve (Fed). Is the economic outlook as bleak as suggested? And did this drive the weakness in equity markets?

The OECD sees a sharper recession than the International Monetary Fund (IMF) predicted back in April. It expects the global economy to shrink -6.0% this year followed by a 5.2% rise in 2021 – this means a more severe economic crisis and a slower recovery than the IMF's forecasts of -3.9% and +5.8% in 2020 and 2021 respectively. On the OECD's reckoning, the US economy will shrink -7.3% in 2020 and recover 4.1% next year whereas the IMF estimated -5.9% and 4.7% for the two years.

In fact, the US economy was already in recession before the coronavirus hit the United States. On Monday this week, the National Bureau of Economic Research (NBER) declared that the recession began in February this year, marking the end of 128 consecutive months of expansion, the longest stretch on record. This came before lockdowns began to impinge on economic activity. Indeed, the US counted only 24 confirmed cases and one death at end-February.

On Wednesday, the Fed held its regular monetary policy meeting and updated its forecasts and projections. Regarding GDP, the Fed expects a -6.5% contraction this year followed by a 5.0% pick-up in 2021 with unemployment ending this year at 9.3% and 6.5% at end-2021. Moreover, policy-makers' individual projections for key rates (known as the "dots") suggest no increase in rates for the next three years. This point was underlined by Fed chair Jerome Powell in his comments – he stressed that "we're not even thinking about thinking about raising rates". He also underlined that the Fed's asset purchases will continue at around current levels (c.$120bn per month) for the foreseeable future – he made clear that the Fed was focused more on the impact of monetary easing on "normal people" than on asset prices.

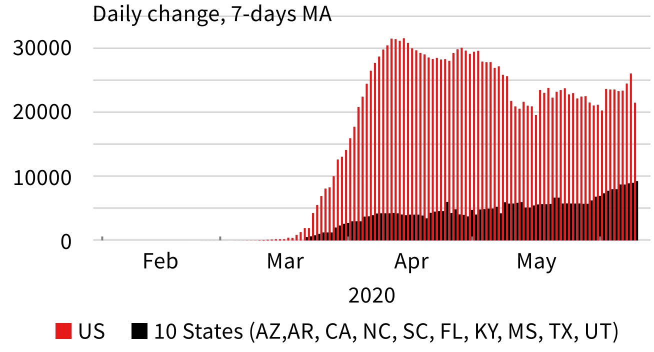
While the Fed's outlook is decidedly downbeat for the economy, the central bank's view is not far-removed from the OECD and IMF forecasts. Moreover, these projections amply justify the confirmation that policy settings will remain very loose for years to come, in particular as regards asset purchases, which have been instrumental in easing financial conditions and fuelling the rally in stocks in recent weeks. So why did markets correct so sharply?

Part of the explanation may be linked to the CoViD-19 pandemic itself. Unlike many European countries, the US has not seen a meaningful decline in new confirmed cases, which have remained stuck between 20,000 and 25,000 per day since early May. Despite the marked improvement in New York in recent weeks, a number of states across the south and west of the country have seen a worrying acceleration in cases as they have eased lockdown restrictions (see left-hand graph). With the White House urging states to get back to work, it is unlikely that the renewed spread in the virus will lead back to lockdown. But it does mean that economic activity and household spending patterns are unlikely to return to pre-crisis norms any time soon.

**Bottom line.** The US equity market has just registered its best 50-day performance on record (see right-hand graph). The correction this week is unlikely to be due to the Fed stance or indeed the lingering coronavirus worries – both are little changed from previous weeks. It may simply be that the rally could only be justified by a V-shaped recovery, which for now looks a rather distant prospect.

**New CoVid-19 cases in the US remain high**

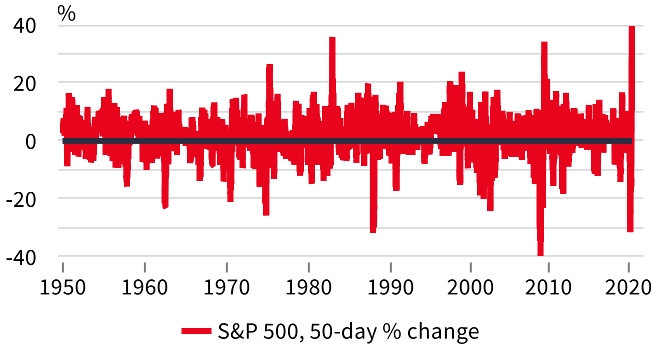
*US, new confirmed Covid-19 cases, daily change*




*Sources: SGPB, Macrobond, data as of 12/06/2020*

**S&P 500 best 50-day performance on record**

*S&P 500, 50-day % change*




*Sources: SGPB, Macrobond, Gavekal, data as of 12/06/2020*

# OUR MACRO COMMENTS

## This week and next

EUROZONE

- Gross domestic product (GDP) fell 3.6% QoQ in the first quarter of 2020, slightly better than the initial estimate of -3.8%. It remains the largest decline in GDP since the creation of the euro in 1999.
- According to Sentix, investor confidence improved to -24.8 in June from -41.8 in May as economic activity began to stabilise. However, it remains deep in negative territory.
- Industrial production slumped 17.1% MoM in April, after -11.9% in March, beating expectations for a 20.0% decline. On an annual basis, it fell 28.0% in April, the largest decline since 1999.

| Next week's key events | | Per. | Prev. | Cons. |
|---|---|---|---|---|
| 16 June | Inflation rate YoY | May | 0.1% | 0.1% |
| 17 June | Germany: Eco Sentiment | Jun | 51 | 57 |

UNITED KINGDOM

- Britain's GDP fell by a record 20.4% MoM in April as the first full month of the coronavirus lockdown triggered to an economic crisis. On an annual basis, it fell 24.5% in April from -5.7% in March.
- Industrial production dropped 24.4% YoY in April after -8.2% in March. It was the largest decline recorded in Britain since 1969.
- Manufacturing production slumped 28,5% YoY in April from -9.7% in March.

| Next week's key events | | Per. | Prev. | Cons. |
|---|---|---|---|---|
| 16 June | Unemployment rate | Apr | 3.9% | 4.7% |
| 17 June | Inflation rate YoY | May | 0.8% | 0.6% |

UNITED STATES

- Headline inflation fell for the fourth straight month to 0.1% YoY in May, as demand for goods and services remained subdued amid the Covid-19 induced recession.
- The Federal Reserve kept its key interest rates at 0-0.25% and said that it will hold them near zero through 2022 to help the economy recover from the coronavirus pandemic.
- Initial jobless claims came in at 1.542 million for the week ended June 5, bringing the total over the past twelve weeks to 44.1m.

| Next week's key events | | Per. | Prev. | Cons. |
|---|---|---|---|---|
| 16 Jun | Retail sales MoM | May | -16.4% | 7.0% |
| 16 Jun | Industrial production MoM | May | -11.2% | 2.4% |

ASIA & EMERGING

- In China, the inflation rate stood at 2.4% YoY in May, from 3.3% in April and slightly below expectations of 2.7%. M2 money supply rose 11.1% YoY in May, unchanged from the previous reading.
- In Japan, GDP shrank an annualised 2.2% in Q1, less than the 3.4% contraction estimated in a preliminary reading. Machinery orders fell 17.7% YoY in April, from -0.7% in March. It was the largest decline since the financial crisis.

| Next week's key events | | Per. | Prev. | Cons. |
|---|---|---|---|---|
| 15 Jun | China : Industrial production YoY | May | 3.9% | 5.0% |
| 15 Jun | China: Retail sales YoY | May | -7.5% | -2.0% |

Sources: DataStream, Bloomberg, 12 June 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 | 1.13 | 1.13 |
| GBP/USD | 1.26 | 1.27 |
| EUR/CHF | 1.07 | 1.08 |
| USD/JPY | 106.9 | 110.0 |
| Brent | $38.7 | $37 |
| Gold (oz.) | $1742 | $1725 |

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

## What is the outlook for the USD/CAD exchange rate?

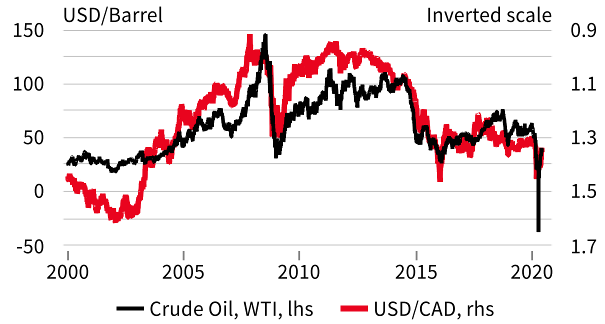
As elsewhere, the CoVid-19 pandemic and the countermeasures implemented by the government have plunged the Canadian economy into deep recession. The unemployment rate jumped to 13% in April from 5.6% in February, the Purchasing Managers' Index (PMI) dropped into deep contraction territory and the consumer confidence index fell to 35.6 in April from 54 in February.

In the face of the crisis, the BoC has cut rates by 150 basis points since March, leaving the policy rate at 0.25%, and has extended its C$200 billion bond buyback program across all maturities to include provincial bonds and investment-grade corporate paper. In addition, the federal government has launched a fiscal stimulus package worth C$205 billion (almost 10% of GDP).

May economic data releases are showing signs of stabilization, suggesting that the support measures are bearing fruit. Like most major economies, Canada is restarting its economy but, as shown by the Google Mobility Report, people are only returning gradually to their workplaces – it will be a long and difficult journey to recovery.

According to the OECD, real house prices in Canada are now 66% higher than before the financial crisis. This boom has been financed by heavy borrowing which is weighing on household balance sheets – the ratio of household debt to disposable income has risen 64% over the past two decades. This makes the Canadian real estate market extremely vulnerable to the current CoVid-19 crisis – valuations are very stretched, debt ratios are high and supply exceeds demand. The speed of economic recovery and the government's capacity to continue with fiscal stimulus will be essential to preventing a fall in the Canadian housing market and a rapid deleveraging cycle.

**The relation between oil prices and the CAD**




Source: SGPB, Macrobond, 12/06/2020

Since 1990, the purchasing power parity of the Canadian dollar (CAD) against the US dollar (USD) has moved sideways between 1.20 and 1.25. However, the spot price of the currency is much more volatile, having hit 1.61 in 2002 and 0.94 in 2007. Among the explanatory factors, there is Canada's dependence on the exploitation of its natural resources – the graph below compares the evolution of the CAD / USD with oil prices.

As the coronavirus crisis unfolded, the CAD fell sharply against the USD, down 7.5% between March 6 and 19, before beginning to stabilise. The crash in oil prices in April, given the perfect storm of collapsing demand and brimming storage capacity, kept the CAD under pressure at slightly undervalued levels. Once the oil market began to stabilise in May and the economy began to reopen, the CAD rallied against the USD.

Bottom line. However, we expect this rally to be short-lived. Oil prices should remain range bound and Canada's underlying fundamentals – especially debt ratios and the housing market – are not conducive for capital inflows. We expect the CAD to remain range bound against USD around 1.35 over the next 3 months.

# MARKET PERFORMANCE

## Interest rates

| Interest rates | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| EONIA (EUR) | -0,46 % | 0 bp | → | 0 bp | -11 bp | -9 bp |
| 3mth Euribor (EUR) | -0,36 % | -1 bp | → | 12 bp | -5 bp | -4 bp |
| 3mth Libor (USD) | 0,31 % | 0 bp | → | -46 bp | -249 bp | -214 bp |
| 3mth Libor (GBP) | 0,20 % | -3 bp | ↓ | -18 bp | -71 bp | -58 bp |
| 10-year US Treasury bond | 0,65 % | -17 bp | ↓ | -17 bp | -204 bp | -149 bp |
| 10-year German bond | -0,42 % | -9 bp | ↓ | 34 bp | -66 bp | -18 bp |
| 10-year French bond | 0,00 % | 1 bp | → | 30 bp | -71 bp | -12 bp |
| 10-year UK bond | 0,20 % | -11 bp | ↓ | -10 bp | -107 bp | -66 bp |

## Credit

| Credit | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|
| BAML EURO Corp. IG | 0,5% | ↑ | -0,7 % | 4,8 % | 0,4 % |
| BAML EURO Corp HY | -0,3% | ↓ | 1,2 % | 5,4 % | -0,7 % |
| BAML GBP Corp IG | 1,4% | ↑ | 1,8 % | 15,1 % | 7,5 % |
| BAML US IG | 1,4% | ↑ | 2,9 % | 19,1 % | 10,8 % |
| BAML US HY | -0,7% | ↓ | 2,2 % | 9,5 % | 0,4 % |
| BAML Global EM Sov. External Plus | 0,3% | ↑ | -0,3 % | 7,4 % | -0,6 % |

## Exchange rates

| Exchange rates | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| EUR/USD | 1,13 | -0,3 % | ↓ | 0,3 % | -1,5 % | -0,3% |
| EUR/CHF | 1,07 | -1,5 % | ↓ | 0,8 % | -5,2 % | -5,1% |
| GBP/USD | 1,26 | 0,1 % | → | -1,7 % | -1,2 % | -1,0% |
| USD/JPY | 106,9 | -2,1 % | ↓ | 2,2 % | -2,5 % | -1,5% |
| USD/BRL | 4,98 | -2,8 % | ↓ | 3,4 % | 28,2 % | 29,0% |
| USD/CNY | 7,07 | -0,6 % | ↓ | 1,5 % | 2,7 % | 2,2% |
| USD/RUB | 70,1 | 1,4 % | ↑ | -4,2 % | 0,6 % | 8,7% |

## Government bonds*

| Government bonds* | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|
| United States (3-7yr) | 0,5 % | ↑ | 2,1 % | 6,8 % | 8,9 % |
| United Kingdom (3-7yr) | 0,3 % | ↑ | 0,9 % | 2,9 % | 3,1 % |
| Germany (3-7yr) | 0,3 % | ↑ | -1,6 % | 0,4 % | -0,5 % |
| Japan (3-7yr) | 0,1 % | → | -0,5 % | 0,0 % | -0,6 % |

## Equities*

| Equities* | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| MSCI AC World | 515 | -2,5 % | ↓ | 9,5 % | -7,9 % | 2,6 % |
| Eurostoxx 50 | 3 145 | -3,6 % | ↓ | 9,6 % | -14,7 % | -5,5 % |
| DAX | 11 970 | -3,7 % | ↓ | 14,7 % | -9,7 % | -1,5 % |
| CAC 40 | 4 816 | -3,9 % | ↓ | 5,6 % | -18,4 % | -9,4 % |
| S&P 500 | 3 002 | -3,5 % | ↓ | 10,1 % | -6,2 % | 6,1 % |
| FTSE 100 | 6 077 | -4,1 % | ↓ | 4,0 % | -18,2 % | -14,7 % |
| SMI | 9 829 | -2,5 % | ↓ | 10,2 % | -4,4 % | 3,3 % |
| Topix | 1 589 | -1,0 % | ↓ | 16,1 % | -6,5 % | 4,4 % |
| IBOV Brazil | 94 686 | 0,9 % | ↑ | 11,2 % | -18,1 % | -4,3 % |
| MICEX Russia * | 2 744 | -0,8 % | ↓ | 10,1 % | 16,3 % | -0,3 % |
| MSCI EM | 994 | 0,5 % | ↑ | 5,7 % | -10,1 % | -0,9 % |
| SENSEX 30 India | 33 538 | -1,3 % | ↓ | -5,8 % | -18,4 % | -15,1 % |
| Hang Seng (H-K) | 24 480 | 0,6 % | ↑ | -2,2 % | -12,1 % | -9,1 % |
| Shanghaï Composite | 2 921 | 0,1 % | → | -1,6 % | 17,1 % | -0,2 % |

## Commodities

| Commodities | Last | 1wk | | 3mth | YTD | 12mth |
|---|---|---|---|---|---|---|
| Brent | $38,7 | -3,5 % | ↓ | 7,0 % | -27,1 % | -38,3 % |
| Gold | $1 742 | 1,7 % | ↑ | 5,6 % | 36,0 % | 31,3 % |
| Copper | $5 742 | 4,2 % | ↑ | 4,0 % | -3,5 % | -2,0 % |

Source: DataStream, on 12 June 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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