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## FACED WITH A SUDDEN STOP, POLICY SWITCHES TO A 'WHATEVER IT TAKES' MODE

Recent activity and demand data for China show the huge impact of the coronavirus epidemic. German business expectations have seen an unprecedented monthly drop in March. The drop in the price of oil acts as an additional drag on growth and a source of increased credit risk. The strengthening of the dollar is a source of concern for issuers with foreign currency debt in dollar. Despite swift action of the major central banks and the announcement of increasingly important fiscal policy support in various countries, equity markets have barely reacted: lack of visibility dominates.

Sudden stop. Until recently, the words referred to a sudden halt in private capital flows to emerging economies. Following the epidemic, they now also apply to demand and activity, witness the unprecedented 11-point drop in business expectations in the ifo survey for Germany. The latest data from China provide another illustration: over the January-February period industrial production dropped 13.5% versus last year, real retail sales declined 23.5% and fixed asset investment was down 24.5%. In case this would still be necessary, this is a reminder of the quasi-impossibility of assessing the extent of the hit to growth which results from what is, after all, an exogenous, non-economic shock. This explains why, despite massive, swift action of the major central banks and the announcement of increasingly important fiscal policy support in various countries, equity markets have barely reacted. At most, these actions significantly slowed the speed of decline.

The big additional drop this week in oil prices is making matters worse. Lower oil prices entail a transfer of spending power from producers to consumers, so the former spend less and the latter more. However, today, demand is in no position to react to any significant degree due to lockdowns and bans on international travel. It implies that the negative effect dominates by far: pressure on budgets of oil exporting countries, increasing default risk of certain highly-levered oil companies in the US. Given their weight in the index, this in turn can create a contagion effect within the high yield market as investors decide to reduce their exposure to the asset class.

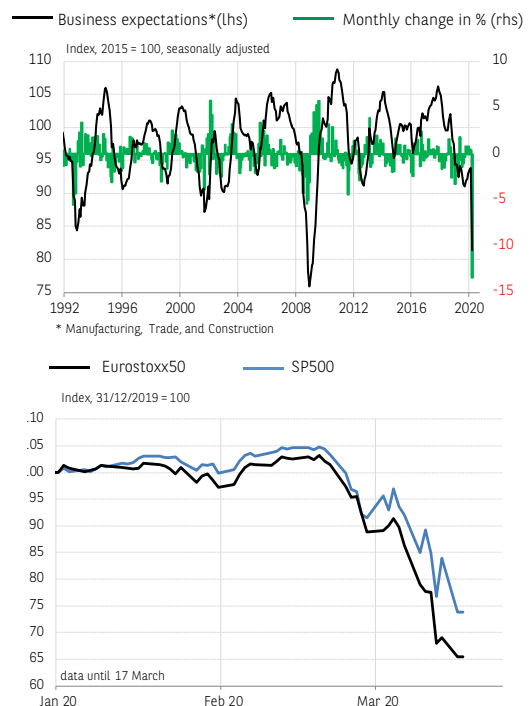
Finally, the recent, across the board, strengthening of the dollar is complicating matters for the corporate sector in developing economies given their USD debt load. Not only are they faced with a drop in their exports to the advanced economies, but the dollar appreciation puts pressure on their credit quality.

The policy reaction has been swift and impressive. The Federal Reserve has taken the federal funds rate down to zero, restarted QE and embarked on a programme of buying corporate paper. The ECB has introduced a EUR 750 bn Pandemic Emergency Purchase Programme which will run until the end of the year. The US administration and Congress are preparing a USD 1.3 tn (6.5% of GDP) stimulus package. Several European countries have also taken measures to support households and companies. For the eurozone, most important of all is the flexibility which the ECB is now demonstrating. Quoting its President "while the benchmark allocation across jurisdictions will continue to be key to the capital contributions of the national central banks, purchases will be conducted in a flexible manner.

This allows for fluctuations in the distribution of purchase flows over time, across asset classes and among jurisdictions"<sup>1</sup>. It couldn't be clearer.

William De Vijlder

### BUSINESS CLIMATE (IFO, GERMANY) AND FINANCIAL MARKETS



SOURCE: IFO, DATASTREAM, BNP PARIBAS

1. Opinion piece of ECB President Lagarde in the Financial Times, 19 March 2020.

The spreading of the coronavirus epidemic triggers a feeling of a 'sudden stop' for the world economy but massive monetary and fiscal policy action should mitigate the impact.

data:image/



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# ECONOMIC PULSE

## GERMANY: COVID19 KILLS ECONOMIC ACTIVITY IN H1 2020

In the latest months, economic activity was virtually stagnant. As can be seen in the chart, the export-oriented manufacturing sector was operating well below potential, whereas activity in the more on the domestic market oriented sectors such as construction and services remained buoyant. The outbreak of the Covid19 in Germany has changed the picture completely.

In order to stop the spread of the virus, the economy has largely come to a standstill. To reduce public movement, non-essential shops had to close and restaurants could only open for lunch. In addition, border controls were reintroduced with five countries. More drastic measures such as home confinement could be expected if citizens do not voluntarily limit interaction. In a television address, Angela Merkel, the German chancellor, called the coronavirus epidemic the biggest challenge Germany has faced since the Second World War.

To support business and protect jobs, the government has unveiled an assistance programme and tax policy measures totalling billions of euros. The programme has three main pillars. First, access to the short-time work compensation scheme (Kurzarbeit) will be facilitated. In particular, eligibility requirements have been loosened. During the global financial crisis in 2008-10, the Federal Employment Agency paid almost EUR 10 billion in short-time work allowances.

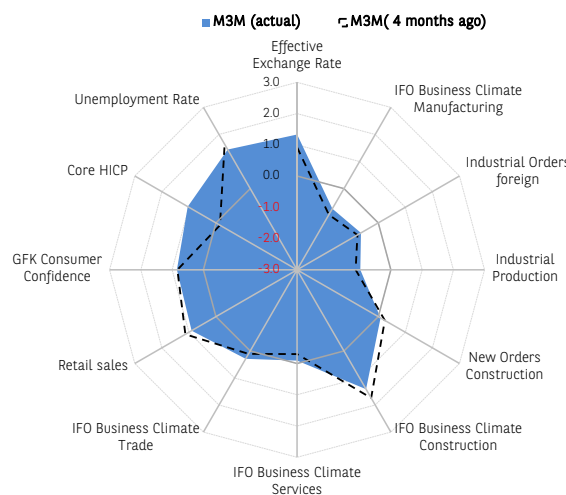
Second, to improve their liquidity, businesses will be able to defer billions of euros in tax payments. Third, existing liquidity programmes will be broadened to give companies access to cheap loans, in particular through the state development bank KfW. The government is still working on how these loans can be repaid once the pandemic ends without unduly weighing on the recovery. Programmes of export credits and other guarantees to help companies in crisis are to be expanded.

At this stage, it is very difficult to foresee when the epidemic will be contained and the economy could restart again. Based on what happened in China and Korea, we assume this to happen in Q3 2020. However, as it takes some time before supply chains are fully restored, the government might consider a modest fiscal stimulus programme in Q3 2020 in order to restore confidence. Moreover, the partial abolition of the solidarity tax may be brought forward to 1 July 2020. Both measures would be welcome for kick-starting the economy.

**Raymond Van Der Putten**

### QUARTERLY CHANGES

■ 3-month moving average (actual) --- 3-month moving average (4 months ago)



SOURCE: THOMSON REUTERS, BNP PARIBAS

The indicators in the radar are all transformed into z-scores. By construction, the z-scores have mean zero and their values, which indicate how far the indicator is removed from its long-term average, are in the interval between -3 and 3 in almost all cases. In the radar chart, the blue area shows the actual conditions of economic activity. It is compared with the situation four months earlier (dotted-line). An expansion of the blue area signals an improvement. In the right pane, the surprise is an actual outcome that differs from the market forecast (Bloomberg).



# ECONOMIC SCENARIO

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## UNITED STATES

• The economy is increasingly impacted by the spreading of the coronavirus and concern is mounting about an increase in the unemployment rate, which would weigh on consumer spending. This explains the very significant measures taken by the Federal Reserve and those announced by the Administration. Clearly, the near term prospects depend on how the epidemic evolves. Once we will be beyond the peak, the measures taken thus far will be instrumental in supporting the recovery in demand and activity.

## CHINA

• The Covid-19 shock has represented a severe shock to both demand and supply. Economic activity collapsed in the first two months of the year (industrial production fell by 14% year-on-year, exports by 18% and retail sales by 24%), and we have revised strongly downwards our real GDP growth forecast for 2020. Activity has already started to recover, but this process should remain very gradual in the coming months.

• Since the outbreak of the virus, the central bank and the government have considerably stepped up stimulus measures aimed at helping enterprises and supporting domestic demand. However, the extent of the economic recovery is likely to be constrained by the consequences of the sanitary and economic crisis currently spreading in the rest of the world.

## EUROZONE

• The huge impact of the coronavirus epidemic is becoming increasingly visible in activity and demand data, following lockdowns, but also in confidence data and business expectations. The first semester will be significantly affected although the extent depends on when the epidemic will be brought under control. Taking guidance from the experience in China, the second semester should see an improvement in activity, which should be helped by the huge support measures which are being taken. Forecasts are entirely dependent on the scenario which is assumed for the epidemic.

## FRANCE

• A sharp GDP contraction is now expected in the first half of 2020 because of the propagation of the Covid-19 epidemic and ensuing lockdown measures. The recessionary shock should be temporary, but the shape of the recovery remains uncertain. The fiscal and financial packages announced by the Government, as well as the ECB measures on the monetary front, are aimed at limiting as much as possible the shock and at creating the conditions for activity to resume and get back to normal as rapidly as possible. We expect a quick rebound but risks lie on the downside. Inflation will also be negatively impacted, especially because of the plunge in oil prices.

## INTEREST RATES AND FX RATES

• In the US, the Federal Reserve has taken, in several meetings, a host of measures to inject liquidity in the financial system and facilitate the financing of companies. The federal funds rate has been brought down to the zero lower bound and QE has been restarted. Additional measures are to be expected should the economic and liquidity situation deteriorate further. Treasury yields have seen a big drop, reflecting a flight to safety but have also been very volatile. Eventually, given the temporary nature of the coronavirus epidemic and the fiscal stimulus measures, this should be followed by a rebound in yields but the timing is completely unclear.

• In the eurozone, the ECB has taken considerable measures to inject liquidity by starting a temporary Pandemic Emergency Purchase Programme, expanding the range of eligible assets under the corporate sector purchase programme (CSPP) to non-financial commercial paper and by easing the collateral standards by adjusting the main risk parameters of the collateral framework. More is to be expected should circumstances require. These measures should also keep a lid on sovereign bond spreads. The movement of bond yields will be very

much influenced by what happens to US yields, and hence, in the near term, by news about the epidemic.

• The Bank of Japan has kept its policy rate unchanged but has decided to double its purchases of ETFs and J-REITS (Investment funds tied to Japanese real estate). The target for its corporate bonds purchases has also been increased.

• Growing concerns about the global economic impact of the coronavirus have caused big drops in equity markets and a quest for liquidity, in particular in dollar. In this environment the dollar has acted as a safe haven currency.

### GROWTH & INFLATION

%	GDP Growth			Inflation		
	2019	2020 e	2021 e	2019	2020 e	2021 e
United-States	2.3	-0.7	2.4	1.6	1.2	2.2
Japan	0.7	-2.6	0.8	0.5	-0.2	-0.2
United-Kingdom	1.4	-1.8	5.6	1.8	0.7	1.7
Euro Area	1.2	-4.3	6.4	1.2	0.2	1.2
Germany	0.6	*	*	1.4	*	*
France	1.2	*	*	1.3	*	*
Italy	0.2	*	*	0.6	*	*
China	6.1	2.6	7.6	2.9	3.1	2.0
India**	6.1	5.0	4.5	3.0	4.6	3.5
Brazil	1.1	-1.0	3.0	3.7	3.6	3.5
Russia	1.3	0.5	2.5	4.3	3.3	3.5

Source : BNP Paribas (e: Estimates & forecasts)

\*\* Fiscal year from April 1st of year n to March 31st of year n+1

\* under review

SOURCE: BNP PARIBAS GROUP ECONOMIC RESEARCH (E: ESTIMATES & FORECASTS)  
\*FISCAL YEAR FROM 1<sup>ST</sup> APRIL OF YEAR N TO MARCH 31<sup>ST</sup> OF YEAR N+1

### INTEREST & EXCHANGE RATES

Interest rates, %	2019		2020				2018	2019	2020e
	Q3	Q4	Spot (19/03/2020)						
End of period	Q3	Q4	Q2e	Q3e	Q4e	Q2e	Q3e	Q4e	
US Fed Funds (upper limit)	2.00	1.75	0.25	0.25	0.25	0.25	2.50	1.75	0.25
T-Notes 10y	1.67	1.92	1.00	0.80	1.00	1.25	2.69	1.92	1.25
Ezone Deposit rate	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
Bund 10y	-0.57	-0.19	-0.34	-0.50	-0.30	-0.20	0.25	-0.19	-0.20
OAT 10y	-0.28	0.08	0.06	-0.15	0.00	0.05	0.71	0.08	0.05
BTP 10y	0.83	1.32	1.64	1.30	1.20	1.10	2.77	1.32	1.10
BONO 10y	0.15	0.47	0.77	0.50	0.50	0.50	1.42	0.47	0.50
UK Base rate	0.75	0.75	0.25	0.10	0.10	0.10	0.75	0.75	0.10
Gilt 10y	0.40	0.83	0.80	0.55	0.85	0.90	1.27	0.83	0.90
Japan BoJ Rate	-0.06	-0.05	-0.10	-0.10	-0.10	-0.10	-0.07	-0.05	-0.10
JGB 10y	-0.22	-0.02	-0.08	0.00	0.00	0.05	0.00	-0.02	0.05

Source: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES), last update 20/03/2020

Exchange Rates	2019		2020				2018	2019	2020e
	Q3	Q4	Spot (19/03/2020)						
End of period	Q3	Q4	Q2e	Q3e	Q4e	Q2e	Q3e	Q4e	
USD EUR / USD	1.09	1.12	1.07	1.12	1.13	1.14	1.14	1.12	1.14
USD / JPY	108	109	110	108	106	105	110	109	105
GBP / USD	1.23	1.32	1.17	1.35	1.36	1.39	1.27	1.32	1.39
USD / CHF	1.00	0.97	0.98	1.00	0.99	1.00	0.99	0.97	1.00
EUR EUR / GBP	0.89	0.83	0.92	0.83	0.83	0.82	0.90	0.83	0.82
EUR / CHF	1.09	1.09	1.05	1.12	1.12	1.14	1.13	1.09	1.14
EUR / JPY	118	122	118	121	120	120	125	122	120

Source: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES), last update 11/03/2020

SOURCE: BNP PARIBAS GLOBAL MARKETS (E: ESTIMATES)



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## CALENDAR

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## LATEST INDICATORS

Economic numbers were weak to bad across the board. The data for China showed huge declines as a consequence of the coronavirus epidemic. For the same reason, the ZEW survey showed huge drops for Germany and the eurozone. Japanese import data reflect the weakness of the domestic economy. Eurozone car registrations registered a considerable decline and in the US, housing starts and building permits also declined. The Philadelphia Fed business outlook showed a significant weakening. The small increase of the Conference Board index of leading indicators brings little comfort as it is expected to decline in March. As a sign of the times, the Federal Reserve took several major policy easing decisions and did not wait for its scheduled meeting.

DATE	COUNTRY	INDICATOR	PERIOD	ACTUAL	PREVIOUS
03/16/2020	Japan	Core Machine Orders YoY	Jan.	-0.3%	-3.5%
03/16/2020	China	Industrial Production YTD YoY	Feb.	-13.5%	5.7%
03/16/2020	China	Retail Sales YTD YoY	Feb.	-20.5%	8,0%
03/16/2020	China	Property Investment YTD YoY	Feb.	-16.3%	9.9%
03/16/2020	China	Fixed Assets Ex Rural YTD YoY	Feb.	-24,5%	5.4%
03/16/2020	United States	Empire Manufacturing	Mar.	-21.5	12.9
03/17/2020	Japan	Industrial Production YoY	Jan.	-2.3%	-2.5%
03/17/2020	United Kingdom	ILO Unemployment Rate 3Mths	Jan.	3.9%	3.8%
03/17/2020	Germany	ZEW Survey Expectations	Mar.	-49.5	8.7
03/17/2020	Eurozone	ZEW Survey Expectations	Mar.	-49.5	10.4
03/17/2020	United States	Retail Sales Control Group	Feb.	-0.5%	0,0%
03/17/2020	United States	Industrial Production MoM	Feb.	0.6%	-0.3%
03/17/2020	United States	JOLTS Job Openings	Jan.	6963	6423
03/17/2020	United States	NAHB Housing Market Index	Mar.	72	74
03/18/2020	Japan	Exports YoY	Feb.	-5.1%	-2.6%
03/18/2020	Japan	Imports YoY	Feb.	-13.9%	-3.6%
03/18/2020	Eurozone	EU27 New Car Registrations	Feb.	-7.4%	-7.5%
03/18/2020	Eurozone	CPI Core YoY	Feb.	1.2%	1.2%
03/18/2020	United States	Housing Starts MoM	Feb.	-1.5%	-3.6%
03/18/2020	United States	Building Permits MoM	Feb.	-5.5%	9.2%
03/18/2020	United States	FOMC Rate Decision (Upper Bound)	Mar.	meeting cancelled	1.25%
03/19/2020	United States	Philadelphia Fed Business Outlook	Mar.	-12,7	36.7
03/19/2020	United States	Leading Index	Feb.	0.1%	0.8%
03/19/2020	Japan	BOJ Policy Balance Rate	Mar.	-0.1%	-0.1%

SOURCE: BLOOMBERG



## CALENDAR: THE WEEK AHEAD

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## COMING INDICATORS

A very important week ahead of us with survey data for March which will show the impact of the coronavirus epidemic: flash PMIs in several countries and consumer confidence for the eurozone, France and Germany. We will have data on business confidence in France and Germany (IFO index) and in the US regional manufacturing surveys as well as University of Michigan sentiment. The ECB will publish its bulletin. The meeting of the Bank of England will be watched for what it may bring in terms of comments on the economic situation, rather than for more easing measures considering that the zero lower bound has been reached and that many measures have already been taken in the recent past.

DATE	COUNTRY	INDICATOR	PERIOD	CONSENSUS	PREVIOUS
03/23/2020	Eurozone	Consumer Confidence	March	--	-6.6
03/24/2020	Japan	Jibun Bank Japan PMI Composite	March	--	47.0
03/24/2020	France	Markit France Composite PMI	March	--	52.0
03/24/2020	Germany	Markit/BME Germany Composite PMI	March	--	50.7
03/24/2020	Eurozone	Markit Eurozone Composite PMI	March	--	51.6
03/24/2020	United Kingdom	Markit/CIPS UK Composite PMI	March	--	53.0
03/24/2020	United States	Markit US Composite PMI	March	--	49.6
03/24/2020	United States	New Home Sales MoM	Feb	-1.8%	7.9%
03/24/2020	United States	Richmond Fed Manufact. Index	March	--	-2
03/25/2020	Germany	IFO Business Climate	March	--	96.1
03/25/2020	United Kingdom	CPI Core YoY	Feb	--	1.6%
03/25/2020	United Kingdom	CBI Retailing Reported Sales	March	--	--
03/25/2020	United States	Cap Goods Orders Nondef Ex Air	Feb	--	1.1%
03/26/2020	Germany	GfK Consumer Confidence	April	--	9.8
03/26/2020	France	Business Confidence	March	--	105
03/26/2020	Eurozone	ECB Publishes Economic Bulletin			
03/26/2020	United Kingdom	Retail Sales Ex Auto Fuel MoM	Feb	--	1.6%
03/26/2020	United Kingdom	Bank of England Bank Rate	March-26	--	0.250%
03/26/2020	United States	GDP Annualized QoQ	4Q	2.1%	2.1%
03/26/2020	United States	Kansas City Fed Manf. Activity	March	--	--
03/27/2020	France	Consumer Confidence	March	--	104
03/27/2020	United States	U. of Mich. Sentiment	March	--	95.9

SOURCE: BLOOMBERG



## FURTHER READING

<a href="#">China: economic contraction is expected in Q1 2020</a>	Chart of the Week	18 March 2020
<a href="#">ECB: targeted measures and flexibility of instruments</a>	EcoFlash	16 March 2020
<a href="#">Addressing the economic consequences of the coronavirus: waiting for the fiscal policy impulse</a>	EcoWeek	13 March 2020
<a href="#">The covid-19 epidemic: economic consequences, pervasive uncertainty, delayed recovery</a>	EcoFlash	12 March 2020
<a href="#">The cryptocurrency economy</a>	EcoConjoncture	11 March 2020
<a href="#">Poland: Economic growth under scrutiny</a>	EcoConjoncture	11 March 2020
<a href="#">The global economy after the coronavirus outbreak</a>	EcoTV	10 March 2020
<a href="#">The liquidity positions of major US banks have not improved</a>	Chart of the Week	10 March 2020
<a href="#">The importance of monetary policy in addressing the economic consequences of the coronavirus</a>	EcoWeek	6 March 2020
<a href="#">The coronavirus: which role for economic policy?</a>	EcoTV Week	6 March 2020
<a href="#">Spain : the weight of services in the economy continues to increase</a>	Chart of the Week	4 March 2020
<a href="#">The coronavirus: international propagation and tail risks</a>	EcoWeek	28 February 2020
<a href="#">Japan: a difficult year ahead in 2020</a>	EcoTV Week	28 February 2020
<a href="#">China: the central bank is taking action to support corporates amid the Covid-19 outbreak</a>	Chart of the Week	26 February 2020
<a href="#">Japan: Consumer spending is suffering</a>	EcoFlash	25 February 2020
<a href="#">The Federal Reserve's strategy review: towards a target range for inflation?</a>	EcoWeek	21 February 2020
<a href="#">Indonesia: Robust but still insufficient growth</a>	EcoTV Week	21 February 2020
<a href="#">Despite tiering, the rate of the deposit facility still costs French banks EUR 1.5 billion</a>	Chart of the Week	18 February 2020
<a href="#">The coronavirus: putting a number on the economic consequences</a>	EcoWeek	14 February 2020
<a href="#">Pensions: Working longer for lower benefits</a>	Chart of the Week	12 February 2020
<a href="#">ECB, Fed: Central banks redefine their strategies</a>	Eco TV	11 February 2020
<a href="#">The economic consequences of the coronavirus: after the sudden stop, what type of recovery?</a>	EcoTV Week	7 February 2020
<a href="#">The coronavirus and the profile for global growth in 2020: V, U or L</a>	EcoWeek	7 February 2020
<a href="#">Mexico: sluggish growth in 2020</a>	Chart of the Week	5 February 2020



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# GROUP ECONOMIC RESEARCH



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Structural or in news flow, two issues analysed in depth



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