WEEKLY UPDATE

Wuhan goes Viral (Update)

The number of confirmed cases of Wuhan flu has continued its rapid increase, rising from 282 on January 20th, to 11,953 on the 31st and 28,276 on February 5th according to the World Health Organisation's daily reports. How bad is the outbreak? And what is the outlook for global growth and markets?

So far, the virus spread has been mainly concentrated in mainland China, which represents 99% of all current confirmed cases. Moreover, 70% of those cases are in Hubei province, of which Wuhan is the capital. Internationally, the spread appears to have been slower thus far, rising at approximately half the rate in China since end January. Although many commentators have questioned the accuracy of Beijing's reports, the international data suggests that China might have been rather transparent in its communication of cases.

The crisis has prompted a series of draconian measures to combat the progression of the virus, closing factories and offices after the planned return from the lunar new year holiday, restricting travel to and from the most-affected areas while a number of territories such as Australia and the United States have barred entry to foreigners arriving from mainland China. Given these restrictions, global supply chains are being disrupted, with many manufacturers warning of looming component shortages.

The economic impact of the SARS epidemic saw Chinese GDP growth slow by an estimated 1% in the first half of 2003. The measures taken this time round are more comprehensive, suggesting that the hit to growth could be harder this year – Standard & Poor's, the rating agency, estimates that real growth in China could slow to 5% for the whole year, down from 6.1% in 2019. Moreover, China is a much larger, more integrated part of world business than it was 17 years ago – it represents 19.3% of global GDP today in purchasing power parity terms, up from 8.7% in 2003.

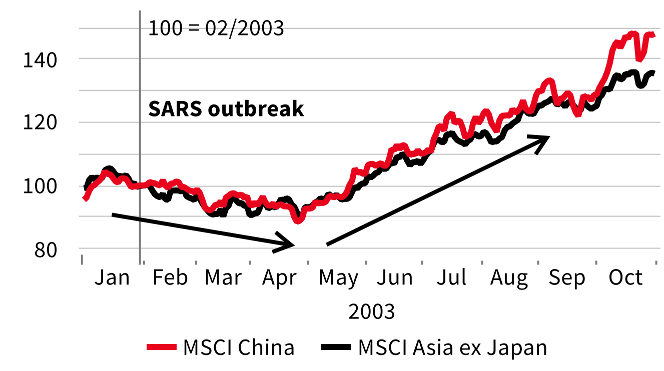
Regarding equity markets, the SARS outbreak saw Chinese equity markets tumble 10% until the outbreak began to come under control in late-April 2003, before rallying steadily higher (see left-hand chart). This time round, the MSCI China index is down 4.4% since January 20th, having touched -9.2% last week, while the onshore CSI300 index tumbled 11.9% before retracing some of its fall to close Friday down 6.8%.

This stabilisation has sparked hopes that the speed of progression has begun to slow. The day-to-day rate of increases in mainland China has indeed eased, from 47% on January 20th to 22% at end-January to 11% on February 6th. As illustrated in the right-hand table, actual confirmed cases have begun to undershoot initial projections. However, we should be cautious in drawing conclusions from the data available at this juncture – further declines in the propagation rate are necessary before we can look forward to the epidemic coming under control.

Bottom line. As we have seen, the hit to global growth is likely to be higher this year than in previous viral outbreaks. However, China stands ready to ease policy further if necessary, after injecting $173bn to money markets and cutting short-term rates by 10bp earlier this week. Moreover, previous cases suggest that the economic impact tends to be temporary, with output recovering to previous levels once the crisis comes under control. Coming weeks are likely to remain volatile for stocks, but we expect markets to recover lost ground in due course.

Equity markets rapidly recovered the ground lost in 2003

MSCI China and Asia ex. Japan (price return, in USD)



Sources: SGPB, Macrobond, data as of 07/02/2020

The virus progression shows signs of slowing

Coronavirus outbreak statistics

Date	Projected cases	Confirmed cases
02/02/2020	14,557	14,557
03/02/2020	17,688	17,391
04/02/2020	21,809	20,630
05/02/2020	26,559	24,554
06/02/2020	31,973	28,276
07/02/2020	38,082	
08/02/2020	44,907	
09/02/2020	52,460	

Sources: SGPB, WHO, Gavekal, data as of 07/02/2020

OUR MACRO COMMENTS

This week and next

EUROZONE

- The final manufacturing PMI ticked up to 47.9 in January from 46.3 in December, the highest reading since April 2019. However, it remained in contraction territory for the twelfth straight month.
- Retail sales decreased by 1.6% MoM in December following November's rise of 0.8%. On an annual basis, they rose 1.3%.
- German industrial production fell 3.5% MoM in December from +1.1% in November. At the same time, industrial orders dropped 2.1% after falling -1.3% the previous month.

Next week's key events		Per.	Prev.	Cons.
10 Feb	Investors' confidence	Feb	7.6	--
14 Feb	GDP growth YoY	Q4	1.0%	1.0%

UNITED KINGDOM

- The final manufacturing PMI reading came in at 50.0 in January, up from 47.5 in December, while the services PMI rose from 50.0 to 53.9. Construction PMI rose to 48.4 in January, from 44.4 in December.
- According to Halifax, house prices started 2020 with a modest monthly rise of 0.4% in January, following stronger gains of 1.2% and 1.8% in November and December respectively.

Next week's key events		Per.	Prev.	Cons.
11 Feb	GDP growth YoY	Dec	0.6%	1.1%
11 Feb	Industrial production YoY	Dec	-1.6%	-0.8%

UNITED STATES

- Markit manufacturing PMI fell slightly from 52.4 in December to 51.9 in January but remains in expansion territory. The second gauge of manufacturing confidence – released by the ISM – jumped to 50.9 from 47.2.
- US factory orders rose 1.8% MoM in December, after falling -1.2% in November.
- US labour productivity increased 1.4% QoQ in the fourth quarter (Q4) of 2019, from -0.2% in Q3.
- Private payrolls rose by 291,000 in January, the highest reading since May 2015, according to the ADP survey.

Next week's key events		Per.	Prev.	Cons.
13 Feb	Inflation rate YoY	Jan	2.3%	2.4%
14 Feb	Industrial production MoM	Jan	-0.3%	-0.1%

ASIA & EMERGING COUNTRIES

- Chinese manufacturing PMI fell to 51.1 in January, from 51.5 in December, but the index remained in expansion territory for the sixth straight month. On the other hand, services PMI rose from 49.4 to 51.0.
- In Japan, household spending fell 1.7% MoM in December, from +2.6% in November.
- Hong Kong retail sales fell -19.4% YoY in December, after -23.7% the previous month.
- The Philippines central bank cut overnight reverse repo rate to 3.75%, from 4.0%.

Next week's key events		Per.	Prev.	Cons.
10 Feb	China: inflation rate YoY	Jan	4.5%	4.9%
10 Feb	China: exports YoY	Jan	7.9%	-4.8%

Sources: DataStream, Bloomberg, 07 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	1.10	1.11
GBP/USD	1.29	1.31
EUR/CHF	1.07	1.10
USD/JPY	110.0	108
Brent	$55.2	$65
Gold (oz.)	$1564	$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

Eurozone banking sector

The Eurozone banking sector has been one of the region's worst performing sectors over the past three years, falling 18% against a 14% rise in the Euro Stoxx 50. Unlike in the US, where stock prices now exceed pre-crisis levels, Eurozone banks trade at less than half 2007 prices, as they face a challenging environment in both structural and macroeconomic terms.

Improving macro backdrop and attractive valuations

Eurozone bank stocks are one of the most cyclically-sensitive sectors, as shown by their correlation with industrial confidence (see chart 1). Manufacturing PMIs have suffered from the global slowdown over the last 2 years, driven by uncertainties over geopolitical issues – such as the US-China trade war and Brexit – and sector-specific problems like the slump in automotive output. However, signs of stabilisation and improvement are now emerging as geopolitical tensions ease. Moreover, the policy mix remains accommodative and consumer sentiment is supported by a strengthening labour market. We expect the Eurozone economy to grow at around its potential rate in 2020, i.e. slightly above 1%.

In terms of valuation, the Euro Stoxx Banks index looks cheap, trading at more than a 10% discount to its historic average price-to-earnings ratio (PER). The consensus expects earnings-per-share (EPS) growth to be positive in 2020 after falling 8% in 2019. Moreover, dividend yields are attractive at 5.6%, well above the 3.2% for the Euro Stoxx 50 index.

Significant progress in balance sheet repair…

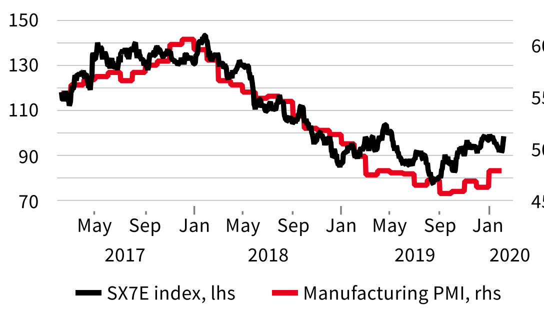
Eurozone banks have improved their balance sheets at a robust pace over the last 5 years through capital increases, enhanced asset quality and modest credit growth. Solvency ratios have risen rapidly – the Tier 1 Capital ratio (CET1) reached 14.4% in 2019 from 11.3% when this Basel III measure was introduced in 2014. At the same time, the proportion of non-performing loans (NPLs) on balance sheets has contracted, from 6.5% in 2014 to 2.8% in 2019 (see chart 2), an improvement which is likely to continue given the supportive macroeconomic backdrop. To be sure, pockets of weakness still exist – for example, Italy's NPL ratio is still above 7% and its banks still have very high exposure to Italian sovereign debt – but improvements have been tangible. For these reasons, eurozone banks today look much better equipped to face a downturn compared to before the crisis.

…but banks are still dealing with tough structural and cyclical issues

Profitability remains low and has been identified as a risk to Euro area financial stability. In recent years, the eurozone banking sector's Return on Equity (ROE) has been stuck below the cost of capital as estimated by the European Central Bank (ECB). ROEs fell from 7.5% to 6.9% in 2019, in part due to the global slowdown. Moreover, intense competition between banks and from financial technology firms is adding to pressure on bank profitability, keeping earnings very sensitive to the credit cycle and leaving little room for error. Further, new Basel IV regulatory rules on capital in 2022 are also expected to put even more pressure on bank profitability and force them to review their business models. Finally, the September deposit ECB rate cut from -0.4% to -0.5% and recent falls in long-dated bond yields have put further pressure on banks' net interest margins and revenues despite the introduction of an interest rate tiering mechanism on excess reserves.

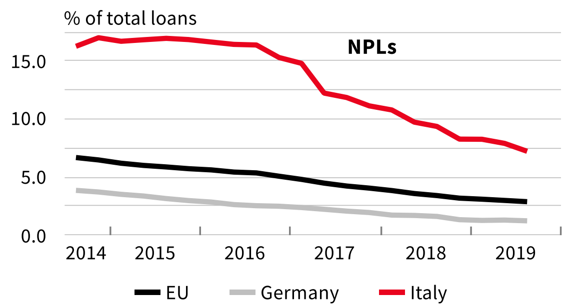
Bottom Line. Eurozone banks may continue recent outperformance in the short-term, supported by the improving macroeconomic environment and accommodative policy-mix. However, given their sensitivity to the credit cycle and the challenges they face to improve profitability, we suggest a Neutral stance in the medium/long run.

Euro Stoxx Banks index is highly correlated with industrial confidence



Source:SGPB, Macrobond, 07/02/2020

Non-performing loans (NPLs) have decreased



Source: SGPB, Macrobond, 07/02/2020

Past performance should not be seen as a guarantee of future returns.

MARKET PERFORMANCE

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-0,45 %	0 bp	→	0 bp	-9 bp	-9 bp
3mth Euribor (EUR)	-0,40 %	0 bp	→	1 bp	-9 bp	-9 bp
3mth Libor (USD)	1,73 %	-3 bp	↓	-17 bp	-107 bp	-100 bp
3mth Libor (GBP)	0,76 %	6 bp	↑	-4 bp	-16 bp	-15 bp
10-year US Treasury bond	1,64 %	9 bp	↑	-17 bp	-105 bp	-106 bp
10-year German bond	-0,37 %	4 bp	↑	-4 bp	-61 bp	-53 bp
10-year French bond	-0,11 %	4 bp	↑	-8 bp	-82 bp	-69 bp
10-year UK bond	0,58 %	4 bp	↑	-13 bp	-69 bp	-63 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	-0,1%	→	0,7 %	7,2 %	5,7 %
BAML EURO Corp HY	0,5%	↑	2,4 %	12,2 %	9,1 %
BAML GBP Corp IG	-0,2%	↓	3,2 %	14,5 %	11,8 %
BAML US IG	-0,3%	↓	3,1 %	16,5 %	14,0 %
BAML US HY	0,6%	↑	2,8 %	15,2 %	9,3 %
BAML Global EM Sov. External Plus	0,3%	↑	3,5 %	14,4 %	9,5 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1,10	-0,5 %	↓	-0,8 %	-4,3 %	-3,4%
EUR/CHF	1,07	0,1 %	→	-2,6 %	-5,0 %	-6,0%
GBP/USD	1,29	-1,3 %	↓	0,6 %	1,3 %	0,0%
USD/JPY	110,0	0,9 %	↑	0,9 %	0,4 %	0,0%
USD/BRL	4,28	0,9 %	↑	4,9 %	10,3 %	15,8%
USD/CNY	6,97	0,5 %	↑	-0,4 %	1,3 %	3,3%
USD/RUB	63,3	0,3 %	↑	-0,7 %	-9,1 %	-3,8%

Government bonds*

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

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	577	2,0 %	↑	6,9 %	2,1 %	19,5 %
Eurostoxx 50	3 806	3,2 %	↑	3,6 %	1,9 %	22,7 %
DAX	13 575	3,2 %	↑	3,0 %	2,5 %	19,9 %
CAC 40	6 038	2,8 %	↑	3,2 %	1,2 %	22,9 %
S&P 500	3 346	1,9 %	↑	9,3 %	3,7 %	24,9 %
FTSE 100	7 505	1,7 %	↑	2,1 %	-0,5 %	9,5 %
SMI	11 012	2,5 %	↑	6,7 %	3,7 %	24,5 %
Topix	1 737	3,7 %	↑	2,7 %	0,9 %	12,6 %
IBOV Brazil	115 190	-0,3 %	↓	6,3 %	-0,4 %	21,7 %
MICEX Russia *	3 097	-0,4 %	↓	3,9 %	31,3 %	21,9 %
MSCI EM	1 102	2,7 %	↑	3,6 %	-1,1 %	8,3 %
SENSEX 30 India	41 306	1,0 %	↑	2,1 %	0,1 %	12,9 %
Hang Seng (H-K)	27 494	4,0 %	↑	-0,6 %	-2,4 %	1,8 %
Shanghaï Composite	2 867	-3,7 %	↓	-3,8 %	14,9 %	9,5 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$55,2	-6,1 %	↓	-11,4 %	3,8 %	-12,1 %
Gold	$1 564	-1,2 %	↓	5,0 %	22,1 %	19,2 %
Copper	$5 722	2,8 %	↑	-2,8 %	-3,8 %	-8,6 %

Source: DataStream, on 07 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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