WEEKLY UPDATE

Pushing the Boat (Further) Out

Euro zone assets have been in high demand over the past three weeks. The Euro STOXX 50 equity index is up almost 18% while the euro has risen almost 5% against the US dollar. What has spurred this rare bout of euro zone outperformance? And can it be sustained?

The main catalysts for the rally have been 1) the gradual easing of coronavirus lockdown restrictions as the number of new confirmed cases has continued to dwindle, 2) a tick higher in business confidence surveys such as the Purchasing Manager Indices, 3) the European Commission's proposal for a €750bn EU recovery fund, 4) Germany's new €130bn stimulus plan, and 5) the latest increase in asset purchases by the European Central Bank (ECB).

The new German plan was announced on Wednesday and comes in addition to the previous €250bn support plan and a further €1,200bn in loan guarantees, delayed taxes etc., taking the total value of programmes to around 49% of German GDP. The new programme focuses more on long-term stimulus than its predecessor which aimed to help companies and households through the crisis, via measures such as Kurzarbeit income support (which covers 18% of total workforce). This week's plan includes a cut in VAT from 19% to 16% until December, investments in growth-generating new technologies (digital, renewables and electric vehicles for example), a €300 payment per child and continued bridging support for companies. All in all, an extraordinary package for a government which is supposedly conservative on fiscal matters.

The ECB's economists have revised their economic forecasts lower – they now expect euro zone GDP to contract -8.7% this year, followed by +5.2% and +3.3% in 2021 and 2022, meaning that the euro zone economy will not recover to end-2019's level until end-2022. Moreover, inflation is set to remain below 1% until 2022, far below the central bank's 2% target.

Such a dire outlook demanded an adjustment in monetary policy, which duly came in the form of a €600bn increase in the Pandemic Emergency Purchase Programme (PEPP) to €1,350bn, extension of its timetable by 6 months to June 2021 and announcement that reinvestment of maturing bonds will continue until at least December 2022. The ECB has already bought €235bn in the PEPP, leaving €1,115bn to buy over the next 13 months. If we include all the other ECB programmes, the average monthly run rate of purchases will be €120bn in 2020 and €106bn next year, slower than May's €150bn pace but still well above the €80bn per month the ECB bought during the euro zone crisis.

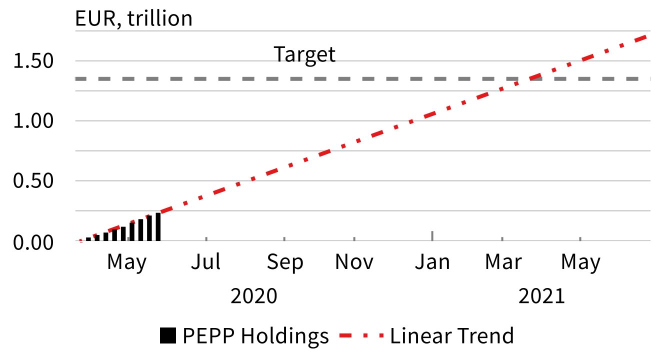
If we consider that the ECB will continue to direct three-quarters of all these planned purchases to sovereign bonds, this would mean the ECB buying a total of around €1,460bn in 2020 and 2021, more than enough to cover euro zone members' anticipated budget deficits of €1,366bn. Moreover, by committing to reinvest the proceeds from maturing bonds, the ECB will neutralise much of the financing cost of governments' additional debt burden for at least three years, given that it typically returns much of the coupon income received on its holdings to national treasuries.

This week's announcements sparked a marked easing of financial conditions across the euro zone. For example, the yield differential between 10-year sovereign bonds issued by Germany and Italy tightened 17bp to 174bp yesterday, taking it well below the 280bp level we saw before the PEPP was launched in March. Moreover, the euro rose a further 0.9% against the USD.

Bottom line. The decisive action from Germany and the ECB this week has further boosted risk appetite for euro zone assets. However, the economic backdrop remains dire, meaning continued headwinds for companies. Moreover, the EU still must overcome threatened vetoes from the "Frugal Four" (the Netherlands, Austria, Denmark and Sweden) against the recovery fund at the European Council summit on June 18 and 19. It may still be too early to overweight the region.

Adjustment in monetary policy (PEPP)

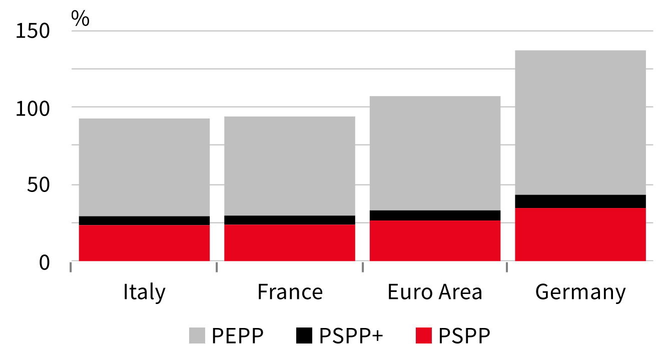
PEPP programme, ECB holdings in EUR



Sources: SGPB, Macrobond, data as of 05/06/2020

Potential ECB sovereign bond purchases during 2020-21

As a share of projected budget deficits for 2020-21



Sources: SGPB, Macrobond, Gavekal, data as of 05/06/2020

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

OUR MACRO COMMENTS

This week and next

EUROZONE

- The final manufacturing PMI reading came in at 39.4 in May, up from 33.4 in April, suggesting that economic activity is recovering gradually. Services PMI rose to 30.5 in May from 12 in April.
- The unemployment rate stood at 7.3% in April, up from 7.1% in March, and should continue to deteriorate.
- Retail sales fell 19.6% YoY in April, after -8.8% in March, showing the extent of the damage caused by the lockdown.
- The European Central Bank kept key deposit rates unchanged at -0,5% during its last meeting.

Next week's key events		Per.	Prev.	Cons.
08 June	Sentix Investor sentiment	Jun	-41.8	-22.5
12 June	Industrial production YoY	Apr	-12.9%	-27.5%

UNITED KINGDOM

- The final manufacturing PMI reading rose to 40.7 in May, from 32.6 in April, suggesting that economic activity is stabilising. Services PMI rose to 29 in May from 13.4.
- According to Nationwide, house prices fell 1.7% MoM in May, the largest monthly fall for 11 years. On an annual basis, house prices rose 1.8% in May, compared to +3.7% in April, as the coronavirus crisis hit market activity.

Next week's key events		Per.	Prev.	Cons.
12 June	GDP 3m/3m	Apr	-2.0%	-9.8%
12 June	Industrial production YoY	Apr	-8.2%	-19.3%

UNITED STATES

- The ISM manufacturing PMI came in at 43.1 in May, up from 41.5 in April. According to Markit, the manufacturing PMI rose from 36.1 to 39.8.
- US jobless claims totalled 1.9 million for the week ended May 29, bringing the 11-week total to nearly 43 million.
- Spending on US construction projects decreased by 2.9% in April as the coronavirus dented the whole economy.
- Unemployment rate fell to 13.3% in May, from 14.7% the previous month.

Next week's key events		Per.	Prev.	Cons.
10 Jun	Inflation rate YoY	May	0.3%	0.3%
12 Jun	U. Mich. Cons. Confidence	Jun	72.3	75.0

ASIA & EMERGING

- In China, the Caixin manufacturing PMI rose to 50.7 in May, from 49.4 in April. Services PMI increased to 55.0 from 44.4. Both PMI returned to expansion territory.
- In Japan, investment spending (CAPEX) rose 4.3% YoY in Q1, from -3.5% in Q4 2019, but the data were gathered before the coronavirus crisis. On the other hand, household spending fell -6.2% MoM in April, from -4.0% in March.

Next week's key events		Per.	Prev.	Cons.
08 Jun	Japan : GDP revised QoQ	Q1	-0.9%	-0.5%
10 Jun	China: inflation rate YoY	May	3.3%	2.7%

Sources: DataStream, Bloomberg, 05 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	**1.08**	1.08
USD/JPY	**109.1**	**110.0**
Brent	**$40.1**	$37
Gold (oz.)	**$1712**	$1725

Our changes made to our 3-month targets this week.

Forecast figures are not a reliable indicator of future performance.

MARKET PERFORMANCE

Interest rates	Last	1wk	3mth	YTD	12mth
EONIA (EUR)	-0,46 %	0 bp →	0 bp	-10 bp	-10 bp
3mth Euribor (EUR)	-0,35 %	-6 bp ↓	12 bp	-4 bp	-3 bp
3mth Libor (USD)	0,32 %	-3 bp ↓	-68 bp	-249 bp	-216 bp
3mth Libor (GBP)	0,23 %	-1 bp →	-27 bp	-68 bp	-56 bp
10-year US Treasury bond	0,82 %	12 bp ↑	-17 bp	-187 bp	-130 bp
10-year German bond	-0,32 %	10 bp ↑	31 bp	-57 bp	-12 bp
10-year French bond	-0,01 %	5 bp ↑	31 bp	-72 bp	-20 bp
10-year UK bond	0,31 %	10 bp ↑	-6 bp	-96 bp	-60 bp

Credit	1wk	3mth	YTD	12mth
BAML EURO Corp. IG	0,7% ↑	-2,9 %	4,2 %	0,4 %
BAML EURO Corp HY	2,1% ↑	-4,2 %	5,7 %	0,4 %
BAML GBP Corp IG	0,3% ↑	-1,1 %	13,5 %	7,1 %
BAML US IG	0,5% ↑	-1,6 %	17,4 %	9,5 %
BAML US HY	2,2% ↑	-3,6 %	10,3 %	2,2 %
BAML Global EM Sov. External Plus	2,5% ↑	-7,0 %	7,1 %	0,6 %

Exchange rates	Last	1wk	3mth	YTD	12mth
EUR/USD	1,13	2,4 % ↑	1,8 %	-1,2 %	0,8%
EUR/CHF	1,08	1,4 % ↑	1,7 %	-3,8 %	-3,0%
GBP/USD	1,26	2,2 % ↑	-2,1 %	-1,3 %	-0,8%
USD/JPY	109,1	1,4 % ↑	1,5 %	-0,4 %	0,9%
USD/BRL	5,12	-5,3 % ↓	11,7 %	31,9 %	32,8%
USD/CNY	7,11	-0,5 % ↓	2,7 %	3,4 %	2,9%
USD/RUB	69,1	-1,9 % ↓	4,4 %	-0,8 %	6,1%

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

Equities*	Last	1wk	3mth	YTD	12mth
MSCI AC World	528	3,7 % ↑	-0,8 %	-5,6 %	8,3 %
Eurostoxx 50	3 262	5,5 % ↑	-3,5 %	-11,6 %	0,1 %
DAX	12 431	5,5 % ↑	2,5 %	-6,2 %	3,8 %
CAC 40	5 012	5,1 % ↑	-7,3 %	-15,1 %	-3,0 %
S&P 500	3 112	2,8 % ↑	0,0 %	-2,8 %	13,3 %
FTSE 100	6 341	2,0 % ↑	-6,3 %	-14,7 %	-8,7 %
SMI	10 076	1,5 % ↑	0,9 %	-2,0 %	8,5 %
Topix	1 604	1,7 % ↑	8,1 %	-5,6 %	9,8 %
IBOV Brazil	93 829	7,9 % ↑	-12,5 %	-18,9 %	-3,7 %
MICEX Russia *	2 766	-0,5 % ↓	-2,2 %	17,3 %	2,2 %
MSCI EM	989	7,0 % ↑	-4,1 %	-10,5 %	1,3 %
SENSEX 30 India	33 981	5,7 % ↑	-11,3 %	-17,3 %	-14,2 %
Hang Seng (H-K)	24 366	5,8 % ↑	-6,4 %	-12,6 %	-6,0 %
Shanghaï Composite	2 919	2,6 % ↑	-3,1 %	17,1 %	2,0 %

Commodities	Last	1wk	3mth	YTD	12mth
Brent	$40,1	13,7 % ↑	-22,6 %	-24,5 %	-35,2 %
Gold	$1 712	-0,6 % ↓	4,4 %	33,6 %	29,6 %
Copper	$5 512	3,9 % ↑	-2,7 %	-7,3 %	-5,8 %

Source: DataStream, on 05 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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