Perspectives
Economics

SwissLife Asset Managers

April 2020

Key messages

- In our base case, the world economy recovers in the second half 2020 in a U-shaped form from recession
- China: coal consumption, which can be used as a proxy for industrial activity, rises continuously
- Coronabonds? The Eurozone will likely need to resort to some form of risk sharing

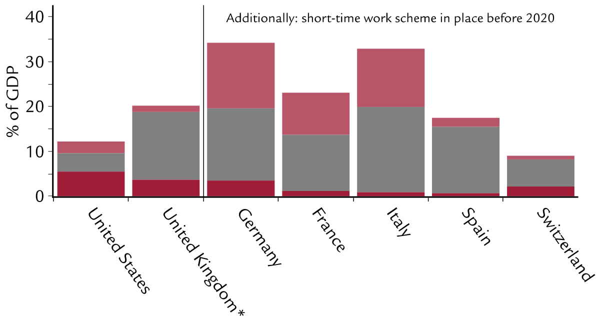
Comparison of forecasts

	GDP 2020		GDP 2021		CPI 2020		CPI 2021	
	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus	Swiss Life AM	Consensus
US	-1.0% ↓	1.6% ↓	3.2% ↑	2.0%	1.6% ↓	1.8% ↓	2.1%	2.1%
Eurozone	-2.0% ↓	0.6% ↓	2.8% ↑	1.3% ↑	0.6% ↓	1.1% ↓	1.4%	1.4%
Germany	-1.7% ↓	0.5% ↓	2.6% ↑	1.2% ↑	0.7% ↓	1.3% ↓	1.4%	1.5%
France	-1.6% ↓	0.8% ↓	2.5% ↑	1.2%	0.8% ↓	1.2% ↓	1.4%	1.1% ↓
UK	-1.4% ↓	0.8% ↓	2.5% ↑	1.3% ↓	1.3% ↓	1.5% ↓	1.8%	1.8% ↓
Switzerland	-1.3% ↓	1.0% ↓	3.1% ↑	1.4% ↑	-0.3% ↓	0.2% ↓	0.6%	0.7%
Japan	-3.1% ↓	-0.7% ↓	2.3% ↑	1.1% ↑	0.3% ↓	0.4% ↓	0.3%	0.5% ↓
China	3.8% ↓	5.2% ↓	8.4% ↑	6.1% ↑	3.6% ↑	3.4% ↑	2.0%	2.2%

Arrows indicate difference from previous month
Source: Consensus Economics Inc. London, 9 March 2020

Chart of the month

Estimated fiscal response to pandemic



■Government expenditure (*including new short-time work scheme)
■Liquidity and loan guarantees for firms ■Tax and other deferrals

Source: Bruegel.org, Swiss Life

With the global spread of the coronavirus and the implementation of strict containment measures, most economies will experience an enormous drop in economic output. Fiscal and monetary authorities have already announced generous stimulus measures, which include new discretionary spending (dark red bars) as well as liquidity provisions and loan guarantees for companies (grey bars). Besides these measures, short-time work schemes already in place before 2020 are key to cushion the impact on labour markets. The UK introduced such a scheme in March 2020. With no such scheme in place, the US will likely experience a sharp increase in unemployment despite its $2 trillion spending package.

US
The sudden recession

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.0 %	2020: 1.6 %
2021: 3.2 %	2021: 2.0 %

Since the previous edition of this publication, the US has moved from one of the least affected developed economies to the global hotspot of the coronavirus pandemic. As test capacities have been finally ramped up, US data on the coronavirus have become more reliable, showing – at the time of writing – unabated exponential growth in new infections. In terms of infection dynamics, the US is lagging Italy and Switzerland by about 15 and 9 days, respectively, implying that even more severe lockdown measures might become necessary. We thus expect an immediate, sharp, but short-lived recession in the first half of this year. Contrary to European countries, there is no nationwide short-time work scheme in place in the US. Hence, companies affected by lockdowns have resorted to mass layoffs. In the last week of March and the first week of April, 10 million workers (6% of the employed workforce) claimed unemployment benefits, the fastest increase seen in history. Hence, we would not be surprised to see the unemployment rate peaking between 10 and 15% in April and May before rapidly declining again if lockdown measures are eased as expected. It will, however, not be a swift return to normal. In our base case, we expect some supply-side restrictions in the services sector to remain in place, while fiscal policy is unlikely to fully compensate for the demand shortfall. Despite the expected gradual recovery in the second half of the year, we only foresee output to return to pre-crisis levels in early 2021.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.6 %	2020: 1.8 %
2021: 2.1 %	2021: 2.1 %

The collapse of the oil price might push headline inflation as low as 0.8% in April, down from a January peak of 2.5%. Meanwhile, core inflation surprised to the upside in January and February, and we only expect a minor decline to around 2.1-2.3% over the next months. We think that the disinflationary demand shortfall might be compensated by higher inflationary pressure from the supply shock, at least in the near term.

Eurozone
Next stop: coronabonds?

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -2.0 %	2020: 0.6 %
2021: 2.8 %	2021: 1.3 %

The coronavirus pandemic is not only causing extraordinary human suffering but will also bring an unprecedented drop in economic activity in the first half of this year. No hard data is available at the time of writing, but survey data for the Eurozone paint a bleak picture. In March, the Purchasing Managers' Index (PMI) for services dropped to 26.4 points, a contraction never seen in the history of the series (i.e. well below the low of 40.9 registered during the 2009 financial crisis). The manufacturing PMI held up better at 44.5 points but should deteriorate further in April due to falling external demand and the fact that Spain and Italy decided to shut down all non-essential industrial activity at the end of March. In our base case, we expect activity to rebound in May and June, assuming that lockdown measures were successful enough to be gradually lifted. Nevertheless, the economic damage, especially in Italy, will be enormous and fiscal sustainability issues in this highly indebted country will soon arise. So far, monetary policy has provided an effective backstop to widening peripheral bond spreads, with the European Central Bank stepping up asset purchases and relaxing the issue limits on bond purchases. Medium-term, however, the Eurozone will likely need to resort to some form of risk sharing to avoid the risk of a "euro crisis 2.0", be it through established instruments such as the European Stability Mechanism (ESM) or common bond issuance (so-called eurobonds or "coronabonds").

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.6 %	2020: 1.1 %
2021: 1.4 %	2021: 1.4 %

The economic havoc caused by the coronavirus pandemic will make it even harder for monetary policymakers to achieve their inflation target. While supply shortages of certain products might cause upward pressure on inflation, this will be outweighed by lower energy prices in the near-term and a widening output gap in the medium term, in our view.

Germany
Corona spread ousts black zero

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.7 %	2020: 0.5 %
2021: 2.6 %	2021: 1.2 %

At little over 6000 cases the German Robert Koch Institute raised the threat level for Germany to "high" on 17 March. Cases have since surged further. Albeit avoiding a total lockdown, on 22 March Germany prohibited gatherings of more than two people until at least 20 April. These developments have prompted us to sharply revise down our 2020 GDP forecast as we now expect massive output contractions in March and April. Peak to trough, the hit will by far exceed the one seen during the global financial crisis. Short-time work will help to cushion the effect on unemployment, which we, nevertheless, expect to increase. The March ifo survey showed the largest ever drop in business expectations over the next six months. The decline was broad-based across sectors with food, beverage and toilet articles within retail sales being the exception. The services sector was hit most, particularly travel agencies and tour operators as well as accommodation and food services. Given this unprecedented economic shock, Germany's finance minister Scholz suggested already on 13 March that the black zero may have to go. On 25 March the lower house suspended the debt brake and approved a €750 billion stimulus package consisting of €600 billion in loan guarantees (around 10% of GDP) and €120 billion in new discretionary spending (3.5%). The massive policy stimulus will support the gradual recovery in the second half of 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.7 %	2020: 1.3 %
2021: 1.4 %	2021: 1.5 %

As oil prices crashed, March inflation dropped to a four-months-low of 1.3%, down from 1.7% in February. We expect price pressure to remain low during the quasi-shutdown of the economy. However, the massive policy stimulus together with potential supply shortages could exert upward pressure on inflation in the second half of the year.

France
35% of activity is being missed

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.6 %	2020: 0.8 %
2021: 2.5 %	2021: 1.2 %

France is hit much harder by the coronavirus pandemic than neighbouring Germany. In certain regions of eastern France, the sheer number of hospitalisations has overwhelmed the health care system, which has most likely contributed to the above-average case fatality rate of more than 6% currently. The government reacted with far-reaching lockdown measures as well as with a significant fiscal package. The latter includes government spending (including for a short-time work scheme and for postponement of tax payments) and state guarantees for new company loans (ceiling of EUR 300 bn). During recessions, France is usually faring better than other European economies due to the large share of its services and government sector. While the latter is a stabilising factor indeed, the current lockdown is hurting the services sector disproportionately. The Purchasing Managers' Index for the services sector fell to 27.4 in March, lower than in Germany, Japan, the US or the UK. As there is no historical precedent to estimate the effect of widespread lockdowns on GDP, there is currently huge uncertainty regarding any point forecast. Our working assumption was that GDP in European economies might drop to 80-90% of normal levels in March and April, which could still turn out to be too optimistic. The French statistical office INSEE recently published a preliminary estimate that activity in France was in fact running, at the end of March, at just 65% of pre-crisis levels.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 0.8 %	2020: 1.2 %
2021: 1.4 %	2021: 1.1 %

The bigger-than-expected drop of the oil price triggered a significant downward revision of our 2020 full-year inflation forecast to 0.8% from 1.4%. We expect, however, inflation to normalise to an average level of 1.4% in 2021, assuming that a gradual U-shaped economic recovery kicks in in the second half of this year, gradually narrowing the output gap in France.

UK
No man is an island

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.4 %	2020: 0.8 %
2021: 2.5 %	2021: 1.3 %

For some time, it seemed that the UK might use a different, less radical way to cope with the coronavirus pandemic. Eventually, the government needed to resort to the same lockdown measures that were taken on the Continent as it became clear that the healthcare system would otherwise be overwhelmed. The fiscal response was impressive, with targeted measures including a job retentions scheme, broadening of unemployment benefits to the self-employed, loan guarantees, tax deferrals and outright spending measures. The government attached a price tag of 18% of GDP to the package, but the ultimate fiscal cost will be determined by the length and depth of the recession. We expect activity to drop by at least 12% in March and April, followed by a recovery in May and June if lockdown measures can be gradually eased. The crisis complicates several issues in the UK: First, it hits consumers at a time when the savings rate is already low in historical comparison (5%, versus around 7% before the 2009 financial crisis). Second, the generous fiscal package increases external financing needs as the UK is running a chronic current account deficit (sterling was among the worst-performing major currencies year-to-date). Third, EU-UK negotiations are likely to take a backseat as policymakers are absorbed by the pandemic. More time is likely needed, but Boris Johnson is still ruling out an extension of the deadline. Hence, uncertainty regarding trade relations will remain elevated in 2020.

Inflation	
Swiss Life Asset Managers	Consensus
2020: 1.3 %	2020: 1.5 %
2021: 1.8 %	2021: 1.8 %

We lowered our 2020 inflation forecast on the back of lower energy prices to 1.3% from 1.5%. Core inflation however, is likely to hover between 1.5% and 2.0% this year. While the recession is likely to reinforce the trend of moderating wage pressure, the depreciation of sterling and supply constraints should add positively to underlying inflation, with an overall neutral effect in our base case.

Switzerland
The safety net is in place

GDP growth	
Swiss Life Asset Managers	Consensus
2020: -1.3 %	2020: 1.0 %
2021: 3.1 %	2021: 1.4 %

For the time being, we have hardly any real economic data available to properly assess the economic damage of the pandemic and of the necessary lockdown measures. In our base case, we assume that developed economies will see a similar timespan as China between local outbreak and the relaxation of subsequently imposed lockdown measures. If China can be used as a blueprint, we expect a gradual pick-up in activity from May onwards. Until then, we expect the output of Switzerland's economy to drop by 12%. This would imply a real GDP drop of 1.3% on average in 2020 from year ago levels. The main risks to our scenario are an even sharper drop until May, a second wave of the pandemic in Asia or a renewed debt crisis in Europe caused by the catastrophic situation in Italy and Spain. Meanwhile, we think that Switzerland's authorities have spun an efficient safety net to limit the risk of a longer-lasting demand shock. Nevertheless, the damage that is already visible leaves no doubt that Switzerland is currently in recession. Data published by SECO (State Secretariat for Economic Affairs) allow a first estimate of the short-term impact on the labour market: despite an extensive short-term work compensation programme, the cantonal labour offices registered a sharp increase in people applying for unemployment benefits. We expect the unemployment rate to have risen to 2.9% in March from 2.5% in February, when the world economy was still a different animal.

Inflation	
Swiss Life Asset Managers	Consensus
2020: -0.3 %	2020: 0.2 %
2021: 0.6 %	2021: 0.7 %

Compared with the start of the year, heating oil is currently 25% cheaper, which by itself lowers Switzerland's consumer price index by around 0.2%. Uncertainty as regards the short-term inflation outlook is high, but we think that the disinflationary effect of discounting by retailers is likely to outweigh rising prices for goods and services which became temporarily scarce.

Japan
Is the worst already over?

GDP growth

Swiss Life Asset Managers	Consensus
2020: -3.1 %	2020: -0.7 %
2021: 2.3 %	2021: 1.1 %

Japan was hit early by the coronavirus pandemic. In the last edition of this publication, Japan was the fourth-most affected country in terms of infections but has since even moved out of the top 30. This was achieved with surprisingly few restrictions to daily life. The closing of schools was the most dramatic move. Otherwise, the government mostly issued recommendations, from avoiding unnecessary travel to cancelling large events. Activity data up until February turned out to be surprisingly good, with both retail sales and industrial production recovering from the slump experienced after the October 2019 consumption tax hike. Nevertheless, the outlook has since worsened. First, the massive spread of the virus in other developed economies will weigh on external demand in the second quarter. Second, the postponement of the Tokyo Summer Olympics into 2021 is a drag on third-quarter growth. Third, infections have recently started to re-accelerate notably in the Tokyo area, which might trigger lockdown measures in Japan's economic powerhouse. While we previously assumed that the economic pain will be centered to the first quarter, it now looks likely that it will be more evenly spread across the first and second quarter, with a neutral effect on our full-year GDP forecast.

Inflation

Swiss Life Asset Managers	Consensus
2020: 0.3 %	2020: 0.4 %
2021: 0.3 %	2021: 0.5 %

As in other economies, we revised Japanese headline significantly on the back of lower energy prices and now expect inflation to average 0.3% in both 2020 and 2021. Interestingly, the Japanese yen has only appreciated marginally year-to-date, while the spring wage negotiations (so-called shunto) still point towards modest wage gains for Japanese workers. Hence, we do not expect this recession to trigger renewed deflation in Japan for the time being.

China
Tepid economic recovery

GDP growth

Swiss Life Asset Managers	Consensus
2020: 3.8 %	2020: 5.2 %
2021: 8.4 %	2021: 6.1 %

China's economy suffered a slump as the draconian lockdown measures to contain the spreading of the coronavirus paralyzed economic activity. All economic indicators fell to levels never seen before, with fixed asset investments contracting by 24.5%, industrial production plunging by 13.5% and retail sales dropping by 20.5% in January and February from a year earlier. This will translate into a substantial economic contraction in the first quarter this year, leading us to sharply revise down our full year GDP growth forecast to 3.8% from 5.4% previously. As new domestic coronavirus cases papproach zero, the government is lifting lockdown restrictions and has started to move towards a pro-growth stance. High frequency indicators such as coal consumption, which can be used as a proxy for industrial activity, are continuously improving. However, the recovery in consumption remains tepid, as indicated by weekly car sales that remain at weak levels. A potential further increase in unemployment could dent consumption over the course of the year. Moreover, the pandemic has caused a global recession, which dampens demand for Chinese goods. Therefore, we expect only a gradual recovery of the Chinese economy in the second quarter this year.

Inflation

Swiss Life Asset Managers	Consensus
2020: 3.6 %	2020: 3.4 %
2021: 2.0 %	2021: 2.2 %

February inflation remained elevated at 5.2%, driven by rising food prices. Food prices accelerated due to food hoarding as well as transport restrictions in order to limit the spreading of the coronavirus. As new coronavirus cases decreased significantly, restrictions are being lifted. This together with the slump in energy prices should lead to a decline in inflation in the upcoming months.

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Perspectives
Emerging Markets

Second quarter 2020

Key messages

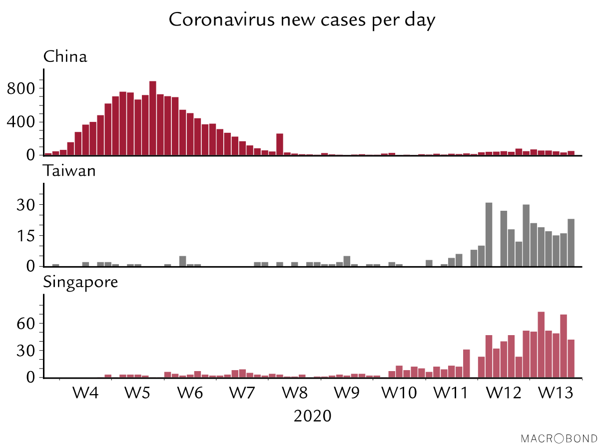
- China's economy to contract in the first quarter, while recovery will be gradual due to weak external demand
- Emerging markets hit by own lockdown measures and weak external demand as coronavirus cases soar
- Oil price shock is an additional drag on economies as exporters see their revenues squeezed

Number in focus

1/3

One third of the world population is under lockdown. On March 24, India's Prime Minister Narendra Modi ordered the country's 1.3 billion people to stay at home, initiating the world's largest coronavirus lockdown. Containment measures vary by country from full quarantine restrictions, non-mandatory recommendations, travel bans, to business closures. While lockdown measures imply severe economic repercussions via a supply shock, they are essential to dampen the speed of the virus transmission and deal with the global health crisis.

Chart in focus



Countries that had been able to swiftly tackle the spreading of the coronavirus, such as Taiwan and Singapore, face a new surge in coronavirus cases, as travellers are bringing the virus back to Asia. Also, in China most of the new cases that started to increase as of late are imported cases and pose a risk of a second wave. In order to control a new surge in infections, countries might need to reimpose lockdown measures, denting economic activity for an extended period and falling into deeper recession.

Coronavirus threatening the emerging world

The coronavirus is spreading rapidly across the globe and has reached more than 170 countries. Europe as well as the United States are already reeling from the outbreak and the emerging world is not being spared. From a health as well as from an economic point of view the threat of the virus for emerging economies is even more severe. Weak healthcare systems as well as the lack of proper sanitation to prevent infections create a risk of a humanitarian crisis. This institutional weakness means that strict lockdown measures are needed and might have to be implemented over an extended period of time. A wide range of emerging economies have already implemented different forms of containment measures in order to tackle the rising number of new coronavirus cases. India entered the world's largest complete lockdown, shutting down virtually all economic activity, except for essential services such as supermarkets and pharmacies. South Africa entered a nationwide lockdown as well. On the other hand, populist governments in Brazil and Mexico dismiss the dangers and resist the implementation of countrywide containment measures, creating the risk of a rapid surge in infections that can easily overwhelm their unprepared healthcare systems. Moreover, working from home during the lockdown period is often not an option, due to the lack of infrastructure, such as laptops etc. At present, the depth of the economic fallout is highly uncertain as it depends on the duration of the lockdown. However, since the spread of the virus can only be contained via sudden stops of economic activity due to the need of social distancing, dramatic economic repercussions are to be expected, with many major emerging markets falling into recession.

Weak external demand weighing on EM growth

As the pandemic hits the global economy, demand and supply chains are hurt and emerging markets are uniquely vulnerable to a global economic collapse. For many emerging countries exports make up a significant part of their economic output and since the world is in recession, demand for these goods will remain lackluster over the course of the year. Moreover, a number of emerging markets are highly exposed to tourism from abroad. Recent travel restrictions across a large part of the world are already being felt, contributing to sharp reductions in leisure activities. Since these shortfalls are likely to be lost for good, tourism dependent economies such as Thailand, Hongkong, Malaysia, Vietnam, etc. will only see partial compensation of lost output, once the situation is normalizing. Since both, the negative external backdrop as well as own lockdown measures pose an unprecedented threat for emerging economies, they are stepping up unprecedented fiscal and monetary support measures. A wide range of emerging market central banks delivered large rate cuts this month, such as Brazil and Mexico that cut their rates by 50 basis points (bps). India delivered a 75bps rate cut, while South Africa and Turkey reduced their policy rates by a total of 100bps. At the same time, also fiscal support is being ramped up. India announced a 1.7trillion rupee (1% of GDP) fiscal package in order to provide welfare assistance to over 800 million people. South Korea increased its emergency funds to 83 billion USD (6% of GDP) in order to support businesses hit by the coronavirus. Malaysia announced 58bn USD (15% of GDP) support for the economy and Brazil's government agreed to an income support scheme for 38 million of informal workers. As

Chart 1: Coronavirus cases have only started to surge in emerging economies

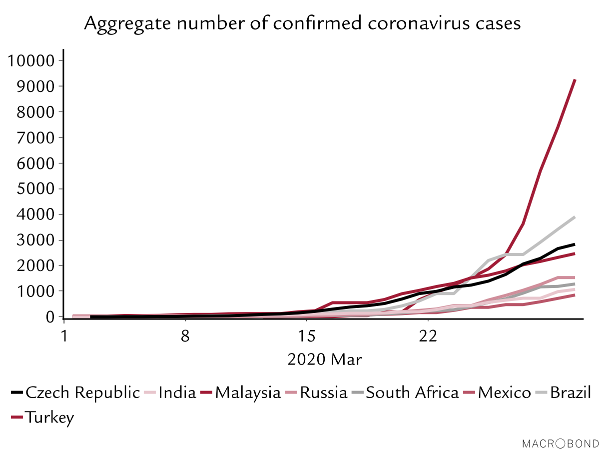
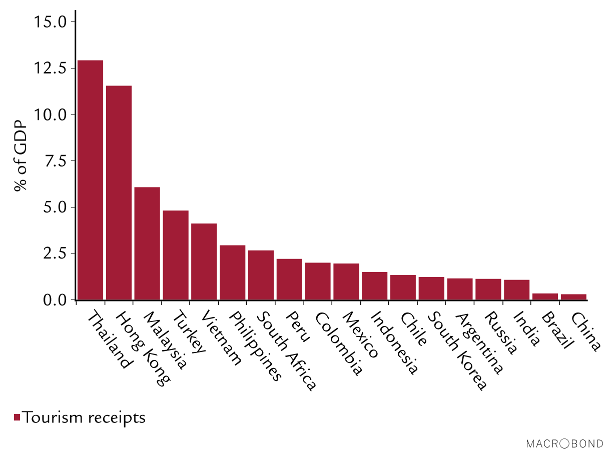


Chart 2: Tourism-dependent economies hit as coronavirus halts travel



these support measures contribute to fundamental vulnerabilities, capital outflows are likely to increase. South Africa already lost its investment grade credit rating due to worsening public finances and more rating downgrades of emerging economies could follow. Especially for those economies that rely on external financing to cover their current account deficits and foreign debt repayments, such as Turkey, South Africa and Colombia, capital outflows pose a major challenge.

China's economy to contract sharply in first quarter

China's economy suffered a large slump as the draconian lockdown measures to contain the spreading of the coronavirus paralysed economic activity. All economic indicators fell to levels never seen before, with fixed asset investments contracting by 24.5%, industrial production plunging by 13.5% and retail sales dropping by 20.5% in January and February from a year earlier. The readings indicate a massive fallout of economic activity in February which is to translate into a substantial contraction in the first quarter this year, leading us to sharply revise down our full year GDP growth forecast to 3.8% from 5.4% previously. As new domestic coronavirus cases approach zero, the government is lifting lockdown restrictions and started to move towards a pro-growth stance. High frequency indicators, such as coal consumption, which can be used as a proxy for industrial activity, are continuously improving. However, the recovery in consumption remains slow, as indicated by the weekly car sales that remain at weak levels. A potential further increase in unemployment could dent consumption over the course of the year. Moreover, the fast coronavirus spread causes a global recession, which dampens demand for Chinese goods. Therefore, we expect only a gradual recovery of the Chinese economy in the second quarter this year. Against this backdrop, Beijing will likely ramp up its monetary and fiscal support via further interest rate cuts and increased infrastructure investments in targeted projects, such as the 5G network and the healthcare system.

Oil price slump as an additional drag on growth

Oil prices crashed to a 17-year low, amid weak global demand due to the coronavirus crisis, coupled with an oil price war between Saudi Arabia and Russia who did not manage to agree on deeper oil production cuts in order to support crude oil prices. As demand is expected to remain subdued, oil prices will likely remain at low levels. Moreover, Saudi Arabia and Russia do not seem to feel pressured to find an agreement on production cuts. Saudi Arabia's oil production costs are lower than the current oil price, while Russia has built up ample reserves, including a national welfare fund, which can be tapped to offset lower oil revenues. Oil producers, such as Colombia, Mexico, Brazil as well as Middle Eastern countries, will take an immediate hit from the plunge in oil prices. First, a slump in oil revenues derails public spending. Second, a confidence shock leads to a depreciation of currencies which can translate into higher inflation and therefore lower real incomes. At the same time, any positive impact on oil importers, such as India, Thailand or South Korea, is likely to be muted as a big part of the consumers are locked down amid the coronavirus spread.

Chart 3: China's economic activity indicators slump to record low

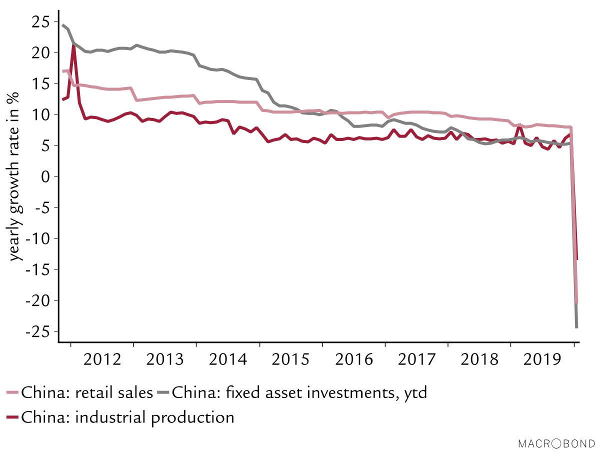
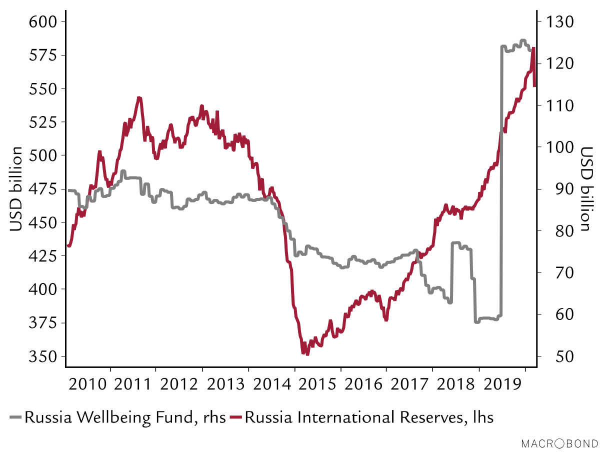


Chart 4: Russia has built up reserves to counter oil price volatility



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Perspectives

Financial Markets

SwissLife Asset Managers

April 2020

Interest rates & bonds

The month of superlatives

USA

- As the coronavirus crisis unfolds, we are starting to see the first signs of its impact on the US economy with a record high number of initial jobless claims and a plunge in sentiment indicators.
- The US Fed cut its policy rates by 150 basis points and introduced unlimited quantitative easing. At the same time, the government signed off on a fiscal stimulus program worth USD 2 trillion.

Eurozone

- Exponentially rising infections forced governments to implement strict lockdown measures. Unsurprisingly, economic data signal a sharp recession.
- Fiscal rescue packages have been implemented to dampen the economic impact from the pandemic, while the significant increase in asset purchases by the ECB and more flexibility regarding their implementation has so far prevented a blowout in peripheral bond spreads.

UK

- The UK's infection numbers are bound to rise sharply in the coming weeks given the late implementation of lockdown measures.
- The BOE cut rates by 65 basis points and launched a GBP 200 billion bond purchase program.

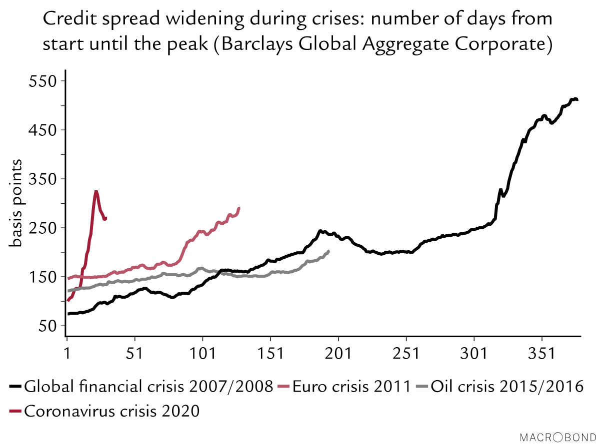
Switzerland

- Switzerland has one of the highest infections per capita and will likely see a severe economic impact.
- The SNB has so far not put out any extraordinary measures apart from FX interventions, but the government issued loan guarantees for firms and extended the reach of its short-term work scheme.

Japan

- So far, Japan seems to handle the spread of the virus better than other countries, but the economy is nevertheless going to contract significantly this year.
- The BOJ kept interest rates unchanged but increased the purchases of equity ETFs.

The sudden recession



Recessions usually hit financial markets by surprise, and this time is no different. However, the speed at which this correction unfolded is unprecedented. Equities, corporate bonds and even gold all sold off in unison as investors struggled to find the cash to serve outflows and margin calls. Markets became heavily distorted as we witnessed a severe liquidity crunch. Even safe haven government bonds sold off and bond market credit curves inverted as investors tried to sell what they could, not what they wanted. Only after central banks opened the flood gates, volatilities decreased, and markets started to function properly again. During the month of March, EUR and USD corporate bond spreads widened sharply by 125 and 150 basis points, respectively. Total returns for the month were deeply negative with -6.9% and -7.1%, respectively. While we ultimately expect a U-shaped economic recovery to unfold in the second half of this year in developed markets, the next three months will remain challenging and uncertain. We therefore remain defensively positioned within credit, with a bias to sectors such as utilities and telecommunication, while we remain wary of consumer cyclicals and financials. We also keep our slight overweight position in duration.

Equities

Volatility is here to stay

USA

- Economic prospects have deteriorated sharply in the US as the country has become the hotspot of the coronavirus pandemic. While the number of new infections is stabilising in Europe, growth of new cases in the US is still exponential.
- The fiscal response has been impressive in the form of a USD 2 trillion package, which helped to calm the equity market at the end of March. Nevertheless, the US unemployment rate is set to rise sharply to around 10-15% in April and May due to the lack of a nationwide short-time work scheme.
- Given the bleak near-term prospects, we do not expect US stocks to outperform for the time being and have thus downgraded the US to a neutral stance.

Eurozone

- Widespread lockdown measures in the Eurozone will lead to a sharp recession in the first half of 2020. Equity markets dropped by 20% in March. Equity markets in Italy and Spain, countries particularly hit by the epidemic, underperformed.
- It is still unclear when the economic situation will start to normalise, but at least the number of new infections appears to be stabilising. We expect EMU stocks to perform at least in line with global equities.

UK

- The strategy to achieve herd immunity as soon as possible has been abandoned, and – with a delay – the UK adopted strict lockdown measures as on the Continent.
- Hence, it might take a bit longer to bring the epidemic under control in the UK. We thus expect UK stocks to extend their year-to-date underperformance in the coming months, despite attractive valuations and dividend yields.

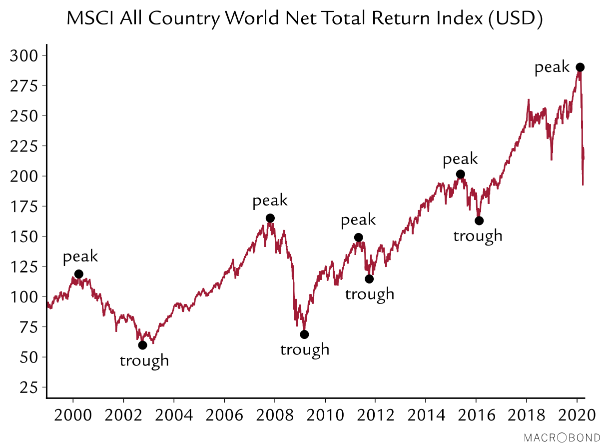
Switzerland

- Swiss stocks significantly outperformed global equities year-to-date due to their defensive character.
- We do not expect this to change anytime soon amid high uncertainty.

Japan

- So far, Japan has managed the pandemic better than other developed markets and additionally benefits from the ongoing economic recovery in China.
- Japanese equities thus outperformed in March.

Up and down. And up?



The coronavirus pandemic caused one of the fastest equity market corrections in history and led to a spike in volatility not seen since the global financial crisis. While the recession is just starting to become visible in economic data, investors are already pondering whether they should increase their equity exposure. This is not surprising as markets usually turn positive way before economic data bottom out. We have defined a few milestones that we need to see before turning more constructive. First, credible measures to contain the pandemic. The UK and the US have been laggards in that respect, but lockdown measures are now in place almost everywhere. Second, targeted fiscal and monetary measures to contain the economic fallout. Here, we can also tick the box. The US fiscal package was the latest addition and the most important reason why equity markets stabilised in March. The next milestone is medical in nature. We need to see a "flattening of the curve" in Europe and the US followed by a testing and tracing regime that will allow a gradual easing of restrictions (China being the blueprint). Here, uncertainties are elevated in the near term, and the risk of a second infection wave in Asia is not yet off the table. Hence, we expect volatility to remain elevated and stay underweight equities on a one-month horizon.

A long-term investor may, however, be tempted to look through these short-term uncertainties. The last two decades have delivered a few significant equity market drawdowns (see chart). They all have one thing in common: in the long run, indices always recovered and ultimately moved above the pre-crisis peaks. We do not think that the "coronavirus crisis" will be any different.

Currencies

More cautious on the USD as carry advantage fades

USA

- USD exchange rates were unusually volatile in March. The emergency policy rate cuts by the US Fed weighed on USD up until early March, before stress in USD funding markets temporarily pushed up the greenback.
- Due to the significant Fed rate cuts, the interest rate advantage of USD has faded. This is the main reason why we have turned tactically negative on the USD.

Eurozone

- After a significant up and down, EUR/USD ended the month of March exactly at the same level as at the beginning of the month.
- We have turned constructive on EUR/USD for the next three months. Besides lower interest rate differentials, dynamics on the coronavirus front have also shifted. The relative outlook has recently worsened significantly for the US, as cases are still surging while Europe has recently seen a stabilisation in new infections.

UK

- In March, GBP temporarily lost almost 13% against USD, driven by lower oil prices, the worsening coronavirus epidemic in the UK and the announcement of a massive fiscal boost amid a chronic current account deficit.
- Even though GBP already recovered somewhat at the end of March, we see further upside potential for GBP/USD, in line with our generally negative near-term view on the USD.

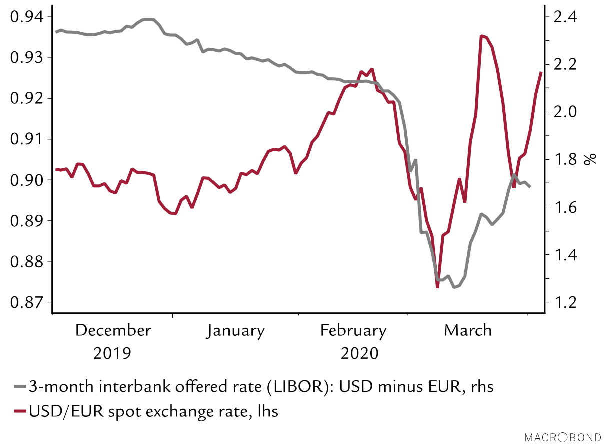
Switzerland

- In March, CHF remained under appreciation pressure against EUR.
- Continued SNB currency intervention limits the downside on EUR/CHF, in our view.

Japan

- Like other USD exchange rates, USD/JPY was very volatile in March. Nevertheless, JPY appreciation has been surprisingly limited year-to-date despite the turmoil in equity markets.
- In line with our generally cautious three-month outlook on the USD, we have turned negative on USD/JPY.

USD funding stress led to temporary USD surge in March



From 2017 to 2019, implied volatility in foreign exchange markets had been constantly declining before hitting a multi-year low in mid-February 2020. Even in times when great uncertainty hit risky assets (e.g. end of 2018), FX markets remained surprisingly calm. The coronavirus epidemic brought about a sudden change. Since mid-February, implied volatility has surged and notably USD exchange rates have been on a roller-coaster ride. The first shock to markets were two emergency decisions by the US Federal Reserve which brought policy rates back to almost zero and narrowed or even erased the interest rate advantage of holding USD against other major currencies. The resulting depreciation of the USD was quickly reversed due to stress in the USD funding market, which led to higher interest rate differentials in unsecured markets (LIBOR) and a wider USD cross-currency basis. The USD funding issue has been addressed by coordinated global central bank action, and we believe that the first issue – the faded USD carry advantage – will dominate over the next three months. Hence, we have turned negative on USD against EUR, CHF, GBP and JPY. In addition, the US economy is now also hit significantly by the coronavirus pandemic, which might make the USD a somewhat less attractive safe haven currency as compared to CHF and JPY (in Switzerland and Japan, we are already seeing a flattening of the infection curve). The CHF has indeed remained under appreciation pressure in March, especially against EUR, and this is unlikely to change as long as the economic outlook remains uncertain. However, the extent should be limited due to ongoing currency intervention by the Swiss National Bank.

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