Shifting To Recovery Gear
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As the first half of 2020 draws to a close, it looks like the worst is over for the global economy and the path to normalisation is becoming clearer, as more countries emerge from lockdowns and activity picks up. But the recovery path ahead will be uneven and protracted as policymakers scale back fiscal support to limit the brutal hit to public finances.

Most developed economies are likely to report an unprecedented drop in output when 2Q2020 GDP data is released in late July and early August. 3Q2020 should show a strong rebound, although activity is unlikely to reach 2019 levels until late 2021 or 2022.

There is little change in our forecasts this month, with global GDP expected to shrink 2.1% in 2020, before rebounding by 5.3% in 2021. The primary risk to this outlook is a second wave of infections and renewed lockdowns that push recovery well into 2021.

Geopolitical risks remain a significant threat to market performance and we continue to monitor developments closely. US-China tensions in particular, are likely to remain a persistent source of market volatility, as the US presidential election in November draws closer.
Signs Of A Recovery

“The path for the global recovery from the coronavirus-driven recession is becoming clearer, as more countries start to emerge from their lockdowns and activity picks up.”

- The path for the global recovery from the coronavirus-driven recession is becoming clearer, as more countries start to emerge from their lockdowns and activity picks up. Estimates of the magnitude of the downturn are still unavoidably wide, but information over the past month does not point to any major reassessment of the scale of the damage.
- Most developed economies are likely to report an unprecedented drop in output when 2Q2020 GDP data is released in late July/early August. It looks like May was a little better than April, while June should be significantly stronger. 3Q2020 should show a good rebound, although activity is unlikely to reach 2019 levels until late 2021 or 2022.
- There is little change in our economic growth forecasts this month, with global GDP expected to shrink 2.1% in 2020, before rebounding by 5.3% in 2021. The primary risk to this outlook is a second wave of infections and renewed lockdowns that push recovery well into 2021.

China offers hope

- China offers a blueprint for what to expect in developed markets, even though magnitudes will differ. Reflecting its position as the source of the virus, China was the first to shutdown parts of its economy and the first to come out on the other side.
- China’s recent National People’s Congress took the pragmatic step of not producing a GDP target for the year but instead put the emphasis on job stability. Plans for a moderate amount of bond issuance point to some restraint on fiscal stimulus, which is perhaps an indication of confidence in the economic rebound.
- If the government can use this opportunity to move away from the custom of GDP targeting, then in future it could allow focus to shift to a better quality of growth as well as helping to control excessive credit. President Xi Jinping can reasonably claim that China met its target of doubling incomes by 2020 and move away from a raw growth target.

Fiscal policy may be scaled back

- As economies emerge from lockdowns, the focus is shifting towards finding ways of re-opening the economy and scaling back various subsidy programmes. It is a fine balance between providing the right incentives to start to normalise, while avoiding too much stress on companies.

Monetary policy will remain loose

- Monetary policy responded rapidly and aggressively to the crisis. Low interest rates look set to remain around current levels through to the end of 2021 and probably beyond.
- The US Federal Reserve continues to push back against suggestions that it needs to adopt negative interest rates, while the Bank of England seems to be wavering. On balance, negative interest rates appear to provide some additional stimulus if they are well structured.

Will inflation or stagflation become an issue in time?

- The short-term impact of the virus-driven recession is deflationary. Demand has collapsed while the plunge in oil prices adds further downward pressure on prices, so inflation has already dipped.
• Longer term, the tail risk of inflation merits attention. Supply is set to shrink and that will be exacerbated by further de-globalisation. After years of increasingly favouring capital, the pendulum is set to swing towards labour, as the crisis has highlighted the vulnerabilities of low-skilled workers. The explosion of monetary growth points to a further risk.

• Inflation (or stagflation: inflation with low economic growth) is hard to imagine at the bottom of the cycle. However, it could become a concern over the next two to three years if activity rebounds and policymakers struggle to remove the array of emergency measures enacted in recent months.

• Questions about the scale of monetary stimulus can translate into concern about the longer-term consequences of such an aggressive expansion of central bank balance sheets.

### Global growth outlook

<table>
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<th>%</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
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<tr>
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<td>-4.3</td>
<td>3.9</td>
</tr>
<tr>
<td>US</td>
<td>2.3</td>
<td>-4.1</td>
<td>3.8</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.2</td>
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<td>Japan</td>
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<td>2.9</td>
</tr>
<tr>
<td>Emerging Markets</td>
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<td>-0.5</td>
<td>6.2</td>
</tr>
<tr>
<td>China</td>
<td>6.1</td>
<td>-1.0</td>
<td>8.0</td>
</tr>
<tr>
<td>Rest of Asia</td>
<td>4.9</td>
<td>1.5</td>
<td>7.2</td>
</tr>
<tr>
<td>World</td>
<td>2.9</td>
<td>-2.1</td>
<td>5.3</td>
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</tbody>
</table>

Source: Bank of Singapore

### Money growth has exploded in the US

Source: Bloomberg
Staying Balanced

“We remain neutral in equities, where we believe a balanced stance is optimal given current valuations after a sharp rally that has priced in much of recent positive developments, and still-limited earnings visibility.”

- Multiple positive factors have driven market optimism over the last few weeks, including the massive stimulus packages globally, as well as the fact that we may be past the worst of the global Covid-19 crisis as economies start to re-open. However, these are balanced out against significant risks including:
  a) uncertainties over the trajectory of the post-Covid-19 path to normalcy which could be tenuous and long drawn out,
  b) less attractive global valuations following the recent market rally, and
  c) a ratcheting up of US-China tensions, which underpin our overall neutral view of equities.

United States
- Despite dire economic fundamentals and the lack of earnings visibility, the S&P 500 index’s rally since 23 March has been breath-taking. Still, we believe investors should adopt a more cautious stance, with three key risks worth considering:
  a) First, tensions between US and China are escalating, and these are manifesting in areas such as politics, financial markets, and technology. This is likely to remain as a headline risk going into the November US presidential elections.
  b) Second, the heavy concentration of the S&P 500 Index’s market cap in just 5 (tech) stocks also calls into question the durability of the rally without broader participation across sectors, and the ability of long-only funds to maintain increasingly concentrated portfolios.
  c) Third, while lower rates are positive for multiples, they could be neutral for profit margins in the short term, given the high proportion of fixed-rate corporate debt, while the rebuilding of cash buffers through debt capital markets reduces credit risk but at the expense of lower profitability.

Europe
- This earnings season will likely be remembered as one of the dimmest in terms of forward visibility in history. Of the 200 companies that reported where management commented on guidance, 42% removed guidance, 32% held, 23% cut and only 3% upgraded. The ones that raised guidance were mainly in Pharma/Healthcare. Looking at all the sectors in Europe, those that have the greatest visibility ahead are Pharma, Telecoms and Utilities, while those with the least visibility are Capital Goods and Chemicals.
- Looking ahead, the extent to which the gradual reopening of economies is protracted and fragmented would likely be a key catalyst going forward. Hopes were lifted, however, by the European Union’s proposal for a EUR750 billion recovery fund to help restart the region’s economy.

Japan
- Reflecting the urgency on mending the economic damage from the Covid-19 outbreak as daily infection rates eased, Japan lifted its state of emergency slightly earlier than scheduled last month and announced additional stimulus which included more support for small to medium sized enterprises.
- While the worst in the fall in consumption may have passed, we see a subdued road to recovery ahead, with potential risks including heightened US-China tensions. Market valuations however are at undemanding levels of about 1.1x price/book, near the previous lows of 0.9x over the past decade. We recommend a barbell approach for long term investors, favouring a mix of quality defensive consumer staples and cyclical beneficiaries.
Asia ex-Japan
- The MSCI Asia ex-Japan Index corrected mildly for the month of May after seeing a good rebound in April. While the world’s attention is undoubtedly focused on rising US-China tensions, there are also signs of geopolitical risks brewing within Asia, as China and India have both moved in more troops along a section of their border amid a border dispute.
- In China, the MSCI China index has rebounded since its low in March 2020. During the same period, consensus earnings forecasts have been revised downwards by 5% and we believe there is still downside risk, with consensus forecasting 3% earnings growth this year. Concerns of a re-escalation of US-China tensions are likely to persist going into the US presidential elections this November.
- The latest flare-up has expanded beyond trade and tariffs-related issues and broadened to technology (Huawei and semiconductor sectors), capital flows and access to the US capital markets (increasing uncertainties related to possible de-listing of Chinese ADRs), and more potential US responses in relation to the passing of the national security legislation at the National People’s Congress.
- All these uncertainties are likely to cap any significant valuation multiple expansion and we urge investors to remain cautious and selective. Any pullback in the market would offer opportunities to accumulate companies that can benefit from structural themes, such as our investment theme of rising online engagement, which should benefit internet and e-commerce related players.

<table>
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<tr>
<th>Total Returns %</th>
<th>12-months</th>
<th>YTD</th>
<th>May</th>
</tr>
</thead>
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<tr>
<td>World</td>
<td>5.9</td>
<td>-9.0</td>
<td>4.3</td>
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<tr>
<td>US</td>
<td>12.3</td>
<td>-5.4</td>
<td>4.2</td>
</tr>
<tr>
<td>Europe</td>
<td>-2.2</td>
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<td>4.6</td>
</tr>
<tr>
<td>Japan</td>
<td>7.5</td>
<td>-6.9</td>
<td>7.7</td>
</tr>
<tr>
<td>Asia Ex-Japan</td>
<td>-0.6</td>
<td>-12.8</td>
<td>-2.0</td>
</tr>
</tbody>
</table>

Source: Bloomberg, MSCI, Bank of Singapore as of 28 May 2020
HONG KONG / CHINA MARKET OUTLOOK

ELI LEE
Head of Investment Strategy, Bank of Singapore

Balancing Between Policy Easing And Earnings Pressure

“The long-awaited National People’s Congress (NPC) was held at the end of May and the Government Work Report (GWR) outlined a number of key targets. The emphasis has shifted from a hard GDP growth target to setting the tone that the policy stance remains on an easing bias with a focus on jobs creation, as can be seen from its job creation target of 9 million and its urban surveyed unemployment rate of 6%. The fiscal package announced was more or less in line with market expectations, with a headline fiscal deficit target of 3.6% or above. While there has yet to be any sector-specific policy stimulus announced, the NPC has shed light on structural opportunities.”

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- While there has yet to be any sector-specific policy stimulus announced, the NPC has shed light on structural opportunities.
- We are constructive on infrastructure, including both traditional and “new” infrastructure sectors. The ongoing Hukou reform and the accelerated pace of urbanisation should support construction-related sectors and unleash demand for consumer durables.
- We are neutral on property and maintain our expectations that a massive nationwide loosening in the property sector is highly unlikely. While we maintain our view that banks could offer a tactical trading opportunity until going ex-dividend in end-June/early-July, our view is that banks will be under pressure post ex-div as lower policy rates continue to put pressure on net interest margins, and we expect the market to shift its focus to asset quality in light of potential national service that has to be performed by banks. With the tax and fee cuts, we are also cautious on sectors that are likely to face pricing pressures, such as power and telcos.
- MSCI China has rebounded by about 16% since the trough in March-20, driven largely by valuation multiple expansion where the forward price-to-earnings multiple has been re-rated from 11x to 13x currently, which is slightly above its historical average level.
- During the same period, consensus earnings forecasts have been revised downwards by 5% and we believe there is still downside risk, with consensus forecasting 3% earnings growth this year. Concerns of a re-escalation of US-China tensions are likely to persist going into the US presidential elections this November.
- The latest flare-up has expanded beyond trade and tariffs-related issues and broadened to technology (Huawei and semiconductor sectors), capital flows and access to the US capital market (increasing uncertainties related to possible de-listing of Chinese ADRs), and more potential US responses in relation to the passing of the national security legislation at the NPC.
- All these uncertainties are likely to cap any significant valuation multiple expansion and we urge investors to remain cautious and selective. Any pullback in the market would offer opportunities to accumulate companies that can benefit from structural themes, such as our investment theme of rising online engagement, which should benefit internet and e-commerce related players.
Benefiting From A Search For Yield

“Aggressive monetary easing by the major central banks has driven already low interest rates even lower, enhancing the appeal of emerging market high yield bonds among investors who are in search for yield.”

- We see interest rates staying at current ultra-low levels for a significant period and believe that the hunt for yield will be supportive of Emerging Markets (EM) High Yield (HY) bonds over the long term despite the scope for some near-term volatility. Within EM HY, we maintain our preference for Asia, driven by our constructive outlook for China, which continues to outperform other emerging markets.

Bond markets’ strong performance in May
- For the second straight month, global corporate bonds rallied strongly. EM bonds were up 3.8%, with HY up 5.6% and Investment Grade (IG) up 2.7% on optimism towards global economies opening. In Developed Markets (DM), IG bonds rose 1.2% while HY bonds added 4.9%.
- Emerging Market Credit had an outstanding month in May as investors shifted their focus away from worst-case “left tail” outcomes towards a more sanguine outlook as hopes grew that Covid-19 may lose momentum.

Emerging Market spreads stage big rally
- EM HY spreads tightened an incredible 123 basis points (bps) in May and at +765 bps have erased half the loss since 23 March. Meanwhile, IG spreads tightened 50 bps to +308 bps, still well off the pre-Covid tight of +180 bps.
- Several weeks ago, the Federal Reserve had also introduced a Special Purpose Vehicle to purchase US IG bonds on the open market, with the intention of unfreezing the credit markets. This is also supportive of our neutral position on DM IG bonds.

Nascent signs of optimism in EM
- There are cautious green shoots of optimism in EM. The Fed’s actions to calm markets and stabilise liquidity were not targeted at EM bonds specifically, but had a salutary impact, nonetheless. The aggressive monetary and fiscal easing in EM has not led to a widespread tightening of financial conditions, and capital flight has improved demonstrably since March. Furthermore, EM currencies have been relatively stable since March and oil is at its highest level in three months. From a technical perspective, the new issue market remains robust, with massive oversubscriptions.

Prefer Asian High Yield
- China continues to outperform other EM year-to-date and our preference remains for China within Asia in the HY space. Despite Sino-US tensions, we continue to see value in Chinese HY USD denominated bonds in the medium term based on several factors.
- Firstly, China’s economy continues to recover in May. Secondly, governments around the world, including China, continue ensuring that plentiful liquidity is available in the market, by fiscal or monetary means, to curb further defaults in the economy. This would ensure keeping the lid on any potential credit crunch. Thirdly, Chinese HY names, especially properties, continue to offer good relative value against other EM counterparts.
- During May, more high-yield issuers, ranging from BB+ to B rated, returned to the primary market with issuance as high as 10x oversubscribed. This is evidence that markets have plenty of appetite for Chinese HY bonds barring any short-term volatility due to Sino-US tensions. Nevertheless, in the medium term, the higher level of liquidity will need to find more stable risk assets with higher yield, at the same time and which are more insulated from Covid-19 and trade conflicts.

Maintain overweight rating on EM HY and neutral rating on EM IG
- We are maintaining our overweight stance on EM HY and neutral stance on EM IG. Within the EM corporate bond space, HY has understandably borne the brunt of risk reduction since the impact of Covid-19 began in earnest in January. However, it has started to outperform.
Worst Is Over For Oil

“The easing of lockdown measures and steep production declines in non-OPEC countries along with OPEC+ gives us hope that the worst is behind us in the oil market.”

Oil
- The collapse in supply and partial demand rebound should be enough to move oil markets back into deficit in 2H2020, providing price support which we expect to continue in the coming months. 12-month Brent crude price forecast is unchanged at US$45/bbl but we have raised the 3-month and 6-month forecast to US$36/bbl (old: US$30) and US$40/bbl (old: US$38) respectively.
- Supply side has adjusted fast amid steep production declines in non-OPEC countries along with OPEC. A gradual recovery is underway in oil demand, occurring in stages with China the furthest ahead, and Europe and the US a step behind. Easing restrictions in Europe and the US is likely to lead to only a gradual rebound in transportation-driven oil demand. Jet fuel demand remains subdued and any sizeable recovery will depend on international travel restrictions being lifted.

Gold
- The big balance sheet expansion by major central banks, near-zero interest rates in the US and concerns that money printing may eventually result in US Dollar debasement, keeps us positive on gold’s medium-term outlook. We see the precious metal trading close to US$1,800 per ounce in 12 months’ time.

Currency outlook
- Markets seem to be ignoring negative headlines and have been broadly risk positive. Unrest in US cities should remain a domestic affair but if it persists, it could be negative for the US Dollar (USD). The broad USD could be further affected negatively in the near term given that the DXY index has broken key support levels.
- Near term, we expect a firmer Euro to be the beneficiary of USD weakness. The increased odds of a coordinated fiscal response from EU members augurs well for the Euro. Cyclicals like the Australian Dollar and the New Zealand Dollar may also push higher as shorts entered on Sino-US developments capitulate.
- Economic data has been poor, but generally still better than consensus estimates. This has contributed to economic optimism and if it continues, the defensive and long-USD thesis may lose further traction.
- For now, we have turned less defensive, but we are still not ready to completely give up on it. Although economic data has beaten expectations, this may be because of over pessimistic estimates. We prefer to wait for stronger evidence of a recovery in data before we give up on our defensive stance.
- In Asia, weakness of the Renminbi versus the USD has not translated to materially weaker Asian currencies versus the greenback. This suggest to us that although Sino-US tension has worsened, it has not been a driver in FX markets.
- This may remain the case so long as both sides stick to a verbal exchange, and do not take concrete policy action to curtail trade and/or portfolio flows. In the near term, Asian currencies vis-à-vis the USD should be driven by broad USD dynamics, which at this stage is USD-negative. As for the USD-Singapore Dollar (SGD) pair, there is possibly further downside for the greenback in the short term.
- On the domestic front however, any positivity from the ending of the circuit breaker period should be short-lived as most of the restrictions remain in place. The domestic economy is still expected to face headwinds, and this should limit excessive SGD strength.
Hong Kong Economy Under Pressure

“The Hong Kong economy contracted by a record 8.9 per cent YoY in the first quarter amid the Covid-19 pandemic. Going forward, a raft of relief measures and the partial relaxation of the containment measures may help mitigate some downside risk. However, since the restriction measures have not been fully lifted, we expect the economy to contract at a faster pace in the second quarter. For the second half of this year, any rebound is expected to be sluggish given the demand shock and the uncertainty about pandemic. Since first quarter GDP surprised on the downside, we further downgrade our 2020 GDP growth forecast from -4% YoY to -5% YoY for Hong Kong. Downside risks remain high especially if the lifting of lockdown causes another wave of infections. On top of that, we will also closely monitor the renewed social unrest and the heightened US-China tensions which could threaten HK’s special trading status.”

- Hong Kong’s economy contracted by a record 8.9% YoY in the first quarter as the Covid-19 outbreak dented local consumption (-10.1% YoY), curbed exports of goods (-9.9% YoY) and services (-37.8% YoY, largest decline on record) and took a toll on investment (-14.3 per cent YoY).
- Hong Kong PMI rebounded only slightly from 34.9 in March to 36.9 in April, which is still close to the record low of 33.1 seen in February. New orders sub-index rose from 23.3 in March to 26.8 in April while production sub-index edged higher to 30.5 from the prior month’s 26.0. However, both remained in deep contraction territory.
- This suggests that economy may contract at a faster pace in the second quarter (we pencil in a contraction of 9.2% YoY) despite a raft of relief measures and the partial relaxation of the containment measures from 8 May. For the second half of this year, any rebound is expected to be only sluggish given the internal and external demand shock and the lingering uncertainty about the pandemic.
- First, as restriction measures have not been lifted fully, business sentiments may weaken further while construction activities may remain at an almost standstill, which indicates that investment would inevitably contract in the second quarter.
- Second, more companies (particularly the SMEs) in hard-hit sectors could be forced to go out of business in the second half of this year as fiscal stimulus measures will fade with time whereas the demand shock may persist. This could also weigh down private investments.
- Third, due to the resultant increase in retrenchments due to a wave of bankruptcies, the jobless rate may rise towards 6% from the current 5.2% which was already the highest since 2009. Layoffs and pay cuts are expected to dent local consumer demand. This will inevitably hit the economy hard as private consumption contributed to over 65% of total GDP.
- Fourth, exports of goods and services may remain subdued amid strong travel restrictions and soft external demand.
- In conclusion, as first quarter’s GDP surprised on the downside, we further downgrade our 2020 GDP growth forecast from -4% YoY to -5% YoY. Likewise, the government also expects a contraction of 4% YoY to 7% YoY, down from the previous range of -1.5% YoY to +0.5% YoY.
- Downside risks remain high, especially if the lifting of lockdown causes another wave of infections. On top of that, we will also closely monitor renewed social unrest and the heightened US-China tensions which could threaten HK’s special trading status.
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