BARINGS INVESTMENT INSTITUTE

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Throwing Money At The Problem With The Hope A Vaccine Will Stick

MONTHLY MACRO DASHBOARD

BARINGS

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Summary

The global economy is in the throes of a recession. While a depression will likely be avoided, the extent and length of the downturn depends on the world's ability to contain the COVID-19 pandemic. China has begun lifting restrictions and the economy is re-opening, though weaker export demand from Europe and the U.S.—as the virus spreads in these regions—will weigh on China's recovery. Stricter social distancing measures have been implemented throughout Europe and the U.S., which has led to a sharp deterioration in services industries and is wreaking havoc on labor markets. However, impressive fiscal and monetary stimulus will help cushion the blow to these countries' economies. If the virus can be contained and restrictions are lifted by 3Q20, a recovery should begin before year-end, but many downside risks weigh on the outlook. Offshore U.S. dollar liquidity also remains top of mind, especially in Emerging Markets, where dollar-denominated debt has only increased since 2008. The call is still out on whether the recovery will resemble one that follows a natural disaster or a financial crisis. If the virus is contained quickly and policies support financial markets through the downturn, it would likely lean more toward the former.

The U.S. is likely currently in recession as it battles COVID-19. Widespread social distancing and store and restaurant closures are decimating the service-dependent economy and leading to record-setting layoffs. The duration and extent of the downturn hinges upon the containment of the outbreak. U.S. fiscal and monetary policy will help, but more spending is likely needed before we see the other side. Elevated debt levels appear to be the principal issue, and focus will be on bridging the near-term liquidity gap affected corporates are now facing. Despite this, the banking system appears to be holding up fairly well, with funding stresses looking contained thanks to Basel III and associated measures. However, these same measures that have kept banks more sound have also pushed more borrowing activity toward capital markets, which may be less prone to benefit from the Federal Reserve liquidity operations.

GDP growth across the eurozone and U.K. is set to contract in the second quarter as country-wide closures span the continent. Business and investor confidence has plummeted on the backs of announced wide-spread shutdowns. The first impact of the crisis was on the travel and services sectors, but manufacturing will likely also take a step back amid weaker global demand and social distancing orders. The duration and extent of the downturn will depend on when the virus can be contained, but large monetary and fiscal stimulus measures should help cushion the blow. Market stress appears contained, and the ECB's purchase program have significantly decreased credit risk for periphery sovereigns. While corporate leverage doesn't appear to be a major concern, earnings expectations continue to get significantly marked down and solvency risks will nevertheless rise as containment measures become more prolonged.

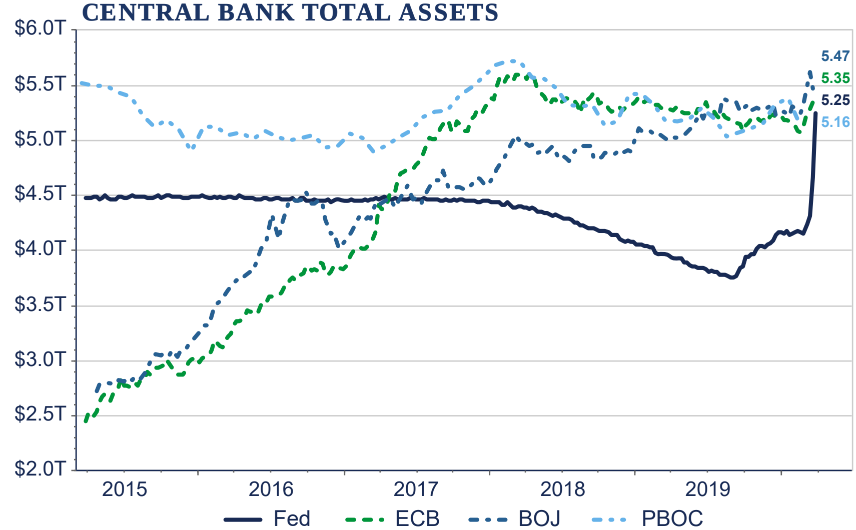
COVID-19 is a tale of two cities in Asia. **While China is beginning to lift restrictions, Japan is only beginning to crack down on social distancing as the number of cases rises.** China's economy is coming back on-line but is now threatened by weaker export demand as the pandemic spreads through Europe and the U.S. Meanwhile, Japan's economy is coming into the virus already weak with spending hurt from the consumption tax hike and typhoons in 4Q19. Furthermore, this appears to add a final nail in the coffin of longer-term expectations for the return of inflation. Stimulus measures will be needed, and are expected, in both countries in order to aid their economies. The world looks to China to see if and how the virus is contained as they reopen their cities and economy. As the Federal Reserve opens up its FX swap lines to address the acute U.S. dollar shortage the crisis has catalyzed, risks remain in how the PBOC monetizes its foreign reserves to the extent it needs to, especially as it doesn't have direct access to these swaps.

Governments and Central Banks are enacting record-breaking stimulus measures to aid their economies

U.S. $2.2 TRILLION CARES ACT HIGHLIGHTS

Item	Amount (billions USD)
Rebates to individuals	290
Unemployment Insurance	~250
Aid & Loans to Small Businesses	376
Corporate Tax Relief	232
Loans for distressed companies	425
Industry-specific loans	75
Appropriations	340
Total	**2,170**

CENTRAL BANK TOTAL ASSETS



To limit the economic damage of the COVID-19 pandemic, the public sector is taking extraordinary action in many countries, including fiscal stimulus to boost health systems and protect affected companies and workers. In addition to the $2.2 trillion stimulus package in the U.S., European governments are attempting to avoid the fall in demand that is associated with a near-complete lockdown, as it could have a permanent effect on the economy after the crisis. These measures include:

- Cash support to households (Germany, Italy, Spain, U.K.), one-off grants (Italy, Poland) and the deferral of mortgage and other payments (France, Italy, Spain).
- Provision of public guarantees to companies' debt in all countries, deferral of tax and social security payments (France, Italy, Spain, U.K.), and direct loans (Germany).
- Many governments have hinted at the possibility of nationalizations (Italy, France) and recapitalizations (Germany) or a "national shield" to protect firms from foreign takeovers (Spain).
- Support and investment within the health sector and the rest of the economy.

It is likely that more spending will be needed in many countries before we see the other side of this crisis. Fiscal stimulus should continue to target the health sector and the most vulnerable parts of the economy and those populations that are suffering the most from the shock, to avoid depressionary long-term effects.

Central Banks are aggressively easing monetary policy and signaling regulatory forbearance. Central Bank total assets have hooked up and are expected to go a lot higher with announced whatever-it-takes policies. The ECB launched a QE program through a €750 billion Pandemic Emergency Purchase Program, which can increase in size as needed. The ECB is also providing unlimited liquidity to the money markets and reduced banks' regulatory ratios to release capital for lending.

In the U.S., the Fed took the unprecedented step of announcing an open-ended QE program that broadens monetary support well beyond Treasury and MBS markets. The new facilities are aimed at helping corporates, households and municipalities. Of particular interest are the corporate and ABS credit facilities, as those will be levered 10x to provide up to $300 billion in new financing.

The determination of the governments and central banks brings hope that the economic and financial impact of the virus can be mitigated. The most important factor, however, is how fast the pandemic can be contained so people can return to work. Monetary policy should continue to arrest the transformation of the economic crisis into an even worse financial crisis, with a potential feedback loop that would reduce the fiscal space for sovereigns to protect their economies.

Source: Bloomberg and Factset. As of 03/30/2020.

Global

OUTLOOK

The global economy is in the throes of a recession. While a depression will likely be avoided, the extent and length of the downturn depends on the world's ability to contain the COVID-19 pandemic. While China has begun lifting restrictions and the economy is re-opening, weaker export demand from Europe and the U.S.—as the virus spreads in these countries—will weigh on China's recovery. Stricter social distancing measures have been implemented throughout Europe and the U.S., which has led to a sharp deterioration in services industries and is wreaking havoc on labor markets. However, impressive fiscal and monetary stimulus will help cushion the blow to these countries' economies. If the virus is able to be contained and restrictions are lifted by 3Q20, a recovery should begin before year-end, though many downside risks weigh on the outlook. Offshore U.S. dollar liquidity also remains top of mind, especially in Emerging Markets, where dollar-denominated debt has only increased since 2008. The call is still out on whether the recovery will resemble one that follows a natural disaster or a financial crisis. If the virus is contained quickly and policies support financial markets through the downturn, it would likely lean more toward the former.

Economic Activity	2016	2017	2018	2019	2020 (E)	2021 (E)
Real GDP (Y/Y %)	3.4	3.8	3.6	2.9	2.5 ▼	3.3 ▼
CPI (Y/Y %)	2.8	3.2	3.6	3.4	2.8 ▼	2.8 ▲
Trade Volume (Y/Y%)	2.3	5.7	3.7	1.0 --	2.9 --	3.7 --
Inter-Bank Rates						
3-Month USD Libor	1.00	1.69	2.81	1.91	0.69 ▼	1.06 ▼
3-Month Euribor	-0.32	-0.33	-0.31	-0.39	-0.47 ▼	-0.43 ▼
3-Month GBP Libor	0.37	0.52	0.91	0.79	0.27 ▼	0.49 ▼
3-Month JPY Libor	-0.05	-0.02	-0.07	-0.05	-0.10 ▲	-0.03 ▲

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg and IMF as of 03/30/2020. (E)—Bloomberg private market consensus estimates for GDP, CPI and rates. Full-year 2019 trade volume data is a projected figure from the IMF.

CENTRAL BANKS have enacted more accommodative policy this past year, aiding spending.

Economy	Policy Rate (%)	Next CB Meeting	Implied Policy Rate (%) 3M	6M	1Y
U.S.	0.13	04/29/20	0.08	0.09	0.11
Eurozone	-0.50	04/30/20	-0.55	-0.57	-0.59
U.K.	0.10	04/30/20	0.11	0.12	0.10
Japan	-0.02	04/28/20	-0.07	-0.09	-0.08
China	2.20	—	1.57	1.98	1.92

- The **FOMC** has so far led the Committee To Save The World and unveiled an alphabet soup of measures to shore up domestic and foreign dollar liquidity. With the policy rate cut to the lower bound, the focus has turned to asset purchases. FX swap lines were also cheapened and broadened to include more global central banks.
- The **ECB** has engaged in unlimited asset purchases to shore up liquidity but also to price-out credit risk within the region. There is also focus on refinancing operations to ensure a smooth operation of the banking system.
- The **BoE** has reduced its policy rate to 0.1%, expanded its asset buying program and introduced funding facilities to incentivize lending to the real economy, especially to SMEs.
- The **BOJ** has increased the size of its asset purchases as the policy rate is perceived to be firmly at the lower bound. There is also focus on providing U.S. dollar funding via swaps to shore up domestic dollar liquidity.
- The **PBOC**, while remaining accommodative by keeping its policy rates low and expanding its lending facilities, remains the outlier in terms of large-scale monetary stimulus.

UPSIDE/DOWNSIDE RISKS TO THE OUTLOOK

Upside	Downside
Fiscal stimulus	COVID-19 unable to be contained or re-intensifies in later quarter
Accommodative monetary policy	Pull back in consumer & services industries
Quick containment of COVID-19	Permanently damaged global psyche – push off spending, investment, business formation, higher personal savings rates
More political cooperation	Delayed delivery mechanism of fiscal stimulus

Source: Bloomberg and Factset. As of 03/30/2020.

Global

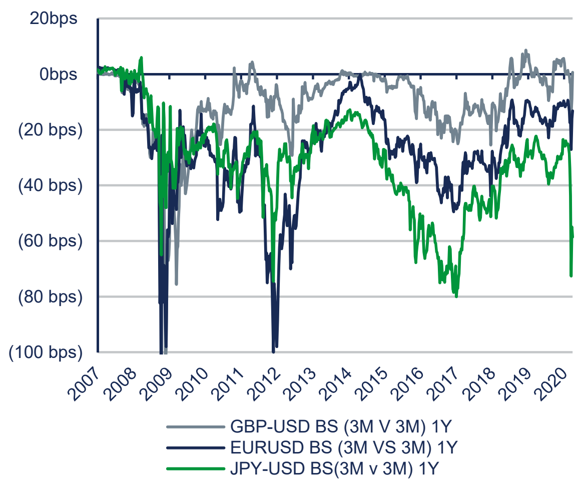
GLOBAL GROWTH is forecast to slow substantially in 2020 as the economy is in the throes of a recession.

U.S. DOLLAR FUNDING stress emerged, with liquidity demands peaking amid a near shutdown of the global economy.

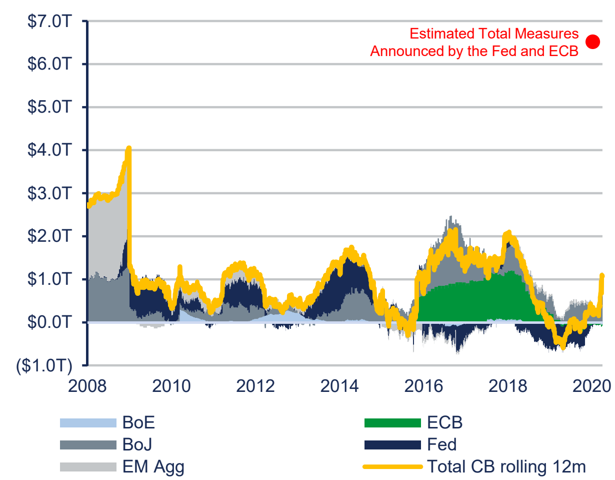
CENTRAL BANK PURCHASES are ramping up in a major way to promote liquidity and provide a backstop to the system.

WORLD GDP GROWTH

EUR/GBP/JPY-USD XCCY BASIS



12-MONTH ROLLING PURCHASES



- The global economy is in a recession as the spread of COVID-19 has led to country-wide shutdowns.
- As the virus spreads to new countries, the impact will get worse before growth rebounds.
- The depth and length of the recession will depend on how quickly and effectively the pandemic can be contained around the globe as well as support from world-wide monetary and fiscal policies.

- The premium paid for receiving U.S. dollar funding against major currencies such as the Euro, the British Pound and the Japanese Yen have widened close to levels last seen during the Great Financial Crisis, suggesting a scarcity of dollars in offshore markets.
- Amid an increased reliance on USD-denominated funding post-2008, global central banks have been accumulating dollars reserves. However, monetizing them to meet demand may be difficult to achieve without further increasing financial market stress. The Federal Reserve's activation of swap lines are a welcome relief in preventing a liquidity doom loop.

- Global Central Banks have announced a variety of asset purchase programs to shore up liquidity in their domestic markets. Most notable are those from the Federal Reserve and the European Central Bank, which roughly total at least $5.5 trillion in purchases over the next 12 months.
- Only less than half of this amount, however, will be dedicated to outright asset purchases in the form of Quantitative Easing. Thus, while the potential dry-powder for monetary stimulus is significantly larger than in 2008, key to gauging the efficacy of these programs is whether the announced lending facilities are fully drawn.

Source: Bloomberg and Factset. As of 03/30/2020.

OUTLOOK

The U.S. is likely currently in recession as it battles COVID-19. Wide-spread social distancing and store and restaurant closures are wreaking havoc on the service-dependent economy and leading to record-setting layoffs. The duration and extent of the downturn hinges upon the containment of the outbreak. U.S. fiscal and monetary policy will help, but it is likely more spending will be needed before we see the other side. Elevated debt levels appear to be the principal issue and focus will be on bridging the near-term liquidity gap affected corporates now face. Despite this, the banking system appears to be holding up fairly well, with funding stresses looking contained thanks to Basel III and associated measures. However, these same measures that have kept banks more sound have also pushed more borrowing activity toward capital markets, which may be less prone to benefit from the Federal Reserve liquidity operations.

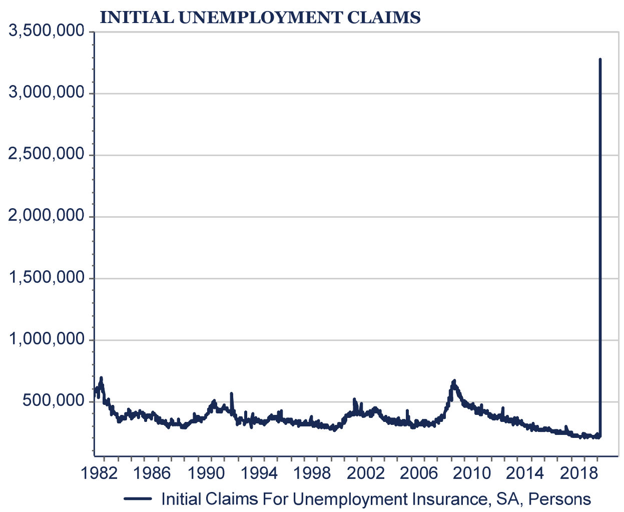
Economic Growth	03/30/2020	12/31/2017	12/31/2018	12/31/2019	2020 (E)	2021 (E)
Real GDP (Y/Y %)	2.3	2.4	2.9	2.3	1.2 ▼	2.0 --
Inflation						
CPI (Y/Y %)	2.3	2.1	2.5	1.8	1.7 ▼	2.1 --
Core PCE (Y/Y %)	1.8	1.6	2.0	1.6	1.7 ▼	1.9 --
Labor Market						
Unemployment (%)	3.5	4.3	3.9	3.7	3.7 ▲	3.9 ▲
Rates						
Fed Funds	0.13	1.38	2.38	1.63	0.50 ▼	0.80 ▼
2Y Treasury	0.23	1.89	2.52	1.57	0.62 ▼	1.04 ▼
10Y Treasury	0.69	2.41	2.72	1.92	1.10 ▼	1.59 ▼

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg and IMF as of 03/30/2020. (E)—Bloomberg private market consensus estimates for GDP, CPI and rates. IMF estimate for trade volume.

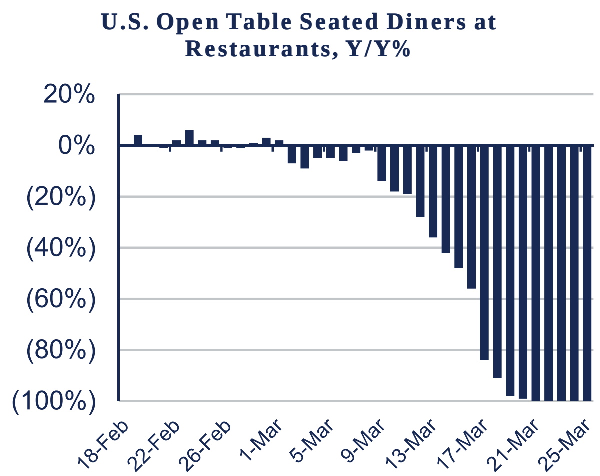
U.S.

THE LABOR MARKET has done an about-face in a matter of weeks as mass closures result in record-setting layoffs.



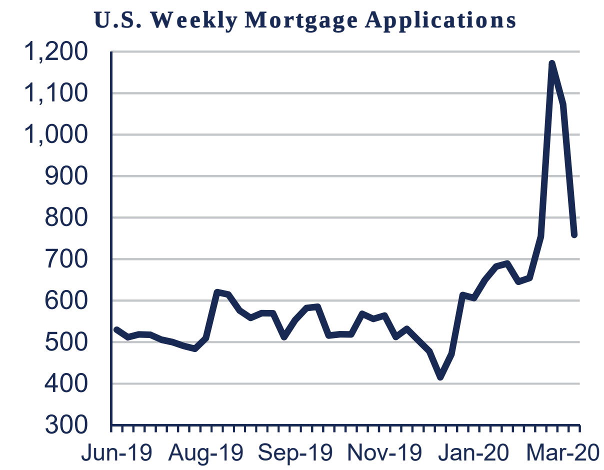
- Initial claims for unemployment insurance surged to a record 3.283 million in the week ending March 21—almost five times the previous peak in 1982.
- The increase was broad-based with no states noting a decline, while consumer-facing services industries were heavily cited for increased layoffs.
- Continuing claims are set to surge as the backlog of claims are filed, layoffs continue, and a greater number of workers are eligible for unemployment insurance under the new fiscal stimulus bill.

SERVICES felt the first impact of this downturn, as widespread closures and social distancing lead consumers to pull back.



- Restaurant bookings are down 100% Y/Y as most states have ordered closures. While some have switched to delivery or pick up, as unemployment skyrockets and consumer confidence takes a hit, consumers will likely pull-back on purchases of non-necessities such as food away from home, retail, and entertainment.
- The pull-back in services will be detrimental to growth, as services accounted for nearly 70% of U.S. GDP growth in 2018, while leisure/hospitality accounts for 11% of U.S. employment.

The HOUSING MARKET is reeling from supply- and demand-side disruptions but is positioned well for recovery.



- Weekly mortgage applications have taken a nose-dive as demand quickly dissipates amid social distancing orders.
- Meanwhile, homebuilders are also dealing with supply constraints.
- However, once the outbreak is in the rearview mirror, the housing market is positioned well with pent up demand, limited supply, and low mortgage rates.

Source: Bloomberg and Factset. As of 03/30/2020.

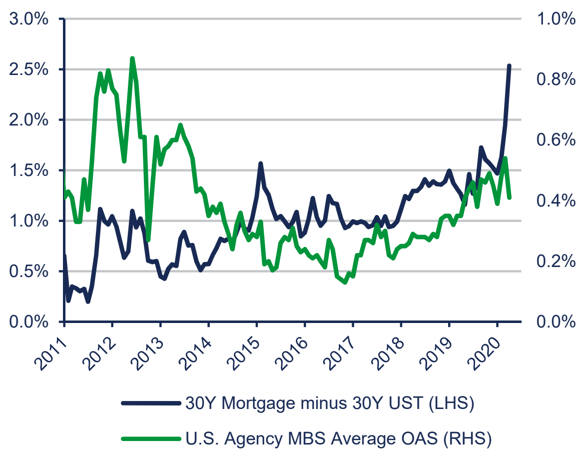
U.S.

MORTGAGE RATES are rising amid increasing credit risks. The Fed's MBS purchases could alleviate this pressure.

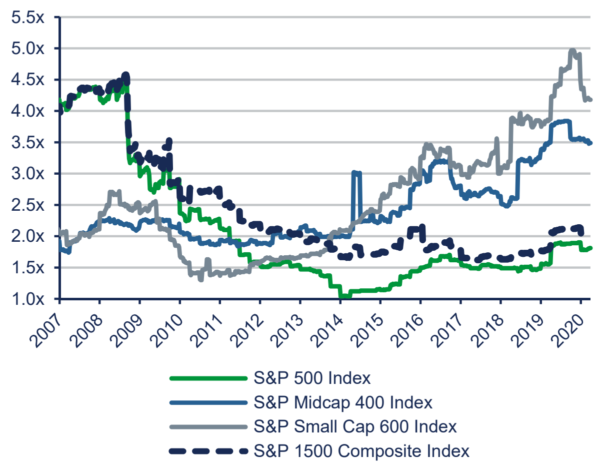
CORPORATE LEVERAGE has been rising for small and mid-cap companies even though aggregate leverage remains low.

The BANKING SYSTEM is showing signs of stress but not yet to the same extent seen in the Global Financial Crisis.

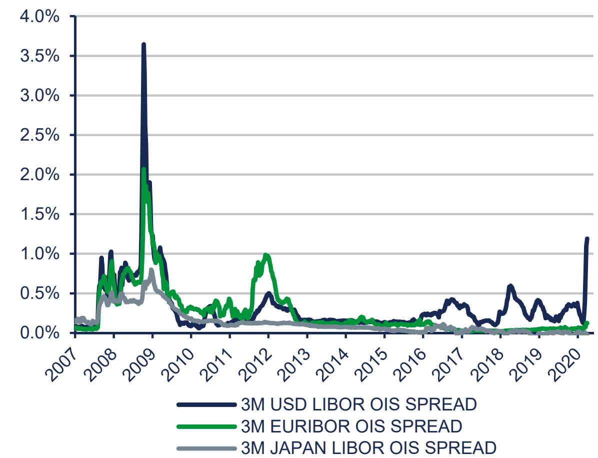
U.S. MORTGAGE RATE VS. AGENCY MBS



CORPORATE NET DEBT TO EBITDA



LIBOR OIS SPREAD



- Though the 30-year Treasury rate has dropped 40 bps over the course of a month, the negative pass-through to mortgage rates have been minimal amid rising credit risk and dislocations in the financial markets.
- The Federal Reserve's purchases of agency Mortgage Backed Securities has had a stabilizing effect as MBS spreads are starting to compress.
- While this should help anchor mortgage rates, the Fed's purchase program has actually had a negative impact on Mortgage Banks, which tend to hedge their lending with short MBS positions. This comes at a time when mortgage activity has all but ceased.

- Though the corporate sector as a whole is much less indebted now compared to 2008, this is a bifurcated story. The low-rate environment heavily incentivized small and mid-cap companies to lever up their balance sheets, while large caps took the opportunity to de-lever.
- As near-term cash flow becomes increasingly scarce, it's likely that credit events for this segment will start becoming a noticeable problem.
- While positive on the margin, it's yet to be seen whether large-scale fiscal support programs are enough to bridge the liquidity gap some corporates face.

- Despite a flood of liquidity from the Federal Reserve, interbank funding costs have remained elevated, suggesting strains as corporates start drawing on their revolvers and default risk is priced in.
- While there are risks that ample liquidity is not flowing to those who need it, the post-2008 regulatory shift towards an excess reserves regime minimizes system-wide risks in aggregate.
- The U.S. also seems unique in the fact that European or Japanese banking systems are not seeing similar stresses.

Source: Bloomberg and Factset. As of 03/30/2020.

Europe

OUTLOOK

GDP growth across the Eurozone and U.K. is set to contract in the second quarter as country-wide closures span the continent. Business and investor confidence has plummeted on the backs of announced wide-spread shutdowns. The first impact of the crisis was on travel and services sectors, but manufacturing also will likely take a step back amid weaker global demand and social distancing orders. The duration and extent of the downturn will depend on when the virus can be contained, but large monetary and fiscal stimulus measures should help cushion the blow. Market stress appears contained, and the ECB's purchase program has significantly decreased credit risk for periphery sovereigns. While corporate leverage doesn't appear to be a major concern, as earnings expectations continue to get significantly marked down, solvency risks will nevertheless rise as containment measures become prolonged.

Economic Growth	03/30/2020	12/31/2017	12/31/2018	12/31/2019	2020 (E)	2021 (E)
EZ Real GDP (Y/Y %)	1.0	2.5	1.9	1.2	-0.1 ▼	1.5 ▲
U.K. Real GDP (Y/Y %)	1.1	1.9	1.3	1.4	0.1 ▼	1.5 --
Inflation						
EZ CPI (Y/Y %)	0.7	1.5	1.8	1.2	1.0 ▼	1.4 ▲
U.K. CPI (Y/Y %)	1.7	2.7	2.5	1.8	1.3 ▼	1.7 ▼
Labor Market						
EZ Unemployment (%)	7.4	9.1	8.2	7.6	7.6 ▲	7.6 ▲
U.K. Unemployment (%)	3.9	4.4	4.1	3.8	4.1 ▲	4.2 ▲
Rates						
EZ Central Bank	0.00	0.00	0.00	0.00	0.00 --	0.00 --
EZ 2Y Note	-0.71	-0.64	-0.62	-0.61	-0.69 ▼	-0.54 ▼
EZ 10Y Bond	-0.47	0.42	0.24	-0.19	-0.42 ▼	-0.08 ▼
U.K. Central Bank	0.10	0.50	0.75	0.75	0.20 ▼	0.35 ▼
U.K. 2Y Gilts	0.12	0.43	0.74	0.53	0.29 ▼	0.53 ▼
U.K. 10Y Gilts	0.35	1.19	1.27	0.82	0.51 ▼	0.76 ▼
Currencies						
EUR/USD	1.10	1.20	1.14	1.12	1.13 --	1.15 ▼
GBP/USD	1.24	1.35	1.27	1.33	1.31 ▼	1.35 ▼

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg. As of 03/30/2020. (E)—Bloomberg private market consensus estimates.
*Represents actual data

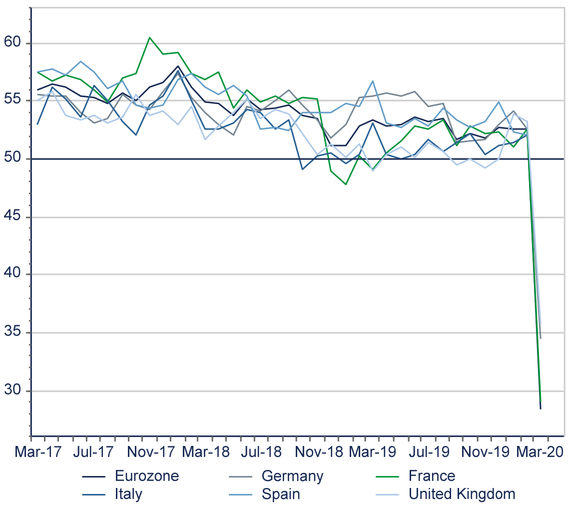
Europe

SERVICES industries took the first hit amid reduced travel and as store and restaurant closures spread across the continent.

BUSINESS AND INVESTOR CONFIDENCE has plummeted amid announcements of mass shutdown orders.

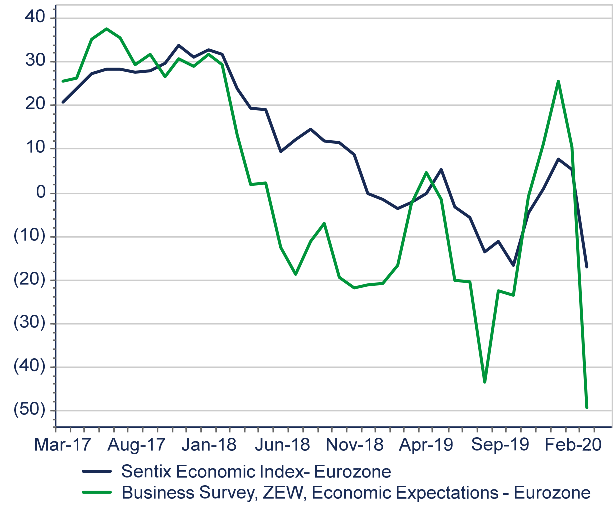
PERIPHERY YIELDS remain well behaved following the ECB's announcement to stabilize markets through asset purchases.

MARKIT SERVICES PMI



- March flash services PMIs in Europe fell at record speed—sharper declines than during the Global Financial Crisis—hitting record lows. Consumer-facing industries felt the greatest pain.
- Services industries accounted for 66% of EA GDP and 71% U.K. GDP in 2018.
- This is likely not the bottom, as U.K. flash PMI survey was conducted prior to the order to shutdown stores and restaurants.

EUROZONE BUSINESS AND INVESTOR CONFIDENCE



- Business and investor confidence across Europe plunged rapidly following announcements of shutdown orders.
- Confidence was on the mend as trade tensions eased at the beginning of 2020, but have more than re-traced these gains.
- Confidence will likely remain down as the virus plagues European economies, and business investment will likely be weak.

PERIPHERY YIELD SPREAD

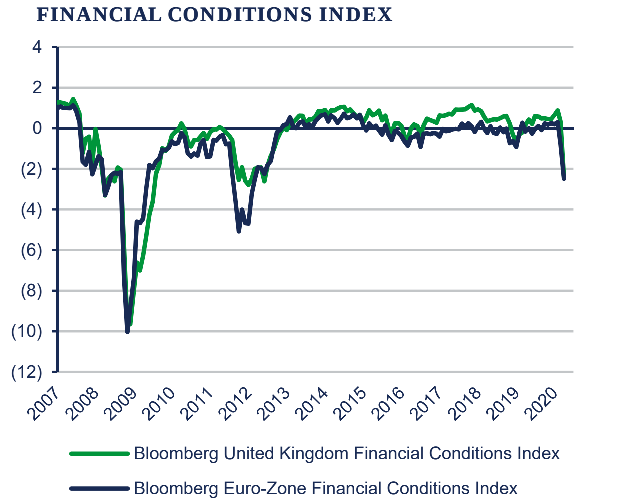
- Despite initial worries that periphery sovereigns' fiscal position will deteriorate significantly as containment measures halt economic activity, the announcement of the ECB's Pandemic Emergency Purchase Program proved to be enough to stabilize investor confidence.
- As liquidity is much less of an issue in the Euro Area compared to the U.S., the ECB's purchase program is seen to decrease the credit risk getting priced into sovereign bonds.
- While periphery spreads remain elevated, they are firmly at levels below those seen during the 2008 or 2011 financial crises.

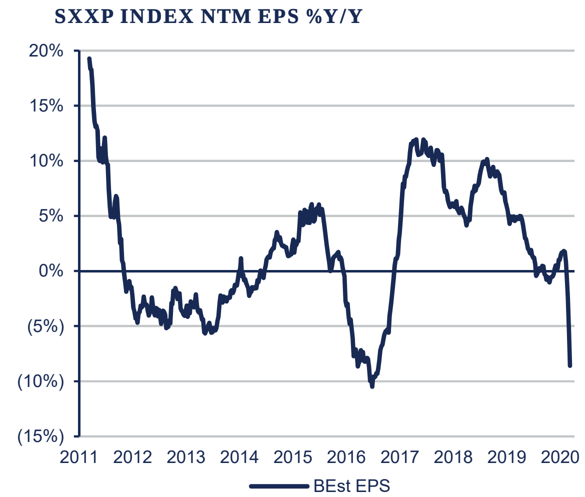
Source: Bloomberg and Factset. As of 03/30/2020.

MARKET STRESS has been relatively contained as emerging risks remain largely separated from the financial system.

CREDIT RISK looks manageable as lower-tier Investment Grade bonds see only a marginal amount of spread expansion.

EARNINGS EXPECTATIONS take a leg down as containment measures significantly depress economic activity.





- While funding spreads and market volatility have indeed ticked higher, the COVID-19 outbreak and the resulting containment measures have not caused a significant impact on the stability of the financial system.
- While measures from the ECB have proven enough to shore up confidence, the structural shift in the financial system in Europe post-2008 has seen better capitalized banks and less reliance on capital markets for funding.

- With corporate net debt to EBITDA levels in the region in decline since 2010, risks stemming from too much leverage don’t appear to be an issue. Indeed, CDS spreads for both financial and non-financial corporates, while elevated, remain at levels below the 2011 European Financial Crisis.
- Risks of Investment Grade downgrades thus remain low as the bulk of the nonfinancial corporate sector remain net lenders and sit on historically large cash savings on their balance sheets.
- Corporates also rely more on the bank-based lending versus capital market-based lending, which suggests that the region is more insulated from the impact of credit markets seizing up.

- While leverage isn’t necessarily a concern, with economic activity effectively halted, solvency risks will rise as containment measures become more prolonged.
- Short- to medium-term funding can only bridge the liquidity gap for so long before the lack of revenues ultimately cause a wave of corporate defaults. This will become a growing issue as containment measures extend.
- Given the uncertainty regarding virus containment, it’s likely earnings expectations will continue to decline until corporate visibility improves.

Source: Bloomberg and Factset. As of 03/30/2020.

OUTLOOK

COVID-19 is a tale of two cities in Asia. While China is starting to lift restrictions, Japan is only beginning the crack down on social distancing as the number of cases rise. China's economy is coming back on-line but is now threatened by weaker export demand as the pandemic spreads through Europe and the U.S. Meanwhile, Japan's economy comes into the virus already weak with spending hurt from the consumption tax hike and typhoons in 4Q19. Furthermore, this only appears to add the final nail in the coffin of longer-term expectations for the return of inflation. Stimulus measures will be needed, and are expected, in both countries in order to aid their economies. The world looks to China to see if and how the virus is contained as they open up their cities and economy. As the Federal Reserve opens up its FX swap lines to address the acute U.S. dollar shortage the crisis has catalyzed, risks remain in how the PBOC monetizes its foreign reserves to the extent it needs to, especially as it doesn't have direct access to these swaps.

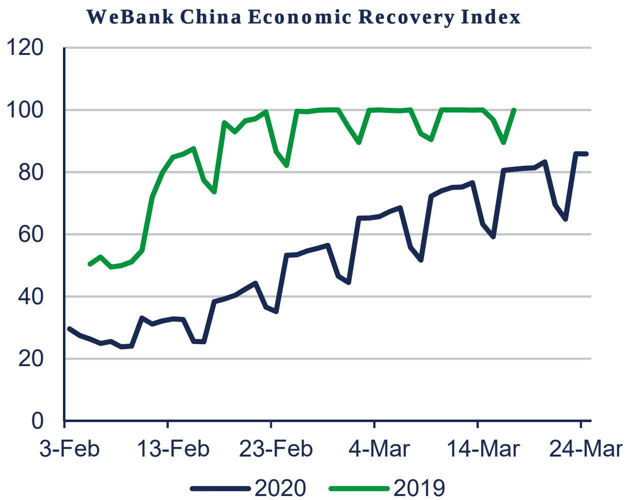
Economic Growth	03/30/2020	12/31/2017	12/31/2018	12/31/2019	2020 (E)	2021 (E)
Japan Real GDP (Y/Y %)	-0.7	2.2	0.3	0.7	-0.8 ▼	1.1 ▲
China Real GDP (Y/Y %)	6.0	6.9	6.7	6.1	4.0 ▼	6.2 ▲
Inflation						
Japan CPI (Y/Y %)	0.4	0.5	1.0	0.5	0.5 ▼	0.6 --
China CPI (Y/Y %)	5.2	1.6	2.1	2.9	3.3 --	2.1 ▼
Labor Market						
Japan Unemployment (%)	2.4	2.8	2.4	2.4	2.4 --	2.4 ▲
China Unemployment (%)	3.6	3.9	3.8	3.6	4.0 ▲	3.8 ▼
Rates						
Japan Central Bank	-0.10	-0.10	-0.10	-0.10	-0.10 --	0.00 --
Japan 2Y Note	-0.15	-0.14	-0.15	-0.13	-0.14 ▲	-0.08 ▲
Japan. 10Y Bond	0.01	0.04	-0.01	-0.02	-0.04 ▲	0.01 ▼
China Central Bank	4.35	4.35	4.35	4.35	4.25 --	4.10 ▼
China 2Y Note	1.94	2.40	2.75	2.75	2.06 ▼	2.15 --
China 10Y Bond	2.58	3.88	3.30	3.14	2.64 ▼	2.83 ▲
Currencies						
USD/JPY	107.62	112.69	110.27	108.61	107.00 --	108.00 ▲
USD/CNY	7.09	6.53	6.86	6.98	6.95 ▼	6.85 ▼

Arrows indicate consensus estimate change compared to one month ago

Source: Bloomberg. As of 03/30/2020. (E)—Bloomberg private market consensus estimates.

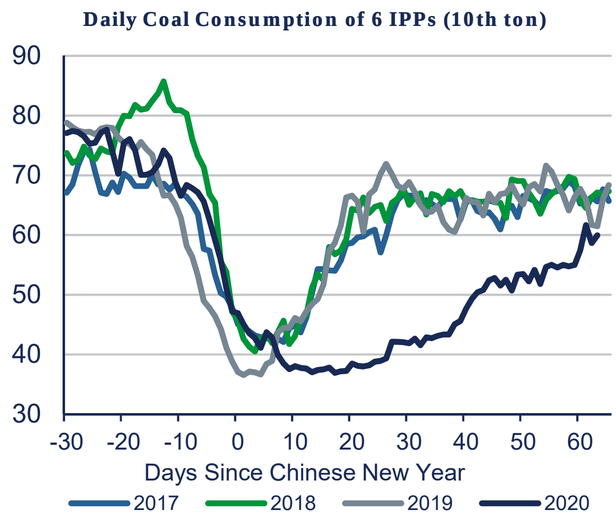
Asia Pacific

After coming to a halt in February, CHINA'S ECONOMY is coming back on line as the country lifts restrictions.



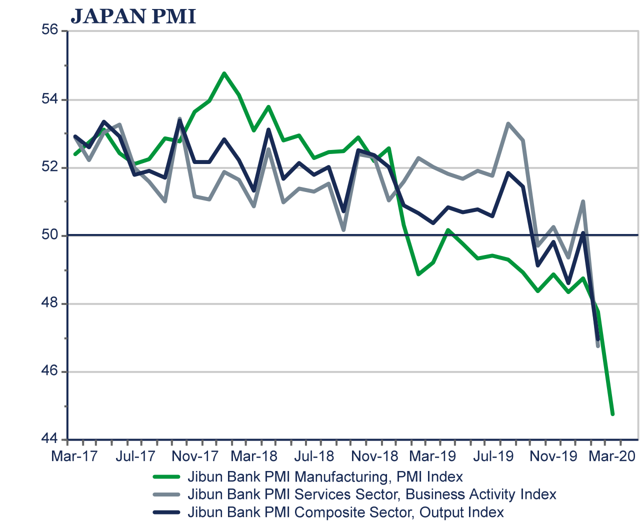
- After activity data in China tumbled in February, the WeBank China Economic Recovery Index—based on mobility data—suggests that the economy is functioning at 86% of its normal levels.
- Services are lagging behind as consumers are slower to get back out and spend as lockdown restrictions are lifted.
- As the virus spreads through Europe and the U.S.—large markets for Chinese exports—demand for Chinese exports, and therefore export orders, is falling, which will weigh on manufacturing and the export-dependent economy.

CHINA ACTIVITY is nearing previous years' levels as the country lifts lockdown orders.



- As China lifts restrictions, businesses are resuming work and people are beginning to go about their day, as seen by daily coal consumption data.
- Hubei will allow most of its 60 million residents to leave, after nearly two months of lockdown; those in Wuhan remain sealed off until April 8.
- The globe looks to China to see if and how the virus is contained as restrictions are lifted and how the economy rebounds.

JAPAN'S ECONOMY was hurting prior to COVID-19 and will likely be hurt further as the virus reduces global demand.



- Japan's economy is entering the pandemic on shaky ground following pull-back from the typhoons and consumption tax hike in 2019.
- While Japan has not yet enforced strict social distancing measures, as the number of COVID-19 cases rise, these measures will likely be put in place. Data suggests consumers have been stockpiling in advance.
- Weaker external demand has already been weighing on orders and manufacturing, and services will be hit if lockdowns similar to other countries are put in place.

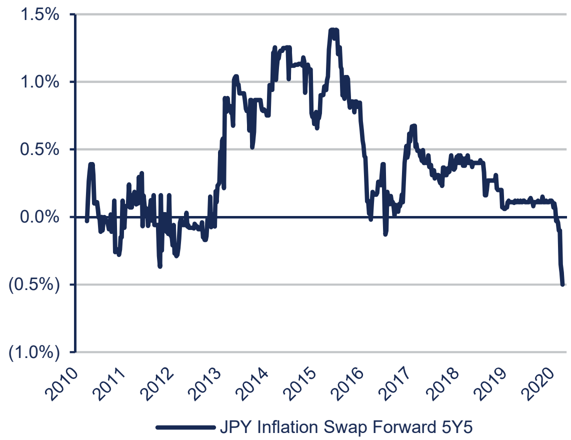
Source: Bloomberg, Factset, and UBS. As of 03/26/2020.

INFLATION EXPECTATIONS have become unanchored and is signaling deflation as the central bank's inflation target losses all meaning.

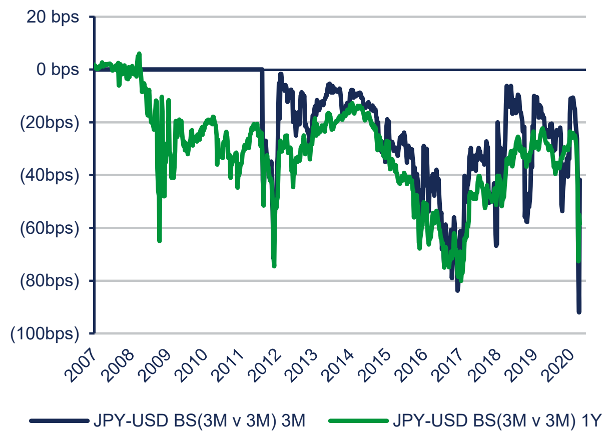
U.S. DOLLAR SHORTAGE seems most acute in Japan, where premiums for USD borrowing have spiked.

BANK LIQUIDITY in China has been abundant, despite minimal direct injections from policymakers.

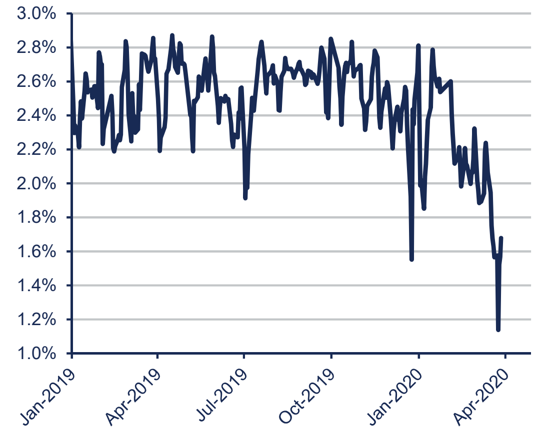
INFLATION EXPECTATIONS



JPY-USD XCCY BASIS



CHINA INTERBANK 7-DAY REPO RATE



- Longer-term activity is now expected to contract meaningfully as inflation expectations over the next 10 years drop to negative territory despite increased monetary policy stimulus from the Bank of Japan.
- While containment measures being implemented in Japan are more lax compared to other developed economies, the viral outbreak appears to be the final nail in the coffin that eroded market confidence on the return of inflation especially after the consumption tax hike last year.
- With inflation expectations unanchored, monetary policy increasingly becomes ineffective.

- U.S. dollar borrowing by Japanese banks has doubled since 2007 and about 30% of Japanese banks' dollar funding needs come from cross-currency swap markets. Thus, they are most vulnerable when foreign dollar funding markets tighten.
- The Federal Reserve's FX swap liquidity operations are a welcome relief and seem well utilized by the Bank of Japan. Funding pressures have abated somewhat but remain elevated relative to history.
- The overall risk this issue posses to the banking system, however, appears low for now. Domestic funding pressure, reflected by LIBOR-OIS spreads, remains contained.

- The interbank seven-day repo rate, having taken a leg down since the beginning of February, suggests that financial system liquidity remains robust despite rising economic costs related to containment efforts.
- While a "bazooka stimulus" response has yet to be seen from either fiscal or monetary policymakers, especially when compared to other virus-stricken countries, an overall easing bias is still evident in China.
- As China was the first impacted by the viral outbreak, it appear poised to be the first to restart economic activity. Whether we see a resurgence of new COVID-19 cases, however, remains uncertain.

Source: Bloomberg and Factset. As of 03/30/2020.

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