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Harr's View

Easing market volatility despite depression risk

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Good evening all

Today, I discuss the risk of a global depression, why market volatility may have peaked, and the repercussions for the Nordics. **I see a 50% chance (base case) of a gradual recovery during H2, following the current deep global recession. I believe there is a 10% chance (best) of a quick recovery from the beginning of H2, but there is a significant risk of a prolonged crisis and depression (worst). I put this probability at 40%.** The COVID-19 figures worsened over the weekend, as new infections rose sharply in the US and German and French numbers jumped. I continue to believe that it will take longer to control the virus in Europe and the US than it did in China and South Korea. Still, the number of newly infected people may be peaking in Italy. In Germany and France, new infections could peak in the coming week, while the US may peak in the week thereafter. (See *this piece*).

Stimulative policies will support the recovery when restrictions are eased. As usual, the US has reacted faster and more aggressively than the Eurozone. In a span of just eight days, the Fed cut interest rates to 0% and pursued unlimited and open-ended QE. During the GFC, it took the Fed 45 months from cutting to zero to pursuing open-ended QE. On Friday, the Congress signed an USD2.15trn stimulus package (10% of GDP), including appropriate measures such as unemployment insurance and hospital spending. However, the package also includes USD301bn in direct payments to households where the experience is negative. A *survey* found that only 20% of those who received cheques in 2008 spent them. The USD456bn set aside in aid to backstop lending by the Fed implies that credit could in principle rise to USD4,560bn (21% of GDP), which could be very powerful. In the Eurozone, the details of the pandemic purchase programme announced on Thursday show that the ECB has essentially introduced a supercharged OMT for all countries with no conditionality attached, as argued by our ECB strategist, Piet Christiansen. **In our view, the ECB has introduced a soft yield curve cap, which is an extremely important signal. This should keep government bond yields low, as ECB purchases should dominate very high issuance.** In contrast, the European Council meeting on Thursday was again a disappointment. The EU is facing a common shock. Therefore, it should react with a common instrument like the ECB, for example through a common debt instrument. Eurozone countries have now committed 2.5% of GDP in fiscal stimulus. In my view, this is not enough given the depth of the recession. A fiscal package of 4-5% on average for the Eurozone would be appropriate, led by Germany and The Netherlands.

The spread of the virus and politicians' desire to open the countries will determine whether we will have a global recession or a global depression. Data based on Danske Bank's personal customers suggests that total private spending is down 20% in Denmark, which is likely to be comparable to other countries. If politicians in Europe and in the US manage to open up countries in end-April or May, retail spending should recover. This requires that COVID-19 does not surge back when restrictions are lifted, and a second wave of the virus in autumn would not require renewed lockdowns. In this positive scenario, the base case or even the best case could play out. However, there is significant risk of a second wave of infections forcing new lockdowns. This could occur in Europe, US, or in emerging markets where the COVID-19 crisis is growing. This could trigger a wave of bankruptcies, persistently high unemployment rates, ballooning fiscal deficits and an ever-expansion of central banks' QE programmes. This is the worst case. In any case, I do not expect we will go back to where we were before the crisis for an extensive period. The crisis engenders wealth destruction in many sectors. I expect all manner of supply disruptions and change in consumption patterns, which will create frictions and require time to adjust. Indeed, recent *research* shows that pandemics have a persistently negative impact on exposed areas.

Last week, market sentiment improved as the aggressive easing from the Fed and ECB dominated the fact that we are in a very deep recession. **Tomorrow, I expect the market will open on a weak footing given the rise in virus numbers over the weekend. Still, I believe that the pure fear and volatility, which dominated markets during the week of 16-20 March, may not come back.** We should watch the oil price and the market for USD term funding for signs of renewed stress. In my view, the Fed's aggressive easing on Monday marked the end of a two-year rally in the US dollar. In the Nordics, we expect all economies to be hit hard by the COVID-19 crisis, but substantial fiscal and monetary easing should cushion the recession in Norway, despite the collapse in oil prices. (See Nordic Outlook *here*). Last week, we recommended clients to dip their toes into risk by selling EUR/NOK, and buying DKK and SEK covered bonds. Our fixed income team argues *here* why we think that it is unlikely that Danmarks Nationalbank will pursue QE due to the currency peg, but other measures have been taken to stabilise the market. I find it encouraging that the Danish market performed on Friday despite European equities losing 4-5%. Finally, our credit research team assesses the risk of Nordic IG companies becoming fallen angels *here*. That is all for today's comment. I wish you a great Sunday night and coming week. Best regards, Thomas

Important disclosures and certifications are contained from page 2 of this report.

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