

The Big Picture

Reopening, recovery and risks

- The coronavirus has sent the world economy into its deepest recession since the Great Depression. However, we continue to think it will be relatively short-lived, seeing a rebound on the cards in late Q2/early Q3 as economies open up.
- High-frequency data support the view that the advanced economies are recovering, as the virus comes under control and economies start to reopen.
- Based on better news on treatment and the positive experiences in Denmark and Norway, as well as significant policy support, we have increased the probability of the positive scenario playing out to 15% from 10% and lowered the probability of the downside scenario to 35% from 40%.
- Key downside risks include a new wave of infections and economy-wide lockdowns in advanced economies, a related emerging market crisis, escalation of tensions between the US and China resulting in the cancellation of the phase-1 trade agreement, a no deal Brexit and a surge in bankruptcies and unemployment.
- Among key upside risks are finding a vaccine this year and a faster rebound in economic activity when economies are opened up.

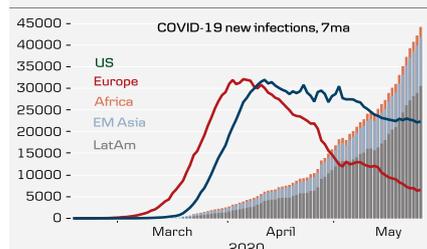
Reopening of economies on track so far

In our *global forecast update* on 16 March we assumed a peak in COVID-19 infections in Europe and US in late March and early April, respectively, and that this would pave the way for a gradual reopening in the second half of April and early May. **The development since then has pretty much unfolded as expected.** While the decline in US daily cases has not come down as much as we expected (although much more testing blurs the picture), the individual US states have decided to go ahead with the reopening anyway. It is positive that so far we have not seen an increase in the number of infections in the US and Europe, despite the reopening of many countries.

The virus's development in Emerging Markets/developing countries has been significantly worse than we had assumed. Many countries have seen a continued strong increase in new infections, not least India and Brazil. Even so, many governments have chosen to reopen their economies as the cost of the lockdowns has been severe and had a big human cost as well.

The gradual reopening across Europe and the US is happening at different speeds, but most of the countries are on track for reducing around 80-90% of the lockdown measures by the end of June. This is broadly in line with our expectations from March. It is difficult to measure how strict the lockdowns have been, but Oxford University has attempted to measure this across countries with its Stringency Index, see chart overleaf.

Virus development across regions



Source: ECDP, Macrobond Financial, Danske Bank

Note: For Africa, EM Asia and LatAm the series shows top 10 worst hit countries

Chief Analyst

Jakob Ekholdt Christensen
+45 45 12 85 30
jakc@danskebank.dk

Chief Analyst

Allan von Mehren
+45 45 12 80 55
alvo@danskebank.dk

Senior Analyst

Aila Mihr
+45 45 12 85 35
amih@danskebank.dk

Analyst

Bjørn Tangaa Sillemann
+45 45 12 82 29
bjsi@danskebank.dk

Senior Analyst

Mikael Olai Milhøj
+45 45 12 76 07
milh@danskebank.com

Chief Strategist, ECB and Fixed Income

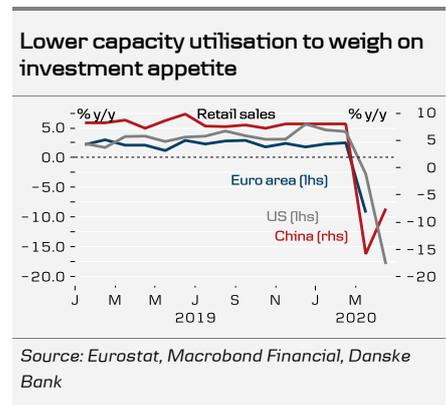
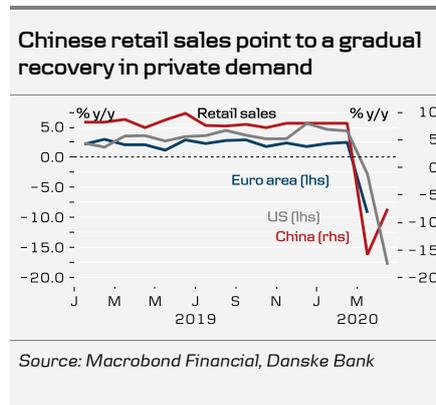
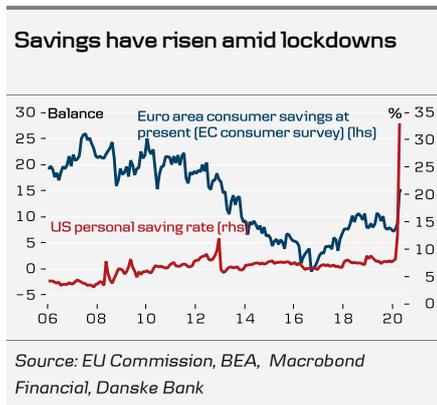
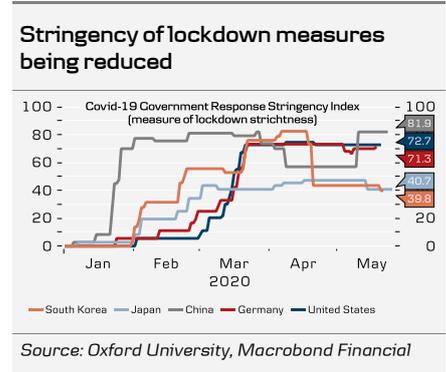
Piet Haines Christiansen
+45 45 13 20 21
phai@danskebank.com

Assistant Analyst

Rune Thyge Johansen
+45 45 13 76 15
RUJO@danskebank.dk

High frequency data show gradual improvement in business activity and household spending

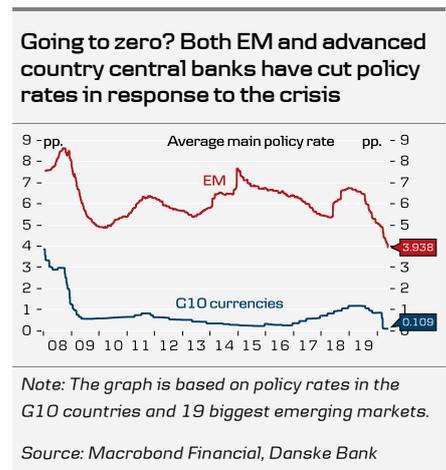
The response of businesses and consumers will be important in determining the depth and duration of the crisis. Across the globe, consumer sentiment has tumbled, as worries about unemployment, households' financial situation and health risks have risen. As a consequence of a reduced ability to spend, savings ratios have shot up, although a large part still seems to be of an 'involuntary' rather than of precautionary nature, driven by a combination of COVID-19 fears and lockdown restrictions. The Chinese example has shown that even after lockdowns end, private demand will only rebound gradually, with retail sales showing a much slower recovery than industrial production. The experiences in Denmark and Norway are, however, more positive, where transaction card spending in nominal terms is more or less back to the same level as last year, *Spending Monitor - Overall spending at more normal levels but holidays muddle the picture*. This is probably driven by a combination of diminishing COVID-19 fears and lifting of lockdown restrictions. High frequency spending data for the US and the UK have also been improving, although at a slower pace than in Norway and Denmark, probably because the reopening is not as advanced and because the fear of catching COVID-19 is higher.



Aggressive central bank easing has helped ease credit conditions

In response to COVID-19, central banks globally have put in place a swathe of measures to contain financial conditions and volatility in markets. Central banks with positive policy rates have cut rates as much as possible and the discussions on negative policy rates have re-emerged. Most central banks have re-started (or expanded) their QE programmes and launched credit facilities to support businesses and banks during the health crisis.

In the US, the Fed is buying bonds at an unprecedented pace via its unlimited QE programme and has created many different lending facilities, which have helped reduce the increasing risk premium in markets. While there has been more discussion about negative policy rates in the US, the Fed policymakers have been quite clear that this is on the last page of the Fed's playbook and they would prefer not to go there. Stronger forward guidance, an expansion of credit facilities and possible yield curve control are more likely (in that order). We do not expect the Fed to raise rates in coming years and an extension of credit facilities may be on the cards, depending on how gradual the recovery will be. In case of e.g. a second COVID-19 wave in the autumn, we would expect a longer extension of the facilities. We expect the Fed to continue buying bonds but at a slower pace now that financial market stress has diminished.



At the same time, the ECB has significantly scaled up its bond purchase programme via its additional EUR120bn envelope by year-end, and its EUR750bn Pandemic Emergency Purchase Programme (PEPP). We expect a further increase in bond purchases at its 4 June meeting, by EUR500bn in the first half of 2021. Additionally, the ECB has provided significant liquidity facilities, some even below the deposit rate, in order to secure that corporates and households have sufficient liquidity through the crisis until the economy is on its footing again.

In China, the PBoC has taken a range of steps to ease monetary policy, such as reductions in the reserve requirement ratio for banks, guiding the Loan Prime Rate lower and targeting easing at SMEs. Rules for the issuance of corporate bonds have also been eased. At the National People's Congress (NPC), starting on 22 May, the Premier of the State Council, Li Keqiang, said further easing would come through the same tools. Also, other emerging market countries have cut policy rates aggressively to mitigate the shock to their economies, as can be seen in the chart on previous page.

As a result of the easing in most countries, money growth has picked up speed and the ample liquidity has helped reduce market stress. Credit spreads have narrowed significantly after the spread widening in the initial phase of the crisis in March. This is the case in both the European and US high yield markets and with emerging markets bonds. However, the spreads are still somewhat wider than pre-crisis but now within recent years' upper ranges (see figure on the right).

Massive fiscal support to lead to widening of fiscal imbalances

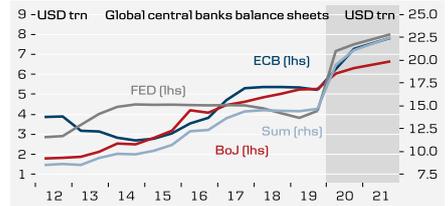
The global fiscal policy response to the crisis has also been swift and sizeable. Although the unprecedented measures taken to contain the macroeconomic fallout and alleviate liquidity constraints have succeeded in stemming market turmoil, they have also exposed the fiscal vulnerabilities of countries which entered the crisis with less sound public finances, like Italy, and in selected emerging markets, like Brazil, India and South Africa.

After the initial fiscal response focused on liquidity provision to companies via tax deferrals and state guarantees, as well as income and employment support for workers, **governments' concerns have now shifted more towards supporting economic activity during the recovery phase.** Chinese leaders have already announced fiscal stimulus in the magnitude of 4-5% of GDP this year, and more might be in the pipeline if the economic recovery is not unfolding as planned.

In the US, Democrats have proposed another USD3,000bn stimulus package, including a new round of direct payments to Americans as well as funding to state and local governments. So far, the proposal has got the cold shoulder from the Republicans, but we think the still elevated jobless claims raise the pressure for the US to do more stimulus. We think an extension of the temporary higher unemployment benefits (although perhaps at a lower level going forward) and/or another round of direct payments to US citizens are likely. If there is no extension of the temporarily higher and broader unemployment benefits, it risks derailing the recovery, as it would imply a negative income shock. Taken together, the fiscal deficit in the US will widen to 17.9% in 2020 (according to the EU Commission spring forecast), followed by a significant drop in 2021 as the economy rebounds and some of the measures are rolled back.

In Europe, the EU commission announced its proposal on the long-awaited EU recovery fund on 27 May. According to the proposal, the recovery fund will total EUR750bn (4.6% of EU GNI), consisting of EUR500bn in grants and EUR250bn in loans. The fund will be an important tool in our view to alleviate the asymmetric recovery that is unfolding in the euro area and, as the Commission will do the borrowing, it will not add to countries' debt levels (at least not in the short term). However, it remains to be seen to what degree and how fast EU money can be 'applied on the ground' and channelled effectively

QE is leading to a significant expansion in the central banks' balance sheets



Source: Macrobond Financial, Danske Bank

The monetary easing has led to a surge in global money creation, normally preceding a significant rise in global PMI



Source: Macrobond Financial, Danske Bank

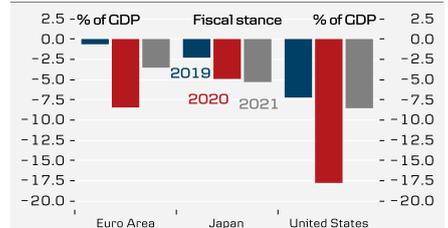
Credit spreads in advanced and emerging markets have tightened on the back of policy support



Note: The emerging market bond spread is the J.P Morgan EMBI index.

Source: Macrobond Financial, Danske Bank

...but will lead to a large deterioration in government balances in 2020.



Note: the figure for Japan does not take into account the latest package announced in late May

Source: EU Commission spring forecast 2020.

to the needy. We expect most of the fiscal boost only to materialise in H1 21 and be centred on investments in Southern Europe.

Our base case is still a gradual recovery from H2 onwards

The combination of extensive lockdown measures, health risks, disruption to global value chains and heightened uncertainty has sent the world economy into the deepest recession since the Great Depression. The shock has been felt in advanced markets and, lately, increasingly so in emerging and frontier markets. This has led to a sudden stop in consumption and investment as a majority of people have been forced to stay home, have lost their jobs and/or are afraid of catching COVID-19. Uncertainties have risen sharply for many companies with earnings declining significantly, turning the crisis into a dual demand- and supply-side shock. The hit to the economy has, unlike past crises, been particularly pronounced in the service sector, as lockdown measures have undermined key activities in the travel and entertainment industry. Meanwhile, the manufacturing sector has held up better, as consumption of essential goods (food, medicine, etc.) has continued (although part of the smaller fall in manufacturing PMI is due to longer delivery times). The shock has led to an unprecedented rise in unemployment, reaching 14.5% in the US, while the unemployment rate has not yet increased so much in the Eurozone.

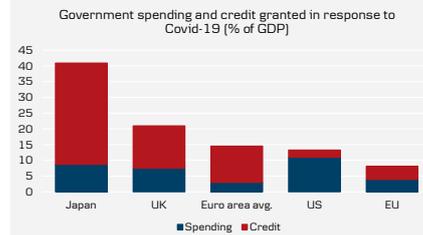
The ongoing opening up of economies, a declining fear of catching COVID-19 and the policy support are now engendering a recovery that we expect to gather speed in H2. As outlined above, there are early indications that spending is recovering fairly fast in some of the countries that have opened up. We expect the gradual improvement to continue but not as fast as in e.g. Denmark and Norway, as they have been prime examples of getting the virus under control. The return of consumers releasing pent-up demand should also lift business optimism and hence investments over time. We see pent-up demand as a key driver over the next few quarters, albeit with waning effects over time. Furthermore, the recovery might also be supported by the possible launch of an effective COVID-19 vaccine in the first half of 2021. This should help relieve most of the economic shock and lead to a sigh of relief among consumers and businesses and an unleashing of pent-up demand.

Although we are expecting a rebound in H2 20, we think it will take time before GDP returns to the level before coronavirus. The same goes for unemployment. We don't think GDP will return to index 100 during our forecast horizon (2021). This is because we think there has been some permanent damage to the economy stemming from the COVID-19 outbreak, and other sectors, such as tourism and travel, will only slowly recover over the next two years. In 2021, we expect the recovery to continue, but GDP growth will slow to more normal levels (although stay above potential GDP growth, i.e. unemployment will continue to fall).

Considerable downside risks to our outlook (negative scenario 35%)

While our base case represents a cautiously optimistic outlook for the world economy, we assign a 35% probability of a prolonged economic downturn. We have become more upbeat and have lowered the probability from 40% to 35%. Economic visibility is quite low at the moment, as we are in uncharted territory with an economic shock without precedent in modern times. Unfortunately, there are many things that could go wrong, causing the recovery to drag out, related to the virus but also geopolitical risks, such as relations between the US and China. We think that if the negative scenario becomes increasingly likely, there would be an extension and/or expansion of the emergency policies implemented by politicians and central banks around the world. The discussions of negative policy rates in the US, for example, would probably intensify given the limited policy space left.

Global fiscal policy response to COVID-19 has been swift and sizeable...



Source: Various government sources, Danske Bank

The global service sector has been particularly hard hit in this crisis



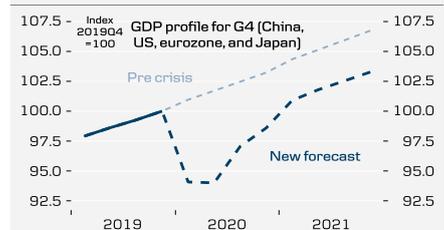
Source: Macrobond Financial, Danske Bank

A sizeable contraction in the global economy in H1 20 followed by a rebound in H2 and early part of 2021

% y/y	2019	2020	2021
Global	2.8	-3.3	5.6
USA	2.3	-5.3	4.4
Euro area	1.2	-6.7	5.2
Japan	0.7	-4.0	2.6
UK	1.4	-5.8	4.2
Emerging Markets of which	3.6	-1.6	6.4
China	6.2	1.0	9.0
India	4.2	1.9	7.4

Source: Macrobond Financial and Danske Bank

...But there will be persistent losses from the virus shock even at end-2021



Source: Macrobond Financial, Danske Bank

Here we list the most important downside risks in our view:

New wave of infections and economy-wide lockdowns: A key thing to watch out for is whether the reopening of economies triggers new waves of infection, which may eventually force governments to implement economy-wide lockdowns again. We see a particularly big risk with regard to emerging markets, which are struggling to get the virus under control, notably the larger, more vulnerable ones like Brazil, Chile, Mexico and India. While we have seen an improvement in consumer spending in most countries, we are definitely not back to index 100 in the largest economies. The fear of catching COVID-19 may mean that the recovery drags out and consumers stay at home despite the economy having reopened. This may particularly be the case if there is delay in finding a vaccine or better treatment.

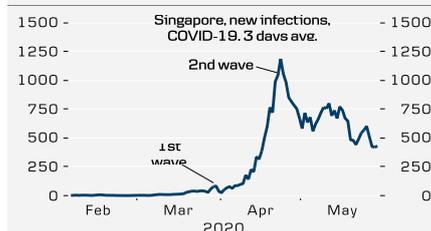
More traditional recession dynamics kicking in: It could also be the case that the current crisis has already triggered what we could call “traditional recession dynamics” or “negative animal spirits”. Normally, high unemployment rates and less job safety would mean more precautionary savings and hence it would take a long time for consumption to return to pre-corona levels. This would lead to a negative economic spiral, whereby currently temporary job losses become permanent over time, as demand does not return rapidly enough. The same goes if businesses on a broader scale go bankrupt because of lack of demand.

Escalation of US-China tensions pulling the phase-1 trade agreement apart: Sharp exchanges of words have taken place regarding the origin of the new coronavirus, Taiwan and a new Chinese National Security Law for Hong Kong. And when it comes to the ongoing tech war, the US has not kept it to words, but taken action by broadening an export ban of US technology to Huawei, which in effect cuts off the giant Chinese telecom equipment maker from buying semiconductors from all the major chip producers in the world. China has vowed to retaliate, but so far not taken action. The heightened tensions and the likelihood that China will be a big theme in the Presidential elections has raised the risk that the renewed confrontation extends to the area of trade, and we see a 50-50 chance that Trump could pull the plug on the US-China Phase One deal and start imposing tariffs back on China, see *The China Letter – the tech war is heating up, will the trade war return too?*, 20 May 2020.

Another risk, mainly to the European economy, is the increasing probability of a no deal Brexit by 31 December 2020: The Brexit negotiations have, for good reason, been overshadowed by the handling of the COVID-19 crisis and so far there has been no breakthrough ahead of the important deadline of 1 July, where decisions on a possible extension, fishery and financial services are to be made. In our base case, we do not expect an extension of the transition period. We remain cautiously optimistic that the two parties can reach an agreement before year-end, as we expect the negotiations will follow the same pattern as the withdrawal negotiations, where a deal was struck close to the deadline. This is only natural in political negotiations. Given that time is short and the two sides remain far apart, we would not rule out the UK and EU trading on WTO terms from 1 January 2021.

In case the above factors (or a combination) materialise, the crisis will prove longer lasting, possibly extending the recession through Q3 and Q4. This would cause unemployment rates to stay at elevated levels for a prolonged period, a sharp drop in credit growth, a wave of bankruptcies and sovereign debt defaults, deflation and increased savings rates. The enormous job losses and wealth destruction would leave consumers unwilling to increase their spending quickly and businesses unwilling to increase investment. The financial turmoil triggered by the crisis would also re-emerge, with both the equity market and the corporate credit market weakening and central banks and governments with fiscal

New waves have been seen in other countries – Singapore worst hit



Source: Macrobond Financial, Danske Bank

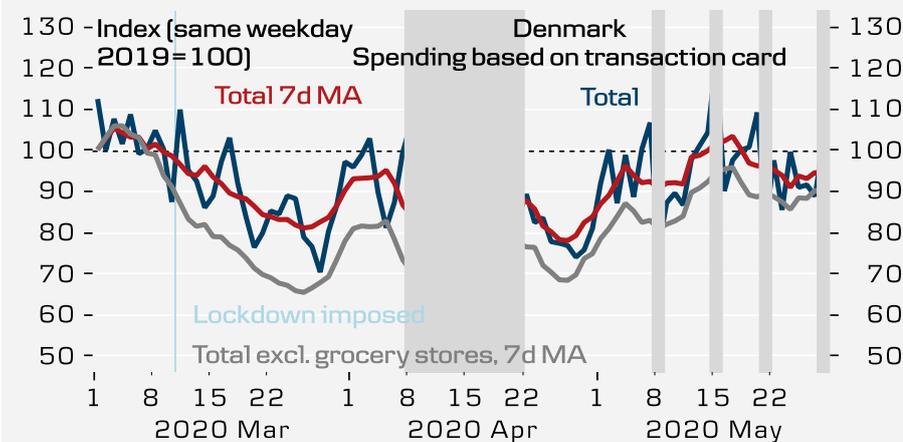
room stepping up policy support further. However, the scope for policy action is probably more constrained as a lot of monetary and fiscal firepower has already been applied.

...but the recovery could also prove stronger (15% chance)

We have been caught by surprise at how quickly consumer spending has returned in countries like Denmark and Norway, where COVID-19 seems under control with few new cases each day. Right now, consumer spending based on transaction card data is close to index 100 (although probably still under when taking fewer cash payments and inflation into consideration). This is probably related to people's fear of catching COVID-19 in these two countries being quite low and that the economies have reopened. If other countries are just lagging Denmark and Norway by a few weeks and the fear of catching COVID-19 declines in the larger economies, we may see a swift recovery in these countries as well.

We have lifted the probability of the positive scenario to 15% from 10%.

Denmark: Signs of recovery continue, with total spending around normal



Note: Spending by card and MobilePay does not include cash and account transfers; hence, it cannot be compared directly with private consumption in national accounts. Grey areas mark holidays in 2020 and 2019 that are timed differently from one year to another. These include Easter, the General Prayer Day and Ascension Day.

Source: Danske Bank

Another (very) positive scenario is if we soon get a vaccine or effective drugs that prevent severe illness from coronavirus. This would mean that things can normalise even further by lifting mass gathering and travel bans. Some reports point to a vaccine being ready by end-year rather than in the latter half of 2021 which has so far been the expectation. There are also promising results with drugs like Remdivisir on moderate cases and work is starting on combining it with Roche's Actemra to improve treatment of severe cases.

In case of faster medical advances and/or recovery in confidence and spending, the economy would bounce back stronger in H2 and thereby help in reducing unemployment faster than envisaged in our main scenario. Moreover sectors susceptible to a slow recovery, like travel, tourism and entertainment, would see a quicker rebound. As such, this would mean that the persistent income losses from the virus at the end of 2021 would be much smaller than in our main scenario. In this positive scenario, we may see discussions begin on whether to roll back emergency support from both governments and central banks. Fiscal measures would be gradually reduced, and during 2021, monetary policy might be tightened as QE programmes are reduced, while talks about rate hikes would only begin after QE was scaled back. This discussion has already started in Denmark, where politicians and experts are discussing when to end the emergency

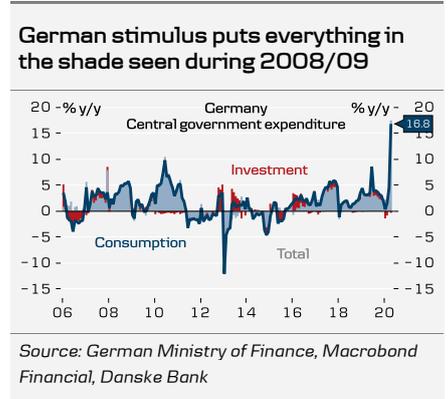
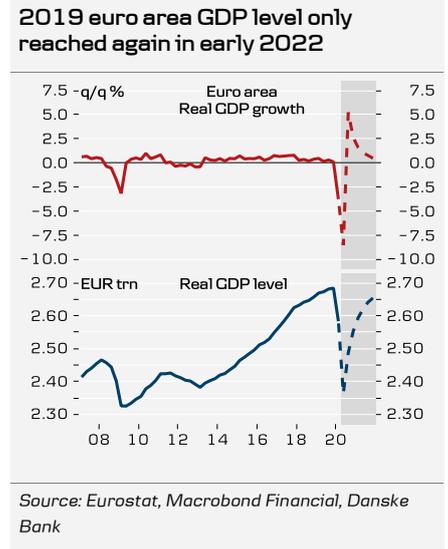
support. The central bank playbook seems to be to end QE before starting discussions on a rate hike.

Euro area: from symmetric shock to asymmetric recovery

The coronavirus crisis has plunged the euro area into its deepest downturn ever recorded. Already in the first quarter, the economy contracted by -3.8% q/q as containment measures deeply disrupted people’s lives and the economy. We expect an even deeper GDP contraction in the second quarter and now look for annual GDP growth of -6.7% in 2020 and 5.2% in 2021.

With some rays of light recently emerging in leading indicators after European economies exited their lockdowns, **we still expect a gradual recovery to take shape in H2 20, led by private consumption and supported by a sizeable fiscal boost.** Euro area countries have committed discretionary fiscal measures of c.15% of euro area GDP on average (of which 3% are spending measures and 12% are liquidity and credit guarantees) and these come on top of automatic stabilisers. However, we expect the recovery will be incomplete, with 2019 GDP levels only reached again in early 2022. A continued sluggish pace of investment spending in light of lingering uncertainties about future sales prospects and companies’ strained liquidity situation will remain a drag on growth. The EU recovery fund might alleviate some of this drag, but it remains to be seen to what degree and how fast EU money can be ‘applied on the ground’ and channelled effectively to the needy. Weaker demand from key export markets and elevated trade uncertainty – not least amid renewed trade jitters between the US and China – also make a quick recovery in net exports seem unlikely in our view and some industries will continue to grapple with supply chain disruptions, notably in developing countries.

Although we still look for a euro area recovery in H2 20, we expect it to be an asymmetric one, with the South lagging behind the North, as we have discussed in *Euro Area Research: The road to recovery*. In particular, the German economy remains better positioned to weather the COVID-19 storm than other European countries, due to its fiscal space, Kurzarbeit scheme and, not least, ample testing capacity, which reduces the risk of renewed lockdown. Some high-frequency data, such as truck toll mileage, electricity consumption and clothing sales, have also pointed to a pick-up in economic activity recently. Aided by a stronger tailwind from residential investments and government plans of an additional recovery stimulus package focused on strategic investments, we expect a less steep collapse in German GDP growth of -5.5% in 2020 and growth of 4.7% in 2021. That said, more long-term challenges abound: its dependency on exports leaves Germany highly exposed to the projected slump in global trade and especially the battered car sector will remain a drag on industrial activity, as global car sales are feeling the pinch from consumers’ loss of spending power. In that light it remains to be seen whether government initiatives succeed in tilting Germany’s economic model in a more diversified and future-proof direction.



US: early signs the bleeding is stopping

Like the rest of the world, the US economy has been hit hard by the COVID-19 outbreak. While we expect US GDP to have dropped by an unprecedented 10.7% q/q (34.4% q/q at an annualised rate) in Q2, the bleeding in the US economy seems to have stopped, according to our reading of the high-frequency US data, see *US Macro Monitor: Early signs the bleeding is stopping but the wound has not healed*, 26 May. In particular, we find it encouraging that transaction card spending has improved from -45% y/y by the end of March to -17.9% y/y now. The gradual recovery in consumer spending is similar to what we have seen in other countries, but the US is lagging given it has not got the virus under control to the same extent other advanced economies have (not least Denmark and Norway). We think the gradual recovery will continue, but given the US population's fear of catching COVID-19 is high, we expect it to take longer to reach index 100 again. A good thing about this crisis is that the emergency packages from Congress and the Federal Reserve have helped smooth income, making it more likely that spending can recover and people return to their jobs. We expect the US Congress to approve (eventually) an extension to the temporarily higher unemployment benefits (expiring on 31 July) and perhaps even another round of direct payments to US citizens, which should also support the recovery. If there is no extension to the higher and broad unemployment benefits, there is a risk of derailing the recovery, as it would mean a negative income shock.

Business investment have taken a hit, but should return gradually when the economy opens up and things start to normalise. The pace is likely to be slower than for consumer spending, given the anxiety over how robust the recovery is, particularly if the US is hit by a second wave. Based on mortgage applications, the housing market seems to have recovered quite quickly, which should be positive for residential investment.

We do not expect the Federal Reserve to change its policy rate over our forecast horizon. The Federal Reserve has said it does not think negative rates are a good idea in the US and we don't think the Fed is keen on raising rates either. If more easing is needed, it would be by strengthening the forward guidance ("how long are we going to keep rates at 0%"), extensions and expansions of the lending facilities and potentially yield curve control.

China: gradual recovery driven by policy support

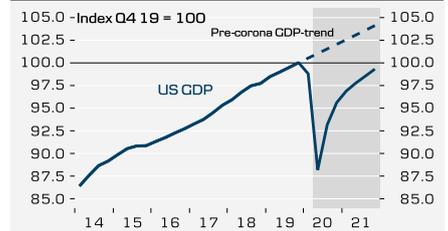
After an historic drop in GDP of close to 10% q/q, we look for a gradual recovery starting in Q2. Part of the rebound is driven by a return of production capacity back to close to 100%, leading to a turn in industrial production. We expect demand to be slower to normalise, though.

Consumers are set to stay cautious for some time, as unemployment has jumped higher and job uncertainty is elevated for some time. Wage growth will also take a hit, keeping income growth at moderate levels.

We expect private investment to be slow to normalise as businesses have been struggling with the collapse in demand. The uncertainty will still be around as long as the risk of second waves is there and an effective treatment has not yet been found.

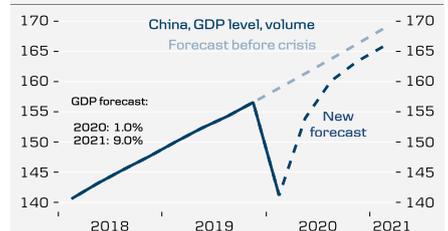
Finally, exports have taken a hit due to the global recession. As the global economy recovers, so should exports. In the short term, growth will be underpinned by policy support through a fiscal stimulus of 4-5% of GDP, where the most direct effect comes from publicly driven investments in infrastructure and construction. More monetary policy easing has also been announced, which should give some support to activity. Our growth forecast for 2020 is 1.0% followed, by 9.0% growth in 2021, as the catch-up of lost ground lifts growth rates (for more details, see *China Outlook: From output to demand crisis*, 29 April 2020).

US GDP to recover but will take time before we hit index 100 again and there are permanent GDP losses as well



Sources: BEA, Macrobond Financial, Danske Bank forecasts

China GDP outlook



Source: Macrobond Financial and Danske Bank

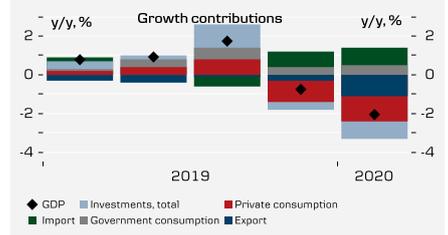
Japan was caught on the wrong foot when the crisis hit

A typhoon and the VAT-hike in October hit the Japanese economy hard in Q4. That meant Japan went in to a technical recession in Q1. Private consumption, investment and exports have plunged and the worst hit will not show before we get the Q2 figures, when the countrywide state of emergency caused a steep decline in economic activity. As the country has been opening up in May, demand should start to rebound, but only slowly, as the opening has been gradual and Tokyo only opened in late May.

The government has tried to limit the fallout from this crisis by adding liquidity to businesses by delaying taxes and social security payments and offering favourable credit lines to SMEs. Consumer demand will be boosted by JPY100,000 cash-handouts to all citizens, which will be implemented throughout Q2. The total bill is huge, and could add up to 40% of GDP, but most of that money will not be used for direct spending and consumers will probably choose to save a large portion of the cash handout. Within the limits of what is left in the toolbox, the Bank of Japan (BoJ) provided significant support as well. The BoJ is actually paying financial institutions for tapping its crisis response lending programme and the flexibility within the QE programme has been extended. There is still no appetite for cutting rates further to negative.

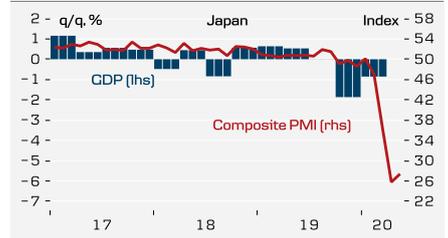
In the short run, an end to the state of emergency is essential to get the economy out of the deep slump it is in. We expect the economy to recover slowly through Q2, but it could still very likely be the worst quarter on record from a growth perspective. Looking a little further ahead, global demand has to recover for the economy to really get back on its feet. Japanese exporters have been suffering from tensions between their two biggest trading partners, the US and China, for a long time. The extensive repercussions from this crisis to the US economy in particular will remain a drag on Japanese exporters in 2020.

Domestic demand already on the way down before coronavirus



Source: Japanese Ministry of Economy, Trade & Industry, Macrobond Financial

The economy in a deep hole in Q2



Source: Japanese Cabinet Office, IHS Markit, Macrobond Financial

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Jakob Ekholdt Christensen, chief analyst, Allan von Mehren, chief analyst, Aila Mihr, senior analyst, Bjørn Tangaa Sillemann, analyst, Mikael Milhøj, senior analyst, Piet Haines Christiansen, chief strategist, ECB and Fixed Income, and Rune Thyge Johansen, assistant analyst.

Analyst certification

Each research analyst responsible for the content of this research report certifies that the views expressed in the research report accurately reflect the research analyst's personal view about the financial instruments and issuers covered by the research report. Each responsible research analyst further certifies that no part of the compensation of the research analyst was, is or will be, directly or indirectly, related to the specific recommendations expressed in the research report.

Regulation

Danske Bank is authorised and subject to regulation by the Danish Financial Supervisory Authority and is subject to the rules and regulation of the relevant regulators in all other jurisdictions where it conducts business. Danske Bank is subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority (UK). Details on the extent of the regulation by the Financial Conduct Authority and the Prudential Regulation Authority are available from Danske Bank on request.

Danske Bank's research reports are prepared in accordance with the recommendations of the Danish Securities Dealers Association.

Conflicts of interest

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high-quality research based on research objectivity and independence. These procedures are documented in Danske Bank's research policies. Employees within Danske Bank's Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and the Compliance Department. Danske Bank's Research Departments are organised independently from, and do not report to, other business areas within Danske Bank.

Research analysts are remunerated in part based on the overall profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Financial models and/or methodology used in this research report

Calculations and presentations in this research report are based on standard econometric tools and methodology as well as publicly available statistics for each individual security, issuer and/or country. Documentation can be obtained from the authors on request.

Risk warning

Major risks connected with recommendations or opinions in this research report, including as sensitivity analysis of relevant assumptions, are stated throughout the text.

Expected updates

Ad hoc.

Date of first publication

See the front page of this research report for the date of first publication.

General disclaimer

This research has been prepared by Danske Bank A/S. It is provided for informational purposes only and should not be considered investment, legal or tax advice. It does not constitute or form part of, and shall under no circumstances be considered as, an offer to sell or a solicitation of an offer to purchase or sell any relevant financial instruments (i.e. financial instruments mentioned herein or other financial instruments of any issuer mentioned herein and/or options, warrants, rights or other interests with respect to any such financial instruments) ['Relevant Financial Instruments'].]

This research report has been prepared independently and solely on the basis of publicly available information that Danske Bank A/S considers to be reliable but Danske Bank A/S has not independently verified the contents hereof. While reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation or warranty, express or implied, is made as to, and no reliance should be placed on, the fairness, accuracy, completeness or reasonableness of the information, opinions and projections contained in this research report and Danske Bank A/S, its affiliates and subsidiaries accept no liability whatsoever for any direct or consequential loss, including without limitation any loss of profits, arising from reliance on this research report.

The opinions expressed herein are the opinions of the research analysts and reflect their opinion as of the date hereof. These opinions are subject to change and Danske Bank A/S does not undertake to notify any recipient of this research report of any such change nor of any other changes related to the information provided in this research report.

This research report is not intended for, and may not be redistributed to, retail customers in the United Kingdom (see separate disclaimer below) and retail customers in the European Economic Area as defined by Directive 2014/65/EU.

This research report is protected by copyright and is intended solely for the designated addressee. It may not be reproduced or distributed, in whole or in part, by any recipient for any purpose without Danske Bank A/S's prior written consent.

Disclaimer related to distribution in the United States

This research report was created by Danske Bank A/S and is distributed in the United States by Danske Markets Inc., a U.S. registered broker-dealer and subsidiary of Danske Bank A/S, pursuant to SEC Rule 15a-6 and related interpretations issued by the U.S. Securities and Exchange Commission. The research report is intended for distribution in the United States solely to 'U.S. institutional investors' as defined in SEC Rule 15a-6. Danske Markets Inc. accepts responsibility for this research report in connection with distribution in the United States solely to 'U.S. institutional investors'.

Danske Bank A/S is not subject to U.S. rules with regard to the preparation of research reports and the independence of research analysts. In addition, the research analysts of Danske Bank A/S who have prepared this research report are not registered or qualified as research analysts with the New York Stock Exchange or Financial Industry Regulatory Authority but satisfy the applicable requirements of a non-U.S. jurisdiction.

Any U.S. investor recipient of this research report who wishes to purchase or sell any Relevant Financial Instrument may do so only by contacting Danske Markets Inc. directly and should be aware that investing in non-U.S. financial instruments may entail certain risks. Financial instruments of non-U.S. issuers may not be registered with the U.S. Securities and Exchange Commission and may not be subject to the reporting and auditing standards of the U.S. Securities and Exchange Commission.

Disclaimer related to distribution in the United Kingdom

In the United Kingdom, this document is for distribution only to (I) persons who have professional experience in matters relating to investments falling within article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the 'Order'); (II) high net worth entities falling within article 49(2)(a) to (d) of the Order; or (III) persons who are an elective professional client or a per se professional client under Chapter 3 of the FCA Conduct of Business Sourcebook (all such persons together being referred to as 'Relevant Persons'). In the United Kingdom, this document is directed only at Relevant Persons, and other persons should not act or rely on this document or any of its contents.

Disclaimer related to distribution in the European Economic Area

This document is being distributed to and is directed only at persons in member states of the European Economic Area ('EEA') who are 'Qualified Investors' within the meaning of Article 2(e) of the Prospectus Regulation (Regulation (EU) 2017/1129) ('Qualified Investors'). Any person in the EEA who receives this document will be deemed to have represented and agreed that it is a Qualified Investor. Any such recipient will also be deemed to have represented and agreed that it has not received this document on behalf of persons in the EEA other than Qualified Investors or persons in the UK and member states (where equivalent legislation exists) for whom the investor has authority to make decisions on a wholly discretionary basis. Danske Bank A/S will rely on the truth and accuracy of the foregoing representations and agreements. Any person in the EEA who is not a Qualified Investor should not act or rely on this document or any of its contents.

Report completed: 1 June 2020, 07:43 CEST

Report first disseminated: 2 June 2020, 06:00 CEST