Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

China's Policy Disaster and Weekend Links

This week from Macrolens: Coronacrash Roadmap V: it's All Over But the Shoutin'. The peak is in for the Coronavirus in the U.S., and the lows are in for equities. Many vol-inducing issues remain, including:

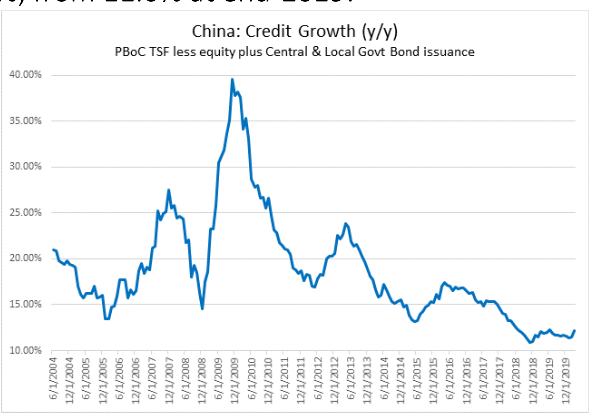
- the degree of normalcy that can be achieved as we exit the economic shutdown
- whether Washington is up to the task of supporting industries likely to remain impaired
- the degree of political fallout
- the lackluster policy response in Europe and China
- EM credit risks
- A severe cleavage in U.S.-China relations

But for the next couple of weeks I suspect the focus will remain on the virus statistics, and **further improvement is almost certainly baked in** there, as a result of the broadening and tightening of social distancing over the past month. By end-April I suspect it will look very much like the coast is clear for substantial economic reopening.

China's Policy Paralysis

Regular readers will be aware that I'm wildly unimpressed with China's policy efforts in response to the Coronavirus Crisis. At one point I recall writing something along the lines of "I doubt Chinese leadership will choose the currency peg hill to die on." But so far, that seems to be what they're doing.

Next week's markets might cheer last night's RMB 5.15T total social financing print for March, but there is really little to cheer about. The y/y growth rate in credit outstanding has accelerated only to 12.1%, from 11.6% at end-2019:



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Chief Strategist
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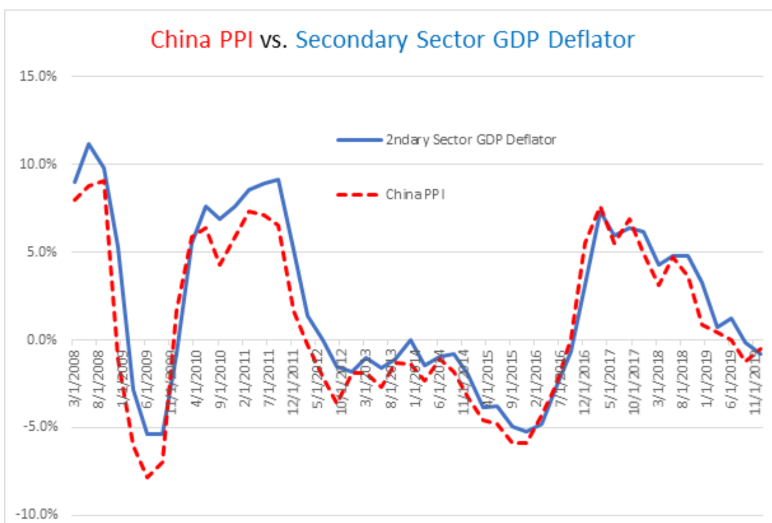
That ain't gonna cut it. The problem, of course, is that generating a high rate of growth in a really big number requires tacking on a really, really big number. Here is the USD value of credit that would have to be extended in 2020 for credit growth to hit various growth rates:

15%	$5.5T
20%	$7.3T
25%	$9.1T
30%	$11.0T

In order to hit 20% credit growth for 2020 – which still won't cut it given the extent of the downturn – TSF would have to average RMB 4.4T per month for the rest of the year.

(Note, that my credit metrics embed any so-called "fiscal stimulus," as they incorporate all manner of on-balance sheet government bond financing – central, local, and "special bond" issuance).

The bigger, badder news last night was that PPI inflation decelerated to -1.5% y/y. As I've described in the past, <u>PPP is the deflator for China's Industrial Sector</u>:



Given the hit to real economic activity, in combination with a negative deflator, China's industrial sector (which is where the bulk of the debt is), <u>is likely to contract in nominal terms</u> this year.

Yet, despite the prospects for a sharp deceleration in nominal growth rates, nominal interest rates on offer to Chinese corporates have barely declined, and remain above 5% on average.

MACROLENS
Markets in High Resolution

Brian McCarthy
Chief Strategist
(o) 203-614-8600
brian.mccarthy@macrolens.com

Effective real rates to Chinese industry are spiking, and could in reality be well above 5% now. China's policy course will lead to <u>the destruction of much of its SME sector</u>.

<u>There is NO set of policies that both saves the guts of China's private industrial sector and remains compatible with a stable RMB against a strong Dollar</u>.

As has been the mantra here for weeks, until they cut the benchmark deposit rate, they are simply not being serious about stabilizing the economy. They're doing nothing but nibbling around the edges of the problem.

Here, PBoC talks about conserving "ammunition." The only restraint on the amount of "ammunition" a central bank can unleash is the currency.

Exclusive: China's central bank to step up easing, won't borrow Fed playbook - sources

> *China's central bank will ramp up its policy easing to support the coronavirus-ravaged economy but debt worries and property risks will prevent it from following the U.S. Federal Reserve's steep rate cuts or quantitative easing moves, policy sources said.*
>
> *The central bank will largely rely on a mix of liquidity policy tools to support the economy, such as RRR and various lending facilities, and price-based tools including various market rates and its benchmark lending rate - the loan prime rate (LPR), the sources said.*
>
> *"The PBOC will step up monetary policy easing, but it's impossible for it to follow the Federal Reserve," said one of the sources. "The PBOC will take a step by step approach and reserve some ammunition."*

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The PBOC is likely to cut the LPR on April 20, following a 20 basis point cut in the 7-day reverse repo rate on March 30, and trim the benchmark deposit rate in the coming months as consumer inflation is expected to ease, the sources said.

A deposit rate cut could help ease pressure on lenders and create more room for lowering lending rates, but ***such a move could be politically sensitive****, given that real deposit rates are already deep in negative territory, the sources said.*

Vice PBOC governor Liu Guoqiang said last week that China would tread warily in cutting the benchmark deposit rate due to elevated inflation and the potential impact on ordinary savers.

"We should continue to cut RRR and interest rates. But we should be worried about the side-effects if monetary policy easing becomes too strong, as we are still digesting the hangover from previous stimulus measures," said a second source.

"If more money flows into the property sector, it would fuel property speculation and lead to social problems."

This week saw some uptick in the Trivium metrics, but the picture remains the same: getting the run-rate up to 75% was easy but it's been very tought sledding from there…

Trivium Activity Index: Activity is running at 82% of normal (vs. 81% last week) for large companies, 82% for small (vs. 77%), 82% on a national average (vs. 78%). Here was Trivium's commentary on the situation:

Over the past three weeks our headline index has increased just 10.4 percentage points – from 71.4% on March 20 to 81.8% today.

- ***Uh oh:*** *The previous three-week period (February 28 to March 20) saw a 26.9 percentage point increase.*
- ***Even more uh oh:*** *The two-week period before that (February 14 to February 28) saw a 39.8 percentage point increase.*

Get smarter: *This slowdown makes sense. In the days immediately after COVID-19 was brought under control in China, there was a kickstart as firms got back to business.*

Get smarter: *Getting a base level of operations was relatively easy – getting back to full production from here, not so much.*

Autos: The pent-up demand remains pent-up, I guess….

Brian McCarthy
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China's March passenger car sales down 40.8% year-on-year: industry association

> *China's March passenger car sales fell 40.8 percent from a year earlier to 1.08 million units, the China Passenger Car Association said on Thursday, as efforts to curb the coronavirus epidemic in the country weakened economic activity.*
>
> *The association said during an online briefing that overall passenger car sales volume in April will be much higher than March's, however.*

China's Chernobyl?

If the Lab-leak theory is proven, this episode starts to look almost exactly like Chernobyl - accident resulting from sub-standard safety measures, authoritarian cover-up, hundreds of thousands dead…

Ministers 'not discounting' theory corona came from infected blood in China lab

> ***BRITISH ministers are "no longer discounting" the theory*** *that coronavirus originated after leaking from a Chinese bio research lab in Wuhan, according to reports.*
>
> *Senior sources have reportedly admitted while the "balance of scientific advice" is that the virus originated naturally, a leak is also being considered by security services.*
>
> *Theories about the origins of coronavirus being linked to a lab in Wuhan have been batted around since the early days out of the outbreak.*
>
> *One member of Cobra, the emergency committee led by Prime Minister Boris Johnson, said security services are now considering a possible leak, reports The Mail on Sunday. The source added however they did not dispute the virus was "zoonotic" - meaning it originated in animals.*
>
> *Chinese officials have previously attempted to dismiss claims of a leak as "internet rumours".*
>
> *The government source's comments come as pressure ratchets up on China to come clean over the outbreak.*
>
> *The member of Cobra, which receives classified briefings from British intelligence, said: "There is a credible alternative view [to the zoonotic theory] based on the nature of the virus. "Perhaps it is no coincidence that there is that laboratory in Wuhan. It is not*

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> *discounted.”*
>
> *Downing Street has said it “does not recognise” the claims made by the source.*

The Virus was circulating freely in Wuhan throughout December…

Signs coronavirus was spreading in Wuhan earlier than thought: study

> *A look back at samples of patients with flu-like symptoms in the central Chinese city of Wuhan has uncovered signs of coronavirus outbreaks in the wider community in early January – well before the public was even told the pathogen was contagious.*
>
> *Researchers with the Wuhan Centre for Disease Control and Prevention analysed 640 throat swabs collected from young and adult patients with influenza-like illnesses – all outpatients with a sudden onset of a fever higher than 38 degrees Celsius and a cough or sore throat.*
>
> *Nine adult samples tested positive for the Sars-CoV-2, the previously unknown coronavirus. One of 40 samples taken from two Wuhan hospitals on January 4 tested positive. There were three positive swabs among samples taken the next week and five the following week.*
>
> *“Interestingly, the nine patients with Covid-19 came from six different districts of the Wuhan metropolitan and surrounding areas, which provided additional evidence for community transmission in this region.”*

U.S.-China Relations

I think we’ve reached the point of no return now…

Opinion | The coronavirus crisis is turning Americans in both parties against China

> *a new poll shows that, outside the Beltway, the coronavirus crisis is actually bringing Americans together on the China issue.* ***Republicans and Democrats now largely agree*** *that the Chinese government bears responsibility for the spread of the pandemic, that it can’t be trusted on this or any other issue, and that the U.S. government should maintain a tough position on China on trade and overall, especially if Beijing again falters in its commitments.*

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"It's as much of a consensus issue as you can get in today's divided world," said Mark Penn, chairman of the Harris Poll. "Overall, there's very little trust for anything that the Chinese government says or does, especially its premier. Xi Jinping has less than half the credibility of President Trump in this poll."

Of the nationally representative sample of 1,993 American adults Harris surveyed online between April 3 and April 5, a net total of 23 percent said Xi, the Chinese president, was a trustworthy source of information related to the covid-19 outbreak, with Republicans and Democrats closely aligned.

The bipartisan consensus on China doesn't stop there. Ninety percent of Republicans said the Chinese government is responsible for the spread of the virus, compared to 67 percent of Democrats. Only 22 percent of Republicans and 34 percent of Democrats said they thought the Chinese government reported their coronavirus statistics accurately.

On trade, there's even more agreement. Neither party seems to know whether China will fulfill its obligations under Trump's "phase one" trade deal. But ***strong majorities in both parties believe that the U.S. government should reimpose tough tariffs if Beijing doesn't live up to its obligations****. Majorities in both parties also believe U.S. manufacturers should pull back from China in the wake of the crisis.*

These comments are notable given Kudlow's long-standing free-trade leanings…

Kudlow: 'Pay The Moving Costs' Of American Companies Leaving China

Call the moving company, Washington's picking up the tab.

The same day Japan announced that it would spend upwards of $2.2 billion to get its corporations out of China and either back home or spread throughout southeast Asia, White House National Economic Council Director Larry Kudlow said the U.S. should "pay the moving costs" of every American company that wants out of China.

"I would say, 100 percent immediate expensing across the board for plant, equipment, intellectual property, structures, renovations... In other words, ***if we had 100 percent immediate expensing, we would literally — literally pay the moving costs of American companies****," Kudlow said on the FOX Business Network's America Works Together Town Hall which aired on Thursday.*

The Japanese government announced that it would provide direct loans 220 billion yen ($2 billion) for companies shifting production back to Japan and 23.5 billion yen for those

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seeking to move production to other countries, according to details of the plan posted online.

EU Policy Respose

If the U.S. gets a B+ for its policy response, and China a D-, Europe probably grades to about a C on that curve…

Congratulations, It's a Fudge: EU Crisis Deal Leaves Much Unresolved

Their deal was a classic European Union fudge, however, and it left unresolved the most contentious question of how to share the financial burden that has so bitterly divided them.

French Finance Minister Bruno Le Maire said that after 16 hours of "brutal" inconclusive negotiations earlier in the week, the ministers realised they were "standing at the edge of the abyss and what is at stake is quite simply the construction of Europe".

While Paris and Rome said the agreement paved the way for issuing common EU debt to kickstart economic growth on the continent headed for a steep recession, The Hague and Berlin said no "coronabonds" *will happen.*

The art of the EU deal lies in ambiguous language that leaves the matter open to further arm-wrestling between the divided member states, whose national leaders will meet via videoconference on April 23.

"Way too early to celebrate the Eurogroup's deal," Mujtaba Rahman, Eurasia Group's managing director for Europe, said in a research note that predicted a flare-up over the undecided details when it comes to implementing the package of measures.

…the ministers kicked into the long grass the question of how to pay for a temporary recovery fund for Europe because it goes to the heart of a disagreement over jointly issued debt.
This has been the stumbling block all along, pitting a camp of financially ailing southern states led by Italy against the Netherlands as the bulwark of the fiscally conservative north.

…the bloc's leaders will ***now have to agree on what is meant by "innovative financial instruments"*** *when they come to thrash out the scope and sources of funding for the recovery fund.*

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> *…without any agreement on debt sharing, Thursday's deal does not solve the longer-term question of debt sustainability in countries such as Italy, which have been most affected by the crisis.*
>
> *"While unconditional use of the ESM was unthinkable just a few months ago, more unthinkable steps would need to happen for individual country risk to disappear," an ING note said.*

There is **very little chance of Spain and Italy extricating themselves** from this crisis absent either wide scale debt mutualisation or Euro exit and devaluation. Italy's small business sector looks like it may be hung out to dry…

Italy's Economic Pain Shows Burden of National Coronavirus Lockdowns

> *Italy faces a particularly grave economic risk from the lockdown because of the prevalence of small and midsize businesses, many of which are family-owned and have limited financial flexibility.* ***In Italy, 95% of companies have fewer than 10 employees****.*

U.S. Elections

The candidates for the November election have been decided: its Trump vs. "not Trump." The Democrats have nominated a ham sandwich under the "not Trump" banner. Now they're wondering if the electorate might prefer prosciutto…

Democrats want to drop Joe Biden for Andrew Cuomo, poll finds

> *The national poll found* ***56% of Democrats prefer Cuomo, with 44% wanting to stick with presumptive nominee Biden*** *— a 12-point margin well outside the 4.8% margin of error for the Democratic sample.*
>
> *Hispanic voters, young people, women and self-identified liberals are most likely to favor dumping the former vice president for Cuomo.*
>
> *The poll, conducted April 3-6, was commissioned by the conservative pro-market Club for Growth, which generally supports Republican candidates.*
>
> *The results build on the findings of a Rasmussen Reports poll conducted April 2-5, which found 46% of Democratic voters preferred Biden and 45% wanted Cuomo.*

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Poll results shared with The Post also rated approval or disapproval of how Biden and Cuomo are handling the coronavirus outbreak. For Cuomo, 54% of all respondents approved and 20% disapproved of his job. For Biden, 32% approved, 35% disapproved and 34% were unsure.