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Markets in High Resolution

Virus Math, Chinese Policy Failure & Weekend Links

One of the remarkable aspects of this saga markets are not acting in a forward-looking manner. Perhaps because the situation is so highly unusual and uncertain, or perhaps because of the grimness of the news, markets seem stuck doing static analysis of a situation that is inherently dynamic.

It's critical to remember that the near-future is predetermined:

- Roughly two weeks ago human beings had some number of interactions that resulted viral transmission
- A bit over 80% of those people have become symptomatic.
- Some proportion of these will take the Covid-19 test and show positive.
- About a quarter of those people will end up in the hospital
- These data will show up in the statistics in the next few days

This cake is baked.

New York State is providing a wealth of granular data on all aspects of the infection rate and healthcare utilization that I am currently in the process of torturing. I suspect it to confess this weekend, at which point I'll present the model and lay out what is shaping up as a bullish roadmap for next week. Some simple points to preview:

- Given the known lags between infection, the emergence of symptoms, testing and results, we are now on the cusp of seeing the effects of social distancing in the U.S. appear in the data.
- Once the rate of daily new cases plateaus, the system approches a steady state for the healthcare system at which patients coming in equal patients coming out.
- The objective is to achieve this plateau at a level which leaves ample headroom to systemic healthcare capacity.

It appears highly likely that this objective will be comfortably met.

I'm afraid many market participants have fallen into the trap of naïve extrapolation. If you forecast a persistent growth rate in any variable, over time it goes to infinity. (Check out this

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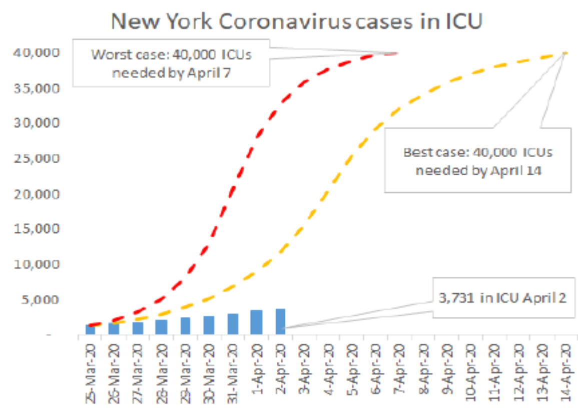
great 8-min video on why exponential growth is **never sustainable in the real world** and the mathematical importance of the levelling of the case rate).

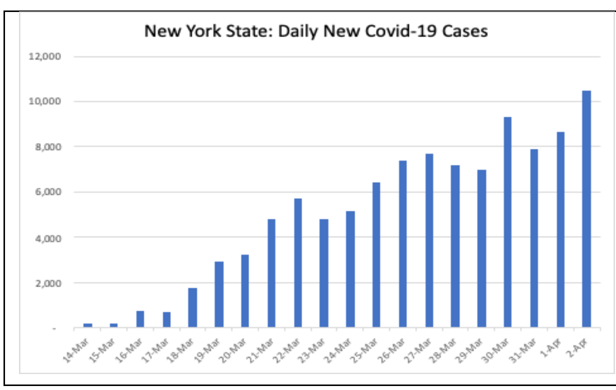
I'm afraid the so-called "experts" have fallen into the same trap. A friend sent me this picture today, which comports with the work I'm doing:

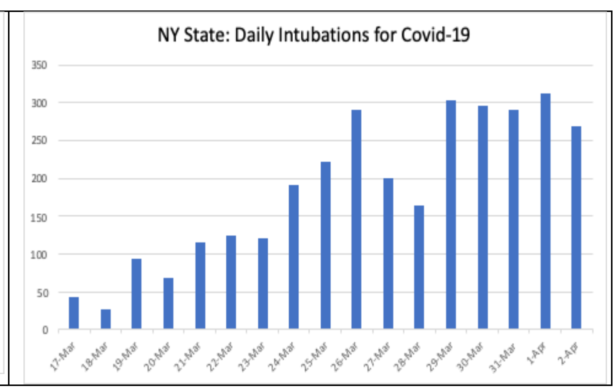


If the NY State case rate plateaus around current levels, there is simply **no way to get to an estimate of 10,000 ventilators** being necessary, let alone the 30,000-40,000 we're being told might be required. These worst-case estimates are predicated on continued exponential growth in cases while **ignoring any mitigating effect from social distancing**.

Keep in mind that **"victory" need only be defined as reaching and acceptable steady-state** as we work towards improved therapeutics and a vaccine. **Eradication is impossible**. Not only would you have to strictly quarantine the entire country for a month, you would have to maintain a closed border until the virus was eradicated *globally*.

The objective should be a **gradual relaxation of social distancing** at whatever pace remains consistent with maintaining an acceptable steady state.





China: Policy Failure

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China is really scuffling to get the economy back on track. I saw nothing this week to change my view that this episode is likely to sound the **death knell for the Chinese growth model**.

Only a minor uptick in activity again this week…

Trivium Activity Index: Activity is running at 81% of normal (vs. 80% last week) for large companies, 77% for small (vs. 71%), 78% on a national average (vs. 75%). **The Chinese economy remains stuck in the mud**.

It remains to be seen to what degree the continued headwinds are a result of collapsing external markets, lingering fear of the virus, or permanent damage to the nations' capital stock. I continue to foresee a significant degree of **permanent damage to China's capital stock** as result of recent events, given the highly vulnerable state of the SME sector and a **feckless policy response**.

Clearly, the reported near-zero rate of community spread in China is not accurate…


The Business Source @GlobalTimesBiz · Apr 1
KTVs, cinemas and internet cafes in #Shanghai closed again recently after a short resumption. A government official from the city's Minhang district told the Global Times that it is to curb a #COVID19 rebound. bit.ly/3dlEafr

Its only one country, but why are they locking down anything if there is zero community spread taking place?

Chinese county enters coronavirus lockdown amid second wave fears

> *Henan province in central China has taken the drastic measure of putting **a mid-sized county in total lockdown** as authorities try to fend off a second coronavirus wave in the midst of a push to revive the economy.*
>
> *Curfew-like measures came into effect on Tuesday in Jia county, near the city of Pingdingshan, with the area's roughly 600,000 residents told to stay home, according to a notice on the country's official microblog account.*
>
> *On Wednesday, the National Health Commission reported 36 new infections – all but one of which were imported cases.*

Not only is the virus clearly still lingering, but as I've stressed in recent weeks, China's **policy**

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approach thus far is an abject failure.

For those experienced in reading through the CCP bullshit, there is actually very little here…

China to roll out mix of fiscal, financial policies to vigorously meet challenges

Related plans were made at the State Council's executive meeting chaired by Premier Li Keqiang on March 31.

The meeting underscored the need to scale up special local government bonds and expand effective investment in areas of weakness. Such funding will be directed to where the projects are. It will prioritize regions with key projects, low risks and the prospect of quickly boosting effective investment and will be channeled to expediting those projects and livelihood programs.

"It is essential to make well-calibrated arrangements in advance to keep the projects under construction going, and launch some new projects in light of real needs," Premier Li said.

*The meeting adopted stronger measures to offer inclusive financial support to micro, small and medium-sized enterprises. Since the start of this year, the People's Bank of China has allocated a 300 billion yuan ($43 billion) special re-lending quota, which has so far supported more than 7,000 key enterprises involved in the outbreak response. Another 500 billion yuan in re-lending and re-discount quota is now supporting an increasing number of micro, **small and medium-sized firms to get loans at rates below 4.55%** for their business re-opening.*

Do they really think private SME's are going to falling all over themselves to borrow at 4.55%?

Chinese authorities seem not to understand that this slowdown is unlike anything they have ever faced. Their standard playbook is as follows:

- Keep the currency stable to avoid credibility loss and capital flight
- Keep interest rates high to support the currency
- Support growth via forced lending to rate-insensitive SOE's and local government who will invest regardless return prospects

For a while, this process can be supportive of nominal GDP growth, thereby also propping up the property sector, SME's and consumption – at the cost of growing hidden losses in the state sector and addiction to high rates of credit growth. It's a treadmill to financial crisis, but as long as it works, it works.

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The problem now is that a hole has been blown in the Chinese private sector…

China's virus-hit small firms turn to friends, family for cash to stay alive

> *"All the entrepreneur friends I know, either in the service industry or the manufacturing industry, are already in debt. Many of us, including me, have been forced to max out our credit cards or even start selling properties and cars to maintain our business operations."*
>
> *"Our company's trapped. There are no new orders, and even if there were, there are no funds for us to buy raw materials," said the factory owner, who asked not to be identified.*
>
> *"Besides bank loans, I myself have more than 1 million [yuan] of 'triangular debts' where I owe money to suppliers and my clients owe me money," said Liang Lu, who runs a business consultancy firm in Dongguan in central Guangdong province helping local manufacturers to promote their businesses.*
>
> *Banks have long avoided lending to small businesses because of creditworthiness concerns and the fact that they do not have the same government backing as state-owned firms.*
>
> *"To be honest, we all know now that the risk of lending to SMEs is extremely high and going higher and higher," said a loan department head of a private bank's Guangzhou branch, who asked not to be named.*

The policy conundrum is the same the world over: **maintaining the small business capital stock**. China's policy apparatus is simply **not built to address this problem**. Furthermore, there's some question as to whether the government even cares about salvaging "private" businesses.

PBoC Fiddling While SME's Burn

Meanwhile, PBoC keeps screwing around with nonsense like cutting the 7-day repo rate by 20 basis points and trying to squeeze banks into lowering lending rates in 5 basis point increments. Yet they refuse to do needs to be done: they must cut the benchmark household deposit rate:

PBOC Signals No Imminent Cut to Deposit Rate, Evaluation Needed

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The deposit rate is the "ballast" in the nation's interest-rate system and multiple factors should be taken into consideration, PBOC Deputy Governor Liu Guoqiang said at a briefing. The comments counter expectations that the central bank would ***act soon to alleviate the pressure on bank profit margins****, amid reductions on lending rates in recent weeks.*

China's monetary and fiscal authorities are currently increasing support to the economy as the global coronavirus crisis hammers economies from the U.S. to Asia. At the same time, they're sticking to ***a relatively measured approach*** *taken since last year amid high debt levels and fears of financial instability.*

"The PBOC has surprised the market -- investors had been expecting a deposit rate cut very soon, whereas now the comments suggest a reduction won't happen in the second quarter," said Xing Zhaopeng, an economist at Australia & New Zealand Banking Group.

The deposit rate, through which the central bank fixes what banks must pay customers for their deposits, stands at 1.5%.

Liu said factors to consider include inflation, economic growth and the nation's balance sheet. Now the CPI is obviously higher than the one year deposit rate, and one also needs to think about ***whether a deposit rate cut will add to the depreciation pressure on the currency****, he said. Above all, a deposit rate cut needs to consider the public's feeling, he added.*

"A deposit rate cut needs to consider the public's feeling?!?!?!" Huh? I guess he means the public's feeling as to whether they want to hold RMB or alternatively, GTFO by any means possible. Themreality is that PBoC cannot adequately address the dire economic circumstances while constrained by a managed exchange rate.

Lastly, as to why the benchmark deposit rate is so critical, deposits remain the predominant form of systemic funding, accounting for 63% of total liabilities, vs 14% for interbank and central-bank funding. Rate cuts on the latter are an insignificant salve.

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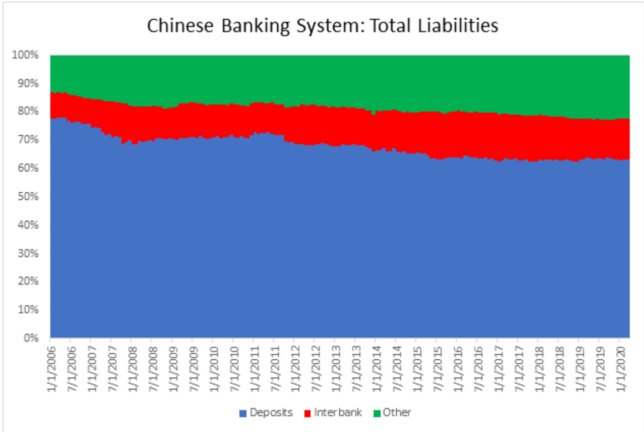

Ditto on these incremental increases in special bond issuance to fund infrastructure. Credit last year expanded by 26T RMB, and will probably have to approach 40T RMB (at least) to avoid a debt-deflation spiral. So **let's not get too excited about an extra 2T in special bond issuance…**

China Will Tolerate More Debt to Help Virus-Stricken Economy

> *Lu Ting, chief China economist at Nomura International Ltd. in Hong Kong, estimated that the issuance value of special treasury bonds could be between 2 trillion yuan and 4 trillion yuan, equivalent to around 2% to 4% of GDP.*
>
> *"As STBs (special treasury bonds) are excluded in the official fiscal deficit, the size of STBs will partly fill the gap between the official fiscal deficit target and the actual fiscal deficit," he wrote in a March 28 research report.*
>
> *The proceeds from the special treasury bonds could be spent on infrastructure and on bailing out small and midsize companies, analysts said. "We expect a majority, perhaps two-thirds of the proceeds from STBs, to be used for financial relief, and the remainder to be used on infrastructure," Lu said.*
>
> *Yang Fan, an analyst at Citic Securities Co. Ltd., said that special treasury bond proceeds might end up mostly invested in infrastructure, and might also be used to support issuance of perpetual bonds by banks.*

Oh man, that is classic Lu Ting: *"STBs will partly fill the gap between the official fiscal deficit target and the actual fiscal deficit."* ☺

Here an interesting insight on the annual GDP target. While some are suggesting they simply not set a target for this year, the fact is that China's is a planned economy – it actually **can't**

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function without the top-down direction of a GDP target.

The Big Debate: Should China Ditch GDP Growth Target for 2020?

> *Yu Yongding, one of China's most influential economists and a former central bank adviser, is among the latest to add his voice to the discussion, urging the government to stick with its tradition of issuing a numerical goal for expansion in gross domestic product (GDP), even if it is a low one.*
>
> *The government has not officially released its GDP growth target for 2020. Premier Li Keqiang was due to announce the figure at the annual meeting of the National People's Congress (NPC) in Beijing on March 5 but the gathering has been postponed due to the coronavirus epidemic and a new date has not yet been set. Even so, a meeting on Friday of* ***the Politburo central committee, the Communist Party's top decision-making body, urged efforts to "achieve this year's economic and social development goals," which suggests that a GDP target, even a lower one, may not have been abandoned yet****.*
>
> *The target is* ***a crucial tool for companies****, especially large enterprises, to use as a reference when setting their business plans, Yu told Caixin in an interview on March 31.* ***"If they don't have a GDP target number at all, they can't make their business plans****," he said.*
>
> *Policymakers should come up with a "realistic" target based on the impact the coronavirus epidemic has already had on the economy and on expectations for the rest of the year, he said. "If we can make it to 4% that would be very good," he said.*

Sorry, no. You can't make it 4%