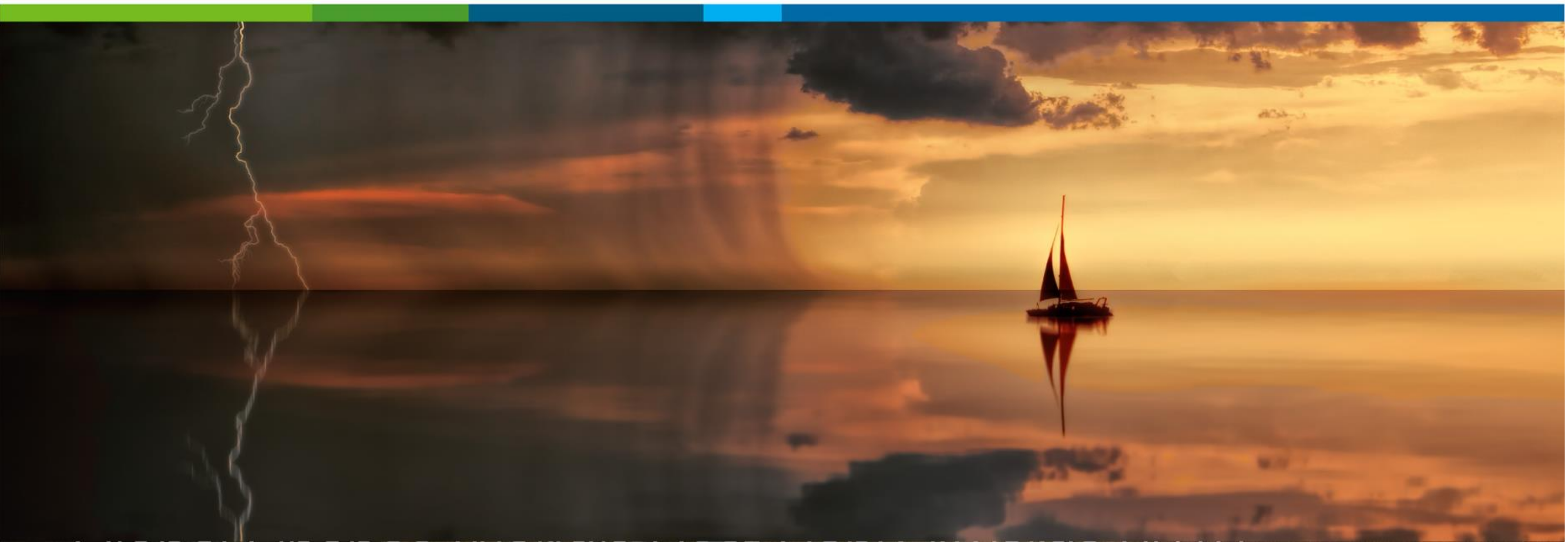

US: unprecedented contraction

The COVID-19 outbreak is set to hit US GDP hard in the second quarter, followed by a recovery towards the later part of the year. As a result, we have lowered our 2020 GDP growth forecast to -2.8 per cent (from -0.3 per cent).

On a positive note, we now expect a stronger 2021 recovery to 4.6 per cent (1.0 per cent previously), driven by aggressive fiscal and monetary stimulus.

For 2020, we predict a substantial rise in the US unemployment rate, from the current 3.5 per cent to 15 per cent, with some 20 million job losses. Business and residential investment is also likely to be severely affected in the second quarter, as demand collapses and uncertainty soars, despite government measures to provide support via loans and grants. We expect second-quarter GDP to contract by around 40 per cent quarter-on-quarter (10 per cent year-on-year).

However, based on China’s experience, we expect activity to recover as the virus is brought under control. Given the high degree of policy stimulus, we expect US GDP growth to turn positive again in the third quarter on a quarter-on-quarter basis.

There are some downside risks to our forecast: job losses could be twice as high as we expect, and GDP could contract by over 5.0 per cent.

Given the high degree of policy stimulus, we expect US GDP growth to turn positive again in the third quarter on a quarter-on-quarter basis.

Policy response – sizeable support

Our view is that the US Federal Reserve (Fed) wants to remove as many impediments to bank lending as possible and maintain sufficient USD liquidity in the financial system. It has announced a slew of monetary policy easing measures since 15 March: it cut the Fed funds rate 100bps, reducing the target range to 0-25bps and bringing total easing in March alone to 150bps.

On 23 March, the Fed announced that it will buy Treasuries and agency mortgage-backed securities in unlimited amounts and unveiled two new facilities that allow it to buy corporate bonds (including new issues) for the first time.

The government has announced three support packages so far, totalling some USD2.2-2.3 trillion, equivalent to 11 per cent of GDP, to provide wide-ranging support for the health-care sector, businesses, states, cities and individuals.

We expect the fiscal deficit to widen as a result of the support packages and have raised our deficit forecasts to 20 per cent of GDP in 2020 (from 4.6 per cent) and 17 per cent in 2021 (5.0 per cent).

Politics – it's the economy, stupid

The economic impact of coronavirus – especially on employment – will likely influence the outcome of November's presidential election, even though President Trumps approval ratings have risen since the Coronavirus outbreak.

Market outlook

We expect Fed buying to keep 10-year bond yields below 1 per cent at least through the second quarter. US Treasury yields have declined year to date, primarily due to the coronavirus crisis and consequent Fed policy easing.