Rosa & Roubini

MAKING SENSE OF *THIS* WORLD

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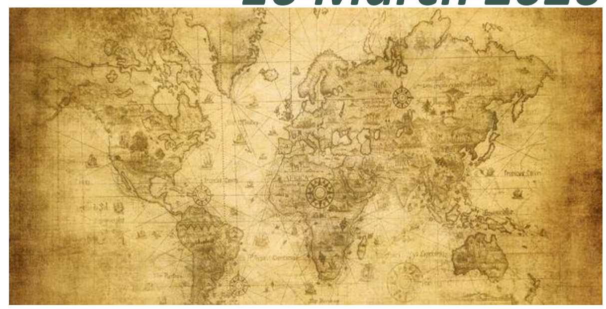
R&R Weekly Column
By Brunello Rosa



The World Is Likely To Be Radically Different After The Coronavirus Crisis

Now that the new Coronavirus (COVID-19) has officially been declared a pandemic by the WHO, an increasing number of countries are adopting measures to counter its spreading. Financial markets have collapsed as a result; it is clear that we are facing a serious health, economic and financial crisis. This is likely to be more serious than that in 2008-09, which was a banking, demand, and confidence crisis. This is a demand, *supply*, and confidence crisis, in which banks have not yet played a major role. In 2008-09 there was the element of uncertainty as to how low housing and asset prices would fall before finding a floor. Today, in contrast, there is a much larger element of uncertainty: How long will this crisis last?

In fact, the re-opening of economies even after the number of *new cases* is dropped to zero will remain gradual at best. Until a vaccine becomes available, the virus can always come back and force the authorities to close their economies all over again to stop the contagion. So, let us make the assumption that not until 12-18 months from now, if a vaccine then becomes available to everybody, will the end of the health emergency occur. For the sake of the argument, let us assume that we will be able to expedite the production of a vaccine to only 12 months from now. The world would then be in some form of emergency until Q1 2021. What will the world be like that will emerge from this crisis? We believe that the world in 2021 will be radically different from that which exists today.

In China , there will be two opposing forces. On the one hand, there will be the conviction that the regime was able to contain the virus in three months of very hard work, which in turn gave much of the rest of the world the template to use when attempting to contain the virus themselves. The regime could use this to strengthen its grip on society, and on any form of dissent, or against any emerging appreciation for Western values such as "privacy". On the other hand, the regime will at the same time be blamed for hiding the real nature of this pandemic for too long, causing the damage at global level that now plainly exists. Chinese society might also have to rethink some of its millennial traditions (including food and hygienic standards) that make China the origin of virtually every new flu strain. Overall, we believe China will come out stronger and even more modernised from this experience, even if its regime might need to make further strides to regain legitimacy and trust among the wider populace.

On the other side of the Pacific, there is the US, where the political leadership is held by a person, President Trump, who embodies of the polar-opposite attitude that led the Chinese to a rapid victory against the virus: indecisiveness, mis-representation of facts, open criticism of scientifically-proven theories in favour of his *gut feelings*, under-reaction followed by over-reactions. There is enough to make many people re-think the idea that a large and complex country like the US can be governed by virtually anybody so long as the "deep state" and its institutions are alive and well. Given its initial mistakes, the US will take much longer to rein in the disease. Perhaps the worst economic impact will be felt just before the November election, and therefore COVID could easily cost Trump the re-election. But the country will be shaken in its preference for relatively low personal and corporation tax levels at the cost of many public goods such as a universal healthcare system and good-quality education. The US has lost its supremacy in many domains versus China; this crisis will further shake its position as the world's leading country.

In between these two countries, there is the EU, which will face its most serious existential crisis since its foundation. The uncoordinated health and fiscal response to the virus, plus the arbitrary and unilateral closures of the borders (i.e. suspending the Schengen agreement) have, once again, shown the fragility of the European construct and the possibility of its collapse. The only truly pan-European institution has missed this opportunity to show leadership, as it did during its previous existential crisis, the Euro crisis, in 2012. The package of measures adopted last week was borderline adequate given the stage of the threat, considering that the package could be further expanded in coming months. But the ECB cannot afford mishaps such as that which was made by President Lagarde, when she said that "it's not the ECB's job to close the spreads within the EZ sovereign bond yields." In the absence of Eurobonds or EZ safe assets, it is precisely the ECB's job to ensure that the spreads remain compressed, in order to ensure the smooth transmission of monetary policy. Additionally, the ECB has a facility (OMT) specifically designed to close widening spreads unwarranted by market fundamentals. In addition, because most countries will move into forms of fiscal-monetary coordination, the EU, with its 27 fiscal regimes and several central banks, will have much harder time than the ECB would at implementing a similarly coordinated response to the crisis.

In conclusion, we believe that all the three main areas of the world will face serious crises of political legitimacy and, in the case of the EU, existential threats. Other countries and regimes will equally come under severe stress and could collapse as a result of this crisis. The rankings of countries at the global level will change drastically after this crisis, in many dimensions. We should prepare to see debt/GDP ratios approaching 150-200%, as often occurs during wartime. Global supply chains will be further disrupted; the tendency towards de-globalisation will be reinforced. Returning to the "new normal" will be another enormous task of world leaders in 2021; at least, for those leaders who will have politically survived.

Our Recent Publications

- Flash Preview: BOJ To Follow Global Central Banks And Ease Its Policy Stance, *by B. Rosa, F. Aladsani, N. Roubini, 13 March 2020*
- Flash Review: ECB Delivers Initial Easing Package Amid Market Route, *by Brunello Rosa, 12 March 2020*
- The UK Shows Initial Signs Of Policy Coordination Against Coronavirus, *by Brunello Rosa, 12 March 2020*
- ECB To Deliver An Easing Package To Counter COVID-19 Shock, *By Brunello Rosa and Farah Aladsani, 9 March 2020*
- UK Battling Over Brexit, Budget and Coronavirus, *by Nouriel Roubini and Brunello Rosa, 6 March 2020*
- **GEOPOLITICAL CORNER:** Joe Biden Has Risen From The Ashes, But Can He Beat Trump?, *by John C. Hulsman, 10 March 2020*

Looking Ahead

The Week Ahead: A Number of Central Banks Will Continue To Ease Their Policy Stance

In Japan, trading activity will sharply contract, due to weak internal and external demand (Imports Feb., c: -14.4% y-o-y; p: -3.5; exports, c: -4.3% y-o-y; p: -2.6). Inflation is expected to accelerate (CPI Feb., c: 0.8% y-o-y; p: 0.7; Core CPI, c: 0.9% y-o-y; p: 0.8). The BoJ is likely to remain on hold at (-0.10%), but will announce supportive policy measures, such as increasing its corporate bond and ETF holdings.

In the EZ, CPI inflation is likely to weaken (CPI Feb., c: 1.2% y-o-y; p: 1.4) while core CPI - excluding the impact of declining energy prices - will likely rise (c: 1.2% y-o-y; p: 1.1).

In Switzerland, we expect the SNB to act to make its policy stance more accommodative

In China, the PBoC is expected to lower its 1-year loan prime rate (LPR) by 10bp, to 3.95% (p: 4.05%).

In Turkey, the CBT will likely keep its interest rates unchanged at 10.75%.

The Quarter Ahead: Economic Disruption Ahead

According to the ***WHO***: *i)* COVID-19 is a 'pandemic', as the virus spread to more than 150,000 people globally; and *ii)* Europe is now 'the epicenter'. As cases decline in China, the country sent medical aid to deeply-hit economies, including Iran and Italy. So far, 20 countries implemented lockdowns, to try and contain the outbreak; more are likely to follow suit. All economies will endure: *i)* a 'supply-side' shock - e.g.: supply-chain disruptions will reduce output; and *ii)* a 'demand-side' shock – e.g.: consumers and businesses will freeze spending, precautionary savings will rise, demand for commodities will fall. Very large fiscal stimuli could help mitigate the economic impact: *i)* ***in the US,*** after a delayed response, President Trump declared a 'state of emergency', unlocking more than USD 50 bn of federal aid; and *ii)* ***in Germany,*** the government pledged 'unlimited cash' to the country's SMEs.

In the US, the Fed announced: *i)* it is accelerating its purchases of USTs, by buying USD 80 bn of USTs per month - including USD 20 bn to replace existing, maturing holdings; and that *ii)* purchases will include long-term government debt.

Last Week's Review

Real Economy: Governments Started Enacting Containment Measures. CBs Easing Intensifies.

In the US, on Sunday the Fed cut its Fed funds target range by 100bps to 0-25bps. It also re-started a program of asset purchases to the tune of USD 700bn, to be implemented in coming months. With other central banks (ECB, BOJ, BOC, SNB), the Fed has re-enacted USD swap lines, to ensure that global central banks have enough USD liquidity to meet their obligations.

The ***COVID-19 outbreak*** is starting to show in economic data. ***In the US,*** consumer sentiment fell (Michigan Consumer Sentiment Index Mar., a: 95.9; c: 95; p: 100), with a sharp drop in its forward-looking components. February's CPI inflation rose by 2.3% y-o-y (c: 2.2; p: 2.5) and core CPI by 2.4% y-o-y (c: 2.3; p: 2.3).

In the EZ, January's IP improved, yet remaining in contraction, at -1.9% y-o-y, (c: -3.1; p: -3.6). In February, economic sentiment dropped (ZEW Survey, a: 10.4; c: 30.0; p: 25.6). The ECB: *i)* kept its policy rates unchanged at 0%; *ii)* enacted additional TLTROs, to provide immediate liquidity support to banks; and *iii)* expanded QE, with EUR 120 bn of extra asset purchases.

In China, February's CPI inflation fell to 5.2% y-o-y (c: 5.2; p: 5.4).

In the UK, the BoE: *i)* announced its first emergency interest-rate cut since the financial crisis (a: 0.25%; p; 0.75), coordinating its move with the government's fiscal stimulus announcement; and *ii)* unveiled stimulus measures to incentivize banks to lend.

In Norway, Norges Bank delivered an emergency 50 bps cut, bringing the policy rate down to 1.00% - while stating it is 'prepared to make further rate cuts'.

Financial Markets: Sell-Off Across All Asset Classes, Equities Enter Bear Market (>20% Fall)

Market drivers: As the outbreak intensifies, financial conditions rapidly tighten and asset prices fall.

Stocks: w-o-w global indices fell (MSCI ACWI, -21.7%, to 451), driven by DMs (S&P 500, -18.5% to 2,711; Eurostoxx 50, -30.8% to 2,586). Volatility remains at historical highs (VIX S&P 500, +15.9pts to 57.8; 52w avg,: 16.3; 10y avg.: 16.8). On Thursday, Wall Street recorded its biggest one-day drop since 1987, followed by its largest one-day rally on Friday.

Bonds: w-o-w, returns on bond indices fell (BAML Global, -2.6% to 289.3), as yields on DM bonds rose: i) 10y UST yields (+25bps, to 0.95%); ii) German bunds (+14bps, to -0.59%); possibly, investors sold bonds to cover their losses elsewhere.

FX: w-o-w, the USD rose (DXY, +2.9% to 98.749), while the EUR fell (EUR/USD. -1.6% to 1.111).

Commodities: Oil posted its biggest weekly loss since 2008 (Brent, -25.2% to 33.9 USD/b), as: i) Saudi Arabia pledged to raise production, intensifying the supply surplus; and ii) OPEC lowered its forecasts for global oil demand growth to zero. Gold fell (Gold, -8.6% to 1,529 USD/Oz), as extreme market volatility compels investors to sell, and raise cash.

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The picture in the front page comes from this website

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	thousand	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*

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