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R&R Weekly Column
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Stock Markets Belatedly Correct on Coronavirus Concerns

At very long last, financial markets caught up with the reality of the coronavirus, selling off last week in the worst market performance since the Global Financial Crisis of 2008. As the Financial Times reported, "mounting concerns at the rapid spread of the coronavirus caused one of the quickest market corrections in the benchmark US S&P 500 since the Great Depression in the 1930s."

As we have written in our in-depth report on the subject, market participants are finally realising the impact that COVID-19 could have on the economic performance of the countries that have been most affected by the disease. In our column on the potential impact of COVID-19 (which we published a month ago already), we warned that the downside risks posed to the global economy by the public reaction to the virus could be huge, possibly greater even than the virus itself. In effect, last week market participants staged a panic reaction to the news coming from Italy, where entire cities were quarantined in the country's northern region, which is the industrial powerhouse of the country, with Milan, the financial capital of the country, being the epicentre.

Since then, the situation has not improved: the number of infected people and fatalities worldwide have risen (albeit at a slower rate than in previous weeks), surpassing 85,000 and 3,000 respectively. At the same time, the number of people who have recovered from the disease has also increased, surpassing 42,000. Most importantly, the US has suffered its first fatality from COVID-19 (near Seattle). This could mark the beginning of a new phase in the crisis. In fact, as we have already said, unless the pathogen mutates suddenly in coming months, the mortality rate will remain relatively low, around 2% globally of those who become infected with it. Nevertheless, the economic impact of the virus will derive from the *reaction* of governments to the news about it. No politician wants to be blamed for not having taken sufficient action in response to the virus. The first reaction from the US was the suspension of certain flights from the US to Northern Italy. As the number of cases and deaths increases in the US, however, so too will the escalation in the counter-measures the government takes. The economic impact of severe counter-measures in the US would take the economic impact of COVID-19 to a different order of magnitude, and would have a global economic impact. A global recession in 2020 is now becoming a real possibility.

The countries that have experienced the largest number of cases of infection show that the economic impact of the virus could be large, and might not necessarily be V-shaped as had been optimistically assumed by some commentators until just a few days ago. In China, the manufacturing PMI has collapsed to 35.7 in February, down from 50 in January, marking a new all-time low. Any figure below 42 in China signals an outright contraction in activity. The GDP in China, Japan, South Korea and Italy will contract sharply in Q1, and perhaps also in Q2. Fiscal packages to ease the sharp fall in economic activity are in the process of being approved in those countries. The latest is the EUR 3.6bn package announced by Italy on Sunday. These measures will help to a certain extent, but ultimately will not be able to achieve much. In particular, monetary policy, which will likely become more expansionary at the global level pretty soon, is likely to prove impotent against a supply-side shock.

Considering all of this, it is clear that market participants should brace themselves for more volatility and corrections in the weeks and months ahead. The impact of Coronavirus on global economic activity will be large and persistent. The policy response will be slower, smaller and less effective than expected. This will necessarily have to be reflected in the valuation of risky asset classes. Fasten your seatbelts.

Our Recent Publications

- Flash Previews: BOC and RBA To Remain on Hold In March, While Sounding Dovish, *By Brunello Rosa, 28 February 2020*
- COVID-19 Will Trigger a Massive Shock to the Global Economy and Markets, *By Nouriel Roubini and Brunello Rosa, 25 February 2020*
- Thuringia-Gate Has Decisive Consequences For Both Germany And Europe As A Whole, By *John Hulsman and Brunello Rosa, 25 February 202*
- **GEOPOLITICAL CORNER:** Brexit Painfully Illuminates Europe's Weakness, But Is There Light at the End of the Tunnel?, *John C. Hulsman, 11 February 2020*

Looking Ahead

The Week Ahead: US Manufacturing PMI And NFP Are Expected To Fall

In the US, February's manufacturing PMI is expected to slightly fall, but remain above the 50-benchmark (c: 50.5; p: 50.9). In the labor market: *i)* nonfarm payrolls are expected to decline to 178k in February (p: 225k); while *ii)* the unemployment rate is expected to remain at 3.6%; and *iii)* average hourly earnings is expected to improve to 3.2% y-o-y (p: 3.1%).

In the EZ, CPI inflation is expected to fall in February (c:1.3% y-o-y; p:1.4%), while core CPI inflation is expected to remain muted at 1.1% y-o-y.

In Australia, the RBA is expected keep its interest rates in hold, at a record low of 0.75%.

In Canada, the BoC is also expected to leave its benchmark overnight rate unchanged, at 1.75%.

The Quarter Ahead: COVID-19 Uncertainties To Rise

The ***COVID-19 outbreak*** is expected to materially disrupt the global economy, by depressing: *i)* China's Q1-2020 growth; and *ii)* the rest of the world, via demand and supply shocks (i.e. spillovers).

Global GDP growth is likely to weaken significantly. WHO's director general, Mr. Tedros Adhanom, said "the outbreak has pandemic potential", as the number of countries with confirmed cases reached 64. Globally, disruptions to the medical supply chain and shortages of critical medical products are likely.

In the US, the Navy denounced a Chinese military warship "for firing a grade laser at US Navy P-8 surveillance aircraft" while it was flying over the Pacific Ocean. The Pentagon emphasized that 'China represents an increasingly serious threat to regional security' – increasing geopolitical tensions. Investors, unconvinced by the Fed and ECB's 'wait and watch' stance, anticipate 'interest-rate cuts'. Fed Fund futures price in a 95% probability (p: 0%) of a 25bps rate cut in March, and an 87% prob. (p: 2%) of a 75-100bps cut in June.

In the EZ, OIS rates suggest a 100% probability of a 10bps interest rate cut by the ECB over the summer.

In China, to cushion the coronavirus impact, the PBoC: 1) authorized USD 42.9bn as 're-lending quota' to support agricultural entities and SMEs; and 2) injected an additional USD 71.5bn in 'funding support for SME lending'.

Last Week's Review

Real Economy: Global Growth Hindered By Coronavirus: Central Banks Keep Or Move To An Easing Bias

In the US: 1) the economy grew at 2.1% y-o-y in Q4 (c: 2.1%; p: 2.1%); 2) January's durable goods orders (excluding defense) – a key measure of business investment – rose by 3.6% (c: 1.3%; p: - 1.9%), the biggest increase since June 2017; and 3) January's PCE rose to 1.7% y-o-y (c: 1.7%; p: 1.5%), while core PCE slightly increased to 1.6% y-o-y (c: 1.7%; p: 1.5%).

In China, February's manufacturing PMI dropped to 35.7 (c: 45.7; p: 51.1), below the 38.8 figure reported in November 2008, at the start of the global financial crisis. The non-manufacturing PMI – a gauge of sentiment in the services and construction sectors – also dropped to 29.6 (c: 50.5; p: 54.1), the lowest since November 2011.

In Japan, January's IP data beat market expectations, improving to -2.5% y-o-y (c: -9.5%; p: -3.1%).

In Turkey, the economy grew at an annualized rate of 6.0% y-o-y in Q4-2019 (c: 5.0%; p: 1.0%), the second consecutive quarter of economic growth and the strongest since Q1-2018, driven mainly by: *i)* household consumption; *ii)* government spending; *iii)* services sector recovery; and iv) industrial production. As a result, the trade deficit jumped by 94.3% to USD 4.45bn in January (p: USD 2.29bn).

Financial Markets: 'Risk-Off' Driven By COVID-19 And Lower Global Growth. Oil And Gold Rise.

Market drivers: The COVID-19 outbreak weighed on financial markets, and Wall Street suffered the worst week since the 2008 GFC.

Stocks: w-o-w global indices fell (MSCI ACWI, -10.5% to 513), driven by DMs (S&P 500, -11.5% to 2,954; Eurostoxx 50, -12.4% to 3,329). Volatility spiked to its highest level since the 2008-09 financial crisis, surpassing levels reached during the market selloffs of 2011, 2015, and 2018 (VIX S&P 500, +23pts to 40.1; 52w avg,: 15.1; 10y avg.: 16.7).

Bonds: global bonds rose (BAML Global, +0.8% to 293.3), while the yields of safe haven sovereign bonds plunged: 10y UST yields hit a new record low (-34 bps to 1.13%). In EZ, yields fell across the board, led by Germany (-18bps to -0.61%).

FX: w-o-w, the USD fell (DXY, -1.1% to 98.132) as COVID-19 cases in the US rose, while the EUR edged up (EUR/USD. +1.7% to 1.103) on: i) positive economic data; and ii) expectations of fiscal policy measures to tackle the COIVD-19 outbreak. Despite a weakening USD, all EM currencies depreciated, and the TRY was hit by the developments of the conflict in Syria.

Commodities: Oil prices suffered their biggest weekly drop since 2008 (Brent, -13.6% to 50.5 USD/b) as the spread of the COIVD-19 created fears that a weakening global demand could dent the global economy. Gold fell w-o-w (Gold, -3.6% to 1,585 USD/Oz), the biggest single-day slide since 2013.

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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*