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Reassessing the 2019-nCov implications

Recent developments suggest that the spread of the virus might continue around the world before we see some positive newsflow resulting from quarantine measures put in place.

Global financial markets have reacted strongly to rising concerns over the spread of novel coronavirus outside of China with a double dip in stocks. Market risks remain to the downside as the earnings outlook remains currently uncertain.

The 2019-nCoV has introduced new uncertainty to markets with the spread outside of China. Consumer demand is being reduced, tourism has fallen up to 90% in China and supply-chain disruptions in several sectors might be envisaged if the contagion coefficient* (currently between 2.5-5) of the virus does not fall below 1 in the near-term.

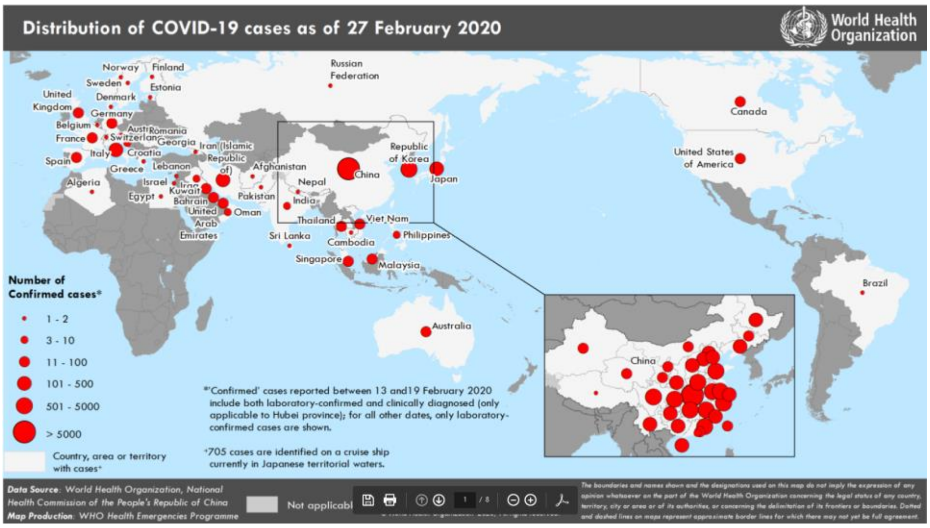
*Contagion coefficient (R0 or “R naught”) is a mathematical term indicating how contagious an infectious disease is. If R0 is more than 1, each existing infectious case causes more than one new infection. The estimation of the coefficient is based on assumptions about the time delay between infection and diagnosis and the incubation period

2019-nCoVID beyond China

Since our last update on Coronavirus earlier in February, overall markets have been caught by surprise by how fast the virus has spread beyond China with major outbreaks in Korea, Italy and Iran. Within less than one week from 19th February to 27th February the number of confirmed cases in Korea has jumped from 31 to over 1'766 (out of which 1'385 cases in the last 5 days).

According to the latest report from the WHO, as of February 27th 2020, there are 82'294 globally confirmed cases and 2'814 deaths (vs 71'709 confirmed cases and 1'775 deaths as of 16th February), the vast majority of which occurred in China (78'191 and 2'747 deaths). Outside of China the latest number of confirmed cases is 3'664 and 57 deaths, affecting 46 countries.

Italy is the third largest basin of infectious cases, with 14 deaths and over 400 ascertained infections. In the aftermath of the outbreak in Italy, some regions have locked down a few towns to contain the spread of the virus, and put in place through a decree extraordinary measures mandating among others the suspension of events, as well as gatherings in public or private places, of education services (i.e. schools and universities) and the closing to the public of museums and public offices.



Source: World Health Organisation as of 27.02.2020

The global situation appears to have changed. On the one side, within China, which undertook draconian and unprecedented measures (closing down factories, construction sites and even entire cities) to reduce the spread, as well as to get the outbreak under control, the peak seems to have been reached and after a 2-3 week negative newsflow, some *centers* are trying to slowly get back to "normality" while still under severe controls imposed by the Chinese authorities. Probably no other country has the capacity to impose China-like quarantine measures.
On the other hand, currently new cases are reported mainly outside of China (meaning that the measures taken there seem to be working) and we do not expect the newsflow in other regions to improve prior to the next 3 weeks, when in many parts the quarantine measures imposed will show their effect.

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Macroeconomic impact

According to the figures released by the State Council press conference of the People's Republic of China, work resumption rate is currently around 30%. In a few provinces which are less impacted, the rate is over 70%. The current assumption is that by mid-March, most of the provinces are expected to see close to full work resumption (if no unexpected rise of contagion led by worker migration is assumed). If this is the case, Q1 2020 GDP growth rate could still surprise the market on the downside, with early March PMI figures being key; However, Q2 2020 GDP growth could surprise on the upside. More specifically, measures announced in China include fiscal aspects (tax and fee reduction to help SMEs go through difficulties, a more focused use of central government funds for epidemic prevention as well as an increased subsidy transfer to local governments to ensure salary payment and normal operations), whilst on the monetary side China stands ready to possibly introduce new monetary stimulus to ensure sufficient liquidity.

However, over the short-term this situation will take its toll on commerce, with smaller companies in China suffering interruptions that could cause them to default on their debt. Chinese consumers might spend less on domestic as well as on imported goods.

The financial community agrees that the current situation of the virus' first outbreak in China (which generates around 16% of global economic growth, and is a leading player in supply chains and the tourism industry) will impact negatively 2020 GDP growth forecast which has been revised down from 6%-6.2% to a range between 5.3%-5.5%. Further, Japan is also likely to be hit hard, having started the year quite weak following a sharp decline in economic activity. Across the board growth expectations for the first quarter in the Eurozone have also been downgraded. Earnings revisions might also be reviewed to the downside for 2020.

The US are somewhat more insulated from the Coronavirus and the infection could hit the US economy harder if markets sense that the economic damage will be more lasting, making it more difficult for the global expansion to continue.

Implications for markets and market reactions

Current inflation expectations are already trending lower because of the global virus outbreak and the negative market sentiment. As the virus spreads, we do expect company fundamentals to be impacted. Rate pricing for monetary easing has increased in the short-term, which pushed bond yields to very low levels. The market expects yields to rebound quickly if the virus impact on growth has reached its peak. Until then, there might be higher volatility in financial markets and further episodes of "risk-off" moves in equities, with government bond yields remaining at very low levels or moving even lower (i.e. in the US). On the contrary, credit markets have been largely resilient given strong technical demand, driven by huge inflows.

Within global equity sectors over the last two weeks (14.02-27.02.2020) all sectors were negative with Energy (-13%), IT (-12.7%), Industrials (-10%) and Consumer Discretionary (-10.1%) giving up the most. In terms of regions the MSCI-US was down (-11.9%), the MSCI-Europe (-9.5%) and the MSCI-EM (-6.8%). Crude oil lost more than 12.4% over the period while gold, as a safe haven asset, gained 2.8%.

Bottom line

Heightened volatility is expected to continue as uncertainty dominates. We cannot predict the future but we prepare for it and maintain a more cautious outlook for risky assets. Moreover, we expect the intra-sector and industry return dispersion to persist in the near future. However, past epidemic crises have shown that the economic impact is usually sharp and temporary. The longer and larger the spread of the virus, the less likely a V-shaped recovery in growth will be. Historical epidemics show that markets recover relatively quickly.

Data source: Statestreet / Factset