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## Coronavirus impact and response: A global view

Weekly Market Compass: What can we learn from the hardest-hit countries, and what does this all mean for markets?

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Mar 23, 2020 | Kristina Hooper, Chief Global Market Strategist

Every morning, my day begins by discussing the latest developments in the coronavirus fight with my team of strategists on-the-ground in Hong Kong, Italy, London, Tokyo, New York and elsewhere. Today, my weekly blog features several members of Invesco's Global Market Strategy Office, who answer the most pressing questions they've been hearing from investors who are concerned about COVID-19 and its impact on the global economy.

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**What did China do right, and is economic activity really returning?**

**David Chao (Hong Kong):** Chinese authorities acted late to contain the mysterious illness, and they then had to resort to extreme social-distancing controls and lockdown measures. Despite being disruptive, these measures have achieved effective results: For example, two months after the government locked down Wuhan on Jan. 23, the Ministry of Health has reported no new infection cases.<sup>1</sup> The new infections curve in China was also flattened through large-scale virus testing, which led to more accurate diagnosis and ultimately slowed the contagion.

That being said, China is still not out of the coronavirus woods yet. The country has shifted its attention from preventing the domestic spread of the disease to preventing foreigners from bringing the contagion back into China.

These extreme health control measures have come at a steep cost. Beijing sacrificed near-term economic growth,<sup>2</sup> recently reporting its worst monthly economic data on record,<sup>3</sup> which will likely translate into flat or negative gross domestic product (GDP) growth in Q1.

Demand-driven economic activity remains soft, including land transactions and rail and air travel. But production activities are rebounding, including freight transport and coal consumption, and many people are returning to work – as of last week, the work return rate reached above 95% for large industrial companies and around 60% for small and mid-sized enterprises.<sup>4</sup>

The Chinese economy is seeing healthy increases in credit demand and money supply growth. These developments are encouraging and – when coupled with recent monetary stimulus from the People's Bank of China and a widely expected significant fiscal stimulus – point to the potential for China's economy to experience a V-shaped recovery.

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**What can we learn from South Korea?  
What is the situation in Japan?**

**Tomo Kinoshita (Tokyo):** South Korea's efforts to combat coronavirus yielded impressive results. After a dramatic increase in cases through the first week of March, driven by a surge among participants in a large religious gathering in Daegu, the number of daily new patients has dropped to only approximately 100 over the past week.<sup>5</sup> The slower pace of spread is due to the Korean government's aggressive measures, including testing as many potential patients as possible (including via drive-through testing), providing testing and treatment free of charge, and closing schools. While there still is a risk of an explosive increase, the situation is stabilizing.

In Japan, the government was widely criticized for how it handled a large cruise ship case early in the outbreak. But it also took bold actions from an early stage. On Feb. 26, Prime Minister Shinzo Abe publicly asked organizers of national-level major events (such as sports and cultural events) to cancel, postpone, or downsize those events. He also asked all primary, secondary, and high schools to terminate classes from March 2 until the end of this school year (which normally runs to the end of March). An explosive increase in patients cannot be ruled out in the near term as Japan continues to have daily new cases with untraceable sources. But for now, Japan is not in a crisis situation on an epidemiological front.

On an economic front, Japan's consumption has been deteriorating since the majority of the population has generally refrained from going out for dining and non-essential activities. Responding to the prospect that negative GDP growth is very likely for the second and third quarters, the Abe administration announced that it would reveal a significant fiscal package in April, which would add fiscal firepower to the existing fiscal easing measures incorporated in the fiscal year (FY) 2019 supplemental budget and FY2020 general budget.

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### **What is the situation on the ground in Italy?**

**Luca Tobagi (Milan):** The COVID-19 emergency in Italy is still proving very complicated to manage. The number of infected people keeps increasing, and we have not yet seen a meaningful slowdown in growth rates in the North, notwithstanding three weeks of lockdown with increasingly tight containment measures. Those measures are not yet as draconian as those we saw in Hubei province in China, but Italy has already closed all schools and all places where people can gather, from bars and restaurants to movie theaters and churches. The Army is starting to patrol the streets in some cities in order to support the tighter containment measures.

The number of deaths has risen rapidly, mostly among elderly people, and has surpassed China. However, the biggest problem is that the Italian health care system is under serious strain. If we do not see a slowdown in the contagion soon, it might not have the capacity to treat all patients. This is a cautionary tale for the US and other countries. The more containment measures that can be adopted now, the better.

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### **What is the state of the monetary and fiscal policy response globally?**

**Arnab Das (London):** Monetary policy coordinated closely with fiscal policy are key lines of defense against the economic blow of the coronavirus. Major central bank responses have included rates near or below zero, a sharp rise in quantitative easing (QE), a revival of crisis programs such as Federal Reserve funding of commercial paper and primary dealers, and more.

The Fed's sharp increase in intervention in the financial markets on March 23, with Treasury fiscal backstops for credit risk, should help stop the seizing up of major swaths of the US financial system including corporate and municipal credit markets, which would have otherwise impaired the provision of fiscal support for the US and global economies. This should also help alleviate the upward pressure on the US dollar, which has been severely tightening both US and global financial conditions.

Looking forward, two questions stand out:

#### **1 Given such low rates and large balance sheets, what more can central banks do?**

A lot: QE programs can be expanded, limits on the European Central Bank's QE program can be loosened or lifted, Fed asset purchases can be expanded from Treasuries and mortgage-backed securities to include

corporate debt, Fed dollar swaps can be extended to more central banks, and bank liquidity coverage ratios and high-quality liquid asset holdings can be eased to reduce strains in US dollar funding. The last three would require legislation and a Treasury backstop against credit risk.

## 2 How do we know enough is being done?

The US dollar is the single most-important indicator. Whenever the dollar surges, the Fed should get back on the case, providing all the dollar funding required to ensure markets operate and clear. Second, “safe-haven” bond yields – especially US Treasury yields – should fall when risk assets are under pressure; if they don’t, the Fed should offer more liquidity.

In terms of fiscal policy, governments everywhere are stepping up to the plate with spending, lending, and guarantee programs. The UK has gone furthest, and France and Germany are floating fiscal plans. Italy’s plan is far too small for the country hardest hit by the pandemic, but relaxation of European Union fiscal rules paves the way for more. We expect the US to act too as lockdowns spread across the country. US fiscal support is taking shape, but is already taking longer because Congress must work with federal, state, and municipal governments – but pressures in labor, credit, and muni bond markets already show the need. The key goal of fiscal programs is for public spending to tide the economy over by cushioning sharp falls in private spending as governments impose social-distancing lockdowns, people prioritize basic needs over discretionary spending, and firms respond with their own spending cutbacks in staff, purchasing and investment.

How long will such emergency support last? In such a severe, sudden shock, we believe governments must come in, and in a big way. Support will be needed until the coronavirus is credibly contained, perhaps months, quarters, or even a year from now (as more governments are starting to acknowledge). Eventually, the economy should recover and tax revenue rise, so both public spending and public debt can be slowly reduced. But if societies do not act in this way, the economy could emerge from the pandemic significantly smaller with lower potential growth rates given major, long-running job losses, widespread bankruptcies, and greater wealth destruction.

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### What is the potential hit to US GDP?

**Brian Levitt (New York):** It is evident that containing the spread of the coronavirus requires social distancing and isolation. The ultimate loss of US economic activity will be difficult to estimate with any precision. Consider that roughly 50% of the US economy is driven by non-health care related consumption.<sup>6</sup> Industries such as general merchandise and other retail, transportation, and arts and entertainment account for over \$2 trillion in US economic output, suggesting that approximately 10% of the economy will now exhibit limited activity for weeks, if not longer.<sup>6</sup> For example, US restaurant bookings have declined 56% from 12 months ago (the number is the same globally).<sup>7</sup> Jobless claims are already rising rapidly<sup>8</sup> and will likely hit all-time highs. The next couple of quarters will likely produce declines in economic activity globally, the likes of which we have never seen, including during the 2008 global financial crisis. It is no longer a question of whether there will be a recession, but rather the magnitude and duration of the recession. Policymakers will continue to work to support the global financial system and to provide bridge support to households, businesses, and communities.

We maintain confidence that pent-up demand will build during this prolonged period of social distancing and will support growth later in the year, assuming the virus is ultimately contained. However, we temper our expectations

for the recovery as we expect a ripple effect on future consumption due to the rise in the number of furloughed or unemployed workers. Ultimately, we would expect deep contraction in US economic growth for the next couple of quarters, followed by an economic recovery driven by pent-up demand (the greater the fiscal stimulus, the sharper the economic recovery is expected to be; the smaller the fiscal stimulus, the more modest the outlook for economic recovery). Fortunately for investors, history suggests that financial markets bottom four months before the trough in economic activity.<sup>9</sup>

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#### **What are your thoughts about equity and bond markets?**

**Talley Leger (New York):** Near-term chaos can create long-term opportunities for patient investors. We're starting to see the kind of despair that kills old bull markets and gives birth to new ones. To be clear, bottoming is a process, and virus-related uncertainty could continue to weigh on markets until the number of new cases outside of China peaks and/or the fiscal response becomes coordinated and forceful. However, indications of excessive caution in the marketplace suggest savvy investors should start considering opportunities to be contrarian when others are fearful.

**Tim Horsburgh (New York):** Treasuries, commercial paper, municipals, investment grade credit, and high yield credit have all shown significant signs of systemic stress, with echoes of 2008, during the recent sell off. Amidst this turmoil, bid/ask spreads have hit levels not seen since 2008-2009. We don't believe that the US fixed income market is fundamentally broken, however. This volatility is likely more a function of lower dealer inventory and heavy selling pressure rather than a breakdown in the market. Trades and new deals are still getting completed.

With spreads wide by historical standards, investment grade US corporate credit looks attractive to us relative to US high yield given the greater flexibility and financial stability inherent in many high-quality borrowers. In an environment of heightened stress and dislocation, a rise in defaults is almost assured at this point. High-quality names should be able to better absorb the financial hits looming. Within the large universe of BBB bonds, we will likely see some downgrades into high yield territory as this crisis progresses. However, we don't expect this to overwhelm the high yield universe. Many (but not all) BBB borrowers have financial room to maneuver in order to maintain that rating, even in this current crisis, preventing a wider wave of downgrades.

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#### **What is an asset allocator to do?**

**Paul Jackson (London):** Diversification is more important than ever but is harder to achieve than usual, given that assets have been moving together.

My favored "defensive" assets are cash and gold. I currently favor a barbell approach of combining cash and gold with commodities and real estate (REITs), which are the cyclical assets that I think have the most upside under our more optimistic scenarios.

Equities are also an important part of any long-term investor's portfolio. Equity markets that I believe have the most upside in the shorter term include the UK and Japan.

Investment grade credit seems to offer a good combination of risk, reward, and diversification. I am, however, more wary of high yield credit.

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## Conclusion

**Kristina Hooper:** I value the input of the seasoned strategists in the Global Market Strategy Office, and I believe their experience and knowledge can help us put today's tumultuous events into perspective. We have all lived through a range of economic and market crises, which enables us to look beyond the short-term turmoil and to take a measured approach with a long-term view. It is our greatest priority to serve our clients in this difficult time, and we are committed to providing you with regular commentary and insights as we work through this crisis together.

You can find further commentary from this team and from our portfolio managers here: [What investors need to know about the coronavirus](#).

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### Source

<sup>1</sup>Source: National Health Commission of the People's Republic of China

<sup>2</sup>Source: National Bureau of Statistics of China, "Total Retail Sales of Consumer Goods Went down by 20.5 percent in the First Two Months of 2020"

<sup>3</sup>Source: Financial Times, "Chinese economy suffers record blow from coronavirus"

<sup>4</sup>Source: China's Ministry of Industry & Information Technology

<sup>5</sup>Source: Yonhap News Agency as of March 23, 2020

<sup>6</sup>Source: Bureau of Economic Analysis, Dec. 31, 2019

<sup>7</sup>Source: Booking.com, March 19, 2020

<sup>8</sup>Source: US Department of Labor, March 19, 2020

<sup>9</sup>Sources: Bloomberg, L.P.; Strategas Research Partners, Dec. 31, 2019

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### Important information

Diversification does not guarantee a profit or eliminate the risk of loss.

Quantitative easing (QE) is a monetary policy used by central banks to stimulate the economy when standard monetary policy has become ineffective.

Safe havens are investments that are expected to hold or increase their value in volatile markets.

A shared dollar swap line is a temporary reciprocal agreement between central banks to trade currencies at the current exchange rate.

The bid-ask spread is the difference between an asset's ask price and its bid price.

Fluctuations in the price of gold and precious metals may affect the profitability of companies in the gold and precious metals sector. Changes in the political or economic conditions of countries where companies in the gold and precious metals sector are located may have a direct effect on the price of gold and precious metals.

Commodities may subject an investor to greater volatility than traditional securities such as stocks and bonds and can fluctuate significantly based on weather, political, tax, and other regulatory and market developments. Investments in real estate related instruments may be affected by economic, legal, or environmental factors that affect property values, rents or occupancies of real estate. Real estate companies, including REITs or similar structures, tend to be small and mid-cap companies and their shares may be more volatile and less liquid.

The opinions referenced above are those of the authors as of March 23, 2020. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.