Monthly Newsletter Savings and Investments

High volatility in markets due to uncertainty about the impact of the coronavirus outbreak on the global economy

March 2020

Market overview

In February, the coronavirus (COVID-19) outbreak replaced trade as the main focus for the markets. During the last week of February, we saw one of the fastest weekly stock market declines due to the news that the coronavirus was spreading rapidly outside China, including the risk of a pandemic that might severely affect economic growth and corporate earnings worldwide. Central banks and other government authorities reacts to this with news about countermeasures. However, so far it had mixed share price reactions. It is now obvious that the virus outbreak will have an impact on Chinese economic growth and, to a lesser extent, global growth during the first quarter of 2020. The question is how deep the slump will be and how long it will take before production resumes on a normal scale. Various factors complicate the outlook. First and foremost, of course, is the fact that no one knows how long accelerating spread of the virus outside China will continue. It is also hard to predict the scale of countermeasures by central banks and governments and how these actions can be coordinated to have the best impact. We agree that the risk of a sharp economic slowdown has risen, but our main scenario is that this need not trigger a recession. When it comes to equities, we will have to live with continued higher equity price fluctuations in nearest future. If we see stabilization in Covid-19 there is significant upside in equities given the global monetary stimulus. Investors were reluctant to buy into the Q4 2019 rally and will be reluctant to buy into the Q2 2020 rally that we will see if Covid-19 starts to fade. If Covid-19 continues to spread and western world companies and governments are forced to shut down production and services, in that scenario there is, naturally, further downside in equities.

Stock market indexes' performance (until 29 February 2020)

Region	Index	Currency	Performance							
			2020 Feb	2020 YTD	12 Months	2015	2016	2017	2018	2019
USA	S&P 500	USD	-8,4%	-8,6%	6,1%	-0,7%	9,5%	19,4%	-6,2%	28,9%
Europe	MSCI EURO	EUR	-8,3%	-10,1%	-0,3%	6,1%	1,7%	8,7%	-14,2%	22,0%
Eastern Europe	MSCI EM Eastern Europe	USD	-14,2%	-17,7%	-3,5%	-8,1%	33,0%	12,9%	-8,3%	26,9%
Asia	MSCI EM Asia	USD	-2,9%	-7,3%	-0,8%	-11,8%	3,8%	40,1%	-17,3%	16,6%
Latin America	MSCI EM Latin America	USD	-12,3%	-17,3%	-14,5%	-32,9%	27,9%	20,8%	-9,3%	13,7%

Major events and expectations

Recently we saw one of the fastest weekly stock market declines. What finally triggered the latest global stock market decline was the news that the coronavirus was spreading rapidly outside China, including the risk of a pandemic that might severely affect economic growth and corporate earnings worldwide. So far, the scale of the downturn is not so unusual or alarming. Recent years have witnessed similar or larger downturns more than once – for example in early 2016 and especially in late 2018, when equity indices plummeted by nearly 20%.

Countermeasures by central banks and other government authorities. In reaction to virus outbreak, authorities in many countries reacted to minimize the spread risks in the infection process itself. In addition, economic-policy efforts have already been launched in China and fiscal policy measures in other countries as well, Italy and South Korea announced extra stimulus packages. Central banks globally started talking about coming with rescue measurements, and few of the already did it.

Emergency Fed rate cut. Before the last week of February, the market foresaw a 6% probability of the Federal Reserve (Fed) rate cut in March. By Feb 28, expectations of such action had risen to 95%. On March 3, Fed Chairman J. Powell announced that policymakers at the US central bank had voted unanimously for a 0.5% emergency cut in the federal funds target range: from 1.50-1.75% to 1.00-1.25%, effective immediately. The US stock market initially rose after the announcement, but soon resumed its downturn and the 10-year Treasury yield fell to below 1.00% for the first time. Our latest forecast is that the US central bank may also reduce rates by an additional 0.25% at the ordinary policy meeting on March 17-18.

After historical weekly decline, so far we have mixed share price reactions to the news of countermeasures by central banks and other government authorities. Over the next few weeks we are likely to see continued volatility in response to disturbing news about new virus outbreaks and announcements of various countermeasures. **It is now obvious that the virus outbreak will have an impact on Chinese economic growth** and, to a lesser extent, **global growth** during the first quarter of 2020. The question is how deep the slump will be and how long it will take before production resumes on a normal scale.

Various factors complicate the outlook. First and foremost, of course, is the fact that no one knows how long we must live with an accelerating spread of the virus outside China. Another is how effective the steps taken to limit the spread of the virus will be and how many activities in our societies will have to be shut down. It is also hard to predict the scale of countermeasures by central banks and governments and how these actions can be coordinated to have the best impact.

The biggest problem is not the epidemic itself. The COVID-19 disease is of course the most important issue from a human perspective, but in economic terms it is the effects of shutdowns and how our worries affect consumption and business investments. According to the World Health Organisation (WHO), panic and fear may have a bigger negative impact than the virus itself.

After external shocks like this one, the world economy usually recovers fairly quickly. Companies catch up with and exceed lost production, in order to refill drawn-down inventories, and consumers make purchases that postponed during the crisis. Given the ongoing spread of the disease, we can no longer count on a rapid return to normalcy. If the epidemic leads to many months of restrictions on ordinary life, factory shutdowns and broken global supply chains, businesses may be forced to cut costs and lay off employees. If so, the impact will be more lasting and lead to lower long-term growth. Such a scenario might cause the world economy to slide into recession. One important reason behind stock market downturns is that the risk of recession has increased. **We agree that the risk of a sharp slowdown has risen, but our main scenario is that this need not trigger a recession**.

In China, the increase in the number of new COVID-19 cases began to fall about one month after the authorities imposed travel restrictions and shutdowns. Along with preparations there and elsewhere aimed at limiting the spread of the virus, this suggests that the situation can be brought under control before businesses are forced to take drastic steps. Official stimulus measures will also help by improving the general economic mood, and targeted actions to support businesses are now being discussed in many countries.

GDP forecasts revised downward. Due to the impact of the virus, all major organizations globally are downgrading global economy growth forecasts for this year. The Organisation for Economic Cooperation and Development (OECD) has slashed its forecast of global gross domestic product (GDP) growth in 2020 from 2.9% to 2.4%. Meanwhile the OECD raised its 2021 forecast from 3.0% to 3.3%, which thus represents a recovery. At the end of February SEB lowered 2020 GDP growth forecast for China from 5.7% to 5.5%. Chinese output has begun to recover, though slowly. According to SEB's Asia strategist, at the current pace China might be back at about 90% of normal production by late March.

Other news. **In US**, the Democratic presidential contest gained much attention on March 3 with so called Super Tuesday – primary elections in more than a dozen states representing about one third of delegates to this summer's convention, which will choose the party's presidential candidate. Joe Biden unexpectedly came out ahead of Bernie Sanders in more than half of the Super Tuesday primary states, but Sanders led in the biggest one: California. The New York Times now estimates that Biden is slightly ahead of Sanders in total convention delegates so far. **Escalating tensions around EU-UK trade agreement**. In Brussels, tensions are on the rise due to first round of trade negotiations between the European Union and the United Kingdom. The EU would like the UK to conform with future changes in EU competition, environment protection, taxation and labour market laws. For their part, the British would like full self-determination with regard to laws. We are sticking to our forecast that it will be extremely difficult for the EU and the UK to reach a trade agreement before the post-Brexit transition period ends in December. One positive development on the trade agreement front, however, is that the US noted that the Chinese have begun taking steps to implement the recent Phase 1 trade pact between the US and China, which included major increases in Chinese purchases of US farm products.

Conclusion. We will have to live with continued higher equity price fluctuations and with the risk of new stock market slides. Unfortunately we cannot reject more negative news about the worldwide COVID-19 outbreak, but we are also likely to see new countermeasures and stimulus. Given this situation – and good prospects for slowing the spread of the virus within months rather than quarters – we expect economic growth to revert to normal levels by next year. The combination of lower interest rates and fiscal stimulus programmes may even enable the economy and stock markets to emerge from this with better potential than before. If we are right about this uncertain forecast, it means there will be good buying opportunities this spring for those who are willing to take risks. At this writing, however, we consider the risks and uncertainties too great to justify a higher risk level right now.