Monthly Newsletter Savings and Investments

Hopes of a return to more open economies decreased market tension, but uncertainty persists

May 2020

Market overview

Stock markets rebounded strongly in April after the shock and huge decreases in March. Volatility in markets also declined significantly from extreme levels in March. Coronavirus continued to spread globally, but the pace of infection spread in some countries started to slow. Countries are now planning to gradually reopen their economies and already started to do that. Meanwhile, governments and central banks introduced very significant stimulus measures to reduce the damage caused by the economic shutdown, restoring some positive sentiment to markets. The Q1 corporate report season is substantially worse than last year, but somewhat better than feared. The main impact of the coronavirus pandemic will not be visible until corporate reports for Q2, which will be published this summer. However, despite April's market rebound, considerable uncertainty remains over the global growth over the coming quarters. A lot will depend on the extent to which economies can successfully reopen. Lately the worries and risk of second Covid-19 wave increased. Further high volatility is expected in markets.

Stock market indexes' performance (until 30 April 2020)

Region	Index	Currency	Performance							
			2020 April	2020 YTD	12 Months	2015	2016	2017	2018	2019
USA	S&P 500	USD	12,7%	-9,9%	-1,1%	-0,7%	9,5%	19,4%	-6,2%	28,9%
Europe	MSCI EURO	EUR	5,7%	-21,3%	-17,8%	6,1%	1,7%	8,7%	-14,2%	22,0%
Eastern Europe	MSCI EM Eastern Europe	USD	10,8%	-29,8%	-20,2%	-8,1%	33,0%	12,9%	-8,3%	26,9%
Asia	MSCI EM Asia	USD	9,1%	-10,8%	-7,9%	-11,8%	3,8%	40,1%	-17,3%	16,6%
Latin America	MSCI EM Latin America	USD	6,0%	-42,7%	-39,2%	-32,9%	27,9%	20,8%	-9,3%	13,7%

Major events and expectations

The economic recovery: more information about pandemic impact, but uncertainty persists. Our main scenario continues to be U-shaped economic trend. We now have the initial steep decline behind us and are moving along the bottom of the U, hoping that the trend will start climbing again relatively soon. But unlike the letter U, we must expect the ride back up to the old level to take far longer than the downward slide.

The economic outlook is still very uncertain, but gradually more bits of evidence are emerging that can be used in order to quantify various forecasts and scenarios. Estimates in Western European countries such as France and Italy indicate that 30-35% of economic activity had ceased when the lockdowns were at their broadest in April. This would mean that each month of this situation leads to a GDP loss of nearly 3% for the full year 2020. The Organisation for Economic Development and Cooperation (OECD) has presented estimates in which the corresponding effect in advanced economies as a whole is more than 2%.

The chronology of the pandemic and lockdown strategy will remain crucial to economic growth. In our main scenario, economies reopen gradually and cautiously during May. This implies that in Q3 there will be a relatively clear economic recovery as the pattern of consumption in some areas normalizes and industrial production that depends on functioning cross-border supply chains can restart. But in many other areas, it will take time before the situation normalizes. Travel restrictions, both domestic and international, will remain in place and greatly reduce tourism. Continued social distancing rules will inhibit large parts of the service sector.

The difference in GDP growth between countries will largely depend on how severely they are affected by COVID-19 and what lockdown strategy they have chosen. In countries like Italy, Spain and the UK, we expect full-year 2020 GDP to fall by more than 10%. Meanwhile the US, Germany and Sweden will manage slightly little better, with downturns of around 6-7%. Our forecast is based on the assumption that the degree of lockdowns in different countries will converge in the course of 2020, but contrasting views in the epidemiological debate indicate that a number of scenarios are possible.

Chinese recovery, but threats of new outbreaks. China's GDP fell by nearly 7% year-on-year in the 2020 Q1 after large-scale lockdowns in February. The country's recovery has now begun and is most apparent in manufacturing, where we estimate that production now totals 90-95% of its pre-crisis level, but the risk of new virus outbreaks and negative impulses from other countries will continue to hamper the economy. We expect full-year 2020 GDP to increase by only 2%.

Second wave of indirect effects this autumn. During the second half of 2020, we will enter a crucial phase with regard to the indirect consequences of lockdowns. Capital spending will be hampered by low capacity utilisation. Unemployment in various countries is expected to peak at 10-15%. This will exert downward pressure on home prices, which in turn will decrease household consumption. The commercial real estate market will also be hard hit, due to permanent closures of some shops and a reduction in the need for office space. Even though GDP growth in 2021 will look impressive, largely because of these forces we expect the GDP level at the end of the year to be well below our earlier forecasts. In the OECD countries as a whole, the gap is about 5 percentage points. This is one reason why unemployment will also remain far higher than we have become accustomed to in recent years. A combination of plunging nominal GDP and fiscal stimulus measures will lead to large budget deficits and cause public sector debt levels in many countries to climb by 15-20% of GDP.

Tensions between real-economy and financial market. The stress in financial markets culminated in late March. Since then, tensions in bond markets decreased and we have witnessed a robust stock market recovery. Central bank liquidity injections and the expansion of quantitative easing (QE) programmes have certainly played a major role. Another reason behind the stock market rebound is that the market has already made allowances for a sharp economic downturn this year and is now looking ahead towards better corporate earnings in 2020 and 2021. During crises and recessions, share prices often show a W-shaped curve. In the middle of a crisis, the market experiences a relief rally, which proves unsustainable, followed by a renewed downturn in share prices. In light of this, there are strong reasons to ask whether the stock market is being a bit too optimistic about the consequences of a second wave, which macroeconomists are now very concerned about.

Corporate earnings down in 2020, up again in 2021. The Q1 corporate report season is of course substantially worse than last year, but somewhat better than feared. The main impact of the coronavirus pandemic will not be visible until corporate reports for Q2, which will be published this summer. There is enormous uncertainty about both the supply and demand sides of the economy. For many companies, 2020 may turn out to be a lost year, but bright spots include pharmaceuticals, convenience goods and both goods and services for the home.

Corporate earnings forecasts for 2020 are adjusted down considerably. From expectations of profit increases of around 10% globally a couple of months ago, forecasts now point to profit declines of over 20%. Most observers, including us, expect earnings to regain a lot of lost ground during 2021 and probably also set the stage for earnings to continue increasing after next year. But already driving up share prices towards their earlier peaks is challenging, given the prevailing uncertainties and the sizeable dips in earnings curves we are now seeing.

Oil prices add risks in a nervous world. Low energy prices are normally positive for global growth, due to cheaper production costs for businesses and increased purchasing power for households. Today's low oil prices are instead a destabilising factor, especially for oil-producing emerging market economies. Plunging oil prices since January have mainly been due to sharply falling demand during the pandemic. Early in March, Saudi Arabia also chose to start a price war. In April this led to an agreement by the hard-pressed OPEC+ countries to reduce their production by about 10%, but many observers believe that the COVID-19 crisis has lowered near-term demand by as much as 20-30%. This is likely to require additional production cuts. We saw some additional production cuts and slowly reopening economies that resulted oil prices to stabilise at higher but still depressed levels as uncertainty remains. Our price forecast for Brent oil 2020 is an average of USD 40/barrel. During the second half, prices will be around USD 30 and then gradually rise toward year-end as the economic outlook stabilises. Our forecast for 2021 is USD 50/barrel.

Alternative economic development scenarios. We stick to our main scenario described above, but because of the exceptional uncertainty now prevailing, it is natural to work with various alternative scenarios. The main kind of uncertainty concerns how rapidly economies will actually reopen. This, in turn, may depend both on strategic trade-offs between medical and economic aspects, but also to what extent we will see setbacks in the form of new COVID-19 outbreaks when restrictions are lifted.

Our negative scenario assumes that economic recovery is significantly delayed compared to our main scenario and that important parts of the economy do not restart during the second half of 2020. In that case, full-year GDP in the OECD member countries will fall by about 12% in 2020. Unemployment will climb to around 20% both in the US and Western Europe. Permanent business closures will occur on such a large scale as to put severe pressure on the financial system. In this scenario, economic policy makers will need to resort to dramatic actions that we have not seen so far during peacetime. Public sector debt will explode, climbing in 2020 and 2021 by an accumulated 35-40% of GDP in most countries.

Our more positive scenario may assume that the virus spread situation turns out to be more favourable than expected or that for other reasons, economies reopen earlier than in our main scenario. Looking a bit further ahead, it is also possible to imagine that economic stimulus measures begin to have a significantly better effect as the general social environment normalises. In such a scenario, it is difficult to foresee governments and central banks acting especially quickly to withdraw their stimulus due to fear of overheating.

We foresee a roughly symmetrical probability for these alternative scenarios and are setting a 60% probability for our main scenario and 20% each for the positive and negative scenarios, respectively.

Overall, weak incoming economic data, concerns about new virus outbreaks are set against hopes of a return to more open, functioning economies – supported by aggressive stimulus measures from central banks, governments and others. Mixed reports about the spread of virus and the pace of reopening after lockdowns are contributing to continued stock market volatility. Although the fluctuations are still large, we do see signs of stabilization. The return to a more normal situation will probably drive the coming recovery. This undoubtedly justifies a rebound in share prices from their sharp declines during March. But the scale of this rebound is a source of concern. In the short run there are still many risks of disappointments, since the rapid upturn makes the market more sensitive to the negative news about economic growth and corporate earnings that can reasonably be expected to pop up during the coming months.