



# Coronavirus Concerns Shift to New Outbreak Areas

Spread of virus and policy responses will govern long-term impact

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## KEY INSIGHTS

- Near-term market volatility could persist as the coronavirus outbreak will remain a concern in the coming months.
- If new global outbreaks are contained, markets could stabilize as the rate of the spread of the coronavirus in China appears to have eased.
- The impact on Chinese and global economies remains unclear. The policy responses by major central banks form a key area of focus.



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The coronavirus (COVID-19) outbreak will likely remain the primary driver of short-term market sentiment. The recent spike in new cases in Italy, Iran, and South Korea shows that the global impact is unpredictable despite signs that the infection rate in China could be stabilizing.

Although it is too early to determine the full extent of these outbreaks, the meaningful jump in cases adds to market nervousness and will drive near-term volatility. Below are our latest views on some of the key themes we are monitoring.

### New Global Outbreaks Could Bring Near-Term Volatility

Markets could remain volatile amid concerns about the virus's spread outside of China. Sentiment had calmed in recent weeks on the back of growing signs that the infection rate in China had stabilized. However, the

emergence of potential new outbreak centers in Italy, Iran, and South Korea revealed that markets may have been underpricing the threat posed by COVID-19. Further volatility is possible as these outbreaks evolve and potentially spread to other countries.

Calm could return if the new outbreaks are contained quickly. The spread of COVID-19 within China, the source of the outbreak, appears to have eased over the past week and a half. However, the total case count will likely remain elevated for some weeks with the potential for infection rates to accelerate again. Overall, we remain focused on the regular data updates both within China and internationally.

The fluid nature of the COVID-19 outbreak makes it difficult to predict short-term market moves. In this environment, we believe it is important to keep a longer-term perspective on markets. Broken down by asset class, our near-term outlook is as follows:

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- **Equity**—After a period of calm, volatility and weakness could continue in the near term as news surrounding the new outbreaks develops. Asian markets will likely see ongoing volatility as new cases in South Korea will likely rise further.

Looking longer term, we are monitoring for supply-chain disruptions and sectors that could be the hardest hit. The auto sector and commodity-linked names could experience greater volatility than others. Near-term market dislocations could open up pockets of opportunity. Certain sectors could emerge relatively unscathed, and individual names with strong fundamentals could rebound once the global outbreak is under control.

- **Fixed Income**—If the new outbreaks escalate, global demand for high-quality fixed income assets will likely keep core developed market yields suppressed. Short-dated core government bonds could potentially outperform in the near term. Italian spreads versus core eurozone bond markets could widen as investors shift to safe-haven regions.

Risk sectors of fixed income, including credit and emerging market hard currency bonds, held up relatively well in the initial COVID-19 volatility. However, if the global outbreaks escalate, these sectors could come under pressure in the near term. This potentially opens up longer-term opportunities in sectors offering the strongest fundamentals. The Asian high yield sector could be an attractive opportunity when markets recover.

- **Currencies**—COVID-19's expected impact on global growth will likely translate into currency market moves. We continue to expect the People's Bank of China (PBoC) to manage the renminbi within a tight range despite the potential for moderate depreciation against the U.S. dollar.

We could see further weakness in Asian currencies, particularly if the global outbreak spreads. Currencies of commodity-producing emerging market countries may also see downward pressure if commodity prices decline due to reduced global demand.

### China Could Rebound Later in 2020

The spread of COVID-19 has already reached a point where it will significantly impact the first-quarter economy. In China, a negative quarter-on-quarter growth rate for the first quarter of 2020 is likely.

The return to normal manufacturing operation has been slow due to travel disruptions and quarantine efforts disrupting the return of workers to factories following the Chinese New Year holidays. While we have started to see improvements in various metrics, it will still take at least two to three weeks for levels to return to normal.

The outlook beyond the first quarter is still unclear. The recent signs that the spread of the coronavirus in China has peaked could point to a potential recovery in the second quarter.

The situation outside of China depends on whether the spread of the virus escalates further in other regions. Overall, the spread of COVID-19 globally has not reached a level that we believe will severely weaken the long-term growth outlook in the U.S. and other developed economies. However, the recent outbreaks in South Korea and Italy give cause for concern. Italy's economy was already weak, and the domestic outbreak, even if short-lived, will likely negatively impact growth data.

### Central Bank Policy Responses Evolving

We expect global central banks to continue to take a wait-and-see approach. China's initial policy response focused on crisis management. Authorities implemented interest rate cuts alongside targeted

fiscal stimulus to support the corporate sector. The coming weeks could feature additional stimulus measures along these lines.

The focus of the political leadership is shifting from all-out containment to a more balanced approach between containment in areas where the virus is still severe and promoting a return to work in areas where the virus appears to be easing. The authorities also still appear determined to keep growth on track, at least 5.6% this year, which is the minimum needed to hit their doubling of incomes target over 2010–2020. Over the weekend, the Politburo endorsed more forceful monetary and fiscal stimulus policies to meet this goal. Following this directive, we expect the PBoC and Ministry of Finance to roll out more detailed medium-term stimulus measures over the coming months. However, if policymakers decide that they are willing to sacrifice the growth target,

we would expect more modest stimulus measures. In this case, growth could fall to around 5% or below on the year.

In some areas elsewhere, we think markets may be overpricing the possibility of rate cuts. However, if the new outbreaks outside of China continue to escalate, the outlook for monetary stimulus could change. Specifically, if quarantines lead to a significant loss of working days in Italy or elsewhere in Europe, the European Central Bank would be more likely to act.

Overall, the spread of COVID-19 globally has not reached a level that we believe will severely weaken the long-term growth outlook in the U.S. and other developed economies. We remain vigilant in monitoring the real-time news flows that could trigger market swings while also keeping our focus on the long-term picture.

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