



# Coronavirus: Markets Likely to Remain On Edge in the Near Term

Duration and spread of virus will govern longer-term impact.

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## KEY INSIGHTS

- Near-term market volatility is likely to persist as the coronavirus outbreak will remain a key concern in the coming months.
- Higher-risk assets and industry sectors most closely linked to the impact of the outbreak are likely to underperform.
- The impact on the Chinese and global economies remains unclear. The Severe Acute Respiratory Syndrome (SARS) example indicates that a rebound could follow once the outbreak dissipates.



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The recent bouts of market volatility across the globe triggered by the coronavirus outbreak are likely to continue in the near term. The full and lasting impact on economies and financial assets remains unclear.

In this environment, it is important to remember that various asset classes and regional economies will perform differently as the situation unfolds. We are closely monitoring a range of indicators to understand the potential impacts across asset classes and our portfolios.

## Uncertainty to Drive Near-Term Volatility Across Asset Classes

Markets are likely to remain volatile as the virus spreads and uncertainty remains high. After a positive start to the year, global equities and risk sectors of fixed income sold off notably in mid-January when the seriousness of the coronavirus threat began to emerge.

Many Asian markets then sold off sharply on February 3 due to pent-up concerns unleashed on the first day of business following Chinese New Year holidays.

We do not expect a meaningful rebound in the short term. It will likely be at least several weeks before any clear signs emerge that the outbreak is under control and markets can more confidently assess the full impact on the Chinese and global economies. In the absence of a significant escalation in the outbreak, markets could stabilize following the recent sharp drops, helped by short-term monetary stimulus from Chinese authorities.

Broken down by asset class, our near-term outlook is as follows:

- **Equities**—Global equity markets declined significantly since the middle of January. Markets had seen a sustained risk rally in previous months, meaning valuations had

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become stretched in some places, exacerbating near-term volatility. We expect continued volatility and weakness in the near term. The severity of the outbreak is likely to cause, at minimum, a short-term drag on Chinese growth, which will spill over into other areas of the global economy.

- **Fixed income**—A period of risk aversion across global markets has exerted downward pressure on core government bond yields. U.S. Treasury and German bund yields have already fallen to levels not seen since October and will likely remain suppressed until there is more clarity on the coronavirus spread.

Risk sectors of fixed income, including emerging markets and higher-yielding corporate bonds, could see near-term volatility similar to equity markets. However, most emerging market debt sectors, apart from China, have only seen modest losses. Within Asia, investment-grade corporate bonds, in particular, should continue to display relative stability.

- **Currencies**—Coronavirus’s expected impact on global growth is likely to influence currency markets, including downward pressure on the renminbi. The post-holiday market sell-off saw the Chinese currency move below RMB 7 to the U.S. dollar.

We expect the People’s Bank of China (PBoC) to help smooth any abnormal volatility during this period. China may want to avoid raising potential objections from the U.S. authorities in the event of a sharper currency depreciation.

During the SARS outbreak in 2003, many Asia-Pacific (APAC) currencies were more heavily managed, which limited their volatility at the time. Today, there could be more fluctuations, with countries most exposed to tourism and trade with China being the

hardest hit. Fundamentals in most APAC countries remain healthy, which should provide a supportive influence.

### **Chinese Growth Could See Post-outbreak Rebound**

The spread of the coronavirus has already reached a level where it will have a noticeable impact on China’s economy. We expect to see a meaningful drop in China’s first-quarter growth rate and potentially future quarters if the outbreak persists.

The last major comparable outbreak, SARS, first appeared in late 2002. The peak of the economic impact came around March and April 2003, with the seasonally adjusted annual growth rate dropping sharply from 12% in the first quarter to 3.5% in the second quarter of 2003. It is worth noting that many aspects of the Chinese economy are different today than in 2003. The services sector constitutes a larger share of China’s gross domestic product (GDP) than in 2003. This could result in a larger overall impact than SARS had.

Yet, if the pattern of the SARS impacts are a guide, there is the potential for the Chinese economy to rebound with an above-potential growth rate once the outbreak subsides. In 2003, China’s growth rate climbed to 15.5% in the third quarter as pent-up demand saw consumption rebound as the SARS outbreak waned.

A similar rebound following the coronavirus could help keep the longer-term track of the Chinese economy on a relatively even keel. Likewise, equity and credit markets could recover as sectors hardest hit from the outbreak benefit from pent-up demand.

That said, outbreaks of this sort remain unpredictable and prone to a range of factors that govern the spread and duration. There is a risk that the coronavirus outbreak could persist longer and with a larger economic impact than SARS.

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# 1–14 days

Reported incubation period before symptoms appear.


## Short-Term Stimulus Provides Support

China has already responded with a wide-ranging set of short-term stimulus measures to counter any initial market panic. The policies include a 10-basis-point cut to the reverse repo rate and additional liquidity to maintain market functionality, as well as other measures to support the financial sector. Additionally, China has announced a RMB 300 billion lending program to support Wuhan, the city at the epicenter of the outbreak.

Looking longer term, we expect Chinese authorities to take a restrained approach to any sustained stimulus. In recent years, China has focused on deleveraging and will not be overly aggressive in deviating from this path. The PBoC will likely remain reactive to weakness in growth data. Fiscal stimulus rather than monetary measures could be the primary tool to support growth. Overall, we think the aim will be keeping the full-year growth rate broadly in line with targets while tolerating a degree of temporary weakness in the near term.


## Key Features of the Epidemic to Watch


The speed and spread of the coronavirus outbreak could change quickly. The key features we are monitoring include:

 **Rate of spread**—We are certain that the number of confirmed cases will grow as authorities improve their ability to locate and diagnose people and as those who are already infected begin to show symptoms. However, Chinese authorities have implemented aggressive containment measures. How markets react will depend on whether the spread appears to reach a peak in the near term or accelerates.

Recent signs that infections in Hubei province are leveling off suggest that containment measures could be having their desired effect. We will be watching

for signs that the spread does not reaccelerate in the coming days.

 **Location of spread**—We are monitoring the progression of cases outside of the Wuhan area in Hubei province. Most international cases have been among people that have visited Wuhan, and recent data have shown that the incidence of new cases outside of China have eased. However, as the virus has a reported incubation period of between one and 14 days before symptoms appear, this trend could change. The number of cases across China could grow substantially in the near term. The extent of spread within China and international infection rates will guide analysis of wider impacts.

 **Risk of mutation**—So far, the reported number of cases and deaths from the new coronavirus indicate that it has a lower mortality rate than SARS. There remains a risk that the virus could mutate to a more lethal form or becomes more easily transmittable among people.

## Impacts Beyond Asian Economies

It is too early to accurately assess the longer-term impact on global economies. Compared with SARS, the impact on the rest of the world could be larger simply because China is more embedded in the global economy in 2020 than it was in 2003, and its output forms a much larger share of global GDP.

The lower demand due to slower growth could weigh on oil prices. Countries and companies that typically benefit from lower oil prices could see relative stability, while those more directly affected could experience more volatility.

We expect exports and travel from the APAC region to suffer. This could make a noticeable dent in developed market growth data in the coming months, including lower quarterly GDP figures. At this stage, changes in policy direction from the Federal Reserve or European Central Bank appear unlikely.

Overall, the spread of the coronavirus 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.



#### **WHAT WE'RE WATCHING NEXT**

We are looking deeper at idiosyncratic impacts on individual market sectors and asset classes. As the virus spreads, industry sectors more directly exposed to the disruption caused by the virus will likely suffer the largest price swings. Specifically, we are closely watching the Macau gaming sector amid travel restriction and casinos suspending operations. In the retail sector, traditional brick-and-mortar business will likely bear the brunt of the pain, whereas companies focused on online delivery could perform better. The Chinese real estate sector is also coming under pressure due to pauses in home sales to reduce public gatherings in some regions of China. We will continue to look closely at which names are best suited to withstand these pressures and how Chinese authorities respond with any potential sector-specific stimulus.

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