

# Global Insight

## Weekly

## Uncertainty unleashed: Sizing up the coronavirus impact on markets & the economy

Kelly Bogdanova – San Francisco

With COVID-19 now officially a pandemic, acute uncertainty about the fast-moving implications has thrown markets into turmoil. While recession risks are becoming more real, financial system stress is nowhere near 2008–2009 levels, and the Fed has added even more stimulus. We diagnose the current market and economic situation.

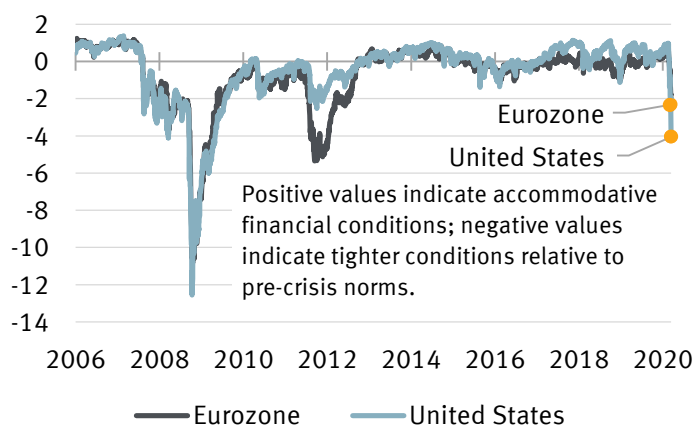
The rapid spread of the coronavirus, combined with the reactions by governments, central banks, corporations, and other entities, and last but not least the collapse in crude oil prices, have overwhelmed financial markets recently. There have been more developments for markets and investors to absorb in the past couple weeks than normally occur over many months, and of course these pandemic-related events are anything but normal.

Equities have continued to drop worldwide, with numerous markets now in bear market territory. The S&P 500 has fallen by 27 percent from its peak in mid-February, while developed markets outside of the U.S. have fallen by 28 percent as measured from the recent peak in the MSCI World ex-U.S. Index.

Fixed income markets have struggled with liquidity as yields have drifted lower. As a result, the Fed surprised markets with a liquidity announcement on Mar. 12. Effectively, it is expanding the existing quantitative easing program and boosting liquidity via \$1 trillion in weekly repurchase operations. The move is an effort to support Treasury market dislocations due to illiquidity around coronavirus fears and broader fixed income market volatility. The tweak served to briefly boost market sentiment, but our fixed income strategist views it as only a Band-Aid solution until we see what the Fed's bigger plan of attack is at, or even before, the scheduled Mar. 18 meeting of the policymaking Federal Open Market Committee.

### Financial system stress nowhere near extremes of 2008–2009

Bloomberg Financial Conditions Indexes



Note: The indexes track the overall level of financial stress in the money, bond, and equity markets to help assess the availability and cost of credit. Source - RBC Wealth Management, Bloomberg; data through 3/12/20

### Market pulse

- 3 Seattle provides clues to what may be awaiting the U.S.
- 3 How Canada is coping with coronavirus
- 4 How the BoE & ECB are trying to shield their economies
- 4 Chinese economy facing demand shock

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## Time for the politicians to step up

In addition to hesitancy about central banks' actions, financial markets have been dissatisfied by some of the fiscal stimulus announcements thus far, especially those coming out of Washington.

The importance of U.S. federal government stimulus can't be overstated, in our view, as market participants worldwide seem to be focused on this issue. RBC Capital Markets, LLC Head of U.S. Equity Strategy Lori Calvasina wrote, "... we think equity investors need to see very clear progress towards fiscal stimulus very soon to keep [U.S.] recession fears at bay."

It's almost always challenging for Republicans and Democrats to compromise, including during times of crisis, so the current disagreements about how to tackle the coronavirus crisis should be no surprise. The partisan and personal acrimony is as bad as we've ever seen in the modern era, and the upcoming election complicates matters.

But we think U.S. leaders will ultimately come together with a bold stimulus plan. The equity market is sending a loud signal that it's needed *sooner* rather than later—and the timing is important. During the global financial crisis, the federal government (and the Fed) took too long to recognize the need for stimulus and too long to deliver it. The sooner that fiscal and monetary authorities act boldly during this pandemic, the better the buffer for the U.S. and global economies, in our view.

Would fiscal stimulus fix the coronavirus problem? No, this is fundamentally a public health and medical crisis. But we think stimulus can go a long way toward mitigating the damage to the economy, especially if it comes in the near term.

## Hits to the bottom line

From an equity market standpoint, earnings estimates are being reassessed as the coronavirus has continued to spread, and as some companies are beginning to alter operations. Because of the mounting risks, Calvasina has lowered her outlook for the U.S. equity market.

For 2020, Calvasina cut her S&P 500 earnings forecast from \$174 to \$165 per share. This estimate assumes one negative quarter of U.S. GDP growth in Q2, and a recovery beginning in Q3. In this scenario, a recession would be avoided, as those contractions typically feature at least two consecutive quarters of negative growth. As a result of the lower profits outlook, she cut her S&P 500 year-end price target from 3,460 to 3,279. (The S&P 500 closed at 2,480 on Mar. 12.)

If economic activity ends up contracting for longer and an outright recession unfolds, Calvasina estimates there would be an additional, meaningful hit to corporate profits. In this case, S&P 500 earnings could retrench to \$149 per share in 2020, much lower than her \$165 estimate. This harsher scenario would represent an 8.6 percent year-over-year decline in earnings growth compared to the \$163 achieved in 2019. While this scenario is possible, it is not her base-case forecast.

## Alternative indicators

Gauging recession risks is more challenging due to the exogenous and swift nature of the coronavirus shock. Normally, our favorite leading economic indicators can pick up weakness in the U.S. economy and provide a good sense of when a recession could appear, often six to 12 months ahead of time. However, in this case, traditional data is less useful because developments are unfolding so rapidly, and even the best leading indicators signal with a lag.

Therefore, RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli believes it's critical to analyze "alternative" data that provide more real-time indications of the potential impact of the coronavirus on the domestic economy. For example, he's examining vehicle traffic flows and the number of subway rides in major cities in order to estimate the slowdown in consumer spending. From these and other data he can model consumption patterns for the U.S. population. While he anticipates a [sizeable near-term hit to consumption](#), he is still of the belief this will be a short-lived event with one quarter of negative GDP growth.

There is a caveat, however. If the spread of the coronavirus does not let up by the beginning of summer, the risk of a recession would rise meaningfully.

## Coronavirus question won't be going away anytime soon

Whether or not a recession unfolds, concerns about the coronavirus outbreak will probably go on suppressing investor attitudes for months to come.

We are still of the mindset that if the U.S. economy avoids a recession in 2020, by year end, stock markets in the U.S., Canada, the UK, Europe, and Asia have the potential to advance meaningfully from correction levels.

But U.S. recession risks are rising as businesses and individuals attempt to cope with the health crisis, and this heightens the prospects of additional volatility and downside for equities worldwide.



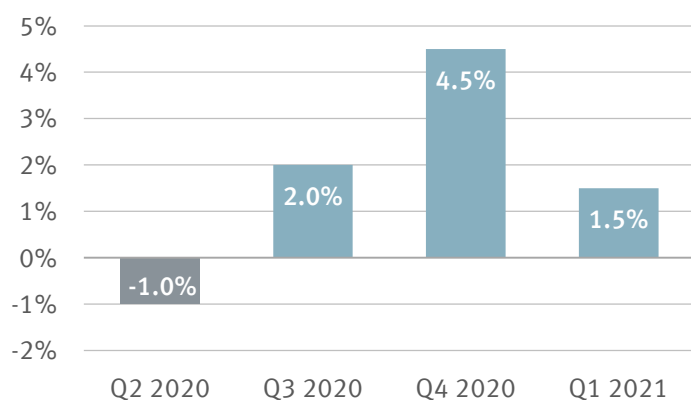
## United States

Alan Robinson – Seattle

- Greater Seattle was the first major urban area in the nation to report a significant cluster of COVID-19 cases. In our view, **the impact of the Seattle outbreak, and the policy response to it, provides clues to the potential impact nationwide.** Seattle's downtown economy is dominated by technology workers and tourists—two groups at the forefront of the “stay at home” trend. In addition, the cruise industry that uses Seattle's port has effectively ceased operations. Consequently, road traffic volumes have declined 30%–40% and restaurants have announced closures, some of which are permanent.
- Seattle-area authorities have banned gatherings of more than 250 people and all schools are closed. Voluntary compliance with these restrictions has been widespread, as communication by medical experts has been candid and unrestricted. As virus testing approaches levels seen in other developed nations, **we believe many other major U.S. cities are likely to experience economic slowdowns like the one in Seattle.**
- We believe **U.S. economic data does not yet reflect the impact of the virus** due to the speed of its onset. However, we can build a framework for understanding the likely economic impact using alternative data such as traffic volumes and travel patterns. RBC Capital Markets, LLC Chief U.S. Economist Tom Porcelli believes this **timely data implies a single-quarter economic contraction in Q2 2020, followed by a significant rebound in Q4** (see chart). Importantly, he believes mortgage refinancing and lower energy prices are potential stabilizers for consumer spending patterns.

Our base case for the U.S. economy is a one-quarter contraction

Estimated U.S. real GDP (base case)



Note: Assumes COVID-19 follows typical seasonal flu patterns  
Source - RBC Capital Markets, RBC Wealth Management

- Gilead Sciences (GILD) was in focus during the week after the World Health Organization designated COVID-19 as a pandemic. Investors view the company's drug remdesivir as **a potential treatment for the virus, and we expect interim trial data for the drug to be released over the next few weeks.** However, RBC Capital Markets, LLC Biotechnology Analyst Brian Abrahams cautions that case reports remain mixed and a potential government stimulus bill could limit monetization of coronavirus treatments. Additionally, competitors are attempting to fast-track other potential therapies. Unfortunately, a safe vaccine for the virus appears likely to be several quarters away.



## Canada

Arete Zafiriou & Sayada Nabi – Toronto

- On Mar. 11, Canada's federal government released its initial plan to tackle the coronavirus pandemic. **Prime Minister Justin Trudeau announced that roughly CA\$1 billion will be allocated to various resources across the country** in an effort to mitigate the economic impacts of the global outbreak. The government indicated CA\$500 million of the planned spending will be health transfers to the provinces; CA\$200 million will be allotted for federal public health efforts, including funding for virus testing, health services for indigenous communities, public education efforts, and medical supplies such as face masks; CA\$275 million will be put towards research into the virus, including vaccines and clinical trials; and CA\$50 million will be made available as international aid to help other countries prepare for outbreaks.
- Canada's tourism, airlines, and oil & gas sectors have already taken a hit** from COVID-19. The S&P/TSX Composite Airlines sub-industry has lost 46.9% year to date as of Mar. 12, while the Oil & Gas Exploration & Production sub-industry is down 60.9%.
- While the adverse effects from COVID-19 and the oil price war on Canada's economy remain uncertain, RBC Economics believes consumer demand and business spending will be impacted directly, and expects exports to fall if the outbreak in the U.S. worsens. As supply chain shortages and labour interruptions will likely be a challenge for businesses, RBC Economics believes **consumers will probably rein in spending in anticipation of income loss from layoffs, shorter hours, and/or quarantine.** When combined with already high levels of household and business debt, RBC Economics expects the impact for the Canadian economy to be amplified, further limiting Canadians' ability to borrow to smooth out the shocks.

- Trudeau noted that the outbreak has already impacted the budget planning process, suggesting **the government may include additional supportive measures when the budget is unveiled** at the end of March.



## Europe

Frédérique Carrier & Thomas McGarrity, CFA – London

- The stock market rout continued, and indexes in both the UK and Europe have fallen more than 15% so far this week. While no sector closed the period in positive territory, Consumer Staples and Health Care fared relatively better. Signs of tightening monetary conditions appeared, as shown by the spread of Italian bonds over German Bunds increasing sharply. **Investors were given a sense of things to come for global companies by Adidas, the athleisure wear and sporting goods manufacturer, which announced profits would likely halve this year as a result of the coronavirus epidemic.** The company derives half of its profits from Asia, and a quarter from Europe. Its share price is down more than 40% from its January high.
- British policymakers announced powerful coordinated action in an attempt to shore up confidence and support the economy. **The Bank of England (BoE) cut its bank rate by 50 basis points (bps) to 0.25%** and reintroduced a scheme enabling banks to borrow from it at a preferential rate for a period of four years. The BoE's next scheduled meeting on Mar. 26 will be the first under new BoE Governor Andrew Bailey. A new round of asset purchases should not be ruled out. Meanwhile, **the chancellor of the exchequer announced a significant loosening of fiscal policies**, including a £12 billion package of near-term measures to soften the impact of the outbreak. This is in addition to already planned stimulus of some £18 billion. Combined, these two measures amount to just under 1.5% of the UK's 2020 GDP. RBC Capital Markets expects that newsflow related to the coronavirus is likely to remain the main driver of the UK Gilt market going forward. Sterling reached a 5-month low against the dollar at 1.26.
- **The European Central Bank (ECB) disappointed markets by maintaining its main deposit rate at -0.5%, but it announced a €120 billion bond purchase programme** and more attractive terms on targeted longer-term refinancing operations (TLTROs), a tool which offers loans to banks at a preferential rate. RBC Capital Markets notes that this is in effect a targeted rate cut to support the banking system. The ECB is also giving banks some capital relief by allowing them to run lower capital ratios.

- **Attention is quickly turning to the possibility of fiscal stimulus.** The EU Commission announced a €25 billion package. Italy announced a €12 billion initiative with more likely to come. Others may follow suit.



## Asia Pacific

Jasmine Duan – Hong Kong & Nicholas Gwee, CFA – Singapore

- **Asian equity markets have traded lower across the board** this week as investors are becoming increasingly concerned about the continuing spread of COVID-19 outside of China, particularly in the U.S. and Europe. The unexpected collapse of the OPEC+ talks, which sent oil prices plunging, is also weighing on investor sentiment. The decline in Asia was led by Vietnam and Thailand as **foreign investors went into risk-off mode and headed for the exit on emerging markets.**
- **The number of new confirmed COVID-19 cases in China fell to a new low on Thursday (Mar. 12).** With cases falling dramatically in recent weeks, authorities this week began to **loosen some restrictions on Hubei's 56 million people**, who have been under quarantine since late January. Chinese President Xi Jinping visited Wuhan for the first time since the disease emerged. Observers believe the trip was intended to project confidence that the government has managed to stem the disease's spread domestically.
- According to a Bloomberg report, **manufacturing firms across China are close to being able to resume full production** as domestic infections slow. However, many companies are facing canceled orders and fewer opportunities for new orders as the virus continues to spread outside of China. Economists have warned of a **potential demand shock to the Chinese economy even as production begins to recover.** According to a report by state broadcaster CCTV, China's State Council has called for required-reserve ratio cuts for joint-stock banks and for lenders participating in a program to secure funding for smaller companies.
- **Japan unveiled a second emergency stimulus package** this week to tackle economic woes stemming from the coronavirus outbreak. According to a Nikkei report, **the government has begun planning for new stimulus measures for April as it turns ultra-aggressive in order to combat a looming recession.** The Bank of Japan will hold a policy meeting on Mar. 18–19 to discuss the possibility of increasing its exchange-traded fund purchases, which would be the bank's first decision on additional monetary easing in more than three years.





## MARKET SCORECARD

Data as of March 12, 2020

Equities (local currency)	Level	MTD	YTD	1 yr	2 yr
S&P 500	2,480.64	-16.0%	-23.2%	-11.1%	-10.9%
Dow Industrials (DJIA)	21,200.62	-16.6%	-25.7%	-17.0%	-15.8%
NASDAQ	7,201.80	-15.9%	-19.7%	-5.1%	-5.1%
Russell 2000	1,122.93	-23.9%	-32.7%	-27.5%	-29.9%
S&P/TSX Comp	12,508.45	-23.1%	-26.7%	-22.5%	-19.8%
FTSE All-Share	2,942.21	-19.9%	-29.9%	-25.0%	-26.3%
STOXX Europe 600	294.93	-21.5%	-29.1%	-21.0%	-22.2%
EURO STOXX 50	2,545.23	-23.6%	-32.0%	-23.0%	-25.8%
Hang Seng	24,309.07	-7.0%	-13.8%	-15.9%	-23.1%
Shanghai Comp	2,923.49	1.5%	-4.2%	-4.5%	-12.1%
Nikkei 225	18,559.63	-12.2%	-21.5%	-13.7%	-15.0%
India Sensex	32,778.14	-14.4%	-20.5%	-12.7%	-3.4%
Singapore Straits Times	2,678.64	-11.0%	-16.9%	-16.6%	-24.3%
Brazil Ibovespa	72,582.50	-30.3%	-37.2%	-25.8%	-16.5%
Mexican Bolsa IPC	36,636.70	-11.3%	-15.9%	-12.2%	-24.7%
Commodities (USD)	Price	MTD	YTD	1 yr	2 yr
Gold (spot \$/oz)	1,570.50	-1.0%	3.5%	20.7%	18.7%
Silver (spot \$/oz)	15.72	-5.6%	-11.9%	1.8%	-4.9%
Copper (\$/metric ton)	5,520.75	-1.7%	-10.2%	-15.0%	-19.7%
Oil (WTI spot/bbl)	31.50	-29.6%	-48.4%	-44.6%	-48.7%
Oil (Brent spot/bbl)	32.87	-34.9%	-50.2%	-50.7%	-49.4%
Natural Gas (\$/mmBtu)	1.83	8.4%	-16.6%	-34.4%	-34.3%

Govt bonds (bps chg)	Yield	MTD	YTD	1 yr	2 yr
U.S. 10-Yr Tsy	0.826%	-32.2	-109.1	-177.5	-204.2
Canada 10-Yr	0.605%	-52.7	-109.7	-113.4	-163.4
U.K. 10-Yr	0.265%	-17.7	-55.7	-89.8	-122.9
Germany 10-Yr	-0.741%	-13.4	-55.6	-79.6	-137.3

Fixed Income (returns)	Yield	MTD	YTD	1 yr	2 yr
U.S. Aggregate	1.69%	0.1%	3.8%	11.0%	15.3%
U.S. Invest Grade Corp	2.75%	-2.4%	1.2%	12.1%	16.4%
U.S. High Yield Corp	7.44%	-4.6%	-6.0%	1.2%	5.7%

Currencies	Rate	MTD	YTD	1 yr	2 yr
U.S. Dollar Index	97.2970	-0.9%	0.9%	0.4%	8.2%
CAD/USD	0.7175	-3.9%	-6.8%	-4.2%	-7.8%
USD/CAD	1.3931	3.9%	7.2%	4.3%	8.5%
EUR/USD	1.1168	1.3%	-0.4%	-1.1%	-9.5%
GBP/USD	1.2562	-2.0%	-5.2%	-3.9%	-9.7%
AUD/USD	0.6251	-4.1%	-11.0%	-11.7%	-20.6%
USD/JPY	104.8100	-2.9%	-3.5%	-5.9%	-1.5%
EUR/JPY	117.0600	-1.6%	-3.9%	-6.9%	-10.8%
EUR/GBP	0.8891	3.4%	5.1%	3.0%	0.2%
EUR/CHF	1.0560	-0.8%	-2.7%	-7.2%	-9.7%
USD/SGD	1.4112	1.3%	4.9%	4.1%	7.5%
USD/CNY	7.0294	0.5%	1.0%	4.8%	11.1%
USD/MXN	21.8529	11.2%	15.5%	12.9%	17.6%
USD/BRL	4.7768	6.8%	18.5%	26.4%	46.4%

Source - Bloomberg. Note: Equity returns do not include dividends, except for the Brazilian Ibovespa. Bond yields in local currencies. Copper Index data and U.S. fixed income returns as of Wednesday's close. Dollar Index measures USD vs. six major currencies. Currency rates reflect market convention (CAD/USD is the exception). Currency returns quoted in terms of the first currency in each pairing. Data as of 9:35 pm GMT 3/12/20.

Examples of how to interpret currency data: CAD/USD 0.71 means 1 Canadian dollar will buy 0.71 U.S. dollar. CAD/USD -6.8% return means the Canadian dollar fell 6.8% vs. the U.S. dollar year to date. USD/JPY 104.81 means 1 U.S. dollar will buy 104.81 yen. USD/JPY -3.5% return means the U.S. dollar fell 3.5% vs. the yen year to date.

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Sell [Underperform]	82	5.57	5	6.10

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