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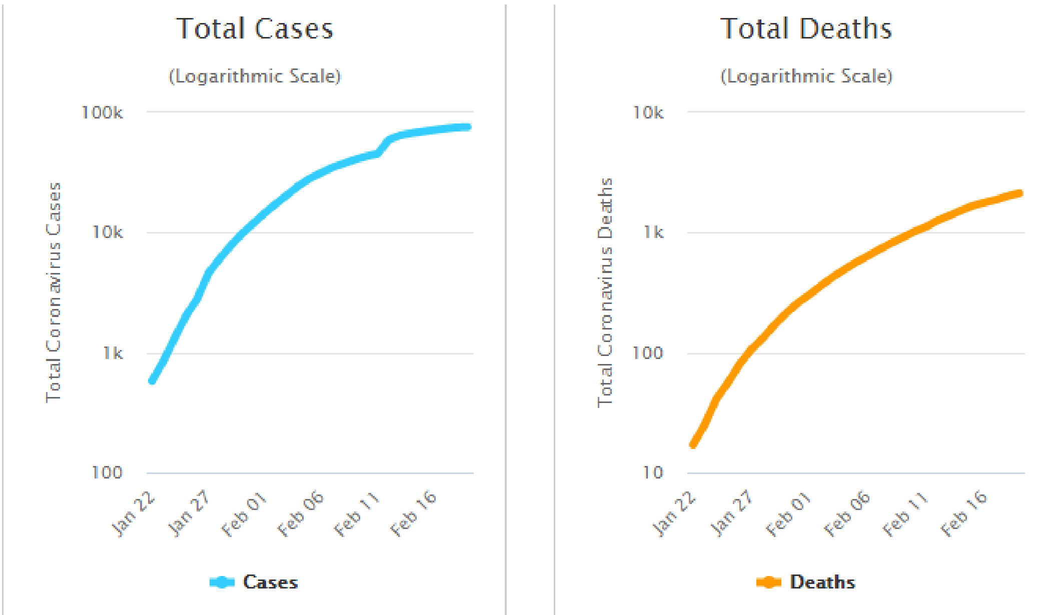
Market Update: 20th February 2020

China Unleashes Fresh Stimulus in Bid to Offset Coronavirus Impact

Over the week, despite continued uncertainty over the economic impact of the recent coronavirus outbreak, markets have been heartened by daily reports of a slowing rate of the spread of COVID-19, the infectious disease that originated in Wuhan towards the end of last year. After weighing heavily on investor sentiment in recent weeks, fears of contagion and continued spread of the virus within China have begun to abate, with data now suggesting that the rate of spread and number of deaths resulting from the virus has been slowing. As a result, Chinese authorities are now turning to plans to mitigate the economic impact of the virus, issuing fresh stimulus measures in a bid to stimulate the economy as the country begins to return to normality.

Figure 1: Total Coronavirus Cases and Deaths to 20th Feb 2020

**Please note that the sharp increase in cases earlier this month resulted from a change in methodology for counting infections in Hubei, rather than a significant increase in the rate of spread of the virus.*



Source: Worldometers.info

Economic Impact of the Outbreak

Despite signs that the intra-day growth rate in new cases is beginning to decline, the virus continues to have a severe impact on the lives of dozens of millions of people, especially in Hubei province. To date, according to figures from the World Health Organisation, the virus has infected over 75,000 and claimed more than 2,100 lives, primarily in China. As a result, many factories, shops and restaurants across China remain closed, disrupting supply chains, revenues and productivity in businesses across the globe.

As new developments in the coronavirus situation feed through into economic models and expectations, global markets continue to speculate over the economic realities of the outbreak. According to recent data, indicators on Chinese transportation, property sales and industrial activity have not yet picked up meaningfully, in contrast to the usual resumption in the weeks following the Chinese New Year. Any updates in Chinese economic activity are expected to be subject to intense scrutiny in the coming weeks, with market movements likely to remain volatile as a result.

Policy Shift

In response to this week's weak economic data, China's senior leadership has called for a shift in the balance of policymaking from containing the outbreak to resuming economic activity and provincial local governments have already started to respond accordingly. China's President Xi Jinping has called on government officials to strive to "achieve this year's social and development goals". This suggests that despite the coronavirus outbreak, the senior leadership still expects China to meet the objective of doubling GDP between 2010 and 2020 literally, for which 5.6% growth is needed.

As a result, Xi has called on officials not to take excessive measures to curb contagion. China's more than 2000 counties will now be classified according to the risk to the virus, which should influence policy priority and focus. Over the week, the People's Bank of China announced plans to cut the benchmark one-year prime rate by 10 basis points, and the five-year loan prime rate by 5 basis points as part of a plan to curtain harm from the outbreak. The Politburo Standing Committee meeting also called for tax cuts and breaks in areas particularly badly hit by the outbreak. In the coming weeks, as large numbers of people are supposed to return to work, the two key questions will be:

- **How fast can operations in factories, offices and shops return to normal** given restrictions by governments and reluctance to go back to business as usual by firms and people?

- **Can the outbreak be contained as people resume normal daily life?**

Government policies will be crucial to a successful return to normalcy. It is too soon to say what extent the adjustments to the policy response that China's senior leadership has asked for will take place, however provincial governments have begun to ease restrictions and make guidance less blunt.

While uncertainty about the speed of the move to normalcy implies a downside risk to growth forecasts in the near term, the shift in policy indicates that the economic impact of the outbreak is likely to be relatively short-lived, and we do not expect any major long-term impact on growth. The next two weeks will be key, and we will likely know more towards the end of the month, both about the containment of the outbreak and the economic damage.

Market Movements

Despite renewed optimism over progress towards containment, new deaths and cases of the disease outside of China continue to provide a source of anxiety for investors, culminating in the mixed intra-day performance of global equity indices this week. A fresh wave of cases in outside of China raised fears of contagion as reports suggest that the virus has claimed its first life in South Korea, after cases in the country have more than doubled to 104 in day with 35 additional cases cropping up in the city of Daegu alone. Japan also reported the death of two elderly passengers from a quarantined ship that had been hospitalised, according to the country's health ministry. The outbreak has spread to 26 other countries; however health officials say that the most severe and largest number of cases are in China, and that overall rate of infection beginning to decline.

On the whole, stock markets continue to look through short term uncertainty to test new heights on hopes for further easing in central bank monetary policy. With concerns over the business impact of COVID-19, investors are weighing a possible rate cut from the Fed before year-end, providing support for equities. Gold reached a new seven year high and the US dollar strengthened as investors sought safety assets on concerns that the outbreak will hurt global growth.

Our Positioning

With the rate of spread of the virus reducing while Chinese authorities remain committed to stimulating economic growth, our expectation remains that the impact will be limited to Q1. As it stands, our medium to long term outlook remains unchanged, and we expect some disruption prior to a sharp rebound in April and May. Overall, we expect to see further volatility ahead in the near term as the economic impact becomes known, however our medium-term expectations remain unchanged.