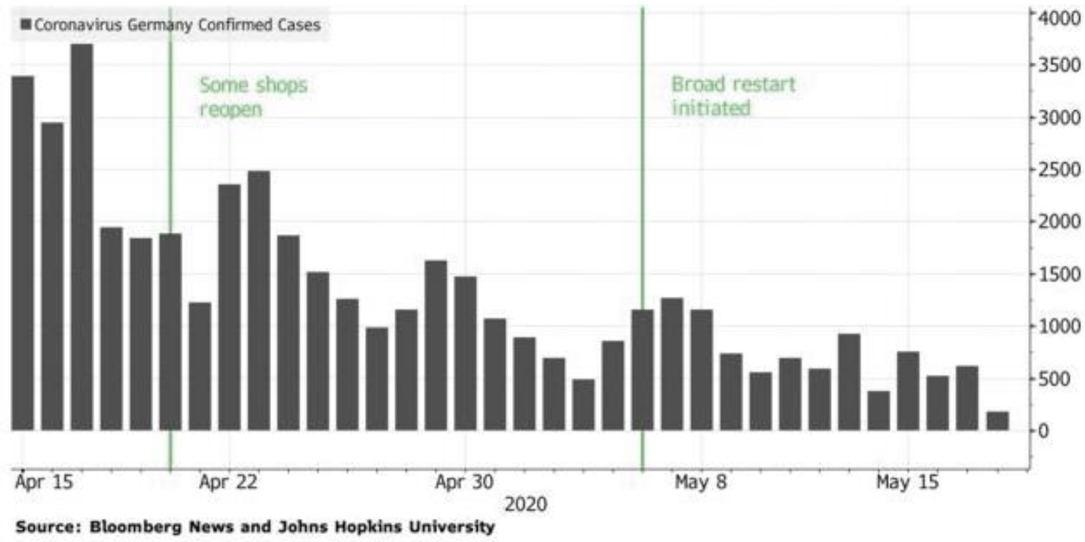
Market Update: 20th May 2020

Europe's Lockdowns Keep Coronavirus Spread in Check

As countries across Europe gradually relax lockdown restrictions, officials across the continent are closely monitoring the coronavirus data for signs of a resurgence in infections. In doing so, they are focusing on more than daily case numbers and death tolls which are lagging indicators, with surveys and indications from front-line medical staff forming a more complete up to date picture. Although that data is yet to feed through into the official numbers, as the lockdowns of varying degrees of severity are lifted, with a number of weeks now passed since restrictions began to be relaxed, we are able to analyse the data to see whether efforts to contain the virus have so far been effective.

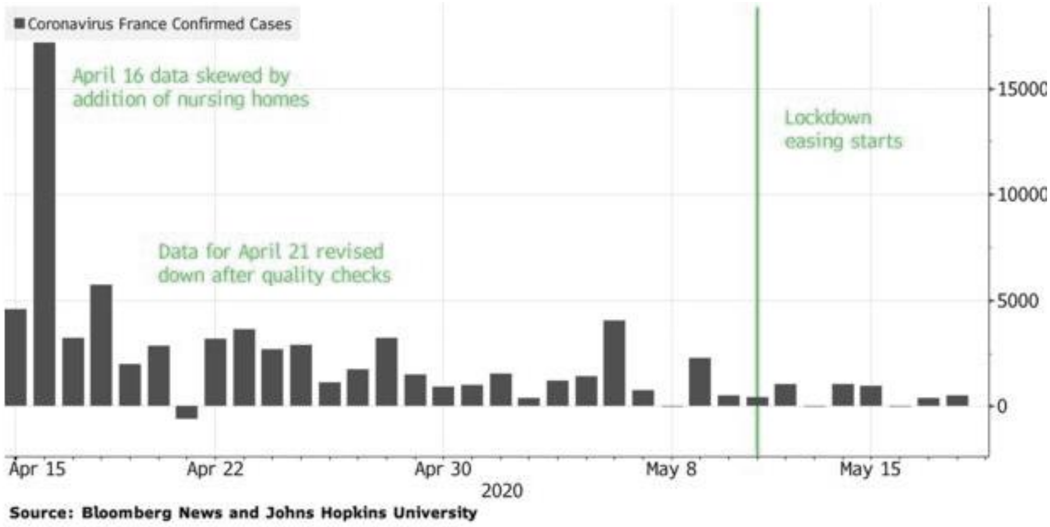
Germany

In the first steps towards normality, German shopkeepers resumed trading on 20th April after the nation appeared to bring the virus under control relatively quickly. Schools were partially reopened from 4th May and two days later, it was announced that restaurants and hotels would reopen. Social distancing rules remain in force, and some regions where infection rates are lower are easing restrictions faster. Two weeks on, according to the data from John Hopkins University, Germany appears to be making progress in keeping new cases under control.



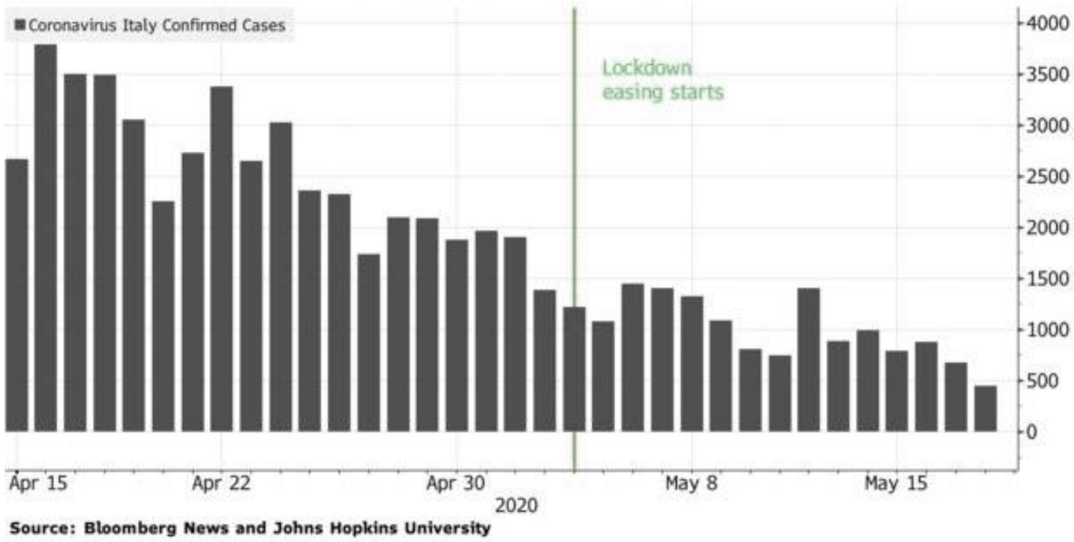
France

France was much later to ease restrictions, initiating its return to normality from 11th May, with shops allowed to reopen under strict hygiene conditions and some students returning to school. Some parks and beaches have been reopened, with social distancing rules remaining in force. While it is still early to say, the data suggests that the government appears to be having success in containing the virus. The government is expected to decide by the end of May whether restaurants, cafes and concert venues can reopen for the summer season.



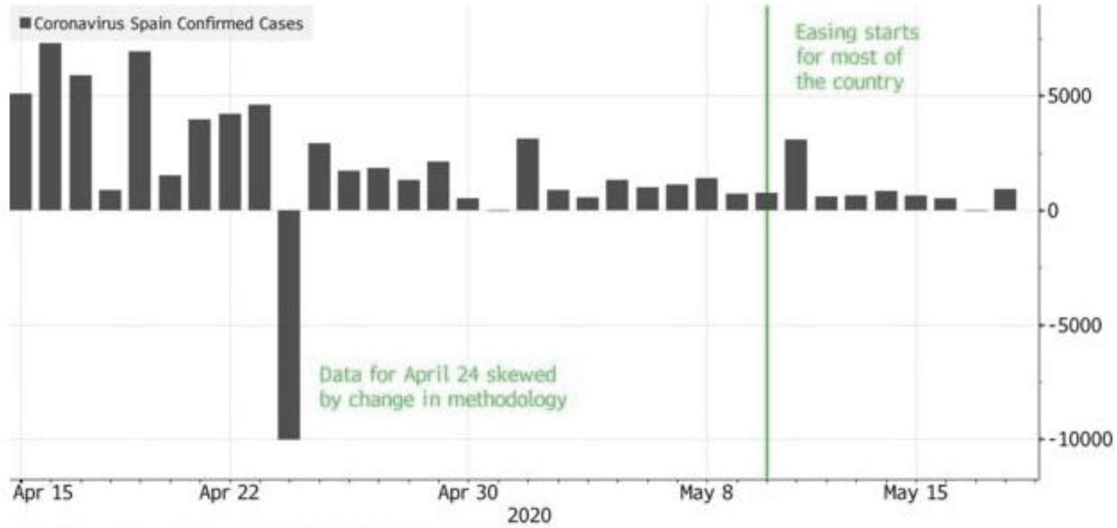
Italy

After experiencing one of the worst outbreaks in Europe, Italy began emerging from its extremely rigid lockdown on 4th May, when 4 million people returned to work and citizens were allowed to leave their homes for exercise for the first time in two months. The data indicates that the virus remains under control in the country, and as a result, most shops, bars and restaurants were allowed to reopen from Monday with distancing rules. The final restrictions are expected to be lifted in June, resuming free movement within the country and allowing theatres and cinemas to reopen.



Spain

In Spain, the relatively slow response to the coronavirus outbreak contributed to the rapid spread of the disease, resulting in one of the highest death tolls alongside the UK and the Netherlands. After the country had made progress in containing the virus outbreak, the relaxation in lockdown restrictions began on 10th May via a phased strategy. Around 70% of the country (not including major cities Madrid or Barcelona) are now in the second stage after a preliminary period of preparation. The government had already allowed children to leave their homes for brief periods from 26th April and some outdoor sports and walks from 2nd May. In the second stage, social contact is still limited to smaller groups and restaurants and bars are only allowed to open terraces to 30% capacity, with no indoor seating. Hotels can resume business without use of communal spaces, and small shops can open. With signs that the virus is not yet as controlled in Madrid or Barcelona, these areas will be slower to reopen.



Source: Bloomberg News and Johns Hopkins University

Which European Countries Were Most Effective in Containing the Virus?

According to an Oxford University study, in Europe, when we look at virus fatalities, three groups of countries emerge. One group including the UK, the Netherlands and Spain, experienced extremely high excess mortality. Another, encompassing Sweden and Switzerland, suffered many more deaths than usual, but significantly less than the first group. Finally, there were countries where deaths remained within a normal range such as Greece and Germany.

The study shows that the relative strictness of containment measures had little bearing on a country's membership in any of the three groups. While Germany had milder restrictions in place than Italy, it has been much more successful in containing the virus.

The overall impression is that while restrictions on movement were seen as a necessary tool to halt the spread of the virus, when and how they were wielded was much more important than their severity. Early preparation, and plentiful healthcare resources were enough for several countries to avoid draconian lockdowns. As an example of this, with better testing and contact tracing and more intensive care units than its neighbours, Germany was able to keep the economy more open. Greece, by acting quickly and surely, appears to have avoided the worst so far.

As expected, those with the most intense lockdowns will suffer the most economically. The economic data for the lockdown period are only just appearing, however it is becoming clear that the economic cost is not the only downside to a draconian lockdown. The experience has taught us that it's far better to respond quickly and smartly, with the right technology and mass testing and tracing, rather than only relying on the crudest of shutdowns. If there are second waves of the virus, it is therefore hoped that governments would not just revert to draconian measures which would further damage the economy, but rather to ramping up testing and tracing efforts to regain control over the spread. After experiencing a lack of testing in recent months, we are encouraged by the UK government's plans to adopt this new approach should we start to see an increase in cases when lockdown measures are lifted, and see other European countries doing the same moving forward.

The Economic Impact of The Virus

After lockdown measures were imposed in March, Q1 figures have confirmed that lockdown measures are taking a massive toll on the Eurozone economy, with GDP suffering the largest fall in its history. Given that quarantines ran throughout April and part of May in most countries, we expect the Q2 GDP decline to be even larger.

With January and February largely unaffected by the pandemic, national account figures suggest that activity fell in March by around 10%, even though most countries only implemented quarantine measures in the second half of the month. With most economies shut down for the entire month of April, these numbers will be much worse, although should mark the trough of the crisis. April PMIs corroborate this view. With most countries across the Eurozone now easing restrictions and reopening their economies, we expect to see a pickup in activity in May, gradually increasing over the coming months. The main risk to that forecast is that health conditions force a delay in the return to normal activity, however so far we are encouraged by the data we are seeing on the health front.

Stimulus

The European Central Bank (ECB) continues to announce new measures in order to ease financial conditions. Following the announcement of a stimulus package in March, including an increase in asset purchases and changes to the TLTRO programme to improve liquidity conditions, the ECB announced a further scaling up of its QE programme shortly afterwards. The central bank will purchase €1.1 trillion of bonds in 2020, a move that has helped calm bond markets and which allows governments space to raise their debt issuance substantially. Most recently, the ECB has announced a relaxation in collateral requirements for banks, further tweaks to its TLTRO programme and a new emergency lending programme for financial institutions. On a longer-term horizon, the weak growth and inflation outlooks mean that we still expect monetary conditions to remain supportive.

Alongside monetary stimulus, on Monday, European leaders signalled that a new fiscal package could be on the way to help the ECB to support the economy. The proposal from German and French leaders for a €500 billion aid package to help the European Union shake off the coronavirus pandemic was seen as a significant step toward a stronger common fiscal policy, complementing the euro's monetary foundations. The ECB has been calling for combined fiscal stimulus for some time to support the embattled Eurozone economy. The plans still need to be supported by all 27 EU members, and aid is likely to be delayed, however the proposal represents cause for optimism that combined fiscal aid could be coming.

Positioning

Although the economic data will remain weak in the near term, there are tentative signs that the virus remains under control as European countries relax lockdown restrictions. It is still early days, however we are optimistic that countries have learnt from other experiences should we see second waves, preventing further significant damage to the Eurozone economy. At the same time, we remain content that the ECB will continue to support the economy, with expectations for further fiscal and monetary stimulus further down the road. Following the March sell off, as the economies reopen, we are cautiously optimistic on growth prospects for European assets from here, and see strong opportunities for long term growth arising.