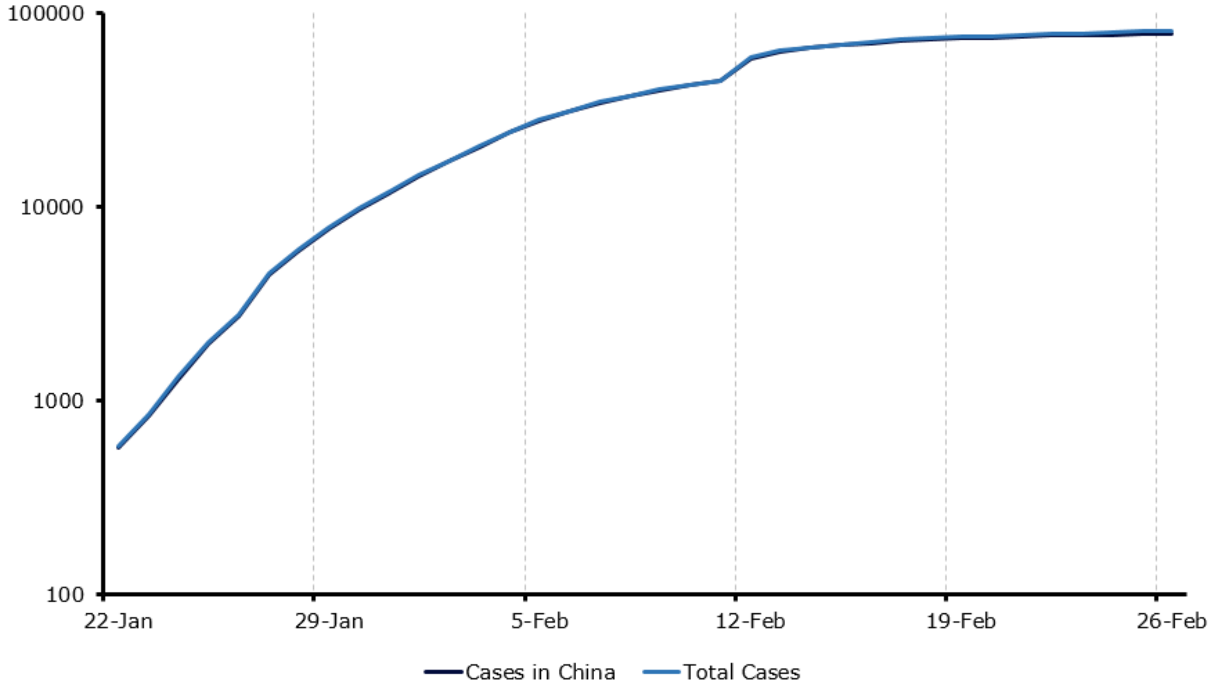
Viernes, 28/02/2020

FX market jolted as coronavirus cases jump outside China

Headlines surrounding the coronavirus outbreak, now officially named the COVID-19 virus, are dominating developments in financial markets.

Concerns regarding the virus had undoubtedly eased in financial markets last week and, up until this past weekend, currency trading had begun to return to at least some sense of normalcy. The rate of growth in the number of overall confirmed cases, and indeed deaths caused by the virus, has eased in the past couple of weeks (Figure 1). Approximately 82,000 cases of the virus have now been reported across the globe in a total of 50 countries at the time of writing (up 7k from around a week ago), leading to the deaths of a slightly over 2,800 people (up from 1,870)*.

Figure 1: Coronavirus Confirmed Cases [Overall & China] [log] (22/01/20 - 26/02/20)

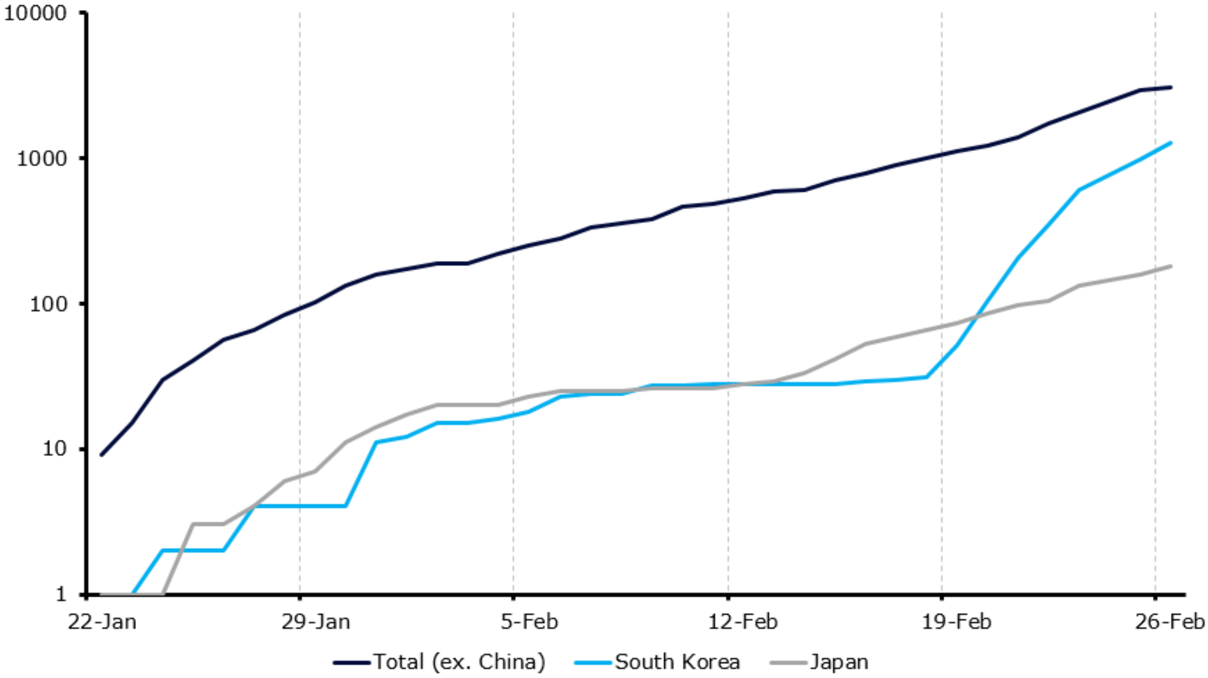


Source: WHO Date: 26/02/2020

The primary cause for concern for investors in the past few days has been the jump in the number of confirmed cases of the virus outside of China. As of 18th February, approximately

1,000 cases of the virus had been confirmed in countries other than China. This figure has since more than tripled (as of 27th February), with Italy, South Korea and Iran, among others, announcing a spike in both the number of confirmed cases and fatalities over the weekend. This brings the subtotal for coronavirus cases outside of China to more than 3,300 (Figure 2), approximately 4.1% of the total number of global cases. This marks a meaningful increase given that the figure had been contained to less than 1% throughout almost the entirety of the outbreak thus far.

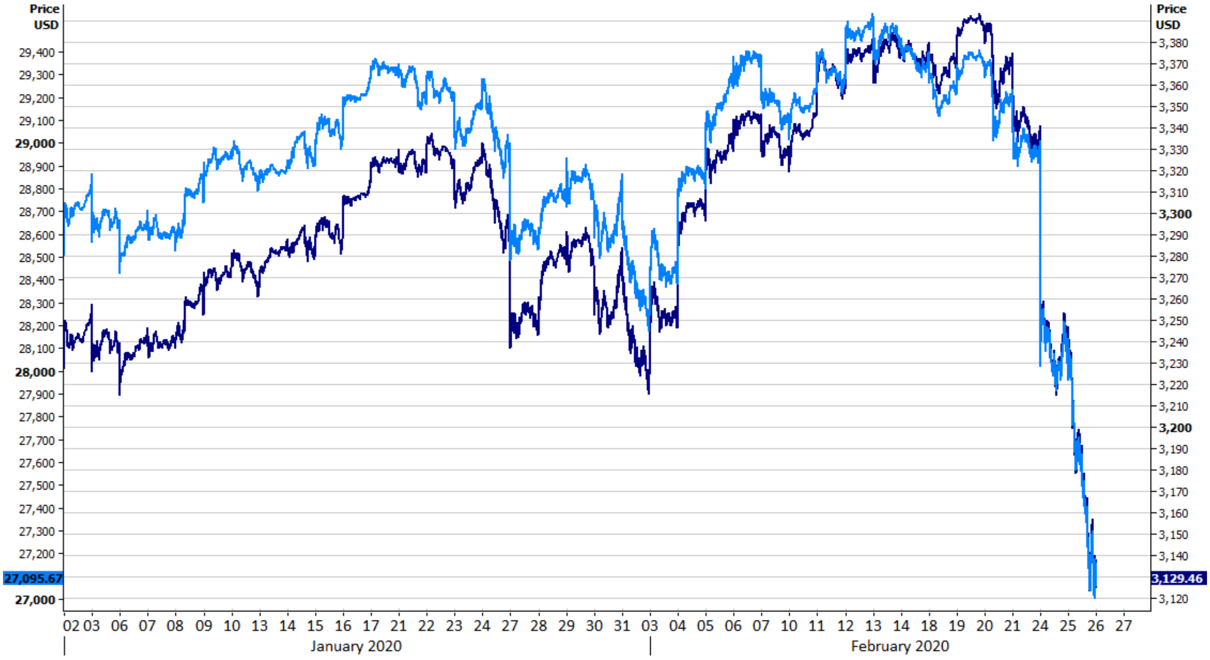
Figure 2: Coronavirus Confirmed Cases [outside of China] [log] (22/01/20 - 26/02/20)



Source: WHO Date: 26/02/2020

The reaction in the markets to the latest virus figures has been the most severe among equities. US stock indices have sold-off sharply since Monday, with the Dow Jones and S&P 500 indices currently trading approximately 6% lower for the week (Figure 3). The Shanghai Composite index fell by a similar amount, although it has since recovered some of these losses. Currency traders have reacted in a more orderly fashion. We've seen the yen strengthen again as investors overlook Japan's dire fourth-quarter growth data and once again favour the currency as a safe-haven destination. Unsurprisingly, the South Korean won has been one of the hardest hit, a direct result of the jump in the number of cases there. Other than that, the moves in the currency market have been largely contained. CNY itself has found at least some support just above the level of 7 to the US dollar.

Figure 3: Dow Jones & S&P 500 Index (2020)

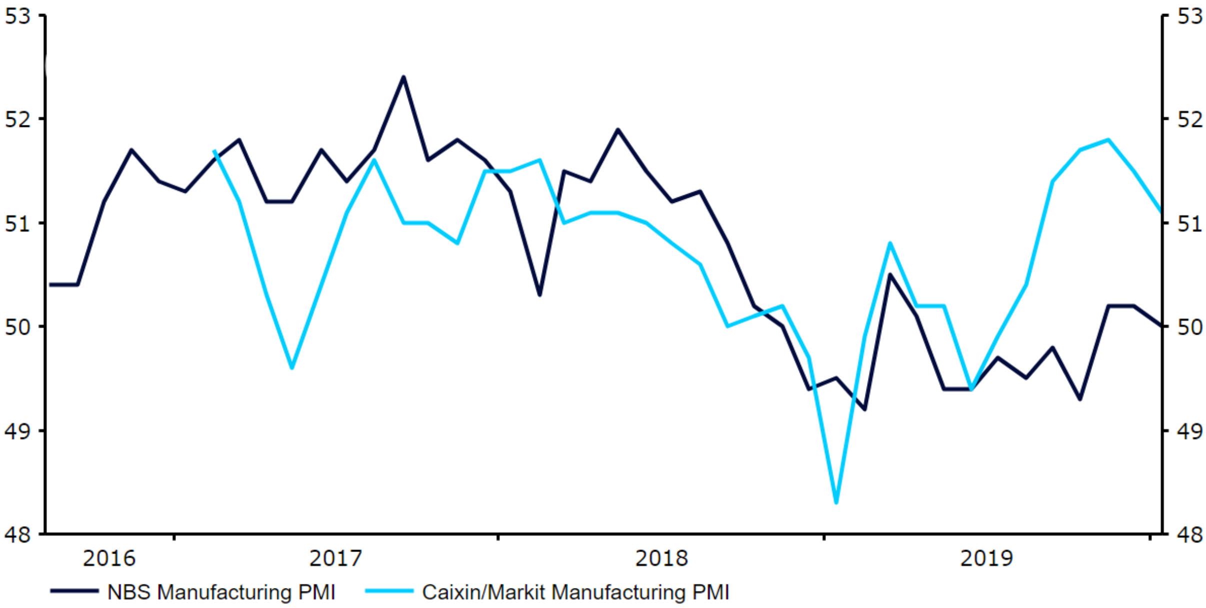


Source: Refinitiv Date: 26/02/2020

How have virus concerns impacted the global economy?

Investors have so far had limited macroeconomic data to digest that shows the full extent of the virus' impact. The January PMIs in China showed little signs of a slowdown (Figure 4), albeit concerns surrounding the virus didn't peak until late in the month. Elsewhere, Chinese imports fell year-on-year in January, although the contraction was also less severe than anticipated.

Figure 4: China PMIs (2016 - 2020)



Source: Refinitiv Datastream Date: 25/02/2020

Outside of Asia, the latest indicators of economic activity have actually held up relatively well. The most timely measure of growth in the Euro Area, the business activity PMIs, have continued to stabilise. The services PMI increased in February, rising back up to 52.8, its joint-highest level since August. Manufacturing activity, which of the two industries relies more heavily on external demand, increased to its highest level in a year and is now just below the level of 50 that denotes flat growth (49.1). Much of this bounce was, however, due to an increase in new orders and employment, with the supply chain disruption in China leading to lower foreign orders. We will have to wait until next month's numbers are out on 24th March to get an accurate read on the impact on business confidence.

Asia on course to take a short-term economic hit

Despite the gloomy headlines, we maintain our view that the long-term impact on financial markets will be limited and that the damage done to the economy will be mostly temporary.

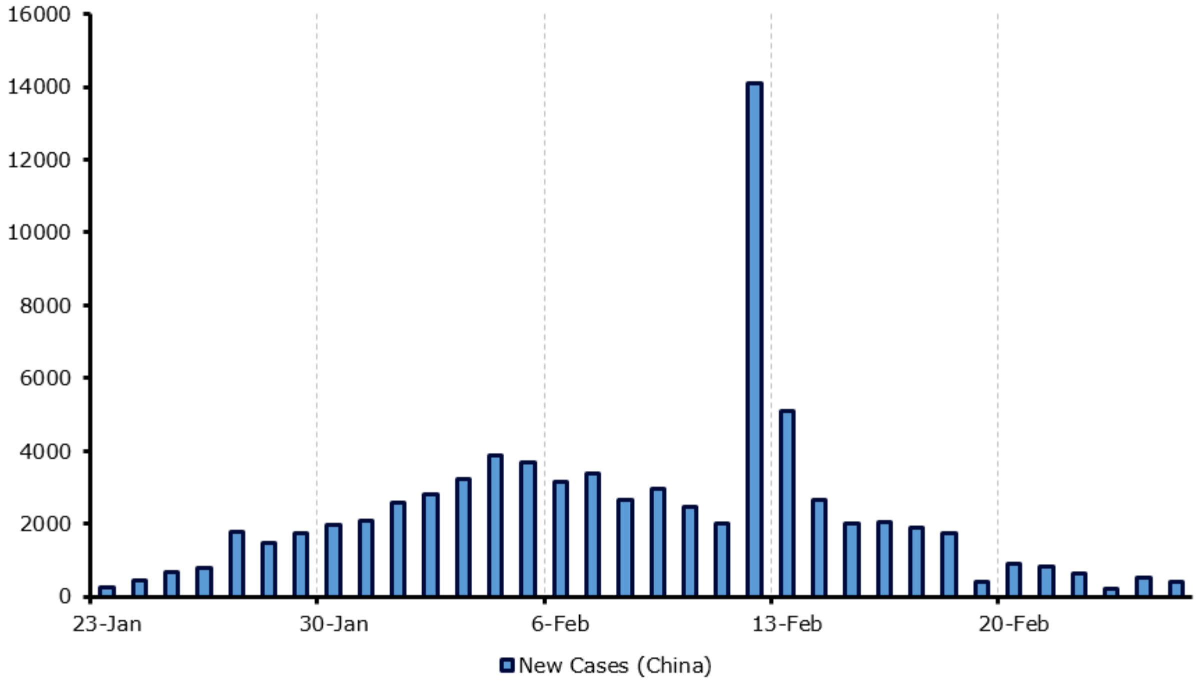
Economies in Asia, particularly those that are heavily dependent on external demand from China, South Korea (25% of total exports to China), Thailand (20%) and Japan (20%) for instance, are likely to take a hit in the short-term. We believe there is now a reasonable chance that the Japanese economy enters into recession in the first quarter of the year following its sharp 6.3% annualised contracting in Q4, which itself was in large part due to a recent sales tax hike. As far as China is concerned, Q1 growth is almost certain to slow, although we think that calls for 5% growth this year from S&P is an overreaction. The next big test for CNY will be this Saturday's Chinese official PMI data for February, which we think is all but certain to post a slowdown.

We do, however, expect a recovery in the medium- to long-term, once concerns surrounding the virus begin to recede, much like following the SARS virus. The pace of the recovery will, in our view, now depend on how long the containment measures remain in place. Some of these have been eased, although most remain in place. Monetary authorities in Asia are also likely to step in should upcoming data take a turn for the worse. Central banks in the region should have room to ease policy further in the coming months and inject liquidity into the market in order to support the economies there. As we noted in our previous coronavirus special report, the PBoC has already done so. We also think that there is scope for an increase in fiscal stimulus in Asia, which could soften the blow caused by the virus. The massive HKD$120 billion relief package unveiled by the Hong Kong government this week is one such example.

What could happen next?

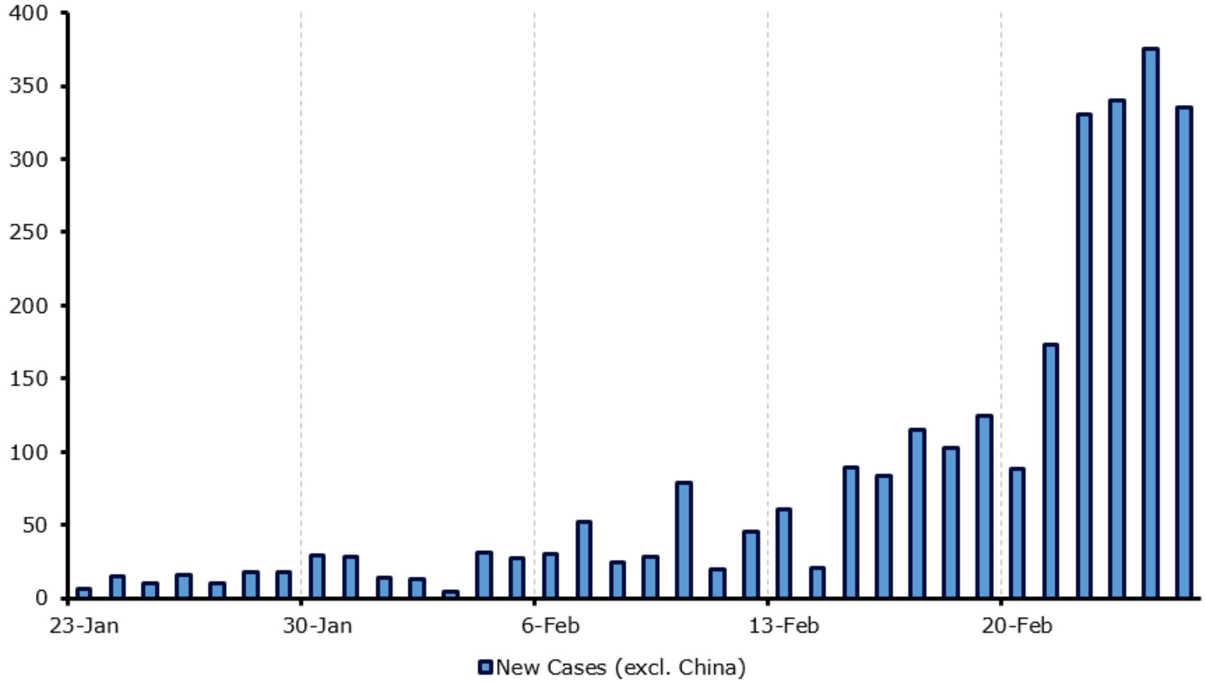
We maintain a cautiously optimistic view of the medium-term impact of the epidemic on the economy and world markets. It's worth noting that while the death toll continues to tick higher, so far only 57 of the fatalities (2%) have been recorded outside of China, with most (94.3%) contained within the Hubei province. The number of cases seem to have peaked in all major hubs (Figure 5), while the recovery rate has also increased sharply. We noted earlier in the month that the ratio of those fully recovered to deceased was around 4:1. This now stands at almost 12:1, with approximately 40% of the total confirmed cases now totally recovered from the virus.

Figure 5: Daily New Coronavirus Cases [China] (23/01/20 - 26/02/20)



Source: Worldometer Date: 26/02/2020

Figure 6: Daily New Coronavirus Cases [excluding China] (23/01/20 - 26/02/20)



Source: Worldometer Date: 26/02/2020

We, therefore, see no reason to panic, and are not yet rushing to revise our currency forecasts - we continue to think that emerging market currencies are well placed to post gains this year once uncertainty surrounding the virus abates. We will, however, be closely monitoring the daily virus numbers for any signs of increased contagion and taking note of the global PMI data to assess the extent of the potential negative economic repercussions.

*according to Worldometer (worldometers.info)