Covid-19 - what will be the economic impact?

Philippe Ledent, Senior Economist

At the end of last week, the markets appeared to be reassured by the notion that the risk of the virus spreading more widely appeared to be marginal: that it would be nothing but a regional Chinese story. However, last weekend's developments sparked a change in the way the markets view the Covid-19 story. **It is now a more significant global concern**, given the new Coronavirus cases in Italy and Korea. Moreover, new cases in new locations are being reported every day.

The global financial markets are now under pressure, causing an increase in volatility at levels which have not been seen since last August, when the rhetoric of the trade war was at its greatest height. The sudden awareness that the risks associated with Covid-19 were not that far away hit the stock markets. As far as the economic impact of this crisis is concerned, attention now has to be diverted from the obvious focus of tourist flows from China towards a much broader one where many countries (including Italy) could become less attractive destinations and where there could be a "scare effect" on consumption and possible disruptions in the supply chain.

Let us be clear about it, It is **very difficult to provide a clear picture of the scope and duration of the epidemic as yet**. The coming weeks will be crucial, both from the medical and from the economic point of view. On the one hand, the number of new cases is falling in China, where it seems the epidemic will soon be under control, at the expense of unprecedented restriction of the population's movements. But on the other hand, the number of new cases outside China increased considerably this weekend, and new locations have been indicated.

The capacity to control them will be crucial to the economic scenario. **It is certain that the probability of containing the epidemic is shrinking as the number of locations multiplies.** That being the case, intermediate results of studies on patients show that some existing drugs are relatively efficacious in combating complications from the disease. This could change the game radically.

A loss of business for many companies in China and elsewhere has to be taken for granted. **However, it may be possible to make up for a temporary block later**, and economic policy measures may help to overcome this hurdle. In contrast, **if the situation is prolonged by the emergence of new locations and more and more numerous restrictions on movement, it will not be easy to make up for the loss of business,** and, as the IMF fears, the economic recovery may be at risk.

To sum up the situation, there are still more questions than answers. It is therefore impossible to define exactly what scenario will materialise, with respect to either health or the economy. **Accordingly, Covid-19 should be considered as a factor which will have a negative impact on the first quarter, but whose effect on the year as a whole is very uncertain**. It is that uncertainty that is currently weighing on the market.

What is the right strategy to adopt?

Steven Vandepitte, Strategist

After a long period of extreme resilience in Western financial markets, which is not easy to explain, **stock markets have slumped in the last few days because of growing uncertainty about the economic impact** of Covid-19 (Coronavirus). Despite this current market correction, there is no question so far of a free fall.

This development is taking place in a very well-defined context. **The government bond market already sensed the negative economic impact of the epidemic some time ago,** as illustrated by the recent fall in market interest rates. However, the stock markets had not really followed up on this expectation. Not until this week, when they were suddenly forced to build more and more economic uncertainty into share prices.

A closer examination of the current correction **soon reveals that it is more of a rational movement, which is more damaging to those companies which have most to lose from the current measures** aimed at curbing the spread of the disease: airlines, hotels, travel agencies, luxury goods companies etc. Companies which have already issued warnings about the negative impact of the Coronavirus on their upcoming quarterly figures are likewise among those most affected.

The lessons of the past after the outbreak of SARS and swine flu, for example, teach us that these phenomena often have more of a local impact, including on stock markets. In historical terms, once the number of infections has peaked media attention tends to ease off progressively and, in parallel, stock markets tend to recover strongly. However, these lessons from the past are not enough. **In the current case, the fact that we are living in a truly globalised economy and that everything happens much more quickly than it used to, including the spread of new diseases, has potentially been neglected by the markets up to now.**

Beyond the fall in stock prices, it should be noted that **government bonds and "safe havens" such as the dollar and gold are tending to appreciate at the moment, which will tend to absorb the negative shock and stabilise well diversified portfolios.** Furthermore, it is likewise interesting to see that, **in emerging countries in Asia, some stock markets are falling much less than stock markets in developed countries. This could indicate that in these countries at least stock markets could start to make a tentative recovery.**

In conclusion, our advice remains unchanged, which means that we are still aiming for a balanced (in other words, neutral) portfolio of fixed-income assets and equities. What we are seeing today exemplifies the nature of a market correction. Even though it may not be entirely unexpected, the timing of a correction is never favourable and may make inexperienced investors jittery, leading to emotional reactions and inadvisable selling. We will stay the course and stick to our recommendations.