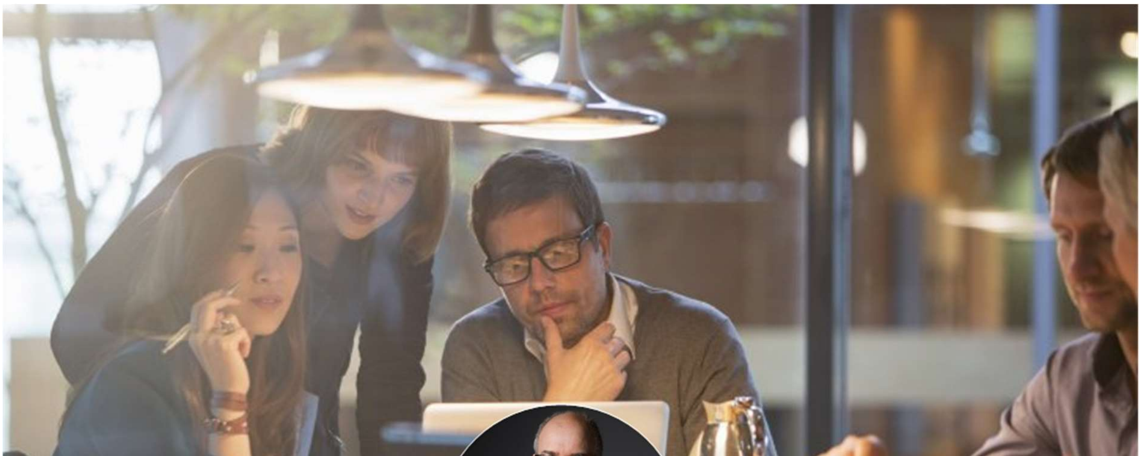
COVID-19: 18 MARCH UPDATE

18 March 2020



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IN A WORD:

Volatility remains extremely high and short-term uncertainty persists but current stock market levels offer opportunities to add to positions for the medium/long term.

Volatility in financial markets is very high at present. The good trading day of 17 March (the US stock market was up 6% yesterday) was eclipsed by another drop of nearly 4% this morning when the European markets opened, and Asian stock markets had closed in the red. Risk indicators are very tight (VIX at 75, V2X at 83) and credit spreads are at unprecedented levels since the 2008/2009 crisis.

In terms of the Covid-19 pandemic, the number of new cases is almost zero in China, and stabilising at a low level in South Korea. On the other hand, in Europe, the new epicentre of the epidemic, the number of cases continues to soar, including in Italy, the first European country to implement confinement measures. To be precise, the speed of acceleration of new cases in Italy is beginning to tail off, which is the prelude to a future decline in the number of cases. This could happen in the next 8 to 15 days if the pattern of developments in China and South Korea is repeated. Elsewhere in Europe, the number of cases continues to climb. In the United States, the number of cases remains surprisingly low, but a sudden acceleration is feared. Everywhere, confinement measures (for health reasons) are accelerating, and now widespread in Europe.

Little economic news: more and more downgrades to economic growth forecasts, and our scenario of a global technical recession in the first half of the year is now widely accepted. The key issue will be the rebound we expect in the second half of the year. At the moment, many European companies are announcing factory closures and almost complete shutdowns of activity, which are translating into sharp downgrades of growth forecasts, and fuelling concerns in the media.

Other concerns are the risk of liquidity and credit. We observe that companies are drawing on their traditional credit lines with banks in order to cover their short-term liquidity needs. Furthermore, on the credit/corporate bonds/corporate loans markets, liquidity indicators are worsening; bid/ask spreads are widening, the spread on the US High Yield (risky segment of the corporate bond market) has reached a new recent high, and the iTraxx cross-over index in Europe now exceeds 650. All these technical indicators are at unprecedented levels since the 2008/2009 crisis. As shown below, the systemic risk of the feared credit crunch is being taken very seriously by central banks.

In the context of all this bad news and the stress on financial markets, the response in terms of economic policy is massive, global and coordinated. It concerns monetary policy and fiscal policy. The 'policy mix' is expansionary overall. Monetary policy tools are being fully utilised; key rates are being cut to 0, there are massive liquidity injections, as well as support given to banks for their specific role in financing SMEs. There is also the task of countering the well-known risk of a credit crunch in times of recession, during which companies have liquidity needs.

We are reminded of Draghi's 'whatever it takes' approach to saving the euro during the regional crisis in 2012. This expression now applies to fiscal policy in the G20. All governments are announcing massive measures. The table below summarises most of the measures announced to date.

	Tax measures	Monetary policy measures
Germany	Easy access to short-term employment. Increase in public investment in 2021-24 Support for corporate liquidity through tax deferrals Development of existing guarantee systems provided through public bank KfW Additional expenditure of €1 bn for the Ministry of Health	The ECB has taken strong measures similar to those taken in the 2008 crisis: Increase in the bond purchase programme to EUR 120 bn Refinancing facility (TLTRO) for commercial banks (negative rate -0.25% or very negative -0.75%)
France	Subsidies for short-term employment Late payment of taxes and social security contributions Suspension of the new tax on the use of temporary contracts Increase of loan guarantee schemes for SMEs Solidarity Fund for small businesses	
Italy	Tax package of over €25 bn Postponement of all tax payments until 31 May Compensation of 60% of corporate property rental costs Mortgage adjustment for the self- employed Increased support for short-term employment Household support for childcare and the health system	
Spain	Fiscal package of €14 bn Tax and social security credits State Development Bank credit lines Support for income loss due to Covid-19 €3.8 bn in government support to the health care sector	
UK	£30 bn fiscal package £12 bn (0.5% of GDP) for targeted support measures (£5 bn emergency fund to support utilities, £7 bn of measures to help households and businesses) £18 bn earmarked to longer-term measures to be implemented later this year But also: £20 bn of tax cuts and grants to corporates £330 bn of government-backed loans to corporates	The Bank of England cut rates by 50bp Support programme in the short maturity corporate bond market
USA	Fiscal package of $1.2 trn $300 bn of small business loan provisions $200 bn of stabilization funds Tax postponements for individuals and businesses that make up the rest of the $1.2 bn stimulus	The Fed cut rates by 150 bp to 0-0.25% New programme of bond purchasing and lending to companies ($700 bn) Support measures to reduce stress in the commercial paper market Relaunch of financing facilities for large corporates Resumption of a USD swap policy with other central banks to ensure USD liquidity

Sources: Financial Times, UBS, Deutsche bank, BNP Paribas

On the stock markets, there have been many downward revisions to earnings estimates. Overall sentiment is deteriorating (more rapidly among individual investors than institutional investors), but pessimism is now very dominant. This indicator is often 'contrarian,' meaning that an excess of pessimism often indicates good entry points in the medium term. But in the short term, there is high uncertainty because fundamentals are deteriorating, the oil price has recently hit a new low (at $28 per barrel of Brent), the situation in the credit market is tight and volatility levels are excessive.

However, we remain convinced that the impact of the current economic policy measures, which will take time to impact economies and businesses, should not be underestimated. As soon as the first signs of the epidemic peak emerge, it will be the right time to anticipate a rebound in economies, interest rates and equity markets.

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