Perspectives
Weekly update

24 March 2020

COVID-19: Impact on economies and financial markets

Navigating with scenarios and milestones

- Besides the distressing cost of lives, the outbreak of COVID-19 causes a global recession in 2020
- Volatility on financial markets reached levels not seen since the height of the great financial crisis.
- Below, we describe our revised economic scenarios for 2020 as well as potential milestones which could signal tipping points in investors' sentiment.

Base case: Recession, followed by a U-shaped recovery (Probability: 50%)

- Based on the experience in China and South Korea, we assess the impact of the supply shock on an economy in lockdown as well as the time until capacity utilisation recovers.
- We now assume that output in Europe and the US drops by around 10% to 20% in the first half 2020 (see chart).
- Unprecedented fiscal and monetary policy measures help to partially offset the fall in output and a longer lasting demand shock. They are intended to ensure liquidity of the corporate sector, to avoid a wave of layoffs and to protect fiscally weaker countries in Europe's periphery.
- A partial normalisation of activity once the quarantine measures prove effective would result in a U-shaped recovery of the developed economies in the second half of 2020.
- Under this scenario, we expect output to reach its end 2019 levels by end 2020 the earliest.

Alternative scenarios

- In an adverse scenario (30% probability), corporate defaults trigger a renewed financial crisis. Demand fails to recover in the second half 2020. A second wave of COVID-19 infections in Asia poses an additional risk.
- A more positive scenario (20% probability) would be triggered by a rapid decline in new cases, or news on the availability of treatments or vaccines.

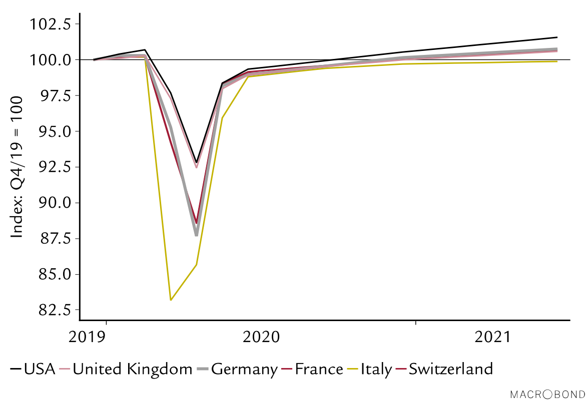
Developments on the financial markets

- Despite tentative signs of stabilization in Europe on the back of support measures, US equities weakened due the ineffective handling of both the pandemic and its economic fallout.
- Sovereign bond yields started the week with a sharp increase, but central bank actions moved yields down again. Credit markets remain disrupted, although spreads narrowed slightly.
- Markets are to stay volatile as long as US response appears ineffective. We keep a defensive positioning but start looking for opportunities.

Milestones to observe until March 30th

- *Medical:* No second wave in Asia, Europe reporting decrease in daily new cases
- *Fiscal and monetary policy measures:* Credible policy response in the US to ringfence labour market and corporate liquidity. Steps towards issuance of a common "Eurobond".
- *Economic data:* We expect a sharp fall in purchasing managers' indices (PMI) for Europe. Labour market data seen to deteriorate fast. In China, coal consumption to confirm pick-up in activity. Rebound of China's PMI is the next important milestone.

U-shaped recovery in second half 2020



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