Investment Insight

February 2020

Hope in spite of coronavirus

The coronavirus outbreak has the world and the financial markets on tenterhooks, although the consequences currently appear to be only temporary. The signs of an economic recovery look good for the medium term.

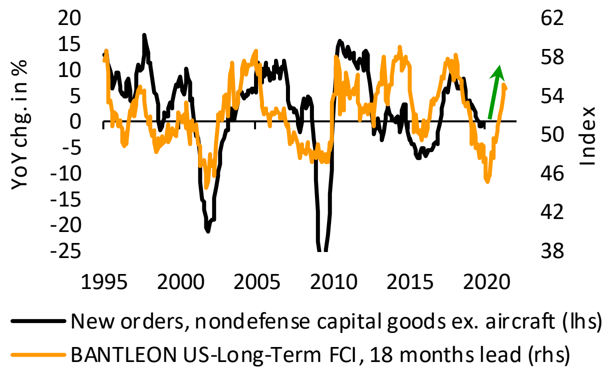
This new strain of the coronavirus is keeping the world on tenterhooks and is increasingly leaving its mark on economic developments. Production in large parts of China has been halted for some time. More than half of the provinces – which together generate around 70% of China's gross domestic product – have extended their New Year's holiday by at least a week. It is not certain when companies will be allowed to resume operations. However, even a rough estimate shows that this is likely to slow down GDP growth in the current quarter significantly more than previously expected. We consider a decline in the annual growth rate from +6.0% in Q4 2019 to between 3% and 4% possible.

The actual extent of the braking effect on economic growth in the first quarter of 2020 will critically depend on the further spread of the virus. However, regardless of this, we only see it as a temporary problem. The wave of infection is likely to peak sooner or later, enabling protective measures to be gradually removed. This is supported not least by the fact that, according to current knowledge, the new pathogen is less aggressive than SARS was in 2003, for example. At least in the industrial sector, the impending production losses will therefore likely be offset in the medium term and thus provide new impetus for economic growth in the subsequent quarters. The government's fiscal support measures should further cushion the economic slowdown.

In the USA, GDP growth remained respectable in Q4 2019. With an annualised increase of 2.1% over the previous quarter, the pace of expansion was on a par with the previous two quarters. There was no surprise in the structure of GDP growth. Private consumption, for example, took a breather following its sharp rise in the summer half-year of 2019 (+3.9% on average), growing by only half as much (+1.8%). In addition, the development of inventories had a noticeable braking effect, while falling corporate investments also generated a dampening effect. These adverse factors were offset by foreign trade, which lent a considerable boost to growth due to declining imports.

The recent setback in orders received for non-defence capital goods in December 2019 still points to sustained weak demand for capital goods in the current quarter. In addition, the suspended production of the Boeing 737Max is likely to slow down GDP growth in the 1st quarter by 0.5 percentage points. However, this trend is likely to completely reverse at some point during the year. The braking effect of the virus epidemic is also likely to be temporary, given the low dependence of the USA on exports. We assume an expansion rate of just 1.0% to 1.5% for Q1 due to the disruption. Looking further ahead, however, incoming orders will likely climb again and thus trigger a new upturn in investment (see figure below). We expect a significant upturn as early as the second quarter, which will be the prelude to a sustained recovery in growth.

USA: Investment set to pick up soon

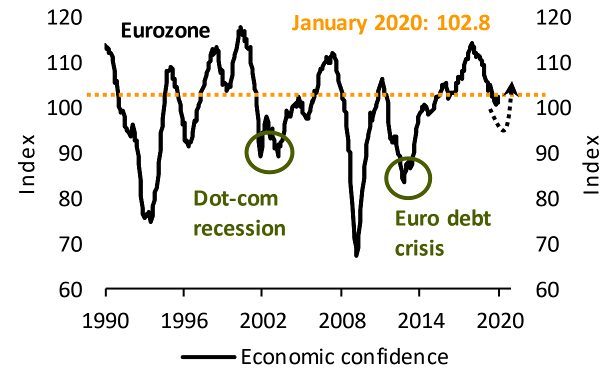


Sources: Census Bureau, BANTLEON As of December 2019

Domestic demand in the Eurozone lost momentum at the end of 2019

Eurozone economic output in Q4 2019 rose by just 0.1% over the previous quarter. This was the smallest increase since Q1 2013, when the Eurozone economy was still suffering from the effects of the debt crisis. In addition to a slowdown in consumption, inventory investments once again put a damper on growth. Domestic demand in the Eurozone lost momentum at the end of 2019. Unlike in the past, this was not cushioned in that quarter by a positive contribution to growth from foreign trade. Spain and Belgium posted the largest increases in GDP growth, while France and Italy recorded a decline (-0.1% and -0.3%, respectively).

Eurozone: Economic confidence turns positive



Sources: EU-Commission, BANTLEON

However, more important than looking into the economic rear view mirror is looking ahead. For instance, we consider the weakness in private consumer spending to be a mere blip. This is supported by a still very robust labour market, solid real wage growth and a high savings rate. We therefore assume that private households will increase their spending again significantly this year. The same applies to government consumption, as there is considerable fiscal space in Germany and the other core euro countries. Moreover, export demand is expected to increase as the year goes on and the trend in inventory investments to reverse. We therefore maintain our assessment that Q4 2019 marked the cyclical trough, and GDP growth will already be higher again in Q1 2020. This is also supported by the fact that the ifo index for the manufacturing sector and the industrial confidence survey conducted by the European Commission confirmed the positive signs from the purchasing managers' index for industry in January. Driven by the sharp increase in industrial confidence, the European Commission's economic sentiment indicator for the Eurozone also jumped unexpected, by 1.3 points, to 102.8 points (see figure above). We currently assume that the effects of the coronavirus crisis will, in the worst case scenario, delay the upswing in the Eurozone, but not stifle it.

The financial market outlook remains two-speed in the current environment

However, the coronavirus currently has a tight grip on the financial markets. Equity markets reacted to the spread of the flu outbreak with significant discounts, whereas safe havens such as gold and top-rated government bonds (Germany, Switzerland, USA) were in great demand. In the long term, however, severe waves of influenza affect the financial markets like »natural disasters«. Based on the SARS epidemic of 2003, the global economy is likely to suffer a visible setback, but recover quickly and enter an upward trend as early as the second quarter.

The financial market outlook therefore remains two-speed in the current environment. As long as the steep upward trend in the number of people infected with the coronavirus continues, uncertainty is likely to persist in the financial markets and play into the hands of safe havens. However, as soon as there is light at the end of the tunnel, the risk-on atmosphere will likely return. In the medium term, this should give a renewed boost to the stock markets in particular, and lead to a reduction in risk premiums for corporate bonds. By contrast, the recent price gains in high-quality government bonds will not last and yields will rise again in the medium term.

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