Market Bulletin

21 July 2020

Monitoring the global impact of Covid-19

The spread of the coronavirus and its impact on global economic activity has materially changed the investment outlook for 2020. In this piece we provide a framework for tracking the state of play in different countries and monitoring the impact on economic activity. We consider how government and central bank interventions are working to avoid lasting scars to the global economy and facilitate an economic recovery.

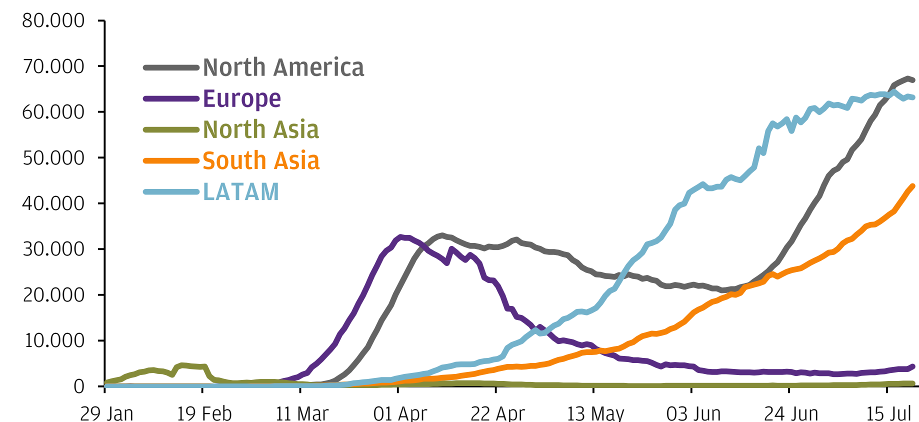
Many countries have had some success in controlling the virus by implementing drastic social distancing measures, and are now moving to reduce restrictions. However, pockets of outbreaks around the world have highlighted that the virus has not yet been beaten. We expect the reopening of the economy to prove gradual. In the absence of a meaningful medical advancement, it will be some time before full normality is restored. For that reason we retain a degree of caution and suggest that within both equity and credit markets, we focus on investing in companies with strong balance sheets that are better positioned to cope in this challenging economic environment. Core government bonds have performed strongly. However, further upside for US Treasuries and UK Gilts will be more limited from here unless these central banks shift their guidance that they do not intend to take interest rates into negative territory. Investors may wish to consider alternative diversifiers such as macro funds, or real assets if liquidity is not a requirement.

What are the latest virus statistics?

Exhibits 1-3 provide the latest data on the spread of the coronavirus. China, South Korea and several continental European nations have made particularly notable progress in controlling infections, following the significant restrictions on activity. Early evidence suggests that targeted lockdowns and extensive track and trace programmes have allowed these economies to limit new cases as they begin gradual reopening. It appears that the US is currently experiencing a renewed spike in infections, and we remain watchful of the UK and Spain where, despite having reduced infection rates prior to reopening, recent data is showing an increase. Globally we continue to be concerned about Latin America and Southern Asia which are still experiencing their significant first waves of infections.

EXHIBIT 1: COVID-19 DAILY INCREASE IN CASES

Seven-day moving average



Source: Johns Hopkins CSSE, J.P. Morgan Asset Management. Cases include both laboratory confirmed and 'presumptive positive' cases. Europe includes countries in the EU27 plus Switzerland and the UK. North Asia includes data from: China, Hong Kong, Taiwan, Japan, and South Korea. South Asia includes data from: Bangladesh, India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, and Vietnam. Data as of 20 July 2020.

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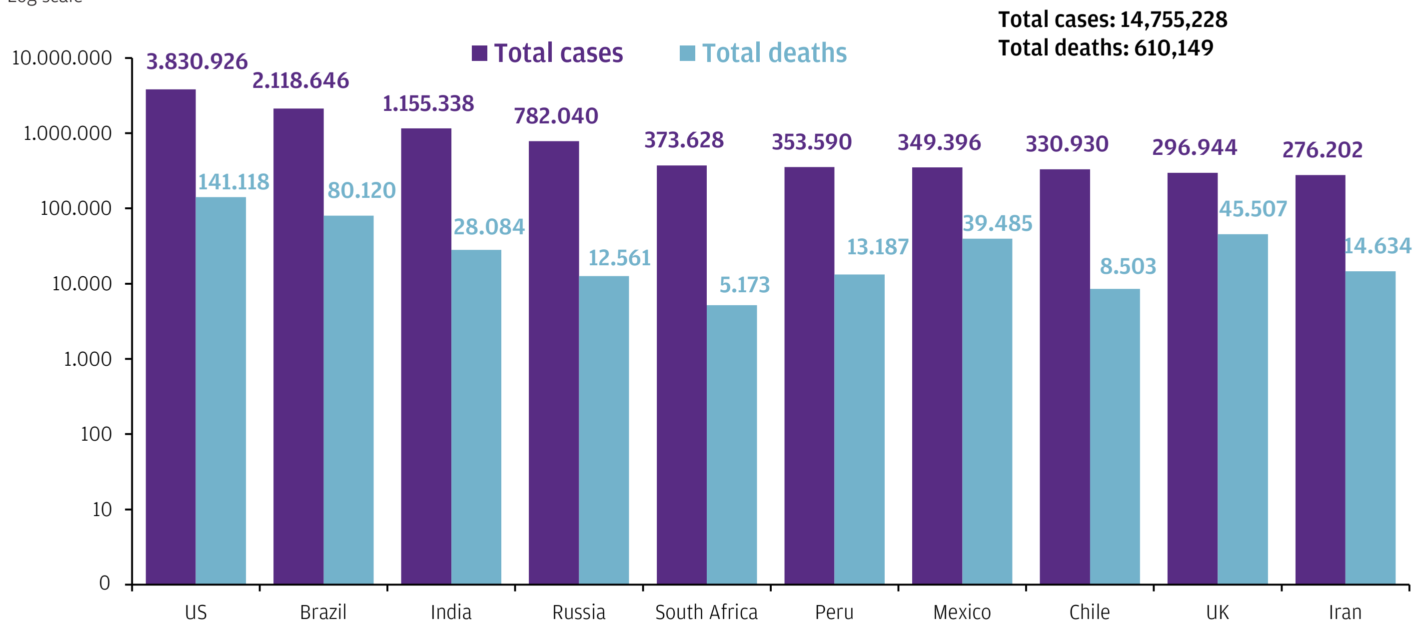
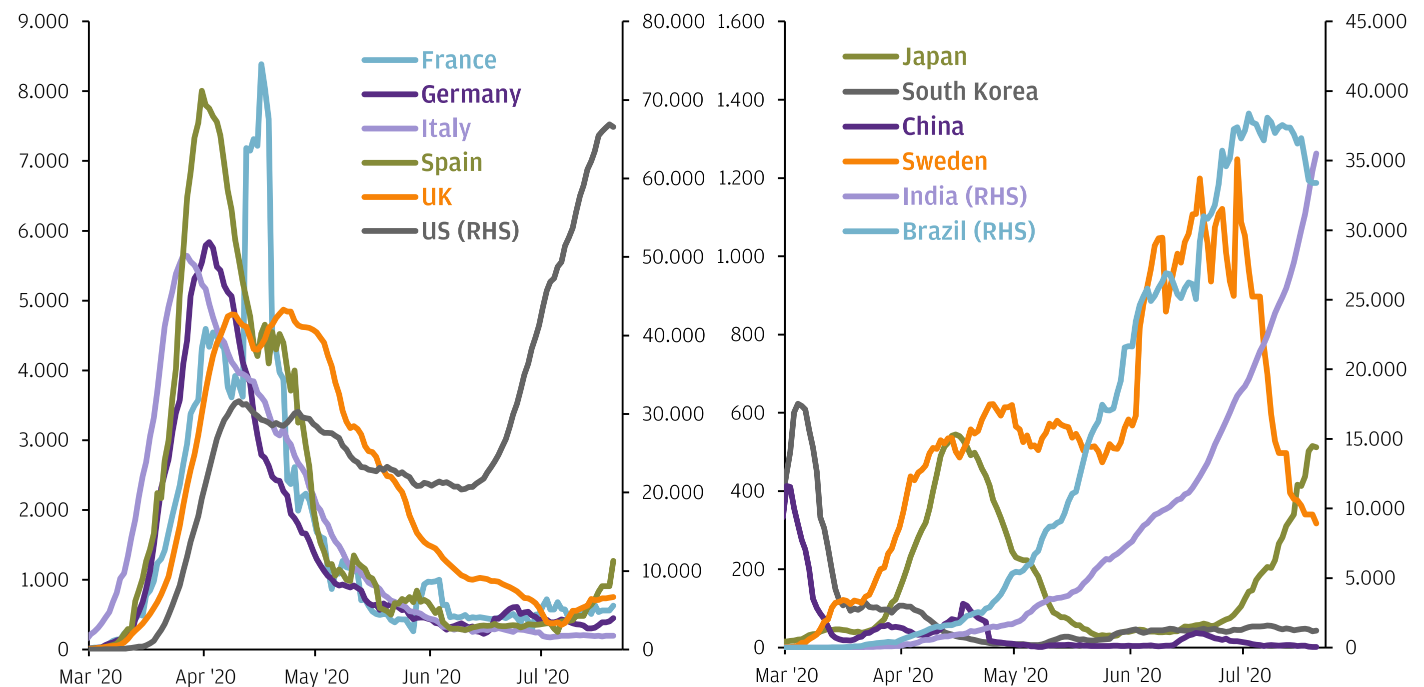
EXHIBIT 2: COVID-19 REPORTED CASES AND DEATHS BY COUNTRY
Log scale



Source: Johns Hopkins CSSE, J.P. Morgan Asset Management. Cases include both laboratory confirmed and 'presumptive positive' cases. Data as of 21 July 2020.

EXHIBIT 3: COVID-19 DAILY INCREASE IN CASES
Seven-day moving average



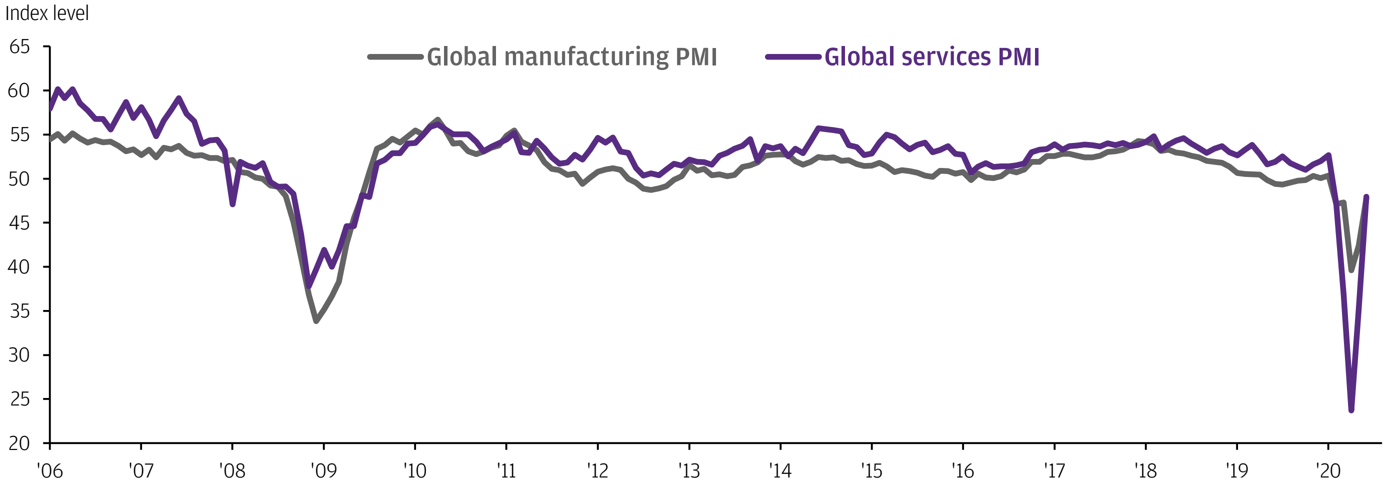
Source: Johns Hopkins CSSE, J.P. Morgan Asset Management. Cases include both laboratory confirmed and 'presumptive positive' cases. Data as of 20 July 2020.

How is current activity being affected?

The impact on the global economy is large and broad. The manufacturing sector is coming back on line in many economies given the ability to adhere to social distancing requirements for workers. Services will likely take longer to return to normal (**Exhibit 4**). Airlines, hotels, restaurants, cinemas and concert venues are among those most acutely feeling the squeeze. After Purchasing Managers' Indices (PMIs) dropped to levels in April last witnessed during the financial crisis, more recent data has generally bounced off the lows. We would caution against interpreting this pickup as signalling a V-shaped economic recovery. While economic momentum is improving, the absolute level of activity in most sectors still looks well below the level seen prior to the virus.

EXHIBIT 4: GLOBAL PURCHASING MANAGERS' INDICES

Index level



Source: Markit, J.P. Morgan Asset Management. Data as of 20 July 2020.

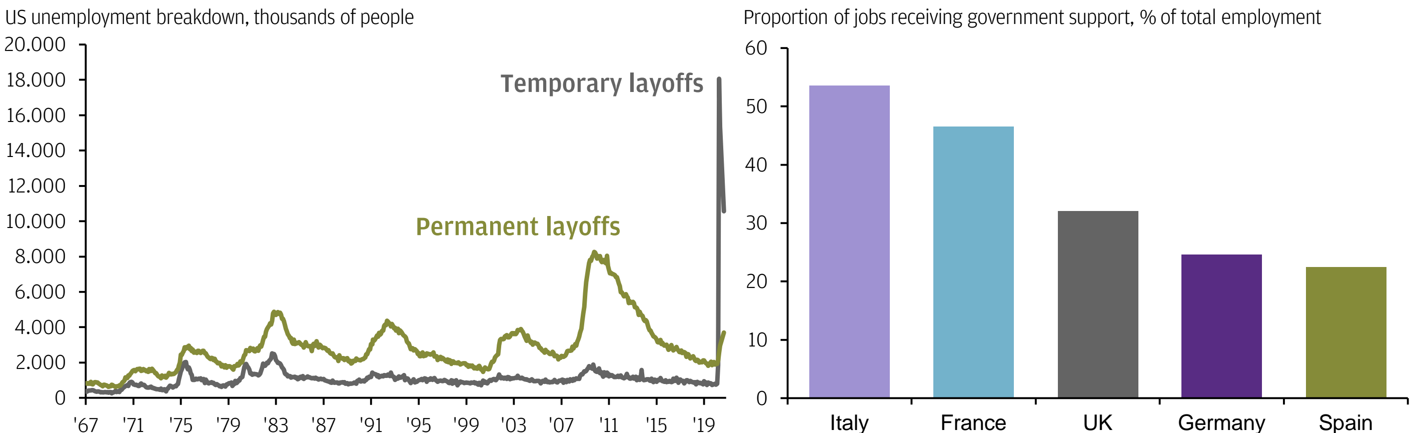
Are government policies succeeding in preventing lasting scars?

Governments across the globe have launched huge stimulus packages in an attempt to hold their economies in "suspended animation". The goal is to prevent lasting damage to the economy, reducing the likelihood of a vicious cycle whereby firms make lasting cuts to staff, business investment, inventory orders and so forth.

Approaches vary by region. In Europe, several countries have implemented wage subsidy schemes such as Germany's "Kurzarbeit" short-shift programme. These schemes aim to limit job losses, with the government providing subsidies for a portion of a company's wage bill. The US fiscal stimulus package takes a slightly different approach, focusing on bolstering the safety net for the unemployed. Unemployment insurance payments have been temporarily increased by an additional $600 a week, meaning that some unemployed US citizens have been receiving more from unemployment pay-outs than they would have earned by continuing to work. The challenge for governments is to strike the right balance between encouraging citizens to return to work where safe to do so, without withdrawing support for those who need it. We see a risk that labour markets are not ready to absorb all of the jobs that have been lost (or paused via furlough schemes) at the point at which stimulus expires **(Exhibit 5).**

These policies will lead to larger fiscal deficits, which will of course lead to much larger bond issuance. This is where the central banks have been required to show willing to buy government debt to ensure the market can absorb this additional issuance without undue stress. Again we're encouraged by the speed with which the central bank community has reacted and the magnitude of the asset purchases and liquidity schemes that have been announced. In many cases including the Fed, ECB and BoJ the packages that have been announced exceed those delivered during the financial crisis, and markets have broadly reacted positively. The Fed's commitment to buy both investment grade and high yield credit for the first time, as well as an unlimited amount of US Treasuries and mortgage-backed securities, has been particularly striking. We are tracking the key policies from both governments and central banks (**Exhibit 6**), which gives us a sense of the steps policymakers are taking in an effort to prevent lasting scars for their economies.

EXHIBIT 5: US UNEMPLOYMENT BREAKDOWN AND PROPORTION OF JOBS RECEIVING GOVERNMENT SUPPORT IN EUROPE



Source: (Left) BLS, Refinitiv Datastream, J.P. Morgan Asset Management. (Right) Bloomberg, J.P. Morgan Asset Management. Data as of 20 July 2020.

EXHIBIT 6: FISCAL AND MONETARY POLICY RESPONSES BY COUNTRY*

Monetary policy response

Federal Reserve

- Federal Funds Rate cut to a target range of 0.0 – 0.25%.
- Restarted asset purchase programme
- Treasury and agency MBS purchases are now unlimited
- Expanded the programme to include agency CMBS
- Launched a Primary (PMCCF) and Secondary Corporate Credit Facility (SMCCF), and restarted Term Asset-backed securities Loan Facility (TALF)
- Significantly enhanced USD liquidity swap arrangements with a wide range of central banks to ensure there is sufficient U.S. dollar funding available
- New Foreign and International Monetary Authority (FIMA) repo facility, which lends US dollars overnight against Treasury holdings of foreign central banks
- New Paycheck Protection Program Liquidity Facility (PPPLF) and Main Street Lending Program to support funding to small businesses
- Municipal Liquidity Facility to be established to purchase short-term notes directly from U.S. states

European Central Bank

- Launched the Pandemic Emergency Purchase Programme (PEPP)
    - Minimum of EUR 1350bn (original EUR 750bn was increased by EUR 600bn at May meeting) with purchases to run until at least June 2021
    - Increased flexibility on issuer and maturity limits
    - Short-term deviations from the capital key permitted
    - Greek bonds are eligible for purchase
- Expanded existing Asset Purchase Programme (APP) by EUR 120bn
- Expanded eligibility of non-financial commercial paper for the Corporate Sector Purchase Programme (CSPP)
- Enhanced Targeted Longer-Term Refinancing Operations (TLTROs)
- Launched non-targeted Pandemic Emergency Longer-Term Refinancing Operations (PELTROs) to provide a liquidity backstop
- Bonds downgraded to junk since 7 April will be viewed as eligible collateral to access ECB lending on a temporary basis
- Euro liquidity will be provided to a broad set of central banks outside the euro area via the Eurosystem repo facility

Bank of Japan

- Purchases of commercial paper and corporate bonds (up to ~ JPY 20trn)
- Special Funds-Supplying Operations to facilitate financing with private debt accepted as collateral ~ JPY 25trn
- SME fund provisioning against eligible loans ~JPY 30trn
- Doubling of annual purchase limits of equity ETFs and REITs
- New measures to provide financing to banks to facilitate lending to SMEs

Bank of England

- Cut interest rates to 0.1%
- Restarted asset purchase programme
- GBP 300bn of purchases to be made by year-end
- Commitment to expand purchases further if necessary
- Launched a COVID Corporate Financing Facility (CCFF) to purchase commercial paper
- Launched a Term Funding Scheme for SMEs (TFSME)
- Cut the countercyclical capital buffer from 1% to 0%
- Temporary direct financing of government spending needs, reviving the "Ways and Means Facility" that was used in 2008

People's Bank of China

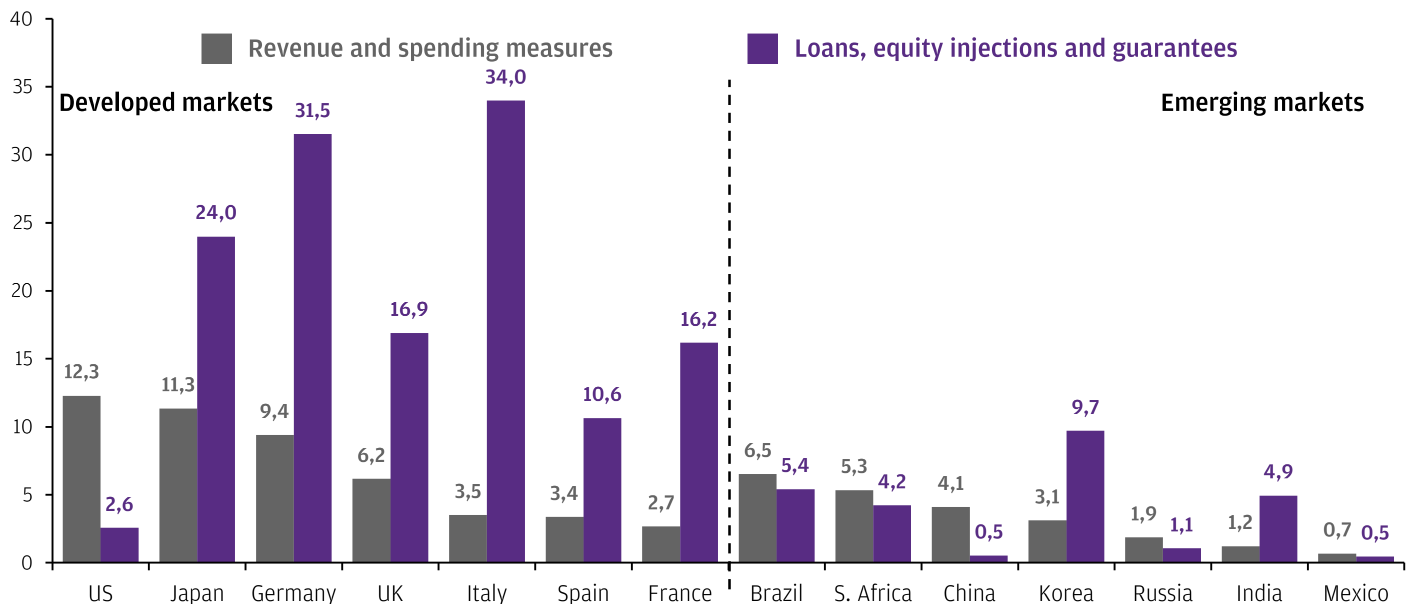
- Widespread cuts to 1-year Medium-term Lending Facilities (MLF) rate, Loan Prime Rate (LPR), 7-day reverse repo rate and excess reserve rate. Targeted RRR cuts
- Further rate cuts and RRR cuts are anticipated
- Non-performing loan recognition temporarily relaxed
- RMB 2.2trn re-lending loans to SMEs, and deferred principal and interest payments for SME loans

Reserve Bank of India

- INR 3.74trn injection to support the financial markets and smooth volatility, which includes
    - TLTRO of up to INR 1trn
    - repo rate cut by 75bps to 4.00%
    - reverse repo rate cut by to 3.35%
    - cash reserve ratio cut by 100bps to 3%

GLOBAL DISCRETIONARY FISCAL STIMULUS MEASURES IN RESPONSE TO COVID-19

% of 2020 nominal GDP, based on IMF estimates



Source: (Top) Bloomberg, J.P. Morgan Asset Management. Data as of 20 July 2020. List of policy measures is not exhaustive. (Bottom) Source: IMF Fiscal Monitor, IMF World Economic Outlook, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Guide to the Markets - UK. Data as of 30 June 2020. For full details of the fiscal policy response, please see the IMF Policy Tracker.

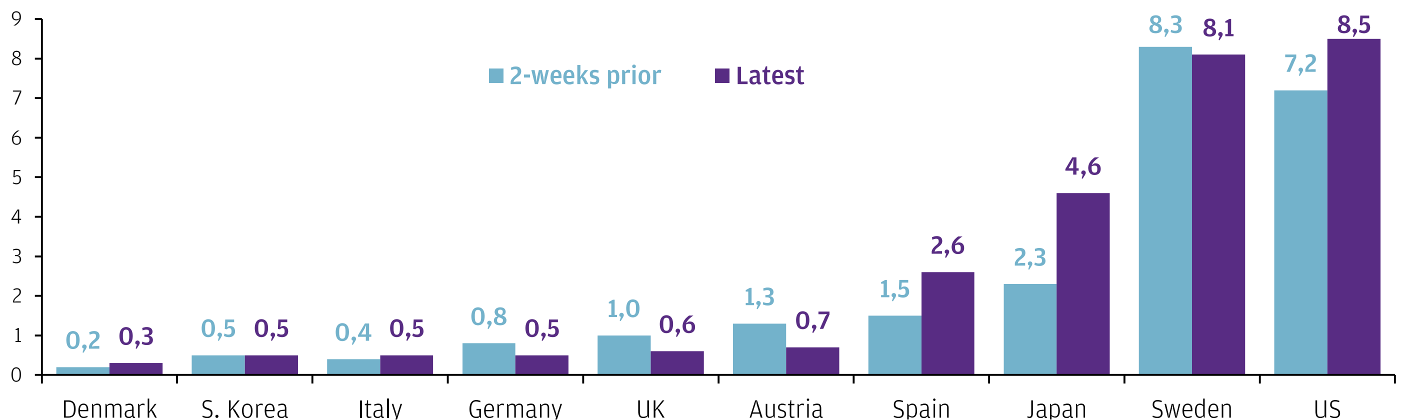
In summary, policymakers have acted decisively. Economic data in the developed world is clearly highlighting the magnitude of this shock, but the willingness of governments to spend is no longer in doubt, and the central banks are acting at a pace and in a size that has never been seen before. What will be critical going forward are signs that the policy response is working to facilitate a bounceback later in the year once economies have reopened. Chief amongst the indicators to follow are those of hiring intentions to assess whether policies are serving to shore up the labour market. Risks remain that second waves of infections could force investors to reassess their expectations of how quickly global activity can normalise.

How can economies begin to restart successfully?

Investors are now increasingly focused on how governments will be able to limit a second wave of infections while lifting lockdown measures. A study put together by the University of California, Berkeley, set out a series of conditions, which would be required for governments to efficiently exit lockdown measures. Those conditions include: high levels of population testing, effective contact tracing, a gradual approach to exiting lockdown and maintaining social distancing, and shielding of the most vulnerable in society. We have a higher degree of confidence for countries that meet these criteria in being able to successfully reopen their economies.

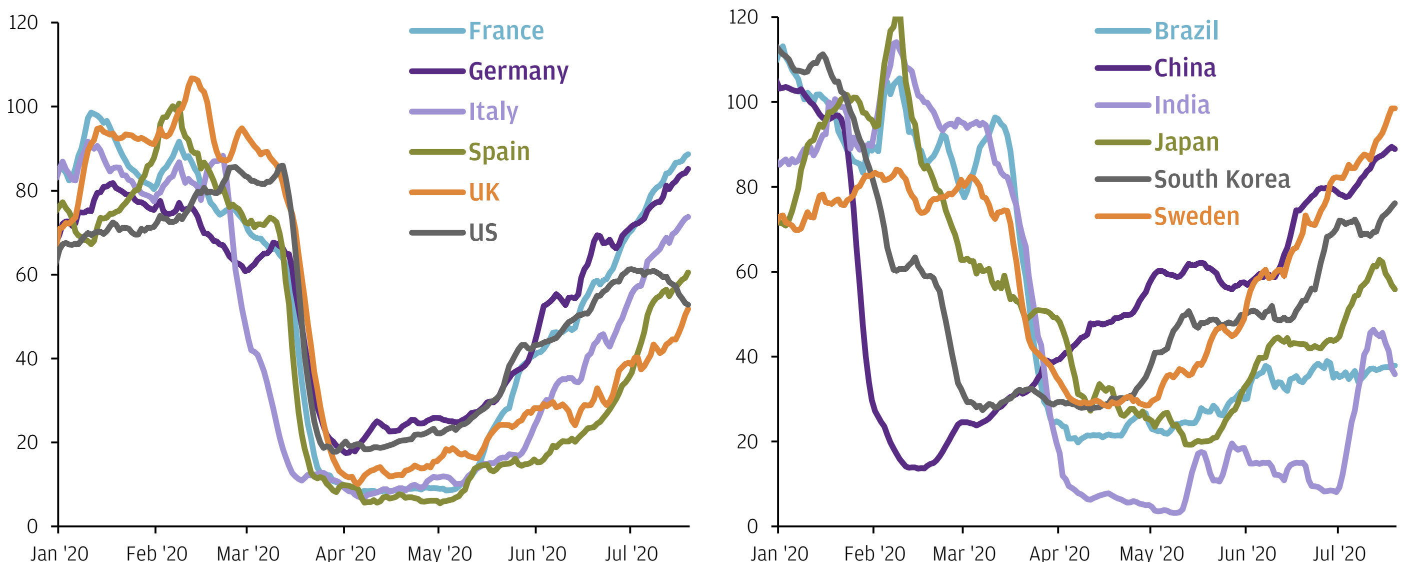
High testing capabilities will allow governments to effectively isolate individuals with Covid-19 and reduce the spread of the disease among the broader population. The current data on testing suggests that some countries are better placed than others to reduce lockdown measures **(Exhibit 7).** China and South Korea are making steady progress in restarting activity, although both countries remain highly vigilant to any signs of subsequent outbreaks. Testing there has been high, in particular in S. Korea, and the infection rate has remained low. In Europe, Denmark and Austria appear to be most on top of testing for new infections. Those countries with lower levels of testing and with high infection rates are most at risk of an increase in infections when opening their economies.

EXHIBIT 7: PERCENTAGE OF COVID-19 TESTS THAT ARE POSITIVE
Seven-day moving average



Source: Our World in Data, J.P. Morgan Asset Management. Data used for each country is the latest available. Testing figures are reported differently across countries and may refer to people tested or the number of tests performed. Data as of 20 July 2020.

EXHIBIT 8: TRAVEL AND NAVIGATION APP USAGE
% of 2019 average



Source: App Annie, J.P. Morgan Asset Management. Data is sourced from App Annie with over 600 travel and navigation apps globally, including Google Maps, Uber, Airbnb and Booking.com. Data as of 19 July 2020.

We can track the extent to which economies are reopening, both to monitor the extent to which activity is returning as well as identifying which countries look vulnerable to a second wave of infections. Travel and navigation app data, which is a proxy for the amount of travelling taking place amongst people, is a way we can monitor this **(Exhibit 8)**. The data so far shows that China, S. Korea and the major eurozone economies are getting back to normal with activity levels rising. In the US the indicator looks to be rolling over as a result of reopening measures being rowed back, as well as consumers and corporates exercising more caution due to the rise in Covid-19 infections.

Ultimately the decisions around how quickly containment measures should be relaxed need to carefully weigh the economic costs against the risk of further infections and the capacity of each health system to cope. New increases in cases in countries that have had relatively short lockdown periods highlight the challenges that face policymakers. A decision from governments to move too quickly may ultimately result in a voluntary lockdown by the broad population and a scenario where the economy does not restart and the health system may again come under pressure. A gradual approach and ongoing social distancing will be required to avoid this scenario and to allow the economy to slowly get back to full fitness.

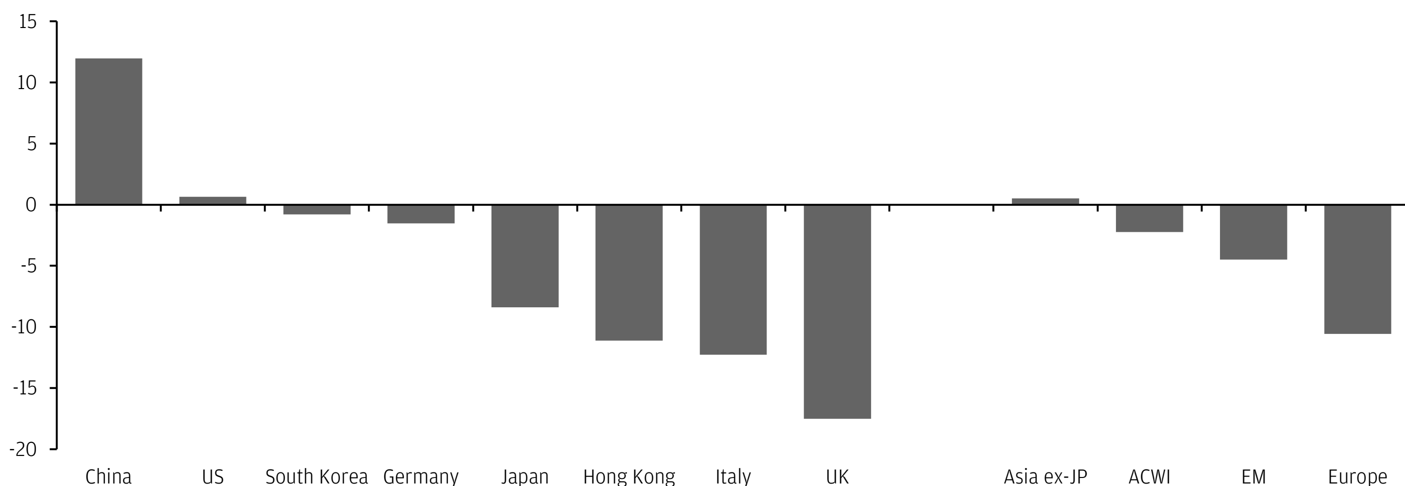
How have the markets reacted?

This sell-off is not remarkable in its magnitude but it is in terms of speed. Energy heavy benchmarks – including the UK market – were hit especially heavily given the collapse in oil prices, although the energy sector has bounced back in recent weeks. Sentiment is shifting around rapidly, yet while both the depth and duration of the hit to activity is so uncertain we do not think it appropriate to have overweight positions in riskier assets. Policy support is set to remain strong, but the market appears to be priced for the best outcome and we believe downside risks remain.

EXHIBIT 9: MARKET REACTION

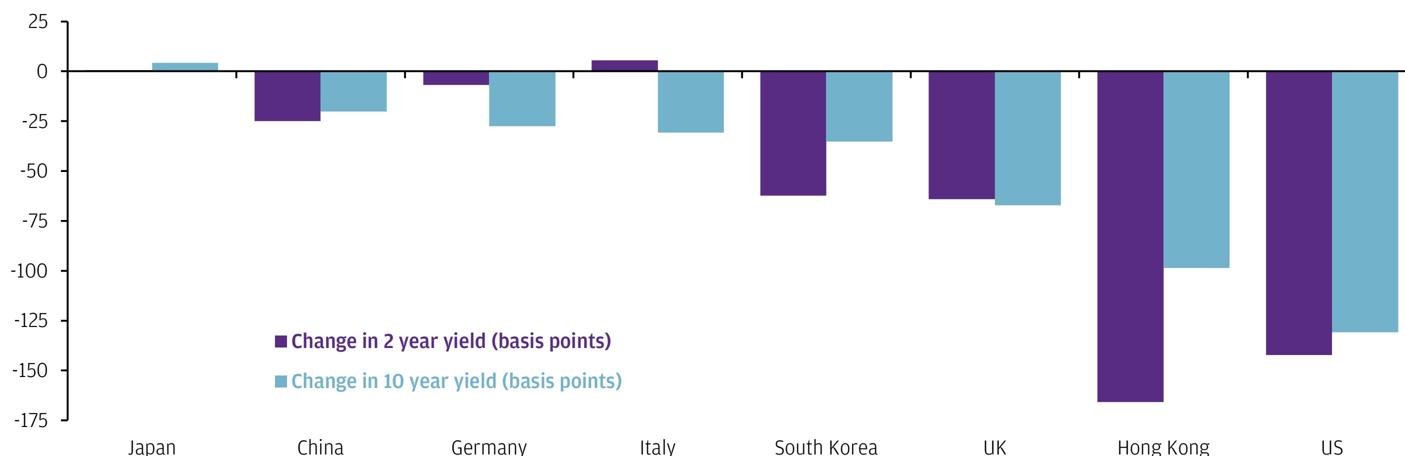
EQUITY MARKETS

% stock market price returns year-to-date, local currency unless specified



GOVERNMENT BOND MARKETS

Basis point change in yield year-to-date



Source: (Top) Bloomberg, DAX, FTSE, Hang Seng, MSCI, Standard and Poor's, TOPIX, J.P. Morgan Asset Management. MSCI indices are used for China, S. Korea, Europe (EUR), ACWI (USD), Asia ex-JP (USD), EM (USD). Other indices used: Germany: DAX; Hong Kong: Hang Seng; Italy: FTSE MIB; Japan; TOPIX; UK: FTSE All-Share; US: S&P 500. (Bottom) Bloomberg, J.P. Morgan Asset Management. Past performance is not a reliable indicator of current and future results. Data as of 20 July 2020.

Conclusion

It is still too early to accurately predict the ultimate impact of the coronavirus on economic activity and corporate earnings. The sooner the virus is confidently contained, the quicker the recovery in economic activity will be, particularly given governments and central banks are acting decisively to shore up the economy and support the prospects for recovery. However, the longer the period for which social distancing measures are required, and the longer the period of reduced travel to restrict the transfer of the infection, the greater will be the impact on corporate earnings.

Global policymakers are to thank for the market's resilience against this economic backdrop, and their commitment should not be underestimated. The knowledge that more stimulus will come if needed makes us cautious about being underweight risk assets, yet valuations and uncertainty around the economic and earnings outlook keep us neutral. With markets now confident in the policy response, the bar for upside surprises has moved higher. We think that investors may benefit from having more than just a toe dipped in to risk assets, but should not be jumping in with both feet.

Within both equities and credit, we favour an "up-in-quality approach", focusing on those companies with robust balance sheets who have the financial flexibility to survive this shock.

Core government bonds have performed strongly. However, significant further upside for US Treasuries and UK gilts will be more limited from here unless these central banks shift their guidance that they do not intend to take interest rates into negative territory. Investors may wish to consider alternative diversifiers such as macro funds, or real assets if liquidity is not a requirement.

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