Coronavirus provokes turbulence on global stock markets

By Nick Beams
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The underlying fragility of global share markets, which have been boosted to record levels by the injection of trillions of dollars from the world’s central banks over the past decade and more, was underscored by the sharp falls on Monday and Tuesday in response to the coronavirus crisis.

The major Wall Street indexes dropped by the largest amounts since last October on Monday, with the Dow down by 454 points, or 1.6 percent. The S&P 500 experienced the same percentage decline. The yield on the 10-year Treasury note also fell to 1.605 percent to reach its lowest level in three months—a clear signal of investor uncertainty.

Asian markets, which had been largely closed on Monday, followed Wall Street on Tuesday, with shares prices in South Korea, Singapore and Australia all recording declines. The Hong Kong market remained closed due to the Lunar Year holiday.

Commenting on the Wall Street fall, one corporate investment analyst told the Wall Street Journal: “It reminds investors that this market can turn on a dime, should it start to question what is causing it to go higher.”

Yesterday the Dow recovered some of its Monday losses, rising by 187 points while the S&P 500 also rose.

Markets had been steadily rising since last October following the US-China “phase one” trade deal signed earlier this month, due to calculations that it would lessen trade war tensions.

But the prospect that the coronavirus will hit Chinese growth in the coming weeks and months led to the sell-off, particularly by stocks exposed to the Chinese market. Yesterday’s market rise appears to have been sparked, at least in part, by what one financial analyst told the Financial Times is the current “market mythology” that “the stock market can’t go down when the Fed is adding reserves.”

While the Fed has ended its quantitative easing program, it has indicated that interest rates will not rise and is pumping money into the market via purchases of assets in order to stabilise the overnight repurchase or “repo” market, which spiked when rates jumped to as high as 10 percent in mid-September.

The key issue for financial markets in the weeks ahead will be the full impact that the virus has on the Chinese economy. Comparisons have been made with outbreak the SARS virus in 2002–2003. After a brief downturn in its growth rate from 11.1 percent in the first quarter of 2003 to 9.1 percent in the second, the Chinese economy then underwent a recovery.

At that time, however, the Chinese growth rate was around 10 percent per annum and the world economy was experiencing an upturn that led to the highest global growth since the 1970s, in the period immediately prior to the financial crisis of 2008.

The situation today is very different. The world economy as a whole is in what the International Monetary Fund has termed a “synchronised slowdown” and the growth rate in the Chinese economy is barely above 6 percent—its lowest level in three decades.

Commenting on the market fall, Kit Jukes, a strategist at Société Générale, told the Financial Times: “The belief that low rates can and will smooth over the deepest potholes in the road ahead for financial markets is deeply ingrained. But there will be an economic impact from the virus outbreak, even if we don’t know how long it will last and how big the economic hit will be.”

The economic impact of the virus in China is already being widely felt. In Shanghai, the country’s financial
capital, companies have been told not to reopen year until February 10. The manufacturing centre of Suzhuo—where iPhone contractor Foxconn, Johnson and Johnson and Samsung have major factories—has delayed the return to work of millions of migrant labourers by a week.

International car manufacturers, including Nissan and Renault, have started to pull foreign staff out of the country and there are concerns about how the outbreak will hit the country’s already depressed auto market.

In a bid to lessen the economic effects, the China Banking Regulatory Commission has said companies would receive support “through measures such as encouraging appropriate lowering of loan interest rates, approving arrangements for loan renewal policies and increasing medium-term and credit loans.”

But the most immediate effect will be on consumption spending, which plays a much more important role in the Chinese economy than it did 17 years ago when the SARS outbreak hit.

Railway transport fell on Saturday, the first day of the Lunar New Year, by 42 percent compared with the same day last year. Passenger flights plunged by the same amount. Retail sales, and consumer demand more broadly, will be the first areas to be affected.

According to Julian Evans-Pritchard, senior China economist at Capital Economics: “The coronavirus makes a pronounced slowdown even more likely and if the disease is not brought under control quickly, then even our downbeat forecasts may turn out to be too high.”

With China contributing about one third of total growth, the world economy as a whole will feel the effects, starting in the Asia-Pacific region. This prospect was reflected in the fall of 2.6 percent in Singapore’s major stock market index on Monday and warnings that the effect on the region could be “enormous.” The full impact will not register for weeks or even months.

In a comment published on Bloomberg, well-known financial analyst and commentator, Mohamed El-Arian said the market reaction to the virus had followed a familiar pattern—a short sell-off followed by a recovery as investors moved in to “buy the dip.”

But this pattern, he warned, obscured long-term challenges. The markets were motivated by the belief that economic fundamentals were resilient enough to navigate shocks and, “perhaps more important,” faith that central banks will provide sufficient stimulus.

However, he continued, markets faced not only the effects of this latest shock but a “considerable list” of medium-term uncertainties. These included “weak structural growth dynamics, de-globalisation, central bank policy effectiveness, climate change, technological disruptions, demographic change and the prospects for China’s historical development process.”