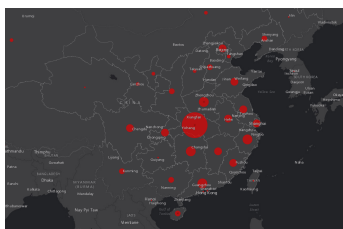


# Gauging the cost of the coronavirus

Our latest research on what the outbreak means for the global economy and financial markets

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# Coronavirus: Gauging the market fall-out

Risk aversion has hit asset markets as the world reacts to news of the coronavirus. Uncertainty stands to demand a further risk premium of assets exposed...



Source: John Hopkins CSSE (WHO, CDC, NHC and Dingxiangyuan)

Wuhan Coronavirus (2019-nCoV) Global Cases (by Johns Hopkins CSSE) As of 28 January, 2020, 11pm

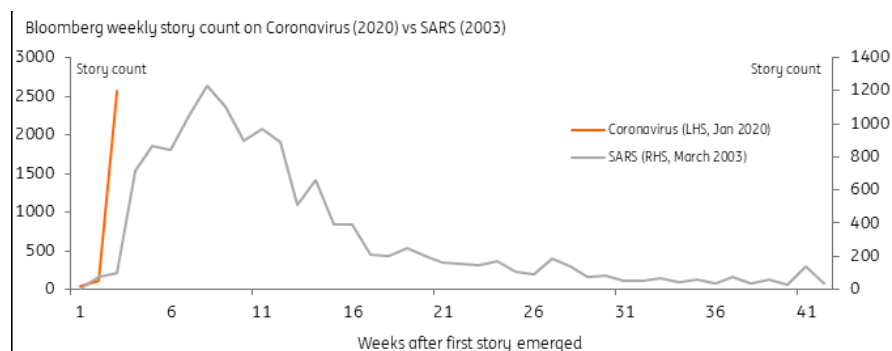
## Parallels to SARS?

Ever since 7 January, when Chinese authorities confirmed that they had identified a new virus, global financial markets have increasingly taken notice of the coronavirus. This follows the US-Iran conflict and further threatens to undermine what was expected to be a gradual rebound of the global economy in 2020. Of course, we do not know for sure, but any potential spreading of the virus across the globe – currently the virus has already been reported in 18 countries from Asia to North America – could last until March/April and mark a new downside risk to the global economy in the first half of 2020.

The fact that the World Health Organization has said that the coronavirus comes from the same family of viruses as SARS and MERS have prompted comparisons with the SARS outbreak in 2003. At the time, the news of the SARS outbreak only hit financial headlines in March 2003 and then dominated the headlines for an eight-week period. We can only hope that containment measures prevent an acceleration in the number of cases identified and that the mortality rate does not rise above current reported levels of 4%.

In economic terms, however, the global economy has become more integrated and intertwined since 2003. Global air traffic, for example, is currently more than twice as big as in 2003. Also, contrary to 2003, when Chinese tourism was mainly inbound-oriented, Chinese tourists have become a significant driver of global tourism. Consequently, the speed of the virus spreading could be faster than in 2003, while at the same time the negative impact on global growth could also be higher than in 2003.

## Fig. 1 - Coronavirus hits the headlines



Source: Bloomberg, ING

## What weaker Chinese growth means for trading partners

[As Iris Pang notes](#), the largest impact on Chinese consumption will come through retail sales, travel, tourism and clearly the ability of Chinese residents to return to work. SARS is believed to have knocked 1.0%+ off Chinese GDP back in 2003, but the huge uncertainty around the spread of the coronavirus makes the macro impact very difficult to forecast. A study by Jong-Wha Lee and Warwick J. McKibbin from the Korea University and the Australian National University found that the full impact of SARS on the global economy came close to USD 40 bn in 2003, taking second-round effects between sectors into account.

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*SARS is believed to have knocked 1.0%+ off Chinese GDP back in 2003, but the huge uncertainty around the spread of the coronavirus makes the macro impact very difficult to forecast*

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Accurate forecasting of that impact will take time, but clearly slowing Chinese domestic demand will impact the global economy – just as it is trying to recover from the effects of the 2018/19 trade war. Just think of the fact that for some global hotel chains or companies of luxury goods China and Greater Asia accounts already for 10 to 20 percent of their annual sales.

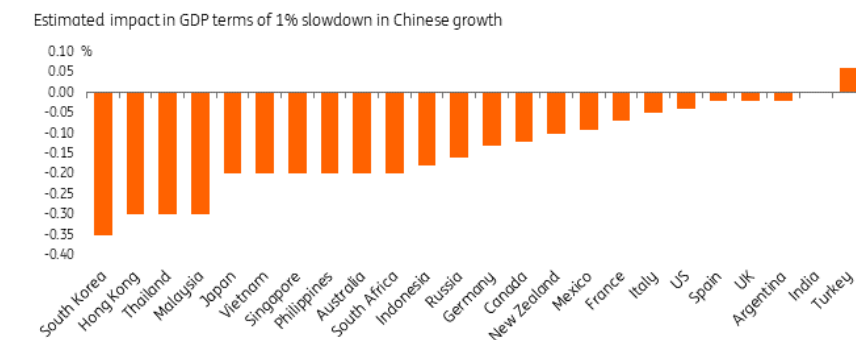
The precise extent to which a weaker Chinese economy impacts its global trading partners will also be uncertain, but a 2016 IMF study may offer some insights here. Even though the study focused on the spill-over effects of China's maturing economy, one of the simulations included a Chinese cyclical slowdown prompted by financial stress – that stress triggered by 'a credit event, a re-assessment of growth prospects, or another shock.'

The impact of a 1% cyclical slowdown in China is largely felt in the APAC region where trade

linkages are the highest and also in the commodity-producing countries. Notably, the fall-out on the US economy was seen as limited, possibly resurrecting the narrative of wider US-Rest of World growth differentials – a dollar bullish story.

[Read our China economist's assessment of the virus impact on the economy](#)

## Fig. 2 - Who would suffer the most from a Chinese slowdown



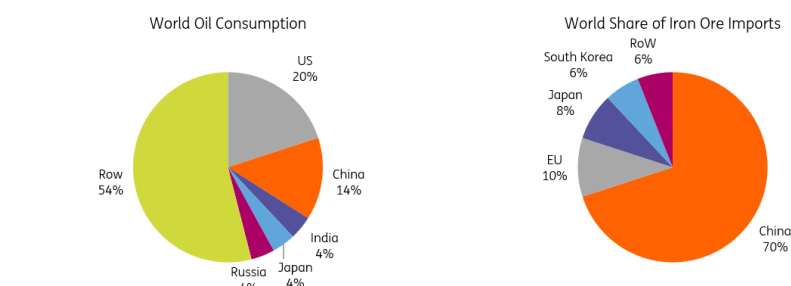
Source: IMF, ING

## Commodities: China is the kingpin

China is the kingpin of the global commodities market. The longer factories remain closed, travel restricted and construction stalled, the larger the ramification for commodities demand. This asset class has seen a massive sell-off since the outbreak of coronavirus in China. At the time of writing, copper prices have fallen by 8.5% from their mid-January peak. Singapore iron ore has collapsed more than 6% and ICE Brent plunged by nearly 10%.

It is very hard to say how quickly this virus will spread but suffice to say we see mounting pressure on commodities. However, the level of damage to their market price will also depend on their exposure to China and their own fundamental story.

## Fig. 3 - China's share in oil and iron ore demand



Source: EIA, World Steel Association, ING

## Copper and iron ore vulnerable, OPEC+ may support crude

Looking first at the metals, the key question is how long will travel restrictions last and when construction and industrial activities resume? A prolonged delay would have an impact on supply chains. This would likely feed through to major sectors where metals demand has significant relevance, including infrastructure, property construction, automotive and other manufacturing

industries.

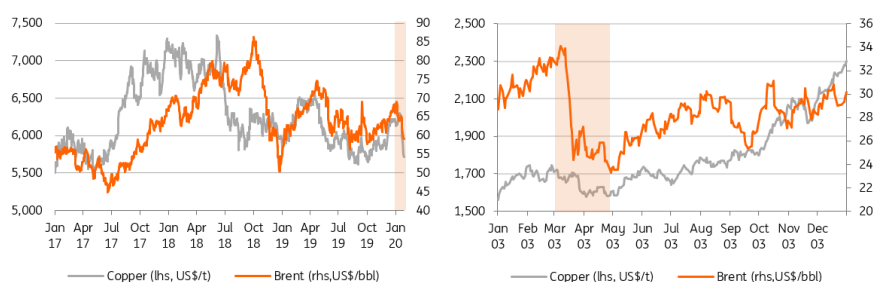
*On the oil side, wider travel restrictions are apparently hitting oil demand through jet fuels, gasoil and other middle distillates within China*

Copper has relatively healthier fundamentals than the rest as a result of tightened supply in global mine production last year and production growth is expected to be largely muted this year. The market had expected to see demand recover from China in 2020, supporting a constructive fundamental picture. Copper is regarded as the economic barometer, and China accounts for 50% of global copper usage. However, with the absence of China demand short term, downbeat sentiment may be exacerbated since some investors tend to short copper to express bearishness on the global macro view. For iron ore, China accounts for 70% of the global seaborne market. Should the coronavirus prompt a long delay in construction activities, any demand pick-up in iron ore may be postponed.

On the oil side, wider travel restrictions are apparently hitting oil demand through jet fuels, gasoil and other middle distillates within China, along with any spillover across the region. Overall, the global transportation industry accounts for around half of the demand for global crude imports – and has been rising rapidly. Concerns are unsurprisingly reflected in refinery margins, which continue to trade at depressed levels. In fact, the spot gasoil crack in NW Europe is trading under US\$10/bbl now - levels last seen in early 2017. The weakness in gasoil cracks has surprised many, given the broadly constructive view held due to IMO 2020 shipping regulations.

However, as oil sink lowers, there is increasing pressure for OPEC+ to extend cuts through until at least mid-year, and that may provide some psychological support. However, the OPEC+ members will be watching developments in Libya closely. Any extended outage there would mean less need to curtail supply amongst the rest of OPEC+.

**Fig. 4 - Copper and Brent suffer, as they did during SARS in 2003**



Source: Bloomberg, ING

## FX: Commodity currency rally postponed

Events in China impact the global currency markets via two channels: (1) the risk channel (as global growth concerns hit equity markets); and (b) the commodity channel (given the importance of China in global commodity demand). In the chart below, we blend the two channels. Unsurprisingly

in the G10 space, it is AUD, NZD and NOK (as well as CAD) that stand out given their high beta to risk and the commodity nature of the currencies.

We continue to see AUD, NZD and NOK as the most exposed if market sentiment remains weak. With our commodities team seeing larger downside to metals than oil prices (where OPEC may extend cuts versus a softer floor under metal prices), AUD looks the most vulnerable among these currencies. Supporting this view is also the prospect of RBA easing over the next months (we expect a cut in 1Q) and the ongoing bushfire emergency which may have a sizeable impact on the Australian economy. All this underlines our preference for lower AUD/NZD in the relative value space (where we look for a decline to AUD/NZD 1.02). Among Scandies, this means lower NOK/SEK as SEK exposure to commodity prices is limited.

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*Unsurprisingly in the G10 space, it is AUD, NZD and NOK (as well as CAD) that stand out given their high beta to risk and the commodity nature of the currencies*

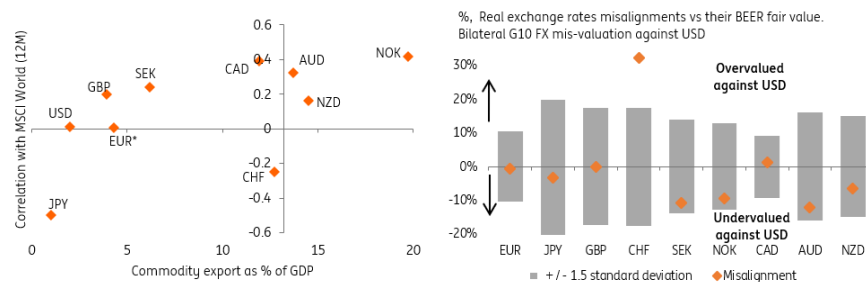
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Among the majors, JPY and USD should continue their out-performance given their safe-haven characteristics. We look for a lower EUR/USD as the dollar continues to benefit from its safe-haven appeal, while the open eurozone economy is more vulnerable to any impact on the global economy. The story of US exceptionalism (growth outperformance) may return as well.

As long as the situation will be seen as unresolved, the skew to both risk appetite and commodity prices remains on the downside. With G10 commodity currencies largely reversing all their December gains (at the time caused by anticipation of the phase-one deal), this currency segment is now as undervalued as it was prior to the December rally. Still, unless both risk sentiment and commodity prices stabilize, a sustainable rebound is unlikely at this point

As for EM FX, we have observed a similar pattern to G10. Deteriorating risk sentiment is weighing on the generally higher beta EM FX, where the currencies with a commodity exposure are leading the losses (CLP, RUB or ZAR). While Asian FX remains vulnerable due to its direct trade links to China, it is the higher beta, commodity-exposed EM FX leading the losses (partly because the managed decline in CNY is limiting the spillover into regional EM Asia currencies). Should the situation deteriorate, we would expect the same pattern to continue, with commodity EM FX leading the losses. Typically Latam FX and its big metals exposure perform poorly in this environment.

**Fig. 5 - Commodity currencies appear the most vulnerable**



\*commodity exports data for Germany  
 Source: UNCTAD, Bloomberg, ING

## Rates: Low or lower rates with flatter curves

Market psychology is an important starting point. As we progressed towards the end of 2019 there were numerous good reasons for the 10yr US yield to attempt a break back above 2%. But despite elevated US consumer confidence, tight labour market and an improved trade war narrative that break higher never really materialised. We saw this from the structure of the curve too, as the 5yr remained very rich to 2's and 10's, which is a classic sign that a preference was there to test the downside rather than the upside. This is why, backed by weak PMIs, our projections pitched a lower rates bias. Fast forward to January 2020 and it has just taken a flu from China to cause a significant move down to 1.6%.

That is not to underplay the event, as one thing we do know is we are at the beginning of an event that could easily stretch for months. The SARS virus is a go-to template, as there are more similarities than differences and it stretched from November 2002 to June 2003. Remarkably back then the Fed funds rate was very similar to where it is today (1.75%). It had been cut from 6.5% on the dot.com crash, and ultimately got down to 1% after the flu had faded.

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*First and foremost, rates were already in a stressed mode before the flu virus narrative hit, and the subsequent move has confirmed the path of least resistance – lower rates*

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It is not easy to break out precise market reactions, but before the flu had receded the 10yr yield had fallen from around 4% down to a little under 3.25%. Part of this was the virus, but a large part was also the other background noise. The curve was already steep (c.200bp), and only steepened further on the final Fed cut to 1%. Away from the virus itself, it is interesting to note the difference in the shape of the 2/10yr curve (200bp) and the level of the 10yr yield back then (4%) compared to now where we have a 20bp & sub-2% combo – a good illustration of the excess of demand oversupply that is driving yields today.

So, there are numerous nuances to consider as we examine the current circumstances. First and foremost, rates were already in a stressed mode before the flu virus narrative hit, and the subsequent move has confirmed the path of least resistance – lower rates. Second, risk assets have been worried about a catalyst that could take back the outsized gains made in 2019, and this virus event is as good a catalyst as any. That vulnerability can become circular and push core rates even



lower. However, let's not get carried away here; it does not mean we need to push our 1.5% target for the 10yr lower though; for that to happen we'd need to see a more definitive turn for the worse.

From a Eurozone perspective, this is the last thing the ECB needs. Europe is already down, with Germany and Italy at the bottom of the spectrum of contemporaneous growth observations, as the ECB practically is out of bullets. The German 10yr yield has shot down to almost -40bp. That said, the Treasury/Bund spread has tightened, which means that the move in US Treasuries has been more significant. There is already a deep negative discount in the price for Eurozone bonds, but with the likely ECB standing pat at -50bp there is a limit to how bad things can get; for that to change, again, we'd need to see a clear turn for the worse on the virus impact.

Bottom line, market rates are likely to remain low; at about current levels or lower in the coming weeks (and likely months). Curves will maintain a flattening bias, as central bank action is unlikely given what we know so far. Reversion to higher rates would need evidence that there has been a positive turn of the tide. In the meantime, an information vacuum perception sustains vulnerability.

## Credit: Rollercoaster

European credit spreads widened significantly earlier in the week on the back of the virus news. However, it seems spreads have simmered now. This all comes after we have seen some substantial performance in January, with spreads tightening down to the lower levels seen in 2019. This was in line with our mildly bullish view on credit for 2020, driven by a swing in technicals, lower net supply and of course CSPP. We stand by our long-term call of tighter spreads and flatter curves, but of course, the coronavirus is a potential threat.

As for the underperformance, autos were hit worst, as well as the longer end of the curve, causing some steepening. The Chinese car market, the largest in the world, is very important for European car producers. 2019 had been a dismal year for Chinese car sales and further spreading of the virus could dampen any hope of a recovery this year, pressuring spreads further. In addition, Wuhan accounts for a sizeable portion of Chinese car production.

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*While the fallout on the economic picture is still unclear, we see a key risk for EM sovereigns with weaker fiscal and external balance sheets as well as those more exposed to a slowdown in China*

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Energy and some consumer names were also amongst the worst performers on Monday. It is clear that if things are set to get worse it will be these higher beta names that will underperform most significantly. For instance, the consumer sector is looking tighter compared to the industrials, particularly because they have traded very in line in the past. We may see consumers pull back up to this level. We, therefore, stand by our call for being overweight non-cyclical.

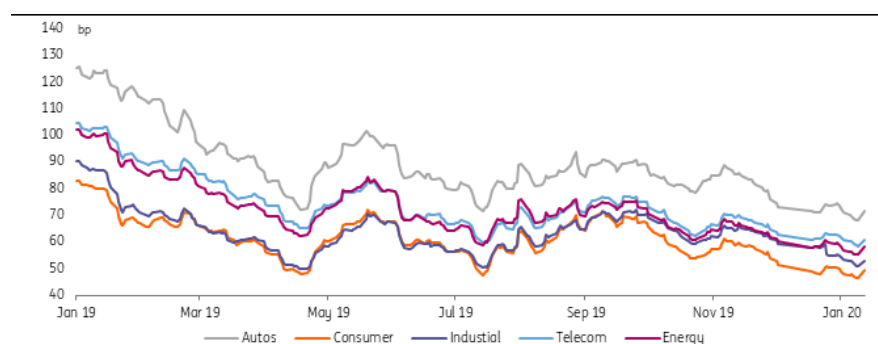
Of course, if the news turns more positive, we will likely see Euro spreads return down to the tight spreads we saw last week.

In EM credit space, the fallout has been limited on balance: Credit spreads widened by 17bp (based

on Bloomberg Barclays EM USD Aggregate Index) over the last week but this has been matched by a decrease in underlying core rates (with US 10yr Treasuries also rallying 15bp), meaning that all-in yields have little changed on balance. That said, we have seen a spread decompression across the lines of credit quality, with high yield widening by 34bp while investment-grade names remained fairly insulated (+9bp only), implying that there has been a shift into safe havens within the asset class.

Technicals have remained supportive so far with EFPR Global reporting US\$8bn of inflows into EM debt in the first three weeks of January, following US\$40bn of inflows throughout 2019. Notwithstanding, we expect some softening of technicals and sentiment as the spread of the virus continues. While the fallout on the economic picture is still unclear, we see a key risk for EM sovereigns with weaker fiscal and external balance sheets as well as those more exposed to a slowdown in China. Aside from trade and investment channels (with EM Asia, Sub-Saharan Africa and commodity producers most affected), we would be concerned on a reversal in the strong investor sentiment in EM credit.

**Fig. 6 - European Investment Grade spread developments, by sector**



Source: Bloomberg, ING

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## Coronavirus: Markets and the fear factor

The economic impact of an epidemic like the coronavirus typically transmits through a four-letter f word, called fear. Households have stopped doing...



Source: Shutterstock



### Coronavirus: Markets and the fear factor

The economic impact of an epidemic like the coronavirus typically transmits through a four-letter f word, called fear as households stop doing certain things like going to restaurants, or the cinema

or the theatre, which can have a substantial negative impact on the economy.

[Watch video](#)

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# China: Fighting the coronavirus with a fiscal-monetary policy combination

China is using extra fiscal budgets and central bank lending to fight the effects of the coronavirus. It seems that policymakers do not want to confuse...



## Fiscal and monetary policy combination to fight against the coronavirus

With an official name of NCP (Novel Coronavirus Pneumonia), the Chinese government has initiated more fiscal stimulus and monetary easing to combat the effects of the virus. These are specific measures. They are different from the usual broad-based policies that are used when there is a need to support the overall economy.

### Fiscal policies

Fiscal policies include tax concessions on companies that are directly affected by the NCP, eg, tourism and catering. Companies that manufacture medical supplies and medicines are exempted from taxes and are allowed to receive subsidies from the government.

### Monetary policies

Apart from ensuring ample liquidity in the financial system (injection of CNY1.7 trillion on 3 and 4

February), the central bank, [PBoC, sets up a CNY300 billion special re-lending fund](#). Banks will start distributing the money to selected companies on 10 February. Banks have to lend money to those companies at a rate of no more than 3.15%, which is 100 bps below the Loan Prime Rate, which is now at 4.15%. These companies are selected based on their nature, eg, manufacturing medical supplies and medicines or helping to combat the NCP in other ways.

The Ministry of Finance will subsidise half of the interest expense for these companies. The government expects that the actual interest costs for these corporates to be at most 1.6% per annum.

## Focused vs broad-based policy

With these very focused policies in place, we may need to wait for some time to see broad-based policy actions, eg, a cut in the reserve requirement ratio (RRR). It seems as though the government does not want to spare extra money for non-virus-specific activities.

We expect more focused policies to be announced if there is such a need. At the same time, we believe that broad-based monetary easing will be delayed until the economic recovery stage.

As such, our previous expectation of a RRR cut in March could be deferred to a later stage. But it does not mean that the liquidity in the financial system will be tight. Rather, it may be the opposite. We expect the PBoC to provide enough liquidity via open market operations to ensure that there is no emergence of spikes in interest rates, in order to limit the possibility of chaos in the market.

## How the coronavirus is re-shaping the currency market

The coronavirus will have a material impact on China's economy, hitting demand for raw materials. ING FX strategist Francesco Pesole takes a look at...





## The coronavirus threat to currencies

Coronavirus fears have rippled through the FX market, with emerging market currencies bearing the brunt of the sell-off. Is the worst over? We take a look.

[Watch video](#)

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Article | 10 February 2020

## Zinc's turning tide amid the coronavirus outbreak

The rebalancing of zinc may have been brought forward by the coronavirus outbreak, as prices come under pressure amid the recent stock surge. And the...



Source: Shutterstock

One prominent issue in the zinc market over last year or so has been the lack of tangible stock building which provided strong support to the zinc market amid a broad bearishness in light of its mine supply surplus and strong production growth from China. We discussed the case that there weren't enough stockpiles being built in China [here](#).

Over the last week, there are signs that the tide might be turning. First of all, there have been sharp rises in both London Metal Exchange inventories as well as the Shanghai Futures Exchange. Second, the long-standing backwardation in the LME market has flipped over into a contango market, making zinc vulnerable in the near-term. As the stock continues to climb, there would be a stronger mandate to short zinc and a broad bearish case is likely to unfold sooner than later.

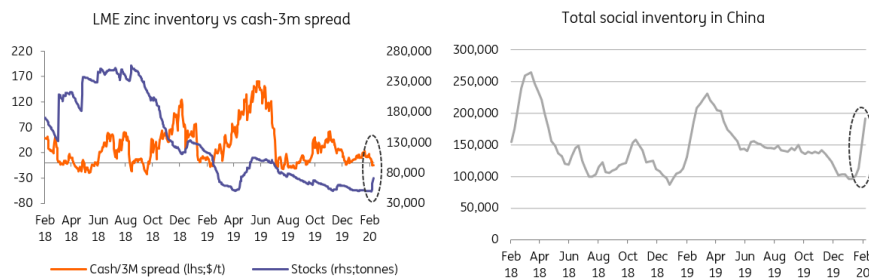
The outbreak of the epidemic did not cause the turn, it only accelerated it. It essentially 'destroys' the case that as demand picks up over Q2 coupled with low inventory, we might see some upside potential there. Now things might have changed. With short term demand stagnating, the galvanising metal continues to pile up in warehouses. The case that a strong inventory drawdown over the traditional seasonality pattern does not exist any more. Any stimulus that Beijing brings

to prop up a strong demand case seems more distant.

However, this doesn't mean we won't see any support at all. Logistic bottlenecks are bringing in sulphuric acid storage issues at some smelters. The downside risk is that some smelters may be forced to cut their running rate. There are likely to be more logistics-related issues that could affect other raw material supplies after stockpiles run out.

Again, this is dependent on how the coronavirus outbreak is contained and whether smelters can manoeuvre logistics. Nevertheless, the risk from this side will need to be stronger to defy the short term stock surge.

## Zinc stock rise across LME and China market



Source: Bloomberg, ING

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Article | 7 February 2020

# Coronavirus ‘fear factor’ is the biggest risk to the economy

The coronavirus has already hit domestic demand in China, as well as supply chains further afield. But if the outbreak becomes more widespread overseas,...



## What's the latest?

The rapid spread of the coronavirus (nCov) throughout China is quickly becoming a major source of uncertainty for the economy. Markets – most notably commodities – have taken a hit as concerns over demand become more widespread.

Comparisons are naturally being made to SARS back in 2003, and the early data suggests that nCov is proving less fatal (the mortality rate is around 2% so far), but importantly it is much more infectious. The number of nCov cases is already far in excess of SARS at the same point in time after the first case was reported.

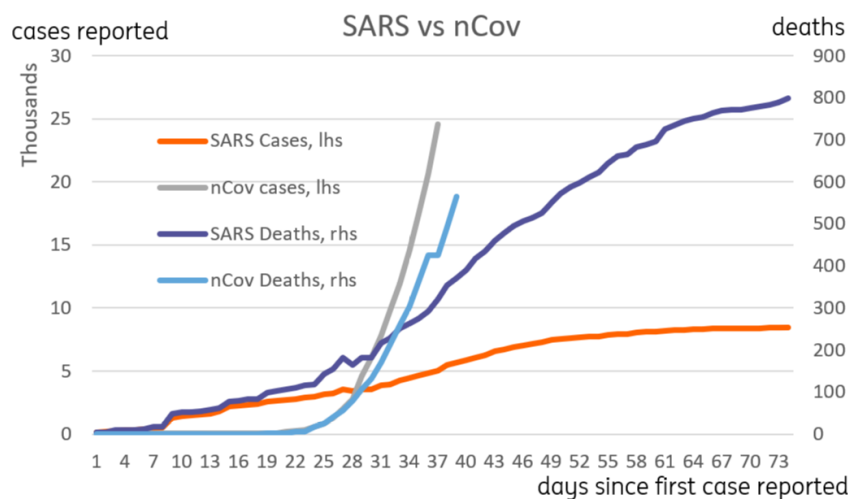
If there's one glimmer of hope, it's that the rate of change in cases each day has not gone exponential, though these trends can change rapidly.

While this may tentatively hint that the virus has been contained, the reality is we still don't know just how far the virus has spread outside of China. The number of cases confirmed overseas is still limited - especially outside of Asia - but the total is now over 200 and rising. Many of these,

however, were visiting Chinese tourists. Cases of community transmission remain low.

Given the virus has a 14-day incubation period, the full spread may only become apparent over coming days. And despite market optimism on potential vaccines, it could be several months before these can come into use.

## Growth in coronavirus cases compared to SARs



Source: WHO

Coronavirus cases compared to SARS

## What's been the impact so far for the global economy?

As Iris Pang notes in this month's economic update, Chinese retail and associated services have felt the immediate brunt of the virus. From shops to restaurants, a lack of footfall is hitting sales, while a sharp fall in inbound tourism will also take its toll.

But as time goes on, supply chain disruption will become a bigger concern globally. China is much more integrated into the global economy than it was back in 2003 when the SARS virus hit. A sustained drop in Chinese production of electrical components could quickly cause knock-on effects elsewhere. Production outages have already forced [carmaker Hyundai](#) to close South Korean factories owing to a lack of Chinese components.

Carsten Brzeski reckons this [could be yet another headache for German industry](#), where the latest data suggests the sector is still experiencing sharp order book deterioration.

World trade growth will inevitably suffer, particularly if marine shipments are cancelled and air freight becomes more restrictive. [Our trade team notes](#) that capacity constraints within global logistics mean the current fall in trade volumes might not be made up quickly later in the year.

## What would a global pandemic mean for global growth?

If the number of cases begins to surge outside of China, one of the principle channels of transmission to the economy will be through "fear". Fear of catching the virus results in a change in household behaviour that is arguably disproportionate to the chances of either catching the disease, or of dying from it.

That change in behaviour typically manifests through a very substantial decline in consumption of consumer services. Spending on recreation (cinema, theatre), transport (public), eating out and accommodation, could be particularly vulnerable.

Our latest forecasts assume that the epidemic is not contained within China, and there is some 'community transmission' in major economies. Taking the US as a guide, we reckon roughly 18-20% of consumer spending is directly exposed to the 'fear' factor. A 5% fall in those categories could quickly see around 1% knocked off consumer spending. This is a worry given that consumer spending has been a key growth driver throughout the developed world over recent years, often in the absence of investment and net export growth.

The spread would inevitably hit other sectors, too. Some airlines are already furloughing staff in the region as they cancel flights. And some imports of commodity goods and fuels have been rejected with a force majeure as demand slumps and storage facilities reach capacity.

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*Our latest forecasts assume that the epidemic is not contained within China*

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As always with shocks like this, it's fair to say there is limited scope for policy responses in some countries. Interest rates are low or negative in many advanced economies, while fiscal policy is bound by political constraints (e.g. US), regulatory ones (e.g. EU) or structural (e.g. Japan).

This situation is especially unfortunate since the improvement in US-China trade relations was expected to reduce uncertainty and provide a platform for stronger global growth for 2020. White House officials have acknowledged that the impact on the Chinese economy means that the predicted US "export boom" will be less than hoped, but are keen to emphasise the situation should not be used as an excuse by China to backtrack on commitments made as part of the deal.

## **What would a widespread pandemic mean for markets?**

A generalised shift to risk aversion will likely see equity markets sell off, though how far they fall may be highly dependent on how stretched their valuations had previously been, so US markets may be more exposed here than some in Europe or Asia. In general, we would expect EM currencies to underperform those of the DM universe which also may hinder the ability of local central banks to respond to weak domestic demand with more accommodative policies. Reliance on commodity exports is another factor that could affect the resilience of an economy, and its asset and FX performance.

Government bond yields will also likely fall further in the short term, which on the one hand will likely see more accommodative financial conditions, but if accompanied by a sell-off in riskier high yield credits could more than undo that result, spreading further pain through the business channels – which are already very weak in many parts.

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Snap | 3 February 2020

## Coronavirus to hit world trade

Attempts to contain the coronavirus are about to hit world trade



Measures to control the spread of the coronavirus are hitting world trade. China's factories remain closed and airlines are cancelling passenger flights to and from China.

Although most cargo flights are continuing operations for now, more than half of air freight is shipped via passenger aircraft and therefore dependent on these flights departing.

Worldwide air freight has a value of \$6 trillion, accounting for a third of world trade. At Schiphol Airport, one of the major European freight hubs, 17% of incoming freight originates from China.

While cancelled flights are a logistical constraint on world trade, production is also affected by the coronavirus. Chinese factories remain closed to prevent the virus from spreading. Many provinces, regions and municipalities, including Shanghai, have extended the Chinese New Year holidays until 10 February. This means production will be delayed. If this continues, there will be more container shipping services cancelled on top of the annual New Year dip.

The interruption of supply chains could have a snowball effect if stocks of essential electronic components from China are depleted.

And this isn't necessarily a temporary slowdown. The coronavirus could potentially impact the annual level of world trade in 2020, as it's not certain that factories and logistics will be able to catch up and fully compensate for earlier delays, given the limited capacity. If they cannot fully recuperate, global trade growth in 2020 will suffer.



When the situation normalises, goods that would ordinarily be shipped by sea are likely to be transported via an air carrier in order to quickly restore supply chain deliveries and limit possible damage further down the line. However, the costs of air freight are normally five times higher than transport costs over sea, which may affect prices and profit margins.

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