March 25, 2020

Extra Market Commentary
New stimulus measures aim to offset lockdowns

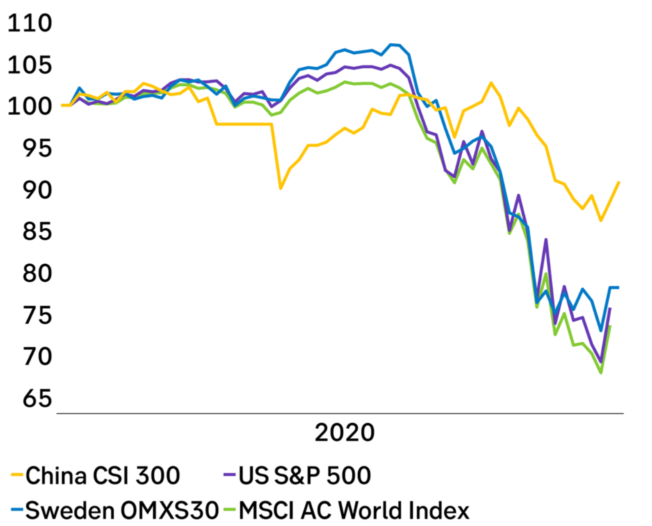
As the COVID-19 pandemic spread continues, we are seeing increasingly widespread lockdowns, with extremely fast and negative effects on economies and growth. To offset this, unprecedented stimulus packages by central banks as well as governments are being unveiled. Currently, the pandemic, the lockdowns and thus the economic slowdown is expected to culminate during the second quarter. Given that forecast, and the large stock market falls we have already seen, a buying opportunity is likely approaching.

Tug-of-war between lockdowns and new stimulus
Economies and markets are dominated by an inconclusive tug-of-war between opposing forces, due to the coronavirus. As the COVID-19 pandemic continues across Europe and accelerates in the US, we are seeing responses in the form of increasingly widespread lockdowns, causing economies to almost grind to a halt. To offset this, unprecedented stimulus packages are being unveiled. Central banks that have any key interest rate left to lower are making aggressive rate cuts and launching gigantic programmes to buy bonds and other market securities. The US Federal Reserve has pledged virtually unlimited bond purchases, accompanied by signals that it will "do whatever it takes" to rescue the US economy. Governments elsewhere are announcing a wide range of measures to soften the impact of their own lockdowns, targeted to both businesses and consumers.

Helping businesses is naturally important. Once the economy rebounds, there have to be businesses that can produce goods and services. If too many businesses fail – at least for a time – there will not be enough resources to revert to the same production levels as before. The situation is similar for consumers. When the turnaround comes, people need to be both willing and able to consume more, ensuring demand for what businesses produce.

So far, stimulus measures have had a limited impact on financial markets. Share prices have continued to fall, amid great volatility. Credit spreads – how much extra companies have to pay for their borrowing – have widened considerably. With stock markets falling by more than 30% and corporate bond yields rising well above 10% in the high yield segment, we are approaching levels last seen during the 2008/09 financial crisis.

Stock market performance so far this year



Source: Bloomberg/Macrobond

A reasonable question is why all the large-scale stimulus programmes do not seem to be having an impact. The answer is both simple and a little scary. When a country is locked down and people are not going to their jobs, companies cannot produce – regardless of what financial help they receive. And people sitting at home cannot consume as usual either. So in the short term, during the temporary freeze that many economies are experiencing, stimulus measures and lower interest rates can do very little to limit the decline in production and thus in growth. We can regard it as yesterday's news that the world economy will enter a recession (a deep downturn).

Recession, followed by recovery

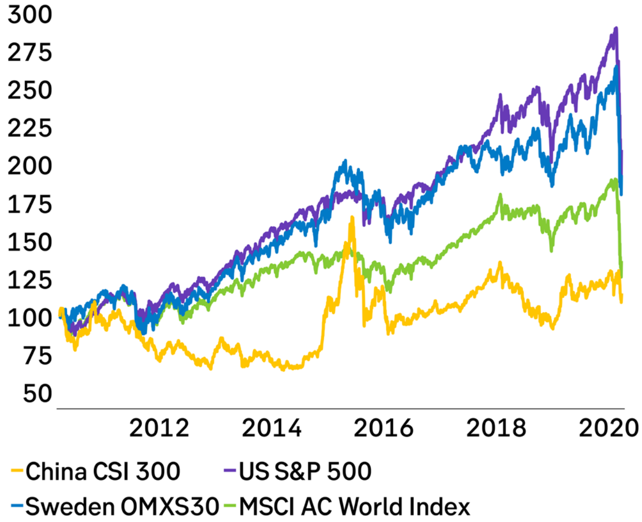
Current estimates indicate that gross domestic product (GDP) in the US and Europe may fall by more than 5% between the first and second quarters of 2020, equivalent to a decline of about 20-30% on an annualised basis. We at SEB expect GDP to fall by around 25%, according to our latest forecast published on March 20. This is a deeper downturn than we saw during the financial crisis. According to most medical experts, the pandemic and thus the lockdowns are expected to culminate during the second quarter. After that, the economy will accelerate again, and all the stimulus measures will then undoubtedly help support growth. The dip in the growth curve caused by the lockdowns will not fade completely, but within a couple of quarters we expect the economy to return to at least the growth trajectory that prevailed before the crisis hit.

What happens to financial markets when the economy turns around?

What will happen then in financial markets? Given our main scenario, it will not be the question of whether the economy turns around, but when. And of course it matters what happens before then: will things get worse before they get better? Once the turnaround arrives and lockdowns have ended, we expect stimulus measures along with pent-up consumption needs to be enough to provide a major boost to the growth rate. Once this trend can be spotted – for example through early signs that the spread of the virus is slowing – there is reason to assume that investors' risk appetite will increase rapidly and that stock exchanges will bounce back early and begin to recapture a lot of lost ground.

As for whether things will get worse before they get better, that remains to be seen. We expect investors to gradually shift their focus of attention from the stimulus measures now being undertaken, to their impact on the economy and on growth. There is reason to assume that we will see a series of highly negative macroeconomic statistics, as the lockdowns have their impact. If this is accompanied by news of further acceleration in the spread of the virus, there is a risk that the market's reaction will be negative.

Stock market performance over the past 10 years



Source: Bloomberg/Macrobond

On the other hand, a lot of negative news is already priced into market expectations, after the unprecedented stock market declines of the past several weeks. In recent days, there has also been a debate about the risks that overly aggressive lockdown measures may do more harm than good (both financially and socially). This may suggest that we are approaching the point where the downturn will end and the stock market climate will improve. It is too early to say that we are there. But given the sharp declines that we have already seen – and the extreme stimulus measures being taken – we believe signals that the pandemic is increasingly under control will be the starting point for investors to search for potential purchases and that new declines, all else being equal, will then be regarded as buying opportunities.

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