

The COVID-19 crisis: Economic impact and policy responses

26th March 2020

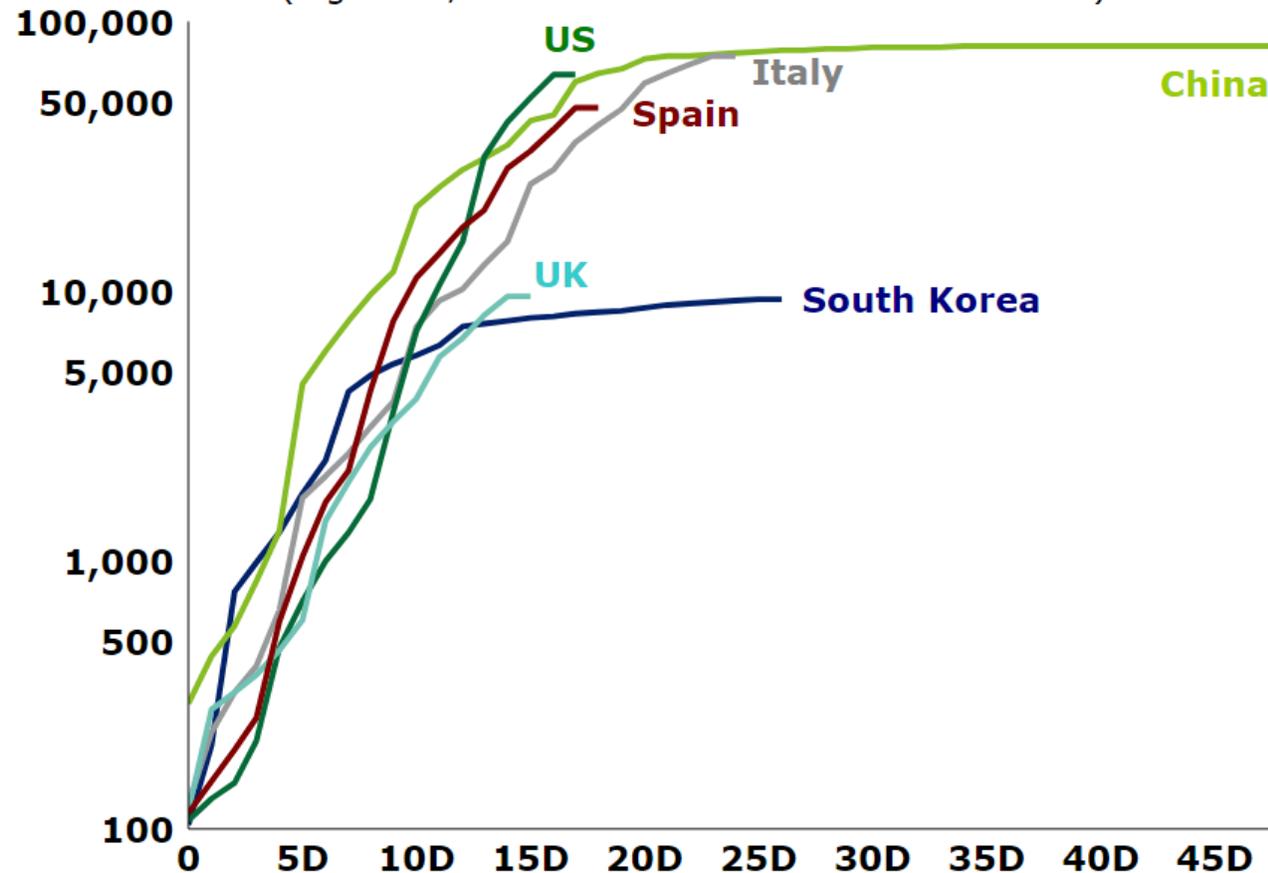
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Economics & Markets Research, Deloitte, London

Cases accelerating in Europe and US

While new daily cases in Italy appear to have peaked on 21st March, Spain and Portugal see sharply rising numbers. Other major western European countries seem a week or two behind Italy. The US is also bracing for a sharp spike over the coming weeks, with the outbreak particularly acute in cities such as Seattle and New York. Also concerning is news from Asia about a, so far limited, second wave of (largely imported) new cases, with authorities rolling back some relaxations to restrictions.

Total COVID-19 cases

(log scale, rebased to date when cases ≥ 100)

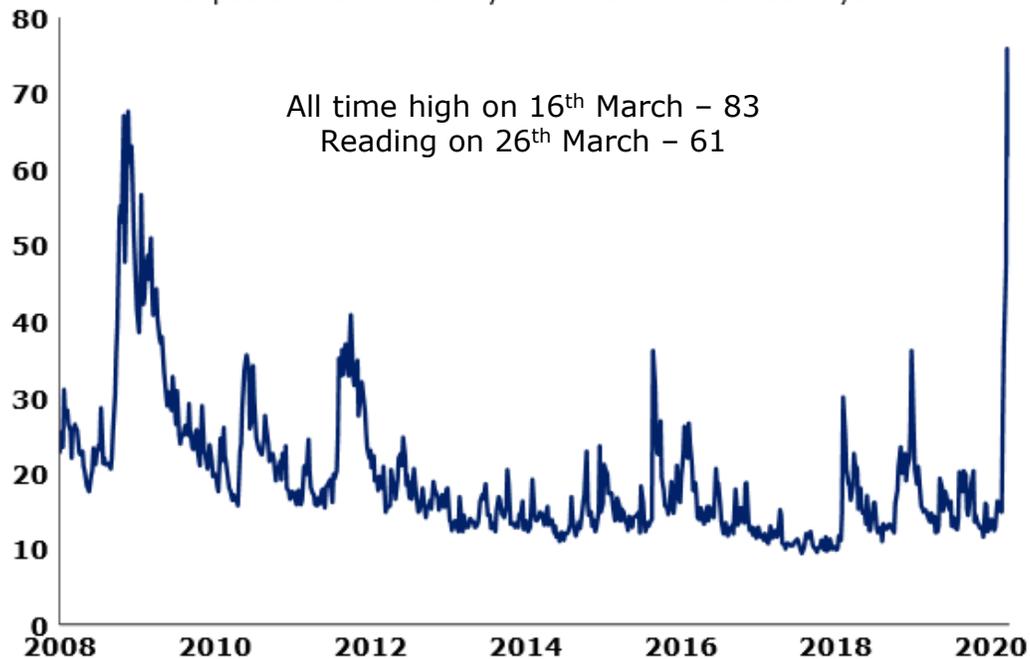


Financial stress indicators flash red

On many financial market indicators, the impact of the COVID-19 crisis has equalled or surpassed the shock seen during the global financial crisis. The VIX volatility index remains at financial crisis levels, having hit a record high recently. The performance of the S&P 500 has also been on a trajectory similar to that seen in 2008.

VIX volatility index

Expectations of volatility in S&P 500 in next 30 days



S&P 500, 2008 vs 2020

Rebased, 100 = crisis start date

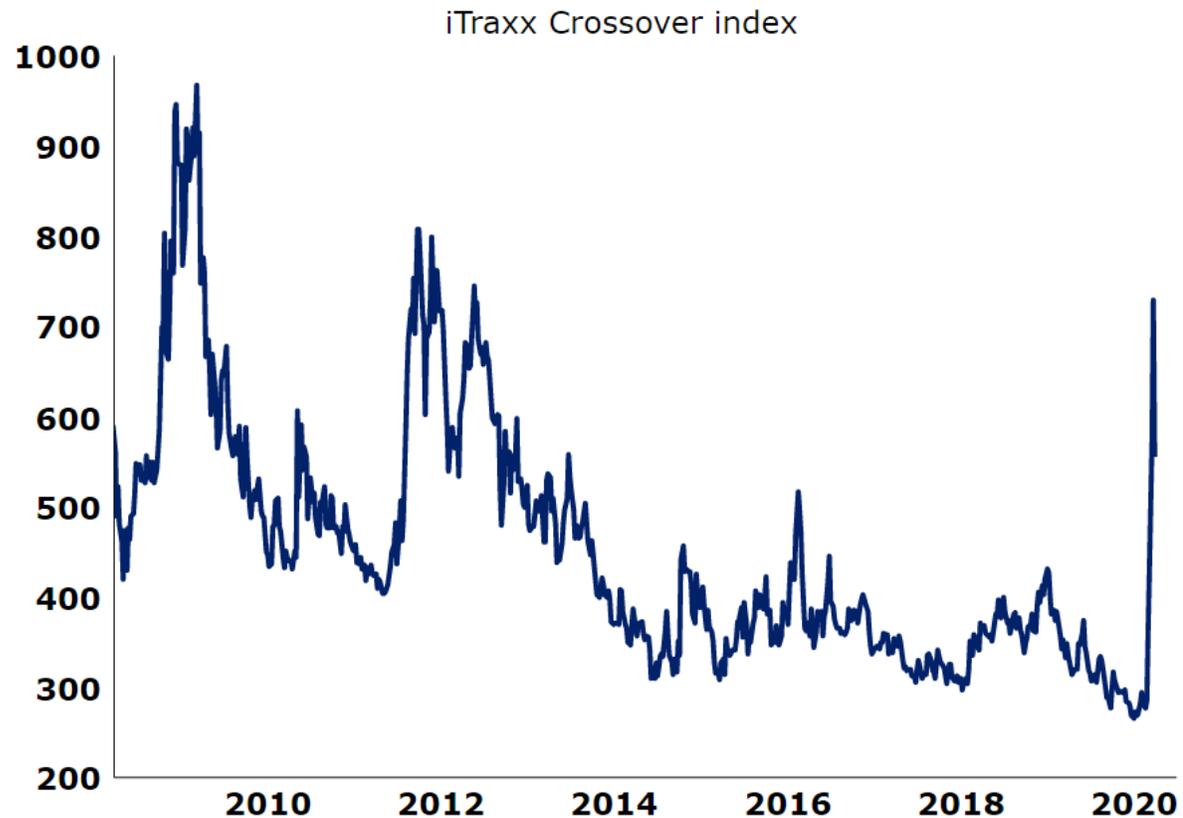


Charts as on 26th March 2020

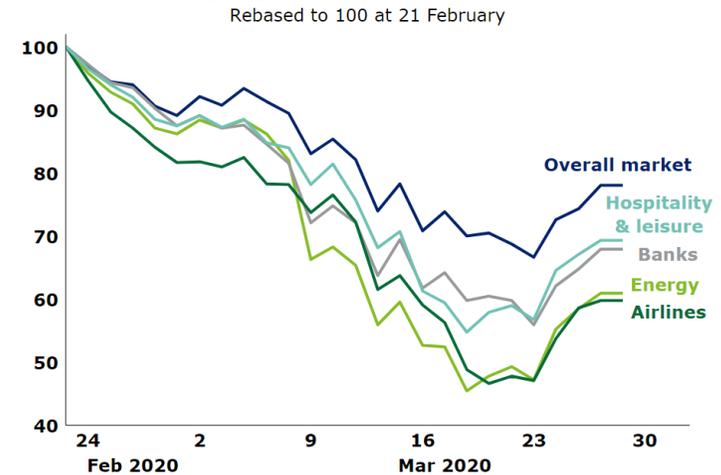
Riskier businesses and most vulnerable sectors under greatest pressure

Predictably, the greatest levels of stress are visible among riskier (typically small) non-investment grade businesses, who have seen a sharp rise in default risk. Stocks in the airline, energy and hospitality & leisure sectors, that are particularly exposed to the COVID-19 demand shock have also seen the most significant declines. Technology, healthcare and utilities stocks have also sold off but to a lesser extent than the overall market.

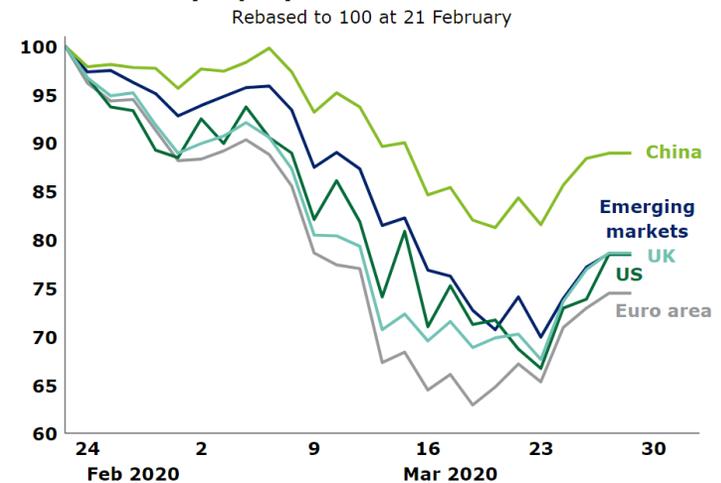
Default risk of non-investment grade corporates



MSCI World equity indices



MSCI Country equity indices

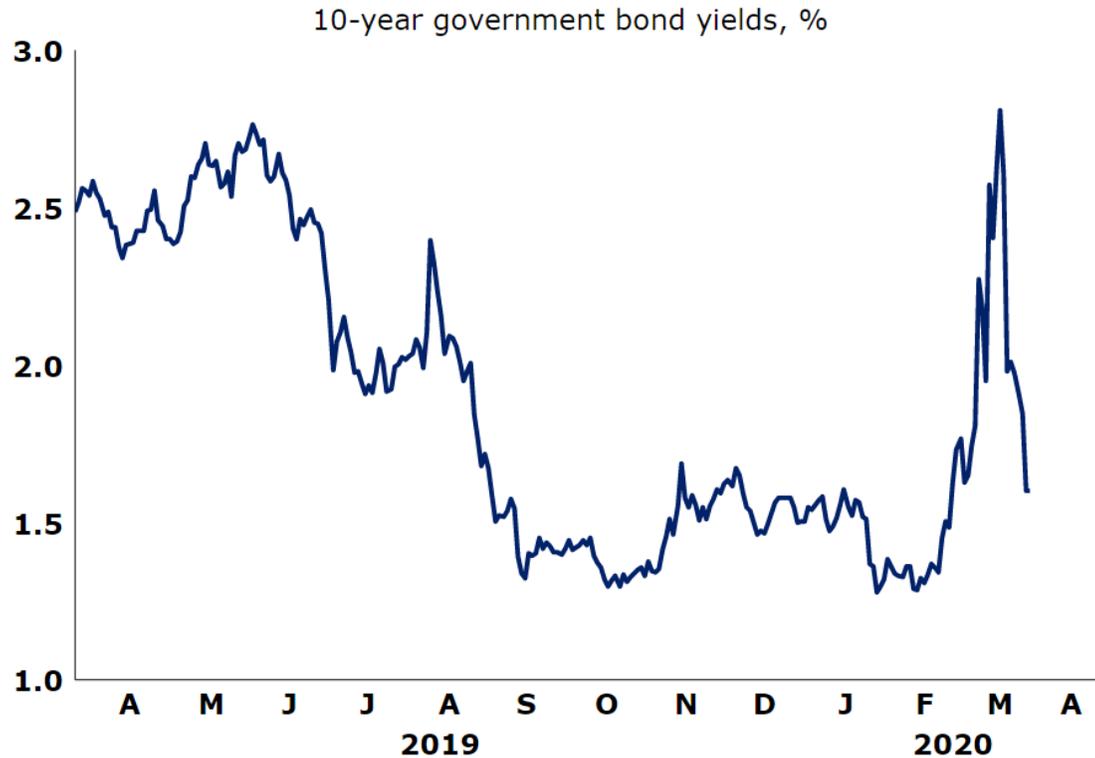


Charts as on 26th March 2020

Monetary ease has dampened stress in some areas

At the time of writing, central bank action has moderated stress in specific areas of the financial system. In Europe, ECB asset purchases have reduced the pressure on at-risk sovereigns, lowering yields on Italian debt. The US Fed has provided much-needed liquidity to the market for treasuries, arresting a spike in yields. However, equities remain well below their latest peak, with investors awaiting a better assessment of the scale of the shock and governments' evolving responses.

Spread between Italian and German bond yields



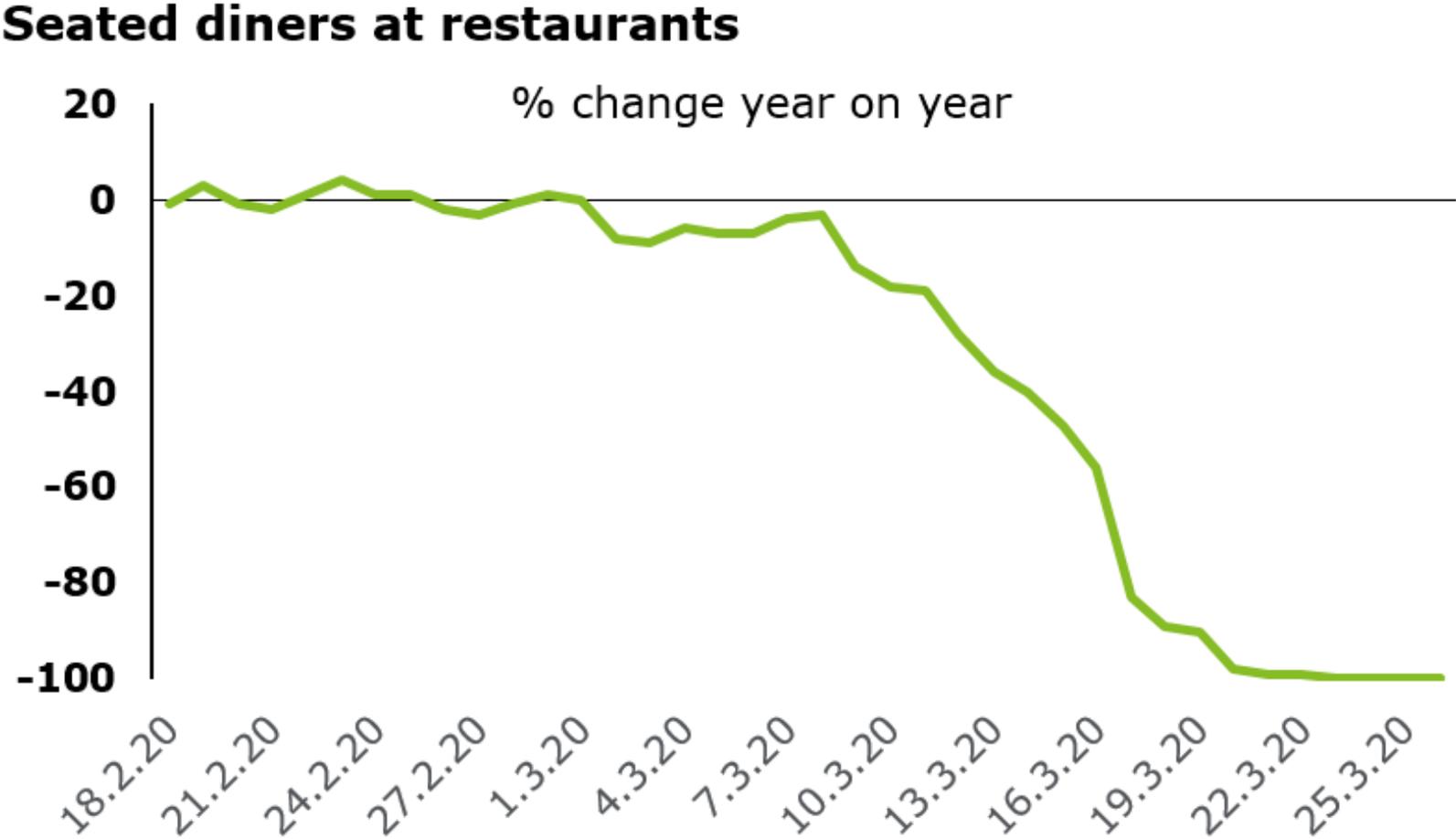
US government bond yields



Charts as on 26th March 2020

High frequency data highlight scale of shock to real demand

In several consumer discretionary sectors, demand has collapsed.

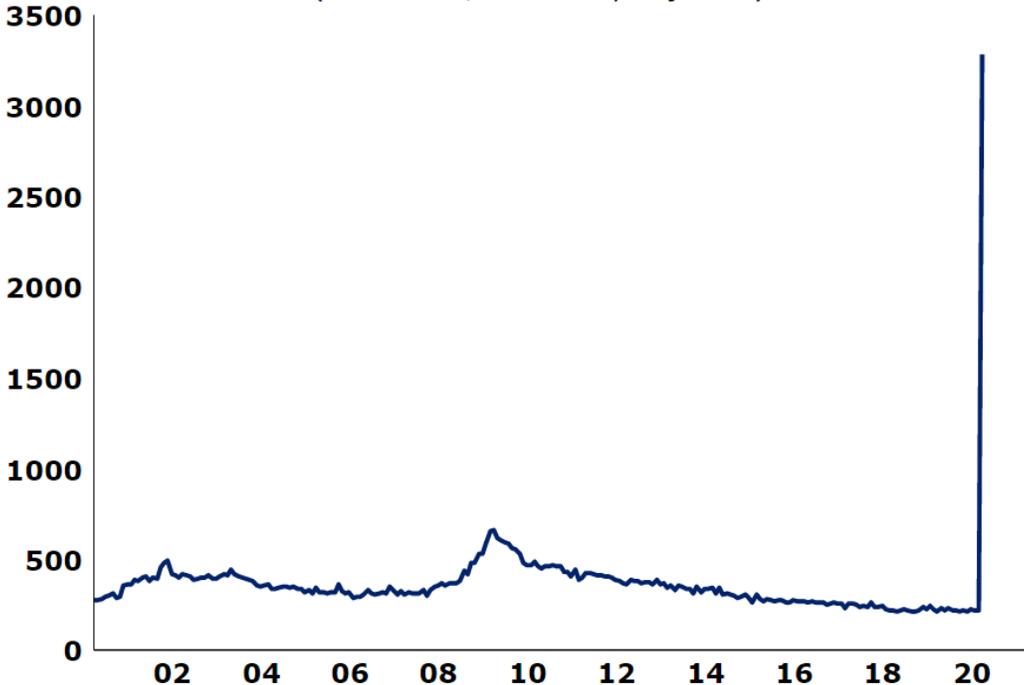


Source: OpenTable data covering restaurants in Australia, Canada, Germany, Ireland, Mexico, UK and US

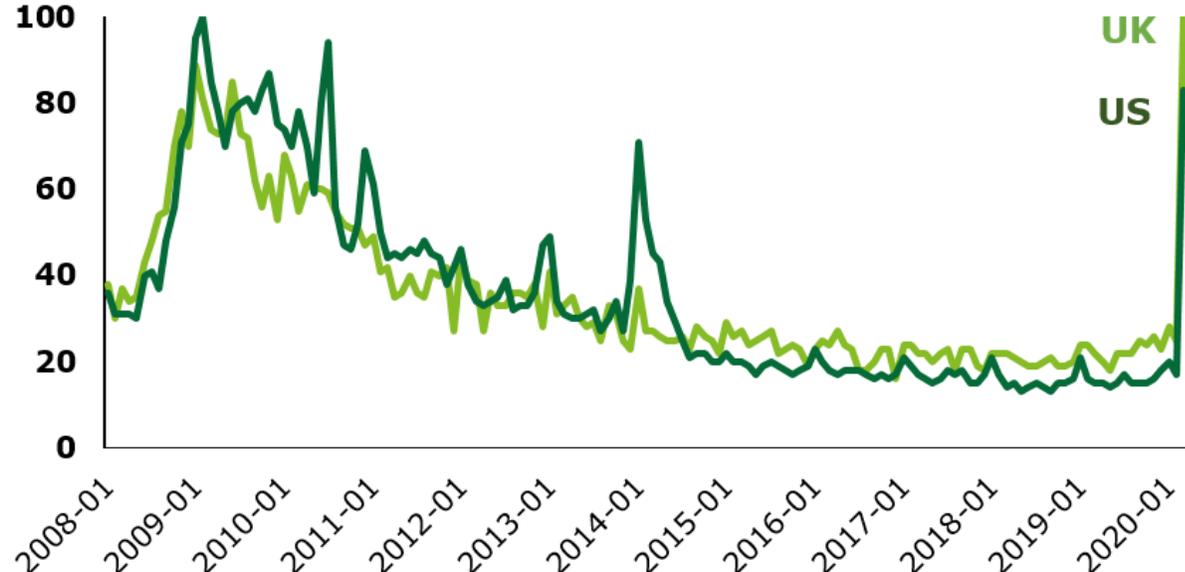
Unprecedented spike in US unemployment underscores risk of downward spiral

What makes this crisis unique is the rapid contraction in demand and the unprecedented pace of job losses. US weekly jobless claims have hit their highest level on record and a further surge seems likely. Google search trends also show a sharp rise in the volume of searches for unemployment benefits in the UK, to a level higher than during the financial crisis. Rising unemployment risks further exacerbating the ongoing squeeze in consumption.

US weekly initial unemployment claims
(thousands, seasonally adjusted)



Google search trends for "unemployment benefits"



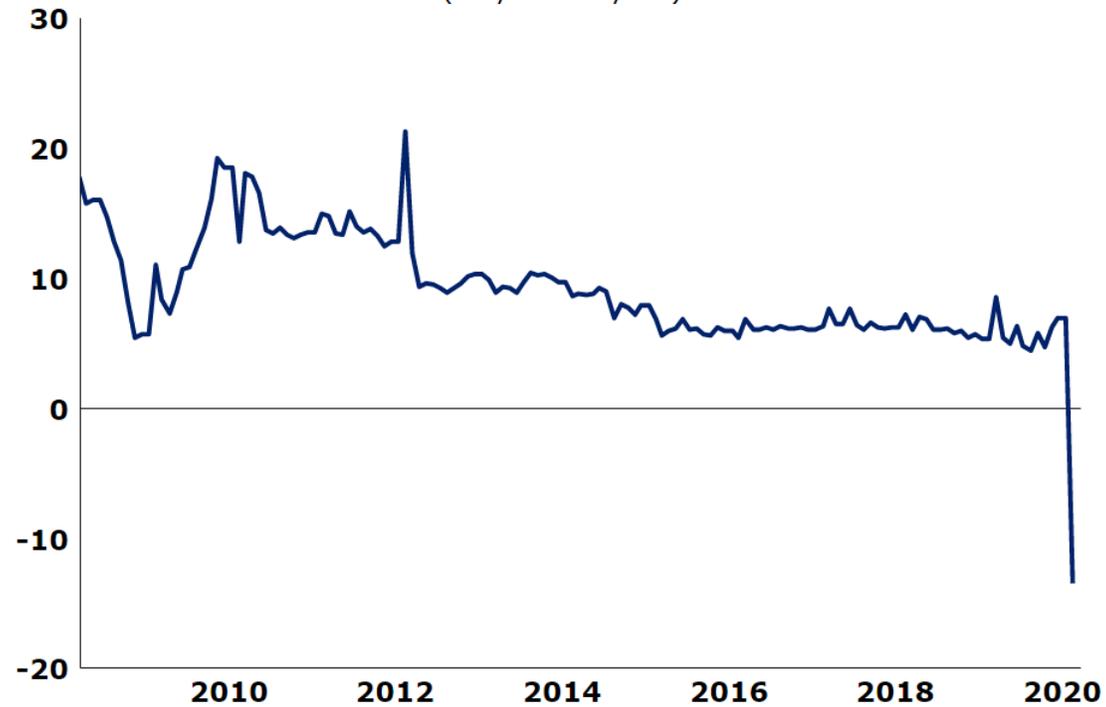
Source: Google Trends

Manufacturing sector bearing brunt of supply shock

Restrictions on the movement of workers and supply chain disruptions have led to a dramatic contraction in manufacturing activity. The automotive industry has been hit particularly badly, with factories closing across Europe and the US.

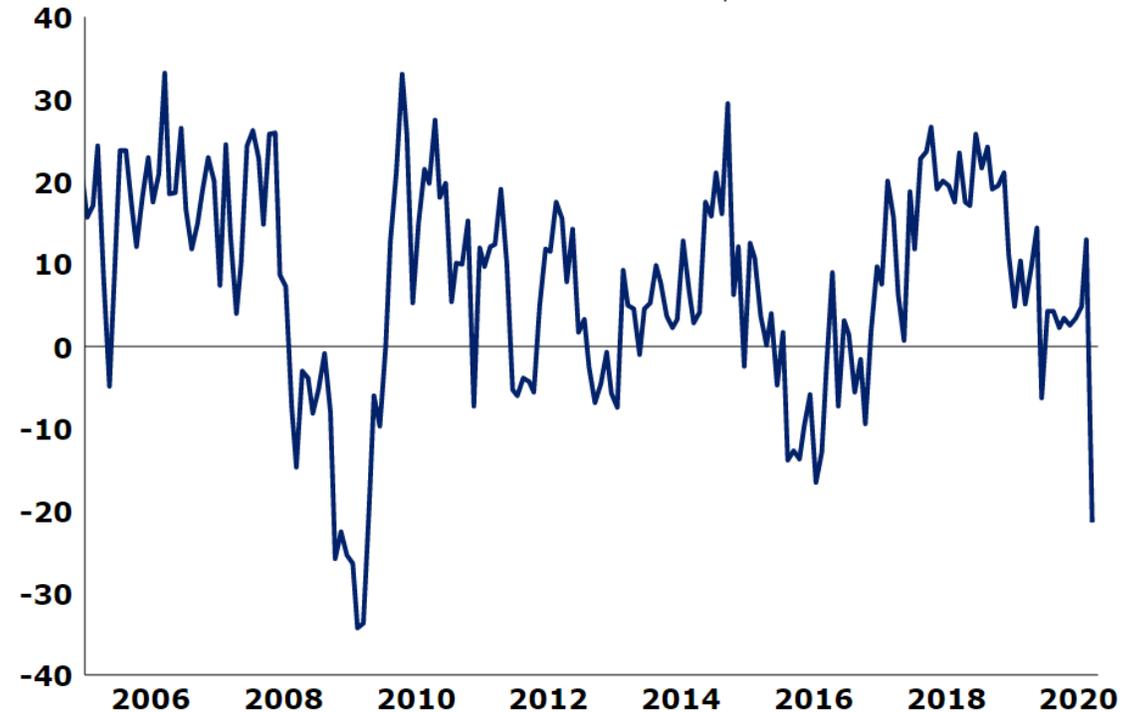
China industrial output

(% year on year)



US empire state manufacturing survey

General business conditions, index



Policy supporting financial stability and preserving productive capacity

Central banks across the globe have acted to provide liquidity and support the normal functioning of financial markets. Governments have announced massive fiscal stimulus packages. But, unlike previous crises where the policy goal was to support demand, the focus now is preserving capacity, helping businesses and individuals tide over a sudden, sharp shock to activity and endemic uncertainty. It is difficult to judge the adequacy of the fiscal response yet. Policy will likely be fine tuned as we better understand the scale of the shock. Governments' ability to improvise and adapt, and their choice of channels for relief provision will determine the success of their interventions.

Key policy responses in a selection of developed economies (as on 26th March 2020)

	Monetary policy		Fiscal policy		
	Rate cuts	Asset purchases and liquidity support	Lending for businesses	Tax relief for businesses	Job/income support scheme
US*	Yes	Unlimited QE, corporate bond purchases, short-term loans to banks	Yes*	-	Yes*
UK	Yes	Expanded QE, schemes targeting banks and corporates	Yes	Yes	Yes
France	No	ECB sovereign and corporate bond purchases	Yes	Yes	Yes
Germany	No	ECB sovereign and corporate bond purchases	Yes	Yes	Yes
Denmark	No (Rate rise)	Macro-prudential easing	Yes	Yes	Yes
Korea	Yes	Short-term loans to banks	Yes	Yes	Yes

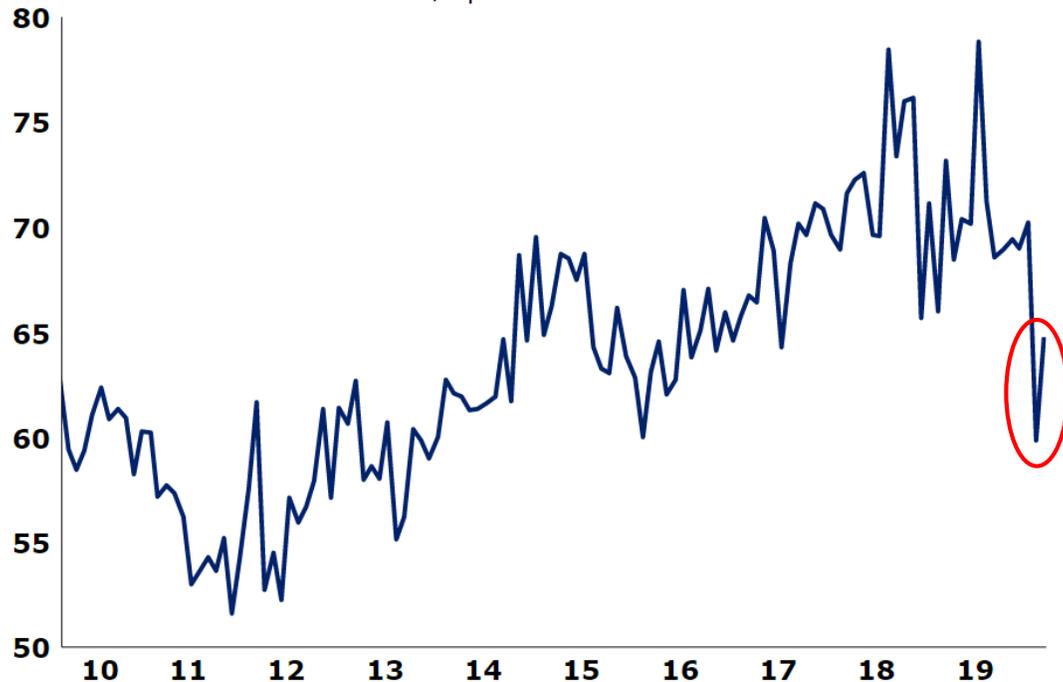
*Full details of package not available; yet to pass the House of Representatives

Where to look for green shoots?

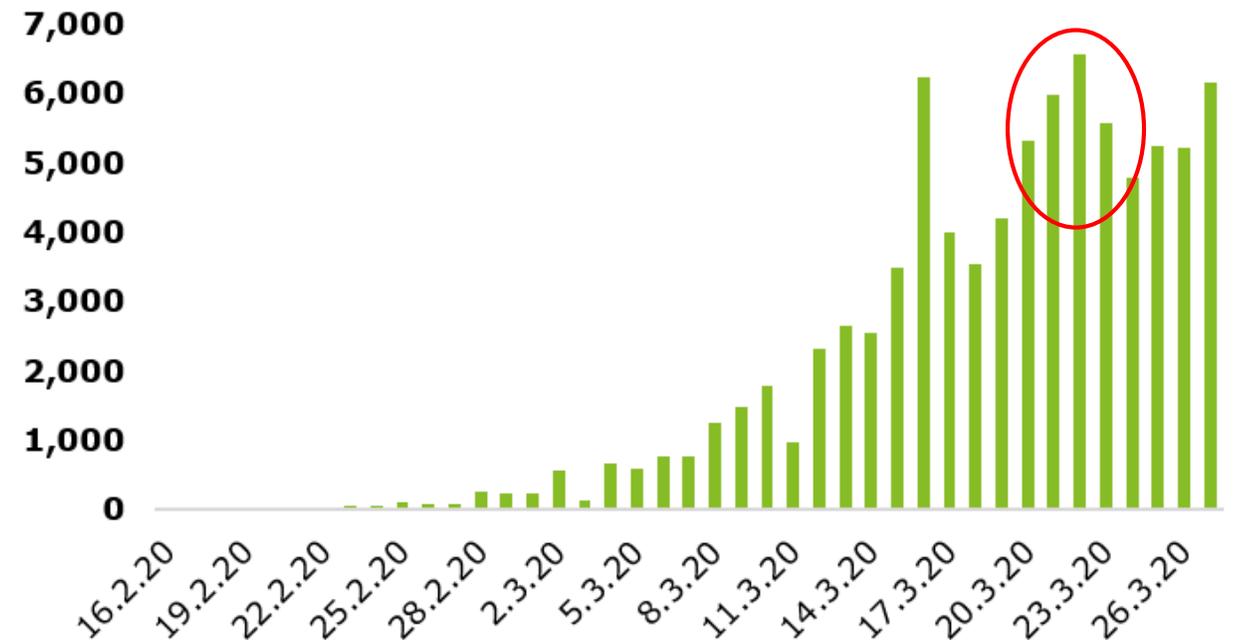
We are closely monitoring data from Asian economies that appear to have contained the outbreak, for early signs of a pickup in activity. Chinese consumer sentiment has rebounded in March. In Europe and the US, we continue to assess the spread of the epidemic. As of 26th March, new cases appear to have peaked in Italy but European countries lag well behind Asian exemplars in containing the outbreak.

China consumer sentiment

Thomson Reuters / Ipsos consumer sentiment index



New daily COVID-19 cases in Italy



Source: European Centre for Disease Prevention and Control



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Data for all the charts in this document was sourced from Refinitiv Datastream unless otherwise stated. Charts as on 26th March 2020.

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