Monthly Economic Outlook -- COVID-19 and You

At this point, much remains unknown about COVID-19. About 80% of people infected show minor symptoms, but 20% become seriously ill and about 2% die. That is less deadly than Severe Acute Respiratory Syndrome (SARS), which had a mortality rate of about 10% and hit South China in 2003. However, the coronavirus appears to be highly transmittable. Infected individuals showing no symptoms can spread the disease. Deaths in China have been concentrated among the elderly and about half have been men. Children appear to be much less susceptible. The theory is that they are more exposed to colds at school and have built up resistance, whereas older people’s immunity tends to fade over time. In addition, smoking is more common among men than women in China, and smokers are more prone to respiratory diseases.

COVID-19 has brought a large portion of China’s economic activity to a halt in recent weeks. China makes up about one-fifth of the global economy, but accounted for nearly a third of global growth in the last two years. Restrictions, some voluntary, have reduced travel and consumption. Supply chain disruptions have dampened production in a number of countries (for example, motor vehicle output in Japan and South Korea) and appear to have begun having an impact in the U.S. Chinese tourism has grown rapidly in recent years and the coronavirus has sharply reduced travel to the rest of the world. Chinese economic activity will eventually recover once the virus is contained, but that is now likely to be months instead of weeks.

While confirmed cases of the coronavirus appear to have slowed in China, the spread to other countries has added to uncertainty and fanned investor fears of a broader economic impact. On February 25, Nancy Messonnier, M.D., Director of the National Center for Immunization and Respiratory Diseases, said that “to date, our containment strategies have been largely successful.” The U.S. has had relatively few cases and no spread in the community. However, “as more and more countries experience community spread, successful containment at our borders becomes harder and harder – and ultimately, we expect we will see community spread in this country.” Messonnier emphasized, “it’s not so much a question of if this will happen anymore but rather more a question of exactly when this will happen and how many people in this country will have severe illness.” The coronavirus has spread to 53 countries, and the number of cases has grown in South Korea, Italy, Iran, and Japan.

Should COVID-19 spread more widely in the U.S., as anticipated, the economic consequences could be severe. Most of the damage to the economy would come through avoidance rather than the virus itself. That is, we could see sharp reductions in travel. People would avoid shopping centers, restaurants, and theatres. The economy would eventually rebound, but it may take a long time.

Doing the math, based on what we think, if half of the U.S. is infected, more than 30 million would become seriously ill and more than 3 million would die. Of course, there is a lot of uncertainty in that calculation (which may be seen as a worst-case scenario). Consumers and businesses should hope for the best and prepare for the worst. Warm weather may curtail the spread of the virus, but that’s unclear, and even if that were to be the case, we could see its return later this year. A vaccine would likely be a year or more away.

Fear of COVID-19 has sent the major stock market indices sharply lower in the last couple of weeks. The market may have been highly valued to begin with, but the downside risk to the economy is significant – and that’s what is driving the market. Bond yields have plunged to record lows, reflecting a flight to safety. We can expect volatility to remain elevated as information on the virus arrives.

On February 28, following a week of sharp stock market declines, Fed Chair Powell issued the following statement: “The fundamentals of the U.S. economy remain strong. However, the coronavirus poses evolving risks to economic activity. The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy.”

All of that goes without saying, but the statement implies that the Fed is likely to lower short-term interest rates at the March 17-18 Federal Open Market Committee meeting. Lower short-term interest rates would do little to counter the effects of an epidemic. Monetary policy affects economic activity with a lag. The impact of lower rates would show up in a year, possibly when the economy is recovering. There’s a common belief that the Fed always reacts to stock market weakness. That’s not always the case. If the Fed cuts when the stock market is down, that’s because it’s reacting to what the stock market is reacting to (say, expectations of weaker economic growth). Still, a rate cut couldn’t hurt, especially as the Fed is missing on its inflation goal (1.6% y/y in January, vs. a target of 2.0%). Expectations of the spread of COVID-19 in the U.S. should come into focus in the next couple of weeks, just ahead of the FOMC meeting.

Recent data reports suggest that U.S. economic activity has remained mixed in early 2020. Consumer spending (nearly 70% of Gross Domestic Product) is supported by a strong job market. Business fixed investment was restrained by trade policy uncertainty and slower global growth.
last year. Global economic activity was expected to improve moderately this year, but the coronavirus has been a major setback. Yet, business fixed investment (a little over 17% of GDP) has trended only gradually lower in recent quarters – not the kind of sharp drop that we would see in a recession. Home construction and sales have rebounded sharply from year-ago weakness. Solid consumer fundamentals and low mortgage rates will continue to provide support for the housing sector (although residential fixed investment accounts for only about 3.1% of GDP). Should the spread of COVID-19 appear limited, the moderate growth outlook should remain in place. However, if we see a broader contagion, the near-term outlook would darken. (M20-2974110)
Notes on the forecast: The table represents a baseline forecast. Any forecast will be wrong. Forecasts should be thought of in probabilistic terms – a most likely scenario, but one surrounded by risks. While growth is expected to be moderate in 2020, the risks to the growth outlook remain prominently to the downside, more prominently now due to the coronavirus.

GDP growth figures can be quirky from quarter to quarter. Net exports and the change in inventories make up a relatively small portion of the level of GDP, but they account for more than their fair share of volatility in GDP growth – and these components are likely to be erratic in the near term. As Fed Chair Powell has put it, net exports and inventories are “components that are generally not reliable indicators of ongoing momentum.”

Investors should focus on Private Domestic Final Purchases, which is consumer spending plus business fixed investment plus residential fixed investment (or equivalently, GDP less government, less net exports, less the change in inventories). Powell: “The more reliable drivers of growth in the economy are spending on consumption and business investment.”

Underlying domestic demand is expected to be moderate in 2020. While there is likely some slack remaining in the job market, constraints can be expected to limit the pace of job growth

Nonfarm payrolls should be boosted by temporary hiring for the decennial census in the first half of 2020, falling back in the 3Q20.

Once again, long-term interest rates are expected to move somewhat higher over time, but are likely to remain low in the near term – bouncing somewhat higher is COVID-19 fears are overdone.

The Fed had been expected to remain on hold this year, but would respond with a rate cut if the outlook deteriorates (which is likely in the next couple of weeks). The hurdle for a rate increase appears to be high for the time being. The Fed may make some changes to its inflation goal around mid-year.
The economy through changes in the aggregate market value of 500 stocks representing all major industries. The Shanghai and Shenzhen stock exchanges. It had a sub-indexes CSI 100 Index and CSI 200 Index. The Euro Stoxx 50 Index is a market capitalization weighted stock index of 50 large, blue-chip European companies operating within Eurozone nations. Components are selected from the Euro STOXX Index which includes large-, mid- and small-cap stocks in the Eurozone.

The China CSI 300 is a capitalization-weighted stock market index designed to replicate the performance of top 300 stocks traded in the Shanghai and Shenzhen stock exchanges. It had a sub-indexes CSI 100 Index and CSI 200 Index. The S&P 500 Futures is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The DJIA Futures is a stock market index futures contract traded on the Chicago Mercantile Exchange’s Globex electronic trading platform. Dow
Futures is based off the Dow 30 stock index.

The Nasdaq 100 Futures is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international companies listed on the NASDAQ.

Europe: DAX (Deutscher Aktienindex (German stock index)) is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange.

Asia: Nikkei is short for Japan's Nikkei 225 Stock Average, the leading and most-respected index of Japanese stocks. It is a price-weighted index composed of Japan’s top 225 blue-chip companies traded on the Tokyo Stock Exchange.

Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor’s results will vary. Past performance does not guarantee future results. Future investment performance cannot be guaranteed, investment yields will fluctuate with market conditions.

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