
Recession risks: Coronavirus + oil shock + what else?

Multi-asset | March 2020



Anwiti Bahuguna
Head of Multi-Asset
Strategy, North America

To begin with, supply was the concern, but now demand is at risk. What is without doubt is that recession risks are elevated

When news of the novel coronavirus first began to emerge from China, economic analysis was generally focused on the disruption of supply chains, and the effect on companies unable to easily relocate manufacturing. Now that companies and consumers are cutting back on spending, the drop in demand has heightened fears of a sharp slowdown in economic growth. A collapse in the price of oil has added to concerns.

The growth outlook dims

Recession risks are now clearly elevated, and we expect there will be a hit to US growth. The extent of the decline in growth will depend on the severity and the duration of the coronavirus infections. If the spread of the virus disrupts demand for a prolonged period – beyond the next two months – the impact on growth will be more significant. Swift and draconian actions have led to containment in some East Asian countries (China/Singapore/Hong Kong), but as is evident from Chinese data, and likely Italian data to come, these measures also take a severe toll on economic growth.

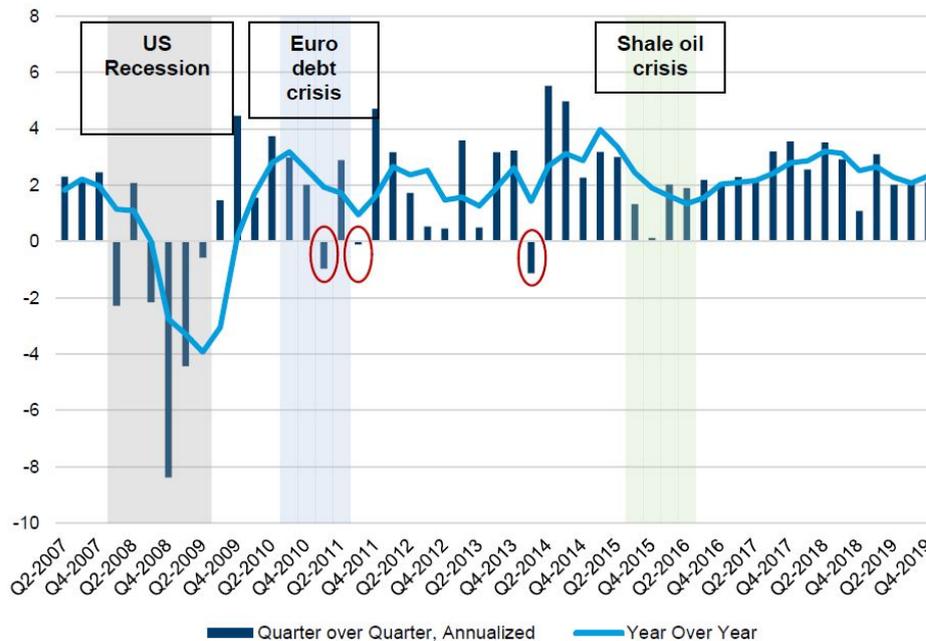
Further headwinds: falling oil prices and capital expenditure

As the experience of 2015-16 has shown, a decline in oil prices is no longer a net positive for the US economy. It may benefit consumer pocketbooks, but at times of uncertainty consumers are likely to save the windfall and not spend. With the sharp fall in oil prices we cannot rule out the risk of credit downgrades and increased defaults among energy companies, which could spill over to other segments of the US economy. Our expectation for capital expenditure (capex) generally, and in energy production specifically, is for deep cuts, perhaps to zero, in 2020 which will also be a drag on growth.

Watching how consumers and businesses react

In the current expansion – the longest on record – there have been three instances of negative quarterly growth, and yet the economy has continued its long upward grind.

Figure 1: United States real GDP growth



Source: Macrobond; Bureau of Economic Analysis; Columbia Threadneedle Investments.

If containment and mitigation efforts are successful in the US, we expect the hit to growth from coronavirus to be short lived. In addition to public health efforts, much depends on how businesses and consumers react. US companies will likely see a hit to earnings, but it is not clear how they will respond. Consumers are also likely to be impacted, and we must watch to see if they retrench spending sharply or benefit from lower rates and oil prices. Leading indicators to help assess these responses include the Institute of Supply Management Purchasing Managers' Index, consumer and business sentiment indicators, and monthly payroll data.

Catalysts for improvement

The most significant catalyst for improvement will be limiting the spread of coronavirus. Monetary and fiscal responses will also be important to ensure that companies can continue to borrow if needed to fund operations:

Monetary policy It is evident that the US Federal Reserve Board is prepared to act quickly and decisively. The Fed's activities and forward guidance can help stabilise market sentiment. Cutting rates is less important than keeping the credit channels open; maintaining liquidity in the markets will be essential.

Fiscal policy A well-thought-out and targeted fiscal response is also needed to support demand in the economy. In the US we have seen an announcement of \$8.3 billion in emergency funding from the administration, and more is likely to come. In China we have seen coordinated monetary, fiscal and credit programs.

The bottom line

If coronavirus disrupts demand for a prolonged period – beyond the next two months – the impact on growth will be far more significant. Ongoing economic reports may continue to fuel volatility as investors digest the data, and it will be important for investors to distinguish between backward looking reports (eg, retail sales and payroll) and forward-looking indicators such as sentiment.



Important Information. For internal use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Past performance is not a guide to future performance. Your capital is at risk. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. This material is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments, or to provide investment advice or services. Where references are made to portfolio guidelines and features, these are at the discretion of the portfolio manager and may be subject to change over time and prevailing market conditions. Actual investment parameters will be agreed and set out in the prospectus or formal investment management agreement. Please note that the performance targets may not be attained. The analysis included in this document has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable, but its accuracy or completeness cannot be guaranteed. Any opinions expressed are made as at the date of publication but are subject to change without notice. Information obtained from external sources is believed to be reliable, but its accuracy or completeness cannot be guaranteed. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guaranty, or other assurance that any of these forward-looking statements will prove to be accurate. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document and its contents are confidential and proprietary. The information provided in this document is for the sole use of those receiving the document. It may not be reproduced in any form or passed on to any third party without the express written permission of Columbia Threadneedle Investments. This document is the property of Columbia Threadneedle Investments and must be returned upon request. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating to an investment with Columbia Threadneedle Investments. This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparty and no other Person should act upon it. Issued by Threadneedle Asset Management Limited, registered in England and Wales, No. 573204. Registered Office: Cannon Place, 78 Cannon Street, London EC4N 6AG. Authorised and regulated in the UK by the Financial Conduct Authority. Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.