The COVID-19 spreads, temporarily, to the macro environment and the financial sector

The spread of the COVID-19 across the five continents and the high degree of uncertainty over its economic implications have already had a clear impact on the financial markets, which have experienced a surge in volatility. Economic activity data are still scarce, but all the indicators suggest that the impact of the coronavirus, while most likely temporary, will be far from negligible.

The financial markets have experienced an episode of major risk aversion, with capital flows shifting towards safe-haven assets, such as the dollar and US and German sovereign debt, while punishing assets more closely linked to the business cycle, such as stocks. The price of a barrel of Brent oil fell by over 10% in the month as a whole, also driven down by the forecasts for oil demand produced by OPEC. In FX markets, risk aversion and uncertainty over the performance of economic activity in emerging economies accelerated the depreciation of their currencies, which are closely linked to the performance of their commodity exports.

In this context, markets quickly turned to central banks the central banks which, as is common in this type of situation, are the quickest institutions to react. At an emergency meeting, the Fed cut the reference interest rate by 50 bps and hinted that it is very likely to implement further cuts in the coming months. Treasury yields fell to historic lows. Furthermore, the sovereign yield curve once again inverted, with the 10-year rate reaching well below the 3-month rate - something that has traditionally anticipated the onset of a recession in the US in the following year. On the other hand, financial asset prices also anticipate that the ECB will implement some adjustments to its monetary policy, albeit less significant ones given that it has much less much less policy space. In fact, it is likely to focus the bulk of its support in measures to ensure even more abundant liquidity, with the aim of preventing the coronavirus from causing difficulties for firms that are creditworthy but are experiencing liquidity problems due to disruptions in the production chain or a temporary drop in demand.

At the macroeconomic level, the available data are still limited, but the economic recovery that we were beginning to see materialise until recently has been temporarily called into question. The global economic activity indicators for the month of January showed a certain acceleration in the global economy, but they have been completely overshadowed by the historic correction that China's economic activity indicators suffered in February. For instance, the services and manufacturing PMI indices fell to historic lows and point towards a contraction of the economy in the first quarter.

In advanced economies, the available data do not yet capture the impact of the COVID-19, since the spread has occurred more recently and is much less severe than in China. In fact, US GDP figures reminded us that the US economy was in very good shape at the end of 2019, as it closed Q4 with growth of 2.3% in year-on-year terms, in spite of the protectionist measures and the trade tensions with China. In contrast, the euro area bid farewell to last year with a very modest growth rate, placing it in a relatively vulnerable position ahead of the foreseeable impact of the COVID-19 in the first half of 2020. Specifically, the region grew by 0.1% quarter-on-quarter in Q4 2019, leaving the figure for the year as a whole at a modest 1.2%.

In this context, the performance of the Spanish and Portuguese economies remains relatively favourable. Both ended last year with a growth rate well above that of most European countries, although it is also foreseeable that they will be affected by the spike in uncertainty and the slowdown of the global economy over the coming months. In addition, the tourism sector - one of the hardest hit by the situation generated by the COVID-19 - accounts for a significant portion of both countries' economies. The sector will suffer, but it is also true that, in this context, both countries can once again gain in appeal relative to alternative destinations such as Turkey or Egypt, which could help to cushion the impact.

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