



Economic and Investment Implications of COVID-19

25 February 2020

Summary and key views on investment implications

- This note is an update as the COVID-19 outbreak continues to evolve and it is a tragedy with significant human and social cost. We reiterate our lack of expertise in infectious diseases but we have collated input from health experts, China based professionals, and Frontier Senior Consultant, Martin Thompson, who has a PhD in Molecular Cell Biology and previously undertook virology research. We are assessing the investment implications of COVID-19 for clients using the framework that was highlighted in our previous Market Insights on COVID-19

Frontier COVID-19 Framework

- Scale and duration of disease outbreak before it is stabilised
- Scale and duration of economically disruptive measures imposed
- Scale of stimulus response by authorities
- Financial market response

Investment Implications

- The outlook remains highly uncertain and Frontier continues to monitor developments. The expectation is that COVID-19 will have a short temporary impact on the global economy and then recover (similar to the SARS experience). However, there seems an increasing probability that the outbreak will not be quickly contained and although authorities are likely to counter with significant stimulus the negative economic impact could be more protracted. COVID-19 is another downside risk that reinforces Frontier's current DAA advice to have a small underweight exposure to growth assets. However, if there are large swings in market prices it could also provide tactical opportunities to look through the short-term volatility

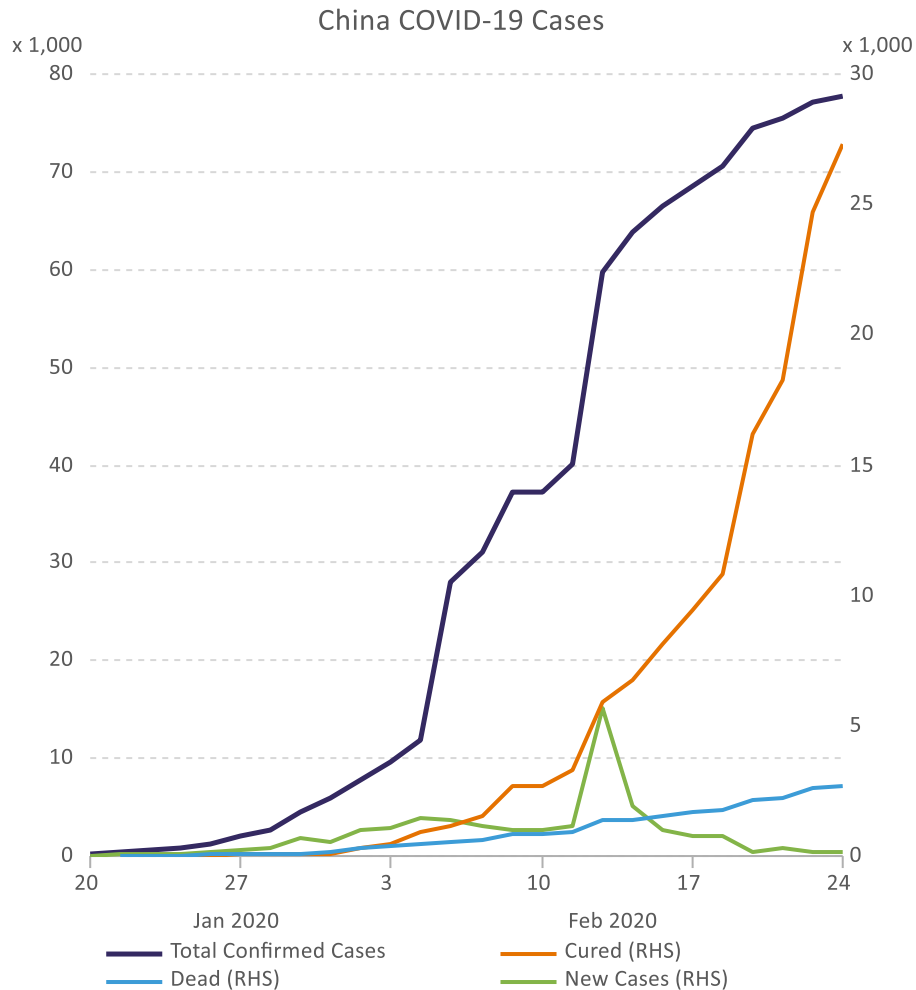
Assessing COVID-19 using Frontier's framework

- Scale and duration of disease outbreak before it is stabilised
 - It is still highly uncertain on when the outbreak will be contained; data on new confirmed cases in China appears to be declining, but the increase in new cases in South Korea, Italy and Iran indicate it is spreading
 - So far, it would seem that the mortality rate is relatively low (particularly when examining cases outside China where medical care has probably been of a higher degree) but the contagiousness is quite high. With a vaccine potentially months (or more than a year away), the virus spread may become more managed but may not be contained for some time
- Scale and duration of economically disruptive measures imposed
 - The containment measures implemented by China to date remain aggressive and very disruptive for economic activity
 - There may be some loosening in measures with some factories reported to have labour returning back to work in phases, however high frequency activity data suggests the Chinese economy has yet to restart in a meaningful way
 - This puts increased pressure on balancing public health against the economically disruptive measures that have been implemented in response to the outbreak

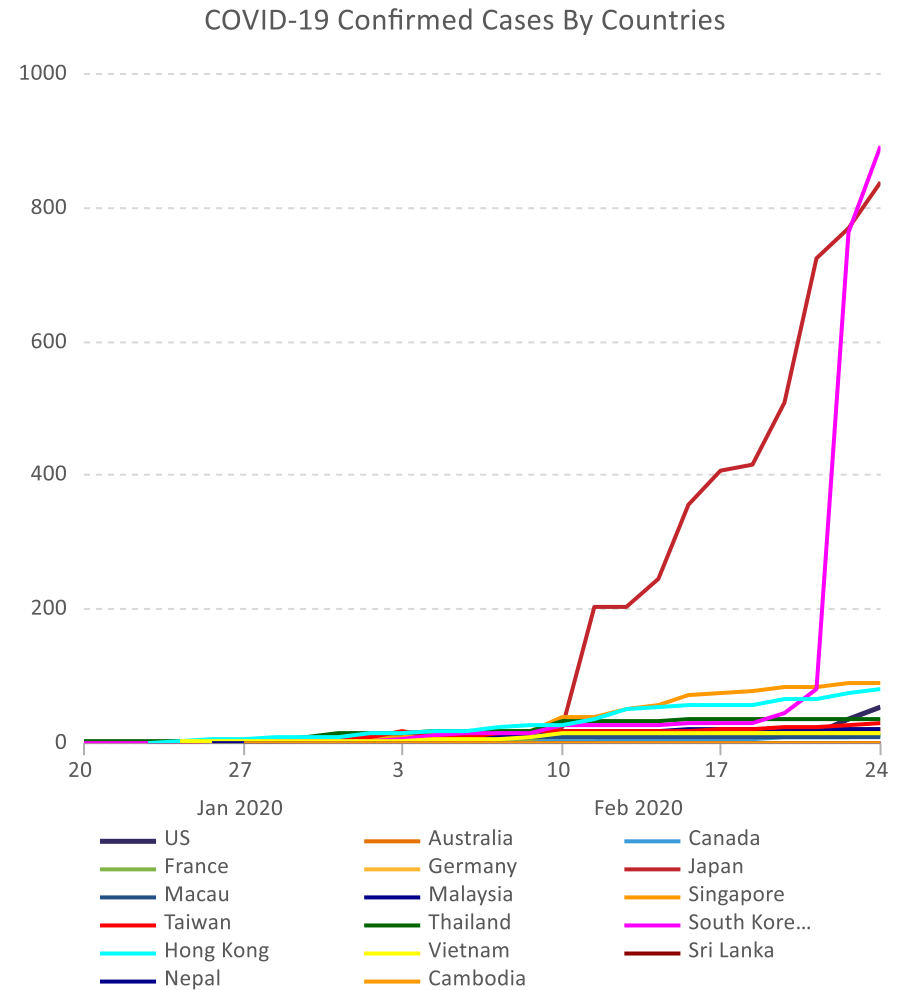
Assessing COVID-19 using Frontier's framework (cont'd)

- Scale of stimulus response by authorities
 - The Chinese authorities have implemented a multi-pronged policy response covering monetary, fiscal and regulatory policies. President Xi has continued to emphasise the “need to deliver this year’s economic and social targets” and “stressing orderly resumption of work and production”
 - Authorities in other Asian economies that are heavily exposed to the halt in economic in China have also started to provide policy support
- Financial market response
 - Market expectations are for strong policy response globally to offset the negative economic impact of the outbreak. Further interest rate cuts are expected from the US Federal Reserve and domestically from the Reserve Bank of Australia (RBA). Equity market performance has been volatile, however Australian equities is still positive and developed market equities is flat since the start of the year

Confirmed cases in China slowing but COVID-19 spreading outside of China

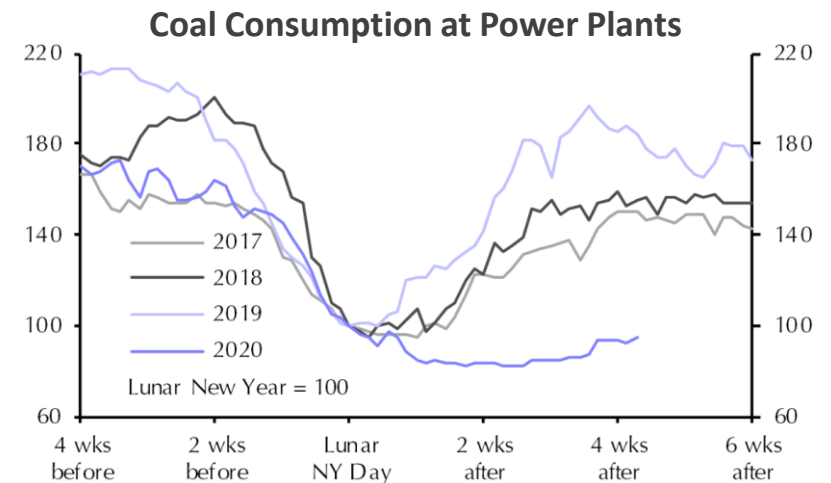
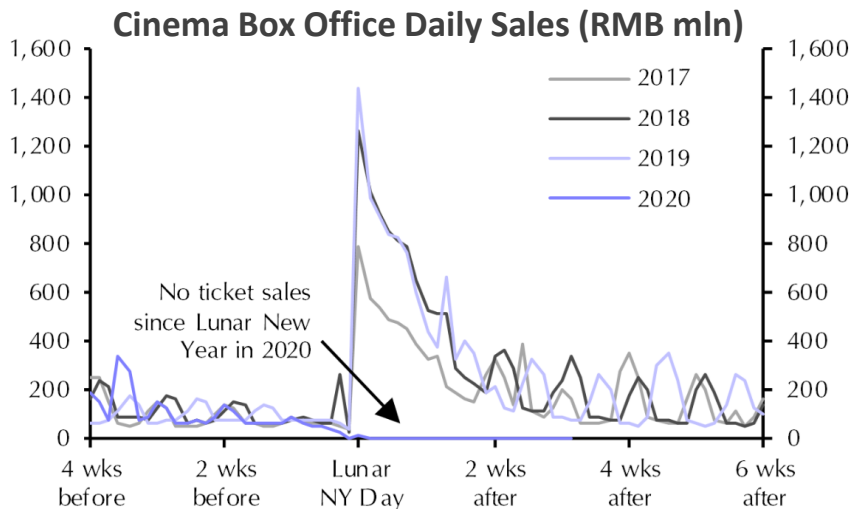
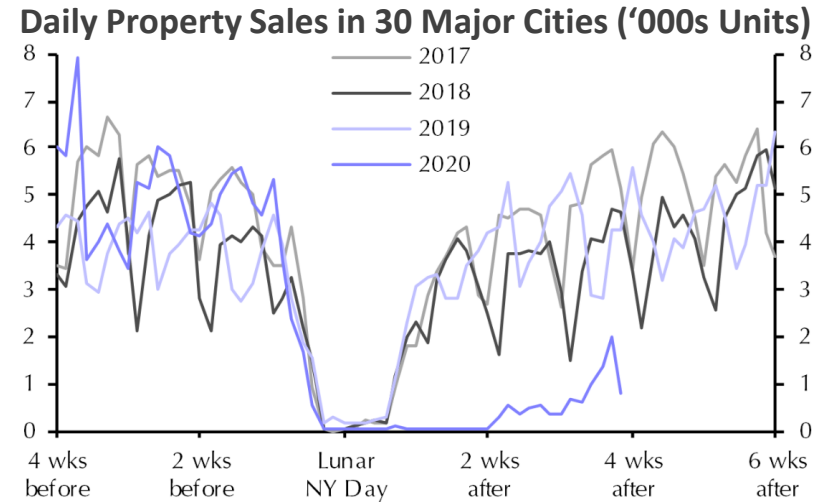
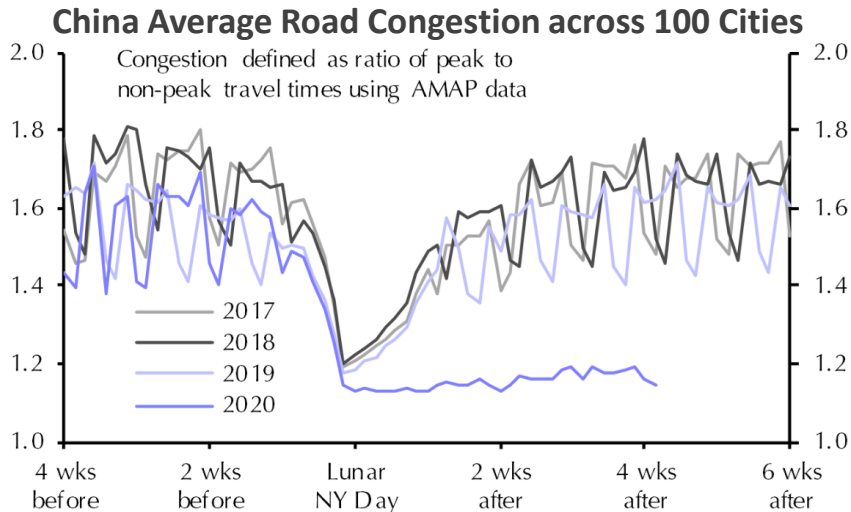


Source: Refinitiv Datastream



Source: Refinitiv Datastream

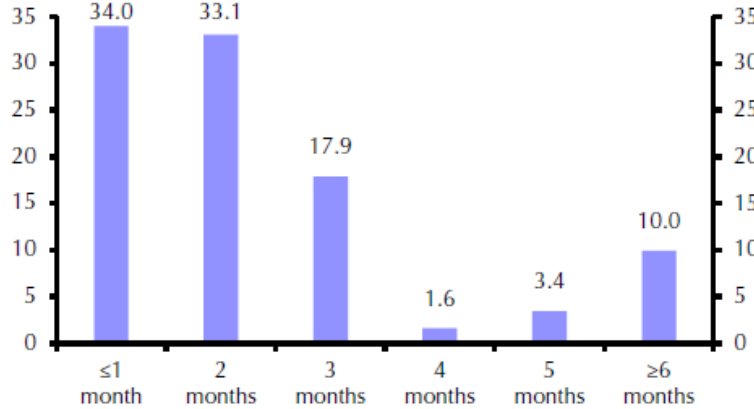
High frequency economic activity indicators show little change in China



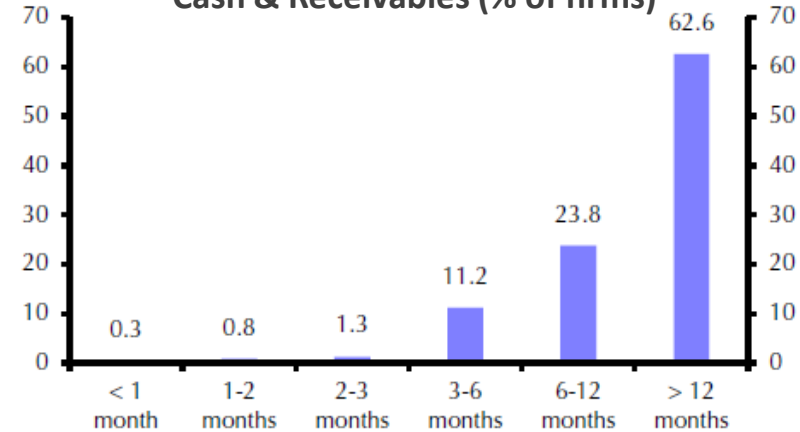
Sources: Capital Economics, CEIC, Wind, OECD, Refinitiv

Scale and duration of economically disruptive measures imposed Chinese business cash flows and global supply chain linkages

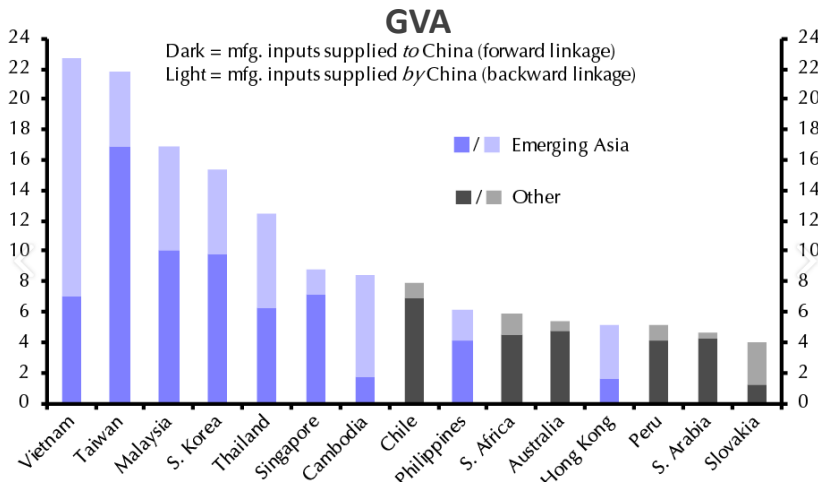
Survey of 1000 SMEs: "How many months can cash reserves sustain your firm?" (% of respondents)



Listed Firms – Months of Liabilities & Wages Covered by Cash & Receivables (% of firms)

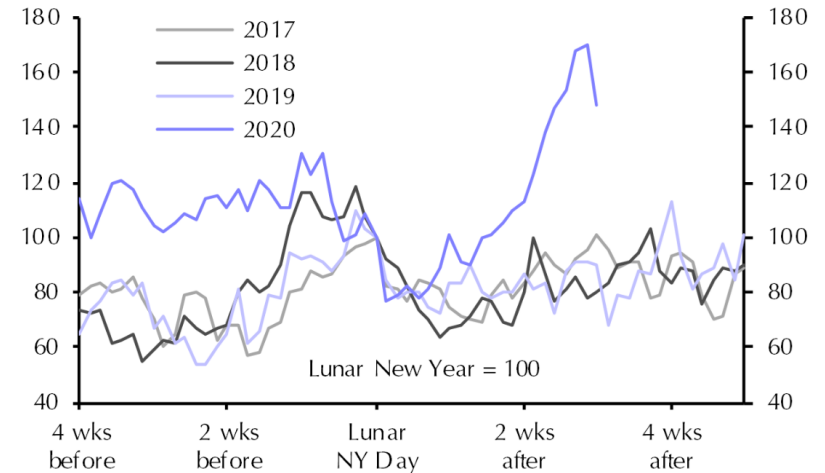


Manufacturing Supply Chain Linkages with China as a %



Sources: CEIC, Wind, Peking & Tsinghua Uni., Capital Economics

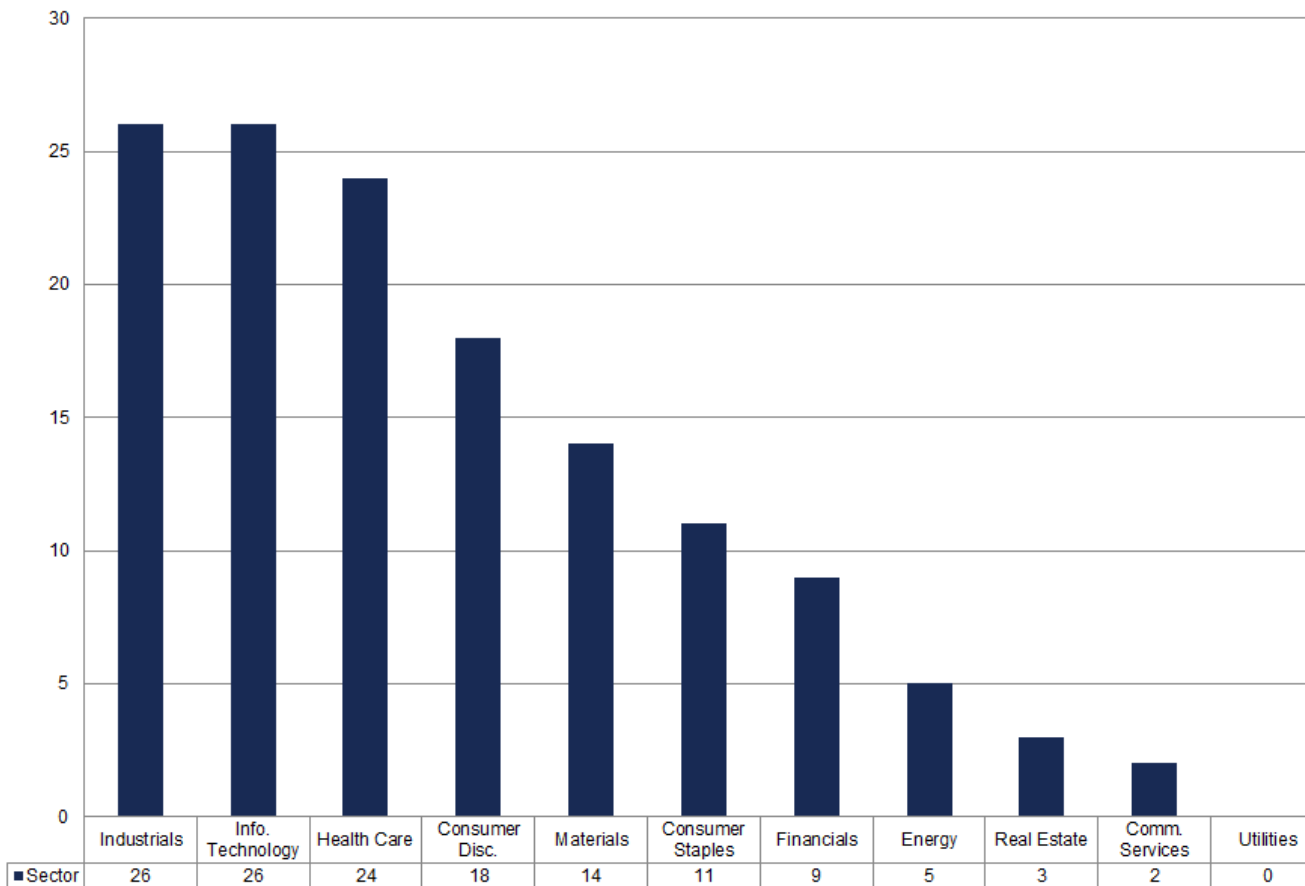
Containers waiting to be offloaded at Chinese ports (TEU)



TEU = Twenty foot equivalent unit

Earnings guidance from US reporting season suggest industrials and IT sectors more heavily impacted

Number of S&P 500 Companies citing "Coronavirus" on Q4 Earnings Calls



Source: Factset

Current news on Communist party-linked Chinese newspapers



China to win battle against epidemic while ensuring economic stability

Thanks to these arduous efforts, China's prevention and control measures are making visible progress.



Nation confident of virus battle victory

China is capable of winning the battle against the novel coronavirus pneumonia outbreak, which cannot undermine the foundation of China's long-term development, President Xi Jinping said on Thursday.



Enterprises resume production in orderly manner under strict prevention measures

Some enterprises have resumed production in an orderly manner under strict measures taken to prevent and control the novel coronavirus disease (COVID-19) recently.

75 pct of companies confident in prospects for Chinese economy: report

Regardless of the impact of the novel coronavirus outbreak, 75 percent of respondent companies in a survey said they are confident in the prospects for the Chinese economy and will not change their re-investment plans.



Members of Belt and Road News Network hail China's efficient efforts in fighting epidemic

Global members of the Belt and Road News Network (BRNN) have paid close attention to and spoken positively of China's effective measures to fight the novel coronavirus epidemic.

Source: People's Daily, Xinhua

China policy stimulus announcements since December

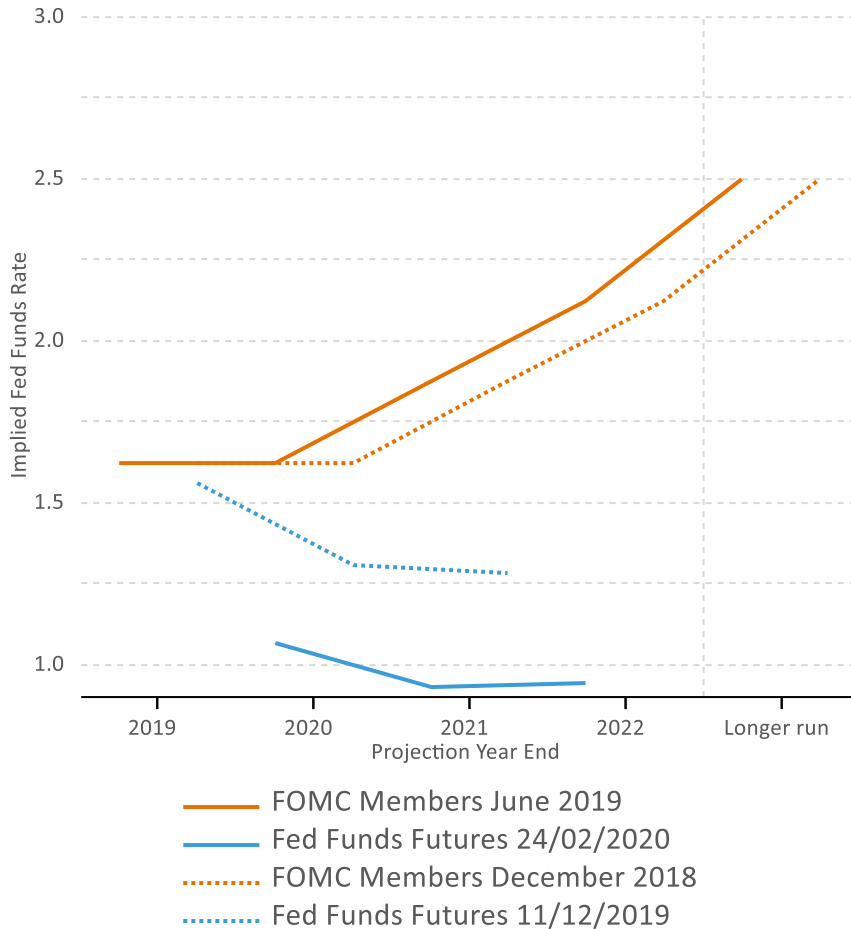
Date	China Policy Stimulus Announcements
Dec 2019	The Central Economic Work Conference has decided “prudent monetary policy should be pursued with moderate flexibility to maintain market liquidity at a reasonably ample level for 2020” however "would not resort to flood-style stimulus while facilitating counter-cyclical adjustments"
Jan 2020	PBOC cuts RRR by 0.5%
Feb 2020	<p>Monetary policy:</p> <ul style="list-style-type: none"> • PBOC reduces the 7-day and 14-day repo rates by 0.1% to 2.4% and 2.55% respectively • PBOC injected short term liquidity of RMB ~1500 bln (1.5% of GDP) since Coronavirus outbreak • PBOC offered RMB 300bn (~US\$42bn) in relending funds to banks to support manufacturing and SMEs in worst-hit regions • PBOC has lowered its interest rate on the one-year medium term loans to financial institutions, from 3.25% to 3.15%. The one-year Loan Prime Rate (LPR) reduced from 4.15% to 4.05% by commercial banks
Feb 2020	<p>Regulatory policy:</p> <ul style="list-style-type: none"> • Regulators provide window guidance to banks to lower rates on operation loans for SMEs by 50bps. PBOC instruct banks to cap rates on loans for selected firms at 3.15% • The Ministry of Finance will subsidise 50% of actual interest payments for impacted companies on their special purpose relending, such that the actual financing cost falls below 1.6% • Overdue loan breaks for retail loan delinquencies (mortgage and credit card) from individuals affected by the coronavirus • CSRC loosened the regulation of refinancing and private offering for ChiNext companies, which is a positive signal to facilitate indirect financing and improve the balance sheet of quality technology companies • CBRC announced that banks will provide RMB 537bn (~US\$77bn) worth of credit support to SMEs in retail, catering and travel sectors that suffered during the outbreak • Financial Institutions are prohibited from seeking early repayment or cutting off loans for industries severely hit by the virus outbreak • Extending terms if maturing loans by less than 1 year for individual entrepreneurs and SMEs who have been infected by the virus
Feb 2020	<p>Fiscal policy:</p> <ul style="list-style-type: none"> • Exempt 3-month rent for state-owned assets for medium, small and micro enterprises • Ministry of Finance released additional local government debt quota of RMB 848bn (~US\$120bn) in advance and urging quick execution of key infrastructure projects • Reduce VAT and income tax to industries affected by the epidemic, such as transportation, retail, hotel and tourism • Loan subsidies by the Ministry of Finance for new loans to companies that produce medical supplies • Halved the tariff rate on US\$75bn of US imports

Stimulus response by Asian countries

- Asian central banks that have cut interest rates in 2020:
 - Sri Lanka
 - Malaysia
 - China
 - Thailand
 - Philippines
 - Indonesia

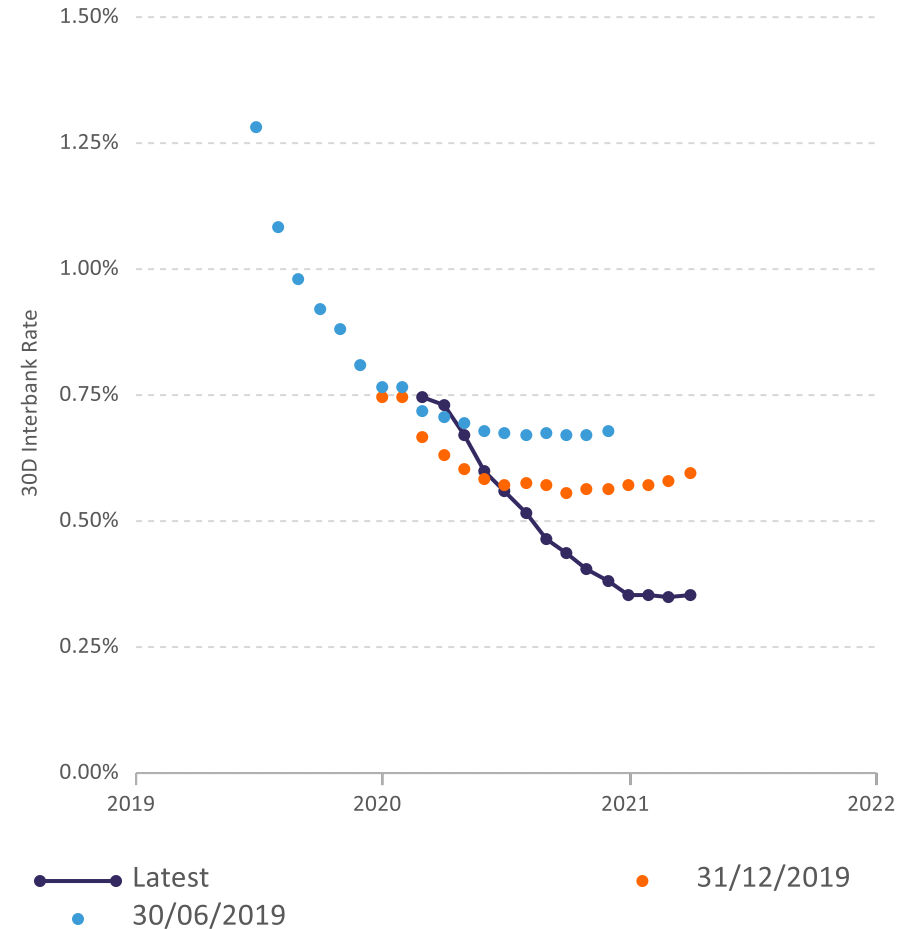
Market expectations on central bank easing

US Federal Funds Rate Futures



Source: Refinitiv Datastream

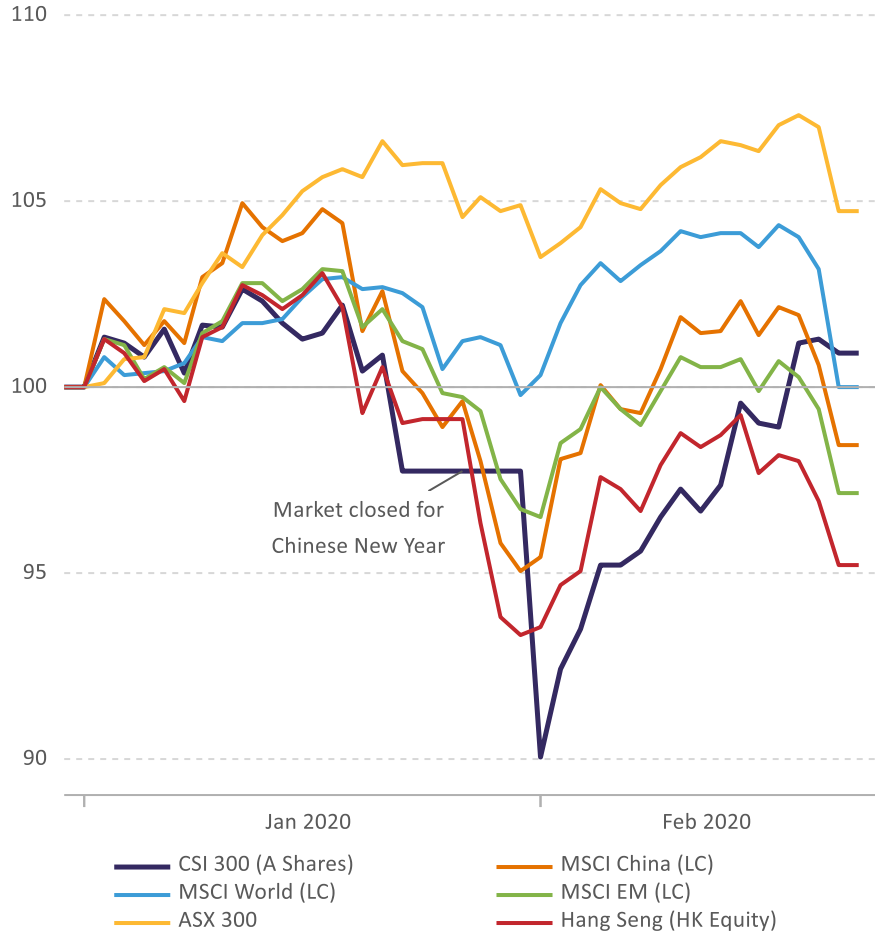
RBA Futures Curve at 25 Feb 2020



Source: Refinitiv Datastream

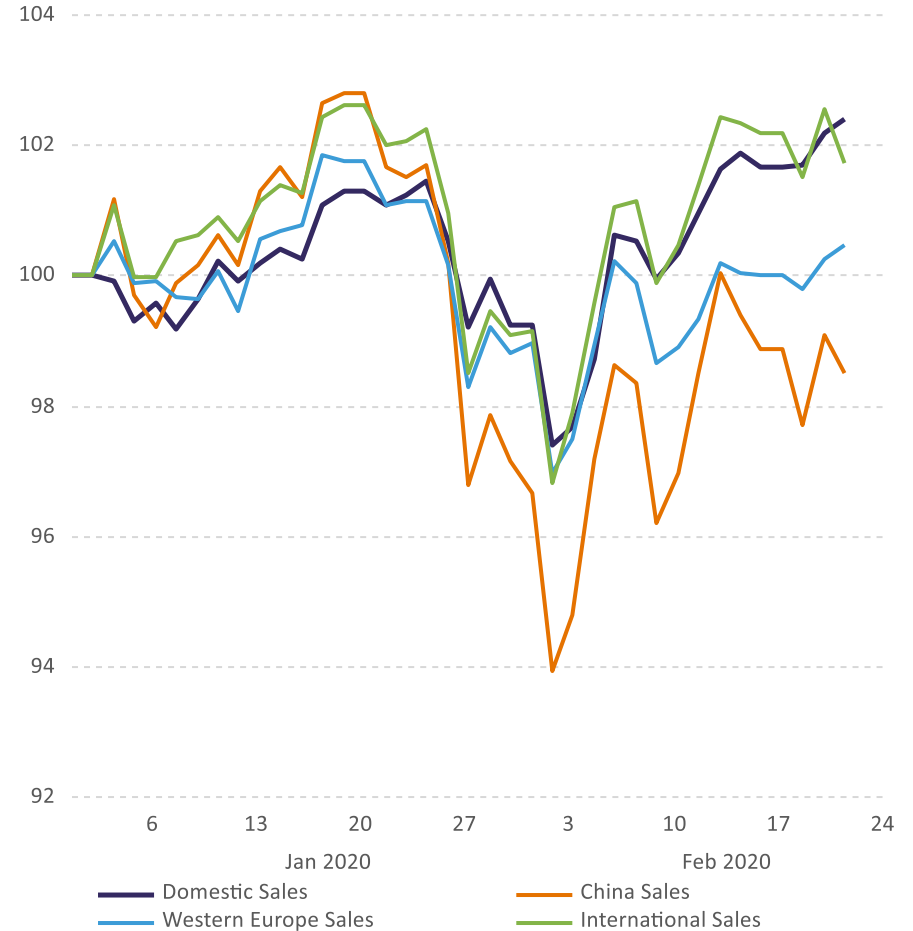
Equities performance were strong until this week, US stocks with sales exposure to China have been impacted more

Coronavirus Impact on Equities (31 Dec 19 to 24 Feb 20)



Source: Refinitiv Datastream

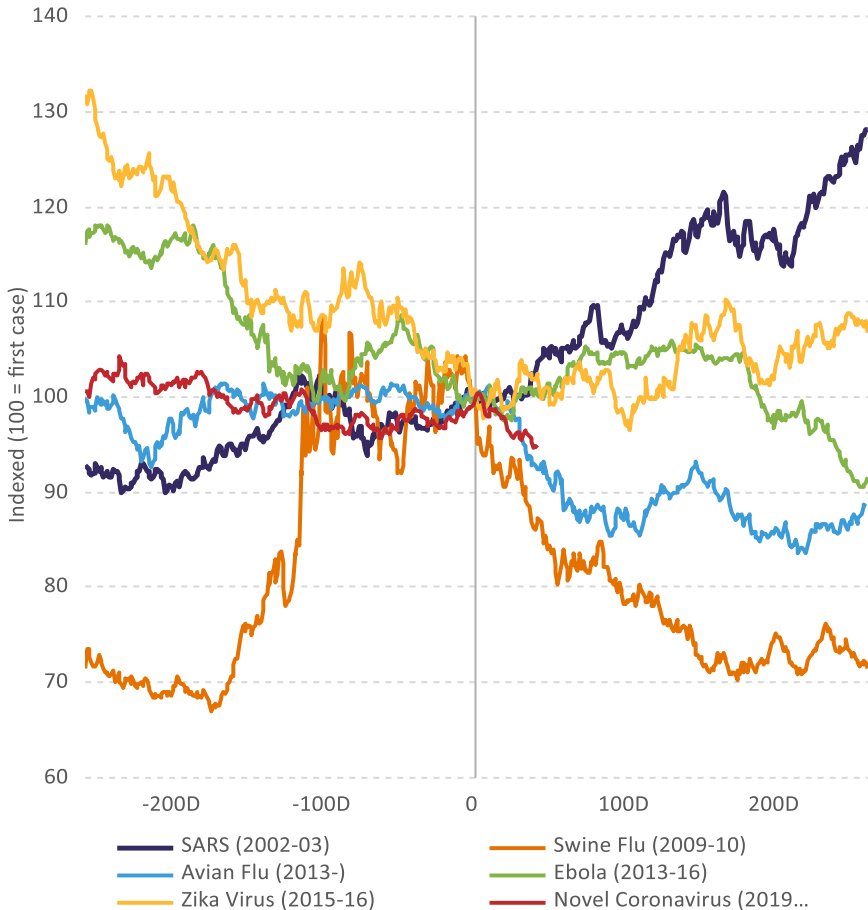
US Stocks by Sales Exposure



Source: Refinitiv Datastream

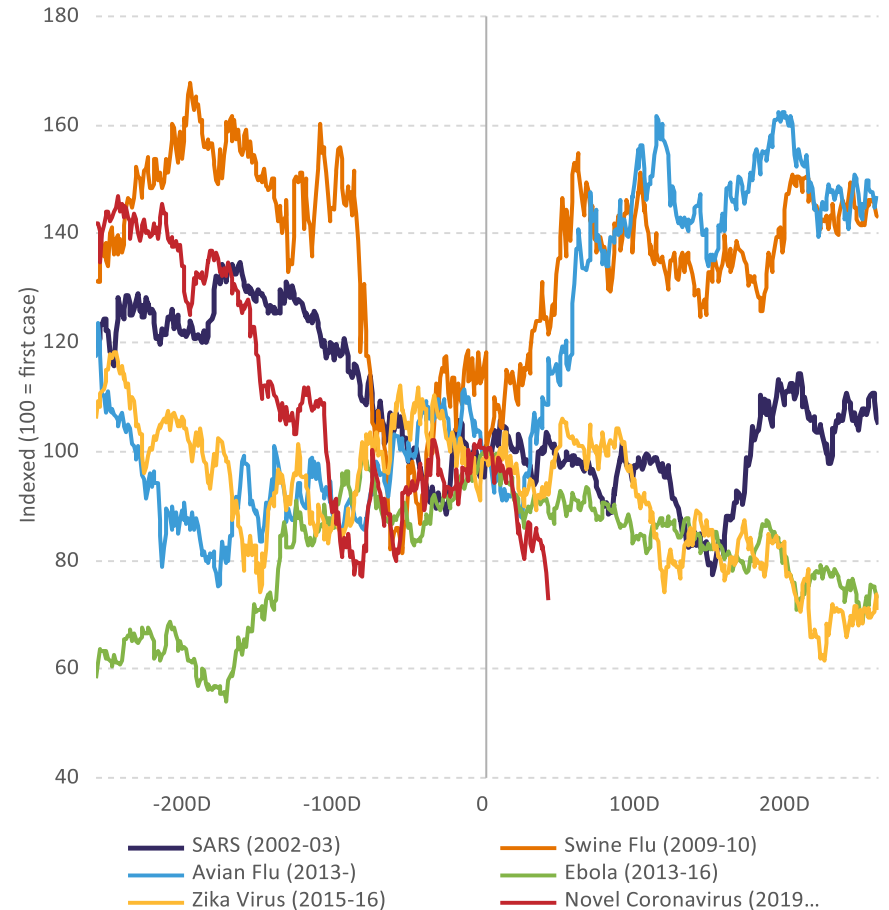
AUD/USD and US 10 year bond yields have fallen in reaction to COVID-19 concerns

Historical Impact of Pandemic on AUD/USD



Source: Refinitiv Datastream

Historical Impact of Pandemic on US10Y



Source: Refinitiv Datastream

Day 0 marks first case. Charts show financial market performance 12 months before and after first case was reported.

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