Wall Street falls as coronavirus spreads

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Wall Street fell sharply for the second day in a row yesterday, with the Dow dropping by around 1,900 points so far this week on the back of the spread of the coronavirus.

The index fell more than 1,000 points on Monday, only the third 1,000-point drop in its history, in response to news of significant outbreaks in Italy, Iran and South Korea and warnings from Japan that it was on the brink of a rapid expansion in coronavirus cases.

Yesterday's fall took place after a leading public health official said there was the potential for "severe" disruption in the US in the event of a large outbreak.

Nancy Messonnier, the director of the Centers for Disease Control and Prevention, said, "Ultimately, we expect we will see community spread in this country. It's not so much a question of if this will happen any more, but rather more a question of exactly when this will happen and how many people in this country will be infected."

Wall Street opened yesterday with a recovery of some of the losses it incurred on Monday, but then started to fall rapidly. The Dow finished down 879 points, or 3.1 percent; the S&P 500 dropped 3 percent; and the Nasdaq fell 2.8 percent.

After reaching record highs last week, the major indexes have lost all of their gains for the year, wiping out around $2.1 trillion from share values, with the stock market suffering its largest two-day fall since February 2018.

The market had been sustained by the belief that the effects of the coronavirus would rapidly pass through the economy and any adverse consequences would be countered by the injection of still more money into the financial system by the Fed and other major central banks.

But there is a growing realisation that the effect of the coronavirus may be far larger than originally thought. "The size of this economic shock is looking increasingly large on a global scale," James Athey, a senior investment manager at Aberdeen Standard Investments, told the *Wall Street Journal*.

One indication is the sharp sell-off of high-yield junk bonds, particularly those issued by energy companies. They have been hit by the fall in commodity prices and the 15 percent fall in oil since start of the year because of fears of a slowdown in the world economy.

A pithy comment by *Financial Times* journalist Katie Martin punctured the scenario of a central bank rescue operation. "The expectation alone of monetary assistance may already be softening the blow," she wrote. "But anyone who can clearly articulate how easier policy can fix an economic pullback based on deaths, grounded flights, closed factories and ghost cities is very welcome to get in touch."

The virus outbreaks in Italy and South Korea are particularly significant. At least 10 Italian towns, located in the northern region that accounts for around half of the country's economic output, have been quarantined. The country's financial capital, Milan, has shut down schools, offices and tourist attractions.

Before the outbreak, the Italian economy was already struggling, having recorded a 0.3 percent contraction in the last three months of 2019. It could slow further in the first three months of this year, pushing the economy into a technical recession, defined as two consecutive quarters of contraction, for the first time since 2008.

South Korea, one of the world's leading manufacturing centres, had already been significantly affected by the outbreak of the virus in China, and its spread within the country will deliver a further blow to the economy.

Global trade is one of the channels through which the economic effects are being spread. Data from the CPB World Trade Monitor, reported by Bloomberg, reveals that trade volumes contracted by 0.4 percent last year, largely as a result of the Trump administration's trade

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war measures. This was the first such decline since 2009 in the wake of the global financial crisis.

The contraction is already deepening. There are reports that container shipments from China have "collapsed," with almost half of planned sailings from Asia to Northern Europe cancelled in the past four weeks—a reduction of 300,000 container shipments per week.

The longer-term outlook for the world economy is indicated by the bond market. Yesterday the yield on 10-year US Treasury bonds fell to a record intraday low of 1.306 percent, as investors from the US and around the world sought a safe haven.

The US yield curve has again inverted, as the return on long-term debt falls below that in short-term markets. An inverted yield curve is widely regarded as an indicator of recession, because such an event has preceded every recession in the past 50 years.

Jim Paulsen, chief investment strategist for the Leuthold Group, told the *Financial Times* the situation was "scary" and hard to ignore. "A lot of investors have been worried for a while that the bond market knows something that stocks don't," he said. "Stocks have been foolishly rising, while bonds have been suggesting a more sinister outcome."

There are estimates that the Chinese economy will suffer at least a two percent fall in growth in the first quarter—some put the downturn even higher—as large sections of the economy either remain in lockdown or are unable to resume production at previous levels because of worker shortages and constrictions on transport within the country.

If the China contraction continues, Oxford Economics has estimated that the world economy will record a reduction in global output of around $1.1 trillion. But the impact could be even greater as the virus spreads.

The International Monetary Fund is struggling to provide an estimate of the effect on the global economy, saying only that it will downgrade its forecast for growth.

In an address at the weekend to the meeting of G20 finance ministers held in Riyadh, Saudi Arabia, IMF Managing Director Kristalina Georgieva said that under the current baseline scenario, China's economy would return to normal in the second quarter and "as a result the impact on the world economy would be relatively minor and short-lived."

It is the measure of the speed with which the economic effects of the spread of the coronavirus are making themselves felt that in a matter of just four days those remarks appear to be outdated.

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