

Development scenarios of the global financial market in conditions of COVID-19 pandemic

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ABSTRACT

In many countries, quarantine measures in connection with the COVID-19 pandemic have negatively affected production and economic growth. The influence of the virus on the Chinese stock markets, stock markets of other countries, economic activity and financial markets was investigated. It has been established that the spread of COVID-19 in the world has led to a decrease in demand for petroleum products and a decrease in gold's prices. Enterprises with a significant share of loans in the capital structure were identified as particularly vulnerable. Due to the coronavirus, many industries in different countries have lost their high credit ratings. The reports of consulting agencies and investment banks, such as McKinsey, Morgan Stanley and UBS, were analyzed. These organizations have developed optimistic and pessimistic scenarios for the development of the global financial market in modern conditions. The prospects for economic activity in the context of coronavirus remain unclear, but the level of risk impact on the global financial market remains quite high.

KEY WORDS: financial and economic crisis, global financial market, pandemic, scenario of the development, stock market.

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1. Introduction. Against the backdrop of the outbreak of a new disease, views on the future of the world economy have been revised. The restrictive measures introduced in different countries have negatively affected almost all sectors associated with consumer activity: tourism, trade, catering, entertainment and others. Bidders began to get rid of shares in airlines, oil companies, consumer electronics manufacturers and other companies, expecting a drop in revenue and income. The indices of the world's leading stock exchanges collapsed. The Italian FTSE MIB index alone lost **29.8%**.

In response to the continued exceptional impact of the coronavirus pandemic on economic activity and financial markets, the forecast for global GDP growth has dropped to **0.4%** in **2020**, and is expected to recover to **4.9%** in **2021**. According to the forecast of Oxford Economics, the coronavirus epidemic will take away at least **\$1.1** trillion. Against the background of an already stagnant economy, a recession may begin, and then a global crisis. The head of the IMF stressed that the world found itself "in an unprecedented situation when the pandemic turned into a financial and economic crisis" [1]. At the same time, economist Jesse Colombo believes that the new crisis may be much more serious than the previous one. It is important to understand that any crisis is not only losses, but also opportunities. If the possibilities of the economic crisis caused by the coronavirus pandemic are only taking on vague outlines, then the losses are already measurable.

2. Proposed Techniques. In the last week of February **2020**, financial markets around the world lost at least **\$5** trillion due to the coronavirus panic. Several periods can be distinguished in the process of the pandemic's impact on global financial markets. The first period was until mid-February, when the threat was localized mainly in China with a corresponding impact on the region's economy. At this time, only Chinese markets responded to the epidemic.

In February **2020**, trading on the Chinese markets ended with a landslide drop in quotations. The Shanghai Composite Index declined **8.13%**; correction of SZSE Component in Shenzhen was even more significant - **8.40%**. The Shenzhen Component Index (Shenzhen Stock Exchange) lost **9%** [2]. According to Bloomberg, the Chinese market crash was a record since **2015** [3]. At this time, western indices, although they reacted to news from China, did not succumb to panic. At the end of January, when the scale of the Chinese quarantine became apparent according to WHO reports and reports from the scene, global markets went through the first wave of correction - the S&P **500** index lost **3-4%** in a week (fig. 1).



Figure 1. S&P 500 index dynamics

However, the Chinese stock market began to recover, while in other countries it continued to fall. However, for the time being, all the market drawdowns were recouped by investors, the quotes returned to local highs, and when there were signs of a slowdown in the spread of the virus in China, the markets switched to rapid growth again: the S&P 500 reached historic highs by February 19 [2]. February and March 2020 are the worst months for global stock markets since 2008. Stock indices lost tens of percent, and experts started talking about the end of the 11-year growth cycle since the last financial crisis. At the same time, uncertainty remains regarding the further development of the situation with COVID-19. It is one of the main driving forces in the increasingly volatile stock markets. The movement of quotations actually depends on the development of the situation with the pandemic. After the WHO announced the coronavirus pandemic, investors wondered if the world economy was waiting for a new global recession. A wide variety of sectors have faced significant challenges due to constraints in logistics and trade. The spread of COVID-19 around the world has led to a decrease in demand for petroleum products: gasoline, aviation kerosene and others. Therefore, financial analysts expected that the ministers of the OPEC+ group countries would agree on additional measures to reduce oil production by 1.5 million barrels per day.

However, the key participants in the meeting, Saudi Arabia and the Russian Federation, were unable not only to sign a new agreement, but also to extend the old one. The rejection of the deal caused a collapse of oil prices by more than 20%. After the unsuccessful OPEC+ meeting, the main oil exporters unleashed a price war for the main markets. Bloomberg sources said that Saudi Arabia offered its Arab Light crude oil to European and Asian consumers at a large discount to the market – at \$25 per barrel with Brent stock quotes above \$32 (fig. 2). Iraq and Kuwait have taken the same step [4].

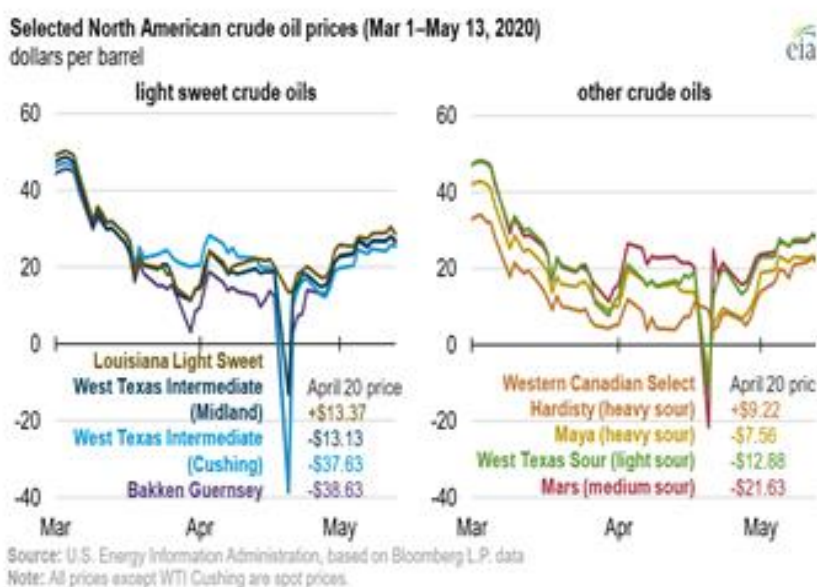


Figure 2. Dynamics of oil's prices

The gas industry expects a decline in demand for "blue fuel" in 2020. The Forum of Gas Exporting Countries has updated its forecast for market dynamics this year to minus 2.8% in the best scenario and minus 6% in the worst-case scenario. It is expected that the recession will be overcome in 2021, and only in 2022 global consumption may return to the level 2019. Due to the global coronavirus pandemic, most marketplaces and buyers have moved their operations online, minimizing their visits to offices, banks and shopping centers. For the majority of quarantined consumers, communication during purchases has been reduced to contactless receipt of goods ordered in online stores and paid for online with bank's cards. A massive stock dump, comparable to the financial market crash in 2008, has sparked a feverish race for assets deemed reliable in times of crisis, including government bonds and gold. The yields on US Treasury bonds, considered the safest of all, fell to record lows. There has been massive panic and potentially massive global economic damage. Asset value remain vulnerable to significant declines if the pandemic moves in unpredictable directions, the economic impact becomes more adverse, or the financial system re-emerges.

No less vulnerable due to the coronavirus, according to the FED's forecast, will be indebted enterprises and businesses. The regulator notes that until the beginning of 2020, their debts were quite large in relation to GDP. The general decline in revenues, associated with a significant economic failure, weakened the ability of companies to meet these and other obligations. At the same time, in a situation with a pandemic, financial markets turned out to be more stable than during the crisis of 2008–2009. Despite this, serious tensions arose in the economy, which required additional measures. The credit ratings of industries such as energy, retail, entertainment, tourism and banking were hit hardest by the pandemic. By the end of the summer, S&P Global and Fitch Ratings had initiated almost as many credit rating downgrades as the 2007–2008 financial crisis. Canada became the first country to lose

its 'triple A' credit rating. Regardless of whether economies manage to avoid a recession, the scenario for a return to growth amid Covid-19 will depend on a number of factors. What matters is the extent to which demand will be postponed or lost, whether the shock is short-lived or lasting, and whether the structure of the economy is damaged. It is advisable to consider three "V-U-L" scenarios [5].

V-shaped. This scenario describes a "classic" economic shock – a decline in production – and assumes that growth will eventually rebound. In this case, the annual growth rates can fully cushion the shock. While this scenario may seem overly optimistic in the current dire situation, we believe it is the most likely.

U-shaped. This is a derivative of the previous scenario. It implies prolonged shock. Although the economy will return to growth, there will be a certain irreversible decline in production. To recognize this scenario as the main one, more evidence is needed that the virus is causing real damage.

L-shaped. To recognize that it can materialize, one must believe in the ability of Covid-19 to cause significant damage to the structure of the economy, that is, to break something on the supply side – the labor market, the possibility of capital accumulation or productivity. It is difficult to imagine, even if we look pessimistically at things, because at some point we will find ourselves on the other side of this epidemic. Several consulting agencies and investment banks have outlined various scenarios of how the coronavirus situation will develop and how it will affect the markets, as did McKinsey, Morgan Stanley and UBS.

2.1 Optimistic scenarios for the development of global financial market. McKinsey [6] says the coronavirus outbreak will put the greatest strain on healthcare systems in the United States, Europe and other countries, but will soon slow down. The authorities will have to take increasingly aggressive steps, which will slow down the gradual economic growth

Certain industries, such as air travel and hospitality, will be hit hard. The global economy has the ability to avoid recession and recover.

However, global economic growth will be halved to 1–1.5%. The US economy will grow by less than 1% annually, and China's GDP will grow by less than 4%. Morgan Stanley's interim scenario [7] envisages that the peak incidence will lead to a slowdown in US economic growth, and a gradual recovery is possible only in the second half of the year. The growth of the world economy in the first half of 2020 will be 2.3%, but it will accelerate in the second half of the year. Despite the economic fallout, the outlook for the stock market is not all bad. According to investment director Mike Wilson, the market will freeze "in limbo between bulls and bears," but remain ready to rally. Morgan Stanley rated this scenario as "the most plausible."

UBS [8], if the number of infected grows significantly, predicts that it will be possible to bring the situation under control in the middle of the year, however, the United States, Europe and Japan will fall into recession, after which their economies will return to rapid growth in the fourth quarter. If the spread of the coronavirus can be stabilized in the near future, then, together with monetary and financial incentives, this could lead world quotes to highs in a year. The global economy will accelerate its recovery until China suffers from a relapse of the coronavirus. Markets could fall 25% from their highs before regaining the decline – by the end of the year they will fall 3%. In early August, Apple

reported its record-breaking revenue, which grew 11% year over year despite store closures worldwide due to the COVID-19 pandemic. It does not look like a “technology bubble” collapsing at all.

If we turn to Europe, here, too, the nearest economic prospects do not look worsening, but quite the opposite. Research organization Market Economics has published an index of business activity in the industry and services 19 countries in the Eurozone. The result is almost sensational: if in June the index showed 48.5 points, then in July it amounted to 54.9 points. It is worth recalling that the index is formed based on regular surveys of those who make decisions in the field of business. The essence of the survey is an assessment of the immediate economic prospects primarily based on the dynamics of orders. A value of the index below 50 points is a negative forecast; above 50 is an optimistic one. It should be emphasized once again that the authors of the forecast are entrepreneurs themselves. Thus, in the short term, Europe will see a turning point towards the growth of economic activity.

2.2 Pessimistic scenarios for the development of global financial market. McKinsey [6] says the coronavirus is proving immune to hot weather and the pandemic is dragging on, leading to a global recession. The spread of COVID-19 continues in the third quarter. In this case, the world economy will face a serious shock, which could last for almost a year. Health systems can be overwhelmed. Ultimately, this will lead to a global recession, and the economic growth rate in 2020 will be minimal – from 0.5% to 1%. Morgan Stanley [7] claims that the virus continues to spread and affects all major world economies, resulting in company losses and increased credit risk. US GDP growth in the first half of 2020 will be close to 0%. The S&P 500 may end the year at 2750, but may fall lower during periods of maximum panic. According to UBS [8], a protracted pandemic, expectations for a vaccine in 2021 and effective treatments will stave off widespread panic. In this scenario, UBS predicts that the Dow Jones (fig. 3), S&P 500 and NASDAQ will decline by about a third from their peaks.

The International Monetary Fund predicts a 3% contraction in the entire global economy in 2020 and more dire consequences than during the 2007-2009 global financial crisis [1].

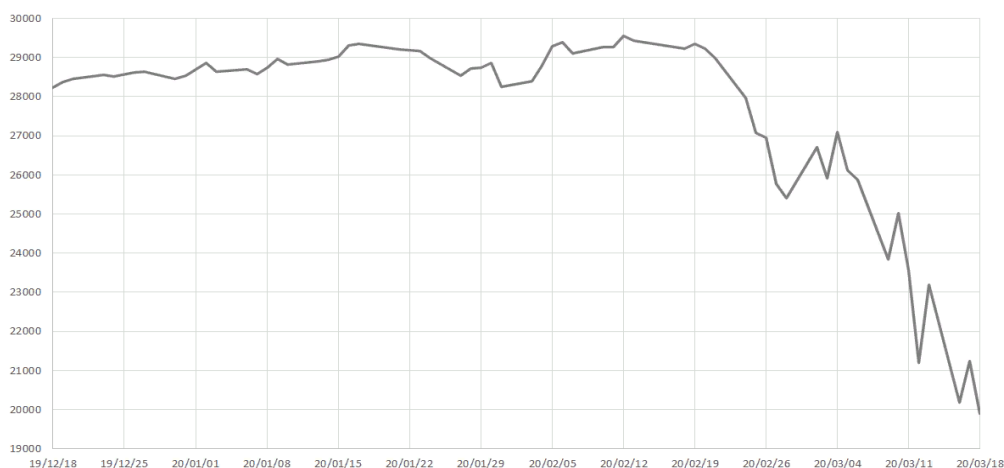


Figure 3. Dow Jones index dynamics

Developed economies are expected to suffer even greater losses at 6.1%, systematically disrupting global cash flows, halting financial market activity and disrupting all monetary transmission mechanisms in the arsenal of regulators, central banks and large commercial financial institutions.

3. Experimental Results. The optimistic forecasts regarding the coronavirus have not materialized, so need to adhere to the moderately pessimistic ones, according to which the world economy will soon begin to come out of a coma. Borders will open, production will start to recover, oil's prices will start to rise slowly but surely. In this situation, the global stock market can win back the main losses by the end of 2020, and investors can make good money on this. In such a situation, everything will fully recover, except for the oil price (which is unlikely to rise to previous levels in the coming years).

In the current crisis, investors need to look closely at dividend stories. The failure of the OPEC+ deal provoked a drop in oil prices, combined with quarantines in many countries, everything fell in price: stocks, bonds, gold. And even in such difficult times, there is something to pay attention to. Namely, dividend stories. Many companies choose to share their income with shareholders by paying dividends. Unlike bonds, dividends can rise year-on-year, and stocks have unlimited potential. It is obvious that the fight against the spread of the coronavirus will drag on for a long time, during which time the economies of different countries and the global economy will suffer very serious damage. Now financial markets are on the verge of a global economic and financial crisis.

In such a situation, investors sell everything that is possible, even gold, due to which the price of the metal has decreased in the world market. There are no protective assets left for investors, and it is very difficult to predict anything. It is obvious that the situation will worsen and more stock markets will crash soon. It can be concluded that this is a new Great Depression – of the model of 2020. The countries have taken certain measures to reduce the panic in the global financial markets.

The Federal Reserve System (USA) cut its key interest rate from 1.5-1.75% to 1-1.25% to support the country's financial market and economy. The FED also promised to provide the financial market with \$500 billion in repo transactions. Later, the FED again reduced the rate from 1-1.25% to 0-0.25% and lowered the banks' reserve ratio to zero. A new quantitative easing program was launched, which has no limits on the volume of transactions [9].

The Bank of Russia began selling currency on the stock exchange as part of the budget rule. The purpose of this operation is to reduce volatility in the Russian market.

The Bank of England unplanned cut the base rate from 0.75% to 0.25% and continued to buy government bonds from the market.

The European Central Bank has increased the volume of asset repurchase transactions by €120 billion by the end of the year.

French exchange regulator AMF has banned short sales of 92 shares.

Financial regulators in South Korea, Spain and Italy have banned short selling. This operation allows speculators to make money in the falling market and at the same time increased the pressure on the asset's price during the sell-off period.

4.Discussion and Conclusion. The development of the pandemic has largely controlled the movement of financial markets. The Federal Reserve System admits another crash in global financial markets due to the coronavirus. Prices in global financial markets may collapse again if the situation with the coronavirus develops according to an unpredictable scenario. Now it is impossible to make serious forecasts about the development of the market. There are too many open questions regarding the spread of the coronavirus, the duration of the epidemic and its impact on the economy and financial markets. All this uncertainty is a real poison for financial markets. Global financial markets cannot fail to see the threats of the second wave of coronavirus, but so far, they are rather optimistic. This is a credit of confidence to politicians, who must organize a reliable defense against the epidemic. The FED also predicts vulnerability for companies with loans, which are finding it increasingly difficult to meet obligations due to the general decline in income. The FED points out the risks to real estate in an unpredictable pandemic. Due to the pandemic, real estate, commercial sector and agricultural premises may be under pressure, although prices in this area, as a rule, do not immediately respond to changes in the economic situation.

The outlook for economic activity given the coronavirus remains unclear. In the near future, the risks associated with the direction in which the pandemic is developing and their impact on the global financial market remain high.

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