PIDE
COVID-19 BLOG
No. 14

COVID-19 AND WORLD'S FINANCIAL MARKETS

Impact of the COVID-19 pandemic on global economy has been widely discussed in recent weeks. As the number of cases increase across the world, people are worried about its impact on almost all sectors of the economy, ranging from aviation, retail industry, tourism, hospitality to the manufacturing sector. Globally, the Coronavirus shock is being considered to be even more severe than the Great Financial Crisis of 2007–08. While it is difficult to estimate when the outbreak will end, most epidemiologists expect the situation to be under control by the end of August 2020, which is still months away.

Stock markets all over have responded to the COVID-19 pandemic with worrying volatility, as traders have panic-sold out of fear. As a result, world-wide circuit-breakers have been triggered many times to prevent panic-trading. Even S&P 500 triggered level-1 market wide circuit breakers on March 9, 12 and 16 and 18th based on the rule, 'drop of 7% from the previous close before 3:25 pm and market pauses for 15 minutes'. Trading also, traditionally, halts on both the Dow and the Nasdaq when a circuit-breaker is triggered on the S&P 500.

The S&P 500 has faced 12% loss and Down almost 30% from its all-time high on March 16th 2020. The same day Dow Jones Industrial Average lost almost 13%, the Russell 2000 lost more than 14%, the MSCI Emerging Market Index declined 6.3%, the MSCI Asia Pacific Index decreased 3.7% and Brent crude dipped below $30 a barrel for the first time since 2016. The European markets including FTSE (UK), DAX (Germany), CAC (France) and Italian stock markets also tumbled, and all stock markets are in a freefall.

Stock returns of the 10 vulnerable COVID-19 Countries

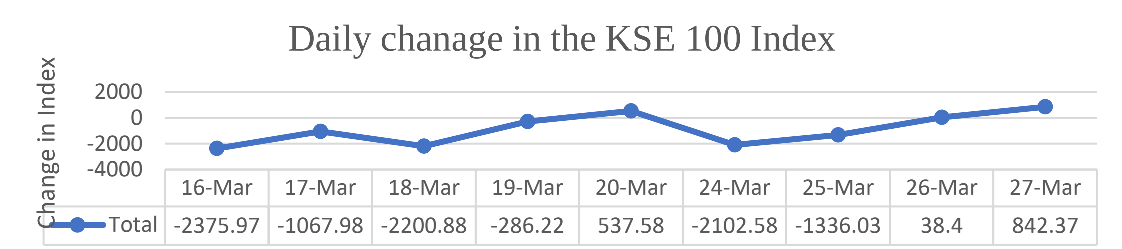
Stock markets	Jan 1, 2020 to Jan 31,2020*	Jan 31, 2020 to Mar 27,2020**	16-Mar-2020***
United States (S&P)	-0.52%	-0.14%	-12.77%
Italy (MIB)	-0.81%	-0.12%	-6.30%
China (SSE)	-0.18%	-0.15%	-3.46%
Spain (IBEX)	-0.73%	-0.09%	-8.21%
Germany (DAX)	-0.75%	-0.15%	-5.45%
France (CAC)	-0.72%	-0.13%	-5.92%
UK (FTSE)	-0.70%	-0.16%	-4.09%
Switzerland (SMI)	-0.42%	-0.03%	-1.69%
South Korea (Kospi)	-0.52%	-0.14%	-3.25%

**Average returns of the markets from first public alert issued by china from Jan 01, 2020 for corona till World Health Organization (WHO) traced and named it COVID-19 on Jan 31, 2020.*
*** Average returns of the markets from COVID-19 announced by WHO on Jan 31, 2020 till Mar 27, 2020.*
*** Average returns on Mar 16, 2020, the day most of the global financial markets crash*
Data is collected from www.investing.com | Table constructed by author , The Iranian market data is not available.

The Covid-19 pandemic has brought volatility in the global markets and has created uncertainty among investors. These shocks to the stock markets are putting doubts on the economic outlook and inducing fear among the investors. The spread of this pandemic, and the resulting lockdowns, would lead to a global slowdown, and depress demand and disrupt supply chains.

The current situation has created an uncertain environment which is quite damaging for the future perception of investments in Pakistan where the economy is already under strain. Stock market has already started reflecting downward trend as panicked investors are pulling out of the stocks.

Pakistan Stock Exchange on 16th March traded in a bearish trend, and the Index dropped by 2375.97 point in a single day. The benchmark KSE-100 Index recorded its biggest fall in a single day since 2009 and closed at 28,109.57 points on 27th March, 2020. The market has faced a six-year low intra-day value by reaching the 27,169.14 level and reduced its value by 28 percent this year. The market halted 8 times only in the month of March and faced a drop of 11,000 points only in this month. All the other Indices including KMI 30 and KSE also faced similar losses. However, as the impact continues to grow in terms of scope and magnitude, attention is now turning to the long-term consequences for the stock market.



Daily KSE 100 Index from Mar 16, 2020 to March 27, 2020
Source: www.investing.com| Graph constructed by author

The US market after the announcement of the $ 2 trillion by White House has climbed significantly including S&P, Dow Jones and Nasdaq. Same happened with the Asian markets including Nikkei, Kospi, Hang Seng and Shanghai. European markets also took steps like the US but due to more new Coronavirus cases and related death these markets could not gain momentum. However, the net gains reported by London FTSE, DAX, CAC-40 were positive.

Things are different in Pakistani stock market. 171 companies gained and 141 companies lost their value on March 27, 2020. KSE-100 shares index gained 3.09 percent, or 842.37 points, to close at 28,109.57 points after the SBP announcement. The market is unable to restrain the divestment of investors even after two stimulus decisions taken by SBP and the federal government. First was further reducing the policy rate by 150 bps to 11%, and second the $7.5 billion economic bailout package equivalent to 2.6% of country's GDP. Other related steps include eliminating the Capital Value Tax (CVT), and introducing restrictions on short selling.

Due to the less than desired reduction in the policy rate and global economic conditions the net investment looks certain to fall in future. As suggested by the former PSX director, Mr. Amin Yousuf, the government should inject ETF at the earliest and the SBP should bring down the interest rate to single digit for the revival of the economy and the capital market of the country.

The higher interest rate is not a solution to attract foreign exchange for stability of the currency at the expense of local businesses in Pakistan. My personal opinion is (not necessarily that of my Institute) that the government must reduce the policy rate for the sake of lowering operating cost of the companies, because most of the companies use loan for their working capital. As the cost of working finance goes down it will reduce their financing cost. That will help to increase their future cash flows and increase the present value of future expected cash flows. Secondly, by lowering the interest rates to single digit the government will be able to reduce debt servicing cost.

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