Key Questions

Has the Coronavirus Reached American Shores?

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"If we had no winter, the spring would not be so pleasant."
-- Anne Bradstreet

It's clear that the coronavirus (COVID-19) outbreak that began late last year has already caused global economic growth to suffer. However, most of the concerns revolve around China, where the outbreak started, and its closest trading partners like Southeast Asia, Central Africa, and Australia. Economic data in the US has remained largely positive -– until now.

Despite concerns over the health of manufacturing due to supply chain disruptions, the US Manufacturing Purchasing Managers' Index™ (PMI™), a key private sector economic indicator, held up well at 50.8 in February versus 51.9 in January. A value above 50 signifies expanding economic activity; a value below 50 is a sign of contracting economic activity.

The bigger concern is over the sudden and unexpected plunge in the US Services PMI™ to 49.4 in February versus expectations of 52.5 and a reading of 53.4 in the prior month. This is the first time the services sector has slipped into contraction territory since 2013, which caught traders' eyes since this sector accounts for nearly 80% of the US economy.

While the sharp drop in the Services PMI is of concern, we are wary of placing too much emphasis on a single data point. In our estimation, the decline in the index largely reflects concerns over the eventual impact of the virus on business activity and consumer spending. Indeed, while the headline figure fell into contracting territory, the Future Output Index rose to 58.9, suggesting that purchasing managers are optimistic about the future and possibly view the impact from COVID-19 as temporary.

The US economy grew by a modest-but-solid 2.1% during Q4 2019. While the impact of the virus is likely to slow Q1 2020 GDP growth (perhaps to as low as 1.5%), most economists are anticipating a "V" bounce once the dust settles. As we have highlighted in previous articles, the longer it takes Chinese industries to ramp up production, the greater the knock-on effect to the world economy.

However, the slowdown in growth has also led many countries to boost monetary and fiscal stimulus, the lagged impact of which we will likely see in the coming months. In the case of the US, strong housing data coupled with resilient consumer spending has helped us avoid a major slowdown, and we believe falling corporate borrowing rates should also help boost business investment.

Overall, we are optimistic that the full impact of the coronavirus will be transitory and doubt that the global economy will experience a prolonged period of sustained weakness. With that said, we think there is a bit of near-term complacency regarding the full impact of the coronavirus and are concerned that its effect might persist longer than many believe. In a recent investor poll, for instance, 77% of respondents believed that concerns regarding COVID-19 would fade by April.

We don't profess to have an edge for knowing the outlook with certainty, but such optimism seems a bit too much for us. Consequently, we are positioned more cautiously versus many of our peers by recommending a neutral stance in the stock-versus-bond decision and maintaining an above-average allocation to high-quality assets within US equities and bonds.

For more information, please contact your Key Private Bank Advisor.