

Coronavirus: The end of the bull market?

Last week, financial and foreign exchange markets displayed abnormal levels of volatility. The increase in systemic risk caused by the expansion of the coronavirus (COVID-19) and the quickening of its contagion rate was the main reason for this behavior. This behavior reflects concerns regarding the uncertain costs of the epidemic, and the possibility of a sharp decline in economic growth or even a recession.

The correction in the prices of equities could mean an end to the upward ("bull") cycle observed in the United States stock markets for the last ten years. The VIX index, associated with the volatility of the S&P 500 index, reflected these fears, by skyrocketing to a level of 46 points, comparable to other crises such as:

- i. In December 2018, faced with concerns of a full-scale trade war between China and the United States, the VIX index reached 36 points.
- ii. In August 2011, due to the reduction in the rating of the United States sovereign debt by Standard & Poor's, the index reached 48 points.
- iii. In October 2008, during the global financial crisis caused by the bankruptcy of Lehman Brothers, the VIX index reached 80 points.

The increase in systemic risk also affected financial markets in Mexico. And the release of weak economic data was an additional factor which affected the outlook for the economy.

- i. In December 2019, gross fixed investment dropped -3.48% YoY.
- ii. In February 2020, consumer confidence declined -9.7% vs. February 2019.
- iii. The confidence of the businessmen within different sectors fell for eight months in a row.

Based on the March 6th closure, the balance of the financial markets so far in 2020 became negative:

- i. Mexbol (41,272 points) displays a year to date decrease of -11.02%.
- ii. The spot exchange rate, at MX\$20.12 per dollar, fell to its lowest level since September 2019 and accumulates a year to date depreciation of 6.31%.

Due to the financial uncertainty, investors favored assets considered as safe havens, with the following results:

- i. The spot price of gold reached US\$1,670 per ounce, which allowed it to continue with the bullish rally that began in November last year. The year to date return reached +10.1%.
- ii. The 10-year Treasury Bond yield to maturity (ytm) was 0.77%, the lowest figure since the introduction of auctions of these instruments in 1963. So far this year, the ytm has dropped 110 basis points.
- iii. Due to the integration of ytm of the M bonds with the US Treasuries, the 10-year M Bond ytm accumulates a 52-bps year over year drop to settle around 6.38%.

Stimulus actions taken against COVID-19

As of March 5th, there are confirmed cases of COVID-19 in 86 countries. The central banks and financial authorities of some countries made monetary and fiscal policy decisions to offset the economic costs that COVID-19 containment measures could cause. There are four types of policies, namely:

- i. Reductions in reference interest rates. In an unexpected decision, the Federal Reserve of the United States (FED) reduced its primary reference rate by 50 basis points (bps), the range now lies within 1.0% and 1.25%. The Central Bank of Canada followed the FED, so its rate stood at 1.25%. We expect Banxico to make a similar announcement in the following weeks.
- ii. Long-term operations in the repo markets. The idea is to inject cash into the financial systems to encourage credit. The People's Bank of China injected approximately US\$173 billion. Other central banks, such as India's, have also taken these measures, although for smaller amounts (US\$13.6 billion).

- iii. Anti-epidemic bonds. In China, state banks bought approximately US\$34 billion of the so-called "coronavirus bonds" - instruments that pay a meager interest rate. The objective is that companies remain afloat for as long as the health crisis lasts.

- iv. Relief packages. These are direct capital injections intended to cover unexpected expenses, the following stand out:

- a. The International Monetary Fund announced a US\$50 billion package aimed at emerging and low-income countries to combat the outbreak.
- b. In Mexico, there is an initiative to create a US\$ 1.33 billion fund to counteract the damage of COVID-19 in the country.
- c. The US Congress approved US\$8.3 billion to strengthen the needs of the health sector.
- d. South Korea will designate approximately US \$ 13 billion to enhance health services that have been exceeded by the outbreak.
- e. Italy is designing a €7.5 billion package to suspend debt payments from companies altered by recent outbreaks of the virus.

Economic Indicators

Production, Sales and Exports of Light Vehicles

The Mexican Association of the Automotive Industry (AMIA) released sales figures for light vehicles in February. 104,328 units were sold within the domestic market, practically unchanged regarding the same month of the previous year. In total, AMIA produced 326,183 vehicles, 4.45% more than last year. Lastly, 266,035 automobiles were exported, a -1.86% year over year drop.

Gross Fixed Investment

The gross fixed investment indicator closed at 98.8 points in December 2019, an annual contraction of -3.48%. investment is at worse levels since 2013. The most significant drop was in the construction sector, which dropped -5.0% although the purchase of machinery declined -2.0%.

International US Trade

Just as in 2019, Mexico started 2020 as the leading trading partner of the United States. The combined trade's volume between the two countries was US\$51.14 billion, 3.12% higher than that observed in January 2019. Mexico had a surplus of US\$9.27 billion, US\$3.45 billion higher than that in January 2019.

United States International Trade (As of January 2020)									
Country	Exports	Imports	Total Trade	Balance	Country	Exports	Imports	Total Trade	Balance
Mexico	20,957	30,184	51,141	-9,227	India	3,281	4,997	8,278	-1,716
% of Total	3.6%	3.8%	3.7%		% of Total	0.6%	0.6%	0.6%	
Canada	24,604	25,302	49,906	-698	Taiwan	2,845	4,619	7,464	-1,774
% of Total	4.3%	3.2%	3.6%		% of Total	0.5%	0.6%	0.5%	
China	7,740	31,410	39,150	-23,670	Italy	1,826	4,454	6,280	-2,628
% of Total	1.3%	3.9%	2.8%		% of Total	0.3%	0.6%	0.5%	
Japan	5,671	10,932	16,603	-5,261	Brazil	3,788	2,057	5,845	1,731
% of Total	1.0%	1.4%	1.2%		% of Total	0.7%	0.3%	0.4%	
Germany	5,086	10,675	15,761	-5,589	Singapore	2,523	2,652	5,175	-129
% of Total	0.9%	1.3%	1.1%		% of Total	0.4%	0.3%	0.4%	
Korea, South	5,691	6,268	11,959	-577	Hong Kong	2,216	381	2,597	1,835
% of Total	1.0%	0.8%	0.9%		% of Total	0.4%	0.0%	0.2%	
United Kingdom	6,359	4,781	11,140	1,578	Saudi Arabia	1,010	1,012	2,022	-2
% of Total	1.1%	0.6%	0.8%		% of Total	0.2%	0.1%	0.1%	
France	3,329	4,023	7,352	-694	All other countries	481,877	654,579	1,136,456	-172,702
% of Total	0.6%	0.5%	0.5%		% of Total	83.3%	82.0%	82.5%	
					TOTAL 2019 YTD	578,803	798,326	1,377,129	-219,523
					TOTAL 2018	1,664,064	2,542,735	4,206,799	-878,671
					TOTAL 2017	1,546,654	2,342,905	3,889,559	-796,251

Source: U.S. Census Bureau
Amounts in millions of dollars

Remittances

US\$2.58 billion of remittances arrived in Mexico in January, 5.18% more than in January 2019. The significant generation of jobs in the US nonfarm payroll and the low unemployment rate motivated this positive performance. However, the economic costs caused by COVID-19 containment measures could negatively alter its future performance.

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Definitions

Banco de México (Banxico): Is the central bank of Mexico. Its main function is to provide domestic currency to the Mexican economy and its main priority is to ensure the stability of the domestic currency's purchasing power.

Basis points (bps): Refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001.

Chicago Board Options Exchange Market Volatility Index (CBOE VIX): Is a real-time market index that represents the market's expectation of 30-day forward-looking volatility. Derived from the price inputs of the S&P 500 index options, it provides a measure of market risk and investors' sentiments.

COVID-19: The disease caused by the coronavirus, a family of viruses that were discovered in the 60s but whose origin is still unknown. Its different types cause different diseases, from a cold to a severe respiratory syndrome.

Gross Fixed Investment (IFB): Describes the net capital accumulation during an accounting period for a country. The term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity.

International Monetary Fund (IMF): An international organization headquartered in Washington DC, consisting of 189 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world.

M-Bond: Mexico Federal Government fixed-rate development bonds that are issued and placed at terms of over one year, pay interest every six months and their interest rate is determined at issue date and remains fixed all along the life of the bond.

Mexbol: The S&P/BMV IPyC seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. It is not possible to invest in an index.

Mexican Association of the Automotive Industry (AMIA): Is a civil association formed by the will of the vehicle manufacturing companies established in Mexico, with the purpose of having an exclusive representation for this industrial sector. As a group it strives to reconcile the interests of these companies in a collegial way in practically all fields, with respect to other similar institutions.

Spot Exchange Rate: Is the current price level in the market to directly exchange one currency for another, for delivery on the earliest possible value date.

The Federal Reserve System (FED): Is the central bank of the United States and arguably the most powerful financial institution in the world.

The Standard & Poor's 500 Index (S&P 500): Is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value. It is a market value or market-capitalization-weighted index and one of the most common benchmarks for the broader U.S. equity markets.

Treasury Bond (T-Bond): Is a marketable, fixed-interest U.S. government debt securities with a maturity of more than 10 years. Treasury bonds make interest payments semiannually, and the income received is only taxed at the federal level.

Year over Year (YoY): Indicates the change from the comparable amount reported in the same period one year earlier.

Yield to maturity (YTM): Is the total return anticipated on a bond if the bond is held until it matures. Yield to maturity is considered a long-term bond yield but it is expressed as an annual rate.

Disclosures

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