Coronavirus: the dash for the door

Governments and central banks are grasping for solutions amid panic-selling of assets

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The man in charge of the Bank of England during the credit crisis sees a comparison with the one gripping financial markets today. Using gambling odds, Lord (Mervyn) King explains that no one would have taken a 20-1 bet three months before each crisis unfolded that the banking system would go to the brink, or that all sporting fixtures would be cancelled.

“This is an example of what we call radical uncertainty,” said King, who has co-written a book of that name. “They’re events you can’t easily imagine beforehand at all. We would have thought three months ago that it was likely a virus would appear . . . but we couldn’t possibly have put any probabilities on when it would happen, where it would happen, the nature of the virus.”

Both crises are global, which “is what made both so difficult to deal with and so costly”. There are differences, too.

“Dealing with the financial crisis was a lot easier in one sense,” King said. “We had to deal with the failure of a limited number of institutions. Now the problem is you have to deal with everybody. And this is another example of radical uncertainty. How this virus will evolve and how fast it will spread will depend on the behaviour of people. That is not something you can easily predict.”

It helps explain why markets are in turmoil. A dash for cash is under way — especially for dollars, said Chris Turner of financial group ING. It was a week when records were smashed as stock markets plunged, the oil price gyrated and even gold was sold off in a race for the exit.

Covid-19 — first traced to a Chinese food market last year — has sparked fear in financial markets and forced policymakers not only to run their playbook from the banking crisis, but also invent new ways to stem its impact.

A week that started with a dramatic move by the US Federal Reserve, which slashed interest rates close to zero after an emergency meeting last Sunday, ended with chancellor Rishi Sunak unveiling an unprecedented package of measures that would have been unthinkable only a week ago, including a plan to pay up to 80% of staff wages.

Lord King: ‘This is an example of what we call radical uncertainty’

Last Monday, the Dow Jones Industrial Average crashed 12%, the third-biggest one-day drop of all time. By the end of the week, the broader S&P 500 index had recorded its worst weekly fall since the 2008 banking crisis — 15% — with a particularly jumpy Friday because of the “quadruple witching” expiry of options and future contacts. Economists at Goldman Sachs reckon the American economy could contract by a whopping 24% in the second quarter.

In an undignified dash for the dollar, investors pulled money out of funds at a rate never seen before. Bank of America said the largest-ever daily outflow from bond funds took place on Monday, ushering in a record week of $108.9bn (£91.3bn) outflows. Some $20.7bn was taken out of stock market funds. Bank of America analysts calculated that more than $25 trillion had been wiped off global markets since their peak in late January, when they were convinced that the virus spreading across China was a local, not a global, affair.

“We are getting an immediate shutdown of economies,” said Neil Birrell at Premier Miton Investors.

That is what makes it different from what has gone before. “In a regular business cycle, bars and restaurants go bust and other bars and restaurants in better shape buy their assets, take on their staff and start again,” said Ian Shepherdson of Pantheon Macroeconomics. “That’s the process of creative destruction. What we have now is just destruction.”

Hence the wave after wave of measures announced last week, pouring billions of pounds into global markets to ease bottlenecks caused as positions are unwound and money is poured into dollars. At the same time, “social distancing” policies encouraged in two of the world’s biggest financial centres — London and New York — are exacerbating moves, as dealers are split into different locations to cut risk of infection.

“This is a significant global economic shock and both the magnitude and the duration of it are highly uncertain,” said Andrew Wilson at Goldman Sachs Asset Management. “We are all trying to understand the implications. It is also becoming a liquidity issue, as people are getting out of risky positions and everybody is doing the same thing globally.

“That is why you are seeing extreme market moves, exacerbated by the fact that everyone is working from home.”

Many of the tools rolled out during the 2008 crisis re-emerged last week — including so-called swap lines between central banks, making it easier for the market to get dollars. On Monday, Andrew Bailey, in his first day as Bank of England governor, took to the airwaves in an attempt to reassure markets that enough was being done.

By Thursday, after an emergency meeting, Bailey was announcing a cut in interest rates to a record 0.1% low — only a week after an emergency rate cut overseen by his predecessor Mark Carney. The Bank also unleashed a further £200bn of quantitative easing, or money printing, coming on top of a programme that already amounts to £435bn. Ruth Gregory at Capital Economics said that at 9% of GDP, this was bigger than the programmes announced by the Fed (3.3% of GDP) and the European Central Bank (7.3% of GDP).

Bond markets tightened as they did during the 2012 eurozone crisis. “This is the kind of thing that keeps central bankers awake at night in the first stage of any financial crisis,” she said.

Sterling has plunged to its lowest levels since March 1985 — in part because the dollar is so strong, although it had lifted off the week’s lows by the end of Friday.

Tensions in American bond markets have also been detected, making it hard for companies to turn to the usually liquid commercial paper market and sparking rounds of Fed liquidity injections, including in the municipal bond markets where local governments raise funding.

“There is a shortage of dollars, corporates were not getting their dollars from the usual place — everyone was chasing down dollars,” said ING’s Turner.

Wilson said it was “very encouraging” to see central banks step in. “This is not a financial issue, but the sector is critical in terms of providing the finance that companies will need as the result of the economic downturn,” he said. He also noted that yield curves for bonds had been steepening, showing that amid increased uncertainty, investors want higher yields for owning longer-dated bonds, as the market braces for a wave of issuance to fund the emergency rescue packages.

Germany is reportedly planning to borrow around €350bn to fund its emergency package. Bloomberg reported that the White House is considering issuing 25-year and 50-year bonds to fund what economists at Deutsche Bank describe as measures to issue $1,200 cheques for individuals, in the form of tax breaks. “Recession is now unavoidable in the US,” according to economists at ING.

They pointed to a “big bad number” coming this week: jobless claims, which last week rose by 70,000 to 281,000. Looking at regional numbers, they said there had been between a four and tenfold increase in jobless claims in recent days. “Assuming we average out at a sevenfold increase in claims versus last week, this would translate into a two million rise in jobless claims,” they said. The record high was 695,000 in early October 1982, with a recent peak of 665,000 in March 2009 during the financial crisis.

Amid all the uncertainty, one thing seems clear: policymakers will have to keep devising new ideas. King spoke of the need to develop schemes to compensate those who had suffered losses due to forces beyond their control.

“How do we pay for it?” he asked. “The government will have to find the money by borrowing, and that will increase the national debt. All of us will participate in paying off that debt in years to come.”

King concluded: “The scale that we will need to borrow is not something we can quantity now and we should not put any artificial limit on it. We should be prepared to do this, for the government stepping in to replace the private sector, for as long as is necessary.”