

AcF 304 Financial Markets

Topic 3 - Why Do Financial Crises Occur and Why Are They So Damaging to the Economy?- Part 2

Part 1 – 2020/21 Covid-19 Financial Crisis



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AcF 304 End Term Test

WEEK 17 (Included) - As per your
timetable - test will be on Moodle page

50 Multiple Choice Questions in 60 minutes - Random questions for each student from a large bank of questions.

- If you have any technical difficulties – in order for the university to try and assist you...
- Email: ugacccfin_office@lancaster.ac.uk
- **during** the exam – NOT 30 minutes afterwards
- provide photo evidence of any problems with your email
- Good luck!

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Topic 3

Part 1 – 2020/21 Covid-19 Financial Crisis

Part 2 – Regulatory Response to Financial Crisis

Part 3 – The Impact of regulation on the Fixed Income market

Part 4 – Summary & Next Week's Preview

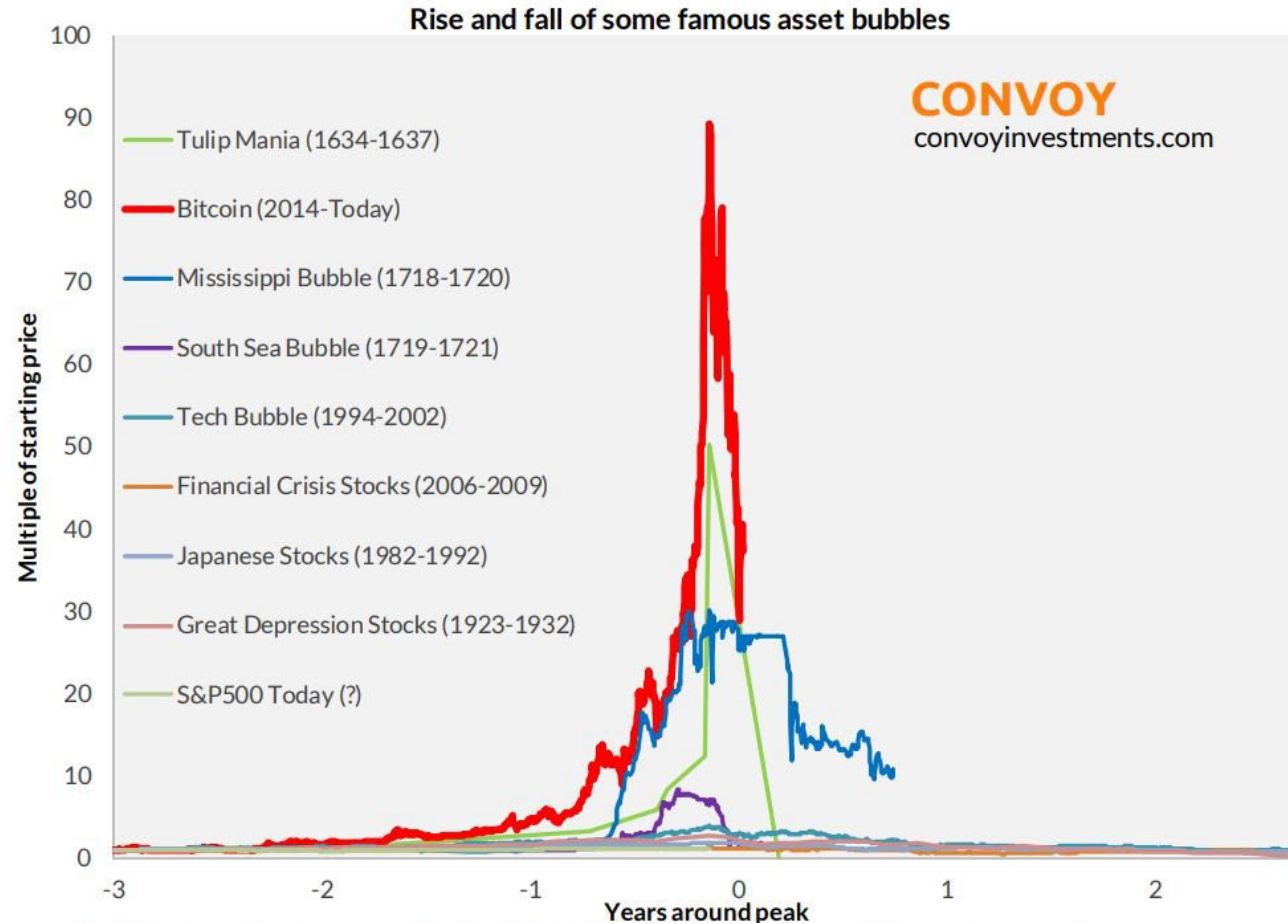
None of the Topic 3 material is covered in core text book.

Refer to lecture recordings, slides, MCQ, Commercial Awareness lecture and reading on module Moodle page.

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As of 2/12/2018. Source: Elliot Wave International, Yale SOM, St. Louis FRED, Global Financial Data, and Convoy analysis.

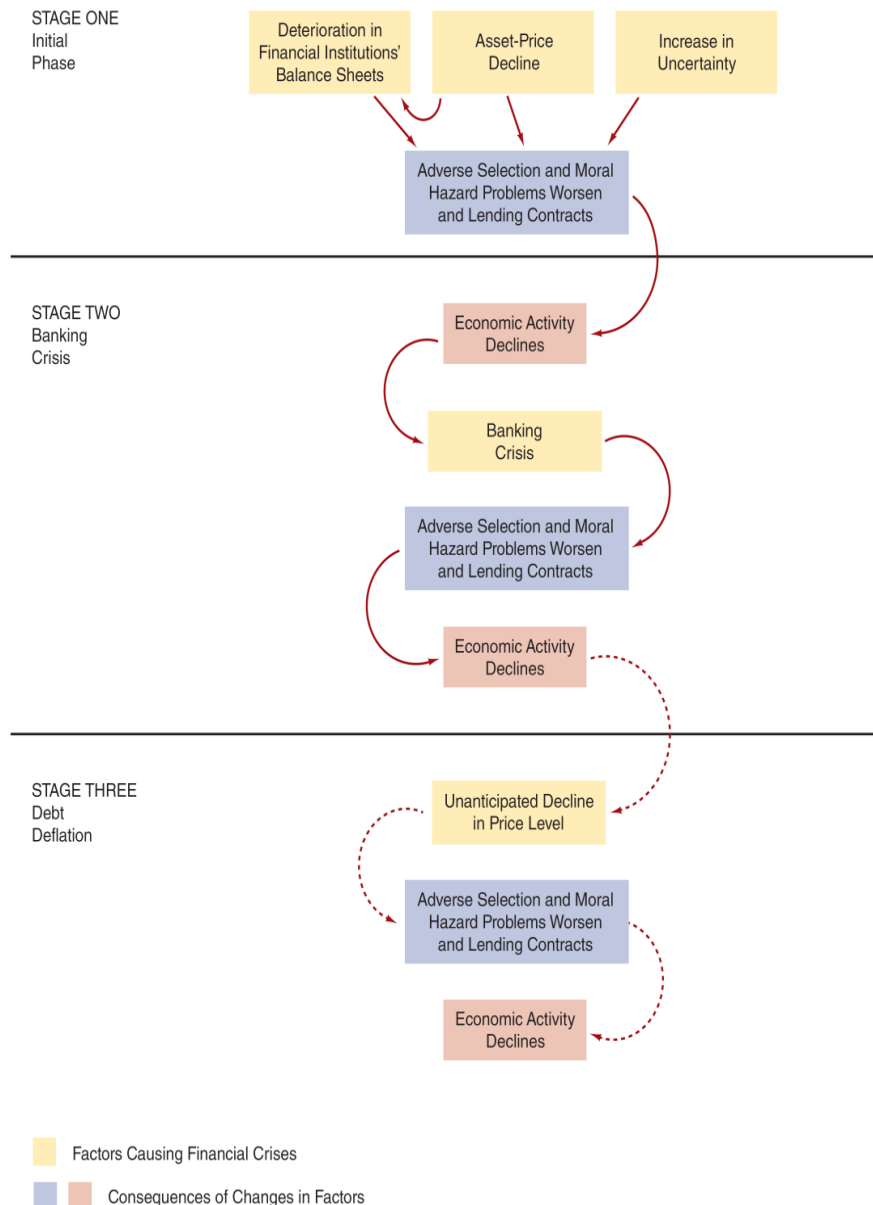
The 2020/21 crisis was not an 'Asset Bubble' crisis

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Figure 8.1 Sequence of Events in Financial Crises in Advanced Economies



...but the theory of Financial Crisis still applies...to a point

- Very special event: shock both on demand and supply side
- No Stage Two Banking Crisis
- The Central Banks learnt their lessons especially from 1929-33
- Huge injection of financial support - a combination of monetary and fiscal policy

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Monetary Policy (March 2020)

Markets tumble as Fed rate cut fails to ease fears



The Fed cut its policy rate 50 basis points to 1-1.25 per cent

The Fed last slashed interest rates by half a percentage point in October 2008 at the depths of the financial crisis

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Financial Headlines (March 2020)

Markets tumble as Fed rate cut fails to ease fears



The Fed cut its policy rate 50 basis points to 1-1.25 per cent on Tuesday

The Fed last slashed interest rates by half a percentage point in October 2008 at the depths of the financial crisis.

What's the problem with this?

- The problem was interest rates were only 1.50-1.75% to start with!!
- The average 'Fed Funds' rate over last 40 years is 5.95%
- The Fed had been trying to '*normalise*' interest rates over the last few years just for this reason (reaching 2.40% around 2018)
- With monetary policy largely ineffective (i.e., liquidity trap), fiscal intervention was required

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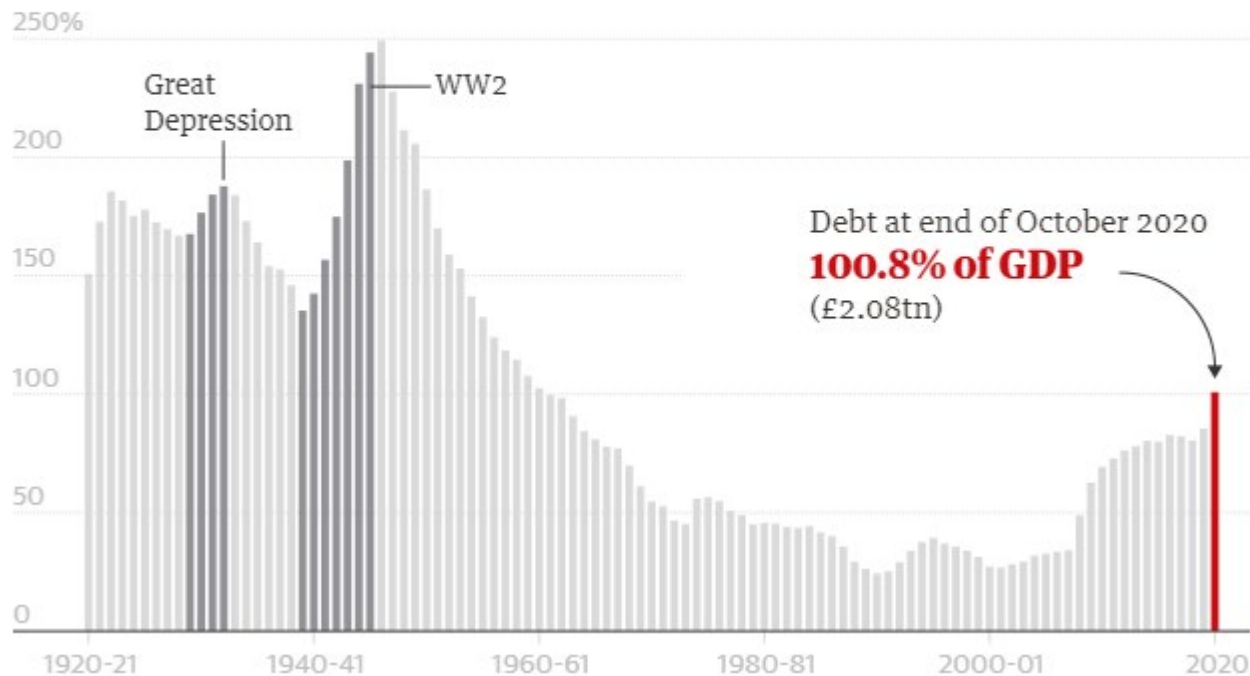


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Remember Greece in the Sovereign Debt crisis and Debt/GDP ratio was 120% (in the end 160%)

UK debt as a percentage of GDP has reached levels last seen in the early 1960s

Public sector net debt excluding public sector banks



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US taps market for stimulus funds at historically low rates

Record weekly Treasury bill issuance foreshadows huge spending to prop up economy

Year	Debt / GDP
2007	61%
2013	99%
2020 (Q2)	127%

The US has said it wanted to borrow a record \$3tn (£2.4tn) in the second quarter 2020, as coronavirus-related rescue packages blow up the budget.

In all of 2019, the country borrowed only \$1.28tn

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That's OK when yields are low like they were in 2020 and 2021 ...but...

Bonds & rates >

Country	2-year yield	10-year yield
Europe	-0.71%	-0.53%
Japan	-0.13%	0.05%
United Kingdom	-0.13%	0.29%
United States	0.14%	1.09%

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Financial Headlines

Investors stunned by blowout bond rally

Fund managers rush for safety of government debt at quickest pace since crisis of 2008



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US Govt Bond Yields (End 2019 /Early 2020)



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Downgrades flood junk bond market with 'fallen angels'

Record pace of ratings cuts amid coronavirus outbreak shakes up corporate bond market



Bloomberg, which operates what is widely considered to be the benchmark investment-grade bond index, booted out issuers like Ford, Occidental and Macy's at the turn of this month © Financial Times

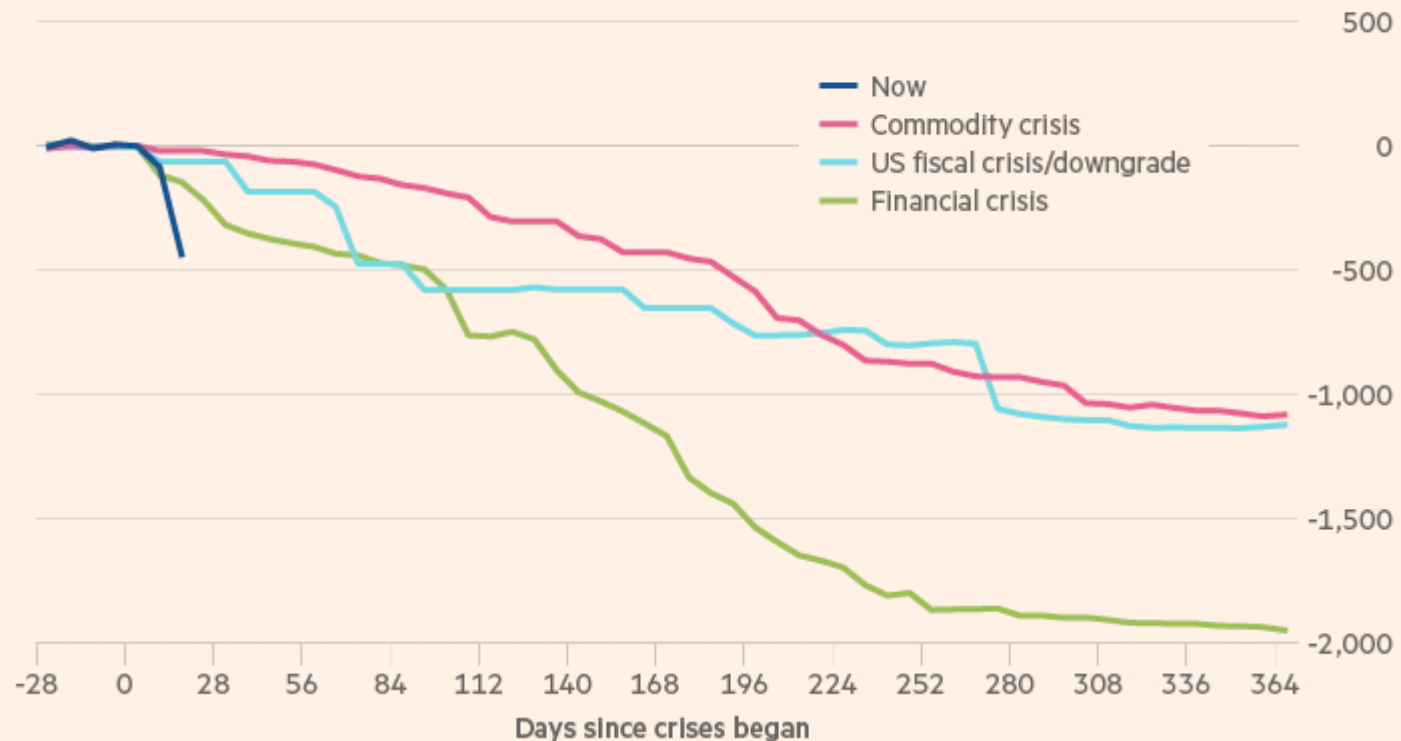
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Covid-19 crisis sparks record US company downgrades

Investment grade ratings change (\$bn)



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Yield on 10-Year Treasury Constant Maturity (BAA10Y)

DOWNLOAD 

Observation:

2020-04-22: 3.30

Updated: Apr 23, 2020

Units:

Percent,

Not Seasonally Adjusted

Frequency:

Daily

1Y | 5Y | 10Y | Max

2015-04-22

2020-04-22

EDIT GRAPH 

FRED 

Moody's Seasoned Baa Corporate Bond Yield Relative to Yield on 10-Year Treasury Constant Maturity



Financial Headlines 2020

Oil plunges as Opec output cut talks with Russia collapse

Prices near three-year low as biggest producers fall out over coronavirus response



Prince Abdulaziz bin Salman, Saudi energy minister, arrives at the Opec meeting on Friday © AFP via Getty Images

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April 2020

Opec secures record global oil cuts deal under US pressure

Oil prices fall back on doubts over the impact of agreement



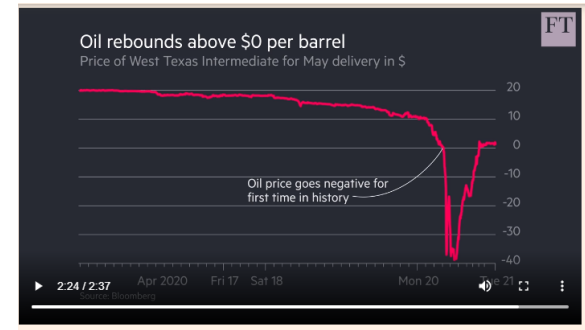
- Global demand is down about one third
- Oil prices dropped below \$20 p.b.- first time in 18 years
- A severe drop in demand coinciding with levels of US production remaining robust despite storage tanks being just weeks away from reaching capacity!
- US Oil for immediate delivery fell to -\$40 per barrel !!!

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April 2020



- *This means producers will pay you to take oil off them! Extremely rare!*
- US Oil for May delivery opened at \$18 per barrel but fell to -\$40 (that day!) as buyers who were taking delivery of oil had nowhere to store it. *That's a \$60 dollar price move!*
- 20 Jan 21 – US Oil is \$50 a barrel!
- 20 Jan 23 – US Oil is \$80 a barrel!

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Commodities - GOLD

10 Year Gold Price in USD/oz

Last Close: 1484.00

High: 1889.70 Low: 1050.80 ▲384.70 34.99%



goldprice.org

Friday, March 20, 2020

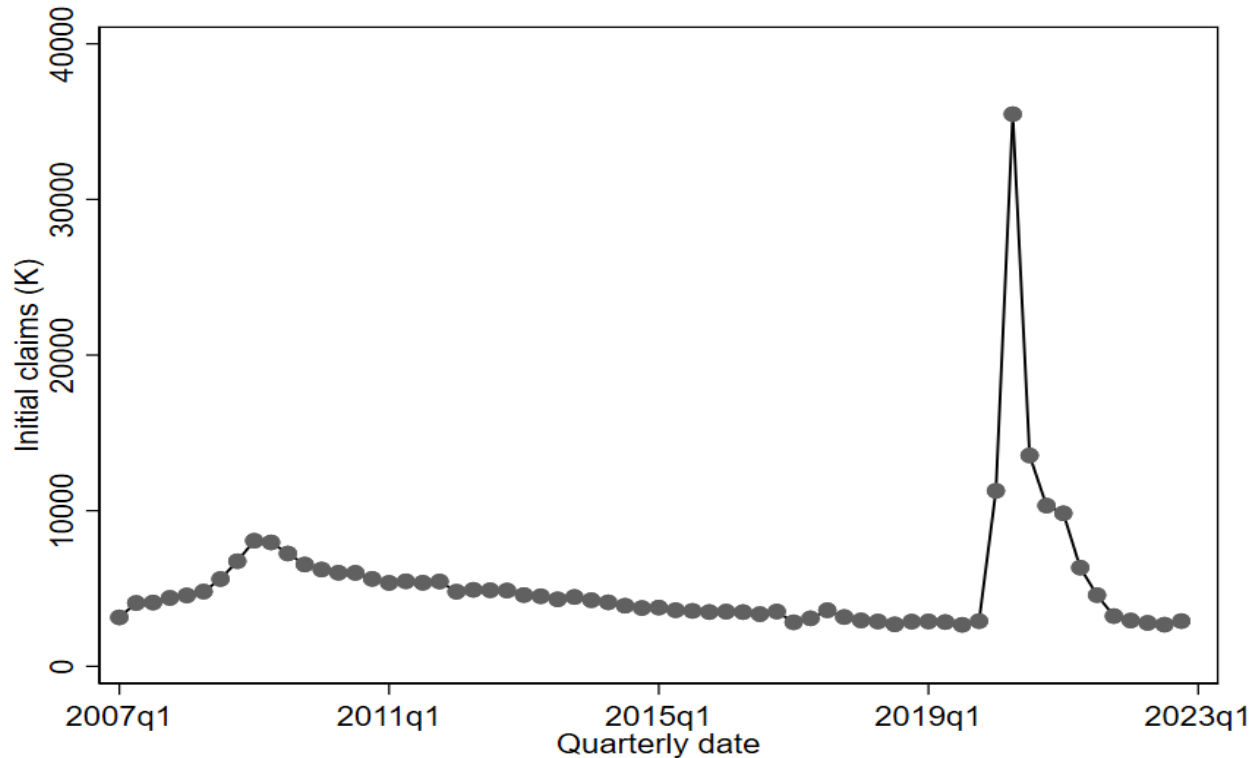
Commodities – GOLD – March 2020



**Gold not behaving as typical safe-haven asset in 2020 crisis!
As investors take profits on gold to balance their losses on
stocks!!**

**It did in the end - Jan 2020 - \$2,000 per ounce! And is \$1,930 per
ounce Jan 2023**

2020 - US Jobless Claims



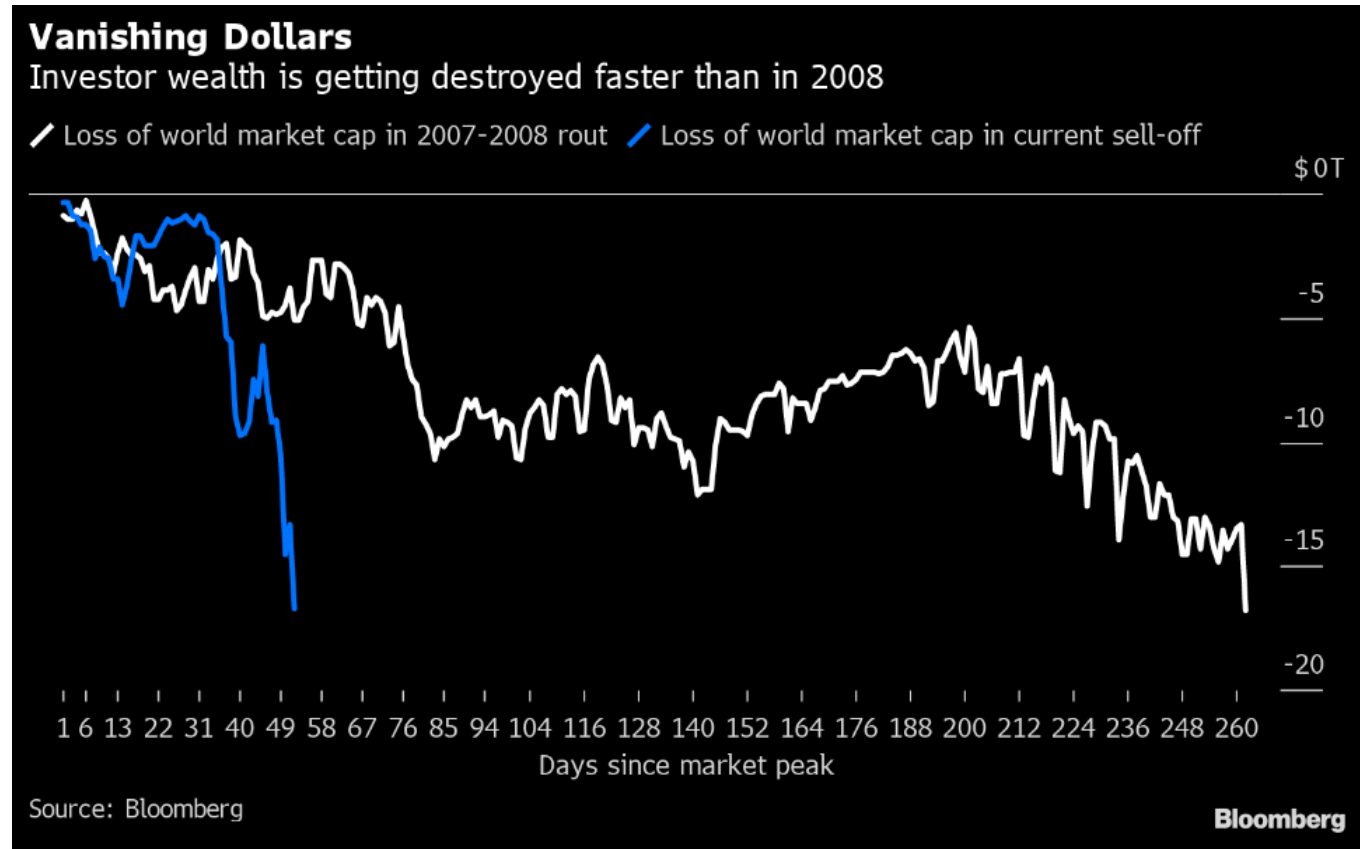
Compare to the financial crisis

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Comparing 2020 v 2008



Stocks fell 30% in 22 days !!! But then it enjoyed quickest rebound!!!

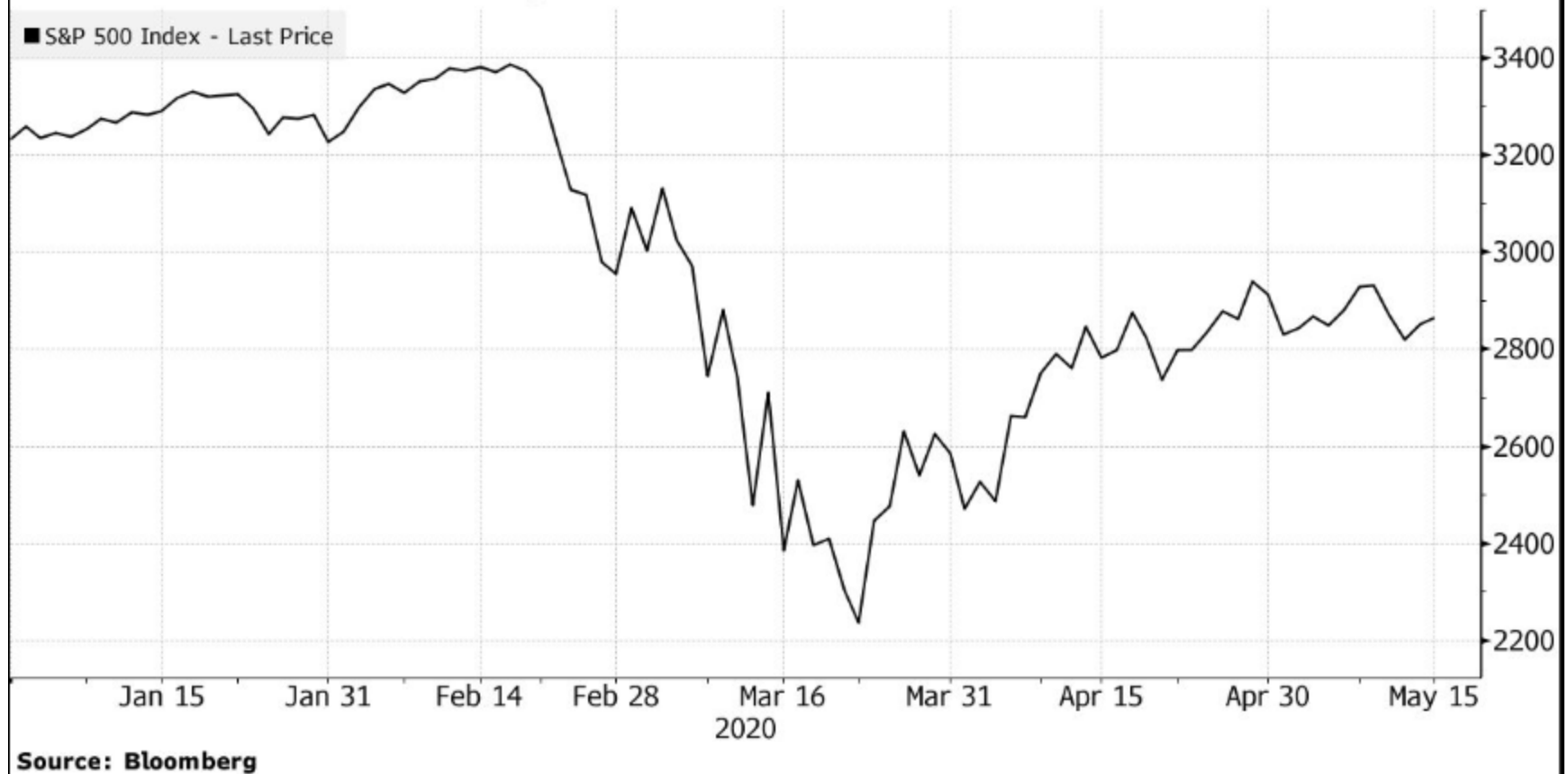
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Staying the Course

The S&P 500 has held onto gains off its March lows



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2020

Global stocks spring back from March lows

FTSE All-World index



Source: Refinitiv
© FT

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Stocks a lot higher than their lows!

Investors keep 'buying the dip'

April 2020



Americas

NAME	VALUE	NET CHANGE	% CHANGE	1 MONTH	1 YEAR
INDU:IND DOW JONES INDUS. AVG	23,480.41	-34.85	-0.15%	+13.41%	-11.72%
SPX:IND S&P 500 INDEX	2,793.66	-4.14	-0.15%	+14.15%	-4.56%
CCMP:IND NASDAQ COMPOSITE INDEX	8,510.72	+15.97	+0.19%	+14.73%	+5.04%

Europe, Middle East & Africa

NAME	VALUE	NET CHANGE	% CHANGE	1 MONTH	1 YEAR
SX5E:IND Euro Stoxx 50 Pr	2,809.35	-43.11	-1.51%	+3.47%	-18.77%
UKX:IND FTSE 100 INDEX	5,760.73	-65.88	-1.13%	+5.78%	-22.34%
DAX:IND DAX INDEX	10,349.01	-164.78	-1.57%	+6.68%	-15.95%
CAC:IND CAC 40 INDEX	4,399.77	-51.23	-1.15%	+3.70%	-21.36%

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Summary – Where are we now?

- US stock markets reached all-time highs 2021 supported by
 - a) massive central bank support
 - b) strong technology company performance
- Global stocks followed in 2021
- Bond yields now a lot higher Jan 2023 (remember inflation now the issue)
- Gold back near \$2,000 per ounce (Jan 2023)
- Oil price has rebounded and now near \$83 per barrel (2024) and traded a lot higher in 2022

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The 2020 Crisis created so much fear!

Part 1 – Appendix – VIX Volatility Index or *'Fear Gauge'*



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