<u>The economic impact of the coronavirus</u>

by

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Have you ever read the back of the Clorox wipes container? It states that the wipes can be used to kill the influenza A2 virus and the human coronavirus. Given that this has been on their packaging for years, we can assume that the coronavirus is not something new—and it isn't. The 2003 SARS outbreak was a strain of the human coronavirus and so was the 2012 MERS outbreak. The 2019 Wuhan coronavirus outbreak is another newly discovered strain of the same type of virus and has been officially named COVID -19.

So what makes this deadly virus different?

The number of deaths reported as a result of the Wuhan originated virus has easily exceeded 2,600, already surpassing the nearly 800 people who died from SARS. While the number of confirmed cases continues to rise, exceeding 79,000 worldwide, the fatality rate is still lower than the 9.6% SARS death rate. The fact that the majority of deaths are among older patients and those with weak immune systems has quelled fears somewhat. On the other hand China's role in the global economy is unambiguously greater today compared to 2003, when the second largest economy accounted for less than 5% of the world GDP compared to more than 15% today. With greater integration of global supply chains and lower growth rates in China and the rest of the world, there is growing angst about the potential ripple effect that this coronavirus can generate.

In an effort to contain the spread of the virus, Chinese authorities have imposed travel bans to and from Wuhan and the surrounding areas, essentially placing the city under quarantine. Further afield more than 50 countries including the US, Australia and Japan are limiting entry for passengers arriving from China. We are only now starting to get a glimpse into the potential economic impact to China, let alone the rest of the world. Tourist attractions, restaurants and hotels are certainly feeling the pain as a result of a decline in consumption. With factories now closed beyond the traditional Lunar New Year holidays, manufacturing is also being disrupted. Even if factories would like to resume operations many of their employees can't return to work due to travel restrictions.

The economic impact

In today's highly integrated global supply chain, the closure of factories in China is directly disrupting production in emerging Asian countries. Cambodia, for instance, relies heavily on inputs from China in its textile and apparel industries. For Vietnam and South Korea more than 40% of imported manufacturing inputs used in the electronics industry are sourced from Chinese manufacturers. Likewise India's pharmaceutical industry, which imports nearly 80% of pharmaceutical ingredients from China, is at risk of shortages. The country is already noticing price increases in commonly used antibiotics and fever medications.

Even countries with a relatively low reliance on inputs from China, have specific industry giants getting caught up in the fallout of COVID-19. This was the case with South Korean carmaker Hyundai which has already been forced to close its Korean plants due to a shortage of specific auto parts. As for North America, US car producers are reporting potential plant closures if part supplies are not replenished within a few weeks. Dow Jones industrial member, Nike Inc., forecasts a material impact to earnings as it closed nearly half of it stores in China. Global tech giant, Apple Inc. already warned earlier this month of an expected revenue shortfall in the first quarter of the year due to depressed Chinese demand as well as manufacturing interruptions.

Due to strong trade connections, China's neighbours in Asia are expected to experience the greatest impact and there is already evidence of that. According to Singapore's prime minister the number of visitors has already declined by 20,000 a day as a result of this outbreak, which is pushing policymakers to take an expansionary fiscal stance. As a result of a natural disaster and tax increases, Japan reported a 6.3% contraction in GDP in the fourth quarter. Now the world's third largest economy is faced with dwindling tourist flows and falling exports, easily thrusting the country into a recession by the end of the quarter. The hardest hit developed nation could be Australia, given the country's dependence on exports as well as tourism from China. Regardless, the impact will be global with select regions and industries affected more than others.

In addition to signs of negative impacts on the airline, technology, car and health care industry, commodities have not been spared. Concerns mount as the world's largest importer of crude oil tries to manage the coronavirus outbreak resulting in reduced oil demand. Consumers are reaping the benefits with gasoline prices down at least 6% year to date, but this may not last long as OPEC producers hint towards tightening supply.

By and large economists are expecting a contraction in China's GPD in the first quarter followed by looser monetary and fiscal policy to stabilize growth for the remainder of the year. Current estimates suggest a first quarter GDP slowdown in China close to 4.5%, down from 6% in the fourth quarter of 2019. On February 17 the People's Bank of China (PBoC) reduced its Medium-Term Lending Facility rate by ten basis points to 3.15%. The move should lower funding costs for banks and most likely feed through to the Loan Prime Rate set by banks in an effort to encourage lending. More monetary and fiscal stimulus will probably be required the longer coronavirus disruptions persist, but in the case of a protracted crisis, such stimulus may be insufficient. Equity markets seem to be ignoring the potential economic impact at the moment, perhaps due to the lack of massive contagion beyond China. If China can contain the spread of the virus, the impact to the global economy may be minimal; if not, the rest of the world would also have to boost their economies, but may not be in a position to do so. Then again, we may see further accommodative policies from major central banks. All eyes will be focused on China in the coming weeks.

Sources: Bloomberg LP, Capital Economics, IMF, Barclays