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MARKET PERSPECTIVES

The economic impact of the coronavirus

As the novel coronavirus, named COVID-19, spreads across the globe, reaction from the capital markets has been dramatic. For the week ending Feb. 28, Wall Street had its worst week since 2008, with the major stock indexes dipping into correction territory as anxiety over the threat the outbreak poses to the global economy shook the markets. Investors sought refuge in safe havens like U.S. Treasuries, pushing bond yields to record lows. While the human toll of the coronavirus is tragic, we believe the economic impact will be sharply negative, but temporary.

DEREK HAMILTON
Global Economist

Two characteristics of the virus that are worrisome are its person-to-person transmissibility and its mortality rate. While the COVID-19 data is incomplete, it appears the virus is nearly twice as contagious as seasonal influenza and has an estimated mortality rate of one in 100 patients. By comparison, the mortality rate for people who contract an influenza virus is approximately one in 1,000.

The rapid and widespread outbreak has thus had a negative impact on global capital markets. While the situation remains fluid, we believe global economic growth, and especially China's performance will be very weak in the first quarter of 2020, but the slowdown could be temporary. China's unprecedented action to contain the spread of the virus should result in a sharp slowdown in its economy. The move to essentially close all business across much of the country for two weeks was extremely harmful to economic growth, but could ultimately result in a quicker containment of the outbreak.

Recently, the situation in China seems to be improving. While workers have begun to return to work in most provinces, the recovery has been slow as government officials and businesses work to balance containing the virus with preventing further weakness in economic growth. We think the Chinese economy will likely continue to improve from here, albeit from very weak levels.

With the number of coronavirus cases outside of China rising rapidly, the economic disruption is spreading. While mortality rates are lower outside of China, we are concerned about fear impacting confidence in the U.S. and Europe, which could result in consumers avoiding public areas. This is in addition to the impact on travel decisions by corporations. If COVID-19 is seasonal like other coronaviruses, any slowdown could be short lived.

In response to the economic weakness, global policymakers are reacting with further stimulus. China has increased the amount of bank lending at lower interest rates and reduced fees for businesses and consumers. The government has encouraged more infrastructure spending. Local

governments have recently eased up on property restrictions. Among emerging markets countries, a number of central banks have reduced interest rates and some governments are beginning to introduce fiscal stimulus. Similar discussions around monetary and fiscal stimulus are occurring in developed markets, though no action has been taken to date. Markets are pricing in a high likelihood of interest rate cuts from the major developed central banks. The recent performance of capital markets could force them into action.

Based on the underlying fundamentals we have discussed in the past, the global economy should have been in recovery mode. Recent surveys, concluded before the COVID-19 outbreak, showed economic activity was beginning to regain ground. We believe those fundamentals – stimulus, the postponement of the trade war between the U.S. and China and a better inventory situation – are still in place. In fact, these fundamentals could be amplified by the crisis as inventories are drawn down further as a result of supply-chain disruptions and more monetary and fiscal stimulus is added to the system.

What's next?

The economic and market impact of the coronavirus has led us to reevaluate our 2020 global outlook. We now believe the global growth rate for 2020 will be around 3%, down from our initial forecast of 3.4% coming into the year. However, we think growth in the second half of 2020 will be closer to our original forecast and could surprise to the upside because of these reasons. Of course, the situation continues to be murky and short-term risks are clearly to the downside.

Where could we be wrong? If the virus does not follow the typical seasonal pattern and continues to spread, then our expectation of a strong recovery will turn to concerns about a global recession. Also, if supply-chain disruptions are long-lasting and factories cannot get essential components needed for production for an extended period, we could see closures and layoffs, which will result in a downgrade to economic forecasts. However, we are hopeful that any economic impacts will be short-lived.

From a longer-term perspective, we believe the coronavirus outbreak could further motivate companies to diversify their supply chains. Last year, companies were confronted with supply-chain issues related to the trade war and higher tariffs. Now, factories across China have shut down because of the virus. We believe this could accelerate a move away from China as a sole supplier, serving as an impetus for companies to look for multiple sources to prevent disruptions like this from occurring in the future.

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