

Wall Street rises as coronavirus weighs heavily on global economy

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The growing divergence between financial markets, boosted by continual injections of cheap money, and the underlying real economy, has been underscored by the impact of the coronavirus outbreak.

While the Chinese economy has ground to a virtual standstill this week and the effects of production cutbacks are starting to flow to the rest of the world, Wall Street has undergone a rapid rise, after significant falls, and returned to positive territory for the year.

Yesterday, the Dow finished 408 points higher, or 1.4 percent, after being up more than 500 points during the course of the day. The S&P 500 was up by 1.5 percent and the tech-heavy Nasdaq index rose by 2.1 percent to finish at a record high.

The rise in the market was the result of major central bank interventions both in China and the US. Share prices in China rose yesterday—after falling by more than 8 percent when markets re-opened on Monday after the extended lunar New Year break—due to a \$174 billion intervention by the People's Bank in China and indications that state-run institutional investors were buying up stocks to support the market.

In the US, the market was boosted by a \$94 billion injection of cash by the New York Federal Reserve into the short-term repo market in order to keep down overnight interest rates.

The *Wall Street Journal* reported that the upward movement in the market was due to the “growing belief that fiscal and monetary policy will blunt the impact of the virus outbreak.” The newspaper pointed to “investor psychology” that assumed the central banks “will do whatever they need to.”

A comment reported by CNN from Michal Every, senior Asia-Pacific investment strategist at Rabobank, put the issue more directly. “The underlying market hope is clear: central banks will save us, not just from

the business cycle, and not just from climate change, but not from global pandemic too,” he wrote.

This week, 21 provinces in China told businesses not to resume work at least until February 10. They warned that the shutdown could be extended if the virus continued to spread. According to calculations by the US business channel CNBC, the shutdown covers areas that account for more than 80 percent of China's gross domestic product and 90 percent of its exports.

In Hubei province, where the disease outbreak began in the city of Wuhan, businesses have been told not to re-open before February 14, with provincial authorities stating that they could extend the shutdown to an “appropriate extent.”

China is the world's largest exporter of intermediate manufactured products, which form part of the global supply chains of major corporations. It is the source of 20 percent of the global total of such products and 40 percent for production carried out in South Korea, Japan, Vietnam and Cambodia.

The effects have already begun to be felt. Yesterday, Hyundai, the world's fifth largest carmaker by sales, announced that it was shutting down all of its car factories in South Korea because it had run out of components from China.

European car production could soon be affected. The *Financial Times* has reported that parts manufacturers Continental and Thyssenkrupp both held crisis meetings this week. Travel restrictions in China are preventing the normal resumption of work, and while companies have said they expect to resume production next week, it is by no means guaranteed.

Analysts at the Japanese financial firm Nomura pointed to the effect of the shutdown of the car industry. “Restrictions on movement and other measures have raised the risk of disruption to supply

chains, and we see potential for a stalling in automobile production within China. We also see a risk that supply chain issues could have knock-on effects in Japan and elsewhere in Asia,” they said.

Seventeen years ago, the outbreak of the SARS virus delivered a hit both to China and the rest of the world. The new coronavirus has a much greater potential for damage because of the growth of the Chinese economy. In 2002–2003, China accounted for about 4 percent of global GDP. Now that figure is over 16 percent, and China accounts for about one-third of all global growth annually—more than the US, Japan and Europe combined.

The increased weight of China in the global economy is reflected in the sharp fall in the prices of industrial commodities, of which it is a major consumer.

The price of oil has fallen by around 20 percent over the past three weeks and has officially entered bear market territory. Earlier this week, the Kremlin issued a statement that President Vladimir Putin had taken a call from Saudi Arabia’s King Salman and the two sides were ready to coordinate their actions to “ensure stability on the global oil market.”

Olivier Jakob at the consultancy firm Petromatrix told the *Financial Times* that while initially the estimates of reduced consumption were focused on air transport, “the true risk is lower economic activity. That’s much bigger in scale.”

Estimates for the growth of the Chinese economy, at least for the first quarter, have already been revised sharply down from just below 6 percent to as low as 4.5 percent or even 4 percent.

With China accounting for around half the consumption of the world’s metal and mining resources—a level double what it was when the 2003 SARS outbreak took place—the price of metals has fallen sharply. Copper, often regarded as a bellwether for global industrial production, is down 13 percent, and the price of iron ore has dropped by more than 8 percent. The price of liquefied natural gas has also fallen sharply, with a key price index used in Japan and Korea dropping to a record low on Monday.

In contrast to the surge on the markets, the *Wall Street Journal* warned in an editorial this week of the effects on the US economy. It noted that Apple, McDonald’s, Levi Strauss and Starbucks have announced temporary closures of their stores in China,

and manufacturers such as Ford, Apple and Tesla have temporarily halted production.

It pointed out that one sixth of Apple’s sales and nearly half of the chip-maker Qualcomm’s revenues come from China, and that 80 percent of the active ingredients used by drug makers to produce finished medical products in the US are sourced from China.

“Because China is the world’s largest manufacturer and an enormous consumer market, the economic freeze will disrupt supply chains and reduce corporate earnings,” the *Journal* commented.

Goldman Sachs said last week it expected the impact of the virus to cut US output by between 0.4 and 0.5 percentage points in the first quarter of this year, with a rebound to follow in the second quarter. But with the full effects as yet unknown, there is no way of determining the accuracy of such an assessment.

With industrial production falling in China and the knock-on effects in Japan, Asia, Europe and the US, an ongoing rise in US markets—fuelled by the belief that cheap money will continue to be pumped out by the Fed—could create the conditions for a financial crisis whose economic contagion would exceed those of the coronavirus.



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