Coronavirus could deliver major hit to world economy

Nick Beams
12 February 2020

It will take many weeks, possibly months, for the Chinese economy to return to anything resembling previous levels of output following the coronavirus shutdown, if this week's partial return to work is anything to go by.

Even after some local government authorities called for workers to return, large cities outside the province of Hubei and the city of Wuhan, where the infection began, remained deserted and industrial complexes closed.

Reporting on the situation on Monday, the *Wall Street Journal* said workers remained stranded and unable to reach their factories, office towers stayed dark and there was a "ghost-town ambience across China" as it published a photograph showing empty streets in Beijing's central business district.

The *New York Times* cited a comment by Jörg Wuttke, the president of the European Chamber of Commerce in China. "It's like Europe in medieval times where each city has its checks and crosschecks," he said.

There are indications that the government is becoming concerned over the effects of the shutdown of the economy, amid indications that as much as 2 percent could be cut from the growth rate in the first quarter. There is least one forecast that China could experience zero growth for the first three months of the year.

The Ministry of Industry and Information Technology has said regions that are less affected should accelerate the resumption of production and that it was "very urgent" that economic activity should recommence. Reuters has reported that during a meeting of Politburo on February 3 president Xi Jinping said that efforts to control the virus were threatening the economy.

The official position is that the impact of the virus will be V-shaped, that is, a sharp downturn followed by a rapid recovery as back orders are filled and lost production is made up. This assessment is one of the factors that has sustained global markets—Wall Street has hit new record highs in the past week—even as the world's second largest economy comes to a virtual standstill.

But this assessment is not universally shared. Prominent financial analyst Mohamed El-Erian has issued several warnings that the "look through" approach to the crisis—to regard it as containable, temporary and reversible—may be inaccurate.

"What makes China's economic outlook particularly uncertain is the multifaceted nature of this latest shock," he wrote in a comment published on Bloomberg, noting that "it involves critical interruptions to both demand and supply" and that it impacts manufacturing and services, disrupting both internal and external trade.

There had been a "cascading" effect in the Chinese economy amid evidence that this was now extending to the rest of the world, he wrote.

The London-based global financial consultancy firm Capital Economics has issued one of the first forecasts about the impact of the coronavirus shutdown on the global economy. In a note issued last week it said its "best guess" was that economic disruption would cost the world economy about $280 billion in the first quarter of the year, meaning that global GDP would not grow for the first time since the beginning of 2009 in the aftermath of the financial crisis.

The forecast was based on the assumption that the virus would be contained soon and that lost output in the first quarter would be made up subsequently. If that is not the case, then the impact would clearly be more severe.

Even with the assumption that production will recover in subsequent quarters, the impact will be significant. Capital Economics forecast that Chinese growth in the first quarter would halve from just under 6 percent on an annual basis to 3 percent.

One of the most significant international follow-ons is the effect on Australia. The forecast is for "Australia's economy to contract owing to its high dependence on

China for tourism receipts and goods exports," it said.

The outbreak of the China coronavirus is the second major blow to the Australian economy since the start of the year following the outbreak of devastating bushfires. Goldman Sachs has predicted that they will slice 0.3 percent from GDP growth in the March quarter.

According to Oxford Economics economist Sarah Hunter, "There is a very real risk that gross domestic product will contract as a result of the combined drag from the bushfires and coronavirus."

The outcome could be the end of the 28-year stretch in which the Australian economy has avoided an outright recession.

The effects of the hit to China are likely to be amplified by the slowdown in the global economy that was manifesting itself before the coronavirus struck. Industrial production in Europe has slowed, with significant falls being recorded in Germany and France.

A major index of world trade has shown a precipitous fall. The Baltic Dry Index, which tracks freight rates for the world's dry bulk shipping carriers and is regarded as something of a bellwether for international economic conditions, is now at an all-time low having plunged by 83 percent since September.

Global commodity prices are falling, with oil down by 18 percent since the start of the year amid indications that Chinese demand will fall by 25 percent this month.

The Bloomberg Commodity Index has fallen by 8 percent in the past month with significant falls in the prices of iron ore and copper in addition to oil.

Currency values are falling across the Asia-Pacific region, led down by the Australia dollar, which is at its lowest point in a decade. The Bank of Thailand has cut its interest rates in an attempt to boost the economy, leading to a sharp fall in the currency, which is down 4 percent for the year after rising by 10 percent in 2019. South Korea's currency has dropped by 2 percent and the Singapore dollar has fallen by 2.8 percent.

The outlook for the region had been expected to improve following the "phase one" trade deal between the US and China. Now all the indicators are pointing to lower growth.

"From a trade war to a war against a virus. It's a shock to financial markets, to the global growth situation," Christy Tan, head of markets strategy and research at the National Australia Bank, told the *Financial Times* .

So far, the US has yet to feel the effects of the China shutdown and the stock market remains at near record highs. This is largely because of market confidence that the US Federal Reserve will step in with additional monetary stimulus measures to prevent a precipitous fall.

Addressing the House Financial Services Committee yesterday, Fed chairman Jerome Powell said that risks to the outlook remained. "In particular, we are closely monitoring the emergence of the coronavirus, which could lead to disruptions in China that spill over to the rest of the global economy."

There would "likely" be some effects on the US economy, but it was too early to say what they would be.

Powell's remarks prompted a response from US president Trump underscoring the dependence of Wall Street on the expectation of the continued flow of cheap money from the Fed in the face of the crisis in the world's second largest economy.

"When Jay Powell started his testimony today, the Dow was up 125 and heading higher. As he spoke its drifted steadily downward, as usual, as is now at -15," he tweeted.

Trump repeated his call for negative interest rates, noting that the rise in the value of the US dollar—a result of financial investors seeking a "safe haven"—was "tough on exports." During his testimony, Powell pushed back against negative rates, saying they would hurt banks and credit creation. But there is no question the Fed will open the financial spigots further in the event that markets start to take a hit, which may come sooner rather than later if conditions in China continue to worsen.