Coronavirus Outbreak: An Economic Shock?

Recent development of the coronavirus outbreak seems to suggest that the virus is more contagious than SARS in 2003. The number of infected individuals has already surpassed SARS in a much shorter period of time and is still rising rapidly, although the fatality rate is lower (currently ~2% vs ~9.7% for SARS). Does this imply that the economic impact could be larger this time given the broader and faster spread of the virus? Is it a Blackswan event that is going to derail the moderate global growth recovery that we had expected at the beginning of this year?

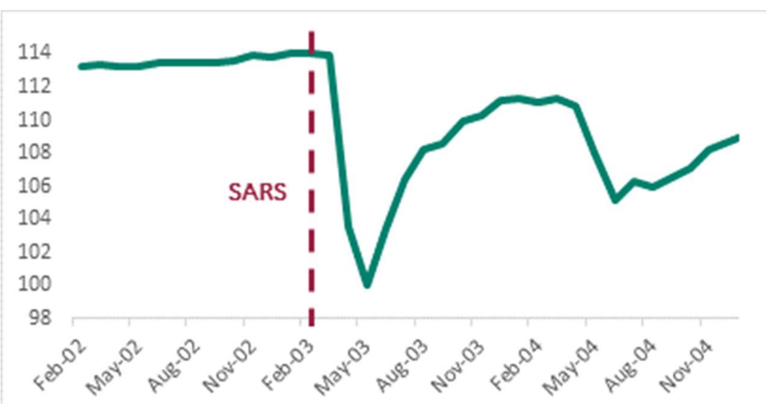
A short but sharp economic shock

We mentioned in our strategy note (https://wealthmanagement.bnpparibas/asia/en/expert-voices/impact-of-coronavirus.html) published before the Lunar New Year that the impact of coronavirus on economy and markets tend to be short-lived (last for a few months) based on the experience of SARS, and digital consumption (e-Commerce, online entertainment and online education) could be beneficiaries. Here we try to **assess the potential economic damage in the near term** amid the evolving situation of the current outbreak

(1) Aggressive quarantine measures lead to a sharp economic disruption in China

Lockdown of cities are unprecedented moves by the Chinese authorities. Most provinces suspending business and production until 9 February will also incur economic cost. Not only offline retail (include catering), transport and hotels (altogether account for 16% of China GDP and 29% of service sector output) are hit due to travel restrictions and heightened uncertainty, the manufacturing sector is also affected given factory closures and logistical disruption. In addition to a high base in 1Q 2019, year-on-year China's GDP growth in 1Q 2020 could fall below 5%.

China's consumer confidence plunged during 2003 SARS



Source: Bloomberg, BNP Paribas (WM), 31 Jan 2020

(2) Demand shock in economies with strong links to China through tourism and trade

- **Tourism** – The substantial decline in outbound tourism from China hurts the economies that are highly exposed to China visitors. In Asia, Hong Kong and Thailand are the most exposed as Chinese tourism accounts for 8% and 3% of their respective GDP, and share of China tourists are 79% and 28%, respectively. While visitors from China to Hong Kong were already sharply lower due to the protests, the actual impact may not be as large as shown from the numbers.

Chinese tourism as % of GDP in DM and EM

Source: Haver, UBS, BNP Paribas WM as of 31 Jan 2020

- **Trade** - China is more integrated into global supply chains today than in 2003. Travel restrictions create large uncertainties and supply chains disruptions. For instance, some Taiwan and Korea technology companies and component makers with factories in Hubei and adjacent provinces could be affected. Furthermore, much slower China growth could have spillover effects across all Asian economies. However, US-China trade war has triggered a partial shifting of supply chains over the past 18 months and growing online consumption nowadays (vs minimal in 2003) could mitigate the overall impact.

(3) Indirect impact from precautionary behaviors

Indirect impact due to precautionary behaviors from consumers, business owners and investors are hard to quantify. An increasing number of countries and many multinational companies have imposed travel ban to China. Slowdown in flows of people also significantly limit business and production opportunities. Overall, India and Indonesia, which are more domestic demand driven economies, appear to be more insulated in the region. However, they could also be vulnerable amid their weaker healthcare systems should the virus spread to these countries.

Economic impact could be shaper but unlikely to derail global growth

The current outbreak which tends to be more infectious, together with more dramatic and widespread measures to limit further contagion, as well as China's larger share in the global economy now (~20% vs ~8% in 2003), suggest that economic impact this time could exceed SARS. However, **we do not expect the economic shock (which we assume to be temporary at this point of time) to derail global growth significantly for the whole year.** On the contrary, **pent up demand after the outbreak situation is contained and potential policy stimulus could offset the weakness in 1H20, seeing a stronger sequential recovery in 2H20.**

The final economic cost of the outbreak is determined by how quickly the epidemic is deemed to be under control and whether it is affecting a much broader part of the world, which are big unknowns now and causing anxiety. Markets particularly those link closely with China would remain very volatile in the short term. During SARS in 2003, MSCI Asia ex-Japan fell 15% from peak to trough, but rebounded 32% in 2H03 after the outbreak was contained. **There will be bottom-fishing opportunities, but it is still early days as the situation is escalating. We may see the peak of outbreak within a couple of months** if SARS is any guide**.**

China central bank's huge liquidity injection of RMB 1.7 trillion (USD 243 billion) through open market operations after the Lunar New Year holiday shows their determination to stabilize financial market. In case of a more severe scenario with the duration/magnitude of the epidemic much longer/bigger than expected and economic disruptions much more sizable, we believe central banks globally are ready to ease and many governments are likely to response with acceleration in fiscal spending.

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