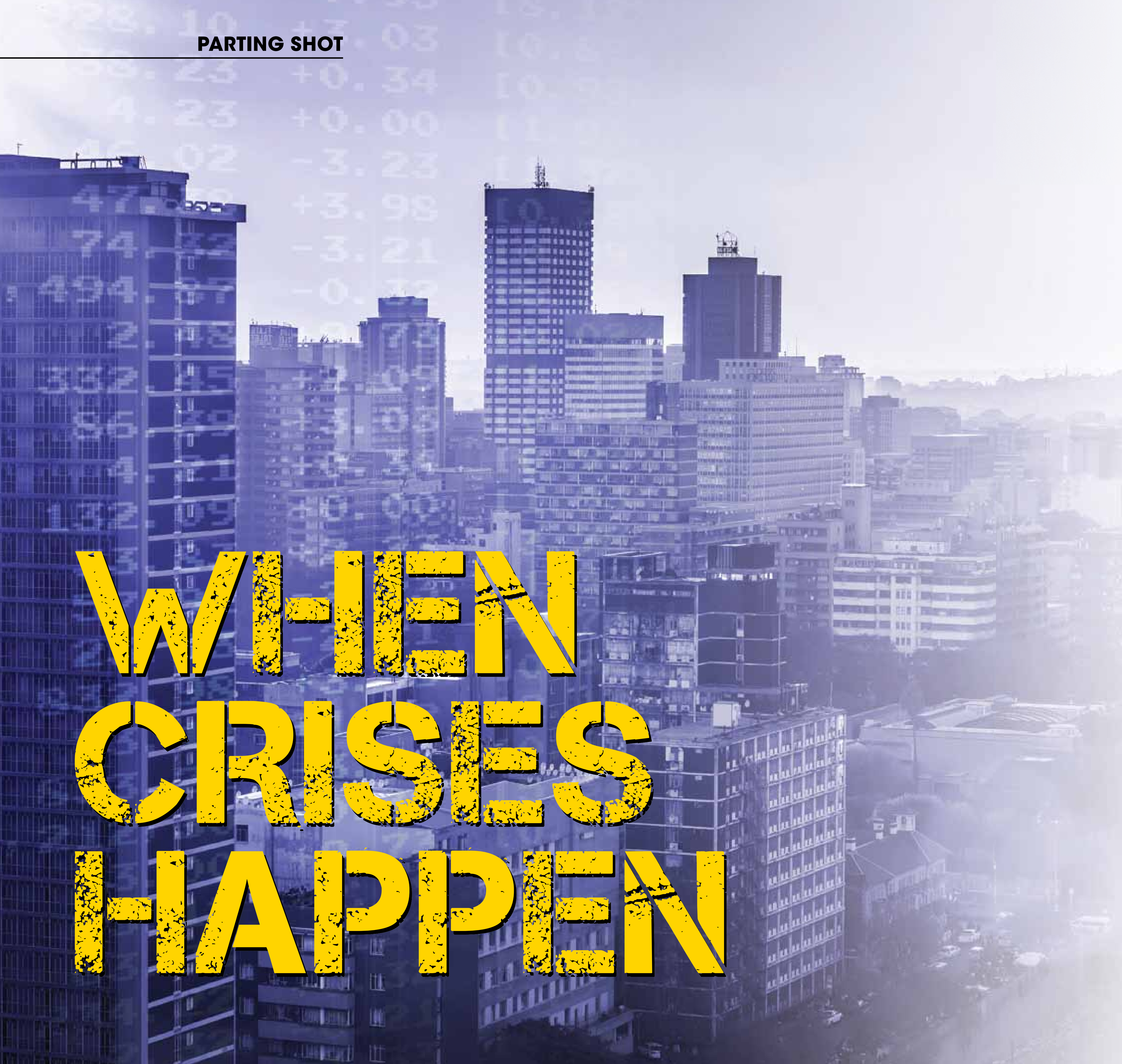

WHEN CRISES HAPPEN

Coronavirus and what we expect for global growth.

By Waqas Adenwala

The coronavirus pandemic presents a severe threat to global growth. Prior to the outbreak, global real GDP growth for 2020 was already expected to be lacklustre at 2.3 percent (at market exchange rates). However, the emergence of the epidemic in China and its rapid spread to the rest of the world is a game changer. It is expected to shrink the global economy by 2.2 percent, which is steeper than the contraction during the 2008 global financial crisis. The negative effect on growth will come via both demand and supply channels. Quarantine measures, illness, and negative consumer and business sentiment will suppress demand. At the same time, the closure of some factories and disruption to supply chains will create supply bottlenecks.

The hit for firms

The outbreak has created a direct spike in mortality rate and has prevented both patients and their carers from working. However, a bigger impact on labour output will probably come from the reluctance of employees to enter the workplace for fear of infection. This would have an obvious impact on labour-intensive manufacturing, but services companies could also be affected. Businesses will be forced to implement business continuity plans that may undermine efficiency. The use of public services globally will drop as people start to avoid crowded places.

The main concern will be how the viral outbreak affects consumer spending. Although the authorities aim to maintain public calm, there are already signs that panic has spread among the general public. This will weigh on consumer confidence and deter spending. Consequently, the fall in demand will cause firms to scale back their activities, which would result in higher unemployment as well. Downward shifts in local stock prices, resulting from the outbreak, would also have negative wealth effects. However, the presence of e-commerce means that consumers have platforms on which they can maintain their spending without having to visit brick-and-mortar establishments.

The government's top priority is to curb the spread of the virus. Aside from isolating those affected, it would probably continue to restrict people from travelling and/or curb goods being shipped from affected areas. This could lead to shortages of food, energy, and essential resources, and hinder critical business functions, although such forceful measures may have a better chance of bringing the economy back to normal more quickly.

There is a real risk of the global healthcare system not having sufficient resources to control the outbreak. This would mean that economic disruption could spiral down further and lead to higher healthcare costs. Consumers are already forced to cut their spending, especially on non-essential items, in order to afford treatment or to save money for contingency planning. For governments, rising expenditure on healthcare will also limit spending in other areas such as infrastructure.

The business sectors that will be hit the hardest are logistics, travel and tourism, as well as labour-intensive industries. Health- and life-insurance companies could see their costs go up, although in the long term they might benefit from increased awareness among the public about the benefits of purchasing insurance. More positively, pharmaceutical companies will see strengthened demand for vaccines and antibiotics. Potentially, there may be increased consumer spending on the Internet and communication services (including online entertainment and e-commerce platforms) and the electronic devices used to access them. The pandemic has also led to a surge in demand for services from firms like Netflix and Disney that are engaged in online streaming of content. While firms like Amazon are benefitting from higher demand for deliveries, the disruptions to supply chains have affected their delivery schedules.

Coping with the virus

Travel restrictions and other operational challenges will continue until the global emergency is brought under control. The most pressing concern for businesses is to assess the health of their employees. Businesses are likely to remain understaffed throughout the public health emergency; some employees may be stranded in severely affected areas owing to quarantine restrictions, and staff could also be stuck overseas owing to flight cancellations and disruptions to cross-border transportation.

Businesses need to revise budgets for 2020 as their previous assumptions about the economy are no longer valid. These adjustments should be communicated in a timely manner to investors and other stakeholders. Firms should stay alert to announcements of government stimulus and be ready to take advantage of the commercial opportunities they may create, such as subsidies for consumer goods purchases. In addition, firms will have to take into account their revised budgets for continued wage payments. To protect their business revenues during this difficult period, firms will have to take new initiatives. For instance, retailers that have been forced to close physical stores should more strongly embrace e-commerce, or firms should move into alternative business and product lines.

Companies may wish to put on hold their investment plans to ensure ample liquidity during this public health emergency. Domestic private firms, especially smaller companies, could be at risk of going out of business due to liquidity issues. Businesses may therefore aim to clear receivables as soon as possible and also be prepared for requests from business partners for extended credit. Companies may also consider sourcing alternative contractors, given the potential disruptions to domestic and international supply chains. This has especially been the case for manufacturers of medical devices as countries have imposed restrictions on their exports to prioritise domestic consumption. This has led to countries diverting existing resources to ramp up production of items such as hospital beds and hand sanitisers domestically.

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Policymakers face difficult choices

Policymakers throughout the world are now left with some difficult choices. In early March, the Federal Reserve (or Fed, the U.S. central bank) announced an emergency interest-rate cut in response to the economic threat posed by the coronavirus. This is the first emergency cut and the largest single rate cut that the Fed has made since the global financial crisis. Several other central banks across the world also followed suit. However, some major central banks such as the European Central Bank and the Bank of Japan are greatly constrained in their response to the coronavirus outbreak, as their headline interest rates are already below zero. The only realistic course of action for major central banks would be to offer a programme for small and medium-sized enterprises that are hit hard by the coronavirus crisis.

Monetary policy constraints and the difficulties of shaping a co-ordinated monetary response at the global level mean that fiscal stimulus might be the only option for many developed countries to support growth. However, this is not a given as a coordinated fiscal stimulus appears unlikely even in regions like Europe. The issue remains extremely contentious between countries advocating for stronger fiscal integration and those that are fiscally hawkish. In addition, the introduction of fiscal stimulus measures in Italy, which is hard hit by the coronavirus, would further worsen the country's public finances and increase the medium-term risk of a financial crisis. Meanwhile, Japan's public debt already stands at almost 230 percent of GDP, the highest ratio in the world. It is hard to imagine that it could go much higher without becoming a systemic threat to the global economy, all the more so if global growth slows sharply. Finally, in many other highly indebted developing countries, fiscal stimulus would only raise the risk of a debt crisis down the road.

Is Asia fit to cope?

The coronavirus outbreak is affecting every economy in Asia right now. In China, the real GDP growth is expected to stand at only 1 percent in 2020, down from an estimated 6.1 percent in 2019. The shock in the first quarter will lead to much slower growth in private consumption, as millions of Chinese limit their movement (and thus their spending), and there is a softening of investment spending amid forced factory closures. China's export growth will also slow down, owing to the impact of factory closures, and—most importantly for the rest of Asia—import demand will also be diminished.

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Economies like South Korea and Japan that have registered a large number of cases will feel the impact of containment measures—which will hold back growth, especially as Chinese import demand falls. There are two main channels through which Asian economies are likely to be affected by the outbreak. The first is weaker tourism inflows, primarily from China. Economies with large tourism sectors that attract a high proportion of Chinese tourists are Hong Kong, Taiwan, Thailand, South Korea, Singapore, Malaysia, and Sri Lanka. The second transmission mechanism is through disruption to industrial supply chains. The economies with the greatest exposure are Hong Kong, Taiwan, South Korea, the Philippines, and Thailand.

Looking ahead

As the coronavirus spreads to other parts of the world, and the number of reported cases rises globally, economic uncertainty will persist at least till the end of the second quarter of 2020, dampening business sentiment, household consumption of non-essential goods, and travel and tourism. The containment measures (quarantine, social distancing and border restrictions) taken to curb the spread of the virus will constrain growth. All this will weigh on corporate earnings and negatively impact job creation and unemployment. Countries with underdeveloped healthcare systems and fragile fiscal positions will suffer the most. Meanwhile, financial markets have already been spooked even as the risk of a crash looms over the world.

Once the outbreak is contained, factories and offices can reopen, and pent-up consumer and investment demand will provide some stability for growth. This should also result in stronger import demand, providing some relief for beleaguered businesses.

The reliance of the global economy has been put to the test, but we will see a bounce-back in activity, employment, and growth eventually. The million-dollar question is: When?

Waqas Adenwala
is Asia Analyst for the Economist Intelligence Unit

Reference
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