Coronavirus could hobble Chinese economy at a precarious moment

February 4 2020, by Stephen Roach

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This week, as the danger of the coronavirus outbreak in China became apparent, airlines suspended flights to the Chinese mainland and multinational companies shut down their activities there. We asked Stephen Roach, a senior fellow at the Yale Jackson Institute for Global Affairs and the former chairman of Morgan Stanley Asia, what the epidemic could mean for the economy in China and the rest of the world.

Has there already been an economic impact from the coronavirus and China's response to it?

The economic impact is only just starting to unfold right now. Just prior to the outbreak in Wuhan, the latest data on the Chinese economy —purchasing managers' sentiment reports for the full month of January—were actually quite stable. But now activity has been hit hard by the confluence of multi-city quarantines and travel (both domestic and foreign) restrictions. This comes at a particularly important time for China, the so-called Golden Week after the Chinese New Year, which is typically associated with a nationwide surge of retail activity and travel.

While it is exceedingly difficult to assess the magnitude of the near-term disruption to the Chinese economy, the SARS experience of early 2003—a more lethal strain of coronavirus (in terms of fatalities)—provides a useful template to assess the implications of the current outbreak. SARS hit the Chinese economy most acutely in the second and third quarters of 2003; the impacts of that epidemic knocked about two percentage points off the year-over-year growth in nominal GDP, with growth slowing from 13.4% in the second quarter of to 11.5% in the third quarter.

What is the potential long-term impact on the Chinese economy and the world economy?

As was the case some 17 years ago, the impact of any such virus-related disruption is likely to be temporary, followed by a sharp rebound. Once the SARS outbreak was contained, nominal GDP growth rebounded sharply, accelerating by about four percentage points over the subsequent four quarters to 15.3%.

However, the Chinese economy is growing far more slowly today than it was back then, making the near-term downside risks to economic growth far more worrisome as a result. With Chinese real GDP growth having slowed to 6% year-over-year in the fourth quarter of 2019 (and nominal

growth at 7.4%), a one-quarter SARs-like shortfall could push Chinese real GDP growth down into the 4% range during the first quarter of 2020.

With China accounting for about 20% of global GDP (measured by the IMF on a purchasing power parity basis), a two-percentage-point shortfall in annualized Chinese GDP growth could knock approximately 0.4 percentage points off annualized world GDP growth during the first and second quarters of 2020. For a global economy that has already slowed into the danger zone (2.9% world GDP growth in 2019 according to the IMF's January 20 update), the Wuhan coronavirus, together with its collateral impacts on neighboring countries, could heighten financial market fears of global recession.

What events and indicators would you be looking at in coming weeks to judge the severity of the impact?

Tracking the coronavirus disease itself is essential to get a sense of the breadth and depth of its impact. In terms of economic indicators, gauges of Chinese retail activity will be especially important to track—namely, retail sales, motor vehicles purchases, and consumer sentiment. But with many multinational companies reporting a virtual cessation of activity in their Chinese subsidiaries—Ford, Apple, Siemens, Honda, Peugeot-Citroen, McDonald's, and Disney, just to name a few—there are likely to be further downward pressures on already weakened global manufacturing, retail, entertainment, and travel sectors. Moreover, with China playing a key role at the center of many global supply chains, collateral damage on the industrial activity in other economies is likely to be significant—from East Asia to Latin America to Europe.

Hopefully, as was the case during the SARS-related disruption of 2003, once the virus is brought under control—as it most assuredly will

be—this will be a temporary disruption to the China and world economy, followed by a sharp post-virus rebound in the second half of 2020. But with China and the world on a far weaker footing than was the case back then, there may well be more downside risks to contend with today than was the case during a much frothier time in 2003.

Provided by Yale University

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