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Research Briefing | Global

Coronavirus: World economy faces a short, sharp shock

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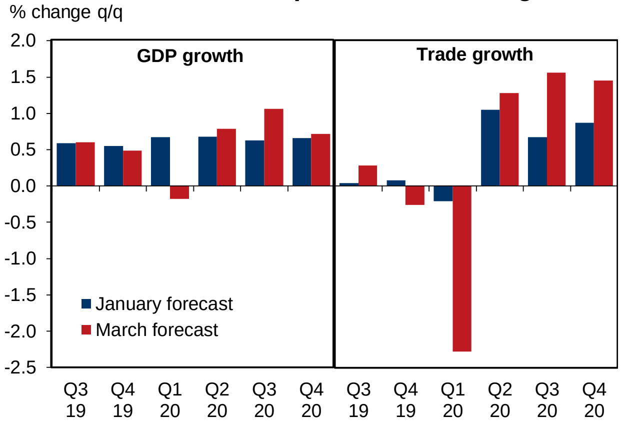
- **The world economy is facing a sharp downturn in Q1 due to the impact of the coronavirus. A dramatic slowdown in China plus the damage to demand as the virus spreads internationally point to world GDP contracting this quarter.**
- **The impact on trade looks set to be especially large. Reports indicate freight activity on some routes is down 20%-40% on normal levels and we think Chinese imports will be down around 12% in Q1 from the previous quarter. We estimate world trade might shrink by as much as 7% y/y in late Q1/early Q2.**
- **Our baseline forecasts assume a relatively rapid rebound in global growth from Q2 onwards, but even this will leave world growth for the year at only around 2%, easily the slowest pace in the last decade.**
- **Moreover, downside risks persist. The slump in equity markets over recent weeks could spark a tightening of financial conditions that amplifies and extends the downturn. And the spread of COVID-19 in Korea, Europe and the US will add to negative impacts on global demand and supply.**
- **These risks have already prompted a 50bp Fed rate cut, but unlike in previous downturns, policymakers have less scope to head-off risks to growth with monetary or fiscal easing. This time, a different agenda based on minimising the economic damage resulting from virus-related disruptions, may be needed.**

Evidence that the coronavirus is having a large impact on world growth is mounting. This will be reflected in our March global forecast, which will revise world growth down further. The steep slowdown in China plus the impact on demand as the virus spreads internationally are likely to see world GDP contract in Q1 2020 for the first time since Q1 2009. The effect on world trade looks set to be even more dramatic (**Figure 1**).

Figure 1: Coronavirus to exact a heavy toll on world growth in 2020



Source : Oxford Economics, data for March is preliminary

We now expect the coronavirus to lead to world GDP contracting in Q1 for the first time in a decade, before recovering from Q2 onwards. The impact on trade is likely to be larger still, as demand declines, supply is disrupted, and travel restrictions bite. Our March forecasts will be released on Friday March 6.

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The Chinese manufacturing PMI collapsed in February to 35.7, lower even than in the global financial crisis (**Figure 2**). With the non-manufacturing PMI also sliding dramatically, Chinese import growth is likely to slump in Q1 – possibly down around 12%. Industrial shutdowns will also slash exports, causing supply disruptions in other economies, while outbound tourism flows will also be dramatically lower.

Survey evidence for February suggests all this will add up to a sharp decline in world trade. Led by China, our export survey-based indicator for February dropped to the lowest level since April 2009. This level is historically consistent with world trade dropping by around 7% y/y in the coming months (**Figure 3**). The tentative upturn seen around the turn of 2020 appears to have been decisively snuffed out. Preliminary evidence from freight movements supports this view, with Chinese port movements reportedly down as much as 20%-40% and knock-on effects materialising in other routes, including between the US and Europe.

Chinese weakness is also showing up in the form of lower commodity demand (LNG imports in February were reportedly especially weak) and prices, both of which will be negatives for commodity-exporting EMs (with potentially additional negative knock-on effects on world trade as EM purchasing power is cut). Brent oil prices are down 25% from their peaks, industrial metals prices are down 10%.

Our forecast assumes world growth recovers quite quickly from Q2 onwards as the virus outbreaks come under control. Nevertheless, world growth for the whole of 2020 is set to be only about 2%, by far the weakest pace in the last decade.

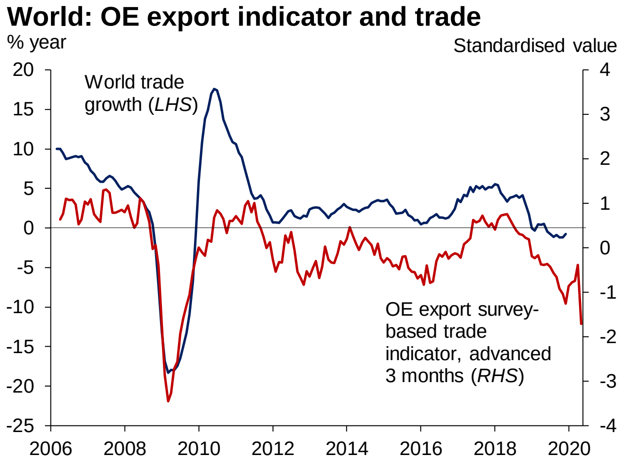
Moreover, downside risks to growth persist. Sliding equity prices, weaker corporate profits, and rising bad debts could lead banks to tighten lending conditions, amplifying the downturn. Historically, the double-digit slump in stocks since mid-February is consistent with US corporate credit standards tightening at a pace only seen during recessions (**Figure 4**). The rapid spread of the virus in Korea, the US, and Europe, also points to additional global demand and supply disruptions.

These risks have already prompted a Fed rate cut with more policy moves likely in the coming days. But unlike in previous downturns, the scope to head off risks with pre-emptive monetary or fiscal easing is narrower. A different policy agenda based on minimising the economic damage from virus-related disruption may be needed.

Figure 2: Collapse in Chinese PMI presages a slump in imports

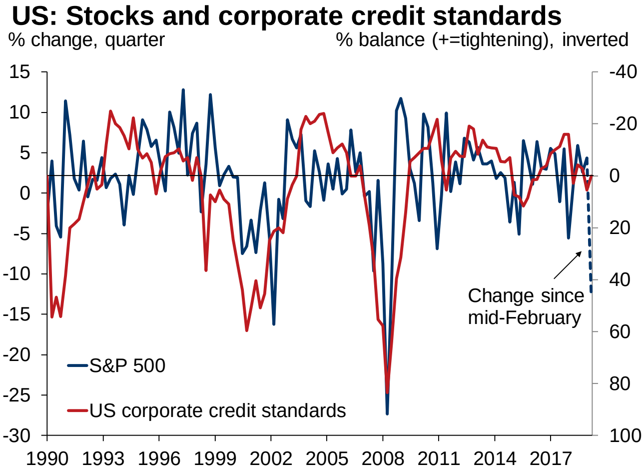
Source : Oxford Economics/Haver Analytics

Figure 3: Surveys suggest world trade growth to slide sharply in the coming months



Source : Oxford Economics/Haver Analytics/Netherlands CPB

Figure 4: Tightening financial conditions could amplify the downturn



Source : Oxford Economics/Haver Analytics

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