THE CONFERENCE BOARD

Coronavirus Crisis: Assessing Economic Impacts

Businesses are deeply concerned with how the Novel Coronavirus (COVID-19) crisis will impact the economy in China, Asia and globally. Given the fast-moving nature of developments at this juncture, forming a full and conclusive narrative is not yet possible, and indeed could lead to miscalculation. With this in mind, and in first instance, we've assembled a set of premises and observations to inform member business planning on a preliminary basis. We will continually refine and detail our analysis, and consolidate an overall view, as key "gating factors" pan out in coming several weeks, in particular:

- Trends with infection and morbidity rates in the Wuhan/Hubei epicenter. Data availability and analytics appear to be improving.
- Spread rates to the rest of China as a function of the mass return of travelers from Chinese New Year holiday. This "migration" began late last week. Outcomes should become evident over the next 2-4 weeks.
- Worker return, business restart and capacity ramp-up rates. Data availability in these areas is weak. Anecdotal and case material will be necessary for situation assessment and may vary considerably by location and industry.

In this note, we start with remarks about implications for China's economy.

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Initial Observations and Premises

1. **China's economy is taking a significant hit from the COVID-19 outbreak**. Assuming the outbreak is contained by the end of Q1 2020, we estimate that Q1 2020 growth will slow by approximately 20 to 25 percent from the Q4 2019 rate. Using official GDP numbers as a baseline, Q1 2020 growth is likely to drop to a range between 4.5 percent to 4.8 percent, down from the reported 6 percent in Q4 2019.

2. **If the outbreak can be contained by the end of Q1, as some public health experts estimate, the economic impact is likely to be intense but temporary – mostly limited to Q1 2020**. Based on this scenario, the growth slump in Q1 should be followed by a recovery starting in late Q2 which will extend into Q3, similar to the pattern observed with SARS in 2003, but featuring a much more moderate recovery (explained below) (see Chart 1).

   In this scenario, official GDP growth in 2020 is anticipated to be 5.5 percent, compared to 6.1 percent in 2019. Most institutes assessing the economic impact of the outbreak consider containment in Q1 as the base case scenario (see table on page 6). A reportedly declining number of new infections in China outside of Hubei Province suggests a high probability of this scenario (see Chart 2), assuming the reported data are accurate.

   **Based on the SARS experience, even in a Q1-peak scenario which includes a reasonably strong Q2 rebound in growth, business conditions for most multinational firms in China will not likely return to pre-crisis trend conditions until early summer at the earliest. In the SARS case, executives we've spoken to reported a 3 to 6 month normalization period, post-peak and once remission was clearly in progress, depending on whether one's sector is leading or lagging in the business cycle.

3. **Even in a Q1-peak scenario, the impact of COVID-19 on the Chinese economy will be greater than the impact of SARS**. This is the case for two main reasons:

   a. The quarantine, travel restrictions, and transportation stoppage measures taken by the Chinese government to prevent the spread of COVID-19 are significantly more restrictive than those taken in 2003 for SARS.

   b. China's services sector – the most vulnerable sector in such a crisis as a function of its high labor content and human interaction intensity – now accounts for a larger share of the total Chinese economy (54 percent in 2019 vs. 42 percent in 2003).

4. **If, in the coming several weeks, the virus continues to spread quickly beyond Hubei, the impacts will become much more significant and long-lasting**. With upwards of 300 million migrant workers and office staff now returning from Chinese New Year holiday to large cities for work, the coming two weeks is a critical gating factor. Given that the COVID-19 incubation period is up to 14 days (or perhaps evening longer), an accurate reading on transmission status is still several weeks away.

If transmission does not peak this quarter but projects out into Q2, then the time-to-restoration of normal production and operations will, of course, be further postponed. In addition to having a much greater impact on China's domestic economy, the likelihood of broader contagion across the rest of the world and innumerable global supply chain impacts will both come into play. Already, supply chain impacts associated are being reported in auto parts, electronics and generic pharmaceuticals – all sectors with significant dependencies on Chinese suppliers (and where major supply chain resources are based in Wuhan).

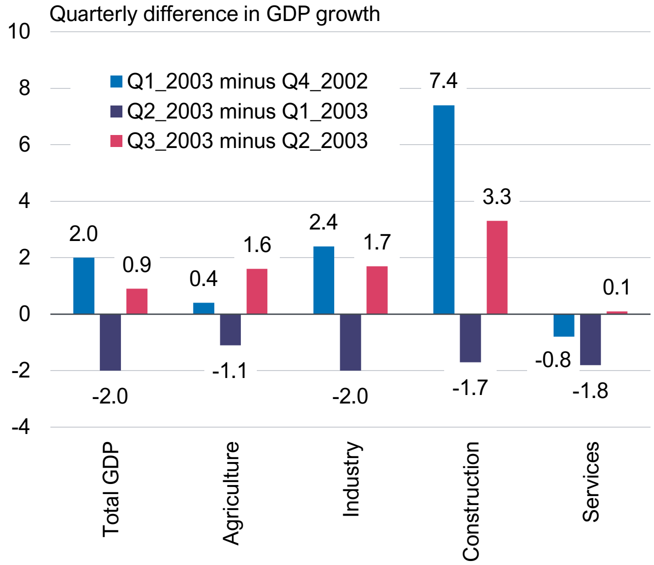
Supply chain impacts notwithstanding, significant global growth depends on Chinese consumption. In order of magnitude, if China's GDP growth in 2020 slows by one third from its 2019 rate, this would bring our estimate for 2020 global growth down to 2.1 percent, compared with 2.4 percent global growth for 2020 in our baseline scenario.

5. **As long as current, extensive travel restrictions and quarantine policies continue, offline services – including retail, catering, tourism, hospitality, transportation, and education and entertainment services – will suffer the most**. However, the SARS experience of 2003 suggests that these sectors should rebound post crisis, possibly strongly. (see chart 3).

   This said, a large number of small and medium-sized enterprises (SMEs) operate in these services segments. Government measures to cushion the shock – including loan payment deferments, social security contribution deferments, tax payment deferments, emergency credit facilities, etc. – may be insufficient to prevent the widespread bankruptcy of SMEs, most of whom probably don't have many months of operating cash on hand.

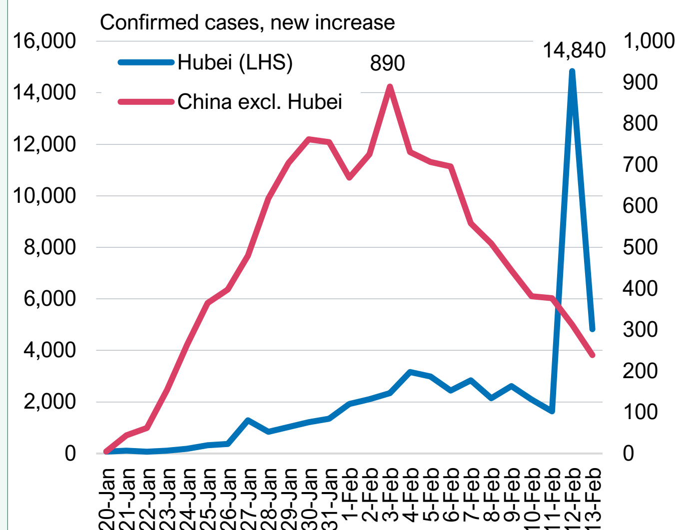
   It is highly uncertain whether the aforementioned government measures will effectively transmit to private SMEs. Well before the COVID-19 crisis, strong directives from the central leadership for state banks to increase lending to SMEs have largely fallen flat. If the virus outbreak continues into Q2 2020 and significant travel restrictions remain in place, the cash-flows for many SME services firms will inevitably be crushed. Defaults on loans and commercial payments will surge, as will layoffs. This will weigh on consumption which will in turn hurt goods manufacturers. If bankruptcies become widespread, recovery will necessarily take much longer. Recent research of The Conference Board demonstrates that these services-sector SMEs are currently the primary driver of urban employment growth in China (see China Labor Market Quarterly Update: Q4 2018 in Review)

CHART 1: In 2003, SARS saw growth plummet in Q2 (peak) followed by a strong rebound in Q3 in most sectors



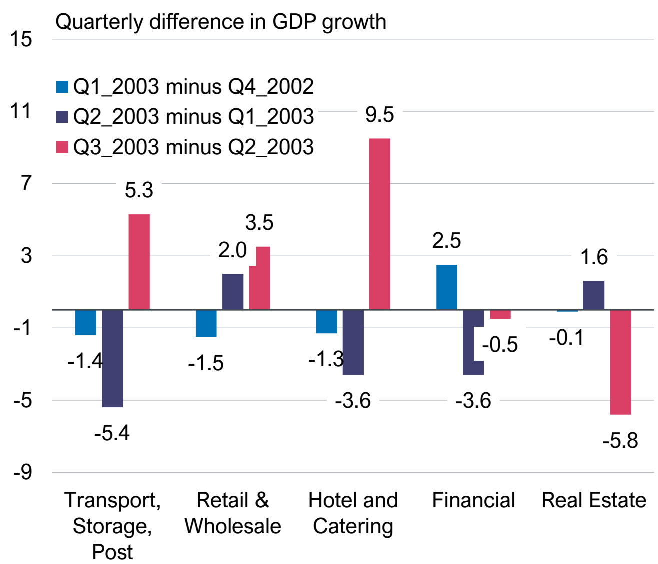
Sources: NBS, CEIC, The Conference Board

CHART 2: The number of newly confirmed cases is declining in China other than Hubei



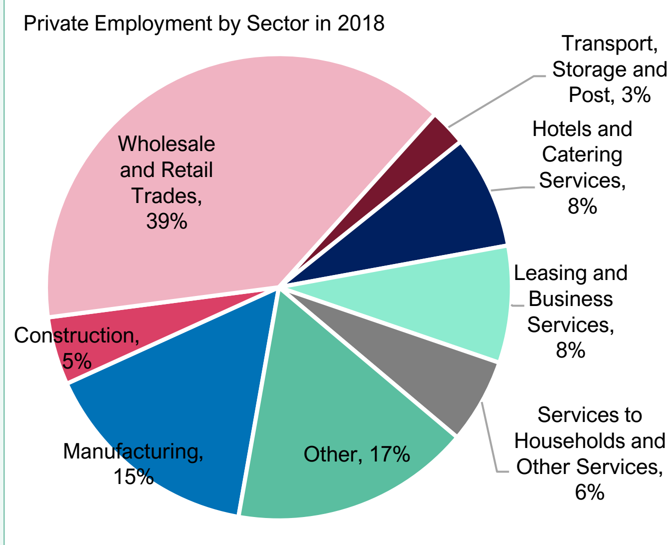
Note: Data as of February 14, 10 am. The sharp increase in the new cases confirmed in Hubei is due to a switch in counting methodology on February 12.
Sources: National Health Commission, Wind, The Conference Board

CHART 3: Retrospective – 2003 SARS impact on selected service industries



Sources: NBS, CEIC, The Conference Board

CHART 4: Private Employment Concentrated in Services



Note: Private sector refers to private enterprises and self-employed individuals.
Sources: NBS, WIND, The Conference Board

6. **The impact of COVID-19 on retail sales will be significant**. For SARS in 2003, the retail categories hit hardest included recreational goods, office goods and luxury goods. The impact on clothing, furniture and home appliances then was less because most spending in these categories was delayed, not canceled. On the other hand, a few categories saw resilient growth, even during the outbreak period, including food and beverage, medicine and daily necessities.

   The currently circulating, investor-community narrative that ecommerce sales in China are booming due to crisis impacts on offline shopping should be viewed with suspicion. For necessity goods, YES to some extent, provided the goods are available and deliverable (i.e. amidst severe disruptions to delivery networks). For non-necessity goods, the available data are conspicuously weak.

7. **The drag on industrial production will extend to Q2 2020, even if the spread of the virus is contained in Q1**. The reduction of working days in February, and the reduced availability of labor in certain regions, will show up in lower Q1 industrial production numbers. Factors including inventory buildups, weak order books, and temporary shortages of input materials (due to slowdowns in imports and domestic transportation bottlenecks) will probably drag on industrial production into Q2.

8. **The post SARS bounce that occurred in 2003 will be more moderate this time around**. Unlike the situation in 2003, China's economy is currently amidst a decelerating cycle as well as a structural downshift. The growth recovery following SARS in 2H 2003 was particularly strong because the Chinese economy was then on an accelerating growth trend. China joined the WTO in November 2001, leading to a 35 percent surge in export growth in 2003. Meanwhile, the housing market boom was underway, and in its early stage. Today, exports are under pressure and the housing market has arguably peaked. These underlying structural features will necessarily limit the velocity of the recovery post COVID-19.

9. **Pro-growth policy measures to counter economic shock are widely anticipated, but the scale is likely to be less than expected**. In 2003, the government offered tax breaks, subsidies and credit support to the sectors hit hardest by SARS. Similar measures are anticipated in response to COVID-19. However, the government faces significantly more fiscal pressure now, especially at the local government level, and the larger size of the Chinese economy necessarily requires much larger outlays for stimulus to have impact. The stimulus measures are likely to be both restrained and targeted. Simply put, the Chinese government does not have unlimited funding capacity and cannot afford the scale of stimulus that would revive growth. The best it can do is provide cushion to prevent over-slowing.

10. **The crisis will exert downward pressure on the RMB in the short-term**. The disruption in economic growth and weak business confidence will both weigh on the RMB. Some depreciation is highly likely.

11. **The Chinese labor market is more exposed to COVID-19 than it was with SARS**. SME employment now accounts for a larger share of the labor pool than it did in 2003, and, as mentioned above, these firms are more likely to suffer wage cuts, furloughs and layoffs due to business stoppage (see chart 4). If the outbreak cannot be contained in Q1, a large number of private enterprises will likely be forced to permanently close. This would yield significant labor market distress.

12. **Negative trade impacts are likely to manifest quickest and hardest in Asia**. China-Asia trade, investment and tourism are all vulnerable to COVID-19 impacts. Manufacturing value chain disruption is a high risk for Taiwan, Malaysia, Vietnam, and the Philippines. Indonesia and Australia are highly exposed on the commodity front. Thailand and Hong Kong are highly sensitive to Chinese tourism – Singapore too, but to a lesser extent. Many Asian countries have important, large-scale BRI projects in-the-works that could suffer delays or postponements; financing arrangements are prone to unravelling if uncertainties are prolonged. Health concerns related imported Chinese laborers on BRI projects will also be a factor. On the global level, supply chain disruptions are likely across the gamut of intermediate and consumer goods produced in China, from electronics to housewares and sundries. BP recently warned that coronavirus impact could hit global oil demand growth by 40 percent this year.

Selected Institutional Views Currently in the Public Domain

Institution / Organization	Base Case Scenario	Optimistic Scenario	Pessimistic Scenario
Morgan Stanley (Jan 29)	If the virus peaks in Feb or Mar, Q1 growth in China could cut by 0.5 to 1 percentage point		If the virus peaks in three to four months, 1H could be dragged down by 0.6 to 1.1 percentage points
JPMorgan (Jan 29)	Q1 growth revised to 4.9% from 6.3%; 2020 growth down 01.3% to 5.8%		
Citigroup (Jan 30)	Q1 growth slow to 4.8% yoy, and 2019 growth slow to 5.5% yoy		
Nomura (Jan 30)	Q1 growth would be 2 percentage point lower than 6% in Q4 2019		
IHS Markit (Jan 30)	China's growth in 2020 could be reduced by 1.1% from current baseline forecast of 5.8%		
Economist Intelligence Unit (EIU) (Feb 3)	If virus contained by Mar, China's growth at 5.4% in 2020 (4.1% in Q1) and 6.4% in 2021	If virus contained by Feb, China's growth at 5.7% in 2020	If virus contained by Jun, China's growth at 4.5% in 2020
S&P Global (Feb 6)	If virus contained by Mar, China's growth at 5.0% in 2020, and 6.4% in 2021	If virus contained by Feb, China's growth at 5.5% in 2020 and 6.0% in 2021	If virus contained by Apr, China's growth at 4.4% in 2020 and 6.8% in 2021
UBS (Feb 7)	2020 growth forecast revised down from 6% to 5.4%; Global GDP growth forecast for 2020 from 3.1% to 2.9%, then rebound to 3.7% in 2021		

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