The impact of the new coronavirus in the global economy

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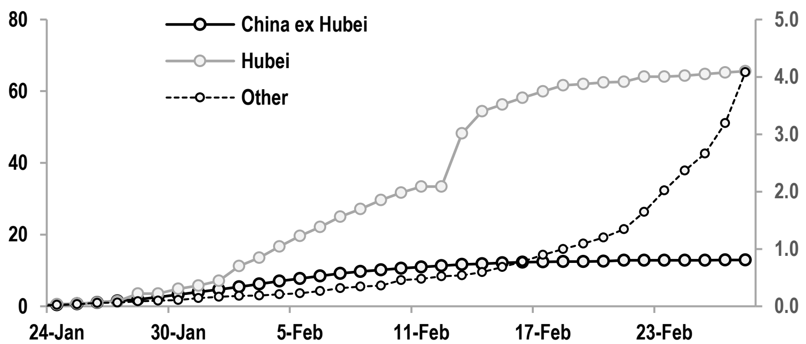
- **The World Health Organization has warned about the risks of a pandemic due to the outbreak of the *coronavirus* known as COV-19**
- **Risk aversion in markets has increased significantly on the back of spread of the virus to countries like Italy**
- **It is still too early to assess the dimension of the impact on global growth, as it depends on how long it takes to contain the epidemic**
- **Nonetheless, we do not rule out that the COV-19 could eventually result in a strong slowdown in activity, bringing the global economy close to a recession scenario**
- **In a scenario where the epidemic is contained before the end of 1Q20, we expect global growth in the area of 2.8% vs. 3.1% before this shock**

COVID-19, about to become a pandemic. The outbreak of a new coronavirus known as the COVID-19, which began in December in Wuhan -capital of the province of Hubei in China-, is in what the *World Health Organization* (WHO) qualifies as phase 5 of a pandemic (of six in total), which means that the transmission of the virus among humans has taken place in at least two countries of the WHO region, with the imminent risk of spreading to a greater number of countries in the world. As of February 27, the disease monitoring carried out by *Johns Hopkins University* reports 82,581 confirmed cases, in about 61 countries. It is worth mentioning that 95% of these cases are concentrated in China, specifically in the province of Hubei (79.4% of confirmed cases). Although the number of daily cases in China has declined in the last few week (from 927 a day on average to just 390), the WHO is still on alert as confirmed cases in other regions of the world have exponentially increased from 145 on a daily basis last week to 487 on average during this week, as shown in the chart below.

Daily increase
Thousand cases, 3-day average



Source: Jonhs Hopkins University

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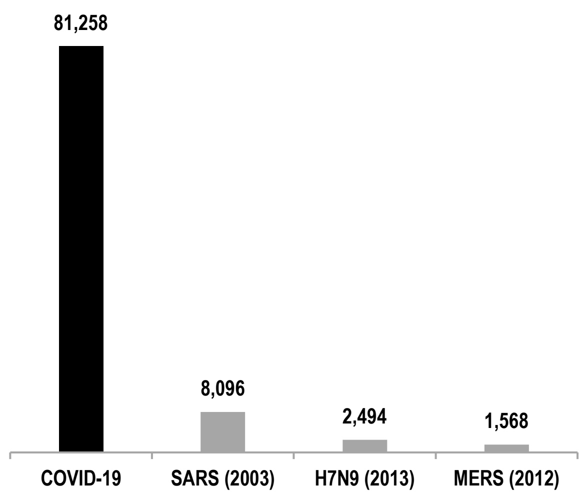
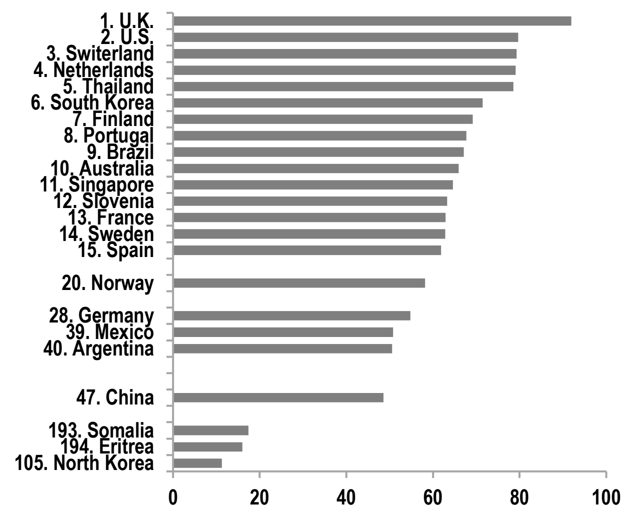
Confirmed cases are now higher than those of other *coronavirus* epidemics, although with a lower mortality rate. It is important to mention that the number of cases already far exceeds other epidemics caused by a *coronavirus* (see chart below on the left). Nevertheless, the mortality of COVID-19 seems to be lower than that of the three previous cases, with a rate of 3.4% of the total confirmed cases (1.7% excluding China) vs. 9.6% in the case of SARS, for example. In this context, although the symptoms of the disease resemble those of a common cold, in some cases, the virus can affect the lungs, so the patient must take special care in intensive care beds. In addition to the possible shortage of these kind of beds, WHO authorities are concerned on the level of preparation of some countries to deal with a health emergency of this type (see chart below on the right).

Confirmed cases in *coronavirus* epidemics
\# of cases



Source: Johns Hopkins University and Centers for Disease, control and prevention

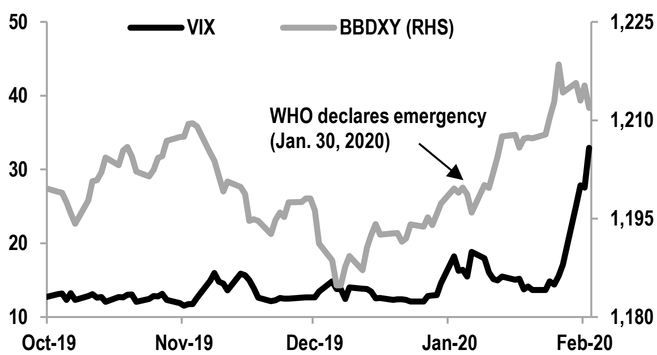
Rapid response to and mitigation of the spread of an epidemic*
Score over 100



Source: 2019 Global Health Security Index. *Selected countries

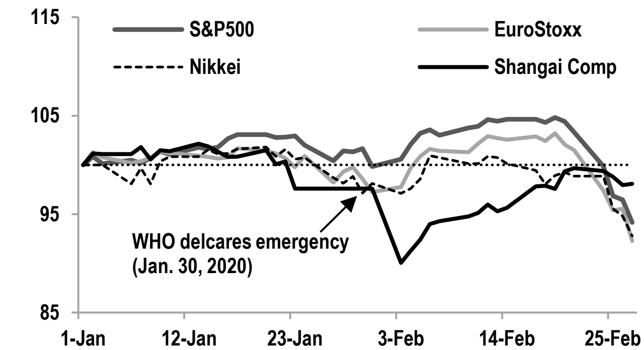
Risk aversion heightens in global financial markets. When the virus was concentrated only in the Hubei region, markets were relatively concerned about the consequences of the disease on global growth figures. Nevertheless, as the epidemic has spread to more and more regions in the world, risk aversion has increased significantly. As can be seen in the chart below on the left, the US dollar has been appreciating vs. other currencies, while volatility indices have jumped. In this context, stock markets have erased year-to-date gains and are now on negative territory (see chart below on the right). In the case of commodities, prices have also headed south both in terms of futures and of the shares of companies in the industrial sector, such as copper or iron, as well as in the energy sector, while gold prices have, in turn, increased in line with risk aversion levels.

VIX and BBDXY
Index



Source: Bloomberg

Stock markets
Index, base Jan 1, 2020=100



Source: Bloomberg

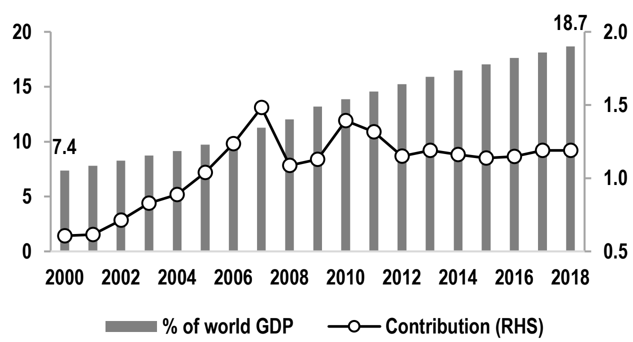
Could the *coronavirus* be the trigger the next global recession? At the beginning of this year, our forecast for global growth expected an expansion very similar to the one observed last year, on the back of a slowdown in the case of China and the U.S., which was going to be partially offset by the expected expansion in some emerging countries such as Brazil or Mexico. The balance of risks to this scenario was on the downside as a result of uncertainty generated by different geopolitical risks, including the elections in the United States (see note from our *Economic Analysis and Financial Market Strategy team*: "*1Q20 Outlook – Geopolitics to continue shaking the already fragile growth dynamics*"<here>).

In fact, a shock like the COV-19 is one of the factors that increased the probability of a global recession taking place earlier than expected. In our view, a recession is coming as early as 2021 on the back of a combination of several factors related to global trade, social and political tensions, a relatively weak outlook for investment, lack of innovation, among others see note, only available in Spanish: "*Recesión Global 2021"* <here>). In this context, we consider that the economy is in a much more vulnerable state than in 2002 as it has been expanding for a long period of time, private investment has not picked up significantly over this period and there is not much room to implement more monetary stimulus as interest rates at a global level are already at historically low levels (*G20 2020 Key Takeaways*" <here>).

In our opinion, it is still to soon to assess the depth of the slowdown. The disruption to the daily routine is already evident, especially in the regions where the strongest outbreaks have occurred. In the region of Hubei, and in China in general, manufacturing centers have suspended operations, while in other regions of the world massive events have been canceled, such as the *Mobile World Congress in Barcelona*. In this context, they are even at risk of canceling the celebration of the *Tokyo 2020 Olympic Games*, as well as the IMF / World Bank spring meetings in Washington.

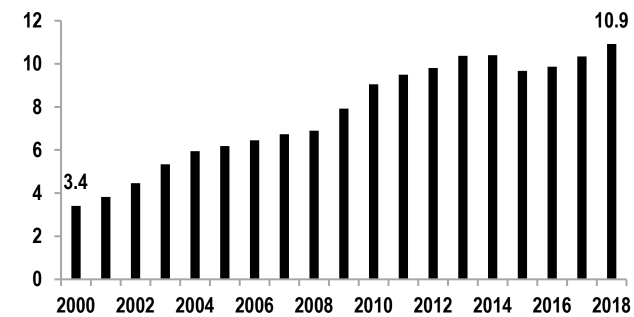
Estimates based on the possible impact on China's economy. The assessment of the impact of the *coronavirus* on 2020 global growth is based primarily on the impact on China's economic activity and based on the experience of the SARS epidemic, although adjusting it for the current weight of the Chinese economy. In this context, China's GDP is now about 18.7% of the global economy, contributing with a point of the three that has grown on average global GDP in recent years (see chart below left) vs. 8.7% in 2003. Additionally, China's share of global imports has increased from 3.4% in 2000 to 10.9% in 2018 (chart below right).

China's participation in world's GDP
% total



Source: IMF

China's imports as a share of global imports
% total



Source: IMF and trademaps.org

The role of China in global production chains should also be factored in. According to the consulting firm *Dun & Bradstreet*, about 51,000 companies have at least one intermediary in China, while five million use inputs from this country, being key in the production chain of some industries. Examples of this are the components used for televisions or smartphones, as shown in the following table. So far, since we still don't have official data, bottlenecks are anecdotal, although they are expected to have a negative impact on the growth figures of their main trading partners, as is the case in Southeast Asian countries.

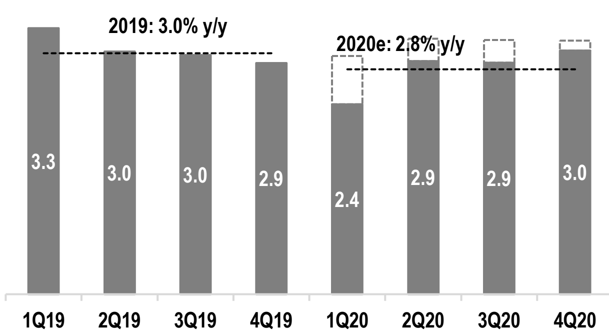
China's weight in global production chains
% total

	2019	2002	Δ%-pts
GDP	**18.7**	**8.3**	**+10.4**
Crude oil consumption	13.5	6.6	+6.9
Steel consumption	47.5	22.6	+24.9
Copper consumption	53.3	17.8	+35.5
Iron ore consumption	57.3	16.5	+40.8
Nickel consumption	53.3	7.2	+46.1
Zinc consumption	48.4	21.0	+27.4
Sales of semiconductors	34.6	5.0	+29.6
Sales of mobile phones	29.2	11.2	+18.0
Sales of computers	20.0	2.4	+17.6
Car sales	34.5	7.3	+27.2

Source: Bloomberg

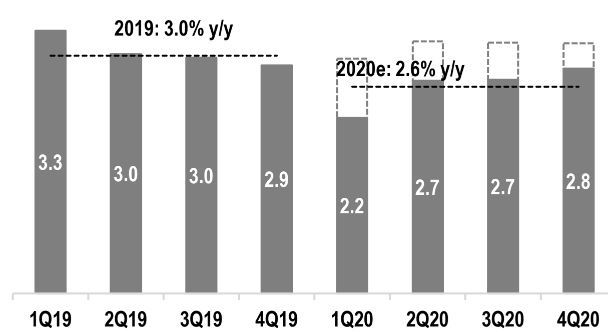
Finally, the overall impact on the global economy will depend on how long it takes to control the pandemic. If it is contained before the end of the first quarter (baseline scenario), we believe that the greatest impact would be reflected in China's figures, where a strong slowdown could be observed in 1Q20 to gradually converge to growth rates of 6% towards the end of the year. In this scenario, contagion to the rest of the economies would be negligible, although only the slowdown in China's economy would subtract 0.3% -pts from our initial estimate for this year's global growth. In a more negative scenario, in which the pandemic is taken under control until the end of the second quarter of the year, the negative impact on China's economy would be larger with spillover being significant to other regions. Under this scenario, China's economy would grow at rates below 5% while the global economy would slowdown to rates of expansion in the area of 2.6% from 3% in 2019. In both cases, it is important to note that our estimates assume an almost immediate recovery of the levels of activity in China, in line with the 'V' recovery expected by consensus. However, one of the downside risks that we already foresaw was that the recovery could be in the shape of an 'L', especially because companies that do not anticipate much growth in the near future, could '*take advantage*' of this external shock to stop investing and then the global economy sees a much slower recovery than initially expected.

Global growth forecast - Baseline
% y/y



Source: Banorte with data from IMF and Bloomberg

Global growth forecast - Negative
% y/y



Source: Banorte with data from IMF and Bloomberg

How should policy makers react? Although most of the central banks are already in easing mode, space to continue lowering rates in case of a stronger shock than expected is limited. At this point, it becomes very important that fiscal policy -mainly aimed at promoting infrastructure projects-, 'accompanies' monetary policy in order to stimulate the global economy, an issue that has been discussed already for some time in different international forums, as is the case of the G20 mentioned above.

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