Premium Coronavirus Impact Tracker

Assessing implications for economies, sectors and markets

27 March 2020

Grant Colquhoun and James O'Rourke

CAPITAL ECONOMICS

Developments and implications summary – 27th March

Overview	■ China remains on the path to emerge from the crisis first, although the path for other Asian countries appears more uncertain than last week. Europe remains in lockdown, with the United States (in many states) and the United Kingdom enacting similar measures. ■ Declines in the global economy in the first half of the year could be even more severe than our already deeply negative forecasts.
Sectors	■ The service sector appears to have seen the greatest hit to activity so far. In some countries, sectors such as restaurants and cinemas have shutdown and will remain that way until containment measures ease. ■ The hit to activity is spreading to manufacturing and will deepen if global trade contracts by one fifth this year, as we expect.
Markets	■ There has been some signs that the latest stimulus measures have caused the tightening of financial conditions to level off at levels below those seen during the global financial crisis. ■ Inflation expectations in the short term have come down considerably, although they too have bounced off lows in recent days. We expect negative rates of inflation to be mainly the result of lower oil prices.
Recovery path	■ We expect the recovery to be led firstly by China in the second quarter, and by the United States and the euro-zone in subsequent quarters, although risks remain globally as demand falters. ■ The longer term path for the economy remains contingent on sufficient government support, bond market tolerance or higher debt, the return of "animal spirits" and avoidance of renewed outbreaks of the virus.
Forecasts	■ The rapidly evolving global situation means a much greater degree of uncertainty than usual is attached to any forecasts. Our latest forecast is for the global economy to shrink by around 3.0 per cent this year. ■ We are assuming a rise of 7.5 per cent in output in 2021, returning the economy towards its pre-crisis path.

Developments and implications summary – 27th March

Asia

- Chinese activity continues on its recovery path, with industry on track to return to 2019 levels in mid-to-late April.
- Although granular indicators point to recovery in China, global demand is likely to drag down any recovery.
- Newly reported cases in Asia remain low, but risks are building in Japan and Singapore, among other countries. New infections from abroad have led China to ban nearly all foreign travellers from Friday at midnight.

Europe

- Restrictions on movement and interaction are being extended. We still assume the lockdown continues until the end of June.
- There are tentative signs that newly reported cases in Italy may be plateauing, but other countries such as Spain continue to see growth in new cases accelerate.
- Weakness in Europe has been evidenced by the service sector, although there are signs that this will extend to manufacturing, as investment is curtailed and as global demand wanes.

Americas

- A wave of new reported cases in the United States has pushed it to the top of the rankings of total reported infections. Roughly a third of the population is now under ‘stay at home’ orders.
- Early macroeconomic indicators have suggested that unemployment will rise sharply to levels even beyond those seen during the Global Financial Crisis going forward.
- Given the surge in new cases and the associated curbs on activity, we have revised down our forecast for growth in 2020 to a contraction of five per cent.

Coronavirus tracker: Lockdowns extended in Europe and some introduced elsewhere

	New confirmed cases	Latest virus containment policy developments
Asia		
China		Outbound travel restrictions in Hubei eased. Virtually all foreign visitors to China banned from Friday at midnight.
Korea		No new policy developments in last week.
Japan		2020 Tokyo Olympics postponed by one year. Tokyo residents asked to stay at home this weekend.
Singapore		No new policy developments in last week.
India		Nationwide lockdown imposed for three weeks.
Europe		
Germany		Strict social distancing measures introduced.
France		Lockdown measures toughened.
Italy		Lockdown to be extended past 3 April.
Spain		Lockdown extended to 11 April.
Poland		Limit on people taking part in masses. Presidential election to go ahead on 10 May.
United Kingdom		Lockdown introduced until 13 April.
Americas		
United States		Additional states including New York under 'stay at home' orders, totalling roughly one third of population.
Mexico		Mexico City mayor closes museums, nightclubs and gyms. Events with over 50 people banned in the city.
Brazil		Sao Paolo begins two week lockdown.

Improving / Less restrictive

Worsening / More restrictive

The United States overtakes China with most confirmed cases, but Asian risks remain

Cases in Europe and now the United States continue to mount

- The United States has joined Europe as the epicentre of the coronavirus outbreak, with cases increasing rapidly over the course of the last week. Today's figures from Johns Hopkins place the United States at the top of global case numbers, with China in second and Italy in third. (See chart.)

Initial signs that European lockdown may be working

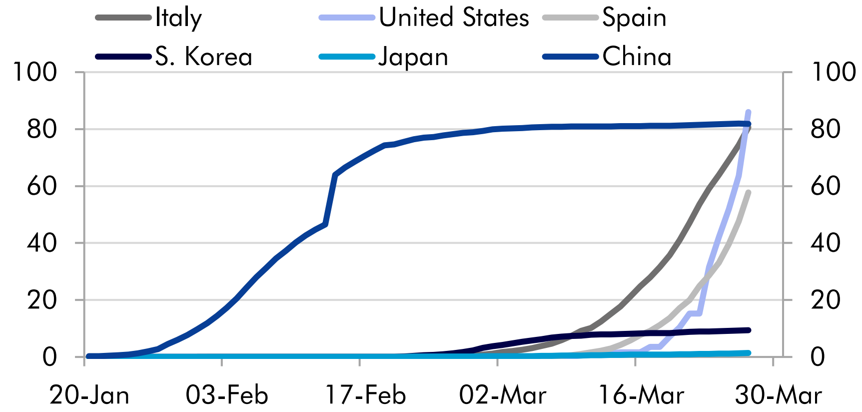
- There are tentative signs in Italy that the lockdown may be working, with new reported daily cases of coronavirus stalling over the last few days, in line with the number of new deaths reported. Other European countries such as Spain, however, are not seeing similar results, and daily new cases there have overtaken those in Italy.

New Asian cases low, but risks remain

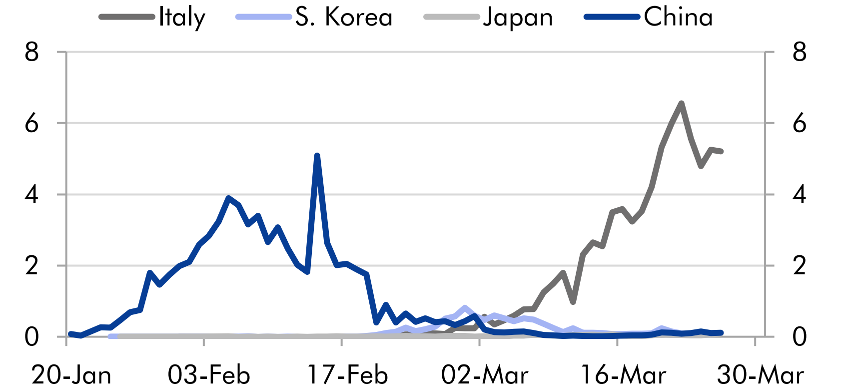
- New daily reported cases in east Asia remain low, as effective measures to deal with the virus continue. In Japan and Singapore however, cases are beginning to inch up. The governor of Tokyo asked residents to stay at home this coming weekend 'at all costs', in a sign that the outbreak may not be fully under control.

- In China, although domestic new cases remain near zero, cases from those returning abroad have risen slightly. In response, the country has decided to ban foreign arrivals with few exceptions, starting on Friday at midnight.

Latest total confirmed cases, thousands, selected countries



New reported daily cases of coronavirus, thousands, selected countries



Sources: Capital Economics and Refinitiv

Chinese activity continues to recover, but drags on demand expected going forward

Indicators suggest recovery is continuing in China

- The latest indicators show that the economic recovery is ongoing in mainland China. Although indicators are yet to reach their 2019 levels, there are encouraging signs of progress. China is, for example, beginning to ease travel restrictions in Hubei province, due to take effect in early April. (See chart.)

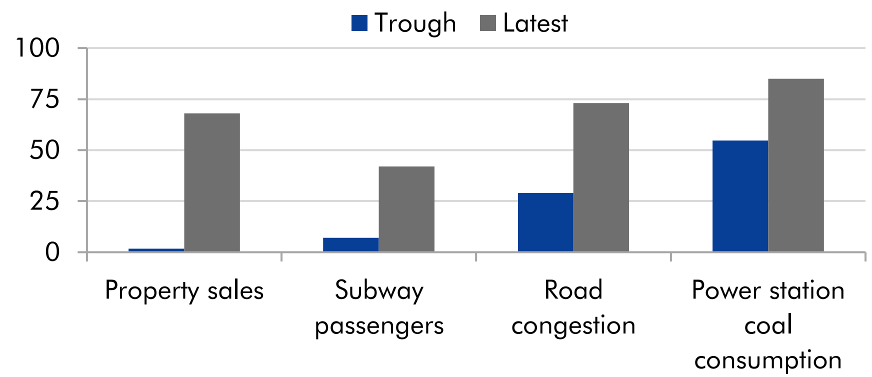
Current trajectory suggests 'normality' in mid-to-late April

- On the current trajectory of recovery in China, we expect most indicators to be back to 2019 average levels by middle to late April. However, this return to normality will vary by sector, with heavy industry expected to return earlier than other indicators, whilst road congestion and subway passengers will be later. Some indicators, such as the net flow of people leaving large cities, may take longer still.

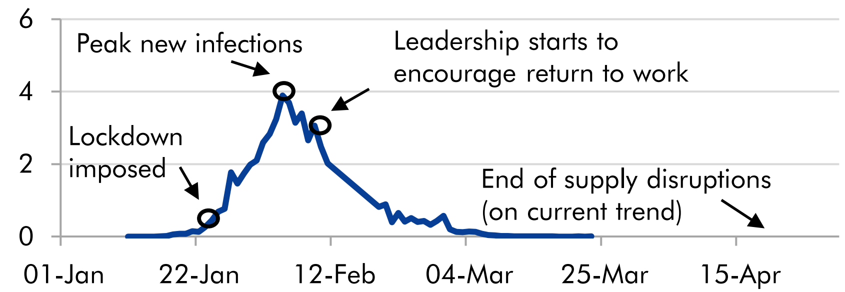
Drags on demand to last longer with global demand falling

- We expect drags on demand to last longer. Both consumers and firms are likely to remain cautious as long as fear of infection lingers. The accelerating downturn and spread of infections globally mean both that export demand is collapsing and that the government and the public in China won't be able to relax, even if domestic infections remain contained.
- Many are now looking to China to provide a guide to the speed at which downturns elsewhere will be reversed. The two-month lag between the leadership signalling that economic conditions should return to normal and our earliest estimate for when supply-side disruption could ease in mid-April suggests that other countries should plan for a drawn-out recovery.

Economic activity in China relative to 2019, percentage of 2019 activity level



New confirmed infection in China (excluding arrivals from abroad), thousands, with stylised timeline of key dates



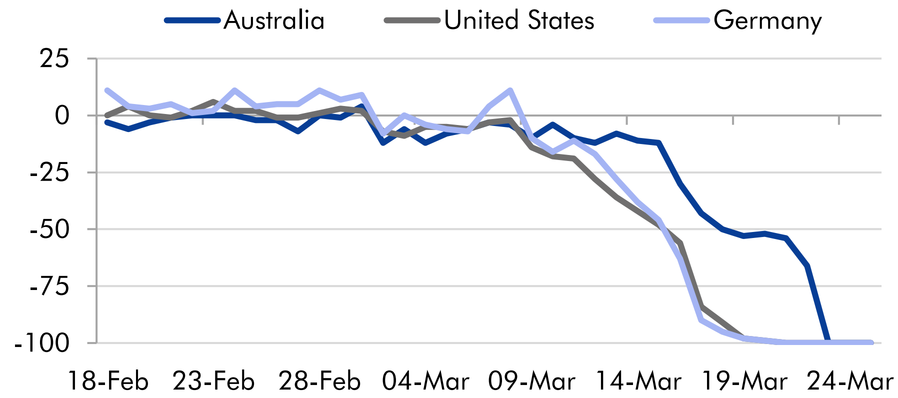
Sources: Capital Economics and Wind

Weakening economic prospects have been initially led by services

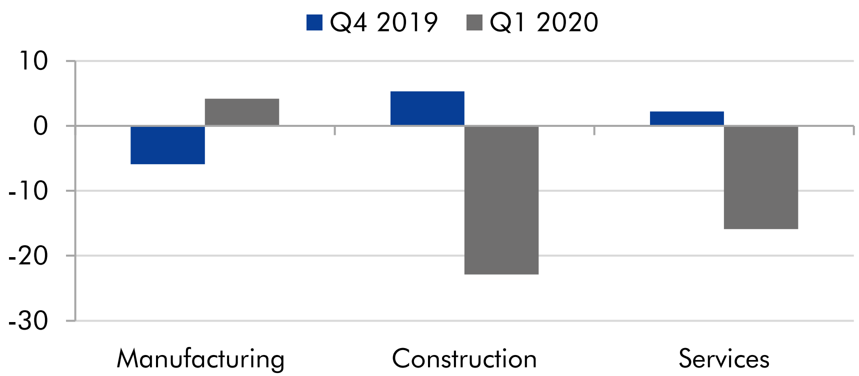
Early indicators suggest slump is down to service sector

- Early data releases from Singapore have suggested that the falls seen in gross domestic product are largely attributable to the services sector, based on early data and estimates.
- Across countries, services such as restaurants have been hardest hit, with many countries now having mandated closures of non-takeaway establishments. Leisure activities such as cinemas and tourism have also seen steep declines. Bangkok Airport, for example, saw 800 arrivals on 25th March, down from a typical 80,000.
- There has been a temporary bounce in supermarket retail in many countries, including the Netherlands. This, however, is unlikely to last as the initial panic buying fades and wider restrictions increase.

Year-on-year change in restaurant visits in Australia, the United States and Germany, per cent

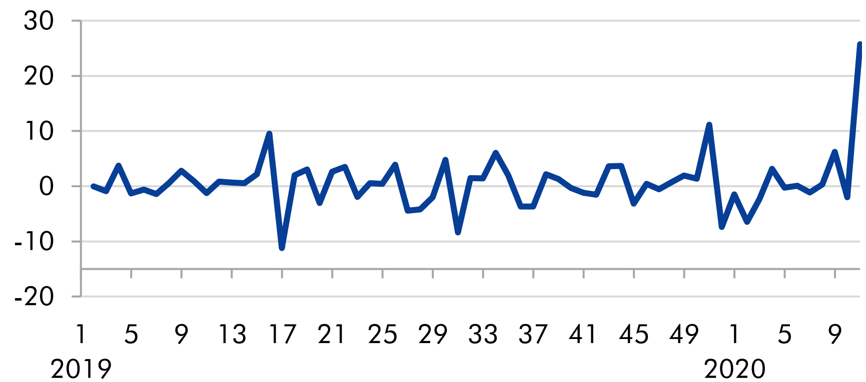


Annualised quarter-on-quarter change in Singaporean gross domestic product by sector, per cent



Sources: Capital Economics and Refinitiv

Netherlands supermarket weekly turnover, week-on-week change, per cent



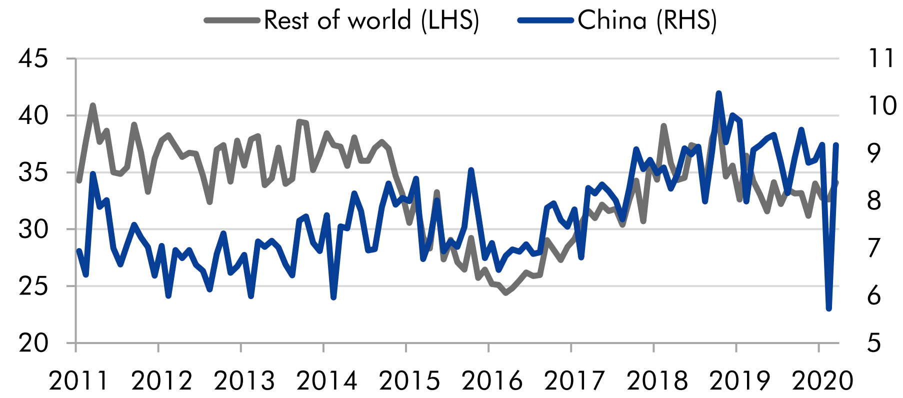
Source: Capital Economics, OpenTable and Statistics Netherlands

The virus and containment measures are beginning to impact on the manufacturing sector

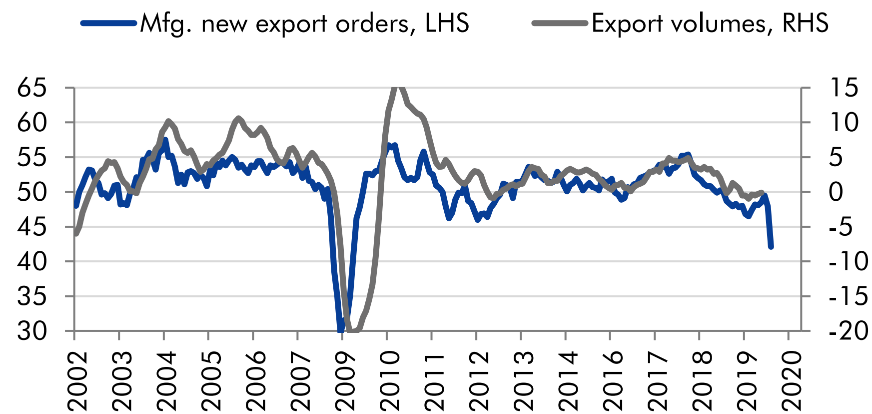
Global trade will be hit hard

- Korean imports from China bounced strongly in March, as activity in China started to pick up. However, the rebound will be short lived because there is growing evidence that the global economic hit is starting to impact on manufacturing.
- The slow average sailing speed of container ships indicates that demand remains weak. And the most recent Purchasing Mangers' Indices (PMIs) imply that worse is to come. Investment is likely to be hit hard hit by uncertainty, cashflow worries and falling consumption demand.
- Based on the experience of the financial crisis, we expect world trade volumes could fall by one-fifth. This is particularly bad for export dependent economies, such as Vietnam and Germany.

Korean imports, working-day adjusted, billions of United States dollars

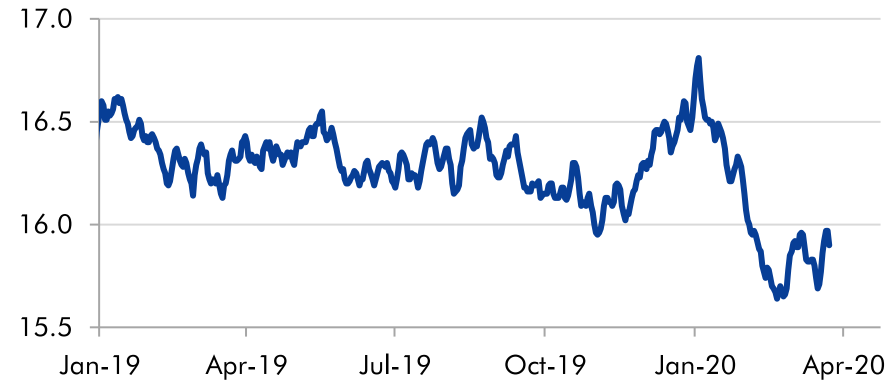


Advanced economies export orders, advanced 3 months and volumes, 3-month average annual growth, per cent



Sources: Capital Economics and Refinitiv

Average container speed, knots, five day moving average



Sources: Korea Customs Service, Refinitiv and Capital Economics. Note March 2020 data based on first 20 days of month.

Policy measures have eased market funding strains, at least for now

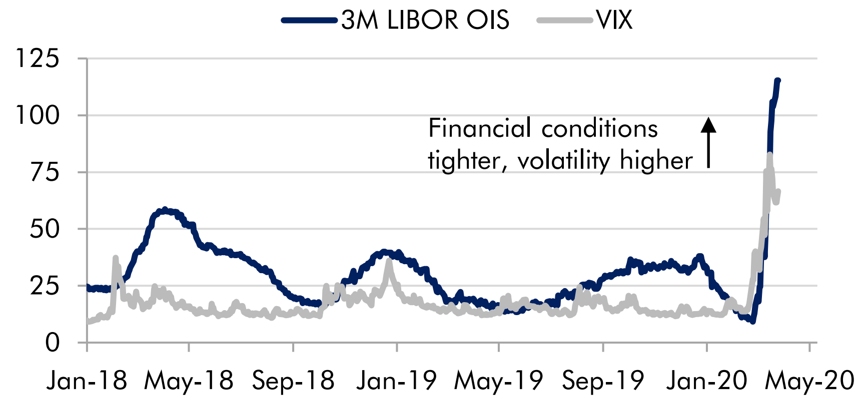
Financial conditions tightening across the board

- The turmoil in markets over the past month as the coronavirus pandemic has spread across the world has led to sharp falls in the prices of risky assets and triggered some of the worst strains in the financial system since the 2007-09 Global Financial Crisis.
- The difference between secured and unsecured lending rates for US dollars in the interbank market has soared. (See chart.) The difference is its highest since 2009, though it remains well below its crisis-era peak.

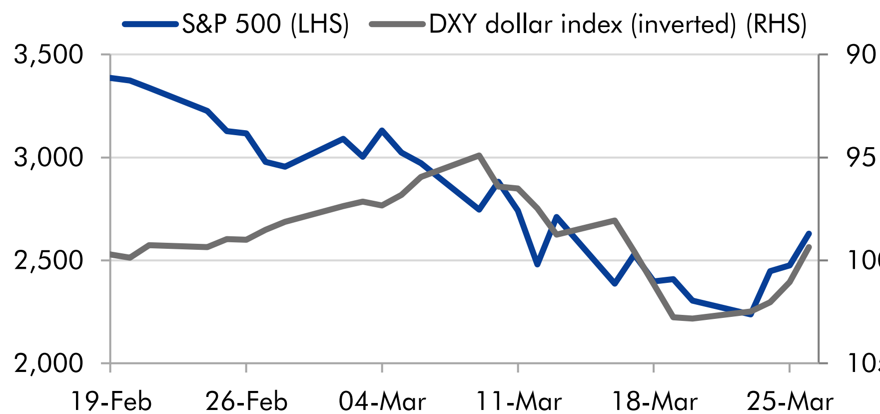
Corporates, liquid assets and FX all under pressure

- Signs of strains are easing, at least for now, as early policy interventions have been enacted. But we do not expect a recovery in asset markets until there are clear signs that the outbreak is under control.
- Funding markets for corporates, for example, are under strain. In the US, the interest rate on 3-month commercial paper has increased considerably, and the spread on longer-dated corporate bonds has also jumped. These initial strains prompted early policy interventions at stress levels below those seen in the financial crisis. The Fed's announcement of large-scale support for corporate funding, however, has had limited impact so far.
- Foreign exchange markets, where daily turnover dwarfs even that in government bond markets, have also seen large swings over recent weeks, in part because liquidity has become scarce. That said, the weakening of the US dollar over recent days suggests that policymakers' efforts to ease strains in short-term funding markets are having an effect.

3-month LIBOR-OIS spread for the United States dollar, basis points and volatility of the S&P 500 equity index, points



S&P 500 equity index and inverted United States dollar index, points



Sources: Capital Economics and Bloomberg

Emerging market vulnerability has come to the fore in recent weeks

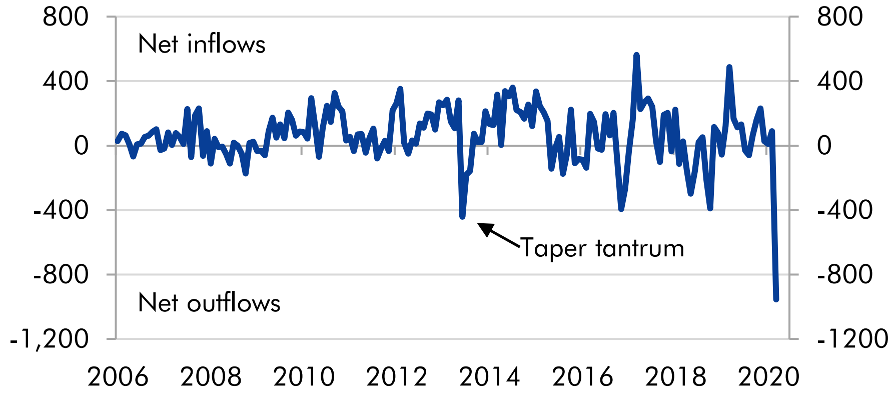
Large capital outflows are tightening financial conditions

- The dislocation in global financial markets has led to large capital outflows from emerging market debt and equity markets, as in the case of India. The outflows have caused financial conditions to tighten.
- The numbers are ominous. The data suggest that outflows from these countries' bond and equity markets have been much larger than they were after the collapse of Lehman Brothers in 2008 and during the China hard landing fears which began in August 2015. Even taking account of the fact that emerging market gross domestic product is twice as large in dollar terms as it was in 2008, the moves are still striking.
- If governments in the developed economies can't shield their banks from the economic effects of the coronavirus, that could result in a much more abrupt pullback in bank flows from emerging markets. Were that to happen, the economic impact could be even more damaging than what we've seen so far.

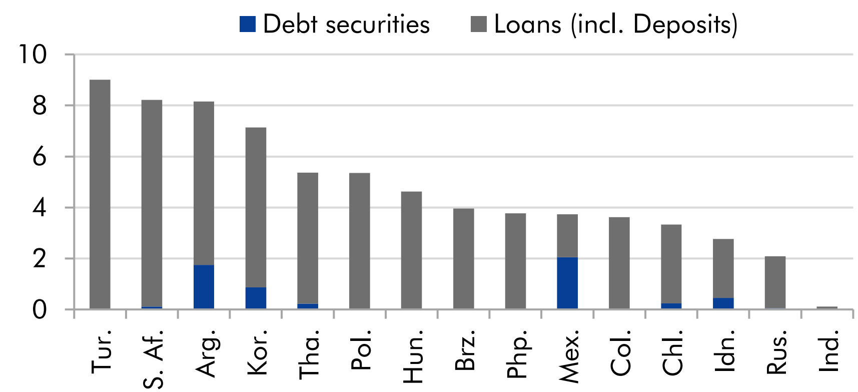
If foreign banks pull back, a painful credit crunch could follow

- The majority of upcoming emerging market external debt repayments are on loans from foreign banks. (See chart.) Much of that loan debt consists of banks' borrowing on foreign wholesale markets, but it also includes foreign banks' loans to emerging market corporates.
- If banks and corporates can't roll this financing over, they would need to sell assets and shrink the size of their balance sheets. That, in turn, could result in a severe and painful credit crunch, as happened across much of Eastern Europe during the global financial crisis.

Net foreign portfolio flows in India, billions of Indian rupees, monthly total



Short-term external debt by type of debt, percentage of 2019 gross domestic product



Sources: Capital Economics and CEIC

Sources: Capital Economics and CEIC

Fiscal stimulus measures appear manageable and more may follow

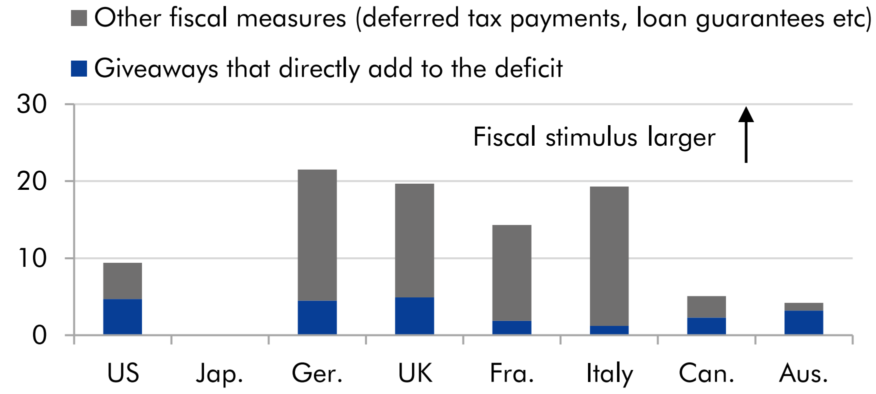
Large fiscal measures have been announced worldwide

- Fiscal support measures have been introduced in a number of countries. The size currently varies a lot between countries, from barely anything in Japan to packages worth around 20 per cent of gross domestic product in some European countries. In all countries, though, this support is certain to rise further. For example, Japan is considering a package worth ¥30 trillion (1.4 per cent of output).
- The measures announced fall into two categories. The first is actual giveaways (e.g. cash payments to people, tax breaks for firms). The second, far bigger component, is loans and guarantees to businesses. Many of the costs attached to the latter may either be recouped (in the case of loans) or never realised (in the case of guarantees), depending on the level of defaults.

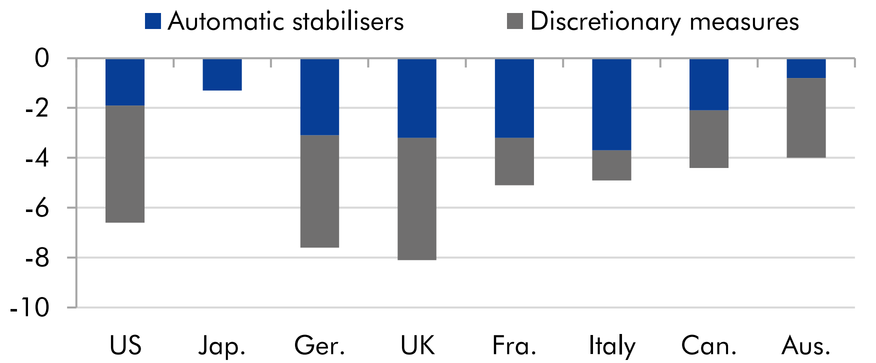
Spending is likely to be debt-financed and relatively sustainable

- These packages will not be funded by raising taxes, so the measures will be debt-financed. Most central banks have announced big (in some cases unlimited) quantitative easing (QE) programmes, meaning that they will hoover up these new bonds.
- A deficit of 10 to 20 per cent of gross domestic product for a year would boost government debt to gross domestic product ratios by 10 to 20 percentage points, which seems manageable for most countries in this era of low interest rates.
- This extra spending is unlikely to result in inflation, especially in the near-term. Even if fiscal policy halts the decline in demand, it will not stop a big recession. Further out, if signs of inflation did emerge, central banks could tighten policy.

Discretionary fiscal stimulus announced since coronavirus, as a share of gross domestic product, per cent



Possible effect of coronavirus on budget balance in 2020 as a share of gross domestic product, as at 26th March, per cent



Sources: Capital Economics and Refinitiv

Negative headline inflation likely to prove temporary

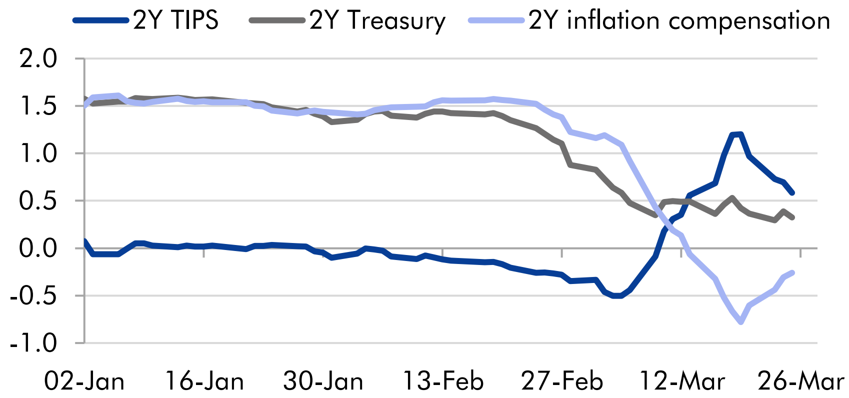
Near-term inflation expectations have fallen dramatically

- Market-based measures of US inflation compensation amid the spread of coronavirus have collapsed to their lowest levels since the Global Financial Crisis. That said, they have partly reversed in recent days in response to the announcement of further policy stimulus. Nonetheless, investors still seem to be braced for a short-lived fall in the annual rate of change in the US consumer price index.

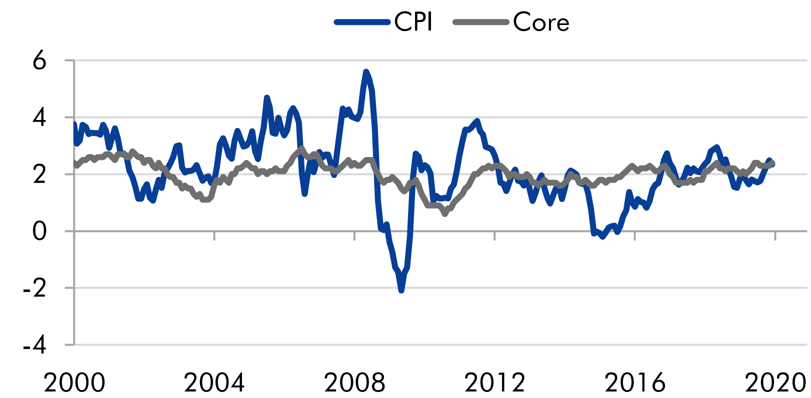
Reasons to expect core inflation to remain positive

- The slump in inflation compensation measures is not surprising. Consumer price inflation in the United States was not far above two per cent before the pandemic, and the recent oil price plunge will push headline inflation into negative territory.
- However, this is not the same as deflation, as the fall is confined to a few sectors. After the financial crisis, headline inflation was also negative during much of 2009 in the United States. Core inflation, meanwhile, remained positive and well above zero. A similar outcome is quite possible this time around.
- Monetary policy may struggle to boost demand compared to the last crisis. After all, nominal interest rates in the US were not very high before the outbreak of the virus, so the central bank has not been able to reduce them by as much as it did during the last crisis. Central banks in other developed economies have had even less scope to reduce interest rates.
- In addition, since the financial crisis, inflation has not been very responsive to changes in unemployment. Unless that changes, it is another reason to think that core inflation will remain positive.

Yields of United States inflation-linked and government bonds, per cent, along with inflation compensation, percentage points



Year-on-year change in consumer price inflation in the United States, per cent



Sources: Capital Economics and Bloomberg

Rise in United States unemployment forecast to be larger than in the global financial crisis

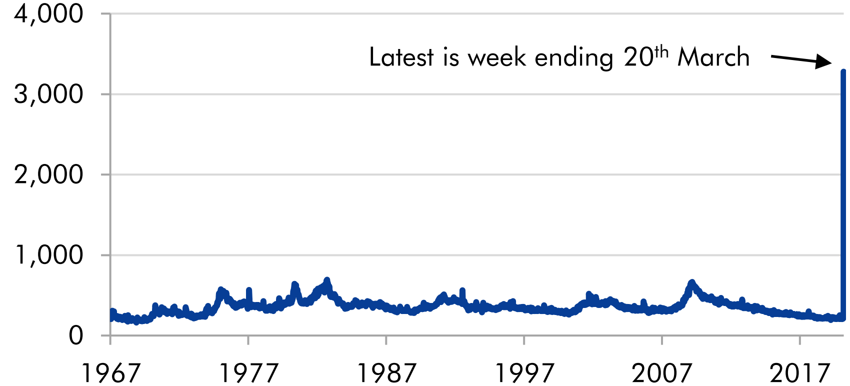
Unprecedented leap in US initial jobless claims

- The nationwide closure of restaurants, bars and other public venues in the United States, along with the total lockdowns in place in many states, resulted in an unprecedented surge in initial jobless claims to 3.3 million last week. (See chart.)
- With reports suggesting that many state employment offices have struggled to process the tidal wave of claims, last week's data will not have captured the full extent of the damage.
- Containment measures are still being extended across the country as the virus continues to spread rapidly. We now expect gross domestic to plunge by 40 per cent annualised in the second quarter, with as many as 14 million jobs likely to be lost over the coming months. That would push the unemployment rate up to around 12 per cent, higher than the 2009 peak.

Other developed markets to be less affected, but still hit

- The United States' more flexible labour market means that a given hit to activity would typically cause a bigger rise in unemployment there than in Europe. But the outlook for the labour market in the euro-zone is still grim.
- We think the unemployment rate in the euro-zone will surge to about 12 per cent by the end of June, giving up seven years' worth of gains. Much of this rise may prove temporary if the economy rebounds in the second half of the year, as we assume, but it will probably still be above 8 per cent at year-end.
- We had expected the United Kingdom government's massive support package to limit the rise in the unemployment rate to 6 per cent, but the recent surge in benefit claims suggests the increase will exceed this.

Weekly jobless claims in the United States, thousands



Peak unemployment rate forecasts for major developed market economies, per cent

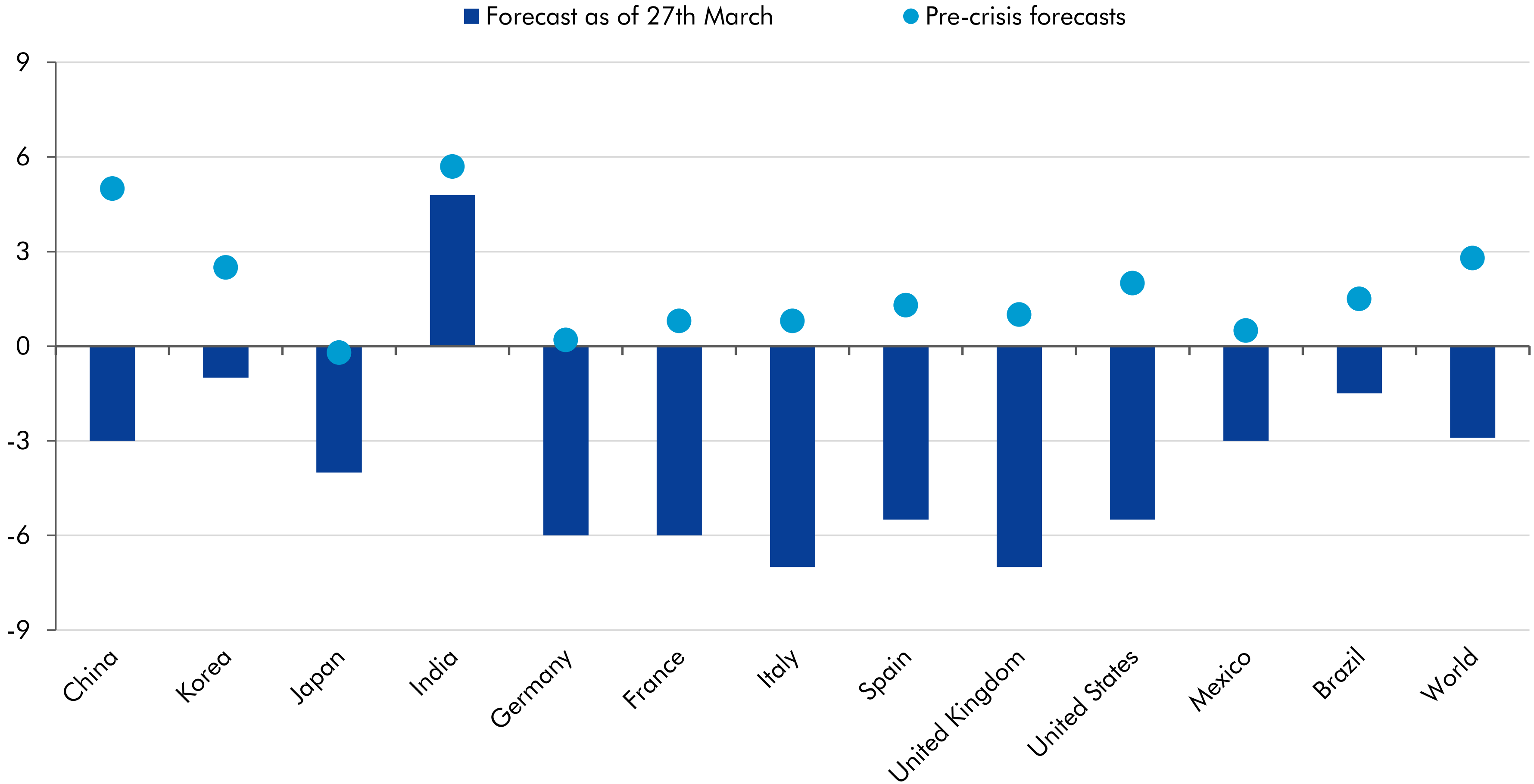
Unemployment rates overview

	Current peak forecast	Most recent datapoint	Peak of financial crisis
United States	12.0	3.5	10.0
United Kingdom	6.0	3.9	8.5
Euro-zone	12.0	7.4	10.3
Japan	3.7	2.4	5.5

Sources: Capital Economics and Refinitiv

Most major economies will contract in 2020, with even emerging markets declining

Latest forecast for year-on-year change in gross domestic product in 2020 (per cent) and revision compared to pre-virus forecasts (percentage points)



Source: Capital Economics

Gross domestic product forecasts in detail – 27th March

	Real economic growth rate, quarter-on-quarter, per cent				Forecasts, year-on-year, per cent		Revisions since pre-crisis, percentage points	
	Q1	Q2	Q3	Q4	2020	2021	2020	2021
Asia								
China	-20.0	14.0	9.0	6.0	-3.0	14.0	-8.0	7.5
Korea	-1.5	-4.0	3.5	2.0	-1.0	5.0	-3.5	2.5
Japan	-0.9	-4.0	2.1	0.7	-4.0	2.0	-3.8	1.1
India	0.0	-5.2	7.7	1.8	1.0	9.0	-4.7	2.5
Europe								
Germany	-2.5	-12.5	7.0	8.0	-6.0	6.0	-6.2	5.4
France	-2.5	-12.5	7.0	8.0	-6.0	6.0	-6.8	5.0
Italy	-5.0	-10.0	10.0	5.0	-7.0	6.0	-7.2	5.8
Spain	-2.5	-12.5	7.0	8.0	-5.5	6.0	-6.8	4.5
United Kingdom	0.0	-15.0	5.0	8.5	-7.0	8.5	-8.0	6.5
Americas								
United States	0.0	-11.5	4.0	5.0	-5.0	7.0	-7.0	4.1
Mexico	-0.3	-10.0	2.5	4.0	-6.0	5.0	-6.5	3.0
Brazil	0.0	-4.0	0.8	1.0	-1.5	7.5	-3.0	5.7
World	-5.4	-3.2	6.1	4.7	-3.0	7.5	-5.8	4.3

Absolute virus containment policies in detail

	Summary of containment measures in place					
	Lockdown	Schools closed	Borders closed	Social distancing	Large events banned	Non-essential businesses closed
Asia						
China	*	✓	✘	✓	✓	*
Korea	✘	✓	*	✓	✓	✘
Japan	✘	✓	✘	✓	✓	*
Singapore	✘	✘	✘	✓	✓	*
India	✓	✓	*	✓	✓	✓
Europe						
Germany	✘	✓	✓	✓	✓	✓
France	✓	✓	*	✓	✓	✓
Italy	✓	✓	*	✓	✓	✓
Spain	✓	✓	✓	✓	✓	✓
Poland	✘	✓	✓	✓	✓	*
United Kingdom	✓	✓	✘	✓	✓	✓
Americas						
United States	*	✓	*	✓	✓	✓
Mexico	✘	✓	✘	✓	✓	✘
Brazil	✘	✓	✓	✓	*	✘

Legend
* Indicates partially in place
✓ Indicates (largely) in place
✘ Indicates (largely) not in place