

CCBI Securities | Research

The Big Picture

First battle in the Year of Rat – How will the Wuhan coronavirus affect the economy?

The economic impact to China of the coronavirus outbreak depends critically on how quickly the virus is contained. Our base case assumes that new cases will peak in the next two weeks with economic activity gradually returning to normal thereafter. A starker alternative would be a surge in new cases in coming weeks before the virus is tamed in Apr. In this case, the near-term negative shock would be much greater.

The economic impact under our base case would be short-lived and mild. GDP in 1Q would slow to 5% YoY before bouncing back in 2Q led by manufacturing. Online services could also make up for some of the losses in off-line activities. We trim our annual GDP forecast to 5.7%, down from 6.0% previously. Under the alternative scenario considering a more severe outbreak, we forecast 1Q GDP of 4.0-4.5% YoY with a prolonged slump in economic activity. Were this scenario to play out, we forecast Chinese annual GDP growth of around 5.4%.

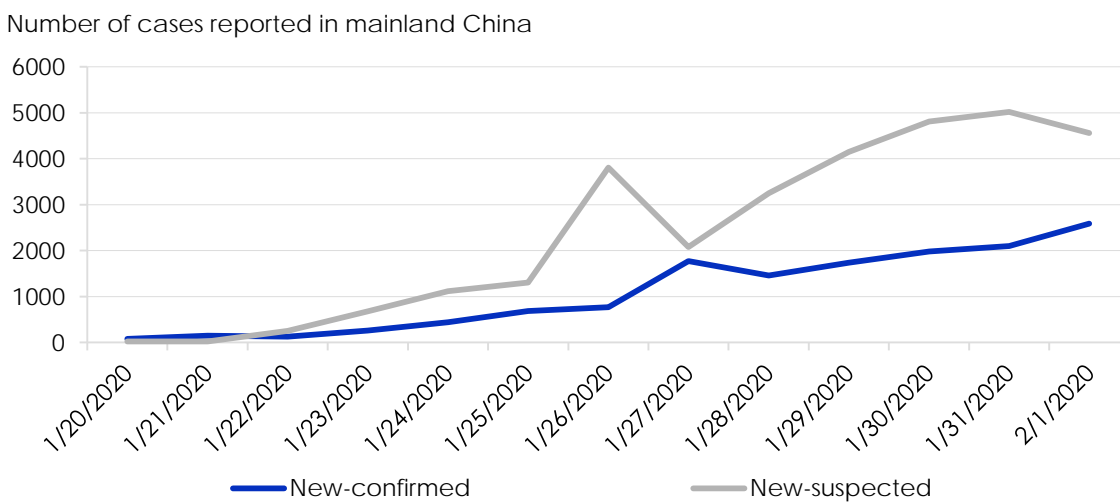
Despite the sharp increase in confirmed cases in Hubei, we have seen promising signs that the identification and quarantine of infected individuals has been effective at containing the outbreak elsewhere. Incremental confirmed cases outside Hubei have stabilized in the week following the province's lockdown, lending support to our base case. Post-Chinese New Year (CNY) travel may lead to a further pickup in transmissions in the coming weeks, and a continued quarantine remains critical to containment.

We expect the government to focus on delivering targeted relief measures such as fiscal subsidies, preferential credit support, tax exemptions, and employment support. Public investment could also pick up following the outbreak, in part due to pent up demand. Liquidity conditions will remain loose with the renminbi range bound in the coming months.

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The Wuhan coronavirus outbreak remains virulent. As of 1 Feb, 14,411 cases have been confirmed in mainland China, with 19,544 suspected cases and 304 deaths. The Chinese government has implemented a range of policies to contain the spread of the virus, including an extension of the CNY and school holidays, and the cancellation of public events. Cities in Hubei are on lockdown while cities outside the province have reduced transportation links. So far, the virus has not spread widely outside of China; nevertheless, the appearance of coronavirus cases in other countries has prompted the World Health Organization (WHO) to declare an international emergency. A number of countries including the US and Japan have banned foreign travelers from China.

Fig 1: Reported 2019-nCoV cases by type



Source: National Health Commission, CCBIS

The ultimate economic impact of the outbreak obviously depends heavily on the success of containment efforts. Our baseline is that new cases will peak between now and mid-Feb, about two-to-three weeks after the lockdown of Wuhan on 23 Jan. This assumes government measures are effective at identifying and isolating carriers of the virus, thereby thwarting human-to-human transmission cases and slowing the spread of the virus.

The alternative to this outcome is a much bleaker scenario. Wuhan, a national transportation hub, is a layover for huge numbers of travelers on their way home for CNY. A study by Hong Kong University warns that new novel coronavirus cases could continue to rise through Apr, with daily cases doubling every few days in the coming months.¹

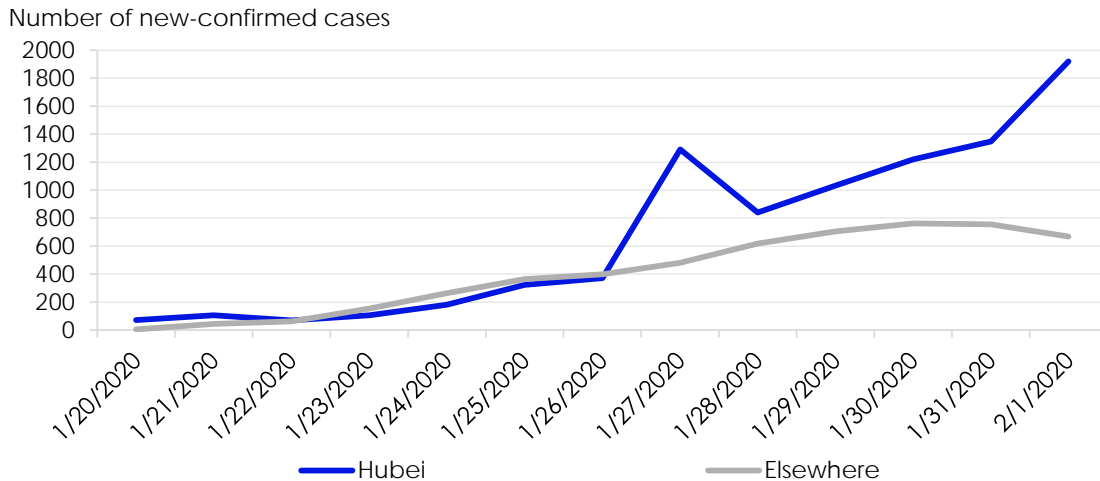
Base case – moderate impact; targeted policies

We take the less dire outcome as our baseline. In recent days, outside of Hubei, confirmed cases have been relatively steady, which we take as a promising sign that the spread of the virus is being contained thanks in large part to the regional lockdown

¹ "Nowcasting and forecasting the potential domestic and international spread of the 2019-nCoV outbreak originating in Wuhan, China: a modelling study". Professors Joseph Wu, Kathy Leung and Gabriel M Leung. *The Lancet* (31 Jan, 2020) [Link](#) to publication.

(Fig 2). Post-CNY travels could lead to a spike in transmissions in coming weeks but we expect these to be similarly contained.

Fig 2: Outside of Hubei the daily increase of new cases has been flat



Source: National and Hubei Health Commissions, CCBIS

Our base case anticipates gradual normalization in economic activity in the second half of Feb with a minimal overall economic impact on China by the end of the year. Certain segments of the services sector, especially catering, will feel the brunt of the coronavirus' impact. Within the manufacturing sector, while some workers may delay their return to work due to transportation shutdowns, most companies already have contingency plans in place. Thus, supply disruptions should be relatively minor with sales holding up better than production.

- We estimate the impact to IP production in 1Q to be around 0.5-0.8 ppt due to the extended holidays with production bouncing back in 2Q. Given logistical constraints due to the outbreak, companies will need to run down inventories in 1Q; however, restocking will take place in subsequent months and so 2Q should enjoy a rebound. The recovery in manufacturing that began in 4Q could hit a speedbump, but the underlying strength of the sector is likely to see activities bounce back. IT and auto, which were mainly to blame for manufacturing weakness in 2019, have picked up since 4Q, and the overall demand picture remains buoyant as seen from the latest PMI figures reflecting solid orders pick-up through the third week of Jan. Certain manufacturing sectors will fare better than others as during the SARS period: apparel, for example, is likely to see softer sales during the lockdown while sales of medical equipment and textiles should hold up.
- More extended negative impact on **services sector**. Certain services like catering, entertainment, travel, and transportation have been hurt badly by the coronavirus, and the impact will likely last through 2Q. However, different from SARS period, online activities now make up for part of the loss in off-line activities. Major companies in online gaming and online grocery deliveries have enjoyed a boost in past few days. Online financial services and IT should help mitigate part of the negative effects as well.

During the SARs outbreak, health care and public services in China both received a boost and we expect the same for the coronavirus outbreak.

- **We estimate 1Q GDP could decline by nearly 1 ppt followed by a stronger GDP performance in 2Q.** We cut our annual GDP forecast to 5.7%.

In terms of policy, adequate liquidity, targeted credit and fiscal subsidies and employment support are likely to be emphasized. The latest PBoC announcement emphasizes a continuation of the loose liquidity stance through OMO and MLF operations, while deploying small and targeted credit support to key producers such as medical suppliers. The MoF has spent RMB27.3b by 29 Jan for epidemic prevention and control. We believe tax relief policies for the most hard-hit sectors are likely (e.g. transportation, catering, hospitality). A key policy area is likely to be employment, especially in the case of SMEs, which account for 50-70% of employment in the sectors most affected by the outbreak – catering, travel, transportation, and household services. Supportive measures such as tax relief, rent subsidies and extended grace periods for loans are likely policy options.

Risky scenario: stronger policy support on fiscal and structural side; the bar for large credit stimulus is high

Under our alternative scenario, the outbreak remains highly virulent through Apr. In response, nation-wide transportation and logistics delays are likely to be prolonged resulting in (1) more downside risk and supply delays in the near-term; (2) possible trade restrictions from other countries, especially coupled with additional WHO declares major Chinese cities as the main affected area, as was the case during SARS, which could result in more trade delays and cancelled orders; and (3) job cuts and further declines in consumption and economic activity. We estimate the overall impact on growth could be up to 1.5ppt in 1Q, with weakness extending into part of 2Q. Under our alternative scenario, full-year growth could slow to 5.4%, 0.6ppt lower than our previous estimate.

In our view, should the coronavirus contagion last beyond Mar, we could see additional public investment projects, extended easy liquidity, more supportive tax and fiscal measures to support enterprises and employment and structural policies to stimulate private investment, including higher investment in the health care industries.

Even under this scenario, broad demand stimulus may not be the preferred medicine. During the SARs epidemic that lasted about half a year, the Chinese government rolled out targeted credit support (including subsidized loans), tax exemptions and direct fiscal subsidies to shore up affected areas and sectors while refraining from significant credit and liquidity stimulus. And the Chinese growth recovered quickly afterwards benefiting from the external opening up. Given the policy constraints the Chinese government currently faces, the bar for large credit loosening is high in our view, targeted measures to manage the loss are likely to remain the main policy option.

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