16 Mar 2020

Research Briefing | Global

Coronavirus Watch: Global recession is on the way

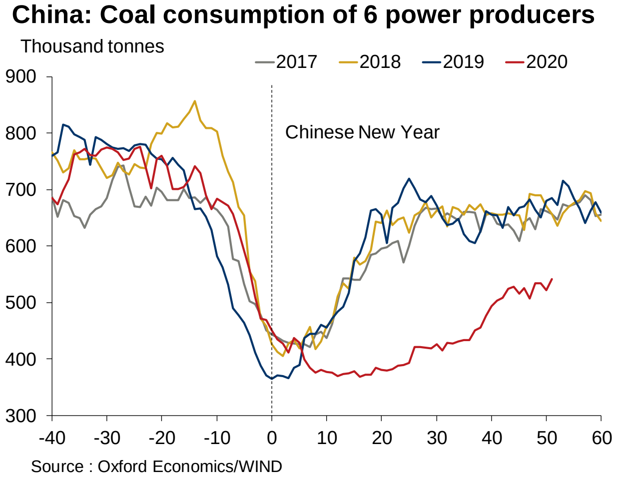
Economist

Ben May
Director of Global Macro Research
+44(0)20 3910 8015

- **Developments over the past week have greatly increased the likelihood that the global economy is moving into recession in response to the surge in COVID-19 cases worldwide, the associated disruption, and the aggressive market sell-off.**
- **The dismal Chinese activity data for February and the continued slow return to business as usual suggest that China will be an even bigger drag on global GDP growth than we had previously expected in Q1. It also suggests that the economic costs elsewhere associated with shutdowns, other less stringent measures, and voluntary forms of social distancing will be substantial.**
- **Our current baseline, which is predicated on a modest acceleration in quarterly non-China global GDP growth in Q2, now looks too optimistic. And there's clearly a risk that disruption extends into Q3, limiting any bounceback as the Northern hemisphere enters summer.**
- **But history suggests that economies revive quickly even after major one-off shocks. For now, we still expect a substantial rebound in H2 after a dreadful H1. But policymakers must minimise the adverse spillovers and second-round effects from the shutdowns, such as minimising the risk of cash-flow problems that trigger a wave of bankruptcies and pile pressure on the banking system.**
- **We will provide a full update to our baseline forecast on Friday, March 20, along with an update to our downside scenario.**

In China, it has become increasingly clear that the tough measures to contain the spread of the coronavirus have been successful, but that they've had a high economic cost. Industrial value added plunged by 13.5% on a year-on-year basis in January and February combined, while the 20.5% fall in retail sales over the same period was worse still. What's more, the return to business as normal remains slow (**Figure 1**).

Figure 1: China is returning to business as normal, but only slowly


China: Coal consumption of 6 power producers

Source : Oxford Economics/WIND

Chinese activity looks set to have plunged in Q1 by substantially more than our existing baseline forecast assumes. And while activity is picking up towards more normal levels, the speed of the transition remains gradual.

Contact: Ben May | bmay@oxfordeconomics.com

At a global level, the latest batch of weak Chinese data has two main implications. **First, it now seems reasonable to expect something in the region of a 5% fall in Chinese GDP in year-on-year terms in Q1.** Prior to the coronavirus outbreak, we had been expecting a 6% gain, and in our March forecasts we had assumed a 2.3% rise. Mechanically, this points to a yearly rise in world GDP in Q1 of just 0.3%, compared to our current baseline forecast of 1.6%. This would push the global economy firmly into recession territory. Global recessions are typically defined as a two quarter where annual GDP growth is below annual population growth – the latter is currently about 1%.

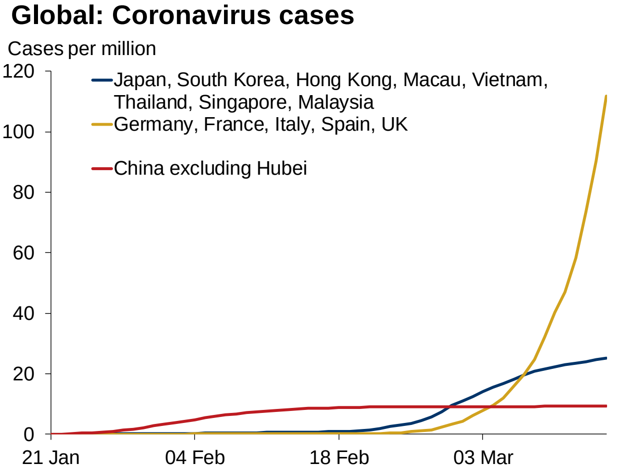
Second, China's economic performance in early 2020 confirms that the short-term cost of shutdowns elsewhere around the world will be substantial. China has done a good job of containing the spread of the coronavirus outside Wuhan, while aggressive containment measures have kept the number of cases stable at low levels in some Asian economies. But the same, of course, cannot be said of Europe (**Figure 2**).

Admittedly, cross-country differences may partly reflect differences in testing procedures. The available data on tests carried out are patchy, but they show huge differences in the number of COVID-19 tests carried out after adjusting for population size (**Figure 3**). Hong Kong and South Korea are two economies that have had the highest numbers of tests per person. While some European economies have also done a huge amount of testing, the overall conclusion is still that Europe, unlike Asia, has failed to "flatten the curve" and that shutdowns such as those imposed in Italy and Spain will spread to other parts of Europe.

Needless to say, we expect Italy to be hit especially hard, and we now see two consecutive contractions in GDP of over 2% in Q1 and Q2 (**Figure 4**). Other advanced economies will also suffer with most, if not all, of the G7 likely to fall into recession.

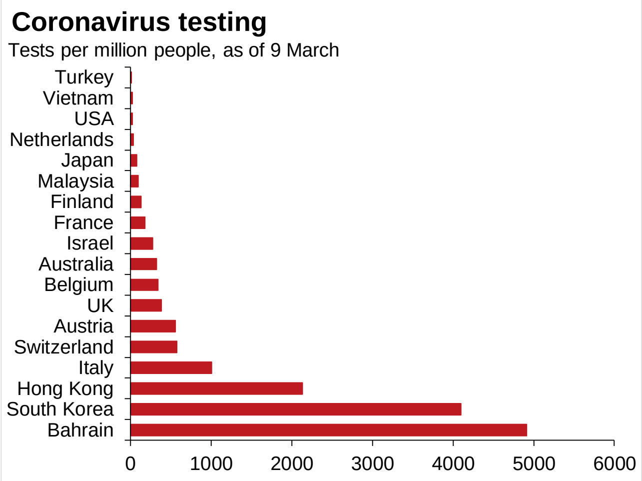
Even where major shutdowns are yet to be imposed, lower-level disruption is set to hit activity, and some belt-tightening in anticipation of tougher times ahead will be inevitable. UNESCO data shows that at the time of writing, 56 economies had announced national school closures, affecting over 500mn students (see **Figure 5** and **Table** on page 4). Given the cancellation of swathes of large public events and the near-collapse in international travel, it seems increasingly likely that the boost to the global economy from

Figure 2: Europe has failed to flatten the curve yet



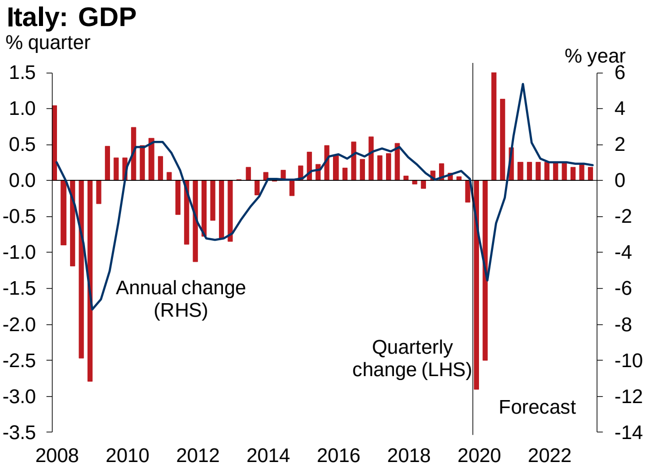
Source : Oxford Economics/Haver Analytics

Figure 3: Bahrain, South Korea and Hong Kong have tested heavily for coronavirus



Source : Oxford Economics/Worldometer

Figure 4: Italy set for steep falls in GDP in H1



Source: Oxford Economics, Haver Analytics the transition back to more normal levels of activity in China in Q2 will be tempered by economic weakness elsewhere.

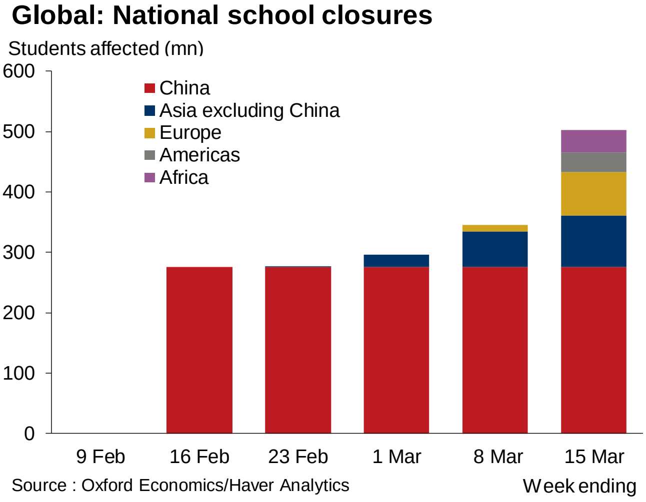
The GDP figures for Q1 and Q2 this year will certainly make grim reading, and policymakers may be able to do little to offset that in the shorter term. Nonetheless, we would caution against the idea that another global financial crisis-style recession is inevitably on its way.

Historical experience suggests that as the coronavirus pandemic starts to be tamed, uncertainty will subside quickly. And as normality returns, households will begin raising discretionary spending back to more typical levels, while firms will also increase output as supply constraints lift. In addition, the money saved because planned discretionary spending during early 2020 didn't take place may burn a hole in households' pockets, meaning that most will eventually be spent rather than saved, accelerating the return-to-normality rebound.

Supporting this view is evidence from other historical temporary supply-side shocks caused by factors such as epidemics and natural disasters. It's normal for GDP to fall below its trend path in the short term and return to its historical trend path over the following quarters. We'll return to this issue in more depth in a forthcoming Research Briefing.

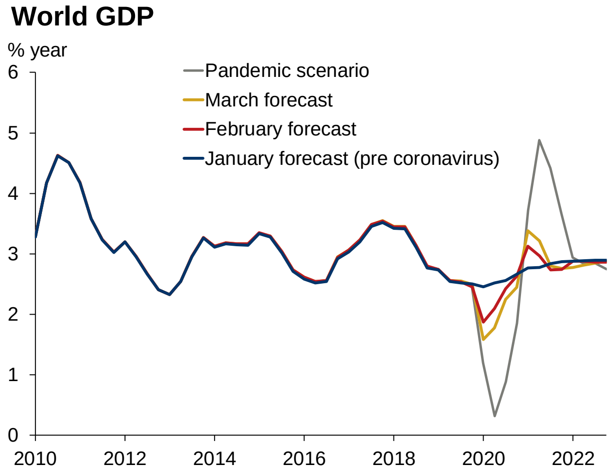
Of course, the risk is growing risk that any rebound is undermined by the coronavirus shock unmasking other vulnerabilities in the global economy or financial system. The most plausible weaknesses are perhaps that the growth shock, tightening US dollar liquidity, and cash-flow shortfalls have the capacity to trigger financial stability issues and a wave of bankruptcies among vulnerable corporates. However, the key point remains that even if we do see major spillovers from the initial shock, these are unlikely to be strong enough to offset the likely boost to activity from the ending of lockdowns and other forms of virus disruption. We will provide a full update of our global economic forecasts on Friday, March 20, as well as a downside scenario that constitutes an even more significant slowdown as a result of the coronavirus.

Figure 5: National school closures now affecting more than 500mn students



Source : Oxford Economics/Haver Analytics

Figure 6: Global growth now likely to evolve more in line with our pandemic scenario



Source : Oxford Economics/Haver Analytics

Coronavirus Watch: Recession risks mount

Coronavirus Economic & Financial Impacts

Indicator	13-19 Jan (Pre outbreak)	20-26 Jan	27 Jan - 2 Feb	3-9 Feb	10-16 Feb	17-23 Feb	24 Feb-1 Mar	2-8 Mar	9-15 Mar
Outbreak metrics (End period)									
Confirmed coronavirus cases - global	121	2,760	17,389	40,554	71,331	79,126	89,000	109,351	165,931
weekly change	121	2,639	14,629	23,165	30,777	7,795	9,874	20,351	56,580
Confirmed coronavirus deaths - global	0	80	362	910	1,775	2,469	3,044	3,809	6,438
weekly change	0	80	282	548	865	694	575	765	2,629
Google search interest for Coronavirus (100=peak of popularity for the term)	0	6	15	8	6	8	27	36	75
China activity indicators									
Coal consumption for electricity use (relative to a year ago and adjusted for CNY)	120.1	123.7	102.0	76.6	59.3	58.9	67.0	75.7	78.5
Steel furnacing operating rate (relative to a year ago and adjusted for CNY)	101.9	101.7	101.7	97.7	95.4	94.1	99.8	102.0	101.7
Urban road congestion (relative to a year ago and adjusted for CNY)	103.2	97.4	86.3	77.2	75.6	75.2	76.5	81.5	84.2
Residential property sales (relative to a year ago and adjusted for CNY)	133.6	78.3	14.6	1.6	11.6	28.7	45.0	50.3	48.0
Financial markets									
S&P 500 (% difference from pre-coronavirus outbreak)	0.0	0.5	-1.2	0.3	2.0	2.1	-6.7	-7.8	-17.8
EuroStoxx 50 (% difference from pre-coronavirus outbreak)	0.0	-0.2	-2.3	-0.7	1.4	1.4	-7.0	-11.5	-26.4
Shangai SEE (% difference from pre-coronavirus outbreak)	0.0	-2.0	-4.0	-8.4	-5.1	-1.8	-2.4	-1.2	-4.4
Hang Seng HK (% difference from pre-coronavirus outbreak)	0.0	-2.5	-6.0	-6.8	-4.4	-4.5	-7.8	-8.9	-14.2
US 10-year Treasury yield (%)	1.8	1.8	1.6	1.6	1.6	1.5	1.3	1.0	0.8
German ten-year government bond yields (%)	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5	-0.7	-0.7
Italian 10-year government bond spread (bps)	162	159	139	136	134	135	157	173	229
US Bloomberg Barclays High Yield OAS (bps)	320	334	380	365	348	347	439	494	673
US Bloomberg Barclays Investment Grade OAS (bps)	95	94	100	98	96	97	112	130	190
VIX	12.3	13.1	17.0	15.9	14.4	15.1	31.9	36.8	57.8
Commodity price: Brent Oil ($ per barrel)	64.5	63.2	58.5	54.7	55.4	58.5	53.5	50.0	35.0
Citigroup economic surprise index	1.7	9.0	10.4	16.6	17.3	17.4	21.9	11.3	14.6
Global supply chains									
National school closures (Millions of children affected)	0	0	0	0	275	276	296	346	503
Baltic Dry Index	0.0	-16.9	-32.0	-42.5	-45.1	-39.1	-32.0	-24.9	-17.8
Dow Jones Global Shipping Index	0.0	-4.3	-11.4	-14.2	-14.7	-15.4	-22.7	-24.5	-30.9
Maersk stock price	0.0	-2.5	-6.7	-5.4	-3.8	-4.9	-17.8	-24.3	-29.7

Source: Oxford Economics/Haver Analytics/Datastream/Bloomberg/WIND