GlobalResearch
Center for Research on Globalization

Coronavirus May Tip the Global Economy Into Recession?

By Dr. Leon Tressell
Global Research, February 17, 2020

Region: Asia
Theme: Global Economy

As each day passes the numbers get worse for the impact of the Coronavirus. The numbers of people infected and who have died from the Coronavirus have already exceeded the Sars virus and look set to get much worse.

As if this wasn't bad enough the Coronavirus threatens the global economy with a China led recession. What happens in China matters more than ever due to its huge role in the global economy. A few statistics serve to illustrate this.

China has the second largest economy in the world which accounts for 17% of global GDP while it has the largest share of global trade standing at 13.45%. China is by far the biggest manufacturer in the world with its factories generating $3.7 trillion of value in 2017, more than the U.S., UK, Germany and South Korea combined.

Coronavirus hits consumer spending in China

The cancellation of Chinese new year celebrations is estimated by Bloomberg to have delivered a $140 billion hit to the economy which won't be recovered once the epidemic has passed. Small and medium sized businesses have been particularly hard hit.

Apparently, tourism, movies, restaurants and consumer spending during the new year period in 2019 accounted for 7% of GDP in the first quarter of 2019. This one off annual boost to the economy cannot be recaptured once the epidemic passes.

Figures just released give some idea of the economic impact of the Coronavirus on travel throughout the new year period. According to the Chinese ministry of transport there was an 82% fall in the number of trips taken compared to last year.

On the railways ticket sales saw a massive decline. Less than one tenth of the 2019 number were sold this year. Meanwhile, domestic airlines had cancelled 20 million tickets worth $2.86 billion.

This week sees a phased return to work of millions of migrant workers travelling back to large urban centres. A week after the officially sanctioned return to work over 27 million migrant workers have yet to return to travel.

Anecdotal evidence coming out of China indicates that consumer spending remains subdued due to the state of semi-lockdown prevailing in most of China's major cities. Many ordinary people are afraid to leave the house and will only venture out for essential supplies. Never mind the 50 million people on full lock-down in Hebei province and 30 million in Zhejiang province.

Millions of small-medium businesses will be sorely tested by this huge drop in consumer demand never mind the impact upon foreign companies who make billions in sales in China's domestic market.

The South China Morning Post notes the huge size of China's domestic market which provides huge sales revenue for many foreign companies from Apple to German car makers.

> "China's consumer market – badly hit by the virus – is bigger than the US and European markets combined, with the e-commerce market alone worth US$615 billion in 2015, and while it is dominated by domestic vendors, it is significant for most internationally prominent brands.''

Recent estimates suggest that smartphone sales could fall as much as 50% during the first quarter of 2020 while China's shipment of smartphones are expected to decline between 30-50% during this period.

Car sales in China fell by a whopping 22% during January the biggest ever drop for this month. This is terrible news for both domestic and foreign car makers. Autovista Group, a European based analyst for the car industry has said this news may, "cause alarm among many manufacturers who pin their financial hopes on the [all important China-LT] market.''

The China Passenger Car Association is predicting that car sales may fall more than 30% in February.

Car sales in China have fallen for the last 3 years which indicates a significant fall in consumer purchasing power due to rapidly rising wealth inequality.

China's middle classes have developed a taste for foreign tourism in the last decade and now account for $23 billion a month which represents around 16% of tourism spending worldwide. One estimate reckons that foreign tourist destinations are losing at $4.6 billion a month due to the Coronavirus while major airlines, from Cathay Pacific, America Airlines, British Airways and Lufthansa are making losses leading to them cancelling flights to China.

The Economic Intelligence Unit estimates that China's outbound tourism will not recover until 2021 leading to a global loss of $80 billion. Many Chinese people start booking holidays after the lunar new year but this year that is just not happening.

As if this wasn't bad enough the Chinese people are also struggling with rapidly rising inflation. Year on year inflation rose by 5.4% while January saw a monthly rise of 1.4% compared to last December. Year on year food prices went up by a whopping 20.6% while consumer prices rose by 7.7%. Food prices from December 2019 to January 2020 rose 4.4%.

It remains to be seen how the epidemic will affect prices over the next few months but it would not be surprising if inflation spiked higher due to the closure of large chunks of the economy. When demand exceeds supply it often results in higher prices.

Threat of widespread job losses in 2020

In December 2019 central government instructed local authorities to prepare for possible large scale job losses in 2020. The executive meeting of China's State Council on 11 February declared that a top priority during the epidemic was to, "Avoid massive lay-offs, and encourage local governments to aid enterprises in stabilizing employment with their unemployment insurance fund balance and other funds.''

Social stability is seen as an essential task at a time of national crisis.

China's service sector, which has absorbed many of the job losses that have arisen from the restructuring of state run heavy manufacturing, accounted for over half of all employment in 2019. It has been hard hit by the lock downs gripping large sections of the country prompting fears that the service sector will suffer many redundancies as businesses close due to a huge decline in customers.

According to central government figures in 2018 there were 63 million small businesses employing over 150 million people.

In 2003 the Sars outbreak led to 8 million job losses when China's economy was booming following its accession to the World Trade Organisation. Before the outbreak of the current epidemic China's economy was slowing leading to a series of mini stimulus measures by the government and People's Bank of China (PBOC) during 2019.

The central government in Beijing is very fearful of the impact of large scale job losses on social stability at a time when it has come under a lot of public criticism due to its handling of the crisis. Tens of millions of small businesses in China face closure over the next two-three months unless the epidemic dies down and the economy is fully opened up again.

According to central government figures in 2018 there were 63 million small businesses employing over 150 million people.

The South China Morning Post has carried a series of reports detailing the job losses, wage cuts and reduced hours already faced by many people in the small business sector.

President Xi this week has said that local government must work to, 'ensure the general stability of the job market.' Meanwhile, Premier Li has declared that China must avoid 'large-scale' job cuts.

National government has introduced measures to 'stabilise employment' including the injection of 1.2 trillion ($173 billion) into financial markets and cutting interest rates to encourage bank loans to small-medium businesses and the public. Besides this, it has brought in tax cuts for the service sector and subsidies to small-medium businesses who do not lay off more than 5.5 % of their staff.

In this last week, China's central bank has injected another $77 billion into the monetary system. Banks are expected to offer loans to struggling small and medium sized businesses. Apparently, companies will be eligible for subsidies, "to the extent that a "small increase" of non-performing loans owed to banks will be "tolerated."

Local authorities are introducing a series of emergency measures ranging from reducing rents to postponing social security contributions.

Many analysts and small business are saying that these emergency measures are not enough to prevent mass closures of small businesses over the next 2-3 months. It is feared that the financial measures will not trickle down in time to save many small-medium businesses from closure.

One financial analysts, Tang Dajie from the China Enterprise Institute, sums up the opinion of many when he said that,"a large batch of firms could die" this spring before the measures from central government trickle down. He said that China's economy needs 'cardiotonics'. In other words measures similar to the drugs used to treat heart failure.

Meanwhile, China's critical manufacturing sector is facing a lot of economic pain.

Tens of thousands of factories have been closed in China for several weeks. The Wall Street Journal has reported on the struggle facing China's factories to resume operation despite government authorization for a mass return to work. Many migrant workers are staying put in their home towns/villages or face quarantine once they return to the cities where they work in the manufacturing hubs of China.

The return to work does not include prosperous regions such as Zhejiang which is close to Shanghai. It has a population of over 30 million which is still in full lock-down. Businesses are closed until at least 18 February while all public transport has stopped. Even funerals are banned.

Hubei province, at the epicentre of the Coronavirus outbreak, with a population over 50 million is still closed for business. It produces a quarter of all cars made in China. All told industry analysts estimate that around 435,00 fewer cars will be produced in China this year. Of course. That may change depending on when the outbreak fully passes.

Disruption of global supply chains

Besides cars there are over 70 factories in Hubei producing essential components, such as lighting, braking and electrical parts, for foreign car manufacturers.

Car factories outside of China are closing due to China's central role in supply chains.

Hyundai closed all of its car factories in South Korea, which include the world's largest car factory at its Ulsan complex, due to a shortage of wiring-parts that are supplied by China. This has led to the temporary lay off of 25,000 workers. This was costing Hyundai an eye-watering $500 million a week.

Latest reports suggest that Hyundai will reopen all its car plants next week as some key Chinese suppliers had resumed production this week.

Meanwhile, Nissan is closing several car plants due to a shortage of essential parts that are made in China.

Car manufacturers in the EU and U.S. warn they are not far behind due to a shortage of critical parts that are made in China. This will have painful consequences for these car manufacturers considering that China has the world's largest market for cars.

Global economy/trade being affected

Besides, the huge impact of the virus epidemic to China it also becoming increasingly apparent that the global trade is being affected by Coronavirus pandemic. This is most graphically illustrated by the impact upon global container shipping. This is likely to lead to months of delivery delays for many companies. 80% of of world goods trade by volume is transported by sea. Everything from clothes to cars, electronic products and oil are shipped in containers.

Alex Longley in a piece for Bloomberg has observed that:

> "February 2020 will come to be remembered as a period of historic disruption to physical supply chains the world over, as the coronavirus wrecks trade.''

Many ships are stuck in Chinese ports awaiting loading/unloading while many can't get into the ports. Shanghai and Hong Kong both reported that only 50% of dock workers returned to work last Monday. Meanwhile, many cargo ships returning home from China are stuck in ''floating quarantine zones'' as seen in Australia and Singapore.

Giant shipping companies such as Maersk. MSC Mediterranena, Hapag-Lloyd and CNA_GGM have reduced the number of vessels on routes to China. Denmark-based maritime data provider Sea-Intelligence said this Monday that over 350,00 container boxes had been removed from global trade networks since the outbreak of the Coronavirus amounting to $350 million a week in lost volumes.

Another alarm bell for the global economy is the impact of weakened demand for raw materials from China's consumers and industries. Dry bulk shipping is being hard hit due to much lower demand for important commodities such oil, iron ore and copper.

Oil prices have fallen by 20% over the last month reflecting the 20% fall in China's daily oil consumption. Industrial metals such as copper and iron ore have also seen double digit falls in price.

China's insatiable demand for oil and industrial metals since 2008 has played a major factor in helping lift the global economy out of recession. The decline in China's demand for these essential commodities does not bode well for the global economy which was slowing down throughout 2019.

The International Energy Agency's (IEA) oil demand report for 2020 makes for grim reading. In 2019 China accounted for more than 75% of oil demand growth as consumption from OECD nations declined. The lock down of China's flat lining economy will have a major impact upon both OPEC and American shale oil producers. The IEA's report states:

> "The consequences of Covid-19 for global oil demand will be significant. Demand is now expected to contract by 435 kb/d in 1Q20, the first quarterly decrease in more than a decade. For 2020 as a whole, we have reduced our global growth forecast by 365 kb/d to 825 kb/d, the lowest since 2011.''

The report concludes that OPEC nations will be forced into making further cuts to production hitting their main sources of income:

> "Now, the risk posed by the Covid-19 crisis has prompted the OPEC+ countries to consider an additional cut to oil production of 0.6 mb/d as an emergency measure on top of the 1.7 mb/d already pledged.''

The impact on America's shale revolution could be substantial considering that both independent and major oil producers are not generating any free cash flow and are surviving due to a massive build up of debt that totals over $200 billion. $40 billion of that debt matures in 2020. The IEA report suggests:

> "Lower oil prices, if sustained, are also bad news for highly responsive US oil companies, but we are unlikely to see an impact on output growth until later in the year. The effect of the Covid-19 crisis on the wider economy means that it will be difficult for consumers to feel the benefit of lower oil prices.''

Numerous reports are emerging of the impact of China's economic woes upon America. U.S. exporters are set to see an 8% fall in exports this year despite the phase 1 trade deal leading J.P Morgan to estimate that the Coronavirus will knock GDP down by 0.25% to a mere 1% growth in 2020.

China's economy was slowing down before the virus epidemic

The slowdown of China's economy during 2019 is shown by the falling profits of industrial companies which were down 3.3% during 2019. It is further illustrated by figures from the Purchasing Managers Index (PMI's).

PMI's provide important insights into the state of an economy and have the power to move financial markets. If they give a reading of over 50 it indicates future growth or expansion compared to the previous month while a reading of below 50 suggests contraction.

In January the National Bureau of Statistics (NBS) revealed that China's January PMI figure to be 50.0 down 0.2% from December 2019. The NBS press release, issued on 3 February, breaks the figures down further suggesting that large and medium manufacturers were hovering above the recession level of 50 while small manufacturers were already in recession territory:

> "… the PMI of large-sized enterprise was 50.4 percent, down by 0.2 percent point from last month; that of medium-sized enterprises was 50.1 percent, 1.3 percentage points of lower than last month. … The PMI of small-sized enterprises was 48.6 percent, 1.4 percentage points higher than last month and stayed below the [recessionary-LT] threshold.''
>
> The non-manufacturing sector fared slightly better with a PMI of 53.1. Yet the new orders index for this sector was 50.6 and the employment index was 48.6.''

China's economy may slip into recession this year

The battering that China's economy is taking across all sectors from the Coronavirus is leading many economists to substantially lower estimates for the country's GDP growth this year. According to a Reuters poll of 40 economists from around the world China's GDP growth for the first quarter is expected to slow to 4.5%. This expected to drag the full year GDP rate to 5.5% which would be slowest since 1990.

Some economists are even more pessimistic. Freya Beamish, chief Asia economist at Pantheon in London estimates that first quarter GDP could be a below 2%.

Most of the financial media and the Chinese government itself are making rosy forecasts that China's economy will rebound and quickly makes up the losses from the first quarter once the Coronavirus epidemic dies down.

However, not all economists are confident of this considering China's growing array of problems before the outbreak of the Coronavirus. These range from American tariffs to massive levels of corporate and consumer debt, rapidly rising income inequality, declining corporate profits, falling industrial production and the rising number of industrial disputes in the service sector.

Iris Pang economist at ING in Hong Kong has stated:

> "We do not expect a speedy recovery for the economy, even in the unlikely event that there are no new confirmed cases. After the coronavirus has been contained, it may still take four quarters to see a full recovery."

This pessimistic assessment is echoed by the CEO of China's most valuable company Daniel Zhang of e-commerce giant Alibaba. He warned of the dangers that the pandemic poses to both China and the global economy. He called the virus a "black swan'' event:

> "The [coronavirus] outbreak is having significant impact on China's economy, and may potentially affect the global economy. It will present near-term challenges to the development of Alibaba's business across the board."

Alibaba's Chief Financial Officer Maggie Wu added to the gloom when she said that revenue's in the first quarter of 2020 will be "significantly'' negative.

Bloomberg notes that the Coronavirus is 'Bringing Alibaba to its knees' and that the companies biggest division was 'already sliding'. It concludes that the Coronavirus may deal a 'knockout blow' to China's most valuable company whose financial health is seen as a barometer for the wider economy.

A steep contraction of China's economy during 2020 has grave consequences for the global economy beyond disruptions to supply chains. Global growth since the 2008 economic recession has been heavily dependent on China.

David Dodwell, executive director of the trade policy think-tank Hong Kong-APEC Trade Policy Study Group has noted:

> "This is significant not just for Beijing, because Chinese growth has been by far the largest contributor to global growth since the 2008 global financial crisis. At its peak in 2012 and 2013, China's growth in dollar terms accounted for 58 per cent and 48 per cent of global growth respectively. Even in 2017, it accounted for 23.5 per cent of global GDP growth, in 2018 almost 30 per cent, and last year an estimated 39 per cent.''

Beijing's ability to continue being the engine of global growth is questionable considering the array of problems its faces both domestically and on the global front. In particular its $41 trillion debt pile, of which $1.5 trillion is considered as distressed bad debt, are ticking time bombs hanging over the economy. This is considered as dangerous and unsustainable by many economists and has been acknowledged as such by the CCP government hence its efforts at deleveraging the economy in recent years.

In 2008 China kick started the global economy by its $586 billion stimulus programme. Its ability to do something similar in 2020 to rescue the economy from the effects of the Coronavirus maybe constrained by its huge debt problems.

In the past it was widely acknowledged that when America's economy sneezed the rest of the global economy caught a cold. It could be argued that this equally applies to China now. Its contribution to the global economy is so vast that a downturn in its economy this year may be enough to tip the world into recession.

*

Note to readers: please click the share buttons above or below. Forward this article to your email lists. Crosspost on your blog site, internet forums. etc.

Comment on Global Research Articles on our Facebook page

Become a Member of Global Research

Articles by: Dr. Leon Tressell