Coronavirus vs. SARS – Potential Economic and Market Implications

- Coronavirus appears to be better contained than SARS in 2003.
- During the SARS outbreak, key macroeconomic indicators took four months to recover. This time around, consumption-related factors may follow a U-shaped recovery but industrial production could see a V-shaped recovery.
- China is much more integrated into the global supply chains than in 2003, so spillover effects will be disproportionate for countries and industries more reliant on China. Our US outlook remains positive.

The arrival of the Coronavirus reminds us how Severe Acute Respiratory Syndrome (SARS) negatively affected the markets in 2003. This article examines the potential economic and market impact of Coronavirus considering past experience with the SARS outbreak.

Coronavirus Spread Rapidly, but Appears More Contained than SARS

The coronavirus is spreading more rapidly compared to SARS. However, it is not spreading as quickly outside of China’s borders, and therefore appears to be better contained compared to SARS. There were 40,171 confirmed cases in China and 455 cases in the Rest of the World (ROW) as of February 10, 2020. SARS took 774 lives with just over 8,000 infected, according to the World Health Organization. Coronavirus had taken more than 900 lives as of Feb. 9, 2020.

Coronavirus Infections vs. SARS Outbreak*

<table>
<thead>
<tr>
<th>Year</th>
<th>Cases</th>
<th>Deaths</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020 Coronavirus Outbreak</td>
<td>40,626</td>
<td>910</td>
</tr>
<tr>
<td>2002-2003 SARS Outbreak</td>
<td>8,098</td>
<td>774</td>
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It is an encouraging sign that the rate of the virus’s growth is slowing both in China and the ROW. In China, the rate of growth of new cases reached a peak of 118.3% day-over-day (d/d) on January 25 to 5.0% d/d on February 4 while for the ROW, the growth rate slowed from 78.6% d/d on January 24 to 3.2% d/d on February 4.

Economic Impact: short term economic impact to China growth sharp, but temporary

The economic impact of the Coronavirus can in some ways be informed by that of SARS, however there are important differences. We estimate that the SARS outbreak brought down China’s Q2 GDP by 2% year over year in 2003 while the average of eleven think tank and investment bank forecasts projects Q1 2020 growth to decline by 1.1% to 4.7%.

The Coronavirus outbreak struck during the Chinese New Year celebration, thus limiting interpersonal contact during a time when work places and factories were closed. SARS peaked when the country was operating “business as usual”, April-May 2003. Nevertheless, more cities and areas have been affected by Coronavirus compared with SARS.

During the SARS outbreak, high frequency macroeconomic indicators, such as industrial production, retail sales and tourism fell sharply, and took four months to recover. This time around, we would expect consumption-related factors to be hardest hit, due to lost holiday spending on leisure activities. While consumption is likely to follow a U-shaped recovery, industrial production could see a V-shaped recovery aided by easier fiscal policy related to infrastructure spending, and favorable borrowing terms.
As the Chinese economy is much larger now compared to 2003, and more integrated into the global supply chains, the Coronavirus is likely to have a global impact, most notably in Northeast and Southeast Asia. China’s GDP in purchasing power parity terms has risen from 8.2% of global GDP in 2002 to 19.3% in 2019.

**Potential Spillover Countries**

There are two linkages whereby the negative effect of the Coronavirus on the Chinese Economy could spill over to the rest of the world (ROW) -- economies with high trade linkages and high trade exposure to China and tourism are most vulnerable.

On the trade side, Hong Kong, Taiwan, Singapore and Malaysia are most exposed to exports to China as a percentage of GDP at 55%, 42%, 25% and 22%, respectively.

On the tourism front, Thailand, Hong Kong, Malaysia and Singapore are most exposed to Chinese tourists, where tourism revenue as a percentage of GDP is 11%, 11%, 6% and 5%, respectively.

Overall, preliminary estimates suggest the hit to global growth from the Coronavirus is small -- between 0.1-0.3% assuming it is contained in the next 2-3 months. If it is not contained, then global growth could be adversely affected between 0.2-0.4%.

**Market Impact Different from Economic Impact**

The SARS outbreak occurred when global equity markets were troughing following the bursting of the tech bubble in 2000. Inversely, the Coronavirus is hitting during an 11-year equity bull market. We do not believe valuations are overly rich, but believe uncertainty surrounding the severity of the Coronavirus could invite volatility, with some investors taking profits and/or reducing risk.

As well, we believe day trading algorithms drive markets to price in risk more quickly compared to the SARS outbreak. As news of the Coronavirus broke, the S&P 500 erased one fifth of the rally that started October 1st in about one week. Global yields declined, with 10-year Treasury yields falling over 20bp from 1.73% on September 25 to a low of 1.53% on October 9, wiping out a three-month sell off in two weeks. Markets have since stabilized with 10-year treasuries resting around 1.6% and the S&P close to all-time highs.

![Global Bond Yields and China GDP](image-url)

The last time the Chinese nominal GDP growth fell below 7% was back in 2015 when the Caixin Manufacturing Purchasing Managers Index troughed at 47.2 (well below the 50+ level indicating growth). The current level of global bond yields are at a level similar to 2016. This indicates that global yields already are pricing in a sharp slowdown in the Chinese economy, particularly impacting 1Q20.

**Treasury Outlook**

During the height of the most recent concern over the Coronavirus, 10-year Treasury yields fell from 1.85% on January 13 to 1.51% on January 31. Upon signs that the virus will be contained and the rate of infection is slowing, risky assets recovered some losses in just days. Ten-year yields responded by jumping 15bp from the lows to 1.66% on February 5 and are now at levels we consider to be neutral.

Over the short to medium term, we expect US Treasuries to be influenced by concerns over the Coronavirus and risk related to the US election. In the long run, we remain constructive on the US economy with continued above-trend growth in 2020. Strength in the consumer sector and housing market is one of the key drivers to this view, and also underpins our bullish view on securitized credit.

**Impact on US Equities**

China’s impact on the global economy is increasingly significant. China is 19.3% of global GDP, and consumption and services (the hardest hit areas), are a larger component of Chinese GDP than in the past. If uncertainty surrounding the containment of the Coronavirus persists, we can expect significant negative impacts on tourism, commodity prices and export-oriented economies (Germany, Japan, Italy and EM countries dependent on exporting commodities). Supply chain disruptions may start to appear.

In this scenario, we would expect a drag on global earnings to affect US equities less than other markets. We should remember that lower oil prices are a boost to domestic consumption. The negative impact of events like Coronavirus are usually
short lived and followed by rapid recoveries, sometimes with the help of some additional fiscal stimulus.

Conclusion:

Given the uncertain nature of health emergencies such as the Coronavirus, we are monitoring the pace and severity of Chinese and global confirmed cases. In particular, the second derivative (i.e. the change in the growth rate) will be vital in determining if we move into a period of acute risk aversion or an orderly reversion to the fundamentals that remain favorable for continued rally in global markets.

The current situation remains fluid, however. With precedent from the SARS experience, we expect investor confidence in the market to return when it is clear that the health emergency is contained. In this era when information moves fast and market valuations respond to news and fundamentals very quickly, the recovery in markets could also prove rapid. We would expect equity markets to remain firm and global bonds yields to migrate higher based on economic fundamentals.

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