The economic effects of the coronavirus

January 29, 2020

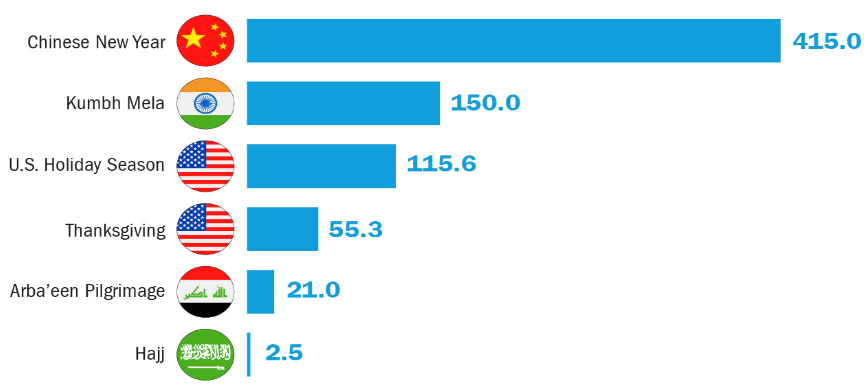
As outbreak headlines shake investor confidence, our analysts assess the coronavirus risk to markets.

The outbreak of coronavirus in central China's Hubei province has unsettled markets. While the absolute numbers around infection and mortality rates are relatively low, the economic consequences of an outbreak can be magnified even when the health impact is limited.* There are more than 6,000 cases of coronavirus confirmed globally (some researchers say the number is likely higher), 98% of which are in mainland China. More than 100 people have died, and the vast majority have been older adults with other health issues. In the U.S., there have been five confirmed cases and investigations into 110 possible exposures. The number of investigations is expected to increase according to the Centers for Disease Control, but the immediate health risk is low at this time.

The Lunar New Year and the high volume of holiday-related travel in Asia have markets on edge — a more widespread outbreak could impact demand and global GDP. Approximately five million people left the city of Wuhan (the epicenter of the outbreak) for the Lunar New Year.

Historically, travel around the Lunar New Year has spiked

Millions of people travelling



Source: Statista, "The World's Largest Human Migration Is About To Begin," January 22, 2020.

It's not the first time that investors have had to consider the market and economic effects of an emerging disease: SARS, MERS, and Zika have all had varying impacts. Our analysts assess relative risk of emerging diseases under three scenarios — epidemic,

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pandemic and extreme pandemic — and assign each a quantitative ranking and qualitative comments. This helps us evaluate expectations for earnings and the potential impact to guidance in 2020.

Historically, market reaction to emerging diseases has been short-lived. In the case of SARS (2003), which affected about 8,100 people and caused more than 770 deaths, a fall and then recovery in the S&P 500 took about six months, with airlines and travel stocks hardest hit. But it's important to understand that SARS was only one driver of stock returns during that time. Travel-related stocks have also seen the greatest drop with the coronavirus.

China is obviously more important to the global economy and travel market today compared with 2003. While major U.S. airlines have better balance sheets and credit metrics relative to 2003, they arguably have more China exposure. Technology stocks, particularly those with higher exposure to (or domiciled in) China have also been affected. Across sectors, revenue exposure to China has certainly shaped investor response.

The healthcare industry is attempting to develop a vaccine as the coronavirus spreads. But this can be tricky because viruses mutate over time, making a potential treatment ineffective. It would likely take at least a year to develop a vaccine for this virus, and there are a lot of unknowns. While certain drug stocks may see a boost in the near term, history has shown that these types of vaccines have not been meaningful contributors to revenue and EPS.

Bottom line

We wouldn't be surprised to see the number of confirmed cases climb in the near future, which may spark further negative headlines and damage consumer confidence. But policy actions by Chinese leaders (e.g., limiting travel and Lunar New Year celebrations) may reduce the spread of coronavirus longer term, which could help mitigate the market reaction.

*IMF Finance & Development, June 2018, "New and resurgent infectious diseases can have far-reaching economic repercussions," David E. Bloom, Daniel Cadarette and JP Sevilla.

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