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Economics Group

Special Commentary

Nick Bennenbroek, Macro Strategist
nicholas.bennenbroek@wellsfargo.com • (212) 214-5636
Jen Licis, Economic Analyst
jennifer.licis@wellsfargo.com • (704) 410-1309

Update on Coronavirus and China's GDP Outlook

Executive Summary

- The coronavirus outbreak centered in China has continued to intensify, with latest reports placing the number of cases in China at more than 20,600, and at least 425 deaths.
- In addition to physical measures to contain the outbreak, Chinese authorities have also taken financial measures to support the economy, including lowering interbank interest rates and adding liquidity to money markets.
- Nonetheless we do expect a significant hit to China's Q1 GDP, with that lost output mostly, but not fully, recovered in subsequent quarters. We now forecast Chinese GDP growth of 5.5% for 2020 (compared to 5.9% in mid-January), and a recovery in growth to 6.1% in 2021 (compared to 5.9% in mid-January).

We now expect a significant hit to China's Q1 GDP.

Factoring the Coronavirus into Our Chinese Economic Outlook

Last week, we offered an initial assessment of the potential economic and foreign exchange impacts from the coronavirus outlook and outlined favorable and adverse scenarios. In the subsequent days the outbreak has continued to worsen, with the number of reported cases and deaths both having jumped significantly compared to last week. In addition, there are increasing reports of potential hits to Chinese economic activity, including the closure of some retail stores and factories, as well as a sharp decline in travel and associated activities surrounding China's Lunar New Year holiday.

The full effects of the coronavirus outbreak on Chinese economic activity (and indeed even its impact on Q1 activity) will not be known for some time. Because the timing of the Lunar New Year shifts each year, China's statistical office publishes some key activity data (namely retail sales and industrial output) for January-February combined to smooth out those gyrations. Accordingly, the first hard data on the impact of the coronavirus will not be available until sometime in March, and even those figures will be somewhat incomplete. Since growth estimates for the individual January and February months will be unavailable, it might not be until we get data for March or April that we know the extent to which Chinese economic activity is being affected.

Chinese authorities are taking measures to try to manage the economic impact from the virus.

Authorities are taking some measures to try to lessen the economic impact from the virus. This week, following the end of the Lunar New Year holiday, China's central bank lowered its 7-day reverse repo rate 10 bps to 2.40% and added liquidity to money markets in an effort to lower interbank rates and support markets. Further monetary measures, as well as fiscal stimulus measures, appear likely in the weeks and months ahead.

That said, given the broadening scope of the outbreak, we expect a significant hit to Chinese growth in the first quarter even with the efforts from Chinese authorities. Much of that impact should be felt on the demand side, particularly in the services sector, as the timing of the outbreak coincided with the timing of the most significant holiday on the Chinese calendar. However, reports of factory closures suggest industrial output should be softer than previously expected as well. While we expect a recovery in economic activity in response to policy measures by Chinese authorities, we do not expect the loss in economic output will be fully recovered.

Figure 1

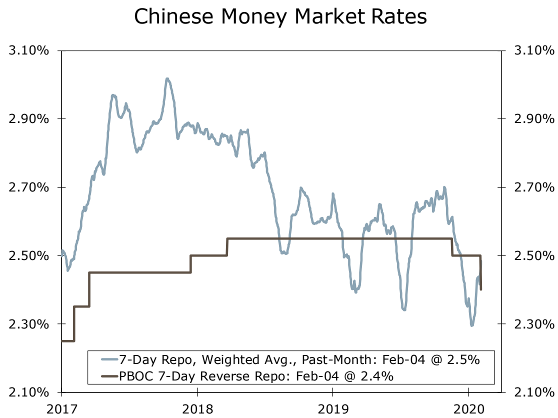

Figure 2

Source: Bloomberg LP and Wells Fargo Securities

We now forecast Chinese GDP growth of 5.5% and 6.1% 2020 and 2021, respectively.

Specifically, we now expect GDP growth of just 5.1% year-over-year in Q1-2020, down from our previous forecast of 5.9% year-over-year. In sequential terms, that would equate to growth 0.5% quarter-over-quarter in Q1-2020, a sharp slowdown from the 1.5% quarter-over-quarter gain seen in Q4-2019. Over time and as the outbreak runs its course and policy measures offer some support to the economy, there should be some recovery in growth. Overall, we now forecast **2020 GDP growth of 5.5% (compared to 5.9% in mid-January)**, while we forecast **2021 GDP growth of 6.1% (compared to 5.9% in mid-January)**.

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com