Tackling the fallout from the coronavirus

by Laurence Boone, OECD Chief Economist

Covid-19 (coronavirus) hit China at the start of December and outbreaks have spread more widely. The virus is bringing considerable human pain. It is also resulting in significant economic disruption from quarantines, restrictions on travel, factory closures and a sharp decline in many service sector activities.

The world economy is in its most precarious position since the global financial crisis.

Global growth, cooling for the past two years to a subdued level, has been dealt a nasty blow by the coronavirus. High frequency indicators such as coal demand, suggest the Chinese economy slowed sharply in the first quarter of 2020. As China accounts for 17% of global GDP, 11% of world trade, 9% of global tourism and over 40% of global demand of some commodities, negative spillovers to the rest of the world are sizeable. There is mounting evidence of sharp declines in tourism, supply chain disruptions, weak commodity demand and falling consumer confidence.

How far the epidemic spreads will determine economic prospects.

Even under a best-case scenario of containment to China and limited outbreaks in other countries as we see today, the OECD expects a sharp slowdown in world growth in early 2020. We have revised our projection for the year from an already low 3% in November to only 2.4%, lower than in any year since the financial crisis. In a downside-risk scenario where epidemics break out in some other countries across the globe, the slowdown will be sharper and more prolonged. Our modelling suggests that the level of world GDP would fall as low as 1.5% this year, halving the OECD's previous 2020 projection from last November of 3%. Containment measures and fear of infection would hit production as well as spending hard and drive many of the epidemic affected countries into outright recession.

Governments cannot afford to wait.

Regardless of where the virus spreads, the world economy, previously weakened by persistent trade and political tensions, has already suffered a sharp setback. Households are uncertain and apprehensive. Firms in sectors such as tourism, electronics and automobiles are already reporting supply disruptions and/or a collapse in demand. The world economy is now too fragile for governments to gamble on an automatic sharp bounce-back.

Containing the epidemic and limiting cases of serious illness is the policy priority.

Limiting travel, quarantines and cancelling events are required to contain the epidemic. Increased government spending should be first directed to the health sector, tackling virus outbreaks and supporting research. Complementary policy action can at least mitigate the economic and social fallout.

Supporting vulnerable households and firms is essential.

Containment measures and the fear of infection can cause sudden stops in economic activity. Beyond health, the priority should be on allowing short-time working schemes and providing vulnerable households temporary direct transfers to tide them over loss of income from work shutdowns and layoffs. Increasing liquidity buffers to firms in affected sectors is also needed to avoid debt default of otherwise sound enterprises. Reducing fixed charges and taxes and credit forbearance would also help to reduce the pressure on firms facing an abrupt falloff in demand.

If the epidemic spreads outside China, the G20 should lead a coordinated policy response.

Countries should cooperate on support to health care in countries where it is needed, as well as on containment measures. In addition, if countries announced coordinated fiscal and monetary support, confidence effects would compound the effect of policies. This would help reverse the drubbing in confidence that a more widespread outbreak would provoke. It would also be more effective than working alone. Our work presented in the Economic Outlook 2019 shows that if G20 economies implement stimulus measures collectively, rather than alone, the growth effects in the median G20 economy will be 1/3 higher after just two years. Some would say it is trite to call for international cooperation. However, in this globally connected economy and society, the coronavirus and its economic and social fallout is everyone’s problem, even if firms decide in the wake of this virus shock to repatriate production and make it a bit less interdependent.

For more information visit the latest Interim Economic Outlook, released 2 March 2020