1. Global economic outlook

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- ***The spread of the coronavirus has the potential to materially impact global economic growth.***
- ***The fallout from the virus will impact production networks, and substantially restrict activity in sectors such as tourism, aviation and energy.***
- ***The extent of the fallout is, however, highly uncertain, and depends on how quickly the virus is contained. To reflect this uncertainty, in addition to our baseline (or pre-coronavirus) projection, we have produced GDP forecasts for three coronavirus scenarios: mild, medium and severe.***
- ***The mild scenario assumes that the impact is serious but short lived, and most of the GDP currently being lost is regained next year. The severe scenario leads to a much bigger negative impact on economic activity in the global economy and CESEE.***
- ***Beyond coronavirus, our broad views on the global economy are unchanged from autumn 2019. Underlying growth is close to its weakest level since the global financial crisis, and this will not change fundamentally during the forecast period. This is despite massive monetary stimulus in the US, Europe and Japan (which we expect to continue).***
- ***Assuming that the coronavirus does not cause a global recession, we continue to see a relatively high degree of resilience to other aspects of global economic weakness in CESEE, helped by loose monetary and fiscal policy. Nevertheless, for most countries, growth will remain substantially weaker than in the peak years of 2017-2018.***
- ***Over the long run, we see a Japan-like scenario for the euro area, with persistently weak growth and inflation. That will also cap the growth potential for CESEE, although we expect some further convergence with Western Europe.***

1.1. CORONAVIRUS AND CHANNELS OF ECONOMIC CONTAGION

The coronavirus has continued to spread. Cases remain concentrated in China, but the virus has spread in particular to South Korea, Iran and Italy. Most European countries have now reported at least a handful of cases, and infection rates are rising. Reports from Northern Italy show a highly advanced medical system in one of the richest regions of the world being effectively overwhelmed. In that context, nothing should be ruled out for the rest of Europe and North America in the coming months.

Death rates are potentially around 10 times as high as those for common flu.[2] Politicians in Europe and the US have been at best slow to react, and at worst downright complacent about the threats posed. In countries where rates of infection appear to be slowing – for example, China and South Korea – this has

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2 The Atlantic (10 March 2020), 'Cancel Everything', https://www.theatlantic.com/ideas/archive/2020/03/coronavirus-cancel-everything/607675/

only been achieved by massively restricting social contact. Among countries in Europe and North America, only in Italy has anything comparable been enacted. As this seemingly inevitable process occurs in the world's other big economies, the extent of the economic fallout will rise markedly.

It is not easy – in fact, it is not possible – to put a number on the global economic effects that the outbreak and spread of the new coronavirus (SARS-CoV-2 – severe acute respiratory syndrome coronavirus 2) which causes the disease COVID-19[3] is going to have – for at least three reasons. First, it is still hard to know how the virus is going to spread, how easily people can be cured (but also potentially re-infected), and whether and how quickly a vaccine/medication can be developed and distributed. Second, because the economic effects depend heavily on governments' and people's (over)reactions: anxiety tends to lead to irrational behaviour, amplifying negative effects. And third, because there are so many direct and indirect effects interacting in multiple sectors that are hard to grasp numerically.

In this section, we discuss some channels through which the local disease outbreak in China is having (and will have) global economic implications.

Production: Naturally, we need to start in China. The new coronavirus has led to a temporary standstill in the factory of the world, affecting both Chinese and foreign firms operating in China, particularly in the sprawling city of Wuhan, in the province of Hubei. As of 10 March 2020, the World Health Organization had reported 67,760 confirmed cases of COVID-19 and 3,024 related deaths in Hubei. These figures correspond to 84% of all cases and 96% of all deaths in China, as well as 60% of all cases and 75% of all deaths globally.

The European companies or joint ventures affected by temporary factory shutdowns and related issues with supplies and logistics include big car manufacturers, such as Volkswagen. Palfinger, an Austrian lifting-equipment specialist, has been unable to operate, because workers were not allowed to return to the production site in Rudong after the Lunar New Year holidays, due to a travel ban aimed at containing the spread of the disease within China.[4]

Growth: According to the National Bureau of Statistics of China, the country's production index fell by more than 45% from January to February 2020. And products that are not produced cannot be shipped: indices on export orders show a very similar picture. A reduction in exports implies lower earnings for China, further curbing its economic growth.

Prior to the outbreak of the virus, the OECD forecast a global GDP growth rate of 3% for the year 2020. Assuming that the epidemic in China will peak in the first quarter of 2020, and the spread in other economies is contained, both Chinese and global GDP are expected to grow more slowly in 2020 – at 4.9% and 2.4%, respectively. However, a longer-lasting pandemic could cut global growth to 1.5% (anything below 2.5% is considered to be a global recession).

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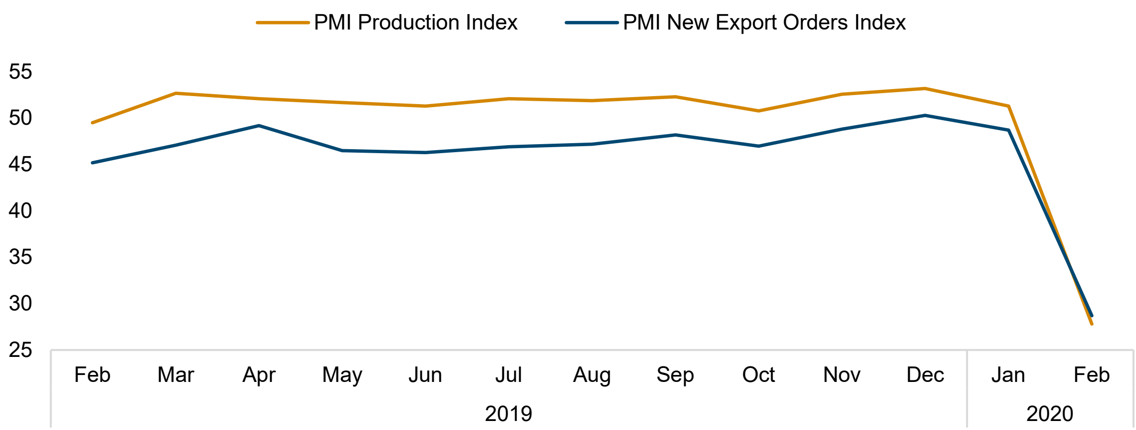
3 WHO, 'Naming the coronavirus disease (COVID-19) and the virus that causes it', https://www.who.int/emergencies/diseases/novel-coronavirus-2019/technical-guidance/naming-the-coronavirus-disease-(covid-2019)-and-the-virus-that-causes-it

4 See e.g. DW (17 February 2020), 'Coronavirus keeps VW's China factories shut', https://www.dw.com/en/coronavirus-china-vw-german-auto/a-52403626; Industriemagazin (19 February 2020), 'Coronavirus: Auch Palfinger hat Schwierigkeiten in China', https://industriemagazin.at/a/coronavirus-auch-palfinger-hat-schwierigkeiten-in-china

Figure 1.1 / Purchasing Managers Index (PMI) for China dropping sharply in February



Data source: National Bureau of Statistics; wiiw visualisation.

Production networks: The other side of the coin is that trading partners are waiting (in vain) for their imports from China. The retail sector will lose out on sales of Chinese products that are currently (or will be) missing from the shelves. Likewise, foreign producers may run short of parts produced in China. For example, Fiat Chrysler has had to suspend its car production in Serbia, as audio system parts have not been delivered. Likewise, Nissan has had to temporarily shut a factory in Japan.[5]

The United Nations Conference on Trade and Development (UNCTAD) published a note in March on which parts of the global economy would be most affected by a 2% reduction in Chinese exports of intermediate inputs. Among the 20 most affected economies, the greatest absolute damage is estimated for the European Union[6], at around USD 15.6 billion. These losses do not take account of commodities and minerals supply, nor of the effect of a slowdown in Chinese demand, nor of the damage resulting from missing deliveries (such as additional strain on healthcare systems, due to shortages of pharmaceuticals). They should thus be interpreted as lower-bound short-term economic effects.

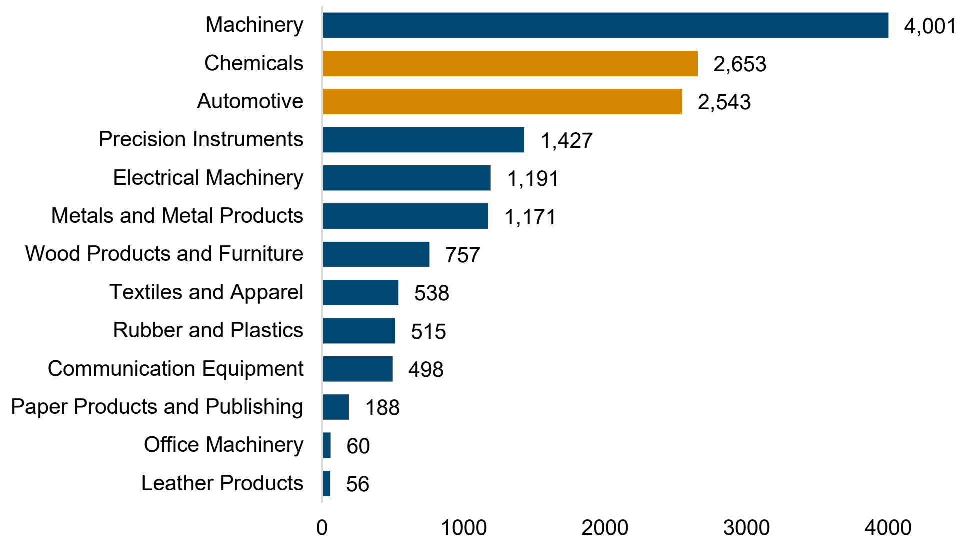
Energy: The massive reduction in (or even the halting of) production at many companies in China has affected energy supply industries in China and abroad. As the demand for imported raw materials and energy has dropped, so have prices. In February, the International Energy Agency expected global demand for oil to drop by 435,000 barrels per day in the first quarter of 2020, compared to the previous year, resulting in the first quarterly contraction in more than a decade. With China's daily crude oil consumption having dropped by 20%, members of the Organization of the Petroleum Exporting Countries (OPEC) were expected to undertake a massive cut in production of between 500,000 and a million barrels a day to support oil prices.[7]

5 See e.g. Reuters (14 February 2020), 'Fiat Chrysler halts production in Serbia over China disruption', https://www.reuters.com/article/us-fiat-chrysler-china/fiat-chrysler-halts-production-in-serbia-over-china-disruption-idUSKBN2081UN; BBC (11 February 2020), 'Nissan to shut Japan factory due to shortage of Chinese parts', https://www.bbc.com/news/business-51441344

6 The UNCTAD report did not include a breakdown of the effect for the European Union by Member State. Other European economies in the top-20 included Belarus, Norway, Russia, Switzerland, Turkey, Ukraine and the UK.

7 See e.g. Bloomberg (2 February 2020), 'China oil demand has plunged 20% because of the virus lockdown', https://www.bloomberg.com/news/articles/2020-02-02/china-oil-demand-is-said-to-have-plunged-20-on-virus-lockdown

Figure 1.2 / Negative effects for the EU through missing Chinese intermediate inputs, in million USD



Data source: UNCTAD; wiiw visualisation.

The diametrically opposite decision by OPEC on Monday, 9 March, to increase supplies, thereby accelerating the fall in prices, came as a shock to experts. The move was allegedly triggered by OPEC's ally Russia refusing to support the organisation's plan to cut total oil production by 1.5 million barrels a day in addition to existing cuts, amounting in total to 3.6 million barrels a day. Oil prices subsequently dropped by 30%, hitting all oil-exporting economies. Not least, US shale oil producers will struggle with a price of around USD 30 per barrel, given that they need a price higher than USD 40 per barrel to cover direct costs.[8]

Aviation: Demand for fuel has also fallen due to reductions in international flights. This comes partly in the wake of government travel bans, and is partly due to precautionary measures taken by individual travellers or airlines. Airlines and airports (including the restaurants and shops in airports) are badly affected. For some crisis-torn airlines, working hours (and correspondingly salaries) have been temporarily cut (e.g. for 7,000 Austrian Airlines personnel).

Tourism: This sector is likely to be the hardest hit worldwide. There will be fewer domestic and foreign tourists. Although the number of Chinese visitors was growing rapidly in recent years, they still constituted only 0.2%-1.1% of total overnight stays for EU member states. The major blow comes from the reduction in intra-EU travel. Hotels and other accommodation, restaurants, public transport and – not least – the entertainment industry will all suffer big short-term losses.

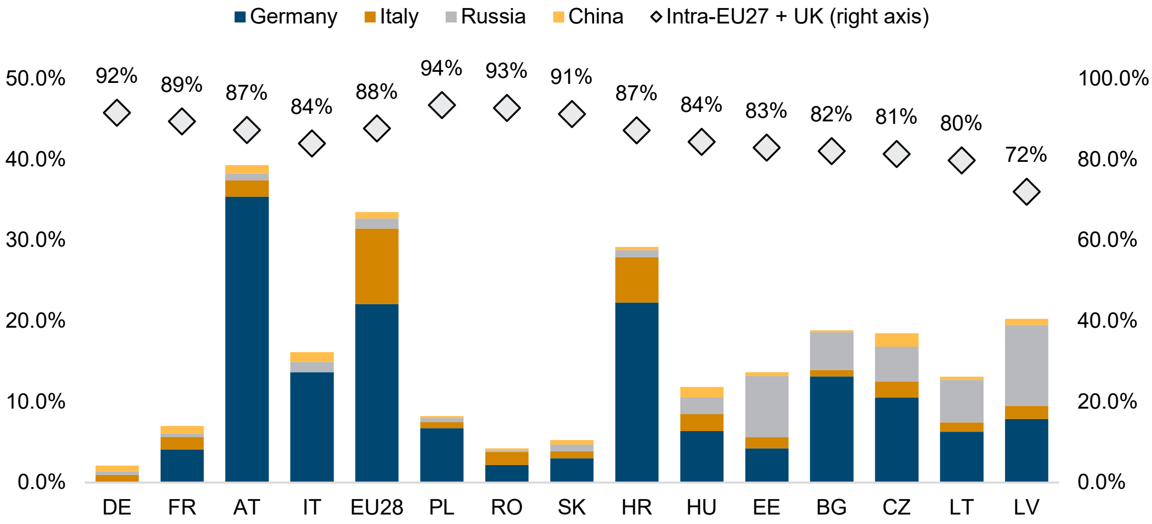
Technology: Demand for digital solutions for production, work platforms and communication (web conferencing tools, live streaming media, podcasts, online courses, cloud services, etc.) was already high, but it has exploded in every country where the government is recommending or restricting physical

8 See e.g. Al Jazeera (9 March 2020), 'The oil price war is a nightmare for US shale producers', https://www.aljazeera.com/ajimpact/oil-price-war-nightmare-shale-producers-200309173245129.html

mobility. Other technological tools and upgrades that are to be expected in public places would include the more frequent use of thermal scanners to detect fever in airports, at train stations and in other places where many people gather; and motion sensors in public conveniences on toilets, taps and soap dispensers, as well as on automatic doors in general, in order to avoid transmission of the virus through people having to touch contaminated surfaces.

Figure 1.3 / The tourism sector is particularly vulnerable to a reduction in intra-EU travel

70% of all nights spent in 2018 concerned intra-EU tourism



Data source: Eurostat [tour_occ_ninraw]. Note: Switzerland including Liechtenstein, China including Hong Kong. Intra-country tourism (e.g. German tourists travelling within Germany) not displayed.

1.2. SCENARIOS FOR THE GLOBAL ECONOMY

Three broad scenarios for economic growth are possible. We define these as ‘mild’, ‘medium’ and ‘severe’.[9] Using OECD baseline projections for the key global economies, we have produced baseline estimates for the impact on growth for CESEE countries, using the World Input Output Database (WIOD).[10] A full discussion of the results and implications for CESEE is included in the CESEE Overview chapter.

In the **mild scenario**, the virus is contained quite quickly and does not spread significantly in Europe or North America. However, commodity markets remain weak, consumers save more, tourism and business travel decline, and the entertainment and hospitality and catering industries suffer. This involves a deeper contraction now, and then a recovery starting from the second half of the year. Much of the GDP that is lost in 2020 is recovered in 2021.

9 Here we follow loosely the projections of the OECD, released on 2 March, see: http://www.oecd.org/economic-outlook/

10 http://www.wiod.org/home

In the **medium scenario**, the virus spreads more in advanced economies, and therefore stricter and longer-lasting containment measures are required to bring it under control. This means the widespread closure of schools and businesses, and a bigger knock-on effect on economic activity.

In the **severe scenario**, the virus would spread significantly in Europe and North America, requiring much tougher action to contain it. This would have far more material economic implications, and would create a deeper and longer-lasting demand shock. In this scenario, we foresee a global recession, including negative growth for at least 1-2 quarters in some of the big European economies on which CESEE depends for export demand, tourism arrivals and capital inflows.

1.3. POLICY RESPONSE

One important area of uncertainty is the timing and scale of a policy response. Although the coronavirus is a medical emergency, policy makers have an important role to play in determining how big the economic fallout will be. Here, we outline our assumptions about what kind of policy response can be expected.

Central banks

The US Federal Reserve has already cut interest rates, and other central banks around the world have also responded. Political pressure is being exerted on central banks to act – not least in the US, where President Donald Trump has not been shy in demanding greater monetary easing in the past. The fact that the crisis is happening in a US election year will probably make the president even more active in this regard. The Fed's actions should have some impact: unlike the ECB, it starts out with positive nominal rates, and so it does have some room to ease policy. Its role is also the most important, given the dollar's central position in global trade and finance. Any dollar squeeze as a result of economic agents hoarding the currency will likely produce more aggressive action from the Fed.

The ECB has less room to act. At its meeting on 12 March, it confirmed that interest rates would remain unchanged – the interest rate on the main refinancing operations currently stands at 0.00%, the interest rate on the marginal lending facility at 0.25% and the interest rate on the deposit facility at -0.50%. However, it announced additional net asset purchases of EUR 120 billion until the end of the year.

However, even the Fed and the ECB are restricted in what they can do to limit the economic fallout from the coronavirus. Simply throwing a huge amount of liquidity at the global economy is unlikely to help very much. Central banks will need to focus on where the real areas of stress are in the financial system, and make sure they provide enough liquidity to keep markets functioning. That will be easier said than done.

At least so far, from a central bank perspective we are still far from a 2008 scenario. Then, the tight relationship between the real economy and finance (via the huge and opaque market for financial products backed by US mortgages) created a systemic risk for the global economy. This crisis does not involve such systemic risks. However, as we have repeatedly warned in previous reports, a decade of extraordinarily loose monetary policy has likely created new risks that will only become fully apparent when a new crisis hits. The fallout from the coronavirus may well expose some of the new vulnerabilities of the global economy and financial system.

Governments

Fiscal stimulus would be arguably a more appropriate policy response to the coronavirus than monetary loosening, and there have already been moves in this direction in many parts of the world. This could be targeted more specifically at the areas that need help, such as the tourism sector or aviation, or small businesses struggling with cashflow.

We believe that a response along these lines will be enacted almost everywhere. However, it is likely to be bigger in China and the US than in Europe. Germany and other Northern European states will be reluctant to bend EU fiscal rules significantly to contain the outbreak, although the pressure on their economies and health systems in the coming months will certainly prompt some loosening of fiscal policy.

Longer-lasting effects

Although the coronavirus itself should constitute a transitory crisis, there may be some important medium-term policy and business implications. First, scientists, medical professionals and economists voice the need for investments in the healthcare system. These include an increase in its physical capacity, the technological upgrading of existing infrastructure, the fostering of research (e.g. for the development of vaccines or medical tests) and ensuring a sufficient number of trained personnel.

Second, short-term responses designed to replace a physical presence with a digital one may well trigger investment in digital infrastructure that will have a lasting effect on the digital transformation of work processes.

Third, some people argue that crises spreading globally through our interconnected world will result in a deglobalisation trend. However, companies affected by supply shortages or by factory shutdowns in China might well decide to internationalise further – diversifying locations for production, in order to have recourse to alternatives, if one location is affected.

Fourth, educational campaigns on proper hand hygiene could shape people's behaviour and the general spread of germs. COVID-19 is by no means the only disease that spreads mainly from person to person through respiratory droplets. Improved behaviour with respect to coughing, sneezing and hand washing could thus contribute to better overall public health.

1.4. BROADER TRENDS: STABILISATION AT A LOW LEVEL

Beyond the coronavirus, we maintain most of our assumptions regarding the global and euro area economies. By post-crisis standards, 2019 was a weak year, and we expect this to remain broadly the case during the rest of the forecast period.[11] However, pre-coronavirus, we had not expected a more serious downturn. Data at the beginning of the year had indicated a stabilisation in the manufacturing sector[12], in line with our expectations. This is now obviously in doubt.

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[11] See Richard Grieveson (2019), 'Global economic outlook', in *Braced for Fallout from Global Slowdown*, wiiw Autumn Forecast Report.

[12] Financial Times (26 January 2020), Signs of a global recovery in manufacturing are starting to show, https://www.ft.com/content/c44dc02c-3d2d-11ea-a01a-bae547046735

A big part of our relatively sanguine outlook on the global economy has been the stance of central banks. The US Federal Reserve, ECB and Bank of Japan have launched unprecedented monetary stimuli over the past decade. We remain concerned about what this means in the long run (owing to the inflation of asset markets); but for now, this stance (and willingness to act further when financial markets get jittery) is an important form of insurance for the global economy.

Even after coronavirus, we continue to see quite big challenges for the global economy, and much of CESEE within that. Although we do not expect the euro area to collapse, we do believe that its future may become Japan-like, with persistently low growth and inflation. The threats to the post-Second World War global trade architecture are clear and go beyond the stance of the current US government[13], with increased protectionism apparently here to stay. This will matter for Germany, in particular, given its relatively high reliance on exports.

For CESEE, the implications are quite significant. Economies in the region will need to transition away from an often high degree of dependence on exports (see CESEE Overview). A large part of the region is heavily integrated into the German automotive cluster, which is facing both cyclical challenges and a structural change towards electric cars. It is not clear that Germany and its CESEE partners are fully prepared for this. Although a large degree of fiscal and monetary stimulus – as well as the strength of domestic demand on the back of high wage growth – will allow CESEE to remain fairly resilient to these challenges, the next few years could be quite tricky for the region.

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13 Bruegel (3 February 2020), From globalization to deglobalization: Zooming into trade, https://www.bruegel.org/2020/02/from-globalization-to-deglobalization-zooming-into-trade/