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The Coronavirus Has Put the World's Economy in Survival Mode

There's little hope for a global economic rebound in 2020.

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Whether or not the coronavirus turns into a global pandemic, the outbreak is already infecting economies and financial markets around the world. While governments try to navigate the fine line between being prepared and setting off panic, the economic costs are growing as countries and communities try to control the spread of the disease.

The hopeful narrative about 2020 heralding a modest rebound in global growth now lies in ruins. Europe stagnated and Japan's economy shrank in the last quarter of 2019, even as China and India were losing momentum. So this year was already off to a rocky start. Now, the coronavirus has put the world economy in survival mode. The spread of the virus is hurting travel, trade and supply chains worldwide. The Baltic Dry Index, a forward-looking indicator of global trade, has fallen by half and oil prices are down by about a quarter so far this year. U.S. stock markets, after initially taking the epidemic's fallout in stride, are now experiencing a major sell-off.

Why were stock markets sanguine for weeks after the outbreak began, and why are they now in full-blown panic mode? Financial markets are prone to large, sentiment-driven swings that sometimes seem out of line with economic fundamentals. But the news of the last few days suggests that, rather than coming under control and being confined to China, the outbreak is spreading and could get far worse. Stock markets in the United States and elsewhere are reflecting this reassessment of the epidemic's future trajectory and the risks it poses.

The notion of this outbreak being a short-lived negative shock to global demand now looks unrealistic. It is not just spending on restaurants and travel that is suffering, but also investment by businesses while they wait for the uncertainty to be resolved. This will have long-term effects on growth even if the outbreak proves short-lived.

Stock markets mainly reflect the prospects of medium-size and large firms. Warnings of weaker revenues and profits from giants like Apple and Microsoft have contributed to the declines in major stock indexes. Even though the United States has so far been relatively unscathed by the epidemic, the plunge in stock markets last week reflects the supply chain disruptions faced by U.S. companies and also weaknesses in foreign markets that account for a significant portion of U.S. multinationals' revenues.

The disruption of supply chains, especially those that pass through Asia, is hurting businesses in multiple dimensions. Countries such as China, South Korea and Japan are critical to the supply chains for products ranging from plastic toys to iPhones to high-tech machinery. In these countries, manufacturers can't get raw materials delivered reliably, are facing worker shortages and are having difficulty shipping out products. Rejiggering supply chains takes months, if not years. If the coronavirus spreads and causes disruptions to other major economies, it could wreak further havoc on supply chains.

Still, big companies are better equipped to cope in difficult times. They tend to have large cushions of cash and can get financing from banks. The picture is bleaker for small companies.

In most countries, including the United States, small private businesses are among the most dynamic in creating jobs. But they usually have slim financial cushions. Banks are often reluctant to lend to small businesses even in the best of times. Moreover, even if their employers stay afloat, employed workers are likely to pare back spending as they face uncertainty about job prospects and shrinking investment accounts.

Another quandary that governments face, especially in China and other countries hit hardest by the coronavirus, is how to balance containing the spread of the epidemic with keeping their economies humming. Every day that factories stay closed and restaurants have no customers makes it harder to get things back up. On the flip side, the very nature of increased economic activity, with more person-to-person contacts, would make it harder to control the spread of the epidemic.

There is no easy way out. The Federal Reserve and other central banks could cut interest rates. This might not do much good, as uncertainty will restrain consumer spending and business investment even if cheap loans were available. Government spending might be more potent. Any assistance that reaches small businesses and allows them to stay afloat or goes directly into the hands of low-income consumers will help. But consumers and businesses are as likely to stash away any extra cash as they are to spend it.

Governments cannot eliminate uncertainty, but they can ensure the transparent and accurate flow of information. Even if the news is bad, consumers, businesses and investors need to know that they have a reliable picture of the facts. That, along with knowing that governments are doing all they can, might be the salve that everyone needs.

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