

Assessing the impact of the COVID-19

HDFC Bank, February 2020

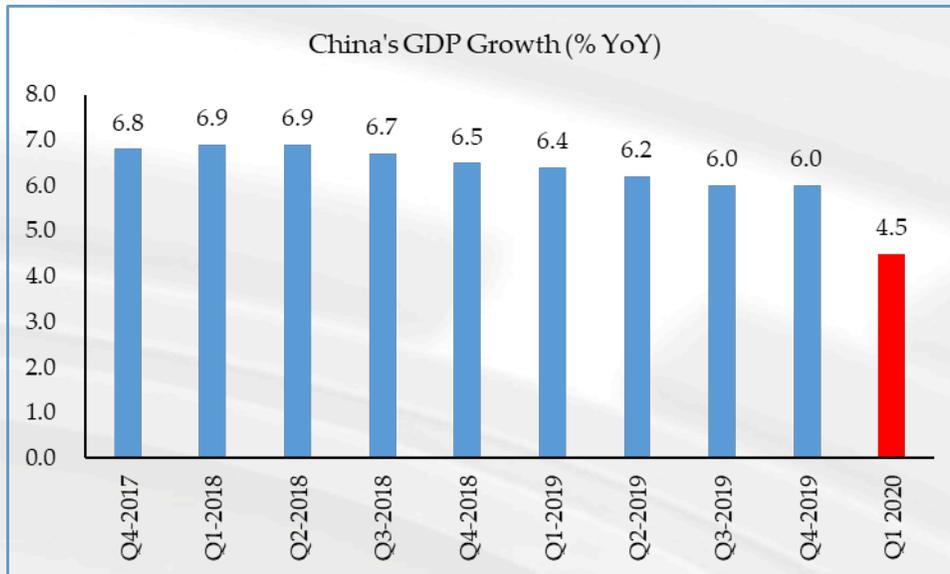


Key Points

- **Impact of COVID-19 likely to be higher than SARS 2003** as number of people affected is higher and China is more closely linked to the global supply chain now than in 2003.
- **Too early to say if the impact is peaking:** Number of cases have started declining in China, but new cases reported globally are rising. Chinese companies have resumed activity but activity levels remain low due to logistics and staffing issues.
- **China Q1 GDP expected to fall by 1.4-1.5 ppt due to coronavirus to 4.5%.** We expect growth to recover gradually from Q2 if the impact of the virus is contained over the coming weeks. China growth for 2020 expected to be below 6%. Monetary and fiscal stimulus to limit the downside to growth.
- **Spillover to the Rest of the world through lower tourism activity, supply chain disruptions and slowdown in China. Activity to be hurt in EMs as well as European countries** (especially Germany) – those that export to China (Brazil, South Africa, Taiwan, HK, Germany) and those that import intermediate goods from China (South Korea, Malaysia, Thailand etc.).
- **Global GDP** revised downwards by 10 bps to 3.2% in 2020 by IMF due to coronavirus related disruptions.
- **On the domestic front,** India and China are major trading partners and a sharp hit to both our exports and imports is likely.
- **The decline in input imports** such as in the pharmaceuticals, auto and electronics sectors could affect India's domestic production downstream.
- **Opportunities:** In relative terms India seems insulated from the virus and could emerge as an alternative global sourcing base for a number of commodities such as textiles, furniture, etc.
- **Constraints:** Limited production capacity and competition from Vietnam and Cambodia in replacement buying space act as constraints

Coronavirus Outbreak: Assessing the impact on China's economic activity

China's GDP growth (%YoY) is expected to moderate in Q1 2020



Measures announced by the government and the central bank to cushion the impact of the coronavirus outbreak

PBoC lowered the interest rates on medium term loans by 10 bps (1 year Prime Lending rate) after having cut the reverse repo rate by 10 bps earlier in Feb-20. Also, provided RMB 500bn special lending fund to support the firms and the agricultural sector. The PBoC is expected to cut the CRR and the LPR further.

Finance Ministry has pledged more fiscal stimulus including a reduction in the corporate taxes

China to cut some pension contributions and insurance fees to help the affected companies

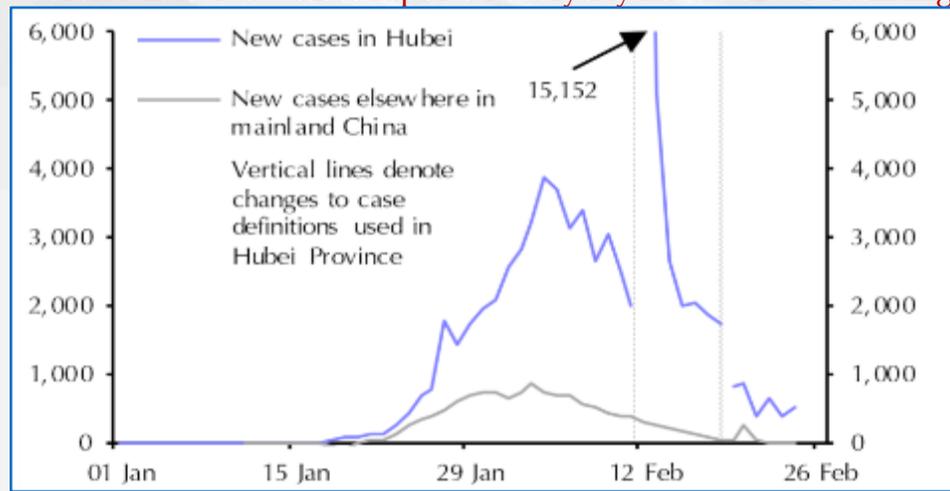
The government to waive VAT for small firms in Hubei (for Mar-May 20) and lower the tax rate from 3% to 1% for small firms in the rest of the country

- China's GDP growth is expected to moderate in Q1 2020 to its lowest level (4%-4.5%) since the global financial crisis amidst an economic fallout from the coronavirus outbreak.
- For the full year, China's growth is expected to decelerate government's estimate of 6%.
- If the virus is contained over the next few days, the impact could primarily be felt in Q1 and growth could catch up from Q2 onwards as activity resumes. However, a prolonged shutdown could mean that the recovery is much more shallow and gradual with growth slowing to 5.5% for 2020.

New cases declining in China – Is the impact peaking?

- **The decline in new cases reported in China signal that the impact from the virus could now be peaking** and the situation could start improving over the coming weeks.
- **Workers' return to work after extended shutdown will be closely tracked.** State media reported on Tuesday that more than 80% of its central state-owned enterprises' roughly 20,000 manufacturing subsidiaries have resumed work (as of Feb 18). However, quarantine restrictions, uncertainties over government approvals, logistics issues and insufficient staff to run at full capacity mean that recovery is likely to be slow. Only 30-50% of production have resumed by the last week.
- **Global supply chain disruptions are hitting production in other countries as well:** While Apple cut its sales forecast, hit to global Auto industry is likely to impact Japan, South Korea and Germany. Within China, Mining, Travel, Construction and Retail are expected to take a hit.
- **The experience from the SARS outbreak shows that activity could rebound as the spread of the virus is contained:** China's gross domestic product growth slipped to 9.1% from 11.1% in the second quarter of 2003 while Hong Kong, Taiwan and Singapore also took a hit. Although, the rebound in manufacturing and other business activity after the outbreak of Severe Acute Respiratory Syndrome, or SARS, in 2003 suggests the damage to manufacturing industries this time around may rebound if the virus is contained over the coming days.
- **However, the impact from the COVID-19 virus is likely to be higher than what was witnessed during SARS 2003 as the number of people effected is higher and China is more closely linked to the global supply chain compared to 2003.**

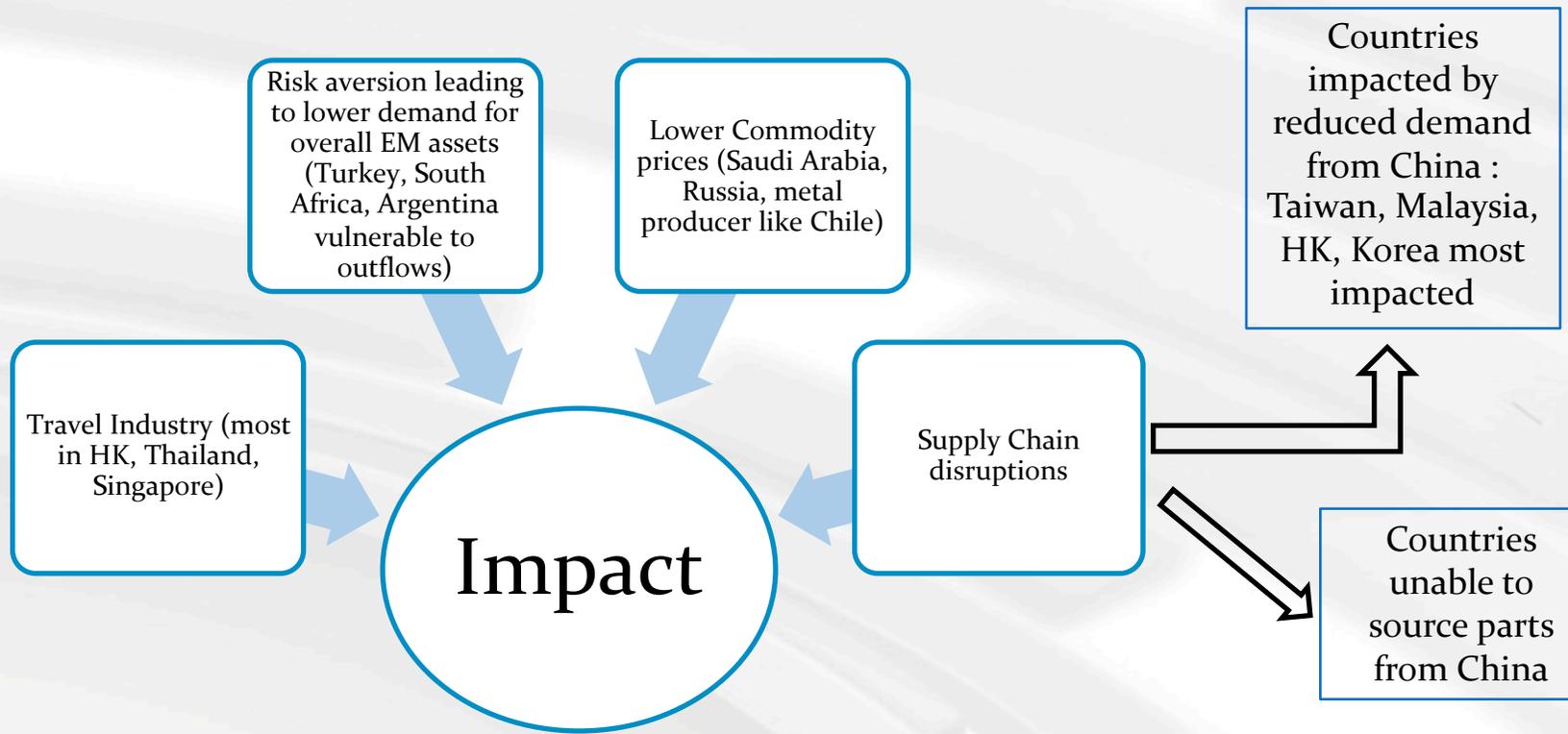
Coronavirus: New cases reported everyday have started declining



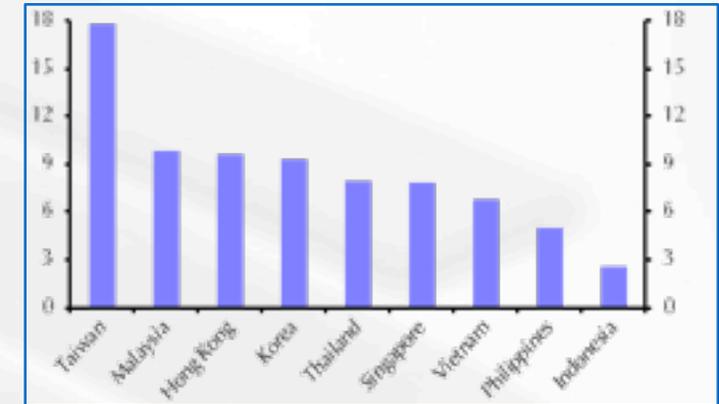
China's GDP growth (%YoY) during SARS outbreak



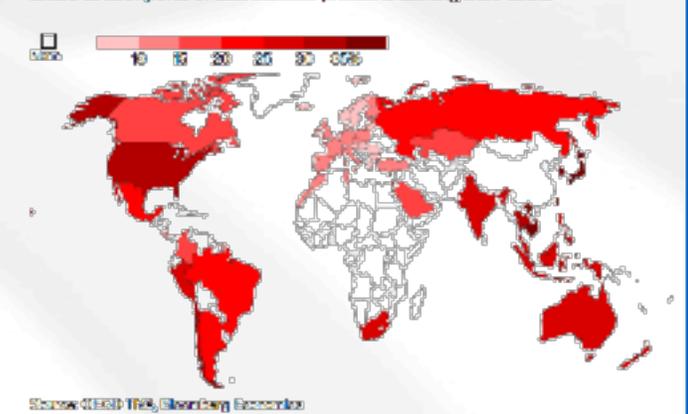
Linkages to the rest of the World



Domestic value added content of intermediate exports to China (%GDP)



How Coronavirus Can Infect Global Supply Chains
Share of all imports of intermediate products coming from China



Loss for China, Gain for others? Due to the US-China trade war, global supply chains have been shifting to other EMs (Vietnam, Bangladesh, Thailand etc.). The supply disruption in China due to the coronavirus could provide an opportunity for some of its EM competitors to gain further. For instance, India has been receiving a higher number of order enquires in textiles, ceramics, homeware etc. in recent days from companies in US & EU.

Countries and sectors that are vulnerable

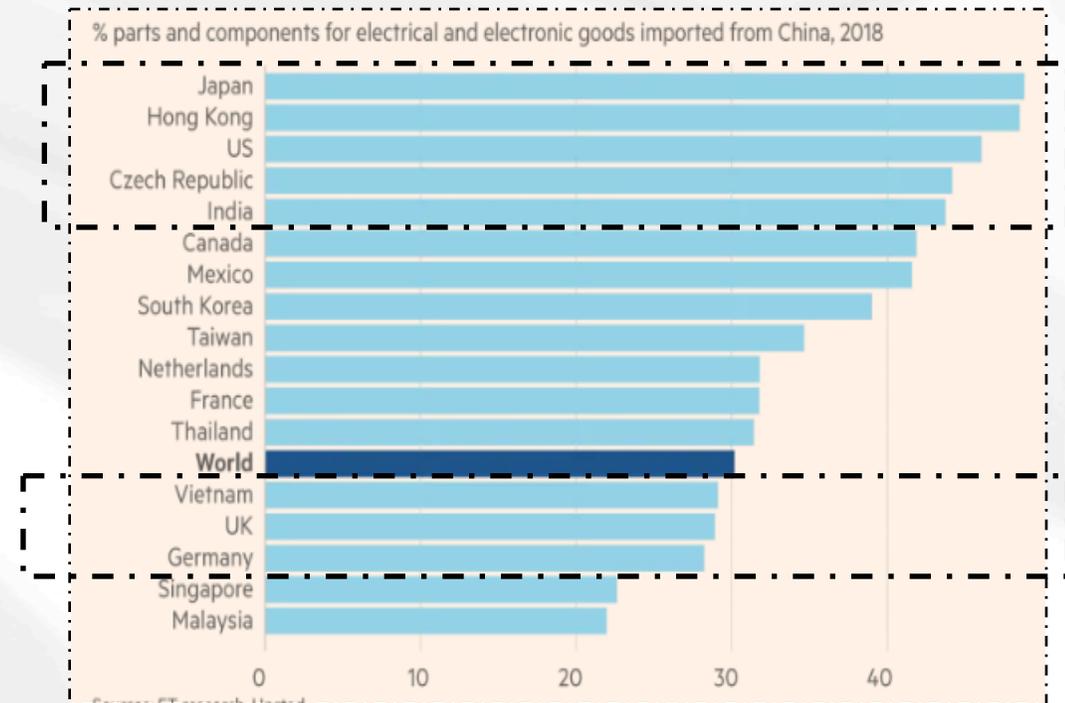
Imported Manufacturing Inputs from China as a% of total imported Manufacturing inputs

Countries: Amongst EMs Vietnam, Malaysia, Thailand, S. Korea, Indonesia and India could suffer

Sectors: Textiles, Auto parts, Electronic devices and machinery most hit

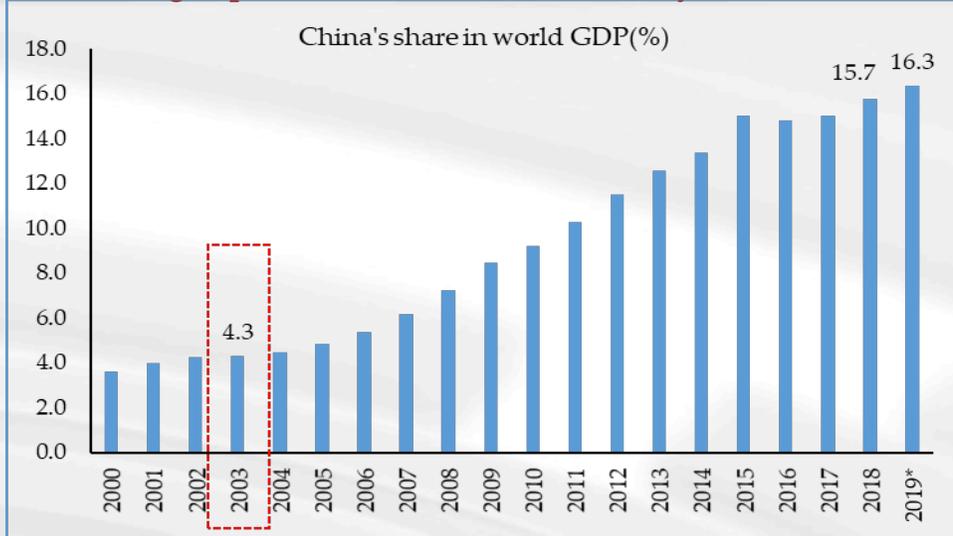
	Food & Drinks	Textiles	Chemicals	Rubber & Plastic	Electronic devices	Electrical machinery	Autos & Parts
Vietnam	12	47	22	29	41	39	40
Malaysia	14	42	14	19	29	28	25
Thailand	17	38	16	23	39	31	27
S. Korea	16	44	15	24	45	33	29
Taiwan	9	29	12	19	36	30	21
Phillipines	14	38	19	22	18	29	18
Singapore	8	21	6	7	6	9	9
Indonesia	12	36	15	21	43	34	14
India	8	35	25	26	48	15	21

Countries dependent on China for their industrial supply chains: US, UK & Germany also taking a hit



Global growth revised downwards amidst COVID-19 outbreak

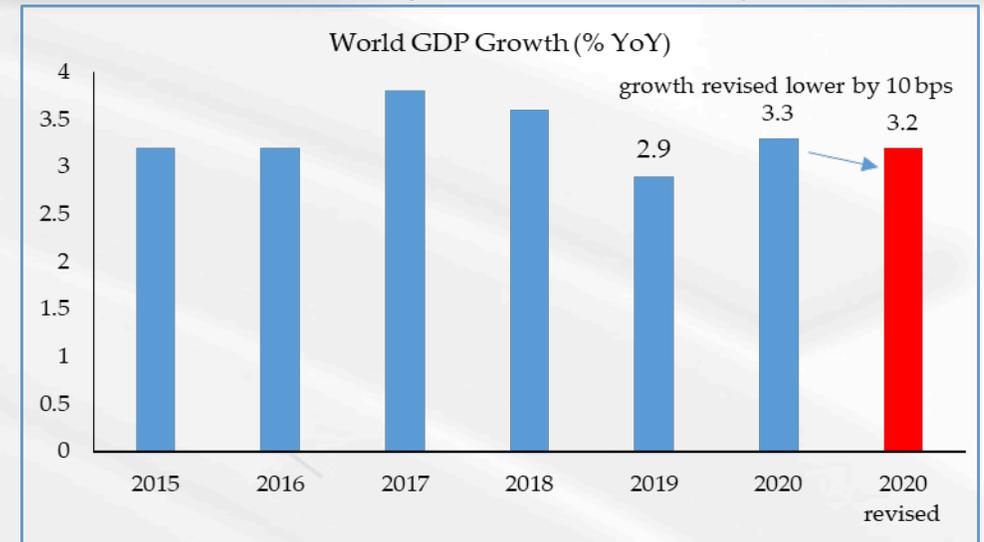
Increasing dependence of the world economy on China



China's share in world trade has risen considerably since the SARS outbreak



Global GDP growth revised lower by the IMF



Goods barometer signals further weakening of trade in Q1 2020



COVID-19 is likely to dampen trade prospects further.

Source: WTO, IMF, WEO, Reuters, Media reports, HDFC bank

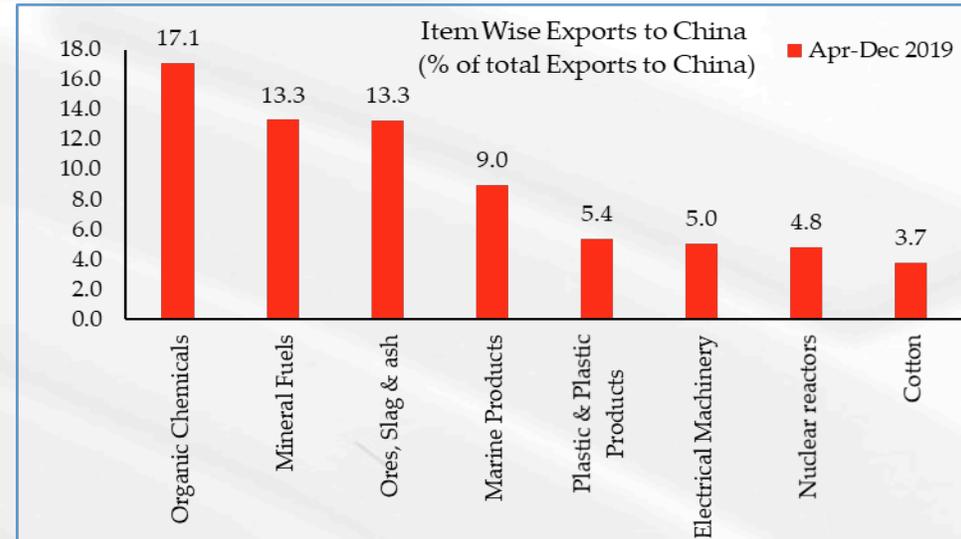
India's trade with China: Snapshot

(USD bn)	2002-03 (SARS Outbreak)	2018-19	CAGR (%)
Total Trade (Ex+Im)	4.8	87.1	20
Exports	1.98	16.8	14.3
Imports	2.8	70.3	22.3
Trade Deficit (-)	0.82	-53.5	29.8

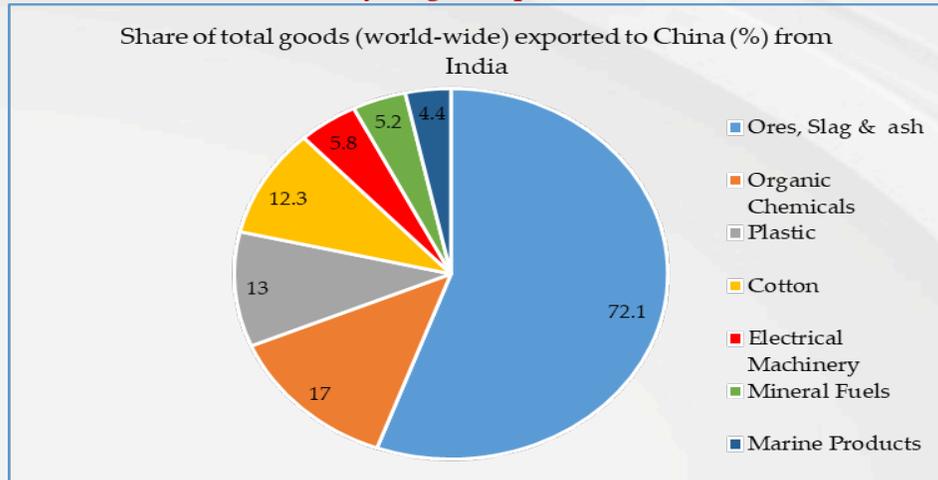
- **India's** trade relations with China were not affected during SARS outbreak as total trade with China stood at a mere USD 4.8 bn in FY03 (accounting for 4.2% of India's total trade). Both exports and imports share from China increased after the SARS outbreak.
- **Present Situation (FY2019):** China is India's second biggest trading partner, accounting for USD 87.1 bn in total trade (10.3% share in India's total trade)
 - **Imports:** China is the biggest importing partner, accounting for 14% of total imports in India.
 - **Exports:** China is third largest market for domestic merchandise goods, accounting for 5.1% of India's exports.

Impact of the coronavirus on the domestic economy: Exports analysis

China is the third largest market for domestic goods



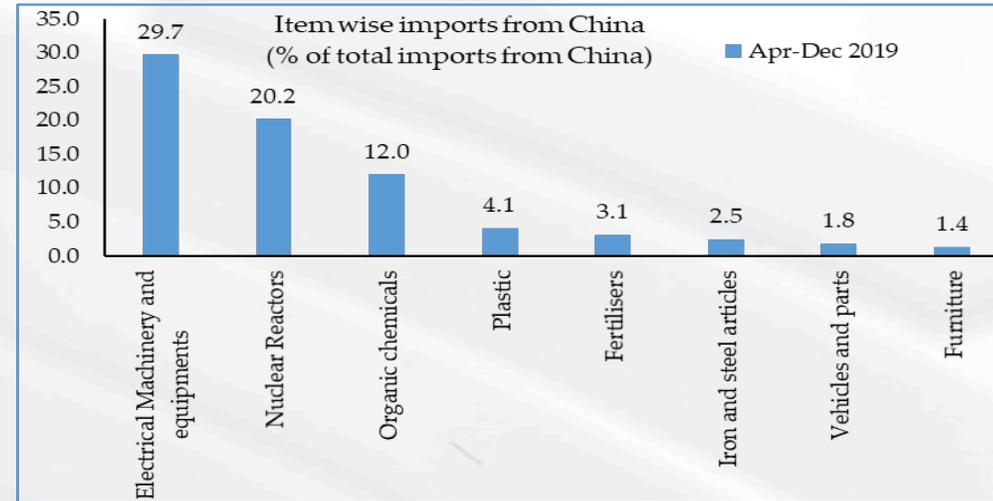
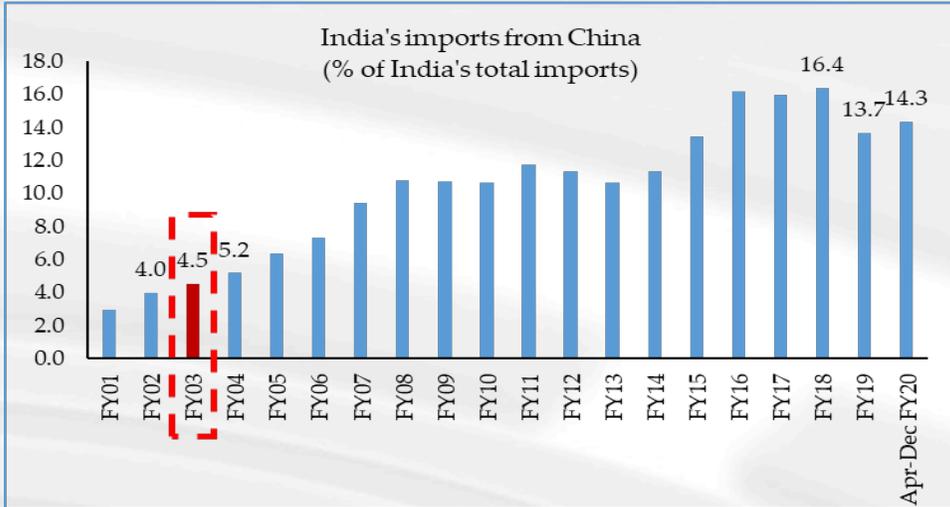
Exports of commodities like ores, organic chemicals, etc are likely to get impacted



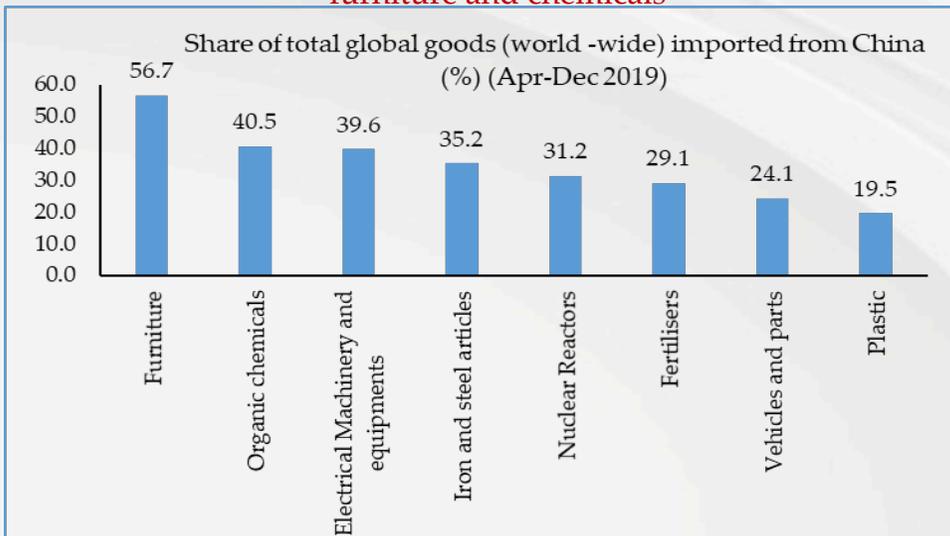
- China is the third largest market for domestic merchandise goods, accounting for 5.1% of India's exports in FY19.
- Slowdown in economic activity in China likely to weigh on exports from India. China's economic growth is likely to moderate to below 6% in 2020
- Export of commodities like ores (India exports 72% of its total ores to China), organic chemicals, cotton, etc is like to get hit should the disruption from the coronavirus continues for an extended period.

How is the coronavirus going to impact India's imports

China is the biggest importing partner, accounting for 14% of total imports in India in FY19.



Heavy reliance on China for the import of electrical machinery, furniture and chemicals



- India gets 14% of total imports from China. Slowdown in imports of inputs could have an impact on domestic production as India has a high dependency on China for manufacturing inputs.

Source: Ministry of Commerce, IMF, WEO, Reuters, Media reports, HDFC bank

India's "input reliance" on China: Sectors expected to be affected

Pharma

India's overdependence on raw material supply: ~68% of active pharmaceutical ingredients (API) imported by Indian companies from China in FY19.

Electronics

Heavy reliance on China for electrical machinery and equipment. ~40% of India's electrical machinery and equipment is imported from China. **That said dependence is reducing as the share of imports reduced from a whopping 59.5% in FY18 to ~40% in FY19**

Power

Solar power parks are dependent on Chinese imports for converting sunlight into grid electricity. 80% of solar cells and modules which absorb sunlight to generate electricity are imported from China based manufacturers.

Consumer Durables

Around 45% of consumer durables are imported from China. Anecdotal evidence suggests that the companies typically maintain inventory for 2-3 months. Hence, the impact of the virus outbreak could be felt from Mar-Apr 20. There could be an upward pressure on the prices, going forward

Auto

- Chinese firms supply around 10-30% of automotive components.
- Empirical evidence suggest that manufacturers maintain inventory for a couple of months. However, if the disruptions last longer (factories do not resume activity in China), it could further impact an already struggling auto sector as supply disruption of even one component could halt the assembly line.

Tourism

According to the Ministry of Tourism, China accounted for 3% of total foreign tourist arrivals in 2019. To highlight, the pace of tourist arrivals from China has been increasing at an annualised rate of ~11% since 2011. Thus, travel curbs on Chinese nationals is likely to have a temporary impact on the tourism industry

- **Supply disruptions are likely to impact the production of companies dependent on inputs from China.**
- **On the other hand, if industries try to source these inputs from other markets, it could lead to higher input costs.**

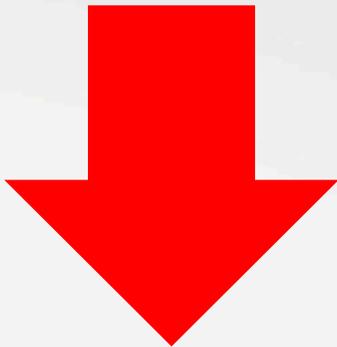
Opportunities and Constraints



Opportunities

- India has been getting queries from the EU and the US for textiles, homeware, ceramic tiles, engineering goods, furniture, etc. seeking to replace China as a supplier
- In relative terms India seems insulated from the virus and could emerge as an alternative global sourcing base for a number of items
- **Developing ecosystem to complete manufacturing rather than just assembly**
- **Making India a manufacturing destination for global companies**
- **Accelerate Make in India**

Constraints

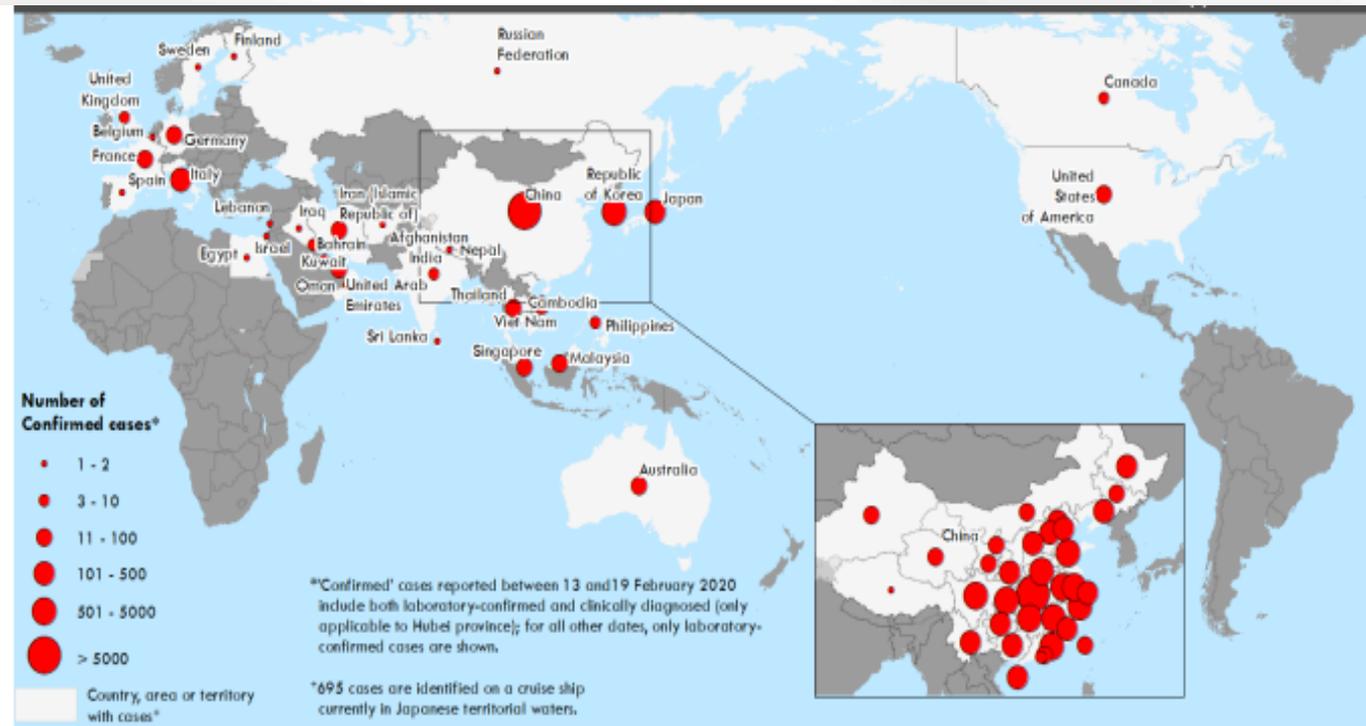


- **Regulatory mechanism**
- **Limited production capacity**
- **Competition from Vietnam and Cambodia in replacement buying space**
- **Leather sector: Heavy dependence of leather footwear companies on components such as soles from China.**

The COVID tracker: The spread of the virus

- **Maximum impact continues to be felt in China.** As of 25th Feb, total number of cases confirmed reached 77780 with 2666 deaths so far – most of them in Hubei province in China.
- **Number of new cases beginning to rise outside China:** Italy, Singapore, Japan, HK and South Korea.

COVID-19 cases as of 25 Feb-20



Cases confirmed outside of China

Countries	Confirmed Cases>10
China	77780
Republic of Korea	977
HK	745
Italy	229
Japan	157
Singapore	90
Iran	61
USA	53
Thailand	37
Australia	22
Malaysia	22
Vietnam	16
Germany	16
UK	13
France	12

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