Is the Coronavirus the Trigger of a Global Economic Crisis?

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hpo forecasting on the current development of the global economy.

Looking back to the present situation in a few years, the Corona crisis will be remembered as a decisive event. Politicians are trying to slow down the spread of the pandemic with unprecedented measures – and rightly so because the health of the population is an absolute priority. But also the question what this means for the global economy is of interest. Have the last few weeks been the beginning of a worldwide economic crisis, or will the situation on the economic front calm down in a few months? Since the downturn – irrespective of the corona outbreak – had already been evident in the systematic observation of real economic cycles for some time, it is possible to formulate reliable statements in this regard.

"Stock market bloodbath," "Supply chains put to the stress test," "The situation is dramatic – fear of coronavirus is causing retailers' sales to collapse," "The Federal Council of Switzerland declares national emergency." These and similar headlines are appearing in the business press these days.

From an economic point of view, the big question is what the consequences of this pandemic will be for the companies. Can we expect a brief economic slump, as was the case with the SARS epidemic of 2003, which will then recover very quickly? Or will it end in a full-scale economic crisis this time? This is the question we are getting to the bottom of in today's exclusive hpo economic commentary in light of current events.
To estimate the future, it is necessary to establish the interpretive outline of facts. In our real economy model, we focus on industrial production, consumption, and sentiment indicators. Of particular interest here is how the situation was before the coronavirus struck us all:

- Industrial production: Demand for capital goods weakened as early as 2019 in Europe, Asia, and most recently in the United States. In Germany, for example, order intake by mechanical engineering companies fell by 9 % compared to 2018. Although the figures for incoming orders in the first two months of 2020 are not yet available, many industrial companies are already reporting that some of them have again seen a sharp decline in incoming orders since the beginning of the year.

- Consumption: The growth rates regarding consumption in Asia have been flattening out for some time now and are far below the long-term trend growth. Consumption in Europe and North America was still very strong at the end of 2019; however, the dynamics have shown a sideways movement since then. The forecasting model used by hpo forecasting has indicated for some time that a substantial decline in consumer sentiment can also be expected in the West by 2020. With the rapid spread of the coronavirus and the measures adopted by governments, this has now occurred even more rapidly and much more drastically than expected. Despite the lack of reliable figures, one thing is clear: the shutdown of entire regions and countries must be expected to result in a sharp decline.

- Sentiment indicators for industry (e.g., the OECD's Business Confidence Index or the Purchasing Managers Index Industry) have been highly reliable indicators for the development of demand in the capital goods industry in the past. In recent months, these indicators have been moving clearly in the contractionary range in most major markets, thus indicating a downturn – irrespective of the coronavirus. The first sentiment indicators from China at the beginning of 2020 suggest a dramatic decline, although reliable figures for the world regions are yet to come.

We can draw the following interim conclusion: The global economy was in an unstable phase even before the outbreak of coronavirus. The forecasting models of hpo forecasting (we observe and analyze around 100 sub-sectors of the capital goods industry worldwide) indicated early on that the decline in incoming orders in the capital goods industry in 2020 would speed up in almost every sector – irrespective of the coronavirus.

The Peter Meier Forecasting Model of hpo forecasting has been indicating for some time that consumption in Europe and the U.S.A. will fall in 2019/2020, similar to what has been observed in Asia. The previous estimates for 2020 by hpo forecasting or Peter Meier – the inventor of the hpo forecasting model – are well documented not only in our quarterly economic commentaries, but also in an article by the Neuen Zürcher Zeitung from 14 May 2018, an interview by the Technische Rundschau from July 2019, as well as a report by the Business Magazine ECO on Swiss Television from 26 August 2019.

Coronavirus is the trigger but not the cause of the approaching economic crisis

The probability that the coronavirus is the trigger for a downturn in the global economy is very high. According to our analyses, the fundamental data of the real economy have led us to expect an economic crisis for some time. However, it was completely unclear what the trigger would be.

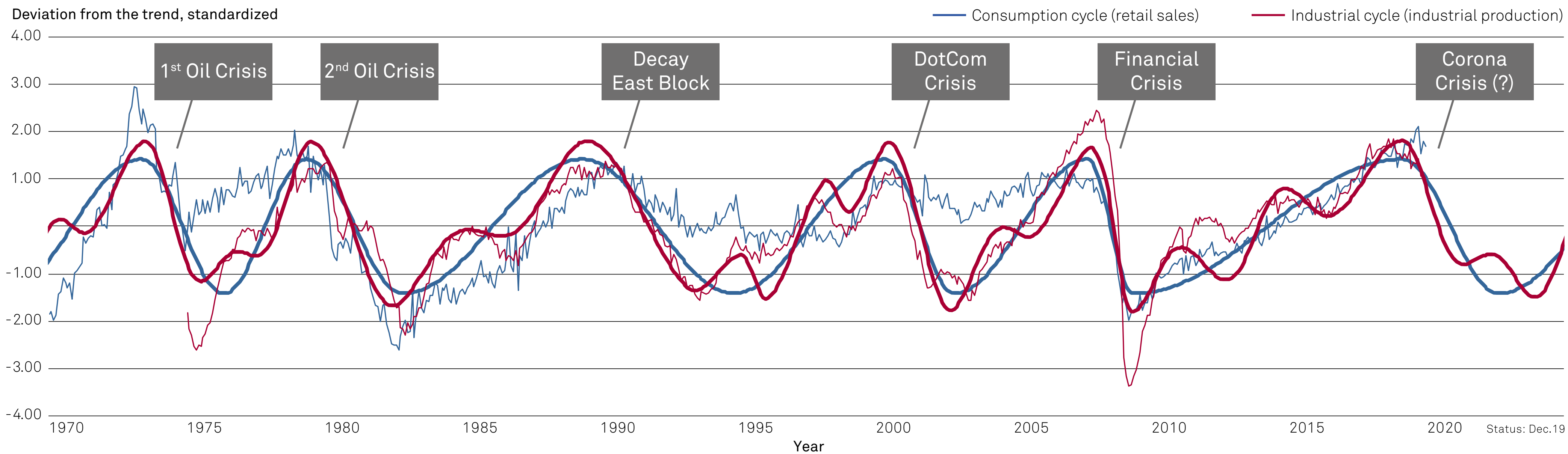
Every global economic crisis can be associated with a drastic event. The structural crisis in the 1990s included the collapse of the Eastern Bloc and the War on Iraq. The 2001 downturn is strongly linked to the bursting of the dot-com bubble and the terrorist attacks in the U.S.A. on 9 September. And the 2008 financial crisis has etched images of freshly laid-off investment bankers walking on the sidewalks of New York and London with cardboard boxes in their arms into our collective memory. What all these economic crises have in common is that the economy moved into an unstable phase long before the respective trigger was known.

The same is now happening with the current downturn. The current economic crisis – of which we are only at the beginning – could have been triggered by any other event. Our secret favorites so far have been the U.S. trade wars, an escalation in Iran, a hard BREXIT, the U.S. Repo Crisis, and the commotions in Hong Kong. However, it has been shown once again that a trigger is usually an event that nobody expects. Even though epidemiologists have long been aware that a pandemic is possible at any time, the spread of this virus – and the governments' strong reactions in response – could not be foreseen, especially regarding the specific point in time. Nevertheless, it was possible to identify the unstable situation of the global economy based on real economic indicators. From an economic point of view, we are unlucky that COVID-19 is entering our lives at this economically unstable time as consumption and investment cycles have just surpassed their peak.

The economy is unstable once the consumption and investment cycles have passed their peak. In the past, this happened every seven to twelve years. Then all it took was a random trigger to set off the crisis. The crisis, at least in terms of consumption, actually began about a year ago in Asia and early-cyclical sectors of the capital goods industry. Yet, there is a high probability that the current downturn will go down in the history books as the Corona Crisis.

The figure below shows the deviation from the long-term trend in retail trade and industrial production in the OECD. The effective values can be approximated with sine curves of different wavelengths. The values from 2020 onwards show the hypothetical trend for the future and were established before the outbreak of the corona epidemic. A global economic crisis followed every time the consumption and investment cycle reached its peak.

The cycles can be predicted reliably with the help of the Peter Meier Forecasting Model by hpo forecasting. It was thus possible for Peter Meier to announce the dot-com crisis of 2001, the financial crisis of 2008, and also the current downturn with a lead time of about two years. Further details on this model can be found in the book “The Economy as an Oscillating System” by Peter Meier (published by Hanser, 2019).



OECD consumer and industrial cycle

Source: Analysis by hpo forecasting, based on raw data by the OECD

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So, what happens next?

A global economic crisis is likely due to the described economically unstable phase in combination with the strong corona impact. However, this can have very different effects on different industries and sub-sectors. We analyze these global effects in our daily work. With the help of industry models, we are also able to make reliable forecasts of order intake for individual companies.

A significant factor of uncertainty is the political and financial market response. Given the extraordinary situation, it is appropriate to take drastic measures to protect the population and thus slow down the spread of the virus. Overburdening of health care providers should be kept within limits, as people's health is the top priority.

The partly drastic effects on the economy of the measures already taken cannot be denied, however. The more drastic these measures are, the greater the short-term economic impact. In the medium and long term, on the other hand, real economic cycles are likely to remain the dominant factors – at least for the capital goods industry. The problem is that these cycles – irrespective of COVID-19 – also lead us to expect a negative development. The sectors of the economy already severely affected by the decline in the real economy are currently further impacted by the pandemic.

We see a severe problem in the high level of corporate debt worldwide. For many debt-ridden companies, several months of poor business performance are enough for them to get into financial difficulties and no longer be able to pay their debts despite low interest rates. If this happens on a large scale, the outlook is likely to worsen, and in extreme cases, a financial crisis could emerge over the next few quarters.

There are also glimmers of hope

Companies that have a solid balance sheet and are therefore able to survive a sharp downturn can, however, emerge from a crisis stronger than before. This is because some competitors will exit the market for financial reasons. There may be excellent opportunities for acquisitions, especially in the fragmented mechanical engineering sector. There are also anecdotal signs that substitution effects are occurring in individual sub-sectors, for example, when Western companies replace their Chinese suppliers with European suppliers.

Conclusion

Overall, it can be said that the initial situation for a global economic crisis has worsened considerably. This is in line with the economic outlook presented by hpo forecasting at a time when we associated Corona primarily with Mexican beer. Due to recent events, we now also know the most probable trigger of the crisis.

However, the outbreak has little impact on our medium- and long-term forecasts as they were already pessimistic. The consequences of the global downturn on the individual sectors and sub-sectors must be analyzed using the differentiated sector models.

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