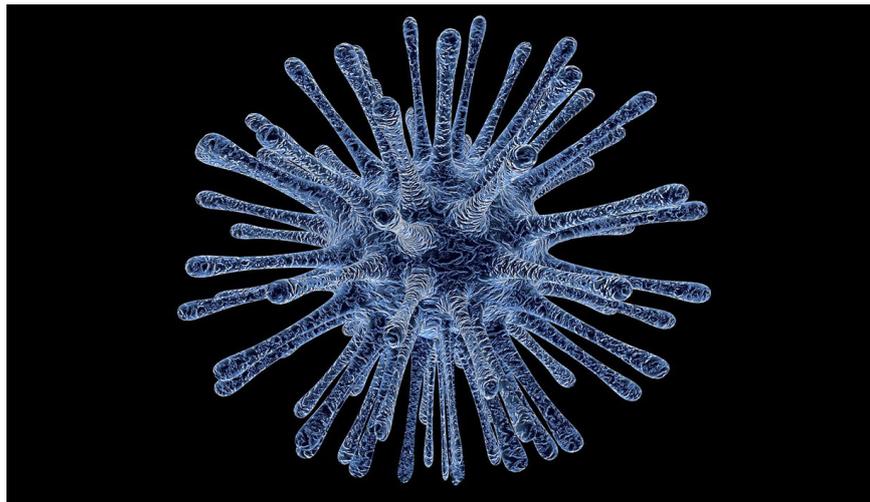

Coronavirus market selloff 'a gross overreaction'

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Although we project a grim set of scenarios in terms of fatalities in our analysis, our view on the economic impact is much more sanguine. Weighting our scenarios by probability, we forecast an average negative 0.2 per cent long-term impact on World GDP due to the COVID-19 pandemic.

To be sure, we expect a much larger impact in the short run (with an average negative 1.5 per cent impact on 2020 World GDP across our scenarios). However, equity valuations on average should be unscathed if our long-term projections on GDP are correct. Therefore, we think a 10 per cent+ fall in global equities since the outbreak began is a gross overreaction.

Likely channels for a pandemic to affect GDP

In the short run, there are many channels through which a pandemic could negatively impact GDP. Below we list some of the channels categorized into "supply-side" and "demand-side." Supply side factors include those which affect the productive capacity of the economy (often referred to as "Potential GDP"). Demand side factors are those which affect actual GDP without affecting the productive capacity of the economy.\

Key supply-side factors:

- ▶ Labor supply would be curtailed by death, illness, quarantining, and preventative furloughs. This could come either from government restrictions (for example, mandatory quarantines), or from voluntary worker decision to avoid risk of infection.
- ▶ Businesses could close in at-risk industries to mitigate infection risk for employees and customers alike. Tourism, transportation, retail, and restaurants are possible examples.
- ▶ Regions or countries not directly impacted by the pandemic could see supply chain impact via trading partners hit with the virus.

Key demand-side factors:

- ▶ "Confidence" is the key demand side channel. Confidence is an elusive concept to quantify or model in a precise way, but it undoubtedly is a major demand-side driver of economic activity.
- ▶ Falling consumer confidence could cause lower household consumption.
- ▶ Falling business confidence could cause lower investment.
- ▶ Laid off or temporarily furloughed workers in affected sectors will likely reduce their short-term consumption, even if workers expect to regain employment in the near future.

	Typical Pandemic	Seasonal Flu
Seasonality	Varies	December to March (winter months)
Timeline	6-8 week outbreaks, with multiple 2-3 month waves, seasonal potential in future	Roughly 4 months
Immunity	Typically lower	Varies
Infected	20-40% of population	3-11%*
Target	Spanish flu hit young adults hardest, 2009 spared elderly, but typically young or old	Young and old, chronically ill
Incubation period	Typically similar to seasonal	2 days
Contagious prior to symptoms	Roughly one day	Roughly one day

Separating short-run and long-run factors

While all of the factors listed above are serious potential drivers of short run GDP impact, most of them should abate once the pandemic is over, and therefore they aren't logical contributors to long-term GDP impact.

On the supply side, for example, laid off or furloughed workers will be able to return to work when the outbreak subsides (with the exception of fatalities). On the demand side, confidence should return quickly, and consumers and businesses will be eager to make up for postponed expenditures.

Some agree short-run impact could be very large, but long-run impact should be minimal

Recent research finds a large short-run GDP impact, but none find a significant long run impact (even in a very severe scenario).

Some of the papers we consulted include an explicit long-term model. WJ McKibben and AA Sidorenko find that the impact of the pandemic shock on GDP fades to virtually zero by about four years after the pandemic occurs.

Within range of the 0.2 per cent population fatality rate projected in our bear-case scenario, the research projects a short run GDP decrease of 9.3 per cent (Kennedy, 2006), 2 per cent (McKibben, 2006), and 1 per cent (Congressional Budget Office, 2006).

The Kennedy paper is the clear outlier; this is chiefly because it is the only paper to incorporate confidence effects in the authors' economic model (accounting for 550 basis points of their total projected impact).

We agree with the inclusion of confidence effects, though we think the arbitrary magnitudes chosen in the Kennedy paper (including a 10 per cent hit to household consumption in the first quarter of the pandemic) are too high.