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Nordic Macro: How will the coronavirus outbreak affect the Nordics?

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The outbreak of coronavirus has caused the World Health Organisation to declare an international health emergency. It will probably weigh on global growth. Although the effects on the Nordics seem small, some developments should be closely watched.

- China's Q1 GDP growth rate is estimated to be reduced by approximately 3% points due to the outbreak of the coronavirus.
- World GDP growth could be reduced by around 0.15% point for the full-year of 2020, but with only marginal effects on exports from the Nordics
- Nordic manufacturers may be hit by global supply chains problems, a risk that increases day by day and with potentially bigger impact on growth
- The impact of the virus must be more severe and prolonged for Norges Bank or the Riksbank to take action

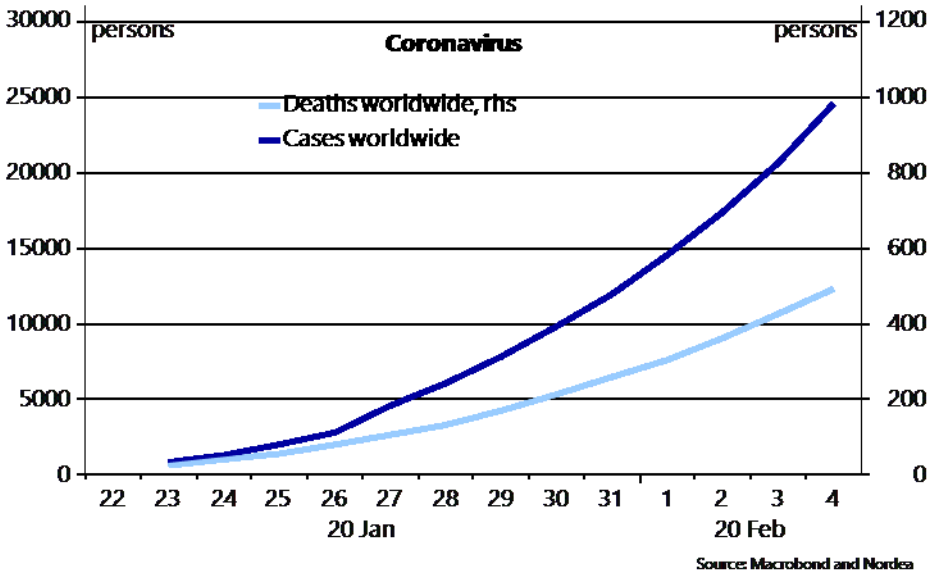
The economic consequences of the coronavirus (2019-nCoV) outbreak cause ripple effects across the globe. The consequences will obviously be greatest in China, but the rest of the world will also be affected. This is due to China's great and still growing importance to the world economy.

Today China is an economic superpower accounting for 16% of world GDP. Only the US and the EU are bigger. China has also played an increasingly prominent role in global value chains over the past 25 years, and many countries today have both production in and significant trade with China, which is one of the world's largest trading nations and largest importer of raw materials. A decline in China's economy therefore also affects the rest of the world.

In this research note we take a closer look at the impact of the coronavirus outbreak on global and Nordic growth. The results should be seen as a risk scenario for the forecast for the world economy, which was published in our latest Economic Outlook, "***Proceed with caution***", 29 January. In the Economic Outlook, we estimated that global growth would reach 2.8% this year and increase to 3.2% in 2021.

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Assuming that the outbreak is relatively quickly contained, the impact on China's economy will be particularly pronounced in Q1 2020. The consequences are likely to be greater than during the 2003 SARS outbreak as the current outbreak has affected major parts of the country. The transport sector in particular has been hit hard, but many services sectors have also been severely affected by closures in the travel industry and among restaurants and cultural attractions, which are now deserted.

However, while the losses in large parts of the services sector cannot be compensated for, the lost production in the manufacturing sector can be relatively fast regained when the virus spread is under full control. In this scenario, activity will accelerate throughout the rest of the year.

Based on developments over the past few weeks, we estimate that the annual growth rate in China's GDP will be reduced by approximately 3% points in Q1 compared to our main scenario. Then we expect that approximately 85% of lost production will be recouped over the following two quarters. Overall, growth in China in 2020 would therefore end up at around 5% compared to our baseline scenario of 5.9%.

In this scenario, world growth could be reduced by approximately 1% point in Q1. But as a result of the higher pace over the coming quarters, growth for the whole year 'only' ends up being around 0.15 percentage point lower than in our baseline scenario.

If the consequences become even worse for China, growth could be reduced by e.g. 5% points in Q1. In that case world growth could be reduced by approx. 0.25% point in 2020.

Unless the outbreak spreads widely and turns into a real pandemic, with production also being shut down in other countries, there is no indication that it will be able to take the world economy decisively off course. In that case, however, there is also no doubt that the major central banks, which are already closely following developments in the coronavirus, will be ready with further monetary policy easing to counter the negative consequences of the new threat to the global growth prospects.

Impact on the Nordics

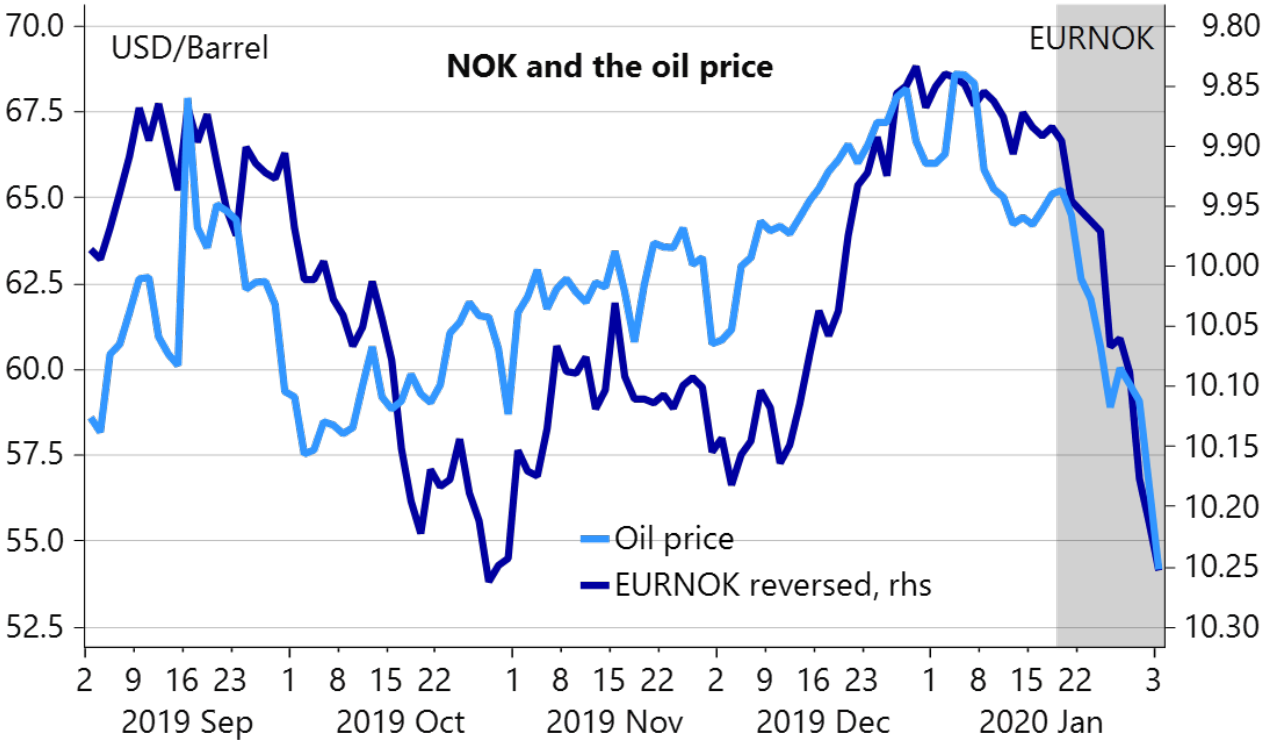
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All Nordic countries are dependent on foreign trade and will thus be affected if world trade slows. Although the effects in general seem small, some developments should be watched. And there are some differences as to how the Nordic countries will be affected.

Norway: An oil and exchange rate story

Norway is probably the Nordic country which is most directly affected by the coronavirus due to its oil-dependent economy. Uncertainties over the consequences for the global economy and lower oil demand due to travel restrictions to/from and in China have led to oil prices falling by approximately USD 10/bbl. Currently, the consequences of lower oil prices for the Norwegian economy and in particular Norwegian oil investments are not very significant. At USD 55/bbl, the oil price is still high enough for most new field developments to be profitable. A lasting drop to well below USD 50/bbl is probably needed for oil investments and thus the Norwegian economy to be affected to a higher degree. That could reduce growth in mainland GDP to below the trend pace. Viewed in isolation, this could make Norges Bank change its interest rate forecast from the current hiking bias to a cutting bias.

As always, the consequences for both the Norwegian economy and interest rates due to lower oil prices must be weighed against the consequences for the NOK. The currency has depreciated some 4-5% against both the EUR and the USD since the outbreak of the virus. This is partly driven by lower oil prices but also by risk-off sentiment in international financial markets. The NOK is a small, illiquid and risk-sensitive currency which is often hurt by a negative mood in financial markets. A weaker currency improves international competitiveness for Norwegian firms and acts as a buffer, counteracting some of the adverse effects of lower oil prices for the real economy. At the same time, a weaker NOK means higher inflation down the road. The more the currency depreciates, the more oil prices must fall to make Norges Bank actually cut interest rates.



Source: Nordea Markets and Macrobond

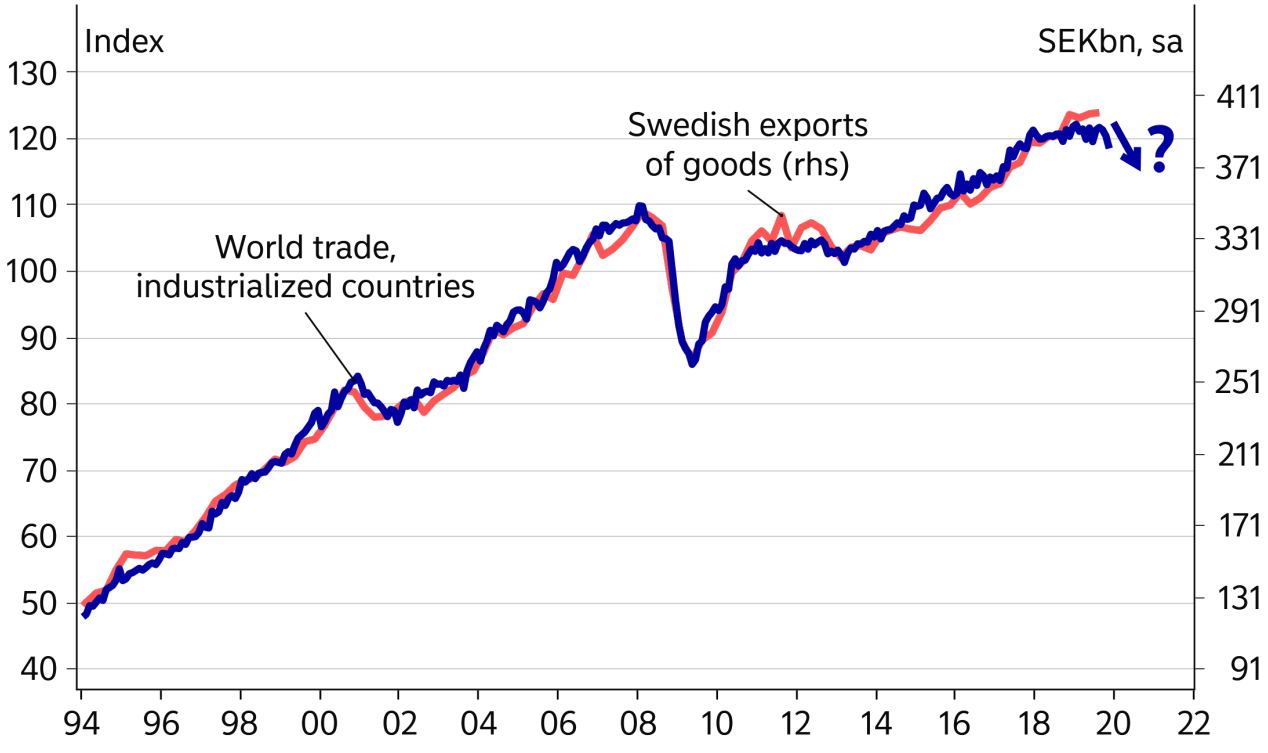
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Given the market impact of the coronavirus so far and the estimated effects on global demand if the virus is relatively quickly contained, we don't think Norges Bank will change its view materially. The negative effects on the interest rate path of somewhat weaker global demand, lower global forward rates and lower oil prices will partly be offset by a positive effect from the weaker NOK. All in all, the impact of the virus must be more severe and prolonged for Norges Bank to signal a rate cut in the period ahead.

Sweden: Watch the supply chains

China has become an increasingly important trading partner over the past ten years. In 2019 China was the eighth-most important market with a share of 5% of Swedish exports of goods. The expected setback in growth in China in Q1 could thus have an impact on Swedish exports in the beginning of the year. But the base-case scenario is that effects should be limited, and any loss in exports should to a large extent be recaptured later in 2020. More important are any indirect effects and whether world trade is hit, especially for industrialised countries, as Swedish exporters are highly dependent on global demand.



Source: Nordea Markets and Macrobond

A potential risk that should be monitored is any problems with the supply chains. If the closedown of production in China is extended, global supply chains could be disrupted. The supply chains have been trimmed over the years and are increasingly sensitive to disturbances. Swedish companies should manage a couple of weeks, but the longer production is down in China, the increasingly severe the effects will be on the Swedish manufacturing industry.

Another channel is if profits are hit, which affects stock markets but also so called merchanting. Merchanting, that is, profit margins generated through production by Swedish companies abroad, is included in Swedish GDP and could thus weigh on growth. Merchanting amounted to SEK 101bn in 2018 and 2% of GDP. Thus, the effect may be noticeable but will not change the outlook for growth in any significant way.

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The number of Chinese tourists in Sweden has tripled over the past ten years. However, in 2018 China nevertheless accounted for only 2% of the total number of foreigners' stays at hotels, camping sites etc. Thus, the effect should be very small on an aggregated level.

As for many other countries, the more direct impact is via financial markets. The effects on inflation and thus the Riksbank go both ways. The SEK weakened in the risk-off environment caused by the outbreak of the coronavirus, boosting inflation, while the drop in energy prices works in the other direction.

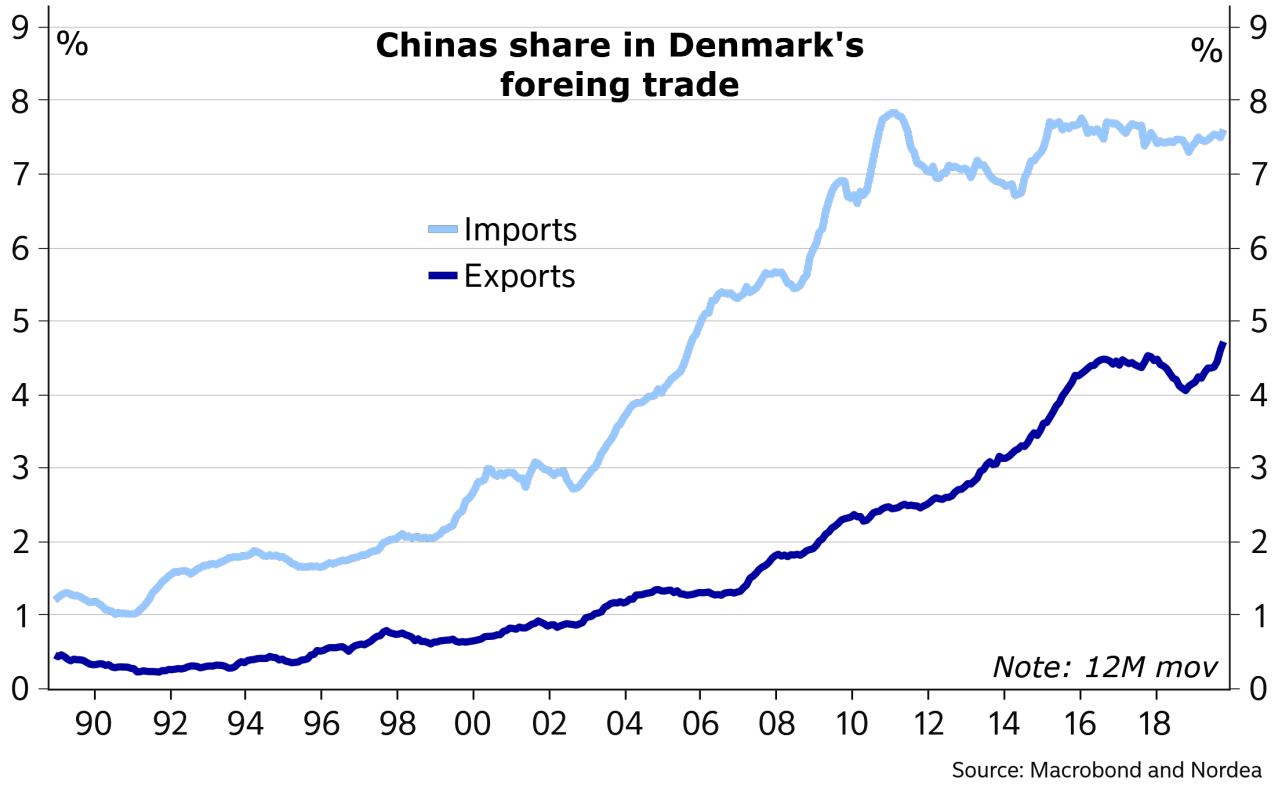
The Riksbank will probably cite the coronavirus as a factor of uncertainty. At the same time other risks have been reduced, at least for now, such as the US-China trade conflict, the situation in the Middle East etc.

All in all, our base-case scenario is that the coronavirus is neither a game changer for the Riksbank nor for Swedish GDP growth.

Denmark: Profits and the shipping industry could be hit

In our base-case scenario, the Danish economy will only be little affected by the temporary drop in Chinese GDP. The most direct effects will most likely stem from a disruption in production processes for companies with production facilities in the Hubei region. This could in a worst-case scenario lead to supply shortages and thereby a reduction in income for the companies affected. This overall lower production volume in the Chinese economy could also be a drag on the Danish shipping industry, thereby reducing Danish service exports through a drop in sea transport to and from China.

On the demand side, Danish exports to China have grown rapidly over the last ten years. Over the past year Danish exports of goods to China have reached a total of DKK 35bn, making the country the sixth-largest trading partner with an export share of just below 5%. More than 60% of Danish goods export to China are agricultural and pharmaceutical products. Especially Danish exports of pork to China multiplied during 2019 as a consequence of the outbreak of African swine fever in a number of Asian countries. At this juncture it seems very unlikely that exports of these defensive Danish export goods will be adversely affected.



Source: Macrobond and Nordea

On the domestic side, the coronavirus outbreak has been one of the main drivers behind the drop in swap rates and mortgage bond yields since mid-January. If anything, this will have a slightly positive effect on the Danish economy. This supports our view that at the moment we do not expect the current situation in China to markedly change the overall activity level in the Danish economy.

Finland: Trade frictions and tourism

Currently it seems that the Finnish economy as a whole will not suffer any material damage due to the coronavirus. The main effect will be trade frictions caused by production shutdowns in China. The country accounts for roughly 5% of Finnish goods and services exports, and it is an even more important trading partner if we look at the final destination of Finnish exports through other countries. Also, about 6% of Finnish imports come from China, and some firms are likely to suffer from shortages of intermediate goods especially if the epidemic is prolonged.

Some local effects are likely visible in Lapland, where Chinese tourists usually account for about 6% of visitors this time of the year. One tourist from Wuhan was already diagnosed with coronavirus more than a week ago, but currently no further contagion has been reported, limiting the effect on the tourist industry. However, Finnair has halted flights to China, which is likely to be a drag on the company's earnings.

All in all, we expect a short production shutdown to have only a negligible impact, and we see no need to revise our growth forecast for the Finnish economy for now.

Read more:

China View: The corona effect

Nordea Economic Outlook *"Proceed with caution"*

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Global: Wuhan vs. previous outbreaks

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