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Industrials

Is the Coronavirus Already Much Worse Than '03's SARS Outbreak, Implying '20 Global Growth Risk?

Gordon L. Johnson II

917 970-1167

gordon@glj-research.com

James A. Bardowski, CFA

917 670-1168

james@glj-research.com

Fireside Chat w/ China Economist, Victor Shih, Sheds Light on the True Extent of Coronavirus "Threat". In short, after our conference call this morning with Harvard-educated Chinese economist & former principal for the Carlyle Group in its hedge fund arm in New York City, Victor Shih, we believe the market is grossly underestimating the potential negative knock-on effects from the coronavirus outbreak in China. By way of background, we remind our readers that over the Nov. 2002-to-Jun. 2003 timeframe which defined the China SARS outbreak and agreed-upon month the pandemic was under control, 8K people were infected & around 800 died (i.e., a ~10% mortality rate over the 8 months). However, according to Mr. Shih, taking the confirmed number of coronavirus cases (i.e., **4.690K** [as of 6:52pm EST] - **Ex. 1**) and adding in the ~6K suspected cases (of which Mr. Shih believes the lion's share will convert into confirmed cases, given a near 1:1 conversion of suspected to confirmed SARS cases in 2003) **the coronavirus pandemic is already larger, in just roughly one week's time, than the SARS pandemic was over the entirety of its lifecycle.** Other takeaways, according to Mr. Shih, associated w/ the coronavirus center on: **(a)** a lower mortality rate of 2-3% (vs. ~10% for SARS), which leads to it spreading faster as the fear of death is lower (which, due to the harsh quarantine regiment, also emboldens carriers to hide it to get through airport scanners by taking Tylenol to lower their fever levels), **(b)** the virus being asymptomatic (meaning one can carry it without any noticeable symptoms), **(c)** 5mn people who were allowed to leave Wuhan ([link](#)) before China quarantined the city to contain the coronavirus outbreak, **(d)** Dr. Eric Daniels of Harvard, who believes the virus is mutating faster than SARS ([link](#)), **(e)** 7 provinces w/ over 100 confirmed cases, **(f)** the epidemiologists Mr. Shih has been briefed by both in the US and in China who say we are only in the early stages of the outbreak, & **(g)** the coronavirus outbreak will likely be much worse than the SARS pandemic given SARS was contained to 3 provinces (Guangdong, Hong Kong, & Beijing), while the coronavirus has already spread to 25 provinces ([link](#)) - *air travel within China is ~8x more today vs. where it was during the SARS outbreak.* In short, in Mr. Shih's view, based on his work suggesting "hundreds of thousands" of potentially infected Wuhan residents left for Shanghai & Guangdong, the number of cases being reported in these economically important provinces (66 and 207, respectively) are likely "grossly" understated, suggesting the impact to growth, globally, will be much worse than currently implied by market valuations.

What will be the Economic Impact, Based on Mr. Shih's Calculus? According to Mr. Shih, while the Chinese Communist Party ("CCP") promised that it would cover 100% of the costs of the outbreak, in reality they are only paying for ~70%, meaning ~30% of the costs are falling on local provinces. Yet, given many local provinces in China are low on cash due to high debt-service after years of heavy stimulus misallocation towards ghost cities/empty houses, they are under-reporting the true extent of the coronavirus outbreak. For this reason, Mr. Shih noted that hospitals are running out of supplies ([link](#)). Furthermore, and rather telling, Mr. Shih said many of his friends in the upper-middle class, or the ones who go to restaurants, buy cars, and are the real consumers of goods in China, are telling him they plan to stay "inside their homes" & "eat ramen noodles" out of fear of contracting the virus. In Mr. Shih's view, it is this mentality among China's "rich" that will likely wreak havoc on consumption

throughout the country over the next 6-to-9 months. In fact, Mr. Shih described the impact as a "massacre" to consumption. In his base case scenario, Mr. Shih said nominal GDP growth would likely slow to +5% in 1Q-3Q20, while real GDP growth would slow to +2-3% over the same timeframe (vs. +6% real GDP growth at present). However, should the spread of the coronavirus in places like Shanghai, Guangdong, or Beijing prove perverse, Mr. Shih sees a scenario where real GDP growth in China could turn negative 1Q-3Q20, before rebounding in 4Q20. By way of background, we remind our readers **that China's sequential GDP growth moderated sharply from an estimated >12% q/q SAAR in 1Q03 to 3.5% in 2Q03 (i.e., the peak of the SARS outbreak), driven mainly by hits to tourism, and other related sectors (i.e., hotel and catering and transportation)**. Meanwhile, when looking to China's property sector, y/y growth in residential property sales and new starts, as well as industrial output and fixed asset investment displayed an initial decline, followed by a sharp spike higher, thereafter, due to the government's targeted fiscal stimulus support for the sectors most affected - *via a much more accommodative credit policy (Ex. 2-6)*.

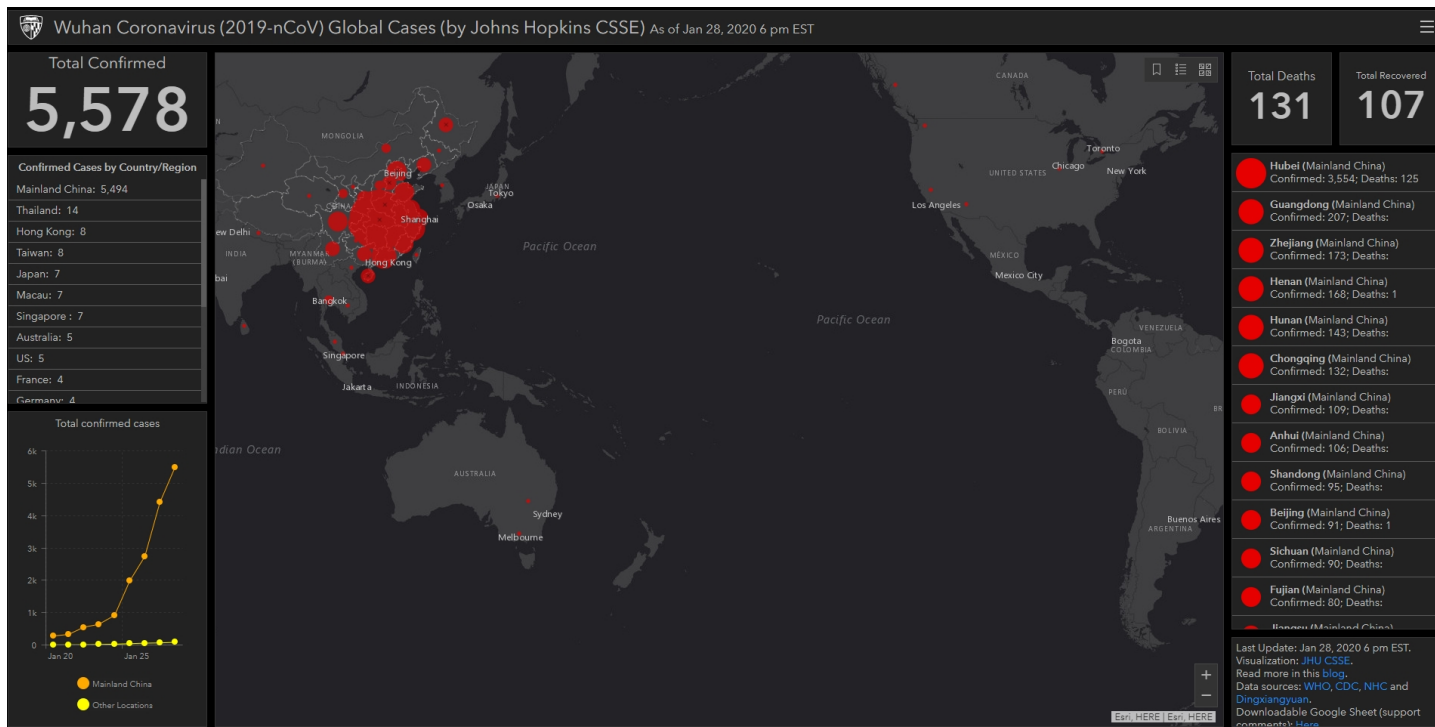
What Sectors Does Mr. Shih View as the Most Vulnerable to the Coronavirus Outbreak? Underpinning the extent of the fear in China as it relates to the coronavirus at present, Mr. Shih noted that while the CCP is sending food boxes to people's doors, they are afraid to eat the food due to fear of infection - Mr. Shih believes this implies the hit to overall consumption in China is going to be much worse than feared, even by those in the bear camp. Furthermore, due to the physical checkpoints being erected all over China at present, Mr. Shih's view is that industrial output in China sees a material decline over the next 6-to-9 months (i.e., manufacture of machinery, steel output, iron ore output, automotive production, mining raw material demand, etc.). One space that Mr. Shih felt would be among the most adversely impacted, due to far less travel throughout China as people "stay home", is the automotive space (i.e., demand for both internal combustion ["ICE"] cars, as well as electric vehicles ["EVs"]). Admittedly, Mr. Shih acknowledged that Dr. Zhong Nanshan, a renowned scientist at China's National Health Commission, said the infection rate associated with the virus should peak in 10 days ([link](#)). However, based on discussions he's had (and continues to have) with epidemiologists, Mr. Shih said he puts very little faith in this prediction, and believes it will take at least another 2-to-3 quarters for the Chinese government to get control of the viral pandemic. **In fact, Mr. Shih noted that the ratio of serious cases (i.e., people who needed to be treated in the intensive care units ["ICU"] of hospitals) to the total infected is actually closer to 30%.**

Will China be Able to "Stimulate" Its Way out of this Mess Should it be Worse than Anticipated? In a best case scenario, based on Mr. Shih's economic models, in addition to the ~CNY\$6tn of stimulus that will be needed this year in China to roll-over existing local government debts, an additional ~CNY\$4tn will be needed to address the slowdown associated with the coronavirus. However, should the contagion spread to the bigger provinces of Shanghai, Guangdong, or Beijing, the stimulus needed to counter the coronavirus impact would be closer to CNY\$16tn. **Yet, given, as part of the Phase 1 trade deal China negotiated with the Trump administration it said it would not devalue its currency**, Mr. Shih believes simply "printing" its way out of the knock-on effects from the coronavirus impact could put the trade deal at risk as this would likely cause a "material" devaluation in China's currency.

Were There Any Green Shoots? First, it's worth noting, Mr. Shih believes the confirmed cases will continue to grow, and potentially exponentially, likely putting structural pressure on stock markets, and ultimately leading to foreign investors, who were spooked by the trade war, being pushed over the edge, & ultimately seeking out alternative supply chains (i.e., as it becomes clear the CCP/government is being deceptive regarding the viral numbers being reported). However, assuming China is able to get control of the spread quicker than expected (which, at this point, Mr. Shih ascribes a low probability), such a dynamic could spark a second derivative trade later this year. While Mr. Shih sees this sequence of events as unlikely, he didn't completely rule out the possibility of such a scenario unfolding, particularly given the current "frothy" nature of stock market investors today.

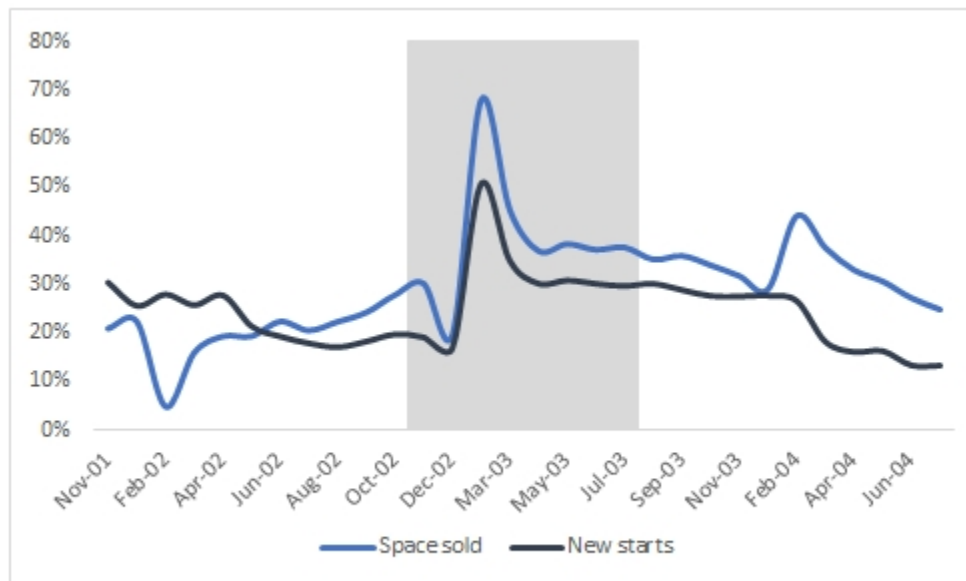
Is There a Replay of the Call? For a replay of our call today with Mr. Shih, the dial-in is: 800 332-6854; the password/ID is: 485794.

Exhibit 1 - Coronavirus Tracker



Source: Johns Hopkins CSSE, GLJ Research, LLC.

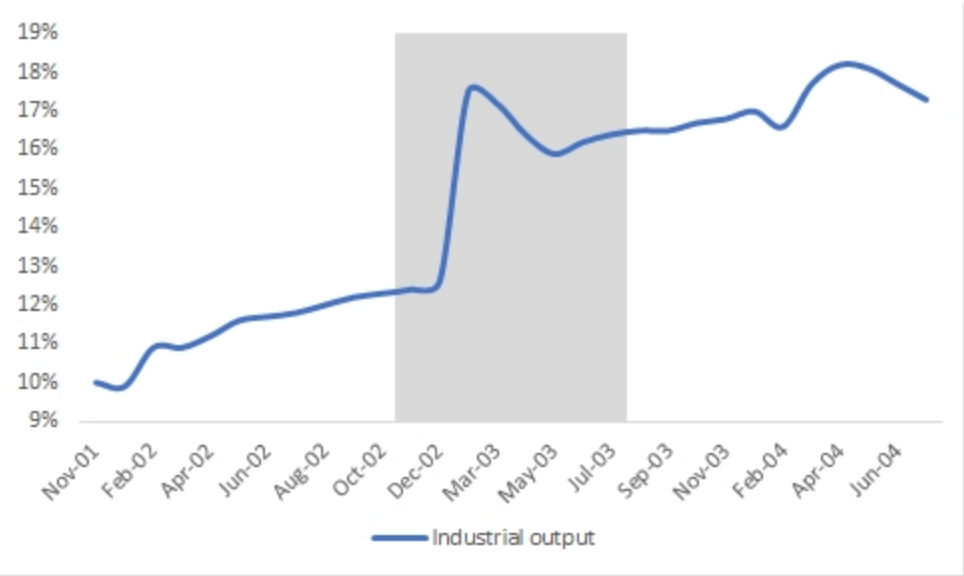
Exhibit 2 - Y/Y Growth in China's Real Estate Activity during the SARS Outbreak



Note: Shaded area represents period of SARS outbreak.

Source: National Bureau of Statistics, Center for Disease Control, GLJ Research, LLC.

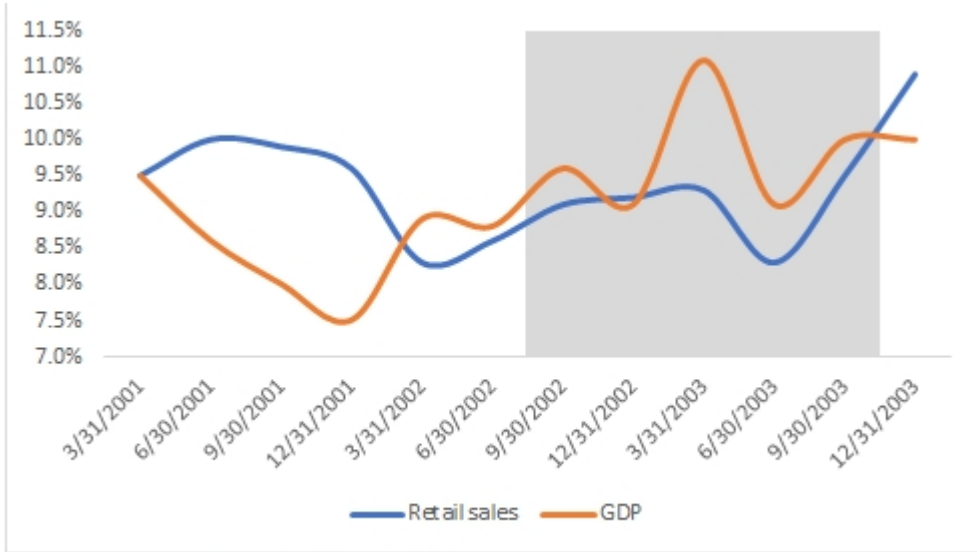
Exhibit 3 - Y/Y Growth in China's Industrial Output during the SARS Outbreak



Note: Shaded area represents period of SARS outbreak.

Source: National Bureau of Statistics, Center for Disease Control, GLJ Research, LLC.

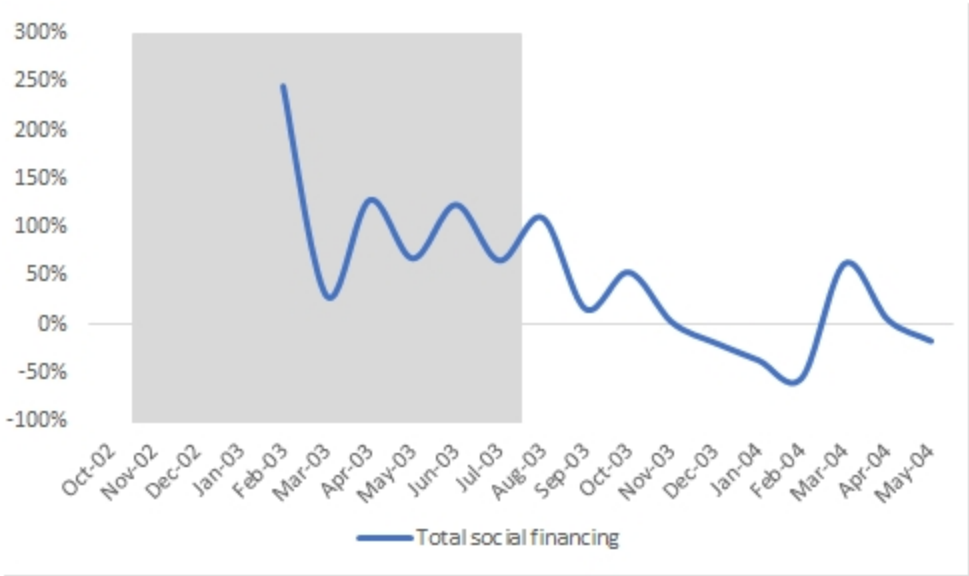
Exhibit 4 - Y/Y Growth in China's Quarterly Retail Sales and Nominal GDP during the SARS Outbreak



Note: Shaded area represents SARS outbreak.

Source: National Bureau of Statistics, Center for Disease Control, GLJ Research, LLC.

Exhibit 5 - Y/Y Growth in Total Social Financing during the SARS Outbreak



Note: Shaded area represents period of SARS outbreak.

Source: National Bureau of Statistics, Center for Disease Control, GLJ Research, LLC.

TIMESTAMP**(Article 3(1)e and Article 7 of MAR)**

January 28, 2020, 20:13 ET.

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