Coronavirus threatens the global economy with a 'sudden stop'
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As well as spreading to Europe, the outbreak could spark a contractionary chain reaction that ends in a worldwide deflationary bust

Covid-19 is self-evidently beyond the point of meaningful containment.
Virologists and infectious disease experts have known for three weeks that this was highly probable, and certainly not a mere tail-risk as suggested by equity market pricing. We are now there.

The global economy may be heading for some sort of "sudden stop" in supply chains, trade flows and tourism more akin to the outbreak of the First World War than the Lehman or dotcom crises.

What happens or does not happen in Wuhan has been overtaken by events in Iran, Italy, the Pacific Rim and no doubt Africa as well if there were surveillance data.

The bond market is already signalling a downward lurch into global deflation. Yields on 10-year US Treasuries have fallen to all-time lows. Evercore ISI says zero yields are coming into "plausible" range.

The question is whether this will be a short-sharp episode followed by a V-shaped recovery in the second quarter (priced by stocks), or a slower elongated "U-shaped" recovery (priced by the dollar, Swiss franc, and safe haven bonds), or a Spanish cedilla (priced by almost nobody) as real fear of central bank impotence starts to take hold in the markets for the first time.

I don't wish to digress too far into Covid-19 science, except to point out that much of the global virology fraternity has lost patience with the World Health Organisation – deemed a political captive of China – and is exasperated by the reflexive reassurances of public health officials.

Contagion experts Peter Sandman, Ian Mackay, and Jody Lanard sum up my view in this passage from Past Time to Tell the Public: It Will Probably Go Pandemic, and We Should All Prepare Now:

"We are near-certain that the desperate-sounding, last-ditch containment messaging of recent days is contributing to a massive global misperception about the near-term future. One horrible effect of this continued 'stop the pandemic' daydream masquerading as a policy goal: it is driving counter-productive and outrage-inducing measures by many countries against travellers from other countries, even their own citizens back from other countries.

"But possibly more horrible: the messaging is driving resources toward 'stopping' and away from the main potential benefit of containment – slowing the spread of the pandemic and thereby buying a little more time to prepare for what's coming."

For readers who can spare the time, I suggest tuning out media noise – much of it dwelling on the malevolent distraction of which individual may have been spreading Covid-19 – and going straight to research papers being released daily by PubMed Central, the data bank of the US National Library of Medicine.

That way you avoid the sort of misunderstanding I just heard on the BBC, which stated that the death rate is comparable to flu. No, it is not. The average morbidity of flu annually is 0.1pc; Covid-19 is an order of far greater magnitude.

The latest tracking data as of Feb 22 (unreliable, but the best we have) is that the mortality rate is 4pc in Wuhan, 2.8pc in Hubei, and 0.8pc in other regions of China, though all figures are creeping up as slow deaths hit the data.

There can be long lag times after infection so it is too early to infer ratios from South Korea, Italy and Iran, but this is surely more like the Spanish Flu of 1918 than anything we are used to. Chinese data suggests that roughly 14pc of those infected over the age of 80 are dying.

You can read most of the PubMed abstracts free and can see what is coming out of labs in China – some of them excellent – or in Hong Kong, Korea, Japan, Europe and North America. There are already 80 peer-reviewed papers. The unfiltered findings are arriving almost in real time. They give you an extra edge.

This paper, for example, suggests that the anti-malarial prophylactic chloroquine phosphate helps inhibit Covid-19 pneumonia complications.
You can buy this drug without a prescription in many countries.

Equity markets are essentially "looking through" the Covid-19 saga.
The "Fed Put" lives on in the collective mind.

Fund managers have become so reflexively certain that there will always be a central bank rescue whatever happens, that they will continue to buy the dips into the teeth of almost any storm.

But this is a risky proposition. Monetary stimulus is useless against a genuine supply shock because the transmission channels are blocked and demand for fresh credit collapses.

The authorities can suspend tax payments for firms, or strong-arm state banks into rolling over debts, as China is already doing.

Yet this is much harder in the West, and is strictly forbidden in the EU by an edifice of rigid competition and state aid laws. In any case such measures do not stimulate: they limit damage.

Nor can fiscal expansion do much when chunks of the economy are closed.

China's Baidu migration index shows that 72pc of travellers and migrant workers have not returned to the 15 largest cities since the Lunar New Year. Nomura says journeys on the Guangzhou metro are still down 85pc. Coal use at six key power plants – a proxy for industry – is down 47pc.

Obviously the economy cannot function in these circumstances. Capital Economics expects Chinese output to contract by 10pc (annualised) in the first quarter based on proxy measures – not the massaged official data, which will look OK.

The Chinese government claims that the manufacturing region of Zhejiang is almost back to normal but the latest data from the State Grid shows that power use in the industrial sector is still down 32pc even there.

Xi Jinping is clearly alarmed by the economic crisis and has issued orders to restart production come what may, but this means relaxing the fight against Covid-19.

It is not believable that people are going back to work and at the same time that the spread of the virus is being contained dramatically outside Hubei.

Since the Communist Party has launched a propaganda blitz and is using totalitarian methods to suppress media reporting, we are groping in the dark. Nothing can be taken at face value.

The danger in any case is that the coronavirus epidemic not only spreads to Europe and the US but also that it lasts long enough to set in motion a contractionary chain-reaction, ending in a worldwide deflationary bust.

Central bank impotence

The Federal Reserve's former chief economist David Wilcox told me recently that this would be the nightmare come true. "I am seriously worried about the Fed's policy space if the next recession is deep and nasty.

"The Fed could do a whole boatload of QE and might just scoot by with enough counter-cyclical punch if it is an average recession, but it would be in deep trouble if it is any worse, like an artillery that has spent its shells before the job is done. The European Central Bank is clearly in much worse shape, and so is the Bank of Japan," he said.

Well, quite. The ECB can do almost nothing to arrest such a process or to escape the trap once it has happened, unless it calls in "helicopters" and prints money to fund public spending, which would violate the Lisbon Treaty and would not happen until matters were already desperate, if at all.

The ECB's policy rate is already minus 0.5pc and at the "reversal"
threshold where cuts do more harm than good. Nor can it gain any traction by pulling down long yields when the entire gamut of core-eurozone bonds out to 10 years' maturity is already trading below zero. This is what the monetary dead end looks like.

Italy is facing 231 cases and already has seven deaths. The epidemic has spread to Florence and now Sicily as well.

The shock of seeing 12 Italian hotspots and 50,000 people in Wuhan-style lock down has been sobering, as has been the cancellation of the Venice Carnival, and Rome's emergency decree suspending civil liberties and mobilising the army.

Italy is certainly in the eye of the storm. It was in recession or very close before Covid-19 hit. The hotspot regions of Lombardy and the Veneto account for a third of its GDP and half of its exports. Its public debt ratio is about to blow through 140pc of GDP.

However, we are all in the eye of the storm. What is happening in Italy today will probably be happening soon enough in France, Germany, Britain and the whole of Europe.