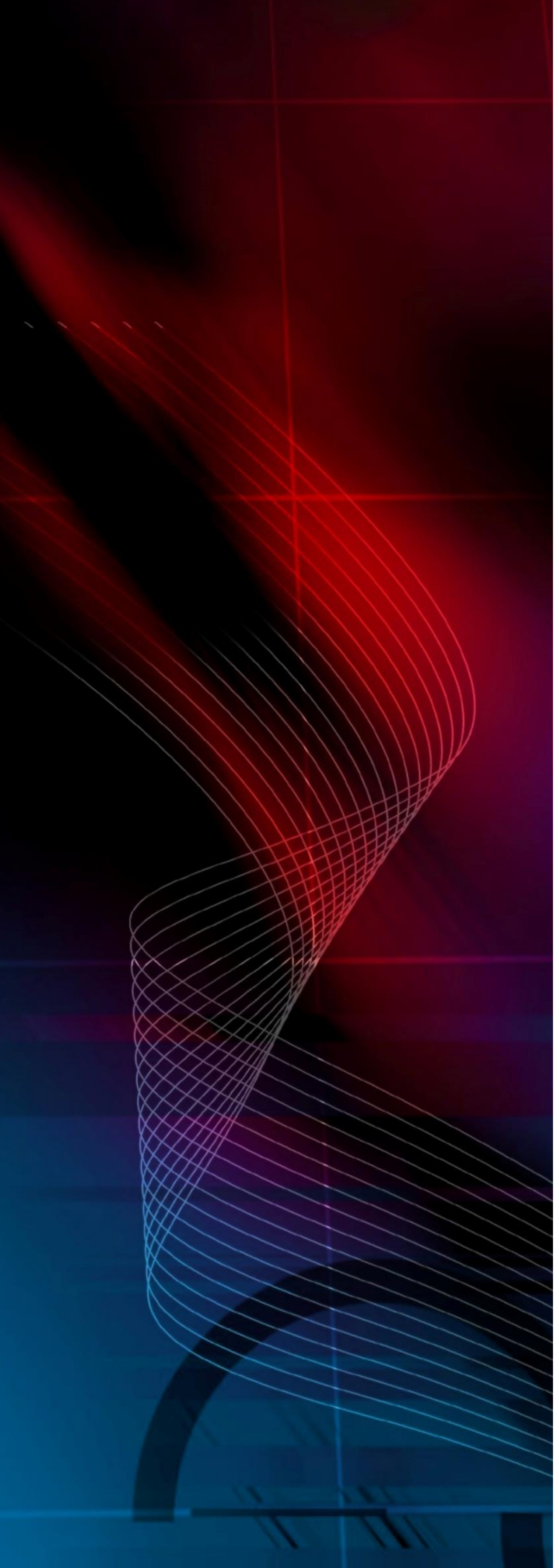


kochański & partners Business Law Firm

Coronavirus and global economic growth

"Coronavirus will affect the global economy," stated the International Monetary Fund on February 27, 2020, with negative effects being particularly experienced by global supply chain operators. The impact of coronavirus on global economies results from its rapid spread, uncertainty about possible mutations, and ignorance of potential complications. Although the number of coronavirus victims is not high compared to other diseases and illnesses, the feeling of fear is being gradually reinforced, causing panic on global stock exchanges.

Countries in the era of globalization show intense socio-economic connections. Due to the frequent movement of people between countries, coronavirus has already appeared in over 30 states in the first weeks. Consequently, the Director-General of the World Health Organization declared on January 31, 2020 that the spread of coronavirus could be considered a "Public Health Emergency of International Concern" (PHEIC).

The disease develops dynamically, however, mortality due to coronavirus infection is relatively low. Available data show that only 2% of those infected with coronavirus die. Scientists of the Polish Academy of Sciences indicate that the death toll may be even lower, given that the course of the disease in some patients is so mild that such people are not even diagnosed as sick, with those aged 60+ being more prone to fatal complications. By comparison, the mortality rate of the SARS virus was 9.6%, and the MERS virus – as high as 34%.

Due to the low mortality rate among patients infected with coronavirus, its long-term effect on the functioning of society does not have to be significant. However, it is still unclear what measures will be taken by governments around the world to fight the progressing epidemic, as well as how effective the use of digital tools will prove in mitigating the economic effects of decreased public mobility. Given the above, the article disregards advanced quantitative analytics of the phenomenon which would not be very reliable.

CHINA AND THE GLOBAL ECONOMY

Collapse of china's production capacity

The dynamic spread of coronavirus is increasingly affecting the Chinese economy causing a subsequent domino effect on the global economy. As early as on February 18 this year, the global media announced that more than 760 million Chinese people, i.e. 50% of China's and 10% of the world's population, are subject to quarantine, with its severity varying by region. In mid-February 2020, China's production capacity utilization was estimated at 40-50% which illustrates the scale of coronavirus's impact in this respect.

For fear of the spread of a coronavirus epidemic, some businesses are temporarily suspending their activity in coronavirus-affected markets, including primarily in China. As a result, workers posted to work in the city of Shenzhen, China, returned to Poland in early February 2020.

A number of renowned international events were postponed or cancelled, including Art Basel in Hong Kong, one of the most prestigious and important art fairs, and the Light + Building 2020 trade fair in Frankfurt am Main. The further deepening of the health crisis may lead to the collapse of economic and social relations between China and the rest of the world, which the Communist Party of China wants to avoid at all costs.

Collapse of the global supply chain

China's decreasing production capacity and increasing isolation negatively affect the performance of businesses across the world, as the Chinese industry exists in most of the global value chains of international corporations. Consequently, the problems affecting Chinese suppliers have a proportionate impact on the financial performance of other businesses operating in numerous global sectors.

Response in oil prices

China's global production capacity makes it also the world's largest importer of oil which is considered one of the basic raw materials of the chemical and conventional energy industries. The abrupt and deepening decline in China's industrial production entails a proportional decrease in demand for oil and, consequently, its price. A change in the supply and price of such an important raw material entails a change in the prices of numerous products and services around the world, requiring oil at various stages of production. The productivity of economies, where the energy sector is largely based on oil, is also falling. This forced the OPEC nations and other non-allied countries to hold a meeting in March, aimed at setting rules for further world oil supply reduction to prevent the deepening decline in oil prices.

Potential downturn in technological development

The problem also affects the global rate of technological development. At present, China is the largest producer of rare earths used in the high tech industry, including for the production of computers, smartphones, monitors, wind power generators and cars. Abrupt restrictions on rare earth exports will result in a slowdown in the development and production of technologically advanced equipment, which will most severely affect countries generating the highest added value in the global economy.

REACTION OF SELECTED ECONOMIC SECTORS TO THE CHINA ISSUE

Automobile sector sales slump

Due to China's production capacity decline, more and more Chinese businesses find it difficult to meet contractual deadlines. This hits both Chinese businesses, due to untimely fulfilment of obligations, and their foreign contractors, due to bottlenecks in the manufacture of products whose components come from China.

The car production sector has reacted extremely intensively to the situation in China. Jaguar Land Rover announced that soon there would be problems with maintaining production levels in British factories which are highly dependent on intensively to the situation in China.

Jaguar Land Rover announced that soon there would be problems with maintaining production levels in British factories which are highly dependent on the supply of components from China. Fiat, Chrysler, Renault and Hyundai have also reported similar problems.

The internal car production and distribution market is also in a state of collapse, recording a 92% drop in car sales during the first two weeks of February due to the coronavirus fears of potential customers making them stay at home. In February this year, sales value may even plummet as low as 70%.

Financial, mobile, aviation and brewing

Companies in the financial sector are also experiencing difficulties. As a result of Chinese businesses' limited activity due to the coronavirus outbreak, one of the leading opinion-making banks in China, i.e. HSBC, announced its intention to reduce the employment level by 35,000 jobs and operating costs by USD 4.5 billion.

Even Apple forecasts a noticeable drop in sales caused by the situation in China. The largest decreases in the U.S. stock market are being recorded by companies from the financial, energy and industrial sectors.

The air freight market is another sector to be particularly affected by the spread of coronavirus. The International Air Transport Association (IATA) indicates that the global rapid drop in demand for air services is threatening businesses in this market with a potentially USD 29.3 billion loss in 2020 alone.

The drop in demand for tourist and food services are also affecting the financial performance of global brewing businesses. According to AB InBev, the world's largest beer producer, the decline in demand for beer in China alone, taking into account the deterioration of the situation in the Brazilian market, may cause a drop in EBITDA in the 1Q by up to 10% compared to the same period last year.

Pharmaceutical market

China is also a global supplier of medical devices and trade suspensions are also hitting the availability of pharmaceutical products. India, the second largest global supplier, relies on semi-finished products from China.

The spread of coronavirus entails a risk of potential disruptions in the supply of ca. 150 medicines exported by China to the U.S. Most countries that depend on the supply of medicines from China to varying degrees may face similar problems. For example, Poland imports as much as 30% of active substances used in the production of medicines from China. The collapse of the global drug supply chain may lead to the worsening of human health which will directly affect, inter alia, their associated economic activity

Global investors expectations

By affecting numerous economic sectors, uncertainties about the global spread of coronavirus are also being reflected in expectations on the potential growth of the world economy. The interest rate on U.S. 10-year bonds fell below 1% in early March 2020, indicating that investors are becoming sceptical about global economic growth. Thus, potential damage arising from Coronavirus can affect companies in virtually every sector.

CORONAVIRUS AND NEW TECHNOLOGY DEVELOPMENT

Development of green technologies

The rapid fluctuation of oil prices, triggered by a fall in demand and subsequent reduction in supply, affects the economies of countries heavily dependent on oil extraction, distribution or consumption, who thus find it more difficult to plan their operations in oil-dependent energy and industrial sectors. The current difficulties may encourage oil-producing countries to change their economic structure, while countries dependent on oil supplies will be more inclined to develop green initiatives in the energy and industrial sectors. Currently, as a result of the decline in industrial production and the mobility of a large part of the Chinese population, greenhouse gas emissions have fallen sharply by more than 25%.

Accelerated digitization of society

The quarantine, which restricts worker mobility in China, can encourage companies to digitise their business at a faster rate. In a fully deployed digital economy, quarantining even half of the population would not pose a major challenge to the economy and supplies would only be slightly disrupted.

Therefore, events related to coronavirus spread in China may encourage not only local businesses, but also local societies, to carry out a faster digital transition. An example of society's adaptation to the spreading epidemic is the use of digital tools for teaching in selected schools in Northern Italy with similar solutions being already introduced in China, allowing students to attend school classes without leaving home.

School e-classes are only an example of the digital transformation of functioning of the society, with the barrier to its development being, among other things, the resistance of communities to embrace the rules governing the digital world. Forced leapfrogging in the use of digital tools in certain aspects of life may in the future encourage the public to accept and increase their use of digital tools in other areas of life.

Increasing the digitisation of society's life will allow for more effective collection of data on the current life of societies. On this basis, the industrial and service sectors will more effectively be able to meet people's needs, provided that the operations of companies from these sectors have adapted to the digital environment in advance.

Polish economy and coronavirus

Effect on Germany and Poland

The decline in China's economic activity may seriously affect the European market by severely weakening its main pillar, namely the German economy, which is heavily dependent on global demand for cars and machinery. As a consequence, the Polish economy, with Germany being its main business partner, will also suffer. In 2018, Germany had the largest share in both imports to and exports from Poland: 22.4% and 28.2% respectively.

Poland, a new supplier of industrial components

In the long run, the global spread of coronavirus may create new conditions for development in countries that have so far been only marginally integrated into the global value chain, such as Poland. Global corporations are already planning to diversify the global supply chain in order to avoid future supply bottlenecks resulting from events that could paralyse the functioning of a country being a major supplier of various components, such as China. In this respect, Poland is attractive for investments due to its stable economic growth, political stability, and membership in the EU and other international organisations.

The polish tourism sector

Reducing the mobility of the public may also generate some benefits via the tourism industry. According to data from the Central Statistical Office (GUS), in 2018, travel-related expenses of Poles amounted to PLN 72.5 billion, which is potentially a capital that could remain in Poland, and have positive impact on the economy.

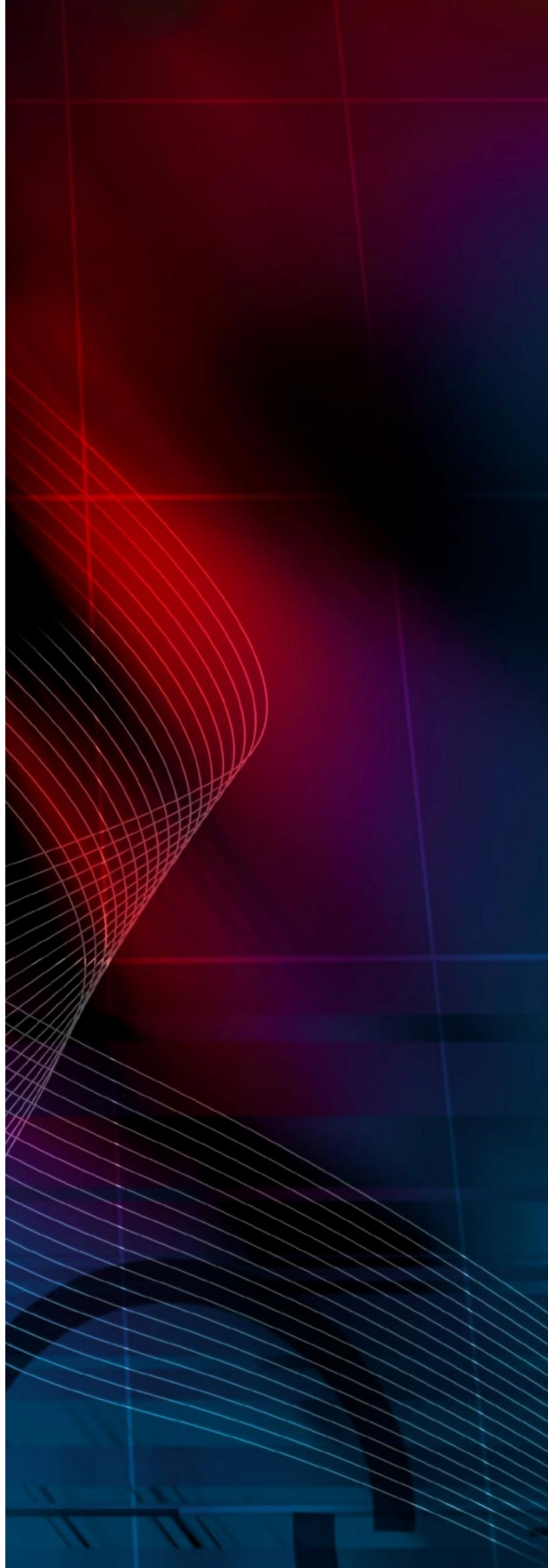
On the other hand, a drop in the number of foreign tourists will cause income in the Polish tourism industry to fall. Nevertheless, the potential balance of profits and losses would probably be overall favourable, as Poland's income from tourism in 2018 amounted to PLN 34.95 billion.

SUMMARY

The dynamic spread of coronavirus worldwide has paralysed numerous sectors of the economy. The magnitude of the losses recorded by individual sectors are linked to the level of their internationalization and digitalization. The occurrence of coronavirus may encourage governments of many countries to revise their economic priorities by placing more emphasis on the development of modern digital technologies and greater diversification of supply sources, however the actual impact of such a phenomenon on the global economy can only be determined once it has subsided.

Adrian Grzegorzewski

Analyst, Transaction Advisory and Analysis
M: +48 883 323 451
E: a.grzegorzewski@kochanski.pl



METROPOLITAN
Plac Piłsudskiego 1
00-078 Warsaw, Poland

EQUAL BUSINESS PARK
Wielicka 28B, C building
30-552 Cracow, Poland

T: +48 22 326 9600
F: +48 22 326 9601
E: biuro@kochanski.pl
www.kochanski.pl

kochański & partners Business Law Firm