Economic Commentary

Risks of the coronavirus on Canada's economy

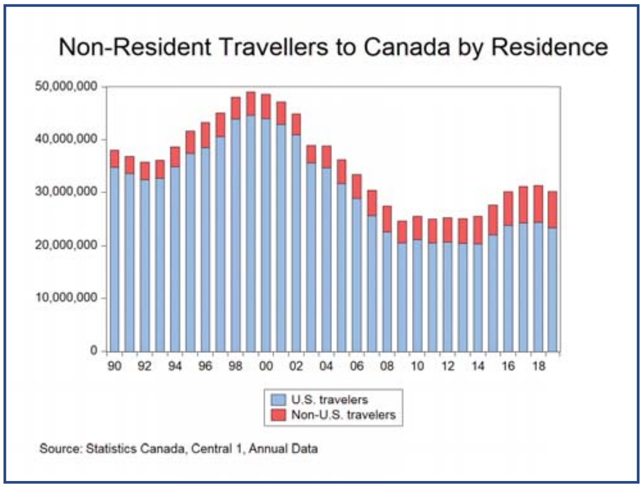
Fears of a new pandemic intensified this past week as the coronavirus, originating from a seafood market in Wuhan, China, continued to spread. While numbers are still evolving and have accelerated, the number affected has surpassed 2,500 and more than 80 people have died in China. An interconnected world has led to cases spreading across the globe, albeit largely among Asia Pacific nations at this point. A handful of positive cases have emerged in the U.S., as well as Europe, Canada and other countries. China has taken unprecedented steps to curb the outbreak, locking down transportation networks and essentially quarantining at least 14 cities and more than 57 million people.

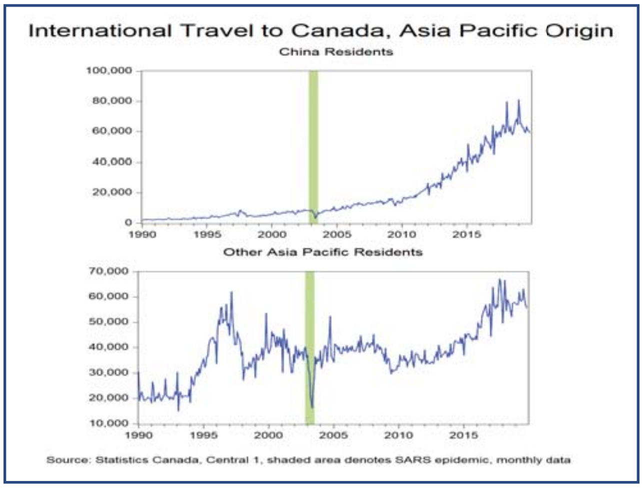
While health is paramount, this will negatively impact global economic growth, specifically given the timing of the virus near the Lunar new year. Transport networks have been restricted, impacting flows of goods and services. Global tourism will likely take a hit going forward. The effects on the Canadian economy will be dependent on the evolution of the outbreak, its severity and whether it largely remains contained to China.
We see a two main channels in which economic growth can be impacted: travel and tourism and the overall global economic environment.

Travel and tourism downturn

Canada welcomed more than 31 million non-resident travelers in 2018, with trends through November pointing to an increase in 2019. The U.S. makes up about 80 per cent of non-resident travelers to Canada. Among other countries, China was second only to the UK in entries with more than 750,000 visitors in 2018 and trending at a similar pace in 2019, representing about 2.5 per cent of all visitors to Canada. China has been Canada's fastest growing source of tourists for more than a decade.

The coronavirus has coincided with the Lunar New Year, typically one of the busiest times of the year for Chinese travel. The virus has likely led a negative impact on travel flows to Canada in January that will extend through February.



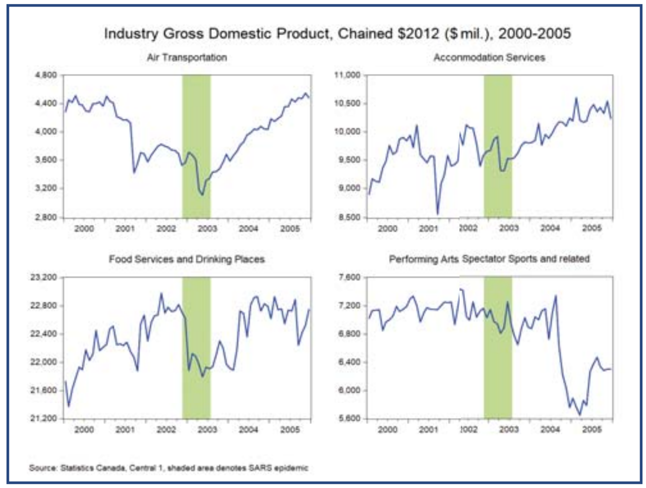


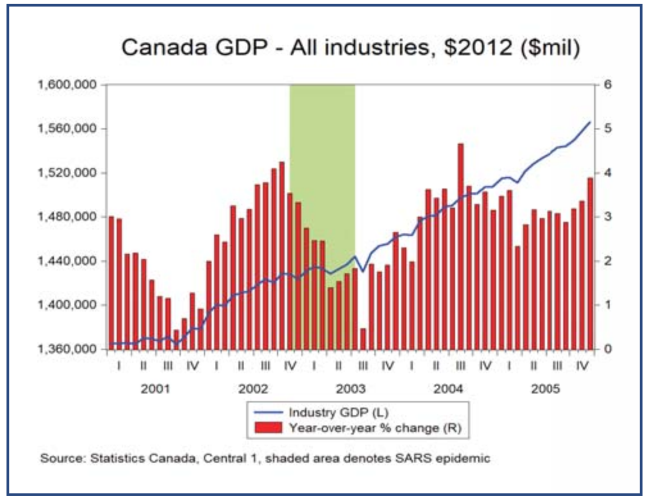
Going forward tourism flows from China will be curbed, but at this juncture it also seems likely that fears around the virus will impact broader tourism activity. Travel demand in other Asia-Pacific markets is likely to dip as tourists act with an abundance of caution, limiting unnecessary or leisure travel. Combined travel to Canada from other Asia-Pacific rim markets is similar to China's share with more than 600,000.

A decline in tourism will be felt across Canada, but disproportionately felt in B.C. Due to geographic proximity and strong Asia-Pacific linkages in Vancouver, the province receives about half of all Chinese travelers Canada and nearly 60 per cent of the flow of residents from other Asia-Pacific markets to Canada. Ontario, with a much larger population, receives about 40 per cent of Chinese visitors and 30 per cent of regions.

The magnitude of tourism decline is unknown, but a comparison to the 2002-2003 Severe Acute Respiratory Syndrome (SARS) epidemic can be considered. There are signs that the coronavirus is less deadly but could be more contagious. On this occasion, authorities have acted more quickly to contain the virus. The SARS epidemic led to a severe drop in traveler visits to Canada both from the U.S. and non- U.S. countries. During the SARS epidemic, the trend in non-resident travelers to Canada declined 20 per cent. Declines in overseas markets were deeper, with a 35 per cent drop which was led by Asia-Pacific markets. The number of visits from China and the broader region declined 60 per cent during the period. It should be noted that travel from China has increased seven times since the pre-SARS period and a decline today would have a more significant impact on Canadian tourism.

The SARS epidemic (along with other factors at the time) contributed to a deceleration in Canadian economic activity. Canada's economy as whole continued to expand during the period but as a more muted pace. Industry gross domestic product for tourism reliant sectors such as air transportation, food services and drinking, entertainment and accommodations all experienced notable declines. At its low, air transportation fell 20 per cent year-over-year, with restaurant activity down five per cent. An abundance of caution by domestic consumers was an additional driver, contributing to lower restaurant sales as households avoided crowded areas.





Impact on global economic environment

The global economic environment is stable but remains littered with trade and geopolitical uncertainties that are constraining growth. The timing of the coronavirus adds another downside risk to the environment. Thus far the virus coincides with Lunar New Year, pointing to a hit to global travel and retail spending activity. Various countries and markets are restricting traveler entry from Chinese provinces at the epicenter of the virus.

Chinese factories generally close during the New Year period to facilitate urban-rural migration as workers visit families in rural areas, meaning a seasonal slowdown in production was already in play. However, the government has already extended the new year holidays from January 30 to February 2 to stem the spread of the viral outbreak, and further extensions may occur. Extensions to the shutdown in transportation networks and factory output will place negative pressure on global manufacturing activity and supply chains in the first quarter of 2019 which would constrain global economic growth. Downside risk on economic activity could feed through a lower interest rate environment. Indeed, markets have already been rattled, digesting an increased likelihood of a slowing economy. Equity markets have pulled back and bond yields have declined since January 24 when a travel ban was imposed on Wuhan, which was followed by restrictions to other cities.

Insofar as economic expectations weaken, and global growth shows signs of persistent weakness, this will mark a headwind for Canadian growth and interest rate expectations. That said, it is unlikely to shift the Bank of Canada from its current neutral stance.

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