

CORONA



VIRUS

The Coronavirus Report

by Jodie Walker

“While progress in infectious disease prevention, control, and treatment has improved our ability to respond to such outbreaks, globalisation processes relating to human behaviour, demographics, and mobility have increased the threat of pandemic emergence and accelerated global disease transmission.”

(Krewski et al, 2016)

In a range of ways, globalisation can be seen as a something of a double edged sword. On the one hand it enables the expansion of businesses into new locations, increases shareholder wealth, makes travel easier and enhances the rapid exchange of ideas and technology across the globe. On the other hand, it has resulted in increasingly distorted social hierarchies, expansive fossil fuel usage, and the swifter, more pervasive transmission of both mental viruses (such as terrorism), and infectious disease.

When the newest (yes, we have actually been historically exposed to them) coronavirus initially broke out, it seemed distant enough not to worry about, unless you had travel plans to China.

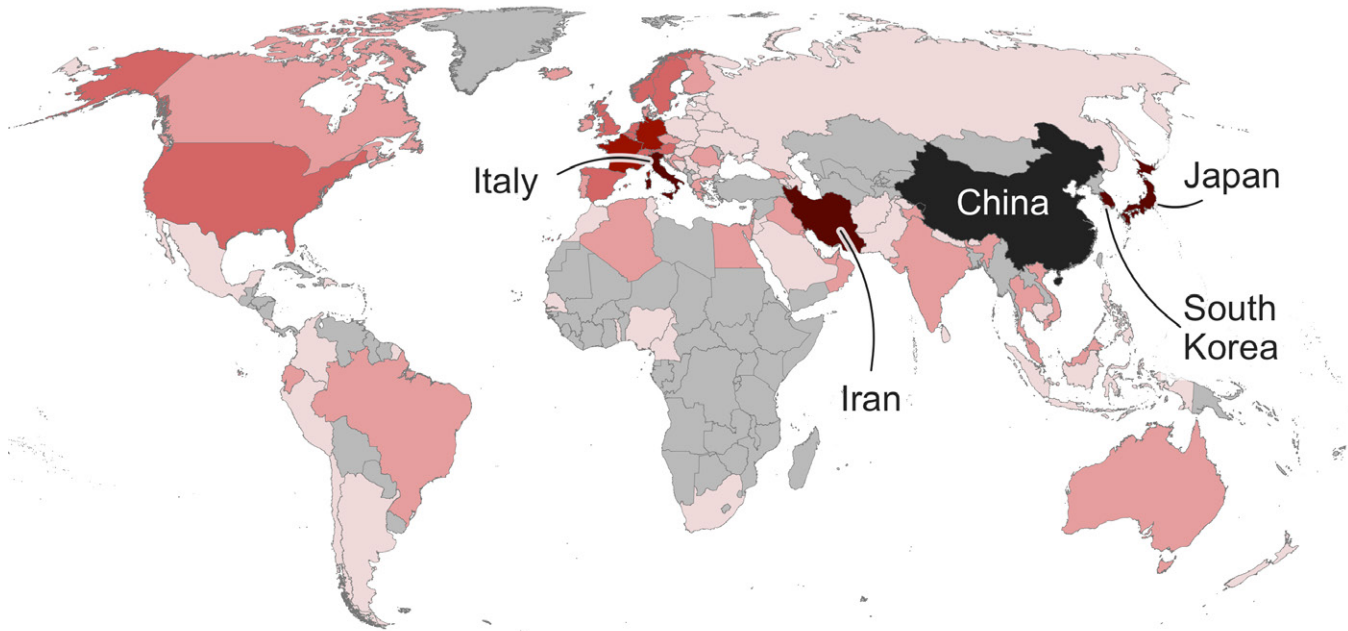
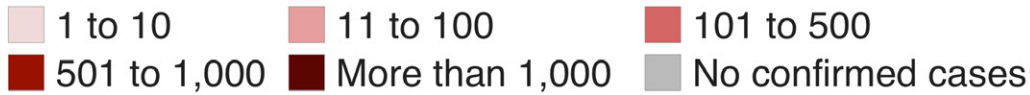
Skip forward just a month and it has quickly spread enough to force many people to cancel their travel plans and stock up on essential supplies. The economy, as well as the sporting world, seem almost certainly to be highly affected by the virus.

In this report, Secret Agent will consider some of the downstream effects of the new coronavirus outbreak.

WHAT ARE CORONAVIRUSES?

Coronaviruses are a group of related viruses that can cause disease in animals and humans. Examples of diseases caused by coronaviruses include the common cold and Severe Acute Respiratory Syndrome (SARS). Recently a new strain of coronavirus was discovered and this is called nCoV for short. It causes the infectious disease that has been called COVID-19. Symptoms include fever, cough, and other respiratory issues like shortness of breath and in extreme cases Acute Respiratory Distress Syndrome. (WHO, 2020) The main difference between COVID-19 and SARS (both diseases

Cases of coronavirus outside China



Cases of coronavirus outside China (Image from BBC News)
Source: WHO, health ministries. Updated: 8 Mar 10:00 GMT

caused by coronaviruses) is the severity of disease and the ease of transmission between humans. COVID-19 seems to be less severe than SARS in terms of mortality risk. However, the new coronavirus seems to be more easily spread compared to the SARS virus which sits deeper in the lungs. (Piot, 2020)

HOW DO THESE VIRUSES KEEP POPPING UP?

Zoonotic diseases are those which can be transmitted between animals and humans. Examples include salmonella infection, Lyme disease and COVID-19. There are several coronaviruses present in animals that have not yet infected humans to cause disease. It is when humans come in close contact with these animals, or eat them, that the viruses can be transmitted. Once a human is infected, the spread to more humans is very easy and that is how these outbreaks are thought to occur. For example, the virus that caused the SARS epidemic in 2002 came from bats which then spread to cats and then humans. The virus that caused the Middle East Respiratory Syndrome in 2012 came from camels. COVID-19 appears to have come from an animal at a seafood and meat market in Wuhan, China.

IMPACTS OF COVID-19

It's unknown how long this outbreak will last and what the extent of the impact will be long term. The hard thing to understand is what the second, third and fourth order effects from this virus will be. There is no doubt that there will be

impacts on the manufacturing, tourism, travel, and retail industries worldwide. As a result the property market and the economy as a whole will be affected, especially in Australia.

Currently, the world's supply chain has been severely disrupted. Australia is a trading economy, meaning that we supply much of Asia with the raw materials for manufacturing, while we in turn import items such as food, general goods and products, as well as building materials. A disruption in the supply chain is likely to impact Australia to a large extent.

Adding to this is the fact that Australia's winter is approaching. We are more likely to see a faster spread of infection in the colder months than those based in the Northern hemisphere where warmer temperatures will prevail.

In addition, Australia's ongoing need to recover from summer's bushfires contributes another layer to the complexity of the challenge that dealing with widespread coronavirus infection would entail.

The sharemarket has already responded with savage sell-offs. Central banks and Governments are looking at large-scale stimulus measures. It's clear that asset valuation has become even more difficult over the past few weeks.

On March 3rd, the RBA dropped the cash rate by 25 basis points, taking Australia to a record new interest low of 0.5%. While the Federal Reserve dropped the US key interest rate by 50 basis points. The effect, at the time of writing, has been the opposite of the central bank's desired objective. The sharemarket panicked, interpreting the central bank's approach as reactionary rather than strategic.

There are many unknowns when it comes to COVID-19 and it is hard to distinguish trustworthy information from fear based input or commentary. This was also the case during the SARS outbreak, when a lack of misunderstanding by authorities and the media resulted in a lot of unnecessary panic. (Qiu et al, 2018). Newspaper reports of shortages in certain items, from toilet paper to broccoli, are propelling those most concerned by the virus to embark on panic buying to stock up on essential supplies. It's clear that there will be some sort of shortages in the months ahead.

Fear in our communities spreads quicker than the viruses do and that fear has its own consequences.

Even those who may not be concerned by the virus itself, may become fearful of what a large cohort of people will do when fearful, as evidenced by the raids on supermarket supplies. It can often be the case that people fear people having fear or, put another way, fear breeds more fear.

Recently, an aversion to attending public spaces has been observed – which may well be an over-reaction to advice circulated by some local authorities. From a corporate rather than a civic perspective, businesses that are reliant on face to face meetings with customers often choose cafes and restaurants as venues for these exchanges. Consequently the hospitality industry is now being challenged to respond adequately so that coronavirus concerns have as little impact as possible – and so that business deals can continue to be discussed over coffee!

PROPERTY MARKET

How the property market may be impacted by COVID-19 is extremely difficult to predict. Property markets are generally slow to react to external events. The combination of high transaction costs, difficulty in obtaining price discovery, loss aversion and low holding costs produce a “wait and see” approach to sale considerations. This means the potential impacts often take time to materialise.

The most recent auction activity was largely unaffected by the news of the new coronavirus. There is a view that recent

sharemarket volatility and the most recent cut in interest rates will prove the housing market resilient. This is an increasingly shaky proposition.

There is limited literature investigating virus impacts on property markets, although some studies were conducted regarding the ways in which SARS affected the Hong Kong property market. It was found that there was a decrease in property values of around 2% on average. (Wong, 2008) Hong Kong had only recently emerged from the Asian Financial Crisis, so it was coming from a much lower base than many property markets are coming from today. SARS was also not as pervasive and global as the Coronavirus appears to be, and the supply chain has been vastly more impacted in the case of the recent outbreak. These factors would indicate a decline in value could be far more significant in response to COVID-19.

The supply chain shock is only beginning to be understood. As a result of the closure of Chinese factories, materials are becoming more difficult to source from Asia. The production of many raw building materials do not occur within Australia,



'Fear in our communities spreads quicker than the viruses do'
(Photo from Boredpanda.com)

primarily due to high local labour costs. Many large building development projects across our cities obtain facade and joinery packages directly from China. Their arrival is most likely to be severely delayed putting stresses on the system, including potential contractual disputes and a possible rise in insolvency risk.

Clearly, development sites need to remain active. A stalled project can be catastrophic to its owners. It may also be much more difficult to obtain a degree of certainty around construction costs, hence we may see caution in the appetite for new development sites.

Potential investors are also likely to re-access hurdle rates required for investments. In the short term, investors may seek better compensation for a greater perceived risk in the world. Commercial rents, which have soared within the inner city of Melbourne and Sydney, may be deemed too high. If a commercial lease is devalued by 10-15% after its lease term, and the investor expects an increased return to compensate for more uncertainty, it could be very likely that many commercial properties, from retail to industrial, are re-priced accordingly.

Residential property can respond more slowly to such events. Yet, if we see casuals, non-permanents, and gig economy workers losing employment it's likely to impact rents,

especially for the non-premium properties, which make up the majority of properties within our cities. This will feed back into investors' expectations.

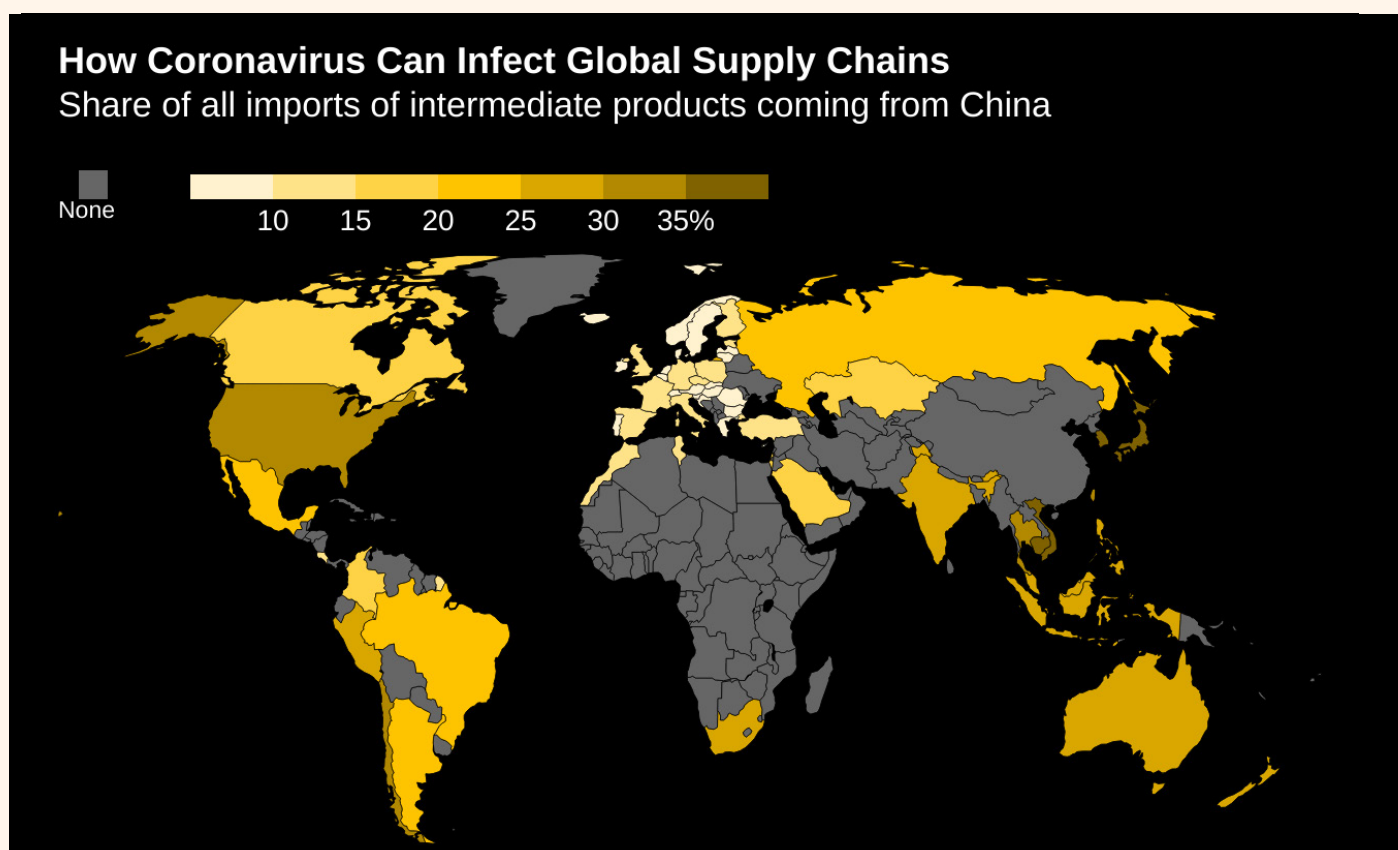
Of course, the human perception of what may happen will be enough in itself to have an impact.

If the perception from the majority of people is that this situation will get much worse, and a strong narrative builds around loss of life, job losses, food scarcity and general falling asset prices, then reality will likely follow. It's a classic self-fulfilling prophecy scenario.

The battle for this story, of what may happen, is still unfolding. In the meantime, it's likely that the "wait and see" approach works best for many looking to facilitate property transactions.

HISTORICAL EXAMPLES

SARS had a large impact on the travel, tourism and retail industry resulting in an estimated USD12-18 billion loss for Asian states. (Qiu et al, 2018) It can reasonably be expected that this current coronavirus outbreak will impact the same industries the most, resulting in huge losses to the economy.



How coronavirus can infect global supply chains (Image from Bloomberg)
Source: OECD TiVA, Bloomberg Economics

The biggest problem with comparing COVID-19 with SARS is that China's position in the world's economy has changed drastically in the past 18 years.

China has become a lot more important to the ecosystem, especially in terms of its trade. Many countries and industries rely more heavily on China than ever before. Back in 2002-2003, China represented 4% of the world's GDP, whereas now it represents 16%. (Harren et al, 2020) This means that COVID-19 could have a similar impact to the SARS outbreak in 2002, but it is likely to be worse.

History is littered with epidemics. From The Black Plague that wiped out 1/3 of Europe, to the Antonine Plague of the Roman Emperor that wiped out an estimated 5-10 million people, to the Spanish Flu that was thought to kill 40-100 million people, to the most recent viruses of Ebola, Measles and the Swine Flu; viruses have been successful at impacting human life. Thankfully, our knowledge has expanded at a great pace and we have been relatively successful at limiting the impacts of the viruses since the Spanish Flu took hold.

THE FUTURE

In one of his TED talks, Bill Gates (2015) said "if anything kills more than 10million people in the next few decades, it's most likely to be a highly infectious virus, rather than a war. Not missiles, but microbes. Part of the reason for this is that we've invested a huge amount in nuclear deterrents, but we've actually invested very little in a system to stop an epidemic."

The problem with many of these viruses is that they have a fairly long latency period, which means someone may be contagious for a week or more without showing any symptoms. Basic security measures at airports of taking people's temperatures before letting them into a country are ineffective and unless travel is completely banned it becomes almost impossible to control the spread.

It's uncertain what the mortality rate from this current strain of coronavirus will be, however it is likely that a future strain could be worse.

Whilst it seems that mostly the elderly are at highest risk, it might not always be the case. The Spanish Flu in 1918 killed just as many young and healthy adults as it did elderly people. (Craig, 2017) One of the ways that the flu and viruses like the coronavirus can kill people is through Acute Respiratory Distress Syndrome (ARDS). In ARDS, the immune system overreacts to the novel virus in the body and causes too much

inflammation in the lungs. This results in fluid building up in the lungs and lack of oxygen moving into the blood. So even if you have a strong immune system, it could work against you when it comes to surviving a pandemic virus. (Seheult, 2020)

It's possible to learn lessons from past experiences of infectious disease outbreak. However, since each disease is different in terms of ease of transmission and severity, it's likely that each new event will be different and have unpredictable outcomes. Global efforts are required to continue to improve surveillance and resource planning to successfully contain future pandemics. (Krewski et al, 2016)

CONCLUSION

The downstream effects of COVID-19 will become more certain as 2020 goes on. For now, we can speculate that there will be large repercussions on the economy as a whole, due in particular to the impacts on travel, tourism and entertainment industries. It will also impact our local property markets and it is prudent for investors, developers and commercial property owners to be prepared. ♦

SECRET

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