ARTICLE
28 FEBRUARY, 2020

Steven G. Cochrane
Steve.Cochrane@moodys.com
Chief APAC Economist

Denise Cheok
Denise.Cheok@moodys.com
Economist

Contact Us

Americas
+1.212.553.1658
clientservices@moodys.com

Europe
+44.20.7772.5454
clientservices.emea@moodys.com

Asia (Excluding Japan)
+85 2 2916 1121
clientservices.asia@moodys.com

Japan
+81 3 5408 4100
clientservices.japan@moodys.com

Korea Takes a Different Approach to COVID-19 Threat

Introduction

Outside of China, South Korea has the largest number of reported cases of COVID-19 infections. According to the World Health Organization, as of Thursday there were 1,766 confirmed cases. Of these, 505 were new cases and 605 were reported as likely the result of exposure within the country. This illustrates the rapid expansion of the disease within the country.

Location and spread

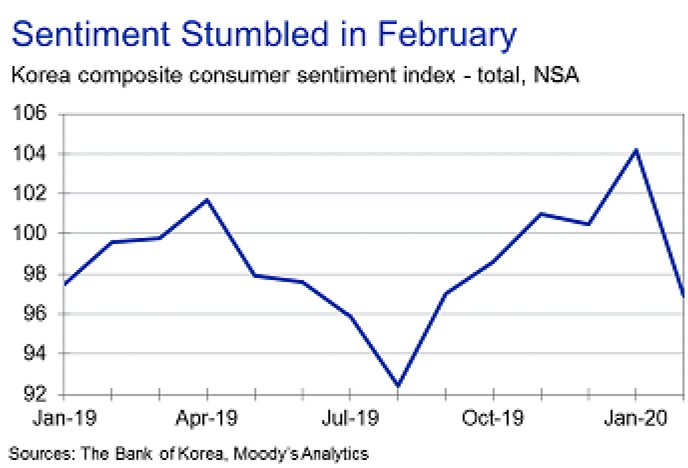
The countries with the next largest number of confirmed cases include Italy (400 confirmed cases; 78 new), Japan (186; 22), Iran (141; 46) and Singapore (93; 2). Ironically, one reason the numbers from Korea may be much higher than elsewhere is that the country is in some ways better prepared for an epidemic. For example, the Korea Centers for Disease Control and Prevention, following the MERS outbreak in 2015 that resulted in 38 deaths in the country, has devised methods for rapidly and effectively detecting any coronavirus infection.

But the spread of COVID-19 among members of a megachurch with a large congregation in Daegu accelerated the pace of infection and caused the government to raise its alert level to red, the highest level. Nevertheless, this alert level is not leading to any large-scale quarantines such as limiting travel in and out of Daegu using the model of Hubei province in China, or closing schools as has the Japanese government, which is striving to contain the virus before a decision must be made in May as to whether the 2020 Olympic Games will be cancelled.

Central bank responses

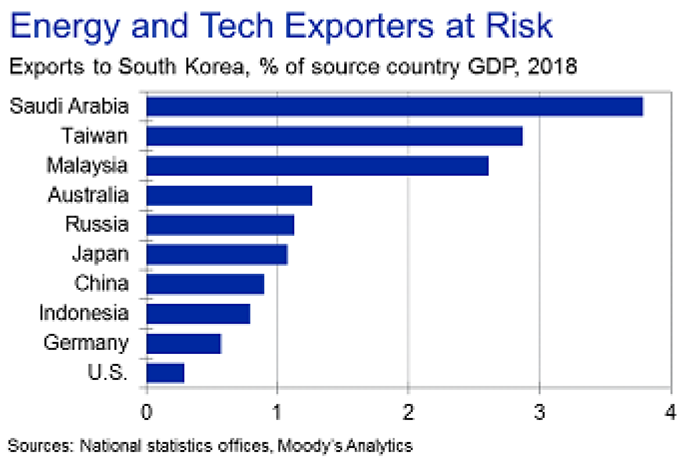
Similarly, the Bank of Korea surprised market expectations when it decided to keep its policy rate unchanged at 1.25% at its late-February meeting, despite that the spread of COVID-19 was already evident. This, too, differs from the reaction in China, which has been actively using all of the monetary and fiscal policy tools at its disposal to support its troubled economy. The Bank of Thailand and Bank Indonesia also have eased monetary policy in the wake of the virus outbreak. Japan is a different case, where there is little room for the Bank of Japan to provide further support. But Japan has already applied fiscal policy with a $120 billion spending package to support the economy following last year's value-added tax increase and the impacts of the U.S.-China trade war, and to help rebuild typhoon-devastated areas. Japan may consider further fiscal stimulus if the economy remains weak this year.

Thus, the potential for the virus to spread in South Korea remains high. And if this is the case, the economic impact could be large. Korea's economy was already weakened over the past year by the U.S.-China trade war and its own trade dispute with Japan. Real GDP growth that had been averaging close to 3% per year between 2015 and 2018 slowed to 2% in 2019. Exports had been falling sharply due to the trade war, and employment has been weak with the jobless rate rising from 3.1% in August to the current 4% as of January. More recently, the composite consumer sentiment index in February fell sharply to 96.9 from 104.2 in January and is now well below the neutral level of 100. Further, the domestic economic conditions component of the index for February fell to 66. The magnitude of decline of the top-line figure was similar to its fall when MERS appeared in 2015.



Businesses are beginning to prepare for an economic slowdown. South Korea's oil refiners already are accelerating production cutbacks that began last year. Both domestic demand as well as export demand in China for refined petroleum products have weakened, and more is expected. Airlines are reducing flights in and out of Korea. And manufacturers are feeling the initial impacts of the epidemic in China and Korea. Earlier in February, Hyundai Motors temporarily closed its Ulsan plant due to parts shortages from China. Samsung's plant in Gumi, not far from Daegu, quarantined a number of its employees following infections there.

The global impact will be limited at first. South Korea's three largest sources of imports are China, the U.S. and Japan. They are large enough to withstand a temporary fall in demand from South Korea. Electronic components, minerals and chemicals, and nuclear machinery are among the largest commodities delivered to South Korea. However, relative to the size of their economies, Saudi Arabia, Taiwan and Malaysia are the most highly exposed. Saudi Arabia ships oil, fuel, and other downstream energy-related products. Taiwan is primarily a supplier of electronics. Malaysia ships a combination of the two plus other high-value products such as optical equipment. This will compound the impact of lower commodity prices, particularly crude oil, on the value of exports from Saudi Arabia, Malaysia, and other oil exporters.



However, the global impact would deepen if widespread shutdowns were to follow in South Korea along the lines of shutdowns in China. The one factor in Korea's favor is that the nation's factories, offices and service-providing industries do not rely on migrant labor as is the case in China. So at least industries will be much more flexible in managing production since their workforces are generally local. Labor will be available when needed, illustrating a key difference between the two hard-hit countries. And the examples of China, South Korea and Japan illustrate how differences in industrial structure, labor markets and policy reaction will determine the breadth and depth of the global COVID-19 epidemic.