NEW ZEALAND
FOREIGN AFFAIRS & TRADE
Manatū Aorere

South Korea: Impacts of Covid-19 on the South Korean Economy

Market Report

13 JULY 2020

Prepared by the New Zealand Embassy in Seoul on the 13 July 2020

Summary

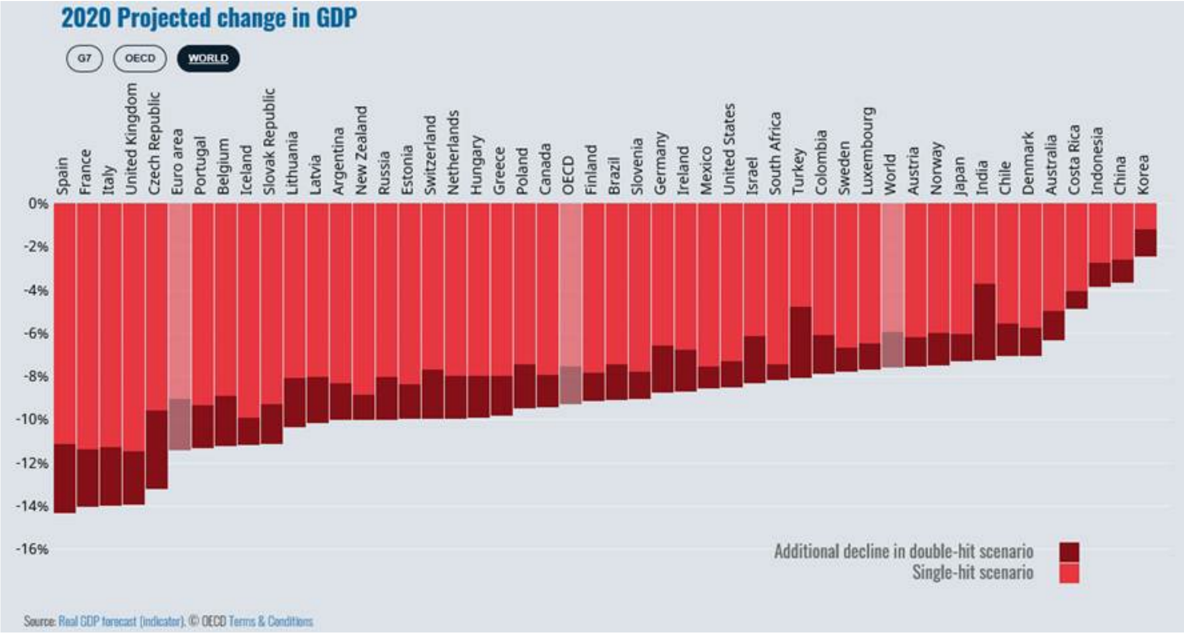
- Swift and large-scale intervention by the South Korean government has **minimised impact** of COVID-19 on the economy.
- South Korea faces the prospect of **economic contraction** this year (1.2-2.5%) which is markedly smaller than other OECD countries (6-8%).
- **Employment** figures have a held up better than OECD counterparts, contracting by 1.5%.
- **GDP growth** is expected to bounce back in Q2 2020 provided that a second wave of COVID-19 can be avoided.
- Key drivers in this (relative) success include: **massive support** from government (14% of GDP) and the central bank; **avoidance of lockdown and border closure**; and (despite South Korea's exposure to trade) the **strength of key parts of the export economy**.
- We include a summary of government measures. The government has also announced a "**Digital New Deal**" aimed at job creation through digitisation and a "**Green New Deal**" but details of both are sparse at this stage.
- Some commentators have criticised the emphasis on **short-term cash for jobs** and absence of ambitious **structural reform** to address underlying issues such as inequality and the concentration of wealth among the "chaebol".

Report/Findings

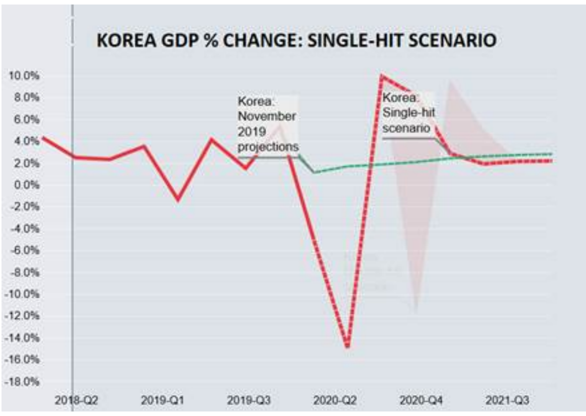
South Korea was one of the first countries hit by COVID-19. Although the country continues to suffer from a stubborn and persistent tail of cases, a swift and large-scale intervention by the government has flattened the epidemiological curve and contained the virus within manageable levels. Massive support from the government, amounting to 14% of GDP, and the central bank, coupled with the strength of key parts of South Korea's export economy have helped to minimise impact on the economy. Forecasts suggest that South Korea's economic contraction will be markedly smaller than other OECD countries, but the country still faces negative growth, falling exports and rising unemployment which President Moon has called an "economic wartime situation".

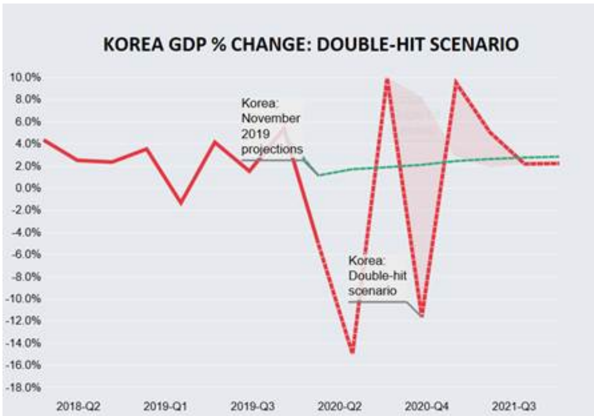
South Korea expected to be least affected economy in the OECD

2 South Korea's real GDP contracted 1.3% in Q1 2020 (quarter on quarter), by far the slowest growth in over a decade. In single-hit (where global economic output falls 6%) and double-hit (i.e. second wave scenario, where global economic output falls 7.6%) scenarios, the OECD forecasts that the South Korean economy will contract by only 1.2% and 2.5% respectively this year (see graph below, with South Korea farthest right).

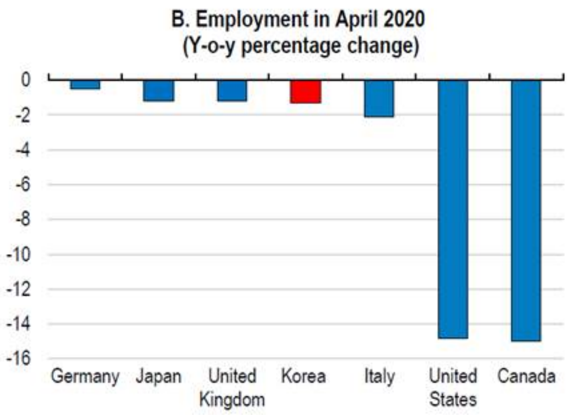


3 If a second wave scenario or "double-hit" can be avoided, GDP growth is expected to bounce back in Q2, followed by a slower recovery in Q3, but the global recession will continue to loom large over South Korea's exports and investment. In the event of a "double-hit", GDP growth is expected to suffer another sharp drop before bottoming out again in Q4. Private consumption is expected to pick up as social distancing recommendations are eased, albeit at a moderate pace as households exercise caution and suffer from income losses and relatively high unemployment.





4 South Korea's overall employment figures have also held up better than OECD counterparts. Its April (year-on-year) employment figures suggest the contraction has been much smaller (only around 1.5%) than that experienced by countries such as Canada and the United States (both of which have declined by around 15%) though similar to Japan.



Reason one: Avoidance of lockdown and border closure

5 South Korea's response to COVID-19 has been marked by a flexible, voluntary approach, a refusal to close borders and to impose lockdown. This has allowed it to escalate and ease back social advice in response to outbreaks, while its focus on tracing, testing, and treatment has enabled South Korea to flatten the curve. It has however left it with a persistent stubborn tail of COVID-19 cases which are proving difficult to eradicate. Despite reduced foot traffic, the avoidance of lockdown measures has allowed many parts of the economy - including restaurants and bars – to remain open for business throughout the epidemic.

6 The outlook for outbound international tourism remains grim but the domestic tourism industry – although significantly damaged – remains active. Despite suffering from a 99% drop in international visitors, Jeju Island was visited by upwards of 200,000 domestic tourists between the 30 April and 1 May holiday period, providing tourist operators on the island with much needed respite. New Zealand-owned Skyline - which operates a large luge in Tongyeong - has remained open, launching two new luge tracks this month, and plans to launch a new facility in Busan in mid-2021.

7 While the retail sector has been hit hard and once packed shopping districts shunned, consumption has been supported by well-established e-commerce and logistics channels and a population already accustomed to online purchasing. After declining by 6.5% in Q1 (quarter-on-quarter), retail sales in May grew by 4.6% from April.

Reason two: Massive support from the government and the central bank

8 Massive fiscal and stimulus measures by the government and central bank have helped the economy weather the worst of the storm to date. The response from the government has so far amounted to KRW270 trillion (NZD347 billion) or 14.3% of South Korea's GDP, considerable by international standards and on par with countries such as Canada but below New Zealand, France and Singapore as a percentage of GDP.

9 Having vowed to do whatever it takes to support the economy, the South Korean government has undertaken measures ranging from loans and guarantees (for SMEs, banks, and insurance companies) to coupons and vouchers (for relief grants to all households), tax benefits (for the reduction of rent and individual consumption tax on vehicles), and subsidies (for employment retention). The central bank has provided massive support for liquidity (including the purchase of treasury bonds and a US currency swap agreement). We include below a summary of government measures.

10 South Korea's strong public finances prior to the epidemic placed the government in a strong position to support the economy. Government debt was less than 40% of GDP in 2019, lower than all G7 countries and far below the OECD average of over 100%. Government measures are expected to push government debt up to 50-60% of GDP by 2023, still below the OECD average.

11 On top of this raft of existing measures, the National Assembly in early July passed a third supplementary budget totalling 35.1 trillion KRW (NZD 44.9 billion) with funds earmarked for: the creation of 550,000 jobs in publicly initiated programmes and strengthening of social safety nets (NZD12 billion); emergency loans for businesses (including small merchants, SMEs and large businesses) (NZD6.4 billion); and "New Deal" project investments (NZD6.5 billion). Additional economic measures are expected.

"Digital New Deal" and "Green New Deal"

12 The government has announced a "Digital New Deal" aimed at job creation through digitisation and a "Green New Deal". Although details of both remain sparse at this stage, inspiration is clearly being drawn from US President Franklin Roosevelt's Great Depression-era New Deal of the 1930s.

13 Under the "Digital New Deal", the South Korean government hopes to lay the groundwork for a digital economy for job creation. KRW50 billion (NZD63 million) has been earmarked for building 5G infrastructure and cloud computing for the government and KRW660 billion (NZD837 million) for promoting industrial convergence between 5G and AI.

14 The "Green New Deal" was a key part of the ruling centre-left Democratic Party's manifesto in the lead up to April National Assembly elections. The manifesto contained three elements: a pledge to reach net zero carbon emissions by 2050; ending investment in coal fired power plants offshore; and investment in renewable energy sources. Despite the clear electoral victory for the party, it remains unclear to what extent the government will embrace these promises, but there is strong support at local level, with 226 of South Korea's 228 local governments (including Seoul) expressing support.

Reason three: Strength of key parts of the export economy

15 The impact of COVID-19 on global demand and supply chains (on which South Korea is heavily reliant) has had a direct effect on South Korean exports - down 24.3% in April and 10.9% in June (Y.O.Y). Yet the relative strength of key parts of its export economy has helped to offset the decline and signs have started to emerge of a recovery for some sectors.

16 Despite sharp declines in exports of petroleum products (-56.8%), petrochemicals (-33.6%) and semi-conductors (the country's top export generator) (-14.9%), exports of computers have nearly doubled (+91.5%) due to increased work-from-home practices. Biopharmaceutical exports have also grown (+53%), led by strong demand for South Korean-made diagnostic COVID-19 test kits.

17 Motor vehicle exports have declined – now accounting for only 5.2% of total exports in May (compared to 8.6% a year ago) – but exports of South Korean-made electric vehicles reached new highs in June (+15.3%), followed by strong exports of plug-in hybrid electric vehicles (+16%).

18 Samsung Electronics – the world's largest smartphone and semiconductor - has forecast a 23% rise in second quarter operating profit (KRW6.6 trillion/NZD8.3 billion), driven by strong demand for memory chips used in personal computers and servers, after global smartphone sales slumped by more than 20% in the first quarter. Samsung is optimistic that sales figures will rise in Q3.

19 There are also signs of a recovery in exports. Exports to China, down 17.9% in April, recovered 9.5% in June, suggesting a broader improvement in regional trade. This is significant given that 80% of South Korea's exports and 32% of its imports to/from China are intermediate goods.

But some criticism of failure to address deep-seated challenges

20 Despite the government's efforts, some commentators have argued that short-term cash for jobs will fail to address many of the long-standing structural issues facing the South Korean economy, such as inequality (between generations, between Seoul and the regions, and between rich and poor) and concentration of wealth among the huge, family-run conglomerates known as "chaebol" (Samsung, Lotte, LG, etc.).

21 A low birth rate, ageing population and low rates of immigration have created demographic challenges. Studies suggest more than two-thirds of South Korean youth obtain tertiary degrees but are slow to transition to employment despite SMEs suffering a shortage of skilled workers.

22 South Korea's relative poverty rate is currently the third highest OECD-wide, driven by the worst old-age relative poverty rate in the OECD. Income inequality, as measured by the Gini coefficient after taxes and transfers, is the seventh highest in the OECD. Although the government has attempted to address income inequality in recent years, including by increasing the minimum wage by almost 30%, results have been slow to appear.

23 The impact of COVID-19 has been particularly acute for the irregular and temporary workforce in South Korea which had been steadily growing pre-COVID, now accounting for one-third of the salaried workforce. Employment of temporary and daily workers dropped by 12% and 13.7% respectively this year compared to last.

Summary of South Korean government measures

Type	Details
Loans and Guarantees	• For SMEs and small merchants: KRW72.7 trillion (NZD93.6 billion) • For low cost airlines: KRW0.3 trillion (NZD386 million) • To local credit guarantee funds: KRW0.5 trillion (NZD643 million) • Loans and guarantees to avoid a credit crunch: KRW41.8 trillion (NZD53.8 billion) • Loans to banks as well as securities and insurance companies for 3 months: KRW10 trillion (NZD12.8 billion)
Coupons and vouchers	• Family care leave: KRW2.8 trillion (NZD3.6 billion) • Emergency livelihood support and deduction in national health insurance: KRW3.5 trillion (NZD4.5 billion)

	• Emergency relief grants of up to KRW1 million (NZD1287) to all 21 million households. Note: 2.7 million lower income households can receive grants in cash and remaining 19 million households to receive vouchers or credit card points.
Liquidity	• Liquidity support to the financial sector: KRW8.2 trillion (NZD10.5 billion) • Expansion of FX liquidity by raising ceilings on FX derivatives positions of banks and easing of FX market stability rules • Bilateral currency swap agreement between the Bank of Korea and US Federal reserve for 6 months • 50 point policy rate cut to 0.75% • Interest cut on Bank Intermediated Lending Support Facility to 0.25% • Purchase of treasury bonds: KRW1.5 trillion (NZD1.9 billion) • 25 basis point policy rate cut to 0.50% • Bond Market Stabilisation Fund: KRW20 trillion (NZD25.7 billion) • Securities Market Stabilisation Fund: KRW10.7 trillion (NZD13.7 billion) • Key Industry Relief Fund (to purchase corporate debt and equity): KRW40 trillion (NZD51.5 billion)
Tax benefits	• Reduction of rents and cut in individual consumption tax on cars: KRW1.7 trillion (NZD2.1 billion)
Subsidies	• Aid to employees and severely affected provinces, including expanded employment retention subsidy: KRW1.2 trillion (NZD1.5 billion)

More reports

View full list of market reports from MFAT at www.mfat.govt.nz/market-reports

If you would like to request a topic for reporting please email exports@mfat.net

To contact the Export Helpdesk

Email exports@mfat.net
Call 0800 824 605
Visit Tradebarriers.govt.nz

Disclaimer