

Japan: In case of emergency

Japan only has about 45 cases of coronavirus, but if this is just the start of a bigger outbreak, it could see GDP growth slow sharply



thermometer

Source: Shutterstock

How a virus can bring down an economy

We have historical first-hand experience of how a virus can bring down an economy with SARS back in 2003. And while there are many differences between that epidemic and what is happening now, the principal mechanism remains the same.

Where many economic simulations are actually just a form of actuarial arithmetic, for example, the costs of crime, the costs of obesity on the economy and so on, that sort of approach fails with an epidemic like the coronavirus. It may well be that the numbers infected and the total death toll will look insignificant compared to a regular flu outbreak. Such flu epidemics annually affect tens if not hundreds of thousands, and the global death tolls can be very substantial. Yet apart from some of us getting a flu jab, they don't affect our behaviour much.

It may not be proportionate to the individual risk, but the fear generated by an epidemic like the coronavirus, coupled with the official response - quarantines, curfews, lockdowns and travel bans, can have a very substantial impact on economic behaviour, and most of it, negative.

Service sector the hardest hit

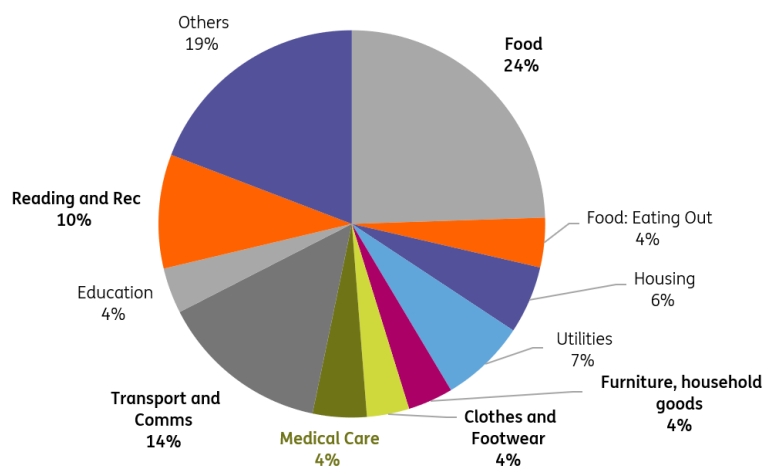
When the fear of infection leads to economic retrenchment, by households, certain types of activity are typically shunned, The following, using Japan's household spending and income survey is not an exhaustive list, but shows the sorts of activities curtailed:

- Eating out (part of the food category - accounts for an average annual expenditure of about JPY152,000, out of the average total household spending of JPY3.3m);
- Recreational activities things like movies, theatre (part of the reading & recreation category - accounts for about two-thirds of the JPY350,000 annual spending of this category);
- Transport and communications - in particular, public transport, which accounts for about one-eighth of the total transport and comms JPY523,000 annual spending.
- Retail sectors such as clothes and footwear and furniture/household goods - together amount to about JPY270,000 annually. Online shopping may make up for some of these losses.

Of course, some other things get a boost. Medical care and medical products: Maybe in such environments, households are quicker to seek professional medical help in the event of sickness even if unrelated to the epidemic. Spending on preventative medicines, vitamins, disinfectant wipes and surgical masks, all may soar if stocks have not run out.

The average annual household spending on medical goods and services in the latest twelve months summed to JPY165,000.

How Japanese households spend their incomes (latest 12M JPY3.5m)



Source: CEIC

Evaluating an epidemic

It is thus a simple job to "shock" the consumer spending part of our GDP forecasts by cutting spending on the consumer services likely to be affected and providing an offsetting boost to medical care spending. In terms of the profile of the "shock", we are in February now, so if there is going to be a sizeable increase in Japanese coronavirus infection, it will probably take most of this

month to emerge.

The onset of the warmer, drier northern hemisphere spring and summer typically makes it harder for such infections to persist. So an April peak followed by some moderation would seem a reasonable scenario

We can only guess the timing of any peak in infection and thereby the most intense impact on household spending, but the onset of the warmer, drier northern hemisphere spring and summer typically makes it harder for such infections to persist. So an April peak followed by some moderation would seem like a reasonable scenario. This leaves both 1Q20 and 2Q20 hit with progressively weaker spending in these areas before the recovery sets in.

But the recovery is unlikely to be "V-shaped", as sometimes is the case in the event of some other natural disasters, like an earthquake. Given the types of expenditure avoided, mainly services, there is unlikely to be much in the way of "pent-up" demand. For example, you don't take two bus journey's in May because you didn't take one in April. So the return to normality might be a relatively subdued one. Put another way, some of the expenditure lost, is lost forever.

Outcome of the "shock"

As we said at the outset, only about 45 cases of coronavirus are confirmed in Japan, and most of them were Chinese visitors. What we do not know now, and won't know for some weeks, is whether the virus is now established in the local Japanese population. If it is, it should begin to emerge (individuals will become symptomatic) through "community infection". If that happens, then the sorts of economic impacts we have noted above, plus others, for example, production slowdowns due to logistics interruptions (already affecting some car plants in South Korea), could add considerably to the damage.

If we see numbers of infections in Japan rise to thousands, then this would almost certainly push Japan to negative growth for the year as a whole, and a full-blown recession of two consecutive quarters of negative growth would be hard to avoid

Hitting our sensitive spending areas with a 10% decline in 1Q and a further 5% decline in 2Q, but allowing for some greater spending on medical categories, then allowing for a return to pre-epidemic spending levels in 3Q and later, is enough to strip off about 1 percentage point from consumer spending. So relative to the previous forecast for 2020, it knocks off about a half to two-thirds of a percentage point from GDP growth. The effect would have been larger, but the aftermath of the consumption tax had already left household spending

depressed so pushing it lower still is somewhat harder than if it had been quite buoyant.

This isn't a "worst-case" scenario but represents a "first-step" forecast given the uncertainty of what may emerge from this corona epidemic, but on the assumption that what we are seeing now is not the peak in infections either for China or for Japan. If we see numbers of infections in Japan rise to thousands, mirroring what is happening in China, then this would almost certainly push Japan to negative growth for the year as a whole, and a full-blown recession of two consecutive quarters of negative growth would be hard to avoid, especially with both monetary and fiscal policy already maxed out.

Author

Robert Carnell

Regional Head of Research, Asia-Pacific

robert.carnell@asia.ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.