

KOREA

GDP growth declined in the latter part of 2016 in the context of political uncertainty, corporate restructuring and a drop in exports. Assuming that domestic and international political uncertainty dissipates, growth is projected to edge up to 2.8% in 2018, supported by a pick-up in exports and rising business and consumer confidence. Inflation reached the 2% target in early 2017, while the current account surplus is expected to remain large at 6% of GDP.

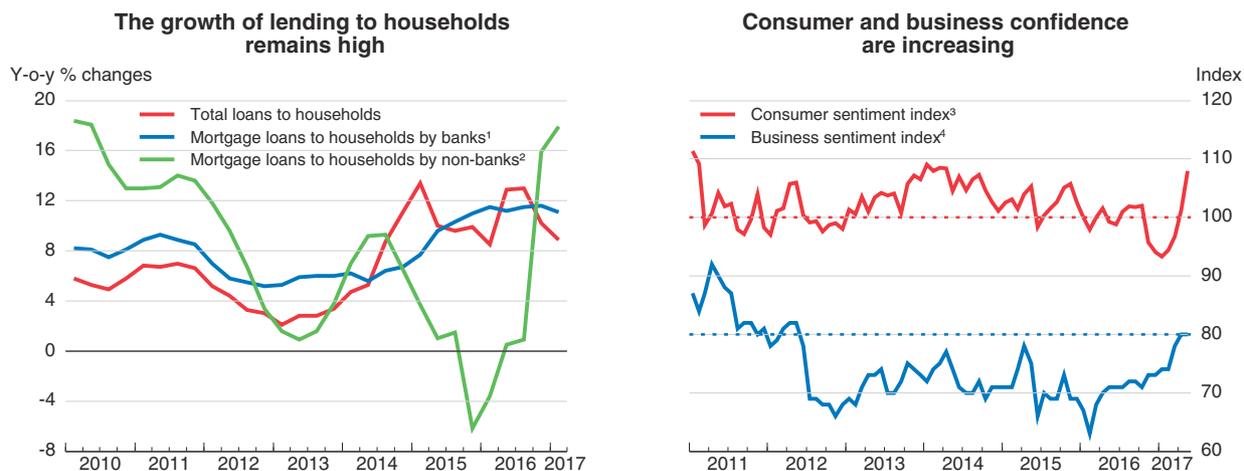
A supplementary budget is needed to support growth in 2017. The measures to restrain mortgage lending will have to be carefully calibrated to achieve a soft landing in the housing market and stabilise household debt. Gradually reducing the degree of monetary accommodation by raising the policy rate from its all-time low of 1¼ per cent would help keep inflation in check and contain household debt.

Korea has joined 16 free trade agreements since 2003, promoting its integration in global value chains. However, excess world capacity in some capital-intensive industries, such as shipbuilding, is forcing restructuring and driving up unemployment in some areas in Korea. The government should ensure that unemployment benefits and active labour market policies are adequate to help affected workers move to new jobs.

Output growth remains modest in 2017

The expansion is supported by a pick-up in export growth, led by semiconductors, in early 2017. China accounts for a quarter of Korean exports and is a key source of demand, along with other Asian countries. Stronger exports are boosting business investment despite low capacity utilisation, which is linked to the restructuring of troubled industries. Manufacturing employment is falling and the rise in inflation from 0.9% to 2.1% (year-on-

Korea



1. Commercial and specialised banks.

2. Non-bank depository institutions.

3. The long-term average over 2003-16 is displayed as red dotted line and is set at 100.

4. For all industries. The long-term average over 2003-16 is displayed as blue dotted line and is set at 80.

Source: Bank of Korea.

Korea: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices KRW trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 429.4	3.3	2.8	2.8	2.6	2.8
Private consumption	727.8	1.7	2.2	2.5	2.0	2.7
Government consumption	214.5	3.0	3.0	4.3	2.5	3.1
Gross fixed capital formation	418.3	3.4	5.1	5.2	7.2	2.9
Final domestic demand	1 360.6	2.5	3.2	3.6	3.7	2.8
Stockbuilding ¹	- 2.3	0.5	0.7	0.0	0.4	0.0
Total domestic demand	1 358.3	3.0	3.9	3.6	4.2	2.8
Exports of goods and services	770.1	2.0	-0.1	2.1	3.9	4.4
Imports of goods and services	698.9	1.5	2.1	4.5	7.5	3.8
Net exports ¹	71.2	0.4	-1.0	-0.7	-1.0	0.4
<i>Memorandum items</i>						
GDP deflator	—	0.6	2.4	1.8	1.4	2.3
Consumer price index	—	1.3	0.7	1.0	2.0	2.0
Private consumption deflator	—	1.0	0.9	1.0	1.7	2.0
Unemployment rate	—	3.5	3.6	3.7	3.8	3.7
Household saving ratio, net ²	—	7.2	9.3	9.3	9.0	8.8
General government financial balance ³	—	1.3	1.3	2.0	2.0	1.8
General government gross debt	—	43.7	45.7	45.6	45.3	45.5
General government net debt ⁴	—
Current account balance ³	—	6.0	7.7	7.0	6.0	6.0

1. Contributions to changes in real GDP, actual amount in the first column.

2. As a percentage of disposable income.

3. As a percentage of GDP.

4. Consolidated data on an SNA 2008 basis is not available.

Source: OECD Economic Outlook 101 database.

StatLink  <http://dx.doi.org/10.1787/888933505942>

year) over the past year has eaten into wage gains. A drop in consumer confidence to its lowest level since 2008 in the wake of recent political uncertainty held back consumption.

High household debt of more than 170% of household disposable income is another headwind to growth. Over 2014-16, residential investment increased by 45%, fuelled by the relaxation of regulations on mortgage lending in 2013-14. Policies implemented since early 2016 to stabilise the housing market appear to be having an impact, although more may be needed. Nationwide house prices rose by only 0.7% (year-on-year) in the first quarter of 2017, and expected house price inflation has fallen.

More expansionary fiscal policy and progress in structural reform are needed

Supplementary budgets in 2015 and 2016 boosted government spending. In the absence of another supplementary budget in 2017, central government spending is set to grow by only 0.5%. With the gradual withdrawal of monetary policy accommodation, fiscal policy should be used more actively to support growth, particularly given Korea's low level of government debt and persistent budget surpluses.

Structural reforms, including regulatory reform in the service sector, are needed to boost labour productivity growth, which has slowed to an annual rate of around 1% since

2011. In addition, with the working-age population (15-64) declining, reforms to boost employment of women, youth and older persons and break down labour market dualism are a priority to promote socially-inclusive growth.

Output growth is projected to pick up

Output growth is projected to edge up from 2.6% in 2017 to 2.8% in 2018, thanks in part to faster world trade, which will boost exports and business investment, helping to offset a gradual decline in the growth of residential investment. However, China's decision to cut imports of Korean consumer products and cultural goods and to ban Chinese tour groups to Korea in retaliation for Korea's decision to deploy a missile defence system could, on Bank of Korea estimates, lower GDP growth by 0.2 percentage point. Following the election of a new president in May, consumer confidence is likely to improve further, boosting private consumption. Inflation is projected to stabilise at around 2%, while the current account surplus will remain high at 6% of GDP in 2018.

Downside risks to the outlook include heightened geo-political tensions and trade protectionism, notably a possible revision of the US-Korea free trade agreement. However, Korea's strong external position provides a buffer against such events. On the domestic side, the main risks relate to a hard landing in the housing market or a failure to rein in household debt. On the upside, a faster-than-projected increase in world trade growth and effective structural reforms could reignite domestic demand and reverse the decline in Korea's export performance.