KOREAN ECONOMY

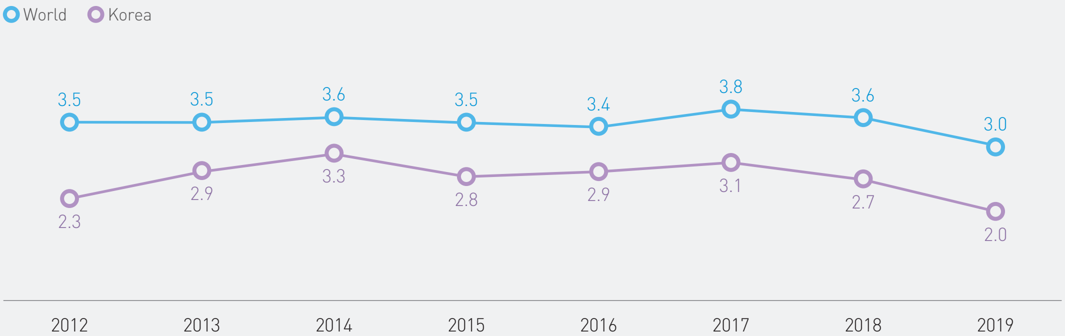
2019 in Review

GDP

Korea's GDP grew 2.0% in 2019, down from 2.7% in 2018. Throughout 2019, the Korean economy suffered a series of difficulties due to aggravating external conditions. Global trade has weakened due to the U.S.-China trade war, and thus the semiconductor industry, the nation's primary exporter, struggled as a result. Over the course of this time, financial and foreign currency markets have been highly volatile, thereby eroding the confidence of investors. As a result, consumption and exports showed only modest growth, and investments were considerably affected.

GDP Growth Trends

(Unit: %)



(Source: IMF World Economic Outlook (October 2019), Bank of Korea)

Consumer Spending

Consumer spending in 2019, despite improved job markets, recorded just a modest increase of 1.9%, affected by a slow-paced recovery in consumer confidence that was the result of negative economic conditions, both internal and external. Specifically, consumers spent more on medical and health care, food, and accommodation services, and less on buying durables such as cars and electronic devices. In the fourth quarter of the year, rising expenditures on durables like automobiles, food and entertainment services in the face of reduced spending on semi-durables such as clothes led to a slight increase of 0.9% compared to the prior quarter.

Equipment Investment

A deepening negative trend in investment for machinery, particularly those items required for the IT sector, as well as transportation equipment investment suffering a setback in 2019, drove total equipment investment down by 7.7% from a year earlier. However, fourth quarter results increased by 3.3%, which were mainly reflected by an 8.8% surge in machinery for manufacturing semi-conductor products and precise engineering machines, and a 9.2% drop in equipment for transporting aircrafts and trains.

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Construction Investment

In 2019, construction investment fell by 3.1% year on year. Investment in civil works increased, but investment in building construction largely declined. By region, the total area of residential/commercial building construction in progress substantially decreased across the nation except for South Jeolla province, which is located in the southwest of Korea. In terms of quarterly growth, the fourth quarter of 2019 saw a 4.9% increase in building construction for residential and non-residential purposes, and a jump of 12.3% in civil construction, which was fueled by government SOC projects.

Employment

The job market in 2019 appears to have improved across the board, with the number of employed people significantly increased from the previous year. The number for the fourth quarter of the year rose by 422,000 compared to the same period last year. By industry, there was a huge increase in the service sector, mostly in healthcare and welfare, dining and hospitality. This was boosted by the government's job creation policy and a surge in incoming tourists to the country. Yet a further decline in the manufacturing sector is anticipated because electronics companies are in an economic slump. Affected by continued slowness in construction investment, the number of workers in the construction sector has declined.

Inflation

The annualized inflation rate in 2019 marginally increased by 0.4%, much lower from the previous year, which stood at 1.5%. This represented a significantly weakened inflationary pressure. Due to fair weather conditions in the first half of the year, the price of agricultural products and livestock rose modestly, but price levels in the second half were much lower compared to the same period in the previous year. Among industrial goods, petroleum product prices recorded negative growth due to fallen oil prices and relevant tax rates that were lower than the previous year, but non-petroleum product price rates increased slightly, to 0.7% from 0.5%. Boosted by City Gas price increases, utility prices went up 1.5%. Service prices increased 0.9%, a slowdown from 1.6% compared to the previous year.

Current Account Balance

Korea's current account surplus in 2019 stood at USD 60.0 billion, down USD 16.4 billion from the previous year. The decrease can be attributed to a steeply fallen surplus in merchandise account, which was adversely affected by global trade issues and declining prices of major export items. Korea's service account deficit was reduced mostly in the tourism sector. However, the country's primary income account surplus went up as domestic companies received more dividends from their overseas legal entities.

Interest Rate

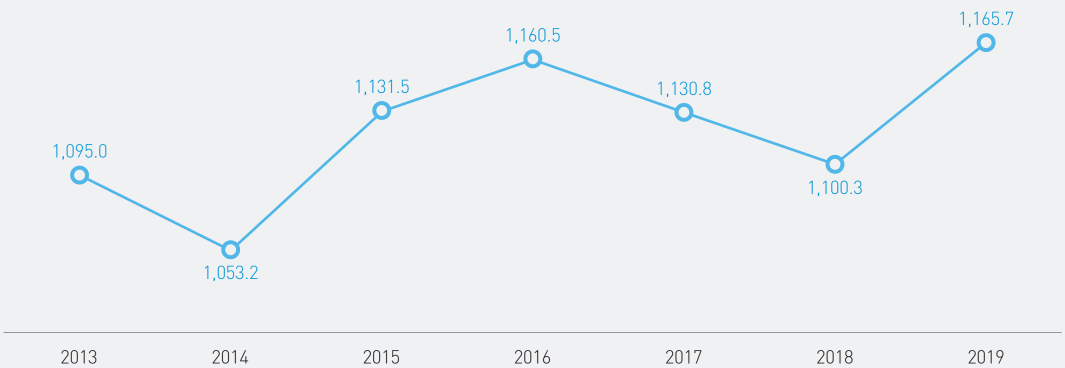
In 2019, the average three-year treasury yield decreased to 1.5%, down 0.6%p from the prior year. The yield plummeted to 1.09% in mid-August, a record low, over growing concerns of the gloomy outlook of the economy, as well as rising uncertainties caused by the negative outlook of the U.S.-China trade negotiations, and export restrictions imposed by the Japanese government. However, the Korean economy made a significant rebound that was boosted by pressure over a low interest rate and a concern over supply increase, as well as mitigated external risks. After October, in particular, due to improvements in external condition, such as a positive outlook over the trade talks between the U.S. and China, lowered expectations over further cuts of policy interest rates, as well as foreigners' increased short positions over Korea Treasury Bond futures, the yield increased by a large margin.

Foreign Exchange Rate

Throughout 2019, the Korean won fluctuated against the U.S. dollar, with the yearly average exchange rate rising to KRW 1,166 per U.S. dollar, up KRW 65. It was after July, the Korean won-U.S. dollar exchange rate has climbed up to 1,220, fueled by a growing concern over Japanese export restrictions and a deepening trade tension between the U.S. and China, and then from September the exchange rate came down when the U.S. and China returned to negotiations, and concerns over Brexit eased. In mid-November, the rate shot up again when trade talks between the U.S. and China seemed uncertain once more, and uncertainty in Hong Kong grew worse, giving rise to a geopolitical risk impact on the rate movement.

KRW/USD Exchange Rate Trends

(Unit: KRW)



(Source: Bank of Korea)

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Prospects for 2020

GDP

As of the end of February 2020, the Bank of Korea (BOK) forecast the nation's GDP growth rate for 2020 would be 2.1%. However, unlike the earlier forecast, in which the BOK believed that COVID-19 may peak in March, the virus spread quickly across the world. Later, in mid-March, the BOK governor called a press conference and suggested that the domestic growth outlook may fall below 2.1%. He also added that it is not possible nor meaningful to forecast the economic outlook, and that it may become possible only when the coronavirus curve starts to flatten. As overall factors — consumption, production, and financial markets — are uncertain due to COVID-19, the Korean economy will be contracting for some time, yet when the virus is contained, and consumer spending and exports start rising again, a growing trend will resume gradually. Domestic demand is expected to increase by 1.6%, and exports by 0.5%, contributing to Korea's growth in 2020. Currently, it is highly uncertain where we can expect growth, as the country is faced with a growing possibility that COVID-19 may linger for some time, while the semi-conductor industry is not likely to recover anytime soon.

Consumer Spending

Consumer spending is anticipated to increase by 1.9% in 2020. Although spending will experience a short-term contraction due to COVID-19, it will pick up rapidly when the virus curve starts to flatten. In the short term, due to people avoiding outdoor activities and overseas travels, private consumption of services and spending overseas may decrease. At the same time, spending on semi-durables, including clothes, will be adversely affected. Meanwhile, expanded subsidies and stimulus packages from the government are likely to encourage lower-income families to spend more money.

Equipment Investment

In 2020, equipment investment is likely to bounce back to a 4.7% increase following a sharp decline (8.1% decrease) in 2019. Recovery in investment spending may be observed primarily in technology industries such as semi-conductors and display manufacturers. But the current COVID-19 crisis, if prolonged, will pose a downside risk to equipment investment, as the global semi-conductor recovery may be delayed. In non-IT sectors, maintenance and repair sectors are likely to see a modest increase, and carmakers and telecom service providers can expect new investments. However, the aviation sector, which has already suffered from underperformance and thus reduced purchase of aircrafts, was severely hit by travel restrictions due to COVID-19, and may face intensified hardship in equipment investment.

Construction Investment

Construction investment throughout 2020 is projected to decline by 2.2%, but the extent of the decrease may become lower than 3.3% in 2019. Although the downward trend will be continuously seen, particularly in residential building construction, but the pace of decline may be partly compromised by a likely improvement in activities in SOC projects. In the non-housing sector, investment in commercial building construction may go down, but in a much smoother way. Investment in civil engineering construction will most likely post better results based on an expanded SOC budget from the government and increasing investment from the public sector.

Employment

The job market will continue to grow in 2020, as new jobs are expected to increase in the service sector and partial improvement can be seen in the manufacturing sector. But the number of new jobs may decline to 230,000 from 300,000 in 2019. Prolonged slowness in the construction sector will be a restrictive factor. Employment in the service sector is likely to increase on the back of the government budget increase for job creation projects and R&D activities. Shortened mandatory working hours and growing awareness of a healthy work-life balance may demand more people in the workforce in the sectors of healthcare and welfare, arts, sports, and leisure activity services. Nevertheless, due to the spread of COVID-19, the hospitality and dining, transportation, wholesale and retail industries will inevitably struggle for the time, discouraging employment in the service job market.

Inflation

Consumer price inflation is expected to be 1.0% in 2020, higher than the rate of 0.4% in 2019. Demand-side inflationary pressure is weak and the government's current welfare policy will continue, while downward pressure from the supply side, such as agricultural and livestock supply, is also expected to become weaker. The core inflation rate, which excludes volatile food and energy prices, is expected to be 0.7%, almost flat from the previous year. A high degree of uncertainty from COVID-19 has spread, and other unstable elements are making it difficult to foresee a price direction. Increased welfare support for telecommunication access and medical & health care services is likely to cause domestic demand to improve rather slowly, which will add downward pressure.

Current Account Balance

Korea's current account surplus is expected to decline to USD 57.0 billion, compared to USD 60.0 billion in 2019. The decrease is mainly driven by an increase in the service account deficit and a decrease in the primary income account surplus. The surplus in the merchandise account will rise on the back of rebounding exports that will mainly be tied to the semi-conductor sector's recovery. The service account deficit will rise driven by the struggling tourism sector, which was hit hard by the COVID-19 outbreak. The primary income account surplus amount will see a relative reduction following a sharp rise in dividend income in 2019.

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Interest Rates

In 2020, the average three-year treasury yield is forecast to drop to 1.4%, down 0.1%p year on year. The current low interest rate is expected to persist due to a concern over the COVID-19's impact on the economy, and the U.S. Federal Reserve Board's benchmark rate cuts. However, it is likely there will be volatility in the yield movement depending on monetary policy changes from the U.S. government.

Foreign Exchange Rate

The yearly average exchange rate of the Korean won against the U.S. dollar is forecast to go up slightly, to KRW 1,169. Rising external risks mainly caused by the COVID-19 outbreak and consequent departure to safe and risk-free assets may drive the exchange rate to soar, but such a rising trend could be curbed by the Fed's rate cuts and a possible bounceback in emerging economies, and the Korean government's monetary expansion plan.

Key Economic Indicators

(Unit: %)

	2018	2019	2020(E)		
			First Half	Second Half	Annual
Real GDP	2.7	2.0	2.0	2.2	2.1
Consumer Spending	2.8	1.9	1.1	2.6	1.9
Equipment Investment	-1.7	-7.7	4.8	4.7	4.7
Construction Investment	-4.0	-3.1	-2.4	-2.0	-2.2
Unemployment Rate	3.8	3.8	4.0	3.4	3.7
Current Account Surplus (USD Billion)	76.4	60.0	18.0	39.0	57.0
Exports	4.0	0.4	1.4	2.3	1.9
Imports	1.9	-1.0	0.8	3.4	2.1
Consumer Price Inflation	1.5	0.4	1.0	0.9	1.0
Three-year Treasury Yield	2.1	1.5	1.4	1.5	1.4
USD/KRW Exchange Rate	1,100	1,166	1,175	1,163	1,169

(Source: Bank of Korea, Korea Institute of Finance)