Economic Analysis

Domestic Economic Trends in the Aftermath of the Sewol Ferry Disaster

The Sewol ferry disaster caused a slump in consumption, but growth and consumption are expected to improve in the second half of the year.

The Sewol ferry disaster has taken a toll on the Korean economy, weakening consumer sentiment and causing a rapid slowdown in domestic sales. Various indicators point to a clear slowdown in domestic consumption. Signs of a cut down in spending are evident across society, and trips and gatherings have been canceled while entertainment events and concerts have been postponed. In the culture, leisure and tourism industries, revenue from credit sales has dropped, and the retail industry’s sales declined from the same period last year. The service industry has suffered the biggest blow from dwindling domestic consumption, and this has hit small business and shop owners particularly hard.

Because the disaster deeply wounded the national psyche, the economic impact has been particularly grave. The consumption slump is expected to have a visible effect on second quarter earnings, and there are concerns that prolonged social anxiety and self-imposed abstinence on spending will dampen the economy, which had just started to show signs of recovery.

However, it seems that the Sewol ferry accident will not completely reverse the economy’s recovery trend. The negative impacts of major disasters have proven to rapidly dissipate with time. For example, the negative economic impacts caused by the Seohae ferry accident, the Sampoong Department Store collapse and the Daegu subway fire were all short-lived. While it is obvious that the after-effects of the Sewol ferry accident will be more serious than other major disasters Korea has experienced, the economic impact will be significantly weaker in the second half of the year. In fact, department stores and large retail outlets saw sales recover during the May holiday season.

Although the pace of economic growth in the second quarter may slow, the growth trend will resume in the second half, driven mostly by exports. More specifically, Korea will benefit from the steady uptrend in advanced economies such as the United States and Europe. Also, the gradual increase in global durable goods consumption will drive Korea’s export of finished durable goods and IT components.

Domestic consumption will improve in the second half as well. The financial market will stabilize as economic entities become more immune to the effects of the U.S. Federal Reserve’s tapering of quantitative easing. Positive signs in the job market, such as the increase in employment, will also drive up consumer buying power. The upward trend in real estate and asset prices is also a positive sign for consumption. Domestic demand and export will equally drive growth this year, and the economy is expected to post an annual growth rate of almost 4 percent. This is lower than the pre-global financial crisis average growth rate, which stood at a mid-4 percent range, but is still higher than last year’s 3.0 percent.

There are several prerequisites for the Korean economy to maintain a sustainable recovery. First, the government should take proper measures to prop up consumer sentiment and mitigate the economic fallout from the Sewol disaster. Second, to revive the local economy, local government agencies should refrain from canceling all local festivals and events and group tours. Another important condition for sustaining economic recovery is that the rapid appreciation of the won should not hurt exports too much.

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