Economic Outlook for Korea

With the economic pickup slow, the Korean economy is expected to experience moderate growth next year.

The Korean economy is estimated to have entered its recovery phase, after hitting bottom in the first quarter of 2013. Yet, the pickup is very slow, with a production increase of less than half of what it was in the four post-2000 recoveries. Weak exports lead to slow domestic investment and consumption. Corporations are hit hard by poor export performance and profitability. A meager recovery is also reflected in weak household consumption. A prolonged weakening of demand raises concerns of a blow to the production base, which, in turn, undermines long-term growth potential. Having felt the need to regain lost demand, the government is presenting a series of bold economic stimulus packages. The new economic team, led by Finance Minister Choi Kyunghwan, previously reaffirmed that the government will implement expansionary macroeconomic policies until they produce tangible results. The new economic policy direction consists of three parts: galvanizing the domestic business, stabilizing livelihoods and innovating the economy.

The new economic policy has a number of special features that set it apart from its predecessors. First, it is much more aggressive. It aims to trigger cooperation among policymaking authorities, and one way of doing that is with the Bank of Korea setting low interest rates. The policy even entails measures that previously faced strong backlash, such as easing loan-to-value ratio limits for mortgage lending and the easing of construction regulations. When it comes to industrial policy, it seems likely that regulation easing will focus on medicine and leisure tourism, two of seven key industries that are the government’s top industrial policy priorities. Also noticeable is the triggering of an asset price increase in order to boost consumption, through means of real estate deregulation and an increase in dividend income.

Considering the future impact of economic policy and global economic recovery, the domestic economy is likely to pull itself out of its sluggish phase. The government’s bold economic stimulus measures will act favorably toward the country’s economic growth. Although the government anticipates 0.1 percentage point growth following the expansion of government expenditure, the actual boosting impact could be much greater, given low interest rates and an increase in asset price. Advanced economies, with the United States in the lead, are expected to enter the recovery phase next year, which would gradually improve Korea’s export performance. Thanks to the steady increase in income and improvements made in the real estate market, the outlook on consumption is optimistic.

The effects of the government’s economic stimulus will most prominently be seen in the construction sector. The government is likely to use all possible deregulation measures to boost housing prices, and heightened expectations of a rise in housing prices will add vibrancy to private investment in housing construction.

Such an assumption is already proving to be true, with a clear upsurge of interest in housing sales. Furthermore, an anticipated increase in government budget next year will lead to a rise in SOC construction as well.

Despite the positive outlook on the Korean economy, constraints remain. Because advanced countries are restraining from increasing their imports, Korea’s exports will not increase at a fast pace. An appreciated won will also weaken the price competitiveness of exporters. As for consumption, a fast recovery will be limited by prolonged concerns over the financial security and household debts of retired elderly. Considering all of these factors, the future recovery of the domestic economy is likely to take place at a moderate pace. Korea’s annual economic growth rate is projected to increase slightly from this year’s 3 percent to 4 percent next year.

By Geun Tae Lee
Senior Research Fellow
LG Economic Research Institute
gtlee@lgeri.com