Korean Economic Forecast for 2015

Light and shadows are expected to coexist in the Korean economy in 2015

The Korean economy in 2015 is likely to be one of both hope and concern. Korea’s greatest hope is to be ranked as an advanced nation by joining the “30-50 Club” (countries with a population exceeding 50 million and GDP/capita over USD 30,000). However, the general concern about deflation is set to continue due to the prolonged low growth rate and low inflation rate. Major characteristics of the Korean economy in 2015 are as follows.

Joining the “30-50 Club”
Korea is forecast to join the “30-50 Club” as its 7th member in 2015. Korea’s entry into this so-called club will be one of the most inspiring milestones in Korean economic history. Most major advanced G7 nations are already members, except Canada. Korea’s credit rating is expected to be upgraded upon Korea’s joining the club, which would contribute to stabilizing macroeconomic sectors including government finance, debt and prices.

Renewal of employment rate record for four consecutive years
The employment structure has substantially improved with the shift in middle-aged individuals and women in the labor market. With this trend continuing, the employment rate for those between 15 and 64 years of age is forecast to reach 66.2 percent in 2015, a record high for the fourth consecutive year. When the quantitative expansion of employment is combined with qualitative improvement, household income will significantly rise and purchasing power will be improved.

Housing market: Boosting domestic economic recovery
The improved housing market is poised to energize the domestic economy. It will recover construction businesses and expand employment. Asset growth following rising property prices will contribute to the recovery of consumption. Housing-related services such as removal, remodeling, leasing and financing will also benefit from the improved housing market.

Concerns about deflation to continue
Concerns about deflation are expected to continue as the low growth rate and low inflation rate persist. A “deflation gap,” or an economic situation in which the real GDP stays below the potential GDP, has continued for nine quarters, and the “negative price gap,” an economic situation in which the real price stays below the potential price, has lasted for as long as 13 quarters. This trend will continue through 2015.

Exports fettered by China
The Chinese economy, which drove Korea’s total export growth in the past, is now exerting a negative influence on Korea’s exports. The main causes are China’s falling economic growth rate and intensified technology following the upgrade of China’s industrial infrastructure.

Fear of weak yen and weakening competitive edge of Korea’s export items
The KRW/JPY exchange rate is expected to fall further in 2015, and the level of export competition with Japan has steadily increased since the global financial crisis. Japanese businesses are likely to make a move to lower export prices in 2015, which will further weaken the competitive edge of Korean export items. When the KRW/JPY exchange rate falls by 10 percent, Korea’s total export amount is expected to drop by 9.2 percent.

Policy suggestions
Positive action by the government is desperately needed to avoid the low-growth/low-price trap. First, the budget for 2015 should be expanded and implemented early in the first half of the year, with the option of further reduction in the base interest rate. Second, countermeasures for revitalizing the housing market should be strengthened to promote asset growth effects to create virtuous circulation that leads to the recovery of private consumption and construction businesses. Third, the government should introduce a policy to initiate qualitative improvements as well as the quantitative expansion of employment to promote the growth of household income. Fourth, there needs to be some fine-tuning, to adjust the speed of the falling exchange rate and to ensure that the exchange rates do not break away too far off the equilibrium exchange rate. Finally, policies to enhance potential growth rate should be consistently enforced.

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