



Diagnosis and Response Strategies for the Korean Economy¹⁾

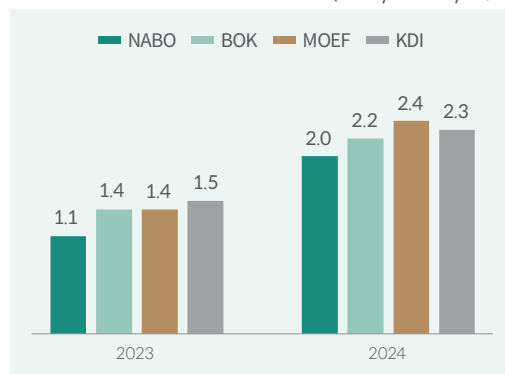
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2023–2027 Outlook for the Korean Economy

- **The National Assembly Budget Office forecasts that, from 2023 to 2027, the Korean economy will experience an average annual growth rate of 2.2%.**
 - For 2023, the expected economic growth rate is 1.1%, influenced by potential reductions in fiscal spending due to inadequate tax revenues and uncertainties surrounding inflation.
 - Assuming that the potential growth continues to hover around the low 2% range, it is anticipated that real GDP growth will see a gradual recovery in 2023, aligning with its long-term equilibrium level.

[Figure 1] Forecast of Korea's Economic Outlook by Major Institutions

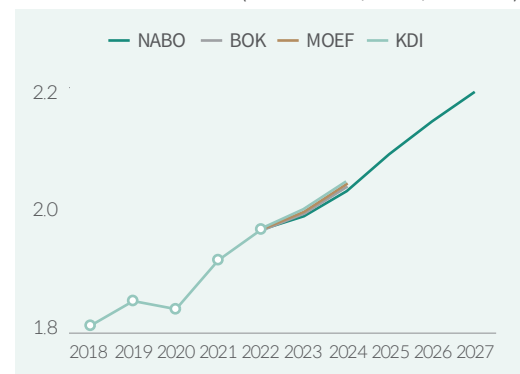
(Unit: year-on-year, %)



Source: National Assembly Budget Office (Oct. 2023), Bank of Korea (Aug. 2023), Ministry of Economy and Finance (Jul. 2023), Korea Development Institute (Aug. 2023)

[Figure 2] Projected Real GDP Growth Trajectory (2023–2027)

(Unit: Real GDP, KRW 1,000 trillion)



Source: National Assembly Budget Office

- **Between 2023 and 2027, the Korean economy is anticipated to see significant growth contributions from both the private sector (on the demand side) and other productivity²⁾ (on the supply side).**
 - In terms of demand, domestic demand is projected to recover, primarily driven by the private sector. The growth contribution from the private sector is likely to surpass that of the government sector.
 - Regarding the supply side, it is expected that the primary driver of growth will be an increase in other productivity.

1) This is based on a series of discussions at the National Assembly Budget Office titled the Diagnosis and Response Strategies for the Korean Economy, which took place on November 1, 2023.

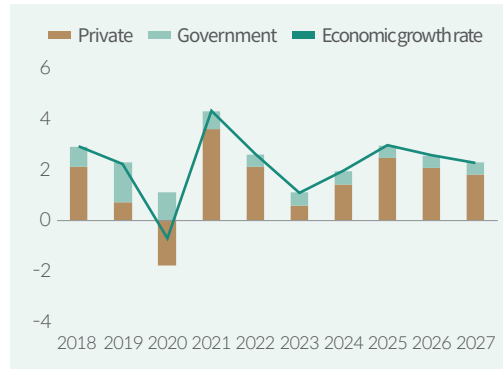
2) Total factor productivity, defined as the portion of GDP growth not attributable to labor and capital inputs, encompasses more than just productivity-related elements like technological advancements, institutional reforms, and educational improvements. It also includes factors such as external conditions and the economic psychology of market players. Therefore, the part of growth contribution that labor and capital cannot account for is termed 'other productivity' rather than total factor productivity, as detailed in the Economic Outlook for 2024 and the Mid-Term IV: Growth (p.10).



- The anticipated slow expansion of capital stock is likely to lead to a decreased contribution from capital towards growth.
- The sluggish pace of hiring is expected to keep hindering labor's contribution to growth.

[Figure 3] Contributions to Growth from the Demand Perspective

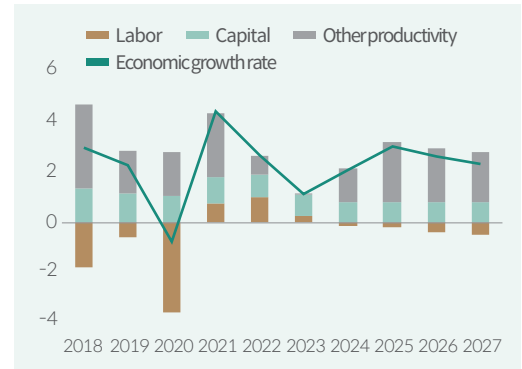
(Unit: %, %p)



Source: National Assembly Budget Office, Bank of Korea

[Figure 4] Contributions to Growth from the Supply Perspective

(Unit: %, %p)

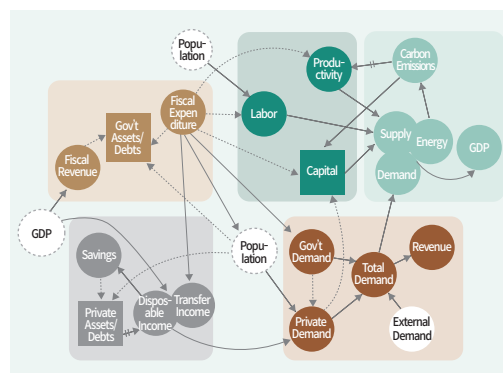


Note: Labor = Number of people employed × Labor hours
Source: National Assembly Budget Office, Bank of Korea

Evaluation of Policy Intervention Necessity

- **There is a risk of economic growth deceleration considering factors such as the trajectory of growth, supply and demand dynamics, etc.**
 - (Growth Trajectory) The uncertainty in the economic growth trajectory is expected to intensify due to factors like reduced productivity, a tightening labor market, and delayed increases in incomes.
 - The spillover effects of fiscal expenditure, such as the impact on private demand, the relationship with interest rates, and the transfer income effect, may also diminish.

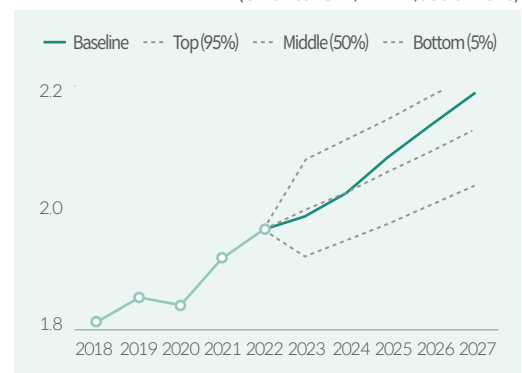
[Figure 5] The National Economic System



Source: National Assembly Budget Office

[Figure 6] Korea's Growth Trajectory

(Unit: real GDP, KRW 1,000 trillions)

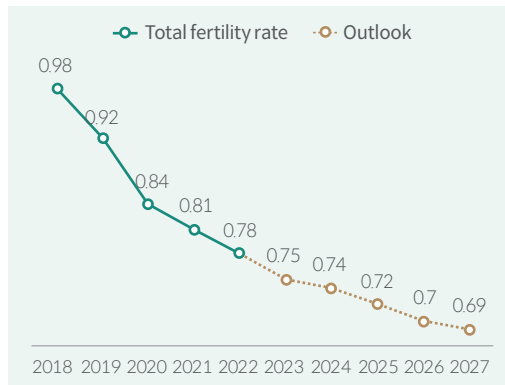


Note: Based on real GDP
Source: National Assembly Budget Office

- (Supply: Labor) The supply of labor is diminishing due to a declining working-age population, a consequence of low birth rates and an aging demographic.
- (Supply: Capital) The transition to a net-zero economy risks slowing capital growth, especially as a portion of the existing capital stock shifts towards low-carbon alternatives.
 - The competitiveness of domestic industries in exports (like steel, petrochemicals, and semiconductors) might decline as the move towards carbon neutrality leads to a global supply chain realignment.

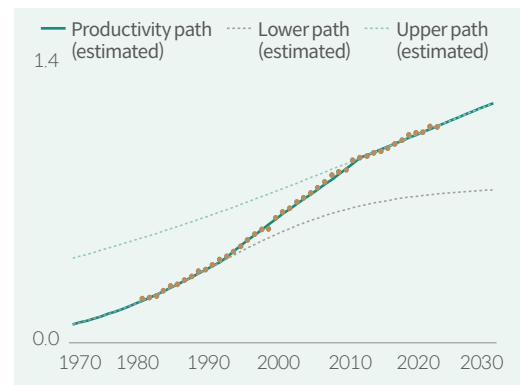
- (Supply: Productivity) Post-financial crisis, the productivity of the Korean economy embarked on a higher trajectory. Yet, the rate of improvement on this current trajectory has recently been losing momentum.
 - The likelihood of successfully transitioning to mid- to long-term paths may differ, influenced by the extent of the lock-in effect on existing trajectories.
- (Demand: Income) With household income conditions worsening due to sustained high interest rates and inflation, there's a concern that the rebound in domestic demand might decelerate.

[Figure 7] Forecast of the Total Fertility Rate



Source: National Assembly Budget Office, Statistics Korea

[Figure 8] Trajectories of Productivity in the Korean Economy

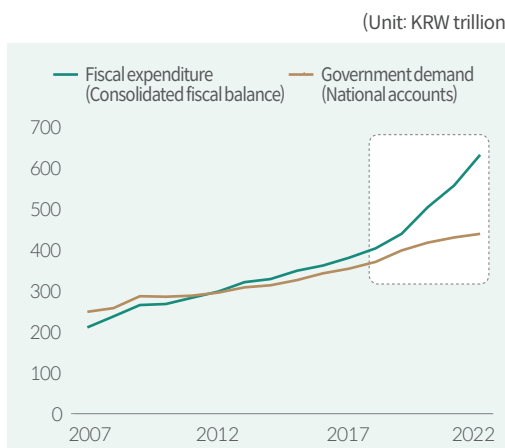


Source: National Assembly Budget Office

Assessing Methods to Increase Policy Effectiveness

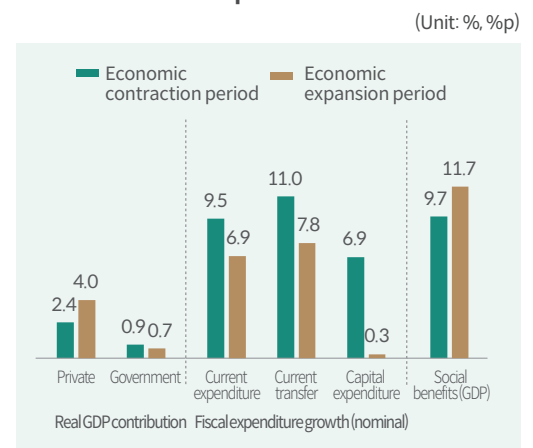
- Investigate the potential decline in the connection between fiscal spending (consolidated fiscal balance) and government demand (national accounts) during policy execution
 - This bilateral relationship has recently weakened, partly due to a rise in fiscal outlays (like transfer payments) that don't directly correlate with government demand in the national accounts.
 - It's crucial to shorten the delay in enacting policies to boost the promptness of fiscal spending and enhance the efficiency of capital expenditures in tackling current economic challenges.

[Figure 9] Comparison of Fiscal Expenditure with Government Demand



Source: National Assembly Budget Office, Bank of Korea

[Figure 10] Relationship Between Government Sector Growth Contribution and Fiscal Expenditure Growth



Note: 23 years (2000 to 2022), contraction period (14 years), expansion period (9 years)

Source: National Assembly Budget Office, Bank of Korea

▪ Consider combining monetary and fiscal policies to address the economic slowdown and promote sustained growth

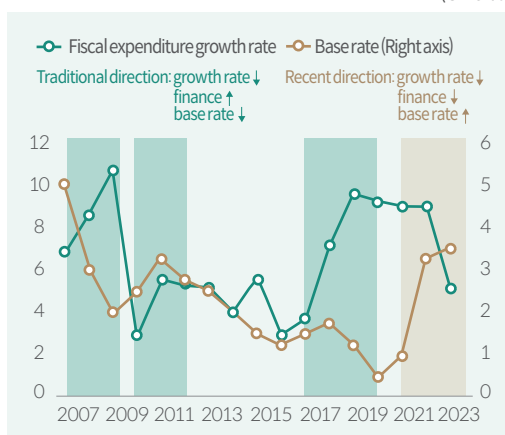
- Traditionally, the response to a slowdown involves a mix of increased fiscal spending and reduced interest rates.
 - However, a recent shift in policy favors reducing fiscal expenditures and raising interest rates.
 - It is essential to find an optimal balance of monetary and fiscal policies that can stimulate private demand recovery while maintaining inflation within targeted limits.

▪ Sustain the time consistency of policies

- The impact of policies can differ based on private sector anticipation of fiscal expansion (or contraction) during periods of economic downturn (or upturn).
 - Foster confidence in the private sector by establishing a National Fiscal Management Plan that outlines medium-term fiscal goals and approaches

[Figure 11] Correlation Between Economic Growth Rate and Directions of Fiscal and Monetary Policies

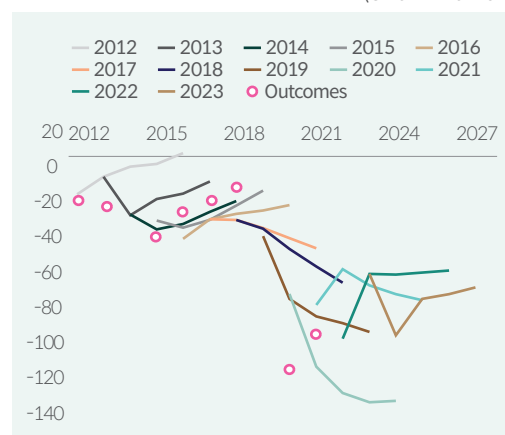
(Unit: %)



Source: Ministry of Economy and Finance, Bank of Korea

[Figure 12] Overview of Managed Fiscal Balance and Outcomes as per the National Fiscal Management Plan (2012-2022)

(Unit: KRW trillion)



Source: Prepared by NABO based on the annual National Fiscal Management Plan

Implications

▪ To promote sustainable growth in the Korean economy, exploring policy options that increase government intervention effectiveness is crucial.

- Recently, the Korean economy has encountered increased uncertainty in its growth trajectory.
 - Factors like demographic changes and climate change are expected to influence the long-term dynamics of supply (productivity) and demand (income).
- In order to promote the long-term growth of the Korean economy, it is crucial to establish a shared understanding within society regarding key policy priorities, including fiscal aggregate growth rates and sector-specific budget allocations.
 - It is important to consider policy approaches that can improve the efficiency of government interventions, such as conducting cost-benefit analyses related to increasing fiscal aggregates and enhancing the coordination with monetary policy.