Economic Outlook 2020

Summary

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1. Economic Growth

❑ In 2020, the growth of real GDP (gross domestic product) in Korea is projected to drop to 1.6% in annual rate on the sharp slowdown in private consumption and exports under the impact of the COVID-19 outbreak.

- ○ As the pandemic weighs on economic activity and sentiment, this is expected to result in a dramatic contraction in private consumption, regarding both domestic consumption and consumption abroad.
- ○ Total exports are projected to grow at a rate of just 0.9%, a slower rate than last year (1.7%) as the recovery in goods exports is delayed by shrinking global trade, and service exports re-embark on a downward trend on a sharp drop in inbound tourism.
- ○ Amid the expansionary fiscal policy response to COVID-19, the contribution of government consumption to growth is expected to remain high, continuing last year's trend.
  - − Contribution government consumption to growth (%p): 0.9 (2018) → 1.1 (2019) → 1.2 (2020, projected)

❑ In 2020, the growth of nominal GDP is forecasted to accelerate from last year (1.1%) to 2.6% in annual rate on the improvement of trade conditions.

Economic projections in this forecast were developed on the assumption that the global spread of COVID-19 pandemic would slow its pace worldwide during the 2nd quarter of 2020, based on the most up-to-date data available as of the time of their preparations in March 2020.

○ In spite of a slowing growth in real GDP, improving external trade conditions are likely to boost the rate of increase in GDP deflator during this period.

 − The GDP deflator, which slipped into negative territory (-0.9%) last year on the worsening of trade conditions caused by falling prices of semiconductors, is expected to climb to a 1.0% range as tumbling international crude oil prices and rising prices of semiconductors help improve trade conditions.

○ However, this rate of growth in nominal GDP is a near-record low since 2000, second only to 2019 when it was brought down to an exceptionally low level (1.1%) by the economic slowdown and unfavorable trade conditions.

 − The growth of nominal GDP has been on a downward trend, falling from 7.2% on average in 2000-2009 to 5.4% in 2010-2014 and 4.2% in 2015-2019.

❑ In 2020, depending on the extent and duration of the COVID-19 outbreak, a significant level of uncertainty about the growth path could loom over the Korean economy.

○ If the spread of COVID-19 slows down during the first half, the economy can quickly recover in the second half, growing at a quarterly rate of over 1%. However, if the pandemic continues for a prolonged period, economic growth can decelerate further.

Domestic Economic Outlook for 2020

(units: %, 100 millions of USD, KRW)

	2018	2019	2020
Real GDP Growth	2.7	2.0	1.6
Private consumption	2.8	1.9	1.4
Facilities investment	−2.4	−7.7	1.8
Construction investment	−4.3	−3.1	−2.3
Intellectual property products investment	2.2	2.7	2.6
Total exports	3.5	1.7	0.9
Total imports	0.8	−0.4	1.2
Current account (100 millions of USD)	775	600	605
Goods exports (customs basis)	5.4	−10.4	−0.1
Goods imports (customs basis)	11.9	−6.0	−1.9
GDP deflator	0.5	−0.9	1.0
Consumer price inflation	1.5	0.4	0.9
Unemployment rate	3.8	3.8	3.9
USD to KRW exchange rate (reference rate)	1,101	1,166	1,196
Treasury bond yield (3-year)	2.1	1.5	1.1
Nominal GDP growth	3.5	1.1	2.6

Note: The unemployment rate is based on persons unemployed who made an attempt to find a job in the last four weeks, and the exchange rate and the Treasury yield are annual average values.

Sources: National Assembly Budget Office, Bank of Korea, Statistics Korea.

2. Domestic Demand

❑ Private consumption is forecasted to remain weak as the COVID-19 outbreak takes a toll on consumer confidence, and the recovery in consumption ability is delayed.

- In 2020, private consumption is expected to grow at an annual rate of 1.4%, a significantly slower rate than last year (1.9%).

○ Private consumption is anticipated to decline particularly sharply during the first half of this year, as consumer confidence is weakened by the economic slowdown in Korea and worldwide and heightened uncertainty.

  − Amid the COVID-19-induced drop in sales of offline businesses, a marked decrease is expected in the consumption of services such as accommodation and food services, air transport, wholesale and retail and leisure services.

  − Moreover, restrictions on cross-border mobility are expected to result in a sharp decline in domestic consumption by non-residents as well as consumption abroad by residents.

○ Consumption ability is also likely to be weakened by a slower wage growth and the increase in housing cost burden amid the economic downturn.

○ Notwithstanding, the decreased debt service burden under a low interest rate environment and income support measures and measures to stimulate consumption by the government are expected to provide buffers against a precipitous drop in private consumption.

❑ Construction investment is anticipated to continue on a downtrend from last year amid the continuing slump in housing construction.

○ In 2020, in spite of an increase in investment in non-residential construction and civil engineering, construction investment is projected to fall 2.3% overall on the persistent weakness in residential construction.

  − Residential construction is expected to decrease due to a downturn in leading indicators of construction investment, together with housing market stabilization measures by the government and the continuous tightening of lending rules on housing loans.

  − Amid an increase in the inventory of unsold homes centered on areas outside the Seoul metropolitan area, there are increasing concerns about an oversupply of housing.

- On the other hand, non-residential construction and civil engineering, buoyed by the increase in the government's SOC budget and the earlier-than-planned start of civil engineering projects, are expected to help reduce the extent of decline in construction investment.
  - Conditions for public-sector construction investment have improved this year, centered on civil engineering and community infrastructures, with the government's SOC budget increasing 12.6% from last year to 22.3 trillion won.

- ❑ In facilities investment, although investment activity is anticipated to pick up, driven by IT sectors, new investment has been delayed due to the COVID-19 outbreak.
  - ○ A slow recovery trend is expected, centered on IT industries such as semi-conductors, display and 5G wireless services, due in part to the base effect of a long-term downturn that preceded.
    - – Facilities investment forecast (year-on-year, %): -0.5 (1st half of 2020) → 4.0 (2nd half of 2020), 1.8% increase from last year
    - – An upward trend is likely in IT sectors as the price recovery in semiconductors has improved the earnings outlook. The planned expansion of production facilities for high value-added display panels and the ongoing commercialization of 5G services are also expected to be among the contributing factors.
    - – Among non-IT sectors, although an increase in investment is expected in next-generation cars and environmentally-friendly new and renewable energy fields, the volume of investment is likely to be more modest in other sectors, limited to the maintenance and repair of existing facilities.
  - ○ The worsening of demand conditions in Korea and worldwide and heightened uncertainty, brought about by the COVID-19 pandemic which originated in China, new investment in key industry sectors is likely to be delayed or reduced.

- ❑ Intellectual property products investment is projected to increase 2.6%, a rate of growth similar to last year's, on continuous R&D investment in new technologies and increased software spending.
  - ○ R&D spending is anticipated to rise slightly from last year, lifted by continuing private R&D investment and an increase in the government's R&D budget, with the demand for new ICT-related software also

growing.

- However, R&D spending among SMEs is expected to drop as earnings are likely to be impacted by the COVID-19 pandemic.

○ The private sector's investment is projected to maintain a solid pace of growth as both R&D spending on new ICT and the corporate demand for related software increase amid the accelerating Fourth Industrial Revolution.

- Corporate software spending by domestic firms (trillions of KRW)[2]: 6.4 (2019) → 7.1 (2020) → 7.8 (2021)

○ The government sector's intellectual property products investment is expected to gain pace from last year (3.1%) on the increase in R&D budget and a rise in software purchases (3.1%).

- The government's budget allocation for R&D, which edged up by 4.1% (20.5 trillion won) in 2019, jumped a whopping 18.0% (24.2 trillion won) in 2020.

2) Gartner (As of January 2020 forecast)

3. External Trade

- ❑ Exports (customs basis) are forecasted to drop as the recovery in global trade is likely to be delayed by the global spread of COVID-19.
  - ○ Although not as deep into negative territory as last year (−10.4%), exports are expected to decline by 0.1% this year under the impact of the COVID-19-induced damage to global supply chains and a slowdown in production and investment.
    - − As China, Korea's largest trade partner and a key player in global value chains, is experiencing COVID-19-induced production problems and a slump in domestic demand, this is likely to have a negative impact on Korean exports to this destination.
    - − Moreover, as the COVID-19 outbreak is growing into a global pandemic, there will be also a negative shock to exports to other key countries.
    - − Average daily exports, calculated without considering the number of customs clearance days, which declined last year by 11.3% from the previous year to 1.99 billion dollars, are also expected to drop slightly this year to 1.98 billion dollars.
  - ○ The trade surplus is projected to widen amid a continuous downward trend in both goods exports and imports.
    - − In 2020, Korea's trade surplus is expected to rise from last year (39.9 billion dollars) to the range of 48.0 billion dollars.

- ❑ The current account is forecasted to record a surplus of 60.5 billion dollars, similar to last year's level, as the increase in the goods account surplus was largely offset by the increase in the deficit in services, primary and secondary income accounts.

- ○ The surplus in the goods account on the balance of payments is projected to slightly widen to 82.6 billion dollars as exports, after a double digit fall (-10.3%) last year, record a small increase, buoyed by the rise in the prices of semiconductors.
- ○ In spite of the improvement expected in the travel account from the US dollar's advance against the Korean won amid the COVID-19 outbreak, the service, primary income and secondary income accounts are forecasted to post a deficit of 22.1 billion dollars on the widening deficit in other business services and the reduction of dividend income from abroad.
- ○ The current account surplus-to-GDP ratio and the service account deficit-to-GDP ratio are anticipated to reach 3.7% and −1.4%, respectively.

4. Employment

❑ In the labor market, while employment is expected to increase in some service sectors, growth in the number of employed persons is likely to slow from last year.

- ○ In 2020, the increase in the number of employed persons is forecasted to decelerate to 250,000 from last year's level (301,000) (280,000 in the 1st half, 220,000 in the 2nd half).
- ○ By industry sector, although the number of employed persons is likely to increase in some service sectors, a downward trend may persist or the recovery may be delayed in construction and manufacturing.
  - − The publicly-funded job creation program and the increase in the government's R&D budget are expected to contribute to the improvement in employment conditions in public administration, public health and social welfare and professional science and technology services.
  - − The number of employed persons may continue to decrease in the con-

struction sector as the downturn in construction persists, with the recovery in employment delayed in manufacturing as plants are operating at reduced capacity amid the COVID-19 outbreak.

- The rate of unemployment is forecasted to inch up slightly from last year to 3.9% (4.2% in the first half, 3.5% in the second half), with the rate of employment (based on persons aged 15-64) at 61.0%. The economic activity participation rate is expected to reach 63.5% on a continuing upward trend in the participation in the labor market by women and the elderly.

5. Prices

- ❑ Consumer prices are forecasted to grow at a modest rate below 1% on weakened inflationary pressures on both the demand and the supply side.
  - In 2020, the annual rate of consumer price inflation is expected to reach 0.9%, due largely to the base effect of the exceptionally low rate recorded last year (0.4%).
  - As the economic slowdown persists, this is expected to lower demand-side inflationary pressures, with the breakeven inflation rate and the expected inflation rate by economic agents, also trending lower.
  - Inflationary pressures on the supply side are also forecasted to remain low due to the drop in international crude oil prices and stalled wage growth.
  - However, prices of agricultural, livestock and fisheries goods are expected to shift to an upward trend owing to the base effect of last year's price decline, coupled with the reduction in cultivated areas. Rental (including *jeonse* and monthly rentals) prices, which are projected to remain on the upward trajectory from recent months, are likely to contribute to the increase in the rate of inflation in service prices.

6. Interest Rates and Exchange Rates

❑ The annual average yield on Treasury bonds (3-year) is forecasted to drop to 1.1% on heightened uncertainty from the shock of the COVID-19 outbreak, the economic slowdown and falling international crude oil prices.

- ○ The spike in uncertainty amid the COVID-19 outbreak, coupled with aggregate demand and supply shocks, is projected to lower the rate of economic growth.
- ○ The decline in international interest rates and the expanded supply of liquidity to ease credit crunch are expected to cause market interest rates to drop.
- ○ Treasury bond yield (3-year, %): 2.1 (2018) → 1.5 (2019) → 1.1 (2020, projection)

❑ The USD to KRW exchange rate is projected to continue to show a high level of volatility amid uncertainty in the international financial markets, but stabilize in the second half to reach an annual average of 1,196 won.

- ○ If calm returns to the international financial markets in the second half after the turmoil caused by the COVID-19 outbreak in early 2020, the US dollar is likely to resume a downward trend against the Korean won.
- ○ Given the high returns on Korean Treasury bonds, compared to the returns on Treasury bonds in major developed markets, and Korea's excellent sovereign credit rating as well as the its sizeable foreign reserves, foreigners' portfolio investment in domestic securities is expected to show an inflow in the second half.
- ○ The US dollar is likely to weaken in the second half as the benchmark

interest rate is kept near zero by the US Federal Reserve, which furthermore pledged unlimited quantitative easing.

- ○ USD to KRW exchange rate (annual average rate, KRW): 1,101 (2018) → 1,166 (2019) → 1,196 (2020, projected)