Korean Economy

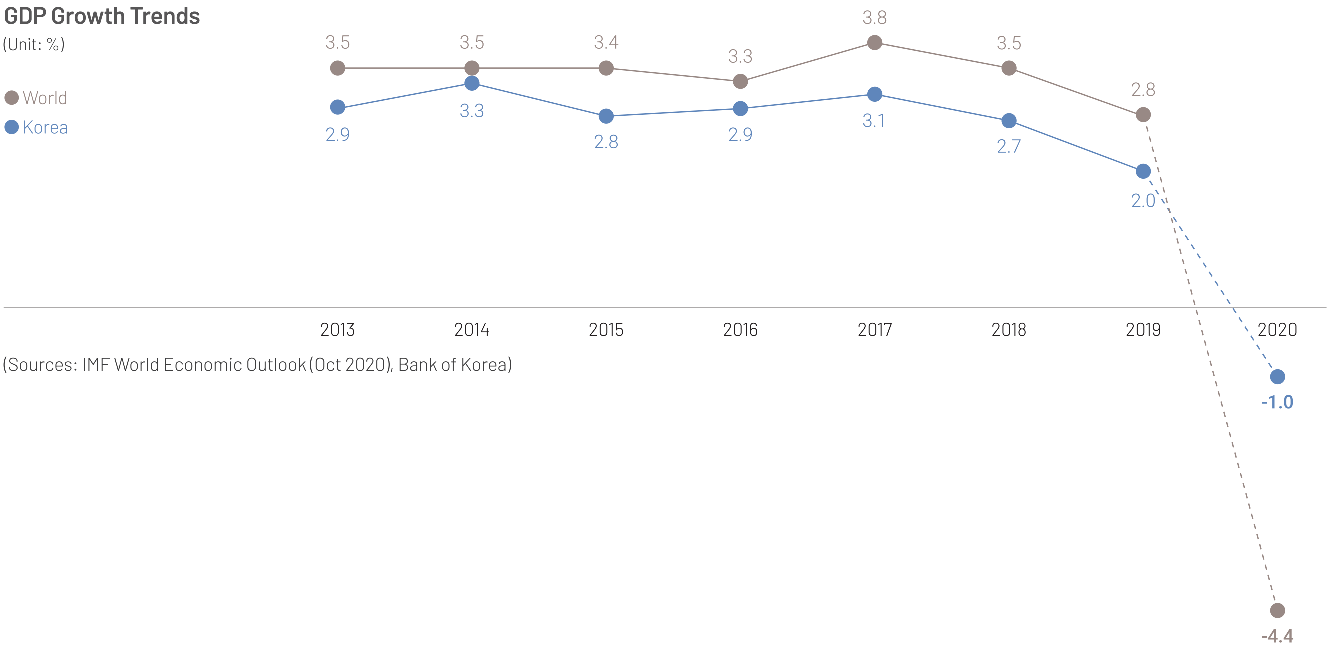
2020 in Review

GDP

The coronavirus pandemic dealt an unexpected blow to the Korean economy, and 2020 was the worst year for its GDP growth since the Asian financial crisis. As the pandemic hurt consumer spending and business investment, Korea's GDP contracted by 1% in 2020 from a year earlier. That was the first time the economy has shrunk for the year since 1998 when GDP declined by 5.1%. Still, the economy remained surprisingly resilient compared to other economies, with the global economy contracting by 4.4% amid the fallout from the pandemic. Among major economies in the world, Korea is likely to be one of the best performers in terms of GDP growth.

GDP Growth Trends

(Unit: %)



(Sources: IMF World Economic Outlook (Oct 2020), Bank of Korea)

Consumer Spending

Consumer spending bore the brunt of the pandemic's impact on the economy. Private consumption plunged by 5% in 2020 due to an extended period of social distancing restrictions and worsening job market conditions. Expenditures on services and semi-durable goods took a greater hit than others. This disproportionate impact on services spending reflected a cutback on nonessential purchases that involved going to places where the risk of contracting the virus was relatively high due to physical proximity with others. In particular, consumers shied away from movie theaters, bars, theme parks and other recreational service venues.

Equipment Investment

Equipment investment sharply rebounded in 2020, growing by 6.8%. The growth was mostly driven by the semiconductor industry. There was explosive pandemic-induced demand for semiconductors and chips that power everything from personal computers and consumer electronics to communications and IT infrastructure such as data centers. On the other hand, investment spending on transportation equipment, particularly in the aviation industry, dipped due to travel restrictions being placed in many countries around the world.

Construction Investment

Construction investment decreased by 0.1% in 2020, showing some signs of recovery in construction activity. Although there seemed to be a limited direct impact of the pandemic on construction investment, most sectors of the construction industry appeared to suffer some setbacks due to the financial toll that was inflicted on businesses. Public spending on infrastructure increased, however, as the government expanded its investment in support of economic recovery. Infrastructure development has been one of the key focus areas of policymakers as a means to boost employment and economic output.

Employment

It was a painful year for the labor market in 2020 as many people were pushed out of work unexpectedly during the pandemic. The number of employed people fell by 218,000, the largest decline since the Asian financial crisis in 1998. Workers at retailers, restaurants, hotels and other accommodation services were the hardest hit as the government imposed strict social distancing measures, such as a ban on indoor restaurant dining after 9 pm. Jobs in manufacturing also took a hit as external trade conditions worsened, causing export growth to slow down.

Inflation

Consumer price inflation remained mostly subdued at 0.5% in 2020, far below the target rate of 2%. Demand-side inflationary pressure weakened after the onset of COVID-19, and plummeting international oil prices added to downward pressures. On the other hand, there was some upside momentum such as a rise in fresh food prices. In particular, the record-long rainy season in the summer drove up the prices of agricultural produce. The core inflation rate, which excludes volatile food and energy prices, dropped to 0.4% in 2020 from 0.7% in 2019.

Current Account Surplus

Korea's current account surplus rose by 26% to USD 75.3 billion as merchandise imports decreased more sharply than merchandise exports amid falling import prices of commodities, including crude oil. The nation's outbound shipments were significantly hit by the fallout from the pandemic outbreak, but picked up gradually toward the end of the year as major economies started to ease lockdowns and resume business activities.

Interest Rate

Since May 2020, the Bank of Korea has kept the benchmark interest rate at its record low of 0.5% as the coronavirus pandemic continued to weigh on economic activity, inflation, and employment. The central bank maintained its stance that it would be necessary to help foster accommodative financial conditions in a bid to support the flow of credit to households and businesses. The average three-year treasury yield fell to 1.0% in 2020 from 1.5% in 2019. The government bond market took investors on a bumpy ride in 2020, with yields plunging to historic lows early in the year before making some recovery in the second half when there were growing expectations of economic rebound and COVID-19 vaccine development.

Foreign Exchange Rate

The yearly average exchange rate of the Korean won against the U.S. dollar increased to KRW 1,180.1 in 2020 compared to KRW 1,165.7 in 2019. Following the outbreak of COVID-19, the exchange rate soared in March when the U.S. dollar rallied to a new high for the year amid anxiety-driven capital flight to safe assets, and then fell steeply on expectations of improvement in economic indicators and China's recovery. Economic stimulus measures in the U.S. and the resulting increase in the supply of the greenback led the U.S. dollar to slide against major currencies, providing a boost to a strengthening Korean won. News of progress in coronavirus vaccine development and Joe Biden's victory in the U.S. presidential election drove a windfall for equity markets and other riskier asset classes, causing the greenback to further weaken.

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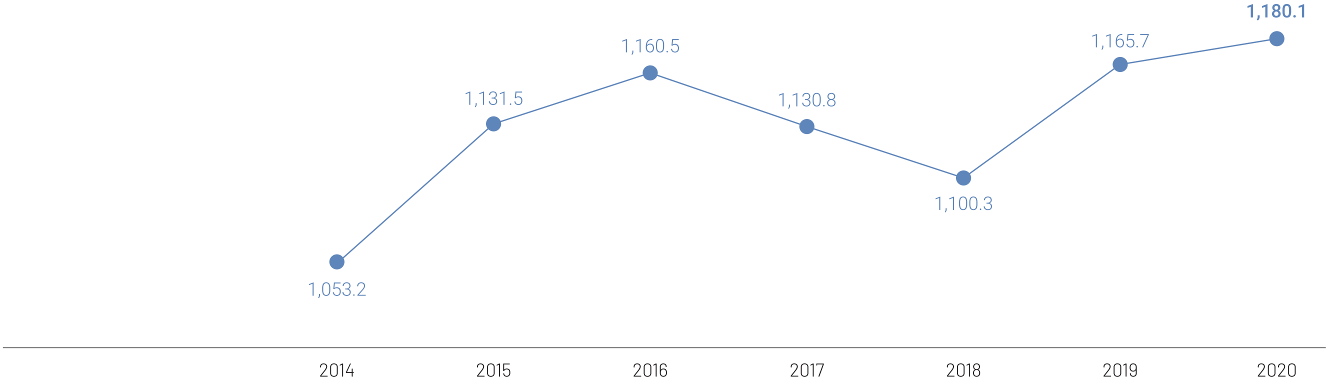
KRW/USD Exchange Rate Trend
(Unit: KRW)



(Source: Bank of Korea)

Prospects for 2021

GDP

The Korean economy has proven relatively resilient even as the COVID-19 pandemic drags on. After the pandemic-induced shock in 2020, economic growth is expected to normalize in 2021. The economy is on track to deliver a 3% growth in 2021 following a contraction of 1% in 2020, according to a forecast released by the Bank of Korea in February 2021. It will gradually recover from a recession triggered by the outbreak of coronavirus infections, and the recovery will be characterized by three factors: global economic improvement, export rebound, and investment spending growth.

Consumer Spending

Consumer spending will return to growth in 2021, rising by 2%, after a pandemic-led reduction in 2020, but the pace of recovery may not be as fast as hoped for. The slower recovery may be attributed to delayed improvement in household income and the continued implementation of social distancing measures. Household savings have increased as the COVID-19 pandemic caused uncertainty regarding future income and employment prospects. These increased savings may turn into a driver of consumption growth once the pandemic is kept in check, but any resurgence of COVID-19 may further drive up household savings, putting pressure on consumption growth. Growing household debt amid an ultralow interest rate environment may also hold back the recovery of consumer spending. There are some other positive factors that boost consumption, such as the extension of the government's expansionary policy and measures to support job creation.

Equipment Investment

Equipment investment is expected to rise by 5.3%, driven by solid investment spending in the IT sector and a recovery in non-IT investment. COVID-19 has led to an exceptional surge in technology investment across the globe, and those investments are mostly focused on accelerating the rollout of 5G networks and building more data centers. In the non-IT sector, a growing amount of investment will be made in eco-friendly technologies involving electric vehicles and other mobility services. The inland transportation sector will also see a rise in equipment investment amid the growth of e-commerce, which is backed by growing demand for online purchases.

Construction Investment

Construction investment will rebound with a 0.8% growth being forecast for 2021. The civil engineering construction sector will continue to fare well thanks to the government's increased investment in infrastructure, while the severe contraction in residential construction is set to slow down. Leading indicators of building activity, such as new housing starts or construction orders, show some improvement in conditions for the housing construction sector. In particular, there will be an expansion in public-sector housing construction, driven by the government's policy measures to increase housing supply. On the other hand, investment in private-sector housing construction is expected to pick up slowly due to strengthened regulations in the housing market.

Employment

The job market has been severely disrupted by the COVID-19 pandemic, with the number of new jobs declining sharply. Sluggish labor market conditions are set to continue into early 2021 considering another massive outbreaks of coronavirus infections in late 2020. Once the surge in new cases is contained, a modest recovery is expected in the most impacted sectors, such as hospitality, brick-and-mortar retailers, restaurants, entertainment and recreation. Job reduction in the manufacturing industries will also slow down, backed by demand recovery at home and abroad. The unemployment rate is projected to be steady at 4.0% in 2021.

Inflation

Consumer price inflation will likely trend up from 0.5% in 2020 to 1.3% in 2021 due to base effects of low levels of inflation over the previous two years. Upward pressures may gather some strength in line with economic recovery. Slowly rising prices of oil and commodities and a hike in housing rental costs will also become factors that push inflation up. Other upside factors include improving consumer confidence amid expectations of the fast rollout of COVID-19 vaccines. At the same time, there will be weaker downward pressures coming from government policy measures, such as government subsidies for high school education and mobile phone bills. However, an extended delay in economic recovery and muted import prices in the midst of a weakening U.S. dollar against major currencies may put further downward pressure on inflation. Core inflation, which leaves out food and energy prices, is also forecast at 1% in 2021, up from 0.4% in 2020.

Current Account Surplus

Korea's current account surplus is projected to go down to USD 64 billion in 2021 from USD 75.3 billion in 2020 mostly due to growing imports amid rising international oil prices. The ratio of the country's current account surplus relative to its GDP is expected to decrease to the mid-3% range in 2021 from mid-4% in 2020. The nation's merchandise account surplus is likely to narrow in spite of increasing exports as higher oil prices are also set to push up the prices of imported goods. Korea is expected to see a decrease in its service account deficit on the back of a growing transport account surplus in tandem with rising global trade volume. Since the onset of the COVID-19 pandemic, many countries have imposed travel restrictions, and the resulting plunge in international travel has led to a decline in service account deficit. When the spread of the coronavirus is subdued, the amount of deficit may widen again.

Korean Economy

Interest Rate

The average three-year treasury yield is projected to rise slightly to 1.1% in 2021. The current low-yield environment is expected to persist due to concerns over the impact of the pandemic on the economy. The Bank of Korea is expected to keep the benchmark rate at a historically low level to support economic recovery, which will keep a lid on the yields of treasury notes. Pandemic-related news will likely dominate investor sentiment and projections for interest rates in the financial market during the first half of the year. A surge in treasury issuance may push up the yield, and it is thus worth watching when and how much the Bank of Korea will purchase treasury notes.

Foreign Exchange Rate

In 2021, the value of the Korean won will strengthen even further against the U.S. dollar, bringing the yearly average exchange rate of USD/KRW down to KRW 1,125.0 per dollar. The supply of dollars is likely to continue to increase in step with the expansionary fiscal and monetary policies maintained by the U.S. government. The new Biden administration is set to take a wide range of pump-priming measures. However, the exchange rate is not likely to tumble sharply, as the Korean government will remain on high alert and take some actions to curb any drastic decline in the exchange rate. There are some external risks that may drive the exchange rate to soar, such as escalating trade tensions between the U.S. and China, another resurgence of COVID-19, and a flight to safe and risk-free assets.

Key Economic Indicators

(Unit: %)

	2019	2020	2021(E)		
			First Half	Second Half	Annual
Real GDP	2.0	-1.0	2.6	3.4	3.0
Consumer Spending	1.9	-5.0	0.2	3.8	2.0
Equipment Investment	-7.7	6.8	6.9	3.8	5.3
Construction Investment	-3.1	-0.1	-1.2	2.6	0.8
Unemployment Rate	3.8	4.0	4.5	3.6	4.0
Current Account Surplus (USD Billion)	60.0	75.3	33.0	31.0	64.0
Exports	0.4	-0.5	13.0	2.0	7.1
Imports	-1.0	0.0	7.6	5.3	6.4
Consumer Price Inflation	0.4	0.5	1.2	1.4	1.3
Three-year Treasury Yield	1.5	1.0	1.0	1.1	1.1
USD/KRW Exchange Rate (KRW)	1,166	1,180	1,132	1,118	1,125

(Sources: Bank of Korea (Feb 2021), Korea Institute of Finance)