

# Korean Economy

## 2022 in Review

In 2022, economic growth in Korea slowed down sharply after a strong recovery in the previous year, with its gross domestic product (GDP) growing by 2.6%. The economy got off to a relatively good start in the first quarter of the year, driven by robust growth in exports, followed by a solid performance in the second quarter thanks to consumer spending recovery. By the end of the year, however, its growth momentum weakened as private consumption growth tapered off in the second half of the year due to increased uncertainty about the future economic outlook, rising inflation, and supply chain disruptions.

Korea's exports sharply slowed in 2022, growing by 3.1% after a strong recovery in 2021. This sluggish export performance had to do with weakening global demand, which signals a global economic slowdown. Although export growth lost steam toward the end of 2022, the rate of growth remained positive for the full year. In terms of export volume, Korea set a meaningful milestone in 2022, reaching an all-time high of USD 683.9 billion since 1956 when it started to compile trade data. This record performance was backed

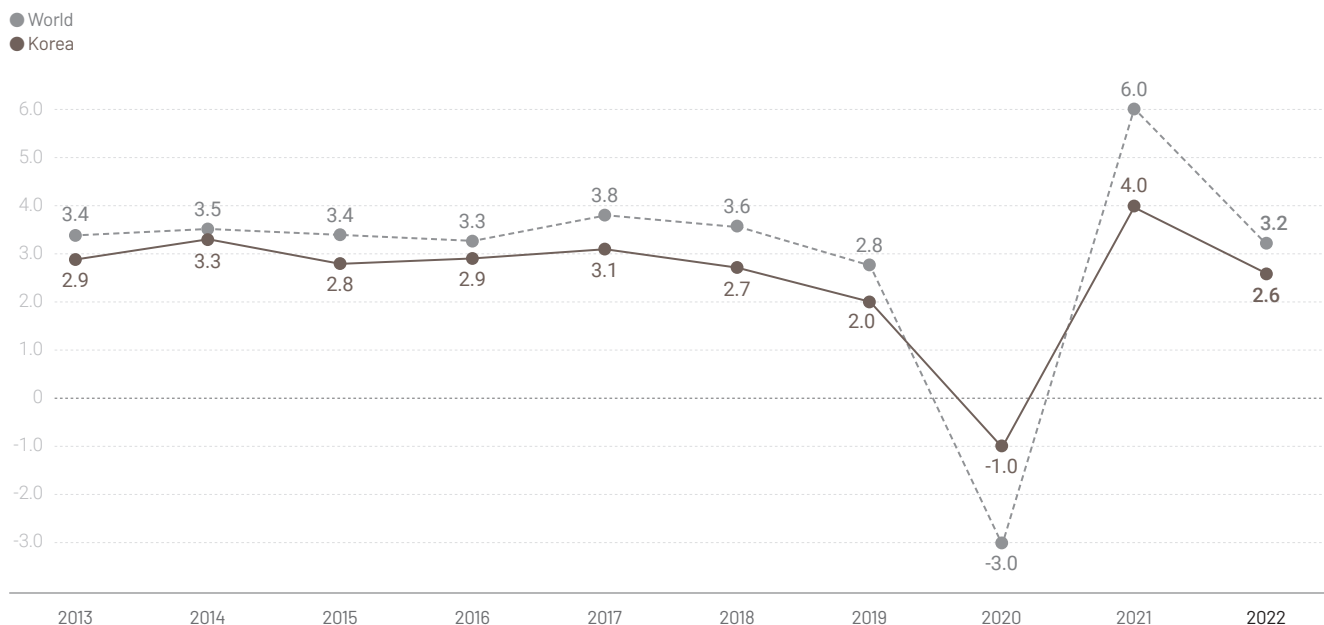
by robust global demand for Korea's flagship export items such as semiconductors, petrochemical products and secondary battery cells. As a result, Korea rose to become the world's sixth-biggest exporter, following China, the U.S., Germany, the Netherlands, and Japan.

However, the Korean economy suffered its largest trade deficit ever as the value of imports spiked on elevated international energy prices. It was the first time since 2008 that the economy posted a trade deficit. Given that it depends largely on imports for its energy needs, global energy price hikes pushed up its overall import volume, which began to exceed exports in April 2022.

Private consumption growth improved to 4.4% in 2022, representing an increase from the previous year's 3.6% rise. The acceleration of consumer spending growth was attributable to the lifting of social distancing restrictions, which led to an uptick in consumption in the hospitality, dining, and transportation sectors.

### GDP Growth Trends

(Unit: %)



(Sources: IMF World Economic Outlook (Oct. 2022), Bank of Korea (Feb. 2023))

## Prospects for 2023

Korea's economic growth is forecast to decelerate from 2.6% in 2022 to 1.6% in 2023, according to the Bank of Korea's latest economic outlook report. There is a growing possibility that the Korean economy could slip into a mild recession in the coming year due to weakening exports and consumer spending, which are two major growth drivers. Considering the economy is heavily dependent on exports, its growth outlook is bound to worsen when the global economy is slowing down amid supply chain disruptions, elevated inflation, and a faltering Chinese economy.

The growth projection for 2023 by other organizations has also been readjusted downward. The Ministry of Economy and Finance projects Korea's GDP growth for 2023 at 1.6%, which is equivalent to the Bank of Korea's forecast. According to the OECD's outlook, the Korean economy is expected to grow by 1.8% in 2023, which compares to the IMF's projection of 1.7% and Fitch's 1.5%.

In tandem with the moderation of overall economic growth, consumer spending is likely to weaken, but remain relatively resilient amid a stable COVID-19 situation and improving income conditions. Private consumption is projected to grow by 2.3% in 2023. Inflation could be a major threat to consumer spending growth, as soaring prices are eroding the real purchasing power of households and curbing consumer confidence.

Equipment investment is expected to continue declining by 3.1% in 2023, following a decrease of 0.7% in 2022, due to a lackluster manufacturing performance. Companies are struggling with ongoing supply chain issues and increasing interest rates, with high inflation remaining one of their biggest concerns.

Construction investment is projected to contract by 0.7% in 2023, a slower pace of decline compared to a 3.5% contraction in the previous year. Rising commodity prices continue to dampen construction investment, but investment spending will bottom out soon and start to improve in 2024, with the recovery being led by building construction. Investment in the civil engineering construction sector may remain weak due to a cut in the government's investment in infrastructure.

A positive growth trend will continue for intellectual property investment, which is forecast to grow by 3.5% in 2023 following a 4.8% increase in 2022. R&D investment is expected to be on the rise thanks to improving corporate revenues in the private sector and an increase in the government budget for R&D. Growing

demand for software applications for online platforms and services will also help boost investment activities in other intellectual property sectors.

Korea's merchandise export growth is anticipated to keep slowing to 0.5% in 2023, with volatility in commodity prices and the war in Ukraine making global trade conditions uncertain. In particular, the trend of slowing economic growth in major economies like the U.S. and China is hurting Korea's export prospects. Moreover, a potential shortage of commodities sourced from Russia and Ukraine could weaken the country's semiconductor exports. In spite of the gloomy outlook, the IT sector is likely to remain robust in terms of export performance.

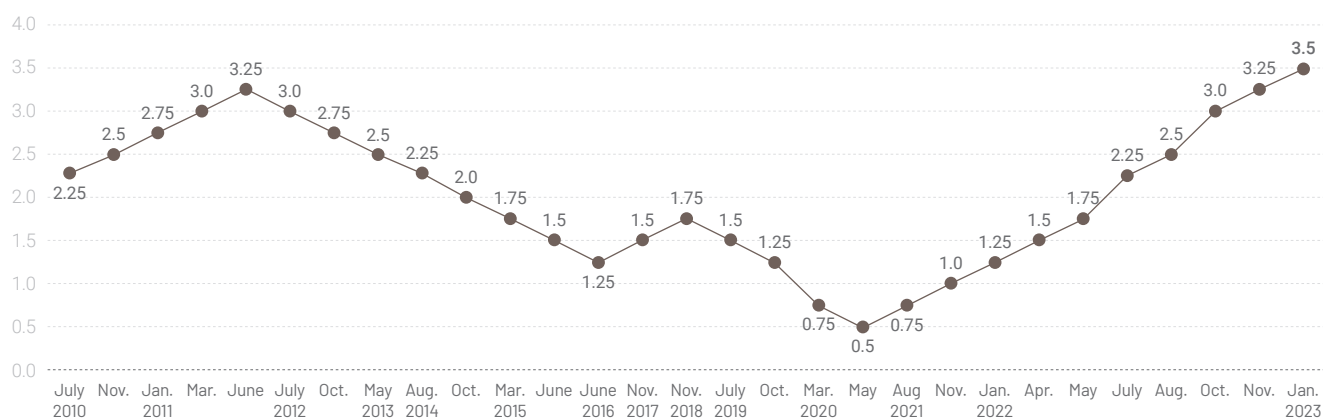
Korea's current account surplus is projected to drop to USD 26 billion in 2023 from USD 29.8 billion because of soaring energy and commodity prices and the resulting increase in imports. Following eased travel restrictions and quarantine measures, international travel is expected to recover, which will widen the country's service account deficit in the coming year.

Consumer price inflation is forecast to temper from 5.1% in 2022 to 3.5% in 2023. A drop in gasoline prices is likely to put further downward pressure on inflation, but there is a lot of uncertainty over the inflation outlook due to Russia's conflict with Ukraine and energy supplies. Core inflation, which excludes food and energy prices, is projected to fall to 3.0% in 2023 from 3.6% in 2022.

The Bank of Korea (BOK) has been raising its benchmark interest rate to tame rising inflation. Since August 2021, the BOK has made ten interest rate hikes, bringing the rate to 3.5% as of January 2023 - the highest level since 2008. With a recent 25p increase, the central bank has maintained its usual pace of tightening after delivering two big step rate hikes in October and July 2022. Despite the pace of rate increases was slowed, it is too premature to expect a pivot back toward rate cuts. As inflation has persistently stayed way above the central bank's target of 2.0%, the BOK is likely to hold on to its tightening policy for some time to come. Meanwhile, the average three-year Treasury yield in Korea is expected to increase to 4.0% in 2023 from 3.2% in 2022.

## BOK Benchmark Interest Rate (2010-2023)

(Unit: %)



(Source: Bank of Korea (Feb. 2023))

With the economy stuttering, the labor market is cooling down in 2023 after a strong year of job creation in 2022. While the service sector, such as dining and accommodation, is expected to generate job growth, the manufacturing sector is showing signs of slowing in terms of employment growth. The number of employed people is expected to increase by 130,000 in 2023 compared to a rise of 820,000 in 2022. The unemployment rate is anticipated to climb to 3.4% in 2023 from 2.9% in 2022.

Going forward, economic policymakers will keep a close watch on risks that may tip the economy into an inflationary downturn. While they will continue to focus on the effective control of COVID-19 to help the economy emerge fully from the pandemic, they will be challenged to walk the narrow path between tamping down inflation and shoring up the economy, which is teetering on the brink of a recession.

## Key Economic Indicators

(Unit: %)

	2021	2022	2023 (F)		
			First Half	Second Half	Annual
Real GDP	4.0	2.6	1.1	2.0	1.6
Consumer Spending	3.6	4.4	3.3	1.3	2.3
Equipment Investment	8.3	-0.7	3.2	-8.9	-3.1
Construction Investment	-1.5	-3.5	0.1	-1.5	-0.7
Unemployment Rate	3.7	2.9	3.6	3.1	3.4
Current Account Surplus (USD billion)	88.3	29.8	-4.4	30.4	26.0
Exports	9.8	3.1	-4.0	5.0	0.5
Imports	11.8	4.6	-0.4	-0.1	-0.2
Consumer Price Inflation	2.5	5.1	4.0	3.1	3.5
Average Three-year Treasury Yield	1.4	3.2	4.1	3.8	4.0
KRW/USD Exchange Rate (KRW per USD 1)	1,145	1,305	1,390	1,330	1,360

(Sources: Bank of Korea (Feb. 2023), Korea Institute of Finance (Dec. 2022))