

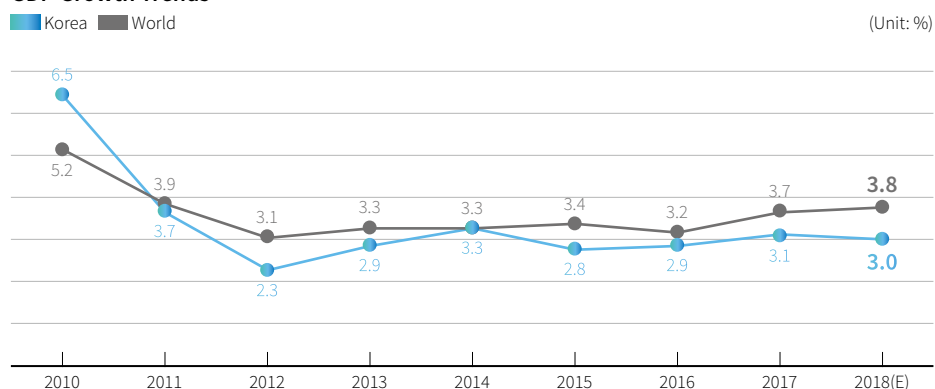
Korean Economy

2017 in Review

GDP

Korea's economic growth for 2017 beat earlier forecasts with improving exports and investment activities. According to the Bank of Korea, the nation's real gross domestic product (GDP) grew by 3.1 percent in 2017. This was well above the earlier projections of the mid-two percent range. The domestic economy had begun to slow from 2015 until the first half of 2017, with GDP growth hovering around the two percent level. However, improvements in exports and consumer confidence following the recovery of the world economy boosted local economic output in the second half of 2017.

GDP Growth Trends



(Source: Bank of Korea)

Consumer Spending

The nation's consumer spending grew by 2.6 percent in 2017 compared to 2.5 percent in 2016. Despite the government's efforts to enhance consumer confidence, political uncertainties at home were mainly to blame for the dampening of consumer spending on services and overseas consumption.

Equipment Investment

In 2017, equipment investment soared, recording a year-over-year growth of 14.6 percent after a sharp dip in the previous year. The improvement is due to expanding IT investment. In particular, there was a robust increase in investment spending on semi-conductor manufacturing equipment on the back of strong demand in the global semi-conductor industry.

Construction Investment

Investment in construction grew by 7.6 percent year over year, representing a weakening trend compared to the double-digit growth rate recorded a year earlier. It showed signs of slowing down in the second quarter and eventually turned negative at the end of the year, recording - 3.8 percent in the fourth quarter. A decrease in both civil engineering works and apartment construction triggered the downturn toward the end of the year.

Employment

Roughly 320,000 new jobs were created in 2017 – a slight improvement compared to the previous year. The main driving force was the government’s employment policy and an improving construction sector. The number of new employees in the manufacturing sector declined by 18,000, affected by corporate restructuring in the shipbuilding industry. Despite the drop in the number of incoming tourists in Korea, the service sector continued to add new jobs. Health, social welfare and public administration recruits were particularly strong due to the government’s job creation policy.

Inflation

The annualized inflation rate rose to 1.9 percent in 2017 from 1.0 percent in 2016. Due to severe weather and avian influenza, the prices of agricultural, livestock and agro-fishery products increased substantially. Industrial goods prices turned to an upward trend following rises in international oil prices. On the other hand, an uptrend in service prices slowed compared to the previous year, with rent and public service prices slowing down.

Current Account Balance

In 2017, Korea’s current account surplus dropped to USD 78.5 billion from close to USD 100 billion in 2016. The figure of the merchandise account surplus remained strong, while the service sector continued to worsen, bringing the total current account surplus down to about 80% of what it stood in the previous year. The merchandise account surplus exceeded USD 120 billion thanks to expanding exports and global demand. On the other hand, service sector deficits reached USD 34.5 billion due to a sharp reduction in the number of Chinese tourists visiting Korea and restructuring in the shipping industry.

Interest Rates

The average three-year treasury yield in 2017 stood at 1.8 percent, up modestly compared to the previous year. The Bank of Korea (BOK) raised on November 30 its benchmark interest rate for the first time in more than six years, bringing an end to a period of record-low borrowing costs. The rate was raised to 1.5 percent from an all-time low of 1.25 percent as the nation’s economic conditions convinced the central bank to begin normalizing its monetary policy.

Foreign Exchange Rate

The Korean won’s weakening trend against the U.S. dollar was stalled in 2017, with the yearly average exchange rate slightly down to KRW 1,141 per U.S. dollar. At the beginning of the year, the won remained weak, as it was affected by growing concerns over North Korea-related political uncertainties and U.S. protectionary measures. As the year progressed, however, the won started to gain strength against the U.S. dollar, backed by reduced external uncertainties involving North Korea and an improving Korean economy. The value of the Korean won against the dollar increased by 12.8 percent throughout the year.

Prospects for 2018

GDP

The Korean economy is on track to solid recovery, with its GDP growth forecast at around 3.0 percent for 2018. The key drivers will be improving consumer spending and robust merchandise exports. Consumer spending is likely to continue moderate growth backed by the government's efforts to boost private consumption, while a trend of recovery in major economies should help boost the nation's exports. There are some downside factors, however, such as a slowdown in domestic construction investment and a substantial contraction in equipment investment.

Consumer Spending

Consumer spending is expected to rise by 2.7 percent, continuing a growing trend backed by the government's stimulus measures and weakening savings demand. Moreover, a significant improvement in the inter-Korean relationship could further boost consumer spending. Yet the increasing burden of household debt payment and a delayed improvement in job market conditions could limit any pick-up in consumer confidence.

Equipment Investment

Equipment investment growth is projected to slow down to 2.9 percent in 2018 following a sharp turnaround in the previous year. The IT sector, which led a 14.6% jump in 2017, is the main factor of the drastic downturn in overall equipment investment, and this slowdown trend is likely to continue into the coming year. However, non-IT sectors will show modest growth in their investment spending, including some new investments in new and eco-friendly technologies by the communications, motor, and petrochemical sectors.

Construction Investment

The strong pace of expansion in construction investment in the past several years seems to be over now. The nation's construction investment is expected to decline by 0.2 percent in 2018. In particular, the housing sector is slowing down rapidly as a large number of housing starts between 2015 and 2016 are now turning into completions. The non-housing sector is also experiencing a decrease in construction starts, and a cut in government spending on infrastructure is expected to render civil engineering works sluggish.

Employment

Around 260,000 new jobs are projected to be created in 2018, down from 320,000 in the previous year. In spite of a slumping construction sector, the unemployment rate is expected to remain at 3.8 percent, while the employment rate is projected at 61 percent. With improving exports, employment in the manufacturing industry will likely improve, but only at a gentle pace due to sluggish production in some sectors. In the service sector, new jobs will be added by the government's policy to spur job creation and a recovery in the number of incoming tourists.

Inflation

The nation's consumer price inflation is forecast to remain at 1.6 percent in 2018, down from 1.9 percent in 2017. The core inflation rate, which strips out volatile food and energy prices, is projected at 1.6 percent. Agricultural prices are likely to move upward, recovering from a large drop in the prior year. Also, public utility prices are expected to show a moderate increase due to the oil prices that have recently risen, but the extent of the increase will be limited due to the government's policy to stabilize prices. Still, it is possible that an increase in shale oil production may put a brake on the rising international oil prices. A slowdown in rent increases amid the growing supply of new apartments could also counterbalance some of the inflationary pressure.

Current Account Balance

Korea's current account surplus is anticipated to decrease to USD 70.5 billion in 2018, compared to USD 78.5 billion in 2017. Global economic recovery will expand the nation's exports, leading to an overall positive balance in the merchandise account. Also, exports in the service sector will rebound following a sharp decline in 2017 mainly due to an improving travel sector, contributing to reducing the nation's service account deficit.

Interest Rates

In 2018, the average three-year government bond rate is expected to increase marginally to 2.1 percent. As is widely expected in the market, the nation's benchmark interest rate will likely be raised over the course of the year. A tightening monetary policy by the U.S. Federal Reserve (Fed) may also push up market interest rates in Korea, but the rise will be only limited unless local economic conditions improve drastically.

Foreign Exchange Rate

The average KRW/USD exchange rate is projected at KRW 1,150 in 2018, slightly up from KRW 1,141 in 2017. The U.S. dollar is expected to gain some strength due to the government's economic stimulus programs and the monetary policy normalization by the Fed throughout the year. However, the upward pressure on the exchange rate may be limited as a potential boost for the dollar will be mostly outweighed by other central banks' move toward monetary policy tightening. Furthermore, the recovery trend of the global economy could curb demand for U.S. assets, leading to the dollar's weakness. Meanwhile, reduced geopolitical tensions involving North Korea have significantly decreased the volatility in the foreign exchange market.

Key Economic indicators

(Unit: %)

	2016	2017	2018 (E)		
			First Half	Second Half	Annual
Real GDP	2.8	3.1	3.0	2.9	3.0
Consumer Spending	2.5	2.6	3.1	2.3	2.7
Equipment Investment	-2.3	14.6	5.0	0.9	2.9
Construction Investment	10.7	7.6	1.6	-1.8	-0.2
Unemployment Rate	3.7	3.7	4.1	3.4	3.8
Current Account Surplus(USD billion)	98.7	78.5	28.0	42.5	70.5
Exports	2.1	3.8	2.8	4.3	3.6
Imports	4.5	7.4	2.9	3.7	3.3
Consumer Price Inflation	1.0	1.9	1.4	1.7	1.6
Three-year Treasury Yield	1.4	1.8	2.0	2.2	2.1
USD/KRW Exchange Rate (Won)	1,161	1,141	1,153	1,146	1,150

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