

KOREA

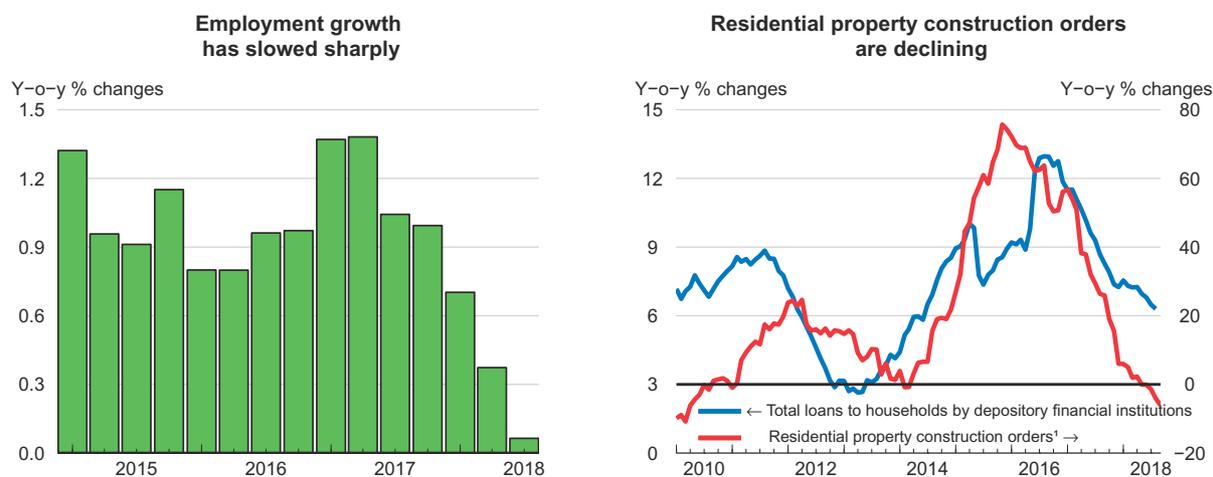
Economic growth is projected to remain close to 3% through 2020, as fiscal stimulus offsets sluggish employment growth, which reflects double-digit hikes in the minimum wage in 2018-19 and restructuring in the manufacturing sector. Measures to stabilise the housing market have led to a decline in construction orders for residential property. Inflation is expected to edge up from 1½ per cent toward the 2% target, while the current account surplus will remain above 5% of GDP.

Hikes in the minimum wage should be moderated to avoid negative effects on employment. The “income-led growth” strategy, driven by minimum wage increases and higher public employment and social spending, needs to be supported by reforms to narrow productivity gaps between manufacturing and services, and between large and small firms. Short-term fiscal stimulus should be accompanied by a long-term framework to cope with population ageing, which will be the fastest in the OECD. With inflation below target, the withdrawal of monetary accommodation should be gradual.

Domestic demand has slowed

Output growth fell below 3% in 2018, reflecting a slowdown in fixed investment and employment. With employment growth dropping from 1.2% in 2017 to 0.4% in the first three quarters of 2018, the unemployment rate reached 4% for the first time since 2010. The 16.4% hike in the minimum wage in 2018 and restructuring in manufacturing have negatively affected the labour market, although a pick-up in wage growth is limiting the impact on household incomes and private consumption. With tighter regulations on mortgage lending, residential property construction orders started to decline in mid-2018. Core inflation has fallen to 1% in the context of sluggish domestic demand, government measures that reduce the cost of education and healthcare and a cut in the consumption tax on cars. Export growth has remained robust despite slowing international trade.

Korea



1. A 24-month moving average.

Source: Statistics Korea; OECD Economic Outlook 104 database; and Bank of Korea.

StatLink <http://dx.doi.org/10.1787/888933876974>

Korea: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices KRW trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 564.1	2.9	3.1	2.7	2.8	2.9
Private consumption	771.2	2.5	2.6	2.8	2.7	2.8
Government consumption	234.8	4.5	3.4	5.2	6.5	5.6
Gross fixed capital formation	458.4	5.6	8.6	-2.2	-0.6	2.1
Final domestic demand	1 464.4	3.8	4.7	1.6	2.3	3.1
Stockbuilding ^{1,2}	- 9.2	0.0	0.4	0.0	-0.2	0.0
Total domestic demand	1 455.2	3.8	5.1	1.6	2.1	3.1
Exports of goods and services	709.1	2.6	1.9	4.7	4.5	3.4
Imports of goods and services	600.2	4.7	7.0	1.9	3.1	4.1
Net exports ¹	108.9	-0.7	-1.7	1.3	0.8	-0.1
<i>Memorandum items</i>						
GDP deflator	—	2.0	2.3	0.7	2.0	2.1
Consumer price index	—	1.0	1.9	1.6	1.9	1.9
Core inflation index ³	—	1.9	1.5	1.2	1.6	1.9
Unemployment rate (% of labour force)	—	3.7	3.7	3.9	4.0	4.0
Household saving ratio, net (% of disposable income)	—	8.7	8.8	9.0	8.6	8.4
General government financial balance (% of GDP)	—	2.4	2.8	2.7	2.1	1.6
General government gross debt (% of GDP)	—	45.1	44.5	43.3	43.3	43.8
Current account balance (% of GDP)	—	7.0	5.1	5.2	5.5	5.4

1. Contributions to changes in real GDP, actual amount in the first column.

2. The actual amount for 2015 includes statistical discrepancy equal to KRW -3.1 trillion.

3. Consumer price index excluding food and energy.

Source: OECD Economic Outlook 104 database.

StatLink  <http://dx.doi.org/10.1787/888933877905>

Supportive macroeconomic policies should be accompanied by structural reforms

The government is responding to weaker domestic demand with fiscal stimulus. Spending is to increase by 9.7% in 2019, the highest since 2009 in the wake of the global recession. Social welfare spending is the priority, along with outlays for job creation, which are set to rise by 22%. In addition, the government aims to boost public employment by 34% over 2017-22. Despite increased spending, the general government budget will remain in surplus at around 2% of GDP in 2019, while government debt is low at just under 45% of GDP.

The policy interest rate has remained at 1.5% since late 2017. With consumer price inflation below 2%, the normalisation of monetary policy should be gradual. Monetary policy also needs to consider potential risks to financial stability, including capital flows and household debt, which rose at an 8% pace in the first half of 2018. At 186% of net disposable household income in 2017, household debt remains a headwind to private consumption.

Raising labour productivity, which is 46% below that in the top half of OECD countries, is increasingly important for growth as the working-age population peaked in 2017. The priority is regulatory reform, focusing on services, where labour productivity is less than half of that in Korean manufacturing. Policies to promote entrepreneurship and raise productivity in SMEs are also needed to promote inclusive growth. Increasing female

employment and reducing the gender wage gap, which is the highest in the OECD at 37%, is another priority.

Growth is projected to be stable

Output growth is projected to remain close to 3%, despite sluggish employment growth in 2019, partly as a result of a hike in the minimum wage by a further 10.9%. Further large increases, as part of the government's commitment to a sharp increase in the minimum wage, would damp employment and output growth. The improved relationship with North Korea is a landmark event that may also have positive economic implications. Moreover, progress with structural reforms to raise productivity in lagging sectors would boost output growth. However, trade protectionism remains a concern: with intermediate goods accounting for four-fifths of Korea's exports to China, its largest trading partner, Korea is vulnerable to higher import barriers on Chinese exports to the United States.