KOREA

Following the decline in private consumption in spring 2014, the economy is gradually rebounding, thanks in part to monetary policy easing, fiscal stimulus and measures to boost the housing market. Output is projected to grow at around 4% in 2015-16, helping to narrow Korea's large current account surplus and to lift inflation to the target range of 2.5% to 3.5%.

While fiscal stimulus to support growth is appropriate, given Korea's strong fiscal position, the top priority should be wide-ranging reforms, particularly those in the 2014 Three-Year Plan for Economic Innovation, to sustain the country's growth potential. Policies to revitalise the housing market should be implemented carefully to avoid aggravating the household debt problem.

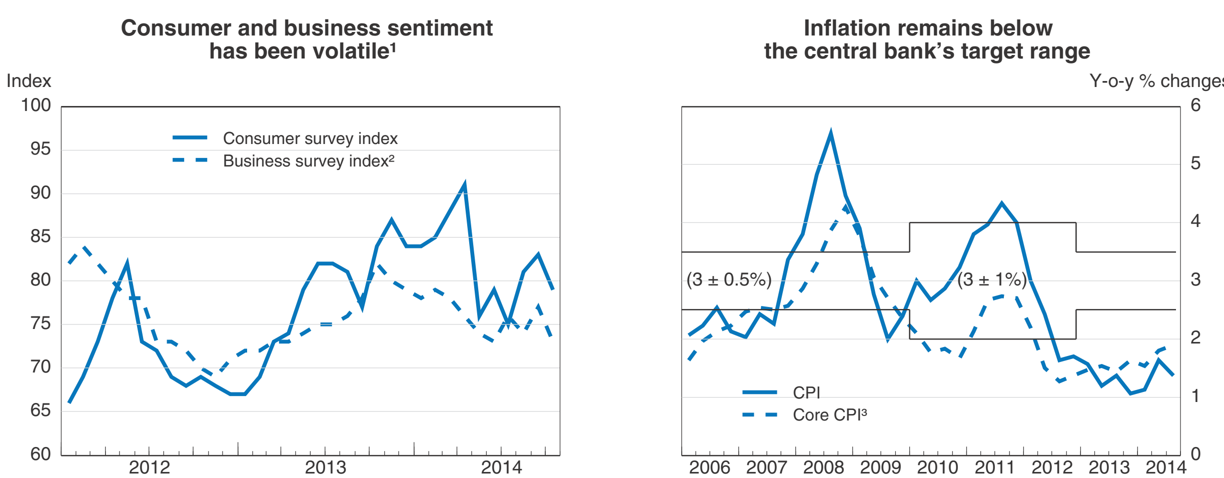
Output growth is picking up following a period of sluggish growth

Private consumption, which fell following the tragic ferry accident in April 2014, is rebounding, while residential investment remains strong, aided by a relaxation of macro-prudential regulations that had constrained mortgage lending. Despite the 10% appreciation of the won since early 2013, export growth picked up in the first half of the year. Nevertheless, considerable slack remains in the economy, with the current account surplus at 6% of GDP and inflation falling to around 1¼ per cent (year-on-year).

Monetary and fiscal policies are supporting growth

With inflation undershooting its target range, the Bank of Korea cut its policy rate in the second half of 2014 by a total of 50 basis points to 2%, matching its record low in 2009. Fiscal policy has also shifted to a more pro-growth stance. Government spending is set to increase 5.7% in 2015, as against 1.9% in 2014, and the consolidated central government budget, excluding the social security surplus, is to remain in deficit, albeit at only

Korea



1. Current domestic economic conditions for consumers and business conditions for firms. A value less than 100 indicates that the number of consumers and firms with a negative view exceeds those with a positive view.
2. Seasonally-adjusted of manufacturing sector.
3. Corresponds to the OECD measure of core inflation, which excludes food and energy.

Source: Bank of Korea; and OECD Economic Outlook 96 database.

StatLink http://dx.doi.org/10.1787/888933169659

Korea: **Demand, output and prices**

	2011	2012	2013	2014	2015	2016
	Current prices KRW trillion	Percentage changes, volume (2010 prices)				
GDP at market prices	1 332.7	2.3	3.0	3.5	3.8	4.1
Private consumption	679.1	1.9	2.0	1.8	3.0	3.2
Government consumption	194.4	3.4	2.7	2.7	4.2	3.4
Gross fixed capital formation	403.0	-0.5	4.2	4.7	5.2	6.0
Final domestic demand	1 276.6	1.4	2.8	2.9	3.9	4.1
Stockbuilding[1]	36.2	-0.6	-1.3	0.3	-0.1	0.0
Total domestic demand	1 312.8	0.7	1.4	3.1	3.8	4.2
Exports of goods and services	742.9	5.1	4.3	3.4	4.9	6.3
Imports of goods and services	723.0	2.4	1.6	2.5	5.2	6.7
Net exports[1]	19.9	1.5	1.5	0.6	0.1	0.1
Memorandum items						
GDP deflator	_	1.0	0.7	0.6	0.4	0.7
Consumer price index	_	2.2	1.3	1.4	2.2	2.5
Private consumption deflator	_	2.2	1.0	1.2	1.9	2.3
Unemployment rate	_	3.2	3.1	3.5	3.4	3.3
Household saving ratio, net[2]	_	3.9	5.1	5.3	5.2	5.3
General government financial balance[3]	_	1.0	-0.4	-0.6	-1.0	-0.7
General government gross debt[4]	_	34.8	35.6	36.7	38.2	39.6
General government net debt[4]	_	-35.9	-35.2	-34.0	-32.5	-31.1
Current account balance[3]	_	4.1	6.1	6.0	5.0	4.2

1. Contributions to changes in real GDP, actual amount in the first column.
2. As a percentage of disposable income.
3. As a percentage of GDP.
4. As a percentage of GDP at market value.

Source: OECD Economic Outlook 96 database.

StatLink http://dx.doi.org/10.1787/888933170443

around 1% to 2% of GDP, through to 2018. Nevertheless, government debt is projected to remain below 40% of GDP. The government is also implementing regulatory reform and measures to boost the employment rate from 64% of the working-age population in 2012 to 70% by 2017, focusing on higher female employment. To promote employment and investment, the authorities plan to impose a 10% tax on firms that do not spend a government-determined amount of their income on salaries, investment and dividends, although this measure remains controversial.

Growth of around 4% is projected for 2015-16

Output is projected to grow at an annual rate of close to 4% over 2015-16, led by an upturn in exports due to stronger world trade and to the trade-promoting effects of Korea's free trade agreements with the European Union (2011), the United States (2012), Canada (2014), Australia (2014), China (2014) and New Zealand (2014). Stronger exports will sustain fixed investment, but the high level of household debt, at 161% of household disposable income, remains a headwind to private consumption. Stronger domestic demand is expected to help reduce the current account surplus to around 4¼ per cent of GDP in 2016 and raise inflation back into the target range (the planned hike in the cigarette tax could temporarily add as much as a ½ percentage point to the inflation rate).

Risks are broadly balanced

Although the government is aiming to reduce the household debt ratio, the measures to revitalise the housing market could further increase it, raising risks to private consumption as well as financial institutions. On the external side, Korea is particularly sensitive to the fragile global economic situation and exchange rate shifts, given that exports account for more than half of GDP.

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