

## KOREA

Growth slowed in 2011, reflecting the deceleration in world trade and sluggish activity in the domestic sector, which has not yet fully benefited from the export-led recovery from the 2008 global crisis. More moderate growth is helping to bring inflation back into the central bank's target range of 2 to 4%. Aided by continued buoyant demand from China, which accounts for a quarter of its exports, and won depreciation, exports are projected to lead a gradual upturn, with output growing by just over 4% in 2013, with the unemployment rate at around 3½ per cent.

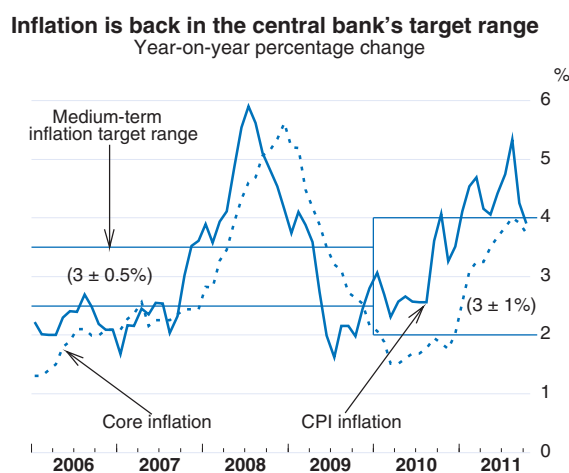
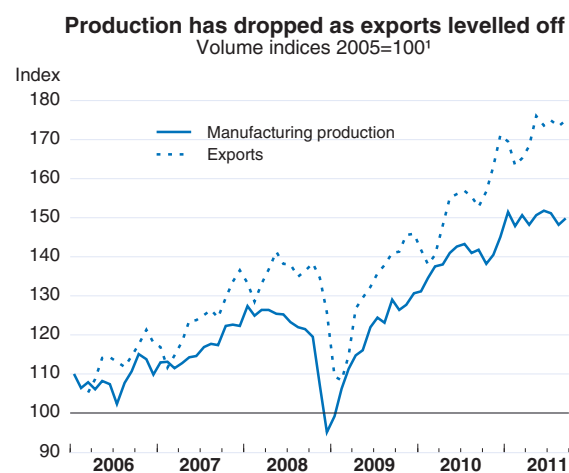
### Output growth is slowing as exports level off

The economy experienced slowing output growth and rising inflation during 2011. The deceleration of exports has been accompanied by weaker domestic demand, including fixed investment. In addition, private consumption has been subdued as wage gains have failed to keep up with inflation, which exceeded the central bank's target range during the first three quarters of 2011. Meanwhile, core inflation has risen to nearly 4%, boosting expected inflation. The unemployment rate has fallen to 3¼ per cent, despite rising labour force participation.

### Monetary conditions remain supportive of growth

The normalisation of the policy interest rate, which had remained at a record low of 2% until mid-2010, has paused since June 2011. At 3¼ per cent, the rate remains negative in real terms. Monetary conditions have been further eased by a moderate depreciation of the won, which has declined by 3% since May 2011 in effective terms. Although Korea has a current account surplus, estimated at almost 2% of GDP in 2011, the won remains relatively volatile, particularly during periods of global financial turbulence. Once the economy has overcome the current soft patch and high uncertainty, further policy interest rate hikes will be needed to contain inflation.

### Korea



1. Seasonally-adjusted for production and a three-month moving average for non-seasonally-adjusted exports.

Source: Korea National Statistical Office, OECD Economic Outlook 90 database and Bank of Korea.

StatLink  <http://dx.doi.org/10.1787/888932541132>

## Korea: Demand, output and prices

	2008	2009	2010	2011	2012	2013
	Current prices KRW trillion	Percentage changes, volume (2005 prices)				
<b>GDP at market prices</b>	1 026.5	0.3	6.2	3.7	3.8	4.3
Private consumption	561.6	0.0	4.1	2.6	3.2	3.8
Government consumption	156.9	5.6	3.0	2.9	4.0	3.0
Gross fixed capital formation	300.8	-1.0	7.0	-1.5	4.6	4.6
Final domestic demand	1 019.4	0.6	4.8	1.5	3.7	3.9
Stockbuilding <sup>1</sup>	19.2	-3.9	2.0	0.6	-0.1	0.0
Total domestic demand	1 038.5	-3.3	7.0	2.1	3.6	3.8
Exports of goods and services	544.1	-1.2	14.5	11.0	7.9	9.8
Imports of goods and services	556.2	-8.0	16.9	8.1	7.7	9.0
Net exports <sup>1</sup>	- 12.1	3.7	-0.6	1.7	0.3	0.6
<i>Memorandum items</i>						
GDP deflator	–	3.4	3.7	2.0	2.5	2.1
Consumer price index	–	2.8	3.0	4.4	3.6	3.0
Private consumption deflator	–	2.6	2.6	4.0	3.6	3.0
Unemployment rate	–	3.6	3.7	3.4	3.4	3.4
Household saving ratio <sup>2</sup>	–	4.6	4.3	3.8	3.8	4.1
General government financial balance <sup>3</sup>	–	-1.1	0.0	0.8	1.3	1.9
General government gross debt <sup>3</sup>	–	33.5	34.6	35.5	36.3	36.8
Current account balance <sup>3</sup>	–	3.9	2.8	1.8	1.3	1.1


Note: National accounts are based on official chain-linked data. This introduces a discrepancy in the identity between real demand components and GDP. For further details see *OECD Economic Outlook Sources and Methods* (<http://www.oecd.org/eco/sources-and-methods>).

1. Contributions to changes in real GDP (percentage of real GDP in previous year), actual amount in the first column.

2. As a percentage of disposable income.

3. As a percentage of GDP.

Source: OECD Economic Outlook 90 database.

StatLink  <http://dx.doi.org/10.1787/888932542633>

### Fiscal policy is focused on limiting public debt

Korea continues to limit government spending growth in line with the National Fiscal Management Plan's objective of balancing the consolidated central government budget (excluding the social security surplus) by 2013. The fiscal stance is appropriate given that Korea faces strong pressure to boost public social spending from its current low level, not least to cope with rapid population ageing. In addition, there is considerable uncertainty about the eventual cost of greater economic integration with North Korea.

### A gradual pick-up in growth is projected during 2012-13...

After a few quarters of sub-par output growth, the economy is projected to pick up as world trade rebounds in 2012. Korean exports will be sustained by strong demand from China, its largest trading partner, and by the relatively low level of the won. Stronger exports should prompt a recovery in fixed investment and a pick-up in private consumption, boosting output growth to more than 4% in 2013.

### ... depending in part on developments in the world economy

The economy faces both domestic and external risks. Household debt has continued to increase, reaching 132% of household income in 2010. Rising interest rates could thus have a larger than expected damping

effect on private consumption. On the external side, with exports accounting for more than half of GDP, Korea is particularly vulnerable to a sharp deterioration in the world economy.

**Policy orientation should  
downside risks materialise**

If such downside risks materialised, the OECD has identified, as part of its Strategic Response, key macroeconomic policies, as well as structural reforms which, while desirable in any case, would become essential to raise growth:

- Given its strong fiscal position, with gross government debt around 35% of GDP, fiscal stimulus would be warranted.
- Making spending targets more binding, while maintaining flexibility to cope with shocks, would further strengthen confidence in public finances and thereby allow continued flexibility to deal with shocks.
- There is scope to cut the policy interest rate if output growth were to falter.
- Enhancing labour productivity would spur growth, particularly in network industries and services, where productivity is only around 60% of that in the manufacturing sector. Regulatory reform, including reducing entry barriers, is essential to enhance productivity.
- Another priority to boost productivity growth is to deepen Korea's integration in the world economy by increasing inward foreign direct investment, which is currently the second lowest in the OECD area as a share of GDP. Encouraging greater inflows requires reducing explicit barriers, which are among the highest in the OECD area, and improving the business climate.



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