Korean Economy

2021 in Review

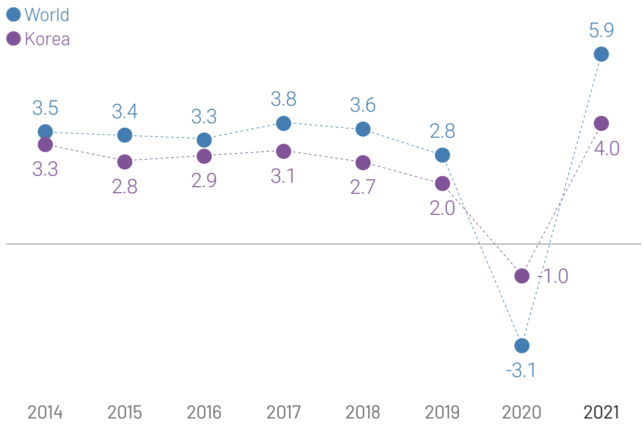
The Korean economy finished 2021 in strong shape, with its gross domestic product (GDP) growing by an estimated 4% despite growing concerns about the rapid spread of Omicron. That is the highest economic growth rate in 11 years, suggesting that even with an unrelenting pandemic, the economy made a sharp turnaround from the previous year's contraction. The economy was on track for a strong rebound in the first quarter of the year, driven by robust growth in exports and equipment investment, but GDP growth slowed a bit through the second and third quarters due to lackluster consumer spending. In the final quarter, the economy regained its recovery momentum on the back of an uptick in consumer spending, export gains, and fiscal support.

Private consumption growth improved to 3.6% in 2021, representing a strong recovery from the previous year's 5% contraction, while there was a growth of 5.5% in government spending, backed by a rise in health care expenditures. Consumer spending improved due in no small measure to eased social distancing rules, which led to an increase in consumption in the hospitality, dining, and transportation sectors.

Exports bounced back from a contraction in 2020 and jumped by 9.7% in 2021, the fastest annual pace in 11 years, and this robust export performance was led by semiconductors and petroleum products. Imports also surged by 8.4% in 2021 compared to a 3.3% drop in 2020 due to increased inbound shipments of crude oil and chemical products.

GDP Growth Trends

(Unit: %)



(Sources: IMF World Economic Outlook (Oct. 2021), Bank of Korea)

Another important driver of GDP growth was equipment investment, which increased by 8.3% in 2021 versus 7.1% in 2020. The acceleration in equipment spending growth was supported by an increase in machinery investment. On the other hand, construction investment declined by 1.5% amid higher office vacancy rates and reduced hotel occupancy. Commercial real estate construction was among the hardest-hit segments of the economy in the wake of the pandemic outbreak because remote work became more common than before, and a greater fraction of businesses relied on virtual platforms, resulting in lower demand for construction.

Prospects for 2022

In 2022, the Korean economy is expected to have another strong year of recovery from the pandemic-induced contraction of 2020, supported by consumer spending growth, export recovery, and an improving business investment. However, rising inflation, supply chain disruptions, and the build-up of household debt cast a cloud over the growth outlook for 2022.

GDP

The Korean economy is on track to deliver a GDP growth of 3% amid improving economic activities both at home and abroad. While COVID-19 remains a threat to the economy, it appears to be having a far less negative impact on economic output. Effective vaccines have allowed most economies to move away from lockdowns and focus on how to live with the virus. Rising consumer spending coupled with global demand recovery will likely continue to help the Korean economy maintain its strength in the year ahead.

However, there are growing concerns about potential threats to economic recovery, such as the emergence of new coronavirus variants, rising inflation, a supply chain crunch, and the surge in household debt. A political crisis surrounding Russia's invasion of Ukraine is also casting a pall over the growth outlook for 2022 because several spillover effects from the invasion, including rising energy and food prices, could create macro uncertainty for the world economy.

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Consumer Spending

Consumer spending is expected to grow by 3.5% in 2022, with consumer confidence gaining strength from growing household income and improving job market conditions. Spending on services will recover since the government is lifting many of the restrictions designed to curb the spread of COVID-19. In particular, pent-up demand is likely to cause a strong rebound in consumer expenditure on hotels, leisure, recreation, and transport. Consumption of goods is also being boosted by increasing online transactions. Furthermore, consumer spending growth will be driven by excess household savings, which have increased during the COVID-19 pandemic amid rising uncertainty regarding future income and employment prospects. Government support programs for small business owners and low-income families will also help shore up the growth of private consumption across the board.

Equipment Investment

Equipment investment is projected to grow by 2.2%, driven by solid investment spending in the information and technology (IT) sector and a recovery in non-IT investment. Demand for IT and communications equipment will remain strong, with COVID-19 spurring an exceptional surge in technology investment across the globe. Investments in IT are mostly focused on accelerating the rollout of 5G networks and building more data centers. In the non-IT sector, a growing amount of investment will be made in automobile and transportation. The inland transportation sector, in particular, will see a rise in equipment investment amid the growth of e-commerce, which is backed by growing demand for online purchases. Disruptions in automobile production will likely ease, and there will be a continued increase in investments in electric vehicles and batteries.

Construction Investment

Construction investment will rebound to positive growth, but the pace of recovery is likely to be moderate due to rising commodity prices. Backed by both building construction and civil works, construction investment is expected to increase by 2.4% in 2022. The civil engineering construction sector will bounce back thanks to the government's increased investment in infrastructure. Leading indicators of building activity, such as new housing starts and construction orders, suggest a steady improvement in conditions for the housing construction sector. Investment in commercial building construction is on track to solid growth, while the industrial building construction sector is not likely to see a notable increase in investment spending due to the high base in 2021 when there was a big jump in investments with regard to the construction of semiconductor factories and warehouses.

Employment

Labor market conditions are expected to improve, with the number of employees increasing by 280,000 and the unemployment rate declining modestly to 3.6% in 2022. Much of the job growth will come from face-to-face service sectors that were severely affected by COVID-19, such as restaurants, hotels, entertainment, and passenger transportation. These industries will be supported by improving consumer confidence and a rise in the government budget for job creation. The manufacturing industries will also see a modest increase in job growth, backed by growing investment in the IT sectors. Automobile production disruptions are also likely to ease off, supporting job growth in the manufacturing sector. As long as another big wave from COVID-19 can be staved off, the job market seems primed for continued growth, but a decrease in the number of economically active people could potentially pose a challenge to job market recovery, as that makes it difficult for businesses to keep up with labor demand growth.

Inflation

Inflationary pressure has been building amid rising energy and commodity prices coupled with supply chain bottlenecks. Consumer price inflation is forecast to increase to 3.1% in 2022 from 2.5% in 2021. Prices for energy, food, and goods have risen sharply as factories struggle to keep pace with strong consumer demand. Eased social distancing measures are helping boost consumer confidence and release pent-up demand. The current situation has been compounded by global supply chains for everything from mobile phones to cars, which is being fueled by the relative shortage of semiconductors across the world. Semiconductor chips are essential to many consumer goods from smart phones and laptops to desktop computers and automobiles, and demand for semiconductors soared during the pandemic due to the increased use of electronic communications equipment. However, a delay in economic recovery, the risk of new COVID-19 variants, and oil price retreats may put some downward pressure on inflation.

Current Account Surplus

Korea's current account surplus is expected to fall to USD 70 billion in 2022 from USD 88.3 billion in 2021 due mostly to growing imports amid rising commodity prices and consumer demand recovery. The ratio of the country's current account surplus relative to its GDP is projected to drop to around 4% in 2022 from 5% in 2021. The nation's merchandise account surplus keeps narrowing in spite of increasing exports because higher energy prices and domestic demand growth are set to push up the value of imported goods. Although Korea will see an expansion in its transport account surplus in tandem with increasing global trade volume, there will likely be a rise in its service account deficit because the number of outbound tourists is bound to increase again due to the end of travel restrictions.

Interest Rate

The average three-year treasury yield in Korea is anticipated to rise to 1.8% in 2022 from 1.4% in 2021. The Bank of Korea (BOK) has been under pressure for interest rate hikes amid growing concerns over rising inflation and household debt. The central bank raised its benchmark interest rate by 25 basis points to 1.25% in mid-January 2022, which was the third interest rate hike during the COVID-19 pandemic following its previous rate hikes in August and November 2021. Previous to that, the rate had been kept at a record low of 0.5% since May 2020. The latest rate increase has brought the policy rate back to the pre-pandemic level. Throughout the year 2022, more rate increases are likely to come as the BOK Governor hinted at the possibility of further rate hikes via an online press briefing on January 14. Whether the central bank will further raise the base rate depends on economic conditions including the pace of GDP growth and tapering in the U.S. as well as inflationary pressure. However, the government is expected to reduce its treasury issuance in 2022 compared to the previous year, and this may help curb the rise in the treasury yield.

Foreign Exchange Rate

The value of the Korean won is expected to recover its strength against the U.S. dollar in 2022, bringing the yearly average exchange rate of USD/KRW down to KRW 1,135.0 per dollar. Still, like most other currencies, the won is not likely to make any significant gains against the greenback, as monetary tightening from the Federal Reserve will help the U.S. dollar gain enough momentum to continue its dominance in 2022. There are some external risks that may drive the exchange rate to soar, such as political instability surrounding the conflicts between Russia and Ukraine, another resurgence of COVID-19, and global inflationary pressure. Among other things, Russia's assault on Ukraine has significantly undermined the euro due mostly to Europe's high volume of trade with Russia, allowing the USD to strengthen against the euro.

Key Economic Indicators

(Unit: %)

	2020	2021	2022 (E)		
			First Half	Second Half	Annual
Real GDP	-1.0	4.0	2.8	3.1	3.0
Consumer Spending	-5.0	3.6	3.9	3.2	3.5
Equipment Investment	6.8	8.3	-1.3	5.8	2.2
Construction Investment	-0.1	-1.5	0.6	4.0	2.4
Unemployment Rate	4.0	3.7	3.8	3.3	3.6
Current Account Surplus (USD billion)	75.3	88.3	28.0	42.0	70.0
Exports	-0.5	9.8	4.5	2.5	3.4
Imports	0.0	11.8	5.6	2.1	3.8
Consumer Price Inflation	0.5	2.5	3.5	2.7	3.1
Three-year Treasury Yield	1.0	1.4	1.8	1.7	1.8
USD/KRW Exchange Rate (KRW)	1,180	1,144	1,162	1,107	1,135

(Sources: Bank of Korea (Feb. 2022), Korea Institute of Finance (Dec. 2021))