AT A GLANCE | South Korea

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South Korean Economy: Concerns Subside

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At the end of this month, South Korea's real GDP for the July-September 2023 quarter will be announced. In the April-June quarter of the same year, growth was up 0.6% from the previous quarter, the second consecutive quarter of growth, but imports were the only items contributing positively. The contribution of other demand items was negative or zero compared to the previous fiscal year, and the actual situation was unfavorable for both internal and external demand (Figure 1). However, this situation is likely to improve in the July-September quarter.

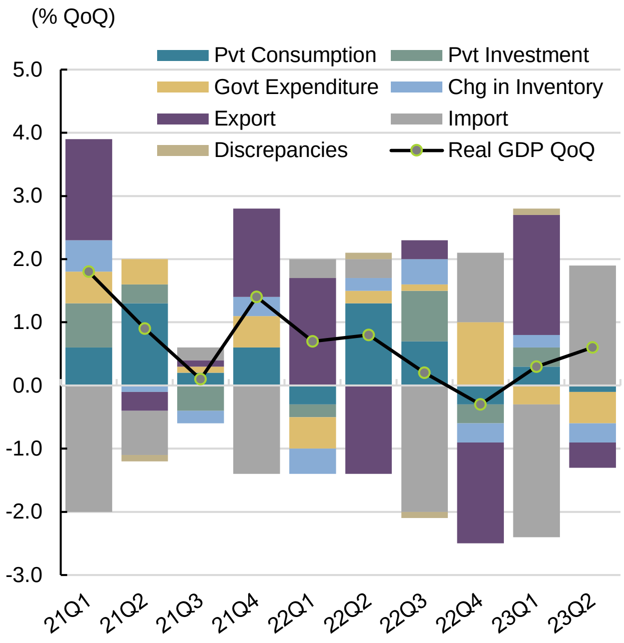
In this report, we would like to review the current state of South Korea's external demand, domestic demand, and real estate, and look ahead on what to expect for the South Korean economy.

Bottoming Out in Both Domestic and External Demand

Although exports have not yet emerged from their year-over-year decline, the contraction in both August (year-over-year down 8.3%, market forecast down 11.8%) and September (-4.4%, market forecast -9.3%) has narrowed faster than market expectations (Figure 2). Regarding semiconductors, the most important export item, the negative range of exports has improved against the background of the bottoming out of global semiconductor sales in the July-September quarter (Figure 3), and the outlook for the industry is turning optimistic.

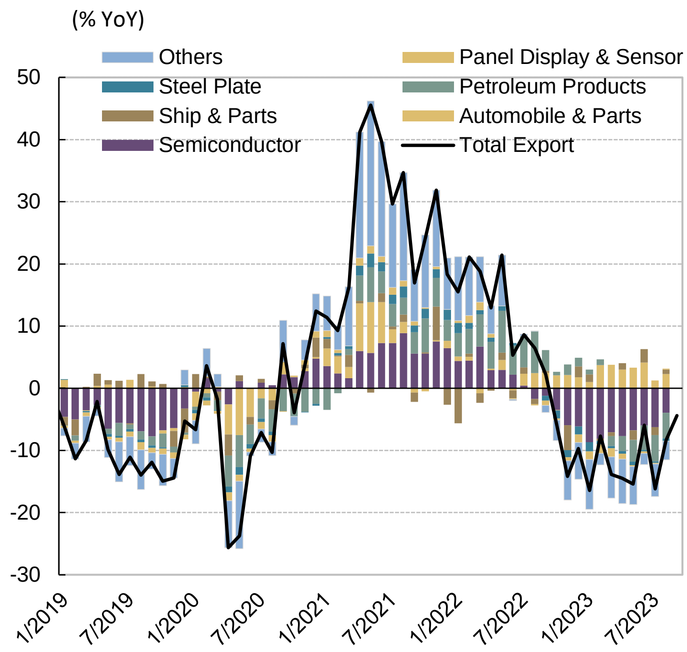
According to the industrial production index, as of August, production and shipments in the South Korean semiconductor industry have recovered to around zero from the previous year (Figure 4). The problem of overstocking in the semiconductor industry, which was pointed out in the June 30 issue of this report, is still a matter of concern. However, if global semiconductor demand continues to recover, driven by final demand for artificial intelligence, electric vehicles, and other products, this concern will recede somewhat from the first half of this year.

Figure 1: South Korea's GDP (YoY)



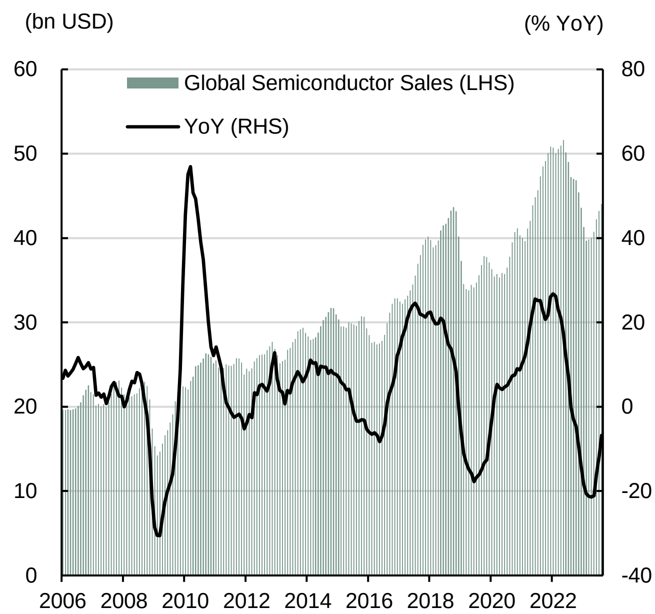
Sources: Korea Statistics Bureau, Haver

Figure 2: South Korea's Exports (YoY)



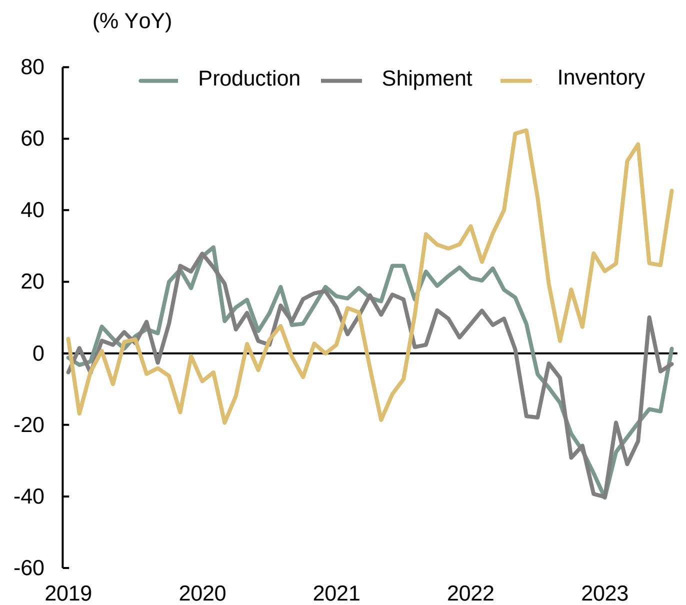
Sources: Korea Ministry of Trade, Industry and Energy, Wind

Figure 3: Global Semiconductor Sales



Source: Wind

Figure 4: Industrial Production Index – Semiconductor Industry



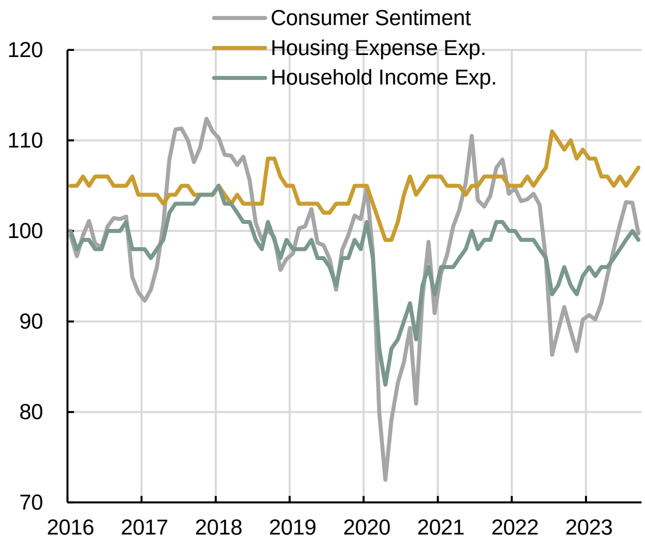
Sources: Korea Bureau of Statistics, Wind

As for household consumption, in the second half of 2022, concerns about a decline in real income as a result of soaring inflation and concerns about an increase in mortgage interest payments due to successive interest-rate hikes significantly depressed consumer sentiment. Meanwhile, in 2023, the most recent consumer sentiment index largely reversed all the declines in the second half of 2022, as interest-rate hikes stopped, inflation subsided and the minimum wage rose. This is good for the recovery of household consumption.

Overall, business fixed investment has not yet bottomed out. However, as demand for semiconductors and electronic products is expected to recover, investment in electrical equipment, which had been stagnant from April to June, has recovered significantly from July to August. The South Korean government announced the first Basic Plan for the Development of National Advanced Strategic Industries in May and designated seven special industrial parks for national advanced strategic industries in July. As the government has made clear its commitment to supporting cutting-edge industries such as semiconductors and next-generation automobiles, factory construction and capital investment in innovative industries are expected to increase.

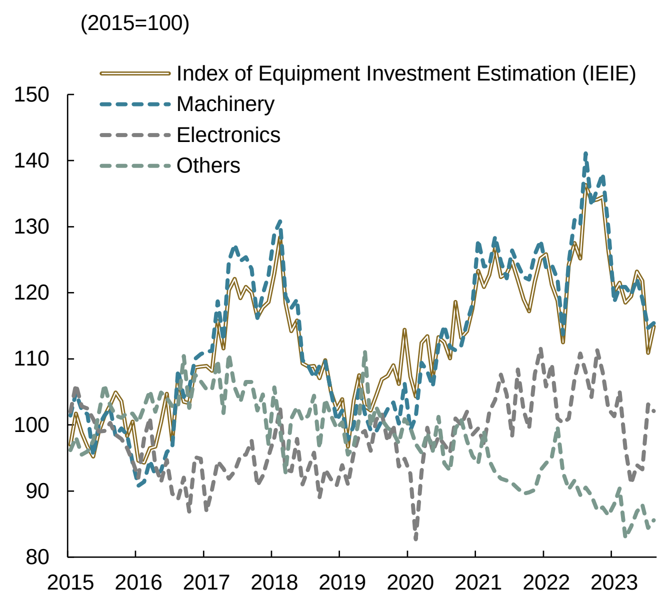
Overall, the South Korean economy has not returned to a healthy growth path, but there are signs of improvement in the domestic and foreign demand environment, and the pessimistic mood from the second half of 2022 has receded somewhat. Of course, the extent to which the economic recovery will continue depends on the trend of external demand and, more importantly, on the economic trends of the two major demand destinations, namely the United States and China. With concerns of an economic slowdown in both the United States and China, it is necessary to continue to closely monitor data on exports and other factors.

Figure 5: Consumer Sentiment Index



Sources: The Bank of Korea, Wind

Figure 6: Corporate Capital Investment Index (seasonally adjusted)



Sources: Korea Statistics Bureau

Real Estate Has Seen Its Worst, but Concerns Remain

The real estate sector is widely cited as a vulnerability in the South Korean economy.

Household debt is one of the largest in the developed world (the ratio of household debt to GDP at the end of 2022 was 104.5%, much higher than the 73.5% average in developed countries), and even small negative changes in household income and interest rates can trigger a sell-off in real estate.

In addition, South Korea's unique rental practice of "jeonse" is amplifying real estate-related risks.

"Jeonse" is a rental agreement in which a tenant deposits a certain percentage of the housing value (usually between 6% and 70%, positively correlated with real estate market conditions) with the lessor as a security deposit and does not pay monthly rent, and the entire security deposit is returned to the tenant at the end of the contract period (usually two years). At the beginning of 2022, just under half of all housing lease contracts were "jeonse" contracts, and although the percentage has been declining in recent years, the sense of scale is still large.[1]

From a renter's point of view, the bond is almost the same as borrowing money at zero interest. This increases the incentive to use security deposits to buy more housing assets during periods of rising property prices. Conversely, lenders may be forced to sell assets and return deposits during periods of declining property prices.

In other words, "jeonse" may increase price fluctuations by encouraging buying when the real estate market is strong and pushing selling when the market is weak. As a result, the greater the decline in real estate prices and the longer the downturn, the greater the risk of "jeonse".

On the other hand, the pace of decline in housing prices slowed in the April-June period of 2023 against the backdrop of the suspension of interest-rate hikes by the Bank of Korea, and housing prices remained almost flat in the July-September period (Figure 7). At the very least, the likelihood of negative linkage is reduced.

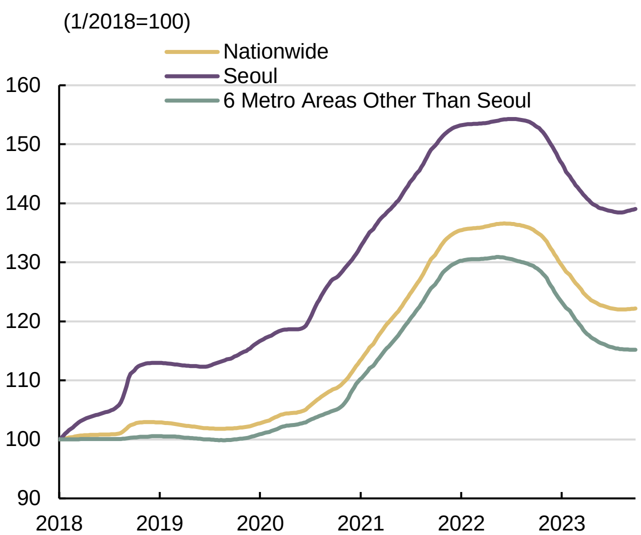
But we will have to wait until at least mid-2024 to determine whether the potential jeopardy (i.e., the potential for a concentration of residential property sales due to security deposit returns) of the "jeonse" contract, which was signed during the period of rising housing prices up to the first half of 2022, has been overcome. In addition, although the deterioration in the real estate market has abated, it is highly likely that risks will surface from real estate-related loans made during the period of rising housing prices from 2020 to 2022 due to a decline in collateral value.

In July of this year, a major credit union with a large proportion of real estate loans experienced a run on the bank after it was revealed that the delinquency rate of loans rose sharply, suggesting that the public is sensitive to the soundness of financial institutions.[2] The loan delinquency rate for banks as a whole is still at a low level, but has recently started to rise slightly (Figure 8). Changes in real estate market conditions and their impact on the financial position of financial institutions should continue to be monitored with caution.

1 https://koreajoongangdaily.joins.com/2022/05/17/business/economy/Korea-Real-estate-prices-jeonse/20220517184838337.html

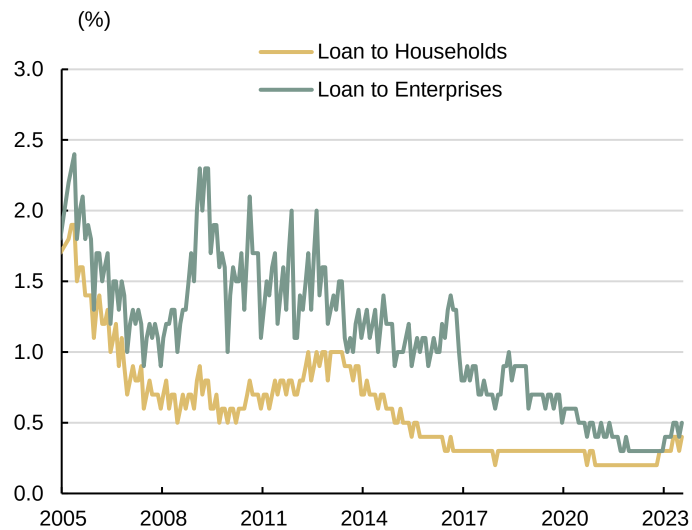
2 https://www.bloomberg.com/news/articles/2023-08-20/risk-of-debt-crisis-return-seen-in-korea-on-credit-union-woes

Figure 7: Housing Price Index



Source: CEIC

Figure 8: Bank Loan Delinquency Rate



Sources: Bank of Korea, Bloomberg

Economic Outlook: 2023-2024 Forecast

Figure 1: Forecasts for Economic Growth, Inflation, and Unemployment Rates

		2022			2023				2024				2021	2022	2023	2024
		Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
US	Real GDP	−0.6	2.7	2.6	2.2	2.1	2.5	1.2	0.6	1.0	1.2	1.7	5.9	2.1	2.1	1.2
	Inflation	5.2	5.2	5.1	4.8	4.6	4.0	3.6	3.0	2.7	2.6	2.5	3.6	5.2	4.3	2.7
	Unemployment	3.6	3.6	3.6	3.5	3.6	3.7	3.9	4.2	4.4	4.4	4.5	5.4	3.7	3.7	4.4
Euro Area	Real GDP	0.8	0.3	−0.1	0.1	0.1	0.0	0.1	0.2	0.3	0.3	0.4	5.6	3.4	0.5	0.8
	Inflation	8.0	9.3	10.0	8.0	6.2	5.1	3.2	3.3	3.2	3.0	2.8	2.6	8.4	5.6	3.1
	Unemployment	6.7	6.7	6.7	6.6	6.4	6.5	6.6	6.7	6.8	6.8	6.8	7.7	6.7	6.5	6.8
Japan	Real GDP	5.3	−1.2	0.2	3.2	4.8	0.9	0.8	0.9	0.9	1.1	1.1	2.2	1.0	1.5	1.0
	Inflation	2.1	2.7	3.8	3.5	3.2	2.9	2.5	2.9	2.8	2.5	2.1	−0.2	2.3	3.0	2.6
	Unemployment	2.6	2.5	2.5	2.6	2.5	2.4	2.4	2.3	2.3	2.3	2.3	2.8	2.6	2.4	2.3
China	Real GDP	0.4	3.9	2.9	4.5	6.3	4.4	4.8	3.7	4.1	4.6	5.0	8.4	3.0	5.0	4.4
	Inflation	2.2	2.8	1.8	1.3	0.2	0.0	0.6	1.1	1.5	1.8	2.0	0.8	1.7	0.5	1.6
	Unemployment	5.8	5.4	5.6	5.5	5.2	5.2	5.2	5.1	5.0	5.0	5.0	5.1	5.1	5.3	5.0

Real GDP growth is in QoQ annualized for U.S. and Japan, QoQ for euro area and YoY for China and India. Inflation rate is in YoY%. Inflation rate is YoY, % of core index (ex. fresh food) for Japan, YoY % of PCE deflator for U.S., and total YoY% for the rest.

Figure 2: Forecast for Rates

Interest rate		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
US	Policy rate	4.25 ~ 4.50	4.75 ~ 5.00	5.00 ~ 5.25	5.25 ~ 5.50	5.25 ~ 5.50	5.25 ~ 5.50	5.00 ~ 5.25	5.00 ~ 5.25	4.75 ~ 5.00	4.25 ~ 4.50	5.25 ~ 5.50	4.75 ~ 5.00
	2yr	4.43	4.03	4.90	5.04	5.00	5.00	4.75	4.75	4.75	4.43	5.00	4.75
	10yr	3.87	3.47	3.84	4.57	4.20	4.00	3.90	4.00	4.00	3.87	4.20	4.00
Germany	Policy rate	2.50	3.50	4.00	4.50	4.50	4.50	4.50	4.25	4.00	2.50	4.50	4.00
	Deposit rate	2.00	3.00	3.50	4.00	4.00	4.00	4.00	3.75	3.50	2.00	4.00	3.50
	2yr	2.50	2.68	3.20	3.20	3.00	2.80	2.60	2.40	2.30	2.50	3.00	2.30
	10yr	2.20	2.29	2.39	2.84	2.50	2.30	2.20	2.10	2.10	2.20	2.50	2.10
Japan	Policy rate	−0.10	−0.10	−0.10	−0.10	−0.10	−0.10	0.10	0.10	0.10	−0.10	−0.10	0.10
	2yr	0.04	−0.06	−0.07	0.06	0.15	0.20	0.30	0.30	0.30	0.04	0.15	0.30
	10yr	0.42	0.35	0.40	0.77	0.75	0.80	0.90	0.90	0.90	0.42	0.75	0.90
China	Policy rate	2.75	2.75	2.65	2.50	2.40	2.40	2.40	2.40	2.40	2.75	2.40	2.40
	2yr	2.39	2.41	2.11	2.26	2.27	2.32	2.37	2.47	2.52	2.39	2.27	2.52
	10yr	2.83	2.85	2.64	2.67	2.62	2.67	2.72	2.77	2.82	2.83	2.62	2.82

Figure 3: Forecast for FX and Oil Price

		2022	2023				2024				2022	2023	2024
		Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
USD/JPY	Range	130.58 ~ 151.95	127.23 ~ 137.91	130.64 ~ 145.07	137.25 ~ 149.71	138.00 ~ 152.00	133.00 ~ 147.00	126.00 ~ 140.00	128.00 ~ 142.00	128.00 ~ 142.00	113.47 ~ 151.95	127.23 ~ 152.00	126.00 ~ 147.00
	End of quarter	131.12	132.86	144.31	149.37	145.00	140.00	133.00	135.00	135.00	131.12	145.00	135.00
EUR/USD	Range	0.9633 ~ 1.0735	1.0806 ~ 1.1033	1.0635 ~ 1.1095	1.0488 ~ 1.1276	1.0100 ~ 1.1100	1.0000 ~ 1.1000	1.0100 ~ 1.1100	1.0100 ~ 1.1100	1.0200 ~ 1.1200	0.9536 ~ 1.1495	1.0100 ~ 1.1276	1.0000 ~ 1.1200
	End of quarter	1.0705	1.0839	1.0909	1.0573	1.0500	1.0400	1.0500	1.0600	1.0600	1.0705	1.0500	1.0600
EUR/JPY	Range	138.81 ~ 148.40	124.40 ~ 145.67	142.55 ~ 158.00	151.42 ~ 159.76	148.00 ~ 162.00	141.00 ~ 155.00	135.00 ~ 149.00	135.00 ~ 149.00	136.00 ~ 150.00	124.40 ~ 150.00	137.39 ~ 162.00	135.00 ~ 155.00
	End of quarter	140.41	144.01	157.43	157.93	152.25	145.60	139.65	143.10	143.10	140.41	152.25	143.10
Crude Oil Prices (WTI)		82.64	75.99	73.67	82.22	89.50	85.50	79.50	80.50	80.00	98.74	80.35	81.38

※ Crude oil prices are averages for each period. Source: SMBC.

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