Economic Recovery Gathering Strength

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There are growing signs that Korea’s economy is growing in a more sustainable manner after a long battle to overcome the depressive effects of household debt problems and a reluctance of business to invest in plant and equipment.

2005 Results: Preliminary data for the final quarter of 2005 were somewhat stronger than expected, as year-over-year (y/y) real GDP growth accelerated to 5.2%. Private consumption reached 4.6%, the highest level in three years, and facilities investment jumped to 9.8%, the largest quarterly increase since 2000. In seasonally adjusted, quarter-over-quarter (q/q) terms, real growth slowed a bit to 1.7% from the sizzling 1.9% recorded in the third quarter, but apart from that was the highest in two years. Private consumption held at the 1.2% growth recorded in the previous quarter, while facilities investment jumped sharply to 5.9%, the highest gain since the first quarter of 2000.

Concerns at the beginning of 2005 that exports, the main engine of growth in preceding years, would falter under the burden of a significant appreciation of the won in 2004 proved to be unwarranted. Growth of exports of goods and services (y/y) remained in or near double digits and continued to outpace import growth in real terms, although not in value terms, as the sharp rise in oil prices drove Korea’s terms of trade index down to 77.3 in December compared to 82.5 in December 2004. At $23.2 billion, the trade balance (customs clearance) for the year was lower than the $29.4 billion recorded in 2004 but substantially greater than in the previous three years. The current account declined by a greater amount, from $28.2 billion to $16.6 billion, as the net deficit on services rose sharply, reflecting particularly a rise in outbound travel and education and medical treatment abroad.

Initial 2006 Developments: Consumer sentiment has been rising for several months, consistent with the pattern of significant job creation. In January, the National Statistical Office’s consumer expectation and evaluation indices were over 100 for the fourth and fifth straight months, respectively. The cumulative increase in jobs from September to January was 171 thousand, largely in the service sector, and the seasonally adjusted unemployment rate declined from 4.0% to 3.4%. Sales of consumer durables, particularly motor vehicles, have been on a sharp uptrend, as has service industry activity. Although overall growth of credit to households has been slowing, credit card usage remained strong in January, recording a 17.5% (y/y) increase after similar gains in recent months, according to the Credit Finance Association.

Business spending also appears to have remained strong, judging from lending data. Credit to business has been rising, indicating continued solid capital expenditures in response to rising capacity utilization. In recent months, small and medium enterprises have finally begun to share in the trend of increased credit growth. Although exports in January fell sharply, largely because of the Lunar New Year holiday and a temporary blip in delivery of ships, preliminary data for February indicate a sharp rebound.

Forecasts for 2006: In his most recent comments, Deputy Prime Minister and Minister of Finance and Economy Han Duck-soo said that the growth rate achieved in the fourth quarter (5.2%, y/y) is close to Korea’s potential growth rate and should continue in 2006. He acknowledged concerns about the renewed appreciation of the won but said that its importance in determining export growth has lessened, noting that the structure of exports has shifted toward IT products and heavy industries. The Samsung Economic Research Institute was less optimistic about the impact of the appreciation, predicting that export growth will decline to 8.3%, and that the current account surplus will shrink sharply, to about $3 billion.

The Korea Economic Research Institute (KERI), the research arm of the Federation of Korean Industries (FKI), in its January Economic Bulletin projected growth of 4.9% in 2006. KERI saw consumption growing by 4.7% for the year and facilities investment by 6.2%, while construction investment remains at a depressed growth rate of around 1.5% as a result of the authorities’ policies aimed at restraining real estate price increases. KERI argued that it would be difficult to sustain a 5% GDP growth rate until the corporate investment environment has improved, which would largely entail increasing labor market flexibility and deregulation. FKI Chairman Kang Shin-Ho added improvement of the managerial environment and infrastructure of the service industry as another criterion.
A number of private forecasters have raised their estimates of 2006 growth recently. Some still see growth under 5%, while others have projections ranging up to 6%, or even a bit higher. One of the most bullish is Lehman Brothers, whose senior economist for Asia is quoted as saying, “We are bullish on the Korean economy this year as the country [is] set to fire on all cylinders—exports, consumption, and corporate investment.”