Economics

South Korea Chartbook

More stimulus needed, more coming

Economics/Growth/Monetary/Fiscal/South Korea

Group Research

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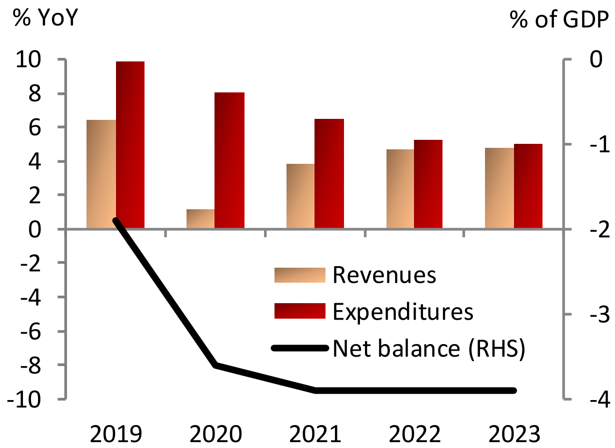
Charts of the month

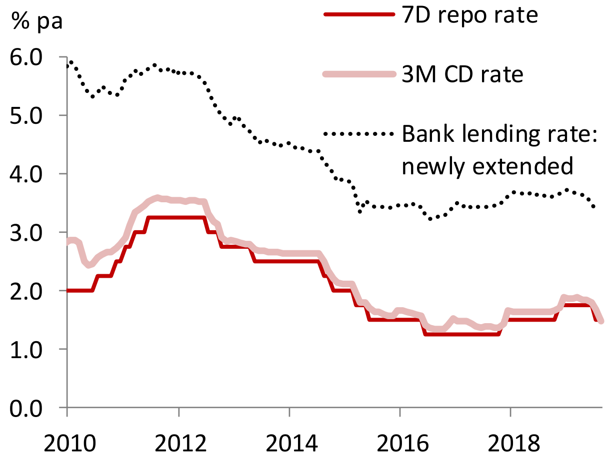
- *Exports and domestic private demand both weakened during the Jul-Aug period, pointing to GDP growth slowdown in 3Q.*
- *CPI inflation fell to zero in August, raising the chances of negative figures during Sep-Nov.*
- *Concerns over prolonged economic weakness / deflation will likely mount in the months ahead, justifying the call for more stimulus.*
- *The central government has strongly boosted spending this year and will continue doing so in 2020. The FY20 budget pencils in a sharp rise in fiscal deficit to 3.6% of GDP vs 1.9% this year.*
- *The Bank of Korea's July rate cut has effectively lowered the KRW funding costs. One more 25bps rate cut is on the cards in the rest of 2019, and further easing is possible next year.*
- *A modest growth rebound is expected in 2020 but public debt dynamics are set to deteriorate.*

South Korea: Fiscal outlook (official projections)



Sources: Ministry of Economy and Finance, DBS

South Korea: Key interest rates

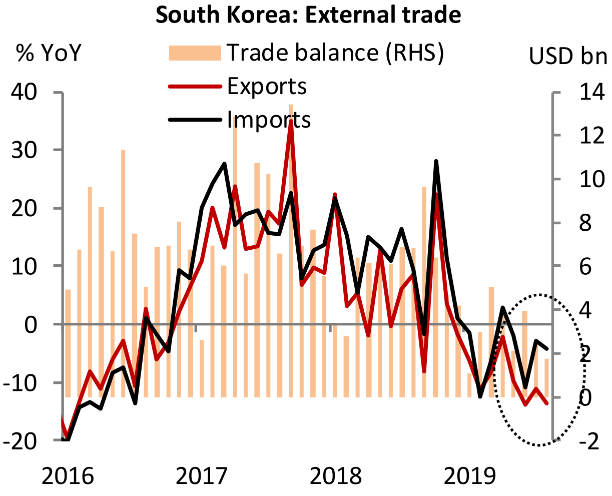


Sources: CEIC, DBS

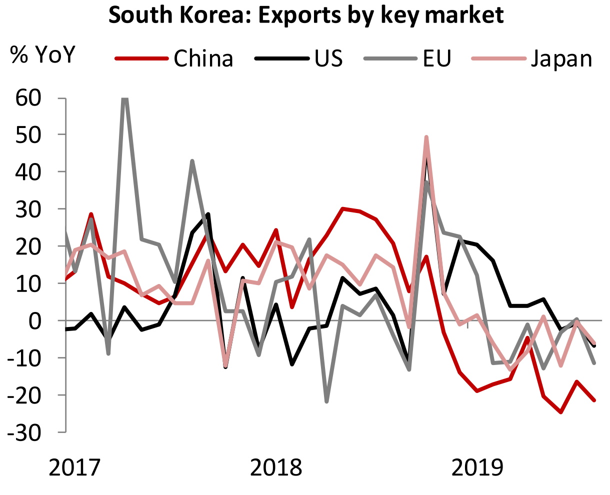
High-frequency indicators – Exports

Exports contracted at double-digit rate for the third consecutive month in August (-13.6% YoY). Trade balance deteriorated to USD 1.7bn, the smallest monthly surplus seen since October 2011 (excluding Lunar New Year).

Exports to all the major markets posted deeper declines in August, amid the headwinds from China-US trade war, Japan-South Korea trade tensions, and global growth slowdown.



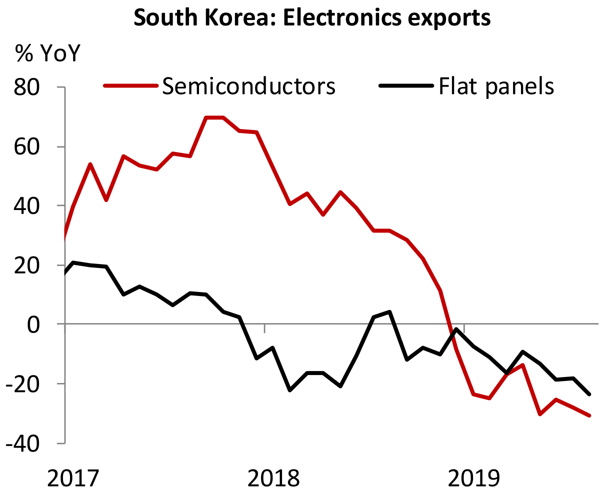
Sources: CEIC, DBS



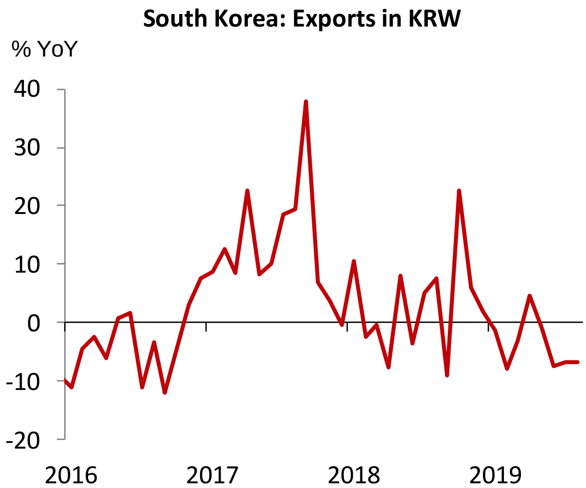
Sources: CEIC, DBS

Semiconductors and display screens – the two sectors that are most vulnerable to Japan's export controls – saw further deterioration in shipments in August.

The KRW's YTD depreciation was not enough to arrest the decline in exporters' revenues. The KRW-denominated export growth stayed negative for the fourth straight month in August.



Sources: CEIC, DBS

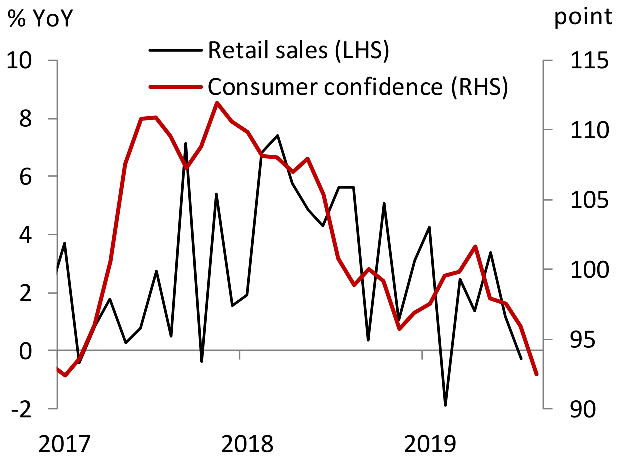


Sources: CEIC, DBS

High-frequency indicators – Domestic demand

Consumer confidence plunged to a 31-month low in August. Expectations for general economic outlook, household incomes and employment conditions all deteriorated.

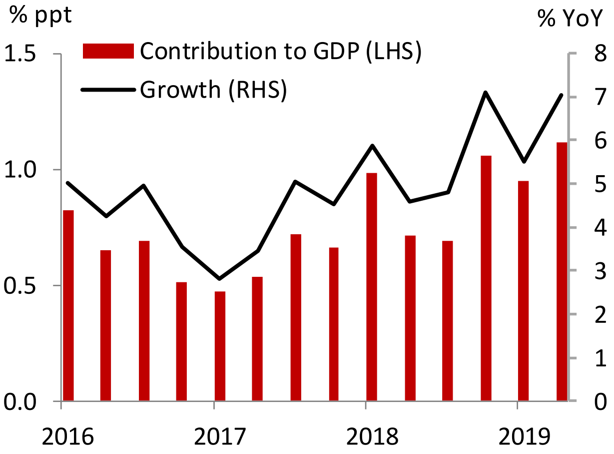
South Korea: Consumer confidence & retail sales



Sources: CEIC, DBS

Public spending plays an increasingly important role in supporting the economy. The contribution of government consumption to GDP growth reached 1ppt in 1H19.

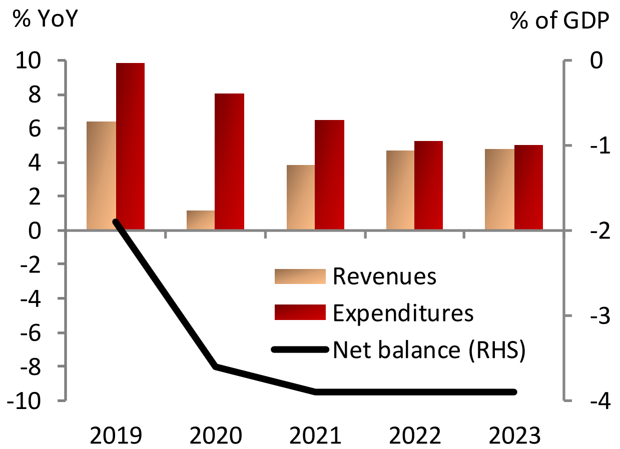
South Korea: GDP - government consumption



Sources: CEIC, DBS

Government expenditures are set to increase by 8% YoY next year on top of the 9.9% this year, according to the FY20 budget proposal. Net fiscal balance will fall into a bigger deficit equivalent to 3.6% of GDP, vs 1.9% this year.

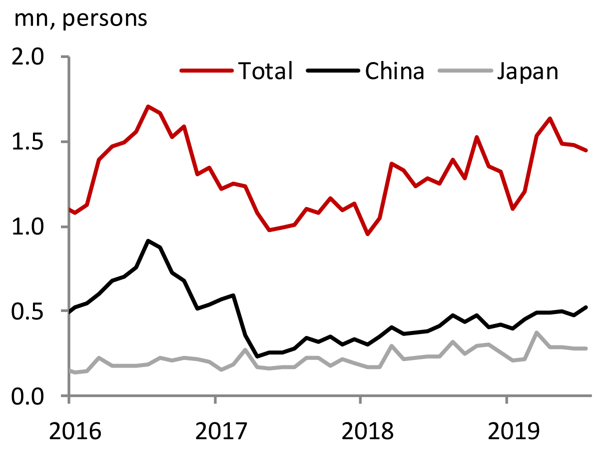
South Korea: Fiscal outlook (official projections)



Sources: Ministry of Economy and Finance, DBS

The KRW's depreciation appears to have benefited the tourism sector. The number of visitor arrivals has surged through this year, returning to the peak levels in 2016 before the THAAD dispute / China's boycott began.

South Korea: Visitor arrivals

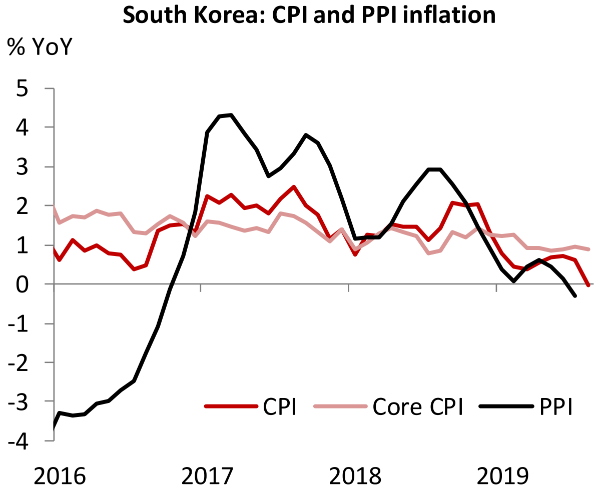


Sources: CEIC, DBS

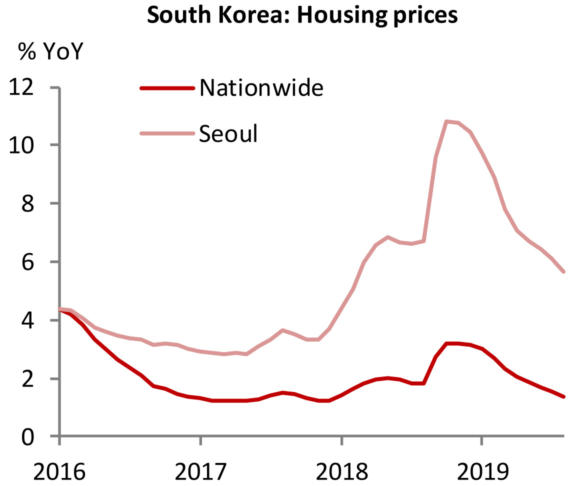
Monetary

Inflation continued to come down on food and oil prices. Headline CPI fell to 0% YoY in August, raising the chances of negative figures during Sep-Nov. Core CPI remained at close to 1%.

Housing prices eased further on the back of the government's cooling measures, as well as the slowdown in income growth and the deterioration in the labour market.



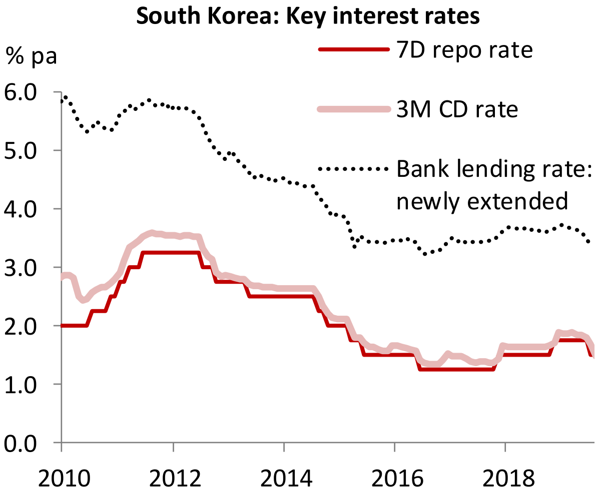
Sources: CEIC, DBS



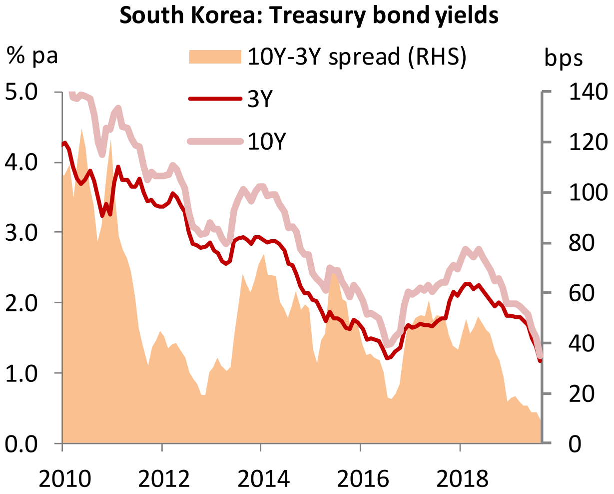
Sources: CEIC, DBS

Interbank rates and lending rates have fallen in tandem with the repo rate since the Bank of Korea's 25bps cut in July, reflecting abundant liquidity in the financial system.

KTB yields dropped to all-time lows and yield curve flattened substantially in August, in context of the dim growth/inflation outlook, BOK easing, and global yield decline.



Sources: CEIC. DBS



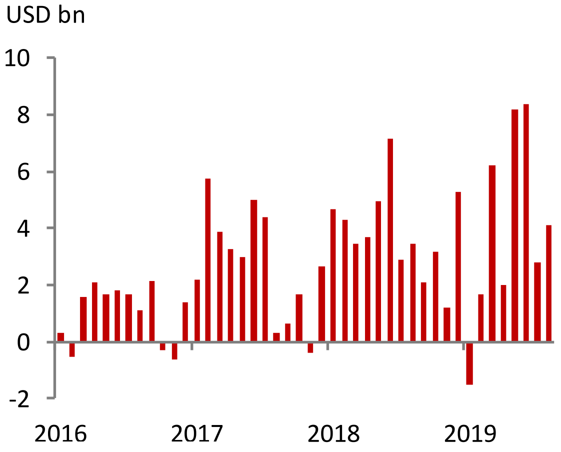
Sources: CEIC, DBS

Capital flows

Bond inflows remained buoyant. Foreign net purchase of KRW bonds stayed positive for the 7th consecutive month in August (USD 4.1bn), albeit down from the peak levels in May-Jun.

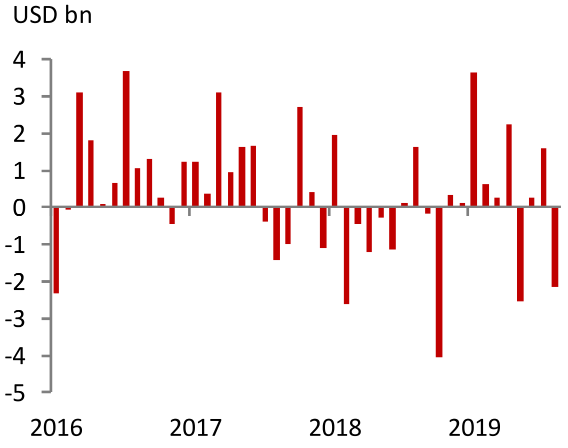
Equity inflows were weak and volatile. Foreign net investment in KOSPI and KOSDAQ posted an outflow worth USD 2.1bn in August (cumulative amount in the past six months was near zero).

South Korea: Foreign net purchase of KRW bonds



Sources: Bloomberg, DBS

South Korea: Foreign net equity investment

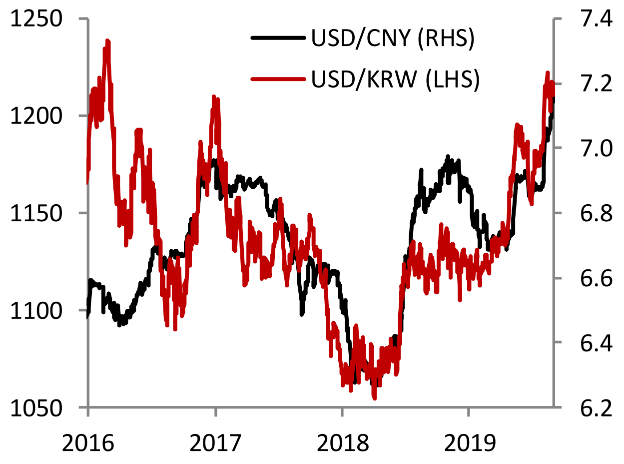


Sources: Bloomberg, DBS

The KRW depreciated further vs the USD to breach 1200 in August. In addition to domestic drags, the spillover effect of China-US trade war was at play (correlation between USD/KRW and USD/CNY was as high as 0.86 during Jan-Aug).

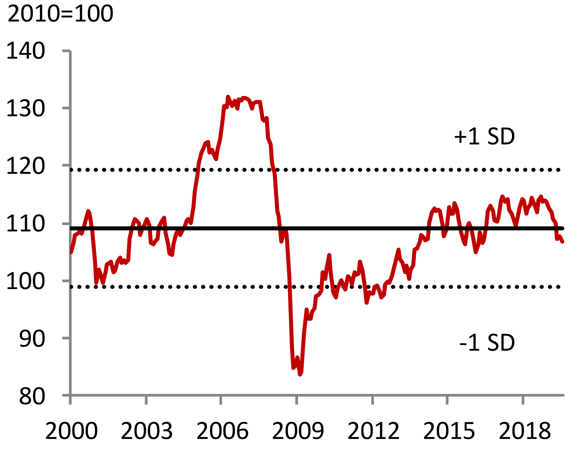
The KRW also depreciated on the REER basis this year (a total of 6% during Jan-Jul). This, theoretically, should lend some support to South Korea's export competitiveness with a time lag.

USD/KRW vs USD/CNY



Sources: Bloomberg, DBS

KRW REER



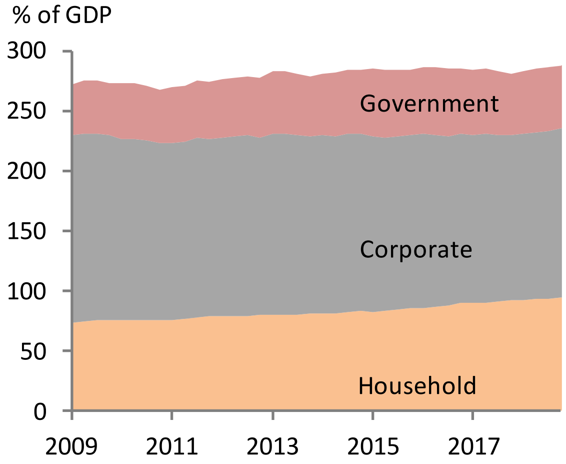
Sources: CEIC, DBS

Domestic and foreign debt

Household debt overhang poses a potential threat to financial/economic stability. Adding to the concerns is the faster rise in public debt as a result of fiscal policy expansion. Government debt-to-GDP ratio is projected to rise to 40% in 2020 and mid-40% in 2022.

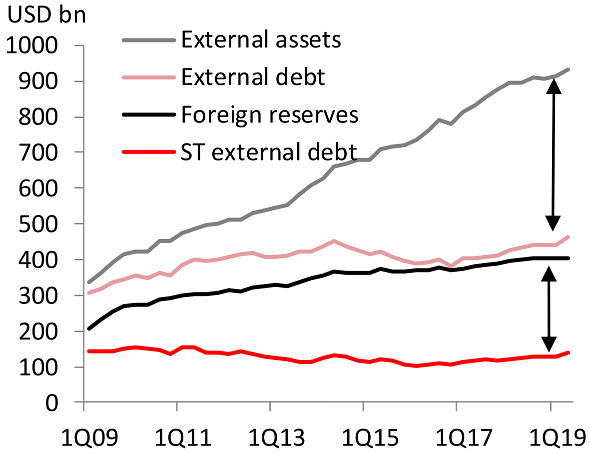
External balance sheet remains strong. External asset-to-external debt coverage ratio and foreign reserve-to-short term external debt coverage ratio stood at 2.0 and 2.9, respectively, at the end of 2Q.

South Korea: Public and private debt



Sources: CEIC, DBS

South Korea: External position



Sources: CEIC, DBS

Forecasts on major indicators

	GDP				CPI inflation			
	2017	2018	2019f	2020f	2017	2018	2019f	2020f
Annual change (%, YoY)	3.1	2.7	2.1	2.4	1.9	1.5	0.5	1.5

Exchange rate and interest rates forecasts									
		1Q19	2Q19	3Q19f	4Q19f	1Q20f	2Q20f	3Q20f	4Q20f
USD/KRW	**eop**	1135	1155	1230	1250	1240	1230	1220	1210
Benchmark repo rate	**(%, eop)**	1.75	1.75	1.50	1.25	1.25	1.25	1.25	1.25
3M CD rate	**(%, eop)**	1.90	1.78	1.62	1.37	1.37	1.37	1.37	1.37
Government bond yields	**3Y (%, eop)**	1.69	1.47	1.25	1.25	1.25	1.25	1.25	1.25
	10Y (%, eop)	1.83	1.60	1.35	1.30	1.25	1.35	1.45	1.55
	10Y-3Y (bps)	14	13	10	5	0	10	20	30

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).