



New Year's Prospects for the Korean Economy

| Summary |

The Year of the Ox has dawned. I wish a very Happy New Year to all readers of *i-KIET Issues & Analysis* and I thank you for your unwavering support for this publication.

The year 2020 was one of considerable hardship for our economy. We witnessed the first instance of negative growth since the 1997 Asian financial crisis, with sharp decreases in consumption and exports due to the COVID-19 pandemic. However, after the bottoming-out of major economic indices, the government's unprecedented and timely policy response and widespread public adherence to quarantine rules made it possible for our economy to rebound more quickly than expected. As a result, expectations are currently very high for Korea's early recovery from the economic side effects of COVID-19.

The year 2021 will be the year in which we climb out of the valley of recession and return to the path of recovery. Uncertainty surrounding COVID-19 is still the variable that we are all the most concerned about. Despite this, gradual improvements in both domestic and international consumption and the base effect of 2020 (due to negative growth) are expected to result in a 2021 growth rate of 3.2 percent. Exports are expected to return to an upward trend in the automobile, shipbuilding, and general machinery industries, while industries that maintained strong performances throughout the COVID-19 pandemic, including info-communications devices, semiconductors, and rechargeable batteries, are expected to continue to do well.

However, this optimistic outlook for economic normalization in 2021 after the ravages of COVID-19 must be tempered by the reality that internal and external factors which constrain our economy remain formidable. For the quickest possible recovery of Korea's economy, now is the time for a combined and concerted effort by the public and the private sectors. KIET will redouble its efforts in analyzing the status of the real economy and developing appropriate policies for it. We also hope to be of help in re-invigorating the domestic economy and our industries.

I hope all of our readers are blessed with fortune and happiness in their homes and workplaces throughout 2021. KIET promises to fulfill our responsibilities as a think tank that enhances Korea's industrial development.

January 1, 2021
Chang, Ji-sang (president, KIET)

■ **Global Economy Recovers Positive Growth Rate amid COVID-19 Uncertainty**

In 2020, Korea experienced its first instance of negative growth since the Asian Financial Crisis of 1997. Measurable declines in consumption and exports due to the COVID-19 pandemic were observed. Despite increased investment in equipment, domestic consumption plummeted and the average annual growth rate fell by as much as four percent. Along with a significant decrease in private consumption, investment in the construction industry declined. After a sharp economic contraction in Korea in the second quarter of 2020 due to the rapid spread of COVID-19 and the wider contraction of the global economy alongside falling oil prices, an economic rebound was witnessed in Korea in the second half of 2020 based on the resumption of economic activity by major countries.

Given the premise that the COVID-19 threat will be largely contained this year through the widespread distribution of vaccines, the global economy is expected to display positive growth through the combined effect of a slow but steady recovery in developed countries and a strong economic rebound in developing countries. The United States in particular is expected to see positive growth due to the gradual improvement of employment figures aided by government-directed fiscal stimulus and the Federal Reserve's policy of keeping interest rates low. Japan and the EU are also expected to experience positive growth due to the gradual stabilization of investor and consumer sentiment due to the alleviation of concerns surrounding COVID-19. The Chinese economy is expected to experience an even higher rate of growth due to the combination of two factors: 1) the receding of the COVID-19 pandemic and 2) simultaneous improvement in domestic and international consumption.

The biggest factor that will determine the future of the global economy is the unfolding of the COVID-19 pandemic and the speed at which vaccines are developed and distributed. Other variables include geopolitical risks faced by major countries and the effectiveness of various economic stimulus policies. Furthermore, government debt ratios are increasing sharply based on expansive financial programs implemented in response to the COVID-19 pandemic. There are also concerns that risks related to the financial capability and soundness of emerging economies will limit the growth of the global economy.

From a financial market perspective, the real economy is expected to remain relatively stable in 2021 based on the continuation of "economic recovery first" monetary policies by the central banks of major countries. In 2020, the provision of liquidity by central banks had only minimal impacts on the real economy. There had been widespread concerns about the expansion of uncertainty caused

by the gap between the real economy and financial markets. This year, in which economic recovery is expected to begin in earnest, such phenomena are forecast to gradually recede. Nevertheless, the need still exists to monitor credit flows in the private sector (i.e. changes in corporate loans and developments in financial markets) during the economic normalization process.

■ Korean Economy Expected to see Limited Recovery of Consumption with Rebound and Increase in Investments

This year, amid continuing uncertainty surrounding COVID-19, the Korean economy is expected to grow by 3.2 percent over 2020 levels due to the gradual recovery of domestic and international consumption as well as the impact of the negative growth seen in 2020 (base effect). Uncertainty surrounding COVID-19 is still the single largest determining factor of future growth. However, growth expectations will be tempered by domestic and international economic factors, and it remains to be seen whether the recovery plans and policies of major countries will continue to be effective. How the prolonged U.S.-China trade dispute will unfold is another factor contributing to uncertainties. Domestic factors, including the effects of the Korean New Deal and whether semiconductor exports will continue will also play an important role in the emerging economic picture.

With decreasing export-related headwinds due to the strong response by most countries in dealing with the COVID-19 pandemic, global average annual growth is expected to reach approximately 11 percent. This expectation is due to the economic recovery of major countries (including China) as well as the base effect of 2020. Exports for product categories that benefited from the COVID-19 pandemic (e.g. “K-quarantine,” biotech, and health) will continue to increase this year. Exports are also expected to increase in the following industries: 1) the machine industry, which experienced a relatively large decrease in exports last year (but is expected to do better in 2020 due to an increase in global demand), 2) the automobile industry (due to the base effect of 2020 and the filling of waitlisted orders), and 3) the shipbuilding industry (due to the resumption of deliveries that were delayed last year).

The Korean economy grew in 2020 despite the COVID-19 pandemic. For the IT industry, conditions for international competition do not look very bright due to the expansion of international production and intensified competition with China. On the other hand, exports are expected to increase in the following

areas: 1) home appliances (due to increased demand for premium-grade devices), 2) info-communications devices (due to the expansion of 5G and the continued conversion to a contactless society), 3) semiconductors (improved supply conditions due to large-scale investment and continued increases in demand), 4) display panels (the accelerated transition to OLED benefits Korean companies due to the increased regulation of the Chinese company Huawei), and 5) rechargeable batteries (enormous increase in international demand).

On the other hand, the materials industry, in which exports decreased drastically last year due to decreased demand and a drop in prices, is expected to experience only a partial recovery due to the low-price stance of the refined oil and petrochemicals industries and intensified competition with the Chinese market.

The steel and textile industries are expected to experience limited recoveries due to the base effect, but the scope of the recovery is expected to be limited due to intensifying international competition.

Equipment investment, despite the uncertainty surrounding COVID-19, is expected to continue increasing (by seven percent over 2020 levels) due to expectations of vaccine development and demand for preemptive investments in the ICT sector (e.g. semiconductors). Construction investment is expected to increase by 3.2 percent compared to 2020, with a focus on civil engineering, through expanded social overhead capital (SOC) expenditures on public infrastructure.

Private consumption is expected to increase due to the base effect of the negative growth of 2020. However, the scope of this improvement will be quite limited due to lagging employment rates, increased household debt and residential costs, slower income growth (due to decreases in corporate earnings), and the government's reluctance to implement additional stimulus measures.

■ Efforts Needed in the Post-COVID-19 Era to Transform Crisis into Opportunity

Major economic forecasting institutions in Korea and overseas generally predict that this year, the global economy will overcome the effects of the COVID-19 pandemic and begin a process of normalization. However, given the sheer size of the present uncertainties, in order for the Korean economy to normalize as quickly as possible, the government needs to respond proactively.

In the short term, we must focus our efforts on recovering from the damage

caused by the COVID-19 pandemic, rebuilding the economy, and revitalizing the real economy. The major economic indices that had dropped due to the pandemic are recovering relatively quickly. However, considering the increase in uncertainty caused by COVID-19 and structural decline in consumer tendencies, the scope of recovery may not be as broad as we might expect. In order to normalize the economy as quickly as possible and improve the conditions of the real economy, the government needs to make a concerted effort and implement a bold policy response through maintaining the K-quarantine infrastructure, boosting domestic consumption, stabilizing employment, providing support and subsidies for exports, and establishing the foundation for economic stability.

This year, the Korean government will concentrate its efforts on crafting the national budget and executing measures to lift the country out of its current adverse situation. Such measures include the creation of support plans to stabilize the real economy and the financial sector. In order for such efforts to bear fruit, they must be preceded by adherence to COVID-19 quarantine measures by the general population and by the securing of enough vaccines for all citizens. Care must also be taken to make policies more effective through selection and concentration.

In the mid to long-term, we must engage even more diligently in improving our economic disposition in order to alleviate the structural problems confronting the Korean economy. Internally, the Korean economy is embedded with many structural problems including a shrinking labor force due to an aging population, a slump in investments, and the absence of new growth industries. Internationally, there are unavoidable, widespread changes resulting from the COVID-19 pandemic that have produced a veritable mountain of problems that need to be addressed. With multiple changes anticipated in the post-COVID-19 era (e.g. a contactless economy, a decline in free trade, changes in the industrial landscape, changes in work methods), we must ascertain any and all opportunities presented by these changes and utilize them to our advantage.

Therefore, in order to overcome the COVID-19-caused economic recession and prepare for the post-COVID-19 era, the Korean government has announced the National Strategy for a Great Transformation to prepare a bright future for Korea and for its ascent as a leading international power. The pillar of the strategy is the Korean New Deal, which aims to transform Korea into a leading global economic power through the Digital and Green New Deals, which in turn are based on strengthening employment and the social safety net. However, because it will take some time for this policy's effects to become tangible, the

Korean government must take care to apply its policies consistently, taking a long-term view, and avoid being caught up in considering only short-term results.

COVID-19 has been changing human life for almost one full year. Now is the time to heal the wounds created by the COVID-19 pandemic and return to our daily routines. This year is the first year of the post-COVID-19 era. The circumstances we face are, of course, not entirely rosy. In order for the Korean economy to fully recover, the leaders of the domestic economic community must constantly seek out new opportunities.

The government must encourage an effective reorganization of industries, with an emphasis on the transition from traditional to new industries. There also needs to be regulatory reform with tangible benefits for companies. For their part, companies need to monitor the constantly-changing business environment, stay on the lookout for opportunities in new industries, and aspire to create new business models. Most of all, companies need to be willing and ready to actively engage in business areas that are in demand in the economy of 2021. Finally, individuals must consistently make an effort to acquire the capabilities that are currently in demand in our fast-changing socioeconomic environment. If these three parties can make a combined and concerted effort, there is much hope in the Year of the Ox for Korea's economic position to advance to even greater heights.

Chang, Ji-sang (president, KIET)



A PUBLICATION OF THE KOREA INSTITUTE FOR INDUSTRIAL ECONOMICS AND TRADE
PUBLISHER **Chang, Jisang**
EDITOR-IN-CHIEF **Kim, Youngsoo**
ASSISTANT EDITORS | **Jeong, Gyeonghee & Jo, Gyehwan**
COPY EDITOR **Aaron Crossen**
370 Sicheong-daero, Sejong City, 30147, Republic of Korea
Tel. 044-287-3114 Fax. 044-287-3333 www.kiet.re.kr

This article from *i-KIET* is available for viewing and download at eng.kiet.re.kr/kiet_eng/main.