

The Long and Short Run Challenges to the Korean Economy: Some International Perspectives

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Japan Society for International
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Sogang University

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Outline

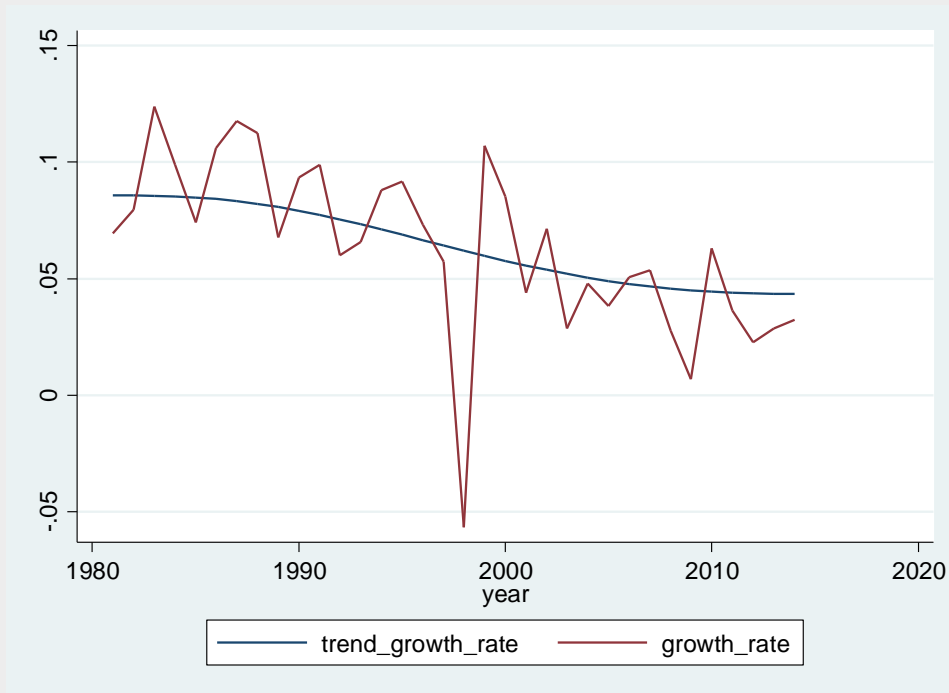
A quick glance at the Korean economy in relation to international trade and finance

Concerns over Korea's growth slowdown are growing inside Korea.

- The possibility of long-run stagnation (Japanification) is intensely discussed.
 - It is natural from the supply side (aging economy).
 - A housing bubble in Korea? – possible, but not much.
 - Demand side reasons (secular stagnation in Korea?)
 - Weak export demand
 - Weak consumption demand (indebted households and rising inequality)
- Short-term risks
 - A financial crisis is unlikely.
 - Marginal households and firms are vulnerable to interest hikes.
 - BOK's ability to keep interest rates low is limited by global financial instability and investors' perception of the Korean economy.

Korea's growth slowdown

Growth rate in 2015 is around 2.7%.

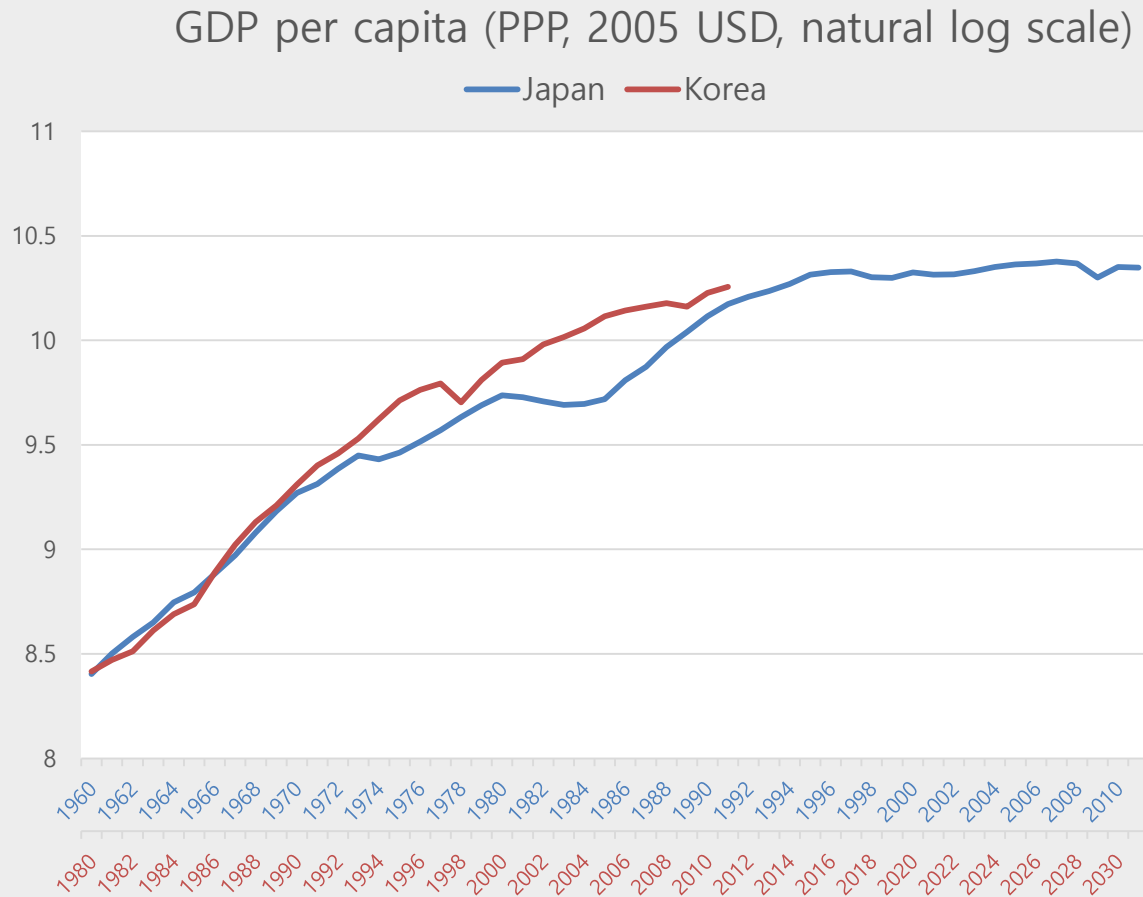


Period	GDP	Employment	Capital	TFP
2001~2005	4.6	0.9	2.1	1.5
2006~2010	4.0	0.5	1.8	1.7
2011~2015	3.1	1.0	1.3	0.8
2016~2020	3.0	0.4	1.0	1.6
2021~2025	2.5	0.1	1.0	1.4
2026~2030	1.8	-0.2	0.8	1.3
2031~2035	1.4	-0.4	0.5	1.3

Bank of Korea, Trend rates obtained from Hodrick-Prescott filter..

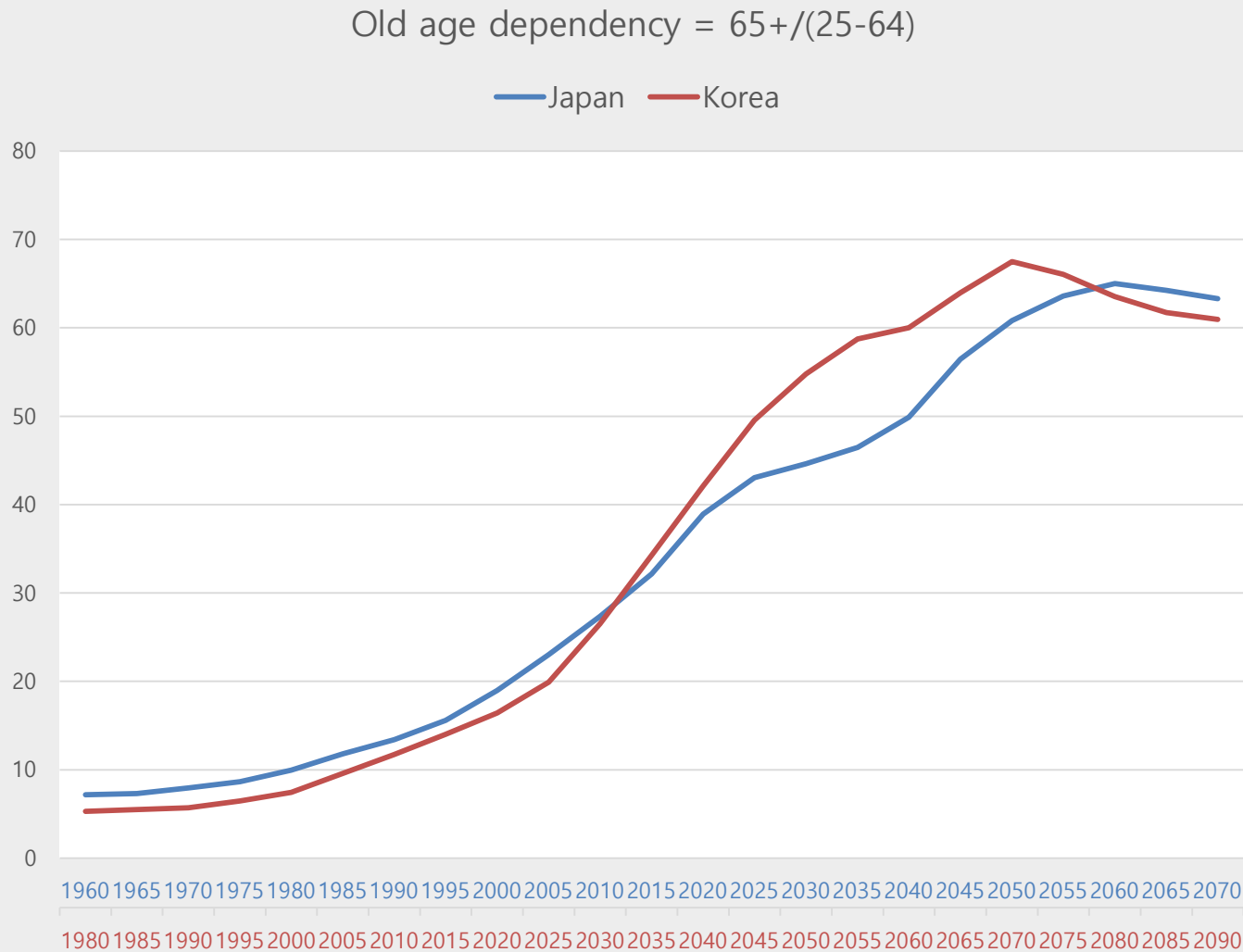
Cho (2014)

Is Korea following Japan with 20 years lag?



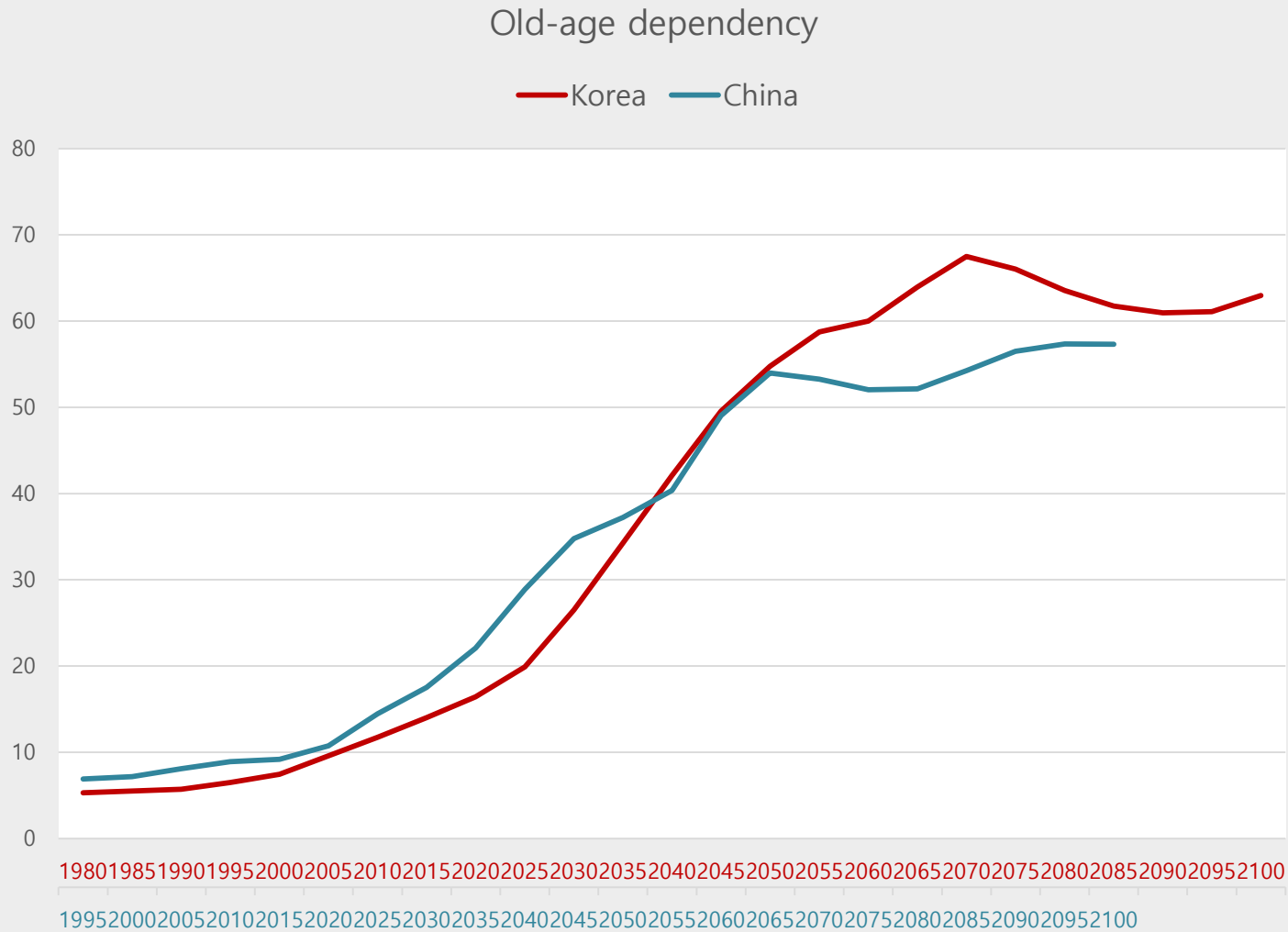
PWT 8.1

There is a strong parallel.



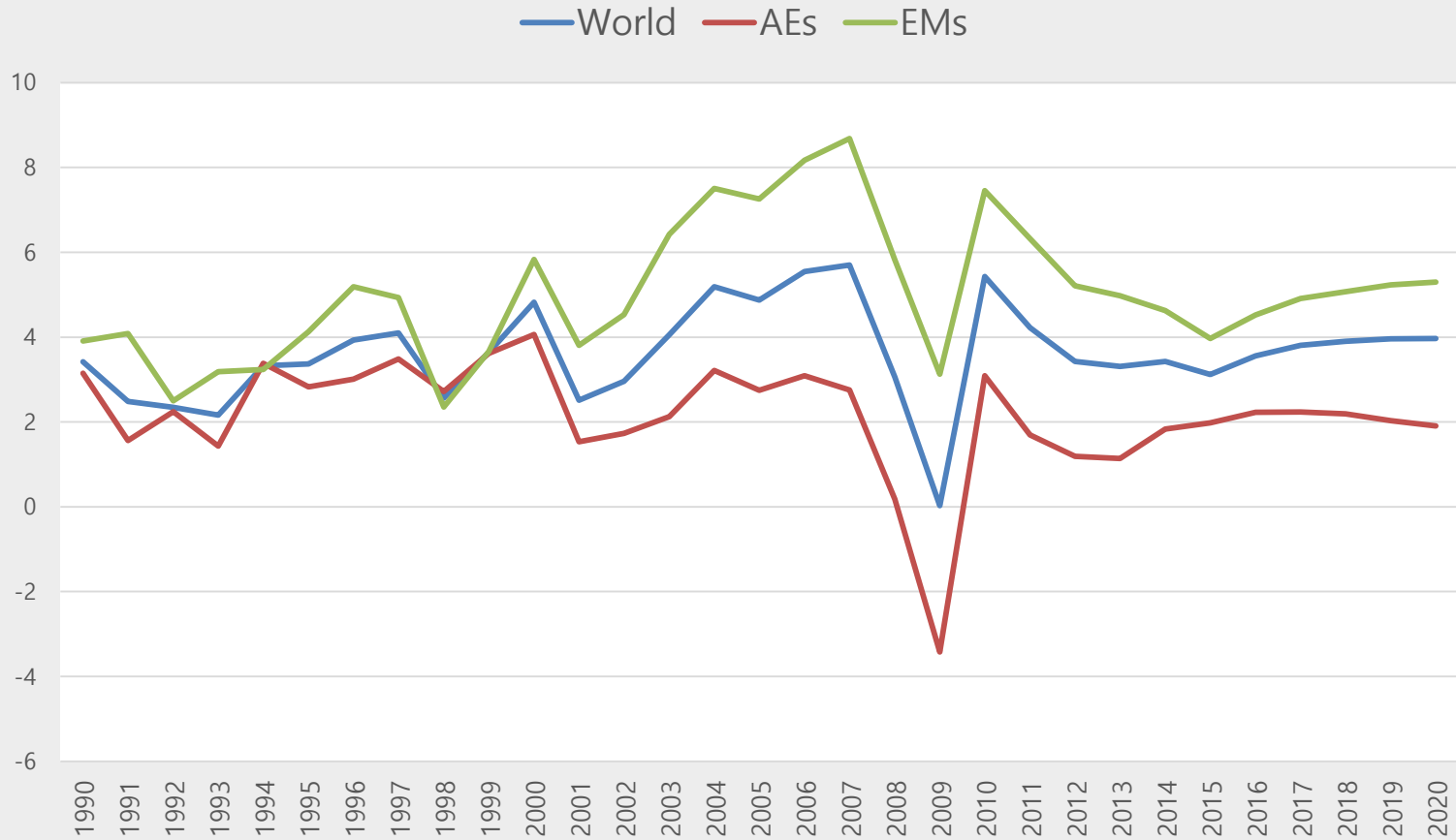
World Population Prospects, UN (2015)

Maybe China, too, in 15 years.



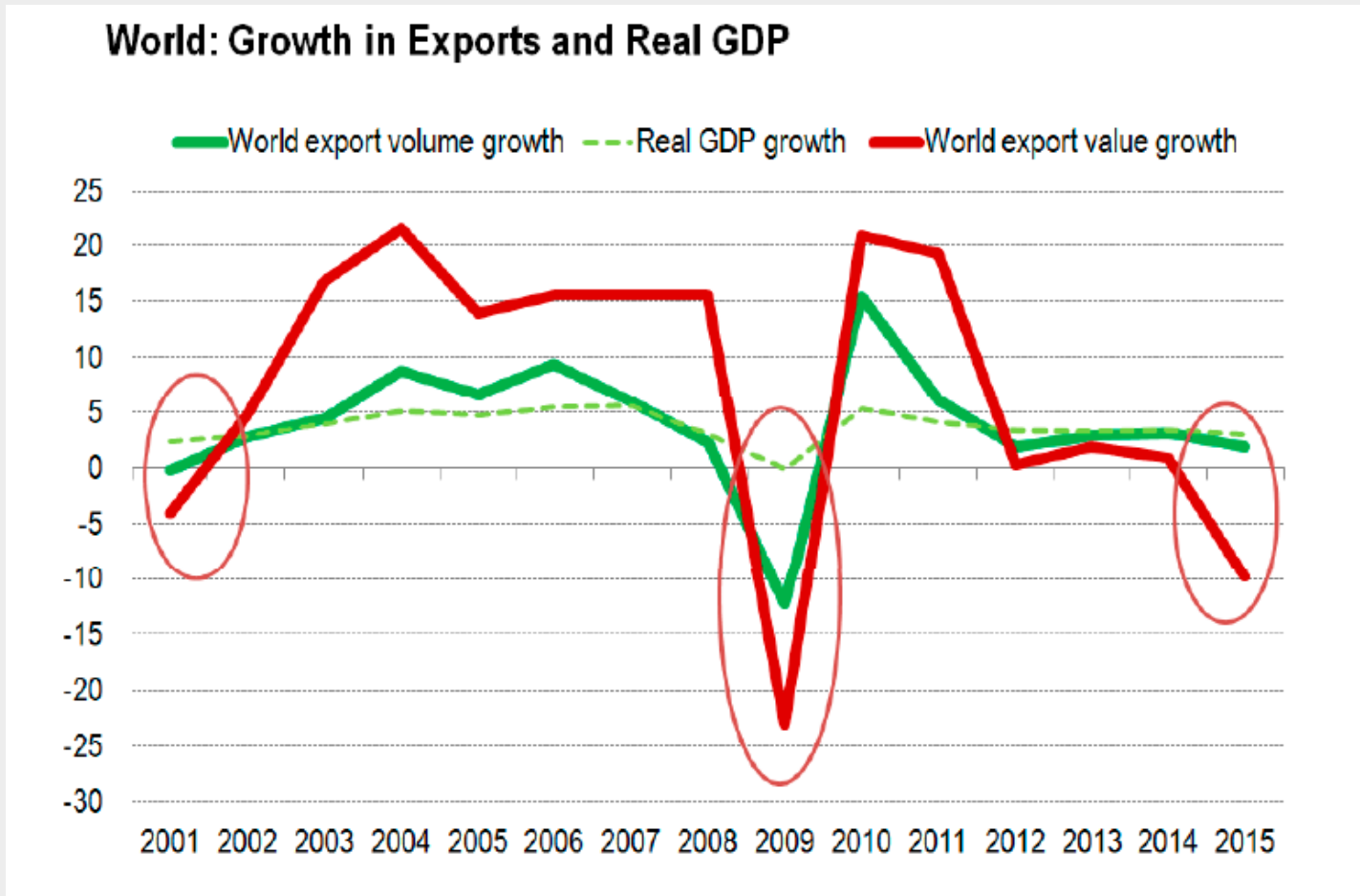
World Population Prospects, UN (2015)

There may be demand side reasons Weakening world growth



World Economic Outlook, IMF

Global trade is contracting more.

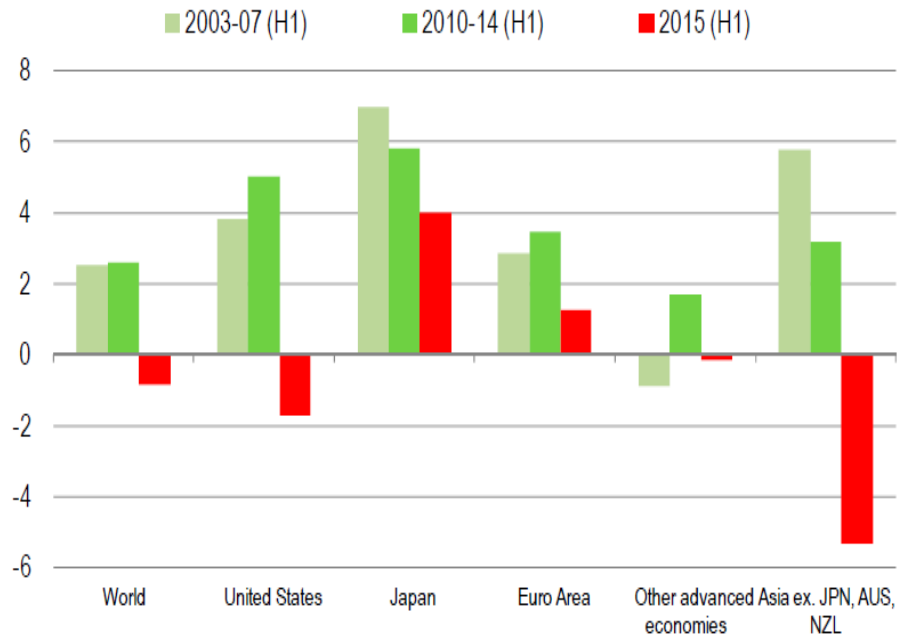


Hong(2015), IMF (2015)

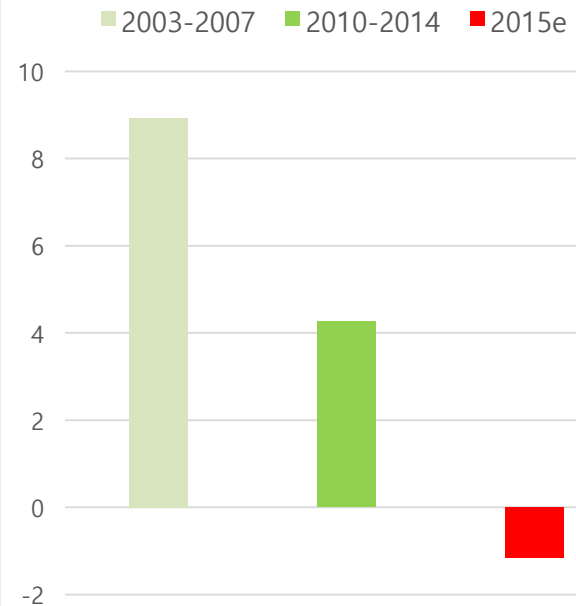
Asia is a major driver of global trade contraction.

Trade-Growth Wedge: Export Volume

(In percentage points; defined as growth in export volume minus real GDP growth)



Korea

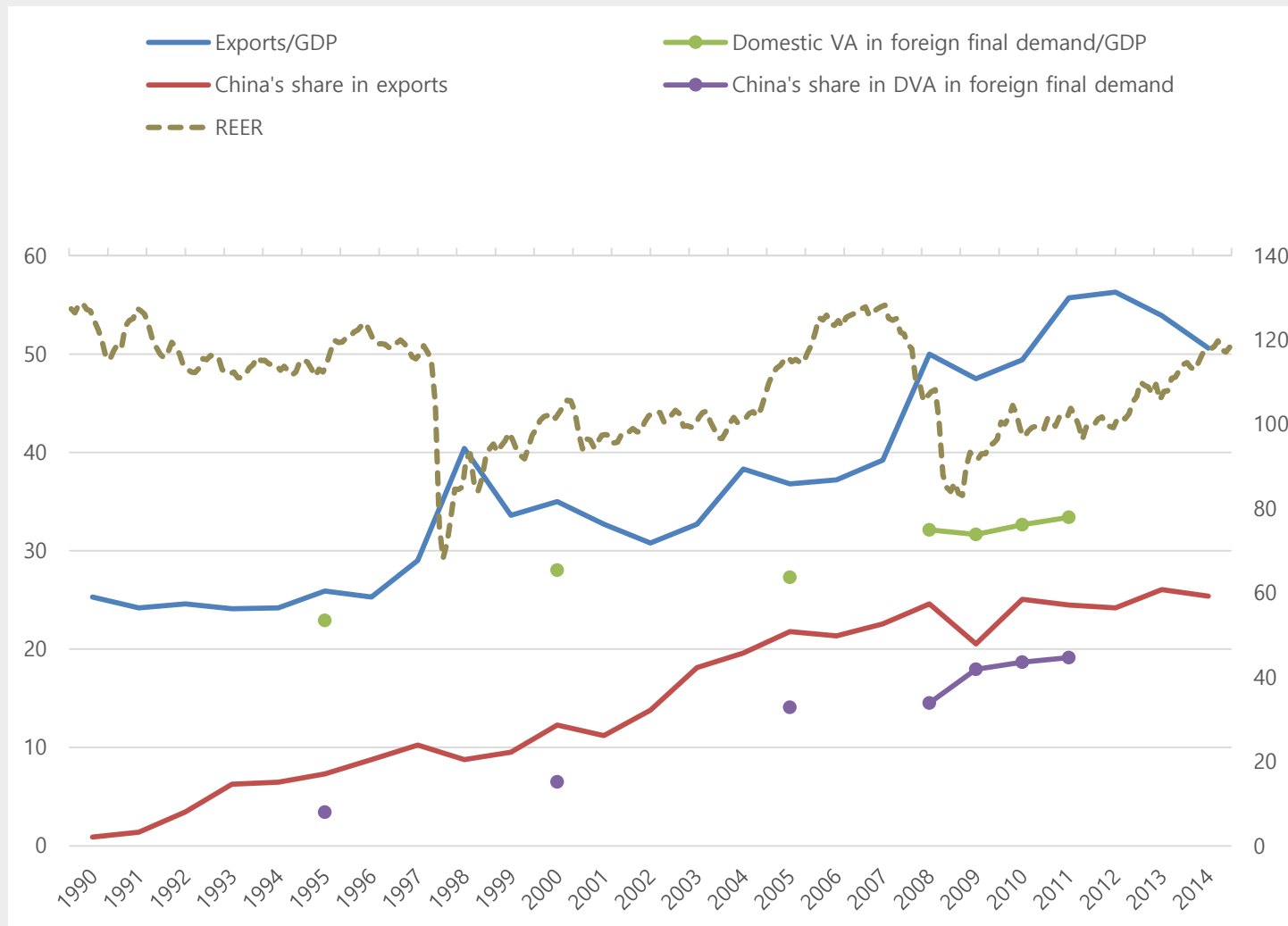


China is at the center of trade contraction.



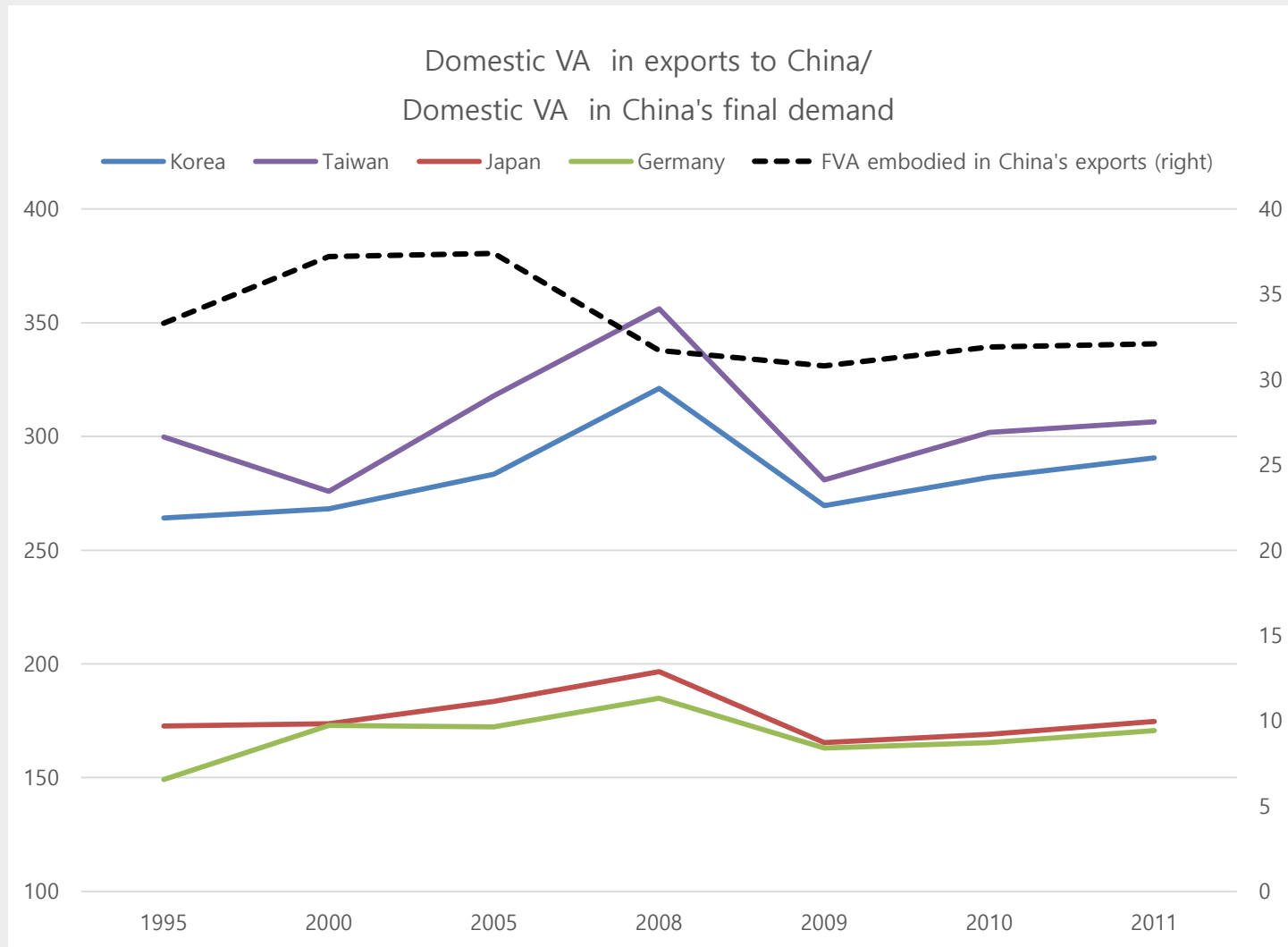
WEO, IMF

When Korea's dependence on exports and China is growing.



Bank of Korea, TiVA, BIS

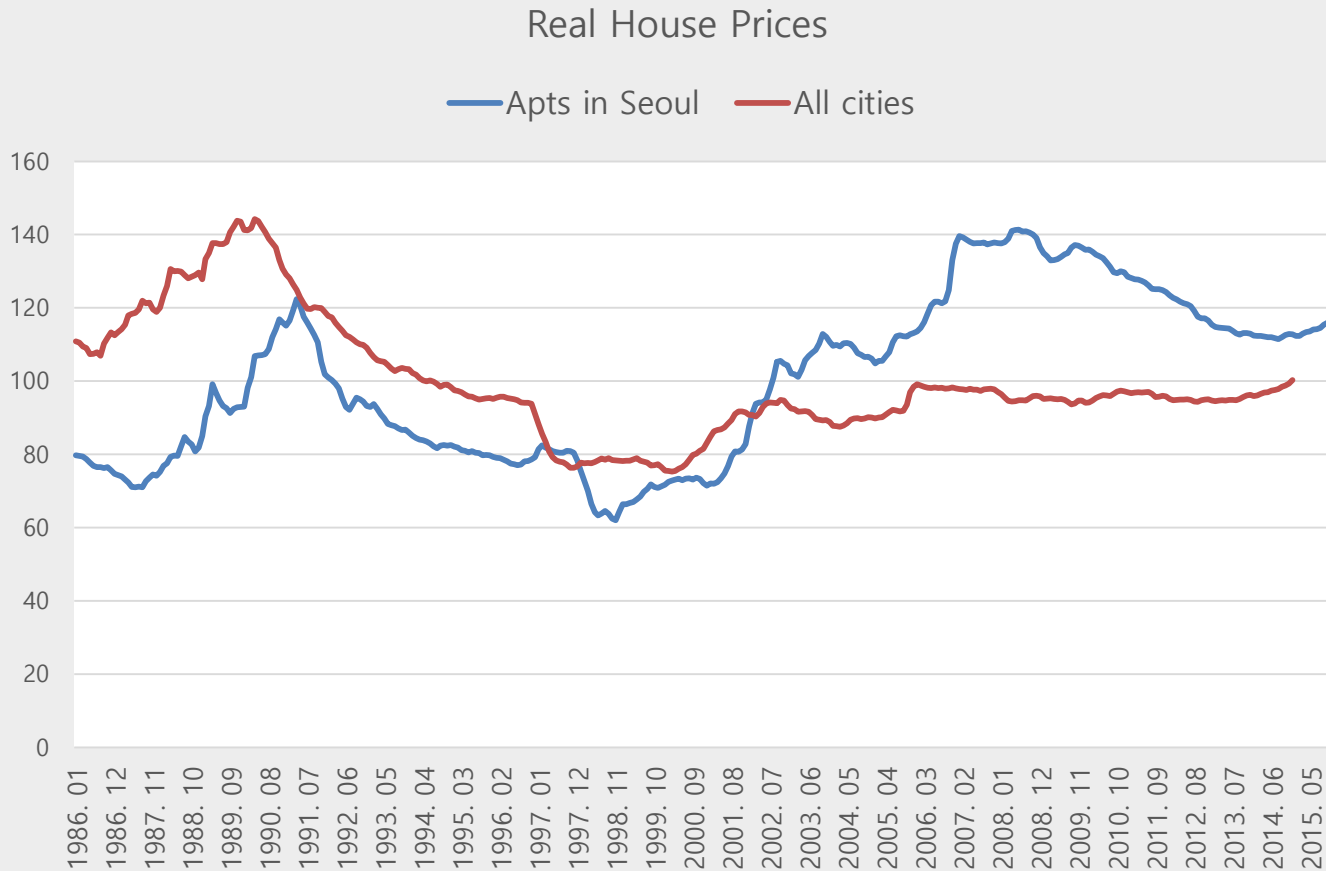
Unwinding Asian Value Chains?



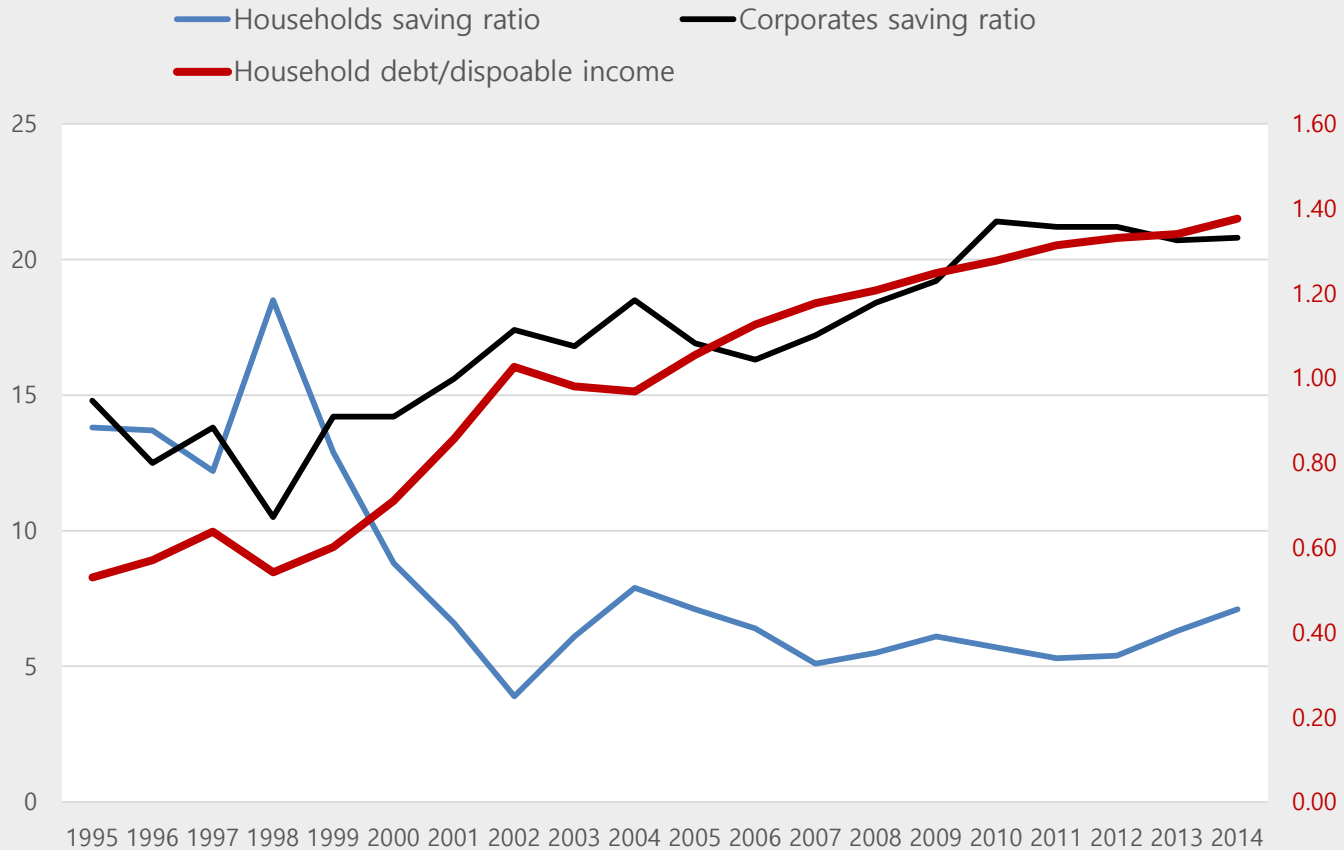
TiVA, OECD

Is there a housing bubble in Korea?

- Scale is not comparable to Japan and US.
- No bubble is visible in the index for all cities.
- Maybe some bubble in Seoul apartment prices.



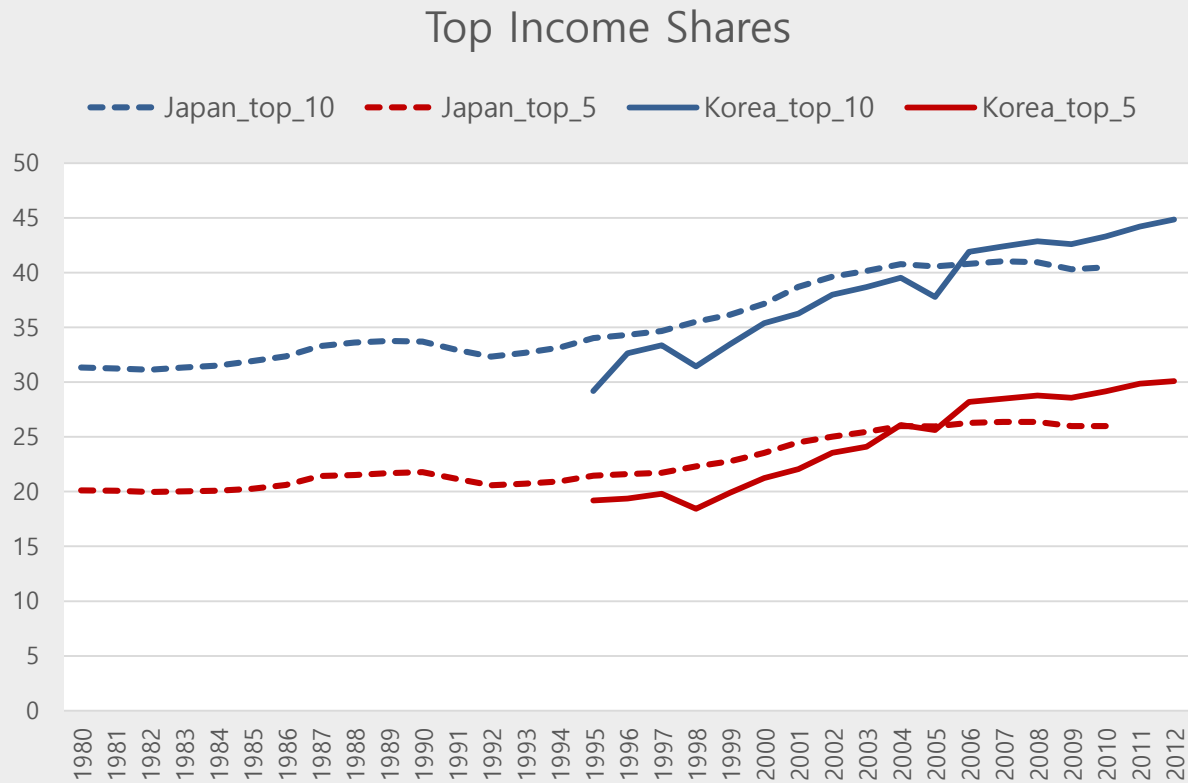
Indebted Korean households



Bank of Korea

Rising inequality

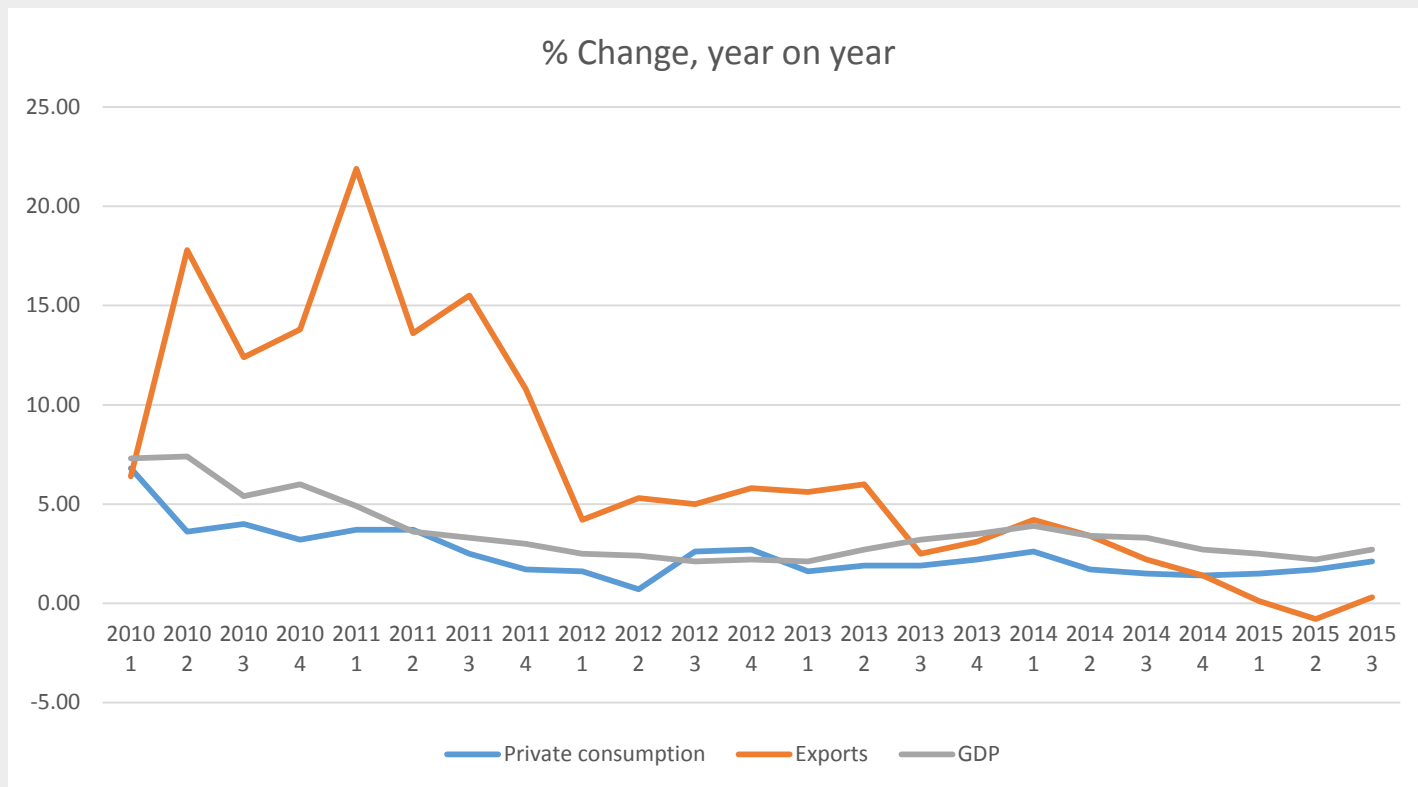
- Income inequality is rising across all fields.
(Gini, share of household income, share of labor income)
- Real wages are stagnant.



World Top Incomes Database

Weak consumption and export demand

- Consumption growth is stagnant.
- Export growth was making it up, but not any more.



Bank of Korea

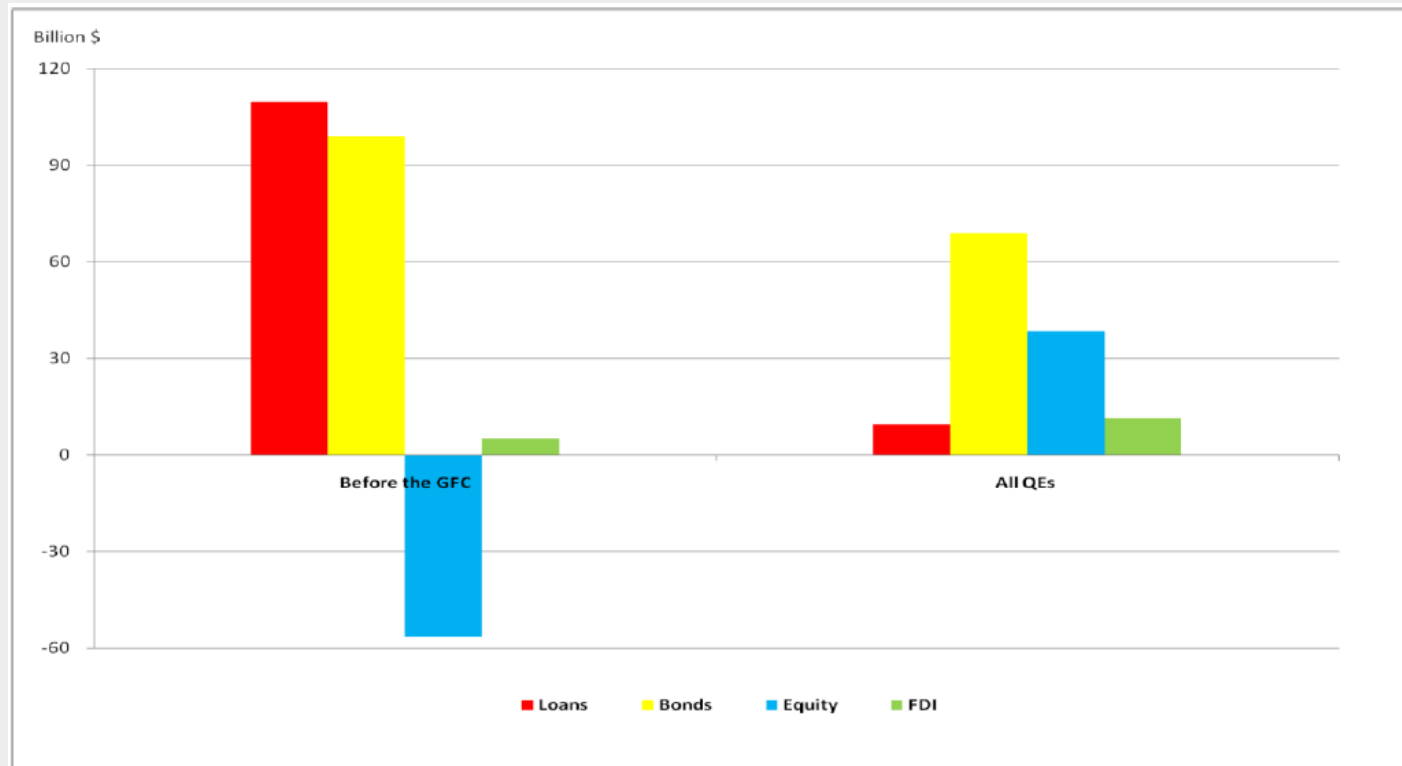
Capital inflows into developing countries during QEs were larger than those before GFC, but now....



Financial Times, IIF

But, not much into Korea.

Cumulative capital inflows into Korea
Pre-GFC period (Q1, 2006 - Q2, 2008) vs.
QE periods



Park, Ramayandi, and Shin (2014), IMF

Korea's external finance position is superb.

Year	Net Foreign Lending /GDP	Foreign Reserves/ GDP	Short term debt/ Foreign Reserves	Current Account/ GDP
2000	4.4	24.1	45.5	1.86
2001	7.6	21.8	34.3	0.51
2002	8.4	21.1	36.6	0.77
2003	13.0	20.3	30.8	1.75
2004	18.1	19.4	27.3	3.89
2005	17.2	18.0	31.8	1.41
2006	14.7	22.7	49.5	0.35
2007	6.7	30.2	63.3	1.05
2008	2.5	31.5	74.0	0.32
2009	7.8	38.2	55.1	3.72
2010	8.7	32.5	46.8	2.64
2011	8.2	33.3	45.6	1.55
2012	10.6	33.5	39.1	4.16
2013	14.2	32.4	32.3	6.22
2014	18.4	30.1	32.0	5.98

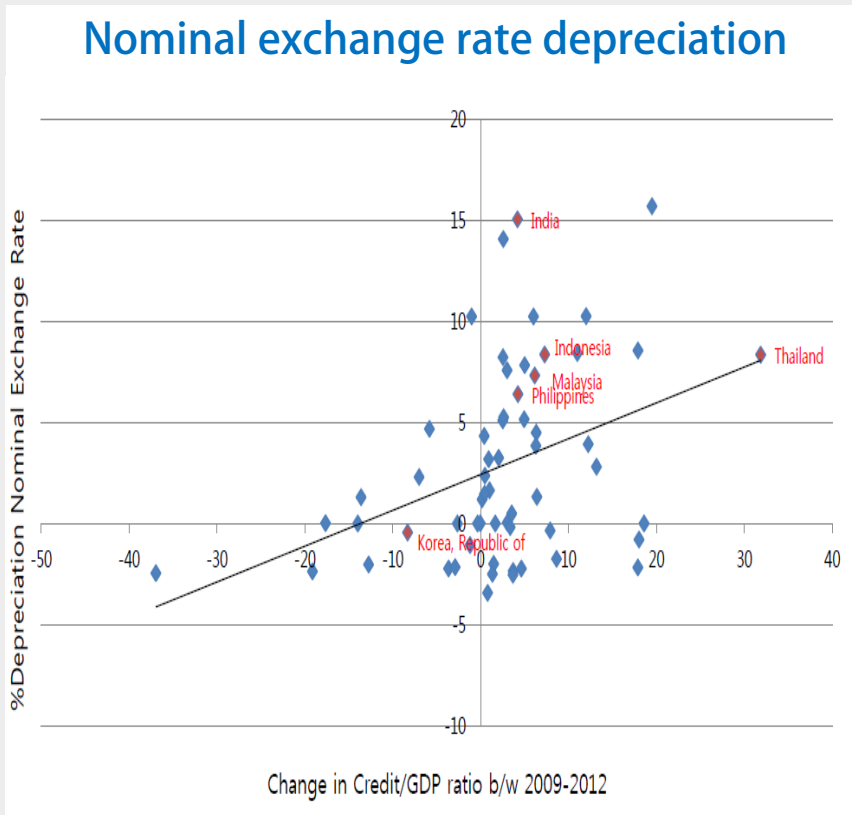
- Tighter regulation on banks' FX position
- Tighter regulation on banks' loans/deposit ratio
- Korea's credit rating is higher than Japan's

Bank of Korea

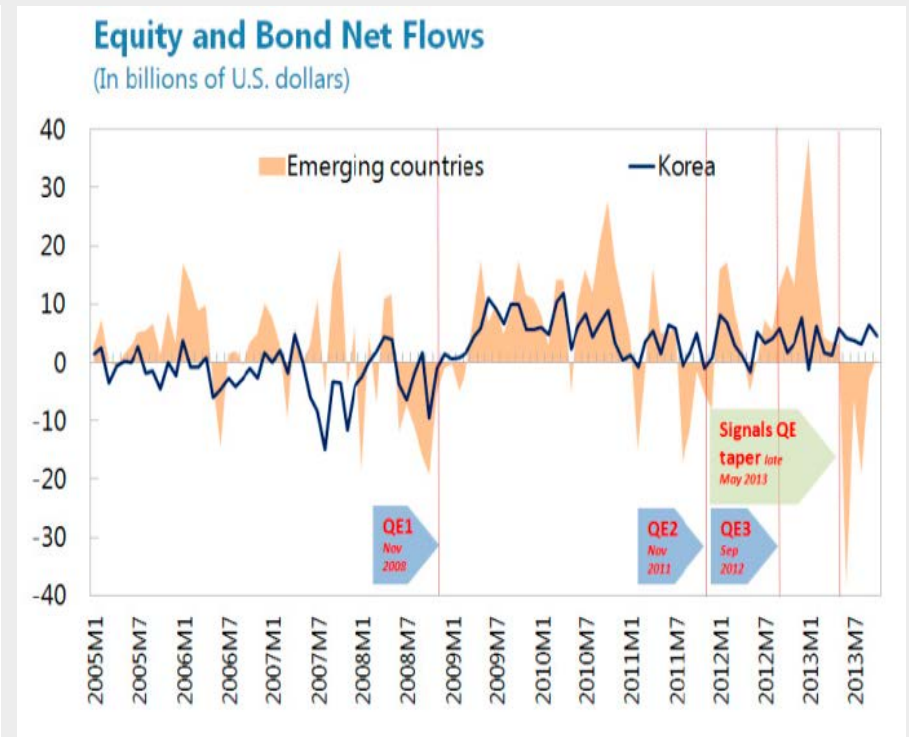
Korea emerged unscathed from the Taper Tantrum.

(April, 2013 – August, 2013)

Safe Haven Korea?



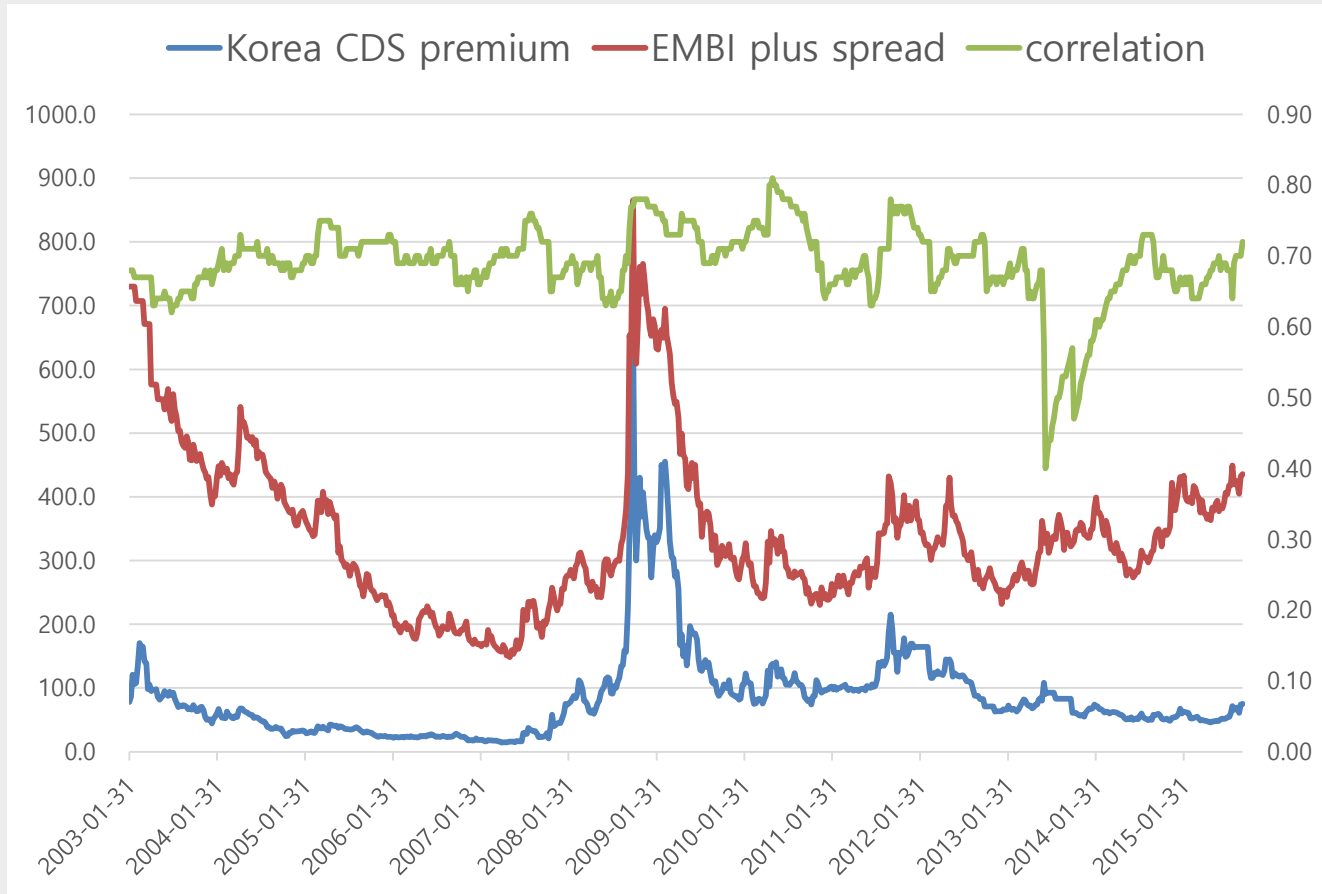
Park, Ramayandi, and Shin (2014)



Ree and Choi (2014)

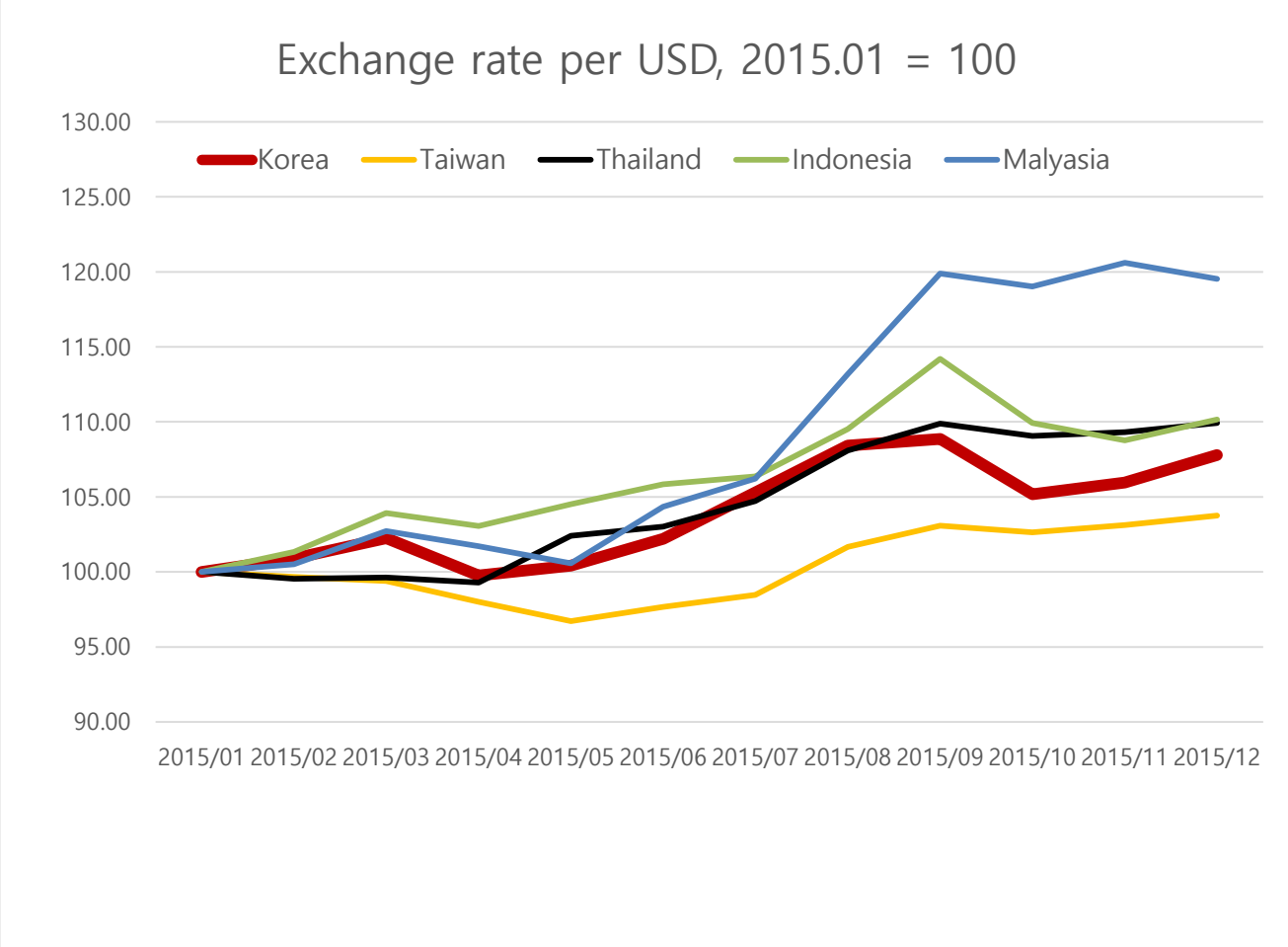
Decoupling from EMs vanishes after the 'China Tantrum'.

(July, 2015-September, 2015)



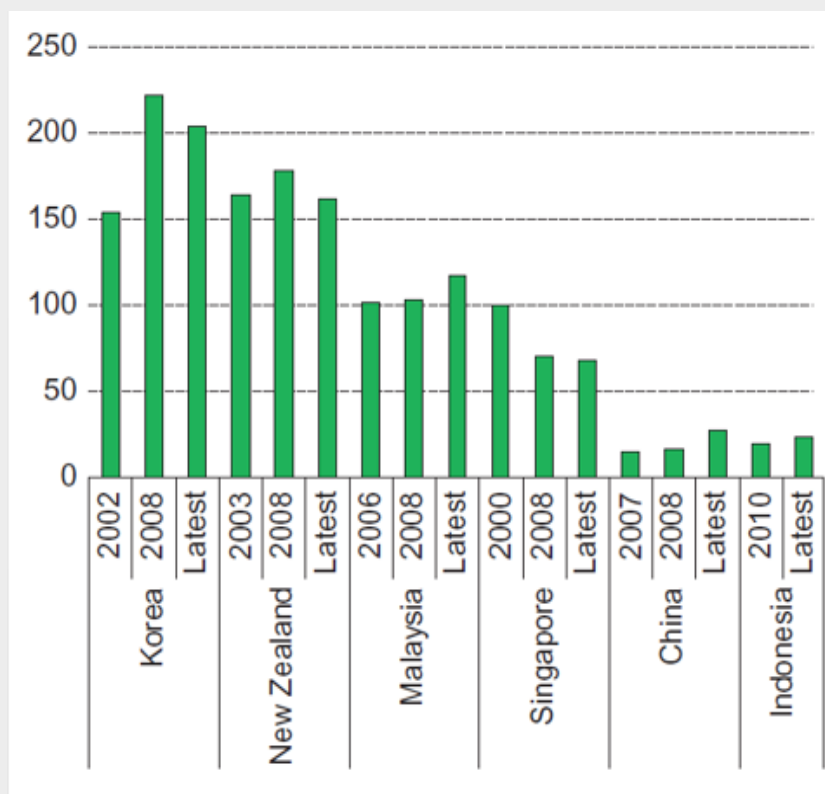
Bank of Korea, Bloomberg

No more safe haven?



Bank of Korea

Household debt is large, but unlikely to cause a major crisis.



- Debt is concentrated on rich households.
- Debt to Income and Loans to Value ratios are very low (60-70%).
- Consumption is vulnerable to an interest rate hike.
- Risky household debt can surge if an interest hike is combined with a large drop in house prices.

Regional Economic Outlook: Asia and Pacific,
IMF

Marginal firms in corporate sector are vulnerable to interest hikes.

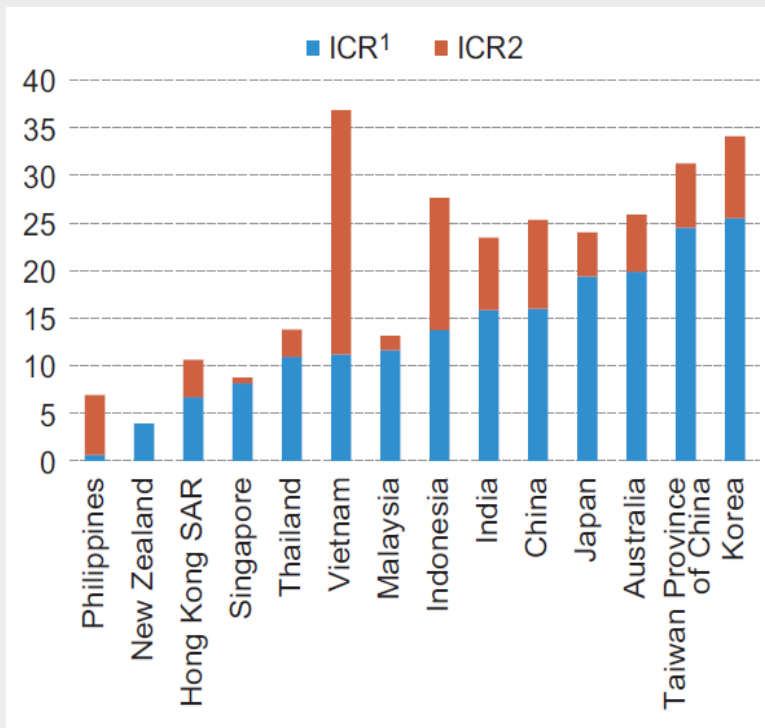
ICR = earnings before interests/
interest payments

ICR¹ = % of debt with ICR < 1 in 2012

ICR² = 2%p rise in interest rate

Risky if

ICR < 1 & Liquidity ratio < 1



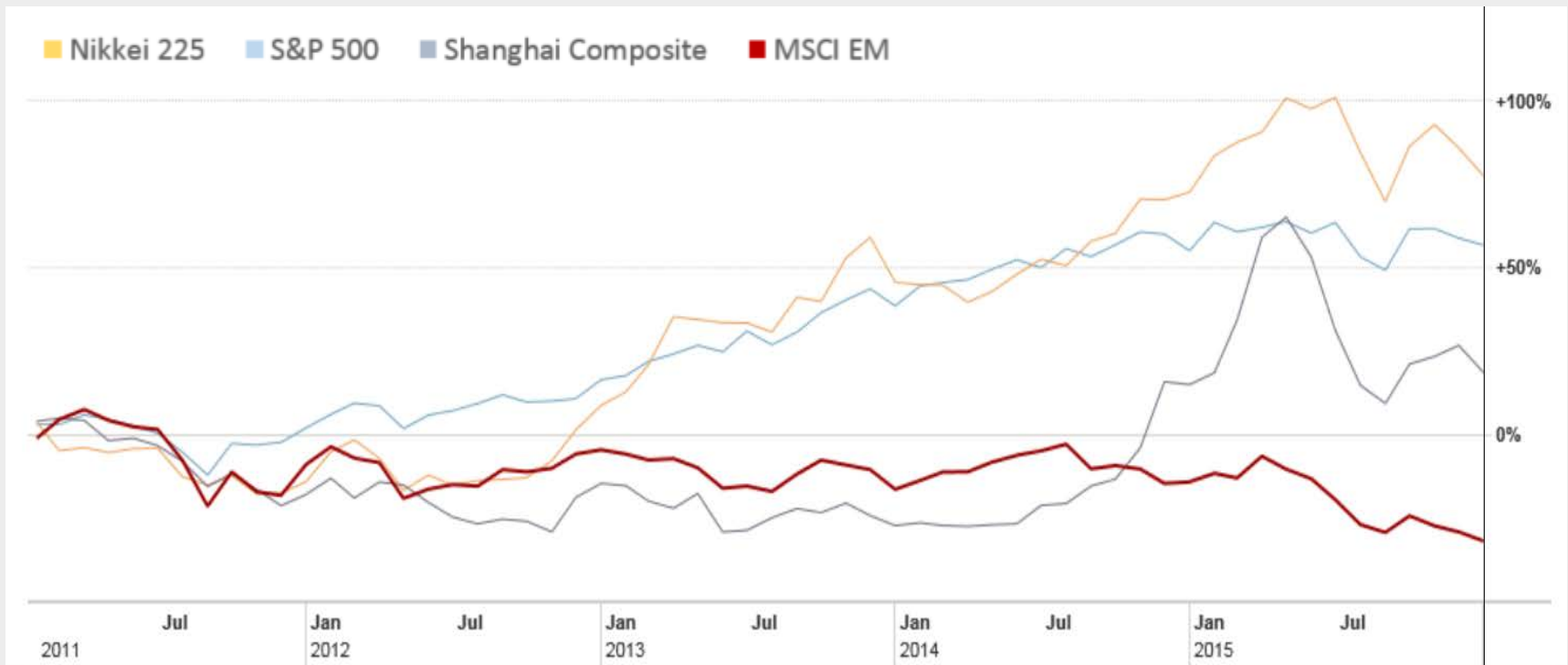
Regional Economic Outlook: Asia and Pacific,
IMF

	H1, 2015	Growth rate -1.5%p & Interest rate +1.5 %p
Industry	Risky corporate debt	Stress Test
Shipbuilding	93.7	93.7
Transportation	53.9	55.8
Machinery	38.5	69.2
Construction	25.3	28.9
Petrochemicals	8.5	24.7
Iron and Steel	11.7	24.2
Retail and Wholesale Trade	6.6	22.2
Electrical	5.4	15.5
Automobiles	4.1	25.1
All	24.1	32.5

Financial Stability Report, Bank of Korea

Asset prices in AEs might be pricked by EMs crises.

- US, Europe and now EMs (China)? – IMF and mainstream economists
- Global investors seem to be in exit psychology.
- They are overly sensitive to small turbulences.



Managing long and short run challenges

- Korea's long-run growth slowdown is unavoidable.
- Conservatives in Korea have been using concerns over Japanification as an excuse for boosting housing markets.
- The government eased regulations on housing loans in 2014 and succeeded in boosting house prices.
- It rekindled household debt growth, further diminishing BOK's room for interest rate maneuvering.
- The government should tighten housing loans, and accelerate the financial restructuring of marginal firms to reduce short-term risks.
- The government should accept long-run slowdowns more calmly, and try to boost TFP growth and strengthen social safety nets.

Thanks