Emerging Insight

Korea – Export-led cyclical recovery on the way

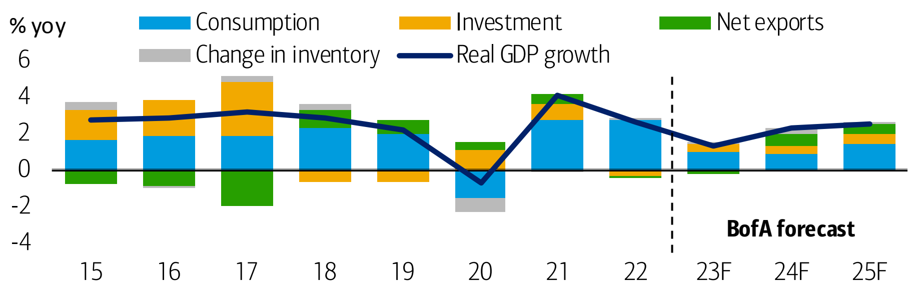
Key takeaways

- We expect Korea GDP growth to pick up to 2.3% in 2024, led by export cyclical recovery amid lower rates & tech cycle tailwind
- 2024 headline inflation likely to normalize, avg at 2.3% yoy. Expect BoK to ease from May, with three cuts to 2.75% by end-24
- We saw a healthy recovery with higher growth, lower inflation & lower rates in 2024-25. Risks largely balanced on either side

By Benson Wu and Ting Him Ho

Exhibit 1: Real GDP forecast by expenditure

We expect Korea to grow 2.3% in 2024, with higher growth contribution from net exports



Source: Haver, BofA Global Research estimates

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Korea in Focus

We expect a higher growth, lower inflation, and lower rates likely for Korea in 2024-25. This year, Korea faced tough headwinds on economic growth, in which we expect only a growth of 1.4% yoy, notably below the trend growth. However, with the help of exports turnaround and spill over to domestic sectors, we expect its GDP to accelerate to 2.3%/2.5% in 2024/25. Headline CPI inflation is also likely to moderate to 2.3% yoy in 2024, after an above-target 3.6% in 2023, as the core inflation has been moderating continuously.

Monetary policy is likely to be more accommodative as unfavorable domestic and external factors recede. We expect three cuts by the BoK from May 2024 the earliest, with 25bp in each following quarter in 2024, and one more cut in 1Q25 with a terminal rate of 2.5%. Overall, risks are largely balanced on both our growth and inflation outlook.

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Korea Year Ahead 2024

Growth: Export-led cyclical recovery on the way

Korea faced tough headwinds on economic growth in 2023, in which we expect only a growth of 1.4% yoy, notably below the trend growth. The major drag came from the external sector, as exports contracted significantly in 1H23 from the weak China demand amid a downturn in the tech cycle. Meanwhile, the domestic economy faced sustained pressure from the high-rate environment.

In 2024, we expect growth to accelerate to 2.3%, led by export recovery. In Oct, we finally saw a turnaround in export growth, the first time in 13 months, and this recovery is likely sustain, in our view. Given the significance of the export sector in Korea, as well as its spillover effect to the domestic economy, we see a heathy and balanced recovery on the way. We expect net exports to see a notable pick-up next year amid better semi demand and manufacturing cycle despite the slower global growth (see also: Korea viewpoint).

In addition, this recovery in the export sector may also deliver a positive spillover effect to both consumption and investment. In particular, the improvement in consumer sentiment during the export cycle upturn may offset the downward pressure on household balance sheet amid the high rates environment. Also, we think the external demand-led facility investment recovery may kick in from 2H24 to hedge with the moderating construction activities.

Overall, despite the headwinds, we see a stabilized and robust sequential economic growth path in 2024, and foresee a more balanced growth contribution from private consumption, facility investment as well as net exports in 2024 (Exhibit 2).

Exhibit 2: Major economic indicators for Korea
We expect Korea GDP to rebound to 2.3%/2.5% in 2024/25

		2019	2020	2021	2022	2023F	2024F	2025F
GDP by expenditure								
Real GDP growth	% yoy	2.2	-0.7	4.3	2.6	1.4	2.3	2.5
Final consumption expenditure	% yoy	3.2	-2.2	4.1	4.1	1.6	1.4	2.3
Gross capital formation	% yoy	-2.1	3.5	3.2	-0.5	1.5	1.5	1.8
Contribution to GDP growth								
Net exports	pp	0.8	0.4	0.6	-0.1	-0.2	0.6	0.5
Major activity indicators								
Household consumption	% yoy	2.1	-4.8	3.6	4.1	1.8	1.7	2.5
Construction investment	% yoy	-1.7	1.5	-1.6	-2.8	2.7	1.5	-1.3
Facility investment	% yoy	-6.6	7.2	9.3	-0.9	-0.8	1.4	5.8
Intangibles investment	% yoy	3.1	3.4	6.1	5.0	1.7	1.5	2.8
Exports of goods	% yoy	-1.1	-0.2	10.7	3.6	2.5	5.9	5.9
Import of goods	% yoy	-2.5	0.3	12.6	4.3	-0.4	2.9	5.3
Trade balance	US$bn	79.8	80.6	75.7	15.1	30.5	64.3	71.6
Current account	% of GDP	3.6	4.6	4.7	1.8	1.7	2.0	1.9
Key price and policy indicators								
CPI	% yoy avg	0.4	0.5	2.5	5.1	3.6	2.3	2.0
BoK base rate	% year-end	1.25	0.50	1.00	3.25	3.50	2.75	2.50
USDKRW	year-end	1,158	1,088	1,186	1,267	1,300	1,230	1,240

Source: Haver, BofA Global Research estimates

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Inflation: Expect core CPI reaching the target by mid-2024

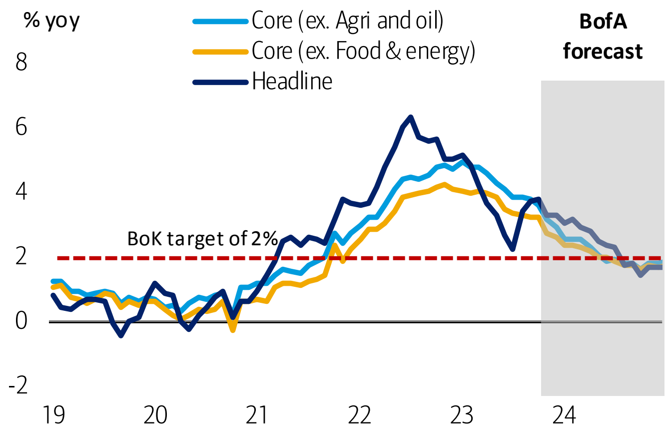
Despite the recent upside surprises, we remain confident that the inflationary pressure will ease going forward, as the core inflation has been moderating continuously. Specifically, private services inflation, the stickiest part, was softening sequentially from its peak level in most of the months lately.

In terms of energy and utility prices, admittedly, the outlook remains much dependent on geopolitical developments, especially the recent incident in the Middle East. Our base-case base scenario sees no significant escalation of the conflicts, hence we expect Brent crude oil prices to moderate in 2024 (with a higher start in 1Q24 but US$86/bbl by

4Q24). For utility prices, we do expect price hikes next year after the inflation pressure eases. That said, the room for further hikes may be limited, in our view.

In all, we remain confident that the inflation is under control, and expect the disinflation trend to continue in both headline and core inflation next year (Exhibit 3). We forecast CPI inflation to moderate to 2.3% yoy in 2024, with further stabilization in the price level to 2.0% in 2025. On a quarterly basis, we expect the core inflation to reach around 2% level in 2Q24 and the headline to come in below 2% by 3Q24.

Exhibit 3: Monthly CPI inflation forecast
We expect average headline CPI inflation to moderate to 2.3% yoy in 2024



Source: Haver, BofA Global Research estimates

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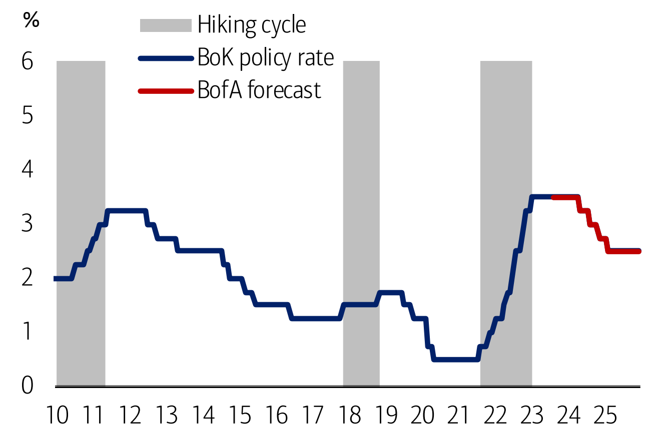
Exhibit 4: Policy rate forecast
We expect rate cut since 2Q24 and reach terminal level of 2.5% in 1Q25



Source: Haver, BofA Global Research estimates

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Policy: Combination of fiscal prudence & monetary easing

After a long hold of the benchmark rate, we see BoK to ease next year. In particular, we expect three cuts in 2024, with 25bps in each quarter, starting from May the earliest (Exhibit 4). In our view, three preconditions may be needed for the BoK to deliver its first cut: **1)** domestic inflation pressure easing to be on track towards the policy target (of 2%); **2)** the Fed should have been done with hiking and should have paused for multiple months, with little financial market volatilities; and **3)** domestic household leverage ratio to have stabilized with no significant risk of acceleration. We also pencilled in one more cut for 2025, with the terminal rate at 2.5%, slightly higher than the estimated neutral rate (of 2-2.5%). Overall, we see a relative favourable monetary condition next year, especially in 2H24.

For fiscal policy, after a challenging year for fiscal management in 2023, we expect the current administration's fiscal policy to remain relatively conservative, as outlined in the 2024 Budget. Especially, the fiscal spending is set to rise only by 2.8% yoy in the next year—the lowest increase since 2005. Meanwhile, the administration also announced a more conservative KTB issuance plan, which reaffirms its commitment to rein in debt growth after a massive rise during the pandemic. As such, we do not envisage any supplementary budgets without an expected crisis-like event. That said, the fiscal deficit target has been set at 3.9% of the GDP, still relatively higher than the pre-pandemic level, and there could be pressure on more transient spending before the parliamentary elections in April 2024, in our view.

Exhibit 5: MPC meeting and release schedules in 2024
Policy meetings held in first two months of the quarter; minutes released after three weeks

	Monetary policy meeting	Monetary policy minutes	Submission of reports to Parliament
Jan	Thursday, 11 Jan	Tuesday, 30 Jan	
Feb	Thursday, 22 Feb	Tuesday, 12 Mar	Monetary Policy Report

Exhibit 5: MPC meeting and release schedules in 2024

Policy meetings held in first two months of the quarter; minutes released after three weeks

	Monetary policy meeting	Monetary policy minutes	Submission of reports to Parliament
Mar			
Apr	Friday, 12 Apr	Tuesday, 30 Apr	
May	Thursday, 23 May	Tuesday, 11 Jun	
Jun			Monetary Policy Report, Financial Stability Report
Jul	Thursday, 11 Jul	Tuesday, 30 Jul	
Aug	Thursday, 22 Aug	Tuesday, 10 Sep	Monetary Policy Report
Sep			
Oct	Friday, 11 Oct	Tuesday, 29 Oct	
Nov	Thursday, 28 Nov	Tuesday, 17 Dec	
Dec			Monetary Policy Report, Financial Stability Report

Source: Bank of Korea, Bloomberg

Note: quarterly macro forecasts are due Feb, May, Aug and Nov 2024

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Risks: Largely balanced on the either side

The risks are largely balanced on both our growth and inflation outlook. On the bright side: **1)** a more proactive China policy supports should likely boost external demand for Korea exporters; **2)** in the case of stronger-than-expected recovery in global semi and tech demand, external sector in Korea will likely provide an additional boost to the domestic economy. On the other hand: **1)** any upside surprise to keep the Fed stay higher for longer could hurt consumer and capex demand in the US, paring the current recovery in the manufacturing cycle; and **2)** the alternative scenario where commodity prices go higher, the BoK could face pressure to hold rates for a longer period to stabilize the non-core inflation.

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