SOUTH KOREA'S ECONOMY IN 2017: MODERATE ECONOMIC EXPANSION DESPITE GROWING GEOPOLITICAL TENSIONS

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Executive Summary

1. Despite growing tensions in the Korean Peninsula in 2017, South Korea has posed the highest annual economic growth rate in the third quarter of the year since 2012. The Bank of Korea has therefore revised the country's growth forecast for 2017 upwards to 3%, from the average rate of 2.8% during the 2012-2016 period.

2. Unemployment rate remained relatively low at 3.2% in October 2017 with total employed up by 278,000, compared to a year ago. However, the unemployment rate for youth aged 20 and 29 stood at a high of 9.4%.

3. Economic growth is mainly attributed to the export expansion, led by Samsung and SK Hynix in the semiconductor industry. The electronic integrated circuit (a semiconductor wafer), which accounted for 14.5% of Korea's exports, registered the highest export growth rate in 2017 (Jan-Oct) among Korea's top export items.

4. China has remained as South Korea's most important trade partner, constituting 24% of Korea's exports and 20% of its imports in 2017 (Jan-Oct). Despite China's trade sanctions against certain Korean products over Terminal High Altitude Area Defence's (THAAD) deployment, Korea's exports to China registered decent growth (13.4%) in 2017 (Jan-Oct) compared to a year ago.

5. Although Korea's overall trade with China has remained stable, certain Korean firms in cultural and retailing sectors (Lotte) and car makers (Hyundai motors) had reported significant declining business sales in China. The number of Chinese tourists to Korea also dropped by 50% in 2017 (Jan-Sep).

6. The two countries have attempted to mend their ties after one year of strained relations. Nonetheless, the approaches towards the North Korean issue remain different. This may again result in Chinese economic retaliation. The Hyundai Research Institute estimates the cost of China's economic sanction will be US$76 billion, resulting in a 0.5% drop in Korea's gross domestic product.

7. In September 2017, South Korea agreed to renegotiate the South Korea-US free trade agreement in the fear that President Trump may pull out of the whole deal. The intention to reduce South Korea's trade barriers in automobile, steel and agricultural sectors poses another challenge to Korea's economic prospect.

8. To stimulate domestic consumption and reduce income inequality, the Moon Jae-in administration plans to increase Korea's hourly minimum wage, from the current 6,470 won (US$5.80) to 10,000 won (US$9.2) by 2020. A subsidy of 130,000 won (US$119.1) per worker per month would be offered to small businesses to alleviate their financial burden from the rising labour cost.

9. The Moon government is also set to increase government expenditure by 7.1% in 2018 for a wide range of social welfare programmes and create jobs in both public and private sectors. To finance rising social welfare expenditure, the government will target leading conglomerates and high-income individuals by raising corporate and individual income tax to 25% and 40% respectively from 2018.

10. The improving global economy, growing wages and extra government spending are positive factors for the country's economic growth prospect whereas its growing household debt is a downside risk. The uncertain relations with China and US protectionism are great challenges to the polarised economy dominated by chaebols.