

## Korea: May Industrial production rose firmly but the business survey suggests a gloomier outlook

The all-industry industrial production (IP) outcome (0.8% MoM) for May showed activity in services and investment gaining strongly, indicating that growth momentum continues despite heightened external uncertainties. However, the weaker-than-expected business survey puts some downside risk to the growth outlook for the next quarter



Source: istock

**0.1%** Industrial Production  
(% MoM, sa)

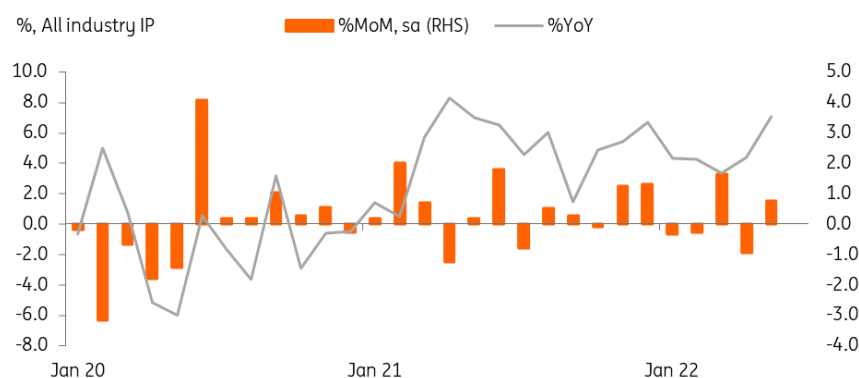
Lower than expected

### Manufacturing rises only 0.1% MoM in May (vs -3.3% in April)

Manufacturing production rose only marginally in May (0.1%MoM), but machinery and automobile

production, which have been contracting in recent months, rebounded by 6.2% and 1.8% respectively. Electronic components production fell sharply (-13.8%) and we think that supply chain disruption caused by China's lockdown could be a factor in this sharp drop. However, the production of specialist machinery, such as wafer-makers and semiconductor production equipment, showed solid growth, so the weak production of electronic components should reverse in the coming months.

## All industry IP rebounded firmly in May, driven by the reopening of both the onshore and offshore economies



Source: CEIC

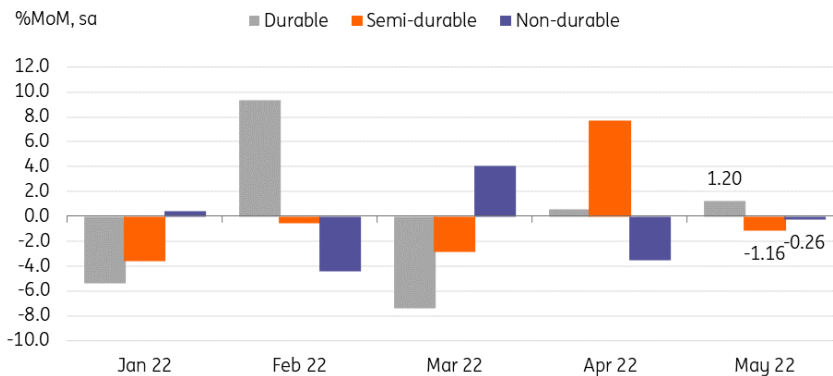
## Service output rose 1.1% in May (third consecutive monthly rise)

Service sector activity continued to improve in May, mainly due to the lifting of almost all covid-related restrictions since March. Monthly gains in services were more broadly based in May compared to previous months. Leisure-related services, such as lodging, restaurants, and travel showed particularly strong outcomes, while wholesale and retail sales, professional services and education turned around from the last month's declines.

## But weak retail sales continued with a -0.1% drop in May

Despite the reopening and improvements in industrial activity, retail sales contracted for a third consecutive month. We believe that reopening has boosted the service side of consumption more than the goods side. The decline in retail sales was mainly led by non-durable goods sales such as pharmaceuticals, where consumption dropped as the number of covid patients reduced. However, more important durable goods consumption gained for a second month with vehicle sales up 2.1% in May (after a gain of 4.7% in April). Thus, underlying consumption conditions appear to be improving. To help this along, the government has started offering various types of shopping vouchers and extended consumption tax cuts to help offset some of the negative impacts of rising prices.

## Durable goods consumption was solid in May



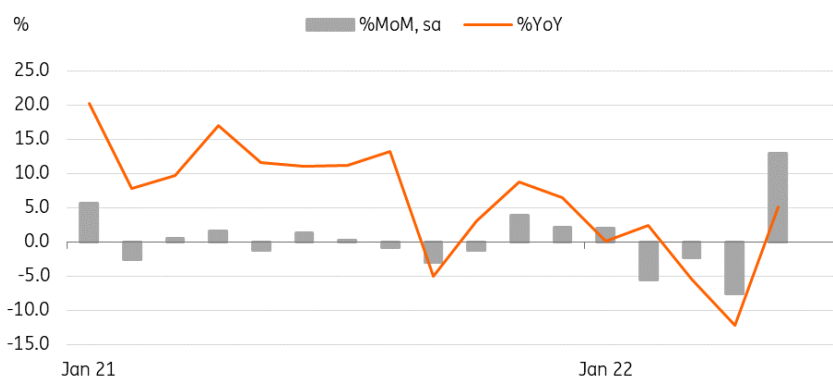
Source: CEIC

## Strong gain in investment is the highlight of today's outcome

Investment has been very fragile and one of the most worrisome elements of the economy. Facility investment has been particularly weak, contracting in the prior three months. However, facility investment in May expanded firmly (13.0%). Equipment investment for chip manufacturing rose 11.9%, and the volatile transport equipment sector (such as aircraft), increased 16.4%. However, it is not clear that strong investment will continue because forward-looking machinery orders and today's business survey results were both quite weak. Domestic machinery orders declined 10.0% YoY as an increase in government orders (9.6%) was offset by a decline in private orders (-11.2%). Additionally, today's business survey data suggested a rather pessimistic view of future investment.

Separately, construction completions rebounded. And construction orders continued to rise, lifted by the government's pledge to supply more residential units and soften some construction rules.

## Investment rebounded for the first time in four months



Source: CEIC

## Business sentiment index fell sharply in July, cloudy outlook for near term growth

Local business surveys by the Bank of Korea and the Federation of Korean Industries (FKI) showed

that businesses appear to be getting more concerned about the weakening of household purchasing power and rising input costs.

The BoK's manufacturing outlook index declined 3pts to 82, and the non-manufacturing index declined 5pts to 80. In another local survey by the FKI, the all-industry outlooks slid to 94.4 (vs 98.1) in May, staying below its neutral level of 100 for the last three months. What both surveys have in common is that domestic demand is expected to weaken in the near future, raising the prospect that the pent-up consumption recovery may slow down much faster than expected.

## We expect quarterly growth to bottom out this quarter, but the rebound next quarter may be smaller than expected

With yesterday's weak consumer survey results, we now have evidence that both households and businesses are becoming gloomier about the outlook, posing downside risks to our 3Q GDP (0.7% QoQ) forecast. However, high-frequency real activity data such as google mobility and credit card transactions do not show a sharp decline yet. Thus, we think that the reopening and government stimulus packages are going to boost domestic demand in the third quarter. Today's data releases appear to support the BoK adopting a "big step" hike in July with relatively solid growth in the current quarter. The Bank of Korea will therefore continue to prioritize suppressing inflation but will be also concerned about the impact of rapid hikes on the Korean economy for the rest of the year.

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