South Korea's labour market weakens, supporting central bank's dovish stance

South Korea's labour market weakened in December. Although seasonal fluctuations in government jobs exaggerated the increase in the unemployment rate, private employment softened overall. The Bank of Korea is expected to stand pat tomorrow, but keep its dovish stance due to sluggish domestic demand. The KRW may weaken a bit further in the very near term

4.0%

The unemployment rate

Labour participation rate 65.0%

Higher than expected

The unemployment rate jumped to 4.0% in December

South Korea's unemployment rate increased more than anticipated in December to 4% from 2.7%

in November (ING forecast: 3.0%, market consensus: 2.7%). In addition to the typical year-end seasonal rise attributed to a public job programme, private-sector hiring fell short of expectations.

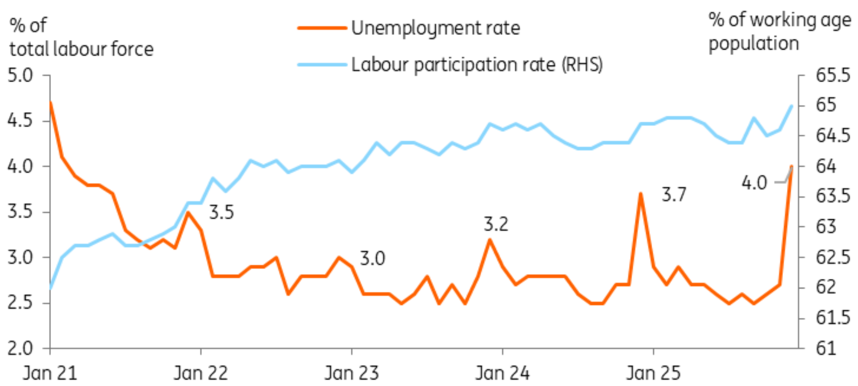
Unemployment usually increases at the end of the year because most government job programmes last fewer than 11 months. The issue lies less in the high unemployment rate itself than in the fact that Korea's labour market relies heavily on government support and private sector hiring remains sluggish.

Jobless rates increased in all age groups over 20, with the sharpest rises among those aged 60+ (from 2.5% to 3.6%) and 20-29 (from 6.0% to 6.8%) between November and December. Government job programmes are usually targeted at these two age groups.

By industry, as expected, employment in the health and social work sector saw the largest decline, with a loss of 185k jobs. Although recent survey results have improved, manufacturing hiring remained sluggish, falling for the second consecutive month. On a positive note, the construction sector added 26k jobs for the first time in three months. Monthly job numbers in construction are expected to fluctuate, but after two years of significant decline, the overall trend appears to be stabilising.

Service sector employment remained subdued. While wholesale and retail sales jobs gained, other key service areas -- including hospitality, Information/Communications/Technology, and financial services -- experienced declines.

Seasonal spikes in unemployment rate due to public work programmes



Source: CEIC

BoK preview

We anticipate that the unemployment rate will decline in January and February following the resumption of the public job programme. Additionally, recent survey data indicates a potential recovery in the manufacturing and construction sectors. Nevertheless, weakness in private sector hiring may influence the Bank of Korea’s policy decisions in the coming months. We expect the BoK to maintain the current policy rate for an extended period while selectively providing liquidity to sectors requiring support through its bank lending facility programme. A dissenting vote against the hold decision is possible tomorrow since recent data indicates a distinct K-shaped recovery. As a result, looser monetary conditions may be necessary to bolster the weak segments of the domestic economy. However, most BoK board members likely prefer to maintain a cautious stance given recent KRW and housing market trends.

The USDKRW may peak at 1,500 level in near term

We expect USDKRW to fall below 1450 by mid-year, though it may approach 1,500 in the near term. Currently, FX market movements are primarily driven by flows rather than fundamentals or valuations.

We saw a temporary dip in the last week of December for two main reasons: authorities' smoothing operations and year-end clearing of foreign equity investments for tax advantages.

The year-end closing price is critical as it serves as the benchmark for preparing next year's financial statements for companies and financial institutions. A high year-end FX rate increases the won-denominated value of foreign-currency debt, thereby raising financial companies' debt ratios. This could raise the risk of future credit rating downgrades. Thus, the FX authorities had to manage the exchange rate more actively at year-end. The USDKRW is expected to remain cautious around 1,500 level due to intervention risks.

With regard to retail flows, retail investors increased overseas investment in early January following the position closures prompted by tax considerations. We expect this outflow to continue to keep pressure on the KRW.

In our view, the National Pension System's hedging strategy will be a significant factor influencing USDKRW in the near term. We expect them to come into play once USDKRW approaches the 1,500 level. Furthermore, if NPS shares detailed offshore USD funding plans, it could also help stabilise the FX market. Meanwhile, the government will follow December's measures by offering more incentives for FX hedging and tax benefits for onshore investments.

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