South Korea: Weak IP report suggests a bleak outlook for 1Q23 GDP

Forward-looking data suggest the economy will contract in the current quarter. The Bank of Korea will pause its tightening policy from February.

Source: Shutterstock

-2.9% Industrial Production

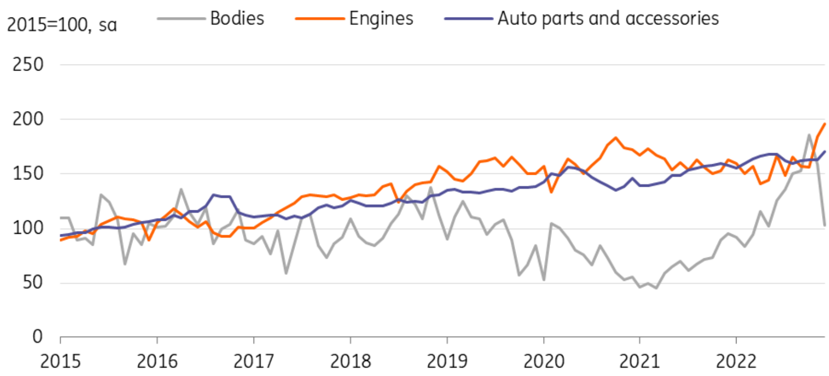
% MoM, sa

Lower than expected

Production activity declined while retail sales rebounded temporarily in December

Industrial production dropped more than expected -2.9% MoM sa (vs 0.6% November, -0.2% market consensus) in December. Semiconductor (4.9%) and basic material (3.1%) products rose, but motor vehicles (-9.5%), and electronic components (-13.1%) fell even more. The inventory/shipment ratio edged down to 126 in December from 127.4 in November, but it remained at an elevated level, which is not favourable to the inventory cycle this quarter. Also, we believe there is a supply mismatch in some industries. For example, in the case of automobiles, inventories for engines and auto parts continued to grow, while those for auto bodies declined significantly.

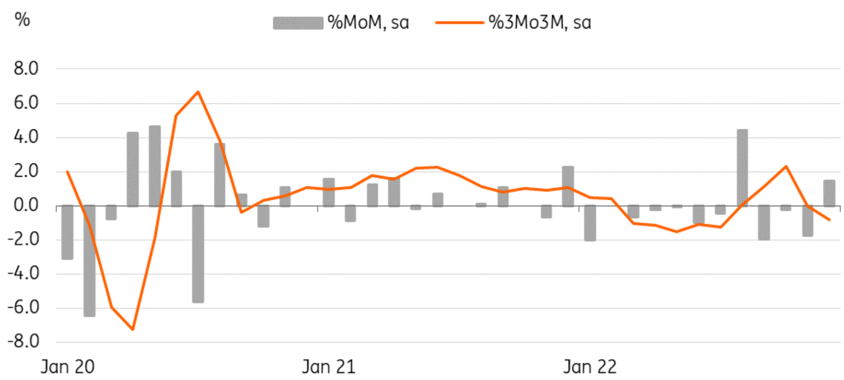
Supply mismatch in auto sector



Source: CEIC

Meanwhile, retail sales rebounded 1.4% in December, boosted by several one-off factors. Firstly, weather-related product sales rose as severe weather conditions continued. Secondly, there were larger-than-usual year-end sales promotions. And lastly, there was a technical payback from the early November crowd-crush accident. We believe that household purchasing power continues to weaken thanks to higher utility fees and a rising debt service burden. As a result, we expect retail sales to decline again in January.

Retail sales rebounded temporarily in December



Source: CEIC

Forward-looking data point to weak growth in the current quarter

Forward-looking data is more important to gauge this quarter's growth. The cyclical leading index fell 0.5 points, recording six consecutive monthly declines. Both machinery and construction orders fell by –23.0% and -3.0%, respectively. Both are highly volatile in monthly comparisons, but in 3-month sequential terms, data show both intensifying their contractions in December. Today's data support our view that 1Q23 GDP will also contract (-0.2%QoQ sa), following the contraction in the fourth quarter of last year (-0.4%).

China's reopening is unlikely to have much positive impact on Korea's economy in the first half of the year

Forward-looking data suggest that Korea's growth momentum will soften further in the current quarter. At face value, China's reopening should be good news. But careful consideration of how this might affect Korea's exports and services suggests caution is warranted. Both Japan and the Netherlands have decided not to provide chip-manufacturing equipment to China. Korean semiconductor companies have production lines in China, which cannot install top-notch equipment from the second half of the year, and this should adversely affect exports.

As for services, it may take a bit longer for Korea to benefit from increased numbers of Chinese tourists entering the country as Korea now requires additional COVID-19 tests for Chinese tourists. These measures will eventually be lifted. But the initial reopening boost will be less than expected.

BoK watch

We maintain our view that the Bank of Korea will pause its rate hikes from February. We believe that the current quarter of growth is unlikely to improve, while inflation will slowly fall further over the next few months. We see no clear signs of improvement in exports while domestic economic activity continues to slow. Consumer price inflation in January will remain around the current level of 5.0% YoY (Market consensus 5.1%, ING forecast 4.9%) mainly due to hikes in gasoline and power prices, but the trend has clearly passed its peak. The Bank of Korea will monitor the cumulative impact of the earlier rate hikes from now on. If we are right about weak growth this quarter, coupled with weakening labour markets, tightening financial conditions, and slowing inflation, the Bank of Korea will probably consider a rate cut in the second half.

Author

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com