

**UNDER EMBARGO UNTIL 07.00 GMT, WEDNESDAY, 6 AUGUST 2014**

REPUBLIC OF KOREA

Country briefing notes

Domestic demand key to reviving growth engine

- The economy expanded by 3% in 2013, up from a 2.3% growth in 2012. Economic growth picked up in the second half of the year, owing to higher private and public consumption.
- Exports recovered from subdued growth in the early months of 2013 as demand from the United States and Europe increased, particularly for mobile phones, automobiles and vessels. In contrast, imports dropped by 0.8% on the back of lower price of, and demand for, oil. As a result, the current account surplus increased to record levels in 2013.
- Economic growth in 2014 is expected to increase further to 3.7%, supported by the fiscal stimulus package announced in July 2014. Among others, the stimulus is aimed at boosting income support for poor households, ensuring financial support to small companies, and reviving the property market.
- The positive outlook is nonetheless subject to several headwinds. Weaker-than-expected private consumption in early 2014 is weighing down on the economy. Construction investment is also slowing in response to continued sluggishness of property markets.

Inflation remained low

- The inflation rate fell from 2.2% in 2012 to 1.3% in 2013, as global commodity prices moderated. In 2014, prices started to gradually move up, and it is forecast to reach 2.1% on average for the year as a whole.

Expansionary monetary and fiscal policy aided recovery

- In April 2013, a supplementary budget amounting to 1.25% of GDP was implemented to support the sluggish growth momentum in the first half of 2013. Together with lower government revenues, higher spending led to a slightly higher fiscal deficit of 1.5% of GDP.
- In 2014, the government plans to front-load its spending (about 60% of the total fiscal budget) to address the deteriorating consumer spending observed in the early months of the year.

- The Bank of Korea reduced the core policy rate to 2.5% in May 2013 and kept it unchanged in the June 2014 Monetary Policy Committee meeting.

Policy Challenges

- Amid intensifying pressures on export growth due to the strengthening of the local currency and greater competition in key export products, the economy could be entering into a trajectory of lower economic growth in the coming years.
- One of the key challenges for the economy is unlocking domestic demand. Private consumption has been sluggish, which is attributable to increasing household debt burden and flat household real wealth, of which 75% is tied up in real estate.
- The government has responded by increasing expenditure on social protection; supporting small and medium-sized enterprises; promoting deregulation of the services sector to boost output and productivity; and encouraging labour market participation by women to increase household income.

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