Mizuho Chart Speak: Korea

Economics & Strategy | Asia ex-Japan

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MIZUHO

Korea: Tightened (Policy), Tight (Labour Market), Growth Slowdown

In a Nutshell: With a 25bp hike last week, the Bank of Korea (BoK) has risen rates by 300bps since late 2021 to take their policy rate to 3.50%. Amid **two dissenters** opting for policy hold among the 7-person committee, the decision last week has signs of a **hawkish hold**. On one hand, **rising risk of slowing growth and financial instability** support the growing case for pausing at 3.50%. On growth, Governor Rhee has flagged the risks of Q4 2022 GDP contraction and an underlying assumption that the semiconductor industry will recover in the second half of this year. Meanwhile, amid rising borrowing costs and damaged confidence in property markets, demand for Project Financing Asset Backed Commercial Paper (PF-ABCP) remains a key concern as the authorities provided liquidity via a special purpose vehicle.

On the other hand, the labour market remains resilient with job gains in 2022 of **permanence nature and in higher value-added sectors**. As such, the **attendant wage pressures which underpin pipeline core inflation are still a key threat**. That said, Korea's **structural** issues of **insufficient job creation to absorb yearly inflows of graduates** will keep a lid on the extent of wage growth. Furthermore, **migrant worker inflows** are also set to increase in 2023 as visa quotas will be lifted to record highs.

With the next BoK meeting on 25 February, barring a **sharp upside surprise** to Q4 GDP print (26 January) and January CPI print (2 February), **odds skew towards a policy rate pause** especially if the KRW appreciation thus far provides sufficient room to dent inflationary pressures and blunt policy trade-offs.

A Tight BoK Decision

The Bank of Korea's **decision last week was not unanimous** among the 7 members of the Board as two members voted against raising rates. Notably, BoK Governor Rhee referring to **monetary policy decision 3 months ahead** stated that the **terminal rate of 3.50% had the support of three members**. **Three other members** wanted to keep the options **open for 3.75% which is to say another 25bps hike in Q2.**

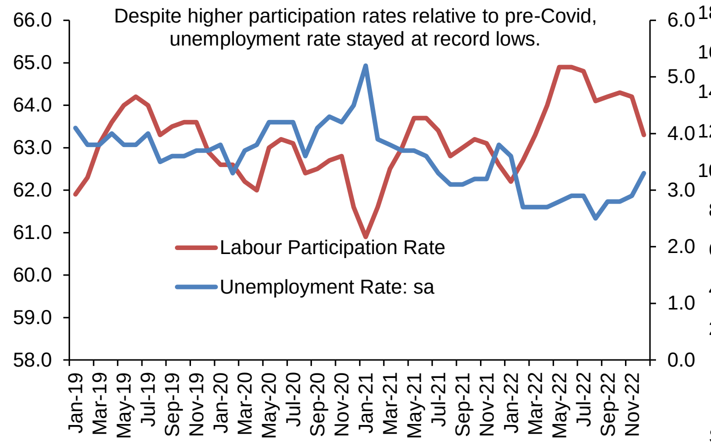
On the risk front, the policy statement alluded to the **high credit risk aversion among non-prime bonds and project financing asset-backed commercial paper**. A tacit acknowledgment of the real estate developer issues in Q4 2022 which feedback to dent confidence on corporate credit worthiness. Amid the higher policy rate, the need to re-price risk assets to ensure appropriate risk premiums and attract financing may pose further strains on corporate balance sheets.

For now, the BoK will likely keep the policy rate unchanged at their next meeting (23 Feb). The BoK expects inflation in January and February is expected to be around 5% with full year headline expecting to be around 3.6%. It may take a sharp surprise to these working forecasts to derail the BoK from implementing their window to "**assess the effects of the Base Rate raises"** — this phrase was also inserted in the January 2022 statement and was followed up by a policy hold in February 2022. Barring a sharp upside to inflation print on 2 Feb or abrupt bouts of sharp KRW depreciation pressures, the **BoK will remain unfazed to keep hold at their next meeting.**

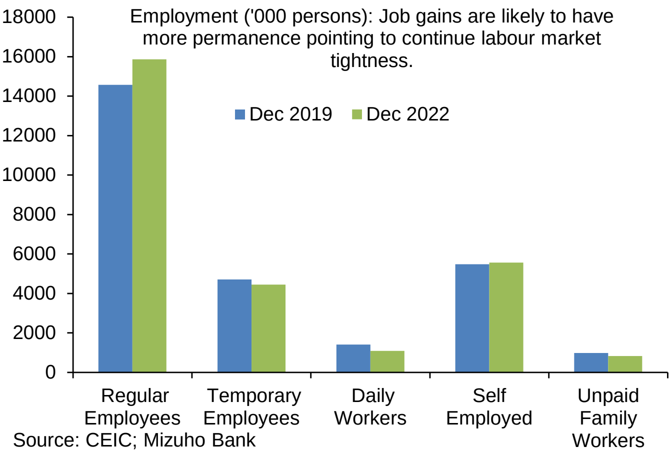
A Tight Labour Market

Beyond the Q1 inflation prints, we take a long at fundamental underpinnings which monetary policy faces in 2023. A **review of the labour market in 2022 shows a picture of a tight labour market which may underpin wage pressures and core inflation ahead**, albeit **some dampening from Korea's structural headwinds.** Despite **higher participation rates, unemployment rates remained at record lows in 2022**.

This is in stark contrast to other developed economies such as the US which have yet to see participation rates return to above pre-Covid levels. Furthermore, with **a higher proportion of hiring being that of regular employees rather than temporary workers** or self-employed, labour market is imbued with a tinge of stability.



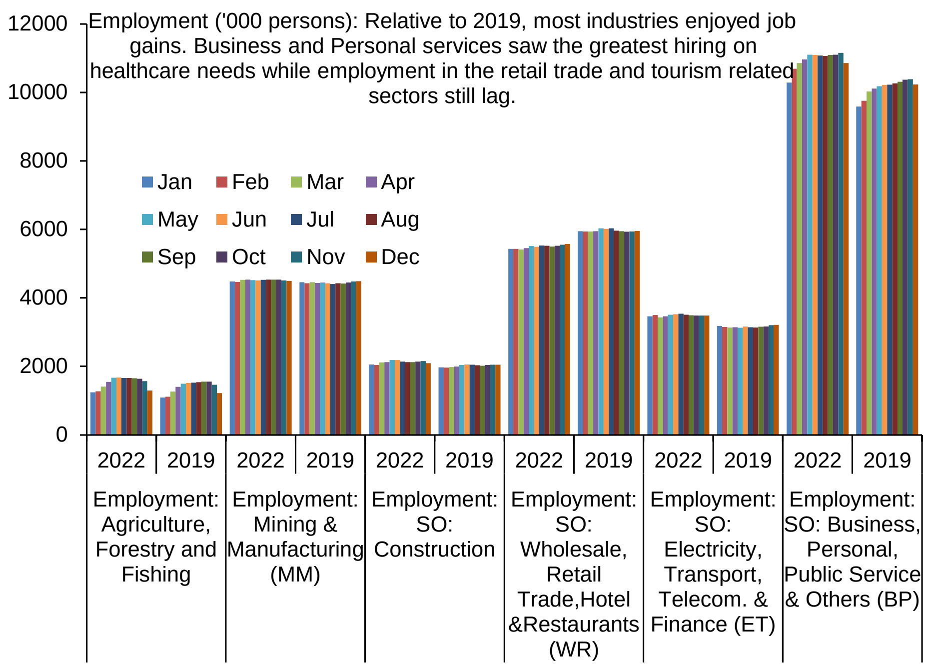
Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

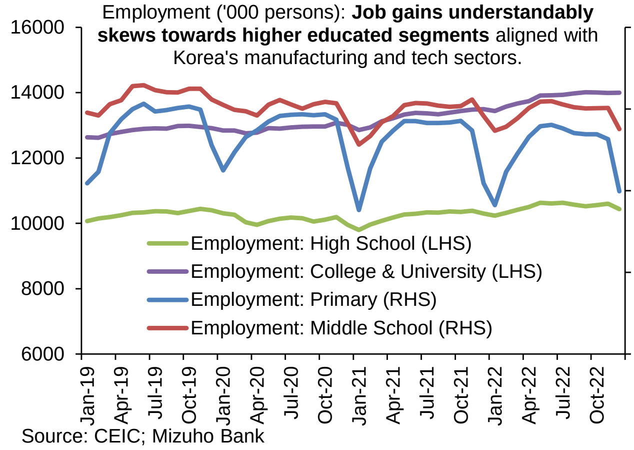
In 2022, employment picked up strongly and **recovered above pre-Covid levels for most sectors**. The business, personal and public services sectors saw the largest jobs gains. The demand for workers in the healthcare sector is a clear consequence arising from the pandemic. Diving deeper, it is worth noting that job gains were also accrued in the professional, scientific & technical activities sector which are of higher value add.

On the contrary, hiring in the tourism related "Wholesale, retail trade and hotel and restaurants" sector which remain below 2019 levels will see **further room for recovery in the months ahead given that visitor arrivals were only 32% of average 2019 levels as of November 2022 and in view of the return of Chinese tourists**.

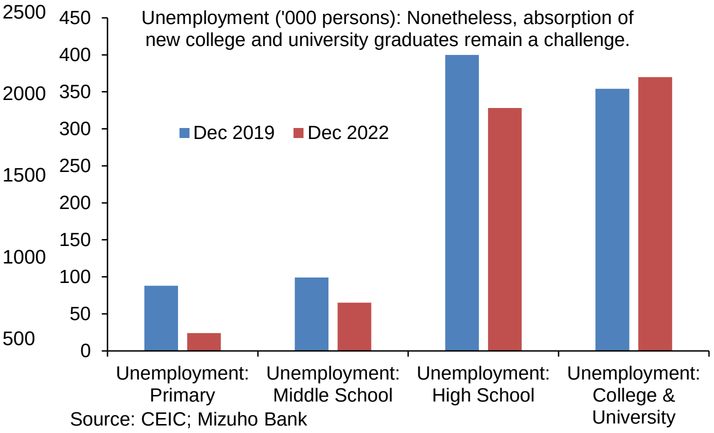


Source: CEIC; Mizuho Bank

From the perspective of the education level of workers being hired, we continue to see a trend of healthy rising demand for college and university graduates in line with Korea's comparative advantage in manufacturing and technological sectors. That said, **unemployment levels of workers with college and university education continues to rise.** This speaks to the structural issues which were already **prevalent pre-Covid as job creation is often outpaced by the yearly inflow of new graduates** and on-going need to re-train workers who are already in the labour force. In addition, an expansion of work visa quotas to foreigners in 2023 to 110,000 from 70,000 will alleviate manpower constraints in the lower end manufacturing sector which take 68% of the quotas. Meanwhile, the remaining inflows will fulfil needs in the labour intensive agricultural, livestock, fisheries and construction industries.



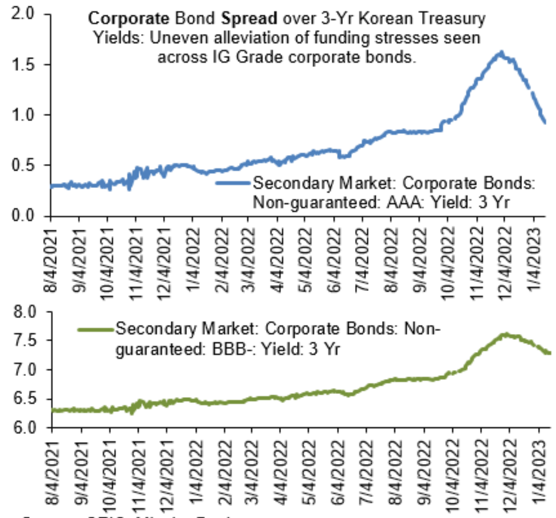
Source: CEIC; Mizuho Bank



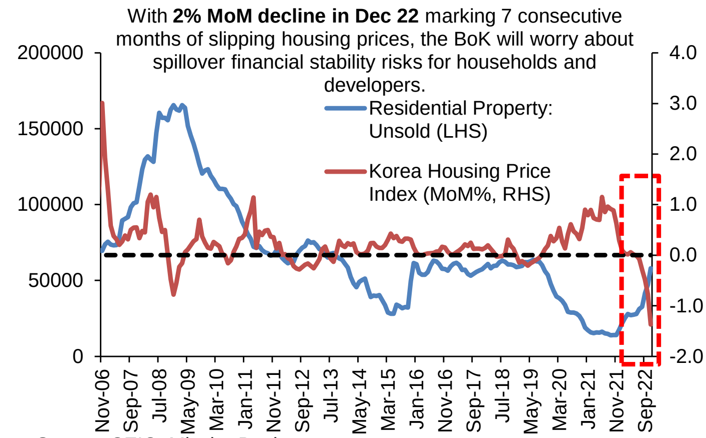
Source: CEIC; Mizuho Bank

This anticipated increase in labour supply from both domestic and foreign flows will keep a lid on wage pressures. Even under the assumptions of a return to potential growth estimated to be close to 2%, the associated increase in unemployment rate in 2023 restrains purchasing power and may concomitantly restrain core inflationary pressures.

Growth/Housing Slowdown and Financial Stresses



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

With semiconductor demand slowing down, a Q4 GDP contraction will not be too surprising. Net exports may increasingly pose a drag on growth in 2023. While the hit to current account balance may be large, the decline in net exports is expected to be milder in real terms. This stems from likely price cuts to enhance semiconductor demand alongside higher volumes arising from a phased resolution of supply chain issues such as automobile chip shortages. Muted growth support in 2023 will translate to slower job creation.

On the risk front, **housing prices have slipped for 7 consecutive months** from June to December 2022 alongside rising **number of unsold units**. On top of wealth effects weighing on consumption, **higher borrowing costs** coupled **with deteriorating confidence in real estate developers have led to liquidity and financing concerns.** While these liquidity constraints have been largely duly addressed by the authorities' establishment of Project Financing Asset Backed Commercial Paper (PF-ABCP) purchasing program in November 2022, some re-pricing of risk premiums could remain.

All in, given the rising financial imbalances, the **bar for BoK to hike further in Q2 2023** will rest on **substantial inflationary upside surprise from solid economic growth prospects** which in turn rest on the stability of growth in China as well as an aversion of recession in the US.