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Asia Economic Research

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Global and Korea economic outlook

Macro stability continues with rotating growth drivers

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See the end pages of this presentation for important disclosures.
Some global economic outlook pages authored by J.P. Morgan's global economic research team.

Global backdrop

Trend-like GDP growth is expected to be sustained, yet downside risks have risen with global capex slowdown

	%y/y			%q/q saar				
	Avg 00-15	2018	2019	2020	3Q18	4Q18	1Q19	2Q19	3Q19
Developed markets	**1.7**	**2.2**	**1.7**	**1.6**	**1.7**	**1.6**	**1.5**	**1.8**	**1.8**
US	2.0	2.9	2.3	1.8	3.4	2.2	2.0	2.3	1.7
Euro	1.3	1.8	1.4	1.7	0.6	0.9	1.7	1.5	1.5
Japan	0.9	0.8	0.2	0.6	-2.4	1.9	-1.0	1.0	2.5
Emerging markets	**5.7**	**4.7**	**4.5**	**4.6**	**4.1**	**3.9**	**4.3**	**4.9**	**5.0**
EM Asia	7.4	6.0	5.7	5.7	5.3	5.6	5.7	5.9	6.0
China	9.6	6.6	6.4	6.2	6.0	6.1	6.4	6.6	6.6
Korea	4.3	2.7	2.7	2.6	2.3	3.9	2.0	2.6	2.9
Latin America	2.9	1.2	1.7	2.4	1.5	0.8	1.8	3.0	2.7
EMEA EM	3.9	2.9	1.6	2.4	1.1	-0.5	0.5	2.4	3.1
Global (JPMorgan universe)	2.8	3.2	2.8	2.8	2.6	2.5	2.6	3.0	3.1

Source: J.P. Morgan

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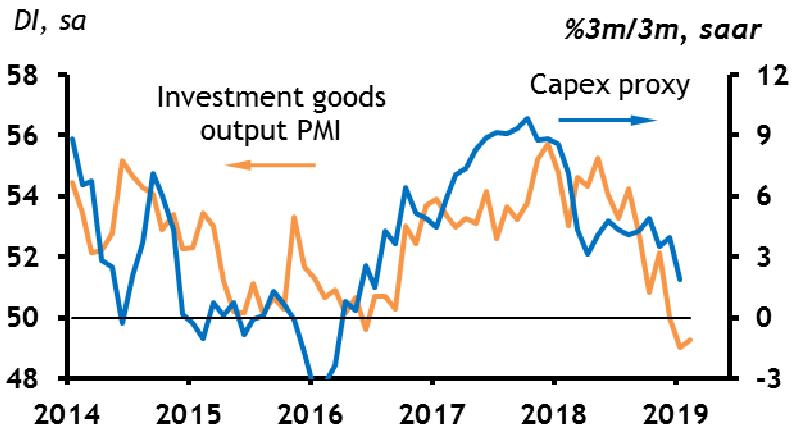
Rising global concerns: Capex stalls

Global GDP growth slows down in 1Q, mainly as corporate capex growth stalls

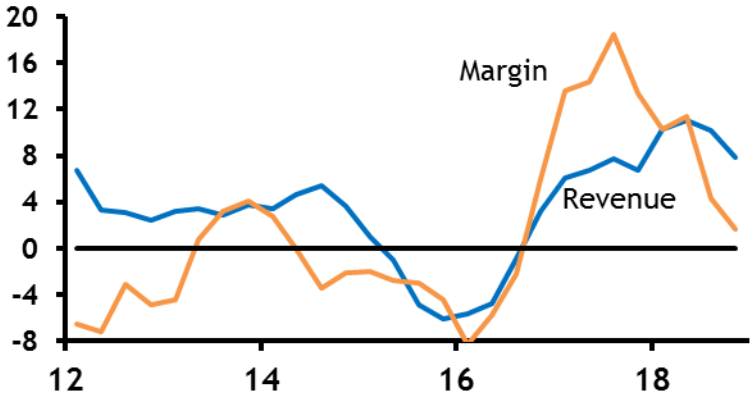
Global investment goods PMI & capex



Source: J.P. Morgan, Markit

Global corporate capex growth decelerated materially, hinted by survey

Corporate profit growth, decomposed



Source: MSCI (Bloomberg), and J.P. Morgan

Underlying force: Corporate's profit margin compression is ongoing amid a wage growth

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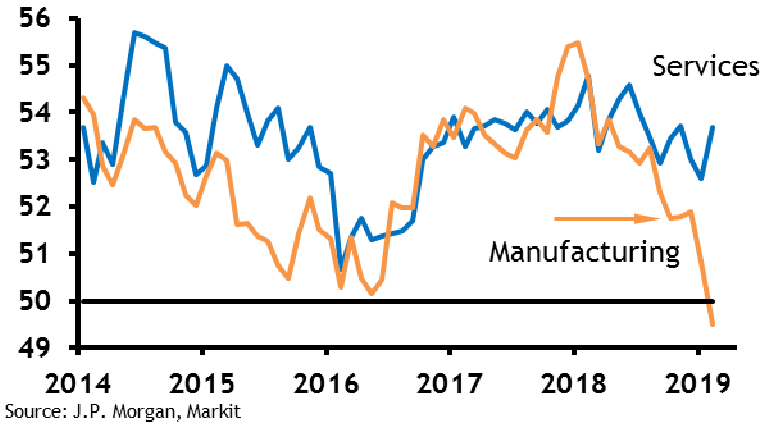
Rising global concerns: Weakness in manufacturing

The break is mainly on manufacturing sector weakness (notably in Asia), while service sector is holding up

J.P. Morgan global output PMI

DI, sa. Feb 19 est based on flashes

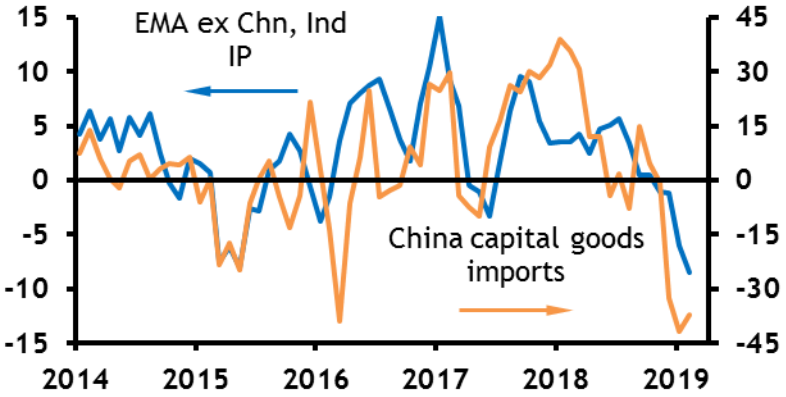


Source: J.P. Morgan, Markit

Manufacturing PMI fell sharply since late 2018, while services PMI held up

EMAX IP and China capex imports

%3m/3m, saar; both scales



Source: J.P. Morgan

EM Asian IP fell sharply as China's capital goods imports plummeted

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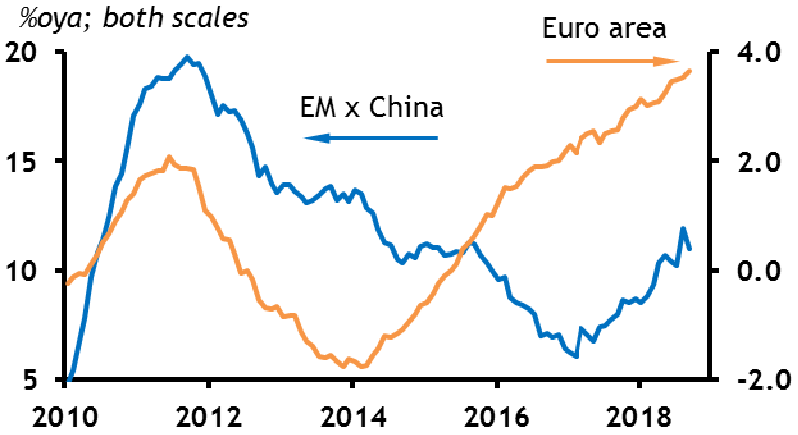
Global policy stances

Policy stance still supportive:
Deleveraging shocks have passed, fiscal tightening is over

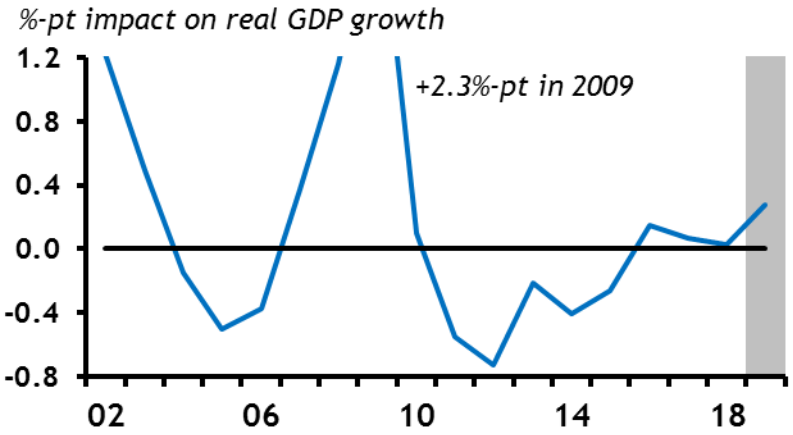
Domestic credit growth



Source: ECB, IMF, national sources, J.P. Morgan

Fading deleveraging shocks, credit growth normalized over the past two years

Global fiscal thrust



Source: J.P. Morgan, IMF; Defined as change in structural deficit with some adjustments

Global fiscal policy set to turn the most accommodative in a decade

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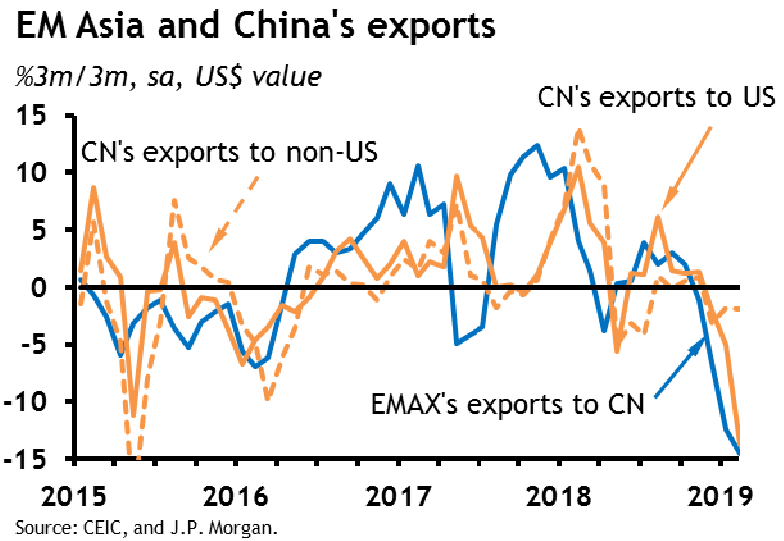
US-CN trade tension and EMAX impacts

Stress in regional exports chain is focused in EMAX exports to CN and CN exports to US



EMAX exports to CN plunged while exports to non-CN holding up: Initial reaction of US-CN trade tension

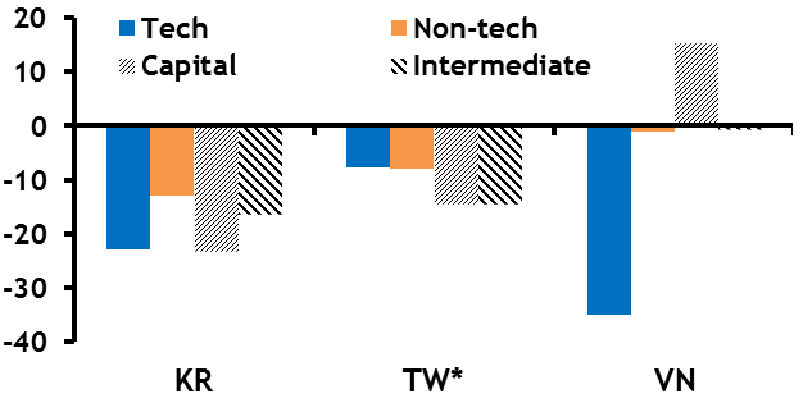
EMAX exports to CN is a leading indicator of CN's exports, notably to US

US-CN trade tension and EMAX impacts

Broad-based weakness, thus the cause of the weakness also wide;
Hinting that the recovery may be slow and modest

EMAX exports to China by product groups

%3m/3m, sa, US$ value, February 2019

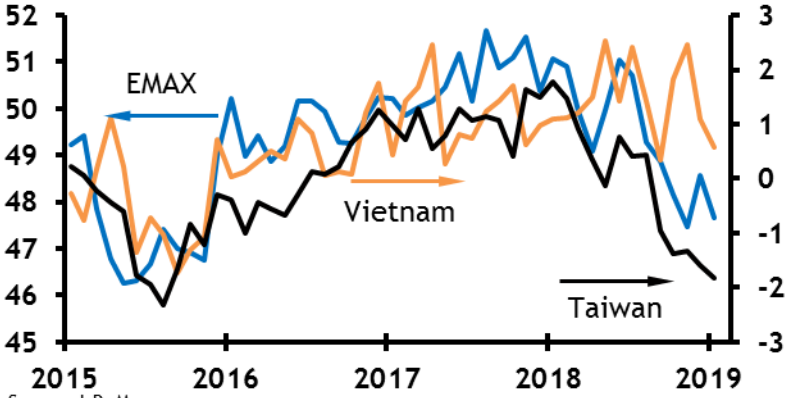


Source: National sources, and J.P. Morgan. * Includes exports to HK.

In KR and TW, the weakness is broad-based over product group

PMI exports orders

D.I. sa *standard deviation from 2012-17 average*



Source: J.P. Morgan

Looking for a recovery signal from PMI; likely to stabilize after recent falls

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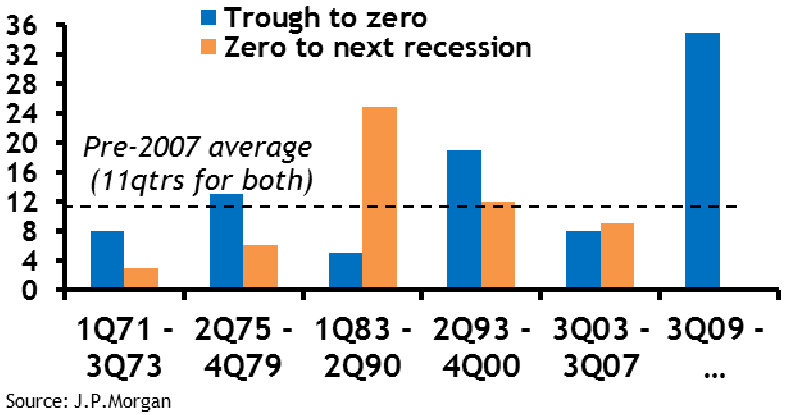
How long will this global cycle last?

Durations are not the sole determinant;
Combination of forces to lead to recessions

Output gap durations over expansions, DM



Source: J.P.Morgan

Currently in a matured cycle, yet cycle durations have a large range of outcomes

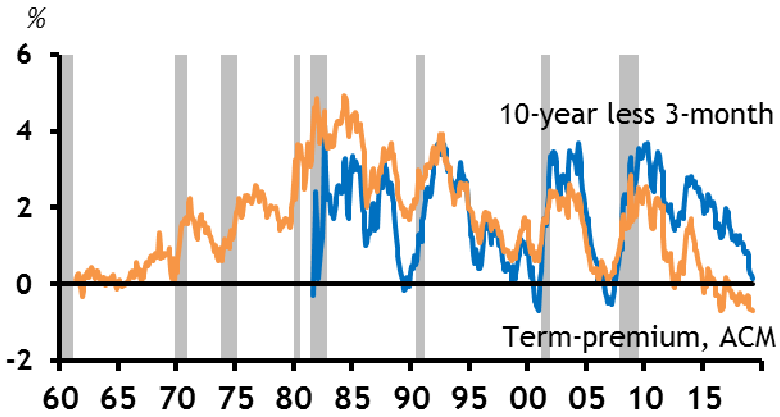
Combination of forces to lead to recessions:

1. Supply-side performance deteriorates: as resources are fully utilized
2. Margins come under pressure: upward pressure on wages, lower productivity growth
3. Central bank tightening: rising inflation lead to slowing the pace of demand growth
4. Imbalances: from earlier excessive leverage and investment boom

Not expecting US recession yet, but risks are rising

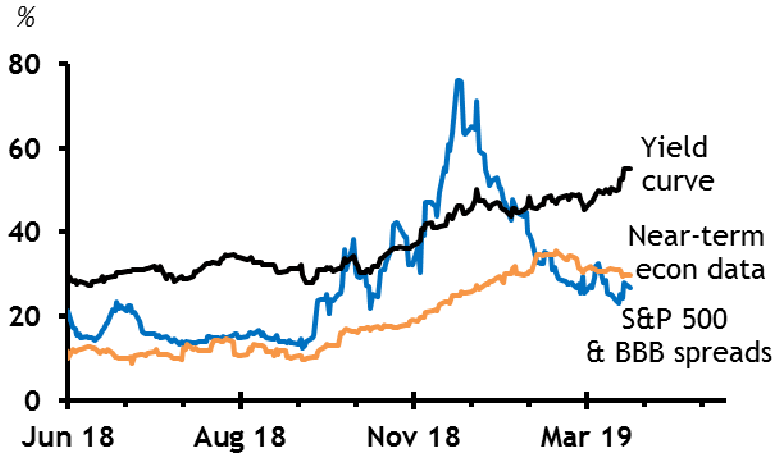
US yield curve inversion shouldn't be ignored

US treasury yield and term premium



Source: Federal Reserve Board, NY Fed, J.P. Morgan

US probability of recession within one year



Source: J.P. Morgan

Yield-curve inversion amid the structural downturn in term premium – Recession risk? Secular low inflation risk?

Baseline is a continued growth in 2019, but risk has increased since last year

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Korea economic outlook (executive summary)

Global tailwinds are fading, while local drags are easing
We expect macro stability to continue as growth drivers are rotating

Korea's real GDP growth has been stable over the last six years
- Rotation of drivers between net exports and domestic demand
- We expect stability to continue in 2019: Fading global tailwinds, domestic demand recovering with policy stimulus

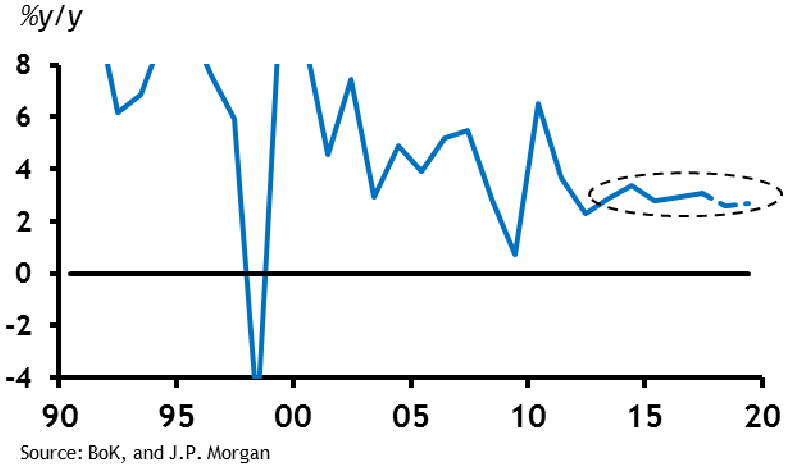
Outlook by demand component
- Exports: Overall volume growth is likely to moderate
- Consumption: Policy stimulus should buffer soft patch from disappointing job growth
- Capex: Growth to remain subdued but to turn modestly positive
- Construction: Soft-landing should be finished by early 2019, gradual recovery to follow

Policy outlook
- Fiscal surplus to narrow from 1.4% of GDP (2018) to 1.0% (2019)
- Final hike of BoK in 2H19 is expected, yet no-action risk is rising

Macro stability in the current cycle

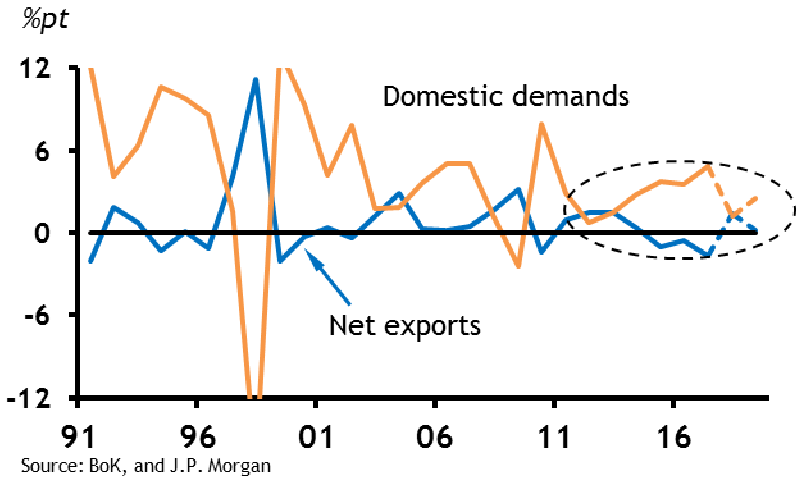
Real GDP growth has been stable since 2013 with rotating drivers
And we expect the stability to continue in 2019

Real GDP growth



Source: BoK, and J.P. Morgan

Contribution to growth



Source: BoK, and J.P. Morgan

Real GDP growth oscillated within a tight range (2.7~3.3%y/y) since 2013; We expect 2.7% for 2019

Growth drivers (domestic vs. net exports) have been rotating to offset each other

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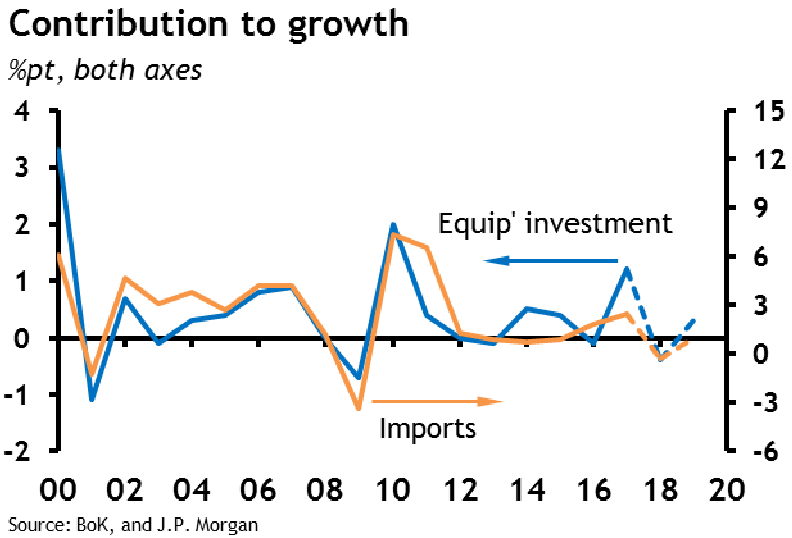
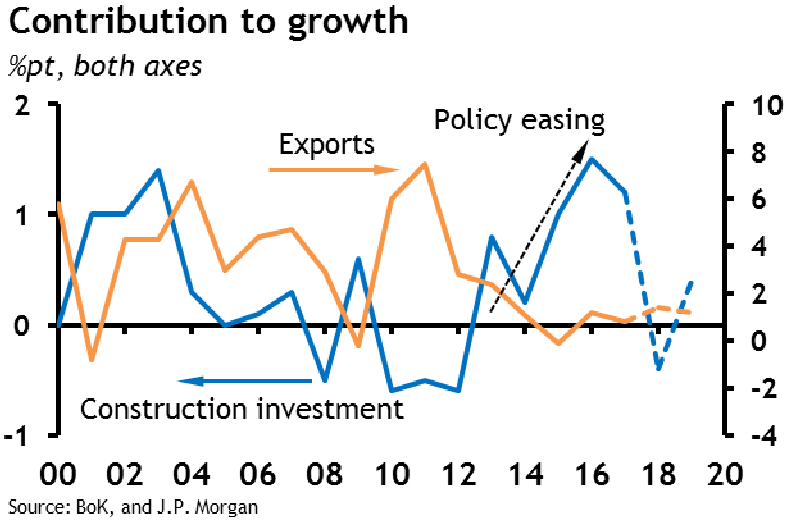
Macro stability in the current cycle

Source of stability: Automatic stabilizer role by imports; and a policy revision in construction cycle



Facility investment and imports are tightly correlated through capital goods, thus NX acts as an automatic stabilizer



Policy revision: Construction cycle has buffered external drags. Construction cycle soft-landed, to recover gradually in 2019

Exports outlook

Global demand is assumed to hold up in 2019; should support Korea's export performance

Real exports growth and global demands

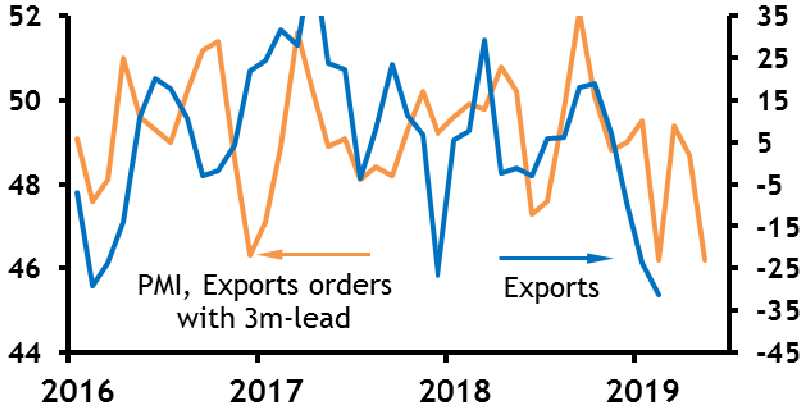
%oya, both axes

Source: BoK, and J.P. Morgan

Under the assumption that global growth holding up above trend, KR's export growth should hold up as well

Customs exports and PMI exports orders

D.I., sa *%3m/3m saar*



Source: Markit, MoTIE, KITA, and J.P. Morgan

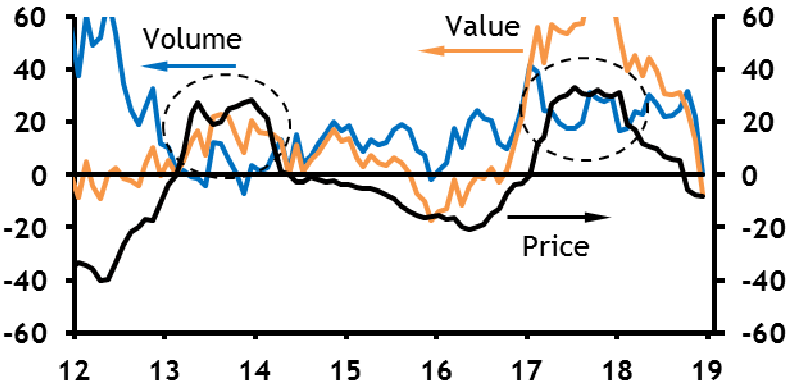
Near-term outlook: Exports trend growth should stabilize, yet only gradually

Tech cycle: Volume vs. value growth

Semiconductor prices fell after unsustainably high growth in 2017-18;
Value fell on price effect, yet still elevated compared with 2016

Semiconductor exports indices

%oya, both axes



Source: BoK, and J.P. Morgan

Semiconductor export price growth started to moderate since early last year

Semiconductor exports

US$ billion, nsa

Source: KITA, and J.P. Morgan

Robust volume growth / price correction would imply stabilization in value level

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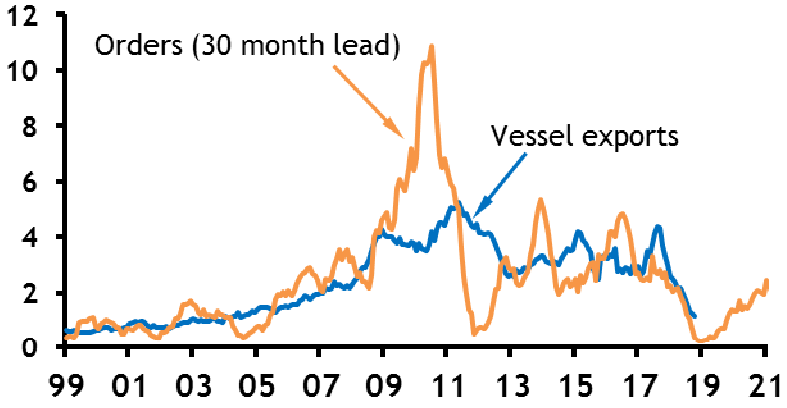
Non-tech cycle

Mixed outlook: Shipbuilding should modestly turn up, while oil and machinery growth should moderate

Shipbuilding orders and exports

US$bn, sa 6mma

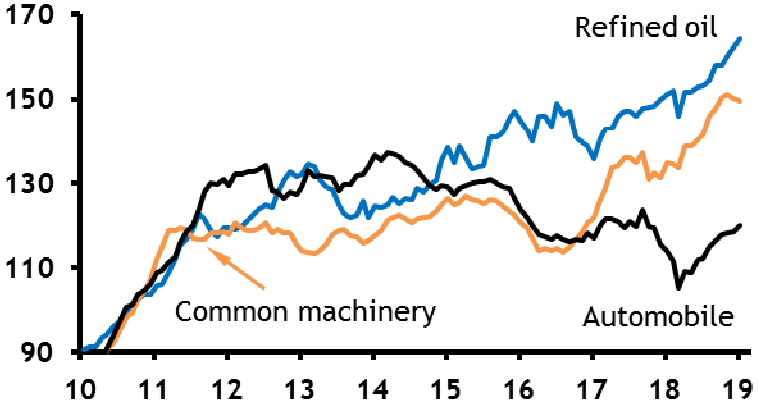


Source: Clarkson, KITA, and J.P. Morgan

If based on orders, vessel deliveries should gradually turn up in 2019

Exports volume index

index, 2010=100, 6mma sa



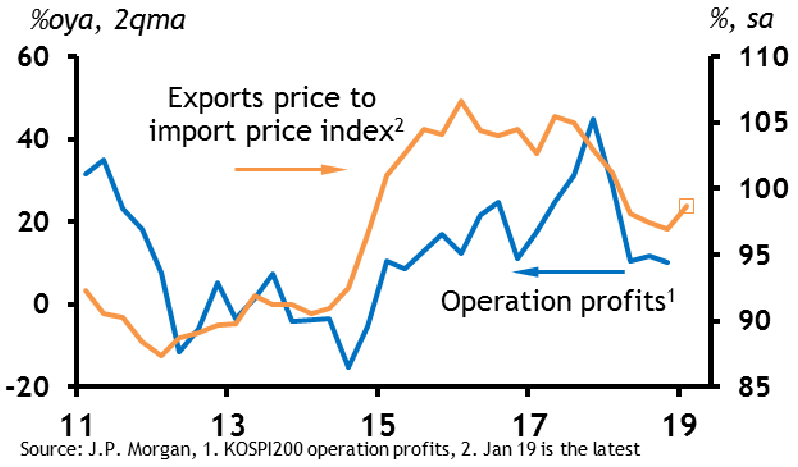
Source: BoK, and J.P. Morgan

Machinery and refined oil growth likely to moderate, while automobile exports are weakening in trend

Fixed investment: Capex outlook

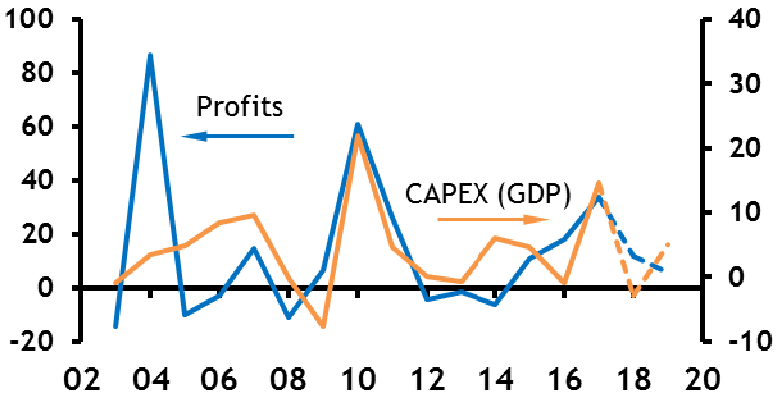
Fading fundamental tailwinds in 2018, yet to stabilize in 2019

Corporate profits and terms of trade



Source: J.P. Morgan, 1. KOSPI200 operation profits, 2. Jan 19 is the latest

Operation profits and capex



Source: BoK, and J.P. Morgan

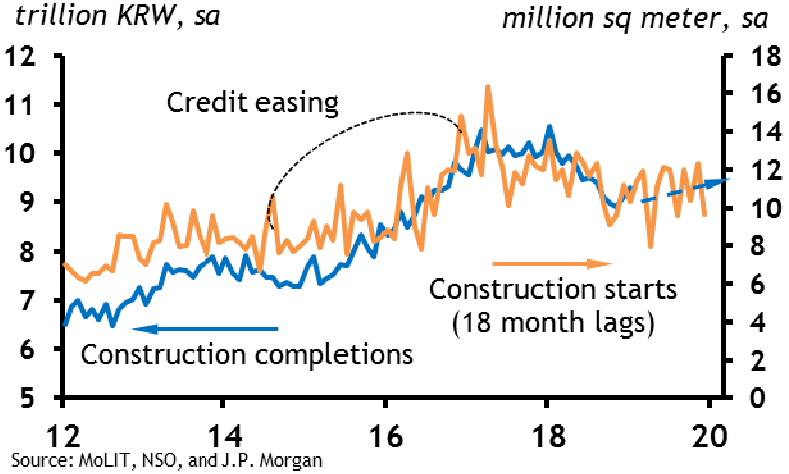
Firms' profit growth decelerated with fading tailwinds from terms of trade; yet likely to stabilize

The slowdown in profit growth should be modest in 2019, capex growth to recover from 2018's dip

Fixed investment: Construction outlook

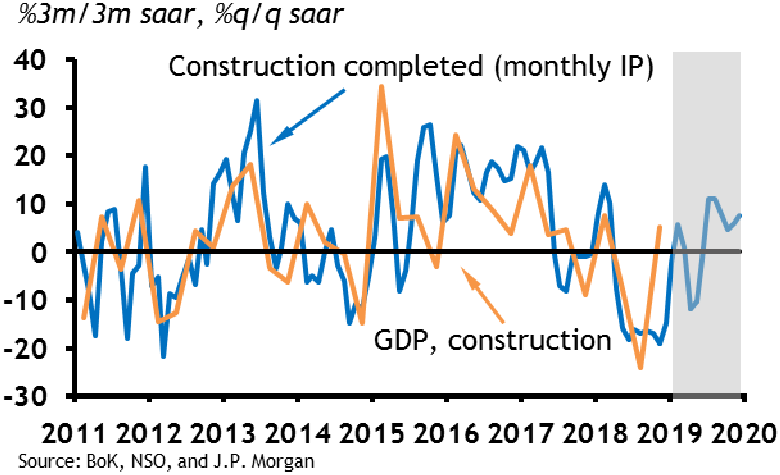
Construction cycle is going through a hangover from policy easing
Should recover through 2019 if based on forward-looking data

Construction starts and completions



Source: MoLIT, NSO, and J.P. Morgan

Construction activities



Source: BoK, NSO, and J.P. Morgan

Construction starts area leads construction activity with time lag: Start area recovered already on non-residential construction

If extrapolating with construction starts data, construction growth should recover in 2019

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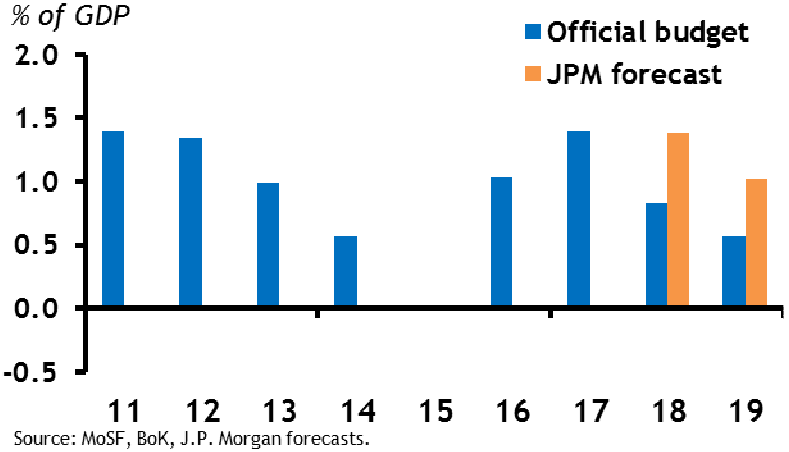
Fiscal policy outlook

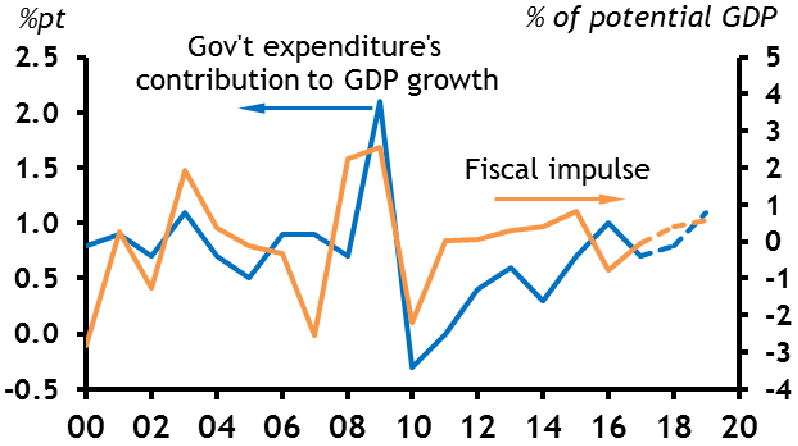
Gradual decrease in fiscal surplus with rising expenditure growth; Providing a buffer for soft patches in domestic demand

Fiscal balance (consolidated)



Source: MoSF, BoK, J.P. Morgan forecasts.

Fiscal impulse and growth impact



Source: BoK, MoEF, and J.P. Morgan

Budget plan implies the surplus to narrow from 1.4% of GDP (2018) to 1.0% (2019)

Pro-growth stance: “Income-led growth” to “Innovative and inclusive growth”

The accommodative policy stance should contribute to a modest rise in GDP growth impacts

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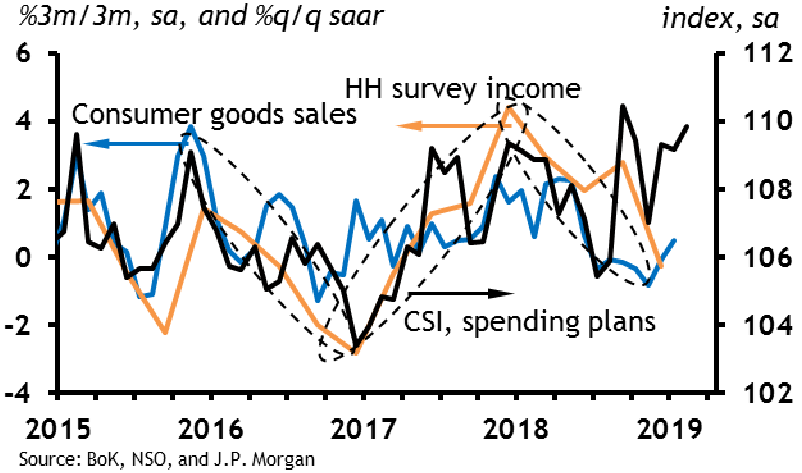
Consumption outlook

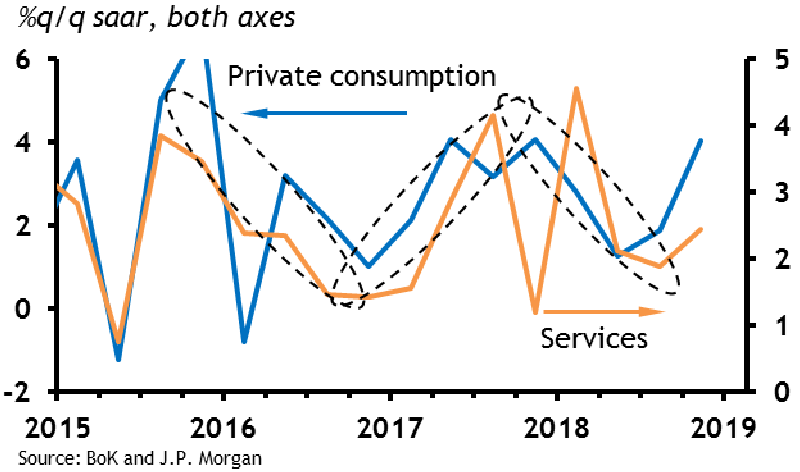
Consumption demand pace softened in mid-2018
Disappointing employment growth, amid a labor restructuring

CSI vs. consumer goods sales



Source: BoK, NSO, and J.P. Morgan

GDP: Private consumption and services



Source: BoK and J.P. Morgan

High frequency domestic demand indicators turned soft in mid-2018 after buoyant 2017

Consumer survey turned up in recent months

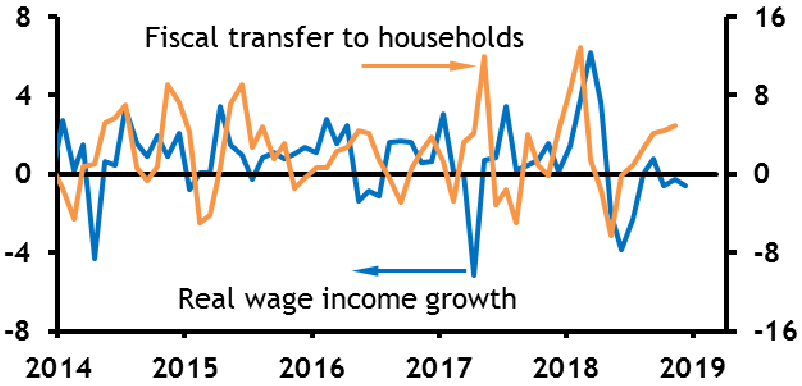
Quarterly GDP also points to slowdown in domestic activities in mid-2018; yet a hint of recovery in 4Q18

Consumption outlook

Rising fiscal transfer; recovery in service employment condition should stabilize overall household consumption

Income growth and policy support

%3m/3m sa, both axes

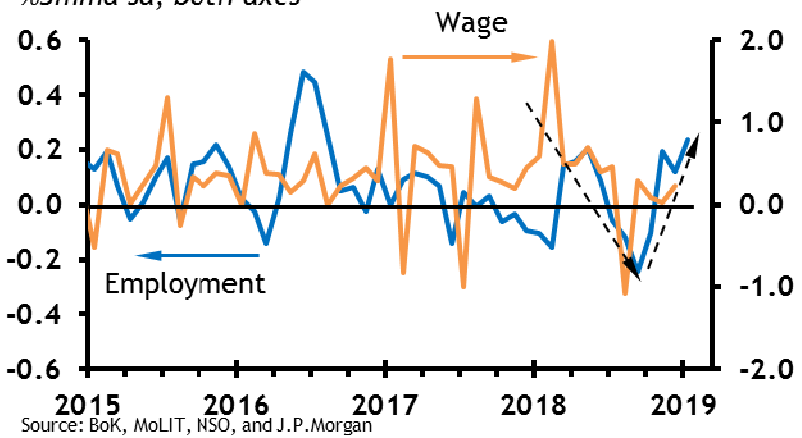


Source: NSO, MoEL, MoEF and J.P. Morgan

A deep correction in real wage growth in mid-2018, buffered by rising fiscal transfer to households in 2H18

Priv. service employment and wage growth

%3mma sa, both axes



Source: BoK, MoLIT, NSO, and J.P.Morgan

There is a silver lining, as private service employment and wage recovered amid sluggish manufacturing sector

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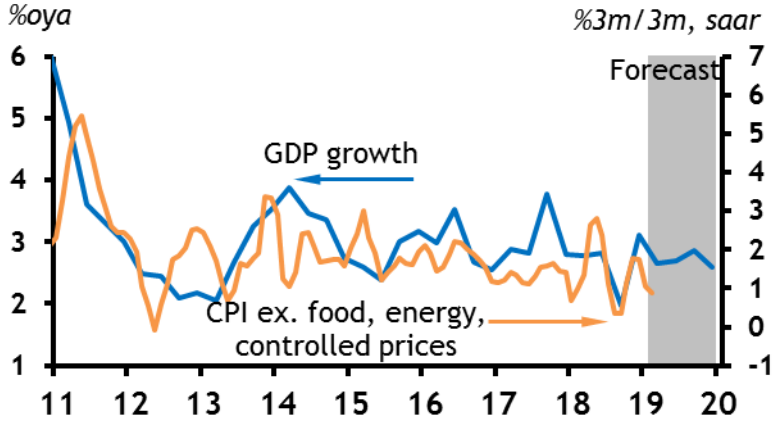
Inflation outlook

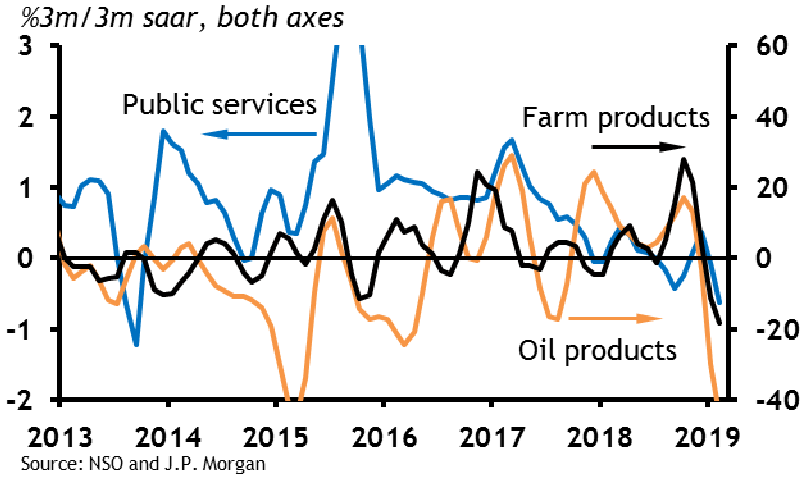
Demand side underlying inflation should be at upper 1% pace
Supply-side pressure eased as global oil prices dropped

GDP and demand-side price pressure



Source: NSO, and J.P. Morgan

Consumer prices, supply-side pressure



Source: NSO and J.P. Morgan

Underlying inflation pressure estimated to stay at upper-1% pace

Headline inflation is dragged down by deeper-than-expected supply side drags

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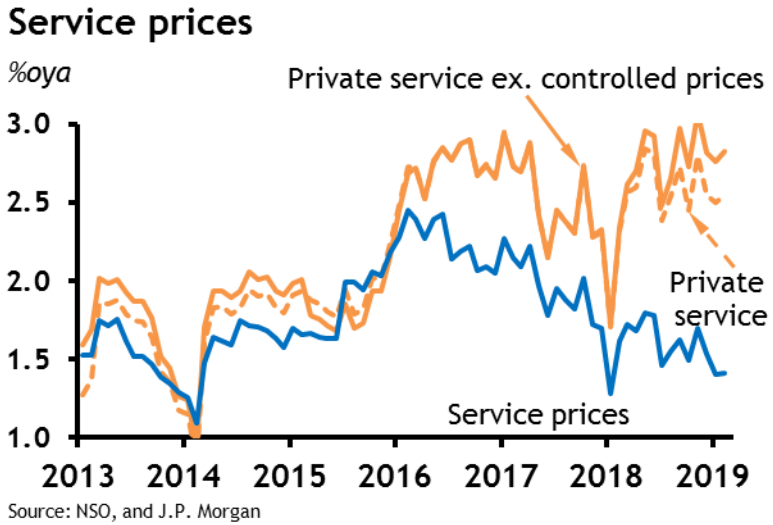
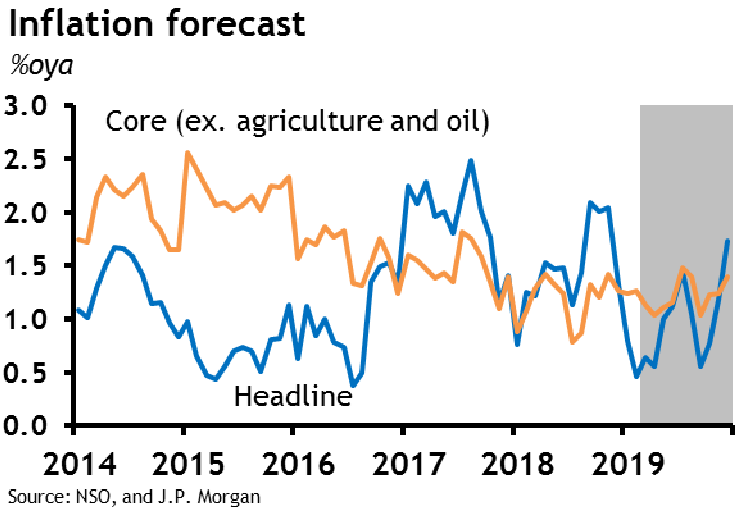
Inflation outlook

Excluding regulatory drags, service inflation robust at upper-2% pace
Core inflation should be higher than the headline in 2019





Headline service prices were dragged down by housing rental and public prices:

Service inflation is robust at around upper-2% pace if excluding those drags

Headline inflation dived deeper-than-expected to lower 2019 bases, while core inflation relatively stable around mid-1%

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Monetary policy outlook

Output gap is small; and policy stance is still accommodative
Buffer remains to neutralizes policy stance

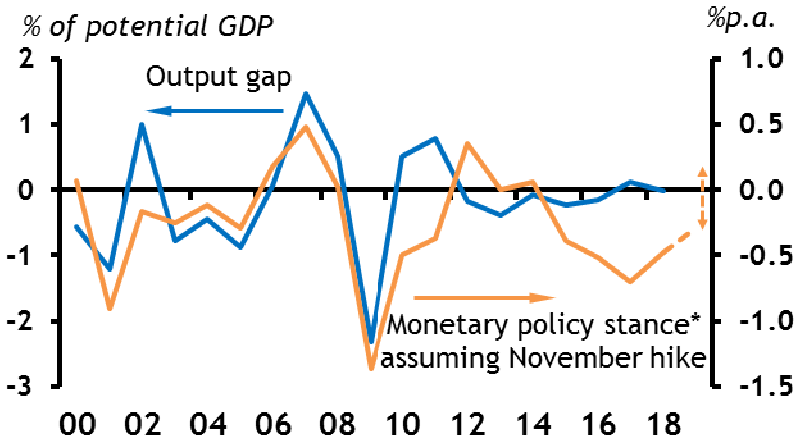
Estimation of policy stance:

- Output gap as a function of (r-r*)
- Policy stance (r-r*) as a function of inflation and output gap

- r* as a function of potential GDP growth and DM real interest rate

About 30bp additional buffer for (r-r*) remains; Dovish turn of DM central banks abated the potential rise in r*

Output gap and monetary policy stance



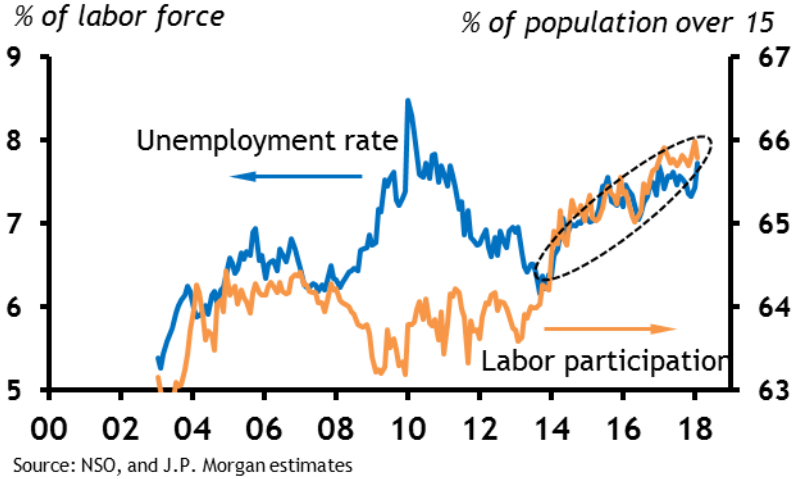
Source: BoK, NSO, and J.P. Morgan, * Deviation of real policy interest rate from neutral rate

In all, final one more hike is possible if BoK neutralizes policy stance

Monetary policy and labor market

Medium-term risk: Ample labor supply may limit wage growth

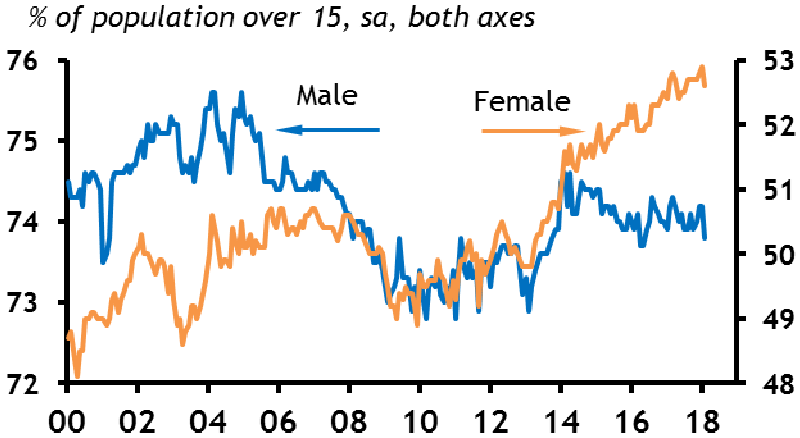
Extended labor market indicators



Source: NSO, and J.P. Morgan estimates

Extended jobless rate rose in trend since 2014, led by rising labor supply

Labor force participation rate

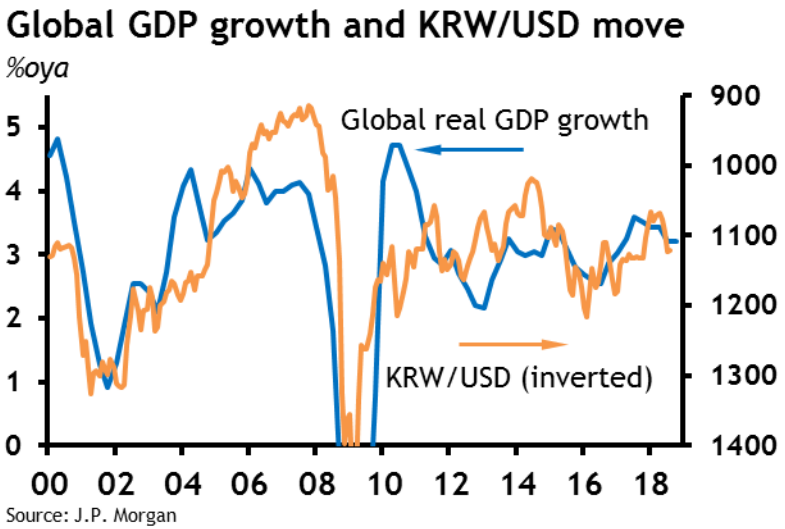


Source: NSO, and J.P. Morgan

Female labor participation to rise further to catch up with males

FX market view

House view: USD/KRW to be 1150 in end-2019



Current USD/KRW level did not deviate from global growth backdrop

US-Korea real GDP differential may imply a modest real depreciation

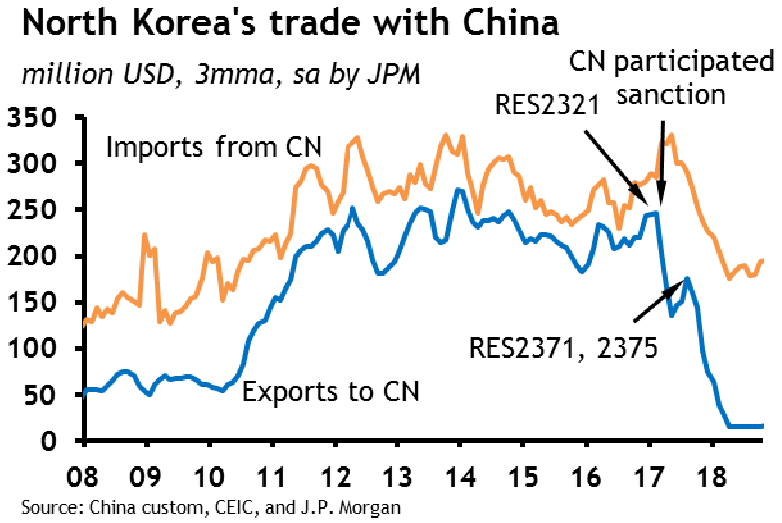
North Korea: At a crossroads

Breakthrough is possible considering changed incentives of related parties; yet hurdles remain high

NK government intentionally stretch out negotiation for a hidden agenda?

- Cost of stretching out rises with effective economic sanction (trade deficit rose significantly)
- Marginal benefit from extending the negotiation is limited if the benefit stems from additional leverage with more refined missile system

High hurdles still remain: Multiple years' efforts for declaration, inspection, verification, and dismantling nukes



NK's trade deficit with China likely widened to about 13% of NK GDP in 2018

North Korea: Integration scenario

Integration of NK to global economy unlikely to follow German case
Gradual income convergence; and impact on SK should be modest

Table: South and North Korean economy

Most recent year available

	South (A)	North (B)	(B/A, %)
Population in thousands	50,982.0	25,491.0	(50.0)
GDP in billion current US$	1,377.9	16.3	(1.2)
Exports in billion US$	495.4	1.0	(0.2)

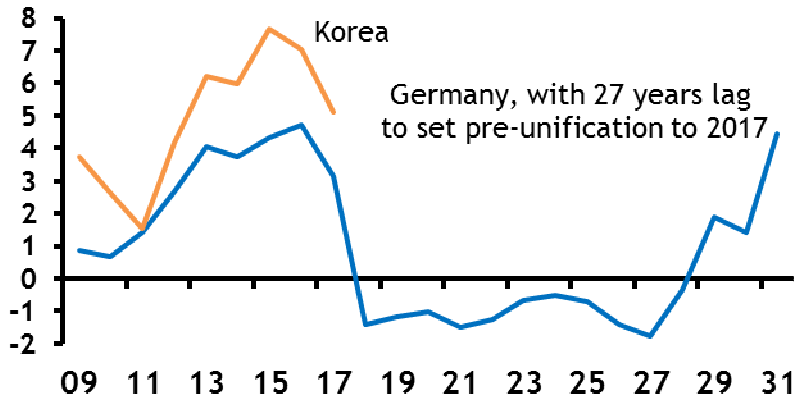
Source: United Nations

Scenario 1, Full-scale economic and political reunification (German style): Not feasible considering productivity gap, tight border control, political situation

Scenario 2, Gradual transition: SK's "New economy plan for Korean peninsular". SK's investments on NK is FDI in this case.

CAB in Korea and Germany

Percent of GDP



Source: IMF, and J.P. Morgan

In gradual scenario, SK's fiscal surplus to narrow modestly, CAB impact not obvious

Economic forecasts

South Korea: economic indicators

	Average 2012-16	2017	2018	2019f	2020f
Real GDP, % change	2.8	3.1	2.7	2.7	2.6
Consumption*	1.4	1.8	2.2	1.8	1.8
Investment*	1.2	3.8	-0.9	0.7	0.8
Net trade*	0.3	-2.5	1.4	0.2	0.1
Consumer prices, %oya	1.3	1.9	1.5	0.9	1.8
% Dec/Dec	1.2	1.4	1.3	1.4	1.8
Producer prices, %oya	-1.5	3.5	2.0	0.5	2.2
Government balance, % of GDP	0.8	1.4	1.4	1.0	0.8
Current account balance	84.2	79.7	69.9	66.8	68.7
% of GDP	6.3	5.2	4.3	4.1	4.0

* Contribution to growth of GDP.

Source: J.P. Morgan

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