

Embargo:

Release Date: March 21, 2025

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AMRO PROJECTS KOREA'S 2025 GROWTH RATE AT 1.6% AND INFLATION RATE AT 1.9%

The ASEAN+3 Macroeconomic Research Office (AMRO)¹ released its 2024 Annual Consultation Report on Korea on March 21st (Friday). This report is based on the annual consultations conducted in November 2024 when the AMRO mission team visited Korea and held discussions with government ministries and relevant institutions, including the Ministry of Economy and Finance and the Bank of Korea.

AMRO projected that the Korean economy will grow by 1.6% in 2025, down 0.4%p from 2.0% in 2024; while domestic demand is expected to recover, the growth forecast has been lowered due to expected impact of factors such as the U.S. government's tariff imposition. The inflation rate is expected to decline to 1.9%, down by 0.4%p from 2.3% in 2024, reflecting stable domestic food prices and a moderation in global energy prices.

Also, AMRO cited escalating geopolitical conflicts in the Middle East and Ukraine, as well as rising energy and food prices stemming from extreme weather conditions, as upside risks to inflation. As downside risks to growth, AMRO pointed to a sudden slowdown in economic growth in major economies such as the U.S., Europe, and China, a sharp increase in U.S. tariffs, and weakened business and consumer sentiment owing to domestic political uncertainties. Along with it, it noted the debt servicing ability of SMEs, small merchants, self-employed business operators, and low-income households, which reflects the scarring effects of the COVID-19 pandemic, as well as real estate project financing (PF) held by non-bank financial institutions (NBFI) as risk factors.

AMRO assessed that the recent easing of the tight monetary policy in Korea will contribute to the recovery in domestic demand. In addition, it highly evaluated the Korean government's efforts to ensure a soft landing for real estate PF projects, while recommending enhanced risk management for NBFIs.

With regard to fiscal policy, AMRO emphasized the importance of securing fiscal sustainability to step up the ability to respond to economic uncertainties. In particular, it was mentioned that fiscal discipline should be strengthened through the legalization of fiscal rules, and efforts to implement revenue-enhancing and spending-restructuring measures are essential.

Last but not least, AMRO stressed the need to bolster the resilience and dynamism of the manufacturing sector, as well as addressing structural issues – devising countermeasures to demographic changes such as low birth rates and implementing reforms in pensions and health insurance.

¹ An international organization established in Singapore in 2011 to analyze and review economic trends in the ASEAN+3 region and support the economic and financial stability of its member countries.

The Korean government plans to continue close consultations with international organizations such as AMRO and maintain detailed monitoring of the trends in the Korean economy.

Original AMRO's 2024 Annual Consultation Report on Korea

Korea: Supporting Growth while Safeguarding Financial Stability

SINGAPORE, March [19], 2025 –The Korean economy has improved on the back of strong exports, with GDP growth registering 2.0 percent in 2024. In the near term, domestic demand is expected to pick up while export momentum moderates with the downswing in the tech cycle and the impact of the US protectionist trade policy. GDP growth is expected to be lower at 1.6 percent in 2025, taking into consideration the impact of US tariffs onwards. Meanwhile, interest burden and scarring effects of the COVID-19 pandemic continue to exert pressure on borrowers, and pockets of risk remain in savings banks, which are more exposed to project finance (PF) loans in the real estate sector. Given these considerations, macroeconomic policies should be recalibrated to support growth while maintaining financial system stability.

These insights are highlighted in the 2024 Annual Consultation Report on Korea released today by the ASEAN+3 Macroeconomic Research Office (AMRO). The report is based on AMRO's Annual Consultation Visit conducted in November 2024.

Economic developments and outlook

Growth improved in 2024 on the back of strong exports, driven by the upswing in the global semiconductor cycle. Private consumption was relatively tepid in the first half of 2024, weighed by debt servicing burden and modest wage growth, but showed signs of recovery in the second half. Construction remained weak amid real estate PF distress.

Domestic demand is expected to pick up with the easing of monetary conditions and a recovery in manufacturing investment, while export momentum moderates with the downturn in the semiconductor cycle and impact of potential increases in US tariffs. Inflationary pressure is expected to remain contained on the back of stable domestic food prices and moderation in global energy prices.

Credit quality, particularly of loans to SMEs and self-employed business operators, continues to deteriorate, reflecting weak recovery from the pandemic downturn. However, the financial system remains sound, with ample liquidity buffers among banks and capital adequacy ratios of banks and non-bank financial institutions (NBFIs) well above regulatory standards. Comprehensive measures have been put in place to ensure orderly resolution of the PF distress.

The fiscal deficit widened on account of a decline in tax revenue driven by lower corporate income tax. Fiscal spending has risen less than expected, largely due to reduced mandatory transfers to local governments and education. The fiscal deficit in 2024, excluding social security funds, is estimated at 4.0 percent of GDP, higher than the budgeted deficit in 2024 and the actual deficit of 3.6 percent in 2023. The fiscal stance shifted from neutral as intended in the budget to slightly expansionary.

Risks and vulnerabilities

Further escalation of the conflicts in the Middle East and Ukraine could push up energy prices and shipping costs. Meanwhile, extreme weather conditions can disrupt agricultural production and drive up food prices, and adjustments to fuel tax and electricity tariffs can push up inflation.

A sudden growth slowdown in the US, Europe, or China can dampen global demand and affect Korea's exports. The country's export prospects may also be eroded by significant increases in import tariffs by the US. Lastly, political uncertainty following the declaration of martial law in December 2024 may dent business and consumer sentiment and cause foreign investors and tourists to take a wait-and-see

attitude, posing an additional risk to the near-term outlook for aggregate demand.

The debt servicing ability of SMEs, small merchants, self-employed business operators, and low-income households remains weak, reflecting the scarring effects of the pandemic. Although the banking sector's credit quality has stabilized, non-bank deposit-taking institutions are experiencing a rise in delinquency.

There are pockets of risk in savings banks, which have financed a significant portion of troubled PF loans in the real estate sector. Some savings banks may not have sufficient financial buffers to absorb a surge in non-performing loans, particularly as the increase in unsold units in regional areas has strained the finances of many developers.

Policy recommendations

As inflation is expected to further moderate in the near term, a continued dial-back in the restrictiveness of monetary policy would be appropriate to support the recovery in domestic demand. Although the reduction in the policy rate may lead to an increase in household borrowing, it can help alleviate households' debt burden for existing borrowers and spur domestic demand. The lower interest rates can also help ease financial conditions for developers, construction companies, and NBFIs involved in troubled PF projects.

Stronger buffers and enhanced risk management are necessary for NBFIs. Savings banks and credit cooperatives should actively liquidate non-viable PF projects, develop rehabilitation plans for viable ones, and increase provisions and liquidity buffers. Moreover, NBFIs' risk management and credit assessment should be strengthened.

Macroprudential measures should be further finetuned. The currently tight loan-to-value ratio for borrowers owning multiple homes or properties in speculative zones should be maintained. However, to support real housing demand, normalizing the ratio for first-time buyers should be considered.

Continued efforts are needed to ensure fiscal sustainability. Given the narrowed fiscal space post-pandemic, a medium-term fiscal consolidation program would be prudent to rebuild fiscal space and stabilize the debt-to-GDP ratio. Over the longer term, it is essential to strengthen fiscal discipline and implement revenue-enhancing and spending-restructuring measures.