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THE PENINSULA

Understanding the Gap in South Korea's Perceived and Indexed Economy

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Several important economic figures released by the South Korean government last week suggest that the overall economy is in good shape. One perplexing trend, however, is the less sanguine numbers reported on the general perception and sentiment about the country's macroeconomic performance. This seeming discrepancy is worth examination because “feelings” about the economy can affect market behaviors or even constrain policymakers.

Strong Economic Indicators

A series of figures announced last week by the Korean government were encouraging on many fronts. For instance, the August figures for trade looked strong, with exports rising 11.4 percent year-on-year (YoY) to 57.9 billion USD. Imports also climbed 6 percent to 54.1 billion USD, keeping South Korea's trade balance in the black for 15 consecutive months at 3.4 billion USD. Semiconductors, wireless communication, computers, petroleum products, shipping, and biomedicine all stood out as leading exports. Automobile exports, however, took a slight dip (decreasing 4.5 percent) due to disruptions in manufacturing arising from production line modernization and collective bargaining negotiations.

The latest figure for inflation was also encouraging. The consumer price index rose by 2 percent YoY, which was the lowest recorded since March 2021. The latest reporting was helped by modest price gains for agricultural, livestock, and fishery products (2.4 percent YoY) as well as crude oil (0.1 percent YoY). Although the general outlook on inflation for the year is promising, prices are expected to bounce back in the month of September, with an anticipated surge in demand for essential goods during Chuseok. Officials at the local and national level are working to address the seasonal spike in price with various forms of subsidies and price stabilizing measures.

Moreover, the revised GDP figure for the second quarter of 2024 appeared in line with slowed inflation data, which seems to suggest that growth is moderating with real GDP, decreasing by 0.2 percent to a YoY increase of 2.3 percent. However, the Bank of Korea still expects growth to be on track to achieve 2.4 percent by the end of this year, which is slightly lower than the IMF projection of about 2.5 percent and the OECD forecast of 2.6 percent.

Perception, Sentiment, and Economic Trends

The combination of robust (but modest) growth backed by strong exports and slowed inflation appears to paint a positive picture of the South Korean economy. However, on-the-ground perceptions and sentiments do not appear to align with these trends. For instance, while YoY inflation moderated significantly between July (2.6 percent) and August (2.0 percent), the corresponding perceived inflation was 3.5 percent in August compared to 3.6 percent in July. Inflation expectations, on the other hand, remained unchanged at 2.9 percent. Although exports looked strong and YoY GDP growth was positive, both consumer and business sentiments *declined* by 2.9 percent and 2.7 percent, respectively.

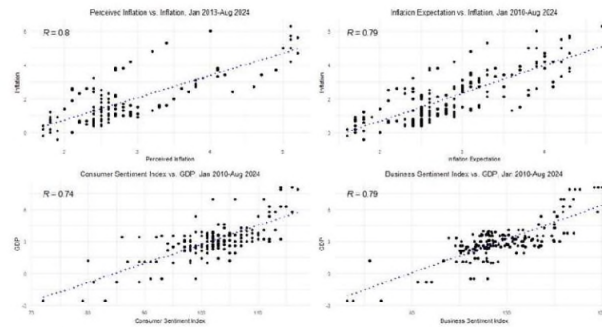
Figure 1: Perceived/Expected Inflation and Inflation in South Korea, Jan 2010 – Aug 2024 (in %)



Sources: KOSIS, MOEF, BOK

Perhaps the above findings should not be all that surprising. Looking back in time, it is rare that perceived and expected inflation matched the actual inflation rate (Figure 1). On average, South Koreans tend to overestimate inflation by approximately 1 percent. Even after accounting for this bias, however, there appears to be a relatively high correlation between inflation perception and expectation and actual inflation (Figure 2).

Figure 2: Correlation Matrix of Perception/Expectation/Sentiment vs. Economic Indices



Sources: KOSIS, MOTIE, MOEF, BOK

Consumer and business sentiments also appear to do well in estimating the overall trend in the state of the economy, with the correlation between such sentiments and GDP growth being above 0.7 (Figure 2). However, this analysis does not explain why South Koreans tend to be pessimistic about their economy, which is not the case in other countries.

Some research on this topic appears to attribute the existence of this gap to economic factors, such as differences in export and domestic demand, cost of living, interest rate, and inequality. However, competing explanations also suggest that the disconnect may be due to negative media reporting and growing partisan polarization. If the latter is true, then how economic issues are framed in public discourse would play an important role in shaping public perception and sentiment about the economy. The ability of the ruling party to reach across the aisle by identifying areas of mutual interest with the opposition and looking for areas of cooperation on economic issues would also matter.

Conclusion

There is ample research suggesting that public opinion can constrain policymakers from implementing necessary reforms. To the extent that general perception and sentiment about the economy can shape public attitudes about the government's policy performance, the gap between perceived and indexed economies should not be taken for granted by policymakers. Transparency coupled with effective communication should be prioritized and crafted with care if the government wishes to have the people's support for its policy and reform.

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