PMI™ by S&P Global

Week Ahead Economic Preview

US and China inflation, UK GDP, plus Bank of Korea meeting

6 January 2023

The coming week will see a number of key releases including US and China CPI data and China's trade numbers. In Europe, the UK publishes its monthly GDP figures for November while the eurozone's unemployment and industrial production statistics will also be due. On monetary policy, the Bank of Korea is expected to raise rates next week while attention will also be on comments from Fed speakers for insights into US policy. The first S&P Global Investment Managers Index report of 2023 will meanwhile provide fresh indications of US equity investors' expectations following the muted start to the year.

Ahead of US corporate earnings releases, the market can be seen treading water, caught between concerns over continued Fed hikes and hopes for a China reopening boost. The Hong Kong Hang Seng Index notably kicked off 2023 on a positive note, cheering the easing of COVID-19 curbs in mainland China. This also followed the release of the December China Caixin General Composite PMI, compiled by S&P Global, which saw business confidence about the year ahead soaring to the highest since May 2021. That said, the PMI's overall current business activity index remained in contraction territory amid the flaring up of COVID-19 cases. A return to expansion will be eagerly awaited in the coming months, but a fuller picture of economic conditions in December meanwhile becomes available with CPI and trade data in the coming week.

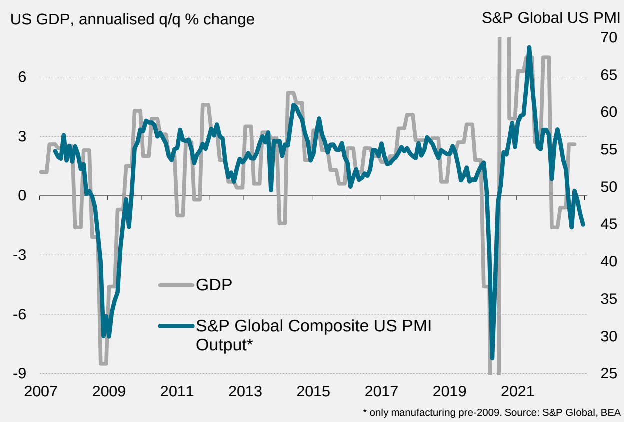
Meanwhile the latest Fed minutes from the December FOMC meeting reinforced the US central bank's commitment to targeting inflation and suggested that the Fed continued to view inflation as concerning despite the recent easing of inflationary pressures. The upcoming CPI release will therefore be of interest especially if the data should surprise on the downside, as hinted at by the S&P Global Flash US Composite PMI. The degree to which risk assets may positively respond to softening inflation indications appears more ambiguous now, post the caution from Fed officials on market rallies hindering the inflation-targeting operations.

Finally, the Bank of Korea will be an APAC central bank expected to lift rates for the first time in 2023. Positioning by the central bank will be watched given the stress for various APAC economies from both tightening financial conditions and a deteriorating global economic outlook.

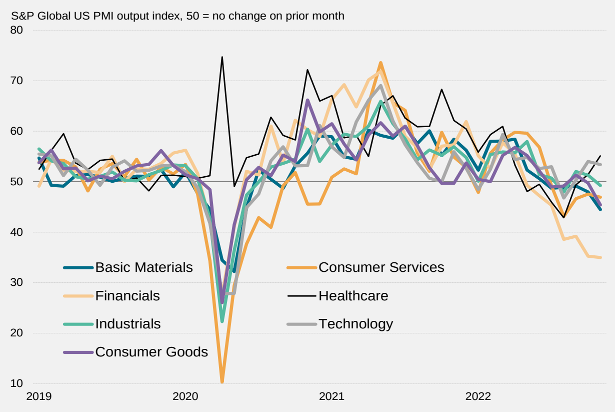
US economy set to weaken amid financial services woes

Official data have yet to indicate any significant impact from recent Fed rate hikes, with GDP likely to have risen at an annualised rate in excess of 2% in the fourth quarter. However, the dampening effect of tighter policy is becoming increasingly evident in the survey data, and especially where one would expect to see a detrimental impact from higher borrowing costs: financial services. S&P Global's PMI survey data, based on data collected each month from a representative sample of US companies, showed business activity falling sharply in December, with financial services recording by far the steepest rate of contraction. Consumer facing sectors also struggled, linked to the rising cost of living, and manufacturing faced additional headwinds from a slowing in global trade. While there was some good news from other sectors, notably tech and healthcare, which remained in expansion territory, the overall suggestion is that GDP growth could disappoint in the New Year.

US PMI and GDP



US PMI output by sector



Key diary events

Monday 9 January
Japan Market Holiday
Australia Building Approvals (Nov)
Switzerland Unemployment Rate (Dec)
Germany Industrial Production (Nov)
Switzerland Forex Reserves (Dec)
Eurozone Sentix Index (Jan)
Eurozone Unemployment Rate (Nov)
Canada Leading Index (Dec)
Canada Building Permits (Nov)
S&P Global Metals PMI* (Dec)
S&P Global Electronics PMI* (Dec)

Tuesday 10 January
Japan All Household Spending YY (Nov)
Japan CPI, Overall Tokyo (Dec)
United Kingdom S&P Global/REC Report on Jobs* (Dec)
Norway Consumer Price Index (Dec)
United States S&P Global Investment Manager Index* (Dec)
United States Wholesale Inventories (Nov)
China (Mainland) M2, New Yuan Loans, Loan Growth (Dec)

Wednesday 11 January
Australia Retail Sales (Nov)
Malaysia Industrial Output (Nov)

Thursday 12 January
Japan Current Account (Nov)
Australia Trade Balance (Nov)
China CPI, PPI (Dec)
Norway GDP (Nov)
India CPI (Dec)
India Industrial Output (Nov)
United States CPI (Dec)
United States Initial Jobless Claims

Friday 13 January
Japan M2 Money Supply (Dec)
Japan Broad Money (Dec)
China Trade (Dec)
South Korea Bank of Korea Base Rate (Jan)
United Kingdom monthly GDP, incl. Manufacturing, Services and Construction Output (Nov)
United Kingdom Goods Trade Balance (Nov)
Eurozone Total Trade Balance (Nov)
Eurozone Industrial Production (Nov)
United States Import Prices (Dec)
United States UoM Sentiment (Jan, prelim)
Canada House Starts (Dec)

* Press releases of indices produced by S&P Global and relevant sponsors can be found **here**.

What to watch

Americas: US CPI, UoM sentiment, Fed comments
The final US CPI figure from 2022 will be released in the coming week and watched intently for further signs of inflationary pressures easing. The consensus points to a 0.1% month-on-month (m/m) rise for headline CPI and a quicker 0.3% m/m uptick for core CPI. With the Fed closely watching the inflation trend, this will be an important reading following the jobs report this week. Several Fed appearances are also scheduled with comments scrutinised for insights into the rate hike path in 2023. S&P Global Market Intelligence expects the Fed to raise the policy rate to 4.75-5.00% by March before reversing course in May 2024.

Meanwhile the preliminary January University of Michigan consumer confidence survey will also be released, while insights into US equity investors' sentiment will be gleaned from Tuesday's S&P Global Investment Manager Index.

Europe: UK monthly output and trade figures, Eurozone unemployment and industrial production data, German industrial output
In the UK, official November monthly GDP, output and trade figures will be updated on Friday. This comes after November's S&P Global / CIPS UK Composite PMI revealed that private sector output fell for a fourth straight month with the manufacturing output contraction outpacing that of services. Export orders meanwhile declined for a fifth consecutive month in November and at a faster rate compared to the month prior.

November's eurozone unemployment and industrial production figures will also be due in the coming week.

Asia-Pacific: Bank of Korea meeting, China CPI and trade data, India inflation
In APAC, the Bank of Korea convenes for the first time in 2023 following a 25-basis point hike in November 2022 and the 50 bps prior rise in October. With the Monetary Policy Board expected to further lift rates, another 25 bps hike in January should not be ruled out. Read more in our special report on the South Korean economy.

China's CPI and trade data for December will also be highlights in the coming week following the easing of COVID-19 restrictions. Caixin China General Manufacturing PMI data had so far alluded to a sustained fall in export orders.

Special reports:

Global Price Pressures Cool Further as End of 2022 Sees Manufacturers Cut Capacity | Chris Williamson | **page 4**

South Korea's Economy Faces Growing Headwinds in 2023 | Rajiv Biswas | **page 8**

Recent PMI and economic analysis from S&P Global

Global	Flash PMI survey data signal growing impact from rate hikes on economy and inflation	16 Dec	Chris Williamson
	PMI surveys show emerging markets outperforming global benchmarks in November but trend deteriorating	15-Dec	Joseph Hayes
	Global Autos production slumps in November amid declining demand	15-Dec	Laura Denman
	Global employment trend softens in November but labour shortages and hiring challenges support continued jobs growth	9-Dec	Andrew Harker, Joseph Hayes, Pollyanna De Lima
Americas	Expectations of further Fed tightening in December, as PMI survey data suggest policy is helping cool inflation and reduce demand	9-Dec	Sian Jones
Europe	Eurozone recession fears ease as flash PMI signals slower rate of contraction for second month	16-Dec	Chris Williamson
	Flash UK PMI data signal cooling inflation and moderating downturn, but jobs are cut amid uncertain outlook	16-Dec	Chris Williamson
	Recruitment downturn signals cooling wage growth in UK	12-Dec	Chris Williamson
Asia-Pacific	ASEAN manufacturing outlook for 2023 softens as demand remains lacklustre	4-Jan	Jingyi Pan
	Asia PMI indicates region slipping further into contraction ahead of 2023 arrival	12-Dec	Jingyi Pan
Commodities	Weekly Pricing Pulse: A mixed week for commodity markets overshadowed by sharp decline in energy prices	16-Dec	Michael Dall

S&P Global Economics & Country Risk highlights

Top 10 economic predictions for 2023

Efforts by central banks to subdue inflation will dominate the economic landscape in 2023, producing a pronounced slowdown in global economic growth, according to the annual Top 10 Economic Predictions by S&P Global Market Intelligence.

Click here to read our research and analysis

Purchasing Managers Index: Stocks of finished goods and a new data set

Tune in for the latest trends seen in our Purchasing Managers Index data. Our economists discuss the strength of Middle East economies and challenges facing economies within Africa. They also look at what's driving the rise in global manufacturing stocks of finished goods and highlight a new data set within the PMI offering that aims to quantify the impact of common themes like demand inflation and delivery times.

Click here to listen to this podcast by S&P Global Market Intelligence

For further information:

For more information on our products, including economic forecasting and industry research, please visit the Solutions section of **www.ihsmarkit.com**. For more information on our PMI business surveys, please visit **www.ihsmarkit.com/products/PMI**

Special Focus

Global Price Pressures Cool Further as End of 2022 Sees Manufacturers Cut Capacity

Global manufacturing output fell for a fifth successive month in December 2022, according to the JPMorgan Global Manufacturing Purchasing Managers' Index™ (PMI™) compiled by S&P Global, driven by an accelerating rate of decline of order books.

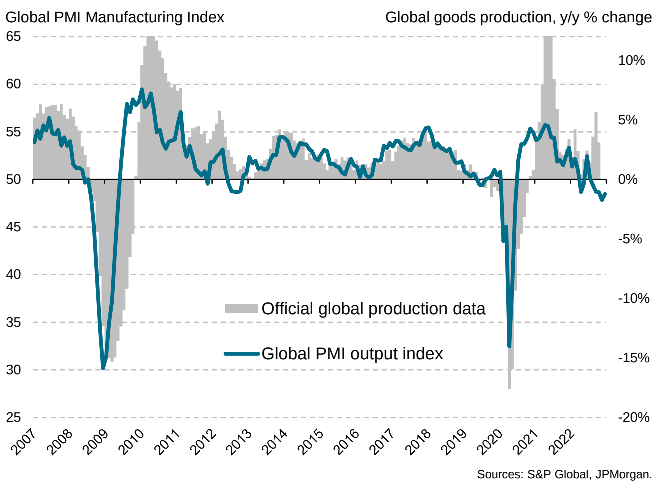
In a marked contrast to earlier in the year, when manufacturing conditions were characterised by firms struggling to source sufficient quantities of raw materials and labour, the end of 2022 saw increasing evidence of producers cutting back sharply on input purchases and reducing headcounts amid growing signs of slumping demand and excess capacity.

The upsides to falling demand and spare capacity were fewer supply constraints and a further marked moderation of price pressures. These improving inflation signals, as well as reduced COVID-19 restrictions in mainland China, helped bolster business confidence in the year ahead, albeit with sentiment continuing to run below the survey's long-run average.

These developments are explored further below in 10 key charts from our December manufacturing PMI surveys.

Chart 1: Global factory output decline extends to fifth month

Global manufacturing output



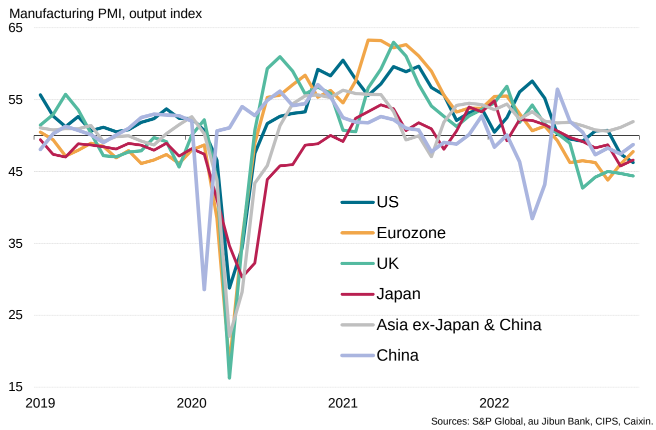
The global manufacturing PMI Output Index, which acts as a reliable advance indicator of actual worldwide output trends, signalled a fifth consecutive monthly decline in worldwide factory production in December.

Although the rate of decline moderated, the pace of contraction remained steeper than at any time since 2009, which was during the global financial crisis, excluding the initial pandemic lockdown months in early 2020.

Chart 2: South Asia bucks global downturn

By region, Asia ex-Japan and China bucked the global downturn, with output growth accelerating slightly at the end of 2022. Rates of contraction meanwhile quickened in the US and UK but moderated in the eurozone, mainland China and Japan.

Manufacturing output in key economies



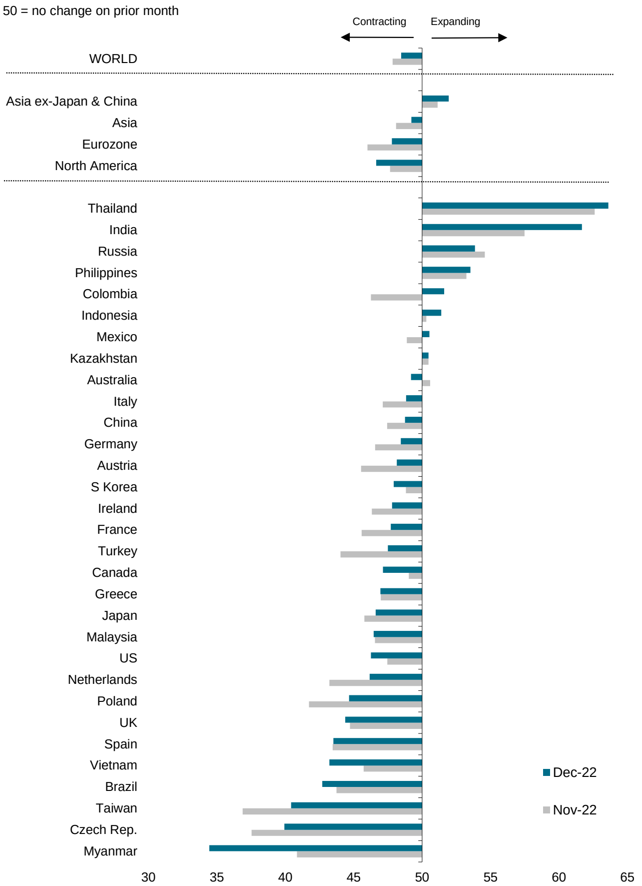
Excluding pandemic lockdown months, the US and UK contractions were the steepest since 2009 and 2012 respectively. In contrast, the eurozone's decline was the smallest for six months and China's decline was the mildest seen in the recent four-month period of falling production. While Japan's factory output downturn likewise moderated slightly, it remained among the sharpest witnessed over the past decade.

Chart 3: Thailand and India lead global rankings

Of the 31 economies for which S&P Global PMI data are available, only nine reported higher production volumes in December, with only marginal growth seen in two of these nine economies. Thailand and India reported stand-out performances, with both enjoying strong and accelerating growth. A strong production gain was also seen in the Philippines and – to a lesser extent – Indonesia, where, like Thailand and India, expansions were helped by the diversification of supply chains from mainland China amid the ongoing COVID-19 disruptions.

Robust growth was also recorded in Russia, reflecting the ramping up of production to meet domestic demand amid sanctions and import restrictions.

Manufacturing PMI output index



Sources: S&P Global, JPMorgan, CBA, ISO, CIPS, au Jibun Bank, NEVI, BME, Bank Austria, AIB, AERCE, Caixin, HPI, Istanbul Chamber of Industry, Tengri Partners.

At the other end of the rankings, the steepest fall in manufacturing production was recorded in Myanmar during December, followed by the Czech Republic and Taiwan. Especially steep falls were also recorded in Brazil, Vietnam, Spain, the UK and Poland.

Chart 4: Demand downturn accelerates

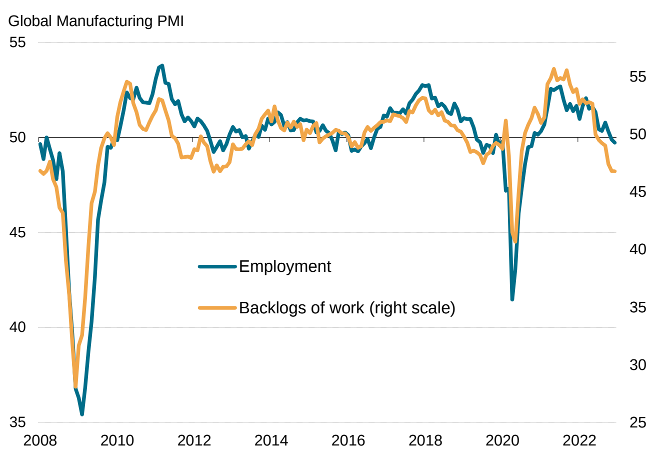
One of the most concerning metrics in terms of the near-term outlook was the degree to which new orders continued to fall. New orders, changes in which reflect current demand conditions, have been falling at a notably faster pace than output in recent months, with December seeing the rate of decline accelerate further to a pace exceeding that seen at any time since the global financial crisis, barring initial pandemic months. Moreover, the spread between new orders and output widened further, to one of the largest on record, pointing to an increasing excess of operating capacity relative to current demand.

Global manufacturing output and order books

Sources: S&P Global, JPMorgan.

Chart 5: Employment falls amid order book downturn

Global factory employment and backlogs of work



Sources: S&P Global, JPMorgan.

The accelerating global downturn in demand for manufactured goods was also reflected in increased rate of decline of backlogs of work, which continued to fall at a rate not seen since 2009 if pandemic lockdown months are excluded. Worldwide factory employment was consequently cut, dropping slightly for a second straight month in December, as increasing numbers of firms adjusted workforce numbers lower in line with reduced capacity requirements.

Chart 6: UK sees especially steep employment decline

An especially steep fall in manufacturing sector employment was recorded in the UK, where the cut to workforce numbers was the steepest since 2009 if early pandemic months are excluded. December also saw jobs being lost in factories in mainland China as well as notable declines being suffered in Vietnam, Poland and the Czech Republic. A slight reduction in headcounts was also seen in Asia excluding Japan and China as a whole, despite the region seeing stronger production growth.

Job creation meanwhile slowed close to stagnation in the US and Japan and weakened in the eurozone, albeit the latter outperforming in terms of overall employment growth.

PMI manufacturing employment indices

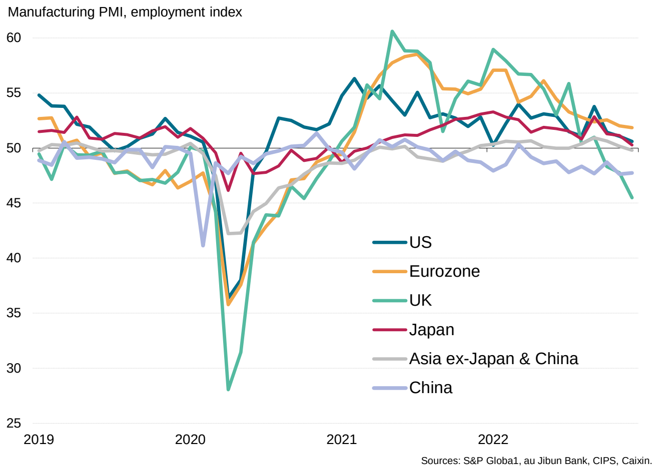
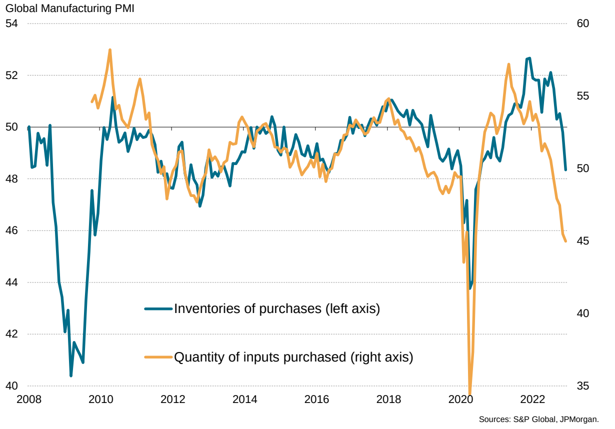


Chart 7: Input buying plunges

As well as reducing headcounts, factories also cut back on their purchasing of inputs to a degree not seen since comparable data were available in 2009, barring the initial pandemic months.

Global manufacturing inventories



Inventories of raw materials likewise fell sharply reflecting the growing worldwide incidence of deliberate inventory reduction policies, contrasting sharply with the trend of intentional inventory accumulation seen earlier in the year and during 2021.

Chart 8: Supply improves, price pressures moderate close to long-run average

The downturn in manufacturing order books and commensurate slump in input buying took further pressure off global supply chains in December 2022. The incidence of longer supplier delivery times fell to the lowest since January 2020, just prior to the pandemic, to represent a major improvement in the global supply situation compared to the unprecedented supply scarcities reported at the start of the year and throughout 2021.

The combination of fewer supply delays and falling demand for inputs took pressure off prices. Average input prices rose in December at the slowest rate since October 2020, the rate of inflation cooling markedly compared to November to a pace only slightly above the survey's long run average.

Worldwide manufacturing prices vs. supply and demand

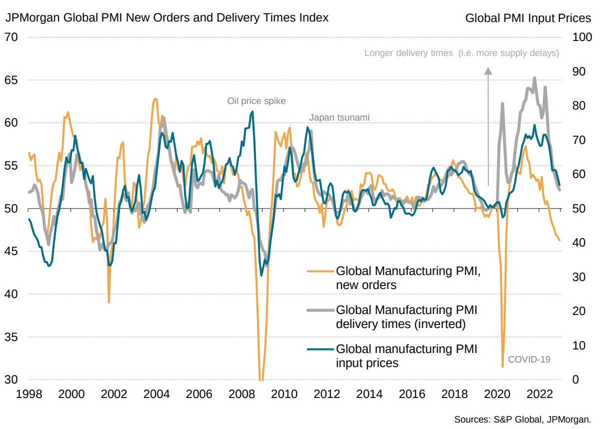


Chart 9: Factory selling prices rise at slowest rate since 2020

Slower growth of input costs fed through to weaker global factory selling price inflation in December, which saw the average rise in output prices charged by producers falling to the weakest since December 2020, the rate of increasing continuing to descend markedly from the all-time high seen back in April.

Rates of producer selling price inflation cooled in the US, eurozone, UK, Japan and the rest of Asia as a whole, with mainland China seeing a marginal fall in prices. Prices also fell in Australia, Vietnam, Taiwan and Malaysia.

PMI manufacturing output price indices

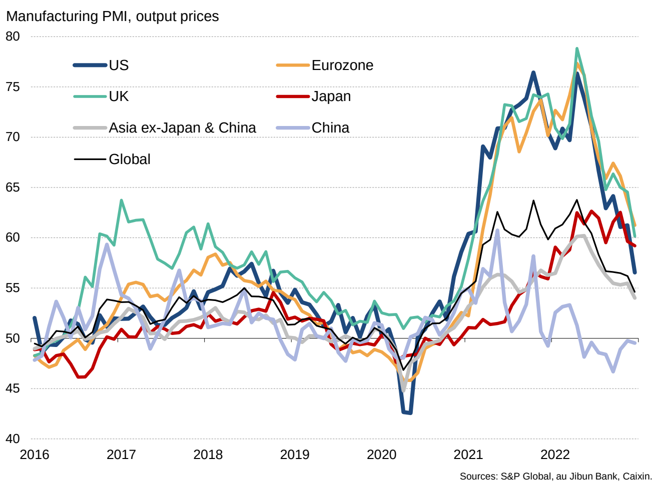
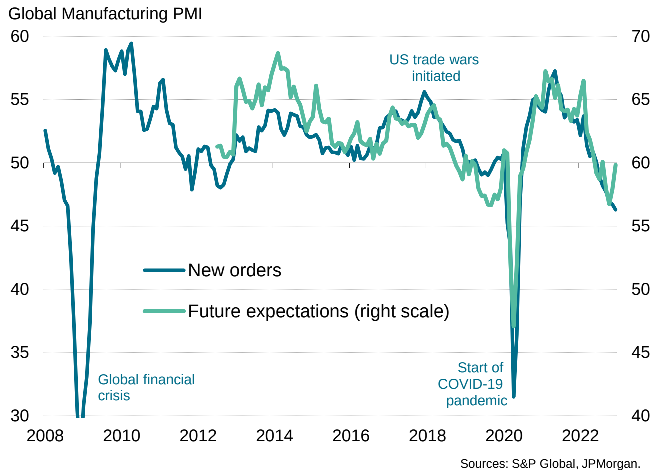


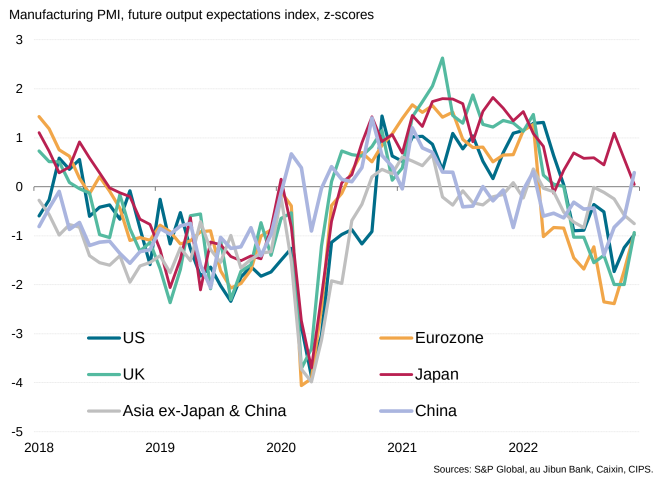
Chart 10: Future output expectations rise sharply higher

While the survey gauges of new orders, backlogs of work, input buying, inventories and employment all painted a darkening picture of current manufacturing conditions, the improvement in the supply situation was accompanied by one other glimmer of light: business expectations of output in the coming year improved in December, rising to the highest since last August. However, even with the latest improvement, the level of business optimism remained below the survey's long-run average, underscoring persistent concerns regarding the outlook for demand.

Of particular note, future output expectations recovered to a level above the long-run average in mainland China, reflecting the rolling-back of COVID-19 restrictions. Sentiment also picked up in the US and Europe, albeit remaining firmly below long-run averages. Sentiment meanwhile deteriorated in Japan and the rest of Asia as a whole, in part reflecting growing global headwinds amid a waning post-Omicron rebound.

Future output expectations





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Special Focus

South Korea's Economy Faces Growing Headwinds in 2023

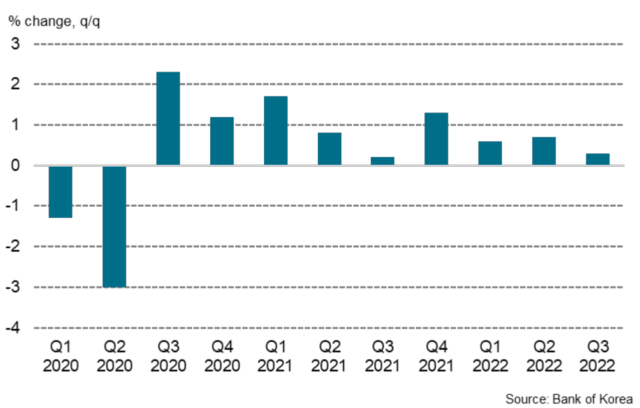
The South Korean economy is expected to face growing headwinds in 2023, due to the impact of weakening exports and the cumulative transmission effects of monetary policy tightening by the Bank of Korea, South Korea's central bank, during 2022. Merchandise exports declined by 9.5% year-on-year (y/y) in December 2022, with South Korea recording its first trade deficit since 2008 in calendar 2022 due to moderating export growth and a surge in energy imports.

Weak economic growth in the US and the European Union (EU) have become a key downside risk for South Korea's manufacturing export sector in 2023. Mainland China is South Korea's largest export market and weak economic momentum in the Chinese economy also weighed on South Korean exports in 2022.

GDP growth momentum weakens due to net exports

South Korea's economic growth momentum slowed in the second half of 2022, as export growth momentum moderated while imports surged due to higher world energy prices.

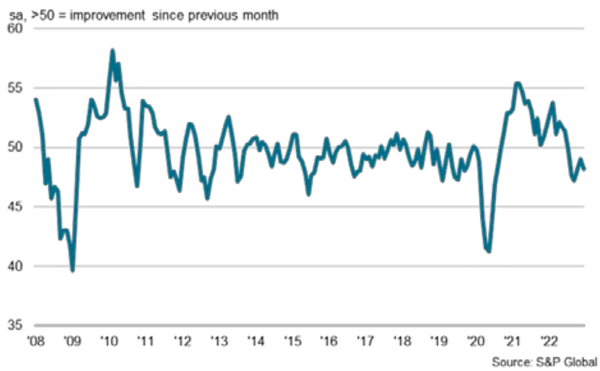
South Korea real GDP growth

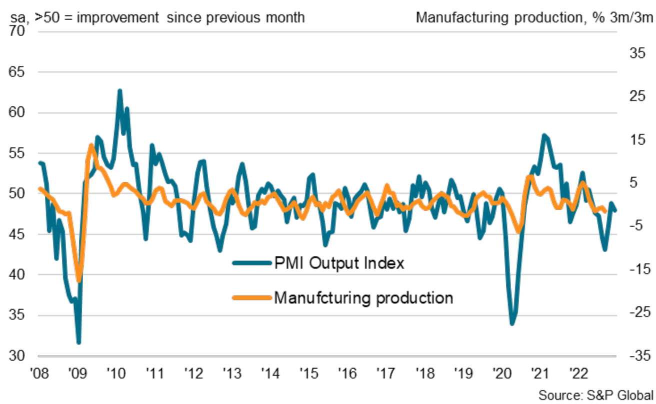


South Korea's economic growth rate slowed significantly in the third quarter of 2022 despite strong private consumption growth. On a year-on-year basis, real GDP growth rose by 3.1% y/y in the third quarter of 2022. The weak GDP outturn reflected the negative impact of net exports, albeit private consumption showed strong growth during the third quarter, rising by 1.3% quarter on quarter (q/q) and up 5.9% y/y. Negative net exports were a key drag on growth momentum, with exports up by just 1% q/q while imports rose by 5.8% q/q. Weak export growth reflected declining semiconductors exports, while import growth was strong, boosted by rapid growth in consumer expenditure.

Construction grew by 1.8% q/q in the third quarter of 2022, while services output rose by 0.7% q/q. Services output rose by 4.5% y/y and construction output rose by 2.1% y/y. Manufacturing output contracted by 1.0% q/q in the third quarter of 2022, as output of computer, electronic & optical products and chemical products decreased. This was the second successive quarter of contraction in manufacturing output, which fell by 0.7% q/q in the second quarter of 2022. Compared to a year ago, manufacturing output rose by 2.2% y/y.

South Korea Manufacturing PMI



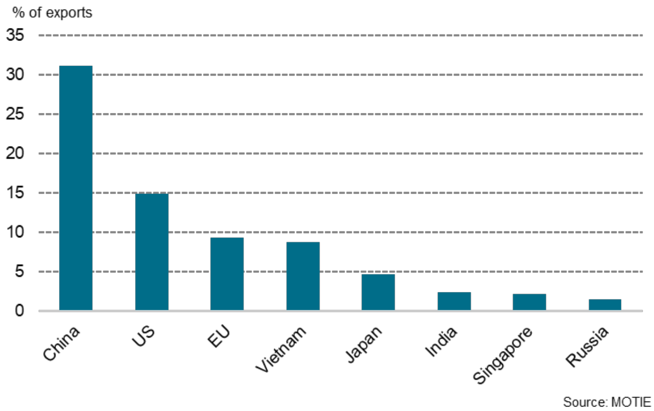


The seasonally adjusted South Korea Manufacturing Purchasing Managers' Index (PMI) lost momentum in December, falling to 48.2 from 49.0 in November. The December survey reading was indicative of modest contraction in South Korea's manufacturing sector, and the sixth in as many months.

The December survey results showed that firms within the South Korean manufacturing sector continued to struggle at the end of 2022. Subdued demand conditions became a recurring theme throughout the latest survey and was reportedly a pivotal factor driving faster downturns in several indices including output and new orders. Recent cargo trucker strike action contributed to the most pronounced lengthening in delivery times since June while firms expressed the weakest outlook for output since July 2020.

Moderating economic growth in mainland China due to the impact of pandemic-related restrictive measures on domestic demand has contributed to weaker demand for South Korean exports, since China is South Korea's largest export market. As the EU is one of South Korea's largest export markets, weakening economic growth in the EU has also become a negative factor for South Korea's manufacturing export sector.

South Korea's export markets



Rising raw material costs and a weak exchange rate against the US dollar continued to push up average cost burdens for South Korean firms in December. Despite this, the rate of input price inflation has moderated in recent months, and in December was the joint-lowest in two years, with output prices rising at the slowest pace in 27 months.

South Korean CPI inflation has eased in the second half of 2022, moderating to a pace of 5.0% y/y in December, compared with a recent peak 6.3% y/y in July. The annual average CPI inflation rate of 5.1% for 2022 compares with an average CPI inflation rate of 2.5% in 2021. The 2022 average CPI inflation rate was the highest annual average since 2011.

At its 24th November meeting, the Monetary Policy Board of the Bank of Korea decided to raise the Base Rate by 25 basis points (bps), from 3.00% to 3.25%. In its rate rise decision, the Monetary Policy Board decided that the policy response should be strengthened, as inflation has remained high, although it was also noted that inflation risks related to the exchange rate had eased.

In their November decision, the Monetary Policy Board assessed that consumer price inflation outlook is marginally lower than the August forecast of 5.2% in 2022 and 3.7% in 2023, with projected average CPI inflation for 2022 revised down to 5.1% while CPI inflation for 2023 is expected to be 3.6% y/y. The recent rebound of the Korean won against the USD has helped to mitigate the upside risks to inflation. The KRW had depreciated from 1,189 against the USD on 1st January to 1,428 by 12th October but has since appreciated to 1,277 by 3rd January 2023.

Due to the upturn in inflation pressures during 2022, the Bank of Korea has tightened monetary policy seven times in 2022, having raised the Base Rate to 3.25%, bringing the total cumulative tightening to 225 bps in 2022.

Electronics sector downturn hits South Korean exports

The electronics manufacturing industry is an important part of the manufacturing export sector for South Korea which is one of the world's leading exporters of electronics products to key markets such as the US, China and EU. As Vietnam is an important production hub for South Korean electronics multinationals such as Samsung and LG for a wide range of electronics products such as mobile phones, Vietnam is also a key export market for South Korean electronics components.

Exports of South Korea's information and communications technology (ICT) goods for November fell by 22.5% y/y, with a total value of USD 16.7 billion, accounting for 32.1% of South Korea's total merchandise exports. Deteriorating global economic conditions have resulted in lower exports of chips, displays, computers and peripherals.

Semiconductors exports slid by 28.4% y/y to USD 8.7 billion in November as memory unit prices fell and demand for downstream industries slowed down. The export value of display products fell by 17.3% y/y to USD 2.0 billion as demand from downstream industries weakened due to contracting demand for OLED and LCD panels.

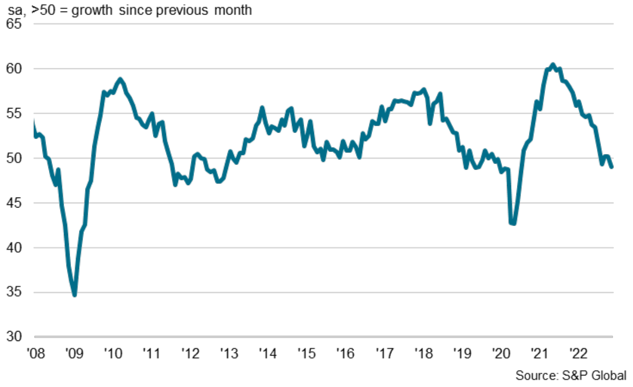
Mobile phone exports fell by 6.2% y/y to USD 1.4 billion, with exports of finished products down by 34.5% y/y and high value-added parts up by 5.5% y/y.

South Korean ICT exports to mainland China and Hong Kong SAR shrank by 30.2% y/y in November to USD 7.0 billion, reflecting the impact of pandemic restrictions on China's domestic consumer demand and industrial output.

South Korean ICT exports to the EU fell by 24% y/y due to reduced demand for semiconductors, computers and peripherals.

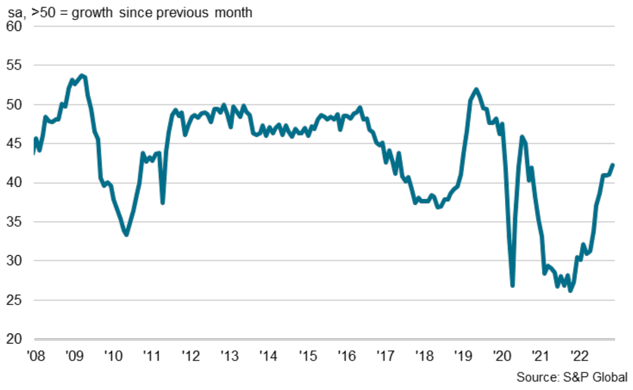
The downturn in South Korea's ICT exports reflects the slowdown in the global electronics industry. The headline seasonally adjusted S&P Global Electronics PMI has slowed significantly since mid-2021. The latest headline PMI for November was at 49.0, down from 50.5 in October and slightly below the 50.0 no-change mark to signal slightly contractionary business conditions for global electronics manufacturers.

S&P Global Electronics PMI



Global electronics producers continued to show significant delays in suppliers' delivery times in November. That said, the extent of delays has diminished to the lowest since August 2020. Where longer lead times were reported, global electronics firms often mentioned the lingering impacts of COVID-19, input shortages among suppliers and shipping delays.

S&P Global Electronics PMI: Suppliers' Delivery Times



Near-term economic outlook

South Korean GDP growth is estimated to moderate from 2.5% in 2022 to 1.6% in 2023, according to the latest forecast by S&P Global Market Intelligence.

South Korea's export sector, which accounts for an estimated 38% of GDP, is expected to face increasing headwinds during 2023 due weak growth in the US and EU and the recent downturn in the global electronics cycle.

In its Monetary Policy Decision in November, the Bank of Korea estimated that GDP growth for 2022 is likely to be 2.6%, but lowered its forecast for 2023 from 2.1% to 1.7%. Due to the upturn in inflation pressures during 2022, total cumulative tightening of 225 bps by the Bank of Korea during 2022 will continue to act as a brake on domestic demand during 2023. Higher policy rates have also resulted in a cooling property market, with South Korean apartment prices estimated to have declined by 4.8% y/y in the first eleven months of 2022, according to the Real Estate Board.

Inflationary pressures remain an important risk to the near-term outlook. This reflects a number of factors, including higher input prices and supply chain disruptions, which have contributed to rising input price inflation pressures.

Medium-term outlook and key risks

Over the medium-term outlook, South Korean exports are expected to grow at a rapid pace, helped by the sustained strong growth of intra-regional trade within APAC, as China, India and ASEAN continue to be among the world's fastest-growing emerging markets. South Korea's strong competitive advantage in exporting key electronics products, notably semiconductors and displays, as well as autos and auto parts, are expected to be an important positive factor underpinning export growth.

The rapid growth of South Korean exports is also expected to be strengthened by the APAC regional trade liberalization architecture. This includes the large recent Regional Comprehensive Economic Partnership (RCEP) multilateral trade agreement and major bilateral free trade agreements (FTAs). The RCEP trade deal, which South Korea has ratified, entered into effect from 1st January 2022 for the first 10 ratifying members, and from 1st February 2022 for South Korea.

A key macroeconomic risk to the South Korean economy over the medium to long-term outlook continues to be from the high level of household debt as a share of disposable income. This has risen to 206% by 2021, the fifth highest amongst all OECD countries. A key factor driving this debt ratio higher has been large mortgage lending flows for residential property purchases. Such a high household debt ratio creates macroeconomic vulnerability to significant monetary policy tightening, with Bank of Korea rate hikes in 2021-22 increasing financial pressures on highly leveraged households.

Managing the energy transition towards renewable energy is also a key policy priority for South Korea. The country has already been at the forefront globally in planning initiatives to develop hydrogen as a key future fuel source for domestic power generation.

Among South Korea's greatest economic challenges will be long-term demographic ageing, which will have severe implications for South Korea's economy and society. The number of seniors aged 65 or over has already reached 16.5% of the population and by 2025 is projected to rise to 20% of the population. Meanwhile the working age population (aged 15 to 64) is declining as a share of the total population, from 71.4% in 2021 to a projected 55.7% by 2041.

Demographic ageing has already contributed to the moderation of South Korea's potential GDP growth rate from around 7% per year in the mid-1990s to around 2.5% per year by 2021. South Korea's potential growth rate could drop to a range of around 1% to 1.5% per year by 2050 due to demographic ageing.

Consequently, structural reforms to increase the potential growth rate will be a key policy priority over the medium term. These reforms would include policy changes to lift the labour force participation rate, improve services sector productivity, accelerate digitalization and further boost the adoption of industrial automation.

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