

March 15, 2022

**Statement by the Staff Representative on the Republic of Korea
Executive Board Meeting
March 18, 2022**

This staff statement provides an update on developments and information that has become available since the staff report was issued. The statement does not alter the thrust of the staff appraisal.

1. *Suk-yeol Yoon from the People Power Party (PPP) won the presidential election on March 10.* Following a tightly contested race and a high voter turnout at 77 percent, the PPP garnered 48.6 percent of the vote with a narrow margin of 0.7 percent over the incumbent Democratic Party candidate. The PPP does not have a majority in parliament, elections for which are scheduled in 2024. The new administration will take office on May 10.

2. *The new government is likely to follow through on its electoral pledge to reduce the tax and regulatory burdens.* The immediate policy priorities are expected to focus on supporting vulnerable sectors, including additional measures to compensate small businesses and the self-employed for losses during the pandemic, stabilizing the housing market, and advancing labor and financial market reforms. Proposed policy measures included a scaling back of regulations on the housing market and recent property tax increases, promotion of emerging financial activities, including digital finance, labor market reforms focused on increasing flexibility to support private sector led job creation, and continuation of efforts aimed at supporting carbon neutrality, including through an expansion of nuclear energy (reversing the previous policy stance to phase it out). The incoming administration has also pledged to implement the fiscal rule laid out in 2020 which included a cap on the public debt ratio of 60 percent of GDP.

3. *The macro-financial impact from the conflict in Ukraine has been contained thus far.* Financial conditions remain broadly accommodative despite a worsening of risk sentiment, reflected by a shift away from equities and toward safer assets. The Korean won has modestly depreciated against the U.S. dollar and the Chinese renminbi, but dollar funding conditions remain accommodative. Markets are pricing in higher short-term inflation, but bond yields suggest that inflationary pressures are viewed as being transitory.

4. *The main spillover for Korea from the conflict in Ukraine would come from the commodity price shock, potential supply-chain disruptions, and a weakening in partner country demand.* Direct links are limited, with about only 2 percent of Korea's total exports destined to Russia and Ukraine. Sustained supply chain disruptions would, however, weigh on key exports, since Korea relies on Russia and Ukraine for about half of its imports of

some rare gases used in the manufacturing of semiconductors. This could likely be compounded by potential difficulties in procuring other raw materials and inputs if there are broader disruptions of global distribution channels. While rising energy prices will adversely affect Korea's terms of trade, higher semiconductor prices from global pent-up demand and production capacity limits would help buffer the adverse terms of trade shock. A weakening of partner country demand will have a large effect on Korean exports across a broader range of products. A sustained increase in global oil and food prices would add to inflation pressures in the coming months and delay the convergence of inflation to target.

5. *Inflation in February rose to a near decade high.* Headline inflation increased to 3.7 percent, a 0.1 percent rise from January, driven by rising housing and fuel costs. Core inflation increased to 2.9 percent in a sign of some broadening of price pressures. However, market indicators suggest that the spike in inflation is still viewed as transitory.