

As exports have remained strong and domestic demand including consumption shows signs of recovery, though less than initially projected, the Korean economy achieved a favorable year-on-year growth rate of 2.8% in the first half of this year. Private consumption, a key component of domestic demand, has increased at a faster pace since the first half of this year, and its growth is expected to accelerate gradually¹ (Figure 1). Here, we examine major factors contributing to the delay in private consumption recovery and project the pace of recovery going forward.

Major Factors Delaying the Recovery in Private Consumption

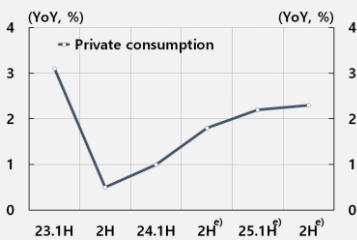
The recovery in private consumption has stalled due to ① high price level, ② debt service burdens caused by high interest rates, ③ a delayed recovery in income, and ④ other structural and idiosyncratic factors.

① High Price Level

Accumulated inflation following the pandemic has delayed the recovery in private consumption. Specifically, since 2021, the accumulated increases in the cost of living, which largely consists of necessities,² have outpaced the headline inflation.³ This suggests that the decline in purchasing power has been more severe for economically vulnerable groups (elderly and low-income households) that spend a larger portion of their income on necessities (Figure 2), as effective prices are higher for them than other population segments. By type of consumption, the recovery has been particularly slow in the consumption of nondurable goods (food, etc.) which have experienced the largest accumulated price increases since 2020 (based on private consumption deflator) and are mostly necessities (Figure 3).

Recovery in private consumption is likely to accelerate gradually

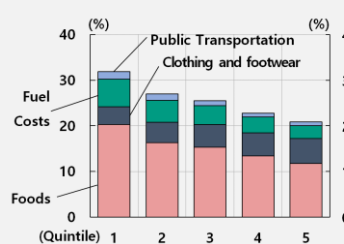
Figure 1. Private consumption growth rate



Source: Bank of Korea.

Share of spending on necessities is higher for low-income households

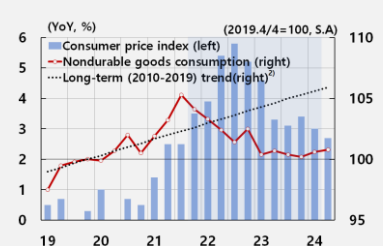
Figure 2. Share of household consumption by income quintile¹⁾



Note: 1) Based on 2023. Source: Statistics Korea.

Recovery of nondurable goods consumption, which experienced higher accumulated price increases, has been delayed

Figure 3. Nondurable goods consumption¹⁾ and inflation



Notes: 1) Figures for Q2 2024 are estimates of the Research Department. 2) Long-term trend of nondurable goods consumption. Source: Bank of Korea.

¹ Private consumption growth rate: 23.2H 0.5 → 24.1H 1.0 → 24.2H 1.8^e → 25.2.2^e (YoY, %)

² Necessities make up 53% of the basket of goods and services whose prices are tracked by the consumer price index.

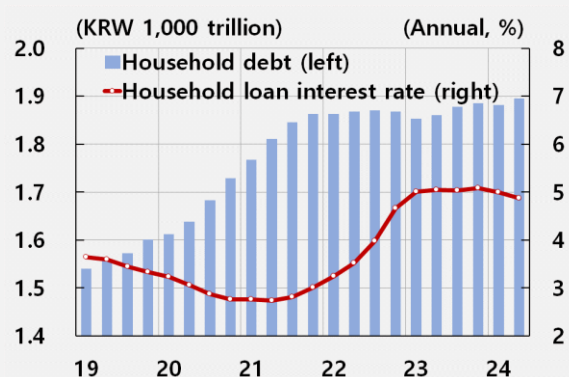
³ As of July 2024, overall consumer prices and the cost-of-living were up 13.8% and 16.3%, respectively, compared to the end of 2020.

② Debt service burdens caused by high interest rates

At a time when household debt has increased significantly, the burden of repaying principal and interest has constrained the improvement in consumption capacity, especially among the “losers of higher interest rates” (Figure 4).⁴ “Losers of higher interest rates” refers to households that suffer losses of their net assets due to higher interest rates, and the group largely comprises households in their 30s and 40s, the upper middle-income households, and upper consumption households. If the decrease in consumption among these losers of higher interest rates exceeds the increase in consumption among the winners of higher interest rates, the overall impact of higher interest rates on decrease in consumption expands. According to recent credit card microdata, for the upper middle-income group, higher debt levels are associated with lower growth rates in credit card purchases (Figure 5).

Debt service burdens persist due to high levels of household debt

Figure 4. Household debt¹⁾ and interest rates²⁾

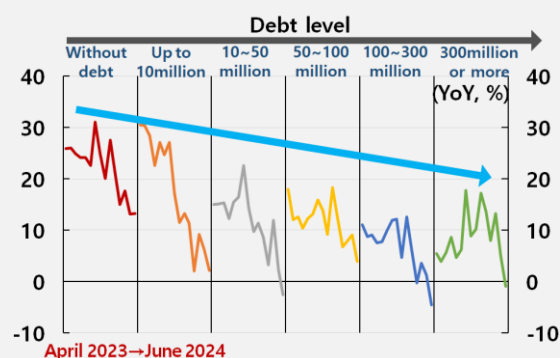


Notes: 1) Based on household credit.
2) Loan interest rate at deposit-taking banks (based on balance).

Source: Bank of Korea.

There is a significant gap in consumption growth between those with high debt and those with low debt

Figure 5. Credit card purchases by debt level



Notes: 1) Based on card users with an income over 60 million KRW.
2) Growth rate of credit card purchases by debt level during April 2023 to June 2024.

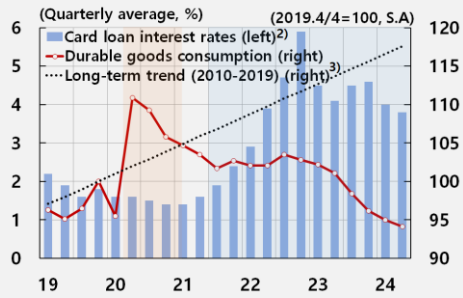
Sources: Shinhan Card, Bank of Korea.

By consumption type, durable goods consumption, heavily influenced by interest rates, has continuously declined since the fourth quarter of 2022 (Figure 6). In addition, one of the major factors for the slump in durable goods is that replacement cycle for these goods (3-4 years or more) has not yet arrived after the demand for durable goods increased significantly due to low interest rates during the early phase of the pandemic (2020-2021) (Table 1).

⁴ Considering the heterogeneous interest rate exposure path among households, the consumption reduction effect of rising interest rates was estimated to be about 20% greater compared to when only the intertemporal substitution effect is considered, mainly for heavily indebted households in their 30s-40s with a high marginal propensity to consume (MPC). (“Impact of Interest Rate Increases on Consumption Considering Heterogeneous Households’ Interest Rate Exposure,” February 2024, Key Issues, Korea Economic Outlook, Bank of Korea).

Consumption of durable goods declines after surging in the early phase of pandemic

Figure 6. Durable goods consumption¹⁾ and interest rates



Notes: 1) Q2 2024 figures are estimates of the Research Department.
 2) Linked to installment interest rates for durable goods.
 3) Long-term trend of durable goods consumption.
 Sources: Korea Financial Investment Association, Bank of Korea.

Replacement cycle of major durable goods has not yet arrived

Table 1. Replacement cycle of major durable goods

Items	Replacement cycle
① TVs	4-5 years
② Smartphones	43 months
③ PCs	3-4 years
④ Passenger cars	5-7 years
⑤ Home appliances	5-9 years

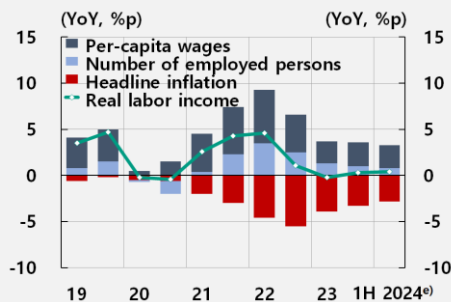
Sources: Public Procurement Service, OMDIA Counterpoint, manufacturers, media coverage, etc.

③ Delayed recovery in income

The improvement in household income has been slowed by the lagged effects of corporate earnings and dampened sales growth in self-employed sector. Despite progress in disinflation, it is estimated that households' real labor income, which was weak last year, only slightly increased in the first half of this year. This is mainly due to the decline in special wages at early this year, especially among large companies,⁵ resulting in wage growth falling below the inflation rate (Figure 7). In addition, as sectors with large numbers of self-employed⁶ (accommodations and food services, wholesale and retail trade) have shown slower growth, (Figure 8), the profitability of self-employed households would have worsened amid the growing market share of large platforms. These factors contributed to the slower income recovery for self-employed households.

Household real labor income remained sluggish through the first half of the year, following last year's trend

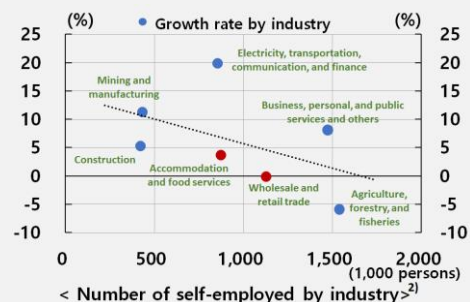
Figure 7. Real household labor income¹⁾



Note: 1) Number of employed persons × per-capita average wages / consumer price index.
 Sources: Ministry of Employment and Labor, Statistics Korea, Bank of Korea.

Slow growth in industries where self-employed business owners predominate

Figure 8. Growth rate by industry after the pandemic¹⁾



Notes: 1) GDP growth rate for Q1 2024 compared to Q4 2019.
 2) Unpaid workers by industry (as of August 2023).
 Sources: Statistics Korea, Bank of Korea.

⁵ Lackluster earnings among large corporations last year led to lower special wages early this year (10% year-over-year decrease in special wages for regular workers during the first quarter of 2024).

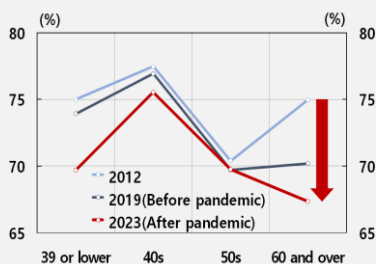
⁶ Self-employed workers account for about 20% of total employment. If workers employed by self-employed businesses and unpaid family workers are included, the figure could rise to as much as 40% (2023 Economically Active Population Survey).

④ **Structural decline in propensity to consume, driven by population aging and the low fertility rate, and idiosyncratic factors such as passenger car sales**

Changes in demographic structure, such as the population aging and a low fertility rate, are **structurally slowing the recovery in consumption**. In particular, a significant decline in the propensity to consume among those aged 60 and older due to a lack of retirement savings and an increase in the share of this age group among the total population are contributing to lowering the propensity to consume in the overall economy (**Figure 9**). Moreover, it is estimated that the effects of low fertility rates are becoming apparent, as consumption in sectors closely related to youth (those aged 14 and younger), such as education, has recently decreased (**Figure 10**). Meanwhile, there are a number of factors that explain dampened passenger car sales (10% of total goods consumption), which accounts for a significant portion of the decrease in durable goods consumption since the second half of last year, including **the end of special consumption tax cuts in July 2023 and stagnant demand for electric vehicles (chasm)** (**Figure 11**).

Propensity to consume has declined mostly among the elderly

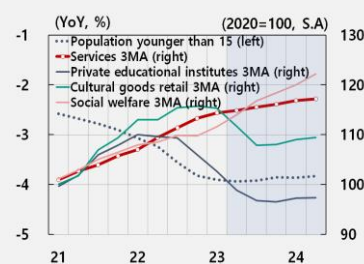
Figure 9. Average propensity to consume by age group



Source: Statistics Korea.

Consumption in sectors closely related to youth, such as education, is sluggish due to the impact of low fertility

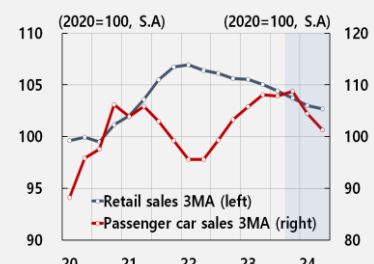
Figure 10. Impact of a decrease in the population of children



Sources: Ministry of the Interior and Safety, Statistics Korea.

Passenger car sales are sluggish due to the end of special consumption tax cuts and electric vehicle chasm

Figure 11. Domestic passenger car sales



Source: Statistics Korea.

Outlook

From the second half of this year, the recovery of private consumption is expected to accelerate gradually as households' real purchasing power improves, thanks to stronger wage growth driven by improved corporate earnings and progress in disinflation. After slowing sharply during the first quarter of this year (1.3%), nominal wage growth regained momentum during April and May (3.5%). Regular wages are projected to grow at their long-term average rate (3.5%) and special wages will restore to previous levels thanks to higher corporate earnings, accelerating the improvement in nominal wages (**Figure 12**). As the inflation gradually slows down, the per-capita real wage (growth rate of per-capita nominal wage divided by consumer price index) is expected to revert to positive from the second quarter of this year.

Moreover, as financial conditions ease, the gradual arrival of the replacement cycle for durable goods, such as IT devices, is projected to mitigate the sluggish consumption of durable goods (Figure 13). Meanwhile, there also seems to be room for further growth in consumption abroad (outbound travel), which has rapidly recovered since the pandemic, considering past trends (Figure 14). However, the recovery in consumption could be slowed somewhat by demographic factors, such as an aging population and low fertility, as well as by the slump among the self-employed segment.

Looking ahead, the Korean economy is projected to achieve balanced growth, driven by a gradually narrowing gap between exports and domestic demand, amid continuously favorable exports and recovering private consumption.

Improvements in corporate earnings precede special wages to regular employees

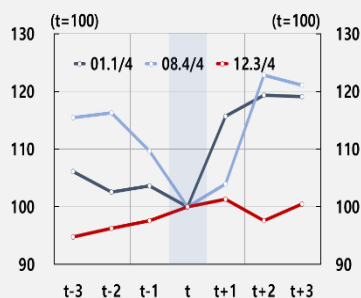
Figure 12. Manufacturing operating profit margin and special wages for regular employees



Sources: Bank of Korea, Statistics Korea.

Consumption of durable goods historically rebounds after rate cuts

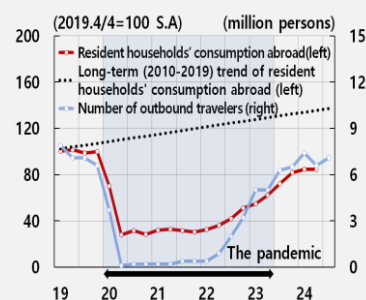
Figure 13. Durable goods consumption before and after past interest rate cuts¹⁾



Note: 1) Interest rate cuts in Feb. 2001, Oct. 2008, and Jul. 2012.
Source: Bank of Korea.

There is further room for an increase in resident households' consumption abroad

Figure 14. Trend of consumption abroad¹⁾



Note: 1) Consumption abroad in Q2 2024 and the number of outbound travelers in Q3 are estimated by Research Department.
Sources: Korea Tourism Organization, Bank of Korea.