

# South Korea Business Forecast Report Q1 2015

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## Abstracts

### Core Views

The compromise between the ruling Saenuri party and opposition New Politics Alliance for Democracy (NPAD) over the passing of the Sewol special bill will improve business confidence. However, we note that other contentious issues pose risks to the smooth functioning of parliament.

Our expectations for continued weakness in South Korea's economy following Q314 figures have prompted us to revise our real GDP forecast for 2015 downwards from 4.1% to 3.6%. Though domestic consumption has recovered slightly, we expect weak global demand to continue presenting headwinds to Korean exports, while high levels of household debt will constrain domestic consumption. Korea's larger 2015 budget reflects the government's pro-growth stance and will result in short-term fiscal strain. We believe that the long-term impact will be minimal but note that challenges remain. The Bank of Korea (BoK) held its base rate at 2.00% during its monetary policy meeting on November 13. We forecast rates to remain on hold for the rest of 2014 and through 2015 due to subdued growth and falling inflations expectations, but cannot rule out a possible rate cut should domestic consumption remain persistently weak.

We have downgraded our Korean won end-year forecast for 2014 and 2015 to KRW1,100/USD from KRW1,000/USD to reflect the increasingly bearish technical picture and the risks posed by the ongoing weakness in the Japanese yen. Over the long term, strong fundamentals, particularly the large current account surplus, will provide support for currency strength.

### Major Forecast Changes

Our expectations for continued weakness in South Korea's economy have prompted us

to revise our real GDP forecast for 2015 downwards from 4.1% to 3.6%.

We have downgraded our Korean won end-year forecast for 2014 and 2015 to KRW1,100/USD from KRW1,000/USD to reflect the increasingly bearish technical picture and the risks posed by the ongoing weakness in the Japanese yen.

## Contents

Executive Summary  
Core Views  
Major Forecast Changes  
Key Risks To Outlook

### **CHAPTER 1: POLITICAL OUTLOOK**

SWOT Analysis

BMI Political Risk Index

South Korea Domestic Politics

Political Compromise To Bolster Business Confidence

The compromise between the ruling Saenuri party and opposition New Politics Alliance for Democracy over the passing of the Sewol special bill will improve business confidence. However, we note that other contentious issues pose risks to the smooth functioning of parliament.

Table: Political Overview

South Korea Long-Term Political Outlook

Constitutional Reform To Improve Governance?

South Korea is likely to see a renewed push for constitutional change in order to address imbalances in the political system that lead to periodic instability. In addition, owing to the single-term restriction on the presidency, most presidents typically become 'lame ducks' well before departing office, leaving the country in a state of drift.

North Korea Domestic Politics

Domestic And Foreign Policies To Remain Volatile

North Korea's domestic and foreign policies will remain volatile over the coming months, as the power struggle between groups around leader Kim Jong Un continues, and Pyongyang seeks to reduce its isolation.

North Korea Long-Term Political Outlook

Status Quo Increasingly Unsustainable

Although North Korea's regime has proved much more durable than many expected, it is becoming increasingly difficult to see how the country can avoid dramatic change over the course of the next 10 years.

### **CHAPTER 2: ECONOMIC OUTLOOK**

SWOT Analysis

BMI Economic Risk Index

## Economic Activity

### Growth Headwinds To Persist

Our expectations for continued weakness in South Korea's economy following Q314 figures have prompted us to revise our forecast for 2015 downwards from 4.1% to 3.6%. Though domestic consumption has recovered slightly, we expect weak global demand to continue presenting headwinds to Korean exports, while high levels of household debt will constrain domestic consumption.

Table: Economic Activity

## Fiscal Policy

### 2015 Budget: Fiscal Discipline Fast Fading

Korea's larger 2015 budget reflects the government's pro-growth stance and will result in short-term fiscal strain. We believe that the long-term impact will be minimal but note that challenges remain.

Table: Fiscal Policy

## Monetary Policy

### BoK To Maintain Policy Stance Through 2015

The Bank of Korea held its base rate at 2.00% during its monetary policy meeting on November 13. We forecast rates to remain on hold for the rest of 2014 and through 2015 due to subdued growth and falling inflation expectations, but cannot rule out a possible rate cut should domestic consumption remain persistently weak.

Table: Monetary Policy

## Currency Forecast

### KRW: Near-Term Weakness Prompts Downgrade

We have downgraded our Korean won end-year forecast for 2014 and 2015 to KRW1,100/USD from KRW1,000/USD to reflect the increasingly bearish technical picture and the risks posed by the ongoing weakness in the Japanese yen. Over the long-term, strong fundamentals, particularly the large current account surplus, will provide support for currency strength.

Table: CURRENCY FORECAST

Table: Current Account

## **CHAPTER 3: 10-YEAR FORECAST**

### The South Korean Economy To 2023

#### Robust Growth To 2023

We expect annual real GDP growth in South Korea to decelerate marginally from an average of 4.4% between 2001 and 2008 to around 4.4% over 2014-2023. While we see many of South Korea's traditional exports meeting fierce competition in the coming years from emerging Asia, we believe that underlying conditions within the country are

conducive to a move up the production value chain, ensuring a robust economic growth profile. Furthermore, we see private consumption being a key contributor to growth over this forecast period.

Table: Long-Term Macroeconomic Forecasts

## **CHAPTER 4: OPERATIONAL RISK**

SWOT Analysis

Operational Risk Index

Operational Risk

Table: Operational Risk

Transport Network

Table: Asia Transport Network Risks

Economic Openness

Table: Asia – Economic Openness

Table: Top 5 Products Exported (USDmn), 2007-2013

Table: Top 5 Trade Partners Product Imports (USDmn), 2007-2013

## **CHAPTER 5: KEY SECTORS**

Infrastructure

Table: Infrastructure & Construction Industry Data

Table: Infrastructure & Construction Industry Data

Oil & Gas

Table: Oil Production

Table: Oil Production

Table: Gas Production

Table: Gas Production

Other Key Sectors

Table: Pharma Sector Key Indicators

Table: Defence & Security Sector Key Indicators

Table: Telecoms Sector Key Indicators

Table: Food & Drink Sector Key Indicators

Table: Autos Sector Key Indicators

Table: Freight Key Indicators

## **CHAPTER 6: BMI GLOBAL ASSUMPTIONS**

Global Outlook

Warning Signs Growing

Table: Global Assumptions

Table: Developed States , Real GDP Growth H, %

Table: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH  
FORECASTS, %

Table: Emerging Markets , Real GDP Growth , %

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