

South Korea Business Forecast Report Q3 2014

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Abstracts

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Core Views

The South Korean leadership's increasing rhetoric on the benefits of eventual reunification with the North does not alter our view that such an eventuality is highly unlikely. While a collapse in the North Korean regime remains the most likely scenario under which reunification would come about, the status quo is likely to remain in place for the foreseeable future.

South Korea's relatively strong Q114 real GDP growth print has prompted us to upgrade our 2014 growth forecast to 3.5%, from 3.0% previously. Korean exporters will continue to ride on the economic recovery in the developed markets for now while a recovery in real estate sector may support construction investment. That said, downside pressure is still likely to stem from China's slowing economy, elevated household debt levels, as well as risks of a continued contraction in business investment. South Korea's government debt rises sharply when public sector enterprise debt is included on its balance sheet. However, even at 64.5% of GDP, we do not see this as a concern given our forecasts for primary fiscal surpluses and attempts by the government to reign in state-owned enterprise (SOE) debt.

We continue to see the Bank of Korea (BoK) holding its benchmark seven-day repo rate at the current level of 2.50% for the remainder of 2014, before hiking by 50 basis points in 2015. Consumer price inflation looks to have hit a trough, and should rise slightly over the coming months, but will remain well below the BoK's 2.5-3.5% target as the high level of household debt will cap consumer demand. The Korean won has been on a tear since breaking through resistance at KRW1,050/USD, and the trend remains bullish for the currency.

However, we are seeing bearish divergence on the relative strength index which warns of a short-term reversal. As such we are neutral in the short term, with KRW1,050/USD likely to act as strong support and KRW1,000/USD as firm resistance. Against other developed market currencies, however, we are much more bullish, especially the euro.

Major Forecast Changes

This increased demand for credit should feed through into higher money supply growth rates in H214, and put upside pressure on CPI. As such, we are revising our end-2014 CPI to 2.0% from 1.8% previously. That said, the high level of household debt will continue to act as a drag on consumer demand, keeping inflation pressures in check.

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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.

CHAPTER 2: ECONOMIC OUTLOOK

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%previously. Korean exporters will continue to ride on the economic recovery in the developed markets for now while a recovery in real estate sector may support construction investment. That said, downside pressure is still likely to stem from China's slowing economy, elevated household debt levels, as well as risks of a continued contraction in business investment.

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South Korea's government debt rises sharply when public sector enterprise debt is included on its balance sheet. However, even at 64.5% of GDP, we do not see this as a concern given our forecasts for primary fiscal surpluses and attempts by the government to reign in state-owned enterprise debt.

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The Korean won has been on a tear since breaking through resistance at KRW1,050/USD, and the trend remains bullish for the currency. However, we are seeing bearish divergence on the relative strength index which warns of a short-term reversal. As such we are neutral in the short term, with KRW1,050/USD likely to act as strong support and KRW1,000/USD as firm resistance. Against other developed market currencies, however, we are much more bullish, especially the euro.

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Robust Growth To 2023

We are expecting annual real GDP growth in South Korea to decelerate marginally from an average of 4.4% between 2001 and 2008 to around 4.3% 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

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