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South Korea

Political & policy issues to watch

- Pres. Park is toppled**
... as Koreans tire of a corrupt elite
- Korea's political crisis has built since last April, when the ruling Saenuri party was unexpectedly beaten in legislative elections. It peaked on March 10, with a court confirmation of parliament's impeachment of President Park Geun-hye over an influence-peddling scandal. Koreans will go to the polls on or before May 9 to elect a new president. Tied into the scandal is Samsung's vice-chairman, Lee Jae-yong, who is under investigation for a US\$37m payment to entities linked to a friend of President Park, likely in return for government support for a contentious merger of two Samsung affiliates that helped secure his control over the whole group at the expense of other shareholders.
- The left is set to lead government**
... taking a harder line on business & the chaebol
- Park's toppling will swing Korean politics to the left, bringing regulatory challenges for companies and geopolitical challenges for the US. Moon Jae-in of the Democratic Party leads the presidential race with a 33% approval rating, followed by Ahn Hee-jung, governor of South Chungcheong province, with 22% support. If elected, Moon is expected to adopt a friendlier attitude towards North Korea, and will try to diffuse an escalating conflict with China over the deployment of the US-operated THAAD antiballistic missile system in Korea. That could see ties with the US cool, which risks triggering an uncertain response from President Trump. Moon will also try to reduce the dominance of the family-run chaebols with a focus on the big four: Samsung, LG, Hyundai, and SK.

Outlook for the market

- Weak sentiment limits growth prospects**
- A swift rise in trade flows hints at a strong start to 2017 for Korea. Exports for the first two months grew 15.7%yoy from 1.8%yoy in Q4'16, while imports surged 21.5%yoy from 4.1%yoy. The trade lift has yet to flow to other indicators, with the February purchasing managers index (PMI) for manufacturing stuck below the 50 expansion/contraction level due to weak output, new orders, and employment. Despite the strong trade start, we are cautious about growth this year, as household finances look fragile, consumer and business sentiment is weak, and a two-year surge in construction growth is set to cool. We maintain our GDP growth forecast at 2% for 2017 and 2.4% for 2018 from 2.7% in 2016.
- Financially constrained consumers**
- Consumers face record-high household debt (90% of GDP in 2016 from 62% in 2005), a weak job market (employment growth halved to 1.2% in 2016 from 2.1% in 2014), and slowing pay growth (3.4%yoy in Q4'16 from 5.3%yoy in Q1'16). These headwinds, along with political turmoil, saw consumption growth slow to 1.6%yoy in Q4'16 from 2.7%ytd for Q1-Q3'16. We expect consumer demand to grow 2.2% in 2017 and 2.5% in 2018 from 2.4% in 2016.
- Capex growth to ease**
...as construction moves to a lower gear
- Fixed investment growth lifted to 5.3% last year thanks to an 11% jump in construction capex (real growth for construction GDP also rose 11%). However, weak forward-looking indicators, such as construction permits (-18.3%yoy in 2H'16 from peak growth of 48.7%yoy in Q4'15), suggest that construction growth will slow to 6-7% this year and less than 4% next year, which will see total fixed investment growth slip towards 4% this year and 3% in 2018. Plant and equipment capex fell 2.4% last year, and with exports likely to lift 8-10% this year and about 5% next year after a 13.5% fall over 2014-16, a lift of 2-3% is likely this year and next.
- Rising inflation to force interest rate hikes**
- With producer prices rebounding from a fall of 4.4%yoy in Q4'15 to a rise of 0.8%yoy in Q4'16 (and a 3.8%yoy rise in January), consumer prices are on an uptrend that will take them from 1% last year to 2.3% this year and towards 3% next year. The Bank of Korea will try to stick with its current record low policy rate of 1.25% to support local demand but may need to edge up rates this year and next year. That should help limit the Won's year average slide on the US\$ to around 1.5% in 2017 and 2018 from 2.5% in 2016.

	2014	2015	2016	2017	2018
GDP growth, %	3.3	2.6	2.7	2.0	2.4
CPI, year average, %	1.3	0.7	1.0	2.3	2.5
BOK Base rate, year-end, %	2.00	1.50	1.25	1.75	2.25
Won to US\$1, year average	1,053	1,131	1,160	1,179	1,199

Sources: 2013-2016 government data (NSO, BOK) and CEIC; 2017-2018 forecasts by IMA Asia.

The above forecast is by IMA Asia. Companies seeking local advice and forecasts should contact:

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