

# Asia Pacific Executive Brief May 2017

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## South Korea

### Political & policy issues to watch

**President Moon takes over** President Moon Jae-in took office on May 10 for a single six-year term, the day after winning a snap poll triggered by his predecessor's impeachment. His win swings Korean politics to the left, after nine years of conservative rule. While he wants major policy changes, he'll have to compromise, as his Democratic Party needs opposition support to pass bills, and the next parliamentary election is not until 2020. Moon aims to lower high youth unemployment (10.3% versus a 4% national rate) by creating 810,000 new public sector jobs during his term, and adding US\$8.9bn to the \$356bn in spending planned for 2017 by the prior Park administration. More challenging is his plan to trim the dominance of Korea's family-run conglomerates, the chaebol. With their allies in the national assembly, they'll fight any bill aimed at weakening their power or improving corporate transparency. Still, the promise of chaebol reform, which would lift dividend payouts to investors, pushed the stock market to a record high in mid-May, up 18.3%yoy.

**... bringing new stimulus spending**

**... and plans to curb the chaebol**

**Geopolitical risk is rising** Foreign policy will be particularly tricky, as South Korea faces a belligerent North Korea with more powerful weapons, an unpredictable US ally asking for money for military support and renegotiation of a massive FTA, and a rising China keen to dominate Asia. South Korea, and its companies, are particularly exposed to such geopolitical shifts, so there is considerable risk here, and it must be closely watched.

### Outlook for the market

**A recovery builds from Q1'17** For the second month in a row we've lifted our 2017 GDP forecast, now to 2.9% from 2% two months ago, while 2018 rises to 2.7% from 2.4% forecast in March, due to firmer global demand, improved consumer sentiment, and rising capex on plant & equipment. In Q1'17, GDP grew 2.8%yoy from a weak 2.5%yoy in 2H'16. Meanwhile, a surge in plant & equipment spending pushed total capex up 9.4%yoy in Q1'17 from 5.2% growth for full 2016. As a result, domestic demand growth accelerated to 4.5%yoy in Q1'17 from 3.6% for full 2016. Moon's extra public spending, and the rise in factory capex (see below) should push domestic demand up 4.0% this year and 3.3% in 2018.

**... led by rising exports & local demand**

**Chips & screens lead an export surge**

Exports to April rose by 17%ytd after a 6% fall last year and an 8% drop in 2015. Chips led the recovery, up 48%ytd by April, followed by flat panel displays (18%ytd), steel (17%ytd), and machinery (13%ytd). Automobiles lagged at 5%ytd. We expect exports to lift by about 10% this year and 5% next year, which should lead to 3-5% annual growth in the industrial production index, after five years with an average 0.5% annual growth.

**... triggering a jump in capex**

Capex on plant and equipment jumped 14%yoy in Q1'17 after average growth of just 1.5% for the prior five years. For 2017, we expect an 8% lift followed by 4% in 2018. That should push total fixed investment growth to 6.5% this year and 3.8% next year from around 5% for the last two years. Construction capex was firm at 9.6%yoy in Q1'17 and will likely finish 2017 with 7-8% growth followed by 4-6% in 2018 after 10.7% last year.

**... watch for a consumer lift**

Consumer sentiment rebounded in April, and will have surged in May with the new government taking office. With employment and pay prospects set to mildly improve in 2H'17, and Moon's stimulus measures aimed at youth unemployment taking effect, we've lifted our 2017 consumer forecast to 2.8% followed by 3% next year from 2.5% in 2016.

**Little inflation & a firm Won**

Despite a good 1H'17 recovery, there's plenty of slack in Korea's industrial system, so inflation won't lift much from the 1.9%yoy reported for April, and the BOK can keep its low policy rate well into 2018. Capital inflows and a large current account surplus are holding the Won firm on the US\$, despite a widening interest rate gap.

	2014	2015	2016	2017	2018
GDP growth, %	3.3	2.8	2.8	2.9	2.7
CPI, year average, %	1.3	0.7	1.0	2.2	2.6
BOK Base rate, year-end, %	2.00	1.50	1.25	1.25	2.00
Won to US\$, year average	1,053	1,131	1,160	1,124	1,083

Sources: 2013-2015 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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