



Rabobank

Country Report South Korea

Country Report
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South Korea's economic momentum has been improving, as on the back of higher consumption and government spending the economy grew by 0.9% quarter-on-quarter in the third quarter of 2014.

Strengths (+) and weaknesses (-)

(+) Well developed and diversified economy

South Korea's economy is the 14th-largest in the World with a relatively high GDP per capita. It has a strong, diversified and internationally highly competitive industrial and manufacturing base.

(+) Strong democratic institutions

Underpinned by a mature and stable democratic system, South Korea has relatively strong institutions. Especially the rule of law, regulatory quality and government effectiveness are solid.

(-) Relations with North Korea

The Korean War ended in 1953 without a formal peace-treaty and the countries are thus still officially at war. As a result of highly erratic and at times aggressive behaviour of North Korea, tensions flare up from time to time, while a collapse of North Korea could result in very high re-unification costs for South Korea.

(-) High household debt

Korea's households have increased their borrowing over the past decade. Korea's household debt to GDP ratio has risen from 62.3% in 2008 to 71.5% in 2013, which is similar to the most indebted advanced economies in the world.

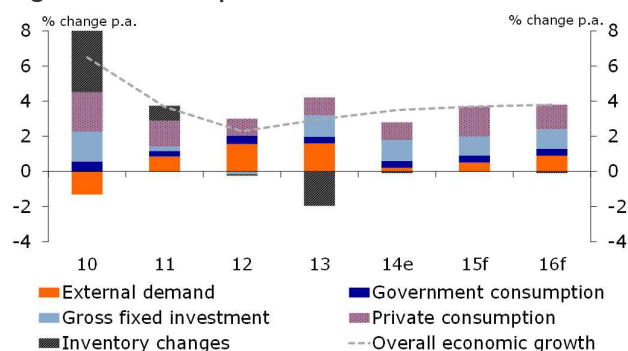
Key developments

1. Economic momentum improves

South Korea's economic momentum has been improving, as on the back of higher consumption and government spending the economy grew by 0.9% q-o-q in the third quarter of 2014, up from 0.5% q-o-q in the second quarter. The economic expansion was a result of an increase in consumer spending (1.0% qoq), as consumer confidence picked up in the third quarter. Consumer confidence dropped in May, as a result of a ferry (Sewol) in April whereby more than 300 people died. Government spending increased by 2.3% qoq, after a stimulus package had been announced in July. The package is worth around USD 44 billion (3.2% of GDP) of which two-thirds was already spent by the end of 2014. Growth was restricted by a negative contribution of the external sector, as exports fell by 2.2% qoq, while imports shrank by 0.2%.

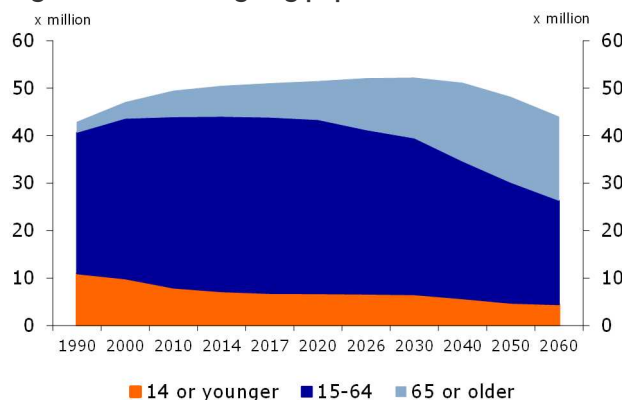
South Korea's economic outlook also improved. First, consumer spending is expected to increase further, as borrowing costs have decreased. This relates to the fact that the Bank of Korea lowered its policy interest rate in October for a second time in 2014 to 2%. The positive impact of a lower interest rate is restricted by the already high level of household debt. Second, exports are expected to rise on the back of an improving US economy. For 2014, the South Korean economy is expected to have grown by 3.5%, while GDP is expected to expand by 3.7% this year (figure 1). For the longer term, President Park is trying to boost South Korea's economic growth potential by a Three-Year Plan for Economic Innovation. The plan includes 1) improving the overall regulatory environment and removing red tape 2) reducing the level of debt in public organisations 3) boost domestic demand and 4) increase the labour participation of women and the youth. Raising the participation rate is important since South Korea will be confronted by ageing (figure 2). Currently 73% of the population is between 15 and 64 years old but this figure will decrease to less than 50% in 2060. Finally, the number of SME's that will be labelled as potential (export) champion will be increased from 634 in 2014 to 1150 in 2017.

Figure 1: Growth performance Korea



Source: EIU

Figure 2: Korea's ageing population



Source: Statistics Korea

2. Political party disbanded

In December, the Supreme Court ruled that the United Progressive Party (UPP) had to be disbanded, as the party was violating the basic principles of democracy. Due to the ruling the UPP also has to give up its five seats in parliament. The government had asked the Supreme Court to disband the party, after the party had secretly organised a meeting in May 2013. During the meeting the party discussed possible attacks against South Korea's utilities in case a war between the two Korea's would break out. The Supreme Court ruled against the UPP with 8 against 1, while 6 votes were needed to ratify the decision. A lawmaker from the UPP, Lee Seok-ki, still awaits for his appeal against a 12 year sentence for organising the meeting. In a comment, Amnesty International expressed its concerns that national security was used to repress the political opposition.

3. Talks or no talks with North Korea

Relations with North Korea remain difficult and uncertain. On 8 January, North Korea rejected an invitation from South Korea's parliament to restart talks about human rights in North Korea and re-unification of Korean families. This is a setback as Kim Jong-un, the North Korean leader, surprisingly said in his New Year speech

that he was open to a high-level summit with South Korea. Another offer from South Korea to hold talks later in January remained unanswered.

In December, South Korea was also confronted by cyber-attacks on its nuclear plants. President and CEO Cho Seok of Korea Hydro & Nuclear Power Co Ltd said that the plants were still operating safely. South Korean prosecutors have started an investigation in cooperation with the Chinese authorities, as the attacks were linked to a Chinese city close to the North Korean border. The North Korean authorities however deny that they were involved in the attack. Tensions between the United States, a South Korean ally, and North Korea have also been rising after the US accused North Korea of cyber-attacks on Sony. It is however still unclear whether North Korea is indeed responsible for the attack. Nevertheless, the US imposed additional sanctions on North Korea following the Sony cyber-attack.

Factsheet of South Korea

South Korea					
National facts		Social and governance indicators			
Type of government	Republic	Human Development Index (rank)	15 / 187		
Capital	Seoul	Ease of Doing Business Index (rank)	5 / 189		
Surface area (thousand sq km)	100	WEF Global Competitiveness Index (rank)	26 / 144		
Population (millions)	50.3	Corruption Perceptions Index (rank)	43 / 175		
Main languages	Korean	Press Freedom Index (rank)	57 / 180		
Main religions	English	Gini index (income distribution)	n.a.		
	Christian (26%)	Population below \$1.25 per day (PPP)	n.a.		
	Buddhist (23%)				
	None (49%)				
Head of State (president)	Park Guen-hye	Foreign trade			
Head of Government (prime-minister)	Chung hong-won	2013			
Monetary unit	South Korean won (KRW)	Main export partners (%)	Main import partners (%)		
		China	26	China	16
		US	11	Japan	12
		Japan	6	US	8
		Hong Kong	5	Saudi Arabia	7
Economy		2014			
Economic size		bn USD	% world total		
Nominal GDP	1,430	1.86			
Nominal GDP at PPP	1,751	1.64			
Export value of goods and services	735	3.12			
IMF quotum (in m SDR)	3,366	1.55			
Economic structure		2014	5-year av.		
Real GDP growth	3.5	3.2			
Agriculture (% of GDP)	2	2			
Industry (% of GDP)	39	38			
Services (% of GDP)	59	60			
Standards of living		USD	% world av.		
Nominal GDP per head	28,306	244			
Nominal GDP per head at PPP	34,660	215			
Real GDP per head in 2005 prices	24,580	282			
		Main export products (%)			
		2014			
		Machinery & Transport Equipment	51		
		Manufactured Goods Classified by Material	13		
		Chemicals & Related Products, N.E.S.	12		
		Mineral Fuels, Lubricants and Related Mat.	11		
		Main import products (%)			
		2014			
		Mineral Fuels, Lubricants and Related Mat.	36		
		Machinery & Transport Equipment	24		
		Chemicals & Related Products, N.E.S.	11		
		Manufactured Goods	9		
		Openness of the economy			
		2014			
		Export value of G&S (% of GDP)	51		
		Import value of G&S (% of GDP)	46		
		Inward FDI (% of GDP)	0.9		

Source: EIU, CIA World Factbook, UN, World Economic Forum, Transparency International, Reporters Without Borders, World Bank.

Background information

South Korea is a high-income country with a strong industrial base. South Korea is the 14th largest economy in the world and a member of the G20 and the OECD. After South Korea adopted an outward-looking strategy in the second-half of the 20th century, in which growth and development were supported by labour-intensive manufactured exports, the country industrialised rapidly. The industrial sector still remains the backbone of the South Korean economy. From the 1990s onwards, South Korea's manufacturing sector expanded into other, more high-tech areas such as microelectronics and microbiology. The importance of the export sector to the South Korean economy does, however, increase the country's vulnerability to external developments. As a result of continued focus on business friendly policies, the country is ranked 7th out of 183 countries on the ease of doing business index.

A constitutional change in 1987 laid the foundation for the current stable multi-party democracy. South Korea's political and business environment is dominated by close personal relationships and a strong influence of chaebols (large business conglomerates). The downside of this is economic nationalism and corruption. Since fighting between North and South Korea ceased in 1953 without a formal peace-treaty, the tense and uneasy relationship between the two nations remains an important downside risk. Tensions flare up from time to time, usually due to provocations initiated by the North Korean regime.

Economic indicators of South Korea

South Korea							
Selection of economic indicators	2010	2011	2012	2013	2014e	2015f	2016f
Key country risk indicators							
GDP (% real change pa)	6.5	3.7	2.3	3.0	3.5	3.7	3.8
Consumer prices (average % change pa)	2.9	4.0	2.2	1.3	1.5	2.0	2.5
Current account balance (% of GDP)	2.6	1.6	4.2	6.1	5.5	4.9	4.0
Total foreign exchange reserves (m USD)	291,491	304,255	323,207	341,650	360,000	365,000	375,000
Economic growth							
GDP (% real change pa)	6.5	3.7	2.3	3.0	3.5	3.7	3.8
Gross fixed investment (% real change pa)	5.5	0.8	-0.5	4.2	4.0	3.8	3.9
Private consumption (real % change pa)	4.4	2.9	1.9	2.0	2.1	3.4	3.0
Government consumption (% real change pa)	3.8	2.2	3.4	2.7	2.9	3.0	3.0
Exports of G&S (% real change pa)	12.7	15.1	5.1	4.3	4.2	5.3	5.6
Imports of G&S (% real change pa)	17.3	14.3	2.4	1.6	4.4	5.0	4.7
Economic policy							
Budget balance (% of GDP)	1.3	1.4	1.3	1.0	0.5	0.5	0.6
Public debt (% of GDP)	32	33	35	37	37	37	36
Money market interest rate (%)	2.2	3.1	3.1	2.6	2.4	2.4	4.0
M2 growth (% change pa)	6	5	5	5	6	7	8
Consumer prices (average % change pa)	2.9	4.0	2.2	1.3	1.5	2.0	2.5
Exchange rate LCU to USD (average)	1156.1	1108.3	1126.5	1094.9	1041.5	1018.0	1048.3
Recorded unemployment (%)	3.7	3.4	3.2	3.1	3.3	2.9	2.8
Balance of payments (m USD)							
Current account balance	28,850	18,656	50,835	79,884	79,004	74,930	63,860
Trade balance	47,915	29,090	49,406	80,569	85,094	79,950	69,890
Export value of goods	463,770	587,100	603,509	617,128	628,000	654,090	693,380
Import value of goods	415,855	558,009	554,104	536,559	542,907	574,150	623,490
Services balance	-14,238	-12,279	-5,214	-7,927	-8,962	-7,530	-6,770
Income balance	490	6,561	12,117	11,425	7,457	7,450	5,810
Transfer balance	-5,317	-4,716	-5,474	-4,182	-4,585	-4,930	-5,070
Net direct investment flows	-18,783	-19,932	-21,136	-16,952	-17,669	-17,870	-22,300
Net portfolio investment flows	42,365	13,143	6,748	23,163	23,163	23,160	23,160
Net debt flows	21,793	-458	-7,002	-4,928	1,216	2,050	16,050
Other capital flows (negative is flight)	-52,667	3,443	-8,898	-61,691	-67,364	-77,370	-70,670
Change in international reserves	21,559	14,851	20,547	19,476	18,350	4,910	10,100
External position (m USD)							
Total foreign debt	435,074	440,404	425,086	422,620	424,154	420,090	435,700
Short-term debt	139,762	137,370	127,185	112,844	102,377	89,480	89,060
Total debt service due, incl. short-term debt	164,853	193,428	190,607	178,695	166,072	158,020	149,780
Total foreign exchange reserves	291,491	304,255	323,207	341,650	360,000	365,000	375,000
International investment position	-131,104	-81,029	-94,370	-32,517	n.a.	n.a.	n.a.
Total assets	697,092	759,527	861,041	964,233	n.a.	n.a.	n.a.
Total liabilities	828,196	840,556	955,411	996,750	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	4.4	2.4	4.0	6.2	6.0	5.2	4.4
Current account balance (% of GDP)	2.6	1.6	4.2	6.1	5.5	4.9	4.0
Inward FDI (% of GDP)	0.9	0.8	0.8	0.9	0.9	0.9	1.0
Foreign debt (% of GDP)	40	37	35	32	30	27	28
Foreign debt (% of XGSIT)	75	62	57	56	54	51	50
International investment position (% of GDP)	-12.0	-6.7	-7.7	-2.5	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	29	27	26	24	21	19	17
Interest service ratio incl. arrears (% of XGSIT)	1	1	1	1	1	1	1
FX-reserves import cover (months)	6.8	5.5	5.9	6.3	6.6	6.3	6.0
FX-reserves debt service cover (%)	177	157	170	191	217	231	250
Liquidity ratio	143	133	139	149	153	152	151

Source: EIU

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