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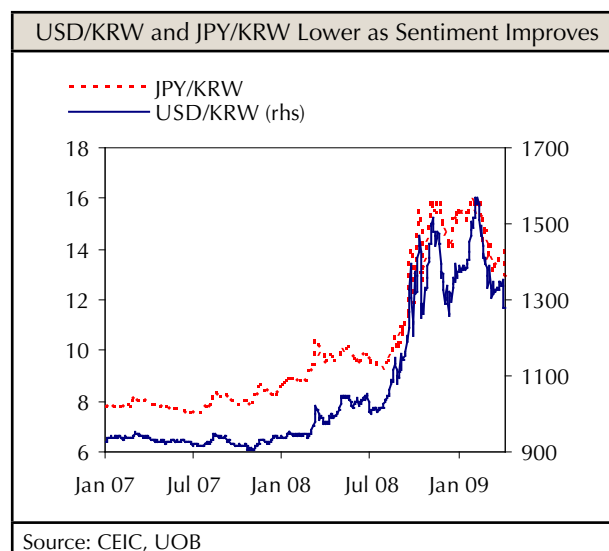
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South Korean Won: Is The Worst Over?

The improvement in risk appetite over the last two months saw Asian currencies, particularly the KRW rebounding as much as 24% to 1,262.30/USD, its value at the end of 2008. It has continued to slide to as low as 1,570/USD in early-March after plunging 25.8% against USD last year, as concerns over the country's huge external debt and highly leveraged household sector weighed and the currency was perceived to be one of the most vulnerable in Asia in the midst of the global financial crisis. JPY/KRW cross has also eased to below 13.0 from as high as 16.0 just two months ago. Onshore market USD-shortage condition has eased as the perception was that the worst might be over for the KRW. The basis between the 1Y CCS and IRS has fallen below 300bps in April although the spread is still relatively wide compared with pre-crisis periods.

The recent turnaround in USD/KRW was remarkable. Economic data including the record high current account in March and 1Q09 GDP seem to suggest that the worst is over for the KRW. In 1Q09, the current account surplus was already US\$8.6bn compared with a deficit of US\$6.4bn last year. 2008 was the first year since the Asian Financial Crisis that South Korea had a net outflow on its current account, which partly explained the bearish sentiment towards the currency then. The country's current account is expected to rebound to 2.0% of GDP this year (around US\$15bn) from -0.7% in 2008 as a result of weaker imports demand and lower oil prices.

While there is risk for USD/KRW to pull back to 1,300 by end-2Q, we expect the pair to end the year at around 1,250.



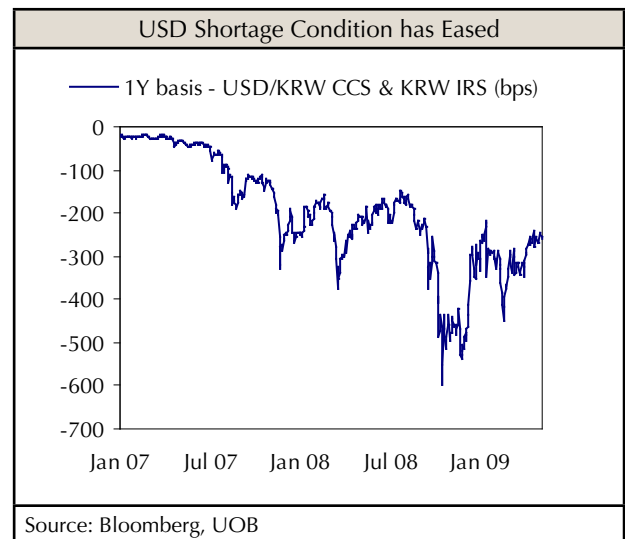
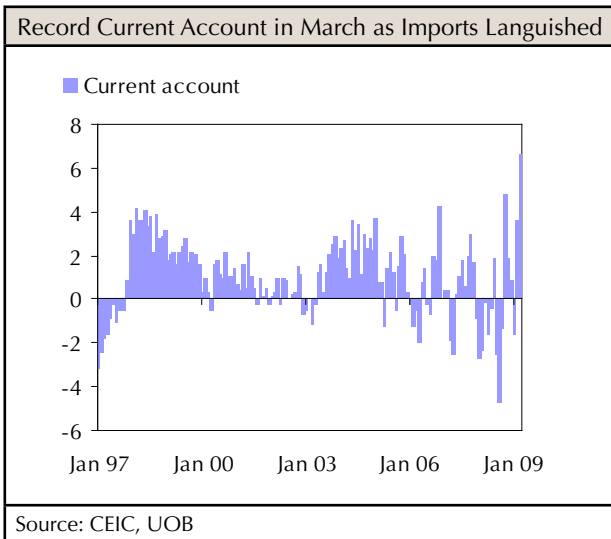
Concerns About South Korea's External Debt Overblown?

At the end of 2008, an estimated US\$194bn of foreign debt matures this year, a daunting 94% of the country's foreign reserves. However, the FSC estimated that US\$62.6bn of this amount was foreign bank branches' borrowing and thus should not have difficulty in being rolled over. There was also a large part which was being backed up by export payments, in particular for the shipping industry which typically takes 3-4 years for order delivery. As a result, we estimate that only about a third of the maturing debt this year would be in relation to the domestic banks and corporates.

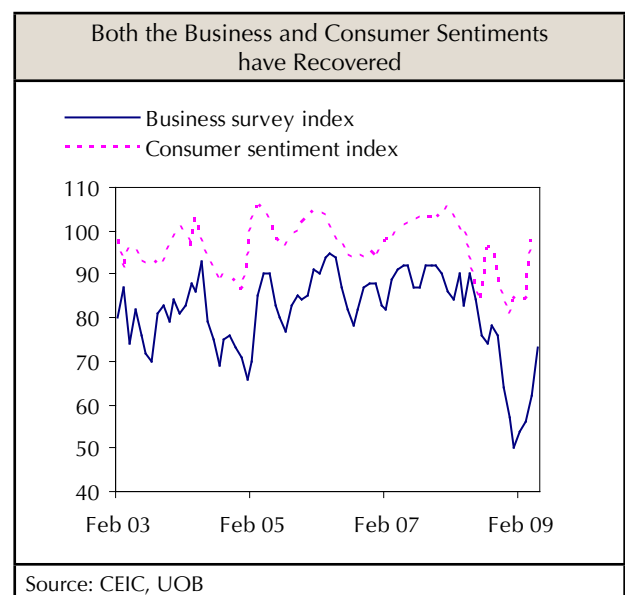
While this amount was not small, it was certainly manageable for the country, taking into account the possibility for it to increase its US\$30bn swap facilities with the US (which was already half utilised). There were also reports of South Korea converting a third of its RMB180bn (US\$26.4bn) KRW-RMB currency swap into USD in April.

Economic Growth: Signs of Bottoming-out But Any Firm Recovery Still Far From Sight

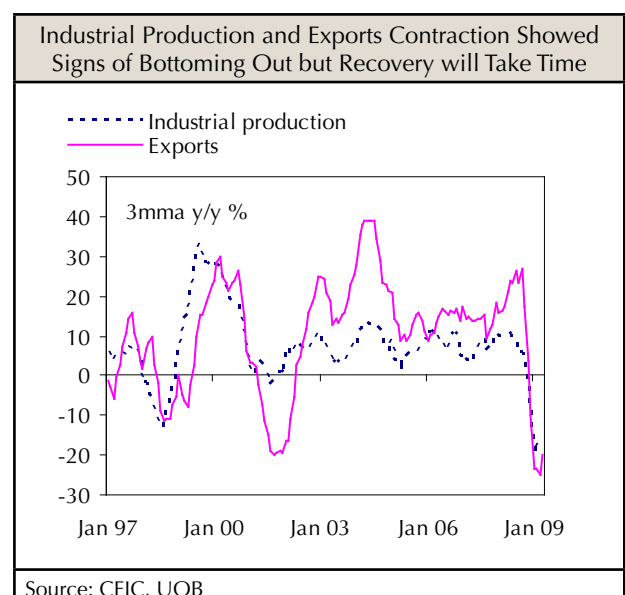
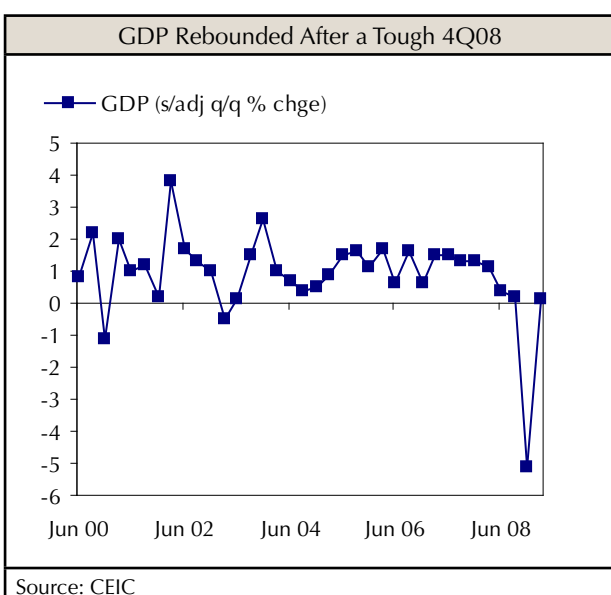
The South Korean economy managed a marginal 0.1%q/q expansion in 1Q09 following sharp 5.1% plunge in 4Q08 as the country narrowly escaped a 'technical' recession. On a y/y basis, growth contraction deepened to -4.3% in 1Q09 from -3.4% in 4Q08, the worst since the Asian Financial Crisis. The decline was contributed by stocks drawdown and contractions in private consumption, facilities investment and private consumption. Nonetheless, government spending and sharper fall in imports demand have helped to cushion the economy in 1Q09.



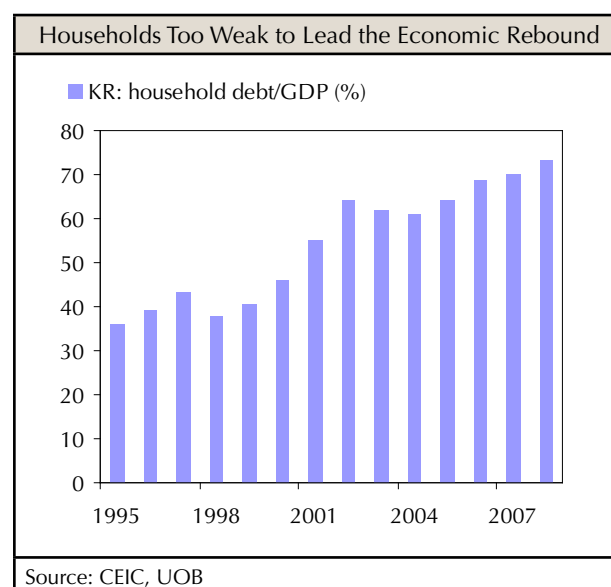
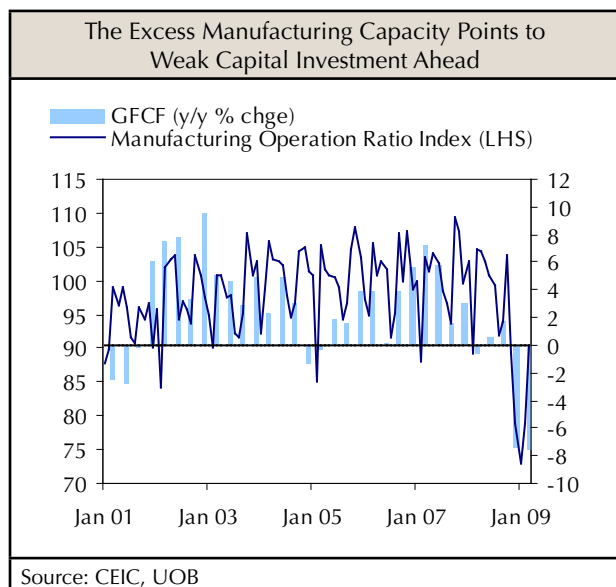
While the economy has probably bottomed out, it could remain at the bottom for a while at least. Facilities investment is unlikely to return in a big way soon given the excess capacity in the manufacturing sector. Manufacturers in the country were operating at 90.5% capacity in March and below 80% in December-February. Based on historical trend, we need an operation ratio of at least 90% for a substantial period before manufacturers would be confident to make additional fixed investment. Similarly, households which are burdened with debt of around 73% of GDP, will not likely be the catalyst for the eventual economic recovery. As a percentage of disposable income, household debt has already reached 140% and will see greater pressure from lower wages and job losses this year. This means a sustained upturn in Korea will ultimately be dependent on export demand and therefore a recovery in US consumption.



There are also indications of bottoming-out in the recent



exports and industrial production data. Nonetheless, the weak trend in the data would likely persist at least until 3Q09. Although the substantial government spending has positive impact on GDP (government estimates 1.5ppt growth contribution from the KRW28.9trn supplementary budget), we are maintaining our full-year growth forecast for South Korea at -4.0% for now.



1Q09 GDP: Signs of Bottoming-Out							
	2008	1Q08	2Q08	3Q08	4Q08	1Q09	1Q09
	y/y % change						q/q % change
Real GDP	2.2	5.5	4.3	3.1	-3.4	-4.3	0.1
Final Consumption	1.6	3.9	2.6	2.0	-1.9	-2.0	1.2
Private Consumption	0.9	4.0	2.3	1.4	-3.7	-4.4	0.4
Government Consumption	4.2	3.6	4.0	4.5	4.7	7.2	3.6
GFCF	-1.7	-0.5	0.6	1.8	-7.3	-7.5	0.2
Construction	-2.1	-1.9	-0.3	0.2	-5.6	1.7	5.3
Facilities Investment	-2.0	1.5	1.1	4.3	-14.0	-22.1	-9.6
Change in Stocks (% of GDP)	1.5	2.9	2.6	2.1	-1.3	-1.8	-
Net Exports	30.6	34.0	47.2	12.2	33.6	109.8	26.2
Exports of G&S	5.7	11.0	11.5	9.3	-6.9	-10.5	-4.2
Imports of G&S	3.7	9.7	8.9	9.0	-11.2	-18.4	-8.7

Source: CEIC, UOB

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