

Thursday, 27 January 2011

# Flash Notes

## South Korea: Moderate Economic Growth, Higher Inflationary Pressure

South Korea economy grew within market's expectation at 4.8% y/y in 4Q10, picking up slightly from 4.4% pace in 3Q10. On a s/adj basis, GDP retains a positive growth momentum although the expansion eased to 0.5% q/q from 0.7% in 3Q10.

The key drivers for the fourth quarter were private consumption, facilities investment and net exports. Facilities investment has rebounded strongly since 4Q09 with double-digit growth rate but the growth moderation could take hold in the quarters ahead, partly due to base effect. Construction investment remained a laggard as the contraction deepened to -4.7% y/y in 4Q10, reflecting the cooling off of the real estate market.

We expect the growth momentum to strength this year, led by private consumption and investment. Despite an expected moderation in facilities investments growth from double-digit pace this year, the component will likely remain firm due to higher capacity utilization following under-investment in 2008-2009. The long-delayed inventory building could also kick in to provide further boost to GDP growth. This is likely to bring 2011 GDP growth to around 4.6% from 6.1% last year. The BoK said it could raise its growth forecast for this year from earlier estimate of 4.5% while the government is expecting economic expansion of 5.0% for the year.

### Interest Rate Normalisation To Be Frontloaded

The higher inflation risks and healthy growth outlook suggests that the policy focus will be on containing the inflation expectation in the near-term. Domestic headline inflation has risen to 3.5%y/y in Dec 2010, and could continue to rise to around 4% y/y sometime during 3Q11 before easing off in the last quarter of the year. This could cause concerns against the BoK's inflation target of 2%-4%.

Reflecting pressure to rein in inflationary pressure, the BoK surprised markets with a 25 bps hike to its benchmark base rate earlier in January. We still expect a further 75bps move this year to bring the base rate to 3.50% by year-end and this is likely to be frontloaded. BoK Gov Kim Choong-soo said the 'neutral rate' for the country is close to the IMF's estimate of 4%. We expect the 'neutral' rate to be 3.50%-4.00% based on the long-term inflation trend in South Korea and this means that the central bank will try to bring the benchmark interest rate to at least 3.50% this year amid the higher inflationary pressure.

On the currency front, we expect the KRW appreciation pace to pick up this year. This is despite expectation that the current account surplus could halve from US\$41.9 bn last year. Capital inflows and RMB appreciation pace will likely be key drivers for the KRW strength this year. More importantly, the authorities might also be more willing to allow for currency appreciation to fight the imported inflation. We expect USD/KRW to trend lower over the course of the year, falling to 1,110 by end-1Q11 and 1,080 by 4Q11.

South Korea 4Q10 GDP Was In Line With Expectation						
	2010	1Q10	2Q10	3Q10	4Q10	
	y/y % change					ppt cont
<b>Real GDP</b>	<b>6.1</b>	<b>8.1</b>	<b>7.2</b>	<b>4.4</b>	<b>4.8</b>	<b>4.8</b>
<b>Final consumption</b>	<b>3.9</b>	<b>5.7</b>	<b>3.6</b>	<b>3.2</b>	<b>3.3</b>	<b>2.2</b>
Pte consumption	4.1	6.3	3.7	3.3	3.2	1.6
Govt consumption	3.4	3.8	3.2	2.8	3.9	0.6
<b>GFCF</b>	<b>6.2</b>	<b>11.4</b>	<b>6.1</b>	<b>6.6</b>	<b>2.1</b>	<b>0.6</b>
Construction	-2.3	2.3	-2.7	-2.3	-4.7	-0.8
Facilities Investment	24.5	29.9	29.0	24.3	16.0	1.5
<b>Change in stocks (% of GDP)</b>	<b>-0.8</b>	<b>-0.4</b>	<b>-0.8</b>	<b>-1.0</b>	<b>-1.1</b>	<b>0.5</b>
<b>Net exports</b>	<b>-1.8</b>	<b>-9.7</b>	<b>-8.3</b>	<b>-6.7</b>	<b>16.4</b>	<b>1.2</b>
Exports of G&S	14.1	16.6	13.9	11.1	14.9	6.9
Imports of G&S	17.2	21.0	19.0	14.7	14.6	5.7
<i>Source: CEIC, UOB</i>						

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