

South Korea: Easing growth unlikely to deter a rate hike in 3Q11

GDP growth in South Korea slowed to 3.4% y/y in 2Q11 from 4.2% in 1Q11. This is the slowest growth rate since 4Q09. On a s/adj basis, growth momentum eased to 0.8% q/q in the quarter from 1.3% in 1Q11. With first half growth at just 3.7% y/y, we are revising our full-year growth forecast for the country lower to 4.2% from 4.6% previously. Nonetheless, we are still expecting an acceleration in the growth rate in 2H11. The y/y growth is likely to rebound back above 4.0% in the next two quarters. In its mid-year review, the BoK has also lowered its 2011 GDP growth forecast to 4.3% from 4.5% given the external uncertainties.

The main drag in 2Q11 came from weaker-than-expected exports, resulting from the slippage in June. Fixed investment has continued to contract on a y/y basis in the quarter. However, the momentum in the decline for construction fixed investment has eased while facilities investment (led by semicon and transport sectors) strengthened during the quarter. Going forward, consumption demand will likely continue to be the key growth driver as investment and exports expansion will face strong headwinds from the economic and fiscal woes in US and the EU.

On the whole, Asia's growth momentum appears to be easing. Besides the lackluster June manufacturing PMI readings in Asia suggesting a softer outlook, advance estimates from Singapore earlier this month also showed 2Q11 GDP weakening more than expected to 0.5% y/y. China is the outperformer with GDP growth holding up at 9.5% y/y in the second quarter. Besides the weak outlook in US and EU economies, monetary policy tightening in Asia would also rein in the GDP growth in this region in the quarters ahead. Our base scenario remains that Asia growth would moderate to a more sustainable level in 2011 and 2012.

Implication on Monetary Policy

The probability of a 25 bps rate hike remains high in August/September despite the weaker GDP growth in 2Q11. The BoK remains concerned over the high inflation in the months ahead. Core inflation has edged up to 2-year high in June and the headline inflation remained stubbornly high at 4.4% y/y in June despite coming off its 26-month high in March. We expect headline CPI to stay above the central bank's target of 2%-4% in July and August before moderating in 4Q11.

As such, we are maintaining our forecast for the BoK to hike one more time in 3Q11 to bring the base rate to 3.50% and then keep its interest rates steady in 4Q11 as price pressure is expected to ease. That would bring the total interest rate increase for this year to 100 bps. South Korea: Easing growth unlikely to deter a rate hike in 3Q11

South Korea's GDP Growth Eased Further in 2Q11						
	2010	3Q10	4Q10	1Q11	2Q11	
	y/y % change					q/q % change
Real GDP	6.2	4.4	4.7	4.2	3.4	0.8
Final consumption	3.9	3.4	3.0	2.5	2.9	1.0
Pte consumption	4.1	3.6	2.9	2.8	3.1	1.0
Govt consumption	3.0	2.5	3.2	1.5	2.2	0.9
GFCF	7.0	6.8	3.4	-2.2	-2.2	1.2
Construction	-1.4	-3.1	-2.9	-11.9	-8.6	-0.4
Facilities Investment	25.0	26.6	15.9	11.7	7.6	4.0
Exports of G&S	14.5	11.6	15.7	16.8	10.2	1.8
Imports of G&S	16.9	14.7	14.2	10.8	7.9	2.8
Source: BoK						

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