

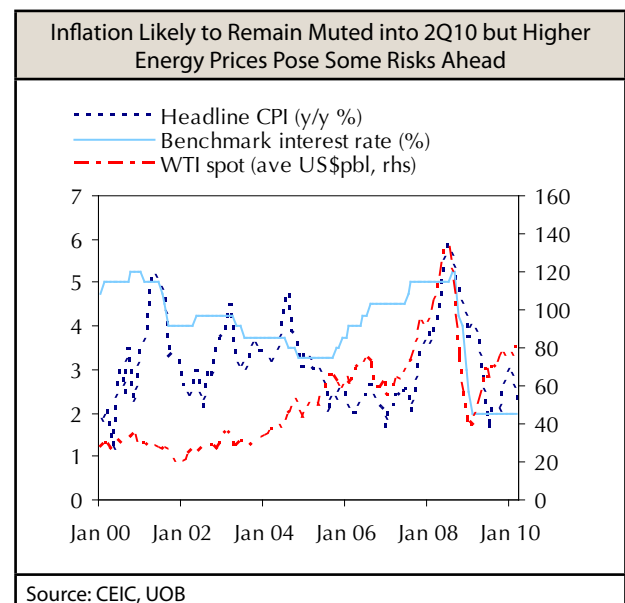
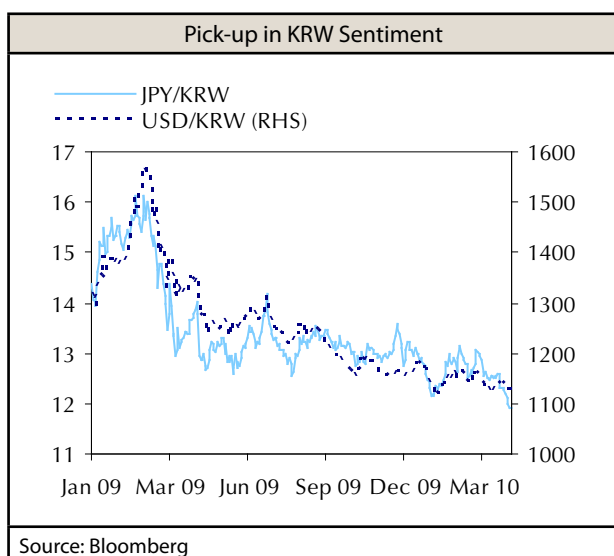
South Korea

UOB Economics Projections	2008	2009	2010F	2011F
GDP	2.3	0.2	5.0	4.6
CPI (average, y/y)	4.7	2.8	2.8	3.2
Unemployment (4Q avg)	3.3	3.6	3.4	3.1
Current account (% of GDP)	-0.6	5.1	1.7	1.3
Fiscal balance (FY, % of GDP)	0.3	-4.1	-2.8	-0.5

- *KRW appreciated by 2.9% against USD during 1Q10 while JPY/KRW softened to around 12.0 from as high as 16.1 in early 2009 and competitiveness consideration will underlie BoK's reluctance to see more KRW appreciation from here. Unless we see more move on the RMB, USD/KRW will probably hit 1,100 in 2Q10 before running out of steam particularly if the economic growth momentum eases in the second half of the year. Nonetheless, prospects of interest rate normalisation from 3Q10 will provide some support for the KRW in 2H10.*
- *It has become increasingly clear that the BoK is not planning for any interest rate normalisation until 2H10, particularly as inflation will likely remain muted in 2Q10.*
- *The high household indebtedness and debt servicing is a key consideration for South Korean policy makers. We believe this will keep BoK cautious about raising interest rates too aggressively in the near-term and will probably opt for more administrative measures such as those in 2H09 to cool the property market if prices rise at a faster-than-expected pace from here.*
- *We expect the GDP growth rate to peak in 1Q10 and then moderate in the later part of the year as the impact from the government's spending eases. We are expecting South Korean economy to post 5.0% growth in 2010 compared with 0.2% last year.*

USD/KRW bears dominated in 1Q10, bringing the pair to 1,131.45/USD by the end of the quarter from 1,164.65 end-2009. Compared with the sharp rebound in KRW during 1H09, the 2.9% KRW appreciation during the quarter was still fairly moderate. With confidence creeping back, JPY/KRW also softened to around 12.0 from as high as 16.1 in

early 2009 and competitiveness consideration will underlie BoK's reluctance to see more KRW appreciation from here. The BoK's unwillingness to begin normalising interest rates also reflected its concerns over the growth momentum in the country. Unless we see more move on the RMB, USD/



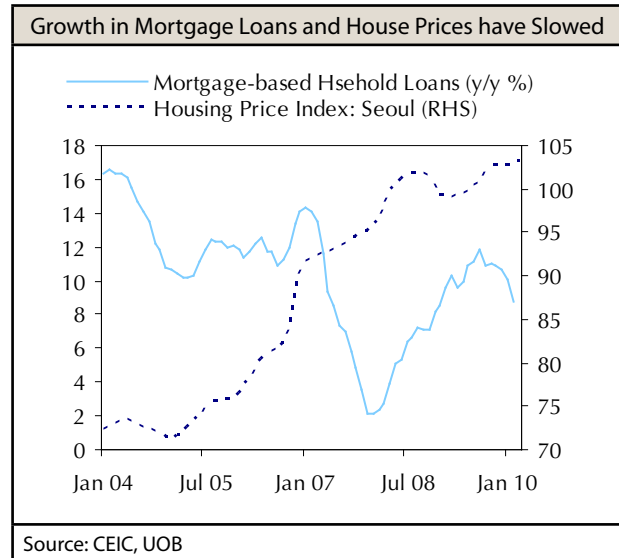
South Korea

KRW will probably hit 1,100 in 2Q10 before running out of steam particularly if the economic growth momentum eases in the second half of the year. An expected halving of the current account surplus from a record USD42.7bn in 2009 should also ease the downward pressure on the pair. Nonetheless, prospects of interest rate normalisation from 3Q10 will likely provide some support for the KRW in 2H10.

Rate Normalisation Likely from 3Q10

The BoK kept its benchmark base rate at record low of 2.0% for the 13th consecutive month in March. It has become increasingly clear that the BoK is not planning for any interest rate normalisation until 2H10. The new BoK governor, Kim Choong-soo is widely expected to go along with the Finance Ministry's preference for low interest rates for as long as possible, particularly as inflation remains muted. CPI inflation averaged 2.7%/y/y in 1Q10, up slightly from 2.4% in 4Q09. While inflation could moderate in 2Q10, we expect it to rebound to 3.0%/y/y in 3Q. There is risk of higher inflation rates should the government raise utilities prices and public services fee this year.

Another key consideration – the real estate market has also begun to stabilise owing to the policy measures in 2H09 which includes tougher debt-to-income ratio regulation and on loan-to-value ratios in Seoul and metropolitan area. Household mortgage loans growth peaked at 11.9%/y/y in Aug 09 and while the house price index in Seoul continued to rise, apartment transactions in the area has fallen by 40% from its peak in Jul last year. Furthermore, the high household indebtedness and debt servicing might become a concern when interest rates start to increase. Household



debt has risen steadily to 69% of GDP in 2009 from 67.1% in 2008 and under 40% before the Asian Financial crisis. Moreover, individual debt to disposable income has already surpassed 140%. We believe this will keep BoK cautious about raising interest rates too aggressively in the near-term and will probably opt for more administrative measures such as those in 2H09 to cool the property market if prices rise at a faster-than-expected pace from here.

The KRW appreciation has certainly helped to tighten monetary conditions in the country and the currency strength will allow the BoK more room with regards to postponing interest rate rise in the country. At least for 2Q10, the risk from low interest rate will be contained. We are now expecting the BoK to begin its interest rate

4Q09 GDP: Private Consumption Contributed to the Bulk of GDP Growth							
	2009	4Q08	1Q09	2Q09	3Q09	4Q09	4Q09
	y/y % change						ppt cont
Real GDP	0.2	-3.3	-4.3	-2.2	1.0	6.0	6.0
Final Consumption	1.3	-1.7	-2.0	0.7	1.7	4.7	3.2
Private Consumption	0.2	-3.6	-4.4	-1.0	0.7	5.8	3.0
Government Consumption	5.0	4.7	7.2	6.7	5.3	1.1	0.2
GFCF	-0.2	-8.7	-7.4	-2.3	0.4	7.1	2.0
Construction	4.4	-7.7	2.8	5.1	4.4	5.0	0.9
Facilities Investment	-9.1	-13.3	-23.1	-17.3	-7.0	13.3	1.1
Change in Stocks (% of GDP)	-2.5	-1.3	-1.8	-4.4	-2.1	-1.7	-0.4
Net Exports	68.3	47.8	122.0	94.6	93.3	15.8	1.1
Exports of G&S	-0.8	-6.1	-10.7	-3.4	1.0	9.8	4.4
Imports of G&S	-8.2	-11.8	-18.8	-13.3	-7.7	8.7	3.3

Source: CEIC, UOB

South Korea

normalisation in 3Q with a total move of 100bps to bring the base rate to 3.00% by the end of this year.

Growth Momentum Eased in 4Q09

South Korea's GDP growth surged to its highest in 15 quarters at 6.0%/y in 4Q09, boosted by low base effect. The key contributions came from private consumption (+3.0ppt) and fixed investments (+2.0ppt). On the whole, the country managed to avoid a full-year growth contraction that market was anticipating at the beginning of 2009. Nonetheless, growth momentum has begun to ease in the quarter with the s/adj GDP growth rate at just 0.2%q/q following the sharp 3.2% surge in 3Q09. This was primarily due to weaker government spending and a slowdown in net exports during the quarter. The bright spot was facilities investment which retained solid growth momentum since 2Q09 as the global environment

improved.

First quarter economic data remained robust. South Korea's exports strengthened further to 36.6%/y in 1Q10 from 11.7% in 4Q09 as it rebounded from four preceding quarters of deep contractions. Similarly, the country's industrial production has sustained four consecutive months of double-digit expansion since Nov 2009. On the private consumption, there is some moderation in consumer confidence from Oct last year. The cooling of the property market and higher interest rates in the later part of this year could be slightly negative for private consumption. We expect the GDP growth rate to peak in 1Q10 and then moderate in the later part of the year as the impact from the government's spending eases. We are expecting South Korean economy to post 5.0% growth in 2010 compared with 0.2% last year.