

South Korea Continues to Face Rising Domestic and International Challenges amid Ongoing Political Paralysis

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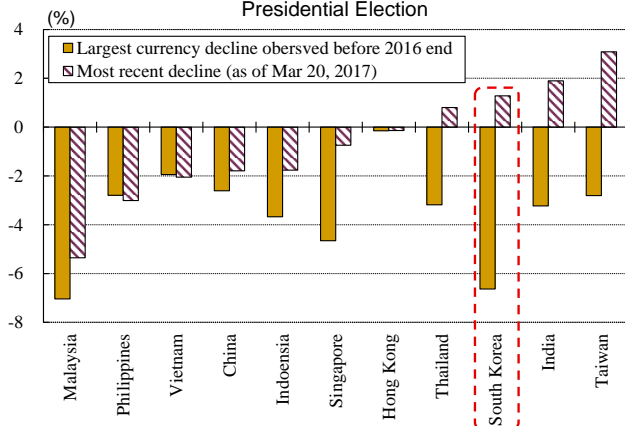
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Asian economies as a whole continue steady growth supported by strong domestic demand and improving exports. Although major Asian currencies had weakened somewhat towards the Federal Reserve's additional rate hike in March, they have remained generally stable compared to when they depreciated sharply following the US presidential election last November (see chart 1). As inflationary pressure is expected to be generally small and the US is anticipated to increase interest rates at a moderate pace than in the past, the implementation of monetary policy that responds to economic conditions will continue to provide a boost to the economy of the region.

Meanwhile, it is difficult to imagine a scenario of accelerating growth for the South Korean economy, despite a recovery in exports. The South Korean economy is showing positive signs of growth, as evidenced by an improvement in corporate capital expenditure thanks to an uptick in exports. However, the unemployment rate rose to a seven-year high, while a worsening of consumer sentiment due to political turmoil has led to a slowdown in private consumption and weighed on growth (see table 1). Additionally, South Korea is faced with mounting economic and foreign policy challenges such as growing tension between North and South Korea, and worsening relations between South Korea and China due to the deployment of the U.S. Terminal High Altitude Area Defense system (THAAD) to South Korea. In fact, immediately following the announcement at the end of February by a South Korean retailer of its decision to provide one of its sites for the US THAAD missile to be installed, China has applied intense economic pressure against South Korea by shutting down some shops of the retailer located in China (because of a fire inspection) and prohibiting the sales of travel tour packages for South Korea (because of the increasing number of troubles associated with immigration checks upon arrival at Jeju airport). South Korea is expected to continue to face these internal and external challenges for the time being.

On the political front, South Korea's Constitutional Court formally removed impeached President Park Geun-hye from office on March 10, paving the way for the next presidential election to be held on May 9. One of the main South Korean presidential candidates, Moon Jae-in, former leader of the largest opposition Minjoo Party of Korea, is leading recent opinion polls, but he favors a more conciliatory approach towards North Korea, which has caused greater wariness both at home and abroad. On the other hand, with no strong candidates from the ruling party running, Ahn Cheol-soo, leader of the second largest opposition People's Party of Korea and currently second in the polls, has broadened his support, highlighting his moderate political position to attract conservative and centrist voters. Building a stable administration is essential to escaping economic downturn and the direction of the presidential election should be closely watched.

Chart 1: Volatility Rate of Major Asian Currencies after US Presidential Election



Note: The above currency volatility rate is calculated against the base date, Nov 8, 2016.
Source: Bloomberg, BTMU Economic Research Office

Table 1: South Korea's Major Monthly Economic Indicators

	Year 2016				Year 2017		
	Sep	Oct	Nov	Dec	Jan	Feb	
Household sector	Real retail sales (YoY,%)	0.2	2.5	3.2	1.8	4.0	n.a.
	Consumer sentiment (%pt)	101.8	102.0	95.7	94.1	93.3	94.4
	Unemployment rate (%)	3.9	3.8	3.6	3.5	3.6	4.0
Corporate sector	Industrial production (YoY,%)	-2.0	-1.2	5.4	4.2	1.7	n.a.
	Capital expenditure (YoY,%)	-4.0	-3.3	10.2	10.3	11.4	n.a.
	Export(YoY,%)	-6.0	-3.2	2.3	6.3	11.1	20.2
	Manufacturing PMI (%pt)	47.6	48.0	48.0	49.4	49.0	49.2

Note: Highlighted parts represent economic indicators that saw a decline (or a rise for the unemployment data) from the previous month.

Source: Bank of Korea, Korean Statistical Information Service, Ministry of Trade, Industry and Energy, BTMU Economic Research Office

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