Ugly start!

Korean economy runs a high risk of contracting in 1st quarter

A survey on Korean economy

Organizations	Goldman Sachs	Morgan Stanley	Standard Chartered	Nomura	HSBC	ADB Institute	Korea Institute of Finance	Wharton
Economists	Kwon Goo-hoon	Shawn Kim	Oh Suk-tae	Kwon Young-sun	Ronald Man	Park Jae-ha	Lee Myong-hwal	Mauro Guillen
Negative growth in 1st quarter? (q-o-q)	Yes	Yes	No	Yes	No	Yes	No	No
2012 growth, inflation outlook (%)	3.5, 3.1	3.2, 2.7	3, 3	3, 3.3	3.1, 2.6	3, 4	3.7, 3.1	3, 4
When will the economy bottom out?	3rd quarter	2nd quarter	3rd quarter	2nd quarter	2nd quarter	Not unti 2013	3rd quarter	2nd quarter
Timing of key rate cuts	1st quarter	4th quarter	2nd quarter	2nd quarter	1st quarter	Not unti 2013	Not until 2013	Not until 2013
Biggest obstacles to economic recovery	Eurozone crisis, weak links in the financial sector	Euronzone crisis, slowing Chinese economy	Eurozone crisis, household debts	Eurozone crisis, slowing Chinese economy	Euronzone crisis, household debts	Eurozone crisis, inflation	Eurozone crisis, slowing U.S. economy	Slowing Chinese economy

Analysis

Business Focus conducted a survey of five Korea economists at global investment banks — Goldman Sachs, Morgan Stanley, Nomura, Standard Chartered and HSBC — and three macro economists at economic institutes to figure out where the Korean economy is heading. — ED.

By Kim Jae-kyoung

The Korean economy has started the Year of the Dragon with a glut of bad news. It grew at the slowest clip in two years in the last quarter of 2011 as Europe's debt crisis combined with domestic woes has crippled all growth engines — exports, private consumption and firms' investments.

The nation's gross domestic product (GDP), the total value of goods and services produced in a country during a given period, expanded only 0.4 percent between October and December, a setback from 0.8 percent in the third quarter.

What is worse is that the quality of the fourth-quarter performance was poor. All major components of final domestic demand, as well as exports, shrank on a quarter-on-quarter basis. Weak global demand caused by the eurozone's debt fiasco was blamed mainly for the poor scorecard.

The main concern is that things are not likely to improve soon. Many organizations have rushed to lower their outlook for the Korean economy. Some of them expect the economy will contract in the first quarter, citing lingering woes, such as a debt crisis in Europe, a slowing Chinese economy and snowballing household debts.

Economists have been split over whether or not Korea's GDP growth will fall into a negative territory but reached a consensus that Asia's fourth-largest economy will hit bottom in the second quarter and bounce back beginning in the second half.

"European sovereign debt crisis and its impact on global economic growth are likely to persist for the time being. But conditions for growth will gradually improve as we approach the second half," Standard Chartered Bank in Korea economist Oh Suk-tae said.

Starting 2012, nearly all key economic indicators are pointing to a downturn, which has sent a growing number of economists into a pessimistic camp forecasting a contraction in the first quarter.

Contraction in 1st quarter?

First of all, it looks really bleak in external trade. Korean exports fell in January, marking the first contraction in 27 months. Exports dropped 6.6 percent in January from a year ago, compared to growth of 10.8 percent in December, the first negative reading since October 2009. The trade balance turned to a $2 billion deficit in the month from a $3.4 billion surplus in December.

Additionally, domestic activity has deteriorated and is showing no signs of a turnaround in the coming months. The nation's industrial production (IP) fell for the third consecutive month in December.

BOK expected to start cutting key rates in March; Eurozone crisis, household debts key risk factors for economy.

Nomura economist Kwon Young-sun is one of the pessimists expecting a contraction.

"Details of the fourth-quarter GDP report paint a worse picture. We forecast GDP to decline by 0.1 percent in the first quarter on weaker exports and tepid domestic demand," he said.

"The impact of the European sovereign debt crisis and weaker Chinese demand have lowered Korea's GDP through negative wealth effects, delayed capital expenditure and weakening exports."

However, more economists still remain in a positive camp, expecting that domestic demand will slowly improve playing a key role in preventing GDP growth from slipping into negative.

They point out that central banks in advanced nations, including the U.S., will continue to resort to credit-easing policies to keep the global economy from derailing, which will help Korea manage to stay the course.

"Aggressive monetary easing by major countries will improve the export outlook, and the underlying strength of the labor market and credit growth should bring renewed strength in domestic demand," Oh of Standard Chartered said.

"In particular, we expect private consumption to resume growth in the first quarter given favorable job-market and credit conditions. This will reduce the likelihood of a contraction in the first quarter, which some people are concerned about."

Key risks

In 2012, inflation will no longer be a key issue here as the headline inflation receded sharply to 3.4 percent in January year-on-year, falling below the central bank's target range — 2 to 4 percent. However, policymakers will not be active in boosting growth as there are key risks both at home and abroad.

On the overseas front, the eurozone crisis will continue to be the number one risk factor as it will affect both exports and domestic demand. "Eurozone instability will likely weigh on the global economy and markets in the first quarter," Goldman Sachs economist Kwon Goo-hoon said, expecting that Korea will see negative spillovers from the region's sovereign risks.

A slowing Chinese economy is also posing a threat as it will affect its people's purchasing power.

"Although China's purchasing managers index (PMI) unexpectedly rose 50.5 in January from 50.3 in December, the import component fell to 46.9 from 49.1. This suggests that Korean export growth to China should slow further," Kwon of Nomura said.

On the domestic side, household debt remains as an Achilles heel for the Korean economy. Korea's household debt is now tallied at over 1 quadrillion won, which means consumers here owe more money than the economy generates in an entire year.

Back to credit-easing mode

Whether economic growth falls into a negative territory or not, most economists expect that the economy will weather the ongoing turmoil and head for a soft landing.

The fact that Korea has enough ammunition to fight is the key reason many economists expect the economy to pick up in the second half after bottoming out in the second quarter. Most expect the Bank of Korea (BOK) to start cutting key rates in the first half.

"Although the outlook for the first quarter remains challenging, we maintain our view of a soft landing in Korea. We expect the economy to expand by 0.6 percent in the first quarter and pick up gradually from the second quarter," HSBC economist Ronald Man said.

"I think that support from policy officials will be required to restore strength in the economy. I expect the BOK to deliver a 25 basis point cut by the end of the first quarter. This should provide much needed stimulus to domestic demand," he added.

Kwon of Goldman Sachs also expects the first reduction before April. "The overall growth momentum should remain weak in the first half mainly on weak exports and capital expenditure although activity could rebound in the first quarter," he said.

"With moderating growth momentum and still elevated uncertainties surrounding the eurozone, we expect a 50 basis point in rate cuts in 2012, with the first reduction likely in the first quarter," he added.

The Korea's key rate has been untouched at 3.25 percent since June 10, 2011 when the central bank raised it by 25 basis points.

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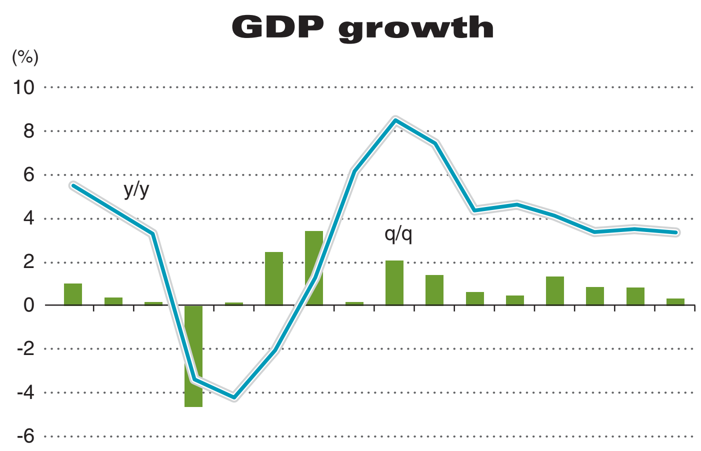

Source: Bank of Korea