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Highlights

Editor: **Anwita Basu**

Forecast Closing Date: **June 26, 2015**

Outlook for 2015-19

- Park Geun-hye of the ruling Saenuri Party will retain her position as president until her term ends in early 2018. The political scene will increasingly become dominated by the search for candidates for the next presidential election.
- The president will focus on strengthening the economy for the rest of her mandatory single term.
- The government will continue to pursue economic policies that promote domestic demand to reduce South Korea's dependence on export-led growth. Fiscal policy will remain expansionary for most of the forecast period.
- The Bank of Korea (BOK, South Korea's central bank) will maintain a loose monetary policy stance until early 2016, before embarking on a gradual tightening cycle from late 2016.
- The Economist Intelligence Unit expects real GDP to grow by 3.1% in 2015 and by an annual average of 3.7% in 2016-19.
- We expect the rate of consumer price inflation to average 1.2% in 2015, before accelerating to an annual average of 2.3% in 2016-19 as consumption picks up and oil prices gradually recover from their 2015 levels.

Review

- In early June the presidential office and ruling Saenuri Party lawmakers in the National Assembly (parliament) disagreed over revisions to the National Assembly Act that the party had agreed to pass in parliament. Later in the month Park Geun-hye vetoed the revisions.
- On June 22nd Park Geun-hye and Japan's prime minister, Shinzo Abe, each commemorated the 15th anniversary of the resumption of diplomatic relations between the two countries by visiting the other nation's embassy.
- On June 11th the BOK lowered the benchmark interest rate from 1.75% to another all-time low of 1.5% over fears that the outbreak of Middle Eastern Respiratory Syndrome (MERS) would severely affect economic growth.
- On June 21st the National Assembly began a four-day interpellation session primarily to discuss plans to stimulate the economy, as there are fears that the outbreak of MERS will cause growth to slow.
- According to data released by Statistics Korea on June 2nd, consumer prices rose by 0.5% year on year in May, compared with 0.4% in April.
- According to data released by the Ministry of Trade, Industry and Energy on June 1st, South Korean exports declined by 10.9% year on year in May (the biggest monthly fall since August 2009), while imports fell by 15.3%.

Outlook for 2015-19

Political stability

Park Geun-hye, of the ruling Saenuri Party, will retain her position as president until her term ends in early 2018. However, there is a risk that she will become a lame-duck president following the 2016 parliamentary elections. Furthermore, growing tensions between her office and the rest of the Saenuri Party in the National Assembly also raise concerns about policymaking in 2015-18. In her election campaign in 2012, Park Geun-hye had alluded to reducing income inequality and improving the public welfare system, but the lack of proper budgeting has led to many of these plans

being shelved.

It is also becoming evident that Park Geun-hye's hitherto firm grip on the Saenuri Party—for which she has been instrumental in securing electoral success—is clearly slipping. In February 2015 the party appointed Yoo Seong-min and Won Yoo-chul as floor leader and chief policymaker respectively. Both are seen as critics of the president. However, she still has loyalists in the party, who have been given positions in her cabinet with these figures. In mid-June 2015 the National Assembly approved the erstwhile minister of justice, Hwang Kyolahn, as prime minister; he is believed to be a close associate of the president.

The president has made some controversial personnel choices, which have not stood her in good stead. In late April Lee Wan-koo became the second prime minister to resign under her leadership, after only two months in office. He is under investigation for his alleged connection to a bribery scandal, sparked by a suicide note left by a businessman, Sung Wan-jon. Although Lee Wan-koo has denied all charges, he came under pressure to resign from his post after the opposition expressed an intention to begin impeachment proceedings against him.

The administration has faced severe criticism over its poor performance in handling crises. Public perception of the administration soured considerably following the sinking of a passenger ferry, the Sewol, off the country's south-western coast in April 2014. It highlighted a range of government failures, from lax vessel-safety enforcement to poorly handled rescue operations and an inadequate disaster response. The government's slow response to containing the spread of the Middle Eastern Respiratory Syndrome (MERS) virus across the country in June 2015 has brought down the president's approval rating to new lows.

The Saenuri Party controls 160 out of 300 seats in the National Assembly (parliament), which should—in theory—guarantee that the president's policy measures are passed swiftly. However, proposed bills have a tendency to run into days of debate and deadlock in parliament, and can be delayed further should the presidential office disagree with the final outcome. For instance, in June 2015 Park Geun-hye vetoed a revision to the National Assembly Act that had already been approved in parliament; it would have given the National Assembly the power to require changes to presidential decrees and prime ministerial ordinances. Such deliberations will continue to cause delays in policymaking.

The Saenuri Party's success in gaining a comfortable majority, especially after winning two by-elections in June 2014 and April 2015, reflects more the weakness of the opposition camp than an expansion of its own support base. The opposition is dominated by the left-leaning New Politics Alliance for Democracy (NPAD), which is based on the merger in March 2014 of the Democratic Party and the New Political Vision Party, a group led by a rookie politician, Ahn Cheol-soo, who was a challenger to Park Geun-hye during the 2012 presidential election. Unable to secure much traction in the June 2014 local elections, despite the ruling party's lack of popularity at the time, the NPAD's two leaders, Ahn Cheol-soo and Kim Han-gil, stepped down to take responsibility for the party's electoral failure. In February Moon Jae-in, who served as chief of staff to a former president, Roh Moo-hyun, in 2003-08, was appointed party leader. He was also unable to improve the party's prospects in the April 2015 elections, and continues to face a steep uphill battle to quell internal wrangling in the NPAD.

Election watch

Despite strong by-election victories for the Saenuri Party, the April 2016 parliamentary election and the December 2017 presidential poll remain wide open. Ahead of the parliamentary election, the Saenuri Party will need to maintain internal unity, but Park Geun-hye's falling popularity is likely to hurt its chances. If the party keeps factionalism at bay it will be able to take advantage of the disunity in the opposition and succeed in the elections. It is also important for the party not to veer too far to the right, as the NPAD could stake out the centre ground. So far, the only clear potential contender from the right is Kim Moo-sung, a five-term lawmaker who was elected as Saenuri Party chairman in July 2014.

In the liberal camp, a number of possible presidential contenders are emerging. Moon Jae-in, who was a candidate for the presidency in 2012, is most likely to run again. The reputation of Ahn Cheol-soo has been tarnished by the NPAD's dismal performance at the 2014 by-elections. However, in June 2015 he confirmed his desire to run again in 2017. Park Won-soon, a lawyer and civic activist elected in 2011 as mayor of the capital, Seoul, is also popular. The Seoul mayoralty is widely considered a stepping-stone to the presidential palace.

International relations

Inter-Korean relations are at a low ebb, and the outlook remains uncertain. At the start of her presidential term, Park Geun-hye had promoted the building of "trustpolitik" with North Korea, which required a minimum level of trust in the North's agreements with the international community. So far, however, relations have remained volatile, suggesting that Park Geun-hye continues to struggle to find a middle path between the unilateral generosity of the "sunshine" era (1998-2007) and the hard line of Lee Myung-bak, who demanded denuclearisation before any deepening of economic relations. Meanwhile, North Korea remains acrimonious towards the South. Nevertheless, the risk of major conflict remains small.

Relations between South Korea and Japan are likely to remain tense over the denial by the Japanese prime minister, Shinzo Abe, of key aspects of Japan's conduct during the second world war. There seems to have been a softening of strains in recent months, with some progress on trilateral talks between South Korea, Japan and China. In mid-April the foreign and defence ministers of Japan and South Korea held their first round of security talks in nearly five years. Following this, the three countries' chief trade negotiators met in mid-May to discuss a free-trade agreement (FTA). A bilateral summit between the leaders of the two countries will remain contingent upon the tone adopted by Mr Abe in his speech to commemorate the 70th anniversary of the end of the second world war, which is due in August.

South Korea's traditional alliance with the US will remain close; however, the government has increasingly placed emphasis on relations with China, the country's largest trading partner. The South's deployment of a US missile-defence system, Terminal High Altitude Area Defence, has raised tensions with China. In June, however, a Sino-South Korea FTA, which had been negotiated for three years, was officially signed. The FTA is due to be implemented later this year, once it is approved by the countries' respective legislatures. China's status as South Korea's largest bilateral trading and tourism partner suggests that its influence in the country will grow in 2015-19.

Policy trends

South Korea's current export-oriented economic growth model, which relies heavily on the goods produced by family-run conglomerates (chaebol), has not provided employment and wage growth to sustain an improvement in the living standards of the country's middle classes. Furthermore, South Korean households, which are highly indebted, remain under pressure and are deterred from discretionary spending by the government's low levels of social expenditure. The country's rapidly ageing population further complicates the long-term problems caused by low welfare spending.

When she took office in 2013, Park Geun-hye not only pledged to increase welfare-related spending but also envisioned a "paradigm shift" in which the economy would be driven by innovation and creativity, rather than export-oriented manufacturing. This also meant curbing the influence of the chaebol and encouraging more competition in the economy. Unfortunately, the president's policy agenda has been stalled periodically through the course of her term so far, first by the fallout from the Sewol ferry disaster in April 2014 and then by the outbreak of MERS in June 2015. Meanwhile the chaebol have been closing ranks and consolidating their ownership structures. This, in effect, reinforces their domination of the economy. The government has made some fringe efforts to mobilise small and medium-sized enterprises (SME) and to provide them with funding and assistance. However, given that Park Geun-hye has a little more than a year left in government before she potentially becomes a lame-duck president, she will be eager to prioritise the health of the economy over long-term structural reforms.

Fiscal policy

The challenge for the government will be to provide support for the economy while keeping the public finances stable. The governor of the Bank of Korea (BOK, the central bank), Lee Ju-yeol, has expressed concern about sluggish revenue growth in recent years. In order to boost economic growth, the government has adopted an expansionary fiscal stance. The 2015 budget was set to raise total expenditure by 5.5% year on year to W375trn (US\$3339.7bn). This was topped up by an additional W15trn in June to bolster the economy against the negative impact of the MERS outbreak. Under the 2015 budget outlay, the government expects the fiscal deficit (excluding social-security funds) to widen to the equivalent of 2.1% of GDP (W33.4trn).

Based on the government's spending plans and on consolidated expenditure and revenue numbers (which include social security funds, such as pensions), The Economist Intelligence Unit forecasts that a small fiscal deficit at the equivalent of 0.1% of GDP will be recorded in 2015 and that the fiscal balance will bounce back into surplus through the 2016-19 period. This is attributable to modest revenue growth and an eventual fall in government expenditure as economic growth firms up.

Monetary policy

The BOK has adopted a loose monetary policy in recent months to align itself with the government's stimulus efforts. Consumer price inflation is likely to remain well below the BOK's target of 1.9% for 2015, while private consumption looks vulnerable following the MERS outbreak. So far this year the BOK has cut its policy rate twice, each time by 25 basis points, bringing it down to a historical low of 1.5%. While this was in line with our forecast, another 25-basis-point cut in the second half of the year cannot be ruled out, should the data for the second quarter come in lower than the BOK's forecast. We believe that the BOK will maintain its loose monetary policy stance in early 2016. However, the central bank will seek to normalise policy later in 2016, as it remains wary of fuelling household debt, which is already burdensome at almost US\$1trn. Furthermore, it will also be eager to align its policy with that of the Federal Reserve (the US central bank), which is expected to tighten its own policy throughout 2016. Nevertheless, high levels of household indebtedness will mean that rate increases will be incremental in the 2016-19 period.

International assumptions

	2014	2015	2016	2017	2018	2019
Economic growth (%)						
US GDP	2.4	2.4	2.5	2.4	2.6	1.4
OECD GDP	1.8	2.1	2.3	2.3	2.4	1.9
World GDP	2.3	2.4	2.8	2.8	2.9	2.5
World trade	3.0	3.7	5.0	5.5	5.6	5.6
Inflation indicators (% unless otherwise indicated)						
US CPI	1.6	0.2	2.2	2.3	2.5	2.0
OECD CPI	1.6	1.5	1.9	2.2	2.2	2.0
Manufactures (measured in US\$)	-0.3	0.4	1.5	1.9	1.2	1.4
Oil (Brent; US\$/b)	98.9	60.2	69.3	79.9	86.4	89.3
Non-oil commodities (measured in US\$)	-5.3	-12.2	6.5	4.6	2.6	2.7
Financial variables						
US\$ 3-month commercial paper rate (av; %)	0.1	0.3	1.2	2.6	3.4	4.1
¥:US\$ (av)	105.86	121.69	124.41	124.00	122.00	120.00
W:US\$ (av)	1,053	1,104	1,111	1,099	1,087	1,082
US\$:€ (av)	1.33	1.07	0.99	1.07	1.15	1.20

Economic growth

The outbreak of MERS has had a negative impact on consumer and business sentiment in South Korea. As a precaution to ward off the negative impact of this on economic growth, monetary and fiscal policy has been expansionary. These policies will counterbalance any negative impact MERS has on the economy. As a result, we continue to expect real GDP to grow at an average annual rate of 3.1% in 2015. We then expect the economy to expand at an average annual rate of 3.7% in 2016-19. There is likely to be a strong pick-up in the first half of 2016 as the economy bounces back from the MERS crisis and also benefits from the additional policy-driven stimulus measures. However, tepid demand conditions in some of South Korea's largest export markets will continue to weigh on export prospects, even though a recovery in the US economy will support South Korean exporters. A dramatic acceleration in private consumption growth in the forecast period remains unlikely, in view of high levels of household debt.

Economic growth

%	2014 ^a	2015 ^b	2016 ^b	2017 ^b	2018 ^b	2019 ^b
GDP	3.3	3.1	3.8	3.7	3.7	3.4
Private consumption	1.8	1.7	3.3	3.8	3.8	2.5
Government consumption	2.8	3.5	4.0	2.8	2.5	2.2
Gross fixed investment	3.1	3.3	4.5	3.0	3.2	3.0
Exports of goods & services	2.8	2.9	3.6	4.0	5.2	4.4
Imports of goods & services	2.1	0.3	3.6	3.6	4.8	3.1
Domestic demand	2.4	1.8	3.9	3.5	3.4	2.6
Agriculture	2.6	2.8	3.0	2.9	2.8	2.5
Industry	3.5	3.5	3.5	3.4	3.5	3.4
Services	3.1	2.8	4.1	4.0	3.9	3.4

^a Actual. ^b Economist Intelligence Unit forecasts.

Inflation

We expect inflation to average 1.2% in 2015 and 2.3% annually in 2016-19. In 2015 price pressures will be kept partly in check by weak global oil prices. South Korea is the world's fourth-largest importer of oil and is therefore highly susceptible to changes in oil prices. In 2016 consumer prices will increase at a slightly faster rate than in 2015, as growth in domestic demand accelerates and the local currency, the won, weakens moderately against the US dollar. We forecast that producer prices will decline by an average of 3.2% in 2015; this is because the sudden drop in oil prices in late 2014 lowered the producer price index dramatically in January. As a result, even with a recovery in prices, producer costs will fall in 2015 as a whole. They are, however, expected to rise by an average of 2.6% in the 2016-19 period, in line with an expected strengthening in global commodity prices and the domestic economy.

Exchange rates

Factors such as South Korea's sizeable trade and current-account surpluses have buttressed the value of the won in recent years, and a positive interest-rate differential with most other advanced economies has encouraged financial inflows, further supporting the local currency. However, economic weakness and the MERS outbreak, which have prompted monetary easing, will put downward pressure on the currency in 2015-16. Furthermore, South Korea will record a lower current-account surplus as the largely export-dependent economy grapples with global headwinds and the interest-rate differential with the US narrows substantially. Given low consumer price inflation and concerns about economic growth, the central bank's loose monetary policy stance will be maintained throughout 2015 and early 2016. We expect the won to depreciate to an annual average of W1,107:US\$1 in 2015-16. It will then start to strengthen gradually in 2017 and will continue to appreciate modestly in 2018-19, averaging W1,089:US\$1 a year in 2017-19, in line with rising local interest rates.

External sector

As a proportion of nominal GDP, the current-account surplus will decline from 6.3% in 2014 to 5.1% in 2015. South Korea will maintain its long-standing services deficit, but this will narrow gradually throughout the forecast period. The service sector deficit will widen in 2015 as tourist inflows fall as a result of MERS. However, services credits will accelerate over the forecast period, driven by increasing Chinese tourism to South Korea (although spending by outbound South Korean tourists will continue to exceed local tourism receipts). South Korea remains a net exporter of construction and telecommunications services, and policies to support other subsectors will also facilitate the narrowing of the services deficit.

The merchandise trade surplus will decline substantially, from US\$92.7bn in 2014 to US\$77.3bn in 2015, as export growth weakens because of lower global commodity prices and tepid demand from key export markets. The trade surplus will continue to trend lower in 2016-19. The overall income account will remain in the black during the forecast period, as outflows of profits on foreign investments in South Korea will be offset by inflows from the substantial stock of assets held abroad by local firms. Overall, the current-account surplus will average the equivalent of 3.8% of GDP in 2015-19.

Forecast summary

Forecast summary

(% unless otherwise indicated)

	2014 ^a	2015 ^b	2016 ^b	2017 ^b	2018 ^b	2019 ^b
Real GDP growth	3.3	3.1	3.8	3.7	3.7	3.4
Industrial production growth	0.5	2.0	2.8	4.2	4.2	4.3
Gross fixed investment growth	3.1	3.3	4.5	3.0	3.2	3.0
Unemployment rate (av)	3.5	4.3	3.8	3.0	3.1	3.1
Consumer price inflation (av)	1.3	1.2	2.5	2.4	2.3	2.1
Consumer price inflation (end-period)	0.8	2.6	2.4	2.3	2.2	2.1
Short-term interbank rate	4.3 ^c	3.8	4.2	4.8	5.3	5.6
Government balance (% of GDP)	0.6 ^c	-0.1	0.0	0.1	0.3	1.0
Exports of goods fob (US\$ bn)	621.3	528.3	547.3	569.5	596.3	631.8
Imports of goods fob (US\$ bn)	-528.6	-451.8	-470.6	-508.4	-550.7	-590.1
Current-account balance (US\$ bn)	89.2	71.2	68.4	56.0	44.9	42.6
Current-account balance (% of GDP)	6.3	5.1	4.7	3.7	2.8	2.6
External debt (end-period; US\$ bn)	425.2 ^c	420.4	448.3	491.4	536.1	577.1
Exchange rate W:US\$ (av)	1,053	1,103	1,110	1,099	1,087	1,082
Exchange rate W:US\$ (end-period)	1,099	1,110	1,109	1,095	1,080	1,078
Exchange rate W:¥100 (av)	995	890	874	886	891	901
Exchange rate W:€ (av)	1,399	1,196	1,146	1,210	1,253	1,294

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Economist Intelligence Unit estimates.

Quarterly forecasts

Quarterly forecasts

	2014				2015				2016			
	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr
GDP												
% change, quarter on quarter	1.1	0.5	0.8	0.3	0.8	1.0	0.9	1.1	0.8	0.9	1.1	0.9
% change, year on year	3.9	3.4	3.3	2.7	2.4	2.9	3.0	3.9	3.9	3.7	3.9	3.8
Private consumption												
% change, quarter on quarter	0.4	-0.4	0.8	0.5	0.6	0.2	0.6	0.1	1.0	1.0	0.9	1.8
% change, year on year	2.6	1.7	1.5	1.4	1.6	2.1	1.9	1.5	1.9	2.8	3.1	4.9
Government consumption												
% change, quarter on quarter	0.1	0.6	2.1	0.2	0.2	-0.4	2.0	2.7	2.7	-1.4	-1.6	2.8
% change, year on year	3.1	1.8	3.3	3.1	3.2	2.2	2.1	4.6	7.2	6.1	2.3	2.4
Gross fixed investment												
% change, quarter on quarter	2.6	0.6	0.5	-2.9	4.0	0.1	2.0	2.1	0.5	0.5	0.7	0.6
% change, year on year	5.5	3.3	3.1	0.7	2.2	1.6	3.1	8.4	4.7	5.1	3.8	2.3
Exports of goods & services												
% change, quarter on quarter	1.4	1.3	-1.7	0.4	0.1	2.3	1.2	1.4	0.6	0.6	0.9	0.7
% change, year on year	4.3	3.3	2.2	1.4	0.2	1.2	4.2	5.1	5.6	3.8	3.5	2.8
Imports of goods & services												
% change, quarter on quarter	-1.1	1.2	-0.7	0.7	0.6	-0.8	-0.1	0.1	1.4	1.4	1.6	1.4
% change, year on year	3.2	2.9	2.3	0.1	1.8	-0.2	0.4	-0.2	0.6	2.7	4.5	5.9
Domestic demand												
% change, quarter on quarter	-1.2	0.4	1.6	0.5	0.6	-0.8	1.1	1.1	1.5	0.4	0.4	1.5
% change, year on year	2.7	2.7	2.8	1.3	3.1	1.9	1.4	2.0	2.9	4.1	3.3	3.8
Consumer prices												
% change, quarter on quarter	0.9	0.3	0.2	-0.4	0.4	0.4	0.9	0.4	0.8	0.6	0.7	0.0
% change, year on year	1.1	1.6	1.4	1.0	0.6	0.6	1.3	2.2	2.5	2.7	2.5	2.1
Producer prices												
% change, quarter on quarter	0.4	-0.1	-0.1	-1.5	-2.0	-0.9	0.8	0.8	0.5	0.6	0.7	0.6
% change, year on year	-0.5	-0.1	-0.2	-1.3	-3.6	-4.4	-3.5	-1.2	1.2	2.7	2.6	2.4
Exchange rate W:US\$												
Average	1,069	1,028	1,027	1,087	1,100	1,106	1,106	1,102	1,096	1,106	1,115	1,124
End-period	1,065	1,012	1,055	1,099	1,110	1,106	1,104	1,110	1,101	1,111	1,120	1,109
Interest rate (%; av)												
Money market rate	2.5	2.5	2.4	2.0	1.9	1.8	1.4	1.2	1.0	0.5	2.3	3.3
Long-term bond yield	3.6	3.4	3.1	2.7	2.4	2.3	2.5	2.8	2.7	2.6	2.8	3.2

Data and charts

Annual data and forecast

	2010 ^a	2011 ^a	2012 ^a	2013 ^a	2014 ^a	2015 ^b	2016 ^b
GDP							
Nominal GDP (US\$ bn)	1,094	1,202	1,223	1,306	1,410 ^c	1,397	1,443
Nominal GDP (W trn)	1,265	1,333	1,377	1,429	1,485 ^c	1,542	1,602
Real GDP growth (%)	6.5	3.7	2.3	2.9	3.3	3.1	3.8
Expenditure on GDP (% real change)							
Private consumption	4.4	2.9	1.9	1.9	1.8	1.7	3.3
Government consumption	3.8	2.2	3.4	3.3	2.8	3.5	4.0
Gross fixed investment	5.5	0.8	-0.5	3.3	3.1	3.3	4.5
Exports of goods & services	12.7	15.1	5.1	4.3	2.8	2.9	3.6
Imports of goods & services	17.3	14.3	2.4	1.7	2.1	0.3	3.6
Origin of GDP (% real change)							
Agriculture	-4.3	-2.0	-0.9	3.1	2.6	2.8	3.0
Industry	10.4	4.5	1.9	3.3	3.5	3.5	3.5
Services	4.4	3.1	2.8	2.9	3.1	2.8	4.1
Population and income							
Population (m)	48.5	48.7	49.0	49.3 ^c	49.5 ^c	49.8	50.0
GDP per head (US\$ at PPP)	31,067	32,000	32,676	33,732 ^c	35,184 ^c	36,086	37,919
Recorded unemployment (av; %)	3.7	3.4	3.2	3.1	3.5	4.3	3.8
Fiscal indicators (% of GDP)							
General government revenue	21.4	21.9	22.6	22.0	21.6 ^c	21.3	21.3
General government expenditure	20.1	20.5	21.3	21.0	21.0 ^c	21.4	21.4
General government balance	1.3	1.4	1.3	1.0	0.6 ^c	-0.1	0.0
Public debt	31.8	33.3	34.8	34.8	34.5 ^c	34.1	32.9
Prices and financial indicators							
Exchange rate W:US\$ (end-period)	1,134.8	1,151.8	1,070.6	1,055.4	1,099.3	1,110.0	1,109.0
Consumer prices (end-period; %)	3.0	4.2	1.4	1.1	0.8	2.6	2.4
Producer prices (av; %)	3.8	6.7	0.7	-1.6	-0.5	-3.2	2.2
Stock of money M1 (% change)	9.9	3.3	6.3	9.7	13.6 ^c	10.0	10.5
Stock of money M2 (% change)	6.0	5.5	4.8	4.6	8.1	7.0	7.5
Lending interest rate (av; %)	5.5	5.8	5.4	4.6	4.3 ^c	3.8	4.2
Current account (US\$ m)							
Trade balance	47,915	29,090	49,406	82,781	92,688	76,481	76,687
Goods: exports fob	463,770	587,100	603,509	618,157	621,299	528,270	547,317
Goods: imports fob	-415,855	-558,009	-554,104	-535,376	-528,610	-451,789	-470,629
Services balance	-14,238	-12,279	-5,214	-6,499	-8,163	-10,715	-8,714
Primary income balance	490	6,561	12,117	9,056	10,198	10,907	7,497
Secondary income balance	-5,317	-4,716	-5,474	-4,189	-5,502	-5,450	-7,070
Current-account balance	28,850	18,656	50,835	81,148	89,220	71,222	68,400
External debt (US\$ m)							
Debt stock	435,074 ^c	440,411 ^c	425,083 ^c	422,621 ^c	425,248 ^c	420,450	448,344
Debt service paid	15,637 ^c	53,666 ^c	53,238 ^c	51,510 ^c	53,228 ^c	55,055	56,571
Principal repayments	11,753	45,504 ^c	46,695 ^c	45,903 ^c	47,733 ^c	49,467	48,247
Interest	3,885 ^c	8,162 ^c	6,542 ^c	5,607 ^c	5,495 ^c	5,588	8,324
International reserves (US\$ m)							
Total international reserves	291,571	306,422	326,968	346,445	363,580	366,700	374,800

^a Actual. ^b Economist Intelligence Unit forecasts. ^c Economist Intelligence Unit estimates.

Source: IMF, International Financial Statistics.

Quarterly data

	2013			2014				2015
	2 Qtr	3 Qtr	4 Qtr	1 Qtr	2 Qtr	3 Qtr	4 Qtr	1 Qtr
General government finance (W bn)								
Revenue	77,862	82,119	78,407	79,154	77,992	81,004	82,745	81,121
Expenditure	91,705	55,602	62,105	94,527	86,904	63,186	67,777	97,328
Balance	-13,843	26,517	16,302	-15,373	-8,912	17,818	14,968	-16,207
Output (seasonally adjusted)								
GDP at constant 2010 prices (W bn)	343,819	346,850	349,819	353,643	355,438	358,252	359,208	362,171
GDP at constant 2010 prices (% change, year on year)	2.7	3.2	3.4	3.9	3.4	3.3	2.7	2.4
Industrial production index (2010=100)	107.1	107.4	109.5	109.2	108.5	108.6	107.6	107.5
Industrial production (% change, year on year)	-0.6	1.5	0.9	1.2	1.3	1.1	-1.7	-1.6
Employment, wages and prices								
Employment ('000)	25,326	25,410	25,346	24,914	25,790	25,927	25,768	25,267
Employment (% change, year on year)	1.3	1.7	2.2	3.0	1.8	2.0	1.7	1.4
Unemployment rate (% of labour force)	3.1	2.9	2.8	4.0	3.7	3.3	3.2	4.1
Average monthly wages, all industry (W m)	2,973	3,181	3,126	3,258	3,026	3,227	3,253	3,357
Average monthly wages, all industry (% change, year on year)	4.6	4.0	3.2	2.9	1.8	1.4	4.0	3.0
Consumer prices (2010=100)	107.4	107.9	107.8	108.8	109.1	109.4	108.9	109.4
Consumer prices (% change, year on year)	1.2	1.4	1.1	1.1	1.6	1.4	1.0	0.6
Producer prices (2010=100)	105.7	105.7	105.3	105.7	105.6	105.5	103.9	101.9
Producer prices (% change, year on year)	-2.3	-1.4	-0.9	-0.5	-0.1	-0.2	-1.3	-3.6
Financial indicators								
Exchange rate W:US\$ (av)	1,123	1,109	1,061	1,069	1,028	1,027	1,087	1,100
Exchange rate W:US\$ (end-period)	1,142	1,075	1,055	1,065	1,012	1,055	1,099	1,110
Deposit rate (av; %)	2.8	2.8	2.8	2.8	2.7	2.5	2.3	n/a
Lending rate (av; %)	4.6	4.6	4.5	4.5	4.4	4.2	3.9	n/a
3-month money market rate (av; %)	2.6	2.5	2.5	2.5	2.5	2.4	2.0	1.9
Money supply, M1 (end-period; W trn)	502	494	516	520	540	551	586	605
Money supply, M1 (% change, year on year)	11.8	9.3	9.7	8.5	7.5	11.5	13.6	16.4
Money supply, M2 (end-period; W bn)	1,893	1,900	1,921	1,961	2,000	2,037	2,077	2,128
Money supply, M2 (% change, year on year)	4.9	4.2	4.6	5.0	5.7	7.2	8.1	8.5
KOSPI Composite stockmarket index (end-period; Jan 4th 1980=100)	1,863	1,997	2,011	1,986	2,002	2,020	1,916	2,041
KOSPI Composite stockmarket index (% change, year on year)	0.8	3.5	2.2	3.4	21.3	3.0	-8.6	-1.4
Foreign trade (US\$ m)								
Exports fob	141,156	136,791	146,367	137,536	145,672	141,759	147,697	133,455
Imports cif	-	-	-	-	-	-	-	-
Trade balance	14,399	10,758	13,305	5,170	14,715	8,919	18,347	21,659
Foreign payments (US\$ m)								
Merchandise trade balance	20,585	23,306	24,592	17,745	26,428	21,676	26,838	25,258
Services balance	648	-2,079	-2,401	-3,503	-1,839	-904	-1,917	-5,413
Primary income balance	1,661	2,347	3,236	1,906	1,331	3,144	3,818	4,831
Net transfer payments	-546	-1,323	-1,491	-962	-1,680	-1,350	-1,510	-1,221
Current-account balance	22,347	22,250	23,936	15,186	24,240	22,566	27,228	23,455
Reserves excl gold (end-period)	321,646	332,127	341,665	349,547	361,751	359,612	358,798	357,956

Sources: Bank of Korea; IMF, International Financial Statistics.

Monthly data

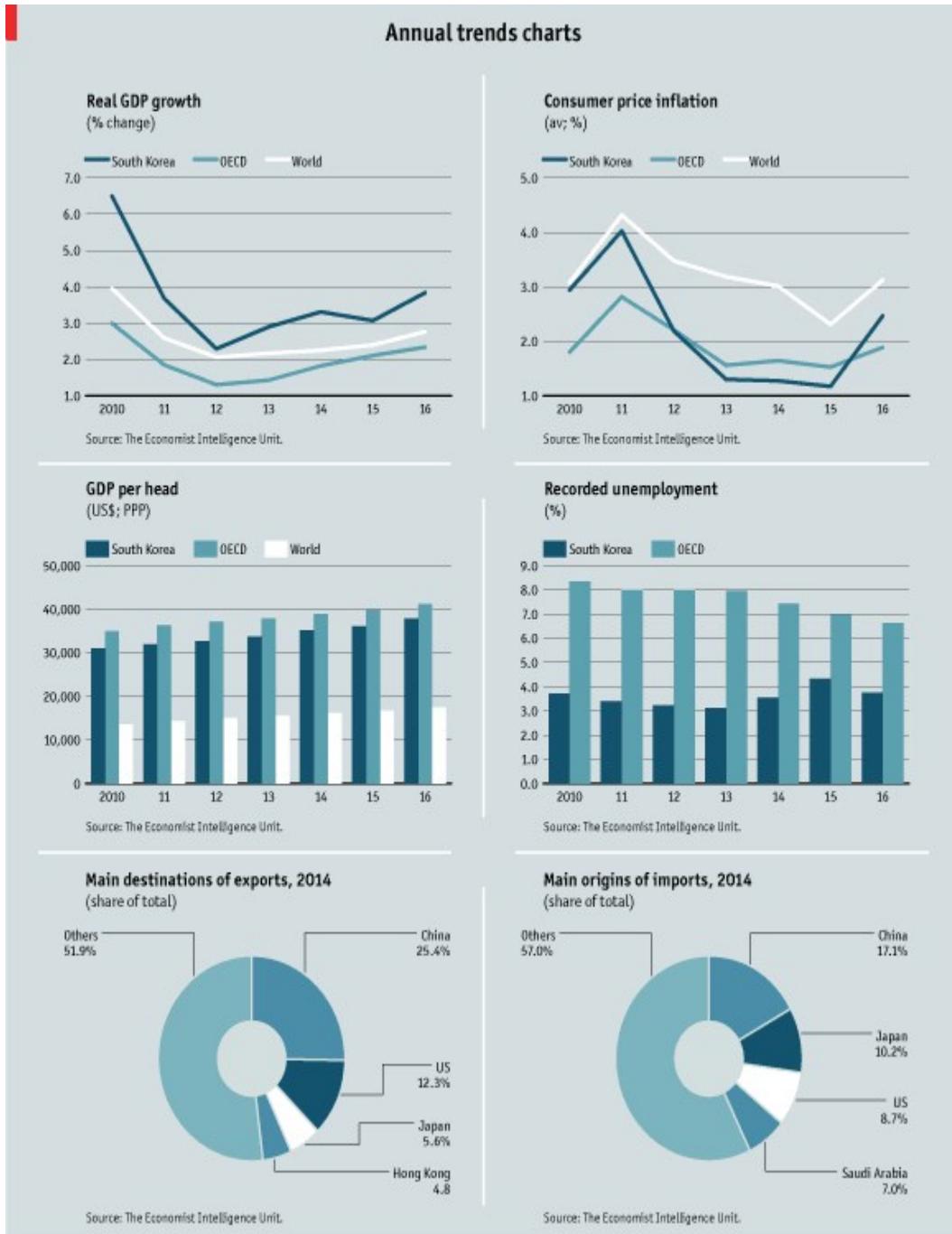
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Exchange rate W:US\$ (av)												
2013	1,066.5	1,086.1	1,103.8	1,121.1	1,112.1	1,136.6	1,126.6	1,116.2	1,084.8	1,065.7	1,062.7	1,056.1

2014	1,065.8	1,071.0	1,070.7	1,042.8	1,024.0	1,018.7	1,020.6	1,024.6	1,035.8	1,060.9	1,097.1	1,103.6
2015	1,088.5	1,098.4	1,113.1	1,088.7	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Exchange rate W:US\$ (end-period)												
2013	1,089.0	1,083.0	1,111.1	1,101.2	1,129.7	1,142.0	1,109.4	1,110.0	1,074.7	1,060.7	1,058.2	1,055.4
2014	1,070.4	1,067.5	1,064.7	1,033.2	1,020.1	1,011.8	1,027.9	1,014.0	1,055.2	1,068.5	1,107.9	1,099.3
2015	1,093.5	1,098.4	1,109.5	1,068.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
General government revenue (W bn)												
2013	34,531	14,631	26,888	37,563	21,455	18,844	34,761	21,527	25,831	32,478	19,818	26,111
2014	32,985	16,518	29,651	36,521	21,715	19,756	35,295	19,295	26,414	33,784	18,990	29,971
2015	34,393	16,196	30,532	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
General government expenditure (W bn)												
2013	29,367	29,112	32,347	33,030	25,531	33,144	17,962	16,812	20,828	15,981	17,319	28,805
2014	28,873	28,877	36,777	25,022	25,636	36,246	20,072	20,260	22,854	21,931	21,088	24,758
2015	28,564	31,131	37,633	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
General government balance (W bn)												
2013	5,164	-14,481	-5,459	4,533	-4,076	-14,300	16,799	4,715	5,003	16,497	2,499	-2,694
2014	4,112	-12,359	-7,126	11,499	-3,921	-16,490	15,223	-965	3,560	11,853	-2,098	5,213
2015	5,829	-14,935	-7,101	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply, M1 (% change, year on year)												
2013	5.9	8.5	7.1	9.1	10.2	11.8	9.5	11.5	9.3	12.0	12.9	9.7
2014	12.1	10.2	8.5	9.0	10.1	7.5	11.0	12.1	11.5	12.1	13.0	13.6
2015	11.5	15.9	16.4	18.3	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Money supply, M2 (% change, year on year)												
2013	5.4	5.5	4.8	5.4	5.2	4.9	3.8	4.9	4.2	4.8	5.3	4.6
2014	5.5	5.7	5.0	5.4	6.4	5.7	7.4	7.4	7.2	8.2	8.5	8.1
2015	7.7	8.2	8.5	9.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Industrial production (seasonally adjusted; % change, year on year)												
2013	1.7	-1.8	-0.2	-0.4	-1.5	0.2	0.3	3.9	0.5	1.6	-0.2	1.4
2014	0.8	-0.2	3.0	2.6	-0.6	2.0	3.9	-1.5	0.8	-2.7	-1.9	-0.5
2015	-3.5	0.2	-1.4	-2.5	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Unemployment rate (%)												
2013	3.4	4.0	3.5	3.2	3.0	3.1	3.1	3.0	2.7	2.8	2.7	3.0
2014	3.5	4.5	3.9	3.9	3.6	3.5	3.4	3.3	3.2	3.2	3.1	3.4
2015	3.8	4.6	4.0	3.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Deposit rate (av; %)												
2013	3.2	3.1	3.0	2.9	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
2014	2.8	2.8	2.7	2.7	2.7	2.7	2.6	2.4	2.4	2.3	2.2	2.3
2015	2.2	2.1	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Lending rate (av; %)												
2013	5.0	4.9	4.8	4.7	4.6	4.5	4.6	4.6	4.5	4.5	4.5	4.5
2014	4.5	4.5	4.5	4.4	4.4	4.4	4.4	4.2	4.1	4.0	3.9	3.9
2015	3.9	3.9	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
KOSPI Composite stockmarket index (end-period; Dec 4th 1980=100)												
2013	1,962	2,026	2,005	1,964	2,001	1,863	1,914	1,926	1,997	2,030	2,045	2,011
2014	1,941	1,980	1,986	1,962	1,995	2,002	2,076	2,069	2,020	1,964	1,981	1,916
2015	1,949	1,986	2,041	2,127	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Consumer prices (av; % change, year on year)												
2013	1.6	1.6	1.5	1.3	1.1	1.2	1.6	1.5	1.0	0.9	1.2	1.1
2014	1.1	1.0	1.3	1.5	1.7	1.7	1.6	1.4	1.1	1.2	1.0	0.8
2015	0.8	0.5	0.4	0.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Producer prices (av; % change, year on year)												
2013	-1.6	-1.6	-2.4	-2.8	-2.6	-1.4	-1.0	-1.3	-1.8	-1.4	-0.9	-0.4
2014	-0.3	-0.9	-0.5	-0.3	0.0	0.1	0.2	-0.2	-0.5	-0.8	-0.9	-2.1
2015	-3.6	-3.6	-3.7	-3.6	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Goods exports fob (US\$ m)												
2013	45,673	42,332	47,313	46,158	48,308	46,691	45,830	46,311	44,650	50,480	47,905	47,981
2014	45,560	42,912	49,064	50,267	47,577	47,828	48,205	46,108	47,446	51,631	46,605	49,461
2015	45,116	41,481	46,858	46,245	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Goods imports cif (US\$ m)												
2013	45,297	40,458	43,977	43,648	42,390	40,719	43,384	41,594	41,055	45,605	43,106	44,351
2014	44,746	42,062	45,559	45,873	42,607	42,476	45,864	42,792	44,185	44,097	41,343	43,910
2015	39,495	33,824	38,477	37,714	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Trade balance fob-cif (US\$ m)												
2013	376	1,873	3,336	2,510	5,918	5,972	2,445	4,718	3,595	4,876	4,799	3,630

2014	814	850	3,506	4,394	4,970	5,351	2,341	3,317	3,262	7,533	5,262	5,551
2015	5,621	7,657	8,381	8,531	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
Foreign-exchange reserves excl gold (US\$ m)												
2013	325,151	322,603	322,614	324,005	323,309	321,636	324,900	326,280	332,118	338,416	340,202	341,650
2014	343,568	347,005	349,538	351,032	356,103	361,743	363,209	362,725	359,579	358,905	358,286	358,785
2015	357,381	357,537	357,928	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

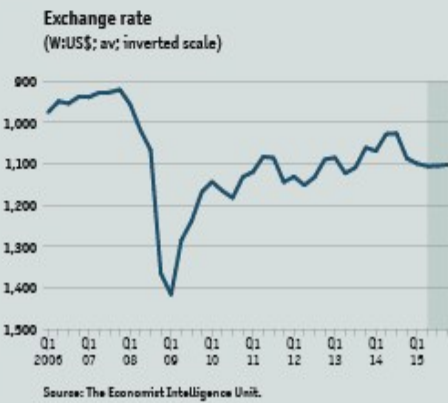
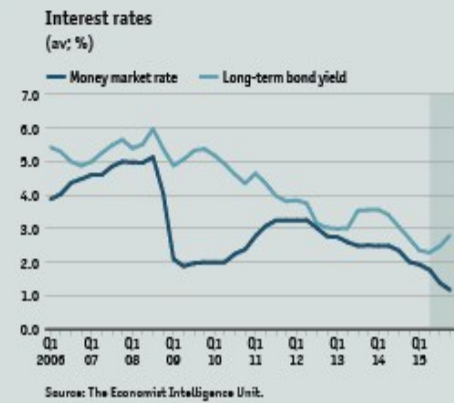
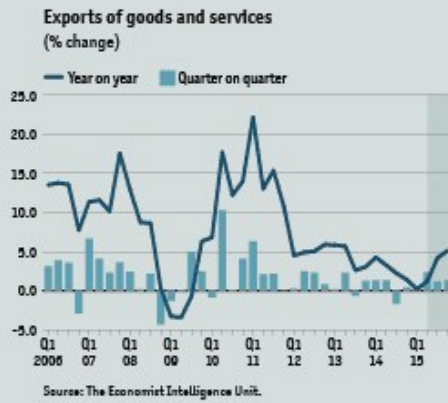
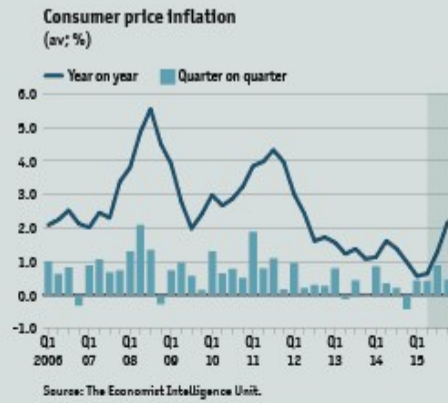
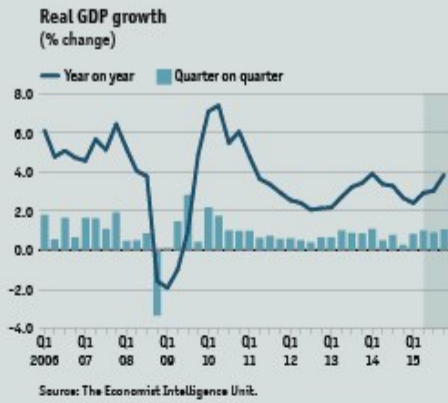
Sources: IMF, International Financial Statistics; Haver Analytics.

Annual trends charts



Quarterly trends charts

Quarterly trends charts



Monthly trends charts

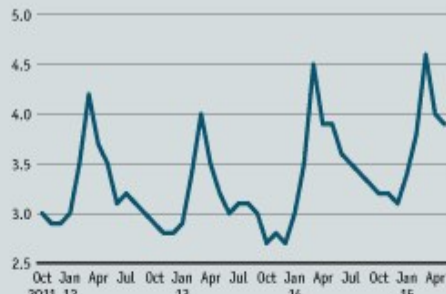
Monthly trends charts

Price inflation
(% change, year on year)



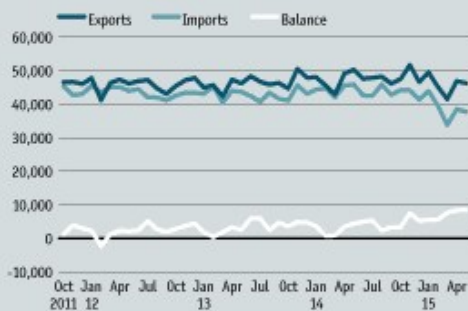
Source: The Economist Intelligence Unit.

Unemployment rate
(%)



Source: The Economist Intelligence Unit.

Foreign trade
(US\$ m; goods only)



Source: The Economist Intelligence Unit.

Foreign-exchange reserves
(US\$ m)



Source: The Economist Intelligence Unit.

Exchange rate
(W:US\$; av; inverted scale)



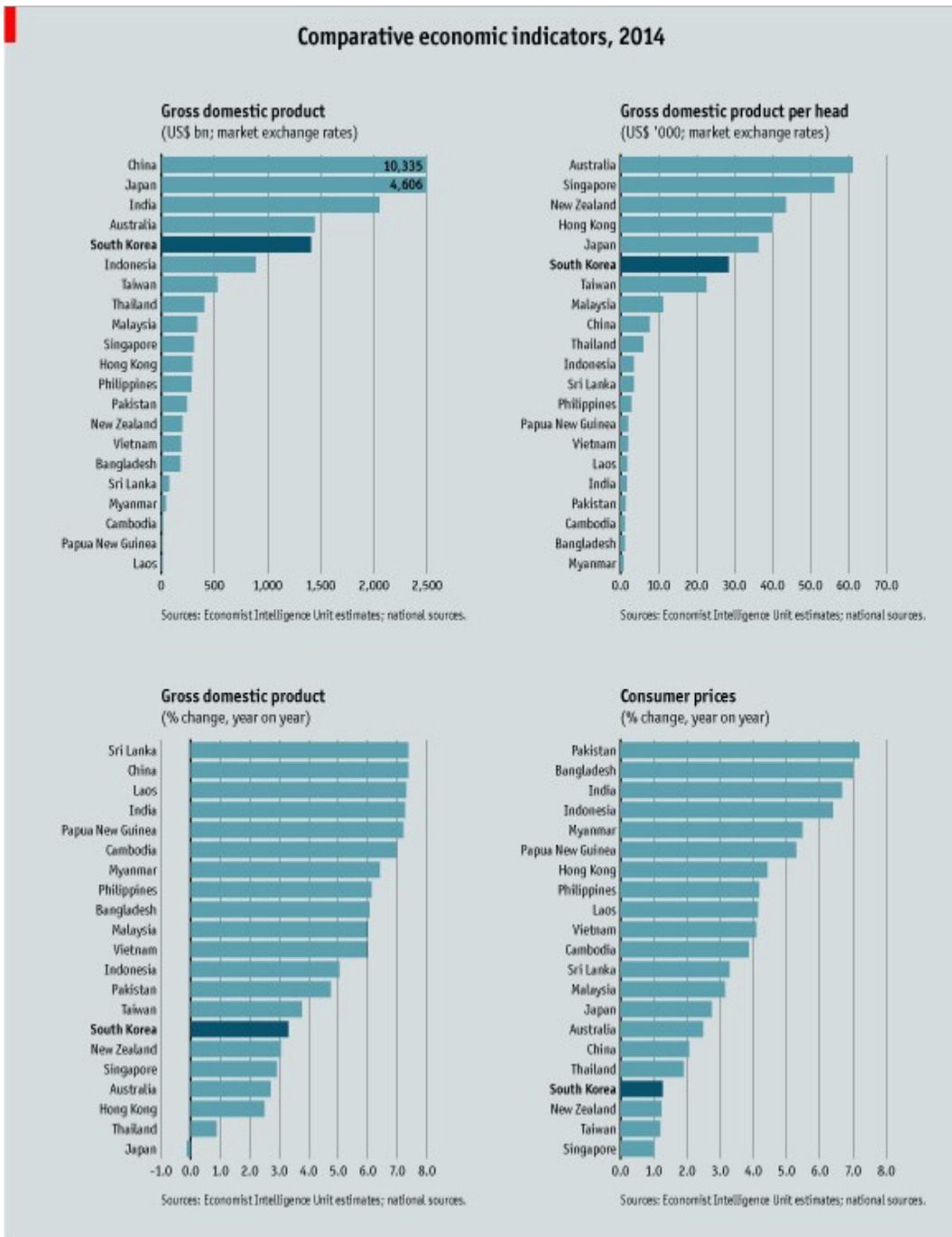
Source: The Economist Intelligence Unit.

Oil: Brent crude price
(US\$/b; av)



Source: The Economist Intelligence Unit.

Comparative economic indicators



Basic data

Land area

99,678 sq km

Population

49.5m (2014; UN estimate)

Main towns

Population in '000 (2010)

Seoul (capital): 9,895

Busan: 3,663

Daegu: 2,481

Incheon: 2,475

Gwangju: 1,414

Daejeon: 1,368

Climate

Continental, with extremes of temperature

Weather in Seoul (altitude 87 metres): Hottest month, August, 26.5°C; coldest month, January, minus 0.4°C; driest month, January, 10.8 mm average rainfall; wettest month, July, 274.1 mm average rainfall

Language

Korean

Measures

Metric system. Some local measures are:

1 pyong = 3.3058 sq metre

1 chungbo = 0.992 ha

1 suk = 100 dai = 180.39 litres

1 kwan = 1,000 don = 3.75 kg

Currency

Won (W). Average exchange rate in 2014: W1,053:US\$1

Time

9 hours ahead of GMT

Public holidays

January 1st (New Year's Day); February 18-19th (Lunar New Year); March 1st (Independence Movement Day); May 5th (Children's Day); May 25th (Buddha's Birthday); June 6th (Memorial Day); August 15th (Liberation Day); September 27th-29th (Chuseok holidays); October 3rd (National Foundation Day); October 9th (Hangeul Day); December 25th (Christmas Day)



Political structure

Official name

Republic of Korea

Form of state

Presidential system; the president and the National Assembly (parliament) are directly elected; members of parliament (MPs) are elected using a mixed system of first past the post and proportional representation

The executive

The president (elected for a single term of five years) appoints the State Council (cabinet), which comprises the president, the prime minister and 15-30 ministers. Cabinet ministers are not normally members of the National Assembly

Head of state

Elected president

Legislature

Unicameral Kuk Hoe (National Assembly) elected for a four-year term. The current assembly, which was elected in April 2012, has 300 seats. Most of the assembly's seats are filled by election from geographical constituencies, with the remainder distributed among the various parties in proportion to their shares of the national vote

National elections

April 2012 (parliamentary), December 2012 (presidential). The next parliamentary election will take place in 2016, and the next presidential poll will be held in December 2017

National government

The government is headed by Park Geun-hye of the Saenuri Party, who was inaugurated as president in February 2013

Main political organisations

Saenuri Party, Unified Progressive Party, Progressive Justice Party, Forward Unification Party (formerly the Liberty Forward Party), New Politics Alliance for Democracy (NPAD)

Main members of State Council

President: Park Geun-hye

Prime minister: Lee Wan-koo

Deputy prime minister: Choi Kyung-hwan

Key ministers

Defence: Han Min-koo

Employment & labour: Lee Gi-gwon

Foreign affairs: Yun Byung-se

Health & welfare: Moon Hyung-pyo

Land, infrastructure & transport: Yoo Il-ho

Strategy & finance: Choi Kyung-hwan

Trade, industry & energy: Yoon Sang-jick

Unification: Hong Yong-pyo

Central bank governor

Lee Ju-yeol

Recent analysis

Generated on July 29th 2015

The following articles have been written in response to events occurring since our most recent forecast was released, and indicate how we expect these events to affect our next forecast.

Politics

Forecast updates

July 3, 2015: Political stability

Ex-prime minister indicted for bribery

Event

On July 2nd the Seoul Central District prosecutors' office charged Lee Wan-koo, who served as prime minister in February–April, and Hong Joon-pyo, governor of South Gyeongsang province, for taking bribes from the late Sung Wan-jong, the former head of Keangnam (a construction firm).

Analysis

The [high-profile bribery scandal](#) is the result of revelations within a suicide note left by Sung Wan-jong, who claimed to have bribed the lawmakers. The list of names left by him included eight senior legislators, the charges against six of whom were dropped by the Seoul prosecutors. Lee Wan-koo is suspected by the prosecutors of receiving ₩30m (US\$27,000) in 2013, while Hong Joon-pyo allegedly accepted ₩100m in 2011. The prosecutors also announced that they were investigating two other senior politicians not on Sung Wan-jong's list for similar misdemeanors: Rhee In-je, a Saenuri Party lawmaker, and Kim Han-gil, former head of the opposition New Politics Alliance for Democracy (NPAD). Both so far have refused to prosecution summonses to present themselves for questioning.

These indictments—especially that of Lee Wan-koo, whose [brief stint as premier](#) saw him declare a ["war on corruption"](#) in March—are a new blow to the president, Park Geun-hye, just as her administration is finally getting a grip on the now-receding [Middle East respiratory syndrome \(MERS\) outbreak](#). The six cleared lawmakers include three former chiefs of staff from Park Geun-hye's inner circle in the Blue House (the presidential office). Lee Wan-koo was part of this group only briefly, as he was forced to step down when the bribery investigations began in April. But the investigations also show that the opposition camp is not without fault, either.

Ahead of the April 2016 parliamentary elections, it appears that both the Saenuri Party and the opposition are struggling to keep peace within their respective camps. In the ruling party, there is an [ongoing battle](#) between the president and the party's floor leader, Yoo Seong-min, while there are rumours that the faction-ridden NPAD could be on the verge of splitting. For over a year the opposition has proved unable to turn successive disasters, blunders or scandals by the Saenuri Party into [political or electoral capital because of its internal rivalry](#).

Impact on the forecast

We continue to believe that the Saenuri Party will gain political capital owing to the opposition's internal rivalry, despite all the problems the ruling party is facing and the rift between the Blue House and parliament.

July 14, 2015: Election watch

Ruling party nominates new floor leader

Event

The ruling Saenuri Party named Won Yoo-chul, hitherto its chief policymaker, as its new floor leader on July 14th.

Analysis

The party has closed ranks to avert a potentially divisive row. Won Yoo-chul will succeed Yoo Seong-min, who stepped down on July 8th following fierce criticism from the president, Park Geun-hye, over a deal he made with the opposition coalition, the New Politics Alliance for Democracy (NPAD). Won Yoo-chul is believed to be less abrasive than Yoo Seong-min, and is on good terms with all camps in the party. While there are contradicting views in the Saenuri party over policy stance and some tensions between the presidential office and the party at parliamentary level, it is very important for the party to remain united ahead of the 2016 parliamentary elections.

It is likely that Saenuri's decision comes in light of the growing disunity in the opposition camp, whose [losses in recent by-elections](#) serve as a cautionary tale. The NPAD is now struggling to contain its own divisions, which are mainly regional. Followers of the late Kim Dae-jung (president, 1998-2003) in the southwestern Jeolla region feel marginalised under the current leader, Moon Jae-in, who comes from the south-east. This divide has already lost the NPAD two by-elections, on April 29th, when pro-Kim Dae-jung candidates ran separately, splitting the liberal vote. On July 9th a former NPAD deputy secretary-general, Jeong Jin-wu, announced that around 100 party stalwarts from Jeolla are quitting to join a new reformist group, the Age of People's Hope. The defectors do not yet include any current lawmakers. On July 13th the NPAD approved a draft reform plan, albeit less radical than first envisaged, to promote internal democracy and reinvigorate the party.

The NPAD's fate hinges on whether senior Jeolla figures, including lawmakers, stay or leave the party. Either way, divisions and disarray will render the opposition ineffectual, to the benefit of the ruling Saenuri party.

Impact on the forecast

The event is likely to boost the Saenuri's prospects in the forthcoming parliamentary elections and perhaps even the December 2017 presidential election.

Economy

Forecast updates

July 2, 2015: Inflation

Inflation strengthens moderately

Event

According to data released on July 1st by Statistics Korea, consumer prices rose by 0.7% year on year in June, compared to 0.5% in May.

Analysis

Although inflation remained below 1%, the data in June showed a sustained faster growth in consumer prices compared with March, when inflation was at a [historic low of 0.4% year on year](#). Core inflation, which excludes the prices of agricultural produce and oil products, remained stable at 2.0%. The uptick in headline inflation, however, was driven by a strengthening in food prices, which rose by 2.7% in June, faster than the 2.2% increase recorded in May. This increase is largely attributable to the drought conditions that have affected farming in the region. Furthermore, with international oil prices gradually recovering, imported inflationary pressures have also returned.

At least in terms of prices, [the negative impact that the outbreak of the Middle East Respiratory Syndrome \(MERS\)](#) in June was expected to have on domestic demand, appears to be limited. Since the first case was reported in South Korea on May 20th, there have been 183 confirmed cases and 33 related deaths as of July 2nd. In June, the Bank of Korea's (the central bank) consumer sentiment index dropped by 7.5% year on year, with respondents showing concern for the economy and the standard of living in the country. MERS is expected to impact virtually all areas of consumer spending, but has especially hampered spending in the retail, hospitality and entertainment sectors, as people are keeping off the streets.

However, as the [MERS panic](#) subsides, with the public healthcare authorities and the government taking swifter action, retail activity is set to pick up. Furthermore, the [government's efforts to boost consumption](#) will also help keep domestic demand relatively buoyant. Meanwhile, the ongoing recovery of global oil prices will also add to inflationary pressures.

Impact on the forecast

Inflation is set to firm up in the second half of the year. We maintain our view that consumer prices will rise by an average 2.1% in 2015.

July 3, 2015: External sector

Demand from key export markets rebounds

Event

According to data released by the Korea Customs Service on July 1st, the value of merchandise exports declined by 1.8% year on year in June, slower than the 10.9% decline experienced in May, while imports fell by 13.6%.

Analysis

Sluggish global export demand and weak commodity prices have been weighing on South Korean exporters, but reassuring signs have emerged that demand in some key export markets is picking up. After five straight months of decline, vehicle shipments picked up by 7% year on year. Steel and general machinery exports grew by 7.6% and 2.6%, respectively; both these items had also been subject to sharp declines in the first five months of the year. Like imports, exports have also been affected by the oil-price rout in late 2014, but, as global oil prices continue to stage a modest recovery, the decline in the value of outbound shipments of petroleum products has also been ebbing. After falling by 40% year on year in May, petroleum-product exports fell by 14.4% in June.

In the first 20 days of the month, shipments to Asia fell at a slower rate, declining by 1.7% year on year in June after a 7.7% fall in May. While exports to Japan and China continued to decline, those to the Association of South-east Asian Nations (ASEAN) expanded by 7.1%. A surge in demand from some key developed markets was largely responsible for this. Shipments to the US grew by 16.4%, while those to Germany rose by 15.6%, and those to Australia by 14.2%.

As imports fell much faster than exports, South Korea recorded a merchandise trade surplus of US\$10.2bn in June, sufficiently large to keep the current account in the black.

Headwinds facing South Korea's trade prospects remain, not least owing to increasing competition from other exporting countries in the region. The Korea International Trade Association (KITA), a non-governmental organisation (NGO), released a report on July 3rd that contained findings that, between 2010 and 2014, export similarity between Japan, China and South Korea, especially in the US market, has been steadily increasing. This makes South Korean exports more vulnerable to currency fluctuations and any loss of competitiveness in key export markets.

Impact on the forecast

The latest data reinforce our view that, although both exports and imports will decline for most of 2015, the merchandise trade balance and current-account balance will both record a surplus.

July 9, 2015: Monetary policy outlook

Central bank keeps rates unchanged

Event

On July 9th the monetary-policy committee of the Bank of Korea (BOK, the central bank) kept the benchmark policy rate unchanged, at 1.5%.

Analysis

The central bank last [cut the benchmark policy rate by 25 basis points](#), in June, in order to support economic growth and contain the negative impact that the outbreak of Middle Eastern Respiratory Syndrome (MERS) has had on economic sentiment and, especially, consumption. In its latest statement, the BOK has stated that it remains concerned about the domestic economy, but expects it to recover strongly in the second half of the year as the [government's stimulus takes hold](#). They also remain vigilant concerning volatility in the financial market and capital outflows owing to the crisis in Greece. The sustained economic recovery in the US and EU, however, is a positive for the export-oriented sectors in the economy and this should also support growth in the second half of the year.

Against the background of muted inflationary pressures and weak domestic demand, the BOK has room to ease its policy further. The central bank is usually cautious about cutting its policy interest rates, owing to South Korea's burdensome household-debt levels. The MERS outbreak has changed their position somewhat, but the risks of severe economic downturn owing to the virus have receded, with the public health authorities having some success in containing the spread. The Economist Intelligence Unit expects the BOK to maintain its accommodative stance throughout 2015 and into early 2016. Should the domestic fundamentals or external conditions worsen, another 25-basis-point rate cut by the central bank should not be ruled out. However, from the second half of 2016, it will be looking to normalise policy gradually.

Impact on the forecast

The BOK's decision is in line with our view that the central bank will maintain an accommodative policy stance in 2015 in order to support the economy.

July 20, 2015: Policy trends

Samsung and Cheil merger goes ahead

Event

On July 17th Samsung shareholders voted in favour of a controversial merger between two of the conglomerate's subsidiaries, despite strong opposition by a US-based hedge fund, Elliott Associates.

Analysis

The merger between two Samsung affiliates, Samsung C&T and Cheil Industries, was nearly derailed last week by Elliott Associates, a US-based hedge fund. Led by activist investor, Paul Singer, Elliott owns 7% of C&T. It argued that the deal significantly undervalued C&T's shares, forcing losses on minority shareholders. This merger is [another step](#) towards ensuring that Lee Jae Yong, son of current conglomerate chair, Lee Kun Hee, will retain effective control as leadership passes to him. His father has been incapacitated by a heart attack since May 2014.

Large South Korean conglomerates, or *chaebol*, often have complicated cross-ownership structures designed to ensure consolidated family control, despite relatively small formal stock holdings. Critics have argued that these opaque structures punish smaller shareholders. Chaebol corruption and privilege are resented in South Korea. The "[nut rage](#)" [incident in December 2014](#) became a global scandal indicative of chaebol licence and, indeed, abuse of power. However, the conglomerates are also widely viewed as national champions, responsible for South Korea's economic progress. While many successive presidents, including the incumbent, Park Geun-hye, have threatened to rein in the conglomerates' power, the regulatory environment is still fairly lax. [Senior chaebol executives and politicians are often close associates](#) and this stymies tougher crackdowns.

Shareholder meetings are often formalities, with politicised investors, such as the National Pension Service, rubber-stamping the plans of the leadership. Openly contested votes with high public visibility are quite rare. The contest with Elliott became quite nasty, with public accusations that Elliott was a "vulture" representing "Jewish finance". Samsung was forced to withdraw cartoons mocking Mr Singer personally and issue a statement rejecting anti-Semitism.

Impact on the forecast

The event reaffirms our view that little is likely to be done in the way of limiting the power of the chaebol by the current administration. No change in our forecast is necessary.

July 23, 2015: Economic growth

Growth momentum falters on MERS and drought

Event

On July 23rd the Bank of Korea (BOK, South Korea's central bank) reported that real GDP grew by 2.2% year on year in the second quarter, compared with 2.5% in January–March. On a quarter-on-quarter basis, the economy expanded by 0.3%.

Analysis

The BOK's preliminary reading of economic growth for April–June fell slightly short of its forecast of 0.4% quarter on quarter. The [Middle East respiratory syndrome \(MERS\) outbreak](#) in May and June dampened private consumption, which contracted by 0.3% quarter on quarter. This was the first quarterly decline since April–June 2014, when the [Sewol ferry disaster](#) had a similar dampening effect on private consumption. Meanwhile, persistent drought conditions hurt primary industry output with an 11.1% drop in the output of the agriculture, fisheries and forestry sector. Adding more gloom to economic growth in the second quarter was the continuing weakness in exports of goods and services, which eked out a mere 0.1% rise.

On a year-on-year basis, real GDP grew by 2.2% in the second quarter, the slowest rate of expansion since the first quarter of 2013. Once again, the figures reflected weakness in exports as shipments of goods declined by 1.2%, while exports of goods and services fell by 0.9% (compared with a moderate rise of 0.1% in the first quarter). In mid-July the BOK revised down its growth forecast for 2015 as a whole to 2.8%, from 3.1% previously. Against the performance of the economy so far this year, this appears to be a more realistic projection, provided that the [government's fiscal stimulus measures](#) provide adequate support. On the other hand, postponed consumption during the MERS outbreak is also likely to spur growth in the third quarter.

The weakening economic outlook also adds urgency to the economic reform policy of the Park Geun-hye administration, with labour and financial reform becoming a high priority in the second half of the president's single term. However, the benefits from progress in economic reform will be slow to trickle down, meaning that the growth outlook will be challenging for the remainder of 2015.

Impact on the forecast

The economy remains fragile and growth momentum weak. As a result, we will revise down our real GDP growth forecast for 2015 to an average of around 2.8–3%.

Analysis

July 28, 2015

No closer to economic democracy

Two catchphrases have been used to encapsulate foreign-business misgivings about South Korea. "Korea Inc" implies a symbiosis between the government and South Korea's industrial conglomerates (*chaebol*), which were indeed nurtured by the state, while "Fortress Korea" denotes the paradox of a country whose systematic penetration of export markets worldwide has not been matched by the equivalent willingness to open up its own. Both tendencies are now much attenuated, thanks variously to OECD membership, the 1997–98 Asian financial crisis and the assiduous pursuit of trade agreements with major economic partners. Yet neither is wholly dead, implying that the corporate playing field in South Korea remains neither level nor open.

On August 25th Park Geun-hye will be halfway through her five-year presidency; South Korea does not permit a second term in office. The first half of her term has seen a steady retreat from the "economic democracy" that she promised during her election campaign in 2012. Pledges to curb the power of the *chaebol* helped her to win the election, yet in office this theme subsequently vanished from her reform programmes. Lacklustre GDP growth and chronically weak consumption (owing to high household debt), in addition to the further dampening caused by last year's *Sewol* ferry sinking and the recent Middle East respiratory syndrome (MERS) epidemic, have thrown the economy back on its traditional engine: exports, where the *chaebol* play an indispensable role. Their chairmen have been prominent in Park Geun-hye's entourage during the president's overseas diplomatic visits.

Get out of jail free?

Park Geun-hye had, however, stood firm on one pledge: that businessmen convicted of financial crimes should not receive special pardons as in the past. In 2014 two ministers advocated this, to no avail. But on July 16th Kim Moo-sung, chairman of the ruling Saenuri Party and front-runner to be its presidential candidate in 2017, announced after a meeting with Park Geun-hye that she would consider such pardons as part of a wider amnesty around August 15th—to mark the 70th anniversary of Korea's liberation from Japanese occupation in 1945, and to "promote national development and forge national reconciliation." (Jailed politicians, however, will not qualify.)

With rare unanimity, local media predict that this will benefit two heads of top-ten *chaebol*, neither of whom saw a criminal record as reason to resign his chairmanship. Hanwha, ranked tenth by assets, is on a roll: its W1.9trn (US\$1.7bn) acquisition of controlling stakes in four former Samsung units, completed on June 29th, makes it South Korea's market leader in both defence and petrochemicals; while on July 10th Hanwha Galleria won one of three new licences for duty-free shops, which are highly lucrative thanks to Chinese tourist spending.

Yet Hanwha's chairman, Kim Seung-youn, has four criminal convictions and was jailed three times, most recently in 2012 for embezzling W288bn (US\$260m); he was released on probation last year. A pardon is also expected for Chey Tae-won, the chairman of SK Holdings (South Korea's third-largest conglomerate), who was jailed for four years in 2013 for embezzling W49.7bn. This is Chey Tae-won's second prison term; in 2003 he was convicted for a W1.5trn accounting fraud, but was rapidly released. That prompted Sovereign Asset Management, a New Zealand-owned investor in SK Holdings, to seek to oust him. He riposted by deploying nationalism to see off the interfering foreign fund.

Samsung vanquishes "vulture"

Two current confrontations echo that bitter battle a decade ago. On July 17th a majority of shareholders of Samsung Construction & Trade (C&T) [voted in favour of a buyout by Cheil Industries](#). A US-based hedge fund, Elliott Associates, which owns 7.1% of Samsung C&T, tried to block the US\$8bn merger by arguing that the firm was being undervalued and that the deal was adverse for its shareholders. Despite talk of synergies, the real aim is to ensure that Samsung's heir-apparent, Lee Jae-yong—his father and chairman of the Samsung Group, Lee Kun-hee, has been hospitalised for over a year—can fully control Samsung Electronics through a complex web of cross-holdings, and also to enable him to pay a huge inheritance tax bill in due course.

Elliott Associates may fight the merger in South Korea's courts, although they have been unsuccessful there so far. Widely portrayed as an "eat and run" vulture, it has nevertheless won support from local activists and some small shareholders. Yet nationalism has triumphed, as seen in three interventions. On July 3rd Park Yong-sun, an opposition lawmaker usually critical of the *chaebol*, introduced a bill to protect South Korean companies from "foreign speculative funds". The National Pension Service, which owns 11.9% of Samsung C&T and raised governance

activists' hopes on June 24th by voting against a similar merger at SK, backed Samsung. The finance minister, Choi Kyung-hwan, on July 21st defended the merger as positive for stable management in the long run. Admitting deficiencies in domestic capital markets, Choi Kyung-hwan said that firms like Elliott Associates are welcome—provided "their investment and actions are within the legal framework."

Lone Star: the struggle continues

However, Elliott Associates has not been accused of illegality, unlike Samsung, and Choi Kyung-hwan's comment would sound hollow to a US-based private equity firm, Lone Star Funds. Lone Star is seeking damages of US\$4.7bn in South Korea's first investor-state dispute, whose second-round hearing took place at the International Centre for Settlement of Investment Disputes (ICSID) earlier in July. In a complex and much contested dispute, Lone Star alleges that regulators' prolonged refusal to let it sell Korea Exchange Bank (KEB), which it bought in 2003, to successive would-be buyers—first locally based KB Kookmin Bank, and then HSBC of the UK—while legal proceedings were ongoing caused it large losses, especially after the 2008–09 global financial crisis saw valuations plunge. Another local bank, Hana, eventually bought KEB in 2012, but trade-union hostility has delayed the actual merger; only on July 22nd did the Financial Services Commission (FSC) approve this.

Opinion on Lone Star is sharply polarised. Most South Koreans regard its W2trn tax-free profit—the sum would have been more had the earlier sales succeeded—as unacceptable. Foreign business sees that sentiment as the real driver of action against Lone Star, regarding its prosecution as, in effect, persecution. Kim Seok-dong, then the FSC's chairman, admitted in 2012 that the whole episode had left a "very unfortunate...negative impression on...foreign investors."

The ICSID panel may not reach a verdict until 2016. If it rules in favour of Lone Star, there will be an outcry in South Korea. In 2013 local courts twice refused to enforce international arbitral awards; that might happen again, despite the reputational consequences. Meanwhile, if *chaebol* chairmen Chey Tae-won and Hanwha's Kim Seung-youn are pardoned in August, as is expected, and [Lee Jae-yong continues to tighten his control of Samsung](#) by the methods seen in the recent merger, foreign investors will draw their own conclusions. The world's seventh-largest trading nation is too large and important a market to be ignored. However, long-standing *chaebol* governance concerns, as well as signs that neither "Korea Inc" nor "Fortress Korea" are yet extinct, will not encourage the inward foreign direct investment that South Korea professes to want in its quest to become a regional hub.