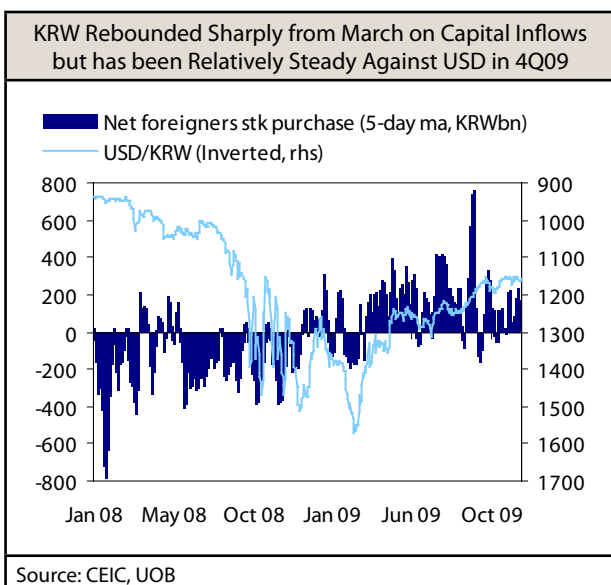


South Korea

UOB Economics Projections	2007	2008	2009F	2010F
GDP	5.1	2.2	0.0	5.0
CPI (average, y/y)	2.5	4.7	2.7	2.8
Unemployment (4Q avg)	3.1	3.2	3.5	3.3
Current account (% of GDP)	0.6	-0.7	5.3	1.8
Fiscal balance (FY, % of GDP)	3.5	1.2	-5.0	-3.0

- After the significant downtrend from 1,570 in early-March, USD/KRW traded in a relatively narrow range of 1,140-1,190 in 4Q09 as the bounce in stocks and currency ran out of steam without more significant impetus from the real economy. Recovering domestic demand and commodity prices will likely narrow the current account surplus in 2010. While we are expecting USD/KRW to end 1Q10 at around 1,150, a sooner interest rate normalisation in South Korea will likely put further upward pressure on the KRW.
- We are maintaining our forecast for the rate normalisation to begin in early 2Q10 although comments from the BoK suggest that the rate hike could materialise slightly earlier given the improvements in growth prospects.
- On the assumption of moderate recovery in global demand and commodity prices in 2010, we expect inflation risks to stay relatively low next year. Headline consumer price inflation is likely to average around 2.8% in 2010 which is similar to 2009's level.
- We have raised our GDP growth forecast for 2010 to 5.0% from 4.5% (BoK: 4.6%) but expect the y/y growth to peak in 1Q10 before moderating to around 4% in 2H10 due to base effect. The key drivers would likely be stocks rebuilding, higher exports and to some extent the continued improvement in private demand.

The stronger-than-expected recovery in South Korea's economy and record-high current account surpluses drove KRW's recovery from its low in March. Current account surpluses hit US\$37bn in the first ten months this year, reversing sharply from deficit of US\$6.4bn in 2008.



Foreign reserves also recovered strongly to reach a record high of US\$270.9bn in November compared with previous peak of US\$264.2bn in March 2008. The recovery from the liquidity and credit crisis post-Lehman was also marked by the government rolling back USD liquidity measures. As an indication, USD supplied to banks using the US-Korea currency swap line has been pared down to US\$3.1bn by end-Oct from as high as US\$16.4bn at one point. The facility is set to be terminated by February 1.

After the significant downtrend from 1,570 in early-March, USD/KRW traded in a relatively narrow range of 1,140-1,190 in 4Q09 as the bounce in stocks and currency ran out of steam without more significant impetus from the real economy. The recent debt issues in Dubai and Greece also demonstrated the lingering risks in the global economy. We expect USD/KRW to remain within ranges in 1Q10 as the BoK will become more cautious about letting the KRW appreciate faster without hurting exports recovery. Furthermore, recovering domestic demand and commodity prices will likely narrow the current account surplus in 2010. While we are expecting USD/KRW to end 1Q10 at around 1,150, a sooner interest rate normalisation in South Korea will likely put further upward pressure on

South Korea

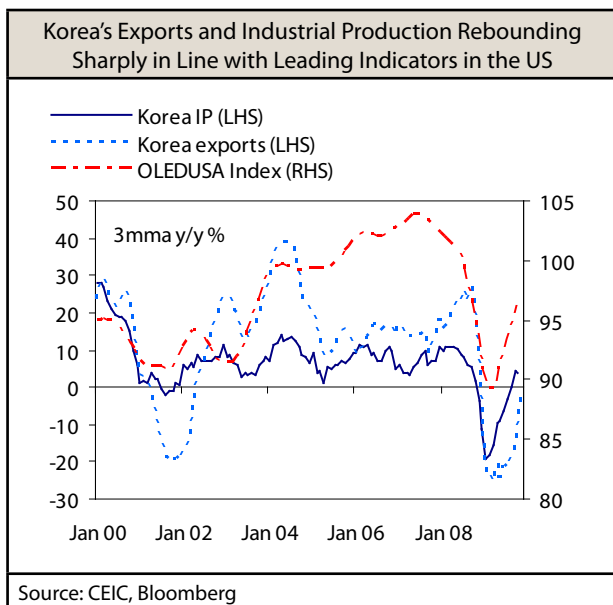
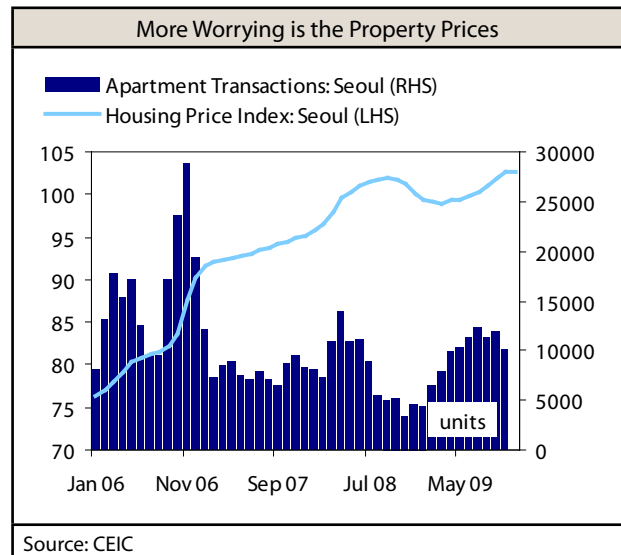
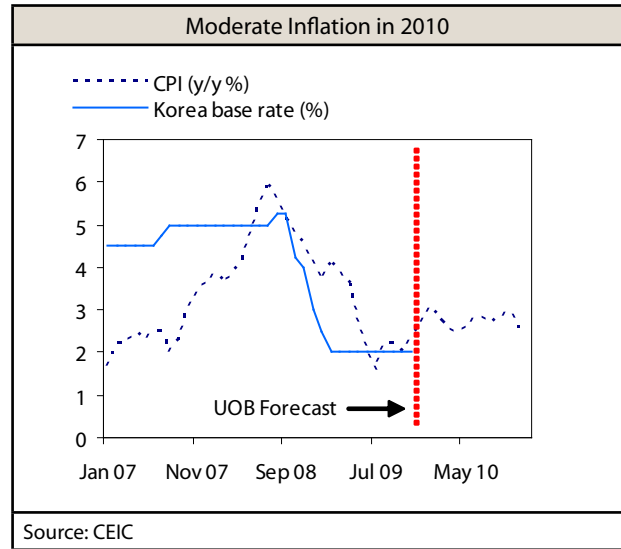
the KRW.

Monetary Policy: Still Holding Onto Our Forecast for a Move in Early 2Q10

The BoK maintained its benchmark base rate at record low of 2.0% for the tenth consecutive meeting in December but BoK governor Lee Seongtae dropped more hints for an earlier interest rate normalisation. He said that the interest rate level is “considerably” low given the improvement in the country’s growth outlook, suggesting that planning is underway for an eventual exit from the loose monetary policy although it will not be an abrupt move. We expect the central bank to give ample warning to the market before beginning to hike rates. If the positive growth momentum gets carried over to 4Q09, the BoK will probably have more reason to start hiking interest rates in 1Q10, especially if the property prices continue to move higher. We are maintaining our forecast for the rate normalisation to begin in early 2Q10 with total move of 125bps.

Moderate Inflation Risks, Focus on Asset Prices

Currency strength has continued to cap inflation in South Korea as consumer prices likely averaged 2.4%/y/y in 4Q09 compared with just 2.0% in 3Q09. On the assumption of moderate recovery in global demand and commodity prices in 2010, we expect inflation risks to stay relatively low next year. Headline consumer price inflation is likely to average around 2.8% in 2010 which is similar to 2009’s level and the monthly inflation rate will largely remain under 3%. The BoK foresees stable consumer price increase in the months ahead which means more attention will be on the asset price trajectory in the country for determining the timing of interest rate normalisation. Sector-specific measures



will be more helpful to contain property price increase but interest rate hikes will have an important signalling effect. In November, the BoK widened its inflation target to 2.0%-4.0% for 2010-2012 period from 2.5%-3.5% in the two preceding years to allow for more flexibility in its monetary policy. On the property prices, BoK said concerns over the real estate ‘bubble’ appeared to have eased somewhat as price increase has slowed after the government introduced dampening measures in September.

Growth Surprises on the Upside

South Korea’s GDP growth came in above expectation at s/adj +2.9%q/q or +0.9%/y/y in 3Q09 (mkt: +2.1%q/q, -0.2%/y/y). This was the first positive y/y expansion in 4 quarters. Growth momentum has continued to accelerate after the economy hit the bottom with 5.1%q/q contraction in 4Q08.

South Korea

Private consumption y/y growth rebounded into the positive territory after three straight quarters of contraction while government consumption remained firm as spending was frontloaded from 4Q to sustain the recovery momentum. While the government said it would continue to frontload spending, we expect the impact to wane off by around 3Q10. The sharp improvement in facilities fixed investment was encouraging with y/y contraction down to single-digit from double-digit fall in the three preceding quarters. The pick-up in external environment was also evident in the rebound in exports which grew 1.2%/y/y in the quarter following three preceding quarters of contraction. However, inventory continues to drop and this was the main drag to the headline y/y growth in 3Q (-4.5ppt). Nonetheless, the positive momentum in capital investment suggests that re-stocking could start to contribute to headline growth by 4Q09.

Overall, the Korean economy contracted by 1.8%/y/y in the first three quarters of the year. The BoK expects 4Q09 y/y growth to be higher than 5% if the current growth

momentum continues. Indeed, as long as 4Q growth momentum remains positive, the GDP growth rate would be close to 6%/y/y, largely due to a low base. The government is now looking at the possibility of a positive GDP growth for the full-year. This can be achieved if the growth momentum is at least 0.8%/q/q in 4Q. Given the robust numbers in 3Q09, we expect 2009 GDP growth rate to be better than our original forecast of -1.0%, probably coming in around 0% (BoK: 0.2%). We have also raised our GDP growth forecast for 2010 to 5.0% from 4.5% (BoK: 4.6%) but the y/y growth is likely to peak in 1Q10 before moderating to around 4% in 2H10 due to base effect. The key drivers would likely be stocks rebuilding, higher exports and to some extent the continued improvement in private demand. The country's exports contracted a sharp 16.9%/y/y in the first 11 months of 2009 and is expected to rebound 15% in 2010 in line with the recovery in the US leading indicators. Although recent recovery in Korean exports was led by demand in the Asian markets as shipments to US still contracted by double-digit pace, the eventual recovery in global demand would have to be driven by US consumption.

3Q09 GDP: Rebounding Into Positive Territory							
	2008	3Q08	4Q08	1Q09	2Q09	3Q09	3Q09
	y/y % change						ppt cont
Real GDP	2.2	3.1	-3.4	-4.2	-2.2	0.9	0.9
Final Consumption	1.6	2.0	-1.9	-2.0	0.9	1.6	1.0
Private Consumption	0.9	1.4	-3.7	-4.4	-0.8	0.8	0.4
Government Consumption	4.2	4.5	4.7	7.3	7.1	5.0	0.7
GFCF	-1.7	1.8	-7.3	-8.1	-2.7	-0.8	-0.2
Construction	-2.1	0.2	-5.6	1.6	3.7	2.7	0.4
Facilities Investment	-2.0	4.3	-14.0	-23.5	-15.9	-7.4	-0.7
Change in Stocks (% of GDP)	1.5	2.1	-1.3	-1.4	-4.0	-2.3	-4.5
Net Exports	30.6	12.2	33.6	104.5	93.1	99.7	4.2
Exports of G&S	5.7	9.3	-6.9	-10.6	-3.9	1.2	0.6
Imports of G&S	3.7	9.0	-11.2	-18.2	-13.7	-8.7	-3.7

Source: CEIC, UOB