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

Analysis

The Korean economy has started the Year of the Dragon with a glitzy 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, expanded from a 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 demand — household, government and corporate — saw a slowdown.

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 fall bottom in the second quarter and barrier back in the second half.

European sovereign debt crisis and the impact of global economic growth are likely to persist for the coming months and Korean growth for 2012 will gradually improve as we approach the second half, Standard Chartered Bank in Korea economist Oh Suk-tae said.

GDP growth

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.

Contractors in the 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 decline 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, sharply to 3.4 percent in January year-on-year, falling below the central bank’s target range — 2.5 to 4.5 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 European countries.

A slowing Chinese economy is also posing a threat as it will affect the nation’s purchasing power. Although China’s purchasing managers index (PMI) unexpected the economy to expand by 0.6-0.8 percent in December, the import component fell to 49.9 from 51.1. 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 over 170 percent of GDP, which means consumers have more money than the economy generates in an entire year.

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 point a worse picture. We forecast GDP to decline by 0.5 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.”

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 to manage to stay the course.

“Avoiding monetary easing by major countries will improve the exchange rate, providing underlying strength of the labor market and credit growth should bring renewed strength in domestic demand,” Kwon of Goldman Sachs also added.

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