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KOREA ECONOMIC FOCUS

New Bank of Korea Governor to keep interest rates low

- **New Governor announces that BoK will support the government's economic growth plan**. Interest rates have therefore been kept low at 2.5%.

Tackling red-tape

- **Deregulation takes centre stage in President Park's bid to revitalise the economy**, as she chairs a televised ministerial roundtable to address the issue head on.

- **Burdensome regulation is an area of direct concern to UK companies.** The UK's One-in Two-out model is highlighted as a model for Korea's own cost-in cost-out policy.

External risks to the Korean economy

- **Korea maintains its earlier economic growth forecast of 3.8% for 2014. We look at three external factors that could affect this growth:**

I. **Weaker Chinese economy:** There is growing concern about China's economic slowdown as 26% of Korean exports go to China.

II. **Russia-Ukraine:** The Russian-Ukraine crisis caused a slight temporary contraction in the Korean economy, but with limited impact on Korea's total exports.

III. **North Korean provocations:** North Korea's recent provocation off the West Coast had limited impact on the Korean economy including the financial markets.

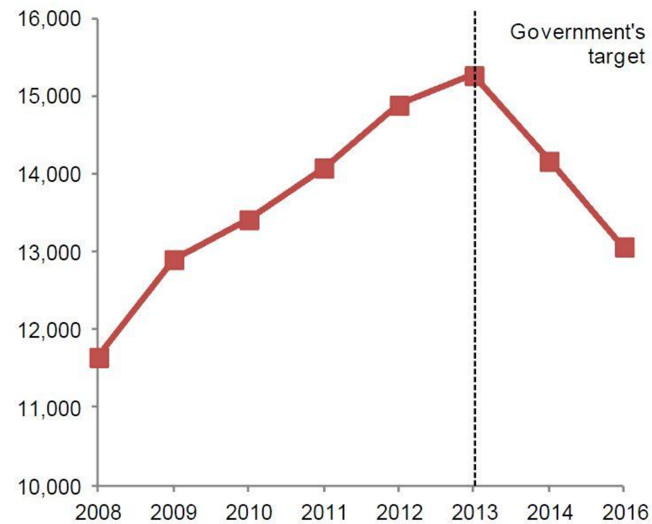
New Bank of Korea Governor to keep interest rates low

Governor Lee, Ju-yeol started his 4-year term on 1 April. In his inaugural speech he said that BoK's monetary policy will support the government's plans to boost the economy through price and financial stability. Interest rates have therefore been kept low at 2.5%, and most analysts expect this to remain the case until the last quarter of 2014, by which time BoK expects construction investment and net exports to have picked up.

Tackling red-tape

On 21 March, President Park chaired a televised ministerial roundtable on tackling regulation, inviting the views of business and experts. Deregulation is central to the President's 3-year economic plan and the key to investment, job creation and economic growth.

Chart 1: Number of economic regulations in Korea



Source: Nomura

In 2013 Korea ranked 95th in the regulatory burden category of the World Economic Forum Global Competitiveness Report. Regional rivals Singapore, Hong Kong and Taiwan were 1st, 5th and 15th respectively.

Korea's difficult regulatory environment means new businesses and SMEs struggle and the financial sector is among the worst performing in Asia. It also has implications for levels of foreign investment. Burdensome regulation is the most frequently cited market access issue for UK businesses in Korea.

The government plans include:

- Introduction of a UK type one-in one-out system: 'cost-in cost-out' in 2015;
- Cutting the number of registered business regulations by 10% within a year and 20% by 2016;
- Expanding the use of 'sunset clauses' to speed up removal of redundant regulations;
- Ministries to report all unregistered regulations by June 2014.

The seven-hour televised round table reflects the importance President Park places on deregulation. And it had the desired effect: the issue is now at the top of the agenda of all government departments. Businesses and experts welcomed the heavy emphasis placed on better regulation, including the proposed practical measures. However, many are concerned that embedding a culture of better regulation across government will be challenging.

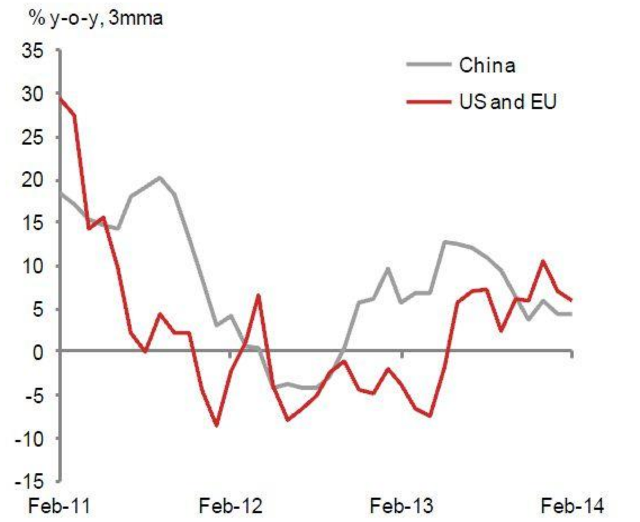
External risks to the Korean economy

The Korean economy is forecast to grow 3.8% in 2014. Here, we summarise three topical external factors that could inhibit this growth.

I. Weaker Chinese economy

There is growing concern among business, government and the expert community about China's economic slowdown. Moody's Investor Services recently said this was the biggest risk for the Korean economy. China is Korea's largest trade partner, accounting for 26% of Korea's total exports in 2013. The impact on Korea will largely depend on how China is able to buoy its own economy, including through short term stimulus measures.

Chart 2: Korea's export to China & US/EU



Source: CEIC and Nomura Global Economics

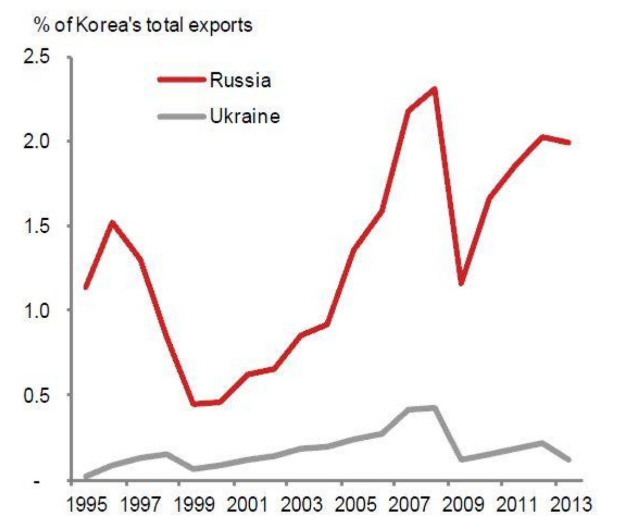
More optimistic analysts judge that the risk will largely be offset by improving demand for Korean goods from the US and Europe. They also point to the fact that much of China's demand for Korean goods is due to strong final demand from outside of China, for which Korea provides components or machine parts (processing related goods accounted for 73.3% of total exports to China in 2013).

II. Russia-Ukraine

The Russia-Ukraine crisis caused a slight temporary contraction in the Korean economy. Industrial production declined 1.8% in February from a month earlier largely due to uncertainty about the situation in Russia and Ukraine. Korea's main exports to Russia, road vehicles and machinery & computers (48% and 14% of total exports) dropped 7.2% and 4.9% on-month, respectively, in February.

However the impact on Korea's total exports has so far been negligible, as exports to Russia and Ukraine accounted for 2.0% and 0.1% respectively of Korea's total exports in 2013**.**

Chart 3: Korea's export share to Russia and Ukraine



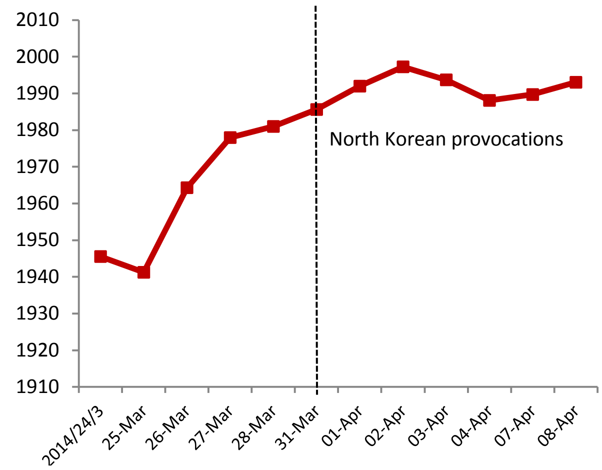
Source: CEIC and Nomura Global Economics

III. North Korean provocations

North Korea's recent provocations off the West Coast had little impact on the Korean economy including the financial markets.

On 31 March North Korea fired around 100 artillery shells across a boundary off the West Coast. However, KOSPI, the Korean stock exchange was unaffected, rising 5 percentage points due to continued strong buying from foreign investors.

Chart 4: Korean Stock Exchange (KOSPI)



Source: Korea Exchange

Such provocations tend not to damage confidence in the Korean economy: the situation is generally factored in by the investment community, and the Korean government has learnt from experience to make statements that effectively calm the markets.