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Economics Group

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Korean GDP Slows a Bit in Q3 but Not as Much as Feared

Korea's economy grew 0.7 percent in the third quarter. Although that is a bit slower than the 0.8 percent growth reported in Q2, the outturn was a bit stronger than expected.

How Long Can Korea Grow in the Face of Slow Global Growth?

If there has been a theme to the growth story in Korea over the past couple of years, it has been how a trade-dependent economy has plodded forward despite steady headwinds from a slow-growing global economy. The slowing in global trade has been reflected in a drag from net exports in eight out of the past nine quarters.

While the challenges for Korea will not disappear overnight (particularly given the fact that growth in key trade-partner China is expected to slow further), there are some early signs that the drag from trade may be fading somewhat. While net exports exerted a 3.1 percentage point drag on growth during the quarter, it is worth observing that exports actually increased for the second straight period. The reason that net trade was a drag has to do with the fact that import growth has been outpacing the more modest gains on the export side.

Imports surged at a 10.0 percent annualized rate in the third quarter, which is the second fastest quarterly increase over the past three years. Importers are keeping up with back-to-back quarterly gains in consumer spending and three straight quarters of increased fixed capital formation.

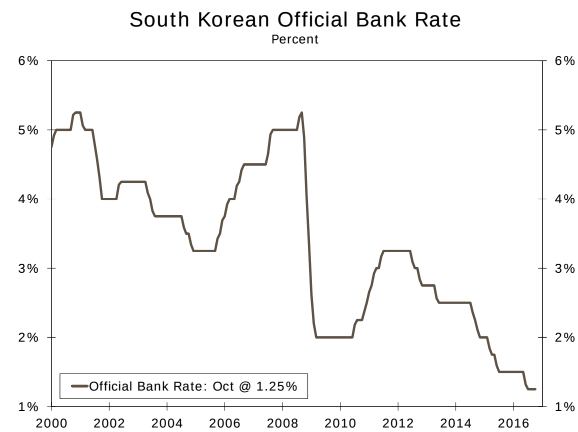
We are wary of the ability of consumer spending to be a steady long-term driver of Korean economic growth. The aging population combined with a household debt to GDP ratio that has increased from 80 percent three years ago to 85 percent today are two of the biggest reasons for our concern.

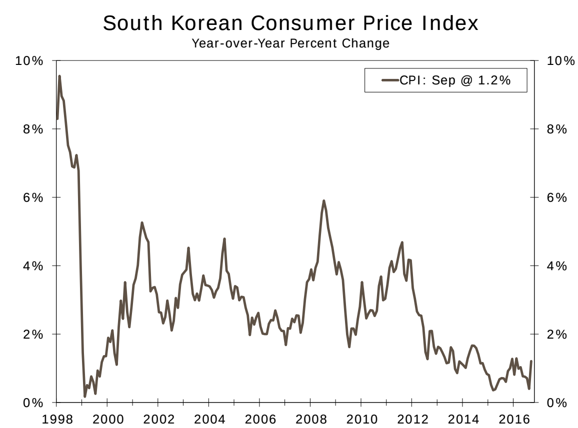
It also bears noting that the well-publicized bankruptcy filing for Hanjin Shipping combined with major strikes at Hyundai Motor Co. may be weighing on activity both directly and in terms of the negative impact on business confidence. The Nikkei/Markit PMI for Korea has fallen for three straight months and, at 47.6 in September, is currently signaling a contraction in manufacturing activity.

Implications for Monetary Policy

The Bank of Korea (BoK) has made only one adjustment to interest rates in 2016; a 0.25 percent cut in June which reduced the target lending rate to 1.25 percent. That marked the eighth cut in interest rates since 2012 and financial markets were weighing prospects for whether or not another cut was in the offing for this year. The two remaining BoK meetings are November 11 and December 15.

In our view, today's better-than-expected report likely means that the BoK has cover to sit tight at least through the end of 2016. The year-over-year rate of CPI inflation was 1.2 percent in September and while that marks the second-fastest inflation rate reported this year, it is still shy of the BoK's 2.0 percent target.





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