



Economics Group

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South Korean GDP Expands as Geopolitical Tensions Rise

The growing tensions on the Korean peninsula did not stop the South Korean economy from growing faster than the consensus expected in the first quarter. A Chinese boycott could be a factor in Q2.

Better Than Expected Growth

The South Korean economy grew 0.9 percent in the first quarter (3.6 percent at an annualized rate) which beat consensus. In fact, the outturn matches the fastest quarterly growth rate posted in 2016.

Despite a pick-up in exports, trade was actually a net drag on Korean GDP growth in the first quarter owing to an even larger surge in imports, which posted the largest sequential increase in six years. Last year (2016) was a mediocre year for imports with two quarterly declines amid a backdrop of only tepid domestic demand, so low base effects may have played a role. The official press release also noted the surge in imports was attributable to an expansion in imports of machinery & equipment as well as precision instruments reflecting a demand-pull from the business sector.

Speaking of businesses, gross fixed capital formation was the largest positive driver of growth during the period posting a 4.0 percent (not annualized) increase. The gain was roughly split between machinery & equipment and the construction segments.

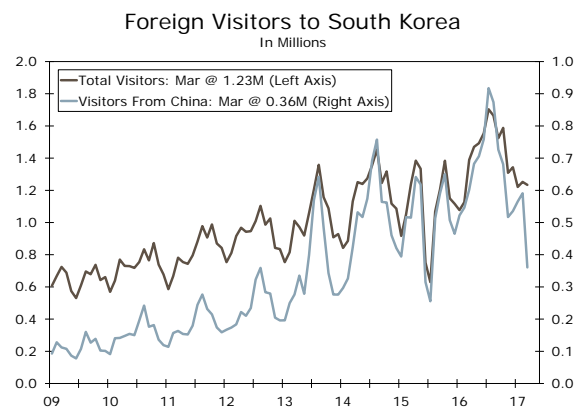
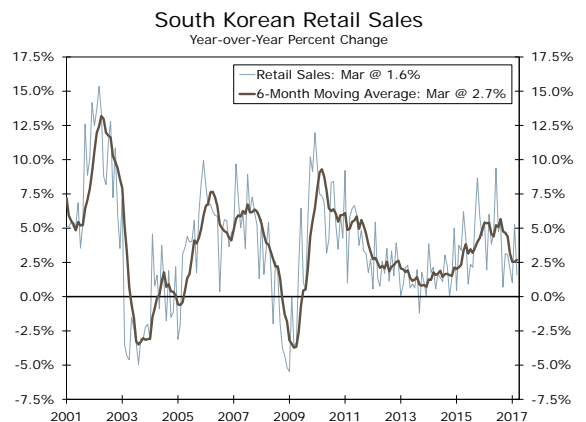
Consumer spending eked out a gain of 0.4 percent. With back-to-back monthly declines in retail sales to start the year, the weakness here was to be expected. If there is a silver lining for the consumer spending outlook, it is that retail sales picked up as the quarter ended in March so there may be momentum heading into Q2.

Geopolitical Risk

When you share a border with North Korea, there is always a degree of geopolitical risk, but there may be a measurable economic impact in coming quarters. Amid the recent escalation in tensions, the United States recently installed a missile defense system in South Korea. The stated purpose is to protect South Korea, Japan and other U.S. allies in the region from a potential North Korean missile launch. The move is not welcomed by China, Korea's largest export destination, who sees the installation as a check against Chinese power in the region as well.

The Chinese government banned Chinese tour groups from visiting South Korea and is encouraging a boycott of South Korean goods in China. While current export figures are not available, tourism visits are. In March only 360,782 Chinese tourists visited Korea, down from 601,671 in the same month last year. Chinese visitors usually comprise about half of all the tourism in Korea, but in March, that share fell to just 29.2 percent.

On balance, we do not expect a lasting drag on the Korean economy from this regional spat; a similar boycott situation with Japan over disputed islands a few years ago was short-lived. But it could be a factor holding back growth in the second quarter by holding back exports and tourism-related spending.



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