March 2017

Deutsche Bank South Korea Newsletter

Brief update on the Korean economy and the financial sectors

Economic /Political Update

Korea's to suffer economic loss of KRW 17 trillion from THAAD row with China: A study estimated that Korea's economic loss from the Terminal High Altitude Area Defense (THAAD) system and the Chinese government's retaliatory measures would be 17.2 trillion won (US$14.97 billion). Chang Woo-ae, research fellow with IBK Economic Research Institute, said in a research report titled "Rising Anti-Korea Sentiment in China and Its Impact" on March 8, Korea's loss could be estimated by looking at what happened when China and Japan went head-to-head over the island disputes.

The first dispute between Japan and China erupted on September 7, 2010 when the Japan Coast Guard caught Chinese fishermen who were working near the Senkaku Islands (Diaoyudao Islands in Chinese). The second dispute began on September 11 in 2012 when the Japanese government nationalized the islands from an owner who is a Japanese national.

At the time, anti-Japanese sentiments were at its peak, causing large-scale protests in major Chinese cities while campaigns to boycott Japanese-made goods spread quickly. Accordingly, the Japanese exports to China shrank 20.6 percent in 2011 and 6.4 percent in 2012, while the number of Chinese tourists to Japan fell 28.1 percent during the 11-month period from October 2012 to August 2013.

Chang of IBK Economic Research Institute estimated that the negative impact of Korean exports to China would be much higher than that for Japan given the share of export in the GDP is much higher at 45.9 percent comparing to that of Japan (17.9%) and the share of Chinese exports in total is also higher at 26.0 percent than Japan's 17.5 percent. (Hankyung, 8 March 2017)

Korea's exports surge more than 20%, first in 5 years: After years of remaining sluggish, Korea's exports took a sharp rebound, rising by more than 20 percent in February 2017. The figure was the highest monthly growth in five years. The rebound was led by the nation's flagship export items, including semiconductors, automobiles, steel products, and petrochemicals.

Some analysts predicted that the bullish export trend would continue for the next several months as emerging economies are showing signs of recovery following the recovery seen earlier by advanced economies such as the United States and Japan.

The Ministry of Trade, Industry, and Energy announced on March 1 that the nation's exports amounted to US$43.2 billion last month, up 20.2 percent from a year ago. This was the highest monthly growth rate since 20.4 percent in February 2012.

The country's exports have registered positive growth for four straight months starting from November 2016. The nation's exports registered a double-digit growth for two consecutive months, first in 65 months since September 2011.

The nation's semiconductor shipments, in particular, reached $6.4 billion last month, up 54.2 percent year on year, renewing its record-high performance again. (Hankyung, 2 March 2017)

Household income-spending balance hits record high…due to people's belt-tightening: The household balance between income and spending last year was a record-high level. This is not

Abbreviation index: **BOK**=Bank of Korea, **CPI**=consumer price index, **DB**=Deutsche Bank, **FCY**=Foreign currency, **FDI**=foreign direct investment, **FSC**=Financial Supervisory Commission, **FSS**=Financial Supervisory Service, **FTA**=Free Trade Agreement, **FX**=Foreign exchange, **GDP**=gross domestic product, **GM Re**= Deutsche Bank Global Markets Research, **GNI**=gross national income, **IMF**=International Monetary Fund, **KAMCO**=Korea Asset Management Corporation, **KCCI**=Korea Chamber of Commerce & Industry, **KDI**= Korea Development Institute, **KOSPI**=Korea Composite Stock Price Index, **KOTRA**=Korea Trade-Investment Promotion Agency, **KRW**=Korean Won, **KRX**=Korea Exchange, **KS**=Korea Statistics (former National Statistics Office), **KT**=Korea Times, **KTB**=Korean Treasury Bonds, **MAEIL**=Maeil Business Newspaper & mk.co.kr, **MLTM**=Ministry of Land, Transport & Maritime Affairs, **MOCIE**=Ministry of Commerce, Industry & Energy, **MOCT**=Ministry of Transport & Construction, **MOKE**=Ministry of Knowledge Economy, **MOL**=Ministry of Labor, **mom**=month-on-month, **MOSF**=Ministry of Strategy & Finance, **nsa**=not seasonally adjusted, **NPL**=Non-performing loan, **NTS**=National Tax Service, **OECD**=Organization for Economic Cooperation & Development, **PPI**=producer price index **qoq**=quarter-on-quarter, **sa**=seasonally adjusted, **saar**=seasonally adjusted annual rate, **SERI**=Samsung Economic Research Institute, **SME**=small-/ medium-sized enterprises, **yoy**=year-on-year, **ytd**=year to date.

because their income has increased but because they tightened their belt in the face of continuing economic slump while the income level remained stagnant.

According to "2016 Household Trend" published by the National Statistical Office on February 26, the monthly average household income was 4,399,000 won last year. The corresponding spending amount was 3,361,000 won, with the monthly surplus amount reaching more than 1 million won at 1,038,000 won. This is the first time for the household's monthly surplus exceeds 1 million won since 2003.

The record-high household surplus has to do with the fact that families pinched pennies due to the ongoing economic recession. The volume of household spending fell 0.4 percent from the previous year, for the first time since the statistical bureau began collecting the data. Last year's monthly average income growth rate was 0.6 percent from 2015, the first time the growth rate declined below the 1-percent level.

The penny-pinching behavior of consumers is most visible in items such as food, clothing items, and shoes. The average monthly consumer spending on such items fell 1.3 percent to 349,000 won from the previous year. The spending on clothes and shoes was also down 2.4 percent to 158,000 won from a year ago. Meanwhile, the spending on communications equipment and automobiles shrank 15.2 percent and 4.5 percent year on year. (Hankyung, 27 February 2017)

Financial/ Industrial Sector

Samsung Engineering expected to gain boon from rising oil prices: Earnings and stock outlook for Samsung Engineering Co., the plant engineering arm of South Korea's largest conglomerate Samsung Group have brightened on expectations that oil-producing countries would increase their facility investment following a rebound in international oil prices.

Fuelled by optimism over its business prospects, Samsung Engineering shares hit a new 52-week high on Tuesday after soaring 31.1 percent since the first trading of this year on foreign and institutional buying. Its shares closed Wednesday at 13,300 won, down 1.48 percent, or 200 won, from the previous session, taking a breather after the recent winning streak.

In particular, hopes are high for a turnaround in its chemical business unit from the rebound in oil prices.

Samsung Engineering's plant business consists of chemical and non-chemical units. Its chemical unit, which constructs oil and gas facilities, refinery plants and petrochemical plants, accounted for 48 percent of its total sales as of the third quarter in 2016, while non-chemical unit building power generation facility and semiconductor and pharmaceutical factories contributed 52 percent.

In the last few years when international oil prices had remained depressed, the company's chemical unit had struggled from a plunge in oil-related facility investment across the world. Samsung Engineering registered 1.45 trillion won ($1.26 billion) in operating loss in 2015 and over 1 trillion won in 2013 as orders have remained extremely scarce. Reflecting concerns over its chemical unit performance, the company's share price had remained in the doldrums.

But with a recovery in the international oil prices in the latest months, expectations have grown that the company's share price that moves closely with the company's order backlogs would pick up, Lee Kyung-ja, a researcher at Korea Investment said, adding the company's order is largely affected by oil prices.

Market analysts expect that when the oil price exceeds $55 a barrel, its offshore oil projects and construction of refinery plants are also expected to pick up speed. The international oil prices including WTI crude and Brent crude, have lately surpassed $50 per barrel. Backed by the recent recovery in the oil price, Samsung Engineering successfully made a turnaround last year by posting 70.1 billion won in operating profit.

Samsung Engineering that heavily relies on plant orders from its sister companies is also expected to gain boon this year from its affiliate Samsung Display Co. that landed a deal to supply light-emitting diode (OLED) displays for Apple this year, a move that would require Samsung Display to expand production facility. Samsung Engineering that has earned orders of 2 trillion to 3 trillion won each year from Samsung affiliates received orders worth 1.9 trillion won from Samsung Display alone last year.

The Korean plant builder is also expected to benefit from Donald Trump administration's drive to build energy infrastructure in the US taking cue from the recovery of the global oil prices.

According to brokerage houses, Samsung Engineering is forecast to record 161.2 billion won in operating profit this year, more than doubling from a year ago, on sales of 5.69 trillion won. (Maeil, 8 March 2017)

Samsung Elec, SK Hynix to up 11%, 16% in capex spending this year: South Korean memory chipmakers Samsung Electronics Co. and SK Hynix Inc. that are the world's largest two players in the dynamic random access memory (DRAM) market will up capital investment by 11 percent and 16 percent, respectively this year, buoyed by recovery in prices of mainstream memory and heated demand for next-generation memory to power high-performance computing and mobile devices, according to global market data provider IC Insights.

Samsung Electronics will top in the capex rank with estimated spending of $12.5 billion, up 11 percent from last year. SK Hynix pledged $6 billion to ramp up capacity to meet burgeoning demand in 3D non-volatile storage (NAND) flash. They had cut spending by 13 percent and 14 percent, respectively, last year on weak DRAM market that ended up in a supply shortage and jump in DRAM prices toward the end of the year.

SK Hynix has already approved a budget for 7 trillion won spending largely to expand cleanroom space at the M14 fab in Icheon, Gyeonggi Province.

The world's largest memory chipmaker is yet to announce its spending plans for this year. Samsung Electronics is building the world's largest chip making compound in Pyeongtaek, south of Seoul. From latter half, the facility would turn out NAND flash. (Maeil, 7 March 2017)

28 February 2017 KOSPI 2,091.64p, KOSDAQ 612.20p

31 January 2017 KOSPI 2,067.57p, KOSDAQ 616.13p

FX Rates	(Source: Reuters)	**KRW/USD**	**KRW/100JPY**	**KRW/EUR**	**KRW/GBP**
	- As of 28 Feb 2017	1136.40	1007.35	1201.73	1406.85
	- As of 31 Jan 2017	1150.60	1019.90	1242.24	1447.17

Interest Rates	**Certificate of Deposit (CD) yield (91d)**	1.49% p.a. (28 Feb 17)	1.49% p.a. (31 Jan 17)
	Treasury Bond yield (5y)	1.86% p.a. (28 Feb 17)	1.85% p.a. (31 Jan 17)
	Corp Bond yield ("AA-" rated, 3y)	2.26% p.a. (28 Feb 17)	2.14% p.a. (31 Jan 17)

The House View 7 Feb 2017

More than two weeks removed from President Trump's Inauguration, politics and policy remain key market drivers. We continue to believe that Trump's victory has the potential of being a positive regime change for the economy and markets. Tax cuts and deregulation are expected to jolt the economy toward a better long-term equilibrium of higher growth, inflation and interest rates. But this regime change also brings a greater degree of policy uncertainty.

Politics remain the key risk in Europe, especially in the first half of the year, where we are more concerned about risks in Italy than France. While we do not expect a material negative macro impact this year, these developments bear close watching. Markets have started to price some of this risk.

Despite these political uncertainties, global momentum has strengthened and is currently running at its best pace in more than a year. Our global macro outlook remains largely unchanged, though: global growth should pick up only gradually this year, as the spillover from better US growth prospects is limited before 2018.

The focus in markets has been on the underperformance of Trump trades – US equities stalling, the dollar softening, and rates declining. Positioning and the perceived lack of policy progress are behind this underperformance. Incoming news flow on Trump policies will be an important driver from here, but cleaner positioning should allow for a resumption in Trump trades.

Central banks have stepped back from the spotlight for the time being. But attention should return to monetary policy later this year, as the Fed considers changing its reinvestment policy and balance sheet easing could slow in the eurozone and Japan.

(Please feel free to contact your DB representatives for the full version of the "The House View" or other periodical reviews.)

Economic & Financial Indicators

Sources: Asia Economics Monthly

As of **10 Feb 2017**

-Please note that these figures may not match with those mentioned before due to different sources.-

		2015	2016F	2017F	2018F
Nominal GDP	USD bn	1379	1399	1408	1430
GDP per Capita	USD	27,236	27,533	27,627	27,958
Real GDP Growth	% yoy	2.6	2.7	2.4	2.5
Priv. consumption	% yoy	2.1	2.4	1.8	2.0
Gov't consumption	% yoy	3.6	3.9	3.3	4.0
Inflation	% yoy ann avg	0.7	1.0	1.9	2.2
Merchandise Exports	USD bn	542.9	511.8	543.1	579.6
Merchandise imports	USD bn	420.6	391.3	432.3	475.5
Trade Balance	USD bn	122.3	120.4	110.8	104.1
Current Account	USD bn	105.9	98.7	87.4	78.6
Gov't debt	% of GDP	38.2	39.4	40.3	41.8
>Domestic	% of GDP	37.8	38.9	39.9	41.4
>External	% of GDP	0.5	0.4	0.4	0.4
Total external debt	% of GDP	28.7	26.8	25.9	25.4
FX reserves	USD bn	368.0	371.1	368.0	371.4
Unemployment	%	3.6	3.7	3.9	3.9
FDI (net)	USD bn	-19.7	-16.4	-17.0	-17.0
FX Rate (eop)	KRW/USD	1172	1209	1245	1215

Financial market	Current	1Q 17	2Q 17	4Q 17
BoK base rate	1.25	1.25	1.25	1.25
91-day CD	1.49	1.45	1.45	1.50
10-year yield (%)	2.14	2.50	2.70	2.90
KRW/USD	1147	1170	1210	1245

Moody's: Aa3 **S&P:A+** **Fitch: AA-**

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