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Korea's GDP: Anemic, Vulnerable.

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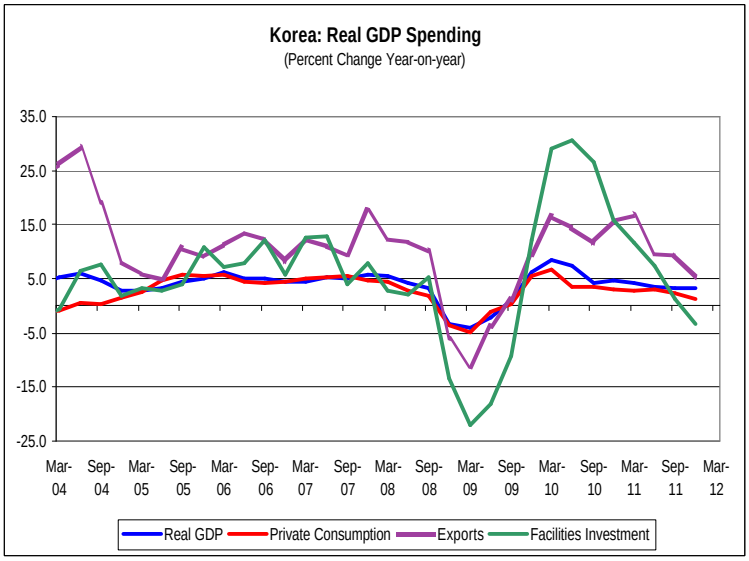
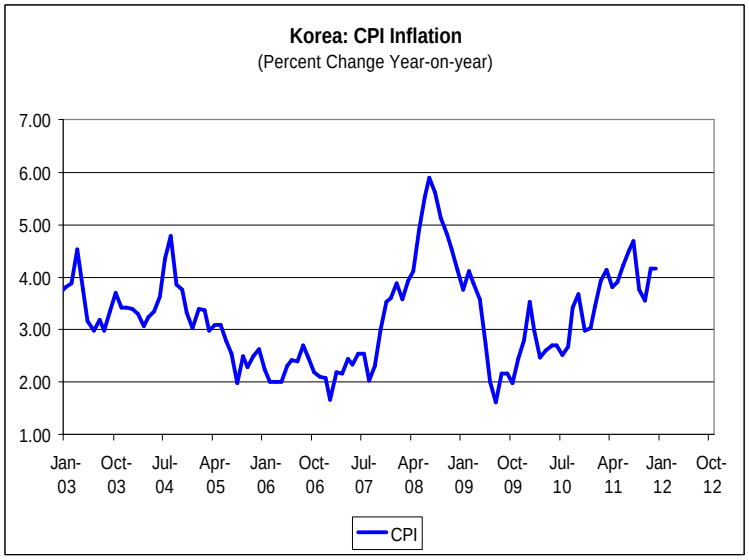
The first national accounts data installment of the year, corresponding to the fourth quarter of 2011, continues the clear downward trend depicted by data throughout the past few quarters. Real GDP was modestly above previous-year levels (3.4% year-on-year), practically unchanged from the third quarter, and on a sequential basis the expansion nearly came to a halt, with a seasonally-adjusted gain of only 0.4% quarter-on-quarter, the smallest since the end of the global recession.



Moreover, the composition of growth clearly indicates that even such a meager gain overstates the strength of the economy, and its potential resilience.

Private consumption, for example, contracted (-0.4% quarter-on-quarter) for the first time since the recession. Gross capital formation shrunk even more markedly (-2.1% quarter-on-quarter), the third such development in the last five quarters. Meanwhile, the decline of Facilities investment (machinery and equipment) was rather abrupt (-5.2% quarter-on-quarter). On an annual basis these changes left private consumption up just barely on last year's level: 1.2% year-on-year, the weakest since 2009, while gross investment actually fell below last year's level by 3.0%.



Among the components of investment, Construction continued its nearly two-year decline, shrinking by 4.0% year-on-year, while Facilities dropped for the first time since the 2008-09 crisis (-3.4% year-on-year).

Indeed, most of the annual GDP gain (roughly two thirds of it) is traceable to net exports. But the export sector posted its first seasonally-adjusted quarterly drop since 2009 (-1.5% quarter-on-quarter) and remains vulnerable as a clear weakening of trade persists across Asia--a downward cycle that could still worsen on account of China's cooling and Europe's unfolding recession.

To be sure, China's apparent turn towards policy-easing points to a light at the end of the tunnel for Korea, via exports. But there is a hlow likelihood that—absent domestic developments—Korea's real GDP will rebound rapidly or strongly, at least during the early part of 2012. This is especially the case given the Bank of Korea's (overly) cautious stance. The bank raised rates starting in June 2010 and continued to do so through June 2011—a total of 125 basis points. It has refrained from further rate hikes since then, but it has also failed to react to what is now a clear downward trend in the economy. There is *some* chance that the data just released might push the Bank of Korea to consider a policy easing, although not because the sluggishness of domestic demand that they depict will shock

policymakers. That has been acknowledged with seeming complacency in the most recent communiqué. What *could* move them to reconsider their stance is the very visible deterioration of exports, a factor not present as of the last policy review (mid-January), and which—given the relative size of the export sector-- should dent the BoK's confidence regarding the solidity of labor market trends. Interestingly, the bank's January decision to hold rates was not argued—at least not with any forcefulness—on the basis of strong inflationary pressures. All of which suggests that there should be little resistance to an easing move, but that perhaps some additional pressure, in the form of further evidence of a downturn in the monthly data, might be needed to tilt the Bank of Korea's stance in that direction.