



Republic of Korea

Briefing Notes for the Launch in Seoul, 6 May 2011

Recovery gains momentum

- The Republic of Korea was among the first in the Asia-Pacific region to recover from the economic crisis. Economic output stabilized as early as the first quarter of 2009 as a result of swift and aggressive response by the Government and strong economic fundamentals. In 2010, the economy grew by 6.2%, up from 0.2% in 2009, supported by the recovery in demand for exports, growth in private consumption, fixed asset investment and stock-building.
- The property market remained subdued throughout 2010 and early 2011 despite the introduction of fresh government incentive programmes to revive activity in the real estate sector. In contrast, the stock market rallied strongly with the KOSPI, the country's representative stock market index, reaching its highest level ever recorded. The inflow of foreign capital significantly contributed to rising stock prices as global excess liquidity and expectations of higher returns led to an overall increase in foreign portfolio investment.
- The export sector, especially for consumer durables which had been sensitive to the economic downturn, posted strong recovery in 2010. Exports also benefitted from specific incentive programmes designed to boost demand for consumer goods such as "cash for clunkers" in the United States, and the strengthening of the yen. In nominal terms exports increased by around 29% year-on-year.
- Continuing from 2009, the economy experienced a large inflow of foreign capital in 2010. FDI inflow which recorded negative growth in the first half of 2010, picked up during the last quarter. By the end of the year FDI inflow increased around 14% year-on-year. Inflow of portfolio investment capital was particularly strong in response to increased earning performance of private sector companies and expectations of currency appreciation.
- GDP growth started to slow down by mid-2010 as the base effect wore off and recovery of the global economy showed signs of waning. In 2010, the economy is forecast to grow by 4.5%.

Rapid rise in fuel and food prices poses major threat to economic growth

- Consumer prices which increased by 2.8% in 2009, rose marginally to 3% in 2010. However, during the second half of 2010, extreme weather conditions

in the summer months followed by a major outbreak of hoof-and-mouth disease during winter led to a dramatic rise in food prices. Inflation is likely to rise further in 2011.

- Rising inflationary pressure led the Government to increase the benchmark rates several times beginning from July 2010. After the latest increase of 25 basis points in March 2011, the interest rate reached 3% with further hikes expected during the year.
- While it remained on a rising trend, the won continued to experience volatile movements triggered by external events and swings in investor sentiment. For instance, the Korean won dropped by 12% within the month following the onset of the European debt crisis. The day-to-day volatility of the Korean won ran at 0.92% in the second quarter of 2010, much higher than 0.51% of the Japanese yen. In order to curb the potentially destabilizing effect of capital flows on currency movements, the government implemented capital controls, setting limits on the accumulation of foreign exchange derivatives.

Fiscal situation improves

- The Republic of Korea continued to inject fiscal stimulus through spending on infrastructure projects in 2010, however, due to stronger-than-expected economic growth, the government's fiscal deficit narrowed to around 2% of GDP. Further improvements are expected in 2011 as the government wraps up the stimulus cycle.

Emerging challenges

- The rapid rise in household debt is a growing concern for the economy. According to the Bank of Korea, the level of household debt increased by 8.9% in 2010 compared to 2009. Given that interest rates are set to rise until strong inflationary pressures are reined in, households will face higher debt-servicing payments for the near future.

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