

Presidential Election Preview

Wednesday, May 03, 2017

Highlights

- In less than a week from now, South Koreans will be heading to the polls on 9th May to vote for their new president, after the impeachment and removal of former president Park Guen-hye earlier this year. Out of the five main presidential candidates, opinion polls are indicating overwhelming support for front runner Moon Jae-in over his closest rival Ahn Cheol Soo.
- Should Moon Jae-in win the presidential election as suggested by the poll, it will mark the end of a decade's worth of governance by the Conservative camp. In accordance to Moon's Liberal stance, he has called for proposals to introduce corporate governance reform targeting the chaebols and announced his intentions to inject an ambitious KRW10 trillion (US\$8.9 billion) to support job creation and economic growth, and improve relationship with North Korea.
- Amid the mix of a recovery economic backdrop and the rise of geopolitical tensions in the Korean peninsula, market-watchers seemed to regard Moon's likely victory to be market-positive. The Korea Stock Index (KOSPI) has rallied to its highest since May 2011, while the Korean Won has appreciated against the USD by as much as 7.9% since the start of this year. Even with the brewing tensions in the North, the overwhelming popularity Moon is commanding should give South Korea the much needed political stability and buoy economic growth should he be elected.

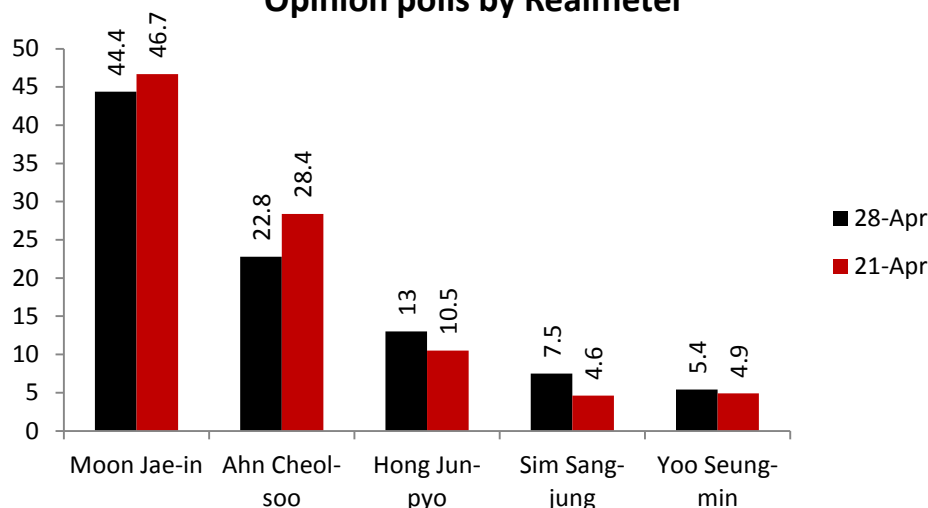
It's up to the liberals now?

South Korean political history has had its fair share of scandals. It was arguably the rise of public political awareness and the message of anti-corruption politics that introduced the "first free and fair" presidential election which elected the 6th South Korean President Roh Tae-woo back in 1987. It was also bribery allegations and a nation-shocking suicide by the 9th President Roh Moo-hyun that saw political power shift from Roh's liberal camp to Lee Myung-bak's conservative camp in 2008 just when the Global Financial Crisis was underway. Now, just as recent as last year, the nation underwent yet another political scandal by then-president Park Guen-hye on bribery and corruption allegations, which shook public confidence over conservative-led governance and lifted the popularity of Moon Jae-in's liberal-influenced Minjoo Party of Korea (or also known as the Democratic Party of Korea).

Should we consider Moon Jae-in's quick rise in popular polls, it is likely less due to his debonair disposition and magnetic personality, but more than likely due to his stronger push for corporate governance reform in targeting the family-controlled business conglomerates (known in the native tongue as Chaebols) and his promise to revive the domestic economy. This message would clearly ring close to many voters' hearts given the public calls for more transparency in chaebol's management in view of the recent

allegations of Samsung bribery to Park's long-time private confidante. Moreover, the message of job creation and economic growth will be comfort to the ears especially to those who were adversely affected by the rise in unemployment numbers especially seen in Korea's manufacturing space. Compound this with the record household debt to nominal GDP at 91% (vs OECD average of 70%) and the risk of elevated debt-servicing burden should global rates rise into 2017, the need for corruption-free politics, a better standard of living and viable job opportunities will surely sit well with the voters.

Opinion polls by Realmeter



Source: Realmeter, OCBC Bank

First off: Moon's stand on the Chaebols

Given that the key issues surrounding the presidential election are that of chaebol's management and economic growth, it is vital to delve deeply into these subject matters in hope to catch a glimpse of Korea's economic environment should the poll results turn into reality.

Moon's economic-related rhetoric surrounding his campaigning has been one that targets Korea's family-owned conglomerates. In a nutshell, despite the chaebols playing an important role in shaping Korea's rapid economic growth in the latter part of the 20th century, the rise of public discontent owing to the relative lack of transparency in chaebols' management and rising unemployment rates even amongst the young and educated raises the issue of chronic unemployment problems.

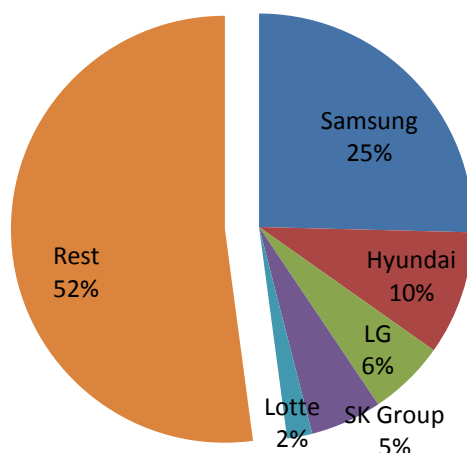
Statistically, Korea's youth unemployment between 15 to 24 years of age remains elevated at 10.6% at end 2016, while pleas by then-president Park Guen-hye to chaebols in recruiting the young and idle workforce did little to arrest the rise in overall unemployment rate to 4.0% earlier this year, the highest print since the global financial crisis. To exacerbate matters, average wage growth continued to decelerate throughout 2016, and eventually contracted starkly by a worrying 10.6% in February 2017 as economic growth bumps emerged.

The chaebols themselves, though once a crucial part of the recovery during Korea's development stage, are constantly under scrutiny by the Korean media for their encroachment on small to medium business enterprises, as well as not allowing deserving executives to become key management holders unless they are part of the family. Moreover, given their significant contribution to growth, rising concerns over the competencies of the on-coming third generation of

leaders is understandable as well. These concerns could have been magnified given the recent bankruptcy of family-operated Hanjin Shipping earlier this year, Samsung heir Jay Lee’s arrest over bribery allegations, and Lotte’s vice-chairman’s suicide during the corruption investigations in August last year.

However, Moon would need to contend with the undeniable importance of the chaebols in the Korean economy. South Korea’s strong growth model had laid the foundation for many successful international brands like Samsung, Hyundai Motor, SK Group, LG and Lotte Group, whose profits accounted for a bulk of all conglomerate names in South Korea. Chaebols have been closely tied to Korea’s economic growth ever since, with these family controlled conglomerates contributing for 58% of South Korea’s GDP in 2015, up from 37% in 2008, while commanding almost 50% in value in the Korean Stock Index (KOSPI).

Chaebols account for almost 50% of the KOSPI index



Source: KOSPI, Bloomberg, OCBC Bank

In short, given the conglomerates’ contribution to growth, South Korea’s economic performance will be invariably tied to the growth of the chaebols. As such, the need for greater transparency over their business model, as well as the introduction of stricter regulatory environment, may promote efficiency and alleviate the current unemployment landscape. In response to the kaleidoscope of factors, Moon Jae-in economic policy agenda includes five-pronged proposed measures in tackling these issues and reduce the chaebol’s influence on the Korean economy.

1	Shareholder-driven corporate governance would be bolstered by electronic voting and proportional-voting systems
2	Requirements will be tightened to hinder efforts to consolidate management controls
3	Restrictions will be placed to penalise nepotistic business practices
4	Board-level labour representation will be legalised to give workers a strong voice in top management
5	Generous corporate tax incentives favouring the chaebol will be curtailed

Source: The Economist Intelligence Unit, “Chaebol reform looms over presidential election”

Moon's foreign policy approach: To be friends with everyone

Another area of focus should Moon wins the blue house will be his approach to foreign relations, especially crucial during this time of heightened geopolitical concerns.

Importantly, Moon's approach to the North-South Korean tensions is one of pro-engagement. A critic of ex-president Park Guen-hye's approach in dealing with the north, Moon calls for a "two-step" approach with talks hoping to lead towards "economic-unification" and ultimately "political and military unification". Moreover, with Moon-led Korea's foreign agenda with North Korea, market-watchers were also quick to point out South Korea's possible ability to take the lead in negotiating over the nuclear issue. In these, he has also pointed out three stages in which he would hopes to achieve a nuclear-free Korean Peninsula: (1) for North Korea to not engage in any further nuclear provocations, (2) prevent North Korea from advancing its nuclear capability further and (3) eventually see North Korea in completely scrapping its nuclear program.

In regards to US-Korea relations, Moon aptly put, "I believe South Korea taking the (discussion) initiative would eventually strengthen our bilateral alliance with the US... (and) to take the lead on matters in the Korean Peninsula as the country directly involved." Moreover, Moon had voiced his agreement with US President Trump's approach in bringing North Korea back to the negotiating table. Elsewhere, Moon has also considered himself as an "American friend" for its role in helping South Korea avoid communism while aiding its economic growth.

The only area of contention is in the deployment of a US missile defense system, known as the Terminal High Altitude Area Defense (THAAD) system. In the period leading to the presidential campaign, Moon has called on China to stop economic retaliation against South Korea over Korea's decision of deploying the THAAD. Empirically, China has imposed restrictions on companies doing business with and in South Korea, while in the past, had prohibited Chinese tourists from traveling to South Korea, thus hurting Korea's tourism industry. The consolation is on Moon's rhetoric that "it is not desirable... to deploy the Terminal High Altitude Area Defense (THAAD) hastily", suggesting his reluctance to sour relationship with both China and North Korea, while hoping to process the deployment decision democratically with the US.

Economic growth from here on now

Should we consider Moon's policy rhetoric in its totality, his calls for increased corporate governance in regulating the chaebols, improving ties with its key foreign counterparts, and eventually wanting to improve the standard of living and economic standing are likely the ones that gained him his much deserved popularity. More importantly, the fresh approach in repairing foreign relationship especially with his northern counterpart could well aid in defusing geopolitical tensions and achieve both political and economic stability in time to come.

Should Moon win the election, he will also inherit an economy that is slowly recovering from the lackluster external environment seen in the past year as well. Importantly, given South Korea's relatively rosier economic outlook from its positive external environment, official export growth outlook has been upgraded to expand 6 to 7 percent to reach US\$525 – 530 billion in 2017, up from a previous growth trajectory of 2.9% made earlier this year.

Moreover, the uptick in export demand has also led the Bank of Korea in revising its economic growth higher to 2.6 percent, up from 2.5 percent. Notably, Korea's economic growth in 1Q17 was underpinned by its strong manufacturing sector, which grew at its fastest pace since June 2014 at 4.4%. This is especially encouraging given that the manufacturing sector accounts for a sizable

portion of GDP (specifically 28.4% in 2016). Other sectors including Gross Fixed Capital Formation (GFCF) saw a double-digit print of 10.9% yoy, led by private investment (+10.6%) while exports accelerated at its fastest pace since June 2013 at 3.7% yoy. Elsewhere, consumer confidence tuned higher into April, suggesting that the nation is moving on from Park's political scandal and may reflect an improvement in domestic spending into the year ahead.

On the whole, we remain encouraged by the rosy external environment, while the recovery in Korea's manufacturing sector should underpin growth into the year. In view of Moon's political promise to inject an ambitious KRW10 trillion in to support job creation and boost economic performance, the move may support growth further into the year. Still, we remain concerned over the high household debt levels, which may keep policy-makers from cutting rates further should economic fundamentals unexpectedly turn south. Meanwhile, the potential for global rates to tune higher given US policy normalisation may also increase debt-servicing burden, which in turn further limits domestic consumption and overall growth.

In view of these uncertainties, we maintain our GDP growth outlook at 2.5% while keeping our inflation outlook at 2.0% in 2017. Given the record household debt, we also look for policy-makers to keep Korea's benchmark rate unchanged at 1.25% for the year ahead. Still, market-watchers should look favourably on Moon's likely victory in next week's presidential election, seen from the rallying in the Korea Stock Index (KOSPI) and sustained appreciation in the Korean won. In that regard, should Moon's political and economic agenda plays true, Korea's economic performance may see further upside risk into the year.

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