Sea Change in South Korea

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Flash Points:
• Wave of reforms sweep South Korea on back of new administration
• Government unveils US$ 10 billion fiscal package
• Measures to enhance corporate governance and transparency of chaebols

Structural Reforms in South Korea

In the wake of President Moon Jae-in’s victory at the South Korea presidential election last month, Moon has positioned himself as a pro-reformist - determined to unite a country torn by bitter divisions after a long-drawn corruption scandal that engulfed a nation.

Former president Park Geun-hye who was impeached and removed from office is now undergoing trial for corruption and for misusing her position to gain personally.

With the scandal now behind the country, South Korea could see a sea change of events which may spell positively for the country in terms of investment opportunities.

Big Test Ahead for Moon Jae-in

Son of North Korean refugees – President Moon campaigned under a pro-reform agenda to clean up corruption and take on the powerful family-run chaebols which traditionally held strong government sway.

The 64-year old, who practiced human rights law before turning to politics, served as chief-of-staff to former president Roh Moo-hyun back in 2004.

A left-leaning Democrat, Moon easily won the election securing 41% of the total votes, beating other conservative and centrist candidates.

Whilst global attention was fixated on mounting tensions between North & South Korea, ultimately it was the economy and concerns of governance that lingered on the minds of South Koreans as they head to the ballot box.

Youth unemployment was a national concern, reaching 11.2% in April which is twice the national unemployment rate.

Rising inequality was another focal point, whereby it was highlighted that the top 20% of income-earners in South Korea made 9.32 times more than those in the bottom 20% as of end-2016.

South Korea’s 1Q’17 GDP reading was revised upwards to 1.1% from 0.9% initially, largely from gains in the construction sector and higher exports.

However, private consumption grew just 0.4% in the same quarter which was well below overall economic growth.

More Fiscal Pump Priming

In early-June, the new government unveiled its 11.2 trillion won (US $10 billion) fiscal stimulus package to bolster job creation and increase welfare subsidy programmes.

The government estimates that this extra spending will add 71,000 jobs to the public sector workforce and 15,000 jobs in the private sector.

Majority of the funding, i.e. 8.8 trillion won (US $7.9 billion) will be financed by excess tax revenue expected this year, while the remainder will come from government revenue from 2016 and public funds from state-owned enterprises.

According to government projections, the budget is expected to add economic growth by 0.2 % this year, raising its 2017 outlook from 2.6 % currently.
While the opposition has questioned the sustainability of continued welfare expenditure and social programmes, markets are drawing similarities to Japan when Shinzo Abe was appointed – where it followed a similar growth & reform trajectory to increase minimum wages and embark on fiscal pump priming.

**Keeping Chaebols in Check**

Another forefront of President Moon’s pledged reforms include a shake-up of South Korea’s powerful family-run conglomerates, known as chaebols. Collectively, the top four largest chaebols – Samsung, Hyundai, SK, and LG’s market capitalization account for half the country’s stock exchange.

Whilst the economy and job creation are top priorities for Moon, public pressure to act upon chaebols is mounting following the recent corruption scandal that toppled his predecessor.

Park Geun-hye allegedly solicited bribes in exchange for business favours from family-owned empires like Samsung. The group’s heir apparent Lee Jae-yong is now serving trial for charges of bribery, embezzlement and perjury.

Long-viewed as national champions and symbols of South Korea’s manufacturing might – public perception of chaebols have now changed, with most regarding them as elites amassing huge amounts of wealth at the expense of small-businesses.

To this end, Moon has appointed Kim Sang-jo, an outspoken critic of chaebols to head the Korea Fair Trade Commission – the country’s anti-trust watchdog.

Dubbed the ‘chaebol sniper’, Kim is a key figure leading the Commission which is responsible for regulating conglomerates and setting policies on fair trade.

By August, markets also expect further changes in stewardship roles including at the country's pension fund.

**Valuations**

We view these developments positively, in painting a long-term sustainable structural story for South Korea. Corporate reforms, especially with regards to chaebols will be beneficial in enhancing transparency and protection of minority shareholders.

Recently, we’ve increased our country-exposure to 14%, with our funds weighted towards the financial and technology sectors.

Valuations for South Korea stocks tend to trade cheaply with a commonly ascribed “Korea Discount” – whereby the market imposes a discount on such counters due to poor corporate governance.

Example, Samsung only trades at single-digit P/E between 7x – 8x, despite a market-cap consisting of over 30% cash.

Korea’s benchmark KOSPI charged towards the 2,300 point mark for the first time recently in end-May - as foreign investors snapped up local stocks and risks surrounding the recent elections abating.

Whilst, the work has only begun for President Moon, key risks stemming from implementation of the new administration’s policies and tensions from a more unpredictable North Korea regime may unhinge this rally.
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