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South Korea – a rebound candidate

Perspective from **EMEA ETF Investment Strategy**

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- After a record year in 2020, Korean equities have been trending downwards
- The FTSE Korea 30/18 Capped Index is trading 24% below its 2021 high, and has so far hardly recovered from its 2022 lows
- With the war in Ukraine, a divisive election of a new president, and a new central bank governor to take over amid spiralling inflation, the situation remains challenging
- However, in line with other select emerging markets, the fundamentals and outlook remain solid; a new government takes action; investor concerns are reflected in cheap valuations

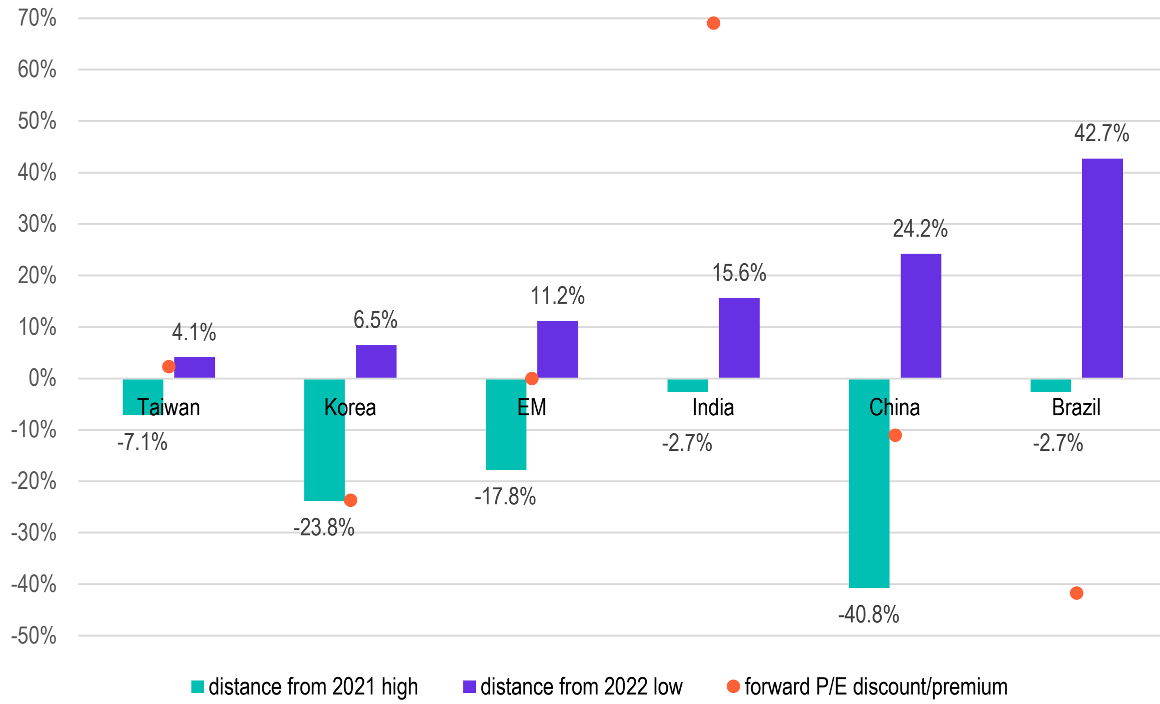
Emerging markets really are as diverse as they come. While 2022 so far has been difficult for most developing nations, some are thriving in this volatile environment. In early March, we highlighted Brazil for its potential to benefit from high commodities prices and low valuations. South Korea, on the other hand, has struggled – but it may be a candidate for a rebound.

After a nail-biter election, the market's focus turns back to fundamentals and questions what can be expected from the new administration. With 4% in 2021, Korea recorded GDP growth at an 11-year high.[1] For 2022, however, expectations are more muted amid slowing export growth and potentially higher interest rates hampering domestic consumption. Consensus estimates are around 3%.[2] But consumer confidence in March remained high at 103.2 (+0.1)[3], well above the 100-threshold separating positive from negative sentiment. The next Bank of Korea (BOK) meeting will take place on April 14th, possibly with a new governor for the first time in 8 years (assuming Rhee Chang-yong can be confirmed by parliament until then).[4]

Like elsewhere, inflation and inflation expectations have risen sharply, in part due to Korea's heavy reliance on commodities imports – crude oil in particular. The BOK expects the CPI to remain around 4% for the time being.[5] The government announced an oil tax reduction from 30% to 20% and temporary subsidies to soften the blow. Before the election, a supplementary budget of USD 14 bln was approved by the Korean National Assembly, partially earmarked to support businesses affected by a resurgence of Covid.[6,7]

Markets have hardly reacted to any of these measures. In fact, Korean equities have clawed back a mere 6.5% from its 2022 lows. That compares with 11% for broad emerging markets, 16% for India, and a staggering 43% for Brazil. Korea is still trading almost one-quarter below its 2021 high and is valued at a Bloomberg estimate forward P/E of 9.5 – significantly lower than broad emerging markets and at a 44% discount vs developed markets.[8]

Korea is still trading close to its 2022 lows and may offer good value



Source: Bloomberg and Franklin Templeton, as of 6 April 2022. Data based on FTSE 30/18 Capped Net country indexes, and FTSE Emerging Index. Calculations are made in USD. P/E discounts and premiums have been calculated based on Bloomberg P/E estimates.

While the debt-to-GDP ratio continues to rise, it remains very moderate at around 0.5.[9] Foreign exchange reserves stood at well over USD 400bln in March, close to an all-time high.[10] The new administration will be looking to reduce fiscal deficits – potentially curbing inflation but with risks to growth. At the same time, the government under president-elect Yoon has also pledged to reduce regulation and step-up efforts to boost R&D, increase child-care support and home building (both public and private)[11] – all of which should be growth-positive over the medium term.

Summary

- Tax cuts for petroleum products
- High inflation but in line with BOK's expectations
- Solid fiscal position, high FX reserves
- Potentially market-friendly reforms in store once the new government takes office
- Low valuations at a forward P/E of 9.5 (compared to 17 for global developed equities and 12.5 for emerging markets)

Sources

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