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Asia

Other

Equity Research

Industry Overview

Republic of Korea: A Change At The HelmAlastair Newton
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LBIE, London**Sector View:**

New: 0-Not Rated

Old: 0-Not Rated

Investment Conclusion

- GNP wins in the presidential and parliamentary elections stand to be good for the chaebols and for economic nationalism.

Summary

- Despite a corruption scandal and related split in the conservative ticket, the GNP's Lee Myung-bak remains favourite to win the 19 December presidential election – a positive for growth prospects, especially if GNP can then secure a majority in the 9 April 2008 parliamentary elections.

GOVERNANCE AND GROWTH

In the run-up to the Korea's 19 December presidential election, the main opposition conservative Grand National Party (GNP) has consistently led the ruling liberal United New Democratic Party (UNDP, formerly the Uri Party) in opinion polls. However, just days before the 25/26 November formal registration of candidates for the election, what had previously seemed something of an electoral formality for the GNP's Lee Myung-bak began to look less of a foregone conclusion, even though Mr Lee himself had enjoyed the support of over half the electorate in some polls.

Late Complications...

The threat to Mr Lee revolved around the resurfacing in mid-November of a corruption scandal involving a former business partner, even though Mr Lee has consistently strongly denied any involvement. This appears to have been the proximate cause of former GNP presidential candidate Lee Hoi-chang (who was defeated in both 1997 and 2002) putting his hat in the electoral ring as an independent. But, in a boost to Lee Myung-bak, his opponent in August's GNP primary, Park Guen-hye who commands significant support on the right of the party, promptly decided publicly to throw her weight behind her party's candidate.

To complicate matters still further, there appeared to be an outside chance that the UNDP might decide to replace its chosen candidate Chung Dong-young (who has been struggling in the opinion polls and who, strangely, seemed to be the main loser when Lee Hoi-chang emerged as a second conservative candidate) with the younger and more business-oriented Moon Kook-hyun.

...But The Show Goes On

Despite this flurry of uncertainty, Lee Myung-bak remains favourite to step into the presidential office when Roh Moo-hyun steps down on 25 February 2008. Furthermore, the expectation is that he will then go on to help secure a majority for the GNP in the 9 April parliamentary elections. His reputation from his time in business and as mayor of Seoul suggests that he would bring significant drive to the pursuit of his policy agenda if elected president.

Going For Growth...

Even though Mr Lee's "747" agenda – i.e. 7% growth, \$40,000 per capita annual income and establishing RoK as the world's seventh largest economy – is almost certainly over-ambitious, his election would certainly place a strong emphasis on economic growth. But there are concerns that a President Lee's undoubted pro-business stance would primarily benefit the *chaebols* at the potential expense of smaller enterprises – including by slowing moves to improve corporate transparency; making it easier for the *chaebols* to take stakes in domestic financial institutions; and possibly reducing corporation tax from 25% to 20%.

Furthermore, he would probably support legislation which would have the effect of protecting Korean corporates from foreign takeover; and, related, do little to slow the growth of economic nationalism in Korea. Both stand ultimately to limit economic potential. There are also concerns – including, reportedly, at the Bank of Korea – that Mr Lee's spending plans could fuel consumer price inflation.

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...And A Second Term?

On the domestic political front, a President Lee and GNP government would be well-placed to move forward with proposed constitutional changes which would allow the president a second term and which would synchronise presidential and parliamentary terms into a single four-year cycle.

Closer Ties With Washington...

On foreign policy, a President Lee would adopt a tougher stance than his predecessor has with North Korea (whose leaders would almost certainly prefer a UNDP win and which may yet try to pull some sort of "stunt" to influence the election outcome accordingly), while looking to engage P'yongyang constructively. In principle at least, this would be welcome in Washington, although tactical differences might emerge as the Bush Administration pushes for real progress dismantling the North's nuclear programme over the next 12 months.

Related, Mr Lee supports the continued US troop presence in RoK and opposes calls (from Mr Roh among others) to bring them under Korean command (a non-starter for the US). Plans for South Korea to regain from the US wartime operational control of its own forces would probably proceed.

Mr Lee also supports ratification of the Korea-US free trade agreement despite protests against it in Korea. But opposition from leading Democrats in the US remains a stumbling block to the FTA coming into force.

...And Possibly Tokyo?

Born in Japan, Mr Lee might also look to build a closer relationship with Tokyo, facilitated by the presence in the prime minister's office there of Yasuo Fukuda.

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