

***HRI***

# Monthly Economic Review

- 
- Recent Global & Domestic Economic Trends
  - Acute Downturn of Domestic Economy and Counter-Measures
  - Next Government's Task of Setting Policies for N. Korea
  - [Annex] Domestic and Global Economic Indices

## □ Recent Global & Domestic Economic Trends

### Major Economies

*The US economy presented a rising expectation for economic recovery, while Europe's economic crisis deepened. Signs of Chinese economy slowing down continue.*

The US industrial production showed a downturn of 1.2% in August, while retail sales continued to rise in August by 0.9%. The third quantitative easing(QE3) by the Fed presented a rising expectation for improvements in employment and housing market.

Europe's economic slump, on the other hand, continued with its retail sales struggling and high unemployment rate of 11.3% in June and July. Europe's economic instability kept on with political uncertainty in Greece and the possibility of Spain's credit rating being downgraded.

Japan's retail sales dropped to 0.7% in July, marking the first downturn in eight months since November 2011. Industrial production also fell to 1.0%, after showing an upturn in June, delaying economic recovery.

Chinese domestic economy including its industrial production showed a slow downturn, and its export growth rate fell to 2.7% in August, a growth rate of below 3% in two consecutive months. Retail sales growth rate hardly changed for two months: 13.1% in July and 13.2% in August.

## Global Financial Market

*Global stock markets were up in September with a growing expectation for the global economic uncertainty to be eased.*

The US and the European stock markets rallied in September with the US policy to stimulate the economy in place(QE3) and ECB's announcement to purchase government bonds of financially vulnerable countries. Japan's Nikkei index rose in September thanks to the strong stock prices of businesses exporting to Europe, while China's SSE Composite Index was also up despite concerns over the slowing business growth, thanks to the announcement of business-stimulating policy including the urban railway construction plan.

The JPY/USD exchange rate was up by a small margin in September due to the good export business performance to Europe despite Japanese government's quantitative easing policy. The EUR/USD exchange rate rose with ECB's announcement of government bond purchasing plan, despite Spain's credit rating lowered. The CHY/USD exchange rate was also up in September by a narrow margin compared with the previous month's figures.

### < Economic indices of major countries >

(unit : %)

(unit : p, yen, euro, yuan)

Economic Sectors		2011	2012			
		Annual	Apr	May	Jun	Jul
US	Industrial Production	4.1	0.0	0.1	0.5	<b>-1.2</b>
	Retail Sales	8.0	-0.1	-0.7	0.6	<b>0.9</b>
EU	Industrial Production	3.5	0.9	-0.6	0.6	-
	Retail Sales	-0.6	0.9	0.1	-0.2	-
Japan	Industrial Production	-3.5	-3.4	0.4	-1.0	-
	Retail Sales	-1.2	3.6	0.2	-0.7	-
China	Industrial Production	13.9	9.6	9.5	9.2	<b>8.9</b>
	Retail Sales	17.1	13.8	13.7	13.1	<b>13.2</b>

  

Economic Sectors		2011	2012			
		Annual	Jul	Aug	Sep	Oct
US	DJIA	12,218	13,009	13,091	<b>13,437</b>	<b>13,515</b>
EU	DAX	5,898	6,772	6,971	<b>7,216</b>	<b>7,327</b>
	EUR/USD	0.772	0.813	0.799	<b>0.775</b>	<b>0.776</b>
Japan	NIKEI	8,455	8,695	8,840	<b>8,870</b>	<b>8,797</b>
	YEN/USD	77.66	78.12	78.58	<b>77.62</b>	<b>78.04</b>
China	SSE	2,199	2,104	2,048	<b>2,056</b>	<b>2,086</b>
	CNY/USD	6.3190	6.3617	6.3498	<b>6.3023</b>	<b>6.2845</b>

Sources: US department of Commerce; Eurostat;  
The People's Bank of China;

Sources: Bloomberg  
note: SSE denotes SSE Composite Index

## Korean Economy

*Poor economic indices of August raised concerns over the possibility of prolonged recession, while exports remained weak due to the global economic uncertainty*

Retail sales dropped to 3.0% in August along with the sales of durable goods including motors. Facility investment dropped to 14.3% in August compared with the figures of August 2011 due to the falling investments in machinery and transport equipments. Construction also fell to 7.3% with declining building and civil engineering works.

Exports fell to 6.2% in August and 1.8% in September compared with the same months' figures of 2011, particularly the industries of shipbuilding, steel manufacturing, and general machinery suffered a sharp fall. Imports also dropped in August to 9.7% and in September to 6.1% due to the declining domestic demand and shrinking exports, marking a continuing fall for seven consecutive months. The aggregate export amount for the period of January to September, 2012 fell to 1.5%, and import for the same period fell to 0.9%. The trade balance for the same period recorded a surplus of US\$18.9 billion, as the recent falling rate of import was greater than that of export, a surplus in the middle of economic recession.

The unemployment rate of August stayed at 3.0% thanks to the continued increase of people employed in service industry. Inflation rate rose to 2.0% in September, much lower than the target of 3% set by the Bank of Korea.

Business Survey Indices in manufacturing(BSI) rose from 80.1 in August to 97.5 in September and 97.8 in October, still remaining below the critical point of 100. The cycle variation value, however, marked 100.1 in August, 0.2p lower than in July, staying close to the critical point of 100.

*KOSPI index rose in September with the national credit rating of Korea moving upward, and the KRW/USD exchange rate appreciated. The corporate bond yield rate fell again in September.*

KOSPI index continued to rise in September with the announcement of ECB plan for government bond purchasing, and with the national credit rating of Korea moving upward. The KRW/USD exchange rate appreciated with the straight purchase of stock by foreigners and the third quantitative easing(QE3) by the US government. The corporate bond yield rate(BBB-) fell to 8.69% due to the frozen base rate imposed by the Bank of Korea.

### < Korea Major Economic Indices >

(unit : p, %)

Economic Sectors		2011			2012						
		Annual	3/4	4/4	1/4	2/4	3/4	Jul	Aug	Sep	Oct
Domestic Market	Retail Sales	<b>4.3</b>	4.7	1.9	2.0	1.0	-	3.5	-3.0	-	-
	Facility Investment Index	<b>0.7</b>	-3.1	-4.7	9.3	-0.4	-	1.3	-14.3	-	-
	Construction	<b>-6.7</b>	-8.4	-0.5	-3.7	-10.8	-	0.2	-7.3	-	-
Foreign Trade	Export Growth Rate	<b>19.0</b>	21.4	9.0	3.0	-1.7	-5.6	-8.7	-6.2	<b>-1.8</b>	-
Employment/ Prices	Unemployment Rate	<b>3.4</b>	3.1	2.9	3.8	3.3	-	3.1	3.0	-	-
	Consumer Price	<b>4.0</b>	4.3	4.0	3.0	2.4	1.6	1.5	1.2	<b>2.0</b>	-
Finance	KOSPI	-	1,770	1,826	2,014	1,854	1,996	1,882	1,905	<b>1,996</b>	<b>1,996</b>
	KRW/USD	-	1,178	1,152	1,133	1,145	1,111	1,131	1,135	<b>1,111</b>	<b>1,113</b>
	Corporate Bond (BBB-)	<b>10.38</b>	10.31	10.12	10.05	9.69	8.69	9.18	8.79	<b>8.69</b>	<b>8.64</b>

Sources: Bank of Korea, National Office of Statistics, Foreign Trade Association

## □ Acute Downturn of Domestic Economy and Counter-Measures

*Korean economy shows a sharp downturn in domestic market as well as in export market.*

Domestic consumer demand, construction, and facility investment continued to shrink. The growth rate of consumer demand in the second quarter of 2012 remained at 1.1% compared with the figures of the same quarter of 2011, remaining a sluggish increase in the range of 1% for the three consecutive quarters due to the burden of repaying the principal and interest accrued therefrom for the accumulated household debt. Construction investment fell to 2.1% in the second quarter of 2012 due to the slack private sector construction business and shrinking public sector investment, and facility investment also dropped to 8.6% in the first quarter followed by another setback of 3.5% in the second quarter due to the sharp fall of machinery investment.

The growth rate of export and import volume plummeted, although the statistics shows the trade surplus of US\$15.6 billion for the period of January to August 2012, indicating "recession trade surplus". Export decreased to 1.5% and import to 0.2% for the same period. The increase rate of export recorded -8.7% in July and -6.2% in August, while import marked -9.7% in July, a negative increase of six months in a row, bringing down the economic growth rate of Korea to 2.3% in the second quarter compared with that of the same quarter of 2011, and to 0.3% compared with the figure of the first quarter of 2012.

*The insufficient recovery of the US economy, continuing European economic recession, and the slowing growth rate of China and other emerging countries continue to deepen the global economic depression.*

The depressing employment market, the possibility of the fiscal cliff phenomenon and other issues of uncertainty seem to be obstacles to the US economy. The economic growth rate of the US in the second quarter of 2012 stayed at 1.7%, and the unemployment rate fell to 8.3% in July and 8.1% in August. However, the population of not economically active people including those who have given up job-seeking increased. The sequestration will be enforced unless the US makes a plan in November 2012 and enacts relevant law by December 2012 to reduce the budget deficit by US\$ 1.2 trillion over the period of 2013 to 2022. European economy will suffer negative economic growth in the second half of 2012 as the financial crisis prolongs. The European economic growth rate marked 0.0% in the first quarter of 2012, and -0.2% in the second. Retail sales continued to be slack with high unemployment rate of 11% in June and July. The unstable Spanish 10-year government bond is causing European financial crisis to persist. China's economic growth rate is continuing to be down due to the falling growth rate of export and retail sales; the growth rate in the second quarter of 2012 marked 7.6%, showing a downturn for the sixth consecutive quarter since marking at 9.8% in the fourth quarter of 2010. The growth rate of export volume significantly dropped to 1.0% in July and 2.8% in August, and industrial production also fell to 8.9% in August, while the slow-falling retail sales stayed at 13.2% in August. The composite leading index of OECD major countries continued to fall, making the prospect of major economies' business recovery uncertain.

*Korean economic environment is weakening due to slow-moving consumption and investment and deteriorating economic sentiment. The financial maneuvering room of the government is also running out.*

The falling asset price due to the increasing burden of repaying capital and interest for household debt and slack house construction business left little room for consumption. The household debt as of the end of second quarter of 2012 increased to KRW 922 trillion, a rise of KRW 11 trillion compared with that of the previous quarter. The growth rate of durable goods sales fell to 3.6% in the first quarter and 2.2% in the second, reflecting the deepening depression of consumption. The facility investment index as well as the requirement for facility investment of manufacturing industry turned to negative growth. Domestic orders for machinery and the import volume of capital goods are also on the decrease. The increase rate of construction stays at 1%. The growth rate of construction orders rose in July, but not strong enough for the construction business recovery, considering the base effect compared with that of the same quarter of 2011. Consumer sentiment index fell to 99 in August from 105 in May, a significant decrease, showing a sign of worsening consumer sentiment. ISM manufacturing index plummeted to 80.1% in August from 104.7% in May, but rose to 97.5 in September, still below the critical point of 100. The budget cash flow rate for the first half of 2012 marked 60.9%, and the prospect for the second half is not much better.



*The economic growth rate of Korea is likely to stay below 3% with the worsening economic environment home and abroad.*

The economic growth base in the second half of 2012 will be weakened with low possibility of domestic and global economic situation improving. To achieve 3% of annual economic growth rate, the quarterly growth rate for the remaining two quarters should be minimum 1.4% higher than those of the previous quarters, which means the growth rate in the third quarter and the fourth should be 2.9% and 4.0% respectively. It looks almost out of reach to achieve these rates, considering the slow business in the third quarter. The annual growth rate will stay at around 2.7%, even if the growth rate of the third and the fourth quarter is 1% higher than the previous quarter.

*To achieve annual growth rate of 3% requires emergency financial commitment, emergency financial support to businesses, improvement of investment sentiment, removal of unstable household sentiment of working class, price level stability, promotion of exporting business, presenting middle and long term vision for economic growth, and confidence recovery of the nation.*

## □ Next Government's Task of Setting Policies for N. Korea.

Hyundai Research Institute conducted a survey in the form of questionnaires on a group of experts on N. Korea(August 8th–20th) with maximum sampling error of  $\pm 3.08$  and confidence level of 95%. The survey result shows that all respondents suggested the next government should honor the existing agreements made between the South and the North, and implement forward-looking policies for N. Korea. They also requested that the next government should try to ease the tension and resolve the pending issues between the South and the North in a future-focused fashion by holding high-level meeting or summit meeting or by resuming the suspended sight-seeing tours to N. Korea and expanding the Gaeseong Industrial Complex(GIC).

*The next government's policies for N. Korea should be either totally different from the present government's or flexibly revised.*

**(One voice for the flexible policies for N. Korea)** Overall change of policies for N. Korea was called for by 50% of the respondents, and flexible change of the policies by the remaining 50%. Respondents of conservative inclination voiced for flexible change(90.3%), and the progressive respondents for overall change(73.7%). The great majority of respondents(87.5%) were for respecting existing agreements made between the South and the North regardless of the change of government. Progressive respondents voiced 'yes' for 'absolutely agree for the overall change'(71.1%), whereas only 12.9% of conservative respondents were for the same.

< Next government policy frame for N. Korea >

Policy frame for N. Korea	Total	Political inclination		
		Con.	Mid.	Pro.
Overall Change	50.0%	9.7%	58.1%	73.7%
Flexible Change	50.0%	90.3%	41.9%	26.3%
Continuing present policy	0.0%	0.0%	0.0%	0.0%

< Respecting existing agreements between the South and the North >

level of agreement	Total	Political inclination		
		Con.	Mid.	Pro.
Absolutely agree	42.0%	12.9%	37.2%	71.1%
Agree	45.5%	54.8%	55.8%	26.3%
Do not agree	8.9%	22.6%	7.0%	0.0%
Do not agree at all	3.6%	9.7%	0.0%	2.6%

***The South-North high-level meeting and reactivation of economic cooperation between the South and the North recommended as priority policy to be adopted by the next government.***

**Politics and Diplomacy:** Half of the responding experts called for the South-North high-level or summit meeting to ease the tension surrounding Korean peninsula and build a new South-North relationship, which suggest that the resumption of dialogue between the two authorities is the most urgent task for the next government to ease the tension and make further progress in the relation between the South and the North.

**Economy:** The participants in the survey showed the highest responding rate to the question of ‘Economic cooperation including resumption of sight-seeing tour to N. Korea and expanding Gaeseong Industrial Complex’(38.4%), which seems to reflect the view of the respondents that the two projects mentioned above are most important and the dialogue between the two authorities should begin at the earliest possible to build trust between the two.

**Social and Cultural area:** The participants responded that expanding the social and cultural exchange’(35.7%), ‘Reunion of the separated family members’(32.1%), and ‘expanding humanitarian aid to the North’(31.3%) should be seriously and realistically dealt with.

< Priority policy recommended to the next government >

Politics, Diplomacy	Total	Economy	Total	Social and cultural exchange	Total
Promoting high-level or summit meeting	50.0%	Accelerating Economic cooperation including sight-seeing tour to the North and Gaeseong Industrial Complex	38.4%	Expanding social & cultural exchange between the South and the North(culture, arts, academy, and sports)	35.7 %
Discussing peace treaty on Korean peninsula	20.5%	Legislation for economic cooperation and support for the reform and opening of N. Korea	29.5%	Promoting reunion of separated family members	32.1 %
Discussing on weapons of mass destruction including nuclear weapons & missiles	17.9%	Promoting the South-North economic union	17.0%	Expanding humanitarian aid to the North	31.3 %
Promoting balanced diplomacy in Korea-US, & Korea-China relations	9.8%	Supporting revival of N. Korean economy including expansion of SOC investment	8.9%	Promoting co-excavation of cultural properties and historic relics	0.9%
Promoting scheduled military talks between South & North	1.8%	Others	7.3%		

*The next government should deal with the pending issues with the North in a forward-looking manner.*

**(Task of the next government to deal with the outstanding issues involving N. Korea)**

Regarding the question of whether S. Korea should lift the May 24 ban imposed on N. Korea and resume the suspended economic exchange with N. Korea, 9 out of 10 respondents voiced for ‘yes’(56.3% ± for ‘absolutely agree’, 32.1% for ‘agree’). The great majority also supported the idea of maintaining or expanding Gaeseong Industrial Complex(98.2%) and of resuming the sight-seeing tour to Diamond mountain and Gaeseong(91.1%). For the question of whether S. Korea should strengthen cooperation with neighboring countries to denuclearize N. Korea, conservative-minded respondents said ‘yes’(74.2% for ‘absolutely agree’), much higher support than the respondents in the middle of the road or progressive ones. As to the question of humanitarian aid and exchange programs between the South and the North, 98.2% said ‘yes’, an overwhelming support regardless of the respondents’ political inclination.

**<Task of the next government to deal with the pending issues involving N. Korea>**

	Absolutely agree	Agree	Not agree	Not agree at all
Lift the May 24 ban to resume suspended exchange programs	56.3%	32.1%	9.8%	1.8%
Maintaining and expanding the Gaeseong Industrial Complex	74.1%	24.1%	1.8%	0.0%
Resuming sight-seeing tours to Diamond mountain and Gaeseong	67.0%	24.1%	7.1%	1.8%
Expanding humanitarian aid and exchange programs	65.2%	33.0%	1.8%	0.0%
Cooperating with neighboring countries for denuclearization of N. Korea	59.8%	38.4%	1.8%	0.0%

### *Suggestions*

Expert respondents, regardless of their political inclination, called for a change of policy for N. Korea, particularly in the area of economic cooperation including sight seeing projects and Gaeseong Industrial Complex. Politically, respondents believe that S. Korea should push on a summit meeting. Expert participants appear to believe that the next government should push forward economic cooperation between the South and the North regardless of change of government based on the following **three principles**:

1. **The principle of separating economy from politics** should be kept on and a system set-up to ensure the continuity of economic cooperation between the two Koreas regardless of political or military issues.
2. **The principle of separating private sector from the authority** should be in place to facilitate private sector's exchange programs even when dialogue between the two government authorities is suspended.
3. **The principle of separating humanitarian aid from commercial transaction** should be enforced to build up and sustain mutual trust.

## [Annex] Domestic and Global Economic Indices

### Domestic/Global Growth Rate

Category	2010					2011					2012
	Annual	1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Annual(E)
US	3.0	3.9	3.7	2.5	2.3	1.7	0.4	1.3	1.8	3.0	2.2
Euro Region	1.9	0.4	1.0	0.4	0.3	1.4	0.8	0.2	0.1	-0.3	-0.4
Japan	4.4	6.1	5.2	2.3	-0.6	-0.9	-6.8	-1.5	7.0	-2.3	2.2
China	10.3	11.9	11.1	10.6	9.8	9.2	9.7	9.5	9.1	8.9	7.8

Note: 1) IMF figures of October 2012 for 2012 global projections

2) Annual rates were compared with those of previous term for the US and Japan, with the rates of the previous term for Euro region, and with the same term in the previous year for China and Korea.

### International Finance Index

Category		End of 2010	2011		2012		
			End of June	End of Dec	Oct 8	Oct 9	Compared with previous day
Overseas	Ten-year Treasury Bond Interest(%)	3.30	3.16	1.88	1.69	1.71	0.02 %p
	JPY/USD	81.19	80.66	77.66	78.35	78.25	-0.10 ¥
	USD/EURO	1.3350	1.4492	1.2955	1.2927	1.2869	-0.0058 \$
	DJIA(p)	11,578	12,414	12,218	13,584	13,474	-110 p
	Nikkei(p)	10,229	9,817	8,455	8,822	8,770	-52 p
Domestic	Three-year Government Bond Interest Rate(%)	3.38	3.76	3.34	2.76	2.76	0.00 %p
	KRW/USD(KRW)	1,134.8	1,067.7	1,151.8	1,112.0	1,110.7	-1.3 KRW
	KOSPI(p)	2,051.0	2,100.7	1,825.7	1,981.9	1,979.0	-2.9 p

### International Raw Materials Price Index

Category		End of 2010	2011		2012		
			End of June	End of Dec	Oct 8	Oct 9	Compared with previous day
International Oil Prices	WTI	91.40	95.18	99.22	89.54	92.34	2.80 \$
	Dubai	88.80	106.75	104.89	107.73	108.98	1.25 \$
CRB Future Indices		332.80	338.05	305.30	306.17	309.12	2.95 p

Note: The CRB index is calculated by giving the same weight to the prices of a total of 19 major commodities including grains, crude oil, industrial raw materials, and precious metals. The index is widely acknowledged as an international standard for the price of raw materials.



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