

HRI

Monthly Economic Review

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I. Recent Economic Trends

□ Recent Global & Domestic Economic Trends

Major Economies

The economic indices of the US and Europe turned negative, showing a sluggish economy, while China is continuing its recovery phase with improving domestic demands and exports.

The US industrial production dropped in October to 0.4% compared with that of the previous month, and the retail sales also fell for the first time in four months due to the havoc caused by hurricane Sandy, particularly the sales of motor cars dropped to 1.5%.

The unemployment rate of Europe rose to 11.7% in October, and consumer sentiment deteriorated with slow economic growth. Retail sales showed negative growth of -0.2% in September. Germany's retail sales, particularly, fell to 2.8% in October compared with the previous month, the biggest fall in four years. Europe's industrial production also dropped to 2.5% in September with the industrial production of Portugal and Ireland rapidly falling.

Japan's retail sales was dropped to 1.2% in October, while industrial production rose to 1.8%, the highest rise in nine months.

China's industrial production and retail sales increased in October to 9.6% and 14.5% respectively, and exports also rose to 11.6%.

Global Financial Market

The DJIA showed downturn due to the Fiscal Cliff negotiations proceeding with difficulty, while European stock markets rose within narrow limits thanks to the agreement for the relief loan condition for Greece.

The DJIA showed downturn due to the poor economic indices and the fiscal cliff negotiations proceeding with difficulty, while European stock markets rose within narrow limits thanks to the agreement for the relief loan condition for Greece. The Nikkei, however, jumped with expectation for additional stimulation policies based on the rising possibility of change of government. The Chinese stock market fell due to the shrinking investment sentiment as a result of the absence of government economic policy announcement.

The JPY/USD exchange rate dropped in November by a small margin compared with the previous month due to the quantitative easing policy, while the CNY/USD exchange rate rose within limits in November.

< Economic indices of major countries >

(unit : %)

(unit : p, yen, euro, yuan)

Economic Sectors		2011	2012			
		Annual	Jul	Aug	Sep	Oct
US	Industrial Production	4.1	0.7	-1.1	0.2	-0.4
	Retail Sales	8.0	0.7	1.0	1.3	-0.3
EU	Industrial Production	3.5	0.5	0.9	-2.5	-
	Retail Sales	-0.6	-0.1	0.2	-0.2	-
Japan	Industrial Production	-3.5	-1.0	-1.6	-4.1	1.8
	Retail Sales	-1.2	-0.7	1.7	0.4	-1.2
China	Industrial Production	13.9	9.2	8.9	9.2	9.6
	Retail Sales	17.1	13.1	13.2	14.2	14.5

Economic Sectors		2011	2012			
		Annual	Sep	Oct	Nov	Dec
US	DJIA	12,218	13,437	13,096	13,026	12,966
EU	DAX	5,898	7,216	7,261	7,406	7,435
	EUR/USD	0.772	0.775	0.771	0.771	0.769
Japan	NIKEI	8,455	8,870	8,928	9,446	9,458
	YEN/USD	77.66	77.62	79.03	82.14	82.40
China	SSE	2,199	2,056	2,069	1,980	1,960
	CNY/USD	6.3190	6.3023	6.2647	6.2282	6.2267

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

Sources: Bloomberg
note: SSE denotes SSE Composite Index

Korean Economy

The investment sector in the real economy continued to show downturn while exports kept on recovery phase in November.

Semi-durable goods such as clothing and others fell to 1.0% compared with the same month of 2011 while durables like cars, home electric appliances and others rose to 8.5%, and nondurables such as vehicle fuels rose to 0.2%, showing 2.0% increase in retail sales. Investment in precision instruments and transportation equipment rose, but fell in general machinery, making the total facility investment down to 0.7%. Construction declined in October to 11.5%, an increasing rate of reduction.

Exports marked US\$47.8 billion in November, a 3.9% increase compared with that of the same month of 2011, while imports US\$43.3 billion, a 0.7% increase, recording US\$4.5 billion trade surplus. Both exports as well as imports are on the upturn, generating a trade surplus for the tenth consecutive month. Exports are on the increase thanks to the rising exports to ASEAN, China and other countries.

The unemployment rate was kept low due to the increasing number of people finding jobs in manufacturing industry. The inflation rate in November showed 1.6% rise compared with that of the same month of 2011, due to stable public utility and personal service rates and falling prices of agricultural and petroleum products thanks to cheapening international oil price and the improvement of climate conditions.

Since the Business Survey Index (BSI) recorded 97.8 in October, 2012, it continued to decline to 89.7 in November and 78.6 in December. Cycle variation value, composite leading index, marked 99.1, 0.3p down from the previous month due to the index of the shipments for domestic demand for machinery, and orders for construction falling.

The KRW/USD exchange rate was up in November, and the corporate bond yield rates(BBB-) rose by a small margin in November.

KOSPI rose thanks to the improving economic indices of major economies, and the agreement for relief loan for Greece. The KRW/USD exchange rate continued to strengthen due to the continuing foreign investment and the current account surplus. The corporate bond yield rates (BBB-) rose by a small margin to 8.74% in November.

< Korea Major Economic Indices >

(unit : p, %)

Economic Sectors		2011			2012						
		Annual	3/4	4/4	1/4	2/4	3/4	Sep	Oct	Nov	Dec
Domestic Market	Retail Sales	4.3	4.7	1.9	2.0	1.0	1.6	2.3	2.0	-	-
	Facility Investment Index	0.7	-3.1	-4.7	10.2	-0.2	-7.0	-8.1	-0.7	-	-
	Construction	-6.7	-8.4	-0.5	-3.7	-10.8	-4.8	-5.2	-11.5	-	-
Foreign Trade	Export Growth Rate	19.0	21.4	9.0	3.0	-1.7	-5.6	-2.0	1.1	3.9	-
Employment/ Prices	Unemployment Rate	3.4	3.1	2.9	3.8	3.3	3.0	2.9	2.8	-	-
	Consumer Price	4.0	4.3	4.0	3.0	2.4	1.6	2.0	2.1	1.6	-
Finance	KOSPI	-	1,770	1,826	2,014	1,854	1,996	1,996	1,912	1,933	1,940
	KRW/USD	-	1,178	1,152	1,133	1,145	1,111	1,111	1,091	1,083	1,083
	Corporate Bond (BBB-)	10.38	10.31	10.12	10.05	9.69	8.69	8.67	8.67	8.74	8.74

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

II. Economic Issues Facing Korea

□ Diagnosis of the US Economy for 2013: Expecting speedy recovery in the second half

The US economic indices show mixed trends.

The US economy shows no clear economic tendency. The unemployment rate stayed at 7.8% in September and 7.9% in October, prompting the expectation for the improvement of employment market growth, and the third quarter growth rate of industrial production turned positive(0.4%) compared with the previous quarter. Retail sales dropped by 0.3% in October compared with the previous month, but increased by 3.8% compared with October of 2011. In contrast, private investment and net exports are struggling; the contribution ratio of private investment towards GDP growth rate was only 3.5% in the third quarter, showing no sign of improvement, and the contribution ratio of net exports towards GDP growth rate, which tends to be low, turned negative(-9.0%) in the third quarter.

Considering the characteristics of US economy with consumption taking so much weight, we should examine the improvement prospects of consumption, property market, employment market, and government expenditure to forecast whether the 2013 US economy will recover or not.

The increase in consumption and improvement of consumption environment are the major forces for the economic recovery, considering the characteristic of US economy with consumption taking as much weight as 70% in the contribution ratio to economic growth.

Similarly, revitalization of the housing market is one of the leading factors directly affecting the trend of US consumption, as residential housing takes most weight in individuals' assets. Unemployment rate, an element of lagging composite index, indicates the vitality level of the employment market. However, the most important factor for the recovery of the US economy in 2013 seems to be whether or not the fiscal cliff can be avoided. A cautious optimism for the recovery of the US economy in 2013 can be forecast when various economic aspects involving the US economy are closely checked: ① **The improving consumption environment.** Real income is on the increase and disposable income per capita remains high. The real disposable income per capita hit the lowest point of US\$32,345 in the fourth quarter of 2011 and then is on the increase to mark US\$32,779, the highest in the third quarter of 2012 since 2010. The growth rate of real consumption in the third quarter of 2012 rose to 2.0%, an increase of 0.5%p compared with the previous quarter. Additionally, the Michigan consumer sentiment index showed a sharp rise after June 2012, marking 84.9 in November, the highest since July, 2007. Based on this trend, the consumption is expected to continue to rise for the time being. ② **The housing market enters recovery phase having passed the trough.** The house price is on the rise thanks to the reduction of existing housing stocks and the housing affordability index. The Housing Market Index (HMI), a leading composite index, continued to rise for the sixth consecutive month, indicating the house price would be on the increase for the time being. The number of new housing building and increasing number of issuance of building permits will result in increasing number of housing sold. The sales of existing houses, which represents the demand for housing also rose compared with the same month of 2011. The increase of house supply and the increase of house demand reflects the recovering housing market. ③ **The improvement of employment market.** The unemployment rate remains at 7+% due to an increase of people finding jobs. The structure of employment is being improved with the reduction of the long-term unemployed and the reduction of the unemployment period. The number of people unemployed for 27 weeks or more, which shows the ratio of long-term

unemployed people out of the total number of the unemployed fell by 1.8%p in 2012 to average 41.5% down from average 43.3% in 2010. The employment index of Institute for Supply Management (ISM) is also on the increase. The employment index of ISM in September marked 54.7, higher than 52.0 in July and 51.6 in August. ④ **The clearance of uncertainty.** While the policy uncertainty related to the fiscal cliff is believed to have affected the economy, Obama's re-election as the president of the US will bring a positive effect to the US economy. The Grand Bargain will soon start to deal with various issues including reduction of government expenditure, tax plan, and energy. Although some issues such as exhaust of government debt limit still exist until March 2013 when the provisional budget expires, the policy uncertainty afterwards is projected to be cleared to some extent.

There is a sign for economic virtuous circle where the recovery of housing market and employment market lead to an increase of consumption, with the economic recovery of the US economy being more visible from the second half of 2013.

The recovery of the US economy will bring a positive effect to the global economy, although every preparation should be made against some possible trade and currency conflicts which could arise from the sustained quantitative easing policy and possible emergences of industrial protectionism in the course of recovery of the US economy. Korea should first prepare for the free trade policy adopted by the US in the form of the Trans-Pacific Partnership on top of the free trade agreement with Korea. Korea also needs to prepare against direct and indirect trade conflicts which could occur in the course of the US expanding influence on Asian market with the catch phrase of 'Pivot to Asia'. Finally, Korea should be ready for drastic currency exchange fluctuations and appreciation of KRW due to the sustained quantitative easing, and adopt policies to stabilize financial market.

□ Chinese Economy: Increasing Expectation for Recovery

With expectation for achieving the projected economic growth rate, Korea should respond appropriately to the changing Chinese economy. Chinese economy, with rising possibility of economic recovery both home and abroad, is set to turn for recovery from the fourth quarter of 2012 thanks to the growing expectation for economic boost with the advent of Xi Jinping government.

The direction of Chinese economy in 2013 can be looked at in five areas: consumption, investment, exports, financial easing, and economic boost.

① **The growing possibility of consumption recovery:** Recently, consumption marginally recovered thanks to the increase of employment, rising wages, and consumer price stability. The growth rate of retail sales in October rose by 14.5% compared with the same quarter of 2011, showing a continuing upturn for three consecutive months, which helped consumer sentiment improve.

② **Weakening sign of investment slowdown:** Not only did the slowdown tendency of the investment in construction and facility weaken, but also the Purchasing Managers' Index (PMI) rallied in October, and the investment sentiment is recovering. The growth rate of the investment in fixed assets rose in October by 20.7% compared with the same quarter of 2011, an increase for two months in a row, and the PMI also marked 50.2p, the first above 50p since 49.2p in August.

③ **The recovery of exports on the way:** Although the exports business was subdued in the first half of 2012 due to the sustained economic slowdown, the export growth rate rose to 11.5% in October compared with 9.9% in September. The global economy, though

marginal, is projected to improve in 2013, and Chinese export business will continue to recover. According to IMF(2012), the economic growth rate of the US and Japan will be 2.2% respectively, a marginal recovery compared with 2011, and the US is anticipated to grow in 2013 in the similar pace to this year's. Euro Zone, although not entirely clear from potential threats, is expected to achieve marginal recovery in economic growth rate.

④ **Easy money policy:** As a result of the quantitative easing policies of lowering interest rate and cash reserve ratio, the liquidity rose, and the People's Bank of China is taking measures to expand liquidity further. The Bank lowered cash reserve ratio by 0.5%p in February and May respectively, and lending/deposit rate also fell by 0.5%p and 0.56%p in June and July. The M2 money supply, which denotes the level of financial liquidity rose in September to mark 14.8%, a continuing increase since May. The People's Bank of China supplied approximately CNY 2 trillion to the market from May to October through Reserve Purchase type of open market operation, substantially improving the liquidity.

⑤ **Rising expectation for the effect of full-scale economy-stimulation and the new government's measures for economic boost:** The size of China's provincial business stimulation plan is thought to be approximately CHY 2 trillion as of the second half of this year, which is expected to lead China's GDP to rise. Chinese government announced in June that it would give subsidy for the energy-saving products such as household electric appliances, small cars and others, and again in September policies on investment in construction of infrastructure including underground railways, roads, and harbors. For the provincial economic stimulation plan involving Canton, Tienjin, Chongqing, CHY 2 trillion is to be invested by the end of second half of this year, raising the expectation for economic recovery of China. Furthermore, next Chinese government's economic policy is known to be market-friendly, and seeking stabilized and sustainable economic growth.

Having bottomed-out, Chinese economy is expected to achieve a growth rate of 8%+ in the first half of 2013. Korean economy needs to take appropriate measure to cope with changing Chinese economy:

- ① Korea should set up policies to adapt to the gradual recovery of Chinese economy. It is necessary to excavate and cultivate promising small and medium sizes businesses with competitive edge for export promotion rather than simply relying on multi-national companies.
- ② In the long run, strategy for diversification of export items should be prepared in line with Chinese domestic-demand-driven economic growth policies, and Korea should try to shift export items from traditional intermediate goods to consumption goods targeting Chinese domestic demand.
- ③ As Chinese government is employing economic policies to stimulate economy throughout the nation until 2015, it is recommended that Korea adapt policies tailored to meet the existing Chinese investment strategy for each province. The 12th Five-Year Economic Development Plan which was launched in 2011 is set to be accelerated from next year, focusing on mid-western and north-eastern China.
- ④ It is recommended that Korea make effort to explore diversified markets in emerging countries including Middle East, Russia, Central Asia, and South America.

III. The North Korean Issues

□ The Mt. Keumgang Tourism—Starting Point to Improve South-North Korea Relationship

Current Standing of the Keumgang Mountain Tour Project

The Mt. Keumgang tour, which was launched in 1998 with the Keumgang-ho, the first cruise-ship for the Keumgang Mountain tour sailing for the North, now marks 14th anniversary of its launch on November 18th. However, the tour has been suspended for four years since July, 2008 when the number of tourists visiting Keumgang mountains was about to reach as many as 400,000 per year. The total number of tourists who visited Mt.Keumgang since 1998 up until just before the tour suspended aggregates 1.96 million, and the South-North Korean relationship rapidly cooled down since. Therefore, the resumption of the Mt.Keumgang Tour can be a starting point to improve the relationship between two Koreas.

The Necessity for the Resumption of the Mt. Keumgang Tour

Increasing demand from public: According to the survey conducted by HRI in June, 2012 on 1,012 men and women of 19 years of ages and above, 67.8% of respondents said ‘yes’ to the resumption of the Mt. Keumngag Tour, which means 7 out of 10 are for it.

< Necessity for resumption of Mt. Keumgang Tour >

Is the resumption of the Keumgang Mountains Tour necessary?	Total	Age Groups			
		20s	30s	40s	50s
Yes	67.8%	64.3%	66.5%	70.2%	70.2%
No	32.2%	66.5%	33.5%	29.8%	29.8%

Resources: Hyundai Research Institute, 『Improving the strained South-North Korean relationship and the role of the Keumgang Mountains Tour』, July 2012

Easing of the political and military conflict: The resumption of the Mt. Keumgang Tour, a symbol of the South-North Korean reconciliation, cooperation, and mutually beneficial economic collaboration, can help ease the tension arising from the political and military conflicts and reinstate trust between two Koreas.

Regional economic invigoration: The resumption of the Tour would help invigorate national as well as regional economy, improve tourism balance, and expand investment for unification infrastructure. It is estimated that the suspension of the Tour for the past four and half years has brought an economic loss of US\$1.55 billion in total including the loss Gangwon Province suffered because of the suspended Tour. This amount is an estimate of the direct loss alone excluding any value added, and production and employment that would have been induced from the Tour.

< Estimated economic loss due to the suspension of the Mt. Keumgang Tour >

(Units : 10,000 tourists, US\$1 million)

	Number of tourists	Loss to the national economy	Loss to the regional economy	Loss to the tourism industry	Total
July 2008-	20.0	64.6	6.2	47.3	118.1
2009	43.0	140.2	13.3	102.8	256.3
2010	53.0	174.5	16.4	128.1	319
2011	66.0	219.4	20.4	161.2	401
2012. 1~11	74.25	249.5	22.9	183.5	455.9
Total	256.25	848.2	79.2	622.9	1,550.3

Note: The project of tourist number is based on the date of Hyundai Asan.

Reactivation of personnel and cultural exchange: The reunion of the separated families can be reactivated with normalized management of the Mt. Geumgang Meeting Hall, and the sense of one-Korea can be further promoted by resuming exchange programs involving sports, culture and peace-camp events for students of South and North Korea.

Case studies of Taiwan's Tourist exchanges with China

China and Taiwan, despite continuing political tension between the two countries, have steadily made progress in the area of tourist exchange in quantity as well as in quality through active collaboration of semi-governmental organizations between the two. The first scheduled tour cruise ship was commissioned in service, and the tour exchange between China and Taiwan progressed in earnest even at the time of mounting military tension in 2002 caused by China's missile deployment in the Taiwan Straits. Similarly, the first direct flight between China and Taiwan was put in service in 2005 amid continuing political conflict, and the tourist exchange project further progressed when Taiwan accepted China's proposal to allow Chinese tourists travelling direct from China despite the ever-present political and military tension between the two countries. Following the agreement to promote tourism, both governments commissioned nongovernmental organizations, the Straits Exchange Foundation of Taiwan and the Association for Relations across the Taiwan Straits of China, to carry out what had been agreed through working level discussions and negotiations.

Suggestion

The Mt. Keumgang Tour is a project which can contribute with a concept of peace-making through stable management of Korean peninsula and enhancement of national sentiment for unification, and with an economic concept of stimulating regional economy and promoting the national brand. It is important to resume the Tour through dialogues and negotiations as it bears a symbolic meaning of starting point for South-North reconciliation and economic cooperation.

[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
Korea	6.3	8.7	7.6	4.5	4.9	3.6	4.2	3.5	3.6	3.3	2.5

Note: 1) IMF figures of October 2012 for 2012 global projections, and HRI figures for Korea projection.

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		Compared with previous day
			End of June	End of Dec	Dec 5	Dec 6	
Overseas	Ten-year Treasury Bond Interest(%)	3.30	3.16	1.88	1.59	1.59	0.00 %p
	JPY/USD	81.19	80.66	77.66	82.43	82.40	-0.03 ¥
	USD/EURO	1.3350	1.4492	1.2955	1.3072	1.2961	-0.0111 \$
	DJIA(p)	11,578	12,414	12,218	13,034	13,074	40 p
	Nikkei(p)	10,229	9,817	8,455	9,469	9,545	76 p
Domestic	Three-year Government Bond Interest Rate(%)	3.38	3.76	3.34	2.86	2.83	-0.03 %p
	KRW/USD(KRW)	1,134.8	1,067.7	1,151.8	1,081.5	1,083.0	1.5 KRW
	KOSPI(p)	2,051.0	2,100.7	1,825.7	1,947.0	1,949.6	2.6 p

International Raw Materials Price Index

Category		End of 2010	2011		2012		Compared with previous day
			End of June	End of Dec	Dec 5	Dec 6	
International Oil Prices	WTI	91.40	95.18	99.22	87.88	86.26	-1.62 \$
	Dubai	88.80	106.75	104.89	107.47	106.06	-1.41 \$
CRB Future Indices		332.80	338.05	305.30	297.23	295.91	-1.32 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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