

Monthly Economic Review

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I . Recent Global & Domestic Economic Trends

Major Economies

The US economy shows a slow recovery, but the growth rate of emerging countries has softened and EU still remains in economic recession

Although the ISM manufacturing index stayed at 53.5, a moderate fall compared with the previous month's figure, the US still shows a healthy state of economy staying well above the critical line 50. The unemployment rate stayed more or less the same: 8.1% in April and 8.2% in May. House prices are steadily up for the last two months encouraging an expectation for the recovery of real estate market to gain pace.

With the possibility of Greece leaving the Euro Zone, concern over the potential insolvency of Spanish banks, and oncoming elections in major countries, EU's financial uncertainty is continuing and expanding. The unemployment rate of EU marked 11% in April, the highest since 1995, and the manufacturing index fell to 45.2 in May, well below the critical line 50.

Japan's economy, despite its export slump, marked 1% of GDP growth in the first quarter of 2012 compared with the previous quarter. However, the growth rate of the industrial production and retail sales of April marked 0.2% and 5.8% respectively, a moderate slow-down compared with previous month.

China's economic growth rate has slowed down with the weakening growth rate of industrial production and retail sales. The export growth rate recorded only 4.9% in April.

Global Financial Market

EU's deepening financial crisis brings negative influence on global share price and currency exchange rate in May.

The DJIA fell in May by 6.9% compared with previous month due to the growing concern over EU's financial crisis and the possible insolvency of major banks of the US, but rose in June by 1.3% with the extension of short-term liquidity supply by the ECB and China's reduction of the base rate. The DAX index of Germany was down by 7.4 % in May and another 2.0% in June due to the business slump in the Euro Zone. Nikkei index also fell in May by 10.3% and 1.0% in June with growing concern over the deteriorating business performance.

China's SSE composite index was down in May by 1.0% with the worsening manufacturing index and the concern over the possible reduction of export volume to Europe, and fell again in June by 2.8%.

The JPY/USD exchange rate appreciated in May by 1.6% from the April closing rate due to the flight to quality (preference for the riskless asset?), but depreciated in June by 0.7% with the concern over strong yen expressed by the Japanese government authorities in charge of foreign currency control.

EUR/USD exchange rate depreciated by 7.2% in May with the possibility of EU's financial crisis spreading, but appreciated by 2.2% in June, expecting the financial crisis would ease.

The CNY/USD exchange rate was down by 0.8% in May due to the negative forecast of business slump, and fell again by 0.2% in June.

Economic indices of major countries

(Unit: %)

(Unit: p, yen, euro, yian)

Economic Sectors		2011	2012			
		Annual	Jan	Feb	Mar	Apr
US	Industrial Production	4.1	0.6	0.4	0.6	1.1
	Retail Sales	7.9	0.6	1.0	0.7	0.1
EU	Industrial Production	3.5	0.0	0.8	-0.3	-
	Retail Sales	-0.6	1.1	-0.2	0.3	-
Japan	Industrial Production	-3.5	0.9	-1.6	1.3	0.2
	Retail Sales	-1.2	1.8	3.4	10.3	5.8
China	Industrial Production	13.7	-	11.4	11.9	9.3
	Retail Sales	17.1	-	14.7	15.2	14.1

Economic Sectors		2011	2012			
		Annual	Mar	Apr	May	Jun
US	DJIA	12,218	13,212	13,214	12,393	12,554
EU	DAX	5,898	6,947	6,761	6,264	6,131
	EUR/USD	0.772	0.752	0.755	0.809	0.791
Japan	NIKEI	8,455	10,084	9,521	8,543	8,625
	YEN/USD	77.66	82.41	80.35	79.10	79.62
China	SSE composite Index	2,199	2,263	2,396	2,372	2,306
	CNY/USD	6.3190	6.3058	6.3099	6.3578	6.3702

Source: Reuters

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

Korean Economy

Korean domestic market is not making solid progress, and the fluctuation of financial market has widened with no good signs of business recovery for the time being.

The growth rates of retail sales and facility investment index shrank in a large scale, and construction continued to show negative growth with the poor performance in building and civil engineering sectors.

The trade balance continued to remain in surplus although exports decreased by 0.4% in May compared with the same month of 2011, as imports was also down by 1.2% in the same month.

The unemployment rate fell in May by 3.1% due to the rising number of people in their 20s and 50s being employed and increasing number of people employed in service industry thanks to the expanding demand of social service. The consumer price index rose in May by 2.5% with the prices of agro-fishery, livestock and other industrial products falling.

BSI in manufacturing rose to 84 in March, to 85 in April, and to 90 in May showing upturn for four consecutive months, but marked 86 in June. Composite leading index and cycle variation value marked 99.8 in April, still remaining below the critical line 100.

Share prices fell in May with the expanding political and economic uncertainty in Greece and Euro Zone, but showed upturn in June. KRW/USD exchange rate surged in May, but fell in June. Interest on corporate debentures also continued to show downward trend due to the flight to quality and investor preference for safe haven assets).

KOSPI fell in May as the Euro Zone's political and economic uncertainty increased, but rose back due to the decreased uncertainty of financial market with the bailout of Spain funded by international collaboration including EU and IMF, expectation for the solution to the Euro Zone crisis, and increased stock purchasing by foreigners.

The KRW/USD exchange rate soared to 1,180 in May due to the concern over Europe's financial crisis, but fell in June as the uncertainty of financial market decreased and stock

purchasing by foreigners increased. The corporate bond yield rates (BBB-) dropped by 0.25% p in May and 0.02%p in June due to the preference for riskless assets.

Korea's major economic indices

(Unit: p, %)

Economic Sectors		2011					2012				
		Annual	1/4	2/4	3/4	4/4	1/4	Mar	Apr	May	June
Domestic Market	Retail Sales	4.3	5.4	5.7	4.7	1.9	2.0	0.0	0.1	-	-
	Facility Investment Index	0.7	5.4	5.7	-3.1	-4.7	9.4	1.0	5.0	-	-
	Construction	-6.7	-12.6	-6.6	-8.4	-0.5	-3.7	-7.9	-7.5	-	-
Foreign Trade	Export Growth Rate	19.0	29.6	18.6	21.4	9.0	3.0	-1.4	-4.8	-0.4	-
Employment/Prices	Unemployment Rate	3.4	4.2	3.4	3.1	2.9	3.8	3.7	3.5	3.1	-
	Consumer Price	4.0	3.8	4.0	4.3	4.0	3.0	2.6	2.5	2.5	-
Finance	KOSPI	-	2,107	2,101	1,770	1,826	2,014	2,014	1,982	1,843	1,867
	KRW?USD	-	1,097	1,068	1,178	1,152	1,133	1,133	1,130	1,180	1,166
	Corporate Bond (BBB-)	-	10.58	10.38	10.24	10.01	10.06	10.06	9.79	9.54	9.52

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

II. Economic issues facing Korea

Nominal income of USD 20,000, Living standard of USD 30,000

- Korea's standard of living based on the real purchasing power

Continual rise of GDP per capita based on assessment of purchasing power

Nominal income-based Korea's GDP/capita dropped since the global financial crisis before it rose back to USD 22,778, ranking 34th in the world in 2011, still considerably below those of advanced countries. However, purchasing power-based GDP/capita was rapidly going up, marking USD 31,714 (25th in the world) in 2011, close to those of advanced countries including Japan and the UK. Here, we assess Korea's living standard in terms of food, clothing, shelter, welfare, and leisure by comparing the prices of necessities of life according to the OECD's statistics published in 2011, which shows prices of major necessities of life based on the purchasing power assessment of 2008.

Analysis of living standard based on purchasing power per item.

1. Clothing: The price index of clothing and footwear assessed on the basis of purchasing power is 10% lower than the average of OECD countries and higher than the US, but lower than the UK and Japan.
2. Food: Prices of food and beverage are 3% higher than the OECD average, higher than the US, while much lower than Japan. Price of grain is lower than the OECD average, but the prices of meat, milk, cheese, egg, fruits, and vegetables are higher. In particular, the prices of alcoholic and non-alcoholic beverage are 20 to 33% higher. However prices are as much as as 51% less than OECD average when it comes to the price of tobacco products
3. Shelter: The cost for housing, water, electricity and gas in Korea is 47% lower than the OECD average, and particularly the rates of water, electricity, and fuel are much lower compared with advanced countries. General transportation price including taxi, bus, and train service, and vehicle maintenance appears to be 30% lower than the OECD average.
4. Medical Care: The cost for medical care in Korea is 48% lower than the OECD average

5. Modern Living and Leisure: The cost for communication including postal & telephone services is 41%, leisure and entertainment 24%, and food & hotel accommodation 5% lower than the OECD average. Therefore, the living standard of Korea appears to be close to advanced countries considering the fact that the consumer prices for clothing, food, housing, welfare, entertainment, and leisure are much lower than advanced countries.

Proposal

The GDP/capita of Korea appears to be close to those of advanced countries when assessed with real purchasing power. However measures to ensure the price stability is recommended considering that prices of foodstuffs of daily necessities essential to the people of lower income bracket such as meats and vegetables are higher than advanced countries. It is also necessary to raise the relatively low utility rates for electricity, water and others, as they seem to encourage overconsumption, although it is advisable to increase the rates gradually over a period considering the burden to people in the low income bracket.

III. The North Korean Issues

□ Competitive edge analysis of Kaeseong Industrial Complex

Outcome and Significance of Kaeseong Industrial Complex Project

It is nine years since Kaeseong Industrial Complex (KIC) started to operate. As of end of March 2012, there are 123 South Korean companies in KIC employing 51,102 North Korean employees with its aggregate production amounting to USD 1.618 billion. The trade volume of 2011 between the South and the North in connection with KIS recorded USD 1.698 billion, 99.7% of the total trade volume between the South and the North. KSI is undergoing a 3-phase expansion plan and is expected to employ as many as 350,000 North Korean workers with anticipated production volume of USD 16 billion. Apart from the economic aspect, KIC plays an important role as a catalyst to create an atmosphere to ease the political and military

tension existing between the South and the North, and also reduce the sense of heterogeneity through a large-scale exchange of human resources and materials between the two Koreas.

Competitive Edge of KSI

1. KSI enjoys a tax benefit of only 14% of corporate income tax, while China in 2008 and Vietnam in 2009 abolished the tax benefit applied to foreign investment and instead apply the flat rate of 25% to both domestic and foreign companies.
2. KSI is equipped with greater competitive edge as it employs high quality laborers at lower cost than China and Vietnam can offer. However, it has some drawback of little labor flexibility; laborers are employed indirectly through North Korean employment agency, and no incentives can be offered to workers to enhance productivity. It may seem paradoxical that the lack of labor flexibility, in effect, results in a low staff turnover.
3. KIC is exempt from paying the land-use fee until 2014, while China and Vietnam abolished this benefit for foreign companies.

Task of Revitalization of KIC

It is recommended to further develop and expand the KIC as it contributes to the revitalization of S. Korean domestic economy, enhances the competitive edge of small & medium businesses, offers vitality to light industry, and eases the polarization of the Korean economy. It also serves as a success model of the South-North Korea's collaboration for common wealth, and provides a foundation for large and small & medium businesses to cooperate for mutual benefits. At the same time, over the long run, it also helps reduce the cost of unification of Korea, as it will contribute to narrowing the economic gap between the two Koreas by helping the North Korean economy come to life. It is, however, a pity that political intervention and military confrontation prevents the KIC from reaching its maximum utility and all the advantages that it can offer. It is advisable that a limited level of civilian-based economic cooperation between two Koreas is maintained at businesses' discretion to minimize restricting factors and to continue endeavoring to overcome the hurdles facing KIC.

[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	연간(E)
US	3.0	3.9	3.7	2.5	2.3	1.7	0.4	1.3	1.8	3.0	2.1
Euro Region	1.9	0.4	1.0	0.4	0.3	1.4	0.8	0.2	0.1	-0.3	-0.3
Japan	4.4	6.1	5.2	2.3	-0.6	-0.9	-6.8	-1.5	7.0	-2.3	2.0
China	10.3	11.9	11.1	10.6	9.8	9.2	9.7	9.5	9.1	8.9	8.2
Korea	6.3	8.7	7.6	4.5	4.9	3.6	4.2	3.5	3.6	3.3	4.0

Note: 1) IMF figures of April 2012 for 2012 global projections; Hyundai Research Institute figures for Korean 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		Compared with previous day	
		End of Jun	End of Dec	Jun 11	Jun 12		
overseas	Ten-year Treasury Bond Interest (%)	3.30	3.16	1.88	1.59	1.65	0.06 %p
	JPY/USD	81.19	80.66	77.66	79.28	79.57	0.29 ¥
	USD/EURO	1.3350	1.4492	1.2955	1.2471	1.2492	0.0021 \$
	DJIA(p)	11,578	12,414	12,218	12,411	12,574	163 p
	Nikkei(p)	10,229	9,817	8,455	8,625	8,584	-41 p
Domestic	Three-year Government Bond Interest Rate (%)	3.38	3.76	3.34	3.32	3.29	-0.03 %p
	KRW/USD(KRW)	1,134.8	1,067.7	1,151.8	1,165.9	1,170.5	4.6 원
	KOSPI(p)	2,051.0	2,100.7	1,825.7	1,867.04	1,854.74	-12.3 p

International Raw Materials Price Index

Category		End of 2010	2011		2012		Compared with previous day	
			End of Jun	End of Dec	Jun 11	Jun 12		
International Oil Prices	WTI	91.40	95.18	99.22	82.47	83.31	0.84	\$
	Dubai	88.80	106.75	104.89	98.66	95.41	-3.25	\$
CRB Future Indices		332.80	338.05	305.30	270.75	270.86	0.11	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