

HRI

Monthly Economic Review

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I . Recent Global & Domestic Economic Trends

Global Major Economies

The US economic recovery is held back, the growth rate of emerging countries has softened and EU still remains in economic recession.

The US ISM manufacturing index marked 53.5 in May, a healthy state of economy staying well above the critical line 50, but plunged to 49.7 in June. The unemployment rate, which continued to show a downward trend until April 2012, also went up to 8.2% in May, an increase of 0.1%p compared with previous month. Month-on-month house sales decreased in May by 1.5%.

The Euro Zone decided at the EU Summit meeting held in the last week of June to allocate 120 billion euro to boost the economy and create new jobs, but the unemployment rate still stays at around 11% as the economic crisis persists, and the manufacturing index continued to fall to 45.1 in June from 45.2 of May, marking the lowest point since September 2009.

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 of April showed a negative growth of -3.1%, and the growth rate of the retail sales also slowed down to 3.6% compared with previous month. Although China managed to mark a double-digit export increase of 15.3% in May, the slowdown trends of industrial production and retail sales growth rates held back the upward trend of Chinese economy.

Global Financial Market

Global share prices rose in June as the concern over the EU's financial crisis diminished and the expectation for positive monetary policies rose.

The DJIA, despite the poor US economic indices, was up in June by 3.9% compared with previous month due to the growing expectation for imminent monetary easing policies by the Fed to stimulate the market. The DAX index of Germany was also up in June, despite the Euro Zone's overall poor performance with growing expectation for the ECB and other central banks of EU member countries to take co-ordinated action to boost economy. Nikkei was up thanks to the improved economic indices including short-term Business Conditions Diffusion Index, which recorded -1, much better than the forecast -4. China's SSE composite index was down mainly due to the worsening manufacturing index.

The JPY/USD exchange rate depreciated in June by a small margin from the May closing rate due to the concern over strong yen expressed by the Japanese government authorities in charge of foreign currency control.

EUR/USD exchange rate appreciated in June and July, in anticipation of central bank policies to tackle EU's financial crisis that were agreed at the EU summit meeting. The CNY/USD exchange rate was up in June by a small margin compared with previous month.

Economic indices of major countries

(Unit: %)

(Unit: p, yen, euro, yuan)

Economic Sectors		2011	2012			
		Annual	Feb	Mar	Apr	May
US	Industrial Production	4.1	0.4	-0.5	1.0	-0.1
	Retail Sales	7.9	1.0	0.4	-0.2	-0.2
EU	Industrial Production	3.5	0.7	-0.1	-0.8	-
	Retail Sales	-0.6	-0.2	0.3	-1.0	-
Japan	Industrial Production	-3.5	-1.6	1.3	0.2	-3.1
	Retail Sales	-1.2	3.4	10.3	5.8	3.6
China	Industrial Production	13.7	11.4	11.9	9.3	9.6
	Retail Sales	17.1	14.7	15.2	14.1	13.8

Economic Sectors		2011	2012			
		Annual	Apr	May	Jun	July
US	DJIA	12,218	13,214	12,393	12,880	12,871
EU	DAX	5,898	6,761	6,264	6,416	6,496
	EUR/USD	0.772	0.755	0.809	0.804	0.790
Japan	NIKEI	8,455	9,521	8,543	9,007	9,003
	YEN/USD	77.66	80.35	79.10	79.37	79.89
China	SSE composite Index	2,199	2,396	2,372	2,225	2,226
	CNY/USD	6.3190	6.3099	6.3578	6.3575	6.3536

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

Korean Economy

Korean domestic market is not making solid progress. Although the expectation for the EU's financial crisis to be somewhat resolved helped Korean financial market to set a marginal recovery, it has yet to gain traction.

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.

Exports were up by 1.3% in June thanks to the ‘base effect’ while imports were down in June by 5.4% mainly due to the volume of the imported raw materials, capital goods, and consumption goods decreasing. The trade surplus of June recorded US\$ 5 billion, well above the forecast made by the financial market.

The unemployment rate fell in May by 3.1% due to the rising number of people being employed in service industry. The consumer price index rose in June by 2.2% with the prices of agro-fishery, livestock and core producer prices stabilizing and falling.

BSI in manufacturing was up to 84 in March, to 85 in April, and to 90 in May showing upturn for the four consecutive months, but marked 86 in June and 84 in July, a downturn due to the faltering business recovery. Composite leading index and cycle variation value marked 99.8 in April 2012, and 99.4 in May, down by 0.4p from previous month, still remaining below the critical line 100.

Share prices showed upturn in June in hopes for the EU’s financial crisis to be eased, and additional business-stimulating policies to be resolved at the EU summit meeting. KRW/USD exchange rate surged in May, but fell in June. Interest on corporate debentures also continued to show downward trend in June 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 in June due to the uncertainty of financial market decreasing with the bailout for Spain funded by international collaboration including EU and IMF, expectation for the solution to the Euro Zone crisis to be resolved at the EU summit meeting, 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 0.29%p in June and 9.25% in July due to the preference for safe haven assets.

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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	Apr	May	June	July
Domestic Market	Retail Sales	4.3	5.4	5.7	4.7	1.9	2.0	0.3	0.2	-	-
	Facility Investment Index	0.7	5.4	5.7	-3.1	-4.7	9.4	5.4	-1.5	-	-
	Construction	-6.7	-12.6	-6.6	-8.4	-0.5	-3.7	-8.0	-6.5	-	-
Foreign Trade	Export Growth Rate	19.0	29.6	18.6	21.4	9.0	3.0	-5.0	-0.6	1.3	-
Employment/Prices	Unemployment Rate	3.4	4.2	3.4	3.1	2.9	3.8	3.5	3.1	-	-
	Consumer Price	4.0	3.8	4.0	4.3	4.0	3.0	2.5	2.5	2.2	-
Finance	KOSPI	-	2,107	2,101	1,770	1,826	2,014	1,982	1,843	1,854	1,852
	KRW/USD	-	1,097	1,068	1,178	1,152	1,133	1,130	1,180	1,145	1,146
	Corporate Bond (BBB-)	-	10.58	10.38	10.24	10.01	10.06	9.79	9.54	9.25	9.25

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

II. Economic issues facing Korea

□ 2012 Revised Outlook for Korean Economy

The Characteristics of Korean Economy for the First half of 2012

The growth rate of private sector consumption fell to 1.6% in the first quarter of 2012, a downturn to 1% level for two consecutive quarters, due to the household burden of repaying principal with interest coupled against the accumulated household debt. The investment growth rate in construction marked modest increase of 1.5% in the first quarter of 2012 with the struggling private sector construction business and the shrinking investment in the public sector. The export growth rate for the first half of 2012 recorded 0.7%, while import growth was 2.5%, a sharp fall. The slump of both the domestic and export market is largely responsible for the fall of the national economic growth rate to 2.8% in the first quarter. Domestic financial market managed to maintain overall stability despite some insecure factors both home and abroad, but the volatility increased in June.

The KRW/USD exchange rate soared from around 1,130 as of early May to 1,182 as of June 4th, to drop again to 1,145 as of June 29th. KOSPI fell in May to 1,783p, the lowest of the year, but bounced back to 1,904p on June 20th before it fell again to 1,854 on June 29th. The unemployment rate fell to 3% or slightly higher, while the unemployment rate of young people went up to around 8%. The consumer price inflation rate stayed at stable 2% level, but the expected inflation rate stayed at 3% plus.

Domestic and Global Economic Trends

The global economic environment has rapidly worsened with the growing EU's financial crisis, insignificant signs of the US's economic recovery, and China's weakening economic growth rate. The Euro Zone's economic crisis is deteriorating with the political uncertainty of Greece, followed by Spain and the possibility of Italy requiring a bailout fund. IMF forecast that the economic growth rate of European economy would plunge from 1.4% in 2011 to 0.3% in 2012. The US's economic growth rate was reduced to 1.9%, while unemployment rate rising to 8.2% in May due to the continuing slump of housing market, weak consumption recovery, and insufficient financial cushion. China's economy also slowed down with the weakening growth of export and retail sales, and the growth rate of the first quarter of 2012 was at 8.1%, downturn for five consecutive quarters since 9.8% of the fourth quarter of 2010.

The overall growth rate of the world economy is projected to be between 2 and 3%, and it could worsen should the EU's financial problems fail to be convincingly settled.

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.

Revised Domestic Economic Outlook

Korean economic growth is forecast to stay around 3.5% due to the domestic market slump and deteriorating global economic environment – a reduction of 0.5% from the previous prediction of 4.0%, showing an underlying trend of lower growth in the first half, and medium growth in the second half of 2012.

Although the growth rate in the second half of 2012 is projected to reach 3.5% plus, the overall trend in economic recovery will remain weak when the base effect is considered. Modest consumption recovery is expected in the midst of weak investor sentiment when it comes to the domestic market. The consumption growth rate of private sector in the second half of 2012 is expected to reach around 3%, higher than 1.7% of the first half thanks to the increase of the real income brought by the price stability. The recovery of construction investment is forecast to be weak, staying around 2% in the second half of 2012, similar to that of the first half. The facility investment looks to keep around 6% growth rate because of the base effect, although the recovery trend is projected to be weakened due to the falling leading indices including reduced pressure for the facility investment adjustment and order placement for machineries.

Export suffered a setback due to the unstable global economic factors including the EU's financial difficulty. The export growth rate looks set to shrink from 19.0% in 2011 to mere 4.5% in 2012, while import growth rate from 23.3% to 6.9%. The trade surplus is also expected to be reduced from US\$30.8 billion in 2011 to US\$19.6 billion in 2012, and the balance on current account to be reduced from US\$26.5 billion in 2011 to US\$13 billion in 2012.

Consumer price has been kept stable thanks to the poor domestic market demand, and the inflation rate is anticipated to be down from 4.0% in 2011 to 2.9% in 2012. The value of KRW is projected to be up by a small margin from 1,140 won, the average of the first half of

2011, to 1,110 won in the second half of 2012 with the incoming foreign investment, increasing global volatility, and the continuing surplus in the balance on current account.

Policy Proposal

To tackle the global economic slump and sluggish domestic market, it is urgently required to implement policies to stimulate domestic business and extend growth power. In the short term, the following policies to simultaneously boost consumption, investment and the domestic economy is recommended as well as creating reasonable financial policies to enhance growth power in the medium and long-term:

1. Ensuring soft landing of household debt to sustain the business upturn trends and expand potential purchasing power.
2. Deregulation and policy reinforcement to stimulate construction and facility investment.
3. Easing the volatility of financial markets by tight management of risk arising from European financial crisis.
4. Maximizing utilization of FTAs and strengthening policies to help Korean businesses expand into emerging countries with potential growth power.

< Revised Forecast of Major Economic Indices for 2012 >

Category		2010	2011	2012(F)
National Accounts	Economic Growth Rate (%)	6.3	3.6	3.5
	Consumption by private Sectors (%)	4.4	2.3	2.5
	Construction Investment (%)	-3.7	-5.0	2.1
	Construction Investment (%)	25.7	3.7	6.3
Foreign Trade	Balance on the Current (USD100M)	294	265	130
	Trade Surplus(USD100M))	412	308	196
	Export (USD100M)	4,664	5,552	5,799
	Import(USD100M)	4,252	5,244	5,603
Consumer Price (%)		3.0	4.0	2.9
Unemployment Rate (%)		3.7	3.4	3.3

III. The North Korean Issues

□ Review of S. Korea's Policies toward N. Korea and the Economic Cooperation between the South and the North Korea

Hyundai Research Institute recently conducted a survey on 'issues between South and North Korea, and policies toward N. Korea' on a group of panels of 72 experts on N. Korea with maximum sampling error of $\pm 3.08\%$ and confidence level of 95%. Experts responded that the present S. Korean government should within its term of office resume non-military and non-political cooperation with N. Korea with no further delay, starting with realistically achievable projects including aid on humanitarian ground, reunion of family members separated from between South and North Korea, and economic cooperation. Most of the experts who took part in the survey pointed out that the present Korean government was failing in its policies toward N. Korea, and suggested that the next government should review the current policies toward N. Korea in all areas.

Cooperation between South and North Korea in non-military/non-political areas should resume without further delay

A considerable number of experts on N. Korea share the view that priority should be placed on such projects as 'increase of humanitarian support for the North'(81.9%), 'arrangement of reunion of family members separated from between North and South Korea' (81.9%), 'resumption of economic cooperation between North and South' (77.8%), 'Amicable conclusion of the pending issues – attack on Chonanham, S. Korean naval boat, and attack on Yonpyongdo island' (65.7%), and 'launching of the second phase development of Kaeseong Industrial Complex' (63.4%). It is notable that experts are clearly divided with a sharp contrast in responding to the questionnaires depending on their political inclination, especially on the issue of 'resumption of Diamond Mountain and Kaeseong sightseeing Project' Although the overall 'yes' for the immediate resumption was 62.5%; only 30.4% of experts of conservative inclination said 'yes' while 82.6% of experts of progressive inclination said 'yes' – a difference of staggering 52.2%.

< Projects urgently required to resume/initiate within the term of office of the present government >

Projects urgently required to resume/initiate within the term of office of the present government		Composite	Conser- vative	Middle of the roaders	Progre- ssive
Humanitarian Issues	Increase of support for N. Korea (foodstuffs, medicines)	81.9%	60.9%	88.5%	95.7%
	Arrangement of reunion of family members separated from between South and North	81.9%	69.6%	84.6%	91.3%
Economic Issues	Resumption of economic cooperation between South and North to regain mutual trust	77.8%	60.9%	84.6%	87.0%
	launching of the second phase development of Kaeseong Industrial Complex	63.4%	56.5%	65.4%	68.2%
	resumption of Diamond Mountain and Kaeseong sightseeing Project	62.5%	30.4%	73.1%	82.6%
	Development of N. Korean underground resources and encouragement for investment in N. Korea	42.3%	30.4%	46.2%	50.0%
Political/ Diplomatic	Amicable conclusion of the pending issues – attack on Chonanham, S. Korean naval boat, and attack on Yonpyongdo island	65.7%	69.6%	60.0%	68.2%
	Denuclearization of N. Korea in collaboration with neighboring powers	63.4%	82.6%	61.5%	45.5%

Note : The figures above show the percentage of respondents saying ‘urgently required’

Assessment of Policy toward N. Korea

Most of the participating experts had a negative view on current government policies toward N. Korea; 79.2% of them said, ‘not doing well’ showing an increasing trend of negative view compared with 73.8% in the survey conducted in November 2011. Regarding the policies to be taken by the next government, experts said, ‘present government policies should be reviewed in all areas’ (58.3%), ‘the framework of the current government policies should be kept, but revised or supplemented as necessary’ (41.7%). None of them said the present government’s policies toward N. Korea should be carried on.

< Assessment of Policies of Present Government toward N. Korea, and Recommendation to the next Government >

Assessment of Present Policies	2011.11	2012.2	Recommendation to the next Government	Composite
Doing very well	1.2%	0.0%	Total review in all areas	58.3%
Doing well	25.0%	20.8%	Maintain the framework of the present policies with revision as necessary.	41.7%
Not doing well	35.0%	41.7%	Carry on the present policies	0.0%
Not doing well at all	38.8%	37.5%		

[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	Jul 2	Jul 12		
overseas	Ten-year Treasury Bond Interest (%)	3.30	3.16	1.88	1.59	1.63	0.04	%p
	JPY/USD	81.19	80.66	77.66	79.52	79.83	0.31	¥
	USD/EURO	1.3350	1.4492	1.2955	1.2584	1.2604	0.0020	\$
	DJIA(p)	11,578	12,414	12,218	12,769	12,872	103	p
	Nikkei(p)	10,229	9,817	8,455	9,040	9,140	100	p
Domestic	Three-year Government Bond Interest Rate (%)	3.38	3.76	3.34	3.30	3.29	-0.01	%p
	KRW/USD(KRW)	1,134.8	1,067.7	1,151.8	1,146.1	1,138.3	-7.8	KRW
	KOSPI(p)	2,051.0	2,100.7	1,825.7	1,851.7	1,867.8	16.1	p

International Raw Materials Price Index

Category		End of 2010	2011		2012		Compared with previous day	
			End of Jun	End of Dec	Jul 2	Jul 3		
International Oil Prices	WTI	91.40	95.18	99.22	83.68	87.62	3.94	\$
	Dubai	88.80	106.75	104.89	93.72	95.29	1.57	\$
CRB Future Indices		332.80	338.05	305.30	284.21	292.64	8.43	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