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# HRI Monthly Economic Review

- 
- I . Recent Economic Trends
  - II . Economic Issues Facing Korea
  - III . North Korean Issues

[Annex] Domestic and Global Economic Indices

# Contents

## **I. Recent Economic Trends**

- Recent Global & Domestic Economic Trends

## **II. Economic Issues Facing Korea**

- Four characteristics of housing market for 2013: Debt deflation of the households in the metropolitan area, non-metropolitan area's property price turning around to fall
- Trend of job creation capabilities of industries since the global financial crisis

## **III. The North Korean Issues**

- The currency reform of N. Korea :  
N. Korean economy has operated over the last 3 years since the currency reform implemented to act as a catalyst to accelerate reform and open-door policy

## **I. Recent Economic Trends**

### **□ Recent Global & Domestic Economic Trends**

#### **Major Economies**

##### ***Recovery signs with economic indices of the US and China improving***

The industrial production of the US in November showed 1.1% increase compared with that of the previous month, a good sign of recovery from the aftermath of hurricane Sandy. The retail sales index rose by 0.3% in November thanks to the increased sales of motor cars, having fallen in October by 0.3%, thus showing some upturn of the US economy.

The retail sales of Europe sharply declined in October by 1.2% with deteriorating consumer sentiment due to the rising unemployment rate and shrinking economic growth rate. The industrial production also fell in October by 1.4%, yet another month of negative growth.

Japan's industrial production dropped in November by 1.7% from the previous month, marking the lowest ever since the mega earthquake in 2011.

China's industrial production and retail sales were up in November by 10.1% and 14.9% respectively, an increase for two consecutive months. China's economy is expected to be on the continued upturn in 2013, having passed through the trough.

## Global Financial Market

*The US stock market is on the upturn with improving economic indices, and the European stock market also rallied thanks to the announcement of plan for repurchasing of Greek government bond*

The US stock market traded up within small limits as the economic indices improved despite the difficulty in political negotiations to avoid the Fiscal Cliff. European stock markets also marginally rose thanks to the announcement to buy back the Greek government bonds and the agreement on a single bank supervision system for the Eurozone. Japan's stock market rose sharply with Abe Shinzo, the new premier's announcement for economic expansionary policy and the continued weakening trend of the Yen. China's stock market also rallied with the impending announcement for 'New Urbanization Plan' and upgraded prospect for economic growth rate.

### < Economic indices of major countries >

(%)

(p, yen, euro, yuan)

Economic Sectors		2011	2012			
		Annual	Aug	Sep	Oct	Nov
US	Industrial Production	4.1	-1.1	0.2	-0.7	1.1
	Retail Sales	8.0	1.0	1.2	-0.3	0.3
EU	Industrial Production	3.5	0.9	-2.3	-1.4	-
	Retail Sales	-0.6	-0.2	-0.6	-1.2	-
Japan	Industrial Production	-3.5	-1.6	-4.1	1.6	-1.7
	Retail Sales	-1.2	1.7	0.4	-1.2	-
China	Industrial Production	13.9	8.9	9.2	9.6	10.1
	Retail Sales	17.1	13.2	14.2	14.5	14.9

Economic Sectors		2011	2012			
		Annual	Sep	Oct	Nov	Dec
US	DJIA	12,218	13,437	13,096	13,026	13,104
EU	DAX	5,898	7,216	7,261	7,406	7,612
	EUR/USD	0.772	0.775	0.771	0.771	0.756
Japan	NIKEI	8,455	8,870	8,928	9,446	10,395
	YEN/USD	77.66	77.62	79.03	82.14	85.86
China	SSE	2,199	2,056	2,069	1,980	2,269
	CNY/USD	6.3190	6.3023	6.2647	6.2282	6.2317

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

Sources: Bloomberg  
note: SSE denotes SSE Composite Index

## **Korean Economy**

### ***Economic recession is persistent as investments in facility and construction decrease.***

The overall retail sales increased in November by 3.9% compared with that of the same month of 2011 as semi-durable goods such as clothing was up by 7.3%, durable goods such as motor cars up by 6.0%, and non-durable goods such as gasoline up by 1.8%. Facility investment in November, however, was down by 9.3% due to the poor investment in general machinery and other transportation equipment. Construction business is still in recession with a 2.2% fall in November.

Exports fell in 2012 by 1.3% and imports also declined by 0.9%, resulting in a trade surplus of US\$28.6 billion. Exports in December amounted to US\$45.1 billion with imports at US\$43.1 billion, a 5.5% and 5.3% respective year-on-year decrease and a US\$2 billion surplus. The size of imports and exports which was on the increase since October 2012 dropped for the first time in three months due to the reduced number of working days for customs clearance. The total number of the employed increased by more than 300,000 compared with the same month of 2011. The unemployment rate in November was down by 0.1%p to 2.8%, compared with that of the same month of 2011, as the number of the unemployed in all age groups except for 50s dropped. The prices of agricultural products were marginally up, but the inflation rate in December stayed at 1.4% compared with the same month of 2011 thanks to the prices of industrial products such as petroleum products falling, marking inflation rate of 1%+ for two months after recording 1.6% in November.

The Business Survey Indices in manufacturing by The Federation of Korean Industries(BSI) has risen since August 2012 before it fell in November and December, but bounced back in January 2013 by 5.5p compared with previous month. The cycle variation value marked 99.4, 0.3p up compared with the previous month.

*KOSPI increased owing to the additional expansionary policy of the US. The KRW/USD exchange rate appreciated and the corporate bond yield rates(BBB-) increased within limits in December.*

The KOSPI index rose in November, despite N. Korea's missile launching, thanks to the additional expansionary policy of US and the straight purchase by foreigners. The KRW/USD rate continued to appreciate due to the weakening US Dollar as a result of Fed's additional expansionary policy and the straight purchase of stocks by foreigners. The corporate bond yield rate(BBB-) reached 8.81% in December, recording a marginal rise.

**< Korea Major Economic Indices >**

(p, %)

Economic Sectors		2011			2012						
		Annual	3/4	4/4	1/4	2/4	3/4	4/4	Oct	Nov	Dec
Domestic Market	Retail Sales	4.3	4.7	1.9	2.1	1.0	1.6	-	1.9	3.9	-
	Facility Investment Index	0.7	-3.1	-4.7	10.2	-0.2	-7.0	-	-1.0	-9.3	-
	Construction	-6.7	-8.4	-0.5	-3.7	-10.8	-4.8	-	-11.7	-2.2	-
Foreign Trade	Export Growth Rate	19.0	21.4	9.0	3.0	-1.7	-5.7	-0.3	1.0	3.8	-5.5
Employment/ Prices	Unemployment Rate	3.4	3.1	2.9	3.8	3.3	3.0	-	2.8	2.8	-
	Consumer Price	4.0	4.3	4.0	3.0	2.4	1.6	1.7	2.1	1.6	1.4
Finance	KOSPI	-	1,770	1,826	2,014	1,854	1,996	1,997	1,912	1,933	1,997
	KRW/USD	-	1,178	1,152	1,133	1,145	1,111	1,071	1,091	1,083	1,071
	Corporate Bond (BBB-)	10.38	10.31	10.12	10.05	9.69	8.69	8.81	8.67	8.74	8.81

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

## II. Economic Issues Facing Korea

- Four characteristics of housing market for 2013: Debt deflation of the households in the metropolitan area, non-metropolitan area's property price turning around to fall

*The demand and supply conditions of the housing market for 2013 appears to be inclined for over-supply due to economic deterioration, diminishing number of medium & large families, increased volume of house-building, the number of unsold medium & large apartments, and a temporary increase of people owning two or more houses, etc.*

Attention to the direction of the housing market for 2013 is rising amid a clear trend of falling house prices in the metropolitan areas and nationwide contraction of real estate business volume. The housing market for 2013 seems clear for increasing supply amid shrinking demand with 77% of housing mortgage loans set to start repaying principal from 2013, and with the sharp increase of small-sized families, relative to medium & large-sized families decrease.

National Office of Statistics forecasted that the number of households with three or fewer family members would increase in the next five years(2013-2017) by 1.9 million, while households with four or more family members would decrease by 0.67 million. When we look at the prospect of supply, first, the trend of annual house construction volume of 0.5 million houses in 2011 is likely to continue for another two or three years, resulting in over-supply. Second, the number of the non-presold medium & large apartments(60 to 70% of all unsold apartments) which surged just before and after the financial crisis are still increasing, and they remain unsold even 'after the completion' of construction. Third, the number of undisposed houses owned by people temporarily with two houses or more sharply increased due to the deteriorating housing market. The number of unresolved Bogeumjari loans, specially tailored mortgage loans for home-buyers by Korea Housing Finance Corporation is marking 16,184 as

of July 2012, and other unresolved mortgage loans lent by private banks is estimated to be quite large, judging from the amount lent. With all these circumstances in consideration, there are more factors for the property price to fall and not rise.

*The prospect of housing market for 2013 looks to continue to show the following four characteristics: ① the house price in and around the capital area will continue to fall, ② the possibility of the housing market in the non-metropolitan area turning to recession, ③ clear distinction in the preference between the small versus the medium & large sized properties and ④ continuing preference for rent with Key Money:*

1. It is feared that the debt deflation is likely to happen in the Seoul Metropolitan area where the vicious cycle of excessive supply and falling prices is persistent. In 2012, the decrease of bank loan to the households in the metropolitan area coupled with the debt-deflation are extra factors bringing down the house price. The index of apartment sales & purchase in the metropolitan area has fallen by more than 7% as of November, 2011 from the highest point recorded just before the financial crisis, and the falling trend is accelerating.
2. The housing market in non-metropolitan area, which was relatively good until recently is likely to turn around to recession starting with medium & large sized properties. The sales of apartments in the non-metropolitan area dropped since 2011, and the number of non-presold apartments has risen in 2012. The trend of falling price for medium & large properties in the non-metropolitan area is increasingly clear from the second half of 2012, and is set to continue in 2013 especially with medium & large properties.
3. The difference in the preference between property sizes is set to be even clearer. Despite increasing number of small-sized apartments having been built in the metropolitan and non-metropolitan area, the demand for small-sized properties has ever risen to the extent of excessive demand, while continuing supply of medium & large properties despite shrinking demand is set to pose a serious problem to the market already saturated with excessive supply of medium & large apartments. The



trend of fast increasing demand for small-sized property, and decreasing demand for medium & large properties may pick up speed faster than the estimates forecasted by the National Office of Statistics.

4. Property lease market will remain strong. Although the lease price to the sale-price of apartment increased by 14% during the period of July 2009 to November 2012, it did not affect the sale price of apartments in the metropolitan area. In the non-metropolitan area too, the increasing uncertainty of selling price of mostly of medium & large apartments is pushing the demand for lease even further.

*The negative impact of depressed housing market in the metropolitan area on the national economy should be minimized. It is important to ensure soft landing of real estate market by reducing non-presold apartments, supplying appropriate level of liquidity to the financially healthy households, and setting up relevant policies to deal with the house-poor.*

The property market recession will be deepened mostly with medium & large properties in the metropolitan area, and its impact on the national and ordinary people's economy should be minimized. First of all, the soft landing of real estate market is imperative. It is recommended that the government should do everything for the unsold apartments in the metropolitan area to be sold at market-oriented price, and set up a housing policy focusing on 'invigoration of transactions' rather than on 'price stabilization with no transactions'. Government also needs to introduce a measure for the house-poor with consideration for mortgage borrowers in the metropolitan area. Appropriate level of liquidity should be supplied to the financially healthy households, especially to those 'with determination to pay back' with flexible operation of the regulation related to household loans. Also various tax benefits should also be considered for the aged and people living in multi-household houses with no housing welfare to improve their residential environment.

## □ Trend of job creation capabilities of industries since the global financial crisis

### *Deteriorating domestic employment*

The number of domestic youths in employment is continually falling since the global financial crisis, whilst the number of non-standard employees increased, expanding the uncertainty of employment. It is now a priority task for government to create good quality jobs and raise employment rate. Creation of good quality jobs is possible only when industries progress. This report analyses the capability of job creation of major industries, considering the inter-relation between the job creation and the progress of industries before and after the global financial crisis.

### *Growth rate and job-creating capability of industries*

**(Definition)** Four industrial types were set-up based on the growth rate of industry and the increase/decrease rate of employment:

1. 'Win-win type' when the growth rate of industry and the employment rate of the same industry are above the average.
2. 'Growth-oriented type' when the growth rate is above the average, but the employment rate is below the average.
3. 'Employment-oriented type' when the growth rate is below the average, but the employment rate is above the average.
4. 'Lose-lose type' when the both are below the average.

**(Analysis summary)** When we compare the figures of industries before and after the global financial crisis, the Win-win type, the most ideal one, fell from 5 to 4, while the Lose-lose type steeply rose from 3 to 7. The Growth-oriented type decreased from 2 to 1, and the Employment-oriented type from 5 to 3. Included in the Win-win type are manufacturing, information/communication, health/social work, and transportation/storage industry. Real estate/renting, educational service, construction, electricity/gas/water supply, recreational/cultural/sporting, agriculture/forestry/fishing, and mining/quarrying belong to the Lose-lose type. The growth-oriented type includes wholesale/retail trade industry, and the Employment-oriented types are financial intermediation, public administration, and business-supporting services.

**(Win-win type)** Manufacturing and information/communication industries turned out to have played major role in industrial growth and employment in the process of overcoming the global financial crisis. The two industries upwardly transformed from the Growth-oriented type when it was before the financial crisis to the Win-win type after the crisis. The manufacturing industry managed to make remarkable improvement both in industrial growth and in employment thanks to the good export performances of various industries including motor car, chemical, petro-refinery, and electronics. Information/communication industry also improved in job creation owing to the expansion of new technologies such as smart devices, and the fast growth of internet. Health/social work industry managed to keep itself in the Win-win type with growing women's participation in the labor market, expansion of government grant for child care, and the progressively aging society, establishing itself as the industry that achieved the fastest growth in employment.

**(Growth-oriented type)** The wholesale/retail trade industry upwardly moved from the Lose-lose type to the Growth-oriented type. Although the number of traditional markets and small-sized shops and employments thereof are decreasing, the industry managed to grow by making business size larger with new business ideas.

**(Employment-oriented type)** Financial intermediation industry moved downward from the Win-win type to the Employment-oriented type. Banking industry suffered a weakening profit-foothold as the net interest margin declined due to the falling interest rate, and the total lending amount decreased. The profitability of securities business also fell due to reduced trading volumes. Public administration and business-supporting service industry remained in the Employment-oriented type. The public administration service created substantial

number of jobs through government-led projects such as 'Hope for the work' scheme, although most of the jobs created were low-paid and unskilled, and therefore failed to act as a driving force for the industry

**(Lose-lose type)** Real estate/renting industry and the educational service business fell from the Employment-oriented type to the Lose-lose category. The depressed property lease business mostly in the metropolitan area resulted in low productivity and falling number of employees. Education service industry's growth rate and job creation capacity fell due the government's policy to curb household spending on private education, and the reduced real income of households since the financial crisis. Construction industry remained in the Lose-lose type. The inactive civil-engineering business due to the government's budget cut on SOC, combined with the prolonged depression of construction industry have brought down the growth rate of the industry and also weakened job creation capacity.

***Policy suggestion***

1. Expand assistance for business start-up and discovery of businesses with potential growth in manufacturing and Information/communication industry, focusing on assistance for business start-up in new industry.
2. Tailor-made training programs must be prepared and offered to the increasing number of low-paid workers to enhance the productivity of the business-supporting service industry by upsizing and upgrading business.
3. Efforts must be made to recover construction business by finding a new growth driver such as development of energy-saving and environment-friendly technologies, and exploring new overseas markets.
4. Provide practical re-educating or refresher programs to effectively support wholesaler/retailer/hotelier-turned occupational changers to acquire technologies and enhance capability in the respective field.
5. Implement positive policies to attract investment from both home and abroad to create secure and market-oriented jobs instead of trying to create simple and temporary works.

### III. The North Korean Issues

#### □ The currency reform of N. Korea :

**N. Korean economy has operated over the last 3 years since the currency reform implemented to act as a catalyst to accelerate reform and open-door policy**

On the 30th of November 2011, N. Korea carried out the 5<sup>th</sup> currency reform since it established communist regime. The purposes of the 5th currency reform are to:

1. Remove the pressure for inflation by absorbing the excess liquidity in the market.
2. Strengthen financial capability. Currency reform was an attempt to reinstate the nation's financial capability which had been deteriorating since 1990s and to have liquidity in the market available to the government to secure funding for economic development to build a strong nation in 2012.
3. Strengthen the government-initiated economic system and normalize public economy by cracking down on political and economic forces that accumulated wealth through illegal market activities and corruption.

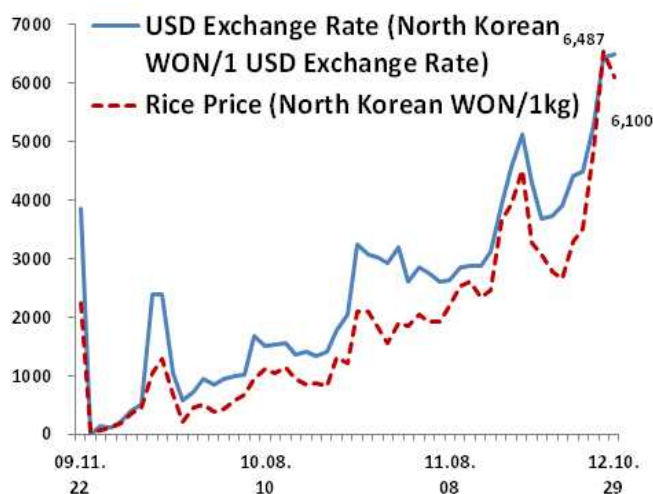
#### *The 5<sup>th</sup> currency reform of 2009 is assessed to be half-successful.*

The continuing inflation and deepening preference for foreign currency are assessed to be negative, but expansion of financial revenue, strengthening of government-initiated economic operation, and realigning laws relevant to economic development and creating favorable conditions for wider opening-up are thought to be positive.

#### **1) Negative effect**

**(Continuing inflation)** Chronic shortage of supplies has pushed up prices to such an extent that N. Korean economy reverted to where it had been before the currency reform as of November 2011, in just two years of currency reform. The foreign exchange rate and the price of rice as of October 2012 have risen 200-300 times as much compared with the period just after the currency reform.

< Trend of foreign exchange rate and rice price since currency reform >



Source : Daily NK  
Note : Average of Pyongyang, Shineueju, and Heisan

<Latest N. Korean market price trend >

	(NK won)			
	J u l 2012	Aug 2012	Sep 2012	Oct 2012
<b>Gasoline (1L)</b>	9,475	12,625	12,625	12,625
<b>Pork (1kg)</b>	10,250	14,000	15,250	15,250
<b>Egg (1EA)</b>	538	888	1,000	1,000
<b>Salt (1kg)</b>	1,475	2,275	2,725	2,050
<b>Cooking oil (1kg)</b>	10,375	13,750	19,250	19,250

Source : NK Intellectuals Solidarity  
Note : Average of Pyongyang, Pyeongseong, Wonsan, & Heisan

**(Deepening preference for foreign currency)** The preference for foreign currency increased due to the falling credibility of N. Korean won and the general public's increasing reliance on market economy, which pushed the Chinese yuan to be ever more preferable as a settlement currency nationwide.

2) Positive Effect

**(Expansion of financial revenue)** Financial revenue of N. Korea increased from US\$3.66 billion in 2009 to US\$5.24 billion in 2010, and US\$5.84 billion in 2011 thanks to the retrieving of old currency and ban on use of foreign currency since the currency reform.

< Trend of N. Korea's financial size since mid-2000s >

	(US\$100m, %)							
	2004	2005	2006	2007	2008	2009	2010	2011
<b>Budget</b>	25	29	30	32.2	34.7	36.6	52.4	58.4
<b>Growth rate from previous year</b>	-	16	3.5	7.3	7.7	5.5	43.2	11.5

Source : NK economic date, Bank of Korea

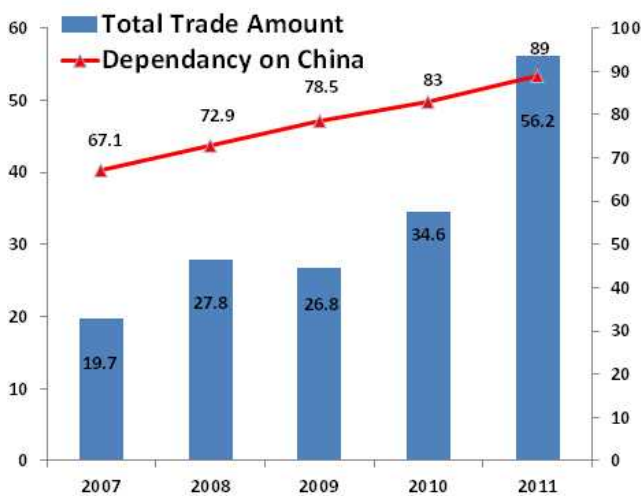
**(Inwardly: Reorganization of economic and legal system)** The main force of economic operation shifted from the army which played a key role in carrying out the currency

reform in 2009 to the cabinet, and as a result enhanced its driving force for internal economic improvement. At the same time, N. Korea legislated a number of new laws such as Raseon Economic & Trade Region Law and Hwanggeumpyong Economic Region Law, and also extensively revised existing laws to attract more foreign investment.

**(Outwardly: Expansion and acceleration of opening-up)** N. Korea makes more effort to open-up the door, attract foreign investment, expand trade with China, and to co-develop with China special economic zones such as Raseon, Hwanggeumpyong, and others.

< Trade volume between N. Korea and China for the last 5 years>

(US\$ 100million)



Source : KOTRA

< China's investment in N. Korea for the last 5 years>

(US\$10,000, %)

	New investment/year	Growth rate from previous year
2007	1,840	66.4
2008	4,123	124.1
2009	586	-85.8
2010	1,214	107.2
2011	5,595	360.9

Source: Dept. of Trade, China: China's investment overseas in 2010 and CEIC

***N. Korea is expected to expand open-up policy to deal with issues home and abroad***

N. Korea is believed to take necessary measures to expand reform and open-door policy to ease the inflation pressure by enhancing supply capability and to have the sanction imposed on N. Korea by international community lifted. However, the speed and the breadth of reform seem to depend largely on the direction of N. Korean economic situation, North-South Korean relations, and the sentiment of international community. South Korea needs to strengthen efforts to improve the relation with the North at the same time that N. Korea shows willingness to continue its economic reform and open-door policies. Resumption of the Mt. Kumgang Tourism project and expansion of Kaesong Industrial Complex are good starting agend as for the economic benefit of both Koreas, as well as the development project of Hwanggeumpyong involving South-North Korea and China, and also the project of constructing gas pipes connecting South-North Korea and Russia.

## [Annex] Domestic and Global Economic Indices

### Global Growth Rate

Category	2011					2012				2013
	Annual	1/4	2/4	3/4	4/4	Annual(E)	1/4	2/4	3/4	Annual(E)
US	1.8	0.1	2.5	1.3	4.1	2.2	2.0	1.3	3.1	2.1
Euro Region	1.4	0.8	0.2	0.1	-0.4	-0.4	0.0	-0.2	-0.1	0.2
Japan	-0.8	-7.3	-2.8	10.4	0.3	2.2	5.7	-0.1	-3.5	1.2
China	9.2	9.7	9.5	9.1	8.9	7.8	8.1	7.6	7.4	8.2

Note: 1) IMF figures of October 2012 for 2012/2013 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.

### Economic Indicators of South Korea

Division		2011			2012(E)	2013(E)
		the first half	the second half	Annual		
National Account	Economic Growth rate (%)	3.8	3.4	3.6	2.2	3.1
	Private Consumption (%)	2.9	1.6	2.3	1.6	2.5
	Construction Investment (%)	-7.1	-3.0	-5.0	-0.4	2.2
	Facility Investment (%)	8.9	-1.1	3.7	-0.7	4.8
Foreign Trade	Current Account (100 million Dollars)	81	184	265	390	285
	Exports(100 million Dollars) [Increase rate, %]	2,736 [23.6]	2,816 [14.9]	5,552 [19.0]	5,535 [-0.3]	5,845 [5.6]
	Imports(100 million Dollars) [Increase rate, %]	2,582 [26.7]	2,662 [20.2]	5,244 [23.3]	5,233 [-0.2]	5,568 [6.4]
Consumer Price (Average, %)		3.9	4.1	4.0	2.2	2.5
Unemployment rate (Average, %)		3.8	3.0	3.4	3.3	3.3

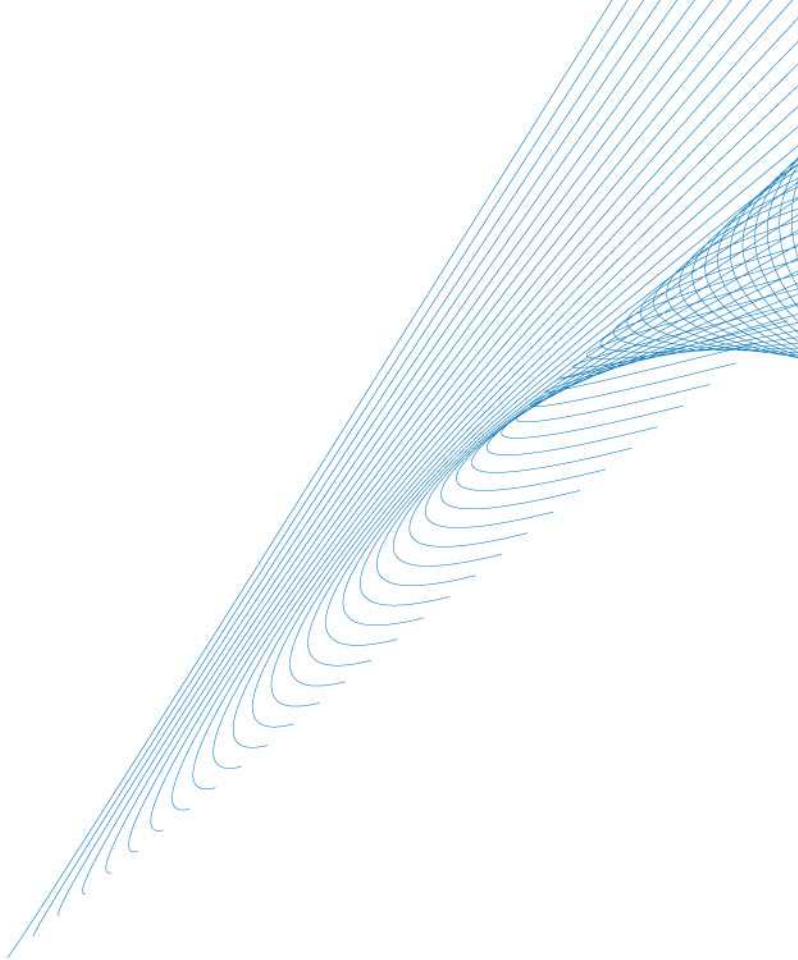
### Economic Indicators of North Korea

(USD million)

		2005	2006	2007	2008	2009	2010	2011	2012.1~11
Per capita GNI		105	103	104	114	119	124	133	-
Amount of Trade by Year	South-to-North	715.5	830.2	1,032.6	888.1	744.8	868.3	800.2	828.0
	North-to-South	340.3	519.5	765.3	932.3	934.3	1,043.9	913.7	987.8
	Total	1,055.8	1,349.7	1,797.9	1,820.4	1,679.1	1,912.2	1,713.9	1,815.8

Source: THE BANK OF KOREA, Ministry of Unification Source: Ministry of Unification





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