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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

△ Hyundai Research Institute



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Devoting to economic research
and human resource development
with intellectual conscience and sincerity,
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< Executive Summary >

I . Recent Economic Trends

The US economy keeps on track for recovery, while Europe manages to avoid the worst economic scenario. Japan is exposed to the limitation of quantitative easing monetary policy, and China's economic recovery appears to be delayed due to shrinking industrial production and trade volumes. In terms of Korean Economy, consumption and investment are on the recovery, unemployment rate is improving, and consumer prices marginally rose.

II . Economic Issues Facing Korea

『The Five Major Paradoxes of the First Half of 2013, and the Risk Factors of the Second Half』

Defining the Korean economic situation during the first half of 2013 as a paradox, we examine the economic characteristics from different perspectives including growth rate, exports, employment, inflation, and finance. Korea's economy for H2 2013 is expected to improve to some extent compared to H1, but risk factors involving advanced countries including the US, a potential hard landing of China's economy, and the uncertainty of domestic economic factors are likely to have negative effects on Korea's economic growth rate.

『Industrial Forecast for the Second Half of 2013』

Of all industrial sectors, the IT manufacturing industry related to Semiconductors and Smart Devices is expected to make the speediest recovery. The petrochemical industry is set to continue improving in the second half, whilst the shipping industry shows some sign of recovery. The construction and shipbuilding industries are anticipated to pass the trough of the business cycle. The automobile and machinery industries may enter a recovery phase whilst the steel industry looks set to stay in recession.

『Recent Sharp Increase of Floating Money and Suggestions』

Generally, short-term floating funds, comprising financial items and cash, not only reduces production activities of businesses but also has a negative effect on national economy as it can easily lead to an asset bubble. Asset markets such as shares and real estate shrink as uncertainties prevail throughout the financial market due to the on-going economic recession, resulting in long term falling returns, and open market capital becoming short-term floating money.

III . The North Korean Issues

Based on Hyundai's 'Model for N. Korea's GDP Estimate', N. Korea's nominal GDP per capita in 2012 is estimated to be USD783, a rise of USD63 from USD720 in 2011, equivalent to 3% of S. Korea's USD23,113. Asian countries whose income level is similar to N. Korea are Bangladesh(USD850) and Myanmar(USD835)

I . Recent Economic Trends

1. Recent Global & Domestic Economic Trends

Major Foreign Economies

The US economy keeps on track for recovery, while Europe manages to avoid the worst economic scenario. Japan is exposed to the limitation of quantitative easing monetary policy, and China's economic recovery appears to be delayed due to shrinking industrial production and trade volumes.

The US maintains the recovery trends due to rising industrial production and private consumption. Industrial production in June 2013 marked a month-on-month increase of 0.3% with good performances of automobile, motor parts, machinery, and mining industries in particular. Retail sales was up by 0.4% in June due to the improving sales of automobiles and gasoline. Unemployment rate marked 7.4% in July, the lowest in four years and seven months since December 2008. The number of the newly employed recorded 162,000.

The Eurozone economy appears to have emerged from the worst of the crisis situation. Although industrial production showed a month-on-month drop of 0.3% in May, the first decrease in the recent four months, the Purchasing Managers' Manufacturing Index(PMI) recorded 50.1, the first figure above 50 in two and half years, heralding a sign of economic expansion. Retail sales also recorded a month-on-month increase of 1% in May, the biggest rise since January this year. The unemployment rate of Eurozone stayed at 12.1%, same as the previous month.

Japan's monetary policy of quantitative easing appears to have reached its limitation. Industrial production marked a month-on-month decrease of 3.3% in June, the biggest drop since March 2011. Retail sales fell by 0.2% in June, a big

drop from 1.5% increase recorded in May.

China’s economic recovery is delayed due to the falling industrial production and trade volume. Industrial production showed a year-on-year increase of 8.0% in June, a marginal drop from the growth rate in May, whilst retail sales recorded a year-on-year rise of 13.3%, a continuing sign of recovery after the previous month’s performance. China’s export and import volumes marked a year-on-year decrease of 3.1% and 0.7% respectively in June, according to China’s Office of Customs Administration. The negative growth rate recorded in June, in particular, is the first minus growth rate in 17 months due to the reduced export demand, strong yuan, and rising labor cost.

The global financial market was affected by many positive as well as negative signs such as relief from the concern over the US exiting its monetary easing policy, prospect of the US credit rating upgraded, maintenance of quantitative easing policy by Abenomics, approval of execution of bail-out fund to Greece, and political uncertainty in Portugal and Egypt.

< Economic indices of major countries >

(%)

(p, yen, euro, yuan)

Economic Sectors		2011	2012	2013			Economic Sectors		2011	2012	2013		
		Annual	Dec	Apr	May	Jun			Annual	Annual	Jun	July	Aug
US	Industrial Production	3.4	0.1	-0.3	0.0	0.3	US	DJIA	12,218	13,104	14,910	15,500	15,658
	Retail Sales	4.7	0.5	0.2	0.5	0.4		DAX	5,898	7,612	7,959	8,276	8,407
EU	Industrial Production	3.2	0.7	0.5	-0.3	-	EU	EUR/USD	0.772	0.756	13,677	13,668	14,466
	Retail Sales	-0.2	-0.7	-0.2	1.0	-		NIKEI	8,455	10,395	1,979	1,994	2,029
Japan	Industrial Production	-1.4	2.4	0.9	1.9	-3.3	Japan	YEN/USD	77.66	85.86	1.3031	1.3261	1.3276
	Retail Sales	-1.2	0.0	0.6	1.5	-0.2		SSE	2,199	2,269	98.51	98.08	98.97
China	Industrial Production	13.9	10.3	9.3	9.2	8.9	China	CNY/USD	6.3190	6.2317	6.1490	6.1317	6.1294
	Retail Sales	17.1	15.2	12.8	12.9	13.3							

Source: US Department of Commerce; Eurostat;
The People’s Bank of China
Note: US, EU, Japan QoQ, China YoY

Source; Bloomberg

Korean Economy

Consumption and investment are on the recovery. Unemployment rate is improving, and consumer prices marginally rose.

Production dropped, while consumption and investment increased. Industrial production marked a month-on-month decrease of 0.3% in June despite the rise in construction and manufacturing industries due to the drop in service industry. Retail sales increased by 0.9% from the previous month thanks to the rising sales of durable goods such as home appliances, and nondurable goods such as vehicle fuels. Equipment investment was up by 4.5% in transportation and machinery equipments compared with that of the previous month.

Both imports and exports increased in July. Exports showed a year-on-year improvement of 2.6% to USD45.84 billion, and imports were also up by 2.7% to USD43.13 billion, with a trade surplus of USD2.71 billion, a surplus for the 18th consecutive month. The export volume of general machinery dropped while the exports of IT products and ships increased. Imports of raw materials and capital goods fell, but imports of consumer goods was up.

Labor market shows signs of improvement. The total number of the employed recorded a year-on-year improvement of 360,000 due to employment growth in hygiene, social welfare service, and manufacturing industries, partly offset by falling rate of employment in agro-fishery, whole sale, and retail sale industries. The unemployed rate marked 3.1% in June, a year-on-year drop of 0.1%p. The number of the unemployed fell to 813,000 in June, a drop for the 10th consecutive month. Although the growth rate of inflation is on the increase, it still stays around 1% plus. The inflation rate showed a month-on-month rise of 0.2% in July, and a year-on-year increase of 1.4%. The core price index also marked a month-on-month rise of 0.1%, and a year-on-year increase of 1.5%.

The Korean financial market was affected by various factors including the achievement of 1.1% of economic growth rate, the first growth rate exceeding 1% after nine consecutive quarters of 0% plus growth, the poorer-than-expected corporate performance results in the second quarter, and the uncertainty of the global financial market.

< Korea Major Economic Indices >

(p, %)

Economic Sectors		2011			2012					2013		
		Annual	3/4	4/4	Annual	1/4	2/4	3/4	4/4	1/4	June	Jul
Domestic Market	Retail Sales	4.5	0.5	0.0	2.3	1.0	0.3	1.2	0.4	-1.3	0.9	-
	Facility Investment Index	4.0	0.1	-2.8	-2.0	6.4	-5.0	-6.8	0.8	-4.6	4.5	-
	Construction	-6.4	-5.4	3.0	-5.8	-5.6	-0.9	1.0	1.4	4.4	0.4	-
Foreign Trade	Export Growth Rate	19.0	21.4	9.0	-1.3	2.9	-1.7	-5.8	-0.4	0.4	-1.0	2.6
Employment/ Prices	Unemployment Rate	3.4	3.1	2.9	3.2	3.8	3.3	3.0	2.8	3.6	3.1	-
	Consumer Price	4.0	4.3	4.0	2.2	3.0	2.4	1.6	1.7	1.4	1.0	1.4
Finance	KOSPI	-	1,770	1,826	-	2,014	1,854	1,996	1,997	2,005	1,914	1,923
	KRW/USD	-	1,178	1,152	-	1,133	1,145	1,111	1,071	1,111	1,124	1,124
	3yr Government Bond	-	3.55	3.34	-	3.55	3.30	2.79	2.82	2.52	2.92	2.96
	Corporate Bond (BBB-)	-	10.31	10.12	-	10.05	9.69	8.69	8.81	8.50	8.99	9.02

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

II . Economic Issues Facing Korea

1. The Five Major Paradoxes of the First Half of 2013, and the Risk Factors of the Second Half

Amid the poorer-than-expected performance of economic recovery of both advanced as well as emerging countries, Korean economy remains below the target growth rate for the third consecutive year. With an annual growth rate of just 2% plus, measures for revitalization of economy are desperately needed. We begin by examining the risk factors that defined the characteristics of Korean economy in the first half of 2013 as a paradoxical phenomenon, before recommending policy initiatives to minimize the negative impact those risk factors may have on Korean economy going forward.

The Five Major Paradoxes of the First Half of 2013

Defining the Korean economic situation during the first half of 2013 as a paradox, we examine the characteristics of Korean economy from different perspectives including growth rate, exports, employment, inflation, and finance:

1. Economic indicators improved whilst consumer economic sentiment deteriorated. The growth rate of Q1 2013 recorded a q-o-q growth of 0.8% after the flat q-o-q growth of Q4 2012, whilst consumer economic sentiment worsened with real household income growth of 0.3% during Q1 2013, compared to 4.6% for Q3 2012.
2. The trade surplus increased although export business has yet to recover. The recovery of exports fell short of expectation with the global export market remaining depressed. However, imports also dropped, resulting in the trade surplus of Q1 2013 increasing, and a 'miniature-type of trade surplus.'
3. Despite the falling unemployment, the employment rate also dropped. With most of the newly employed being salary workers, the

unemployment rate in Q1 2013 fell to 3.6% from 3.8% in Q1 2012. However, the employment rate also fell to 57.7% in the same period due to the increasing number of economically inactive people.

4. Consumer confidence weakened during a low-inflation economy. Although inflation rate remained at a stable level of 1% plus, insecure sentiment of consumers was high with expected annual inflation rate reaching close to 3.0%.
5. The financial market was inundated with liquidity, but volatility was also high, due in part to the remarks of the possibility of downsizing quantitative easing and concerns over the risk of failure of Abenomics. Liquidity however is abundant compared to the real economic activities since the global financial crisis.

Risk Factors facing the Second Half of 2013

Korea's economy for the second half of 2013 is expected to improve to some extent compared to the first half, but risk factors involving advanced countries including the US, a potential hard landing of China's economy, and the uncertainty of domestic economic factors are likely to have negative effects on Korea's economic growth rate. The uncertainties and risk factors are:

1. The impending enforcement of the exit strategy of quantitative easing by the US: The demand for exit strategy is growing as the recovery of the US economy becomes visible. The US exit strategy is likely to be implemented in three phases: reduction of quantitative easing, normalization of interest rate, and disposal of mortgage-backed securities. The reduction of quantitative easing, the first phase, is likely to start in the second half of 2013. The clear sign of recovery of housing market no longer justifies continued quantitative easing, and the time has come to enforce policies suitable for leveraging as loans to businesses have started to increase. However, judging by the Evans Rule, which is based on unemployment and inflation rates, the normalization of interest rate, (i.e., the second phase), cannot yet be implemented. The unemployment rate in May 2013 was 7.6%, 1.1% higher than the reference point of 6.5%, and the long-term

inflation rate remained at 1% plus, therefore failing to meet the requirements of the Evans Rule. The reduction of quantitative easing will prompt withdrawals of foreign capital, resulting in share prices falling and rising interest rates will result in USD/KRW exchange rate rising. The depreciating won will help improve the competitive edge of Korean export products to the US, and the falling prices of crude oil, raw materials, and grain will work positively for Korean economy.

2. Risk of failure of Abenomics(Abegeddon): The Japanese government pushed forward with Abenomics since the inauguration of the Abe administration to revitalize Japan's economy amid growing sentiment towards economic recovery and rising share prices. The economic growth rate shows positive growth for a second consecutive quarter with improving domestic demand led by private consumption. Japan's economy is expected to recover and reach a growth rate of 2.5% plus, but Abenomics is not entirely free from risk of failure if and when risk factors such as a rise of interest rates, side effects of quantitative easing, delay in recovery of real economy, and the loss of momentum of Abe Cabinet become visible. As regards the Korean economy, domestic demand as well as exports, are feared to plunge into a recession due to the slowdown of global economic recovery should Japan re-enter economic depression as a result of these risk factors. With a share of 8.3% in the Global GDP, Japan's economic recession will negatively impact the global economy. With a high level of interdependence between the economies of Korea and Japan, the inevitable volatility of Japan's financial market - if Abenomics fails - is highly likely to impact the Korean financial market. Korea's trade with Japan accounted for 9% of its total trade in 2012, and the size of Korea's investment in Japan in the same year recorded USD101.4 billion, 6.5% of Korea's total overseas investment of USD1.5614 trillion.
3. Rapid cooling of global export market(Re-emergence of European economic recession and hard landing of China's economy): European financial crisis is unlikely to reoccur as the interest rate for government bonds is falling despite the burden of large-scaled repayment of bonds maturing in Q3 2013, although real economy issues such as the slowdown

of growth due to rising unemployment caused by fiscal prudence remain a concern. Q3 2013 will be a crucial time for the governments of Southern European countries (PIIGS), Italy in particular, as the maturity of government bonds is concentrated in the same period, although it is unlikely to cause a financial crisis thanks to lower 10-year refinancing rates reducing the burden of interest coverage. With European financial crisis gradually easing, the volatility of Korean financial market is set to reduce, although the recovery of Korea's export market will be delayed due to the prolonged depression of the real economy. China's economic growth rate is expected to stay around 7% with slow recovery of both domestic and export business due to the weak global economy. There is growing concern over the possibility of a hard landing of China's economy with sharply increasing utilization of shadow banking system due to the declining trade of small and medium businesses, and the risk of insolvency of provincial governments. China's economic recession is feared to cause a significant negative impact on the growth rate of Korean economy; Korea's real growth rate will fall by 0.4% for a 1% drop in China.

4. Collapse of household debt: Korea's household debt to disposable income ratio is 136% in 2012 as compared to 111% and 131% of the US and Japan, although slightly lower than 141% of the UK. Qualitative deteriorations such as rising loans by non-bank financial institutions, weakening ability of people in lower income bracket to repay debt and increasing household debt default rates are also cause for concern. Household debt looks set to increase due to monetary policy easing to be enforced in the second half and measures to boost real estate market, and non-performing loans to the socially disadvantaged is likely to grow rapidly. As of the end of 2012, loans provided by non-bank financial institutions and other informal money lenders accounted for 65.5% and 5.5% respectively of the total loans given to low credit rating individuals, and this continues to rise. The growth rate of real household income in Q1 2013 remained almost flat at 0.3%, whilst youth unemployment rate marked at over 7% and the quality of employment deteriorated with low-paid jobs for the aged increasing. A collapse of the household debt bubble would lead to mass credit

delinquency, which could result in insolvency of non-bank financial institutions that lend money predominantly to borrowers with poor credit rating or those in the low income bracket.

5. Further deterioration of real estate market: The real estate market continues to struggle due to delayed economic recovery and imbalance of demand and supply. Despite newly announced measures to revitalize real estate business on April 1st, house price have failed to rise with supply continuing to outweigh demand. The effectiveness of the government's new real estate policy is being questioned and terminating the benefit of a reduced acquisition tax may prompt further softening of the real estate market. 'The real estate transaction cliff' is feared to reemerge when the incentive of reduced acquisition tax ends at the end of June. The struggling real estate market is set to lead to further recession of construction industry resulting in employment, ordinary consumer income, and consumption falling, consequently bringing a negative effect on the domestic economy as a whole. Production and employment will suffer a setback as long as the housing market remains in recession as the construction industry in particular is an industrial sector that induces production and employment more than any other.

Countermeasures

Although Korean economy is expected to make a modest recovery in the second half, it may have to face five major challenges, and the following preemptive measures should be considered to deal with these risk factors:

1. Countermeasures should be prepared against imminent reduction of quantitative easing by the US, and the risk of failure of Abenomics. While maintaining eased monetary policy such as low interest rate, sentiment of inflation growth should be managed lower, and constant monitoring of macro-economic regulation and international capital flows should be strengthened to prevent instability of financial market. Measures to deal with wide fluctuation of financial markets should also be established.
2. Korea should be prepared for the rapid cooling of global economy should

Europe's economic crisis reemerge and a hard landing of China's economy materializes. Every effort should be made to revitalize domestic economy by maintaining the basic economic policy of early execution of public finance and revised supplementary budget, while minimizing the shock generated by overseas economic factors through the development of new export markets and utilization of FTAs. The foundation of domestic demand should be strengthened by promoting a knowledge-based service industry in preparation for the changing global market trends.

3. A rapid cooling of the economy should be prevented by inducing a soft landing of household debts. Policies should be introduced bearing in mind the possibility of household debt restructuring being delayed, and considerations for the easing of the burden of household debt repayment should be made on the basis of low interest rates. The delinquency of increasing household debt should be checked by rescheduling those household debts in arrears, refinancing at lower interest rates, and utilizing the National Happiness Fund.
4. The slow recovery of real estate business should be dealt with by introducing new policies such as reduction of transfer tax, which is part of a comprehensive plan to revitalize real estate market announced on 1st April, 2013. Flexible operation of price ceiling system for the sale of new apartments, abolition of heavy taxation system for multiple-housing owners, as well as a further reduction of basic tax rate should also be considered. To reinvigorate real estate transactions of end-users, people entitled to the exemption of acquisition tax should be expanded to include 'first-time buyers', and the exemption should be available until the end of the year.

2. Industrial Forecast for the Second Half of 2013

Economic Forecast for Major Industries for the Second Half

Of all industrial sectors, the IT manufacturing industry related to Semiconductors and Smart Devices is expected to make the speediest

recovery. The petrochemical industry, which was on track to recovery in the first half, is set to continue improving in the second half, whilst the shipping industry, though within a narrow limit, shows some sign of recovery. The construction and shipbuilding industries are anticipated to pass the trough of the business cycle in the second half of 2013. The automobile and machinery industries may enter a recovery phase thanks to improving demand, though within a narrow limit, whilst the steel industry looks set to stay in recession due to the delayed recovery of demand and over-supply in the market.

Five Major Characteristics of Industrial Business in the Second Half

1. Domestic industrial business is forecast to make a balanced recovery without much deviation between industries for home demand and export (Yeast-type recovery) in the second half of 2013. Domestic industries performed relatively better than export industries in the first half, but both industries are expected to make a turn for recovery with export industries likely to make more contribution toward economic growth.
2. Economic decoupling is expected to take place between export industries of consumer goods and production goods. Overall, export business shows a visible sign of gradual recovery in the second half although the rate of recovery is forecast to vary across export segments. Specifically, the export business of production goods (intermediary goods, capital goods) is set to make a slower recovery than that of consumer goods due to the effect of time-lag and a weaker yen.
3. Public service industry is forecast to turn for the better thanks to the government's positive effort to boost this sector. The overall business recovery speed is not fast enough to support the growth of all service industries, but the public service industry is expected to perform better than the private market due to the government's economic stimulus projects.
4. Semiconductor-led recovery of global IT industry is projected to lead other industries in recovery, and is expected to gain momentum with its

industrial position as a core industry of the creative economy strengthening further.

5. Industries in structural recession are likely to make a turn for recovery. With global economic climate slowly improving, shipping, ship-building, and construction industries are expected to either reach the trough of business cycle or enter a recovery phase in the second half.

Suggestions

Although there are some signs for economic recovery, uncertainties involving domestic and global economy still pose risks to recovery in the second half, and therefore, the government should consider the following points to strengthen economic conditions for speedy recovery:

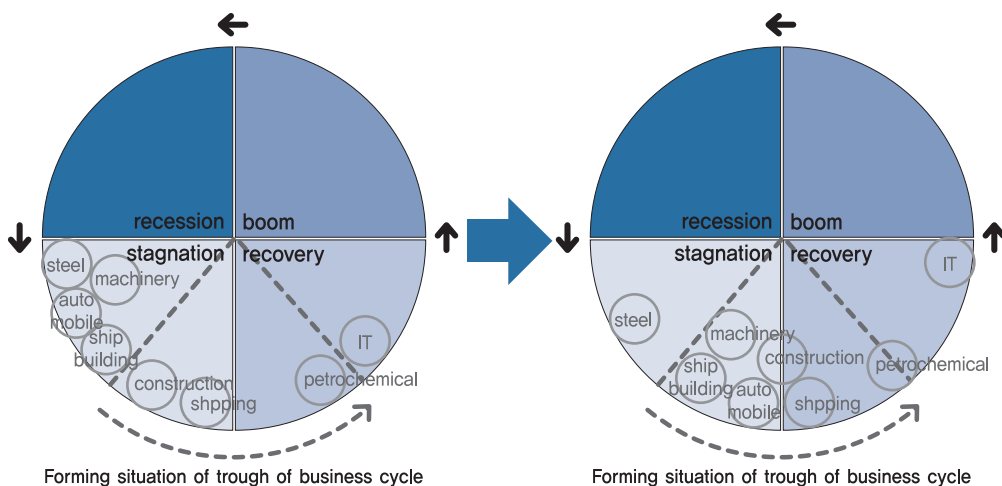
1. Policy consistency and enhancement of policy efficiency should be sustained to prevent signs of weakness in the economic recovery. The government should ensure to maximize the impact of economic reinvigoration by maintaining consistent monetary and related micro-economic policies coupled with early enforcement of government projects.
2. Export-friendly economic environment should be fostered to maximize traction for the growth of export industries. Market strategies should be tailored to individual countries by enhancing the level of FTA utilization for the markets of advanced countries, and by creating diversified marketing strategies to promote export markets of developing countries. It is also necessary to provide liquidity support for businesses suffering from the effect of a weaker yen, together with policy support to minimize the risks arising from fluctuations in foreign exchange rate.
3. Aggressive efforts are required to stimulate domestic demand to promote the growth of service industry for which governing regulations should be eased, and the system improved. Corporate investment should be encouraged by enhancing investment sentiment, while striving to find ways for household debt defeasance on a macro-level together with micro-level efforts such as reduction of consumption tax, and expansion of financial support.

4. The competitive edge of IT industry should be further enhanced to dominate the global market and to play a pivotal role in achieving a creative economy. Technological competitive edge should be upgraded to preserve market power of IT industry by securing core source technology, and by developing human resource specialized in IT. IT industry should be further supported to play a locomotive role of Korea's creative economy through converging technologies with other industries.
5. Positive support is needed to protect the foundation of industries in structural recession, and to raise their cutting edge innovation. The construction industry, to begin with, should establish a foothold to upgrade business service by striking a balance between demand and supply in domestic market, while the shipbuilding industry, which faces the challenge of global imbalance of demand and supply, needs to shift its strategy from a low value, volume-oriented model to a high value, technology-focused industrial phase. Government policy support is desperately needed for the domestic shipping companies suffering short-term challenges to reemerge as one of the major industries of Korea.

<Business Cycles of Major Industries for the First and the Second Half of 2013>

(Performance of the First Half)

(Forecast for the Second Half)



3. Recent Sharp Increase of Floating Money and Suggestions

Reasons for and Concerns over Short-term Floating Money

Generally, short-term floating funds, comprising financial items and cash, not only reduces production activities of businesses but also has a negative effect on national economy as it can easily lead to an asset bubble. Asset markets such as shares and real estate shrink as uncertainties prevail throughout the financial market due to the on-going economic recession, resulting in long term falling returns(interest rate) , and open market capital becoming short-term floating money.

Sharp Increase of Short-term Floating Money

Short-term floating money, which remained stable since 2011, is rapidly increasing, based on estimates from the credit received by financial institutions. As of March 2013, it was KRW767.8 billion won(KRW814.5 billion won including cash), surpassing the previous high set in May 2010. Judging from the flow of funds by the Bank of Korea, it rose for the past two years, marking KRW925.4 billion won as of the first quarter of 2013. Although the short-term floating funds to nominal GDP ratio is not as high as at the time of financial crisis(65% as of 2009 based on credits received by financial institutions), it still stays at an uncomfortable level of 58.3%. With economic recession persisting, the short-term floating money to nominal GDP ratio recently showed an upturn, and is feared to rise further if the economic recession continues.

Characteristics of Short-Term Floating Fund

1. Agents of Economic Activities: Household short-term floating money is rapidly rising due to the sharply increasing uncertainty since the financial crisis. With shrinking investment sentiment, the reserve funds of businesses show a sign of turning into short-term floating funds instead of being invested.

2. **Financial Institutions:** Money is moving from traditional banks to other types of financial institutions related to capital market. The ratio of saving banks used to be 70% plus, but has now fallen to 67% as of March 2013, whilst the share of the securities companies substantially increased to 17% thanks to the sharp increase of CMA accounts with payment and settlement function since 2010.
3. **Financial Products:** Money is moving from interest rate-oriented products to performance-focused ones in the current financial climate of low interest rates. Time deposits shorter than six months - traditional short-term interest rate products - started to decline from the second half of 2012, as are transferable Certificates of Deposit and bond transactions with repurchase agreements, whilst stock market-related products such as MMF and CMA, short-term bond-type funds, and performance-focused products such as RP are steadily rising.
4. **Priority on Functionality:** Demand deposit is steadily on the increase, and cash currency is also sharply rising since the release of 50,000 won notes in June 2009, which show the consumer preference for conveniently transferable financial products. The CMA of securities companies and MMDA of banks with fixed interest rates combined with payment and settlement function are solidly on the increase.

Suggestions

Virtuous circulation of funds should be gradually established to avoid asset bubble, considering rapidly increasing short-term floating funds as ex post facto and simultaneous warnings and countermeasures applied in haste can only lead to an excessive amount of shock to the market. Measures for virtuous circulation of short-term floating funds should be in place by revitalizing corporate investment, and by encouraging household funds to flow into capital market by clearing uncertainty felt by the agents of economic activity. Efforts should be made to ensure the usage of 50,000 won notes in circulation for the purpose of payment and settlement rather than any others.

III. The North Korean Issues

1. Estimate of N. Korea's Nominal GDP per capita in 2012

HRI Model for the Estimate of N. Korea's GDP

Hyundai Research Institute(HRI) developed a 'Model for N. Korea's GDP Estimate' to assess N. Korea's economic standard, and has reported its GDP per capita every year. This report looks into N. Korea's current economic status, and arrives at an estimate of N. Korea's GDP per capita of 2012 applying the 'Model for N. Korea's GDP Estimate'

N. Korea's Economic Status of 2012

Home Front: N. Korea's economic situation improved in 2012 with a strong crop harvest thanks to the good weather, and increased investment in construction. According to statistics released by FAO, N. Korea produced 5.03 million tons of crops in 2012, an increase of 5.9% from 4.75 million tons in 2011. Rice production amounted to 2.68 million tons, an increase of 8.2% from 2.48 million tons in 2011, and corn production increased by 9.9% from 1.86 million tons in 2011 to 2.04 million tons in 2012. Investment increased in many areas such as the construction and operation of Hwachon Power Plant, the housing construction projects in Pyongyang, and various types of service facilities.

Overseas Front: Trade volume with both China and S. Korea grew, and so did aid from the international community. Trade with China marked USD5.93 billion in 2012, a year-on-year increase of 5.4% from USD\$5.63 in 2011. Trade with the South recorded USD19.8 billion, a 15.3% increase from USD1.71 billion in 2011. International aid to N. Korea amounted to USD120 million, the highest since 2004, a 32% increase from USD89.23 million in 2011, and four times as much as that of 2010.

Estimated GDP per capita of N. Korea in 2012

Based on Hyundai's 'Model for N. Korea's GDP Estimate', N. Korea's nominal GDP per capita in 2012 is estimated to be USD783, a rise of USD63 from USD720 in 2011, equivalent to 3% of S. Korea's USD23,113. Compared to other communist countries, N. Korea's is viewed way below China's USD6,076, Vietnam's USD1,528, and Laos's USD1,445. Compared to countries with similar population size, N. Korea is well below Malaysia(USD10,304) and Rumania(USD7,935). Asian countries whose income level is similar to N. Korea are Bangladesh(USD850) and Myanmar(USD835)

Suggestions

1. The standard of N. Korea's economic strength is insufficient to support itself, and therefore, N. Korea should strive to secure self-sufficiency by reactivating North-South economic cooperation as inter-Korean relation improves.
2. Appropriate humanitarian aid should be continually provided to N. Korean infants suffering the most from low income and food shortage.
3. Efforts should be made to narrow the gap in income between the North and the South before Korea is unified as the cost of unification would be enormous due to the huge gap in economic power between the two Koreas.

[Annex]
Domestic and Global Economic Indices

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□ Global Growth Rate

Category	2011					2012					2013
	Annual	1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Annual(E)
US	1.8	0.1	2.5	1.3	4.1	2.2	2.0	1.3	3.1	0.4	1.7
Euro Region	1.4	0.8	0.2	0.1	-0.4	-0.6	-0.1	-0.2	-0.1	-0.6	-0.6
Japan	-0.6	-7.3	-2.8	10.4	0.6	2.0	6.1	-0.9	-3.7	0.2	2.0
China	9.3	9.7	9.5	9.1	8.9	7.8	8.1	7.6	7.4	7.9	7.8

Note: 1) IMF figures of July 2013 for 2013 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.

□ Economic Indicators of South Korea

Division		2011	2012			2013(E)
			the first half	the second half	Annual	
National Account	Economic Growth rate (%)	3.7	2.6	1.5	2.0	2.6
	Private Consumption (%)	2.4	1.2	2.2	1.7	2.1
	Construction Investment (%)	-4.7	-1.9	-2.4	-2.2	2.5
	Facility Investment (%)	3.6	2.3	-6.1	-1.9	1.0
Foreign Trade	Current Account (100 million Dollars)	265	137	294	431	395
	Exports (100 million Dollars) [Increase rate, %]	5,552 [19.0]	2,750 [0.5]	2,729 [-3.1]	5,479 [-1.3]	5,589 [2.0]
	Imports (100 million Dollars) [Increase rate, %]	5,244 [23.3]	2,641 [2.3]	2,555 [-4.0]	5,196 [-0.9]	5,319 [3.5]
Consumer Price (Average, %)		4.0	2.7	1.6	2.2	1.6
Unemployment rate (Average, %)		3.4	3.5	2.9	3.2	3.3

□ Economic Indicators of North Korea

(USD million)

Category	2005	2006	2007	2008	2009	2010	2011	2012	
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	897.2
	North-to-South	340.3	519.5	765.3	932.3	934.3	1,043.9	913.7	1,074.0
	Total	1,055.8	1,349.7	1,797.9	1,820.4	1,679.1	1,912.2	1,713.9	1,971.2

Source: THE BANK OF KOREA, Ministry of Unification

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