

HRI Monthly Economic Review

- I . Recent Economic Trends
- II . Economic Issues Facing Korea
- III . The North Korean Issues
- [Annex] Domestic and Global Economic Indices

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Devoting to economic research
and human resource development
with intellectual conscience and sincerity,
the Hyundai Research Institute leads
the advancement of Korean Economy
in the 21st century by proposing
creative policy alternatives.

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< Executive Summary >

1. Recent Economic Trends

The US economy maintains a firm economic recovery while China keeps its course of gradual recovery. The Eurozone and Japan show a weak recovery. In terms of Korean economy, domestic demand shows a marginal recovery. Employment improves to some extent and inflation rates remain low.

2. Economic Issues Facing Korea

『Analysis of Influence of Korean Wave on Economy』 Lately, exports of Korean culture contents are sharply rising as Korean culture(Korean Wave or Hallyu) spreads all over the globe. Since statistics were first gathered in 2005, the export of culture contents has consistently increased, especially to China and the South-East Asian countries. As the Korean Wave(K-Wave) evolves beyond generation 1.0 to generation 2.0, we now reach a stage where we can analyze the positive influence brought about by the K-Wave not only on the Korean cultural industry but also the Korean economy as a whole. The K-Wave phenomenon can lead to promoting sales of Korean-made goods, increase tourism to Korea and possibly generate foreign direct investment in the K-Wave-related industry.

『The significance of the 22nd Anniversary of Establishing Diplomatic Ties with China, and Cooperation Tasks』 With this year making the 22nd anniversary of establishing diplomatic ties with China, and with Xi Jinping's state visit to Korea, the relationship between the two nations appears to have entered the age of 'Warm Political and Hot Economic Relationships' where a close relationship exists not only in the economic area, but also in the political affairs between the two countries. The outcome of Korea-China economic cooperation for the last 22 years was reviewed in the areas of trade, investment, technology, and culture.

3. The North Korean Issues

Despite holding the reunion of separated families in the beginning of the year and expectations for the Unification Jackpot, a breakthrough for the improvement of the North-South Relations has yet to be made although there are still some opportunity factors such as the 8.15 congratulatory speech and the participation of North Korea in the Asian Games. Hyundai Research Institute conducted a survey from July 4 to July `18 on 117 experts on issues of unification, diplomacy, national security. This paper covers the results.

I . Recent Global and Domestic Economic Trends

Major Economies

The US economy maintains a firm economic recovery while China keeps its course of gradual recovery. The Eurozone and Japan show a weak recovery.

The US keeps a strong economic recovery. Although retail sales showed a similar level to the previous month, industrial production marked a month-on-month increase of 0.4%. The growth rate of imports/exports maintained a positive trend with the trade deficit decreasing for the last two months. Manufacturing Industry's PMI recorded 59.0p, an increase of 1.9p compared to that of August. The Conference Board composite leading indicator keeps rising since the beginning of 2014, although the Case-Shiller home price index has been on the downturn for the last two months recording 170.7p in June.

The recovery of the Europe's economy(EU) is weak. Economic growth rate of the EU dropped from 0.3% in Q1 to 0.2% in Q2. Germany's GDP growth rate in particular showed a quarter-on-quarter fall of 0.2% due to the depressed investment in gross fixed capital and in construction. Industrial production of the EU fell for the last two months showing a month-on-month drop of 0.1% in June. High unemployment rate of more than 10% and less than 1% inflation persist in the EU.

Japan shows a marginal economic recovery. Industrial

production and retail sales marked weak month-on-month growth of 0.2% while retail sales recorded a month-on-month decrease of 0.5%. Although exports showed a year-on-year rise of 3.9%, recovery is marginal considering the downward trend over the last two months. Manufacturing industry's PMI increased from 50.5p in July to 52.2p in August.

China's economy shows a gradual recovery. Although the year-on-year growth rate of industrial production and retail sales dropped marginally to 9.0% and 12.2% respectively in July, it maintains an average level for the last five months. The year-on-year growth rate of export rose from 7% plus in May and June to 14.5% in July although official manufacturing industry's PMI of medium & large businesses and HSBC manufacturing industry's PMI of small & medium companies fell in August compared to the previous month.

<Economic indices of major countries>

(%)

(p, yen, euro, yuan)

Economic Sectors	2012	2013	2014			International Finance Sector	2012	2013	2014					
	Annual	Annual	May	Jun	Jul		Annual	Annual	Jul	Aug	Sep			
US	Industrial Production	3.8	2.9	0.3	0.4	0.4	Stock index	DJIA	13,104	16,577	16,563	17,098	17,098	
	Retail Sales	5.1	4.2	0.4	0.2	0.0		DAX	7,612	9,552	9,407	9,470	9,479	
EU	Industrial Production	-2.5	-0.7	-1.1	-0.1	-		NIKEI	10,395	16,291	15,621	15,425	15,477	
	Retail Sales	-1.7	-0.8	0.0	0.3	-		SSE	2,269	2,098	2,202	2,217	2,236	
Japan	Industrial Production	0.6	-0.8	0.7	-3.4	0.2		Rate of Exchange	EUR/USD	1.3222	1.3799	1.3393	1.3183	1.3131
	Retail Sales	1.8	1.0	4.6	0.5	-0.5			YEN/USD	85.86	105.04	102.87	103.69	104.33
China	Industrial Production	10.0	9.7	8.8	9.2	9.0	CNY/USD		6.2317	6.0617	6.1714	6.1428	6.1420	
	Retail Sales	14.3	13.1	12.5	12.4	12.2								

Source : US Department of Commerce; Eurostat; The People's Bank of China

Note : US, EU, Japan QoQ, China YoY

Korean Economy

Domestic demand shows a marginal recovery. Employment improves to some extent and inflation rates remain low.

Domestic demand slowly comes off the depression seen in April and May although marginal in scale. All industrial production showed a month-on-month increase of 0.2% in July. Mining and manufacturing production increased while service industry production fell. Retail sales marked a month-on-month rise of 0.3% in July due to the increased sales of semi-durable goods such as clothes and non-durable goods such as cosmetics. Facility investment bounced back from a negative growth in June to a month-on-month increase of 3.5% although construction dropped by 1.4% in July.

Exports fell while imports increased. Exports recorded US\$46.3 billion in August, a year-on-year fall of 0.1% due to the reduced number of working days caused by auto workers' strike and long weekend. Imports marked US\$42.9 billion, a year-on-year rise of 3.1%, showing a trade surplus of US\$3.4 billion, a surplus for the 31st consecutive month. Lately, exports to China dropped for the four consecutive months up to August although the rate of decrease fell in August.

Employment improved to some extent. The total number of the employed showed a year-on-year rise of 505,000, an upturn after five consecutive months' decrease thanks to the increased number of the newly employed and the self-employed engaged in wholesale/retail, restaurant, and hotel businesses. However, the quality of jobs worsened as the number of regular workers dropped while temporary workers increased. The unemployment

rate was 3.4%, a year-on-year increase of 0.3%.

Inflation rate stays low. The consumer price index rose by 1.4% in August, a month-on-month increase of 0.2% while the year-on-year increase rate slowed for the last two months. The core price index excluding agricultural and petroleum products showed a year-on-year rise of 2.4% in August, the highest increase since 2.5% recorded in February 2012.

The Korean won remains strong with the diminishing possibility of early rate hikes by the Fed.

<Korea Major Economic Indices>

(p, %)

Economic Sectors		2012	2013				2014					
		Annual	Annual	1/4	2/4	3/4	4/4	1/4	2/4	Jun	Jul	Aug
Domestic Market	Retail Sales	2.3	0.7	-1.0	0.9	0.8	0.4	0.3	-0.4	0.1	0.3	-
	Facility Investment Index	-2.0	-5.0	-3.1	1.1	5.0	5.9	-5.2	2.1	-1.2	3.5	-
	Construction	-5.8	10.5	3.5	6.3	-0.1	-0.7	1.5	-0.8	3.1	-2.0	-
Foreign Trade	Export Growth Rate	-1.3	2.2	0.4	0.7	2.7	4.8	1.7	3.3	2.5	5.4	-0.1
Employment/ Prices	Unemployment Rate	3.2	3.1	3.6	3.1	3.0	2.8	4.0	3.7	3.5	3.4	-
	Consumer Price	2.2	1.3	1.6	1.2	1.4	1.1	1.1	1.6	1.7	1.6	1.4
Employment/ Prices	KOSPI	-	-	2,005	1,863	1,997	2,011	1,986	2,002	2,002	2,076	2,068
	KRW/USD	-	-	1,111	1,142	1,075	1,067	1,065	1,012	1,012	1,028	1,014
	3yr Government Bond	-	-	2.52	2.88	2.82	2.86	2.87	2.68	2.68	2.52	2.51
	Corporate Bond (BBB-)	-	-	8.50	8.99	8.97	9.10	9.11	8.91	8.91	8.77	8.76
Economic Index	Coincident Composite Index	-	-	112.3	113.9	115.1	116.8	118.4	118.8	118.9	119.4	-
	Lending Composite Index	-	-	110.7	113.1	114.6	117.0	118.2	119.7	119.8	120.3	-

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

II. Economic Issues Facing Korea

1. Analysis of Influence of Korean Wave on Economy

Summary

Lately, exports of Korean culture contents are sharply rising as Korean culture(Korean Wave or Hallyu) spreads all over the globe. Since statistics were first gathered in 2005, the export of culture contents has consistently increased, especially to China and the South-East Asian countries. As the Korean Wave(K-Wave) evolves beyond generation 1.0 to generation 2.0, we now reach a stage where we can analyze the positive influence brought about by the K-Wave not only on the Korean cultural industry but also the Korean economy as a whole. The K-Wave, which started in the late 1990s to the early 2000s led by the Korean soap opera fever, evolved to the age of generation 2.0 in the middle and the late 2000s focused mainly in the South-East Asian countries.

The K-Wave phenomenon which began with some content in a handful of countries is now benefiting from a development strategy to initiate the age of generation 3.0. K-Wave generates an economic effect as it grows and spreads. The worldwide expansion of K-Wave generates a direct effect of boosting exports of K-Wave-related cultural content and Korea-related commodities and services as well as attracting investment into Korea. This report aims to analyze the effect of K-Wave on

Korean economy divided in three parts: exports of consumer goods, foreign tourists visiting Korea, and foreign direct investment.

Analysis of K-Wave Influence on Economy

The K-Wave phenomenon can lead to promoting sales of Korean-made goods, increase tourism to Korea and possibly generate foreign direct investment in the K-Wave-related industry:

1. Exports of consumer goods especially to the Asian countries are steadily on the increase since the mid 2000s. The recent upturn of consumer goods exports shows that the K-Wave phenomenon may well have exerted a positive influence towards the export of Korean-made consumer goods.

2. Foreign tourists visiting Korea are rising rapidly. The number of foreign tourists who visited Korea in 2013 exceeded 12 million, of which 9.8 million were from Asia. Asia accounted for 70.7% of all tourists in 2003, 73.7% in 2005, and 80.9% in 2013. The sharp increase of foreign tourists is a good sign of the influence the K-Wave has exerted on the attraction of foreign tourists.

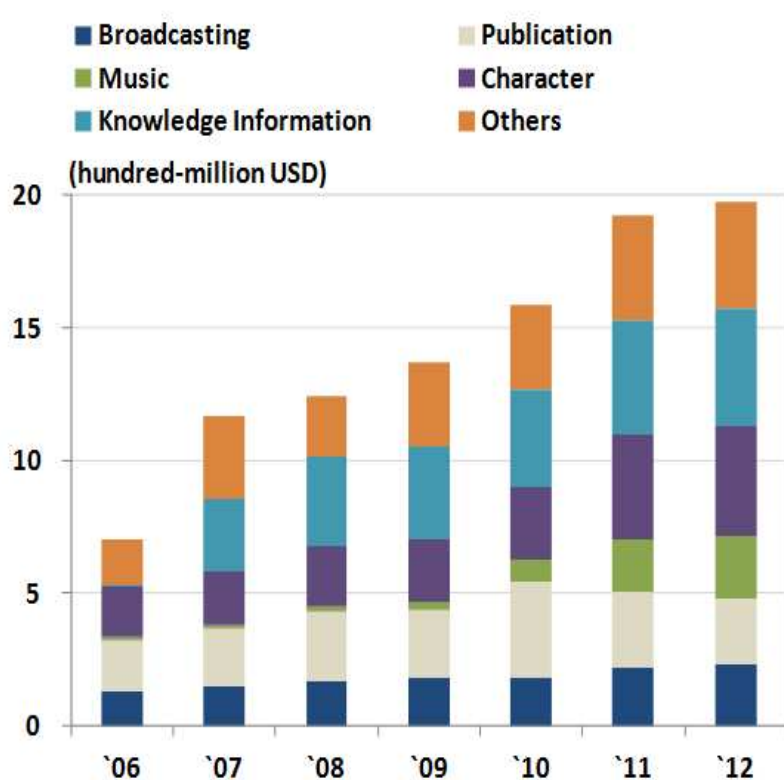
3. Foreign direct investment(FDI) is rising focused on the service industry. Foreign capital inflow amounted to US\$16.2 billion in 2012, the largest to date, and the majority of the FDI is in the service industry, especially in tourism. In particular, Asian countries-led FDI is on the increase. Amongst the Asian countries' FDI, China's FDI in the tourism industry

in Korea was US\$200 million in 2001, but leaped to US\$1.4 billion in 2013, seven times as much, having reached a record-high of US\$2.4 billion in 2012.

The result of the Panel Tobit model-based analysis of the economic effects that K-Wave is believed to have generated from 1995 to 2012 shows that K-Wave led to export growth of consumer goods,, attraction of foreign tourists and foreign direct investment, occurring at staggered times. K-Wave appears to enhance Korea's international profile which promotes consumption of Korea-made goods in the same year that the K-Wave hits while the effect of K-Wave is observed in the following year when it comes to the attraction of foreign tourists.

This is due to the fact that demand for tourism cannot react instantly unlike consumption of commodities, but rather the impact of demand for tourism is seen only in the following year. K-Wave also contributes to the attraction of FDI in the service industry not only in the same year, but in the following years as well. It is believed that the increase of foreign tourists triggered by the K-Wave fever has revitalized the domestic service industry including tourism which also helps attract foreign investment.

< Export Amounts per Culture Content >



Source :Ministry of Culture, Sports and Tourism.
 Note: Others includes comics films, animations, commercials, characters, content solutions and etc

< Economic Effects of K-Wave >

		Economic Effects of K-Wave	
Increase of Consumer Goods Export	t	0.038***	(0.010)
	t-1	0.003	(0.010)
Attraction of Tourists	t	0.01	(0.007)
	t-1	0.019**	(0.007)
FDI Attraction in Service Industry	t	0.097***	(0.037)
	t-1	0.079**	(0.036)

Source: Hyundai Research Institute.
 Note: Figures in brackets show standard errors:
 *** 10%, ** 5%, and * 1%.

Suggestions

To enhance the economic effects K-Wave is generating:

1. The K-Wave should be stepped up for the expansion and evolution to Generation 3.0.
2. The K-Wave phenomenon should be utilized to consistently promote Korean brands and Korea-made goods by linking the K-Wave to exports of the manufacturing industry.
3. Excellent tourist attractions should be constructed and developed while linking the K-Wave phenomenon to the promotion of tourism by publicizing strategically through image contents.
4. The economic effects of K-Wave should be included in promotional materials and utilized as a part of the strategy for attracting foreign investment.

2. The significance of the 22nd Anniversary of Establishing Diplomatic Ties with China, and Cooperation Tasks

Leaping Growth in the Korea-China Relationship

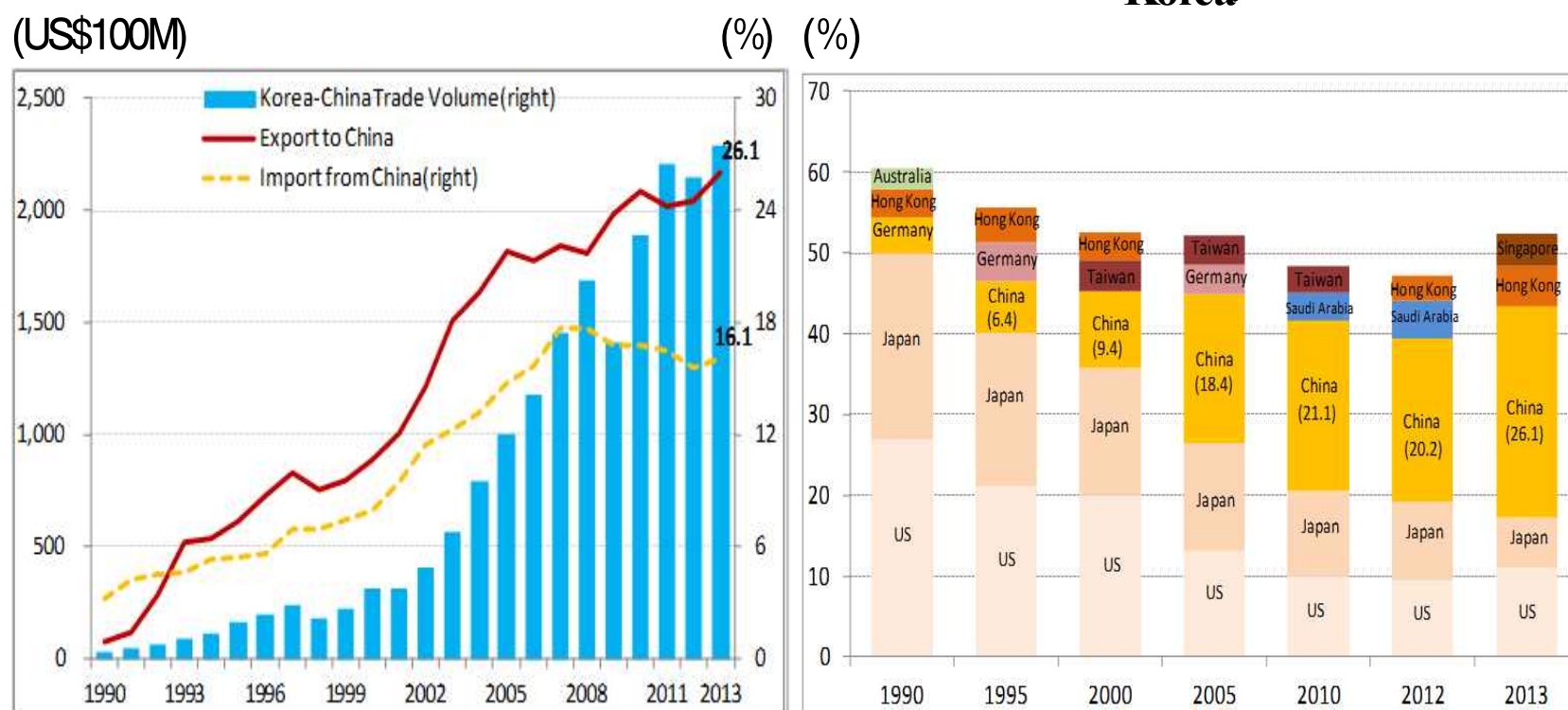
With this year making the 22nd anniversary of establishing diplomatic ties with China, and with Xi Jinping's state visit to Korea, the relationship between the two nations appears to have entered the age of 'Warm Political and Hot Economic Relationships' where a close relationship exists not only in the economic area, but also in the political affairs between the two countries. China, since it adopted reform and opening-up policies in 1978, laid the foundation for establishing diplomatic ties with Korea by steadily increasing trade with Korea via third-party countries before officially signing a joint statement on August 24, 1992 to set-up diplomatic ties with Korea [which had already served diplomatic relations with the Republic of China(Taiwan)]. Furthermore, Xi Jinping's state visit to Korea in July this year elevated the relations between the two nations from one of good neighborliness at the time of establishing diplomatic ties to the strategic partnership that it is now.

Pending Issues in Economic Cooperation between Korea and China

The outcome of Korea-China economic cooperation for the last 22 years was reviewed in the areas of trade, investment, technology, and culture:

1. Korea's trade dependence on China has significantly increased as the trade between the two countries substantially expanded. The trade volume since establishing diplomatic ties increased by an annual average rate of 19% from US\$6.4 billion to US\$228.9 billion as of 2013, a 36 fold growth.

<Trend of Korea's Trade with China> <Trend of Top 10 Trading Partners of Korea>



Source: Calculated by HRI based on Korea Trade Association Data.

2. High value addition in the investment and exports to China is gathering pace. The pattern of export items to China is changing from steel and textile-centered items to advanced products such as semiconductors. The export volume of steel plates to China in 1992 amounted to US\$420 million, the largest single export item, while semiconductors emerged as the top export item in 2013 marking US\$21.7 billion. Korea's direct investment in China is also fast transferring to areas of high value addition such as electrical/electronic instruments, semiconductors, finance, and insurance. Of note, Korea's direct

investment in electrical/electronic industry jumped from US\$17 million in 1992 to US\$3.114 billion in 2013, a 190 fold growth during the 22-year period, while direct investment in wholesale/retail and financial industry also increased substantially.

3. Monetary cooperation between the two nations is also strengthening. Korea concluded a currency swap agreement with China for 180 billion yuan in December 2008 and renewed it for 360 billion yuan in October 2011. Monetary cooperation has been stepped-up by opening a trade market where Korean won and Chinese yuan is accepted as a settlement currency.

4. Technological cooperation also solidified. The technological trade between the two countries leapt from US\$192 million in 2001 to US\$2.224 billion in 2012, 12 times as much at an average annual growth rate of 24.9%. The number of joint research projects also increased from 39 in 2005 to 186 in 2011.

5. Cultural exchange is also actively developing. The size of human exchange between the two countries increased dramatically from 90,000 in 1992 to 7.89 million in 2013. In particular, the influence of K-Wave in China expanded sharply as the volume of content-related trade with China steadily increased.

Suggestions

Korea and China should put forth multi-front efforts into sustaining a qualitative cooperation partnership in areas such as

economy, industry and finance. At the same time, Korea should maintain and strengthen its competitive edge as Korea inevitably finds itself competing with China on a cooperative basis, and make best use of opportunities available:

1. Korea should prepare a new roadmap to explore China's consumption market in preparation for Korea-China FTA
2. Efforts to secure competitive edge against China should continue to sustain initiative in industrial standardization by implementing a positive frontier studies related to the technologies of the manufacturing industry.
3. Strategies should be in place to seek advancement of Korean finance trade to China in line with China's opening-up of its financial market.
4. Development of human resource and cultural service is imperative to revitalize cultural and personal interchange.

III. North Korean Issues

Survey on Experts on the Prospects of North-South Relations for the Second Half of 2014

Providing Momentum for a Breakthrough of the North-South Relations

Despite holding the reunion of separated families in the beginning of the year and expectations for the Unification Jackpot, a breakthrough for the improvement of the North-South

Relations has yet to be made although there are still some opportunity factors such as the 8.15 congratulatory speech and the participation of North Korea in the Asian Games. Hyundai Research Institute conducted a survey from July 4 to July `18 on 117 experts on issues of unification, diplomacy, national security, the implications of suggestions made in the 8.15 congratulatory speech and the prospects of North-South relations for the second half of this year in a wish to provide momentum for North-South relations.

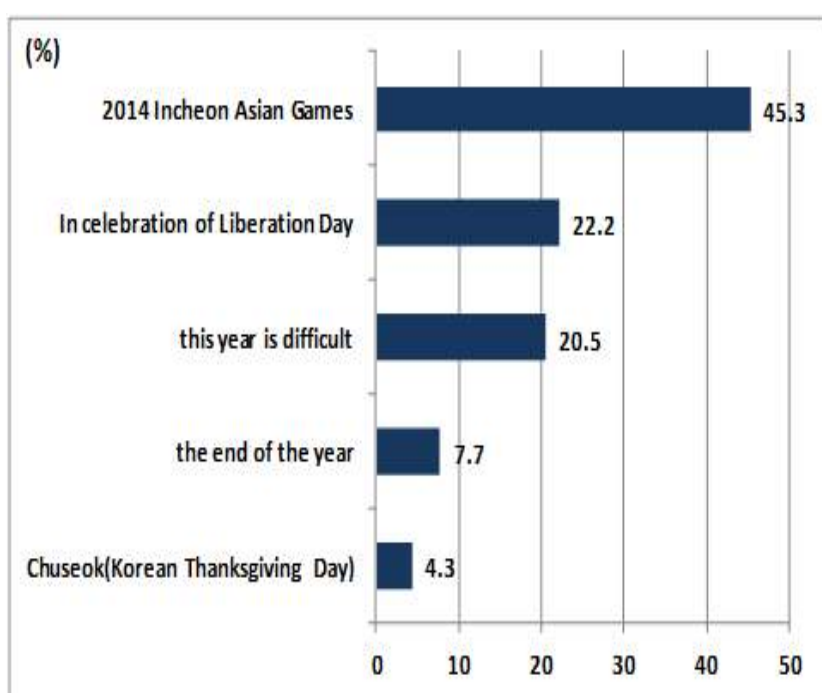
Questionnaire Survey on Experts on North-South Relations

(Turning Point of the North-South Relation) Experts believe that this coming Asian Games(45.3%) and the congratulatory speech(22.2%) can be the beginning of improvement in the North-South relations considering that the participation of the North Korean cheering squad in the Asian Games held in 2002 and the Asian Athletic Championship in 2005 brought a positive effect towards improving North-South relations at that time.

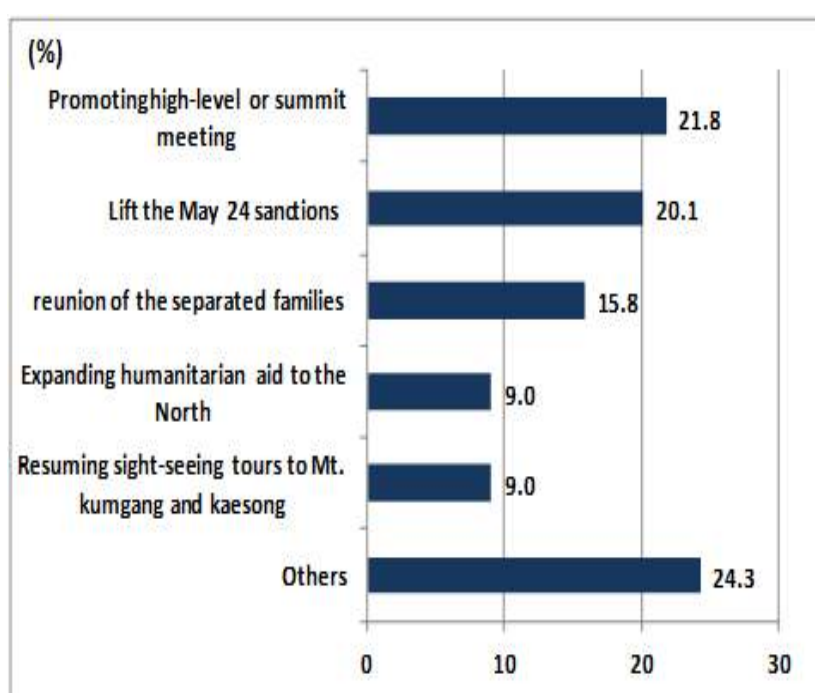
Respondents believe that a political decision should be made by the supreme leaders of both North and South Korea and that the North-South relations in economic and social areas should be reinstated to pre-strained relations level to provide a turning point for improvement. They also responded that efforts should be made to restore trust between the North and the South by holding a high-level North-South meeting(21.8%), lifting the 5.24 sanction(20.1%), arranging reunion of separated

families for Chuseok holidays(15.8%), resuming Mt. Geumgang tours(9.0%) and increasing humanitarian aid to the North(9.0%).

<Timing of Turning Point for Improvement of North-South Relations>



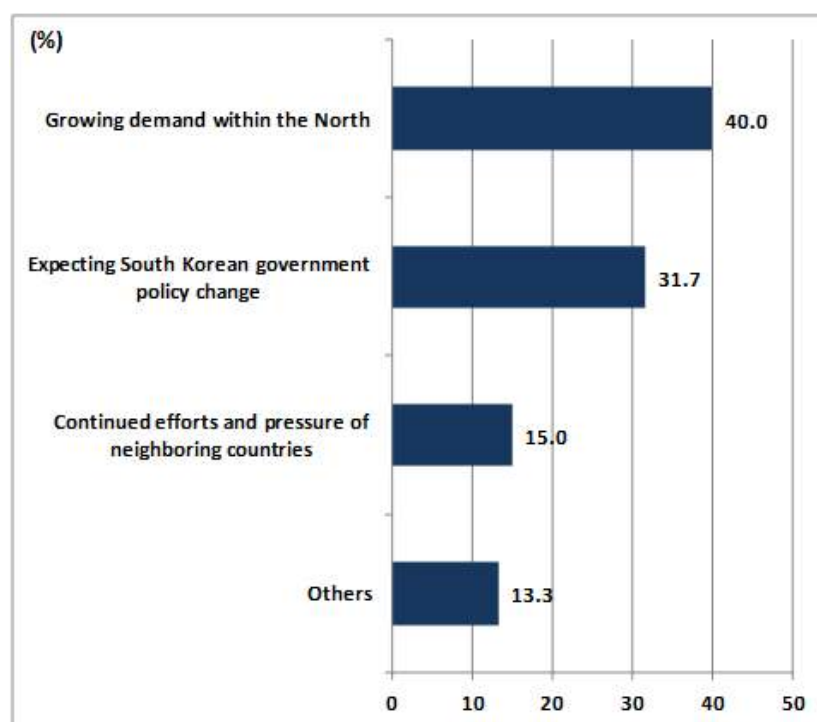
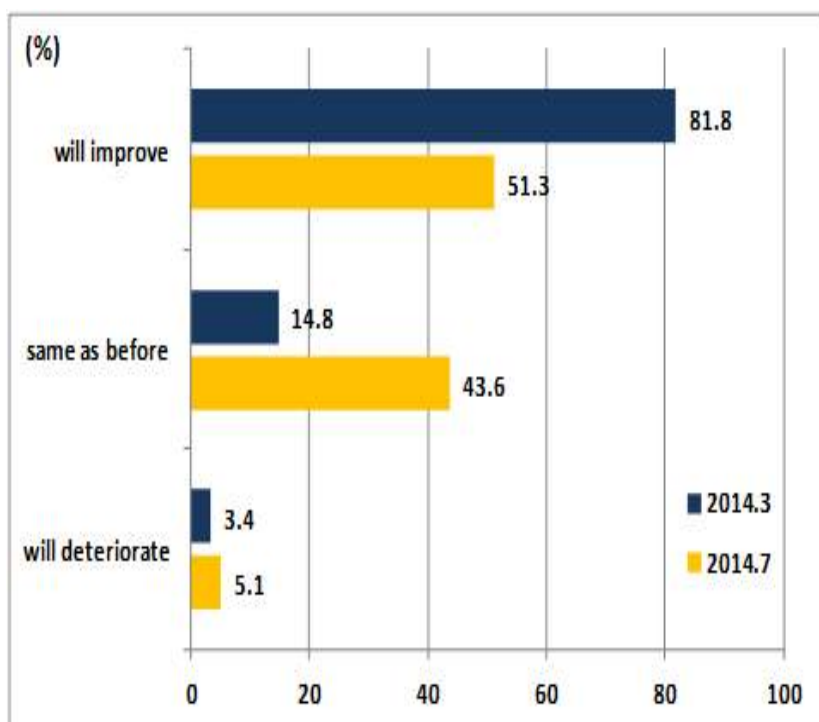
<Suggestions made in the 8.15 Congratulatory Speech>



(Forecast on the Prospects of North-South Relations for the Second Half of 2014) Experts replied that ‘the relations will improve’(51.3%) or ‘maintain the present level’(43.6%). Positive opinions dropped compared to the similar survey conducted in March this year(81.8%→51.3%) due in part to N. Korea’s repeated missile launchings and the South Korean government’s stance of maintaining its present policy of stressing principles toward the North. ‘Increasing necessity for visible achievement of attracting foreign investment and breaking from international isolation’ was the first reason for the positive view(40.0%) followed by ‘growing demand within the North(40.0%)’ and ‘expecting South Korean government policy change’(31.7%).

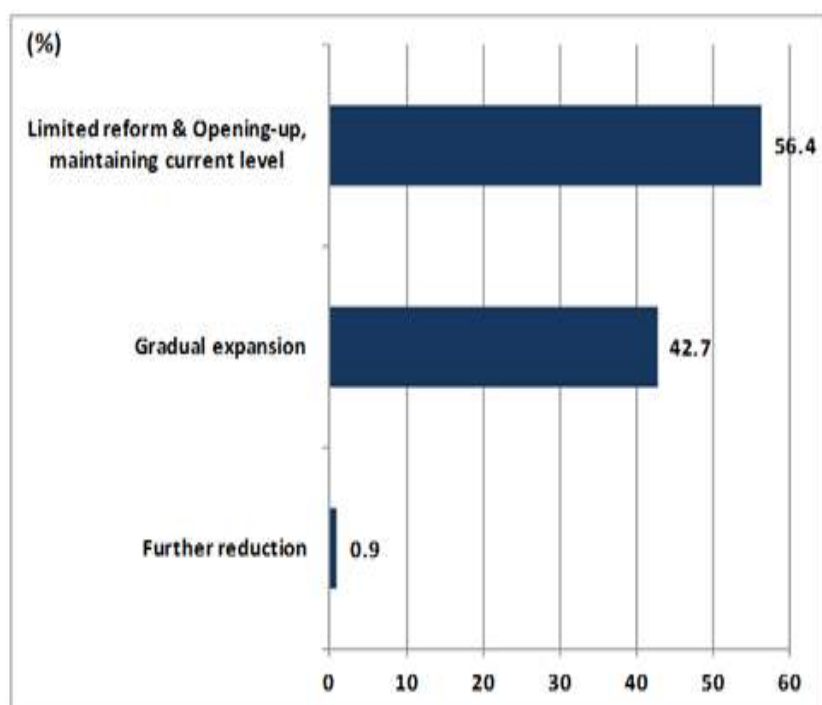
<Forecast on North-South Relations for the Second Half of 2014>

<Grounds for Optimistic View>

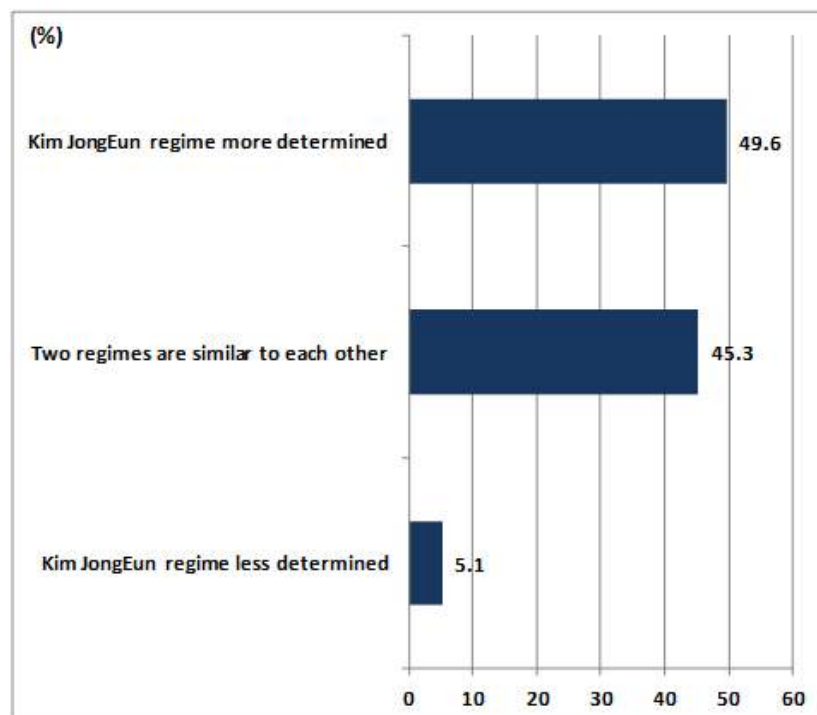


(Forecast on N. Korea's Reform and Opening-up) Experts appear to assess N. Korea's current drive to amend various economy-related laws and to designate broad-scaled economic development zones as a positive sign for willingness for reform and opening-up. Almost all respondents are of the positive opinion that N. Korea will 'keep present level'(56.4%) and 'gradually expand'(42.7%). Experts assessed that the current N. Korean government will promote economic reform more aggressively compared to the KIM JongIl regime in view of the fact that KIM JeongEun is a young leader with a western educational background combined with the reinforced role of the cabinet government and the ambitious introduction of economic development zones.

<Forecast on N. Korea's Reform and Opening-up Drive>



<Comparison of Kim JongIl and King JongEun Regimes>



Suggestions

To provide momentum for the improvement of the North-South relations in the second half of 2014:

1. More flexible policy toward N. Korea should be employed to make best use of the opportunities to be provided by the 8.15 congratulatory speech and the Asian Games. In particular, forward-looking suggestions such as high-level official talks and the lifting of the 5.24 sanction should be included in the 8.15 congratulatory speech.

2. Creation of friendly atmosphere is necessary through economic cooperation to encourage and help N. Korea to achieve a positive result out of its reform policy drive and further sustain the policy with determination.

3. Trust between the two Koreas should be restored through continued support for vulnerable social groups and the expansion of social and cultural inter-exchange.

[Annex] Domestic and Global Economic Indices

Global Growth Rate

Category	2012					2013					2014
	Annual	1/4	2/4	3/4	4/4	Annual(E)	1/4	2/4	3/4	4/4	Annual(E)
US	2.8	3.7	1.2	2.8	0.1	1.9	1.1	2.5	4.1	2.6	2.8
Euro Region	-0.6	-0.1	-0.3	-0.1	-0.5	-0.4	-0.2	0.3	0.1	0.3	1.2
Japan	2.0	3.7	-1.7	-3.1	-0.2	1.7	4.8	3.9	1.1	1.0	1.4
China	7.7	8.1	7.6	7.4	7.9	7.7	7.7	7.5	7.8	7.7	7.5

Note: 1) IMF figures of April 2014 for 2013 and 2014 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		2012	2013			2014(E)
			the first half	the second half	Annual	
National Account	Economic Growth rate (%)	2.3	2.4	3.5	3.0	3.6
	Private Consumption (%)	1.9	1.9	2.1	2.0	2.5
	Construction Investment (%)	-3.9	6.4	7.0	6.7	2.6
	Facility Investment (%)	0.1	-8.3	6.2	-1.5	5.4
Foreign Trade	Current Account (100 million Dollars)	508	313	486	799	790
	Exports (100 million Dollars) [Increase rate, %]	5,479 [-1.3]	2,765 [0.5]	2,832 [3.8]	5,596 [2.1]	5,836 [4.3]
	Imports (100 million Dollars) [Increase rate, %]	5,196 [-0.9]	2,565 [-2.9]	2,591 [1.4]	5,156 [-0.8]	5,381 [4.4]
Consumer Price (Average, %)		2.2	1.4	1.2	1.3	1.7
Unemployment rate (Average, %)		3.2	3.4	2.9	3.1	3.6

Economic Indicators of North Korea

		2005	2006	2007	2008	2009	2010	2011	2012	2013
Per capita GNI (10,000 won)		105	103	104	114	119	124	133	137	138
Trade by Year (USD million)	Amount of South-to-North	715.5	830.2	1,032.6	888.1	744.8	868.3	800.2	897.2	520.6
	North-to-South	340.3	519.5	765.3	932.3	934.3	1,043.9	913.7	1,074.0	615.2
	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	1,135.8

Source: THE BANK OF KOREA, Ministry of Unification.

Hyundai Research Institute

Current Status

HRI is established by Chung Ju-yung, the first CEO, founder and honorary chairman of Hyundai Group in 1986. HRI is a leading Korean research think tank committed to studying and analyzing the economic and industrial environment as well as reunification economy of Korea. HRI, further, has its own businesses such as business consulting, education and training service, and knowledge-content business.

Main Research Topics

HRI is mainly composed of four divisions. The major working areas of each part are as following :

Research Sector deals with the macroeconomic issues relating to domestic-and-international economy as well as the industrial trends and issues. Reunification Economy Center is one of its sub-sectors, specialized in both the North Korean political and economic issues.

Business Consulting Sector devotes to helping domestic and international companies improve their competitiveness by providing strategic solutions.

Knowledge-Business Sector produces a great deal of invaluable online-and-offline contents such as educational videos and reading materials.

Human Resource Development and Education Sector provides HR development consulting services to companies for improved talent management, and also provides educational services such as training and lectures.

Messages to Future-Cooperation Partner

HRI is prepared for cooperation and coworks with your institute, especially in the field of survey, economic trend analysis and business consulting. For more information on cooperation, please contact us.

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