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HRI Monthly Economic Review

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Devoting to economic research
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the Hyundai Research Institute leads
the advancement of Korean Economy
in the 21st century by proposing
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■ Characteristics of Domestic Economy in 2013

Economic Growth

Having passed the trough in the first quarter of 2013, the Korean economy has since entered a recovery phase with an annual growth rate of 2.8%, well below the potential growth rate of 3.8%. Inflation rates of consumer prices and core prices are expected to stay around 1.0% plus, rendering Korean economy in a deflationary gap of low growth rate-low prices.

Domestic Demand

The growth rate of consumption has not performed well due to the sharp rise of household debts and deposit-based rents. Construction investment both in the public and private sectors increased thanks to the government budget expansion for SOC and the revised supplementary budget, while recovery of facility investment is insubstantial due to the delayed recovery of domestic as well as global economy.

External Demand

The growth rate of export volume is expected to remain low due to the delayed recovery of world economy, while stabilized raw material prices and shrunken imports due to the slowdown of domestic consumption is likely to produce a large trade surplus.

■ Global economic environment for 2014

Global Economy on the Upturn Led by Major Economies

World economy is expected to improve in 2014 led by the economies of advanced countries including the US. The growth rate of advanced countries' economies is likely to mark 2% plus. Led by China and India, economies of emerging countries are expected to achieve a similar level of growth rate to 2013. World trade volume is anticipated to grow by 4.5% plus with gradual recovery of global economy.

Downturn of International Raw Material Prices

International oil price is expected to fall due to the reduced imports by the US and strong dollar, while metal price is likely to rise marginally due to the recovering global economy. Increased production of wheat is likely to act as a factor to bring down the price of agricultural products, which can be affected by increasing fluctuations caused by extreme weather changes.

Appreciation of the Euro and the Yuan

Euro is likely to appreciate marginally as the Eurozone economy is slowly emerging from recession. Yuan is also expected to appreciate as China's economy recovers and the trend of adopting yuan as a settlement currency increases, while the yen is expected to continue to depreciate with the continuing QE monetary policy.

■ Domestic Economic Forecast for 2014

Economic Overview

In terms of Economic Growth, with a good prospect of strong momentum in global trade, rising exports will lead to increased facility investment boosting economic recovery. The anticipated economic growth rate for 2014 is 3.5% plus, and is likely to achieve a growth rate similar to the potential growth rate.

In Domestic Demand, although household debts, sharply rising deposit-based rent, and falling average consumption propensity due to the aging society are acting as factors to discourage consumption, the growth rate of consumption is expected to increase thanks to rising real income, improving export trade conditions, and base effects. Construction investment is unlikely to achieve a fast recovery due to the reduced government budget for SOC in 2014, although facility investment is forecast to make a gradual recovery thanks to the expectation for the recovery of export business. Export Demand conditions are expected to improve with the recovering US economy, Eurozone's economy emerging from recession, and China's rising export volumes to advanced countries.

Domestic Economy

Private consumption is expected to increase by 2.5% plus thanks to rising real purchasing power and a gradual increase of household real income with stabilized international raw material prices and improving trade conditions.

Facility investment is forecast to increase by 6.5% plus due to the pressure to adjust facility investment and recovering orders for machinery with expectations for domestic and global economic recovery.

In terms of Construction investment, SOC is expected to increase marginally with rising construction investment led by private sector housing constructions following government measures to boost real estate market. Public sector construction investment is set to fall due to the reduced government budget for SOC.

The growth rate of imports and exports is expected to show a modest increase owing to the recovering US economy, Eurozone's emergence from recession, and improving Chinese export volume to the US. Export volume is likely to increase by around 8.5% with exports to the US and Europe recovering and exports of intermediary goods via China also increasing. Trade balance is anticipated to reach a surplus of US$37 billion, and current account balance a surplus of US$49 billion; the size of the surplus is, however, expected to shrink due to the increasing imports in 2014.

Employment and Price

Unemployment rate is expected to fall in 2014 by a small margin driven by recovering corporate investments and construction business in the private sector along with the top priority of government policy placed on job creation.

With the prospect of increasing pressure from demand as a result of economic recovery and rising nominal wages from supply, inflation is expected to be higher than in 2013 although international raw material prices stabilizing at a low level and a strong Won would act as factors to limit the inflation rate.

Exchange Rate on Won

Won/Dollar exchange rate is to be determined by the balance of various factors for appreciation or depreciation of the won.

■ Prospects for and characteristics of major industries for 2014

○ Prospects for major industries in 2014

Outlook on the Business of Major Industries for 2014

Although most industries are expected to emerge from the recession as the global economy recovers, some are feared to fail to come out of the depression or achieve only an insignificant recovery due to the depressed demand and oversupply caused by structural problems.

Industries on Recovery Track

Steel Industry: Having passed the trough of business cycle, steel industry shows signs of upturn though the recovery is to be lackluster due to the limited increase of demand.

Construction Industry: The public sector is still in recession due to the government budget cut for SOC although construction business in the private sector is to improve due to the base effect as a result of protracted depression.

Shipping Industry: World cargo volume is expected to rise, but the recovery of freight rates will be limited due to the excessive supply in the market.

Machinery Industry: Production and exports of machinery products are to improve gradually as facility investment increases following the global economic recovery.

Booming Industries

Automobile Industry: Motor exports are likely to increase as economies of advanced countries recover. Domestic car market is also expected to grow although a substantial portion of the growth is likely to be taken by imported cars.

Industries in Recession

Petrochemical Industry: Business performance of petrochemical industry is forecast to soften due to the insignificant recovery of upstream industries and an appreciating won. The oversupply in the North East Asia is to remain a key pending issue in the mid-long term.

IT Industry: Although the production and export of IT products will continue to grow owing to the expanding global IT market, the growth rate of global market for key products is to slow causing concerns over the risk of the IT industry falling into recession.

Industry Failing to Emerge from Recession

Shipbuilding Industry: Profitability is unlikely to improve substantially due to the effect of existing orders secured at low prices, and new orders heralding speedy recovery is unlikely to happen in the near future.

○ Characteristics of 7 Major Industries for 2014

1. Business Recovery Led by Export and Manufacturing Industries

Export businesses are expected to recover faster than domestic demand in 2014 outperforming the service industry, and therefore, manufacturing industry will return to play its role as a main engine for economic growth.

2. Comparative Boom of Export Industries Exporting to Advanced Countries

Global economic recovery is expected to be led by advanced rather than by emerging or newly industrialized countries in 2014, and therefore, export items for advanced countries such as IT products, automobiles, and ships are more likely to recover faster than those items mainly for emerging countries such as petrochemical products, machinery, and steel.

3. Key Materials Industries Facing 'China Risk'

As Chinese government is adopting a policy of expanding localization ratio for steel and petrochemical industries as strategic industries, China's capability to produce these products is fast growing rendering Korea's exports of the same products to China at risk of shrinking as a result of oversupply(China Risk).

4. Imported Products to Take a Larger Share in Domestic Market

Imports of major nondurable goods is to substantially increase due to the reduced customs duty following the conclusion of FTAs with the US and EU and strengthening marketing activities of foreign exporters. The growth rate of imported nondurable goods is likely to rise fast with the possibility of Korean won exchange rate further strengthening.

5. Comparative Boom of Public Services within Service Industry to Continue

Government expenditure related to boosting domestic economy and expanding social welfare has increased to a large extent since 2012, and the government is set to increase further expenditure on strengthening economic recovery and social security, resulting in a high growth rate of public services in 2014.

6. Order-Driven Production Industries Facing Continuing Structural Recession due to the Delayed Recovery of Demand

Construction industry's order book continues to drop although it could marginally improve led by private sector if a series of government policies to boost real estate market takes place. Shipbuilding industry might suffer deteriorating profitability as a result of securing orders for the lowest prices since the latest financial crisis.

7. IT Industry Facing Necessity to Provide Opportunity for the Launch of Development Stage

The growth rate of global IT market for Korea's key IT export items such as smart phone and memory semiconductor chips is likely to slow, and therefore, the government is promoting various IT industry-friendly policies so that IT industry can play a pivotal role for creative economy by increasing R&D investment and enhancing the level of performance. It is understood that effective demand of public sector coupled with real demand within the industry will provide momentum to enhance IT industry to a higher level.

■ Policy Issues

Although Korea's economic growth rate for 2014 is estimated to be around 3.5% plus, the potential growth rate is likely to continue to fall. Considering the risks of unmeasured confounders both internal as well as external, the government needs to introduce the following policies:

1. Planning of Comprehensive Measure to Enhance Potential Growth Rate

A measure should be introduced to effectively deal with social issues such as aging society, retirements, insufficient use of female human resource and youth unemployment, and various policies should be considered to reinstate middle class by offering tax relief and creating good quality jobs. Policies should also be considered to encourage Korean manufacturing businesses operating overseas to make U-turn to Korea, promote ICT convergence, and to strengthen R&D activities. At the same time, entrepreneurial spirit should be encouraged by readjusting the speed of economic democratization and easing administrative regulations.

2. Measure to Reinstate Consuming Wherewithal

Consumption of middle class people should be enhanced by ensuring soft landing of household debts, revitalization of real estate market, and creation of good quality jobs.

3. Policy Support to Reinvigorate Investments

Regulation reform, readjustment of speed of economic democratization, compromise between employers, labor unions, and government, removal of obstacles to investment, and expansion of tax benefits for investment should be promoted to revitalize facility investment, while adopting policies to reinvigorate housing market, increasing the housing supply for rent and easing housing cost burden for the working class in line with the measure announced on August 28. Investment on SOC should also be maintained at expansionary levels by means of employing BTO and BTL if government budget is insufficient.

4. Enhancement of Fiscal Sustainability

Excessive welfare service should not be allowed to deteriorate financial stability. Although expansion of welfare service is inevitable, it should be provided only for those who really need it, and the increase of welfare costs should be met by increasing tax and legalizing the underground economy.

5. Preparation for Potential Confounders

Prudent macro regulations and movements of international capital should be constantly monitored to prevent uncertainty of financial market in preparation for the rapidly cooling global economy that could be caused by the reduction of QE in the US, risk of Japan's Abenomics, and possible hard landing of China's economy. Measures should also be set up to minimize external shocks by exploring new markets and by utilizing FTAs while strengthening fundamentals of domestic market and promoting knowledge-based service industry.

Ⅰ. Korea's Economic Characteristics in 2013

■ Characteristics of Korean Economy in 2013

(Status of Economy) Domestic economy in 2013 is in deflation gap situation with economic growth rate below the potential growth rate and inflation of 1% plus.

Although Korean economy entered a recovery phase having passed the trough in the first quarter, the annual growth rate is likely to stay well below the potential growth rate of 3.8%. Having recorded a year-on-year increase of 3.6% in Q3 of 2011, the growth rate dropped to 1.5% in Q1 of 2013 before bouncing back to 2.3% in Q2, 3.3% in Q3 and 3.9% in Q4 of 2013. However, the growth rate in 2013 is 2.8%, well below the potential growth rate of 3.8%.

Concern over Korean economy entering deflation is growing with the growth rate of consumer prices and core prices continuingly staying at 1% plus due to the lasting domestic economic recession.Consumer price index remains unchanged at 1% plus with average monthly rate of 1.1% for the period from January to December 2013, helped by low pressure for inflation due to depressed domestic demand and stabilized prices of agricultural and oil products. The risk of Korean economy entering deflation has reached record levels not seen since the periods of foreign exchange crisis and financial crisis.

(Domestic Demand) Although construction investment showed signs of recovery with increasing investment in both public and private sector, the recovery trend of consumption and facility investment remains insignificant.

The increasing trend of consumption is marginal due to high household debts and sharply increasing deposit-based rent. The growth rate of private consumption was a mere 1.5% in Q1, 1.8% in Q2, 2.1% in Q3 and 2.2% in Q4 of 2013. Construction investment increased thanks to the government budget expansion for SOC and revised supplementary budget.

Having recorded a negative growth of -4.2% in Q4 of 2012, construction investment bounced back to 2.4% growth in Q1, 7.2% in Q2, 8.6% in Q3 and 8.1% in Q4 of 2013 with the government budget expansion for SOC and revised supplementary budget. Facility investment remains weak due to the delayed domestic and global economic recovery. Although the growth rate of facility investment in the first half of 2013 was insignificant, it returned to an upward trend in Q3 by a small margin.

(Overseas Demand) Exports continued to perform well and reached a record-high surplus thanks to the stabilized prices of imported goods and depressed import volume.

Imports continued to remain in a slump due to the stable international raw material prices and slowdown of domestic consumption due to the delayed recovery of global economy although exports increased by a small margin. Exports gradually rose by 4.7% in Q4 and by 7.0% in December having remained weak during the first half of 2013.

Imports, however, remained depressed marking a growth of 0.3% in Q3 before bouncing back to positive growth of 2.5% in Q4 and 3.0% in December 2013. Current account balance is expected to record a large surplus with imports remaining flat. Current account balance showed a surplus of US$64.3 billion as of November 2013, marking a record-high surplus due to the stable raw material prices and depressed imports.

<Growth Trend by Domestic Economic Sector>

(Unit : %, $ 100 million, 1,000 persons)

Growth rate		2011	2012					2013					
			1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Nov	Dec
Economic Growth rate		3.7	2.8	2.4	1.6	1.5	2.0	1.5	2.3	3.3	3.9	-	-
Domestic	Private Consumption	2.4	1.3	1.0	1.7	2.7	1.7	1.5	1.8	2.1	2.2	-	-
	Construction Investment	-4.7	-0.4	-3.1	-0.3	-4.2	-2.2	2.4	7.2	8.6	8.1	-	-
	Facility Investment	3.6	8.8	-3.5	-6.9	-5.2	-1.9	-11.9	-4.6	1.5	9.9	-	-
External	Current account	261	29	134	155	162	481	100	198	190	-	60	-
	Trade Balance	308	12	97	75	99	283	56	144	108	133	48	36
	Export	5,552	1,348	1,401	1,331	1,398	5,479	1,353	1,412	1,368	1,464	479	480
	Growth rate	19.0	2.9	-1.7	-5.8	-0.4	-1.3	0.4	0.7	2.7	4.7	0.2	7.0
	Import	5,244	1,337	1,304	1,257	1,298	5,196	1,297	1,268	1,260	1,331	431	444
	Growth rate	23.3	7.8	-2.9	-6.9	-1.1	-0.9	-3.0	-2.8	0.3	2.5	-0.6	3.0
Employment	Unemployment rate	3.4	3.8	3.3	3.0	2.8	3.2	3.6	3.1	3.0	2.8	2.7	3.0
	Increased number of employed	415	467	430	506	342	437	257	324	421	541	588	560

Note : The trade balance, exports, imports are on customs clearance basis.

Ⅱ. Global Economic Conditions in 2014

1. Global Economy : World Economy on the Upturn in 2014 Led by Advanced Nations

(Current Status) Economies of Advanced Nations as well as Developing Countries are on Weak Upturn.

Economies of Advanced Nations are not completely out of recession in 2013 except for the US, and the recovery of developing nations' economies remain weak due to depressed global demand and falling international raw material prices. **The US:** The US economy is expected to achieve growth of 1.9% thanks to the reduced effect of sequester, consumption expenditures, and improved real estate market. **Europe and Japan:** Eurozone, still lingering in the aftermath of economic recession, is likely to mark a negative growth of -0.4%, and Japan is expected to achieve growth of 1.7% in 2013 due to the QE monetary policy and improving private consumption. **Newly Emerging Nations:** The growth rate of newly emerging nations is expected to be around 4.7%, 0.2%p lower than in 2012 due to the reduced external demand following the slow recovery of world economy and low international raw material prices.

(Forecast for 2014) Global economy on gradual recovery led by advanced nations including the US.

The growth rate of advanced nations for 2014 is forecast to be around 2.0%, higher than 1.7% in 2011, while newly emerging nations' growth is to stay around 5.1%. **The US:** Expected to achieve a growth rate of 2.8% with recovering housing market and improving manufacturing business. **Japan and Europe:** Japan with its lasting QE monetary policy and Europe with its structural adjustment and residual effect of economic recession are expected to make a growth rate of 1% plus. **Newly Emerging Nations:** Economic recovery may face difficulties due to the risk of global capital leakage following the reduction of QE by the US and falling international raw material prices.

< Global Growth Rate Outlook by IMF >

(%)

Division			2012	2013(E)			2014(E)		
				'13.7	'13.10	'14.1	'13.7	'13.10	'14.1
World Economy			3.1	3.1	2.9	3.0	3.8	3.6	3.7
	Advanced Economies		1.4	1.2	1.2	1.3	2.1	2.0	2.2
		US	2.8	1.7	1.6	1.9	2.7	2.6	2.8
		Japan	1.4	2.0	2.0	1.7	1.2	1.2	1.7
		Europe	-0.7	-0.6	-0.4	-0.4	0.9	1.0	1.0
	Emerging &Developing Economies		4.9	5.0	4.5	4.7	5.4	5.1	5.1
		ASEAN-5	6.2	5.6	5.0	5.0	5.7	5.4	5.1
		Middle East and Southwest Asia	4.1	3.1	2.3	2.4	3.7	3.6	3.3
		Central and South America	3.0	3.0	2.7	2.6	3.4	3.1	3.0
		Africa	4.8	5.1	5.0	5.1	5.9	6.0	6.1
		BRICs Brazil	1.0	2.5	2.5	2.3	3.2	2.5	2.3
		BRICs Russia	3.4	2.5	1.5	1.5	3.3	3.0	2.0
		BRICs India	3.2	5.6	3.8	4.4	6.3	5.1	5.4
		BRICs China	7.7	7.8	7.6	7.7	7.7	7.3	7.5

Sources : IMF.
Note : 1) ASEAN-5 indicates Indonesia, Malaysia, Philippines, Thailand and Vietnam.
2) Africa indicates sub-Saharan Africa.

2. Global Trade: Expected to Increase as Global Economy Recovers

(Current Status) Global trade volume is to increase marginally as the economic recovery of advanced as well as developing nations is still weak.

Global Trade: World trade volume is likely to increase by 2.5% plus due to the aftermath of Eurozone financial crisis and depressed exports from China. High interest rates on government bonds of nations in financial crisis and record-level unemployment rates are delaying the dissolution of Eurozone's financial crisis and the restoration of real economy. Export and import business of China is in depression due to weak global demand and the ongoing economic structural readjustment.

(Forecast for 2014) Global trade volume is expected to increase with recovering world economy led by advanced nations.

Advanced Nations: The imports and exports of advanced nations are forecast to increase by around 4.5% in 2014 with continuing recovery of the US economy and Europe emerging from recession. The US is set for positive growth led by real estate business, and Europe is emerging from the recession to mark a zero-plus growth rate.

Emerging Nations: Foreign trade of developing nations is expected to increase by 5.5% plus both in exports and imports thanks to the recovering global and China's economy. The global economic recovery led by advanced nations will stimulate China to import more raw materials, which will contribute to developing nations to increase exports.

< Prospect of Exports and Imports by Region >

(%)

Division		2011	2012	2013(E)	2014(E)
Global Trade Growth		6.1	2.7	2.9	4.9
Export	Advanced Countries	5.7	2.0	2.7	4.7
	Emerging Countries	6.8	4.2	3.5	5.8
Import	Advanced Countries	4.7	1.0	1.5	4.0
	Emerging Countries	8.8	5.5	5.0	5.9

Source : IMF, World Economic Outlook, October 2013.

3. International Commodities : Prices are Expected to Remain Weak

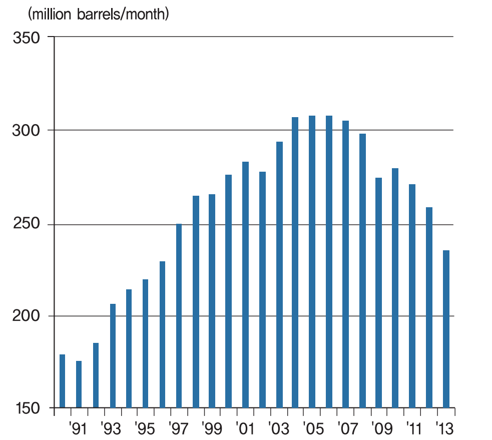
(Current Status) Prices of international raw materials remains weak due to the delayed recovery of global economy and reduced demand of China.

Crude Oil: Prices of crude oil sharply rose in the beginning of the year, but later fell back due to the reduced demand of the US and poor business indicators of Eurozone. The average monthly oil imports of the US in 2013 was 235,521,000 barrels as of October 2013, recording the lowest level of import since 1996 when imported oil amounted to 228,990,000 barrels.

Other Raw Materials: Prices of other raw materials marginally dropped due to the slower-than-expected recovery of global economy including China and improved demand-supply balance with existing inventory. Prices of metals were weak in the first half of 2013 due to the insignificant economic recovery, but later showed an upturn driven by expectation for the recovery of global economy. CRB index futures increased to 303.99p on January 31, 2013 only to fall back later to 280.53p as of January 22, 2014.

< Monthly Average Scale Forecast of U.S. Crude Oil Imports>

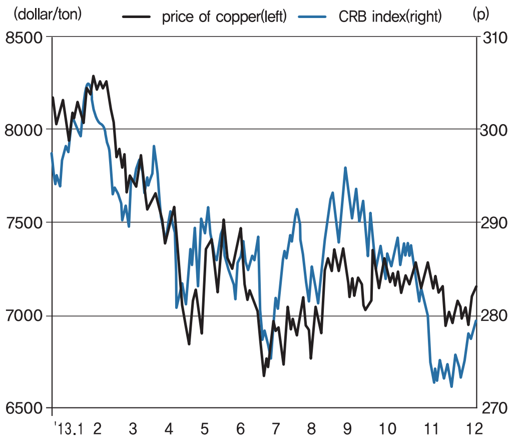
(%)



Source : U.S. EIA.
Note : The data of 2013 is monthly average from January to October.

< Progress of Major International Raw Material Price(2013) >

(trillion won)



Source : Commodity Research Bureau.
Note : CRB index(1967 = 100p).

(Forecast for 2014) Prices of international raw materials are expected to remain weak due to strong dollar following an expected reduction of QE by the US, weakening preference for commodity assets created by reduction of international liquidity, and overall improvement of demand-supply status.

Crude Oil: Price of crude oil is forecast to fall owing to the improved demand-supply status following the lasting reduction of oil imports of the US and reduced oil export price as a result of strong dollar. Increasing trend of domestic oil production of the US including shale oil is replacing imported oil contributing to improvement of demand-supply status of international oil market. Appreciating US dollar is prompting leakage of investment capital in the commodity market and acting as a factor to bring down the crude oil export price of oil-producing countries. Geopolitical variables such as political uncertainty in the Middle East could be a factor causing sharp rise of oil price.

Other Raw Materials: Prices of other raw materials, with contradicting effects of rising demand with recovering world economy balanced by improving demand-supply status with increased production and accumulated stock pile, are likely to be mixed. Prices of metals are likely to rise within limits as global economy recovers. Prices of agricultural products are expected to drop with improving demand-supply status led by increased production of international wheat, which is subject to fluctuation because of extreme weather.

< Global Oil Price Forecast >

(Unit: $/barrel)

Division		2011	2012	2013			2014		
Oil	institute			First half	Second half	Annual	First half(E)	Second half(E)	Annual (E)
Dubai	CERA	106.2	109.1	104.5	105.8	105.2	101.3	99.4	100.4
Brent	EIA	111.3	111.7	107.5	109.3	108.4	105.7	102.5	104.1
	CGES	112.2	112.4	108.4	109.0	108.7	105.0	102.8	103.9
	PIRA	111.3	111.6	107.5	109.8	108.7	106.4	106.1	106.3

Source : CERA(2013.12.6), EIA(2013.12.10), CGES(2013.12.6), PIRA(2013.12.23).
Note : 1) E stands for HRI estimates.
2) CERA, EIA, CGES, PIRA.

< Global Commodities Price Forecast >

(Unit : P, (%))

Division	2011	2012	2013(E)	2014(E)
International Raw material	120 (20.0)	110 (-8.6)	100 (-8.3)	100 (-0.2)
Farm-Product	122 (22.0)	114 (-5.8)	106 (-7.8)	105 (-0.8)
Metal	113 (13.0)	96 (-15.3)	88 (-8.0)	90 (1.5)
Jewelry	136 (36.0)	138 (1.6)	112 (-19.2)	111 (-1.0)

Source : World Bank, Global Economic Prospects, October 2013.
Note : 1) Crude oil isn't included in commodity index(2010 = 100).
2) The number in angle bracket indicates year on year rate.
3) Iron ore, Aluminum, Copper, Lead, Nickel, Tin, Zinc and etc are included in Metal.

4.Exchange rates of Major Currencies : Increasing Volatility in the Framework of Strong Dollar

(Current Status) Volatility of global exchange market increased as major advanced nations adopt different monetary policies, and US dollar gains strength.

Real effective dollar index with consideration of trade volume with major countries rose from 73.5p on January 3, 2013 to 77.6p as of January 17, 2014. India’s rupee and Indonesia’s rupiah depreciated by 11.1% and 18.7% respectively for the period from May 20, just before the announcement made by the chairman of the Fed(May 22), to January 22, 2014.

(Forecast for 2014) According to major international investment banks, US dollar is likely to gain noticeable strength, with the euro and yuan being relatively robust. The yen, however, is expected to remain weak with continuing Abenomics.

Global Dollar: Dollar is expected to remain strong as a global currency with recovering US economy and reduction of QE. **Euro:** Expected to gain strength as Eurozone economy emerges from recession. The average exchange rate of euro to US dollar for the next 3 to 12 months would be 1.29-1.34, according to the estimates of major international investment banks as of January 2014. **Yen:** Expected to remain weak with lasting easing monetary policy. As of January 2014, major international investment banks estimates that average exchange rate of yen to dollar would be 105.54-110.36 for the next 3 to 12 months starting from January 2014. **Yuan:** The yuan is forecast to remain strong as the trend of adopting yuan as a settlement currency for international trade increases and China's economy recovers. Estimates of average exchange rate of yuan to dollar by major international investment banks are 6.00-6.06.

< Exchange Rate Outlook by Major Foreign Investment Banks >

Division	Dollar/Euro			Yen/Dollar			Yuan/Dollar		
	In three months	In six months	In twelve months	In three months	In six months	In twelve months	In three months	In six months	In twelve months
Average	1.34	1.32	1.29	105.54	106.25	110.36	6.06	6.03	6.00
Highest	1.38	1.40	1.40	110.00	112.00	120.00	6.10	6.10	6.10
Lowest	1.28	1.26	1.23	103.00	100.00	101.00	6.01	5.93	5.89

Source : International Finance Center. Major investment bank's exchange rate forecast (2014.1.20).
Note : The exchange rate outlook is based on forecasts made by 13 international banks.

Ⅲ. Domestic Economic Forecast in 2014

1. Macroeconomic Forecast

1) Domestic Economic Forecast

(Precondition for Forecast) The economies of advanced nations are expected to enter a recovery phase while developing nations are to show a gradual recovery. World trade volume is to increase marginally as global economy slowly recovers.

Continuing Recovery Trend of the US Economy: US economy is on track for growth of around 2.5% helped by the recovering housing market and improving manufacturing business outlook.

European Economy Emerging from Recession: The grow rate is expected to be 1% plus thanks to the structural readjustment and base effect.

Gradual Recovery of Developing Nations including China: The speed of recovery will be slow due to the reduced global demand and falling international raw material prices.

Trade Volume to Marginally Increase: World trade volume is expected to increase by a small margin as global economy gradually recovers led by advanced nations including the US.

Raw Material Prices to Remain Weak: Prices of international raw materials are largely expected to remain weak due to strong dollar resulting from the imminent reduction of QE by the US, weakening preference for commodity assets created by reduction of international liquidity, and overall improvement of demand-supply status.

(Forecast on Domestic Economy) Momentum for economic recovery is likely to come from export demand rather than domestic demand in 2014.

Economic growth rate of 2014 is expected to reach 3.8%, close to the potential growth rate. Falling average propensity to consume due to household debts, sharply rising deposit-based rent, and aging society will limit growth of consumption. Construction investment is unlikely to recover fast due to the reduced government budget for SOC for 2014, whilst facility investment is expected to make a gradual recovery. Export business environment will improve with improving US economy, Eurozone emerging from recession, and increasing exports from China to advanced countries.

However, the real economic growth rate is unlikely to be well above the potential growth rate. Even if export business fast improves, it may not lead to a spill-over effect and boost domestic demand. It is also feared that the government's measure to reinvigorate real estate market may not be as effective as hoped.

2) Forecast by Economic Sector

① Consumption : Recovery Trend to Remain Weak

(Current Status) Consumption is likely to show a marginal recovery due to the increasing disposable income with improving employment market, asset effect, and stabilized prices.

The growth rate of national gross disposable income stayed below 1% in the first half of 2013, and private consumption marked a year-on-year growth of 1.5% in Q1, 1.8% in Q2, 2.1% in Q3 and 2.2% in Q4 of 2013. The consumer price index marked an average increase rate of 1.1% for the period from January to December 2013. The growth rate of average monthly real income of households amounted to a mere 1.3% in Q2and 1.6% in Q3 of 2013.

< Economic Indicator Related to Private Consumption >

Division	2011	2012					2013					
		1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	Oct	Nov	Dec
Private Consumption Change(%)	2.4	1.3 (0.8)	1.0 (0.4)	1.7 (0.7)	2.7 (0.8)	1.7	1.5 (-0.4)	1.8 (0.7)	2.1 (1.0)	-	-	-
Retail Sales Change(%)	4.5	2.8 (1.0)	1.4 (0.3)	2.6 (1.2)	2.5 (0.4)	2.3	0.2 (-1.2)	1.1 (0.4)	0.7 (1.3)	1.7 (1.5)	1.3 (0.9)	-
Real Income Change(%)	1.7	3.8	3.7	4.6	3.6	3.8	0.3	1.3	1.6	-	-	-
Consumer Price Index Change(%)	4.0	3.0	2.4	1.6	1.7	2.2	1.6	1.2	1.4	0.9	1.2	1.1
Employee change (1000 persons)	415	467	430	506	342	437	257	324	421	476	588	-

Source : Bank of Korea, Statistics Korea.
Note : 1) The number indicates year on year rate.
2) The number in angle bracket indicates Quarter on Quarter(QoQ) rate.

(Forecast) Private consumption is set to remain weak hindered by the burden to repay principal and interest for the accumulated household debts although improving trade conditions created by stable international raw material prices will increase real purchasing power.

Improving Employment Market : Unemployment rate improved in the second half compared with the first half of 2013 marking 3% plus, which will lead to household disposable income increasing.

Asset Effect : Real estate market, having passed the worst point since the first half of 2013, is likely to improve with the government measures introduced on April 1 and August 28, and asset effect created by this improvement will help enhance consumption.

Consumer Sentiment : Optimistic expectation for domestic economy with improved consumer sentiment will also lead to increasing consumption.

Household Debts Effect : Burden to repay the principal and interest will increase due to the accumulated household debts, but its effect on consumer sentiment will be marginal thanks to the low interest rate.

< Economic Indicator Related to Household Credit Change and CSI >

Division	2011	2012					2013					
		1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	Oct	Nov	Dec
Consumer Price Index Change(%)	4.0	3.0	2.4	1.6	1.7	2.2	1.6	1.2	1.4	0.9	1.2	1.1
Consumption and Spending Index CSI(p)	100	102	101	99	99	99	104	105	102	106	107	107

Source : Bank of Korea, Statistics Korea.
Note : 1) The augmentation of Credit to Households is balance of the end of the month.
2) CSI is the quarterly measured at the end of period.

There fore, the growth rate of private consumption is likely to be 2.8% in the first half and 2.6% in the second half accounting for annual growth rate of 2.7%.

< Private Consumption Change and Outlook >

Division	2011	2012	2013			2014(E)		
			First half	Second half	Annual	First half	Second half	Annual
Private Consumption(%)	2.4	1.7	1.6	2.1	1.9	2.8	2.6	2.7

Source : Bank of Korea, Statstics Korea.
Note : E stands for HRI estimates.

② Facility Investment : Signs of Gradual Recovery with Expectation for Improving Economy

(Current Status) Facility investment shows signs of marginal upturn due to the delayed domestic and global economic recovery in 2013.

Facility investment on national account and facility investment index released by the National Statistical Office show marginal improvement in the third quarter of 2013. Facility investment turned to positive growth of 1.5% in Q3 and 9.9% in Q4 of 2013. Facility investment index recorded a negative growth of -4.7% in the same period due to weak machinery investment before substantially improving to 14.2% in October. Machinery investment marked a negative growth of -0.8% in Q3 of 2013 while transportation facility investment performed well to achieve a growth of 10.1% in the same period and 42.2% in October 2013.

< Economic Indicator Related to Facility Investment >

(Unit : %, %p)

Division	2011	2012					2013				
		1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	Oct	Nov
Facility Investment	3.6	8.8	-3.5	-6.9	-5.2	-1.9	-11.9	-4.6	1.5	-	-
Facility Investment Index	4.0	10.7	-2.7	-8.2	-6.9	-2.0	-15.4	-10.0	-4.7	14.4	6.2
Domestic machinery orders	2.7	12.8	-2.6	-7.8	-10.3	-2.2	-20.8	-13.1	-8.0	7.2	3.5
Transportation equipment	9.8	2.0	-3.1	-10.1	7.2	-1.1	10.4	3.4	10.1	42.2	15.6

Source : Bank of Korea, Statistics Korea.

(Forecast) Facility investment for 2014 is expected to increase by 6.5% plus thanks to the pressure for facility investment adjustment due to the expectation for domestic and global economic recovery and improving order volume.

Pressure for facility investment adjustment recorded negative growth for 6 consecutive quarters since the first quarter of 2012, but is expected to enter a recovery phase henceforth with expectation for domestic and global economic recovery. Domestic machinery orders rose in Q2 and in Q3 of 2013 in the private sector, and also remarkably improved in October in the public sector, healthy signs of increasing facility investment henceforth.

< A Leading Composite Index of Capital Investment and Progress of Pressure to Control>

(Unit : %, %p)

Division		2011	2012					2013				
			1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	Oct	Nov
Pressure to control of capital investment		1.1	0.7	-1.3	-3.0	-1.5	-1.4	-2.9	-2.0	-1.6	1.6	-2.8
Domestic orders received for machinery		7.6	-1.1	-19.8	-10.4	-21.5	-13.4	-10.9	8.7	4.9	71.7	27.6
	Public	-2.6	126.1	-59.7	86.7	-54.6	-11.0	-47.0	94.2	-9.7	815.4	30.2
	Private	8.8	-8.7	-15.1	-16.0	-15.1	-13.6	-5.6	4.0	6.8	27.8	27.4

Source : Statistics Korea.
Note : 1) Pressure to control of capital investment(%p)
= Manufacturing production augmentation(%) - Manufacturing productive capacity augmentation(%).
2) Vessel isn't included in orders received for machinery, The standard is 2010 Constant Prices.

(Forecast) Capital investment in 2014 will be about 6.7. (9.8% in the first half, 3.9% in the second half.)

< Facility Investment Changes and Outlook >

(Unit : compared to previous year, %)

Division	2011	2012	2013			2014(E)		
			First half	Second half	Annual	First half	Second half	Annual
Facility Investment	3.6	-1.9	-8.2	5.7	-1.5	9.8	3.9	6.7

Source : Bank of Korea, Statistics Korea.
Note : E stands for HRI estimates.

③ Construction Investment : Expected to Recover Led by Private Sector rather than Slumping Public Sector

(Current Status) Construction investment in 2013 is on the upturn supported by government measures announced on April 1 and August 28 for housing market normalization and for boosting real estate market.

Construction investment(National Account) turned to recovery phase due to the remarkable improvement of construction starts in both private and public sector. Construction off-the-shelf continued to record negative growth of -6.4% in 2011 and -5.8 in 2012 before it turned to positive growth of 5.2%, 15.6%, and 11.1% in Q1, Q2, and Q3 of 2013 respectively.

< Change of Order Received for Construction >

(Unit : Compared to the same period of the previous year, %)

Division		2011	2012					2013				
			1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	Oct	Nov
Investment in construction (National accounts)		-4.7	-0.4	-3.1	-0.3	-4.2	-2.2	2.4	7.2	8.6	-	-
Construction off-the-shelf		-6.4	-4.9	-9.7	-2.3	-5.6	-5.8	5.2	15.6	11.1	17.2	12.0
Construction off-the-shelf (current)		-0.6	-0.9	-7.7	-1.3	-5.1	-4.0	5.3	15.4	11.5	18.0	12.7
	Public	-0.1	0.9	-5.1	-2.4	-8.7	-4.4	-5.4	5.4	6.9	15.1	4.3
	Private	-2.2	-2.1	-7.5	-0.1	-1.0	-2.7	14.5	24.4	16.1	19.8	18.4
Construction orders (current)		6.1	33.3	-0.7	-13.6	-33.1	-8.9	-41.2	-28.8	-9.0	48.9	-5.4
	Public	-2.0	34.3	-11.2	-18.4	-17.3	-8.8	-22.6	-5.3	-10.8	-22.9	7.3
	Private	12.3	40.0	4.9	-9.6	-43.1	-7.5	-46.9	-35.7	-6.5	87.8	-9.3
Building Permits		9.9	8.7	1.2	-7.3	-8.0	-0.5	-12.4	-14.6	-3.4	5.9	25.6

Source : Bank of Korea, Statistics Korea, Ministry of Land, Transport and Maritime Affairs.

(Forecast) Although construction investment is expected to increase led by private sector, the growth rate of construction investment in 2014 will be limited due to the reduced construction investment in the public sector following the planned government budget cut for SOC.

Private Sector Investment to Improve Following the Government Measures to Boost Real Estate Market : Construction investment is set to increase led by private sector housing constructions supported by a series of government measures to revitalize real estate market.

Public Sector Struggling due to the Budget Cut for SOC : Public sector investment is set to shrink following the government plan to cut the budget for SOC and Bogeumjari(small & medium size house for the working class)housings for 2014. Government budget for SOC is set to shrink from US$2.27 billion(based on the exchange rate of 1 dollar to 1,055 won) in 2013 to US$2.18 billion in 2014, and US$2.15 billion in 2015.

< Construction Investment Outlook >

(Unit: Compared to the previous year, %)

Division	2011	2012	2013			2014(E)		
			First half	Second half	Annual	First half	Second half	Annual
Construction Investment	-4.7	-2.2	5.2	8.3	6.9	1.7	3.3	2.5

Source : Bank of Korea.
Note : E stands for HRI estimates.

④ Foreign Trade : Gradual Increase of Exports Expected as Demand from Advanced Nations and China Recovers

(Current Status) Exports slowed down in the first half of 2013 due to the slow-recovering global economy, but is showing signs of improvement in the second half achieving the highest-ever current account surplus.

Exports business was slow in the first half of 2013, but improved by 2.8% in Q3 and by 7.0% in December. With stabilized raw material prices and depressed imports, the current account surplus reached US$64.3 billion as of November 2013.

< Export, Import and Trade Balance Outlook >

(Unit : 100 million $, %)

Division	2011	2012					2013					
		1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	Oct	Nov	Dec
Current Account	261	29	134	155	162	481	100	198	190	95	60	-
Trade Balance	308	12	97	75	99	283	56	144	108	49	48	36
Export (rate of change)	5,552 (19.0)	1,348 (2.9)	1,401 (-1.7)	1,331 (-5.8)	1,398 (-0.4)	5,479 (-1.3)	1,353 (0.4)	1,412 (0.7)	1,368 (2.7)	505 (7.2)	479 (0.2)	480 (7.0)
Import (rate of change)	5,244 (23.3)	1,337 (7.8)	1,304 (-2.9)	1,257 (-6.9)	1,298 (-1.1)	5,196 (-0.9)	1,297 (-3.0)	1,267 (-2.8)	1,260 (0.3)	456 (5.1)	431 (-0.6)	444 (3.0)

Source : Bank of Korea, Korea International Trade Association.
Note : Import and export customs clearance basis.

(Forecast) Exports is expected to increase by around 8.5% in 2014 with recovering economies of advanced nations including the US and strong recovery trend of exports to China.

The growth rate of imports and exports is likely to marginally increase in 2014 thanks to the recovering US economy, Eurozone economy emerging from recession, and China's strong recovery of exports to advanced countries. Exports are expected to increase by 7.5% in the first half and 9.3% in the second, making the annual growth rate of 8.4% in 2014 with improvement of exports to the US and Europe, and exports of intermediary goods through China increasing. Although trade and current account balances are expected to continue to record surpluses of US$37 billion and US$49 billion respectively in 2014, the size of the surplus is likely to drop due to the increasing volume of imports.

< Export, Import and Trade Balance Outlook >

(Unit : 100 million $, %)

Division		2011	2012	2013			2014(E)		
				First half	Second half	Annual	First half	Second half	Annual
Current Account		261	481	298	397(E)	695(E)	215	275	490
Trade Balance		308	283	200	241	441	171	199	370
	Export(customs) Growth Rate	5,552 (19.0)	5,479 (-1.3)	2,765 (0.5)	2,832 (3.8)	5,596 (2.1)	2,972 (7.5)	3,095 (9.3)	6,067 (8.4)
	Import(customs) Growth rate	5,244 (23.3)	5,196 (-0.9)	2,565 (-2.9)	2,591 (1.4)	5,156 (-0.8)	2,801 (9.2)	2,896 (11.8)	5,697 (10.5)

Source : Bank of Korea, Korea International Trade Association.
Note : 1) Import and export customs clearance basis.
2) E stands for HRI estimates.

⑤ Price : Pressure for Inflation to Increase

(Current Status) Both Consumer price and Core consumer price have since stabilized in 2013.

The trend of rising domestic prices slowed from 2012 and has since stabilized. Consumer price growth stayed at 1% plus since October 2012 and has now dropped to 0% plus with prices of agricultural products recently falling. Core consumer price also maintained low level of 1% plus for the period from January to December 2013.

< Change in the Increase of Major Price Indicators >

(Unit : Compared to the same period of the previous year, %)

Division		2011	2012					2013				
			1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Annual
The Consumer Price		4.0	3.0	2.4	1.6	1.7	2.2	1.6	1.2	1.4	1.1	1.3
	Core producer price index	3.2	2.5	1.6	1.3	1.4	1.6	1.4	1.6	1.6	1.9	1.6
	CPI for Living necessaries	4.4	2.6	2.0	1.0	1.2	1.7	1.1	0.7	0.8	0.3	0.7

Source : Bank of Korea.

(Forecast) The rising rate of consumer prices in 2014 is likely to be higher than in 2013.

Inflation in 2014 is expected to be higher than in 2013 with increasing pressure for price rise and rising nominal wage due to economic recovery. The pressure for inflation is gradually increasing with GDP gap turning positive, and price deflation is receding with expanding introduction of gratuitous child-care service. Pressure for price rise is mounting with expected inflation rate approaching 3%, rising nominal wage and increasing deposit-based and monthly housing rent. Raw material prices stabilizing at a low level and the strong won are factors to limit the rate of inflation. International raw material prices are likely to remain stable at low level due to the strong dollar, accumulated stock pile, and reduced demand of China. The appreciation of the won owing to the lasting current account surplus and foreign capital influx is likely to lower the prices of imported goods.

Therefore, the inflation in 2014 is forecast to be 2.4%, higher than in 2013.

< Consumer Price Change and Outlook >

(Unit : Compared to same period of the previous year, %)

Division	2011	2012	2013	2014(E)		
				First half	Second half	Annual
consumer price	4.0	2.2	1.3	2.2	2.6	2.4

Source : Bank of Korea.
Note : E stands for HRI estimates.

⑥ Employment : Recovery Gains Strength Thanks to Government's Introduction of Employment-Friendly System

(Current Status) Recovery gains strength thanks to government's introduction of employment-friendly system.

Unemployment rate dropped from 3.8% in Q1 and 3.3% in Q2 of 2012 to 3.6% in Q1, 3.1% in Q2, 3.0% in Q3 and 2.8% in Q4 of 2013. The number of the newly employed accounted for 257,000 in Q1, 324,000 in Q2, 421,000 in Q3 and 541,000 in Q4 of 2013.

With the creation of jobs as top priority, the new government initiated various measures to encourage people to set up their own businesses and to create tailor-made jobs. The government also introduced policies to create jobs designed for creative economy through improvement of environment for new business start-ups. Environment consistently introduced various measures focusing on creation of tailored jobs for vulnerable social groups: women and young people.

< Change in Employment Related Indicators >

(Unit : Compared to same period of the previous year, 1000 persons, %)

Division	2011	2012					2013				
		1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Annual
Increased Number of Employee	415	467	430	506	342	437	257	324	421	541	386
Unemployment Rate	3.4	3.8	3.3	3.0	2.8	3.2	3.6	3.1	3.0	2.8	3.1
Youth	7.6	8.2	8.1	6.8	7.0	7.5	8.4	7.9	7.9	7.9	8.0

Source : Statistics Korea.

(Forecast) Unemployment rate is expected to marginally drop in 2014 with corporate investment and construction industry recovering and government policy of putting job creation as top priority.

Expanding Employment Following Economic Recovery : New employment is expected to increase with rising corporate investment and recovering construction business led by private sector benefiting from economic recovery.

Consistent Government Policy for the Creation of New Jobs : Government is determined to achieve the target for the creation of jobs by improving labor market, encouraging people to start up new businesses and introducing flexible work place and part-time jobs of good quality.

< Forecast of Unemployment Rate >

(%)

Division	2011	2012	2013			2014(E)		
			First half	Second half	Annual	First half	Second half	Annual
Unemployment	3.4	3.2	3.4	2.9	3.1	3.2	3.0	3.1

Source : Statistics Korea.
Note : E stands for HRI estimates.

⑦ Exchange Rate of Korean Won : Expected to be Determined by the Balance of Factors for Appreciation and Depreciation

(Current Status) In 2013, the Korean won strenghtened as a result of the weekened global dollar, surplus in current account and steady inflow in foreign capital.

KRW/USD : The won depreciated in the beginning of 2013 due to the political uncertainty of Cyprus and Italy and North Korea risk, but strengthened to 1,050 won to 1 US dollar since June with foreign capital shifting from developing countries to Korea.

KRW/JPY : Abe administration’s adoption of quantitative and qualitative easing policy led the yen to depreciate to the level of 1,020 won to 1 yen as of December 2013.

< Change in Won/Dollar and Won/100 Yen Exchange Rate >

(Unit : Won)

Division	2011	2012					2013				
		1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Annual
Won/dollar	1,108	1,131	1,152	1,133	1,090	1,127	1,085	1,123	1,124	1,062	1,095
Won/100yen	1,391	1,428	1,437	1,441	1,346	1,413	1,176	1,137	1,111	1,058	1,123

Source : Bank of Korea.
Note : Figures refer to the average of daily closing prices during the period.

(Forecast) Won/Dollar exchange rate is to be determined by the balance of various factors for appreciation or depreciation of the won.

Continuing current account surplus, influx of foreign capitals, strong fundamentals of domestic economy, and relatively undervalued won are factors for the appreciation of the won.

However, weak yen, strong dollar following execution of the US exit strategy, and caution of foreign exchange authority's intervention are factors to limit the appreciation of the won.

< Won/Dollar Exchange Rate Outlook by Investment Banks >

(Unit: won)

Division	3 months later	6 months later	12 months later
Average	1,062	1,062	1,053
Maximum	1,100	1,100	1,120
Minimum	1,025	1,025	1,000

Note : 1) Exchange rate of won foresaw by 37 investment banks(JP morgan, City bank and ETC).
2) Figures are based on December 16, 2013.

< 2014 Outlook for Major Economic Indicators>

Growth rate		2012	2013			2014(E)		
			First half	Second half	Annual	First half	Second half	Annual
National Account	Economic Growth Rate (%)	2.0	1.9	3.6	2.8	3.9	3.6	3.8
	Private Consumption (%)	1.7	1.6	2.1	1.9	2.8	2.6	2.7
	Construction Investment (%)	-2.2	5.2	8.3	6.9	1.7	3.3	2.5
	Facility Investment (%)	-1.9	-8.2	5.7	-1.5	9.8	3.9	6.7
Foreign Trade	Current Account (100 million Dollars)	481	298	397	695(E)	215	275	490
	Trade Balance (100 million Dollars)	283	200	241	441	171	199	370
	Exports (100 million Dollars)	5,479	2,765	2,832	5,596	2,972	3,095	6,067
	Increase rate, %	-1.3	0.6	3.8	2.1	7.5	9.3	8.4
	Imports (100 million Dollars)	5,196	2,566	2,591	5,156	2,801	2,896	5,697
	Increase rate, %	-0.9	-2.9	1.4	-0.8	9.2	11.8	10.5
Consumer Price (average, %)		2.2	1.4	1.2	1.3	2.2	2.6	2.4
Unemployment Rate (average, %)		3.2	3.4	2.9	3.1	3.2	3.0	3.1

Note : The second half of 2013 and the annual current account balance reflects the actual performance.

2. Prospects for and Characteristics of Major Industries

1) Prospects of Major Industries

Although most major industries are likely to emerge from recession as domestic and global economies recover, some industries experiencing depressed demand and oversupply are expected to either marginally recover or face difficulty in emerging from continued depression in 2014.

(Recovery) Steel, Construction, Shipping and Machinery Industries

Steel Industry : Although steel industry is expected to enter recovery phase having passed the trough of business cycle, the recovery trend is likely to be slow as the incremental demand for steel will be limited.

Construction Industry : With construction work in the public sector in depression due to the government budget cut for SOC and base effect caused by protracted recession, construction business in the private sector is likely to improve, but only to limited extent.

Shipping Industry : Shipping industry is expected to recover as the volume of goods transported will increase following the gradual recovery of global economy.

Machinery Industry : Production and export of machinery products are forecast to improve gradually as demand for facility investment increases following the global economic recovery.

(Growth) Automobile Industry

Automobile Industry : Motor export performance is likely to increase as economies of advanced countries recover. Domestic car market is also expected to grow although a substantial portion of the growth is likely to be taken by imported cars.

(Declination) Petrochemical Industry and IT Industry

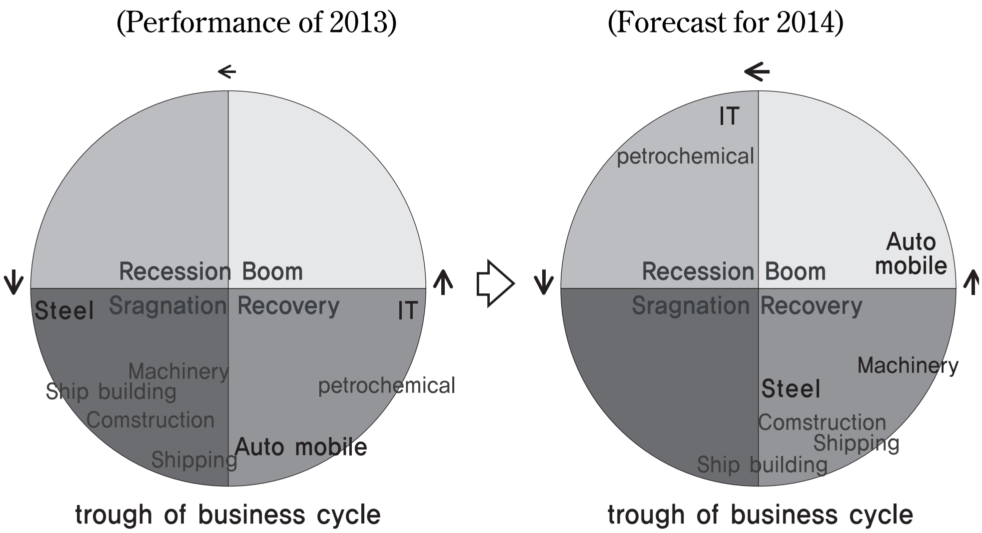
Petrochemical Industry : The petrochemical industry is forecast to decelerate due to the insignificant recovery of upstream industries and an appreciating won.Oversupply in the North East Asia is to remain a key pending issue in the mid-long term.

IT Industry : Although the production and export of IT products will continue to grow owing to the expanding global IT market, the growth rate of the global market for key products is to slow causing concerns over the risk of the IT industry falling into recession.

(Recession) Shipbuilding Industry

Shipbuilding Industry : Profitability is unlikely to improve substantially due to the effect of existing orders secured at low prices. New orders heralding a speedy recovery is unlikely to happen in the near future.

<Business Cycles of Major Industries for 2013 and 2014>



2) Characteristics of 7 Major Industries for 2014

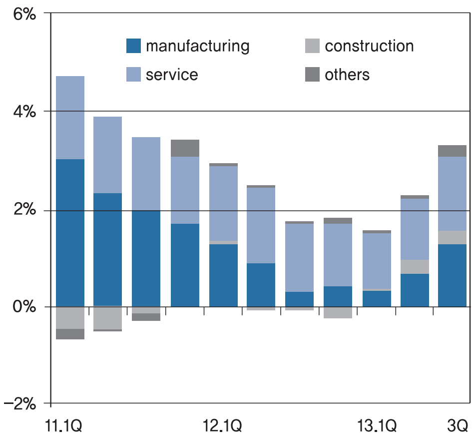
① Recovery of Industrial Business Led by Export-Oriented Manufacturing Industry

Manufacturing is expected to re-emerge as a main engine for economic growth as export business recovers in 2014.

Having experienced depression since the second half of 2012, the manufacturing industry is fast recovering its contribution to economic growth. The manufacturing industry's contribution to economic growth was lower than that of the service industry for the period from 2012 to the third quarter of 2013. However, the gap between these two industries, in terms of their relative degree of contribution to economic growth, narrowed; manufacturing industry 1.3%p and service industry 1.5%p.

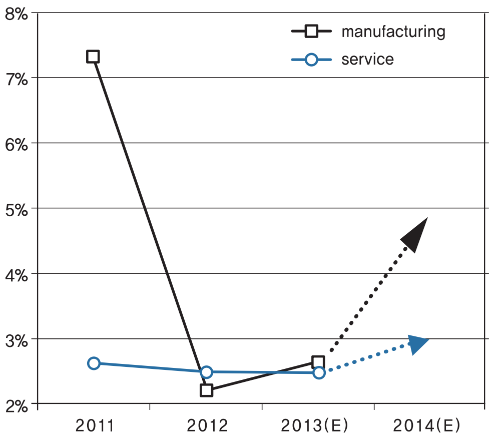
The manufacturing industry is expected to outperform the service industry as 2014 is forecast to be a year of export-oriented economic growth. As the major demand driver of the manufacturing industry and the service industry is based on export market and domestic market respectively, the recovering trend of manufacturing industry will be stronger than that of the domestic marketbased service industry in 2014.

<Contribution to Economic Growth of Major Industries>



Source : Bank of Korea.

<Production Growth Rate of Manufacturing and Service Industries>



Source : Bank of Korea, HRI.

Note : E stands for HRI estimates from 2013.

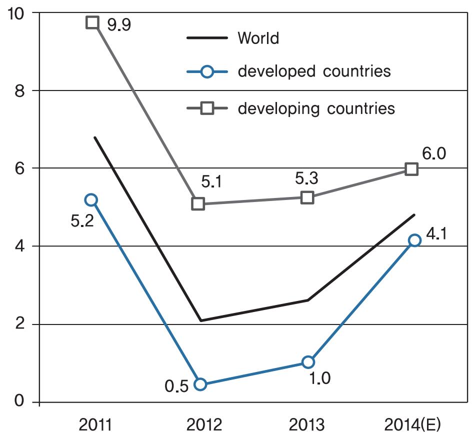
② Relatively Stronger Advanced Countries Oriented Export Business

The recovery speed of advanced countries' economies is expected to be faster than that of emerging nations, and therefore export industries with heavier dependence on advanced nation customers are expected to perform relatively better.

The framework of global economic recovery in 2014 is likely to be led by advanced nations rather than developing ones. According to the IMF1)the growth rate of economic bloc of advanced nations is likely to increase from 1.2% in 2013 to 2.0% in 2014 while developing nations and newly industrialized nations are expected to reach 4.5% and 5.1%, in which case, the growth rate gap between the developing, newly industrialized and the advanced nations will be 3% in 2014, the narrowest since 2002. The growth rate of import volume is also expected to increase from 1% in 2013 to 3.1% in 2014 as the hitherto depressed import demand from advanced nations is likely to increase rapidly.

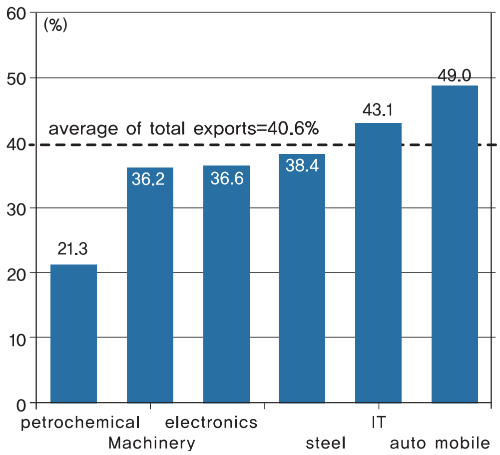
Therefore, positive demand environment is likely to be created for export items with heavy dependence on advanced nations such as IT products and motor cars. Positive demand trend of advanced nations will act in favor of Korean export items such as IT products and motor vehicles, while export items mainly for developing countries such as petrochemical products, machinery, and steel products will be subject to slow recovery. In particular, Korean businesses which have committed to developing nations for direct investment are likely to be heavily exposed to 'emerging market risk'.

<Import Volume Augmentation of Developed and Developing Country>



Source : IMF.

<Market Share of the Principal Exports in Developed Countries Market>



Source : KITA.

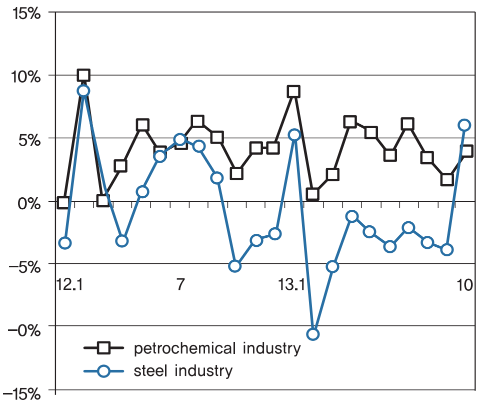
③ Continuing 'China Risk' for Basic Material Industry

Although industries for basic materials such as petrochemical and steel achieved rapid growth from China demand (China Effect)prior to the financial crisis, China's recent expansion of production capacity for similar products resulted in oversupply(China Risk), which is set to last for the time being.

The steel industry began to cut production from the second half of 2012, and the production growth rate of petrochemical industry is rapidly falling. The production growth rate of steel industry has been falling since the second half of 2012, and has continued to fall as at October 2013 with increased inventory of China and import restrictions imposed by major importing nations. The growth rate of petrochemical industry, which recently peaked in July, is softening, turning the export growth rate negative in September and October 2013(exports to China accounts for 48%) and thereby casting a bleak outlook on the petrochemical industry.

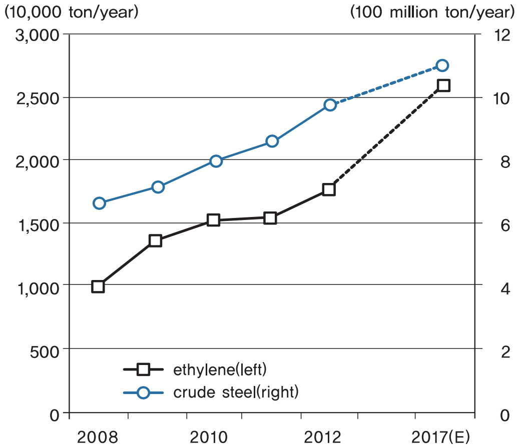
Korean counterpart industries are likely to take a hit henceforth as Chinese government's localization policy of steel and petrochemical production, which are key strategic industries of China, continues to take force. China is expected to increase production capacity again when domestic and global demand recovers. China is also forecast to continue to increase the production capacity of base products, (crude steel and ethylene, in particular) for steel and petrochemical industry respectively.

<Production Indices Growth rate of Steel and Petrochemistry Industries>



Source : Statistics Korea.

<Forecast of Ethylene and Crude Steel Production Ability in China>



Source : China Iron and Steel Association, Japan Petrochemical Industry Association

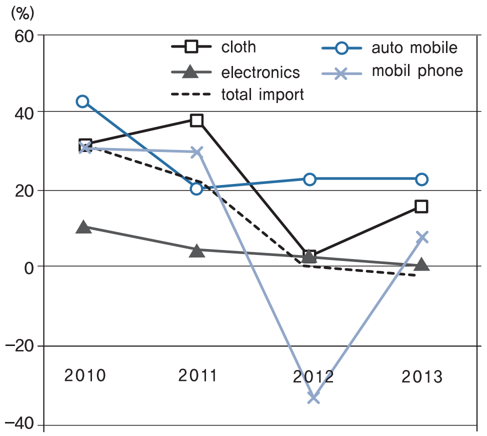
④ Sharp Increase of Imports in Domestic Nondurable Goods Market

FTA conclusions with advanced nations, strengthened marketing of foreign businesses, and an appreciating Korean won are likely to lead to increased imports of nondurable goods.

Lowering of customs duties following FTA conclusions with the US and EU, strengthened marketing of foreign corporates, and an appreciating won have weakened the competitive edge of Korean products, pushing up the growth rate of major imported nondurable goods in 2013. The growth rate of imported nondurable goods recently outperformed the growth rate of total imports. Imports of motor cars, in particular, has remarkably increased with the import penetration ratio(sales of imported cars/sales of domestic cars) rising from 5.8% in 2012 to 10.3% in 2013.

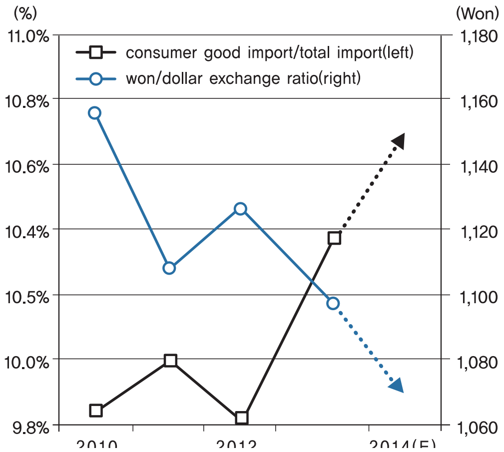
Import of nondurable goods is expected to increase rapidly in 2014 with exchange rate likely to fall further henceforth. The competitive price of Korean products falls when the won is strong, and imported nondurable goods appear to increase faster than other imported goods. If the won appreciates in 2014, imported nondurable goods are expected to rise sharply due to the effect of this correlation.

<Import Growth Rate of Total and Major Items>



Source : KITA.
Note : The data of 2013 was extracted from January to September.

<Won/Dollar Exchange Rate and Ratio of Consumption to Total Import>



Source : KITA, Bank of Korea.
Note : The data of 2013 was extracted from a quarter to third quarter.

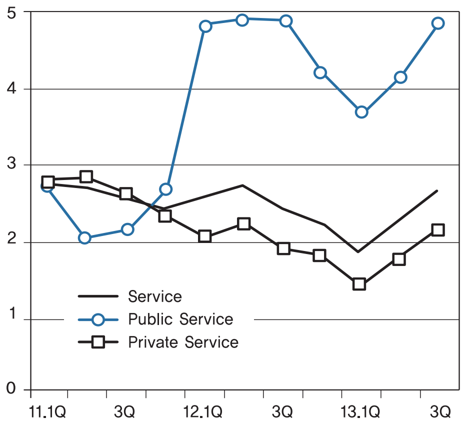
⑤ Within the Service Industry, the Public Service Industry is Expected to Perform Relatively Well.

Public service business is likely to outperform private service industry owing to government policy-oriented elements. The growth rate of public service industry production has continued to rise sharply since 2012.

The growth rate of public service industry production has continued to rise sharply since 2012. Government expenditure for public services substantially increased to meet expanding demand for social welfare as well as to boost domestic economy since 2012. Accordingly, the growth rate of public service production rose to 4% plus while the growth rate of private service production remained at around 2% since 2012.

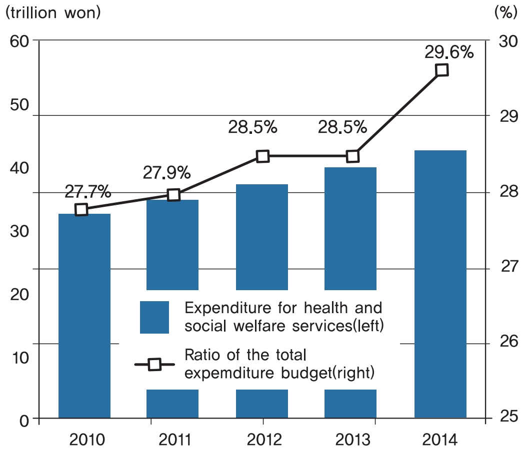
Government expenditure for economic stimulation and social welfare service is expected to increase further in 2014. According to government plans, expenditure for health and social welfare services in 2014 is around US$1 trillion, 29.6% of the total expenditure budget. Although the growth rate of public service production is forecast to be high in 2014, private service industry is also expected to gradually recover narrowing the gap with public sector to some extent.

<Production Growth Rate of Public and Private Service Industries>



Source : Bank of Korea.
Note : Public service = Public administration +Health and Human Services.

<Size and Ratio of Health and Social Welfare Fiscal Spending>



Source : Budget of Ministry of Strategy and Finance.

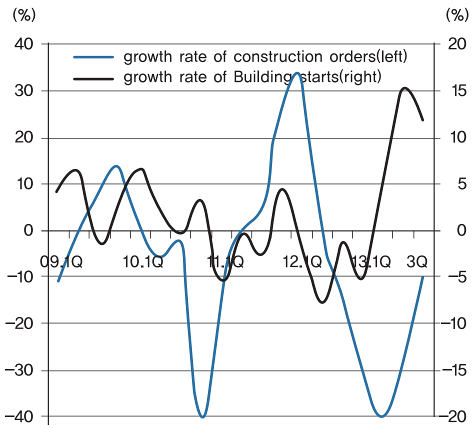
⑥ Structural Recession of Order-Driven Industry to Continue

Korea's two major order-driven industries, construction and shipbuilding, are forecast to remain in depression due to slow order recovery.

The possibility of a speedy recovery in the construction industry is unclear as orders continue to decline despite volume of construction starts increasing in the second half of 2013. The growth rate of construction establishment amount sharply increased both in private and public sector, recording a year-on-year rise of 11% in the third quarter of 2013. However, construction orders 1-2 years out in the forward market are on the decline casting doubt as to recovery, although it could marginally improve if additional government measures to reinvigorate real estate market follow.

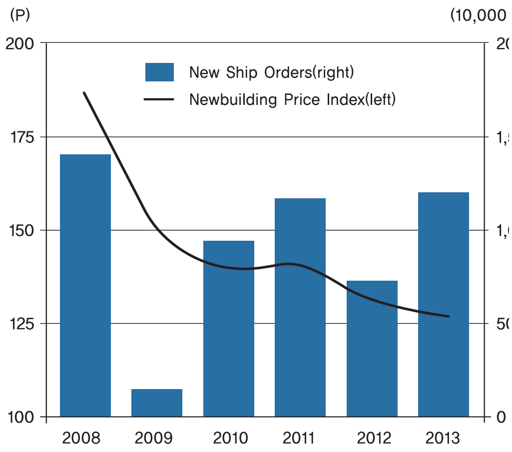
Shipbuilding industry is recovering with new orders increasing. However, the profitability of the industry is likely to deteriorate in 2014 owing to the orders being secured at low prices. Demand for new shipbuilding appears to be on the increase in 2013 as some shipping companies are placing orders in preemptive preparation for increasing demand henceforth. However, the profitability of shipbuilding industry is expected to deteriorate in 2014 as the shipbuilding of orders placed at the lowest prices since the financial crisis is to start this year.

<Growth Rates of Construction Orders and Building Starts>



Source : Statistics Korea.

<Newbuilding Price Index and New Ship Orders>



Source : KMEA.
Note : 1) Newbuilding Price Index : 1988.1=100,
2)Blue bar graph indicates monthly average.

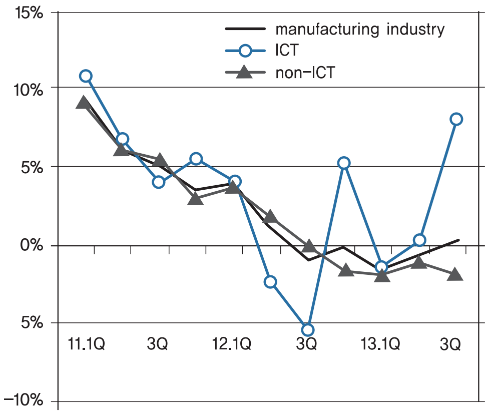
⑦ Necessity of Momentum to Reform IT Industry Increasing

IT industry is facing a task to overcome current issues of slowing growth and move forward.,The need to utilize domestic IT-friendly policy is increasing.

The growth rate of IT industry has been higher than other industries since the beginning of 2013, but is expected to slow in 2014. IT manufacturing industry is leading domestic industrial production with a year-on-year growth of 8% in the third quarter of 2013(the production growth rate of overall manufacturing industry is +0.1% when combined with IT industry, but would be -1.7% without). However, the growth rate of global market demand for key IT products such as smart phones and memory semiconductor chips is feared to slow in 2014.

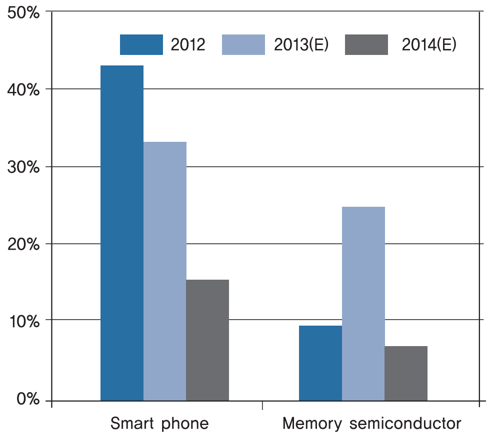
Meanwhile, IT industry requires a momentum for reform to enhance the industry's development stage by maximum utilization of government policies for IT industry to play a pivotal role in relation to creative economy. The government is planning to increase R&D investment to US$28.3 billion in 2013 and US$3.02 billion in 2014, and is also setting up a detailed mid-term target in relation to investment outputs such as export amount of IT products, technique commercialization, and utilization of patents. If the creation of effective public sector demand matches up with real demand of IT industry, it will prompt IT industry to take a leap forward.

<Manufacturing ICT and Non-manufacturing ICT Production Index Augmentation>



Source : Statistics Korea.

<Worldwide Market Forecasts of Major IT Products>



Source : Smartphone-SA, Memory semiconductor-Gartner.

Ⅳ. Policy Issues

Although Korea's economic growth rate for 2014 is estimated to be around 3.5% plus, the potential growth rate is likely to continue to fall.

Considering the risks of unmeasured confounders both internal as well as external, the government needs to introduce the following policies :

1. Planning of Comprehensive Measure to Enhance Potential Growth Rate

A measure should be introduced to effectively deal with social issues such as aging society, retirements, insufficient use of female human resource and youth unemployment, and various policies should be considered to reinstate middle class by offering tax relief and creating good quality jobs. Policies should also be considered to encourage Korean manufacturing businesses operating overseas to make U-turn to Korea, promote ICT convergence, and to strengthen R&D activities. At the same time, entrepreneurial spirit should be encouraged by readjusting the speed of economic democratization and easing administrative regulations.

2. Measure to Reinstate Consuming Wherewithal

Consumption of middle class people should be enhanced by ensuring soft landing of household debts, revitalization of real estate market, and creation of good quality jobs.

3. Policy Support to Reinvigorate Investments

Regulation reform, readjustment of speed of economic democratization, compromise between employers, labor unions, and government, removal of obstacles to investment, and expansion of tax benefits for investment should be promoted to revitalize facility investment, while adopting policies to reinvigorate housing market, increasing the housing supply for rent and easing housing cost burden for the working class in line with the measure announced on August 28. Investment on SOC should also be maintained at expansionary levels by means of employing BTO and BTL if government budget is insufficient.

4. Enhancement of Fiscal Sustainability

Excessive welfare service should not be allowed to deteriorate financial stability. Although expansion of welfare service is inevitable, it should be provided only for those who really need it, and the increase of welfare costs should be met by increasing tax and legalizing the underground economy.

5. Preparation for Potential Confounders

Prudent macro regulations and movements of international capital should be constantly monitored to prevent uncertainty of financial market in preparation for the rapidly cooling global economy that could be caused by the reduction of QE in the US, risk of Japan’s Abenomics, and possible hard landing of China’s economy. Measures should also be set up to minimize external shocks by exploring new markets and by utilizing FTAs while strengthening fundamentals of domestic market and promoting knowledge-based service industry.

[Annex 1]
Opening of South-North Economic Cooperation New Age

■ Opening of South-North Economic Cooperation in New Age

(Significance) South-North(S-N) economic cooperation is now seeking to enter stage three(leap period through institutionalization) having passed stage one(introductory period) and stage two(active and adjusting period).

S-N Economic Cooperation in 3G Age : Preparation for qualitative growth and a leap to build foundation for S-N economic community. Promotion for qualitative change based on institutionalized system lest S-N economic cooperation discontinue due to political or military issues.

(Activities) Laying a foundation for 'win-win' economic cooperation system, promotion of multilateral and multifaceted economic cooperation, and enhancement of S-N economic cooperation status.

S-N Economic Cooperation 1G Age : An entry level of interchange cooperation such as simple trade and process works on consignment basis began and continued for the introductory period from 1989 to 1997.

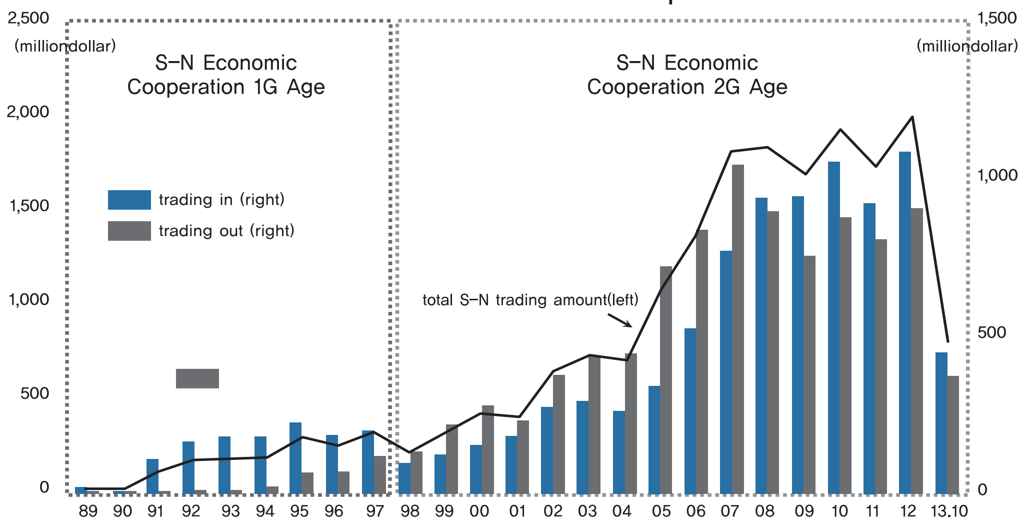
S-N Economic Cooperation 2G Age : The 2G age can be divided into two parts: period of expansion(1998-2007) and period of adjustment(2008-2013). (Period of Expansion) Under the flexible inter-Korean policy for reconciliation and cooperation, quantitative growth of cooperation was promoted focusing on expansion of cooperation with the principle of separation of economic cooperation from politics. (Period of Adjustment) Strict principle of reciprocity and policies of economics linked with politics strained the inter-Korean relations and stalled trade except for the Kaesong Industrial Complex.

< S-N Economic Cooperation 3Gs >

G1	- Period: 1989-2007(Introductory Period) · Focused on process works on consignment basis · S-N Framework Agreement concluded (1991)
G2	- Period: 1998-2013(Period of expansion & adjustment) · Expansion Period(1998-2007) : 1st & 2nd Summit Meeting, Keumgangsan Tourism, 4Economic Cooperation Agreements, Kaesong Industrial Complex(KIC) · Adjustment Period(2008-2013) : Rapid cooling of S-N relations. · Only KIC project maintained
G3	- Period: 2014-present(Leap Period) · Laying foundation for 'win-win' economic cooperation system, and multilateral cooperation

Source : HRI.

<Periods of S-N Economic Cooperation>



Source : Ministry of Unification.
Note : Showing of 2013 is January to October only.

S-N Economic Cooperation 3G Age : Attempts are to be made to forge framework for S-N economic community from 2014. **Laying Foundation to Build a 'win-win' Economic Cooperation System :** South and North should build up legislation and system for sustainable win-win economic cooperation rather than a system depending on one-sided investment or aid from either side. Building up legislation and a system in accordance with global standards is to be promoted by preparing enforcement regulations for 4 major Agreements for Economic Cooperation in relation to investment security, prevention of double taxation, commercial disputes, and open account based settlement. **Creation of Favorable Conditions for Korean Peninsula Trust Process :** Existing S-N economic cooperation is to be strengthened for early completion of the first phase of Kaesong Industrial Complex and resumption of Keumgangsan & Kaesong tourism projects. **Promotion of Multilateral Cooperation Projects :** New northbound projects such as Greater Tumen Area Development Project(GTI) involving S. Korea, China, Russia and Mongolia and other SOC projects in the border areas of North and South Korea, China and Russia are to be promoted and N. Korea encouraged to take part in the projects. **Seeking New Growth Engine for S. Korean Economy :** Securing natural resources and boosting domestic demand are to be promoted through development of N. Korean underground resources, SOC investment, and utilization of N. Korean human resource. In addition, a comprehensive development roadmap should be made to implement 'Vision Korea Project', and development of N. Korean economy is to be sought by carrying out systematic economic cooperation.

(Suggestions) S. Korean government needs to propose to N. Korea a South-North dialogue to create a new turning point by encouraging N. Korea to change its stance in relation to the N. Korean nuclear issue.

Separation of Nuclear Issue from S-N Relationship : It is necessary to approach N. Korean nuclear issue separately from S-N Relationship by seeking resolution of the nuclear issue through 3-party, 4-party and 6-party talks. **Securing Impetus for Korean Peninsula Trust Process :** Foundation for the full operation of the Trust Process should be created by promoting forward-looking policies to encourage N. Korea to change. Mutual trust between North and South should be reinstated by lifting May 24 measure and by providing humanitarian aid for vulnerable social groups. **Creation of Atmosphere for the change of N. Korea by Encouraging N. Korea to Open up and Reform :** S-N economic cooperation should be expanded to ensure that efforts by N. Korea to attract foreign capital such as legislation of Economic Development Area Act and nationwide expansion of economic development area will turn out to be a success.

[Annex 2]
Domestic and Global Economic Indices

[Annex 2] 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	Annual(E)
US	2.8	3.7	1.2	2.8	0.1	1.9	1.1	2.5	4.1	2.8
Euro Region	-0.7	-0.1	-0.3	-0.2	-0.5	-0.4	-0.2	0.3	0.1	1.0
Japan	1.4	3.5	-2.0	-3.2	0.6	1.7	4.5	3.6	1.1	1.7
China	7.7	7.9	7.6	7.4	7.9	7.7	7.7	7.5	7.8	7.5

Note : 1) IMF figures of October 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		2012	2013			2014(E)
			the first half	the second half	Annual	
National Account	Economic Growth rate (%)	2.0	1.9	3.6	2.8	3.8
	Private Consumption (%)	1.7	1.6	2.1	1.9	2.7
	Construction Investment (%)	-2.2	5.2	8.3	6.9	2.5
	Facility Investment (%)	-1.9	-8.2	5.7	-1.5	6.7
Foreign Trade	Current Account (100 million Dollars)	481	298	397	695(E)	490
	Exports (100 million Dollars) [Increase rate, %]	5,479 [-1.3]	2,765 [0.5]	2,832 [3.8]	5,596 [2.1]	6,067 [8.4]
	Imports (100 million Dollars) [Increase rate, %]	5,196 [-0.9]	2,565 [-2.9]	2,591 [1.4]	5,156 [-0.8]	5,697 [10.5]
Consumer Price (Average, %)		2.2	1.4	1.2	1.3	2.4
Unemployment rate (Average, %)		3.2	3.4	2.9	3.1	3.1

▫ Economic Indicators of North Korea

		2005	2006	2007	2008	2009	2010	2011	2012
Per capita GNI (10, 000 won)		105	103	104	114	119	124	133	137
Amount of Trade by Year (USD million)	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

Hyundai Research Institute

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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 it's own businesses such as business consulting, education and training service, and knowledge-content business.

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

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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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