

# **K**ERI **E**CONOMIC **B**ULLETIN

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# Executive Summary

## **Korea's 2012 Growth Likely to Close at 2.2%, 2013 GDP Projected at 2.9%**

Korea's economic growth in 2012 and 2013 are projected to reach 2.2% and 2.9%, respectively. The rates have been downwardly adjusted by 0.4 and 0.3 percentage point respectively from the 2.6% and 3.3% projected in August this year. The adjustments were a result of exports being forecasted to remain at single-digit growth due to a decline in the won-U.S. dollar exchange rate, intensified export competition and strengthened trade protectionism trends amid a stagnant global economic recovery. Significant improvement also will be difficult to achieve due to the household debt burden, fall in housing prices and limitations on policy flexibility.

In terms of the final demand sector, private consumption is expected to stay in the 2% range despite upward pressure on purchasing power such as export growth and a decline in the won-U.S. dollar exchange rate. However, slower than expected recovery of the housing market and employment will offset the increase in demand. Facility investment may rebound but is expected to achieve only a mild recovery at the 3% level due to a slow domestic demand recovery in addition to weak export growth. Notwithstanding an SOC budget increase, construction investment is likely to record a low growth rate of 1.6% in 2013, as a result of a slowdown in the construction of private housing.

## **Consumer Price Growth to Remain Stable at 2.7%, Won-U.S. Dollar Fx-Rate to Mark 1,054 Won per Dollar on Annual Average**

Continuing from a 2.3% expansion in 2012, consumer prices are expected to maintain the 2.5% level of stable growth in 2013, because the value of the won will appreciate and the deflation gap may continue due to a recovery in internal and external demand. With exports growing faster than imports, influenced by the stronger won, and the service balance returning to a deficit, the current account balance is expected to contract to US\$28.9 billion in 2013 from this year's US\$39.5 billion. The won-U.S. dollar exchange rate is predicted to decline to an annual average of 1,140 based on favorable supply and demand environments, easing of the global economic recession, continuation of a surplus in the current account, upgrade in the national credit rating and other factors.

## **Growth for 2013 May Drop to 1.8% with Internal & External Risks, Including Re-Emergence of Eurozone Crisis, Translated Into Reality**

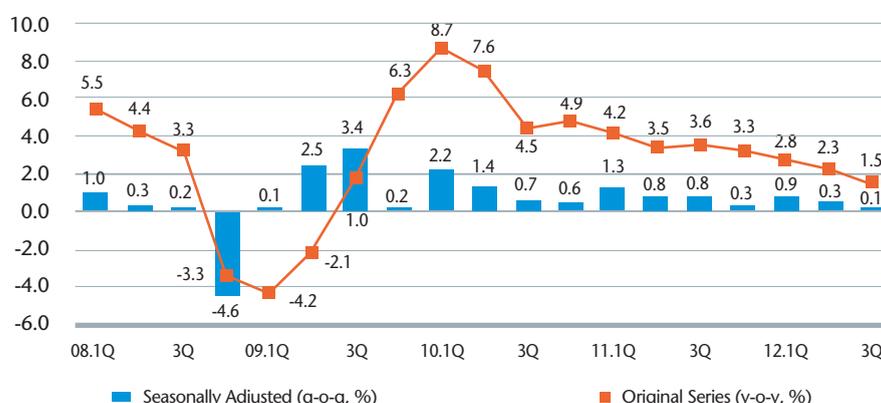
If the global economic growth slows due to the realization of external risks, including a re-emergence of the eurozone crisis, the U.S. fiscal cliff effects and China's growth slowdown, Korea's economic growth for 2013 is expected to drop to 2.3% from the projected rate of 2.9%. In addition, if facility investment shrinks significantly due to internal uncertainties, such as the presidential election aftereffects, and 'economic democratization' pledges, growth for 2013 may decline even further to 1.8%.

## Recent Developments

**Growth in 3rd Qtr. of 2012 Registered 0.1% Year-on-Year, Down from 0.3% in 2nd Qtr.**

Low growth of less than 1% continued for the sixth consecutive quarter since the 2nd quarter of 2011. The year-on-year growth rate was 1.5%, the lowest level since 1.0% in the 3rd quarter of 2009. In the third quarter of this year, consumption, exports and construction investment rebounded slightly, but a significant slowdown in facility investment was a major factor in the poor economic growth. Facility investment in the third quarter recorded -4.8% after posting -7.0% in the second quarter.

**GDP Growth**

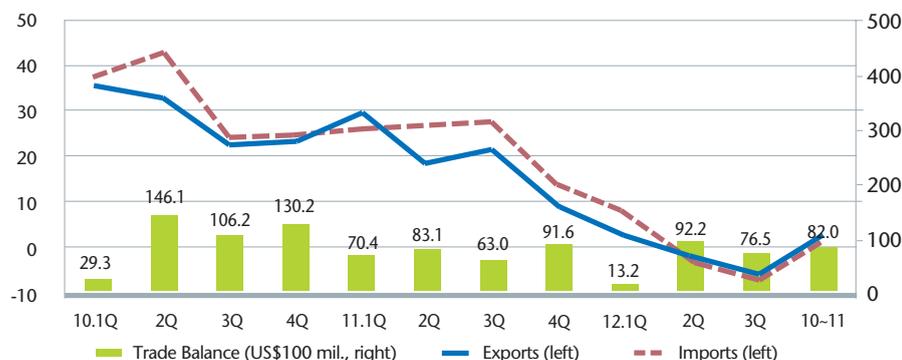


**Export Growth Continued in Oct. and Nov., Trade Balance Also Recorded a Surplus for 10th Consecutive Month**

In October and November this year, export growth rebounded to 2.5% from -5.7% in the third quarter. With imports slowing more than exports since the second quarter, however, the trade balance continues to record a significant surplus. The January-November trade surplus scale was US\$26.8 billion.

**Exports, Imports and Trade Balance**

(Unit: y-o-y, %, US\$100 million)



### Current Account Surplus US\$14.6 Bil. in 3rd Qtr., US\$5.2 Bil. in Oct.

The current account surplus for January-October this year posted US\$34.1 billion, a remarkable improvement of US\$15.2 billion from US\$18.9 billion in the same period of 2011. This result is attributed to the expansion of the commodity balance surplus amid a continuing service balance surplus.

### Current Account Balance

(Unit: US\$100 mil.)

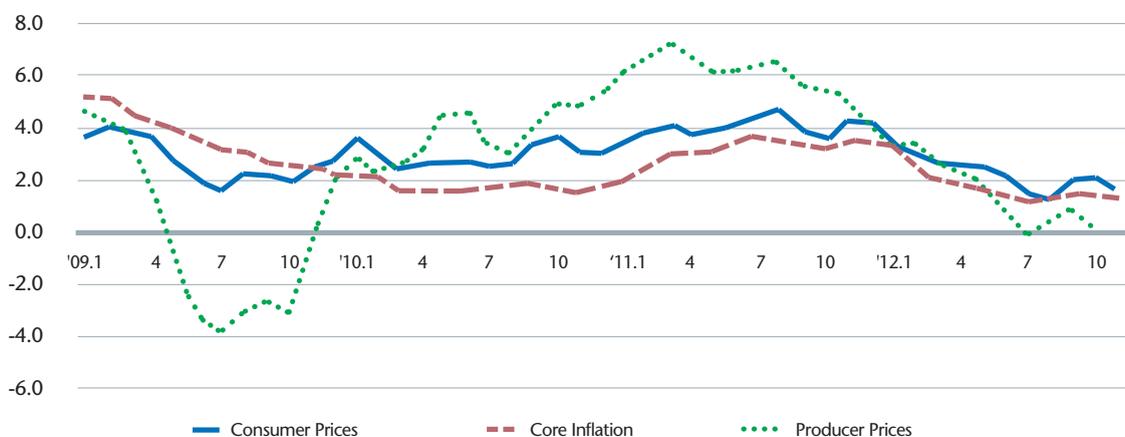
	2011		2012				
	Jan.-Oct.	Year	1/4	2/4	3/4	Oct.	Jan-Oct.
Current Account Balance	189.4	260.7	25.6	111.9	145.6	58.2	341.3
Goods	244.2	316.6	26.1	85.2	133.4	52.1	296.8
Services	-53.5	-58.5	-6.5	23.1	6.5	3.8	27.0
Primary Income	20.8	28.9	14.9	8.2	10.4	5.2	38.7
Secondary Income	-22.0	-26.3	-8.9	-4.7	-4.8	-2.9	-2.12

### Consumer Prices Stabilized After Temporary Rise in Sept.

Despite a bound in September from the low point in August, consumer price inflation was at the 1% level in October and November. Compared with September, consumer prices posted declines for the two consecutive months of October and November.

### Prices

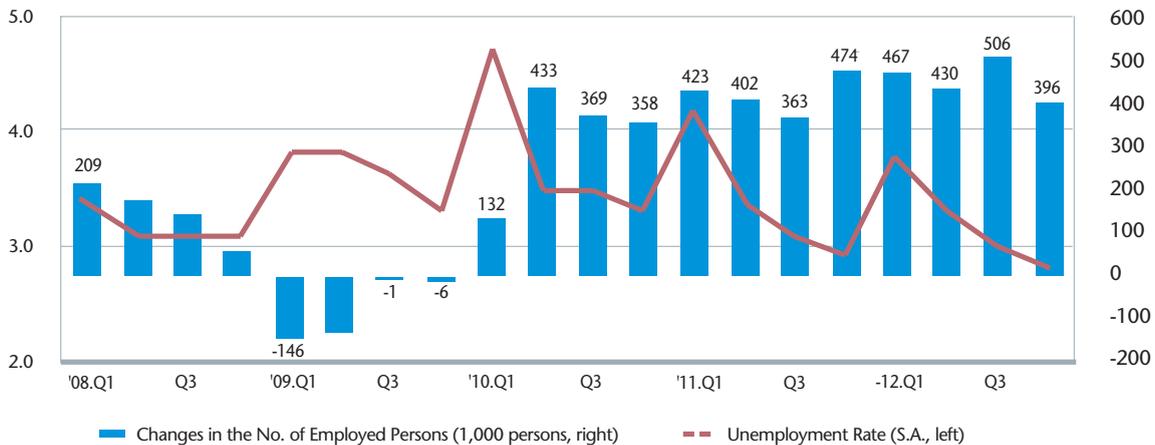
(Unit: y-o-y, %)



**Employment Maintained Quantitative Growth But High Youth Unemployment Continued**

The number of employed increased by about 400,000 in October and the unemployment rate continued its decline since the 1st quarter of this year. However, the downward trend of youth employment worsened further since the second quarter, so the youth unemployment rate rose to 6.9% in October, up 0.2 percentage point year-on-year.

**Employment**



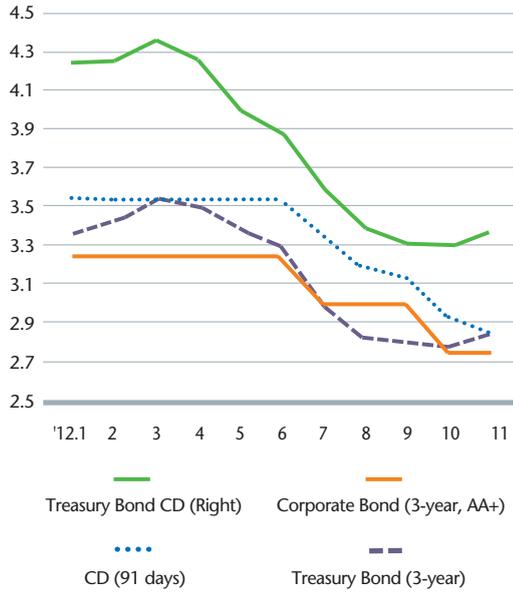
**Market Interest Rate Rises Slightly Due to Base Rate Freeze and Weaker Preference for Safe Assets**

The corporate bond yield rate (2-year, AA-) rebounded to 3.31% on December 4, rising from 3.23% on October 10. The treasury bond (3-year) interest rate also increased from 2.71% to 2.84% in the same period.

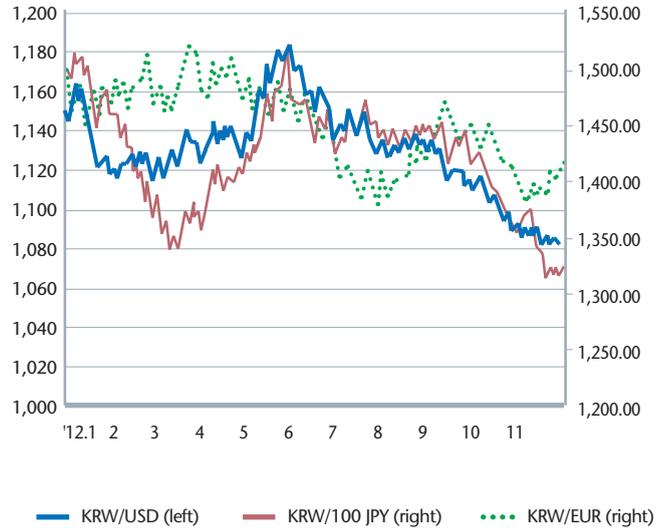
**Won-U.S. Dollar Fx-Rate Falling Since Quantitative Easing Measures by ECB and FRB.**

The won-U.S. dollar exchange rate is declining as factors pushing the rate lower are leading to an increase in the inflow of funds. The dominating factors are, first, the quantitative measures taken by the European Central Bank (ECB) and U.S. Federal Reserve Board (FRB) and a rise in the Korea's national credit rating; second, weaker preference for safe assets following the eurozone crisis and mitigated fears of a global economic recession; and third, continuation of significant current account surpluses.

## Interest Rates



## Exchange Rates



# Outlook for 2012~2013

## 1. Internal and External Environments

### Global Economic Growth for 2013 - Difficult to Expect Visible Rebound (IMF: 3.6%, OECD: 3.4%)

The eurozone economy is likely to continue its economic slowdown in 2013 as investment and consumption sentiment are shrinking in line with the region's fiscal austerity measures amid the fatigue of all eurozone economies from the on-going financial crisis. In the United States, a gradual recovery of housing business conditions may contribute to the recovery of consumption to a certain extent but its strength will not be sufficient to drive the overall economic recovery. Therefore, the U.S. economy is expected to continue to experience low growth of 2.1% in 2013, down from 2.2% in 2012.

China is expected to enter a stabilization stage through the government's full-fledged economic stimulus policies along with its leadership change. Accordingly, China's economic growth is projected at 7.8% for 2012 and 8.2% for 2013. With the completion of recovery expenditures resulting from the earthquake and related disasters, Japan's economic growth is expected to record 1.2% in 2013, lower than the 2.2% in 2012.

### Int'l Oil Prices May Decline Slightly in 2013 Compared With 2012

Despite price push factors, such as the Middle East region's geopolitical risks and the quantitative easing policy measures of major countries, an excess supply situation following mild demand growth is likely to restrict oil price hikes.

### Yen and Euro Currencies to Weaken; Yuan to Strengthen Mildly

The U.S. dollar is expected to weaken due to expanded implementation of QE3 by the Federal Reserve Board (FRB) and other factors. However, the dollar will be stronger against the yen and euro as Japan and the eurozone are experiencing comparatively low economic growth. Considering the Japanese government's implementation of further monetary easing in the wake of the Liberal Democratic Party's rise to power, the yen currency is expected to continue to weaken. With economic depression continuing in the course of adjusting debts in financial-crisis-stricken countries, the euro also is likely to weaken. In expectations of a recovery from the global recession and housing market revival, China's yuan is projected to rebound and appreciate mildly from the current weakening trend.

### Major Assumptions for Projections

Global economic growth rates for 2012 and 2013 were assumed to be 3.3% and 3.5% respectively. International oil prices (Dubai oil basis) were assumed to be US\$105/bbl. for 2012 and US\$100/bbl. for 2013.

## 2. Outlook for the Korean Economy (2012~2013)

**Growth: 2.2% for 2012 →  
2.9% for 2013**

The Korean economy for 2013 is expected to achieve mild growth, slightly higher than the estimated growth of about 2.2% for 2012, and post a growth rate of slightly less than 3%.

Externally, the projected global economic growth of 3.6% for 2013 lags far behind the 4.2% for the 2000~2007 period. The global growth rate is lower because, even if the current crisis is overcome, a stronger contraction in response to the U.S. fiscal debt will be inevitable amid the economic recession that seems unavoidable following fiscal retrenchment in the European region.

Internally, due to a weakening of debt repayment capacity in the household sector, the domestic demand slowdown is likely to continue, buying and selling prices of houses may fall and consumption sentiment also is expected to shrink in the course of rental housing price adjustments. Additional interest rate cuts would not be easy due to the price environment. When considering the aspect of fiscal stability or policy effects, implementation of an expansionary fiscal policy will be limited as well. It will not be easy either to maintain a stable won value amid the exchange rate battles of major countries.

**Private Consumption: 1.6%  
for 2012 →2.4% for 2013**

Private consumption growth for 2013 is expected to rise compared with 2012 owing to an increase in purchasing power following export recovery and the won-U.S. dollar exchange rate decline. However, limiting factors like household debt adjustments remain so growth may be capped at about 2.4%. In the future, an employment growth slowdown and delayed housing market recovery also will serve as factors restricting consumption.

**Facility Investment: 1.0%  
for 2012 →3.4% for 2013**

Facility investment growth for 2013 is forecast to be stronger than for 2012, but will remain in the 3~4% range. This result is because corporate investment sentiment is forecast to shrink, affected by the delayed domestic recovery in addition to limited export growth, slow improvement in external environments below previous levels, etc.

**Construction Investment:**  
**0.3% for 2012 → 1.6% for 2013**

Owing to an increased SOC budget, public construction in 2013 may recover. With recovery in private housing construction being delayed, however, overall construction investment is expected to remain at a low annual growth rate of 1~2% in 2013.

**Export Growth (nominal, US dollar):**  
**0.7% for 2012 → 5.6% for 2013**

An export recovery may continue as an improvement in the global economy is expected in 2013. But with worsening trade environments, including stronger trade protectionism, export growth will likely remain at 5%. The projection of a won-U.S. dollar exchange rate decline will serve as a limiting factor on exports.

**Current Account Surplus:**  
**US\$39.5 Bil. for 2012 → US\$28.9 Bil. for 2013**

The commodity balance surplus is expected to contract slightly in 2013, with growth of imports outpacing that of exports. The service balance is likely to be in deficit due to won currency appreciation, economic recovery and other factors. As a result, the current account surplus for 2013 is projected at US\$28.9 billion, lower than the US\$39.5 billion in 2012.

**Consumer Prices: 2.3% for 2012 → 2.7% for 2013**

Although increase and decrease factors may coexist next year, consumer prices are expected to continue the stabilization trend within the range of 2.5~3.0%. The growth rate of the consumer prices is likely to remain at around 3%, sustaining the deflationary gap, and the won value appreciation will limit price increases.

**Corporate Bond Yield Rate (3-year, AA-):**  
**2.37% for 2012 (2nd Half) → 3.8% for 2013**

Market interest rates are expected to register a slight growth trend as mitigated uncertainty in the eurozone and the global economy may lead to a gradual economic recovery in Korea and a boost in prices. With the focus of monetary policy also turning again to prices, the base rate is likely to be frozen or converted to an increasing trend again in the second half of 2013.

**Won-USD Fx-Rate: 1,128 Won for 2012 → 1,054 Won for 2013**

The won-U.S. dollar exchange rate is expected to decline mildly in 2013 as the preference for risky assets is gradually decreasing due to the improvements in the U.S. economy and the mitigation of the European financial crisis. The inflow of foreign funds into Korea is likely to continue with its continuous current account surpluses and upgraded national credit rating.

### Outlook for Korean Economy

(Unit: y-o-y, %, US\$100 million (int'l balance of payments))

	2011	2012		2013			
	Year	1st Half	2nd Half	Year	1st Half	2nd Half	Year
GDP	3.6	2.5	1.8	2.2	2.0	3.6	2.9
(SA, q-o-q, %)		1.2	0.6		1.3	2.3	
Private Consumption	2.3	1.3	1.9	1.6	2.0	2.8	2.4
Construction Investment	-5.0	-0.6	0.0	-0.3	1.1	2.0	1.6
Equipment Investment	3.7	2.2	-4.2	-1.0	-0.2	7.2	3.4
Exports (Goods & Service)	9.5	3.9	3.6	3.7	4.5	6.6	5.6
Imports (Goods & Service)	6.5	2.4	2.1	2.3	4.1	6.8	5.5
Consumer Prices	4.0	2.7	1.9	2.3	2.5	3.0	2.7
Current Account Balance (US\$100 mil.)	260.7	137.5	257.8	395.3	89.1	200.1	289.2
Commodity	316.6	111.3	256.8	368.1	99.9	211.8	311.8
Exports (BOP Base)	5,517.7	2,734.1	2,821.8	5,555.9	2,854.9	3,015.7	5,870.6
Growth (%)	19.6	1.4	0.0	0.7	4.4	6.9	5.7
Imports (BOP Base)	5,201.1	2,622.8	2,565.0	5,187.8	2,755.0	2,803.9	5,558.9
Growth (%)	23.4	2.3	-2.8	-0.3	5.0	9.3	7.2
Service & Others	-55.9	26.2	0.9	27.1	-10.9	-11.7	-22.6
Ex Rate (Avg. KRW/USD)	1,108.0	1,141.7	1,113.3	1,127.5	1,071.5	1,036.5	1,054.0
Corp. Bonds Yield (3-year, AA-)	4.4	4.2	3.3	3.7	3.5	4.0	3.8
Unemployment Rate (%)	3.4	3.6	3.4	3.5	3.5	3.3	3.4

## Policy Issue:

### Major Risk Factors and the Korea Economy in 2013

#### Major Risk Factors Expected in 2013

##### Possible Re-Emergence of European Financial Crisis

Fears of risks, including uncertainty related to rescuing Spain, are remaining and the possibility of risk infection related to Italy will last until the situation in its neighboring countries improves. Moreover, if the policy coordination in the eurozone encounters uncertainties again, another financial crisis may emerge with severe public resistance and the worsening of credibility regarding belt-tightening policies.

##### Risks Associated With U.S. Fiscal Cliff and Subsequent Expansion of Uncertainties in Financial Markets

If the Congress is unable to reach an agreement on the fiscal cliff, the U.S. economy may fall into a deep and prolonged recession. Even with the settlement over the fiscal cliff, some measures to raise taxes such as ending the social security tax relief would have to be carried out, making economic recovery difficult.

##### China May Continue Unstable Growth of Less Than 8% Level

The effects of the policies to boost domestic demand in China are uncertain since China's local governments have made bad investments, worsening its financial capability. A mountain of debt by the stimulus packages that have been implemented since the global financial crisis in 2008 has limited the capability of the Chinese government to afford another big stimulus budget. Moreover, if its new leadership does not settle in quickly, risks of social unrest will likely rise.

##### Additional Facility Investment Shrinkage due to Economic Democratization, etc.

The growth rate of tangible assets owned by the business groups under the total equity investment ceiling rule was only 3.5% from 2000 to 2008, significantly lower than the 9.3% of other business groups. This analysis shows that the total equity investment ceiling system for large corporations in Korea has negative effects on the real the investment. Also, the circular equity investment ban has to undermine the investment of companies by making them heavily invest in defending their management rights.

### Impacts of Risk Factors on 2013 Korean Economy

#### Basic Assumptions for Risk Factors

*Assumption 1:* Global economic growth falls to 2.0% (about 1.6 percentage points lower than the projected 3.6%) due to the materialization of external risks, such as deepening of the eurozone crisis, U.S. fiscal cliff and China's economic slowdown.

*Assumption 2:* Facility investment drops to -4.5% (about 8 percentage points lower than the projected 3.4%) due to the presidential election effects and 'economic democratization' pledges.

**Analysis Results: National economic growth in 2013 may decrease to 1.8% from 2.0%.**

Growth projections if internal and external risk factors materialize

	Assumptions	Projections of 2013 Korean Economic Growth
Assumption 1	Continuation of European Crisis + U.S. Fiscal Cliff → Global Economic Growth to Fall to 2.0% From 3.6% in Line with IMF's Projection	2.9% → 2.3% (down 0.6% point)
Assumption 2	Investment Sentiment Instability + Economic Democratization → Korea's Domestic Facility Investment Growth to Fall to -4.5% from 3.4%	2.9% → 2.4% (down 0.5% point)
Assumption 1 + 2		2.9% → 1.8% (down 1.1% point)

## **A Study on the Guidelines for the Utilization of the Investor-State Dispute Settlement Mechanism (ISD) in the KORUS FTA for Korean Overseas Investors**

Research Monograph 12-04

Won Mog Choi

This study aims to summarize the ISD in the KORUS FTA and provide a comprehensive guideline for its use to Korean overseas investors. How to settle investment disputes directly affects the risk premium of investment and any overseas investor needs a proper guideline on the use of ISD, a universal tool for settling investment disputes in the contemporary business world.

In this light, this study begins with clear and comprehensive summaries and analysis of substantive and procedural rules of investment provisions of the KORUS FTA. On this base, check points on the use of ISD are derived and specific guidelines for its utilization are suggested for the benefit of investment companies considering investment or ISD claims in the United States.

[www.keri.org](http://www.keri.org)

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