

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

## Contents

<b>Executive Summary</b> .....	<b>02</b>
<b>Economic Trends and Outlook</b> .....	<b>03</b>
Recent Developments	
Outlook for 2013	
Policy Issues .....	<b>11</b>
<b>Recent Publications</b> .....	<b>13</b>



Korea Economic Research Institute

# Executive Summary

## **Korea's 2013 GDP Growth Projected at 2.9%, Continued in a Two-Year Low Growth Below 3%**

The Korean national economy for 2013 is expected to grow at 2.9 per cent, continued by the last year of low growth below 3 per cent. This is attributable to the slowing pace of global economic recovery and a single-digit export growth, owing to a weak-yen, strong-won phenomenon and rampant trade protectionism. Considering household debt burdens, housing price decline and political limitation on stimulus measures to buoy the economy, an increase in domestic consumption is projected to have limited effect on growth. Affected by risk factors as household debt burdens, slowed job growth, and delayed recovery of housing market, the private consumption is projected to be at a low range of 2 per cent. Facility investment is expected a low recovery rate of 3 per cent due to uncertainties with regard to internal and external demand forecasts and dampened investment sentiment by a nationwide discussion of "economic democratization." In the construction sector, a slow growth by 2.2% is expected due to continued struggle with investment growth in residential structures investment, despite an increase of SOC budget and a base effect.

## **The consumer price is in line with a stable growth by 2.6%, the won-dollar exchange rate is expected to be an annual average of 1,065 won/\$.**

The upward pressure on public service fees and prices of food has a staggered effect on the consumer price, but its economic spillover effects are limited, owing to weak external and domestic demand and the appreciation of the Korean won. Total current account surpluses forecast to decrease to US\$ 30.1 billion this year from US\$ 43.1 billion in the previous year, as the rate of imports increase is faster than the rate of exports due to a strong won along with the reversal of service surpluses to deficits. The won-dollar exchange rate is projected to continue to fall but the pace at which the rate is dipping is slowing down in the second half, with an annual average of 1,065 won per dollar. Possibility of outflow of foreign capital, risks associated with North Korea's nuclear program, and exchange policy of the government will be factors that constrict won appreciation against dollar.

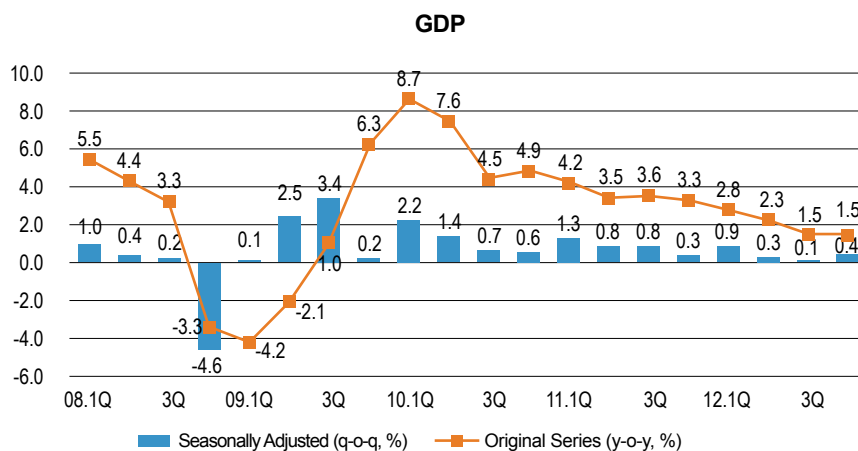
## **In need of export expansion policies such as increasing shares of final goods export among exports to China**

Citable as major downside risks related to constraint factors on the export recovery of 2013 are the weakening price competitiveness of Korea's export goods reflecting a weak-yen and strong-won trend, contraction of export following growing trade barriers in overseas markets, and decrease in export to the Chinese market owing to China's shift in economic policy from export centered growth to growth based on domestic consumption. Following policies are suggested in order to boost export sector: mitigating shocks from a strong-won and weak-yen trend by lowering base interest rate in addition to the existing macro-prudential measures of bank levy, caps on banks' foreign exchange forward positions, and taxes on foreign investment in local bonds; fortifying against trade protectionism through strengthen public-private partnership and creating global supply chains; and enhancing the shares of final goods among exports to China.

## Recent Developments

**Economic growth rate increased 0.4 percentage point, compared to the last quarter of the previous year**

The Korean economy recorded growth rate at below 1 per cent range for the seventh consecutive quarters since the second quarter of 2011, reflecting concerns over US fiscal cliff, household debt burdens and election uncertainties. By final demands, private consumption increased while export and construction investment reverted to decline, and capital investment continued to show a declining trend.

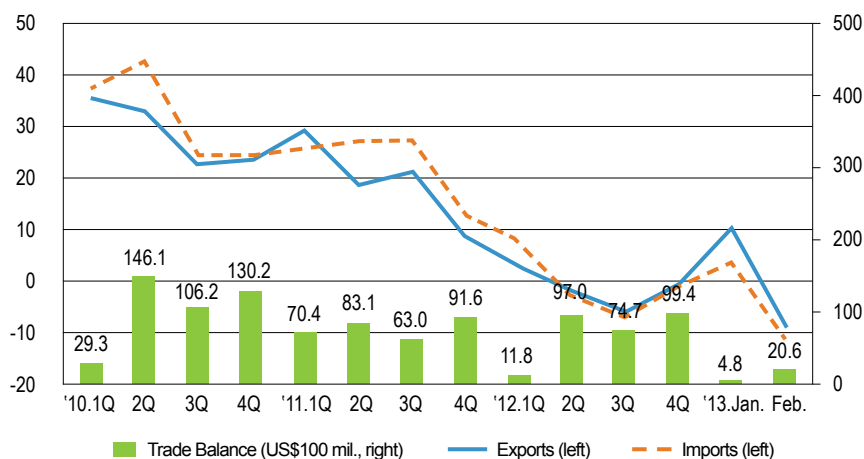


**Exports maintain a slow rebound since the second-half of the previous year. Trade surplus records 13 consecutive months since February 2012**

The rate of export growth rebounded to an average of 0.6 per cent in January and February this year, with the amount of exports of daily average picking up slowly. The trade surplus in January and February displayed a small degree of fall due to seasonal factors.

### Exports, Imports, and Trade Balance

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



### Current-account, continues a huge surplus, degree of surplus declining

In January, current account maintained its large surplus attributed to a continuing surplus in goods balance. However, the size of the total current account surplus showed a contracting trend as deficits of services account balance increased.

#### Current Account Balance

(Unit: US\$100 mil.)

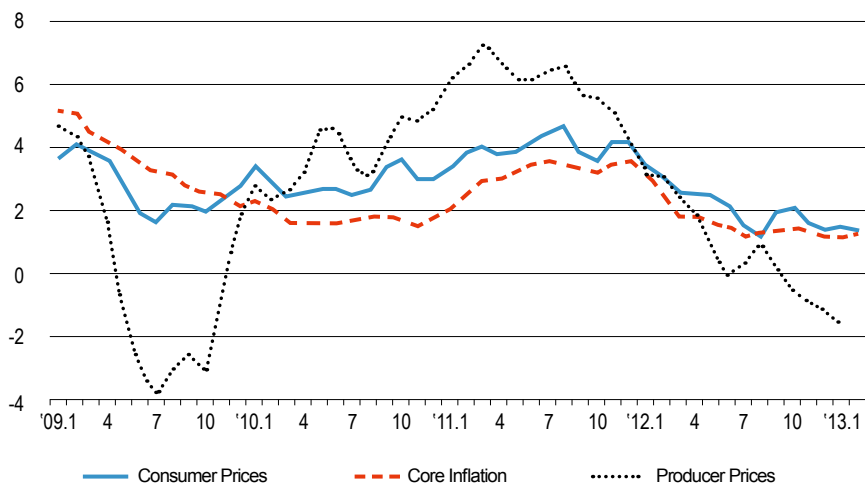
	2011	2012				2013	
	Year	1/4	2/4	3/4	4/4	Year	Jan
Current Account Balance	260.7	25.6	111.9	145.6	148.3	431.4	22.5
Goods	316.6	26.1	85.2	133.4	138.6	383.4	26.0
Services	-58.5	-6.5	23.1	6.5	3.6	26.8	-9.3
Primary Income	28.9	14.9	8.2	10.4	15.4	48.9	9.7
Secondary Income	-26.3	-8.9	-4.7	-4.8	-9.3	-27.6	-3.8

### The growth rate of consumer price maintains low at 1 percent in the new year

The consumer price inclined to 1.4 percent compared to the same month of the previous year, maintaining a 1 percentage point increase for four consecutive months since November last year.

#### Prices

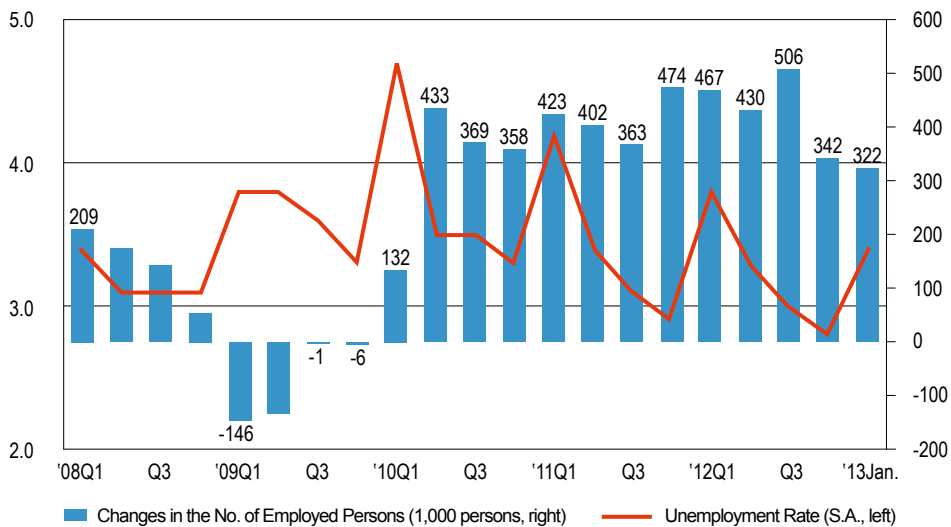
(Unit: y-o-y, %)



**A quantitative recovery in employment slowed down. A growth of senior employment also slowed down amidst high youth unemployment continued.**

The number of employees increased by 322,000 in January, showing signs of slowdown compared with the previous month of 342,000. The rate of decrease for youth employees continued to incline since the second quarter of the last year while the rate of increase for employees over 50 years old was also slowing down.

**Employment**



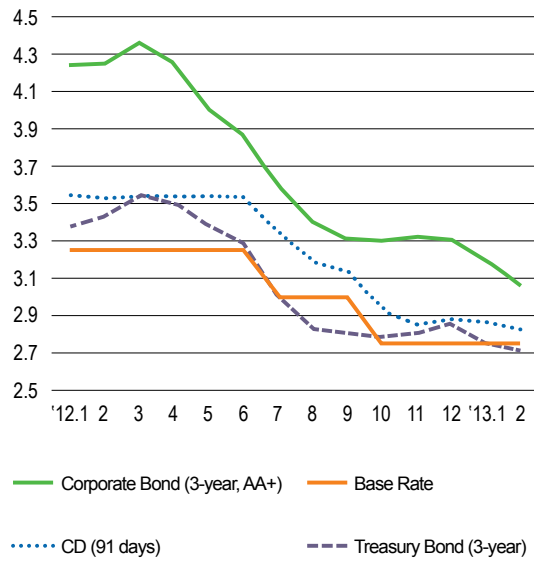
**Money market shows a downward trend due to uncertain domestic economic outlook and expectation on further interest rate cuts**

The corporate bond yield rate (3-year, AA- %) recorded a decline from 3.31 per cent on December 4 last year to 3.19 per cent on January 10, 2013 and 2.99 per cent on February 28, 2013.

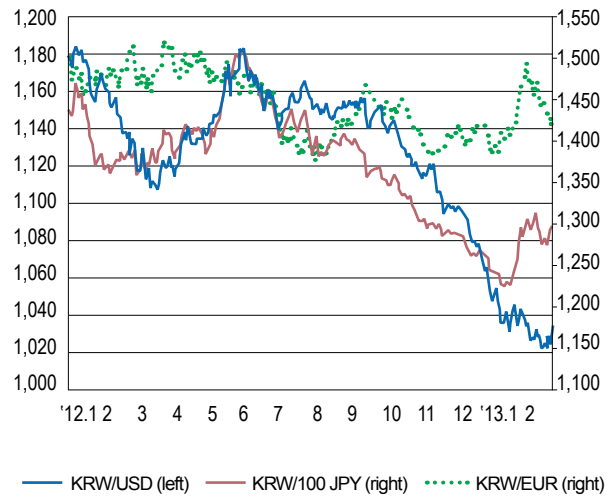
**The fall of won-U.S dollar exchange rate slows due to geopolitical risks associated with North Korea nuclear program**

Following quantitative easing of major economies, the won-U.S. dollar exchange rate plummeted; the value of won is fluctuating at the 1,080 level due to the risks associated with a recent North Korea nuclear test.

## Interest Rates



## Exchange Rates



# Outlook for 2013

## 1. Internal and External Environments

### **Global economic growth for 2013: Difficult to expect a visible recovery due to fiscal austerity measures of the U.S. and Europe**

The eurozone economy is likely to prevent further spread of sovereign debt crisis as new cooperative initiatives are being developed among the member states. However political and economical instability undermines efforts to end the eurozone crisis. In the United States, a gradual recovery of housing market conditions and fall of unemployment rate may contribute to the economic recovery but its impact will be limited due to an inevitable spending cut in 2013. Japan is expected to enter a gradual stabilization stage through the government's active quantitative easing and fiscal expansion policies. The Chinese economy is projected to grow by 8 per cent with incoming leadership taking office with a full-fledge fiscal stimulus package.

### **Estimated overall excess supply of crude oil leads to a nudge-down in oil prices despite geopolitical risk and speculative demand**

Despite price push factors, such as the Middle East region's geopolitical risks and the QE policy measures of major countries, a gradual demand increase for crude oil, increase supply of non-OPEC and incline in oil inventories are likely to keep oil prices down.

### **Yen and euro currencies to weaken; yuan to strengthen gradually**

The U.S. dollar continues to weaken following expanded implementation of QE3, but is expected to be stronger against the yen and euro as the regions are experiencing relatively slow economic growth. Considering the Japanese government's full-fledged monetary easing policy, the yen is forecast to stay weak. To minimize shocks from financial crisis, the European authorities are expected to carry forward the monetary policy that induces weakening the euro. In expectations of stabilization measures of the eurozone and housing price rebound effects, China's yuan is projected to rebound and appreciate.

## 2. Outlook for the Korean Economy in 2013

**Growth:**  
**2.0% for 2012 →**  
**2.9% for 2013**

The Korean economy for 2013 is expected a low growth under 3 per cent, which falls short on the potential growth rate of a mid-3 per cent range for two consecutive years. This is because export growth will be largely constrained by deterioration of export environment regardless of indication of global economic recovery. Externally, the projected global economic growth of 3.5 per cent for 2013 lags far behind the 4.2 per cent for the 2000 to 2007 period. Fall of the won-dollar exchange rate, intensification of competition and rampant trade protectionism render the export environment more difficult.

Internally, household sector's weakening of debt repayment capacity, a decline in housing prices and rental housing price hikes would constrict consumption sentiment. Corporate investment sentiment is likely to remain rigid due to a nation-wide discussion on the issue of "economic democratization" and welfare expansion.

**Private consumption: 1.8%**  
**for 2012 → 2.4% for 2013**

Private consumption growth for 2013 is expected to be higher than that of 2012, buoyed by improvement of domestic and foreign conditions and rise of purchasing power reflecting low won-dollar exchange rate; however, household debt adjustments and decline in housing prices remain a sticking point, which is estimated to be at 2.4 per cent.

**Facility investment:**  
**- 1.8% for 2012 → 3.1% for**  
**2013**

Facility investment in 2013 is expected to turn around to a rising trend following revival in exports and a cost decline for capital goods imports due to an increment of the won. However, limiting factors like a single-digit export growth rate and contraction of corporate investment sentiment, affected by policy limitations in relations to "economic democratization" remain, so the growth may be capped at about 3 per cent rage.

**Construction investment:**  
**-1.5% for 2012 → 2.2% for**  
**2013**

Owing to an increased SOC budget, public construction in 2013 may recover. With recovery in private housing construction being delayed due to structural low demand, overall construction investment is expected to remain at a low annual growth rate around 2 per cent in 2013.



**Export Growth (nominal, US dollar):**  
**0.1% for 2012 → 4.3% for 2013**

An export is expected to recover following an improvement in the global economy. But with worsening trade environments, including weaker yen and growing trade protectionism in the overseas markets, export growth will likely remain at a low annual growth rate of 4 per cent.

**Current account surplus:**  
**\$43bil. for 2012 → \$30 bil. for 2013**

The goods balance surplus is expected to decline slightly while the service balance is in deficit again, making a total current account surplus for 2013 is projected to be at US\$30.1 billion, a fall from US\$ 43.1 billion from last year.

**Consumer prices:**  
**2.2% for 2012 → 2.6% for 2013**

A rise in public services fee and food prices is expected to have a staggered impact on overall prices. However, consumer prices are expected to continue a stabilization trend with the growth rate remaining within 3.0 per cent range since spillover effects from the price increase will be limited owing to a stagnant demand recovery at home and abroad.

**Corporate bond yield (3 years, AA-):**  
**3.8% for 2012 → 3.4% for 2013**

Market interest rates are expected to register an upswing expansion after the second half of 2013. Amidst stagnant economy in the first half an upward pressure on interest rate is projected to ease a little owing to expectation on possibility of a base interest rate decline by the authority. Towards the second half, market interest rates are forecast to increase as mitigated uncertainty in the eurozone and rebound of the global economy may lead to a gradual economic recovery in Korea and a boost in price.

**Won-USD Fx-Rate:**  
**1,127 Won for 2012 → 1,065 Won for 2013**

The flow of foreign funds is projected to be favorable attributed to a positive outlook for the Korean economy that includes a weakening of risk averse sentiment, current account surplus and an incline of sovereign credit rating following. Major downside risks such as possibility of outflow of foreign capital, risks associated with North Korea's nuclear program, exchange policy of the government will be factors that limit the widths of won appreciation.

## Outlook for Korean Economy in 2013

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

	2012	2013						
	Year	1Q	2Q	3Q	4Q	1st Half	2st Half	Year
GDP	2.0	2.3	2.6	3.3	3.3	2.5	3.3	2.9
Private Consumption	1.8	2.2	2.5	2.6	2.4	2.3	2.5	2.4
Construction Investment	-1.5	-1.1	2.2	2.8	3.8	0.8	3.3	2.2
Equipment Investment	-1.8	-4.1	3.2	6.1	7.9	-0.5	7.0	3.1
Exports (Goods & Service)	3.7	4.3	5.5	6.1	6.3	4.9	6.2	5.6
Imports (Goods & Service)	2.3	3.5	5.0	6.4	6.3	4.2	6.3	5.3
Consumer Prices	2.2	1.8	2.5	3.0	3.2	2.2	3.1	2.6
Current Account Balance	431.4	38.8	62.9	95.5	103.5	101.8	199.0	300.7
Goods Balance	383.4	45.4	71.7	103.9	107.5	117.0	211.5	328.5
Exports (BOP Base)	5525.7	1385.3	1443.4	1436.7	1496.0	2828.7	2932.6	5761.3
Growth (%)	0.1	2.9	4.0	4.8	5.3	3.5	5.1	4.3
Imports (BOP Base)	5142.3	1340.0	1371.7	1332.7	1388.4	2711.6	2721.2	5432.8
Growth (%)	-1.1	1.5	5.3	7.7	8.3	3.4	8.0	5.6
Service & Others Balance	48.0	-6.5	-8.7	-8.5	-4.0	-15.3	-12.5	-27.8
Ex Rate (Avg. KRW/USD)	1126.9	1083.0	1065.0	1059.0	1051.0	1074.0	1055.0	1064.5
Corp. Bonds Yield (3-year, AA-)	3.8	3.1	3.2	3.5	3.7	3.2	3.6	3.4
Unemployment Rate (%)	3.2	3.4	3.2	3.0	3.2	3.3	3.1	3.2
Changes in the No. of Employed Persons (1,000 persons)	470.5	313.4	302.5	277.4	251.9	308.0	264.6	286.3

## Policy Issue:

### Examination of major risk factors for export recovery its implication in 2013

#### Major risk factors expected in 2013

##### **Strong won weak yen phenomenon**

Due to high export similarity index of the Korean and Japanese export products in the global market, simultaneous occurrence of strong won and weak yen will create a negative influence on the price competitiveness for the Korean products in the global market. In particular, in areas of high export similarity, such as Korean automobiles, parts, semi-conductor and computers will be expected to face a negative impact. From a macro-economic perspective, when yen/dollar exchange rate rises by 10 per cent, Korea's export and GDP will be projected to fall 3.17 per cent and 0.35 per cent, respectively.

##### **Intensification of global protectionism**

Global trade barriers targeting against Korean corporate are rampant: anti-dumping measures were a record high last year, with 13 cases of investigations and 4 response measures since 2005 and 2006, respectively. In the U.S. alone, anti-dumping tariffs were placed on washing machines and refrigerators made by Samsung Electronics and LG Electronics. Recently, Samsung Display and LG Display have received first disciplinary action for a speculation of price-fixing.

##### **China shifts its growth strategy to focus on domestic demand**

With the creation of global production supply chains that center around China since 2000, the share of exports of intermediary goods, including parts and processed products takes up more than 80 per cent of the all exports from Korea to China. Following Xi Jinping's domestic-centered economic growth strategy, Korea's intermediary goods exports to China is expected to slow down.

### Directions of corresponding policy

#### **Minimize shock from the strong won weak yen phenomenon**

In the short-term, in addition to the current macro-prudential measures (caps on banks' foreign exchange forward positions, taxes on foreign investment in local bonds and bank levy), the government should lower the interest rate. In the medium- and long-term, Korean businesses should focus on raising non-price competitiveness factors, including product quality, designs and brand value.

#### **Strengthening ex-ante and ex-post responses against trade protectionism**

For ex-ante measures, strengthen monitoring for keen awareness of any movement for a lawsuit and a rapid counter-measure; for ex-post measure, take a proactive stance in giving opinions in cooperation with the government is recommended.

#### **Taking initiatives in finding ways to expand exports to China**

Final goods exports to China should be expanded. In particular, by merging with the high-tech information technology, Korea should seek to expand export of high value products, such as electronic and electric products, petrochemical products and machinery, all of which take large share of the export to China.

## A study on the ways to vitalize the corporate bond market – focused on secondary market

Research Monograph 13-01  
Byung Hwa Lim

This study analyzes Korean corporate bond market and suggests the ways to vitalize the well-functioning corporate bond market. The primary and secondary market are investigated separately from the individual bond data. Moreover the promoting policies for the development of the corporate bond market are discussed again. Since the most market functions are revealed from the secondary market, the policy implications of this study are mainly concentrated on the activation plans for the secondary market.

In the primary market, more qualitative growth is required. Despite the Korean capital market was crashed after the asian financial crisis 1997 and global financial crisis in 2008, the issuances of corporate bond were rapidly increased because the banks were enforced to prepare more capital requirements and reduced to corporate loans. In spite of such quantitative growth, there are still many problems in primary market, which are short average maturities, herd behavior for the corporate bonds with high credit ratings, and so on. To resolve these shortcomings, there have been many suggested ways to ensure the market transparency and liquidity. The representative policies are introducing corporate bond specialized funds, QIB(Qualified Institutional Buyers), advancement of credit rating market, and others.

In contrast to the primary market, there have been little concerns for developing the secondary market. To ensure the market functions such as raising risk capital, price discovery, and risk sharing, which are especially crucial for the SMEs(small and medium enterprises), enough corporate bond trading should be occurred with transparency. In this study, to vitalize the corporate bond trading it is suggested that more developed electronic trading system should be introduced. Since most corporate bond trading in Korea take place in the OTC(Over-The-Counter) market the market participants are limited and they should pay high transaction costs including monitoring cost and counterparty risk. Therefore if the electronic trading system of corporate bond is established, most trading records are opened to the public. So the transaction costs and entry barriers for outside traders will be reduced drastically and furthermore, the investor protection is also guaranteed. For the specific policies, introducing ATS(Alternative Trading System) specialized for corporate bond trading like TRACE(Trading Report And Compliance Engine) in US and establishing bankruptcy bond market are suggested.

This study gives important policy implications which exhibit the policy direction for the long-term perspective. To ensure the market functions of corporate bond market, it is emphasized that the core task is an activation of the secondary market. This study is the first work to discuss in earnest for the domestic corporate bond trading system.

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

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