

KERI **E**CONOMIC **B**ULLETIN

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Executive Summary

'09 Annual Growth Rate Projected at -1.9%

The national economy in 2009 is expected to grow -3.9% in the first half and 0.0% in the second half. The annual growth is expected to be -1.9%, a 0.7 percentage point upward adjustment from the -2.6% projected in March this year, which reflected the effect of the supplementary budget.

Foreign exchange effect alleviated the extent of export contraction in the first half. Pump-priming policy for economic conditions, including supplementary budget, and base effects in the second half are likely to lead improvement of the annual growth.

In the final demand sector, owing to fiscal expansion for SOC, construction investment is expected to post positive growth (1.5%) in the second half following a 1.2% growth in the first half.

However, the recovery trend of private consumption is likely to be limited (-0.7% in the second half) due to worsening labor market conditions as the restructuring continues.

Facility investment is expected to decline further, falling about 12% in the second half due to a lack of facility investment pressure, low operating rate, difficulties for enterprises to secure funds, etc.

Current Account Surplus to Contract but Inflation to Remain at 2% Level

The current account will continue a surplus in the second half following a significant surplus (US\$20.8 billion) in the first half. Nevertheless, the surplus scale is expected to shrink sharply to US\$2.6 billion in the second half, affected by a weakening U.S. dollar and oil price hike (US\$55 in the first half to US\$75 in the second). Meanwhile, inflation rate is expected to rise in the fourth quarter due to international oil and raw materials price hikes, but remain at a stable 2% level in the second half with a fall in won-U.S. dollar exchange rate offsetting certain aspects of the price push factors.

Won-U.S. Dollar Fx Rate Forecasted at 1,350 Won in the 1st Half and 1,230 won in the 2nd Half

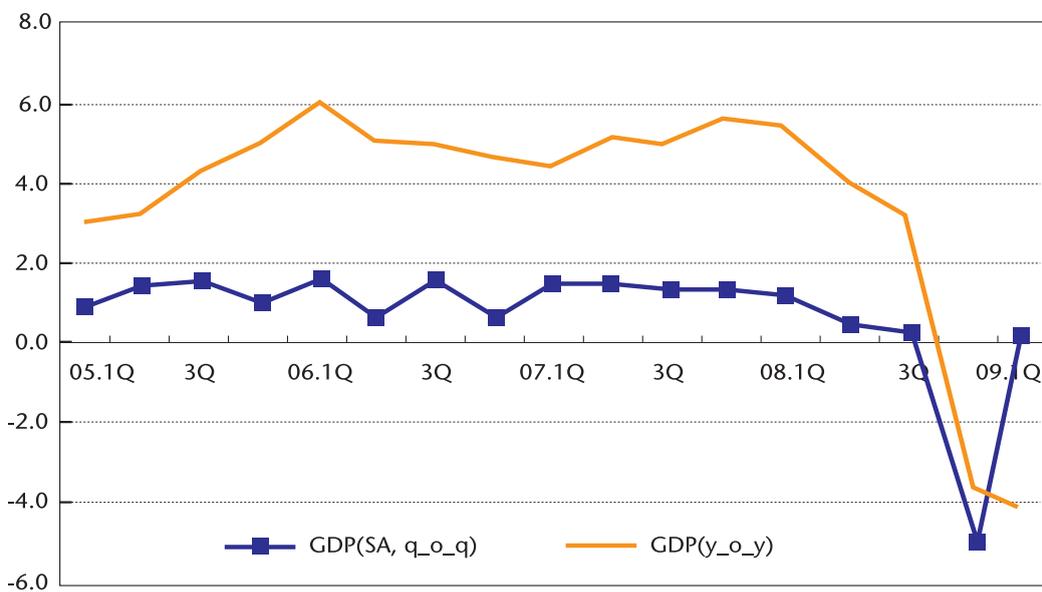
Due to instability in the real economy and the financial sector, the won-U.S. dollar exchange rate maintained a high level averaging 1,350 won in the first half. However, the exchange rate is expected to average 1,230 won to the dollar in the second half due to such factors as stabilization of the financial market, weakening of the dollar and current account surplus.

Recent Developments

The Economy Grows 0.1% in the 1st Quarter

Real GDP growth (SA, q-o-q) in the first quarter of 2009 rebounded from a decline (-5.1%, the lowest since the 1997-98 foreign exchange crisis) in the fourth quarter of 2008. While contribution of domestic demand to economic growth was -2.6% due to a facility investment slowdown, that of net exports was 2.6% owing to a sharp decline in imports.

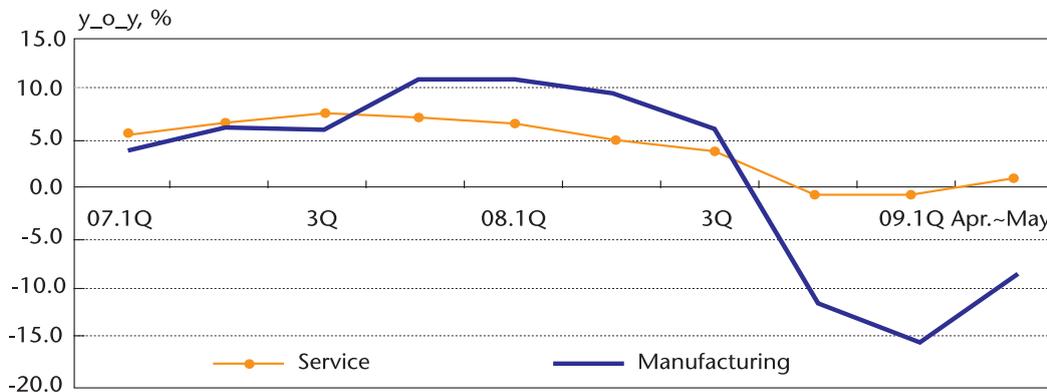
GDP Growth



Recession to Ease in the 2nd Quarter

The decline in manufacturing production slowed (-15.5% in the 1st quarter to -8.6% in April-May) and service production rebounded to an upward trend (-0.5% in the 1st quarter to 1.0% in April-May).

Manufacturing Production and Service Activity



**Consumption Decline
Moderated, Facility Investment
Remains Weak but
Construction Investment
Shows Sign of Recovery**

Consumer goods sales posted a significant decrease (-4.9%) in the first quarter, but improved slightly to -1.1% in April-May. This is attributed to an improvement in consumer sentiment with capital markets, including stocks and real estate, showing a recovery trend despite the worsened employment situation.

Due to a slowdown in the private construction sector, facility investment continued a significant decrease (-19.5% in April-May) consecutively from -22.9% in the first quarter. Notwithstanding the private construction slowdown and affected by early implementation of SOC projects in the public sector and the supplementary budget, however, construction progress payments maintained a growth trend (8.4%) in April-May following a 4.5% growth in the first quarter.

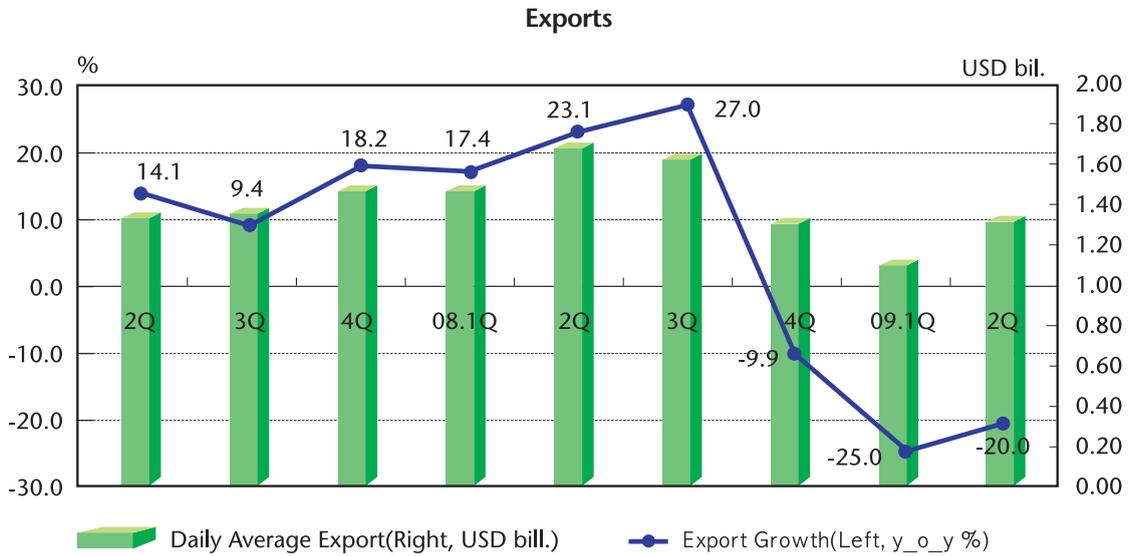
Trends in Domestic Demand

(Unit: y-o-y changes, %)

	consumer goods sales	Facility Investment	Domestic Machinery Order	Construction Completed (nominal)	Construction Orders Received (nominal)
2007	5.2	9.2	21.1	6.6	23.6
2008	0.9	-3.2	-5.5	4.7	-9.0
07. 1Q	5.6	13.4	18.9	7.9	33.5
2Q	3.9	12.6	7.1	6.0	30.2
3Q	6.7	1.3	19.1	4.4	-4.2
4Q	3.9	9.7	39.3	8.0	34.8
08.1Q	4.4	-0.7	25.2	5.6	-3.7
2Q	2.8	-0.5	8.4	6.1	-6.1
3Q	1.5	5.3	-7.6	10.6	-22.7
4Q	-4.2	-16.2	-39.5	-2.2	-6.5
09.1Q	-4.9	-22.9	-36.0	4.5	-16.5
April-May	-1.1	-19.5	-13.3	8.4	-8.0

**Exports Continue Double-Digit
Decrease**

Exports continued on a significant decline (-20.0%) in the second quarter compared with -25.0% in the first quarter. However, the daily average export amount improved from US\$1.06 billion in the first quarter to US\$1.32 billion in the second half.



**Current Account Balance Records
US\$7.9 Billion Surplus in April-
May**

A US\$7.9 billion current account surplus in April-May was the result of a reduction in the service balance deficit and imports declining more significantly than exports.

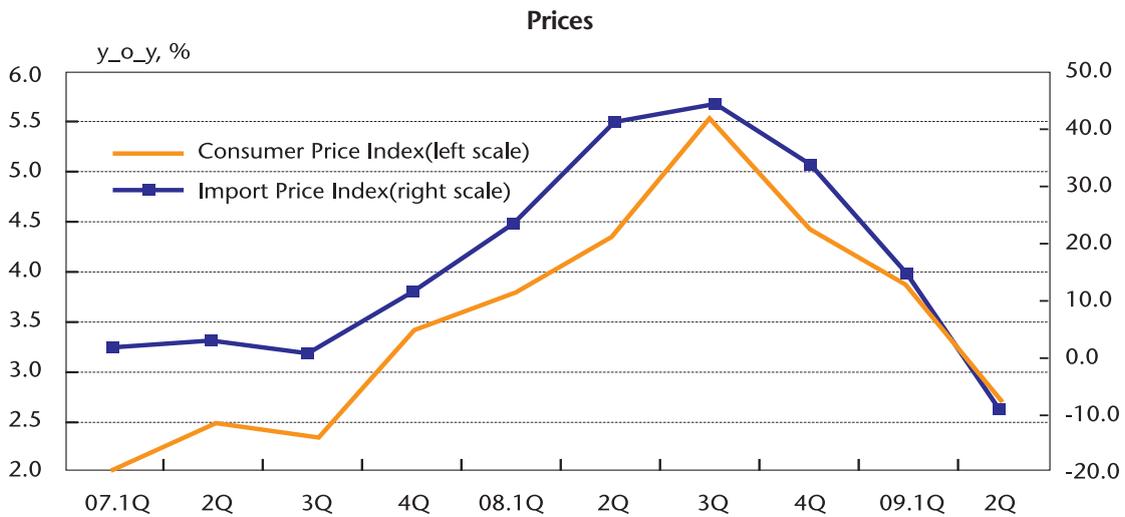
Current Account Balance

(Unit: USD Bil.)

	Current Account Balance						
		Goods	Service	Travel	Business Service	Income	Current Transfer
2007	5.9	28.2	-19.8	-15.8	-7.4	1.0	-3.5
2008	-6.4	6.0	-16.7	-8.0	-14.5	5.1	-0.8
07. 1Q	-1.0	5.7	-5.4	-3.8	-1.7	-0.6	-0.7
2Q	-1.3	5.8	-4.4	-3.8	-1.5	-1.7	-1.0
3Q	4.3	8.9	-5.3	-4.5	-1.8	1.8	-1.1
4Q	3.8	7.8	-4.7	-3.8	-2.3	1.5	-0.7
08. 1Q	-5.2	-1.2	-5.1	-3.0	-2.9	1.7	-0.6
2Q	-0.1	5.7	-4.3	-2.8	-2.9	-0.6	-0.9
3Q	-8.6	-3.5	-5.7	-3.0	-4.1	1.4	-0.8
4Q	7.5	5.0	-1.7	0.7	-4.6	2.7	1.5
09. 1Q	8.6	8.3	-1.9	0.5	-3.2	0.8	1.3
April-May	7.9	11.2	-2.6	-0.6	-2.7	-0.5	-0.2

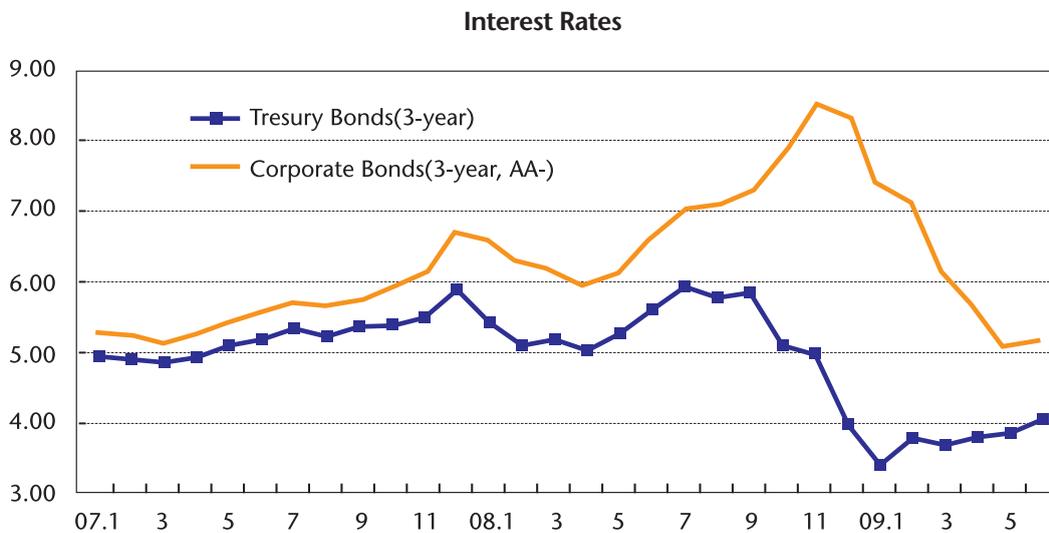
Consumer Prices Remain Stable

With 2.8% growth in the second quarter, consumer prices are continuing a downward trend with the 5.5% in the third quarter of 2008 as the peak. Declining international oil and raw material prices served as major factors in stabilizing prices.



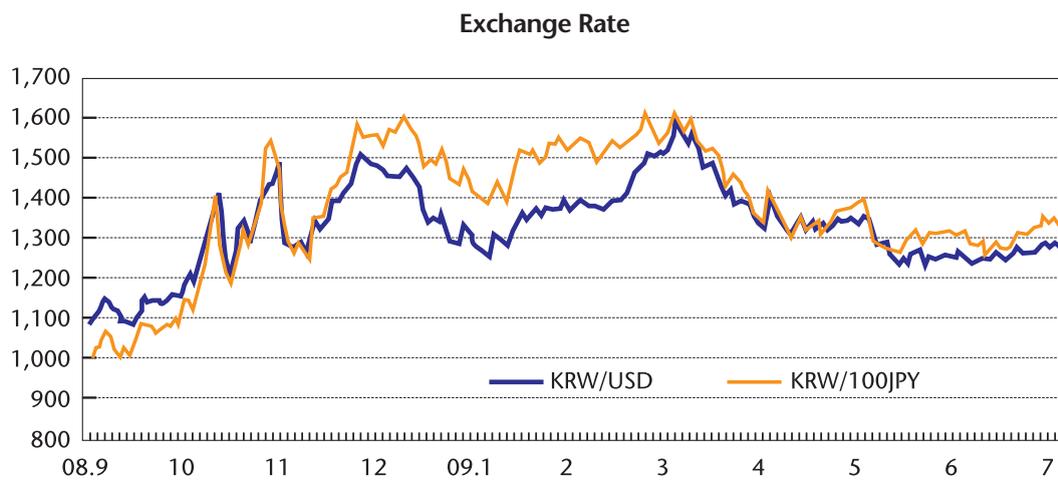
Market Interest Rates Rise With Expectations of Recovery

The yield rates on corporate bonds (3-year, AA-), which had decreased since November 2008 due to policy interest rate cuts and expanded market liquidity, rebounded to an upward trend (5.16% in May to 5.21% in June) with recent expectations of economic recovery.



**The Won-U.S. Dollar Fx Rate
Stabilizing Since March**

With improvement in overseas environment and persistent trade surplus, the won-dollar exchange rate showed a declining trend since March.



Outlook for 2009

Global Economy to Experience Negative Growth in '09

With the prolonged financial market instability leading to a slowdown in the real economy, the growth of the world economy in 2009 is expected to fall significantly. IMF and the World Bank are projecting global economic growth at -1.3% and -2.9%, respectively. The economies of advanced countries, such as the United States, Japan and European Union, are expected to experience negative growth while China is expected to grow 7~8%.

International Oil Prices to Stabilize at US\$65/Barrel on Annual Average (Dubai Oil Price Basis)

With expectations of economic recovery, speculation demand following the weakening dollar, OPEC's oil production reduction, etc., international oil prices are projected to post a mild recovery trend. Due to a decrease in demand following the world's economic slowdown, however, the extent of the rise will be limited.

Consumer and Business Sentiments to Improve

The CSI (Consumer Sentiment Index) has continued a rising trend since March this year. The BSI (Business Survey Index) is, although it is below 100, improving gradually as well. This trend is likely to continue through the second half with scheduled fiscal expansion and a total of 28.4 trillion won supplementary budget.

Policy interest rate Likely to stay at current 2%

The possibility of policy interest rate hike is emerging due to improvements in some economic indicators. Nevertheless, it is more likely that the policy interest rate will remain unchanged, considering negative effects from interest rate increase such as a rise in household interest burden, exchange rate appreciation and perception of the government backtracking the economic boost policies while the global uncertainties largely remain.

Major Assumptions for Economic Projections

Exogenous Variables	2008	2009
RP (% end of period)	3.00	2.00
Won-U.S. Dollar Fx Rate (Won/US\$, avg.)	1,101.3	1,290.8
China's Economic Growth (%)	9.0	7.5
Japan's Economic Growth (%)	-0.7	-6.0
U.S. Economic Growth (%)	1.1	-2.5
Dubai Oil Price (US\$/bbl)	92.1	65.0

Weak Economic Growth: -3.9% (1st Half), 0.0% (2nd Half) and -1.9% (Annual)

Owing to stabilization of the financial market, the government's stimulus policies and base effects, economic growth is expected to improve gradually in the second half.

With export recovery being restricted by a reduction in the exchange rate effect, economic growth is expected to record a stagnant 0.0% in the 2nd half.

Private Consumption to Post Limited Recovery: -4.2% (1st Half), -0.7% (2nd Half) and -2.4% (Annual)

Despite recovery in consumer sentiment, private consumption is expected to experience limited recovery due to corporate restructuring and the poor labor market conditions in the second half.

Slight Growth in Construction Investment: 1.2% (1st Half), 1.5% (2nd Half) and 1.4% (Annual)

Affected by fiscal expansion in the SOC sector, construction investment is likely to grow 1.5% in the second half. However, due to a slowdown in private receipt of construction orders and accumulation of unsold apartments, it is difficult to expect a rapid recovery in construction investment.

Facility Investment Slowdown to Continue: -24.5% (1st Half), -12.1% (2nd Half) and -18.3% (Annual)

Due to weakened facility investment pressure, low average operating rate in the manufacturing sector, fund supply difficulties for enterprises with low credit ratings, etc., facility investment is expected to continue a significant slowdown.

Reduction in Current Account Balance Surplus: US\$20.48 Billion (1st Half), US\$2.64 Billion (2nd Half) and US\$23.11 Billion (Annual)

The service account deficit is expected to expand, and the goods account surplus is expected to shrink in the second half due to a weakening of U.S. dollar and international oil price hike.

Export Decline Trend to Ease: -21.1% (1st Half), -3.5% (2nd Half) and -12.4% (Annual)

Although strengthening of the Korean won currency is likely in the second half, the trend of export decline is expected to improve owing to resolution of uncertainty in the international financial market, China's economic boosting policy, base effects, etc. However, export improvement may be limited due to a delay in the recovery of overall world demand.

Economic Trends and Outlook

Consumer Prices to Stabilize: 3.2% (1st Half), 2.4% (2nd Half) and 2.8% (Annual)

Notwithstanding international oil and raw materials price hikes, consumer prices are projected to post a stable 2% level of growth in the second half due to domestic demand slowdown, falling foreign exchange rate, etc. In the fourth quarter, however, consumer prices are expected to increase due to recent rises in oil and raw materials prices and expectations of economic recovery in the second half.

Market Interest Rates to Rise Slightly in the 2nd Half: 5.8% (Annual)

Market interest rates, which had declined entering this year, are expected to show a mild upward trend starting in the second half reflecting expectations of economic recovery. Nevertheless, the annual average market interest rate is likely to be lower than last year due to global interest rate cuts, quantitative expansion, etc.

The Won-U.S. Dollar Fx Rate to Stabilize at Lower level

The won-U.S. dollar exchange rate is expected to continue a declining trend until the end of the year owing to gradual resolution of uncertainties in the Korean financial market, the real economy, and the current account surplus.

Outlook for Domestic Economy (2009)

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

	2008			2009						
	1st H	2nd H	Year	1Q	2Q	3Q	4Q	1st H	2nd H	Year
GDP	4.9	-0.3	2.2	-4.2	-3.5	-3.1	3.0	-3.9	0.0	-1.9
(SA, q-o-q, %)				0.1	1.3	0.7	0.8	-1.8	1.8	
Private Consumption	3.1	-1.2	0.9	-4.4	-4.0	-3.6	2.3	-4.2	-0.7	-2.4
Construction Investment	-1.0	-3.0	-2.1	1.6	0.9	1.3	1.8	1.2	1.5	1.4
Facility Investment	1.3	-5.2	-2.0	-23.5	-24.5	-20.5	-2.9	-24.0	-12.1	-18.3
Exports (Goods + Service)	11.3	0.7	5.7	-10.6	-8.1	-6.0	4.8	-9.3	-0.7	-5.1
Imports (Goods + Service)	9.3	-1.6	3.7	-18.2	-13.8	-6.3	6.6	-15.9	-0.2	-8.2
Consumer Prices	4.2	5.0	4.7	3.9	2.6	2.0	2.9	3.2	2.4	2.8
Producer Prices	7.0	10.0	8.6	4.2	-0.1	-2.0	1.7	2.0	-0.2	0.9
Current Account	-53.5	-10.6	-64.1	85.8	119.0	7.3	19.0	204.8	26.3	231.1
Commodity	45.0	14.9	59.9	83.5	165.3	58.0	54.7	248.8	112.6	361.5
Exports (BOP Base)	2211.6	2122.6	4334.3	782.2	963.7	1036.8	1012.4	1745.8	2049.3	3795.1
Growth (%)	3.3	6.3	14.4	-24.0	-18.5	-11.5	6.5	-21.1	-3.5	-12.4
Imports (BOP Base)	2166.6	2107.7	4274.3	698.7	798.3	978.8	957.8	1497.0	1936.6	3433.6
Growth (%)	30.2	15.0	22.3	-32.9	-29.1	-18.9	6.3	-30.9	-8.1	-19.7
Service & Others	-98.5	-25.5	-124.0	2.3	-46.3	-50.7	-35.7	-44.0	-86.4	-130.4
Ex Rate (Avg. KRW/USD)	987.5	1215.2	1101.3	1418.3	1285.0	1250.0	1210.0	1351.7	1230.0	1290.8
Corp. Bonds Yield (3-year, AA-)	6.4	7.8	7.1	6.9	5.3	5.5	5.6	6.1	5.5	5.8
Unemployment Rate (%)	3.3	3.1	3.2	3.8	3.8	3.9	3.7	3.8	3.8	3.8

Exit Strategy and Response Measures

Fears of Side Effects from Excess Liquidity Rise

Due to huge liquidity injections by major countries to address the global financial crisis, fears of side effects from excess liquidity are increasing. Analyses of liquidity levels of major countries using liquidity gap ratios show that excess liquidities, exceeding real economic activities, appeared to be expanding in the United States, the U.K., Japan and Korea.

Adequacy of Current Stimulus Policies

Following the G20 London Summit on April 2 that agreed to prepare an exit strategy to maintain long-term price stabilization and fiscal soundness, there have been discussions on the appropriate exit strategies at the G8 Financial Ministers Meeting (June 13), IMF (June 15) and EU Summit (June 19). Korea's Ministry of Strategy and Finance and central bank also are reviewing exit strategies internally but are trapped in a dilemma because expanded liquidity may cause inflation while hasty interest rate increase is feared to produce unwanted negative effects on recovery of the national economy.

Response Measures

First, implementation of an exit strategy is yet premature and the current policy stance both fiscal and monetary should be maintained until the end of the year.

Second, it is necessary to prepare measures to stimulate corporate investment so that liquidity can flow into productive areas and to actively promote restructuring of troubled sectors.

Third, the government should prepare an exit strategy, including ways to restrain liquidity, in advance to be used at a juncture in the future when the economic recovery is in full swing.

Economic Effects and Incidence of Corporate Income Tax Cut

Research Monograph 09-04

Chong-Bum An, Ki-Baeg Park, Seung-Rae Kim, Woocheol Kim

This report investigates the effects of corporate income tax cut on growth and distribution. The economic incidence of changes in corporate income taxation is an important question in public finance, since the burden of this tax is not necessarily borne by those upon whom they are levied. As discussed in the literature, the tax burden is shifted through changes in supply and demand behavior and thus through in all prices and quantities, in the allocation of resources, and in the distribution of after-tax incomes in the economy. Using a Harberger-Shoven-Whalley type general-equilibrium model, this study focused on the annual general-equilibrium incidence structure of the recent 5%p decrease in corporate income tax rates in Korea, and quantifies the distributional effects and the efficiency effects of such a change.

The results imply that policymakers who design the overall progressivity of the tax system in Korea could need to balance these competing policy objectives between distributive equity and efficiency, at least in the short run. At the same time, considering the positive effects of corporate income tax cut on economic efficiency, investment and economic growth in Korea, it would be recommendable to plan a further cut in corporate taxation appropriately.

International Comparison and Analysis of Korea's Competitiveness by Industry

Research Monograph 09-05

Seung-Rok Park, Young Hoon Lee

Utilizing the EU KLEMS database, this report compares and analyzes a wide variety of competitiveness indices through analyses of 28 industries, their integrated primary, secondary and tertiary industries and overall industrial and employment structural changes and composition elements of total factor productivity increase - factor inputs, factor prices and factor productivity - in major advanced economies the United States, Japan, Germany, U.K., France and Italy.

Based on the analysis results, this report suggests several implications from the aspects of corporate management or corporate policy. Compared with advanced countries, Korea remains at the lowest contribution level of technological changes to total factor productivity increase at present. Domestically, the role of technological changes in increasing total factor productivity is growing on a gradual basis. Therefore, Korea should make further endeavors in R&D and manpower development so that technological changes become the key factor in total factor productivity increase. Also in terms of economic growth stage, now is the time that technological innovation should be the core capability for economic growth in Korea.

Study of Improvement Methods for Regulatory Registration System

Issue Paper 09-01

Zusun Rhee, Hyun-Yong Jung

This report reviews the status and problems of the present regulatory registration system and suggests substantial methods on how to improve them, while discussing the kinds of functions the system should perform.

Through the work, this report identified ways to move from the stage in which the present regulatory registration system simply lays out regulations and the Korea Regulatory Reform Committee compiles statistics to the stage in which it operates a regulatory information system while enabling all regulation-related stakeholders to utilize the information productively.

Standard Cost Model Operation Experiences in Major Countries and Policy Implications - Centering on Ways to Reduce Corporate Administrative Burden

Issue Paper 09-02

Byoungki Lee

This report had three research objectives: first, to understand the basics of the Standard Cost Model (SCM) theory; second, to review actually measured practices of administrative burden under the SCM and study empirical problem areas that can occur, i.e, summarizing SCM operating experiences related to administrative burdens in several European countries; and third, based on the foregoing, to obtain implications regarding matters and policies requiring consideration when measuring administrative burdens with application of SCM.

The Status and Problem of Korea's Wage Peak System

Issue Paper 09-03

Sung-Joon Park

The wage peak system introduced at the enterprises in Korea mostly adopts a retirement-age-guarantee type taking the form of reducing wages after a certain age assuring employment until retirement age. The

government supports the wage peak system to extend employment of older workers. Therefore, there is a disparity between the intention of enterprises that are implementing the system and that of the government. Consequently, there is a problem that, unlike the government's desire to support its introduction, the system in actual implementation does not suit the current labor market situation. In this context, the government should make policy efforts to create an environment that firmly establishes a performance-based wage system rather than supporting a wage system that is being introduced to meet the objectives of enterprises.

Study of Corporate Governance Structure, Internal Trading and Corporate Value

Issue Paper 09-04
Jung-Ho Choi

Utilizing the corporate governance assessment score data from a survey by the Korea Corporate Governance Service (CGS) on listed enterprises from 2003 until 2005, this report analyzed relationships between corporate governance structure, internal trading and corporate value.

As a result of the analysis, this report suggests evidences that in the case of large-scale business groups excessive trading of internal goods and provision of credits caused by the corporate governance structure, even if not having adverse effects on future business performance, are having negative effects on corporate value assessment in the stock market. These evidences imply the need for large-scale business groups to make public announcements of information related to their internal trading to prevent such a phenomenon.

International Financial Crisis and New Liberalism

Issue Paper 09-05
Yoong-Deok Jeon

Explanations of mainstream economics on external diseconomies appear wrong and related countermeasures also contain problems as well.

Without clarifying precisely the causes of external diseconomies, mainstream economics attributes the mistakes vaguely to market failure. A market cannot be the cause of failure. All the causes should be attributed to human beings who ultimately act or to the systems that are operated by them. Mainstream economics fails in clarifying the causes of external diseconomies.

Second, countermeasures against external diseconomies suggested by mainstream economics are not appropriate because they are not based on the causes. Even in cases where countermeasures are appropriate for market economic conditions, they are so only by chance.

Third, the failure of mainstream economics in clarifying the causes of external diseconomies and discordant countermeasures is either worsening external diseconomies like environmental pollution or forcing only unnecessary expenditures. The task for resolution of externalities is to avoid all the analyses and countermeasures of mainstream economics regarding externalities.

Protectionist Trade Trend Caused by Global Economic Crisis and Response Measures

Policy Report 09-05

Wongun Song

To prevent and overcome the protectionist trade trend that is spreading in a situation where the decline in trade following the global financial crisis is having a major negative impact on the Korean economy, where the contribution level of exports to economic growth is high, can be said to be one of the preconditions for the recovery of the national economy.

To deal effectively with this, Korea first needs to prepare response measures from a global perspective, including early conclusion of DDA negotiations. Korea should also promote response measures from an individual economy perspective, such as Korea-U.S. FTA and Korea-EU FTA. Finally, Korea should pursue future response measures to prevent any damage following the support by counterpart countries for their own industries.

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