

# **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 2010~2011	
Policy Issue .....	<b>10</b>
<b>Recent Publications</b> .....	<b>11</b>



# Executive Summary

## **Korea's Economic Growth for 2011 Projected at 4.1%**

Major factors that may contribute to slower Korean economic growth in 2011 are U.S. public and private debt adjustment, Europe's fiscal retrenchment, stagnation of the global economic recovery following China's belt-tightening policy and normalization of domestic macroeconomic policy tone.

Considering that the nation's average growth rate over the past 10 years (2001~2010) is 4.2%, however, the projected growth rate of 4.1% for 2011 can be viewed as robust.

Affected by the lessening of economic stimulus effects, interest rate hikes and asset value declines, private consumption may slow but the slowdown is unlikely to be significant owing to improvements in employment and wages in 2010. Facility investment, which showed a high rate of growth of about 23% in 2010, is expected to fall to the 7% level, influenced by mitigation of investment pressure on the heels of sharp investment growth in 2010, slowdown in the economic recovery, interest increases, restructuring, and other factors. The construction investment slowdown is expected to continue in 2011, but is likely to record positive growth owing to the recovery of non-residential and civil engineering construction sectors.

## **Current Account Surplus to Reach US\$14.5 Bil. in 2011**

Export growth may plummet to single digit due to a demand decline following fiscal retrenchment and household debt adjustment in advanced countries, China's conversion to retrenchment, Korea's foreign exchange currency appreciation and intensified competition in export markets. Imports also may slow, affected by the economic and export growth slowdown, but may record higher growth than exports owing mainly to unit price rises. Consequently, the current account surplus is projected to contract to US\$14.5 billion in 2011 from US\$27.3 billion in 2010.

## **Consumer Prices to Rise 3.2%, Won/USD Fx Rate to Appreciate to 1,095 Won**

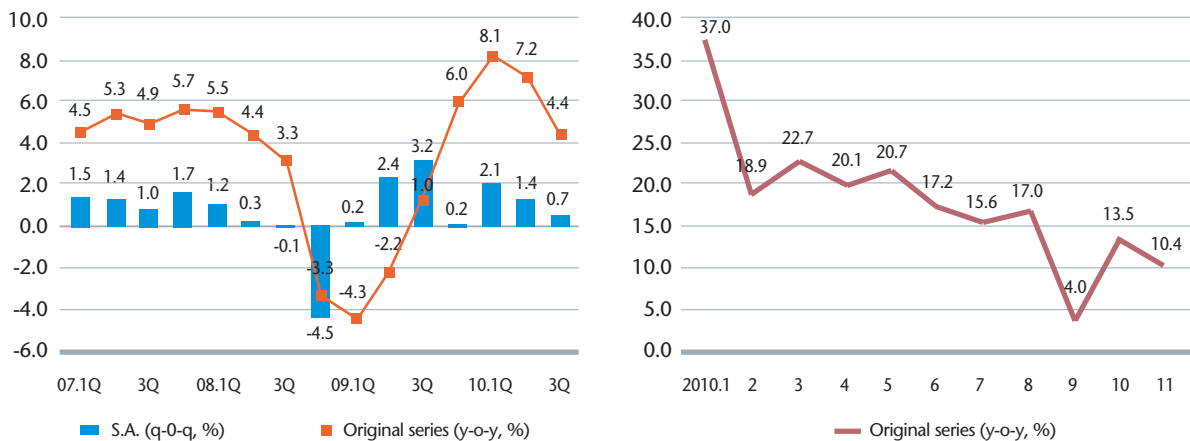
Consumer price growth may show an upward trend, affected by the positive GDP gap, China-originated inflation, increases in domestic public fees, etc., but the trends of a slowdown in international oil price hikes and won currency appreciation are likely to limit consumer price growth. Influenced by global dollar weakening, and increases in base rates, the won-U.S. dollar exchange rate is expected to appreciate gradually, falling below the 1,100 won level.

## Recent Developments

### GDP Growth Slowed Since 2nd Half of '10

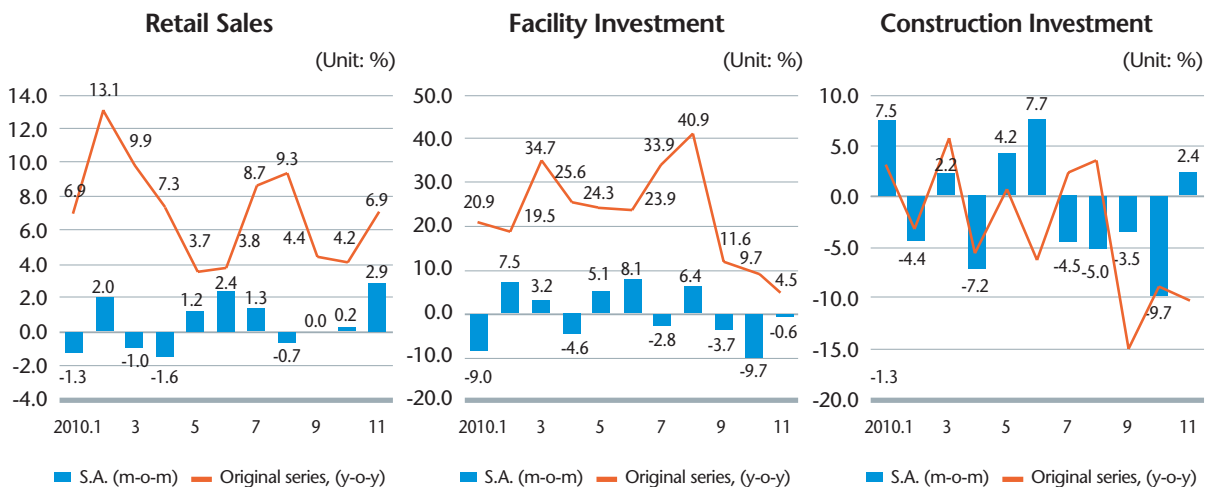
GDP growth in the third quarter of 2010 fell to 0.7%. Industrial production growth also declined to 10.4% year-on-year down from 13.5% in the third quarter.

GDP Growth and Industrial Production



### Improvement Trends in Domestic Demand Sector, Consumption, Investment, etc. Weakened

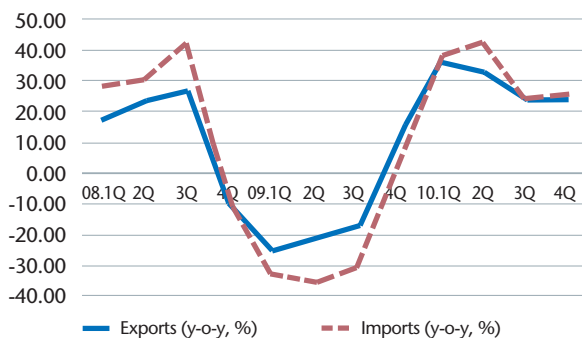
With retail sales slowing down, facility investment continued to decline after September 2010. Construction investment posted mild growth in November after four consecutive monthly decreases since in July.



### Exports Continued Brisk Performance But Current Account Surplus Reduced Due to Import Growth Outpacing Export Growth

Exports grew 24.0% in the fourth quarter from 23.6% in the third quarter, while imports increased 25.1% in the fourth quarter. With an expanded service balance deficit offsetting the significant surplus in the commodity balance, the current account surplus contracted.

Exports, Imports and Current Account Balance

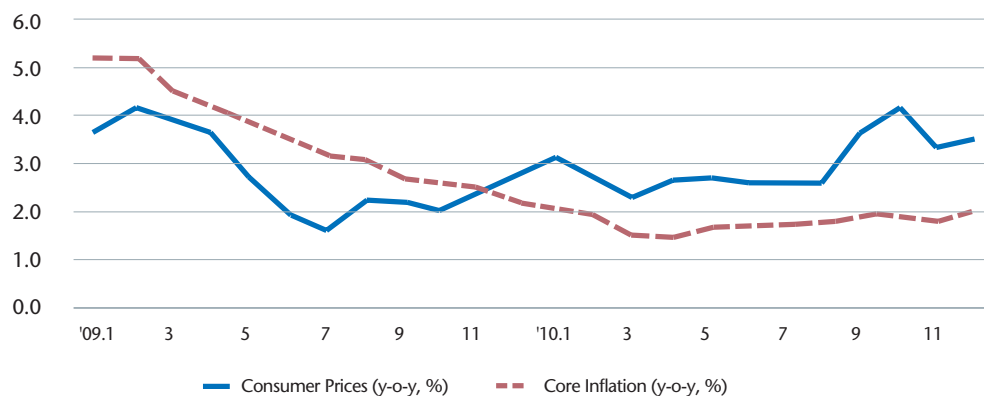


	2009	2010				
	1~11	1/4	2/4	3/4	Oct.	1~11
Current Account	320.8	327.9	2.6	85.7	94.1	250.6
Commodity	356.8	378.7	47.9	121.8	122.9	379.9
Service	-51.3	-66.4	-42.0	-21.1	-32.2	-108.8
Income	18.0	22.8	5.5	-10.1	13.0	8.0
Transfer	-2.7	-7.1	-8.7	-5.0	-9.5	-28.4

### Consumer Prices Rose Slightly

Influenced by the weakening of sharp price increases in farm, livestock and fishery products, consumer inflation eased somewhat. However, expansion in the 3% range continued in November and December.

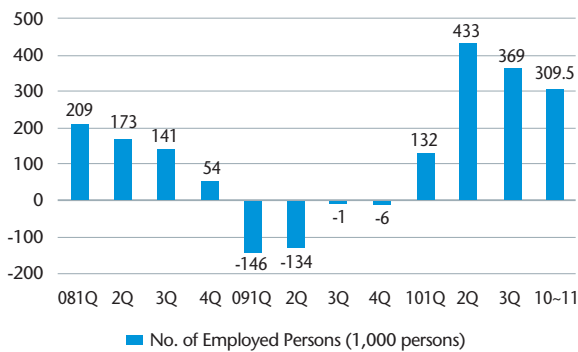
Prices



### Signs of Employment Recovery Slowdown

Employment growth declined to 310,000 in October-November from 433,000 in the second quarter. And the ratio of youth employment (15~29 years old) also dropped to 15.9% in October-November from 16.4% in the second quarter.

Employment



Ages	15~29	30~39	40~49	50~59	60~
2010.1/4	17.0	25.1	27.9	19.8	10.2
2/4	16.4	24.2	27.3	20.0	12.0
3/4	16.5	24.1	27.2	20.1	12.1
Oct.-Nov.	15.9	24.3	27.4	20.5	11.9

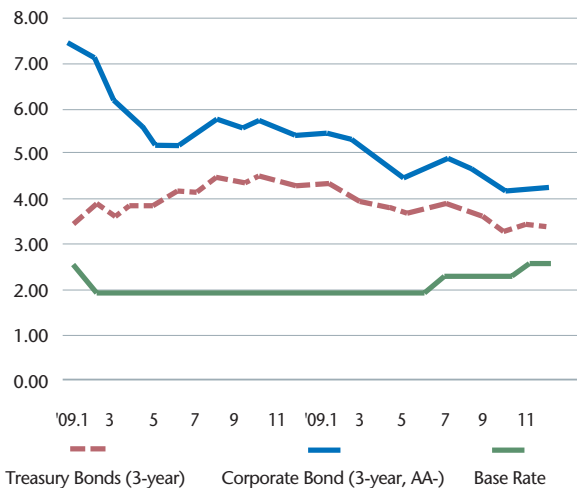
### Market Interest Rates Up Slightly Due to Base Rate Hike

Market interest rates, which had shown a downward trend due to foreigners' expanded investment in bonds, rose slightly following a base rate increase in November.

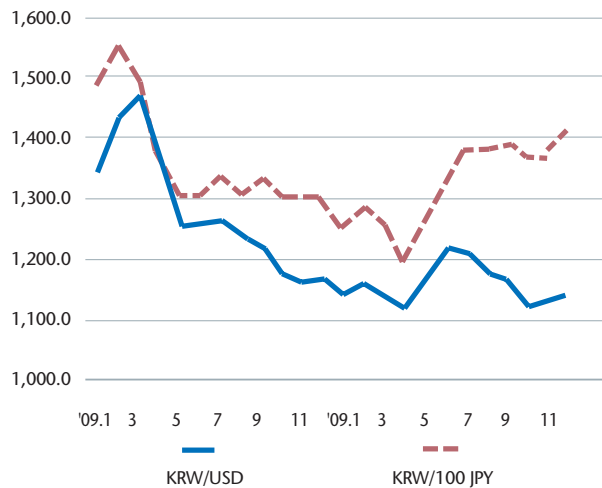
### Won-U.S. Dollar Fx-Rate Depreciates Slightly Since November

The won-U.S. dollar exchange rate continued to appreciate early in the fourth quarter, caused by weakening of the U.S. dollar, economic recovery, domestic base rate increase, trade balance surplus, and other factors. Due to the financial crisis in Europe, North Korea risk, etc., however, the exchange rate depreciated slightly in November.

Interest Rates



Exchange Rates



# Outlook for 2010~2011

## 1. Internal and External Environments

### Growth of World Economy to Slow in 2011

In 2011, advanced countries may not be able to easily escape the economic slowdown as they are facing uncertainties associated with financial reform in addition to reduction of public debt as well as adjustment of household debts. In the case of developing countries, considering their heavy dependence on external demand, economic growth slowdown is also expected to be unavoidable due to a decline in trade volume.

### International Oil Price in 2011 Projected at USD85/bbl.

International oil prices may rise, affected by demand growth in emerging countries, increases in global liquidity and other factors. However, the delay in the economic recovery of advanced countries and retrenchment trends of emerging countries, including China, will be factors in curbing oil demand.

### U.S. Dollar to Grow Slightly Stronger vs. Yen & Euro

The global U.S. dollar weakening trend will continue due to a slowdown in U.S. economic growth in 2011 and the U.S. government's preference for a weaker dollar. However, the U.S. dollar is expected to be slightly stronger against the currencies of the EU and Japan, which are likely to post comparatively slower economic growth.

### Economic Stimulus Potential to Weaken in Internal Environment

Fiscal consolidation may continue, including compilation of the budget bill for 2011 to comprise more revenues than total expenditures, and it will also be unavoidable to increase base interest rates from the perspective of normalizing the rates compared with fundamentals such as the economic growth rate. Taking into account the declining growth trend and the pace of inflow of overseas capital, however, base interest rates are likely to be adjusted.

### Internal Environment: North Korea Risk May Persist in the Long Term

As the North Korean shelling of Yeonpyeongdo was a ground attack and the attitude of the countries concerned has been very resolute so far, an exit strategy for resolution of the situation may not be easily found.

#### Key Assumptions for Projections

Exogenous Variables	Unit	2010	2011
China's Growth	%	10.5	9.5
Japan's Growth	%	2.8	1.5
U.S. Growth	%	2.6	2.1
Dubai Oil Price	US\$/bbl.	78.3	85.0
Base Rate (end of year)	%	2.50	3.00

## Outlook for 2nd Half of 2010~2011

### Outlook for Korean Economy (2010~2011)

**Growth: 6.1% (2010)  
→4.1% (2011)**

The Korean economy is expected to slow in 2011 due to sluggishness in the recovery of domestic demand caused by implementation of measures to normalize fiscal and monetary policies, slowdown of export growth following poorer economic growth in major countries and the end of base effects in the wake of high growth in 2010. Nevertheless, the projected growth is appraised as being at a level close to the potential growth rate. Korea's annual average growth for the past 10 years (2001~2010) was 4.2%.

**Private Consumption:  
4.2% (2010)→3.8%  
(2011)**

Affected by lessening of economic stimulus effects, interest rate hikes, asset value declines, and other factors, private consumption is expected to slow. Owing to employment and wage improvements in 2010, however, the slowdown is likely to be mild.

**Construction  
Investment: -1.1%  
(2010)→0.6% (2011)**

As the SOC budget for 2011 is to be compiled at an amount less than that in 2010 amid sluggishness in the private construction sector, growth in the public construction sector is also projected to be limited.

**Facility Investment:  
23.4% (2010)→7.6%  
(2011)**

Facility investment is likely to slow significantly amid declines in global economic conditions in addition to weaker investment pressure following the sharply increased facility investment in 2010. Facing interest rate hikes and restructuring, small and medium enterprises (SMEs) in particular, are expected to reduce investments sharply.

**Current Account:  
US\$27.3 Bil. Surplus  
(2010)→US\$14.5 Bil.  
Surplus (2011)**

Due to expansion of the gap between import and export growth trends and an increase in the service balance deficit, the current account surplus is expected to contract. Exports will slow to single-digit growth due to fiscal retrenchment and adjustment of household debt in advanced countries, China's adjustment of economic conditions, won-U.S. dollar foreign exchange rate appreciation and intensification of competition in export markets. Influenced by the economic growth slowdown, imports also may slow, but will post a higher growth rate than exports due to the foreign exchange rate appreciation and unit price increases. Meanwhile, the service account balance is expected to continue a deficit, affected by low productivity in the domestic service industry and exchange rate appreciation.

**Consumer Prices: 2.9%  
(2010)→3.2% (2011)**

Consumer prices are expected to grow 3.2% in 2011 similar to 2.9% in 2010. With economic growth maintaining the potential growth level, price pressure from the demand side is likely to be mild. Moreover, price pressure from the supply side is also expected to be low due to slight increases in international oil prices, won currency appreciation, and other factors.

**Market Interest Rates:  
4.7% (2010)→4.9%  
(2011)**

Affected by base rate increases, market interest rates are expected to rise, but the level and speed will be limited. The fact that price push pressures are not great and that the inflow of foreigner funds for investment in bonds is likely to continue will serve as factors to limit market interest rate hikes.

**Won-U.S. Dollar Fx  
Rate: 1,156 (2010)→  
1,095 (2011)**

The won-U.S. dollar exchange rate is expected to appreciate due to the current account surplus from the demand side and the supply of more U.S. dollars continuing with increases in the inflow of foreign capital amid a global dollar weakening trend.



## Outlook for Korean Economy (2010~2011)

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

	2010	2011						
	Year	1/4	2/4	3/4	4/4	1st H	2nd H	Year
GDP	6.1	3.8	3.7	4.3	4.8	3.7	4.5	4.1
(SA, q-o-q, %)		1.1	1.3	1.3	1.0	2.0	2.4	
Private Consumption	4.2	3.6	3.7	3.8	4.0	3.6	3.9	3.8
Construction Investment	-1.1	-0.1	0.5	0.6	1.2	0.2	0.9	0.6
Facility Investment	23.4	7.7	7.2	6.9	8.5	7.4	7.7	7.6
Consumer Prices	2.9	3.3	3.3	3.1	3.1	3.3	3.1	3.2
Current Account	273.4	4.5	55.2	50.3	35.0	59.6	85.3	144.9
Commodity	415.7	43.2	104.8	95.6	79.0	148.0	174.6	322.6
Exports (BOP Base)	4621.6	1120.0	1286.4	1284.6	1364.2	2406.3	2648.8	5055.1
Growth (%)	29.0	10.5	9.4	8.8	9.0	9.9	8.9	9.4
Imports (BOP Base)	4205.9	1076.7	1181.6	212.0	1285.3	2258.3	2474.2	4732.5
Growth (%)	31.3	11.5	12.1	12.4	13.9	11.8	13.2	12.5
Service & Others	-142.4	-38.8	-49.6	-45.4	-43.9	-88.4	-89.3	-177.7
Fx Rate (Avg. KRW/USD)	1155.8	1110.0	1100.0	1090.0	1080.0	1105.0	1085.0	1095.0
Corp. Bonds Yield (3-year, AA-)	4.7	4.4	4.9	5.1	5.2	4.7	5.2	4.9
Unemployment Rate (%)	3.7	4.2	3.5	3.5	3.4	3.9	3.5	3.7

## Policy Issue:

### Prospects of Future North Korean Provocations and Response Direction

#### Prospects of North Korea's Provocations Toward South Korea in 2011

North Korean provocations are expected to take more sophisticated forms. For the time being, North Korea is likely to concentrate on manipulating dissociations in South Korea, including peace offensives and maneuvers. There is also a possibility that it may conduct nuclear and medium & long-range missile tests. Even the possibility that North Korea may attempt landing operations and attacks to occupy four islands and nearby small islands in the West Sea can not be excluded. The level of North Korea's provocations may possibly be curbed and eased through South Korea's firm stance, strong Korea-U.S. alliance, response of the international community, etc.

#### Prospects for International Political Situation in Northeast Asia Surrounding the Korean Peninsula

Considering that the conflicting relationships of superpowers in Northeast Asia are structural and based on fundamental causes, the conflicts related to the North Korea issue may spread all the more. It seems that the United States is pursuing the possibility of cooperation with China in order to prevent the situation on the Korean peninsula from worsening into conflicts, while encouraging the six-party talks and dialogue between the two Koreas. As China believes that its 'Security Interests' with North Korea are more important than its 'Economic Interests' with South Korea, it is expected to continue its 'North Korea Support Policy.' As for issues associated with the Korean peninsula, Japan will maintain its stance of supporting South Korea, and Russia is likely to employ an equidistant diplomacy toward the two Koreas.

#### Countermeasures Against Expected North Korean Provocations

Necessary countermeasures against North Korea's strategies for dissociation and collapse of South Korean society include cutoff of support for the forces following North Korea among South Korean citizens' societies and political circles and their advancement of conspiracy theories; precise analysis of North Korea's real intentions and attitudes and strengthened publicity toward the public; maintenance of a strong and clear North Korea policy tone; etc. To block North Korea's military provocations, South Korea needs to deliver the message to North Korea that it will respond strongly to any provocations as well as declaring the fact clearly to the international community.

## **An Analysis on Relevant Market Delineation**

Research Monograph 10-07

Kim, Hyun Jong

Using Salop(1979)'s spatial model, this research examines how the technical convergence affects the market equilibrium and SSNIP test, the measure method for delineating the relevant market. We show that, as the convergence progresses, the number of firms shrinks in the market and the SSNIP test allows wider ranges for the relevant market. This implies that the governmental agency are misled to test the market definition if it fails to calculate the demand divergent ratio with the convergence level. Therefore this report suggests to replace the higher price changes from the current 5-10% level for the SSNIP test on high-tech industries. Additionally, this paper studies that the critical analysis criterion for the asymmetric multi-sided market competition case. We suppose the platform competition where the platform 1 sells in the market A, B and C while the platform 2 sells in A and B. The results show that the actual loss of the platform 1 is bigger than one of platform 2. This implies that the asymmetry of actual losses appears in the asymmetric multi-sided market competition. On the other hand, we explain what affects to the relevant market delineation of the cluster market.

## **A Critical Survey of Corporate Governance Research**

Research Monograph 10-08

Kim, Hyun Jong

After the studies of Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shlifer and Robert Vishny(hereafter LLSV), it is considered that the common law system may protect investors and improve the corporate governance, and therefore it is superior to civil law system for the corporate governance. However, this study shows that the legal origin theory explains only a few aspects of corporate governance, and modern politics is an alternative explanation for divergent ownership structure and differing depths of securities markets in the developed countries. Roe(2006) explains that nearly every core civil law nation suffered military invasion and occupation in the twentieth century, while no core common law nation collapsed under that kind of catastrophe. Therefore, this study insists that, in order to analyze the general studies on corporate governance, researchers must concern not only legal system but also government's interruption, political positions of people, the degree of labor protection, tax systems on dividends, competition policies and regulation systems. Additionally, this study shows some implication to Korean corporate governance issues.

## **Why Libertarianism Again: A Reply to the Criticisms on Capitalism and Free Market After the 2008 Global Financial Crisis**

Research Monograph 10-09

Kim, Yisok

This paper addresses and retorts those five criticisms and one suggestion by the Korean critics on capitalism and free market, that are raised after the Global Financial Crisis of 2008. In examining and analyzing them, we draw our logic and inspiration mainly from Austrian economists, especially Ludwig von Mises, Friedrich Hayek, and Murry Rothbard. We have found, in sum, that their attacks on free market is not logically well founded, and that their suggestion for policy-regime change will not solve but aggravate those social problems, the cause of which the critics allegedly attribute mainly to the libertarian ideas.

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*KERI Economic Bulletin 13*