

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

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Executive Summary

Growth for '12 Projected at 3.5%, Lower than '11 (3.8%)

The growth of the Korean economy is expected to decline to 3.5% next year, as export growth is likely to slow due to the financial crisis in major advanced countries, deeper retrenchment of newly emerging nations like China, etc.

Furthermore, domestic demand, including consumption and investment, will remain weak, affected by the fiscal retrenchment policy, interest rate hikes, weaker real estate market conditions, etc.

Meanwhile, a downward adjustment was made in this year's growth projection to 3.8%, 0.1 percentage point lower than previously forecasted.

Consumer Price Growth to Fall to 3.4% in '12

Consumer price growth is likely to decline to 3.4% in 2012 from 4.4% in 2011, due to declines of oil and raw materials prices following the slowdown in the world economy and base effects.

Current Account Surplus to Contract, Won-USD Fx-Rate to Decline Slightly

The current account surplus is expected to shrink considerably to US\$14.4 billion in 2012 from this year's US\$23.1 billion due to import growth surpassing export growth, expansion of the service balance deficit, etc. Won-U.S. dollar exchange rates will gradually decline in the second half of next year to reach an annual average rate of 1,080 won in anticipation of stabilization of the global financial crisis and domestic economic recovery amid a global dollar weakening due to such factors as downgrade of the U.S. credit rating, maintenance of ultra-low interest rates and delay in U.S. economic recovery.

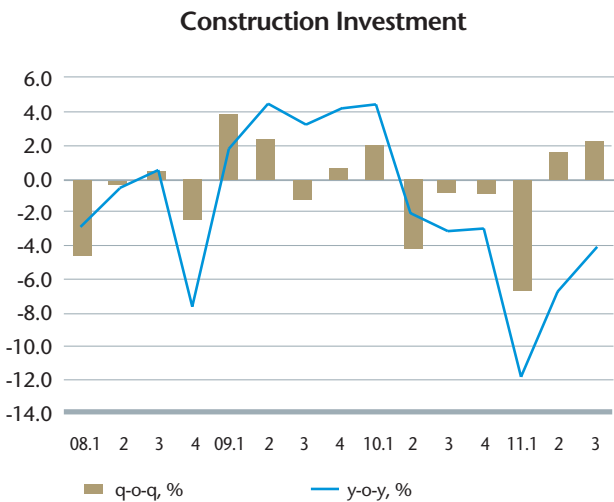
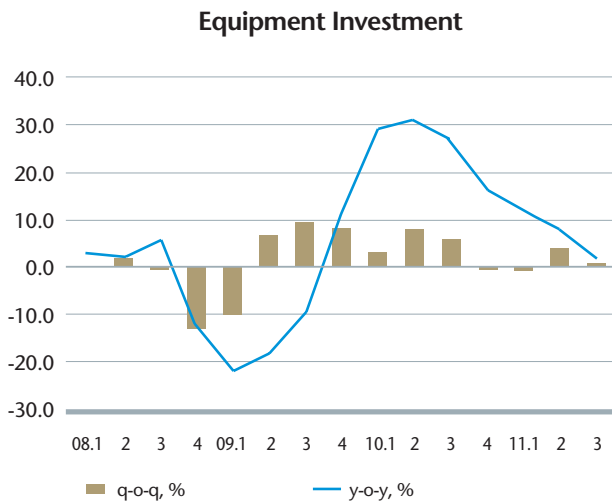
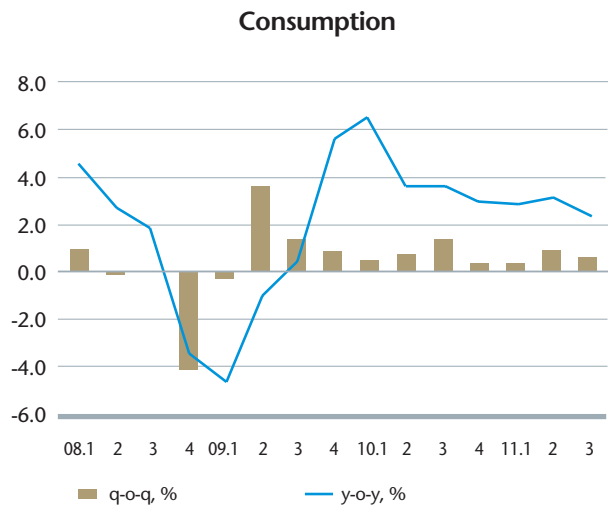
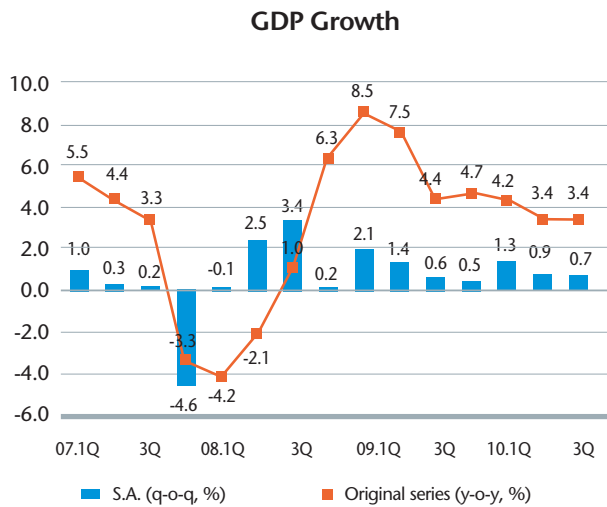
Europe's Financial Crisis Highlights Importance of Stable National Debt Management

Owing to comprehensive agreements, the European financial crisis overcame a major hurdle but it will take considerable time to resolve it fully. Meanwhile, low growth in Europe caused by the crisis and its negative impact on the Korean economy seems unavoidable. Through the European financial crisis, Korea should learn lessons, including stable management of national debt, development of risk management capability and securing of policy reliability and greater cooperation with countries in the region.

Recent Developments

Growth Slowdown Continued in 3rd Qtr. '11

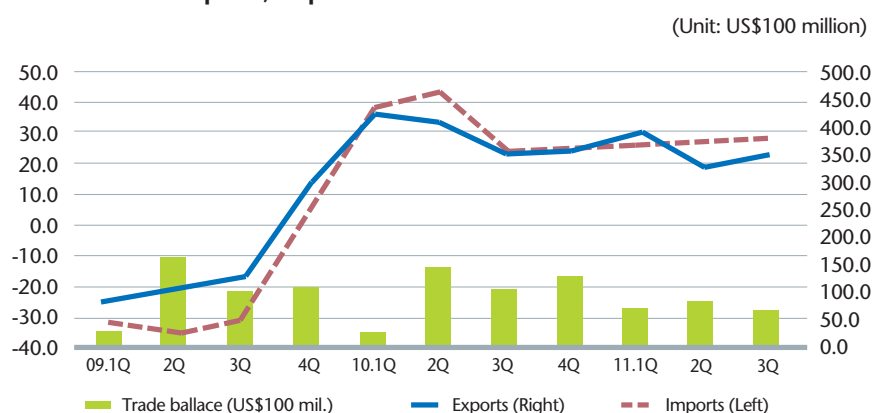
Real GDP growth in the third quarter of 2011 stood at 3.4% year-on-year. Compared with 0.9% in the second quarter, growth slid 0.2 percentage point on-quarter to 0.7%. These results are attributable to significant slowdowns in consumption and facility investment.



Exports & Imports Grew Sharply

Both exports and imports posted increasing trends quarter-on-quarter. Affected by unit price rises, imports grew remarkably. However, with the narrowing of the gap between export and import growth, the trade balance surplus declined.

Exports, Imports and Current Account Balance



Current Account Surplus for Jan.-Sept. '11 Posted US\$15.3 Bil.

The current account surplus for the first nine months of this year recorded US\$15.3 billion, a year-on-year decrease of US\$3.8 billion, caused by a US\$8.6 billion decline in the commodity balance surplus due to import growth outpacing export growth, although the service balance improved by US\$4.5 billion.

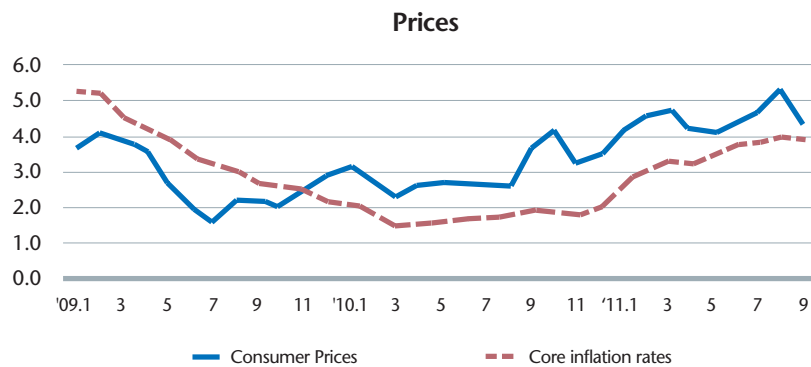
Current Account Balance

(Unit: US\$100 mil.)

	2010	2011			2011	2010	A-B
	Year	1/4	2/4	3/4	1~9(A)	1~9(B)	
Current Account Balance	282.1	26.1	54.9	71.7	152.7	190.5	-37.8
Commodity balance	419.0	58.4	76.6	74.7	209.8	295.7	-85.9
Service balance	-112.3	-25.4	-8.0	-12.0	-45.3	-90.3	45.0
Income balance	7.7	3.9	-8.2	13.1	8.8	8.4	0.4
Transfer balance	-32.3	-10.8	-5.5	-4.2	-20.5	-23.2	2.7

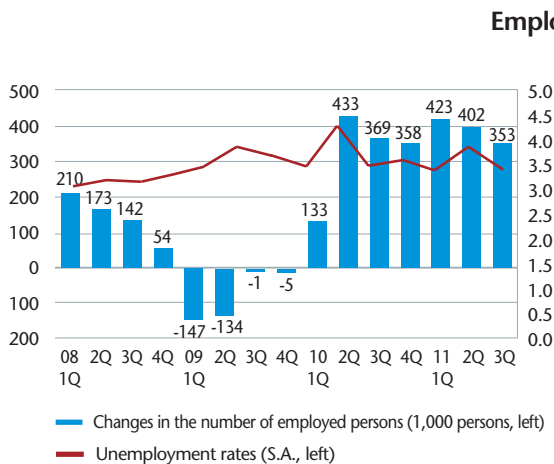
Consumer Prices Up 4.8% in 3rd Qtr. '11

Despite a slowdown in international oil price hikes and base effects, consumer prices increased 4.8% in the third quarter of this year, up from 4.2% in the second quarter. Rises in vegetable prices, higher won-US dollar exchange rates, increases in public utility rates, etc. are cited as the factors.



Employment Recovery Slowed, Aging of Employed Continuing

In the third quarter, the number of employed persons increased about 360,000 year-on-year, lower than the 400,000 recorded in the second quarter. Amid the number of employed persons aged 15 to 29 decreasing and those 30-39 years old also declining, the aging trend of employed persons has continued.



(Unit: 1,000 persons)

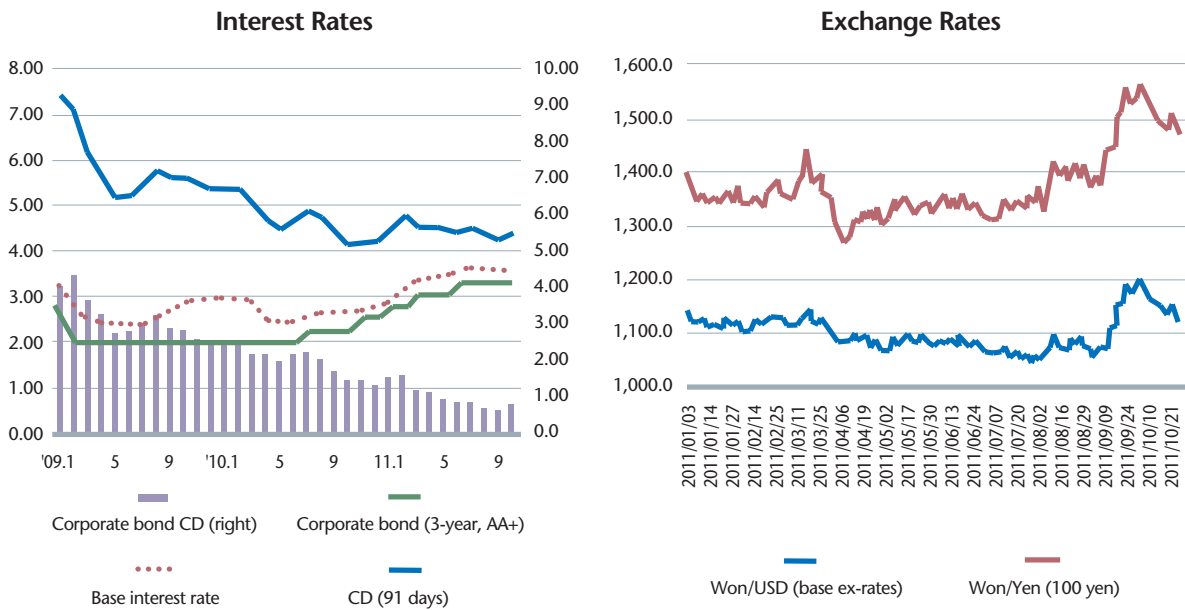
	Total	15~29 Yr.	30~39 Yr.	40~49 Yr.	50~59 Yr.	Over 60 Yr.
10.1Q	132	-11	-42	-21	251	-44
2Q	433	-58	-13	48	342	113
3Q	369	-44	21	40	295	57
4Q	358	-57	17	50	288	60
11.1Q	423	-49	-34	77	285	143
2Q	402	-74	-13	59	293	137
3Q	363	-1	-83	45	270	131

Market & Short-Term Interest Rates on the Rise

Affected by the effects of base interest rate increases to date, short-term interest rates rose. On the other hand, long-term interest rates declined due to expectations of a base interest rate freeze, continuous inflow of foreign bond investment funds, abundant market liquidity and expanded uncertainties over economic recovery.

Won-USD Fx-Rates Fell Again Starting in Oct.

Won-U.S. dollar exchange rates rebounded due to a downgrade of the U.S. credit rating and fears over spread of the eurozone financial crisis. In expectations of eurozone's cooperation to resolve the Greek debt crisis, however, exchange rates started to move downward again with 1,199 won on Oct. 5 as the high point.



Outlook for 2011~2012

1. Internal and External Environments

Slowdown of Global Economy

Amid a situation in which the slowdown of housing market conditions and employment remain unresolved, the United States is expected to face fiscal retrenchment to reduce its national debt and unavoidably experience a low-growth period for the next several years. As for Japan, despite escaping the influence of the large earthquake and subsequent damage gradually, its economic recovery is weak, caused by fiscal deficit and yen appreciation burdens. In the eurozone, uncertainties still exist, notwithstanding the alleviation of risks in the region. The potential for a hard landing is not high, but China may also experience a growth slowdown following its deeper retrenchment.

Int'l Oil Prices to Decline Slightly in '12

Factors foreshadowing lower international oil prices are more or less dominant due to a slowdown in crude oil demand affected by expansion of Europe's financial crisis, weakening of the U.S. economic recovery, deeper retrenchment of newly emerging countries and normalization of crude oil supply with political stabilization in the Middle East, including Libya.

Global Dollar Weakening Projected

The U.S. dollar is expected to continue weakening due to the downgrade of U.S. credit rating, maintenance of an ultra-low interest rate policy and growth slowdown. The Japanese yen also is converting to a slightly weakening trend due to the country's economic slowdown and possibility of the Japanese government's intervention.

Internal Environments: Retrenchment Tone to Be Maintained in Fiscal and Financial Policies

The government prepared the national budget for 2012 with a focus on enhancing fiscal health. It is expected to continue a mild interest rate increase policy, while maintaining a balance between price and growth strategies.

2. Outlook for Korean Economy

Growth:

3.8% (2011) → 3.5% (2012)

Korea's economic growth is expected to slow to 3.5% amid sharply worsening external environments affecting exports and an internal environments that can hardly support a drive for higher domestic demand. In the second half of 2012, when uncertainties over the external environments are expected to be more or less resolved, however, growth is likely to recover some momentum.

Private Consumption:

2.7% (2011) → 2.6% (2012)

Considering the post-cyclical characteristic of employment, the number of employed persons is falling and wages also are on a gradual decline with the third quarter of 2010 as the peak. A credit crunch following loan restrictions and reinforcement of loan screening criteria for a soft-landing of household debt is having a negative impact on private consumption as well. Nevertheless, projections of price growth slowdown and the won's appreciation are expected to serve as factors to mitigate the consumption slowdown.

Construction Investment:

-4.9% (2011) → 1.9% (2012)

Construction investment may continue to record poor progress, but the growth rate itself is expected to improve in 2012 thanks to base effects from the stagnation in 2011. Private construction will recover slightly, with the trend of real estate decline becoming more or less stabilized. But public construction is likely to experience a slowdown due to a decrease in the SOC budget (-7.3%), worsening of financial conditions at public corporations and completion of the Four Rivers Restoration Project.

Facility Investment:

5.3% (2011) → 4.0% (2012)

If the high correlation between exports and facility investment is taken into consideration, the export slowdown is likely to lead to investment contraction by related industries. With the effects of base interest rate increases reflected in market interest rate hikes on a gradual basis, the corporate investment environment may worsen. Investment uncertainties also are expected due to the impacts of the general parliamentary and presidential elections in 2012.

Current Account Balance:

US\$23.1 billion (2011) →
US\$14.4 billion (2012)

Affected by the global economic slowdown, the current account surplus is expected to contract in 2012, with about a 10% decline in export growth following about a 20% decline in 2011.

Economic Trends and Outlook

Consumer Prices:

4.4% (2011) → 3.4% (2012)

Consumer price growth for 2012 is projected to be 3.4%, lower than in 2011, influenced by base effects, a slowdown in international oil price hikes, etc. The fact that won-U.S. dollar exchange rate is expected to fall is also likely to be a factor in lessening price push pressure.

Market Interest Rates:

4.5% (2011) → 4.7% (2012)

Market interest rates are expected to rise gradually due to reflection of base interest rate increase effects and expectations of economic recovery in the second half of 2012.

Won-U.S. Dollar Fx-Rate:

1,104 (2011) → 1083 (2012)

The won-U.S. dollar exchange rate may decline with improvement in the dollar supply due to a slowdown in the outflow of foreign currency from the capital market and continuation of the current account surplus on top of the expected weaker dollar.

Outlook for Korean Economy (2011~2012)

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

	2010	2011						2012			
	Year	1Q	2Q	3Q	4Q	1st H	2nd H	Year	1st H	2nd H	Year
GDP	6.2	4.2	3.4	3.4	4.0	3.8	3.7	3.8	3.2	3.7	3.5
(SA, q-o-q, %)	6.2	1.3	0.9	0.7	1.0	2.0	1.7	3.8	1.5	2.2	3.5
Private Consumption	4.1	2.8	3.0	2.2	2.7	2.9	2.4	2.7	2.4	2.8	2.6
Construction Investment	-1.4	-11.9	-6.8	-4.2	1.2	-9.0	-1.3	-4.9	1.5	2.2	1.9
Facilities Investment	25.0	11.7	7.5	1.4	1.9	9.4	1.6	5.3	1.6	6.3	4.0
Exports (Goods & Service)	14.5	16.8	9.6	9.4	8.1	13.0	8.7	10.7	7.9	8.4	8.1
Imports (Goods & Service)	16.9	10.8	7.9	6.4	6.2	9.3	6.3	7.7	6.8	7.5	7.1
Consumer Prices	2.9	4.5	4.2	4.8	4.2	4.3	4.5	4.4	3.5	3.2	3.4
Producer Prices	3.9	6.7	6.4	6.2	5.3	6.5	5.8	6.1	3.5	4.2	3.8
Current Account Balance (US\$100 mil.)	282	26	55	72	78	81	150	231	53	91	144
Commodity	419	58	77	75	97	135	172	307	105	124	228
Exports	4,643	1,277	1,427	1,417	1,487	2,704	2,904	5,608	2,994	3,184	6,178
Growth (%)	29.6	26.0	22.4	19.8	17.0	23.5	18.3	20.8	10.7	9.7	10.2
Imports	4,224	1,218	1,351	1,342	1,390	2,569	2,732	5,301	2,889	3,061	5,950
Growth (%)	31.9	26.2	28.7	26.9	21.1	27.2	23.9	25.5	12.4	12.0	12.2
Service & Others	-137	-32	-22	-3	-19	-54	-22	-76	-52	-32	-85
Ex Rate (Avg. KRW/USD)	1,156	1,120	1,084	1,084	1,130	1,102	1,107	1,104	1,105	1,060	1,083
Corp. Bonds Yield (3-year, AA-)	4.7	4.6	4.5	4.3	4.5	4.5	4.4	4.5	4.6	4.8	4.7
Unemployment Rate (%)	3.8	4.2	3.4	3.4	3.5	3.8	3.3	3.6	4.1	3.3	3.7

Policy Issue:

Future Direction of European Financial Crisis and Implications

Market Instability Sentiment May Continue for a Considerable Period as the European Financial Crisis Has to Overcome Several Obstacles

Greece's implementation of financial retrenchment by quarter, Italy and Spain's efforts to strengthen fiscal health and whether the European Financial Stability Facility (EFSF) would be increased or not are expected to be major variables related to market instability.

Negative Impacts on Domestic Economy Will Be Unavoidable

Even if the European financial crisis eases gradually, low growth in the region will be unavoidable. And the resulting global economic slowdown will have negative effects on Korea's real economy through export channels.

Implications of European Financial Crisis for Korea

From the aspect that sharp increases in national debt due to excessive government expenditures were the essential cause of the European crisis, Korea should employ all available national policy capabilities to secure fiscal health.

Considering that policy failures, including delayed response by the governments of EU member countries, helped to fuel the crisis, a proactive and bold policy response to a crisis and securing of policy reliability are very important.

As the European financial crisis is not solely a eurozone problem, but a common issue for the global economy, the importance of international coordination comes to the fore once again.

The Impact of Outward FDI on Intra-Industry Trade: Firm-Level Evidence from Korea

Research Monograph 11-09

Choi, Namsuk

This study empirically investigates the impact of Korean multinational enterprise (MNE)s' outward foreign direct investment (FDI) on intra-industry trade at the various levels of aggregations, such as intra-industry trade at the Korean Industrial Standard Classification (KSIC) middle level, and at the KSIC low level. Using firm-level panel data covering Korean MNEs' FDI to US and China during the period between 2001 and 2009, this study finds a positive and significant relationship between intra-industry trade and FDI at the KSIC middle level, even after controlling for intra-industry firm heterogeneity, the role of factor and skill endowments at the industry level, and home and host country trade costs.

Korean MNE's outward FDI explains about 32% of intra-industry trade growth of Korean domestic firms in manufacturing sector. This finding shows that the size of positive effects of outward FDI is economically significant. Thus, enhancing the cooperative relationship between Korean MNE's foreign affiliates and domestic firms is important. Furthermore, the positive impact of outward FDI may spillover the dynamic gains of intra-industry trade to all firms in manufacturing sector.

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