

HRI Monthly Economic Review

- I . Recent Economic Trends
- II . Economic Issues Facing Korea
- III . The North Korean Issues
- [Annex] Domestic and Global Economic Indices

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Devoting to economic research
and human resource development
with intellectual conscience and sincerity,
the Hyundai Research Institute leads
the advancement of Korean Economy
in the 21st century by proposing
creative policy alternatives.

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< Executive Summary >

I . Recent Economic Trends

The US and Eurozone show marginal economic recovery while the economic recovery trend of Japan and China appears to be slow for the moment.. In terms of Korea, domestic consumption fell while industrial production and investment increased. Exports continue to improve, and inflation stays around 1% plus.

II . Economic Issues Facing Korea

『Characteristics of and Forecast on 7 Major Industries for 2014』

Although most major industries are expected to emerge from the recession as global economy recovers, some are feared to fail to come out of the depression or achieve only an insignificant recovery due to the depressed demand and oversupply caused by structural problems. Steel, construction, shipping, and machinery Industries will be on recovery track, and automobile industry will be booming.

『Repairing relations between Korea, China and Japan should start with industrial cooperation』

The cooperative relationships between industries of Korea, China, and Japan can be clearly seen through the analysis of Value Chain appearing in mutual trade. The characteristics of cooperative and competitive relationships between manufacturing industries of the three nations analyzed using international input and output table(WIOD).

『10 Major Trends of Domestic Economy in 2014』

Domestic economy is expected to show the following 10 trends in macro-economy, industry, management, society, and North-South issues in 2014: ① Entering The Age of Moderate Growth, ② Expansion of Smart Consumption, ③ Biflation in Housing Market, ④ Increasing Need for Deleveraging, ⑤ Expansion of Purple Collar, ⑥ Opening of Manufacturing Version of Korean Wave, ⑦ 2014: The First Year of Brand Prestige of Korean Service Industry, ⑧ Take-Off of ICT Converging Industry, ⑨ Society in Need of Comfort, ⑩ Seeking North-South(N-S) Economic Cooperation in 3G Age.

III . The North Korean Issues

N. Korea's economic reform appears set to continue, and economic cooperation between the two Koreas will maintain the status quo or achieve a rapid progress depending on the resolution of outstanding issues facing the two Koreas. It is necessary to expand North-South economic cooperation to encourage N. Korea to reform and to open up. The North-South dialogue should be resumed on a preferential basis in a forward-looking manner for the safe management of the security of Korean peninsula and for the improvement of inter-Korean relationship. Inter-Korean economic cooperation should be expanded to assist N. Korean success in internal reform and in attracting foreign investment. International collaboration with China and Russia should be positively sought to support N. Korea for the same purpose.

I . Recent Economic Trends

Recent Global & Domestic Economic Trends

Major Foreign Economies

The US and Eurozone show marginal economic recovery while the economic recovery trend of Japan and China appears to be slow for the moment.

The economic recovery trend of the US advances as industrial production and retail sales continue to improve. Industrial production recorded a month-on-month growth of 0.3% in December, an increase for the 5th consecutive month. Retail sales showed a month-on-month rise of 0.2% in December 2013, an increase for the 3rd consecutive month.

Unemployment rate marked 6.6% in January of 2014, the lowest for five years. However, new employments in non-agricultural sectors recorded at 142,000 in January of 2014, which was dropped sharply from a monthly average of 11 months of the last year, 204,000. The Purchasing Managers' Index of the ISM substantially dropped to 51.3p in January 2014 from 56.5p of the previous month, drawing concern over the possibility of manufacturing industry business slowing down.

Eurozone's economy yet again shows a sign of recovery. Industrial production and retail sales marked a month-on-month rise of 1.8% and 1.4% respectively in November. The manufacturing industry's PMI accounted for 52.7% in December, the highest for 31 months since May 2011. However, the unemployment rate in December 2013 marked a record high of 12.0%, for the 3rd consecutive month. The inflation rate recorded a month-on-month rise of 0.7% in January of 2014, suggesting economic expansion is still a long way off.

Japan's economic growth appears to slow down. Industrial production in

December marked a month-on-month increase of 1.1%, while retail sales showed a month-on-month decrease of 1.1%. The current balance account marked a deficit of 592.8 billion yen, a deficit for the second consecutive month and the largest deficit since 1985, which is believed to be attributable to rising prices of imported goods as a direct result of the weak yen. The current balance of Japan is expected to remain in deficit as currency depreciation continues.

China's economic recovery trend appears to soften for the moment. Industrial production and retail prices in December recorded a year-on-year increase of 9.7% and 13.6% respectively. Considering the double-digit growth rate up until November 2013, the growth rate of industrial production in December slowed down to some extent. Exports in December marked a year-on-year rise of 4.3%, a sharp month-on-month fall compared to 12.7% in November, and the manufacturing industry's PMI accounted for 50.5p in January, a month-on-month decrease of 0.5% and the lowest for the last six months.

Global financial market performance in January 2014 was shaped by various factors including reduction of quantitative easing by the US, volatile currency movements in emerging countries, delayed recovery of China's economy and the crisis in Bangkok.

< Economic Indices of Major Countries >

(%)

(p, yen, euro, yuan)

Economic Sectors		2011	2012	2013			Economic Sectors		2011	2012	2013	2014	
		Annual	Annual	Oct	Nov	Dec			Annual	Annual	Annual	Jan	Feb
US	Industrial Production	3.4	3.6	0.3	1.0	0.3	US	DJIA	12,218	13,104	16,577	15,699	15,373
	Retail Sales	7.5	5.3	0.5	0.4	0.2	EU	DAX	5,898	7,612	9,552	9,306	9,187
EU	Industrial Production	3.1	-2.4	-0.8	1.8	-		EUR/USD	0.772	0.756	16,291	14,915	14,619
	Retail Sales	-0.3	-1.8	-0.4	1.4	-	Japan	NIKEI	8,455	10,395	2,098	2,033	2,033
Japan	Industrial Production	-2.8	0.6	1.0	-0.1	1.1		YEN/USD	77.66	85.86	1.3799	1.3654	1.3491
	Retail Sales	-1.0	1.8	-0.9	2.0	-1.1	China	SSE	2,199	2,269	105.04	103.40	102.19
China	Industrial Production	13.9	10.0	10.3	10.0	9.7		CNY/USD	6.3190	6.2317	6.0617	6.0508	6.0609
	Retail Sales	17.1	14.3	13.3	13.7	13.6							

Source: US Department of Commerce; Eurostat;
The People's Bank of China

Source; Bloomberg

Note: US, EU, Japan QoQ, China YoY

Korean Economy

Domestic consumption fell while industrial production and investment increased. Exports continue to improve, and inflation stays around 1% plus.

Although consumption dropped, production and investment increased. Retail sales marked a month-on-month drop of 1.3% in December with sales of durable goods such as clothes and passenger cars and non-durable goods such as foods all softening. Industrial production showed a month-on-month growth of 0.1% with increased production in the mining and manufacturing sectors although production in construction and service industries reduced. Facility investment accounted for a month-on-month increase of 5.2% thanks to the rising investment in transport facilities.

Foreign trade reduced marginally due to the reduced number of working days around the lunar calendar New Year. Exports recorded US\$45.6 billion in January, a year-on-year fall of 0.2% while imports accounted for US\$44.9 billion for the same period, a year-on-year drop of 0.9%. Considering daily average performance, foreign trade improved despite unfavorable external factors including the weakening trend of the yen and recent financial crises in emerging countries globally. Trade surplus accounted for US\$700 million in January, a substantial increase compared to US\$400,000 in January 2013 and a continuing surplus for 24 consecutive months.

Total number of employees in December 2013 accounted for 24.96 million, a year-on-year rise of 560,000. The rising trend of regular workers continued, and the number of new employments substantially increased in various service sectors including health, social welfare, hotels, restaurants, whole sale and retail sales. The unemployment rate in December marked 3.0%, a year-on-year rise of 0.1%. The number of the unemployed accounted for 774,000, a year-on-year increase of 37,000.

The consumer price index in January 2014 showed a year-on-year rise of 0.1%,

maintaining 1% plus level for the third consecutive month. The consumer price index for living necessities recorded a year-on-year increase of 0.6%, a continuing 0% plus level since September 2013. The core price index in January with agricultural and petrochemical products excluded recorded a year-on-year rise of 1.7%. The export price index in January showed a year-on-year drop of 2.1%, the lowest for 5 years and 10 months.

The Korean financial market was impacted in January 2014 by the reduction of QE by the US, volatile financial markets of emerging countries, a delay in China's economic recovery, the weak yen, and concern over the unimpressive performance of corporate in the fourth quarter of 2013.

< Korea Major Economic Indices >

(p, %)

Economic Sectors		2011	2012					2013					2014	
		Annual	Annual	1/4	2/4	3/4	4/4	Annual	1/4	2/4	3/4	4/4	Dec	Jan
Domestic Market	Retail Sales	4.5	2.3	1.0	0.3	1.2	0.4	0.7	-1.2	0.4	1.3	0.4	-1.3	-
	Facility Investment Index	4.0	-2.0	6.4	-5.0	-6.8	0.8	-5.0	-4.5	-1.0	0.5	16.6	5.2	-
	Construction	-6.4	-5.8	-5.6	-0.9	1.0	1.4	10.5	4.4	7.7	-1.5	-0.9	-7.4	-
Foreign Trade	Export Growth Rate	19.0	-1.3	2.9	-1.7	-5.8	-0.4	2.2	0.4	0.7	2.7	4.8	7.0	-0.2
Employment/ Prices	Unemployment Rate	3.4	3.2	3.8	3.3	3.0	2.8	3.1	3.6	3.1	3.0	2.8	3.0	-
	Consumer Price	4.0	2.2	3.0	2.4	1.6	1.7	1.3	1.6	1.2	1.4	1.1	1.1	1.1
Finance	KOSPI	-	-	2,014	1,854	1,996	1,997	-	2,005	1,863	1,997	2,011	2,011	1,941
	KRW/USD	-	-	1,133	1,145	1,111	1,071	-	1,111	1,142	1,075	1,055	1,055	1,070
	3yr Government Bond	-	-	3.55	3.30	2.79	2.82	-	2.52	2.88	2.82	2.86	2.86	2.88
	Corporate Bond (BBB-)	-	-	10.05	9.69	8.69	8.81	-	8.50	8.99	8.97	9.10	9.10	9.11

Source: Bank of Korea, National Office of Statistics, Foreign Trade Association

II . Economic Issues Facing Korea

1. Characteristics of and Forecast on 7 Major Industries for 2014

Outlook on the Business of Major Industries for 2014

Although most major industries are expected to emerge from the recession as global economy recovers, some are feared to fail to come out of the depression or achieve only an insignificant recovery due to the depressed demand and oversupply caused by structural problems.

Industries on Recovery Track: Steel, Construction, Shipping, and Machinery Industries

Having passed the trough of business cycle, steel industry shows signs of upturn though the recovery is to be lackluster due to the limited increase of demand. Public sector construction is still in recession due to the government budget cut for SOC although business in the private sector is to improve due to the base effect as a result of protracted depression. Shipping industry is expected to increase with rising world cargo volume, but the recovery of freight rates will be limited due to the excessive supply in the market. Production and export of machinery products are to improve gradually as facility investment increases following the global economic recovery.

Booming Industries

Automobile Industry: Motor exports are likely to increase as economies of advanced countries recover. Domestic car market is also expected to grow although a substantial portion of the growth is likely to be taken by imported cars.

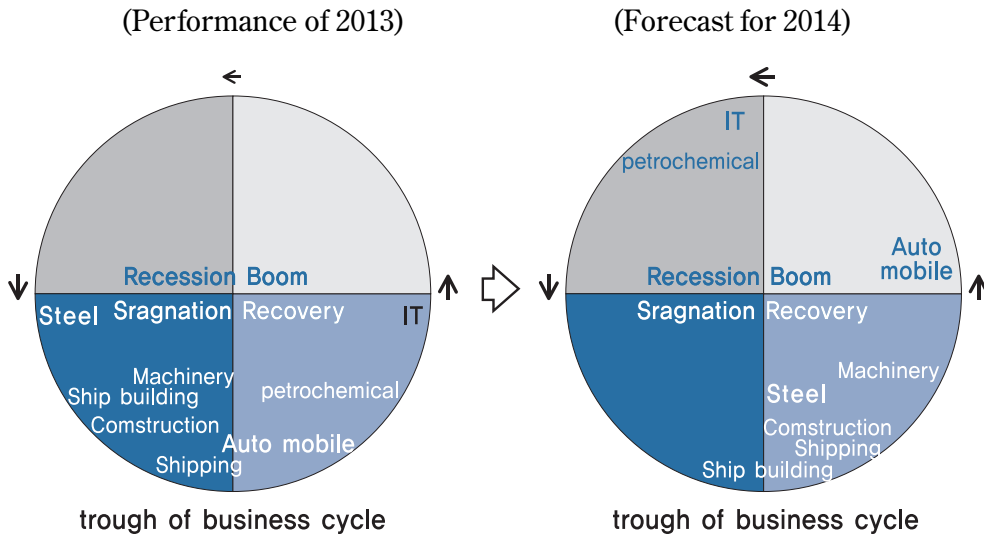
Industries in Recession

Petrochemical Industry: Business performance of petrochemical industry is forecast to soften due to the insignificant recovery of upstream industries and an appreciating won. The oversupply in North East Asia is to remain a key pending issue in the mid-long term. Although the production and export of IT products will continue to grow owing to the expanding global IT market, the growth rate of global market for key products is to slow causing concerns over the risk of the IT industry falling into recession.

Industry Failing to Emerge from Recession

Shipbuilding Industry: Profitability is unlikely to improve substantially due to the effect of existing orders secured at low prices and new orders heralding a speedy recovery are unlikely to happen in the near future.

<Business Cycles of Major Industries for 2013 and 2014>



Characteristics of 7 Major Industries for 2014

1. Having experienced depression since the second half of 2012, the export-oriented manufacturing industry is fast recovering its contribution to economic growth since the beginning of 2013. The manufacturing industry's contribution to economic growth was lower than that of the service industry for the period from 2012 to the third quarter of 2013. Manufacturing is expected to re-emerge as a main engine for economic growth as export business recovers in 2014.
2. According to the IMF, the growth rate of economic bloc of advanced nations is likely to be around 2.0% in 2014, lower than the forecast growth rate of 5.1% of developing nations, but the growth rate gap between the developing and the advanced nations will be the narrowest since 2002. Considering the weight the advanced nations play in the world economy and trade, global economy looks set to improve led by major economies of advanced nations. Therefore, positive demand environment is likely to be created for Korean export items with heavy dependence on advanced nations such as IT products and motor cars while export items mainly for developing countries such as petrochemical products, machinery, and steel products will be subject to slow or delayed recovery.
3. Basic material industry is facing so-called 'China Risk' with shrinking demand. The production growth rate of steel industry has been falling since the second half of 2012, and has continued to fall as at October 2013 with increased inventory of China and import restrictions imposed by major importing nations. The growth rate of petrochemical industry is softening in the second half 2013, having briefly shown signs of recovery in the first half of 2013, and thereby casting a bleak outlook on the petrochemical industry. Korean counterpart industries are likely to take a hit henceforth as Chinese government's localization policy of steel and petrochemical production, which are key strategic industries of China, continues to take force, making it difficult to emerge from the 'China Risk'.

4. Imports in domestic nondurable goods market are likely to increase sharply. FTA conclusions with advanced nations, strengthened marketing of foreign businesses, and an appreciating Korean won are likely to lead to increased imports of nondurable goods. Imports of motor cars, in particular, has remarkably increased with the import penetration ratio (sales of imported cars/sales of domestic cars) rising from 5.8% in 2010 to 10.3% in 2013. Import of nondurable goods is expected to increase rapidly in 2014 with exchange rate likely to fall further henceforth.
5. Within the Service Industry, the Public Service Industry is expected to perform relatively well. Government expenditure for public services substantially increased to meet expanding demand for social welfare as well as to boost domestic economy since 2012. Accordingly, the growth rate of public service production rose to 4% plus. Government expenditure for economic stimulation and social welfare service is expected to increase further in 2014, and therefore, the growth rate of public service production is forecast to be higher than ever in 2014.
6. It is highly likely that order-driven industries are to face structural recession. Korea's two major order-driven industries, construction and shipbuilding, are forecast to remain in depression due to slow order recovery. The possibility of a speedy recovery in the construction industry is unclear as new orders, a leading indicator, continue to decline despite volume of construction starts increasing in the second half of 2013, although it could marginally improve if additional government measures to reinvigorate real estate market follow. Shipbuilding industry is recovering with new orders increasing. However, the profitability of the industry is likely to deteriorate in 2014 as the shipbuilding of orders placed at the lowest prices since the financial crisis is to start this year.
7. IT industry is facing a challenge to overcome current issues of slowing growth and to move forward. IT manufacturing industry has been leading domestic industrial production until recently. However, the growth rate of

global market demand for key IT products such as smart phones and memory semiconductor chips is feared to slow in 2014. Therefore, IT industry requires a momentum for reform to enhance the industry's development stage by maximum utilization of government policies for IT industry to play a pivotal role in relation to creative economy and take a leap forward.

Suggestions

The following measures and policies are recommended to seek a breakthrough and strengthen economic recovery amid rapidly changing global industrial landscape for Korean key industries:

1. The level of utilization of FTAs should be enhanced to secure order demand from economic bloc of advanced nations.
2. Export markets should be diversified and the ability to react to changing environment should be strengthened in preparation for 'emerging market risk'.
3. A breakthrough for industries facing 'China Risk' with the issue of excessive supply should be sought by supplying higher value-added and technically intensive products.
4. In preparation for the trend of sharply rising imported nondurable goods, the authority in charge should rigidly examine the safety of imported products and enhance non-price related competition.
5. Positive action should be taken to strengthen the economic recovery trend of the private sector service industry by easing regulations.
6. Early execution of SOC budget and revitalization of real estate market are recommended to increase demand for construction business which is otherwise expected to remain in a slump
7. Industrial competitive edge should be enhanced for the industrial development stage to leap forward and for the creative economy to strengthen its driving force.

2. Repairing Relations between Korea, China and Japan Should Start with Industrial Cooperation

Intensifying Competitive Composition between Korea, China, and Japan

The contribution to the world trade of Korea, China, and Japan has rapidly risen, and so has the global status of these three nations. However, the trade growth rate of these nations has recently started to fall with industries of the nations competing increasingly fiercely, that is, more competition between industries of these three countries rather than more cooperation. What is more, political, diplomatic, and economic conflicts involving these three nations are on the increase, and therefore, industrial cooperation between Korea, China, and Japan is highly recommended as a part of strengthening economic collaboration.

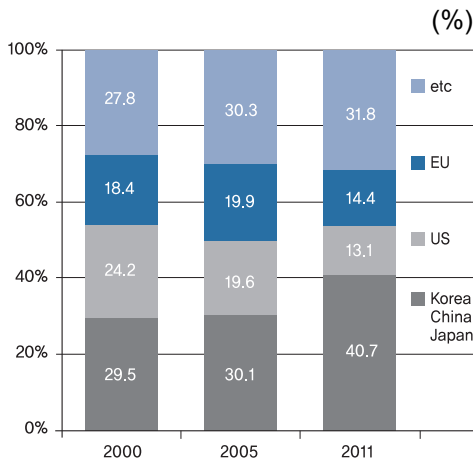
Cooperative and Competitive Relationships between Manufacturing Industries of Korea, China, and Japan.

The cooperative relationships between industries of Korea, China, and Japan can be clearly seen through the analysis of Value Chain appearing in mutual trade. The characteristics of cooperative and competitive relationships between manufacturing industries of the three nations analyzed using international input and output table(WIOD) are as follows:

1. Cooperation between the three nations was strengthened with increasing share of procurement of intermediary goods within the region. Compared to 2000, the share of procurement of intermediary goods within its own country of the three nations fell in 2011: Korea from 75.1% to 72.2%, China from 88.8% to 88%, and Japan from 91.9% to 85.4%. With regional cooperation between Korea and Japan strengthening, the share of procuring intermediary goods within the region of the three nations increased from 10.3% in 2000 to 12.7% in 2012, an increase of 2.4%.

2. Competition for value added output within the region has intensified. The value added contribution ratio of Korea, China, and Japan to the rest of the world increased from 29.5% in 2000 to 40.7% in 2011. However, the same ratio of China sharply rose from 8.9% in 2000 to 27.3% in 2011, and Korea from 3.0% to 3.8% for the same period.

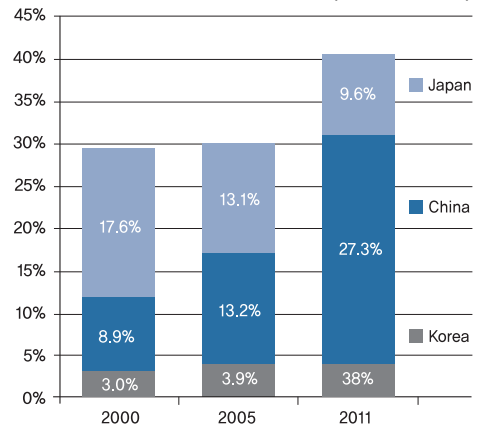
<Value Added Contribution Ratio by Major Nations to the World>



Source : Produced by HRI based on WIOD data

Note : Korea, China, and Japan refers to the aggregate of the value added contribution rates by Korea, China, and Japan combined

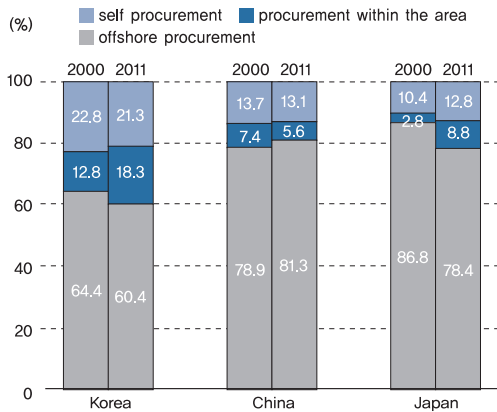
<Value Added Contribution Ratio by Korea, China, and Japan to the World> (trillion won)



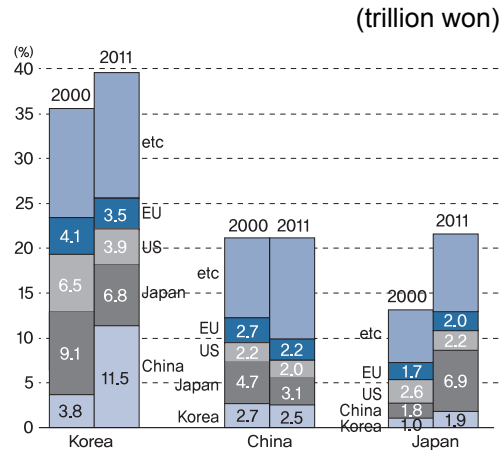
Source : Produced by HRI based on WIOD data

3. The rapidly rising competitive edge of China resulted in deepening imbalance in the region. China's value added contribution share in Korea and Japan increased from 3.8% and 1.8% in 2000 to 11.5% and 6.9% in 2011 respectively while the contribution shares of Korea and Japan in China have either increased by insignificant amount or fallen for the same period. It is evident that industrial cooperation between these three countries has strengthened with increasing procurement of intermediary goods within the region. However, China looks to benefit most from the current framework of cooperation as competition within the region intensifies, while Korea and Japan benefit relatively less as a result of imbalance of value added contribution ratio in the region.

<Value Added Contribution Ratio by Korea, China, and Japan in its Own Country, to the Region, and to the World> (%)



<Value Added Contribution Ratio by Korea, China, and Japan to the Region> (trillion won)



Source : Produced by HRI based on WIOD data

Note : Region refers to China and Japan for Korea, Korea and Japan for China, and Korea and China for Japan.

Policy Suggestions

Korea, China, and Japan should seek to establish the following economic cooperation system through strengthened industrial collaboration:

1. The imbalance in the value added and intermediary goods contribution share within the region should improve.
2. Concordant efforts should be made between the three countries to enhance global competitive edge of the three nations.
3. The three nations should promote to solidify and develop further cooperative relationships between the three nations by exploring new markets for areas of common interest.
4. Korea is facing an increasing need to continue to strengthen competitive edge of parts and intermediary goods through cooperation between the three nations.
5. Korea should be prepared in a preemptive manner to deal with the changing composition of cooperation between the three nations within the region to explore new markets.

3. 10 Major Trends of Domestic Economy in 2014

Domestic economy is expected to show the following 10 trends in macro-economy, industry, management, society, and North-South issues in 2014.

Macro-Economy Area

- ① **Entering The Age of Moderate Growth:** Korean economy, having emerged from the age of low growth since the financial crisis, is likely to enter the age of moderate growth encountering limitation of high growth. Characteristics of the age of moderate growth are the weight shift from manufacturing and export to service and domestic demand, slower recovery of household consumptions, and insufficient corporate investments. Tax-payer's burden will increase with the advent of aging society, expanding welfare service, and insufficient economic growth rate.
- ② **Expansion of Smart Consumption:** With smart consumption - aiming for the highest effective value for the lowest cost - expanding, rising real income does not necessarily lead to rising real consumption. A deepening aging society, low stability of employment, and rising housing expense induce people to a sparing consumption pattern in preparation for the future rather than encouraging spending, limiting the increase of consumption.
- ③ **Biflation in Housing Market:** Recently, housing market shows signs of biflation, a phenomenon where elements of inflation and deflation coexist at the same time. Housing market with oversupply in the capital city and its surrounding area remains in depression whereas other regions continue to improve. Small and medium-sized houses are selling well while large ones are not due to the downsizing phenomenon of households. Therefore, housing policy should also be differentiated accordingly; a policy to ensure soft landing of housing market by dealing with the issue of over-supplied housings in the capital and its surrounding area and a policy to prevent housing market bubble in the non-metropolitan areas. Possible shortage of small and medium housings

should also be taken into account.

- ④ Increasing Need for Deleveraging: With household debts and public debt approaching critical value, as suggested by the World Economic Forum, the need for ‘deleveraging (disposal of assets to reduce debt)’ is on the increase. Household debts passed the KRW1,000 trillion won (around US\$943 billion) mark as at the end of 2013, and public debts including debts owed by state-owned enterprises looks set to reach KRW1,000 trillion won in 2014. Therefore, households and public enterprises will face a situation where they are forced to dispose their least profitable assets to reduce debt.
- ⑤ Expansion of Purple Collar: Purple collar workers who manage jobs and houseworks at the same time will increase as flexible workplace arrangements prevail, such as good quality part-time works. Although on the increase, the number of part-time workers in Korea is well below those of major OECD member countries. It appears that a policy stance of expanding flexible workplace arrangements will be maintained to induce young people to have a job while in school, women to have a job in addition to housekeeping, and baby boomers looking for jobs moving into the employment market.

Industries and Management Area

- ⑥ Opening of Manufacturing Version of Korean Wave: The qualitative and brand cutting edge of Korean products have been well recognized in the world market, especially when combined with expanding Korean cultural wave. In particular, exports of Korean nondurable goods directly related to Korean wave are set to progress by leaps, and also contribute to exploring new export markets.
- ⑦ 2014, The First Year of Brand Prestige of Korean Service Industry: Korean service industries emerged as global players in some areas through the industries’ own efforts and government support. Some areas of culture, entertainment, medicine, education and business service have shown cutting edge performance on the global stage and are expected to

expand further. Medical tourism (tourism combined with medical service), in particular, is fast growing, enjoying its reputation as the top class medical service provider. More efforts should follow to reduce uncertainties and ease regulations in order for Korean service industries to become a secured global leader.

- ⑧ Take-Off of ICT Converging Industry: Korean ICT industry has surpassed the stage of following the standards set by advanced countries, and is now set to play the role of first mover in ICT converging industry. With ICT convergence actively taking place, ICT converging industry is expected to provide a new vitality for economic growth in the areas of products, services, and industry as a whole.

Social and Inter-Korean Issue

- ⑨ Society in Need of Comfort: With the constant presence of anxieties related to employment, housing, and life in old age, 2014 will be the year Korea will need, above all, comfort and rest. The 'Comfort Industry' such as healing, mentoring, and religion will progress, and the value of family as a community will be regarded highly. However, we cannot remove the possibility of deepening social conflict motivated by those who failed to be comforted. Being unable to provide sufficient social welfare service to these people, the government should instead find ways to relieve the sense of insecurity of these people and to comfort them.
- ⑩ Seeking North-South (N-S) Economic Cooperation in 3.0 ERA: Having passed the first phase of introduction and the second phase of adjustment, the North-South economic cooperation is now entering the third phase for a new leap. The North-South (N-S) Economic Cooperation in 3.0 ERA should be focused on laying foundations to build a 'win-win' economic cooperation system through the creation of favorable conditions for Korean Peninsula Trust Process to take effect in earnest, promotion of multilateral cooperation projects and by seeking new growth engine for S. Korean economy, for which the government needs to suggest tangible cooperative measures to encourage the North to change.

III. The North Korean Issues

1. The Latest Economic Policy of North Korea and Future Prospects of the Inter-Korean Economic Cooperation

Since coming to power, KIM JungEun, the First Secretary of N. Korea is believed to have introduced various new economic policies both internally and externally declaring a 'New Economic Management Regime' in an attempt to rebuild the ailing N. Korean economy. N. Korea announced June 28 Agricultural Reform and is enforcing December 1 Enterprise Reform Measure focusing on granting incentives to improve domestic economy. Externally, the Economic Development Zone Act was introduced in May 2013 placing emphasis on attracting foreign investment followed by designations of 13 provincial economic development zones. N. Korea is expected to accelerate its effort to open itself more to the world mainly through the economic development zones and continue to implement internal reform to showcase economic achievement in 2014 which marks the third year of Kim's coming to power.

Internal Reform and Opening-up to the World for Economic Building and Improvement of People's Lives.

(Focusing on Economic Building and Improvement of People's Lives) While enforcing new policies focusing on economic building, N. Korea is strengthening PARK Bongju's cabinet government system for the revitalization of the people's economy. The First Secretary KIM JungEun's publicity visits moved towards economic affairs, increasing from army affairs(32.5%) and economic affairs(24.5%) in 2012 to economic affairs(34.0%) and army affairs(29.7%) in 2013.

<Number of Publicity Visits Made by KIM JungEun(2012~2013)>

Placing	Number of Visits in 2012(151)			Placing	Number of Visits in 2013(151)		
	Area	No. of Times	Ratio (%)		Area	No. of Times	Ratio (%)
1	Army	49	32.5	1	Economy	71	34.0
2	Economy	37	24.5	2	Army	62	29.7
3	Social & culture	33	21.8	3	Social & Culture	48	23.0
4	Others	29	19.2	4	Politics	24	11.5
5	Politics	3	2.0	5	Foreign Affairs	3	1.4
6	Foreign Affairs	0	0.0	6	Others	1	0.4

Source : Internal data, Ministry of Unification.

(Enforcement of Internal Reform) N. Korea is promoting June 28 agricultural reform and December 1 enterprise reform focusing on granting autonomy for the improvement of people’s lives. The core purpose of agricultural reform is to enhance productivity by expanding the level of autonomous crop cultivation. Since the introduction of agricultural reform in 2012, the grain production of N. Korea increased by 4.7% compared to that of 2013.

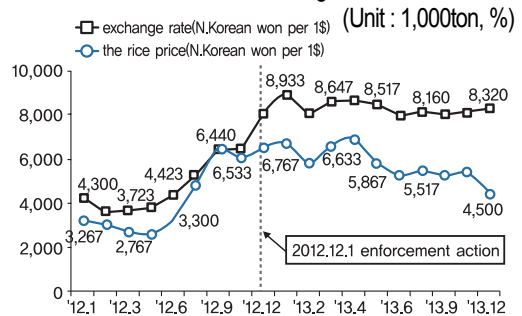
Unlike the previous central government-controlled economic planning system, the newly introduced enterprise reform allows each enterprise an ‘independent accounting system’ by which respective enterprises can autonomously plan their business, determine how many people to employ, and manage their own facility together with a performance-based pay system. The exchange rate of N. Korean currency and the rice price have both stabilized since the introduction of the reform, and it is believed that since September 2013, N. Korean workers are now paid 300,000 won (previously 3,000 won) per month considering market prices of necessities.

< N. Korea’s Grain Roduction(2011~2013)>

	2011	2012	2013(E)	Increasing Rate
Grain Production	4,750	5,031	5,267	4.7
Rice	2,477	2,681	2,901	8.2
Corn	1,857	2,040	2,002	-1.9
Been	245	168	163	-3.0
Potato	121	84	135	60.7
Others	49	59	66	11.9

Source : WFP, FAO.

<Latest N. Korea’s Market Exchange Rate & Rice Price>



Source: Daily NK.

(Wider Opening to the World) While adopting the Economic Development Zone Act to prepare the ground for revitalizing attraction of foreign investment, N. Korean announced the promotion of 13 provincial economic development zones. The economic development zone act legislated in May 2013 focuses on expanding economic development zones nationwide. In particular, it is the first attempt by N. Korea to introduce special economic zones in provincial areas for attracting foreign investment. Preparation for the legal ground allowing local special economic zones to be managed by respective local governments, and not by central government is an exceptional measure.

N. Korea announced a plan in November 2013 to set up 13 provincial economic development zones: 5 zones near N. Korea-China border area, 3 zones near the western sea, and 5 zones near the eastern sea, each focusing on agriculture, tourism, and exports depending on strengths of each area.

N. Korea's economic reform appears set to continue, and economic cooperation between the two Koreas will maintain the status quo or achieve a rapid progress depending on the resolution of outstanding issues facing the two Koreas.

Facing the third year of his coming to power, the First Secretary KIM JungEun is expected to accelerate internal reform and an open-door policy to showcase tangible areas of economic achievement. Internally, official announcement of June 28 and December 1 measures to accelerate economic reform is expected to be implemented soon with the possibility of announcing additional reform measures to revitalize people's economy. Externally, while placing emphasis on the successful operation of the 13 economic development zones, N. Korea is expected to focus on attracting foreign investment based on active economic cooperation between N. Korea and China. However, the speed and degree of economic reform and open-door policy are subject to N. Korea's internal political situation, improvement of inter-Korean relationship, and the conditions of the international community.

Inter-Korean economic cooperation is likely to maintain the status quo although it could rapidly progress depending on the resolution of outstanding issues including the project for reunion of separated families.

Necessity to expand North-South economic cooperation to encourage N. Korea to reform and to open up.

The following actions are conditions precedent to prepare the ground for N. Korea's desirable reform and opening up:

1. The North-South dialogue should be resumed on a preferential basis in a forward-looking manner for the safe management of the security of Korean peninsula and for the improvement of inter-Korean relationship. The spirit of mutual trust should be reinstated by shifting the May 24 sanction and by providing humanitarian aid for N. Korea's vulnerable social group.
2. Inter-Korean economic cooperation should be expanded to assist N. Korean success in internal reform and in attracting foreign investment. N. Korea's efforts to improve its economy is expected to continue and accelerate in 2014, and we need to induce N. Korea to step up internal reform and open-up to the global community by reinvigorating North-South economic cooperation in relation to N. Korea's latest move for reform.
3. International collaboration with China and Russia should be positively sought to support N. Korea for the same purpose.

[Annex]
Domestic and Global Economic Indices

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□ Global Growth Rate

Category	2012					2013					2014
	Annual	1/4	2/4	3/4	4/4	Annual(E)	1/4	2/4	3/4	4/4	Annual(E)
US	2.8	3.7	1.2	2.8	0.1	1.9	1.1	2.5	4.1	3.2	2.8
Euro Region	-0.6	-0.1	-0.3	-0.1	-0.5	-0.4	-0.2	0.3	0.1	-	1.0
Japan	2.0	3.5	-2.0	-3.2	0.6	1.7	4.5	3.6	1.1	-	1.7
China	7.7	8.1	7.6	7.4	7.9	7.7	7.7	7.5	7.8	7.7	7.5

Note : 1) IMF figures of January 2014 for 2013 and 2014 global projections.

2) Annual rates were compared with those of previous term for the US and Japan, with the rates of the previous term for Euro region, and with the same term in the previous year for China.

□ Economic Indicators of South Korea

Division		2012	2013			2014(E)
			the first half	the second half	Annual	
National Account	Economic Growth rate (%)	2.0	1.9	3.6	2.8	3.8
	Private Consumption (%)	1.7	1.6	2.1	1.9	2.7
	Construction Investment (%)	-2.2	5.2	8.3	6.9	2.5
	Facility Investment (%)	-1.9	-8.2	5.7	-1.5	6.7
Foreign Trade	Current Account (100 million Dollars)	481	298	397	707	490
	Exports (100 million Dollars) [Increase rate, %]	5,479 [-1.3]	2,765 [0.5]	2,832 [3.8]	5,596 [2.1]	6,067 [8.4]
	Imports (100 million Dollars) [Increase rate, %]	5,196 [-0.9]	2,565 [-2.9]	2,591 [1.4]	5,156 [-0.8]	5,697 [10.5]
Consumer Price (Average, %)		2.2	1.4	1.2	1.3	2.4
Unemployment rate (Average, %)		3.2	3.4	2.9	3.1	3.1

□ Economic Indicators of North Korea

		2005	2006	2007	2008	2009	2010	2011	2012
Per capita GNI (10,000 won)		105	103	104	114	119	124	133	137
Amount of Trade by Year (USD million)	South-to-North	715.5	830.2	1,032.6	888.1	744.8	868.3	800.2	897.2
	North-to-South	340.3	519.5	765.3	932.3	934.3	1,043.9	913.7	1,074.0
	Total	1,055.8	1,349.7	1,797.9	1,820.4	1,679.1	1,912.2	1,713.9	1,971.2

Source : THE BANK OF KOREA, Ministry of Unification

Hyundai Research Institute

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