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Topics Korea's changing export destinations and expanding FTA network

In recent years, Korea's exports have come to rely more and more on doing business with newly emerging economies. Along with fast economic growth in newly emerging economies, another reason for this has been the energetic efforts by Korean enterprises to develop new markets. The Korean government is working to support the global spread of Korean enterprises by expanding its FTA network.

■ Korean exports increasingly dependent upon newly emerging economies

An examination of Korea's export structure by geographical distribution reveals that the portion accounted for by North America and Europe is gradually diminishing. Among the reasons for this have been Korea's trade friction with the developed economies and the upward revaluation of the won in the '80s, and the increasing regional economic integration pursued in North America and Europe in the '90s (the North American Free Trade Treaty and the establishment of the European Union). The start of Korean enterprises' shift of their production operations from Korea to plants in Asia is also a contributing factor. Meanwhile, in terms of Asia's (Japan + China + other Asian countries) share of Korean exports, the overall share is increasing and, within that, Japan's share is declining while China's is growing. In addition to production goods, in recent years there has been an increase in consumer goods destined for local markets.

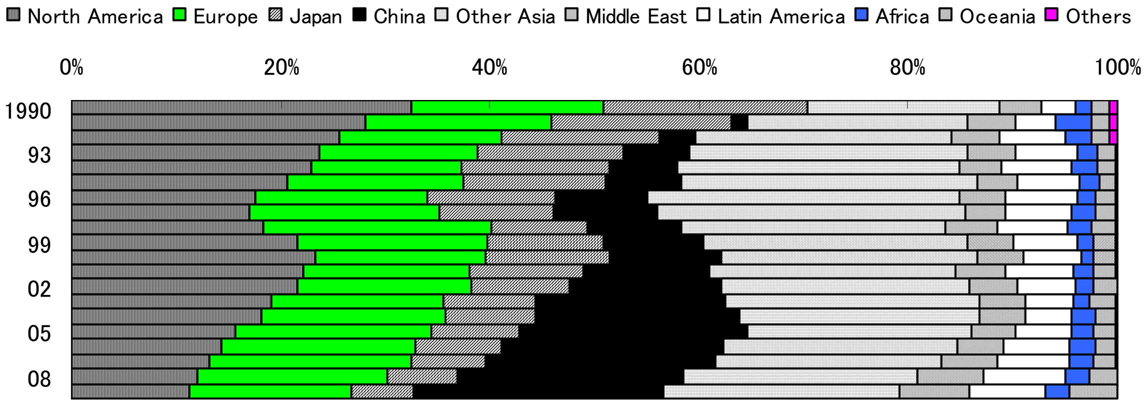
Due to the impact of the Asian currency crisis, the North American - European share of Korean exports climbed throughout 1997 and 1998, but then began to decline again from 1999. In particular, as a result of the severe economic deceleration brought about by the 'Lehman Shock' of September, 2008, the share plummeted to only 26.7% in 2009. Of course it needs to be borne in mind that exports from countries to which Korean companies had switched their production bases have been on the increase, but the figures nevertheless are only about half of what they were in the early '90s, around 50%.

In terms of recent trends, while the Asian share of Korean exports has hardly changed at all (51.2% in 2003, 52.5% in 2009), the share of the newly emerging economies outside of Asia is rising (13.3% in 2003, 20.8% in 2009). In fact, the annual growth of Korean exports to the Middle East, Latin America and Oceania frequently tops that of Asia. The fast economic growth rates among mainly raw material producing countries and the aggressive efforts by Korean enterprises to open up new markets may be cited as contributory factors. Also, Korea's government is trying to bolster the global spread of Korean enterprises by expanding its FTA (Free Trade Agreement) network.

■ Korea's expanding FTA network

Until the early 2000s, Korea's FTA activities lagged behind those of Japan, but in recent years have become more positive. This is because, for Korea, whose domestic market is small and export dependence high, beating other countries to the mark in developing a network of FTAs can be expected to

＜Share of Korea's Export＞



Source: CEIC Database

bring the benefits of 1) securing a position of superiority in terms of trade and commerce and 2) boosting the global spread of Korean enterprises, thus 3) strengthening Korea's international distribution and financial functionality.

By the year 2006, Korea had concluded FTAs with Chile, Singapore and EFTA (European Free Trade Association). Subsequently, a number of FTAs have been concluded at an increasing pace. An agreement on trade in goods was concluded with ASEAN on June 1, 2007, a similar agreement made with Japan and the US on the 30 of that month, an agreement on trade in services signed with ASEAN in May, 2009, negotiations successfully concluded with the EU in July of that year, and an agreement reached with India (due to become effective in January, 2010) in August.

One characteristic of recent activity has been the prioritizing of countries and regions with large markets (Japan is the priority market in Asia). An FTA with the EU is due to take effect in 2010, and it is possible that negotiations with China will get underway. Another characteristic is that, in order to engender more successful results in the general industrial products sector with items of concern to Korea, such as automobiles, Korea has responded with flexibility to the demands of export destination countries. For example, Korea has agreed with Chile to abolish tariffs on tomatoes, cucumbers and pork within 10 years, and with the US to abolish tariffs on beef within 15 years. Also, Korea has agreed to reduce its screen quota (a system whereby domestic movie theaters are required to screen a minimum number of domestically produced films), an issue which had been a point of contention thus far.

In Korea's FTA with India, India has agreed to abolish customs duties on a range of items that account for 75% (85% on the Korean side) of India's import worth from Korea within eight years. The customs duty (12.5%) on automobile parts and components will be reduced to between 1 and 5% within eight years, which will provide an immense cost superiority to the Hyundai Kia Automotive Group, which produces in India.

Further, the final agreement proposals for the FTA between Korea and the EU call for customs tariffs on general industrial products to be lifted by the EU within five years and by Korea within seven years. Korea is looking forward to greater exports of automobiles and household electrical appliances, etc., while the EU is looking to increase exports of cosmetics, chemical products, and wine and other agricultural products. Similarly, it has been agreed that customs tariffs on pork from Chile, which had been a point of contention, will be lifted within ten years. Once Korea's FTA with the EU becomes effective, there is no doubt that Japanese corporations will find themselves at a competitive disadvantage. The automobile industry is expected to be the most effected. The EU imposes a tariff of 10% on passenger vehicles and 22% on commercial vehicles, and once the agreement on automobile parts and components comes into effect, the tariffs on mid to large sized vehicles will be lifted within three years, and those on smaller vehicles within five years. Even in the Korean market, Japanese cars will feel the impact. Japan's share of the recently expanding import car market (especially, luxury cars) has been growing in recent years, but if the prices of European cars come down once the FTA comes into effect, some loss of that market share will be inevitable.

■ Korea's expanding FTA network

While Korea has continuously expanded its FTA network in recent years, negotiations with Japan remain stalled. The two sides began inter-governmental talks on economic partnership in December, 2003, but these were broken off in November, 2004, amid disagreement over the opening up of agricultural and fisheries markets (as well as differences of opinion on trade imbalance, non-tax barriers and industrial cooperation) although discussions aimed at restarting the talks have been on-going since 2008.

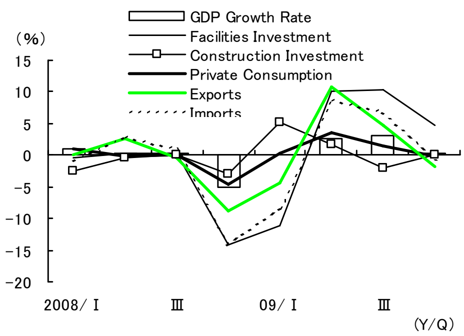
Given that Korea is gradually losing incentive to proceed with negotiations with Japan, the Japanese government will need to come up with more attractive concessions. In the months ahead, as negotiations with Australia and other countries go ahead, it will be necessary to work out how best to manage the balance between agricultural policy and the promotion of FTAs.

(Hidehiko Mukoyama)

Korea *Pace of recovery slowing*

■ Economic growth for October to December, 2009, 0.2% compared to previous quarter

<Korea's GDP Growth Rate(QoQ)>



Source: The Bank of Korea、*Economic Statistics System*

Korea's real GDP growth rate (flash report) for the period October to December, 2009, was only 0.2% compared to the previous quarter (6.0%, compared to the same period in the previous year, 0.2% for the whole year), well below 2.6% (quarter on quarter) in the period April to June, and 3.2% (similarly) in the period July to September. With the exception of facilities investments (up 4.7%) and construction investments (0.0%), private consumption was minus 0.1%, government consumption minus 2.9% and export growth minus 1.7%. While these figures represent in large part a recoil from the rapid recovery seen in the previous quarters, which had been boosted by the implementation of economic stimulus measures (reduced taxation and early budget implementation), and are largely as per expectations, there is little room for optimism in future, for the following reasons.

First, it appears likely that the recovery power of consumption will be weaker than it was in 2009. One of the reasons for this is that the tax reduction on replacement purchase automobiles has ended. The special tax reduction (started in May, 2009, and completed at the end of the year) was behind a rapid recovery in automobile sales, which were up 20.7%, year on year, for the whole year. However, as signaled by a double digit drop in January's sales, month on month, after the special tax measures ended, 2010 will inevitably see a recoil from the previous year's boost. Another reason has been the failure of employment to sustain the pace of recovery. The unemployment rate (seasonally adjusted) began to fall from July, but rose again to 3.5% in November, staying more or less the same in December (figure lower right). Additionally, the number of those employed grew negatively for two consecutive months, and improvements in the employment situation have failed to make much headway. In addition to these factors, the pace of recovery in production has slumped and part of the state and local authority temporary employment projects have run their course.

Second, the export recovery looks very likely to be rather pedestrian in pace (although growing faster than the previous year for the time being). Among the reasons are 1) slow economic recovery in the developed nations, 2) the dwindling effects of China's consumption stimulus measures, and 3) 'excessive' won correction.

Third, the effects of the rising price of crude oil have begun to make themselves felt. The consumer price index increase rate (compared to the same month in the previous year) rose from 2.4% in November to 3.1% in January, giving rise to observations that interest rates might be raised as a preventive measure against inflation. In recent years, household debt (mainly housing loans) has increased and if interest rates increase further in the months ahead, there is every likelihood that consumption will be restrained as a result. Further, due to the impact of the rising price of crude oil, January's balance of trade figures were in the red for the first time in a year.

■ Details of economic recover under scrutiny

In 2010 also, in addition to continuing with the implementation of economic stimulus measures such as bringing forward budget implementation, introducing tax relief,（principally for small and medium sized businesses and those on low income）, and enhancing social safety net provision (raising the minimum wage level and extending temporary employment, etc.), the government plans to encourage the expansion of investment and create employment opportunities through the promotion of the Green New Deal projects and the service industries.

The disparity between fiscal 2009's average economic growth rate and the growth rate of the final quarter is 2.4%, so the economic growth rate for 2010 is expected to be at least 4%. In addition, attention will be focused on whether investment vitalization and employment creation will produce the desired effects this year.

(Hidehiko Mukoyama)

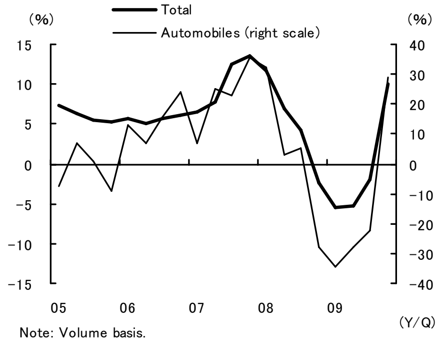
Hong Kong Economic recovery continues

■ Economic stagnation in US and EU is a millstone around the neck of recovery

Hong Kong's economy has maintained its trend of recovery since 2009, but its recovery strength is weak.

It is domestic demand that has been driving the recovery. Total retail sales figures (volume basis) for the period October to December, 2009, rallied significantly to 10.0% growth compared to the same period in the previous year. In particular, the volume of sales of automobiles, which account for a high proportion of Hong Kong residents' purchases, shot up to 28.8% growth. The main factor behind this has been a recovery in consumer sentiment, against the backdrop of rising asset prices and improvements in the employment situation. Hong Kong's Hang Seng index and housing prices rose 52.0% and 26.9%, respectively, within the year.

<Retail Sales (YoY)>



Note: Volume basis.
Source: Census and Statistics Department of Hong Kong

Additionally, the economic stagnation in Europe and the US has been a millstone around the neck of Hong Kong's economy, and the recovery in external demand has yet to materialize fully. Exports for the period October to December continued to post negative growth at minus 2.0%, compared to the same period in the previous year. The rate of decline in exports to Europe and the US, which account for 20% of the total, contracted from minus 24.3% in the period July to September, down to minus 15.5%, due to retailers' inventory replenishment activities, but this is still double digit negative growth. Exports to China, which account for 50% of the total, were up 4.0%, similarly, a fairly small increase in comparison with other Asian countries' exports to China. This was due largely to the fact that the majority of Hong Kong's exports to China are transit trade and are extremely vulnerable to developments in China's exports to Europe and the US. Also, though the number of visitors to Hong Kong from the Chinese mainland is recovering steadily, the recovery in tourists and travelers from other countries and regions has been weak.

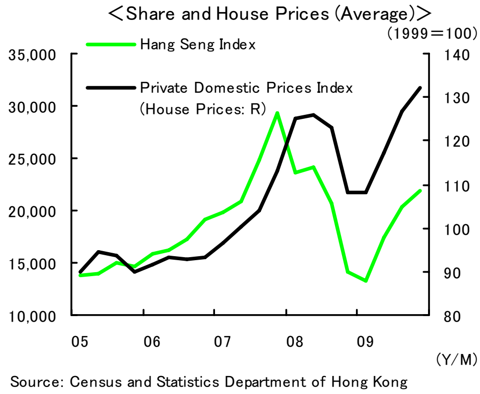
The economic recovery and the government's economic countermeasures have combined to improve the employment situation, and the seasonally adjusted unemployment rate in the October to December timeframe was 4.9%, down 0.4% points from the period July to September. However, in the financial industry and some other industries, recovery appears to be marking time.

■ Brakes on housing prices

Housing prices began to rise rapidly from early in 2009, but in recent months the tempo has slackened.

The main cause for this has been China's tighter monetary policies, best represented perhaps by its 'window guidance' (moral suasion) policy toward the banks. Until now, investment capital mainly from the Chinese mainland flowed into Hong Kong, but the implementation of the tight monetary policy is believed to have caused the inward flow to decrease.

<Share and House Prices (Average)>



Source: Census and Statistics Department of Hong Kong

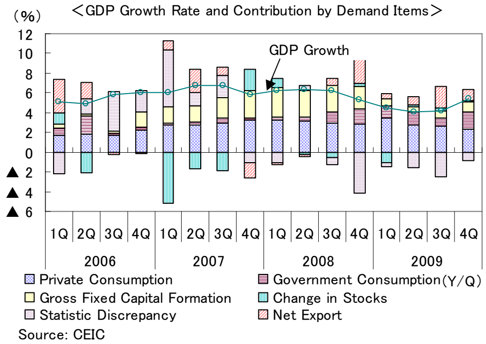
Further, in recent times, fears of capital outflow have been growing. According to Hong Kong's Monetary Authority, capital inflow between Q4, October to December, 2008, and the start of 2010 totaled $640 billion. This equates to some 19.5% of total bank loans in Hong Kong, as of the end of September, 2009. Mr. Norman Chan, Chief Executive of the Hong Kong Monetary Authority, has acknowledged that HK$300 billion of this money is in the form of liquid assets, and has pointed out the possibility that these funds could flow out of Hong Kong overseas.

Given expectations that economic recovery in Europe and the US will be slow in coming, it would be difficult to conceive of liquid assets flowing overseas immediately, but as fears of capital outflow grow, it is thought likely that the pace of housing price rises will slacken still further. **(Shinichi Seki)**

Indonesia Domestic demand also driving economic growth

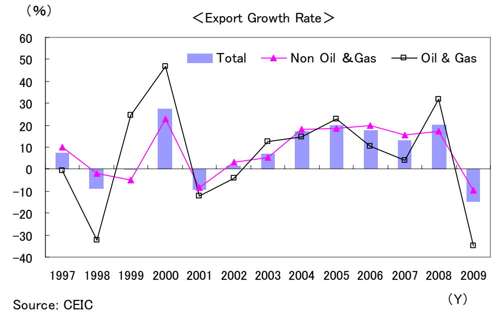
■ Q4 GDP growth rate 5.4%

Indonesia's real GDP growth rate for the period Q4, October to December, 2009, was 5.4%, compared to the same period in the previous year, with a growth rate of 4.5% for the whole year. In terms of the contribution factor of private demand items in the October to December timeframe, private consumption was the highest at 2.3%, followed by net exports at 1.2% and total fixed capital formation at 1.0%. While the contribution of private consumption has come down slightly, this has been made up for by net exports.



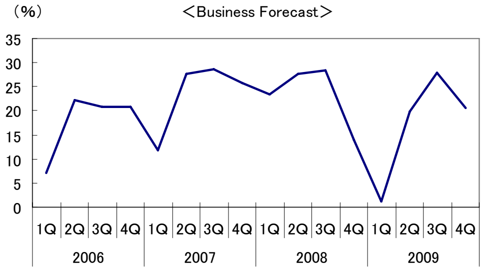
Source: CEIC

Exports in 2009 were down 15.0%, year on year, at $137 billion, and imports (according to a flash report including tax deferred districts) were down 25.0%, similarly, at $96.9 billion. For exports to fall by over 10% is unheard of in recent times, even including the Asian currency crisis of 1997, and is evidence of the severity of the impact of the current financial crisis.



Source: CEIC

There are many optimistic views of economic performance in 2010. Part of the reason for this is that the consumer confidence index has continued at a high level and that private consumption is expected to continue to drive economic growth. Also, there is expected to be a recovery in external demand. The government forecasts that, in 2010, non-oil and gas exports will be bolstered by a recovery in the global economy and will grow by between 7 and 8.5%, similarly.



Note: Net Balance Method
Source: Bank Indonesia, Business Survey

Business confidence among enterprises is also doing well. According to a business survey conducted by Bank Indonesia, business outlooks in the period October to December, 2009, also were optimistic, encouraged by the manufacturing and construction industries. FTAs (Free Trade Agreement) concluded with ASEAN and China will become effective from 2010 and there is growing expectation that there will be healthy business growth among resource-related enterprises, which occupy a comparatively dominant position.

■ Corruption' and 'the enforcement of law' are barriers to growth

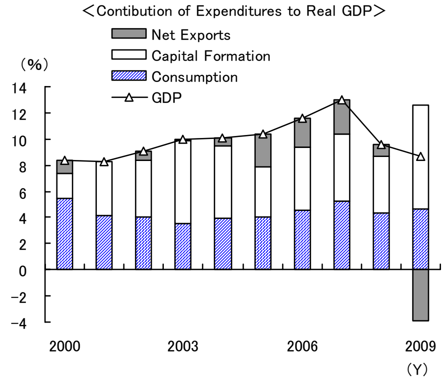
The consumer price index increase rate for January, 2010, was influenced by the rising prices of rice and foodstuffs and rose 0.84% on the previous month, up 3.72% compared to the same month in the previous year. In its monthly report for February, Central Bank voiced some caution over this, but at the same time held that the commodity price rises were caused by seasonal factors and made clear its intention to keep the target inflation rate for 2010 at 5±1%. In a market awareness survey, Central Bank surveyed economists to find out how they rated the problems hindering economic growth, and found that inflation and other macro-economic policy issues are not perceived as factors hindering economic growth.

In the survey, 'corruption' and 'the enforcement of law' were marked poorly. There is considerable interest in these issues at home and abroad, and Transparency International, an NGO investigating global corruption issues, gave the second Yudhoyono administration a bad review, saying that it had achieved little of note in this respect during its first 100 days. At the end of January, a demonstration of 10,000 strong protested against corruption. It is not only a higher growth rate that is required, but also the kinds of reforms necessary in order to increase the sustainability of economic growth. **(Yuji Miura)**

China 10.7% real GDP growth in October to December

■ 'Maintain 8%' target achieved for the whole year

China's real GDP growth rate for October to December, 2009 (compared to the same period in the previous year), was 10.7%, for the first time posting double digit growth in six consecutive quarters. Against the backdrop of a rapid deterioration of the global economy, though growth was down in the first quarter, January to March, at just 6.2%, it began to pick up the pace again from the second quarter, April to June, and onward. Growth for the whole year was 8.7%, which means that the government's target to maintain around 8% economic growth was achieved.



Source: National Bureau of Statistics

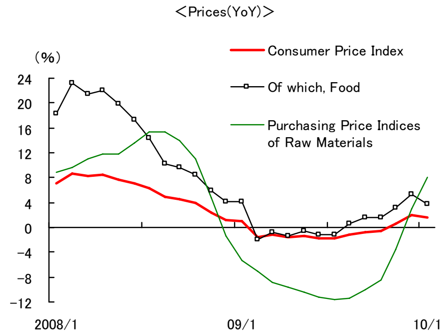
The main factor behind the rapid recovery has been investments (against 8.7% economic growth for the whole year, capital formation's contribution was 8.0% points, figure top right). Boosted by economic stimulus measures worth four trillion yuan, total investment in fixed assets for the whole year grew by 30.1% on the previous year, the highest rate of growth since 1994 (30.4%).

Consumption also performed solidly, with the exception of the beginning of year, and retail sales for the whole year were up 15.5%, year on year. This is believed to have been due to the fact that consumption appetites were roused by factors such as the implementation of subsidies paid to assist with the purchase and replacement of household electrical appliances and automobiles. By region, while retail sales growth in rural areas since September has been somewhat slack, it has been gaining momentum in the urban areas.

Meanwhile, external demand pushed down economic growth (the net exports contribution to the economic growth in 2009 was minus 3.9% points) by a significant amount. Nevertheless, the worst of the global economic downturn would appear to be over and in recent months there has been an unmistakable trend of recovery in exports. In December, 2009, the value of exports exceeded the same month in the previous year for the first time in 14 consecutive months (in January, 2010, also, exports increased 21.0%, compared to the same month in the previous year).

■ Policy fine-tuning likely to continue for the time being

Judging from indices published as of the first half of February, it would appear that economic recovery is continuing. For instance, January's PMI (purchasing managers' index) for the manufacturing industry was 55.8, down 0.8 points on the previous month, but has been over the 50 benchmark for eleven consecutive months. In the same month, automobile sales were 1.6 million vehicles, the highest monthly figure recorded so far.



Note: Purchasing Price Indices are production stage
Source: National Bureau of Statistics

On the other hand, inflation concerns are growing. The consumer price index shows signs of inflation, converting to positive growth for the first time in ten months and coming in at +0.6% in November, 2009, compared to the same month in the previous year, accelerating to +1.9%, similarly, in December (+1.5% in January, 2010).

Under these circumstances, the government's monetary stance grows ever stronger, following January's reserve ratio rise with further hikes in February. However, the Chinese government has steadfastly repeated its commitment to continuing an 'appropriately relaxed monetary policy', and it may be thought premature to assume that it has decided to tighten monetary policy across the board.

It would appear likely that the Chinese government will, for the time being, continue to keep a close watch on commodity price trends, and so on, all the while 'fine-tuning' individual policies. 2010 will see the Hu administration's ability to adapt tested once again, as they attempt to sustain economic growth at a level that will probably be set at around 8% again, while trying to stabilize commodity prices (including the prices of real estate and other assets).

(Junya Sano)