

# **K**ERI **E**CONOMIC **B**ULLETIN

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

Major factors that may contribute to slower Korean economic growth in 2011 are expected to be U.S. public and private debt adjustment, Europe's fiscal retrenchment, stagnation of the global economic recovery following China's belt-tightening policy externally and weakening of economy-boosting potential caused by normalization of its macroeconomic policy tone, end of base effects enjoyed in 2010, etc.

Considering the fact that the nation's average growth rate over the past 10 years (2001~2010) is 4.2%, however, the projected growth rate of 2011 can be appraised as being close to the nation's long-term growth trend.

Affected by the lessening of economic stimulus effects, interest rate hikes and asset value declines, private consumption may slowdown but it is unlikely to be significant owing to improvements in employment and wages in 2010. Facility investment growth is expected to fall to 7% level, influenced by mitigation of investment pressure on the heels of sharp investment growth in 2010, slowdown in the economic recovery, interest rate increases, and other factors. Construction investment slowdown is expected to continue in 2011 due to the stagnation in the real estate sector.

## **Current Account Surplus to Record US\$13.2 Bil. in 2011**

Export growth (U.S. dollar basis) may plummet to a single digit due to demand decline following the fiscal retrenchment and household debt adjustment of advanced countries, China's conversion to retrenchment, Korea's foreign exchange currency appreciation and intensified competition in export markets. Imports (U.S. dollar basis) also may decrease, but record higher growth than exports. Due to faster growth of imports over exports, service balance deficit expansion, etc., the current account surplus is projected to contract to US\$13.2 billion in 2011 from US\$30.6 billion in 2010.

## **Consumer Prices to Rise 3.0%, Won/USD Fx-Rate to Decline to 1,095 Won**

Consumer inflation is expected to remain at around 3% as pressures from the demand side will not be so great due to milder economic growth, and limited international oil prices, and the won currency appreciation trend. Influenced by global dollar weakening, continuation of dollar supply priority and increases in base rates, the won-U.S. dollar exchange rate is expected to decline gradually, falling below the 1,100 won level.

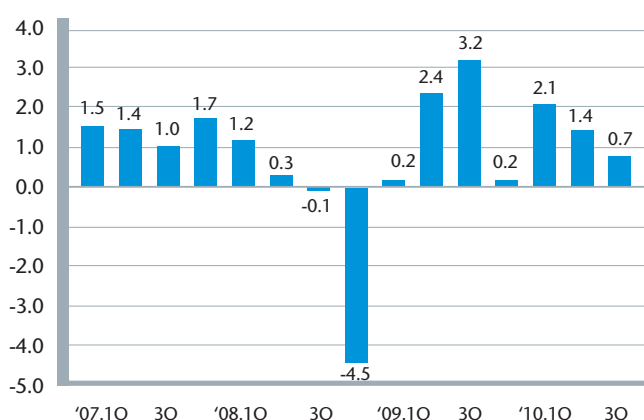
## Recent Developments

### GDP Grew 0.7% in 3rd Qtr. '10

GDP growth in the third quarter of 2010 fell to 0.7% from 1.4% in the second quarter. By sector, private consumption expanded and construction investment returned to an upward trend. However, facility investment and export growth slowed.

GDP Growth

Unit: Seasonally adjusted series (q-o-q, %)

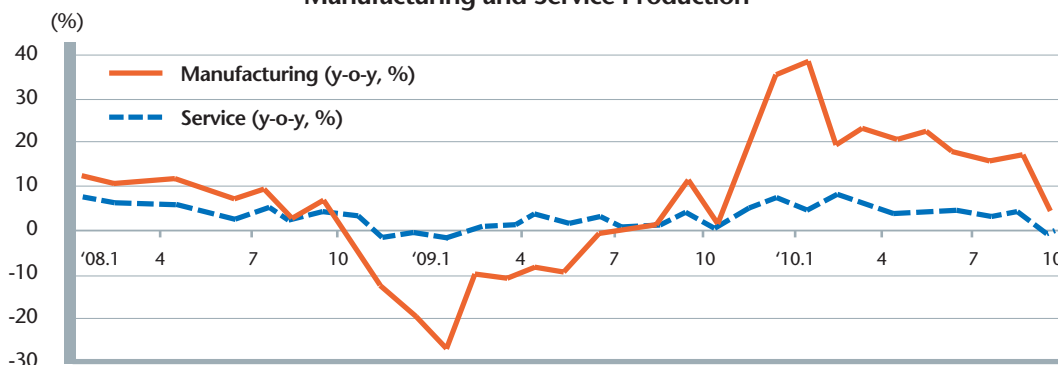


	2010		
	1/4	2/4	3/4
GDP	2.1	1.4	0.7
Private Consumption	0.7	0.8	1.3
Government Consumption	5.8	0.1	-0.6
Construction Investment	1.3	-3.4	1.5
Equipment Investment	2.4	9.1	6.3
Exports	2.9	7.2	1.8
Imports	4.4	7.4	2.3

### Manufacturing and Service Production Grew 12.1% and 2.3%, Respectively, in 3rd Qtr.

In the third quarter of 2010, manufacturing production growth slowed to 12.1% compared with a high year-on-year growth of 20.2% in the second quarter, and service business production growth also declined to 2.3% from 4.0%.

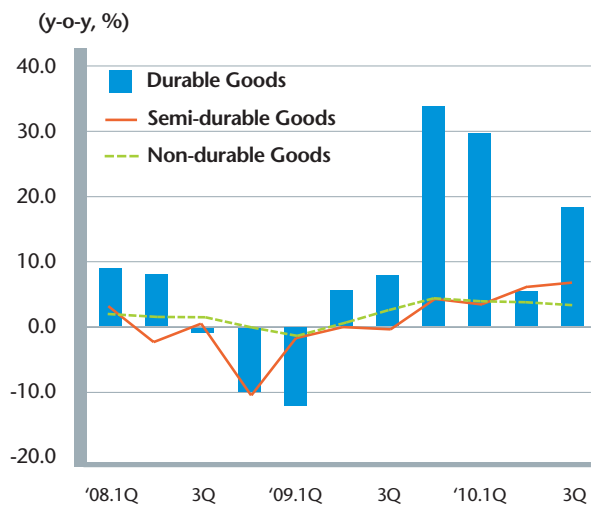
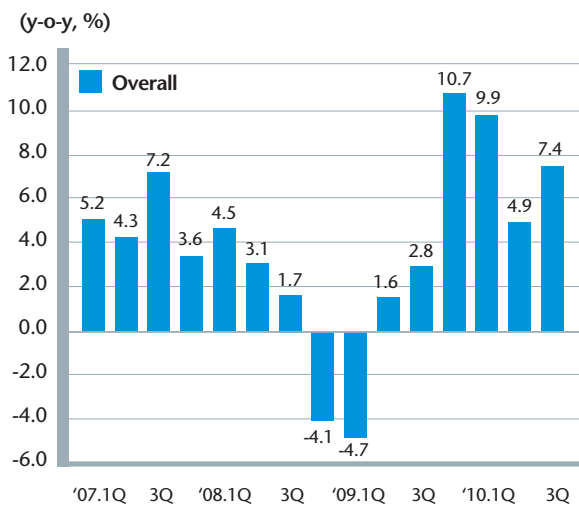
Manufacturing and Service Production



**Consumer Goods Sales Grew 7.4% in 3rd Qtr.**

The growth of consumer goods sales in the third quarter reached 7.4%, compared with 4.9% in the second quarter owing to significantly increased sales growth of durable goods (16.9%) such as passenger cars, electric home appliances and computers.

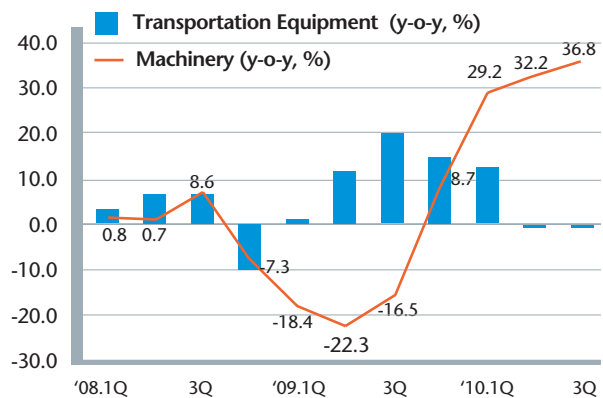
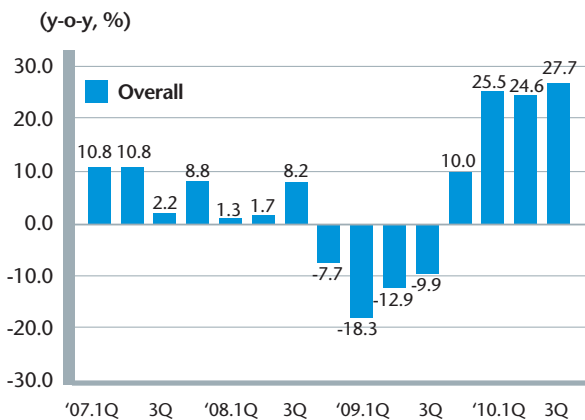
**Consumer Goods Sales**



**Facility Investment Increased 27.7% in 3rd Qtr.**

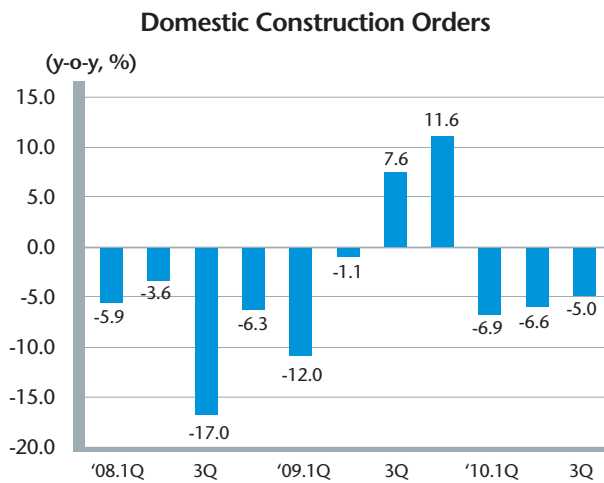
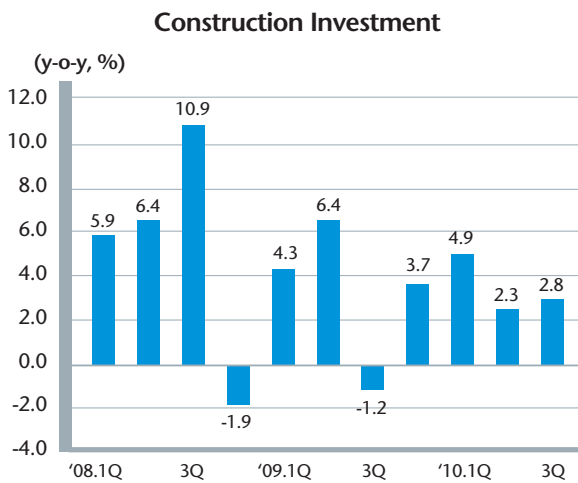
Facility investment growth expanded slightly in the third quarter to 27.7% compared with 24.5% in the second quarter. While machinery investment posted brisk growth, transportation equipment investment made poor progress.

**Equipment Investment**



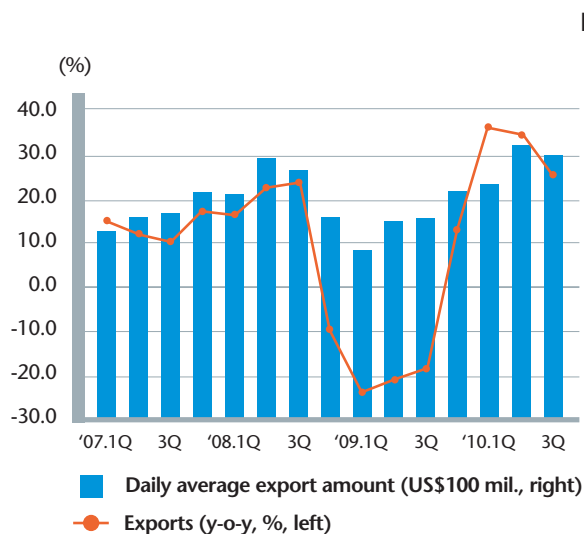
### Construction Investment Rose 2.8% in 3rd Qtr.

Compared with the second quarter (2.4%), the growth of construction investment expanded mildly to 2.8%. However, the growth in receipt of construction orders, a leading indicator, declined for the third consecutive quarter, predicting a construction investment slowdown in the future.



### Exports Grew 23.9% in 3rd Qtr.

Export growth in the third quarter slowed to 23.9% compared with 33.1% in the second quarter due to declines in both export volume and export unit prices. By item, exports of semiconductors and automobiles maintained a high growth trend but those of communications equipment and computers decreased.

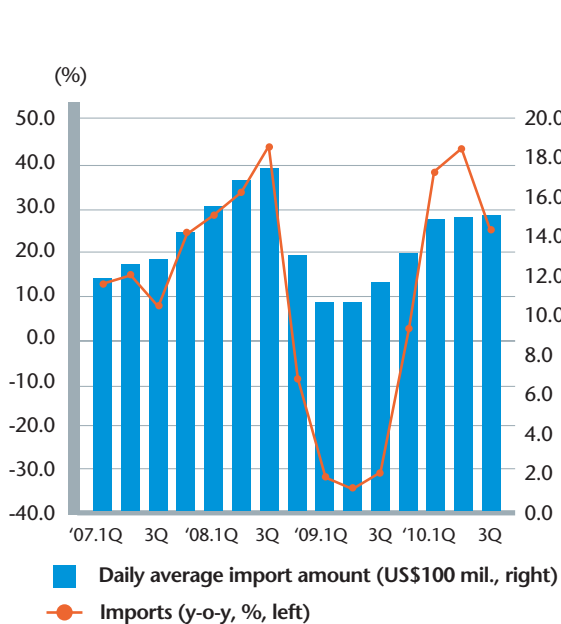


#### Exports

By Items (Ratio, %: Jan.~Aug. '10)	(Unit: y-o-y, %)		
	2010 1/4	2010 2/4	2010 July~Aug.
Semiconductors (11.03)	120.7	84.1	67.8
Ships (10.16)	-8.1	11.7	28.3
Petrochemical Products (7.85)	58.3	33.4	16.5
Automobiles (7.51)	51.2	62.0	45.1
Flat Panel Displays (7.13)	62.0	33.9	27.8
Steel Products (6.07)	14.8	14.8	38.1
Wireless Comm. Equipment (5.65)	-10.6	-23.2	-21.2
Automotive Parts (3.99)	107.6	74.9	60.4
Textile Products (2.99)	22.7	19.8	19.9
Electric Home Appliances (2.90)	42.5	35.2	31.2
Computers (1.94)	33.7	19.1	-2.1

## Imports Increased 24.3% in 3rd Quarter

Compared with the second quarter, import growth slowed in the third quarter to 24.3%. Nevertheless, imports have continued a higher growth trend than exports since the first quarter. By usage, imports of raw materials, including those for exports, slowed compared with the second quarter, affected by import unit price declines.



### Imports

By Use (Ratio, %: Jun-Aug '10)	(Unit: y-o-y, %)		
	2010 1/4	2010 2/4	2010 Jul.-Aug.
Total Imports	37.4	43.1	28.3
For Exports (40.0)	50.3	40.0	16.5
For Domestic Demand (60.0)	29.9	45.1	37.7
Raw Materials (58.9)	38.8	53.2	29.3
Capital Goods (31.5)	36.8	31.5	26.9
Consumer Goods (9.6)	29.5	27.0	30.5

## Current Account Surplus Increased to US\$12.06 Bil. in 3rd Qtr.

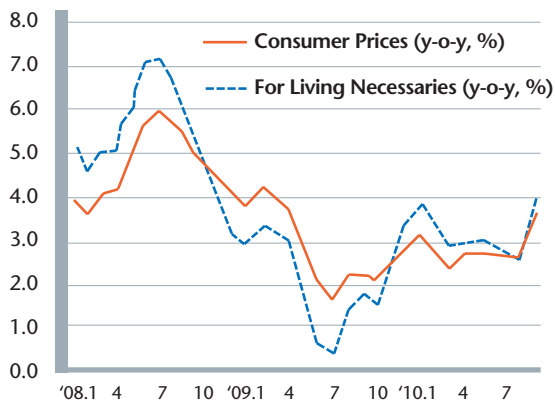
The current account surplus increased sharply in the third quarter compared with US\$10.34 billion in the second quarter. This is attributable to the fact that, despite expansion of the service balance deficit, the surplus in the commodity balance expanded.

### Current Account Balance

	2009		2010			
	1~9	year	1/4	2/4	3/4	1~9
Current Account Balance (= A+B+C+D)	321.1	426.7	13.4	103.4	120.6	237.3
A. Commodity Balance	405.9	561.3	74.3	157.1	166.4	397.8
B. Service Balance	-114.3	-172.0	-60.4	-41.7	-52.4	-154.5
Travel Balance	-26.2	-38.9	-19.9	-13.6	-27.0	-60.6
C. Income Balance	29.1	45.5	7.6	-7.5	15.6	15.6
D. Current Transfer Balance	0.5	-8.1	7.6	-7.5	-8.9	-21.6

### Consumer Prices Rose 2.9% in 3rd Qtr.

Influenced by sharp increases in farm, livestock and fishery products, consumer prices rose slightly in the third quarter from 2.6% in the second quarter. Prices of farm, livestock and fishery products jumped 12.5% year-on-year.

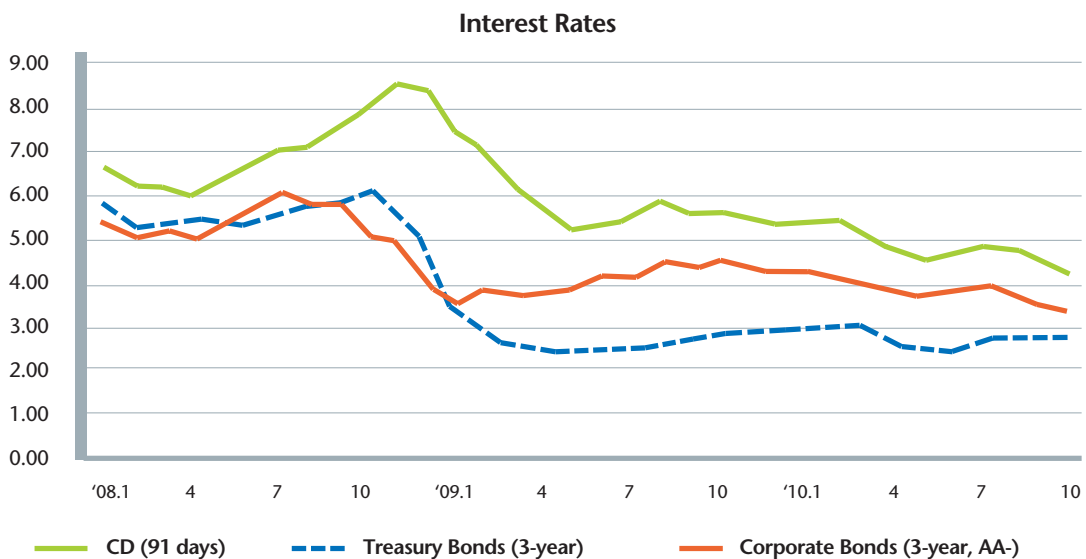


### Prices

	2009			2010		
	2/4	3/4	4/4	1/4	2/4	3/4
Total Index	2.8	2.0	2.4	2.7	2.6	2.9
Commodities	3.3	1.7	3.3	3.8	3.8	4.7
Farm, Livestock & Fishery Products	9.9	5.0	3.9	3.6	5.2	12.5
Industrial Products	1.7	1.0	3.1	3.9	3.4	2.5
Services	2.3	2.1	1.9	2.0	1.8	1.8
House Rental Charges	1.6	1.3	1.2	1.4	1.8	2.0
Public Service	1.6	2.3	1.9	1.7	1.3	0.9
Private Service	2.9	2.2	2.0	2.3	2.0	2.2

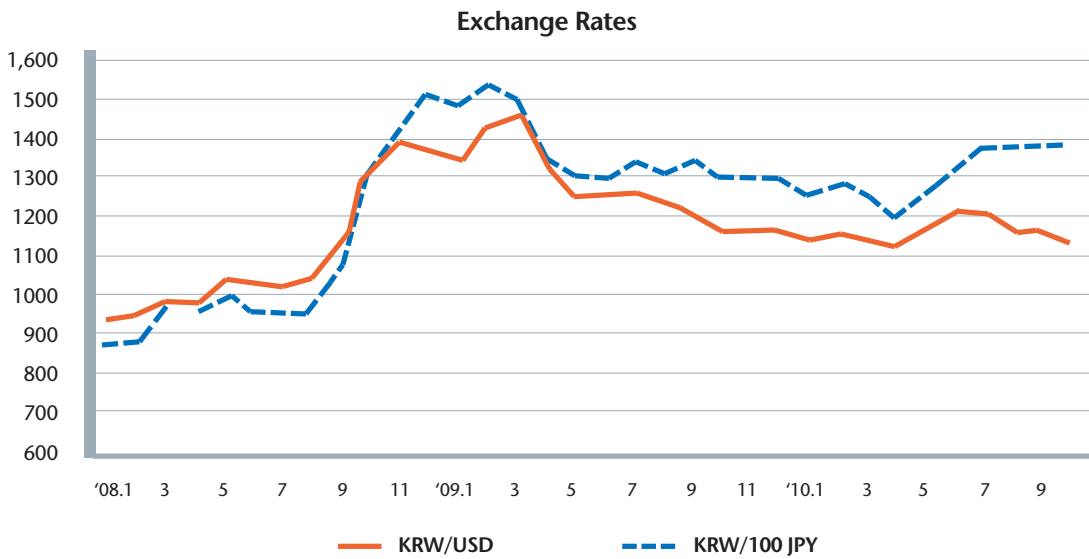
### Market Interest Rates Decreased Despite Base Rate Hike

Market interest rates, which rose for a while after the base rate hike, returned to a downward trend due to foreigners' expanded investment in bonds and delay in additional interest rate increases.



### Won-U.S. Dollar Fx-Rate Declining Since July

The won-U.S. dollar exchange rate continued to fall, caused by signs of stabilization in Europe's fiscal crisis, Chinese yuan currency appreciation, domestic base rate increase, trade balance surplus, and other factors.





# 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 the financial markets face major regulatory overhaul the governments and private households continue deleveraging. 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, also see inevitable slowdown in their economic growth.

### International Oil Prices to Rise Mildly

The delay in the economic recovery of advanced countries and exit strategies of developing countries will be factors in curbing oil demand. Although increases in the flow of investment funds into crude oil in the wake of a weakening U.S. dollar may serve as upward pressure on oil prices, international oil price hikes are expected to be not sharply higher as prices are projected at US\$80~85/bbl. in 2011.

### 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 excessive dollar supply. 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 economic fundamentals. Taking into account the declining growth trend and the pace of inflow of overseas capital, however, basic interest rates are likely to be adjusted.

#### Key Assumptions for Projections

Exogenous Variables	Unit	2010	2011
China's Growth	%	10.5	9.0
Japan's Growth	%	2.8	1.2
U.S. Growth	%	2.6	1.9
Dubai Oil Price	US\$/bbl.	78.8	82.0
RP Interest Rate (end of year)	%	2.50	3.00

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

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

The Korean economy is expected to slowdown 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 end of base effects in the wake of high growth in 2010. Nevertheless, the projected growth is appraised close to the potential growth rate. Korea's annual average growth for the past 10 years (2001~2010) has been 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 growth is expected to be moderate. Owing to employment and wage improvements in 2010, however, the slowdown is likely to be mild.

**Construction**  
**Investment: -1.2%**  
**(2010)→0.6% (2011)**

As the SOC budget for 2011 is to be compiled at an amount less than in 2010 amid sluggishness in the private construction sector due to a delay in real estate recovery conditions. Growth in the public construction sector also is projected to be limited.

**Facility Investment:**  
**23.1% (2010)→7.1%**  
**(2011)**

Facility investment growth is likely to contract significantly amid declines in global economic conditions in addition to less of 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 considerably.

**Current Account:  
US\$30.6 Bil. Surplus  
(2010)→US\$13.2 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 decrease. 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 decline and intensification of competition in export markets. Influenced by the economic growth slowdown, imports also may slow, but will post a higher growth than exports due to unit price increases. Meanwhile, the service balance is expected to post a deficit, affected by low productivity in the domestic service industry and exchange rate declines.

**Consumer Prices: 2.9%  
(2010)→3.0% (2011)**

Consumer prices are expected to grow 3.1% 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 also is to be low due to slight increases in international oil prices, won currency appreciation, and other factors.

**Market Interest Rates:  
4.9% (1st half)→5.1%  
(2nd half)**

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 foreign funds in the bond market is likely to continue will serve as factors to limit market interest rate hikes.

**Won-U.S. Dollar Fx-  
Rate: KRW1,155  
(2010)→KRW1,095  
(2011)**

The won-U.S. dollar exchange rate is expected to decline 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 changes %, US\$100 million)

	2009	2010			2011		
	Year	1st H	2nd H	Year	1st H	2nd H	Year
GDP	0.2	7.6	4.7	6.1	3.7	4.5	4.1
(SA, q-o-q, %)		2.9	1.7	0.0	1.9	2.5	
Private Consumption	0.2	5.0	3.5	4.2	3.7	3.9	3.8
Construction Investment	4.4	-0.7	-1.6	-1.2	0.2	0.9	0.6
Facility Investment	-9.1	30.1	17.4	23.1	7.1	7.2	7.1
Consumer Prices	2.8	2.6	3.1	2.9	3.1	2.8	3.0
Current Account	426.7	116.7	189.0	305.7	58.7	72.8	131.6
Commodity	561.3	231.5	285.4	516.9	170.5	192.3	362.7
Exports (BOP Base)	3735.8	2243.4	2417.5	4660.9	2423.4	2630.0	5053.4
Growth (%)	-13.7	33.6	17.5	24.8	8.0	8.8	8.4
Imports (BOP Base)	3174.6	2011.9	2132.1	4144.0	2252.9	2437.7	4690.7
Growth (%)	-25.7	41.7	21.5	30.5	12.0	14.3	13.2
Service & Others	-134.6	-114.7	-96.4	-211.1	-111.7	-119.4	-231.2
Fx Rate (Avg. KRW/USD)	1278.4	1153.8	1155.3	1154.5	1105.0	1085.0	1095.0
Corp. Bonds Yield (3-year, AA-)	5.8	4.9	4.7	4.8	5.0	5.3	5.1
Unemployment Rate (%)	3.6	4.1	3.4	3.8	3.8	3.6	3.7

## Policy Issue:

### The Future Real Estate Market and Prospects

#### Discussion Background

Recently, real estate transactions are shrinking, especially in the Central Seoul Area. Contrary to house prices in other areas, house prices in Seoul and the capital sphere have declined since March 2010. Notwithstanding the government's continuous announcement of countermeasures, there has been no visible effect. This report discusses the possibility of a real estate recession and suggests policy implications.

#### Housing Market Prospects

Due to an imbalance in supply and demand, the real estate market is expected to continue a declining trend in the short term. This trend is likely to expand from Seoul, and there is also a high possibility that the transaction volume may continue to decrease in the Central Seoul Area. Affected by the already planned housing site developments, the supply volume of houses is expected to increase for the time being, and alleviation of financial restrictions, even if there is such a possibility, is unlikely to drive housing demand higher.

Also in the medium and long term, the housing market is expected to contract after experiencing an adjustment period. From the demand side, retirement of the first baby-boom generation and decreases in major demand classes (35~54 year-old population) will serve as key factors. From the supply side, whether unsold volume can be resolved and whether to supply national rental Bogeumjari houses continuously or not will serve as variables.

#### Policy Alternatives

As price declines are continuing at present due to excess supply, flexible supply and a market role that can reflect future changes in demand are considered important. To strengthen the role of market mechanisms, there is a need to revise the transfer income tax that may be unconstitutional in violation of the 'Principle of (Half-Amount) Taxation' due to the tax burden exceeding 50% of capital gains. Therefore, it is necessary to mitigate the financial regulation policy through DTI and LTV, and also to ease restrictions on re-building businesses involving infrastructure linkage fees and development gains charges in order to stimulate the demand sector. The price ceiling system on sale of apartments should be abolished because it may bring ill side effects caused by price restrictions.

## The Effect of IFRS Adoption on Consolidated Financial Statements in Korea

Research Monograph 10-06

Kang, Sunmin

While 99% of listed firms report consolidated financial statements in developed countries such as U.S. and England, only about half of listed firms in Korea prepare for consolidated financial statements at present. The International Financial Reporting Standards(IFRS) require consolidated financial statements as the main financial statements. Thus, unless the number of firms reporting consolidated financial statements significantly increases following the adoption of the IFRS in year 2011, it would be difficult for consolidated financial statements to maintain the status of the main financial statements in our country.

Under the current accounting standards in Korea, a parent company should consolidate an investee company so long as its ownership exceeds 30%, when it is the major shareholder. In addition, the Korean accounting standards allow for exempting subsidiaries from consolidation, which are established for special purpose, ie, SPC, or small in firm size, ie, less than 10 billion Korean Won in total assets. However, the so-called principle-based IFRS not only sticks to the theoretical 50% ownership rule, but does not allow for any exclusions of subsidiaries in consolidation. Thus two major changes are expected following the adoption of the IFRS in Korea. First, the scope of consolidation could be shrunk significantly, particularly for large business group firms, as their associated companies between 30% and 50% of ownership become ineligible for consolidation under the IFRS. Second, the number of firms reporting consolidated financial statements would substantially increase as there would be many new firms starting to consolidate their SPCs or subsidiaries with total assets less than 10 billion Korean Won under the IFRS. The purpose of this study is to investigate these two aspects empirically. This study expects to aid governmental supervisory agencies to set policies and regulations regarding consolidated financial statements, and to help related companies and information users to prepare in advance for the effect of IFRS adoption on consolidated financial statements.

The results show that the adoption of IFRS in Korea in year 2011 would indeed have an effect to substantially reduce the size of consolidated entity particularly for large business group firms as their several associated companies with large asset bases and sales revenues are deleted under the 50% ownership rule for consolidation. The financial performance of consolidated entity appears to be worsened also for those large firms as profitable associated companies with high operating income are dropped from consolidation. The other results tell that our IFRS adoption would increase the number of firms preparing for consolidated financial statements substantially from the current 53.6% to 86.7% among all the listed firms.

The adoption of IFRS would accelerate our efforts to enhance consolidated financial statements as the main

financial statements in accordance with global standards. Some concerns are that IFRS adoption could instantaneously increase the number of firms preparing for consolidated financial statements too much, and, for existing preparers, could have huge impact on the content of consolidated financial statements at one time. Governmental supervisory agencies and related companies need to take proper actions in anticipation of these drastic changes. In particular, governmental supervisory agencies should be keen to make appropriate revisions in time to regulations based on financial statement numbers such as debt ratio, total assets, and sales revenue as there will be big changes in the main financial statements following the imminent IFRS adoption.

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