

Choongsoo Kim: Emerging Asia and global economic recovery

Speech by Mr Choongsoo Kim, Governor of the Bank of Korea, to the Asia Society, New York, 18 April 2012.

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Introduction

Ms. and Mr. presidents,

Distinguished members of the Asia Society

Ladies and gentlemen,

I am very pleased to have this opportunity to talk today before distinguished guests and economic leaders from New York and people from all walks of life with a deep interest in the Korean economy.

I would also like to express my sincere appreciation to Asia Society's Co-Chairs, Henrietta H. Fore and Ronnie C. Chan, and all of those involved for arranging this wonderful occasion today.

Founded in 1956, the Asia Society has worked as a mediator promoting exchanges and cooperation between the U.S. and Asian countries and greatly contributed to the remarkable economic development they have achieved today.

I would like to praise most highly the impressive achievements of Asia Society not just in the economic sector but across the entire spectrum of culture, arts and policy. I expect Asia Society to play a greater role as an opinion leader for further development in Asia.

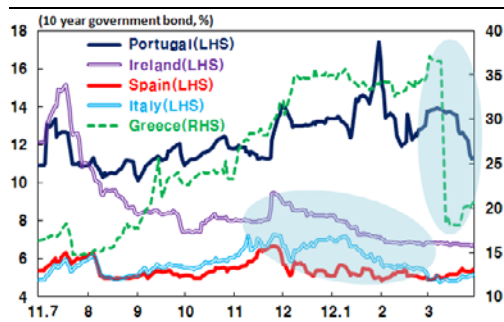
Today, I will first give a brief introduction to the role of Asian emerging market economies that have become the center of the world economy and then go on to talk about the prospects and tasks now facing the Korean economy, which has been assessed to have pulled out of the global financial crisis very quickly.

Body

During the course of overcoming the global financial crisis, the international community has concentrated its financial resources particularly on resolving the euro area sovereign debt problems.

Thanks to this effort, the international financial markets have been stabilized to a certain extent while the real sector economies remain still sluggish.

Government Bond Yield



World GDP Growth

(QoQ annualized rate, %)

	2010				2011				2012
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
World	5.8	5.5	3.7	4.7	3.7	3.2	3.3	3.1	2.6
AEs	4.0	4.2	2.1	1.6	1.3	0.8	1.9	1.2	0.6

Source: Bloomberg

Source: IMF

Given that the weakness of the real economy is at the base of all financial crises, maintaining growth in the real sector is more important than securing financial stability through short-sighted methods.

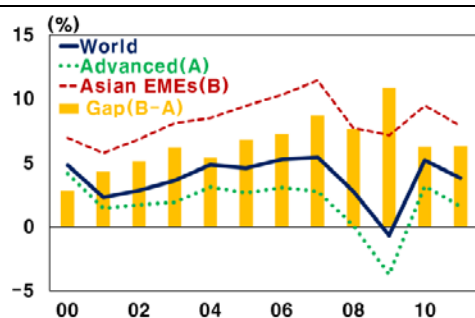
Although financial regulatory reforms, such as Basel III, are underway as part of the efforts to overcome the crisis and prevent another, the highest priority is placed on leading world economic growth.

In this respect, global financial markets are supposed to leave the ICU(Intensive Care Unit), and time is ripe to initiate a new strategy for further growth by attaining a global equilibrium.

Asian emerging market economies(EMEs) have shown rapid growth, boosted by an export-oriented growth strategy, cheap high-quality labor, and the introduction of capital and technology from advanced countries, and so on.

Unlike advanced economies(AEs), Asian EMEs, in particular, have been growing steadily since the global financial crisis.

GDP Growth



(%)

	Korea	China	India	US	Euro
2009	0.3	9.2	6.8	- 3.5	- 4.3
2010	6.3	10.4	9.9	3.0	1.9
2011	3.6	9.2	7.4	1.8	1.6

Source : IMF

Source: IMF, BOK

The Asian economy has been leading global economic growth since the 1980s and its importance is expected to grow even further.

Although having been temporarily sluggish due to the currency crisis in late 1990s, the GDP, trade volume and foreign reserves of the economy in this region have all been on a steady rise.

Share of Asia in the World Economy (%, based on nominal GDP)	12.5 in 1960 → 19.8 in 1980 → 27.4 in 2011
Trade Volume (world rank, 2010)	China(2) Japan(4) Korea(9) Hong Kong(10) Singapore(13)
Official Foreign Reserves (world rank, 2011)	China(1) Japan(2) Taiwan(4) Korea(7) India(8)

Especially, the rate of contribution of Asian EMEs to world GDP rose from 14% in 1970s to 23% in 1980s, 34% in 1990s and 50% during the period for 2000~2011. The IMF forecasts the rate to remain at around 50% for the coming five years.

However, regarding macro-financial linkages, the international community has so far stressed securing financial stability, focusing more on the effect of finance on the macro-economy than on that of the macro-economy on finance.

As a result, the injection of global financial resources concentrated poured mainly into Greece and other heavily indebted countries in the euro area, and a relatively smaller proportion of these resources was allocated for growth promotion and job creation.

In this respect, a true normalization of the current sovereign debt crises in the euro area can take place when individual European countries secure fiscal consolidation through a recovery of their respective growth trends.

Bailout of Heavily Indebted Countries

(billion euro)				
	Greece		Ireland	Portugal
	1 st round	2 nd round ¹⁾		
EU	80	145	45	52
IMF	30	28	23	26
Total	110	173	68	78

Note: 1) Including those not carried out in the first round

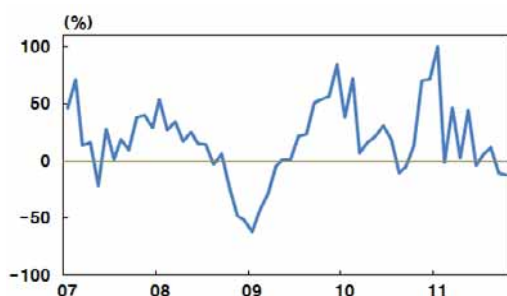
Source: EU Commissions

At another point, a global financial crisis originating in the US and the euro area and the consequent policy responses in advanced countries have negative spillover effects on EMEs through the financial and real channels.

The export momentum of EMEs weakened at the time of the financial crisis due to sluggish import demand in major countries amid the economic slowdown.

In addition, as uncertainty over economic conditions mounted due to the global financial market unrest, the sentiment of economic agents turned sour and, consequently, consumption and investment also weakened.

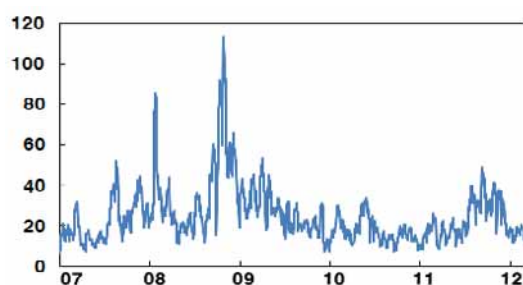
Exports of Asian EMEs¹⁾



Note: 1) Period-on-period annualized rate

Source: IMF

Stock Price Volatility of Asian EMEs¹⁾



Note: 1) Standard deviation of daily volatility of stock price indices of 50 major enterprises in EMEs

Source: Bloomberg

In addition, as the burgeoning global liquidity created by the monetary easing of the central banks in major countries, exchange rate volatility in emerging market countries increased and international commodity prices such as those of oil rose sharply.

Government Bond Yield				Oil Price
FRB	(QE1)	2009 ~2010.3	\$1,725 billion	
	(QE2)	2010.11 ~2011.6	\$600 billion	
ECB		2011.12	€ 489.2 billion	
		2012.2	€ 529.5	
Note: Long-term Refinancing Operation				Source: Bloomberg

The role of the Asian economy is important for the recovery and sustainable growth of the world economy in the future and global financial resources, in this respect, should flow into EMEs with relatively high productivity and a heavy demand for capital.

EMEs have been less affected by the crisis than advanced countries and are relatively sound fiscally. Therefore, they have sufficient latitude in macroeconomic policy to promote growth in the short-term.

In addition, although Asian EMEs achieved high growth thanks to export-oriented strategies, intraregional trade continued its upward trend even after the financial crisis as countries turned to stable growth policies through domestic demand expansion.

Government Gross Debt					Asian Regional Trade	
	(% of GDP)					
	U.S.	EU	China	Korea		
2008	76.1	69.8	17.0	30.1		
2009	89.9	79.4	17.7	33.8		
2010	98.5	85.3	33.5	33.4		

Source: IMF

Source: IMF

Meanwhile, since urbanization and industrialization are proceeding apace in Asian EMEs such as China and India, there is a high demand for capital to build up infrastructures. What is more the growth rates of labor productivity are higher in them than in the advanced countries.*

The labor productivity growth rates in countries such as Korea (3.1%), India (4.1%) and China (9.4%) during 2000~08 greatly exceeded the average for OECD countries (1.6%).

Development Plans		Labor Productivity ¹
China ¹⁾	India ²⁾	
City and western development Set-up of roads, houses, etc Promoting new industries next-generation strategic industries such as IT, BT, etc	Set-up of infra-Structure Investing 200 billion dollars per year Expanding openness automobiles, drug, distribution, etc	

Notes: 1) for 2011~15 2) for 2012~16

Note: 1) Annual average growth rate during 2000~08, on a basis of all industries

Sources: APO, OECD

For its part, the Korean economy has developed thanks to export-driven growth just like other emerging Asian nations, and along the way it overcame crises through bold reforms.

Especially, Korea's trade volume had been over 1 trillion dollars in 2011, only nine countries have reached this trade volume.

	1970	1980	1990	2000	2009	2010	2011
Trade(billion USD)	2.8	39.8	134.9	332.7	696.3	896.3	1,079.6
Export(billion USD)	0.8	17.5	65.0	172.3	373.2	471.1	555.2
Per capita GNI(USD)	255	1,660	6,303	11,292	17,041	20,562	22,489

Sources: KITA, BOK

Notably, Korea has won a reputation for having surmounted both the Asian currency crisis in the late 1990s and the recent global financial crisis faster than other countries around the world without retreating in liberalization; for example by introducing protectionist measures.

During the Asian currency crisis, Korea carried out a strong restructuring of companies and financial businesses in a drive to improve the economy's structural weaknesses. Also, Korea overcame the global financial crisis thanks largely to bold initiatives by the government and the central bank, such as the expansion of fiscal spending and swift policy rate cuts.

So far, the remarkable development of the Korean economy has been attributable mainly to increases in external trade, and in this sense the Korea-US FTA, which came into effect recently, is expected to provide economic benefits to both nations.

The effects of an FTA vary depending upon the counterparts' economic conditions and their trade structures. But for Korea, a number of FTAs have served to spur on the growth of trade.

(The Korea-EU FTA took effect in July 2011) Even though our overall exports to the EU have declined owing to the sovereign debt crisis, since the conclusion of the Korea-EU FTA, the exports of those items that benefit from the FTA have maintained high rates of growth.

► Increases in Exports with EU		H12011	H2	Degree of Tariff Reduction
Total Exports	[100]	16.7	-7.9	
Automobiles	[104]	51.3	87.5	Gradual elimination of 10% over 3~5 years
Petroleum Products	[5.3]	92.8	26.0	Immediate elimination of 3~7%

Notes: YoY %, [] represent the share of items in exports with the EU in 2011

The Korea-US FTA is believed to help maintain Korea's export momentum with the US through tariff reductions.

In addition, the FTA is likely to boost brand recognition of Korean products that rank much lower in terms of technology and quality.

From a medium- and long term perspective, the FTA is expected to heighten the competitiveness of relatively weak service industries in Korea including the financial, legal, accounting and consulting sectors.

Korea-US FTA's Effects

(%, 100mil.USD)

	Average tariff rates in the US	Increases in exports to the US ¹⁾
Total exports	-	12.9
Automobiles	2.5	7.2
Electronics	2.2	1.6
Textile	13.0	1.1
Machinery	1.7	0.6
Chemicals	3.2	0.5

Competitiveness Factors of Export¹⁾



Note : 1) Annual average for 15 years after the FTA takes effect

Note : 1) Survey of US buyers

Source: KIEP

Source : KITA

For the US, the FTA with Korea, the largest after NAFTA, is likely to help the US economy, which is already showing signs of improvement.

The volume of US trade has increased sharply since it concluded the NAFTA with Canada and Mexico in 1994.

Trade scale to Canada & Mexico	1988~1993	1995~2000
(annual average amount, billion USD)	295	587
(annual average increase rate, %)	7.9	11.2

First of all, with greater accessibility to the Korean market, there are increasing opportunities for industries with a comparative advantage, such as the service industry.

In terms of production, the US will be able to secure a new supply line as it becomes possible to purchase high-quality Korean parts and components.

Moreover, the US and the European companies can use Korea as a base for advancing into other East Asian countries as Korea trades on a large scale with China*, which has emerged as one of the G2 in the global economy.

In terms of trade scale in 2011, China is Korea's largest trading partner, and Korea is China's third largest trading partner, following the US, and Japan.

In the long term, I hope the Korea-US FTA will bring positive effects on growth and employment in both countries through the expansion of exports and FDI and heightened industrial competitiveness.

In addition, consumers are expected to benefit from a wider range of choice, and our bilateral relations are likely to be strengthened still further from a political perspective including the security dimension.

In the short term, however, difficulties are expected for the industries having a comparative disadvantage in both nations and therefore every effort should be made to encourage the upgrading of their structure while showing consideration for the industrial fields concerned.

The Korean economy is expected to continue its solid growth, but as the growth rate is anticipated to slow down over the medium to long term, it is vital to be prepared for this situation.

Even in the face of heightened economic uncertainty at home and abroad, the Korean economy is forecast to grow at around 3 1/2% this year, led by domestic demand including facilities investment.

Export momentum is expected to approach the pre-crisis level in the second half in line with global economic growth.

Korea's Economic Outlook			Exports Momentum	
	2011	2012 ^{e)}		
▪ GDP (YoY, %)	3.6	3.5		
▪ CPI (YoY, %)	4.0	3.2		
▪ Current Account Balance (billion USD)	26.5	14.5		
▪ Unemployment Rate (%)	3.4	3.3		
Source: Bank of Korea			Source: Bank of Korea	

However, downside risks are expected to remain high for some time affected by external risk factors including the inflationary pressure from oil prices and possibility of euro area sovereign debt problem spreading.

Prospects for Economic Growth

(YoY, %)

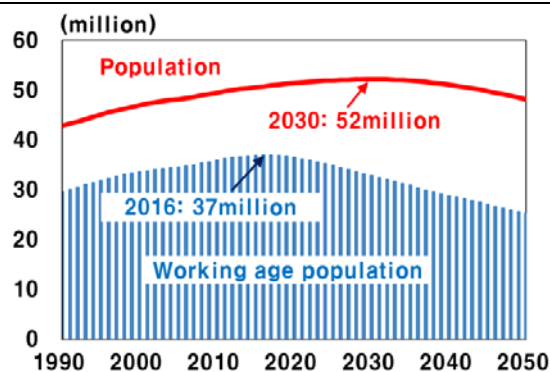
	2011			2012 ^{e)}		
	H1	H2	year	H1	H2	year
	3.8	3.4	3.6	3.0	3.9	3.5
Private consumption	2.9	1.6	2.3	1.8	3.8	2.8
Construction investment	-7.1	-3.0	-5.0	2.1	3.4	2.8
Facilities investment	8.9	-1.1	3.7	5.0	7.3	6.2
Goods exports	14.5	6.9	10.5	3.8	5.8	4.8

Source: Bank of Korea

In the medium- to long-term, the growth rate is projected to decline due to a falling birth rate and ageing population.

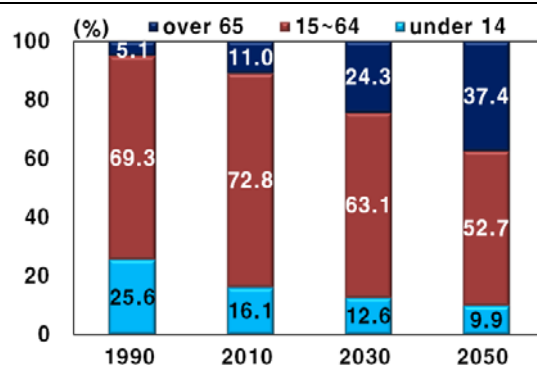
Total fertility rate(persons) : 3.6 in 1970s → 1.9 in 1980s → 1.6 in 1990s → 1.2 from 2000 to 2011

Total & Working Age Population



Source: National Statistical Office

Population by Age Groups



Source: National Statistical Office

To boost the future growth potential, the key is making the transition from input-led growth to productivity-led growth.

As the increase in the productive population will be limited due to the low birth rate, it is more effective to make efforts to increase the quality of human resources and to use the given labor resources more efficiently.

More specifically, it is necessary to induce improvements in productivity as the driver of growth by enhancing that in the relatively laggard service industry and by increasing input quality through investment in R&D and innovative technologies.

Concluding Remarks

Distinguished members of the Asia Society

Ladies and gentlemen,

As I pointed out earlier, the Asian emerging market economies are leading world economic growth and they are sure to become the axis of the world economy.

It is worth noting the attention Korea has been drawing from the international community for the way in which it overcame the Asian currency crisis and the global financial crisis and the country is expected to contribute to global economic growth in the coming years as well.

However, we cannot say that such rapid growth will last in Korea and other Asian EMEs, simply because they are currently exhibiting a remarkable economic performance.

Since the Asian growth model is accompanied by several constraints such as the heavy reliance on overseas demand and production factors, the derivative use of advanced technology and a low degree of financial market development, it is important to recognize these shortcomings and strive to improve them.

For instance, due to their heavy external dependence, Asian EMEs were greatly affected by the recent financial crisis, even though it originated in the advanced Western economies such as the U.S. and European countries. Hence, we need to seek growth based on the quickening of domestic demand.

In addition, on the production side, we need to make efforts to expand growth potential through the improvement of productivity in the services sector, the shared growth between large and small corporations, and the development of new growth industries.

Although the global financial crisis started in New York and then engulfed the euro area, it is important to prevent the contagion from the crisis from spreading to Asia if we are to have a recovery of the world economy and balanced development.

To accomplish this goal,

Firstly, we need strengthen policy coordination among individual countries in the absence of an organization with global jurisdiction that could manage global liquidity.

Secondly, we should seek long-term and stable world economic growth through achievement of a global equilibrium by invigorating global gatherings such as G20 meetings, rather than making local equilibrium efforts to solve problems in individual regions.

Lastly, we need to develop policy instruments and reform the financial system in global terms so that the world's financial resources can flow into sectors with high productivity including the building-up of social infrastructure in Asian EMEs.

Ms. and Mr. presidents,

Distinguished members of the Asia Society

Ladies and gentlemen,

I would like to express my deep gratitude to all members of the audience here today for their close attention to the Asian economy as a whole and that of Korea in particular.

Drawing my remarks to a close, I hope that as true friends of Korea you will not hesitate to give your suggestions and advice about the future of the Korean economy.

Thank you again for listening so attentively.