POSRI Economic Outlook Series (12-2)

2013 Economic Outlook

Continued Downside Risks amid High Uncertainty

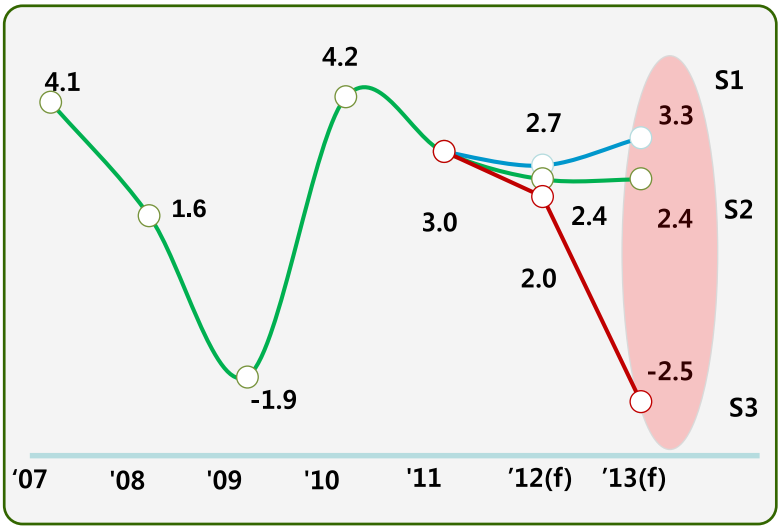
Dec. 2012

POSCO RESEARCH INSTITUTE

Executive Summary

■ The global economy remains in slow growth in 2013 due to worsening economic slowdown in advanced countries, and delayed recovery in developing countries.

2013 World Economic Outlook by Scenario



○ Mild recovery (S1 : 20%)
- Eurozone(EZ) crisis alleviated thanks to policy cooperation
- Recovery in US and China

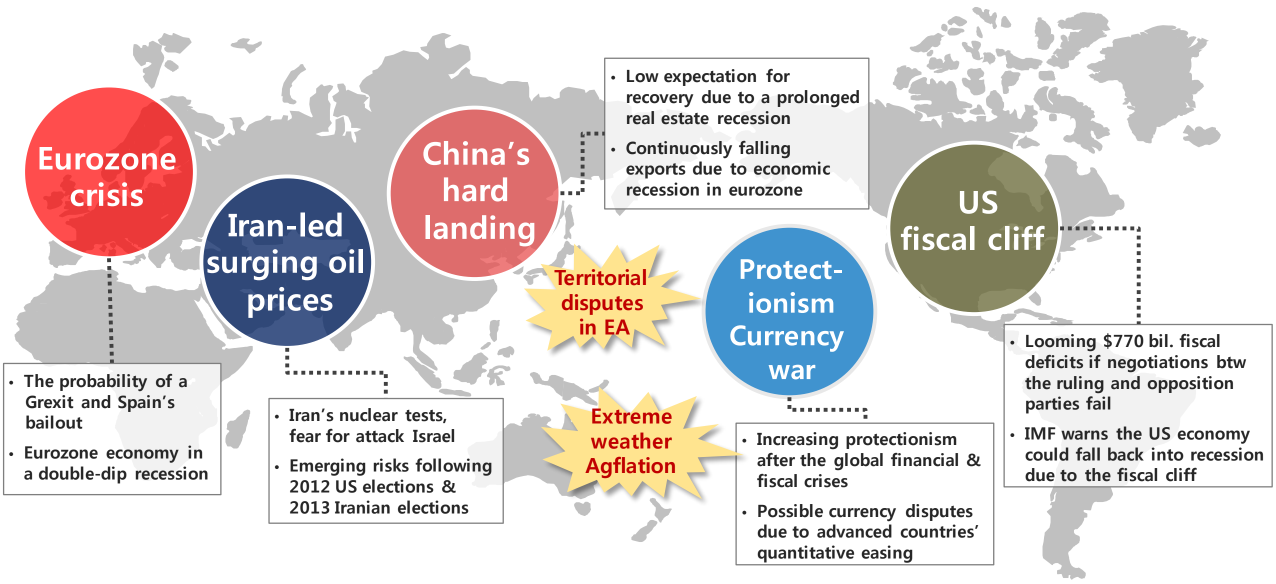
○ Continued low growth (S2 : 65%)
- Persistent EZ crisis
- Prominent 5 risks

○ A double-dip recession (S3 : 15%)
- Grexit spread to Southern European countries
- Realization of US fiscal cliff and hard landing in China

■ Top 5 global risks: continued threat to the world economy

- The eurozone debt crisis remains as the greatest global risk in 2013
  Possible repetition of a vicious cycle: Crisis→Ad-hoc measures→Short-term policy effects → Recurrence of crisis
- Global economic fundamentals may not improve due to the US fiscal cliff, China's hard landing, worries about Iranian oil price hike, and stronger protectionism

Top 5 Global Risks



World Economic Outlook

□ **Delayed recovery in fundamentals and continued slow growth are expected due to the faltering global economy in the presence of the eurozone crisis, the US fiscal cliff, etc..**

○ Global GDP growth is projected to be 2.4% year on year next year (PPP basis, 3.1%), same as this year, due to fiscal austerity in advanced countries and falling consumer/investor sentiments (2013 growth rate ; 1st half 2.2%, 2nd half 2.6%)

○ As high unemployment continues in the west, fiscal tightening is delaying their domestic recovery and will cause unavoidable slowdown in global trade and industrial production until the first half of 2013

○ Since September 2012, QE3 in the US, the ECB's unlimited bond-buying programs, and more quantitative easing (QE) by the Bank of Japan (BOJ) have been implemented, but such measures are anticipated to have limited policy effects due to fiscal tightening

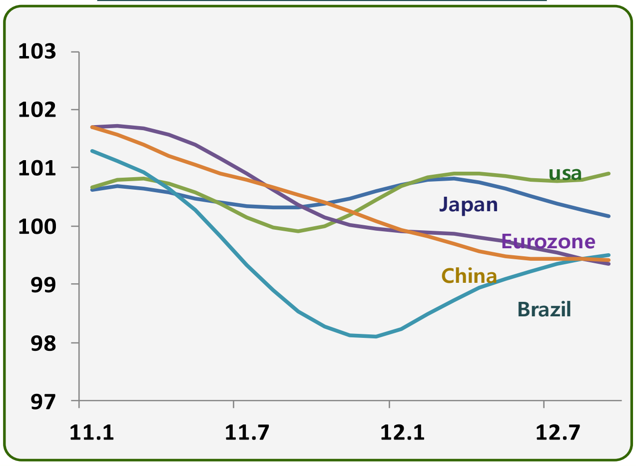
□ **Worries of a double dip in 2013 in the presence of the risks of the eurozone crisis, US fiscal cliff, China's hard landing, stronger trade protectionism, and the Iran oil problem to become reality**

○ Insufficient global policy cooperation on the eurozone crisis may bring a vicious cycle of 'Crisis→Ad hoc measures→Short-term policy effects→Recurrence of crisis'

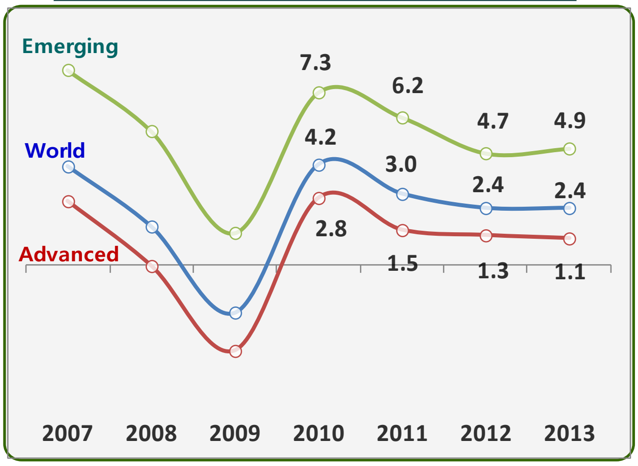
○ Failure of a fiscal deal in the US Congress early next year will result in upheaval of the US economy that will worsen the global economy and make financial markets volatile

○ Although there is a low possibility of a Chinese hard landing, potential conflict among new leaders following China's leadership transition will make it hard to control internal and external risk factors

Leading Economic Index



Global GDP Growth Forecast(%)



- **Deterioration in the real economy due to fiscal austerity to cut excessive debts in advanced economies, falling household and industrial confidence, and prolonged high unemployment**
  - US: GDP growth in 2013 is forecast to fall from last year to less than 2% due to the US fiscal cliff and the prolonged eurozone crisis that would contract consumption and investment
  - Eurozone: Continued recession is forecast next year under a vicious cycle of increasing government debt and stagnation in the real economy
  - Japan: Despite stimulus measures, fading demand for earthquake recovery which led the market recovery this year, and increasing government debt will lead to another drop in GDP growth to mid 1% next year

- **Developing countries will show a slight recovery due to domestic demand increase from policy interest rate cuts and other stimulus measures, although a recovery in exports are delayed in the presence of global downside risks, including the eurozone crisis.**
  - China: Exports, accounting for about 30% of China's GDP, will likely slow down. However, the effects of stimulus measures after the leadership transition will slowly take effect, and its GDP growth is expected to remain around 7.9% in 2013.
  - India: India's GDP growth is projected to be 6% next year due to fiscal consolidation, delayed investment reforms, and agricultural woes triggered by the weaker monsoon.
  - Indonesia: High GDP growth is unlikely sustainable in 2013 due to worsening external conditions, but gradual improvement in private consumption and investment are expected to pick up the Indonesian economy after the second half of 2013.
  - Brazil: We expect Brazil's recovery with a 3.8% GDP growth thanks to the 2014 World Cup, and fiscal and monetary stimulus, such as continuous interest rate cuts, tax reductions, and infrastructure investment.

Real GDP Growth Forecast of Key Regions

(%)

	2011	2012	2013
World	**3.0**	**2.4**	**2.4**
Advanced countries	1.5	1.3	1.1
USA	1.8	2.0	1.8
Eurozone	1.5	-0.5	-0.5
Japan	-0.7	1.8	0.5
Asia (excl. Japan)	6.7	5.6	5.8
China	9.2	7.7	7.9
India	6.9	5.1	6.0
Indonesia	6.6	6.1	6.4
Vietnam	5.9	5.1	5.4
Thailand	0.1	5.4	3.5
Central/South America	4.1	2.8	3.6
Brazil	2.7	1.6	3.8
MENA	3.1	3.2	3.6
Africa (Sub-Saharan Africa)	4.8	4.9	5.1
Russia	4.3	3.8	3.8

Korean Economic Outlook

☐ **Korean economy likely have 3.0% GDP growth due to slower export performance, lower consumer confidence, and investment slump stemming from continuously slowing global demand**

○ Exports will only have single-digit growth due to the weak recovery of the global economy. A strong Won will reduce trade surplus and decrease the current account surplus.

○ Growth in private consumption is expected below GDP growth because of delayed improvement in real household income and the burden of high household debt.

○ Facilities investment is expected to be picked up just by around 5% because of weak export recovery and ongoing internal and external uncertainties.

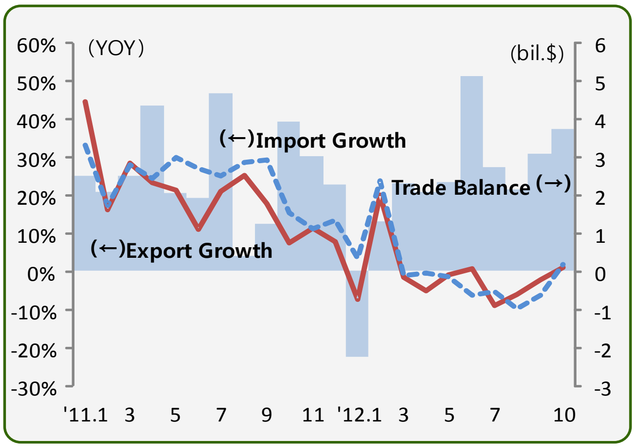
○ Construction investment is expected to increase to a mere 1% despite stagnation in housing market and drop in new SOC orders, because of the implementation of non-residential construction and pre-made orders for civilian plant construction.

☐ **The drop in Won-Dollar exchange rate is expected to be limited due to the US fiscal cliff and the prolonged eurozone crisis, despite an influx of foreign investment and current account surplus. The interest rate is expected to stay low.**

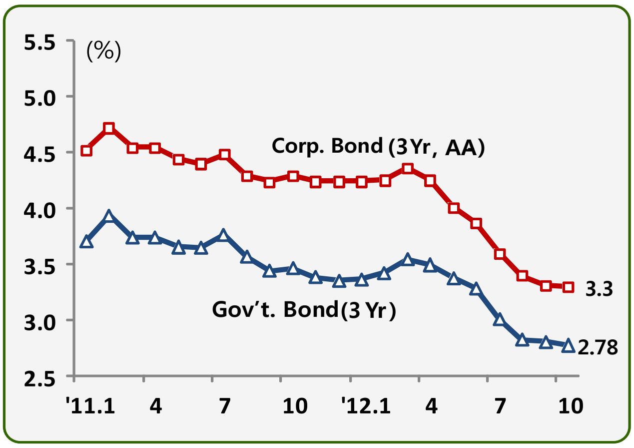
○ The won-dollar rate is on a downward trend due to a recession-type current account surplus and the influx of foreign investment following QE by major countries, but the decline will be limited by the unsolved eurozone crisis and market volatility (2013 avg. 1,080 won).

○ The anticipated economic slump will bring further interest rate cuts, and the market rate for treasury bonds, etc. will remain similar to that of 2012 (3 yr bonds yearly avg 3.3%).

Import/Export & Trade Balance



Govt. Bond & Corp. Bond



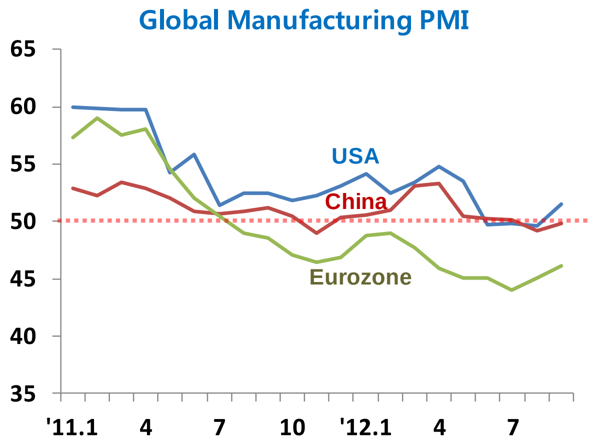
2013 Korean Economic Outlook

(Unit : % YoY)

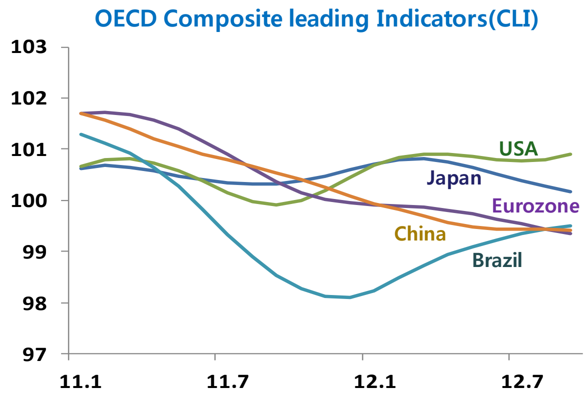
	2011	2012			2013		
		1H	2H	Annual	1H	2H	Annual
GDP Growth rate	**3.6**	2.5	2.1	**2.3**	2.8	3.2	**3.0**
Private Consumption	**2.3**	1.3	1.4	**1.4**	2.2	2.8	**2.5**
Facilities Ivestment	**3.7**	2.2	-1.3	**0.4**	4.6	7.0	**5.8**
Construction Investment	**-5.0**	-0.6	0.6	**0.1**	1.2	1.8	**1.5**
Exports(customs)	**19.0**	0.5	-2.2	**-1.1**	3.8	7.9	**5.8**
Imports(customs)	**23.3**	2.3	-2.3	**0**	5.2	10.2	**7.7**
Current Account (US$ 100 mil.)	**252**	137	191	**328**	80	90	**170**
Unemployment Rate	**3.7**	3.6	3.0	**3.3**	3.1	3.4	**3.3**
Consumer Prices	**3.0**	2.7	2.1	**2.4**	2.9	3.2	**3.0**
Bonds (3 yr)	**3.6**	3.5	2.9	**3.1**	3.1	3.5	**3.3**
Won/Dollar Exchange Rate	**1,108**	1,142	1,112	**1,127**	1,088	1,072	**1,080**
Dubai Oil price(US$)	**107**	111	109	**110**	112	115	**113**

World Economy Faces Sluggish Growth with Persistent 5 Global Risks

"Prolonged Eurozone crisis worsens slump in the global real economy"



Source : Bloomberg



Source : Bloomberg

Worsening global economic slump, particularly in manufacturing

The slump that began in 2H 2011 has been worsening until 4Q 2012. China's GDP growth, which was above 9% in the past, fell to below 8% in 2Q for the first time after the financial crisis, and in Q3, it fell further to 7.4%. In Japan, 3Q growth sharply declined to -3.5% YoY with demand for earthquake recovery diminished. The eurozone in crisis witnessed negative growth for every quarter. The US economy in 3Q rebounded slightly to 2.0% YoY, but declaring the start of a recovery is premature. The global economic slump still continues, especially in exports and manufacturing. Most regions in the eurozone had negative export growth and industrial production has been severely constracted.

5 global risks still to threaten the world economy in 2013

The worsening economic slump is mainly attributed to global risks, such as the eurozone fiscal crisis. Even after the ECB announced unlimited bond-buying programs in Sept. 2012, worries persist about Greece's exit from the eurozone. There is an increased probability that Spain would request a full bailout. The risk of the US fiscal cliff is causing anxiety to global financial markets after the US presidential elections. Failure of a bipartisan agreement between Democrats and Rebublicans will threaten the world economy next year. China's expanded domestic demand and stimulus policy will bring slow recovery. If the new leadership fails to control internal and external risks, a recession seems likely inevitable is inevitable. Also, a slow recovery in the 2013 world economy is threatened by trade protectionism, currency wars and oil price spike caused by the likelihood of the Iran missile crisis.

"Worries about a long-term slump in the face of global rebalancing and the fiscal woes of the advanced economies"

2013 Growth Prospects

(%)

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World	3.0	2.4	2.4
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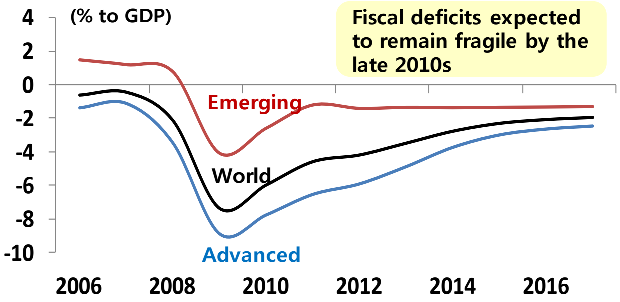
Source : POSCO Research Institute

Mid-term Forecast on Fiscal Balances in Advanced & Emerging Countries



Source : IMF

2.4% global GDP growth in 2013 with continued of slump

The big cuts in government spending by major countries will cause 2.4% economic growth in 2013, similar to 2012. The eurozone countries in crisis and other advanced countries, including US, are expected to beef up fiscal consolidations through tightening policies. There is a high risk of long-term high unemployment in advanced countries and a drop in the household debt that triggered global financial anxiety is slow to come about. So the momentum for recovery is also not to be expected in 2013.

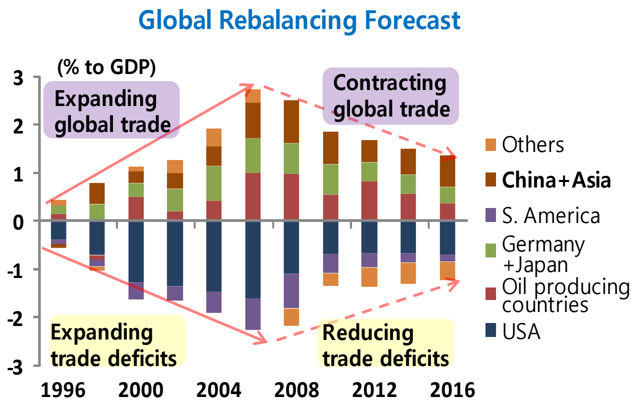
Global financial markets will be faced with chronic anxiety due to the lack of policy coordination on the eurozone crisis and the fiscal drag in US.

Slight rebound in growth in developing countries but delayed fundamental recovery

With China's 7.4% GDP growth in 3Q 2012, developing economies are expected to be sluggish. Thanks to increased domestic demand and stimulus measures by developing countries next year, their growth in 2013 is expected to improve slightly compared to the year 2012. However, the tendency for the re-coupling of advanced and developing economies and sluggish exports to the developed countries makes it difficult to expect a recovery in the developing countries.

Worries about losing recovery momentum with widespread risks

In Oct. 2012, the IMF expected major countries' financial troubles to continue in the long-term until late 2010s. This means it is difficult for them under



Source : IMF, POSCO Research Institute

financial distress to implement a massive stimulus as they did for the 2008 financial crisis. Rebalancing to solve global imbalances will also negatively affect the world economy. World trade continuously increased up to 2007, although the trade deficits of the advanced countries, including the US, widened. After the crisis, the advanced countries increased exports to lower their deficits but this only contracted the global trade and brought continued trade imbalances. If growth is not bolstered by reduction in over-consumption in the advanced economies, and expanded domestic demand in developing economies, resetting the global imbalances will be difficult and the global economic slowdown will most likely become prolonged.

“Difficult resolution of Eurozone crisis given major political uncertainties like the upcoming German election”

Eurozone fiscal crisis— the biggest risk for 2013

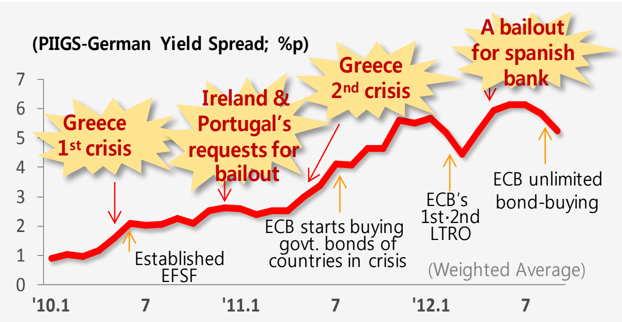
Since 2010, the eurozone fiscal crisis has repeated itself. In 2010, there was the 1st Greek crisis, and Ireland and Portugal requested bailouts. In 2011, the 2nd Greek crisis occurred. In early 2012, there were high hopes for a resolution to the eurozone crisis, but Greece again went into crisis in May and even Spain requested bailout to save its banks.

The economic slump in Europe continues centered on southern Europe, which in the epicenter of debt crisis, and their overcoming it of their own power seems to be difficult. The funds needed by Italy, Spain, etc. in 2013 are expected to be over 20% of GDP. So the eurozone crisis is likely to remain as the biggest risk to the world economy in 2013.

Just treating symptoms repeats crisis

The EU and the ECB have implemented various policies as the eurozone crisis became worse. The

Eurozone Crisis Timeline

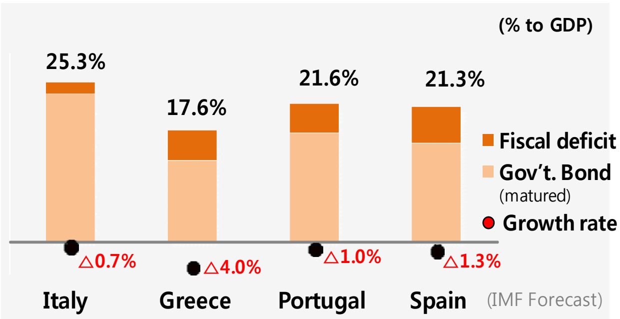


Source : Bloomberg, POSCO Research Institute

EFSF was founded in 2010 and from ESM was estiblished in 2012 to provide financial assistance to members of the eurozone. The ECB implemented interest rate cuts and gov't bond purchases, but breakthrough measures such as issuing Euro bonds and financial alliances are required to resolve the crisis. As Germany, which has ultimate authority over a resolution, has the election in Sept. 2013, there will be a recurrence of political uncertainty in the eurozone in the second half of next year.

No outstanding measures with lack of policy coordination within eurozone and possible Greek exit within 2 years

2013 Financial Requirements for Countries in Crisis



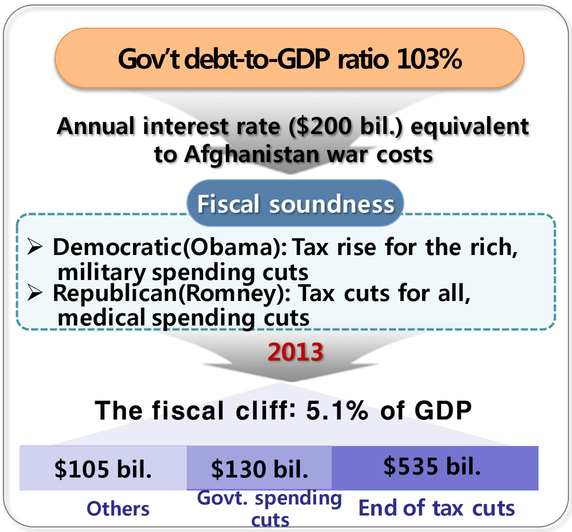
Source : IMF

In the 1st Greek general election held in May this year, opponents of tightening gained ascendancy and an attempt to form a coalition failed, leading to worries about default and eurozone exit, which even spread to Spain. Greek 10-year bond yields soared again into 30% and Spanish 10-year bond yields hit 7% danger level

In the 2nd election in June, thankfully the New Democracy Party, which welcomed tightening, won and QE started in Sept. and the Greek risk was mitigated in the short term. However, their poor financial straits and economic stagnation seem to make the tightening measures difficult to be implemented as agreed. If the implementation of austerity policy stops, market anxiety will linger with worries over a Greek default and orderly eurozone exit.

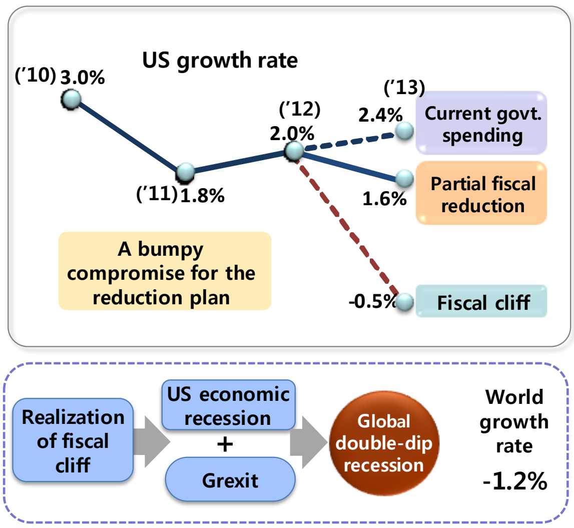
"The most likely scenario is that a cataclysmic end can be avoided by a political agreement on US fiscal tightening level, but market anxiety will be unavoidable"

$770 bil. US fiscal tightening to come in 2013



Source : POSCO Research Institute

The Impact of Failed Deficit Reduction Plan



Source : POSCO Research Institute

US federal debt after 2008 approaching wartime level

Federal debt has drastically increased due to expanded govt expenditures and 3 rounds of QE. At the end of 2011 the debt-to-GDP ratio was 67.7% and 102.9% including state govts and public debts. The Obama administration had active fiscal policies, including bad asset purchase and enforcement of the Reinvestment Act of 2009 ($782.7 bil.) and the Tax Relief and Job Creation Act of 2010 ($857.8 bil.). This increased fiscal deficits led to rising gov't debt. Three rounds of QE also continued to increase debt.

US in facing "fiscal cliff" without a bipartisan agreement by early next year, tax reductions will end and gov't expenditures will be automatically cut, which causes the economy to contract and possibly lend to recession. The US will need $770 bil. of tightening next year, accounting for 5.1% of GDP. Tax reductions and salary tax cuts given by the Bush administration will expire this year, and income deductions will shrink. As the Democratic and Republican Parties failed to agree on tightening in Nov. 2011, $110 bil. per year (total of $1.2 tr.) will be constricted until 2022, and emergency unemployment benefits will be cut.

The US fiscal cliff likely to pull down world economy

The CBO submitted two analysis reports on the fiscal cliff in May and Aug. 2012, in which it emphasized the importance of the Houses. In the August report, the CBO predicts that GDP growth will drop by 1%p to negative 0.5% in 2013, if the fiscal cliff materializes. The report warned, "The US fiscal balance and economic outlook depend on whether the Houses will accept the expected fiscal and tax policy changes or change them."

The IMF has also lowered US growth forecast, and warned of negative growth under the fiscal cliff.

IMF Managing Director Lagarde says, "The US cliff will threaten the global economy in the short- and mid-term."

The most likely scenario at present seems to be that the Democrats and Republicans will reach a consensus on tightening and avert a disaster. However, short-term market anxiety will be unavoidable due to uncertainty in the negotiation process. Failure to reach agreement cannot be excluded, in which case the US economy will undergo a shock and cause anxiety over international financial markets.

"It is very important how Chinese new leaders overcome internal and external risks"

China's Internal & External Risks

Source : POSCO Research Institute

Low chance of a hard Chinese landing, but poor risk management creating worries of economic slowdown

Recently, China's exports have significantly slowed because of the economic slowdown in the eurozone—China's largest export destination. China has policies for activating exports, including value added tax refund, but recovery in exports is difficult given the lackluster global demand. And a long-term slump in real estate cannot be excluded following the govt's curb on real estate speculation.

Another major risk for the Chinese economy is overcapacity following excessive investment-driven growth. The govt adopted restructuring through industrial policies, but overcapacity is highly likely to become a chronic problem in response to local govt's resistance to loss in tax revenue. The widening gap between the rich and poor after the financial crisis is also causing social unrest. The govt endeavors to stabilize the regime by raising the minimum wage but this is driving up labor costs.

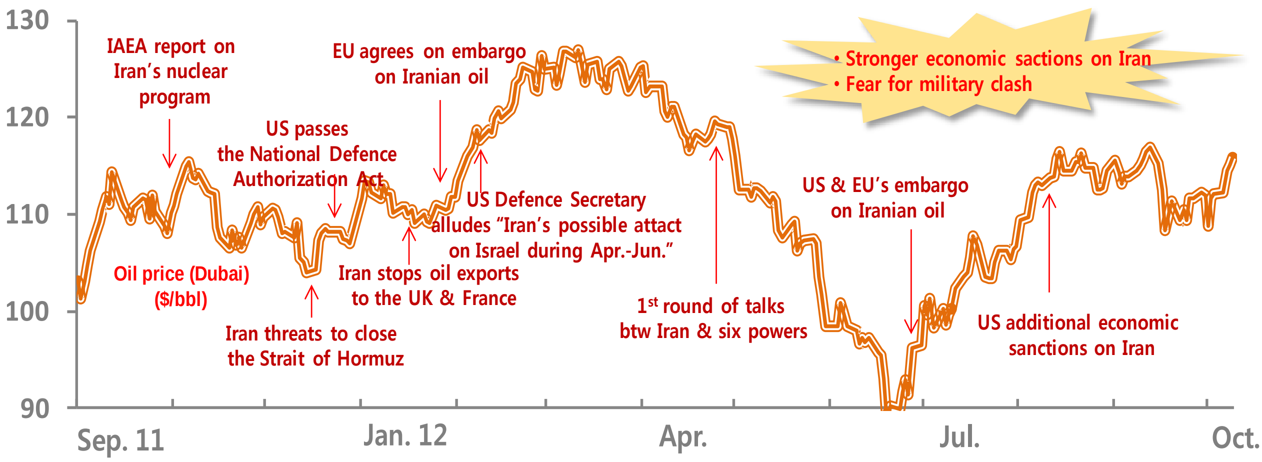
China's stable growth is also threatened by political leadership that could be weaken after the leadership change. After the leadership change in Nov. 2012, there is a risk of internal bickering, especially between the Crown Prince party and the Gongqingtuan on the economy, raising worries about failed policies.

"Low probability of a solution to the Iran nuclear crisis in 2013"

Risk of oil price surge due to Middle East tension over Iran

Around the US presidential elections, the political circle increasingly called for more sanctions on Iran. The Rep. candidate Romney favored strong US leadership and the necessity for military action, and Obama has also spoken out strongly. The Israeli P.M. says if the US does not take action on Iran, they will. Israel also strengthened P.M's power for swift decision making on attack. Iran proclaimed that it would attack nearby US military installations in response to an Israseli strike on Iran. If hardliners win the Iranian elections in June 2013, the situation could become worse. In any event, resolving the Iran's nuclear crisis next year is unlikely and there will be continued anxiety over the oil price.

Iranian Nuclear Crisis & International Oil Price



Source : POSCO Research Institute

"Trade protectionism and currency wars possibly forming a new global trend in 2013"

Increased trade protectionism because of the financial and fiscal crises

After the financial crisis, trade protectionism has increased. There were only 2,001 protectionist cases in Nov. 2008, but the number increased by 429 to 2,430 in late first half of 2012. This is because many countries saw improving their own exports as a breakthrough to economic recovery under the ongoing economic slowdown.

Advanced countries strengthened trade protectionism by recourse to their domestic laws on anti-dumping, countervailing duties, safeguards, anti-monopoly, and technological standards, to detract from the competitiveness of overseas competitors. In response, developing countries took measure of limiting import volume and increasing import duties, etc. This trade protectionism will become a trend in 2013 to damper global trade and economic recovery.

Spread of global trade protectionism

- ❖ Advanced countries capitalize up on domestic laws on anti-dumping, countervailing duties, safeguards, anti-monopoly, technology standards
  → Weaker in competitive foreign corp.
- ❖ Emerging countries limit import volume & increase import duties
  → Utilizing for import restrictions

Source : POSCO Research Institute

QE results in currency wars between 1st and 3rd world

In the second half of this year, advanced countries implemented large-scale QE to bring about economic recovery. The ECB started unlimited bond-buying on Sept. 6th and the Fed announced to keep interest rate near 0% for a extended period until mid-2015 and will buy $40 bil. of mortgage securities per month indefinitely as part of their 3QE. In Sept. and Oct. Japan extended its QE by purchasing ¥10 tr. of long-term bonds and ¥10 tr. of short-term bonds, for a total of ¥21 tr. Advanced countries' such QE measures aim not only at addressing their financial troubles but at responding to developing countries' strong currencies.

Fear for Currency War

Advanced	Romney is pledging to designate China a currency manipulator → triggers tension btw US & China
Asia	Slowing growth momentums of export-driven economies
BRICs	Resource-rich countries(Brazil, Russia, Australia) criticizes Adv. countries' monetary policies

Interest rate cuts in emerging countries (Oct)

- Australia: A 3-year low (3.5% → 3.25%)
- Brazil: An unprecedented low (7.75%→7.5%)
- Korea: Twice this year (3.0%→2.75%)

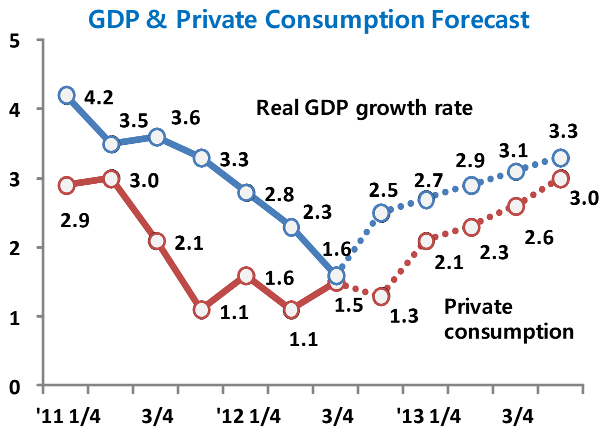
Source : POSCO Research Institute

Recently open currency scuffles are drawing attention. Having China named a currency manipulator, Republicans are provoking China and developing countries. In response, resource exporters like China, Brazil, Russia, and Australia will decry the 1st world's monetary policies. Also, Brazil, Australia, etc. have lowered interest rates to prepare for their strong currencies.

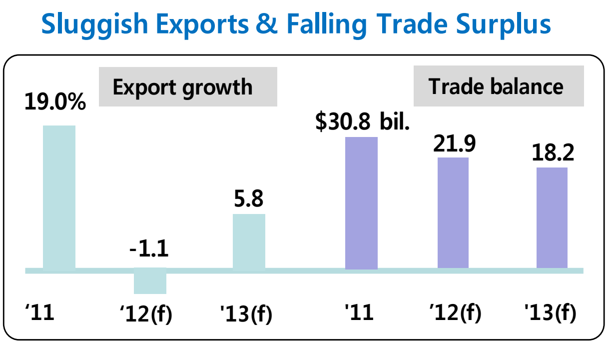
The currency debate has not yet reached its height because of the need for international cooperation to tackle the eurozone fiscal crisis. However, if the slump continues and corporate performance reports continues to be bad next year, the fight over currency and trade protectionism, including WTO suits, will be aggravated.

The Korean Domestic Economy in Continued slump Next Year

"There are 3 domestic downside risks: a dramatic drop in exports, continued sluggish consumption, and increased household debt."



Source : POSCO Research Institute



Source : POSCO Research Institute

The domestic economy assaulted from a double whammy—bad domestic and global demand

On the internal front, gov't private consumption will continue to come in below that of GDP. In 3Q 2012, domestic growth was 1.6% and private consumption 1.5%. The growth at around 1% continued for the four consecutive quarters, from 4Q 2011 to 3Q 2012.

The private consumption-to-GDP ratio has recently continued to drop; private consumption averaged 52% over the last 3 years but has recently dropped to 49%.

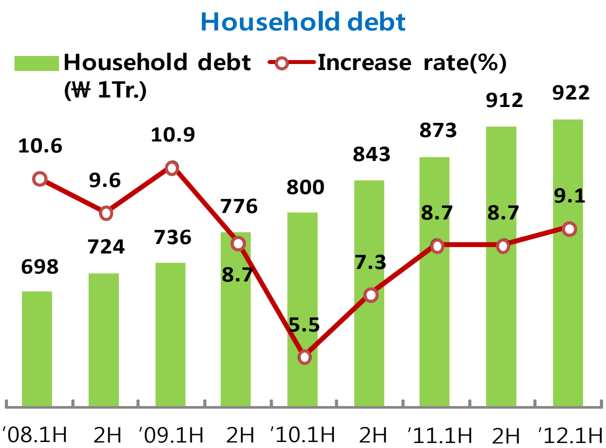
On the external front, the drop in exports is expected to continue. Since an economic recovery will remain distant in advanced countries in 2013, exports will continue their single-digit growth. Considering the 19% growth in exports in 2011, this can be considered a weak rebound triggered by the base effect. Accordingly, the positive balance of trade in 2013 will be below $20 bil., slightly less than 2012.

The influence of the world economic slump and downside risks lead to 3.0% growth next year

The domestic economy in 2013 will be influenced by the continued worldwide economic slump and downside risks and as a result experience low growth.

The three downside risks the domestic economy faces are a drop in exports, a slump in consumption, and household debt. The ongoing slump in exports will continue to worsen corporate profitability. This will be accompanied by investment drying up as companies shy away from investing. Second are worries about continued sluggish consumption as worries about long-term economic stagnation reduce consumer sentiment. There will be a drop in real income which will restrict consumption of house poors. Finally, an increase in household debt is potentially the largest cause of concern for the domestic economy. If real-estate transactions reduces and prices do not move or drop, bankruptcy will increase among house poors. These events could lead to a complicated downturn in domestic financing and the real economy.

"Household debt will restrict consumer sentiment; including public debt, Korea's debt will top 60%"



Source : the Bank of Korea

The increased burden of household debt because of continued real-estate stagnation

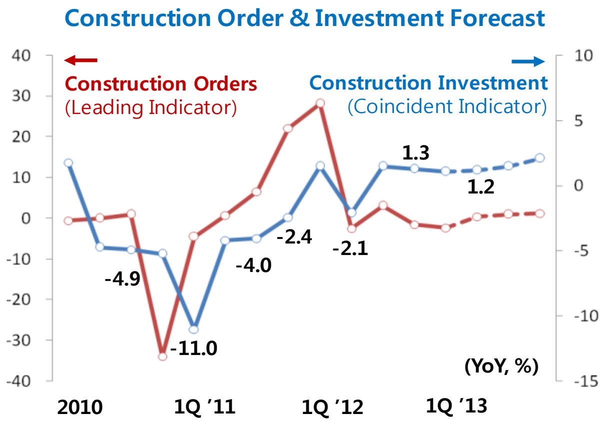
The speed of increase in household debt continues to be fast. Household debt was \800 tr. in late first half of 2010, but increased to \922 tr. in late first half of 2012. The rate of increase over the same period almost doubled, from 5.5% to 9.1%.

The household default rate is also on an increasing trend along with accumulated household debt. The default rate in late first half of 2010 was 0.61% and has slowly edged up to 0.92% at the end of Sept. 2012.

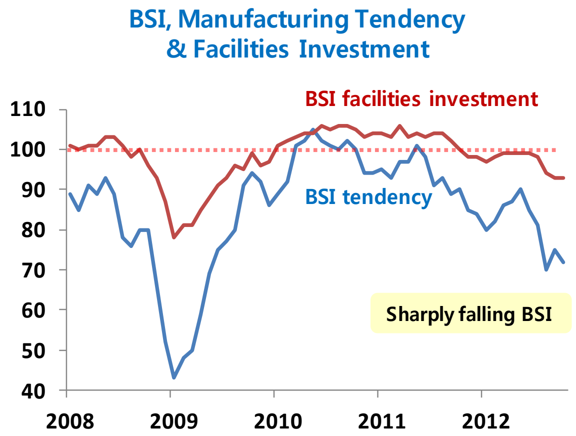
The reason for the increase in the default rate and the debt is real estate stagnation. The value of a home may become less than what it was bought for, leading to the increase in the number of house poors. Real-estate stagnation and the drop in housing prices not only constrict consumer sentiment but also bring more negative wealth effect.

The long-term construction investment slump and restricted facilities investment because of economic uncertainties

The construction investment slump is expected to continue into 2013 because of real-estate stagnation and fewer new SOC orders. Building investment

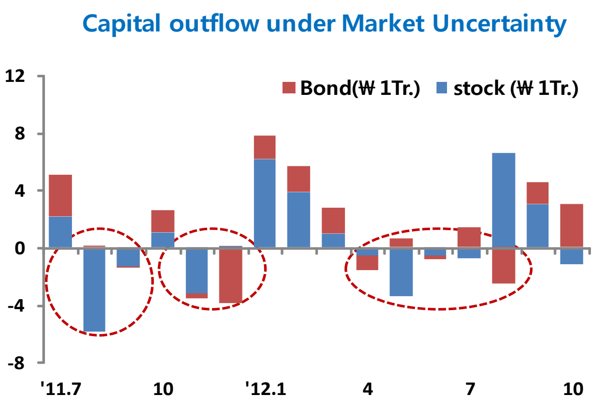


Source : POSCO Research Institute



Source : BOK

"External uncertainty in 2013 expected to cause a limited amount of drop in the Won/Dollar exchange rate"



Source : The Financial Supervisory Service

may be able to shift towards the non-residential type with central gov't relocation to Sejong City and other countryside. Next year's budget allocation for SOC investment is \23.9 tr., a slight increase from 2012. With the implementation of this year's orders for civilian plant construction, however, total construction investment is expected to top in the mid-1% range.

Facilities investment growth is expected to show a 5% increase in 2013 because of growing uncertainty among business investors. The BSI manufacturing index recently taken a sharp drop and the BIS facility investment index has also dropped by a wide amount. This is expected to continue for a while. Because company performance will be hard to improve given the single-digit growth in exports in 2013, businesses will most likely shun facilities investment. Facilities investment has been in a slump after the financial crisis. With facilities becoming obsolete rapidly, the continued constriction of investment will inevitably drag down growth.

The increased debt of public corporations expected to threaten fiscal soundness

Korea has a small amount of gov't debt compared to major countries. For the USA, on the verge of dropping off a fiscal cliff, govt debt at the end of 2011 was 103% of GDP, whereas Italy and Japan gov't debt-to-GDP ratio reached 120% and 230%, respectionly. So Korea's 34% ratio is not yet anything to be worried about.

However, when the debt of public corporations is included, this ratio is in the upper sixties and deemed to have surpassed the threshold level. A high level of public debt in a low-growth period can damage the flexibility for the gov'ts further (fiscal) stimulus a gov't has in making injections. In the mid-term, 41 large public corporations will continue to increase their debt, pointing out the need for thorough management of gov't debt.

Even with a current account surplus and capital inflows, limited bullism on the Korean Won because of the eurozone crisis

In all likelihood, there will be a positive current account balance and the real economy will experience continued capital inflows in 2013. So there are good reasons to be bullish on the Korean Won, given advanced countries' large-scale QE resulting in foreigners buying stocks and bonds. However, Greek secession and Spain's request for a full bailout are creating anxiety in the market, repeating capital outflows. KRW/USD will remain volatile and a limited downturn is to be expected in 2013 (yr. avg. 1,080 won).

2013 Foreign exchange rate outlook

	2011	2012(f)	2013(f)
KRW/USD	1108	1127	1080
USD/EUR	1.39	1.28	1.30
JPY/USD	80	80	82

Source : POSCO Research Institute

The next govt to soften its approach towards N. Korea, but uncertainties in the N. Korean regime posing a risk

N. Korea attaches importance to domestic political stability. First, the dismissal of Lee Youngho, repatriation of N. Korean soldiers, etc. show that if there is any slack in discipline, there will be a military crackdown. Second, they are focused on improving the economy. The '6.28 New Economic Management system', which includes bestowing autonomy on rural areas, has produced no visible effects. Third, they will emphasize the stability of popular sentiment.

They are focused on internal stability, and this is expected to make N. Korean risks eased in 2013. With the US-N. Korea talks at a standstill, the China-N. Korea relationship is ripe with strife, plus the 3rd missile test is making the resumption of talks difficult. Considering S. Korean presidential candidates's commitment to N. Korea, the next administration's N. Korean policy will become softer and inter-Korean economic cooperation will be likely developed.

Conflicts in N. Korea's 3-party relations

- Stalled N. Korea-US talks

America's stronger distrust against N. Korea following missile launch in Apr. 2012

A hard-line stance on N. Korea's provocation (S. Korea-US military drills)

- Potential conflicts btw China & N. Korea

Mixed opinions on N. Korea's reform and opening-up even after high-ranking agreement (Jang Sung-taek's visit to China)

A possibility for the 3rd nuclear test, request for acknowledging N. Korea a nuclear power

Conflicts in border areas, N. Korea's stepping away from China

- S. Koreans' stern attitude toward security