

The beginning of the end

GLOBAL ECONOMY



Mauro Guillen
Wharton School professor of management
Emilio Ontiveros
Universidad Autónoma de Madrid professor

and the specter of a breakup of the monetary union has receded.

The ECB has committed to buying unlimited amounts of its sovereign debt of up to three years' maturity to stabilize the markets and keep risk premiums at manageable levels. This is a bold decision, especially taking into account the adamant opposition of the German Bundesbank. This is the first time that the ECB has made a momentous decision against the will of the very institution that served as its template when it was founded in the late 1990s.

It is a mystery to us why the ECB has waited so long to make a decision that could have avoided the turmoil in the markets over the last year. In delaying decisive action, the ECB has put the monetary union, and perhaps the entire European Union, at risk. Moreover, the recession has been prolonged, perhaps unnecessarily. Unemployment has soared across the eurozone, with the notable exception of Germany.

The creation of a second bailout fund, the European Stability Mechanism (ESM), represents a big achievement for German Chancellor Angela Merkel. This fund will have 500 billion euros ready to be used in case of emer-

gency. The first beneficiary will be Spain, which before the summer negotiated a line of credit of up to 100 billion euros for several of its banks. In the absence of the ESM, this money would have computed toward Spain's sovereign debt burden. Now the banks can borrow directly from the fund.

Another welcome development is the creation of a single banking supervision authority for the 17 banking systems in the eurozone. This is an important move because banks have a high degree of exposure to sovereign debt. It is important to break the vicious cycle damaging banks' balance sheets as the sovereign spreads rise. The ECB will assume eurozone-wide supervisory powers within months as national authorities give up their powers.

Each of these developments improves upon the rather precarious situation in two key ways. First, they show that European leaders are at long last taking steps toward the creation of a credible financial and banking architecture that can withstand the ups and downs of the economy and the markets. And second, they signal that no member state of the eurozone is seriously thinking about a dismantlement or fragmentation of the monetary union.

The latest news from Europe about

the real economy, however, clearly indicates that the ECB's more forceful approach and the creation of the bailout fund are actions directed at averting disaster. They do not address by themselves the lingering problems with economic growth and unemployment. Europe is almost 20 percent of the global consumer market.

Thus, its anemic economic performance represents a major drag on global growth. The crisis that started in 2008 is the first since World War II in which all members of the OECD, the club of the most developed countries, were mired in a recession for two consecutive quarters, as we point out in our new book, *Global Turning Points*.

We need Europe to overcome its growth problem, especially now that Brazil, China, India and other emerging economies are also seeing their economies slow down. European leaders must not be complacent. Now that they have created a sounder financial architecture for the eurozone, they must address the problem of growth.

Mauro Guillen is a professor at Wharton School. Emilio Ontiveros is president of AFI and a professor at Universidad Autonoma de Madrid. They are authors of *Global Turning Points*, just published by Cambridge University Press.

News Focus

Samsung Electronics and paradigm shift

By Daniel Cho

The Lehman Brothers collapse in the third quarter of 2008 triggered a global economic recession that lasted through the first half of the next year. In the four years that followed, Samsung Electronics achieved the fastest earnings growth among Korean companies.

Hyundai Motor Group also grew sharply during the same period. Similarly, it was Samsung Electronics that posted the most rapid growth during the several-year period that followed the Asian financial crisis of 1997-1998 and the subsequent economic recession. Likewise, Hyundai Motor pulled off strong growth for several years following the US economic downturn in 2001.

What explains the remarkable growth of Samsung Electronics and Hyundai Motor through the two severe economic slumps? Likely answers are as follows.

First, when a severe economic downturn sets in, governments react by implementing stimulus measures. The quickest way to stimulate the economy is to let money flow into consumers' pockets directly and indirectly so that they can buy things (consumption boosting). The case in point is China's subsidies scheme for electronics and car purchases and the United States' cash for clunkers program in 2009. Other countries including Korea induced consumers to spend by offering subsidies and tax breaks. Stimulus creates a favorable environment for companies making things from cars, electronics, and mobile phones to make money. Samsung Electronics and Hyundai Motor did the best job of taking advantage of it.

Secondly, both Samsung Electronics and Hyundai Motor are export-oriented companies, and a weak won against the dollar and the yen provides an ideal condition for increasing profits. The two economic recessions triggered by extreme credit risk events in the past decade prolonged the won's weakness relative to the dollar and the yen over a period of several years, providing a boon for Samsung Electronics and Hyundai Motor.

Samsung Electronics' post-Asian crisis growth spurt lasted until 2004. During the following four-year period, its operating profit declined and its share price underperformed the KOSPI. Shipbuilding, construction, steel, and petro-

chemical stocks in the industrials and materials sectors — so-called China plays — took the shine from Samsung Electronics and Hyundai Motor in 2005-2007.

Paradoxically, the KOSPI's upward march did not begin until after Samsung Electronics, which accounts for the largest portion of the entire stock market capitalization, stopped growing.

If history is any guide, the KOSPI will experience another upward trend, or a re-rating (P/E growth) when Samsung Electronics' growth pauses, which could happen from the second half of 2013. In other words, the KOSPI is likely to trend up starting in the second half of 2013.

By then, Europe's debt crisis will be pretty much over and Korea's stock and currency markets will be set free from Europe's worries.

Breaking with the United States, Europe and Japan dealing with the consequences of quantitative easing, Korea may see its currency appreciating for a long run, creating obstacles to Samsung Electronics' earnings growth. China's large infrastructure investments will likely go into full swing, benefiting exporters of capital goods. As China's fixed asset investments accelerate, Korea's capital goods exporters may relive the boom of 2005-2007.

The financial history repeats itself with some variations. Financial crises and subsequent economic recessions set the stage for rapid earnings growth at consumer-oriented manufacturers such as carmakers and electronics companies — the likes of Samsung Electronics and Hyundai Motor. After they are done with several years' worth of growth, investment-oriented companies (capital goods producers) take over. When capital goods companies grow, bubbles result from excessive capital spending, real estate investment overdrives and oversupply in bank credit because too much optimism blinds sound judgment. That is how a new financial crisis is born.



CFA Daniel Cho is the head of research, Daishin Securities.

Turning point for Korea's financial industry

By Min Byung-hyun

Things have been looking up for the Korean economy. On Aug. 27, Moody's upgraded Korea's sovereign credit rating to Aa3. Soon after, Fitch Rating and S&P also raised their ratings to AA- and A+ respectively. This set of upgrades reflects Korea's robust real economy, strong fiscal fundamentals and its resilience to external shocks, all of which points to the nation's enhanced global standing. The country's recent achievement takes on more significance given that many advanced economies are continuing to struggle with the aftermath of the financial crisis.

Indeed, Korea is faring relatively well. Korea's government bonds are gaining more ground globally as one of the safest bonds in the world. And shares held by foreign investors account for more than 30 percent (needs checking) of Korea's stock market, which is proof that Korea's stock market is one of their key markets. As such, the world is looking at the Korean economy increasingly more positively, and foreign investors are now both willing and eager to invest in this dynamic economy.

However, Korea's financial markets are still lagging behind those of other advanced countries. The financial industry accounts for just 6 percent of the country's GDP, which is smaller in comparison to the United States and the United Kingdom. Global financial institutions in Korea are not conducting core

financial services compared to their offices in leading financial centers such as New York and London, and Korean financial companies' overseas expansion is also at a rudimentary stage.

Recognizing the need to foster the nation's financial markets, the Korean government embarked on its financial hub initiative in the mid 2000s. The idea was that Korea needed a city to serve as a financial hub similar to Hong Kong and Singapore in order to truly advance its financial industry. In 2007, the Creation and Development of Financial Hubs Act was enacted, and, in the following year, Financial Hub Korea was set up in the Financial Supervisory Service (FSS) to promote Korea as an international financial center by attracting global financial companies, supporting overseas expansion of Korean financial companies and improving the financial business environment. Such efforts have paid off. The Global Financial Centers Index ranked Seoul the ninth most competitive city this year, a remarkable improvement from 35th in 2009.

A similar progress was seen at the recent 2012 Financial Hub Seoul Conference, which was jointly organized by the Seoul Metropolitan Government and FSS's Financial Hub Korea. The conference held in Hong Kong brought together more than 200 participants, a marked increase from an estimated 80 participants at the first Financial Hub Conference held three years ago.

There was more than just an increase

in the size of the turnout. At the conference, the participants showed increasing interest in the Korean financial markets, which have continually improved, and praised the leadership of the Korean government and financial authorities in keeping the financial markets safe and sound. They were also enthusiastic about Seoul's endeavors to become Asia's financial hub. But an important question was raised that is worth bearing in mind. "There are already leading financial centers in Asia such as Hong Kong, Singapore and Shanghai. How will Seoul differentiate itself from these cities?"

In order to compete with other leading international financial centers, Korea has improved its financial business environment and infrastructure, including the International Finance Centers in Yeouido in Seoul and Munhyun in Busan. An incentive program was also developed to attract foreign financial companies. Now, the next step for Korea's financial industry would be adopting the "select and focus" strategy. If pulled off successfully, this could represent one of the greatest turning points for Korea's financial industry.

So what to select and where to focus on then? First, the emphasis must be placed on turning weaknesses into strengths. Korea's financial markets are still developing which implies greater growth potential and more business opportunities. Therefore, assuring profitable business opportunities of Korea's sound financial markets will whet for-

foreign investors' appetite to invest in Korea; in fact, foreign financial firms are posting higher return on equity (ROE) compared to their Korean counterparts. The growing pension market will also appeal to foreign financial institutions.

Second, it is vital to make Korean financial companies more competitive. They should shift away from focusing solely on domestic markets toward competing on the global stage. In particular, relatively untapped Southeast Asian financial markets present great business opportunities for Korean firms.

The conditions are favorable both at home and abroad. Foreign investors' perception of our markets is positive, and many of them are actually looking to make an investment in Korea. We shouldn't miss this golden opportunity. If we just step up our efforts now, we can make the dream of creating Asia's No. 1 financial hub here in Korea a reality.



Min Byung-hyun is director of Financial Hub Korea, Financial Supervisory Service.

오늘 오전, 바람 잘 날 없는 김고독 사장의 경영 고민

마는 사람을 많은데, 날 도와주는 사람은 왜 이렇게 없나?

#1

스스로 마당발이라고 자랑하는 김사장. 비결을 묻는 사람들에게 그는 어깨를 으쓱대며 핸드폰을 꺼내든다.

#2

"여기에 들어있는 사람들만도 수 천명이야. 그제 다이 모임 저 모임 할 것 없이 열심히 얼굴을 비춘 덕이지."

#3

이런 그가 신상품 설명회를 주최하며 사람들을 초대했다. 최소 수 백명은 올 거라고 예상한 그는 큰 호텔에서 가장 넓은 장소를 빌렸다.

#4

그런데 이게 웬일인가. 설명회장에 모인 사람은 고작 40명에 불과했다. 사람을 많이 알고 있는 김 사장. 대체 뭐가 문제였을까?

Aha!

여기 바로 그 해답이 있습니다!
5분 안에 답을 드리는
신개념 온라인 지혜상자

Aha!CEO

www.ahaceo.org

스마트폰으로 주소를 입력하셔도 이용하실 수 있습니다.

무료체험 문의) 02-2036-8588