# Palpable fear of a second IMF crisis

KOREAN ECONOMY

**Tim Condon**
ING senior economist

The Asian crisis sensitized Asian policymakers to the dangers of asset price inflation. The U.S. subprime crisis reinforced their determination to avert a real estate boom-bust in their economies.

In Korea there is a palpable fear of a second IMF crisis with households replacing chaebol as the source of over-borrowing and a property price correction replacing a devaluation of the won as the crisis trigger.

Household credit reached 795.4 trillion won ($700 billion), 70 percent of GDP in December 2010.

Mortgage loans comprised a bit more than one-third of household credit and a recent estimate puts unofficial housing loans extended in the form of jeonsei deposits at half of outstanding mortgage debt.

Housing loans including the unofficial ones represent 40 percent of GDP, the same share as in Japan on the eve of its housing bust.

Korea has been able to maintain broad market stability using what we call a kitchen sink approach. The phrase originated in the U.S. during World War II when "everything but the kitchen sink" was melted down to contribute to the war effort.

In Korea everything but the kitchen sink has been used to curb property price inflation.

The main elements are macroprudential regulations limits that vary by area and are adjusted frequently on the loan-to-value (LTV) and debt-to-income (DTI) ratios for mortgage loans and tax policy. But a review of the many housing packages introduced since 2003 makes clear that the authorities will try almost anything.

Since 2003 the nationwide housing price index has grown by a steady 3.9 percent annually and mortgage loans have grown by an even steadier 9.5 percent.

Delinquency rates are low and stable. At the national level Korea looks like a Goldilocks property market, not too hot and not too cold. However, property overheating at the national level is seldom the problem. It is almost always a local phenomenon.

In Korea the Gangnam area in southeast Seoul is an overheating prone area. The Gangnam house price index experienced 8.1 percent average annual growth from 2003 to 2006, more than double the national average.

When he took office in early 2003, former President Roh Moo-hyun made curbing house price inflation a priority and his government promulgated more than 30 housing packages toward that end.

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LTV and DTI ceilings were tightened, a comprehensive real estate tax on expensive condos was introduced and capital gains taxes were increased, especially on sales of two more houses.

Price controls on new apartments, which were lifted in 1999, were reinstituted in 2007. Gangnam's rapid house price inflation finally broke in early 2007 and has averaged 1.5 percent since.

The Lehman crash hurt property markets around the world. Policy in Korea shifted from cooling to boosting the property market.

In November 2008 the authorities removed the "speculative" designation from some neighborhoods in southern Seoul and relaxed restrictions on second home purchases in those areas.

There was further tweaking in 2009 and in August 2010, when the government temporarily lifted the DTI ceiling 50 percent in Seoul and 60 percent in other areas for home purchases of less than 900 million won or about $800,000. However, the 40 percent DTI ceiling in Gangnam was retained.

The August 2010 measures were set to expire at the end of March 2011 and on March 22 the Ministry of Strategy and Finance announced that the sunset provision will indeed apply.

However, noting the need "to boost home transactions," the authorities cut the home purchase tax rate by 50 to 1 percent for homes valued at 900 million won or less and to 2 percent for homes above 900 million and on purchases of second- or more homes.

The price controls on new apartments will be lifted "as soon as possible." Mortgage loans below 100 million won also will remain unregulated.

No one looking at the policy interventions in the housing market of the last decade can think the latest announcement will be the last. Steady application of the kitchen sink approach to property market regulation is the price of avoiding another IMF crisis.

# Resurgence of ASEAN economies

GLOBAL ECONOMY

**Frederic Neumann**
HSBC senior economist

Investors keep talking about China. Understandably. But it's time to broaden the focus. After all, it was not always so. Cast your mind back to the 1990s. At the time, the large ASEAN economies were hailed as the new Tigers of Asia, following the impressive lead of Korea and others towards rapid development.

Alas, the Asian crisis put a swift halt to this. And, as these markets struggled to recover from the crisis, China's emergence as a competitor, with an unmatched abundance of cheap labor, represented an additional, ultimately insurmountable challenge. As a result, ASEAN's star started to fade on the investment firmament. China simply stole the show.

Now, ASEAN is back. The region is finally picking up where it left off in the 1990s: attracting again rising amounts of foreign investment and winning back its fair share in key export markets.

Two factors are driving ASEAN's resurgence. First, these economies have finally put their house in order. Countries such as Indonesia and the Philippines are increasingly reaping the economic fruits of hard-earned political stability.

Vietnam and Malaysia have started to enact ambitious reform programs of late that should ultimately render their economies a lot more competitive. Even Thailand, long grappling with local political tensions, is at last regaining stability to the visible benefit of its economy.

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The second big reason for ASEAN's comeback is that China has moved on. With wages on the Mainland rising by leaps and bounds, Chinese firms that produce everything from toys to shoes and apparel are facing the pressure.

This, of course, is not to say that the country is seeing its export engine stall. Rather, it is now migrating to more sophisticated products such as electronics and cars. Also, we shouldn't overplay the argument of labor shortages in China.

Firms, after all, can still move inland, where costs are lower than in the booming coastal regions. But the trend is unmistakable nonetheless: ASEAN economies are finding their niche again in global supply chains as China vacates their sweet spot.

Consider the numbers. Over the past ten years, real wage growth in China averaged over 12 percent per year, well ahead of countries like Indonesia where wages climbed less than two percent, and Thailand where they barely rose at all.

As a result, average monthly manufacturing wages in China currently stand at over $400, which is nearly twice the level in Thailand, and far above Indonesia, the Philippines, and Vietnam.

Malaysian workers, admittedly, enjoy wages closer to $700, and the country feels Chinese pressure still more than its neighbors. But aggressive reforms, such as opening domestic industry to foreign competition, should help Malaysia boost competitiveness.

Many will object that wage levels, or at least their pace of increase, aren't really the issue. What matters, of course, is productivity, and with China having invested on a massive scale over the past few years, there should be plenty of capital around to make Chinese workers incredibly productive.

But, this view is only correct in part. Abundant investment makes Chinese firms more and more competitive in sectors that are capital intensive, such as steel or car production. However, in labor intensive industries, wages matter much more and it is here that China is quickly exiting the playing field, leaving ASEAN increasingly with the home advantage. Economic stability at home, along with rising production costs in China, will attract investment into Southeast Asia and propel these economies back onto the path of rapid development after a disappointing performance over the past decade.

For investors, this means that ASEAN is providing more attractive opportunities than the already well-understood, and widely exploited, China story.

Korea's firms should pay heed and more actively tap the region's potential. ASEAN, after all, offers a market of some 500 million consumers whoare now starting to regain their appetite.

# Safety comes first for nuclear energy

GLOBAL ECONOMY

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The last month has introduced new uncertainties into the global economy. The military intervention in Libya and the earthquake and tsunami in Japan, the world's third-largest economy, remind us about the many contingencies and risks, and about our inability to fully anticipate and control events.

The scale of the human and economic catastrophe in Japan is especially daunting, especially because of the nuclear crisis unfolding over there.

Nuclear energy has become an essential part of the energy matrix for most industrialized countries. In addition, emerging economies such as China, India and Brazil are increasingly betting on this source of electricity even when they have other alternatives at their disposal. Nuclear represents about 6 percent of the world's total primary energy supply, up from 1 percent in 1973, when the first oil shock hit the global economy.

But when it comes to electricity generation, nuclear power stations now produce 13.5 percent of the world's total, up from 3.3 percent in 1973.

Some countries rely on nuclear power for a quarter or more of their electricity: France (77 percent), the Ukraine (47), Sweden (43), South Korea (34), and Japan (24).

**Governments need to strike a delicate balance between ensuring safety and avoiding a major disruption of energy markets**

The world's largest economy, the U.S., relies on nuclear power for 19 percent of its electricity needs and Germany, the world's fourth largest, for 24 percent. Thus, the global economy cannot do without nuclear power.

The nuclear crisis in Japan will likely lead to moratoriums in the construction of new plants and to thorough reviews of ageing facilities, especially those using the same design as at Fukushima.

Governments need to strike a delicate balance between ensuring safety and avoiding a major disruption of energy markets, which could lead to higher electricity prices, which in turn could further undermine the economic recovery.

It is important to keep in mind that none of the existing ways of generating electricity is perfect: hydro damages the environment and is subject to the effects of draughts; wind is unpredictable; solar is expensive; coal is dirty; gas is less dirty but still pollutes; and geothermal is not scalable.

Brazil has shown the world that there is a future in sugarcane-based bio-fuels for both transportation and for electricity generation (burning the excess bagasse that is not used for making ethanol).

But not all countries in the world have Brazil's potential in tropical agriculture, and corn-based ethanol is not nearly as efficient and its subsidization has led to higher food prices worldwide. Biomass and tidal electricity generation are not likely to become important sources in the medium run.

Nuclear power has many advantages, the greatest of which is that it does not contribute to global warming.

Safety at the power plants and the storage of radioactive waste continue to pose challenges. The unfolding crisis in Japan reminds us that transparency, good planning, and avoiding over-confidence in the promise of technology are essential.

Nuclear power designs need to minimize the potential for unforeseen catastrophic interactions among the various subsystems, and incorporate multiple backup mechanisms, including for cooling, even if the cost goes up.

Regulation and supervision needs to be beefed up. Safety must come first.

At a time when the global economic recovery is still tentative and fragile, energy has once again become one of the key issues. Global political and economic leaders will need to re-examine the technological, economic, and geopolitical aspects of this most pressing problem.

## Man in charge

# Ambivalence toward Obama's praising

**Alexander Jun**
Rolls-Royce regional director

Many Koreans feel a degree of ambivalence toward news reports of U.S. President Barak Obama praising Koreans' extraordinary zeal for education.

Obama correctly identified arduous efforts by Korean parents and society to give the best education to the next generation as a factor behind the rapid development of modern Korea.

But many Koreans worry about the currently installed education system, and often criticize that it only challenges students academically but does not prepare them for work in industry and society.

I don't believe this is an issue to Korea alone. More than 80 percent of high school graduates in Korea enter tertiary institutions, the highest among OECD nations.

Korean youngsters rank high in international academic competitions, such as the Math Olympiad, and overall scholastic aptitude tests.

At the same time, Korea experiences relatively high unemployment rates for students fresh out of colleges.

Industries and employers often express frustration from the quality of students, and they are compelled to provide further extensive training and education.

Subject knowledge taught at schools should not be spurious and but relevant to jobs.

What are the particulars that industries and companies are looking for from supposedly smart and capable graduates?

My company, Rolls-Royce, is a world leading provider of power systems and services for use on land, at sea and in the air.

Its products are used in global markets, civil aerospace, defense aerospace, marine and energy. With such a presence and 105 years of history, the company has many elements of pride and success.

But none has been more important and prominently appreciated than the quality of its people. We have over 39,000 skilled people in over 50 countries, including Korea.

The strength of the company lies in the qualities and faculties of people who are leading the company. We always search for young and upwardly mobile individuals with qualities that will one day make him or her leaders in their field.

Also like here in Korea, it is difficult to find such individuals ready-made before joining the company. That is the reason we have comprehensive leadership training programs that emphasize key attributes essential to our success.

Together, these attributes form what we call our "core behaviour framework."

The first attribute that we emphasize to our young and bright recruits are "courage, integrity and leadership."

Courage to commit oneself to achieve an objective in an ethical and professional manner is the foremost attribute. Without it the true grit of leadership would not be there.

Then what follows is "judgment and common sense" — an ability to analyze a variety of data and information, and use sound reasoning to draw accurate conclusions.

The next trait is "breadth and business understanding."

Only when one has courage to challenge oneself and the establishment and within the sane boundaries of common sense, then one's extensive business understanding becomes important to help develop products, services and strategies to drive growth and profitability.

The fourth is "influence and working together."

The process of achievement is through working together with others and further influencing each other. This would require ability to communicate effectively and adapting one's behaviour appropriately.

**"Good habits are gained only by repeating virtues of good behaviour and meditation. These habits then form characters in an individual. Collectively, an individual's character constitutes the character of an organization and the society."**

With all these attributes, one should then be able to impact positively on business performance through decisions and actions that deliver results, thus the last attribute is "delivering and managing work."

None of these are taught through textbooks and lectures at universities. These are elements of training often found in teachings of Buddhist monks or Christian monasteries or in traditional teachings of Jewish families or Korean "Seowon."

Character, however, cannot be taught or trained overnight, certainly not in any of the "hagwon" proliferating here in Korea.

Good habits are gained only by repeating virtues of good behaviour and meditation. These habits then form characters in an individual. Collectively, an individual's character constitutes the character of an organization and the society they are in.

We need to find ways to put such seeds in the minds of our youngsters of the next generation. This can start from dialogue with our sons and daughters at home, over dinner, and by spending more time with them.

In many cases, such requires behaviour and demonstration of character by the older generations.

Then, we will have many youngsters with courage, sound minds and common sense, and the ability to live together and bring the best out of all society.

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