

# The Korea Economic Slice on KBC (Vol. 1.13)

An Exclusive Report from [Korea Business Central](#) and [DS - Financial Market Analysis](#)

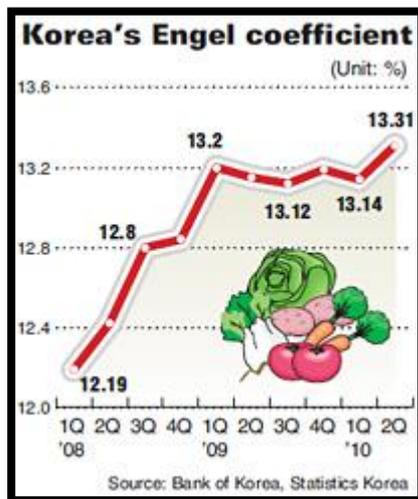
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September 9, 2010

*The Global recession has been dragging on for what seems like ages, as the two-year birthday of the Lehman Brothers failure and the ensuing stock market crash is quickly approaching. Economies are moving forward, mostly with positive rates of growth, but there are open wounds in the hearts and souls of the Planet's people that are becoming infectious and overbearing. One such ailment is the prices of food and the proportion of incomes that are necessary for the sustenance of families and individuals. Korea is experiencing this phenomena even as it touts impressive revisions of growth toward 6% 2010 yearly estimates by the IMF, and it raises the question, "if Korea is truly recovering faster than most, why are its citizens spending more of their incomes on food, and how must the consumers among contracting economies be faring?"*

## Where All the Won Goes...

The ember nursed to flame in this week's "Slice" comes from a Korea Times article, [Engel's Coefficient Highest in 9 Years](#), which identified the trend of consumer outlays by the types of goods purchased.

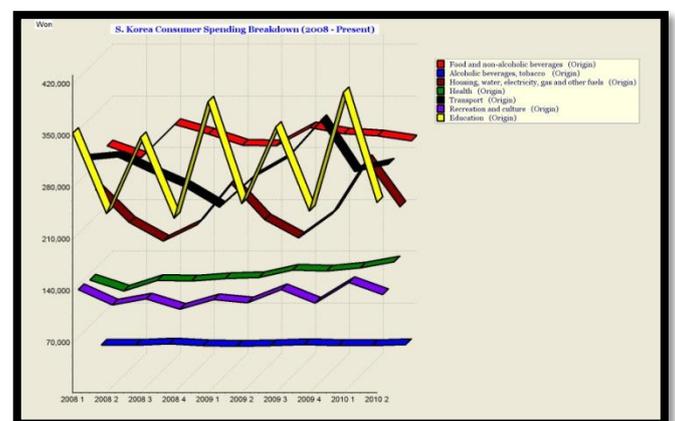


The graph above, compliments of the [Korea Times](#), plots the change in the percent of consumer spending attributed to food purchases. The Engel Coefficient was first developed coined by Ernst Engel, a famous German statistician and economist from the 19<sup>th</sup> century, who began

studying the effects of shifting wages on food expenditures and consumer spending.

From the graph we can immediately tell that the percentage of spending on food, relative to total consumer outlays, is now above 13%. The reading is at its highest since a 13.8% level in the Q3 of 2001, following the Asian financial crisis of the late 90's (Korea Times).

So where are Korean consumers spending the other 86.69% of their money if the percentage of food outlays is rising so dramatically? Take a look at the chart below for a comprehensive view of Korea's quarterly consumer spending trends by category over the past 2 1/2 years. ([Click image to view full size in a new window...](#))



The most apparent surprise from the chart we built, when compared to the Korea Times Engel Coefficient chart, is the contradicting paths of food expenditures. In our chart the survey of *average household monthly expenditures* was used to show real magnitudes of Won spent by consumers, however the Engel Coefficient chart measures the food expenditures as a percentage of total household spending.

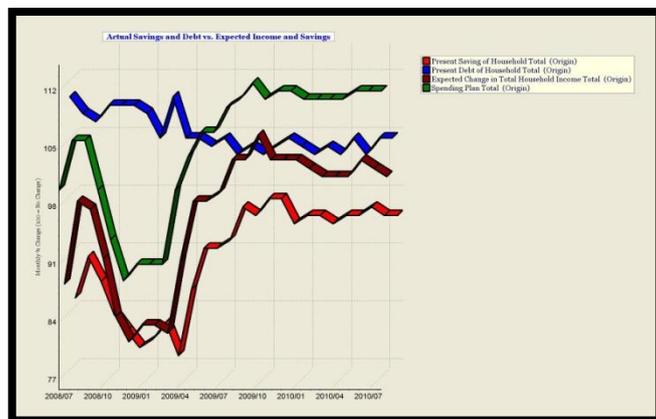
From the charts we see that in Q2 of 2010 the percentage of spending on food rose dramatically, but it seems that actual Won committed to purchasing food declined. We can therefore assume that spending on other items declined more rapidly than spending on food, to make up for the increase in the Engel Coefficient.

From the chart we can tell that Won spent on Housing, Recreation, and Education dipped significantly in Q2, while Health and Transport spending grew slightly and purchases of vice products (alcohol and tobacco) stagnated. We must acknowledge that educational spending is quite cyclically volatile, but that the general trend is towards higher levels, putting pressure on the Engel co-efficient over the longer-term course of the past 2 1/2 years

## Hungry, Thrifty or Neither?

So far we've successfully determined that spending on food has declined, yet the proportion of food spending is growing, thus ruling out the possibility that Koreans are somehow ingesting more food than in previous times. We can also safely say that prices of food aren't to blame for the higher Engel's coefficient, because the actual amount of money spent on food is declining. Higher prices may be contributing to the resilience of overall food spending as other spending falls, but there must be a greater force at work to cause such a drastic rise in food budgeting.

Could it be that Korean consumers have altered their spending plans and are currently spending less overall? Perhaps consumers are saving more of their income or borrowing less on credit?



*Click on the graphic above to expand the chart in a new window, as we answer these questions...*

First, we can see that the average household's savings and debt rates began to narrow to healthier levels starting in March 2009, but then leveled off near the end of that year. Reading the data from the graph, we can tell that households continue to have negative savings rates and take on more debt each month. Here we can see the first signs of stress on the consumer, but it isn't necessarily an explanation for why consumers are spending more on food and doesn't say anything about the overall trend of spending.

Turning to the next two lines (brown and green) we can observe the expectations of the same households that divulged their current savings and debt situation before. The Expected Change in Total Household Income (brown) turned positive near August 2009, but has now declined to a neutral reading. Meanwhile the Spending Plans (green) of the average household turned to an expansion as early as April 2009 and continue to remain quite high near 110 on the scale.

From the looks of the household survey consumers seem to be borrowing more, saving less, planning to spend more, and expecting to earn about the same income moving forward. Simply put, all of these things can't happen at once.

## Engel's Law Doesn't Lie

The Korea Times did a swell job of mentioning the Engel Coefficient and explaining its general definition as it applies to the scope of their article, but it turns out that Ernst Engel was more famous for Engel's Law than for the metric it included.

The Law states that as incomes rise by a certain rate, expenditures on food rise at a slower rate, thus allowing expenditures on other items to rise faster. Conversely, it is also true that as incomes fall, the rate of food consumption falls more

slowly. In terms of the Engel Coefficient falling incomes would translate to an overall increase in the percentage of food expenditures; raising the Engel Coefficient.

With the help of Engel's Law alone, we can assume that in an otherwise unchanging world, incomes should be falling as the proportion of consumer spending devoted to food is rising. Incorporating the survey of households' expectations to spend more and earn less, it is likely that lower incomes and perhaps higher food prices are beginning to have noticeable effects on individual purchasing decisions. We'll soon see whether or not incomes continue this trend in a significant and sustained manner.

*The effects of prolonged recession and depressed global growth rates can be difficult to identify when overall sentiment has shifted to an optimistic attitude. However, we learned today that the actions of the average consumer can tell a great deal about the status of the economy, the consumer market, and even the labor market. If debt levels continue to rise and wages do fall, as surveyed individuals are expecting, we can expect to see the percentage of expenditures on food rise past the previous high in 2001, perhaps as a real decline in overall spending takes hold. Korea has the potential to expand over 6% this year, according to the IMF... Soon we'll know how that growth was dispersed throughout the economy and where Korea's spending habits may lead into the future.*

*All data for proprietary charts are compliments of the Bank of Korea ECOS System.*

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