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North Korea's fragile GDP is 50% trade dependent – implementing 'Singapore Trump Deal' remains inevitable to avoid economic collapse by winter 2018

By Lars Henriksson, Advisory Partner - Southeast Asia & Frontier Asian Economies

Despite the recent disagreements between top negotiating officials from North Korea and the US over the scale and speed of the commitments made in Singapore for a total de-nuclearization of the Korean peninsula – North Korea's need to restore trade ties and save the country's hermitic economy from collapsing by the winter will see Korea ultimately capitulate to most of the US demands. North Korea is surprisingly trade sensitive with nearly 50% of its GDP exclusively dependent on trade. In 2001 only 20% of North Korea's GDP was dependent on trade. The pain of sanctions as well as the hope to emulate other models like Vietnam which successfully combine authoritarianism and economic growth will eventually pull North Korea toward making concessions. This is something often overlooked by pundits covering North Korea as clearly the causation runs as follows: the need for trade is *partly* the source of Korea's sabre rattling and paced intercontinental ballistic missile programme, not vice versa.

At the June 11, 2018 historic summit in Singapore between US President Donald Trump and North Korean Leader Chairman Kim Jong-Un, a slick video prepared by the Trump-team showed how it envisaged the end goal which can best summarized with one word: trade. While western media coverage of the summit was dismissive of the utility of the video, the video apparently made a strong impression on Kim. North Korea is already heavily dependent on trade, and tighter enforcement of sanctions, including by China, will rapidly increase pressure for an adherence to the Singapore deal.

China-North Korea trade fell by 60% in Q1 2018

China is North Korea's pivotal trading partner. In 1Q2018 China's trade with North Korea fell 60% or to $483m compared to the same period last year. The Ministry of Commerce has yet to release 2Q 2018 data, but it will most likely continue to be depressed given the tough UN resolutions imposed on North Korea.

How long can North Korea afford trade slide?

A South Korean lawmaker, Rep Kang Seok-ho of the main opposition Liberty Party said at the end of February 2018, "I received an analysis that, if international sanctions against the North continue like this, all of North Korea's foreign currency earnings and overseas assets will be frozen, and its dollar (reserves) will dry up around October 2018," He didn't elaborate his sources where, but most observers assumed it was from the National Intelligence Service, e.g. the 'South Korean CIA'.

That assessment might be a bit harsh given border smuggling. But that is becoming increasingly tough as various groups use satellites to track ships, which have in the past been the main way to circumvent trade compliance.

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Sebastian Spio-Garbrah
Managing Director & Chief Analyst,
sebastian@daminaadvisors.com

Lars Henriksson
Advisory Partner, Frontier Asia
Lars@daminaadvisors.com

There are also suggestions that the increased Chinese efforts to monitor people using smartphone technology have had an unintended impact. North Koreans, who used to be able travel fairly easily without proper travel documents, are now less able to get around and do their businesses. Indeed it is reported that there are North Koreans who are wives/mistresses of Chinese living close to the North Korean border that are now holed up in remote villages together with their non-documented children.

Crunch time could occur end of this year, coinciding with the winter, when winds from Siberia will keep temperature close to -10C (December through February), and the need for imported oil from China will be the greatest (strictly controlled under Resolution 2397 (12/22/2017) which strengthened limit on refined petroleum products (0.5 million barrels for a year) and crude oil (4 million barrels for a year).

On 12 July, a confidential US report couriered to UN Sanctions Committee stated that at least 759,793 barrels of oil products had been delivered to North Korea during the first five months of the year, well above the annual quota set in a UN resolution at 0.5m barrels. The shipments were said to have been conducted through ship-to-ship transfers using North Korean tankers which had delivered their cargo at least 89 times.

US requested that the UN committee declared that North Korea had violated the UN agreed quote and “order an immediate halt to all transfers of refined products” to North Korea. A deadline has been set at next Thursday (19 July) and it is uncertain how the committee will respond, as China and Russia could block any new measures.

Interestingly, the reported singled out only one foreign ship participating in the scheme: a Russian-flagged tanker, the Partriot, which undertook a ship-to-ship transfer on 10 April, with the North Korean tanker Wan Heng 11. The North Korean tanker then sailed to the port of Nampo in North Korea, docking five days later.

It probably helps to explain response from North Korea following the recent visit by the US Secretary of State Mike Pompeo where local media called the meeting “regretful” and “unilateral and gangster-like demand for denuclearization”.

Chairman Kim has visited China three times this year, and many pundits believe he is taking cues from its large neighbour. The ongoing US-China trade dispute is making any Chinese trade slippage with North Korea less likely as it would be met with fury from President Trump.

Why so little news from Korea since Singapore

There is a paucity of positive North Korean news for another reason. Its closest neighbour, South Korea, has in place an old anti-communist law from 1948 – The National Security Law– which in Article 7 prohibits "praising, encouraging, or propagandizing" on behalf of North Korea but without specifying exactly what that means.

In practice, it blocks and prohibits citizens from directly accessing North Korean websites (and occasionally foreign websites about North Korea) and also interacting with North Korean without government permission. And even case in 2016 when a Korean-American was deported and banned from the country for 5 years after writing in books and giving speeches where she said, “North Korean beer tastes good, and the water of North Korean rivers is clean.”

Interestingly some Chaebols (Korean conglomerates) and banks are quietly building up dedicated investment North Korean teams to get ready to pounce on the economic opportunities ahead. In frontier markets, which are characterised by dearth of reliable information, it pays off to see what the locals do, and we think this case will not be proven much different.

The Vietnam model

Following Secretary of State Mike Pompeo's recent visit to Pyongyang to get Kim Jong UN to give up his nuclear weapons, he made a quick stopover in Vietnam.

In-line with our assessment outlined in the note The Last Frontier Market – The Investment Case for North Korea (June 11, 2018) Pompeo urged North Korea to replicate Vietnam's "miracle" of economic growth by improving ties and said, "The fact that we are cooperating – and not fighting – is proof that when a country decides to create a brighter future for itself alongside the United States, we follow through on American promises." Moreover, "In light of the once-unimaginable prosperity and partnership we have with Vietnam today, I have a message for Chairman Kim Jong-un: President Trump believes your country can replicate this path."

"It's yours if you'll you seize the moment. This miracle can be yours. It can be your miracle in North Korea as well," Pompeo said.

Less appreciated is that Vietnam is itself becoming more tied into the economy of South Korea (and thus ultimately North Korea).

On 5th December 2015 following five years of talks, trade ministers of South Korea and Vietnam inked a free-trade agreement in Hanoi. The agreement simply stipulated that Vietnam was mandated to fully cut import tariffs on nearly 90% of shipments from Korea, while the latter would do the same for about 95% of Vietnamese products. The time period was over the next 15 years, or by 2030.

Stripping it down to its core, Korea promised to include Vietnam in its global manufacturing and service supply chain (and arguably avoid putting too much money/dependence on China), which would allow the latter to get directly plugged into one of the most successful Asian emerging market champions.

The results have been mind blowing.

According to Vietnam's official customs data, bilateral trade rose 51% last year to $66.6bn

In March President Moon pledged South Korea will "contribute" to Vietnam's goal of becoming an industrialized economy by lifting bilateral trade to $100 billion by 2020.

According to the Ministry of Planning and Investment's Foreign Investment Agency, South Korea is the biggest investor accounting for 31.6% of the FDI (followed by Hong Kong and Singapore) with $1.84bn in 1Q2018.

Consequently the Vietnamese stock market has nearly doubled over the last three years. It follows a well-trodden footpath of tiger economies such as Thailand, Malaysia and Singapore, which in the 1980/90s were supercharged by being plugged into Japanese, and Western supply system and saw their stock markets and assets prices roaring.

On 31 May the Russian Foreign Minister Sergei Lavrov made a visit to Pyongyang and invited Chairman Kim to visit Russia. From 23 to 25 June the South Korean President Moon visited

Moscow and Gazprom, the big national gas company, expressed hopes an earlier proposed gas pipeline running through North Korea to South Korea could be built.

On 27 July, the 65th anniversary of the Korean War armistice Chairman Kim may use the platform on this occasion to make a major announcement on de-nuclearization.

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Contact: Stephanie@DaMinaAdvisors.Com

To schedule in-depth Q&A on North Korean potential future investment opportunities

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