

Buddha's Birthday!

Kim Jong-Il celebrates with the threat of war following publication of findings into the sinking of the RoK naval vessel, Cheonan.

May 2010 - Author: Adrian Cowell, Fund Manager

The who-dunnit where the last page is every page, utterly devoid of suspense and surprise; it was... "Colonel Mustard" Kim with the lead piping in the West Sea...

The Republic of Korea has vowed "resolute countermeasures" following publication of the official report into the sinking of the 1,200 tonne Cheonan, a RoK naval vessel. The vessel exploded in mysterious circumstances on 26th March, quickly sinking with the loss of 46 lives. It was in the West Sea off Baengnyong Island, just south of the Northern Limit Line (NLL), the disputed maritime boundary delineating the two halves of the West Sea off the divided Korean peninsula and regular scene of belligerent encounters. An international team of investigators concluded that the Cheonan sank "... as the result of an external underwater explosion caused by a torpedo made in North Korea". The evidence points overwhelmingly to this conclusion, although this conclusion is rejected by the DPRK. The DPRK wants to send its own inspectors to examine the evidence.

Apart of course from the obvious, the corroborating evidence consists of a serial number, Number 1, written in a North Korean style, on a component of a torpedo propeller, and the conclusion is that a heavy acoustic honing torpedo with a 250kg warhead detonated underneath the vessel, splitting it in two with an enormous and powerful air bubble. The torpedo fragments were trawled up by bottom fishing drag nets employed to dredge up any possible incriminating evidence from the sea bed. The parts are identified as being from a CHT-02D, a type which the DPRK has tried to export, hence the ability to identify. The casual observer could be forgiven for thinking the West Sea barnacles or whatever seem to be particularly insatiable fast breeders at this time of year, but that would be to indulge in conspiracy theories.



The propeller and barnacles ...

Source: bbc.com



... the Cheonan

Source: Bild.com

Anecdotaly, a DPRK mother ship and two submarines, one 300 ton Sanyo Class and one 130 ton Yeono Class, are known to have left a DPRK naval base on the West Sea 2-3 days before the incident, and to have returned to base 2-3 days thereafter (the DPRK is thought to have a fleet of 80 subs; 20 1,800 tonne Romeo Class, 40 Sanyos, and 10 midgets and presumably they do move around).

In February, General Kim Kyok-Shik was appointed to oversee naval operations in the West Sea. He was allegedly the chief planner behind the bombing in 1983 of the Aung San National Cemetery in Rangoon, Burma, which was an attempt to assassinate then RoK President Chun Doo-Hwan whilst on an official visit, and claimed the lives of 18 including the deputy prime minister and three other ministers in the government. A serial planner of twenty years experience between plans.

Further circumstantial links are another West Sea incident in November of last year when a DPRK ship strayed south of the NLL near Daecheong Island, to depart in flames following an exchange of fire. Following that defeat it seems that Kim Myung-Guk, a 70 year old and close aide of Kim Jong-Il in charge of military operations under the general political bureau of the People's Armed Forces, was demoted to *sangjang*, three star or colonel general, possibly as punishment for the humiliation. According to the last "sightings" he seems to be back as a *taejang*, or four star general, once again close to the Dear Leader and doubtless offering the fullest of glowing reports on whatever led to his regaining his star.



First there were four... then there were three... and now back to four again!

Source: KCNA

Are these circumstances possibly connected?

The DPRK dismissed the allegations as "sheer fabrication orchestrated by a group of traitors" and warned that the slightest punitive measure would be met with "various forms of tough measures including an all-out war".



The Northern Limit Line (NLL)

Source: Stratfor



– and that firm embrace

Source: Korean Consulting

So why? What next? And what impact on the markets?

Why? The Dear Leader, Kim Jong-Il, as ever has almost nothing to lose. He is 68 years old and visibly ailing, according to analysis of photos from his 17 carriage slow-train visit to China. Despite, or perhaps because, of the exchange of a most unoriental good old style communist bear hug with his Chinese counterpart, Kim Jong-Il is dragging his left foot and cradling his left hand. He has lost lots of hair and weight but if the Cheonan incident is anything to go by, he has not yet migrated from “bouffant” to “buffoon”. He could be on kidney dialysis and some suggest he has around three years left. And he has to set up the transfer of power to the Brilliant Comrade, his youngest son, Jung-Un and all that will entail. The Great Leader gave the Dear Leader ten years of tuition and on-the-spot guidance under his watchful gaze. The Dear Leader may once again need to make his mark for internal purposes, and he could be in more of a hurry than his father.

Mr Kim has completed two nuclear tests and has promised a third, may have as much as 30-40kgs of enriched uranium at his disposal, and could have increased his arsenal of navigationally challenged and thoroughly random missiles to around 1,000. To his mind this may guarantee immunity from any military retribution, even before considering his 18,000 artillery pieces, a significant number of which are hill-side embedded and pointing at Seoul... and his standing army of 1 million.

And let the world not forget that Kim Jong-Il is creating “a great, prosperous and powerful nation by 2012” which happens to be the centenary of the birth of the Great Leader, Kim Il-Sung. Kim Jong-Il bungled a currency reform in late 2009, only increasing domestic economic hardship. The DPRK has been running a trade deficit every year since 1990 which has reportedly reached a cumulative US\$15.8bn or 56% of estimated 2009 GDP of US\$28.2bn. At least two more years of the same?

What next? From without, the usual condemnations from most but not all quarters. Shake, rattle and roll over.

From within, what can Seoul do? A referral to the Security Council of the United Nations seems inevitable, but what stomach will China, permanent council member and sole significant ally of the DPRK, have for tough sanctions, and if imposed who would they hurt? China has appealed for restraint from both sides – not as yet an obvious sign of taking any initiative. In the past, Seoul has resisted the temptation to retaliate with force in the face of such provocations (and there have been several over the years) and it seems most likely that this will again be the case. RoK President Lee Myung-Bak has ruled out direct military action but has reaffirmed the right to self-defence should further such provocations occur. Noise and rattling, but status quo. There is just too much to lose.

RoK has 1,000 people working in the Kaesong industrial zone across the DMZ, who with the reported 14 at the tourist resort Mt Kumgang and 1 unfortunate in Pyongyang, must be nervous, and a small problem. Likely to return south, or be held hostage in the North? President Lee says operations in Kaesong will be reduced. Food aid going north – not likely, support was already dramatically down from what was initially pledged. Also the World Food Programme of aid to DPRK is due to run out in June.

President Lee has announced that all trade with the DPRK will be suspended. In 2009, inter-Korean trade totalled US\$1.7billion (down 7.8% from 2008), just 0.2% of RoK trade, but 33% of DPRK trade. China is the DPRK’s biggest trading partner accounting for 53%. In 2009 DPRK exported US\$790m to China and imported US\$1.9bn. It is pretty obvious who will have to step up.

Balloon-born propaganda from the South could resume, as could the loud speaker blasts across the DMZ, though the DPRK has threatened to shoot out the speakers should they restart ...

...but perhaps the more effective measure will be dropping the plan for South Korean broadcaster SBS to provide a free television feed to the North of the World Cup soccer matches from South Africa (it provided such a feed from the last World Cup – the television rights apply to the whole peninsula). The DPRK and RoK have both qualified for the World Cup, and ironically both were in the same Asian qualifying group, thus having to play each other. In the group stage of the World Cup, the DPRK plays Brazil (15th June), 1966 nemesis Portugal, and Ivory Coast, whilst the RoK plays Greece (12th June), Argentina and Nigeria.

For the DPRK, much will depend upon star striker, Jong Tae-Se who somewhat unusually plies his trade in Japan. He is dubbed “Asia’s Wayne Rooney” though the team slogan, “1966 Again” (the DPRK stunned the world and Italy before going out to a Eusebio inspired Portugal in the quarter finals) could be mistaken for supporting the England team which of course on that occasion won the Cup, and this time probably needs all the support it can get! The RoK meanwhile comfortably beat Japan in a warm up match.

In qualifying the home and away soccer matches between the RoK and DPRK teams were turgid stand-offs with a 1-0 home win to RoK, amidst allegations of food poisoning, and a 1-1 away draw in Shanghai, temporary home for the DPRK. Neither side wished to stamp its authority on either game.

So it is to be hoped that the *whiting* (a Korean rendition of fighting - the rallying cry for South Korea’s soccer team at the 2002 World Cup where they lost in the semi final) is translated from the West Sea or wherever onto the soccer pitches of South Africa, as both RoK and DPRK have a lot to do to make it out of their groups.

And the spirit of the turgid soccer confrontations in qualifying for the World Cup are most appropriate for transfer to the West Sea and surrounds as ineffectual posturings perceived as being in everybody’s best interests, but in reality, completely dodging the issue. The world possibly taking its cue from any startled ostriches in South Africa’s Kruger National Park and burying their heads in the sand!

And almost as an after thought mixed up in all this is the RoK 2nd June municipal elections

There is of course a domestic political angle in South Korea, namely the close-to-call municipal elections of 2nd June. President Lee Myung-Bak and his right wing Grand National Party have been under pressure. Demonstrating the need for a hard line on the DPRK undermines the traditionally more conciliatory opposition, the Democratic Party (DP), heir to the legacy of the late former President, Roh Moo-Hyun, the prime exponent of the Sunshine Policy towards the North. Roh Moo-Hyun took his own life on 23rd May 2009 and the anniversary is proving something of an opposition rallying point.



The anniversary of the death of President Roh Moo-Hyun, Bongha, Kyongsan Province, Sunday 23rd

Source: Korea Times

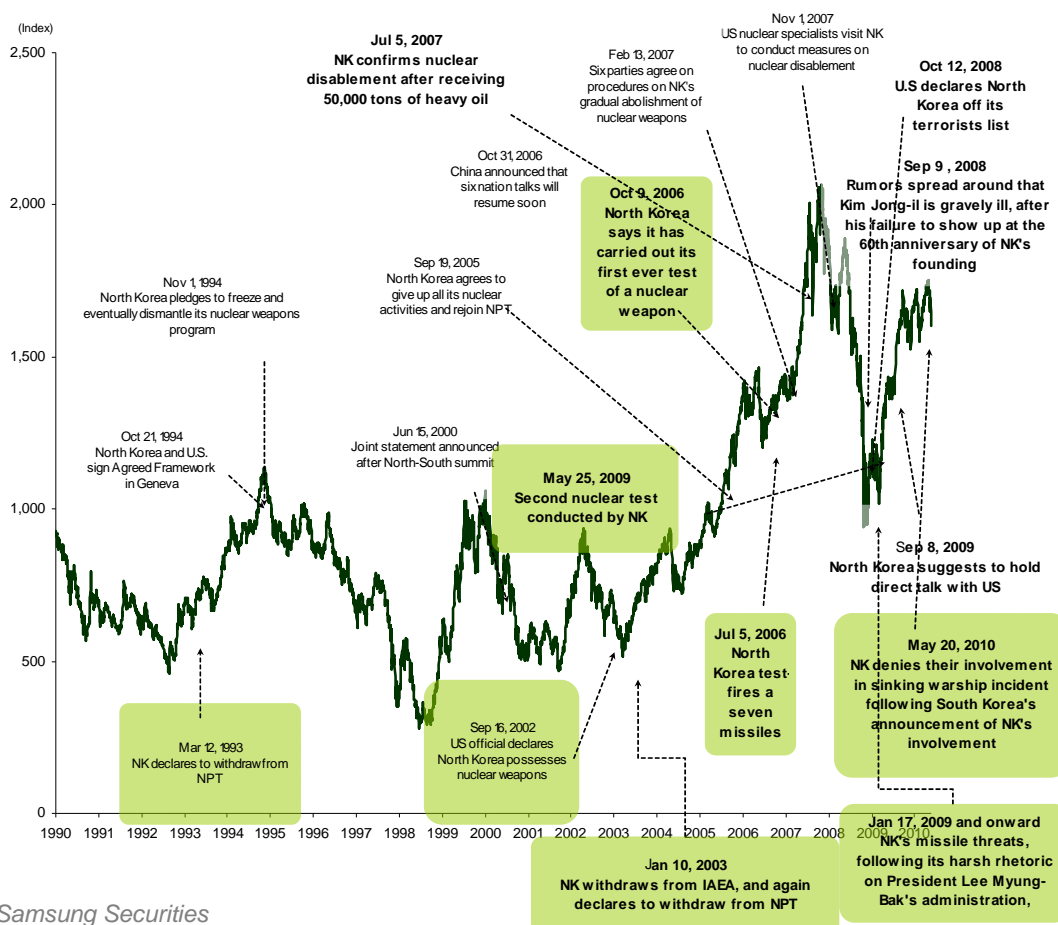
Any amplification of security concerns could play into GNP hands.

There is the Cheonan...

...and now the arrest of a female North Korean spy announced just 11 days before the election. Kim Soon-Nyeo, 36, has been arrested on charges of espionage as has Oh Byung-Doo, a 52 year old former executive of the Seoul Metro subway service for providing her with financial support. Kim, disguised as a defector, crossed into China from the DPRK in February 2006. She worked as an accountant at a hotel and separately ran a cosmetics shop. She lured a number of South Koreans into sexual relationships, the hapless subway executive, a 29 year old student, and two employees of travel agencies. High quality contacts. She obtained confidential information about the Seoul subway network (whose strategic importance should not be confused with the Pyongyang subway system built to withstand nuclear attack), universities, and names of high ranking police officers and public officials. Mr Oh had maintained his relationship with Ms Kim from May 2006 and transferred to her KRW300 million (USD252,000) to help her cosmetics business. In June 2007 he became aware of her espionage activities, but continued the relationship. The spy who came in from the cosmetic cold and got paid for it... by her source? Obviously believing she was on to a good thing, Kim Soon-Nyeo tried to enter RoK in September 2009 as a "defector" but her true identity was uncovered presumably after makeup removal. Aha!

Meanwhile the leader of the main opposition Democratic Party, Chung Se-Kyun, has called on the DPRK to curb its inflammatory rhetoric. Mr Chung stated that a "deterioration of inter Korean relations will lead to instability in the stock and foreign exchange markets that can hurt the economy". He is both right and wrong.

See for yourselves ...



Source: Samsung Securities

As the chart above demonstrates for those with the necessary magnifying glass, as long as we are playing the geopolitical shuffle of steps forwards, sideways and backwards, the stock market occasionally suffers a temporary impact from DPRK activities, and, if it does, the long term impact is quickly discounted, and business as usual is resumed. Equally, the market can completely ignore the DPRK and focus more on matters concerning the global economy and the RoK's roll therein. The exchange rate is driven more by the balance of trade and current account, but foreign inflows and outflows into the stock market can have an impact – some of the current won “weakness” may have a DPRK angle, but it could equally be Euro and Greek related and the impact that that will have on global trade.

So, on the international stage, little fundamental is likely to change. Shake, rattle and roll over. The Korean equity and currency markets may swing along as well, but will probably be more influenced by Euro wobble and Greek tragedies, and what China does to its economy.

And in domestic politics it is the battle of the air bubbles; the legacy of *Rohsammo* (the Roh wind; the internet based movement that had much to do with catapulting Roh to the Presidency) meets the Cheonan's explosive air bubble. Come 3rd June, a possibly emboldened President Lee Myung-Bak may reveal more of his domestic agenda.

Whiting!