

North Korea

December, 2011

North Korea announced at noon Seoul time today that its leader Kim Jong Il, the Dear leader, had passed away of 'exhaustion' while on a domestic train trip two days ago on 17 December. A flavour of North Korea can be garnered from the fact the state television announcer wept as they read the news while thousands in the main square in Pyongyang chanted in unison and waved 'Kimjongilia', a flower named after the deceased leader. The son of Kim Il Sung (the Great Leader) Kim ruled North Korea for 17 years after coming to power in July 1994. The South Korean army and government were put on full alert and developments will be closely watched worldwide. Given the uncertainty it will unquestionably cause the market, the impact is clearly negative, at least in the short term. Having said that, history tells us not to panic. The most recent 'flare ups' were the North Korean torpedo attacks on a South Korean warship on 26 March 2010 (killing 46 sailors) and firing artillery shells on Yeonpyeong Island on 23rd November 2010 (killing 2 soldiers and 2 civilians) and then the market digested concerns and regained pre-accident levels within a week. Post the announcement today the Kospi index lost around 4% closing down 3.4%. The Korean Won fell 1.6% to a 2 month low of 1177 per dollar.

Whenever the leader dies in a highly centralised dictatorship, worries about instability and succession struggles arise. When the country concerned is a failed state such as North Korea, when its neighbours are the two largest emerging markets (China and South Korea) and when the country concerned is trying to develop nuclear weapons, then the worries are that much greater.

Kim Jong-il has nominated his youngest son Kim Jong-eun to continue the dynasty into its third generation, but he is young (28) and others within the government and army will no doubt be manoeuvring to either control or replace him. The relative power bases and influence of these people is impenetrable to outsiders, so we can only work from first principles and make educated guesses from there about who will win and what it will mean. In summary these opinions are:

Fact: The army is the key domestic power base. Whoever controls that controls everything.

Opinion: Whoever emerges as the new leader will have to placate and impress the army and so the chances of low level military actions have risen. The presence of Kim, Jong Il's sister and brother-in-law in the army are designed to help his son to placate the army, so Kim Jong-eun may well be at least the titular leader for now.

Fact: China is the key international player. They are almost alone in being able to influence North Korea.

Opinion: China will act to prevent a fresh wave of refugees crossing its border, but has shown no particular desire to encourage better relations between North and South Korea. This policy mix will not change.

Fact: North Korea was richer than its Southern neighbours 40 years ago and now endures famines and abject poverty. The old guard in North Korea have shown no regard at all for their own citizens.

Opinion: Sadly, this will not change in the short term. In the medium term we must hope that the new leadership will move to open the economy to aid and capital. For now this must remain a hope rather than an expectation.



Fact: South Korean and other regional stock markets have fallen between 2 and 5% on the news.

Opinion: This is a reasonable and proportionate reaction to bad news. The chance of the news changing from “bad” to “catastrophic” has ratcheted upwards, but only modestly. “Uncertainty” is the main issue at the moment. We are not so sure what will happen in the North as very limited information has been leaked. If there are no further follow-ups then the shock to financial markets seems to be already reflected. However, given that the death was released after two days, it’s very difficult to comprehend what’s happening in the North, so more volatility would not be a surprise.