

North Korea: A war of words for now?

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Executive Summary

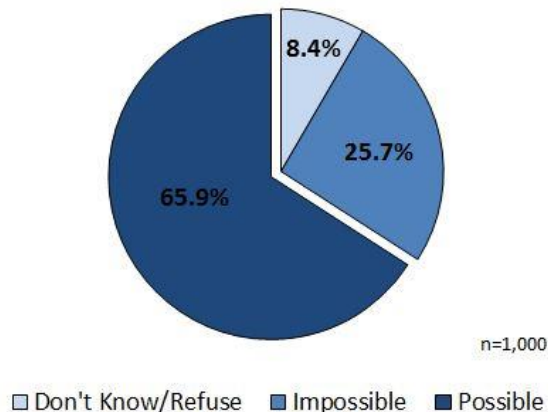
- For now, it is merely a war of words. Rhetorically, US vice-president Mike Pence has mentioned that “all options (are) on the table”, while Trump citing “fire and fury”. Japan, a close proximity to North Korea, has also voiced that North Korea “is a grave threat to (Japan)... We strongly condemn such acts.” The only peace-making comment is heard from China, given official comments that China “will absolutely not permit war or chaos on the peninsula,” and for good reasons.
- However, if the war of words escalate into a military engagement, our estimates suggest a derailing of global growth, led by a fall in both trade volumes and asset prices. Even in today’s war of words, there has been an observable rise in demand for safe haven assets, such as the JPY, UST and gold, while dragging growth-related assets like equities. As of 11th August, the dollar has fallen to its April ‘17 low against the yen, while gold rallied to near its \$1,300/oz. Should the escalation prove to be a prolonged one, gold may rally by as much as 30% while global equities (especially Wall Street) could fall by as much as 20%. Elsewhere, the JPY should eventually fall given the proximity of the conflict.
- Despite the recent intensification, there are no signs that the US is planning a pre-emptive strike against North Korea, nor are there any evidences that Kim will make good on threats to hit US shores. For war to eventually start, the US must (1) first evacuate tens of thousands of US civilians from South Korea and Japan, (2) deploy a reinforcement of troops in the Korean Peninsula, and (3) ensure collateral damage on Asian shores (China, South Korea, Japan) to be limited. A pre-emptive strike by either parties is unlikely as well, as it could adversely dent global risk-taking appetite, not mentioning the many lives lost as a result.

Nuclear Disarmament is the best way forward

Best case: North Korean nuclear disarmament.

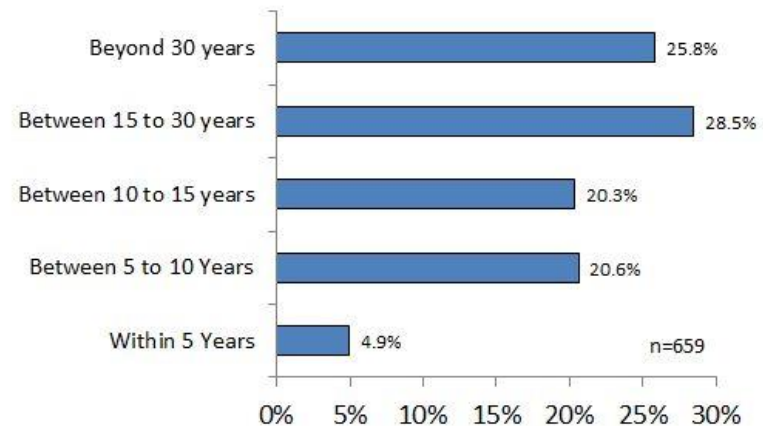
South Korea President Moon Jae-in's "Moonshine Policy" succeeds in garnering adequate interest from the North. South Korea's "Moonshine Policy" is said to "actively pursue reconciliation and cooperation" with North Korea to eventually "achieve peaceful reunification one day". However, improving economic ties may prove to be difficult; Moon has to deal with both domestic and foreign pressure in achieving this goal. S. Korean conservatives perennially criticised the South's effort to provide an economic lifeline to the North. Moreover till date, Moon has not been able to engage in talks with Kim, suggesting a stand-still on his reunification efforts.

Figure 1. Possibility of reunification



Source: TNS Korea

Figure 2. Estimated timing of reunification



Note: Of participants who selected "possible" in figure 1.

Source: TNS Korea

N. Korea will benefit immensely from reunification



25.3 million
North Korea



50.5 million
South Korea

Population, 2016 estimate



North Korea



South Korea

Press freedom index ranking 2013



\$1,300
North Korea



\$28,200
South Korea

GNI per capita, 2014



North Korea



South Korea

Life expectancy at birth, total population



\$78.8m
North Korea



-\$69m
South Korea

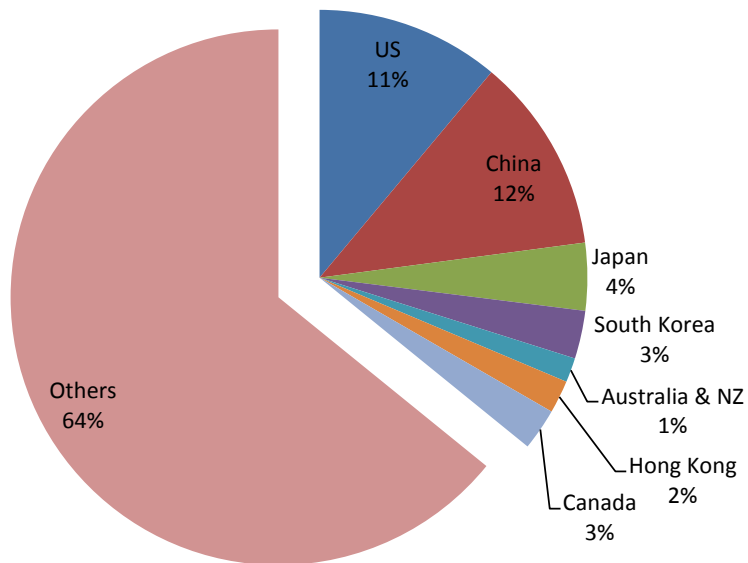
Net official development assistance (ODA) and official aid (current US\$)

A military engagement is a catastrophe

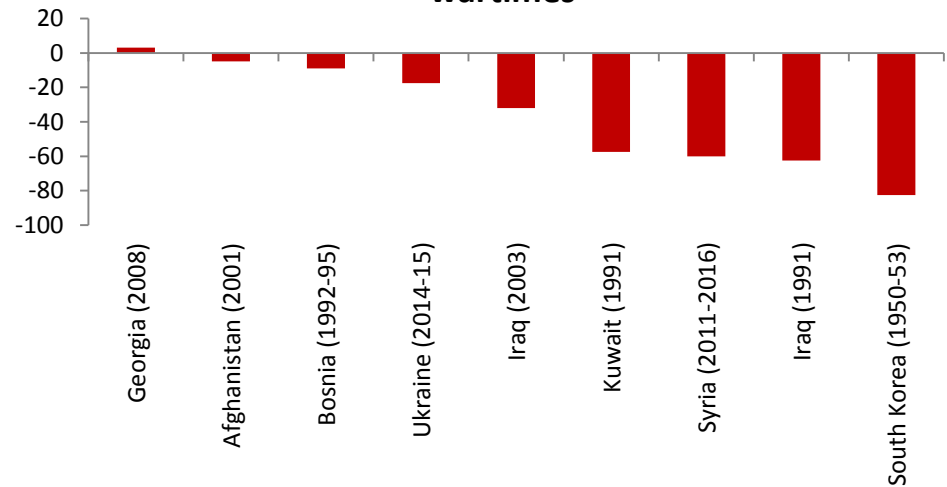
Worst case: An escalation into military intervention

To date, Kim has boasted missile capabilities of striking “anywhere in the world”. Trump’s recent retort that North Korean threats would be met with “fire and fury”. A pre-emptive strike by either the US or North Korea could adversely dent global risk-taking appetite, not mentioning the many lives that will be lost as a result. Even in today’s war of words, there has been an observable rise in demand for safe haven assets, such as the JPY, UST and gold, while dragging growth-related assets like equities.

More than a third of global trade may be adversely affected if a war breaks out

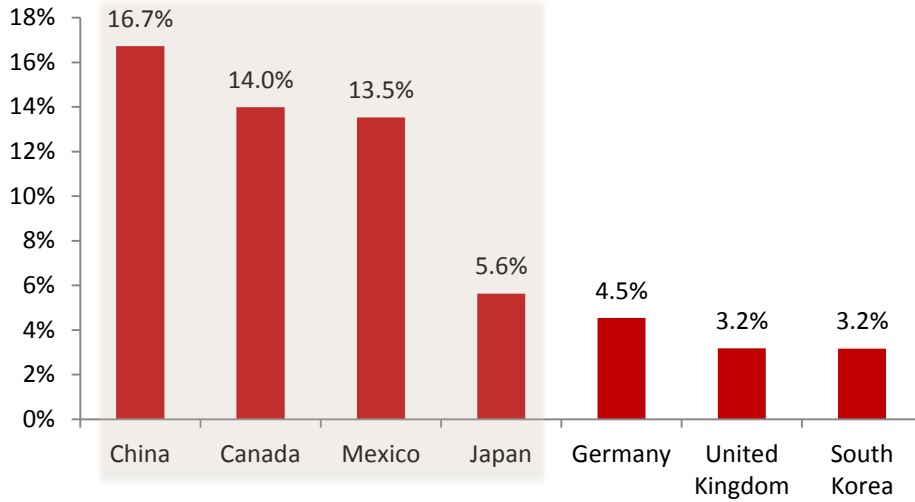


Peak-to-trough change in GDP (% points) during wartimes

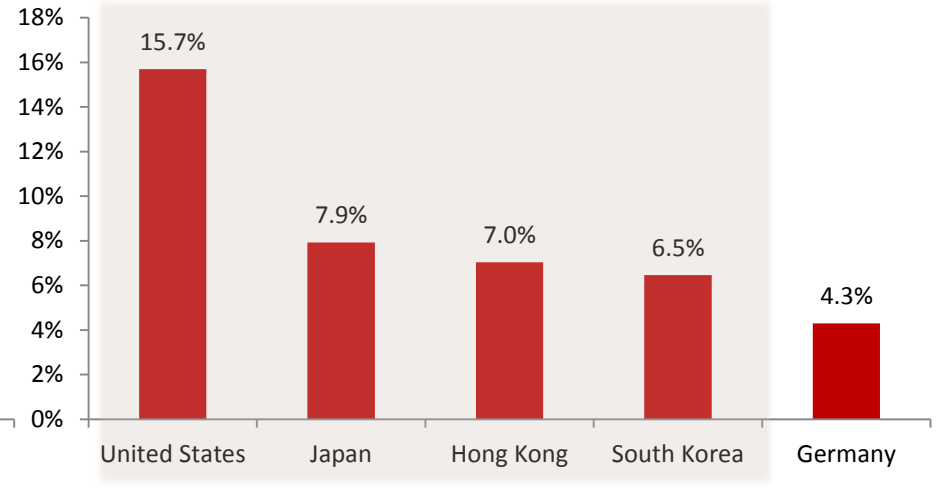


A military act to derail the global trade recovery?

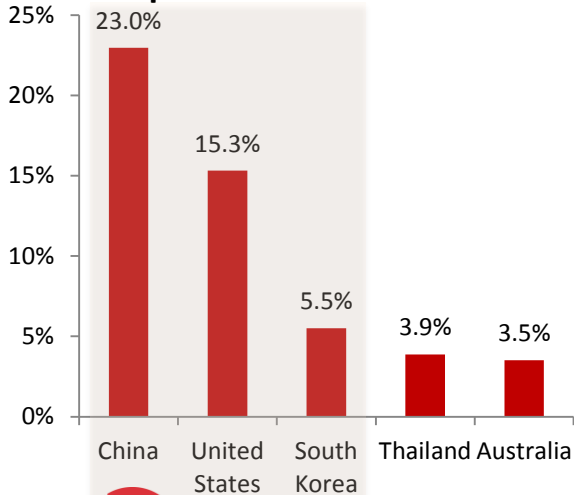
US: % of total trade



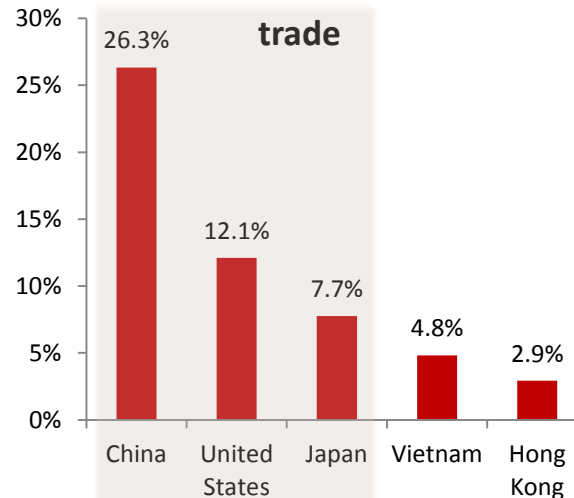
China: % of total trade



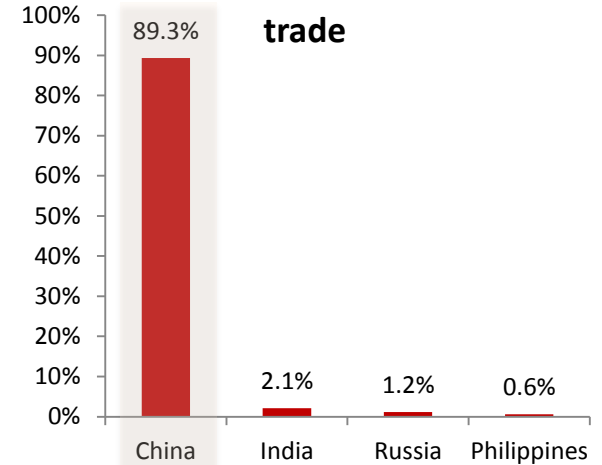
Japan: % of total trade



South Korea: % of total trade



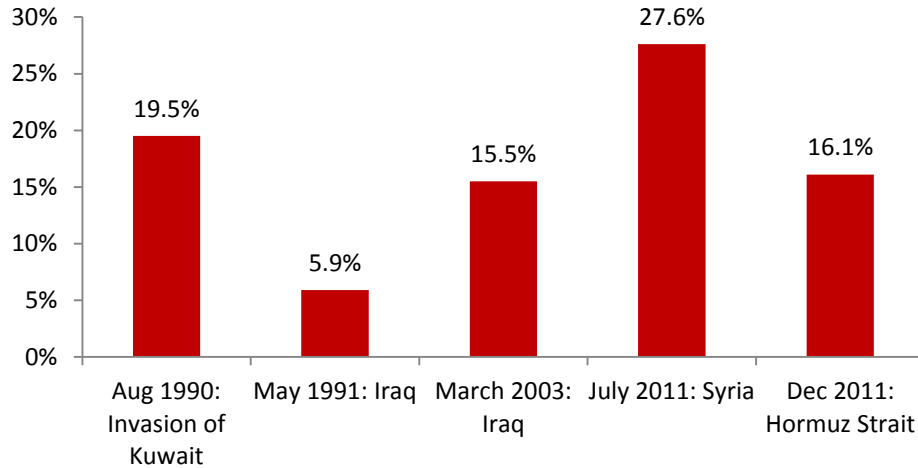
North Korea: % of total trade



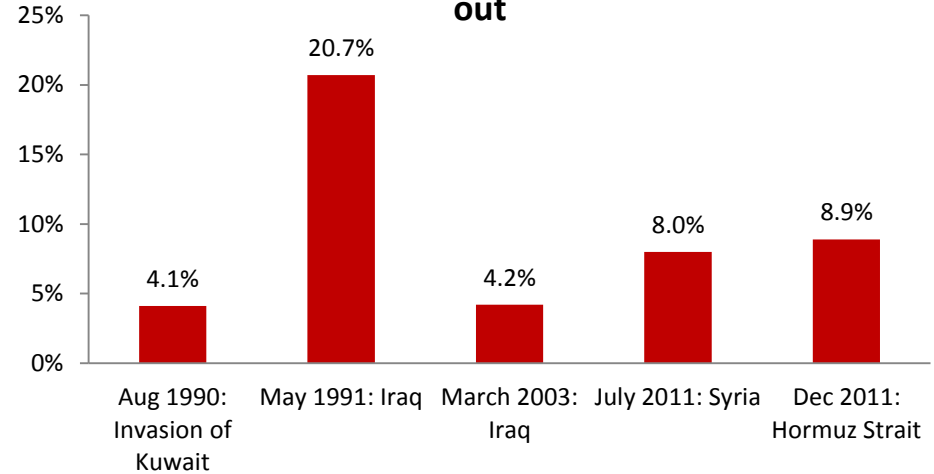
Source: CEIC, OCBC Bank

Impact on key asset class during past conflicts

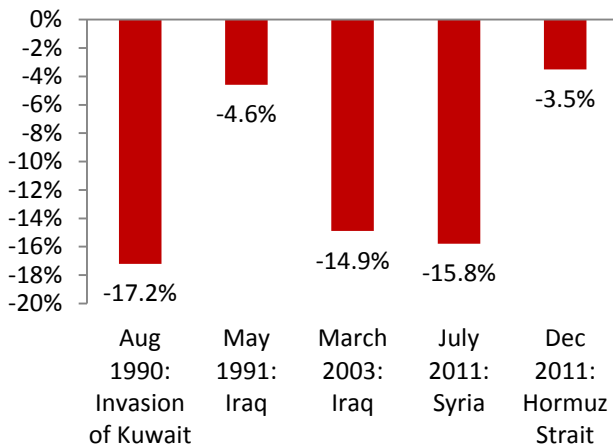
Gold will appreciate as a safe haven asset



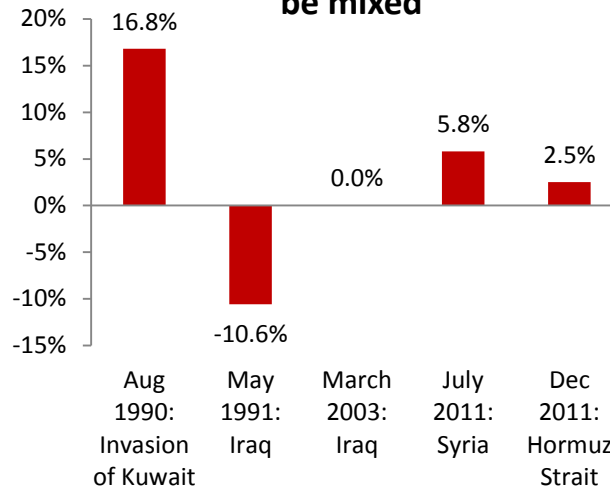
Dollar strength could prevail should war breaks out



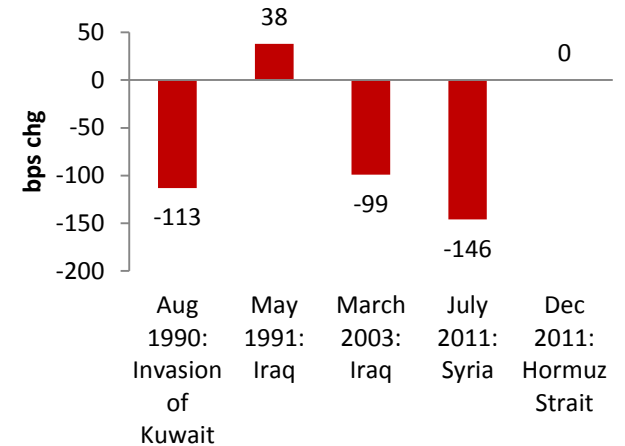
Dow Jones: Equities will likely suffer



Impact on the yen appears to be mixed



US 10Y Treasuries would likely be sought after

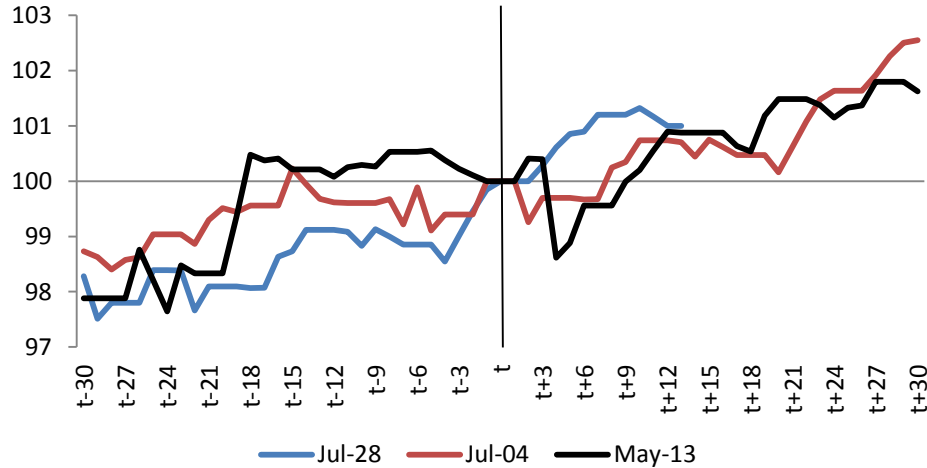


Referencing history: Should a military conflict occur

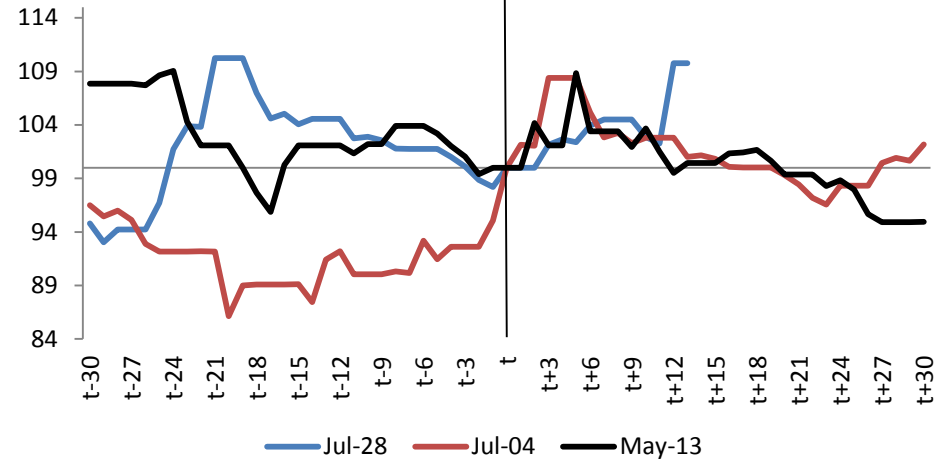
	Current (11th Aug 2017)	Aug 1990: Invasion of Kuwait	May 1991: Iraq	March 2003: Iraq	July 2011: Syria	Dec 2011: Hormuz Strait	Escalation of military conflict?
Gold	1290	+19.5%	+5.9%	+15.5%	+27.6%	+16.1%	+6% to +30%
DJIA	21800	-17.20%	-4.60%	-14.90%	-15.80%	-3.50%	-4% to -20%
JPY	109	+16.8%	-10.60%	Flat	+5.8%	+2.5%	-5% to -15%
UST 10Y Yield	2.19%	-113bps (-12.5%)	+38bps (+4.4%)	-99bps (-24.2%)	-146bps (-46.0%)	Flat	0 to -60bps (0% to -27%)
DXY	93.36	+4.1%	+20.7%	+4.2%	+8.0%	+8.9%	0% to +20%

How asset classes react during missile launches

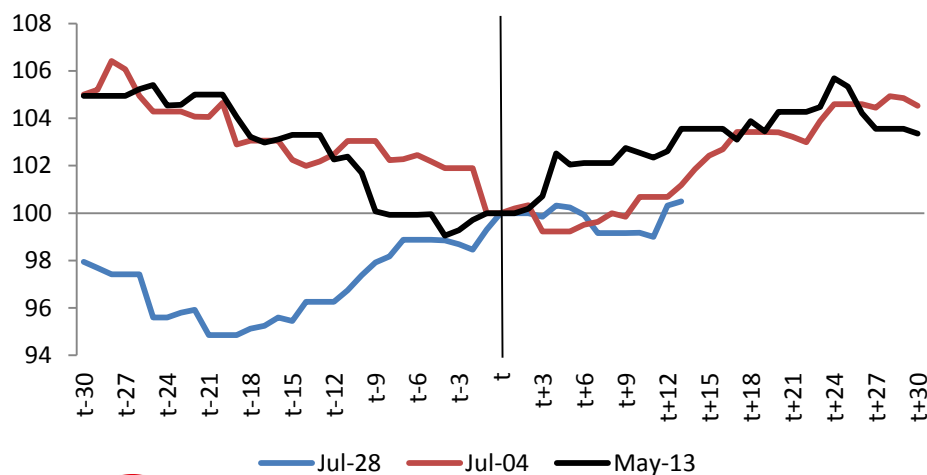
Dow Jones Industrial Average



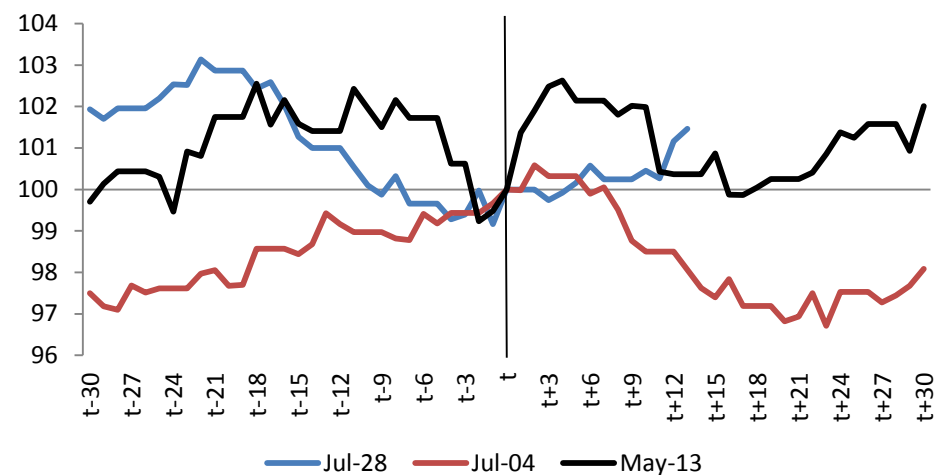
S. Korea CDS



Gold



USDKRW



Source: CEIC, OCBC Bank

Dates refer to recent North Korean missile launches

Another cold war?

Status quo: Still an ongoing war of words

Despite the intensification of geopolitical concerns, there remains no signs that the US is planning a pre-emptive strike against North Korea, nor are there any evidences that Kim will make good on threats to hit US shores. For war to eventually start, the US must (1) first evacuate tens of thousands of US civilians from South Korea and Japan , (2) deploy a reinforcement of troops in the Korean Peninsula, and (3) ensure collateral damage on Asian shores (China, South Korea, Japan) to be limited. Elsewhere, North Korean's missile capabilities are untested in actual battle, and their accuracy is far from certain. To that end, Kim will likely not risk a pre-emptive strike, only to inaccurately hit an unintended target and risk international scorn.

US military bases in the region



DJIA: Investors habitually shrug off geopolitical concerns... For now.





Thank You

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