



## Online Series

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# Recent Trends in Price and Exchange Rate in the North Korean Market

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The first half of 2020 witnessed the expanded volatility in prices and exchange rates in the North Korean market compared to the previous year, which can be explained as follows. First, the increasing threat of COVID-19 has caused domestic and international impact. The steep reduction in trades with China after imposing stricter border control at the international level and the increasing anxiety-driven panic buying and the expectation of inflation at the domestic level seemed to have impacted the expansion of volatility. Second, potential policy changes in North Korea may have caused the increased volatility. As reported recently by the media, policy changes like the issuance of bonds, selling of import licenses in foreign currencies, and limiting of import items may have influenced prices and exchange rates in market. However, the economic uncertainty did not appear to persist as the volatility exhibited from February to April have stabilized over May and June. Nonetheless, the economic circumstances in North Korea is by no means positive. As a food-deficit and low-income country, North Korea is likely to face limitations in fending off the global pandemic under economic sanctions.

## 1. Introduction

Since the demolition of the Inter-Korean Liaison Office by North Korea on June 16, the public's attention was garnered on the reasons behind North Korea's

turn to a hardline position against South Korea. While some experts, amidst analysis of various dimensions on changes of North Korea's attitude, predict North Korea to be in an economic hardship, most predictions lack objective indices. This article analyzes North Korea's economic conditions in the first half of 2020 using one of the timeliest data available—the data on prices and exchange rates in the North Korean market.

The data on prices and exchange rates in the North Korean market, along with Sino-North Korea trade are often used to evaluate the recent status of the North Korean economy. These data usually become available in 1 to 3 months from the inception—the timeliest data on the North Korean economy. The data are collected on a biweekly or monthly basis by the media outlets that specialize in North Korean affairs.<sup>1)</sup> The data on Sino-North Korea trade are also released by the Chinese Customs Statistics every 1 to 3 months.

What do these data tell us? North Korea's market prices usually signal the supply and demand condition on goods and services mostly related to household spending. Market exchange rates reflect the stability of the value of North Korean Won. Also, Sino-North Korea trade reflects North Korea's overall external economic conditions since it makes up 95% of North Korea's foreign trade volume.<sup>2)</sup>

However, it should be taken into account that these data have some limitation. The data on prices and exchange rates in the North Korean market are not systematically collected by the North Korean authority. The Sino-North Korea trade data is mirror statistics released by China, excluding smuggling trade.<sup>3)</sup> Such limitations are common when dealing with economic statistics on North Korea, and caution should be taken in interpreting the results of the data analysis.

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1) The data on market prices and market exchange rates are distributed by media outlets such as the Daily NK and Asia Press that rely on the network among the defector community.

2) Korea Trade-Investment Promotion Agency (KOTRA), *2018 Trends on North Korean Trade* (Seoul: KOTRA, 2019), p. 14.

3) As widely known, data reported by North Korea are limited. Hence, critical information such as national income or trade rely on external estimation, possessing non-observation problems. The data on market prices and market exchange rates are also limited in the regions they cover, the timing of the data collection, and the quality and standards on which the data were collected.

## 2. Trends in Market Prices and Market Exchange Rates in the First Half of 2020

Since Kim Jong-un's rise to power, prices and exchange rates in the North Korean market have generally been stable except for the one-time surge in the second half of 2012. The stability of the North Korean currency has been more clearly observable when compared to the era of Kim Jong-il. In the 2000s, the North Korean market witnessed rampant inflation and in particular, the currency reform at the end of 2009 led to a steep decrease in the value of the North Korean Won over the period of 2010 to 2011. While the side effects of the currency reform had dissipated over time, the stabilization during Kim Jong-un's reign seems to have stemmed from real economic factors including the increase in food production and stabilization of international grain prices, monetary factors such as North Korean authority's liquidity control, and policy factors including marketization continuously allowed and improvements in the commercial distribution system.<sup>4)</sup>

North Korea experienced an inflation in 2017 right after economic sanctions intensified, but the market mostly stabilized again after the second half of 2018.<sup>5)</sup> In 2017, price for refined oil—sanctioned item—has surged along with prices for grains such as rice and corn. However, the price surge is predicted to have derived from increased expectations for inflation rather than from the deepening of lack of supply caused by strengthened sanctions. Considering that the overall import volume had slightly increased in 2017 and that the United Nations Security Council (UNSC) Resolution 2397 limiting the import of refined oil only passed in December of 2017, it is hard to argue that North Korea faced an intensified lack of supply. While prices in 2018 varied by items, prices generally stabilized in the latter half of the year, and the trend continued into 2019.

In spite of stronger sanctions, the following factors have helped stabilize the

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4) On market price and market exchange rate stabilization after Kim Jong-un's coming to power, see Ji-young Choi, "Prices and Exchange Rates in the North Korean Market after Kim Jong-un's Coming to Power," *Focus on Korean Peninsula* vol. 41 (2017) (in Korean).

5) Ji-Young Choi, "2019 Evaluation and Prospects on the North Korean Economy: On Prices and Exchange Rates in the North Korean market," *KDI Review of the North Korean Economy* vol. 22, no. 1 (2020), pp. 80-94.

North Korean market prices. First, most of observable data are food prices in the North Korean market, which are mostly domestic products, not directly impacted by ‘trade shocks’ such as economic sanctions. The UNSC resolution sanctions the import of industrial and transport equipment and refined oil but not food and consumer goods. Major sanctioned items such as refined oil are estimated to be imported below the upper limit or partially smuggled in. While the price of import restricted items like electronics may have increased, data regarding these items are mostly unattainable.

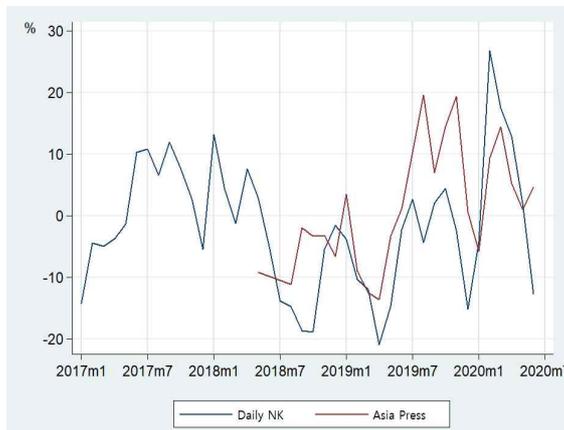
Second, in spite of the reinforced sanctions, there has been an increase in the import of food products and agricultural intermediate products. In addition, the overall import of consumer goods has slightly decreased compared to pre-intensified sanction period. Hence, factors that may have worsened a lack of supply are largely absent unless the amount of domestic production has reduced. Third, exchange rates in the North Korean market have also remained stable, preventing any surge in price from the supply side.

The relative stability in price and exchange rate of the North Korean market that has remained until 2019, however, has met a new tide of increased volatility in the first half of 2020. While price and exchange rate are changing the market clearing process, the volatilities are increasing, meaning that shocks are increasingly impacting the North Korean economy. The expanding volatility increases economic uncertainties, negatively influencing the decision-making processes of economic agents. Prices for rice and gasoline have exhibited two strong surges and returns during early February and late April, and exchange rates relatively fluctuated from February to April. The following two factors can help explain the increased volatility in the price and exchange rates of the North Korean market at the first half of this year.

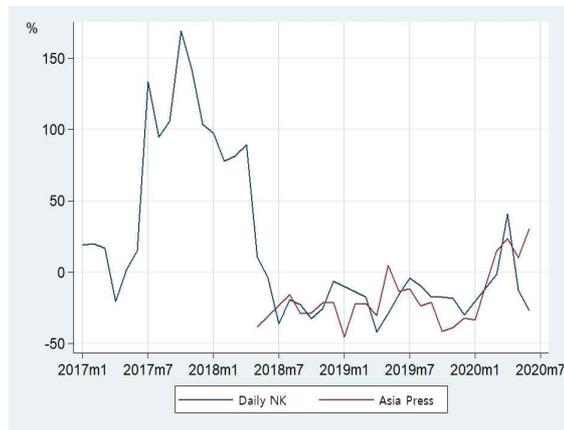
First, the increasing threat of COVID-19 has caused domestic and international impact. After imposing stricter border restrictions in late January, export to and import from China in first quarter have both reduced by 75.5% and 52.7%, accordingly. COVID-19 has further reduced the size of North Korean trade, which has already been cut in half due to prolonged UN sanctions. Considering that post-sanction import volume of food and consumer goods remained the same, the decreased trade volume with China due to COVID-19 inflates market price by a reduced supply of Chinese imports. Especially, the anxiety over the spread of COVID-19 could have caused an

increased demand through panic buying and increased market price through expectations on inflation. The increase in market price in February could highly likely be caused by psychological factors that were observed in a period right after the toughening of sanctions. This exhibits similar trends with the 2017 inflation following the imposition of strengthened sanctions.

<Figure 1> Price of Rice



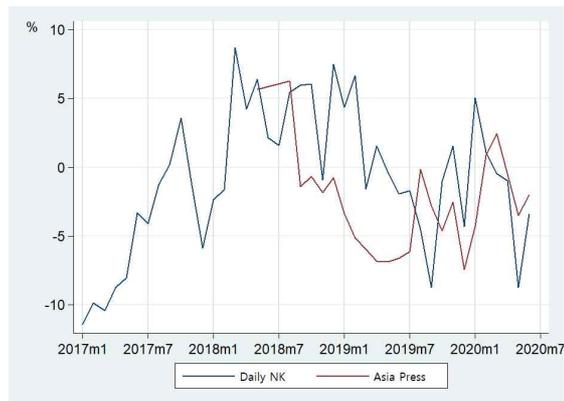
<Figure 2> Price of Gasoline



<Figure3> Exchange Rates for NK Won/U.S. Dollar



<Figure 4> Exchange Rates for NK Won/China Yuan



Note: 1) The author reorganized the raw data into monthly data and calculated the year over year change rate.

2) The Daily NK data provide the average of the data from Pyongyang, Sinuiju, and Hyesan.

Data: Daily NK, Asia Press

Second, the North Korean government's policy changes may have affected

the market. Policy changes can be summarized as the following: 1) the government's issuing of public bonds on April to sell for foreign currencies,<sup>6)</sup> 2) limiting imports to essential goods,<sup>7)</sup> and 3) selling trade licenses in foreign currencies.<sup>8)</sup> Although the veracity of the policy changes have not been cross-checked with official public media in North Korea, the following impact on prices and exchange rates in the North Korean market can be anticipated. First, selling public bonds and trade licenses for foreign currencies indicate the North Korean government's efforts to absorb the foreign currencies held by the public. This can potentially expand exchange rate volatility.<sup>9)</sup> Also, limitations on imported goods can cause increased demand from expectations for a lack of supply or increased price from expectations for a reduction in the number of imported goods.

To recapitulate, the volatility of prices and exchange rates in the North Korean market this year has expanded from that of the previous year. The change can be traced back to the decrease in trade volume caused by stricter border control amid COVID-19 and the reduction in production activities. Also, policy changes by the North Korean government, if there were any, may also have played a role. However, the surges in market price in early February and late April have returned to normal and have continued to stabilize in June. Market exchange rates have also exhibited expanded volatility from February to April but have stabilized during May and June. Overall, the volatility of the various indices related to market transactions in the first half of this year has expanded, albeit in a limited degree.

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6) "North Korea is ready to sell public bonds and ordered sub-departments to buy the bonds starting the 20<sup>th</sup>," *Daily NK*, April 21, 2020.

7) "North Korean government declared limitations on imports due to COVID-19 until the end of the year," *Daily NK*, April 22, 2020.

8) "North Korea allowed partial trades with China starting June 15, 'buy licenses with foreign currencies'," *Daily NK*, May 29, 2020.

9) As stated, market exchange rates between North Korean Won and the U.S dollar exhibit different trend according to the press that reports it, making it hard to evaluate the trend in whole. Asia Press reported that rates increased from February to April and decreased from May to June while Daily NK reported that the first quarter exhibited stable trends followed by a steep decrease in April and a return spike in May. Due to the discrete reports, this article maintains that the North Korean market 'exhibited expanded exchange rate volatility.'

### 3. Prospect

The North Korean economy has hit a roadblock in the first half of 2020 due to the prolonging of sanctions and COVID-19. While market prices and market exchange rates show just one-side dimension of the dual economy of North Korea, the expanded volatility of the indices clearly points to the shrinking of Sino-North Korea trade and worsening of North Korea's economic conditions. Still, the volatile indices have been stabilizing throughout May and June, making it difficult to argue that the market uncertainty has increased as much as it was in the 2000s. The stabilization could have occurred as a consequence of the government's intervention. In other words, the North Korean authority might have imposed a 'ceiling price' in market exchanges<sup>10)</sup> or controlled the amount of ration to stabilize market prices.<sup>11)</sup>

A bigger problem is that North Korea's economic prospect for the second half of the year does not look bright.<sup>12)</sup> First, production activities may continue to shrink in the latter half of 2020. The overall scale of production activities is predicted to have shrunk with the implementation of quarantine measures such as social distancing. Especially, food productions may come to a halt if agricultural intermediate goods such as fertilizers are not provided in a timely manner. Without sufficient commercial import of grains or foreign aids, food prices may increase next year. Second, similar to other countries, the prolonging of the pandemic may impact the North Korean economy. The strict border control put in place in January is seen as a reflection of North Korea's poor public health system. Such policy, if it remains, will negatively influence industries across the board. Third, if the policy changes reported by the media are reliable, meaning that North Korean authority is facing a deficit in its foreign currency reserves, the effects of persisting sanctions could be

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10) "North Korea controlled prices by mobilizing manpower after stricter border control increased prices," *Daily NK*, February 11, 2020.

11) In 2019, North Korea had imported two times the average amount of grain imported in the previous 5 years (2014-2018). If a majority of grain came from Chinese assistance, market prices might have stabilized with increased ration.

12) Recent literature has evaluated the current economic situation in North Korea to be similar to the situation in 1994 and predicted that, while structural sustainability has developed since 1994, the continuation of such overlapping shock may bring about another economic crisis. See Lee, Suk, "North Korean Economy in 2020, a déjàvu of 1994?" *KDI Review of the North Korean Economy*, vol. 22, no. 5 (2020) (in Korean).

more pronounced, such as a continued decrease in import.

If market prices in North Korea surge in the near future, the negative consequences will hit hardest the households that rely on market activities for living. Considering that most prices we observe are food prices, surges in prices are bad signs for the worsening food situations in North Korea. Recent report from the World Food Programme suggested that COVID-19-driven break on the supply chain may spillover into a food security emergency and called for a close monitoring on food prices and market trends.<sup>13)</sup> The report selected 49 countries including North Korea that are facing food security emergencies due to COVID-19 by combining the economic factors in the food security index and each country's dependence on exporting primary products.<sup>14)</sup> Ever since the sanctions have become stricter, North Korea has tried hard to deflect the impact of sanctions by increasing imports of food and agricultural intermediate goods from China. Still, deflecting off the effects of a global pandemic seems to be beyond its capacity as a food deficient, low-income country. The humanitarian emergency in North Korea is relatively harder to advertise<sup>15)</sup>, and it is also difficult to provide humanitarian assistance as it needs to go through the exemption process of the UNSC Sanctions Committee. Considering the special circumstances of North Korea, we must be quick to provide humanitarian assistance.

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13) WFP, *COVID-19: Potential Impact on the World's Poorest People* (2020), pp. 11-13.

14) The report combines the economic factors in the Proteus index, a comprehensive index of food security levels, and each country's dependence on exporting primary products such as fuel, ore, and metal to select countries facing food security emergencies due to COVID-19, predicts the number of people facing chronic food shortages and serious nutrient deficiencies. The report predicts that 212 million people face chronic food shortages and almost half of the North Korean population (12 million) face chronic food shortages.

15) North Korea was selected as one of 10 most under-reported humanitarian crises of 2019 selected by CARE International. According to this report, North Korea's humanitarian crisis is under-reported due to the country's political isolation and limited media activities. CARE International, *Suffering in Silence: the 10 most under-represented humanitarian crises of 2019* (2020).