STILL GOING, GOING...., ENERGIZER

Steady Economic Growth with Deepening Business Polarization

Economic Trends

Polarization is deepening in many sectors of the Korean economy including production, distribution and the stock market. Despite the recent high growth in the heavy and chemical sectors, the growth in light industry is still sluggish. While large enterprises are growing at a double-digit pace, many small and medium-sized (S&M) businesses are concerned about bankruptcy. According to a report released by the Bank of Korea (BOK), the nationwide insolvency rate of bills hit 0.18 percent in August, up 0.01 percentage points from July. Furthermore, the rate in provincial areas increased 0.1 percent to 0.79 percent, the highest since May 1970. These occurrences are caused by a credit crunch and a slowdown in construction for S&M enterprises. In the retail business, small shops are giving way to big supermarket franchisees. While the Korea Stock Price Index (KOSPI) has risen above 1,000 points, blue chips have become more expensive and cheap stocks less expensive. The unbalanced developments among these sectors will likely continue in the foreseeable future unless nation's economic structures are properly changed.

Facility investments, purchase of durable goods, and private consumption have been growing very slowly since the second quarter of this year. Furthermore, domestic construction increased only 20.0 percent in August from 77.5 percent in July on an annual basis. They have led the slow growth rate of the economy. However, the industrial output, led by semiconductors, consumer electronics products, and automobiles, grew at an annual rate of 12.9 percent in August, less than the 14.9 percent in July but still a double-digit growth. In the fourth quarter, both production and sales in the manufacturing sector are expected to experience a slowdown. Overall, the nation's economy is likely to peak in the near future.

Next year the economy will likely expand at a relatively modest pace of 7.6 percent, as investment slows down after more than 30 months of relentless expansion. Heavy and high-tech industries (such as computer, telecommunications, aerospace, precision machinery, chemistry, and metal industries) are expected to propel the Korean economy to grow in the years to come. Exports will also likely lead the nation's economic growth. According to the International Monetary Fund, Korea will occupy 2.4 percent of the global export market next year, up from 2.3 percent this year and 2.1 percent in 1993. The increases in exports are partially affected by a better world economic outlook for 1996 than in 1995. As expected, the nation's output from the agriculture, forestry and fishery will decrease next year.

This year's unemployment rate is likely to be about 2.0 percent, which may be the lowest ever. The low unemployment rate will continue through next year. The government should improve the condition of the labor market in order to help ease labor shortages facing domestic S&M manufacturers by organizing a more efficient supply system, such as a foreign technical trainee system which provides 0.8 percent of the total wage-earning work force, or about 100,000 workers, at present.

Foreign investors have been expanding stock investment since the start of July, when the investment ceiling for foreigners was raised from 12 percent to 15 percent. The government has also been accelerating deregulatory measures to encourage capital outflow, which were unveiled in Washington D.C. early October. These measures are intended to slow down appreciation of the Korean won and to speed up liberalization of its capital markets. This will result in a capital outflow from the country of about 200 million dollars next year. The government also permitted foreign enterprises to be listed on the Korea Stock Exchange (KSE) next year. This will enable foreign firms to raise money, and bring it out of the country by listing their shares on the KSE. The net influx of foreign funds, however, reached $14.2 billion in the third quarter, the largest amount this year.

Major Economic Indicators

(change from previous year, %)

	1994				1995	
	1/4	2/4	3/4	4/4	1/4	2/4
Economic Growth Rate	8.9	7.6	7.6	9.3	9.9	9.6
Consumption for Durable Goods	10.0	11.9	10.9	13.9	15.7	9.3
Consumption for Nondurable Goods	4.8	5.1	5.8	4.8	6.4	7.1
Private Consumption	6.8	7.5	7.5	7.8	8.7	8.1
Facilities Investment	20.9	16.8	24.3	30.6	25.2	19.0
Construction Investment	7.6	2.2	2.8	6.3	8.0	8.3

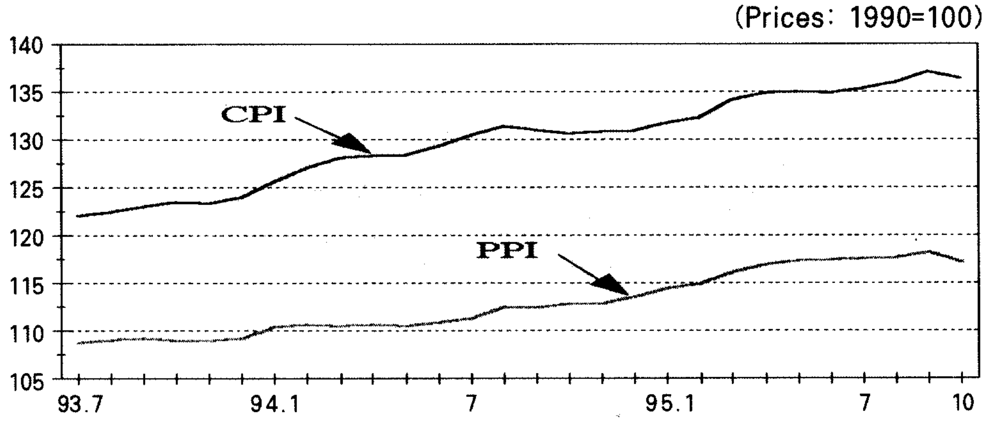
Sharp Rise in Prices

Prices

Consumer prices soared 0.8 percent in September from the previous month. The month-to-month gain was much higher than the average 0.3 percent monthly growth during the 1990-1994 period. In addition, the index rose 4.7 percent from a year ago although consumer prices increased only by 4.7 percent in the first nine months of this year. The September consumer price hike was a temporary one, reflecting sudden rises in vegetable prices due to flooding and strong seasonal demand around a national holiday, Chusok. Despite the recent stability of vegetable prices, increases in the public utility rate and oil prices could cause the index to rise. Consumer prices are expected to rise 4.7 percent for this year, less than last year's 6.2 percent, and to rise 5.2 percent next year.

Wholesale prices rose 0.4 percent from the previous month and 5.2 percent from a year ago in September. Import prices in September remained flat over August, ending a downward trend since May.

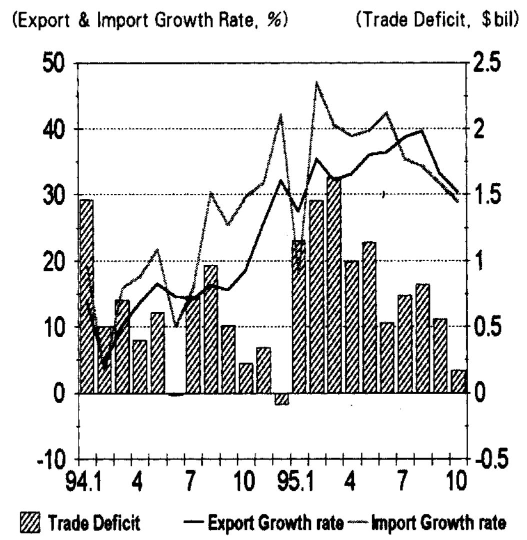
Overall, next year's price level would rise more than this year's due to the upcoming national elections and probable increases in private consumptions. In this regard, macroeconomic policy should be geared toward more stable prices next year than did this year.



Dwindling Current Account Deficit

Dwindling imports and booming exports will narrow the current account deficit. The influx of foreign investment in the Korean stock market and the increased issuance of overseas securities by domestic firms will produce a surplus in the capital account. Since July, the growth rate of Korean exports has surpassed the import growth rate. Exports surged 40.2 percent while imports increased 34.4 percent in August over the same month last year. Similarly, exports expanded 33.2 percent while imports rose 31.8 percent in September from a month ago. Although these developments improve the current account balances, the nation's cumulative current account deficit reached $9.1 billion in the first nine months of the year, which approached the psychologically important 10.0 billion-dollar mark.

The high growth of exports was largely attributable to brisk shipments of vessels, automobiles, and electric-electronic goods. Imports were led by high demands for raw materials and consumption goods in September. Because of business firms' low demand for facility investments from abroad, the trade deficit, which shares about 64 percent of the current account deficit for the first nine months of this year, is likely to decrease for the rest of this and next year.

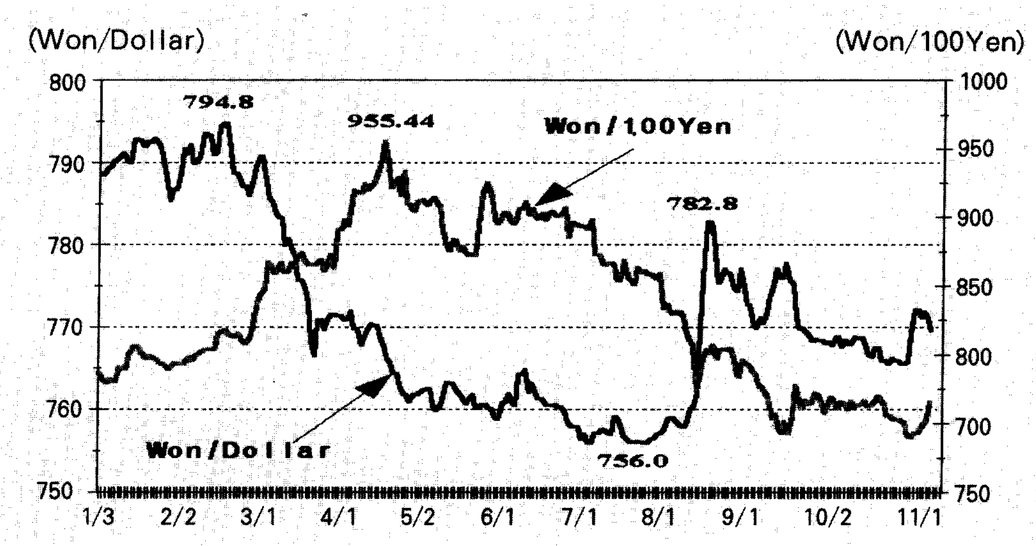


Exchange Rates

Won Continues Appreciating

An increasing trade deficit did not depreciate the won's value against the dollar, owing to large foreign investment into the Korean capital market. Money inflow into Korea hit $5.3 billion and $10.4 billion for the third quarter and the first nine months of this year, respectively. The inflows were due to foreign stock funds and domestic firms' rising issuance of overseas securities. The increase in net foreign funds in the third quarter is attributable to an increase in the ceiling for foreign stock ownership from 12 percent to 15 percent and a booming Korean stock market.

Foreign stock investment funds introduced into the country in the July-September period recorded 4.7 billion dollars, the largest quarterly inflowsince Korea opened the stock market to foreign investors in 1992. It is expected that an increase in foreign investment will continue for the time being, although the government provides measures of capital outflow deregulation. Thus the won's exchange rates against both the dollar and yen still showed appreciating trends in October, and these movements are expected to continue for the next year.



Interest Rates

Low Interest Rates with Abundant Liquidity

Both short-term and long-term interest rates are decreasing, reflecting sufficient liquidity in the domestic money market. In addition, because most firms's facility investment has come to a close, there is not too much demand for money in the financial market. Recently, liquidity has also declined slowly. The M2 growth rate has been stabilized below 15.0 percent in recent months, giving monetary authorities additional room to expand the money supply. In September, M2 climbed 13.9 percent from a year ago, the lowest monthly growth since October 1994. The monetary authorities reported that they would set the M2 growth rate in the 14.0-16.0 percent range for the final quarter of this year. The implementation of the global tax system on financial income could cause the money growth rates to rise, but this scenario is not likely.

The yield on three-year bank-guaranteed corporate bonds (CBY), which had increased to 14.7 percent in late June, plunged to 12.5 percent in late September, stabilized at 12.0 percent in mid-October. The yield on 91-day certificates of deposit (CD) also has declined below 13.0 percent since late September. The rate of overnight call loans (CALL) between investment finance companies has also decreased below 12.0 percent. Finally, it is predicted that CBY will be kept under 13.0 percent for most of next year.

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