

ECONOMY SEEMS IN BUSINESS CONTRACTION

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Recently released data indicates that Korean economic growth is slowing down. The industrial output in the first quarter of this year was on the decline with inventories piling up. Industrial production grew 8.6 percent in the first quarter, a decline from the 14.4 percent gain during the same period of last year. This was because of the tough export situation caused by the lower yen and rises in import prices of raw materials. The great drop in industrial output growth in March may suggest that the economy has entered into a phase of deep slowdown.

Furthermore, producers' inventories increased 19.1 percent, and orders for domestically made machinery dropped 5.1 percent in March from a year ago. Thus, the low growth rates of exports, corporate capital investments and private consumption imply that the economy will experience a slowdown for the rest of this year. In addition, the table below indicates that the gap in output between the heavy and chemical sector and the light industries widened further in the first quarter.

*Not Easy Managing Small Manufacturing Firms*

Despite recent decrease in the insolvency rate for small and medium-sized manufacturing companies, the bipolarization is considered as one of the pending structural problems of the Korean economy. The number of insolvent small and medium-sized companies eased off in the first quarter, after reaching a 15-year high last year. In March, the insolvency rate stood at 0.13 percent, which is the lowest level in 14 months, down 0.06 percentage points from a year ago.

Small and medium-sized companies, which represent 99 percent of Korean manufacturers in number and account for 48 percent of all manufacturing jobs, have difficulties in operating due to the shortage of labor, the lack of technological backing, their unstable financial status and the costly land sites for manufacturing. Local small and medium-sized manufacturing companies

The First Quarter Industrial Activities

		(year-to-year change, %)					
		1995			1996		
		Feb.	Mar.	Jan.-Mar.	Feb.	Mar.	Jan.-Mar.
Output	Output	19.8	14.7	14.4	8.2	5.8	8.6
	Heavy-Chemical Sector	23.5	18.8	18.1	11.2	8.5	11.4
	Light Sector	10.2	3.9	4.3	-3.4	-4.7	-1.8
	Inventory	3.6	5.0	5.0	18.7	19.1	19.1
	Capacity Utilization Rate	80.9	84.6	83.5	83.4	81.3	82.3
Consumption	Wholesale & Retail Sales	6.8	6.4	8.7	11.9	8.4	8.3
	Shipment of Consumer Goods	16.8	10.0	12.9	6.3	3.8	5.3
Investment	Domestically Machinery Orders	58.8	42.9	45.4	6.0	-5.1	9.7
	Imports of machinery	68.4	53.0	47.1	7.1	-8.1	14.3

Source: National Statistical Office

have had difficulties in hiring workers in the first quarter of this year. The Korean Federation of Small Businesses reported that it had received 347 reports of labor-related difficulties among a total of 1,060 reports of management difficulties from small business nationwide. This labor shortage problem accounted for 32.7 percent of total, an increase of 9.4 percentage points over last year. Thus, small businesses are particularly interested in employing foreign industrial trainees and technical specialists.

### *Negative Export Growth to Developed Countries*

Korea's export growth rate slowed down from 17.9 percent in March to 5.5 percent in April on a year-on-year basis, mainly because of the sluggish shipments of heavy and chemical goods to foreign countries. The sluggishness was due to the weakening price competitiveness of Korean-made goods resulting from the weak Japanese yen and the strong Korean won in the foreign exchange market. For example, exports of machinery, steel and petrochemicals showed negative annual growths of 8.5, 5.5 and 14.1 percent, respectively, and exports of semiconductors increased only 3.0 percent in April. In addition, Korean export goods are increasingly being shipped to the developing countries of the world at the expense of Korean exports to U.S. and Japan. Exports to developed countries marked a negative growth of 9.5 percent in April on average. For example, the yearly export growth rate was negative 4.2 percent for the U.S. and negative 2.7 percent for Japan. Furthermore, the leading indicator of exports, the amount of L/C received, confirms that the export growth rate will not rapidly increase for the time being.

The import growth rate, however, increased 14.8 percent in April from 4.2 percent in March.

Imports of raw materials increased 11.3 percent in April from a year ago, due to rises in the import price of oil products. Also, imports of consumer goods, for example, automobiles, clothes and furniture, rose 23.6 percent in April. As a result, the trade deficit widened from \$0.1 Bil. in March to \$2.0 Bil. in April. In addition, Korea recorded a \$5.9 Bil. trade deficit during the first four months of the year.

### *Signs of Rising Interest Rates*

The reserve requirement ratio for commercial banks was lowered 2.0 percentage points on average on April 23 to reduce market interest rates. Many economists have argued that most companies in Korea are worried about their lowered competitiveness compared to their rivals due to the high costs of raising finances. Additionally, because of increasing influx of foreign capital due to the relatively high market interest rates, the value of Korean won has appreciated although Korea's current balance has deteriorated. As a result of the lowered requirement, the yields on three-year corporate bonds, which have been showing a downward trend this year, recorded their lowest rate on April 26.

On the other hand, some disagree with lowering the reserve requirement ratio during a period of less confidence in future price levels because it will cause market liquidity to rise. In May, the yield on three-year corporate bonds has showed a slightly increasing trend because the idea that the interest rate converges to the sum of the GDP growth rate and the expected price level increase has prevailed. Thus, interest rate may show a slightly upward and stable trend during the rest this year so that it will stay around 11.0 percent due to expectations of unstable price levels as well as companies' worsening internal financial situation resulting from decreasing industrial performances. <sup>VIP</sup>

*(Chan-jin Kim)*

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