

## DARK CLOUDS OVER THE HORIZON

### *Increasing Worries Over Economic Contraction*

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The Korean Stock Price Index's (KOSPI) recent downward movements and other signs have shown that many are worrying about economic contraction, especially in the latter half of this year. For instance, the unemployment rate rose slightly in the January-March period of the year to 2.2 percent, up 0.4 percentage points from the record low 1.8 percent recorded in the fourth quarter of 1995. The unemployment rate stood at 1.9 percent for both the second and third quarters of last year. Although the first quarter unemployment rate was down 0.2 percentage points from the same period last year, the quarter-to-quarter increase in the unemployment rate may be a sign of an economic slowdown.

Consumer prices increased 3.5 percent in May from last December which is higher than the 3.1 percent gain during the same period a year earlier. In May, individual service charges were stable, but the prices of agricultural, marine and forest products rose sharply. Consumer prices are likely to rise significantly during the rest of this year due to following reasons. First of all, probable increases in public utility rates and the imposition of an educational tax on tobacco and gasoline will raise consumer prices. In addition, strained labor-management relations may result in higher wages to avoid conflicts between the two sides. The recent rising trend in the money supply growth rate may also lead inflation. Thus, this year's inflation rate is likely to surpass the target rate of 4.5 percent set by the Government.

Furthermore, market interest rates, which recorded a sharp fall in April due to the lowering of the required reserve ratio, have rebounded sub-

stantially since May. For instance, the yield on 91-day certificates of deposit, which stood at a 10.05 percent annual rate at the end of April, rose again to 12.15 percent on June 15th. The yield on three-year bank-guaranteed corporate bonds, which slipped from 11.44 percent at the end of March to 10.44 percent at the end of April, bounced back to 11.68 percent on June 15th. The rising trends in market interest rates are attributed to increases in spurious demand for money that is caused by inflationary pressures and the expectation of a tight monetary policy for the time being. In addition, export-oriented firms, whose financial situations have become worse due to difficulties in exporting and accumulating stockpiles, are demanding more money to use as operational funds, which will also aggravate the market interest rate situation.

### *Snowballing Current Account Deficit*

The top priority in this year's economic policy appears to have changed from achieving price stability to reducing the current account deficit. Korea's current account deficit is expected to far surpass its target for this year due to slower-than-expected exports of semiconductors, which account for about 18 percent of total exports, and steady increases in the invisible trade deficit. Other key factors behind the snowballing current account deficit are the weakened price competitiveness of Korean-made products in international markets due to a weak Japanese yen and the generally weak demand for Korean products stemming from a slow recovery of the world economy.

Furthermore, rises in debits from travel, invest-

ment income and other goods, services and income are also worsening current balances. As a result, the current account deficit is likely to hit a new record high of \$9.5 Bil. this year. The anticipated figure exceeds the earlier target of a \$6.0 Bil. deficit in 1996 and the previous record high of \$8.82 Bil. posted in 1995.

If the Government employs a policy such as an aggregate demand control policy to curb the current account deficit, the national economy will suffer from uneasy commodity prices, higher interest rates and a further drop in economic growth. Thus, it is unlikely that the Government will pursue such a path. To effectively reduce the current account deficit, it is recommended that the Government pursue a policy which addresses the structural weakness of an economy whose export performance is too heavily dependent on a few selected sectors, and a tight fiscal policy.

### *April Industrial Performance Seemingly Good*

So far the economy has been facing very difficult circumstances; however, there is some good news. Industrial output showed a better performance in April due to a rise in exports of ships and a strong domestic demand for automobiles and chemicals higher than the previous year, with the growth rate of business inventories also slowing down.

In particular, the output of light industries rose 1.4 percent in April from a year earlier for the first time in three months. Output declined 4.6 percent in March from a year ago and 3.4 percent in February, respectively. During the first quarter, the output of the light industrial sector decreased 1.8 percent from a year ago. The heavy and chemical sector saw its output surge at a 10.2 percent annual rate in April, up from an 8.3 percent advance for March.

Hence, output grew 8.3 percent in April from a year ago, up 2.6 percentage points from March but down from the 8.6 percent gain in production for the first quarter of the year. Inventories of producers grew at an 18.3 percent annual rate in April, but the rate declined from the 19.1 percent surge for March.

Another bit of good news for the national economy is the Korean won's depreciation trend. The value of the won has continued to decline against the U.S. dollar since May due to the strength of the dollar in the world foreign exchange markets and Korea's widening trade deficits. The won-dollar exchange rate was 774.70 at the end of 1995, 780.70 at the end of February, 778.70 at the end of April, 796.60 on June 15th.

Although the strong dollar/weak won are likely to continue for the time being, the current situation may not be very helpful to Korean exporters because the Japanese yen has depreciated about 7.17 percent against the U.S. dollar from end of last year to June 15th, while the Korean won has only depreciated about 2.83 percent during the same period.

Overall, the Korean economy is likely to decline a little due to decreases in exports and facility investment, growing around 7.2 percent this year (7.3 and 7.1 percents for each half of the year). **VIP**

*(Chan-Jin Kim)*

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