RAISING COMPETITIVENESS : THE NEW SLOGAN

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Prices have continued their upward rise, surpassing the government's annual price-curbing ceilings recently. In September, consumer price levels finally exceeded this year's target rate of 4.5 percent thanks to the rises in public utility rates, wage growth rate and real estate prices during the first nine months of the year. Although the government tried to decrease market interest rates to help businesses, the rates are still high due to some structural problems in the Korean financial market, which is fettered by too many inefficient regulations. Another macroeconomic variable, the foreign exchange rate, shows trends which do not properly reflect the economic status. For example, the large increase in the trade deficit has not depreciated the value of the Korean won. Because of the relatively high interest rates compared to other countries, the chances are high that hot money will flow into the capital market, which may result in unstable foreign exchange rates and financial markets. Beside these macroeconomic variables, high land prices, high logistics costs and high wage rates are also forcing Korean manufacturing companies to suffer from high expenses. In particular, companies are very sensitive to interest rates because they heavily depend on the external borrowing of funds. According to the Bank of Korea, their debt ratio averaged 302.5 percent of their equity capital in 1994, higher than 209.3 percent for those in Japan and 166.5 percent for those in the U.S. Korea's manufacturing enterprises borrowed funds carrying an annual average interest rate of 11.4 percent in 1994, much higher than the 4.3 percent for Japan. Interest rates are the important factor for most companies trying to do business. Furthermore, because most Korean exports lack non-price competitiveness, exports depend too much on foreign exchange rates just as Korean firms depend on interest rates. Such gloomy economic circumstances stem from the structural weaknesses of the ailing economy, and economic conditions are not likely to turn for the better next year if current situation continues. In addition, the domestic market is rapidly being opened to be more like the members of the OECD (Organization of Economic Cooperation and Development), so that most firms will be challenged by intense internal and external competition and suffer from sluggish business. Thus, the government has proposed the slogan, "raise productivity by 10 percent and reduce costs by 10 percent simultaneously" to cope with Korean companies' recent gradual loss of global competitiveness. In addition, the national economy also needs to be transformed into an information and service-oriented economy to satisfy diversified consumer needs.

A $20 Bil. Current Account Deficit

Korea's current account deficit is likely to exceed $20 Bil. this year due to the surge in imports as well as sluggish exports. According to a government report, the nation's current account deficit is estimated at about $17 Bil. for the first nine months of this year. The increasing trade deficit is partly attributed to the declining export unit prices for semiconductor chips and to the rising imports of consumer goods, especially some high-priced luxury items. According to a report by the Bank of Korea, the decline in prices of 16-meg DRAM chips aggravated the nation's terms of trade by 7.4 percentage points in the first nine months of the year. The price of 16-meg DRAM chips was $50 on average last December, compared with $40 this past March, $16 in June and $11 in September. Imports of passenger cars, clothing, cosmetics and furniture have been major items this year due to the removal of import barriers and the growing spending by the new generation of consumers. The ratio of luxury consumer items to overall imports of consumer goods rose from 23.5 percent in 1985 to 41.2 percent in 1990 and 44.9 percent in 1995. Although the national economy has been sharply slowing down, consumers have spent more this year than last year. Household consumption rose 14.7 percent in the first quarter of this year from a year ago, exceeding its income growth rate of 13.2 percent. Hence, the marginal propensity to consume rose to 0.762, the highest level in four years. Unfortunately, the pace of the deficit growth does not look like it will slow down in the rest of this year because imports are rising faster than exports.

Slight Recovery in the Nation's Industrial Output

Korea's industrial output grew 8.2 percent in August from a year earlier but inventories were still high. The August output growth was up from an 8.1 percent year-on-year gain for July and an annual 3.7 percent rise for June due to strong domestic demand for oil products and increased exports of automobiles, office equipment and chemicals. In August, manufacturing industries operated at an average 83.5 percent of capacity, up from 82.7 percent in July. Inventories rose 18.3 percent in August from a year ago because of high inventory levels of base metals and semiconductors and poor domestic demand for passenger cars. Inventories of base metals jumped 66.7 percent, and those of semiconductors and electronics hopped 111.4 percent. This high rate of inventory shows that the economy is in a downturn phase. Wholesale and retail sales, however, increased 6.3 percent in August from a year ago, and the shipment of consumer goods rose 19.5 percent while imports of machinery jumped 25.9 percent in August from a year earlier. VIP

(Chan-Jin Kim)

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Recent Industrial Activities

(year-to-year change, %)

		1995		1996			
		Aug	Whole Yr.	1st. Qtr	2nd Qtr	July	Aug
Output	Output	13.2	11.9	8.6	7.3	8.1	8.2
	Heavy-Chemical Sector	19.0	15.8	11.3	9.8	10.5	11.6
	Light Sector	-2.2	0.9	-1.8	-1.4	-1.2	-3.6
	Inventories	12.4	14.9	19.1	20.9	18.3	18.3
	Capacity Utility Rate	82.5	82.4	82.3	81.7	82.7	83.5
Consumption	Wholesale & Retail Sales	8.1	7.8	8.3	7.0	6.8	6.3
	Shipment of Consumer Goods	7.6	7.4	5.3	7.4	5.0	0.4
Investment	Domestic Machinery Orders	18.4	15.8	9.7	22.5	-0.7	19.5
	Import of Machinery	8.3	27.0	16.0	12.9	9.9	25.9

Source: National Statistical Office