

## CONTINUOUSLY SLUGGISH KOREAN ECONOMY

*"The bottom of this business cycle will be reached in the beginning half of next year."*

The Korean economy seems to have displayed most of the typical characteristics of an economic recession in 1996. It can be said that this year's economic sluggishness has been caused mainly by the steep dive in exports and the subsequent plunge in fixed investment in those industries. Most economic forecasting institutions in Korea have therefore adjusted their predictions for the growth rate of the Korean economy in 1996 down to below 7%. The economic recession that the Korean economy is experiencing at this time is expected to continue through the beginning half of next year. Such a gloomy prediction can be derived by observing the recent cyclical movement of the Korean economy. Recent trends in the Korean economy have exhibited a cyclical pattern in which economic contractions have a time span of 16 to 19 months in one typical business cycle. Thus assuming that the peak of this business cycle was the third quarter of last year, the bottom of this business cycle will be reached in the beginning half of next year. However, the outlook on the Korean economy may be even more gloomy if the plunges in both exports and fixed investments are deeper than expected.

### *Continued Economic Slowdown Expected in 1997*

The key to the recovery of the Korean economy is the recovery of its exports and investments. Predictions on the world economy are a little better for next year so next year's export performance should improve a little over 1996, but not too much. Thus a drastic increase in exports and subsequently strong economic growth next year is not

realistic. Above all, the Japanese yen is supposed to stay weak against the US dollar, and the weak yen will make it tough for Korean exporters since Korean exporters and Japanese manufacturers compete against each other in many spheres in the world market. In addition, in the world market, the demands for the main Korean export goods, such as automobiles, semiconductors, and petrochemicals, are not forecast to be that strong. As a result of the slowdown in exports, next year's fixed investment is not expected to be strong either. Strong investment in equipment and facilities in particular is not expected, because manufacturers are now under pressure to adjust to the unusually high expansion in investment in these areas in 1994 as well as 1995. The low profitability of Korean companies can be another reason to expect low investment next year.

### *Even Private Consumption Expenditures Could Be Unstable*

Next year's presidential election will make the situation even more unclear with increasing uncertainties. Only investment in SOC is expected to increase a little bit next year over 1995 as the government intends to attract aggressively private investment in this area. On the other hand, private investments in construction are not expected to greatly increase next year. Additionally, private consumption expenditures are also expected to be weak, which would be another important factor delaying the quick recovery of the Korean economy next year. So far, private consumption expenditures in Korea have exhibited a tendency to grow some 7% in a fairly stable way. Private consumption

expenditures are, however, expected to plunge by a large degree in 1997 mainly due to the big drop in the growth of wages accompanied by the economic recession. Also, the sluggish movements in asset markets such as the real estate market and the stock market will make partial contributions to the dive in private consumption expenditures next year. Overall, due to the poor performances in exports, investments, and private consumption expenditures, as a whole the growth rate of the Korean economy in 1997 will be somewhere between 6.2% and 6.5%, which will be lower than the 6.9% expected in 1996.

Thanks to both the slowdown in economic growth and increasing openness of the domestic economy, the inflation rate will be lower in 1996 than in this year. On the other hand, the current balance deficit in 1997 is projected to improve a little because imports are supposed to grow at a decreasing rate as the economic slowdown will go on. Next year the invisible trade balance deficit is expected to be larger because economic activities abroad will rise. Interest rates will be lower in 1997 due to the weak demand for domestic credit. The government's efforts to open the financial markets gradually will also make contributions to stabilize interest rates.

### *Growing Current Balance Deficit Major Concern*

At present the most troublesome aspect of the Korean economy is the swelling of the current account deficit. The absolute size of the current account deficit may not be a major economic concern, but the rate at which it is growing is fast enough to cause alarm to policy-makers and economic experts alike. Korea's current account balance was a slight surplus in 1993, but a deficit of \$4.53 billion in 1994, and a deficit of \$8.82 billion in 1995. This year, the

current account deficit up to September has amounted to \$17.1 billion. Thus the current account deficit has been doubling annually in recent years.

The poor performance of the current balance is attributable to the pitiful performance of Korean exports due to the huge decline in the terms of trade. Since the beginning of 1996, the export prices of Korea's primary exportable commodities, such as semiconductors, steels, and petrochemicals, have unexpectedly declined to a large extent. As of August, in comparison with the same period of the previous year, the export unit value index and the terms of trade have declined by 12.8% and 12.9% respectively, which could turn out to be the single most important factor responsible for the poor performances of the current balance. In addition, the weak yen, weak demand in major trading countries for domestic goods, and the surges in travel expenses due to the rising overseas travel by Korean people are also helping to aggravate the current balance.

It is unrealistic to expect any time soon a drastic increase in the unit prices of the Korean primary exportables such as semiconductors thanks to rising demand. On the one hand, in October, exports other than semiconductors have come back to the right track and have increased 3.2% in comparison with the same month last year. On the other hand, exports of semiconductors have declined 44.4% in comparison with the same month in last year. Accordingly, up to October, imports have exceeded exports by \$16.8 billion. The growth of exports other than semiconductors is expected to successfully achieve an annual target of 8.1% this year.

### *Structural Adjustment Needed*

Concerning the explosive rise in the current balance deficit, it seems that economic policy-makers and experts have reached the broad consensus that the government has to be very

*"The current account deficit has been doubling annually in recent years."*

*"Korean companies will find themselves under more competitive pressure from outside."*

cautious in pursuing short-term counter-cyclical macroeconomic management to boost the sluggish exports and economy. It is generally recognized that a temporary makeshift solution is not enough to cure the economic illness of the Korean economy. Instead, most people have reached the conclusion that the Korean economy cannot avoid a painful structural adjustment in the long-run for the Korean exports to be competitive again in the world market. In any case, Korean companies will find themselves under more competitive pressure from outside, since Korea's formal entry into the OECD and the implementation of open-door policy will

inevitably result in a more competitive environment in Korea. The so-called 10-10 campaign to improve competitiveness by 10% can be seen as a recent policy measure to recapture the competitiveness of Korean goods in the world market. It will, however, take some time to see the effect of this kind of campaign and any readjustment of the economic structure cannot be achieved in a short time. Sometime in the future, the Korean economy will see whether its drive to boost its competitiveness in the world market has taken the right approach or not. **VIP**

*(Chang-Kyu Lee)*

<Table 1> Recent Economic Forecasts

(unit: %, billion dollars)

|                                  | 1996     |           | 1996      | 1997        |
|----------------------------------|----------|-----------|-----------|-------------|
|                                  | 1st half | 2nd half  |           |             |
| GNP                              | 7.3      | 6.6       | 6.9       | 6.2~6.5     |
| Private Consumption              | 7.3      | 6.8       | 7.0       | 6.3~6.6     |
| Fixed Capital Formation          | 5.7      | 4.9       | 5.3       | 4.5~6.0     |
| Equipment                        | 3.8      | 4.5       | 4.2       | 1.0~3.0     |
| Construction                     | 7.2      | 5.0       | 6.1       | 7.0~8.0     |
| Current Balance                  | -92.9    | -112.1    | -205      | -167~175    |
| Trade Balance                    | -52.1    | -67.9     | -120      | -101~107    |
| Exports-Imports                  | -77      | -113      | -190      | -172~176    |
| Exports                          | 651      | 655       | 1,316     | 1,409~1,424 |
| (%)                              | 11.8     | -1.5      | 5.3       | 7.1~8.2     |
| Imports                          | 728      | 778       | 12,506    | 1,581~1,600 |
| (%)                              | 11.5     | 11.4      | 11.5      | 5.0~6.2     |
| CPI(%)                           | 3.8      | 4.9       | 4.9       | 4.5         |
| Rate of return of corporate bond | 11.7     | 11.7~12.0 | 11.7~12.0 | 11.0~11.5   |
| Won/Dollar                       | 810.6    | 820~830   | 820~830   | 817~820     |
| Yen/Dollar                       | 109.8    | 109~111   | 109~111   | 106~109     |
| Unemployment rate                | 2.1      | 2.0       | 2.1       | 2.4         |