

KOREAN INDUSTRIES THIS YEAR AND OUTLOOK FOR 1999

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1998: Domestic Market Depressed,
Exports Slower Than Expected

Given the crisis which emerged at the end of 1997, everyone knew that the domestic market would be depressed in 1998; however, the severity of the slowdown has been far worse than anyone expected. In the first eight months of 1998, domestic manufacturing shipments were down -26.5% compared to the same period the previous year. What is worse, the downtrend in domestic shipments is continuing in recent months or even worsening (see <Table 1>). In fact, domestic demand has fallen by more than 30% in most sectors, with output in the automobile sector and domestic

construction sector falling by 50% or more. All in all, the domestic market has contracted to a disturbing degree.

Exports were expected as to act as a shock absorber for the economic downturn given the huge devaluation of the won and firms' determined export promotion drive. However, exports have been slower than was expected or hoped. Through the third quarter of this year, exports were down 1.4% compared to last year. Some of the main reasons behind the slowdown in exports have been the weak overseas markets because of the globe-wide effects of the Asian economic crisis and also the temporary paralysis of the trade financing system because of the domestic financial crisis. However, given the fact that export shipment growth rate has

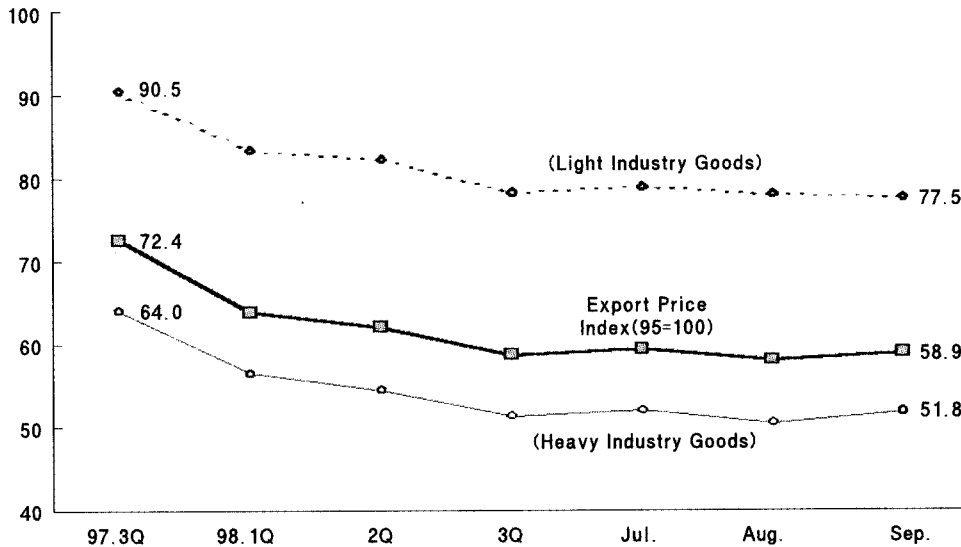
<Table 1> Trends in Manufacturing Production, Shipments,
and Inventories (Volume base)

	1997		1998				
	4Q	Year	1Q	2Q	July	Aug.	Jan~Aug
Production	5.3	6.7	-8.1	-12.0	-13.2	-11.9	-10.7
Avg. Cap. Util. %	78.0	79.9	67.3	67.1	63.7	62.9	66.3
Shipments	3.1	4.8	-7.8	-13.5	-14.4	-16.5	-12.0
Domestic	-3.5	1.0	-22.1	-28.0	-29.1	-32.0	-26.5
Exports	21.3	16.1	30.4	24.8	22.6	21.9	26.2
Inventories	5.3	5.3	-4.8	-7.7	-8.4	-6.4	
Index of Inventories Ratio	113.3	112.0	122.3	120.1	117.6	118.4	

* Note: 1) Index of Inventories Ratio = Inventories Index/ Shipment Index

* Source: Bank of Korea

〈Figure 1〉 Recent Export Price Trends



remained between 20~30%, it becomes clear that the most direct reason for the export drop has been the fall in export prices. In reality, the export volume index for the first seven months of 1998 stood at 172.9, up 25.3% from the same point last year, but over the same time the export price index fell 19.9% to 61.4 (1995 = 100). As a result, Korea's export competitiveness in its major industries seems to have reached its limits; the won's devaluation has caused most export prices to fall, and the resulting increase in export volume has not be great enough to make up the difference.

1999: Domestic Market and Exports To Recover Slightly, But Economy Still Depressed

Domestic demand is expected to recover slightly in the second half of next year as

the government-led restructuring of the financial and corporate sectors should be completed to a certain degree and the effects of the economic stimulus measures started in the fourth quarter this year begin to materialize. However, consumption sentiment will remain weak in 1999 because of internal restructuring and uncertainties about the future and so it is hard to expect a full-scale recovery. Furthermore, even though the statistical turnaround in domestic demand relative to 1998's sharp drop has significant meaning, the economy will continue to feel and appear depressed.

By sector, the automobile and steel sectors should show slight recoveries. Domestic construction will also gradually pick up, centering about the public sector because of the government's increased social overhead capital (SOC) spending as part of its economic stimulus package. However, private sector construction will only show a technical correction to 1998's huge

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Exports too will improve in 1999, but it seems unlikely that external economic conditions or Korea’s export competitiveness will improve significantly, and so the improvement will be slight. By industry, petrochemical exports, which showed a huge jump in 1998, and steel exports will have much lower growth rates (on a volume basis). In fact, exports of steel may actually turnaround and decrease with the emergence of anti-dumping regulations in some markets.

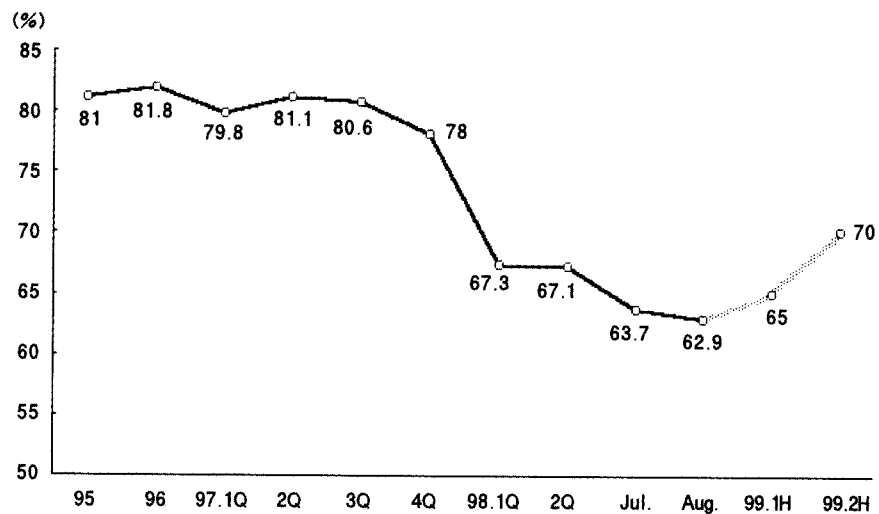
The sector which is expected to post the biggest increase in exports in 1999 is the semiconductor industry. The stabilization of the prices of 16M DRAMs and the on-going generational shift to 64M DRAMs should help semiconductor exports make a strong recovery in the second half of 1999. The shipbuilding sector should also be very promising. The demand for new shipbuilding orders is predicted to increase and with the strong yen, Korea’s price

competitiveness relative to its biggest competitor, Japan, will also improve.

The biggest factor which could the export forecasts for 1999 is whether or not the yen continues to remain strong. If the yen remains at around 120 yen/dollar and the won/dollar rate stays stable at the present level, then Korean steel and auto exports and shipbuilding orders should pick up considerably. Furthermore, if the yen stays strong for a long period of time, Japanese firms in the semiconductor, steel and other sectors whose profitability is strained will have to decrease production or exit the market, which will readjust the Korea-Japan industrial structure.

Because domestic demand and exports will only pick up slightly in 1999, even when the economy begins to recover in the second half of next year, the capacity utilization rate in the manufacturing sector probably still will not rise to the levels in previous years. In 1995~1996, the rate stood stable at around 81%, but when

〈Figure 1〉 Manufacturing Capacity Utilization Rate Trends and Predictions



the economic crisis broke out in the 4th quarter of 1997, it started to fall into the 70% range, and in the first half of 1998, it rapidly dropped to around 67%. The capacity utilization rate has fallen further to 63% in the third quarter, and is expected to stay around the same level in the

4th quarter. This is the lowest level since statistics were first kept in 1985. In the first half of 1999 the rate will remain at around 65%, but in the second half, it should recover to around 70%, but probably no higher. **VIP**

<Table 2> Forecasts for the Major Industries in 1999

		1997	1998(e)	1999(e)
Steel	Domestic (1000 tons)	38,145(1.5)	24,728(-35.2)	26,308(6.4)
	Exports (")	10,364(9.6)	14,738(42.2)	13,991(-5.1)
	Production (")	44,733(5.6)	38,095(-14.8)	38,971(2.5)
	Imports (")	3,776(-19.0)	1,371(-63.7)	1,519(10.8)
Petrochemicals	Domestic (")	8,902(11.2)	7,606(-14.5)	7,377(-3.0)
	Exports (")	4,887(36.5)	6,608(35.2)	7,019(6.2)
	Production (")	12,491(21.4)	13,258(6.1)	13,536(2.1)
Semi-conductors	Imports (")	1,298(0.1)	956(-26.3)	860(-10.0)
	Production (bil. ₩)	18,923(18.0)	21,090(11.5)	22,798(8.1)
	Exports (mil. \$)	17,424(-2.3)	17,721(1.7)	19,546(10.3)
	Imports (mil. \$)	12,888(22.2)	12,169(-5.6)	11,122(-8.6)
Machinery	Orders (bil. ₩)	876.7(-15.4)	701.4(-20.0)	648.8(-7.5)
	Exports (mil. \$)	395(-23.0)	691(75.0)	795(15.0)
	Production (bil. ₩)	952.2(-14.2)	679.8(-28.6)	606.4(-10.8)
Automobiles	Imports (mil. \$)	1,205(-32.9)	490(-59.3)	467(-5.0)
	Domestic (1000 units)	1,513(-8.0)	721(-52.3)	850(17.9)
	Exports (")	1,317(8.8)	1,320(0.2)	1,375(4.2)
Shipbuilding	Production (")	2,818(0.2)	2,041(-27.6)	2,225(9.0)
	Orders (10,000 GT)	1,275(82.8)	970(-23.9)	1,050(8.2)
	Exports (bil. \$)	6.52(-8.5)	7.63(17.0)	7.40(-3.0)
	Production (10,000 GT)	745(-4.5)	850(14.1)	870(2.4)
Domestic Construction	Private (tri. ₩)	44.3(7.5)	20.3(-54.2)	21.5(5.8)
	Construction	37.9(1.6)	18.3(-51.7)	19.6(7.1)
	Engineering	6.5(62.5)	2.03(-68.8)	1.9(-6.4)
	Public (tri. ₩)	35.4(8.9)	30(-15.3)	33.6(12.0)
	Construction	8.1(5.2)	6.6(-18.5)	7.2(9.3)
	Engineering	27.3(9.6)	23.4(-14.3)	26.4(12.9)
	Total (tri. ₩)	79.7(8.1)	50.4(-36.8)	55.2(9.6)

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