

## THE KOREAN ECONOMY IN 1999: A REVISED FORECAST

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*Changes in the Economic Environment*

Recently the Korean economy has been showing some signs that it has almost reached the bottom of business cycle. The downward trend in industrial production is apparently slowing down. Industrial production, which had been showing double digit decreases (year-on-year) for six straight months since March, has been registering much smaller drops and even increased in September. The Gross Domestic Production statistics released by the Bank of Korea last month also imply that the Korean economy almost reached the bottom of the business cycle.

The recovery of exports in November is also deemed to be a positive change. Exports, which had been decreasing on a year-on-year basis for six months since May, increased in November, although the change rate was not very big.

The movements of the business cycle composite indexes also confirm that the Korean economy is near the bottom of its cyclical movement. The cyclical component of coincident composite index rose in October, as well as in September. It is the first time since December of 1996 that the index has risen for two consecutive months, although this is not necessarily evidence of a recovery yet.

The foreign capital inflow for both portfolio investment and direct investment is booming as well. Foreign portfolio investment has amounted to \$4.5 billion since January, compared with the 1997 total of \$1.1 billion. The inflow of foreign direct investment was reported to be \$7.0 billion since January, which is an increase of 16.4% on a y-o-y basis.

*Revision of 1999 Economic Outlook Necessary?*

Korea's economic outlook has improved since the original forecast in October in consideration of the economic performance in the 3rd quarter, the recovery of exports, and the consecutive rises in the cyclical component of coincident composite index. However, it is still difficult to radically revise our forecasts.

The recent slowdown in the decrease in industrial production has been mainly due to the increases in semiconductor production. Exports of semiconductors have been rapidly increasing because of seasonal demand increases and adjustments in production. Production of semiconductors increased 74.0%, but that of machinery equipment dropped -35.3%, automobiles -27.7%, and assembled metallic products -27.2%. The high increase in semiconductor production makes it seem like the entire industrial production index is rising.

Even though exports have been rising, domestic demand remains flat. Aggregate consumption for the 3rd quarter dropped -11.8%, which is hardly different from the 2nd quarter's 12.9%. The wholesale and retail sale index in October decreased 13.6%, which is lower than September's 11.9%.

On the other hand, the predicted current account surplus in 1999 is expected to be higher than we predicted in October. Exports will continue to shrink for the 1st half of 1999, while the increase in imports will not be as much as previously expected. In the last forecast, we predicted the increase in imports will reach up to 21.1% due to the lack of raw materials and cap-

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ital goods resulting from the rapid shrinkage of imports in 1998. However, this estimate for the import increase rate has been revised lower due to the low probability of the recovery of domestic demand and uncertain prospects of exports.

It is hard to expect that the external trade surplus can lead the recovery of the Korean economy. Even though exports may boom, corporate sales cannot increase without the recovery of domestic demand: for example, in the first quarter of 1998, exports increased 8.5% and the trade surplus amounted to \$8.6 billion, but the domestic economy continued to fall.

Due to the factors stated previously, we have not revised our forecast for GDP. Our revisions

were focused on international transactions and financial indicators in consideration of the recent changes in government’s intention and also capital inflows.

Major Economic Indicator Forecasts

The nation’s economy in 1999 is going to grow at a 0.3% rate, which is the same as our previous forecast. Domestic demand does not seem likely to recover in the near future. The speed of recovery in consumption will be very slow due to the decline in real household income and the high unemployment rate.

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<Table 1> 1999 Economic Forecasts

(unit : %, billion dollar)

		1997	1998	1999		
				1st half	2nd half	
	Gross Domestic Product	5.5	-5.5	-2.5	2.8	0.3
	Consumption	3.5	-11.2	0.2	1.7	1.0
National	Private Consumption	3.1	-11.7	-0.4	1.4	0.5
Account	Total Fixed Capital Formation	-3.5	-26.0	1.5	3.5	2.6
	Facility Investment	-11.3	-43.3	-1.4	2.7	0.7
	Construction Investment	2.7	-14.1	2.9	3.9	3.4
	Current Account	-8.6	40.8	12.4	11.9	24.3
	Trade Balance	-8.4	39.5	13.4	12.9	26.3
International	Exports(FOB)	136.2	132.9	65.5	68.1	133.6
Transaction	(change, %)	(5.3)	(-2.4)	(-2.4)	(3.5)	(0.6)
	Imports(CIF)	144.6	93.4	52.1	55.2	107.3
	(change, %)	(-3.8)	(-35.4)	(10.4)	(19.6)	(14.9)
	Consumer Prices (average)	4.5	7.5	1.2	3.0	2.1
Price	Corporate Bond Yield (end of period)	29.0	9.5	8.5	9.5	9.5
Indexes	Won/Dollar Exchange Rate (end of period)	1,415.2	1,250	1,300	1,250	1,250
	Unemployment Rate (average)	2.6	6.8	8.1	7.8	8.0