WHEN WILL RECOVERY BEGIN INDEED?

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Signs of Recovery

The coincident composite index, which reflects the current economic situation, has been rising since August 1998. The leading composite index, which mirrors the economic situation several months ahead, also rose 1.8 percent in January 1999 from December 1998. Therefore, it seems that the Korean economy most likely hit bottom in the 4th quarter of 1998. This can be verified by the fact that in the past, the business cycle has not re-contracted after the leading composite index and coincident composite index had been rising for more than 5 months.

Industrial output grew 14.7 percent in January 1999 on a year-to-year basis, compared with 4.8 percent in December and 0.3 percent in November. It has been rising since November 1998. Consumption and investment are also beginning to show signs of increase. Wholesale and retail sales rose 2.8 percent in January, as purchases of cars and fuel oil increased. At the same time, shipments of consumer goods for domestic demand rose 7.6 percent year-to-year in January, marking the first increase since late 1997. On the capital expansion side, local machinery orders, the main indicator of corporate facility investment, rose 39.6 percent year-to-year in January, compared with a 0.9 percent increase in December.

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Obstacles on the Road to Recovery

In spite of these good signs, domestic aggregate demand still does not seem to have fully recovered in such a short period of time. Above all, high unemployment will impede the revival of consumer sentiment. By all indications, more layoffs are likely this year with restructuring being stepped up. The National Statistical Office (NSO), the government's official statistics bureau, revealed that the monthly jobless rate hit a record high of 8.5 percent in January, which is the highest figure since 1966 on a monthly basis. The 8.5 percent jobless rate means 1.76 million people are out of work despite their active efforts to find a job. Furthermore, unemployment rate is expected to hit the psychologically important 9 percent mark in March.

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To make things worse, this number may not fully reflect the real situation. Many experts think that the actual number of jobless (effective unemployment) could surpass 3 million if part-time workers, homeless and daily workers are combined. Even if the consumer sentiment of the high income group begins to revive, it is still hard to expect that overall consumption, which largely depends on permanent income, of the middle income class will recover amid the high unemployment. In particular, as the recent increase of wholesale and retail sales could be attributed mainly to a sudden increase of car sales, a sustained expansion of consumption expenditure cannot be easily expected.

In addition to the doubtful prospects in consumption, construction activity demand still remains in deep doldrums. Local construction orders fell 20.5 percent in January and the volume of land approved for construction in January contracted 56.4 percent, compared with a year-to-year decline of 61.6 percent in December.

The negative effect of the yen depreciation should also not be neglected. Fortunately, however, the BOK has apparently succeeded in keeping the won/100 yen exchange rate to be around 1,000 won level for now. But after the full liberalization of foreign exchange transactions scheduled in April, more foreign capital inflow might be expected. In fact, the rising trend in exports ended in February this year. Exports fell 16.0 percent from a year earlier in February, mainly because of temporary factors such as the export of gold bars and unused machinery, which inflated last year's total. Since these temporary factors lasted until April in 1998, a short term year-to-year increase in exports cannot be expected for the time being.

In addition, the overall export climate will not be favorable. First, global economic growth will slowdown considerably. We estimate that the growth rate of the global economy in 1999 will be only 1.9%, which is much lower than that in 1998. The slowdown of the U.S. economy and continuation of the emerging markets' unstable situation are the main reasons. Second, developed countries might raise the walls of protectionism. In particular, the U.S. decision to re-institute Super 301 might darken the export outlook.

A storm of labor unrest might also appear on the horizon. The government is trying to appease workers' discontent, which accumulated in the process of the restructuring drive last year, but it appears to be a hard job. In spite of many policy measures, however, the prospect of the tri-partite agreement which was established last year remains very unstable. The Korean Confederation of Trade Unions (KCTU), the more progressive of Korea's two labor union umbrella groups, declared in intent to withdraw from the tri-partite commission. The union leaders demanded the immediate halt of restructuring, the repeal of the legalized layoff system, and shortened legal working hours. Fortunately, the Federation of Korean Trade Unions (FKTU), the other union umbrella group, put on hold its withdrawal for a month until the end of March. At any rate, the government ultimately might have to accept some of the labor unions' demands, which might hurt restructuring.

The government estimates the cost of financial restructuring including the cost of clearing out bad loans will amount to 120 trillion won. Some experts believe the amount of bad loans even exceeds this number. In any way, this will be financed by new issuances of government or public bonds. Therefore, this fiscal burden can impede the government' ability to boost economy by constraining the capacity of government spending.

Turning up smoothly?

The economy seems to have bottomed out from its absolute worst. But it is too early to declare that the economy is turning up smoothly. There are many potential obstacles to impede economic recovery, and so there is definite reason to keep the expansionary policy stance. To preserve the trend of economic recovery, the government should try to accelerate restructuring and build up its stimulus package to boost the economy. VIP

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