

WHEN WILL THE KOREAN ECONOMY REVIVE?

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Performance in 1998

In 1998, the Korean economy experienced the most severe contraction in its history. Gross Domestic Product(GDP) shrank 5.8% after 5% growth in 1997, mainly due to the contraction in domestic demand and investment. This performance is the worst ever since the Bank of Korea began keeping statistics in 1953. Nominal GDP amounted to 321.3 billion dollars(449.5 trillion won), which is 155.3 billion dollars less than 476.6 billion dollars in 1997. Per capita Gross National Income(GNI), a new index developed by the UN and the IMF to measure consumers' real purchasing power and used as a substitute for the per capita GNP, also dropped from \$10,307 in 1997 to \$6,823 in 1998. With these drops, Korea is presumed to have ranked 17th in nominal GDP volume and 42nd in per capita GNI in the world last

year, 6 places and 9 places down from the 1997 rankings, respectively.

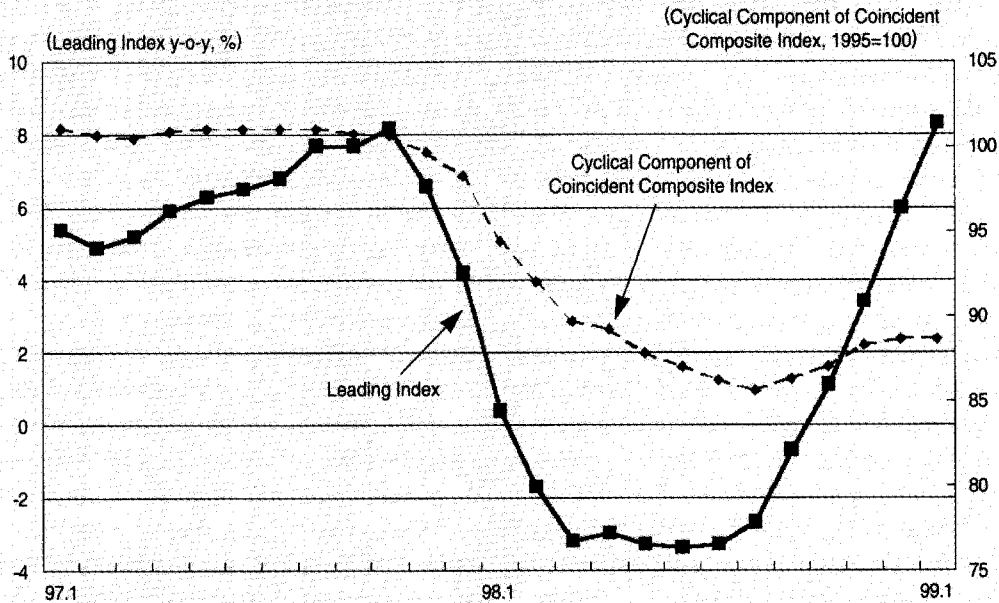
The level of private consumption fell by 9.6% in 1998, against a 3.5% rise in 1997, owing to a reduction of household income during the economic crisis. Meanwhile, facility investment plunged a stunning 38.5% and construction investment dipped 10.2%. Only exports rose 15.6% supported by increases in exports of semi-conductors and steel. All industrial sectors showed negative annual growth rate: -9.0% in construction, -7.2% in the manufacturing sector, -6.3% in the agricultural, forestry and fisheries sector, and -5.4% in the service sector.

Looking at quarterly performances, the GDP growth was -3.6% in the first quarter of 1998. It worsened significantly to -7.2% and -7.1% in the second and third quarters, respectively, mainly due to the continued contraction in domestic demand. But in the fourth quarter, the decline

Table 1. Major Economic Indicators

	1997	1998(P)				(unit: dollar, %)
		yearly	1Q	2Q	3Q	
Gross Domestic Product (GDP)	5.0	-5.8	-3.6	-7.2	-7.1	-5.3
Final Consumption Expenditure	3.2	-8.2	-8.4	-9.7	-8.9	-5.8
(Private)	3.5	-9.6	-9.9	-11.2	-10.4	-6.9
(Government)	1.5	-0.1	1.3	-0.7	-0.6	-0.4
Gross Fixed Capital Formation	-2.2	-21.1	-20.6	-23.7	-22.2	-17.9
(Construction)	2.3	-10.2	-5.9	-7.8	-12.0	-13.7
(Facility)	-8.7	-38.5	-38.3	-46.1	-39.3	-27.4
Exports of Goods, Services	21.4	13.3	25.7	13.2	8.0	8.8
(Merchandise)	21.5	15.6	27.1	16.5	9.5	11.5
Imports of Goods, Services	3.2	-22.0	-27.2	-25.5	-25.9	-9.0
(Merchandise)	3.1	-24.6	-27.7	-27.3	-28.7	-14.8
Gross National Income Per Capita	10,307	6,823	-	-	-	-

Figure 1. Trend of Business Cycle



in GDP growth lessened somewhat to -5.3% as the level of consumption partly recovered.

Current Economic Conditions

As one can see in the quarterly statistics, it seems that the Korean economy hit bottom in the 4th quarter of 1998, which can be confirmed in the movement of composite index of business indicators. The leading composite index has risen for seven consecutive months since June 1998. The cyclical component of coincident composite index has also been rising since August 1998. Industrial product index, which had been falling on y-o-y basis since January 1998, turned to a rising trend from November 1998 onward.

The fact that the economy hit bottom, however, does not necessarily mean that it will be on the upturn at once. Three consecutive months' expansion of industrial output is mainly based on seasonal factors and a technical rebound from the contraction last year.

Therefore, one cannot be sure whether it will continue to rise or not. Although consumption and investment seem to have bottomed out from its worst, they are still in seriously depressed states. Further more, owing to restructuring of the entire economy, conventional ways of analysis through major business cycle indicators possess less and less of their explanatory and forecasting power. So until additional evidence is accumulated, it is not appropriate to say that the economy is in a full recovery. What is more, there are several potential obstacles in each economic sector which might impede the path to recovery.

Potential Obstacles Ahead

Domestic aggregate demand: One of the obstacles of economic recovery henceforth, first of all, is the continued contraction in consumption and investment. Although recent indexes are turning to a rising trend, the general sentiment of consumers and investors have not revived yet. Since the

recent increase in wholesale and retail sales can be attributed mainly to a sudden increase in automobile sales, the persistence of the consumption increase is doubtful. The recent rise in domestic machinery orders received, one of the facility investment indexes, shows that facility investment will at least "grow" this year. In terms of absolute amount, however, it is still below that of January 1996. Construction investment, in particular, still remains in a deep recession. Wage reductions and mounting unemployment will continue this year, so private consumption is not expected to increase greatly. Investment is likely to be quite restrained, since most firms are compelled to reduce their debt burdens and improve their short-term cash flows.

Exports: In February, exports dropped 16.0% on y-o-y basis. This is because couple of extraordinary factors which occurred in February of 1998: unusual exports items (gold and idle machinery) and three extra working days. This falling trend continued in March, marking an 1.9% drop. The export environment is not likely to improve in the next several months. The most important factor is the continuing yen depreciation and strong won vis-a-vis yen. Until now, the weak yen has caused the won/dollar rate to move between the 1,150~1,250 won per dollar range. It is due to the indirect intervention by the BOK in an effort to keep the won/100 yen rate around 1,000 won. The liberalization of foreign exchange transactions scheduled in April may bring the won/100yen below 1,000 won, however, and result in a further slump in exports. Also, global economic and trade growth will slow down in 1999; meanwhile the spread of trade conflicts will persist in 1999. There is a possibility that exports which have supported the Korea economy since the outbreak of the economic crisis, may continue to decrease for the first half of the year.

Labor Market: High unemployment is an obstacle to the economy recovery as well. In spite of the increasing industrial production,

instability of employment is getting worse as the unemployment rate is rising above 8%. Because of the ongoing restructuring in the banking and corporate sectors, it will take time until the economic recovery brings a positive impact to the labor market. Most observers worry over the possibility of potential unrest on the part of the labor. The recent instability in labor-industrial relations recently is quite an obstacle on the recovery path. The Korea Confederation of Trade Unions (KCTU) declared its withdrawal from the tripartite committee which represents labor, business & government; they will go out on a general strike in April if their demands are ignored. In addition to this, wage negotiation is another negative factor. Unlike in 1998, workers are expected to demand higher levels of wages as the economy pulls out of recession, but companies facing the problem of financial restructuring do not have much room for this demand from labor. Meanwhile, restructuring in both the private and public sectors will force the labor unions to adopt hard-line stances in order to ensure their job security. The unstable labor-industrial relations might hurt the economy's sovereign credibility, which is a definite threat to the recovery in the overall economy.

When Will the Economy Turn Up?

As is mentioned above, the Korean economy is out of the worst situation but still faces many obstacles. Many experts agree that the economy will show signs of rising mood from the second half of this year. But if these negative factors linger on, the recovering path is going to show a prolonged "U" shape. What is worse is the possibility of no signs of recovery in the near future ("L" shape) or the double dip "W" shape of the business cycle. It will take longer than expected for a full recovery of the Korean economy if the government, the labor, and the businesses cannot work out a wise and balanced solution to the current problems. 