

ECONOMY IS ON THE UPTURN, BUT WITH PROBLEMS INSIDE

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Economy Is Upturning

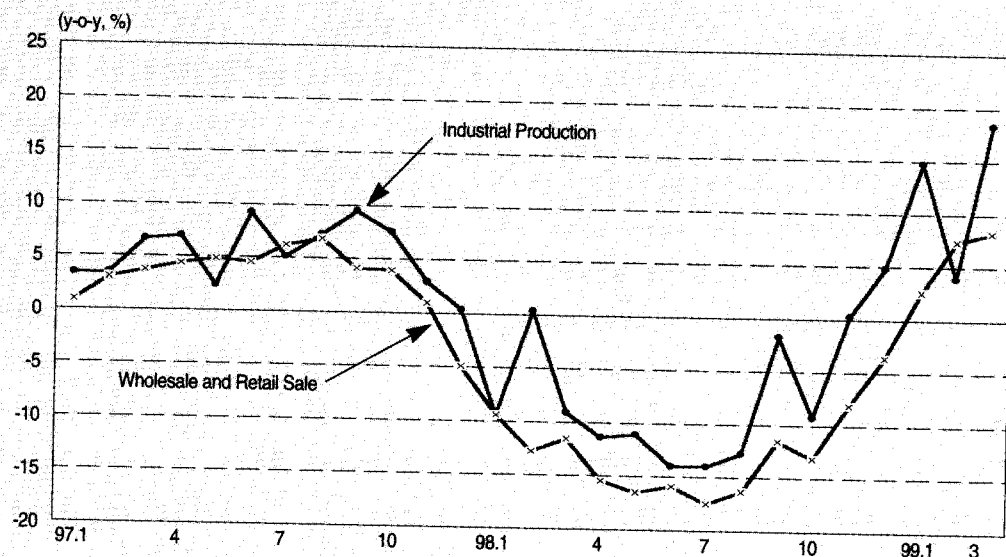
The Korean economy seems to have bottomed out from its worst and is now on the upturn. Consumer spending has been rising since January while wholesale and retail sales rose 8.2 percent in March, as purchases of cars and oil fuel increased. Shipments of consumer goods for domestic demand rose 19.0 percent year-to-year in March. The recent recovery in consumption seems to be a technical rebound from the severe contraction in consumption in 1998. It has also been influenced by the low interest rates, climbing stock prices and lessened wage-cuts.

However, investment and exports still remain stagnant. On the capital expansion side,

local machinery orders, the main indicator of corporate capital spending, rose 15.8 percent year-to-year in March. Nevertheless, the high increasing rate simply signifies a technical rebound from the dramatic spending atrophy last year. In the same month, local construction orders fell 51.1 percent and the volume of land approved for construction dropped 29.6 percent. Exports decreased by 3.6 percent year-to-year in April.

Industrial output has been rising since November 1998 on a year-to-year basis and grew 18.4 percent in March 1999. Industrial output is rising because companies' outlook on the future economic situation is improving. However, industrial output is rising much more than demand is increasing. There are two ways of explaining this phenomenon. One is that industrial output contracted more severely

Figure 1.



than demand in 1998. The other is that a substantial part of the production increase is going to inventories, instead of consumption. Consequently, it is not a demand increase but a reduction in the inventory decreases which is leading the economic recovery.

Several Problems Remain

There are several potential problems lying ahead: the weakened lowered purchasing power, labor dispute, and possibility of instability in financial markets.

Whereas consumption by the upper-income class is still active, the middle class has not yet regained its robust purchasing power. What is worse, many indicators support the worry that Korea's middle class has been dwindling since the outbreak of the crisis.¹⁾ A recent survey by HRI shows that one out of three families which once considered itself middle class before the economic crisis now believes it is lower class. The middle class, which forms the economic backbone of a country, now accounts for only 41.4 percent of the Korean population, as compared to pre-crisis 61.1 percent. The once diamond-shaped social structure with the middle class forming the central bulge has thus been transformed into a pyramid-shaped one with the lower classes becoming the largest component. The major reason for this downgrade seems to be income reduction and layoffs. What makes the situation even worse is that 80% of those who lost their middle-class status are pessimistic about their prospects of regaining the former status within the next three years. To boost the economy, the purchasing power of the middle class should be restored.

Regarding labor disputes, it is fortunate that the recent storm of labor unrest has subsided without drastic side effects. From the late 1980s till the early 1990s labor unions used to

receive moral support from the general public depending on the issues. However, these days the Korean public is focusing its attention on full economic recovery and fair pain-sharing; consequently they do not listen to and nor sympathize with labor's argument. The case of the Seoul subway workers, who went on a bitter strike and failed to gather public support, is a good example. Although the weakened labor organizations are considered not to pose a significant threat to the national economy, elements of instability have not disappeared completely. The Korea Confederation of Trade Unions(KCTU), the more progressive of Korea's two labor organizations, is moving toward an all-out struggle with the government. The KCTU plans to call a nationwide general strike in May in protest of large-scale layoffs under the government-imposed restructuring program.

The possibility of a yen depreciation or the won appreciation is another source of concern. As the current account surplus continues and the capital inflow increases, the won/dollar exchange rate may go down, weakening the competitiveness of Korean exports. Meanwhile, there are still concerns over the possibility of a bubble phenomenon in the securities market. With the large flux of foreign capital into Korea and low interest rates, the KOSPI has jumped over 800 points. These trends are influenced by the spread of optimistic views overseas on Korea's economic outlook and signs of Korean economic recovery reflected in several macroeconomic indicators. However, in financial indexes have improved much faster than the real economy indicators. Though the Korean economy needs a booming stock market for corporate restructuring and for expanding consumption expenditures, stock price and the overall volume of investment may need to be slightly moderated in order to avoid a sudden fall in the market. **VIP**

1) An article in this issue of the *VIP Economic Report* deals with this topic. Please refer to "Korea's Dwindling Middle Class" for the details.