

ECONOMY MAKES A SURPRISE EARLY COMEBACK

Chang-Kyun Chae
(ckche@hri.co.kr)

Surprising Economic Recovery

The GDP growth rate in the first quarter of 1999 marked 4.6%, much higher than the prevalent forecast. In April, production increased by 17.1% year-on-year; capacity utilization ratio of manufacturing was 74.2%, maintaining the level in March. Wholesale and retail sales, which indicate the trend of consumption, went up 8.2%, showing the biggest increase since last February. Facility investment rose 29.4%, finally riding the increasing trend in the second quarter of 1999.

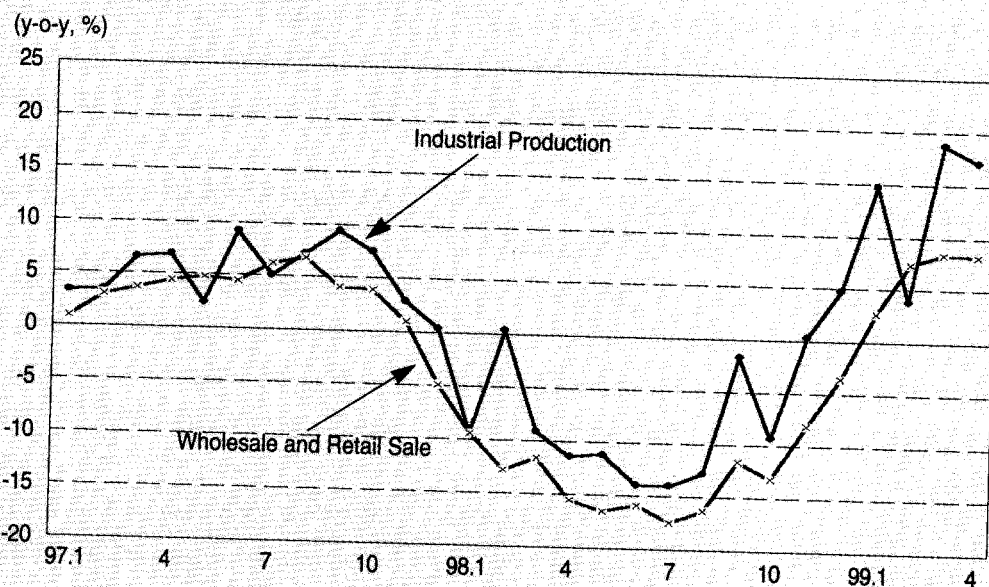
What should be taken into consideration is that the sudden changes are more technical rebounds to the excessive contractions in 1998; thus, the absolute scale of increases is trivial. Construction investment is improving from

April, yet this is mainly due to the government's early fiscal expenditures. It will require more time to see whether this is a signal of the genuine recovery of the construction industry.

As the GDP growth rate in the first quarter was the highest in 1998, the GDP growth rate, which is technically expressed on a year-over-year basis, from the second quarter of 1999 will be higher than that of the first quarter of 1999, as long as the first quarter's trend continues.

The effects of fiscal expenditures in the first half of 1999, which amounts to 70% of this year's planned budget, will materialize in the second half.

Considering all these positive factors, there is a high possibility that the growth rate of 1999 may be in the 5-6% range. The actual growth rate is expected to be close to the



potential growth rate (estimated to be around 5%). It is not likely that Korea will go through what happened to Japan in the 1990s: if economic recession continues for long, those engaged in economic activities may show a prolonged tendency to set their economic goals lower than the potential growth rate, thus the real growth rate may become lower than the potential growth rate.

Figures Are Just Part of the Jigsaw Puzzle

Another important characteristic of the Korean economy's first quarter performance is that the supply side and the demand side of GDP showed different pictures from each other. Also, since increased supply, not demand, is leading the economic recovery, the current economic upturn does not mean the economy is overheating. While the production side of GDP in the first quarter of 1999 marked a 4.6% growth in comparison with the previous year, aggregate demand, or the demand side of GDP, went up only by 0.1%. The gap between supply and demand is attributed to the unprecedented decrease and rebound in inventories during 1998 and 1999, respectively.

Facility investment is not experiencing

substantial recovery because of the aftermath of restructuring; companies cannot commit themselves in investment and are prudently weighing the odds of resuming facility investment, as the economic outlook is still hazy.

As is forecast, the overall GDP growth rate will look decent this year. Economic recovery in the genuine sense will, however, depend on whether the statistics continue to improve in 2000. It is possible that consumption growth may slacken. The recent increase in consumption stems from a technical rebound from the drastic austerity in 1998, backed by the increase of asset income from the bullish stock market; thus, the income rise may not be sustainable. Wage income is likely to remain fixed at the current level, and the high unemployment rate may curtail the recuperating trend in consumer spending. Investment and exports may not easily return to the pre-crisis boom level. A possible US interest rate hike, devaluation of the Chinese yuan and worsening yen weakness will remain as potential stumbling blocks to the Korean economic recovery. Therefore, the policy agenda facing Korea's policy-makers should be focused on how to "revive and sustain" the demand side of the macro-economy. **VIP**

Table 1. Economic Outlook of 1999

Category	1998	1999(p)			
		Q1	1st Half	2nd Half	Annual
GNP (%)	-5.8	4.6	5.2	5.5	5.4
Total spending (%)	-8.2	5.0	5.1	5.9	5.5
Construction investment (%)	-10.2	-13.7	-13.9	-5.3	-9.3
Facility investment (%)	-38.5	12.9	13.0	14.0	13.5
Current account (\$Bil.)	40	6.5	13.7	9.2	22.9
Export (\$Bil.)	132.3	30.3	65.4	67.6	133.0
Import (\$Bil.)	93.3	25.6	53.2	58.1	111.3
Consumer prices (%)	7.5	0.7	1.0	3.2	2.1
Yield on corp. bond (%)	8.0	8.1	8.3	8.7	8.7
Won/\$ exchange rate (won)	1,204.0	1,227.0	1,200.0	1,150.0	1,150.0
Unemployment (%)	6.8	8.4	7.6	6.6	7.1