

REAL ECONOMIC INDICATORS OUTSHINE SHAKY FINANCIAL MARKETS

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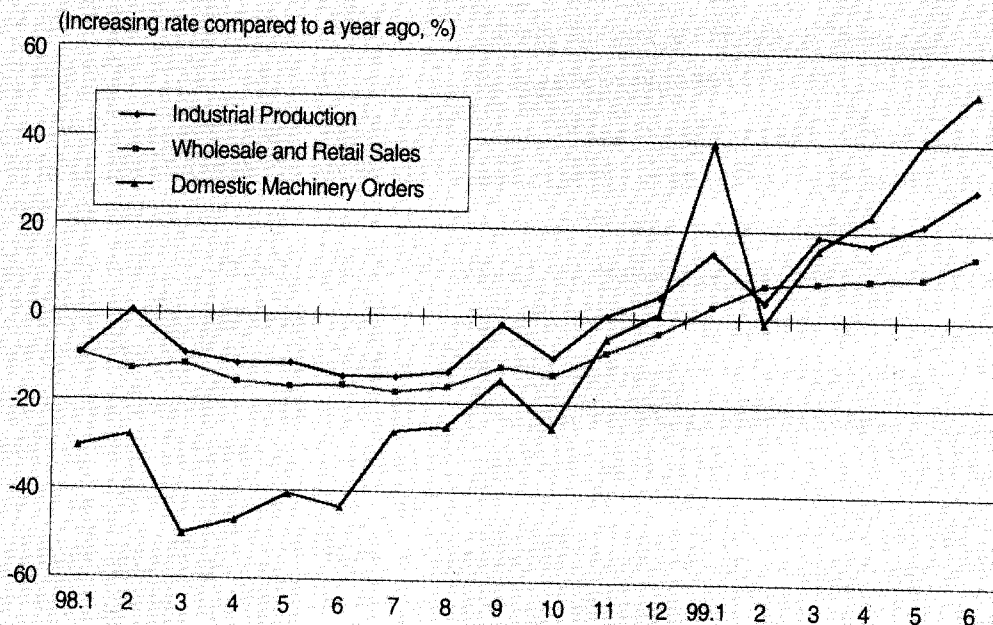
Real Economy Continues to Show Better Results

Industrial production has continued the rising trend since last November. In June, it grew by a remarkable 29.5% increase. More importantly, the capacity utilization rate, which remained in the 60% area last year, began to pick up in this year, recording at 79.8% in June. This is higher than the pre-crisis yearly average (79.0%). The recovery of the real economy is also causing the unemployment rate to continuously drop; in February 1999 it was 8.6% but it fell down to 6.2% in June.

Construction investment still needs to go far

before reaching a desirable level, but facility investment is doing better, led by rising orders of transportation equipment. In June, facility investment-related indicators fared well; domestic machinery orders and imports of machinery products posted 51.1% and 46.9% increases, respectively.

A substantial increase in exports is clearly visible, thanks to the economic recovery of other Asian countries; export orders in the semiconductor and automobile sectors continued to surge. Exports in July amounted to \$11.9 billion, up by 18.6% from the same month a year ago. Meanwhile, rising consumption, coupled with the increasing export-purpose capital goods, drove imports up by 38.3%. As a result, the trade surplus this



year is considerably smaller compared to last year's.

Amidst the rapid improvement of real economic indicators, perceptions of an earlier-than-expected economic recovery are spreading; many including the Bank of Korea and Korea Development Institute (KDI) have expressed their worries of the economy overheating.

A Wait-and-See Attitude Is Needed

Judging from several aspects, however, such concerns may be premature. The absolute level and the pace of recovery in consumption tell us that there is still a long way to go before returning to the pre-crisis level. The current consumption level is close to that of 1996. The recovering pace is not as quick as in the past boom years. One of the reasons for the recent increase is the resumption of consumption from which consumers deferred during 1998. The wealth effect, which is mostly based on the recent boom in the stock market, has also contributed to boosting consumer spending. In sum, the consumption trend today may not be sustained.

The capacity utilization at present is still lower than that of the past days when the economy was indeed overheating. Compared to the 80-81% manufacturing capacity utilization at the peak of past business cycles, the current rate is not high enough to create a bottle-neck situation in the aggregate supply side of the economy.

Although facility investment is rising its absolute size is still too small to act upon the economy as an overheating factor. Rather, if the stagnation of investment continues, inflationary pressures may threaten to depress the potential growth rate from next year on.

The potential GDP growth in the first half of 1999 is 3-4%, whereas the real GDP growth in the first half of 1999, compared to 1997, falls short of the potential GDP growth, staying at the 1-2% level.

Financial Markets Experience Unforeseen Jitters

The financial markets are still shaky from the aftershocks of the Daewoo business group's restructuring plan. Throughout July, Daewoo's debts fueled fears of higher interest rates in the money markets; the yield on 3-year corporate bond jumped to 9%. The government's swift rescue package managed to subside the panicky mood, yet unstable factors still linger in the markets and the supply and demand situation in the bond market continues to deteriorate. The interest rates may experience ups and downs for a while.

The Korea Stock Price Index (KOSPI) truly roller-coastered in July, reaching the year-high 1,027.9 points and an all-time-biggest fall in one day of 71 points. The composite stock exchange index moved in the 900-point range and could not recapture the 1,000-point line. Foreign investors have turned to net selling and investor sentiment in general has been worsened by the foggy future of insolvent Daewoo. It is still early to say whether the fluctuating correction will continue in August as well, but other unforeseen events may wait, either to the delight or horror of the investors.

The won/dollar exchange rate returned to the 1,200 won/dollar range, rising by more than 50 won compared to the end of June because of the Korean government's "control measures" to limit the supply of dollars, Daewoo's credit crunch and the high possibility of the Chinese yuan's devaluation.

All in all, July was a month when the Korean economy was tested on whether or not it can absorb or manage unexpected shocks both inside and outside. As the economy is restructured and opened wider, a similar situation may occur in the near future. How to deal with this uncertainty would be the primary policy issue for the remainder of this year. **VIP**