

HIGH GROWTH AMIDST FINANCIAL INSTABILITIES

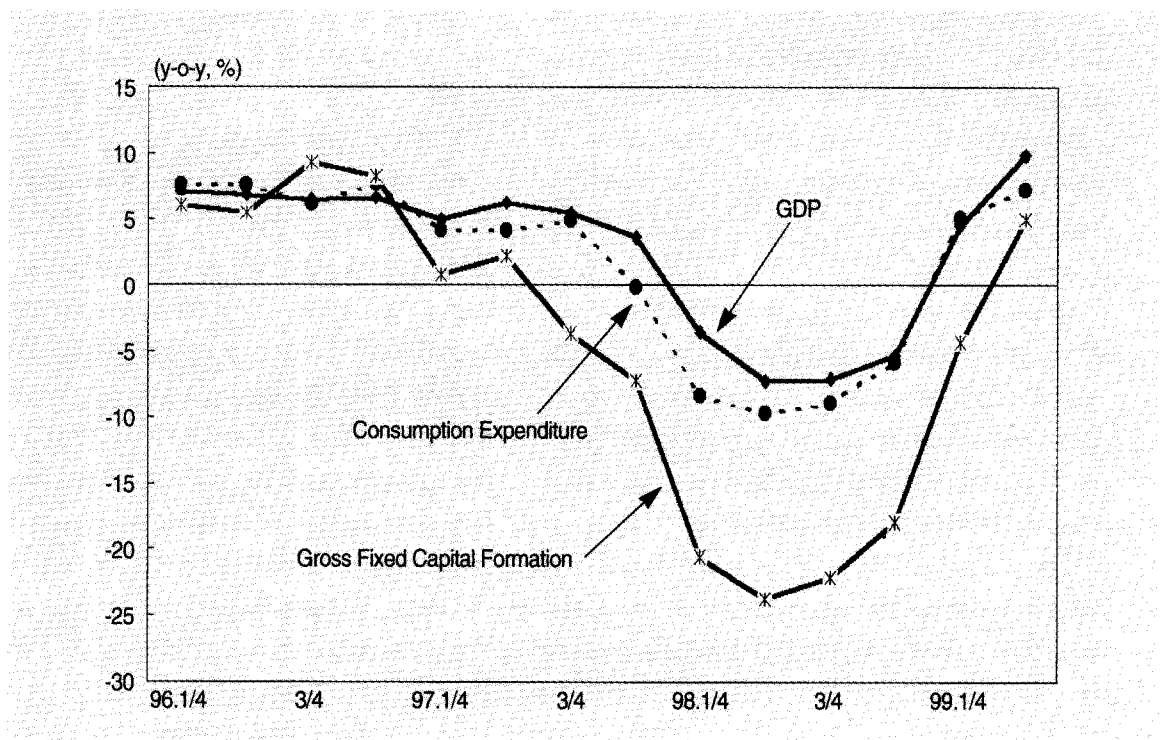
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Growth Is Higher than Expected

During the second quarter of 1999, the Korean economy achieved a surprising 9.8% real GDP growth rate. It is the highest growth rate over the last three and half years. This impressive growth is attributed to the fast recovery in private consumption and facility investment, as well as rapid increase in exports. Private consumption rose by 9% on account of increased household spending for durable goods such as vehicles, personal computers, furniture and home appliances. Fixed investment has made a 4.9% jump from 4.3% contraction in the

previous quarter, in line with an accelerating recovery in facility investment and a slowdown in the decline of construction investment. Merchandise exports, led by semiconductors, computers and machinery products, grew 18.8%. Exports of light manufacturing products switched from contraction to growth.

Thanks to these signs of continuous recovery trend, GDP grew 7.3% in the first half of the year. The previous projection of GDP growth by the Bank of Korea was 6.3% and this better-than-expected performance solidifies a continuous growth forecast for the second half of this year. Accordingly, the HRI forecasts an annual GDP growth rate of 7.0%



or more.

Industrial production continued to climb in July. In particular, the capacity utilization rate reached 81.0 %, which apparently shows that the manufacturing sector is returning to the pre-crisis state. However, considering the fact that thousands of firms with worsened cash flows went bankrupt during the severe contraction period of 1998, the utilization rate could rise even as high as to 85% to meet the solid demand growth.

With these higher-than-expected growth rate and capacity utilization rate, some economists began to show concerns about inflationary pressures. That is to say, the Korean economy may experience a shortage of supply in some products because the current recovery trend mostly depends on the increasing domestic demand. Furthermore, since the growth rate came out higher than expected, feasibility of the current economy being a bubble economy was debated. However, until now and to the year-end, it is rather immature to argue over the economy being overheated. The inflation rate is still maintained at a low level. In August, the inflation rate registered 0.9% over the same period last year. Though it seems to be a big change from last month's data, the rise in consumer prices mostly stems from soaring prices of imported goods (especially the oil price) and shortage of agricultural products resulted from typhoons and heavy seasonal rains. The current state of low inflation amidst the modestly strong growth, therefore, is an indication that there is room for expansion of production to meet further increases in aggregate demand.

Financial Markets Are Expected to Resume Normalcy Soon

While the economic growth is higher than expected, the financial markets are dealing with unstable

factors. The long-term interest rates jumped to the highest levels this year. The yield on 3-year corporate bond soared past 10 %, which is double of the overnight call rate and other short-term interest rates. As the economy recovers, the domestic interest rates have been expected to rise sooner or later, but not in this drastic manner. A jump of this kind reflects that the financial market at least in the grass root level has not been fully recovered from the shock of Daewoo's workout scheme.

Also, the stock market has not yet come out of the swamp of stagnation. While there are some good news, such as the Moody's possible upgrade of Korea's sovereign rating, uncertainties in the financial markets from a bumpy process of the cash-strapped Daewoo's workout programs and skyrocketing interest rates have curbed the upward movement of the Korea Stock Price Index (KOSPI). In particular, stock purchases have been reduced recently; foreign investors turned to a net selling position and domestic institutional investors are put in a situation that requires more liquidity in their accounts to prepare for the redemption of Daewoo-related bonds and certificates.

To bring back stability in the financial markets, the Daewoo crisis should be settled quickly. Daewoo's major companies are officially placed under workout programs, and some affiliates are considered to be sold to foreign investors. These developments however, only mark the beginning of the resolution process. They reduced the volatility of financial indicators and ceased the otherwise-skyrocketing interest rates. Only when the long-term interest rates return to a single-digit level and the stock market resumes a bullish mood, the aftershocks can be safely said to have disappeared completely. **VIP**