

RESTORING MARKET CONFIDENCE IS A KEY TO RESOLVING CREDIT CRUNCH

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The economy is, for sure, on the upswing. However, the rate of increase in economic growth is diminishing.

It turned out that the first quarter's real GDP growth rate reached 12.8%, which is phenomenal considering the fact that only two years ago the nation was hit hard by a foreign exchange crisis and fell under an IMF bailout regime. The economy is, for sure, on the upswing. However, the rate of increase is diminishing as the seasonally-adjusted real GDP growth rate of the first quarter compared to that of the previous quarter has shrunk to 1.8% from 2.8%, a further drop from 3% range for the first three quarters of last year.

Industrial output growth slowed for the fourth consecutive month in April, rising 16.9% on a year-on-year basis. Slowdown in industrial output was due to a decrease in work hours stemming from labor strikes such as that in the automobile industry and the parliamentary elections.

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Although the economy is still riding high on the upturn of the business cycle, it seems that the pace of growth is slowly diminishing. Hence, it looks like the recent hot debate over the overheating of the economy will fade away, along with the need to raise interest rates as a preemptive measure, cooling down the economy so as to deter inflation.

The OECD recently predicted that Korea's GDP growth would reach 8.5% this year and 6.0%, in the next. According to the organization's World Economic Outlook, the economy is likely to slow down but grow in line with its potential.

However, we cannot be too complacent about the economy because there are some worrisome signals that might disturb the stability of the macro-economy. Moreover, the government does not have much room to fight against a potential economic downturn.

First, the current account surplus is eroding fast. Rising international oil prices and a sharp rise in raw materials and parts imports are a major source of concern over a diminishing current account surplus. In addition, the Korean won continued strengthening against the dollar this year, lowering the price competitiveness of Korean goods in the export market.

The current account balance incurred a deficit in April for the first time in thirty months. The deficit was the result of an increase in interest payments on foreign debt at local financial institutions. Another contributing factor to the deficit was the sharp deterioration in the nation's trade balance, which was caused by rising imports. But the government is optimistic about the trade balance since the second half normally represents about 60% of the year's total current account balance. However, it is possible that the current account balance will turn to a deficit next year as the trend of rising imports continues.

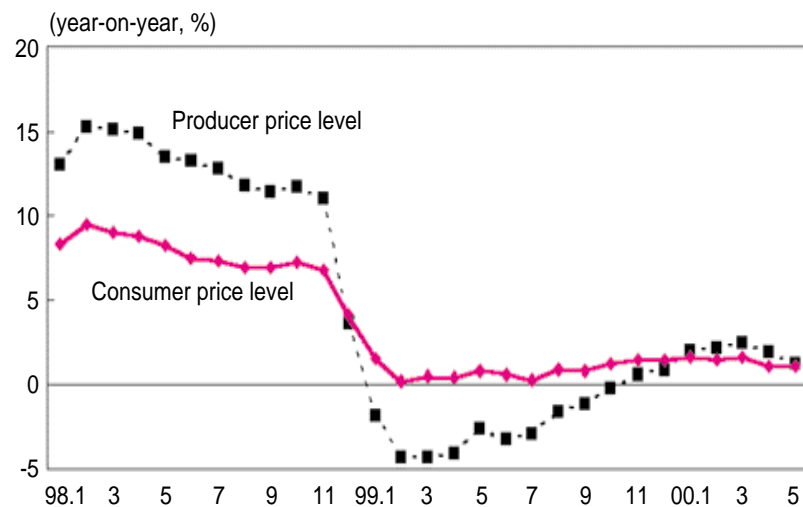
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Although imports continued to outpace exports during the past several months, exports showed some signs of rebounding, resulting in trade surplus of \$1.37 billion

Table 1. Economic Forecast for 2000 and 2001

Category	1999	2000		2001		
		First Half	Second Half		Year	
	GDP growth(%)	10.7	9.5	6.4	7.8	5.5
	Consumption(%)	8.5	8.2	5.5	6.8	5.1
National	Private Consumption(%)	10.3	9.5	6.3	7.9	5.8
Account	Investment(%)	4.1	15.8	10.4	12.9	7.4
	Construction Inv(%)	-10.3	-4.3	6.4	1.5	9.6
	Facility Inv(%)	38.0	46.2	16.5	30.3	4.8
	Current Account(\$ bil)	25	3.6	5.4	9.0	-0.8
	Trade Balance(\$ bil)	23.9	3.0	5.0	8.0	0.6
External	Export(\$ bil)	143.7	82.1	84.0	166.1	182.2
Transaction	(Increase rate, %)	(8.6)	(24.4)	(8.1)	(15.6)	(9.7)
	Import(\$ bil)	119.8	79.1	79.0	158.1	181.7
	(Increase rate, %)	(28.4)	(45.6)	(20.7)	(32.0)	(14.9)
Pricing	Consumer Price(Average, %)	0.8	1.4	3.2	2.3	3.5
Index	Yield to 3-year bonds(Average, %)	8.8	10.2	10.2	10.3	10.3
	Won/\$ rate(Average)	1189	1120	1100	1110	1070
	Unemployment(Average, %)	6.3	4.5	3.8	4.1	3.6

Figure 1. Trend of price level



in May. Exports in May rose 28.7% on a year-on-year basis, amounting to \$14.7 billion, while imports increased 40.9% over the same period, with \$13.3 billion in total.

Actually, inflation is low at present. Consumer prices fell 0.1% in May from the previous month and rose only 0.3% from the end of 1999. The decline in May consumer prices can be attributed to a drop in the prices of oil products and manufactured goods along with steady prices of agricultural, fishery and livestock products.

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Demand-pull inflation is not likely with the recent slowdown of the economy's growth. However, inflation pressure is high on the supply side due to rising import prices and wages. Overall, the inflation rate for the second half of this year is expected to be around 3%.

The dark clouds that have recently been hovering over the domestic financial markets were at the heart of a talk of a new economic crisis. As a matter of fact, financial market instability leading to the current corporate credit crunch is mostly attributable to lingering uncertainty on the direction of the second financial restructuring. Fortunately, the instability seems to be slowly fading away as the stock market resumes confidence and the uncertainty clears a bit. But the government should move swiftly against a possible liquidity squeeze for businesses.

The Korean economy should continue pushing through business and financial reform to restore investors' confidence and build momentum for growth.

As the OECD cautioned the government not to be too confident in its success, the Korean economy should continue pushing through business and financial reform to restore investors' confidence and build momentum for growth. **VIP**