

IS THE ECONOMY HEADED FOR A DOWNTURN?

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“Not yet, but in the near future”

Recently, economic research institutes have noted the possibility of an economic downturn. KDI reported that the economy already entered an economic recession in the first quarter of 2000. Meanwhile, the NSO (National Statistical Office) dismisses this view, saying that the economy appears to have entered a correctional phase after months of expansion before another takeoff.

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Proper diagnosis of current economic conditions is very important to determine macroeconomic policy. If the economy is close to peaking, the goal of government policies should be economic stabilization. If business is falling off, shortening of the downturn period may be the government's main goal. Moreover, restructuring policies are closely connected to business conditions.

Have economic conditions reached the peak of the current business cycle? The answer is “No”. Then is the current slump a temporary economic adjustment before another growth spurt, as the NSO argues? Is the economy expected to peak after next year? Probably not. Considering a number of things, the business cycle is very likely to reach a peak in the second half of 2000.

Has the economy already peaked?

Examining the movement of object economy indexes, it would be premature to

Table 1. Major Business Activity Indexes

(year-on-year %)

	1999			2000			
	Second Quarter	First half	June	Second Quarter	First half	May	June
Industrial Production	24.6	19.3	32.2	18.3	20.8	20.1	17.9
· Manufacture	25.5	20.0	33.3	18.6	21.1	20.4	18.3
Average Operation Ratio	76.0	73.4	79.4	79.4	79.5	80.1	81.9
Wholesale & Retail Sale	11.6	9.2	15.0	12.4	13.4	14.7	11.1
Import of Machinery	20.3	14.3	47.0	51.4	57.0	61.1	34.8
Facility investment	48.1	29.2	55.8	33.3	44.2	33.1	26.1
Machinery Orders Received	38.7	27.8	51.5	8.3	12.8	10.2	-5.8
Construction Orders Received	27.1	-13.6	-6.2	20.4	40.2	18.8	44.3
Area Permitted for Construction	22.4	-17.0	16.8	35.8	56.4	-9.3	25.8

say that the business cycle has already passed its peak. Although economic indexes seem to have slowed down, they show continuing two-digit increases and high growth rates. For the second quarter, industrial output grew at 18.3% from the same period last year and wholesale and retail sales grew 12.4%. Facility investment and construction orders received rose 33.4% and 20.4% respectively. Taking these facts into account, the growth rate in the second quarter is expected to be 8 to 9%.

Also, with the cyclic change of the integrated coincident index, which indicates the current economic situation, rising 0.4% from the previous month, it is unreasonable to say that economy is headed for a downturn.

When will the economy peak?

When considering the business cycle and the economic situation, the economy is expected to peak in November and slowly decline afterwards.

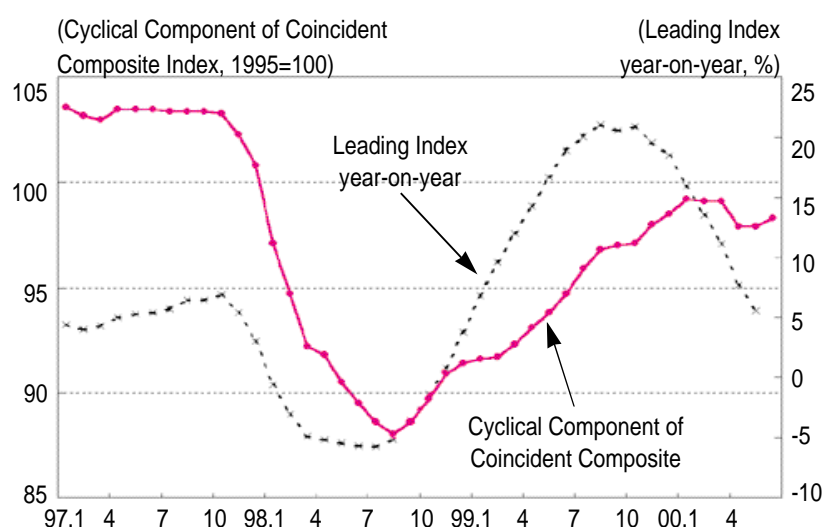
The first reason for this view is the recent slowing trend of the object economic indexes. Although the first quarter recorded a growth rate of 12.8%, and was the fourth consecutive quarter that experienced growth above 10%, GDP rose only 1.8% from the previous quarter, which was a slowdown from the 2.8% growth in the fourth quarter of 1999. For the first three quarters of 1999, the growth rates against the previous quarter were 3.1%, 4.1%, 3.3%.

The slowdown can also be seen in industrial production. In second quarter, the growth rate of industrial production from the previous quarter dropped 1.0% from 2.3% in the first quarter. It is also an extreme fall compared to 7.1% in the fourth quarter of 1999.

From the demand side, it seems that the growth trend of economic indexes

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Figure 1. Business Cycle Trend



indicating consumption and investment activity nearly stopped in second quarter. Wholesale & retail sale in second quarter rose only 0.3% from the previous quarter, while facility investment and machinery orders received also remained stagnant.

Composite indexes of business indicators warn of the slowing business conditions. The integrated leading index foretelling economic activities in the few months ahead marked its eighth consecutive month of decline, which began in November last year. This indicates that the economy will be headed for a downturn near the end of 2000.

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The decline of business conditions that are actually felt by economic actors plays an important role in signaling that the business cycle will enter a downturn sooner or later. Recently, surveys and the BSI (Business Survey Index) which forecast the forthcoming business cycle, worsened dramatically. The Bank of Korea's BSI in the second quarter dropped on a large scale. And about 2000 industrial firms surveyed by the Korea Chamber of Commerce and Industry said that drastic cuts in domestic consumption resulting from slowing business conditions will pose the biggest challenge in the third quarter.

Consumer sentiment threatens to worsen. The NSO's consumer present situation index which indicates current consumer sentiment, fell below 100 for first time in 12 months. Also, the consumer expectation index, a barometer of household spending patterns in the next six months, has showed a slowdown since January.

Implication and policy measures

With the slowdown of the object economy, there is a high possibility that the economic downturn will arrive earlier because of the current financial market jitters. Recently, despite plentiful liquidity in the financial market, there has been a local credit crunch, making it difficult for firms to raise money. This situation has resulted in an aggravation of the object economy.

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With an economic slowdown forecast after the second half, the government should put its policy priority on preventing a rapid decline in the economy. In the short term, stabilizing macroeconomic policies should be used to prolong economic growth by eliminating financial market instability and supplying liquidity to businesses. From the present perspective, a premature austerity policy would only cause the economy to decline faster than already expected. **VIP**

Table 2. Leading Index's Time Lag in the Period of Upturn

	(month)						
Business Cycle	1st	2nd	3rd	4th	5th	6th	Average
Time Lag	10	10	8	13	12	14*	12.8

* Assumed that the peak of the sixth business cycle was May, 1996