

KOREAN ECONOMY SHOWS SIGNS OF RAPID SLOWDOWN

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Industrial Activity

While production in the semiconductor industry sustained its steady growth, office equipment and automobile industries experienced a sharp decline.

The Korean economy is showing signs of rapid slowdown as the growth of both production and domestic demand declined sharply. Industrial production increased 6.4% year-to-year in November, slowing down considerably from two digit increases in the previous months. While production in the semiconductor industry sustained its steady growth, office equipment and automobile industries experienced a sharp decline mainly due to the fall in consumer demand and the closure of Daewoo Motor's main plant at Bu-pyung.

The growth rate of wholesale and retail sales, a major indicator of overall consumption activities, continued to taper off as it increased 3.2% in November, following a 5.0% growth in October and 7.6% in the third quarter. The contraction of consumption seems to have been caused by flagging consumer sentiment, affected by the fall of stock prices and the recent rise in the unemployment rate.

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On the investment side, facility investment posted a negative year -to-year growth in November, the first time since December 1998. Decline in facility investment can be attributed to a slowdown of investment in the IT industry, which

Table 1. Major Industrial Activity Indexes

(year-to-year %)

	1999		2000			
	Year	November	First half	Third Quarter	October	November
Industrial Production	24.2	29.0	20.7	19.6	11.4	6.4
· Manufacturing	25.0	29.9	21.0	20.1	11.7	6.3
Average Operation Ratio	76.6	80.3	79.5	80.4	76.5	75.8
Wholesale & Retail Sale	13.0	16.2	13.4	7.6	5.0	3.2
Import of Machinery	33.5	54.0	57.0	52.6	13.0	1.6
Facility Investment	43.5	63.5	44.8	28.9	20.5	-1.3
Machinery Orders Received	22.6	3.7	12.8	17.1	0.5	18.3
Construction Orders Received	0.8	17.5	40.2	8.5	-16.8	-7.5
Area Permitted for Construction	42.3	120.7	56.3	33.4	-7.5	-23.1

had been a driving force of economic growth in recent years. Construction investment was also sluggish as construction orders received and areas permitted for construction dropped for the second month in a row.

The overall contraction of industrial activities led to a drop in the capacity utilization ratio and a rise in inventories. The average operating ratio in the manufacturing sector fell to 75.8% in November, the third consecutive month of decline. The inventory-to-forwarding ratio rose for the third consecutive month, driven by substantial inventory increases in automobiles and office equipment.

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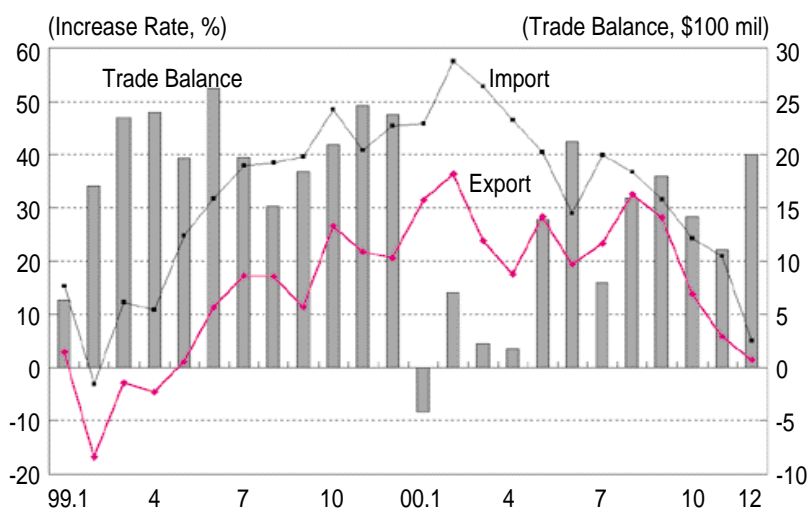
External Transactions

The growth rate of exports has nosedived since September. Exports in December increased only 1.4% over the same month the previous year. Such steep decline in export growth is mainly attributed to continued drop in international DRAM prices coupled with sluggish overseas demand for major export items such as personal computers and automobiles. The trend of the won/dollar exchange rate was also a factor as companies deliberately delayed their overseas shipments in the hopes of further won depreciation.

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Import growth also continued its downward trend. Imports in December recorded a 5.0% increase year-to-year, a substantial drop from 20.8% in November. This was mainly due to lower crude oil prices and less domestic demand. Thanks to a sharp drop in import growth, the trade account surplus in December reached \$2 billion, which enabled Korea to achieve \$12 billion in annual trade surplus, the original goal of the government.

Figure 1. Export, Import, and Trade Balance

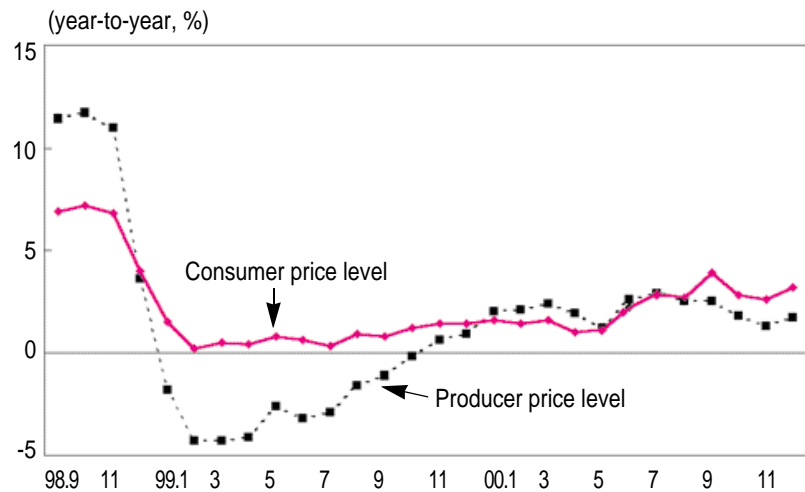


Price Level

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Consumer prices increased 0.4% in December, a 3.2% increase year-to-year. While agricultural product prices remained stable, increases in industrial product prices and service charges contributed to the overall price increase. Consumer prices, however, have remained relatively stable in the last couple of months thanks to stabilized crude oil prices and dampened domestic demand.

Figure 2. Price Level



Implications

The Korean economy appears to have entered a contractional phase of the business cycle as the economic indicators ranging from industrial production to exports have exhibited a sharp decline in growth rates. The cyclical component of the coincidence composite index, which indicates the current state of the business cycle, recorded a third straight month of decline since September while the integrated leading index, an indicator used to predict economic activity in the months ahead, has been steadily declining for the past 13 months.

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As the economy enters the downturn, the policy priority should be put on preventing a hard-landing of the economy. This will be a difficult task for the government because it also has the burden of carrying out the second round of restructuring in the financial, corporate, labor, and public sectors. Thus policy-makers will have to figure out how to strike a delicate balance between restructuring and stabilizing the economy. In this respect, the government and the central bank should remain flexible in utilizing policy measures to achieve this dual goal. **VIP**