

SENTIMENT IMPROVED, BUT PERFORMANCE DIDN'T KEEP PACE

Sung-Soo Yang
(yangs@hri.co.kr)

Industrial activity

In February, the overall business cycle ceased its decline.

In February, the overall business cycle ceased its decline. With semiconductor exports continuously increasing and automobile production recovering significantly, industrial production rose 8.6% year-over-year and 0.6% from the previous month. Auto and wholesale sales also started to recover, and wholesale and retail sales increased by 1.3% year-over-year.

Machinery orders increased 2.8% due to growing orders for ship engines and transportation equipment, but construction orders shrank 14.6% as housing starts remained stagnant. The cyclical component of the business coincident index declined from January by 0.5 to record 97.7.

External transactions

Total exports decreased 0.6% to \$14.28 billion due to the international price cut of semiconductors and a fall in processed goods exports.

Total exports decreased 0.6% to \$14.28 billion due to the international price cut of semiconductors and a fall in processed goods exports. PC exports also continued their rapid decline. Imports decreased 8.8% to \$12.96 billion due to sagging demand for raw materials and capital goods following a slowdown in facility investment. As a

Figure 1. Business Cycle Trends

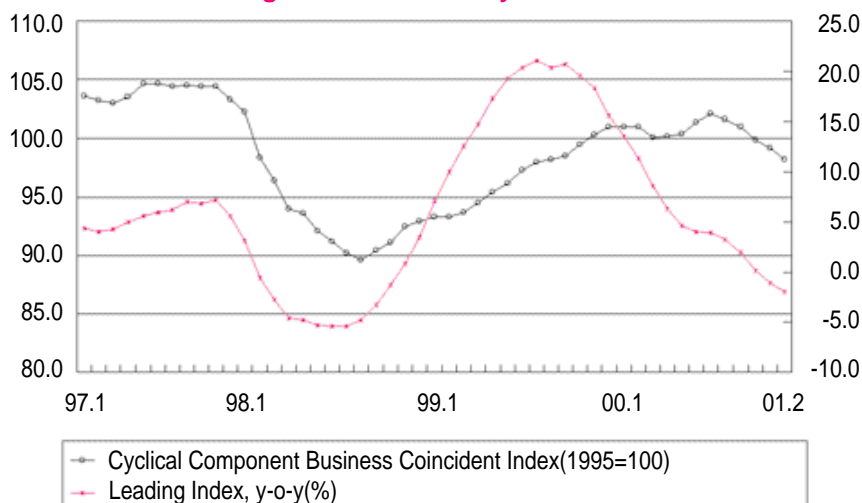
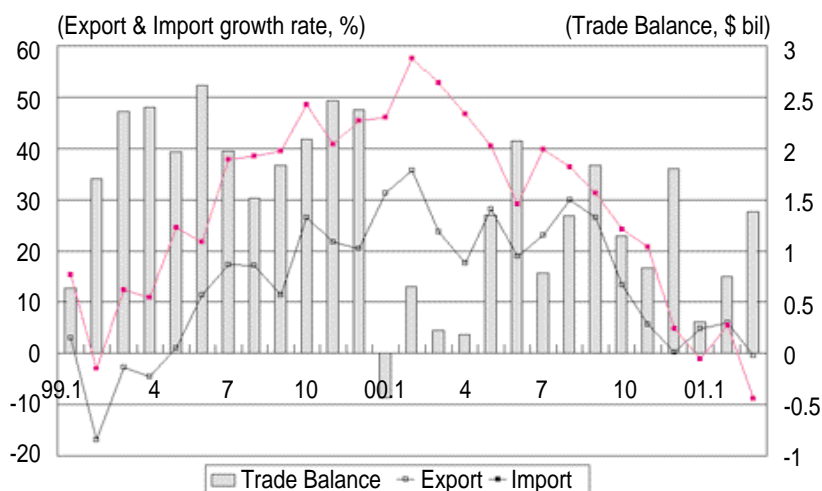


Figure 2. Export, Import and Trade Balance



result, the trade balance recorded a \$1.38 billion surplus, exceeding \$1 billion for the first time this year.

Exports recovered modestly because domestic semiconductor producers gradually raised long-term supply price in reaction to an international price rally. However, overseas economic stagnation will probably limit export growth. Imports increased as consumer sentiment recovered rather quickly as shown in a number of consumer sentiment indexes.

Exports recovered modestly because domestic semiconductor producers gradually raised long-term supply price in reaction to an international price rally.

Prices

Even with the passing of the cold wave and seasonal factors, there was no slowdown in inflation. The consumer price index rose 0.6% from the previous month

Figure 3. Price Trends (1995=100)



the Bank of Korea's plan to keep the consumer price index below 4% faces difficulties

due to significant hikes in prices of agricultural products, individual services and public services. In particular, living necessity prices rose 0.5% from the previous month due to the increase in public service fees. As of now, the Bank of Korea's plan to keep the consumer price index below 4% faces difficulties because the above factors still persist and the won has depreciated significantly. However, the CPI may stabilize gradually because prices of intermediate goods (a leading index of inflationary pressures) have been on a declining trend.

Implication

Even though the indexes for business sentiment and consumer confidence improved further, real economic performance did not keep pace.

Overall, the business cycle demonstrated a few positive signs; exports of semiconductors, transportation and machinery equipment continued to increase, the slowdown of facility investment has nearly ceased, and factory utilization has improved modestly. Furthermore, business sentiment surpassed actual performance. Even though the indexes for business sentiment and consumer confidence improved further, real economic performance did not keep pace.

The most important hindrance to domestic economic recovery is the dramatic slowdown in the U.S. and Japan.

The most important hindrance to domestic economic recovery is the dramatic slowdown in the U.S. and Japan. According to the Bank of Korea, a 1% decline in U.S. import demand would cause Korea's export volume to the U.S. to fall by 1.7% in the long term, and a 1% decline in Japanese import demand would cause Korea's exports to Japan to fall by 1.62%. In particular, exports of automobile, chemical and electrical goods tend to decrease significantly with slowdowns in trading partners' income.

If the yen weakens against the dollar by 10% for a year, it is estimated that Korea's exports will diminish by \$2 billion for a year. Due to weakened competitiveness, Korean export volume is estimated to decrease by 6.4% to the U.S., by 5.0% to Japan, and by 7.6% to Europe.

Considering the decline in world trade volume and the yen's weakness following the U.S. economic downturn, Korea's total exports are forecast to increase by only 7.8% this year, a slowdown from 21.7% in 2000. The won's recent depreciation are not expected to contribute to export increases because the currencies of other Asian competitors have depreciated further. Additionally, the current weak demand in major export markets works against the export-stimulating effects of the won's drop. With domestic demand remaining stagnant, sluggish exports bring the risk of a further slowdown in economic growth. **VIP**