CONTINUING EXPORT DECLINE HINDERS RECOVERY

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Steep fall in exports

The economic downturn that began in the third quarter of 2000 continued in July.

The economic downturn that began in the third quarter of 2000 continued in July, mainly due to a sharp export decline related to external factors. Exports in July plunged by 20% year over year, and recorded their fifth consecutive month of decline. As a result, GDP growth for the second quarter is likely to fall below 3%, and it appears that the government forecast of 5-6% growth for the year will be difficult to achieve.

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The main factors behind the export decline were the continuing recession in Korea's main export markets, and the ongoing slump of the IT market. The US economy, which could post negative growth in the second quarter, might not recover this year as formerly expected. The related depreciation of the dollar will further exacerbate Korea's export situation. In addition, Japan is still in an economic slump, demand from Southeast Asian countries is suffering, and Europe seems to be entering a slowdown.

Table 1. Composition of Exports

(100 million dollars)

	2000		2000		2001			
	Amount	Share	June	July	April	May	June	July
Exports	1722.7	<100.0>	152.5	144.6	121.3	133.6	130.7	115.7
(Growth Rate)			19.0	23.0	-10.3	-8.7	-14.3	-20.0
IT	587.0	<34.1>	43.0	46.4	-22.5	-27.6	-30.0	-40.6
Semiconductor	212.8	<12.4>	28.6	25.6	-35.3	-40.9	-46.9	-63.0
Computers	192.5	<11.2>	132.7	142.8	-25.4	-34.6	-36.2	-37.0
Wireless Telecom	65.4	< 3.8>	18.3	35.1	-1.0	11.0	48.5	15.0
Non-IT	1135.7	<65.9>	9.8	13.2	-4.4	0.5	-6.4	-8.8
Autos	111.0	< 6.4>	-17.9	7.6	15.8	11.5	27.9	3.0
Shipbuilding	2.3	< 4.8>	2.9	39.2	-20.7	85.8	3.7	26.0
Machinery	101.1	< 5.9>	31.5	31.9	6.3	-9.6	-10.3	-5.1
Iron and Steel	113.6	< 6.6>	4.4	9.9	-9.2	-15.4	-10.7	-3.0
Chemical	121.4	< 7.0>	50.2	23.9	-6.7	-12.5	-13.5	-8.0
Textile	176.7	<10.5>	13.0	1.2	-12.9	-13.0	-14.2	-17.0

Source : Bank of Korea

The continuing slump in the world IT market had a negative effect on semiconductor and computer exports. This contributed to a decline in overall exports because of the IT industry's significant export share. Export performance in non-IT sectors were buoyed by global demand for autos and ships, but these figures were overshadowed by the drastic fall in IT exports.

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Meanwhile, imports continued to decline due to decreases in capital goods as well as raw material imports - especially oil - related to the downturn in business activity. Imports of consumer goods recorded a slight increase but could not outweigh the fall in capital goods and raw material imports. As a result, a narrow trade surplus of 0.46 billion dollars was recorded in July despite the steep fall in exports.

Effects on domestic economy

The continuing export decline had negative impacts on business activity. In response to the decreased export demand, manufacturers cut back investment for the eighth consecutive month, which will limit growth in the future. Industrial

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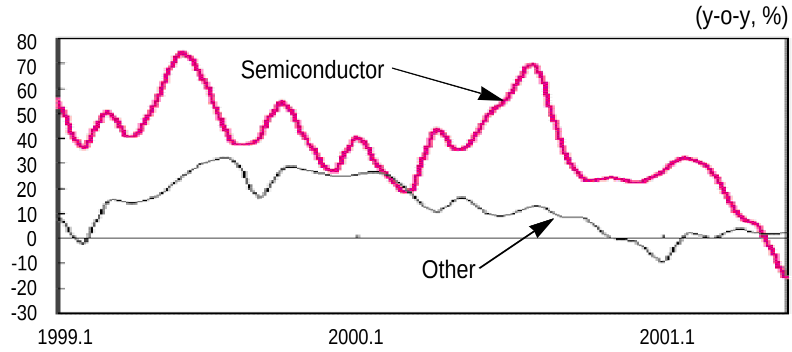
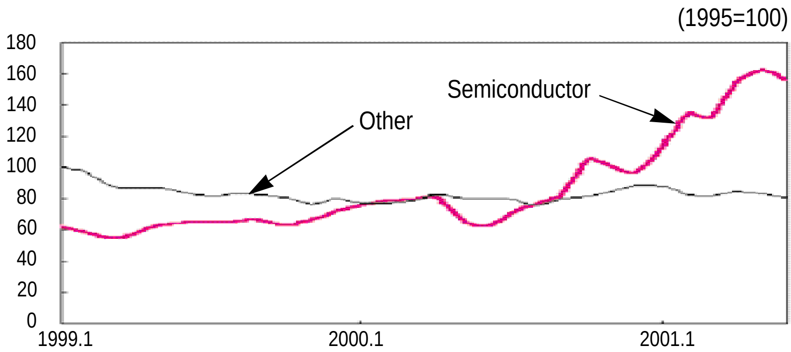
Figure 1. Production Growth Rates



Source: Bank of Korea

Figure 2. Inventory Levels



Source: Bank of Korea

production also fell by 3.1% in June, due to a 16.1% production cut in the semiconductor industry aimed at reducing excess inventory. This was the first fall since October 1998, during the financial crisis. Excluding semiconductors however, production of other goods actually recorded a slight increase.

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Consumer and business sentiment also suffered somewhat due to reduced confidence in the economy. The index for future consumer spending in the next six months fell from 100.3 in June to 98.4 in July, reflecting dampened consumer confidence in the economy. Meanwhile, the BSI composite index reflecting business sentiment fell below 100 for the first time in five months.

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Despite the troubled export sector, there were some relatively positive signs in the economy. One was an increase in the leading composite index, which forecasts future economic performance, in June from the previous month. The unemployment rate also declined to 3.3% in June, partly due to a decrease in the number of persons in the workforce, although the seasonally-adjusted rate remained at the previous month's level. The recent inflationary pressures have also moderated, with the consumer price index falling from 5.5% in June to 5.0% in July.

Need for restructuring and stimulus

Although the current economic downturn is largely due to external factors, decisive and consistent policy is still essential. Both restructuring and stimulus are needed to bolster market efficiency and confidence as well as build a foundation for future growth.

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The continuing restructuring efforts should be prompt and based on market principles, as slow restructuring would only delay the foundation for a sound and efficient economy. The recent OECD recommendation to cut support to ailing conglomerates and increase welfare spending should be carefully considered. One positive sign of restructuring progress was the government's recent announcement to liquidate an additional 49 ailing companies in its second corporate blacklist, a sharp increase from the 18 firms selected in the first liquidation announcement in November last year.

Stimulus policies should be consistent with each other as well as with the restructuring measures, and contain a complementary mix of fiscal and monetary policies. This will be needed to boost market sentiment and expand liquidity. The government has introduced stimulus measures such as higher fiscal spending, including a 10 trillion won package alloted to infrastructure projects for the rest of the year, as well as a low interest rate policy. In addition, measures to promote investment and exports should be considered, such as lower lending rates for exporters, exchange rate stabilization, and support for facility investment, such as the recent plan to lower the interest rate on corporate loans for facility investment. VIP