SIGNS OF OVERALL RECOVERY

Macroeconomic Analysis Team

Improvement of real indicators

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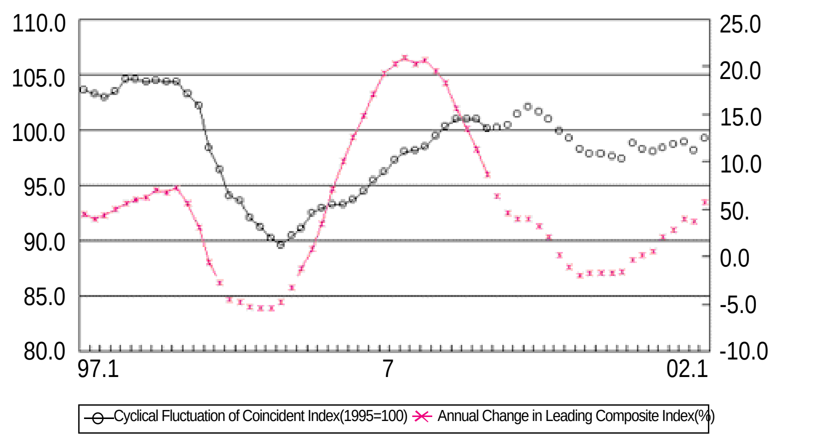
Real economic indicators improved in almost all categories due to an increase in working days and an apparent economic recovery. Production increased by 10.2% year-over-year, with an output increase in auto, telecom equipment, machinery, and computers. Shipments increased by 20.9%, boosted by an increase in auto shipments.The average facility utilization rate was 76.4%, a 4.6% annual increase. Although retail sales slowed, overall sales increased by 7.3% due to an increase in wholesale and auto sales. Machinery orders, which had been in a continued downtrend, increased by 37.9%, while construction orders rose by 39.5% thanks to an increase in private housing construction orders.

Despite these signs of recovery, there are still some factors of uncertainty.

The cyclical fluctuation of the coincident index, which indicates current economic conditions, recorded 99.2, a one point increase from the previous month. The leading composite index, which forecasts future economic conditions, rose by 5.7% year-over-year, a 2% increase compared to the previous month. Despite these signs of recovery, there are still some factors of uncertainty, such as possibility of a continued US war on terrorism, the ailing Japanese economy, and concerns regarding the rapid increase in household debt.

Figure 1. Leading and Coincident Indexes



Lower interest rates

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While the pace of economic recovery is heightening with industrial production higher than expected in January, market interest rates actually went on a downtrend. This was due to a revival in bond buying sentiment with expectations that monetary policy will be flexible and that less new bonds will be issued in the bond market.

As long as the government remains uncertain about the pace of economic recovery, the present flexible monetary policy and consideration for supply and demand in the bond market are expected to continue through the first half of 2002. Therefore, while an additional fall in market interest rates would be prevented by the improvement in fundamentals, the current level of interest rates is expected to be maintained due to market expectations.

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Despite a net selling trend by foreign investors, the steady program buying of domestic institutional investors prevented stock prices from falling. On the contrary, with improving fundamentals such as industrial production indicators and consumption sentiment, the Korea Stock Price Index surged to exceed the 800 level.

Stock prices are expected to see slight adjustment depending on the outlook for the economic recovery, but are not expected to fall below the 800 level. In addition, because market liquidity that was distributed during the Lunar New Year holiday is being absorbed or being distributed through the stock market, the stock buying trend is expected to continue through the first half.

With foreigners showing a net selling trend for eight consecutive business days after mid-February, the demand for dollars has induced an uptrend in the won/dollar rate. Another factor was the weakening Japanese yen resulting from the inability of Japan's deflation policy to gain the trust of participants in the international foreign exchange market.

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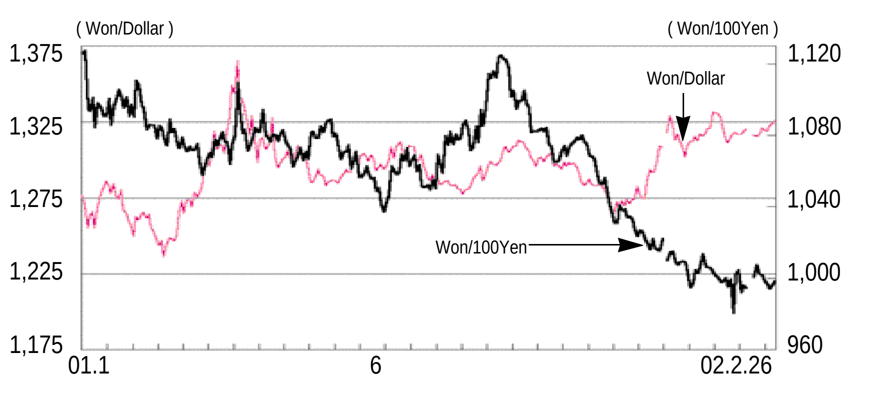
The recovery of the Korean and US economies are expected to create favorable conditions for dollar supply through the stock market. Although foreign stock buying may see slight adjustment in the short run, it is expected to increase in the long run. In addition, as the yen is not expected to decline past 15 yen/dollar, further increases in the won/dollar rate due to a rising yen/dollar rate will probably be limited.

Figure 2. Interest Rate Trends

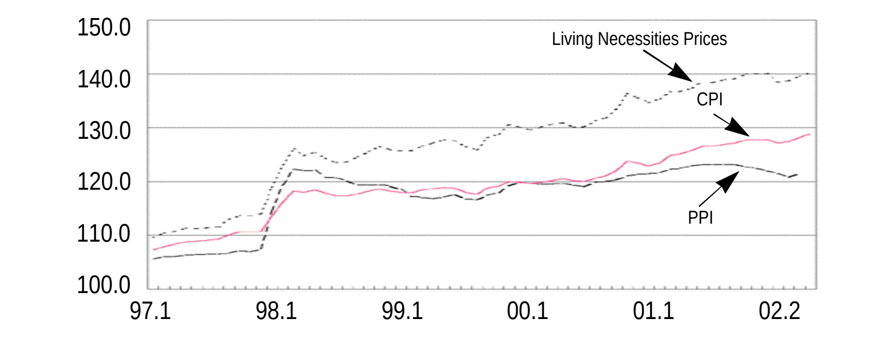


Domestic inflationary factors

Consumer prices in February rose by 0.5% from the previous month and 2.6% year over year. While prices for public services such as mobile phone fees and city gas fees fell by 2.0%, holiday demand caused prices of agricultural products to rise by 4.1%, in addition to a rise in prices of industrial products and private services. The continuing rise of housing rents, which is burdening the working class, rose by 0.4% month-over-month, but the increase was lower than that in late 2001. The prices of living necessities rose by 0.5% from the previous month and 2.4% year over year, continuing to fall short of the rise in consumer prices.

Although there are inflationary factors domestically, supply-side factors are still stable, and the yearly inflation rate is expected to be maintained at last year's level. There are many domestic inflationary factors, including the upturn in consumption and investment sentiment with the recovering economy, the local and presidential elections, and the World Cup. However, the prices of oil or international raw materials are not expected to contribute to inflationary pressure and the yearly inflation rate is expected to record about 4.1%.

Figure 3. Price Trends (1995=100)



Growth of trade surplus

Although there are inflationary factors domestically, supply-side factors are still stable.

Exports in February recorded 11.14 billion dollars, a 16.6% decline year-over-year, while imports fell by 17.6% to record 10.49 billion dollars. The trade surplus was 0.65 billion dollars, an increase from the previous month. Exports declined by more than in January (9.6%) due to seasonal factors such as the Lunar New Year holiday. Imports declined thanks to a downward stabilization of oil prices and other raw materials prices. As the decline in imports was greater than the decline in exports, the trade surplus increased significantly from January's $0.11 billion level, resulting in a cumulative trade surplus of 0.76 billion dollars for January and February, and the 25th consecutive month of surplus.

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The trade surplus in March is expected to rise slightly due to a recovery in IT exports, especially semiconductors. International prices for key export products are continuing to rise, and the downward stabilization of international raw materials prices including oil prices is expected to continue. However, as the oversupply problem still needs to be resolved for key export products, a large trade surplus is not forecast in the short term. VIP