

PREPARING FOR ANOTHER SPRING

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Those whose job is to measure a country's economic activity traditionally classify economic indicators into several categories. The most useful method is to classify by which indicator comes earlier or later than others. For example, stock prices usually predict macro-economic performance a few months ahead; while consumption expenditure reflects macro performance concurrently or a little bit later.

At the end of last year, when Korea's stock market got a wakeup call from its long sleep, many experts diagnosed that it was due to abundant liquidity in the market and lack of investment opportunities elsewhere in the real economy. As a result, there were concerns that unless real economic indicators improved, the stock market performance would not last. However, this apparently conservative view seems to have overlooked a number of facts. First, stock buyings at the time were mostly led by foreign investors. Foreign investors, who can span several other countries' bourses at the same time, are not usually dependent on the liquidity situation of the domestic financial market. Another point is that they are in a position where they can easily and more accurately compare the Korean economy with other national economies, especially within the Asian region. In other words, foreigners did not regard the Korean stock market as merely a place for hit-and-run strategy vis-a-vis changes in the liquidity situation, but probably saw a solid, fundamental base to allure them. In addition, they probably noted that Korea's macroeconomic performance last year was better than those of other Asian countries, and would see even greater benefit if the US economy recovers. Secondly, a look into the domestic economy shows that such a move by foreign investors was sensible. Because Korea was faced with a dramatic plunge in exports, the government has maintained a policy stance of supporting domestic aggregate demand. As a result, Korea was able to enjoy higher real GDP growth than other countries in the region. This provides a contrast to Japan's situation, where every stimulus policy failed to boost domestic demand.

The Korean stock market's movement during the past quarter has verified two things. One is that stock prices should be categorized as leading indicators. Another is that the investment pattern of foreign investors was correct. The Korean economy is currently so filled with expectation for economic recovery that there are even concerns of overheating or bubbles in some sectors of the economy. But even looking at chart analysis, most observers believe that although short term adjustments may happen, stock prices are expected to rise by the end of the year. This is very welcome news considering that the stock market is especially affected by sentiment and psychology. At the end of last year, the editors and writers of the "VIP Millennium Report" have already stated that if real economic indicators improve in the first

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couple of months of 2002, it will be a clear sign of economic recovery. Fortunately, such an assertion may have come true. The economic indicators released in January and February are heralding a recovery. Production and consumption indicators show this. The most remarkable fact is the change in sentiment of both businesses and households. According to a survey by the FKI and Korea Chamber of Commerce, Korean businesses are sure of the recovery and the household consumption index survey shows a green light which is brighter than any time in the past. The only exception is exports, which are continuing to fall on an annual basis. However, this shrinking parade is likely to stop sometime in the second quarter. While demand from major export industries remained solid, export prices are rising. In addition, with the expected recovery of the US economy in May or June, one can look forward to an export recovery. The opening of the World Cup football games in late May will trigger an expansion in domestic demand. In these conditions, the two sectors of the Korean economy that were the most frozen - construction and facility investment - are expected to climb again. Reflecting these changes, there is an anticipation in the financial market that interest rates will moderately rise in the second half of the year.

The current atmosphere in the Korean economy is one of waking up to a "new spring". If so, are there any factors of uncertainty for Korean companies or the government in such a time of economic recovery? Companies are already aware that the most important thing for them is an aggressive but cautious approach. Even though prospects are getting better, they are still in the middle of massive restructuring; and they fully understand that restructuring process should not be deterred nor suspended in times of economic recovery. More specifically, active investment is not expected in sectors that aren't directly affected by the economic recovery. This is because restructuring has put practical limitations on the use of external funds, especially those raised in the financial market, and above all, because companies themselves have learned the hard lesson that dependence on external loans is no longer a good growth strategy. If one more thing could be suggested to these companies, it would be to implement a more elaborate risk management mechanism in their strategy. Although the economy is showing an upward trend, many uncertainty factors still exist, and this is even true considering that the Korean economy is especially vulnerable to external shocks.

What should the government do? The most important thing is to at least maintain an expansionary policy stance in the first part of the year. In particular, fine-tuning through government policy should be continued until export indicators get back on track. Although some critics argue that there are signs that the economy may overheat, it is too early to judge this. Although there are some signs of this in the real estate sector, they are very confined to specific areas in metropolitan Seoul. In addition, real estate prices have been stable for the last decade, and considering that construction was the most severely hit sector in the last few years, the current overheating is likely to be a distortion limited to a sector rather than affecting the entire economy. Therefore there is no need to contract the money supply or abandon expansionary policy. In order to prepare for another spring, everybody seems to have her own mission. **VIP**