

ECONOMY REPORT FOR MAY 2002

Department of Macroeconomic Analysis

Industrial Activity

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Overall, the industrial sector seems to be in good shape. Production and shipment are rising while wholesale and retail sales are slightly falling. Semiconductors and telecommunication equipment sectors are leading contributors for an increase of 7.3% y-o-y in production and shipment. Shipment has increased by 10.9% and for the first time this year, export growth rate (13.2%) have surpassed domestic demand growth rate (9.2%). An average rate of operation for manufacturing sector has increased by 0.1%, compared to last month (77.6%).

Both wholesale and retail sales have increased (7.7%), but the size of increase have dwindled somewhat (8.3% at March).

Investments have increased by 2.1%, mostly due to investments in industrial machinery and automobiles.

Prices

Consumer prices are increased by 0.4% in May.

In the month of May, consumer prices are increased by 0.4%, compared to April. (An increase of 3.0% y-o-y) Public service sector prices have decreased, but due to a poor weather, prices of vegetables have significantly increased. Industrial goods, rents and private service prices all have increased, pushing the overall consumer price level to increase. Compared to April, industrial goods prices have increased by 0.4% thereby increasing the overall price level by 0.15% (Primarily due to an increase of 2.1% in petrochemical goods). Costs of living have increased by 0.6%, compared to April, and 3.1% y-o-y.

Despite the presence of foreign and domestic uncertainties in terms of a price level, the annual increase in price level will likely maintain 3% level (lower than that of the year 2001).

International Trade

Trade surplus recorded 1.62 billion dollars.

Exports in May recorded 14.34 billion dollars, a 7.8% increase y-o-y. Imports amounted to 12.72 billion, a 10.1% increase y-o-y, resulting in a trade surplus of 1.62 billion dollars, continuing the 28 months streak of trade surplus since February 2000. Compared to April (9.2%), exports have decreased somewhat because of drop in prices of several leading export products, such as semiconductors. Consumer and

capital goods imports have maintained an increasing trend since April, primarily due to an increase in consumer confidence and facility investment.

Interest Rates

Interest rates have somewhat decreased despite concerns of the economic overheating. Current uncertainty in exchange rates and stock prices caused many investors to heavily invest in bond market. Even though actual GDP growth rate for the first quarter of this year is very close to the growth potential rate (5.6%), stabilized oil prices, rapid decline of exchange rate, low stock prices and low earnings from the US bonds have caused sales of bonds to decrease. Furthermore, contraction in facility investment and an improvement in the fund for public finance have caused the supply of bonds to dry up.

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Interest rates are expected to rise because the economy is recovering. This increase will not be that drastic, however, because demand for bonds is outstripping supply.

Exchange Rates

Korean Won has appreciated dramatically. The US dollar's worldwide depreciation, a strong recovery of Korean economy and increased trade surplus are main reasons for this dramatic appreciation. A large-scale trade surplus recorded in May caused an increase in supply of the US dollar, lowering the exchange rate even further. Won is appreciating more rapidly than other currencies, such as Japanese Yen. If this trend continues, the Won/100yen rate will fall below 1000 won.

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An upward pressure on won/dollar rate will continue, but government's intervention will help to alleviate this pressure. Even though government is showing strong willingness to intervene in order to slow down the falling exchange rate, a drastic turnaround will be difficult.

Stock Market

Despite positive economic signs, investors lost confidence because of a downturn in the US stock market and the falling exchange rate. Overall, movements in the futures market are controlling the spot market. Fears over the "triple witching day" have put even more pressure on the spot market. The Korea Stock Price Index went below 800-point level for a short period of time due to a large foreign sell-off, caused by the wild fluctuation in the spot market.

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Stock prices are expected to continue their fall primarily due to the upcoming "triple witching day". Also several long-term problems, such as current account deficit, lack of facility investment due to the slumping IT industry, put dampers on "sales in the futures market - purchases in the spot market" forces. **VIP**