

KERI

Economic Bulletin

May 2002 No.27 Quarterly

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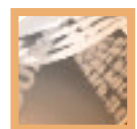
Korea Economic Research Institute

What is KERI?

The Korea Economic Research Institute (KERI) was founded in 1981 upon the basic philosophy, "Free Market, Free Enterprise, Free Competition". KERI is committed to the development of the national economy through the encouragement of principles inherent in a free-market economy.

For over 30 years our scholars have conducted integrated research on all vital aspects of the Korean economy with a special focus on both short-term and long-term prospects for corporate growth.

The soundness of KERI's scholarship and its uncompromising defense of the efficiency of an unfettered marketplace have given the institute a stature of global significance.

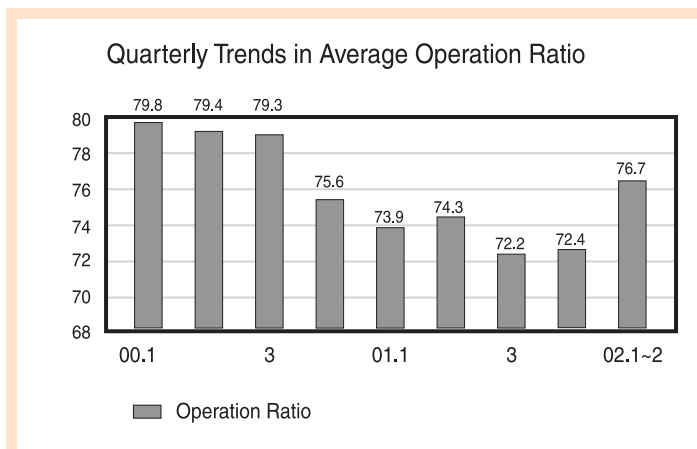
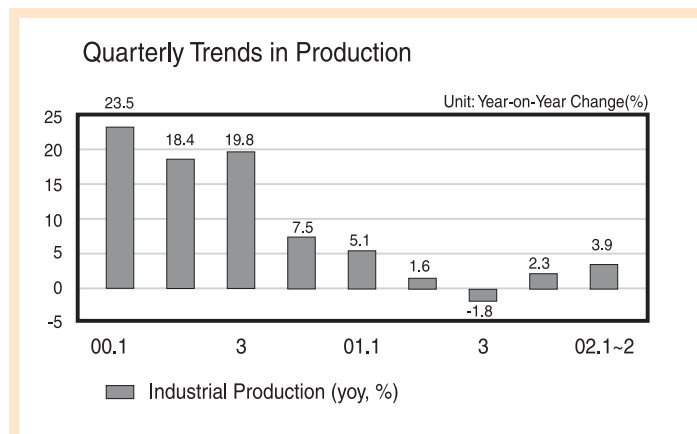


Recent Economic Developments

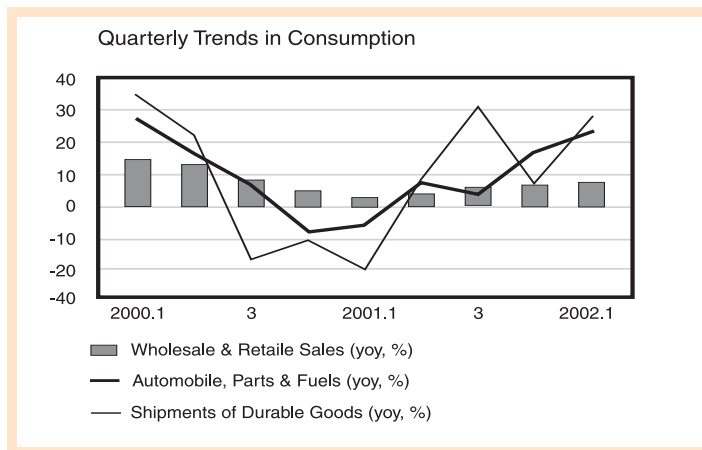
◆ Production, Consumption and Investment

Key economic indicators are manifesting a trend toward recovery with consumption and construction acting as bellweathers.

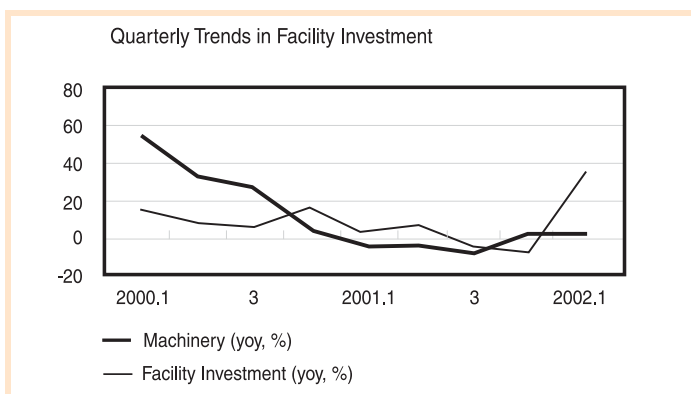
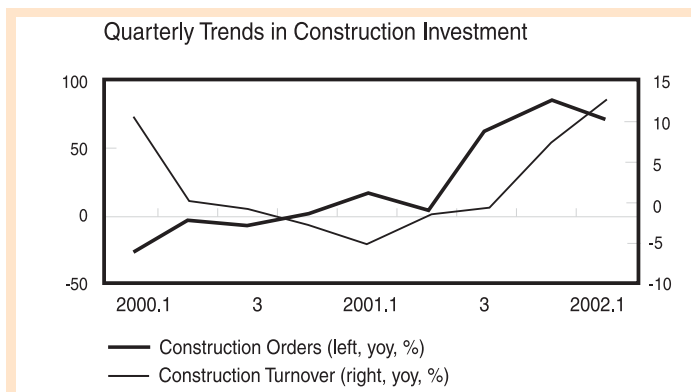
The production index in the first quarter of this year increased by 3.9%, representing a continuation of growth recorded in the fourth quarter last year (2.3%). The average factory operating ratio for the first quarter surged to 76.7%, three percentage points higher than the 73.2% recorded in the last quarter of 2001.



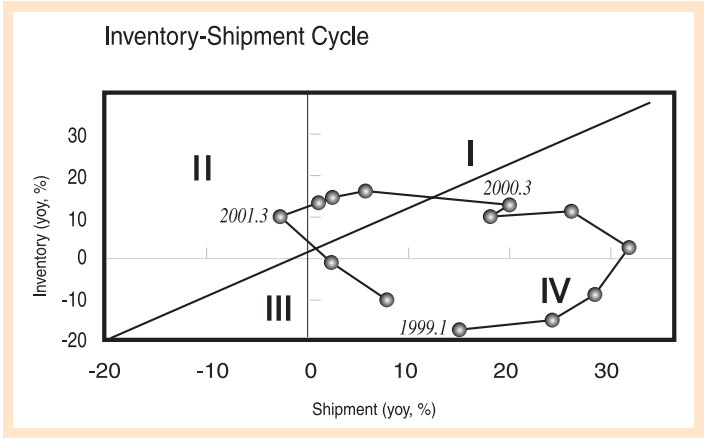
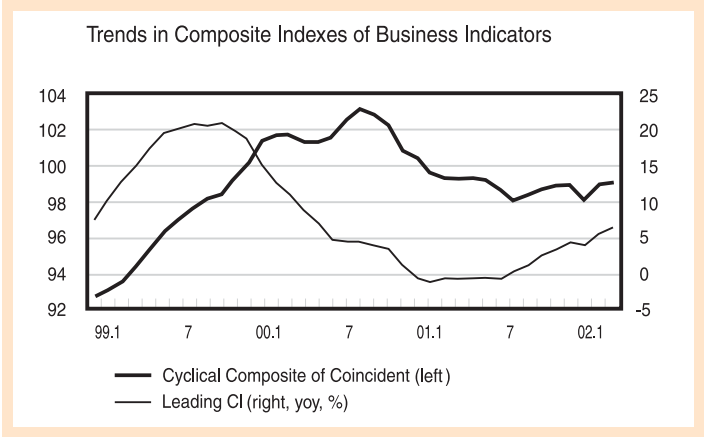
Consumption-related indicators also enjoyed robust growth in the first quarter, centering on consumption of durable goods, favorably influenced by the recovery of consumer sentiment and the reduction in special excise tax effected last December.



Investment in the construction sector has risen sharply as of the second half of last year as the previously sluggish real estate market showed new vigor, mainly in the housing construction area. Facility investment, which had declined for 12 consecutive months since November 2000 (National Statistical Office data), tallied a slight rebound lately. Orders for machinery, a leading indicator, increased significantly in the first quarter.

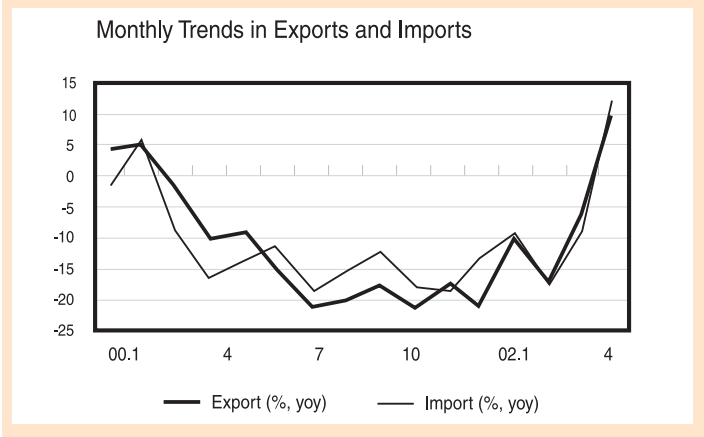


All in all, the present economic situation should be considered as the initial phase of a recovery. The cyclical component of coincident composite index reflecting the present economic situation, has maintained a slight upward trend since September of last year. The inventory-shipment cycle also appears to have reached the recovery phase as inventories continue to fall while shipments continue to rise (phase IV).



◆ **Exports, Imports & Balance of Payments**

Exports and imports, having nosedived by almost 20% in the second half of last year, appears to considerably mitigated their downward slide in the first quarter of this year. In April, they turned upward for the first time in 14 months(since Feb. 2001).



The current account balance has sustained its trend "in the black," thanks to surpluses in the commodity account and improvements in the income account balance, and in spite of a deterioration service account balance. The capital account balance also registered a US\$ 0.9 billion surplus in the first quarter of this year, extending trend toward surplus as of the third quarter of last year.

Trends in Balance of Payments

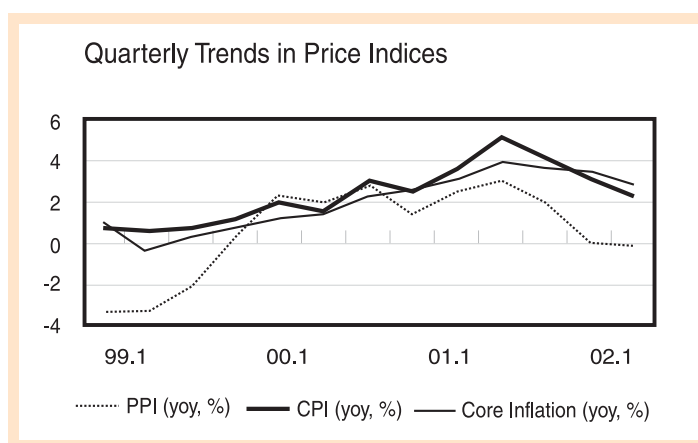
Unit: US\$ 100 million

	2001					2002			
	1/4	2/4	3/4	4/4	Year	Jan.	Feb.	Mar.	1/4
Current Account	27.7	37.6	10.3	10.5	86.2	2.8	3.8	10.9	17.6
Commodity Account	32.6	50.4	29.2	21.7	133.9	6.6	6.6	20.0	33.1
Service Account	-2.1	-6.4	-14.3	-12.4	-35.5	-5.5	-4.7	-4.1	-14.3
Income Account	-3.8	-5.3	-1.3	-1.6	-8.9	1.9	2.4	-4.6	-0.2
Current Transfer Account	1.1	-1.1	-3.3	-0.4	-3.6	-0.1	-0.5	-0.4	-1.0
Capital Account	-41.9	-30.3	13.0	23.4	-35.8	19.6	-5.3	-4.3	9.1

Sources: The Bank of Korea.

◆ Prices

The consumer price index declined to the 2% level in the first quarter of this year, maintaining a stable position from May of last year. Producer prices also fell 0.2% during the same period.



◆ Economic Growth

The pace of consumption and construction growth may lose momentum in the second half of this year while a gradual upswing in exports and facility investment is anticipated. Accordingly, the annual economic growth rate is projected to reach 5.4%. However a considerable measure of downside risk is attached to such a projection as the prospects for a visible increase in exports and facility investment remain uncertain.

The recent surge in consumption growth has been led by purchases of durable goods dating from the second half of last year. Sales of cars and big ticket consumer electronics in particular increased considerably, triggered by the government's reduction of the special excise tax, effective December, 2001. However, the temporary tax relief on new cars is scheduled to expire June 31st of this year and may lead to diminished growth in consumption.

In early 2002, restrictions on mandatory construction of parking spaces for multi-family residences as well as similar new regulations for other buildings were due to go into effect. To avoid such regulations, construction of residential buildings and officetels sharply increased at the end of last year and have continued through the early months of this year. Such developments suggest that the construction boom may be blunted significantly in the second half of the year onward as new regulations gain traction.

Assuming a rapid recovery in the U.S. economy, Korea's exports are widely forecast to rebound in the second half of this year. However, considerable uncertainties tend to cloud this assumption.

◆ Current Account Balance

Exports, having experienced a 10% slide in the first quarter, are expected to reverse course to a net upturn in the second quarter. In the second half of 2002, a double-digit rate of increase is foreseen, keeping pace with the recovery of the U.S. economy. However, owing largely to sluggishness in the first half, the annual increase rate is currently projected to reach only 4.8%.

Imports are expected to show a more rapid recovery than exports thanks to a steady resurgence of consumption and demand for facility investment, spurred by an anticipated gradual economic recovery this year. An annual increase rate of 8.5% is projected. Imports of capital goods and raw materials are expected to increase significantly, particularly in the second half onward, stemming largely from recovery trends in facility investment and exports.

Based on the projection that the annual increase rate for imports will outpace that of exports, the commodity and current account balances are forecast to decline to US\$4.1 billion and US\$8.9 billion respectively, a level lower than 2001. Due to the political unrest in the Middle East, etc., unease over oil prices has not abated. If recent price levels are maintained, an increase in import value will result due to the higher cost of oil imports. Korea's external balance of payments, will also be affected. If oil prices climb to US\$5 higher than our projection (about US\$ 25 per barrel), our commodity account balance this year would, in turn, decline by about US\$1.8 billion.

◆ Prices

Consumer price growth in the first half, at which time a slow economic recovery is expected, is projected to remain below 3% due to low upward pressure from the demand side. However, in the second half the growth rate may gradually improve as the recovery becomes more visible. The consumer price growth forecast has been pegged at 3.7% in the second half and about 3.2% for 2002 overall.

If this year's projected oil prices climb to US\$5 higher than our projection from the second quarter, consumer prices this year are estimated to rise by about 0.4 percentage point.

2002 Korea Economic Outlook

Unit: year-on-year change (%), US\$ 100 million

	2001		2002				
	4/4	Year	1/4	2/4	3/4	4/4	Year
GDP	3.7	3.0	4.4	5.2	6.0	6.0	5.4
(Manufacturing)	2.1	1.7	3.8	6.1	7.2	8.0	6.3
Total consumption	5.6	3.7	6.2	5.7	5.4	5.1	5.6
Private consumption	6.6	4.3	7.0	6.4	5.8	5.3	6.1
Fixed capital formation	4.9	-1.6	5.4	6.2	6.2	3.5	5.3
Facility investment	-3.1	-9.7	0.3	5.0	10.2	5.7	5.2
Construction investment	10.7	5.8	11.0	7.2	3.4	2.2	5.3
Total exports	-1.1	0.9	2.3	5.4	9.9	9.3	6.7
Total imports	1.1	-2.8	3.5	12.0	15.0	13.9	11.1
Producer price	0.1	1.9	-0.1	0.4	2.1	3.3	1.4
Consumer price	3.4	4.3	2.5	3.0	3.4	4.0	3.2
Current account	10.5	86.1	20.2	10.0	6.1	4.5	40.7
Commodity account	21.7	133.9	31.3	23.4	19.6	14.8	89.2
Exports	358.6	1513.7	364.3	396.5	406.8	418.9	1586.6
Change (%)	-20.1	-14.0	-10.4	2.6	12.3	16.8	4.8
Imports	336.9	1379.8	333.0	373.1	387.1	404.2	1497.4
Change (%)	-17.0	-13.3	-11.0	11.1	16.3	20.0	8.5
Service, income & transfer	-11.2	-47.8	-11.2	-13.5	-13.5	-10.3	-48.4
Won/\$ (end of period)	1312.9	1312.9	1325.0	1320.0	1310.0	1300.0	1300.0
3-yr corporate bond (Avg.,%)	6.8	7.1	7.2	7.3	7.8	8.3	7.7
World trade volume		1.1					2.5

Sources: The Bank of Korea, National Statistical Office

Hasty Transition of Economic Policy Deemed Ill-Advised

Arguments are being raised over the need for a shift in macroeconomic policy due to different perceptions of recent economic developments. One side insists on "preserving the existing policy tone for the time being," while another school of thought asserts that "a prompt turn to a stabilization policy is required."

A 0.25% hike by the BOK in May suggests that the second view prevailed in deliberation of the Monetary Policy Board. However, our view remains unchanged : the current seeming recovery might have little 'staying power' unless a visible recovery occurs in Korea's exports. In view of relatively flat economic indicators in the U.S., Korea's principal export destination, the prospects for a quick and vigorous recovery in exports remain slim.

As discussed earlier, there is a good chance that the expansionary trends in private consumption and construction will turn out to be temporary and a slowdown may be in the cards during in the second half. A slackening of domestic components in the aggregate demand without an export recovery presents a serious downside risk. Thus, removing policy stimulus by further raising interest rates is not advisable

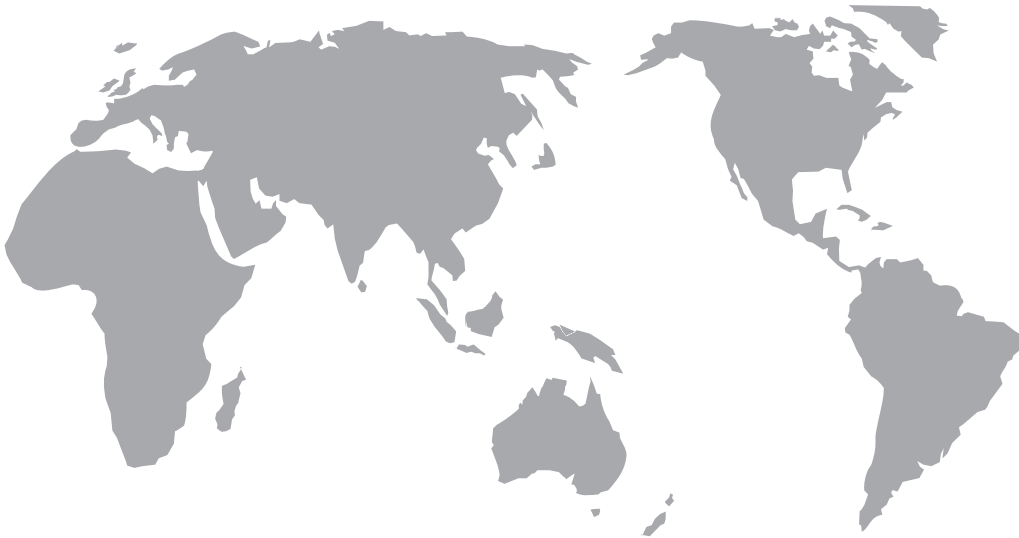
KERI Economic Bulletin

is published quarterly by Korea Economic Research Institute,
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150-756 Seoul, Korea
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www.keri.org

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Suh Joon-Seok

*Designed by Business Time Service (BTS)
Phone: (82-2)6000-7870/3 Fax: (82-2)6000-7877*



The name of this publication was changed to **KERI Economic Bulletin** from **Korea Economic Outlook** from October 2000. We ask our readers for their continued support and patronage. (Ed.)



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