

May 1999 Vol.15

1. Recent Developments

Real Economies

Of late, all real economic indices in Korea have been showing signs of recovery.

The leading composite index has been improving since April last year, while the cycle of coincident composite index has been showing signs of recovery since last September.

Industrial output has been improving since November last year, and consumption and facility investment have also been recovering since early this year. The construction investment sector, however, still remains in the doldrums.

Along with the downturn/stabilization of market rates and the won-dollar exchange rate, the ratio of dishonored bills and the number of bankrupt firms have also been declining.

Nonetheless, in view of the following adverse factors, it is still premature to conclude that an economic upturn cycle has begun in Korea.

The recent recovery of the real economy is being spearheaded by the semiconductor and automobile sectors only. In particular, the synergy effects of the semiconductor sector are very limited, and it remains to be seen whether or not the recent business recovery will herald a full-fledged economic recovery.

Due to ongoing corporate restructuring plans, the number of the unemployed has already topped 1.78million. In fact, if the lower number of economically-active population is taken into consideration, the number of the unemployed would exceed 2 million, thereby dampening the prospects for a sustained recovery of consumption.

Furthermore, the cycle of coincident composite index has been maintained a horizontal level since November 1998. The growth rate of exports, Korea's engine for economic growth, registered negative growth in the first quarter of this year. These factors need to be viewed as impeding an early economic recovery.

Prices

During the first quarter of 1999, the consumer price index increased by 0.7 percent while the producer price index decreased by 3.5%.

Consequently, the price increase trend was stopped.

Such blunt price indices are the result of a protracted business recession and stable raw materials prices and foreign exchange rates, which all tended to mitigate upward pressure on prices.

Money supply and foreign exchange rates

Since last February, the growth of reserve money supply increased, sustaining a continued expansion of money supply in other sectors:

Influenced by the appreciation of the yen against the dollar, the won dollar exchange rate once again appreciated to 1,200 won per dollar.

2. Economic Outlook for 1999

Background

Last March industrial activity picked up more aggressively than earlier anticipated, and the authorities made it clear that the current monetary / financial policies would be maintained this year. Consequently, we have revised our macroeconomic outlook for this year as follows:

Major items of revised outlook

- 1) Influenced by the rapid recovery of the private consumption sector and efforts on the part of enterprises to raise inventories, the production of manufactured goods is now anticipated to grow 10.2 percent this year vs. a negative growth rate of 7.2 percent in 1998.
- 2) The private consumption sector is likely to experience a 6.6 percent growth this year as opposed to a negative growth rate of 9.6 percent in 1998.
- 3) The surplus in the current account is now expected to register \$24 billion this year or about 60 percent of the surplus witnessed in 1998.
- 4) The ratio of inventories to GDP is likely to drop from 8 percent in 1998 to minus 1.7 percent this year.
- 5) The consumer price index is expected to grow at around 2 percent.

Risks of Outlook

Some of the factors used for the revised outlook are being readjusted in order to ensure fine tuning, because of the following risks:

- 1) The revised outlook was prepared based on manufacturing industry output data while household consumption data have yet to be finalized. More over information is still lacking concerning the service sector, which accounts for over 60 percent of GDP.
- 2) When and if the fluctuating real estate market follows the current bullish stock market, there is no denying the fact that macroeconomic policies will be subjected to rapid and unpredictable

changes.

3) The latest economic outlook has not taken into adequate consideration possible changes in the following internal/external conditions: When and if the Kosovo crisis continues into the second half of this year, it will raise the probability of higher crude oil prices and other raw materials on the world market. It will increase political instability in Korea which is to undergo labor-management negotiations and hold general elections in the near future.

Suggestions of the revised outlook

1) It is possible to expect that Korea's economic strength will be restored to pre-crisis levels by the end of this year.

2) It is also possible that on the heels of around 6 percent economic growth this year, Korea will witness about 4 percent economic growth in the year 2000. Thanks chiefly to the government's deficit financing and low-interest rate policies to prop up economic growth, it will be possible to sustain rapid economic growth this year. However, the year 2000 is likely to suffer from weakened national consensus for coping with the economic crisis, while the government's economic policy flexibility will be limited. It is thus possible that Korea will witness a deterioration of its BOP (balance of international payments) and a slower rate of economic growth.

3) This being the case, the government needs to keep the domestic demand recovery rate at an optimum level, while public funds should be distributed so as to support efforts to increase exports insofar as it is externally acceptable.

4) Simultaneously, the government needs to make the best use of the Korea Stock Exchange to help enterprises raise capital through the issuance of shares and further facilitate the privatization of public enterprises, thus stimulating corporate restructuring, minimizing government deficit outlays, and preventing the KSE from overheating.

Furthermore, in order to prop up the stock market and sustain the value of the won at an optimum level, the government needs to maintain its policy of low interest rates.

3. Macroeconomic Environments & Policies

Introduction

According to major economic indicators, recent economic developments are signaling a recovery. Loose monetary policy since September 1998, has led to a stable exchange rate and single digit interest rates, and moreover, the stock price index recovered up to its pre-crisis level.

Nevertheless, overall recovery in the real economy will take more time. Last year's dampened investment mood that caused investment to decrease by 40% compared with the previous year is

expected to carry through to this year.

To once again attract a healthy inflow of investment, which is the key to a brisk real economy, government's help is needed. Considering past experiences where excessive investment resulted in high debt/equity ratios, proper investment activities should be encouraged to solve unemployment and economic growth.

Meanwhile, the government is gearing up corporate restructuring in order to overcome the economic crisis, especially emphasizing the capital structure. The government is prompting enterprises to reduce their debt/equity ratio below 200% and to eliminate cross guarantees. Restructuring can positively affect the capital structure, but it can also harm investment activities. Therefore, considering both effects, more adequate policies should be taken.

Major Issues of Capital Restructuring and Macro-Economy

Major Capital Restructuring Issues

Debt/equity ratios should be reduced to below 200% in order to bring Korea's capital adequacy to international standard.

Cross guarantees between affiliates should be eliminated by March 2000.

Amount of Funds Needed for Capital Structure

The debt/equity ratios of the top five and thirty business groups were 335.0% and 379.8% respectively as of the end of 1998. Those ratios were 472.9% and 518.9% respectively at the end of 1997. Meanwhile, the restricted cross guarantees of the top five and thirty groups amounted to 3.7 trillion won (as of Dec. 1998) and 26.5 trillion won (as of March 1998) respectively.

Debt/equity ratios as of the end of 1998 are based on asset figures inflated through reevaluations. The government, however suggested that asset reevaluations ought to be excluded from the 200% target.

The estimated fund requirement during 1998~9 necessary to repay debts and dissolve cross guarantees, thus reducing the debt/equity ratios below 200% by the end of 1999, amount to 124.7 trillion won on the other hand, the estimated fund supply adds up to 84.9 trillion won. Therefore, additional supplies of 39.8 trillion won are needed in 1998 and 1999.

Effect of Capital Restructuring on the Economy

Because large amounts of money are needed to repay debts, capital for facility investment is not available. Consequently, facility investments are expected to decrease by 9.2 trillion won, and as a result, investment in the private sector will drop by 7.0%.

Moreover, an abundance of new issues and huge asset disposal through sale will make both the stock market and real estate market go from bad to worse. The wealth effect can cause an additional reduction in private consumption, thus impeding economic growth.

Average operation ratio	79.0	67.2	66.7	69.9	68.1	69.6	69.7	74.6
	71.3							
Consumption	Wholesale and retail sale	3.2	13.2	15.1	-8.3	-12.7	2.6	7.4
8.2	6.1							
Investment	Facility	Machinery imported	-22.8	-55.4	-55.2	-44.0	-52.9	7.3
-12.7	28.3	7.9						
	Domestic orders	3.3	-41.9	-22.2	-10.9	-30.5	39.6	-1.0
15.8	16.9							
	received							
Constr-	Domestic orders	5.4	-41.1	-44.8	-44.9	-42.5	-20.5	-52.0
-51.1	-45.3							
uction	received							
	Permits Authorized	-0.4	-44.3	-63.8	-66.1	-55.0	-56.4	-50.5
-29.6	-45.9							

Dishonored Bill Trend

	1997	1998	1999						
	year	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	year	1st qtr.		
Dishonored ratio (total, %)		0.40	0.54	0.43	0.41		0.17	0.38	0.11
No. of bankrupt firms		17,168	9,449	6,357	4,221		2,801	22,828	1,932
Newly established corporates/ 10.1 bankrupt corporates (times)		3.4	1.5	2.3	3.3		5.5	2.6	

Unemployment Trend

(unit: %, 1,000 persons)

	1997				1998				1999	
	year	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	year	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.
Unemployment rate		2.6	5.7	6.9	7.4	7.4	6.8	8.4		
No. of unemployed		556	1,182	1,485	1,600	1,586	1,463	1,751		

Foreign Trade

(unit: \$100 million, year-to-year change %)

	1997		1998		1999					
	year	1/4	year	Jan.	Feb.	Mar.	1/4	Apr.	Jan.~Apr.	May~Oct.
Current account balance	-81.7	108.3	400.4	18.3	23.4	26.2	67.9	-	-	
Trade balance	-84.5	85.8	390.3	6.4	17.4	23.8	47.7	25.6	73.3	
Exports	1,361.6	322.3	1,323.1	92.7	93.8	116.9	303.4	116.3	419.7	
Growth rate	5.0	8.4	-2.8	3.0	-16.4	-2.7	-5.9	-3.6	-5.2	
Imports	1,446.2	236.6	932.8	86.3	76.4	93.0	255.7	90.7	346.4	
Growth rate	-3.8	-36.1	-35.5	15.4	-3.1	12.2	8.1	10.5	8.7	

Price

(unit: % of change on a year-to-year basis)

1997	1998	1999
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year	1st qtr.	year	Jan.	Feb.	Mar.	1st qtr.	Apr.	
C.P.I	4.5	8.9	7.5	1.5	0.2	0.5	0.7	0.4
P.P.I	3.9	14.4	12.2	-1.8	-4.3	-4.3	-3.5	-4.1

Money Supply

(unit: based on average balance, Year-to-year change, %)

1997	1999						1998				
year	Mar.	Jun.	Sep.	Act.	Nov.	Dec.	year	Jan.	Feb.		
Mar.											
Reserve money	4.4	7.2	-15.0	-4.7	-7.5	-13.2	-0.9	-5.7	-6.6	-7.2	-8.7
M2	19.2	13.7	18.1	21.1	26.4	26.1	22.0	19.1	26.6	30.0	
MCT	15.3	9.5	8.2	5.4	6.1	5.2	3.0	7.6	3.6	5.3	
M3	16.3	14.5	14.2	13.1	13.5	13.1	12.4	12.8	13.1	-	
-											

Consequently, the substantial capital market rates dropped and then levelled off.

Market Rates

	1997	1998	1999						
	Dec.	June	Aug.	Sep.	Dec.	Jan.	Feb.	March	Apr.29
Call (daily, %)	31.32	14.41	8.51	7.08	6.48	6.00	5.04	4.85	4.75
CP (91-day,%)	40.77	16.99	10.91	10.78	8.06	7.25	7.05	7.02	6.07

National bonds (3-year, %)	15.00	14.00	11.30	11.50	6.95	7.05	6.96	6.50
6.64								

Corp. bonds (3-year, %)	28.98	16.00	11.70	11.90	8.00	8.13	8.65	8.10	7.52
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Exchange Rates

	1996	1997	1998	1999				
	Dec.	Dec.	Dec.	Jan.	Feb.	March	Apr.	29
Won/dollar	844.90	1,695.00	1,240.00	1,175.00	1,223.00	1,227.0	1,175.5	
Won/100 yen	726.51	1,291.36	1,059.91	1,010.53	1,012.84	1,017.8	985.78	

Revised macroeconomic outlook for this year

	1998	1999 (forecast in April)	1999 (forecast in May)		
GDP	-5.8	3.0	5.7		
Manufacturing		-7.2	6.1	10.2	
Gross consumption		-8.2	2.8	5.5	
Private		-9.6	4.0	6.6	
Fixed capital formation		-21.6	-4.4	-2.6	
Facility investment		-38.3	-1.3	4.0	
Construction investment			-10.2	-5.9	-6.0
Inventory Change / GDP			-8.0	-2.2	-1.7
Producer prices	12.2	0.0	0.0		

Consumer prices 7.6	2.1	2.0		
Current account balance	400.4	250.9	139.4	
Goods	411.6	274.6	264.6	
Exports	1318.1	1310.6	1312.1	
% of change	-4.9	-0.6	-0.5	
Imports	906.4	1035.9	1047.4	
% of change	-36.4	14.3	15.6	
Service and others	-11.3	-23.7	-25.3	
Won-dollar exchange rate (term-end)	1204.0	1180.0	1180.0	

Debt / equity Ratio

(unit: trillion won)

	top five groups		top thirty groups	
	end of 1997	end of 1998	end of 1997	end of 1998
equity	46.8	70.0	68.9	96.6
debt	221.4	234.5	357.4	367.0
debt / equity ratios (%)	472.9	335.0	518.9	379.8

footnote: This table is based on figures released by the Fair Trade Commission
Financial institutions and insurance companies are excluded.

Cross Guarantees

(unit: trillion won)

top five groups top thirty groups

	March 1998	Dec. 1998	March 1998
Total cross guarantees	-	6.3	60.7
Restricted cross guarantees		11.1	3.7 26.5

footnote: Cross guarantees for industry rationalization, export and restructuring is excluded from restriction.

Estimated Fund Shortage (1998-1999)

(unit: trillion won)

	fund use (A)	fund supply (B)	fund shortage (A-B)
	124.7	84.9	39.8

footnote: Among the 84.9 trillion won supplied (B), 48.9 trillion won can be procured through the issuance of shales and loan conversion to equity.

Estimation of Economic Growth and Unemployment Rates

	scenario 1	scenario 2
Economic growth	3.0	1.7 (-1.3)
Unemployment rate	8.1	8.7 (0.6)

footnote: Scenario 1 is based on the condition that debt / equity ratio be lowered to below 200% and that the dissolution of cross guarantees is not mandatory. Scenario 2, however, is based on the condition that these two are mandatory.

Statistics(--)

Economic Growth, Consumption and Investment

1993	5.5	5.4	7,811	5.6	4.6	6.3	0.3	9.7	
1994	8.3	10.8	8,998	8.2	1.9	10.7	23.9	3.7	
1995	8.9	11.3	10,823	9.6	0.8	11.9	18.1	8.0	
1996	6.8	6.8	11,380	7.1	8.2	7.3	9.1	6.1	
1997	5.0	6.6	10,307	3.5	1.5	-2.2	-8.7	2.3	
1998	-5.8	-7.2	6,823	-9.6	-0.1	-21.1	-38.5	-10.2	
1997. 1/4		4.9	5.6	-	4.5	1.7	0.8	4.2	-1.9
	2/4	6.2	7.8	-	4.4	2.5	2.2	1.3	2.9
	3/4	5.5	7.9	-	5.3	2.3	-3.6	-12.6	2.7
	4/4	3.6	4.9	-	-0.1	-0.4	-7.2	-25.9	4.5
1998. 1/4		-3.6	-4.6	-	-9.9	1.3	-20.6	-38.3	-5.9
	2/4	-7.2	-10.4	-	-11.2	-0.7	-23.7	-46.1	-7.8
	3/4	-7.1	-9.1	-	-10.4	-0.6	-22.2	-39.3	-12.0
	4/4	-5.3	-4.7	-	-6.9	-0.4	-17.9	-27.4	-13.7

Trade and Balance of Payments

1992		766.3	6.6	817.8	0.3	-17.6	-39.4	171.5	788.4
1993		822.4	7.3	838.0	2.5	23.2	9.9	202.6	808.1
1994		960.1	16.8	1,023.5	22.1	-28.6	-38.7	256.7	788.7
1995		1,250.6	30.3	1,351.2	32.0	-44.4	-85.1	327.1	774.7
1996		1,297.2	3.7	1,503.4	11.3	-149.6	-230.1	294.2	844.2
1997		1,361.6	5.0	1,446.2	-3.8	-31.8	-81.6	88.7	1,415.2

1998		1,323.3	-2.8	932.8	-35.5	411.6	400.4	485.1	1,207.8
1998	8	97.1	-12.1	71.2	-38.1	27.7	21.0	413.5	1,331.8
	9	107.5	-5.2	72.5	-37.2	36.9	36.9	433.7	1,373.5
	10	106.3	-14.7	76.5	-39.3	32.5	25.5	452.7	1,313.8
	11	116.7	-1.4	83.2	-28.9	31.9	30.4	464.7	1,243.7
	12	124.2	-0.1	86.5	-15.3	33.6	30.9	485.1	1,207.8
1999	1	92.7	3.0	86.3	15.4	18.3	18.7	500.9	1,175.3
	2	93.8	-16.4	76.4	-3.1	24.0	23.0	519.6	1,222.4
	3	116.9	-2.7	93.0	12.2	28.9	26.2	544.5	1,227.0
	4	116.3	-3.6	90.7	10.5	-	-	563.8	1,188.0

Note : Recent data include estimates.

1)Based on available foreign exchange reserves since 1996.

Statistics(-¥)

Prices, Unemployment and Interest Rates

1993	1.5(2.0)	4.8(5.8)	2.8	10.9	18.6	22.9	12.6	728.2	
1994	2.8(3.9)	6.2(5.6)	2.4	15.5	15.6	23.5	12.9	965.7	
1995	4.7(3.4)	4.5(4.7)	2.0	9.9	15.5	21.6	13.8	934.7	
1996	2.7(3.5)	4.9(4.9)	2.0	12.2	16.2	21.7	11.9	833.4	
1997	3.9(10.9)	4.5(6.6)	2.6	5.2	19.2	15.3	13.4	654.5	
1998	12.2(3.6)	7.5(4.0)	6.8	-3.1	19.0	7.5	15.1	406.1	
1998	9	11.4	6.9	7.3	-10.6	21.0	5.4	12.5	312.2
	10	11.7	7.2	7.1	-0.7	26.4	6.1	10.0	358.8

	11	11.0	6.8	7.3	-0.9	26.1	5.2	9.6	429.2
	12	3.6	4.0	7.9	14.2	21.5	2.6	8.3	524.7
1999	1	-1.8	1.5	8.5	-	26.3	3.1	7.9	597.6
	2	-4.3	0.2	8.7	-	30.0	5.3	8.6	533.0
	3	-4.3	0.5	-	-	-	-	-	-
	4	-4.1	0.4	-	-	-	-	-	-

Notes : 2) Figures in parentheses are the increase over the end of the previous year's period.
3) Average balances

Industrial Production and Demand

1993	4.4	77.9	8.5	3.9	12.1	1.1	19.3	24.5	15.2	26.7
1994	10.9	81.3	8.7	9.3	26.9	37.6	18.5	-1.3	16.8	- 8 . 5
1995	12.0	81.0	8.0	7.4	15.8	31.5	24.4	1.0	3.3	- 1 . 2
1996	8.7	80.8	7.0	5.8	16.5	-0.7	21.4	-3.0	-13.2	-2.5
1997	5.3	79.0	3.2	-1.8	3.3	-22.8	5.4	-0.4	-26.2	2.6
1998	-7.3	68.1	-12.7	-21.4	-30.5	-52.9	-42.5	-55.0	-68.2	-50.3
1998.	9	-1.7	70.5	-11.6	-15.9	-14.6	-52.5	-50.4	-57.6	- 61 . 9
		-59.6								
	10	-9.3	69.1	-13.2	-24.5	-25.4	-55.2	-52.2	-79.9	- 74 . 2
		-81.3								
	11	0.3	69.6	-8.1	-18.8	-5.1	-38.7	-35.7	-57.7	- 50 . 5
		-47.8								
	12	4.8	71.1	-3.6	-11.4	0.9	-34.3	-45.2	-61.6	- 51 . 0
		-61.2								
1999.	1	14.8	69.6	2.6	7.8	39.6	7.3	-20.5	-56.4	2 . 2

-67.1

2	3.9	69.7	7.4	11.8	-1.0	-12.7	-52.5	-50.5	3 0 . 0
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-57.6

3	18.4	74.6	8.2	19.0	15.8	28.3	-51.1	-29.6	3 6 . 2
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-37.9

Notes : 4) For domestic use vessels excluded 5) For domestic use, exc. vessels 6) For 1994 and before,