South Korean economy heading toward negative growth in 2009

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There are growing signs that the world's 13th largest economy, the Republic of Korea, is among the most vulnerable to the global financial crisis. A senior Bank of Korea (BOK) official declared on December 2 that annualised growth for the fourth quarter would be less than 3 percent. Last month, Finance Minister Kang Man-soo optimistically promised growth of 4 percent in 2009.

The IMF, however, has already slashed its 2009 forecast for South Korea to just 2 percent and the fear is that it may enter negative growth next year for the first time since the 1997-98 Asian financial crisis. On December 1, Samsung Securities predicted the economy would shrink by 0.2 percent in 2009, following in the steps of the US, Japan and Europe.

Yesterday, in a desperate attempt to boost the country's slowing economy, the BOK slashed interest rates by a full 1 percent to 3 percent—its biggest ever cut. Today, the National Assembly is due to vote on the 2009 budget which includes stimulus measures amounting to around 3 percent of gross domestic product.

Nevertheless, the outlook for the South Korean economy remains bleak. Shin Dong-suk, senior analyst for Samsung Securities, pointed to weak exports as a cause of the downturn, predicting a drop of 6.7 percent due to falling demand, the global credit crunch and general financial distress. The predicted decline in exports is despite a weakening currency, which Shin warned might hit over 1,600 won to the US dollar. Domestic consumption is also expected to be down 3 percent next year.

South Korea is heavily dependent on exports, especially to the US. Although China is now South Korea's largest trade partner, much of what China imports from South Korea is re-exported to the global markets in the form of finished goods. South Korea's exports fell 18.3 percent in November compared to the same period last year, with shipments to China tumbling by 27.8 percent. The last double-digit drop of exports was in 2002, amid the bursting of the so-called US dot.com bubble. For the first 11 months of 2008, South Korea posted a trade deficit of $13.3 billion, compared to a $14.6 billion surplus in 2007.

Official statistics showed computer and home appliance exports recorded the steepest fall in November, by 54.9 percent and 50.6 percent respectively from the same period last year. This was largely due to declining demand in the US, exemplified by the collapse of electronics retailer, Circuit City. Other export sectors, including petrochemicals, semiconductors, auto parts and machinery, fell by 36.6, 44, 30.8 and 24.4 percent respectively.

Both the domestic sales and exports for South Korea's auto companies are at record lows. Hyundai, Kia and the country's three other major automakers sold 74,217 vehicles domestically in November—the lowest monthly figure since February 2005. Auto firms are cutting production and retrenching workers.

Hyundai will slash production by 20,000 vehicles, or 13 percent of domestic output, in December, and will cut production in the US, China, India, the Czech Republic and Turkey. Renault-Samsung, the South Korean venture of French Renault SA, will shut its plant for five days from December 24 for maintenance. Chinese-controlled Ssangyong will shut its plants from December 17 for a month. GM Daewoo, owned by the struggling US-based General Motors, will shut down for 8 days in December. The announcements are likely to trigger a chain reaction among auto subcontractors.

Financial crisis

South Korea is also particularly susceptible to the global economic crisis because of its reliance on credit to drive up consumer spending and business growth in the aftermath of the Asian financial crisis. In 2003, some four million South Korean credit card holders went into default, provoking financial turmoil. A far more extensive crisis is now looming as a result of the global credit crunch, compounded by the falling won.

South Korea's external debt skyrocketed to $420 billion in the first half of 2008, up from $188 billion in 2005. Citigroup economist Oh Suk-tae pointed out that heavily indebted consumers have a low savings rate of just 2.2 percent and a debt-to-income ratio of 142.5 percent. The growth rate for loans for small and medium businesses rose from 4.5 percent in 2005 to 22 percent in 2007.

The BOK dropped interest rates three times in November to 4 percent and is expected to make further cuts in coming months. However, the lower interest rates have not eased the financial strains. According to the BOK, the outflow of capital is growing. The capital account for September-October recorded a deficit of $30 billion, of which $20.6 billion involved local banks paying back short-term foreign loans. Foreign investors have withdrawn $7.7 billion from South Korea's share and bond markets in the past two months. The stock market has lost 44 percent of its value this year.

After the re-eruption of the US financial crisis in September, the South Korean administration promised to inject 133 trillion won (about $91 billion) into the financial system to ease liquidity. By the end of November, only 50 trillion won had been released. In October, 321 firms went bankrupt, up from 118 in September, as the lack of credit took effect.

A $16 billion package to help small and medium exporters has failed to end the cash shortage, because banks are reluctant to apply for BOK funds out of fear that they will be seen as having a cash-flow problem. South Korean banks are weakly capitalised, with "Tier 1" capital, or core equity and cash reserves, making up just 7.5 percent of total assets in 2008, compared to 9.9 percent across Asia.

The *Korea Times* on December 1 described the market panic: "Local banks and firms are scrambling to fix their balance sheets by reducing lending and selling assets. But this process has just added to the problem as forced sales bring down the prices of assets, worsening the balance sheets of other investors."

Morgan Stanley research director Malcolm Wood told the *Korea Times*: "Korea consistently ranks the worst on four key metrics—product, bank, investor and consumer de-leveraging—across Asia. For example, Korea's bank loan-to-deposit ratio is 140 percent compared with 77 percent for the region. Korean banks have low capital ratios and household debt is very high. Secondly, global de-leveraging hits countries with current account deficits, stretched banking systems and a dependence on portfolio capital inflows."

Mass job losses are on the horizon. A recent survey by recruiting firm Incruit found that 77 percent of large firms and 78 percent of medium ones have cut back their hiring plans next year. Many analysts are predicting minus employment growth in 2009. The government meanwhile is planning to slash wages and jobs as a means of downsizing 210 state-owned corporations and agencies.

Fearing social unrest, President Lee Myung-bak announced a $514 million plan on December 1 to help young people find work and to finance college graduates who have a low credit rating as they are unable to pay back tuition loans. Significantly, the program included sending 100,000 youth overseas for "professional training and volunteer services" over the next five years and doubling international "working holiday" programs to 60,000 a year.

The real concern in ruling circles is over the political implications of rising youth unemployment, already at 7 percent. "Honestly my heart sinks when I think about the youth unemployment... It's a big concern for our country," Lee declared. At the same time, he urged youth to lower their expectations of getting a decent job in the midst of a "once-in-a-lifetime kind of global economic crisis".

During June and July, large demonstrations and strikes erupted in South Korea over the resumption of beef imports from the US. Despite its confused character, the movement was sparked by anger among young people who used the Internet to organise the protests. The impact of the global downturn on jobs and living standards is setting the conditions for a social eruption on a far broader scale.