# THE KOREAN ECONOMY IN 1999

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## *Difficult Predictions*

Korea's economic outlook for 1999 is almost unpredictable because the foreign and domestic economic environments are so unstable. Regarding the foreign situation, due to the emerging market crisis, some analysts are presenting the scenario of a worldwide recession resulting from continual global contagion, the rapid yen decline and Chinese currency devaluation in 1999. Internally, it still remains to be seen as to how successful Korea's current economic restructuring will turn out. The government's efforts to overcome the current recession by taking aggressive stimulus measures is a key point in our estimation of the Korean economy in 1999.

In spite of the extreme uncertainty of these situations, we are disclosing HRI's estimates for 1999 under a few assumptions. The premises used to formulate our economic perspectives for the next year are as follows. First, the probability of a global meltdown is not highly significant. With the U.S. interest rate cut and slow recovery of Japan's economy, the worries of a worldwide deflation are not as serious as some feared. As the G-7 nations plan to take joint measures to boost the yen, we see the possibility of the yen's decline and the Chinese currency devaluation as being low. Thus, our assumption is that the Korean economy does not experience severe secondary effects stemming from world economic instability.

Second, we assume that economic restructuring is completed next year and the latest economic stimulus measures will affect business sentiment positively. As a result, the Korean economy begins to gradually recover.

## *Major Economic Indicator Forecasts*

**Economic growth rate:** The nation's economic growth for 1999 is estimated at 0.3 percent, compared with the projected 6.8% contraction for 1998. In the first half of 1999, since domestic demand and exports continue to be stagnant, the GDP growth rate will remain at a minus rate.

However, due to the influence of the government's stimulus packages, further deterioration of growth will cease. A partial recovery in domestic demand & exports and a technical reaction to the sudden contraction of 1998 will lead the growth rate to turn a positive rate in the second half of 1999. Nonetheless, the Korea's gross domestic production (GDP) in 1999 will not reach that of 1996 (based on 1990 constant prices).

**Investment and consumption:** In second half of 1999, investment and consumption seem likely to recover slowly, as business and consumer sentiments improve. Facility and construction investment are expected to increase by 0.6% and 3.4% respectively for 1999. Private consumption will increase by 0.5%, despite the high unemployment rate and tax hikes.

The Korean government plans to boost the economy by implementing tax cuts and expanding public spending in the fourth quarter of 1998. However, these measures will increase private consumption only in the first half of 1999, and that the impact of public spending will be limited to the construction industry, not the overall economy.

**Trade:** The current account is expected to remain a surplus in 1999, but the scale of the surplus will be smaller than in 1998. The current

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account surplus in 1999 will decrease to 12.9 billion dollars, mainly due to increasing imports on the back of the slow recovery of domestic demand.

Exports should increase by 1.6% in 1999 due to the steady growth in Europe and the slow recovery of Japan and Southeast Asia starting from the second half of 1999.

If current restructuring process is completed around next year and the severe credit crunch is resolved, the export increase will be accelerated. Imports should remain far below the level of exports, but with the slow recovery of domestic demand and the technical reaction to sudden contraction in 1998, they will increase by 21.1% in 1999.

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**Employment:** In 1999, the unemployment rate will remain high or rise even higher as businesses, after or during the restructuring process, will probably not employ new workers though the state of economy will begin to recover slowly in the second half of 1999. The government's stimulus policy may result in increased employment, but its effects on employment will be smaller than expected, since more people currently classified as being non-economically active population will enter the labor market with the boosting policy. As a

〈Table 1〉 1999 Yearly Economic Forecasts

*(unit: billion dollars, %)*

| | | 1997 | 1998 | 1999 | | |
|---|---|---|---|---|---|---|
| | | | | first half | second half | |
| | GDP | 5.5 | -6.8 | -2.5 | 2.8 | 0.3 |
| Nat'l Account | Total Consumption | 3.5 | -12.6 | 0.2 | 1.8 | 1.0 |
| | Private Consumption | 3.1 | -13.9 | -0.4 | 1.5 | 0.5 |
| | Total Fixed Capital Formation | -3.5 | -31.7 | 1.5 | 3.5 | 2.5 |
| | Facility Investment | -11.3 | -45.8 | -1.4 | 2.7 | 0.6 |
| | Construction Investment | 2.7 | -22.0 | 2.9 | 3.9 | 3.4 |
| Ext. Sector | Current Balance | -8.6 | 36.4 | 8.4 | 4.5 | 12.9 |
| | Goods Balance | -3.9 | 39.4 | 10.7 | 10.0 | 20.7 |
| | Service Balance | -2.9 | 0.3 | -0.9 | -1.8 | -2.7 |
| | Exports - Imports | -8.4 | 36.5 | 9.7 | 8.9 | 18.6 |
| | Exports (customs clearance) | 136.2 | 132.0 | 65.0 | 69.2 | 134.2 |
| | (Inc. rate, %) | (5.3) | (-3.1) | (-3.3) | (6.8) | (1.6) |
| | Imports (customs clearance) | 144.6 | 95.5 | 55.3 | 60.3 | 115.6 |
| | (Inc. rate, %) | (-3.8) | (-34.0) | (16.3) | (25.8) | (21.1) |
| Price Indices | Consumer Prices (average) | 4.5 | 7.7 | 1.2 | 3.0 | 2.1 |
| | Corporate bond yield (end of period) | 29.0 | 12.5 | 12.0 | 11.0 | 11.0 |
| | Won/Dollar exchange rate (end of period) | 1,415.2 | 1,400 | 1,350 | 1,300 | 1,300 |
| Unemployment Rate(average) | | 2.6 | 7.5 | 8.1 | 7.8 | 8.0 |

result, average unemployment rate in 1999 will be around 8.0%.

**Prices:** Prices in 1999 seem likely to rise to 2.1% (year over year) on average, due to the continuing stability of main price indexes such as the foreign exchange rate, domestic interest rates and international raw material prices. The slow recovery of domestic demand and the relatively high inflation rate in 1998 will also play a part in next year's price stability.

**Exchange rate and interest rates:** Both the exchange rate and domestic interest rates will show a downward stable trend in 1999. Although there will be increasing demand for foreign currencies, particularly the U.S. dollar, because the economy will recover slowly and yen is expected to remain stable, the won/dollar exchange rate should stabilized to 1,300 as of the end of 1999.

Domestic interest rate may continue downward until the end of the year because of the flexible money supply and government's intent to lower rates. But unstable factors exist, such as possible hitches in restructuring, partial or temporary credit crunches, and the possibility of international financial turmoil. VIP

**Rate Cut is Helpful But Insufficient** *S.S. Yang*

*(Cont'd from p. 10)*

contracts, so if a large bank fails and the BOJ lets it go, the positive effect of the economic stimulus packages will be significantly hurt as private finance severely contracts. Therefore the Japanese officials think they should treat the bank problem through bridge banks or M&As in a gradual manner to minimize the negative impact of large banks' failure. But Japanese policy makers are in serious dilemma because people have lost confidence in the Ministry of Finance, the symbol of Japan's bureaucracy, which should lead the financial restructuring. Although accelerating bank reform will open the path for long-term economic growth, it will inevitably disturb any short-term economic recovery.

In the real sector, business fixed investment decreased significantly, and housing investment declined further in August. Private consumption has not yet shown a recovery despite the income tax reduction. With this background of weak demand, production has been reduced substantially. As a result, with the decline in expenditure and production, corporate profits continue to decrease, and the decline of employee incomes is accelerating somewhat, so the unemployment rate remains at a high level. Given the current considerably low level of economic activities, the economy is unlikely to transit immediately to a self-sustained recovery led by private demand, although the economy is expected to stop deteriorating further with the effects of the comprehensive economic stimulus package.

Hence, Japan's government intends to pursue bank reform and to boost business and consumer sentiment at the same time. In this context, the BOJ cut the government discount rate cut from 0.5% to 0.25%. But given the unique Japanese saving pattern, this may result in an increase of private savings since people who have retired or plan to retire account for a considerable portion of the total population.

As everyone is saying, to avoid the decay of Asia, Japan must restore foreign investors' confidence in the economy with certain reform prospects. But perhaps the the more ultimate issue is raising Japanese consumer confidence, which has been destabilized since the bursting of the bubble. It is very difficult to change Japanese consumers' spending patterns. If people increase their own savings in spite of the rate cut, increasing public investment and spending may prove to be more effective than a permanent tax cut or rate cut in boosting the economy. VIP