KOREAN ECONOMY IN TRANSITION: INTRODUCTION

by Soon Won Chung
(e-mail: swjoung@hri.co.kr)

In 1998, the Korean economy went through the rough experience of being under the IMF program. Thus it is no surprise that everyone in Korea is wondering whether or not the new year will be any better.

It does not seem that the global economic environment will significantly improve in 1999. On the one hand, the world economy will apparently avoid falling into a severe recession, thanks to the interest rate cuts and economic stimulus measures being steadily implemented by the U.S., Japan, and the major European economies. However, it is hard to expect a quick recovery in the global economic situation given the economic contractions in emerging markets such as Latin America and Russia, the worldwide credit crunch, the delays in Japan's financial reform, and other negative factors. The global outlook for the new year still looks bleak, and so global capital will flow to safer investment areas, which will keep international financial markets somewhat uncertain. At the same time, many economists in Korea are placing high expectations on the so-called "three lows" phenomenon—low oil prices, low interest rates, and low dollar (strong yen). However, since the strong yen is underpinned by the weak Japanese economy, it is hard to expect the yen to maintain its strengthen for a long time. Furthermore, the worse the global economic situation is, the more trade friction will arise. Because of Asian countries' rising exports stemming from their currency devaluations, the advanced nations are seeing their trade balances deteriorate significantly.

If this is the case, then what will Korea's domestic situation be like? According to the business cycle indicators, the Korean economy will bottom out in March or April of next year. Unlike in the past, though, Korea is in the midst of economic restructuring to emerge from the crisis, and so passing through the bottom of the business cycle does not necessarily mean that economy will immediately recover. Furthermore, the possibility of a second currency crisis has not been fully precluded. Even though Korea's usable foreign exchange reserves have risen to a record $46.47 billion as of the end of November, international credit rating agencies still regard Korea's ratings to be below-investment grade.

It is also likely that the domestic credit crunch will continue next year. Until economic uncertainties are eliminated through the completion of the early stages of corporate restructuring and the start of the economic recovery, the domestic credit crunch will continue to afflict the Korean economy throughout next year.

Given these domestic and international conditions, the Korean economy in 1999 will be about the same or improve only slightly over 1998. With the complete liberalization of foreign exchange transactions in April 1999, the won's value will probably be unstable due to potentially destabilizing factors such as the yen's fluctuations. Exports will also remain slow because of the delayed recovery in major export markets such as Southeast Asia, intensifying trade friction, and the drop in unit prices. However, with the continued downturn in domestic demand, interest rates and prices should remain stable. In looking at all these factors, it

(continued on p.16)

"According to the business cycle indicators, the Korean economy will bottom out in March or April of next year."

"Now that the first stage of restructuring is more or less finished, the government needs to actively push its stimulus package."