

KOREAN ECONOMY IN YEAR 2000

Min-Kyu Jun
(mkjun@hri.co.kr)

Recently, the Korean economy shows two sharply contrasting aspects. Owing to the upturn in exports, facility investments and private consumption, the real sector shows a favorable recovery while the financial sector still remains unstable. Industrial production increased 18.1% in September and exports recorded an increase of 27.0% in October compared to the previous year. Domestic machinery orders in September also show a strong increasing tendency which implies that future facility investments will build up rapidly.

GDP Will Grow 5.9% in 2000

The market players expect the favorable situation in the second half of 1999 to continue in the year 2000 due to the increase in domestic and external demand. Private consumption is expected to rise on account of the increase in household disposal income

resulted from raise in wage, income tax cut and drop in unemployment. External climates for exports will continue to improve for a while. U.S. economy is expected to soft-land and Japan and ASEAN are on their way to recovery. The

EU is also edging away from its deep

recession. That means most of the Korea's major exporting markets will have more leeway to import Korea's products.

The circumstances surrounding facility investment will also continue to be favorable. Many firms expect that their sales are going to climb high next year, owing to economic recovery, along with increase in household income and growth in exports. The contraction in facility investment in the last couple of years is the second reason for favorable situation of facility investment. Although many domestic firms suffer from overcapacity, some other firms do not have sufficient facilities to meet expected sales goals in 2000 and beyond. The statistical rebound effect is the third reason for facility investment in 2000 to continue its upward tendency. Facility investment increased 37.2% in the second quarter of 1999, the highest figure that the Korean economy has ever experienced. Although the increasing rate recorded such a high figure, the actual level of facility investment was only around 70% of the level during the same period of 1997. All these add up to encourage expectations for increase in facility investment.

Construction investment, which is still contracted while other sectors show moderate or steep recovery, is expected to show very slow recovery in 2000. Construction investment is stimulated partly by expectations for economic recovery and partly by economic boom which enables the private sector to afford real estates like houses and buildings. Taking into consideration the continuous fall in domestic construction

The market players expect the favorable situation in the second half of 1999 to continue in the year 2000 due to the increase in domestic and external demand. Private consumption is expected to rise . . . and most of the Korea's major exporting markets will have more leeway to import Korea's products.

orders in 1999, construction investment is expected to show recovery. When making allowances for the expected increase in domestic demand and exports, GDP is forecast to grow 5.9% in 2000. Thanks to the continuation of relatively high growth in 2000, the unemployment rate is expected to drop to 5.4% in average.

Some Bad Features May Emerge

In spite of the bright features mentioned earlier, the Korean economy may also run into some bad moments looming ahead. Increased consumption and investment will incite a big jump in import volume. Imports were exceptionally contracted since 1997 because of the economic crisis. Although imports are expected to increase up to 30% or so in 1999, the actual import level is still too low compared to the export volume. Back in the pre-crisis period, the import-export ratio used to be between 1.01 and 1.16, but in 1998 it sharply dropped to 0.71. The figure is gradually rising back up to 0.83 which is considered still too low a figure.

Korea depends most of its necessary raw materials on imports. Some parts of Korea's export items such as electronics products are procured from overseas; this explains for an import-inducing structure of Korea's exports. Such structure does not seem to have changed during the process of industrial restructuring which is currently under way. The restructuring is focused on business swaps among big conglomerates and improvement of firms' financial structure. What caused imports to drop in 1998 is not mitigation of the import-inducing structure but shrinkage in the domestic demand resulting from the economic crisis. In 2000, the Korean economy may even bury in oblivion its trying experience few years ago and return to the

past state.

The second phenomenon which raises concerns is inflation. Economic recovery will necessarily induce increase in demand. Accompanied by low investment since 1997, increased demand will bring about a possibility of demand-pull inflation. The prices of international raw materials are also expected to rise because of increase in demand precipitated by worldwide economic recovery and to give rise to inflation. The inflation rate is expected to reach 4.0% in 2000, which is much higher than that of 1999. As the expected inflation rate is slightly high, it may well induce the government turn to stabilizing policy. Such policy changeover is forecast to take shape after the general election. Increased investment will boost firms' demand for money. Stabilizing policy and increased investment will push up interest rates; it is difficult to expect single-digit interest rates in 2000.

Assumptions of Economic Recovery

Despite some unstable factors, the Korean economy in 2000 will continue to heal damages from the crisis. However, forecast of good features for the Korean economy is based on the assumption that the financial instability stemming from the Daewoo disintegration will subside. Contrary to the assumption, if the financial instability does not cool down, the shaky financial sector will hinder the course of economic recovery. Firms will hesitate when and what to invest. Since investment in the

Despite some unstable factors, the Korean economy in 2000 will continue to heal damages from the crisis. However, forecast of good features for the Korean economy is based on the assumption that the financial instability stemming from the Daewoo disintegration will subside.

past couple of years has contracted too much, more robust investment is urgently needed to

foster the Korean economy's growth potential. In the case of continuation of financial instability, soaring interest rates will also prevent investment from increasing. Financial instability will dampen the stock market, which will hinder firms from

raising funds through the stock market. A slack stock market will depress households'

propensities to consume. In a word, if the financial instability arising from Daewoo's default does not disappear in 2000, it will precipitate financial instability, raise interest rates, push stock prices down and discourage investment and consumption.

If such is the case, the Korean economy will show a slow recovery. However, most market players have an optimistic view on the recovery of financial markets. What they expect is that it will neither be settled completely in early 2000 nor become worse. With stabilization in financial markets, increase in investment and consumption and improvement in the world economy, the Korean economy is certain to show a moderate growth in 2000. **VIP**

Most market players have an optimistic view on the recovery of financial markets. . . .

With stabilization in financial markets, increase in investment and consumption and improvement in the world economy, the Korean economy is certain to show a moderate growth in 2000.

Table 1. Forecasts of Major Economic Indicators

	1998	1999 (F)			2000 (F)	
		1st Half	2nd Half	Annual		
National Account	GDP (%)	-5.8	7.3	8.8	8.1	5.9
	Consumption (%)	-8.2	6.1	7.2	6.7	5.9
	- Private (%)	-9.6	7.4	8.1	7.9	6.5
	Fixed Investment (%)	-21.1	0.6	8.4	4.7	11.5
	- Construction (%)	-10.2	-10.8	-2.7	-6.4	7.7
	- Facility (%)	-38.5	24.8	36.5	30.5	17.8
External Transaction	Current Account (bil. USD)	40.6	12.3	9.9	22.2	8.7
	Balance on Trade (bil. USD)	390	118	97	214	9.7
	Exports (bil. USD)	132.3	66.1	71.2	137.3	150.5
	(growth rate, %)	-2.8	-1.5	9.2	3.8	9.6
	Imports (bil. USD)	93.3	54.3	61.6	115.9	140.8
	(growth rate, %)	-35.5	15.1	33.6	24.2	21.5
Price Indices	CPI (avg., %)	7.5	0.6	1.1	0.9	4.0
	Corp. Bond Yielding Rate (avg., %)	15.1	8.1	9.7	8.9	11.0
	Exchange Rate (avg., won/USD)	1,403	1,197	1,183	1,190	1,130
Unemployment Rate (avg, %)	6.8	7.5	5.8	6.7	5.4	