HIGHER-THAN-EXPECTED ECONOMIC RECOVERY

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Koreans may feel proud of what they have achieved, not just because the Korean economy has grown quantitatively from a -5.8% GDP growth rate in 1998 to 10% in 1999, but also because it has continuously tried to change from its high-cost and low-efficiency structure. Higher-than-expected economic growth resulted from the rebound of the world economy as well as the restoration of economic confidence at home, reflected in lower interest rates, the stock market boom, and increasing industrial production.

Thanks to increasing foreign demand, the current account surplus recorded \$26 billion in 1999. In particular, renewed export momentum led to a 24% increase in the fourth quarter of 1999, the strongest outcome in the past four years. As a result, despite rising imports, the

trade surplus has been on a widening trend in recent months. For 1999 as a whole, the trade surplus narrowed to a still substantial \$24.5 billion (Table 1), compared with \$39 billion in 1998. Official projections point to a healthy trade account at \$13 billion in 2000, while the HRI's forecast is only \$8 billion due to high expectations of increased imports, but it still expects a surplus for three years. Korea's usable foreign reserves figure continued its phenomenal increase to reach \$74 billion by end-1999, more than eight times the level of two years ago.

Reflecting the economic recovery, foreign capital inflows have rapidly increased. Korea attracted about \$15.5 billion in FDI in 1999, nearly twice the \$8.9 billion achieved in 1998 and attaining the official target of \$15 billion. Not surprisingly, the role of FDI in the Korean economy has increased: it accounted for about

Table 1. Forecast of Major Economic Indicators

	1999 (forecast))	2000
	1998	1st half	2nd half	year	2000
GDP (%)	-5.8	7.3	12.2	9.9	7.5
Consumption (%)	-8.2	6.2	8.5	7.4	6.5
Total Fixed Capital (%)	-21.1	0.6	7.3	4.1	8.4
Current Account (\$billion)	40.0	12.6	14.2	26.8	9.8
Trade Balance (BOP)	390	118	130	248	79
Export (\$billion)	132.3	66.1	77.6	144.2	156.4
Import (\$billion)	93.3	54.3	64.6	119.7	148.5
CPI (%)	7.5	0.6	1.0	0.8	3.7
Yields on Corporate Bonds (%)	15.1	8.1	9.5	8.8	10.5
Won/Dollar	1,403.3	1,195.0	1,184.0	1,189.0	1,090.0
Unemployment (%)	6.8	7.5	5.2	6.3	4.3
Usable Foreign Reserves	48.5	-	_	74.1	85

8% of GDP last year, in contrast to less than 3% in pre-crisis 1996. Furthermore, the relaxation of foreign ownership restrictions and corporate de-leveraging suggest that external financing will continue to be dominated by equity investment inflows. In a recent review, the IMF cautioned that while strong growth and the stock market boom have helped improve corporate liquidity, "Daewoo's failure clearly shows that it is not possible to simply grow out of structural problems." The momentum of structural reforms must be maintained to ensure sustained strong growth over the longer term.

Industrial production has shown a steady rebound with the average manufacturing capacity utilization rate climbing from its low of below 70% in 1998 to over 80% in 1999. This trend is expected to continue in 2000. Along with this, the unemployment rate has slightly dropped from 6.8% in 1998 to 6.3% in 1999. But in the year 2000, it is expected that the rate will reach a stable 4.3%. Consumer prices recorded their slowest annual increase in 1999, rising by 0.8%. The inflation outlook for 2000 appears benign for now; indeed the Bank of Korea (BoK) recently lowered its inflation forecast to 3.1% from an earlier 3.8%. In addition, the CPI stayed low in December at -0.2% month to month. It follows that inflation will have a limited near-term impact on the macro-policy stance. Nonetheless, policy tightening is possible in the second half of 2000, if inflation is higher than government expectations in response to rising domestic wage pressures as Korea's output gap turns positive, the hike of oil prices, and the won's appreciation.

On the other hand, the government is likely to continue moderating the pace of won appreciation in the near term. Monetary and exchange rate policies will probably remain fairly easy in the near term, at least until the National Assembly elections this April and when liquidity concerns among investment trust companies (ITCs) are out of the way. (Several ITCs have brought forward the February 8 effective date: the Daewoo-debt redemption rate has been raised to 95% since late December.) The dollar-won exchange rate is likely to stay mostly range-bound, as appreciation pressures are capped by official intervention. However, the strengthening trend over the medium term is unlikely to be reversed. VIP

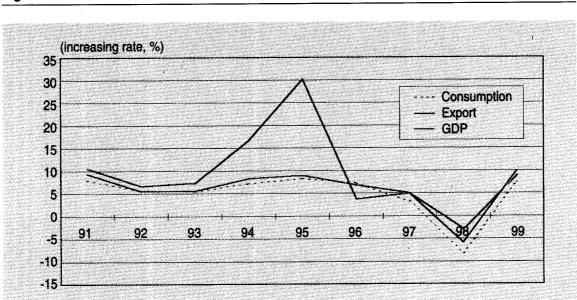


Figure 1. Trend of Macroeconomic Indicators, 1991-1999