APPRAISAL OF THE GOVERNMENT'S MACROECONOMIC POLICY

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The government's economic goals for 2000 are to maintain a stable economy.

In mid-January, the new government economic team announced its economic policy for 2000, the gist of which was maintaining interest rates in the single digits and keeping the inflation rate below 3 percent to help the economy grow in a stable manner.

Other major economic policy directives for the year 2000 included: completing and internalizing the ongoing reforms, achieving a more comprehensive and productive welfare system, establishing a knowledge-based economy to improve growth potential, and strengthening international economic cooperation.

The focus of the government's macroeconomic policy is a policy mix that combines fiscal and monetary policies to stabilize the low inflation/low interest rate trend. To achieve this goal, the government, in conjunction with the BOK, will use

Figure1. Major Economic Policies in the Year 2000

monetary policy and maintain tightened fiscal policy to keep inflation within the limits of $2.5 \pm 1.0\%$. In addition, the capital market will be activated so that domestic companies will be able to raise funds more easily and limit the rise of long term interest rates to single digits.

Maintaining a stable economy while keeping a high growth rate is an ideal cyclical adjustment policy. But there is a problem in the government's macroeconomic policy guidelines.

The government will give priority to internal stability rather than external one.

The target of maintaining the low inflation/low interest rate trend, may be a sign that the government stresses economic stability over economic growth. If there is a contradiction between the internal and external economy, the government will give priority to internal stability. Therefore the government may choose to appreciate the exchange rate to stabilize prices rather than support exchange rates to bolster exports.

The feasibility of government goals is questionable.

A small open economy like Korea, however, should not discount the importance of external equilibrium. In a situation where the ratios of exports and imports to GDP are 48.7% and 35.8% respectively, insecurity in the external sector would directly bring a slump in the internal economy. We must remember that the basic cause of the 1997 currency crisis was the deeping of external imbalances. In times like the present, sustaining the existing current account surplus is more important than internal stability. In the Korean economy, high inflation is not clearly defined and it is difficult to conclude that a 3% inflation rate is high for a 7% growth rate.

Moreover, in the government's own economic forecast for the year 2000, there is a problem of feasibility. The goals of macroeconomic policy can be summarized as: 6% growth, 3% inflation, 4% unemployment rate and a $12,000 million current account surplus. But many economists question the possibility of realizing these goals. Though one or two goals among the four can be achieved, it is not easy for all these goals to be attained at the same time in either theory or practice.

Table1. Government's Major Economic Indicators in 2000

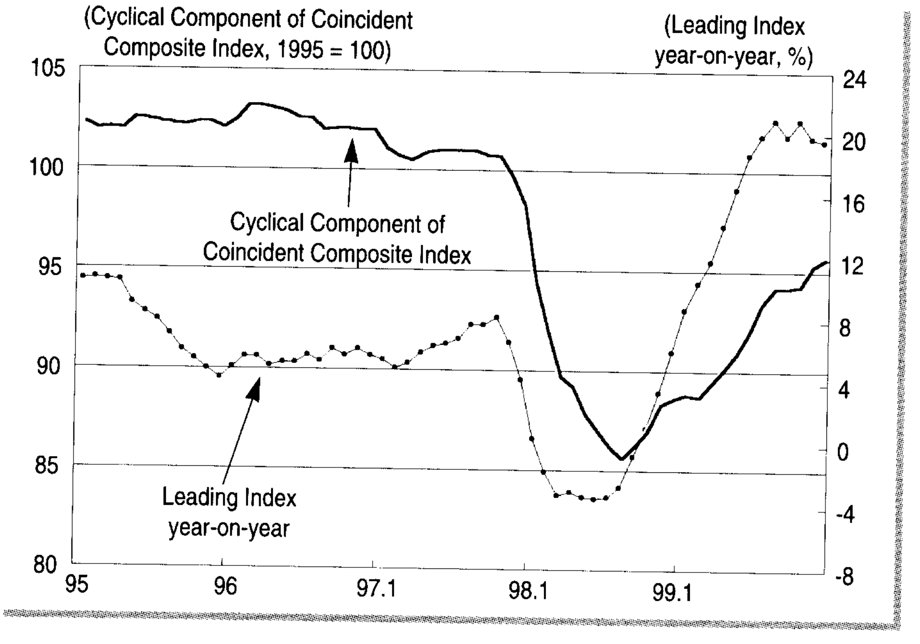
	1998	1999	2000	2000(HRI)
GDP(%)	-5.8	10.0	Approx. 6.0	7.5
Private Consumption(%)	-9.6	9.0	5.0~6.0	7.4
Facility Investment(%)	-38.5	34.0	14.0	15.4
Construction Investment(%)	-10.2	-9.0	5.0	3.8
CPI(%)	15.1	0.8	Approx. 3.0	3.7
Unemployment rate(%)	6.8	6.2	Approx. 4.0	4.3
Current Account(US$ 100 mil)	400	Approx. 260	Approx. 120	98

Although growth of the Korean economy will continue in the year 2000, its pace will be weakened. Production for inventory accumulation and exports will continue to increase. But the technical rebound effect, which was the main factor of 1999's high growth rate, has vanished, and after natural adjustment in economic activity, the increasing trend of the object economy index will be weakened considerably.

The economic growth will be slow.

Actually, in a monthly report on business activity for December by the National Statistical Office, the cyclic change of the integrated coincident index, which indicates current economic activities, rose 0.4% from the previous month, but was lower than the 1% growth in November. The integrated leading index foretelling economic activities in the few months ahead also dropped 0.2% in December from the previous month, following a 1.1% fall in November. The two indices show that economic growth will be slow.

Figure 2. Trend of the Korean Business Cycle



The preemptive government policy should be implemented with great caution.

Taking this situation into account, before the financial instability and the price rises of crude oil cool down, the government should maintain the established policy tone. If the government tightens policy sooner than expected because of fears that the pace of Korea's economic growth is too fast, the result will naturally be a stronger won and higher interest rates. Eventually, exports will shrink, the growth rate of private investment and consumption will slow down, and the economy will enter a recession. The government should pay attention to this possibility of recession resulting from tight monetary policy for the sake of price stability. VIP