GOVERNMENT CHOOSES A POLICY MIX TO MAINTAIN LOW INTEREST RATES

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Annual growth will reach 8% thanks to higher-than-expected growth in the first half, predicted to be around 11%.

Last week, the Korean government announced its revised projection of major economic indicators for the year. The projections were agreed to by the International Monetary Fund(IMF) during the recent semiannual consultations. Both parties agreed to readjust the GDP growth projection from the previous target of 6% to 8%. The government projected that the growth rate in the second half will slow considerably to around 6%. But annual growth will reach 8% thanks to higher -than-expected growth in the first half, predicted to be around 11%.

The two sides also agreed to lower this year's consumer price target from 3% to 2.5%. Consumer prices have remained stable so far this year, posting an increase of 1.5% for the first half of this year compared with the same period last year.

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Inflationary pressure is expected to mount in the second half of the year as the government has begun to raise public service charges and allow the domestic petroleum prices to rise in response to the rising prices of international crude oil. But overall price stability is expected to be sustained thanks to increased competition and enhanced productivity from market opening to international competition.

The IMF and the Korean government decided not to set a specific current account surplus target due to the unpredictability of several factors including the international crude oil price. The Korean government, however, chose to lower the

Table 1. Government's Projection of Major Economic Indicators in 2000

	1999	2000				2000(HRI)
		1st half	2nd half	annual	previous	
GDP(%)	10.7	11.0	6.0	8.0	6.0	7.8
Private Consumption(%)	10.3	9.0	5~6	7.0	5~6	7.9
Facility Investment(%)	38.0	50.0	20.0	34.0	14	30.3
Construction Investment(%)	-10.3	-6.0	7.0	1.0	5.0	1.5
CPI(%)	0.8	1.5	2~3	2.5	3.0	2.3
Current Account(US$ bil)	25	4	6~8	10~12	12	9
Export(US$ bil)	143.7	82.5	87.5	170	160	166
Import(US$ bil)	119.8	79.0	81.0	160	148	158
Unemployment rate(%)	6.3	4.5	3.8	4.0	4.0	4.0

Source: Ministry of Finance and Economy, Hyundai Research Institute(HRI) trade surplus target for the year from the previous projection of 12 billion dollars to 10 billion dollars. The trade surplus in the first half of the year recorded approximately 4.4 billion dollars, less than what the government had projected earlier this year.

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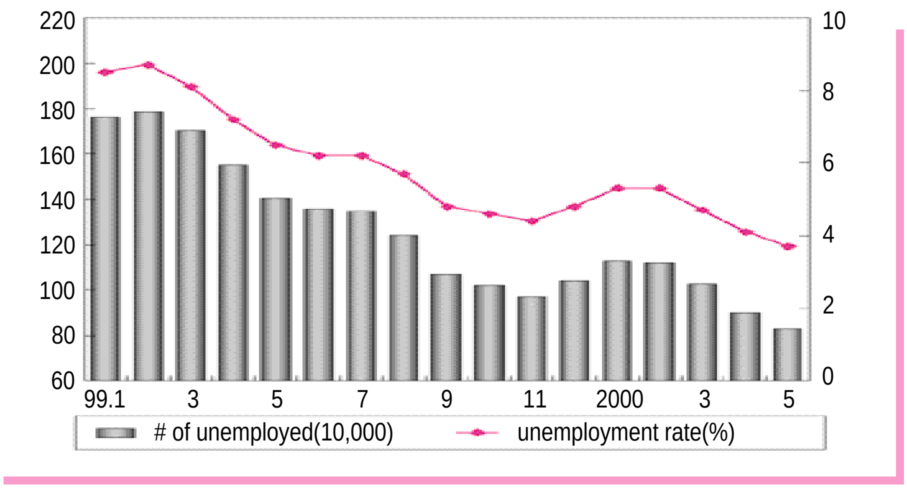
Total exports for the year are estimated to amount to 170 billion dollars(18.3% rise from last year) thanks to increasing prices of semiconductors and an optimistic outlook on the global economy, while annual import volume is expected at around 160 billion dollars (33.6% increase from last year) due to high prices of international crude oil and the larger-than-expected import demand for raw materials and capital goods.

The Korean government remains optimistic about employment conditions as it forecasts the unemployment rate to stabilize below 4% during the second half of the year. The unemployment rate has been steadily declining since the first quarter of last year. In May, unemployment rate recorded 3.7%, the lowest since the onset of the financial crisis in December, 1997.

Figure 1. Trend of Unemployment Rate



Source: The National Statistics Office

The Korean government also announced its economic policy direction for the second half of the year. It vowed to focus its efforts on completing the second stage of restructuring and put priority on sustaining stable economic growth. In order to accomplish these goals, the government decided to maintain the current low interest rates by combining a flexible monetary policy with tightened fiscal spending.

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Instead of resorting to a tight monetary policy to curb likely inflationary pressure in the second half, the government decided to cut public spending by reducing the fiscal deficit from the previous target of 2.6% of GDP to around 2.0~2.5%. The government officials also agreed to absorb possible increases in public service charges through efficient management of public enterprises.

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The government's move to stimulate M&A activities appears partly motivated by its desire to have funds flow back into ITCs. For the past several months, investors have drawn funds from the ITCs because of uncertainty over the restructuring process. Companies were unable to extend bond issues due to the ITCs lack of purchasing power and worries of a credit crunch lingered over most of the business sector. The government's decision to maintain low interest rates, thus appears inevitable to ease the minds of investors and to smoothly carry out the second round of restructuring.

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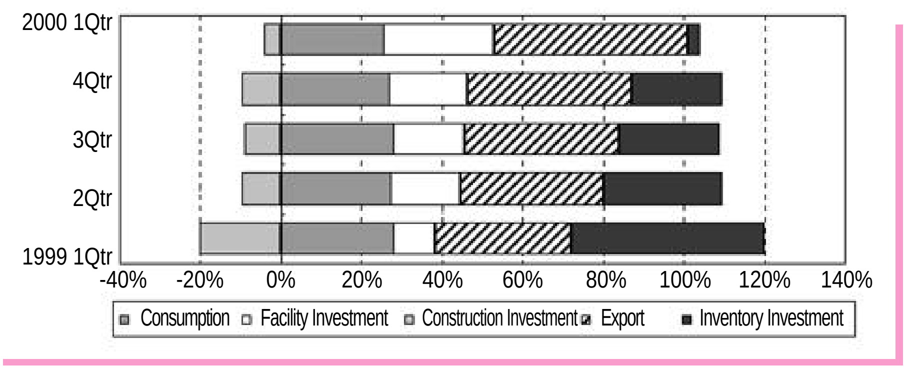
Maintaining low interest rates is also important for sustaining stable growth. A rise in the interest rate imposes extra costs on households and firms by raising the cost of borrowing and increasing the opportunity cost of investments. It also has the effect of strengthening the value of the Korean currency and worsening the price competitiveness of the goods produced by Korean companies in the world market.

Considering the fact that exports accounted for almost 50% of total GDP growth in the first quarter of this year followed by facility investment(27.5%), and consumption(25.5%), maintaining low interest rates has become essential for sustained growth of the Korean economy. VIP

Figure 2. Growth Contribution of Expenditure Components



Source: The Bank of Korea