# CLEARING UP THE MARKET UNCERTAINTY THROUGH POLICY CONSISTENCY IS ESSENTIAL FOR ECONOMIC SOFT-LANDING

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Looking back at the second quarter's economic performance, we can see that the economy maintained its high growth trend but its pace apparently slowed down.

In the second quarter of 2000, the real GDP growth rate recorded 9.6% over the previous year, helped by the rapid rise in facility investment and export. It was the first time the quarterly growth rate went into the one digit level since the second quarter of 1999. Furthermore, the quarter-to-quarter growth rate was a mere 1.1%, which was a drop from the first quarter's 1.8%.

Production activity was brisk as industrial output grew 19.3% year-to-year in July on robust exports led by semiconductors and office equipment. But this figure comes down to only 9.3% if semiconductors are excluded. Production grew 3.4% in July over the previous month.

July's domestic sales were also brisk, rising at 8.3% over a year ago helped by robust car sales and prospering big retailers. But its increase rate dropped significantly compared with June's 11.1%. On the investment side, facility investment and construction orders received in July recorded increase rates of 30% and 12.7% respectively, a steep decline from 33.1% and 44.3% in June.

In August, exports reached US$15.1 billion with an increase rate of 32.5% over the previous year and imports recorded US$13.5 billion at the rate of 36.8% for the same period. As a result, August's trade surplus reached US$1.6 billion, a US$0.8 billion rise from July. Brisk exports owed a lot to the rebound of the Asian economies and the strong Japanese yen.

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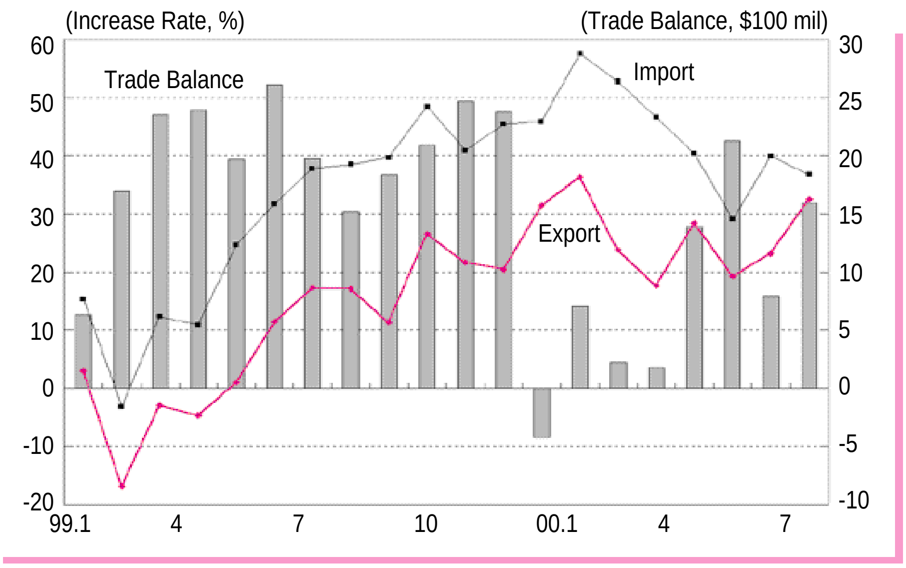
All in all, a continued rising trend in the economy was helped by exports and capital investment which remained firm throughout the year. Meanwhile, domestic demand has apparently been slowing down. It seems that the economy is still on the

**Figure 1. Exports, Imports, and Trade Balance**




upturn of the business cycle but the peak is near with the downturn in sight, probably at the end of this year or early 2001.

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In addition, worries are mounting on the Korean economy, which is still feeble right after it successfully rebounded from the Asian financial crisis. Although the IMF has given South Korea a clean bill of health as the nation prepares to graduate from the IMF's bailout program introduced in late 1997, the current economic situation is not as rosy as it should be.

International crude oil prices have been skyrocketing well over US$30 per barrel in September, dealing a heavy blow to the Korean economy. Soaring oil prices can aggravate overall economic performance since South Korea is a main importer of crude oil of about 900 million barrels a year. According to some analysts, a one dollar rise in oil prices per barrel may result in a trade deficit of US$10 billion, with exports reduced by US$1 billion and imports increased by US$9 billion.

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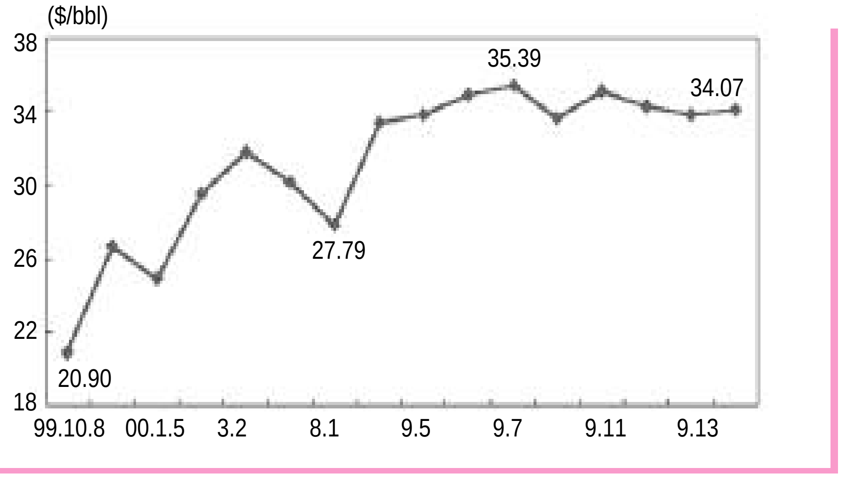
High oil prices can raise energy prices and cause consumer prices to rise. Although rises in the consumer price level have been stable below 2% until this summer, surging oil prices may add inflationary pressure to the economy and result in inflation. It is estimated that a one dollar rise in oil prices per barrel may cause the domestic consumer price level to rise 0.1% per year.

Other factors that may affect the economy negatively are Ford's recent decision to give up its bid for Daewoo Motor and the volatility of international DRAM prices

Figure 2. International Crude Oil Prices




cf: WTI basis

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for semi-conductors. The delay of Daewoo Motor's sale may especially hurt overall business and financial restructuring efforts and de-stabilize the financial markets, lowering the external credibility of the Korean economy.

As the economy is expected to undergo a downturn in the near future, persistent oil price hikes and other negative incidents can really dampen the overall economy and trigger stagflation coupled with severe inflation and low economic growth. Of course, this scenario is a very remote possibility but we need to prepare for the worst.

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The Korean economy is believed to be susceptible to external economic shocks as was shown by the current turmoil due to the recent oil price hike. This is because the overall economic and social system is too weak to absorb the adverse shock and is prone to get worse. The current financial instability is closely associated with investors' lost confidence due in large part to government policy inconsistency and market uncertainty.

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Hence, the first priority for the policy makers should be to continue accelerating the current drive for financial and business restructuring so as to clear up market uncertainty. Even though it is unpopular and painstaking, it may be the only way to regain market confidence and achieve an economic soft-landing. In the meantime, it is also important to fine-tune macroeconomic policy to achieve economic stabilization. And finally, a more active economic policy should be immediately implemented to supply credit for businesses suffering from heavy liquidity shortage caused by the current financial uncertainty. VIP