

## V. Korean Economy This Week

### *Implications of the 3rd Quarter Policy Review by the IMF and the IBRD*

The Korean Government recently concluded its third-quarter policy review with the IMF and the IBRD (World Bank). After the consultations with the IMF, the target for GDP growth rate was lowered to -4%, while the inflation target was placed at 9%, and the current account surplus target at \$33~35 billion. The Government will be allowed a more flexible fiscal and monetary policy, with the fiscal deficit to be expanded to 4% of GDP or 17.5 trillion won and the money supply to be increased by 14.2%. Call rates will also be lowered.

The Government and the IMF also had consultations of the ongoing financial restructuring process. According to the schedule, the remaining undercapitalized banks will have their already-submitted restructuring plans evaluated by September 30. If those are approved, the banks will sign an MOU with the Financial Supervisory Commission to raise their capital ratios to 8% by March 2000; if not, the banks will be subject to mandatory mergers or transfers of businesses. Public funds will be used when necessary to facilitate the liquidation of failed institutions and the restructuring of viable but weak banks.

Working closely with the World Bank, the government has also developed a program for corporate debt restructuring, as agreed upon with the provision of the Structural Adjustment Loan. The main objectives of the program are to provide an overall framework of principles and procedures, assign responsibility for leading voluntary corporate workouts, gain creditor support, provide necessary resources, and help resolve inter-creditor disputes.

### *Restructuring is Top Policy Priority*

With the outcome of the latest quarterly review, there has been a clear shift in the policy priorities. Until now, the top priority was placed on macroeconomic stability, centering around securing sufficient foreign currency reserves and

stabilizing the foreign exchange market. However, with this third-quarter review, emphasis is shifting toward facilitating restructuring by ensuring that the resources needed for restructuring are made available and that obstacles are minimized or removed.

Why did this change come about? First, Korea continues to record considerable current account surpluses and there is sufficient liquidity in the foreign exchange market. While the macroeconomy is admittedly in an extremely depressed state, it seems to have stabilized to a certain degree and is not expected to deteriorate much further in the future.

In addition, the Korean Government, the IMF, the IBRD and virtually everyone else seems to agree that the most urgent task right now is to actively pursue restructuring and eliminate the various weaknesses and inefficiencies in the financial and corporate sectors in order to overcome the current economic crisis. However, this does not necessarily mean that the Government will try to directly boost the economy. Rather, the Government's pursuit of more flexible fiscal and monetary policies will be geared toward facilitating the overall restructuring process as opposed to direct stimulus measures.

Even among the macroeconomic targets, the emphasis has changed. With the growing foreign exchange reserves and stabilizing exchange rate, priority is now being placed on lowering interest rates, improving liquidity, and expanding the issuance of credit. The domestic economy is in its worst slump ever, and authorities agree that efforts must be made to ensure that Korea's growth potential is not irreparably damaged in the course of restructuring. Furthermore, there is growing recognition that for restructuring to be successful, interest rates must come down and the tight credit crunch must be relieved.

One other noteworthy point is that in this review, the IMF agreed to almost all of the Government's proposals and measures as originally suggested. This implies that the Government will have greater flexibility in managing the economy in the future--for example, in allowing limited intervention in the foreign exchange market.

(Edward Park *Parked@hri.co.kr* 8724-4028)