Ⅳ. Korea Economic Focus

Economic Picture Stabilizing

Over the last week or two, there have been two major developments concerning the Korean economy. First, the stock market, which had been booming so fast that people were worrying about the possibility of a bubble forming, cooled down somewhat and stabilized. Second, the international credit rating agencies Fitch IBCA and then S&P upgraded Korea's sovereign credit ratings to investment level. What do these developments suggest? In the most favorable light, it could mean that the worst of the economic crisis plaguing Korea over that past year or so has now passed and the volatility in the financial markets, particularly recently, has subsided. Perhaps more importantly, now the real economy has some breathing room to begin its recovery.

What These Developments Mean

From the perspective of those analysts who were worrying about the unsteady movements in the capital markets, the slightly downward adjustment in the stock market may, in fact, have been a blessing. Their fears centered not so much on the size of the stock market relative to the size of the economy, but rather the possibility of a bubble forming with the rapid pace of recovery from last year. If such a bubble were to burst, it would set back Korea's efforts to recover considerably. In that sense, it is fortunate that the recent troubles in Brazil and Russia did not spillover into a Korean economic crisis but instead acted as a set of brakes to decelerate the Korean stock market.

The international credit agencies' recent upgrading of Korea's sovereign credibility seems to be based on two main considerations. First are the Korea-specific factors and economic fundamentals. Among the countries stricken by the economic crises over the last year and a half, the Korean economy is showing the best signs of recovery, as indicated in the current account balance, foreign exchange reserves, inflation, and other economic indices. The progress made heretofore in sectoral restructuring, in spite of some domestic controversy, has also been a major contributing factor. The other main consideration has been a relative comparison of Korea with other countries as a financial opportunity or destination of investment. In other words, they seem to feel that compared to other emerging markets Korea can guarantee a relatively high and safe return on investment, be it portfolio investment or FDI.

Seizing the Opportunity

While this may be controversial and unfortunate in a certain, larger sense, the recent troubles in Russia and Brazil can be favorable to Korea. For this to happen, there are two necessary conditions. First, thanks to advanced nations such as the U.S. and international organizations such as the IMF, a "fire-wall" has been erected to limit the contagion effect of the economic crisis. This is, of course, beyond the realm of Korea's own abilities. What Korea can do, though, is effectively manage its foreign debt picture and foreign exchange reserves. Paying back foreign debts while trying to boost foreign exchange reserves may seem like mutually contradictory goals. However, if the government repays its foreign debts and enough incentives are provided for private firms to do likewise for their own foreign-denominated debt, Korea's sovereign credibility will be enhanced that much more.

Under these circumstances, what must the government, businesses and consumers do? The most important thing is showing everyone that Korea's situation is different from that of other emerging markets in crisis or at least in a different category, while maintaining a sufficient cushion of forex reserves. Striking the proper balance between maintaining foreign exchange reserves and repaying our foreign debt should be the top policy priority, not only to enhance our credibility but also to keep the exchange rate at an appropriate level.

Second, the monetary and fiscal policies must be adjusted and fine-tuned. The target interest rates must be adjusted to allow the stock market to grow gradually and meet the demand for paid-in-capital increases, thereby allowing firms to improve their financial structures. At the same time, fiscal policy must be fine-tuned and implemented more effectively to bolster social cohesion in the midst of this difficult period. Third, consumption and investment must gradually increase even as consumers' and corporations' incomes or cash flows remain diminished if a recovery in the real economy is to take place.

In sum, with the fear of a bubble bursting having dissipated and with interest rates remaining low, we must take this opportunity to build up the momentum for the real economy to bounce back.

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