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The name of this publication is changed to Korea Economic Outlook from KERI Economic Quarterly effective with this issue. We ask our readers for their continued support and patronage. (Ed)

I. Recent Developments

Stimulated by a continued upswing in major economic indicators such as production, consumption, and facility investment, GDP recorded a growth rate of 12.3% in the third quarter of 1999 versus 9.9% growth in the second quarter.

The major indices upturn continued in October and November. The average capacity utilization rate has surpassed the pre-IMF-level of 80.1%. Thus, the last quarter of 1999 should witness GDP groeth of 10%.

Nonetheless, the remarkable GDP growth in 1999 resulted from the conspicuously low GDP growth recorded in 1998 in the wake of the financial crisis of late 1997, and it cannot be regarded as an overheating of the economy exceeding Korea's economic growth potential.

In fact the GDP growth level recorded during the first nine months of last year (first through third quarters) represents but 96.2 percent of the level for the same period in 1997.

Of the 9.0 percent growth rate recorded in the first nine months of 1999, inventory accounted for no less than 5.1% a fact that demonstrates that substantial growth in the total demand sector was negligible, if the inventory subsector is excluded.

It should not be overlooked that the main economic indices began their upturn in August 1998 and that the growth rates of the indices began to level off in August 1999 and their quarter-to-quarter growth rates also began to decline from August 1999. Thus it is likely that the double-digit growth rate represents a temporary phenomenon.

In parallel with a radical increase in imports, Korea's exports also recorded a sharp increase in the last quarter of 1999, thanks to the appreciation of the yen and increased demand for Korean products in advanced countries and Southeast Asia. As a result, the surplus in foreign trade reached USD24.5 billion last year.
The upturn in the consumer price index since August 1999, stimulated by damage to agricultural products due to typhoons and increased crude oil prices on the world market, leveled off after November thanks to the appreciation of the won and the abolition of the special excise taxes. The growth in the consumer price index thus dropped to a record low of 0.8 percentage point last year.

Influenced chiefly by the restructuring of the Daewoo Group, the domestic financial market has shown signs of instability since last August. Nonetheless, influenced by the establishment of a "Bond Stabilization Fund on September 20 and other measures designed to stabilize the domestic financial market, long- term interest rates dropped to below double-digit level.

However, influenced by the continued business upturn and investment trust companies bond-selling activities, on top of the limited role of the "Bond Stabilization Fund? the long-term interest rate recently began to once again hit double-digit levels.

Outlook for 2000

Korea's GDP grew around 10% in 1999, and we may get a glimpse of this year's GDP, which will most likely not be affected by a technical rebound or inventory effects, by taking into consideration some of the variable factors

First of all, this year the United States economy is expected to experience a soft landing, the economies of Europe and Japan are likely to rebound, and the Asian economy is expected to follow suit. Consequently, it is probable that this year the world economy will top its growth rate of 1999.

The yen's value vis-a-vis the U.S. dollar is expected to remain strong. The international market price of crude oil is expected to level off from the second quarter of this year in view of the current position being assumed by OPEC that a further increase in its prices will only destabilize the crude oil market and hurt its interests in the end. These external economic factors are thus expected to favorably influence the Korean economy.

Internal factors, on the other hand, appear to be somewhat negative. This is because fiscal policy is expected to be tightened in order to maintain long-term soundness. Moreover the monetary policy stance centered around a low interest rate policy will have to be abandoned once Korea's economic stability is threatened by price inflation stimulated by the general business upturn accompanied by expanded consumption. This in turn will oblige the government to shift to wards a more conservative monetary policy.

Nonetheless, the ongoing industrial reform marked by the restructuring of major enterprises is expected to slow down the implementation of any radical stringent monetary and fiscal policies this year. Moreover, the prevailing unrest in financial circles touched off by the Daewoo Group appears to be easing gradually.

All in all, Korea's economy is expected to register around 6~7 percent growth this year, which is lower than last year's estimated growth rate of around 10 percent induced chiefly by a technical rebound and inventory effects. However, this year's anticipated growth rate is higher than Korea's potential annual economic growth rate.

This year's growth in the private consumption sector is likely to surpass the anticipated growth in GDP stimulated by increased wages, decreased unemployment and a recovery of the real estate market, which will automatically raise the purchasing power and boost demand for both durable and nondurable consumer goods.

Facility investment will also witness around 10 percent growth this year or higher than predicted GDP growth thanks to a sustained business upturn and resulting growth in profits.

The construction sector, which experienced a steep plunge in growth last year, is likely to see positive growth this year spearheaded by growth in the private housing construction subsector inasmuch as the government is expected to maintain its policy of minimizing government investment in SOC projects this year.

The export sector will record over 7 percent growth this year, the major contributing factors being the worldwide economic recovery, brisk overseas demand for Korea's major export items, strong Japanese yen, etc., which will more than offset the appreciation of the won against the dollar.

The import sector is expected to register double-digit growth influenced by increased demand for both capital goods and expensive consumer goods, fueled by the economic recovery.

The invisible trade sector will continue to show negative growth due to growing deficits in tourism and unrequited transfers.

All in all, the surplus in the current account this year is likely to be half that of 1999, or USD10 billion.

The employment situation is expected to continue to improve, due to animated production activities and government measures designed to ease unemployment problems.

Nonetheless, this year will most likely witness an unemployment rate of around 4 percent and around 1 million unemployed workers, due to an increased number of economically-active people resulting from the sustained economic upturn.

The consumer price index, which remained stable at around 1 percent in 1999, is likely to increase to 2.6 percent, influenced by wage increases and the general upturn in overall demand this year. This prediction is based on the premise that the won will appreciate by around 5 percent and that the international market prices of raw materials will generally be stable.

The average yield of debentures this year is expected to inch up to 10.2 percent inasmuch as the debenture market will remain bearish with some 4 trillion won worth of debentures maturing this year. The yen will remain strong this year, Korea's current account surplus will be sustained, and the value of the won will gradually inch up.

III. Policy Issues & Recommendations

A tight money supply will underpin Korea's overall financial policy in the year 2000 to ensure an economic soft landing. Nonetheless, an actual policy shift in favor of a tight monetary policy will naturally cause financial market participants to brace themselves for inevitable increases in market interest rates and this in turn will lead to a contraction in financial market activity.

This being the case, we are inclined to suggest that the government needs to gradually raise call rates to ease the impact of any radical policy change on the financial market.

If it is rather difficult to raise call interest rates due to the adverse influence on the government's policy of launching a second financial market restructuring initiative, it will be necessary for the government to ease its influence on the debenture market and help normalize market rates to a realistic level as soon as possible.

In addition, the government has to assume a flexible stance in the implementation of measures related to money supply, government expenditures, and foreign exchange supply and demand in view of the fact that the inflow/outflow of foreign capital has a serious impact on the policy and in the end tend to agitate the economy per se.

For example, it should be noted that a rational rise in market interest rates and proper appreciation of the won will inevitably ease mounting inflationary pressure. In fact, a simulation of macroeconomic factor effects conducted by our institute shows that a 0.5 percentage point increase in market interest rates and appreciation of the won by 2.5 percentage points would lower this year's GDP and price index growth rates by just 0.4 percentage point to 6.3 percent and 2.2 percent, respectively. Thus these proposed measures will reduce prices without withering the economy.

Furthermore, the government this year needs to endeavor to remove such bottlenecks as unemployment, unequal distribution of wealth, increased national debt, etc., which were derived in the course of overcoming the economic crisis of late 1997, in order to sustain economic recovery.

II. Outlook for 2000

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