REPUBLIC OF KOREA

The economic growth that gathered pace in the first quarter of 2000 is likely to moderate over the second half of 2000 and in 2001 as it reaches maturity. Despite progress in corporate and financial sector restructuring, much remains to be done.

Economic Indicator (percent)	1997	1998	1999	2000	2001
GDP growth	5.0	-6.7	10.7	8.3	6.0
Inflation rate	4.5	7.5	0.8	2.3	2.6
Current account/GDP	-1.7	12.8	6.1	1.7	0.4

Economic Assessment. Underpinned by an expansionary fiscal and monetary policy, real GDP expanded by 11.2 percent in the first half of 2000 on a year-on-year basis, compared with 10.7 percent growth for the whole of 1999 and a rate of contraction of 6.7 percent in 1998. The continued recovery was mainly due to a pickup in gross fixed investment and the maintenance of a relatively high level of private consumption. Unemployment fell from 6.3 percent in December 1999 to 4.5 percent in June 2000.

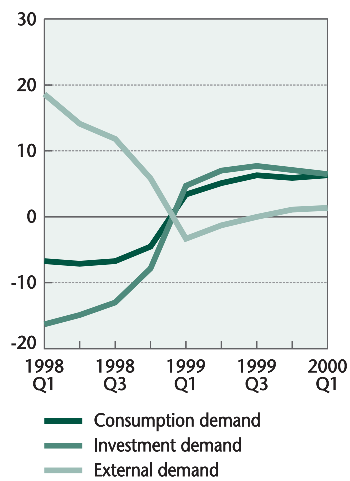
During the first half of the year, private consumption remained robust as consumers made purchases deferred during the financial crisis. Investment demand increased as firms in the information technology sector upgraded their facilities. On the aggregate supply side, manufacturing led the recovery, supported by stronger external demand for electronic products, semiconductors, and cars. Service sector output also grew strongly, due to growth in telecommunications, wholesale and retail trade, and financial services. The construction sector, however, continued to contract, reflecting declines in private residential and non-residential building.

Despite rapid economic growth and increased oil and agricultural prices, consumer price inflation rose by a modest 1.5 percent year-on-year during the first six months of 2000. This was mainly due to the steady appreciation of the won against the dollar and a reluctance of manufacturers to pass on rising costs to consumers, in an attempt to maintain market share.

The trade surplus narrowed significantly in the first half of the year as import growth outpaced export growth. This was accompanied by a higher deficit in the nontrade account because of an increase in import-related services and the servicing of large external debt obligations. The combined effect was to cut the current account surplus sharply to $4 billion from $12.5 billion in the corresponding period of 1999.

Faced with a significantly higher debt burden, the Government plans to curtail its spending over the rest of 2000 and in 2001. This may not be straightforward due both to rising interest payments on government-guaranteed debt that was issued to underwrite financial sector restructuring, and to a sharp increase in the social welfare budget. Strong economic growth is, however, likely to lead to enhanced revenue collections

Decomposition of GDP Growth by Quarter (percent)

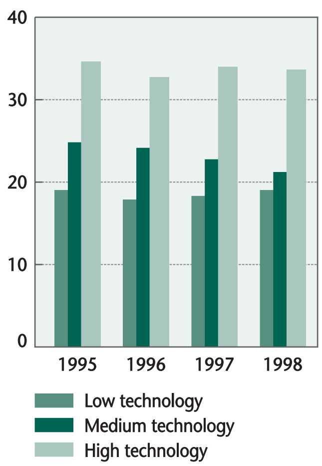


and the consolidated budget deficit is expected to narrow to 2.2 percent of GDP in 2000, from 2.9 percent of GDP in 1999.

With inflation remaining subdued, the Government is unlikely to make any significant changes to its low interest rate policy unless inflation threatens to exceed the target of 2.5 percent. However, given the still large overhang of corporate debt, any increase in rates is likely to be modest. Consequently, the authorities may prefer to weaken potential inflationary pressures by allowing the won to continue appreciating.

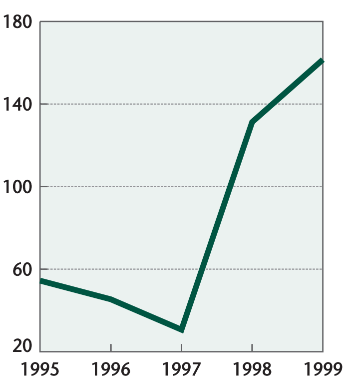
Structural Issues. Although considerable progress has been made in corporate and financial sector restructuring, many items are still on the reform agenda. Much remains to be done to restructure investment trust companies and other nonbank financial institutions, such as insurance companies. Given the links between the *chaebols*, banks, and investment trust companies, financial problems in the latter could undermine both corporate and financial sector restructuring. The Government expects that it will need an additional W30 trillion (on top of the W100 trillion already spent) to complete the restructuring process. However, many private analysts doubt that even this figure will be adequate, given the scale of the investment trusts' problems. Although all the *chaebols* have considerably reduced their debt and divested noncore activities, outstanding debt (based on new consolidated accounts) remains, on average, above government-stipulated levels. There is also some concern over the quality of debt workouts given the slow pace of corporate reform.

Technology Exports as Share of Total (percent)



Forecast. Despite robust growth during the first six months of 2000, GDP growth is projected to moderate to 8.3 percent over the whole year and to 6.0 percent in 2001. Private consumption growth is likely to slow during the rest of 2000 and in 2001 due to a gradual easing of pent-up demand. Gross fixed investment is expected to rise in the second half of 2000 as companies continue to upgrade facilities and implement investment plans that were shelved in 1998. Investment growth is, however, likely to moderate in 2001 owing to weaker demand and a more measured pace of stock building. Economic activity is also likely to be dampened by a slower rate of public investment.

Ratio of Reserves to Short-Term External Debt (percent)



Although higher energy prices are likely to lead to a pickup in consumer prices during the rest of 2000 and in 2001, the rate of increase will probably remain subdued due to continued won appreciation and greater competition in hitherto closed sectors such as distribution. Inflation is therefore likely to average 2.3 percent in 2000 and 2.6 percent in 2001.

In the second half of 2000, continued vigorous US economic growth and higher prices for semiconductors are likely to boost Korea's electronics exports. Import growth is likely to remain strong given the import-dependent nature of exports and increased demand for capital goods. The nontrade deficit is also expected to widen, owing to continued heavy outflows on interest payments and service imports. As a result, the current account surplus is set to narrow to $8.7 billion in 2000 from $25.0 billion in 1999, and will likely be minimal in 2001. However, strong inflows of foreign direct and portfolio investment stimulated by ongoing corporate restructuring should ensure a healthy level of reserves in the next two years.