

# **The Korean Economy**

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## **I. Recent Economic Trends**

Thanks to the recovery in private consumption from the second half of 2005, the Korean economy recorded a solid GDP growth rate of 5.0 percent in 2006. However, the quarterly growth rate on year-on-year basis has declined over the course of the year from 6.1 percent in the first quarter to 4.0 percent in the fourth quarter, as private consumption did not maintain its vitality throughout the year (from 4.8 percent in the first quarter to 3.6 percent in the fourth quarter). The main reason for the consumption slowdown seems to be the almost stagnating income growth (only 2.1 percent increase in terms of GDI), which was attributed to the terms-of-trade deterioration due to oil price hike.

Other demand components did not show any drastic fluctuations. Equipment investment recorded a reasonable pace of increase (7.5 percent) although the base is still low. Construction investment was sluggish (-0.1 percent), but it showed some signs of recovery at the end of the year. Exports continued to grow at a double digit (12.6 percent) despite the strengthened won (particularly against the Japanese yen).

As for the very recent movement of monthly indicators, the industrial production expansion rate has gradually declined since October. However, the service activity indexes in most sectors have maintained stable growth, indicating that domestic demand is likely to continue its stabilized trend.

## **II. Projections for 2007**

The assumptions for the projections are: 1) The world economy soft-lands at around 3.2 percent of growth in 2007, slightly lower than 3.9 percent (Global Insight) in 2006; 2) The oil import price declined to around \$55 per barrel in 2007; and 3) the won/dollar exchange rate throughout 2007 is the same as the year-end level of 2006.

Under these assumptions, GDP growth is projected to be around 4.4 percent in 2007, similar to that for the second half of 2006. In particular, the oil price decline (hence the terms-of-trade stabilization) will help to boost the income growth rate, and contribute to stabilizing private consumption over the year and slightly raising the GDP growth rate in the second half. As financial restructuring pressures in the business sector are easing, equipment investment is likely to continue its healthy growing trend at around 7~8 percent. Construction investment is also projected to mildly recover to 2~3 percent of growth, reversing its downward trend from 2004 in light of rising trends in various leading indicators.

Exports are projected to increase at around 10.6 percent in 2007, lower than 12.6 percent in 2006, as the world economy slows down. In contrast, imports are expected to grow at around 13.0 percent in 2007, higher than 11.9 percent in 2006, as domestic demand gradually recovers and import prices decline. While trade balance is projected to maintain a sizable surplus of around 30 billion dollars, the overall current account

surplus will be expected to almost disappear as the service trade deficit expands.

### Macroeconomic Projection (2007)

(Unit: %)

	2005	2006	2007
Real GDP Growth	4.0	5.0	4.4
Total Consumption	3.4	4.5	4.1
Private	3.2	4.2	3.9
Government	4.3	5.8	-
Fixed Capital Formation	2.3	3.2	4.8
Equipment	5.1	7.5	7.6
Construction	0.4	-0.1	2.6
Export Volume	8.5	12.6	10.6
Merchandise	9.7	13.0	11.9
Import Volume	6.9	11.9	13.0
Merchandise	6.1	11.3	13.5
Balance of Payment (US\$ billion)			
Current Balance	15.0	4.9	-0.4
Trade Balance	32.7	29.2	29.5
Export	289.0	332.9	371.8
(%)	(12.1)	(15.2)	(11.7)
Import	256.3	303.6	342.3
(%)	(16.4)	(18.8)	(12.7)
CPI Inflation(%)	2.8	2.2	2.7