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DIRECTORATE OF INTELLIGENCE

12 December 1986

South Korea: Status of the Economy [Redacted]

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Summary

A reinvigorated South Korean economy this year should produce more than double the 5.1-percent real growth in GNP achieved in 1985. In addition, Seoul will post its first-ever trade surplus--over \$4 billion dollars, which the government will use to reduce South Korea's \$46 billion foreign debt. Although the economic outlook for the near term is bright, unfavorable trends in exchange rates, interest rates, or oil prices, as well as protectionist measures imposed by major trading partners, could cut the recovery short. [Redacted]

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The Economic Rebound

Favorable oil prices, interest rates, and foreign exchange movements have enabled South Korea to revitalize its economy after last year's sluggish, for South Korea, 5.1-percent real GNP growth rate. A weaker dollar, coupled with Seoul's aggressive devaluation of the won last year, has bolstered the competitiveness of

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South Korean goods in all developed country markets, and helped push up exports through October by 19 percent. Seoul will post its first-ever trade surplus this year--probably more than \$4 billion, according to government estimates--and economic officials are eyeing a possible \$4 billion current account surplus. [redacted]

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During the first nine months of this year, real GNP increased an estimated 12 percent compared with the same period last year. Growth will easily surpass Seoul's 8-percent goal for 1986, and the economy is likely to continue growing rapidly. The Korea Development Institute, a quasigovernmental think tank, recently forecast nearly 8-percent real GNP growth next year, and the government has raised its average annual real GNP growth target for the Sixth Five-Year Plan, which commences in 1987, from 7 percent to 7.2 percent. [redacted]

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The Role of External Factors


The growth spurt, however, is closely tied to volatile factors. Key forces shaping South Korea's economic advancement include:

- Economic growth in developed countries. US economic performance, in particular, will be a major determinant of South Korea's fortunes. The US market takes over one-third of Seoul's exports, a dependence that may grow as South Korea looks to the United States to absorb new export items such as autos and semiconductors. But with many economists lowering their projections for US economic gains, continued high export growth is uncertain. Japan, South Korea's second-largest trading partner, also faces a lackluster economic outlook.
- Protectionism. Developed trading partners have tried to use quotas and voluntary restraints to stem imports of South Korean textiles, steel, and footwear--which make up over one-third of South Korea's exports. Protectionist measures will probably increase as South Korea emerges as a strong competitor in knowledge- and technology-intensive goods, such as personal computers and autos.
- Security Issues. A relatively heavy defense burden--nearly 6 percent of GNP--acts as a brake on South Korea's economic growth and diverts scarce technical expertise from commercial endeavors.
- Foreign Debt. South Korea's \$46 billion debt is over half its GNP and debt payments are about 20 percent of export earnings. While Seoul has no major problems servicing its foreign debt, economic technocrats and

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international bankers view continued high export growth as the key to South Korea's creditworthiness. The government has decided to spend part of this year's current account surplus on debt reduction, particularly short-term debt. Nonetheless, South Korea will remain the fourth-largest LDC debtor. 

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The Political Factor

Our outlook is qualified by concern that an unstable political climate could sour growth prospects. Notwithstanding this year's favorable balance-of-payments situation, Seoul will continue to require about \$4 billion in foreign loans annually through 1988. If civil strife hurts South Korea's credit rating, Seoul at a minimum will face higher interest rate spreads on new commercial borrowings, which will add to the debt burden. Moreover, economic planners are counting on foreign investment and domestic savings to spur capital spending and maintain South Korea's industrial competitiveness. Political unrest that undermines the confidence of domestic and foreign investors could cut short the recovery. 

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SUBJECT: South Korea: Status of the Economy [redacted]

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