Press Statement: IMF Staff Visit, November 2-10, 2006

This staff visit has been aimed at continuing our policy dialog with the Korean authorities and preparing the ground for the 2007 Article IV consultation. We would like to express our appreciation to the authorities for their constructive engagement this past week and we look forward to continued close and fruitful cooperation in the future.

The Korean economy, despite its modest slowdown this year, remains fundamentally in good shape. Consumption growth is moderating, but this was not unexpected in light of an extended period of consumption growing faster than personal incomes and rising consumer debt. Moreover, industrial sector output and investment have been solid, with recent data pointing to some strengthening, while construction activity shows signs of bottoming out. Korea has continued its impressive export performance, and this is expected to continue, with only a modest slowdown in response to lower growth in key industrial economies. Overall, we expect growth of 5 percent for 2006 and 4.3 percent in 2007. Meanwhile the external current account is expected to register a small surplus this year and next.

Inflation remains well under control. While some increase from the current consumer price inflation rate of just over 2 percent can be expected, overall price pressures are expected to remain moderate in 2007, and inflation is projected to remain contained toward the lower end of the Bank of Korea's target band.

However, the economy remains exposed to significant risks. Perhaps most important in this regard is the possibility of a sharper-than-expected slowing in the US—in particular from the cooling of the housing market—which could dampen Korea's exports. Geopolitical developments on the Korean peninsula could also influence business and consumer sentiment, although there are no signs as of yet that the recent nuclear test by North Korea is having an economic impact. Finally, while lower oil prices are helping to cushion slowing consumption and hold down inflation, some rise in oil prices from current levels is expected in 2007, and further oil price spikes cannot be ruled out.

In this light, the current mix of macroeconomic policies—which we see as broadly neutral—appears appropriate. We support as well the authorities' intention to monitor developments closely with an eye toward more stimulative policies should downside risks emerge. Moreover, we agree strongly with the government's view that economic policy should focus on raising Korea's growth potential through structural reforms. Key among these are the continued development of the financial sector and steps to enhance productivity among small and medium-sized enterprises and in the services sector. Finally, ensuring sustained growth over the longer-term would require tackling, on a timely basis, large expenditure pressures associated with the expected aging of the Korean population.

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