For Public Release

FAQs

about the Korean Economy and the Financial Market

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Financial Services Commission

Contents

<Hot Issues>

<Other Issues>

10. How large will the current account surplus be in 2009 and on what grounds?

11. What is your estimation of Korea’s economic growth this year?

12. How big is the additional stimulus package being planned by the government and what is the exact plan of implementing that package?

13. About concerns of possible deterioration of fiscal balance and national debt level caused by the economic stimulus package

14. What is the Korean government doing to create jobs?

15. Is it desirable to pursue deregulation at a time when people are arguing that the latest financial crisis in the US was triggered by reckless deregulation?

16. Is the Korean government going ahead with the plan to privatize Korea Development Bank? Will there be government guarantee of payment of foreign currency industrial financial bonds?

17. What corporate restructuring plans does the Korean government have?

18. Is the Bond Market Stabilization Fund sufficient to ease concerns about the liquidity crunch in bond markets?

19. What countermeasures does the Korean government have to address the credit crunch caused by the money injected by the central bank coming back to the central bank through banks?

20. In consideration of the possible rise in nonperforming assets caused by the accelerating deterioration of the economy, do you think 20 trillion won Fund will be enough?

21. What is the trading volume and the level of risk in the Korean derivatives market?

22. Does the Korean government still plan to introduce hedge funds this year as it announced earlier?

Q1. Aren’t Korean banks excessively leveraged as illustrated by their relatively high loan-to-deposit ratios?

(Answer)

Calculation and comparison of loan-to-deposit (LTD) ratios must take into account country-specific or bank-specific characteristics. In the case of Korean banks’ LTD ratio, CDs must be included as deposits, because the Bank of Korea Act classifies CDs as deposit liabilities, for which banks are mandated to set provisions. Furthermore, as of end of December 2008, 83.5 percent of CDs are sold at bank counters and they are in fact same as ordinary deposits in nature.

* While CDs are included in deposits under the U.S. banks’ accounting system, they are separately counted by Korean banks.

Meanwhile, special purpose banks with little reliance on savings should be excluded from the calculation. Special purpose banks are less dependent on savings than commercial banks are due to their special characteristics in terms of financing method, including high bank debenture issuance ceiling.

* Commercial bank debenture ceiling is limited at 3 times the equity capital; while for special banks, it is at 5 to 30 times their equity.

<LTD Ratio>

As of end-Feb. 2009

	Commercial Banks (excluding special purpose banks)	Domestic Banks
Including CD	100.0	109.2
Excluding CD	115.9	125.7

LTD ratio should also consider the level of securitization in each country’s banking sector. Direct comparison of LTD ratio of Korea and that of the U.S. or Europe can be misleading, because Korea has low securitization ratio while the U.S. and Europe are more active in asset securitization.

* In the U.S. more than 80 percent of loans are securitized (less than 5 percent in Korea)

It should be noted that Korean banks are maintaining very sound and stable loan profiles with 54.2 percent of loans secured with collateral (48.6 percent) or guaranteed (5.6 percent). Pure credits account for only 45.8 percent. Moreover, Korean banks are more stable than the U.S. commercial banks in terms of delinquency ratio and NPL ratio, and they have sufficient coverage ratio.

	Korean banks[1)]	U.S. commercial banks[2)]
Delinquency ratio (%)	1.50	3.64
NPL ratio (%)	1.11	2.23
Coverage ratio[3)](%)	147.1	88.7

1) As of end-Dec. 2008 (delinquency ratio: as of end-Jan. 2009)
2) As of end-Sep. 2008 (source: FDIC)
3) loan loss provision/NPL

Korean banks' mortgage loan soundness is particularly better than in other countries thanks to government regulations, including LTV ratio (average LTV ratio as of end-2008: 46.7 %), and the mortgage loan-to-GDP ratio is relatively lower as well.

	Korea	**U.S.**	**Hong Kong**	**Germany**	**Japan**
Mortgage loan-to-GDP ratio	**33.4%**	72.3%	37.3%	52.4%	36.2%
LTV limit	**40-60%**	None	60-70%	60%	Indirect regulation

The leverage ratio (total asset/total capital), cited as one of the main causes of the current financial crisis, is also low in Korea's banking sector. And while the simple leverage ratio of major international banks has risen in the past few years, that of Korean banks has declined to be maintained at a stable level.

<Simple Leverage Ratio Trend of Major Banks>

Unit: %

	2003	**2004**	**2005**	**2006**	**2007**
RBS	23.3	25.5	27.5	29.0	42.9
Deutsche Bank	37.2	44.8	45.2	45.9	71.4
BNPP	30.5	34.6	43.7	41.8	45.0
Barclays Bank	29.6	30.9	49.0	43.3	44.8
HSBC	18.9	19.0	20.2	21.2	22.4
Credit Agriocole	19.9	19.6	22.8	34.2	33.0
Citigroup	18.9	20.0	18.8	20.7	24.5
UBS	46.5	55.9	51.5	59.2	69.4
Bank of America	16.7	17.3	17.5	16.0	20.6
Korean commercial banks	24.6	21.0	17.1	16.7	16.1

Note) Year: fiscal year, Source: The Banker

Q2. Tell us about the Korean government's measures to account for the anxiety over the soundness of real estate related project financing (PF) loans.

(Answer)

As of end-September 2008, financial institutions as a whole have provided a total of 81.6 trillion won in PF loans, but the delinquency ratio is at a moderate level of 4.6 percent.

Meanwhile, the coverage ratio[1] stands at 104.5 percent and PF loans only account for 3.1 percent of the financial industry's total assets.

In the case of savings bank PF loans, the share of PF loans (23.4% in end-Sep. 2008 → 20.9% in end-Dec. 2008)[2] and the delinquency ratio (16.9% in end-Sep. 2008 → 13.0% in end-Dec. 2008) have fallen dramatically thanks to the government's restructuring efforts.

<Financial Sector PF Loan Status>

Unit: %

	Amount of PF loans			PF loan delinquency Ratio			Coverage ratio			PF loans/total loans	
	Banks	**Savings Banks**	**Total**	**Banks**	**Savings Banks**	**Total**	**Banks**	**Savings Banks**	**Total**	**Banks**	**Savings Banks**
End-Dec. 2007	41.8	12.1	70.5	0.48	11.6	2.9	222.8	106.8	138.8	4.1	25.6
End-June 2008	47.9	12.2	78.9	0.68	14.3	3.6	188.6	90.6	113.4	4.4	24.1
End-Sep. 2008	**49.7**	**12.6**	**81.6**	**1.27**	**16.9**	**4.6**	**137.2**	**89.7**	**104.5**	**4.3**	**23.4**
End-Dec. 2008	**52.5**	**11.5**	**83.1**	**1.07**	**13.0**	**4.4**	**131.4**	**101.8**	**113.8**	**4.5**	**20.9**

1 Coverage Ratio: Accumulated loan loss provision ÷ NPL

2 The outstanding balance of PF loans have decreased as a result of sale of potentially non-performing PF loans to Korea Asset Management Corporation (KAMCO) (502.3 billion won) and exercise of security rights (101.1 billion won between Sep.~Dec. 2008).

The banking sector is also sustaining soundness with falling delinquency ratio from 1.27 percent at end-September 2008 to 1.07 percent at end-December 2008.[3]

In addition to reducing credit risk of PF loan-related construction companies through the main creditor-led corporate restructuring scheme, the government is preparing a comprehensive response based on the result of the fact finding on the real estate-related PF loans in the entire financial sector (Jan. 2008).

[3] The outstanding balance of loans has risen slightly in the process of undertaking previously-approved projects.

Q3. Isn’t Korea particularly vulnerable in terms of household debt?

(Answer)

The recent increase in household debt was found among high income class with stable repayment capacity.

* Increase in financial liabilities from 2000 to 2006

1st quartile	2nd quartile	3rd quartile	4th quartile	5th quartile
258%	277%	283%	335%	390%

Of household loans, mortgage loans are substantially less risky than in other countries. The LTV ratio as of the end of 2008 stands at 46.7 percent, which is much lower than that of the U.S. subprime mortgage loans at 90 percent (as of year-end 2006). Moreover, housing prices in Korea are not rising as fast as in other major economies, and there is no notable sign of housing price decline.

* Between 2001 and 2007, annualized rate of housing price increase was 9.4 percent in the U.S., 12.6 percent in the UK and 6.7 percent in Korea.

** In 2008, housing prices fell by 18.6 percent in the U.S., 15.9 percent in the UK and 9.1 percent in Ireland, while they rose by 3.1 percent in Korea.

And the government has in place various measures aimed at easing household burdens, including a) guarantee of collateral supplementation for depreciated value of housing, b) extension of maturity and grace period for mortgage loans (e.g. from 3 years to 5 years) and c) support for conversion of floating rate loans to fixed rate loans.

Therefore, there is little possibility that Korea’s household debt insolvency will give rise to a significant increase in losses in the financial sector.

Q4. How do you judge the stability of mortgages?

(Answer)

Thanks to stringent regulations on DTI and LTV ratios, sensitivity to income or asset price shocks is thought to be relatively low.

<Mortgage Loan Regulatory Systems of Major Countries>

	Korea	US	Hong Kong	Germany	Japan
Mortgage Loan /Nominal GDP	33.40%	72.30%	37.30%	52.40%	36.20%
Regulatory System	Direct Regulation	Indirect Regulation	Direct Regulation	Mixed Form	Indirect Regulation
LTV Limit	40~60%	None	60~70%	60%	Indirect Regulation
DTI Limit	40%	None	60%	None	None

The LTV ratio as of end-September 2008 is 45.4 percent, which is substantially lower than that for U.S. subprime mortgages at 90 percent (end-2006).

Housing prices in Korea are not rising as fast as in other major countries and there has been no sign of significant fall in the prices, yet.

The average rate of housing price increase between 2001 and 2007 was 9.4 percent in the US and 12.6 percent in the UK while it was only 6.7 percent in Korea.

In 2008, housing prices in Korea rose by 3.1 percent while other countries saw 10-20 percent decline in housing prices.[4]

And the delinquency ratio for mortgage loans is maintained at a very low level, currently standing at 0.66 percent as of January 2009 (delinquency ratio for U.S. subprime mortgage loans: 20%, for prime mortgage loans: 4% as of end-Sep. 2008)

4 US: -18.6%, UK: -15.9%, Ireland: -9.1%

<Changes in Mortgage Loan Delinquency Ratio>

(%, % p)

	Year-End ’06	Year-End ’07	End-Aug. ’08	End-Oct. ’08	End-Nov. ’08	End-Dec. ’08 (estimation)	End-Jan. ’09 (estimation)
Household Loan	0.70	0.55	0.58	0.67	0.67	0.60	0.82
	(-0.42)	(-0.15)	(-0.08)	(-0.07)	(0.00)	(0.05)	(0.15)
Mortgage Loan	0.58	0.43	0.44	0.50	0.48	0.48	0.66
	(-0.56)	(-0.15)	(-0.08)	(-0.11)	(-0.03)	(0.05)	(0.13)

* (   ): YoY change (% p)

** in terms of more than one-day delinquency of principal

Q5. Please tell us about the security of SME loans.

(Answer)

Korean banks' SME loans have continued increasing for the past few years driven by rising demand for finance in the real sector with booming SME businesses.

Unit: trillion won, %

Sort	2005	2006	2007	2008
SME Loans	12.4 (5.1)	45.3 (17.7)	68.2 (22.6)	52.4 (23.2)

Note : Amount of increase (increase rate)

This illustrates partial recovery of domestic banks' industrial financing function, which was overly diminished after the Asian financial crisis.

The percentage of corporate loans by domestic banks reached 75 percent in 1996 before the Asian financial crisis.

However, the crisis led banks to engage in safe asset-oriented fund management, such as mortgage loans, driving the share of corporate loans down to 48.8 percent by the end of 2005. Then since 2006, increased SME loans have raised the percentage again to 55.6 percent as of today.

Unit: trillion won, %

Type	Year-end 1996	Year-end 2005	Year-end 2008
Corporate Loans	85.1 (75.0)	299.6 (48.8)	511.3 (55.7)
Household Loans	22.2 (19.6)	300.5 (48.9)	384.9 (41.9)
Loans in Local Currency	113.5 (100.0)	614.2 (100.0)	917.8 (100.0)

Note ( ): percentage

Despite the increase in SME loans, the SME loan delinquency ratio is mere 1.08 percent as of end of January 2009 and the coverage ratio remains high (147.1% for the entire banking sector).

Q6. What is the current foreign currency liquidity status of Korean financial institutions and its outlook?

(Answer)

We believe there is no problem with the Korean banking sector's foreign currency liquidity for the following reasons.

First of all, domestic banks short-term external debt fell by $46.7 billion in the fourth quarter of last year, while term loan rollover ratio has increased to around 90 percent from 50-60 percent post-Lehman fallout last year.

As for long-term loans, which have continued net repayment, the Korean banking sector has already secured funding to repay loans maturing in March and April. Domestic banks have obtained about $5 billion in long-term funds between January and February this year through global bond issuance and private equity funds.

* About $1.7 billion long-term loans reached dues in January and February this year, but about $6.8 billion (estimation) has been newly borrowed in long-term loans.

Moreover, the government has sufficient capacity to supply foreign currency liquidity based on ample foreign exchange reserves ($201.7 billion as of end-Jan. 2009) and currency swap lines signed with the U.S., Japan and China ($30 billion each), and Korea is generally forecast to record current account surplus this year. The government is also continuously strengthening the basis for FX market stabilization through a set of comprehensive measures announced on February 26, including the interest income tax exemption granted to foreigners investing in government bonds.

<Reference> The current status of domestic banks' borrowing in foreign currency

As of end-January 2009, domestic banks' borrowing in foreign currency totals $92.6 billion, $38.3 billion of which will mature within 2009 (except for government support). .

According to the Bank of Korea's data released on February 19, the comprehensive figure of overseas/domestic borrowing in foreign currency, including overseas borrowing in foreign currency ($67.76 billion), foreign banks in Korea and domestic borrowings*, is $92.6 billion ($118.3 billion including government support).

* Transactions between domestic banks and O/N foreign currency call money with small repayment burden not counted as overseas borrowing in foreign currency are included.

Of the $92.6 billion, $38.3 billion ($64 billion including government support) is set to mature within 2009.

<Domestic Banks' Overseas/Domestic Borrowings in Foreign Currency>

(Estimation as of end-Jan. 2009, hundred million US$)

Sort	Balance	Amount Due in 2009
Excluding Government Support	926	383
Including Government Support	1,183	640

<Reference>

As of end-January 2009, foreign bank branches' borrowings in foreign currency amount to $64 billion, $62.6 billion of which will mature in 2009.

<Foreign Bank Branches' Overseas/Domestic Borrowings in Foreign Currency>

(Estimation as of end-Jan. 2009, hundred million US$)

Sort	Balance	Amount Due in 2009
Foreign Bank Branches	640	626

Q7. What is your response to the view that Korea's external debt repayment capacity is weak due to high current external debt-to-foreign exchange reserves ratio?

(Answer)

Korea's current external debt, together with the gross external debt, has been declining since late 2008.

	End-2005	End-2006	End-2007	End-Sep. 2008	End-2008
Total External Debt (hundred million US$)	1,879	2,601	3,832	4,255	3,805
Current External Debt (hundred million US$)	864	1,341	2,040	2,328	1,940

When excluding repayment burden-free borrowings for currency hedging from current external debts, the current external debt-to-foreign exchange reserves ratio is significantly reduced.

* Current external debt ratio (as of end-2008): 96.4 %
Excluding borrowings for currency hedging ($39 billion): 77%

With shrinking shipbuilding orders and overseas equity investment triggered by global economic downturn, we expect external borrowings for currency hedging to decrease, leading to sustained fall in the external debt level.

* Overseas equity investment (hundred million US$):
(2005) 176 → (2006) 313 → (2007) 546 → (2008) 231
* Shipbuilding order (hundred million US$):
(2005) 313 → (2006) 660 → (2007) 975 → (2008)718

Meanwhile, Korea has enough foreign exchange reserves to repay short-term external debts. As of end-January 2009, Korea's foreign exchange reserves amounts to $201.7 billion, the sixth largest in the world. So despite the global credit crunch, Korea has been maintaining its foreign exchange reserves at a stable level for the past four months since last November.

<Foreign Exchange Reserves of Major Emerging Economies>

(Unit: hundred million US$)

	End-Oct. 2008	End-Nov. 2008 (A)	End-Dec. 2008	End-Jan. 2009 (B)	B-A
Russia	4,846	4,557	4,271	3,869	-688

Brazil	1,972	1,947	1,938	1,881	-66
Korea	2,123	2,005	2,012	2,017	12

The claim that Korea's foreign exchange reserves of $200 billion is not enough to meet the current external debt of $194 billion is based on an extremely unrealistic assumption that the government has to repay all of the short-term external debts instead of banks and companies unable to repay them. However, the reality is that Korean banks' foreign currency liquidity ratio continues to hover above 100 percent with rollover ratio of more than 90 percent.

Furthermore, Korea is expected to record a current account surplus in 2009 ($13 billion according to the Ministry of Strategy and Finance forecast) and it has secured ample foreign currency supply channel through currency swap arrangements with the U.S., Japan and China* (worth $90 billion in total).

Lastly, we are assured that the financial crisis in Eastern Europe will only have a limited influence over Korea. Korean financial institutions' exposure to Eastern Europe approximately amounts to $1.9 billion (as of end-2008), which accounts for mere 0.11 percent of their total assets. Although some are concerned that Western European banks will withdraw fund from Korea, Korean financial institutions' borrowing from banks in Western European countries with large exposure to Eastern Europe is small.

※ Korean banks have almost no borrowing in foreign currency from banks in Austria, Belgium, Sweden and Italy.

Q8. Does the Bank Recapitalization Fund mean nationalization of banks? Is there any concern about the possibility of government intervention in banks' management right?

(Answer)

Since the Bank Recapitalization Fund buys hybrid bonds, subordinated bonds and preferred stocks, it will not affect banks' governance structure.

* The Bank Recapitalization Fund will be financed with loans from the Bank of Korea and Korea Development Bank and from institutional and retail investors.

In addition, the "Bank Recapitalization Fund Support Agreement" will just stipulate on the bank's obligation to expand support to real and corporate restructuring and the use of the fund without a clause on government intervention in the bank's management right.

Thus, the Fund will not allow the government to encroach upon banks' ownership and management rights.

Q9. Some investors are voicing concerns that a prolonged global financial crisis may hamper the soundness and stability of Korean banks. Please elaborate on this.

(Answer)

Prudent risk management by the financial authorities has allowed Korean banks to weather the worsened economic climate better than those in many other countries.

As of end-2008, key soundness indicators, including the BIS ratio (12.19%), the NPL ratio (1.11%) and the coverage ratio (147.1%), all stand in good shape.

<Asset Soundness of Korean Banks>

Unit: %

Indicator	End 03	End 04	End 05	End 06	End 07	End Mar. 08	End June 08	End Sept 08
NPL Ratio	2.63	1.90	1.22	0.84	0.78	0.79	0.70	0.82
SBL Ratio	2.17	1.57	0.97	0.71	0.56	0.68	0.56	0.69
Delinquency Ratio	1.95	1.71	1.17	0.81	0.70	0.84	0.74	0.89
Coverage Ratio	84.0	104.5	131.3	173.2	199.1	184.1	197.1	175.1

Note : At end-Sep. 2008, US commercial banks had an SBL ratio of 2.23% and a delinquency ratio of 3.64%.

Financial authorities are implementing various policy measures, including the 20 trillion won Bank Recapitalization fund and purchase of bad debts through KAMCO, to prepare against possible defaults in the banking sector with increased NPL ratio triggered by further economic deterioration.

Q10. The Korean government and the Bank of Korea forecast Korea will record a current account surplus for 2009, which is wildly different from the forecasts given by foreign institutions. How large do you expect the surplus to be and on what grounds?

(Answer)

Some have raised their concern that Korea's current account balance can deteriorate this year as a dramatic fall in exports caused Korea to record a current account deficit ($1.36 billion) in January for two consecutive months.

Nevertheless, despite the slumping exports, the current account is generally forecast to record a surplus in 2009 thanks to the downward stabilization of raw material prices and the decreasing demand for imports triggered by the economic slowdown.

Among others, the drop in oil prices (from $100 in 2008 to $40 in 2009, in terms of WTI) is expected to play the biggest role in boosting the current account balance in 2009.

Even under the conservative assumption that Korea's oil import size remains at its average (890 million barrels a year), the import cost will fall by 17.8 billion dollars if oil prices decline by just 20 dollars.

In addition, in the face of the current global economic slowdown, Korea's imports are falling faster than exports.

* Fall in exports in Feb. 2009 (in terms of customs clearance): -17.1%
Fall in imports in Feb. 2009 (in terms of customs clearance): -30.9%
➔ Trade balance in Feb. 2009 (in terms of customs clearance): +3.3 billion USD

In particular, a large improvement in the service account is expected thanks to improving travel account driven by weaker won.

* The service account deficit in January 2009 has diminished dramatically year-on-year ($2.14 billion → $710 million).

All things considered, it is reasonable to expect the current account balance to improve significantly this year.

* Most institutions forecast the international oil prices at around 50 to 70 dollars per barrel in 2009 and their general outlook is that Korea will record a large current account surplus this year.

<Current Account Balance Estimations by Major Institutions>

(Unit: hundred million US$)

	Barclays	Citi	Deutsche	JP	UBS	KDI
	Jan. 23	Jan. 23	Jan. 22	Jan. 24	Jan. 28	Jan. 20
Current Account Balance (% of GDP)	624	215	258	248	309	136
	6.4%	2.2%	2.7%	2.6%	3.2%	1.4%
International Oil Prices (WTI)	70	-	45	43	60	50[1)]

1) in terms of the Dubai crude

<Reference> Causes of the Current Account Deficit in 2008

Korea's current account deficit in 2008 was mainly attributable to the soaring oil prices.

Korea recorded current account deficit of 6.4 billion dollars for 2008, about 12.3 billion dollar decline from the previous year (+5.9 billion dollars). This was largely driven by the oil price hike that the deteriorated net exports of crude and petroleum products by 11.9 billion dollars from the previous year (-36.1 billion dollars) to minus 48.0 billion dollars.

In fact, in Oct., Nov. and Dec. 2008 when global economic recession brought down the oil prices, Korea achieved current account surpluses of 4.75 billion dollars, 2.06 billion dollars, and 0.86 billion dollars respectively.

<Changes in Current Account Balance and Crude and Petroleum Product Imports and Exports>

Unit: billion dollars

	'06	'07	2008	Sep. 2008	Oct. 2008	Nov. 2008	Dec. 2008
Current Account Balance	5.39	5.88	-6.41	-1.35	+4.91	+1.91	+0.86
Net Exports of Crude and Petroleum Products (B-A)	-35.26	-36.11	-48.03	-4.01	-3.26	-3.09	-2.25
- Crude Oil Imports (A)	55.86	60.32	85.86	7.95	6.44	5.12	3.86
- Petroleum Product Exports (B)	20.60	24.21	37.83	3.91	3.18	2.03	1.61

Note: Imports and exports of petroleum products are on a customs clearance basis.

Q11. What is your estimation of Korea's economic growth this year as a time when people are worried about real economic slowdown?

(Answer)

It is true that the global economic recession has begun to wreck havoc on the Korean economy in earnest as illustrated by the minus 3.4 percent year-on-year growth recorded in the fourth quarter of last year.

As a result, institutions at home and abroad are generally forecasting the Korean economy to shrink this year, but their growth estimations vary a little.

	IMF	Barclays	Citi	Deutsche	JP	UBS	KDI
	Jan. 29	Jan. 23	Jan. 23	Jan. 22	Jan. 24	Jan. 28	Jan. 20
GDP Growth Rate	-4%	-2.0%	-1.8%	-4.0%	-2.5%	-3.0%	+0.7%

However, they have the common view that the mid- to long-term prospect for the Korean economy is bright because Korea has strong economic fundamentals and the government is taking comprehensive and preemptive measures against the external shock, which will enable the economy to recover robust growth once the world economy recovers.

Although the IMF has also made an estimation of a negative growth for Korea in 2009, it is expecting the Korean economy to start recovery from the second half of the year and continue growing at the fastest rate in the world to record 4.2 percent growth in 2010 (+8.2 percentage points).

In particular, Korea has a very sound banking sector (BIS capital ratio: 10.86%, total delinquency ratio: 1.0%) and its corporate sector has healthy balance sheets. The government, too, sustains healthy finances.

<International Comparison of Corporate Financial Structures>

	Current Ratio (%)	Capital Ratio (%)	Debt Ratio (%)
US (2007)	133	44	127
Germany (2005)	126	34	191
Japan (2007)	131	30	232
Korea (2007)	125	48	107

<Estimation of Debt Ratio of Major Economies for 2009 (OECD, Nov. 2008)>

	US	Japan	Germany	France	Korea
Fiscal Balance (% of GDP)	73.2	173.0%	64.8%	72.5%	32.6%

With the government's continued large-scale pump-priming and liquidity provision efforts, the Korean economy is expected to get back on track from the second half of the year.

<International Comparison of Fiscal Expansion Size (as of Jan. 2008)>

Country	% of GDP	Note
US	6%	818 billion~887 billion dollars
Japan	3.3%	17 trillion yen (1st: 2 trillion, 2nd: 5trillion, 3rd: 10 trillion)
EU	1.5%	200 billion euros by 2010 * Size of tax cut has not been decided. Only the fiscal expenditure has been taken into account.
- Germany	2.3%	50 billion euros
- France	1.3%	26 billion euros
UK	1%	20 billion pounds by 2009 (tax cut: 12.5 billion pounds, fiscal expenditure: 7.5 billion pounds)
China	16%	4 trillion yuan by 2010
Korea	5.7%	51.3 trillion won

Q12. How big is the additional stimulus package being planned by the government and what is the exact plan of implementing that package?

(Answer)

In the face of rapidly deteriorating economic circumstances, the Korean government is considering an additional stimulus big enough to supplement the sluggish domestic demand and support the country's efforts to overcome the economic crisis.

Intergovernmental consultations are underway to discuss the exact stimulus size and programs, whose decision will be submitted to the National Assembly by the end of March.

The upcoming supplementary budget is focused on supporting job creation, the vulnerable low-income class and the unemployed, SMEs and the self-employed as well as investments to strengthen future growth potential.

Q13. There are concerns about possible deterioration of fiscal balance and national debt level caused by the economic stimulus package. Can you comment on that?

(Answer)

The Korean government has been maintaining fiscal surplus based on stable fiscal management. As a result, Korea's fiscal soundness is recognized as being much higher than other OECD member countries'.

In response to the current financial crisis, the Korean government has shifted is policy stance to expansionary fiscal management.

More specifically, the Korean government has earmarked 51.3 trillion won, 5.7 percent of GDP, for the economic stimulus package covering expansion of fiscal expenditure and tax reduction.

<Size of Fiscal Expansion under the Economic Stimulus Package (2008 ~ 2012)>

Unit: trillion won

	Total	2008	2009	2010	2011	2012
Fiscal Expansion	16.0	4.6	11.4	-	-	-
Tax Cuts	35.3	6.6	11.7	12.9	3.7	0.4
Total	51.3	11.2	23.1	12.9	3.7	0.4

Source: Ministry of Strategy and Finance

Some are concerned that such expansionary fiscal management can lead to deterioration of fiscal balance and national debt level. However, it is only an unfounded concern, as can be seen in the comparison of Korea's situation with other nations'.

First of all, the fiscal balance (IMF definition) is projected to record a surplus (0.6 percent of GDP) in 2009 despite the fiscal stimulus measures.

Meanwhile, other OECD members are expected to post fiscal deficit amounting to 3.8 percent of GDP on average.[5]

Although the fiscal stimulus is likely to cause the national debt level to shift from a downward trend that started in 2006 to an upward trend in 2009, it will still remain relatively small compared to other countries at 34.5 percent of GDP (OECD average: 82.8 percent).[6]

<Changes in the Size of Government Budget and National Debt Level (2005 ~ 2009)>

Unit: trillion won, %

		2005	2006	2007	2008	2009
Budget	Total Revenue	191.4	209.6	243.6	247.2	263.9
	Total Expenditure	187.9	205.9	209.8	235.8	257.5
	Fiscal Balance	3.5 〔0.4〕	3.6 〔0.4〕	33.8 〔3.8〕	11.4 [1.2]	6.4 [0.6]
National Debt		248.0 [30.6]	282.8 [33.4]	298.9 [33.2]	307.1 [31.9]	352.8 [34.5]

Note: 1) The budget from 2005 to 2008 reflects the special account budget, government fund overhaul and the supplementary budget.
2) ( ): year-on-year growth rate, [ ]: a percentage of GDP
Source: Ministry of Strategy and Finance

Furthermore, even with the supplementary budget, currently under review, Korea will be able to maintain relatively healthy fiscal position compared to other OECD member countries.

5 OECD average fiscal deficit (estimation for 2009, as a percentage of GDP): -3.8% (OECD Economy Outlook No. 84 database)

6 OECD average debt levels (estimation for 2009, as a percentage of GDP): 82.8% (OECD Economy Outlook 84 database)

Q14. What is the Korean government doing to create jobs?

(Answer)

The government remains committed to the job creation and retention measures in place.

First of all, the government will front-load unprecedented 60 percent of its budget spending (70 percent of employment-related budget) in the first half of the year and closely monitor the actual job creation effect.

In addition, the government has announced the "Green New Deal Project*" aimed at securing future growth engines and creating jobs.

* Between 2009 and 2012, a total of 50 trillion won will be invested to create 960,000 new jobs (144,000 in 2009).

Meanwhile, to address unemployment among the vulnerable class, including youth, the government has introduced "Youth Internship Program*" and is working to increase the number of social jobs (110,000 in 2008 → 126,000 in 2009).

* SMEs: 25,000 jobs, public institutions: 25,000 jobs

Furthermore, the government is aiming to strengthen job training so that the country can turn current difficulties into opportunities to prepare for the future.

* Nurturing of future industries (13,000 jobs in 2009) and global youth leaders (15,000 in 2009)

At the same time, the government is revising labor-related laws and institutions to promote job sharing and employment. For instance, the government is going to give tax credits and financial incentives to companies whose labor and management are cooperating to participate in the job-sharing efforts and spread best practices across all industries.

To tackle job insecurity of non-regular workers, the government is improving relevant laws and institutions while revising the minimum wage system** to expand job opportunities for the disadvantaged.

* Extension of the non-regular worker employment term limit (2 years → 4 years), expansion of job types where workers can be dispatched

* Extension of the period where interns' minimum wage rates are cut (currently 3 months), minimum wage rate cut also permitted for elderly employees (over 60)

In addition, the government is planning to focus the supplementary budget, currently under review, on supporting job creation.

Q15. Is is desirable to pursue deregulation at a time when people are arguing that the latest financial crisis in the US was triggered by reckless deregulation?

(Answer)

In the case of advanced countries, lax financial regulation and supervision gave rise to the current financial crisis. However, the problem in the Korean economy is attributable to excessive regulation that limited private sector self-regulation and innovation.

In this regard, the Korean government's financial policy is directed at strengthening prudential regulation to reduce systemic risk while easing anti-competitive regulation to promote private sector self-regulation and innovation.[7]

To minimize potential side-effects of deregulation, such as financial market instability, in particular, the government has established a set of measures designed to strengthen monitoring of factors contributing to financial market instability as well as disclosure and supervision of derivatives trading, which is the main culprit of the current global crisis.(20.Dec.2008)

The supervisory measures include 50 areas for improvement under four main pillars of a) stronger monitoring of the derivatives market, b) enhancement of investor protection mechanism, c) prevention of risks in financial institutions and the capital market and d) re-organization of roles between the supervisory authorities and self-regulatory institutions.[8]

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[7] While the US Securities and Exchange Commission abolished the net capital rule (Apr. 2004) and led to an increase in investment bank leverage by more than 30 times, Korea's Capital Market Consolidation Act will sustain the net capital rule to prevent the leverage from rising by more than 10 times.

[8] The investor protection mechanism, in particular, is to be supplemented greatly to provide protection customized to the concerned instrument's risk level and the investor's risk-taking capacity.

Q16. Is the Korean government going ahead with the plan to privatize Korea Development Bank? If so, will there be government guarantee of payment of KDB's new external debt?

(Answer)

As planned, the Korean government is going to pursue privatization of Korea Development Bank (KDB) in consideration of the need to secure policy credibility and to meet the new demand for the investment bank function after the global financial crisis.

However, the government will follow a flexible schedule to fully account for circumstantial changes, such as deterioration of sell-off condition triggered by the unstable global financial market.

According to the Korea Development Bank Act Revision Bill submitted by the government, the government will guarantee payment of previously issued bonds at the time of the initial sell-off of the stake in the KDB holding company. And the government can provide guarantee on bonds to be newly issued by the KDB between the initial stake sell-off and the government stake sell-off.

Q17. What corporate restructuring plans does the Korean government have?

(Answer)

The Korean corporate sector is maintaining relatively healthy financial soundness and profitability, despite the recent downturn.

<Financial Ratios of Listed/Registered Corporations>

	Q3 2007	Q1 2008	Q2 2008	Q3 2008
Operating Profit /Revenue	7.6%	7.4%	7.6%	5.9%
Debt/Equity	85.7%	92.5%	95.4%	104.3%

But since some construction companies and small and medium-sized shipbuilding companies are suffering from management problems, the government is pursuing prompt corporate restructuring to remove market uncertainties at early stages.

Therefore, we see the need to promptly liquidate insolvent companies while providing liquidity support to viable companies to help them normalize.

Korea already has in place a creditor financial institution-led market-friendly restructuring scheme developed through the 1997 Asian financial crisis and the ensuing corporate restructuring.

Based on that scheme, the government is currently pursuing a company-based restructuring process that entails credit risk assessment led by main creditor banks. [9]

[9] The credit risk assessment categorizes companies into four groups, "A" (Normal), "B" (Temporary liquidity shortage), "C" (Showing signs of distress) and "D" (Distressed), and different actions are taken to each category.

Q18. Is the Bond Market Stabilization Fund sufficient to ease concerns about the liquidity crunch in bond markets? And why?

(Answer)

Recently, financial market conditions have improved with the dramatic fall in the policy rate and the increased supply of liquidity, which drove down the money market rates.

	End of 2006	End of 2007	End of Jun. 2008	End of 2008	End-Jan 2009	End-Feb. 2009	Mar. 9, 2009	From the end of 2008
CP (91-day)	4.97	6.42	5.76	6.39	3.95	3.16	3.13	-3.26%
Corporate bonds (KIS, AA-, 3yr)	5.29	6.77	6.88	7.72	2.79	6.60	6.21	-1.51%
Corporate bonds (KIS, BBB-, 3yr)	8.08	9.12	9.66	12.02	12.16	12.35	12.15	-0.13%

The market has enough liquidity to cover the investment grade corporate bonds, in particular. However, as for non-investment grade bonds, the rates are still high making it harder for the market to finance them.

We expect the fund to further contribute to easing of liquidity problems in the bond market, as the fund (10 trillion won) steps in to buy up both non-investment grade corporate bonds and ABCP within the first quarter this year.

The fund was firstly raised to 5 trillion won and an additional 5 trillion won will be added once it is depleted.

Q19. What countermeasures does the Korean government have to address the credit crunch caused by the money injected by the central bank coming back to the central bank through banks?

(Answer)

It has been frequently said that no matter how much money the government puts into the financial markets, it does not flow into the real economy quickly enough.

This is mainly due to the increase in counter-party risks and economic uncertainty led by the global financial turmoil and the downward trend of growth.

In response, the government is pursuing restructuring of insolvent businesses, such as the construction and shipbuilding companies, in order to eliminate economic uncertainty.

In addition, it will continue to provide liquidity to recoverable companies selectively through policy banks and national guarantors.[10]

The recently created Bond Market Stabilization Fund is also expected to play a role in resolving credit crunch in the bond market.

The government also plans to establish a 20 trillion won "Bank Capital Expansion Fund" to expand bank's credit supply capacity.

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[10] The government is increasing capital of policy banks (Korea Development Bank and Industrial Bank of Korea) by 2.4 trillion won, which will result in an expansion of corporate lending by 14 trillion won.

Moreover, the government is making additional investment into national guarantors (Korea Credit Guarantee Fund and Kibo Technology Fund) worth 1.1 trillion won to increase public guarantee by 11.7 trillion won.

Q20. In consideration of the possible rise in nonperforming assets caused by the accelerating deterioration of the economy, do you think 20 trillion won Fund will be enough?

(Answer)

For the time being, we believe 20 trillion won will be enough, in light of the sustained capital soundness of domestic banks.

However, once we judge that we need to more money due to rapid increase in nonperforming assets, we will consider a variety of measures to expand the size of the Fund.

<Reference> Overview of the Bank Recapitalization Fund

The Bank Recapitalization Fund will be in total amount of 20 trillion won, out of which 10 trillion won will come from the Bank of Korea, 2 trillion won from Korea Development Bank and 8 trillion won from institutional and retail investors.

The government will use the Fund to buy hybrid bonds and subordinated bonds and issue securitization bonds, mainly subordinated bonds, (worth about 8 trillion won) to sell to institutional investors.

The Fund will have to role of supplementing banks' capital to help them engage more actively in providing real economic support and corporate restructuring efforts.

Banks are obliged to use the Fund to support the real economic sector as well as corporate restructurings, and government intervention in banks' management right is excluded.

The Fund's support ceiling and interest rate terms will be decided based on each bank's performance in supporting the real economy and corporate restructuring efforts as well as its foreign currency financing record.

Basically, the Fund usage will be largely limited to real economy support and corporate restructuring support, but various specific methods of the Fund usage will be recognized to ensure effective support.

① Real economy support: new credit lines or maturity extension for SMEs, funding to New Kibo
② Corporate restructuring support: new credit extension or debt-to-equity swap for companies under workout programs, capital injection to the Corporate Restructuring Fund
③ Support of real estate PFs and NPL write-offs

Commercial banks (or holding companies), Industrial Bank of Korea, NACF and NFFC will be able to apply for the Fund support, which will be provided upon request based on a certain limit set for each bank.

In the first phase of support, about 12 trillion won will be provided, and the second round of support will be determined later on depending on the progress made using the first round of the Fund support. To ensure fair access to the Fund, credit limits are set in proportion to banks' asset size for the first support and adjusted afterwards according to each bank's improvement in the BIS ratio (around 1.5 percent) and the record of SME support provision.

Group Ⅰ (Asset size: 200 trillion won or more)	Group Ⅱ (140-200 trillion won)	Group Ⅲ (50-140 trillion won)	Group Ⅳ (less than 50 trillion won)
Credit line: 2 trillion won	**1.5 trillion won**	**1 trillion won**	**0.3 trillion won**
Kookmin, Woori, Shinhan	**Hana, IBK, NACF**	**KEB, Citi, SC First**	**NFFC, regional banks**

※ The ceiling for each asset purchased (hybrid bonds, subordinated bonds, etc.) adjusted in light of the application size and fairness

The credit limit for the second round of support will be determined depending on how well banks used the fund to support the real economy and corporate restructuring and how much foreign currency they have secured.

The terms of support, including assets to purchase and interest rates, will differ according to banks' performances in terms of support provision. But for the first phase of support, banks will be evaluated based on their record of implementing the MOU signed in exchange for the government's external debt guarantee (Nov.-Dec. 2008).

When setting the support limits, the "Bank Recapitalization Fund Management Committee" and the applying bank should sign a "Bank Recapitalization Fund Support Agreement," which shall stipulate on the usage of the Fund and the obligation to submit documents needed to check and review the actual usage. In addition, each bank should submit documents on its performance every month for review.

Q21. Critics say that complicated credit derivatives like credit default swaps played a significant role in exacerbating the current global financial crisis. Please comment on the trading volume and the level of risk in the Korean derivatives market.

(Answer)

As complicated derivatives are not yet actively traded in the Korean financial market, Korean financial institutions' exposure to derivatives is meager compared to institutions in the US or UK.

Unlike exchange-traded derivatives like KOSPI 200 futures and options, but over-the-counter (OTC) derivatives have not been traded actively.

Particularly, credit derivatives, which have contributed to the global financial crisis, only account for less than 0.07% of the total notional amounts outstanding in the Korean OTC derivatives market.

As of end of June 2008, the notional amounts outstanding of OTC derivatives in Korea was approximately 5.9 trillion dollars, amounting to only 3.4% of the US volume (172 trillion dollars) and 23.0% of the Japanese volume (25.7 trillion dollars).

<**Notional Amounts Outstanding of OTC Derivatives in Korea**>

(as of June 30 2008, trillion won)

	Total	Banks	Securities Co.	Insurance Co.	Trust Co.	Others
Total	6144.0	5916.4	159.5	28.9	35.2	4.0
Securities	87.7	14.3	70.3	2.1	1.0	0
Interest Rates	3296.5	3218.8	71.2	2.3	1.8	2.3
Currencies	2746.2	2670.8	16.7	24.5	3.2	1.7
Credits	4.5	3.6	0.98	0	0	0
Others	9.1	8.9	0.3	0	0	0

The average ratio of derivatives assets to total assets for domestic financial institutions remains at a remarkably low level of 2.0 percent compared to 19.7 percent of US commercial banks. [11]

<The Ratio of Derivatives Assets to Total Assets>

(as of March 31 2008, trillion won, %)

	DB	FBB	DSC	FSC	IC	Total (-FBB)	Total	U.S. CB
Total Assets (A)	1,523	198	120	11	371	2,025	2,223	9,046
Derivatives Assets (B)	36	43	2	2	1	41	84	1,780
B/A	2.4	21.9	1.8	17.0	0.4	**2.0**	3.8	**19.7**

Sources: Office of the Comptroller of the Currency (OCC) (as of year-end 2007), Financial Supervisory Service (FSS)

[11] The fair value of gains on derivatives contracts can be counted as derivatives assets according to ISDA Standards.

Q22. Does the Korean government still plan to introduce hedge funds this year as it announced earlier?

(Answer)

The hedge funds that the Korean government intends to introduce will be much different from those in developed countries like the US and UK in that they will be very limited. We plan to introduce hedge funds within this year, and we are now in the process of laying the institutional foundation for that.

In particular, we have established a limitation on borrowing and payment guarantee related to excessive borrowing and derivatives transaction, which are pointed to as causes of side-effects of hedge funds.

< First-phase introduction of hedge funds >

① Hedge funds shall be managed only by asset management companies approved by the Financial Services Commission.

② Asset management companies must operate within clearly set regulations that pertain to borrowing, derivatives trading, debt guarantee and collateral.

③ A minimal regulatory mechanism shall be established that requires reports on current debt level and derivatives transaction status.

Korea already has various supervisory mechanisms in place, including the mandate to report the current status of borrowing and derivatives transaction.

Thus, considering the need to increase market liquidity, finance new growth engine industries and to offer a variety of investment options, it is not desirable to postpone the introduction of hedge funds.