

Korea's foreign exchange reserves

Investment by the Government in Fannie Mae and Freddie Mac was made in the form of senior debt which does not carry a liquidity problem

Sir, I do not agree with the interpretation on the current level of Korea's foreign exchange reserves and their implications on the country's ability to weather external shock from the fallout of Fannie Mae and Freddie Mac (report, Sept 1).

One hundred per cent of investment by the Government in Fannie Mae and Freddie Mac has been made in the form of senior debt whose asset value is stable and does not carry with it any liquidity problem.

The ratio of foreign debt coming due within a year over the total amount of foreign exchange reserves stands at 86.1 per cent as of the end of June and with the short-term debt hovering at this level, the Government has reserves sufficient to pay off maturing debt. An adequate level of foreign exchange reserves may be debatable but I would emphasise that the IMF recommends that emerging economies should hold three months' worth of current payment cover, instead of nine months' worth of import cover. Accordingly, Korea's adequate level of reserves is around \$140 billion. The current foreign exchange reserves of \$243 billion, which places us as the sixth-largest holder of foreign reserves in the world, far exceeds the adequate level set by the IMF.

Furthermore, one should assess the risk of growing external debt in terms of its quality compared with the 1997 financial crisis. Recent growth of external debt has arisen as a counterpart to hedging activity undertaken by the shipbuilders and overseas investors, in stark contrast to massive foreign currency short-term borrowings, which led into the 1997 financial crisis. In addition, 20 per cent of total external debt or 45 per cent of short-term external debt occurred as a result of borrowings by local branches of foreign banks. These branches' debt obligations will be covered by their headquarters in the unlikely event of illiquidity.

Even though the Korean economy is experiencing a wave of difficulties, Asia's fourth-largest economy will continue to demonstrate its resilience and prove its capabilities to absorb recently developed external shocks.

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Sir, The Bank of Korea would like it to be understood that in its management of Korea's foreign reserves, it views them as a last resort that would only be drawn upon in extraordinary circumstances, such as if funding conditions were to deteriorate to the extent that the supply of foreign exchange by the authorities constituted the only solution. We will continue to exert our best efforts to secure the liquidity and safety of our reserves holdings, while enhancing returns under the given constraints.

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