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Press Release

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Corrections, Clarifications and Explanations for October 14 Financial Times News Article "Sinking feeling"

The Financial Services Commission and the Financial Supervisory Service issue the following corrections, clarifications and explanations for factual errors and questionable assertions made in the October 14 Financial Times news article "Sinking feeling."

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Purpose of Finance Minister Kang Man-Soo's meetings with U.S. business executives

"Kang Man-Soo, finance minister, is taking his plea for dollars to Wall Street, where he is due to meet with executives of banks such as Citigroup and Morgan Stanley."

Minister Kang Man-Soo met with Mr. Stephen Roach, chief economist at Morgan Stanley, and Mr. Robert Rubin, the former Treasury Secretary, on Tuesday, October 14, for discussions on the global financial crisis and their market views and assessment. Minister Kang did not meet with Wall Street executives to plea for dollars as the article falsely asserted. He did not take his plea to Wall Street as the news article speculated.

POSCO overseas bond offering

"Posco, the steel maker, said last week it would sell $1bn of bonds overseas as part of efforts to stabilise the won."

In a press release dated October 10, POSCO announced that it is planning a US$1 billion oversea bond offering some time in the fourth quarter this year. The press release explicitly stated that the proceeds from the bond offering would be used for future investment and operating funds. It did not say that the proceeds would be used to stabilize the won as the news article erroneously reported.

Remarks attributed to Finance Minister Kang Man-Soo

"Mr. Kang recently told a parliamentary session that 'apart from exports, everything—including investment, consumption, employment and the current account balance—is showing a trend similar to that seen during the [Asian crisis]."

The quote attributed to Minister Kang appears to refer to one of the many remarks he made at a National Assembly hearing on July 22, 2008, in response to questions on the outlook for the economy from National Assembly members. What he observed was only the mere resemblance of the general directions of several macroeconomic indicators between at the time of the hearing and the pre-crisis period.

More importantly, Minister Kang stated unequivocally in the very same remark that the government does not in any way foresee the macroeconomic indicators reaching a crisis point. It must also be stressed that the remarks were not made "recently" as the article stated but in July, nearly three months ago. In short, the quote attributed to Minister Kang is misleading because it is selective and taken out of context.

Comparison of Macroeconomic Indicators: 1997-2008

	1997	1998	2006	2007	2008	
GDP growth	4.7	-6.9	5.1	5.0	Q2	4.8
Private consumption	3.3	-13.4	4.5	4.5	Q2	2.3
Capital investment	-9.6	-42.3	7.8	7.6	Q2	0.7
Unemployment	2.6	7.0	3.5	3.2	June	3.1
Consumer prices	4.5	7.5	2.2	2.5	July	5.9

Foreign liabilities

"South Korea has some $175bn in external short-term debt that has to be rolled over by the end of next June."

When the foreign debt structure, the underlying causes for the rise in short-term debt, the soundness of Korean banks, and the size of the economy are considered and taken as a whole, the US$175 billion in external short-term debt (less than one year) is well within the manageable range and does not impose any undue burden on domestic banks.

The US$175 billion that the FT article refers to does not take into account the US$60 to 70 billion for which Korean banks have fully covered through forward exchange instruments. Net of the covered amount, the total external short-term debt is substantially lower than US$175 billion. It should also be noted that foreign bank branches operating in Korea account for 43.1% of the total external debt and 57.7% of the short-term external debt of domestic banks. As is the case for domestic banks, foreign bank branches operate in Korea with strict liquidity controls from their main offices and thus pose little or no risk of default.

Domestic banks' one-month gap ratio of 1.5% and seven-day gap ratio of 2.2% at end-September, 2008, exceeded the recommended level. The three-month foreign liquidity ratio stood at 100.5%, again above the recommended level of 85%.

Private sector debt

"Private sector debt stands at 180 per cent of gross domestic product."

The share of household debt relative to the GDP is low compared to that of the U.S. or the U.K. households, particularly when household assets are taken into account. For 2007, Korea's GDP was KRW901 trillion and the total household debt KRW740 trillion, giving household debt ratio of 82%. Corporate debt (KRW940 trillion) relative to the GDP comes to 104%.

At end-June, 2008, the ratio of household financial liabilities to financial assets stood at 45.0%, indicating household financial assets exceed liabilities by a factor of 2.22 and are thus more than sufficient to readily offset the liabilities. Household financial asset and liability growth from 2002 to June, 2008, shows that Korean households' financial assets grew at a much faster pace than liabilities (62.6% vs. 57.4%) when compared to those of the U.S. (48.9% vs. 64.6%), the U.K. (49.3% vs. 64.4%), or Australia (77% vs. 100.8%). It should also be stressed that housing mortgage make up a large portion (60%) of household debt and that an overwhelming majority of the mortgage loans are serviced by stable middle-income households.

Corporate debt relative to the GDP has fallen from 131% in 1997 to 104% in 2007. Similarly, Korean companies on the whole have significantly improved their financial soundness over the years by reducing their debt-equity ratio from 424.6% in 1997 to 92.5% (Q1, 2008). The interest coverage ratio, a measure of the debt-servicing ability of companies, improved substantially as well from a factor of 1.2 to 4.1 during roughly the same period.

When domestic banks' overall soundness—e.g., their high loan loss provisions against likely future losses—is fully considered together with the overall soundness of household and corporate debt structure, the likelihood of a severe distress stemming from household and corporate loans is low. This is backed by the consistently low default rates. The default rate for household bank loans averaged 0.6% as of July, 2008. For mortgage loans, the rate was even lower at 0.4%. At the end of 2007, the ratio of bank loan provisions to loans classified as substandard or below reached 243.8%.

Bank loan/deposit ratio and foreign currency liquidity

"Reliance on overseas markets has increased too. Banks rake in 12 per cent of their funding from overseas, according to Moody's Investors Service… But what makes the position of Korean banks especially precarious is that domestic liquidity too is ebbing. The widening spread between banks' funding rates and policy rates shows that risk aversion exists on home turf as well."

Bank deposits have been the principal form of savings in Korea. In more recent years, bank deposits have begun to shift to non-deposit assets as individual savers became less risk-averse and sought higher yields in wide-ranging investments. This, in part, explains an overall rise in the average bank loan/deposit ratio. Despite the shift to non-deposit assets, however, Korean banks' loan/deposit ratio continues to be in line with, or lower than, those in the developed countries. At end-September, the ratio averaged 103.2%.

Because of their deposit-like characteristics, certificates of deposit (CDs) are included in determining the loan/deposit ratio, as is the convention in many countries. It should be noted that over-the-counter bank teller sales of CDs accounted for about 80% of the total bank CD issues. Moreover, the loan/deposit ratio drops to about 85% if bank-issued bonds are included in the ratio computation, meaning funding from local sources easily covers local lending. In particular, the won-denominated liquidity ratio has consistently stayed above the recommended prudential level of 100% and showed no noticeable variance from 107.5% at end-2007 to 107.7% at end-August this year.

With the anticipated economic slowdown and rising interest rates, the expectation going forward is that bank loan growth will decelerate, deposits will expand, and the loan/deposit ratio as a result will further shift downward. As the regulators have repeatedly stressed in recent days, foreign borrowings are not being used for local lending to small and medium-sized companies, but for foreign-currency-denominated assets.

As of end-June this year, foreign currency liabilities accounted for 13.7% of the total bank liabilities. On the asset side, foreign currency assets made up 12.7% of the total.

<u>Current account balance</u>

"The current account balance has teetered into the red, for the first time since the crisis of 1997-98."

Despite improvement in the service and factor income (interest and dividend income) accounts, Korea posted a current account deficit of US$12.6 billion for the first eight months of the year due to surging oil prices. Korea's exports continued to show strength across expanding overseas markets and increased 23% for the first nine months of the year. Imports jumped 34% during the same period.

The current account balance did not "teeter" into the red. The current account deficit was expected because of record-high oil prices. It is estimated that the higher oil price during the January-August period reduced Korea's current account balance by US$17.7 billion, which is greater than the US$12.6 billion deficit for the same period. For the year, current account deficit is expected to reach approximately US$10 billion, about 1% of the GDP, for the first time in eleven years.

Current Account Balances

	2003	2004	2005	2006	Jan-Aug 2007	2007	Jan-Aug 2008
Current account balance (US$, billions)	12.0	28.2	15.0	5.4	0.5	6.0	-12.6
Goods	22.0	37.6	32.7	27.9	19.0	29.4	1.9
Services	-7.4	-8.1	-13.7	-19.0	-14.7	-20.6	-13.8
Interest/dividend income	-	1.1	-1.6	0.5	-1.3	0.8	1.6
Net transfer payments	-2.9	-2.4	-2.5	-4.1	-2.5	-3.6	-2.3
Avg. won/dollar exch. rate	1,192	1,145	1,024	956	932	929	998
Avg. Dubai crude oil (US$)	27	34	49	62	62	68	109

But the outlook is improving rapidly for the fourth quarter and 2009. With the service account deficit, the key negative contributing factor for the current account balance, expected to drop on falling overseas travels by domestic residents, and the seasonal year-end surge in overseas orders, the current account is likely to post a surplus for the fourth quarter of the year. With stable oil prices, the current account balance for 2009 is expected to show a marked improvement from 2008. On the downside, the global economic slowdown will likely dampen export growth in 2009. But the upside is that more stable oil prices and improving service account deficit will contribute to a more favorable current account balance for the year.

Korea's export outlook

"On a macroeconomic level, a country that derives 40 percent of its GDP from exports will now have to cope with dwindling western demand for its products."

Korea's exports have been expanding at a healthy pace despite the slowing global economy. Recent data show that exports grew 35.7% in July from a year earlier, 18.7% in August, and 28.7% in September. The robust pace of Korea's export growth is helped by more diversified export markets and the global competitiveness of Korea's key export goods, such as semiconductors, ships, and automobiles.

The allusion of major adverse impact from "dwindling western demand" must be questioned on the basis of Korea's export destinations. According to the latest data, exports to developing countries accounted for 69% of the total during the January-August period. China was next with 23%. The U.S., in contrast, accounted for approximately 11%.

Given the dominant industry and market positions of many of Korea's leading export companies, there is a strong expectation that Korea's export growth will continue to show vitality notwithstanding the much anticipated global economic slowdown.

The weakening of the won

"The rapidly weakening won…recalls the 1997 crisis and adds to fears about rolling over short-term dollar-denominated debt. It also risks depleting Korea's formidable foreign exchange currency kitty.

Korea's foreign exchange reserves of $239.7 billion (end-September, 2008) are the world's sixth largest, and the IMF, Fitch Ratings, and many private sector economists and analysts have noted that Korea's foreign reserves are more than sufficient to meet its import and debt-servicing needs. This is further reinforced by the net foreign liabilities, which fall by about 36% or US$150 billion from the gross foreign liabilities of US$419.8 billion because of currency hedging instruments, advance receipts for exports, and other activities that do not require actual payment delivery.

SME loan soundness

"Yet this segment [SMEs] is highly vulnerable to a downturn, implying higher unemployment, reduced domestic demand and more bank loans turning bad… The most likely scenario is a quantum leap in non-performing loans."

SME loans outstanding at the end of August, 2008, totaled KRW397.1 trillion, approximately 46% of the total bank loans (KRW866.5 trillion). The SME delinquency rate rose somewhat from 1.3% in March to 1.6% in August, but continues to stay at a very low level. The number of new SME bankruptcies is low as well.

When these figures are considered together with the high overall bank coverage ratio (197.2%, end-June, 2008), the scenario of a surge in SME bankruptcy and nonperforming loans triggering a major distress in the banking sector that the FT article carelessly alludes to is inconsistent with the available data.

The government recognizes that the SME sector is under strain due to, among others, high oil and commodity prices and a slowing economy and announced on October 1 liquidity support for SMEs facing temporary funding difficulties.