

# **Korea's Financial Market and Economy:**

## **Resilience Amid Turbulence**

**December 2008**

**Financial Services Commission**

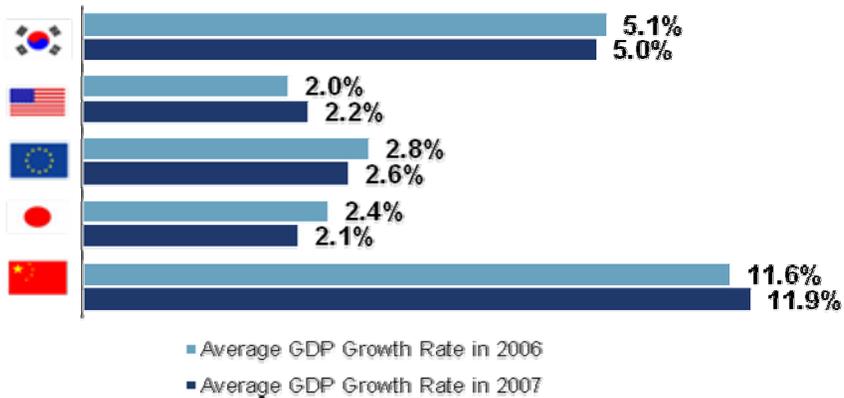


# Macroeconomic Fundamentals

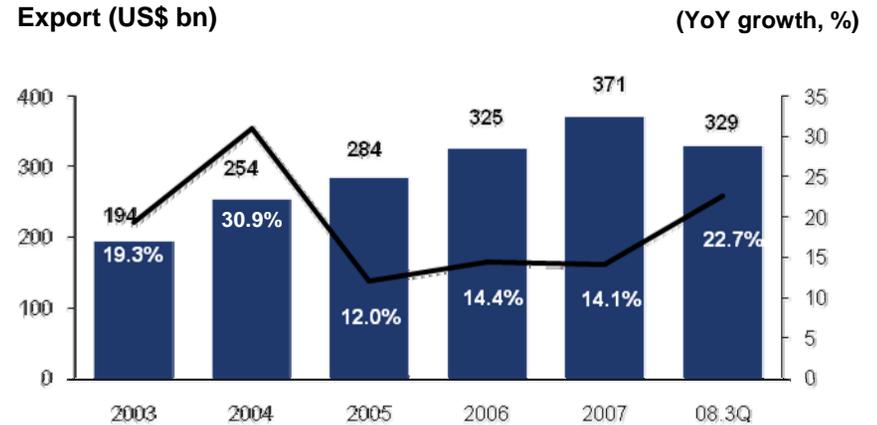


# Macroeconomic Fundamentals

## Sound GDP Growth

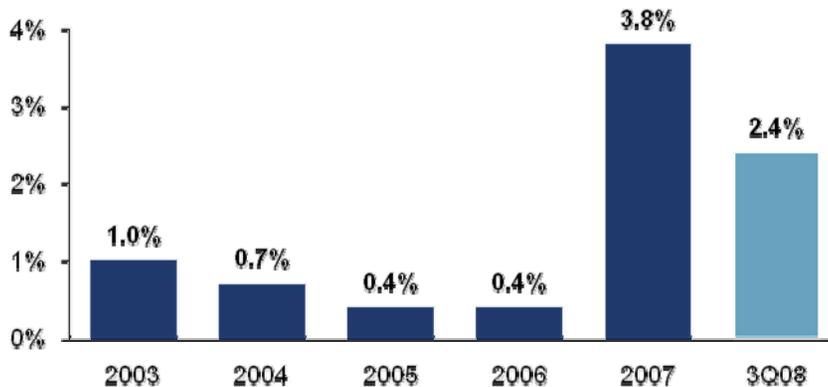


## Robust Exports



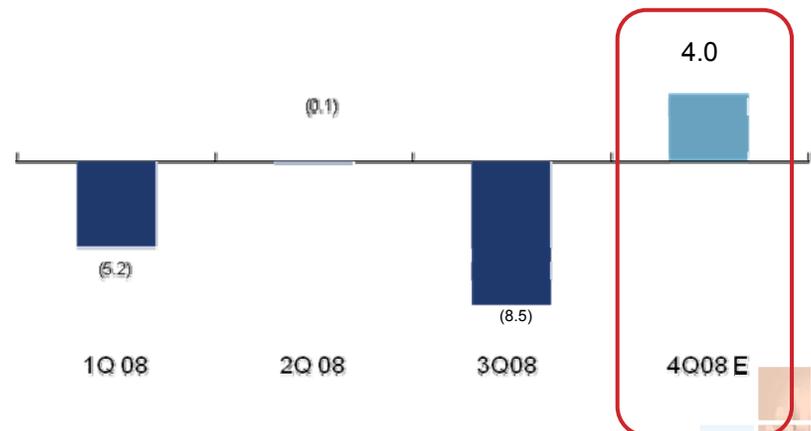
## Continuous Fiscal Surpluses

### Consolidated Government Balance (% of GDP)



## Current Account Balance

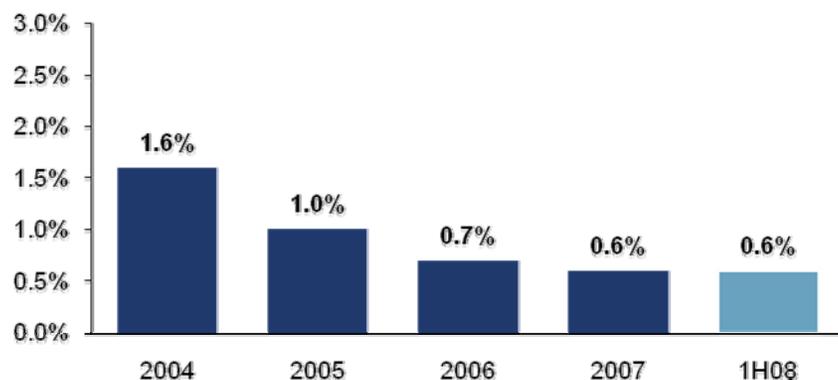
### 2008 Current account balance (US\$ bn)



# Financial & Corporate Sector Trends

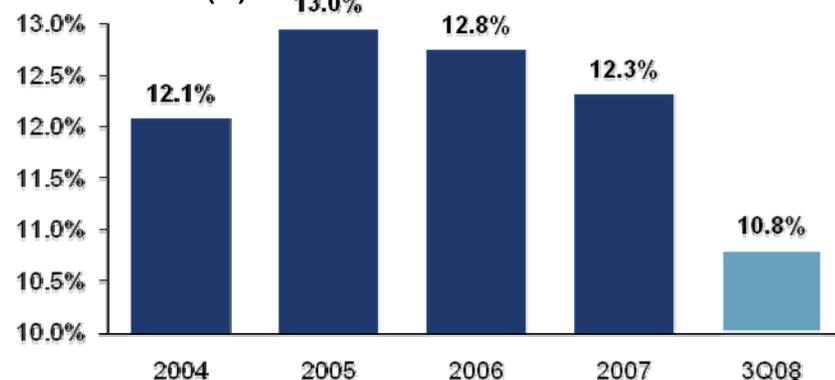
## Improved Asset Quality

Avg. NPL (%)



## BIS Capital Ratio

BIS Ratio (%)

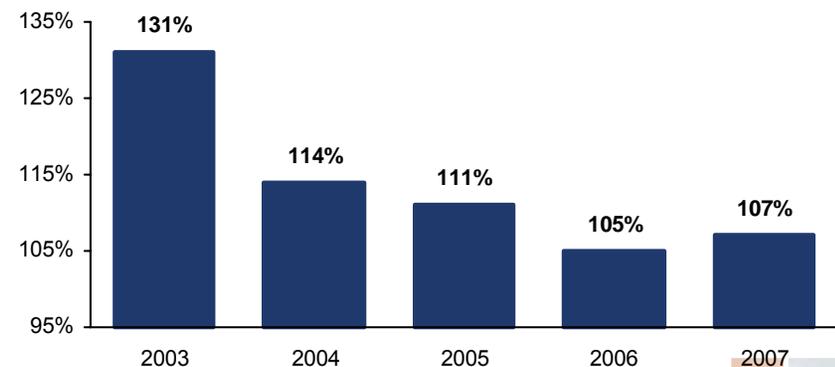


## Improved Earnings of Listed Companies

| (US\$ bn)        | 1H07             | 1H08             | Growth           |
|------------------|------------------|------------------|------------------|
| Revenue          | 355.0<br>(328.9) | 440.0<br>(401.2) | 23.9%<br>(21.9%) |
| Operating Income | 31.7<br>(22.6)   | 39.2<br>(32.4)   | 23.9%<br>(43.7%) |
| Net Income       | 30.0<br>(22.7)   | 30.3<br>(24.4)   | 1.0%<br>(7.8%)   |

## Decreasing Debt/Equity Ratio

Debt/Equity Ratio (%)



\* Includes commercial banks only

**Concerns and Facts:**

# **Fallout from Global Financial Crisis**



# Concerns and Facts

## Concerns

#1

***“Korea is at risk of external debt defaults.”***

#2

***“The Korean Banking System is too levered and faces a liquidity crisis.”***

#3

***“The Korean housing sector is under stress and may collapse.”***

#4

***“Korea will experience a rapid slowdown of exports and economic growth due to the global economic recession”***

## Facts

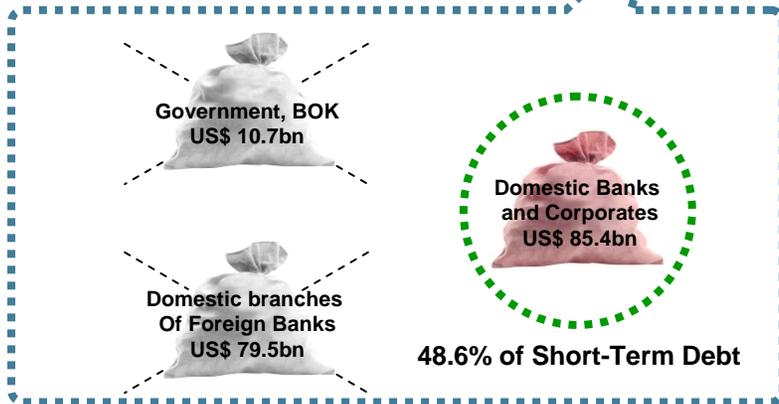
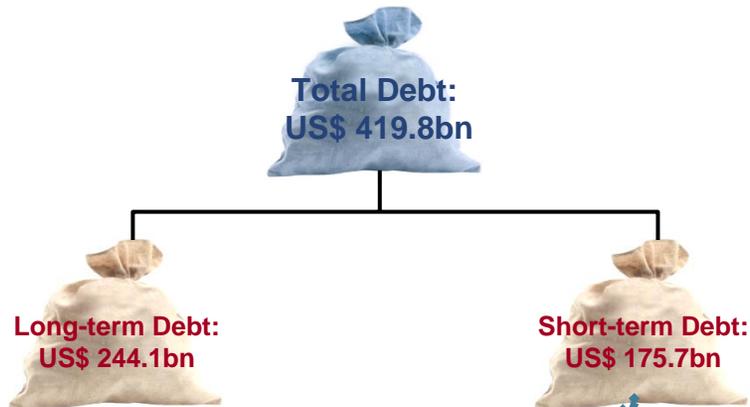
- A closer look at Korea’s external debt composition reveals that significant amount of external debt is risk-free
- In addition, Korea has a healthy external sector with abundant foreign reserves and high liquidity
- The banking sector has seen moderating loan growth in 2008 with continued low levels of delinquency
- Furthermore, there is no mismatch between foreign currency assets and liabilities held by Korean banks; foreign currency liquidity ratio remains high
- The Korean Housing Sector has maintained balanced growth rates supported by robust mortgage regulations
- The majority of household loans have been issued to high income families. Thus, there is a low default rate
- Diversification of destinations and products will limit the adverse effect coming from the global recession
- The OECD forecasts Korea’s export growth rate at 6.4%



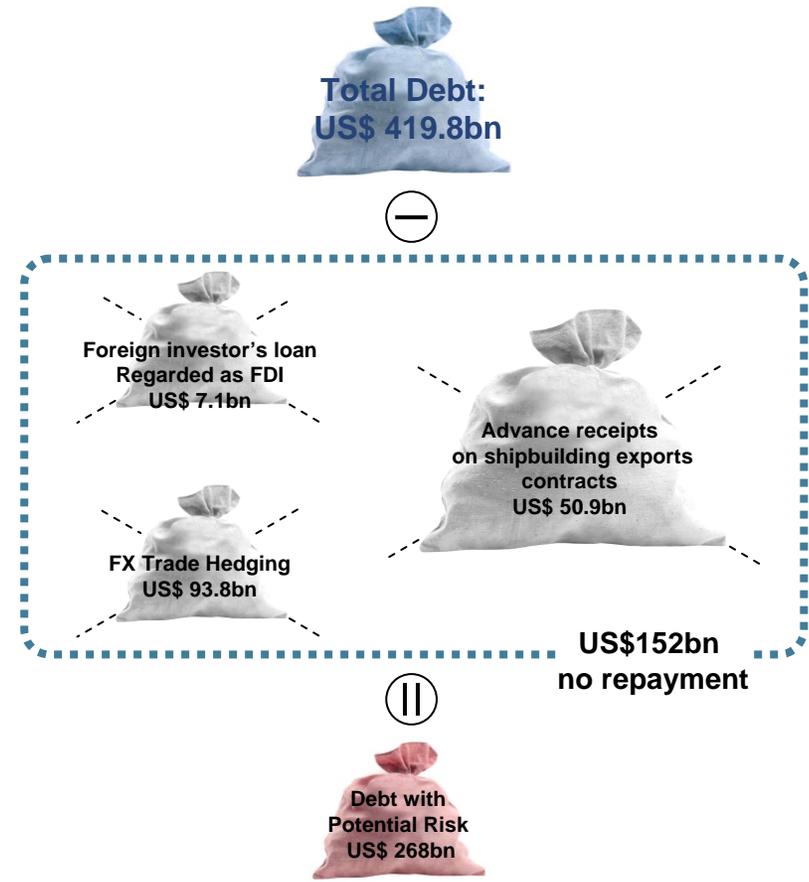
# #1 External Debt

A substantial portion of Korea's external debt is risk-free

## Balanced Short and Long-term Debt



## Large Portion of FX Debt is Hedging

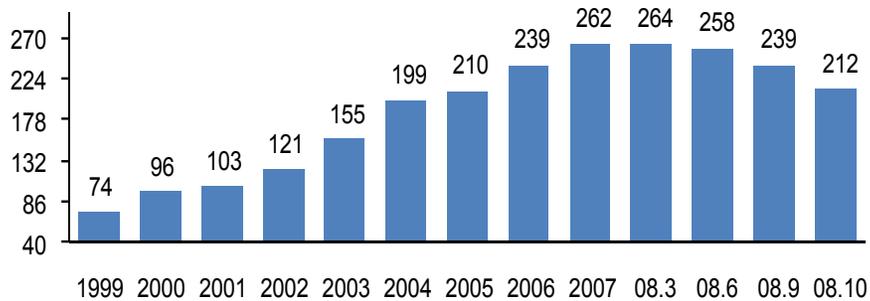


# #1 Foreign Reserves

Korea has the world's sixth largest foreign reserves; most are highly liquid assets

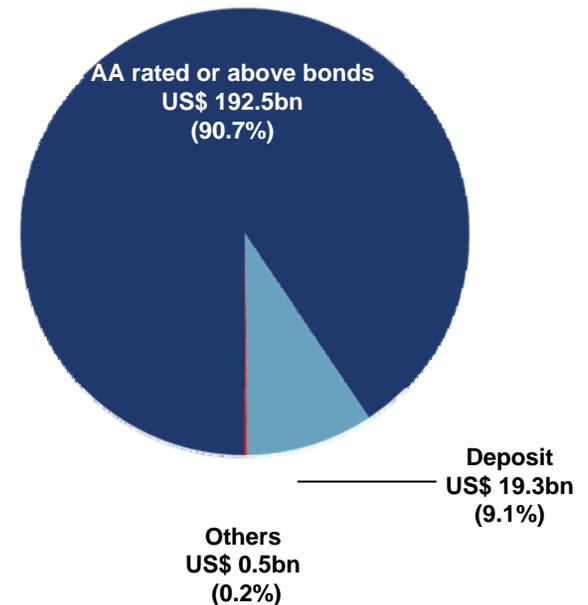
## Adequate Amount of Foreign Reserves

FX reserves (US\$ bn)



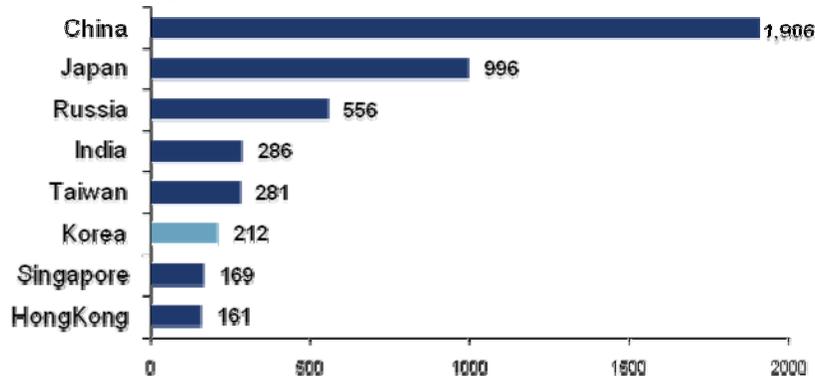
## Highly Liquid Foreign Reserves

Total reserves (US\$ bn)



## World's Sixth Largest Reserves (Oct 2008)

FX reserves (US\$ bn)



# #2 Banks Liquidity

There is no mismatch between foreign currency managing and financing held by Korean banks.  
Foreign currency liquidity ratio remains high

No Currency Mismatch Exists

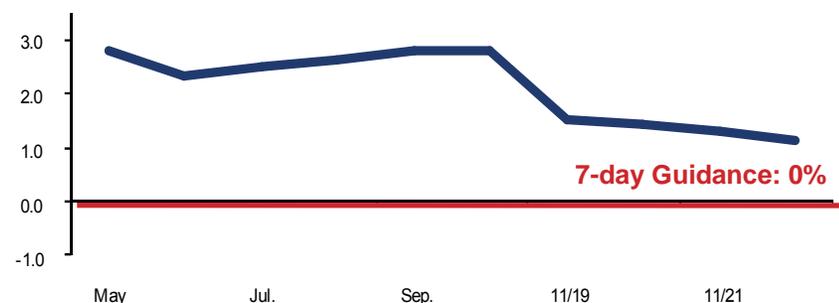
Foreign currency assets/funding - Korean banks  
(US\$ bn, as of Jun. 08)

| Assets                               | Amount | Funding   | Amount |
|--------------------------------------|--------|---|--------|
| Forward exchange purchased (off B/S) | 65.7   | External debt                                       | 127.4  |
| Foreign currency loans <sup>1)</sup> | 45.5   | Residential deposits in foreign currency            | 19.3   |
| Trade bill discount operation        | 50.5   | Foreign bank branches (swap)                        | 23.0   |
| Others                               | 40.0   | Foreigners' investment in bond <sup>2)</sup> (swap) | 32.0   |
|                                      | 201.7  |   | 201.7  |

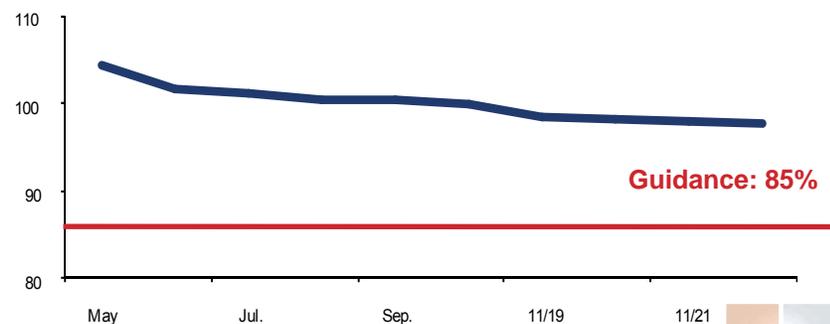
1) NPL: 0.3%    2) Estimates (not included in liabilities)

High Liquidity Ratio: Low Risk from Duration Mismatch

7-day maturity mismatch ratio (%)



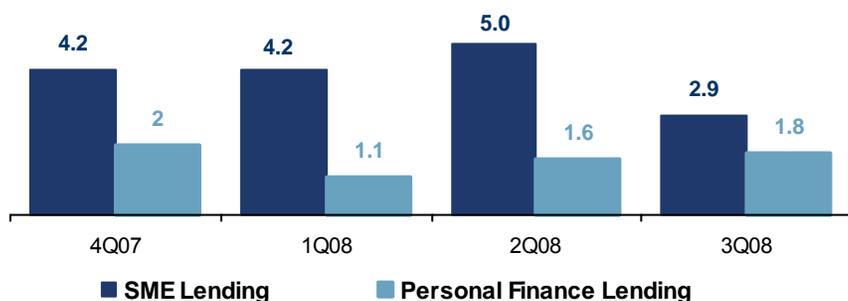
3-month foreign currency liquidity rate (%)



# #2 Sound Banking Sector

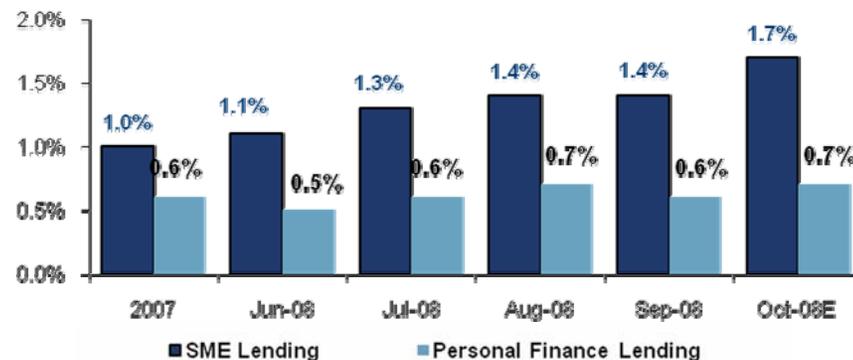
## Moderating Loan Growth

Loan Growth (%)



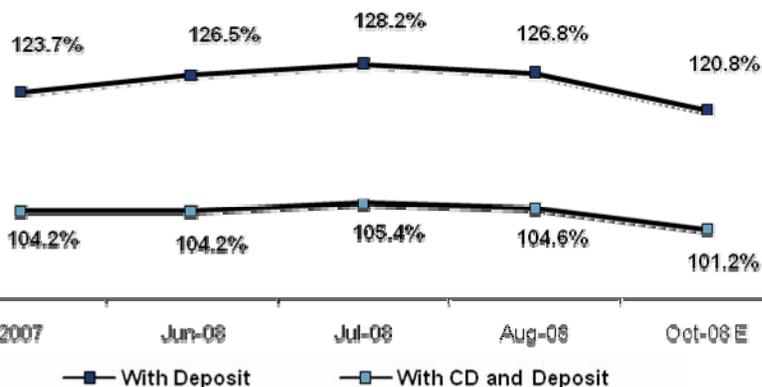
## Low Delinquency Ratio

Delinquency Ratio (%)



## Moderate Loan-to-Deposit Ratio

Loan-to-Deposit Ratio (%)



## Sufficient Room to Withstand Further Default Risks

- Sufficient buffer to absorb the impact of further default risk
  - Coverage ratio is approximately 186%
  - LTV ratio is approximately 47%
- Well-diversified lending exposure to various sectors
  - Manufacturing (35.2%), real estate (17.1%), retail • wholesale sector (14.3%), construction (9.7%)
- Stringent risk management systems implemented after the Asian financial crisis

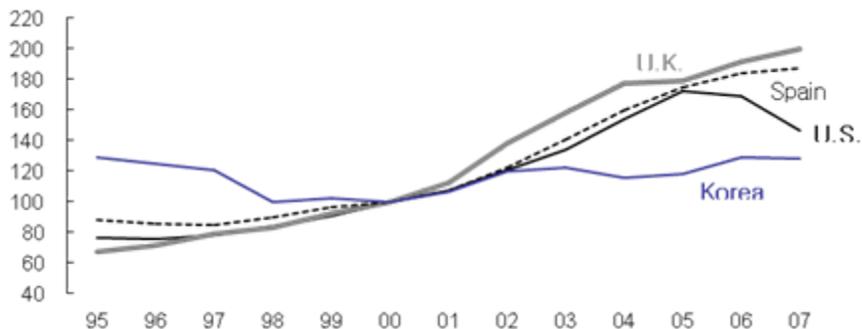


# #3 Real Estate Sector

Historically, Korean real estate prices have lagged GDP growth, especially when compared to other markets. The balanced growth has been supported by prudent housing and mortgage ratios.

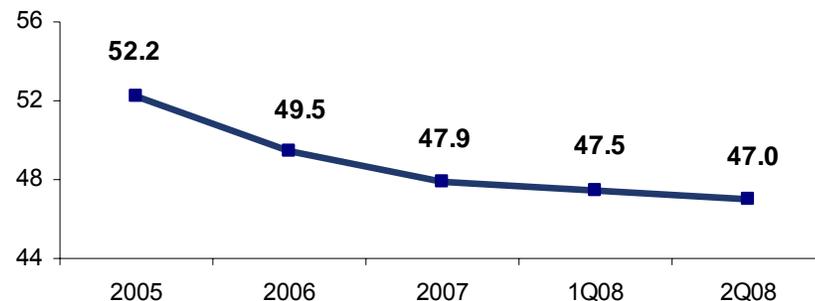
## Balanced Real Estate Price Growth

Housing Price Index (2000=100)



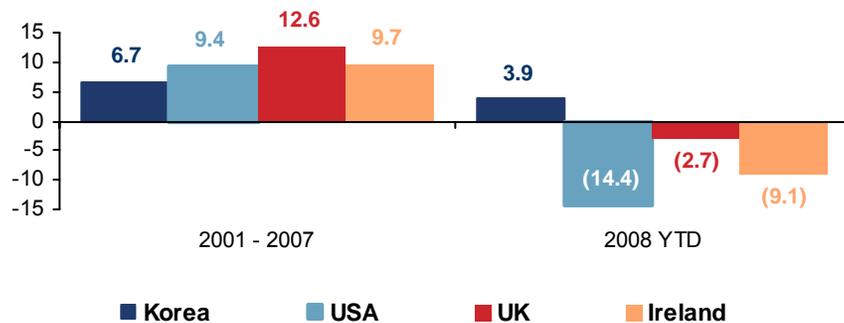
## Improving Mortgage Loan-to-Value Ratio

LTV Ratio (%)



## Stable Housing Price Changes

Housing Price Changes (yoy, %)



## More Stringent Mortgage Regulations than Others

|                   | Korea  | U.S.     | Hong Kong | Germany          | Japan    |
|-------------------|--------|----------|-----------|------------------|----------|
| Mortgage/GDP      | 33.4%  | 72.3%    | 37.3%     | 52.4%            | 36.2%    |
| Regulation System | Direct | Indirect | Direct    | Mixed            | Indirect |
| LTV Limit         | 40~60% | None     | 60~70%    | 60% <sup>1</sup> | Indirect |
| DTI Limit         | 40%    | None     | 60%       | None             | None     |

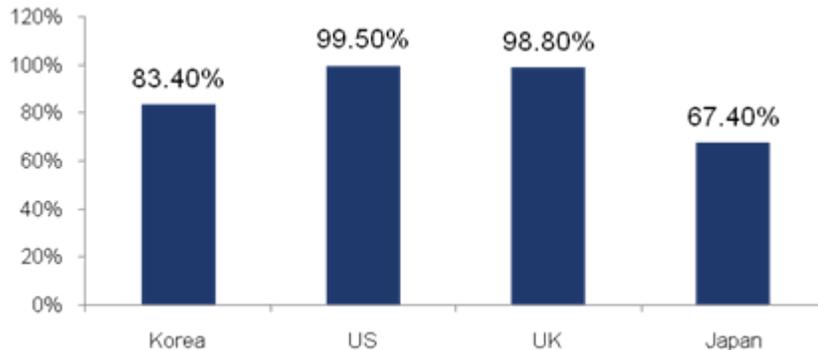
<sup>1</sup> Portion

# #3 Household Debts and Household Loans

- The majority of recent increased household debts belong to high income families.
- A large portion of household loans are collateralized with mortgage asset

## Ratio of Financial Debt to GDP

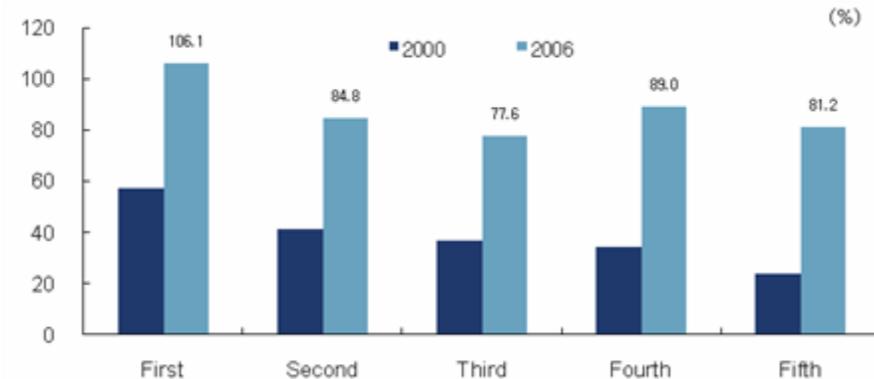
Financial Debt/GDP Ratio (%)



\* Korea as of June 2008, others as of March 2007

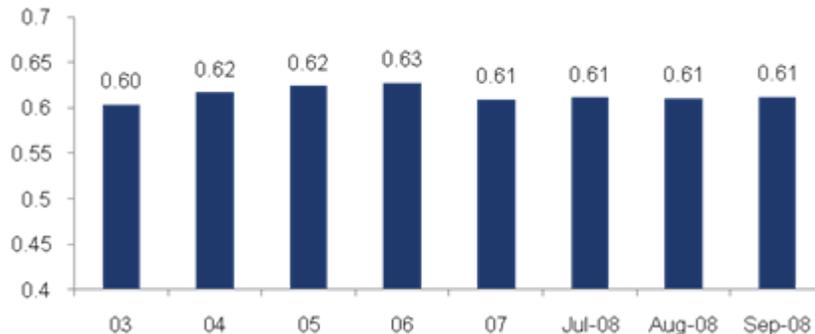
## High Income Tier Household Debts

Household Debt/Income (%)



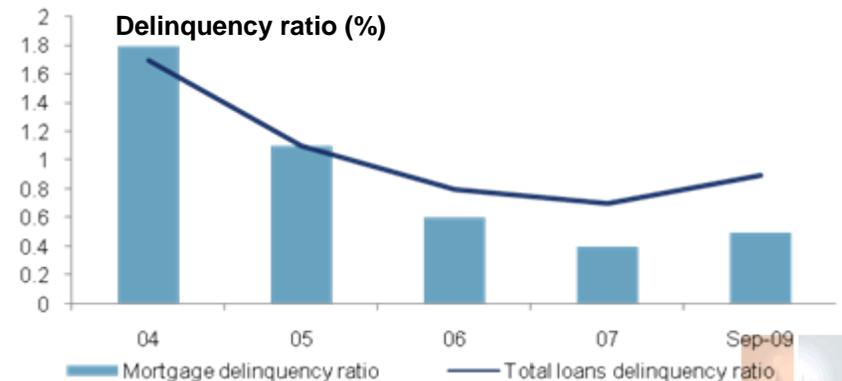
## Ratio of Mortgage to Total Loans (Banks)

Mortgage/Total Loans Ratio (%)



## Delinquency Ratio of Mortgage Loans

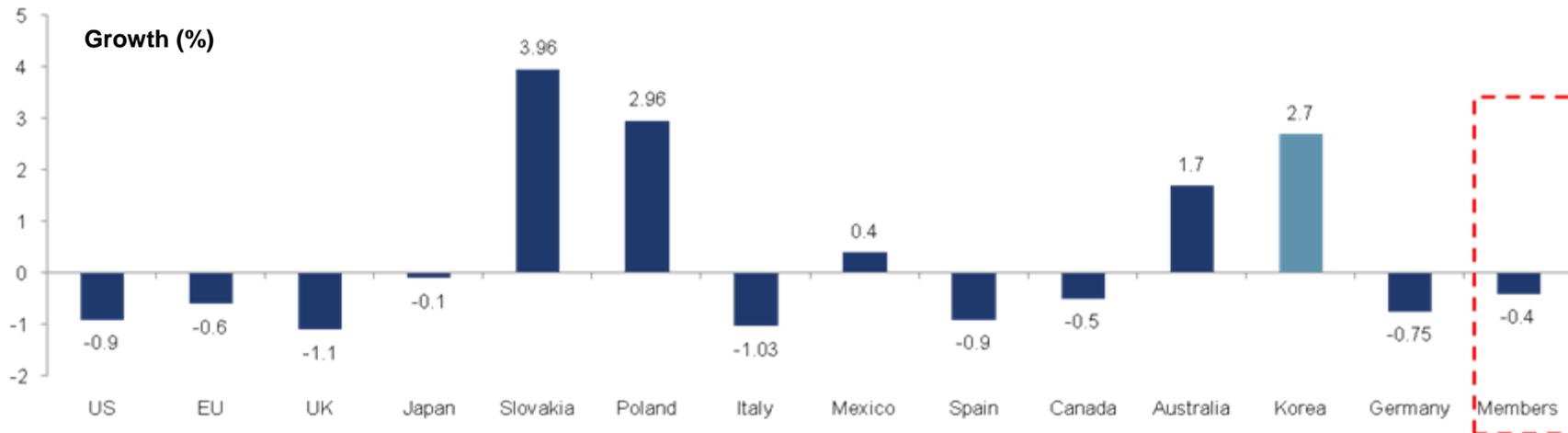
Delinquency ratio (%)



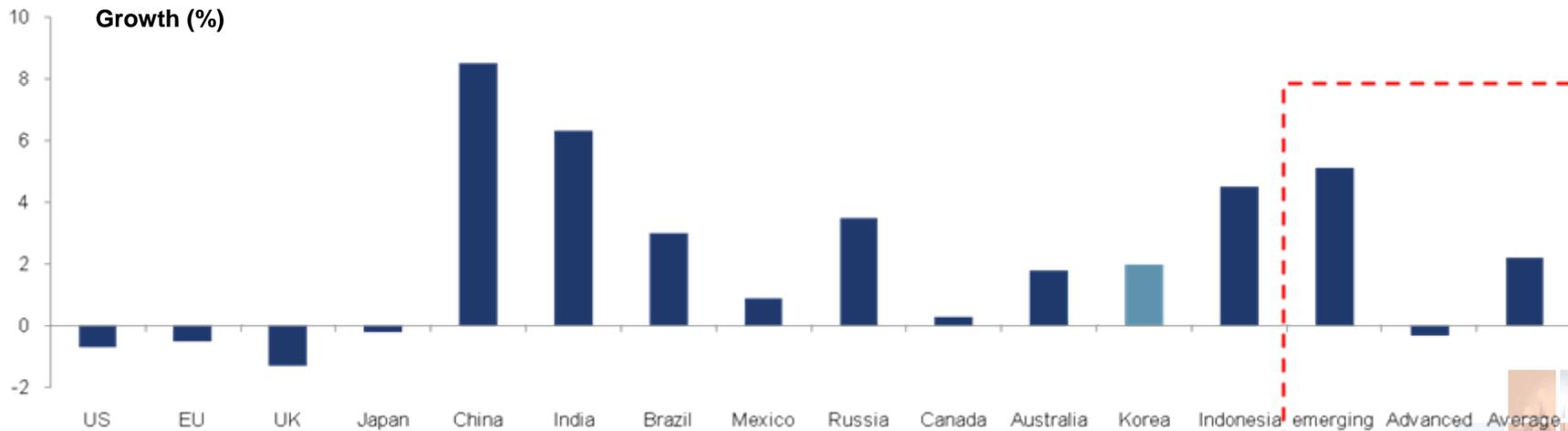
#4

# Growth Forecast: International Comparison

## Third Highest Economic Growth Forecasts among OECD Members (OECD, Nov. 25)



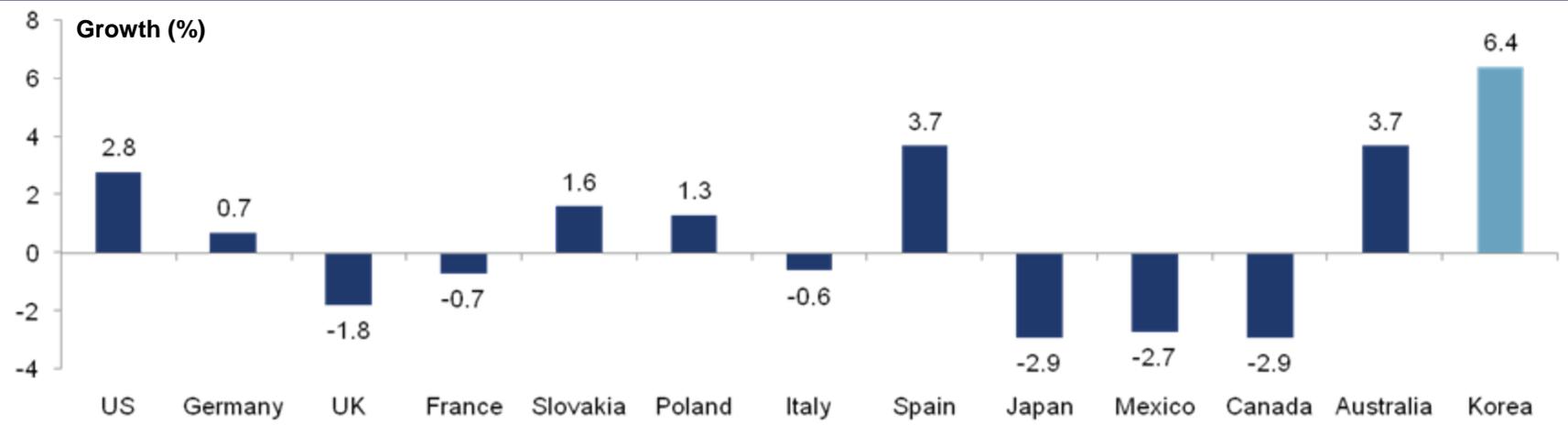
## IMF Forecasts Korea's 2009 Economic Growth at 2%



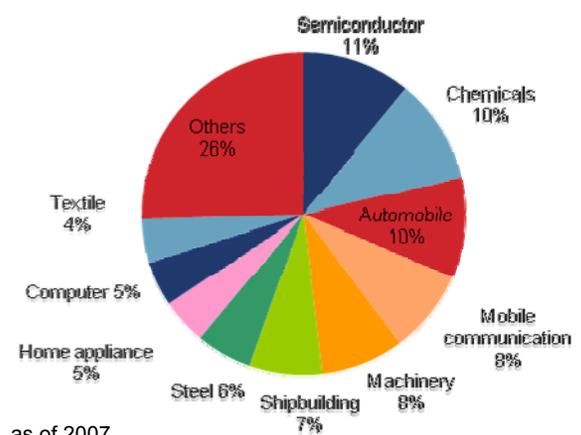
# #4 Export Forecast: International Comparison

▪ Diversification of destinations and products will limit the adverse effect of the global recession

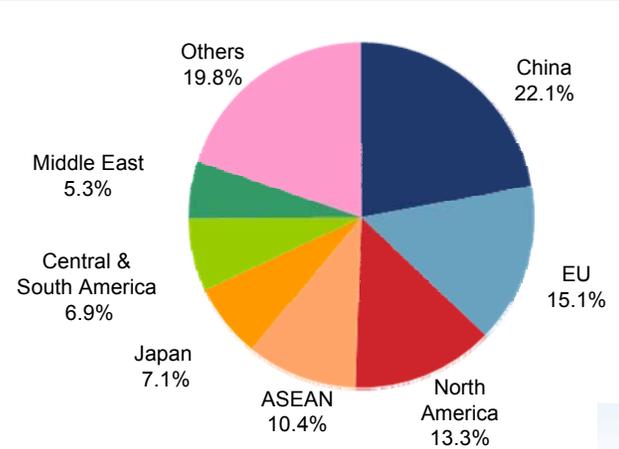
Highest Forecast of Total Exports Growth among OECD Members (OECD, Nov. 25)



Diversified Export Products



Diversified Export Markets

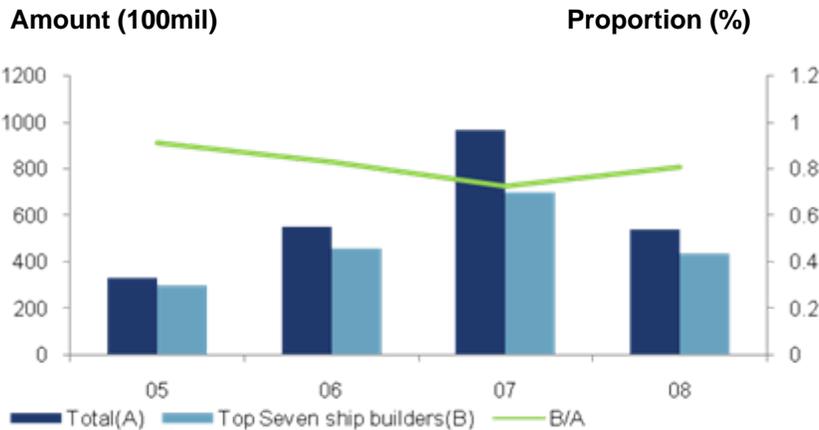


Source: KITA, as of 2007

# #4 Better Positioned in Shipbuilding Industry

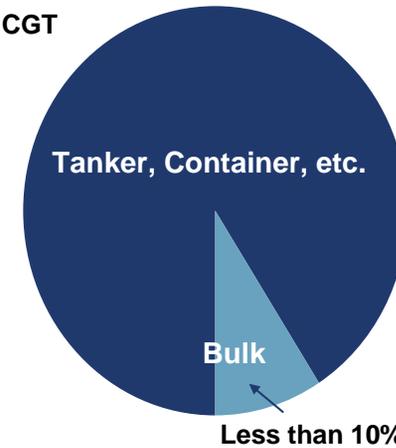
The recent deterioration of the global shipbuilding market will improve the position of top-tier Korean shipbuilding companies.

## Proportion of Top 7 Companies (Over 80%)

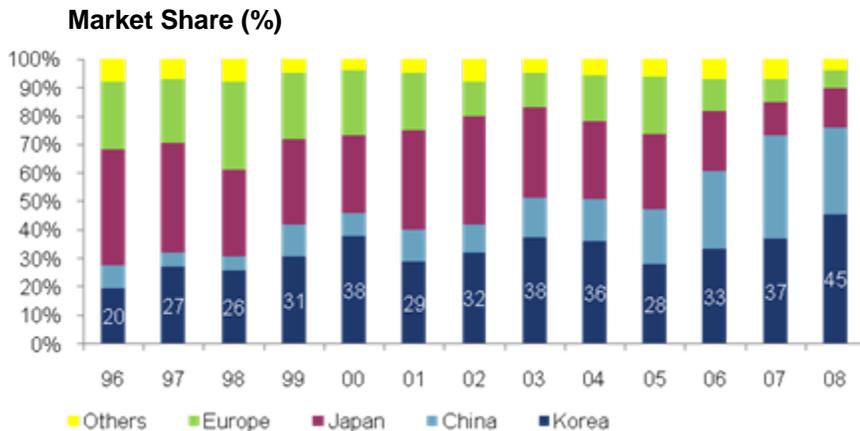


## Proportion of Bulk Carrier for Top 7 Shipbuilders

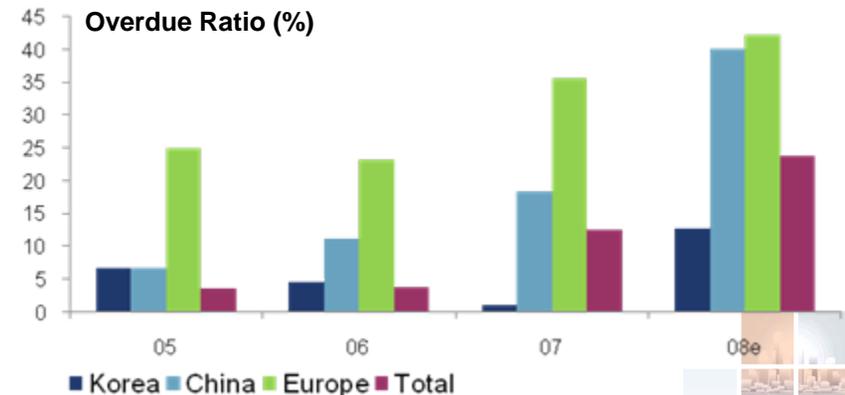
05~07 New Order, CGT



## Increase in Global Market Share in 2008



## Increase in Delivery Overdue by Competitors



# The Korean Government's Response



# Key Frameworks

#1

## FX Liquidity

- Keep sufficient foreign reserves and a balanced external debt profile
- Guarantee FX debt issuance - \$100bn (Oct. 30)
- Supply dollar liquidity (\$55bn)  
MoSF - \$30bn  
BOK - \$20bn, etc.
- BOK - Swap line agreement with the FRB - \$30bn (Oct. 30)
- Open possibility of expanding swap schemes (Bilateral - Multilateral)

#2

## Credit Stability

### For banks

- Expand purchasing Repo by BOK
- Ease the KRW Liquidity Ratio Requirement (Oct. 29)
- Establish Bond Market Stabilization Fund (10 tn)

### For non-banks, bond market

- Provide special liquidity facility for non-bank institutions (Oct. 24)
- Broaden eligible collateral for open market operations to bank debentures
- Help to stabilize corporate bonds and ABCP Market with P-CBO

#3

## Banks' Soundness

- Tighter monitoring on banks' asset size & financing structure
- Enhance risk management via MOU with financial authorities
- Help securitize illiquid assets (e.g. MBS, covered bonds)

<If necessary>

- Support recapitalization of financial institutions
- Enhance deposit guarantees

#4

## Real Economy

### Micro - Measures

- Support for SMEs (Oct. 1)
  - Initiate fast-track programs for differentiating viable companies
  - BOK - Increase the Aggregate Credit Ceiling Loans KRW 6.5tn → 9tn (Oct. 23)
  - Supply KRW liquidity by State owned banks (KRW 3.3tn)
  - Expand public guarantee of SMEs loans (KRW 11.5tn)
  - KODIT - Help issue P-CBO (KRW 3tn)
- Support for the Construction Industry
  - Purchase unsold assets held by construction companies
  - Provide credit enhancements to securitize corporate bonds
  - Provide tax-incentives for housing sector

### Macro - Measures

- Lower base interest rate (5.25 → 4.00%)
- Strong fiscal stimulus packages (KRW 33tn)

# #1 Measures for Enhancing FX Liquidity

## Swift Supply of Liquidity and Cooperative Effort with Other Key Nations

### Sufficient FX Reserves

- Current foreign exchange reserve as of October, 2008 (USD212.3bn)
- Balance external debt profile and maintain high liquidity

### Payment Guarantee for Bank Debts

- Banks' foreign currency borrowing guarantee up to USD100bn
- MOU agreement to reinforce monitoring and improve management

### Swift Supply of Foreign Exchange Liquidity

- Provide liquidity through the currency swap market and competitive swap auction (USD34bn)
- Support exporters and importers by supplying liquidity via KEXIM and BOK (USD21bn)

### Swap Line with the FRB

- Swap line agreement with the FRB (USD30bn)

### Bilateral / Multilateral Swap Lines

- Expanding currency swap lines with other strategic countries

## #2 Measures for Enhancing Credit Stability

### Timely Supply of Liquidity in Response to Rising Counterparty Risks

#### Lower the Interest Rate

- Preemptive measures for soft-landing of real sectors & financial stability (Base rate: Down from 5.25% to 4.00%)

#### Expand Eligible Securities for Operation by BOK

- Allow bank debentures and other bonds eligible for Repo transaction together with KTB, MSB, and KDIC bond

#### Increase BOK's Aggregate Credit Ceiling Loans

- Raise the ceiling from KRW 6.5tn to KRW 9.0tn
- Lower the current interest rate from 3.25% to 2.25%

#### Ease the KRW Liquidity Ratio to Global Standard

- Ease the requirement from 3 months to 1 month, in accordance with the global standard

#### Supply Additional Liquidity to Non-bank Institutions

- Develop special facility to provide liquidity to local securities firms and asset management companies through the Korea Securities Finance Corp.

#### Corporate Bonds and ABCP Markets

- Launch Primary-CBO (KRW3 tn)
- Establish Bond Market Stabilization Fund (Approx. KRW10 tn)

# Measures for Enhancing Soundness of Banks

## Enhance Risk Management to Withstand Market Turbulence

### Transparent Information Disclosure to the Market

- Low delinquency ratios, NPL level, and all other financial figures are in good standing
- More active IRs to relieve concerns on the banks' soundness

### Adjustment of Asset Size for Soft-landing

- Monitor loan-to-deposit ratios and asset size for soft-landing
- Prevent over-competition among banks in the bank debenture market

### De-leveraging

- Encourage de-leveraging by non core assets sales
- Issue covered bonds and develop other means to securitize illiquid assets

### Recapitalization

- Encourage recapitalization in banks
- If necessary, develop mechanism for increasing BIS ratio

### Deposit Insurance

- Evaluate the expansion of the deposit insurance scheme (KRW 50 million), if necessary

# #4 Measures for Boosting Real Economy

Adopt comprehensive measures to boost economy in preparation of slowing real economy

## Fiscal expansion

- Establish measures (KRW 9tn) such as oil tax rebates to overcome high oil prices(June.8)
- Tax reduction for expansion of growth engine (total KRW20.6 tn and KRW 10.3 tn for year 2009 only, Sep.1)
- Increase public spending to create jobs, to support lower-income class and to promote private investment(KRW 14 tn , Nov.3, approx. 3.76% of GDP)  
\* SOC investments etc (KRW 4.6 tn), SMEs and SOHO (KRW 3.4 tn) etc.

## Boost real estate and construction business

- Provide liquidity to construction companies and establish measures to handle unsold house problems (Oct. 21)
- Rationalize reconstruction regulations and removal of assigning of real estate speculative areas (Nov. 3)

## Stabilize SMEs and lower income class

- Managing of Fast track program and strengthen funds support through policy banks  
\* Increase guarantee amount of guarantor (KRW 11.5 tn), Capital injection to policy banks (KRW 2.65tn)
- Support Lower income class through measures such as providing stabilization funds.
- Market friendly corporate restructuring in accordance with existing restructuring process  
\* 71 deals IAW CRP Act (2001 ~ 2007): recovery ratio 69% ② Creditors agreement, 952 deals (2007): recovery ratio 51.9%

## Induce investments through deregulation

- Easing of land, environment, and labor regulations and rationalization of service industry regulations

# Comparison with Asian Financial Crisis

Korea's financial condition has improved vastly over the past ten years and the country is well-prepared to manage the current crisis

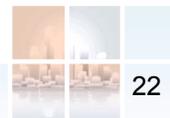
|                         | Asian Financial Crisis<br>(late 1997)         | Current          |                           |
|-------------------------|---|------------------|---------------------------|
| <b>Causes</b>           | Internal factors such as corporate bankruptcy | External factors |                           |
| <b>Foreign Exchange</b> | Foreign Currency Reserves                     | US\$ 8.9bn       | US\$ 212.2bn <sup>1</sup> |
|                         | ST External Debt / FX Reserves                | 717%             | 89% <sup>2</sup>          |
|                         | Liquid External Debt / FX Reserves            | 973%             | 107% <sup>2</sup>         |
|                         | Total External Debt / FX Reserves             | 1,957%           | 201% <sup>2</sup>         |
| <b>Banks</b>            | Bank NPL Ratio                                | 6.0%             | 0.6% <sup>3</sup>         |
|                         | BIS Ratio                                     | 7.0%             | 10.8% <sup>2</sup>        |
| <b>Corporates</b>       | Corporate Debt Ratio                          | 424.6%           | 106.5% <sup>4</sup>       |
|                         | Corporate Interest Coverage Ratio             | 115.0%           | 404.8% <sup>4</sup>       |

<sup>1</sup> as of October 2008

<sup>2</sup> as of September 2008

<sup>3</sup> as of June 2008

<sup>4</sup> as of end of 2007



- This material has been produced by the Financial Services Commission of Korea (the “FSC”) for informational purposes only and does not constitute an offer to sell or a solicitation to buy any security or other financial instrument. The information contained in this document has not been independently verified and neither approval nor guarantee is given that it is accurate or complete. The opinions, forecasts, assumptions, estimates and derived valuations contained in this material should be considered in the context of the circumstances prevailing at the time indicated and are subject to change at any time without prior notice. Neither the FSC nor other persons shall be liable for any direct, indirect, special, incidental, consequential, punitive or exemplary damages, including lost profits arising in any way from the information contained in this material. This material is for the use of intended recipients only and the contents may not be reproduced, redistributed, or copied in whole or in part for any purpose without FSC's prior express consent.

