

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

## **Resilience Amid Turbulence**

**December 2008**

**Financial Services Commission**

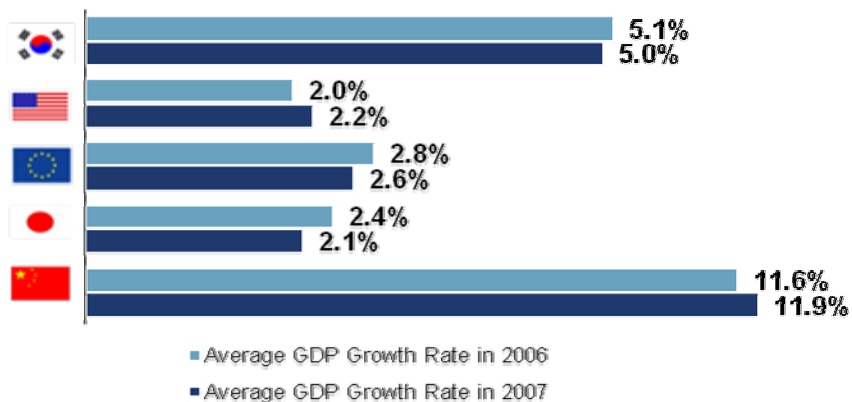


# Macroeconomic Fundamentals

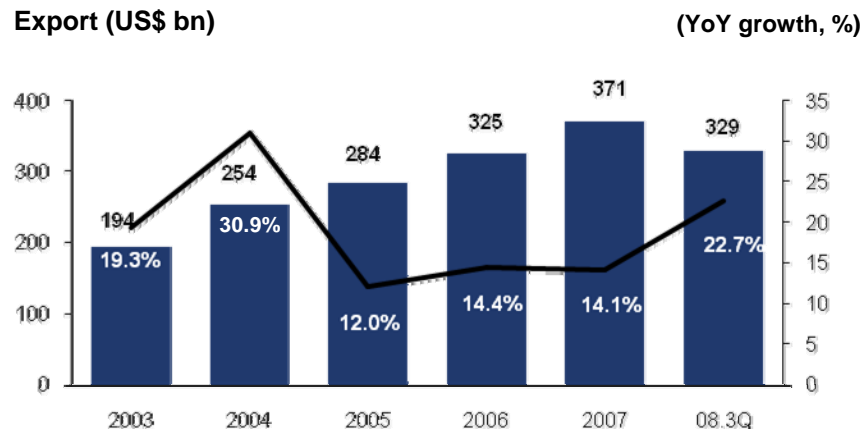


# Macroeconomic Fundamentals

## Sound GDP Growth

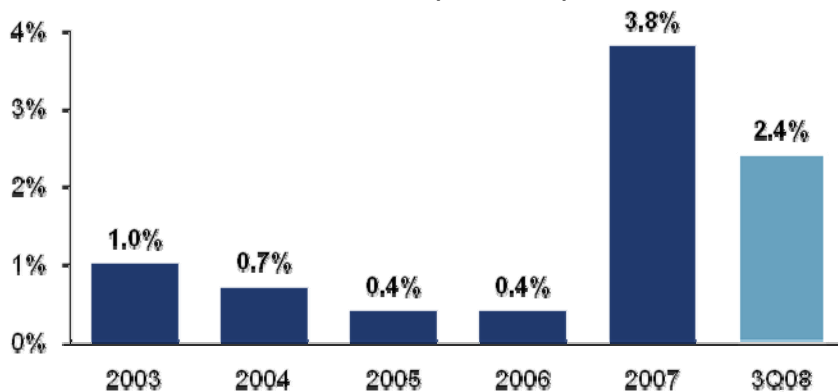


## Robust Exports



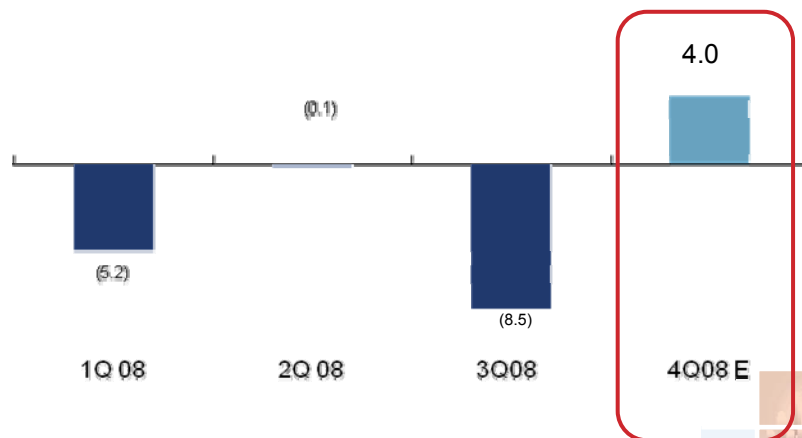
## Continuous Fiscal Surpluses

### Consolidated Government Balance (% of GDP)



## Current Account Balance

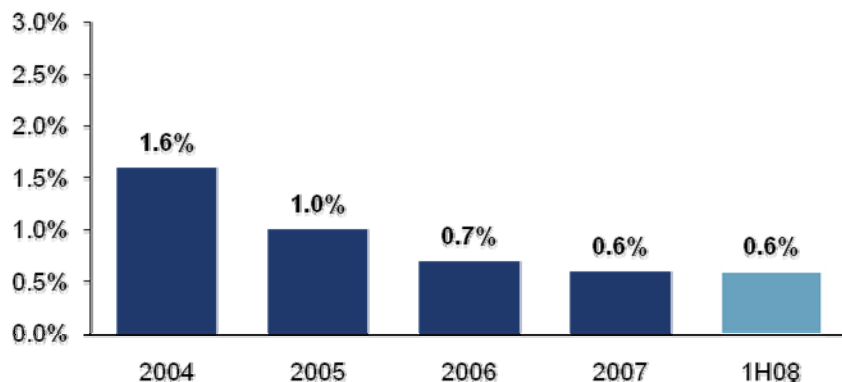
### 2008 Current account balance (US\$ bn)



# Financial & Corporate Sector Trends

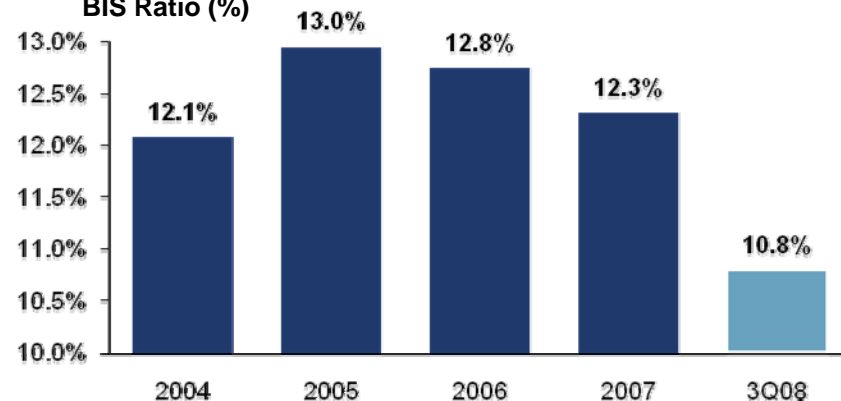
## Improved Asset Quality

Avg. NPL (%)



## BIS Capital Ratio

BIS Ratio (%)

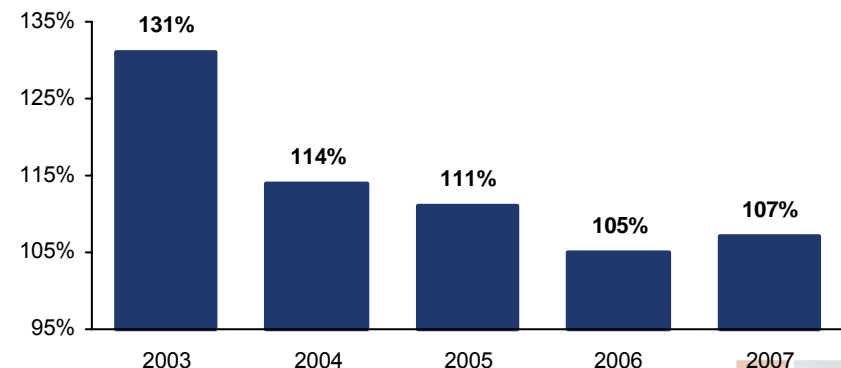


## Improved Earnings of Listed Companies

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

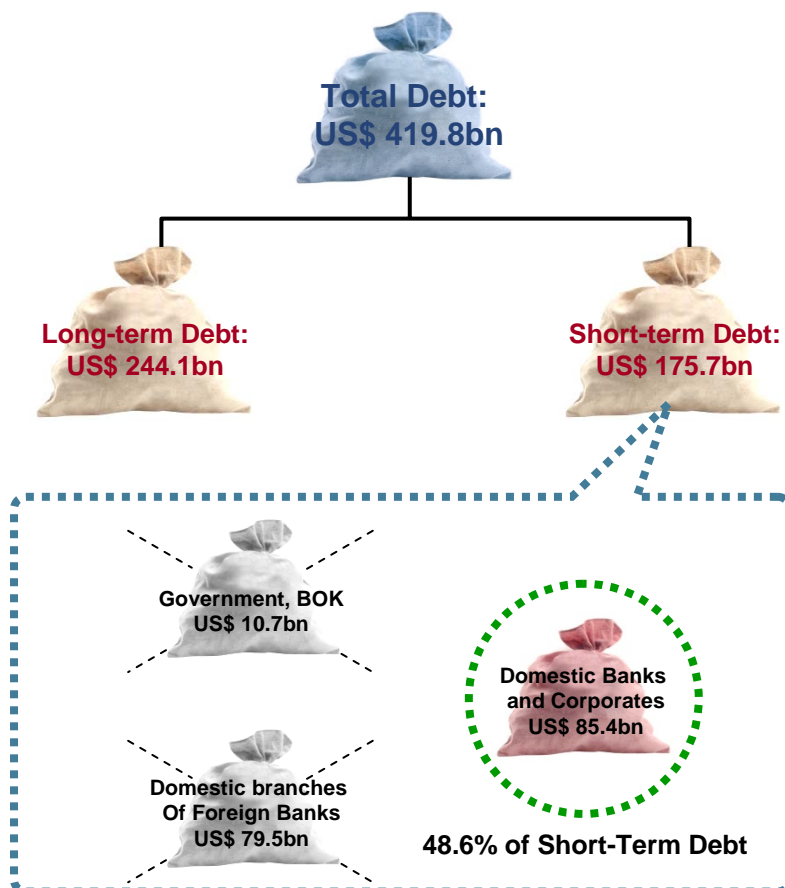
- A closer look at Korea's external debt composition reveals that significant amount of external debt is risk-free
- In addition, Korea has a healthy external sector with abundant foreign reserves and high liquidity
- The banking sector has seen moderating loan growth in 2008 with continued low levels 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%



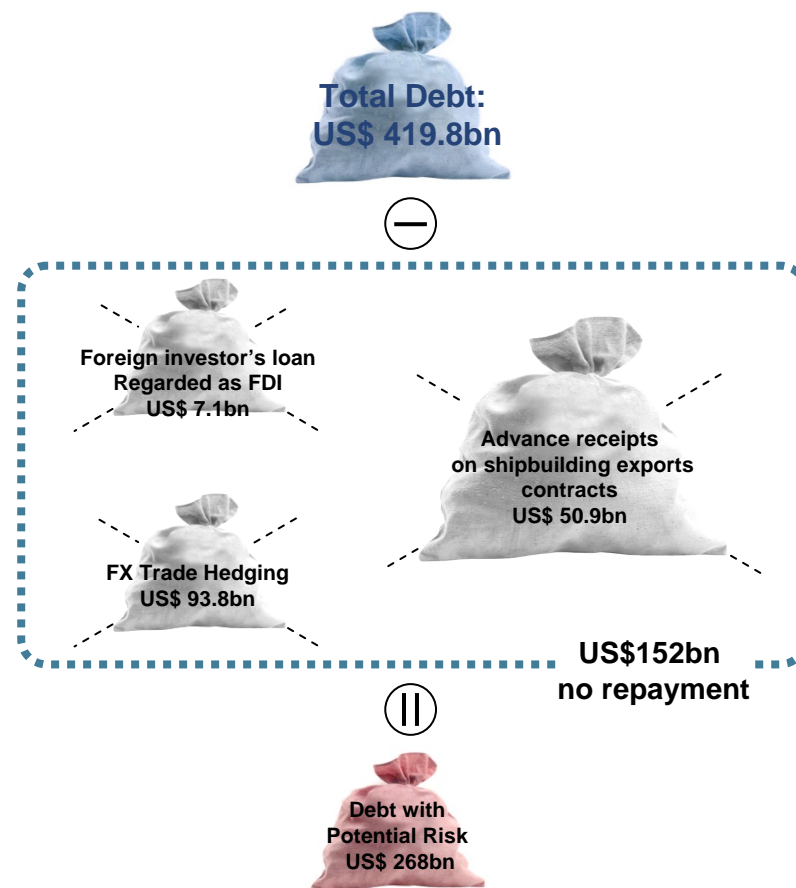
# #1 External Debt

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

## Balanced Short and Long-term Debt



## Large Portion of FX Debt is Hedging

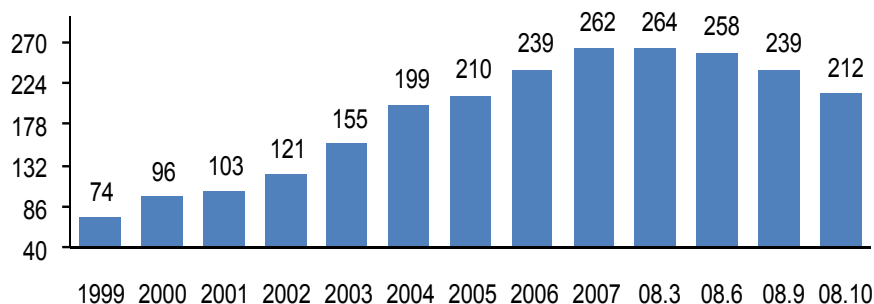


# #1 Foreign Reserves

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

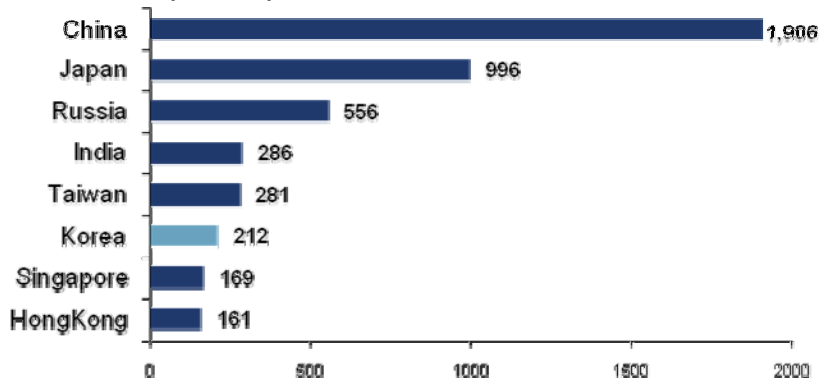
## Adequate Amount of Foreign Reserves

FX reserves (US\$ bn)



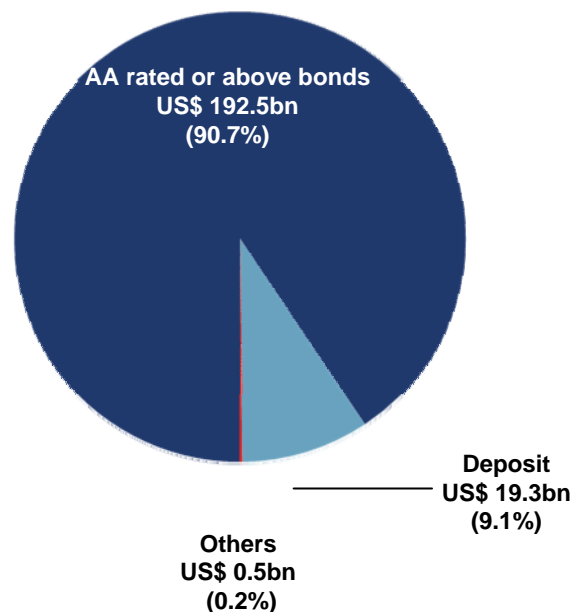
## World's Sixth Largest Reserves (Oct 2008)

FX reserves (US\$ bn)



## Highly Liquid Foreign Reserves

Total 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

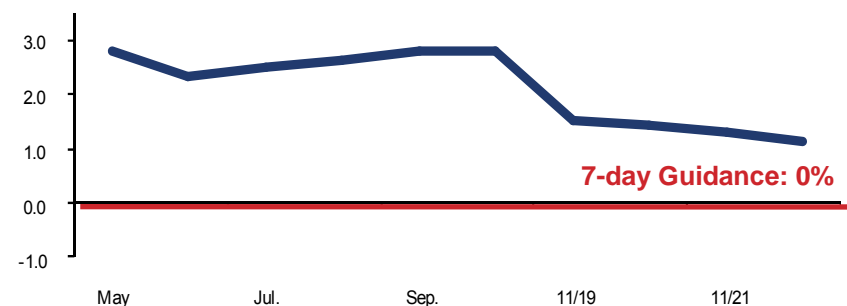
**Foreign currency assets/funding - Korean banks**  
(US\$ bn, as of Jun. 08)

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

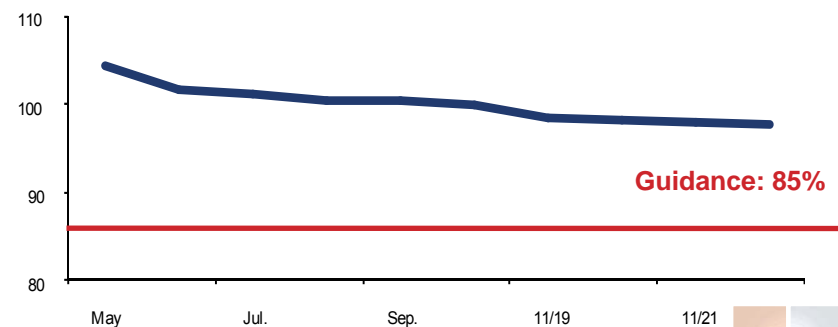
1) NPL: 0.3%    2) Estimates (not included in liabilities)

### High Liquidity Ratio: Low Risk from Duration Mismatch

**7-day maturity mismatch ratio (%)**



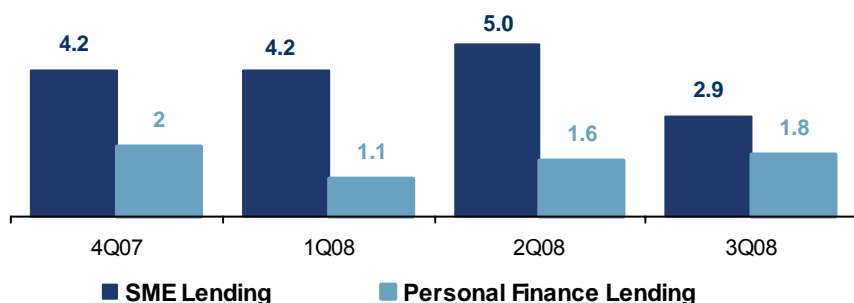
**3-month foreign currency liquidity rate (%)**



## #2 Sound Banking Sector

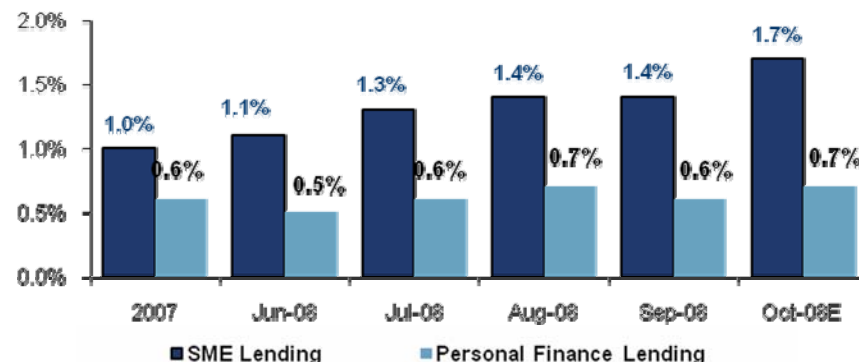
### Moderating Loan Growth

Loan Growth (%)



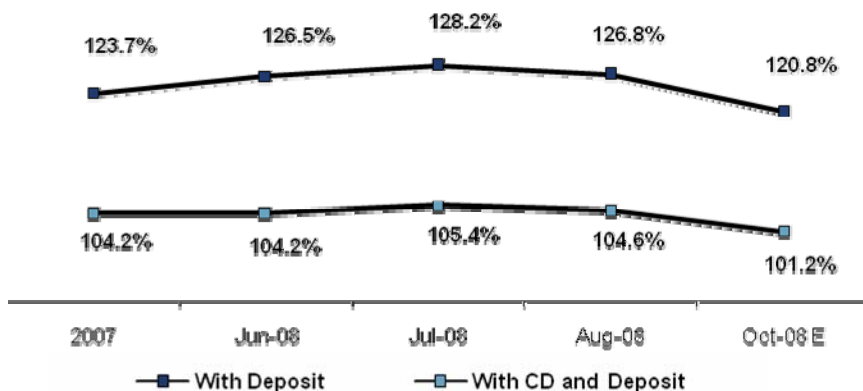
### Low Delinquency Ratio

Delinquency Ratio (%)



### Moderate Loan-to-Deposit Ratio

Loan-to-Deposit Ratio (%)



### Sufficient Room to Withstand Further Default Risks

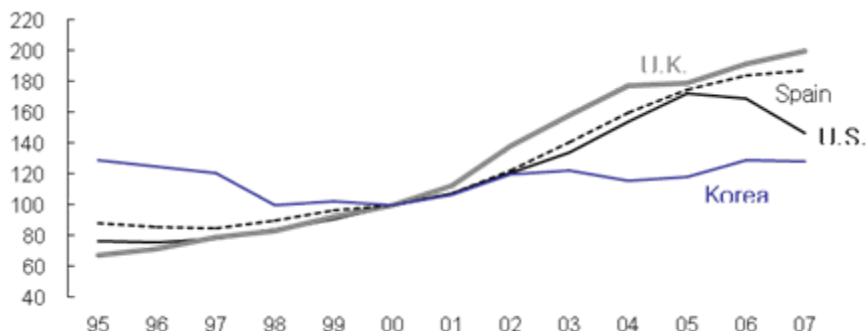
- Sufficient buffer to absorb the impact of further default risk
  - Coverage ratio is approximately 186%
  - LTV ratio is approximately 47%
- Well-diversified lending exposure to various sectors
  - Manufacturing (35.2%), real estate (17.1%), retail • wholesale sector (14.3%), construction (9.7%)
-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

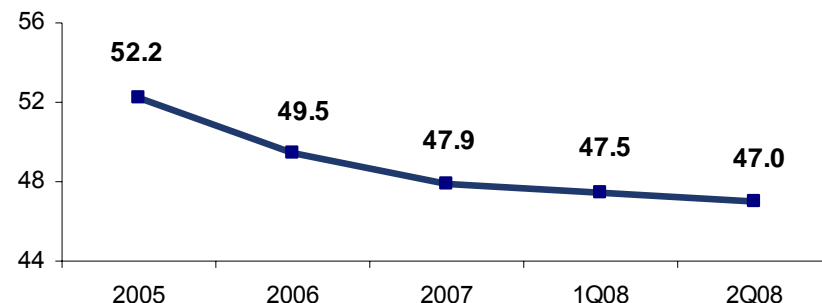
## Balanced Real Estate Price Growth

Housing Price Index (2000=100)



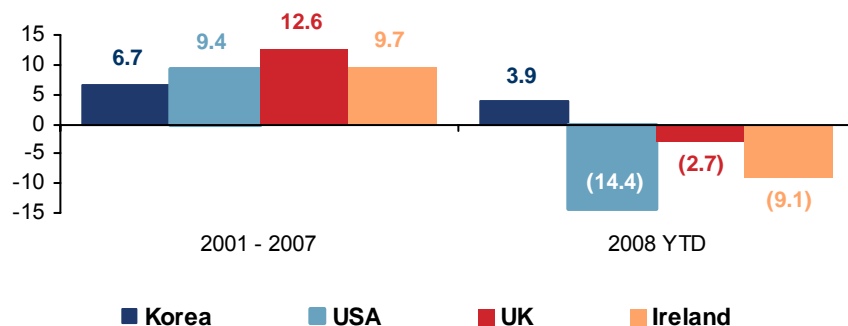
## Improving Mortgage Loan-to-Value Ratio

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

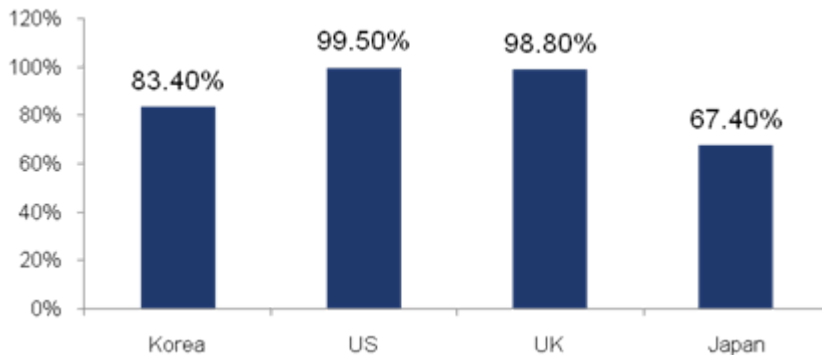
<sup>1</sup> Portion

# #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

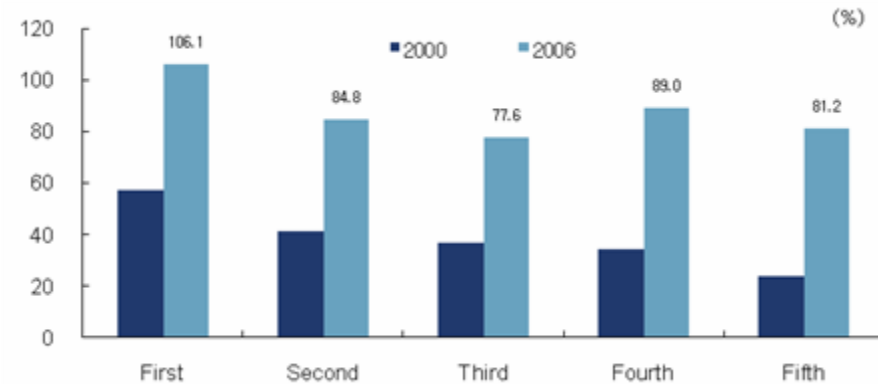
Financial Debt/GDP Ratio (%)



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

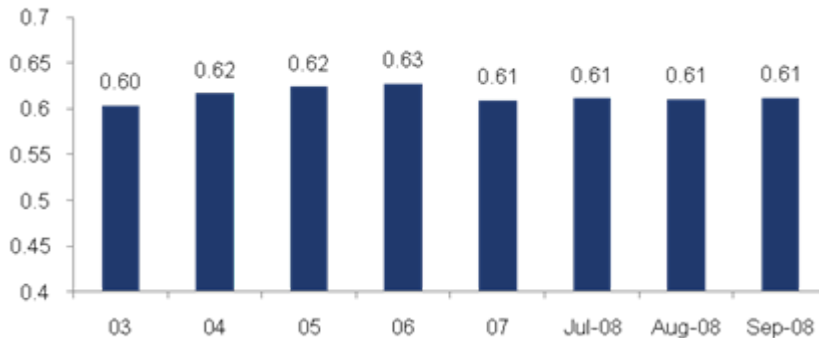
High Income Tier Household Debts

Household Debt/Income (%)



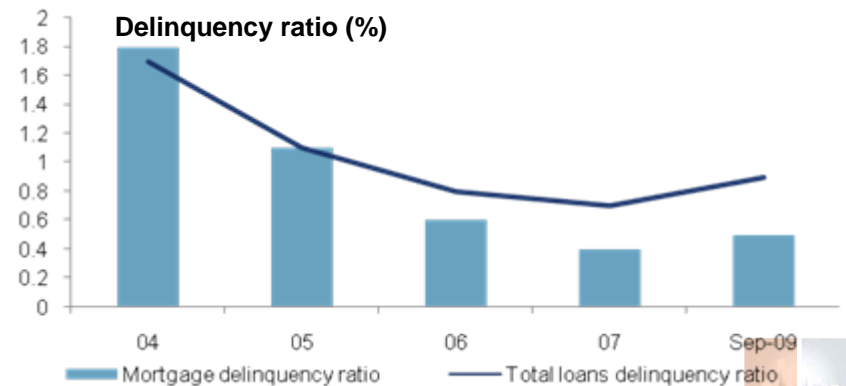
Ratio of Mortgage to Total Loans (Banks)

Mortgage/Total Loans Ratio (%)



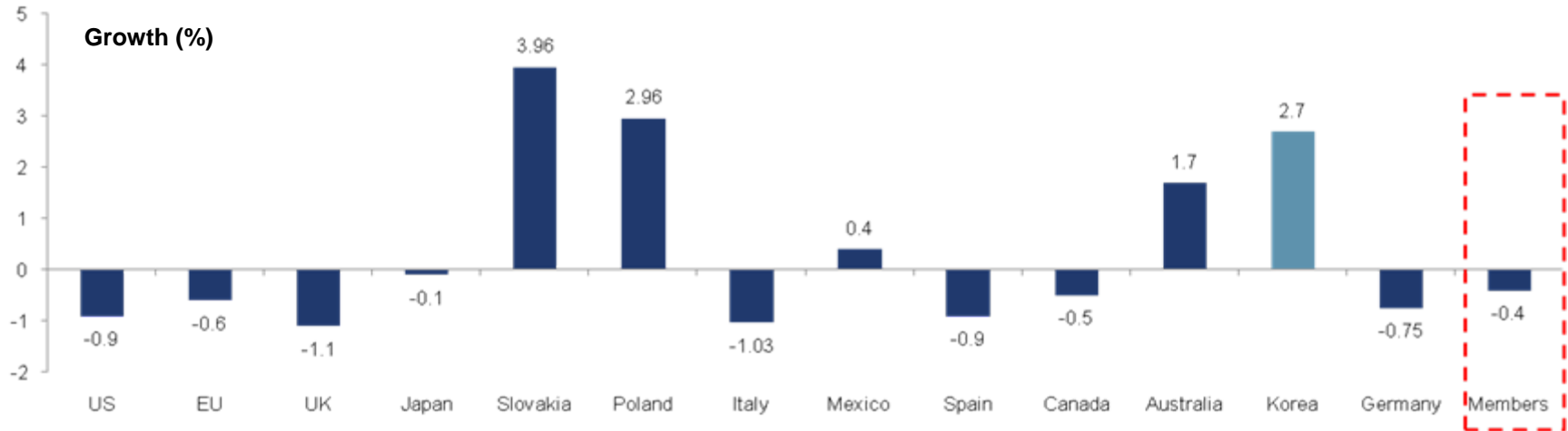
Delinquency Ratio of Mortgage Loans

Delinquency ratio (%)

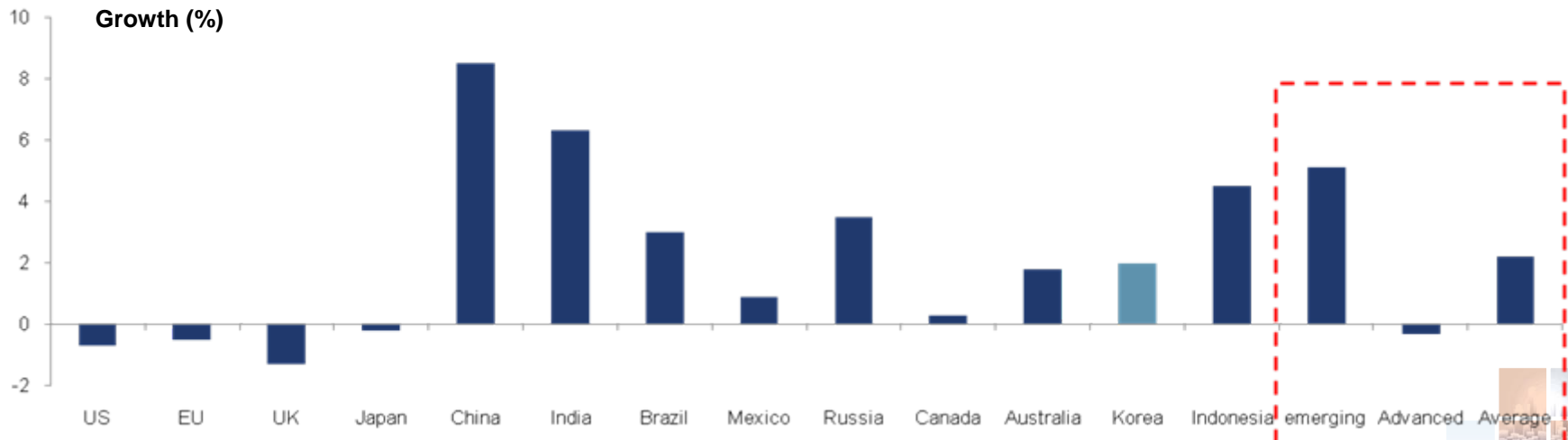


# #4 Growth Forecast: International Comparison

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



IMF Forecasts Korea's 2009 Economic Growth at 2%

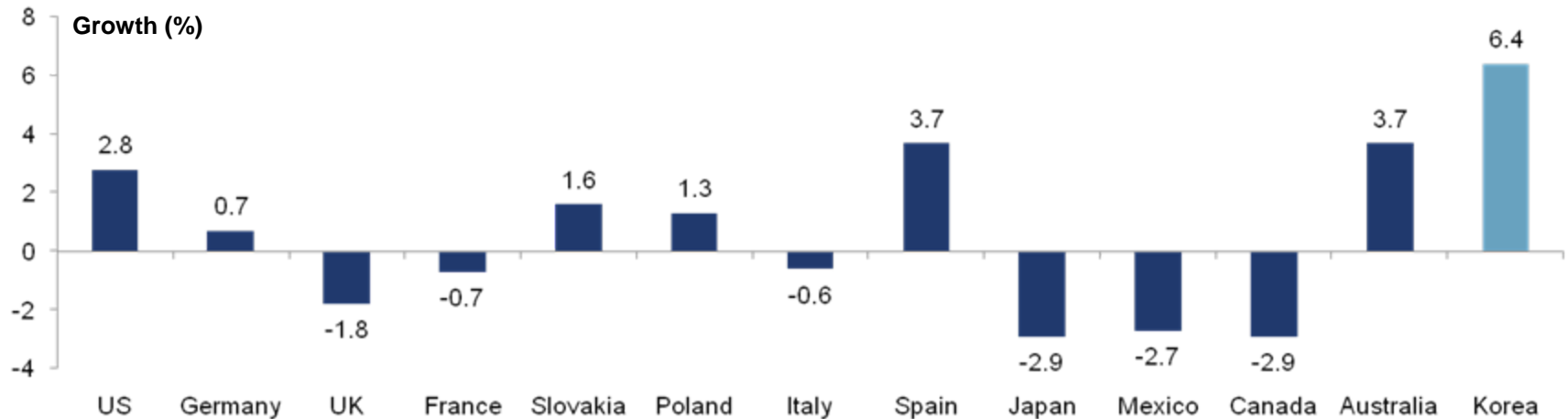


#4

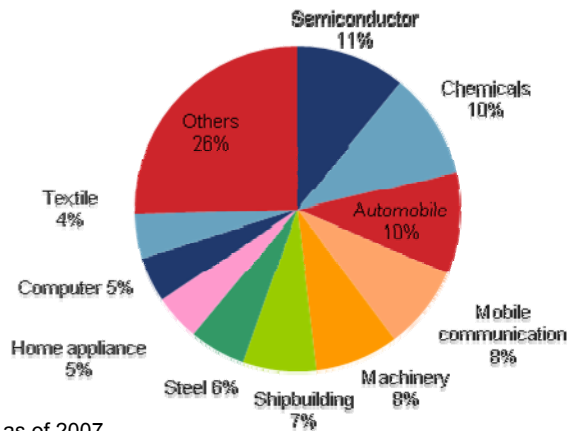
# Export Forecast: International Comparison

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

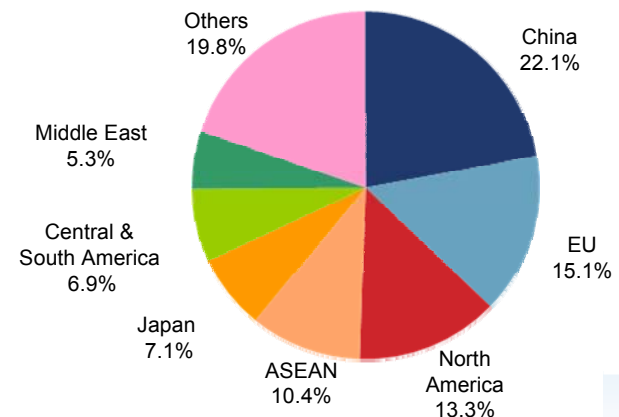
Highest Forecast of Total Exports Growth among OECD Members (OECD, Nov. 25)



Diversified Export Products



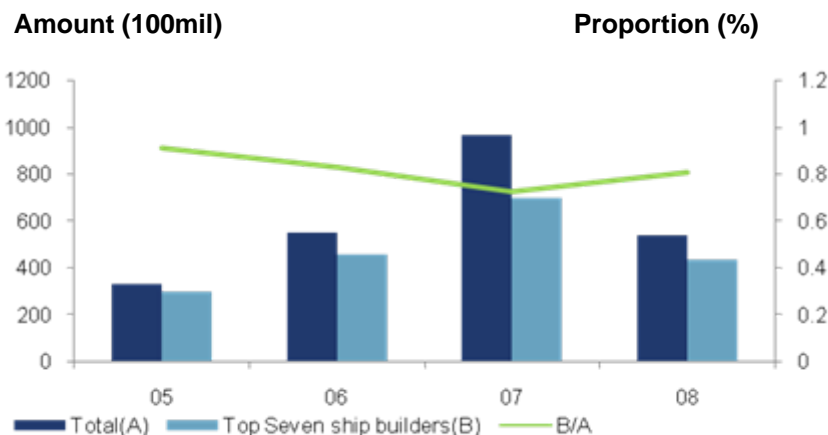
Diversified Export Markets



# #4 Better Positioned in Shipbuilding Industry

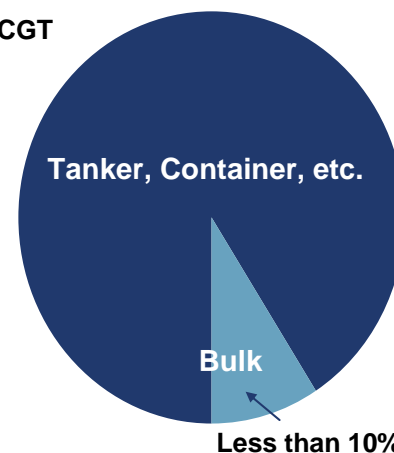
The recent deterioration of the global shipbuilding market will improve the position of top-tier Korean shipbuilding companies.

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

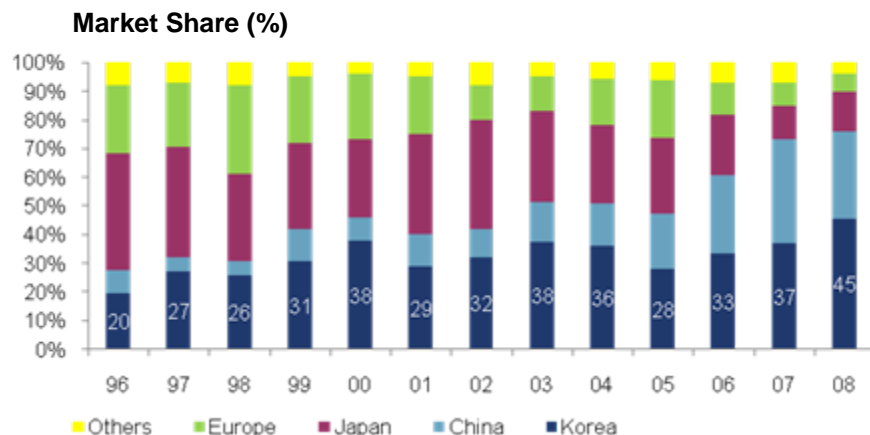


## Proportion of Bulk Carrier for Top 7 Shipbuilders

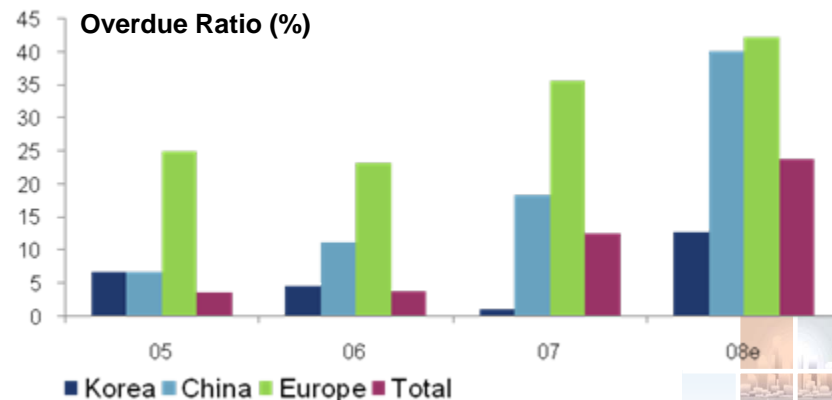
05~07 New Order, CGT



## 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)

# #3 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

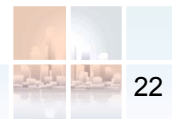
	Asian Financial Crisis (late 1997)	Current
Causes	Internal factors such as corporate bankruptcy	External factors
Foreign Exchange	Foreign Currency Reserves	US\$ 8.9bn
	ST External Debt / FX Reserves	US\$ 212.2bn <sup>1</sup>
	Liquid External Debt / FX Reserves	89% <sup>2</sup>
	Total External Debt / FX Reserves	107% <sup>2</sup>
Banks	Bank NPL Ratio	1957% <sup>2</sup>
	BIS Ratio	6.0% <sup>3</sup>
Corporates	Corporate Debt Ratio	10.8% <sup>2</sup>
	Corporate Interest Coverage Ratio	424.6% <sup>4</sup>
		106.5% <sup>4</sup>
		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



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