FAQs

On the Korean Economy

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Ministry of Strategy and Finance

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Q1 How has Korea reacted to the economic difficulties so far?

A The Korean government has worked on expansionary liquidity supply of USD55 billion, tax reduction of USD35 billion, and increased fiscal expenditure of USD16 billion.

The Korean government has taken preventive, decisive and sufficient policy measures to get out of the global economic turmoil. The measures mainly cover liquidity supply, FX market stabilization, and tax reduction and expansionary fiscal expenditure. To provide more liquidity in the market and lower interest rates, the Bank of Korea lowered a benchmark interest rate four times by 225bp from 5.25 percent to 3.00 percent. Also, the government has supplied the liquidity of KWR19,500 billion through RP purchases and credit limit raise for small- and medium- sized enterprises (SMEs).

Foreign liquidity supply of USD55 billion will have been provided with USD37.6 billion already provided by the end of Dec. '08. Currency swap arrangements with the US, Japan, and China, amounting to USD30 billion each, have been completed along with the IMF Short-term Liquidity Facility of USD22 billion fixed. The government guarantee on banks' borrowing in foreign currencies will total USD100 billion.

A total of USD35 billion tax reduction will have been implemented from '08 to '12 through an oil tax rebate and income/corporate tax reduction. Additional budgets of USD16 billion will have been allocated from '08 to '09, which are earmarked for overcoming economic difficulties including high energy prices.

Deregulations to boost corporate investment, various job maintenance efforts such as promoting employment of female, the young and old, and social safety net reinforcement are among other measures the Korean government has taken.

Q2 What are the key economic policies for 2009?

A The key economic polices for 2009 can be summarized as preparation for the future and job creation. The Korean government will take offensive measures to revitalize the economy and to become one of the most advanced countries in the world. The government will also make ongoing efforts to create more jobs, maintain current jobs and encourage sharing jobs.

The global financial turmoil brings uncertainty, and the Korean government will try its best to turn the uncertainty into an opportunity to join the top-class country group. The 2009 economic policy direction released at the end of 2008 contains measures to prepare for the future as well as measures to cope with the economic difficulties.

To overcome the economic difficulties, sixty percent of the 2009 budget will be executed during the first half along with measures to stabilize financial and FX markets. The government is working on strengthening the social safety net as well as promoting a job-sharing program. The government is also stepping up its efforts to upgrade the economy to prepare for the future. Measures such as supplying liquidity to financial institutions, corporate restructuring and nurturing human resources are all under the policy for future preparation.

A Korean-style New Deal has been laid out with its focus on expansionary SOC investment. To reinvigorate its economy, Korea will nurture future growth engines such as 'green industries', newly born converged industries and service industries. It also promotes the use of the Korean human resources in foreign countries, and plans to acquire more overseas resources by expanding overseas investment.

Q3 How is the outlook of the Korean economy for 2009?

A The 2009 economic outlook is optimistic. If preventive, sufficient and decisive measures are taken, the Korean economy will achieve what is planned to achieve.

The global economic weather surrounding Korea is not favorable as the global economic recession is not predicted to end soon. Major economies including the US, Japan and the Eurozone forecast negative growth rates for 2009. Developing countries are expected to suffer from a ripple effect from those major economies, whose financial institutions are collecting loans to developing countries. The Korean economy, too, is expected to suffer from low growth and employment.

* The World Bank's 2009 economic growth outlook (as of Aug., 2008, %):
(world) 0.9, (US) -0.5, (Eurozone) -0.6, (Japan) -0.1, (China) 7.5, (Korea) 2.0

<2009 growth outlook of the Korean economy by major institutions (%)>

	IMF	OECD	BOK[1]	KDI[2]	SERI[3]	FSC[4]	LGERI[5]
Growth Rate	2.0	2.7	2.0	3.3	3.2	1.7	1.8

However, the Korean government will do its utmost to achieve a growth rate of around three percent along with a current account surplus of more than USD10 billion and job increase of over a billion. Korea aims at making a complete economic recovery by 2010 and becoming one of the most advanced countries in the nearest future.

[1] The Bank of Korea
[2] Korea Development Institute
[3] Samsung Economic Research Institute
[4] The Financial Services Commission
[5] LG Economic Research Institute

Q4 What measures have been taken to generate and maintain jobs?

A The Korean government has taken measures to respond to further deterioration in the job market caused by a decline in the growth rate and corporate restructuring. It has focused on creating, sharing and maintaining jobs.

Although three percent growth is expected to add more than 100 thousand jobs[1], the job market could possibly be affected by worsening external conditions and full scale corporate restructuring, generating less jobs than expected. KDI (Korea Development Institute) and the BOK (Bank of Korea) estimated the number of job increases at 30,000 and 40,000 respectively. The number of those not seeking jobs is projected to increase as the job market contracts.

To maintain the current level of employment, expanded job sharing programs by reducing working hours and job-training programs for the young and vulnerable will be implemented. The government will raise its assistance given to companies maintaining employment rather than laying off by taking some portion of training expenses and closure allowance: The government will take three quarters of the expenses for SMEs and two thirds for large companies, an increase from two thirds and one half, respectively. The conditions of the assistance will be relaxed as the assistance will be given when production decline is expected due to ordering companies' production halts.

To support companies suffering from labor cost increases caused by working hour reduction, KRW2.4 million per worker will be provided quarterly instead of KRW1.8 million. The support program will cover up to thirty percent of all employees, a twenty percent increase from 2008. The government will also introduce a paid training leave program, and support seventy percent of trainees' pay and substitutes' pay.

48,000 young adults will find jobs as interns in SMEs and public firms along

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[1] real growth rate (%)   : ('07) 5.0,   ('08) 3.6,   ('09) 3.0
job increase (thousand): ('07) 282,   ('08) 150,   ('09) 100

with 125,000 people from a vulnerable class employed as social workers. 13,000 young adults will be trained in hi-tech industries and 19,000 to be raised as global leaders, preparing them for the future.

Q5 Are there welfare policies to assist the low-income class?

A Necessities and education will be guaranteed to the low-income class, while basic support will be given through employment policies.

The most effective welfare policy is to create more jobs for the vulnerable class. KRW24,700 billion will be invested in SOC projects such as the development of the four rivers and 'wide economic zones'. More social jobs will be made available, with the number of positions expected to increase to 125,000 in 2009 - up from 110,000 in 2008 - through expanded social services of childcare, handicapped self-support and nursing.

As the lower-income class is afflicted with the difficulties from the economic crisis, more support of necessities and basic education will be provided.

Living costs for the working class will be reduced. Those with earned monthly income below KRW1.73 million will receive a tax exemption, while those below KRW3 million will have their taxes reduced by 42.4% per annum. Support for education and medical fees will also be increased. Up to KRW2 million of education fees will be tax-exempted, and so will the medical fees up to KRW7 million. Through the EITC (Earned Income Tax Credit), families with a child/children, yearly incomes of up to KRW17 million, and total assets of less than KRW100 million will receive up to 1.2 million won, for which the total government tax expenditure amounts to KRW470 billion.

Emergency support for families in difficulties due to the loss of employment will be increased; so will the number of people receiving basic livelihood support. KRW1.32 million will be given to families with total assets less than KRW135 million if their business closes for up to 6 months, a total of KRW51.5 billion for 42,000 families, up from KRW37.8 billion for 31,000 families. Also, less strict regulations will apply for basic livelihood support in terms of total assets and the number of family members supported (the total amount of assets eligible for the support increased from KRW69 million to KRW85 million, and the total asset limits of families with support obligations increased from KRW95 million to

KRW126 million). 60,000 more people will receive these benefits, an increase to 1.59 million people (KRW7,200 billion), up from 1.53 million people (KRW6,900 billion) in 2008.

Childcare and education support for the low-income class and meal support for poorly-fed children will be provided. Free childcare support will be expanded to people with income below 50% of the national average. This will result in an increase to 630,000 people and KRW810.7 billion in 2009, up from 410,000 people and KRW496.9 billion in 2008. Free secondary school education for the lower class will also be expanded with beneficiaries of 386,000 students, up from 250,000. Those receiving basic livelihood support will be granted increased college registration fee support (KRW222.3 billion for 52,000 people in 2009, up from KRW70 billion for 18,000 people in 2008). Poorly-fed children will also receive increased support from the treasury, with KRW42.1 billion committed to providing meals to 454,000 children in 2009, up from 294,000 in 2008.

Support for housing will be increased through permanent rent and residential mortgage loans. 5,000 houses will be made available in 2009 with 30% lower rental rates compared to the market rates. Residential mortgage loans will be offered with maturities of 30 to 35 years and grace periods of 5 to 10 years.

The lower-income class will receive more scholarships and education fee support. Those living in poverty will receive scholarships of KRW222.3 billion in 2009, equivalent to KRW4.3 million per person, up from KRW70 billion in 2008. Also, more working scholarships of KRW109.5 billion, KRW3 million per person, up from KRW8 billion in 2008, will be made available to university students.

Budgets set aside for the lower class will be executed early with 70% being allocated for the first half. A more efficient welfare system will be instituted in order to execute the budget effectively.

Q6 May the fiscal policies undermine fiscal soundness?

A Fiscal policies such as tax reduction and fiscal expenditure expansion must play an important role to overcome the economic difficulties. Our finances are healthier than most OECD nations. Medium-long term efforts will be made to keep Korea's finances healthy through tax revenue and efficient spending.

The government is planning tax reductions and fiscal expenditure expansion in response to the economic difficulties.

Total tax reductions of KRW35,300 billion will have been given (long-term: KRW25,500 billion, short-term: KRW9,800 billion).

(Unit: KRW billion)

	Total	2008	2009	2010	2011	2012
◦ Long-term (compared to 2007)	-25,500	-1,800 (-1,800)	-9,600 (-11,400)	-10,600 (-22,000)	-3,300 (-25,400)	-100 (-25,500)
◦ Short-term*	-9,800	-4,400	-2,100	-2,500	-500	-300

* High oil price measures: KRW5,500 billion, fund support: KRW1,300 billion, temporary investment tax reduction: KRW3,000 billion

Fiscal expenditures will amount to KRW16,000 billion (2008~2009) including the 2009 adjusted budget plan: Revised supplementary budgets for high oil prices (KRW4,600 billion in 2008) and adjusted budgets to overcome the economic difficulties (KRW11,000 billion in 2009).

To overcome the ongoing economic difficulties, aggressive fiscal policies are required, including tax reductions and fiscal expenditure expansion. In time of worsening exports and domestic demand, aggressive fiscal policies are required to support the economy. Advanced nations such as the US and Japan are also responding aggressively to the global economic crisis through tax reductions and expenditure expansions.

* USA : USD168 billion tax relief (May, 2008), USD700 billion financial bailout (Oct. 3), 'New' New Deal programs announced by the president-elect, Barrack Obama (Dec.)

* Japan : A total of JPY11,700 billion support including tax reduction (Aug., 2008), a total of JPY26,900 billion including fiscal expenditure expansion of JPY5,200 billion (Oct.), approx. JPY20,000 billion under review

* UK : Promotion of both tax reduction and fiscal expenditure expansion announced by the UK PM, Gordon Brown (Nov.10, 2008)

* Italy : 30 billion euro support through tax benefits for the automobile industry

Korea's financial state is healthier than that of most OECD nations. National debts may increase temporarily amid responding to the economic difficulties, but they are more manageable than those of advanced nations. Debts likely to fall to deficit amount to 42% of the total national debts.

(Against GDP, %)

	Korea	US	Japan	UK	France	OECD Av.
Debt Ratio (2007)	33.2	62.8	170.3	47.5	69.4	75.4

The operation of national finances will be flexible according to the economic conditions, however medium-to-long term fiscal health will also be sought through efficient expenditures. It is expected that there will be more tax revenue when the economy starts to recover, helping relieve the fiscal burden. This was seen during the 1997 Asian financial crisis, when the fiscal account improved (against GDP, %: (1997) -1.4 → (1998) -3.9 → (2002) 3.3) as the crisis was overcome early with aggressive fiscal measures.

Q7 What are the reasons for greatly expanding SOC investments?

A As with other nations around the world, Korea greatly increased SOC investments to stimulate domestic demand and create more jobs. The provincial economies will receive more support through projects such as those for developing wide economic zones, called 30 leading projects, and for improving provincial small to medium-sized infrastructure, the purpose of which is to strengthen the provincial economies not to be affected by changes in business conditions. In the long run, these projects will contribute to reducing logistics costs, by which the economic capability of Korea will increase and the Korean people will enjoy more comfortable lives.

Nations around the world have introduced stimulus policies to fight against the world financial crisis. China and the US have expanded fiscal expenditures by investing in SOC projects. China will have invested CNY4,000 billion (KRW800 trillion) in creating infrastructure until 2010, while the US will invest USD25 billion (KRW37,500 billion) in SOC projects to create one million new jobs. According to Joseph Stiglitz, tax rebates for the middle-class are not enough to stimulate the economy, and SOC expansion policy is required.

The construction industry is known to be more effective in job creation. It also leads to increased production in related industries. A KRW1,000 billion SOC investment in the construction industry will bring production worth KRW2,000 billion in related industries, as well as create 18,000 new jobs. Also, workfare will be improved by employing the lower-class and having their income raised.

The provincial economies will be revitalized through the 30 leading projects and improvement projects for provincial small to medium-sized infrastructure. Support for the 30 leading projects to develop wide economic zones will be increased to KRW3,653.2 billion in 2009, up from KRW1,693.4 billion in 2008. The infrastructure improvement projects will involve projects to improve elevator facilities in train stations, fix roads in frequent accident areas, maintain drainage systems, renovate old houses and expand gas distribution systems.

Provincial SMEs will be encouraged to participate in such projects, which will also help create jobs in those regions.

Currently, KRW170 trillion is spent every year due to insufficient and unsafe traffic infrastructure (22% of GDP, KRW23,000 billion spent on traffic delays, KRW92,000 billion due to too much logistics fees, KRW40,000 billion on household transportation fees, and KRW15,000 billion on traffic accident damages). Comparing the Korean SOC stock with that of the OECD average, Korea's road infrastructure only takes up 67% of the OECD average, and railroad infrastructure 40% of it. According to IMD's National Competitiveness Rankings (2008), Korea ranks 23rd out of 60 nations in road density and 24th in railroad density.

There had been delays in SOC investments over the last 5 years (2004~2008), which also caused delays in construction. SOC investment increase during the period was 2.5 percent, a lot lower compared to total fiscal growth of 7.0%. Early completion of SOC projects will greatly improve the lives of the Korean people. In 2008, 41 projects were completed including the Janghang Line, but in 2009, 101 projects are planned to be completed including Seoul Subway Line 9.

Q8 What kind of fiscal policy has been taken to create new growth engines?

A The Office of the Prime Minister has taken the initiative in hammering out a plan to create new growth engines, scheduled to be finalized in January 2009. Fiscal support for the plan will be announced after new growth industries are singled out. R&D investments will increase by 53.9% to about KRW1,207.8 billion in 2009 from KRW784.9 billion in 2008.

Future food industries that will feed the Koreans for the next 5 to 10 years will be on the list of new growth industries. A taskforce, led by KAIST President Suh, Nam-pyo, proposed 22 new growth industries in six sectors in September 2008. The six sectors include energy, the environment, transportation, new IT technology, fusion technology industries, and knowledge services. Green cars, robots, LEDs (light emitting diodes), and marine biotechnology are among the 22 new growth engines. The taskforce recommended KRW99,400 billion in investments (KRW7,900 billion from the government and KRW91,500 billion from the private sector) over the next 5 years.
The Office of the Prime Minister has led the government-wide efforts to identify and finalize new growth engines.

<New growth engines (*preliminary*)>

Three sectors	17 new growth engines
Green Industry	New renewable energy, low carbon industries, advanced water treatment, LEDs, green transportation systems, high-tech green cities

Fusion Technology Industry	Broadcasting & telecommunications industries, IT fusion systems, robot applications, Fusion of new material & nano technology , Biopharmaceuticals (resources), Medical equipment, High value-added food industries
High value-added Industry	Global medical services, Global education services, Green finance, Culture content & software, MICE (Meeting, Incentive Travel, Convention, Exhibition), Fusion tourism

The Ministry of Strategy and Finance set aside KRW1,207.8 billion in 2009 to finance the 2009 New Growth Engine R&D project.

Q9 Are tax cuts necessary?

A Tax cuts aim to revive market vitality and create jobs, supporting a rebound of the Korean economy.

Lower rates and an advanced tax system are necessary to increase the economy's competitiveness under global tax competition. Other countries have shown a global trend that lowering tax rates is needed to promote free economic activity in the private sector. Since 2000, the average rate of maximum income tax has been cut by 4.5% (40.0% in 2000→35.5% in 2008), and the corporate tax rate by 6.7% (30.9% in 2000 →24.2% in 2008). Some countries such as Canada and Australia have even eliminated inheritance tax.

Korea's economic growth had been approximately 6 to 7% in the mid 1990's, but has fallen to 4% level recently. Korea's domestic demand has been largely weakened over the last decade unlike its competitors. Korea's investment and consumption growth have not been in line with its GDP growth.

It is time for the economy to rebound supported by tax cut policies. To address a possible economic crisis from the global economic downturn, it is essential to pursue tax cuts and expand fiscal spending at the same time.

Considering Korea's fiscal condition is stronger than that of advanced countries of the OECD, the Korean economy has enough room for running a fiscal deficit to a certain degree.

National debt ratio (2007, %): (Korea)33.2, (U.S.)62.8, (Japan)170.3, (OECD average)75.4

IMF has also indicated that tax cuts are needed to tackle current economic situations effectively. Major advanced countries have been pursuing active fiscal policies, including tax cut packages to overcome the current economic crisis.

Q10 Will lower economic growth in 2009 disrupt fiscal revenue?

A A 1% drop in economic growth may reduce national tax revenue by KRW1,500 billion to KRW2,000 billion.

Generally, a 1%p decrease in economic growth may reduce national tax revenue by KRW1,500 billion to KRW2,000 billion. When economic growth is lower than the government' expectations, revenue shortfall will inevitably arise. Therefore, revenue inflows should be examined thoroughly in 2009 and responsive measures should be considered, if necessary.

* Measures to make up for a revenue shortfall have already been crafted such as the revival of an oil tax (KRW1,300 billion of tax revenue) and tariff quota (KRW800 billion of tax revenue) as of late 2008.

Many factors affecting tax revenue as well as growth should be examined comprehensively to calculate next year's revenue shortfall. Tax revenue is also affected by structural factors such as a tax base along with economic cyclical changes. In 2007, KRW14,200 billion of additional tax revenue resulted thanks to structural factor changes such as a broadened tax base and taxation on actual-transaction prices. The excess resulted even though the economic indexes had not been largely different from the index projections.

Changes in other economic indexes causing a revenue increase need to be considered, including a foreign exchange rate hike.

Q11 Is it legitimate to reform the comprehensive property tax?

A Reforming the comprehensive property tax is a move to reform the system to be in line with tax principles and the ability to pay tax. It was an urgent issue in 2008.

Korea's property holding tax has a sharp progressive rate structure that imposes a heavy tax burden. As for the house property holding tax, property tax rates have a 20 fold gap between the lowest rate(0.15%) and the highest rate(3%), showing an enormous progressive rate structure.

Most countries have a proportional rate structure (the US, Japan, UK, Germany, etc.). Even in the cases of countries with a progressive rate system, they show a moderate progressive rate. The maximum rate of Taiwan's holding tax is 5.5% and the minimum is 1.5%, which shows a 3.6 fold gap.

Korea's Price Income Ratio(PIR)* is high. Therefore, it has a heavier tax burden per income than other countries, even though the holding tax rate is the same.

Seoul has a higher PIR (9.8) than New York (7.2) or Tokyo (5.0)

* PIR : Index to calculate home ownership ability (Median house price/median income, in Korea the price of a house at time of purchase/annual income)

< PIR Comparison in major countries (as of 2006) >

New York	Boston	LA	Washington	Vancouver	Toronto	Metropolitan area in Japan
7.2 (5.8)	6.2 (5.0)	11.4 (9.3)	5.6 (4.5)	7.7	4.4	5.0

* ( ) reflects housing price drops of 18.8% from July 2006 to June 2008.
(Report from Standard and Poor's(S&P))

< Comparison of the holding tax burden per income in major countries >

(PIR in 2006/ effective tax rate in 2003)

New York	Boston	LA	Washington	Vancouver	Toronto	Metropolitan area in Japan
5.5 (4.4)	8.9 (7.1)	12.2 (9.8)	5.9(4.7)	7.7	4.4	5.0

* ( ) reflects housing price drops of 18.8% from July 2006 to June 2008. (Report from Standard and Poor's(S&P))

Holding taxes (including the comprehensive property tax, property tax, surtax) for people with annual income of KRW40 million or less (34.75% of total taxpayers) account for 46.23% of their income.

< Holding taxes per income in each income bracket (as of 2007, %) >

Total income / Type	Total	40M or less	40 M to 60 M	60 M to 100M	100M to 300M	300M to 500M	More than 500M
Percentage of the number of people in total	100	34.75	9.67	15.92	27.08	5.84	6.74
Holding tax burden per income	5.27	46.23	15.60	9.86	5.53	2.87	1.27

* Data Samples of 10,779 households, among comprehensive property taxpayers (380,000 households) as of house prices in 2007

Korea's per capita GNI is lower than that of advanced countries. The share of real estate in household asset holdings is high. Therefore, the holding tax burden in real term is high.

< Comparison of per capital GNI in major countries as of 2007, US dollars) >

Korea	US	Japan	UK	France	Germany	Canada
20,045	46,040	37,670	42,740	38,500	38,860	39,420

*The share of real estate in household asset holdings: Korea's 76.8% is higher than Japan(61.7%), Canada(50.0%), US(38.9%), France(56.7%.)

The tax is not consistent with tax principles and holding tax systems in general. First, it conflicts with the 'principle of universality'. The tax goes against the principle of universality by imposing too heavy a tax burden on an extremely small number of taxpayers (2%of the total households.)

Second, the tax conflicts with the 'benefit principle'. The holding tax covers an expense of local governments' services in general, but the comprehensive property tax is a national tax.

It is desirable to manage the property tax as a local tax item according to the 'benefit principle' (OECD Korean economic survey, June 2007). It is also desirable to incorporate the comprehensive property tax in the property tax. (A policy seminar of Korean Association of Public Finance, January and August 2008)

The tax burden is heavy as taxes are imposed on a market price basis (officially assessed land price), which is measured every year. Assessment costs are high and the assessment can be made arbitrary.

Q12 On what basis is Korea's foreign exchange rate policy?

A The main goal of Korea's foreign exchange rate policy is to maintain an environment where FX rates reflect demand and supply in the foreign exchange market and the economic fundamentals of Korea.

However, in 2008 the Korean won was drastically depreciated due to the current account deficit, net equity selling by foreign investors, and instability in the global financial markets. So, in this light, the Korean government has tried to curb herd behavior arising from excessive expectations towards massive depreciation of the currency.

Since September 2008, foreign currency liquidity conditions have been deteriorating because of the global credit crunch. Thus, the Korean government has planned to provide liquidity supply amounting to USD55 billion. This includes USD8.2 billion to support trade financing and USD29.5 billion to support domestic banks through competitive auction facilities. As of December 24, 2008, USD37.6 billion (68% of the total liquidity supply) have been injected.

< Major indicators >

	Dec '07	Jan 08	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
Current account	-8	-28	-24	-1	-16	-4	18	-25	-47	-12	49	-
Net equity buying by foreigners	-2.8	-8.9	-2.1	-4.5	-1.0	0.9	-5.2	-5.0	-3.2	-3.0	-4.9	-1.9
Dubai (USD, billion)	86	87	90	97	103	119	128	131	113	96	69	51
Monthly average exchange rate	930	942	945	989	987	1,037	1,029	1,019	1,042	1,137	1,327	1,401

Q13 Was the won appreciation a right decision?

A Any foreign exchange policy should be in line with the fundamentals of the economy as well as supply/demand in the market.

The Korean government's position in foreign exchange policy has been that it should reflect the fundamentals of the economy and supply/demand in the market. However, there has been some misunderstanding that the Korean government deliberately took the won appreciation policy. The Korean government has never taken a foreign exchange policy which does not reflect the economic fundamentals.

From '05 to '07, the value of the won had been rising while current accounts had narrowed their surplus.

<Average Exchange Rate and Current Account Balance of Korea and Japan since '03>

($ billion)

		'03	'04	'05	'06	'07
Korea	Average Exchange Rate	119.2 (-4.7)	114.5 (-4.0)	102.4 (-10.5)	95.6 (-6.7)	92.9 (-2.8)
	Current Account Balance	11.9	28.2	15.0	5.4	6.0
Japan	Average Exchange Rate	11.6 (-7.4)	10.8 (-6.7)	11.0 (2.0)	11.6 (5.5)	11.8 (1.2)
	Current Account Balance	136.2	172.0	165.7	170.4	212.8

(an average rate of changes in foreign exchange, y-o-y)

<Appreciation rates of major Asian currencies, %>

	Korea	Japan	China	Taiwan	Singapore	Thailand	Philippine
Jan. '02~ Oct. '07	45.8	14.5	10.9	8.0	27.8	29.9	18.0
Jan. '02~ Nov. '08	-10.6	37.8	21.1	5.0	22.9	24.6	5.6
Jan. '04~ Dec. '07	27.4	-4.5	13.4	4.9	18.0	33.0	34.7
Jan. '04~ Nov. '08	-18.8	12.2	21.1	2.0	12.9	11.7	13.7

'02: the won appreciation started

'04: the won appreciation on a full scale

July '07: the won hit the highest at 900.7/USD

The won depreciation started in Dec. '07 following the deficit in current account balance. There has not been an artificial foreign exchange rate intervention by the government.

This year's won depreciation is due to the current account deficit, capital account deficit caused in part by foreign capital escaping from the Korean stock market, high oil prices and unbalanced supply/demand in the market. After July, the government used a smoothing operation to fix the unbalanced market. However, this kind of government intervention seems to be approved by the IMF as it said that IMF member countries should intervene in their FX markets to cope with fluctuating FX rates.

The intervention worked in the market, and Nomura Securities called the intervention a success in using FX reserves to curb rising prices and further depreciation of the won. Especially after August, net equity selling by foreign investors has increased, and capital inflow from foreign countries has decreased, inviting the Korean government to take a smoothing operation.

< FX market Index >

	Dec. '07	Jan. '08	Feb.	Mar.	April	May	June	July	Aug.	Sep.	Oct.	Nov.
Current Account (USD bil.)	-0.8	-2.8	-2.4	-0.1	-1.6	-0.4	1.8	-2.5	-4.7	-1.2	4.9	-
Foreign Net Selling (KRW trillion)	-2.8	-8.9	-2.1	-4.5	-1.0	0.9	-5.1	-5.0	-3.2	-3.0	-4.9	-1.9
Dubai ($/B)	86	87	90	97	103	119	128	131	113	96	69	51
Monthly Average FX rate	930	942	945	989	987	1037	1029	1019	1042	1137	1327	1401

Q14 Are Korea's FX reserves large enough to weather the global financial crisis?

A Korea holds the 6th largest foreign exchange reserves in the world, which is sufficient to cover external payment obligations.

As of the end of November 2008, Korea's foreign exchange reserves stood at USD200.5 billion. This was down USD11.7 billion from the previous month. However, the FX reserves are still sufficient enough to cope with external payment demand. Of the domestic banks' external debts, the amount to be redeemed in 2009 will be only USD48.8 billion.

The current account has also turned to a surplus, posting a USD4.9 billion surplus in October 2008, and an approximate USD2 billion surplus is expected in November 2008. Supported by the continued trend of the current account surplus, Korea's external fundamentals have improved.

Furthermore, considering a USD30 billion swap line agreement with the U.S., a USD30 billion swap deal with Japan, and a USD30 billion swap agreement with China, it is fair to say that Korea has ample foreign exchange reserves. Of the USD30 billion swap line arrangement with the U.S., USD10.4 billion were provided in December 2008, and the remaining USD19.6 billion may be injected in the future.

Q15 What is Korea's role at G-20?

A Korea, for the first time in its history, actively participates in restructuring the financial market and fulfills its role as a rule-setter. And this reflects Korea's rising status in the international community. It also provides an opportunity to further upgrade Korea's presence in the international community.

South Korea actively takes part in the global collaboration to cope with the financial crisis. Such movement is based on our belief that policy coordination is needed more than ever to surmount the international financial difficulties.

The Korean government will try to turn G-20 into a major cooperation mechanism between developed countries and emerging countries through the next G-20 leaders' meeting scheduled to be held on April 2, 2009. As one of the 2009 G-20 troika along with Brazil and the United Kingdom, and as a G-20 chair country for 2010, Korea will take the lead in discussing issues such as improving the international mechanism to stabilize short-term capital flows. We will also reiterate that coordination of macroeconomic policies and reform of international financial institutions are necessary to ride out a possible economic recession.

At home, the Korean government has made every preparation for G-20, closely working with the private sector. "G-20 Task Force" team will be established, consisting of "G-20 Advisory Committee" and other concerned parties including the Prime Minister's Office, the Ministry of Strategy and Finance, the Ministry of Foreign Affairs and Trade, the Financial Services Commission, the Financial Supervisory Service, the Bank of Korea, and economic research institutes.

Q16 Is the downsizing of public organizations necessary at this time of economic downturn?

A Since inefficiency and bubbles in the public sector have incurred burdens on the Korean economy, it is vital to eliminate inefficient elements and bubbles in bad economic times. The transfer of public organizations' businesses to the private sector will lead to private sector-initiated job creation.

The higher efficiency and productivity public organizations have, the more vitality and higher value-addedness the overall economy will enjoy. Competition will facilitate the transfer of public organizations' businesses to the private sector. For example, public-private partnerships (PPP) are not merely job cuts in the public sector, but rather the transfer of jobs to the private sector. Nevertheless, public organizations' downsizing will take place in a multi-phased progression over the next 3 to 4 years in order to cushion the blow of mass layoffs. As part of the efforts to stabilize the job market, attrition and voluntary retirement will be taken advantage of over the next 3 to 4 years. New hirings will take place in proportion to job cuts.

Q17 What triggered the move to raise managerial efficiency of public organizations?

A Since public organizations have developed excessive bubbles over the past 5 years, reforms of public organizations are required to help Korea restructure itself to move to the next level. Removal of bubbles and inefficiency in the public sector will result in private sector-driven job creation.

Between 2002 and 2007, the number of public organizations swelled to 305 from 260, and the number of public-sector jobs jumped by 21% or 40,000 to 228,000 from 188,000. The share of public organizations in the Korean economy has continued to grow, putting the brakes on growth in the private sector. The total budget allocated to the public sector increased to 33.6% in 2007 from 31.0% in 2002 as a percentage of GDP. Moreover, public sector employment accounted for 1.08% of the total employment in 2007, up from 0.82% in 2002.

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On the Korean Economy

Jan. 2009

Financial Services Commission

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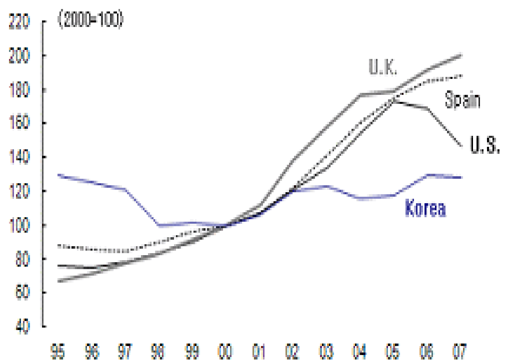
Q1 Recent Contraction in the Real Estate Sector and the Reliability of LTV Ratio

A The rapid increase in mortgage loans from 2005 to 2006 has slowed in 2007, but the housing price continued to increase 7.5%. The current LTV ratio at 48.8% is based on the value of the homes at the time of taking out the loans. Therefore, it is slightly exaggerated taking into consideration the rise in value.

The recent price decline in housing sector in Korea is, by far, not as drastic as other parts of the world and it is not considerable enough to be a cause for concern at this point.

The average annual price increase in housing in Korea from 2001 to 2007 was 6.7%. This is far less than in the U.S. and U.K., 9.4% and 12.6%, respectively. From January to July of 2008, Korea's housing price rose steadily by 3.9%, whereas declines of 3~14% have been witnessed in other countries.

<Housing Price Comparison >



<Rate of Change in Housing Price (yoy)>

An important aspect of the rise in mortgage loans in Korea is that they are mostly issued to high-income earners, thus the risk of default is very limited.

* The debt level of low-income households (1~3 levels) have seen a decrease in 2006 compared to 2000, whereas level 5 income households have seen an increase from 34% to 40% (KDI, Nov. 2008).

Q2 **Mortgage Loans: Comparison of Korea's PIR (Price-to-Income Ratio) to the rest of the world and the concern over the increase in Interest-Repayment Burden (Interest rate x PIR x LTV)**

A The 2007 PIRs in Korea and Seoul (6.6x and 9.8x, respectively) are relatively higher than other parts of the world.

* U.S./N.Y.(3.5x/9.4x[2006]), Japan/Tokyo(6.8x[1995]/5.6x[2001]), U.K./London(3.4x[2000]/4.7x[2001])

However, it is unreasonable to compare only the PIR ratios, because in terms of the *interest-repayment burden, it includes the interest rate and the LTV ratio of which Korea's figure is much lower than most developed nations.

** PIR x LTV x Interest Rate

	Korea (2008.6)	U.K. (2006)	U.S. (2006)	Japan (1990)
LTV(%)	48.8	90	86.5	110

Since Korea is still one of the rapidly advancing economies, the wage increase is faster and the financial debt compared to GDP, as well as the mortgage delinquency ratio, is lower. The government has a variety of measures available for implementation to reduce the interest burden on households.

* Annual wage increase(2003~2007): Korea 6.7%, U.S. 3%, U.K. 1.9%
* Personal debt to GDP: Korea 83.4%08.6, U.S. 99.5%07.3, U.K. 98.9%, Japan 67.4%
* Mortgage delinquency ratio: Korea 0.4%08.9, U.S. 3.8%08.1Q

In the wake of the financial crisis and the economic downturn, the Korean government announced a set of measures to ease the burden on household debt repayent (Oct. 21).

** For example, extending the term of the loan from 3 to 5 years, adjusting duration from 15 to 20 years, and encouraging the switchover to fixed-rate payments

Q3 Concerns Over Possible Loan Insolvencies Owing to Sudden Increase in SME Loans

A Corporate loan fluctuation is pro-cyclical. Between 2004 and 2005 when the economy was in recession, SME loan growth was sharply reduced. However, it grew rapidly since 2006 when the economy was in a recovery phase.

< SME Lending Trend (KRW trillion, yoy %) >

	2002	2003	2004	2005	2006	2007	End of Sept. 2008	End of Oct. 2008	End of Nov. 2008
SME Loans	202.9	237.9	245.2	258.0	303.3	371.7	418.5	421.9	424.5
Rate of Increase	22.6	17.2	3.1	5.1	17.6	22.6	17.3	15.4	13.1

SME financing grew more dependent on loans owing to the lack of direct financing such as IPOs and to the underdeveloped high-yield bond market.

* The ratio of corporate debt to GDP has constantly been higher relative to other developed nations with advanced direct financing structure.

The current level of SME loan is not high enough to trigger a systemic risk. SME loan delinquency ratio is stable at around 1.4%. Preemptive policy measures and liquidity packages have been placed to support liquidity to SMEs. Fiscal soundness of domestic corporations has enhanced the capacity to cushion impacts.

* Corporate management analysis by the BOK (5149 companies with more than 2.5 billion won of annual revenue)

  - Debt Ratio: (1997) 424.6% → (2007) 106.5%
  - Interest Coverage Ratio: (1997) 115% → (2007) 404.8%

Q4 Policy Measures in Response to the Decline in Bank Lending and Increasingly Problematic Credit Crunch

A Banks' reluctant stance on lending may lead to a reduction in corporate loans, but there are no signs of early recollections. The level of lending by large corporations remains stable while the growth rate of SME loans showed a slowdown, but it is still on a rise.

< Bank Lendings >

(Unit: KRW trillion, end-period increase/decrease)

		'07.	'08.1.1~ 11.20	Sep	Oct	Nov	12.1~11	Outstanding (08.12.11)
Bank	Total Lending	104.0	99.7	9.0	12.8	7.1	3.0	927.8
	Corporate lendng	82.0	79.4	6.8	10.6	5.0	2.1	516.5
	(Large companies)	13.8	26.5	3.9	7.2	0.7	2.5	92.7
	(SME)	68.2	52.9	2.9	3.4	4.3	-0.4	423.8
	Household loans	17.6	16.4	2.1	1.4	1.9	0.7	385.4

The government and the central bank are actively mapping out policy response measures to increase corporate liquidity. They include the following:

Provide liquidity through launching P-CBO (KRW 3tn); Increase public guarantee through Korea Credit Guarantee Fund and Kibo Technology Fund (KRW 11.5tn); Capital injection to policy banks (KRW 3.3tn).

Interest rate cuts by the Bank of Korea (125bp in October) and raising the ceiling of BOK's aggregate credit ceiling loans (KRW 6.5tn to KRW 9tn). Signing MOUs with banks in the process of guaranteeing external debt to maintain stable level of SME loans. Further restructuring efforts will be made to prevent the spreading effects of insolvent companies. Examples are as follows:

Run pre-workout programs such as Lenders Agreement and Fast-track Program to ease temporary liquidity shortage. Carry out market friendly corporate restructuring in accordance with existing corporate restructuring process. (Corporate Restructuring Promotion Act and Creditors Agreement, etc.)

Q5 Restructuring Plans for Insolvent Construction Companies and Shipbuilders

A Approach a three-track basis to restructure the construction and shipbuilding industries based on the evaluation of the management and fiscal health.

① Viable companies experiencing temporary cash shortages
⇒ Implement pre-workout and fast-track programs

② Viable companies showing signs of insolvency
⇒ Carry out restructuring led through lenders or through court

③ Unviable companies
⇒ Liquidate through bankruptcy proceedings

Pursue restructuring efforts based on the knowledge and experience gained through the past financial crisis

A pre-workout program will be operated temporarily since it is intended to support companies with temporary liquidity problems.

Lenders Agreement will be available for admission until February 2010 and member companies will be given maximum of one year of roll-over debts maturing within a year since becoming a member.

The fast-track program will remain in operation until June 2009.

A joint task force was launched by the FSC and the FSS on November 28 to increase the efficiency in liquidity support and to coordinate corporate restructuring efforts.

Q6 Measures for the Construction Industry

A While constructors have continued to post operating profits, liquidity issues have arisen owing to increased unsold new houses, triggered by reduced housing demand.

* The figure stands at 16100 (13800 for local areas) as of the end of July 2008, which is higher than the level during the Asian financial crisis (10300).

<Operating profit · Operating cash flow (KRW hundred million, %)>

	2005	2006	2007	'1H07*	'1H08*
Operating profit (per company)	55	54	57	286	300
Operating cash flow (per company)	△4	△1	△31	△284	△471

* Based on 72 listed companies

The government will help ease temporary liquidity problems in the construction industry and promote restructuring of marginal companies.

① Among unsold new houses, only 40,000 have been completely constructed. The distribution of these homes will be manageable within the public sector and the market.
  * Private real estate funds will be constructed through strengthened public guarantee and will be used to purchase unsold homes under the repurchase agreements (KRW 2tn).

② As for unsold houses that have not been completely built, the government will provide liquidity by purchasing the land owned by constructors (KRW 3tn max.)

③ The government will boost the construction business through rationalizing of reconstruction regulations and anti-speculation laws.

④ Liquidity will be provided to companies with temporary shortage of liquidity through the support of P-CBO issuance.

Q7 Response Measures by the Government and the Central Bank for the Liquidity Crunch in the Domestic Currency

A The principal factor for the credit crunch is the deepening of risk adverseness as the volatility in the global financial market and international economic recession spread to the domestic financial market.

The liquidity conditions for banks and large corporations have improved, while they worsened for the relatively weaker sectors such as non-bank institutions, SMEs, and corporate bonds due to frictional liquidity shortage.

<Major capital market trends>

(Unit: KRW trillion, end-period increase/decrease)

		2007	2008	2008.9	Oct.	Nov.	12.1~11
Bank deposit		8.4	92.3	12.1	26.8	9.5	-12.0
Bank loan	Large Corporation	16.1	35.5	3.9	7.2	0.7	2.5
	SME	68.4	52.9	2.9	3.4	4.3	-0.4
Corporate bond yield (AA-)*		6.77%	-	7.76%	8.13%	8.56%	8.82%

* as of year end and month end (FSS figures)

The government and the Bank of Korea (BOK) are pursuing various measures to ease liquidity problems in the market. The BOK is injecting liquidity through open market operations and expanding eligible securities for open market operations as well.

- It also established a new mechanism to supply liquidity by linking the BOK, the securities sector, and the secondary lending sector.

The government will increase public guarantee (KRW 11.5tn), increase lending through policy banks (KRW 3.3tn), and launch P-CBOs (KRW 3tn) to support the SMEs and other weak sectors. Establishment of the Bond Market Stabilization Fund (KRW 10tn) is currently underway as well.

Q8 Risk of Derivatives and Their Transaction Volume

A There are not yet much transactions for complicated derivatives in Korea. Active transactions are underway for derivatives such as KOSPI 200 but the transaction volume for OTC derivatives are minimal.

The amount of OTC derivatives in June 2008 stood at USD 5.9 trillion, which is only around 3.4% of the U.S. (USD 172tn) and 23% of Japan (USD 25.7tn)

< OTC derivatives outstanding (end June 2008, KRW billion) >

	Total	Bank	Securities	Insurance	Trust	Etc
Transactions of OTC derivatives in 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 rate	3296.5	3218.8	71.2	2.3	1.8	2.3
Currency	2746.2	2670.8	16.7	24.5	3.2	1.7
Credit	4.5	3.6	0.98	0	0	0
Etc	9.1	8.9	0.3	0	0	0

The ratio of derivative assets to total assets* is 2.0%, which is significantly lower than the ratio of 19.7% for commercial banks in the U.S.

* Gain on valuation of outstanding derivative contracts is calculated as derivative assets (ISDA standard)

< Ratio of derivative asset to total assets as of end of March 2008 >

(KRW trillion, %)

	Domestic bank	Foreign bank	Domestic securities company	Foreign securities company	Insurance	Total (Excluding foreign banks)	Total (Including foreign banks)	U.S. Commercial banks
Total asset(A)	1,523	198	120	11	371	2,025	2,223	9,046
Derivative asset(B)	36	43	2	2	1	41	84	1,780
Ratio(B/A)	2.4	21.9	1.8	17.0	0.4	2.0	3.8	19.7

*Stats by FSS

To date, no problematic derivatives have been examined except for KIKO. In particular, internationally problematic credit derivatives take up only 0.07% of the total OTC derivatives.

Q9 KIKO Related Losses

A Although KIKO-related losses stemming from the depreciation of the Korean won have become a social problem, the actual losses are somewhat exaggerated.

These contracts are designed to hedge the currency movement, used by exporting companies, and the only companies facing difficulty are the ones that made excessive hedging* for their export advancements. As of the end of October, there are only 55 companies under this condition. (487 companies in total have KIKO contracts.)

* On September 16, Taesan LCD filed for legal management, due to their combined usage of KIKO and Pivot Contranct, resulting in excessive hedging of 500% of their export advancement.

As for the companies that did not hedge excessively, they will be able to make foreign exchange gains even when taking into account the KIKO related losses.

KIKO-related losses of certain companies will eventually depend on court ruling. However, the FSC, as the regulatory authority, will enforce measures to improve the structural weaknesses of improper derivatives selling by banks.

Q10 **The high percentage of companies with interest coverage ratio of less than 100% and the low corporate delinquency ratio in the financial sector seem to be contradicting.**

* According to BOK's financial stability report (Nov. 2008), the percentage of listed companies with lower than 100% interest coverage ratio is 33.3%

A When a company's interest coverage ratio or net interest coverage ratio falls below 100%, it does not necessarily mean that it is unable to pay the principal and interest or be classified as potentially insolvent companies.

A company's operating profit may fluctuate significantly year to year. Thus, it is difficult to classify a company as an insolvent one just because it reported a loss for the current term, especially when it has retained earnings from the previous term in their books.

In this context, a company is normally deemed insolvent when it reports interest coverage ratio below 100% for three consecutive years.

As for the loans of companies that reported for three consecutive years, up to 234 companies among the companies up for examination, below 100% amount to KRW 10.0tn, 1.95% of total banks' loans for corporate sector.

The overall interest coverage ratio for approximately 1500 listed companies that are up for examination in December is 1142%, showing a good cash flow operation.

However, it is expected that marginal companies will face insolvency due to the lack of ability to absorb impact from the economic volatility.

Nevertheless, the interest coverage ratio must take into account the following:

① The high percentage of companies with less than 100% interest coverage ratio is not related to recent events. The percentage has been over 30% since 2006, and importantly, this has not led to any rise in delinquency or difficulty in corporate financing.

< Interest Coverage Ratio (%, BOK) >

	Less than 100			More than 100	Interest revenue> Interest cost	Total
		Operational Loss	0~100			
2006	30.4	25.5	4.9	42.0	27.6	100.0
2007	32.8	27.3	5.4	39.2	28.0	100.0
2008	33.3	26.7	6.6	38.5	28.2	100.0

② After the previous Asian currency crisis, a series of systemic improvements have been put into place. They include pre-workout programs for restructuring, Corporate Restructure Act, and Bankruptcy Act.

The government plans to run a two-track approach of supplying credit to the viable companies and restructuring marginal companies to minimize any negative effects arising from the corporate sector

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Bank of Korea

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Q1 Operational Direction of Monetary and Credit Policies in 2009

A

(Direction of Operation of the Base Rate)
The Base Rate will be operated with a focus on improving economic activity and financial market conditions.

Positive steps will be taken to counter the possibility of a further deterioration of the economic situation in the course of an intensification of the financial turmoil by the lengthening of the business downturn.

The influence on the domestic economy of the trends of the international financial markets and world economic growth will be preemptively reflected in its operation.

(Easing the Credit Crunch)
Positive encouragement will be given to the flow of funds to those areas to which the supply of credit has been constricted.

By way of open market operations, term RPs involving credit securities and the buying and selling of RPs with non-bank financial institution counterparts will be expanded.

So that banks can expand their credit supply capacity, positive support will be given to their efforts to raise BIS capital adequacy ratios. Funding support will be pursued for the government's planned 'Bank Capital Expansion Fund', as it has been provisionally termed.

Plans are being studied to ease the credit crunch by, for example, the active supply of liquidity in the event of a further decline in the financial markets' function of funds intermediation.

(Securing the Foundation for Financial Stability)
The monitoring system that closely tracks market movements will be further

consolidated in order to promptly counter market unrest. Policy coordination with the government on financial stability will be strengthened.

The pooling of information and materials with the government and financial supervisory authorities will be stepped up in order to detect at an early stage symptoms of abnormality in financial markets or at individual financial institutions.

Financial cooperation with the central banks of principal countries and multilateral financial agencies will be strengthened.

(Heightening Policy Efficiency)

The Bank of Korea will improve the conditions for the use of its monetary policy tools including open market operations and the lending facilities.

A fungible issue system and a priority system for fixed rate tenders will be introduced so as to improve the efficiency of the issuance of MSBs.

Improvement of the system of collateral will be pursued including the expansion of the collateral eligibility of debt securities and the introduction of a haircut on the value of collateral.

The Bank will augment monetary policy predictability and transparency. It will strengthen communication by way of a written statement setting out the direction of monetary policy.

Q2 Countermeasure against volatile money market despite expanded liquidity supply

A

The BOK and the government continue to make efforts to prevent a credit crunch in the capital market.

* The BOK ① cut the Bank of Korea Base Rate five times by a total of 275bp and ② supplied a total of 19.5 trillion won through open market operation and raising the aggregate credit ceiling since the bankruptcy of Lehman Brothers (on Sep 14).

* The government invested a total of 5.62 trillion won to public financial institutions (1.85 trillion won in 2008, 3.77 trillion won in 2009).

The BOK continues to make efforts to ensure smooth fund supply.

① The BOK continues to supply abundant liquidity to markets.

- Expanding the supply of liquidity by purchasing more long-term RPs
- Exploring ways to decrease the reflux of money into the central bank

② The BOK directly supplies liquidity to the needed areas

- Supplying funds amounting to 50% of the Bond Market Stabilization Fund (up to 5 trillion won)
- Planning to supply funds, in loans, equal to 10 trillion won to the Bank recapitalization Fund (20 trillion won) (subject to the approval of monetary policy committee meeting).
- Designating more securities firms as eligible counterparties for the BOK's RP operations (on Dec 11, securities firms eligible as counterparties for the BOK's RP operations : 2→14) to provide emergency liquidity to them

③ The BOK Further expands fund supply to Small- and Medium-sized Enterprises (SMEs) and other industrial settings by aiding public financial institutions with their capital increase

＊ The government invested a total of 5.62 trillion won to public financial institutions (1.85 trillion won in 2008, 3.77 trillion won in 2009).

In addition, the Bank of Korea continues its effort to ease financial burden on households and businesses by stabilizing market rates. Interest rates on CDs and CPs declined in accordance with recent base rate cuts and CD and CP purchases by securities firms from whom the central bank purchased RPs.

※ As of January 8, 1.5 trillion won out of 2 trillion won received by banks and securities firms in return for their RP sales (91 days, Dec 16) was invested in CDs (approx. 830 mil.) and CPs (approx. 670 mil.).

＊ CD rates (%) : (Oct 24 2008, record high)6.18→(at the end of Nov)5.45→(Jan 8 2009)3.25(293↓ from the record high)

＊ CP rate(%) : (at the end of Oct 2008)7.25→(Nov 5, record high)7.26→(Jan 8 2009)6.17(109↓ from the record high)

Ref	BOK's Market Stabilization Measures Following the Lehman Bankruptcy (Sep 14)

□ Base rate cuts : 5 times by a total of 275bp

○ Oct 9 2008 (5.25→5.00%, 25bp↓), Oct 27 (5.00→4.25%, 75bp↓)Nov 7 (4.25→4.00%, 25bp↓), Dec 11 (4.00→3.00%, 100bp↓) Jan 9 2009 (3.00→2.50%, 50bp↓)

□ Liquidity support : a total of 19.5 trillion won

① Open market operations : 15.2 trillion won

- RP purchase (13.5 tril.), simple purchase of treasury bonds (1 tril.), buyback of Monetary Stabilization Bonds ahead of their maturity (0.7 tril.)

- Scope of securities increased

: bank debentures · special bonds included (Oct 27), bonds issued by Korea Housing Finance Corporation included (Dec 3)

- Scope of organizations increased : 12 securities firms additionally selected (Dec 12)

② Aggregate credit ceiling loan increased : a 1.7 trillion won increase to date

- Aggregate credit ceiling loan
  (6.5→9.0 tril., a total of 2.5 trillion won increase, Oct 23)

③ Interest-on-reserves : 0.5 trillion won

- Paying interest on banks' required reserve deposits (0.5 tril.)

→ To generate an effect of a 4.6 trillion won increase in banks' lending capacity

④ Support for Bond Market Stabilization Fund : 2.1 trillion won to date

- Bond Market Stabilization Fund (a maximum of 5 tril., Nov 24)
- Bank Recapitalization Fund (a maximum of 10 tril., tentative)

Q3 Currency swap agreements between the BOK and the Fed · the PBCt · the BOJ

A

(Present Condition) On 12 December 2008, the Bank of Korea announced establishment of a bilateral currency swap arrangement with the People's Bank of China and an increase in the maximum amount of its bilateral won-yen swap arrangement with the Bank of Japan. These actions followed announcement of the establishment of temporary reciprocal currency arrangements with the U.S. Federal Reserve on 30 October 2008[1].

Through the reciprocal currency swap arrangement with the Fed, the Bank of Korea has access to US dollar funds of up to USD 30 billion in exchange for Korean won[2].
The swap facility[3] between the BOK and the PBC will support provision of liquidity in an amount of up to 180 billion RMB/38 trillion KRW. The maximum amount of the existing bilateral won-yen swap arrangement with the BOJ has been increased from three billion US dollars equivalent to twenty billion US dollars equivalent.

(Meaning of swap arrangement establishment) The above actions to strengthen financial cooperation through agreeing on swap facilities with major central banks are designed to mitigate the adverse influences of the global financial turmoil on sound and well-managed economies. The swap facilities with the BOJ and the PBC are established in addition to the BOK's existing

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[1] The swap facility with the Fed and the increase in the maximum amount of the bilateral won-yen swap arrangement with the BOJ will be effective until the end of April, 2009. However, the effective periods could be extended by agreement with the central banks concerned, in consideration of global financial conditions. The effective period of the facility with the PBC will be 3 years.

[2] As of January 8th, the Bank of Korea had provided a total amount of 103.5 billion dollars to domestic banks, including Korean branches of foreign banks, by conducting three competitive auctions through its US dollar loan facilities using funds from the swap line.

[3] The two sides have agreed to explore the possibility and extent of converting the swap currencies into reserve currencies.

arrangements[1] with them under the CMI.

The Bank of Korea will continue to strive for financial market stability through cooperation with other central banks.

[1] Under the CMI, the Bank of Korea already has bilateral swap agreements with the BOJ and the PBC for maximum amounts of 4 billion US dollars and 10 billion US dollars, respectively, for crisis situations.

Q4 Evaluation on the recent total external debt level

A

As of the end of September 2008, Korea's net external assets in the form of debt instruments stood at △25.1 billion dollars.

* Korea's net external assets in the form of debt instruments(as of the end of, billion dollars): (2005)129.2→(2006)120.8→(2007)35.5→(Sept 2008)△25.1

However, if we exclude from the total external debt those amounts that pose little burden for repayment (111.2 billion dollars)*, such as foreigners' direct investment in the form of loans, advance receipts for ship exports, and overseas borrowings to hedge against FX volatility, we find that Korea's net external assets in the form of debt instruments are actually around 86.1 billion dollars.

- Foreigners' direct investment in the form of loans ($6.6 billion): long-term borrowings from a foreign direct investor to the direct investment enterprises
- Advance receipts for ship exports (around $55 billion): disappear upon ship delivery
- Overseas borrowings to hedge against FX volatility (around $49.6 billion): Banks' borrowings in relation to forward exchange selling by shipbuilders and AMCs, for FX hedging, are linked to future income (receipts for ship exports) and foreign portfolio investment assets.

The fact that the figure for Korea's net external assets in debt instruments technically shifted to negative position does not have significant implications.

We need to note especially that a substantial portion of the increases in external debt we have seen since 2006 are due to borrowings based upon future income (that is, receipts for ship exports and foreign portfolio assets), including forward exchange selling by shipbuilders and AMCs, unlike during the Asian financial crisis when a majority of the total external debt was made up of borrowings made for the purpose of covering a current account deficit.

Moreover, the net external assets in the form of debt instruments registered negative figures in advanced countries as well, including the U.S., the U.K. and France. Korea's total external debt/GDP ratio also remains lower than those of other advanced countries.

Net External Assets in the form of Debt Instruments of Selected Countries

(as of the end of 2007)

(Unit: billion dollars, %)

	Korea[1)]	U.S.	U.K.	France	Australia	Canada	Japan	Germany	Switzerland
Net external assets in debt instruments	△25.1	△5,498.1	△1,122.4	△208.0	△496.5	△269.3	2,462.2	355.0	498.7
Total external debt/ GDP[2)]	43.8	99.2	409.0	211.8	100.2	57.2	44.4	173.1	341.5

Notes: 1) As of the end of September 2008 for figures for Korea

2) Total external debt as of the end of June 2008/nominal GDP during 2007

Sources: IMF and World Bank

Meanwhile, it is difficult to accurately determine external debt developments since October 2008, because these statistics are compiled and announced only after every quarter.

Nevertheless, our monitoring shows that external debt, especially short-term external debt(with remaining maturity of one year or less), is estimated to have considerably decreased by around 41.0 billion dollars from October to

December 2008, due to banks' repayments of their short-term foreign currency borrowings.

< External Debts and Assets in Debt Instruments >

(Unit : hundred million dollars, %p)

	End-2005 (A)	End-2006	End-2007^p	End-Sept. 2008^p(B)
Total external debt(A)	1,879(156)	2,601(722)	3,822(1,221)	4,251 (429)
Short-term external debt (a)[1]	659 (96)	1,137(478)	1,603 (465)	1,894(292)
Long-term external debt[2]	1,220 (61)	1,463(243)	2,219 (756)	2,357(137)
Ratio of short-term debt to Total external debt(a/A, %)	35.1	43.7	41.9	44.6
Total assets in debt instruments (B)	3,171(282)	3,809(638)	4,177 (368)	4,000(-177)
Net external assets in debt instruments (B-A)	1,292(125)	1,208 (-83)	355 (-853)	-251(-606)
FX reserves (b)	2,104(113)	2,390(286)	2,622 (233)	2,397(-226)
Ratio of short-term external debt to FX reserves (a/b, %)	41.1	54.8	75.8	94.8

Notes : 1) External debt with contract maturity of one year or less

2) External debt with contract maturity of over one year

3) Figures in ( ) represent fluctuations compared to previous year-ends.