

# Key Issues on Korean Economy

## 1 External Debt

- **(Size)** The ratio of external debt to GDP stands at 39% as of late 2007, which is lower than that of major developed economies<sup>1)</sup> and tolerable given the size of our economy.
- **(Nature)** Recent growth of external debt in Korea has risen as a counterpart to hedging activities undertaken by shipbuilders and overseas investors.
  - This is in stark contrast to massive foreign currency short-term borrowings induced for excessive investment by Korean Chaebols that led to the 1997 financial crisis.
  - As of June 2008, \$152 billion out of \$420 billion external debt are free of repayment burden, making the size of foreign debt with repayment burden reduced to \$268 billion.
  - In addition, 22% of the total external debt (45% of short-term external debt) belongs to local branches of foreign banks, which makes it unfitting to be regarded as net external debt.
  - The IMF expressed that today's foreign debt increase in Korea not as risky as in the past. (08. 6.24, IMF Annual Consultation)

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1) the ratio of external debt to GDP as end of 2006 : UK(394%), Germany(144%), US(85%), Japan(35%)

- **(Size)** Korea holds the 6th largest foreign exchange reserve in the world, which is deemed adequate.
  - The size is well beyond the IMF guideline, which is a global reference for the adequate size of FX reserve.<sup>2)</sup>
  - The IMF(Sep.4) and Fitch(July.16), a global credit rating agency, affirmed that Korea's reserve was sufficient.
- **(Composition)** Korea's reserve is composed of assets with low risk such as deposits, sovereign bonds, federal agency securities and supernational bonds.
  - As of September 2008, the total of \$240 billion reserve can be cashed in immediately.

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2) IMF guideline for adequate FX reserve is a total of 3-month current payment and short-term external debt. Korea's reserve exceeds the total of 5-month current payment and is 1.4 times larger than short-term external debt.

□ **(Current status<sup>3)</sup>)** Exports remain brisk despite the slowdown in advanced economies and global financial volatility.

○ Strong growth thus far is largely attributable to the diversification of export destination and the competitive quality of export goods.

- The share of exports to developed countries such as the US and Japan has been diminished while the share to developing economies including China, Latin America and the Middle East increased.

\* Share of exports to developing countries(%) : (05)60 (06)63 (07)66 (Jan.~Aug. 2008)69

\* Share of exports to the U.S.(%) : (90)30 (95)90 (00)23 (05)13 (Jan.~Aug. 2008)11

\* Share of exports to China(%) : (90) 1 (95) 7 (00)11 (05)21 (Jan.~Aug. 2008)23

- The quality competitiveness of flagship exports such as ships, semiconductors and LCDs has been secured.

□ **(Outlook)** Given the strength of Korea's export, it is not likely for our export to be severely impaired by global downturn.

3) Export growth rate(% , yoy) : (07.4/4)18.2→(08.1/4)17.4→(2/4)23.2→(3/4)27.6, (July)35.7 (Aug)18.7 (Sep)28.7

- **(Current status)** Despite strong export growth(Jan~Aug, 22%), the current account deficit stood at \$12.6 billion due to the increased cost of import(Jan~Aug, 33%) caused by high oil prices.
  - About \$17.7 billion of current account deficit is the result of the oil price hike<sup>4)</sup> between January and August.
  
- **(Outlook)** Current account balance is expected to get improved after September as lower oil prices starts to impact, reducing the amount of annual deficit to around \$10 billion.
  - Thanks to the robust export based on strong overseas demand, it is forecast that Korea's current account will turn surplus in the forth quarter.
  - It is believed that the balance of current account in 2009 will improve as the oil price stabilizes at a relatively low level.

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4) Domestic consumption accounts for 70% of \$25.3 billion increase in oil import between the same period.

## 5

## Korean Banks

□ **(Financial Soundness)** Overall, the balance sheets of Korean banks remain sound.

① **(Profitability)** Korean banks are doing better than their peers in the advanced economies.

○ Their current term net profit is 6.7 trillion won, their ROA is 0.9%, and their ROE is 12.5%.

(unit : %)

	US Banks	UK Banks	Germany Banks	Franch banks	Japanese banks	Korean banks
ROA	0.66	0.72	0.32	0.48	0.58	0.88
ROE	6.54	23.71	15.83	16.87	13.40	12.53

② **(Asset Soundness<sup>5)</sup>)** Their assets are also very sound, with a delinquency rate of 1.0% as of August 2008, and an NPL ratio of 0.7% as of June 2008.

③ **(Capital Adequacy)** Korean banks are maintaining BIS ratios(11.55% as of June 2008) comparable to those of their peers in the advanced economies.

5) US Commercial Banks as of June 2008 : delinquency rate 3.16%, NPL ratio 1.87%

- **(Lending)** Growth in their lending has slowed<sup>6)</sup> during the second half of 2008, and their asset soundness and capacity to cover losses have improved<sup>7)</sup> due to strengthening of risk management.
- ① **(Loans to Households)** Household possess financial assets which is equal to 2.26 times of their financial debts. NPL ratios also remain low.
- In particular, mortgage loans which take up about 60% of household loans have an even lower delinquency rate of 0.5% and an LTV ratio of 47%.
- ② **(Loans to SMEs)** Loans to SMEs remain sound thanks to government measures to raise the level of allowances for bad debts.
- ③ **(PF loans)** Project financing loans are only 4.4% of total lending by the banking sector. They are not likely to cause a system-wide crisis.

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6) Increases (by KRW trillion) in average monthly loan

- Household loans : 1.5 (throughout '07), 1.4 ('08. 1Q), 3.0 ('08. 2Q), 2.2 ('08. 3Q)
- SME loans : 5.7 (throughout '07), 5.2 ('08. 1Q), 6.5 ('08. 2Q), 3.9 ('08. 3Q)
- PF loans : 1.3 (throughout '07), 0.7 ('08. 1Q), 1.3 ('08. 2Q), 0.4 ('08. July)

7) Asset soundness indices (%)

- Household loans i ) delinquency ratio: 1.8 (end of '03), 0.6 (end of '07), **0.7** (end of August '08), ii) Coverage Ratio: 259.2 (end of June '08)
- SME loans i ) delinquency ratio: 2.8 (end of March '04), 1.0 (end of '07), 1.5 (end of August '08) ii) Coverage Ratio: 138.4 (end of June '08)
- PF loans i ) delinquency ratio: 0.5 (end of '07), 0.9 (end of March '08), 0.9 (end of July '08) ii) Coverage Ratio: 187.5 (end of July)

□ Korean Banks are having difficulty managing FX liquidity risk since the global credit crunch. Still, the situation is very different from the Asian financial crisis.

- ① (**Asset/liability management**) FX assets and debts have been managed in a stable manner without imbalances, through tight regulation of FX liquidity ratios such as the gap ratio.

(%)	5.31	6.30	7.31	8.31	9.29	9.30	10.1	10.2
FX liquidity ratio ( $\geq 85\%$ )	104.4	101.7	101.2	101.7	100.3	100.5	102.8	102.8
1-month gap ratio ( $\geq \Delta 10\%$ )	1.2	1.1	1.3	0.9	1.4	1.7	2.4	2.5
7-day gap ratio ( $\geq 0\%$ )	2.8	2.3	2.5	2.9	2.4	2.8	2.3	2.4

\* FX liquidity ratio = (FX assets maturing in less than 3 months)/(FX debts maturing in less than 3 months)

\* 1-month gap ratio = (net FX assets maturing in 3 months)/(total FX assets)

\* 7-day gap ratio = (net FX assets maturing in 7 days)/(total FX assets)

- ② (**Foreign Asset soundness<sup>8)</sup>**) Thanks to the continuing soundness of FX assets, securing FX funds by selling those assets shouldn't be difficult.

- ③ (**Financing**) The collapse of Lehman Brothers posed difficulties for FX financing.

- Nevertheless, Korean banks have been able to secure funds through term lending<sup>9)</sup> by leveraging their relationships with foreign banks.

8) NPL Ratio(%) : (05)1.04 (06)0.81 (07)0.53 (08.3)0.50 (08.6)0.29  
Delinquency ratio(%) : (05)0.59 (06)0.45 (07)0.24 (08.3)0.32 (08.6)0.15

9) KDB borrowed a total of \$520 million in FX (for a term between 1 month to 1 year) since the fall of Lehman; other banks also managed to finance some FX through term lending.

- **(Stabilization measures)** Korean government will closely monitor economic conditions at home and abroad, and respond preemptively to minimize the impact of external adversities on the Korean economy.
  - Korean government are running a joint government task force to respond to the global financial crisis.
    - Korean government also operates a hotline with the IMF and other financial authorities in major countries such as the US, China, and Japan.
  - \$15 billion of FX liquidity through the FX swap market and the KEXIM Bank will be provided to Korean Banks.
  - KRW 3.5 trillion of short-term liquidity has been injected through BOK's open market operation.
    - Also, FSC(Financial Supervisory Committee) has taken financial market stabilization measures such as temporarily banning the short-selling of stocks.
- **(Expanding our growth potential)** Alongside efforts to stabilize the financial market, Korean government will seek to expand our growth potential through deregulation and tax minimization - at the same time as reigning in inflation.