

Press Release

October 14, 2008



I . External Debt Analysis

1. Total Foreign Debt

(unit: \$100 million)

	End of '04	End of '05	End of '06	End of '07	End of Mar. '08	End of Jun. '08
External Debt (A)	1,723	1,879	2,601	3,822	4,138	4,198
Short-term	564	659	1,138	1,603	1,765	1,757
Long-term	1,159	1,220	1,463	2,219	2,373	2,441
External Asset (B)	2,889	3,171	3,809	4,177	4,270	4,225
Net External Asset (B-A)	1,166	1,292	1,208	355	132	27
Ratio of Current External Debt (%)	38.6	41.1	54.8	75.8	81.8	86.1

Recent debts have largely been incurred as a result of bridge-financing (based on anticipated future returns) such as currency forwards. This type of financing has different characteristics to that of liabilities incurred to finance current account deficits which were prevalent prior to the Asian Financial Crisis.

As of the end of June 2008, it is estimated that \$151.8 billion out of a total of \$419.8 billion of foreign debt by BOK will be not be subject to any repayment burdens, and thus reduce the actual foreign debt amount to \$268 billion.

*** Foreign debts without any repayment burdens: approx. \$151.8 billion out of a total of \$419.8 billion**

- Currency hedging-related external debts (approx.\$93.8 billion): funds borrowed to purchase currency forwards originating from shipping exports and investments in securities abroad
- Advance payments for shipbuilding orders (\$50.9 billion): to be written off upon delivery of vessels
- FDIs consisting of loans (\$7.1 billion): lending between parent firms and subsidiaries

The exclusion of debts which are not subject to any repayment burdens will result in an actual net foreign asset amounting to \$154.5 billion.

The current external debt ratio as of the end of June 2008 stands at 86.1%. However, the figure falls to 54.4% when foreign bank branches are excluded, significantly reducing external debt risks.

2. External Debt by Sector

A. Government Sector

(unit: \$100 million)

	End of '04	End of '05	End of '06	End of '07	End of Mar. '08	End of Jun. '08
Government Sector	164	155	199	533	580	631
Short-term	20	22	39	82	78	107
Long-term	144	133	160	451	502	524

The bulk of the government sector debt (\$51.8 billion out of \$63.1 billion) consists of KRW-denominated government bonds and currency stabilization bonds purchased by foreigners, for which the Korean government and the BOK has ample repayment capacity.

The remainder consists of \$3.3 billion in foreign currency-denominated FX equilibrium bonds, \$3.4 billion in public loans, etc. (i.e. long-term external debts that pose little risk).

B. Banking Sector

(unit: \$100 million)

	End of '04	End of '05	End of '06	End of '07	End of Mar. '08	End of Jun. '08
Banking Sector	745	834	1,365	1,940	2,144	2,105
Domestic Banks	506	584	821	1,102	1,221	1,274
Short-term	235	280	443	546	626	660
Long-term	271	304	379	557	595	614
Foreign Bank Branches	239	250	544	838	923	831
Short-term	210	233	518	792	875	795
Long-term	29	17	26	46	48	36

Foreign debts without any repayment burdens incurred from shipbuilders' currency hedging, etc. account for 44.6%, or approx. \$93.8 billion, of the external banking sector debt.

Foreign debts incurred by domestic branches of foreign banks from their headquarters abroad are very low-risk compared with those of Korean banks.

* Foreign bank branches hold 43.1% of total external banking sector debts, and 57.7% of short-term debts.

We are applying stringent criteria for FX liquidity to domestic banks than observed in other countries; hence, our current FX liquidity level remains stable.

* Developed nations such as the US, UK, Japan, and Germany do not regulate FX liquidity. It is only applied in some countries, including China and Mexico.

The inconsistent ratios between assets and debts maturing within 7 days, 1 month, and 3 months are within stable ranges.

C. Other Sectors (non-banking FIs, non-financial corporations)

(unit : \$100 million)

	end of '04	end of '05	end of '06	end of '07	end of Mar. '08	end of Jun. '08
Other Sectors	814	889	1,036	1,348	1,415	1,462
Non-banking FIs	113	149	161	255	259	280
Short-term	25	38	46	78	74	76
Long-term	88	111	115	177	184	204
Non-Financial Corps.	701	740	875	1,093	1,156	1,182
Short-term	74	86	91	105	112	118
Long-term	627	654	784	988	1,044	1,064

The bulk of external debt within non-banking financial institutions' (\$20 bn out of \$28 bn) originates from finance companies. Finance companies have stable financing abilities and operational structures.

A high proportion of debts are long-term, while assets are mainly short-term such as credit card receivables.

* This is in contrast with the practice of borrowing short-term and lending long-term by Korean merchant banks prior to the Asian Financial Crisis.

Finance companies employ currency swaps in managing KRW assets: as long as they have enough KRW, they can secure foreign currency to repay external debts upon maturity.

Of the \$118.2 bn external debt held by non-financial corporations, \$50.9 bn are advance receipts for shipbuilding orders and \$7.1 bn are loans from parent companies based overseas. In other words, almost half (49.1%) of the external debt within the non-financial sector are not subject to any repayment burdens.

II . Analysis of Foreign Reserves

1. Definition of "Usable Foreign Reserves" and the Current Composition of Foreign Reserves

Usable foreign reserves: similar to the concept of foreign reserves.*

* External assets readily available to the monetary authority to offset current account imbalances, to intervene in the FX market, etc. (IMF definition)

※ Lately, the term "usable foreign reserves" has been used in some circles to refer to actual foreign reserves that a monetary authority can deploy in the event of a crisis.

Foreign reserve figures released at the beginning of each month refer to usable foreign reserves.

- The foreign reserve figures included in statistics since August 1999, has been clarified to refer to reserves of foreign assets immediately convertible to cash (usable foreign reserves), in line with the IMF definition.

e.g.) The amount of \$2 bn from the Foreign Currency Equilibrium Fund invested to Merrill Lynch through the KIC is excluded from the foreign reserves.

※ Statistics prior to August 1999 featured (official) foreign reserves and usable foreign reserves separately.

(Foreign reserves = usable foreign reserves¹⁾ + deposits in foreign branches of Korean banks + currency swap agreements with the Bank of Thailand)

The current composition of foreign reserves

Korea's foreign reserves currently consist of safe assets including deposits, government bonds, government agency bonds, international organization bonds, etc.

* A is the officially required minimum rating for foreign reserve assets, but their actual ratings are AA or above.

All of the \$239.7 bn in foreign reserves as of the end of September 2008 are immediately convertible to cash.

¹⁾ One of the difficulties in December 1997, during the Asian Financial Crisis, was the fact that only \$8.9 bn out of the total of \$20.4 bn in foreign reserves were immediately convertible to cash.

Changes in Foreign Reserves¹

(unit: \$100 million)	2005	2006	2007	2008		
				July	August	September
Foreign Reserves	2,104 (100)	2,390 (100)	2,622 (100)	2,475 (100)	2,432 (100)	2,397 (100)
Securities	1,868 (88.8)	2,020 (84.5)	2,318 (88.4)	2,084 (84.2)	2,093 (86.1)	2,172 (90.6)
Deposits	231 (11.0)	364 (15.2)	300 (11.4)	386 (15.6)	334 (13.7)	220 (9.2)
Other Assets ²	4 (0.2)	6 (0.2)	5 (0.2)	5 (0.2)	5 (0.2)	5 (0.2)

1) Numbers in parentheses () represent percentages out of the total;

2) IMF positions, SDRs, gold.

2. Analysis on the Adequacy of Foreign Reserves

Question	Answer																		
① Should there be a concern regarding the inadequate level of foreign reserves compared to the current external debt?	<p>▶ Even among the world's ten largest holders of foreign reserves, some countries have less than enough to cover short-term debts (current external debts). However, none are deemed to have inadequate levels of foreign reserves.</p> <p>* <table><tr><td></td><td>Japan</td><td>Singapore</td><td>Hong Kong</td><td>Germany</td><td>Korea</td></tr><tr><td>Foreign Reserves¹</td><td>9,967</td><td>1,701</td><td>1,581</td><td>1,371</td><td>2,432</td></tr><tr><td>Short-term Debt²</td><td>12,952</td><td>3,207</td><td>5,139</td><td>21,097</td><td>1,765</td></tr></table></p> <p>1) As of the end of August 2008 2) As of 1Q 2008 (as of the end of 2007 for Singapore)</p> <p>▶ Such concerns are built on assumptions that are unreasonably conservative and unrealistic (e.g.) zero repayment capacity of the private sector; simultaneous recovery of all current debts without a rollover).</p> <p>※ The rollover rate of short-term debts was 32% even in December 1997, during the Asian Financial Crisis.</p>		Japan	Singapore	Hong Kong	Germany	Korea	Foreign Reserves ¹	9,967	1,701	1,581	1,371	2,432	Short-term Debt ²	12,952	3,207	5,139	21,097	1,765
	Japan	Singapore	Hong Kong	Germany	Korea														
Foreign Reserves ¹	9,967	1,701	1,581	1,371	2,432														
Short-term Debt ²	12,952	3,207	5,139	21,097	1,765														
② What would be an adequate level of foreign reserves?	<p>▶ A uniform criteria for an adequate level of foreign reserves does not exist.</p> <p>* 3-month current payment rule (IMF), short-term debt coverage, etc.</p> <p>▶ Korea's reserves far exceed the IMF standard of a 3-month current payment.</p> <p>▶ The IMF (on Sep. 4) and Fitch (on July 16) agreed on the adequacy of Korea's foreign reserves.</p>																		

③ Is the majority of the foreign reserves represented as illiquid assets?	▶ Our foreign reserves are made up entirely of assets that can be immediately converted to cash.
④ Are assets held in US T-bills still safe?	▶ Since the US financial crisis, US T-bills have been considered the safest assets in the world (rates on 3-month T-bills issued within the last month are below 1%). ▶ There is little evidence to suggest that T-bill prices will collapse in the long run.
⑤ Is it time to use foreign reserves?	▶ The dollar squeeze in the money market triggered by the global credit crunch is threatening to spillover into the real economy. ▶ Other major economies of the world are using foreign reserves to prevent their currencies from tumbling and to inject dollar liquidity ▶ It is necessary for timely government intervention where appropriate , rather than allowing excessive pessimism to develop.

III. The Liquidity of Foreign Currency of Korean Banks

Korean banks have been encountered some difficulties securing overseas funding as a result of disruptions in the global credit markets following the collapse of Lehman Brothers. Offers of more than one-month loans have been disappearing in foreign currency markets, and overnight Call rates have sharply increased following the dollar shortage.

Overnight Interbank Dollar Rates

	Aug. 31	Sept. 16	Sept. 17	Sept. 18	Sept. 24	Sept. 25	Sept. 26	Sept. 30
O/n interbank dollar rate	2.50	6.47	7.24	7.48	3.18	2.94	2.88	8.69
O/n dollar LIBOR*	2.25	6.44	5.03	3.84	2.69	2.56	2.31	6.88

* London Interbank Offered Rate

Excessive demand for dollar funding has lowered the swap point and swap basis in the USD/KRW swap market where banks can procure USD.

Swap Point and Swap Basis in USD/KRW Swap Market

	2007		2008					
	June 29	Nov. 21	Mar. 17	Sept. 12	Sept. 16	Sept. 23	Sept. 26	Sept. 30
Swap point (3 mo., KRW)	-2.4	-12.5	-1.2	1.15	-2.00	-11.7	-2.0	-7.0
Swap basis (1 yr., bp)	-47	-330	-376	-232	-291	-351	-257	-301

Despite these difficulties, Korean banks have been faring relatively well as they hold surplus funds remaining from the first half of the year. They have also been able to secure a certain level of funding based on strong credit relationships with foreign lending institutions.

As of September 30, the foreign currency liquidity ratio of domestic banks was above the recommended level of 85%. The 1-month and 7-day gap ratios were also above the recommended -10% and 0%, respectively.

Foreign Currency Liquidity Ratio

	May.31	June.30	July.31	Aug.31	Sept. 25	Sept. 26	Sept. 29	Sept. 30
Foreign currency liquidity ratio	104.4	101.7	101.2	101.7	102.0	101.3	100.3	100.5
1-month gap ratio	1.2	1.1	1.3	0.9	1.6	1.5	1.4	1.7
7-day gap ratio	2.8	2.3	2.5	2.9	2.3	2.2	2.4	2.8

The monitoring of major economic indices has been increased since concerns over the U.S. subprime market were first raised last year. We have also been tracking the foreign currency liquidity of domestic financial institutions and encouraging them to manage their foreign currency liquidity risk and exposure to mortgage-related products to ensure that they remain financially sound.

As a result, the ratio of foreign currency in Korean banks remains above the levels which supervisory regulations recommend. Moreover, the delinquency rate on bank loans is very low and stable. Even BIS and IMF consider the banks as credible recourse debtors.

In the case of Korean branches of foreign banks', they have a minimum possibility of collecting their loans and funds at the same time due to arbitrage opportunities. The branches borrow foreign currency at a low rate from their headquarters and transact F/X SWAP with Korean banks (Sell&Buy). With the Korean Won bought in the transaction, they invest in safe assets, such as Korean government bonds. Even if they do collect their funds, the impact on the F/X spot market appears to be limited.

Recently, Korean banks have encountered some difficulties securing overseas funding as a result of disruptions in the global credit markets following the collapse of Lehman

Brother in September. However, most of the difficulties stem from domestic banks' in order to deal with the maturing debt without using their foreign currency assets so as not to disrupt foreign currency credit flows to the market.

On October 6, the government began to inject US\$5 billion in fresh foreign currency credit to local banks through the Export-Import Bank of Korea. Given government support and the foreign currency liquidity ratio of domestic banks, the global credit crunch is likely to have limited impact on domestic financial institutions and the real economy. Overseas borrowing conditions are also expected to improve as the U.S. House of Representatives passed the bailout package on October 3.

IV. Status and Evaluation of the Financial Soundness of Domestic Banks

Concerns were recently raised over a possible deterioration of banking soundness as lending growth slowed along with the economic slowdown. However, the financial position of the banks' such as profitability, asset soundness and capital adequacy are in good shape.

Korea also has an excellent record in the first half in terms of net income (6.7 trillion won), ROA (0.9%) and ROE (12.5%) compared to other major advanced nations.

(Unit : %)

	U.S.1)	U.K.2)	Germany2)	France2)	Japan2)	The Korean Banking Industry
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

1) Commercial banks with total assets of more than \$1 billion (1st Q in 2006);

2) Top 5 banks in terms of asset size (The Banker '08);

The delinquency rate (1.0% at the end of August 2008) and the NPL ratio (0.7% at the end of June 2008) also remained relatively low.

* Commercial banks in the U.S. have a delinquency rate of 3.16% and NPL ratio of 1.87% as of the end of June 2008.

With regards to adequacy, the BIS ratio (11.55% of Basel I , 11.36% of Basel II) is similar to that of advanced countries* as of the end of June 2008.

- * There is not much of a difference between Korea and major advanced nations such as the U.S (12.23%) and the U.K. (12.05%).

There is a possibility that the stable position of banks may decline as a result of a prolonged economic slowdown. However, this is not likely to occur abruptly like the US subprime crisis. The loss absorption capacity** is also in good shape thanks to the strengthened supervision policy*.

- * Korea has strengthened mortgage related regulations such as LTV and DTI. It also raised minimum reserves for bad household and corporate debts.

** Coverage ratio: 186.0%

Tightened policy measures are in place as a response to unstable factors in each sector that raises concerns for default risks such as the SME loan.

Looking at the recent trends in lending, bank lending growth has slowed in the third quarter owing to the effects of economic slowdown and strengthened risk management.

- * Monthly (Monthly average) bank lending growth (trillion won)

SME lending: ('07) 5.7, ('08.1/4) 5.2, ('08.2/4) 6.5, ('08.3/4) 3.9

Household lending: ('07) 1.5, ('08.1/4) 1.4, ('08.2/4) 3.0, ('08.3/4) 2.2

PF lending: (2007) 1.3, ('08.1/4) 0.7, ('08.2/4) 1.3, ('08.7) 0.4

The delinquency rate has increased slightly but is not historically high and the coverage ratio is acceptable.

- * Lending Status (%)

SME lending: The delinquency rate (end of March 2004) 2.8, (end of 2007) 1.0, (end of August 2008) 1.5, coverage ratio (end of June 2008) 138.4;

Household lending: The delinquency rate (end of 2003) 1.8, (end of '07) 0.6, (end of August 2008) 0.7, coverage ratio (end of June 2008) 259.2

PF lending: The delinquency rate (end of '07) 0.5, (end of March '08) 0.9, (end of July 2008) 0.9, coverage ratio (end of July 2008) 187.5

However, the delinquency rate (0.5%) of mortgage loans of which consists of household lending (about 60%), is very low and the LTV(47%) is also fine.

For future preparation, policy efforts have been made to preemptively respond to possible default risks by monitoring each bank, thereby continuously enhancing the effectiveness of supervision.

For SME lending, greater liquidity support has been extended for cash-strapped SMEs.

* The Korean government announced its plan to help SMEs affected by a credit crunch on Oct. 1.

For household lending, the government will encourage long-term loans and provide credit recovery support in order to reduce the burden of debt payment for borrowers in the lowest income brackets according to schedule.

For PF lending, preemptive measures were prepared as a response to an abrupt recession in the real estate sector owing to measures dealing with unsold new housings (611,821) up-until now and strengthened risk management*.

* Risk Management Standards for PF (September 30th)

The deposit-loan ratio (including CD) of domestic banks currently stands at 105.4% as of July 2008 (The figure goes up to 86.8% if bank bonds are included).

(Unit: Trillion won, %)

	Loan (A)	Deposits			Deposit-Loan Ratio		
		Deposits in Won (B)	CD (C)	Bank Bonds (D)	A/B	A/(B+C)	A/(B+C+D)
End 2006	508.6	466.6	65.4	95.3	109.0	95.6	81.1
End 2007	583.0	470.6	88.0	121.2	123.7	104.2	85.6
End-June 2008	632.0	499.5	107.3	127.8	126.5	104.2	86.0
End-July 2008	641.0	499.8	108.4	129.8	128.2	105.4	86.8

It is reasonable to include CD because the nature of CD is very similar to deposits.

- ① Eighty two percent of CDs were sold over the counter as of the end of July 2008 to date.
- ② CD has a higher roll over rate than time deposits (In case of a bank, CD has 43.7% while time deposits have about 39% as of June 2008).
- ※ The issued amount has also increased for bank bonds as well (a 20% rise in the first half of 2008).

The deposit-loan ratio has somewhat increased due to a rise in lending but it is no cause for concern given the local-currency based liquidity ratio (106% at the end of July 2008).

* It is higher than Japan (74% including CD) but lower than the U.S. (100~110% including CD).

On the other hand, lending growth has recently slowed because of the effects of the economic slowdown and higher interest rates. Thus, the deposit-loan ratio is expected to improve accordingly.

V. Responsive Measures to the Potential Unstable Factors in the Financial Markets

With respect to PF lending, the government will manage risks preemptively through measures such as Risk Management Standards for PF (September 30th), strengthen the effectiveness of supervision based on the results of a study conducted on 899 construction businesses funded by PF (which is to be completed in October) and to encourage restructuring of savings banks with possible default risks in a manner to minimize any impact on the markets such as M&As.

SME lending trends and the stability of each bank will be closely monitored. Preemptive measures will be mapped out to include ways to help financially distressed SMEs affected by the credit crunch as it was announced by the government (Oct.1) in order to prevent possible spread of a default crisis.

In terms of household lending, the government will closely monitor any additional burdens of debt repayments due to the hike in interest rates and changing trends in the real estate market. It will also provide people in the lowest income bracket who are vulnerable to external shocks with greater support such as a credit recovery support program.

In terms of the real economy such as the construction sector, the government plans to make various efforts. First, it will pursue support led initiatives by financial companies such as work-out programs and agreements to construction companies. Second, it will make institutional improvements that hamper financing through fixed assets such as unsold new housing. Third, it plans to support small (SME) companies suffering from losses related to currency option contracts - known as "knock-in knock-out (KIKO)" options through Korea Credit Guarantee Fund (KODIT) and Kibo Technology Fund(KIBO).