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Financial
Services
Commission

Press Release

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FSC-FSS MEETING FOR MONITORING FINANCIAL MARKET CONDITIONS

The FSC and the FSS held a meeting to make sure that Korea's financial markets are prepared for the impact of the Fed's possible rate hike.

RECENT TRENDS IN CAPITAL FLOWS

The expectation of a U.S. rate increase weighs on global stock markets. External risk factors prompt volatility in Korea's financial market with foreigners' net selling of stocks and investors' appetite for safer assets. Kospi fell 3.0% in recent days(Dec.1~Dec.15), while the yield on 3-year government bonds dropped 5.2bp in the same period.

However, the general market view is that capital outflows would not be expanded sharply, looking into characteristics and causes of recent outflows.

In 2015, foreign investors sold an average of KRW 1.7 trillion per month in the stock market, which is less than the net selling of KRW 2.5 trillion per month for the past 10 months and less than the net selling of KRW 2.4 trillion per month in the following months of the so-called 'taper tantrum' (March~June 2013).

Since September this year, oil producers like Saudi Arabia have been leading foreign net selling as their fiscal conditions deteriorate with falling oil prices. The net selling mode is hardly related to changes in foreign investors' appetite to Korean stocks.

US funds, which represent a largest share of Korea's stock market(40%), continue to remain net buyers in November and December amid rising possibility of a U.S. interest rate increase.¹ European funds sold a net KRW 10.2 trillion of Korean shares from June to September this year, but the pace of selling has slowed since then.

¹ Net buying by US funds: KRW 9.7 trillion(2015), KRW 38.8 billion(Nov. 2015), KRW 16.5 billion(Dec.2015)

STOCK MARKET

The Korean stock market is expected to face turmoil in the short term after the Fed's decision. However, many investment banks forecast that the Kospi will gradually bounce back to a level of 2,100 or beyond in 2016. Given strong fundamentals of the Korean economy, undervaluation of Korean stocks could appeal to investors once the Fed's rate hike finally removes uncertainty.

The FSC will closely monitor the stock market and preemptively prevent external risks such as China's growth slowdown from spilling over to Korea's stock market.

CORPORATE BOND MARKET

Corporate bond market is reacting cautiously over heightened possibility of credit risk, which is attributable to a combination of several factors such as the wait-and-see attitude of institutional investors regarding Korea's future interest rate trend ahead of Fed's rate increase, and uncertainties over corporate restructuring. However, such risk-averse attitude is not a trend confined only to emerging markets but it is rather a common trend in the global financial markets including the advanced economies.²

Shrinking demand even for investment grade bonds is mainly due to temporary factors such as mismatch between supply by issuers and demand from investors ahead of the U.S. rate hike. In order to prevent investors' risk aversion spilling over to high grade corporate bond market or severely hurting investment sentiment, the government will come up with short-term measures to boost investor confidence and longer-term approach to fundamentally improve the structure of corporate bond market by early next year.

HOUSEHOLD AND CORPORATE DEBT MANAGEMENT

It is crucial to be prepared to possible increase in household and corporate debt volume when Korea's interest rates increase following the U.S. The government will preemptively respond to external and internal risk factors by strengthening banks' mortgage application screening and successfully restructuring marginal companies.

In a bid to minimize potential household debt risk and impact on the property market, a guideline will be implemented for banks to strengthen mortgage application screening so that borrowers can pay back their debt in installments from the beginning, as announced on December 14, 2015.

The government will swiftly carry out restructuring process on large companies based on the results of credit assessment on ailing and marginal companies conducted by creditor banks, which is scheduled to be completed by the end of this year. Korea Development Bank will provide financial support to companies having temporary financial difficulties to help them normalize business. Korea Credit Guarantee will provide guarantee for temporarily financially distressed firms affiliated to companies under restructuring.

² U.S. high-yield corporate bond spread (bp): 504 (end-2014), 500 (end-June 2015), 662 (end-Sept. 2015), 640 (end-Nov. 2015), 709 (Dec.15, 2015)

MEASURES TO STRENGTHEN SUPERVISION ON FINANCIAL INSTITUTION'S SOUNDNESS

Korea's financial sector is maintaining soundness in their capital adequacy and asset quality. Moreover, financial institutions have a greater buffer against external shocks compared to that of the 2008 global financial crisis.

Stress tests conducted assuming difficulties during the global financial crisis show that financial institutions, in general, have capacity to maintain appropriate levels of capital adequacy and liquidity.

** (For detailed figures on capital adequacy ratios, asset quality, and buffer capital please refer to the press release dated December 9, 2015)*

The FSC will continue to closely monitor and respond to the possible impact of external risks following the U.S. rate increase on the soundness of Korea's financial institutions.

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