The Korean Economy: Resilience amid Turbulence

Dr. Il SaKong
Special Economic Adviser to the President
Republic of Korea
November 17, 2008
1. Recent Macroeconomic Developments

2. Korea’s External Position & Financial Strengths

3. Government’s Policy Responses

### GDP Growth Trend: Gradual Slowdown

#### GDP Growth Trend (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>GDP Growth (qoq, %)</th>
<th>Private Consumption</th>
<th>Facility Investment</th>
<th>Construction Investment</th>
<th>Export</th>
<th>Import</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>4.2</td>
<td>3.6</td>
<td>5.7</td>
<td>0.2</td>
<td>8.5</td>
<td>7.3</td>
</tr>
<tr>
<td>2006</td>
<td>5.1</td>
<td>4.5</td>
<td>7.8</td>
<td>0.1</td>
<td>11.8</td>
<td>11.3</td>
</tr>
<tr>
<td>2007</td>
<td>5.0</td>
<td>4.5</td>
<td>7.6</td>
<td>1.2</td>
<td>12.1</td>
<td>11.9</td>
</tr>
<tr>
<td>2008</td>
<td>4.0 (1.0)</td>
<td>4.1</td>
<td>10.9</td>
<td>3.7</td>
<td>11.0</td>
<td>11.4</td>
</tr>
<tr>
<td></td>
<td>4.9 (1.7)</td>
<td>4.4</td>
<td>11.0</td>
<td>1.6</td>
<td>10.8</td>
<td>12.1</td>
</tr>
<tr>
<td></td>
<td>5.1 (1.5)</td>
<td>4.8</td>
<td>2.3</td>
<td>-0.1</td>
<td>9.3</td>
<td>6.9</td>
</tr>
<tr>
<td></td>
<td>5.7 (1.6)</td>
<td>4.6</td>
<td>6.5</td>
<td>-0.4</td>
<td>17.0</td>
<td>16.9</td>
</tr>
<tr>
<td></td>
<td>5.8 (0.8)</td>
<td>3.4</td>
<td>1.4</td>
<td>-1.1</td>
<td>11.8</td>
<td>9.0</td>
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<td>2.3</td>
<td>0.7</td>
<td>-1.2</td>
<td>12.5</td>
<td>8.6</td>
</tr>
<tr>
<td></td>
<td>3.9 (0.6)</td>
<td>1.1</td>
<td>4.9</td>
<td>-0.9</td>
<td>9.7</td>
<td></td>
</tr>
</tbody>
</table>
Moderating Inflation

Downward trend in consumer price (2008 YTD)

CPI (%) & WTI (US$)

* CPI: Consumer Price Index
* WTI: West Texas Intermediate
Job Market Situation

### Unemployment Rate

Unemployment Rate (%)

- 2005: 3.7%
- 2006: 3.5%
- 2007: 3.6%
- 2007 Q1: 3.2%
- 2007 Q2: 3.2%
- 2007 Q3: 3.1%
- 2007 Q4: 3.0%
- 2008 Q1: 3.1%
- 2008 Q2: 3.1%
- 2008 Q3: 3.6%
- 2008 Q4: 3.0%

### Job Creation Trend

New Jobs Created (YoY, ‘000)

- 2005: 299
- 2006: 295
- 2007: 282
- 2007 Q1: 264
- 2007 Q2: 289
- 2007 Q3: 296
- 2007 Q4: 279
- 2008 Q1: 210
- 2008 Q2: 173
- 2008 Q3: 141
Trade and Current Account Balance

Robust export growth

Exports (US$ bn, YoY Growth, %)

- 2002: 162.0% (8.0%)
- 2003: 194.0% (19.8%)
- 2004: 254.0% (30.9%)
- 2005: 284.0% (11.8%)
- 2006: 325.0% (14.4%)
- 2007: 371.0% (14.1%)
- Jan-Oct 2008: 367.0% (21.3%)

Source: Bank of Korea

Current account surplus is expected in 4Q08

2008 Current account and Trade balance (US$ bn)

- Q1 08: -5.20
- Q2 08: -0.13
- Q3 08: -5.20
- Q4 08 (e, KDI): 5.0
- 2009 (e, KDI): 5.0

Diversified export products

Semiconductor: 11%
Chemicals: 10%
Automobile: 10%
Mobile communication: 8%
Machinery: 8%
Shipbuilding: 7%
Steel: 6%
Home appliance: 5%
Computer: 5%
Textile: 4%
Others: 26%

Diversified export markets

- China: 22.1%
- EU: 15.1%
- ASEAN: 10.4%
- Others: 19.8%
- Middle East: 5.3%
- USA: 5.3%
- Japan: 7.1%
- Central & South America: 6.9%
- North America: 13.3%
- Others: 26%

Source: KITA (as of 2007)
1. Macroeconomic Performance

2. Korea’s External Position & Financial Strengths

3. Government’s Policy Responses

## Foreign Reserves, Bank & Corporate Sector’s Soundness

<table>
<thead>
<tr>
<th></th>
<th>Current</th>
<th>Asian Financial Crisis (late 1997)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Currency Reserves</td>
<td>US$ 212.3bn 2</td>
<td>US$ 8.9bn</td>
</tr>
<tr>
<td>ST External Debt a / FX Reserves</td>
<td>68% 3</td>
<td>717%</td>
</tr>
<tr>
<td>Current External Debt b / FX reserves</td>
<td>86% 3</td>
<td>973%</td>
</tr>
<tr>
<td>Total External Debt / FX Reserves</td>
<td>173% 3</td>
<td>1,957%</td>
</tr>
<tr>
<td>Bank NPL Ratio</td>
<td>0.7% 3</td>
<td>6.0%</td>
</tr>
<tr>
<td>BIS Ratio</td>
<td>11.6% 3</td>
<td>7.0%</td>
</tr>
<tr>
<td>Debt to Equity Ratio</td>
<td>106.5% 4</td>
<td>424.6%</td>
</tr>
<tr>
<td>Interest Coverage Ratio</td>
<td>404.8% 4</td>
<td>115.0%</td>
</tr>
</tbody>
</table>

1 as of end of 1997  
2 as of October 2008  
3 as of June 2008, Basel I  
4 as of end of 2007

a. Short-Term Debt: Debt with original maturity shorter than 1 year  
b. Current Debt: Debt with remaining maturity shorter than 1 year
Korea’s Foreign Reserves

**Total foreign exchange reserves**

<table>
<thead>
<tr>
<th>Year/Quarters</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
<th>Q4</th>
<th>Oct</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total foreign exchange reserves (US$ bn)</td>
<td>74</td>
<td>96</td>
<td>103</td>
<td>121</td>
<td>155</td>
<td>199</td>
<td>210</td>
<td>239</td>
<td>262</td>
<td>264</td>
<td>258</td>
<td>239</td>
<td>212</td>
<td>1</td>
</tr>
</tbody>
</table>

1 Primarily due to government’s provision of FX reserves to banking sector

**Largest global reserve holders (October 2008)**

<table>
<thead>
<tr>
<th>Country</th>
<th>FX reserves (US$ bn)</th>
<th>Median of peers1: US$ 29.2bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>1,906</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>996</td>
<td></td>
</tr>
<tr>
<td>Russia</td>
<td>556</td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>286</td>
<td></td>
</tr>
<tr>
<td>Taiwan</td>
<td>281</td>
<td></td>
</tr>
<tr>
<td>Korea</td>
<td>212</td>
<td></td>
</tr>
<tr>
<td>Singapore</td>
<td>169</td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>161</td>
<td></td>
</tr>
</tbody>
</table>

1 Includes Hong Kong (AA+), Slovenia (AA), Portugal (AA-), Italy (A+), Chile (A+), Czech Republic (A) and Estonia (A). Credit ratings by S&P. Source: IMF.

**Are Korea’s FX reserves liquid enough?**

- Bonds mostly rated AA or above: 192.5 (90.7%)
- Deposit: 19.3 (9.3%)
- Others: 0.5 (0.2%)

Source: Bank of Korea
Korea’s External Debt

Total External Debt and Short-term Debt

<table>
<thead>
<tr>
<th>Total Debt</th>
<th>Current debt</th>
<th>Short term debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>419.8</td>
<td>222.3</td>
<td>175.7</td>
</tr>
</tbody>
</table>

Proportion of total debt without default risk

- No default risk (34%)
- Hedges for shipbuilders’ export and overseas financial investment (22%)
- Cash Advances for Shipbuilding Contracts (12%)

External debt structure (US$ bn)

- Domestic banks: 127.4 (61%)
- Foreign bank branches: 83.1 (39%)

* Short-term debt: Debt with original maturity shorter than 1 year
* Current debt: Debt with remaining maturity shorter than 1 year
Soundness of Banking Sector

Moderating Loan Growth

Loan Growth (%)

<table>
<thead>
<tr>
<th></th>
<th>SME Lending</th>
<th>HH Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q4 07</td>
<td>4.2</td>
<td>2</td>
</tr>
<tr>
<td>Q1 08</td>
<td>4.2</td>
<td>1.1</td>
</tr>
<tr>
<td>Q2 08</td>
<td>5.0</td>
<td>1.6</td>
</tr>
<tr>
<td>Q3 08</td>
<td>2.9</td>
<td>1.8</td>
</tr>
</tbody>
</table>

Delinquency Ratio (%)

<table>
<thead>
<tr>
<th></th>
<th>SME Lending</th>
<th>HH Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>1.0%</td>
<td>0.5%</td>
</tr>
<tr>
<td>May-08</td>
<td>1.5%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Jun-08</td>
<td>1.1%</td>
<td>0.5%</td>
</tr>
<tr>
<td>Jul-08</td>
<td>1.4%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Aug-08</td>
<td>1.5%</td>
<td>0.7%</td>
</tr>
<tr>
<td>Sep-08</td>
<td>1.5%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>

Low Delinquency Ratio

Sufficient Room to Withstand Default Risks

- Absorptive Capacity for the impact of default risk
  - Coverage ratio is approximately 186%
  - LTV ratio is approximately 47%
- Well-diversified lending
  - Manufacturing (35.2%), Real estate (17.1%), Wholesale and Retail (14.3%), Construction (9.7%)
- Stringent risk management system implemented after Asian Financial Crisis

Moderate Loan-to-Deposit Ratio

Loan-to-Deposit Ratio (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>SME Lending</td>
<td>123.7%</td>
<td>126.5%</td>
<td>128.2%</td>
<td>126.8%</td>
</tr>
<tr>
<td>HH Lending</td>
<td>104.2%</td>
<td>104.2%</td>
<td>105.4%</td>
<td>104.6%</td>
</tr>
</tbody>
</table>

Source: Financial Supervisory Services
Household Debt and Real Estate Bubble?

**Household Debt to GDP Ratio (%)**

- Korea (08 June): 83
- U.S. (07 Mar): 100
- U.K. (07 Mar): 99
- Japan (07 Mar): 67

**Household Financial Debt to Financial Asset Ratio (%)**

- Korea (Jun 08): 45
- U.S. (Dec 07): 32
- U.K. (Dec 07): 35
- Japan (Dec 07): 23

**Real Estate to HH Asset Ratio (%)**

- Korea (Jun 08): 77
- U.S. (Dec 05): 34
- U.K. (Dec 05): 46
- Japan (Dec 05): 42
### Household Debt and Real Estate Bubble (II)

- **Stricter regulation on mortgage than other countries**

<table>
<thead>
<tr>
<th>Country</th>
<th>Korea</th>
<th>U.S.</th>
<th>Hong Kong</th>
<th>Germany</th>
<th>Japan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage/ GDP</td>
<td>33.4%</td>
<td>72.3%</td>
<td>37.3%</td>
<td>52.4%</td>
<td>36.2%</td>
</tr>
<tr>
<td>Regulation System</td>
<td>Direct</td>
<td>Indirect</td>
<td>Direct</td>
<td>Mixed</td>
<td>Indirect</td>
</tr>
<tr>
<td>LTV Limit</td>
<td>40-60%</td>
<td>-</td>
<td>60-70%</td>
<td>60% (Portion)</td>
<td>Indirect</td>
</tr>
<tr>
<td>DTI Limit</td>
<td>40%</td>
<td>-</td>
<td>60%</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

### Improving loan to value ratio

<table>
<thead>
<tr>
<th>Year</th>
<th>LTV ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>52.2</td>
</tr>
<tr>
<td>2006</td>
<td>49.5</td>
</tr>
<tr>
<td>2007</td>
<td>47.9</td>
</tr>
<tr>
<td>1Q08</td>
<td>47.5</td>
</tr>
<tr>
<td>2Q08</td>
<td>47</td>
</tr>
</tbody>
</table>

### Source
- Bank of Korea Financial Stability Report, April 2008

1 Financial Surplus = Financial Asset Increase - Financial Liability Increase.
2 Financial assets and liabilities exclude trade credits and other miscellaneous non-interest-bearing financial assets and debts.
## Why then Some Negative Perceptions?

### Two Main Reasons

#### (1) Korea’s high openness

- **High trade dependency** (Export / Import as % of GDP, as of 2007)
  - Korea (38.7 / 37.2), US (8.4 / 14.6), Japan (16.3 / 14.2), China (37.5 / 29.4),
  - UK (15.9 / 22.5), Germany (41.1 / 33.0), Spore (185.5 / 163.2), HK (166.4 / 177.7)

- **Open capital market**
  - Foreign investors’ share in Korea’s KOSPI: 42% (2004) → 29% (Nov 2008)
  - US (11.3%, Jun 07), Taiwan (30.9%, Oct 08), France (38.2%, Sep 07),
  - Mexico (35.5%, Jun 08), UK (40.0%, end 06), OECD average (25%)

#### (2) Psychological factors

- The 1997-98 currency crisis and impact on investors' psychology

### Performance of KOSPI (2008 YTD)

![KOSPI Performance Chart](chart.png)

- Closing Price (KRW)
- Jan, Feb, Mar, Apr, May, Jun, Jul, Aug, Sep, Oct, Nov
- 1,900, 1,700, 1,500, 1,300, 1,100, 900
- KOSPI: 1,124
1. Macroeconomic Performance

2. Korea’s External Position & Financial Strengths

3. Government’s Policy Responses

Korea’s Policies toward Financial Market Stability

#1 Foreign Currency Provision

- US$ 45bn to the banking sector by utilizing FX reserves (since October)
- Fed-BOK Currency Swap (US$ 30bn)
- Possible Expansion of Swaps with China and Japan
  (Existing swap line: USD 4bn with China, USD 13bn with Japan)

#2 BOK’s Liquidity Provision

- Through RP (KRW 7.5 trn)
  and Bank Debenture (KRW 0.8 trn) purchase

#3 3 Year Guarantees of Bank’s Foreign Borrowing up to US$ 100bn
Fiscal stimulus package

**Fiscal Stimulus Package: Approximately KRW 33trn (US$ 26bn, 3.7% of GDP)**

- Expansion of public expenditure for investing in infrastructure and strengthening social safety net (KRW 15.6 trn)
- Reduction in personal income and corporate taxes (KRW 17.7trn)

<table>
<thead>
<tr>
<th>Country</th>
<th>Amount</th>
<th>GDP Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Korea</td>
<td>KRW 33 trn</td>
<td>3.7%</td>
</tr>
<tr>
<td>U.S.</td>
<td>USD 317 bn</td>
<td>2.3%</td>
</tr>
<tr>
<td>Japan</td>
<td>JPY 6.7 trn</td>
<td>1.2%</td>
</tr>
<tr>
<td>China</td>
<td>RMB 4 trn</td>
<td>17.7% (over 3 yrs)</td>
</tr>
</tbody>
</table>
Korea’s Strong Fiscal Strength enabling Further Stimulus

**Trend of Korea’s fiscal balance**

Consolidated fiscal balance (% of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2Q08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance</td>
<td>1.1%</td>
<td>1.2%</td>
<td>3.3%</td>
<td>1.0%</td>
<td>0.7%</td>
<td>0.4%</td>
<td>0.4%</td>
<td>3.8%</td>
<td>2.1%</td>
</tr>
</tbody>
</table>

Source: Ministry of Strategy and Finance

**Relatively Low Debt Level**

Government debt to GDP (%)

- Korea: 180.0%
- US: 180.0%
- Japan: 62.0%
- Germany: 66.0%
- France: 72.0%
- OECD Average: 77%

Source: S&P Sovereign Risk Indicator, July 2008

**Comparison with other countries**

Fiscal surplus (% of GDP)

- Korea (A): 2.1%
- US (A): -0.4%
- Japan (AA): -2.5%
- Germany (A+): -2.9%
- France (A): -2%
- AA median: -2%
- Hong Kong (AA+): -1.3%
- Slovenia (AAA): -0.5%
- Portugal (AA+): -0.3%
- Taiwan (AA-): -0.7%
- Italy (A+): -0.4%
- China (A+): -2%
- Iceland (A): -4%

Source: OECD and IMF

Korea's Strong Fiscal Strength enabling Further Stimulus

- Relatively Low Debt Level
- Trend of Korea’s fiscal balance
- Comparison with other countries
Monetary Easing

BOK’s Base Rate Trend (%)

- Current rate: 4.00%
- △0.25% (Oct 9)
- △0.75% (Oct 27)
- △0.25% (Nov 7)

Other Central Banks’ Equivalent Rate

- USA: 1.0%
- UK: 3.0%
- Japan: 0.3%
- ECB: 3.75%
- Canada: 2.25%
- China: 6.66%
1. Recent Macroeconomic Developments

2. Current Issues & Answers

3. Government’s Policy Responses


### Original Forecast

<table>
<thead>
<tr>
<th>GDP Growth</th>
<th>Job Creation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Around 3%</td>
<td>120,000 ~ 130,000</td>
</tr>
</tbody>
</table>

### Policy Effect

<table>
<thead>
<tr>
<th>GDP Growth</th>
<th>Job Creation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Around 1%</td>
<td>70,000 ~ 80,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Policy Effect Item</th>
<th>Impact (p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax credit (KRW 4.4 tn)</td>
<td>0.2%</td>
</tr>
<tr>
<td>Supplementary budget (KRW 4.6 tn)</td>
<td>0.3%</td>
</tr>
<tr>
<td>Tax cut (2009: KRW 10.3 tn)</td>
<td>0.5%</td>
</tr>
<tr>
<td>Additional Fiscal Measures (Nov. 3)</td>
<td>0.4%</td>
</tr>
<tr>
<td>- Expenditure (KRW 11 tn)</td>
<td></td>
</tr>
<tr>
<td>- Tax cut (09: KRW 0.9 tn)</td>
<td>0.03%</td>
</tr>
<tr>
<td>- Front-loading of Expenditure</td>
<td>0.1%</td>
</tr>
<tr>
<td>Deregulation &amp; monetary easing</td>
<td>+α</td>
</tr>
</tbody>
</table>

### After Stimulus

<table>
<thead>
<tr>
<th>GDP Growth</th>
<th>Job Creation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Around 4%</td>
<td>190,000 ~ 210,000</td>
</tr>
</tbody>
</table>

- Continued deregulations
- Enhancement of labor market flexibility
Thank You