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What has been happening in Korea
Since the crisis in 1997

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The Korean economy today is categorically different from what it was 4 years ago, and efforts to further promote sound economic policies and restructuring of the corporate and financial sectors are ongoing, which will firmly place Korea on a trajectory to join the leading industrialized nations.

Resulting from the efforts since the financial crisis in 1997, the Korean economy recovered much more quickly than expected and has proven itself to be resilient as it stayed intact during the recent global economic downturn. The following data clearly demonstrate some of the successful outcomes from the continued restructuring efforts.

1.Macroeconomic Environment in the end of 2001

As expected, weakness in external demand and in investment expenditure continued through 2001, and is likely to constrain growth through the first half of 2002. The expected rebound in global growth, along with a stronger consumer demand and continued stimulating policies, will contribute to swifter recovery in the second half of 2002.

The Bank of Korea will conduct a flexible monetary policy in line with the developments of the internal and external environment in order to boost the economy, paying keen attention to the development of inflationary pressures. Now the government intends to carry out fiscal policy with a focus on early economic recovery. And the long track record of sound fiscal policies and the rapid recovery from the crisis in 1997 left ample room for the government to pursue deficit financing when necessary, without jeopardizing long-term fiscal health and stability.

<Table 1> Aggregate Indices of Macroeconomic Environment

(% / million US$)	1995	1996	1997	1998	1999	2000p	2001p
Real GNP Growth Ratio	8.9	6.8	5.0	△6.7	10.9	8.8	2.8
CPI Growth	4.7	3.2	3.9	12.2	△2.1	2.0	1.9
Unemployment Rate	2.0	2.0	2.6	6.8	6.3	4.1	3.7
Current Balance	△8,508	△23,005	△8,167	40,365	24,477	11,405	9,964
Foreign Exchange Reserves	293.9	294.2	88.7	485.1	740.5	962.0	1,028.2

Source : Bank of Korea (www.bok.or.kr)

2.External Position

During the crisis in 1997, the external position of Korea was very weak. But the external liquidity remained exceptionally strong throughout 2001 and is expected to continue to improve in 2002.

The total external assets reached US$161.9 billion in the end of 2001, and the net external assets reached US$42.0 billion. The rise in the export credits, external assets in the private sector and FX reserves contributed to increase, despite the redemption of overseas deposits and loans from the overseas branches of financial institutions. In fact, Korea is one of three net creditor countries in the OECD.

Korea now holds the world's fifth largest stock of foreign exchange reserves. Having dipped below $4 billion during the 1998 crisis, the reserves now exceed US$103 billion. Interest received will contribute to a further accumulation of reserve over time. As of the December 2001, the ratio of external liabilities to GDP stood at 25.5%, maintaining Korea's position as a less-indebted country according to the World Bank standards. The ratio of short-term liabilities to FX reserves stood at 37.8%, and continues to improve.

<Table 2> Total Assets and Liabilities

	Dec. 1997	Dec. 1998	Dec.1999	Dec.2000	Dec.2001(p)
Total External Liabilities	159.3	148.7	137.1	131.7	119.9
Public Sector	22.3	36.5	29.5	28.3	20.8
Domestic Financial Institutions	70.3	57.1	47.3	37.8	32.1
Branches of Foreign Banks	19.6	13.9	13.7	13.0	10.7
Domestic Corporations	47.1	41.2	46.6	52.6	56.3
Long-Term Liabilities	95.7	118.0	97.8	83.8	81.0
Short-Term Liabilities	63.6	30.7	39.2	47.9	38.9

Total External Assets	105.2	128.5	145.4	164.7	161.9
Public Sector	21.5	52.9	74.9	97.0	103.7
Domestic Financial Institutions	68.6	59.6	53.6	49.4	39.3
Branches of Foreign Banks	3.5	4.3	3.7	5.8	5.5
Domestic Corporations	11.7	11.8	13.2	12.5	13.4
Net External Assets	△54.1	△20.2	8.3	33.1	42.0

Source : Ministry of Finance and Economy (www.mofe.go.kr)

Consistent with its robust external position, Korea repaid the remainder of the US$19.5 billion it had borrowed from the IMF on August 23, 2001, three years ahead of schedule. Korea is the first country to do so among the Asian nations that suffered from the financial crisis in 1997.

3.Restructuring in Financial and Corporate Sectors

During the past 4 years, the government has made long strides in its reform efforts in both the corporate and financial sectors. In order to implement efficiently the restructuring plans to quickly overcome and recover from the economic crisis in 1997, the Korean government proposed the consolidation of the four existing financial supervisory authorities, i.e. the Office of Bank Supervision (OBS), the Securities Supervisory Board (SSB), the Insurance Supervisory Board (ISB), and the Non-Bank Supervisory Authority (NSA). The proposal prompted the drafting of reform bills including the revised Bank of Korea Act and the Act on Establishment of Financial Supervisory Organization, which were passed on December 29, 1997.

On April 1, 1998, Korea's first integrated financial supervisory body, the Financial Supervisory Commission (FSC) was founded, and it immediately took on the task of reforming domestic financial institutions and large business groups and oversaw restructuring in the corporate and financial sectors. And on January 1, 1999, the four separate regulators (OBS, SSB, ISB and NSA) were consolidated into a single supervisory body as the Financial Supervisory Service (FSS), thus creating an integrated financial regulatory and supervisory system, for the first time in Korea.

3.1. Financial Sector

First of all, through conservative and effective use of public funds, the government has largely completed the recapitalization of the banking sector, bringing banks in line with the internationally acceptable BIS capital adequacy ratios and helping them to restore their profitability.

By the end of 2001, a total of 155.2 trillion won had been injected toward the financial sector restructuring. The most widely used channels of allocating public funds were the equity participation (KRW60.2 trillion) and purchases of bad loans (KRW25.8 trillion). Redeemed public funds at the end of December 2001 amounted to KRW40.8 trillion.

<Table 3> Prudent Use of Public Funds in Financial Restructuring

	Recapitali-zation	Loss Coverage	Payment for Deposits	Asset Acquisition	Purchase of Bad Loan	Total
Bank	33.9	13.6	-	13.3	24.5	85.3
Non-Bank	26.3	2.7	25.8	1.0	11.9	67.7
Merchant Banks	2.7	-	17.2	-	1.6	21.5
Securities Co.	-	-	0.01	-	0.1	0.1
Investment Trust Co.	7.7	-	-	-	8.2	15.9
Insurance CO.	15.9	2.6	-	0.4	1.8	20.7
Credit Unions	-	-	2.1	-	-	2.1
Mutual Saving & Finance	-	0.1	6.5	0.6	0.2	7.4
Foreign Financial Institutions	-	-	-	-	2.3	2.3
Total	60.2	16.3	25.8	14.3	38.7	155.3

Source : Financial Supervisory Service (www.fss.or.kr)

Since the financial crisis, a number of critically ailing banks and other financial companies posed a major obstacle to the reform efforts aimed at stabilizing the financial market. Accordingly, the FSC/FSS responded by swiftly closing down financial companies that were deemed non-viable after an exhaustive review of their financial situation. As a result, between January 1998 and December 2001, 610 financial companies were removed from the market through closures and mergers.

<Table 4> Closures and Mergers of Financial Companies

	Bank	Merchant Bank	Securities Co.	Insurance Co.	Leasing Co.	ITC	Mutual Savings	Credit Unions	Total
Jan. 1998	33	30	36	50	25	30	231	1,666	2,101
Closed etc.	△14	△28	△7	△15	△10	△7	△122	△407	△610
Newly Created	1	1	16	9	3	6	12	9	57

Dec. 2001	20	3	45	44	18	29	121	1,268	1,548

Source : Financial Supervisory Service (www.fss.or.kr)

Resulting from the use of public funds and restructuring financial institutions, the general operating environment for Korean financial companies has improved. The pre-provisioning profits continued their positive trend since 1999, rising to 14.8 trillion won. Net profit for the sector as a whole amounted to 5.2 trillion won, and all commercial banks except for one, Peace Bank, were profitable in 2001. Overall, Korean commercial banks have dramatically improved their asset quality through write-offs or sales of bad loans, and through provisioning for potential losses. Further, thanks to the continued the NPL reduction, banks' provisions fell to 8.6 trillion won, a 24.8% decrease from 2000,.

<Table 5> Improving Fundamentals of Commercial Banks

(%)	1997	1998	1999	2000	2001
NPL ratio	6.0	7.4	13.6*	8.8	3.3
BIS Capital Adequacy ratio	7.0	8.2	10.8	10.5	10.7
Return of Asset ratio	△0.93	△3.25	△	△0.57	0.77
Return of Earning ratio	△14.18	△52.53	△	△11.9	16.07

Source : Financial Supervisory Service (www.fss.or.kr)

*at the end of 1999, the new criteria for provisioning has been enhanced.

3.2. Corporate Sector

Non-financial companies listed on the Korea Stock Exchange (KSE) have aggressively deleveraged, bringing their debt/equity ratio down from 336.9% at the end of 1997 to 131.2% at the end of the third quarter in 2001. Over the same period return on equity rose from –0.3% to 1.9%.

As of the end of first half in 2001 the manufacturing sectors (both listed and non-listed companies) had an average interest coverage ratio of 170.5%, up from 129.1% in 1997. In addition, the top 30 largest business groups' debt ratio also fell from 502.8% in 1997 to 171.2% in 2000. The number of mergers and acquisitions has been increasing since 1997

<Table 6> Indices of management in non-financial companies

(trillion won)	1997	1998	1999	2000	3Q 2001
Assets	482.3	494.2	528.0	514.4	526.8
Liabilities	371.9	350.9	306.9	302.2	298.9

Equity	110.4	143.3	221.0	212.2	227.8
Debt-Equity Ratio (%)	336.9	244.9	138.9	142.4	131.2
Operating Income	29.5	26.6	28.1	37.1	24.5
ROE (%)	0.3	0.4	4.4	2.7	1.9

Source : Korea Listed Companies Association (Among 609 listed companies whose fiscal year ends in December 2001)

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<Table 7> Interest Coverage Ratio of Manufacturing Companies

	1997	1998	1999	2000	1H 2001
Manufacturing Sector					
Interest Coverage Ratio (%)	129.1	68.3	96.1	157.2	170.5
30 Largest Business Group					
Total Debt (trillion won)	357.0	367.0	283.0	265.0	-
Debt-Equity Ratio (%)	512.8	379.8	218.7	171.2	-
Number of Affiliated Firms	N/A	804	686	544	624
Other Data					
# of Outside Directors / Total # of Directors (%)	-	11.4	24.8	30.9	35.3
Number of Merger & Acquisition	418	486	557	703	-

Source : Bank of Korea (www.bok.or.kr)

3.3. Reform of Restructuring

Ultimately, these efforts have contributed to developing a more market-oriented economical system and the fostering of a genuine credit culture in which financial institutions make lending decisions on an arms-length basis.

As such, since March of 2001, the government has taken a less active role in the restructuring process, allowing the market-oriented approach to dominate. Such shift in its roles effectively reduces moral hazard leaving a self-sustaining reform mechanism.

Going forward, the government will continue to foster an environment in favor of continued reform of banks, corporations, and non-bank financial institutions. The agreement between the governing and opposition parties together with the government has forged a broad political consensus in support of continued reforms ensuring that the process will be immune from politics leading to the 2002 election.

In accordance with the agreement between the ruling and opposition parties and the government, the Corporate Restructuring Promotion Law (CRPL) was enacted on September of 2001. The legislation reflects a general consensus on the issue of prompt corporate restructuring. This cooperative venture by both the legislature and the administration is a sign of their significant commitment to work together toward successful restructuring.

At the center of the market-driven restructuring process is improved credit risk management by commercial banks. As of March 2001, every bank has implemented a "credit risk assessment system" according to the guidelines set by the FSC. Under the FSC guidelines, financial institutions must establish and implement a credit risk assessment plan semi-annually. Currently, in an effort to maximize the efficiency in the exit process, the government is promoting the consolidation of related laws, including the Bankruptcy Law, Corporate Reorganization Act and Composition Act.

4.Conclusions

Korea's sound macroeconomic policies are already reflected in the Republic's strong external and internal balance. On the external side, liquidity continues to grow stronger, with foreign exchange reserves surpassing $103 billion (as of end-January 2002), equivalent to more than two and a half times short-term external liabilities. A continuing current account surplus and adoption of a flexible exchange rate policy will support the external position going forward.

Internally, sound management has resulted in fiscal consolidation and a low-inflationary environment conducive to growth. Fiscal policy and public debt management, in particular, have been exemplary, with the fiscal balance returning to surplus much sooner than expected. Public debt, already low by OECD standards, is expected to continue to decline.

Korea's strong fundamentals have enabled the government to respond appropriately to internal and external shocks. Most recently, the response to the downturn in 2001 exemplifies the government's policy flexibility and credibility. Both monetary and fiscal policies were eased substantially in 2001, but without damaging long-term fiscal health or anti-inflation credibility. As a result, Korea outperformed most of its neighbors in Asia in 2001 and is on the right track to do the same in 2002.