Ⅱ. Economic and Financial Movements

1. Overseas Economy

A. Economic Growth and Trade

The world economy showed signs in the course of 2002 of pulling out of its sluggishness of the previous year, but the speed of the recovery failed to live up to expectations. The growth of the world economy was limited to a small rise from the previous year's 2.2% to 2.8%.(Taken from the IMF Outlook. Unless otherwise noted, all subsequent GDP growth rates in the course of 2002 are on the basis of the IMF's World Economic Outlook, Sep. 2002).

<Table Ⅱ-1>

Trends of Major Overseas Economic Indicators

(%, annual %)

	1999	2000	2001	2002e
Economic Growth[1]				
World	3.6	4.7	2.2	2.8
Industrialized nations	3.3	3.8	0.8	1.7
U.S.A.	4.1	3.8	0.3	2.4
Japan	0.1	2.8	0.4	0.3
Euro area	2.6	3.5	1.5	0.9
(Germany)	2.0	2.9	0.6	0.2
Asian emerging markets[2]	7.9	8.5	0.8	4.7
Developing nations	3.9	5.7	3.9	4.2
Asia	6.2	6.7	5.6	6.1
(China)	7.1	8.0	7.3	8.0
Latin America	0.1	4.0	0.6	-0.6
World trade growth[1]	5.4	12.6	-0.1	2.1
Long-term interest rates[3]				
U.S.A.	5.11	5.11	5.05	3.81
Japan	1.64	1.64	1.37	0.91
Germany	4.84	4.84	5.00	4.20
Exchange rates[4]				
¥/U$	102.5	114.8	131.4	118.7
U$/euro	1.007	0.930	0.885	1.049
Prices of international raw materials				
Rise in crude oil prices[5]	39.9	59.8	-14.4	2.3
Others[6]	-14.0	1.9	-10.1	1.9

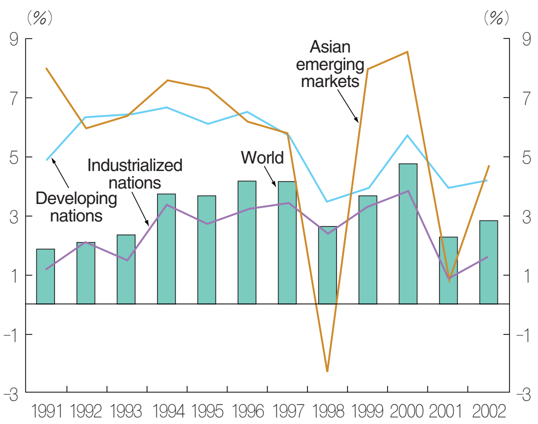
Notes: 1) Based on IMF statistics apart from the growth of the U.S., Japan, Germany and China, which are based on their respective statistics.
2) Korea, Taiwan, Singapore and Hong Kong.
3) Based on the yields of 10-year government bonds and on period-end figures.
4) Based on period-end figures.
5) Based on annual average of Brent crude prices.
6) Based on annual average of the Reuters' Product Price Index.
Source: "World Economic Outlook" (Sept. 2002) by the IMF. Bloomberg, Reuters.

In the United States, GDP growth rose from the previous year's 0.3% to 2.4%(U.S. Department of Commerce figures). The growth was led by increased consumption of durables, notably automobiles, and was also influenced by the buoyancy of housing construction. The recovery trend, however, was not only rather feeble, it also showed signs of slowing down slightly over the course of the year. This was attributable to the progressive weakening of consumer spending, which was the driving force for economic recovery from the beginning of the year. At the same time, companies' zeal for investment shrank in response to the subdued state of the stock market, the murkiness of the prospects for the IT industry and the high level of geopolitical risk.

Once again in 2002, the Japanese economy was unable to break free of the doldrums, because, even though exports(customs clearance basis) shifted from the previous year's 5.2% contraction to a 6.4% increase, consumption and investment remained at a low level owing to the fall in share prices and the high degree of uncertainty surrounding the economic situation at home and abroad. The downward trend of consumer prices intensified(-0.7%→-0.9%) and the unemployment rate rose from the previous year's 5.0% to 5.4%.

<Figure Ⅱ-1>

Trends of World Economic Growth

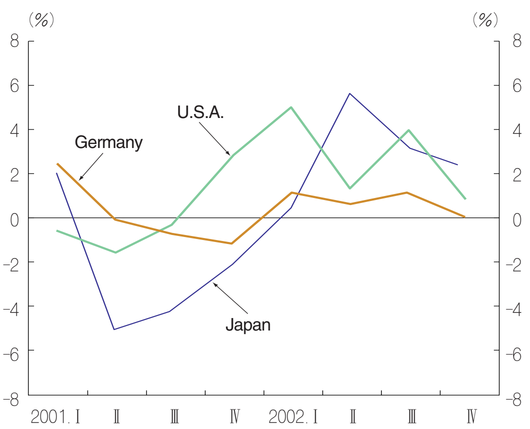


Source: "World Economic Outlook"(Dec. 2002) by the IMF.

In the euro-area, the economy bore a subdued aspect with economic growth, for example, falling from the previous year's 1.5% to 0.9%. Domestic demand was flat partly in response to the dormant stock market while export growth was weak as a result of the delayed recovery of the US economy and so forth. The German economy, in particular, registered growth of only 0.2%(Federal Statistical Office Germany), its lowest level since 1993(-1.1%), as a result of the sharp contraction of consumption and investment[1]. France and Italy, which rank second and third in their share of the euro-area economy as a whole[2], saw their economic growth rate fall from 1.8% in the previous year to 1.2% for the former and 0.7% for the latter.

<Figure Ⅱ-2>

Trends of Economic Growth in Major Industrialized Nations[1]



Note: 1) Based on individual countries' statistics. Annualized quarter-to-quarter changes.

The Asian region experienced a comparatively more rapid recovery trend than other regions with economic growth being driven by exports. Most notably, the Chinese economy continued its strong pace growing by 8%(National Bureau of Statistics of China, estimate), in that the rate of increase of exports accelerated greatly from the previous year(6.8%→22.3%) and, spurred on by a large-scale expansion of foreign direct

1) In 2002, German retail sales fell 2.9% and orders for capital goods by 0.9%.

2) These three member states account for 69.6% of the euro-area economy as a whole (2001 GDP basis. Germany 30.3%, France 21.5% and Italy 17.8%).

<Table Ⅱ-2>

Rate of Increase of Exports in the Asian Region

	China	Taiwan	Hong Kong	Singa-pore	Thai-land	Malay-sia	Phili-ppines
Exports to China	-	39.3	14.5	37.2	18.8	49.8	65.3
Gross Exports	22.3 (6.8)	6.3 (-17.2)	8.9 (-5.8)	2.7 (-8.3)	5.8 (-6.4)	6.0 (-10.3)	9.0 (-15.6)

Notes: 1) Based on performances in 2002.
2) Figures in parentheses refer to the rates of increase of exports in 2001.
Sources: The Bank of Korea, KITA.

investment[3], facilities expanded on a large-scale[4]. After experiencing negative growth during 2001, the economies of both Singapore and Taiwan revived rapidly to grow at the 3% level. The growth rates of both Thailand and Malaysia also rose from around the 1% mark in the previous year to the 3% level. The main reason for this pick-up was that their exports, which had shrunk sharply in the preceding year under the impact of the depressed state of the American IT industry, turned brisk again led by those to China. In the case of Hong Kong, however, owing to continued weakness of domestic demand in response to the plunge in asset prices, GDP growth failed to rise above the low level of 1%.

Turning to Latin America, a succession of panics including a financial crisis in Argentina[5], financial instability in Brazil(April 2002)[6], and political unrest in Venezuela (December 2002) meant that the regional economy was unable to break free of its sluggishness. Argentina has continued to mark negative growth since 1999 and growth rates in both Brazil and Chile are estimated to have fallen. Exceptionally, the Mexican economy shook off its negative growth of the previous year to chalk up growth of 1.5%, led by exports to the United States.

The growth of world trade (Vol. basis) during the year under review shifted from -0.1% in the preceding year

3) In 2002, foreign direct investment in China stood at $52.7 billion (performance basis), as against the previous year's $46.8 billion, an increase of 12.6%.
4) For the first 11 months of 2002, Chinese fixed investment rose by 23.4% over the same period of the preceding year.
5) The Argentinian government declared a default on $95 billion out of total outstanding foreign debts of $141 billion on December 23rd, 2001.
6) From April 2002, the strong likelihood of the Lula, the candidate of Workers Party being elected president led to an accelerated exodus of foreign capital and large falls in the stock market and the exchange value of the Brazilian Real.

to +2.1%(IMF Outlook), which was still a very low level compared to the annual average increase of 8.2% during the years between 1990 and 2000. There was a relatively large expansion within the Asian region centering on trade with China, but due to the delay in recovery of the U.S. and European economies, trade performance in other regions was only lackluster.

<Box Ⅱ-1>

Reasons for the German Economy's Sluggishness

There is concern that the economic downturn of the German economy, as evidenced by the continued low rate of growth and high level of unemployment, is becoming prolonged. German GDP growth has fallen sharply, dropping from 2.9% in 2000 to 0.6% in 2001 and 0.2% in 2002 while the rate of unemployment has risen to 9.8%. Stock prices(Dax Index) plunged 43.9% during the course of 2002.

Trends of Major German Economic Indicators

(%)

	1996～1999[1]	2000	2001	2002
GDP	1.6	2.9	0.6	0.2
Consumer price inflation	1.2	1.9	2.5	1.3
Unemployment rate	10.9	9.6	9.4	9.8
Movements in DAX Index	33.0	-7.5	-19.8	-43.9

Note: 1) Annual average

Although the reasons for the German economy's inability to pull out of its protracted downturn are in part cyclical, they are analysed as principally involving structural rigidities. These include the high tax burden imposed by the overly generous social safety net, the restrictions on the operation of macro economic policies, and the lack of labor market flexibility.

(Excessive social welfare benefits and high tax burden)

Enlargement of the tax burden on companies and households, due to the overly generous German social welfare system, has acted as a factor restricting corporate investment and household consumption. German taxes and social welfare contributions represent a burden equivalent to 40.7% of GDP(year 2000 basis), which is a high level compared to the United States(28.9%) or the United Kingdom(37.7%). It should be noted that the tax burden on the general public has greatly increased since the reunification of Germany with the expansion of the West German social safety net to cover the new Federal Lands and the massive transfer of funds(equivalent to some 4% of GDP annually from 1995 onwards) to revive the economy of those areas. Since the greater part of the huge resources required to fund the social welfare accounts including unemployment allowance, health insurance and pensions are raised through payroll taxes, unemployment is increased through a process whereby high payroll taxes lead to loss of the will to work, which raises wages higher, worsens corporate profitability, and triggers management rationalization.

(Restrictions on the operation of macro economic policy)

Under the EU's "Stability and Growth Pact(SGP)", Germany is obliged not to run a fiscal deficit larger than 3% of GDP. This places a limit on the ability to stimulate the economy through fiscal pump-priming because of the widened scale of the fiscal deficit following the weakening of tax revenues. Moreover, since the establishment of the European Central Bank(ECB), the country cannot pursue an individual monetary policy.

(Lack of labor market flexibility)

The German labor market is very rigid owing to the strict regulations of almost all aspects of it including working hours, employment contracts, dismissals and wage negotiations arrangements. Not only does this weaken corporate profitability and competitiveness, but it also makes it difficult in practice to expand new employment opportunities. In particular, the practice of collective bargaining for each industry means that the rate of wage increase applied universally within the industry is fixed at a high level on the basis of those outstanding large companies able to countenance these payments by a nation-wide industrial sector union having superior negotiating power, and this places a heavy burden on other enterprises.

(The after-effects of reunification)

The fact that wages of workers in the former East Germany were raised excessively for political reasons in the process of German reunification acted as a factor in the weakening of the competitiveness of firms in the new Federal Lands. The excessive wage rises in the East German area increased the number out of work, eroding its industrial base that had been centered on manufacturing and mining. And, again, that had an influence on the West German economy, and weakened its growth potential

B. International Interest Rates and Foreign Exchange Rates

<Table Ⅱ-3>

Trends of Short- and Long-Term Interest Rates[1] in Major Countries

(annual %)

	2001	2002				2003	
	Dec.	Jan.	Mar.	Jun.	Dec.	Jan.	Feb.
Long-term[2]							
U.S.A.	5.05	5.03	5.40	4.80	3.81	3.96	3.69
Japan	1.37	1.49	1.40	1.32	0.91	0.81	0.79
Germany	5.00	4.91	5.26	4.94	4.20	4.07	3.92
Short-term[3]							
U.S.A.	1.73	1.76	1.79	1.68	1.19	1.17	1.19
Japan	0.01	0.00	0.00	0.01	0.00	0.00	0.00
Germany	3.29	3.29	3.28	3.37	2.74	2.70	2.45

Notes: 1) Based on yields on 10-year government bonds.
2) Based on yields on 3-month Treasury bills.
Source: Bloomberg.

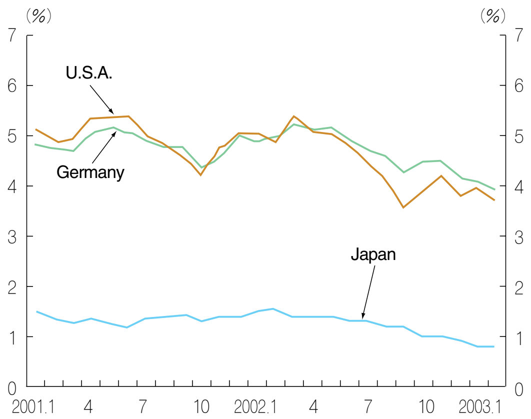
Looking at international interest rate trends in the course of the year under review, both long-term and short-term rates exhibited a downward trend under the influence of the low interest rate policy of major countries' central banks and increased purchases of bonds in response to the accelerated flight to quality.

The short-term rate in United States (yield on 3-month Treasury bills) fell from 1.73% at year-end 2001 to 1.19% at year-end 2002, because of the Federal Reserve's lowering of its target rate. In the first three months of the year, the short-term rate rose to 1.79% as the favorable showing of the principal economic indicators opened up the possibility of the Federal Reserve's raising interest rates. From April onwards, though, anticipations of a further reduction of interest rates mounted in view of the delay in economic recovery, and the benchmark short-term rate had fallen to 1.44% by October. In November, when the Federal Reserve lowered the Federal Funds rate(November 6)[7], it fell to 1.22% and subsequently continued to exhibit a mild downward trend. The long-term rate(yield on 10-year Treasury bonds) fell from 5.05% at the end of the previous year to 3.81% at the end of 2002 amid increased buying demand for secure long-term government bonds owing to the uncertainty of domestic and international economic conditions. The benchmark long-term rate had moved up to 5.40% during the first quarter, reflecting anticipations of a recovery in business activity, but from April onwards, when share prices fell on worries

7) The Federal Reserve's lowering of interest rates eleven times during 2001(6.5%→1.75%) and once in 2002(1.75%→1.25%), brought its Federal Funds rate to its lowest level in the forty-one years and five months since July 1961.

<Figure Ⅱ-3>

Trends of Long-Term Interest Rates[1] of Major Countries



Note: 1) Based on yields of each country's on 10-year government bonds. Period-end basis.
Source: Bloomberg.

about a double-dip recession of the US economy and the Latin American economy became unstable, it continued its downward trend to register 3.57% on the ninth of October, its lowest level for the forty-four years and two months since August 1958. From mid-October onwards, the benchmark long-term rate staged a temporary hike, influenced by a stock market rally in response to the favorable showing of several economic indicators, but it shifted back to a downward trend again from the beginning of December on the heightened probability of a war between the United States and Iraq.

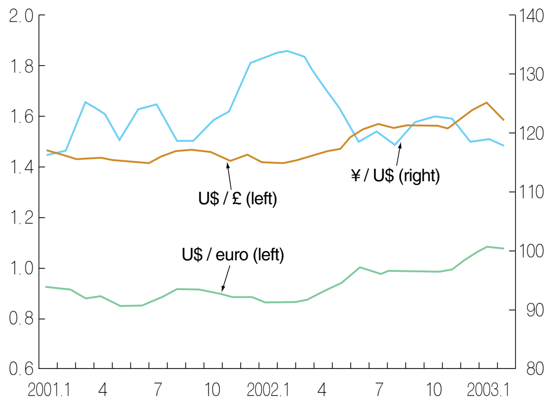
In Japan, the benchmark short-term rate(yield on 3-month Treasury bills) maintained its level of zero as the Bank of Japan continued the easing of its monetary policy stance. The long-term rates(yield on 10-year government bonds) showed a downward trend as the economic recession caused demand for capital to be subdued and the Bank of Japan increased its outright purchases of long-term government bonds[8]. During January and February, the financial institutions sold holdings of government bonds in large quantities to secure the liquidity necessary in the event of withdrawals of deposits ahead of the implementation of the partial deposit insurance system(April 1). This pushed the benchmark long-term interest rate up to 1.53%, but following the Bank of Japan's announcement that it would expand the supply of liquidity, financial institutions' appetite for bond purchases recovered and long-term interest rates dipped downward again to stand at under 1% by the beginning of the fourth quarter. From the beginning of

8) On February 28th, 2002, the Bank of Japan increased its outright purchases of long-term government bonds from 0.8 trillion yen per month to 1.0 trillion yen in order to provide liquidity smoothly, and on October 30th, it enlarged them once again to 1.2 trillion yen in support of government policy to cope with the problem of deflation.

the 2003, long-term interest rates sustained their downward trend and, as of January 30, the benchmark yield on 10-year government bond marked 0.75%, the lowest level ever registered.

<Figure Ⅱ-4>

Trends of Major Exchange Rates[1)]



Note: 1) Based on closing rates in local exchange markets. Period-end basis.
Source: Bloomberg.

In the euro-area, short-term interest rates showed an upward trend at the beginning of the year on anticipations of an economic recovery and the prospect that the European Central Bank(ECB), concerned over rising prices, would act to raise interest rates at an early stage. From July onwards, they marked a downward trend in view of the heightened likelihood of the ECB's lowering interest rates because of the delay in the recovery of business activity. The ECB, in fact, lowered its policy rate from 3.25% to 2.75% on December 5 to help bring about a recovery of the euro-area economy. The benchmark long-term interest rate(yield on 10-year government bonds) rose in the early part of the year in line with the rise of stock prices to reach 5.26% during March. From early in the second quarter, however, the euro-area share prices shifted to a downward trend and funds migrated to the euro-area public bond market in view of US financial market unrest. Consequently the benchmark long-term rate sustained a downward trend to reach 4.20% in December. And at the beginning of 2003, both long-term and short-term interest rates both showed a downward trend owing to the worries about a continuation of the economic doldrums and expectations of the ECB's lowering of its policy rate.

Looking at the exchange rate movements of major currencies during the year 2002, the US dollar exhibited a weak trend against most other major currencies. This resulted from a combination of factors including the depressed state of the stock market, the fall in long-term and short-term interest rates, the widening of the US current account deficit[9], and the shift back into deficit on the budget[10], which together reduced purchasing demand for US dollar assets, along with the emergence of geopolitical risks, particularly the possibility of a war between the United States and Iraq. The US dollar depreciated over the year by 9.7% against the Japanese yen and 15.6% against the euro, while against a basket, an arithmetic average, of four Asian currencies: the Thai baht, the Indonesian rupiah, the New Taiwan dollar, and the Singapore dollar, it fell by 5.7%.

<Table Ⅱ-4>

Changes in Major Countries' Exchange Rates[1)]

	Japanese Yen	Euro	Thai Baht	Indonesian Rupiah	New Taiwan Dollar	Singapore Dollar	Brazilian Real	Mexican Peso
2001	-12.6	-4.8	-1.8	-7.9	-5.5	-6.1	-16.4	4.4
2002	10.7	18.5	2.3	16.4	0.7	6.3	-34.1	-12.2

Note: The appreciation(+) or depreciation(-) rate of each currency against the US dollar and the Asian countries' (including Japan's) are exchange rates based on the Tokyo market.
Source: Bloomberg.

The Japanese yen began to show a weakening trend against the US dollar from the beginning of the year under review amid anticipations that the Japanese government would seek to induce its depreciation. From April onwards, however, it displayed a firmer tone, influenced by US financial market unrest and the widened scale of the US current account deficit, so that the dollar had softened to trade at 117.94 yen by August. As worries mounted over the structural problems of the Japanese economy including the worsening financial insolvencies, and US stock prices rallied, the yen softened to change hands at 122 yen to the dollar during October and November, but from early December the rampant geopolitical risks, etc. drove down the US dollar to the 119 yen level. At the beginning of 2003, the yen showed a weak trend for a while influenced by the rumor that the Bank of Japan would intervene in the foreign exchange market to soften up the yen. As a whole, however, it fluctuated around the level of 117 yen per US dollar because the

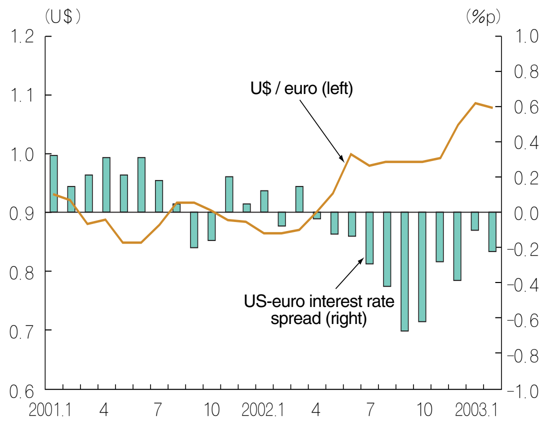
9) In the course of 2002, the US current account deficit widened by 28% against the previous year's $393 billion to reach $503 billion(4.8% of GDP), the largest volume ever registered
10) The US budget shifted to a $158 billion deficit(1.5% of GDP), in 2002 after having recorded a surplus of $127 billion in the preceding year.

dollar showed a weak tone as war between the United States and Iraq drew closer.

With the widening of the spread between US and the euro-area long-term interest rates and a growing recognition that euro denominated assets were a safe haven, there was a constant inflow of investment funds, so that the euro shook off its weakness of the preceding year (4.8% depreciation) and strengthened to change hands at 1.01 dollars per euro by July(14.1% appreciation). But from August onwards, the euro weakened slightly as the sluggishness of the euro area economy was highlighted, so that it fell back to 0.96~ 0.98 dollars per euro. In early December, the euro again moved to a stronger trend as the ECB's interest rate reduction fed expectations of economic recovery and the dollar softened. By the end of February 2003, one euro bought 1.08 US dollars.

<Figure Ⅱ-5>

Trends of Exchange Rates and Interest Rate Spreads between the US Dollar and the Euro[1]



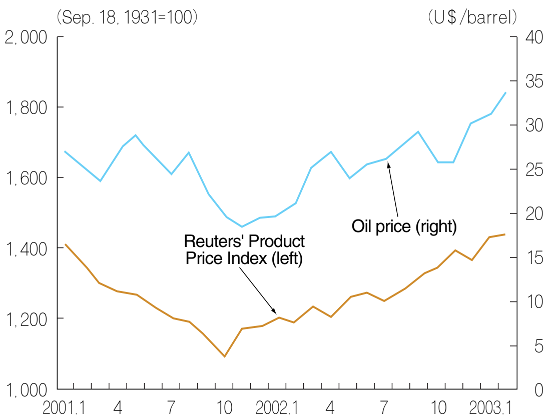
Note: 1) Spreads between the yields on 10-year government bonds of the U.S. and Germany. Period-end basis.
Source: Bloomberg.

C. International Raw Material Prices

International oil prices experienced a large-scale rise(55.7%, Brent crude basis) during the year, affected by the Middle East tensions and cutbacks in output by major oil-producing countries. In the early part of the year, international oil prices exhibited a stable trend thanks to the buildup of US oil reserves, but from March onwards, they rose steeply in response to cutbacks by major producers and the discontinuation of Iraqi oil exports to register 27 US dollars a barrel during May. Then they moved to a downward trend following the resumption of Iraqi oil exports and the announcement by non-OPEC countries including Russia and Norway of a plan to increase production. From June onwards, however, prices showed an upward trend again in the wake of OPEC's decision to maintain oil output quotas and the political unrest in

<Figure Ⅱ-6>

Trends of Prices of International Raw Materials[1]



Note: 1) International oil prices are based on annual averages of Brent crude price. Period-end basis.
Source: Reuters.

the Middle East over weapons inspection in Iraq, rising to 29 dollars a barrel by the end of September. During October and November, the price per barrel fell back to 23 dollars(November 14) as OPEC members increased production and Iraq again allowed UN weapons inspections(November 13). But from early December, as the likelihood of a US-Iraq war became acute and the strike by staff of the national oil company in Venezuela was prolonged, the price rose sharply to 30 dollars a barrel. In 2003, owing to the reduction of oil reserves and the rising geopolitical risk, international oil prices continued on an upward trend to stand at 34 US dollars per barrel.

Prices of raw materials apart from oil generally showed an upward trend. Industrial raw materials(nonferrous metals) rose during the first half of the year, reflecting anticipations of increased demand, but from early in the latter half of the year they fell back in response to the uncertainty of world economic prospects. For the year as a whole the price of copper rose by 5.6% and that of aluminium by 0.5%. International grain prices marked an upward trend because of poor harvests following the worsening of weather conditions in major producing areas. From September onwards, however, increased exports of some cereals in the northern hemisphere harvest season narrowed the scale of the rise in prices, with the price of maize rising by 12.8% and that of wheat by 12.5% for the year as a whole. As of the end of January 2003, the Reuters Commodity Index stood at 1431.7, a rise of 21.5% over its level of 1178.2 at the end of December 2001.

2. The Real Economy

A. Economic Growth

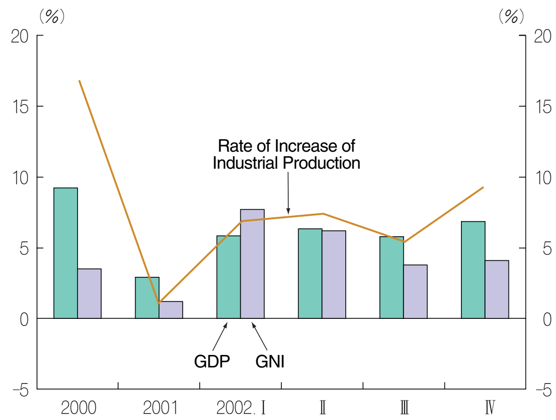
In the course of 2002, there was on acceleration of the case of growth of the Korean economy, which had shown only a low rate of growth in 2001. For the year 2002 as a whole, the growth of GDP registered 6.3%, considerably higher than the previous year's 3.1%. By period, GDP growth stood at 6.2% in the first quarter and accelerated its pace to 6.6% in the second quarter, and to 6.8% in the fourth quarter, though it eased a little to 5.8% in the third quarter.

The explanation for the acceleration of the Korean economy's pace of growth lay in the upswing in domestic demand in the form of consumption and construction investment during the first half of the year in response to measures, undertaken following the September 11 terrorist attacks on the United States, to stimulate the economy, and the rapid expansion of exports to the Asian region including China during the second half of the year. Notably in the fourth quarter, buoyant exports of IT products(semiconductors, mobile phone handsets, etc.) and automobiles maintained the upward trend of domestic economic activity, despite the uncertainty of external conditions including the possibility of a US-Iraq war and the slowdown of domestic demand brought about by the imposition of controls on household loans and of measures to cool the housing market.

Meanwhile, real gross national income(GNI), which shows the real purchasing power of income derived from production activities, rose by only 4.9%, the seventh year in succession since 1995 that it has trailed the growth of real GDP. The reason for this was once

<Figure Ⅱ-7>

Trends of Major Economic Growth[1] Indicators



Note: 1) Compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office.

<Table Ⅱ-5>

Trends of Growth[1] by Expenditure Item

(%)

	2000	2001	2002P				
			year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Final consumption expenditure	6.7	4.2	6.2	8.4	7.4	5.5	3.8
Private	7.9	4.7	6.8	8.9	7.9	6.2	4.3
Government	0.1	1.3	2.9	5.3	4.4	1.5	1.0
Gross fixed capital formation	11.4	-1.8	4.8	6.6	5.4	0.5	6.8
Construction	-4.1	5.3	3.3	9.7	3.8	-4.6	6.0
Facilities	35.3	-9.6	6.8	3.8	7.5	7.8	8.2
Increase in inventories[2]	-0.2	-0.1	-0.1	0.3	0.6	-0.5	-0.9
Exports of goods and services	20.5	0.7	14.9	2.4	12.8	20.3	24.2
(Goods)	23.0	0.3	17.1	3.8	15.3	22.9	26.5
Imports of goods and services	20.0	-3.0	16.4	6.5	18.8	20.5	20.0
(Goods)	21.0	-4.6	16.9	4.3	19.9	22.5	21.8
GDP	9.3	3.1	6.3	6.2	6.6	5.8	6.8

Notes: 1) Compared with the same period of the previous year.
2) Degree of contribution to GDP (percentage points).
Source: The Bank of Korea.

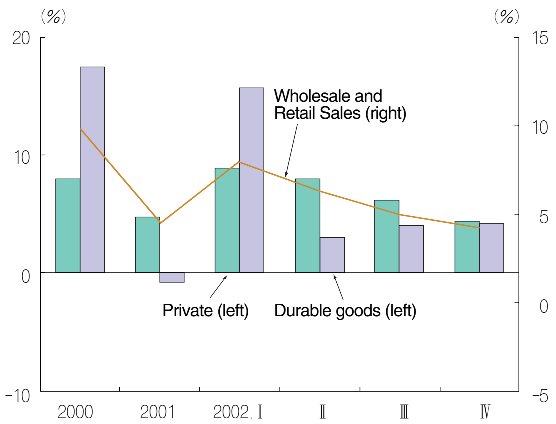
again the worsening of the terms of trade as the prices of export items fell relatively more than those of imports.

(Demand)

Viewing the trends of domestic demand for the year by sector, whereas consumption maintained an uninterrupted increasing trend, and the expansionary trends of both exports and facilities investment accelerated, the pace of construction investment slackened in the second half of the year.

<Figure Ⅱ-8>

Trends of Major Consumption Growth[1] Indicators

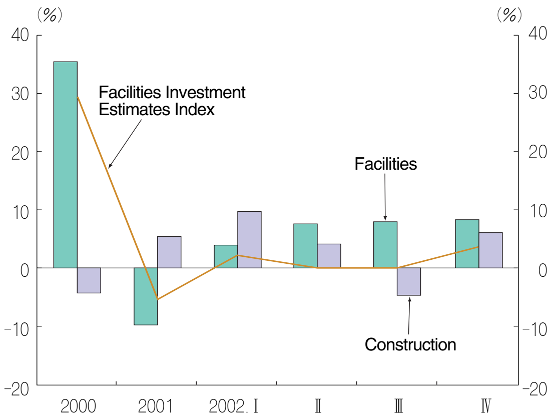


Note: 1) Compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office.

Consumption expenditure accelerated its upward trend with that of the private sector sustaining its robust growth trend and that of government, too, presenting a relatively lively pattern. Private sector consumption increased by 6.8% for the year as a whole. By period, it registered a high rate of increase of 8.4% in the first half of the year, affected by the economic recovery and measures to stimulate domestic demand, but in the latter half of the year its upward pace was slowed to 5.3% by the cooling of consumer sentiment brought about by the heightened uncertainties of the domestic and international environments. Viewed by component, the consumption of services and semi-durables was buoyant and that of durables maintained an unbroken upward trend, while that of non-durables remained at a low ebb. In the case of the consumption of durables, which are particularly sensitive to economic trends, an increase of 6.3% was recorded for the year as a whole. Notably, during the first quarter, it rose sharply to 15.6%, reflecting both a base period-effect and the reduction of special excise taxes, but from the second quarter onwards the scale of the increase narrowed greatly. Government consumption, which had been limited to a trifling increase of 1.3% in the previous year, saw its growth rate accelerate to 2.9% thanks to

<Figure Ⅱ-9>

Trends of Major Investment Growth[1] Indicators



Note: 1) Compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office.

active fiscal disbursements.

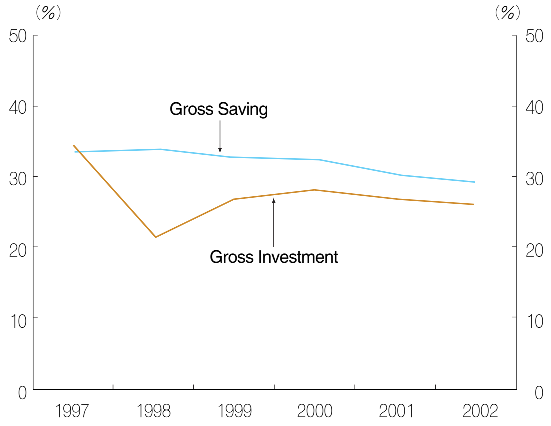
Viewing investment trends, fixed investment shifted to an increase from its contraction in the previous year, while inventories investment fell slightly. Among the components of fixed investment, facilities investment, which had been very slack during the previous year (-9.6%), staged an increase of 6.8%. This was because, despite the uncertainty of conditions at home and abroad, domestic businesses, gradually stepped up, albeit slowly their facilities investment, with the economy showing an upward trend thanks to the buoyancy of domestic demand in the first half of the year and the briskness of exports in the latter half.

And construction investment, which had marked a convincing rate of growth of 5.3% during 2001, registered a high rate of growth of 6.3% in the first half of 2002, thanks to the briskness of private sector construction, housing in particular, riding on the upswing of real estate prices. In the latter half of the year under review, however, it shrank swiftly to 1% as civil engineering activity, which was damaged by typhoons and floods, contracted and housing construction slowed in response to measures to cool down the housing market. But during the fourth quarter, it recovered slightly as non-residential construction became buoyant and civil engineering activity shifted back to an increase thanks to restoration work in areas that had suffered damage from floods.

Inventories continued to contract as they had been the previous year. The reason for their decline during the year under review was that those of manufactured products contracted thanks to the increase of exports and domestic demand, while the increase of those of agricultural and marine products declined sharply owing to reduced rice production.

<Figure Ⅱ-10>

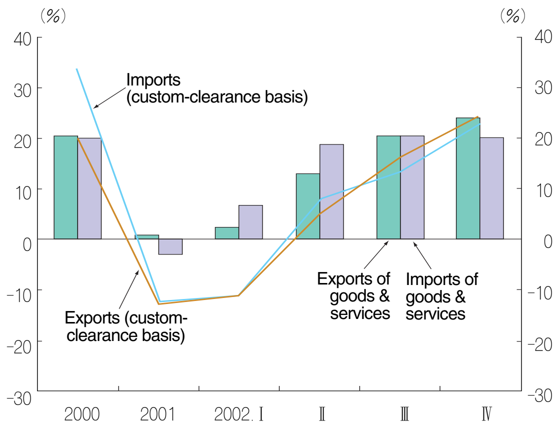
Trends of Gross Investment and Gross Saving



Source: The Bank of Korea

<Figure Ⅱ-11>

Trends of Major Import and Export Growth[1] Indicators



Note: 1) Compared with the same period of the previous year.
Sources: The Bank of Korea, Ministry of Commerce, Industry and Energy.

The gross domestic investment ratio(current price basis), which had declined to the level of 27.0% in the year 2001, fell slightly again to 26.1% in the year 2002, influenced by the slowdown of construction investment, among other factors. Meanwhile, the gross savings ratio fell further from the previous year's 30.2% to 29.2%, reflecting the robust growth of consumption. In consequence, the ratio of self-sufficiency in investment resources, which measures the extent to which gross domestic investment is covered by gross domestic savings, slipped slightly from the previous year's 112.1% to 111.8%.

From the beginning of 2002, exports of goods and services (real basis), which had presented a flat pattern with only a 0.7% increase in 2001, saw their upward trend accelerated sharply to record 14.9%. Broken down by period, in the first quarter the lackluster trend of the previous year was maintained with a 2.4% increase, but from the second quarter onwards the increasing trend of exports continued to accelerate. In spite of the delay in economic recovery in the advanced countries including the United States, the export of goods rose 17.1% during the year, boosted by the buoyant performance of Korea's principal export items such as automobiles and IT products including semiconductors and mobile phone handsets. Service exports, though, shifted from the preceding year's increase of 3.6% to a contraction of 3%, with a decrease in royalty revenues and a sharp falling-off in foreigners' spending on travel expenses in Korea.

Imports of goods and services(real basis), on the other hand, shook off their contraction of the previous year's (-3.0%) to register a large-scale increase of 16.4%. Imports of goods swelled by 16.9% during the year as imports of capital goods and raw materials shifted to an increase and those of consumer goods showed a large-

<Table Ⅱ-6>

Trends of Growth Rate[1] by Economic Activity

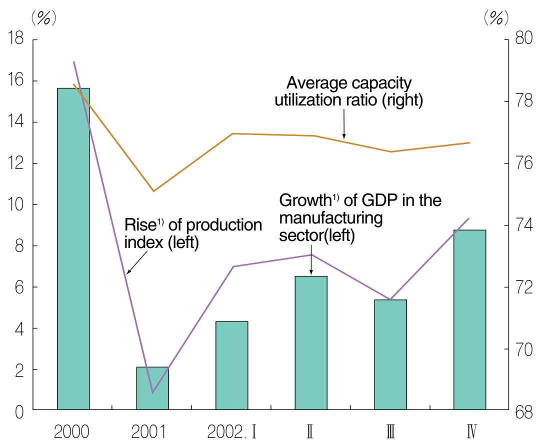
(%)

	2000	2001	2002^p year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Agriculture, forestry & fisheries	2.0	1.9	-4.1	0.7	-3.7	-2.2	-6.3
Mining	2.5	0.6	3.9	16.5	-0.9	-0.6	7.3
Manufacturing	15.9	2.1	6.3	4.2	6.6	5.5	8.8
Electricity, gas & piped water	14.0	5.1	13.2	13.7	13.1	11.7	14.0
Construction	-3.1	5.6	3.2	8.6	3.1	-3.8	6.3
Services[2]	9.5	3.9	8.8	8.1	9.2	9.5	8.6
Wholesale & retail, hotels & restaurants	9.8	4.0	5.6	4.1	4.9	6.3	6.8
Transport, storage & communications	17.9	10.5	7.4	9.4	8.2	6.7	5.5
Finance, insurance, real estate & business services	4.9	3.0	10.6	11.2	11.3	11.8	8.3
Social and private services	5.1	4.5	11.4	12.2	13.8	11.6	8.0
Government & private non-profit services[3]	0.3	0.9	1.1	0.7	0.6	1.4	1.5
GDP	9.3	3.1	6.3	6.2	6.6	5.8	6.8
GNI	3.6	1.4	4.9	7.7	5.6	2.7	4.1

Notes: 1) Compared with the same period of the previous year.
2) Less imputed bank service charges but including import duties.
3) Includes household services.
Source: The Bank of Korea.

<Figure Ⅱ-12>

Trends of Production[1] and Average Capacity Utilization Ratio in the Manufacturing Sector



Note: 1) Rates of change compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office.

scale increase. Service imports greatly widened the scale of their increase from the previous year's 4.7% to 13.7%, as a result of increased outlays on overseas travel by residents and on the payment of royalties.

(Production)

In the course of 2002, apart from the construction sector and the agriculture, forestry and fishing sector, most industrial sectors saw an acceleration in growth.

Viewed by industrial sector, manufacturing, after having grown no more than 2.1% during the year 2001, grew by 6.3% during the year under review, serving as the main driving force for economic recovery. This was because the lackluster performance of some sectors including textiles, footwear and shipbuilding, was overshadowed by the large scale upswing in IT products (semiconductors, communication equipment, etc.), machine tools and automobiles.

Capacity utilization rates in manufacturing, having stood at a low level of 75.1% in 2001, rose to 76.9% in 2002 thanks to the comparative liveliness of production activities from the beginning of the year. Except for a few sectors such as oil refining or textiles, most branches of industry saw higher capacity utilization rates, with the rise in the IT sector, which includes semiconductors, being particularly striking.

The electricity, gas and piped water sector accelerated its growth rate from the previous year's 5.1% to 13.2% during the year under review, driven by the increased consumption of electricity and the expansion of the piped natural gas network.

In the case of construction, the first half of 2002 saw a continuance of the previous year's pattern centering on private sector construction, but from July onwards, its rate of increase sagged greatly, leaving it to record growth at the 3.2% level for the year as a whole.

The service industry greatly augmented its rate of expansion from the previous year's 3.9% to register growth of 8.8% during 2002. The wholesale and retail trade, restaurant and hotel sector, though bearing a somewhat subdued aspect in the first half, presented a restoring pattern from the beginning of the second half to grow by 5.6% throughout the year as a whole. The transport, storage and communication sector rose 7.4% during the year, with the continued buoyancy of communications offsetting the subdued performance of the storage business, while the transport business witnessed a continued expansionary trend thanks to increased export and import volumes. The finance, insurance, real estate and business services sector saw a generally favorable growth trend, registering an increase of 10.6% for the year as a whole. This was because although the real estate business slowed during the latter half of the year, affected by the stability of real estate prices, the finance and insurance businesses experienced a rapid surge in their rate of growth. Community, social and personal services saw their rate of expansion accelerate from the previous year's 4.5% to 11.4%, supported by the briskness of leisure and sports-related services. The agriculture, forestry and fishing sector's growth, which occurred despite the favorable showing of the livestock business, showed a sharp contraction of -4.1% as production declined across most sub-sectors as a result of damage to cultivated crops from floods and typhoons.

B. Labor Market

During 2002, the employment situation continued to show the improving pattern of the previous year, and nominal wages registered rapid growth in the two digits.

<Table Ⅱ-7>

Trends of Major Employment Related Indicators

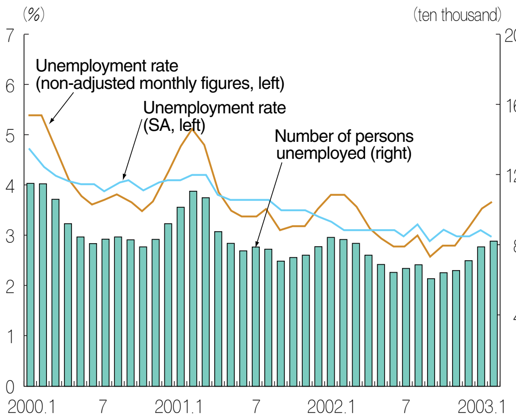
(ten thousand, %)

	2000	2001	2002				
			year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Economically active population	2,207	2,242	2,288	2,234	2,311	2,307	2,299
(rate of growth)[1]	1.9	1.6	2.1	3.0	2.0	1.8	1.4
Economic participation rate	61.0	61.3	61.9	60.7	62.6	62.3	62.0
Number of persons employed	2,116	2,157	2,217	2,151	2,242	2,242	2,233
(rate of growth)[1]	4.3	2.0	2.8	4.3	2.7	2.4	1.8
Number of persons unemployed	91	85	71	83	69	65	66
Unemployment rate	4.1	3.8	3.1	3.7	3.0	2.8	2.9
(SA)	-	-	-	3.2	3.1	3.1	3.0

Note : 1) Compared with the same period of the previous year.
Sources: Korea National Statistical Office.

<Figure Ⅱ-13>

Trends of Unemployment Rate and Number of Persons Unemployed



Source: Korea National Statistical Office

(Employment)

The employment situation presented an improved picture during the year. Thanks to the recovery of business activity, the economically active population increased 2.1% during the year, while the number of persons employed rose 2.8%. As the rate of increase in the number of persons employed outstripped the rate of increase of the economically active population, the unemployment rate declined from the previous year's 3.8% to 3.1% while the number of persons unemployed declined from the previous year's 850,000 to 710,000. Viewed by quarter, in the first quarter of the year the unemployment rate rose to 3.7% and the number of persons out of work to 830,000 as the increase in seasonal unemployment offset the effects of the business recovery. From the second quarter onwards, however, in line with the upswing of domestic demand including consumption, the unemployment rate fell back to around 3% and the number of persons out of work shrank greatly to some 600,000 persons. Notably, in September, the unemployment rate dropped to 2.6%, its lowest level since November 1997(2.7%). Even from the beginning of the fourth quarter with the presence of seasonal factors such as the decline in the number of persons employed in farming and fishing with the advent of the fallow season, and the rise in the number of school leavers and graduates in search of employment, the employment situation maintained its generally favorable state in view of the overall upswing in the domestic economy thanks to buoyant exports.

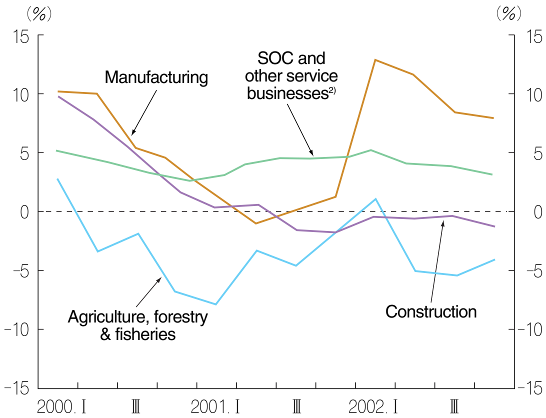
An explanation for the benign state of labor market conditions during the year seems to lie in the comparatively high growth rate of the service sector(8.8%), which is highly labor-intensive and was able to absorb unemployed persons from other sectors such as manufacturing. Another contribution to the stability of the employment situation came from the buoyancy, following the run-up in real estate prices, of housing construction, which saw a large increase in the number of persons employed.

Looking at employment trends by industry, in manufacturing, despite the acceleration of growth(2.1%→6.3%), employment rationalization efforts meant that the number of persons employed retreated from the previous year, while the decline in employment in farming and fishing continued. In contrast, there was a large increase in the number of persons employed in construction(10.2%) thanks to its rapid upward trend during the first half of the year. And the upward trend in the number of persons employed in services was maintained thanks to the business recovery driven by domestic demand.

Even though the number of persons employed rose, the structure of employment presented a somewhat unstable pattern that reflected the labor market's heightened flexibility. Among wage earners, the proportion of temporary or casual workers rose, centering on the service sector. The number of persons in full-time employment (6,860,000) showed only a 2.2% rise during the year which was lower than the rate of increase of wage earners(3.8%). Meanwhile, the average number of hours worked a month and the number of overtime hours worked a month, both declined by three hours from the previous year.

<Figure Ⅱ-14>

Trends of Growth[1] in the Number of Persons Employed by Industry



Notes: 1) Compared with the same period of the previous year.
2) Excludes construction.
Source: Korea National Statistical Office.

<Table Ⅱ-8>

Trends in the Structure of Employment and Working Hours

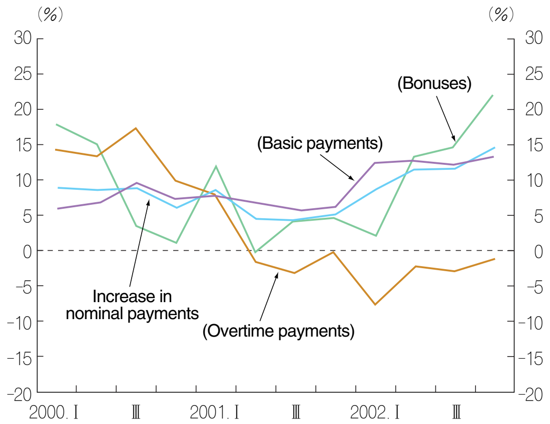
(%, hours)

	2000	2001	2002 year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Full time permanent[1]	47.9	49.2	48.4	48.8	48.1	48.4	48.4
Temporary and casual[1]	52.1	50.8	51.6	51.2	51.9	51.6	51.6
Monthly average working hours[2]	206	204	201	195	203	199	206
(overtime)	26	23	20	19	21	20	21

Notes: 1) Shares of total wage earners.
2) Based on businesses with 10 or more workers.
Sources: Korea National Statistical Office, Ministry of Labor.

<Figure Ⅱ-15>

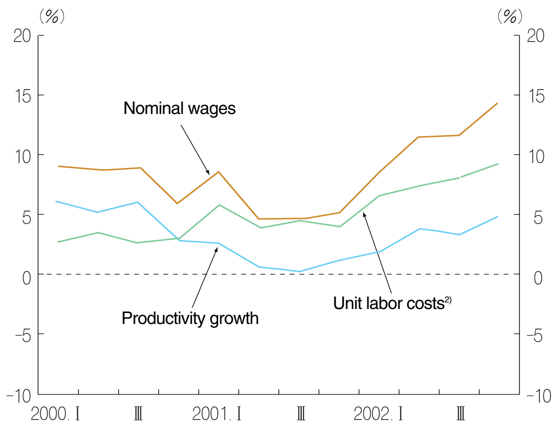
Trends of Wage Increases[1]



Note: 1) Compared with the same period of the previous year.
Source: Ministry of Labor.

<Figure Ⅱ-16>

Trends of Increases[1] in All-industry Unit Labor Costs



Notes: 1) Compared with the same period of the previous year
2) Unit labor costs = nominal wages/(constant GDP ÷ the number of persons employed).
Sources: The Bank of Korea, Ministry of Labor.

(Wages)

During the year 2002, the rate of increase in nominal wages rose from the previous year's 5.6% to 11.6% in line with companies' greater ability to support wage increases in view of their improved profitability as a result of the economic recovery. The rate of increase of real wages, as represented by that of nominal wages adjusted by the Consumer Price Index, rose greatly from the previous year's 1.5% to stand at 8.9%.

Looking at the composition of nominal wages, the rate of increase of regular wages rose sharply from the previous year to stand at 12.7%, while that of special payments registered the high-level of 13.5%. In contrast that of overtime payments fell by 3.4% in line with the reduction in overtime hours worked. Looking at wage trends by industry, most branches of industry registered higher rates of wage increases than the preceding year, but in the wholesale and retail trade the rate of increase declined slightly.

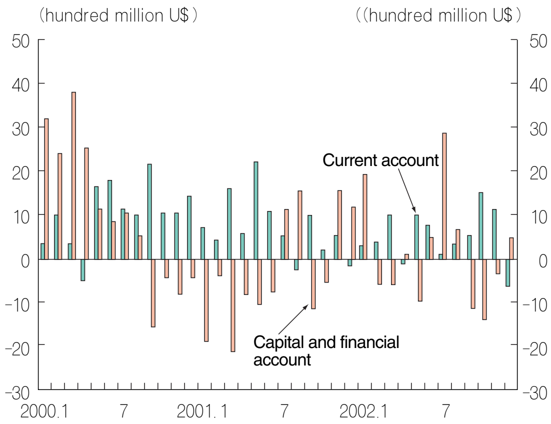
Meanwhile, unit labor costs rose 7.8% during the year 2002, exceeding the previous year's 4.4%. The reason was that the rate of increase of nominal wages accelerated sharply in line with the economic recovery.

C. External Transactions

The current account registered a surplus of $6.1 billion for the year 2002, the fifth straight year it had shown a surplus position. The scale of the surplus, though, shrank from that of the previous year($8.2 billion), its contractional trend persisting. The capital account shifted from the previous year's $3.3 billion deficit to a $1.5 billion surplus thanks to a large increase in the inducement of overseas loans that brought the other

<Figure Ⅱ-17>

Trends of Current, Capital and Financial Accounts



Source: The Bank of Korea

<Table Ⅱ-9>

Balance of Payments

(hundred million U$)

	2000	2001	2002
Current account	122.4	82.4	60.9
Goods & services	139.8	96.6	67.2
Goods	168.7	134.9	141.8
(exports)	1,759.5	1,512.6	1,625.5
(imports)	1,590.8	1,377.7	1,483.7
Services	-28.9	-38.3	-74.6
(credits)	305.3	290.5	281.4
(debits)	334.2	328.8	356.0
Income	-24.2	-12.0	4.5
Current transfers	6.8	-2.3	-10.8
Capital and financial account	121.1	-32.7	15.2
Financial account	127.3	-25.4	26.1
Direct investment	42.8	11.1	-7.0
Portfolio investment	120.0	65.8	1.8
Other investment	-35.6	-102.3	31.3
Other capital account	-6.2	-7.3	-10.9
Changes in reserve assets	-237.7	-75.8	-118.0
Errors and omissions	-5.8	26.1	41.9

Source: The Bank of Korea.

investment account into surplus and offset the deficit on direct investment. Meanwhile the external reserves held by the Bank of Korea rose by $11.8 billion from the previous year as both the current account and the capital account were in surplus.

(Current Account)

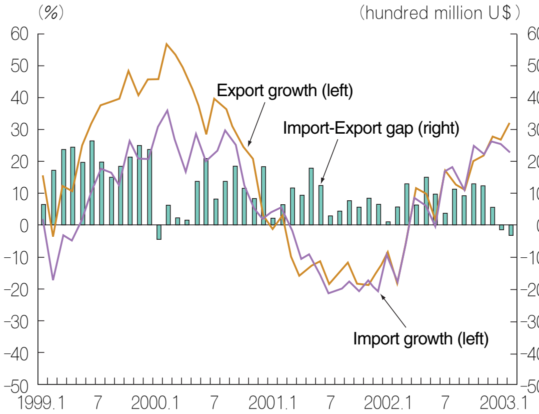
The scale of the annual current account surplus shrank in 2002 from the previous year's $8.2 billion to $6.1 billion with the relatively large increase in the deficit on services offsetting the widened surplus on the goods account. Focusing on particular months, in April, the current account showed a deficit of $0.09 billion following a sharp increase in external interest payments. In July when the travel account deficit widened because of the seasonal effect of the summer, the monthly surplus on the current account shrank to $0.08 billion. In October, however, the scale of change became much greater when the deficit on services narrowed and the surplus on goods widened, generating a monthly current account surplus of $1.5 billion, the largest for 17 months.

By sector, the scale of the surplus on the goods account increased from the previous year's $13.5 billion to $14.2 billion because of the widened export-import gap. But in January 2003, even though exports continued buoyant, imports rose greatly because of the run-up in international oil prices and the export-import gap moved slightly into deficit to the tune of $0.1 billion, the first in 36 months. The scale of its deficit widened even further to $0.38 billion in February 2003.

During 2002 exports(customs clearance basis) rose 8% over the previous year($150.4 billion) to stand at $162.5 billion. The fact that this convincing expansionary trend of exports was possible despite the delay in the

<Figure Ⅱ-18>

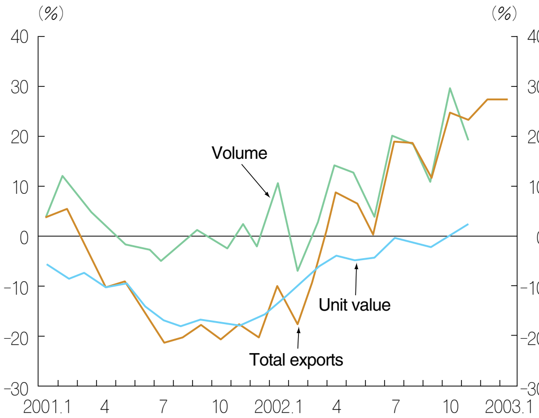
Trends of Import & Export Growth[1] and Import-Export Gap



Note: 1) Compared with the same period of the previous year.
Sources: Ministry of Commerce, Industry and Energy.

<Figure Ⅱ-19>

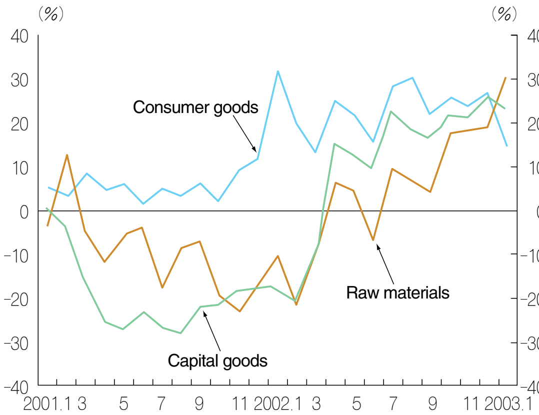
Trends of Volume and Unit Value of Exports[1]



Note: 1) Compared with the same month of the previous year.
Source: The Bank of Korea.

<Figure Ⅱ-20>

Trends of Imports by Use[1]



Note: 1) Compared with the same month of the previous year.
Source: Ministry of Commerce, Industry and Energy.

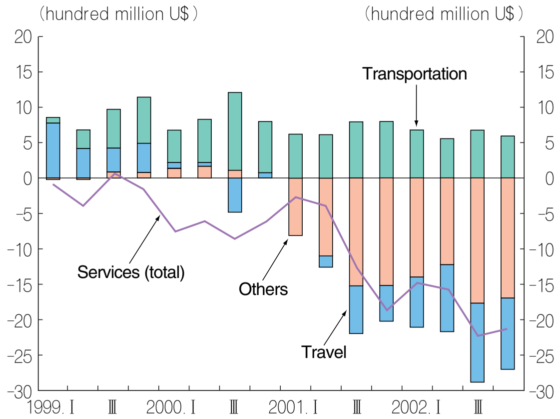
recovery of the advanced economies including the United States and Japan was ascribable firstly to the large increase in exports to the rapidly growing economies of the Asian region including China and, secondly, to the buoyancy of IT products exports including mobile phone handsets, semiconductors, and computers. In the meanwhile, dividing the increase in exports into changes in volume and changes in unit prices, the unit value of exports generally declined whereas export volumes rose by a large margin, thereby bringing about an increase in the total value of exports. Notably, towards the end of the fourth quarter, the unit value of exports rose slightly and this acted to support an increase in exports.

Imports(customs clearance basis) during the year 2002 stood at $152.1 billion, which represented a 7.8% increase over the previous year($141.1 billion). This was because imports of consumer goods saw a constant increase while imports of capital goods rose on a large scale to support the expansion of exports. Besides this, during the latter half of the year, the rise in the unit value of major import items including crude oil and semiconductors worked as a factor increasing the amount of imports.

During the course of the year under review, the services account deficit widened further more from $3.8 billion in the previous year to $7.5 billion as a result of increasing outlays on overseas travel expenses including those of overseas study and training and on royalties and charges for the use of patents. The income account, meanwhile, shifted from a deficit of $1.2 billion in the preceding year to a surplus of $0.5 billion owing to an increase in earnings on the operation of external assets, augmented by the sustained current account surplus, and a reduction in the scale of external interest payments.

<Figure Ⅱ-21>

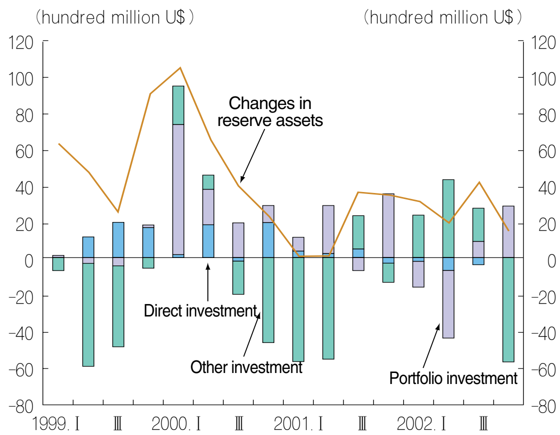
Trends of Service Account by Item



Source: The Bank of Korea.

<Figure Ⅱ-22>

Trends of Capital and Financial Account by Item



Source: The Bank of Korea.

Meanwhile, the scale of the deficit on the current transfers account increased from the previous year's $0.2 billion to $1.1 billion in response to an expansion of overseas remittances by domestic residents.

(Capital Account)

The capital account shifted from the previous year's deficit of $3.3 billion to a surplus of $1.5 billion in the year under review. This conversion was ascribable to a large increase in foreign borrowings by companies and financial institutions, the effect of which was to offset residents' expansion of their overseas investment and the net outflow of foreign portfolio investment funds.

By component account, the direct investment account shifted from its surplus of $1.1 billion the year before to a deficit of $0.7 billion owing to the expansion of outward direct investment by residents and the contraction of nonresidents' inward direct investment.

The scale of the surplus on the portfolio investment account shrank sharply from the previous year's $6.6 billion to $0.2 billion. This was attributable to the net outflow of foreign stock investment funds and the expansion of residents' overseas portfolio investment, which more than offset the effect of the expanded issuance of overseas medium and long-term bonds by domestic companies.

The other investment account, for its part, shifted from a deficit of $10.2 billion the year before to a surplus of $3.1 billion, in response to a large increase in overseas borrowings by Korean financial institutions and companies.

3. Prices

<Table Ⅱ-10>

Trends of Increase[1] of Major Prices

(%)

	1999	2000	2001	2002	Jan.~Feb. 2003
Consumer Prices	0.8	2.3	4.1	2.7	3.8
(Core Inflation)	(0.3)	(1.9)	(3.6)	(3.0)	(3.0)
Producer Prices	-2.1	2.0	1.9	1.6	5.1
Import Prices[2]	-12.1	7.6	3.5	-6.2	3.8

Notes: 1) Compared with the same period of the previous year.
2) The rate of change during 1999~2000 is based on the old index (1995=100).
Sources: Korea National Statistical Office, The Bank of Korea.

<Table Ⅱ-11>

Trends of Movements[1] in Import and Export Prices

(%)

	2001	2002					2003
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Consumer Prices	4.1 (3.2)	2.7 (3.7)	2.5 (1.6)	2.7 (0.8)	2.6 (0.9)	3.3 (0.3)	3.8 (1.2)
Agriculture, livestock & marine products	6.3 (9.5)	6.2 (6.9)	8.5 (5.7)	6.9 (0.5)	4.6 (6.0)	5.2 (-5.1)	5.2 (4.1)
Industrial products	2.6 (0.0)	1.7 (4.1)	0.1 (1.1)	1.3 (1.6)	1.6 (0.2)	3.5 (1.2)	4.3 (1.3)
(petroleum products)	4.2 (-9.4)	-0.8 (10.5)	-6.9 (2.0)	-2.1 (5.6)	-1.1 (-1.3)	7.4 (4.1)	12.8 (5.1)
Services	4.6 (4.0)	2.8 (2.8)	2.9 (1.0)	2.7 (0.6)	2.8 (0.4)	2.7 (0.8)	3.2 (0.5)
(public service charges)	7.5 (3.7)	-1.3 (-0.8)	-0.4 (-1.2)	-1.6 (-0.6)	-1.9 (-0.1)	-1.3 (1.0)	0.5 (0.0)
(Rents)	4.1 (5.7)	5.8 (4.8)	6.0 (1.1)	5.9 (1.7)	5.7 (1.1)	5.3 (0.8)	4.5 (0.4)
Private services	3.1 (3.4)	3.7 (3.9)	3.2 (2.3)	3.6 (0.6)	3.9 (0.5)	3.8 (0.6)	4.2 (0.8)
Core inflation	3.6 (3.6)	3.0 (3.1)	2.9 (1.2)	3.0 (0.6)	2.9 (0.5)	3.1 (0.7)	3.0 (0.6)

Notes: 1) Compared with the same period of the previous year.
2) Figures in parentheses refer to rates of increase compared with the last month of the previous period.
Source: Korea National Statistical Office.

In the course of the year 2002, prices presented a relatively stable pattern compared to the previous year. This was ascribable to the weakness of demand push pressures on prices, to the stability of the prices of industrial products thanks to the appreciation of the Korean won, and to the reduction in charges for some public services. Combined these effects counteracted the effects of higher wage costs and house rentals and the rise in prices of agricultural products following natural disasters. The Consumer Price Index saw a deceleration of its annualized average rate of increase from the previous year's 4.1% to 2.7%, and the Producer Price Index also saw a modest decline in its rate of increase to stand at 1.6%. Strikingly, import prices, which are greatly influenced by the exchange rate, shifted from their increase of 3.5% in the previous year to a decrease of 6.2%.

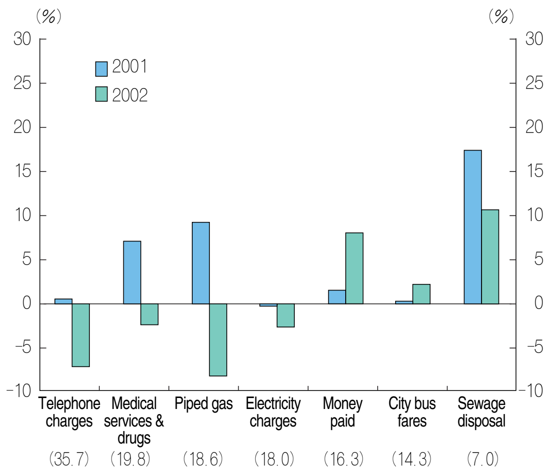
(Consumer Prices)

The Consumer Price Index(CPI) rose by an annual average rate of 2.7% in 2002, showing a substantial easing of its 4.1% upward trend of the previous year.

Viewed by period, the rate of increase compared to the same month of the previous year generally stood below the 3% level. But from early November it exhibited a pattern of movements at a higher level of around 3.5%. During the first five months of the year under review, agricultural, livestock and marine products prices rose and charges for personal services including registration fees and tuition at educational training institutions were also increased. Nevertheless, consumer prices showed a relatively mild upward trend in view of the offsetting reduction of charges for public services including tariffs for natural gas and mobile phones. During the June to August period, the rate of increase in the Consumer Price Index eased to slightly above 2% year-on-year with farm prices stable and prices of petroleum products falling. In September and October, the prices of agricultural products rose steeply because of typhoon damage but subsequently recovered a stable trend thanks to improved harvests, and then the CPI marked a rate of increase of around 3%. From November onwards, however, the rate of increase in the CPI accelerated to around 3.5% with the rise in prices of petroleum-based fuels including gasoline and domestic heating oil, the raising of prices for some public services such as urban bus fares, and higher prices for agricultural products because of a severe cold spell. This rather steeper upward trend was prolonged into the early part of the current year, 2003.

<Figure Ⅱ-23>

Movements of Major Public Service Charges

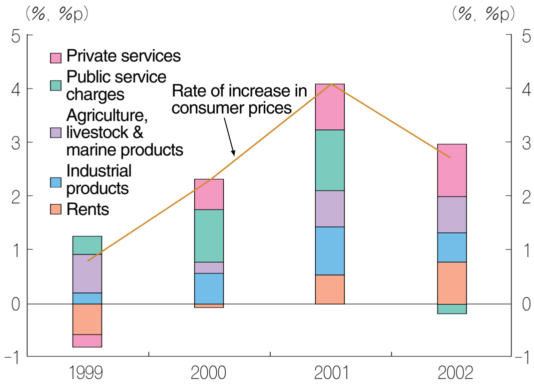


Notes: 1) Compared with the last month of the previous year.
2) Figures in parentheses refer to weighting (total weighting is 1000)
Source: Korea National Statistical Office.

Viewing price movements by category, the prices of manufactured goods and services showed a stable trend while the rate of increase of those of agricultural, livestock and marine products marked a high level. Manufactured goods saw their prices rise by an annualized average of just 1.7% owing to the appreciation of Korean won and the downward trend of prices of fuels such as gasoline and domestic heating oil during the first nine months of the year. The rate of increase of service charges eased from the previous year's 4.6% to an annual average rise of 2.8%. This was attributable to the fact that the reduction of charges for public services offset the upward trend of housing rents and charges for personal services. Charges for public services eased 1.3% because of the reduction of charges for mobile phone and piped natural gas tariffs and medical treatment under public health insurance. Meanwhile housing rents increased 5.8% in line with the continued upward trend of real estate prices, and charges for personal services went up 3.7% in response to the increased cost of eating out, along with higher airfares and tuition fees for educational training institutes. The prices of agricultural products rose 6.2% centering on vegetables and fruits damaged by typhoons and floods and on reduced yields of livestock products.

<Figure Ⅱ-24>

Degree of Contribution to the Rate of Increase of Consumer Prices



Source: Korea National Statistical Office.

Accordingly, the rate of increase in the CPI fell by 1.4% from the previous year, mainly in response to the fall in prices of charges for public services. Viewing the contribution ratio of each type of commodity to the rate of increase in the CPI, that of agricultural, livestock and marine products made a 0.7%p contribution, about the same level as in the previous year, while that of services at 1.5%p represented a large-scale decrease from the preceding year's 2.5%p. The contribution ratio of manufactured goods to the increase in the CPI at 0.6%p registered a slight reduction from the previous year's 0.9%p. Among service charges, those for personal services stood at 1%p and those for housing rents at 0.8%p, which were 0.2%p and 0.3%p lower respectively than in the preceding year. In the case of charges for public services, although these carry only a 15% weight in the CPI, their exceptional reduction caused their contribution to the increase in the CPI to shift from the previous year's 1.1%p to a negative 0.2%p, which represented a total decline of 1.3%p.

Core inflation, which strips out non grain farm products and petroleum based fuels from the CPI, stabilized from the previous year's 3.6% to stand at 3.0%, the mid-point of the inflation target range. Core inflation was higher than the rise of the CPI reflecting the slight fall in the prices of petroleum products and piped natural gas which are excluded from core inflation items.

<Table Ⅱ-12>

Trends of Movements[1] in Producer Prices

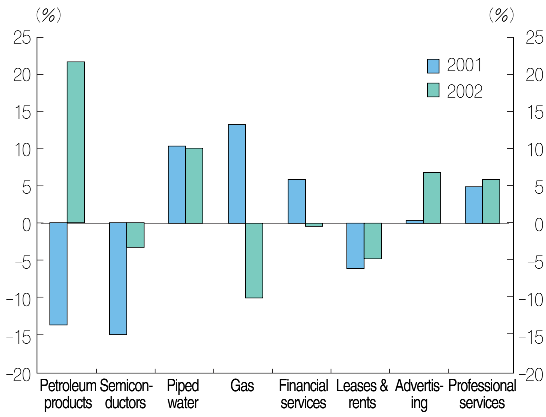
(%)

	2001	2002 year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	2003 Jan.~Feb.
Producer prices	1.9 (-0.7)	1.6 (4.6)	-0.2 (1.7)	1.2 (1.4)	1.5 (0.5)	4.0 (1.0)	5.1 (1.7)
Goods	1.8 (-1.3)	1.1 (4.9)	-1.0 (1.8)	0.6 (1.5)	1.1 (0.6)	4.0 (1.0)	5.6 (1.7)
(agriculture, forestry & marine products)	1.0 (6.1)	4.5 (9.1)	4.9 (5.9)	3.6 (-0.2)	1.8 (0.0)	8.2 (3.3)	5.2 (-0.9)
(industrial products)	1.5 (-2.3)	1.1 (4.9)	-1.5 (1.7)	0.4 (1.7)	1.3 (0.6)	3.9 (0.7)	5.8 (2.0)
(electricity, piped water & gas)	7.3 (3.5)	-2.3 (-1.0)	-1.9 (-2.7)	-2.9 (-0.2)	-3.0 (0.5)	-1.5 (1.4)	2.5 (0.8)
Services	2.4 (1.6)	2.8 (3.7)	1.9 (1.4)	3.0 (1.0)	3.0 (0.4)	3.5 (0.9)	3.9 (1.5)

Notes: 1) Compared with the same period of the previous year.
2) Figures in parentheses refer to rates of increase compared with the last month of the previous period.
Source: The Bank of Korea.

<Figure Ⅱ-25>

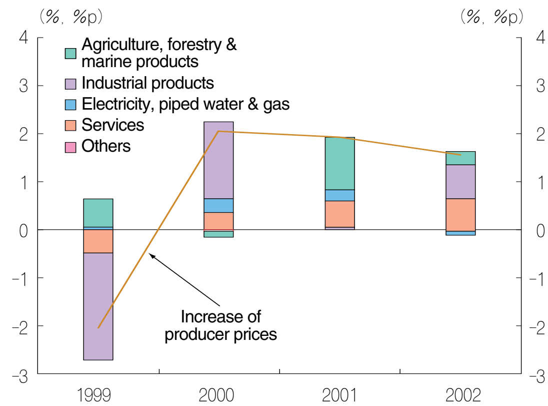
Movements[1] of Producer Prices in Major Businesses



Note: 1) Compared with the last month of the previous year.
Source: The Bank of Korea.

<Figure Ⅱ-26>

Degree[1] of Contribution to the Rate of Increase of Producer Prices



Note: 1) Compared with the same period of the previous year.
Source: The Bank of Korea.

(Producer Prices)

Producer prices rose at an annual average rate of just 1.6% during 2002, a slightly lower rate of increase than the preceding year's 1.9%.

Viewed by period, during the first seven months of the year, a generally stable trend was evident but from August onwards the upward trend accelerated. For the year to July, even though agricultural, livestock and marine products showed a steeper upward trend as a result of temporary mismatches between supply and demand in fruits and livestock, the stable trend of prices of manufactured goods combined with the downward trend as a result of a base period-effect of charges for electric power, water and gas supply, which had been increased sharply in the previous year, meant that producer prices as a whole maintained stable trends. But from August up until the end of the year, producer prices rose on a larger scale because of the run-up in prices of petroleum products in response to rising international oil prices and the upsurge of prices for vegetables and grains, which were affected by seasonal factors including reduced yields and poor harvests brought about by torrential downpours and an unusually severe cold spell. Moving into the new year 2003, producer prices continued their upward trend on a year-on-year basis. Compared to the last month of the previous year, meanwhile they maintained their unbroken upward trend affected by the increase in the prices of petroleum and chemical products stemming from the surge in international oil prices and the international raw materials and the increase in fees in some services related to construction, civil engineering, and computer programming.

By type of commodity, the prices of agricultural, livestock and marine products rose on a large scale but those of manufactured goods showed a stable trend. The upward trend of agricultural, livestock and marine prices accelerated greatly from the previous year's 1% to show a 4.5% rise in the wake of reduced harvests brought about by unfavorable weather conditions including typhoons and a severe cold spell. The prices of manufactured goods saw their rate of increase moderate from the previous year's 1.5% to stand at 1.1%, reflecting the fact that the prices of petroleum products, even though they rose on a large-scale from September onwards, were on a moderate scale for the year as a whole while those of semiconductors showed a downward trend. And charges for electric power, water and gas fell by 2.3% making this the first time for the 12 years since 1991 that they had registered a downward trend. Meanwhile, charges for services rose 2.8% in response to sharp increases in charges for transport services including international shipping, air freight, and urban bus, as well as for financial sector services. The contribution ratios to the annual increase in the producer price index, therefore, stood at 0.3%p in the case of agricultural products and 0.7%p in the case of services, both rather higher than the previous year's 0.1%p and 0.6%p respectively. In contrast, the contribution ratio of manufactured goods at 0.7%p was rather lower than the previous year's 1.0%p.

In the meanwhile, stage-of-processing prices, that is producer prices of goods by stage in terms of sector weighted average for producer price indices of commodities and import price indices, during 2002 shifted from their increase of 2.9% in the previous year to a decrease of 0.3%, as those of raw materials and intermediate goods shifted to a downward trend for the first time since 1999 and final goods, meanwhile, showed a small scale increase of 1.2%.

<Table Ⅱ-13>

Trends of Movements[1] in Prices by Stage of Manufacturing

(%)

	2001	2002					2003
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Gross index	2.9 (-3.7)	-0.3 (4.6)	-2.6 (0.1)	-1.3 (2.3)	-0.9 (-0.6)	3.5 (1.7)	5.2 (2.4)
Raw materials	3.7 (-18.7)	-1.3 (11.5)	-7.1 (-1.8)	-2.3 (10.6)	-4.4 (-3.6)	9.2 (4.3)	13.7 (8.7)
Intermediate goods	3.3 (-3.6)	-1.3 (4.0)	-3.9 (-0.7)	-2.6 (2.0)	-1.4 (-0.2)	2.8 (1.7)	5.5 (2.6)
Final goods	2.2 (0.0)	1.2 (3.9)	0.2 (1.4)	0.7 (1.0)	0.6 (-0.4)	3.2 (1.1)	3.1 (0.7)

Notes: 1) Compared with the same period of the previous year.
2) Figures in parentheses refer to rates of increase compared with the last month of the previous period.
Source: The Bank of Korea.

<Table Ⅱ-14>

Trends of Movements[1] in Import and Export Prices

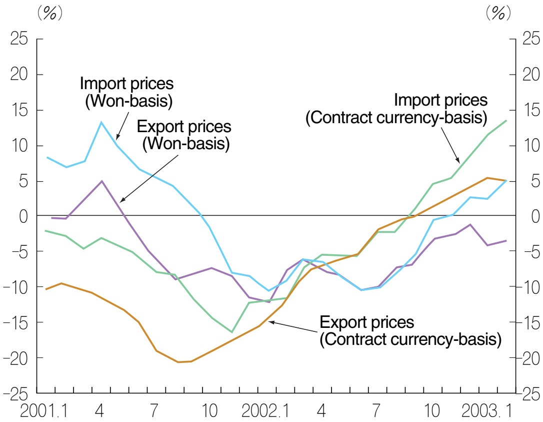
(%)

		2001	2002					2003
			year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Import prices	Won-basis	3.5 (-8.5)	-6.2 (2.9)	-8.5 (6.3)	-8.5 (-4.9)	-8.0 (1.7)	0.8 (0.1)	3.8 (4.4)
	(raw materials)	2.5	-6.4	-10.0	-9.2	-7.9	2.6	6.3
	(capital goods)	7.3	-6.3	-3.3	-6.1	-8.8	-6.9	-6.7
	(consumer goods)	10.6	-3.1	2.3	-2.5	-7.7	-4.5	-5.3
	Contract currency-basis	-7.7 (-12.2)	-3.1 (8.3)	-10.4 (4.0)	-5.7 (1.6)	-1.2 (2.5)	6.0 (0.0)	12.7 (5.5)
Export prices	Won-basis	-3.8 (-11.6)	-7.0 (-1.1)	-8.7 (7.6)	-8.6 (-8.5)	-7.9 (0.5)	-2.2 (-0.1)	-4.0 (1.9)
	Contract currency-basis	-15.2 (-16.3)	-4.2 (4.5)	-11.5 (5.1)	-6.2 (-1.7)	-1.0 (1.5)	2.8 (-0.3)	5.2 (3.0)
Exchange rates[2]		14.2	-3.1	3.8	-2.8	-7.5	-5.5	-10.1

Notes: 1) Compared with the same period of the previous year.
2) Won/U$ basis, Average rate of increase during the given period.
3) Figures in parentheses refer to the rates of increase compared with the last month of the previous period.
Source: The Bank of Korea.

<Figure Ⅱ-27>

Trends of Movements in Import and Export Prices



Source: The Bank of Korea.

(Import and Export Prices)

Import prices(Korean won basis), which had risen 3.5% in the preceding year, shifted to a 6.2% decrease during 2002, thanks to a 3.1% appreciation of the Korean won and also to a fall in import prices on a contract currency basis.

Viewing import prices by period, for the year to August they fell on a large-scale, because of the decline in import prices on a contract currency basis and the intensified competition between firms both domestic and foreign in line with the weakening of domestic demand and the Korean won's appreciation. But from September onwards their downward trend moderated and from early November they shifted to an upward trend, in spite of the rise of the exchange value of the Korean won, thanks to the large-scale rise in international raw materials prices including those for crude oil and nonferrous metals. Moving into the new year 2003, this upward trend was maintained, centering on raw material prices that were affected by the surge in international oil prices.

Meanwhile, export prices during 2002(Korean won basis) fell by an annual average of 7%, showing a deeper downfall than that of the previous year's 3.8% decrease. This resulted from the steady appreciation in the Korean won as well as the 4.2% fall of export prices on a contract currency basis centering on that of manufactured goods, affected by the flatness of demand and the fierce competition between producers both at home and abroad mainly in fields such as radio, TV, communication equipment, textiles products and apparel.

By period, this downward trend of export prices was maintained throughout the year. From early October, however, export prices on a contract currency basis shifted to a rising trend and accordingly the scale of their downturn during the year gradually shrank. Meanwhile, from the beginning of the year 2003, export prices, though they were still on a downward trend on a year-on-year basis, started to show a rising pattern against as of the end of the previous year.

(Real Estate Prices)

<Table Ⅱ-15>

Trends of Movements in Housing Prices and Rents[1]

(%)

	2001	2002					2003
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Housing prices	9.9	16.4	7.6	2.1	5.2	0.8	0.4
(Apartments)	14.5	22.8	11.0	2.0	7.4	1.0	0.6
- Seoul	19.3	30.8	15.0	2.3	11.7	-0.5	-1.3
Housing rents	16.4	10.1	7.3	1.6	2.6	-1.6	0.7
(Apartments)	20.0	12.2	9.3	1.3	3.0	-1.7	1.3
- Seoul	23.4	11.4	11.2	1.8	3.9	-5.3	0.5
Land prices	1.3	9.0	1.8	1.3	3.3	2.3	··

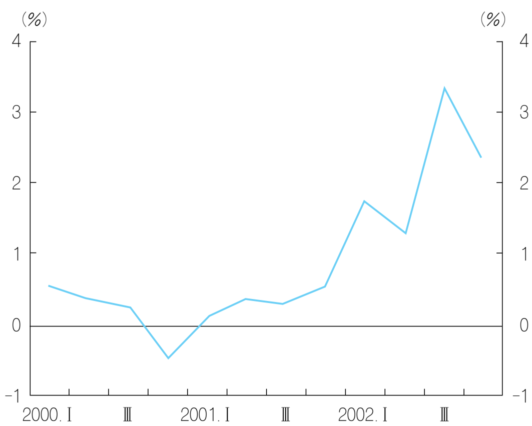
Note: 1) Compared with the end of the previous period.
Sources: Kookmin Bank, Korea Land Corporation.

Over the course of the year 2002, housing prices rose 16.4% on the basis of the last month of the previous year, with their upward trend accelerating rapidly compared to the preceding year. In the Seoul area in particular, the selling prices of apartments experienced a large-scale rise, leading the overall swing in housing market prices. Housing rents rose 10.1% on the last month of the preceding year basis. However, this represented some moderation of their 16.4% upward trend the previous year.

Housing prices began the year by continuing the previous year's upward trend, driven by investment demand for rental units and demand from persons living in rented accommodation to purchase their own home in line with the expansion of household lending. During the second quarter, however, they shifted to a more stable trend owing to seasonal factors and the government's stabilization measures. From July onwards, the extent of the rise in housing prices widened again with the explosive growth in housing prices that was fuelled by speculative demand for apartments scheduled for reconstruction in the Kangnam area of Seoul working its way throughout the metropolitan area. But in the wake of a series of stringent government measures (August 9, September 4 and October 11) to settle housing markets in response to the rise in housing prices, housing prices presented a stable trend from the fourth quarter, with apartment prices in the Seoul region, for example, marking a slight downturn. In the case of the rental of housing on a leasing basis, house owners showed a continued preference for lending on a monthly rental basis and there was a mismatch of supply and demand, so that the cost of leasing deposits showed a steep upward trend from the beginning of the year. From the fourth quarter onwards, however, leasing deposits showed a downward trend, influenced by the stable tone of the overall real estate market amid an improvement in the interplay of supply and demand, especially in the Seoul area with an increase in new rental apartments and the move by leaseholders to become home-owners.

<Figure Ⅱ-28>

Trends of Movements in Land Prices[1)]



Note: 1) Compared with the last month of the previous period.
Source: Korea Land Corporation.

Land prices rose 9% during the year 2002 on the basis of the last month of the preceding year, the rate of increase climbing much more steeply than the year before(1.3%). The main forces driving this rise were the upswing of housing prices within the capital region in connection with the pursuit of reconstruction, an increase in speculative demand for commercial premises as a result of lower interest rates and the lifting of development restrictions in greenbelt areas. From early in the fourth quarter of the year, the upward trend slackened in response to measures to cool down housing prices, but land prices in the Chungcheong area including Daejeon rose steeply in response to discussion over the possible relocation of the administrative capital of the country to this region.

4 . Financial Markets

A. Price Indicators

(1) Interest Rates

Interest rates showed an overall downward trend during 2002. This was because, although there was ample market liquidity, there was no great demand for funds on the part of enterprises in view of the delayed recovery of the global economy and the heightened uncertainty both at home and abroad. Financial institutions' deposit and lending rates dropped only slightly, but market interest rates fell by a large margin. Notably, the spread between long-term and short-term interest rates narrowed in response to the pronounced decline in long-term market interest rates. Risk premiums also showed a decline, reflecting enterprises' reduction of their debts and improvement of their profitability.

<Table Ⅱ-16>

Trends of Major Interest Rates[1]

(annual %)

	Dec. 2001	2002				2003	
		Feb.	Apr.	Sep.	Dec.	Jan.	Feb.
Call (one day)	4.00	3.97	4.28	4.27	4.52	4.34	4.28
CP[2] (91 days)	5.07	4.80	4.94	4.95	5.03	4.68	4.64
Treasury bonds (3 yrs.)	5.91	6.03	6.14	5.30	5.11	4.77	4.60
Corporate bonds[3] (3 yrs.)	7.04	6.97	6.90	6.00	5.68	5.29	5.14

Notes: 1) Month-end basis 2) Based on A1 3) Based on AA-
Sources: The Bank of Korea, Korea Securities Computer Corp.

(Long-term Market Interest Rates)

Long-term market interest rates showed large falls during 2002. Yields on three-year Treasury bonds eased from 5.91% at the end of December 2001 to 5.11% at the end of December 2002, while yields on three-year corporate bonds declined over the same period from 7.04% to 5.68%.

<Table Ⅱ-17>

Trends of Issuance of Major Bonds

(trillion won)

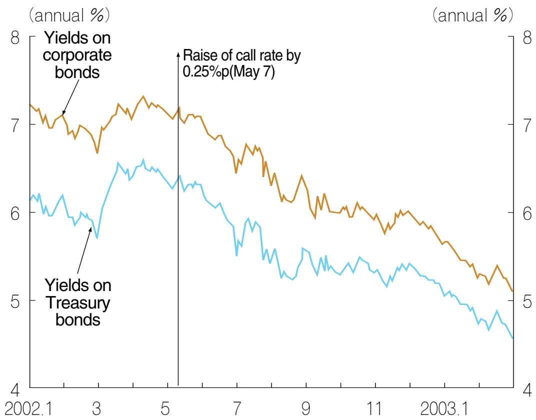
	2000	2001	2002
Government bond	24.7	30.9	34.5
(treasury bond)	15.2	21.8	19.4
Corporate bond[1]	25.0	39.7	19.8
Financial Debenture	20.3	20.8	54.1
ABS[2]	33.7	34.0	29.0
Special bond[3]	29.6	53.0	30.6
MSB	98.8	78.0	69.8
Total	232.1	256.4	237.8

Notes: 1) Excludes those issued by companies under court receivership in process of mediation or workout.
2) Secondary CBO, CLO, ABS of receivables loans.
3) Includes Deposit Insurance Fund Bonds, KAMCO bonds, Credit card bonds, Installment bonds, KEPCO bonds and Land Development bonds.
Source: The Bank of Korea

The main reason for this was that the mismatch between bonds' supply and demand intensified as the scale of new issue contracted greatly while market liquidity conditions remained ample. With structural adjustment having been completed to some degree, new issue of Treasury bonds shrank during the year under review to 19.4 trillion won, 2.5 trillion won less than that of the previous year. The issue of corporate

<Figure Ⅱ-29>

Trends of Major Long-term Interest Rates



Source: Korea Securities Computer Corp.

bonds marked only 19.8 trillion won, which was 19.9 trillion won less than that of the previous year. The issue of corporate bonds did not come close by a large margin to the volume of maturing bonds during the year (25.9 trillion won).

Viewed by period, until the end of February, long-term interest rates followed a smooth downward track, but from early March rose rapidly. Domestic demand showed a brisk pace centering on consumption and construction investment, while some US economic indicators improved and the anticipations of an early recovery of the global economy intensified. In an environment characterized by these economic movements, expectations spread in financial markets that the Bank of Korea would raise its call rate target soon. Interest rates, accordingly, continued their upward trend and in April 9 yields on Treasury bonds reached 6.58% and those on corporate bonds 7.30%, registering their highest level for the year.

The Bank of Korea's raising of its call rate target in early May soothed the markets' feelings of unease, so that, until late May, yields on Treasury bonds showed a generally stable pattern of movements within the 6.0~6.4% range. But from the end of May long-term market interest rates again shifted to a downward trend, which persisted until mid-August. This was because of the heightened possibility that the US economy would suffer a double-dip recession along with the aggravated imbalance between the demand for long-term bonds and their supply. From the beginning of the year, corporate bonds maintained a net redemption position and, while the scale of issue of Treasury bonds contracted, new issue of Deposit Insurance Fund Bonds ceased altogether. Thus, the supply of new long-term bonds decreased. Meanwhile, the fall in US stock prices precipitated by accounting scandals at major large companies led to a matching decline in domestic stock prices, giving rise to a preference for bonds over stocks and causing investors' demand for bonds to increase.

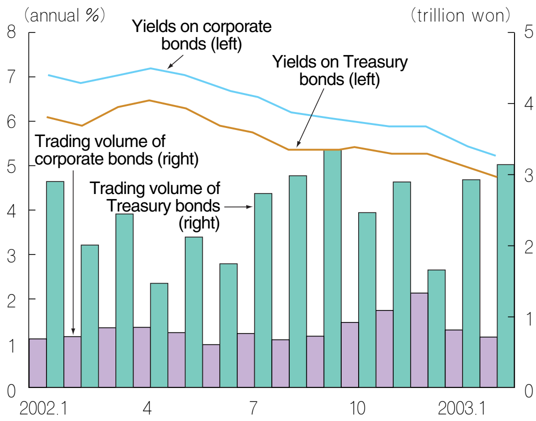
Subsequently, yields on Treasury bonds showed a generally stable movement somewhere at 5.0~5.4% but, from late December, they began to fall back again steeply, so that they began the new year at the 4% level. This was due to the high level of geopolitical risks over the likelihood of war on Iraq and the North Korean nuclear issue at a time when the appetite for bonds was increasing greatly as a result of the large rise in deposits at investment trust companies and banks' cutbacks in household lending. As of the end of February 2003, yields on Treasury bonds stood at 4.60% and those on corporate bonds at 5.14%.

The average volume of daily bond transactions during 2002 (Treasury bonds and corporate bonds, over-the-counter sales basis) shrank by 13.3% from the previous year's 3.6 trillion won to stand at 3.1 trillion won. This was attributable both to the reduced scale of bond issue and to the emergence of a preference for a buy-and-hold strategy on bonds rather than the pursuit of short-term profits from frequent trades amid the spread of domestic and external uncertainties.

In the case of Treasury bonds, amid ample liquidity and in a falling interest rate environment, financial institutions augmented net purchases, causing daily turnover on average to reach 2.8 trillion won in January, but, as interest rates shifted to an upward trend, it showed a contraction. From July onwards, turnover also became more lively again and, during September, the average value of daily transactions rose to 3.4 trillion won. But the volume of transactions shrank as financial institutions' demand for holdings of Treasury bonds increased in view of the need to bolster

<Figure Ⅱ-30>

Trends of Yields on Corporate and Treasury Bonds and Trading Volumes



Source: Korea Securities Computer Corp.

their BIS capital adequacy ratios as of the end of the year, and, during December, the average daily turnover stood at just 1.7 trillion won.

In the case of corporate bonds, turnover in those with a BBB rating showed a brisk pattern of movements in line with the reduction of corporate credit risk. But, with new issue of corporate bonds at a low ebb, the average volume of their daily transactions failed to rise above the 1 trillion won level. In November and December, however, as the breadth of their yield fluctuations widened somewhat, transactions became comparatively livelier and the daily turnover on average rose to the 1 trillion won level.

(Short-Term Market Interest Rates)

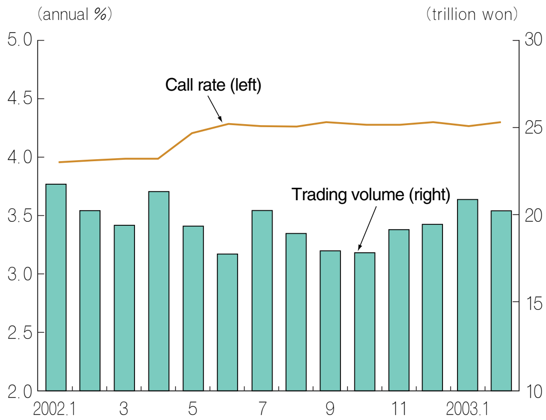
Apart from the call rate, short-term market interest rates also showed a downward trend similar to that of long-term interest rates, but the breadth of their movements was less steep. The overnight call rate, which had stayed at around 4% from September 2001 onwards, rose to around 4.25% following a 25 basis point upward adjustment of the call rate target of May 7 by the Bank of Korea.

The daily average turnover in the call market rose by 9.1%, compared to the previous year (17.9 trillion won), to reach 19.5 trillion won. But much of this increase is attributable to a technicality, namely, the fact that most financial institutions adopted Saturday closing from July of the year.[11] If Saturday trades are

11) Because financial institutions generally adopted the practice of closing on Saturdays from July 2002 onwards, the daily turnover in the first half of 2002 and that during 2001 included Saturday transaction whose scale did not reach up to the level of that on Mondays through Fridays. If Saturday transactions are excluded, the daily average transaction volume shows a modest increase (0.4 trillion won) from 20.7 trillion won in 2001 to 21.1 trillion won in 2002.

<Figure Ⅱ-31>

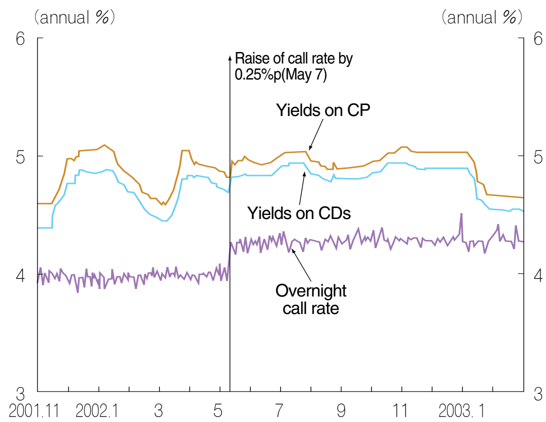
Trends of Call Rate and Call Market Trading Volume



Source: The Bank of Korea

<Figure Ⅱ-32>

Trends of Major Short-term Interest Rates



Sources: The Bank of Korea, Korea Securities Computer Corp.

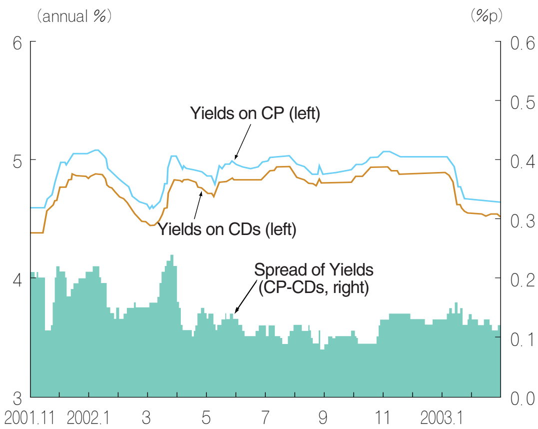
excluded, the daily turnover on average showed an increase of only 1.9%. Meanwhile, looking at the scale of daily call market turnover by quarter (excluding Saturday trades), it presented a pattern of mild decline, falling from 24 trillion won in first quarter to 22.7 trillion won in the second quarter and then retreating further to 19.1 trillion won in the third quarter and to 18.8 trillion won in the fourth quarter. This was ascribable to the shrunken scale of the supply of call money by its main providers as a result of the increase in the move of funds into financial debentures by investment trust companies and the conservative approach adopted by domestic banks to the management of their funds. It was also attributable to the reduced use of call loans by the domestic branches of foreign banks, which were reducing their bond investments.

Yields on 91-day commercial paper (CPs) showed a generally stable pattern of movements throughout the year while being influenced by changes in long-term market interest rates and the interplay of supply and demand for short-term funds. During the first two months of the year, yields on CPs slipped from 5.07% as of the end of the previous year to 4.60% with the increased demand for CPs on the part of financial institutions, including investment trust companies in particular for the operation of their short-term funds following a sharp rise in their short-term deposits such as money market funds (MMF). In March, though, yields on CPs rose steeply to 5.05% for a short period in response to the shift of long-term interest rates to an upward trend.

During May and June, they showed a slight upward trend as the Bank of Korea raised its policy rate and the markets' demand for CP declined in response to financial institutions' securing of liquidity ahead of the

<Figure Ⅱ-33>

Yields on CDs & CP and Spread of CP over CDs



Source: Korea Securities Computer Corp.

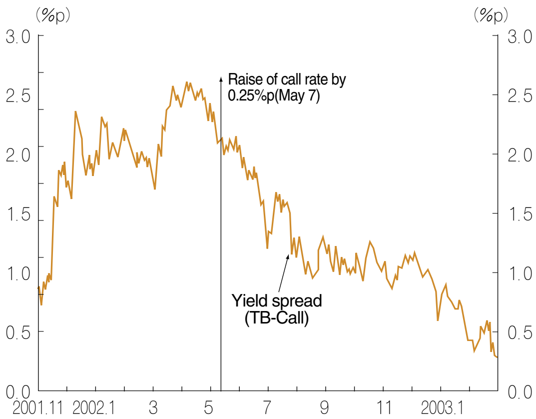
semi-annual closing of accounts. From late July onwards, yields on CP shifted to a downward trend again, influenced by the easing of long-term market interest rates. From September onwards, yields on CP climbed to 5.07%, driven by the decline of financial institutions' purchase for CP in preparation for the withdrawal of deposits for the *Chuseok* holidays and the rise in the loan delinquency ratio of credit card companies, which are heavily dependent on the issue of CP to raise funds. Investment trust companies and other financial institutions, however, recovered their appetite for CP following an increase in their taking of short-term deposits from mid-November, and yields on it maintained an downwardly stable trend until the end of the year. Moving into the year 2003, following a sharp rise in investment trust companies' MMF and the affect of decline in long-term market interest rates, yields on CP retreated even further to the level of 4.64% by the end of February.

With yields on 91-day negotiable certificates of deposit (CDs) showing a pattern of movements similar to those on CP, the spread between the two interest rates[12)]showed a tendency to narrow. This was because of the decline in corporate credit risk brought about by ample market liquidity and improved corporate earnings. Having stood at 0.21%p at the end of the previous year, the differential narrowed to between 0.08 and 0.12%p from June. But from November onwards, amid concerns over card loans turning sour, yields on CP issued by credit card companies rose, causing the differential to widen slightly again.

12) This interest rate spread arises from the difference in credit standing between banks, which are the main issuers of CDs, and general (non-financial) companies and non-bank financial companies (credit card companies, securities companies, etc.), which are the main issuers of CP.

<Figure Ⅱ-34>

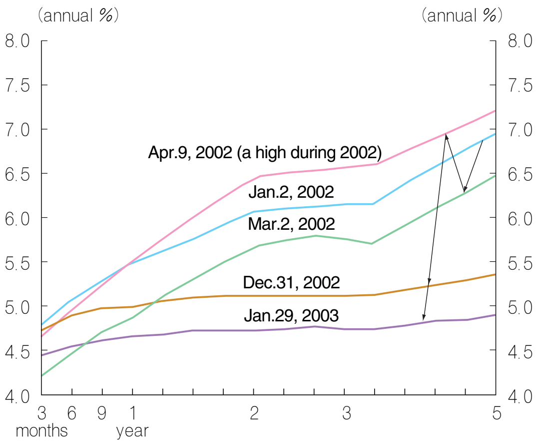
Trends of Spread between Short- and Long-term Interest Rates



Source: The Bank of Korea, Korea Securities Computer Corp.

<Figure Ⅱ-35>

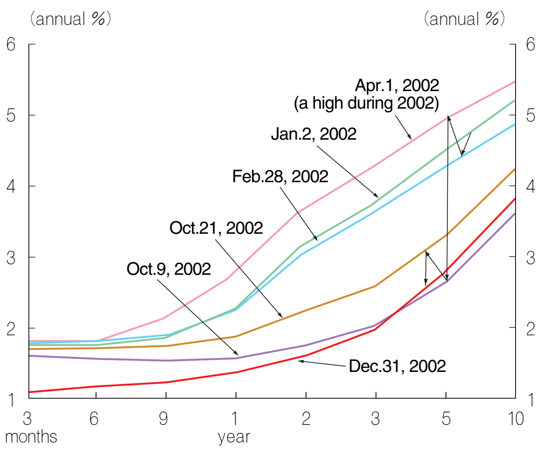
Yield Curves of Treasury Bonds



Source: Korea Securities Computer Corp.

<Figure Ⅱ-36>

Trends of Yield Curves of U.S. Treasury Bonds



Source: FRB

(Spread between Long-term and Short-term Interest Rates)

The spread between long-term and short-term interest rates narrowed greatly during the year 2002 because of the large scale of fall in long-term market interest rates.

Viewing the trends of changes in the spread between yields on the 3-year Treasury bonds and the overnight call rate, during the first two months of the year, a slight narrowing was observed but this widened to as much as 2.60%p (April 4), reflecting the upward trend of long-term market rates in the subsequent three months. But after the Bank of Korea raised its call rate target (May 7) and, from late May, long-term interest rates continued to decline, the interest rate spread rapidly narrowed to reach just 0.95%p on August 14. Subsequently, as Treasury bonds saw their yields move within a comparatively stable trend of movements between 5.2 and 5.6%, the spread was maintained within a band of 1.0~1.2%p, but the spread narrowed again greatly from late December. Amid increasing uncertainty over the economic environment at home and abroad, long-term interest rates have fallen back again by a large margin, so that as of the end of February 2003 the spread between long-term and short-term interest rates stood at the 0.32%p.

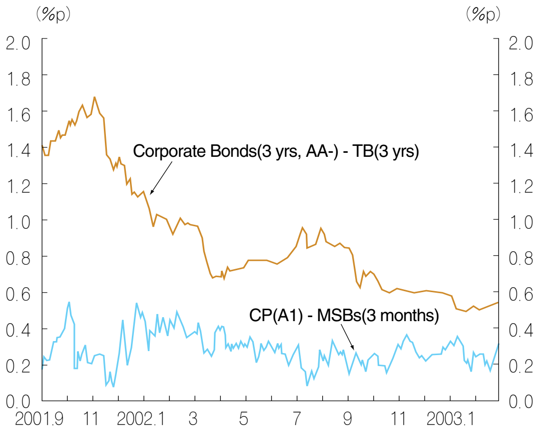
Reflecting these contradictory movements of the spread between the long-term and short-term interest rates, the slope of the spot-yield curve on Treasury bonds continued to show a pattern of flattening-out from mid-April 2002 onwards. This phenomenon of a narrowing spread between short-term and long-term interest rates was not confined to Korea. The slope of spot yield curve on US Treasury bond also continued to flatten out from April onwards and in the case of the member states of the European Union and Japan, a similar trend emerged. The worldwide flattening-out of the spot yield curve may be seen as reflecting the mood of unease that gripped the financial markets as to whether the recovery of the global economy would continue to be delayed by the mounting uncertainty.

(Risk Premiums)

Risk premiums, which indicate the difference in yields between risk- bearing and risk-free assets, generally displayed a pattern of narrowing. This was because of the reduction in corporate credit risk thanks to the ample market liquidity and buoyant corporate performance.

<Figure Ⅱ-37>

Trends of Risk Premiums



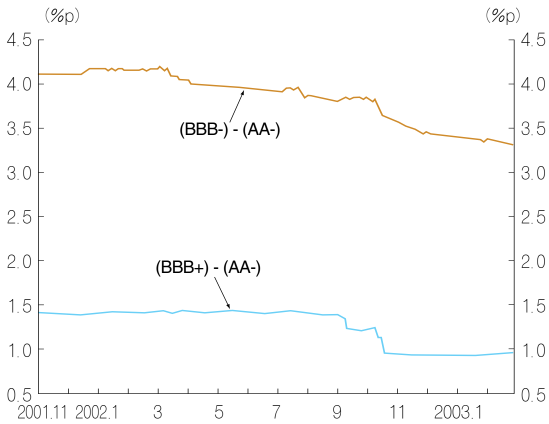
Source: The Bank of Korea, Korea Securities Computer Corp.

If we examine the movements of the long-term risk premium (yields on AA- rated 3-year corporate bonds as against yields on 3-year Treasury bonds), we observe that it contracted from 1.13%p as of the end of 2001 to 0.57%p as of the end of 2002. During the first three months of the year, the long-term risk premium shrank to 0.68%p (March 30) amid reduced issue of corporate bonds and anticipations of an upswing in corporate performance. From April onwards, though, the demand for Treasury bonds continued to mount thanks to the general downward trend of interest rates and the convenience in trading them that facilitates short-term profit taking. And the risk premium, which had been shrinking for some length of time, was not anticipated to narrow any further. As a net result, the risk premium widened again to 0.93%p in late June. From July onwards, corporate credit risk maintained a consistently low level, while banks and insurance companies stepped up their purchases of corporate bonds. The risk premium consequently continued to shrink, so that it stood at just 0.54%p as of the end of February 2003.

The short-term risk premium (yields on A1 rated 91-day CP as against yields on 91-day Monetary Stabilization Bonds) also showed an overall shrinking trend similar to that of the long-term risk premium. Nevertheless, the scale of its decline was relatively smaller and it tended to widen or narrow slightly in line with the interplay of supply and demand for short-term funds. Looking at the trend of changes in the short-term risk premium, we note that it contracted from 0.44%p in early 2002 to stand at around 0.20%p in mid-October. It then widened, however, to reach around 0.30%p during the last two months of the year 2002 in line with the rise in yields on CPs issued by credit card companies. Moving into the year 2003, however, it contracted to the 0.20%p level because of the increase in demand for CPs.

<Figure Ⅱ-38>

Trends of Spread on Corporate Bonds by Credit Rating



Source: Korea Securities Computer Corp.

The demand for corporate bonds, fuelled by the decline in corporate credit risk, extended to those with a sub-prime credit rating and the interest rate differential between investment grade corporate bonds narrowed. The interest rate spread between BBB- rated corporate bonds and those with an AA- rating shrank from 4.16%p at the end of the preceding year to 3.40%p as of the end of the year 2002. During the first two months of the year, despite the general reduction in corporate credit risk, investors' enthusiasm for corporate bonds did not extend to those with the lowest investment grade of BBB-, and the interest rate spread remained at roughly the same level as that at the end of the year 2001. From March onwards, however, the interest rate spread narrowed slightly to stand at 3.31%p as of the end of February 2003. This was attributable to the expansion of purchases of sub-prime grade corporate bonds having comparatively higher yields by long-term institutional investors, such as insurance companies and pension funds, and by small and medium-sized financial institutions in a climate in

<Table Ⅱ-18>

Trends of Spread Between CP by Credit Rating
(month-end basis)

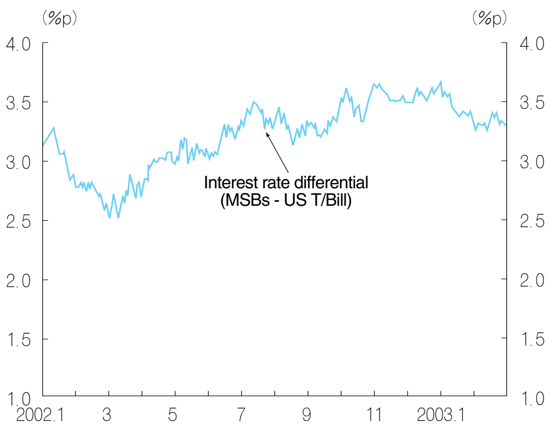
(annual %)

	2001	2002				2003	
	Dec.	Jan.	Mar.	Jun.	Dec.	Jan.	Feb.
A1-rated(a)	5.07	4.80	4.94	4.95	5.03	4.68	4.64
B-rated(b)	9.32	9.02	9.11	9.05	9.11	8.76	8.64
Spread(b-a)	4.25	4.22	4.17	4.10	4.08	4.08	4.00

Source: Korea Securities Computer Corp.

<Figure Ⅱ-39>

Trends of Interest Rate Differential



Source: The Bank of Korea

which an upswing in business performance was awaited.

Meanwhile, the interest rate spread between B rated and A1 rated CP contracted from 4.25%p at the end of 2001 to 4.08%p at the end of 2002 as investment trust companies expanded the operation of their funds using sub-prime grade CP. Moving into the year 2003, this spread narrowed further to 4.0%p as of the end of February 2003.

(Differential between Domestic and International Interest Rates)

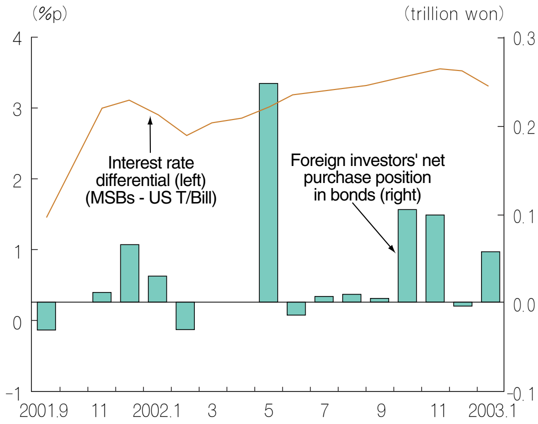
The domestic-foreign interest rate differential showed an overall widening as international interest rates fell on a larger scale than domestic interest rates.

The differential between them on the basis of debentures with a 1-year maturity (yields on MSBs as against US Treasury bills) narrowed to 2.60%p during the first two months of the year in response to the influence of the downturn in yield on domestic bonds. But, from March onwards, as domestic and international interest rates all shifted to an upward trend, the scale of the upswing in interest rates on domestic bonds was comparatively larger, so that the differential began to open up again.

From April onwards, both domestic and international interest rates moved back to a downward track. US interest rates fell by a large margin, reflecting the increased appetite for US Treasury bills generated by the steep fall in the US stock markets. In contrast, the fall in domestic yields was relatively small, being affected by the Bank of Korea's upward adjustment of its call rate target. Thus, by early July, the spread between domestic and international interest rates had

<Figure Ⅱ-40>

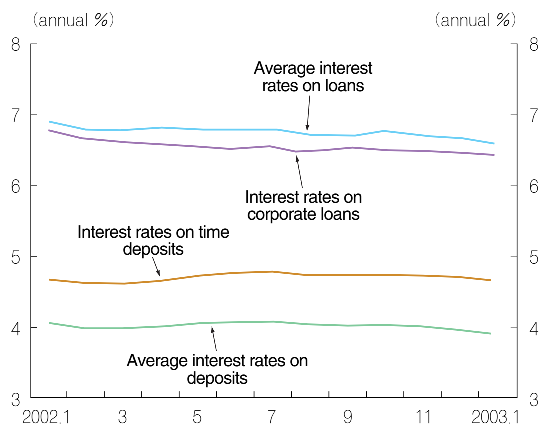
Trends of Interest Rate Differential and Foreign Investors' Net Purchase Position in Bonds



Source: The Bank of Korea, The Financial Supervisory Service, Federal Reserve Board.

<Figure Ⅱ-41>

Trends of Interest Rates on Bank Deposits and Loans



Source: The Bank of Korea.

widened to 3.50%p. From mid-July onwards, domestic interest rates fell by a relatively larger margin than US interest rates, causing the spread to narrow slightly, but from the last few days of August, domestic interest rates moved within a narrow range, whereas US interest rates maintained a downward trend following the reduction of the US Federal Fund rate target. This led to a renewed widening of the domestic-international interest rate spread. From November onwards, it held steady at around 3.60%p.

In early in 2003, domestic interest rates fell sharply under the impact of the North Korean nuclear issue, causing the domestic-international interest rate spread to narrow to 3.32%p as of the end of February.

Foreign investors' net purchases of domestic bonds during 2002 rose sharply to 460 billion won as against 150 billion won of the year before. But foreign investment in domestic bonds has still been on a very small scale compared to that in Korean stocks[13)] and it has as yet no marked correlation with the spread between domestic and international interest rates.

(Interest Rates on Deposits and Loans of Financial Institutions)

During the year 2002, lending rates of financial institutions generally showed a downward trend, reflecting the lowering of long-term market interest rates, the ample liquidity and the low level of companies' demand for funds. In contrast, interest rates on deposits, led by the increase in deposit rates by several banks, showed a slight upward trend, but, from

13) As of the end of the year 2002, the share of foreign investment in Korean stocks stood at 36% (on the basis of Korea Stock Exchange market capitalization, including direct investment stakes), whereas foreign holdings of Korean domestic bonds stood at only 0.1%.

August onwards, they shifted back to the downward trend.

The average interest rate on bank loans (on the basis of newly extended loans) declined during the year by 0.26%p, as firms' appetite for borrowings remained limited and the competition between banks to secure prime customers intensified.

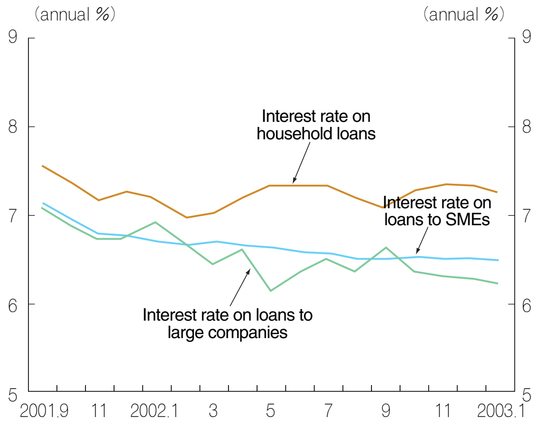
During the first two months of the year, the average interest rate on bank loans declined to 6.78% (a reduction of 0.13% from the previous year-end), as competition for lenders built up between banks, particularly for SMEs and retail customers. From March onwards, household lending rates rose-centering on interest rates on loans secured by housing collateral, but corporate lending rates showed a downward movement centering on interest rates on loans to SMEs.

During August and September, interest rates on lending to SMEs maintained their declining trend while those on loans to households shifted to a falling trend, led by the decline of yields on CDs which serve an anchor rate for loans with floating interest rates. As a consequence, the average interest rate on bank loans eased to 6.71%. As part of measures to rein in household loans, mandatory provisions for them were adjusted upward (October 11). Household lending rates thus showed an upward trend in October. Meanwhile, the average interest rate on lending to SMEs also rose slightly in response to the Bank of Korea's reduction of its Aggregate Credit Ceiling. The average bank lending rate consequently rose to 6.77% again.

From November, interest rates on loans to enterprises shifted to a downward trend as a result of banks' efforts to increase loans to SMEs and the decline in borrowings

<Figure Ⅱ-42>

Trends of Interest Rates on Bank Loans by Borrower



Source: The Bank of Korea

by large companies. This acted to bring down banks' average lending rate in December to its lowest ever level for the year of 6.65%. Moving into the year 2003, the average bank lending rate maintained a downward trend, led by the low level of the demand for borrowing and the decline of yields on CDs.

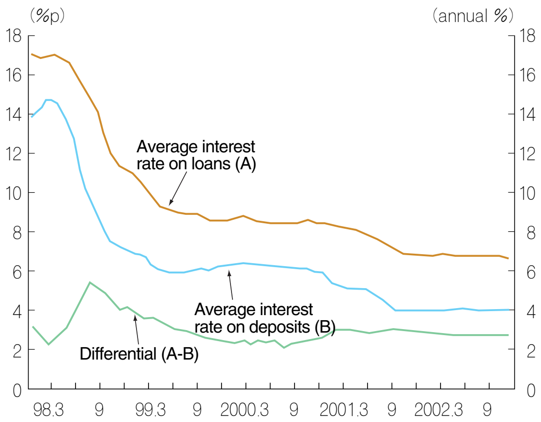
Looking at the trend of interest rates on bank loans by type of borrower, interest rates on lending to households rose slightly from 7.26% at the end of 2001 to 7.31% at the end of 2002 as a result of the government's measures to rein in household lending. In contrast, corporate lending rates showed a comparatively large drop from 6.75% to 6.47% because of mounting competition for lending between banks. Interest rates on loans to large companies were reduced on a comparatively larger scale, falling by 0.46%p, while those to SMEs were cut by 0.25%p.

The average interest rate on bank deposits (on the basis of newly- taken deposits and excluding demand deposits) showed a mild upward trend until July, but, from August onwards, it shifted to a downward trend and went back in December 2002 to approximately the same level as in the December of the previous year.

During January, the average bank deposit rate registered a rise of 0.06%p over the previous month to stand at 4.04% because of the rise in deposit rates brought about by several banks' drive to increase deposits and the reduction in low interest rate savings deposits with transferability. From February, market interest rates showed a downward trend, while the rates paid on large-value deposits were reduced by several banks facing increased difficulties in management of their funds amid the low level of the demand for corporate borrowings. Consequently, the average bank deposit rate was adjusted to its lowest level for the year of 3.96%.

<Figure Ⅱ-43>

Trends of Differential Between Interest Rates on Deposits and Loans of Banks



Source: The Bank of Korea

During the five months from March to July, the average bank deposit rate showed an upward trend. This was attributable to the fact that, although banks lowered interest rates on savings deposits with transferability whose administrative expenses were higher than those of other types of deposits, several banks raised interest rates on long-term deposits in a bid to raise Korean won liquidity ratios[14] and yields on marketable financial products such as CDs and RPs showed an upward trend. Particularly, during May, the average bank deposit rate rose by 0.05%p, as the Bank of Korea raised its call rate target. After edging up to 4.08% during July, the average bank deposit rate turned downward from August onwards. This was because banks lowered interest rates on long-term time deposits as their Korean won liquidity ratios surpassed the Financial Supervisory Service's guideline amid the intensified difficulties they faced in operating their funds as a result of government measures to rein in household lending. Particularly in December, the Deposit Insurance Corporation decided to levy a special insurance premium[15] and banks accordingly lowered most of their deposit rates, causing the average bank deposit rate to slip to 3.97%. As bank deposit rates showed this comparatively stable trend of movements amid the lowering of bank lending rates, the spread between bank deposit and lending rates narrowed from 2.93%p

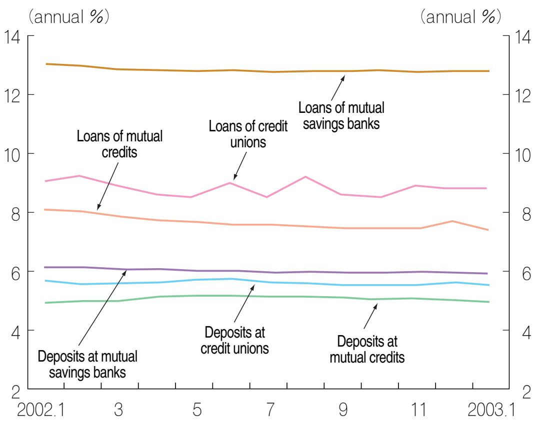
14) In March 2003, the Financial Supervisory Service strengthened regulations so as to require banks to maintain a Korean won liquidity ratio of 105% and this came into force from the end of the second quarter. To meet this ratio, some banks sought to encourage long-term deposits by way of higher interest rates, and as a result, nearly all banks were able to exceed the guideline of Korean won liquidity ratio (105%).

15) In order to make up part of the fund for the redemption of public funds, government decided to levy a special insurance premium of a yearly 0.1% on the average balance of deposits in banks from January 2003.

in December of the preceding year to 2.68%p in December 2002. Moving into the year 2003, the average interest rate on bank deposits maintained its downward trend mainly because of a decline in market interest rates.

<Figure Ⅱ-44>

Trends of Interest Rates on Loans and Deposits of Non Bank Financial Institutions



Source: The Bank of Korea.

During 2002, the lending rates of non-bank financial institutions saw a slight downward trend except for those of mutual savings banks.

Viewing the average lending rate of non-bank financial institutions (on the basis of newly-extended funds), during the first half of the year, a generally downward trend was exhibited in response to competition with banks to secure customers, but, in the latter half of the year, it showed a slightly higher range of movements in line with the expansion of the handling of small-value loans on credit at high interest rate. By type of financial institution, the average lending rate of mutual savings banks (bill discounted basis) lowered from 13.03% in December of the previous year to stand at 12.74% in December 2002. The average lending rate of credit unions fell from 9.56% to 8.81% over the same period and that of mutual credit facilities from 8.66% to 7.69%.

The average deposit rate of non-bank financial institutions (on the basis of the newly-taken amount of fixed interest rate products) rose from 5.52% in December of the year before to 5.59% in December 2002 in the case of credit unions, and from 4.94% to 5.05% in the case of mutual credit facilities. In contrast, the average deposit rate of mutual savings banks moved stably between 6.09 and 6.10% for the first four months of the year, but it shifted to a downward trend from May onwards to close the year at 5.95% in December.

Looking at the spreads between deposit and lending rates by type of financial institution, that of mutual savings banks narrowed slightly from 6.94%p in the last month of the previous year to stand at 6.79%p in December 2002. Credit unions and mutual credit facilities, in contrast, both experienced a relatively large scale of contraction in their spreads, the former from 4.04%p to 3.22%p and the latter from 3.72%p to 2.64%p. The reason that the deposit-lending rate spread of mutual savings banks was relatively larger than those of credit unions and mutual credit facilities was that the former had generally lent at high interest rates to customers who had a relatively greater credit risk.

(2) Stock Prices

Moving into 2002, stock prices sustained their upward trend from October 2001, reflecting strong expectations of economic recovery. From late April onwards, though, they continued on a downward trend as investors' spirits were greatly dampened by the tumbling of US stock markets and the heightened uncertainty surrounding economic conditions at home and abroad.

<Table Ⅱ-19>

Stock Market Trends

	2001	2002		2003	
		first half	second half	Jan.	Feb.
KOSPI[1]	693.7 (+37.5)	742.7 (+7.1)	627.6 (-9.5)	591.9 (-5.7)	575.4 (-8.3)
Volume (ten thousand shares)[2]	47,191	68,960	101,636	59,968	58,098
Value (hundred million won)[2]	19,969	36,321	24,737	17,212	14,668
KOSDAQ Index[1]	72.2 (+37.3)	60.9 (-15.7)	44.4 (-38.6)	43.4 (-2.2)	41.8 (-5.8)
Volume (ten thousand shares)[2]	38,371	34,906	29,367	35,070	36,407
Value (hundred million won)[2]	17,284	15,738	8,516	9,724	8,116

Notes: 1) Based on period-end. Figures in parentheses refer to percentage changes compared with the previous year-end.
2) Daily average.
Source: Korea Securities Computer Corp.

(Korea Stock Price Index)

The Korea Stock Price Index (KOSPI) rose 18.2% in the first two months of the year from its level at the end of the preceding year, driven by a continuing inflow of funds to the stock market affected by anticipations of a business upswing. Subsequently the upward trend was maintained, underpinned by factors that included the rise in stock prices in major countries[16] and Moody's

16) Stock price indices of major countries in March: US Dow-Jones +2.9% (NASDAQ +6.6%), Japan +4.1%, Germany +7.1%, UK +3.4%, Hong Kong +5.3%, Taiwan +8.3%

upgrade of Korea's sovereign rating (March 28). KOSPI consequently registered its highest level for the year on April 18 at 937.61, a 35.2% rise over the previous year-end.

But from late April onwards, domestic stock prices shifted to a downward trend amid mounting unease among investors over the six month run of rises in contrast with their fall in major countries and the United States in particular. Most strikingly, during June, the scale of the fall in KOSPI from the previous month widened to 6.7%, as US stock prices fell by a large margin amid the widening scandal over accounting malpractice at WorldCom, Xerox and other major companies, being followed downward by those in other major countries[17). Stock prices subsequently staged a brief rally, influenced by a revival of market confidence following the US companies' submittal of written confirmation concerning the accuracy of their financial statements[18) and Fitch's upgrade of Korea's sovereign rating. However, they then shifted back to a downward trend as the threat of war on Iraq breaking out mounted and concerns grew over domestic financial institutions' household loans turning sour. This led KOSPI to register its lowest level for the year at 584.04 on October 10, a 15.8% lower level than that at the end of the previous year.

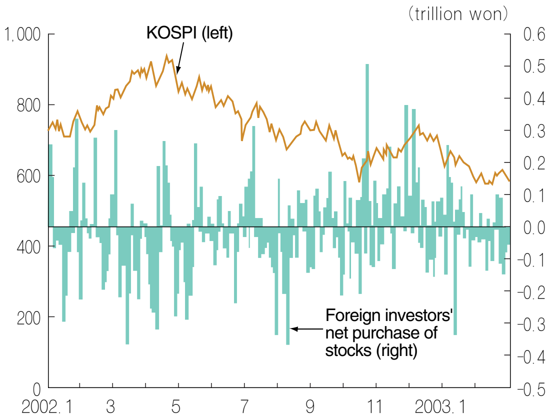
From mid-October, US stock prices showed a firmer trend, buoyed by the Federal Reserve's reduction of its policy interest rate (November 6) and Iraq's acceptance of U.N. weapon inspection (November

17) Stock price indices of major countries in June: US Dow-Jones -6.9% (NASDAQ -9.4%), Japan -9.7%, Germany -9.0%, UK -8.4%, Taiwan -9.2%.

18) The US Securities and Exchange Commission (SEC) had required the chief executive officers (CEO) and the chief financial officers (CFO) of major large corporations to submit written confirmation concerning the accuracy of their corporate financial statements by no later than August 14, 2002.

<Figure Ⅱ-45>

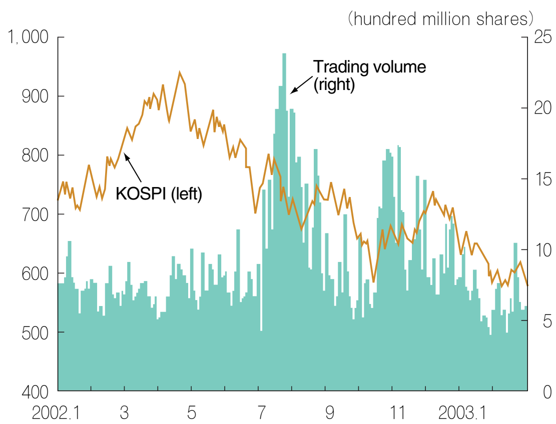
Trends of KOSPI and Foreign Investors' Net Purchase of Stocks



Source: The Financial Supervisory Service, Korea Securities Computer Corp.

<Figure Ⅱ-46>

Trends of KOSPI and Trading Volume



Source: Korea Securities Computer Corp.

13), and in Korea foreign investors shifted to a net buying position. As a consequence, the composite index rebounded to 736.57 (December 3). However, the North Korean nuclear issue and the looming threat of a war against Iraq led to a renewed downturn in stock prices and KOSPI closed the year at 627.55, which was 9.5% lower than that at the end of the previous year.[19] Despite this fall in stock prices, the market capitalization of listed stocks rose by 2.8 trillion won over the course of the year to stand at 258.7 trillion won, as a result of rights offerings (4.8 trillion won) and initial public offerings (1.2 trillion won).

In the new year, as uncertainty mounted over the economic environment at home and abroad in view of the geopolitical risks, while major domestic companies showed only lackluster performance, the downward trend of the index was prolonged, so that as of the end of February KOSPI stood at 575.43, having fallen even further since the end of 2002.

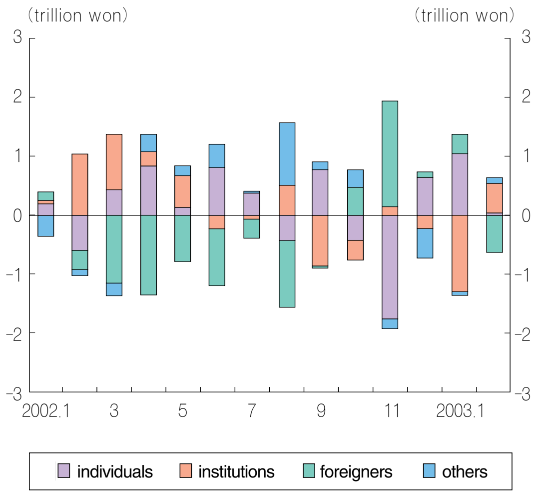
During 2002, the average volume of daily stock transactions almost doubled from the previous year's 0.47 billion shares to reach 0.86 billion shares. This was attributable to a steep increase in speculative transactions involving some low price stocks[20]. Looking at the average value of daily stock transaction throughout the year, we observe a 52.3% rise from the previous year's 2 trillion won to register 3 trillion won.

19) The scale of fall in stock prices in Korea was smaller than that in the United States and other major countries.
 * Falls in major countries' stock price indices: US Dow-Jones -16.8% (NASDAQ -31.5%), Japan -18.6%, Germany -43.9%, UK -24.5%, Taiwan -19.8%.

20) The average volume of daily stock transactions during the year generally remained stable at around 0.6~0.7 billion shares, but the large increase in speculative transactions in low price stocks such as those of Hynix Semiconductor Co. led to a rise in daily turnover to 1.45 billion shares in July and 1.11 billion shares in August, followed by 1.03 billion shares in October and 0.99 billion shares in November.

<Figure Ⅱ-47>

Trends of Net Purchase and Sale of Stocks of the KSE Market by Type of Investor



Source: Korea Securities Computer Corp.

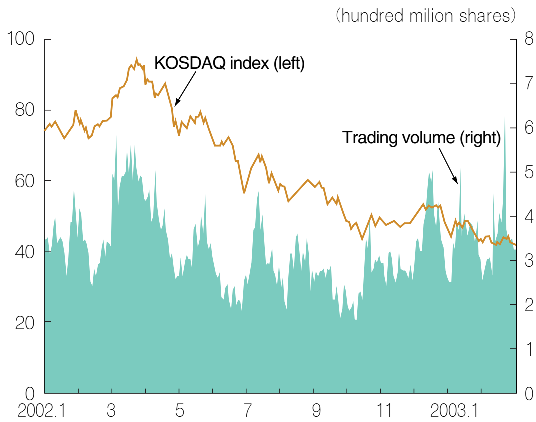
From June onwards, though, the average value of daily stock transactions stood at a comparatively low ebb of around 2 trillion won in view of the subdued state of the stock market.

By type of investor, foreign investors marked a net selling position of 2.9 trillion won throughout the year, whereas institutional investors and individual investors both registered net buying positions of 0.9 trillion won. Among institutional investors, investment trust companies maintained a net buying position of 1.9 trillion won and pension funds one of 0.8 trillion won, but insurance companies registered a net selling position of 0.5 trillion won and banks one of 0.9 trillion won.

Foreign investors' net selling position for the year was the first recorded since the opening of the capital markets in 1992. In January they began the year with a small net buying position, but in February shifted to a net selling position that was maintained until September. It continued during the four months from February to May amid profit taking from the rally in stock prices at that time and the reshuffling of investment portfolios between countries. From June onwards, foreign investor' net selling position was bolstered by the withdrawal of deposits from US mutual funds following the meltdown of the US stock markets, and, by October 10, the scale of net selling by foreign investors since the beginning of the year had reached 5.6 trillion won. From then onwards, inspired by a rally in stock markets worldwide and a rise in semiconductor prices, they shifted to a temporary net buying position, but, from mid-January 2003, turned again to a net selling position.

<Figure Ⅱ-48>

Trends of KOSDAQ Index and Trading Volume



Source: Korea Securities Computer Corp.

(KOSDAQ Index)

In the course of 2002, the Korea Securities Dealers Association Automated Quotation (KOSDAQ) index fell by 38.6% from the previous year end under the impact of the depressed state of the Korea Stock Exchange (KSE) market, worries over lackluster performance by IT companies, and the manipulation of stock prices by some registered companies.

During the first three months of the year, keeping in step with the KOSPI, the KOSDAQ index too staged a rise that was fuelled by anticipations of business recovery and the rise in semiconductor prices, and on March 22 it peaked for the year at 94.30 (30.6% higher than that at the end of the previous year). Moving into April, however, it shifted to a steeply downward trend as investors' spirits were dampened by the downturn in the NASDAQ index, the obscure business prospects for domestic IT companies, and the announcement of an investigation into irregularities and stock price manipulation at new technology start-up companies. From then, the downward trend was maintained under the influence of the weak tone of the KSE market, and on October 11, the index reached its trough for the year of 43.67, a 39.5% drop from its level at the end of the previous year.

From mid-October, the KOSDAQ index turned for a while to an upward trend that reflected the upturn in US stock prices and foreign investors' shift to a net buying position. As of December 3, it registered 53.78 (23.2% higher than its trough for the year). However, from late December, it moved back to its downward track again, influenced by the North Korean nuclear issue and the slide of US stock prices, and, at the end of the year 2002, it registered 44.36. The total market capitalization of KOSDAQ stocks marked 37.4 trillion won as of the end of the year, despite an increase of 122 in the number of registered companies. It thus shrank shrinking by 27.8% from last year-end's 51.8 trillion won to reach 37.4 trillion won.

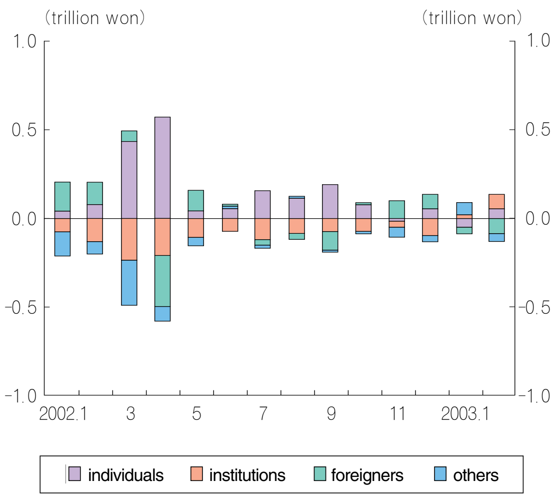
At the start of the year 2003, the KOSDAQ index showed signs of a slight rally, but it returned to its downward trend from mid-January onwards.

Turnover on the KOSDAQ also shrank on a large scale in line with the subdued state of the market. The average volume of daily stock transactions shrank by 16.5% from the previous year (0.38 billion shares) to stand at 0.32 billion shares. In value terms, daily turnover retreated by 30.3% from the preceding year's 1.7 trillion won to stand at 1.2 trillion won. Particularly from June onwards, trading took on a very subdued aspect with the average value of daily trades running below the one trillion won mark.

Looking at the pattern of stock trading by type of investor, individual investors maintained a net buying position of 1.8 trillion won and foreign investors one of 0.2 trillion won. In contrast, institutional investors including investment trust companies, securities companies and the like registered a net selling position of 1.3 trillion won. In the case of foreign investors, they marked a net buying position of 0.3 trillion won during the first quarter when the KOSDAQ index was rising and one of 0.2 trillion won in the fourth quarter when it again moved upward. During the second and third quarters, when stock prices were falling, they registered a net selling position of 0.4 trillion won.

<Figure Ⅱ-49>

Trends of Net Purchase and Sale of Stock on the KOSDAQ Market by Type of Investor



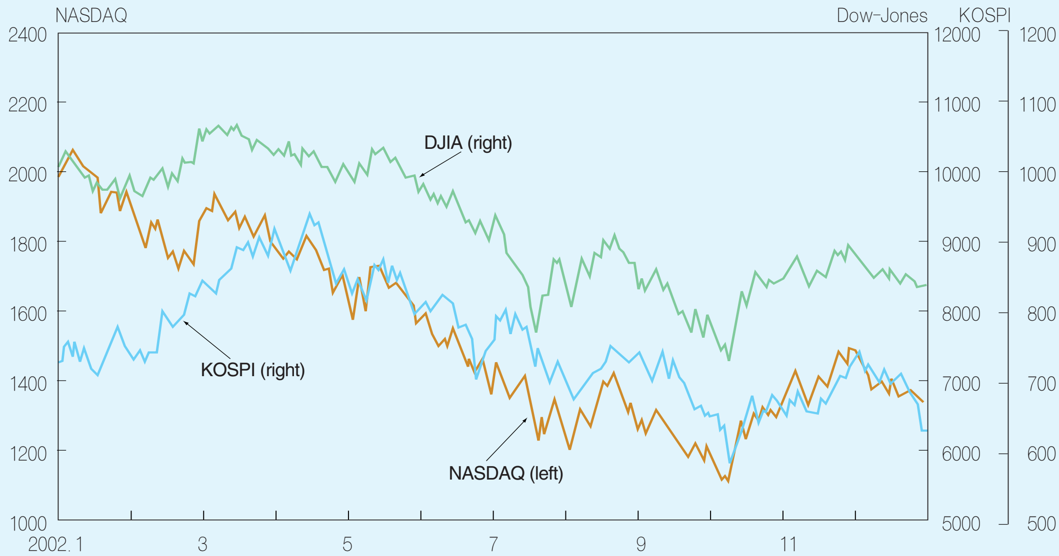
Source: Korea Securities Computer Corp.

<Box Ⅱ-2>

Reasons for the Synchronicity between US and Domestic Stock Prices

Over the last year, domestic stock prices generally showed trends synchronized with those of US stock prices. Until early May, despite worries over the economic slowdown of major countries and in particular the United States, the robust recovery of Korean economy was highlighted and domestic stock prices showed a differentiated pattern of the movement as against US stock prices. From mid-March, however, the phenomenon of synchronicity emerged clearly and it persisted until the end of the year.

Trends of KOSPI · DJIA · NASDAQ



Source: Bloomberg

Although admittedly the degree of synchronicity between stock prices differed, it was not a phenomenon confined to Korea but one that could be similarly found in major countries. This is because the degree of mutual economic dependency among countries has risen with the spread of internationalization, and the influence of the US economy has grown stronger. Particularly in the case of Korea, which relies heavily on exports and therefore is highly sensitive to the US and other overseas economies, stock prices are greatly influenced by US stock prices.

Correlation between Major Countries' Share Prices and U.S. Share Prices During 2002

	Japan	Germany	U.K.	Hong Kong	Singapore	Korea
Dow-Jones	0.81	0.96	0.97	0.88	0.91	0.85
NASDAQ	0.63	0.91	0.92	0.78	0.85	0.66

What is more, in terms of investment style, foreign investors' buying/selling of domestic stocks is strongly affected by the movements of US stock prices, and this also acts as a factor encouraging this synchronicity. If we compare the relationship between foreign investors' daily net buying/selling in the Korean stock market and the range of movement of US stock prices on the immediately preceding day during 1999 with that during 2002, we observe that the correlation between the rate of fluctuation in the NASDAQ index on the immediately preceding day and the extent of foreign investors' buying/selling in the KSE market rose from 0.24 to 0.54 and that the degree of coincidence between the direction of the NASDAQ index' movements on the immediately preceding day and the direction of foreign investors' net buying/selling in KSE market also rose from 57.8% to 66.0%. Furthermore, Korean investors who were not confident as to the underlying tone of domestic economic conditions tended to track foreign investors' stock trading pattern, using it as a benchmark index, thereby causing US stock prices to exert even stronger influence over domestic stock prices.

Relationship between Fluctuation in the U.S. Share Prices and Foreign Investors' Net Buying and Selling

(stock exchange basis)

	Correlation[1]		The degree of coincidence of direction[2]	
	NASDAQ	Dow-Jones	NASDAQ	Dow-Jones
1999	0.24	0.19	57.8	53.4
2000	0.44	0.19	63.9	60.2
2001	0.55	0.42	63.0	59.8
2002	0.54	0.46	66.0	68.0

Notes: 1) The correlation between the rate of fluctuation in U.S. share prices on the immediately preceding day and the extent of foreign investors' net buying and selling on that day.
2) Cases where U.S. share prices rise (fall) on the immediately preceding day and at the same time foreign investors take a net buying (selling) position on that day.

<Table Ⅱ-20>

Growth Rate[1] of Major Monetary Aggregates

(%)

	2001	2002				2003
	Dec.	Mar.	Jun.	Sep.	Dec.	Jan.
M1[2]	25.0	26.8	26.4	18.0	15.2	13.7
M2[2]	8.3	11.1	12.5	10.6	14.1	13.9
M3	11.3	12.9	13.5	12.4	13.3	··
RB	14.0	17.6	16.3	15.3	9.7	10.7

Notes: 1) Based on daily average, compared with the same period of the previous year.
2) new M1 and new M2.
Source: The Bank of Korea.

B. Quantitative Indicators

(1) Money

The growth rates of major monetary indicators rose compared to the previous year because of the increase of credit to the private sector led by household loans and lending to SMEs.

(Monetary Aggregates)

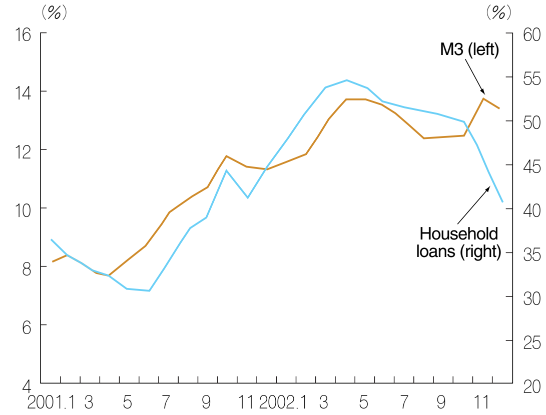
During 2002, the annual growth rate of M3 (average balance basis) rose sharply from 9.6% of the previous year to 12.9%, fuelled by the increase of credit to the private sector. From the beginning of the year, the growth rate of M3 showed a constant upward trend and it rose to 13.7% in April. In May, however, following the downward adjustment of the call rate target, its growth rate stayed at the level of the preceding month. From June onwards, it shifted to a mild downward trend, easing to around the 12.5% level in response to the faltering of the increase rate in household lending and to the base period-effect from its sharp rise a year earlier[21]. From November onwards, its growth rate rose for a while to around 13% in response to the expansion of fiscal spending and the inflow of foreign portfolio investment funds, before showing signs of subsiding again.

A close mutual relationship was exhibited between the pattern of changes in the growth rate of M3 and the rate of increase in household loans (deposit money bank basis, including trust accounts of banks). From mid-

21) During the third quarter of 2001, the growth rate of M3 accelerated sharply in response to three successive reductions of the call rate target by the Bank of Korea and, strikingly, during the 4 months from July to October, the monthly average increase in the volume of M3 rose to 12.4 trillion won, considerably higher than the monthly average of 8.7 trillion won during the year.

<Figure Ⅱ-50>

Trends of the Growth Rate of M3 and Household Loans by Banks



Source: The Bank of Korea.

<Figure Ⅱ-51>

Shares of M3 by Financial Institution Type

Source: The Bank of Korea.

2001 until April 2002, household lending accelerated rapidly and the growth rate of M3 showed a constant upward trend, peaking at 13.7%. But following the upward adjustment of its call rate target by the Bank of Korea, the growth rate of household lending began to recede and, accordingly, the growth rate of M3 showed a gradually subsiding trend from May onwards.

Looking more closely at the weight of each type of financial institutions' deposits in the composition of M3, that of the bank accounts of deposit money banks rose from its 48.6% in the previous December to 50.0% in December 2002, pushed upward by their revolving-style time deposits and their issue of financial debentures[22]. In contrast, in the case of their trust accounts, because of the great scale of withdrawal of the maturing funds, the weight in M3 fell from 7.0% to 5.5%. Accordingly, there was little change in the overall weight of banks' deposits. Meanwhile, though, that of investment trust companies' deposits expanded from 9.0% to 9.8%, thanks to the increased deposits in their MMFs.

The growth rate of M2 (new M2 basis) rose to 11.5% from its 6.9% last year. Looking at the trend the M2 growth rate more closely, it rose to 12.5% in June, but eased from July to stand at 10.6% in September in response to the faltering of the growth of household lending and the government's constriction of its fiscal spending. After October, however, it shifted to an upward trend that was led by the inflow of foreign portfolio investment funds, accelerating to 14.1% in

22) During 2002, in order to raise their Korean won liquidity ratios and solve the problem of mismatch in period between fund raising and the use brought about by the shift of their deposit structure toward the short term and the expansion of household loans, banks expanded their issue of financial debentures. Thus, the volume of the net issue of these securities increased to 33.2 trillion won.
* Trend of net issue of financial debentures: 3.4 tril. won (year 2000) → 5.1 tril. won (2001) → 33.2 tril. won (2002)

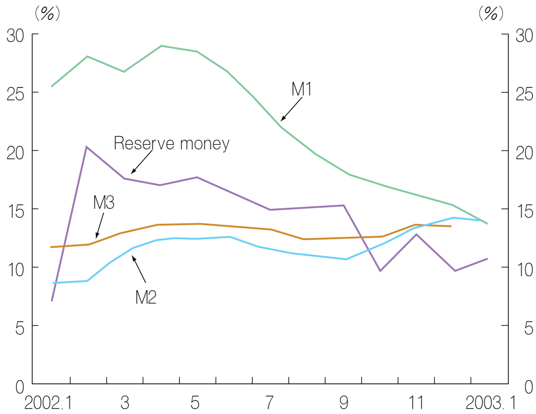
December. Moving into the year 2003, it showed a downward movement again because of a reduction of credit to private sector, and stood at the 13% level.

M1 (new M1 basis) had maintained a growth rate of around the 25% level since the fourth quarter of 2001, fuelled by an increased inflow of opportunistic funds seeking higher yields in a low interest rate environment. Nevertheless, from July onwards, the stable trend of housing prices and the sluggishness of the stock markets along with a base period-effect from the previous year[23] caused its growth rate to maintain a continued downward trend to stand at 15.2% in December. Moving into the year 2003, the growth rate of M1 has also maintained a continuous downward trend.

Reserve money (average balance basis), meanwhile, accelerated its growth rate from 11.5% in the previous year to 14.3% in 2002. Its more rapid growth rate was attributable to the increased demand for bank reserves brought about by the acceleration in the growth of deposits subject to reserve requirements centering on short-term financial products. And it was also ascribable to the increased amount of currency issued subsequent to the expansion of demand for settlement funds in line with the recovery of the real economy. Moving into the year 2003, the growth rate of reserve money showed a small rise because of the increase in the issue of currency, led by factors such as the Lunar New Year holidays.

<Figure Ⅱ-52>

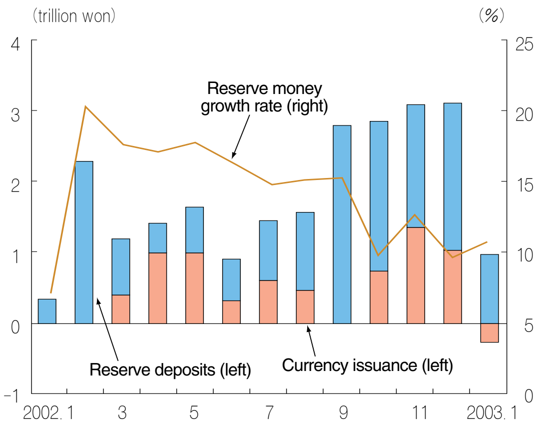
Growth Rates of Major Monetary Aggregates[1]



Note: 1) Based on daily average.
Source: The Bank of Korea.

<Figure Ⅱ-53>

Reserve Money Growth Rate[1] and Changes[2] by Component



Notes: 1) Compared to the same period of the previous year.
2) Compared to the end of the previous year.
3) Based on daily average.
Source: The Bank of Korea.

23) During the third quarter of 2001, under the influence of falling market interest rates and bank deposit rates in line with the step-by-step reduction of the call rate, the rate of growth of M1 rose to 19.3 percent, driven by the explosive growth of banks' instant access type accounts and investment trust companies' MMFs. But from October of the year, opportunistic funds expanded greatly in response to rising stock and real estate prices, and the growth rate of M1 accelerated to around the 25 % level.

<Box Ⅱ-3>

The Bank of Korea's Compilation of Refined Monetary Aggregates

Because of the former method of compiling monetary aggregates with financial institutions centered, their capacity to accurately capture the level of liquidity was limited. The IMF has positively recommended the compilation of monetary indicators centering on financial assets without distinguishing those of deposit money banks and non-monetary institutions in view of the blurring of the boundaries between financial institutions brought about by the spread of financial innovation. The Bank of Korea accordingly launched a study on the development of appropriate monetary indicators in June 1999, leading to the final confirmation of the monetary and financial statistics manual in October 2000 through a public hearing, and release of new monetary indicators commencing from 2002. During the year 2002, for the convenience of monetary statistics users, the former monetary indicators were compiled and issued in parallel with the new indicators. The word "new" is added in front of these newly compiled monetary indicators to distinguish them.

In order to conform to the IMF's manual, the new monetary indicators are divided into narrow money (M1) and broad money (M2) on the basis of the liquidity of financial products. The composition factors of new monetary indicators are as follows.

M1 : Composed of currency in circulation, depository institutions'* demand deposits and savings deposits with transferability (banks' savings deposits and MMDA, investment trust companies' MMF).

* In the compilation system of the new monetary indicators, the current monetary institutions and non-monetary institutions (excluding insurance institutions) are integrated within the definition of depository institutions.

M2 : Additionally includes depository institutions' financial products having a high degree of substitutability but with slightly less liquidity than the financial products making up M1.

M1 + periodical time deposits & installment savings + marketable instruments (CDs, RPs, CMA, cover bills, etc.) + yield-based dividend instruments + financial debentures* + other financial products (investment trust companies' securities investment savings, bills issued by merchant banking corporations, etc.)

* Financial instruments with a maturity exceeding two years are excluded.

The new monetary indicators are assessed as having gained timeliness and utility by achieving greater promptness through digitalization in the stage of information-gathering in addition to providing indices that are faithful to the basic definition of money, thanks to their compilation by the classification of financial products on the basis of liquidity. By bringing the short-term products of non-bank financial institutions within M1, it has become suitable for capturing the level of liquidity in short-term financial markets. Similarly, because the new M2 included non-bank financial institutions' products, it was able to correct the confusion in the monetary indicators resulting from fund transfers between financial institutions. What is more, through the great improvement in the problem of lack of promptness in the reporting of the existing M3, the new indicators are seen as having a much greater role as information variables for monetary policy decision.

Comparison between Old and New Monetary Aggregates

Old	New
M1 = currency in circulation + demand deposits at deposit money banks	M1 = currency in circulation + demand deposits + savings deposits with transferability = old M1 + demand deposts at non-bank financial institutions + savings deposits with transferability at financial institutions (deposit money banks' savings deposits and MMDA, investment trust companies' MMF)
M2 = M1 + time & savings deposits plus residents' foreign currency deposits at deposit money bank	M2 = M1 + periodical time deposits & installment savings + marketable instruments + yield-based dividend instruments + financial debentures + other financial products (investment trust companies' securities investment savings, bill issued of merchant banking corporations, etc.) *Financial instruments with a maturity exceeding two years are excluded = former M2 + short-term savings deposits and installment deposits of non-monetary institutions + money-in-trust (excludes those having a maturity exceeding 2 years) + CDs + RPs + cover bills + financial debentures (excludes those having a maturity exceeding 2 years) - long-term savings deposits and installment savings of deposit money bank
M3 = currency in circulation + bank and non-bank financial institutions' deposits + financial debentures + commercial bills sold + CDs + RPs + cover bills	Unchanged (As on the left)

Note: Shaded expressions show differences from the coverage of previous monetary aggregates.

<Table Ⅱ-21>

M3 Supply[1] by Sector

(hundred million won)

	2001	2002
M3 changes	1,060,735	1,380,245
Government	119,878	25,225
Public sector	172,128	-70,349
Private sector	747,455	1,490,740
(Loans & discounts)	455,767	1,153,501
(Securities)[2]	226,930	137,827
(Loans in foreign currency)[3]	-45,438	174,650
Foreign sector	215,181	-104,186
Others	-193,907	38,815

Notes: 1) Changes based on year-end balance.
2) Securities such as coporate bonds, CP, etc.
3) Advanced payment against foreign currency payment guarantees, foreign currency credits, etc.
Source: The Bank of Korea.

(Fund Supply Structure)

An examination of the supply channel of M3 during the year 2002 reveals that the scale of funds supplied through the private sector expanded from the previous year, whereas both the public and the overseas sector absorbed funds.

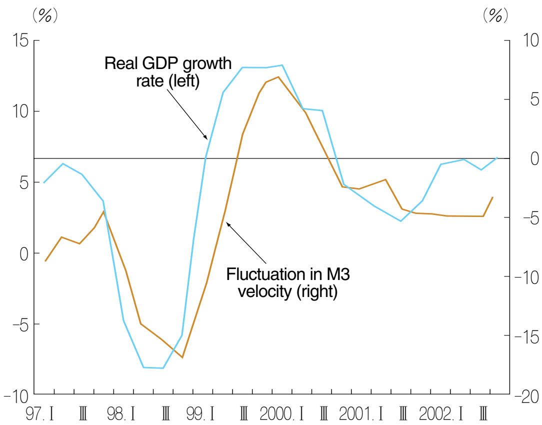
In the case of the private sector, loans increased greatly from 45.6 trillion won of the previous year to the 115.4 trillion won. In contrast, despite the increase in issue of CPs, the scale of securities purchases shrank from the previous year's 22.7 trillion won to 13.8 trillion won because of the net redemption of corporate bonds. By way of the increase in yen-denominated loans at low interest rates, foreign exchange credit increased by 17.5

trillion won. As a net consequence, the scale of funds supplied through the private sector swelled from the previous year's 74.7 trillion won to 149.1 trillion won. The scale of funds supplied through the government sector, meanwhile, contracted from the previous year's 12 trillion won to 2.5 trillion won by way of the expanded surplus on the consolidated fiscal account. In the case of the public sector, the net redemption of Deposit Insurance Fund Bonds and other securities resulted in the absorption of 7 trillion won. The overseas sector shifted to become a channel of absorption to the tune of 10.4 trillion won as a result of the decline in the scale of the current account surplus and the net outflow of foreign portfolio investment funds.

(Money Velocity)

<Figure Ⅱ-54>

M3 Velocity Fluctuations and Real GDP Growth Trends



Note: 1) Compared with the same period of the previous year.
Source: The Bank of Korea.

The downward trend of money velocity (M3 basis) become more accentuated in 2002. This was attributable to the supply of ample liquidity in a low interest rate environment and, despite the recovery of the real economy, to a comparatively stable trend of prices. As a consequence, the divergence between the movements of the rate of change in money velocity and the rate of economic growth became rather more strongly pronounced.

Viewing the rate of change in money velocity by period, the downward trend accentuated from -4.8% of the first quarter to -5.3% of the third quarter but slowed down to -2.5% in the fourth quarter. The rate of change in money velocity during the year fell from -3.6% of the previous year to -4.2%.

(2) Deposits at Financial Institutions

Deposits at deposit money banks and investment trust companies were brisk during 2002, whereas banks' money-in-trust contracted.

(Deposit Money Banks)

During 2002, the increment of deposits at deposit money banks rose by 18.8% from the 54.6 trillion won of the previous year to register 64.9 trillion won. By type of deposit, time & savings deposits rose on a large scale centering on time deposits, and demand deposits in practical and short-term marketable financial instruments including CDs and RPs also rose on a larger scale than the year before. Moving into the year 2003, deposits at banks saw a downward trend centering on short-term deposits such as real demand deposits and savings deposits with transferability because of the migration of some funds to investment trust companies and withdrawals to meet value-added tax payment.

Varying in line with seasonal factors including tax collections, real demand deposits expanded on a larger scale than those in the previous year (6.2 trillion won increase) to register an increase of 8.6 trillion won for the year as a whole. Time & savings deposits increased by 43.1 trillion won, but the scale of their increase was slightly smaller than that in the previous year (44.8 trillion won). Among them, time deposits rose by 31.7 trillion won centering on long-term time deposits, but the scale of the increase in savings deposits with transferability fell greatly from the previous year because of the reduction of MMDAs. In particular, time deposits of more than one year increased from the previous year' 3.6 trillion won to 45.7 trillion won. Their rapid growth was attributable to banks' eager encouragement of revolving-style time

<Table Ⅱ-22>

Trends in Deposits of Financial Institutions

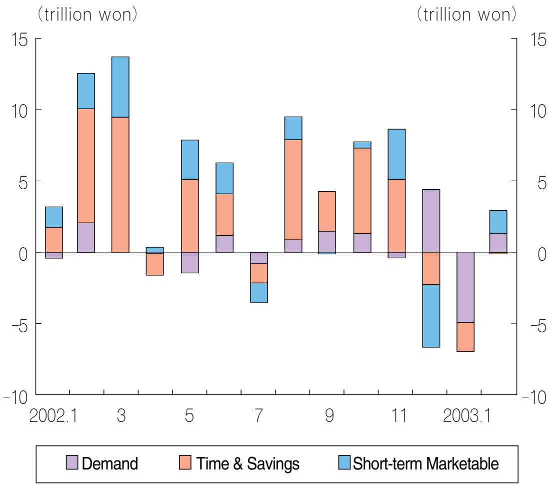
(Changes during the period, trillion won)

	2001	2002					2003
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Deposit money banks	54.6	64.9	29.0	11.6	10.4	13.9	-5.8
Real demand	6.2	8.6	1.8	-0.2	1.6	5.4	-3.6
Time & savings	44.8	43.1	19.1	6.5	8.5	8.9	2.2
(Time)	9.9	31.7	13.6	8.1	6.9	3.1	2.7
<over 1 year>	3.6	45.7	3.5	15.0	15.2	12.1	6.5
(Instant access)	26.1	10.1	7.1	-2.9	0.6	5.3	-5.5
<MMDA>	8.5	-0.1	2.9	-3.7	-2.2	2.9	-2.5
CDs+RPs	10.5	12.9	7.7	4.5	0.3	0.5	1.8
Cover bills	-6.9	0.3	0.4	0.8	0.1	-1.0	-0.1
Money-in-trust	2.7	-8.0	-5.3	-0.7	-1.9	-0.2	-0.8
Specific	5.1	10.9	1.7	3.5	1.9	3.9	0.8
Investment trust companies	14.0	16.3	15.0	-3.5	5.0	-0.2	16.6
Short term bonds	8.8	10.6	1.7	0.5	4.0	4.4	5.6
Long term bonds	-1.1	-14.5	-7.0	-4.5	-2.0	-1.1	0.2
MMFs	8.5	14.0	13.0	-4.6	3.4	2.2	10.6
Stocks	2.6	2.7	1.7	0.8	0.1	0.0	0.5
Mixed investment trusts	-4.8	3.6	5.6	4.4	-0.6	-5.7	-0.3
Merchant banks	-2.1	0.0	2.0	-1.1	0.2	-1.0	2.1
Bills issued	-1.9	0.0	1.4	-0.5	0.0	-0.8	2.2
CMA	-0.2	0.0	0.6	-0.6	0.2	-0.2	0.0
Mutual savings & finance companies	4.7	3.0	1.1	0.8	0.1	0.9	0.3

Sources: The Bank of Korea, Representative associations.

<Figure Ⅱ-55>

Deposits[1] at Deposit Money Banks by Product



Note: 1) Based on changes.
Source: The Bank of Korea.

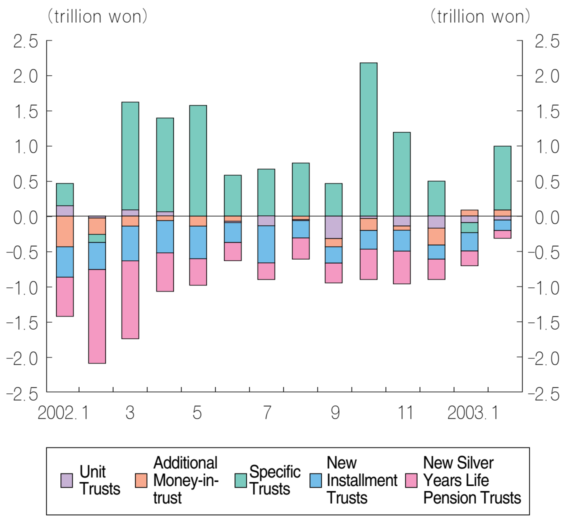
deposits[24] in order to raise their Korean won liquidity ratios following the Financial Supervisory Service's tightening of its guidelines. In contrast, short-term time deposits of less than six months were affected by a migration of funds to revolving-style time deposits and shifted from an increase of 6.3 trillion won in the previous year to a decline of 16.5 trillion won.

Meanwhile, short-term marketable products including CDs, RPs and cover bills rose by 13.2 trillion won, which represented a substantial expansion from the scale of their increase in the year before (3.6 trillion won). By type of product, CDs and RPs together rose by 12.9 trillion won, whereas cover bills, which had suffered a massive reduction the year before, shifted to an increase of 0.3 trillion won.

(Money-in-Trust)

<Figure Ⅱ-56>

Deposits[1] at Money-in-Trust by Product



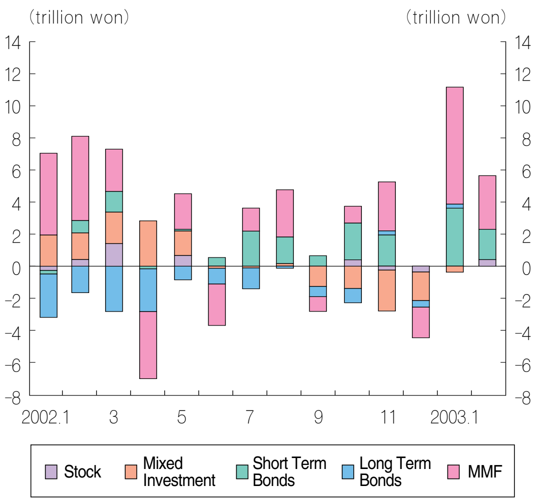
Note: 1) Based on changes.
Source: The Bank of Korea.

Money-in-trust, which had seen an increase of 2.7 trillion won during 2001, shifted to a decrease of 8 trillion won during 2002. While withdrawals continued from maturing products including the new installment trusts and the tax-exempt household trusts, new handling of which was suspended, additional money trusts, new silver life pension trusts and unit money trusts declined on a large scale on expectations of a lowering of yields. Nevertheless, specific money trusts experienced an increase of 10.9 trillion won during the year, centering on products which operated their trusted funds using short-term assets such as CP. Moving into

24) Revolving-style time deposits generally have a contract period of one year but the interest rates applied change every three months, and once three months have passed from the point of contract, the interest rate agreed in the contract will be paid even if the deposits are withdrawn prior to maturity. In practical terms, therefore, these deposit products have the character of short-term time deposits. During the year 2002, they are estimated to have accounted for a considerable portion of increased long-term time deposits with a maturity of one year or more.

<Figure Ⅱ-57>

Deposits[1] at Investment Trust Companies by Product



Note: 1) Based on changes.
Source: Investment Trust Association.

the year 2003, deposits at specific money trusts have been in a favorable condition, whereas other products generally have continued their downward trend.

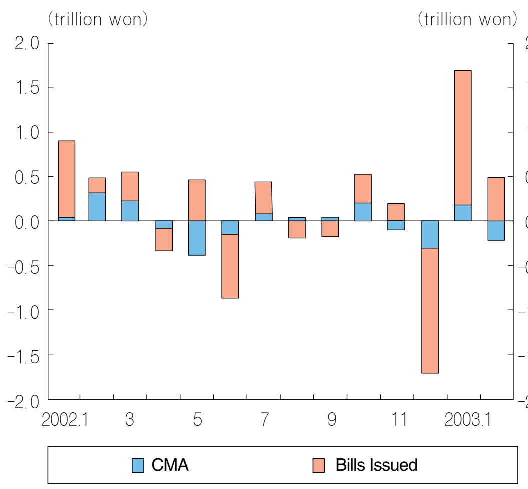
(Investment Trust Companies)

During 2002, the scale of increase in deposits at investment trust companies exceeded that of the previous year (14 trillion won) to post an increase of 16.3 trillion won that centered on short-term products including MMF and short-term bond investment trusts. Viewed by type of financial product, even though, during the second quarter, MMF contracted by 4.6 trillion won because of seasonal factors including tax collections and the semi-annual closing of accounts, during the year as a whole they increased 14 trillion won, accelerating their upward trend from the previous year (8.5 trillion won increase) thanks to the inflow of short-term opportunistic funds seeking comparatively high yields offered as a result of the lowering of trust commissions. On anticipations of a rise in earnings on their operation following the fall in market interest rates, short-term bond investment trusts also saw their increase in deposits accelerate during the second half of the year, so that they posted a rise of 10.6 trillion won for the year as a whole. In contrast, long-term bond investment trusts declined by 14.5 trillion won during the year as a result of the uncertainty over the prospects for long-term interest rates. Meanwhile, stock investment trusts and hybrid investment trusts registered increases of 2.7 trillion won and 3.6 trillion won respectively for the year. This was because, during the first four months of the year, in an environment in which stock prices were rising, deposits at stock and hybrid investment trusts had sustained a favorable pace. But, during the latter half of the year, these deposits did not increase any further and instead showed a pattern of large scale contraction. Moving into the year 2003, deposits at investment trust companies have maintained a strongly upward trend centering on MMFs and short-term bond investment trusts, driven by the decline in banks' deposit rates and by a reduction in the spread between long- and short-term interest rates in response to the decline in the long-term market interest rate.

(Merchant Banking Corporations)

<Figure Ⅱ-58>

Deposits[1] at Merchant Banks by Product



Note: 1) Based on changes.
Source: The Bank of Korea.

With the completion of structural adjustment involving M&A[25] and other methods, merchant banking corporations began to recover some of their credibility and their deposits, which had fallen by 2.1 trillion won in the preceding year, witnessed a slight rise of 8.7 billion won. Looking at the trend of changes in merchant banking corporations' deposits, while there were comparatively large-scale variations brought about by seasonal factors including enterprises' payment of taxes and the semi-annual closing of accounts, during the first half of the year their deposits rose by 0.9 trillion won, buoyed by the upswing in bills issued, but, during the latter half of the year, they fell by 0.9 trillion won amid large-scale withdrawals of corporate funds at the year-end.

(Mutual Savings Banks)

Deposits at mutual savings banks, despite the suspension of operations of several mutual savings banks, maintained their upward trend to register an increase of 3 trillion won during the year. This was because their deposit rates were maintained comparatively higher than those of other financial

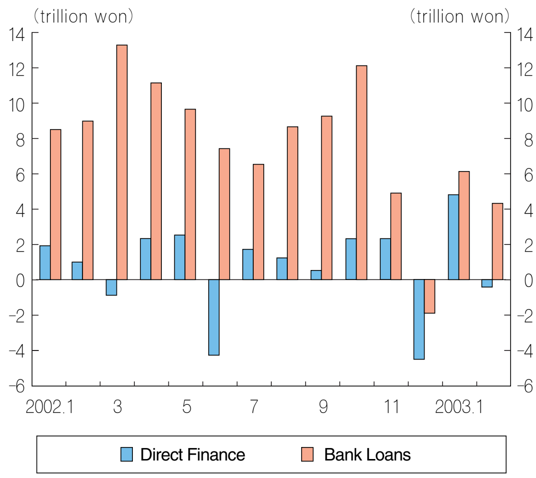
25) In the course of the year 2001, Regent Merchant Bank merged with Tongyang-Hyundai Merchant Bank and the number of merchant banking corporations was reduced from its previous four to three (Hanbul, Woori and Kumho).

institutions to secure funds for extending small-value loans on credit at high interest rates. Consequently, a constant inflow of funds continued.

(3) Corporate Finance

<Figure Ⅱ-59>

Corporate Finance[1]



Note: 1) Based on changes.
Source: The Bank of Korea.

During the year 2002, corporate funding conditions maintained the generally seamless pattern of the previous year. While there was a great improvement in cash flow thanks to buoyant business performance, enterprises' demand for funds was not very large because of the low ebb of facilities investment. What is more, market liquidity was abundant by virtue of the continuing low interest rates. Lending rates of financial institutions were reduced and conditions for the issue of corporate bonds and CPs remained favorable.

Looking at the supply of funds by channel, bank loans rose on a large scale centering on those to SMEs, but direct financing stood by and large at a low ebb.

(A) Bank Loans

Bank loans (including banks' trust accounts) rose during 2002 by 98.6 trillion won, a considerable expansion over their scale of increase in the previous year (37.8 trillion won). Of this, household loans increased by 61.6 trillion won centering on loans secured by housing collateral and overdraft-style minus account loans. Meanwhile, corporate loans rose by 37.2 trillion won centering on those to SMEs. Moving into the year 2003, bank loans have maintained an increasing trend.

(Lending by Sector)

Household loans increased on a large scale as banks competed to expand household loans, which were

<Table Ⅱ-23>

Bank Lending[1] by Sector

(trillion won)

	2001	2002					2003p
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Large companies	-12.0	0.1	3.3	-1.7	-0.3	-1.2	-0.2
SMEs	11.9	37.1	9.3	13.2	8.5	6.1	8.5
Households	45.0	61.6	17.4	17.6	16.0	10.5	2.4
Others[2]	-7.2	-0.2	0.7	-1.0	0.2	-0.1	-0.2
Total	37.8	98.6	30.7	28.2	24.5	15.2	10.5

Notes: 1) Includes trust account lending (except discount of CP). Based on changes.
2) Lending to public and other legal entities.
Source: The Bank of Korea.

favorable in terms of safety and profitability,[26] in an environment where their lending capacity had expanded while at the same time households' demand for funds was on the rise in response to enlarged consumer spending and anticipations of higher housing prices. The expansion of household loans was concentrated on those secured by housing collateral, which rose by 45.9 trillion won (excluding trust account loans) during the year, while minus account loans increased by 23.7 trillion won. However, during the first two months of 2003, household loans increase by only 2.4 trillion won because of the stabilization of housing prices and other factors.

Having decreased slightly by 50 billion won during the previous year, corporate loans rose on a large scale during 2002. This was because, although lending to large companies marked about the same level as the year before, loans to SMEs rose by 37.1 trillion won.

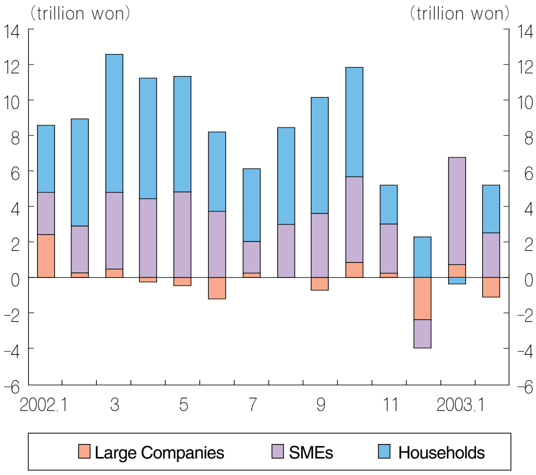
Loans to large companies saw an increase of only 0.1 trillion won during the year, but this was attributable to the lack of their demand for funds prompted by their improved business performance and their aversion to large-scale facilities investment. Moving into the year 2003, loans to large companies have continued on a downward trend.

SMEs experienced heightened demand for short-term operating funds in order to increase their production activities in line with the recovery of the domestic economy. Meanwhile, banks, which had ample scope to operate funds amid the reduced demand for funds of

26) Household loans carry higher interest rates than corporate loans and are exempt from the burden of contributions to the Korea Credit Guarantee Fund (0.3% p.a.). Loans secured by housing collateral also attract a lower risk weighting (50 %, corporate loans 100%) in the calculation of the BIS capital adequacy ratio.

<Figure Ⅱ-60>

Bank Lending[1] by Sector



Note: 1) Based on changes.
Source: The Bank of Korea.

large companies, strengthened efforts to expand their lending to SMEs.[27] As a consequence, the scale of increase in lending to SMEs rose threefold compared to that of the previous year (11.9 trillion won). Despite the favorable conditions for the issue of corporate bonds and CPs, sub-prime SMEs that did not have a high credit standing had no option but to rely on borrowings from banks. Following the government’s moves to rein in household lending, banks having difficulties in identifying suitable targets for the operation of their funds extended their loans to service businesses and small and small-business proprietors, and this also acted as a factor in expanding lending to SMEs. Viewed by quarter, while the upward trend was maintained throughout the year, the expansion of the scale of lending was particularly marked during the second quarter (+13.2 trillion won), supported by seasonal factors including the payment of value added tax. During the fourth quarter, the scale of the increase narrowed to 6.1 trillion won as outstanding loans were temporarily repaid in order to bring down corporate debt ratios at the year-end.

27) Banks pursued a broad range of efforts in order to expand lending to SMEs including the opening of branches specializing in corporate finance, the expansion of the discretion of branch managers in setting loan rates, the exemption of collateral arrangement fees, and benefits for small businesses.

<Box Ⅱ-4>

Characteristics of Trends in Household Loans during 2002

Financial institutions increased their household loans by 87.6 trillion won in the course of 2002. By type of financial institution, the rate of increase in household loans was particularly prominent in banks and credit-specialized financial companies including credit card companies. As of the end of 2002, the total amount of household loans outstanding of financial institutions stood at 391 trillion won and its ratio against M3 rose from the previous year of 31.4% to 35.8% (40.2%, if credits to buyers by credit card companies, etc. are included). Of this, the total amount of household loans outstanding of banks (include banks' trust accounts) stood at 222 trillion won and accounted for about one half of overall household loans (48.1%). The increase in household loans by banks in the course of 2002 was led mainly by loans secured by housing collateral.

Trends in the Amount of Increase in Household Loans

(trillion won, %)

	2000	2001	2002	balance at the end of 2002
Household loans	49.1(25.6)	62.5(25.9)	87.6(28.9)	391.1〈35.8〉
Banks[1]	23.8(25.9)	45.0(38.9)	61.6(38.3)	222.2
Mutual savings banks, etc.[2]	-0.7(-1.3)	2.2(4.8)	6.5(14.1)	52.6
Credit specialized companies	17.4(107.4)	10.1(30.1)	13.5(30.7)	57.1
(Credit card companies)	16.4(120.6)	8.4(27.7)	8.6(22.5)	46.9
Insurance companies	3.6(15.3)	5.5(20.3)	6.1(18.7)	38.7
Merchandise credits	3.7(16.9)	12.3(47.7)	9.8(25.7)	47.9〈 4.4〉

Notes: 1) Includes trust accounts
2) Include mutual savings banks, credit unions, community credit cooperatives, and mutual credits.
Figures in parentheses represent the rate of increase compared to the same period of the precious year, figures in angle brackets represent the relative ratio against M3 in household loans.

The Amount of Increase of Household Loans by Type during 2002

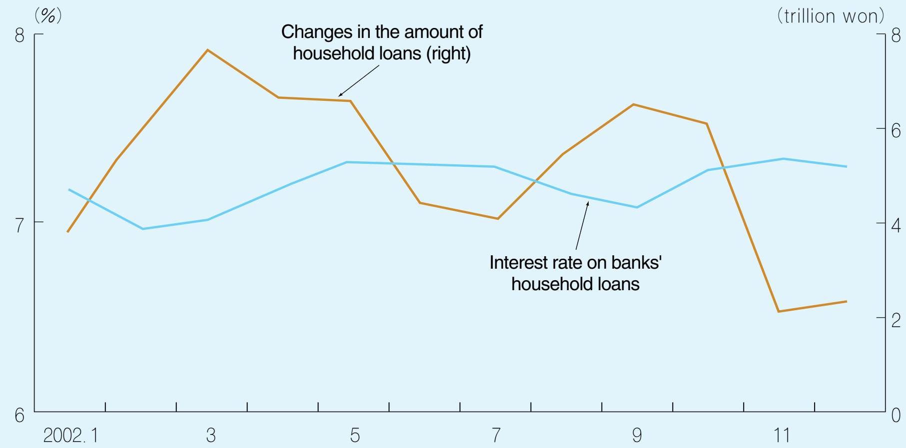
(trillion won, %)

Loans secured by housing collateral	Purchase of loan obligations by financial companies	Minus account loans and other loans	Sum
45.9	-7.3	23.7	62.3
(73.7)	(-11.7)	(38.0)	(100.0)

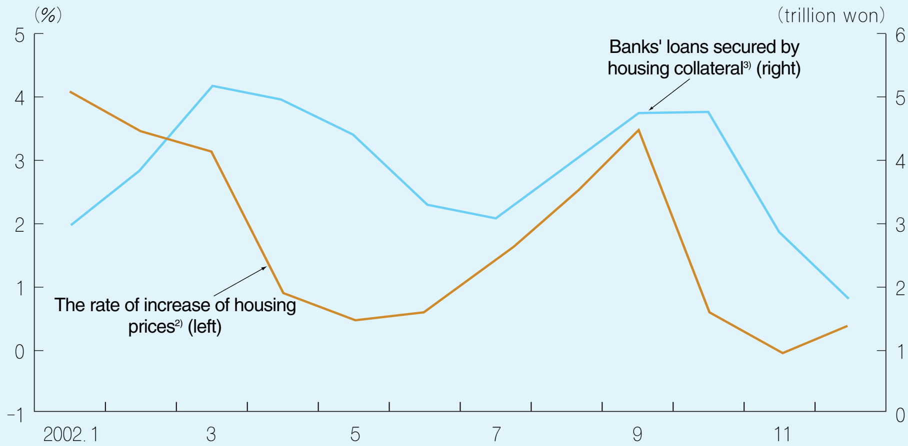
Note: 1) Bank account basis.
Figures in parentheses represent shares in the amount of increase in household loans.

Looking at trends of changes in the amount of increase of household loans (bank loans basis) during the year, they were much influenced by the interest rates on household loans, the rate of increase in housing prices, and the authorities' measures related to household loans. Household loans generally varied inversely with interest rates on household loans (newly extended amount, weighted average interest rate basis), whereas they were closely correlated with the rise in housing prices (basis of nationwide apartment sale prices).

Trends of the Interest Rates on Banks' Household Loans and Changes in the Amount of Household Loans



Trends of the Rate of Increase of Housing Prices and Banks' Loans Secured by Housing Collateral[1)]

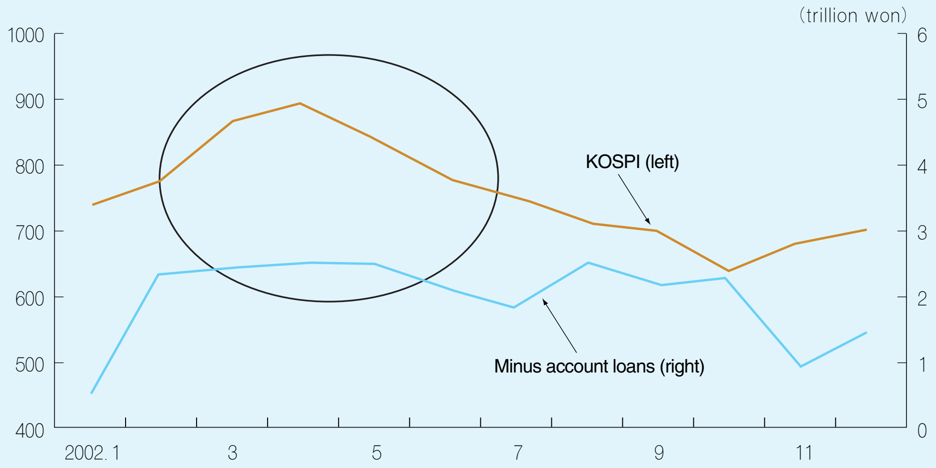


Notes: 1) Compared with the previous month.
2) On basis of nationwide apartment purchase & sale prices.
3) Excludes trust accounts.

Besides this, the authorities' measures related to household loans are deemed to have had an effect in placing a curb on household loans to some extent. The entry into effect of measures such as the Bank of Korea's upward adjustment of its policy rate (May 7), the changes in the method of allocating the Aggregate Credit Ceiling (March and May), the financial supervisory authorities' raising of the mandatory provisions for household loans (April 23 and October 11) and the downward adjustment of the loan-to-value ratio for loans secured by housing collateral (September 9 and October 11) generally blunted the upward trend of household loans or served to accelerate its downward trend.

Apart from this, household loans were to some degree influenced by movements in stock prices and banks' style of fund management. In particular, during the first half of last year, minus account loans showed a pattern of close linkages with the movements of stock prices. This was because individual investors in particular who were short of investment funds had recourse to minus account loans. Meanwhile, in the first quarter of 2002, banks expanded household loans competitively through the upward adjustment of the value of collateral and of the loan-to-value ratio, and the waiving of collateral arrangement fees, together with the lowering of interest rates on loans secured by housing collateral. Consequently, not only did household borrowings increase greatly but some small-business proprietors opted, in view of the convenience of lending procedures, to raise a considerable part of their funds for business by way of household loans.

Trends of KOSPI and Minus Account Loans



<Table Ⅱ-24>

Bank Lending[1] by Product

(trillion won)

	2000	2001					2002
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.
Commercial bill discounts	-6.4	-2.3	-1.3	-0.4	-1.8	1.2	0.2
Overdrafts	-1.5	-0.1	0.7	-0.1	0.2	-0.8	0.1
Foreign trade loans	0.2	0.8	0.9	0.6	0.1	-0.8	0.7
Corporate procurement loans	4.9	2.9	1.3	1.4	0.8	-0.7	1.1
Electronically-processed secured receivables loans	1.3	2.1	0.4	0.6	0.5	0.6	0.3
General loans	46.1	78.7	23.8	20.8	20.4	13.7	1.2

Note: 1) Based on bank-account lending. Based on changes.
Source: The Bank of Korea

(Lending by Type of Funds)

Looking at bank loans by type of funds, discounts on commercial bills maintained their declining trend from the previous year (-6.4 trillion won) to register a fall of 2.3 trillion won. This was largely ascribable to the shift to an emphasis in commercial transactions between companies on settlement in cash rather than through the use of bills[28], as a result of the reduction in the scale of the allocation under the Bank of Korea's Aggregate Credit Ceiling in support of the discount of

28) In the course of 2002, the exchange of promissory notes through the Korea Financial Telecommunications and Clearings Institute stood at 2,412 trillion won, less than half its level before the introduction of Corporate Procurement Loans by the Bank of Korea (4,974 trillion won in 1999).

commercial bills.[29]

In contrast, general loans rose by a large margin centering on household loans and lending to SMEs. The scale of their increase widened from the previous year's 46.1 trillion won to 78.7 trillion won. Foreign trade loans also registered an increase, rising for the year to November to 1.8 trillion won thanks to the expansion of exports, but, during December, their outstanding decreased by one trillion won as a result of the redemption of loans for the lowering of year-end debt ratios. Accordingly, for the year as a whole, their increase stood at 0.8 trillion won. Overdrafts contracted slightly (0.1 trillion won) in view of buoyant corporate funding conditions.

Meanwhile, Corporate Procurement Loans and Electronically- Processed Secured Receivables Loans, which are related to the substitution of bill-based settlement, maintained their upward trend of the previous year with the former swelling by 2.9 trillion won and the latter by 2.1 trillion won. This performance was attributable to a constant expansion of demand for these loans, which was met by the interest rates relatively lower on such lending than those for other credits[30] thanks to the support provided under the Bank of Korea's Aggregate Credit Ceiling and to the active competition between banks to secure prime SMEs.

29) The allocation under the Aggregate Credit Ceiling in support of the discount of commercial bills was reduced in September 2001 from 100% of the value of commercial bills discounted to 80% and subsequently in April 2002 to 70% and in October of that year to 50%.

30) During December 2002, banks' average interest rate on Corporate Procurement Loans (weighted average interest rate during the month on newly extended loans) stood at 5.53% p.a and that on Electronically-Processed Secured Receivables Loans at 5.33% p.a., approximately 1%p lower than interest rates on the discount of commercial bills (6.33% p.a., SME basis).

<Table Ⅱ-25>

Trends in Corporate Fund Raising[1] by Direct Financing

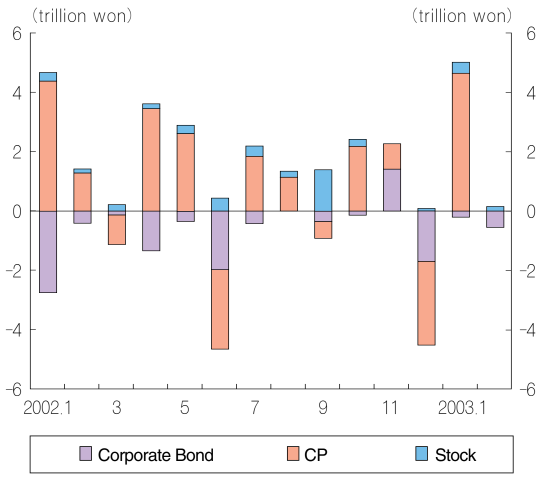
(trillion won)

	2000	2001					2002p
		year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	Jan.~Feb.
Corporate bond issuance (net)[2]	8.2 (0.9)	-8.1 (-1.5)	-3.2 (-2.6)	-3.6 (-1.3)	-0.8 (0.7)	-0.4 (1.7)	-0.7 (0.5)
CP issuance (net)[3]	8.1	10.9	4.7	3.4	2.5	0.3	4.7
Stock issuance[4]	4.2	4.0	0.7	0.9	2.0	0.4	0.4
Direct finance total	20.5	6.8	2.1	0.7	3.7	0.2	4.5

Notes: 1) Based on changes.
2) Excludes those issued by companies under court receivership, in process of mediation or workout. Figures in parentheses exclude those incorporated into primary CBOs and new bonds promptly underwritten by Korea Development Bank (KDB).
3) Based on CP discounts by securities companies, merchant banks and bank trusts accounts.
4) Based on companies listed on the Korea Stock Exchange or KOSDAQ, but excludes fund-raising by financial institutions and debt for equity swaps by creditor financial institutions for the purpose of structural adjustment of corporations.
Sources: The Bank of Korea, The Financial Supervisory Service, Representative associations.

<Figure Ⅱ-61>

Trends in Corporate Fund Raising[1] by Direct Financing



Note: 1) Based on changes.
Sources: The Bank of Korea, The Financial Supervisory Service, Representative associations.

(B) Direct Financing

During 2002, corporate funding through direct financing did not present a lively picture. This was because, even though funding conditions were generally favorable, companies' demand for funds was not very large. Corporate bonds saw a large scale of net redemption and the scale of stock issue also decreased from the previous year. The issue of CP expanded but that by non-financial companies showed a net redemption. As a consequence, the total amount of funds raised through direct financing shrank greatly from 20.5 trillion won during 2001 to just 6.8 trillion won. Moving into the year 2003, the trend of a net redemption of corporate bonds has been maintained, while fund-raising through the issue of stocks has been at a low ebb, but the issue of CP has increased on a large scale because of the re-issuance of CPs that had been temporarily redeemed prior to the previous year-end.

(Issue of Corporate Bonds)

Corporate bonds shifted from a net issue of 8.2 trillion won in the previous year to a net redemption of 8.1 trillion won in 2002. Of these, corporate bonds issued by public flotation shifted from the previous year's net issue of 0.9 trillion won to a net redemption of 1.5 trillion won. Corporate bonds issued by private flotation and pooled in Primary CBOs also shifted to a large net redemption of 6.2 trillion won as against the previous year's net issue of 4.7 trillion won as a result of maturing of a large volume of corporate bonds issued in the year 2000 amid the sharp contraction of new issues. Since the prompt underwriting scheme ceased from February 2002, corporate bonds by private flotation which were underwritten promptly by the Korea Development Bank saw a net redemption of 0.4

trillion won during the year. Thus, corporate bonds as a whole experienced a net redemption on this scale, although there were the favorable conditions for their issue in that the appetite for corporate bonds with low ratings increased while long-term interest rates were on the decline. This paradox was ascribable both to the weakness of the call for their new issue given the subdued demand for funds, and to the fact that companies holding surplus funds thanks to improved business performance showed an active preference for the redemption of maturing corporate bonds.

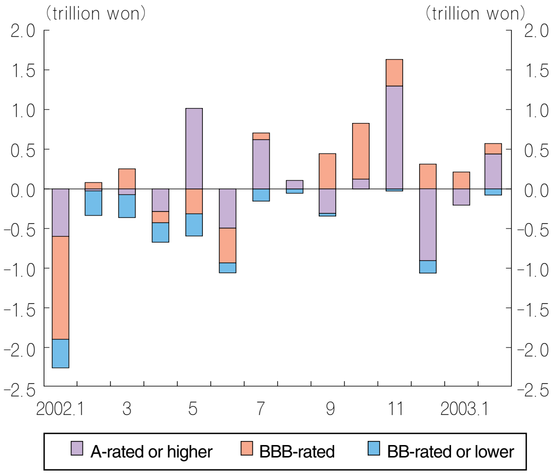
If, however, we look at the trends by quarter, we note that during the latter half of the year the scale of net redemption declined below one trillion won and in the case of corporate bonds by public flotation excluding primary CBOs etc. the third quarter saw net issue to the value of 0.7 trillion won and the fourth quarter net issue to the tune of 1.7 trillion won. This occurred, as firms expanded their issue of corporate bonds in order to convert short-term borrowings at relatively high interest rates, such as bank loans, to long-term debentures at low interest rates and to secure low-cost funds in advance in view of the judgement that interest rates on corporate bonds had dropped to their lowest-ever levels.[31] Moving into the year 2003, the net redemption trend of corporate bonds has continued, while corporate bonds issued by general public flotation have shown a net issue position.

Examining issuance by credit grade (on the basis of corporate bonds by public flotation), we observe that bonds with an A rating saw net issue to the value of 0.5 trillion won and those with a BBB rating also saw a

31) In fact, looking at the purpose of corporate bond issue during the fourth quarter of 2002, those for the improvement of debt structure (34.6%) and rollovers (28.5%) together made up two-thirds the total issue.

<Figure Ⅱ-62>

Trends in Net Issuance[1] of Corporate Bonds by Credit Rating



Note: 1) Based on changes.
Source: The Bank of Korea.

modest net issue of 10 billion won, whereas those with a BB rating experienced a net redemption to the tune of 2 trillion won. Looking at the weight of issue by credit grade (on the basis of aggregate amount issued), those with an A rating or higher fell from 64.3% of total issuance in 2001 to 57.5% in 2002, whereas those rated BBB rose from 27.7% to 37.6%. This occurred because enterprises with low credit standing were comparatively active in issuing corporate bonds thanks to the reduction of corporate credit risk. Notwithstanding this development, corporate bonds at speculative grades (BB or lower grade) declined from 8% to 4.9% because of the base period-effect from the year 2001 when speculative-grade companies including Hynix Semiconductor Co. and Ssangyong Cement Co. had issued convertible bonds on a large scale in the process of corporate restructuring.

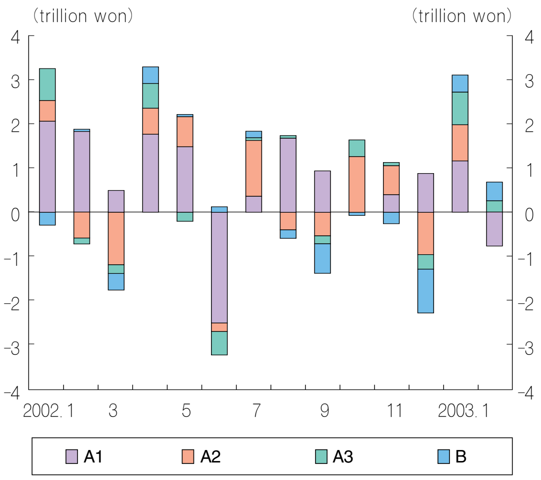
(Issue of CP)

During the year 2002, net issue of CP rose by 34.2% over the previous year (8.1 trillion won) to stand at 10.9 trillion won. This was because credit-specialized financial companies including credit card companies and capital companies had an increased demand for operating funds, while there was also an expansion of the CP purchasing base thanks to the upswing in deposits at MMF and short-term specialized money trusts.

Breaking down the issuers of CP by type, we note the explosive growth of CP issue by financial companies including credit card companies, capital companies and securities companies from the previous year's 2.8 trillion won to 13.3 trillion won. In contrast, the issue of CP by non-financial companies shifted from the previous year's increase of 1.4 trillion won to a decrease of 4.4 trillion won. This contraction was largely

<Figure Ⅱ-63>

Trends in Net Issuance[1] of CP by Credit Rating



Note: 1) Based on changes.
Source: The Bank of Korea.

ascribable to the fact that CPs were redeemed in order to bring down companies' debt ratios of year-end in a movement that centered on large companies, while non-financial companies had little need to raise short-term funds thanks to their upbeat operating performance.

Looking at CP issue by credit grade, CPs with an investment grade of A1~A3 achieved net issue to the tune of 9.5 trillion won for A1 grade and 1.1 trillion won for A2 grade. A tendency was thus revealed for the issue of CP to be concentrated on prime enterprises. This was largely ascribable to the expansion of CP issue by financial companies in high credit standing. In contrast, CP with a A3 grade registered net issue of only 0.2 trillion won, while speculative grade CP with a grade of B or lower saw a net redemption of 2.0 trillion won. Accordingly, the weight of A1~A2 grade CP in the total outstanding balance of CPs rose from 77.5% to 85.7%, whereas that of CP with a grade of A3 or lower declined from 22.5% to 14.3%. Strikingly, the weight of speculative grade CP (B grade and below) fell sharply from 12.6% to 5.9%.

Seen by period, net issue to the value of 8.1 trillion won was registered in the first half of the year as a result of the re-issuance of CP that had been retired prior to the previous year-end and the strong appetite for CP purchases by investment trust companies. During the third quarter, however, the scale of net issue of CPs narrowed to 2.5 trillion won, influenced by credit card companies' active issue of asset-backed securities in domestic and international markets. In the fourth quarter of the year, the scale of net issue contracted to 0.3 trillion won, as credit-specialized financial companies' credit risk was highlighted following the rise in loan delinquencies, and redemption was increased in order to lower debt ratios the prior to year-end closing of accounts. Moving into the year

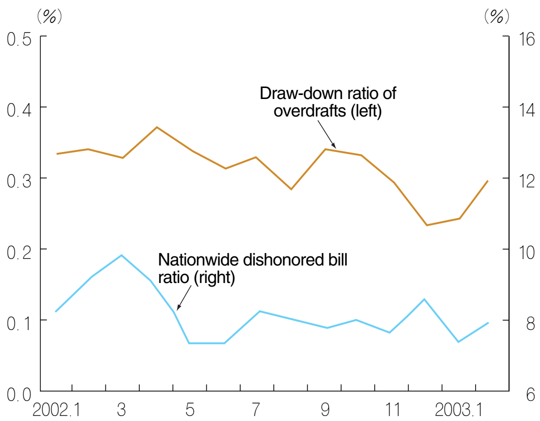
2003, the issue of CP increased on a large scale because of the rise in investment trust companies' MMF deposits and the re-issuance of CP that had been temporarily retired prior to the previous year-end.

(Issue of Stocks)

Throughout the year 2002, corporate funding through the stock markets remained at its low ebb of the previous year. Funding through rights offerings and initial public offerings (excluding debt-for-equity swaps by creditor financial institutions for the purpose of corporate structural adjustment) shrank somewhat from the previous year (4.2 trillion won) to register 4 trillion won. Of this amount, the scale of funding through the KOSDAQ market fell by about one trillion won compared to the previous year (2.8 trillion won) to stand at 1.7 trillion won. In contrast, funding through the KSE market expanded somewhat from the year before (1.4 trillion won) to stand at 2.3 trillion won. This quiescence of corporate funding through the stock markets was attributable to their subdued state from April onwards and the weakness of firms' demand for new funds. Moving into the year 2003, firms' funding has also remained at a low ebb because of the continuing subdued state of the stock markets.

<Figure Ⅱ-64>

Nationwide Dishonored Bill Ratio and Draw-down Ratio of Overdrafts



Source: The Bank of Korea

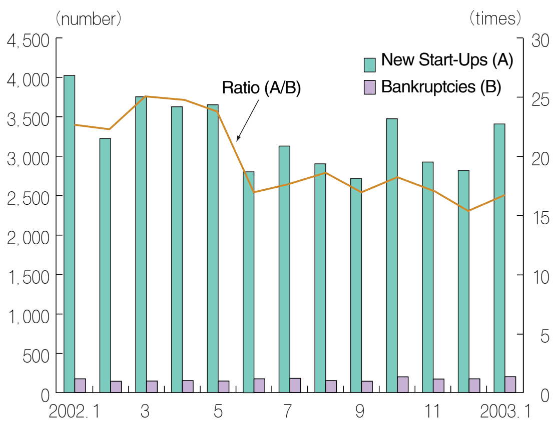
(C) Corporate Funding Conditions

Corporate funding conditions maintained the generally seamless pattern of the previous year. Reflecting this situation, major indicators of corporate funding conditions including the default ratio of checks & bills and the draw-down ratio of overdrafts all presented a satisfactory picture.

The nationwide checks & bills default ratio generally showed very stable movements around the 0.10% level

<Figure Ⅱ-65>

No. of New Corporate Start-Ups and Corporate Bankruptcies in Eight Major Cities[1)]



Note: 1) Seoul, Busan, Daegu, Incheon, Gwangju, Daejeon, Suweon, Ulsan.
Source: The Bank of Korea

during the year and in particular eased to 0.06% during June. The draw-down ratio of overdrafts, which indicates the urgency of businesses' demand for funds, rose for a while during April to 13.4% due to seasonal factors such as the payment of value added tax, apart from which it exhibited on the whole stable movements around the 12% mark.

The ratio of new start-ups to bankrupt companies in Seoul and seven other major cities showed an overall slowdown during the year 2002 apart from the March~May period amid the overall decrease in the number of the new start-ups. The reason for this is as follows. There was little change in the incidence of corporate bankruptcies during the year. However, the number of new start-ups, which originally increased from the beginning of the year in a climate of anticipations of economic recovery, later exhibited a gradually decreasing trend amid the heightened uncertainty surrounding economic conditions at home and abroad.

5. Foreign Exchange Markets

(Foreign Exchange Supply and Demand)

During the year 2002 the interplay of foreign exchange supply and demand remained characterized by a preponderance of supply, thanks to the surpluses exhibited on the current and capital accounts.

The fundamentally healthy surplus tone of the current account was maintained with a widened surplus on the goods account and the shift of the income account into surplus, offsetting the effects of the widened deficit on the services account.

The spirits of foreign investors were dampened by the delay in the recovery of the world economy and the growing danger of a US-Iraqi war. In consequence, not only direct investment but also portfolio investment, shrank sharply compared to the previous year. Foreign investors' investment in domestic stocks, notably, registered a net outflow under the influence of the depressed stock market. The capital account, nevertheless, showed an overall surplus by virtue of the greatly increased inducement of foreign loans by companies and financial institutions, which counteracted the drying-up of inward foreign investment.

With the preponderance of foreign exchange supply being maintained, earnings from the management of foreign currency denominated assets increasing, and, thanks to the strength of the euro and the yen, the dollar-translated value of the assets denominated in these currencies also increasing, the foreign exchange reserves augmented from $102.8 billion at year-end 2001 to $121.4 billion at the end of 2002, and further to $124 billion at the end of February 2002.

<Table Ⅱ-26>

Foreign Exchange Reserves[1)]

(hundred million U$)

	2000	2001	2002				2003
			Mar.	Jun.	Sep.	Dec.	Feb.
FX Reserves	962	1,028	1,061	1,124	1,167	1,214	1,240

Note: 1) Period-end basis.
Source: The Bank of Korea.

<Table Ⅱ-27>

Foreign Credits & Debts[1)]

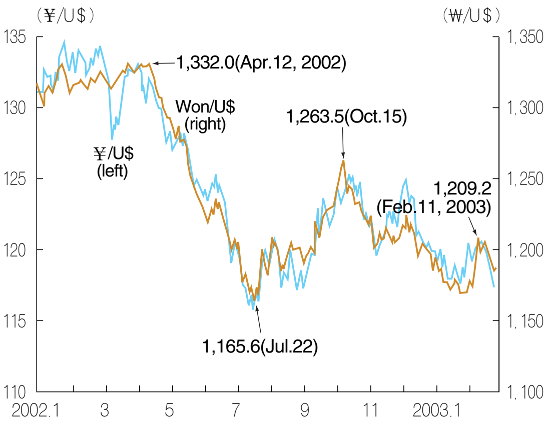
(hundred million dollars)

	2000	2001(A)	2002(B)	Change (B-A)
Credits	1,647	1,654	1,853	199
Debts	1,317	1,188	1,310	122
Long-term	838 (63.6)	778 (65.5)	812 (62.0)	34
Short-term	479 (36.4)	410 (34.5)	498 (38.0)	88
Net foreign credit	330	466	543	77

Notes: 1) Year-end basis.
2) Figures in parentheses refer to shares in total (%).
Source: The Bank of Korea.

<Figure Ⅱ-66>

Trends of Exchange Rates



Source: The Bank of Korea.

(Foreign Credit and Debt)

As of the end of 2002, Korea's total foreign indebtedness stood at $131.0 billion, which represented an increase of $12.2 billion over the end of the preceding year. Claims on the rest of the world stood at $185.3 billion, a rise of $19.9 billion over the previous year-end. Consequently, Korea' status as a net creditor country that it has held since September 1999 was maintained and, as of the end of 2002, the scale of its net creditor position advanced by $7.7 billion from the previous year-end to stand at $54.3 billion.

The reason that external debt rose during 2002 despite the redemption of public sector external loans was that while the local branches of foreign banks increased borrowings from their head offices abroad, domestic financial institutions also increased their inducement of foreign borrowings, in addition to the abolition of restrictions on the use of loans in foreign currency, to meet companies' expanding needs for loans in foreign currency.

Meanwhile, because most of the foreign debt taken on consisted of short-term foreign debt, the share of short-term foreign debt in Korea's total foreign debt rose from 34.5% at the end of the preceding year to 38.0% at the end of the year 2002.

(Foreign Exchange Rate)

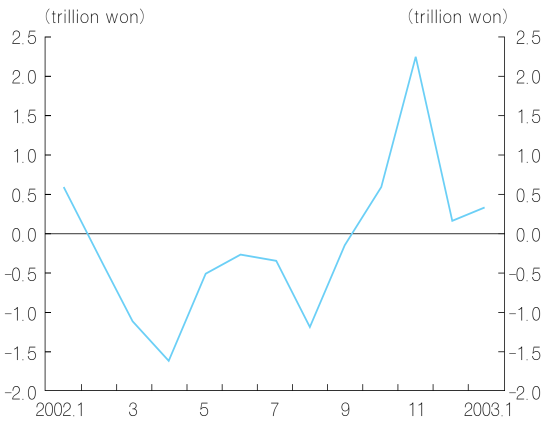
The exchange rate of the Korean won against the US dollar gave the appearance of being greatly swayed by the movement of the Japanese yen-US dollar exchange rate and foreign investors' share investment funds. Until mid-April, the won/dollar exchange rate had sustained a stable trend, but it then fell sharply until the last part of July. It subsequently shifted again to a rising trend, which lasted until mid-October, before exhibiting a generally downward trend until the year-end.

It was in mid-April that the exchange rate of the Korean won against the U.S. dollar attained its peak for the year of 1,332 won per dollar, affected by the exchange rate of Japanese yen and the net outflow of foreign investors' share investment funds. The US dollar then showed a dramatically weaker trend under the combined impact of the expanded US current account and fiscal deficits and corporate accounting malpractice scandals whereas a more rapid economic recovery of the Korean economy was expected and domestic companies increased their foreign borrowings. Consequently, the Korean won/US dollar exchange rate fell to its lowest level for the year in the latter part of July when it reached 1,166 won per dollar. Subsequently, as the weakness of the Japanese and European economies became such a focus of concern, the yen and other major currencies shifted to a weakening trend against the US dollars. As a result, the Korean won-US dollar exchange rate climbed again to reach 1,264 won per dollar in mid-October. In the last two months of the year, though, it fell back again to stand at 1,186 won per dollar at the end of the year, falling 9.7% from its rate at the end of 2001, in response both to the renewed weakness of the greenback as a result of the looming threat of a US-led war against Iraq and to the net inflow of foreign investors' stock investment funds.

Early in the year 2003, as the softening trend of the US dollar persisted, the exchange rate of the Korean won against it showed a generally downward trend. Moody's downward adjustment of the outlook for Korea's sovereign credit rating, because of the delay in finding a solution to the North Korean nuclear problem, caused the won-dollar rate to climb back up to 1,209 won per

<Figure Ⅱ-67>

Trends of Net Inflow of Portfolio Funds

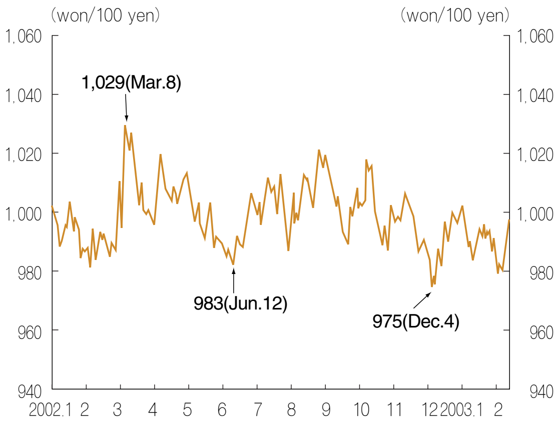


Source: The Financial Supervisory Service.

dollar. It subsequently moved downward again, fluctuating between 1,181 and 1,189 won per dollar in late February, in line with the fall in the exchange rate of the Japanese yen against the greenback.

<Figure Ⅱ-68>

Trends of Won/Yen

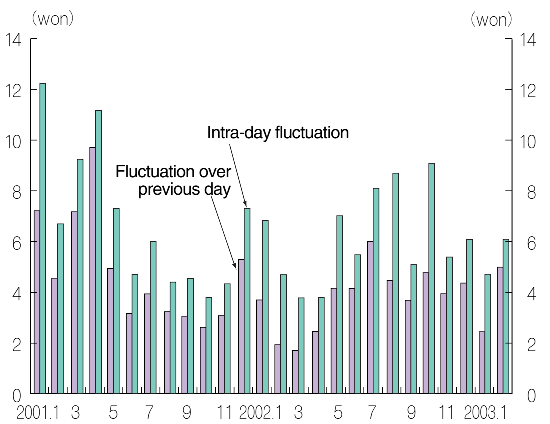


Source: The Bank of Korea.

The Korean won's exchange rate against the Japanese yen moved stably within a fairly narrow range of 971~1,030 won in accordance with the phenomenon of synchronicity between the movements of the Japanese yen and the Korean won. Early in March, the exchange rate of the Korean won rose sharply to the 1,029 Korean won to 100 Japanese yen level, its peak in the course of the year, because the net withdrawal of foreigners' share investment funds greatly weakened the Korean won. Subsequently, the exchange rate maintained a downward trend, with reaching the 983 won per 100 Japanese yen level in mid-June and dropping to the lowest point for the year at 975 won per 100 yen in early December. Early in the new year 2003, the phenomenon of the positive correlation between the movements of the Japanese yen and the Korean won continued and the exchange rate showed relatively stable movements within a range of 980~1,010 won per 100 Japanese yen.

<Figure Ⅱ-69>

Trends of Won/U$ Fluctuations



Source: The Bank of Korea.

Over the course of the year 2002, the exchange rate volatility of the Korean won, against the US dollar, both day on day and intraday, contracted somewhat from the previous year's 4.8 won and 6.7 won, respectively, to 3.8 won and 6.2 won. Viewed by period, during the first half of the year, the range of movements of the Korean won exchange rate was not very large but from July onwards its volatility expanded amid mounting uncertainty at home and abroad. During the first two months of 2003, its range of movements shrank from 4.4 won day-on-day in the last month of the previous year to 3.7 won and from 6.1 won intraday to 5.4 won.

<Table Ⅱ-28>

Trends of Changes in Korea's Sovereign Credit Ratings

	S&P's	Moody's	Fitch IBCA
1997	A+(Oct.24) A-(Nov.25) BBB-(Dec.10) B+(Dec.22)	A3(Nov.27) Baa1(Dec.10) Ba1(Dec.21)	A+(Nov.18) A(Dec.3) BBB-(Dec.11) B-(Dec.23)
1998	BB+(Feb.17)	-	BB+(Feb.2)
1999	BBB-(Jan.25) BBB(Nov.11)	Baa3(Feb.12) Baa2(Dec.16)	BBB-(Jan.19) BBB(Jun.24)
2000	-	-	BBB+(Mar.30)
2001	BBB+(Nov.13)	Baa2(Nov.30)	-
2002	A-(Jul.24)	A3(Mar.28) upward adjustment of outlook (S→P,Nov.15)1)	A(Jun.27)
2003	-	downward adjustment of outlook (P→N, Feb.11)1)	-

Note : 1) P(Positive), S(Stable), N(Negative)
Figures in parentheses refer to the announcement dates.

(Foreign Borrowing Environment)

During the year 2002, Korea's sovereign credit ratings were upgraded. In March, Moody's, taking an affirmative view of Korea's buoyant economic conditions and the expansion of its foreign exchange reserves, raised the country's sovereign rating two notches(March 28, Baa2→A3) and, in June, Fitch IBCA adjusted its rating upward by two grades(June 27, BBB+→A), citing Korea's promotion of ongoing structural reform and sound economic management. In July, Standard and Poor's also raised its sovereign credit rating for Korea by one notch (July 24, BBB+→A-). Thus, all three major credit rating agencies raised Korea's sovereign rating. What is more, on November 15th, Moody's adjusted its outlook for the country's credit rating by one stage from stable to positive in an affirmative evaluation on the view that the progress of corporate and financial restructuring had strengthened the future possibilities of medium and long-term growth for the Korean economy. Nevertheless, in early 2003, Moody's downgraded its outlook for Korea's sovereign credit rating by two steps from positive to negative(February 11), in view of the uncertainty arising from North Korea's actions in connection with the North Korean nuclear issue and the reaction of the international community.

<Table Ⅱ-29>

Spreads[1] on Foreign Exchange Stabilization Fund Bonds

(bp)

	2001	2002				2003
	Dec.	Mar.	Jun.	Sep.	Dec.	Feb.
Foreign Exchange Stabilization Fund Bonds (2003)	30	20	35	40	35	35
(2008)	152	105	115	128	123	128[2]
Industry & Financial bonds (2004)	139	80	85	83	60	70

Notes: 1) Spread over US T-notes. Period-end basis.
2) Yield 3.96% (9.08% at the point of issuance).

Thanks to the upward adjustment of Korea's credit rating by major international credit rating agencies in the wake of its brisk economic conditions and expansion of its foreign exchange reserves, the premium on Foreign Exchange Stabilization Fund(FESF) bonds(2008 series basis) narrowed to stand at 103 basis points by July 19. Subsequently, however, following the fall in the US and other major countries' stock markets along with the eruption of a Brazilian economic crisis, developing country risk premiums widened and, thus, that of Korea also rose to 165 basis points by October 10. But it eased again in line with the improvement in international financial market conditions and closed the year at 123 basis points, 29 basis points lower than the 152 basis points at the end of the previous year. In early 2003, the premium on FESB bonds maintained its downward trend and by the end of January it had fallen a further 6 basis points from the end of December to stand at the level of 117 basis points. On February 15th, it soared to 145 basis points, affected by Moody's downward adjustment of its outlook for Korea's sovereign rating, but, subsequently, eased to stand at 128 basis points.

<Table Ⅱ-30>

Spreads on Short-term Borrowings of Domestic Banks

(bp)

	2001	2002				2003
	Dec.	Mar.	Jun.	Sep.	Dec.	Feb.
Spread[1]	30	20	26	22	27	23
Libor[2]	1.92	1.99	1.90	1.77	1.41	1.34

Notes: 1) Spread over Libor. Period-end basis.
2) 3 months, %.

The premium on interest rates on short-term foreign borrowings by domestic banks fell, compared to the previous year, to stand at the level of 27 basis points at the end of December 2002 amid favorable foreign currency funding conditions, and in January 2003 it narrowed further to 22 basis points. Despite Moody's downward adjustment of its outlook for Korea's sovereign rating, the premium during February remained almost unchanged from the previous month at the 23 basis point level in view of the low demand for funds on the part of domestic banks.