

II . Economic and Financial Movements

1. Overseas Economy

A. Economic Growth and Trade

<Table II -1>

Trends of Major Overseas Economic Indicators

	(% , annual %)			
	1998	1999	2000	2001*
Economic Growth¹⁾				
World	2.6	3.6	4.7	2.4
Industrialized nations	2.4	3.3	3.9	1.1
U.S.A.	4.4	4.1	4.1	1.2
Japan	-2.5	0.7	2.2	-0.5
Euro area	2.7	2.6	3.4	1.5
(Germany)	2.1	1.8	3.0	0.6
Asian emerging markets ²⁾	-2.3	7.9	8.2	0.4
Developing nations	3.5	3.9	5.8	4.0
Asia	4.1	6.2	6.8	5.6
(China)	7.8	7.1	8.0	7.3
Latin America	2.2	0.1	4.1	1.0
World trade growth¹⁾	4.3	5.4	12.4	1.0
Long-term interest rates³⁾				
U.S.A.	4.65	6.44	5.11	5.05
Japan	2.22	1.65	1.64	1.37
Germany	3.87	5.35	4.84	5.00
Exchange rates⁴⁾				
¥/US\$	113.6	102.5	114.4	131.7
US\$/euro	1.167	1.006	0.943	0.890
Prices of international raw materials				
Rise in crude oil prices ⁵⁾	-33.2	39.9	59.8	-14.4
Others ⁶⁾	-17.5	-14.0	1.9	-10.1

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 oil prices.

6) Based on annual average of Reuters' Product Price Index.

Source: "World Economic Outlook" (Dec. 2001) by the IMF.

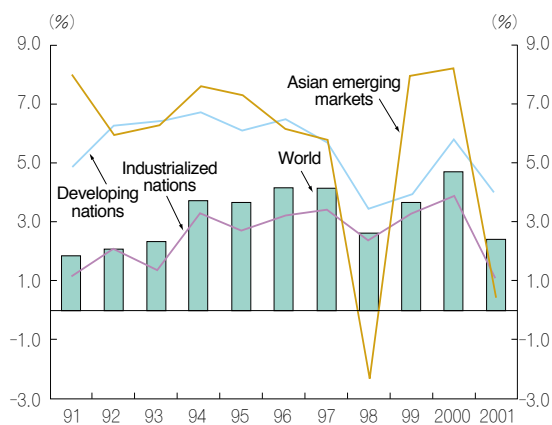
Bloomberg, Reuters.

During the course of 2001 the world economy was unable to escape from the doldrums in which it was caught by the slowdown of U.S. economic growth. The impact of the terrorist attacks on the U.S. further depressed the already low growth. As a result, it registered the lowest growth rate since 1993 with the growth rate falling from the 4.7% of the year 2000 to a little over 2% in the year 2001.

The downturn in the U.S. economy, which had begun in the latter half of the year 2000, was continued in the first quarter of 2001 when its GDP growth stood at just 1.3%(annualized quarter-to-quarter change). During the second quarter, it slowed to near zero growth (0.3%), before moving into negative growth(-1.3%) in the third quarter. This was attributable to the depressed state of the information technology(IT) industry, sluggish exports and depressed investment and other such negative effects of the September 11 terrorist attacks. Although the impact of the terrorist attacks eased as the fourth quarter wore on and the business downturn moderated, fourth quarter growth was somewhat low(1.4%) and GDP growth for the year as a whole came in at just 1.2%.

The Japanese economy achieved a shift into positive growth during the final quarter of the year 2000 and the first quarter of 2001 thanks to the expansion of facilities investment in the IT sector and increasing exports. In

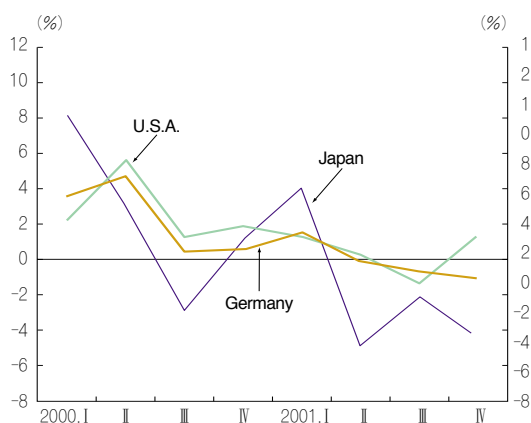
<Figure II -1>

Trends of World Economic Growth

Source: "World Economic Outlook"(Dec. 2001) by the IMF.

the following three quarters, however, it registered continued negative growth as exports, investment and consumer spending all contracted amid the slowing of the global economy and worries over the soundness of the financial sector. In the second quarter of the year 2001, growth slid to -4.8%(annualized quarter-to-quarter change) and stood at -2.1% and -4.5%, respectively, in the third and fourth quarters. For the year as a whole, Japanese GDP growth marked just -0.5%. Under such as depressed economic conditions, Japan experienced deflation with the continual decline in consumer prices since February 1999 and unemployment rose to the level of 5.5% in December 2001, its highest figure in recent economic history.

<Figure II -2>

Trends of Economic Growth in Major Industrialized Nations¹⁾

Notes: 1) Annualized quarter-to-quarter changes.
2) Based on each country's respective statistics.

In Euroland, GDP growth reached 2.4%(year-on-year basis) during the first quarter of 2001, but from the second quarter onwards it dipped sharply as exports and industrial production turned sluggish under the influence of the U.S. business slowdown, dragging down growth to just 1.5%, much lower than the previous year's performance(3.4%). In Germany, with the waning of the exceptionally high demand caused by reunification, construction investment contracted notably. The sluggishness of German exports brought about a slowing of facilities investment. During the latter half of the year, increased unemployment acted to reduce consumer spending. Under the combined influence of these malign factors, the German economy grew just 0.6% for the year 2001 as a whole.

<Table II -2>

GDP Growth and Percentage Shares in IT Export of Major Asian Countries

		Singapore Malaysia Taiwan Korea Hong Kong				
		Shares in IT Export ¹⁾				
		58.2	53.0	41.9	35.0	28.4
GDP Growth	2000	9.9	8.3	6.0	9.3	10.5
	2001	-2.0	0.4	-1.9	3.0	0.1

Note: 1) Based on 2000 statistics.

Source: The Bank of Korea.

In the Asian region, three Asian countries which have a particularly high dependence on IT exports, Singapore, Taiwan and Korea, experienced difficulties as a result of the slowdown of U.S. business activity. It was notable that Singapore and Taiwan, which have both been praised for their strong growth over the past few years, suffered negative growth during the year 2001.

In contrast, the Chinese economy with the vast scale of demand in its domestic market was able to achieve growth in 2001 at the level of 7%, following growth of 8.0% in the previous year, buoyed up by consumer spending and the brisk evolution of government investment, while it remained less affected by the downturn in global business activity. In the case of the countries of South and Central America, while Argentina registered negative growth for the third straight year, the GDP growth of Brazil, Mexico and other regional countries dropped sharply owing to slackened exports under the influence of the U.S. business downturn as well as the contagion effect of the Argentinian economic instability.

World trade during the year under review (on the basis of export and import volumes) grew at a rate of only around 1%, well below the level of the previous year and the lowest recorded since 1983. This was attributable to the fact that not only did the majority of countries see the scale of their exports and imports contract sharply as a result of the slowdown of demand caused by the worldwide economic downturn, but also the exports of Asian emerging markets, Mexico, Canada and so on to the U.S. shrank in response to the rapid deceleration of the U.S. economy.

B. International Interest Rates and Foreign Exchange Rates

Viewing interest rate movements, during the year 2001, most countries experienced a sharp fall in short-term interest rates as central banks around the world reduced their policy interest rates in order to counter the economic downturn. Long-term interest rates fluctuated in line with the interplay of the effects of the business slowdown and of anticipations of economic

<Table II -3>

Trends of Short- and Long-Term Interest Rates¹⁾ in Major Countries

	(annual %)						
	2000	2001				2002	
	Dec.	Jan.	Mar.	Jun.	Dec.	Jan.	Feb.
Long-term²⁾							
U.S.A.	5.11	5.11	4.91	5.41	5.05	5.03	4.88
Japan	1.64	1.50	1.27	1.19	1.37	1.49	1.53
Germany	4.84	4.79	4.68	5.09	5.00	4.91	4.96
Short-term³⁾							
U.S.A.	5.87	4.96	4.28	3.63	1.72	1.75	1.75
Japan	0.40	0.33	0.05	0.01	0.01	0.001	0.001
Germany	5.15	4.63	4.54	4.51	3.29	3.29	3.29

Notes: 1) Period-end basis.

2) Based on yields on 10-year government bonds.

3) Based on yields on 3-month Treasury bills.

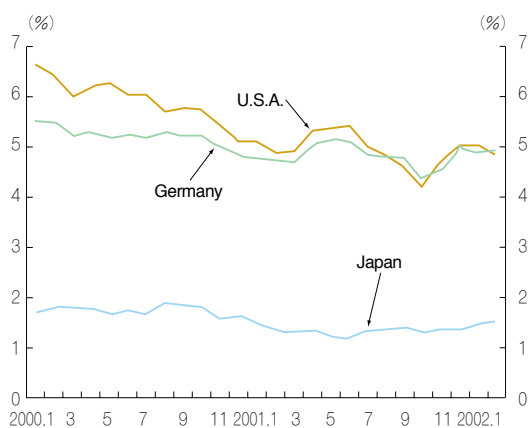
Source: Bloomberg.

recovery. From the end of the year, as expectations of a worldwide economic recovery mounted and central banks of most individual countries desisted from any further lowering of their policy interest rates, the downward trend of short-term interest rates ceased and some long-term interest rates displayed an upward pattern of movements.

Seeking to ward off the economic downturn, the Federal Reserve Board in the U.S. lowered its Federal Funds target rate on 11 consecutive occasions during the year 2001, bringing it down by 4.75%p(6.5% → 1.75%). Three-month Treasury bills, the rate on which had come closer to the level of 6% towards the end of the year 2000, saw their yields slide to the level of 1.7% at the end of the year 2001, the lowest for 40 years. Long-term interest rates maintained their downward trend in the early part of 2001 in reaction to the economic downturn but from the second quarter onwards shifted to a mild upward trend, responding to anticipations of a pick-up in business activity thanks to the Federal Reserve's reductions in interest rates. Moving into the latter half of the year, however, the business downturn deepened and prospects of economic recovery became obscure in the aftermath of the terrorist attacks. This brought long-term rates down relatively sharply. From the fourth quarter onwards, anticipations concerning economic recovery gradually mounted, causing long-term rates to shift back to an upward trend. Meanwhile, moving into 2002, the downward trend of short-term interest rates came to a halt as the Federal Reserve held its Federal Funds target rate at its existing level. Long-term interest rates moved somewhat lower as investors' appetite for corporate bonds dried up in the wake of the Enron scandal, while that for government and public bonds increased.

<Figure II -3>

Trends of Long-Term Interest Rates¹⁾ of Major Countries



Note: 1) Based on yields on 10-year government bonds of each nation. Period-end basis.

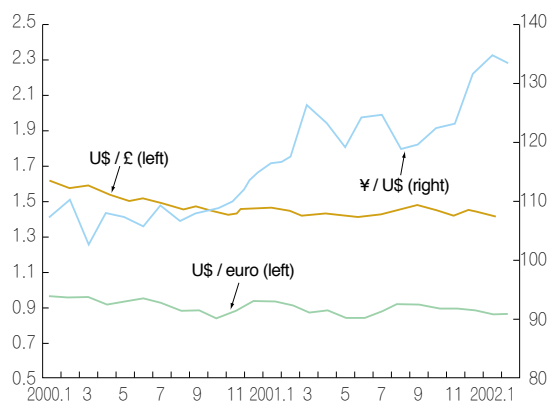
Source: Bloomberg.

In Japan, short-term interest rates maintained a downward trend as the Bank of Japan, amid continuing deflation, intensified the easing of its monetary policy stance by expanding its supply of liquidity. This brought yields on three-month Treasury bills from 0.4% as of the end of 2000 to just 0.01% as of the end of 2001. Long-term interest rates moved smoothly upwards from the first half of 2001 onwards despite deflation, buoyed up by prospects of continued fiscal easing designed to counter the Japanese economic crisis. From early in the year of 2002, while the sense of crisis surrounding the Japanese economy mounted, banks tried to avoid the depletion of their capital anticipated from the introduction of market-based valuation of their share holdings as of the closing of their books at the end of March, by disposal of their bond holdings. This caused long-term interest rates to maintain their upward trend.

In the euro zone, short-term interest rates maintained a downward trend throughout 2001, responding to the European Central Bank's (ECB) decision to lower the interest rate on its open market operations on four occasions. Long-term interest rates moved downwards in the early part of 2001 with the weakening of inflationary pressures amid the business slowdown. They subsequently fluctuated in line with the strength of anticipations concerning economic recovery. In the early part of 2002, the downward trend of short-term interest rates came to a halt whereas long term rates showed a slightly upward pattern of movements.

Looking at the exchange rate movements of major currencies in the course of the year under review, the Japanese yen firmed temporarily against the U.S. dollar but subsequently its tone remained weak, reflecting the fragility of the Japanese economic

<Figure II -4>

Trends of Major Exchange Rates¹⁾

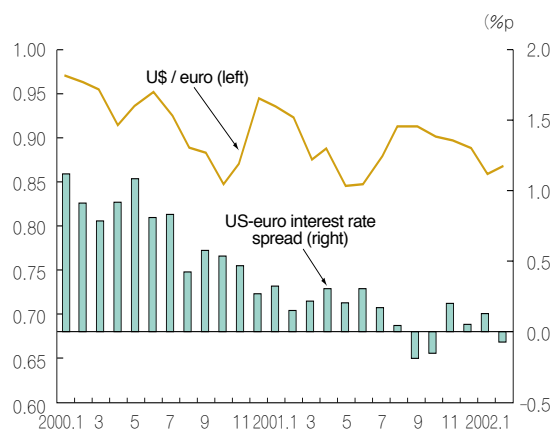
Note: 1) Based on closing rates in local exchange markets.
Period-end basis.

Source: Bloomberg.

situation. The euro also remained generally soft against the U.S. dollar.

The Japanese yen, showing its weak tone against the U.S. dollar from the start of the year 2001, traded at 126 yen per dollar at the beginning of April. With Prime Minister Koizumi's formation of his cabinet during April, however, anticipations mounted concerning the pursuit of economic reform. As a result, the yen firmed against the dollar to stand at 119 yen per dollar as of the beginning of June. However, it subsequently shifted back to a softening trend in the absence of any visible efforts for specific structural adjustment, trading in a range of 120~125 yen per dollar until the beginning of September. Immediately after the events of 11 September, it strengthened to 116 yen per dollar but resumed its softening trend again after that. Particularly, as a sense of crisis concerning the Japanese economy built up from the end of November, the yen depreciated rapidly to stand at 134.7 yen per dollar on January 24, 2002, its lowest level since October 5, 1998(134.3 yen per dollar).

<Figure II -5>

Trends of Exchange Rates and Interest Rates Spreads between the US Dollar and the Euro¹⁾

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

Source: Bloomberg.

The euro also maintained a generally weak tone against the U.S. dollar until the beginning of July, reacting to a net outflow of funds in the form of foreign direct investment and portfolio investment while the euro zone economy performed more sluggishly than had been expected. As of July 2001, the euro, which had been trading at 0.94 dollar for 1 euro, was changing hands at 0.84 dollar per unit. It subsequently appreciated to above 0.92 dollar with the lack of visibility of the U.S. economic recovery and the widening of the spread between U.S. and euro-area interest rates, before falling back below the 0.9 dollar level from October onwards as the euro-area economy also moved into recession. In the early part of 2002, the euro temporarily rallied on anticipations raised by its

being put into physical circulation, before returning to its generally softer trend in response to comparatively weak economic indicators and the ECB's decision to keep interest rates unchanged.

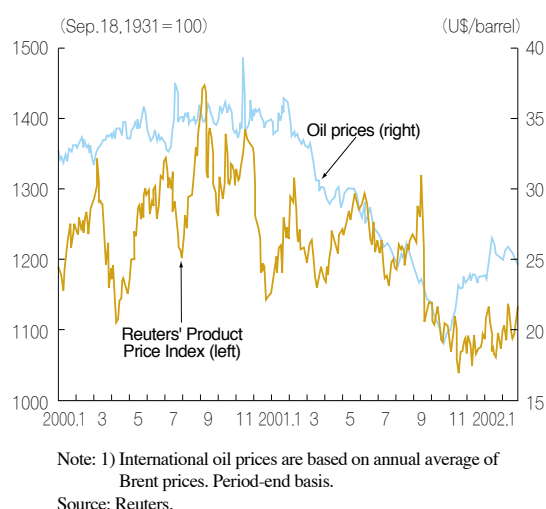
C. Prices of International Raw Materials

During the year 2001, international raw material prices generally exhibited a downward trend in response to the subdued demand in line with the worldwide economic downturn.

International oil prices rose sharply in line with the agreement among Oil Producing and Exporting Countries (OPEC) to reduce production at the beginning of the year 2001, climbing to above 30 dollars per barrel (Brent crude) during February. By the end of March, however, the price fell to 23 dollars per barrel owing to the advent of spring when demand for oil is low and the general reduction in demand for it brought about by the worldwide economic downturn. Subsequently, OPEC undertook a second round of production cuts and, as the world's largest energy consumer, the U.S., increased oil imports to build up its stocks. As a result, prices rebounded to a level of 29 dollars per barrel as of the beginning of June. However, as demand remained low under the influence of the worldwide economic downturn and Iraq resumed its oil exports, which had been frozen for sometime, the price fell back to 23 dollars per barrel. Prices surged to 30 dollars per barrel for a brief period on the back of speculative demand immediately after the terrorist attacks on the U.S., but with the deepening of the worldwide economic downturn, the price fell steeply as OPEC lost its sway over the markets and from mid-October onwards, the price per barrel moved between 17 and 19 dollars. Early in 2002, the OPEC countries

<Figure II -6>

Trends of Prices of International Raw Materials¹⁾



resolved to cut production, in spite of which international oil prices continued stable.

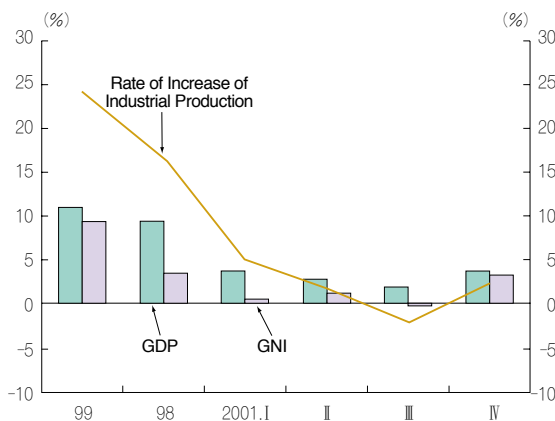
Other raw material prices had risen slightly during 2000, but for the year 2001 as a whole, the prices of the principal food grains generally held steady at the previous year's level whereas the prices of raw materials for use in manufacturing registered a steeply falling downward trend in response to the shrinking of demand worldwide. In the case of nonferrous metals, from November onwards, however, the prices of copper and aluminium shifted to a mild upward trend in response to the reduction of output by producers. Reuters Commodity Price Index stood at a level 14.2% lower at the end of January 2002 than at the end of the year 2000.

2. Economic Growth and Trade

A. Economic growth

<Figure II -7>

Trends of Major Economic Growth¹⁾ Indicators



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

Moving into 2001, the Korean economy, which had registered higher rates of growth in 1999~2000, saw its growth greatly subdued. During the year 2001, GDP growth remained at 3%, much lower than in the previous year(9.3%). Viewing GDP growth by period, during the first quarter it stood at 3.7%, before falling in the second and third quarters to 2.9% and 1.9% respectively; in the final quarter it picked up again to the level of 3.7%.

This rapid deceleration in the growth rate of the Korean economy was attributable to the ebbing of exports in response to the economic downturn in the U.S. and other major countries along with the lacklustre performance of the IT industry. Another major factor contributing to the slowdown was the large scale contraction of facilities investment in response to the murkiness of conditions at home and abroad. From early in the final quarter, however, the picture improved as domestic demand turned increasingly brisk, affected by the stimulation of domestic demand and by measures to revitalize the construction industry.

Meanwhile, real gross national income(GNI), which shows the real purchasing power of income derived from production activities, rose only 1.3%, much less than GDP did, following the trend of the preceding year, as a result of the worsening of the terms of trade with the fall in the prices of major export items such as semiconductors.

<Table II -4>

Trends of Growth¹⁾ by Expenditure Item

(%)

	1999	2000	2001 ^P				
			year	I	II	III	IV
Final consumption expenditure	9.4	6.7	3.7	1.2	3.5	4.3	5.6
Private	11.0	7.9	4.2	1.5	4.1	4.8	6.6
Government	1.3	0.1	0.2	-0.7	-0.1	1.0	0.3
Gross fixed capital formation	3.7	11.4	-1.7	-4.0	-4.8	-3.1	4.9
Construction	-10.3	-4.1	5.8	1.5	1.1	8.2	10.7
Facilities	36.3	35.3	-9.8	-8.4	-11.2	-15.7	-3.1
Increase in inventories ²⁾	4.3	-0.2	0.0	-0.5	-0.1	0.3	0.1
Exports of goods and services	15.8	20.5	1.0	9.0	0.7	-4.1	-1.1
(Goods)	18.7	23.0	0.4	8.7	-0.1	-5.4	-1.1
Imports of goods and services	28.8	20.0	-2.8	0.2	-7.2	-5.5	1.1
(Goods)	32.8	21.0	-4.5	-0.1	-9.2	-7.9	-0.7
GDP	10.9	9.3	3.0	3.7	2.9	1.9	3.7

Notes: 1) Compared with the same period of the previous year.

2) Degree of contribution to GDP (percentage points).

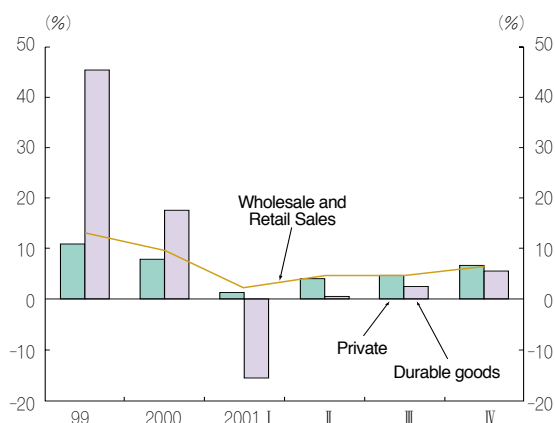
Source: The Bank of Korea.

(Demand)

Viewing the trends of demand for the year by sector, whereas domestic demand witnessed continuing growth, especially in consumer spending and construction investment, the rate of increase of exports eased sharply and facilities investment declined from the previous year.

Consumer expenditure exhibited a moderate level of growth compared to the previous year, in spite of the continued acceleration of the expansion of private-sector consumption and the shift of government spending to an upward trend from the second half of the year. Private-sector consumption increased 4.2%. Viewed by quarter, its rate of increase marked only 1% during the first quarter because of the business slowdown, but from the second quarter onwards with the improvement of labour market conditions, consumer confidence gradually revived and, as the effects of the measures to stimulate domestic demand made themselves felt, its rate of increase also rose. More specifically, while the consumption of services appeared buoyant(7.2%) centering on communications services, medical treatment charges and eating out, consumption of semi-durables(-0.4%) and non-durables(0.7%) marked a low ebb. Although the consumption of durables, which is very sensitive to economic trends, contracted very sharply in the first quarter(-15.3%), leading it to register a decline for the year as a whole of 1.9%, it shifted to a modest rise from early in the second quarter onwards and then accelerated during the latter half of the year. Government spending, which had maintained a very mild pace of increase during the previous year, continued to exhibit a contractional trend during the first half of the year, but, moving into the second half of the year, with the compilation of two supplementary

<Figure II -8>

Trends of Major Consumption Growth¹⁾ Indicators

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

Source: The Bank of Korea, Korea National Statistical Office

<Figure II -9>

Trends of Major Investment Growth¹⁾ Indicators

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

Source: The Bank of Korea, Korea National Statistical Office.

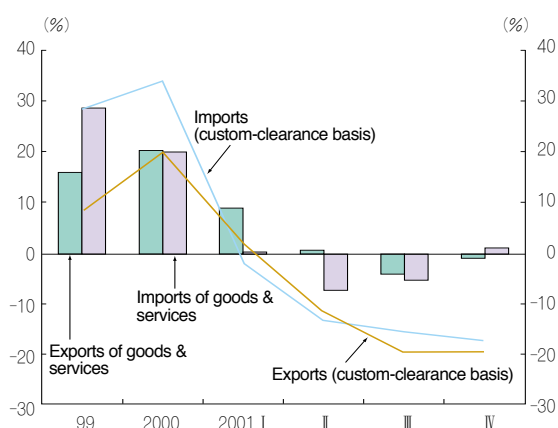
budgets, it shifted to an increasing trend, helped by the energetic disbursement of fiscal spending.

Looking at investment trends, fixed investment and inventories investment both showed a slight decrease. Fixed investment, which had raced ahead at a rate above the 30% level during 1999~2000, declined by 9.8% year on year in 2001. This contraction was attributable to the build-up of surplus capacity because of the reduction in demand in the midst of the business downturn from early in the year 2001. A further factor was the weakening of domestic and external conditions, which reduced business confidence and businessmen's willingness to invest. From the final quarter of the year, however, there was some slight improvement in business confidence with the favourable evolution of domestic demand, causing the scale of the decline in fixed investment to moderate greatly. Construction investment, which had shrunk in 1999~2000, showed a slight increase of above the 1% level during the first half of the year. However, from July onwards, its rate of increase accelerated greatly, as housing construction turned buoyant, especially in apartments and multi-unit, multi-household dwellings while infrastructure investment also increased.

Inventories continued to contract with those of agricultural and marine products and of imports being drawn down sharply, even though there was an increase in those of manufactured items.

The share in GDP of gross domestic investment (current-price basis) which had maintained an increasing trend(21.3%) since 1998, decelerated from the 28.3% of the previous year to 26.8% during the year 2001 in response to the large scale contraction in facilities investment. Even though the rate of increase of the growth of disposable income fell, the

<Figure II -10>

Trends of Major Import and Export Growth¹⁾
Indicators

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

share in GDP of gross savings declined from the 32.4% of the previous year to 29.9% in reflection of consumption's robust pace of increase. There was, in consequence, a slight fall in the ratio of self-sufficiency in investment resources, which measures the extent to which gross domestic investment is covered by gross domestic savings, from 114.3% in the preceding year to 111.5%

After registering a high rate of increase at the 20.5% level during the year 2000, the growth rate of goods and services exports(real basis) failed to rise above the 1.0% level during 2001. Viewed by period, while a mild increasing trend was exhibited in the first half of the year, from the third quarter onwards, a contractional trend was maintained. Affected by the worldwide depression of the IT industry, exports of goods including leading Korean export items such as semiconductors and computers experienced sharply reduced rates of growth; the exports of other sectors were also lacklustre at best, affected by the slowdown in business activities in the U.S. and other major countries. The overall growth rate of exports of goods consequently registered a mere 0.4% for the year as a whole. Service exports, in contrast, accelerated their pace of growth from the previous year to increase by 5.9%, thanks to augmented receipts from transport and communications services and to the larger number of foreign visitors to Korea.

Imports of goods and services(real basis) shifted from the high rate of growth of the previous year to a declining trend. Imports of goods declined by 4.5% over the year as a whole with a rise in those of consumer items being more than offset by a decrease in those of capital goods, raw materials and intermediate inputs, which together make up 88% of Korean imports. Service imports registered a modest rate of

<Table II -5>

Trends of Growth Rate¹⁾ by Economic Activity

(%)

	1999	2000	2001 ^p				
			year	I	II	III	IV
Agriculture, forestry & fishery	5.4	2.0	1.4	-4.1	3.5	1.3	1.5
Mining	5.3	2.5	0.5	-5.8	-0.1	10.8	-1.2
Manufacturing	21.0	15.9	1.7	4.5	2.2	-1.7	2.1
Electric, gas & piped water	10.4	14.0	5.7	7.5	4.7	4.3	6.0
Construction	-9.1	-3.1	5.6	2.4	1.5	7.6	9.5
Services ²⁾	11.9	9.5	4.1	3.9	4.0	3.8	4.7
Wholesale & retail, hotels & restaurants	14.1	9.8	4.0	3.4	3.8	3.8	5.1
Transport, storage & communications	14.5	17.9	7.3	8.2	6.8	7.7	6.8
Finance, insurance, real estate & business services	5.5	4.9	4.6	4.4	4.2	4.2	5.5
Social and private services	11.1	5.1	7.3	3.9	5.8	10.0	9.8
Government & private non-profit services ³⁾	1.2	0.3	0.9	1.2	1.0	0.8	0.6
GDP	10.9	9.3	3.0	3.7	2.9	1.9	3.7
GNI	9.4	3.6	1.3	0.5	1.0	-0.1	3.4

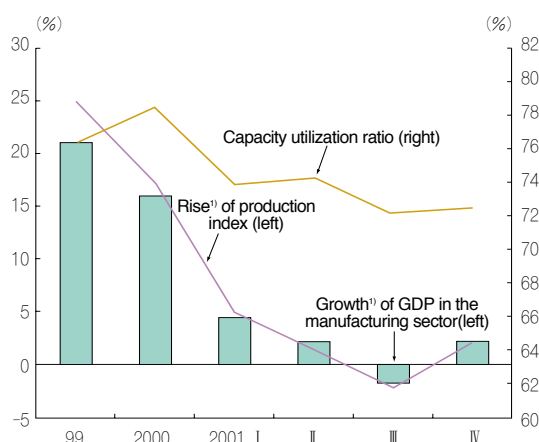
Notes: 1) Compared with the same period of the previous year.

2) Imputed bank service charge (less) and import duties included.

3) Includes household services.

Source: The Bank of Korea.

<Figure II -11>

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

Note: 1) Rates of change compared with the same period of the previous year.

Source: The Bank of Korea, Korea National Statistical Office.

increase of 5.3%, lower than the preceding year's(15.0%), assisted by the expansion of royalty payments and of overseas travel by Korean residents.

(Production)

With the exception of the construction industry, most industrial sectors registered reduced growth in the course of the year 2001. Viewed by period, growth rates were mostly subdued up until the end of the third quarter, but exhibited a pattern of mild recovery in the final quarter.

Manufacturing, which had been the engine driving domestic business activities in the previous year with a growth rate of 15.9%, attained only a 1.7% rate of growth during the year 2001, thereby itself becoming a major contributor to the economic slowdown. The IT sector, embracing semiconductors, computers and communications equipment, which had achieved growth at the high level of 35.8% in the preceding year, saw its rate of growth greatly blunted. Another factor contributing to the slowdown was the shift of light industry, particularly textiles, apparel and footwear, to a declining trend.

Capacity utilization rates in manufacturing, which had reached 78.5% during the year 2000, fell sharply to 73.2% for the year 2001 as a result of the slowdown in business activities, which had begun during the latter half of the preceding year. Apart from a few sectors such as shipbuilding and non-metallic minerals, capacity utilization rates fell across manufacturing industry as a whole. The decline in those of the computer and semiconductor branches, in the aftermath of the depression of the IT sector, was particularly striking.

The electricity, gas and piped water sector grew by 5.7%, maintaining its increasing pace from the previous year thanks to the greater consumption of electricity and expansion of demand for piped natural gas. The construction sector, which had declined 3.1% in the year 2000, registered modest growth in the first half of the year at around the 2% level but its pace accelerated greatly during the latter half to reach 5.6% for the year as a whole. This upswing in the construction industry, which was centered on infrastructure projects such as roads and ports and on the housing sector such as apartments in particular came, in response to measures to revitalize construction activities, including the strengthening of financial and fiscal support for the additional construction of rented housing and for housing purchases.

The service industry continued to exhibit its relatively solid growth of the previous year, rising by 4.1% during 2001. The wholesale and retail, restaurants and hotels sector in particular maintained its incessant pace of growth, thanks to the buoyancy of the restaurants sub-sector in response to the increasing demand for eating out. Transport, storage and communications also continued its strong performance of the previous year, growing 7.3% for the year as a whole in line with the continuing briskness of communications centering on mobile phones and value-added communications services, whose effects more than offset the sluggishness of warehousing and storage. Growth at the level of 4%, similar to the previous year's, was exhibited by financial, real estate and business services, bolstered by financial institutions' earnings of interest and of fees and commissions and by the liveliness of real estate transactions. Another contributing factor was the continually upward trend of business services, most notably legal and accounting services. Social and

personal services accelerated their pace of growth from the previous year in response to the buoyancy of private educational institutions, medical and public health services, and movies and other entertainment services.

The agriculture, forestry, and fishery industry achieved only modest growth, as it had done the previous year, rising by 1.4%. Even though forestry and fishery both shifted to a mild increase, shaking off their sharp falls in the previous year, the livestock business was badly affected by a panic over mad cow disease and agricultural production, particularly that of vegetables, declined.

B. Labor Market

The labour market situation maintained the improved picture of the previous year during 2001, and the rate of increase of nominal wages maintained a downwardly stable trend.

(Employment)

During the year the economically active population rose by 1.1% and despite the business slowdown, the number of persons employed increased by 1.4%, causing employment conditions to present a generally improved picture.

Because the rate of increase of the number of persons employed outstripped that of the economically active population, the unemployment rate fell from the 4.1% of the previous year to 3.7% and the number of persons unemployed declined from 890,000 to 820,000 during the year 2001. Viewed by period, the first quarter saw 1,030,000 out of work and the rate of unemployment at

<Table II -6>

Trends of Major Employment Related Indicators

(ten thousand, %)

	2000	2001					2002	
		year	I	II	III	IV	Jan.	Feb.
Economically active population	2,195	2,218	2,143	2,247	2,243	2,240	2,185	2,190
(rate of growth) ¹⁾	1.5	1.1	0.1	1.6	1.0	1.4	2.7	3.0
Economic participation rate	60.7	60.8	58.9	61.7	61.4	61.2	59.6	59.7
Number of persons employed	2,106	2,136	2,040	2,168	2,169	2,167	2,103	2,110
(rate of growth) ¹⁾	3.8	1.4	0.4	1.9	1.4	1.9	3.6	4.5
Number of persons unemployed	89	82	103	79	73	73	82	80
Unemployment rate	4.1	3.7	4.8	3.5	3.3	3.2	3.7	3.7
(SA)	-	-	4.2	3.7	3.5	3.4	3.2	2.8

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

Source: Korea National Statistical Office.

<Figure II -12>

Trends of Unemployment Rate and Number of Persons Unemployed

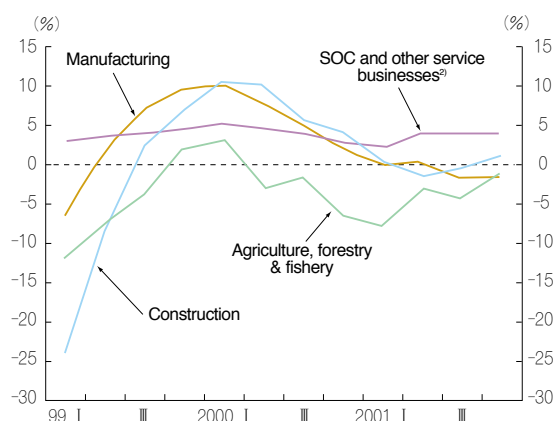


the 4.8 % level owing to the economic downturn and the increase in seasonal unemployment. From the second quarter onwards, however, the unemployment rate fell back to just above the 3% level and the number of persons unemployed declined greatly to around 700,000. In a notable development, unemployment eased to 3% in September, its lowest level since November 1997(2.6%). Moving into the final quarter, the number of persons employed in the agricultural and fishery industry decreased with the advent of the slack period of the farming year. Despite this and other seasonal factors, labour market condition remained favourable with the generally buoyant tone of business activities and the return of vitality to the construction sector in response to revival of real estate market activities. Moving into 2002, the number of persons out of work in the farming and fishing sector and in construction increased, as did the number of new graduates seeking employment, causing the rate of unemployment to rise to 3.7% in February and the number of persons unemployed to 800,000. After seasonal adjustment, the rate of unemployment(2.8%) and the number of persons out of work(630,000) both registered their lowest level since the outbreak of the currency crisis.

The reason that labour market conditions were favourable despite the overall slowdown in business activities seems to lie in the comparatively rapid rate of growth of the service sector, which has a high capacity for absorbing labour. An additional factor was that the decreases in manufacturing and especially in semiconductors, which spearheaded the economic decline, took place in the unit value of exports rather than in volume terms, meaning that the impact on employment was not particularly large. A further explanation was that companies responded to the contraction of demand not by reducing manpower, but

<Figure II -13>

Trends of Growth¹⁾ 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 -7>

Trends in the Structure of Employment and Working Hours

	(%, hours)						
	1999	2000	2001				
			year	I	II	III	IV
Full time permanent ¹⁾	48.3	47.6	48.7	49.5	48.7	48.6	48.1
Temporary and casual ¹⁾	51.7	52.4	51.3	50.5	51.3	51.4	51.9
Monthly average working hours ²⁾	208	206	204	200	205	206	205
(overtime)	25	26	23	24	23	22	22

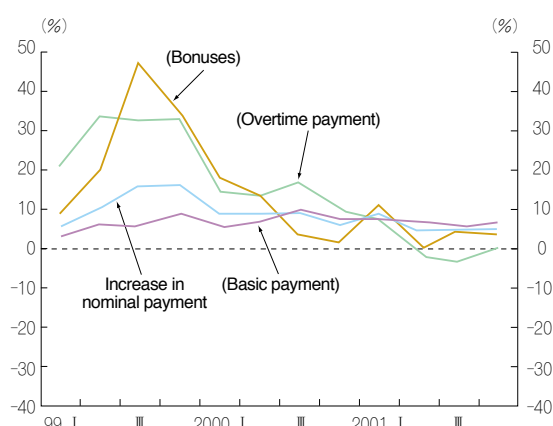
Notes: 1) Shares of total wage earners.

2) Based on businesses with 10 or more workers.

Source: Korea National Statistical Office, Ministry of Labor.

<Figure II -14>

Trends in Wage Increases¹⁾



Notes: 1) Compared with the same period of the previous year.

2) Based on businesses with 10 or more workers.

Source: Ministry of Labor.

by restricting new hirings and the number of hours worked. Consequently the weakening of labour market conditions in response to the downturn was largely avoided.

Looking at employment trends by sector during the year, the downward trend of farming and fishing employment was maintained and the number of persons employed in manufacturing also decreased in response to lacklustre exports and facilities investment. In contrast, thanks to the convincing growth of domestic demand, the number of persons employed in the service industries greatly increased. In the case of the construction industry, the number of persons employed declined year-on-year on an annual average basis. Construction employment, nevertheless, shifted to an upward trend in the latter half of the year with a great expansion in the construction of apartments and multi-unit, multi-household dwellings in response to the government's concentration of its fiscal disbursements on the construction sector.

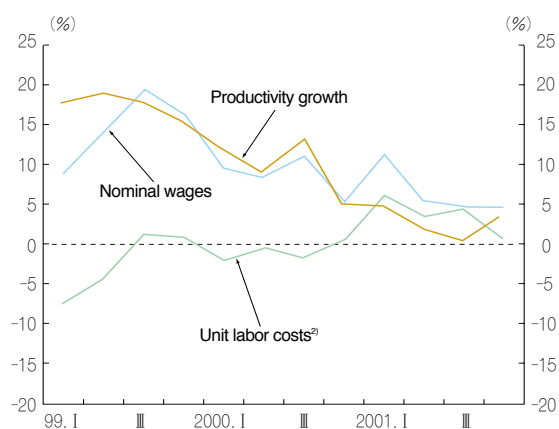
There was a moderate improvement from the preceding year in the structure of employment on an annual average balance, with the share of persons in full-time employment on the rise. However, total persons in full-time jobs(6.50 million) remained at around the level of 1998(6.48 million). Examining the trend by period, the share in total employment of those in full-time employment showed a reduction, whereas that of those employed on a temporary or casual basis exhibited an increasing trend.

(Wages)

The rate of increase of nominal wages during the year 2001 decelerated from the previous year(8%) to stand at 5.6%. On the one hand, the weakening of corporate

<Figure II -15>

Trends of Increases¹⁾ in Unit Labor Costs in the Manufacturing Sector



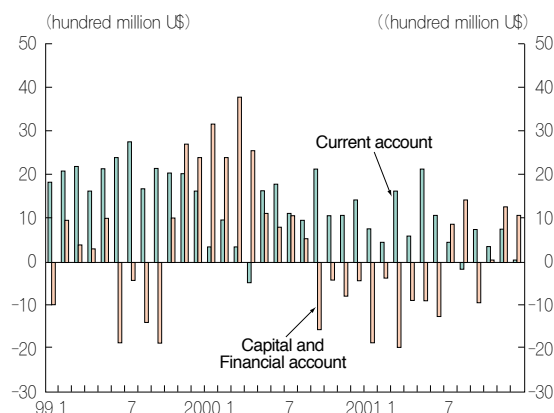
Notes: 1) Compared with the same period of the previous year.

2) Unit labor costs = nominal wages / (constant GDP ÷ the number of persons employed).

Source: The Bank of Korea, Ministry of Labor.

<Figure II -16>

Trends of Current, Capital and Financial Accounts



Source: The Bank of Korea

profitability as a result of the business downturn meant that companies' capacity to pay increased wages was limited while, on the other, with the progress of structural adjustment, workers sought security of employment rather than increased wages. The rate of increase of real wages, as represented by that of nominal wages adjusted for consumer price inflation, fell sharply from the 5.6% of the preceding year to 1.3%.

Looking at the make-up of nominal wages, the rate of increase of regular wages showed a slight deceleration from the previous year to stand at 6.5%, while overtime and special payments saw theirs drop to 0.3% and 5% respectively, reflecting the reduction in the number of hours worked across industry in view of the business slowdown and companies' lackluster performance. Rates of wage increases were lower than in the previous year across almost all branches of industry, but in the case of a few service sectors such as the wholesale and retail trade, wages rose slightly more rapidly than the year before, reflecting the continuing expansion of domestic demand.

Unit wage costs in manufacturing rose by 3.5% during the year 2001. This was a higher rate of increase than the previous year's because of the lower growth of labour productivity amid the business slowdown, which offset the effect of the reduction in the rate of increase of nominal wages.

C. External Transactions

The current account registered a surplus of 8.6 billion dollars for the year 2001. This was the fourth straight year since 1998 that it had been in surplus, but its scale narrowed from the previous year (12.2 billion dollars), continuing its declining trend. The capital account

shifted from the previous year's surplus of 12.1 billion dollars to a deficit of 3.6 billion dollars, as net inflows of direct and portfolio investment decreased whereas the deficit on the other income account was widened by the increased redemption of foreign loans. Meanwhile the Bank of Korea's external reserves rose by 7.7 billion dollars since the surplus on the current account more than offset the deficit on the capital account.

(Current Account)

The scale of the current account surplus narrowed during the year 2001 from last year's 12.2 billion dollars to 8.6 billion dollars with the effect of the narrowing of the deficit on the income account being more than offset by that of the contraction of the goods account surplus and the shift into deficit on the current transfers account. Examining the figures by period, during the first half of the year, the goods account accumulated a large surplus, enabling the current account to register around 1.1 billion dollars in the black on a monthly average basis. The scale of the goods account surplus narrowed from early in the latter half of the year as exports turned lacklustre while the scale of the current transfers deficit enlarged. The effect of these movements was to narrow the scale of the average monthly current account surplus greatly to the 0.3 billion dollar level, scarcely one third that in the earlier half of the year. Strikingly, the current account registered a small deficit(-0.14 billion dollars) in August, the first for sixteen months since April 2000 (-0.49 billion dollars), as a result of the temporary widening of the travel account deficit as Korean residents took summer vacations abroad.

<Table II -8>

Balance of Payments

	(hundred million US\$)		
	1999	2000	2001*
Current account	244.8	122.4	86.2
Goods & services	277.2	139.8	98.7
Goods	283.7	168.7	133.9
(exports)	1,451.6	1,759.5	1,513.7
(imports)	1,167.9	1,590.8	1,379.8
Services	-6.5	-28.9	-35.3
(credit)	265.3	305.3	296.0
(debit)	271.8	334.2	331.3
Income	-51.6	-24.2	-8.9
Current transfers	19.2	6.8	-3.6
Capital and financial account	20.4	121.1	-35.8
Financial account	24.3	127.3	-31.4
Direct investment	51.4	42.8	6.0
Portfolio investment	86.8	120.0	62.5
Other investment	-113.8	-35.6	-99.9
Other capital account	-3.9	-6.2	-4.4
Changes in reserve assets	-229.8	-237.7	-77.1
Errors and omissions	-35.3	-5.8	26.8

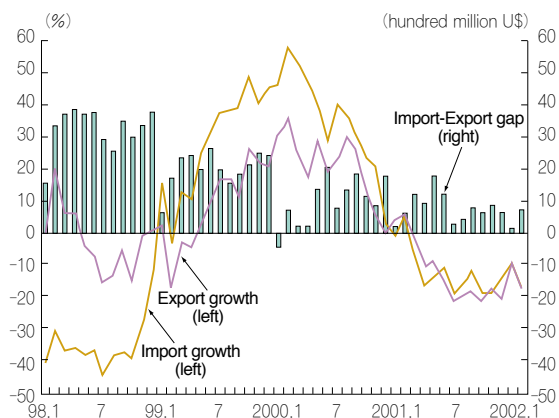
Source: The Bank of Korea.

Viewed by component account, the surplus position on the goods account was maintained with the decrease in

exports being largely counteracted by a matching decrease in imports centering on those of raw materials and intermediate inputs, but the scale of the surplus narrowed from 16.9 billion dollars to 13.4 billion dollars. The import export gap(customs clearance basis) during the first two months of the year 2002 witnessed a slight narrowing of its surplus from the same period of the previous year(0.84 billion dollars) to 0.72 billion dollars.

<Figure II -17>

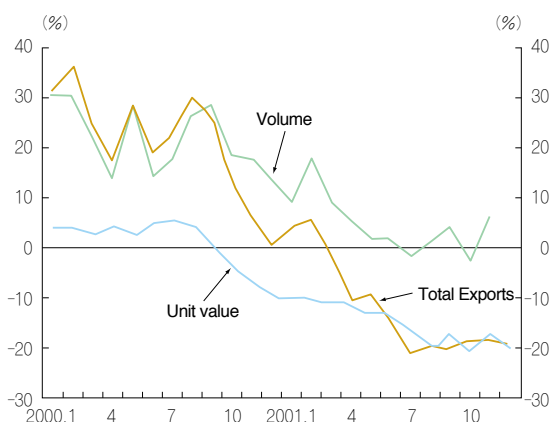
Trends of Import & Export Growth¹⁾ and Import-Export Gap



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

<Figure II -18>

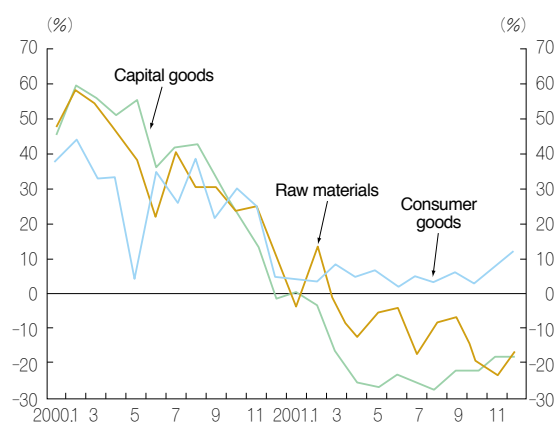
Trends of Volume and Unit Value of Exports



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

For the year 2001, exports(customs clearance basis) fell for the first time since 1958 with the sole exception of the year 1998, which was straight after the currency crisis. They contracted by 12.7% from the 172.3 billion dollars of the previous year to stand at 150.4 billion dollars. What caused this large decline in exports was the synchronized business downturn in major export destinations including the U.S., Japan and Southeast Asia. This was exacerbated by the worldwide depression in the IT sector, which caused exports of major Korean products such as semiconductors to tumble. Consequently most areas of industry apart from shipbuilding saw their performance decline from that of the previous year, the case of the electric and electronic appliances sector, which includes semiconductors, being particularly striking. Dividing the reduction in exports into changes in volumes and changes in unit prices, in the case of export volumes, the scale of the downturn is greatly reduced, with only a slight decrease being registered or even an upward trend maintained. It was in export unit prices that the downward trend of exports continued throughout the year on a large scale, and this acted as the main contributor to the decrease in the amount of exports in value terms. This fall in the unit value of exports was even more pronounced for IT products including semiconductors.

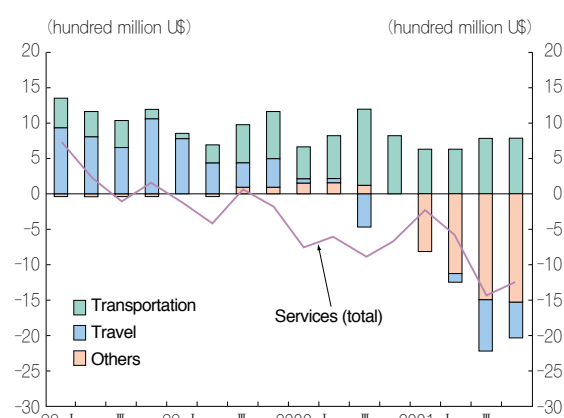
<Figure II -19>

Trends of Imports by Use¹⁾

Note: 1) Compared with the same month of the previous year.

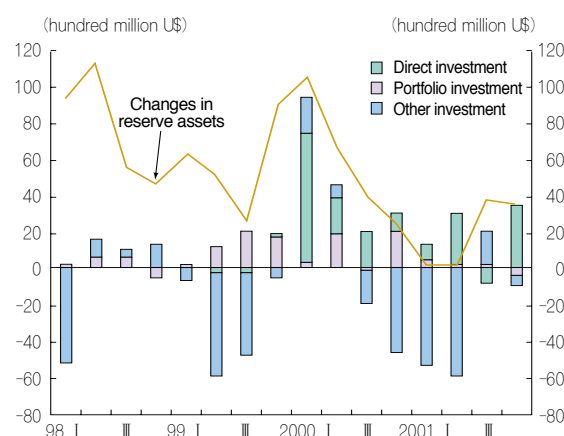
Source: Ministry of Commerce, Industry and Energy.

<Figure II -20>

Trends of Service Account by Item

Source: The Bank of Korea.

<Figure II -21>

Trends of Capital and Financial Account by Item

Source: The Bank of Korea.

For the year 2001, imports(customs clearance basis) fell by 12.1% from the previous year(160.5 billion dollars) to stand at 141.1 billion dollars. This was attributable to the large contraction of imports for export use such as those of raw materials and intermediate inputs because of lacklustre exports. Another contributing factor was the large scale reduction in capital goods imports because of the drying-up of facilities investment. The downward stability of internationally traded raw material prices including those of oil as a result of the worldwide economic recession also served as a factor in reducing imports.

The services account deficit expanded from the previous year's 2.9 billion dollars to 3.5 billion dollars as a result of increased overseas travel expenses, including those for foreign study and training, and the expanded payment of royalties and fees for the use of patents. In contrast, the income account registered a much reduced deficit of 0.9 billion dollars as against the previous year's 2.4 billion dollars, thanks to the heightened operating income from the expanded claims on the rest of the world generated by the accumulated current-account surplus.

The current transfers account shifted from the 0.7 billion dollar surplus of the year before to a deficit of 0.4 billion dollars in response to an expansion of overseas remittances by domestic residents.

(Capital Account)

The capital account shifted from a surplus of 12.1 billion dollars the year before to register a deficit of 3.6 billion dollars for the year 2001. This was mainly attributable to the large scale contraction of net inflows of direct and portfolio foreign investment and also to

substantial redemptions of overseas loans.

Viewing capital transactions by category, the direct investment account saw the scale of its surplus narrow sharply from 4.3 billion dollars a year before to 0.6 billion dollars in the year 2001, with the effects of the contraction of outward direct investment by domestic residents being greatly exceeded by those of the decrease of inward direct investment by foreign residents. The portfolio investment account registered a level of surplus only about half that of the previous year. This was because of a large expansion of investment in overseas securities following an increase in domestic residents' purchases of medium and long-term foreign securities, together with the reduction in the scale of foreigners' inflow of portfolio investment funds, which had increased sharply in the year 2000. Meanwhile the scale of the deficit on the other investment account widened from 3.6 billion dollars to 10 billion dollars as a result of the redemption of foreign borrowings and the reduction of trade related credits in line with the sluggishness of exports.

3. Prices

<Table II -9>

Trends of Growth¹⁾ of Major Prices

	1998	1999	2000	2001	(%) Jan.~Feb. 2002.
Consumer Prices	7.5	0.8	2.3	4.1	2.6
(Core Inflation)	(5.9)	(0.3)	(1.9)	(3.6)	(3.0)
Producer Prices	12.2	-2.1	2.0	1.9	-0.4
Import Prices	28.2	-12.1	7.6	4.9	-7.5

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

During the year 2001, the prices of imported goods rose 4.9% and of domestically produced items 1.9%, a lower rate of increase than in the preceding year. In contrast, consumer prices rose at a rate of 4.1%, accelerating their upward pace from the previous year.

In the case of import and producer's prices, there were factors present on both the demand and the supply-sides making for a reduction in prices, including the downward stability of raw material prices, oil in particular, and the downturn in business activities both at home and abroad, whose effects helped counteract those of the depreciation of the Korean won. In contrast, consumer prices, in which downwardly sticky service charges carry a large weight, was influenced by the sharp rises in charges for public services.

(Import and Export Prices)

<Table II -10>

Trends of Movements¹⁾ in Import and Export Prices

		(%)						
		2000	2001				2002	
			year	I	II	III	IV	Jan.~Feb.
Import prices	Won-basis	7.6 (5.3)	4.9 (-6.2)	8.8 (-4.4)	11.3 (0.4)	4.9 (-3.0)	-4.6 (-7.6)	-7.5 (2.8)
	(raw materials)	11.1	4.5	9.6	11.9	4.2	-6.9	-9.1
	(capital goods)	-4.9	6.6	5.5	7.5	8.4	5.3	-1.1
	(consumer goods)	1.0	7.6	9.1	13.6	7.7	0.5	-2.1
	Contract currency basis	12.0 (0.5)	-6.1 (-9.9)	-1.7 (-0.9)	-2.5 (0.3)	-7.5 (-3.4)	-12.4 (-6.3)	-9.4 (1.2)
Export prices	Won-basis	-1.0 (4.2)	6.2 (-3.1)	7.9 (4.2)	9.8 (-1.5)	6.3 (-1.4)	0.9 (-4.2)	-4.3 (2.2)
	Contract currency basis	3.6 (-1.5)	-6.4 (-8.4)	-3.9 (-1.7)	-5.3 (-1.5)	-7.7 (-1.8)	-8.8 (-3.6)	-7.7 (0.3)
Exchange rates ²⁾		-4.9	14.2	13.0	17.0	16.0	11.0	4.4

Notes: 1) Rates of change compared with the same period of the previous year.

2) Won/US\$ basis.

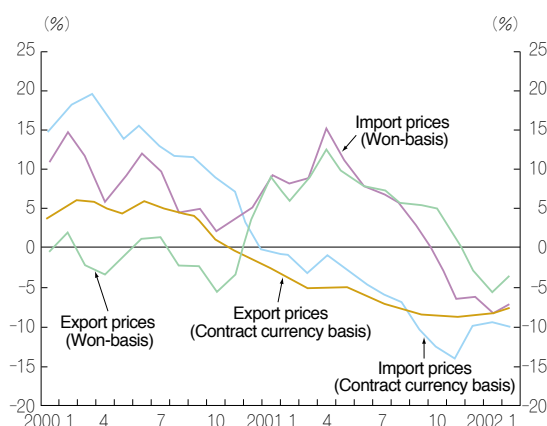
3) Figures in parentheses refer to the rate of increase compared with the last month of the previous period.

Source: The Bank of Korea.

Import and export prices(Korean won basis) rose by a large margin during 2001, pushed up by the large scale of the depreciation of the Korean won. In terms of the contract currency, however, import prices fell 6.1%, limiting their increase in Korean won terms to 4.9% on an annual average, blunting the upward trend of the previous year (7.6%).

Looking at the movements of import prices by period, the rate of increase gradually steepened year-on-year from January to April, but from May onwards, they displayed a downwardly stable trend. On a contract currency basis, during the year to April, there was a modest decrease in import prices but, under the influence of the weakening of the Korean won, their upward trend steepened in local currency terms. The

<Figure II -22>

Trends of Movements¹⁾ in Import and Export Prices

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

exchange rate maintained a more or less stable trend from early May and the price of oil and other international raw materials dropped sharply in response to the worldwide business slowdown, causing the upward trend of import prices in domestic currency terms to level off before shifting to a downward trend year-on-year in October. In the beginning of the year 2002, import prices rebounded slightly compared to the end of the previous year because of higher oil prices and the renewed weakness of the Korean won. On a year-on-year basis, in contrast, they fell on a larger scale.

Export prices(Korean won basis), despite a 6.4% fall in contract currency terms, moved upwards as a result of the Korean currency's sharp loss of exchange value, registering a rate of increase of 6.2% averaged over the year as a whole, the first rise for the last three years.

Viewed by period, export price movements showed a similar pattern to those of import prices, rising more steeply year-on-year until the end of April but flattening their upward pace greatly from May onwards. It was noteworthy that during the second half of the year the export prices of electronic items such as semiconductors and of communications equipment fell by a large margin while the overall upward trend of export prices was greatly blunted as the exchange rate of the Korean won followed a more stable track. Export prices turned upward again in the early part of the year 2001 as compared to the end of the preceding year while continuing to fall year-on-year.

(Producer Prices)

Producer prices rose 1.9% on an annual average basis during the year 2001, a similar increase to that of the previous year(2.0%).

<Table II -11>

Trends of Movements¹⁾ in Producer Prices

(%)

	2000	2001				2002	
		year	I	II	III	IV	Jan.-Feb.
Producer prices	2.0 (1.7)	1.9 (-0.7)	2.5 (1.1)	3.1 (0.2)	2.0 (-0.5)	0.0 (-1.4)	-0.4 (1.2)
Goods	2.2 (1.5)	1.8 (-1.3)	2.3 (1.2)	3.4 (0.2)	2.1 (-0.9)	-0.5 (-1.8)	-1.1 (1.1)
(agriculture, forestry & marine products)	-2.6 (-7.9)	1.0 (6.1)	-4.1 (9.7)	3.0 (0.4)	3.0 (-3.1)	2.4 (-0.7)	6.4 (5.0)
(industrial products)	2.4 (2.2)	1.5 (-2.3)	2.5 (0.2)	3.0 (0.2)	1.7 (-0.7)	-1.2 (-2.1)	-1.7 (0.9)
(electricity, piped water & gas)	8.5 (7.9)	7.3 (3.5)	8.5 (2.6)	8.5 (1.1)	8.0 (0.0)	4.7 (-0.3)	-2.0 (-2.8)
Services	1.5 (2.0)	2.4 (1.6)	3.2 (1.0)	2.9 (-0.2)	1.7 (0.6)	1.9 (0.2)	2.0 (1.2)

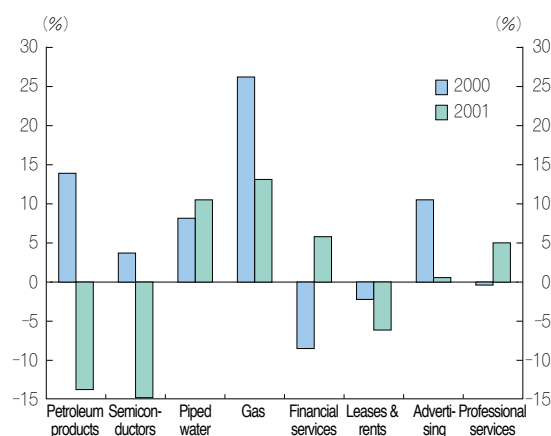
Notes: 1) Rates of change compared with the same period of the previous year.

2) Figures in parentheses refer to the rate of increase compared with the last month of the previous period.

Source: The Bank of Korea.

Viewing producer price movements by period, their upward trend gradually accelerated during the first five months of the year, but from June onwards, they showed downward stability. The high rate of producer price inflation in the January to May period was attributable firstly to increases in the prices of agricultural and fishery products brought about by short-lived supply demand imbalances following heavy snows and a severe cold spell. Another major contributory factor was the increases of charges for utilities and services including piped gas, piped water, blueprint drafting and inspections. The downward stability of producer prices from early June onwards reflected the downward trend of prices for audio, visual and communications equipment including semiconductors, because of the weakening of demand in the wake of the downturn in business activity at home and abroad. The reduction of prices for petroleum products thanks to lower international oil prices was another major factor making for stability. The downward stability of producer prices on a year-on-year basis continued in the early part of the year 2002. Compared to the end of the year 2001, however, they showed an upward trend owing to seasonal price rises for vegetables and fruit, increased prices for petroleum products following the depreciation of the Korean won and the rise in oil prices and a hike in cigarette prices following the imposition of a public health levy.

<Figure II -23>

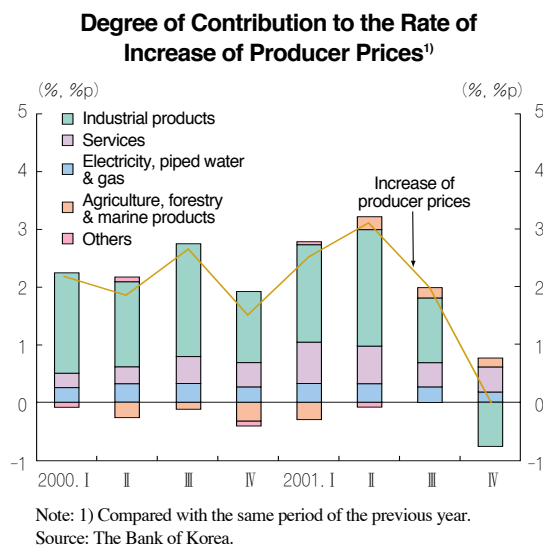
Movements of Producer Prices¹⁾ in Major Businesses

Note: 1) Compared with the last month of the previous year.

Source: The Bank of Korea.

Broken down by type of commodity, the prices of manufactured goods remained stable whereas prices in the electricity, water and gas sector staged a sharp rise. The prices of manufactures rose only 1.5% on an annual average basis, slackening their upward trend of the previous year because of reduced prices for petrochemical products and semiconductors. Following on from the year 2000, charges for electricity, water and piped gas were again raised steeply in the year

<Figure II -24>



2001, being increased by 7.3%. Meanwhile prices of agricultural and fishery products rose 1.8%, reflecting the poor yields brought about by adverse weather conditions in the form of heavy snows, a bitterly cold spell and a drought. Charges for services mounted 2.4%, led by higher fees for blueprint drafting, inspections and patent services and other expert services along with steep increases in charges for financial services.

As a consequence of these price movements, the contribution of manufactured products to the overall increase in producer prices stood at 1%p, lower than the previous year's (1.6%p). The contributions of agricultural and fishery products and services, in contrast, were larger than the previous year's (-0.2%p and 0.4%p each), registering 0.1%p and 0.5%p respectively.

<Table II -12>

Trends of Movements¹⁾ in Prices by Stage of Manufacturing

		2001						2002	
	2000	year	I	II	III	IV	Jan.-Feb.		
Gross index	3.4 (4.2)	2.9 (-3.7)	4.3 (1.3)	5.5 (0.9)	3.3 (-1.0)	-1.5 (-2.6)	-2.7 (1.4)		
Raw materials	22.7 (21.9)	3.7 (-18.7)	7.6 (-5.2)	13.0 (5.2)	6.3 (-1.5)	-10.3 (-8.7)	-6.4 (4.8)		
Intermediate goods	4.1 (4.4)	3.3 (-3.6)	5.5 (1.8)	6.0 (0.6)	3.3 (-1.5)	-1.5 (-2.4)	-4.1 (0.4)		
Final goods	-0.9 (0.3)	2.2 (0.0)	2.0 (2.0)	3.4 (0.4)	2.6 (-0.2)	0.8 (-1.4)	0.0 (1.8)		

Notes: 1) Rates of change 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.

Viewing manufacturing value added by stage in terms of sector weighted average for the goods price and the import price indices, the prices of raw materials and intermediate inputs decelerated their rate of increase while those of final goods shifted to a slight rise. Notably, the prices of raw materials, which had risen sharply the preceding year, slackened their upward pace greatly under the impact of the economic slowdown, increasing at a rate of 3.7% on an annual average basis.

(Consumer Prices)

During the year 2001, consumer prices rose at an annual average rate of 4.1%, accelerating their rate of increase from the previous year (2.3%).

Viewed by period, consumer price inflation continued to gather pace until May in comparison with the end of

<Table II -13>

Trends of Movements¹⁾ in Consumer Prices

(%)

	2000		2001				2002	
	year		I	II	III	IV	Jan.~Feb.	
Consumer Prices	2.3	4.1	3.6	5.0	4.2	3.4	2.6	
	(2.7)	(3.2)	(2.5)	(0.6)	(0.5)	(-0.4)	(1.1)	
Agriculture, livestock & marine products	1.9	6.3	1.0	8.8	8.1	7.4	9.8	
	(-2.3)	(9.5)	(9.4)	(0.2)	(3.6)	(-3.5)	(7.2)	
Industrial products	1.6	2.6	3.2	3.8	2.5	0.9	0.0	
	(2.4)	(0.0)	(0.6)	(0.6)	(-0.3)	(-0.9)	(1.0)	
(petroleum products)	11.0	4.2	9.9	11.1	2.9	-5.9	-7.0	
	(9.3)	(-9.4)	(-1.1)	(-0.2)	(-2.6)	(-5.8)	(1.3)	
Services	2.9	4.6	4.5	5.0	4.6	4.1	3.0	
	(4.3)	(4.0)	(2.3)	(0.8)	(0.3)	(0.7)	(-0.1)	
(public service charges)	7.1	7.5	8.8	9.4	7.0	4.5	0.0	
	(9.0)	(3.7)	(3.6)	(0.5)	(-0.3)	(-0.1)	(-2.0)	
(Rents)	-0.5	4.1	2.5	3.8	4.7	5.4	5.9	
	(2.2)	(5.7)	(0.8)	(2.1)	(1.0)	(1.8)	(0.7)	

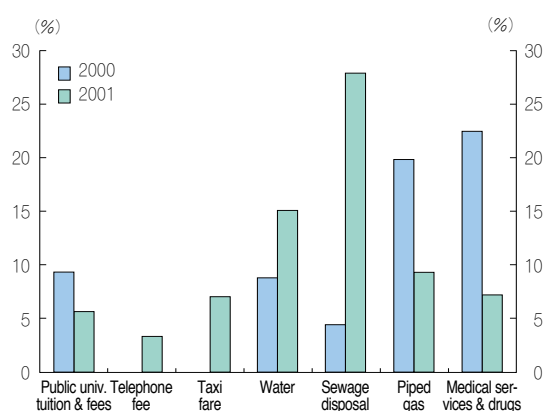
Notes: 1) Rates of change compared with the same period of the previous year.

2) Figures in parentheses refer to the rate of increase compared with the last month of the previous period.

Source: Korea National Statistical Office.

the previous year. After maintaining a high level during the June to August period, it moved to a gradually easing track from September onwards. There was a build-up of upward pressures on prices during the year to May owing to the depreciation of the Korean won, increases in charges for public services such as medical treatment under public health insurance and piped gas, and hikes in prices of agricultural livestock and fishery products. From June through August the rate of increase in consumer prices recorded the high level of 4% year-on-year due to the sharp rise in prices of agricultural livestock and fishery products, and vegetables in particular, caused by a drought, and the acceleration of the rise in housing rents. From September onwards, however, the rate of increase in consumer prices lowered to around 3%. This was brought about the decreases in domestic fuel prices in line with lower international oil prices, reductions in agricultural prices for grains and vegetables thanks to good harvests and stability in public service charges due to the government's efforts to throttle back increases in them. The downward stability of consumer prices was prolonged into the early part of the year 2002.

<Figure II -25>

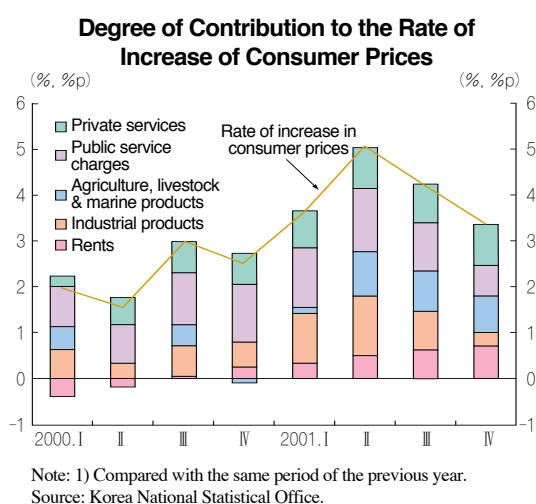
Movements of Major Public Service Charges

Note: 1) Compared with the last month of the previous year.

Source: Korea National Statistical Office.

Viewed by type of commodity, the prices of manufactured goods maintained a comparatively stable trend: services and agricultural, livestock and fishery products, in contrast, accelerated their upward trend. Helped by the large reductions in the prices of petroleum fuels including gasoline and heating oil during the latter half of the year, manufactured goods saw their rise in prices held to 2.6% on an annual average basis. Charges for services climbed 4.6% with those for public services, personal services and housing rentals all increasing. Most notably, charges for public services were raised by 7.5% as a result of the increased charges for treatment under public health

<Figure II -26>



insurance, and for utilities including piped gas, water and sewage disposal. For their part, housing rental charges rose 4.1% following the increased in real estate prices. Apart from rice and other food grains, agricultural and animal husbandry products generally rose in price, bringing the price rise for the agricultural, forestry, livestock and fishery sector to 6.3%.

As a net result of these price movements, the ratio of manufactured goods' contribution to the total rise in consumer prices stood at 0.9%p, somewhat larger than the previous year's(0.6%p). Meanwhile the contribution ratios of services and of agricultural and fishery products expanded greatly compared to the previous year with the former rising to 2.5%p and the latter to 0.7%p(1.6%p and 0.2%p respectively). Remarkably, while the contribution ratio of services was augmented, that of charges for public services, which make up only 15% of the Consumer Price Index, continued last year's high level of contribution to the overall increase, being responsible for a 1.2%p rise in consumer price inflation. Personal services, meanwhile, pushed up inflation by 0.8%p, and housing rents did so by 0.5%p.

(Real Estate Prices)

<Table II -14>

Trends of Movements¹⁾ in Housing Prices and Rents

	2000		2001				2002
	year		I	II	III	IV	Jan.~Feb.
Housing prices	0.4	9.9	0.8	2.2	4.8	1.7	5.2
(Apartment)	1.4	14.5	1.6	3.3	6.7	2.3	7.7
- Seoul	4.2	19.3	2.2	4.8	8.6	2.6	11.2
Housing rents	11.1	16.4	4.9	3.2	6.4	1.1	5.0
(Apartment)	12.2	20.0	5.7	3.7	7.7	1.7	6.6
- Seoul	12.1	23.4	6.8	5.2	9.7	0.1	7.6
Land prices	0.7	1.3	0.1	0.4	0.3	0.5	..

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

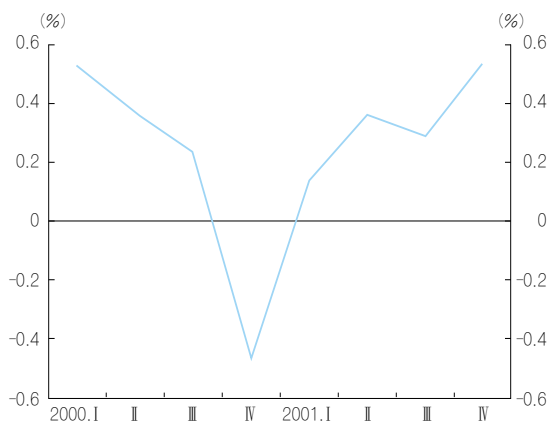
Over the course of 2001, housing prices increased by 9.9% and housing rents 16.4% over their level in the December of the preceding year, greatly accelerating their pace from that during the year 2000. A particularly sharp rise was exhibited in the selling prices of apartments and in the level of housing rents in the Greater Seoul area, which led the overall increase in prices in the housing market.

These steeply increased housing prices and rents were to a large extent the result of an imbalance between the demand and supply of housing. In terms of supply the

number of new housing units fell, reduced by more frequent bankruptcies among construction companies following the currency crisis. At the same time, there was a leap in the demand for housing with demand for apartments scheduled for reconstruction expanding in anticipation of future price rises and speculative demand emerging for housing for rental. In the case of housing rents, the imbalances between supply and demand became evident as householders showed a preference for letting on a monthly rental basis and reconstruction work got underway for a number of large scale apartment complexes.

<Figure II -27>

Trends of Movements¹⁾ in Land Prices



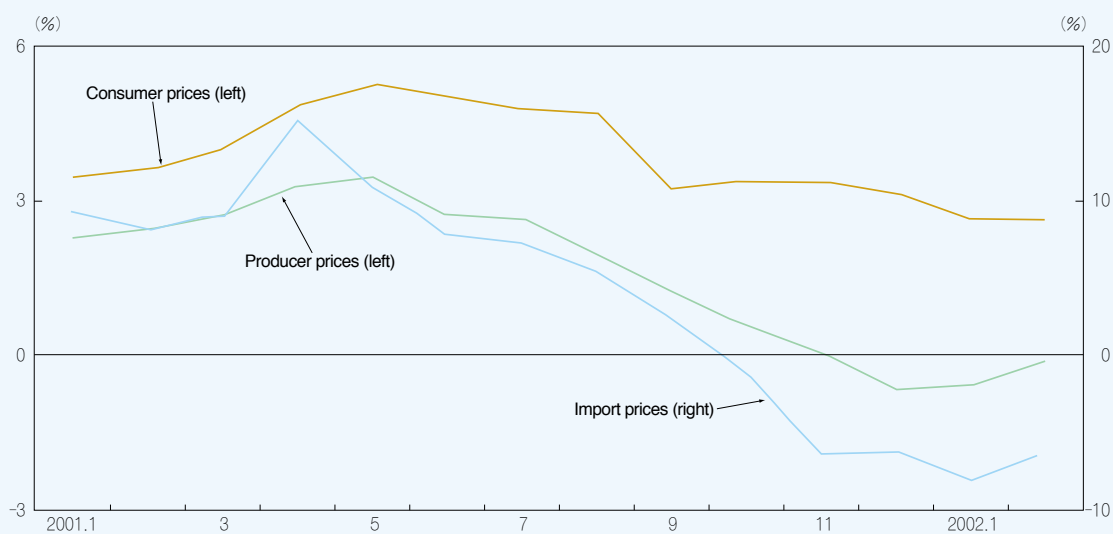
Note: 1) Compared with the last month of the previous year.
Source: Korea Land Corporation.

Nationwide land prices marked a 1.3% rise during the year 2001 from the level in the December of the preceding year, slightly increasing their pace of increase from the previous year(0.7%). It was apparent that this rise was greatly spurred by increased housing prices and the lifting of development restrictions in former green belt areas. Viewed by area land prices rose comparatively more rapidly in Seoul and surrounding suburban areas, where housing prices had greatly increased, and in small and medium-sized towns where zoning restrictions on development had been abolished.

<Box II-1>

Characteristics of Price Movements During the Year 2001

During the year 2001, prices rose steeply during the first half of the year and then their rate of increase slackened or they shifted to a downward track in the second half of the year. From early in the new year, an acceleration of price increases was observed across most categories of prices including consumer prices, producer prices and import prices, but the pace of increase peaked for import prices in April (15.1% year-on-year) and for consumer prices and producer prices in May (5.3% and 3.4% respectively). It then decelerated and, indeed, towards the end of the year, producer prices and import prices fell below their levels of a year earlier.

Trends of Movements¹⁾ in Major Prices

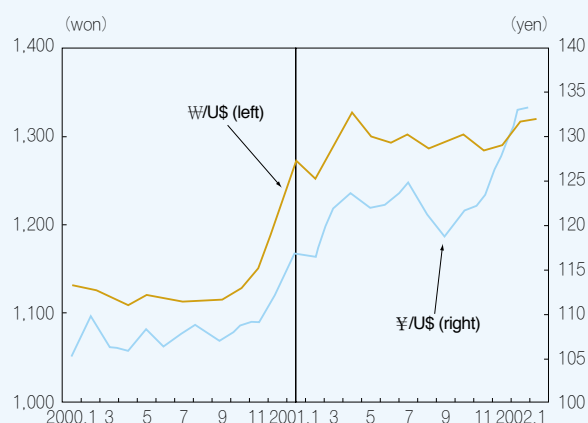
Note: 1) Compared with the same period of the previous year

This pattern of price movements largely reflects the increase of prices during the year as a result of the Korean won's depreciation and the adjustment of charges for public services.

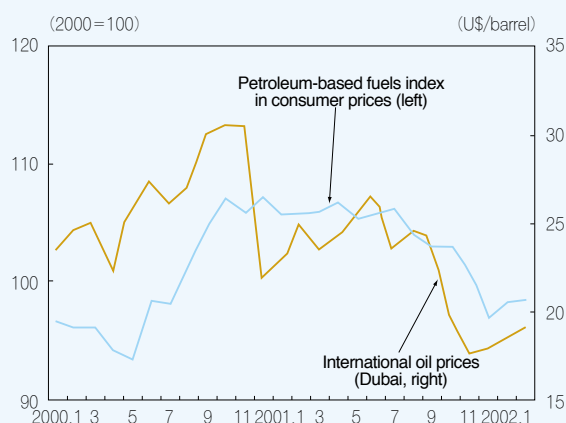
Most strikingly, the Korean won weakened sharply in the year 2001, with its exchange rate against the U.S. dollar, rising 14.2% on an annual average. By period, the Korean won dropped abruptly during the first 4 months of the year and subsequently maintained a generally stable pattern of movements. As a result, the effect of its depreciation fed through gradually into price rises during the first half of the year, causing them to maintain a brisk pace. For import items, prices rose 4.9% on an annual average basis in Korean won terms whereas they fell by some 6.1% on a contract currency basis, which strips out the effects of the Korean won's depreciation. From this it may be concluded that the softening of the currency was the leading factor in the rise in import prices. The upward trend of import prices caused by the weakening of the Korean won had a gradual knock-on effect on both producer and consumer prices. The results of the analysis of the 1998 input-output

tables give an estimated effect from the depreciation of the currency on producer prices and the consumer prices of 4.0%p and 2.6%p respectively. In contrast, international raw material prices, and especially oil prices showed a sharp rise following the terrorist attacks on the U.S., but apart from that they maintained a downwardly stable trend, acting to blunt the pace of price increases.

Trends of Exchange Rates



Trends of International Oil Prices & Domestic Petroleum-based Fuels



The steep rises in the charges for public services also acted as a major contributory factor to price increases during the year 2001. With charges for water, sewage, piped gas and treatment under public health insurance being raised, electricity, water and gas charges were increased 7.3% on an annual average basis in terms of producer prices and public charges 7.5% in terms of consumer prices. The rises in charges for public services were notably concentrated in the latter half of the year 2000 and the first half of the year 2001. In the latter half of the year 2001, in contrast, the upward pressure in charges for public services eased in response to the government's efforts for price stability.

In addition, during the year 2001, the sharp rise in real estate prices made housing rents particularly high in terms of consumer prices, while fanning inflationary expectations. In the course of 2001, housing prices rose 9.9% and housing rents by 16.4% compared with the end of the previous year (Kookmin Bank survey of asking prices), because of which the resulting rise in housing rents among consumer prices stood at 4.1%. In consequence the contribution of housing rents to consumer prices, which had stood at -0.1%p in the preceding year expanded sharply to 0.5%p during the year 2001. The rise in housing rents accounted for 12.2% of the increase in consumer prices (annual average 4.1%).

During the latter half of the year, the slowdown of the pace of consumer price rises was much less sharp than that in the case of import and producer prices. This is because while public service charges and housing rents increased sharply, the share of the services sector, which displays downward rigidity, is 55.0% in the consumer price index as against only 26.5% for the producer price index. Import prices, meanwhile do not include the service sector.

4. Financial Markets

A. Price Indicators

(1) Interest Rates

During the year 2001, both long and short term market interest rates generally maintained a downward trend as a result of the Bank of Korea's conduct of its monetary policy with an emphasis on warding-off an economic recession. From early in the final quarter, however, interest rates shifted to an upward trend on expectations of a recovery of economic activity.

Financial institutions continually reduced lending and deposit rates in reflection of falling market interest rates, their ample liquidity and the reduced corporate demand for funds. From the beginning of the year 2002, though, the downward trend of these rates has evened out in response to the upturn in market interest rates.

(Long-term Market Interest Rates)

Long-term market interest rates fluctuated under the influence of market anticipations of an economic recovery, the Bank of Korea's monetary policy stance, stock market movements, and so forth.

In the early part of the year 2001, business conditions weakened much more than had been expected, leading to widespread anticipations of easier money. Long-term market interest rates, meanwhile, fell sharply in response to the reduction in the Federal Funds rate and the Bank of Korea's downward adjustment of its call rate target(February 8). Yields on three-year Treasury bonds, after testing the 5% level in January, continued

<Table II -15>

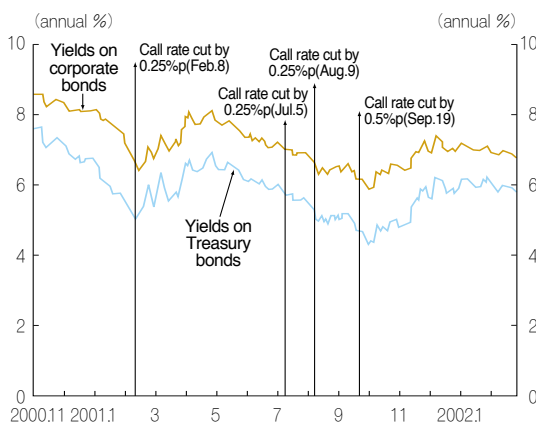
Trends of Major Interest Rates¹⁾

	Dec.2000	2001				2002	
		Feb.	Apr.	Sep.	Dec.	Jan.	Feb.
Call (one day)	6.0	5.1	5.0	3.9	4.0	4.0	4.0
CP (91 days)	7.3	6.2	6.2	4.7	5.1	4.8	4.6
Treasury bonds (3 yrs.)	6.7	5.4	6.8	4.5	5.9	6.0	5.7
Corporate bonds (3 yrs.)	8.1	6.8	8.1	6.0	7.0	7.0	6.7

Note: 1) Month-end basis.

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

<Figure II -28>

Trends of Major Long-term Interest Rates

Source: Korea Securities Computer Corp.

their underlying downward path. On February 6 yields dropped to 5.28% below the call rate(5.31%). Furthermore, they registered 5%, of their lowest ever, on February 12.

After this, long-term market rates shifted to an upward trend, rising sharply until late April in the following environment. Firstly, the perception among market participants gained ground that the scale of the fall of interest rates had been too large. Particularly, market participants began to share the understanding that the interest rate fall after the end of the year 2000 had been partially attributable to a tendency for some investors to engage in short term money plays in search of profits in view of the ample liquidity. Secondly, the real economy, which had been expected to slacken greatly, showed a brighter picture with a steady rise of consumer spending and construction investment. Inflation, meanwhile, had risen above its target level of 4% under the influence of the increased charges for public services and the sharp fall in the exchange value of the Korean won brought about by the weakening of the Japanese yen. In reflection of this, the Bank of Korea refrained from any further lowering of its target call rate while the hopes of an early economic recovery and rising prices acted to put upward pressure on long-term market interest rates. Thirdly, the rise in market interest rates sparked a large-scale redemption of money market funds(MMFs), which in turn itself acted to put further upward pressure on interest rates. Because of the large scale rise in market interest rates, the anticipated yields on MMF funds declined to the point where a large increase in their redemption took place.¹⁾ This centered on institutional investors who

1) Funds under management in MMFs, which had increased by 3.4 trillion won during March, saw an outflow of 3 trillion won between April 1 and 21. The following week, the scale of the withdrawals expanded sharply with 0.23 trillion won on 23, Apr., 0.74 trillion won on 24, Apr., 1.51 trillion won on 25, Apr. and 2.58 trillion won on 26, Apr..

were concerned over the possibility of the loss of their principal.²⁾ In consequence, the upward pressure on interest rates intensified further as investment trust companies sold off the securities operated in their MMFs in order to have funds available for their redemption. Yields on Treasury bonds and corporate bonds, which had fallen to lows of 5% and 6.4%, respectively, rebounded to reach 6.9% and 8.2% as of 26 April under the influence of these factors.

Wishing to moderate the mood of instability gripping the financial markets following the sharp rise in market interest rates, the Bank of Korea announced a package of measures designed to stabilise the bond market; the flexible supply of high powered money, the cancellation of its offers of RPs, and the reduction in the volume of Monetary Stabilisation Bonds.

The upswing in long term market interest rates was checked by the Bank's announcement of measures to stabilise the bond market. Subsequently, they shifted to a downturn amid concerns over the unlikelihood of an early business recovery and in anticipation of a deceleration of consumer price inflation, which had risen sharply in the first half of the year. Furthermore, the Bank reduced its call rate target for three successive months, July, August and September. With the occurrence of the September 11 terrorist attacks on the United States, long-term market interest rates continued to fall in line with forecasts that the economic downturn would be prolonged. This caused yields on Treasury bonds to drop sharply to 4.3% and those on corporate bonds to 5.9% as of October 4.

2) MMFs are in principle valued at historic cost(book price) but if the market price is more than 1% lower than this or if there are fears that such a gap will develop, the underlying securities should be sold. Subsequently, this provision was made more restrictive(0.75% from July 2001, 0.5% from January 2002).

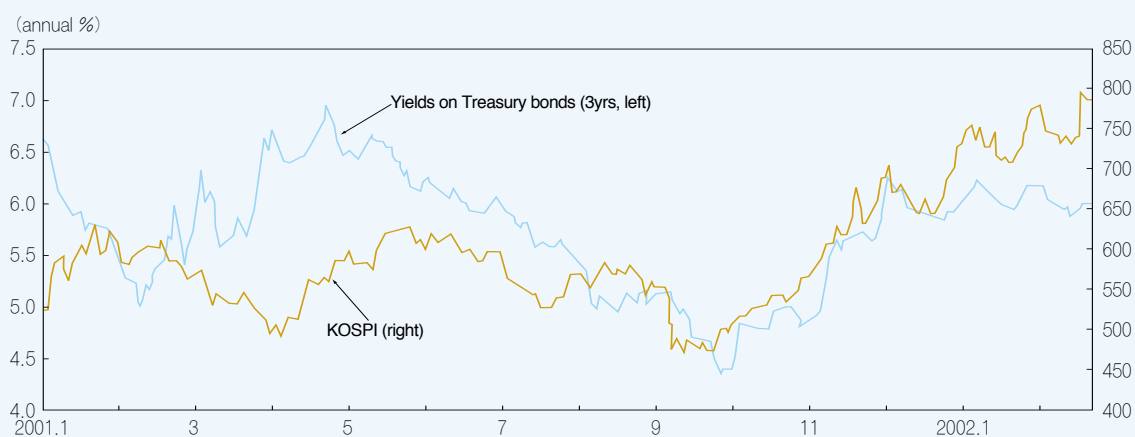
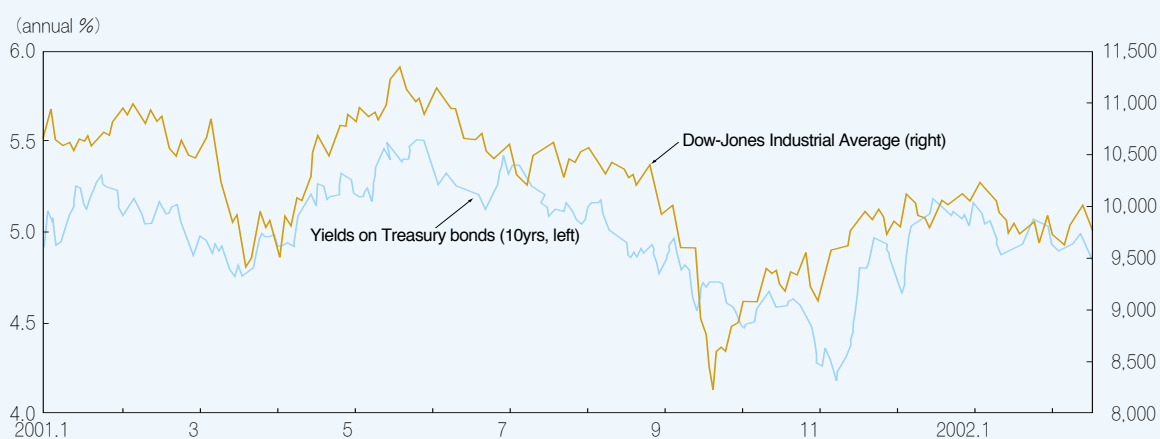
This situation underwent a change from early October. Additional cuts in the call rate were anticipated in the domestic financial market in the wake of repeated interest reductions by the Federal Reserve. Nevertheless, after careful examination of the overall domestic and international environments, the Bank of Korea left the call rate target unchanged at its existing level, considering that there was no great necessity for further interest rate reductions. In addition, the Korean stock market shifted to a sharp upward trend, buoyed by large scale foreign buying of shares. It was synchronised with a rapid rebound of the U.S. stock markets, which had fallen sharply in the wake of the terrorist attacks, on anticipations of an early end to the U.S. war on terror. The stock market rebound and the expectations of economic recovery acted to push up market interest rates, in consequence of which yields on Treasury bonds rose to 5.9% and those on corporate bonds to 7.2% as of November 22. In order to limit the scale of the rise in market interest rates, the Bank of Korea carried out a 1 trillion won retirement of MSBs and outright repurchase of Treasury bonds (announced on November 23 and carried out on the 26th).

Moving into the new year 2002, long term market interest rates exhibited a generally downward pattern, but fluctuated in accordance with the prevailing degree of uncertainty concerning the speed of economic recovery and the prospects of an improvement in the interplay of supply and demand for securities.

<Box II-2>

Synchronisation of Bond Market Rates and Share Prices in Late 2001

In the last six weeks of the year 2001, as anticipations of economic recovery quickened, share prices and the interest rates of long-term bonds quoted on the Stock Exchange both moved upward together, a phenomenon not confined to Korea but also observed in the United States.

Trends of KOSPI and Yields on Bonds**(Korea)****(America)**

Source: Korea Securities Computer Corp., Reuters.

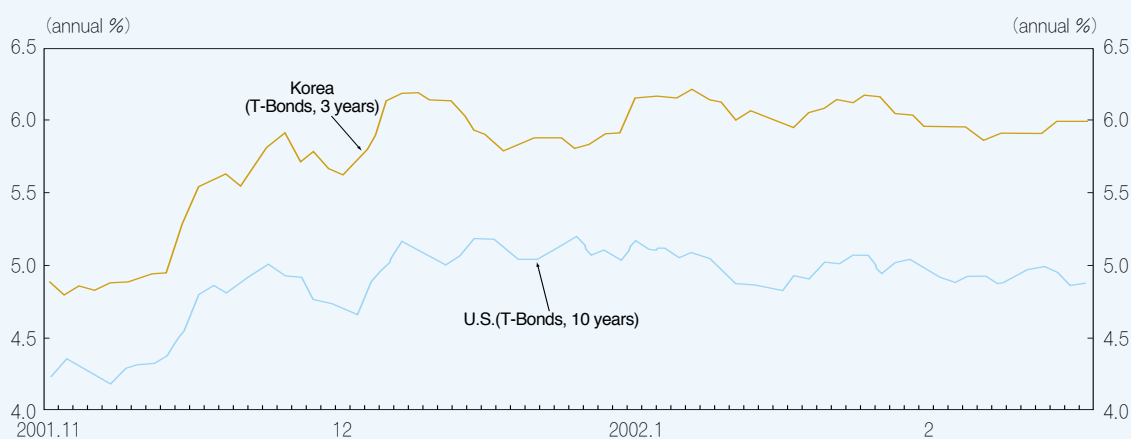
Conventional economic theory has it that interest rates and share prices normally move in opposite directions by way of the following mechanism. Initially, when interest rates drop, there is an improvement in firms' financial structure and profitability. On the other hand the demand for shares, as alternative investment instruments to debt securities, increases and share prices rise. Conversely, when share prices rise, firms' fund-raising through the stock market increases and their need to raise funds through the issue of debt securities

declines, causing interest rates to fall. In addition, where the scale of the increase in share prices is so large that any further increase in earnings performance is considered difficult, the demand for bonds may increase, bringing a fall in interest rates. However, when the rise in share prices brings about a migration of funds from the bond market to the share market, there is the possibility that interest rates will rise as the demand for bonds shrinks.

It should nevertheless be pointed out that whereas share prices and interest rates moved in the same direction in late 2001, it was the expectations factor which impacted on them simultaneously since the power of its influence was greater than the mutually offsetting influence of these two variables on each other mentioned above. For example, where economic actors anticipate an improvement in the level of business activity, there is the prospect that listed firm's profitability will improve. This stimulates the purchase of their shares, causing share prices to rise. In the bond market, meanwhile, market interest rates rise on concerns about an acceleration in inflation accompanying the upturn in business activity. This influence of the expectations variable is greatly magnified because markets react very sensitively to even small signals indicating an economic upturn or recession where a high degree of uncertainty surrounds the economy. Furthermore, in the case of interest rates, a shift to an upward trend in interest rates could easily occur because the monetary authorities have already kept them at a low level under the low interest rate policy.

Towards the end of 2001, the rise in domestic bond market interest rates under the influence of the sharp rise in sovereign bond yield in the U.S. and other advanced countries showed that the phenomenon of synchronicity is not restricted to share prices but also applies in part to interest rates on debt securities.

Phenomenon of Synchronicity Between Yields on Korean and U.S. Bonds



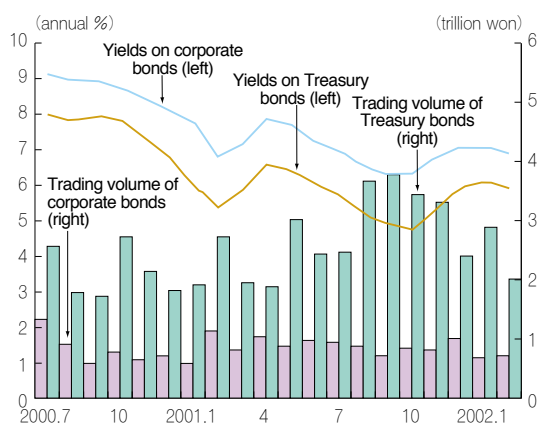
Source: Korea Securities Computer Corp., Reuters.

Average daily bond market turnover(based on Treasury and corporate bonds) expanded greatly during the year 2001, rising from 2.7 trillion won in the preceding year to 3.6 trillion won. This was attributable to brisk dealing activity in search of marginal profits which was fuelled by ample market liquidity, thanks to last year's four successive reductions in the call rate.

In the Treasury bonds market, the average daily volume of transactions expanded when their yields fell but contracted when yields on them rose. During January and February, amid falling yields, turnover expanded to an average daily of around 2.3 trillion won, showing an increase from the end of 2000. As yields rose in March and April, average daily turnover fell back to the 1.9 trillion won level. With the subsequent decline in yields, average daily transaction volume swelled greatly to 3.1 trillion won during the seven months from May to October, before contracting again to 2.8 trillion won following the shift of yields to an upward trend.

<Figure II -29>

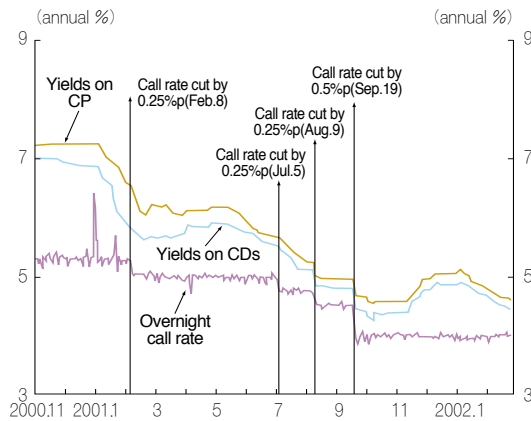
Trends of Yields on Corporate and Treasury Bonds and Trading Volumes



Source: Korea Securities Computer Corp.

The average daily volume of transactions in corporate bonds, which had contracted sharply from August 2000 onwards, expanded slightly early in the year 2001. This was attributable in part to the increased appetite for corporate bonds, which offered relatively higher yields, in a period of falling interest rates. Another contributing factor was the reduction in corporate credit risk as a result of progress in the disposal of insolvent firms. Having languished at 0.71 trillion won during the final quarter of the year 2000, the average daily turnover of the corporate bond market expanded to 0.84 trillion won in the first quarter of the year 2001 and to 0.96 trillion won in the second. Amid mounting concern in the market regarding the large scale of corporate bonds approaching maturity, the average daily transaction volume shrank slightly to 0.86 trillion won in the latter half of the year.

<Figure II -30>

Trends of Major Short-term Interest Rates**(Short-term Market Interest Rates)**

Short term market interest rates maintained a downwardly stable trend in accordance with the Bank of Korea's monetary policy stance.

The overnight call rate was maintained at the level of 5.25% from October 2000 until February 2001. On February 8, the Bank of Korea reduced its target interest rate by 25 basis points, bringing it down to 5%, in the face of an economic slowdown.

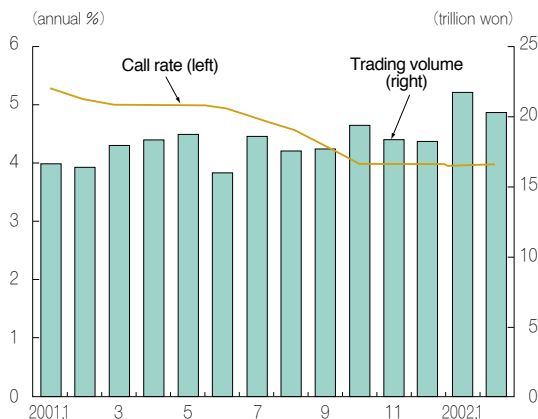
Afterwards, to ward off an economic recession, the target rate was again reduced on July 5 and on August 9, each time by 25 basis points, to stand at 4.5%.

In September, call rates fell to their lowest ever level of 4% following the Bank of Korea's 50 basis points cut in its target call market rate, which was made in order to soften the impact of the terrorist attacks on the United States.

The average overnight call rate moved smoothly downwards in response to these actions. Specifically, by period, it averaged 5.25% from January 1 2001 until February 7; 4.98% from February 8 until July 4; 4.75% from July 5 until August 8; 4.49% from August 9 until September 18; and 3.98% from September 19 until December 31.

Looking at the scale of call market transactions, average daily transaction volume during the year 2001 stood at 17.9 trillion won, an 11.1% increase over the previous year (16.1 trillion won). This was attributable to the great expansion of demand for call market loans as branches of foreign banks sought to adjust their positions arising from transactions involving non

<Figure II -31>

Trends of Call Rate and Call Market Trading Volume

<Table II -16>

**Movements of Net Call Borrowings¹⁾ in
the Call Market by Major Participant**

(daily average, hundred million won)

	2000			2001		
	Borrowing	Lending	Net borrowing	Borrowing	Lending	Net borrowing
Domestic banks	37,492	9,425	28,067	48,712	26,821	21,891
Foreign bank branches	25,518	1,278	24,240	54,918	1,353	53,565
Securities companies ²⁾	71,860	3,243	68,617	44,886	2,124	42,762
Trust accounts of banks	-	6,733	-6,733	-	11,279	-11,279
ITMCs	-	119,094	-119,094	-	112,693	-112,693

Notes: 1) Based on intermediary transactions.

2) Includes ITCs' own account before ITSCs' separation.

Source: The Bank of Korea.

delivery forwards (NDF)³⁾ and the expansion of arbitrage exploiting the spread between long-term and short-term interest rates, which more than offset the reduction of the demand from securities companies for call funds due to the contraction of their unsold beneficiary certificates and the associated call loans.⁴⁾

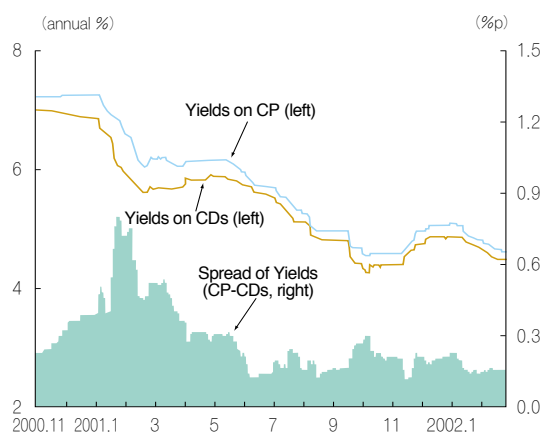
Yields on 91-day commercial paper(CP) continued to fall throughout the year 2001. This was because of financial institutions' increased appetite for CP as a vehicle for the operation of their short-term funds in line with the concentration of market funds at the short term end of the yield curve. Remarkably, while the call rate target was reduced three times from June onwards, the uncertainty of economic prospects and the intensification of the phenomenon of the short-termism of market funds owing to long-term market interest rates' fall caused yields to fall to around 4.5% by mid-October. But from mid-November onwards, because long-term market interest rates rose and investment trust companies' demand for short term securities contracted due to the decline of capital inflows, yields on CP rose to the 5% level in December. Moving into 2002, however, they fell slightly below 5%.

Yields on CDs(91 days) moved with a stable spread over those on CP because the issuer of CDs are banks,

3) Generally, branches of foreign banks hedge their exchange rate risk arising from NDF transactions through purchasing spot exchange while mainly sourcing the required Korean won funds through the call market.

4) Associated call is when an investment trust securities company (formerly an investment trust company's account) borrows funds through a call brokerage company from its subsidiary investment trust management company(formerly an investment trust company's trust account). Under the measures for promoting the stock market of December 1989, a scheme was put in place whereby investment trust companies' own accounts were able to borrow from their trust accounts in order to redeem loans taken out from banks for the purchase of shares, which were in default because of the fall in share prices. As of year end 2001, the outstanding amount of associated call had fallen by around 1 trillion won from the end of the preceding year to stand at 1.798 trillion won.

<Figure II -32>

Yields on CDs & CP and Spread of CP over CDs

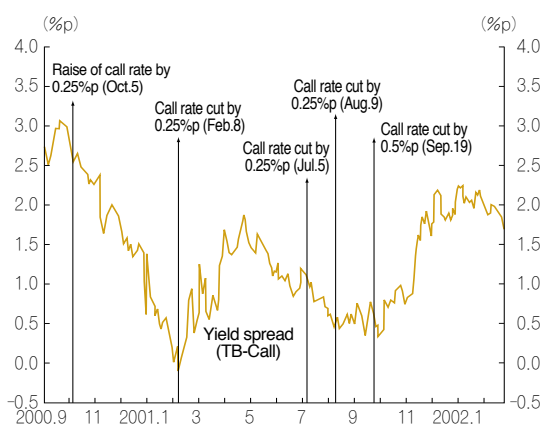
Source: Korea Securities Computer Corp.

which have a comparatively higher credit standing and lower risk weighting than the companies which issue commercial paper. The spread enlarged to 80 basis points in early 2001, but it narrowed to 10 basis points in response to the easing of some companies's liquidity shortage, the ample liquidity available in the financial markets and the fall of market interest rates. Accordingly, yields on CDs continued to retreat from a level of around 6% at the beginning of 2001, falling to below 4.5% in October 2001. In recent months, yields rose slightly to around 4.5%.

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

The spread between short- and long-term interest rates, and especially between the overnight call and three year Treasuries, moved mainly according to the movements of yields on three-year Treasuries.

<Figure II -33>

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

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

The spread, which had narrowed sharply from September 2000, fell to below 1%p reflecting the fall of long-term interest rates. In February, the spread inverted temporarily as long-term interest rates fell below than the short-term interest rates.

During the period from March to April, the spread, which had moved around below 1%p in February, widened to 2%p as the overnight call rate was maintained at its existing level by the Bank of Korea while long-term interest rates firmed due to the easing of the economic recession and concern over price instability. From May onwards, the spread showed a narrowing pattern as long-term interest rates began to sink. Particularly, when the Bank of Korea cut its call rate target by 25 basis points on July 5, long-term interests declined more sharply. Hence the spread contracted to below 1%p at the end of July. From

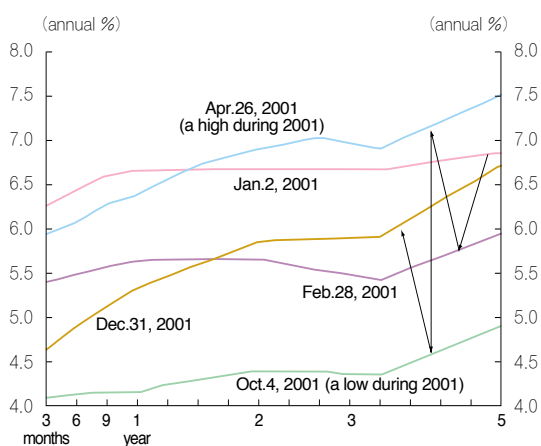
August onwards, although the Bank of Korea reduced the call rate in two successive months, the spread scarcely budged from its previous level, in contrast to the situation in July, because long-term interest rates had fallen on roughly the same scale as the call rate.

In the last quarter, short term interest rates showed only minor fluctuations as the Bank of Korea kept its call rate target unchanged. Long-term interest rates, on the other hand, shifted to an upward trend on the revival of the stock market and anticipations of economic recovery. As of the year-end, the spread between long-term and short-term rates had widened to as much as 2%p.

In early 2002, the call rate target was maintained at its existing level but long-term market interest rates eased slightly, causing the interest rates spread to narrow to between 1.5% and 2%.

<Figure II -34>

Yield Curves of Treasury Bonds



Source: Korea Securities Computer Corp.

Reflecting these movements of the spread between long-term and short-term interest rates, the yield curve on Treasury bonds showed repeated phases of steepening and flattening.

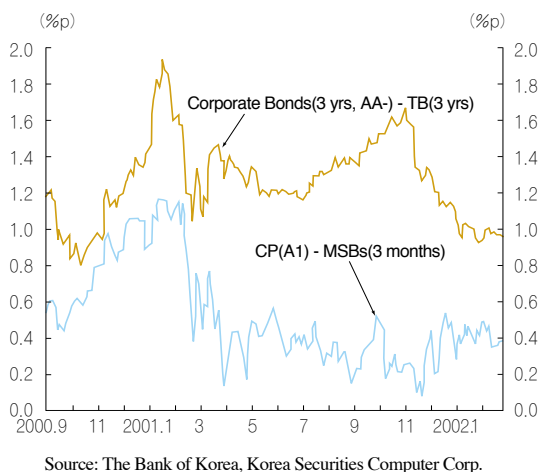
It flattened out during January and February and from May through September when interest rates were falling, but steepened during March and April and from October onwards when interest rates were again on the rise. The fact that the slope of the yield curve underwent repeated shifts on several occasions during the year appears to show that the depth of uncertainty concerning the prospects for the economy and prices was great.

(Risk Premiums)

Risk premiums, spreads between the yields on risk-bearing and risk-free assets, exhibited a generally narrowing pattern during the year 2001. This narrowing reflected the fall in market interest rates, together with the easing of the flight to quality and the progress in the disposal of several insolvent companies, which acted to reduce corporate credit risk.

<Figure II -35>

Trends of Risk Premiums



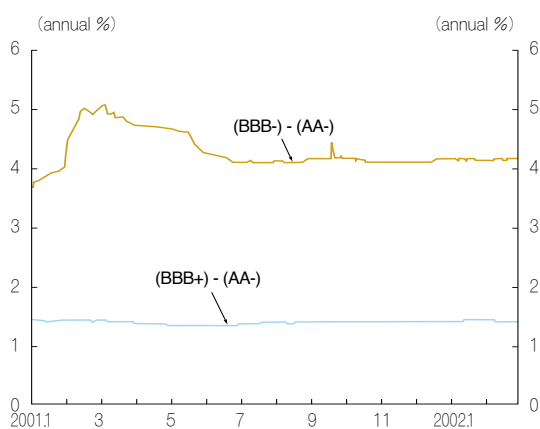
Source: The Bank of Korea, Korea Securities Computer Corp.

The long-term risk premium(yields on AA-rated three year corporate bonds as against yields on three year Treasury bonds) had continued to widen until the end of January 2001, but from February onwards, it narrowed as a result of the easing of investors' flight to quality caused by the progress in corporate restructuring and the reduction in market interest rates. From early July, a mood of instability in the markets nurtured by the bunching of maturities of corporate bonds during the second half of the year and the liquidity problems of Hynix Semiconductor. This led to a renewed widening of risk premiums. They narrowed again, however, from November thanks to the easing of corporate credit risk on the back of expectations of economic recovery and the soothing of market fears by the announcement of a plan to provide funding support to Hynix Semiconductor and the amelioration of the situation with regard to the concentration of corporate bond maturities.

The short-term risk premium(yields on A1 rated CP with a maturity of 91 days versus yields on MSBs with a maturity of 91 days) generally exhibited the same movements as the long term risk premium while responding sensitively to changes in investment trust companies' short-term deposit. With the large increase in their deposit-taking during the first quarter and in July and August, investment in higher yielding, risk

<Figure II -36>

Trends of Spread on Corporate Bonds by Credit Rating



Source: Korea Securities Computer Corp.

<Table II -17>

Trends of Spread Between CPs by Credit Rating

(month-end basis)

	(annual %)							
	2000		2001				2002	
	Dec.	Jan.	Mar.	Jun.	Dec.	Jan.	Feb.	
A1-rated(a)	7.26	6.66	6.19	4.96	5.07	4.80	4.60	
B-rated(b)	11.61	10.98	10.40	9.15	9.32	9.02	8.81	
Spread(b-a)	4.35	4.32	4.21	4.19	4.25	4.22	4.21	

Source: Korea Securities Computer Corp.

bearing assets also expanded, causing the short-term risk premium to narrow. However, it widened again from early October as yields on risk bearing commercial paper rose sharply following the lessened demand for short-term assets due to the reduction in deposit-taking by investment trust companies and the rise in long term market interest rates.

Spreads among the various levels of investment grade corporate bonds exhibited a largely stable pattern of movements. The benchmark spread between BBB- and AA-corporate bonds widened to reach 5%p at the end of February as yields on highly rated bonds dropped sharply in response to a sudden and abrupt expansion of demand for high-grade bonds generated by a decline in yields on Treasury bonds at the beginning of the year. In accordance with the continuing issuance of primary CBO(Collateralized Bond Obligations) and the smooth operation of the prompt underwriting scheme for corporate bonds, the market became more favourable for the issuance of lower grade corporate bonds and the spread gradually contracted to move stably in a range of between of 4%p and 4.5%p from the end of May onwards. The interest rates spread between corporate bonds rated BBB+ and those with an AA-grade moved with little variation during the year at around 1.4%p. It was noteworthy that when yields on AA-corporate bonds dropped sharply in early February, those on BBB+ corporate bonds followed them downwards in virtual lockstep.

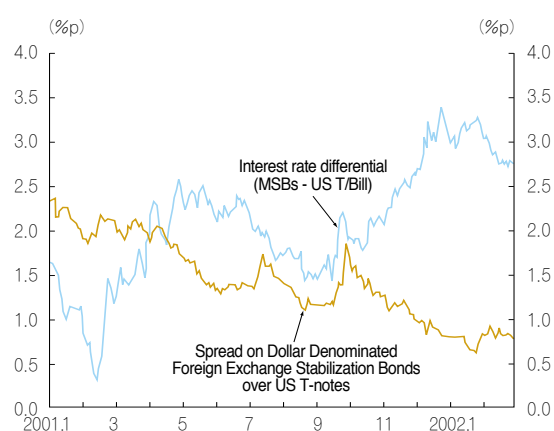
Meanwhile, the expansion of demand for commercial paper, generated by the market's preference for the operation of funds at the short term end, generally led the premium between B grade commercial paper and A1 grade to move stably in the region of 4.2%p during the year.

(Domestic-Foreign Interest Rate Differential and Premiums on Dollar Denominated Foreign Exchange Stabilization Bonds)

The differential between foreign and domestic interest rates generally widened in response to the continued reduction of international interest rates.

<Figure II -37>

Trends of Interest Rate Differential and Spread of Dollar Denominated Foreign Exchange Stabilization Bonds over US T-notes



Source: The Bank of Korea, Federal Reserve Board.

The differential between them on the basis of paper with a maturity of 12 months (yields on MSBs vs. U.S. Treasury bills) narrowed greatly to 0.3%p during January and early February 2001 as yields on short term domestic paper fell steeply. It subsequently widened from mid-February, reaching 2.4%p at the end of April as several leading domestic interest rates shifted to an upward trend whereas U.S. bond rates fell in response to the Fed's lowering of interest rates. Thereafter, it moved undramatically within a range of 2 to 2.5%p as domestic and foreign interest rates fell on a similar scale.

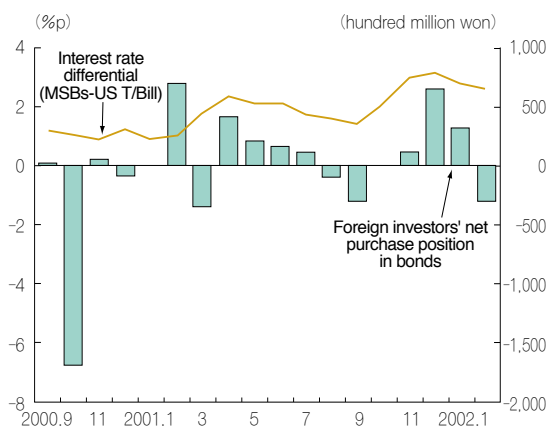
From July onwards, as the Bank of Korea lowered interest rates on two occasions, promoting a steep fall in domestic market interest rates, the differential narrowed to 1.7%p as of the end of August.

Following the events of 11 September, it widened somewhat as a result of the sharp decline in U.S. bond yields generated by the U.S. Federal Reserve's substantial reduction of interest rates. From October onwards, as MSB yields rose sharply on the possibility of an early recovery of the domestic economy whereas U.S. bond market rates staged only a slight rise, the differential between rates at home and abroad widened to the 3.2%p level toward the end of the year.

The scale of foreign net purchases of domestic bonds during the year 2001 stood at 0.15 trillion won, very

<Figure II -38>

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.

much lower than the scale of foreign net purchases of shares(8.9 trillion won). Looking at the linkages between foreigners purchases of domestic bonds and the differential between domestic and foreign interest rates, as the differential widened during the first half of the year, foreign investors increased their purchases of short term securities such as MSBs which offer a high degree of security, maintaining a net buying position. During the third quarter when it narrowed, they preferred to run down their positions. As the differential between domestic and international interest rates widened again in the final quarter, they returned to a net purchase position.

The spread over U.S. Treasury notes on Dollar-denominated Foreign Exchange Stabilisation bonds fell steeply during the course of the year. This was attributable to the fact that, at a time when the international financial markets' appetite for Asian bonds was increasing, Korea's sovereign ratings was upgraded on the strength of its favourable economic performance.

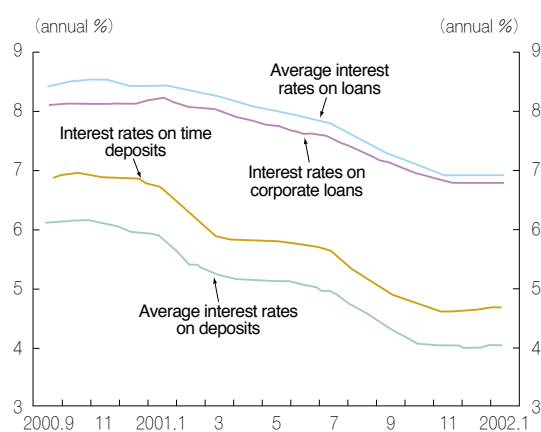
It was above all the Federal Reserve's interest rate reductions and the ensuing abundant international liquidity that brought about the high demand for the sovereign bonds of newly emerging market issuers. In addition to this, the Argentine debacle brought about the migration of funds away from the Latin American region to concentrate on Asian sovereign bonds, which appeared to offer stability and high yields. This contributed to the reduction of the premium on Asian bonds. The events of September 11 led to a temporary hike in the premium, but it quickly fell back again as the international financial markets regained stability thanks to the endeavors of central banks around the world with this end.

Furthermore, while in most Asian countries apart from China, economic activity was in the doldrums, Korea achieved a convincing performance with GDP growth of around 3%. The international financial markets also recognised Korea's relatively high degree of progress in comparison with Japan in the pursuit of financial and corporate restructuring. Reflecting these factors, the premium on Foreign Exchange Stabilisation Bonds narrowed from 235 basis points at the beginning of the year to 81 basis points as of the year-end. The Korea premium on Foreign Exchange Stabilisation Bonds, which had begun the year wider than that on Chinese, Malaysian and Thai sovereigns, narrowed to below the premium on those countries' bonds by the year end.

(Interest Rates on Deposits and Loans of Financial Institutions)

<Figure II -39>

Trends of Interest Rates on Bank Deposits and Loans



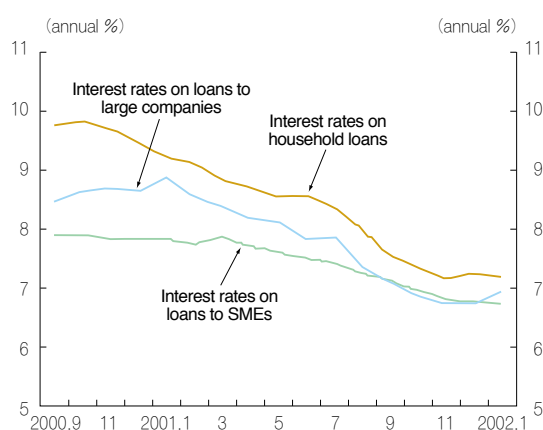
Source: The Bank of Korea.

Financial institutions' interest rates on deposits and loans fell continuously in the course of the year 2001 in view of the weakening of the demand for funds amid the business downturn, the drop in long-term and short-term market interest rates, and their abundant liquidity.

During January 2001, banks' average lending rate (on the basis of amounts newly extended) rose slightly from the previous month's 8.4% to 8.5% in response to an increase in overdraft lending, which carries a high interest rate. It subsequently fell to the 8.1% level by mid-April. This was attributable to two main factors. Backed by ample liquidity, banks followed a strategy of expanding loans to households centering on mortgage lending, which carries a low risk and a favourable risk weighting in the calculation of the BIS capital adequacy ratios. As a consequence, households' lending rates fell to a great extent. They also mounted a campaign to expand lending to outstanding small and

<Figure II -40>

Trends of Interest Rates on Bank Loans by Borrower



Source: The Bank of Korea

medium enterprises in a situation where corporate demand for funds remained lacklustre as a result of the business slowdown. Therefore, corporate lending rates continued their downward path.

Banks' lending rates eased to 7.3% in September, reflecting the constant downward path of market interest rates in view of the increased proportion of lending with floating rates tied to market interest rates. Even though market interest rates shifted to an upward trend from October onwards, fuelled by their ample liquidity, banks applied reduced premiums on lending to the household sector and to outstanding small and medium enterprises. Their average lending rate, in consequence, eased further to stand at 6.9% in December.

Viewed by borrower, banks' interest rates on lending to households fell by a large margin. Specifically, the average interest rate on such lending dropped from 9.88% during the year 2000 to 8.23% in 2001, a reduction of 1.65%p which was much larger than the 0.69%p decline in their corporate lending rate over the same period(8.18% in 2000 → 7.49% in 2001).

The average interest rate on bank deposits(on the basis of amount of new deposit-taking) pursued a generally downward path during the year in a situation in which, after the initially active migration of funds at the beginning of the year following their structural reform and the introduction of the system of only partial deposit insurance coverage, banks were able to focus on increasing profitability rather than attracting deposits, thanks to the fall in market interest rates and the ample liquidity available.

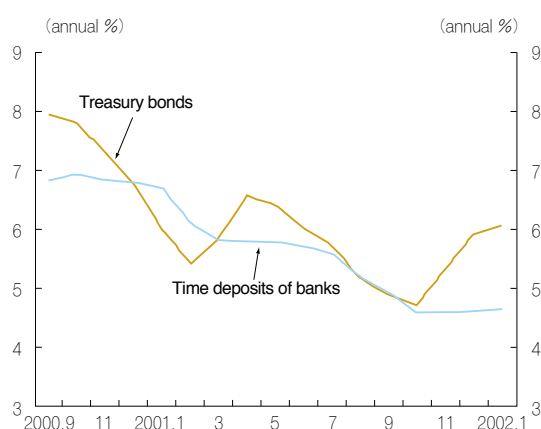
A reduction in deposit rates, which had begun in November 2000, accelerated in the early part of the

year 2001. Banks' deposit interest rates dropped 0.84%p from 6% at the end of 2000 to 5.1% in April.

From early May, the downward course of banks' deposit interest rates was greatly eased. The explanation for this was that several banks expanded their practise of applying preferential interest rates to retain large value deposits while several of the more recently established nationwide commercial banks, whose reputation had increased since the currency crisis, set interest rates on time deposits at a slightly higher level than that offered by those banks that had received injections of public funds, in order to ward off any encroachment on their deposit base following the progressive easing of discrimination according to banks' credit standing.

<Figure II -41>

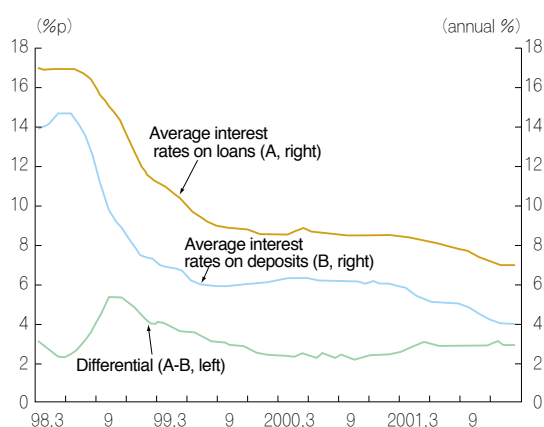
Interest Rates on Time Deposits of Banks and Yields on Treasury Bonds



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

<Figure II -42>

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



From July onwards, however, against the backdrop of the Bank of Korea's three reductions of the target level of its call interest rate, banks adjusted deposit interest rates rapidly downward so that the average deposit interest rates reached 4% in October.

From November onwards, while market interest rates turned upward, some banks offered preferential interest rates on long-term time deposits to counter any consequent lowering of their liquidity ratios with the structure of deposits shifting towards the short term. This brought a levelling-off of the decline in the average deposit rate and its modest rise early in the new year.

Banks' time deposit interest rates generally moved in line with the market based yields on Treasury bonds, but showed a somewhat different pattern in their response when market rates rose or fell. Specifically, when market rates were easing, banks adjusted their deposit interest rates downward by a corresponding margin, but when they were on the rise, banks reduced

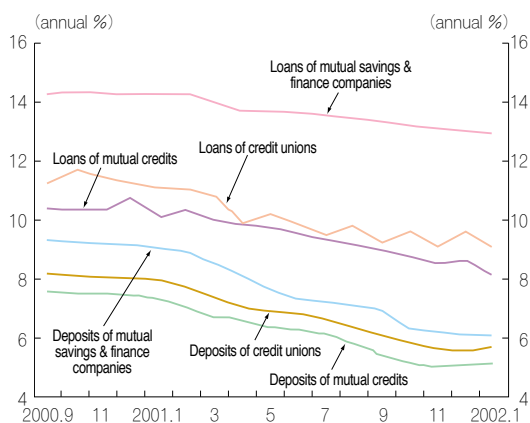
the scale of their interest rate reductions or carried out only a small-scale increase.

Meanwhile, the spread between banks' deposit and lending interest rates widened from 2.5%p as of the end of the year 2000 to 2.9%p at the end of December 2001. This was attributable to the fact that despite intense competition among financial institutions for lending to outstanding customers, banks boldly lowered their deposit interest rates by an even larger margin than the reduction of their lending interest rates.

The lending and deposit interest rates of non-bank financial institutions, meanwhile, saw a generally downwardly stable trend.

<Figure II -43>

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



Source: The Bank of Korea.

Their average lending interest rates (on the basis of amounts newly extended) declined constantly as a result of the overall slackness of the demand for funds and the decline in the cost of raising funds. Mutual savings & finance companies' lending interest rates (bill discount basis) declined to 13% during the December of the year 2001, a 1.2%p reduction from that prevailing in the same period of the preceding year. Those of credit unions fell by 1.7%p (11.3% → 9.6%) and those of mutual credits fell by 2.0%p (10.7% → 8.7%) over the same period.

The average deposit interest rates (on the basis of new deposits taken at fixed interest rates) fell even more steeply than the average lending interest rates in view of the lowering of deposit interest rates by banks, with which they are in competition, and the desirability of ensuring an appropriate spread. Mutual Savings & finance companies' deposit interest rates registered the largest reduction, falling by 3.1%p year on year to stand at 6.1% during December 2001. Those of credit unions and mutual credit both witnessed a 2.5%p

reduction(8.0% \rightarrow 5.5% and 7.4% \rightarrow 4.9% respectively).

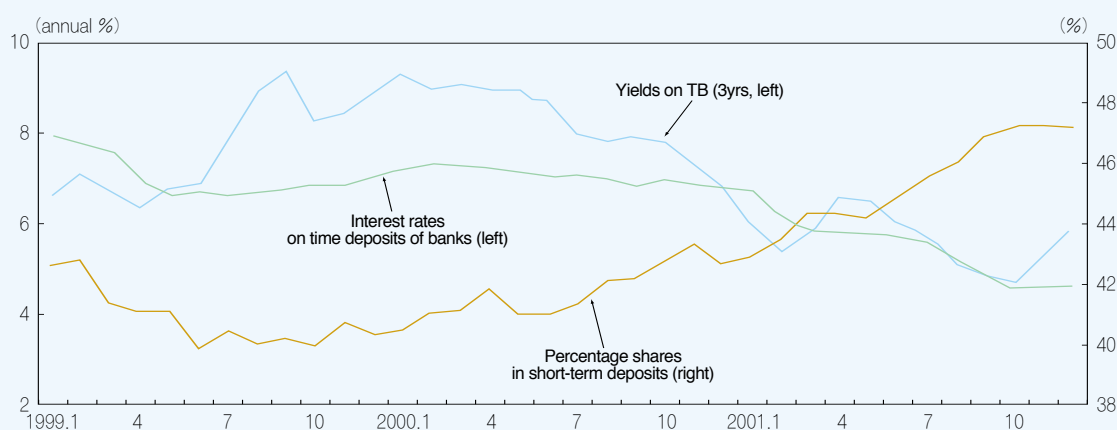
Looking at the spread between lending and deposit rates of these non-bank financial institutions in the last month of the year 2001, that of mutual savings & finance companies was the widest at 6.9%p as compared to credit unions' 4.1%p and mutual credit's 3.8%p. A major factor contributing to this was that mutual savings & finance companies, whose cost of funds is higher, expanded lending at high rates of interest to customers whose credit risk is relatively larger, amid the intensification of competition among financial institutions for lending to the best customers.

<Box II-3>

The Decline of Interest Rates and Changes in Financial Institutions' Deposit Structure

Examining the composition of long term and short term deposits in the deposit structure of the principal types of financial institutions (on an average balance basis of banks, trust accounts of banks, investment trust companies and merchant banking corporations), there was an intensification of the short-termism of financial institutions' deposit products, which had been evident since the latter half of 1999. The proportion of their short term deposit products (less than 6 months) climbed sharply from 42.7% at the end of the preceding year to 47.2% as of the end of the year 2001.

There are two main factors contributing to the shift toward the short term in the holding of financial institutions' deposit products. Firstly, there has been a high degree of uncertainty surrounding finance and the economy in the ongoing process of structural reforms. And there has also been a reorganization of all aspects of the financial system including the introduction of mark to market pricing for bonds and a system of only partial deposit insurance coverage. The general public have, therefore, looked not simply for high rates of return, but also security and liquidity when selecting financial assets. Secondly, expectations persisted of a rise in interest rates, especially among less sophisticated savers, in the course of the downward trend of both market interest rates and financial institutions' deposit interest rates. Taking last year as an example, the shift towards the short term became especially rapid in the months from May to September when interest rates fell sharply, but the phenomenon became less clearly marked from October onwards when interest rates shifted to an upward trend.

Trends of Market Rates and of Percentage Shares in Short-term Deposits of Financial Institutions

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

<Table II -18>

Stock Market Trends

	2000	2001		2002	
		first half	second half	Jan.	Feb.
KOSPI ¹⁾	504.6 (-50.9)	595.1 (17.9)	693.7 (37.5)	748.1 (7.8)	820.0 (18.2)
Volume (ten thousand shares) ²⁾	30,614	41,830	52,726	71,614	64,048
Value (hundred million won) ³⁾	26,021	20,078	19,839	41,032	35,213
KOSDAQ Index ¹⁾	52.6 (-79.5)	76.9 (46.1)	72.2 (37.3)	77.4 (7.1)	78.7 (9.0)
Volume (ten thousand shares) ²⁾	21,191	41,647	35,147	34,893	31,385
Value (hundred million won) ³⁾	24,005	21,072	13,556	14,913	13,497

Notes: 1) Based on period-end.

2) Daily average.

3) Figures in parentheses refer to percentage changes compared with the previous year-end.

Source: Korea Securities Computer Corp.

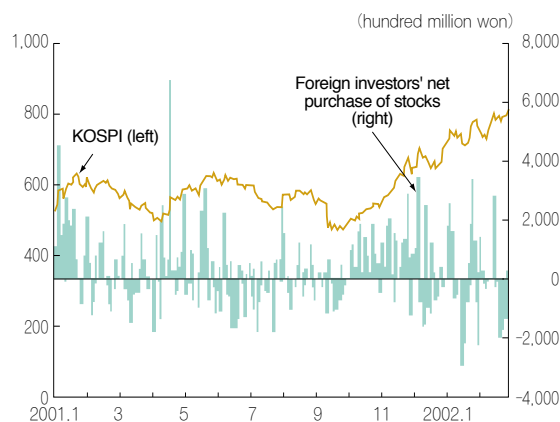
(2) Stock Prices

Stock prices witnessed a pattern of repeated fluctuations in line with changing domestic and international conditions until the third quarter last year, but from the second half of September onwards, they rose by a large margin in response to heavy foreign buying and growing anticipations of economic recovery. This trend persisted into the early part of the year 2002.

(Korea Composite Stock Price Index)

Stock prices had fallen steeply during the year 2000 because of the deterioration of the market environment through a rise in international oil prices, prospects of an economic downturn and financial market instability. From early January 2001, however, they shifted to an upward trend, influenced by hopes for an improvement in the external environment following the U.S. Federal Reserve's reduction of interest rates and net purchases by foreign investors. The composite stock price index(KOSPI), which had registered 627 on January 22, soared 24% in just 3 weeks.

<Figure II -44>

Trends of KOSPI and Foreign Investors' Net Purchase of StocksSource: The Financial Supervisory Service,
Korea Securities Computer Corp.

From mid-February, they, however, shifted to a downward trend amid growing signs of weakness including a mood of caution following an abrupt rise within a short period, the weakness of American share prices in line with the gathering slowdown of U.S. business activity, the depreciation of the Korean won and the liquidity problems of Hyundai Engineering & Construction. By early April, KOSPI had fallen back to the 500 point level.⁵⁾

5) In order to stimulate stock market activity, the government announced a plan to expand the scale of share purchases by major pension funds including the National Pension Fund from the current 8 trillion won to the 25 trillion level within two to three years, and declared its intention to commence by raising the scale of such investment by 6 trillion won within the year 2001.

From mid-April until the end of May, stock prices climbed higher as foreign investors expanded their net purchase position under the influence of the more stable tone of the Korean won, the merger agreement between Kookmin Bank and Housing & Commercial Bank, the U.S. Federal Reserve's additional interest rate reductions and the expansion of the Korean weighting following the change in the composition of the MSCI (11.5% → 14.8%). Similarly, Korean investors increased their share buying activity backed by the continuing increase in customers' security deposit accounts. Together this enabled KOSPI to reach 632 on May 29.

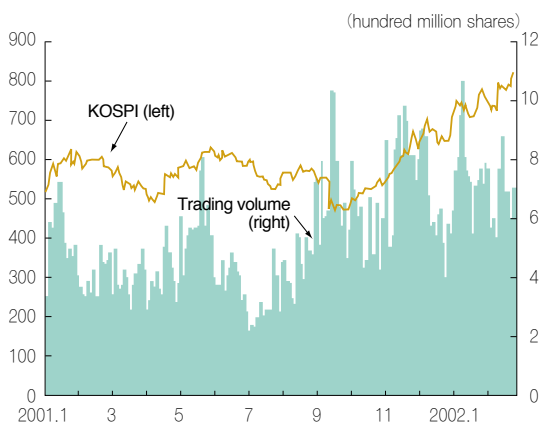
Stock prices shifted back to a downward trend from early June. With the acceleration of the fall in semiconductor prices, financial markets showed signs of instability in the face of structural adjustment problems at several large companies, and especially Hynix Semiconductor, and the large scale of corporate bonds nearing maturity in the latter half of the year. The international financial markets were also troubled by the heightened risk of Argentina's default on its debts. This caused KOSPI to slide back below the 500 level again. In the wake of the events of September 11 and the imminent so called war on terror, there was widespread concern over the volatile global political situation and a long-lasting worldwide economic recession, prompting a renewed fall in KOSPI to 480 as of the end of September.

From the end of September, the fundamental trend of stock prices turned upward. Externally, foreign stock markets, and especially the U.S. markets, recovered rapidly on the prospect of an early conclusion of the war on terror. Internally, an early recovery of business activity was anticipated with a number of economic indicators giving a favourable picture. In addition,

there was renewed recognition that the Korean economy was delivering a better growth performance than that of its rivals such as Taiwan and Singapore and Korea's credit standing saw a rapid improvement. In recognition, Standard and Poor's upgraded Korea's sovereign rating(BBB- → BBB+) on November 13. This coincided with the return to an upward trend of semiconductor prices, which had fallen sharply for some time, while prospects improved greatly for an early solution to the problems of Hynix Semiconductor that had acted to weaken the stock market. Buoyed by these factors, foreign investors began large scale purchases in response to which KOSPI surged 37.5% from its level at the end of the preceding year (504.6) to register 693.7 as of the end of December 2001.⁶⁾ With the large scale of the increase in the prices of listed shares, total market capitalisation expanded sharply from 188 trillion won as of the year end 2000 to stand at 256 trillion won as at the end of the year 2001.

<Figure II -45>

Trends of KOSPI and Trading Volume



Source: Korea Securities Computer Corp.

In the early months of 2002, stock prices rose sharply thanks to anticipations of economic recovery, boosted by the favourable movements of economic indicators, and several blue-chip company's improved their profits. KOSPI thus registered an 18.2% rise from the level of the end of 2001 to reach 820 as of the end of February, the first time it had reached this level in the nineteen months since July 2000.

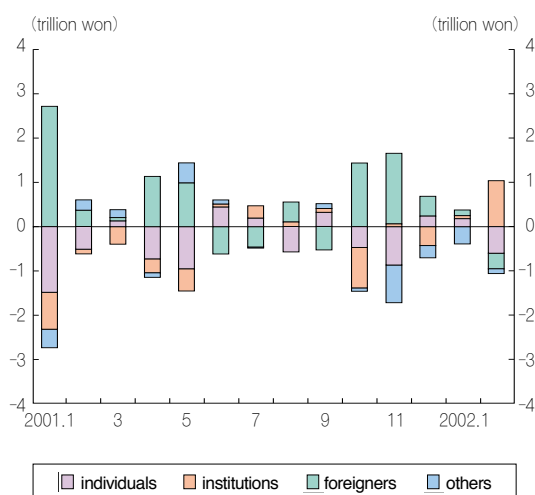
6) Viewing the increase rates of stock prices in several countries, stock prices declined in most of them, but rose sharply in Korea.

	end of yr.2000 (a)	end of yr. 2001 (b)	Increase rate of stock prices (b/a-1) × 100
KOR(KOSPI)	505	694	37.5%
USA(DJIA)	10,787	10,022	-7.1%
UK(FTSE 100)	6,223	5,217	-16.2%
JPN(Nikkei 225)	13,786	10,543	-23.5%
HG(HangSeng Index)	15,096	11,397	-24.5%
Singapore(STI)	1,927	1,624	-15.7%

Stock trading volumes varied with the state of the stock market. Average daily turnover rose sharply from the 310 million shares of December 2000 to reach 510 million shares in January 2001 reflecting the rise of stock prices in January. In the February to April period, stock prices fell and the trading volume also shrank 370 million shares. With stock prices showing a recovery trend during May, share turnover again rose to the 530 million share level a day, and then fell back to the 360 million share level as stock prices fell in the June to August period. From mid-September onwards, however, stock prices showed an underlying upward trend and for the last four months of the year, the average daily share trading volume climbed steeply to 620 million shares. Stock prices held to their fundamental upward trend in the early months of 2002, generating brisk share trading activity and causing daily turnover to rise well above the previous year's level to reach 680 million shares.

<Figure II -46>

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



Source: Korea Securities Computer Corp.

Viewing stock transaction by class of investor, institutional investors, including investment trust management companies, non financial companies and individuals showed a net selling position whereas foreign investors were net purchasers.

Foreign investors' total net purchases on the course of the year 2001 registered 7.6 trillion won, with net buying on a much smaller scale than last year's (11.5 trillion won). For the first half of the year, their total net purchases reached 4.7 trillion won, since Korean shares were regarded as being undervalued and the interest rate reductions in the United States and Korea aroused expectations of a recovery of domestic business activity. In the third quarter, however, there were worries that the Korean economic recovery might be delayed while the international markets were disturbed as the risk of Argentina's default on its debt

augmented. On top of this came the terrorist attacks on the United States. Foreign investors thus took a net selling position to the tune of 0.5 trillion won. From the beginning of the last quarter, as the international financial market became stable and the credit rating of Korea was also upgraded, foreign investors' net purchases again expanded sharply to 3.4 trillion won for the three-month period.

<Table II -19>

**Trends of Foreign Investors' Net Purchase¹⁾ and
Net Inflow of Portfolio Funds**
(based on changes)

	2001					2002	
	year	I	II	III	IV	Jan.	Feb.
Net purchase (billion won)	8,908	3,406	1,733	-434	4,203	592	-257
Net inflow ²⁾ (100M US\$)	75.3	27.3	15.1	-3.8	36.7	5.6	-3.8

Notes: 1) Sum of net purchase in Korea Exchange Market and KOSDAQ market.

2) Preliminary figures.

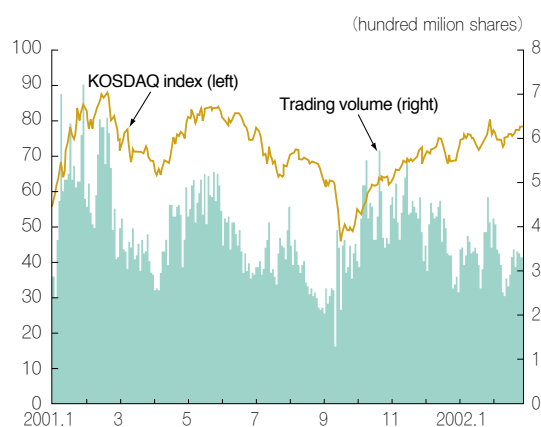
Source: The Bank of Korea, Korea Securities Computer Corp.

For the first and second quarters, the net inflow of foreign capital for portfolio investment reached 4.2 billion dollars, reflecting active share purchases, but for the third quarter, this shifted to a net outflow of 0.4 billion dollars. As share prices mounted rapidly in the final quarter, a total of 3.7 billion dollars flowed into the country to fund foreign portfolio investment in Korean shares. In the early part of the year 2002, foreign investors maintained their net purchase position in regard to Korean shares, resulting in an inflow of some 200 million dollars to the capital account.

(KOSDAQ Index)

<Figure II -47>

Trends of KOSDAQ Index and Trading Volume



Source: Korea Securities Computer Corp.

The KOSDAQ index, which had fallen sharply during the year 2000 as a result of correction of the imbalance between of supply and demand following the massive expansion of share issuance and the emergence of debate over a bubble in information technology(IT) and Internet related businesses, followed a generally similar pattern of movements to that of KOSPI during the year 2001. As of the end of the year it had risen 37.3% from a year earlier to stand at 72.2.

From January to February, as the KOSDAQ market was influenced mainly by the pick-up of activity on the KSE even though the NASDAQ market showed a downward trend, the KOSDAQ index climbed steeply to reach its highest level for the year at 87.7 on February 20.

Amid concerns about overheating in a short period, the NASDAQ index's collapse below 2000 points and the depreciation of the Korean won, the index fell back to 68.4 by the end of March.

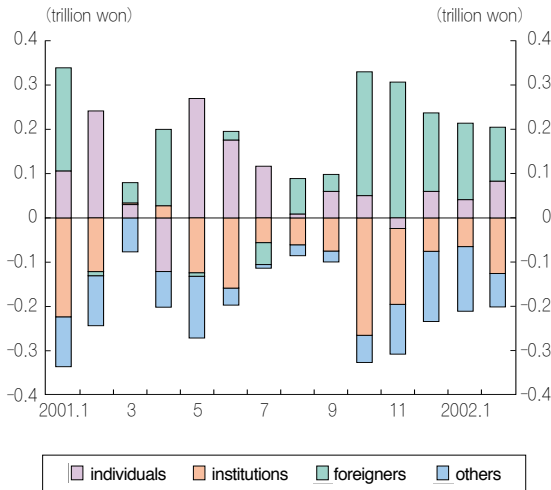
While rising from mid-April to May in sympathy with the NASDAQ market, the KOSDAQ index then followed a downward trend until September. What contributed to this slide was the expansion of the supply of newly issued shares as a result of rights offerings and initial public offerings(IPO) together with the likelihood of a long-term recession in the IT sector following the revelation of the weakening profitability of American IT businesses. It was, nevertheless, in the wake of the terrorist attacks on the United States of September 11 that the KOSDAQ market tumbled to its lowest level for the year, registering 46.1 on September 17.

From October, with a spreading perception that the KOSDAQ's correction had overshot, foreign and individual investors went on a buying spree, taking the KOSDAQ to 72.2 points at the end of the year, a 37% rise from a year earlier.

Moving into the year 2002, as investors' spirits were enhanced by the pick-up of activity on the KSE and the rise of semiconductor prices, the KOSDAQ market showed an upward trend.

Transaction volumes on the KOSDAQ market swelled greatly compared to the preceding year. This was attributable to the continual increase in the number of listed firms and to the expansion of transactions in search of marginal profits from the large fluctuations in the index. The average daily volume of share transactions rose from 210 million shares the previous year to 390 million shares in the year 2001. Moving

<Figure II -48>

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

Source: Korea Securities Computer Corp.

into 2002, average daily turnover marked a level of around 330 million shares.

Examining the trend of KOSDAQ share transactions by investor, foreign and individual investors registered net purchases of 1.3 trillion won and 1.0 trillion won respectively. In contrast, institutional investors and non financial companies made net sales of 1.3 trillion won and 1.0 trillion won. These patterns were maintained in the early months of 2002.

B. Quantitative indicators

(1) Money

Non-bank financial institutions gradually recovered their intermediary function in the course of the year 2001 while banks' supply of liquidity was considerably reduced. Reflecting these trends the growth rates of the principal monetary aggregates showed a divergent pattern.

(Monetary Aggregates)

During the year under review the growth rates of both M2 and MCT+ lowered while that of M3 continued its smooth upward trend. This was attributable to the contraction of banks' supply of liquidity resulting from the reduction of firms' reliance on them for financing because of the revival of the corporate bond market together with their reduced demand for funds in the course of the economic downturn. It was also attributable to non-bank financial institutions' expanded supply of funds to the private sector, buoyed by an increase of deposits attracted by the relatively high anticipated yields on investment trust companies' performance-based products at a time when market

<Table II -20>

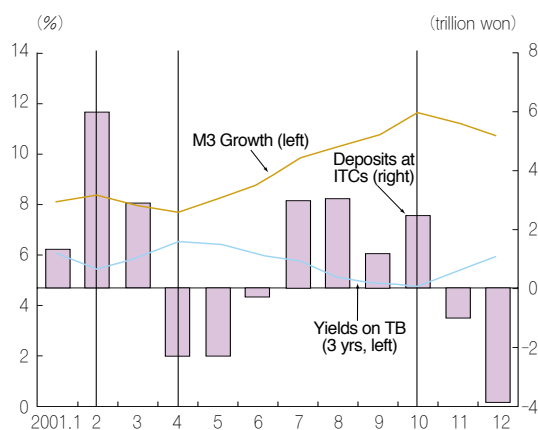
Growth Rate¹⁾ of Major Monetary Aggregates

	2000		2001				2002	
	Dec.	Mar.	Jun.	Sep.	Dec.	Jan.	Feb.	
M1	11.8	13.2	12.6	14.9	18.7	16.7	28.9	
M2	24.5	18.1	13.9	12.8	13.7	12.5	14.7	
MCT+	14.1	11.7	11.3	12.6	13.6	12.3	13.9	
M3	6.7	7.9	8.8	10.7	11.3	
RB	11.3	11.4	9.6	7.2	14.0	7.1	20.3	

Note: 1) Based on daily average, compared with the same period of the previous year.

Source: The Bank of Korea.

<Figure II -49>

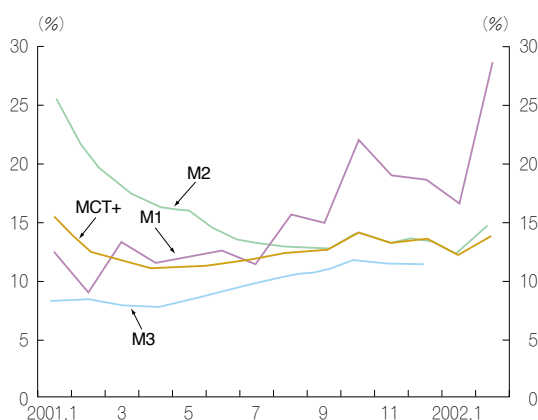
M3 Growth · Market Interest Rates · Deposits at Investment Trust Companies

Note: 1) Based on bond type product, Based on changes.
Source: The Bank of Korea.

interest rates and bank deposit rates were both continuing to fall.

Broad money (M3), which had stayed at around the 5-6% level during the year 2000, saw its growth rate(average balance basis) move smoothly upward during the year under review. During March and April nevertheless, its growth rate dipped for a while as investment trust companies faced redemption of their money market funds amid worries over sagging yields following the jump in market interest rates. From May onwards the upward trend resumed and accelerated to 11.3% during December. During the year the growth rate of M3 varied distinctively by month in line with the movement of market interest rates and the fluctuating inflow of deposits to performance-based products offered by investment trust companies. Specifically, during March, April and again from early October when yields on government bonds rose, deposit taking by investment trust companies slowed and the growth rate of M3 fell. When yields on Treasury bonds showed a downward trend during the May to September period, however, there was an increased flow of funds into investment trust companies and the growth rate of M3 also showed a rising pattern.

<Figure II -50>

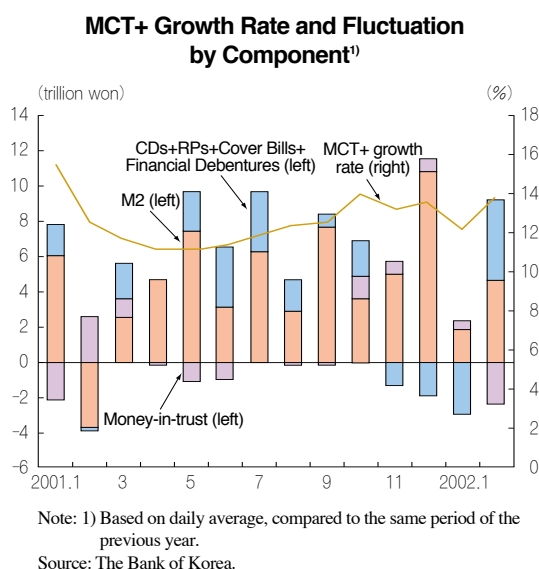
Growth Rates of Major Monetary Aggregates

Source: The Bank of Korea.

M2 growth differed from that of M3 in showing a continued deceleration. Among the reasons for this is that the rate of increase of the supply of liquidity through banks slowed as conditions for direct financing improved and business activity contracted while there was a migration of market funds to banks in response to the flight to quality subsequent to the financial market instability of the preceding year. After registering a rate of 24.5% during December 2000, M2 growth(average balance basis) continued to decelerate so that in January 2002, it had halved to the level of

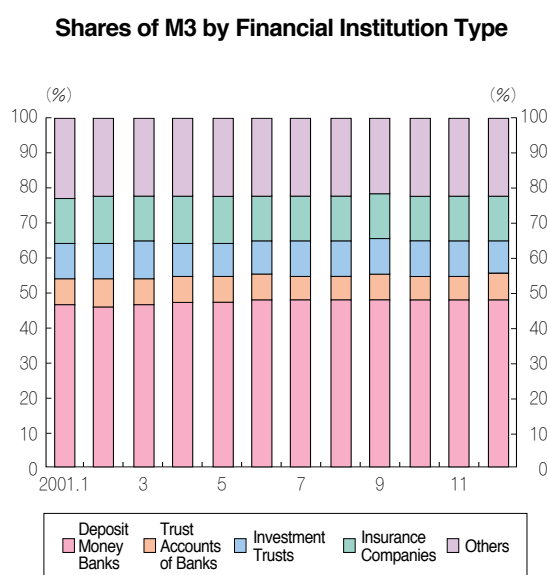
12%. However from October 2001 until the end of that year it moved slightly in a contrary direction mainly because the funds which had moved out of investment trust companies and cover bills upon their maturity flowed into bank deposits.

<Figure II -51>



MCT+(M2 plus CDs plus cover bills plus money in trust plus RPs plus financial debentures), which incorporates all the deposit products of banks, like M2 saw a continued reduction of its growth rate(average balance basis) but one which was comparatively less pronounced in view of the expansion of short-term marketable deposit products and the increased issuance of financial debentures. Specifically, after standing at 15% at the beginning of the year its growth rate slowed to between 11% and 12% from March onwards; its rate of growth, from October onwards, shifted to an upward trend along with that of M2, accelerating to a level of between 13% and 14%. In the first two months of 2002, it fell back to between 12% and 13%.

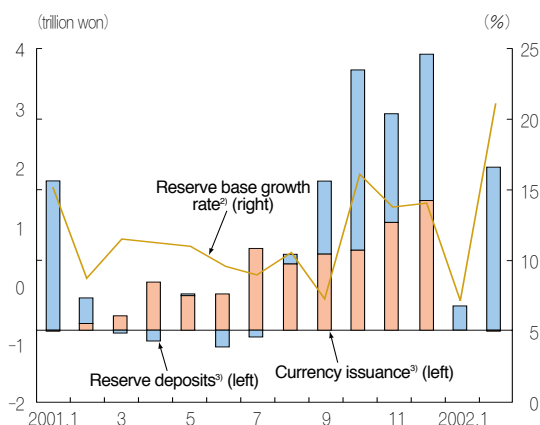
<Figure II -52>



Viewing the composition of M3 by the weight of each type of financial institution, in the case of bank accounts, their share rose from 46.4% at the end of January 2001 to reach 48.5% by the end of the year, reflecting their more active deposit taking. Accordingly, in spite of a contraction of the weight of banks' trust accounts(7.4% → 7%) the combined weight of banks' deposits(bank accounts and trust accounts) rose from 53.8% at the end of January 2001 to 55.6% at the end of December. From October onwards, there was a contraction of the volume of deposit taking by investment trust companies, which caused their share of M3 to fall slightly from 10.3% at the end of January to 9% at the end of December.

The growth rate of reserve money which had been in the region of 20% throughout the year 2000 dropped to

<Figure II -53>

Reserve Base Growth Rate and Changes by Component¹⁾

Notes: 1) Based on daily average.

2) Compared to the same period of the previous year.

3) Compared to the end of the previous year.

Source: The Bank of Korea.

around 11% during 2001. This large reduction in its growth rate was attributable to the contraction of banks demand for reserves following the deceleration of the increase of those deposits which are subject to reserve requirements. During September and October as a result of a base effect caused by the Chuseok festival falling in different months in the two years⁷⁾, causing changes in the amount of cash in circulation, the growth rate of the reserve base surged from 7.2% to 16.1%. In December, the growth rate of the reserve base rose to 14.0% because, under the influence of the migration of market funds to the short term end of the yield curve, there was a large increase in the attraction of deposits to instant access accounts, which carry a comparatively high reserve requirement(5%). In January 2002, it fell back again to 7.1% due to the sharp decline of the rate of increase of cash in circulation as a result of the Lunar New Year festival falling in a different month from the previous year.

Viewing the differences in the volume of the supply of reserve base by its individual components, reserve deposits contributed an increase of 1.8 trillion won and the volume of currency issue expanded by 2.1 trillion won, prompted by the increasing demand for settlement balances amid signs of improvement in economic activity from the latter half of the year under review.

<Table II -21>

M3 Supply by Sector¹⁾

(hundred million won)

	2000	2001
M3 changes	608,140	1,060,735
Government	22,272	119,878
Public sector	90,451	172,128
Private sector	-158,873	747,455
(Loans & discounts)	229,104	455,767
(Securities) ²⁾	-377,749	226,930
(Loans in foreign currency) ³⁾	-47,586	-45,438
Foreign sector	472,122	215,181
Others	182,168	-193,907

Notes: 1) Changes based on year-end balance.

2) Securities such as corporate bonds, CP, etc.

3) Advanced payment against foreign currency payment guarantees, foreign currency credits, etc.

Source: The Bank of Korea.

(Fund Supply Structure)

If we examine the structure of the supply of broad money(M3) during the year 2001, it is striking that the private-sector shifted from being a net absorber to a large supply position and that the supply of money through the government sector also expanded. In contrast, the scale of supply through the foreign sector

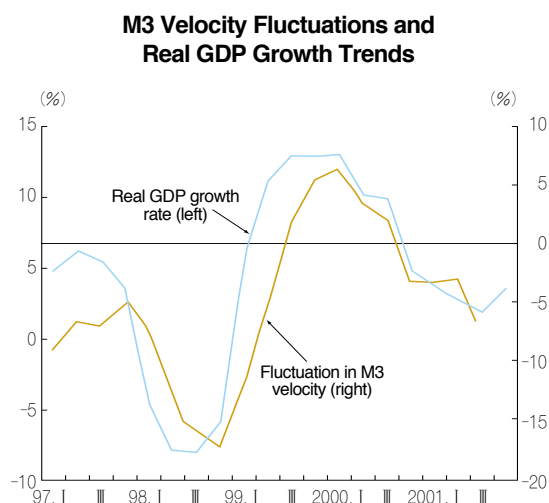
7) September 12, 2000 ; October 1, 2001

was diminished compared to the previous year.

In the case of the private sector, the turnaround in its position from absorption to a large supply position took place through a shift to the supply of funds from purchases of securities such as CP and corporate bonds with the recovery of the direct financing market(year 2000: -37.8 trillion won → year 2001: 22.7 trillion won). Another contributory factor was the large increase in loans(year 2000: 22.9 trillion won → year 2001: 45.6 trillion won). The supply of funds through the government sector increased from 2.2 trillion won in the preceding year to 12 trillion won during the year under review as a result of the expansion of fiscal expenditures from the second quarter onwards. The public sector increased its supply of funds from the 9 trillion won of the previous year to 17.2 trillion won by way of the purchases of Deposit Insurance Fund bonds. The foreign sector, meanwhile, saw a reduction of its net supply from the previous year to 21.5 trillion won in response to the narrowing of the current account surplus and the dulling of foreign investors' introduction of funds for the purchase of securities.

(Money Velocity)

<Figure II -54>



Source: The Bank of Korea.

A gradual blunting of the upward trend in the velocity of money on an M3 basis had begun from early in the year 2000, and from the fourth quarter of that year onwards a shift to a downward trend in money velocity took place, which persisted on into the year 2001. This is attributable in part to the slowing of the level of real economic activity but also to the abundance of market liquidity.

M3 velocity, which had decelerated by 4% in the final quarter of the year 2000, registered a rate of decrease of around the 3% level, similar to the preceding quarter's,

during the first and second quarters of the year under review. As from August onwards the growth rate of M3 rose above 10% reflecting the investment trust companies' buoyant deposit taking, the scale of the decrease in M3 velocity widened to register a fall of 7% in the third quarter.

(2) Deposits at Financial Institutions

In 2001, investors began to demand not just security but profitability as financial market uncertainties had been resolved to a considerable degree with the introduction of the partial deposit insurance scheme and the completion of the principal elements of financial restructuring. Banks accordingly saw a major slowdown in the rate of increase in their deposit taking whereas deposit taking by money in trust and investment trust companies shifted to an increase in view of the comparatively higher yields on offer given the decline in market interest rates. Mutual credit facilities also saw a favourable turn in their deposit taking thanks to interest rates that were higher than banks'. Meanwhile with the wider fluctuations of interest rates and the emerging signs of a recovery of real economic activity, the phenomenon of a migration of market funds towards the short term end became evident.

(Deposit Money Banks)

In 2001, deposit money banks saw an increase in their deposits of 54.6 trillion won. This was the largest increase among financial institutions but represented a sharp contraction from the scale of the previous year's expansion (92 trillion won). By type of deposit product, instant access deposits and RPs, CDs and other types of short term marketable deposits were considerably boosted in reflection of the migration of funds toward the short term end of the market. In contrast long term

<Table II -22>

Trends in Deposits of Financial Institutions

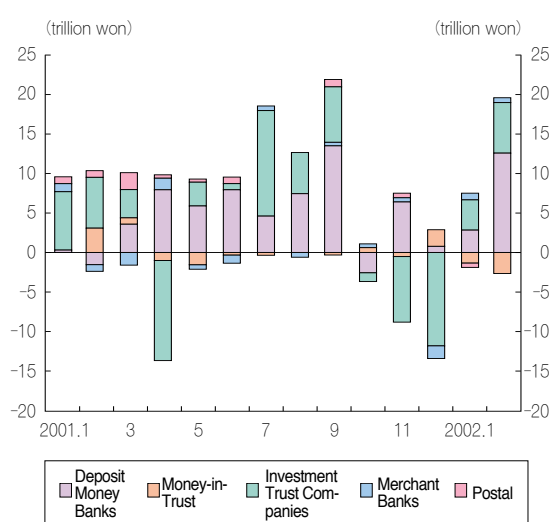
(Changes during the period, trillion won)

	2000	2001					2002
		year	I	II	III	IV	Jan.-Feb.
Deposit money banks	92.0	54.6	2.4	21.9	25.7	4.6	15.3
Real demand	4.1	6.2	-2.7	4.1	2.7	2.1	1.7
Time & savings (Time)	76.8	44.8	2.9	12.6	20.2	9.0	9.7
<over 1 year>	56.0	9.9	0.2	1.8	7.6	0.3	7.3
(Instant access)	51.4	2.8	0.1	-1.7	1.3	3.2	1.1
<MMDA>	15.3	26.1	-1.5	6.9	9.2	11.6	2.7
CDs+RPs	3.3	8.5	-1.3	3.5	2.6	3.7	0.6
Cover bills	4.8	10.5	3.8	6.1	3.3	-2.7	4.0
	6.3	-6.9	-1.7	-1.0	-0.4	-3.8	-
Money-in-trust	-42.2	2.7	3.5	-2.8	-0.4	2.4	-4.2
Additional	4.7	0.7	3.8	-2.9	0.1	-0.3	-0.7
New silver years life pension	1.4	7.9	5.4	0.8	0.8	1.0	-1.9
Unit	-11.9	0.6	-0.4	-0.2	0.4	0.8	0.1
New installment	-11.0	-5.7	-2.4	-1.3	-1.0	-0.9	-0.8
Specific	4.9	5.1	-0.1	1.6	0.6	3.1	0.2
Investment trust companies	-50.2	14.0	17.9	8.8	26.0	21.1	10.5
Short term bond	-23.1	8.8	3.2	1.5	7.8	-3.6	0.5
Long term bond	-26.1	-1.1	3.2	0.6	1.7	-6.6	-4.2
MMF	4.2	8.5	16.5	-10.9	12.7	-9.9	10.3
Stock ¹⁾	-5.2	-2.2	-5.1	-	3.9	-0.9	3.9
Merchant banks	-8.5	-1.7	-0.8	-0.1	-	-1.1	-1.4
Bills issued	-5.9	-1.6	-0.6	-0.1	-	-1.0	1.0
CMA	-2.6	-0.1	-	-	-	-0.1	0.4
Post office	7.6	5.7	3.3	1.2	0.8	0.8	0.2
Mutual savings & finance companies	3.8	4.7	2.1	0.7	0.8	1.1	0.6

Note: 1) Includes mixed investment trusts.

Sources: The Bank of Korea, Representative associations.

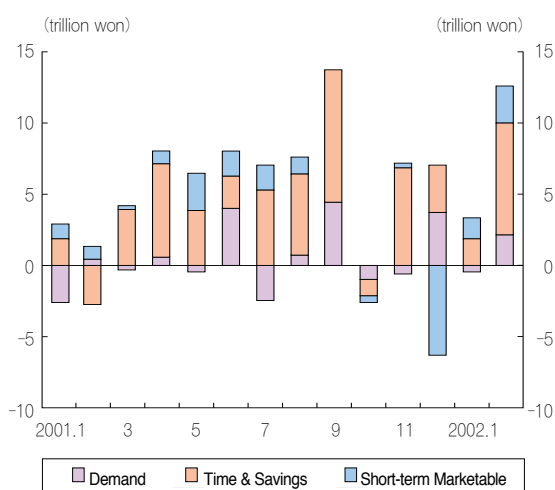
<Figure II -55>

Deposits at Financial Institutions¹⁾
(based on changes)

Note: 1) Based on changes.

Sources: The Bank of Korea, Representative associations.

<Figure II -56>

Deposits at Deposit Money Banks by Product¹⁾

Note: 1) Based on changes.

Source: The Bank of Korea.

deposits saw their rate of increase greatly blunted in view of the continuing downward trend of interest rates. In the early part of 2002, the scale of the growth in the taking of deposits expanded thanks to the return of funds that had been withdrawn at the year end for the redemption of borrowings and settlement purposes.

Time & savings deposit registered an increase of 44.8 trillion won in 2001. This expansion was headed by the increase of 26.1 trillion won in short-term, instant access deposit. It was due to the great increase in floating funds searching for opportunities for increased yields as well as the general decrease in deposit rates and to the subsequent reduction in differentials based on the period of deposit. In addition the government's release of funds by way of the expansion of fiscal expenditures was also a factor increasing the demand for deposit for settlement purposes such as instant access deposits. Long-term time deposits, which in the preceding year had expanded greatly(56 trillion won) in line with the preference for asset security, saw an increase of only 9.9 trillion won in 2001. The fall in the taking of time deposits with a maturity of one year and over fell especially sharply(36.2 trillion won → 2.5 trillion won). From October onwards, the differential between interest rates on long-term and short-term deposits widened slightly, prompting a modest increase in longer-term time deposits. This was however small in scale and they have been unable to shake off their subdued trend since early 2001.

Affected by the placement in them of the proceeds from the maturity of long-term time deposits,⁸⁾ CDs and

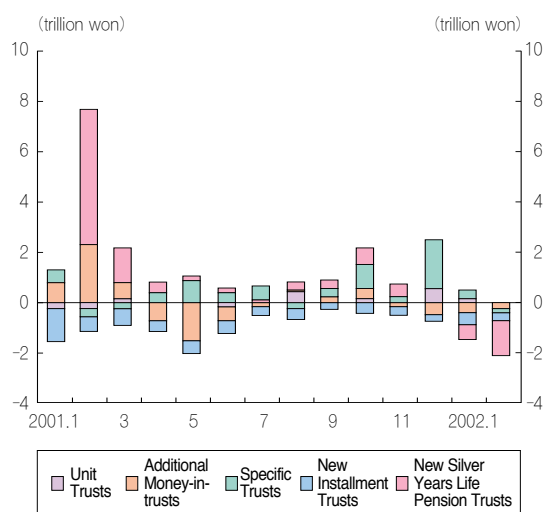
8) In the case of RPs, the cost of funds is approximately 20 basis points lower than that of the time deposit with an equivalent maturity in view of the absence of the deposit insurance levy and of a reserve requirement. Some banks, therefore, applied a preferential interest rate of around 10 basis points to attract the deposit of funds from maturing time deposits.

RPs, which are short-term marketable products, registered an increase of 10.5 trillion won in 2001 but in view of the contraction of 6.9 trillion won in the funds attracted to cover bills,⁹⁾ the overall increase in such products stood at only 3.6 trillion won

(Money-in-Trust)

<Figure II -57>

Deposits at Money-in-Trust by Product¹⁾



Note: 1) Based on changes.

Source: The Bank of Korea.

Money-in-trust had continued to contract by a large margin for several years but the trend shifted to register an increase of 2.7 trillion won in 2001. Broken down by product, new silver years life pension trusts, which offer relatively high yields, witnessed an expansionary trend. Specific money trusts also met a favorable buying response thanks to the increase of their own companies' shares purchase trusts¹⁰⁾ and the less than three month maturity short term trust products¹¹⁾ that were newly offered. In contrast, new capital accumulation trusts and additional money trusts witnessed continual withdrawals. From early in the year 2002, withdrawals at maturity persisted for tax exempt household trusts and new capital accumulation trusts with the blunting of the increase of short term specific money trusts, the taking of deposits by the trust accounts of banks decelerated.

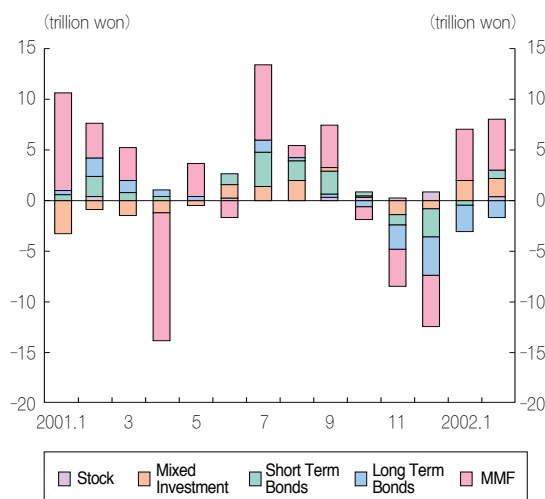
9) The normal maturity of cover bills is 3 months but around the end of the year 2000, cover bills with a maturity of 1 year, known as new cover bill, were sold as a product offering tax incentives(as cover bills were sold on a discount basis, they were exempt from the comprehensive tax on financial income), which made them very popular. There was a big contraction in cover bills when these products reached maturity at the end of the year 2001

10) Money-in-trust companies invest funds for the purpose of purchasing their own shares so as to manage their prices.

11) Following the abolition of the regulation on the minimum maturity of trusts accepted by bank trust accounts(9 November 2001), from November 26, short term(less than three month maturity) special money-in-trust products were offered for sale.

(Investment Trust Companies)

<Figure II -58>

**Deposits at Investment Trust Companies
by Product¹⁾**

Note: 1) Based on changes.

Source: Investment Trust Association.

Investment trust companies, whose deposits had shrunk by 50.2 trillion won in 2000, saw a shift in their deposit taking to an increase of 14 trillion won in 2001. The rationale for this is that the strength of investors' flight to quality weakened with the restoration of stability in the financial markets and the competitiveness of investment trust companies' products was relatively heightened by the reduction of banks' deposit interest rates. In view of the uncertainty of prospects concerning future interest rates movements, however, the increase was principally led by short-term products such as MMF(+8.5 trillion won) and short term bond investment trusts(+8.8 trillion won). Long-term bond investment trusts(-1.1 trillion won) and stock investment trusts(-2.2 trillion won), in contrast, experienced a contraction.

Viewing deposit taking by investment trust companies by period, it rose by 17.9 trillion won during the first quarter led by MMF(+16.5 trillion won). During April with the sharp rise in market interest rates(the sharp fall in bond prices) anticipated yields fell and, prompted also by seasonal factors such as the need to meet tax payments, the net redemption of MMF expanded greatly, becoming a further factor threatening market stability. Following the unveiling of the Bank of Korea's bond market stabilisation measures(April 27), market interest rates returned to stability and from May onwards, MMF shifted back to an expansionary trend. During the third quarter, market interest rates responded to the Bank of Korea's lowering of the call rate by falling, causing operating yields to rise. This created a relatively large increase for short term bond investment trusts and mixed investment trusts¹²⁾ as well

12) The increase was spearheaded by the tax-exempt, high risk, high-yield funds, subscription to which was launched on 14 August 2001.

as for MMF. But in the final quarter, as expectations of an early economic recovery mounted, market interest rates shifted to an upward trend while the inflow of funds was also affected by seasonal factors including financial institutions' year-end management of their BIS capital adequacy ratios, and companies' year-end settlement and reduction of their debt ratios. In consequence, deposits at investment trust companies contracted by 21.1 trillion won.

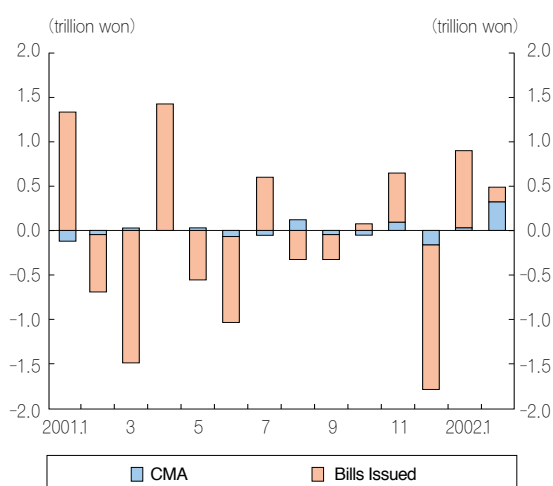
In the early months of the year 2002, despite the continued shrinking of long term bond investment trusts, investment trust companies' deposit taking shifted back to an upward trend. This was because MMF attracted a large volume of funds and mixed investment trusts, which had seen a downward trend since the previous October, also shifted back to a rising trend in a climate of high-yield anticipations.

(Merchant Banks)

Merchant banks' deposits had fallen by 8.9 trillion won in 2000 and in 2001 they were also unable to shake off their sluggishness due to factors such as the reduction in their numbers.¹³⁾ Nevertheless, the scale of the contraction in their deposits was smaller than that of the preceding year(-8.9 trillion won → -1.7 trillion won). For settlement purposes and in order to reduce their debt ratios, companies had withdrawn funds at the end of the previous year and some of these flowed back in early in the new year, and a similar pattern was repeated during July following the half-yearly closing at the end of the preceding month. This and other seasonal factors led to a slight rise in deposits. In addition, in response to the influence of interest rates'

<Figure II -59>

Deposits at Merchant Banks by Product¹⁾



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

13) With the merger of Regent Merchant Bank into Tongyang Investment Bank, the number of merchant banks was reduced from 4 to 3.

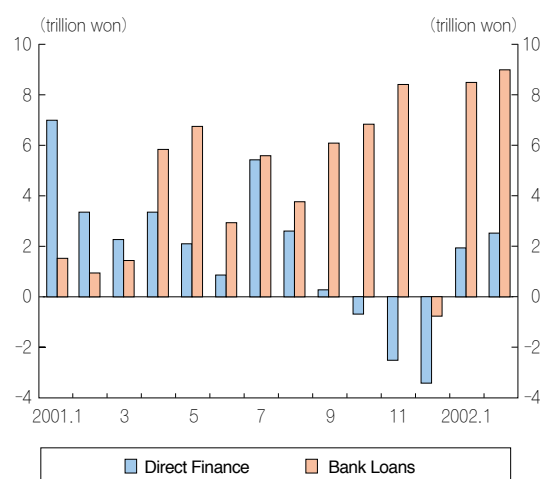
rising in April and November, funds which had migrated out of MMFs moved in some cases into fixed interest rate products such as bills issued, causing merchant banks' deposits to record a temporary upward trend. These remained the sole exceptions to their otherwise contraction throughout the year.

(Mutual Savings & Finance Companies)

Thanks to a constant inflow of market funds, deposits at mutual savings & finance companies accelerated the scale of their increase during the preceding year(+3.8 trillion won) to stand at 4.7 trillion won. This was attributable to the fact that certain mutual savings & finance companies had emerged from the process of structural adjustment with a heightened credit rating, and that their products were given relatively strong interest rate competitiveness by the fall in banks' deposit rates. In the early months of 2002, the upward trend of their deposits was maintained, owing to the increase of deposit interest rates by some mutual savings & finance companies in view of their expansion of small credit loans at high lending rates.

<Figure II -60>

Corporate Finance¹⁾



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

(3) Corporate Finance

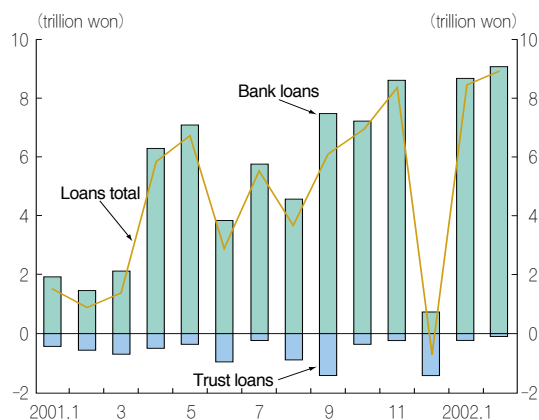
Corporate funding conditions were generally ameliorated in 2001. This can be explained as follows: Given the murkiness of business prospects, corporate investment demand was restrained while with the easing of the stance of monetary policy, ample liquidity prevailed in the markets, allowing market interest rates and financial institutions' deposit and lending rates to continue to fall. The government, for its part, continually pursued measures to ensure the stability of the markets in which funds are raised by, for example, the issue of Primary CBOs.

Viewing the supply of funds by channel, bank lending expanded on a scale similar to the previous year, headed by the lending to households and small and medium enterprises. Thanks to the improvement of fund-raising conditions in the direct financial market, corporate bond and commercial paper shifted to a net issuance. This trend continued on into early 2002.

(A) Bank Lending

<Figure II -61>

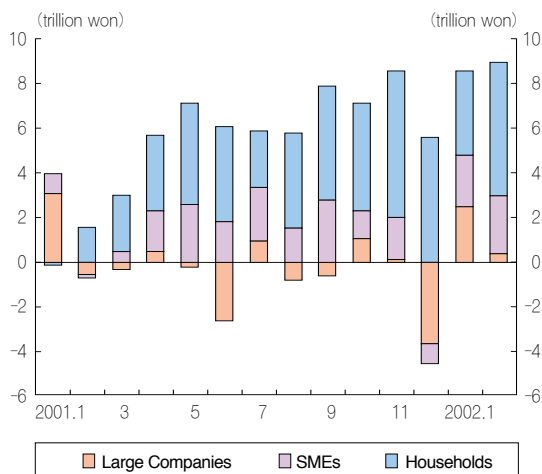
Total Bank Lending¹⁾



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

<Figure II -62>

Bank Lending by Sector¹⁾



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

In 2001, aggregate lending by banks(including trust account loans) expanded by 49 trillion won, maintaining the trend of increase of the previous year(+57.7 trillion won). By type of accounts, loans from the bank accounts experienced a strong increase(+57 trillion won) whereas those from the trust accounts contracted following on from the previous year(-7.9 trillion won) owing to lackluster deposit-taking by money-in-trust. Bank lending as a whole continued to increase in the early months of 2002.

(Lending by Sector)

Lending to households registered an increase of 44.8 trillion won, which was much larger in scale than that of the previous year(26.4 trillion won). This resulted from banks' aggressive efforts to expand retail banking through the expansion of housing mortgage lending and of credit based lending, along with the lowering of interest rates on household loans. Banks concentrated on mortgage lending, which composed the major part of household loans, but as profit margins gradually weakened in this area because of the intensification of competition among banks,¹⁴⁾ they also laid stress on expanding their credit based lending, targeting those

14) In the case of mortgage lending, loan interest rates are comparatively low and banks additionally assumed the mortgage arrangement fees. So banks' actual loan margins were greatly reduced.

not presenting a serious credit risk such as persons in secure employment or with an outstanding record in running their own small business. In addition industrial premises, agricultural land(paddy and dry field), and woodlands were also increasingly accepted as eligible loan collateral and interest rates on overdraft loans(negative accounts) were also lowered, together generating new demand for loans. Around the turn of the year, at which time BIS capital adequacy ratios are calculated, banks greatly increased their mortgage loans, which carry a low risk weighting. This caused the scale of the increase in household lending to register its highest level for the year(November to December monthly average was 6 trillion won ; monthly average for the year as a whole was 3.7 trillion won). Despite seasonal factors such as the redemption of outstanding loans using bonuses received at the year end / new year period, in January 2002, the increase in household lending chalked up the very large figure of 3.8 trillion won.¹⁵⁾ It was attributable to the renewed intensification of banks' competition for household lending through, for example, the continued easing of conditions on mortgage loans.

Lending to small and medium enterprises posted an increase of 16.4 trillion won in 2001, slightly larger than that in the previous year(16.2 trillion won). This was partly attributable to the increased incentives for the extension of such loans through the raising of the Bank of Korea's credit ceiling but it was also due to the banks' active efforts¹⁶⁾ to develop new credit lines and to lure promising small and medium companies whose growth and profitability were anticipated by lowering

15) January totals for household lending over the past 3 years: +200 billion won in 2000, -200 billion won in 2001, +3.8 trillion won in 2002.

16) Some banks put in place a low interest rate loan scheme whose rates floated with market interest rates and established specialist sections to handle SME credits.

interest rates in order to make use of banks' funds. However SME lending contracted slightly in February 2001, when the large volume of commercial bills issued at the end of the previous year¹⁷⁾ reached maturity, and again in December that year, as a result of the strengthening of controls over the BIS capital adequacy ratios. Moving into 2002, it expanded on a large scale owing to the re-extension of loans that had been temporarily redeemed at the previous year end, and to the emergence of demand for loans for the payment of value added tax.

<Table II -23>

Bank Lending¹⁾ by Sector

(trillion won)

	2000	2001				2002 ²⁾	
	year	I	II	III	IV	Jan.-Feb.	
Large companies	7.2	-3.4	2.1	-2.4	-0.4	-2.7	2.8
SMEs	16.2	16.4	1.2	6.1	6.7	2.4	5.0
Households	26.4	44.8	3.8	12.3	11.7	17.0	9.7
Others ³⁾	7.9	-8.8	-3.3	-0.6	-2.7	-2.2	-0.1
Total	57.7	49.0	3.8	15.4	15.4	14.5	17.4

Notes: 1) Includes Trust Accounts lending (except discount of CP).
Based on changes.

2) Lending to public and other legal entities.

Source: The Bank of Korea.

Amid the continuing economic downturn, large enterprises by and large had only modest demand for funds, and with the favourable evolution of their fund-raising conditions in the direct financial market through the issue of corporate bonds and commercial paper, their borrowings from banks shifted from an increase of 7.2 trillion won in the previous year to a contraction of 3.4 trillion won in 2001. Notably in the case of large enterprises with a high credit standing, borrowings from banks carrying relatively high interest rates were redeemed using funds obtained through the issue of corporate bonds and commercial paper. Some companies, which could not easily gain access to the direct financial market due to their relatively low credit standing, raised required funds through bank lending and so forth. At the beginning of the year 2002 bank lending to large enterprises exhibited an upward trend with the partial reextension of some of the loans that had been temporarily redeemed in order to reduce debt ratios at the end of the previous year.

17) In advance of the closing of their books at year end 2000, companies seeking to reduce their debt ratios had, instead of redeeming general loans, expanded their discounting of commercial bills. (Where discounts of commercial bills are increased, cash on hand is increased but receivables are decreased, Thus the overall scale of assets and liabilities is not influenced.)

(Lending by Type)**<Table II -24>****Bank Lending by Product¹⁾**

(trillion won)

	2000	2001					2002
		year	I	II	III	IV	Jan.-Feb.
Commercial bill discounts	1.5	-6.4	-5.6	-0.6	0.1	-0.3	-1.5
Overdrafts	0.3	-1.5	1.3	-0.9	-0.8	-1.0	0.8
Foreign trade loans	2.1	0.1	0.7	0.2	0.1	-0.8	0.6
Corporate procurement loans	3.4	4.9	1.3	1.8	1.8	-	0.7
Electronically-processed secured receivables loans	-	1.3	0.2	0.2	0.3	0.5	0.1
General loans	44.5	45.6	2.9	13.3	13.9	15.5	6.1

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

Discounts on commercial bills shifted from an increase of 1.5 trillion won in 2000 to a massive contraction of 6.4 trillion won in 2001. This was largely because of the continuing substitution of cash settlement for the use of commercial bills with the Bank of Korea's introduction and inauguration, of the system of electronically-processed secured receivables loans in February 2001 in addition to corporate procurement loans.¹⁸⁾ These actions were undertaken to reduce the use of bills for the settlement of commercial transactions between companies and to encourage the use of cash settlement.

General loans rose on a larger scale(+45.6 trillion won) than in the previous year(+44.5 trillion won) owing to the continued increase on lending to households and SMEs. Foreign trade loans saw the scale of its increase (100 billion won) narrow from that of the previous year(2.1 trillion won), reflecting the subdued state of exports. Overdraft loans contracted(-1.5 trillion won), as companies chose to redeem overdraft loans at high interest rates in view of benign funding conditions.

Corporate procurement loans registered a sharply increasing trend, rising by 4.9 trillion won, following the 3.4 trillion won in the previous year. This was because, firstly, the Bank of Korea provided preferential support at low interest rates(2.5% p.a.) for half of the total amount of banks' loans of this type under its Aggregate Credit Ceiling and, secondly, the

18) Corporate procurement loans represent an arrangement whereby a purchasing company take out a bank loan to meet the funds required to effect cash settlement with the supplier. Electronically-processed secured receivables loans work as follows: using as collateral receivables from sales on credit to a corporate customer, a supplier receives a loan from a bank. Instead of settling the purchasing account, the corporate purchaser redeems the supplier's loan from the bank.

government granted various tax incentives for their use. Electronically-processed secured receivables loans which were introduced in February 2001 continued to take firm root, registering 1.3 trillion won up until the end of 2001.

(B) Direct Financing

In 2001, corporate fund-raising through direct financing, which had been in the doldrums for some considerable time, expanded on a relatively large scale. In the case of corporate bonds, which had recorded a net redemption the year before, net issuance of 8.3 trillion won was chalked up in 2001 and commercial paper witnessed a similar turnaround from a contraction to an expansion of 7.8 trillion won. Fund-raising through stock issuance, in contrast, saw an increase of only 4.6 trillion won, considerably less than that of 13.2 trillion won the year before. As a result of these development, the total amount of fund raising through direct financing increased by 20.7 trillion won, as against 4 trillion won in the previous year. In the early months of 2002, there emerged a wave of net redemptions of corporate bonds led by highly-rated companies but the issuance of commercial paper and stock made good headway.

<Table II -25>

Trends in Corporate Fund Raising by Direct Financing¹⁾

	(trillion won)						
	2000	2001				2002 ²⁾	
	year	I	II	III	IV	Jan.-Feb.	
Corporate bond issuance (net) ³⁾	-8.5 (-15.8)	8.3 (1.0)	5.6 (1.9)	5.2 (3.9)	3.8 (2.4)	-6.4 (-7.3)	-2.6 (-2.2)
CP issuance (net) ³⁾	-0.6	7.8	7.0	0.2	3.4	-2.7	7.0
Stock issuance ⁴⁾	13.2	4.6	0.4	0.9	1.0	2.3	0.5
Direct finance total	4.0	20.7	12.8	7.0	8.2	-6.8	4.9

Notes: 1) Based on changes.

2) Excludes those issued by companies under court receivership, in process of mediation or workout and ABS. Includes primary CBO and the share of new bond quickly underwritten by Korea Development Bank (KDB).

3) Based on CP discount by securities companies, merchant banks and bank trusts accounts.

4) Based on companies listed on the Korea Stock Exchange or KOSDAQ, but excludes financial institutions.

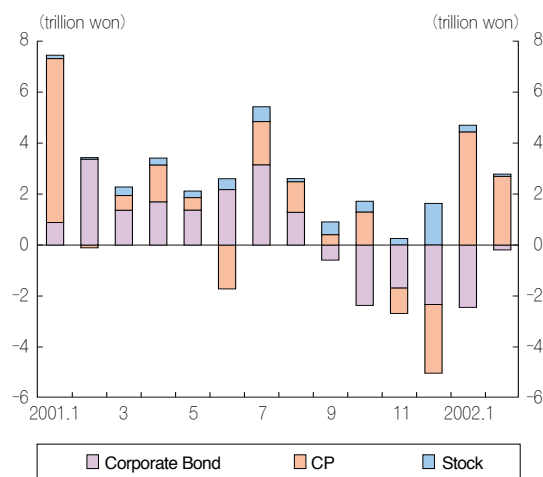
Sources: The Bank of Korea, The Financial Supervisory Service, Representative associations.

(Issuance of Corporate Bonds)

The issuance of corporate bonds showed a pattern of brisk activity in 2001, shifting from the previous year's net redemption(-8.5 trillion won) to net issuance of 8.3 trillion won(net issuance of 1 trillion won through general public flotations, excluding that through Primary CBOs and the Korea Development Bank's prompt underwriting scheme). During January corporate bonds registered a net issuance position for the first time since the preceding October, and in

<Figure II -63>

Trends in Corporate Fund Raising by Direct Financing¹⁾



Note: 1) Based on changes.

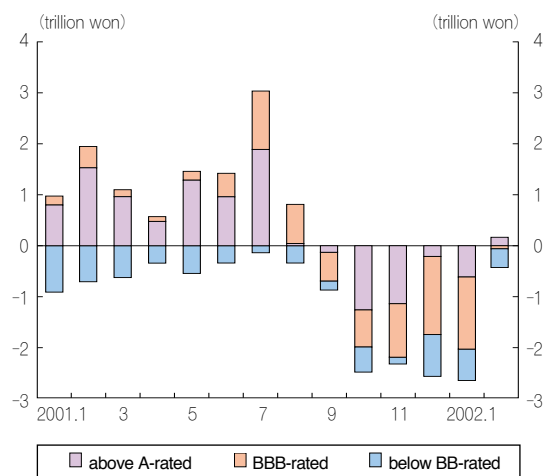
Sources: The Bank of Korea, The Financial Supervisory Service, Representative associations.

February this expanded to 3.4 trillion won, the largest since November 1998. This trend continued until August (January to August +15.3 trillion won)

The reasons for the galvanization of the corporate bond market are as follows. First of all, on the demand side, non-bank financial institutions, and particularly investment trust companies, which have the largest appetite for corporate bonds, saw a recovery of their deposit-taking, enlarging their buying capacity. In addition, preference for corporate bonds as alternative investment instruments rose strongly, in the quest for opportunities for additional profit after the sharp fall of yields on government bonds. On the supply side, the volume of corporate bonds expanded with their acquisition by Primary CBOs thanks to the putting in-place of the government's plan to reinvigorate the issuance of corporate bonds.¹⁹⁾ With benign conditions prevailing in the issue market, an increase in issuance began, led by highly rated large companies seeking to refinance themselves by redeeming existing corporate bonds and borrowings carrying high interest rates through new corporate bonds at low interest rates.

<Figure II -64>

Trends in Net Issuance of Corporate Bonds by Credit Rating¹⁾



Note: 1) Based on changes.

Source: The Bank of Korea.

While the scale of issuance increased, there was a waning of concern over corporate credit risk and a moderation of investors' risk aversion. This made lower rated corporate bonds see brisk issuance activity, with, for example, corporate bonds carrying a rating of BBB, whose issuance had contracted the previous year, achieving an increase in net issuance of 3.3 trillion won during the first eight months of 2001.

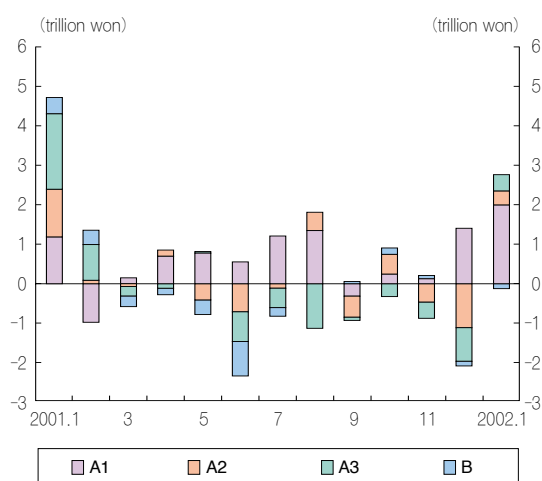
19) On December 26, 2000, the government announced a plan to galvanise the corporate bond market through credit guarantees from the Credit Guarantee Fund and the introduction of a prompt underwriting scheme for corporate bonds (temporarily illiquid companies with many corporate bonds reaching maturity underwrite 20% of the rolled over issue themselves and the remaining 80% is underwritten by financial institutions) in order to support companies' roll-over of their maturing corporate bonds.

From September onwards although the scale of corporate bonds reaching maturity expanded and the question of whether the companies involved would be able to raise to obtain the requisite resources seamlessly came to the fore, in actual fact there were no major problems. Highly rated companies redeemed bonds reaching maturity for themselves from funds which had already been acquired through advance-issues in preparation for the maturity. In addition, less well rated companies, for whose corporate bonds investors' appetite had waned, were able to handle the redemption of maturing issues through bank loans or the issue of Primary CBOs. In the early months of 2002, most companies were in a position to redeem maturing corporate bonds from their own resources or by means of the issue of asset backed securities, which presented few major problems.

(Issuance of Commercial Paper)

<Figure II -65>

Trends in Net Issuance of CP by Credit Rating¹⁾

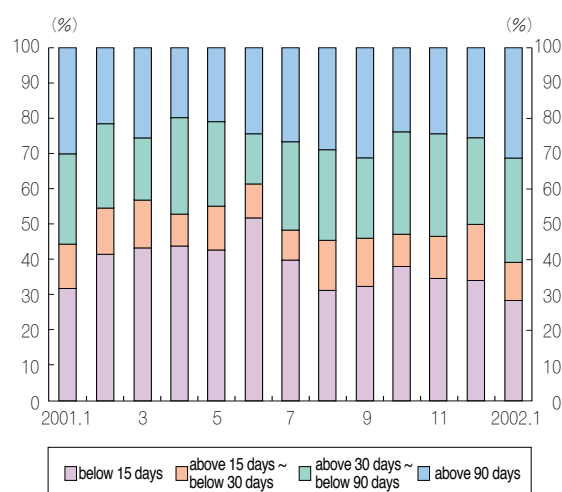


Note: 1) Based on changes.
Source: The Bank of Korea.

Having fallen by 600 billion won in 2000, net issuance of commercial paper(CP) shifted to record a large scale net increase of 7.8 trillion won in 2001. One reason for this was that with the continuing short-termism of market funds, institutional investors such as investment trust companies expanded their purchases of commercial paper for the operation of their short term funds. A further reason was that companies concentrated on the issue of commercial paper for the raising of short-term funds at a time when interest rates were on the decline. Reflecting the short-termism of market funds, there was a change in the maturity structure of commercial paper, causing the proportion of that in the shortest maturity range of less than 15 days to rise to 51.4% in June.

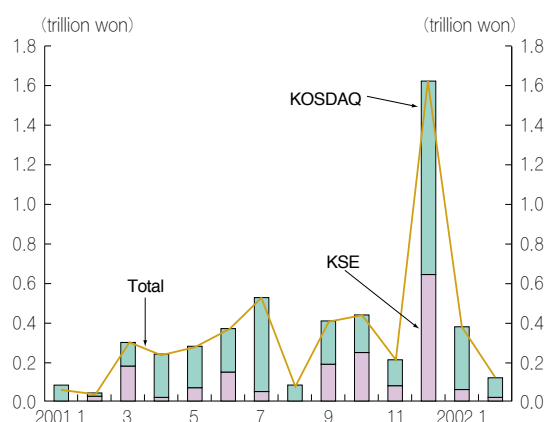
In addition, whereas in the previous year, the issuance of CP had been limited to blue chip companies(A1

<Figure II -66>
Percentage Shares in CP Total by Maturity¹⁾



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

<Figure II -67>
Trends in Stock Issuance¹⁾



Note: 1) Based on companies listed on the KSE or KOSDAQ, excludes those issued by financial institutions.
Source: The Financial Supervisory Service.

grade), from the early months of 2001 it expanded to embrace those companies with a somewhat lower rating(A3 grade) and issuance by companies with a speculative grade(B grade) also took place to a certain extent.

Viewed by period, during the first ten months of the year, companies by and large continued their net issuance of CP, apart from June when they executed a short-lived redemption of their commercial paper in order to bring their debt ratios under control for semi-annual closing.(In July there was a rebound.) Following the events of September 11 in the United States, airlines and companies with low credit ratings experienced difficulties in issuing CP. From November CP issuance shifted to a net redemption position. In November the appetite for CP was slackened in response to a fall in deposit-taking by investment trust companies, and in December, highly rated large companies retired their paper ahead of the year-end closing of accounts. Whereas these two months normally see a net redemption of CP, some less well-rated companies which had been experiencing difficulties in rolling over retiring corporate bonds, resorted to the issuance of CP in order to raise the necessary funds. In early 2002, CP issuance witnessed a large scale increase, with the return to the market of issuers who had redeemed outstanding paper at the end of the previous year and investment trust companies' increased appetite for paper owing to the sharp increase in funds attracted to MMF.

(Stock Issuance)

In 2001, companies' fund raising through the stock issuance contracted sharply from 13.2 trillion won in 2000 to 4.6 trillion won. This was because the stock market remained in a depressed phase for a

considerable period of time while corporate demand for funds was limited as a result of the business slowdown. More specifically, thanks to the increase in venture start-ups' initial public offerings(IPO), fund-raising through the KOSDAQ market registered 2.9 trillion won over the year, surpassing the figure raised through the Korea Stock Exchange(KSE)(1.7 trillion won).²⁰⁾ Moving into the year 2002, stock issuance performance maintained a comparatively brisk pace thanks to the liveliness of the stock market.

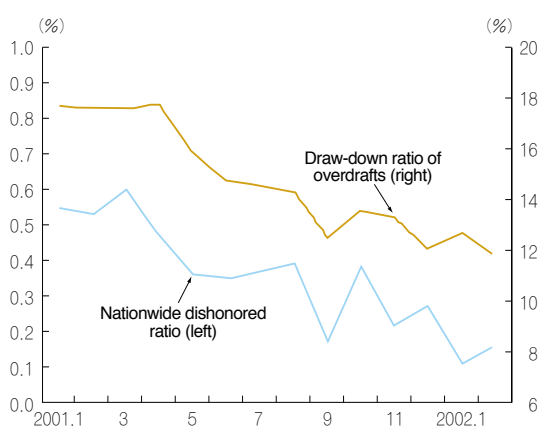
(C) Corporate Funding Conditions

In 2001, the demand for funds was subdued whereas the supply of funds continued smoothly, so that corporate funding conditions were generally perceived as favourable. Reflecting this conjuncture, major indicators of corporate funding conditions including the default ratio of bills & checks and the ratio of the draw-down of overdraft facilities remained benign.

The nationwide bills & checks default ratio eased from the 0.55% of January 2001 to 0.17% in September. In October it climbed back to 0.38%, however, as the amount in default rose greatly upon the maturity of corporate bonds issued by companies belonging to the Daewoo Group, before returning to the 0.2% level in November and December. In addition, the draw-down ratio of overdraft facilities, which indicates urgent corporate demand for funds, eased persistently during the year from the 17% level at the outset to 12.1% in December. The monthly average number of corporate bankruptcies, which stood at 23 in January 2001, contracted gradually until September(15 instances),

<Figure II -68>

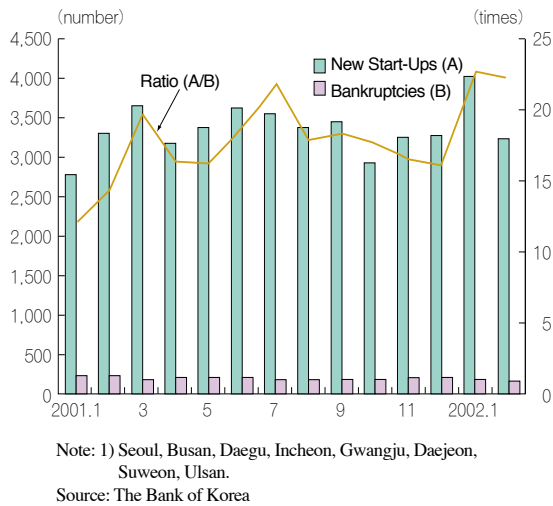
Nationwide Dishonored Ratio and Draw-down Ratio of Overdrafts



Source: The Bank of Korea

20) Looking at the performance of corporate public offerings during 2001, only 3 were held on the Korea Stock Exchange for a total value of 218 billion won whereas there were 166 public offerings on the KOSDAQ market which raised a total value of 1.3 trillion won.

<Figure II -69>

No. of New Corporate Start-Ups and Corporate Bankruptcies in Eight Major Cities¹⁾

after then showing an increasing trend with 18 corporate bankruptcies registered in December.

The ratio of new start-ups to corporate bankruptcies in Seoul and seven other major cities continued to show an upward trend in view of the increasing trend of new start-ups until July, when it reached its highest level for the year of 21.8. After then, with the slight falling off in the pace of increase of new start-ups amid prospects for a delay in economic recovery, the ratio followed a smooth downward path. Nevertheless, for the ten months period from March until December it maintained a high level of above 16 except in January and February when there occurred a comparatively large number of corporate bankruptcies(11.9 and 14.1, respectively).

<Box II-4>

Sharp Increase in Household Lending: Background and Appraisal

Looking at the environment surrounding the sharp increase in household lending from the demand side and from the supply side, we note the following points. Firstly, on the demand side, households increased their demand for loans in order to purchase real estate with the formation of anticipations of rising asset prices in view of the continuance of low interest rates. In a survey covering 1,500 adult men and women held by Korea Gallup in December 2001, it was found that the preference for bank accounts had fallen compared to the same period of the previous year (73.6% → 58.7%), whereas the preference for real estate had risen (13.6% → 26.1%). Secondly in the course of the increase in individual businesses run by people who had lost their employment in the process of structural adjustment after the currency crisis, a considerable proportion of these business funds seems to have been raised in the form of household loans owing to the simplicity of the loan procedures. Surveys report that the share of business funds in total uses of household lending stands above 20%. Thirdly, with the increase in unemployment and the changes in the wage and employment structure such as the larger proportion of people working on a temporary basis and for performance-based wages, the volatility of the flow of household incomes has greatly increased, which has also acted as a factor increasing household demand for loans.

Survey Result of Household Lending Usages

	General living expenses	Business funds	Debt consolidation	Housing funds
	(%)			
Korea National Statistical Office (1999)	23.3	38.8	(interest payment, 6.3)	31.6
Korea Exchange Bank (Dec.1999)	52.6	42.8	36.2	35.4
Hyundai Research Institute (Sep.2001)	..	22.3	30.3	33.1

On the supply side, it can be pointed out that with the maintenance of ample market liquidity while corporate demand for funds was blunted by the economic downturn, financial institutions' availability of resources for household lending was greatly expanded. Moreover, after the currency crisis, financial institutions shifted their business strategy from an emphasis on growth to a focus on profitability and security, which also served as an element in the environment acting to increase household credit. Compared to corporate lending, household lending consists of loans that are generally small in amount and the associated credit risk is low while interest rates are comparatively high, thus being favorable in satisfying both security and profitability. In addition, the increasing proliferation of internet banking is also serving to reduce operational handling expenses.

Apart from such supply and demand factors, the growth of installment financing has also contributed to the rise in household lending through the use of a wide ranging system of redemption by installment of household

consumer spending from houses(housing installment finance) to smaller value consumer items(card installment sales). In the past, consumers would accumulate a substantial sum by setting aside regular installments and then purchase a house, but recently it is increasingly common to first purchase a house using a loan and to pay-off the principal and interest over a long period through redemption by installment, which has led to a rapid increase in mortgage lending. Even though there has been a rapid rise in household lending, it does not seem to give rise to any particular concern at the present stage, considering the overall status of the servicing burden on households, the ratio of delinquencies and the level of asset holdings. In spite of the increase in the scale of liabilities, the burden of servicing interest payments was not that large given the decline in lending rates and the ratio of delinquencies in bank lending remains at the low level of around 1%. The ratio of private sector held financial assets to private-sector financial liabilities rose to 2.5 at year-end 1998 and since then it has declined slightly, standing at 2.5 recently but this is still a high level compared to that of the years before 1997(around 2.1). More than 60% of private-sector financial assets are held in deposit accounts with a high degree of liquidity, and the value of private-sector loan collateral is also relatively stable in the light of the recent buoyant trend of real estate and stock market prices.

Trend in Financial Assets and Liabilities of the Private Sector¹⁾

	(trillion won)						
	95	96	97	98	99	2000p	Sep.2001p
Assets(A)	467.1	537.0	619.3	673.9	731.4	799.5	858.6
	(17.9)	(15.0)	(15.3)	(8.8)	(8.5)	(9.3)	(7.4)
Liabilities(B)	214.6	253.7	300.1	269.9	293.0	329.7	371.6
	(16.3)	(18.2)	(18.3)	(-10.1)	(8.6)	(12.5)	(15.2)
Net assets(A-B)	252.5	283.4	319.1	404.0	438.4	469.9	487.0
Assets/Liabilities (time, A/B)	2.18	2.12	2.06	2.50	2.50	2.42	2.31

Notes: 1) Period-end basis. Figures in parentheses refer to % changes compared with the previous year.
Source: The Bank of Korea.

Having said this, nevertheless it should be pointed out that if financial institutions maintain their strategy of expanding credit to the retail sector beyond its present status, which has already undergone a great expansion, problems may arise should economic conditions change. First, if market interest rates shift to an upward trend, the burden of servicing principal and interest payments will increase and difficulties may be experienced in the redemption of loans. Since there has been a big increase in mortgage lending, there is a possibility that the problem of collateral fragility may arise should real estate prices fall. Above all, the comparative contraction of corporate lending may bring to the fore the question of a lowering of the Korean economy's medium and long term growth potential. For this reason, financial institutions should continue to expand corporate lending and household debt should not be increased excessively compared with incomes.

5. Foreign Exchange Markets

(Foreign Currency Supply & Demand)

Supply and demand conditions in the foreign exchange market were characterized by a prevailing over supply position during the year 2001 that was the result of the sustained current account surplus and net inflow of funds for direct and portfolio investment from foreign investors.

During the course of the year 2001, the scale of the surplus narrowed year on year as a result of lacklustre exports, but since imports contracted greatly, the surplus position was maintained. In addition, foreign investors somewhat reduced the scale of their inflow in response to the global economic downturn and the depression of the IT sector. Nevertheless, the net inflow position was maintained owing to the relatively favourable state of the Korean economy. Large inflows of foreign investment funds had been continued from the beginning of the year but the zeal for investment waned during the third quarter particularly with the terrorist attacks on the U.S., which prompted a temporary shift to a net outflow position. From October onwards, however, with anticipations of economic recovery and the upgrading of Korea's sovereign rating, there was a return to heavy net inflows, setting the tone which prevailed on into the early months of the year 2002.

Together with this continuing net excess of foreign exchange supply, the foreign exchange reserves witnessed a steady expansion, rising from 96.2 billion dollars at year end 2000, to 102.8 billion dollars at the end of 2001, and to 105.1 billion dollars at the end of February, 2002.

<Table II -26>

Foreign Exchange Reserves¹⁾

(hundred million US\$)

	1999	2000	2001				2002
			Mar.	Jun.	Sep.	Dec.	Feb.
FX Reserve	741	962	944	943	990	1,028	1,051

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

<Table II -27>

Foreign Credit & Debt¹⁾

(hundred million dollars)

	1999	2000(A)	2001(B)	Change (B-A)
Credit	1,454	1,647	1,619	-28
Debt	1,371 (100.0)	1,317 (100.0)	1,199 (100.0)	-118
Long term	979 (71.4)	838 (63.6)	810 (67.6)	-28
Short term	392 (28.6)	479 (36.4)	389 (32.4)	-90
Net foreign credit	83	330	420	90

Notes: 1) Year-end basis.

2) Figures in parentheses refer to shares in total (%).

Source: The Bank of Korea.

(Foreign Credit & Debt)

As of the end of the year 2001, Korea had total foreign indebtedness of 119.9 billion dollars, which represented a contraction of 11.8 billion dollars from the previous year end. Claims on the rest of the world declined by 2.8 billion dollars compared to the previous year end to stand at 161.9 billion dollars. As a consequence of these movements Korea, which has been a net creditor nation since September 1999, saw the scale of its net credit position rise by 9 billion dollars to stand at 42 billion dollars as of the end of the year 2001. In the course of the year the scale of net foreign indebtedness narrowed, an increase in the private sector's external payment burden notwithstanding, because of the large scale redemption of borrowings by the government sector and the financial sector.

The net redemption of foreign liabilities continued during the year 2001, centering on short term foreign liabilities, the proportion of which contracted greatly, falling from 36.4% of the end of the preceding year to stand at 32.4% as of the end of the year 2001.

<Figure II -70>

Trends of Exchange Rates

Source: The Bank of Korea.

(Foreign Exchange Rate)

During the year 2001 the exchange rate of the Korean won against the U.S. dollar moved in a very similar pattern to that of the Japanese yen, showing a strongly rising trend from March to early April, followed by a generally stable trend until October and a subsequent steep rise with the rapid weakening of the Japanese yen.

Looking at these movements more closely by period, early in the year foreign investors greatly increased capital inflows for securities investment in Korea at a

<Figure II -71>

Trends of Net Inflow of Portfolio Funds

Source: The Financial Supervisory Service.

time when the Japanese yen showed a stable range of movements against the U.S. dollar. The Korea won consequently generally exhibited upward stability and reached its highest value against the U.S. dollar for the year in February when it traded at 1,236 won per dollar. But with the emergence of the weakness of the Japanese economy in early March, the yen dollar exchange rate rose steeply, causing the exchange value of the Korean won to fall to 1,365 won per dollar in early April. In this situation, the Korean policy authorities expressed their will to stabilize the exchange rate while the Japanese yen recovered some of its lost ground. In addition to that, the net inflow of foreign portfolio funds continued and the Korean won maintained a stable trend, trading within a range of 1,235 to 1,313 won per dollar. With the beginning of December, however the yen dollar exchange rate again climbed steeply and the Korean won again showed a synchronized pattern of movements with the Japanese yen, with the scale of net inflows of foreign portfolio investment narrowing sharply. The exchange rate of the Korean won against the U.S. dollar rose sharply and it closed the year 3.9% higher than the previous year at 1,314 won per dollar.

Just after the new year, the exchange rate of the Korean won showed a repeated pattern of large scale fluctuations in line with flows of foreign portfolio investment funds and the Japanese yen, rising to 1,331 won per dollar in late January. After showing these unstable movements, the exchange rate registered 1,324 won per dollar as of the end of February.

In view of the phenomenon of the synchronization of the Korean won and the Japanese yen exchange rates against the dollar, the won-yen exchange rate generally exhibited a stable pattern, moving within a range of 1,030 won to 1,120 won per 100 Japanese yen. From

<Figure II -72>

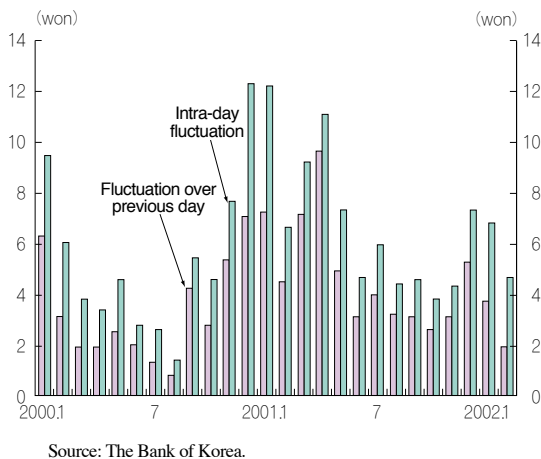
Trends of Won/Yen



early December, however, even though both the Korean won and the Japanese yen rates rose against the U.S. dollar, the Korean won rose on a comparatively smaller scale than the Japanese yen. The Korean won strengthened against the Japanese yen, trading at the 1,000 won level at the end of the year 2001, reflected the apprehensions about a protracted recession of Japanese economy and the relatively good performance of the Korean economy. This trend continued in the beginning of the year 2002, and the Korean won rose to its highest level against the Japanese yen for the thirty months since November 1998 to stand at 980 Korean won per 100 Japanese yen.

<Figure II -73>

Trends of Won/US\$ Fluctuations



Over the course of the year 2001 the exchange rate showed somewhat greater volatility than the previous year, with the scale of the day-to-day variation widening from 3.3 won to 4.8 won and that of the intraday variation from 5.3 won to 6.7 won. Viewed by period, during the first four months of the year, when the exchange rate of the Japanese yen against the U.S. dollar showed great volatility, the range of movements of the Korean won exchange rate also expanded. From May through November, the range of movements progressively diminished, only to expand again during December when the Japanese yen exchange rate showed renewed instability. In January and February 2002, the day-to-day fluctuation range narrowed from 5.3 won in December 2,001 to 2.8 won and the intraday fluctuation range from 7.3 won to 5.8 won.

(Foreign Borrowing Environment)

Korea's sovereign rating maintained its investment grade during the year 2001. In November S&P upgraded the country's sovereign rating by one grade (November 13, BBB → BBB+), making a positive assessment of the progress of corporate and financial

<Table II -28>

Trends of Changes in Korea's Sovereign Rating

	S&P	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)	-	-

Note: 1) Figures in parentheses refer to the date of release.

<Table II -29>

Spread¹⁾ on Foreign Exchange Stabilization Fund Bonds

	(bp)				
	2000	2001			
	Dec.	Mar.	Jun.	Sep.	Dec.
Stabilization bonds (2003)	165	132	112	115	30
(2008)	240	174	136	145	81
Industry & financial bonds (2004)	235	209	180	185	139

Notes: 1) Spread over US T-notes. Period-end basis.

2) Yield 7.04%(9.08% at the point of issuance)

<Table II -30>

Spread on Short-term Borrowings of Domestic Banks

	(bp)				
	2000	2001			
	Dec.	Mar.	Jun.	Sep.	Dec.
Spread ¹⁾	76	53	45	38	32
Libor ²⁾	6.55	4.96	3.83	3.03	1.92

Notes: 1) Spread over Libor. Period-end basis.

2) 3 months, period average, (%).

restructuring. Other major international credit rating agencies meanwhile made upward adjustments on several occasions of domestic banks' ratings, taking into consideration the continuing reduction of non-performing assets, and the improvement of their management performance. This trend was continued on into the year 2002 and additional upgrades were made on several banks.

The premium on Foreign Exchange Stabilisation Fund(FESF) bonds continued to narrow. It widened again for a short lived period in the aftermath of the terrorist attacks on the U.S.(September 11), but resumed its narrowing trend thanks to S&P's upward adjustment of Korea's sovereign rating and expanded purchases by international institutional investors of Asian region government bonds. As a result of these developments it closed the year at 81 basis points, a 159 basis point reduction from the end of the previous year. In the year 2002, reflecting the economic recovery and Moody's upgrading of Korea's sovereign rating, the Korea premium narrowed further and by the end of February, it stood at 60 basis points, the lowest level since FESF bonds were issued in April 1998.

The spread over Libor on domestic banks' short term borrowings eased sharply thanks to the improvement in their external credit standing and the improved environment pertaining in international financial markets. It fell by 44 basis points in the course of the year to stand at 32 basis points at the end of 2001. It declined further to reach 25 basis points as at the end of February 2002, in response to the continued upgrading of domestic financial institutions' credit ratings by international credit rating agencies.