

QUARTERLY

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Current Economic and Financial Movements

Summary

During the fourth quarter of 2003 following on from the previous quarter, the Korean economy showed a mild pace of recovery with the growth rate rising and the current account surplus expanding, even though consumer price inflation accelerated from the previous quarter.

Real gross domestic product (GDP) grew by 3.9 percent year-on-year in the fourth quarter, which was higher than its 2.4 percent rate in the previous quarter, due to brisk exports, which offset that of continued sluggishness in domestic demand. Real gross national income (GNI) also showed a rise of 3.0 percent, higher than the 2.1 percent of the previous quarter.

The current account surplus amounted to 7.7 billion dollars in the fourth quarter, more than double the 3.8 billion dollars of the previous quarter. This was attributable to widened surpluses on the

goods and income accounts, coupled with a narrowed deficit on the service account.

The employment situation showed signs of a modest improvement. The seasonally-adjusted unemployment rate rose by 0.1 of a percentage point from the previous quarter to 3.6 percent in the fourth quarter. The number of persons in employment, though, increased by 116 thousands from the previous quarter and the ratio of the economically active population to total population rose by 0.2 of a percentage point.

The year-on-year rate of increase of consumer prices climbed from 3.2 to 3.5 percent due to a surge in prices of agricultural and livestock products resulting from a steep fall in production and shipment. Producer prices also saw their rising trend accelerate from the previous quarter owing to a surge in prices of agricultural and marine products, coupled with an upward trend in those of indus-

trial goods and services. Meanwhile, core inflation, which excludes prices of petroleum fractions and agricultural products except cereals, was running in the 2.7~2.8 percent range, maintaining a gradually stable trend.

The yield on Treasury bonds (three-year maturity) showed an upward trend in the fourth quarter of 2003, affected by expectations of economic recovery and the expanded issuance following the compilation of supplementary budget. The Korea Composite Stock Price Index (KOSPI) posted a rise in the fourth quarter, owing to expectations of economic recovery and the continued net purchase of stocks by foreign investors.

The Korean won had showed a persistent weakening against the U.S. dollar since the middle of October due to the liquidity problem of credit card companies, but firmed again owing to continued inflow of foreigners' stock investment funds, the widening of the current account surplus, as well as the strong Japanese yen.

The growth rate of M3 slowed down in the fourth quarter from the previous quarter due to the reduced growth of credit supply to households and large enterprises. The growth rate of M1 also dropped slightly from the previous quarter, affected by the withdrawals from MMF contracts.

Economic Movements

Economic Growth

During the fourth quarter of 2003, real gross domestic product (GDP) expanded by 3.9 percent year-on-year, up from 2.4 percent in the previous quarter, owing to the accelerated pace of exports growth and the high rate of growth in construction investment, which helped overcome the effects of the continued sluggishness of private consumption and facilities investment.

The growth rate of real gross national income (GNI) registered 3.0 percent in the fourth quarter, an improvement from 2.1 percent in the previous quarter. It nevertheless remained below the real GDP growth rate since it reflected real trade losses following the depreciation of the terms of trade.

Final consumption expenditures declined by 1.1 percent year-on-year owing to the sluggishness of private consumption, which was only partially offset by a modest rise in government consumption. The decreasing pace of private consumption accelerated somewhat to 2.2 percent year-on-year in the fourth quarter from 1.9 percent in the previous quarter as the expenditures for durables, semi-durables and non-durables all maintained their declining pace and the increasing pace of services slowed. Meanwhile, government consumption rose by

3.5 percent, which was the same as in the previous quarter.

The growth rate of fixed investment risen from 2.6 percent in the third quarter to 3.6 percent in the fourth quarter, as the declining scale of facilities investment eased and construction investment kept going on a high growth course. Facilities investment declined by 2.4 percent in the fourth quarter year-on-year, easing a downward course to that of the previous quarter(-5.0 percent). This was attributable to the fact that the decreasing scale of investment in transportation equipment reduced to some extent and the increasing scale of investment in machinery expanded to a slight extent.

On the other hand, following on from its 7.9 percent rise in the previous quarter, construction investment showed a high growth rate of 7.4 percent in the

fourth quarter, as the increasing pace of investment in residential and non-residential buildings continued, while investment in infrastructure projects, including harbors, railroads and roads shifted to a slightly upward trend.

The year-on-year growth rate of exports of goods and services accelerated sharply further from 14.9 percent in the third quarter to 23.1 percent in the fourth quarter. That of goods exports accelerated, led mainly by semiconductors, communication equipment, and motor vehicles. That of service exports shifted to an upward trend owing to an increase in spending by inbound foreign tourists and a rise in exports of transportation services.

The year-on-year growth rate of imports of goods and services also expanded from 7.7 percent in the third

[Table 1] Growth Rates by Component of Expenditure¹⁾

	Unit : percent					
	2002		2003 ²⁾			
	Year	Year	I	II	III	IV
G D P	7.0	3.1	3.7	2.2	2.4	3.9
G N I	7.0	1.8	0.5	1.5	2.1	3.0
Final consumption expenditure	7.6	-0.5	0.9	-0.8	-0.9	-1.1
Private consumption	7.9	-1.4	0.3	-1.8	-1.9	-2.2
Government consumption	6.0	3.7	4.0	3.7	3.5	3.5
Gross fixed capital formation	6.6	3.6	4.6	3.7	2.6	3.6
Equipment	7.5	-1.5	1.9	-0.6	-5.0	-2.4
Construction	5.3	7.6	8.0	7.3	7.9	7.4
Intangible fixed assets	14.2	-1.3	-2.3	-3.8	0.2	0.4
Exports of goods and services	13.3	15.7	15.9	8.4	14.9	23.1
Imports of goods and services	15.2	9.7	14.2	5.2	7.7	11.7

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

2) p : preliminary

quarter to 11.7 percent in the fourth quarter. Viewing the growth by goods, imports of petroleum products accelerated their upward pace, and those of capital goods such as semiconductors, machinery and steel maintained their high growth. The growth rate of imports of services remained similar to that in the previous quarter, with a rise in imports of transportation services, being offset by a decline in residents' spending on overseas travel.

Viewing growth by type of economic activity, manufacturing accelerated its upward pace and construction continued its high growth rate. The growth rate of services, meanwhile, expanded somewhat from the previous quarter's level.

The agricultural, forestry and fishery industry posted negative year-on-year growth of 9.1 percent owing to the poor performance of the cultivation and live-

stock sub-sectors, affected respectively by a reduction in the rice harvest and the outbreak of avian flu. The construction industry enjoyed a high growth rate of 8.4 percent, following on from the 8.1 percent in the previous quarter, thanks to brisk construction activities for both residential and non-residential buildings.

For its part, manufacturing posted a high growth rate of 8.0 percent, a significant improvement from the 3.3 percent of the previous quarter. By sector, the textile, clothing, printing and publishing sectors continued their downward trend of the previous quarter. The transportation equipment sector, in contrast, shifted to a sharp rise and the growth rates of the semiconductor, audio communications, industrial machinery, steel, and non-metallic minerals sectors accelerated.

The service industry posted a year-on-year rise of 2.4 percent, slightly up from

[Table 2] Growth Rates by Sector of Economic Activity¹⁾

	Unit : percent					
	2002		2003 ²⁾			
	Year	Year	I	II	III	IV
Agriculture, Forestry & Fishing	-3.5	-7.1	-5.1	-1.3	-9.1	-9.1
Manufacturing	7.6	4.8	5.1	2.6	3.3	8.0
Electricity, Gas & Water	7.7	5.7	7.1	8.9	3.1	3.7
Construction	2.8	8.1	8.4	7.7	8.1	8.4
Services	7.8	1.8	1.9	1.1	1.6	2.4
(Wholesale and retail trade, restaurants and hotels)	5.4	-2.3	-0.6	-3.9	-3.0	-1.8
(Transport, storage and communication)	9.2	3.7	3.8	3.3	3.1	4.5
(Finance, insurance, real estate and other services activities)	8.3	2.6	2.2	2.1	2.7	3.2

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

2) p : preliminary

the previous quarter's 1.6 percent. The wholesale & retail trade, restaurant & hotel sector showed negative growth of 1.8 percent, affected by sluggish transactions in agricultural and industrial goods as well as the poor performance in the restaurant and hotel sector.

The transport, storage and communication industry grew by 4.5 percent year-on-year in the fourth quarter, up from the previous quarter's 3.1 percent, as the growth rate of the cargo and passenger transportation sector accelerated somewhat and the communication sector maintained relatively robust growth.

The finance, insurance, real estate and other service activities sector posted 3.2 percent growth, slightly higher than the previous quarter's 2.7 percent, as the growth pace of the business service sub-sector accelerated along with the steady

growth of the finance and insurance, education service sub-sector.

Employment and Wages

The seasonally-adjusted unemployment rate rose by 0.1 of a percentage point from 3.5 percent in the third quarter to 3.6 percent in the fourth quarter as the number of jobless increased by 22 thousands from the previous quarter to 821 thousands. However, the number in employment increased by 116 thousands from the previous quarter to 22,204 thousands in the fourth quarter and that of the economically active population expanded by 136 thousands, showing signs of some improvement in the overall employment situation.

In the meantime, the unemployment rate in January 2004 (seasonally-adjusted

[Table 3]

Employment^{a)} Trends

Unit : thousand persons, percent

	2002			2003					2004
	Year	III	IV	Year	I	II	III	IV	Jan.
<Seasonal Adjusted>									
Labor Force	-	22,896	22,893	-	22,918	22,843	22,888	23,024	23,369
(Participation Rate)	-	61.9	61.7	-	61.6	61.2	61.2	61.4	62.2
Unemployment Level	-	691	687	-	721	775	799	821	779
(Unemployment Rate)	-	3.0	3.0	-	3.1	3.4	3.5	3.6	3.3
Employment Level	-	22,204	22,206	-	22,196	22,068	22,088	22,204	22,591
<Not Seasonally Adjusted>									
Labor Force	22,877	23,067	22,989	22,916	22,439	23,055	23,050	23,119	22,790
(Participation Rate)	61.9	62.3	62.0	61.4	60.3	61.8	61.6	61.7	60.7
Unemployment Level	708	652	663	777	806	751	756	794	854
(Unemployment Rate)	3.1	2.8	2.9	3.4	3.6	3.3	3.3	3.4	3.7
Employment Level	22,169	22,416	22,326	22,139	21,633	22,303	22,295	22,325	21,936

[Table 4]

Rates of Increase¹⁾ of Nominal Wages

Unit : percent

	2001		2002		2003				
	Year	Year	Ⅲ	Ⅳ	Year	I	Ⅱ	Ⅲ	Ⅳ
Nominal wages per worker	5.1	11.2	11.2	13.8	9.2	12.9	8.3	8.6	7.3
(Regular Payment)	6.3	12.1	11.6	12.7	8.8	9.0	8.4	8.6	9.0
(Overtime Payment)	-1.6	-3.9	-3.3	-1.4	7.3	9.3	6.5	4.7	8.5
(Special Cash Payment)	3.4	13.4	14.7	22.2	11.4	28.5	8.4	9.7	2.0
(Manufacturing)	5.8	11.9	11.9	17.3	8.7	13.7	7.2	7.7	6.3
(Construction)	-0.9	10.2	9.0	12.9	11.5	14.7	9.3	11.0	11.1
(Wholesale, retail, restaurants and hotels)	9.7	10.1	10.2	7.9	8.8	11.2	7.6	9.0	7.0
(Transport, storage and communications)	1.9	8.4	9.2	10.8	10.4	15.6	9.6	10.4	6.2
(Finance, insurance and real estate)	5.1	10.4	8.9	11.4	8.9	11.5	8.3	8.8	7.1
(social and personal services)	2.7	12.4	13.8	14.4	8.6	10.6	8.2	7.8	8.3

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

basis) marked 3.3 percent, down from the previous quarter. The number in employment rose by 387 thousands, and that of unemployed dropped by 42 thousands.

Nominal wages rose by 7.3 percent year-on-year during the fourth quarter, slightly lower than the previous quarter's 8.6 percent. The growth rate of regular wages and overtime payments accelerated, but that of special wages slowed down significantly. By industry, most industries saw the pace of wage growth slow down.

External Transactions

During the fourth quarter of 2003, exports rose by 25.6 percent over the same period of the previous year to 56.9 billion dollars, posting higher growth

than the previous quarter's. Broken down by commodity group, exports of most products, except for ships and textiles, increased sharply. By export destination, exports to China and Southeast Asia registered a high rate of increase, and the growth rate of exports to advanced countries, including the United States, Japan, and EU, accelerated from the previous quarter.

In January 2004, meanwhile, exports rose by 32.7 percent over the same month of the previous year to chalk up 19.0 billion dollars, continuing their buoyant growth. By item, exports of most items, apart from textiles, saw an increase. In particular, those of computers, wireless communication equipment, and ship building registered high growth rates.

[Table 5] Exports by Sector and Destination¹⁾
(Custom-clearance Basis) Unit : billion US dollars

	Share ²⁾	2002		2003				2004
		Year	Year	I	II	III	IV	Jan.
Exports	<100.0>	162.5 (8.0)	193.8 (19.3)	43.0 (20.7)	46.1 (14.4)	47.8 (15.9)	56.9 (25.6)	19.0 (32.7)
IT products	<30.7>	48.8 (20.0)	59.6 (22.1)	12.7 (17.4)	12.9 (9.8)	15.8 (27.7)	18.1 (31.2)	5.8 (33.5)
Semiconductors	<10.1>	(16.6)	(17.5)	(9.7)	(3.5)	(23.6)	(30.3)	(16.6)
Computer	<7.6>	(15.6)	(15.1)	(0.4)	(-0.7)	(23.2)	(37.4)	(45.0)
Wireless communication apparatus	<7.7>	(34.6)	(37.5)	(52.0)	(31.6)	(42.2)	(29.0)	(51.2)
Non-IT products	<69.3>	113.7 (3.5)	134.3 (18.1)	30.3 (22.2)	33.1 (16.3)	32.1 (10.9)	38.8 (23.1)	13.2 (32.3)
Automobile	<11.6>	(12.3)	(33.5)	(24.9)	(48.8)	(13.7)	(44.2)	(18.4)
Ships	<5.7>	(10.0)	(4.0)	(17.8)	(26.9)	(11.4)	(-31.4)	(134.8)
Machinery	<6.6>	(10.8)	(17.7)	(25.0)	(16.0)	(9.4)	(21.5)	(19.1)
Iron & steel products	<6.8>	(2.8)	(26.9)	(34.1)	(20.4)	(24.1)	(30.0)	(25.2)
Chemical products	<7.6>	(9.4)	(24.8)	(29.6)	(19.5)	(21.5)	(28.7)	(25.6)
Textile & Apparel	<7.4>	(-2.3)	(-3.3)	(0.5)	(-5.5)	(-5.7)	(-1.6)	(-11.7)
U S	<17.7>	(5.0)	(4.4)	(3.1)	(3.4)	(-1.0)	(11.1)	(1.3)
Japan	<8.9>	(-8.3)	(14.1)	(20.5)	(10.4)	(7.4)	(18.2)	(11.8)
E U	<12.8>	(10.5)	(14.7)	(24.8)	(15.0)	(9.5)	(11.3)	(20.6)
China	<18.1>	(30.6)	(47.8)	(60.6)	(35.6)	(51.4)	(46.2)	(45.0)
Southeast Asia	<21.6>	(10.8)	(19.3)	(10.5)	(9.0)	(15.0)	(42.2)	(42.5)
Central & South America	<4.5>	(-8.9)	(-0.7)	(16.2)	(-9.6)	(-14.1)	(8.6)	(-11.6)

Notes : 1) Figures in parentheses refer to rates of increase compared with the same period of the previous year(%).
2) Based on the year 2003.

During the fourth quarter, imports increased by 18.1 percent year-on-year to stand at 49.9 billion dollars. By item, imports of raw materials and capital goods posted a higher rate of increase than in the previous quarter due, respectively, to a rise in international prices of raw materials and sharply expanded imports of machinery and electric & electronics goods, including semiconductors. Imports of consumer goods also rose sharply.

Imports in January 2004 expanded by

11.2 percent over the same month of the previous year to stand at 16.1 billion dollars, cooling their growth pace. By item, the growth rate of imports of raw materials slowed down sharply due to a reduction in imports of crude oil. Those of capital goods, led by semiconductors and machinery, increased steadily, and those of consumer goods adhered to their high growth rate of the previous month.

Reflecting these export and import trends, the surplus on the goods account

[Table 6] Imports by Sector and Use¹⁾
(Custom-clearance Basis) Unit : billion US dollars

	Share ²⁾	2002		2003				2004
		Year	Year	I	II	III	IV	Jan.
Imports	<100.0>	152.1 (7.8)	178.8 (17.6)	44.2 (30.9)	41.7 (12.1)	43.0 (10.5)	49.9 (18.1)	16.1 (11.2)
Raw materials & Fuels	<48.3>	73.9 (2.7)	86.4 (16.9)	22.4 (31.5)	20.2 (11.5)	20.7 (11.3)	23.2 (14.8)	8.1 (6.7)
Crude oil	<12.9>	(-10.1)	(20.2)	(49.9)	(3.4)	(7.7)	(22.8)	(-12.8)
Iron & steel products	<4.6>	(24.6)	(30.9)	(35.6)	(35.8)	(28.1)	(25.5)	(44.7)
Chemical products	<8.1>	(8.8)	(17.7)	(26.7)	(15.2)	(12.0)	(17.9)	(19.9)
Capital goods	<38.5>	58.0 (10.4)	68.9 (18.7)	16.5 (33.6)	16.1 (13.3)	16.7 (10.6)	19.6 (19.6)	5.9 (15.2)
Electric & electronic products	<23.8>	(6.4)	(18.1)	(26.3)	(13.6)	(13.0)	(20.4)	(19.5)
Machinery	<8.2>	(15.8)	(17.4)	(42.6)	(9.1)	(8.6)	(15.3)	(15.8)
Consumer goods	<13.2>	20.3 (21.8)	23.6 (16.5)	5.4 (21.1)	5.5 (11.3)	5.6 (7.6)	7.1 (25.8)	2.2 (19.1)
For domestic use	<58.4>	(12.7)	(15.2)	(29.2)	(12.9)	(7.1)	(13.2)	(8.2)
For export	<41.6>	(1.3)	(21.1)	(33.3)	(11.0)	(15.4)	(25.6)	(15.5)

Notes : 1) Figures in parentheses refer to rates of increase compared with the same period of the previous year(%).
2) Based on the year 2003.

(B.O.P. basis) widened from 6.8 billion dollars in the third quarter to 8.3 billion dollars in the fourth quarter. The current account posted a surplus of 7.7 billion dollars in the fourth quarter, a significant improvement from the 3.8 billion dollars of the previous quarter.

In January 2004, the current account

posted a surplus of 2.3 billion dollars, similar to that in the previous month.

Prices

The year-on-year increase rate of consumer prices, which had dropped to the level of slightly above 3 percent in the

[Table 7] Balance of Payments: Current Account Unit : billion US dollars

	2002		2003				2004
	Year	Year	I	II	III	IV	Jan.
Current account	5.4	12.3	-1.5	2.4	3.8	7.7	2.3
Goods	14.8	22.2	1.2	5.8	6.8	8.3	3.0
Services	-8.2	-7.6	-2.3	-1.7	-2.7	-1.0	-0.8
Income	0.4	0.6	0.3	-1.0	0.5	0.9	0.4
Current transfers	-1.6	-2.8	-0.7	-0.6	-0.9	-0.6	-0.2

third quarter of 2003, rose back to the level of around 3.5 percent in the fourth quarter. This was mainly attributable to a sharp rise in prices of agricultural products, which declined somewhat over the previous quarter by an increase in seasonal shipments, resulting from the unusually steep fall in production amid severe weather. Thereafter, consumer price inflation continued on this upward trend during the first two months of 2004, affected by higher prices for agricultural, livestock and marine products and petroleum fractions, and increase in public utility charges.

Viewing the trend of consumer prices by item, compared with the preceding period, prices of agricultural, livestock and marine products showed a downward trend during the fourth quarter due to a rise in seasonal shipments of agricultural products and subdued demand for livestock products after Chusok. However,

they shifted to an upward trend again in January and February 2004 owing to the reduced shipments during the winter season and the rising demand over the Lunar New Year's Holiday period.

Despite sluggish domestic demand, prices of industrial products continued an upward trend from the fourth quarter as prices of petroleum fractions rose in response to a run-up in international oil prices.

Service prices maintained a stable upward trend during the fourth quarter as the rising pace of housing rents slowed and public utility charges were held down, helping offset the rise in charges for personal services led by those for eating out. The service prices showed a stable trend during the first two months of 2004 despite hikes in such public utility charges as health care fees and charges for city gas and water.

Meanwhile, core inflation, which

[Table 8] Rates of Increase of Consumer Prices¹⁾

Unit : percent

	2002		2003				2004	
	Year	Year	I	II	III	IV	Jan.	Feb.
Consumer prices	3.7 (2.7)	3.4 (3.6)	2.4 (4.1)	-0.6 (3.4)	1.3 (3.2)	0.4 (3.5)	0.6 (3.4)	0.4 (3.3)
Agricultural, livestock and marine products	6.9	8.9	6.6	-5.9	10.3	-1.6	2.2	1.6
Industrial products	4.1	1.4	1.7	-1.1	-0.2	1.0	0.5	0.4
Services	2.8	3.5	1.9	0.7	0.4	0.4	0.3	0.3
Core inflation ²⁾	3.1 (3.0)	2.8 (3.1)	1.6 (3.2)	0.5 (3.2)	0.3 (3.1)	0.5 (2.7)	0.4 (2.8)	0.1 (2.7)

Notes : 1) Compared with the last month of the preceding period. Figures in parentheses refer to rates of increase over the corresponding period of the previous year.
2) The CPI after stripping out prices of petroleum fractions and agricultural products except cereals.

strips out non-cereal agricultural products and petroleum fractions from the CPI, remained stable at the level of slightly below 3 percent year-on-year from the fourth quarter of 2003, opening up a wider difference from the CPI. This was attributable to its exclusion of non-cereal agricultural products, whose prices surged over the corresponding period of the previous year, from its composition and the stable prices of industrial products except petroleum fractions amid sluggish domestic demand.

The year-on-year rise in producer prices accelerated significantly from the fourth quarter of 2003 to post 4.5 percent in February 2004, its largest increase since November 1998.

Viewing the trend of producer prices by item, compared with the preceding period, those of agricultural, forest and marine products maintained an upward trend in the fourth quarter due to a sharp

drop in shipments of agricultural products, affected by torrential rainfalls and a typhoon. They soared higher during the first two months of 2004 due to the reduced shipments during the winter season and the rising demand over the Lunar New Year's Holiday period.

The increasing pace of prices of manufacturing industry products, led by petrochemical and metal products, accelerated from the fourth quarter owing to a rise in prices of international raw materials, notably crude oil and steel.

The rate of increase of service prices, which had shown a stable upward trend since the second quarter, gathered pace in the fourth quarter due to a sharp hike in rates for sea freight and a rise in automobile insurance premiums and railroad fares. This steep upward trend continued until January 2004 owing to a rise in rents of business offices and fees for building design and supervision, but the

[Table 9] Rates of Increase of Producer Prices¹⁾

	Unit : percent							
	2002		2003				2004	
	Year	Year	I	II	III	IV	Jan.	Feb.
Producer prices	2.3	3.1	2.3	-1.6	1.0	1.4	1.4	1.2
	(-0.3)	(2.2)	(3.0)	(1.3)	(1.9)	(2.6)	(3.8)	(4.5)
Agricultural, forest and marine products	4.9	12.1	3.9	-4.9	11.0	2.3	3.8	3.2
Manufacturing industry products	2.2	2.7	2.9	-2.3	0.6	1.5	1.3	1.7
Electric power, water, and gas supply	-1.8	0.6	2.4	-0.1	-1.9	0.2	1.3	0.1
Services	2.4	2.9	1.0	0.4	0.3	1.2	0.9	0.2

Note : 1) Compared with the last month of the preceding period. Figures in parentheses refer to rates of increase over the corresponding period of the previous year.

pace slowed down sharply in February, affected by a reduction in airline passenger fares.

Export prices, led by petrochemical and metal products, shifted to an upward trend in the fourth quarter as prices of international raw materials continued an increasing trend and the effects of the Korean won's weakness materialized. Despite a modest appreciation of the won, export prices held to their steep upward trend in January 2004 as international prices of raw materials moved persistently higher and exports continued buoyant amid the global economic recovery.

Import prices also shifted to an upward trend from the fourth quarter when they grew rapidly as prices of raw materials, including crude oil, steel and nonferrous metals, continued their rising trend while those of both capital and consumer goods went up, affected by the depreciation of the Korean won against major foreign currencies. Although prices of capital goods dropped slightly as the

Korean won gained back some ground, import prices, led by raw materials, intermediate goods and consumer goods, maintained their rising pace in January 2004.

Housing prices showed a downward trend from November, affected by the government's comprehensive measures announced on Oct. 29 to stabilize real estate prices, including the imposition of heavier taxes on real estate and the lowering of the loan-to-value ratio of housing offered as collateral. Consequently, housing prices dropped slightly during the fourth quarter as a whole. Housing prices continued the downward trend during January 2004, but rebounded somewhat in February owing to increasing seasonal demand.

Housing rents remained on a declining trend during the fourth quarter and on into January 2004. Their downturn accelerated in the fourth quarter of 2003, affected by low seasonal demand, but housing rents shifted back to a rising pattern in February owing to increasing

[Table 10] Rates of Increase of Export and Import Prices¹⁾

	Unit : percent						
	2002		2003				2004
	Year	Year	I	II	III	IV	Jan.
Export prices	-1.1	3.3	4.6	-5.7	-1.2	6.0	1.7
	(-7.0)	(-2.2)	(-3.9)	(-4.5)	(-0.7)	(0.6)	(5.7)
Import prices	2.9	6.5	6.3	-6.4	-1.1	8.2	1.8
	(-6.2)	(1.8)	(3.5)	(-1.6)	(1.4)	(4.0)	(7.4)

Note : 1) Compared with the last month of the preceding period. Figures in parentheses refer to rates of increase over the corresponding period of the previous year.

[Table 11] Rates of Increase of Real Estate Prices¹⁾

	Unit : percent							
	2002		2003				2004	
	Year	Year	I	II	III	IV	Jan.	Feb.
Housing prices	16.4	5.7	1.2	3.3	1.4	-0.2	-0.4	0.2
(Apartments in Seoul)	30.8	10.2	-0.8	5.4	4.4	0.9	-0.3	0.7
Housing rents	10.1	-1.4	1.4	-0.7	-0.3	-1.8	-0.5	0.2
(Apartments in Seoul)	11.4	-3.2	1.3	-2.4	-0.5	-1.6	-0.3	0.5
Land prices	9.0	3.4	0.4	0.5	1.1	1.5	-	-

Note : 1) Compared with the end of the preceding period.

demand for moving house.

Meanwhile, land prices consolidated their upward trend during the fourth quarter, as land prices in Daejeon, Chungcheong Province and the Seoul metropolitan area climbed considerably due to anticipations of the relocation of the administrative capital and the development of new towns.

Financial Developments

Financial Markets

Long-term market interest rates in the fourth quarter rose sharply as the expectations of economic recovery mounted, boosted by favorable exports, and the supply of bonds increased due to expanded issuance of Treasuries following the compilation of a second supplementary

[Chart 1] Market Interest Rate Movements

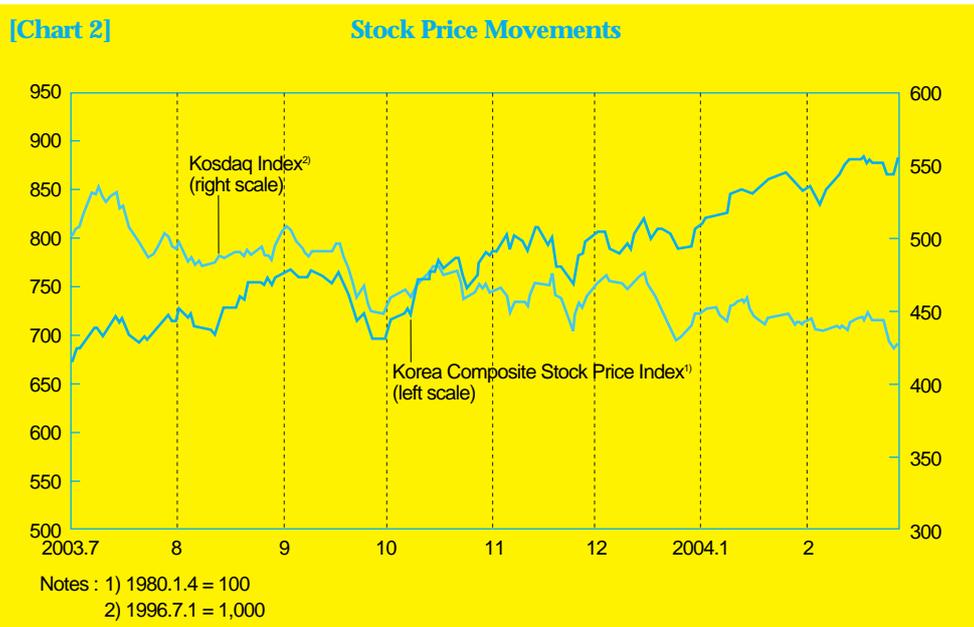


budget. From early December, however, the rates dropped slightly again, showing a correction phase following their earlier surge. Yields on Treasury bonds (three-year maturity) rose by 71 basis points from 4.11 percent at the end of September to 4.82 percent at the end of December, and those on corporate bonds (AA⁻ grade, three-year maturity) climbed by 53 basis points from 5.05 percent to 5.58 percent during the corresponding period.

Long-term market rates rebounded slightly in January 2004, buoyed by expectations of economic recovery, but fell back somewhat in February due to the likelihood of the United States keeping to low interest rates. As a result, yields on Treasury bonds (three-year maturity) and corporate bonds (AA⁻ grade, three-year maturity) stood at 4.78 percent and

5.56 percent, respectively, at the end of February, showing the level posted at the end of the previous year.

The Korea Composite Stock Price Index (KOSPI) showed a strong upward trend in the fourth quarter, boosted by expectations of economic recovery and the continued net purchase of stocks by foreign investors. It slipped temporarily in late November as some credit card companies faced a renewed insolvency crisis phase and major countries' stock prices, including those of the U.S., entered a correction phase. Once the U.S. stock prices regained their strength in December, KOSPI surged to 822.16, the year's highest level, on December 15. Subsequently it dropped back slightly again, registering 810.71 at the end of December, a sharp rise from 697.52 at the end of



the previous quarter.

The KOSDAQ index also showed similar movements in general, but it fell sharply from the middle of December as foreign investors shifted to a net selling position in sympathy with the correction phase of stock prices on the Nasdaq market. It posted 448.7 at the end of December, showing a level similar to that of the end of the previous quarter.

Entering the year 2004, the KOSPI continued to rise as foreigners stepped up their stocks owing to expectations of an improvement in companies' business performance and it posted 883.42 as of the end of February. On the other hand, the KOSDAQ index dropped to 428.68 at the end of February due to poor business performance of major internet related companies.

The Korean won weakened sharply against the U.S. dollar from mid-October and dropped to 1,203.1 won per dollar as the liquidity problem of credit card companies emerged from mid-October. From early December, however, the Korean won firmed against the greenback, affected by the steady inflow of foreigner's stock investment funds, the widening of the current account surplus, and the strength of the Japanese yen.

Strikingly, Korean won rose sharply against the U.S. dollar from Jan. 20 despite the government's impositions of regulations on Non-Deliverable Forward (NDF) positions in the middle of that month and it traded at 1,152.2 won to the dollar on Feb. 18. Subsequently, however, it showed a weakening trend in sympathy with that of the Japanese yen



[Table 12] Growth of Deposits at Financial Institutions
(Changes during the period) Unit : billion won

	2003				2004	
	I	II	III	IV	Jan.	Feb.
Deposit money banks ¹⁾	8,414	14,624	-1,501	18,353	-272	13,339
Money-in-trust	-2,246	-7,049	-3,211	-3,166	-2,829	-623
Investment trust companies	-8,062	-9,054	6,329	-17,802	521	6,458
Merchant banking corporations ²⁾	2,672	-1,030	-827	-1,541	1,268	-6,122

Notes : 1) Bank deposits + CDs + RPs + Cover bills
2) Bills Issued + CMA

and it stood at 1,176.2 won to the dollar on Feb. 27.

In the meantime, the Korean won continued its weakening trend against the yen since August 2003, posting 1,122.8 won per 100 yen on Jan. 6. However, it firmed sharply from mid-February, and changed hands at 1,072.5 won per 100 yen at the end of that month.

Deposit-taking by banks showed an increasing pace in the fourth quarter owing to an inflow of funds withdrawn from investment trust companies in the wake of growing worries over the financial market and a handsome rise in time deposits with a maturity of one year, affected by banks' efforts to expand long-term deposits in a bid to enhance their liquidity ratios at the end of the year.

On the other hand, deposit-taking by investment trust companies dropped sharply, led downward by their MMFs during the fourth quarter, affected by an increase in enterprises' withdrawal of funds for year-end settlements, a hike in market interest rates, and the re-emer-

gence of severe liquidity problems at some credit card companies.

In early 2004, deposit-taking by banks, centering on such short-term products as demand deposits and MMDAs, increased sharply as liquidity supply through the government and foreign channels expanded. Deposit-taking by investment trust companies, led by MMFs, also showed a recovering trend due to re-introduction of funds withdrawn temporarily at the end of the last year.

Monetary Aggregates

The growth rate of M3 slowed from 8.1 percent in the third quarter to 5.4 percent in the fourth quarter, owing to a remarkable slowdown in the year-on-year growth of credit supply to the private sector, particularly in the form of household loans, which more than offset the effects of the government's expansion of fiscal spending. The growth rate of M1 also fell from 6.6 percent in the third quarter to 5.4 percent in the fourth quarter, affected

[Table 13]

Monetary Aggregate Trends¹⁾

(On the basis of average figures)

Unit : percent

	2003				2004	
	I	II	III	IV	Jan.	Feb.
M3	12.4	9.6	8.1	5.4	4.9	-
M1	10.3	5.5	6.6	5.4	6.0	-
M2	13.1	9.1	6.5	3.3	2.4	-
Reserve money	7.7	7.2	6.4	4.7	9.6	4.0

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

by the withdrawals from MMFs.

In early 2004, the growth rate of M3 continued its falling trend to stand at 4.9 percent in January. The M1 growth rate shifted to an upward trend to register 6.0 percent in January, affected by a handsome rise in MMDAs and MMFs.

Bank Loans and Corporate Finance

Bank lending to enterprises declined in the fourth quarter in a development centered on large companies as enterprises, enjoying improved cash flow owing to favorable exports, repaid massive amounts of loans and banks expanded their sales and write-offs of non-performing loans. The growth of bank lending to households slowed, affected by a reduction in loans against housing collateral in line with the policy guideline on curbing household lending and some banks' securitization of household loans.

Meanwhile, the issuance of corporate bonds shifted to a net issuance position owing to enterprises' efforts to secure

long-term funds preemptively to guard against an expected hike in market interest rates. Meanwhile, Commercial Paper (CP) posted a net redemption as enterprises were reluctant to float bills because of the need to manage their debt ratios at the year-end, while the purchasing demands of investment trust companies for CPs waned due to reduced deposit.

In early 2004, corporate lending by banks shifted to an upward trend as they re-extended loans to enterprises that had been temporarily redeemed for the massage of their debt ratios at year-end. Bank lending to households decreased slightly in January due to seasonal factors, including the payment of bonuses, but recovered an upward trend in February.

Meanwhile, there was a net redemption of corporate bonds during the first two months of 2004 as issuance conditions worsened, affected by a reduction in purchases of the bond-type beneficiary certificates offered by investment trust companies and the liquidity problems of some credit card companies. CPs posted a

[Table 14] Bank Lending and Corporate Funding
(Changes during the period) Unit : billion won

	2003				2004	
	I	II	III	IV	Jan.	Feb.
Bank Loan ¹⁾ to Enterprises	16,447	10,970	7,418	-2,745	6,586	1,364
(Large enterprises)	1,756	-971	90	-3,811	2,701	-468
(Small and medium Enterprises)	14,691	11,941	7,328	1,066	3,885	1,832
Bank Loan to Household	4,815	9,078	8,735	7,947	-499	2,667
Net bond issuance ²⁾	-1,038	-1,027	-3,129	1,155	-1,576	-624
Net CP issuance ³⁾	2,475	-3,697	3,088	-3,871	3,267	-477

Notes : 1) Excludes changes to bank accounts in connection with the disposal of bad loans and debt-for-equity swaps, but includes trust accounts and CLO.
2) Excludes under court management, court receivership and workout programs, by financial companies, and by state-run corporations, but includes Primary CBO that was accepted by Korea Development Bank in its prompt underwriting arrangements and that was redeemed prior to maturity.
3) Based on the amount of CP discounted by securities firms and merchant banking corporations and excluded the amount of financial institution's issuance.

net issuance in January owing to the renewed issue of bills that had been temporarily retired at the year-end, but it

shifted to net redemption in February as enterprises' demand for funds remained sluggish.

Monetary Policy Decision

Adopted by the Monetary Policy Committee

January ~ March 2004

Monetary Policy in January 2004*

Despite the continuing sluggishness of private consumption and facilities investment, industrial production has exhibited solid growth mainly owing to strong exports. Overall, the real economy continues to show signs of gradual improvement.

Consumer price inflation accelerated temporarily in December, as prices of industrial products and private services rose. Fundamentally, however, inflation has remained stable and housing prices have also continued to decline since the previous month.

The current account is estimated to have maintained its relatively large surplus, owing to the continued surplus on the goods account.

In the financial markets, overall liquidity conditions have been relatively favorable due to the low demand for funds.

* Unofficial English translation based on the Korean original that was decided upon by the Monetary Policy Committee on January 8, 2004

However, concern over the deterioration of the soundness of some financial institutions - notably a few credit card companies - has grown and risk aversion from low-rated corporations has not lessened.

Taking the above economic and financial conditions into consideration, the Monetary Policy Committee of the Bank of Korea decided today to maintain the benchmark call rate (uncollateralized overnight rate) at its current level (3.75 percent) for the intermeeting period.

Monetary Policy in February 2004*

Private consumption and facilities investment still show downward movements, whereas the growth of industrial production has accelerated greatly owing to strong exports. Overall, the real economy continues to show signs of a gradual improvement.

Consumer price inflation showed a relatively rapid rise in January for the second month in a row due to seasonal factors associated with the Lunar New Year and the upswing in international oil prices. Fundamentally, however, inflation has remained stable, as demand-pull pressures are still weak.

* Unofficial English translation based on the Korean original that was decided upon by the Monetary Policy Committee on February 6, 2004

It is estimated that the current account surplus widened in January owing to the enlargement of the surplus on the goods account compared to that of the previous month.

In the financial markets, overall liquidity conditions have been relatively favorable due to subdued demand for funds. Concern over the fragile management status of certain financial institutions including a few credit card companies has, however, persisted and there has been no let-up in risk aversion from low-rated corporations.

Taking the above economic and financial conditions into consideration, the Monetary Policy Committee of the Bank of Korea decided today to maintain the benchmark call rate (uncollateralized overnight rate) at its current level (3.75 percent) for the intermeeting period.

Monetary Policy in March 2004*

* Unofficial English translation based on the Korean original that was decided upon by the Monetary Policy Committee on March 11, 2004

Private consumption and facilities investment still show downward movements, whereas industrial production has exhibited solid growth driven by strong exports. Overall, the real economy continues to show signs of a gradual improvement.

Core inflation has remained stable owing to the sluggishness of domestic demand. However, consumer and producer price inflation continued to show a relatively rapid rise mainly due to the upswing in the prices of international raw materials and seasonal factors.

The current account surplus is estimated to have been similar in scale to the previous month's, due to the continued large surplus on the goods account.

In the financial markets, overall liquidity conditions have been favorable due to subdued demand for funds. However, fund-raising conditions have remained difficult for small- and medium-sized corporations with a low credit rating.

Taking the above economic and financial conditions into consideration, the Monetary Policy Committee of the Bank of Korea decided today to maintain the benchmark call rate (uncollateralized overnight rate) at its current level (3.75 percent) for the intermeeting period.

Medium-term Inflation Target and Monetary Policy for 2004

I . Introduction

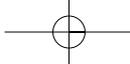
Since the adoption of inflation targeting in 1998, the Bank of Korea has set an inflation target every year, but pursuant to the implementation(effective January 2004) of the 7th revision of the Bank of Korea Act, a medium-term inflation target has been set from this year in place of the annual inflation target.

Previously, the Bank of Korea had set and announced the annual inflation target at the beginning of each year, after consulting with the government at the end of the preceding year. However, under this framework, there were some difficulties in conducting preemptive monetary policy, owing to the facts that it takes over one year for monetary policy

to have an impact on prices and that policy effects are highly uncertain. In order to alleviate these shortcomings, the setting of a medium-term inflation target along with the annual inflation target was begun from 2000. However, no legal framework allowing for a medium-term inflation target was prepared at that time. Further, in the event of two totally different sets of policy responses being called for to meet the two inflation targets, policy focused on achieving the annual target would have been required by the Act, despite any impracticalities which this might have involved. In order to eliminate the possibility of such conflict between two inflation targets, the Bank of Korea Act was amended last year¹⁾ and the legal basis put in place for operation

1) (Before amendment) Article 6 of the Bank of Korea Act : ① The Bank of Korea shall set a price stability target every year in consultation with the Government and formulate and publish an operational plan for monetary and credit policies including this price stability target.

(After amendment) Article 6 of the Bank of Korea Act : ① The Bank of Korea shall set a price stability target in consultation with the Government. ② The Bank of Korea shall set and publish the operational direction for monetary and credit policies every year.



of a medium-term inflation target system from this year. Therefore, the Bank of Korea is now able to conduct monetary policy under a medium-term horizon.

The Bank of Korea announced the medium-term inflation target and the operational direction of monetary policy for 2004 in a resolution by the Monetary Policy Committee on January 8. The main points are detailed as follows.

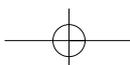
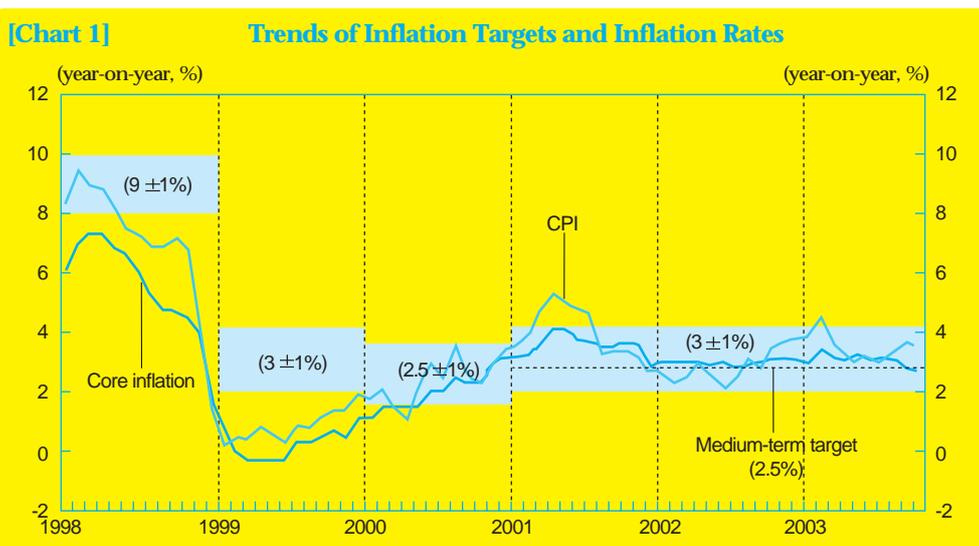
II . Medium-term Inflation Target

1. Brief History of Inflation Targeting in Korea

In 1998, its first year of operating an inflation targeting system, the Bank of Korea needed to take into account the

very special policy environment and economic situation following the foreign exchange crisis. It set the annual inflation target, based on the Consumer Price Index (Headline CPI), at a relatively high $9.0 \pm 1\%$. However, with the decline in the exchange rate and improvements of other indicators from the second half of 1998, inflation fell dramatically and the target was consequently lowered to $3.0 \pm 1\%$ in 1999.

Setting the inflation target based on CPI at that time reflected consideration of the fact that the CPI is the representative inflation index in the mind of the general public. In addition, when consultations on macroeconomic policies were held after the foreign exchange crisis, among the IMF, the government, and the Bank of Korea, Headline CPI was used as the main indicator to check on inflation tendencies.



[Table 1] Trends of Inflation Targets¹⁾ and Inflation Rates

	Unit : annual average, %					
	1998	1999	2000	2001	2002	2003
Medium-term target ²⁾	-	-	2.5	2.5	2.5	2.5~3.5
Annual target	9.0 ±1	3.0 ±1	2.5 ±1	3.0 ±1	3.0 ±1	3.0 ±1
Inflation rate						
Core inflation	5.9	0.3	1.9	3.6	3.0	3.1
CPI	7.5	0.8	2.3	4.1	2.7	3.6

Notes : 1) Based on the CPI for 1998 and 1999, and on core inflation from 2000

2) Based on the time of target setting (target application from the following year)

From 2000, however, the index for the inflation target was changed to core inflation²⁾, for the reason that core inflation, excluding the influence of non-monetary factors such as climate, international oil prices and the like, better reflects the trend of inflation, which makes it more appropriate as the target index.

Setting of a medium-term inflation target was also begun from 2000. This was first established as a single point target of 2.5%, but in 2003 it was changed to a range of 2.5~3.5%(to be applied from 2004), considering the uncertainty of medium-term inflation conditions. This year is the first to see a medium-term inflation target set and applied without an annual inflation target.

Meanwhile, looking at the change in monetary policy operation system, from 2001 the monetary aggregate(M3) was no

longer used as an intermediate target, but only as one of the information variables to monitor.³⁾ Direct inflation targeting has been a framework for monetary policy since that time, and there is only a final target – inflation. The reason why a target rate of increase for M3 was announced as an explicit intermediate target after inflation targeting was first launched in 1998, was that the channel for transmission of interest rate policy to the real economy was uncertain following the foreign exchange crisis, and it was considered that failure to announce a target for M3 increase, which had long been operated as an intermediate target, might invoke fears stimulating an increase in inflation expectations. From 2001, however, considering the accumulation of experience with a monetary policy focused on interest rates, together with

2) Regarding estimation of core inflation, there are several possible methods, including adjustment by exclusion, specific adjustment, weighted median, trimmed mean, etc. However, adjustment by exclusion is deemed to be more objective and easier for the general public to understand than other methods. This fact led to the choice of the current method, which excludes price changes in non-cereal agricultural products and petroleum products.

3) The annual M3 monitoring range had been previously announced, but this practice was stopped from 2003, to clear up misunderstandings concerning the monetary policy operation system.

the fact that market rates were also reacting sensitively, the annual target figure for M3 growth was no longer announced separately as the intermediate target, but has been utilized as an information variable only.

After inflation targeting was introduced in 1998, the Bank of Korea began immediately announcing the monetary policy decisions of the Monetary Policy Committee and informing the general public of the policy intent, in order to heighten the credibility and transparency of monetary policy. Pursuant to Clause ① of Article 96 of the Bank of Korea Act, the bank has also submitted a report on monetary policy to the National Assembly each year since 1998. This monetary policy report, which provides the basis for the bank's accountability, sets out whether the inflation target has been achieved or not, a detailed account of monetary policy performance, the future policy direction, and other matters.

2. Introduction of Medium-term Inflation Target System

For efficient operation of the new medium-term target system, the Bank of Korea comprehensively reviewed not only the inflation target level, but also the appropriate index for the target, the appropriate target application period, and the criterion for assessing target achievement. Following this, the medium-term inflation target for the 2004-to-2006 period was set in consultation with the government at 2.5~3.5% (average rate of increase during the period), based on core inflation.

The reasons for setting the target level at 2.5~3.5% were varied. First, the inflation level that is compatible with current economic fundamentals while also supporting stable growth of the economy was presumed to be around 3 percent,⁴⁾ and medium-term inflation was forecasted at the 3 percent level.⁵⁾ Second, maintaining policy consistency

4) The optimal inflation rate for use as an inflation target is defined as: ① An inflation rate that does not interfere with growth; ② An inflation rate that minimizes the social cost of inflation; ③ An inflation rate chosen in consideration of the inflation gap compared with major countries; ④ An inflation rate that considers the upward bias of the Consumer Price Index, and the like. The results of estimating the appropriate inflation rate for Korea according to such definitions are as set out below :

Optimal Inflation Rate Estimations

Estimation method	Estimation value
1. Trade-off between inflation and growth	3.1%
2. Estimation using uncertainty of inflation	5% or below
3. Considering inflation gap compared with major countries	3.2%
4. Considering upward bias of CPI	1.5% or above

(“Optimal Level of Inflation Target of Korea”, Report on Academic Conference hosted by the Research Department of the Bank of Korea in 2002)

5) In such a situation, if the inflation target were set lower than at this figure, monetary policy would need to be operated with a tighter budget to achieve the target, which would limit monetary policy flexibility and could lead to disinflation costs such as a slowdown in growth, etc.

was also believed to be important. The medium-term target set in 2003 under the former dual target system, also for the period beginning from 2004, had been 2.5~3.5%, and modifying it under the amended Bank of Korea Act, might have aroused concerns about the consistency and reliability of policy. Third, there was a desire to clearly reflect the monetary authority's strong intention to stabilize prices. The newly established medium-term inflation target has an upper limit (3.5%) that is 0.5 percentage point lower than the upper limit of the previous year's annual target. Given the great risk of damage to its credibility that would occur should this more restricted target not be met, this choice of target makes the monetary authority's commitment to maintaining price stability clear.

Concerning the question of the appropriate target index, a review was undertaken on changing to the CPI, to conform with the practices in most countries that implement inflation targeting.⁶⁾ However, it was concluded that core inflation should continue to be employed. The current core inflation basket includes most (88.4%) of the items that are

included in the CPI basket, but has insignificant short-term variability, which makes it an appropriate target index for monetary policy. Also, if the target index were changed at this point, after having been in use for only 4 years, it might cause confusion among the general public. In Korea's case, moreover, non-monetary factors such as international oil prices have to be considered, as they have more significant impacts on CPI in Korea than they do in major advanced countries.

Determination of the period for target application as three years was done in consideration of the inflation cycle,⁷⁾ the general recognition of what the "medium-term" is, and the like. Taking a two-year period might give an impression of the inflation target being changed too frequently. Also, in a case where the rate of price increase deviated from the upper level of the target range in the first year, there might be a significant burden during the second year in having to lower the rate of price increase too steeply. A target application period of four years, on the other hand, would generally be recognized as a long-term horizon.⁸⁾

6) The countries that use core inflation as their target indexes are Thailand and South Africa. Recently, the U.K. converted from core inflation to the consumer price index in December 2003.

7) After seasonal adjustment using X12-ARIMA, the inflation cycle is extracted by using the growth cycle program of the National Bureau of Economic Research (NBER), giving an estimation of 3~4 years.

8) In light of the fact that most countries setting inflation targets do not independently set the target periods for their application, once price stabilization trends are firmly established, the Bank of Korea may need to consider operating its inflation control targeting without separate establishment of the applicable inflation target period.

The criterion used to assess inflation target achievement was determined as the average rate of increase during the period. This was done in order to secure monetary policy flexibility and prevent excessive economic fluctuations which could result if a monetary policy response were required whenever prices deviated temporarily from the target range due to non-monetary factors such as supply impacts, etc.

III . Monetary Policy for 2004

1. Operational Performance of Monetary Policy in 2003

With the domestic economy experiencing difficulties due to shriveling domestic demand, monetary policy in 2003 laid emphasis on supporting economic recovery while paying careful attention to price stability.

During the first four months of 2003 the Bank of Korea maintained the call rate target at 4.25 percent, taking into account concerns over upward price pressures and the worsening current account

position following the increase of international oil prices. It was judged that these factors outweighed the effects of the domestic economic slowdown and the heightened uncertainty caused by the War in Iraq and the North Korean nuclear issue. However, while there were concerns over the delay in world economic recovery and the spread of SARS, which together deepened the slowdown of the domestic economy, the declared ending of the War in Iraq helped somewhat to improve the nation's inflationary situation and current account position. The Bank of Korea therefore lowered its call rate target by twenty-five basis points in May and again by the same amount in July. While the slowdown in domestic demand persisted after August, the world economy improved with major countries showing clear evidence of recovery, and the call rate target was therefore held steady at 3.75 percent. Meanwhile, financial market confusion caused by the SK Global accounting scandal, the liquidity problems at some credit card companies and a strike by Cho Hung Bank staff was expeditiously taken care of through means such as open market operations, provision of Liquidity-Adjustment Loans, etc.

Inflation Targets of Major Countries

	New Zealand	Canada	United Kingdom	Australia	Sweden	Israel	Chile	Thailand
Inflation target	1~3%	2±1%	2.0%	2~3%	2±1%	1~3%	2~4%	0~3.5%
Applicable period	until 2007	until 2006	1 year	None	None	None	None	None

In this way, the operation of monetary policy is regarded as having contributed not only to the stabilization of prices within the inflation target range, but also somewhat to economic recovery by warding off overly deep contractions in consumption and investment and lessening household and corporate financial cost burdens.

2. Operational Direction of Monetary Policy for 2004

A. Operational Environment of Monetary Policy

During 2004, provided that domestic and overseas economic uncertainties do not deepen, the Korean economy is expected to see a stable inflation rate of around 3 percent,⁹⁾ with GDP growth at the 5 percent level and a current account surplus of 6 billion dollars. The domestic economy is likely to regain a 5 percent growth level, with expanding world eco-

nomie growth leading to continued buoyant exports and a gradual recovery of facilities investment and private consumption in the second half. The scale of the current account surplus will narrow compared to last year, owing to an increase in imports with the recovery in facilities investment and to an expansion of the service account deficit. The underlying surplus trend is expected to continue, however. Prices, meanwhile, should show a slower rate of increase than in 2003, with demand-side pressures remaining weak even if the domestic economy recovers.

Stable conditions in both the financial and foreign exchange markets are generally deemed to be continuing. In the loan market, the effects of a comprehensive package of measures to stabilize the housing market (October 29, 2003) and the tightening of loan review requirements by financial institutions are considered to have cooled down household loan

[Table 2]

Outlook for Major Economic Indicators

Unit : year-on-year, %

	2003			2004 ⁹⁾		
	1st half	2nd half	Year	1st half	2nd half	Year
GDP Growth rate	2.9	3.2	3.1	4.8	5.6	5.2
Current Account (100million dollars)	9	114	123	25	35	60
CPI Inflation	3.8	3.3	3.6	2.8	3.0	2.9
Core Inflation	3.2	3.0	3.1	2.6	2.9	2.8

9) However, in the event that cigarette prices are increased in the second half as planned by the government, consumer price inflation may exceed 3 percent.



demand. The corporate sector has sufficient funds available, and its efforts to improve financial structures are likely to continue in the future, so external borrowings are not likely to expand significantly even if facilities investment does recover. The bond market will see a reduction in issuance of credit card company paper, but as the issuance of government and corporate bonds and the like expand, the total issuance amount is likely to increase slightly compared to last year. Looking at bond demand, the strength of bond purchasing by investment trust companies will decline somewhat due to factors including the upward movement of interest rates in the course of economic recovery, but the funds under management of pension funds and insurance companies are likely to expand and thereby allow relatively smooth absorption of the bond supply. In the foreign exchange market, the trend of foreign currency oversupply is expected to last due to the sustained current account surplus and inflows of both direct and indirect foreign investment, but the scale of the surplus is expected to narrow compared to last year.

Meanwhile, the government budget for this year (general account plus special accounts, net account basis) is 2.4 percent larger than the initial budget for 2003. It is, however, reduced by 2.1 percent compared to the 2003 budget including the supplementary budget. The

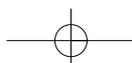
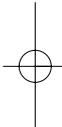
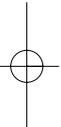
consolidated fiscal balance (excluding social security funds) will probably follow that of the previous year in showing a deficit, but on a slightly smaller scale

B. Operational Direction of Monetary Policy

As medium-term inflation targeting is being implemented from this year, the Bank of Korea plans to conduct monetary policy in a more flexible manner. In particular, when prices are expected to deviate from the target range, the underlying causes will be precisely analyzed, and the response measures and their degree of intensity will be determined by considering the policy transmission lag and financial and economic conditions. While undertaking such policy responses, efforts will of course also be devoted to minimizing any negative impacts on the real economy and financial market.

In order to allow the new inflation target to take firm hold and establish an efficient system for its operation, efforts will be made for precise analysis of medium-term inflation conditions as well as to supplement the capacity to analyze monetary policy effects. Additional efforts at the same time will be aimed at promoting the credibility with the general public of monetary policy and the central bank.

In accordance with this basic direction, interest rate policy in 2004 will focus on supporting the economic recovery and stabilizing prices within the



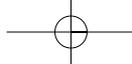
medium-term target range through responding preemptively to inflationary pressures. Together with this, efforts will be made to enhance the efficiency of interest rate policy through application of a policy-mix involving fiscal, exchange-rate and financial supervisory policies. In its management of the monetary aggregates, the Bank of Korea will implement policy so as to induce formation of the overnight rate in the call market at around the target determined by the Monetary Policy Committee. Policy will be operated flexibly, in consideration of financial market conditions.

Steady efforts will be made as well to improve the conduct of policies. The Liquidity Adjustment Loan system, a facility for providing temporary funding support to banks with insufficient short-term liquidity, is under consideration for adoption as the regular method of liquidity support provision for all banks. Focus will also be put on encouraging cash payment as the norm in commercial transactions, on providing support for small and medium-sized exporting companies, and on the boosting of local economies through support supplied under the Aggregate Credit Ceiling system. In addition, reserve requirement policy will be

modified in response to the complete liberalization of interest rates,¹⁰⁾ the diversification of deposit products of financial institutions, and the expansion of e-commerce.

Lastly, coordinated policy efforts for maintaining financial market stability are planned. Potentially threatening factors, such as the management statuses of credit card companies, are being checked frequently, and prompt responses will be made, if necessary, through open market operations. Examination of the banking institutions will also be undertaken, to gather on-site information needed in establishing monetary policy as well as to check the transmission effects of policy on-site and identify any factors threatening the financial system at an early stage. Additionally, to heighten the stability of the payment and settlement system, a framework for monitoring and assessment of the system will be put into place as early as possible.

10) With the December 2003 amendment of the Regulations on the Deposit and Loan Rates of Financial Institutions (implemented in February 2004), regulations on ordinary deposits, current deposits, household current deposits, temporary deposits and company savings deposits of less than 7 days were abolished. Thus, the liberalization of interest rates that had been pursued since November 1991, in accordance with the August 1991 announcement of the Four-Stage Interest Rate Liberalization Plan, has been completed.



Major Details of Financial Sector Restructuring in 2003

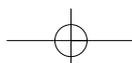
I . Introduction

In 2003, the government promoted privatization by disposing of its stockholdings in Chohung Bank and Kookmin Bank. It additionally pursued financial restructuring with a focus on cleaning up troubled non-bank financial institutions including securities companies, insurance companies, mutual savings banks, and credit unions. During the process, public funds totally 2,165.7 billion won from the Deposit Insurance Fund and elsewhere were additionally injected for the repayment of deposits, recapitalization, compensation for losses of financial institutions, and purchase of non-performing loans(hereinafter, NPLs). Furthermore, the government strengthened the protection of consumers and investors and improved the governance structure of financial institutions, while overhauling finance-related legislation in a spirit of financial deregulation.

This paper summarizes details of the restructuring of financial institutions including the market exit of insolvent financial institutions and support from public funds, and provides the main points of the new and revised financial-related legislation.

II . Restructuring of Financial Institutions

In the pursuit of the restructuring process during the year under review, 151 insolvent financial institutions were forced to close down and exit the market. They consisted of 2 insurance companies, 3 mutual savings banks and 145 credit unions. Meanwhile 1 merchant banking corporation and 2 credit unions merged. During this process, the government used public funds to a total amount of 2,165.7 billion won for the repayment of



deposit, recapitalization, compensation for losses of financial institutions, and purchase of NPLs.

1. Merger and Withdrawal of Financial Institutions

Taking a more detailed look at the restructuring of financial institutions in 2003, in the case of banks, the government disposed of its stocks in Chohung Bank (equity stake of 80.04%) to Shinhan Financial Holding (July), and sold its stocks in Kookmin Bank (equity stake of 9.10%) in the open market (December). Its objectives were to speed up denationalization and the recovery of public funds.

Regarding securities companies, the government entered into an agreement for the acquisition of Hyundai Investment & Securities by Prudential Financial, Inc. (November). Meanwhile, considering that CJ Investment & Securities' net working capital ratio still fell short of standard ratio (150%), issue of a management improvement recommendation was postponed until the end of February 2004 since negotiations for its sale were still underway (September). In the case of 3 converted securities companies, Korea Investment & Securities, Daehan Investment & Securities and Tongyang Orion Investment Securities, for whom the period deferment for the taking of appropriate corrective measures was to expire in

December 2003, this deadline was extended by a further year (November). Kuseol Securities, which became insolvent in a worsening operational environment including intense competition to lower the commission fees, went into liquidation following the suspension of its operation of securities business and a resolution that it be wound up by a special meeting of shareholders (January).

Concerning insurance companies, Regent Fire Insurance, which was assessed as an insolvent financial institution in 2001, was liquidated using the contract transfer method (January), and Daishin Life Insurance, which had been looking for sale to a suitor since 2001, was acquired by Green Cross Life Insurance (June). In the meantime, Lucky Life Insurance and Ssangyong Fire & Marine Insurance were evaluated respectively as belonging to the third and fourth grades in the comprehensive assessment grading of their management. The former received a management improvement recommendation and the latter a management improvement request (July).

A total of 145 credit unions including some placed under the administration of the Financial Supervisory Commission (hereinafter, "the FSC") were forced to exit the market as were 3 insolvent mutual savings banks. Furthermore, Woori Merchant Banking Corporation was absorbed by Woori Bank (July), and Kookmin Card was taken over by Kook-

min Bank (September). In a further development, Korea Futures, whose net working capital ratio still did not meet the guidance ratio (150%) due to management, was served with a management improvement recommendation (March), and More Securities Brokerage, whose ratio fell short of the guidance ratio (100%), received a management improvement order (November).

Taking a look at the current status of the ongoing process of restructuring among financial institutions in November 2003, eight banks came to the rescue of LG Card, which had experienced a liquidity crisis due to insolvent manage-

ment, with support totally 2 trillion won. This was followed up by support from a further sixteen creditor financial institutions (ten banks and six insurance companies) in a debt for equity swap in January 2004. Converting bonds with a par value of two trillion won to shares, they put up a further 1.65 trillion won to convert the full value of the bond issue into shares. In the future, LG Card will ostensibly be managed by the 'LG Card Steering Committee' of creditor financial institutions, but it is intended that Korea Development Bank, the largest shareholder (equity stake of 25%), will effectively exercise management control.

[Table 1] Changes in the Number of Financial Institutions¹⁾ during 1998~2003

	Number of institutions at the end of 1997	1998~2002			2003			Number of institutions at the end of 2003
		Exit ²⁾	Merger ³⁾	Newly established	Exit ²⁾	Merger ³⁾	Newly established	
Banks	33	5	9	-	-	-	-	19
Merchant Banking Corporations	30	22	6	1	-	1 ⁴⁾	-	2
Securities Companies	36	6	3	18	1	-	1	45
Investment Trust (Management) Companies	31	6	1	7	-	-	1	32
Life Insurance Companies ⁵⁾	31	7	5	1	1	-	1	20
Non-life Insurance Companies	14	-	1	2	1	-	2	16
Mutual Savings Banks ⁶⁾	231	99	28	13	3	-	-	114
Credit Unions	1,666	337	105	9	145	2	-	1,086
Total	2,072	482	158	51	151	3	5	1,334

Notes : 1) Excluding for domestic branches of foreign financial institutions
 2) Including bankruptcy, liquidation and cancellation of license(application)
 3) Number of financial institution's going out of existence following a merger or amalgamation
 4) Woori Merchant Banking Corporation was taken over by Woori Bank(July 2003)
 5) Excluding Postal Life Insurance
 6) The designation of mutual savings & finance companies was replaced by mutual savings banks from March 2002.

Sources : Financial Supervisory Service

Korea Investment & Securities, Daehan Investment & Securities, and other ailing securities companies whose pursuit of a management turnaround was inadequate. Efforts are undertaken to arrange the sale to domestic or foreign investors.

In addition, saw the launch of Dongwon Financial Holding in May 2003, following the setting up of Woori Financial Holding (March 2001) and Shinhan Financial Holding (September 2001). Dongwon Financial Holding was established to exercise control over three subsidiary companies : Dongwon Securities, Dongwon Mutual Savings Banks, and Dongwon Venture Investment. It is scheduled to sever all links with the Dongwon group of interlinked companies chaebol) by the end of 2005.

2. Providing Public Funds to Financial Institutions

During the financial restructuring process in 2003, the government used public funds amounting to 2,165.7 billion won for the repayment of insured deposits, recapitalization, compensation for losses of financial institutions, and purchase of NPLs. The accumulated total of public funds employed to support financial institutions from November 1997 to the end of 2003 reached approximately 161 trillion won.

Taking a look at the details of public funds support by each support agency to

financial institutions during 2003, the Korea Deposit Insurance Corporation (hereinafter, "the KDIC") provided additional support of 2,230.4 billion won. On the other hand, the Korea Asset Management Corporation(hereinafter, "the KAMCO") provided no additional support in the course of the year. This was attributable to the termination of the period for the gathering of the financial resources into the Non-performing Asset Fund (November 2002), and indeed recouped 64.7 billion won from the proceeds of the purchase of NPLs reducing its outstanding support by that amount.

The KDIC provided support of 1,095.6 billion won for the repayment of legally protected deposits at credit unions (1,095 billion won), mutual savings banks (500 million won) and merchant banking corporations (100 million won), and used 607.7 billion won and 527.1 billion won for compensation of losses and the purchase of the NPLs of financial institutions. Taking a closer look at the breakdown of support, there was provision of 92.9 billion won in support for the loan-loss reserve following the exercise of the put-back option by Korea First Bank, and 522.3 billion won for the acquisition of NPLs, with a contribution of 1.3 billion won to Shinhan Bank in compensation for losses related to the acquisition of Donghwa Bank. In addition, 64.7 billion won was contributed to Woori Merchant Banking Corporation, which had

[Table 2] Public Funds Injected in 2003¹⁾

Unit : billion won

	KDIC	Repayment of deposits	Recapitalization	Compensation for losses	Purchase of assets	KAMCO	Total
Banks	6,165	-	-	942	5,223	-	6,165
Merchant Banking Corporations	648	1	-	647	-	-	648
Securities Companies	-	-	-	-	-	-	-
Insurance Companies	4,100	-	-	4,052	48	-	4,100
Investment Trust (Management) Companies	-	-	-	-	-	-	-
Mutual Savings Banks ²⁾	441	5	-	436	-	-	441
Credit Unions	10,950	10,950	-	-	-	-	10,950
Others	-	-	-	-	-	△647 ³⁾	△647
Total	22,304	10,956	-	6,077	5,271	△647	21,657

Notes : 1) These statistics were compiled provisionally by the Bank of Korea on the basis of the Public Fund White Paper issued by the Ministry of Finance and Economy in August 2003, and the home pages of KDIC and KAMCO, so these are subjects to subsequent adjustment.
2) The designation of mutual saving & finance companies was replaced by mutual savings banks in March 2002.
3) Details of recoupment was not announced by KAMCO during 2003, the total amount of it was classified 'Others'.

Sources : The Ministry of Finance and Economy, KDIC, KAMCO

assumed the assets and liabilities of Youngnam, Korea, Joongang and Hans Merchant Banking Corporation. Regarding insurance companies, 139.3 billion was contributed to Green Cross Life Insurance which had acquired Daeshin Life Insurance. A total contribution of 238.6 billion won was provided to the five non-life insurance companies, namely Dongyang, Samsung, Hyundai, LG, and Dongbu, which had assumed the obligations under the insurance contracts of Regent Fire Insurance. Additionally 27.3 billion won was contributed to Daehan Life Insurance in compensation for losses on its acquisition of Samshin and Hyundai Life Insurance, and 4.8 billion won was used for the purchase of NPLs of

four life insurance companies, namely Donga, Kookmin, Taeyeongyang and SK. In addition, 43.6 billion won was contributed to the failed mutual savings banks, including Gimcheon Mutual Savings Bank.

Taking a look at public funds support in 2003 for each financial sector, support was provided to credit unions for a total amount of 1,095 billion won, to banks for a total of 616.5 billion won, to insurance companies for a total of 410 billion won, to merchant banking corporations for a total of 64.8 billion won, and mutual savings banks for a total of 44.1 billion won.

III . Adjustment of Financial-related Legislation

In the adjustment of legislation related to financing during 2003, the government focused on protecting financial consumers and investors, improving the governance structure of financial institutions and easing financial regulation.

1. Strengthening the Protection of Financial Consumers

To strengthen the protection of financial consumers, the government introduced a system of comparison and notification of insurance contracts while prohibiting the use of inequitable methods by insurance agencies in selling insurance products.

As a first step, the Insurance Business Act and its Enforcement Decree (which came into effect from August 30, 2003 ; hereinafter, dates in parentheses are those of entry into force) was revised to make it obligatory to give notice of all matters related to insurance products, including the insurance policy, the insurance premiums, the scale of refund cancellation, the scheduled base rate, and so forth. It also provided for the setting up of an Insurance Product Notification Committee by the Korea Life Insurance Association to compare and announce of insurance premiums, insurance proceeds,

term of insurance, insured risks, insurance coverage rate and the immunity clauses in policies for each insurance company.

Next, methods of the gathering insurance by furnishing money and goods, the repayment of insurance premiums, the reduction of insurance premiums without justifiable grounds, and other special inducements were prohibited and more severe penalties were provided for in the event of violation. In addition, following the revision of the Insurance Business Act, banks, securities companies and financial institutions apart from insurance companies were allowed to sell insurance products, and their unfair actions of the gathering insurance products were prohibited. Specially, it forbade the requirement by the insurance agency of a financial institution that an insurance contract be entered into as a condition for the provision of services by the said financial institution as a loan or that insurance premiums be included such in loans without the consent of the contracting party (applicant).

Furthermore, in order to protect the victims of the liability insurance contract (non-life insurance contract), where this involves compulsory insurance in accordance with the provisions of particular Acts including the Automobile Liability Compensation Guarantee Act, the Urban Gas Business Act, the Seaman Act, and Basic Act Concerning Young Persons

Minors Youths Act, if the payment of compensation to victims of accidents covered by insurance cannot be performed due to the cancellation of the insurer's business license or permit or filing for bankruptcy, that portion of the claim for physical damage that exceeds the amount (50 million won) guaranteed under the Depositor Protection Act shall be paid by the Korean Non-life Insurance Association up to the amount guaranteed under the Act concerned.

Also, in the event of a company's status as a small and medium enterprise being lost because of expansion of the transaction volume, under the revised Industrial Bank of Korea Act (December 11, 2003), it shall retain its status as a small and medium enterprise for a period of three years from the following year in dealings with the Industrial Bank of Korea irrespective of the remaining repayment period.

2. Strengthening the Protection of Investors

The Indirect Investment Asset Management Business Act (January 5, 2004) was passed in order to strengthen investor protection with respect to the asset management industry, as well as to galvanize the asset management through the same regulation of asset management actions and expansion of those subject to asset management. This Act brought

about the consolidation of the Securities Investment Trust Business Act and Securities Investment Company Act which had regulated mutual investment management companies and mutual funds respectively.

As a first step, an Investment Trust, a qualified indirect investment organization, establishes a general meeting of beneficiaries consisting of all beneficiaries to have the changes of the important trust stipulation or the articles of incorporation including the increase of fees, consignment period, and existing period of the investment company passed by a resolution of the general meeting of beneficiaries. Along with that, a beneficiary who owns 5% or more of the total number of beneficiary certificates is entitled to convene a general meeting of beneficiaries, while the right to purchase the company's beneficiary certificates is granted to the beneficiaries who oppose the resolution of the general meeting of beneficiaries.

Furthermore, in regard to conformity with legislation and the trust agreement, details of the drawing-up or modification of the investment prospectus of an asset management company that operates the indirect investment assets are to be confirmed by the trustee company or asset safekeeping company concerned. In addition, the Act clearly specifies the liability of asset management company in regard to compensation for damages arising

ing from deviation from the prospectus, and the joint liability of directors for negligence. And recommendation of the acquisition of beneficiary certificates based on an investment prospectus that simply summarizes an important part of the investment prospectus is also simply prohibited.

In a further move, the disclosure system is strengthened to require the drawing up and submission of an asset management report, and the period of provision redefined to at least once every three months rather than at least once every six months. The details to be provided including the assets and liabilities of the indirect investment organization, standard price of indirect investment securities, and the profit and loss status during the period the assets are under management, which had formerly been set out in the Enforcement Decree are now incorporated within the main body of the Act. Moreover a prompt disclosure requirement is imposed whereby indirect investors (beneficiaries and shareholders) are be notified without delay of the occurrence of important matters, including changes in the fund management experts, a decision to postpone redemption, resolutions of the general meeting of beneficiaries, and in the event of non-performing assets arising details of the circumstances and rate of refunding. Also the justification for any delay of the redemption shall be disclosed and any

such delay shall require a resolution by the general meeting of beneficiaries (investment trust) or the general meeting of shareholders (investment company), with all pertinent matters being notified to indirect investors without delay. And, while permitting the partial redemption of indirect investment assets irrelevant to the delay of redemption, in order to prevent the joint insolvency of the two companies and protect indirect investors, the asset management company and selling company shall not purchase indirect investment securities whose redemption is requested.

In order for the asset management company to make a fair and accurate assessment of indirect investment assets, an Indirect Investment Asset Assessment Committee has been formed to set out evaluation standards and procedures for indirect investment assets, and to receive confirm by a trustee company or asset safekeeping company concerning the details of the evaluation of the investment assets. In addition to improve the external audit system, external audit by the nominated external auditor as prescribed under the 'Act on External Audit of Corporations' is now required for all indirect investment assets (investment trust assets and investment company assets) rather than only investment trust assets as was previously the case. Also, to strengthen the independence of the external auditor, the consent of the

trustee company or asset safekeeping company shall be obtained at the time of the appointment of the external auditor. The asset management company, trustee company, asset safekeeping company and general management company shall not in principle entrust to another company with operations for which they have received consent and registration.

3. Improvement of the Governance Structure of Financial Institutions

The government made efforts to improve the governance structure by strengthening the regulation of transactions between financial institutions and major shareholders and introducing a system of expert directors for the National Credit Union Federation of Korea.

First, the government revised the Insurance Business Act and its Enforcement Decree (August 30, 2003) to modify the ceiling on lending to the majority shareholders and affiliates of insurance companies, as well as the limit of holdings of bonds and stocks issued by them. The ceiling on lending to affiliated companies was changed from 2% of total assets to the lesser of 40% of equity capital or 2% of total assets, and the limit of holdings of bonds and stocks issued by affiliated companies was revised from 3% of total assets to the lesser of 60% of equity capital or 3% of total assets. In the

event of any single transaction within either of the above ceilings representing 0.1% or more of the equity capital or 1 billion won or more, it shall be decided upon only with the unanimous vote of all registered directors at a meeting of the board of directors, and the transaction shall be reported to the FSC without delay and announced via electronic communication media. In addition the revised legislation prohibits the action of majority shareholders of insurance companies demanding undisclosed information so as to exercise undue influence over it or demanding the early recovery of a loans with a view to disrupting the business activities of a competitor.

The government revised the Credit Union Act (November 1, 2003) and its Enforcement Decree (November 4, 2003) to improve the governance structure of the credit unions. The National Credit Union Federation of Korea is obliged to elect a legal representative director (1 person) for credit cooperative business and an inspection and supervisory director (1 person), and 1/3 or more of the total number of the members of its directors should consist of outside persons with expertise (expert director). In addition, for audit of the work execution and accounting of the National Credit Union Federation of Korea, an audit committee at least 2/3 whose members are expert directors shall be established in the board of directors. Furthermore, the obligation

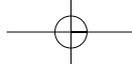
has been imposed on National Credit Union Federation of Korea to set internal control standards that stipulate matters concerning its organization and operations, a duty compliance with operational norms and sanctions for failure to observe the criteria. For this purpose, one or more of the compliance officers shall be employed to monitor compliance with internal control standards and investigate violations. The audit system for credit unions has also been improved. The auditor's obligation to compare and confirm the deposit books and other certificates of union members and the ledger or record of unions is expanded from 'once or more per year' to 'once or more per six months'. Also, the FSC may, where desirable for the protection of depositors, have a credit union whose total outstanding assets as of the end of its previous fiscal year amounted to 30 billion won or more undergo a mandatory external audit.

4. Relaxation of Financial Regulations

The government maintained from the previous year its pursuit of the relaxation of financial regulations in 2003. The Insurance Business Act and its Enforcement Decree (August 30, 2003) were revised to enable financial institutions other than insurance companies to sell insurance products and to ease entry bar-

riers through the reduction of minimum capital. At the same time, to heighten the managerial autonomy of insurance companies, the scope of the operation of their assets was widened.

Banks, securities companies, mutual savings banks, and credit card companies are now allowed to register as insurance agents or insurance brokers, and the range of insurance products that they may offer is to be gradually increased. The official classification of insurance business has been changed from 'personal insurance' and 'non-life insurance', to 'life insurance', 'non-life insurance' and 'third-party insurance', and a person who has permission to engage in either life insurance or non-life insurance may carry out third-party insurance as an ancillary business. In relation to the regulations on market entry, a 'communications-based insurance company', which had previously required a minimum capital equivalent to that needed to establish a general insurance company, saw this figure lowered to 2/3 of that required for a general insurance company. And, a foreigner owning an insurance subsidiary in his home country was permitted to set up an insurance company in Korea whereas this had previously only been allowed in the case of a foreigner directly carrying on insurance business in his home country. In addition, the eligible objective of investment by special accounts, which was classified and treated separately for



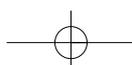
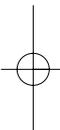
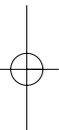
accounting purposes from the general insurance contract assets, have been expanded to include the ownership of investment-related real estate (within 15% of special account assets), ownership of non-listed stocks (within 10%), and ownership of foreign exchange or foreign real estate (within 20%). Meanwhile, in order to encourage the development and sale of new insurance products, changes in the basic documentary requirements such as terms of business and insurance policy for each permission no longer require prior to the FSC but only from the filing of a report with it.

The Credit Union Act (November 1, 2003) and its Enforcement Decree (November 4, 2003) were revised to expand the single person lending limit, which had hitherto been set at 15% of the equity capital of credit union to the larger of 20% of equity capital or 1% of its total assets outstanding. In addition, so that persons who are not members of credit unions can use their services insofar as this does not prejudice the interests of members, individual credit unions were additionally allowed to extend their loans or discount bills to them and the National Federation Credit Union of Korea was allowed to conduct credit and mutual-aid business with them. And, the limitation of persons eligible to lend the funds to individual credit unions those designated by the National Credit Union Federation of Korea and the FSC was

removed. At the same time, the borrowing ceiling of individual credit unions was changed from the equivalent of a union's equity to capital the larger of 5% of total asset or equity capital. Additionally, this borrowing ceiling may be exceeded where consent is given by the president of the National Credit Union Federation of Korea.

The Industrial Bank of Korea Act (December 11, 2003) was revised to ease regulations on the Industrial Bank of Korea's management of its assets. Operations involving the issue of marketable securities which had previously required approval works were included in the business specified to the Industrial Bank of Korea, while to heighten the business discretion the management of surplus funds should accord with 'decisions made under the Article of Incorporation'. In addition, the requirement of approval from the Minister of Finance and Economy for foreign capital borrowings was abolished.

To facilitate a stable pattern of stock investment on a long-term basis, the Enforcement Decree of the Securities Transaction Act (February 24, 2003) was revised to expand the range of marketable securities and stock investment products linked with stock prices or a stock price index were included among marketable securities. And, in order to galvanize the secondary market of marketable securities, securities companies



specializing in bond transactions saw the range of marketable securities transactions that they might broker widened to include transactions in marketable securities between institutional investors. Moreover, in order to stimulate the discretionary investment business of securities companies, the restriction of business to the investment of a certain ratio (30% or more) of funds in bonds of at least investment grade was abolished.

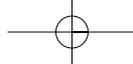
The Indirect Investment Asset Management Business Act (January 5, 2004) was passed to lower entry barriers to the asset management industry, while the range of institutions allowed to sell indirect investment securities was expanded. Provided the requirement having equity capital of at least 10 billion won within a certain period after the entry into effect of the Act is met, securities investment companies, merchant banking corporations, banks, and insurance companies are recognized to be qualified as asset management companies, without any need for special permission, and the business of selling indirect investment securities is expanded to become permitted even to insurance companies. Meanwhile, in view of the desirability of even-handedness with bank's trust accounts which may make direct sales, asset management companies are now allowed to sell indirect investment securities of an indirect investment organization that it itself operates, although only to a limited

extent. Furthermore, the setting up of a fund is permissible not only based on cash but also through the acceptance of marketable securities, real estate and physical assets. The objects for the management of assets is broadened from marketable securities to include over-the-counter derivative products, real estate and physical assets. And, with the introduction of a system for the merger of investment trusts, it become possible for investment trusts operated by the same asset management company to be merged. The revised legislation also allows departure from the principle of cash payment of the redemption proceeds to allow them to be paid in the form of holdings of indirect investment assets subject to consent by all beneficiaries (stockholders) of the investment trust (investment company).

5. Miscellaneous

A. Adjustment of Depositor Protection System

The government revised the Credit Union Act (November 1, 2003) and its Enforcement Decree (November 4, 2003) to accord with the entry into effect of the Regulation (Supplementary Article 1, January 1, 2004) excluding credit unions from those financial institutions with insurance coverage under the revised Depositor Protection Act (January 1, 2003). Instead a 'Credit Union Deposit



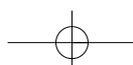
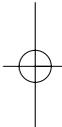
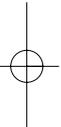
Insurance Fund' was established within the National Credit Union Federation of Korea. In order to deliberate on and decide on important matters relating to the operation of this fund, a Fund Management Committee was also set up. The Fund provides insurance of up to 50 million won for the principal and interest of member's deposits and installment saving deposits and mutual aid funds. In order, however, to mitigate the burden on the National Credit Union Federation of Korea at the early stage, following the migration of the Deposit Insurance Funds from the KDIC, the actual shift is deferred for 6 years. Furthermore, legal provisioning requirements for individual credit unions have been increased from the setting aside of at least 10% of the profits each business year until the reserves reaches a sum equivalent to the total amount of paid-in capital, to the setting aside of at least 10% of profits each business year until the reserves reaches the equivalent of twice the total amount of paid-in capital.

Furthermore, the legal operation period of the resolving financial institutions that were established for the purpose of cleaning up the insolvent financial institutions came to an end, but it having been decided that an extension of this period was needed for the seamless resolution of troubled financial institutions that had gone into bankruptcy, the Depositor Protection Act was revised

(December 27, 2003) to prolong the operation period of the resolving financial institutions from the original three years to five years by an extra two years.

B. Enactment of Korea Housing Finance Corporation Act

In order to promote a stable long-term supply of housing finance and seek stabilization of the financial market through the absorption of floating funds, the Korea Housing Finance Corporation Act (promulgated on December 31, 2003 and entered into effect on March 1, 2004) was enacted. The Act provides for establishment of the Korea Housing Finance Corporation and sets up a housing finance credit guarantee fund within it to galvanize housing financing by the provision of guarantees, carrying out the securitization of mortgage-backed claims and loan obligations for academic funds. The Korea Housing Finance Corporation was established through the capital by the government and the Bank of Korea (authorized capital : 2 trillion won) and it has the six-member Housing Finance Steering Committee as its highest decision-making body. To support use of the facility by the actual users of housing for members of low income groups and the middle class, the Korea Housing Finance Corporation will handel the securitization of ten-year or longer mortgage loans of up to 200 million won for the purchase of housing. As of the end of Febru-



ary 2004, an Establishment Preparatory Committee and Office of General Affairs of the Korea Housing Finance Corporation had been established to carry out the tasks of setting up the Corporation and undertaking the preparation tasks for its operation.

IV. Future Tasks

During 2003, the government pursued financial restructuring with a focus on the privatization of banks and the resolution of insolvent non-banking financial institutions. In addition, it prohibited the unfair selling of insurance products in order to protect financial consumers and strengthened the system for the protection of persons entering into an insurance contract. A systematic basis was laid for the galvanization of the indirect investment asset management industry by improving the system of disclosure related to investment trusts so as to protect investors. The governance of financial institutions was also improved with regulations strengthened transactions between financial institutions and majority shareholders, being tightened up, and an expert director system introduced for National Credit Union Federation of Korea.

Thanks to the efforts for financial restructuring and the strengthening of

the financial infra-structure that has been steadily pursued since the foreign currency crisis, the soundness and transparency of financial institutions shows definite improvement.

Despite these results of financial restructuring, there has been rising concern over the acute liquidity problems of credit card companies together with the high rate of delinquencies on credit to households. This gets hand in hand with erosion of the capital of certain recently converted securities companies. Thus, there still remain factors present in the financial market making for instability.

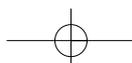
Therefore, future financial restructuring policy must focus on dispelling these factors making for financial market instability as early as possible. For this purpose, insolvent securities companies and credit card companies should be resolved promptly through disposal or management turnaround, and the restructuring of troubled mutual savings banks and credit unions should also be energetically pursued. Furthermore, the government needs to unceasingly press ahead with the privatization of Woori Finance Holding and Hana Bank, and so forth, by disposing of its equity stake in them.

During the year ahead, moves are underway to sell off large financial companies including Daehan Investment & Securities, and the increased penetrations of foreign capital is anticipated to speed the reorganization of the financial indus-



try. Furthermore, competition among financial institutions is expected to intensify, as bancassurance gets properly underway with financial deregulation and the asset management industry sees dynamic expansion. In response to such changes in the financial structures, the policy authorities should prepare a systematic basis for fair competition and improve the method of implementing policy. To this end, the transparency of policy must be heightened and, while maintaining consistency, financial supervision should be exercised in a market-friendly manner. Should the short-termism and speculative approach of market funds

persisted, making the fund management of financial institutions problematic. It is therefore important to construct a more efficient risk management system. At the same time, monitoring of the potential risks of businesses and financial institutions should be augmented through mutual cooperation by the policy authorities in order to counter financial market instability arising from changes in the domestic and international economic environment, including the heightened volatility of major countries' price variables such as interest rates, exchange rates, and stock prices.



Payment and Settlement Trends in 2003

I. Overview

In 2003, the average daily volume of settlements through financial institutions' retail payment systems stood at 19.8 million, for a total value of 35.0 trillion won. This represented an increase of 2.7 percent in volume and 1.1 percent in value from the previous year.

The slight rise in settlement volume and value, which occurred despite a steep hike in the use of the Interbank Shared Networks and electronic-based Giro, was mainly attributable to a sharp drop in the use of credit cards and a decrease in the paper-based settlements, including checks and bills.

As the paper-based settlements decreased and electronic-based settlements increased, the share of the electronic-based settlements in the total retail payment systems registered 70.4 percent in volume terms and 39.3 per-

cent in value terms, up from the previous year's 69.5 percent and 36.2 percent, respectively.

Looking at the share of various instruments within retail payment systems as a whole in value terms, that of the Interbank Shared Networks expanded from the previous year's 30.9 percent to 35.0 percent and that of the Bank Giro system maintained a level similar to the previous year's. On the other hand, the shares of checks & bills and credit cards decreased. In volume terms, the shares of the Bank Giro system expanded from 16.4 percent to 18.9 percent, and that of the Interbank Shared Networks stood at 30.7 percent, showing a similar level of the previous year's. However, the shares of checks & bills and credit cards dropped.

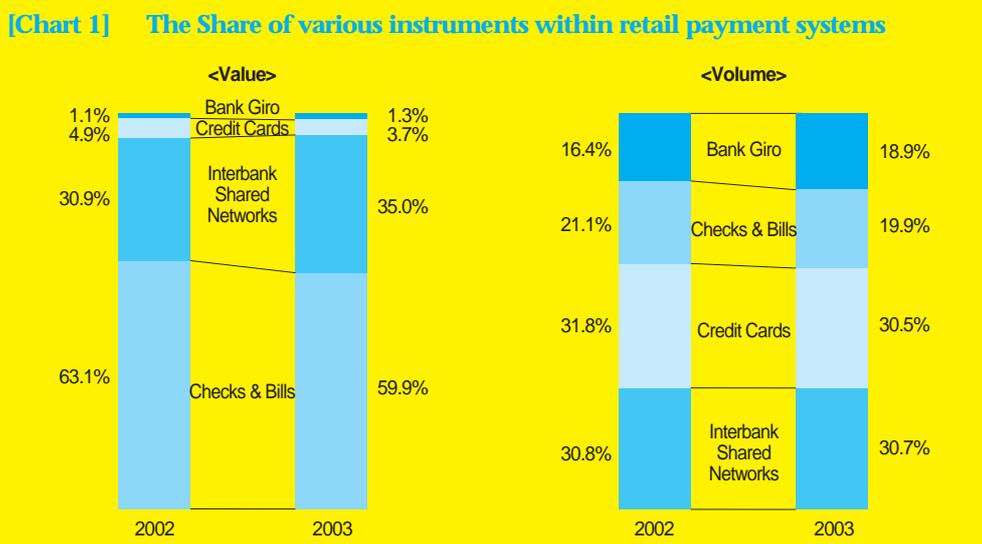
In the meantime, the average daily volume of fund transfers and settlements between financial institutions through the Bank of Korea Financial Wire Net-

[Table 1] Retail Payments and Settlements¹⁾ in 2003
(daily average²⁾)

Unit : thousand transactions, billion won, %

	2002		2003		Change	
	Volume	Value	Volume	Value	Volume	Value
Paper-based	5,865.6	22,072.2	5,841.6	21,220.2	-0.4	-3.9
Checks and bills	4,052.7	21,844.2	3,937.0	20,968.6	-2.9	-4.0
Bank Giro credit transfers	1,812.9	227.9	1,904.6	251.6	5.1	10.4
Electronic-based	13,377.8	12,534.8	13,917.0	13,766.9	4.0	9.8
Interbank Shared Networks ³⁾	5,917.8	10,680.6	6,064.6	12,248.5	2.5	14.7
Electronic Bank Giro ⁴⁾	1,338.4	157.9	1,830.7	212.0	36.8	34.3
Credit cards	6,121.5	1,696.3	6,021.7	1,306.4	-1.6	-23.0
Total	19,243.4	34,607.0	19,758.6	34,987.0	2.7	1.1

Notes : 1) Payments between financial service users whose financial institutions differ are cleared through the Korean Financial Telecommunications and Clearings Institute(KFTC) and are finally settled through BOK-Wire
2) According to each payment system's business day
3) Electronic Banking Network, Interbank Funds Transfer(IFT) System, Cash Dispenser and Automated Teller Machine(CD/ATM) Network, Cash Management System(CMS), Electronic Funds Transfer at the Point of Sale(EFTPOS) System and Bank Line
4) Direct debits, Standing orders and Direct credit transfers



work (BOK-Wire), a large-value fund transfer system, was 6,412 for an average daily value of 88.0 trillion won, representing an increase of 16.5 percent in volume terms and 9.7 percent in value

terms, from the previous year.

The sharp rise in the settlement was largely ascribable to a steep hike in the settlement volume of call transaction and securities transaction through BOK-Wire,

[Table 2]

Settlements through BOK-Wire in 2003

(daily average)

Unit : transactions, billion won, %

	2002		2003		Change	
	Volume	Value	Volume	Value	Volume	Value
Domestic currency funds transfer	5,502.5	80,284.9	6,412.3	88,041.7	16.5	9.7
Gross settlements	3,984.4	62,812.1	4,329.3	70,040.5	8.7	11.5
(Call transaction) ¹⁾	626.2	25,224.9	767.4	30,252.3	22.5	19.9
(Securities transaction) ²⁾	1,451.9	15,184.7	1,671.0	16,675.9	15.1	9.8
Net settlements	750.8	14,149.2	662.9	13,889.5	-11.7	-1.8
Others ³⁾	767.2	3,323.6	1,420.1	4,111.6	85.1	23.7

Notes : 1) The total of call transactions settled through General transfer system and Call transaction system

2) The total of securities transactions settled through General transfer system and Delivery versus Payment(DVP) system

3) Treasury funds transfer, BOK loans and discounts, Government and Public bonds, etc.

which resulted from an increase¹⁾ in call and bond transactions between financial institutions.

sented decreases of 2.9 percent and 4.0 percent, respectively, from the previous year.

It was attributable to a sharp drop in the use of promissory notes amid a gradual decrease in the paper-based settlements, including checks and bills, which was affected by activation of electronic-based settlements.

Viewing the clearing volume of checks and bills by type, the use of promissory notes and current account checks decreased in both volume and value terms. The use of other documents, including corporate bonds and certificates of deposit(CD), and cashier's checks dropped on a volume basis, but increased on a value basis.

As the issuance of commercial paper

II . Payment and Settlement Trends by Payment Media

1. Checks and Bills

In 2003, the average daily clearings of checks and bills, which were made through the checks and bills clearings system of Korea Financial Telecommunications and Clearings Institute(KFTC), recorded 3.9 million by volume and 21.0 trillion won by value. These figures repre-

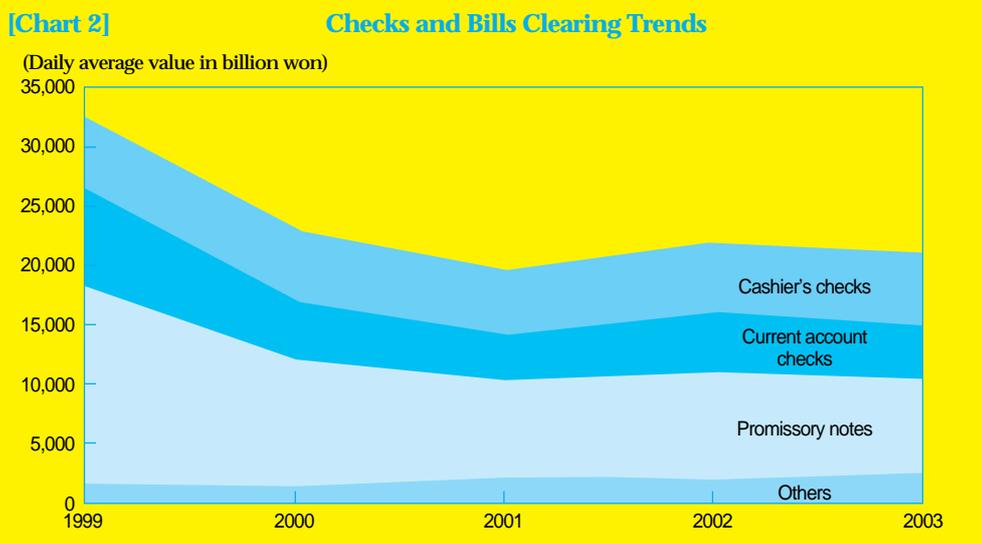
1) In 2003 the average daily trading value in the call market amounted to 22.0 trillion won, representing an increase of 12.8 percent from 19.5 trillion won recorded in 2002 and the daily trading value in the bond market was 10.8 trillion won, representing an increase of 35.0 percent from the previous year's 8.0 trillion won.

[Table 3] Clearing Figures for Checks and Bills in 2003
(daily average)

Unit : thousand transactions, billion won, %

	1999	2000	2001	2002	2003	Change
<Volume>						
Promissory notes	32.2	32.4	27.1	27.8	25.8	-7.2
Current account checks	13.4	12.9	10.5	12.3	11.3	-8.1
Cashier's checks	3,364.2	3,617.6	3,602.1	3,984.1	3,874.2	-2.8
Non-preset value	248.4	173.9	128.6	130.0	116.4	-10.5
Preset value	3,115.8	3,443.7	3,473.4	3,854.1	3,757.8	-2.5
(100,000 won denomination)	2,549.9	2,894.6	2,974.2	3,337.9	3,278.2	-1.8
Household checks	22.1	21.3	15.3	14.2	12.2	-14.1
Others ¹⁾	15.0	16.7	17.9	14.4	13.5	-6.3
Total	3,446.9	3,701.0	3,672.9	4,052.7	3,937.0	-2.9
<Value>						
Promissory notes	16,689.6	10,877.2	7,977.6	8,931.4	7,853.3	-12.1
Current account checks	8,313.9	4,899.3	4,014.4	4,999.8	4,526.3	-9.5
Cashier's checks	5,863.3	5,891.5	5,290.0	5,862.0	6,112.9	4.3
Non-preset value	5,074.9	5,082.3	4,516.8	5,032.1	5,321.4	5.7
Preset value	788.4	809.3	773.2	830.0	791.5	-4.6
(100,000 won denomination)	255.0	289.5	297.4	333.8	327.8	-1.8
Household checks	58.9	59.0	56.2	47.3	46.0	-2.7
Others ¹⁾	1,548.4	1,290.2	2,138.3	2,003.6	2,430.1	21.3
Total	32,474.2	23,017.2	19,476.5	21,844.2	20,968.6	-4.0

Note : 1) Corporate bonds, Certificates of Deposit(CD), etc



(CP) by card companies facing a liquidity crisis decreased sharply and the use of the bill substitution scheme,²⁾ such as corporate procurement loans and loans with accounts receivable as collateral, increased, the clearing volume of promissory notes dropped by 7.2 percent in volume terms and 12.1 percent in value terms from the previous year.

The clearing volume of cashier's checks decreased by 2.8 percent in terms of volume, but rose by 4.3 percent in terms of value due to a rise in the use of non-preset value cashier's checks. In the meantime, the clearings of 100,000 won-denominated cashier's checks, which accounted for 83.3 percent of the overall clearings of checks and bills by volume, fell by 1.8 percent.

2. Interbank Shared Networks

In 2003, the average daily figures for payments through the Interbank Shared Networks of KFTC registered 6.1 million by volume and 12.2 trillion won by value, representing increases of 2.5 percent and 14.7 percent, respectively, over the previous year.

In the Interbank Shared Networks, the use of Electronic Banking Network that made fund transfers through Internet banking and Telebanking increased sharply. However, the use of other Interbank Shared Networks, such as Interbank Funds Transfer (IFT) System and Cash Dispenser and Automated Teller Machine (CD/ATM) Network, decreased, showing that the settlements through Electronic Banking Network is rapidly replacing those through other Interbank Shared Networks.

By settlement system type, the use of the Electronic Banking Network, the biggest in the Interbank Shared Networks, rose by 27.9 percent in volume terms and 38.6 percent in value terms from the previous year as it absorbed customers using IFT System and CD/ATM Network by making the use of its merits, such as a relatively low fee³⁾ and free uses without time restriction.⁴⁾

As a result, the share of the Electronic Banking Network to the overall Interbank Shared Networks stood at 23.5 percent in volume terms and 62.7 percent in value terms, a sharp expansion from the previous year's 18.8 percent and 51.9 per-

2) Corporate procurement loans amounted to 12.4 trillion won and loans with accounts receivable as collateral amounted to 6.3 trillion won at the end of 2003, up 11.6 percent and 82.5 percent, respectively from a year earlier.

3) Transfer charge of 100,000 won to other bank (as of January 2004)

Interbank Funds Transfer System : 600~3,000 won

CD/ATM : 600~2,000 won

Internet banking & Telebanking : 300~600 won

4) Seventeen banks out of nineteen domestic banks provided 24-hour service and the others delivered service from 07:00 to 24:00 as of the end of 2003.

cent, respectively.

On the other hand, the use of the IFT System dropped by 9.9 percent in volume terms and 10.8 percent in value terms from the previous year as fund transfers through the IFT System were replaced with Internet banking and telebanking.

The use of CD/ATM Network, which had been on an upward trend, also decreased by 12.4 percent in volume terms and 13.6 percent in value terms, respectively, reflecting the spread of Internet banking⁵⁾ and a drop in the use of cash advance services through credit cards.

The use of the Cash Management Service(CMS) System increased by 6.1 percent in volume terms as the number of corporations enrolled in the system increased from 2,306 in 2002, to 4,094 in 2003. In value terms, however, it decreased by 10.2 percent as the use of credit cards reduced and credit card companies' withdrawal of money for card settlements through the system decreased.

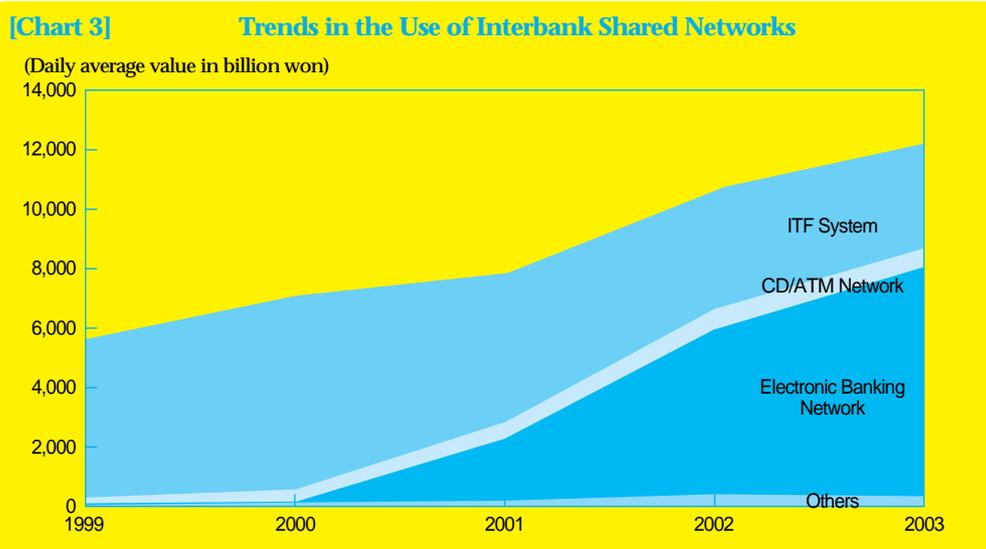
Besides, the use of the Bank Line and Electronic Funds Transfer at the Point of Sale(EFTPOS) System dropped in both volume and value terms owing to the spread of the use of the Internet Banking.

[Table 4] Payments through Interbank Shared Networks in 2003
(daily average)
Unit : thousand transactions, billion won, %

	1999	2000	2001	2002	2003	Change
<Volume>						
Electronic Banking Network ¹⁾	0.5	0.2	446.1	1,112.4	1,423.0	27.9
IFT System	1,075.8	1,329.2	1,276.7	1,162.7	1,047.1	-9.9
CD/ATM Network	888.5	1,081.0	1,293.5	1,445.0	1,266.4	-12.4
CMS System	579.6	982.2	1,472.4	2,191.0	2,323.6	6.1
Bank Line	4.0	4.1	4.4	3.5	2.0	-42.9
EFTPOS System	5.2	4.9	4.4	3.2	2.5	-21.9
Total	2,553.7	3,401.5	4,497.6	5,917.8	6,064.6	2.5
<Value>						
Electronic Banking Network ¹⁾	0.0	0.0	2,047.4	5,543.3	7,684.6	38.6
IFT System	5,332.9	6,515.6	4,990.8	4,050.6	3,612.6	-10.8
CD/ATM Network	301.3	449.4	566.0	682.3	589.2	-13.6
CMS System	48.8	109.8	211.2	387.9	348.3	-10.2
Bank Line	11.3	13.6	14.4	16.3	13.7	-16.0
EFTPOS System	0.3	0.3	0.3	0.2	0.2	-0.0
Total	5,694.6	7,088.7	7,830.0	10,680.6	12,248.5	14.7

Note : 1) Until march 2001, it consisted of payments through the ARS(Automatic Response Service) System

5) As of the end of 2003, the number of registered customers and corporations for Internet banking stood at 21.8 million and 1 million, representing an increase of 27.8 percent and 42.9 percent, respectively, over the previous year.



3. Credit Cards

In 2003, credit cards were used for a daily average of 6.0 million by volume for a value of 1.3 trillion won, decreases over the previous year of 1.6 percent and 23.0 percent, respectively.

It was attributable to a sharp decline in the use of cash advance service in the wake of reduced consumption following the sluggish economy, an increase in the number of credit card-related delinquent debtors⁶⁾, a reduction in the ceiling on the use of credit cards, as well as a rise in fees for cash advance service.

Viewing the use of credit cards by item, the average daily transactions for

purchases of goods and services rose by 7.4 percent in volume terms, but decreased by 9.4 percent in value terms over the previous year as the using amount per case⁷⁾ decreased owing to a reduction in the ceiling on the use of credit cards and an overall reduction in consumption.

The use of credit cards for cash advance services dropped sharply by 34.5 percent in volume terms and 32.9 percent in value terms over the previous year, due to slashed ceiling on the use of cash advance service and a rise in fees for cash advance service. However, the use of cash advance service per case showed no significant change, even though it increased⁸⁾ some-

6) As of the end of 2003, the number of credit card-related delinquent debtors stood at 2.4 million, up 61.1 percent from the previous year.

7) The use of purchase of goods and services per case decreased by 15.4 percent from 149,000 won in 2002, to 126,000 won in 2003.

8) The use of cash advance service per case came to 761,000 won in 2003, representing an increase of 2.4 percent from 743,000 won in the previous year.

what from the previous year.

As the use of cash advance services decreased sharply, the share of cash advance services in total credit card use stood at 14.3 percent in volume terms and 50.3 percent in value terms, decreases of 7.2 percentage points and 7.4 percentage points, respectively, over the previous year.

Comparing the credit card use after classifying into bank-affiliated cards floated by BC Card, Kookmin Bank, KEB Card, Shinhan Card, Woori Credit Card, and KDB Capital, and nonbank-affiliated ones issued by LG Card, Samsung Card, Hyundai Card, and Lotte Card, the use of bank-affiliated cards dropped by 3.6 percent from the previous year in volume terms, whereas that of nonbank-affiliated cards rose by 1.4 percent, show-

ing a contrast.

In terms of value, however, the use of both bank-affiliated cards and nonbank-affiliated cards decreased. The decrease rate of nonbank-affiliated cards (-32.7 percent) was bigger than that of bank-affiliated cards (-14.5 percent).

Meanwhile, as of the end of 2003, the total number of credit cards issued stood at 94.4 million, which consisted of 53.0 million bank-affiliated cards and 41.4 million nonbank-affiliated cards, showing a drop of 10.0 percent from the 104.9 million recorded at the end of the previous year.

It was attributable to card companies' steps to suspend service of unused cards, which were issued but have not been used, and to tighten the issuance guidelines of fresh cards. But the number of

[Table 5]

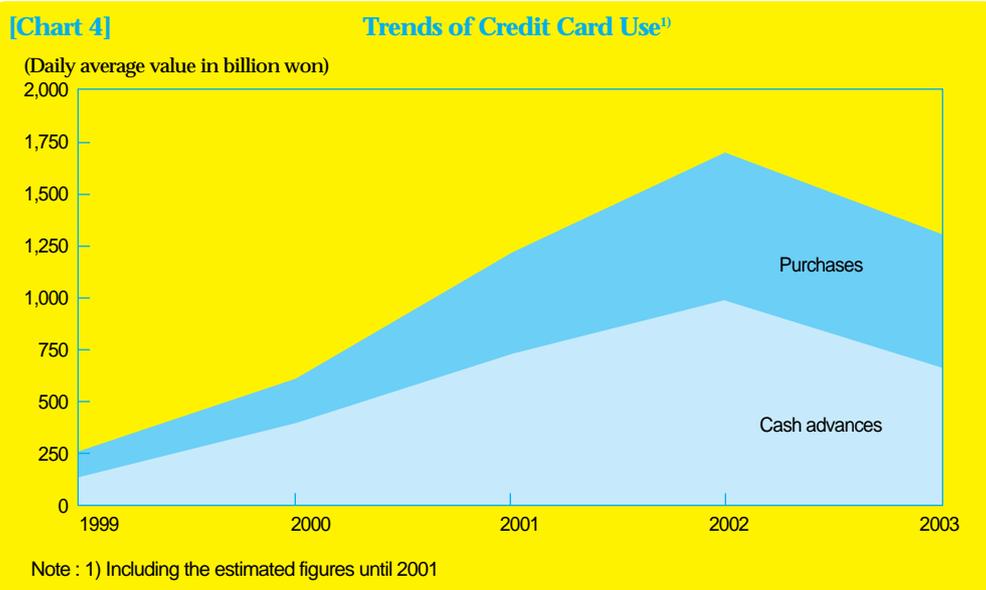
Payments Involving Credit Cards in 2003

(daily average)

Unit : thousand transactions, billion won, %, %p

	2002		2003p ¹⁾		Change	
	Volume	Value	Volume	Value	Volume	Value
Purchases	4,802.7	717.0	5,158.4	649.4	7.4	-9.4
Bank-affiliated	2,931.4	376.7	3,055.4	393.6	4.2	4.5
Nonbank-affiliated	1,871.2	340.3	2,103.0	255.8	12.4	-24.8
Cash Advances	1,318.9	979.4	863.3	657.0	-34.5	-32.9
Bank-affiliated	812.9	526.2	555.0	378.5	-31.7	-28.1
Nonbank-affiliated	505.9	453.2	308.3	278.5	-39.1	-38.5
Total	6,121.5	1,696.3	6,021.7	1,306.4	-1.6	-23.0
Bank-affiliated	3,744.4	902.9	3,610.5	772.1	-3.6	-14.5
Nonbank-affiliated	2,377.2	793.5	2,411.3	534.3	1.4	-32.7
Dependence on cash advance services(%)	21.5	57.7	14.3	50.3	-7.2p	-7.4p
Bank-affiliated	21.7	58.3	15.4	49.0	-6.3p	-9.3p
Nonbank-affiliated	21.3	57.1	12.8	52.1	-8.5p	-5.0p

Note : 1) Including provisional figures of KEB Card



merchants accepting credit cards expanded by 9.7 percent over the previous year to 17.1 million, which broke down into 9.0 million for bank-affiliated cards and 8.2 million for nonbank-affiliated cards.

4. Bank Giro

In 2003, the average daily transactions through the Bank Giro registered 3.7 million by volume and 0.5 trillion won by value, exhibiting rises of 18.5 percent and 20.2 percent, respectively, over the previous year.

This was attributable to a change of way to receive premiums and telephone charges by some insurance and communication companies from the method through CMS System to direct debits through the Bank Giro.

Some insurance and communication

companies changed the way to receive insurance contributions and telephone charges as the Bank Giro requires low fees, even though it delays the deposit period by one or two more days than the CMS System.

By settlement system type, the use of electronic-based settlements, including direct debits, standing orders and direct credit transfers, rose by 36.8 percent in volume terms and 34.3 percent in value terms from the previous year. On the other hand, the use of paper-based credit transfers increased by 5.1 percent and 10.4 percent, respectively. Accordingly, the share of electronic-based settlements in Bank Giro went up by 49.0 percent by volume and 45.7 percent by value.

[Table 6] Payments through Bank Giro in 2003
(daily average)

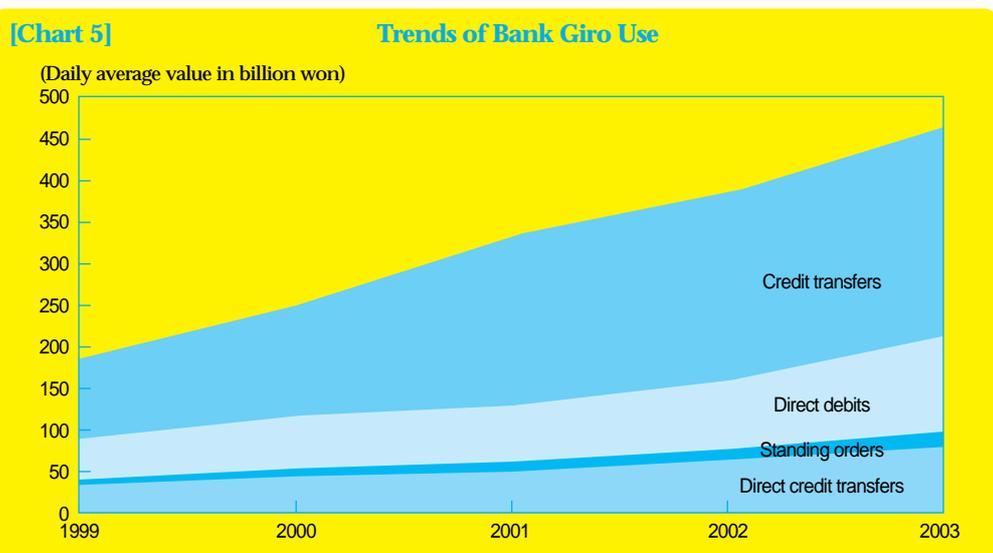
Unit : thousand transactions, billion won, %

	1999	2000	2001	2002	2003	Change
<Volume>						
Paper-based credit transfer	1,108.2	1,312.3	1,703.8	1,812.9	1,904.6	5.1
Electronic-based	1,026.8	1,141.7	1,139.4	1,338.4	1,830.7	36.8
Direct debits	968.2	1,066.6	1,054.8	1,220.5	1,670.3	36.9
Standing orders	27.8	37.6	47.2	63.0	80.9	28.4
Direct credit transfers	30.8	37.5	37.4	54.9	79.5	44.8
Total	2,135.1	2,454.0	2,843.2	3,151.4	3,735.2	18.5
<Value>						
Paper-based credit transfer	97.7	135.4	202.9	227.9	251.6	10.4
Electronic-based	87.5	114.1	128.0	157.9	212.0	34.3
Direct debits	47.8	61.3	67.7	81.1	114.7	41.4
Standing orders	5.8	8.1	10.4	14.4	19.3	34.0
Direct credit transfers	33.9	44.7	49.9	62.4	78.0	25.0
Total	185.2	249.5	330.9	385.8	463.6	20.2

[Table 7] Trends in the Share of Electronic Giro Use

Unit : %, %p

	2001	2002(A)	2003(B)	B-A
Volume	40.1	42.5	49.0	6.5
Value	38.7	40.9	45.7	4.8



5. The Bank of Korea Financial Wire Network (BOK-Wire)

In 2003, the average daily settlement volume of domestic currency funds between financial institutions, which were made through BOK-Wire, came to 6,412 transactions for an average daily value of 88.0 trillion won, representing increases of 16.5 percent in volume terms and 9.7 percent in value terms over the previous year.

Real-time gross settlements, which account for the majority of domestic currency fund settlements through BOK-Wire, increased by 8.7 percent in volume terms and 11.5 percent in value terms, over the previous year. This was mainly attributable to a rise in fund transfers through this system, affected by an increase in call and bond transactions among financial institutions coupled with a change of the settlement formula.

Of the gross settlements, the settlements through the Call transaction system of BOK-Wire expanded by 24.1 percent by volume and 26.5 percent by value as the scope of transactions for the use of the Call transaction system, which had been limited to interbanks call transactions, expanded to all of call transactions between institutions participating in BOK-Wire in July 2003, and invest-

ment trust companies' funds for call transactions, which had been settled through the exchange of receipts for repayment of call funds, were settled through this system.

Of the gross settlements, the settlements through the Delivery versus Payment(DVP) System for securities trading soared by 202.3 percent by volume and 139.4 percent by value as the bond settlement date changed from the day of a trade to the next day in June 2003, and bond transactions, which had been settled through General transfer system, were settled through the DVP system.

On the other hand, the settlements of funds for securities trading made through the General fund transfer system of BOK-Wire decreased by 13.0 percent by volume and 2.0 percent by value over the previous year.

In the meantime, the net settlements interbanks through BOK-Wire decreased by 11.7 percent in volume terms and 1.8 percent in value terms as retail payments and settlements concentrated on the Electronic Banking Network and the number of institutions participating in the net settlements reduced.⁹⁾

The settlements related to BOK loans and discounts, treasury funds transfer and transactions of government and public bonds soared by 85.1 percent by vol-

9) Kookmin Bank and the former Housing and Commercial Bank of Korea unified their computer systems on Oct. 7, 2002, and Hana Bank and the former Seoul Bank consolidated their computer systems on May 12, 2003.

[Table 8]

Settlements through BOK-Wire in 2003

(daily average)

Unit : transactions, billion won, %

	1999	2000	2001	2002	2003	Change
<Volume>						
Gross settlements	3,208.3	3,299.5	3,727.4	3,984.4	4,329.3	8.7
· General transfers	3,066.9	3,147.9	3,449.6	3,612.7	3,531.0	-2.3
(call transaction)	..	..	..	443.6	540.8	21.9
(securities transaction)	..	..	..	1,262.8	1,099.2	-13.0
· Call transaction system	141.2	126.5	173.7	182.6	226.6	24.1
· DVP system	..	25.1	104.1	189.1	571.7	202.3
Net settlements	856.0	792.9	793.9	750.8	662.9	-11.7
Others ¹⁾	630.2	674.9	747.9	767.2	1,420.1	85.1
Domestic currency total	4,694.4	4,767.3	5,269.2	5,502.5	6,412.3	16.5
Foreign currency fund transfers ²⁾	12.5	9.9	9.1	8.9	9.5	6.7
<Value>						
Gross settlements	51,499.4	48,961.9	60,047.2	62,812.1	70,040.5	11.5
· General transfers	46,674.5	44,217.2	49,725.8	51,472.7	54,260.7	5.4
(call transaction)	..	..	..	15,156.0	17,514.2	15.6
(securities transaction)	..	..	..	13,914.2	13,634.4	-2.0
· Call transaction system	4,824.7	4,538.7	9,480.9	10,068.9	12,738.1	26.5
· DVP system	..	206.0	840.5	1,270.5	3,041.7	139.4
Net settlements	13,255.6	12,115.3	12,456.5	14,149.2	13,889.5	-1.8
Others ¹⁾	2,277.8	2,790.0	3,044.1	3,323.6	4,111.6	23.7
Domestic currency total	67,032.7	63,867.1	75,547.8	80,284.9	88,041.7	9.7
Foreign currency fund transfers ²⁾	389.8	97.3	113.0	88.1	112.5	27.7

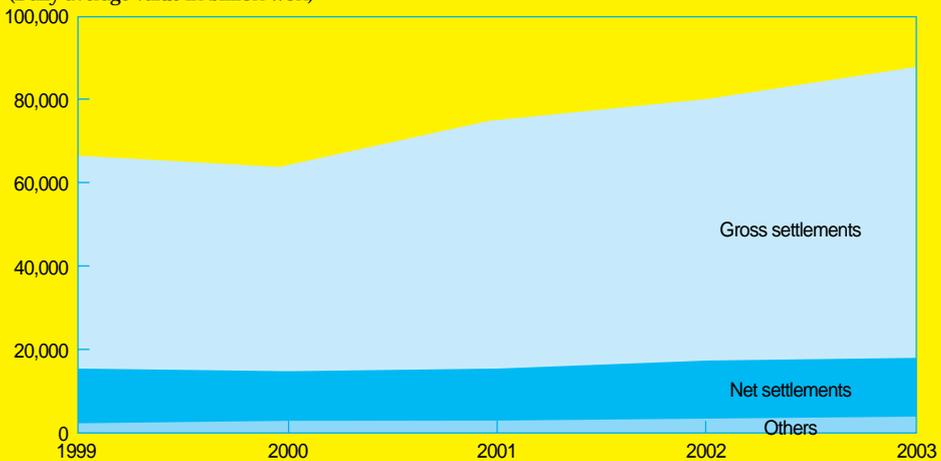
Notes : 1) Treasury fund transfer, BOK loans and discounts, Government and Public bonds, etc

2) Unit : million dollars

[Chart 6]

Trends of BOK-Wire Use

(Daily average value in billion won)



ume and 23.7 percent by value as the Treasury funds real-time account transfer system¹⁰⁾ was implemented in January 2003 and fiscal expenditures expanded sharply in 2003.

In the meantime, the settlement value of foreign currency funds through BOK-Wire in 2003 increased¹¹⁾ by 27.7 percent from the previous year to 112.5 million dollars on the daily average.

III . Developments in Payment and Settlement Systems

In 2003, the Bank of Korea established an oversight system to enhance the safety and efficiency of the nation's payment and settlement systems and sought measures to reduce settlement risk. At the same time, it expanded an institutional basis to help financial consumers make more convenient use of payment and settlement services.

<Establishment of Oversight System for Payment and Settlement Systems>

Under the provisions of the revised

“Bank of Korea Act” promulgated on September 3, 2003, the Bank of Korea was given the authority for the comprehensive management and oversight of the nation's payment and settlement systems, it completely rewrote the “Regulation concerning the operation and management of the payment and settlement systems”, inserting basic provisions concerning the setup of an effective oversight system for the payment and settlement systems in preparation for the Act's entry into effect January 1, 2004.

Firstly, it set the scope of its surveillance business as being the selection and classification of payment and settlement systems subject to oversight, the gathering demands and analysis of relevant materials, evaluation of the system's safety and efficiency, demands for improvement in the light of evaluation findings, as well as steps in case of emergent situation.

Also, it decided to classify the payment and settlement systems subject to its oversight into Systematically Important Payment Systems, Prominently Important Payment Systems, and Other Payment Systems according to their degree of importance in the financial market, applying different methods and frequency of evaluation to each category.

10) In the past a government officer issued a treasury check and a receiver presented it to his or her bank, which credited to the receiver through the check clearing process. After implementation of the Treasury funds real-time account transfer system, treasury funds were deposited in receiver's account directly.

11) The average daily trading volume in the foreign exchange market in 2003 amounted to 12.2 billion dollars, an increase of 32.6 percent from the 9.2 billion dollars recorded in 2002.

Along with this, it clarified the frequency of evaluation and the criteria to be applied in appraising systems' safety and effectiveness. In case the evaluation's results fall short of a certain level, it was laid down that the relevant operating or supervisory institutions would be requested to improve operational standards.

In case an incident or other emergency situation arises affecting the safety and efficiency of Systematically Important Payment Systems or Prominently Important Payment Systems, the operating institutions are required to notify the Bank of Korea at once of the matter. In a further move to heighten the safety of BOK-Wire, the conditions for institutions applying to join BOK-Wire were tightened.

<Measures to reduce settlement risks>

The Bank of Korea drew up and put in place policies designed to counter settlement risks. To reduce settlement risk arising where a call loan is granted in return for a promissory note and enhance the

safety of the settlements of call fund, in July 2003 it expanded the scope of transactions eligible for use of the Call transaction system¹²⁾ of BOK-Wire from inter-banks call transactions to all call transactions between BOK-Wire participants.

Accordingly, call loan institutions including banks and investment trust companies, which had previously collected call funds by way of a procedure¹³⁾ involving the submission to a clearing house of a promissory note for the repayment of call funds or a receipt for the repayment of call funds when engaging in call transactions with nonbank financial institutions or foreign banks' domestic branches, were allowed to use the Call transaction system of BOK-Wire.

As a result there was a corresponding decline in the net settlement risk accompanying call transactions and some relief in the burden on financial institutions of move in the physical transfer of large-value bills for clearing.

The Bank of Korea and the institutions concerned pressed ahead with preparation of the procedures and operations needed for the construction before the

12) This is one of the sub systems of BOK-Wire, participants in which hold current accounts with the Bank of Korea. Call money is supplied by a transfer between the counterparts' current accounts. On the maturity date the principal and interest of the call loan are automatically redeemed by another transfer between the counterparts' accounts at the designated time(14:30).

13) The call transactions between banking counterparts are carried out by means of the supply of call money and their redemption through the Call transaction system of BOK-Wire. In case that the borrowing counterparts are securities companies, non-bank financial institutions or domestic branches of foreign banks, the call money is supplied through BOK-Wire and a promissory note for redemption of the call money or a receipt for redemption purposes issued by the call loan institution itself is passed on to a Clearing House. Consequently the net settlement risk of the checks and bills clearings system increased to a corresponding extent by the exchange of high denomination call bills and call money redemption receipts through the Clearing House.

end of 2004 of a Payment-versus-Payment (PVP) System, which can reduce foreign exchange settlement risk arising in the case of foreign exchange transactions in which payment for the currency sold and receipt of the currency purchased cannot be made concurrently due to the different time-zone of the counterpart financial institutions.

In 2003 Continuous Linked Settlement Bank(CLS Bank)¹⁴⁾, a specialist bank for the across-borders simultaneous settlement of foreign exchange, approved in principle the inclusion of the Korean won among the eligible settlement currencies.

Kookmin Bank and Korea Exchange Bank completed their subscription of capital to CLS Bank in September 2003 to qualify as settlement members of CLS Bank.

In keeping with this move, the Bank of Korea prepared the institutional and technical environment for other domestic financial institutions to join the CLS foreign exchange simultaneous settle-

ment system. At the same time, it pressed ahead with the tasks of linking the CLS foreign exchange simultaneous settlement system and domestic financial institutions, and of linking the CLS foreign exchange simultaneous settlement system and BOK-Wire.

<Increasing convenience for financial consumers>

Along with this, the Bank of Korea expanded the systematic basis for helping financial consumers use payment settlement services conveniently.

As one aspect of the projects picked out by the Subcommittee for the Promotion of Financial Informationalization, first, it expanded the scope of eligibility for use of CD/ATM Networks of Korea Financial Telecommunications & Clearings Institute(KFTC), enabling bank customers to pay Giro bills or public utility charges using CD/ATMs from April 2003.

In June, it also added regional health insurance contributions to the objects¹⁵⁾

14) Continuous Linked Settlement Bank was originally established in 1999 through subscription by 66 financial institutions from 17 countries as a specialist private sector bank based in New York for the foreign exchange settlement. In September 2002 seven currencies, the US dollars, the Japanese yen, the UK pound, the euro, the Swiss franc, the Canadian dollar and the Australian dollar were designated as eligible currencies for settlement and the system for the simultaneous settlement of foreign currency transactions went into operation. In September 2003 the Singapore dollar, the Swedish krona, the Danish krone and the Norwegian krone were added as eligible settlement currencies.

15) The EBPP system handles giro charges, taxes and legal imposts and public charges; giro charges including charges for city gas, newspaper subscription, telecommunication charges, insurance premiums and registration fees; taxes and legal imposts including national taxes, customs duties, local taxes, minor police fines, patent fees, harbor dues, contributions to official and treasury funds; also public charges including national pension contributions, health insurance contributions, unemployment insurance contributions, industrial casualty & fire insurance premiums, water & sewage charges, telephone charges, veterans' welfare debt services.

of the Electronic Bill Presentment and Payment (EBPP) System of KFTC, which allows users to pay taxes or public utility charges via the Internet.

To prevent illicit deposit withdrawals through forged bank magnetic stripe cards, meanwhile, the Bank of Korea pressed ahead jointly with banks in a project to convert bank magnetic stripe cards into financial integrated circuit(IC) cards, which are excellent in terms of security. Standards for these financial IC cards were established in November 2003.

In August 2003, it also allowed banks that purchased domestic L/C bills to make an online request to the issuing bank, for relevant information through the Electronic Banking Network of KFTC.

In September, it improved procedures for settlement of domestic L/C bills so as to allow the details of the bills to be input automatically through a linking up with the computer system of the bank that

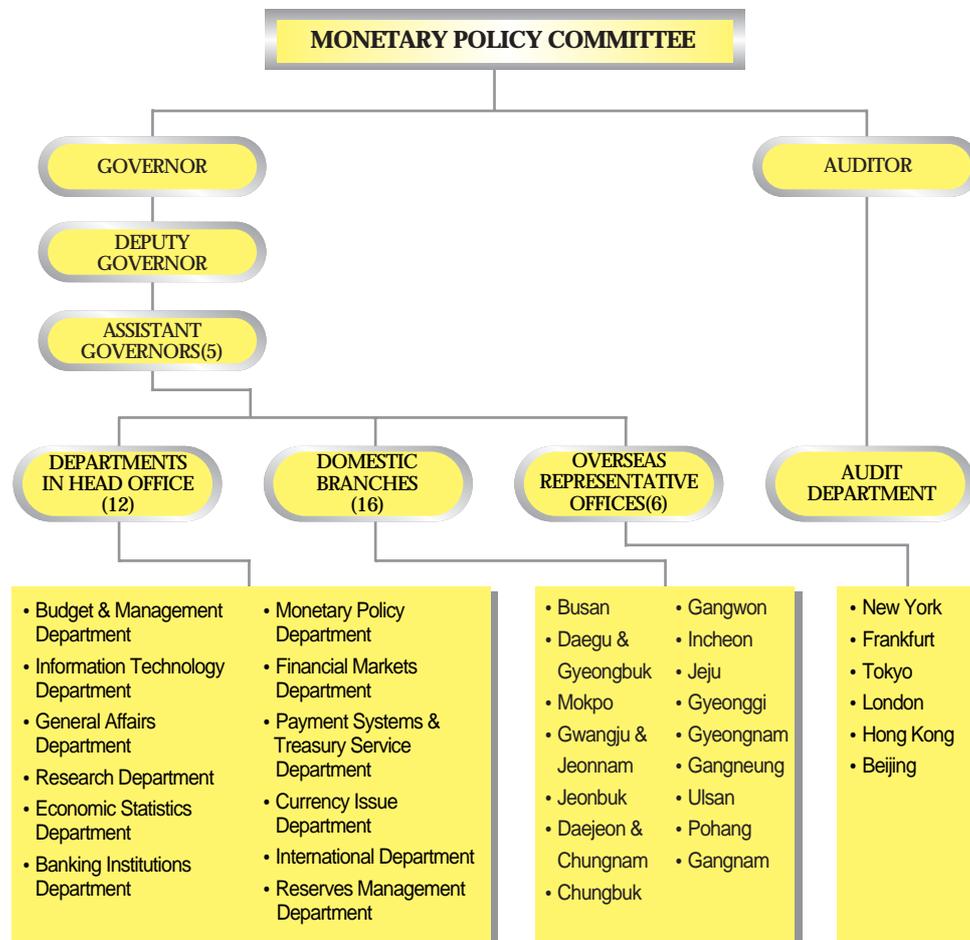
opened the domestic L/C, instead of inputting the contents to the computer system of the purchasing bank when a bank purchases or collects money for domestic L/C bills. It also changed the bill clearing method for net settlement of won-denominated domestic L/C bills from that of exchanging physical receipts to that of exchanging information.

Besides this, the Bank of Korea mapped out emergency measures to ensure that the overall payment settlement systems, including BOK-Wire, would operate smoothly at the period of the strike by members of the Chohung Bank Labor Union in June 2003. In preparation for a possible liquidity shortage by Chohung Bank, it completed procedures in advance for the registration of securities as collateral and the screening of eligibility for the extension of liquidity-adjustment loans, enabling them to be extended promptly.

Organization of the Bank of Korea

(As of March 2004)

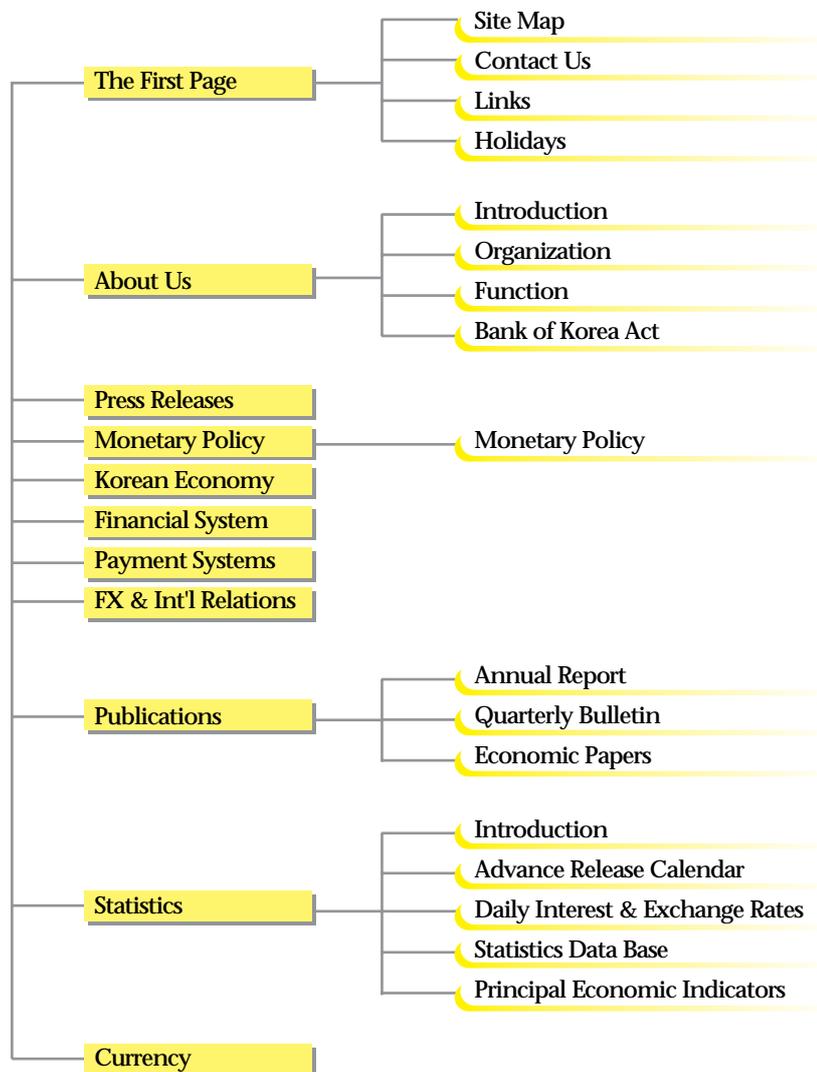
<p>Monetary Policy Committee Seung Park, Chairman Won-Tai Kim Hoon Namkoong Tae-Dong Kim Kun-Kyong Lee Seong-Tae Lee Jong-Chang Kim</p>	<p>Governor Seung Park</p> <p>Deputy Governor Seong-Tae Lee</p> <p>Assistant Governor Jae-Ouk Lee Kyuyung Chung Shang-Heon Lee Bang-Woo Jung Jae-Hwan Park</p>	<p>Auditor Sang-Yong Lee</p>
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The Bank of Korea's Internet Web Site

1. Press releases and selected data from statistical series - National Accounts, etc - are posted on the Bank of Korea's Web Site
(<http://www.bok.or.kr>)

2. Internet Web Site Menus are set out below :



List of Publications

● Periodical

Title	Frequency	Language	Dissemination Type*
Annual Report	Annually	English	P, O
Quarterly Bulletin	Quarterly	English	P, O
Monthly Bulletin	Monthly	Korean	P, O
Working Paper	Occasionally	Korean	P
Economic Analysis	Quarterly	Korean	P, O
Economic Papers	Semiannually	English	P, O
Finance and Economics Working Paper	Occasionally	Korean	P
Financial System Review	Semiannually	Korean	P, O

* Notes : P : printed publication, O : available on-line at the Bank of Korea's web site

● Statistics

Title	Contents	Frequency	Dissemination Type*
Monthly Statistical Bulletin	Major national economic statistics covering money and banking, prices, balance of payments, foreign trade, industry, employment, national accounts, etc.	Monthly	P, B
Economic Statistics Yearbook	Statistics included in the Monthly Statistical Bulletin and others	Annually	P, B
Principal Economic Indicators	Principal indicators and the statistics included in the Monthly Statistical Bulletin	Semimonthly	B
Money & Banking Statistics	Statistics on monetary aggregates(M1, M2, M3, etc.), the principal accounts of CBs & SBs and other financial institutions, capital market trends, principal interest rates, etc.	Monthly	P, B

Title	Contents	Frequency	Dissemination Type*
Regional Financial Statistics	Statistics on the issuance and withdrawal of banknotes and coin by BOK's branches, the deposits and loans of BOK, CBs & SBs, other financial institutions by province, etc.	Monthly	P
Balance of Payments	Current account, capital account, financial accounts, exports & imports by type of goods, indexes of foreign trade and terms of trade, etc.	Monthly	P, B
Price Statistics Summary	Brief review of price movements, statistical compilation procedures and statistics on the producer price index for 949 commodities, and export and import price indexes for 220 and 223 goods.	Every 5 years	P
Monthly Prices	Brief analysis of price movements and statistics on producer price index, export price index, import price index and prices of major world trade commodities, etc.	Monthly	P, B
Input-Output Tables	Outline of compilation method, inter-industrial structure of the Korean economy, transactions tables, input coefficients matrices, production inducements coefficients matrices, supporting tables	Every 5 years	C
National Accounts	Principal indicators of national accounts, consolidated accounts for the nation, income accounts by institutional sector, capital finance account by institutional sector, supporting tables	Annually	P, B, C
Gross Domestic Product	Gross domestic product by kind of economic activity, expenditure on gross domestic product	Quarterly	P, B

Title	Contents	Frequency	Dissemination Type*
Financial Statement Analysis	Summary of survey results, description of survey methods, explanation of company accounts and financial analysis ratios, statistics of estimated balance sheets, income statements, statistics of cost of goods manufactured, funds flow statements and financial ratios, series of major countries' financial analysis ratios, etc.	Annually	P, B
Flow of Funds	Financial surpluses and deficits by economic sector, fund raising and investment by non-financial sectors, the financial sector's sources and uses of funds, accumulation of financial assets	Quarterly	P, B

* Notes : P : printed publication,
 B : on-line database system (BOKIS, accessible via the Bank of Korea's Web Site),
 C : CD-ROM

List of Bank of Korea Working Papers*

Serial No.	Title
2004-1	Inter-regional Economic Divide and the Tasks for Policy
2004-2	Comparison of the Availability of Core Inflation Indicators Employing Different Methods
2004-3	The Emergence of the Chinese Economy and the Hollowing-Out of Japanese Industry

* Published in Korean only.

Titles of Articles Appearing in Monthly Bulletin*

January ~ March 2004

● January 2004

- ☒ The Governor's New Year Speech
- ☒ Identifying Cyclical Phases in Korea
- ☒ Medium-term Inflation Target and Monetary Policy for 2004
- ☒ Financial and Foreign Exchange Market Trends During 2003

● February 2004

- ☒ An Analysis of Demand for Coins in Korea
- ☒ Major Details of Financial Sector Restructuring in 2003
- ☒ The Employment Structure and Labor Linkage Effects as Derived by 'Employment Table in 2000'

● March 2004

- ☒ Analysis of How Exchange Movements are transmitted to Export and Import Prices
- ☒ Payment and Settlement Trends in 2003

* Published in Korean only.

Titles of Articles Appearing in Quarterly Bulletin*

March 2000 ~ December 2003

● March 2000

- ☒ Current Economic and Financial Movements
- ☒ The Inflation Target for 2000
- ☒ Financial Sector Restructuring in 1999
- ☒ Payment and Settlement Trends in 1999

● June 2000

- ☒ Governor's Speech on the 50th Anniversary of the Bank of Korea's Foundation
- ☒ Current Economic and Financial Movements
- ☒ Flow of Funds in 1999
- ☒ Financial Statement Analysis for 1999

● September 2000

- ☒ Current Economic and Financial Movements
- ☒ The Relationship between Business Survey Results and the Growth Rate of GDP

● December 2000

- ☒ Current Economic and Financial Movements
- ☒ Monetary Policy in a World of Increased Capital Flows
- ☒ Flow of Funds in the First Half of 2000

* Entitled 「Quarterly Economic Review」 until March 2000.

● **March 2001**

- ☒ Current Economic and Financial Movements
- ☒ The Inflation Target and Monetary Policy for 2001
- ☒ Financial Sector Restructuring in 2000
- ☒ Payment and Settlement Trends in 2000

● **June 2001**

- ☒ Governor's Speech on the 51st Anniversary of the Bank of Korea's Foundation
- ☒ Current Economic and Financial Movements
- ☒ Flow of Funds in 2000
- ☒ Financial Statement Analysis for 2000

● **September 2001**

- ☒ Current Economic and Financial Movements
- ☒ The Structure and the Interindustry Effects of the Korean Economy Based on the Input-Output tables of 1998
- ☒ Payment and Settlement Trends in the First Half of 2001

● **December 2001**

- ☒ Current Economic and Financial Movements
- ☒ Flow of Funds in the First Half of 2001
- ☒ Financial Statement Analysis for the First Half of 2001

● **March 2002**

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- ☒ The Inflation Target and Monetary Policy for 2002
- ☒ Financial Sector Restructuring in 2001
- ☒ Payment and Settlement Trends in 2001

● **June 2002**

- ☒ Governor's Speech on the 52nd Anniversary of the BOK's Foundation
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- ☒ The Redefined Monetary Aggregates
- ☒ Flow of Funds in 2001
- ☒ Financial Statement Analysis for 2001

● **September 2002**

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● **December 2002**

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- ☒ Financial Statement Analysis for the First Half of 2002

● **March 2003**

- ☒ Current Economic and Financial Movements
- ☒ The Inflation Target and Monetary Policy for 2003
- ☒ Financial Sector Restructuring in 2002
- ☒ Payment and Settlement Trends in 2002

● **June 2003**

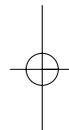
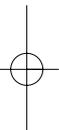
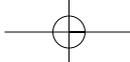
- ☒ Address upon the 53rd Anniversary of the Foundation of the Bank of Korea
- ☒ Current Economic and Financial Movements
- ☒ Summary of Financial Stability Report
- ☒ Flow of Funds in 2002
- ☒ Financial Statement Analysis for 2002

● **September 2003**

- ☒ Current Economic and Financial Movements
- ☒ Short and Long-run Exchange Rate Determinants of the Korean Won
- ☒ Payment and Settlement Trends in the First Half of 2003

● **December 2003**

- ☒ Current Economic and Financial Movements
- ☒ Summary of Financial Stability Report
- ☒ The Structure of the Korean Economy on the 2000 Input-Output Tables
- ☒ Flow of Funds in the First Half of 2003
- ☒ Financial Statement Analysis for the First Half of 2003



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