

**Asian Capital Market Law and Regulation Forum  
: China, Japan and Korea**

# **Macroeconomic Policy Response to the Global Financial Crisis : Policy Tasks in the Capital Market in Korea**

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I . Global Financial Crisis and Macroeconomic Policy Response

II . Recent Economic Developments & Policy Decisions

III . Assessment & Policy Tasks in the Capital Market

- I. Global Financial Crisis and Macroeconomic Policy Response
  - 1. Impacts of Global Financial Crisis
  - 2. Policy Response

II. Recent Economic Developments & Policy Decisions

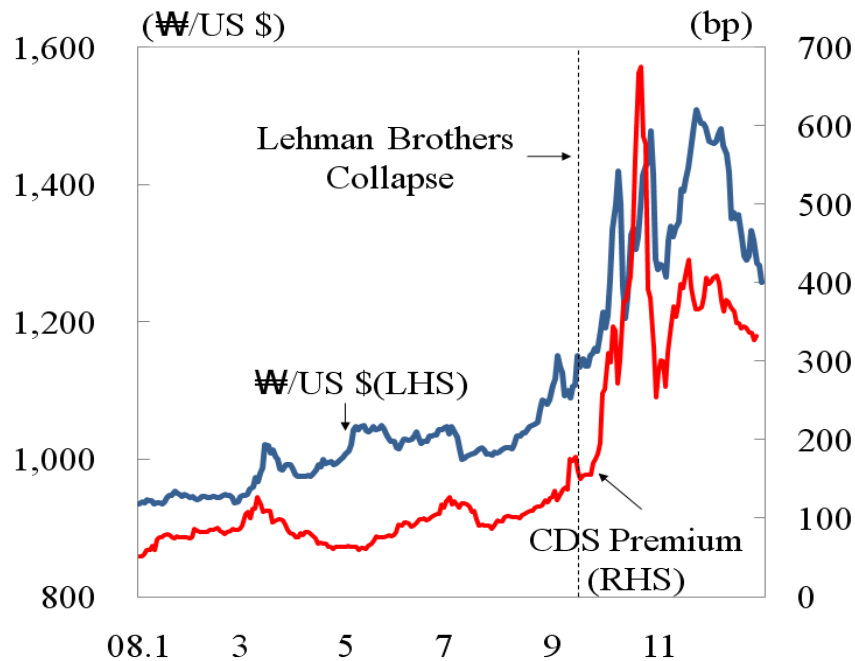
III. Assessment & Policy Tasks in the Capital Market

# 1. Impacts of Global Financial Crisis

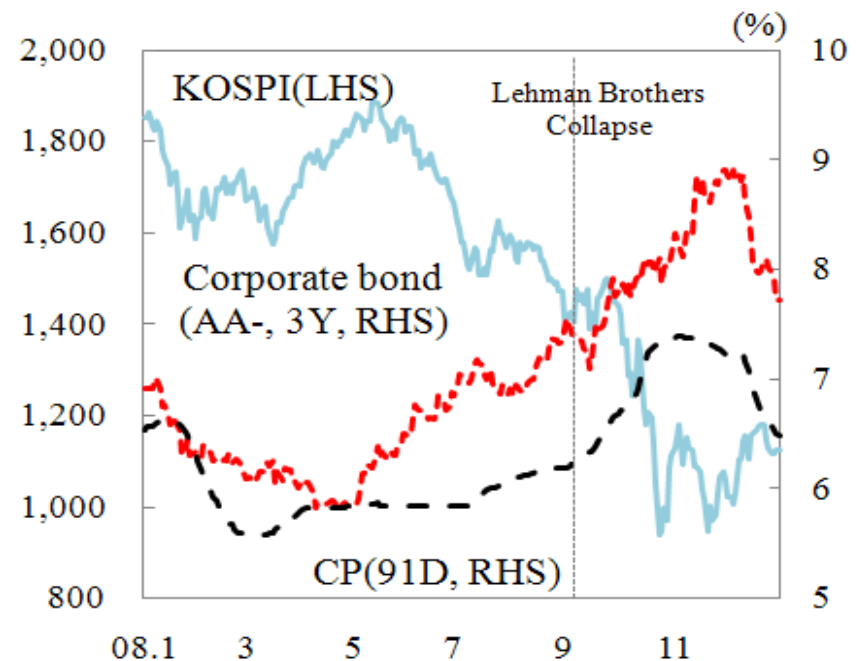
## ● Korean FX and Financial Markets (late 2008)

- **Korean Won/US dollar** : 1,089 (Aug. 31) → 1,530 (Nov. 24) (+28.0%)
- **Credit Default Swap premium** : 116bp (Aug. 31) → 675bp (Oct. 27) (six-fold)
- **Stock Price (KOSPI)** : 1,474.2 (Aug. 31) → 938.8 (Oct. 24) (-36.3%)
- **Credit Spread on CBs (AA-, 3 yr)** : 157bp (Aug. 31) → 465bp (Dec. 9) (three-fold)

### Exchange rate and CDS premium



### Stock price and interest rates



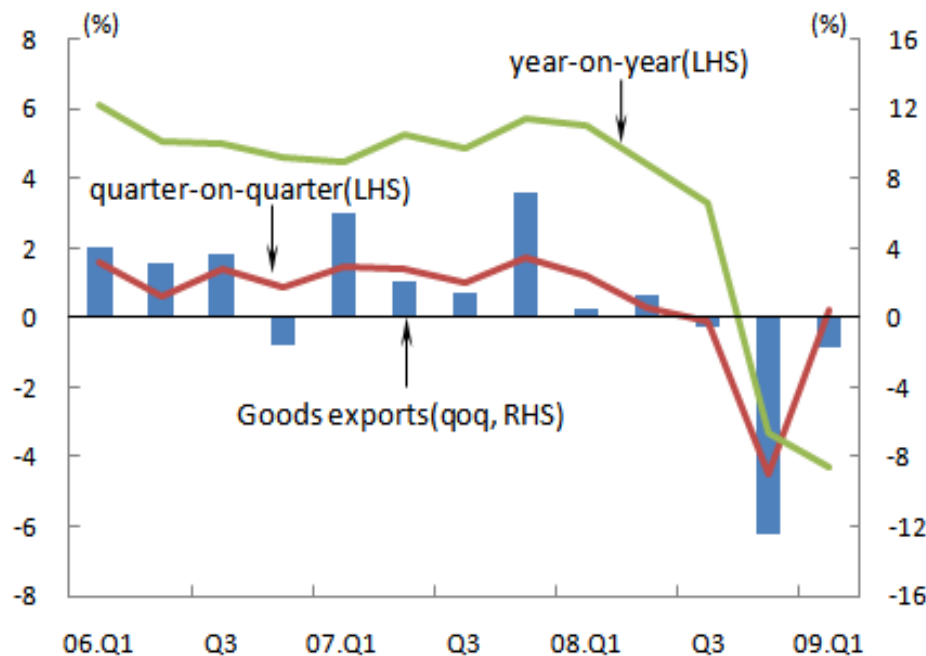
# 1. Impacts of Global Financial Crisis

## ● Real Economy of Korea

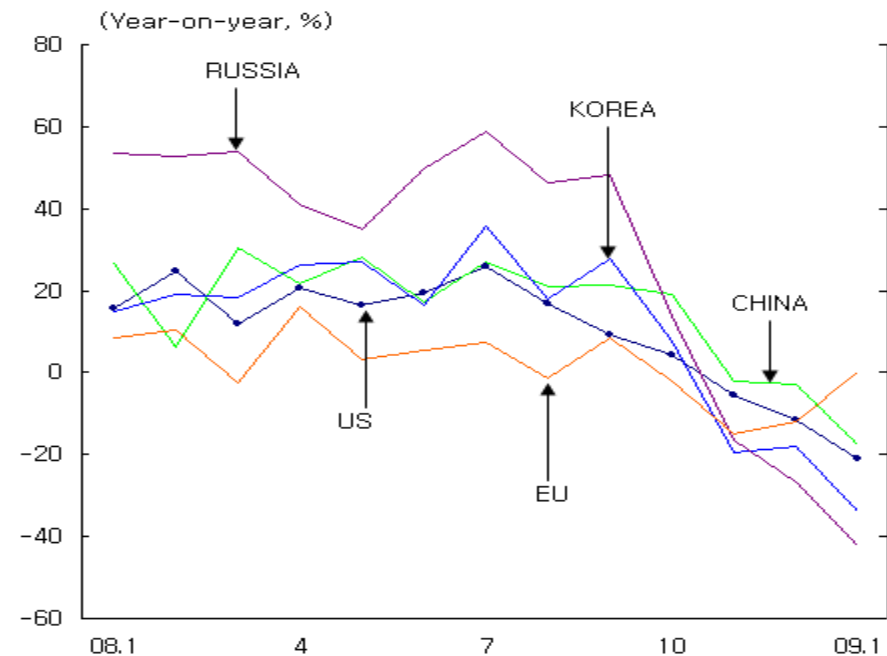
- GDP growth rate fell to **-4.5%** quarter-on-quarter in 4Q 2008.  
(Exports : -8.9%; Private Consumption : -4.5%; Investment : -15.9%)

Unemployment rate : Aug. 2008 3.1% → Mar. 2009 4.0%

### GDP growth



### Exports of selected countries



## 2. BOK's Policy Response

### ● BOK responded exceptionally and aggressively to the crisis:

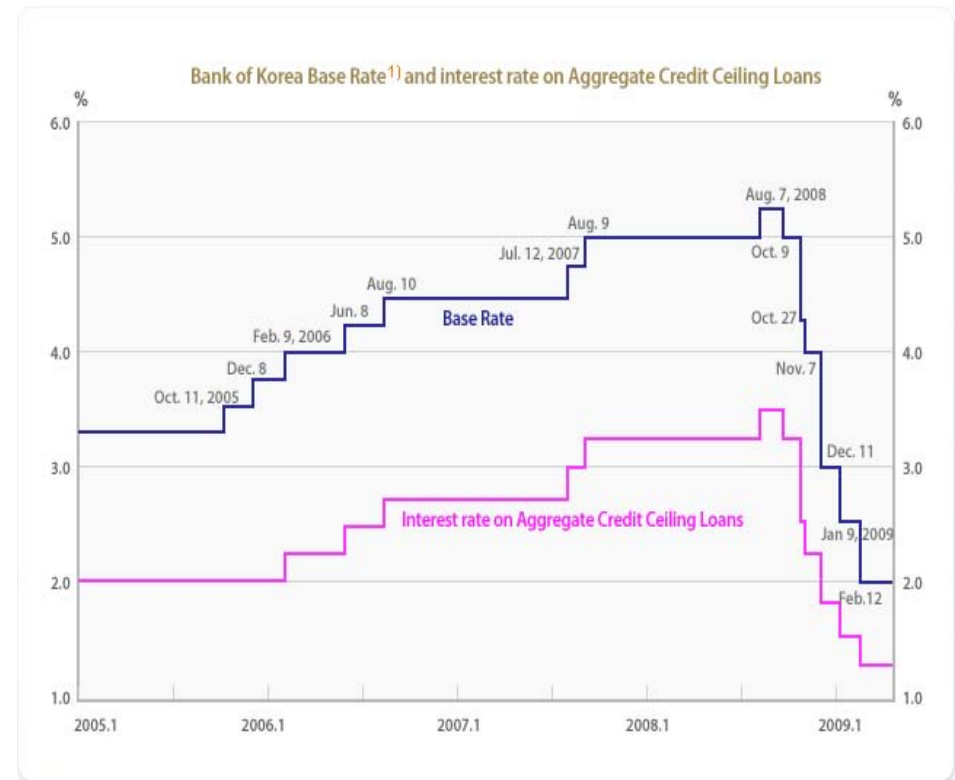
- to cushion the direct effects of the financial turbulence on the economy
- to reduce the damage of the **adverse feedback loop** (in which economic weakness and financial stress become mutually reinforcing)

### ① Reduction of Base Rate

- Six cuts between Oct. 2008 and Feb. 2009, by total 3.25%p (5.25% → 2.0%\*)

\* Previous lowest level 3.25%, between Nov. 2004 and Oct. 2005

- Interest rate cuts also on Aggregate Credit Ceiling Loans (3.5% → 1.25%)

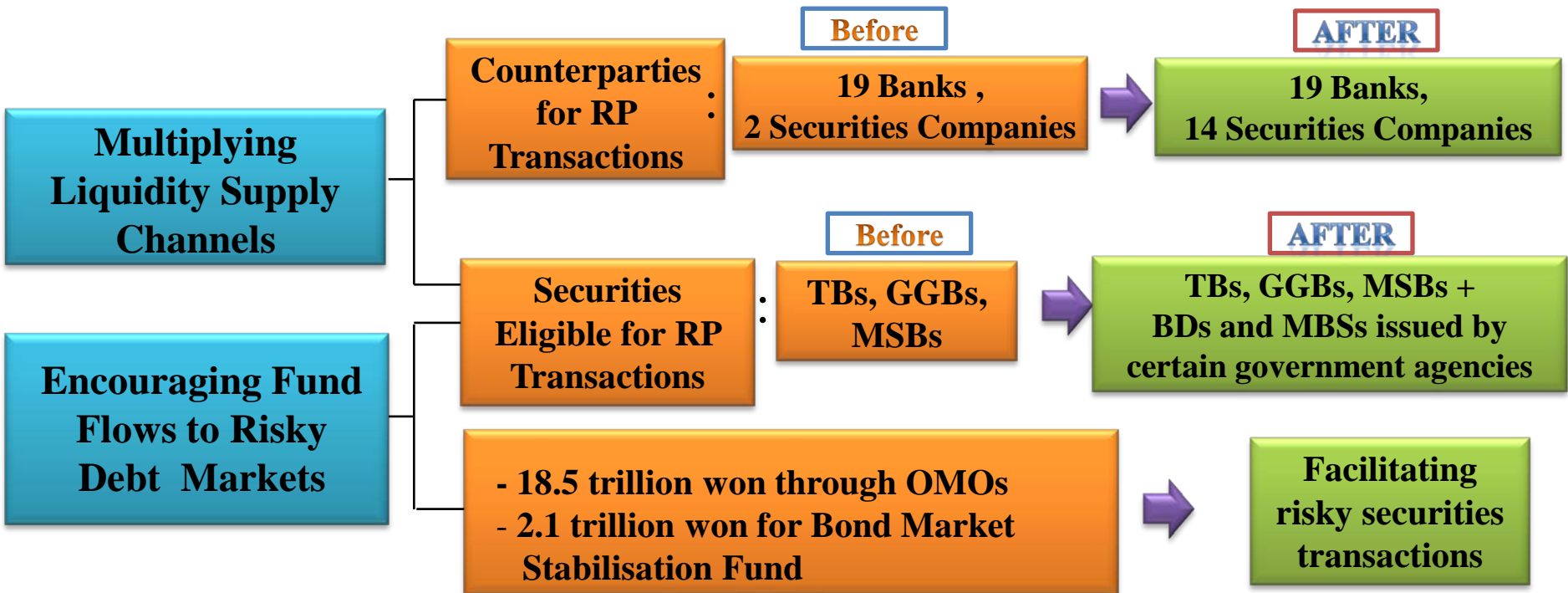


Note: 1) The overnight call rate target, until February 2008

## 2. BOK's Policy Response

### ② Expansion of Liquidity Supply to Financial Markets

- 1) supplied liquidity by OMOs (18.5 trillion won)
- 2) lent to the **Bond Market Stabilisation Fund** ( 2.1 trillion won)
- 3) expanded securities & counterparties eligible for RP operations



Note : TB – Treasury Bond; GGB – Government-Guaranteed Bond; MSB – Monetary Stabilisation Bond; BD – Bank Debenture

## 2. BOK's Policy Response

### 3 Support for Expansion of Banks' Credit Supply Capacity

- 1) Raised Aggregate Credit Ceiling for banks (6.5 trillion won → 10.0 trillion won)
- 2) Paid banks one-off interest on required reserves (0.5 trillion won)
- 3) Lent to **Bank Recapitalisation Fund** (3.3 trillion won)





## 2. BOK's Policy Response

### 4 Stabilisation of Foreign Exchange and Foreign Currency Funding Markets

- **Currency Swap Agreements with 3 Central Banks** (76.5 bil. USD)
  - 1) 30 billion US dollar swap arrangement with Federal Reserve, and 180 billion yuan/38 trillion won SA with People's Bank of China
  - 2) Increase in ceiling of SA with BOJ (3 bil. → 20 bil. USD)
- **Foreign Currency Liquidity Supply** (26.8 bil. USD)
  - 1) Provided 10.3 billion dollars from BOK's foreign reserves
  - 2) Supplied 16.3 billion dollars using proceeds of currency swaps with Federal Reserve
  - 3) Introduced Foreign Currency Loans Secured by Export Bills Purchased

## 3. Government's Fiscal Policies

- **Government announced comprehensive economic recovery measures**
  - **Provided guarantees of Korean banks' external debt (Oct. 2008)**
    - 1) Guarantees of external debt of Korean banks or their overseas branches offered for 5 years
    - 2) Total guarantee value : USD 100 billion
  - **Set up Emergency Credit Guarantee Program (Oct. 2008)**
    - 1) Expedited and expanded credit guarantees for SMEs and Business Owners
    - 2) Provided 100% guarantee for core industries in exports, high-tech companies, green growth industries and new entrepreneurs
  - **Established supplementary budget (28.4 tril. won, Apr. 2009)**
    - 1) Support for low income family livelihood (4.1 tril. won)
    - 2) Employment maintenance and job creation (2.8 tril. won)
    - 3) Support for SMEs, export companies and self employed (4.5 tril. won)
    - 4) Measures to boost local economy (3.0 tril. won)
    - 5) Making up for losses in annual revenue (11.2 tril. won)
  - **60% of major items in main budget executed in first half**

# I. Global Financial Crisis and Macroeconomic Policy Response

## II. Recent Economic Developments & Policy Decisions

1. Recent Financial and Economic Conditions
2. Recent Policy Decisions

## III. Assessment & Policy Tasks in the Capital Market

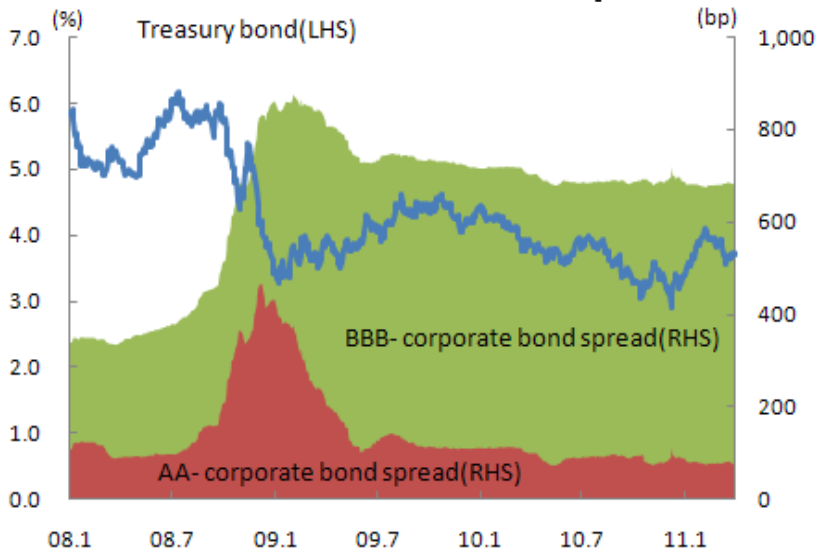
# 1. Recent Financial and Economic Conditions

## 1 Financial·FX Markets

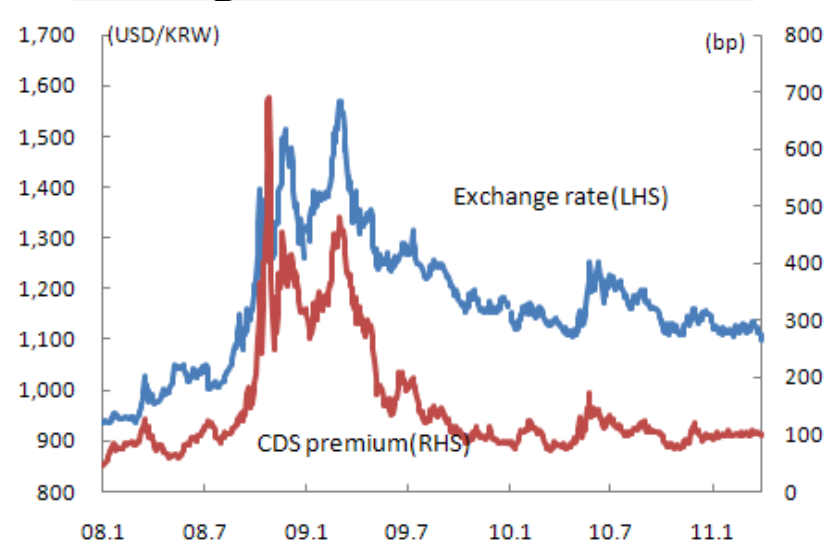
|               |        | Right after crisis    | As of end-Mar. 2011 |
|---------------|--------|-----------------------|---------------------|
| Credit Spread | (AA-)  | 465bp <sup>1)</sup>   | 78bp                |
|               | (BBB-) | 876bp <sup>2)</sup>   | 684bp               |
| KOSPI         |        | 1,474.2 <sup>3)</sup> | 2,106.7             |
| KRW/USD       |        | 1,513 <sup>4)</sup>   | 1,096               |
| CDS Premium   |        | 675bp <sup>5)</sup>   | 100bp               |

Notes: 1) Dec. 9 08; 2) Feb. 4 09; 3) Aug. 31 08; 4) Nov. 24 08; 5) Oct. 27 08

### Bond Yields and Credit Spreads



### Exchange Rate and CDS Premium

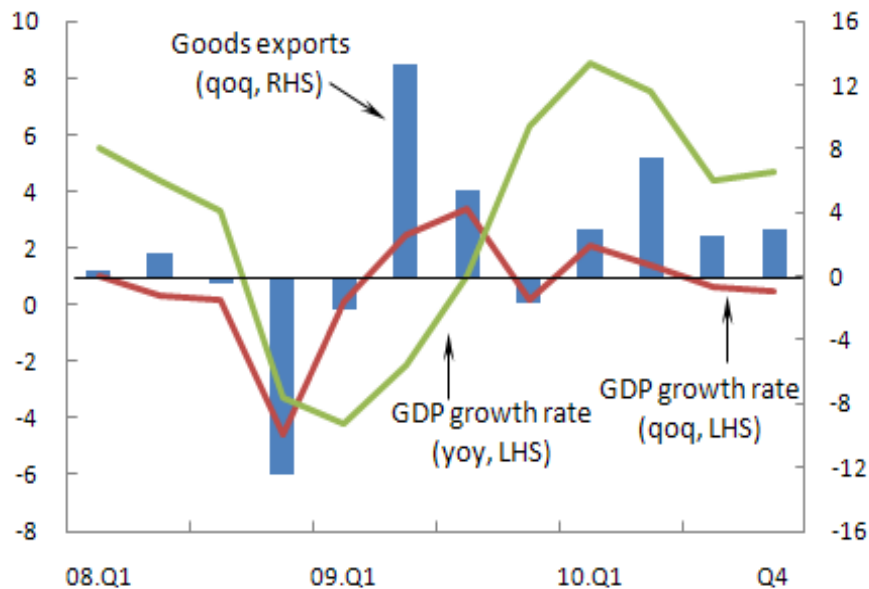


# 1. Recent Financial and Economic Conditions

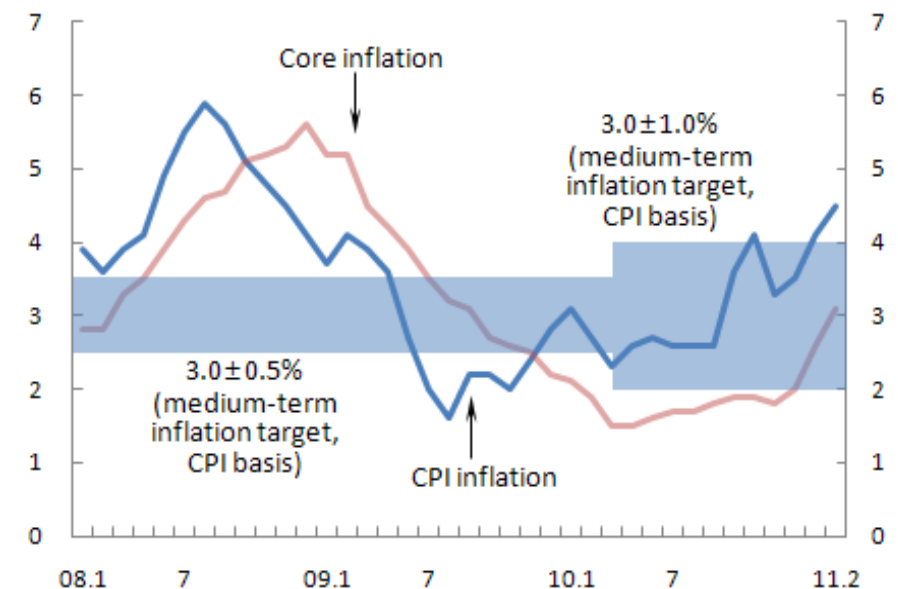
## 2 Real Economy and Prices

- **GDP growth** : maintaining upward trend, helped by increasing exports
- **CPI inflation** : exceeding upper bound of medium-term inflation target

Real GDP growth



CPI and Core inflation



## 2. Policy Response

### ① Increase in Policy Rate

: 2.0% → 2.25% (2010.7) → 2.5% (2010.11) → 2.75% (2011.1) → 3.0% (2011.3)

- The global economy is recovering at different speeds.  
(EM economies vs. advanced countries]
- The upward trend of domestic economic activity continues.
  - 1) Exports : strong upward track
  - 2) Domestic demand (consumption & investment) : steady increase,  
led by private sector
  - 3) Labor market conditions : improving trend,
  - 4) Inflation : further acceleration in upward price trend  
with build-up in demand side pressures

## 2. Policy Response

### 2 Withdrawal of Korean Won Liquidity

- Significant portion already withdrawn

(trillion won)

|   | Amount     | Current status         |
|---|------------|------------------------|
| ▪ Increase in Aggregate Credit Ceiling                        | 3.5 (1.0)  | Support still provided |
| ▪ Support for Bank Recapitalisation Fund                      | 3.3 (2.8)  |                        |
| ▪ Support for Bond Market Stabilisation Fund                  | 2.1 (1.7)  |                        |
| Subtotal  | 8.9 (5.5)  | -                      |
| ▪ Non-regular RP purchases                                    | 16.8       | Withdrawn              |
| ▪ Direct purchases of Treasury bonds                          | 1.0        |                        |
| ▪ Repurchases of Monetary Stabilisation Bonds before maturity | 0.7        |                        |
| ▪ Interest payment on required reserves                       | 0.5        |                        |
| ▪ Contribution to Korea Credit Guarantee Fund                 | 0.1        |                        |
| Subtotal  | 19.1       | -                      |
| Aggregate total   | 28.0 (6.9) | -                      |

Notes : 1) Figures in parentheses are end of Feb. 2011 basis

## 2. Policy Response

### 3 Withdrawal of Foreign Currency Liquidity

- Completed in full

(as of end-Feb. 2011)

| Classification                   |                            | Amount                          | Current Status            |
|----------------------------------|----------------------------|---------------------------------|---------------------------|
| Foreign<br>Currency<br>Liquidity | ▪ Foreign currency swaps   | 10.3 billion US\$ <sup>1)</sup> | Withdrawn                 |
|                                  | ▪ Foreign currency loans   | 16.3 billion US\$ <sup>2)</sup> |                           |
|                                  | ▪ Export bill-backed loans | 0.2 billion US\$                |                           |
|                                  | Total                      | 26.8 billion US\$               | -                         |
| Currency<br>Swaps                | ▪ United States            | 30 billion US\$                 | End at 1 Feb. 2010        |
|                                  | ▪ China                    | 180 billion Yuan                | End at 11 Dec. 2011       |
|                                  | ▪ Japan                    | 20 billion US\$                 | From May 2010: 3 bil. USD |

Notes : 1) End of Dec. 2008 basis      2) End of Feb. 2009 basis



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1. Assessment of Policy Response

2. Future Policy Tasks in the Capital Market


# 1. Assessment of BOK's Policy Response

- Rapid recovery of Korean economy seems led by :
  - ① active and swift policy response
  - ② high competitiveness of export companies
  - ③ restructuring of economy since 1997
  - ④ accumulation of foreign reserves
  
- BOK response played important role in stabilising financial and FX markets and promoting economic recovery
  - By implementing most counter-measures right after outbreak of the crisis, the Bank facilitated a prompt halt to the spread of financial instability.
  
  - The swift supply of foreign liquidity prevented the worsened overseas fund-raising conditions from evolving into a currency crisis.

# 1. Assessment of BOK's Policy Response

- The Bank relied principally on traditional policy instruments; rather than unconventional measures:
  - 1) reduction of interest rates
  - 2) expansion of liquidity by means of loans and OMOs
  
- Currency swap agreements with major central banks extremely useful:
  - 1) in resolving foreign currency liquidity shortage problems
  - 2) in restoring investor confidence at home and abroad  
(announcement effect)

### Global financial crisis calls for introduction of a new paradigm in capital market

 Strategy for development of Korean capital market needed,  
in response to global financial crisis  
and changes in regulatory mechanisms around world

- 1) Examining policy measures to enhance stability  
of domestic financial and FX markets
- 2) Examining measures to improve FX market  
and boost international status of Korean won
- 3) Preparing measures to strengthen international  
competitiveness of domestic bond market

## ① Enhancing Financial and FX market stability

- The BOK and the Government have devoted policy efforts to maintain Financial and foreign exchange market stability.

### Major measures for financial and FX market stabilization

| Major Measures                                  | Details   | Introduction date            |
|---|---|------------------------------|
| Measures limiting use of foreign currency loans | <ul style="list-style-type: none"> <li>• <b>Purpose of foreign currency loans limited to funds for overseas use</b></li> </ul>  | Jul, 2010                    |
| Setting ceilings on currency forward trades     | <ul style="list-style-type: none"> <li>• <b>Currency forward trades</b> to be maintained at <b>certain ratios to equity capital at end of preceding month</b></li> <li>- domestic banks: <b>50% or less</b></li> <li>domestic branches of foreign banks: <b>250% or less</b></li> </ul> | Oct, 2010                    |
| Reviving taxation on foreign bond investment    | <ul style="list-style-type: none"> <li>• Measure to eliminate <b>tax incentives* for foreigners' investment in treasury bonds and MSB</b></li> <li>* exemption from income taxes(14%) and capital gains taxes(20%)</li> </ul>   | Jan, 2011                    |
| Introducing Macro-prudential Stability Levy     | <ul style="list-style-type: none"> <li>• <b>Charged on non-deposit foreign currency liabilities of financial institutions</b></li> <li>• Accumulated levy funds to be used to <b>provide foreign currency liquidity to financial institutions in times of crisis</b></li> </ul>         | Expected in 2nd half of 2011 |

### ② Measures to improve FX market And boost international status of Korean won

#### ● Korean FX market structure quite vulnerable to external shocks

– Since the won is not circulated outside the region,  
Korea has a small FX market.

– If Korea had a deep and liquid FX market,  
the influence of external shocks, such as deleveraging  
of short-term external borrowings, would be minimized.

➔ The scale of the FX market thus needs to be expanded,  
by allowing international trade payments in won  
and expanding won-denominated external bond issues.

- Discussion on internationalization of the won is necessary, but has been temporarily deferred due to the global financial crisis.
  - Among Asian currencies, the Japanese yen and the Singapore, Hong Kong and Australian dollars are used internationally.
  - China has recently made gradual efforts to promote regional use of the yuan.
- ➔ The won's internationalization should be actively considered, to promote Korea's financial hub development policy and strengthen competitiveness of the Korean real economy and financial sector.

### 3 Internationalization of Domestic Bond Market

- Future growth path of domestic bond market
  - Various ways of fund-raising should be developed, to facilitate capital supply at each stage of corporate development.
  - Particularly, the corporate bond market should be promoted to develop a stable long-term channel for raising funds.
  - Policy support should be provided to internationalize Korea's bond market, to thereby promote it as a central fund-raising and secondary market in East Asia.



- Introduction of QIB (Qualified Institutional Buyer) system
  - For securities issued and traded exclusively for QIBs, the issue process has been substantially streamlined, as demonstrated by the exemption from obligation of public disclosure.
  - in a bid to promote globalization of its bond market, Japan recently established the Tokyo Pro-bond Market, which allows participation of professional investors only.

### ● Strengthened roles and functions of Asian bond markets

- Korea's bond market is competitive in Asia, in terms of combined market value and market infrastructure.
- Korea's bond market needs to **take various roles and responsibilities**, as a member of the Asian regional bond market.

- Plays a leading role in introduction of Asian MTN Program\*
- Discusses and promotes establishment of guarantee institutions, settlement agents and credit rating agencies in Asia

\* MTN program : Medium- and long-term fundraising method – setting limitations on medium- and long-term borrowings and their maturities, with bond issuance possible at any time under these conditions

Thank you.