

## RISE IN FOREIGN INVESTMENT CEILING AND KOREAN STOCK MARKET PERSPECTIVES

### *Sluggish Stock Market*

Despite the booming Korean economy, the Seoul stock market has been sluggish for the past six months. The composite stock price index marked 871.18P as of June 22, which is a fall of 142.39 points, or 14.05 percent, from 1,013.57P on January 3.

In early March, the market showed a drastic retreat to 885.69, arising from near panic selling caused by the bankruptcies of Baring Brothers, Doksan Business Group, and Samdo Corporation. The news of the government's continuing investigation into stock price manipulation also added cold water onto the already-frozen market sentiment. Moreover, this market sentiment has firmly entrenched since mid-April due to the negative news reports that one of the major construction companies, Youone Engineering & Construction, went into bankruptcy.

On May 27, the Korean Stock Price Index (KOSPI) marked a new yearly low, 847.09P. This was due to many unfavorable developments: i) a recent liquidity drainage with the high corporate bond yield of 15.2 percent; ii) the continuous outflow of bank deposits which hit yearly lows; iii) worries over President Kim's revelation of North Korea's uncertain power transfer to Kim Jung-Il and worsening food shortage; and iv) the uncertain political clouds in China related to the rumors about Deng Xiaoping's health.

Nonetheless, the KOSPI shot up more than 40.41 points May 29, buoyed by the government's move to boost the stock market on May 27, when the Stock Market Stabilization Fund started its move. It placed buy orders on low-priced shares, while refraining from massive buying on a strong rebound. The government's decision to drastically cut new share issues and to put some privatization plans on hold, while maintaining the net buying position of institutional investors - which, according to market

experts, would have contributed to curbing selling pressures - helped to make investors regain their confidence on the market.

### *Supply of New Stock Issues to be Reduced*

The government unveiled a set of measures to boost the sagging stock market by reducing the supply of new stock issues in the second half of this year. Under the plan, the volume of new stock issues will be cut to about 6 trillion won (\$7.89 billion) in value from the original 8 to 10 trillion won. In the third quarter, the government will also ban government-invested corporations from selling off their equity shares. Given the stock market condition, the government-owned corporations may be allowed to sell off their shares in the last quarter. A drastic cut in the volume of new stock issues will result in striking a proper balance between supply and demand of stock shares, while stable money-market rates and reduced transaction costs will boost investor's confidence.

### *Local Elections Might Sag Stock Market*

The spending for the June 27 local elections is expected to be at least 412.2 billion won, according to a report of the Ministry of Finance and Economy. However, should the expenditures of individual candidate be included, more than 2 trillion won is estimated to be spent on the occasion. The elections will choose 9 provincial governors, mayors of the 6 largest cities, 230 heads of counties, small cities and wards, and 5,416 councilors.

The elections will mobilize about 1,040,000 people, including 272,000 administration officials to assist elections, and 97,000 school teachers to

count ballots. Now that the nation's economy is in a booming stage, the shortage of labor is becoming serious. Furthermore, the elections will wrest labor forces away from workplaces. The shortage of labor is expected to be worst during June when workers in the manufacturing industry move into the highly paid jobs related to the elections. These factors are likely to adversely affect the economy and the stock market.

*Foreign Investment Ceiling Increases to 15% on July 1*

The measure to raise the foreign stock ownership ceiling announced May 3 is significant in that the announcement came earlier than expected. Foreign capital flows into Seoul will be high as the announcement was made at the time when international funds were expected to return to emerging Asian markets.

The foreign investment ceiling on Korean stocks is scheduled to rise from 12 percent of capital share to 15 percent July 1. For public corporations such as KEPCO and POSCO, the equity investment ceiling will rise from the current 8 percent to 10 percent. The investment limit for foreign individuals, however, will remain at the present level of 3 percent.

Meanwhile, with the additional market opening, the volume of foreign capital inflows into the Seoul stock market is likely

to reach as much as \$2.0-2.4 billion. Of the total, \$1.5-2.0 billion will enter by the end of this year. With the expansion of foreign investment ceiling, the amount of stocks foreign investors can purchase will reach around 3.8 trillion won based on June 10 prices. Foreign capital worth about 1.5 trillion won is expected to flow into the market in the short term.

The condition for the market opening this July 1 is much different from last year. While the market expanded late last year at the time when the Seoul stock market reached its short-term peak, this year's opening will be made after several months' correction of prices. While foreign investors concentrated on selling with the market opening last year, they have recently started buying Korean stocks. In addition, more institutional investors show signs of returning to emerging markets after profit-taking in the U.S. market.

*Investment Sentiments to be Boosted*

The KOSPI is likely to exceed 950P during the third quarter of this year and 1,000P during the fourth quarter. The market will be strong within a range of 950 - 1,000P, based on such favorable developments as the expansion of foreign investment ceiling and the enforcement of the real-name system for real estate transactions. Although the

Estimated Spending for Local Elections

(₩ bil)

	Local Council		Head of Local Autonomy		Total
	Small-unit	Large-unit	Small-unit	Large-unit	
Spending	200	67	66	79	412

supply of money is expected to decrease during the third quarter after the local elections and Chusok (Korean Thanksgiving Day), the continuing facility investments and the flooding foreign capital will expand investment.

Foreign share capital is expected to rush into the Seoul stock market from June. Three Japanese securities companies-Nicco, Nomura and Daiwa-plan to invest \$460 million in Korean stocks from early June, while Templeton Financial Group of the U.S. plans to buy \$50-200 million worth of Seoul stocks. Unlike in the past when they invested passively in the Seoul stock market, Japanese investors plan to aggressively purchase Korean stocks for several reasons: the U.S. dollar's depreciation, the sagging stock market in Japan, the brisk Korean economy, and the expansion of foreign

ownership ceiling scheduled to take effect in the third quarter.

Without the government's austere monetary policy after the local elections, stock prices may possibly rise to a 950P level. If the government manages liquidity elastically after the elections, the average stock price index will reach approximately 950 for the third quarter. If the government tightens money supply, the stock price index will be near 920. Stock price recovery will accelerate during the third quarter as the money used for the elections returns to the stock market. Meanwhile, during the fourth quarter, the average stock price index will reach about 1,000P under an elastic monetary policy, while it will be around 980P under a tight monetary policy.

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## KOSPI

