

BOURSE RECOVERS FROM TEMPORARY PLUNGE

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A Short-Lived Panic Strikes the Market

Korean stock prices stayed in the long-lasting bullish mood until mid-July. The Korea Stock Price Index (KOSPI) hit the much-talked 1,000-point line early in the month; stocks were traded in the 1,000-point range previously in 1989, 1994 and 1995.

However, the KOSPI was drawn under the 1000-point line and showed big swings, as investor sentiment was significantly undercut by surging bond yields and cash-strapped Daewoo business group's restructuring measures. On July 23, a panic seized the stock market; gripped with worries about Daewoo's fate and the domestic interest rate hike, institutional and individual investors alike dumped stocks to stop further losses. The composite index fell 7.34 percent or 71.70 points, its largest-ever drop.

Anticipation of a possible financial squeeze in the money market by the immediate bailout loan offers to Daewoo and the rollover of 6.5 trillion won in mature short-term loans pulled the composite stock price index down. Investors also worried that a probable delay in solving Daewoo's financial problems would cause the interest rates to rise, induced by a massive injection of money into the insolvent Daewoo by financial institutions. Fortunately, the immediate rescue package offered by the government prepared swiftly over the weekend managed to

restore stability to the Seoul bourse.

Net Sales by Foreigners Continue

As the government's emergency package soothed the domestic financial markets, investors are now back to the market. There remain in the market worries over rising interest rates, especially facing the better-than-expected economic recovery.¹⁾ In the short run, an interest rate hike may dampen the confidence of stock investors but it will not necessarily result in an additional falling of stock prices. This is because a rate increase is more likely to serve as a preemptive tool in preventing the economy from overheating.²⁾

In addition to the interest rates, foreign investors' attitude requires keen observation. As a matter of fact, the continuing foreign investors' net selling is a major uncertainty. Foreign investors were the biggest net buyers in the first five months of this year. However, this trend has reversed from May and the outbound flow of foreign funds invested in stocks posted an all-time high of 1.62 trillion won last month. It seems that the nature of recent selling by foreigners was a strategic profit-taking based on the ten-month strong bull run, mixed with a wait-and-see stance regarding the still uncertain fate of Daewoo and interest rate movements. **VIP**

1) Recently, the Korea Development Institute, a public think tank, upwardly revised the growth rate of Korea's gross domestic product (GDP) this year to 7.5%, the highest growth forecast made so far.

2) More importantly, since the liquidity-led boom in the Seoul bourse came to an end, a pattern of growth based on fundamentals will resurface in the stock market during the second half of this year. As a result, moderately rising interest rates will possess only limited effect on the market.