

STOCK MARKET BRUSHES OVER DAEWOO CRISIS

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Daewoo's Workout Program Pulls Down Stock Prices

The consolidation which began from mid-July deepened last month, halting for the time being the long rally which began early this year. KOSPI passed beyond the 1,000-point level in early July, but moved within the range between 850 and 1,000 points in recent months. Local stock prices tumbled on increasing fears from dismantlement and workout program of the Daewoo Business Group and an alarming upsurge of interest rates. Financial institutions were largely hit by Daewoo's credit crunch; the stocks of banks, brokerage firms and insurance companies became bearish in the wake of the Daewoo crisis. Most Daewoo-related shares also fell sharply during August.

On the other hand, semiconductor shares and blue-chip manufacturers showed solid gains during the period, helped by the yen's strength against the U.S. dollar. Korean companies usually benefit from the higher yen by gaining price competitiveness against their Japanese rivals, with which they compete directly in such key export industries as shipbuilding, automobile and semiconductor.

Given the huge size of Daewoo's total debts of the 12 subsidiaries amount to 53 trillion won, some financial institutions are expected to bear huge losses that will cut into their capital adequacy ratios. Creditors are expected to set the interest rates on loans to Daewoo firms at a level 2-3%p lower than the prime rates in order to facilitate smooth restructuring.

In particular, the Daewoo Group's severe debt

crisis has accelerated the cash outflow from investment institutions, leaving investment trust companies (ITCs) with less money for bond purchases and thus adding upward pressure on the benchmark 3-year corporate bond rate. In August alone, 15.38 trillion won was retrieved from short-term funds, including a 6.28 trillion won outflow from money market funds (MMF), while 3.9 trillion won moved out of long-term funds. The yield on 3-year government bond rose over 9%, while the return on 3-year corporate bonds stood up at the upper 10% level.

Fundamentals Are Still Good for Stock Market

Mixed with positive and negative factors, Seoul share prices are forecast to consolidate until early September. Although financial issues turned weak after the government decided to begin the workout program for Daewoo's 12 main units, manufacturing stock prices in general remained stable. The fact that the local bourse did not crash on Daewoo crisis shows that the Korean stock market is able to absorb shocks.

The composite index may test the 1,000-point level again in the months to come, depending on how fast the financial markets and investors shake off their fear and anxiety. However, worries over the Daewoo crisis have not disappeared completely and interest-rate instability and other possible negative factors may crop up to adversely affect the stock prices. In addition, KOSPI's movement is projected to hinge, in large part, on the positions of foreign and domestic institutional investors, who were the major driving force behind rebounds. **VIP**