

## UNCERTAINTY REMAINS IN MARKET

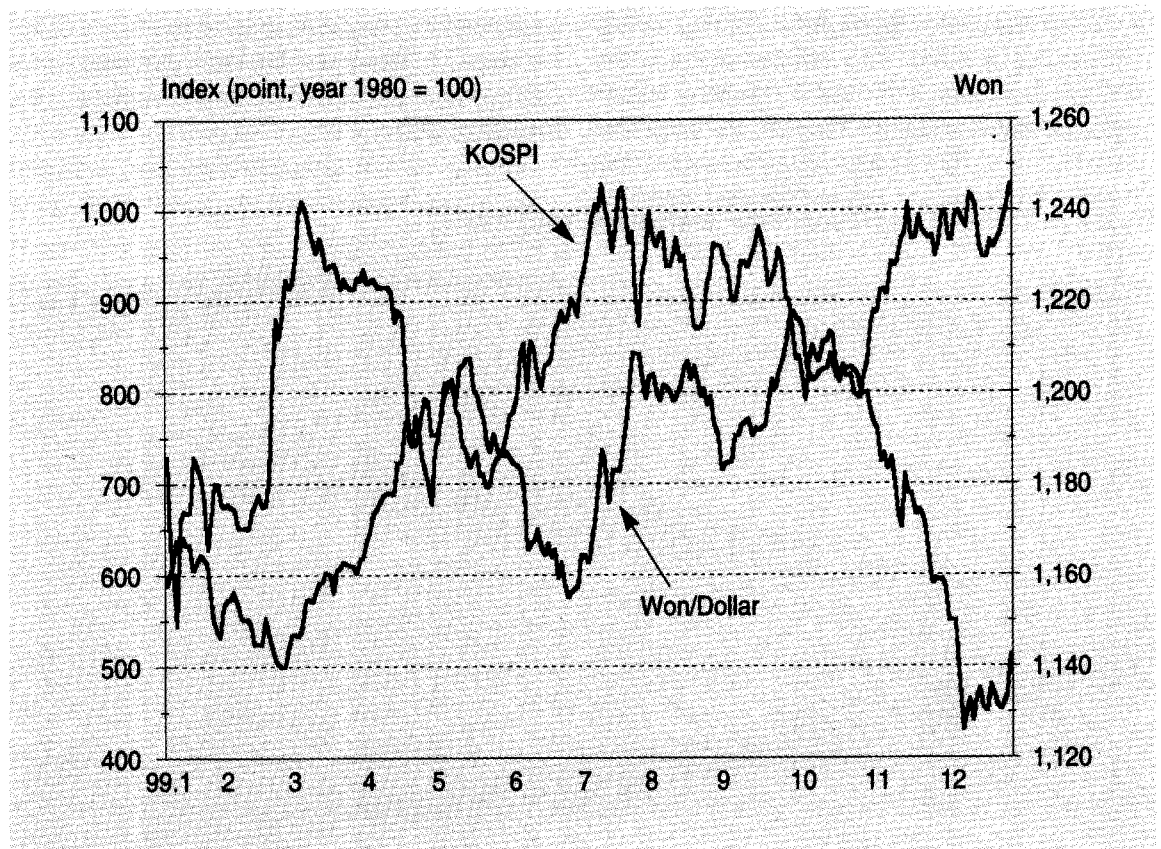
Hee-Seong Kim  
(hiskim@hri.co.kr)

### Financial Markets in 1999

In 1999, the benchmark Korea Stock Price Index (KOSPI) recorded a 74.95% rise from 587.63 points in the year's beginning to 1,028.07 points at the year-end. It was also the first time that the bourse session

closed with the year's highest index on the last trading day. The Korea Stock Exchange (KSE) and the KOSDAQ finished 1999 with an aggregate market value reaching 445.04 trillion won in total, with 341.60 trillion won and 103.44 trillion won respectively. The combined figure is higher than the previous year's gross domestic product of 438.94 trillion won. Due to

Figure 1. Stock Market and Exchange Rates



the booming stock market, listed companies raised more than 46 trillion won on the KSE and 3.5 trillion won on the KOSDAQ market. This allowed large companies to lower their debt-to-equity ratios to 200% or below. In particular, technology firms' stock prices soared rapidly and these stocks have gained immense popularity. As a result, more entrepreneurs are developing technology, services and products related to the Internet and telecommunications that have potential global competitiveness. Soaring profits of venture companies went hand in hand with growth in revenue, suggesting that most of venture entrepreneurs are adopting sound business models.

The won has been appreciating sharply against the dollar since last November. The won's appreciation was so rapid that the exchange rate fell from 1,150 won per dollar in early December to 1,140 won per dollar in late December. A rate of around 1,100 won per dollar is expected in January. It seems inevitable that the won will appreciate in the long term as well. This is due to the current account surplus and massive foreign capital inflows into the financial market. While daily trading volume in the domestic foreign exchange (FX) market has been about \$1.5 billion, the current account surplus was estimated at as much as \$26 billion in 1999. This current account surplus trend will continue in 2000. The amount of dollars in the domestic FX market shall be oversupplied by \$20 billion. The strong Japanese yen and the stable Chinese currency will also help the Korean won to appreciate.

The government has tried to control the rate of the won's appreciation mainly through the Foreign Exchange Stabilization Fund, whose proceeds are used to buy dollars in the local market. The government plans to issue \$28.1 billion in government bonds and five trillion won in Foreign Exchange Stabilization Fund bonds in 2000. Even though the increased bond supply would naturally increase interest rates in the short term, the government is not likely to intervene directly in the foreign exchange market, but will probably just control the rate of the won's appreciation because of inflation pressure.

The 3-year maturity corporate bond yields increased to 9.95% in December from around 9.5% in November. The increases of bond yields in December reflect investor's concerns about a revival of inflation as well as anticipation of the corporate sector's increased money demand.

The government has been keeping local interest rates at a lower level to stimulate the sluggish economy and to speed up economic restructuring. The corporate sector's liquidity is fairly good. However, if the won is appreciated continually, interest rate also should be increased to absorb inflationary pressure. The current gap between the real market rate and benchmark rate is so big that the interest rate is likely to be raised to decrease this gap within a fairly short time. Also, the unexpected strength of the country's economic recovery has spurred speculation of a possible rise in short-term interest rates. Thus, the top priority should be placed on establishing price stability by maintaining a conservative monetary and

fiscal policy. It might be desirable to maintain a tight fiscal policy this year not only to restore fiscal soundness but also to prevent possible overheating of the economy. The general election in April 2000 may prevent such policies, however. It seems proper for the Bank of Korea to set Korea's target for price stability target for the year 2000 in the 1.5~3.5% range, slightly lower than last year's 2~4%.

### What to Expect in 2000

The government should continue to help the restructuring of the financial market and other non-financial sectors while following market-oriented principles. For example, financial institutions that were nationalized during restructuring should be privatized. Newbridge Capital and the Korean government closed their deal on the takeover of Korea First Bank (KFB) recently. It was the first time in Korea that a local commercial bank was sold to a foreign entity. The widely anticipated agreement confirmed growing foreign confidence in Korean reform efforts, and it should help enhance the efficiency and competitiveness of

the country's banking industry. Foreign ownership of local banks will make them more market-and competition-oriented, and help local banks learn advanced banking techniques, including sophisticated credit evaluations. KFB has offered higher interest rates to its deposit clients following its ownership transfer to the United States.

This trend will affect other commercial banks that are hesitating to raise their interest rates for fear of intervention by the financial watchdog, the Financial Service Commission. Increased competition could spark another round of mergers among domestic banks. Good banks will attempt to merge in order to improve their performance, while bad ones will merge to survive. Furthermore, it seems unlikely that top bankers' meeting participants will be able to produce a consensus toward the government policy. The government will find it increasingly difficult to manage the financial institutions and market. Thus, instead of direct intervention in the market, the government should remove the barriers hindering competition, and ultimately construct an advanced financial infrastructure. **VIP**

**Table 1. Major Financial Market Indexes**

	end of '97	end of '98	Dec. 28, 1999
Corporate Bond Yield (3 yr.)	28.98	8.00	9.95
CD rate (91 days)	25.00	7.70	7.35
Call rate (overnight)	26.49	6.61	4.74
KOSPI	376.31	562.46	1,028.07
Won/\$ rate	1,695.00	1,209.20	1,142.50