

STOCK MARKET'S DOWNWARD MOVEMENT AND CONTINUOUS APPRECIATION OF WON

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The Korean stock market showed severe fluctuation during March. At the beginning of March, the KOSPI jumped up to 894.66 points, 66.28 points up from 828.38 on February 28th and continuously moved upward until March 8th to close at 915.94. But the index dropped again to 837.53 after one week. The decision by Fitch IBCA to increase Korea's country credit rating failed to attract new buying interest as it was already reflected in share prices. In addition, the news that Tiger Management, an international hedge fund, will soon be closed hurt the local market as the fund's portfolios included some of Korea's key blue chips.

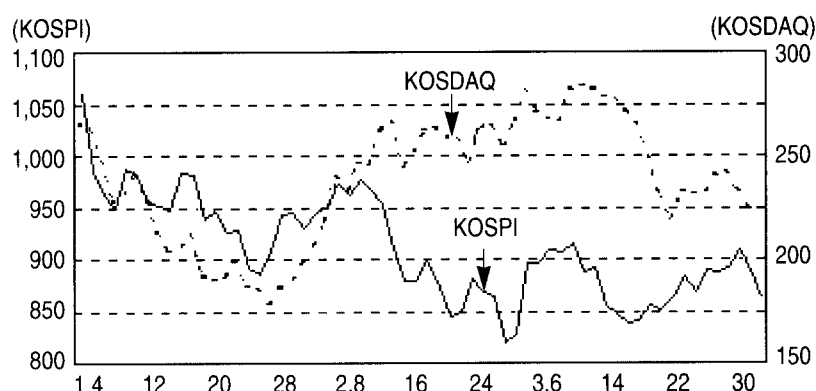
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The KOSDAQ also had its ups and downs, but it showed a continuous downward trend. As of March 9th, KOSDAQ skyrocketed to 283.44 points, a record-high level since KOSDAQ was opened on 1996, but closed at 221.27 points of the end of March as concerns over the rise in the supply of new shares from rights and dividend issues weighed down investor sentiment. Amid doubts over the inflated valuations of Internet related hi-tech issues, investors turned into profit takers by selling shares.

The contrasting positions of the stock market's two largest investors, institutional investors and foreigners, heightened the local market's anxiety. Local institutional investors including Investment Trust Companies (ITC) were net sellers. Since the Daewoo Group nearly went bankrupt last July, ITCs became sellers and pulled down the index due to an upsurge in redemption demands of investment funds

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Figure 1. KOSPI and KOSDAQ Indexes



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and a consequent liquidity outflow. As investor distrust continued early this year, ITCs were forced to unload net shareholdings of around 3 trillion won in the first quarter of 2000. But foreign investors kept on a buying spree. Foreigners' net purchases of domestic stocks in the first quarter of this year were worth about 6 trillion won (\$5.4 billion), which came close to a record-high since the local market was opened in 1992.

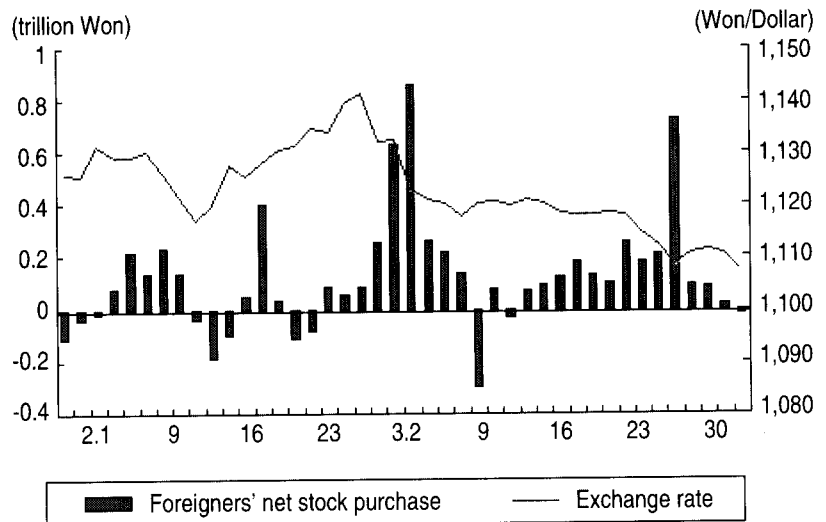
In April, the supply of new shares in the market including the KOSDAQ is expected to reach 9 trillion won, whereas demand will be between 6 to 7 trillion won. New rights issues may reach around 2.3 trillion won thanks to last year's bull market. In addition, new offerings and stock dividend are estimated at about 2 trillion won. This high volume of new shares is expected to weigh down the index.

Local institutions are not expected to become net purchasers in the short-term, and the excess of supply over demand is predicted to continue for a considerable time. However, the long-term prospects for the Korean stock market are fairly good since Korea's economy will grow steadily.

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The surge in foreigners' net purchases of local stocks this year helped keep the downward exchange rate trend, which broke through the 1,110 won per dollar level. The Korean won appreciated to 1,106 won per dollar at the end of March, the highest level since 1997. Coupled with continued inflow of foreign stock investment funds, dollar selling by domestic companies put upward pressure on the Korean won. Domestic companies are likely to continue to sell their assets as part of their restructuring efforts, while local banks will borrow foreign capital by issuing depositary receipts or subordinated bonds in order to raise their capital adequacy ratios. All these factors will combine to create a glut of dollars in the domestic foreign exchange market.

— **Figure 2. Net Amount of Foreign Stock Purchase and Exchange Rate** —



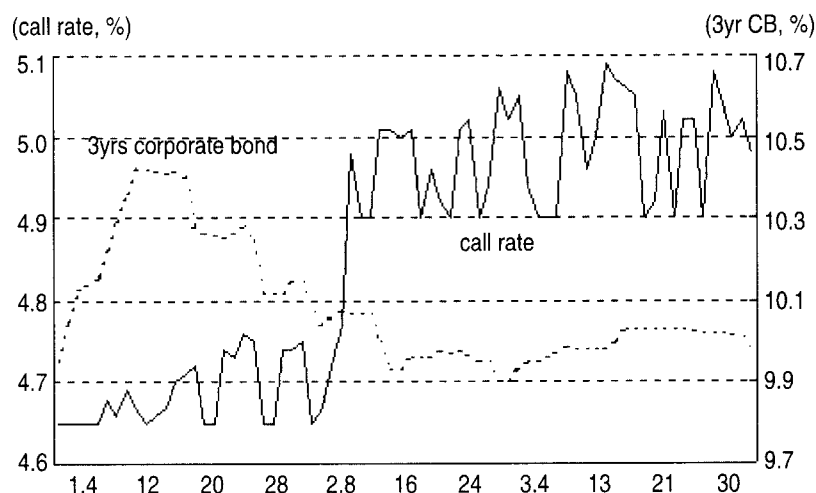
Even though the government tried to intervene in the exchange market and had two state-run banks, the Korea Development Bank and the Export-Import Bank of Korea, absorb the excess, the dollar-selling positions overshadowed the government's efforts. Alarmed by the rapid rise of the won, the government has vowed to take steps to rein in the currency. The government will float foreign exchange equalization bonds worth about 1 trillion won (\$904 million) in April.

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Amid the debate over economic overheating, a strong signal of inflationary pressure has emerged. The fast-paced economic growth, hitting a 12-year high of 13.5 percent in the fourth quarter of 1999, is heightening fears of inflation. Consumer prices have already risen by 3.4 percent in the first two months of this year, exceeding the government's annual target of 3 percent.

The long-term interest rate walked sideways around 10 percent and the short-term rate fluctuated within 4.9 and 5.1 percent. Three-year corporate bonds declined to below 10% in February from 10.4% in January this year. In connection with the imminent rise of the U.S. interest rate, anti-inflationary measures are expected, even though the government repeatedly said rates would be lowered after the elections and the conclusion of the Daewoo bond crisis.

Figure 3. Short-Term and Long-Term Interest Rate



Consequently, Korean stock indexes seem to be down for a short-term period and need considerable time to recover investor sentiment due to the oversupply of new shares. The decline of the won/dollar exchange rate is expected to continue below 1,100 won by the end of this year unless the government's currency stabilization efforts work properly. Furthermore, the domestic interest rate will remain at the upper 9% level because of faster-than-expected economic growth and resulting worries about inflationary pressure. **VIP**

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