

## FINANCIAL MARKET STILL UNSTABLE

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### Stock Market: continuing slackness with bribery scandal and bankruptcies

The Korea Stock Price Index (KOSPI) slid further to 504 points in the end of October from the previous month's 613 points. Meanwhile, the tech-heavy KOSDAQ fell to 74 points from the previous month's 90 points. These figures were the lowest seen by the two markets this year.

In October, stock prices fell to new lows because of a bribery scandal in the KOSDAQ market and the possibility of some large construction companies going bankrupt. In early October, stock prices were greatly affected by external factors such as the slump of the NASDAQ market and high world oil prices. In the end of October however, domestic factors became more prominent.

The KOSPI began to fall in early October as foreign investors began dumping their shares of Samsung Electronics in light of a possible slump in the world semiconductor market. The KOSPI's slump continued into the middle of October because of fears that the record-high oil prices will increase further with the possibility of war in the Middle East. Although these external factors gradually stabilized by the end of the month, the stock market was affected by domestic problems such as the delay of corporate and financial restructuring with the failure to sell off Daewoo Motors, and the delay of public fund injections into bad banks.

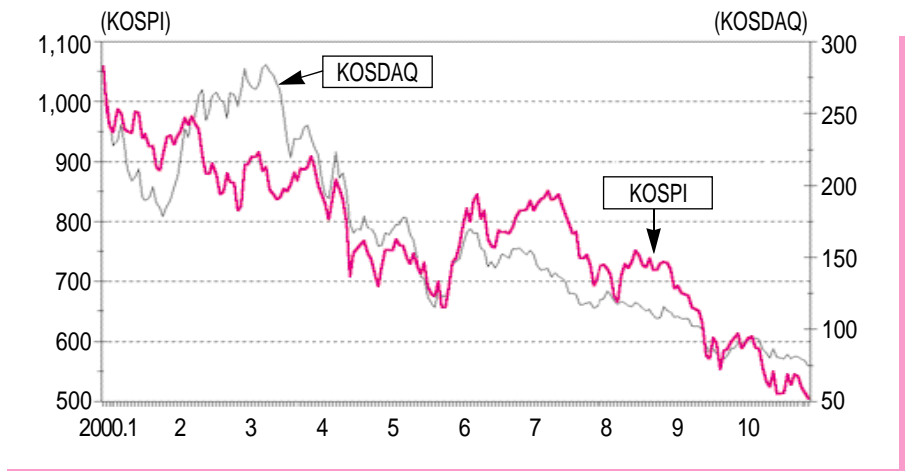
In the KOSDAQ market, stock prices slumped in October because of rumors of an "October Crisis" involving the potential bankruptcy of venture firms with insufficient funds. In addition to this rumor, the latest scandal involving the Financial Supervisory Service, the government's top financial watchdog, worsened the KOSDAQ's blues. In the latest scandal, FSS officials were suspected of accepting bribes from a venture businessman and his financier in exchange for overlooking their irregular activities.

Stock prices in November are expected to exceed those of this month because of the government's reform efforts in response to the scandal and the workout of ailing companies. In the end of October, most American mutual companies ended their fiscal year, and as a result foreign investors have stopped selling their stocks. In the KOSDAQ market, because further bribery scandals or fabrication of prices are not expected to occur, the index is forecast to gradually stabilize in November. Moreover, as external factors (such as the DOW, NASDAQ, and oil prices) are expected to settle down next month, the Korean stock market will gradually stabilize.

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Figure 1. KOSPI and KOSDAQ Indexes



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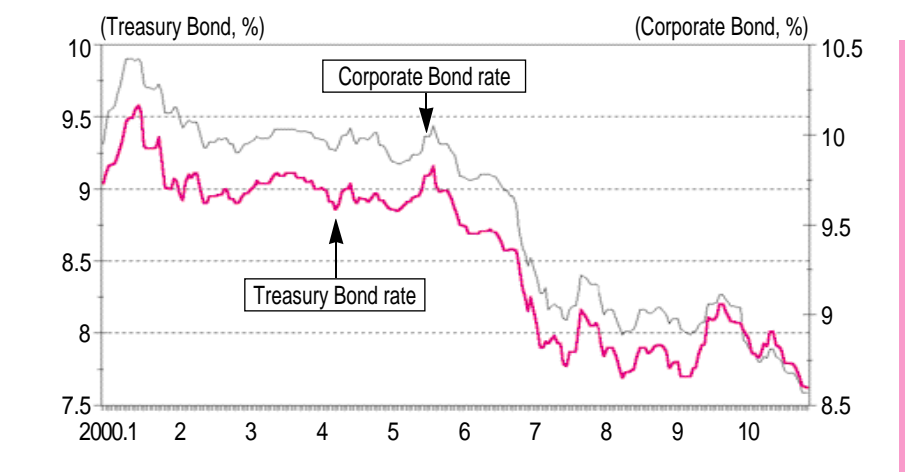
In November, the KOSPI and KOSDAQ will move into the 480-600 and 70-100 point ranges respectively, as most of the current negative factors influencing the market have already been reflected. The stock market will be influenced much more by the progress of market stabilization measures and corporate and financial restructuring efforts than by overseas factors.

**Money Market: polarization of the corporate bond market**

The government bond rate slid further to 7.6% a year in the end of October from the previous month's 8.1% a year. The corporate bond rate fell to 8.6% a year in the end of October from the previous month's 9.1% a year.

Although the government bond and corporate bond rates were stable in October, the interest rate for junk bonds (below a BBB- rating) reached around 13 to 20%. This shows that the money market is gradually becoming polarized, and as a result

Figure 2. Government and Corporate Bond Rates



unstable companies are confronted by the possibility of bankruptcy when their bonds mature. In particular, companies with high debt-equity ratios (such as construction companies), are confronted with a higher possibility of bankruptcy. Moreover, as trade has not occurred recently in the junk bond market, most junk bonds will have to be redeemed on maturity. Also, because financial restructuring has been delayed, banks are not loaning to unsound companies any more. Fortunately, as the bonds of most healthy companies were traded actively, corporate bond rates are stable.

The interest rate (corporate bond rate) is expected to record below 9% because of the demand of banks and other financial institutions. However, bonds of unhealthy companies will be expected to see rates of above 13% in November because of uncertainty in financial restructuring.

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### Foreign Exchange Market: Fluctuation in the won/dollar rate

The won/dollar rate rose further to 1,136 in the end of October from the previous month's 1,115. Meanwhile, the yen/dollar rate mounted to 108.9 from the previous month's 108.1.

In October, the won/dollar rate rose marginally from the previous month because of unstable external factors. Especially, with foreign investors selling their domestic stock and sending dollars back home, the rate fluctuated more than in the previous month. From September, the net flow of foreign stock investment was continually negative. However, because the uptrend of the won/dollar rate was mostly caused by external factors, the rate is expected to fall again as long as domestic factors stabilize. According to the Bank of Korea, with hedge funds amounting to about \$2.3 billion at the end of August, it will be possible to fluctuate the won/dollar rate in case of another crisis in the financial market. However, as the stock market is forecast to gradually recover, the foreign exchange rate is also expected to stabilize, although Southeast Asia's foreign exchange rates are still unstable. **VIP**

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— Figure 3. Foreign Exchange Rates (won/dollar, yen/dollar, and won/100yen)—

