Ⅱ. Financial and Economic Trends

1. International Economies

A. International Economic Growth and Trade

<Table Ⅱ-1>

Trends of Major International Economic Indicators

(%, annual %)

	2000	2001	2002	2003
Economic Growth[1]				
World	4.8	2.4	3.0	3.2
Industrialized nations	3.9	1.0	1.8	1.8
US	3.7	0.5	2.2	3.1
Japan	2.8	0.4	-0.4	2.7
Euro area	3.5	1.6	0.9	0.4
(Germany)	2.9	0.8	0.2	-0.1
Asian emerging markets[2]	8.5	0.8	4.8	2.3
Developing nations	5.7	4.1	4.6	5.0
Asia	6.8	5.8	6.4	6.4
(China)	8.0	7.3	8.0	9.1
Latin America	4.0	0.7	-0.1	1.1
World trade growth[3]	12.1	0.1	3.4	4.0
Long-term interest rates[4]				
US	5.11	5.05	3.81	4.25
Japan	1.64	1.37	0.91	1.37
Euro area	4.85	5.00	4.20	4.29
Exchange rates[5]				
US$/€	0.943	0.890	1.049	1.260
¥/US$	114.8	131.4	118.7	106.9
Prices of international raw materials				
Rise in crude oil prices[6]	59.9	-14.7	2.5	15.2
Others[7]	1.9	-10.1	1.9	17.6

Notes: 1) Based on IMF statistics (the figures in 2003 are prospects) apart from certain individual countries which are based on their respective national statistics (including 2003).
2) Korea, Taiwan, Singapore and Hong Kong.
3) Based on OECD statistics (the figures in 2003 are prospects)
4) Based on the yields of 10-year government bonds and year-end basis.
5) US$/euro on New York market, ¥/US$ on Tokyo market, year-end basis.
6) Based on annual average of Brent crude prices.
7) Based on annual average of the Reuters' Commodity Price Index.

Sources: IMF, World Economic Outlook, Sep. 2003
OECD, Economic Outlook, Nov. 2003
Bloomberg, Reuters

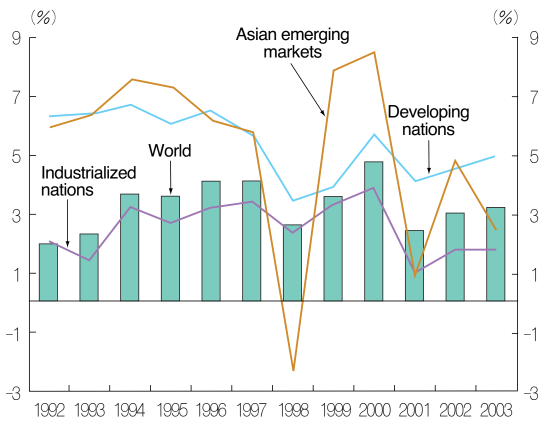
In the early part of the year 2003, the world economy continued to exhibit the subdued pattern of activity that it had maintained in the preceding year, being influenced by the high level of geopolitical tensions and the spread of the severe acute respiratory syndrome (SARS). The economic environment showed a gradual improvement, however, as major economies sustained their pursuit of expansionary macro economic policies while oil prices fell back upon the declared prompt ending of the war against Iraq,[1] share prices rose, and consumer and investment confidence began to pick up again. From the beginning of the third quarter, recovery trend became evident centering on the US economy. Accordingly the growth rate of the global economy during the year 2003 is estimated to have shown a mild acceleration from the previous year's 3.0% to stand at 3.2% (IMF forecast).

The US economy exhibited a trend of rapid recovery from early in the latter half of the year, leading the global economic revival. During the first quarter of the year, despite a buoyant housing market, consumer and business confidence had contracted because of the heightened uncertainties surrounding the war against Iraq, and the hoped-for recovery was delayed. Share

1) Major dates: final US ultimatum to Iraq (March 18), US declaration of war (March 20), fall of Baghdad (April 9), US proclamation of the end of hostilities (May 1).

<Figure Ⅱ-1>

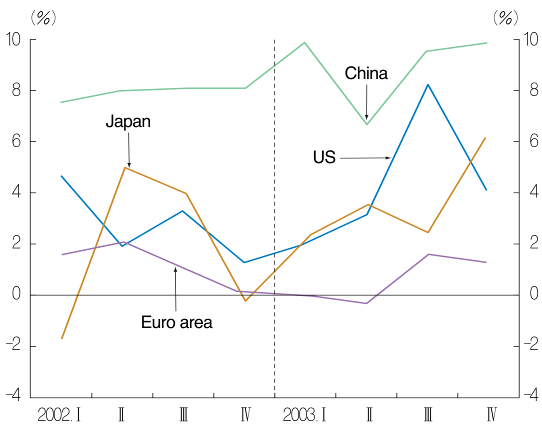
Trends of World Economic Growth



Source: IMF, World Economic Outlook, Sep. 2003

<Figure Ⅱ-2>

Trends of Economic Growth[1] by Major Economies



Note: 1) Annualized quarter to quarter changes, apart from China for which the figures are year-on-year.

prices shifted to an upward trend, however, upon the outbreak of the war against Iraq and the early conclusion of hostilities while the macro economic stimulation measures including interest rate cut[2] and tax reduction[3] began to take effect. Consumer and investment confidence turned the corner while the housing market remained brisk, so that it became clear that the economy was on the mend. The speed of the recovery picked up its pace further from early in the latter half of the year, bringing GDP growth in the third quarter (annualized quarter to quarter change) to 8.2%, its highest level since the first quarter of 1984 (9.0%). Consequently, US GDP growth for the year as a whole rose from the preceding year's 2.2% to stand at 3.1%.

The Japanese economy also showed signs of breaking free from its protracted recession. Although the recovery of consumer spending remained conspicuously weak, exports rose strongly fueled by the expansion of import demand from China and other countries in the Asian region and the pickup in the US economy. Investment showed briskness on rising anticipations of a coming upswing in business activity. Consequently GDP, which had displayed negative growth (-0.4%) during 2002, shifted to positive growth at the comparatively high level of 2.7%.

In the economy of the euro zone, the subdued pattern of the previous year persisted with a reduction of investment and the unemployment rate remaining at a high level. Strikingly, during the first half of the year the growth rate of GDP (compared to the previous period) registered a negative figure for two straight

2) The Federal Open Market Committee (FOMC) lowered its policy Federal Funds rate from the previous 1.25% by 25 basis points to 1.00% on June 25, bringing it to its lowest level since 1958 (0.68%).
3) The Upper and Lower Houses of the US Congress on May 23 approved a plan for tax reductions amounting to some 350 billion dollars in all.

quarters as exports and investment shrank. For the year as a whole, therefore, GDP growth is estimated to have marked a level of 0.4%, rather lower than the preceding year's performance (0.9%). In the latter half of the year, nevertheless, exports showed an upswing in line with the US recovery and there were signs of improvement in the confidence of economic agents.

The Chinese economy maintained its high rate of economic growth despite the negative impact of SARS. Second quarter's GDP growth (year-on-year basis) fell from the preceding quarter's 9.9% to stand at 6.7% as consumption and production activities shrank following the spread of SARS. Even so, exports and investment both maintained their rapid growth and with consumption again rising sharply after shaking off the impact of SARS from June onwards, the growth rate of GDP for the year as a whole reached 9.1%[4], outpacing that of the previous year (8.0%).

Other economies in the Asian region were unable to break free of their downturn during the first half of the year because of the delayed recovery of the global economy and the spread of SARS, but from the beginning of the second half of the year a pattern of recovery gradually emerged with the increase of domestic demand and exports. Specifically, Taiwan and Singapore, which suffered a high incidence of SARS showed subdued pattern, while other countries generally saw an acceleration of growth in comparison to the previous year.

The economies of the Central and South American region showed a somewhat improved performance with the financial unrest soothed. Argentina registered substantial positive growth, shaking off the negative

4) The GDP growth rate of 9.1% for the year 2003 was the highest level registered since that of 9.6% in 1996.

growth of the preceding few years thanks to favorable investment and consumption. Brazil, too, showed a relatively buoyant tone with the current account showing a large-scale surplus and share prices on the rise. In the case of Venezuela, however, the economic stagnation intensified amid the financial market unrest generated by the strike action by staff of the Venezuelan National Petroleum Company that continued until the beginning of the year.

For the year 2003 as a whole, the growth rate of global trade (volume basis) is estimated to have stood at 4.0% (OECD forecast), slightly higher than the previous year's level (3.4%). During the first half of the year, world trade decreased under the influence of the heightened geopolitical tensions and the spread of SARS. From the beginning of the latter half of the year, however, the growth rate of world trade showed expansionary movements in line with the economic recovery of major countries.

B. International Financial Markets

During the year 2003, international financial markets turned gradually brisker with the early conclusion of the war against Iraq.

International interest rates showed a generally downward trend from the beginning of the year that reflected the reductions in the policy rate in major countries and the uncertain economic prospects. They shifted to an upward trend, however, from the end of June amid spreading anticipations of business recovery.

US long-term interest rates (ten-year Treasury bond yields) maintained a downward trend amid a marked flight to asset quality, which resulted from the

<Table Ⅱ-2>

Trends of Short- and Long-term Interest Rates[1] in Major Economies

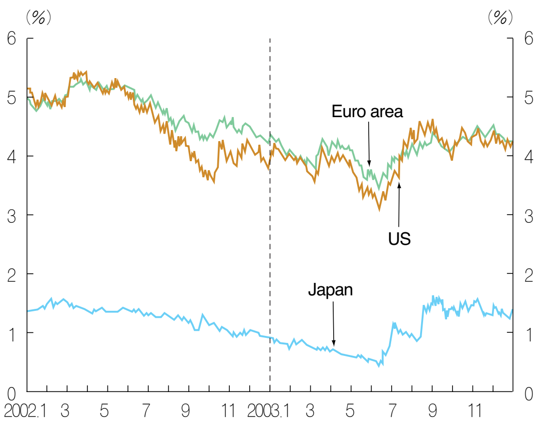
(annual %)

	2001 Dec.	2002 Dec.	2003 Mar.	2003 Jun.	2003 Sep.	2003 Dec.
Long-term[2]						
US	5.05	3.81	3.80	3.51	3.94	4.25
Japan	1.37	0.91	0.71	0.85	1.39	1.37
Euro area	5.00	4.20	4.04	3.80	4.00	4.29
Short-term[3]						
US	1.73	1.19	1.10	0.85	0.94	0.92
Japan	0.01	0.00	0.01	0.01	0.01	0.00
Euro area	3.29	2.87	2.52	2.15	2.13	2.12

Notes: 1) Month-end basis.
2) Based on yields on 10-year government bonds.
3) Based on yields on 3-month Treasury bills, apart from Euro area, which is based on yields on 3-month EURIBOR.
Source: Bloomberg.

<Figure Ⅱ-3>

Trends of Long-term Interest Rates[1] of Major Economies



Note: 1) Based on yields of each country's 10-year government bonds.
Source: Bloomberg.

uncertainty of domestic and external economic conditions, and anticipations of additional interest rate reductions by the Federal Reserve. They registered a historic low level of 3.1% on June 13. However, amid mounting anticipations of economic recovery and the increased volume of Treasury paper issued because of the expansion of the fiscal deficit, they shifted back to an upward trend to reach their highest point during the year of 4.6% on September 2. They subsequently fell back to remain in the 4~4.5% range during the remainder of the year. Short-term interest rates held stable at the low level of around 1% in line with the Federal Reserve's reduction of its policy rate to 1% (June 25), the lowest level since 1958 (0.68%).

Japanese interest rates, meanwhile, continued to exhibit a downward trend influenced by the protracted business recession, so that long-term interest rates (ten-year government bond yields) eased to their lowest-ever level of 0.435% on June 12. They subsequently edged upward to record their highest level for the year of 1.66% on September 2 affected by the shift of funds from bond investments under the influence of a rise in share prices in line with mounting expectations of economic recovery. During the fourth quarter, they showed generally stable movements at around the 1.4% level. Short-term interest rates held steady at the 0% level, reflecting the Bank of Japan's continued accommodating monetary stance.

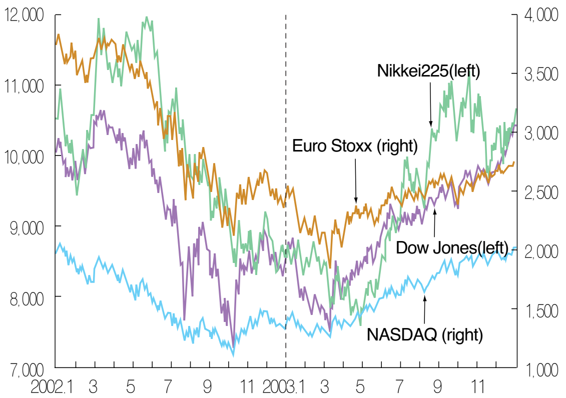
In Euroland, interest rates showed similar movements to those in the US and Japan. During the first half of the year, they displayed a downward trend in response to worries about an economic recession, the European Central Bank's (ECB) reduction of its policy rate[5], and

5) The European Central Bank (ECB) reduced its policy rate on two occasions during 2003, from 2.75% to 2.5% on March 6 and from 2.5% to 2% on June 5.

the decline in US interest rates. From early in the latter half of the year, however, they turned to an upward trend, affected by portfolio shifts out of bond investments as share prices rose, the spreading mood of anticipation concerning the recovery of the US economy, and concerns over a deterioration of fiscal deficits in several euro zone member states.

<Figure Ⅱ-4>

Trends of Share Prices Indices[1] in Major Economies



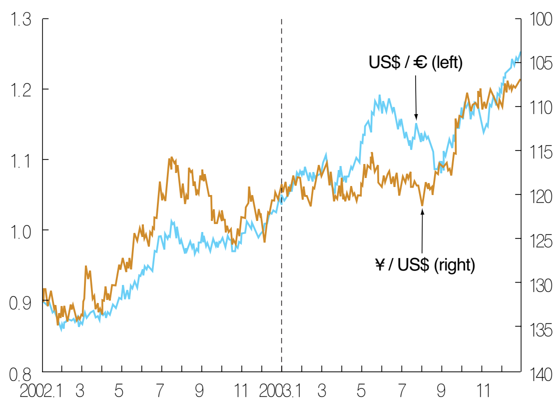
Note: 1) Spot market stock price basis.
Source: Bloomberg.

During the year 2003, share prices in major industrialized countries initially exhibited a downward trend, but turned upward after the outbreak of the war against Iraq. Amid brighter economic prospects, they subsequently showed gains on a larger scale.

In the United States, share prices started off the year on a downward trend as uncertainty ran high over the looming war against Iraq, but they shifted to an upward trend in mid-March on rampant expectations of an early conclusion of hostilities once war broke out. With businesses reporting more favorable results and mounting expectations of economic recovery, share prices maintained a sharply upward trend, leading the Dow Jones Industrial Index to finish the year with a 25.3% rise and the NASDAQ Index with a 50% rise. In Japan and the euro zone, share prices by and large showed similar movements to those in the US, with the Nikkei Index posting a rise for the year of 24.5% and the Euro Stoxx Index one of 15.7%.

<Figure Ⅱ-5>

Trends of Major Exchange Rates[1]



Note: 1) US$/€ on New York market, ¥/US$ on Tokyo market.
Source: Bloomberg.

Looking at exchange rate trends during 2003, the US dollar showed a weakening trend against other major currencies. This was attributable to rising concerns over the accumulated US budget and current account deficit and to the US administration's perceived willingness to tolerate a weaker dollar in contrast to its previous position.

Turning to the movements of individual currencies

<Table Ⅱ-3>

Changes in Major Exchange Rates[1)]

(%)

	Euro	Japanese yen	UK pound	Taiwanese dollar	Singapore dollar	Thai baht
2002	+18.0	+10.7	+11.3	+0.7	+6.3	+2.3
2003	+20.0	+11.0	+10.5	+2.3	+2.2	+8.9

Note: 1) The appreciation(+) or depreciation(-) rate of each currency against the US dollar. Based on the Tokyo market, apart from the euro which is based on the New York market.
Source: Bloomberg.

against the US dollar, the greenback continued weak against the euro from the beginning of the year and on May 29, it had fallen to 1.19 dollars per euro. It later picked up to show a mildly strengthening trend against the euro until early September, influenced by the weakness of the euro zone economy. The exchange value of the US dollar subsequently fell back rapidly again following confirmation of the US weak dollar policy at the G-7 meeting of finance ministers on September 20, together with signs of a recovery of the euro zone economy. Consequently, the euro appreciated by 20% against the US dollar during the year under review, so that the exchange rate stood at the level of 1.26 dollars per euro as of the end of the year 2003.

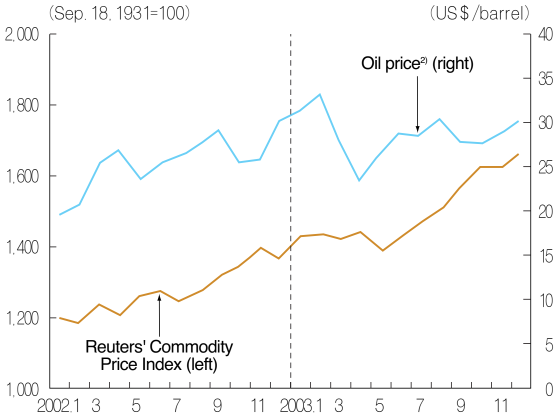
Against the Japanese yen, with the US dollar showing a pattern of repeated fluctuations the scale of depreciation of the greenback remained minimal until August in view of large-scale intervention by the Japanese foreign exchange authorities. From September onwards, however, the dollar displayed a rapidly weakening trend against the yen affected by mounting expectations of the Japanese economic recovery and the outcome of the G7 meeting of finance ministers. As of year-end 2003, the Japanese yen had appreciated by 11% against the greenback over the course of the year to stand at 106.9 yen per US dollar.

C. International Raw Material Prices

International oil prices were heavily influenced by the political situation in the Middle East during the first half of the year and, after showing repeated wide fluctuations, they maintained a comparatively high level until the end of the year.

<Figure Ⅱ-6>

Trends of Prices[1] of International Raw Materials



Notes: 1) Month-end basis
2) International oil prices are based on Brent crude price.
Source: Reuters.

From the beginning of the year, international oil prices maintained a steep upward trend, affected by the geopolitical tensions surrounding the looming war against Iraq and the continuation from the previous year of strike action by staff of the Venezuelan National Petroleum Company. The price of Brent crude oil rose to 34.9 US dollars a barrel by March 10. Following the actual outbreak of hostilities with Iraq, international oil prices shifted to a sharply downward trend amid growing anticipations of an early end to the war, dropping to the lowest level for the year of 23.2 dollars a barrel on April 29. Subsequently, however, they showed a pattern of movements within a range of 27~30 dollars. This was attributable to the changes in the interplay of supply and demand factors including the level of US oil reserves, the possibility of a resumption of Iraqi crude oil production, the adjustment of production volumes by OPEC, world economic prospects and seasonal variations in demand. It also reflected the weak underlying term of the US dollar.

Apart from oil products, international raw materials generally saw their prices on a rising trend during the year. The prices of raw materials for industrial use rose by a larger margin from the beginning of the second half of the year with the increase of demand generated by the recovery of the world economy. Grain prices also displayed an upward trend from early in the second half of the year affected by poor harvests of corn and wheat. As a net consequence, by the end of the year, the Reuters' Commodity Price Index had risen 21.1% compared with the end of the previous year.

<Reference Ⅱ-1>

Background to the Weakness of the US Dollar

The US dollar maintained its weak tone of the preceding year against other major currencies throughout the year 2003. It depreciated by 20% against the euro, 11% against the Japanese yen and 10.5% against the pound sterling, and it also showed a pattern of large-scale depreciation against almost all other currencies.

Appreciation(+) or Depreciation(-) of Major Currencies[1] against the US Dollar

(%)

	Korea won	Euro	Japanese yen	UK pound	Australian dollar	Taiwanese dollar	Singapore dollar	Thai baht	Brazilian real	Argentinean peso
During the year 2002	+10.7	+18.0	+10.7	+11.3	+10.7	+0.7	+6.3	+2.3	-34.1	-70.4
During the year 2003	-0.6	+20.0	+11.0	+10.5	+33.0	+2.3	+2.2	+8.9	+22.0	+15.5

Note: 1) Based on Tokyo market, apart from euro which based on New York market
Source: Bloomberg.

The background to this weak trend of the dollar was provided by the expansion of the US current account and budget deficits and the US administration's perceived tolerance of a weaker dollar.

During the year 2003 the US current account deficit widened to the equivalent of 5% of GDP with having already accumulated a deficit of some 2 trillion dollars during the previous five years. These large-scale current account deficits served as the direct cause of the dollar's weakness, bringing about outflows of capital. Besides in line with the spreading of a climate in which further weakness of the greenback was seen as inevitable in order to reduce the scale of that deficit, it actually hastened its depreciation still further. Meanwhile, the fiscal deficits, which has shifted deeply into the red since the Bush administration took office, served as a factor fanning import demand, thereby also widening the current account deficit and acting to accentuate the dollar's weakness.

Trends of the US Current and Fiscal Accounts

(billion dollars)

	1996	1997	1998	1999	2000	2001	2002	2003
Current GDP(A)	7,817	8,304	8,747	9,268	9,817	10,101	10,481	10,986
Current account(B)	-117	-128	-205	-291	-412	-394	-481	-542
Fiscal account(C)	-111	-2	54	157	255	92	-230	-375
B/A(%)	-1.50	-1.54	-2.34	-3.14	-4.20	-3.90	-4.59	-4.93
C/A(%)	-1.42	-0.02	0.62	1.69	2.60	0.91	-2.19	-3.41

Sources: US Department of Commerce, US Treasury

Another factor in the rapid loss of the exchange value of the US dollar was a shift in the US government's stance away from a strong dollar policy toward one of tolerating a weak dollar. In May, 2003, US Treasury

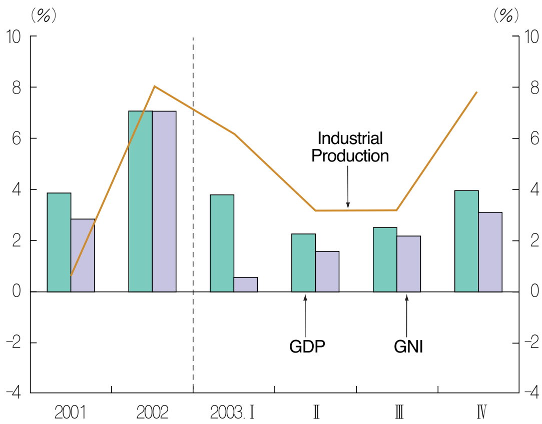
Secretary John Snow declared: “When the dollar is at a lower level, it helps exports, and I think exports are getting stronger as a result.” (May 11) and “We want the currency set through a regime of open, competitive markets with interventions kept to a minimum.” (May 13) His comments served to make this policy shift evident, and US economic policy makers subsequently continued to declare their toleration of the dollar’s weakening. Most notably, the communiqé issued following Dubai meeting of G-7 countries’ finance ministers and central bank governors read: “calling for greater flexibility in exchange rate policy as the most suitable method of inducing the smooth adjustment of imbalances within the international financial system”. This reasserted the previous position that exchange rates should reflect underlying economic conditions. Other countries were perceived as aligning themselves with the US position that through such exchange rate adjustment the problem of current account disequilibria among major countries could be resolved. The weakening of the US dollar promptly accelerated thereafter.

2. The Real Economy

A. Economic Growth

<Figure Ⅱ-7>

Trends of Major Economic Growth[1] Indicators



Note: 1) Compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office.

During the year 2003 economic growth (real GDP basis) fell sharply from the previous year's 7.0% to 3.1%. During the first quarter, GDP growth marked a rate of 3.7% in view of the contraction of domestic demand resulting from the heightened uncertainties including the US-led war against Iraq and the North Korean nuclear issue. In the second quarter, it fell further to 2.2% as the problems of credit card companies served to compound the negative economic effects of SARS. From July onwards a recovery trend became evident in the global economy, particularly in the United States, and GDP growth rose slightly to stand at 2.4% during the third quarter and 3.9% during the fourth quarter.

The rate of increase of gross national income (GNI) was slipped from the previous year's 7.0% to 1.8% in response to the deterioration of the terms of trade and the reduction in GNP growth.

<Table Ⅱ-4>

Trends of Growth[1] by Expenditure Item

(%)

	2001	2002	2003P year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Final consumption expenditure	4.9	7.6	-0.5	0.9	-0.8	-0.9	-1.1
Private	4.9	7.9	-1.4	0.3	-1.8	-1.9	-2.2
Government	4.9	6.0	3.7	4.0	3.7	3.5	3.5
Gross fixed capital formation	-0.2	6.6	3.6	4.6	3.7	2.6	3.6
(Construction)	6.0	5.3	7.6	8.0	7.3	7.9	7.4
(Facilities)	-9.0	7.5	-1.5	1.9	-0.6	-5.0	-2.4
Increase in inventories[2]	0.0	-0.2	-0.6	0.8	-1.3	-1.1	-0.8
Exports of goods and services	-2.7	13.3	15.7	15.9	8.4	14.9	23.1
(Goods)	-4.4	16.5	18.7	20.1	10.6	18.4	25.3
Imports of goods and services	-4.2	15.2	9.7	14.2	5.2	7.7	11.7
(Goods)	-5.9	15.6	10.8	16.3	6.1	8.2	12.9
GDP	3.8	7.0	3.1	3.7	2.2	2.4	3.9
GNI	2.8	7.0	1.8	0.5	1.5	2.1	3.0

Notes: 1) Compared with the same period of the previous year.
2) Degree of contribution to GDP (percentage points).
Source: The Bank of Korea.

(Domestic Demand)

Looking at demand trends over the year, exports retained a strong expansionary trend and construction investment showed a dynamic tone but private consumption and facilities investment remained in the doldrums.

Among consumption expenditures, private sector expenditures shifted from the preceding year's 7.9% increase to a decline of 1.4% because of a combination of factors including a deterioration of the financial soundness of households, the problems of credit card companies and the weakening of employment conditions. By type of spending, the consumption of durables, which is highly sensitive to economic fluctuations, decreased on a large scale while that of semi-durables and non-durables was also below the previous year's level. The consumption of services showed just a little increase compared with the previous year's. Government consumption, however, accelerated its pace of increase to 3.7%, influenced by active pump-priming policies including the drawing up of supplementary budgets.

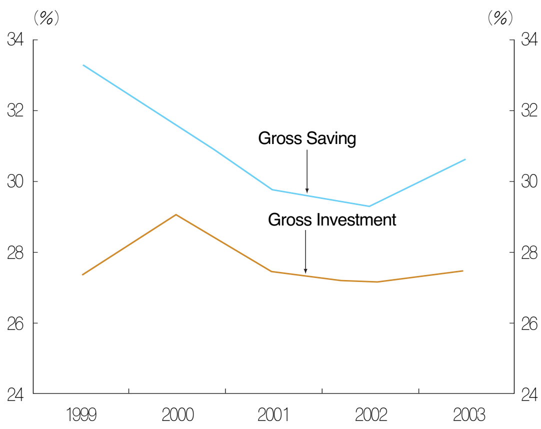
Turning to investment trends, the briskness of exports failed to spark a revival of investment confidence and facilities investment shifted from the preceding year's 7.5% increase to mark a decrease of 1.5%. In contrast, construction investment rose from the preceding year's 5.3% to stand at 7.6% in line with the buoyancy of building construction thanks to the upswing in housing prices.

Exports of goods and services (real term basis) maintained their liveliness from the previous year, rising from the previous year's 13.3% to stand at 15.7%. Goods exports grew 18.7% with a particularly buoyant tone shown by those of semiconductors, mobile phone handsets, computers and other IT items, spurred on by the rapid growth of the Chinese economy and the global recovery. Those of services, on the other hand, continued on a downward path with the contraction, for example, of foreigners' spending on travel expenses in Korea.

Imports of goods and services (real term basis) saw their rate of increase dip from the previous year's 15.2% to stand at 9.7%. Goods imports rose by 10.8%, centering on those of capital goods and raw materials for export use. Service imports decelerated their rate of

<Figure Ⅱ-8>

Trends of Gross Investment and Gross Saving Ratios



<Table Ⅱ-5>

Trends of Growth[1] by Economic Activity

(%)

	2001	2002	2003P year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Agriculture, forestry & fisheries	1.1	-3.5	-7.1	-5.1	-1.3	-9.1	-9.1
Mining	-0.1	-7.7	3.0	7.3	-1.1	2.4	4.0
Manufacturing	2.2	7.6	4.8	5.1	2.6	3.3	8.0
Electricity, gas & piped water	7.2	7.7	5.7	7.1	8.9	3.1	3.7
Construction	5.5	2.8	8.1	8.4	7.7	8.1	8.4
Services[2]	4.8	7.8	1.8	1.9	1.1	1.6	2.4
Wholesale & retail, hotels & restaurants	4.6	5.4	-2.3	-0.6	-3.9	-3.0	-1.8
Transport, storage & communications	14.9	9.2	3.7	3.8	3.3	3.1	4.5
Finance, insurance, real estate & business services	3.0	8.3	2.6	2.2	2.1	2.7	3.2
GDP	3.8	7.0	3.1	3.7	2.2	2.4	3.9

Notes: 1) Compared with the same period of the previous year.
2) Less imputed bank service charges but including import duties.

growth somewhat from the previous year's 13.5% to show a 4.8% increase, as SARS had a negative impact on overseas travel spending by Korean residents.

The gross saving ratio (current price basis) rose by 1.3 percentage points from the preceding year's 31.3% to stand at 32.6%, while the gross domestic investment ratio registered 29.5%, rising slightly by 0.4 percentage point from the preceding year's 29.1%. Accordingly, the share of gross domestic saving to gross domestic investment, which measures the self-sufficiency of investment resources, rose slightly from the previous year's 107.3% to 110.6%.

(Production)

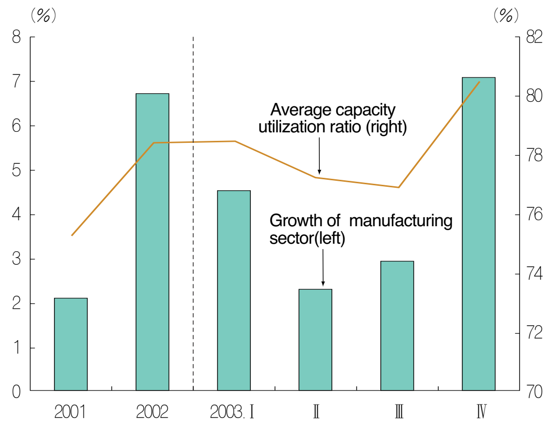
Looking at production activities by sector during the year, manufacturing and services saw a slowdown in their rate of growth while construction experienced an expansion.

In manufacturing, the growth rate slipped from the previous year's 7.6% to stand at 4.8%, dragged down by the sluggishness of businesses focusing on domestic demand, which contrasted with the buoyancy of export-oriented businesses including automobiles, semiconductors and communications devices. Despite this slackening of production activity, the capacity utilization rate in manufacturing stood at 78.3%, a very similar level to the previous year's 78.4%. This was attributable to the limits imposed on the growth of production capacity by the contraction of facilities investment.

The electricity, gas and piped water sector grew at a rate of 5.7%, below the previous year's level of 7.7% owing to the deceleration of expanding trend in electricity as a result of the sluggishness in electricity consumption.

<Figure Ⅱ-9>

Trends of Growth[1] and Average Capacity Utilization Ratio in the Manufacturing Sector



Note: 1) Rates of change compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office.

In the case of the construction sector, private construction activity increased greatly centering on that of buildings for housing and commercial use. This led to an acceleration in the growth of the production of the sector as a whole from the previous year's 2.8% to 8.1%.

Services saw their rate of expansion dropped sharply from the previous year's 7.8% to stand at 1.8%. Broken down by subsector, wholesale and retail, hotels and restaurants saw negative growth of 2.3%, influenced by the lackluster consumption. Transport, warehousing and communications, meanwhile, slowed from the preceding year's 9.2% to 3.7% because of the sluggishness of transport and warehousing business, which offset the effects of the buoyancy of communications. Financial, insurance, real estate and business services also saw their rate of growth fall back sharply under the impact of the business downturn.

Farming, forestry and fishing, showed an expansion of their declining trend from the previous year's -3.5% to stand at -7.1%, with the reduction in output volumes from cultivation and animal husbandry, which were badly affected by typhoons and inclement weather.

B. Employment and Wages

During the course of the year 2003 employment conditions were more difficult than in the previous year and the growth rate of nominal wage declined slightly.

(Employment)

Amid the continued economic downturn, the rate of increase of the economically active population fell sharply to just 0.2% and the number of people in

<Table Ⅱ-6>

Trends of Major Employment Related Indicators

(million, %)

	2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Economically active population	22.4	22.9	22.9	22.4	23.1	23.1	23.1
(rate of growth)[1]	1.6	2.1	0.2	0.4	-0.2	-0.1	0.6
Economic participation rate	61.3	61.9	61.4	60.3	61.8	61.6	61.7
Number of persons employed	21.6	22.2	22.1	21.6	22.3	22.3	22.3
(rate of growth)[1]	2.0	2.8	-0.1	0.6	-0.5	-0.5	0.0
Number of persons unemployed	0.85	0.71	0.78	0.81	0.75	0.76	0.79
Unemployment rate	3.8	3.1	3.4	3.6	3.3	3.3	3.4
(SA)	-	-	-	3.1	3.4	3.5	3.6

Note : 1) Compared with the same period of the previous year.
Source: Korea National Statistical Office.

<Table Ⅱ-7>

Trends in the Structure of Employment and Working Hours

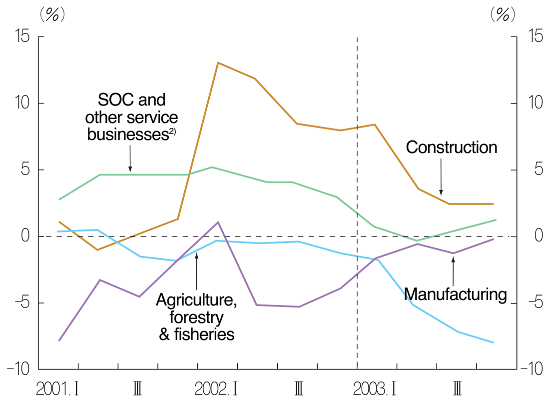
(%, hours)

	2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Full time permanent[1]	49.2	48.4	50.5	50.6	50.0	50.6	50.6
Temporary or casual[1]	50.8	51.6	49.5	49.4	50.0	49.4	49.4
Monthly average working hours[2]	204	201	199	197	200	195	205
(overtime)	23	20	20	19	20	19	20

Notes: 1) Share among total wage earners.
2) Based on businesses with 10 or more workers.
Sources: Korea National Statistical Office, Ministry of Labor.

<Figure Ⅱ-10>

Trends of Growth[1] in the Number of Persons Employed by Industry



Notes: 1) Compared with the same period of the previous year.
2) Excludes construction.
Source: Korea National Statistical Office.

employment fell by 0.1%, the first decline registered since 1998.

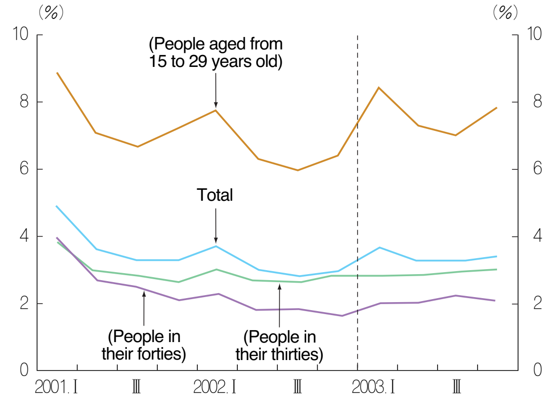
In consequence, the number of people unemployed increased from the previous year's 708 thousand to 777 thousand and the unemployment rate rose from 3.1% to 3.4%. Seen by quarter, the unemployment rate rose to 3.6% in the first quarter as the number of the unemployed increased to 806 thousand for seasonal reasons. From the second quarter onwards, together with the decline in the number of people out of work, the unemployment rate eased to around 3.3%. The seasonally adjusted unemployment rate rose steadily to 3.1% in the first quarter, to 3.4% in the second, to 3.5% in the third and to 3.6% in the fourth quarter.

Viewing employment trends by industry over the course of the year, the reduction in the number of persons employed in agricultural, forestry and fisheries, continued as a result of migration to the cities. The number of persons employed in manufacturing also continued to decline with the continuation of the business downturn and the reorganization of the industrial structure toward the information and communications sector, which has a low employment generating effect. The service sector, which has a large capacity for absorbing labor, experienced only a slight increase in employment from the previous year because of the depressed state of consumer spending and other domestic consumption. The construction sector, which had seen a sharp rise in employment the previous year, registered a deceleration of the increase in the number employed.

Breaking down unemployment by age brackets, the unemployment rate among adolescents and young people (15~29 years old) increased on a large scale from 6.6% during 2002 to 7.7% during 2003. This was

<Figure Ⅱ-11>

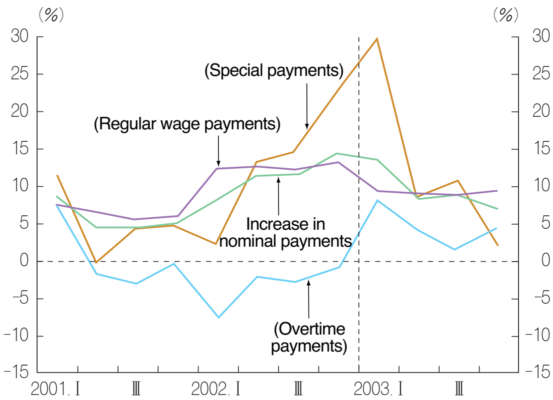
Trends of Unemployment by Age Brackets



Sources: Korea National Statistical Office.

<Figure Ⅱ-12>

Trends of Wage Increases[1)]



Note: 1) Compared with the same period of the previous year.
Source: Ministry of Labor.

largely attributable to the decrease in the demand for fresh human resources affected by economic sluggishness and the change to an employment structure based primarily on experience and career record.

In relation to the type of employment, there was a decline from the previous year's 51.6% to 49.5% in the share among waged employees of those working on a casual or temporary basis, largely because of the sharp contraction of those working on a casual basis in the service sector. Meanwhile, average working hours per month declined by two hours from the previous year, but overtime hours worked remained unchanged.

(Wages)

During the year 2003, the all industry nominal wage (based on businesses with 10 or more workers) rose 9.4%, which was lower than the 11.6% increase of the previous year. Deflating nominal wages by the rise in the Consumer Price Index (CPI), the rate of increase of real wages fell from the previous year's 8.9% to stand at 5.8%.

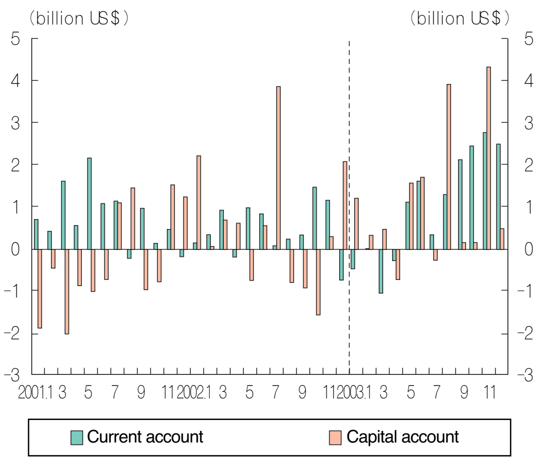
Looking at the composition of nominal wages, the rate of increase of regular wage payments declined from the previous year's 12.7% to register 9.2%, and the rate of increase of special payments also dropped, moving down from the preceding year's 13.5% to 11.9%, whereas that of overtime marked a level of 4.4% increase, outpacing the previous year's 3.4% decline. Viewed by industry, rates of wage increases were relatively subdued across almost all branches of industry compared to the preceding year, especially centering on those of the financial, insurance, real estate and business services, and for the social and private service sectors.

C. External Transactions

In the course of the year 2003, the current account and the capital account both exhibited a substantial surplus. The current account registered a surplus of 12.3 billion dollars thanks to the buoyancy of exports while the capital account surplus stood at 13.1 billion dollars, largely owing to the inflow of foreign capital for investment in stocks. Consequently, reserve assets as recorded in the international balance of payments statistics increased by 25.9 billion dollars in the course of the year.

<Figure Ⅱ-13>

Trends of Current and Capital Accounts



(Current Account)

The current account of the balance of payments saw its largest surplus since 1998, largely centering on the goods account. The scale of the surplus widened greatly from the previous year's 5.4 billion dollars to stand at 12.3 billion dollars. Viewed by period, during the first four months of the year apart from February the current account exhibited a deficit because of the run-up in oil prices precipitated by the looming war against Iraq. From May onwards, however, exports turned lively and a pattern emerged of a widening surplus. From September, the monthly surplus continued to exceed 2 billion dollars.

Viewed by component account, the surplus of the goods account widened greatly from the previous year's 14.8 billion dollars to 22.2 billion dollars, thanks to the swelling export-import gap. The income account also recorded a surplus, albeit only slight (0.6 billion dollars), which centered on income from salaries and wages. In contrast, the service account ran up a deficit of 7.6 billion dollars, owing to the decline in earnings from inbound tourism, increased spending on study and training abroad and an expansion of royalty payments

<Table Ⅱ-8>

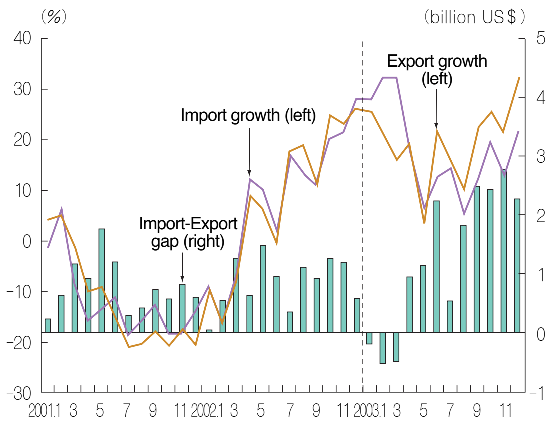
Balance of Payments

(billion US$)

	2001	2002	2003p
Current account	8.0	5.4	12.3
Goods	13.5	14.8	22.2
(exports)	151.5	163.4	197.6
(imports)	138.0	148.6	175.5
Services	-3.9	-8.2	-7.6
(credits)	29.1	28.4	32.7
(debits)	32.9	36.6	40.3
Income	-1.2	0.4	0.6
Current transfers	-0.4	-1.6	-2.8
Capital account	-3.4	6.3	13.1
Financial account	-2.7	7.3	14.5
Direct investment	1.1	-0.2	-0.2
Portfolio investment	6.6	0.7	18.0
Other investment	-10.4	6.9	-3.2
Other capital account	-0.7	-1.1	-1.4
Changes in reserve assets	-7.6	-11.8	-25.9
Errors and omissions	2.9	0.2	0.4

<Figure Ⅱ-14>

Trends of Import & Export Growth[1] and Import-Export Gap



Note: 1) Compared with the same period of the previous year. Customs clearance basis.
Source: Ministry of Commerce, Industry and Energy.

and patent fees.

During the year 2003, exports (customs clearance basis) rose 19.3% over the previous year (162.5 billion dollars) to chalk up a figure of 193.8 billion dollars, boosted by the sustained rapid growth of the Chinese economy and the economic recovery in major advanced countries including the US and Japan.

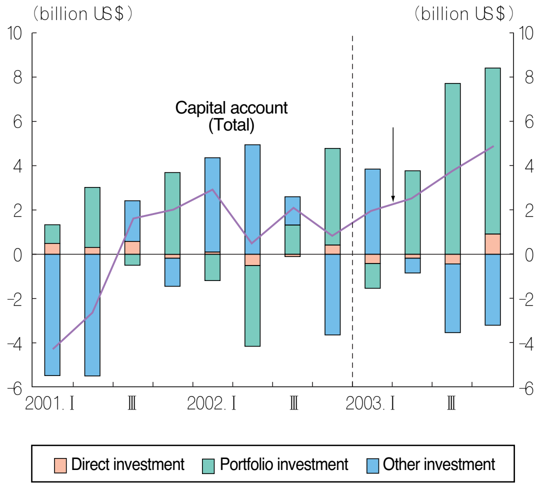
Breaking down exports by major product group, those of semiconductors, mobile phone handsets, computers and other IT related items sustained their brisk tone while those of automobiles and steel witnessed a sharp acceleration of their upward trend. Splitting the expansion of exports into volume factors and price factors, the shift in the unit price of exports from the previous year's downward trend to an upswing served as a factor accelerating the growth of exports.

Imports (customs clearance basis) during the year 2003 rose 17.6% over the previous year (152.1 billion dollars) to reach 178.8 billion dollars.

Broken down by major product group, those of raw materials such as oil, iron and steel rose sharply along with those of capital goods for use in the processing of export items. Imports of consumer goods shrugged off the generally subdued tone of consumer spending to rise by a wider margin, centering on those of durables, particularly household electrical appliances and automobiles. Besides this, with the freeing of imports of gold bullion from value-added tax early in the latter half of the year, imports of gold saw a sharp acceleration of their upward trend. Looking at the growth of imports in terms of prices and volumes, the rise in the unit value of imports outpaced that of their volume growth.

<Figure Ⅱ-15>

Trends of Capital Account by Item



(Capital Account)

The capital account registered a surplus of 13.1 billion dollars for the year 2003 that was primarily driven by foreign stock market investment funds. This represented a large-scale increase over the surplus exhibited the previous year (6.3 billion dollars).

Viewed by component account, the direct investment account registered a 0.2 billion dollar deficit, the same figure as the previous year. Inward and outward foreign direct investment both saw a sharp acceleration of their upward trend.

The portfolio investment account saw a massive increase in the scale of its surplus from 0.7 billion dollars the previous year to 18 billion dollars, which reflected the sharp increase in the scale of foreigners' investment in Korean securities at a time when overseas securities investment by Korean residents remained flat.

The other investment account shifted from the previous year's surplus of 6.9 billion dollars to a deficit of 3.2 billion dollars, led by a large increase in lending by financial institutions to non-residents.

3. Prices

During the year 2003, prices showed a steeper upward trend than in the preceding year owing to the large-scale of the rise in prices of internationally traded raw materials and agricultural products. The annualized average rate of increase in the Consumer Price Index (CPI) rose from 2.7% the year before to 3.6% while the Producer Price Index (CPI) shifted from a decline of 0.3% the previous year to a rise of 2.2%. Core inflation, nevertheless, exhibited a rate of increase of 3.1%, similar to that of the previous year's 3%.

<Table Ⅱ-9>

Trends of Movements[1] of Major Prices

(%)

	1999	2000	2001	2002	2003
Consumer Prices	0.8	2.3	4.1	2.7	3.6
(Core Inflation)	(0.3)	(1.9)	(3.6)	(3.0)	(3.1)
Producer Prices	-2.1	2.0	-0.5	-0.3	2.2
Import Prices	-12.1	7.7	3.5	-6.2	1.8

Note: 1) Compared with the same period of the previous year.
Sources: The Bank of Korea, Korea National Statistical Office

(Consumer Prices)

In the course of the year 2003, the CPI rose at an annualized average rate of 3.6%, showing a steeper upward trend than the previous year's 2.7%. This was largely because oil prices and private service charges sustained their elevated levels of the first quarter throughout the rest of the year. In addition, the prices of agricultural, livestock and fishery products rose sharply under the impact of typhoons in the last quarter.

<Table Ⅱ-10>

Trends of Movements[1] in Consumer Prices

(%)

	2001	2002	2003				
			year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Consumer Prices	4.1	2.7	3.6	4.1	3.4	3.2	3.5
	(3.2)	(3.7)	(3.4)	(2.4)	(-0.6)	(1.3)	(0.4)
Agriculture, livestock & marine products	6.3	6.2	5.9	6.1	2.7	3.5	11.3
	(9.5)	(6.9)	(8.9)	(6.6)	(-5.9)	(10.3)	(-1.6)
Industrial products	2.6	1.7	2.3	4.5	2.5	1.8	0.8
	(0.0)	(4.1)	(1.4)	(1.7)	(-1.1)	(-0.2)	(1.0)
(Petroleum products)	4.2	-0.8	6.0	13.8	4.5	4.2	1.9
	(-9.4)	(10.5)	(4.3)	(6.9)	(-6.6)	(0.6)	(3.9)
Services	4.6	2.8	3.6	3.4	3.9	3.9	3.6
	(4.0)	(2.8)	(3.5)	(1.9)	(0.7)	(0.4)	(0.4)
(Public service charges)	7.5	-1.3	2.5	1.1	3.1	3.5	2.4
	(3.7)	(-0.8)	(2.0)	(2.0)	(0.6)	(-0.5)	(-0.2)
(Rents)	4.1	5.8	3.5	4.4	3.8	3.2	2.9
	(5.7)	(4.8)	(2.8)	(0.7)	(1.0)	(0.6)	(0.4)
(Private services)	3.1	3.7	4.5	4.3	4.4	4.6	4.7
	(3.4)	(3.9)	(4.7)	(2.7)	(0.6)	(0.6)	(0.7)

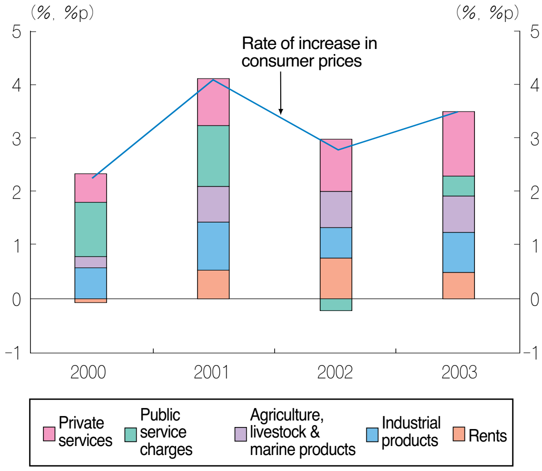
Notes: 1) Compared with the same period of the previous year.
Figures in parentheses refer to rates of increase compared with the last month of the previous period.
Source: Korea National Statistical Office.

Viewed by commodity group, the prices of agricultural and fishery products increased by 5.9%, centering on vegetables and fruits, while the prices of industrial goods rose 2.3%, led by those of petroleum products. For services, the rise was 3.6%. Although there was a reduction in the scale of increase of housing rents, this was more than offset by the rise in charges for private services including those for eating-out and for tutoring institutes and the effects of heights in the charges for public utilities and services such as railway fares and health insurance contributions.

Looking at the contribution to the rise in the CPI by

<Figure Ⅱ-16>

Degree of Contribution[1] to the Rate of Increase of Consumer Prices



Note: 1) Compared with the same period of the previous year.
Source: Korea National Statistical Office.

<Table Ⅱ-11>

Trends of Movements[1] in Producer Prices

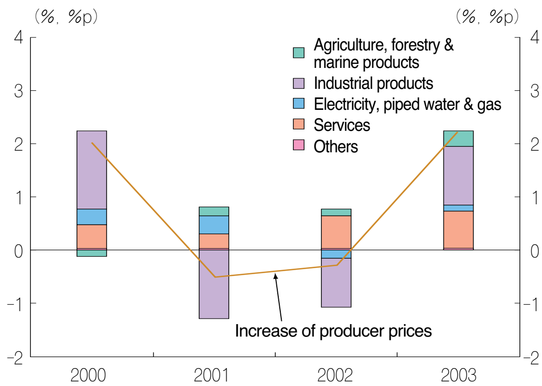
(%)

	2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Producer prices	-0.5 (-2.5)	-0.3 (2.3)	2.2 (3.1)	3.0 (2.3)	1.3 (-1.6)	1.9 (1.0)	2.6 (1.4)
Goods	-1.1 (-4.2)	-1.2 (2.2)	2.0 (3.2)	3.1 (2.9)	1.1 (-2.4)	1.5 (1.2)	2.7 (1.5)
(Agriculture, forestry & marine products)	3.7 (6.7)	2.5 (4.9)	5.7 (12.1)	2.6 (3.9)	0.6 (-4.9)	5.3 (11.0)	14.6 (2.3)
(Industrial products)	-2.1 (-5.6)	-1.5 (2.2)	1.8 (2.7)	3.3 (2.9)	0.9 (-2.3)	1.1 (0.6)	1.8 (1.5)
(Electricity, piped water & city gas)	8.4 (4.0)	-3.2 (-1.8)	3.0 (0.6)	3.4 (2.4)	4.4 (-0.1)	3.3 (-1.9)	0.9 (0.2)
Services	1.0 (1.4)	2.1 (2.4)	2.3 (2.9)	2.3 (1.0)	1.8 (0.4)	2.3 (0.3)	2.6 (1.2)

Notes: 1) Compared with the same period of the previous year.
Figures in parentheses refer to rates of increase compared with the last month of the previous period.

<Figure Ⅱ-17>

Degree of Contribution[1] to the Rate of Increase of Producer Prices



Note: 1) Compared with the same period of the previous year.

product group, that of agricultural, livestock and fishery stood at 0.7 percentage point similar to the previous year's figure, that of industrial goods expanded from the previous year's 0.5 percentage point to 0.8 percentage point and that of services enlarged from 1.5 percentage points the previous year to 2.1 percentage points. Within the services group, the contribution of housing rents declined from the preceding year's 0.8 percentage point to 0.5 percentage point. In contrast, that of individual services enlarged from the previous year's 1.0 percentage point to 1.2 percentage points and that of charges for public utilities shifted from a negative contribution of 0.2 percentage point to a positive contribution of 0.4 percentage point.

(Producer Prices)

During the year 2003, the PPI showed a rise on a similar scale to that of the CPI during the first and final quarters, shifting to an increase of 2.2% on an annual average basis compared to its decrease in both 2001 and 2002.

Viewed by commodity group, the prices of agricultural and fishery products rose 5.7% as a result of the reduced volume of output brought about by unfavorable weather conditions including typhoons and a particularly heavy rainy season. The prices of industrial products, meanwhile, rose 1.8%, led by those of petroleum products and primary metals. Charges for electricity, piped water and city gas moved up 3.0%, driven by an increase in the city gas tariff. For their part, service charges showed a mild acceleration of their upward trend that centered on ocean shipping and airfreight charges.

Turning to contribution to the rise in the PPI by commodity group, that of industrial products showed a

<Table Ⅱ-12>

Trends of Movements[1] in Stage-of-Processing Prices

(%)

	2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Gross index	0.2 (-5.4)	-2.7 (2.4)	1.9 (4.1)	3.3 (3.8)	0.4 (-3.4)	1.5 (0.5)	3.1 (3.4)
Raw materials	2.3 (-7.9)	1.3 (18.3)	6.4 (9.1)	16.4 (7.4)	-1.0 (-7.3)	3.7 (-0.8)	7.3 (10.5)
Intermediate goods	-0.4 (-7.1)	-3.9 (0.8)	2.2 (4.9)	2.5 (4.7)	0.8 (-3.6)	2.0 (0.6)	3.3 (3.3)
Final goods	0.5 (-2.3)	-2.0 (0.9)	0.7 (1.7)	1.1 (1.7)	0.0 (-2.2)	0.1 (0.7)	1.4 (1.5)

Notes: 1) Compared with the same period of the previous year. Figures in parentheses refer to rates of increase compared with the last month of the previous period.

<Table Ⅱ-13>

Trends of Movements[1] in Import and Export Prices

(%)

		2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Export prices	Won-basis	-3.8 (-11.6)	-7.0 (-1.1)	-2.2 (3.3)	-3.9 (4.6)	-4.5 (-5.7)	-0.7 (-1.2)	0.6 (6.0)
	Contract currency-basis	-15.2 (-16.3)	-4.2 (4.5)	1.3 (2.9)	4.0 (2.1)	-1.1 (-3.2)	0.2 (1.4)	2.3 (2.6)
Import prices	Won-basis	3.5 (-8.5)	-6.2 (2.9)	1.8 (6.5)	3.5 (6.3)	-1.6 (-6.4)	1.4 (-1.1)	4.0 (8.2)
	(raw materials)	2.5	-6.4	2.5	5.6	-1.5	1.8	4.3
	(capital goods)	7.3	-6.3	-1.8	-5.7	-2.1	-1.1	2.0
	(consumer goods)	10.6	-3.1	-0.6	-3.9	-2.6	1.3	3.3
	Contract currency-basis	-7.7 (-12.2)	-3.1 (8.3)	5.0 (5.5)	11.1 (3.6)	1.7 (-3.6)	2.5 (1.0)	5.1 (4.6)
Exchange rates[2]		-12.4	3.2	4.9	9.8	5.0	1.9	3.3

Notes: 1) Compared with the same period of the previous year. Figures in parentheses refer to the rates of increase compared with the last month of the previous period.
2) Won/US$ basis, average rate of increase during the given period.

large transformation from the previous year's 0.9% decrease to a 1.1% increase. Enlarged contributions to the rise in the index were also made by agricultural and fishery products, electricity, water and city gas, and by the service sector.

Meanwhile, looking at the stage-of-processing prices[6], the scale of the rise in those of raw materials expanded greatly while that of intermediate imports and of final products shifted from the previous year's decline to a rise, centering on petroleum and chemical products, primary metals and agricultural and fishery products.

(Import and Export Prices)

During 2003, export prices (Korean won basis) saw a 2.2% decrease. This was ascribable to the 4.9% appreciation of the Korean won against the US dollar, which more than offset the effects of the 1.3% rise in the contract currency price of exports brought about by rising demand in line with the recovery of the global economy.

Viewed by period, up until the end of the third quarter, export prices (Korean won basis) moved downward led by audio, visual and communication equipment, and by textiles and apparel in a development that reflected the US dollar's weakness and the intensification of competition between producers both at home and abroad. From the beginning of the final quarter, however, they shifted to an upward trend as the upsurge in the price of imported raw materials put increased pressure on Korean won prices while the Japanese yen and the euro strengthened against the dollar.

6) Producer prices of goods in terms of sector-weighted average of the PPI of commodities and import price index.

Even though the Korean won appreciated in dollar terms during the year 2003, import prices (Korea won basis) shifted from the previous year's 6.2% decline to a rise of 1.8%, led by a 5% rise of the contract currency price of imports.

Viewed by period, the rise in import prices showed a particularly pronounced pattern of upward movements during the first and the fourth quarters, largely influenced by movements in the prices of international raw material prices and especially those of oil.

(Real Estate Prices)

Housing prices during 2003 showed a rise of 5.7% on the basis of the final month of the previous year. This was a milder upward trend than that of the previous year, but it still outpaced the rate of increase in the CPI. Prices of apartments in the Gangnam area of Seoul continued to spearhead the upward movement of housing prices in general. On the other hand, leasehold deposits showed a 1.4% decline on the basis of the last month of the previous year.

<Table Ⅱ-14>

Trends of Movements[1] in Housing Prices and Leasehold Deposits

(%)

	2001	2002	2003				
			year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Housing prices	9.9	16.4	5.7	1.2	3.3	1.4	-0.2
(Apartments)	14.5	22.8	9.6	1.3	4.7	2.4	0.9
- Seoul	19.3	30.8	10.2	-0.8	5.4	4.4	0.9
<Gangnam>	22.0	35.2	14.3	-0.8	7.1	6.6	0.8
Leasehold deposits	16.4	10.1	-1.4	1.4	-0.7	-0.3	-1.8
(Apartments)	20.0	12.2	-0.4	2.0	-1.3	0.0	-1.1
- Seoul	23.4	11.4	-3.2	1.3	-2.4	-0.5	-1.6
Land prices	1.3	9.0	3.4	0.4	0.5	1.1	1.5

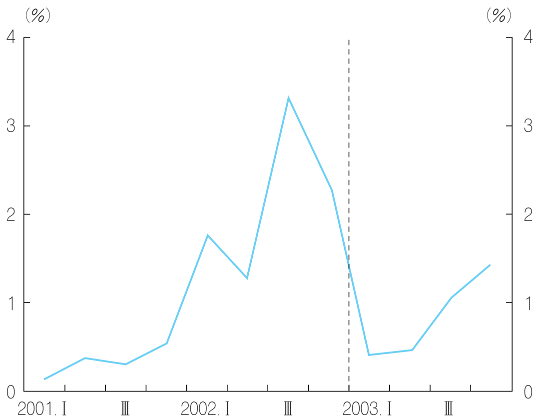
Note: 1) Compared with the last month of the previous period.
Sources: Ministry of Construction and Transportation, Kookmin Bank.

Looking at the movements of housing prices during the year, they showed a stable pattern during the first quarter in line with the heightened uncertainties overshadowing the economy as a whole including the looming war against Iraq and the North Korean nuclear issue. The scale of their upward movement expanded greatly from early in the second quarter and on through into the third quarter. It was stirred by speculative demand for apartments slated for reconstruction in the Gangnam district, and spread to its neighborhoods centering on large and medium sized apartments, new satellite cities around Seoul, and on areas reported as possible sites for the construction of the new administrative capital in the Daejeon and Chungcheong regions. During the fourth quarter, they shifted to a downward trend, albeit in a minor key, following the government's unveiling of its 「Comprehensive Package of Housing Market Stabilization Measures」 (October 29), designed to tackle the protracted sharp rise in housing prices.

In the case of housing leasehold deposits, although prices rose temporarily at the beginning of the new school year in February and March, and again in August and September, stable trends were maintained, largely as a result of the improved interplay of supply and demand thanks to an increase in the completion of new apartments.

<Figure Ⅱ-18>

Trends of Movements[1] in Land Prices



Note: 1) Compared with the last month of the previous quarter.
Source: Ministry of Construction and Transportation.

Land prices showed a rise of only 3.4% from the previous year's 9.0% upswing. From the third quarter onwards, however, there were signs of an acceleration of the upward trend of land prices in districts in which development restrictions were abolished, in suburban areas surrounding Greater Seoul in connection with the planned development of satellite cities, and in the Chungcheong region in response to the decision to move Korea's administrative capital.

4. Financial Markets

A. Price Indicators

(1) Interest Rates

In 2003, long-term interest rates initially fell steeply during the first half of the year owing to the worries about the delay of economic recovery and the imbalance between the supply and demand of bonds, moving below the level of short-term market interest rates for a while. From early in the latter half of the year, they shifted to an upward trend and, in line with the brightening of prospects for a recovery of business activity, showed a progressive expansion in the scale of their rise. Interest rates on financial institutions' deposit and loans showed a small-scale decrease affected by the downward adjustment of the overnight call rate target.

<Table Ⅱ-15>

Trends of Major Market Interest Rates[1]

(annual %)

	2001 Dec.	2002 Dec.	2003 Mar.	2003 Jun.	2003 Sep.	2003 Dec.
Call (one day)	4.00	4.52	4.25	4.09	3.75	3.95
CD (91days)	4.86	4.90	4.70	4.30	3.89	4.36
CP (91days, A1)	5.07	5.03	5.27	4.67	4.11	4.55
Treasury bonds (3yrs.)	5.91	5.11	4.62	4.16	4.11	4.82
Corporate bonds (3yrs., AA-)	7.04	5.68	5.38	5.45	5.05	5.58

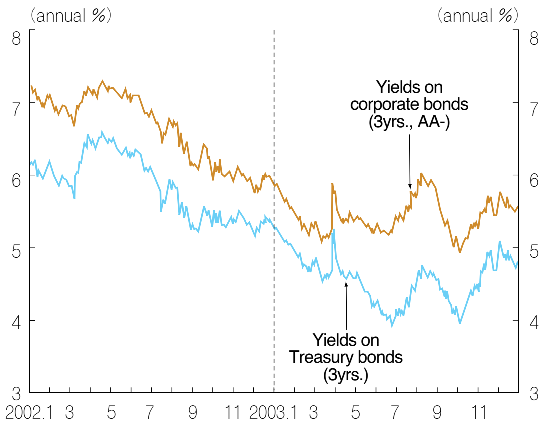
Note: 1) Month-end basis
Sources: The Bank of Korea, Korea Securities Computer Corp.

(Long-Term Market Interest Rates)

A downward trend was exhibited from the beginning of the year in the movements of long-term interest rates owing to the worries about the delay of economic recovery generated by the geopolitical tensions surrounding the looming war against Iraq and the North Korean nuclear issue. Another factor acting to pull down long-term rates was the increased buying demand from financial institutions resulting from the strengthened preference for asset quality and increased deposit-taking by investment trusts at a time when the scale of the supply of long-term bonds, including both Treasury and corporate bonds, was on the decline. In consequence, secondary market yields on three-year Treasury bonds dropped to 4.57% (February 27).

<Figure Ⅱ-19>

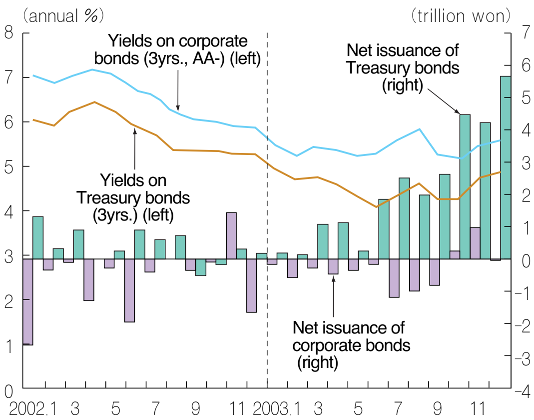
Trends of Major Long-term Market Interest Rates



Source: Korea Securities Computer Corp.

<Figure Ⅱ-20>

Trends of Yields[1] on Corporate and Treasury Bonds and Net Issuance



Note: 1) Monthly average.
Source: Korea Securities Computer Corp.

The financial unrest precipitated in mid-March by the revelation of accounting malpractice at SK Global and concerns over possible defaults on credit card companies' paper led to a sharp temporary rise in yields on three-year Treasury bonds, bringing them to their highest level for the year (March 13, 5.24%). Helped by the steps to stabilize the financial markets taken by the Bank of Korea and the government, though, they swiftly returned to their previous level. They subsequently maintained this downward trend on growing anticipations that the Bank of Korea would lower its call rate target in response to the protraction of the downturn of the real economy under the impact of the spread of SARS and so forth. Notably, on June 18, yields on three-year Treasury bonds dropped below the overnight call rate to register their lowest-ever level of 3.95%. Three-year corporate bond yields showed similar movements to those on three-year Treasuries, but from March onwards the scale of their decline was relatively narrower owing to the heightened risk premium on them.

In the last days of June, long-term interest rates shifted from their long sustained downward trend to an upswing. As the revival of the US economy gathered momentum from early in the latter half of the year, they showed a rapid upward trend amid a growing mood of optimism about economic recovery thanks to pump-priming measures including the Bank of Korea's further reduction of its call rate target and the government's drawing-up of a supplementary budget. Secondary market yields on three-year Treasuries consequently moved up to 4.75% by August 1, at which date those on three-year corporate bonds (AA-) registered their highest level for the year as a whole of 6.01%.

After this rally, long-term yields retreated to their downward trend owing to the persistent sluggishness of domestic business activity, which contrasted with the recovering movements of the world economy and particularly those of the US economy. Yields on three-year Treasuries slipped back to 3.98% (October 2) as the domestic real economy ran into heavier difficulties due to the faltering of production in response to strikes at some large enterprises and fears mounted over further delay in the recovery given the strength of the Korean won against the US dollar.

Long-term yields shifted back to an upward trend, however, from October onwards with the further acceleration of the US economic recovery and the forming of expectations of an expanded supply of government bonds following the compilation of a second supplementary budget. At the same time, optimism concerning domestic economic recovery was becoming widespread in view of the buoyancy of exports. The upward trend of secondary market yields persisted on into early December when they eased back slightly so that yields on three-year Treasuries ended the year at 4.82% and those on three-year corporate bonds (AA-) at 5.58%, down respectively 29 basis points and 10 basis points from their level at the end of the previous year.

<Table Ⅱ-16>

Trends of Issuance[1] of Major Bonds

(trillion won)

	2001	2002	2003
Government bond	11.2	15.9	37.5
(Treasury bond)	8.4	4.7	25.9
Corporate bond[2]	8.2	-8.1	-4.0
Financial debenture[3]	4.7	27.4	8.5
ABS[4]	19.2	6.7	-1.9
Special bond[5]	30.5	8.4	-27.2
MSB	12.7	5.2	21.2
Total	86.5	55.5	34.1

Notes: 1) Based on the value of net issuance.
2) Excludes those issued by companies under court receivership in process of mediation or workout.
3) Industrial Finance bonds, SMEs' Finance bonds, Kookmin Bank's bonds, etc.
4) Secondary CBO, CLO, ABS of receivables loans, etc.
5) DIF bonds, NPLMF bonds, Credit card bonds, Installment bonds, Leasing bonds, etc.

Looking at the interplay of the supply and demand for major types of bonds during the year under review, net issuance volumes contracted from the previous year in a movement centering on short-term issuance. At the same time, financial institutions, with investment trusts to the fore, reduced the scale of their purchases.

In the case of long-term bonds, those of the Deposit Insurance Fund (DIF) and the Non-performing Loans Management Fund (NPLMF) saw a large-scale net redemption, as did those of corporate bonds and asset-backed securities (ABS). In contrast, there were large increases in the issue of Treasury bonds including those for foreign exchange market stability[7], because of the need to finance the two supplementary budgets, and of Monetary Stabilization Bonds consequently the supply of long-term bonds showed an overall increase from the previous year. In contrast, the volume of supply of short-term bonds shrank considerably with a decrease in the scale of net issuance of bank debentures and a sharp contraction in the issue of credit card company paper in response to fears over the precarious state of credit card companies' management.

<Table Ⅱ-17>

Status of the Changes of Holding Bonds by Institutions

(trillion won)

	Banks	(Branches of foreign banks)	Banks' trust	Investment trust	Pension funds	Insurance companies
2002	12.2	6.8	-4.0	-4.4	18.3	16.4
2003	6.4	5.4	-7.1	-13.4	26.1	11.2

Source: Korea Securities Depository

In terms of the demand for bonds, pension funds and insurance companies maintained their buying position and banks, led by the branches of foreign banks, built up the scale of their bond holdings. Meanwhile, investment trust companies and banks' trust accounts expanded the scale of their disposal of bonds holdings in view of their reduced deposit-taking.

(Short-Term Market Interest Rates)

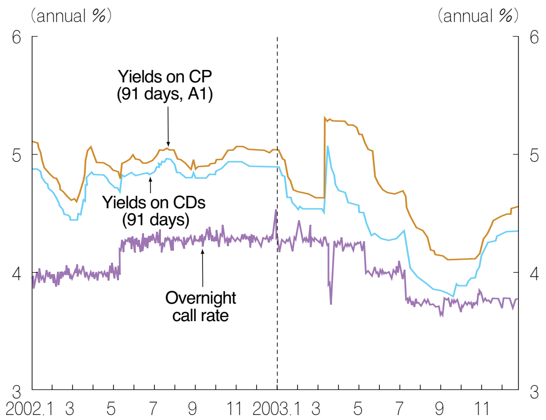
Short-term market interest rates, taking their cue from the adjustment of the call rate, exhibited smooth downward trend during the year to September, apart from a sudden spike in March. From the beginning of the fourth quarter, however, they shifted to an upward trend.

They showed a comparatively sharp fall during January, influenced by the decline of long-term market rates and the expanded demand for short-term financial assets following increased deposit-taking by investment trust companies. Thereafter they exhibited

7) From the November 10, 2003, the domestic issue of Foreign Exchange Stabilization Fund bonds was replaced by the issue of Treasury bonds for foreign exchange market stability.

<Figure Ⅱ-21>

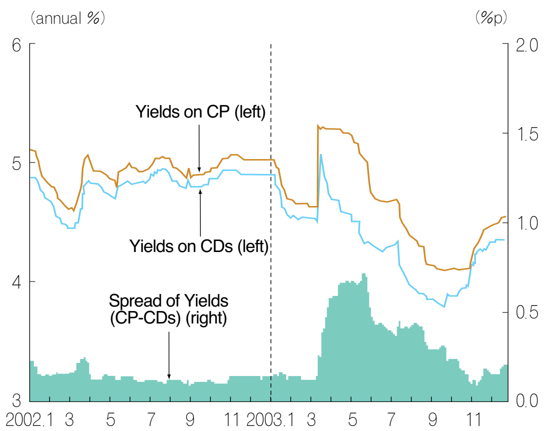
Trends of Major Short-term Market Interest Rates



Sources: The Bank of Korea, Korea Securities Computer Corp.

<Figure Ⅱ-22>

Yields on CDs & CP and Spread of CP over CDs



Source: Korea Securities Computer Corp.

stable movements until the early part of March with secondary market yields on CDs (91 days) around the 4.5% level and those on A1-rated commercial paper (CP, 91 days) at 4.6%.

There was a sharp rebound of short-term interest rates in mid-March when the revelation of the accounting scandal at SK Global coincided with large-scale withdrawals from investment trust companies' money market funds (MMFs). There was a particularly large-scale increase in CP yields, which involve comparatively high risk, with financial institutions becoming increasingly sensitive to the degree of risk. After the spike, short-term market rates quickly regained their stability thanks to the measures taken to counter the financial market instability. They then moved steadily downward until late September, reflecting the Bank of Korea's reduction of its policy rate target on two occasions.

From October onwards, short-term market interest rates shifted to an upward trend, tracking the similar movements of long-term market rates, as the appetite for short-term financial assets dried up following the contraction of investment trust companies' MMFs deposits. In particular, yields on CDs showed a comparatively steep rise as banks increased their sales of CDs in order to bring up their liquidity ratios at year-end. As of the end of 2003, yields on 91-day CDs stood at 4.36% and those on the same maturity CP (A1) at 4.55%, respectively 54 basis points and 48 basis points lower than at the end of the preceding year.

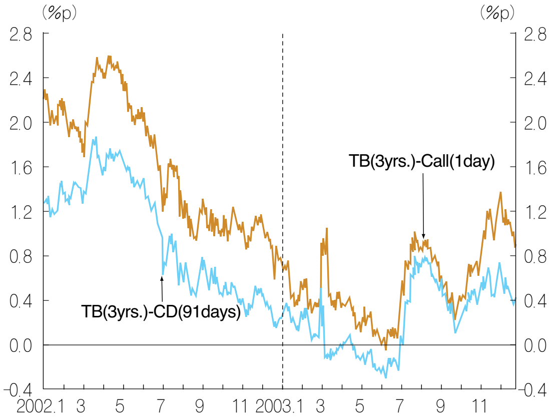
The differential between CD and CP yields widened greatly from early March, but gradually narrowed from mid-May, before opening up again somewhat around the year-end.

Overnight call rates were generally formed at the level of the Bank of Korea's call rate target. After running at a level of around 4.25% from May 2002, they eased to the 4% level in line with the Bank of Korea's downward adjustment of its call rate target by 25 basis points on May 13, 2003, and subsequently formed at around the 3.75% level after a second 25 basis-point cut in the policy rate on July 10.

(Spread between Long- and Short-Term Interest Rates)

<Figure Ⅱ-23>

Trends of Spread between Short- and Long-term Interest Rates



Sources: The Bank of Korea, Korea Securities Computer Corp.

The spread between long- and short-term interest rates continued to narrow and, during the second quarter, there was an inversion of the yield curve. From the beginning of the latter half of the year, however, the term structure of interest rates returned to normal with the rise in long-term interest rates.

The spread between long- and short-term interest rates maintained in the early part of the year its narrowing trend of the previous year as long-term market interest rates continued their downward trends. Notably from mid-March, secondary market yields on Treasuries (3 years) began to form below those on CDs (91 days) in a period when short-term market interest rates were rising steeply because of the financial market unrest generated by the SK Global accounting scandal and so forth. This phenomenon of an inverted yield curve persisted on through the second quarter so that, by mid-June, yields on three-year Treasury bond were running for a while below the overnight call rate.

After the late June, long-term market interest rates shifted to an upward trend whereas short-term market rates maintained their downward trend, influenced by the reduction of the call rate target. The phenomenon of an inverted yield curve began to disappear from early

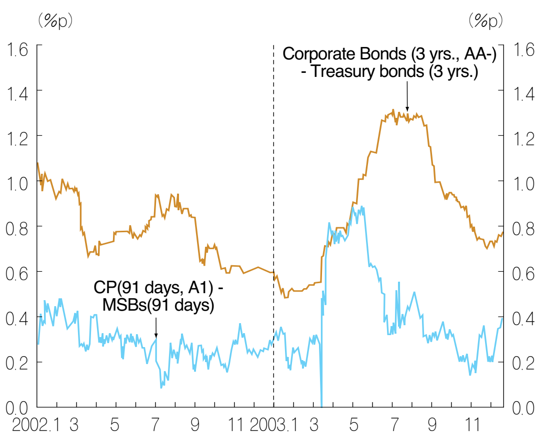
July onwards and, by early August, the differential was rapidly widening. Subsequently, the spread between long- and short-term interest rates, after narrowing a little in response to the movements of long-term market rates, opened up again somewhat. From mid-October, the spread between Treasuries (3 years) and CDs (91 days) was of the order of 0.5 percentage point. As of the end of December 2003, the spread between the two interest rates stood at 0.46 percentage point (previous year-end 0.21 percentage point).

(Risk Premium)

The risk premium, which is the difference between assets deemed to carry a high risk and those judged as having little or no risk, widened greatly during the first half of the year in line with the accelerated preference for asset quality, but from the beginning of the second half of the year it showed a narrowing pattern.

<Figure Ⅱ-24>

Trends of Risk Premiums



Source: Korea Securities Computer Corp.

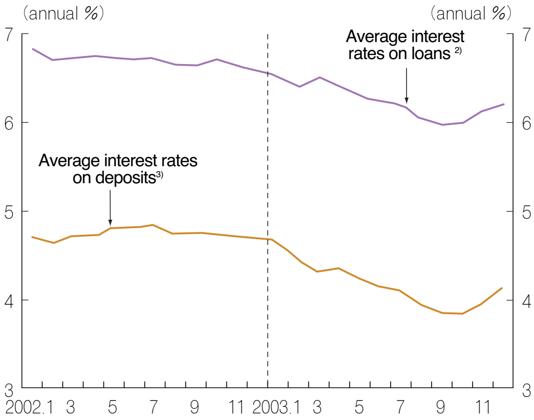
Up until mid-March, a relatively stable pattern of movements was exhibited by the risk premium on corporate bonds (3 years, AA-) over Treasury bonds (3 years), which remained at around 0.5 percentage point as yields on the two types of asset both declined at a similar pace in view of the prevailing uncertainty of economic prospects. After that time, however, a heightened preference was observed for asset quality amid worries over the fragility of credit card companies and the SK Global accounting scandal. While yields on Treasuries continued to fall by a large margin, the scale of the decline in corporate bond yields was limited. This led to a sharp widening of the risk premium between them, so that it reached 1.2 percentage points in mid-June. It persisted at this high level until the early part of August but then settled down to reach a level of 0.7 percentage point at year-end as the credit risk of large enterprises declined in response to the buoyancy of exports and the improved prospects for economic recovery.

The short-term asset risk premium for CP (91 days, A1) over Monetary Stabilization Bonds (91 days) widened greatly during March in consequence of the sharp rise in CP yields. From early June, however, it narrowed to a considerable degree. Subsequently, although showing mild fluctuations, it generally moved within a range of 0.2~0.4 percentage point.

(Interest Rates on Financial Institutions' Deposits and Loans)

<Figure Ⅱ-25>

Trends of Interest Rates[1] on Bank Deposits and Loans



Notes: 1) Based on newly extended loans and deposits.
2) Excludes overdrafts and minus account loans.
3) Excludes demand deposits and savings deposits with instant access.

Interest rates on the deposits and loans of financial institutions maintained a downward trend during the first three quarters, influenced by the subdued demand for funds and the Bank of Korea's reduction in its policy rate along with the consequent fall in short-term market interest rates. They shifted to a mild upward trend, however, from the beginning of the fourth quarter.

The average deposit rate on the Bank deposits (newly-extended deposit basis) maintained a continuing decline, repeatedly touching new historic lows. The factors putting downward pressure on deposit rates included the difficulties that banks experienced in the operation of their funds from early in the year because of the policy authorities' guidelines on reining in household credits and the subdued demand for corporate funds in view of the economic downturn. This was exacerbated by the Korea Deposit Insurance Corporation's imposition of a special insurance premium on deposits.

In April deposit interest rates rose briefly, centering on those on short-term marketable financial products such as CDs. This came in response to the sharp rise in market interest rates following the financial market turmoil of the previous month. Subsequently, however, as banks continued to experience difficulties in their use of funds while short-term market interest rates declined under the influence of the two-step cut in the policy rate, deposit interest rates repeatedly tested new lows each month, dropping to 3.81% in October.

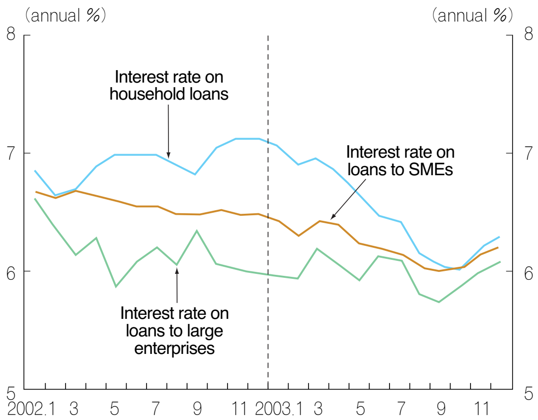
Rates paid by banks on deposit products eventually shifted to an upward trend from November onwards, as banks raised their rates on long-term deposits in line with the need to achieve their desired liquidity ratios at year-end, while interest rates on marketable financial products were also pushed up by rising market interest rates. In consequence, the average deposit rate moved up to 4.12% in December, but this level was still 0.57 percentage point lower than that a year earlier.

Banks' average lending interest rate (newly-extended lending basis) showed a similar downward trend, repeatedly touching new lows from the beginning of the year, in line with the backdrop of subdued corporate demand for funds and the downward trend of market interest rates. There was a short-lived hike in March amid increased demand for borrowings following the rise in market interest rates and the contraction of the bond market, but lending rates swiftly returned to a downward trend. Once again from May onwards they repeatedly touched new lows, and the average lending rate eased to 5.97% in September.

From early October onwards, though, the average lending rate shifted to an upward trend centering on floating-rate products linked to market interest rates such as loans secured against houses, and in December registered 6.20%, which was 0.38 percentage point lower than its level a year before.

<Figure Ⅱ-26>

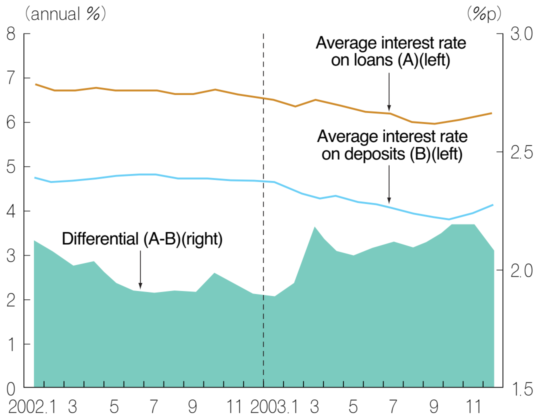
Trends of Average Interest Rates[1] on Bank Loans by Borrower



Note: 1) Based on newly extended loans.

<Figure Ⅱ-27>

Trends of Spread Between Interest Rates[1] on Deposits and Loans of Banks



Note: 1) Based on newly extended loans and deposits.

Looking at bank loans rates by type of borrower, those on households loans, linked mainly with market interest rates, fell steeply compared to those on corporate loans. Among types of loans to businesses, those to small and medium enterprises (SMEs) witnessed a comparatively large-scale decline amid banks' efforts to expand lending to SMEs. Loans rates on lending to large businesses showed a pattern of iterative fluctuations around the 6% mark, influenced by the high interest rates imposed on a number of enterprises with less than distinguished credit standing.

The spread between banks' interest rates on deposits and loans (newly-handled amount basis) widened from 1.89 percentage points as of the last month of the previous year to stand at 2.08 percentage points in December 2003. The widened spread reflected the rather greater fall in deposit rates than in loan rates.

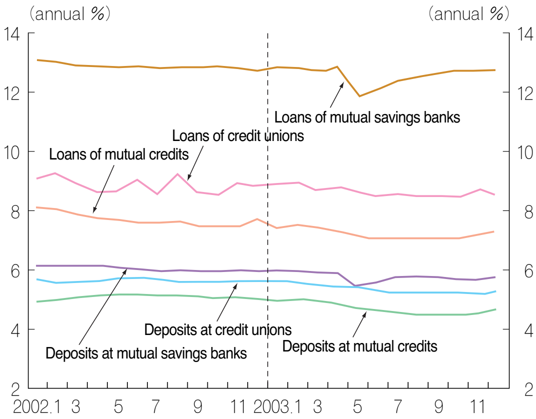
The deposit and lending rates of non-bank financial institutions exhibited downward trends more or less similar to those of banks during the year.

The average deposit rate paid by non-bank financial institutions (newly-extended deposits basis), while differing across the various types of institutions, evidenced an underlying downward trend during the first ten months of the year in line with the generally subdued character of the demand for funds and the decline of market interest rates, although it showed a mild upward trend from November onwards. The deposit rates paid by mutual savings banks, which handle various distinctive products paying relatively high interest rates; maintained the highest level among non-bank financial institutions, and the scale of their decline remained minor.

The average loan interest rate of non-bank financial

<Figure Ⅱ-28>

Trends of Interest Rates[1] on Loans and Deposits of Non-Bank Financial Institutions



Note: 1) Based on newly extended loans and deposits.

<Table Ⅱ-18>

Trends of the Major Indicators of Stock Market

	2001	2002	2003
KOSPI[1]	693.7 (+37.5)	627.6 (-9.5)	810.7 (+29.2)
Volume (million shares)[2]	473	857	542
Value (billion won)[2]	1,997	3,042	2,217
KOSDAQ Index[1]	72.2 (+37.3)	44.4 (-38.6)	44.9 (+1.1)
Volume (million shares)[2]	384	320	408
Value (billion won)[2]	1,728	1,205	1,079

Notes: 1) Year-end basis. Figures in parentheses refer to percentage changes compared with the previous year-end.
2) Daily average.
Source: Korea Securities Computer Corp.

institutions (newly-extended loan basis) also showed a generally downward trend until October, shifting to an upward trend thereafter. The lending rates of mutual savings banks showed a comparatively rapid upward pace, propelled by their expansion, from early in the second half of the year, of lending to SMEs with low credit ratings.

(2) Stock Prices

Korean stock prices showed a pattern of movements during the course of the year under review that was closely synchronized with those of stock markets in the US and other major countries. They started off the year on a downward trend, but upon the outbreak of the war against Iraq shifted to an upswing, thereafter maintaining a comparatively steep rising trend up until the end of the year.

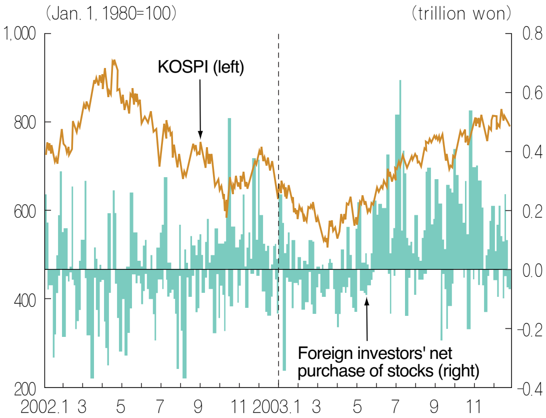
(Korea Stock Price Index)

The Korea Stock Price Index (KOSPI) started off the year on a downward trend that reflected the heightening of concerns over the delay in economic recovery as consumer and business confidence shrank amid mounting uncertainties concerning the North Korean nuclear issue and the looming war against Iraq. What is more, major domestic companies had shown disappointing business performance the previous year and foreign investors maintained a net selling position. The stock market adhered to its downward trend until mid-March, with KOSPI reaching its bottom for the year of 515.24 on March 17, following the emergence of widespread accounting malpractice at SK Global and the threat of default on credit card companies’ bonds.

Around the time of the outbreak (March 20) of the US-led war against Iraq, however, as much of the uncertainty over the war was dispelled and the anticipations of an early ending of hostilities mounted, KOSPI began to rise, keeping pace with US share prices. Notably, they maintained a steep upward trend once financial market unease had been soothed by the announcement (April 3) of measures to appease the credit card companies' woes, and rising expectations of a peaceful settlement of the North Korean nuclear question.

<Figure Ⅱ-29>

Trends of KOSPI and Foreign Investors' Net Purchase of Stocks



Sources: The Financial Supervisory Service, Korea Securities Computer Corp.

In the last week of April, amid the spreading of the SARS epidemic and its negative influence, share prices briefly showed a steep decline as the North Korean nuclear issue was complicated by the North's declaration (April 25) of its holdings of nuclear weapons. However, KOSPI once again staged a large-scale rally with the assuaging at an early date of much of the concern over SARS and the North Korean nuclear issue, which coincided with the sustained upward trend of US share prices and the progressive spread of a mood of anticipation concerning an economic recovery in the latter part of the year. Notably, foreign investors shifted to a net buying position from around the end of April and greatly stepped up the scale of their net purchases thereafter, so that KOSPI's upward pace accelerated, setting a trend that was maintained until mid-September.

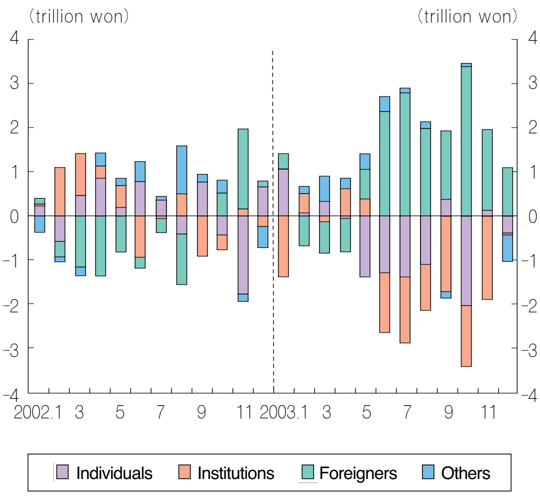
Share prices briefly retreated to a downward trend in mid-September. This was attributable to the worsening for a while of the economic environment at home and abroad as Typhoon Maemi caused widespread damage, oil prices rose in reaction to OPEC's decision (September 24) to reduce production, and the Korean won strengthened against the US dollar just after the G-7 meeting (September 20). Worse still, US stock prices entered on a correction phase and foreign investors, who had driven the upswing in Korean share prices for several months, moderated their net buying position.

In the early part of October, with the recovering movements of the US economy becoming more evident, US stock prices shifted back to an upward trend and major Korean companies reported greatly improved business performance during the third quarter. What is more, foreign investors, after briefly scaling back their purchases during September, greatly expanded their net buying position. As a result of these developments, KOSPI shifted back to a steep upward path, achieving a month-on-month rise of 12.16%, its largest since November 2001 (19.72%). In the last two months of the year, while showing temporary fluctuations, share prices maintained a smooth underlying upward trend that brought KOSPI to a level of 810.71 at the year-end, which represented a 29.2% rise over the previous year-end.

This large-scale rise in share prices led to a 37.4% (96.7 trillion won) expansion of market capitalization, so that the total value of shares listed on the Korean Stock Exchange registered 355.4 trillion won at the year-end.

<Figure Ⅱ-30>

Trends of Net Purchase of Stocks on the KOSPI Market by Type of Investor



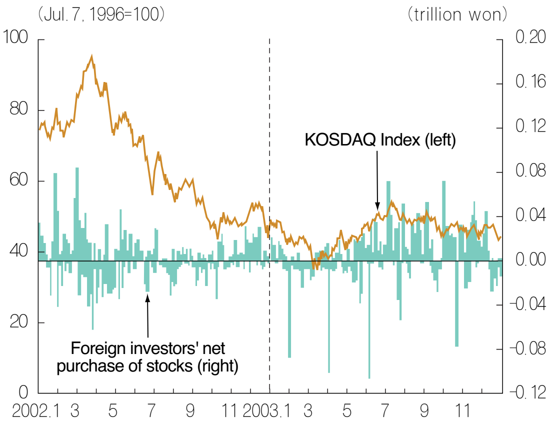
Source: Korea Securities Computer Corp.

Looking at transaction trends by category of investor during the year 2003, foreign investors who had shown a net selling position (2.9 trillion won) during the year 2002 for the first time since the opening of the stock market (1992) were the biggest buyers, registering net purchases of 13.8 trillion won for the year as a whole. In contrast, domestic institutional and individual investors recorded net sales of 9.0 trillion won and 5.9 trillion won respectively.

If we examine the trends of foreign investors' share trading by quarter, we see that a relatively large-scale net selling position was maintained by them from mid-January up until late April in consequence of the obscurity of the conditions shrouding stock markets at home and abroad. From around the end of April, however, there was a shift to a net buying trend and the scale of purchases progressively increased so that, for the six-month period from June to November, monthly average purchases were running at 2.5 trillion won, leading the rise in share prices. During December, although share prices showed a short-lived correction phase, foreign investors still registered net sales of more than one trillion won.

<Figure Ⅱ-31>

Trends of KOSDAQ Index and Foreign Investors' Net Purchase of Stocks



Source: Korea Securities Computer Corp.

(KOSDAQ Index)

The Korea Securities Dealers Association Automated Quotation (KOSDAQ) Index[8] displayed similar movements to those of KOSPI during the first half of the year. From early in the year it maintained a downward trend to reach 34.64 on March 17, its historically lowest level. But then it shifted to a sharp upward trend, keeping pace with that of KOSPI, which brought it to stand at 53.50, its highest level for the year, on July 9.

In mid-July, however, it shifted to a downward trend as it emerged that major Internet-related businesses' second-quarter business performance fell far short of expectations. Notably under the influence of suspicions of illicit internal transactions and the window dressing of accounts on the part of certain Internet-related businesses, the KOSDAQ Index, contrary to KOSPI's upward path, showed an uninterrupted downward trend centering on IT companies until the end of the year. As

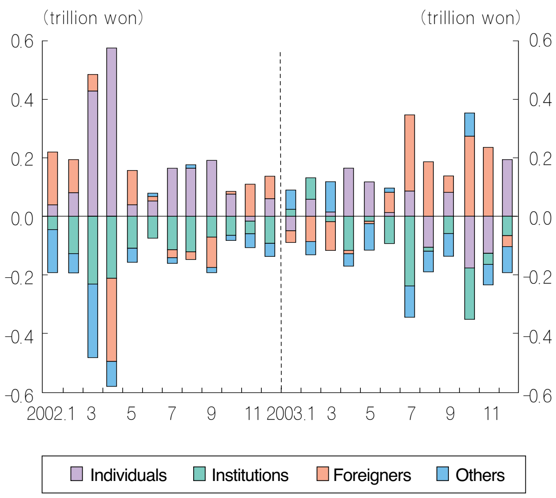
8) Figures for the KOSDAQ Index shown in this report take the base value of 100 with the base date of July 1, 1996, although, on and from January 26, 2004, the KOSDAQ Index has been rebased from 100 to 1000.

a consequence, the KOSDAQ Index finished the year standing at 44.87, a rise of just 1.1% over the previous year-end. The total market capitalization of the KOSDAQ market, meanwhile, did not budge from the previous year's 37.4 trillion won.

Looking at the trends of transactions by type of investor during the year under review, foreign investors and domestic individual investors had net purchasing positions of 0.8 trillion won and 0.3 trillion won respectively whereas domestic institutional investors, including investment trust companies and securities companies, had a net selling position to the tune of 0.7 trillion won. From early in the year foreign investors maintained a net selling position, but after shifting to a net buying position in June, they chalked up net purchases of more than one trillion won by the end of the year, helping to limit the scale of the decline in the index.

<Figure Ⅱ-32>

Trends of Net Purchase of Stock on the KOSDAQ Market by Type of Investor



Source: Korea Securities Computer Corp.

B. Quantitative Indicators

(1) Money

During 2003, the growth rate of the monetary stock decelerated greatly owing to financial institutions' reduction of the supply of credit to the private sector, notably households, compared to the previous year, which more than offset the government's expansion of fiscal spending.

<Table Ⅱ-19>

Growth Rate[1] of Major Monetary Aggregates

(%)

	2001 Dec.	2002 Dec.	2003 Mar.	2003 Jun.	2003 Sep.	2003 Dec.
M3	11.3 (9.6)	13.3 (12.9)	11.7	9.1	7.5	5.0 (8.8)
M2	8.3 (6.9)	14.1 (11.5)	11.9	7.9	5.8	3.0 (7.9)
M1	25.0 (18.0)	15.2 (22.5)	7.8	5.9	6.8	5.4 (6.9)
RB	14.0 (11.5)	9.7 (14.3)	6.0	8.6	6.8	6.6 (6.5)

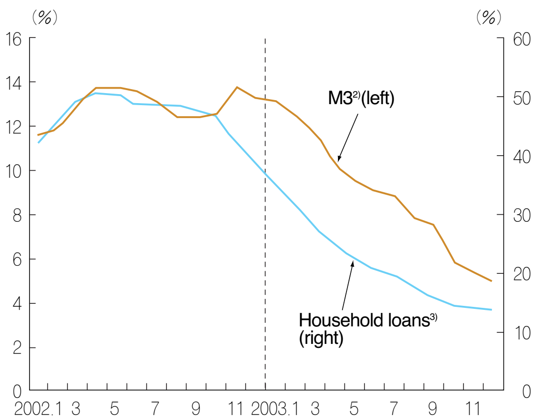
Notes: 1) Based on monthly average, compared with the same period of the previous year.
Figures in parentheses refer to yearly average basis.

(Monetary Aggregates)

The annual growth rate of M3 (average balance basis), the broad money aggregates encompassing overall liquidity, declined from the preceding year's 12.9% to 8.8%.

<Figure Ⅱ-33>

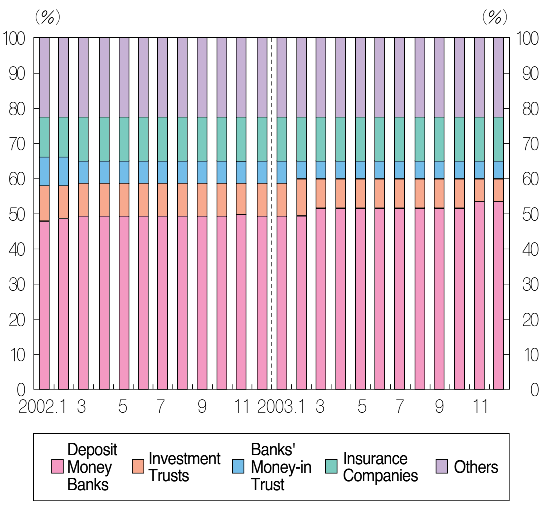
Trends of the Growth Rate[1] of M3 and Household Loans by Banks



Notes: 1) Compared with the same period of the previous year.
2) Monthly average basis.
3) Period-end basis.

<Figure Ⅱ-34>

Shares of M3 by Financial Institution Type



The growth rate of M3 showed a downward trend from early in the year owing to the shrinkage of the supply of the credit to the private sector by banks. This contraction was largely attributable to the government's guidelines on reining in household loans along with a base period effect from their sharp rise a year earlier, which more than offset the relative buoyancy of corporate lending as financial institutions endeavored to step up their lending to SMEs. Strikingly, despite the government bringing forward its disbursement of the budget to stimulate the economy, the downward trend in the growth rate of M3 accelerated from early in the second quarter as the financial intermediation function contracted centering on non-bank institutions, for example, large-scale withdrawals from investment trusts' MMFs.

During the latter half of the year, the growth rate of M3 sustained its downward trend, dropping to the level of 5% in December. This occurred despite the further expansion of fiscal spending brought about by the government's complication of two supplementary budgets on two occasions, and was ascribable to the slowdown in household loans and companies' reduced demand for funds as a result of the delay in economic recovery.

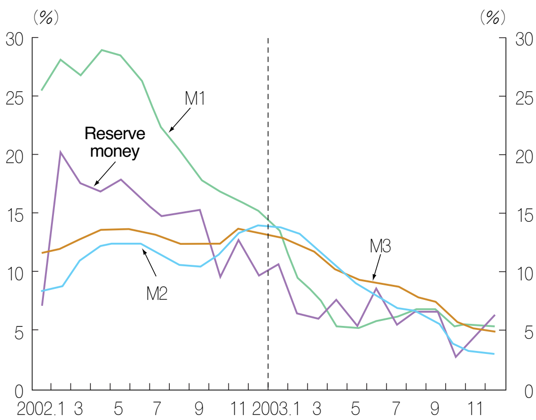
Looking at the composition of M3 in terms of the deposits of the various categories of financial institutions, the share of bank accounts rose from the previous year's 50% to 52.5% as of year-end 2003 thanks to their absorption from March onwards of funds that had previously migrated to investment trust companies. In contrast, the weight of investment trust companies in M3 slipped from 9.8% to 7.3% as a result of the contraction of their MMFs and the share of banks' trust accounts also saw a reduction, declining from 5.5% to 4.1% in a move centering on specific money trusts.

For its part, M2 (average balance basis) also maintained a downward trend from the beginning of the year and saw its growth rate fall sharply from 11.5% the year before to stand at 7.9% during 2003. Most notably, from early in the fourth quarter, its rate of growth slid to the 3% level.

The growth rate of M1 (average balance basis), narrow money, fell back dramatically from 22.5% the previous year to stand at 6.9%.

<Figure Ⅱ-35>

Growth Rates[1] of Major Monetary Aggregates



Notes: 1) Based on monthly average.
Compared with the same month of the previous year.

Viewed by period, M1 growth tumbled by almost 10 percentage points within a four-month period from 15.2% in the December of the preceding year to 5.3% in April 2003. This was attributable to the subdued demand for transaction balances during the year 2003 owing to lackluster business activity, base-period effects resulting from the sharp increase in demand for short-term funds a year earlier, and the large-scale redemption of investment trust companies' MMFs.

Later in the year, the downward trend of M1 growth began to show signs of faltering as instant-access account products turned buoyant and some of the funds from the redemption of MMFs flowed back in thanks to the early stabilization of financial market. Indeed, from June onwards, it shifted to a mild upward trend. Notably, during the third quarter, there was a concentration into short-term financial assets of market funds waiting for appropriate investment opportunities, and the growth rate of M1 rose to above 6.5% level.

With the onset of the fourth quarter, however, the growth rate of M1 resumed its downward trend amid large-scale withdrawals of funds from financial institutions associated with the redemption of Deposit Insurance Fund (DIF) and Non-performing Loans Management Fund (NPLMF) bonds. In particular, the growth rate of M1 fell to 5.4% in December because of the redemption of MMFs prompted by the liquidity crisis of credit card companies and seasonal factors including, for example, businesses' withdrawal of short-term deposits in banks to meet their year-end demand for funds.

The growth rate of reserve money (average balance basis), which had risen sharply by 14.3% the previous year, dropped back steeply, largely because of the subdued demand for transaction balances owing to lackluster business activity.

(Money Supply Structure)

Looking at the supply of money by sector during the year 2003 on the basis of M3, money supply through the private sector shrank greatly compared with the previous year whereas supply through the government sector expanded. The foreign sector, meanwhile, shifted from a channel of absorption to one of supply.

<Table Ⅱ-20>

M3 Supply[1] by Sector

(trillion won)

	2001	2002	2003
M3 changes	106.1	138.0	54.0
Government	12.0	2.5	11.2
Public sector	17.2	-7.0	-19.7
Private sector	74.7	149.1	60.0
(Loans & discounts)	45.6	115.4	76.6
(Securities)[2]	22.7	13.8	-18.1
(Loans in foreign currency)[3]	-4.5	17.5	2.9
Foreign sector	21.5	-10.4	31.8
Others	-19.4	3.9	-29.3

Notes: 1) Changes based on year-end balance.
2) Securities such as coporate bonds, CP, etc.
3) Advanced payment against foreign currency payment guarantees, foreign currency credits, etc.

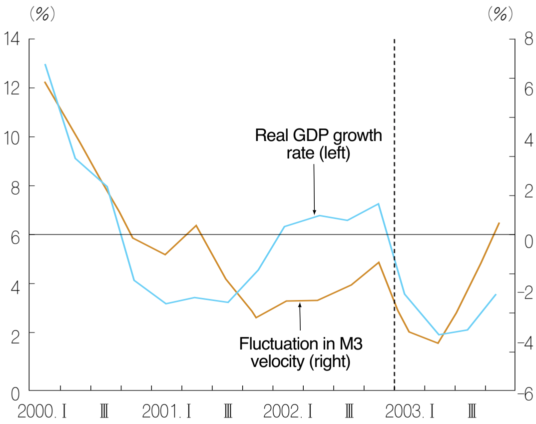
The overall supply of M3 through the private sector shrank greatly from 149.1 trillion won in 2002 to 60.0 trillion won in 2003. This decline was led by the slowdown of the growth of loans from 115.4 trillion won the previous year to 76.6 trillion won in a movement centering on household loans. Meanwhile, securities including corporate bonds and CP shifted from a supply of 13.8 trillion won to a net absorption of 18.1 trillion won.

The public sector expanded its scale of absorption from the preceding year's 7.0 trillion won to 19.7 trillion won in line with the large-scale redemption of DIF and NPLMF bonds. For its part, the government sector expanded the scale of its supply of money from 2.5 trillion won the previous year to 11.2 trillion won, owing to the increased fiscal spending resulting from its compilation on two occasions of supplementary budget as a pump-priming measure.

The foreign sector, meanwhile, shifted from a net absorption of 10.4 trillion won the previous year to a supply of 31.8 trillion won as a result of the greatly expanded current account surplus and large-scale inflows of foreign capital for portfolio investment.

<Figure Ⅱ-36>

M3 Velocity Fluctuations and Real GDP Growth Trends[1]



Notes: 1) Compared with the same period of the previous year.

(Monetary Velocity)

Despite the sharp fall in the growth of money supply, monetary velocity on an M3 basis decelerated only slightly during the year under review. Its movements reflected the maintenance of price stability amid a swift cooling of business activity.

<Reference Ⅱ-2>

Judgment Concerning the Decline in Money Supply Growth and Market Liquidity Conditions

From the early part of 2003, the growth rates of the major money supply aggregates such as M3 decelerated rapidly as the government's expansion of fiscal spending was more than counteracted by the generally subdued demand for corporate funds and the sharp decline in the rate of increase in household loans.

Growth Rates[1] of Major Monetary Aggregates

(%)

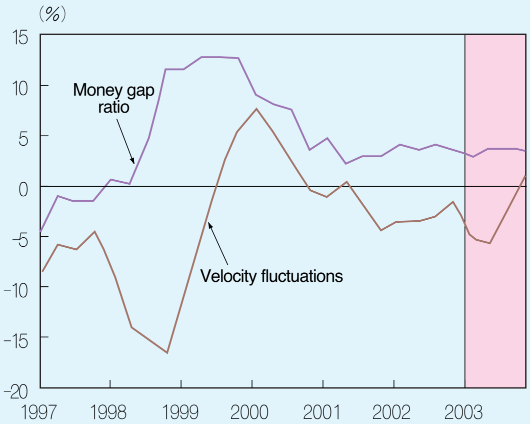
	2001	2002	2003				
			year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
M3	9.6	12.9	8.8	12.4	9.6	8.1	5.4
M2	6.9	11.5	7.9	13.1	9.1	6.5	3.3
M1	18.0	22.5	6.9	10.3	5.5	6.6	5.5

Notes: 1) Compared with the same period of the previous year.
Average balance basis.

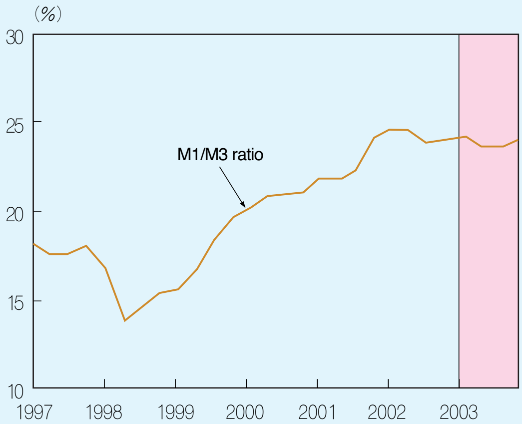
Nevertheless market liquidity conditions are judged to have been generally smooth in view of the fact that the M3 money gap (the gap between current real M3 stock and that consistent with long-run equilibrium) estimated through the long-term money demand function remained positive and monetary velocity continued the slackening trend during the year.

This is because the decline in monetary growth rates was ascribable not so much to money supply factors but to the subdued money demand of households and companies resulting from the downturn in business activity. In fact, the Bank of Korea continued its accommodating monetary stance during the year 2003, lowering, for example, its call rate target on two occasions by a total of 50 basis pionts. At the same time, financial institutions, with holding ample overall funds, experienced difficulties in operating them. In addition, from the aspect of the composition of monetary aggregates, the ratio of M1, which has a high degree of moneyness, to M3 remained at an elevated level during the year. This is served as a factor making for ample liquidity conditions by offsetting to a considerable extent the influence of the decline in the growth rate of M3.

Trends of Money Gap and Velocity Fluctuations of M3



Trends of M1/M3 Ratio



<Table Ⅱ-21>

Trends in Deposits[1] of Financial Institutions

(Changes during the period, trillion won)

	2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Deposit money banks[1]	54.6	64.9	39.9	8.4	14.6	-1.5	18.4
Real demand	6.2	8.6	1.4	-5.4	2.7	-0.3	4.4
Time & savings	44.8	43.1	29.3	11.2	5.5	-2.7	15.3
(Time)	9.9	31.7	14.7	2.9	5.9	-0.3	6.2
<over 1 year>	3.6	46.5	30.9	8.1	10.0	5.1	7.7
(Instant access)	26.1	10.1	15.7	7.9	-0.6	-2.8	11.2
<MMDA>	8.5	-0.1	14.6	9.8	1.7	-3.5	6.5
CDs+RPs	10.5	12.9	9.3	2.6	7.1	1.6	-1.9
Cover bills	-6.9	0.3	-0.2	0.1	-0.6	-0.1	0.5
Banks' trust account	2.7	-8.0	-15.7	-2.2	-7.0	-3.2	-3.2
Specific money trust	5.1	10.9	-6.7	0.3	-4.4	-1.4	-1.2
Investment trust companies	14.0	16.3	-28.6	-8.1	-9.1	6.3	-17.8
Short-term bond type	8.8	10.6	-3.5	2.7	-1.9	-1.4	-3.0
Long-term bond type	-1.1	-14.5	-3.7	-0.3	1.9	-1.5	-3.8
MMFs	8.5	14.0	-7.2	-9.6	-2.7	11.3	-6.1
Stock type	2.6	2.7	-1.0	1.4	-0.4	-1.0	-0.9
Mixed type	-4.8	3.6	-13.1	-2.2	-6.0	-1.1	-3.9
Merchant banks	-2.1	0.0	-0.7	2.7	-1.0	-0.8	-1.5
Bills issued	-1.9	0.0	-1.1	2.2	-0.7	-0.9	-1.7
CMA	-0.2	0.0	0.4	0.4	-0.3	0.1	0.2
Mutual savings banks	4.7	3.0	4.5	0.9	0.6	0.9	2.0

Note: 1) Includes due from governments and excludes deposits of the Korea Development Bank.
Source: Representative associations.

(2) Deposit at Financial Institutions

In the course of the year under review the growth rate of deposits at deposit money banks (bank account only basis) decelerated and the level of deposits at investment trust companies and in banks' trust accounts contracted absolutely.

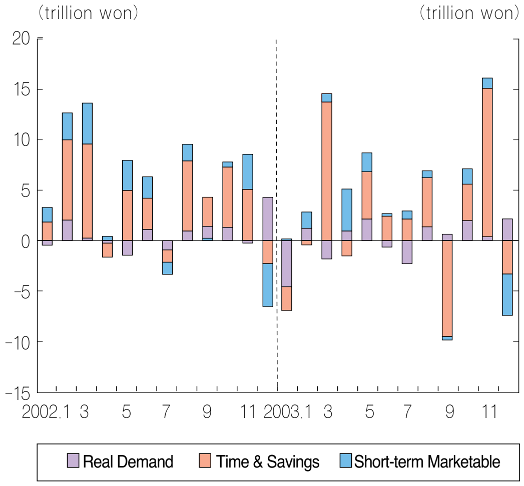
(Deposit Money Banks)

Deposit money banks received a constant influx of market funds owing to the continued preference for asset quality and showed relatively convincing growth, but their total increase during the year of 39.9 trillion won represented a reduction compared to that of the previous year's 64.9 trillion won.

Broken down by type of deposit product, demand deposits marked a small increase of 1.4 trillion won over the year. Instant access accounts enjoyed buoyant growth centering on money market deposit accounts (MMDA), attracting funds away from investment trust companies and the banks' own trust accounts. Time deposits experienced a sharp fall in their rate of increase, influenced by the withdrawal of funds by the Korea Deposit Insurance Corporation (KDIC) and the Korea Asset Management Corporation (KAMCO) for the redemption of respectively DIF and NPLMF bonds. In consequence, there was a sharp decline in the growth of time and savings deposits as a whole, and their overall increase fell from that of the previous year's 43.1 trillion won to 29.3 trillion won during the year under review. Meanwhile short-term marketable products such as CDs and RPs maintained a relatively sharp pace of expansion from the previous year to register an increase of 9.3 trillion won, profiting from the contraction in the issue of CP, with which they compete.

<Figure Ⅱ-37>

Deposits[1] at Deposit Money Banks by Product



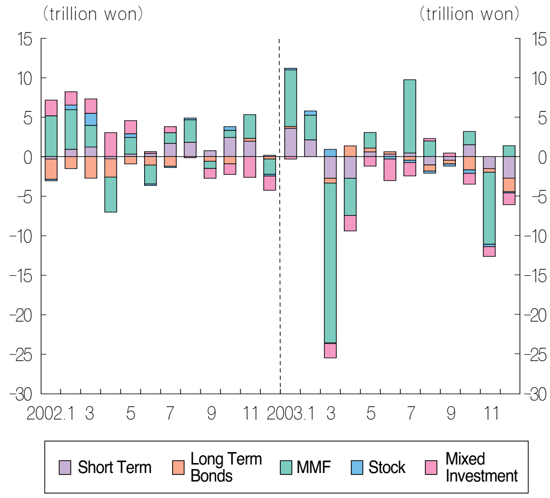
Note: 1) Based on changes during the month.

Viewed by period, during January and February, demand deposits and instant access accounts displayed a subdued pattern owing to seasonal factors, including the strong demand for money in circulation around the Lunar New Year holiday period. From early in March, however, there were large portfolio shifts out of investment trust companies and banks' trust accounts into MMDAs, leading to brisk deposit-taking by banks. Subsequently, too, the preference for asset quality was maintained with banks, sustaining a convincing rate of deposit growth centering on time deposits and CDs until the year-end. In September, though, the KDIC and the KAMCO withdrew funds on a large-scale for the redemption of their maturing bond issues, bringing about a very large reduction in deposits centering on time deposits with a maturity of less than six months. From early December, there was again a considerable reduction, this time prompted by seasonal factors, particularly firms' demand for funds over the year-end.

(Investment Trust Companies)

<Figure Ⅱ-38>

Deposits[1] at Investment Trust Companies by Product



Note: 1) Based on changes during the month.
Source: Investment Trust Association.

Deposits at investment trust companies, which had seen a 16.3 trillion won increase the previous year, shifted to a 28.6 trillion won decrease during the year under review. Their MMFs contracted particularly sharply under the influence of scrambles on two occasions, in March and November, to withdraw funds from them. At the same time, their bond-type and composite-type beneficiary certificates also presented a lackluster pattern.

Viewing their deposit-taking by period, a buoyant tone was evident in January and February with the inflow of short-term funds to MMFs in particular. From mid-March, however, concerns over the SK Global accounting scandal and the threat of default on credit card companies' bonds led to a large-scale migration of funds out of MMFs, and consequently to a sharp fall in deposits. During May some of the funds pulled out of MMFs flowed back into them again and there was a slight increase in deposits, but in June they shrank again as composite-type beneficiary certificates continued sluggish because of anticipations of an upturn in long-term market interest rates.

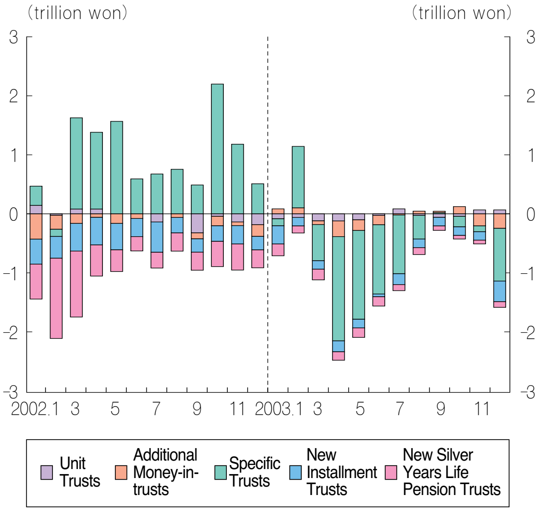
Over July and August, while the phenomenon of the short-termism of market funds intensified, the reduction by banks of interest rates on their MMDAs led to a big increase in deposits for the rival MMFs offered by investment trust companies. However, investment trust companies' deposits subsequently shifted back to a contraction amid the continued sluggishness of sales of bond-type and composite-type beneficiary certificates. From early November onwards, this declining trend gathered pace following renewed mass redemption of MMFs, this time as a result of the LG Card debacle.

(Banks' Trust Accounts)

Banks' trust accounts saw deposits shrink by 15.7 trillion won during 2003, representing an acceleration of their declining trend compared to the previous year's reduction of 8 trillion won. This was mainly attributable to a large-scale contraction of specific money trusts, which had shown strong growth during the previous year, due to an increase in the risk on CP, the principal vehicle for the operation of this type of trust, prompted by worries over the SK Global accounting scandal and the possibility of defaults on credit card companies' bonds. This situation was worsened by the continued exit at maturity of funds from tax-exempt household trusts and new installment trusts, new offers of which ceased.

<Figure Ⅱ-39>

Deposits[1] at Banks' Trust Accounts by Product

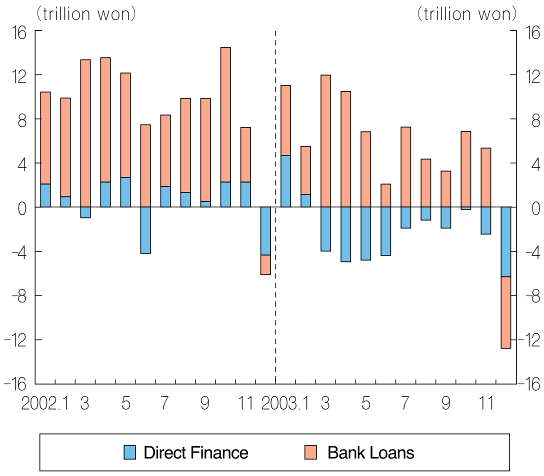


Note: 1) Based on changes during the month.

(3) Corporate Financing

<Figure Ⅱ-40>

Corporate Finance[1)]



Note: 1) Based on changes during the month.
Sources: The Bank of Korea, The Financial Supervisory Service, Representative associations.

Corporate financing conditions presented a comparatively smooth picture over the course of the year 2003: cash flow improved particularly for large companies thanks to the influence of buoyant exports while there was a contraction of demand for investment funds owing to the delay of domestic economic recovery. There was, nevertheless, a strengthening of credit differentiation with some deterioration of funding conditions in the case of SMEs with sub-optimal credit standing.

Looking at the channels of external corporate fund-raising, the bank lending channel maintained a robustly increasing trend that centered on SMEs, but the direct financial markets channel was sluggish owing to the lackluster demand for long-term investment funds and the heightened credit risk.

(A) Bank Loans

<Table Ⅱ-22>

Bank Lending[1)] by Sector

(trillion won)

	2001	2002	2003 year	2003 Ⅰ	2003 Ⅱ	2003 Ⅲ	2003 Ⅳ
Large Enterprises	-12.0	0.1	-2.9	1.8	-1.0	0.1	-3.8
SMEs	11.9	37.1	35.0	14.7	11.9	7.3	1.1
Households	45.0	61.6	30.6	4.8	9.1	8.7	7.9
Others[2)]	-7.2	-0.2	-0.5	1.1	-0.9	-1.2	0.4
Total	37.8	98.6	62.2	22.4	19.2	15.0	5.7

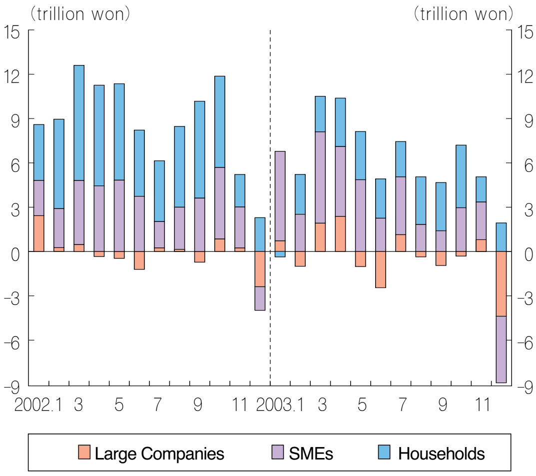
Notes: 1) Includes trust account lending (except discount of CP). Based on changes during the period.
2) Lending to public and other legal entities.

During the year 2003, bank loans (including those from banks' trust accounts) rose by 62.2 trillion won, showing a considerably smaller-scale increase than the previous year's 98.6 trillion won.

Viewed by sector, loans to large companies declined by 2.9 trillion won during the year. They had relatively little demand for borrowings owing to the postponement of facilities investment decisions while prospects for business remained obscure and to the comparatively favourable state of their cash flow thanks to strong business performance driven by a continuing export boom. In contrast, lending to SMEs sustained its strongly increasing pace of the previous year (37.1 trillion won), registering an increase of 35.0 trillion won during the year. This reflected companies'

<Figure Ⅱ-41>

Bank Lending[1] by Sector



Note: 1) Based on changes during the month.

need for short-term working capital because of lackluster domestic sales amid the contraction of domestic demand. At the same time, banks expanded their efforts to make loans to SMEs in response to the government's issue of guidelines on reining in household loans and subdued demand for borrowings on the part of large companies. A further factor in this expansion was that SMEs had become relatively more dependent on borrowings from banks in view of the worsening of conditions in the corporate bond and CP markets. Because SMEs are largely dependent on domestic demand, banks, nevertheless, increasingly fretted over the possibility of their loans to them turning sour as the economic recovery receded. The consequent progressive strengthening of their credit screening caused a decline in the growth of their lending to SMEs as the year-end drew near.

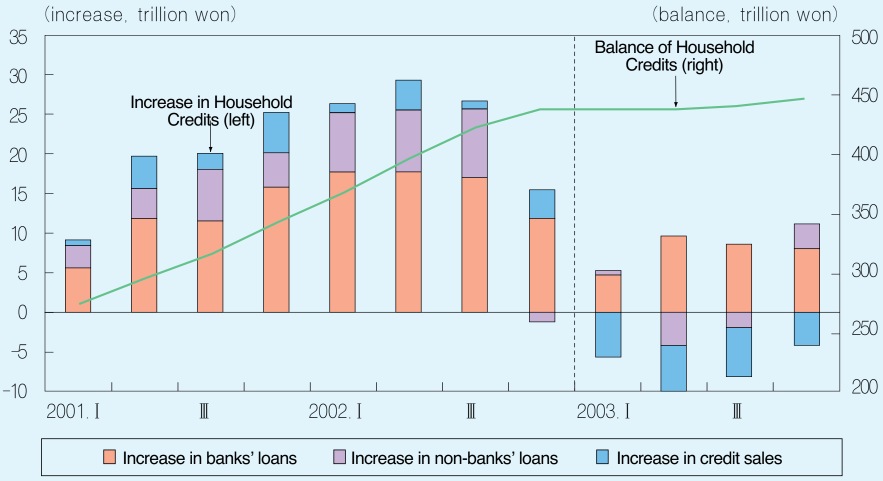
Meanwhile lending to households registered an expansion of some 30.6 trillion won, less than half the scale of that the year before (61.6 trillion won). This slowdown reflected the government's moral suasion on banks to rein in their credit to households and the increased credit risk of such lending because of the domestic economic downturn. Strikingly the growth of loans secured against housing collateral (excluding trust account loans) contracted sharply from 45.5 trillion won the previous year to 20.7 trillion won. Minus account loans also saw their growth reduced from 24.1 trillion won to 16.1 trillion won.

<Reference Ⅱ-3>

Impact of the Deterioration of Household Credit

Household credits had increased greatly during 2001 and 2002, giving rise to concerns both about their deterioration and a run-up in real estate prices. This prompted the government to issue guidelines on reining in such credits and the financial institutions to strengthen their risk management. From the beginning of 2003, in consequence, there was a sharp contraction of household credits. The rate of increase in household loans slackened considerably and credit card sales shrank on a large-scale.

Trends of the Amount of Increase and the Balance of Household Credits



Such a contraction of household credits became a principal factor in the slowdown of domestic economic activity by giving rise to an abrupt shriveling of private consumption. During the year 2003, private consumption shifted from the previous year's increase of 7.9% to register a decline of 1.4%, which caused the contribution rate of private consumption to GDP growth to shift from its positive 61.8% the previous year to a negative contribution of 25.4% during the year under review.

Trends of Growth[1] in Real GDP and Private Consumption

(%)

	2002					2003				
	Ⅰ	Ⅱ	Ⅲ	Ⅳ	year	Ⅰ	Ⅱ	Ⅲ	Ⅳ	year
Real GDP	6.5	7.0	6.8	7.5	7.0	3.7	2.2	2.4	3.9	3.1
Private consumption	9.8	8.7	7.8	5.5	7.9	0.3	-1.8	-1.9	-2.2	-1.4

Note: 1) Compared with the same period of the previous year.

Along with the contraction of household credits, delinquency rates on banks' household loans and on credit cards rose steeply from the beginning of 2003 as the latent problem of their deterioration, which had been present for some time, materialized. The number of people blacklisted as credit defaulters also increased rapidly to encompass 3.7 million people, emerging as a serious social issue.

Trends of Delinquency Ratios and Number of Credit Defaulters

(year-end basis, %, thousand)

	2002				2003			
	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.
Delinquency rates on banks' household loans[1]	1.43	1.30	1.61	1.50	2.06	2.01	2.27	1.78
Delinquency ratios on credit cards[2]	2.9	3.8	5.1	6.6	9.6	9.5	11.2	14.3
Number of credit defaulters	2,455	2,260	2,455	2,636	2,957	3,225	3,502	3,720

Notes: 1) Deposit money bank basis (includes banks trust account)
2) Based on management assets over 30 days of eight specialized credit card company, but excludes Korea Exchange Bank Credit Company in Dec. 2003, which was affected by a strike.
Sources: The Bank of Korea, The Financial Supervisory Service.

Meanwhile, the deepening spiral of management failure of credit card companies acted as a destabilizing factor on financial markets. Credit card companies had expanded their business excessively by the issue of cards without adequate credit screening procedures and the overextension of cash advances and add-on services. They had also greatly increased the scale of their liabilities involving notably short-term debt instruments such as bonds, asset backed securities (ABS) and CP. Thus, when the government put in place measures to control household credit and households' capacity to redeem their outstanding debts declined amid the economic downturn, credit card companies saw their net profit move deeply into deficit from the fourth quarter of 2002. On top of these problems, turmoil erupted in the financial markets when fears spread about the possibility of default on credit card companies' paper together with the revelation of the accounting scandal at SK Global (March 11). There were large-scale withdrawals from banks' specific money trusts and investment trust companies' MMFs, which had been heavy buyers of credit-card companies' paper. Credit card companies' liquidity position worsened greatly as they found difficulty in issuing new paper including ABS and CP and, amid renewed turmoil from early November, several of them were hit by a severe liquidity crisis, forcing them, for example, to suspend their cash advance services. Fortunately, calm was restored at an early stage in the financial markets, thanks to the swift action of the Bank of Korea and the government on the two occasions in taking appropriate countermeasures.

Trends of Major Indices Related with Credit Card Companies[1]

(period-end basis)

	2000	2001	2002			2003		
			first-half	second-half	year	first-half	second-half	year
Number of cards issued (million)	57.9	89.3	98.0	104.8	-	101.2	95.2	-
Amount settled with credit card (during the period, trillion won)	224.9	443.4	324.1	356.7	680.8	290.2	227.2	517.3
(ratio of cash advances to toal)[2] (%)	66.3	63.5	63.8	57.6	60.6	55.1	51.4	53.5
Net profit[3] (during the period, trillion won)	1.1	2.6	0.9	-0.5	0.5	-2.8	-7.7	-10.5

Notes: 1) Based on the all credit card companies (including both specialized card companies and bank-linked card companies)
2) Includes card loans.
3) Based on specialized credit card companies, and excludes the Kookmin Credit Card Company in 2002 and 2003.
Source: The Financial Supervisory Service.

(B) Direct Financing

<Table Ⅱ-23>

Trends in Corporate Fund Raising[1] by Direct Financing

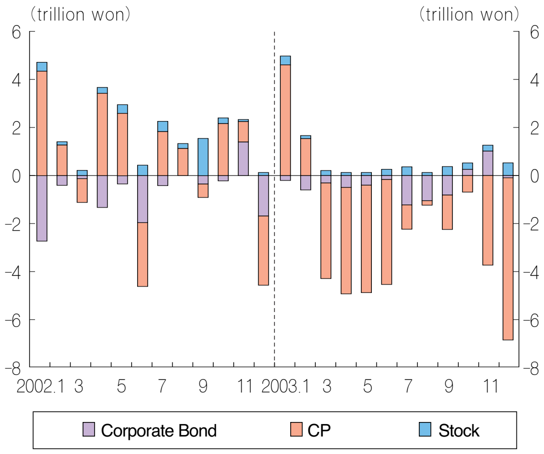
(trillion won)

	2001	2002	2003 year	Ⅰ	Ⅱ	Ⅲ	Ⅳ
Corporate bond issuance (net)[2]	8.2 (0.9)	-8.1 (-1.5)	-4.0 (-1.8)	-1.0 (0.7)	-1.0 (-0.3)	-3.1 (-2.7)	1.2 (0.5)
CP issuance (net)[3]	8.1	10.9	-22.6	2.3	-13.3	-2.5	-9.1
Stock issuance[4]	4.2	4.0	2.8	0.6	0.4	0.8	1.1
Direct financing total	20.5	6.8	-23.8	1.8	-13.9	-4.8	-6.9

Notes: 1) Based on changes during the period.
2) Excludes those issued by companies under court receivership, in process of mediation or workout. Figures in parentheses exclude those incorporated into primary CBOs and new bonds promptly underwritten by Korea Development Bank (KDB).
3) Based on CP discounts by securities companies, merchant banks and bank trusts accounts.
4) Based on companies listed on the Korea Stock Exchange or KOSDAQ, but excludes fund-raising by financial institutions and debt for equity swaps by creditor financial institutions for the purpose of structural adjustment of corporations.
Sources: The Financial Supervisory Service, Representative associations.

<Figure Ⅱ-42>

Trends in Corporate Fund Raising[1] by Direct Financing



Note: 1) Based on changes.
Sources: The Financial Supervisory Service, Representative associations.

During the year under review, companies' fund-raising through the direct financial market was greatly reduced. Companies' demand for funds was generally subdued in view of the sluggish pace of business activity and there was a large net redemption of CP because of the worsening of the conditions for its issue. At the same time, corporate bonds maintained their net redemption trend from the previous year and fund-raising through the stock market shrank a little in spite of its buoyancy. In consequence, last year's amount of 6.8 trillion won raised through the direct financing market turned to a massive redemption of 23.8 trillion won.

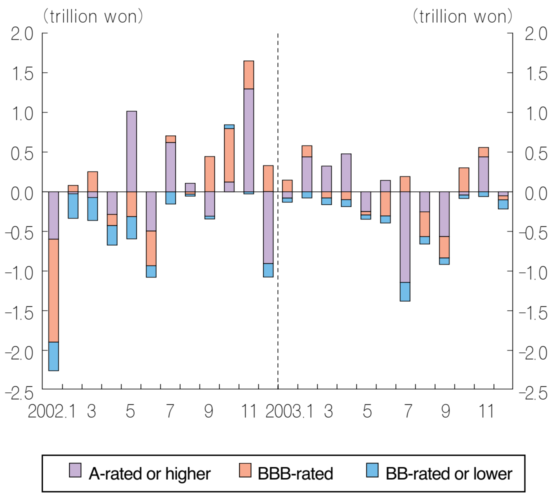
(Issue of Corporate Bonds)

Corporate bonds saw a net redemption during the year of 4.0 trillion won, retaining the pattern of the previous year. This was ascribable both to businesses' diminished demand for long-term investment funds amid uncertain economic prospects and to the reduced scale of their bond issuance thanks to the relatively healthy flow of funds from their operations. Another factor behind the net redemption of corporate bonds was that financial institutions grew increasingly sensitive to credit risk, meaning that companies with undistinguished credit ratings found difficulty in issuing bonds; meanwhile, a large volume of the corporate bonds that had been incorporated into primary collateralized bond obligations (CBO) fell due at maturity. From early in the fourth quarter, however, there was a shift to a net issuance position as companies stepped up their sale of corporate bonds both to impose a longer term structure on their liabilities and to secure long-term investment funds at an early stage in line with indications of an upswing in market interest rates as anticipations of business recovery grew more widespread. Accordingly, total net redemption of corporate bonds for the year as a whole narrowed to 4.0 trillion won, less than half of the previous year's 8.1 trillion won.

Broken down by the type of bond, the scale of net redemption of corporate bonds issued through public subscription widened slightly from the 1.5 trillion won of the preceding year to 1.8 trillion won. Despite the large-scale redemption of maturing bonds, those packaged into primary-CBOs saw incessant new issues, bringing down the scale of their net redemption from 6.2 trillion won the year before to just 2.0 trillion won.

<Figure Ⅱ-43>

Trends in Net Issuance[1] of Corporate Bonds by Credit Rating



Notes: 1) Based on changes.
On the basis of corporate bonds issued by public subscription.

Looked at by credit grade on the basis of corporate bonds issued by public subscription, there was an intensification of the tendency toward credit differentiation despite a general reduction in the scale of issuance. The proportion of corporate bonds issued with an A rating (total amount basis) rose from 57.5% to 68.7%, whereas that of those with a rating of BBB or below declined from 42.5% to 31.3%. Strikingly, that of those with a speculative grade rating of BB or lower shrank still further from 4.9% to 1.9%; moreover, the scale of their net redemption during the year marked 0.9 trillion won, standing higher than that of both A-rated and BBB-rated corporate bonds, 0.6 trillion won and 0.3 trillion won respectively.

(Issue of CP)

The issuance of CP in the year 2003 showed a very subdued pattern ascribable both to the low level of corporate demand for funds and financial institutions' shrunken purchasing power. As a net consequence, there was a shift from net issuance of 10.9 trillion won the previous year to a large-scale net redemption of 22.6 trillion won for the year under review.

CP issuance started off the year maintaining its brisk trend of the previous year, helped by the increased placement of deposits with MMFs. From mid March onwards, however, it began to show a steep contraction. This came as the environment for the issuance of paper worsened sharply in a movement centering on credit card companies' CP, as financial institutions grew increasingly risk averse in response to worries over possible defaults on credit card companies' paper and the corporate accounting scandal at SK Global. Apart from this, investment trust companies and banks' trust accounts were greatly restricted in their capacity to purchase CP owing to the reduction in deposit-taking by MMFs and specific money trusts.

From July to October, a renewed increase in the flow of deposits into MMFs in line with the short-termism of market funds meant that the issue of CP turned buoyant, centering on non-financial businesses, and the net redemption trend moderated somewhat. From the beginning of November, though, the scale of net redemption widened again, centering on financial institutions' CP, amid renewed withdrawals from MMFs owing to fears about the management status of credit card companies.

(Issue of Stocks)

Corporate Financing through the stock market showed a subdued pattern.

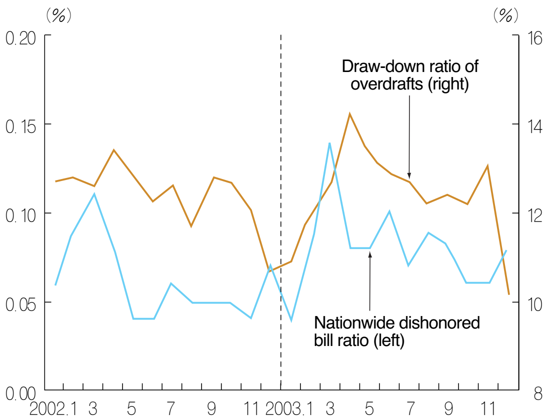
Funding through rights offerings and initial public offerings (excluding debt-for-equity swaps by creditor financial institutions for the purpose of corporate structural adjustment) narrowed from the previous year's 4.0 trillion won to 2.8 trillion won owing to businesses' diminished demand for long-term investment funds despite the hike of KOSPI. Viewing by period, though, the scale of funding showed an increasing trend in line with the rise of the KOSPI as the year-end drew near.

Broken down by the type of market, the scale of funding through the Korean Stock Exchange market shrank sharply from the previous year's 2.7 trillion won to 1.1 trillion won while that through the KOSDAQ market maintained the previous year's level of 1.7 trillion won.

(C) Corporate Status of Fund

<Figure Ⅱ-44>

Nationwide Dishonored Bill Ratio[1] and Draw-down Ratio of Overdrafts



Note: 1) After adjustment for electronic settlement amount.

Major indicators of corporate status of fund conditions exhibited a generally favorable pattern during the year 2003.

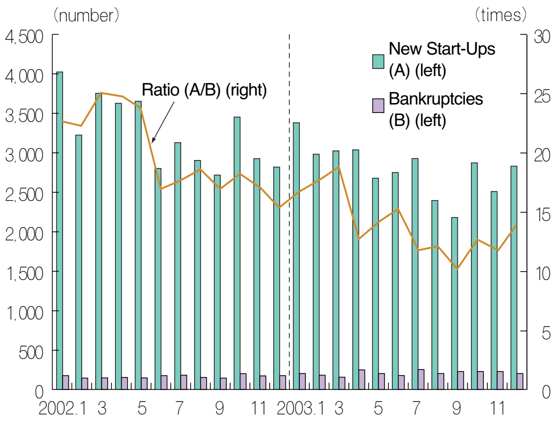
The dishonored bill ratio (after adjustment for electronic settlement amount) showed stable movements, generally remaining at the low level of below 0.1%. However, it registered a modest rise to 0.08% for the year as a whole, higher than the 0.06% of the previous year, because of the large-scale defaults of bill associated with the SK Global accounting scandal in March.

The drawdown ratio of overdrafts, an indicator of the urgency of businesses' demand for funds, rose briefly to the high level of 13.2% during April because of seasonal factors including collections of value-added tax. With this exception, it showed stable movements, remaining at around the 12% level.

The proportion of new corporate start-ups to corporate

<Figure Ⅱ-45>

No. of New Corporate Start-Ups and Corporate Bankruptcies in Eight Major Cities[1)]



Note: 1) Seoul, Busan, Daegu, Incheon, Gwangju, Daejeon, Suweon, Ulsan.

failures in eight major cities including Seoul fell markedly from 19.8 the previous year to 13.8. This was attributable to the increase in the number of bankruptcies, owing to the contraction of domestic consumption activities, along with the decline in the number of new corporate start-ups. From the beginning of the fourth quarter, nevertheless, amid more widespread anticipations of a business recovery, the number of new start-ups increased somewhat, causing the proportion to show a mild upward trend.

5. Foreign Exchange Markets

(Foreign Exchange Supply and Demand)

A clear preponderance of foreign exchange supply over demand prevailed during the course of the year 2003, with the current account and the capital account both showing much wider surpluses than the year before, owing in the former case to the buoyancy of exports and in the latter to increased inflows of foreign capital for investment in stocks.

<Table Ⅱ-24>

Foreign Credits and Liabilities[1]

(billion US$)

	2001	2002(A)	2003(B)	Change (B-A)
Credits	165.5	186.1	226.6	40.5
Liabilities	130.8	144.0	159.8	15.8
Long-term	88.9 (68.0)	93.9 (65.2)	104.5 (65.4)	10.6
Short-term	41.9 (32.0)	50.1 (34.8)	55.3 (34.6)	5.2
Net foreign credit	34.7	42.1	66.8	24.7

Notes: 1) Year-end basis.
Figures in parentheses refer to shares in total (%).

Reflecting this interplay of foreign exchange supply and demand, the scale of the net creditor position rose from 24.7 billion dollars as of the end of the preceding year to stand at 66.8 billion dollars at the year-end. Gross claims on the rest of the world increased 40.5 billion dollars over the preceding year-end to reach 226.6 billion dollars. External debt mounted 15.8 billion dollars over the end of December 2002 to stand at 159.8 billion dollars at year-end.

The rise in the rest-of-the-world's claims on Korea, which occurred despite the repayment of borrowings by the government sector, was ascribable to the expanded issuance of overseas bonds by banks and public companies and to the increase in the prepayment for exports on a deferred payment basis owing to brisk shipbuilding exports. Together these acted to increase long-term debt, causing the ratio of short-term debt to total foreign indebtedness to ease slightly from its 34.8% at the previous year-end to 34.6% as of the end of 2003.

<Table Ⅱ-25>

Foreign Exchange Reserves[1]

(billion US$)

	2001	2002	2003			
			Ⅰ	Ⅱ	Ⅲ	Ⅳ
FX Reserves	102.8	121.4	123.8	131.7	141.5	155.4

Note: 1) Year-end basis.

Foreign exchange reserves rose from 121.4 billion dollars as of the end of the year 2002 to stand at 155.4 billion dollars as of the end of the year under review.

Their build-up was attributable to the preponderance of foreign currency supply over demand, profits on the operation of foreign-currency-denominated assets, and the increased value in US dollar terms of euro and yen-denominated assets owing to the strength of these two currencies.

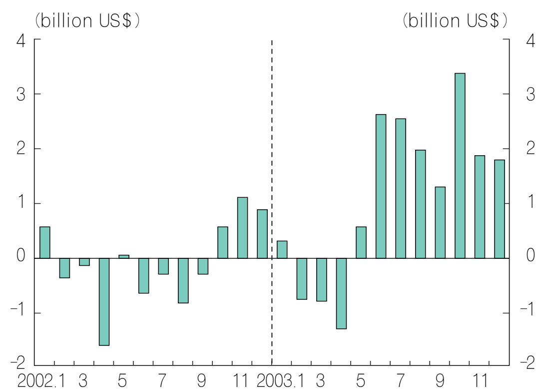
(Foreign Exchange Rates)

<Figure Ⅱ-46>

Trends of Won/US$

<Figure Ⅱ-47>

Trends of Net Inflows of Foreign Portfolio Capital



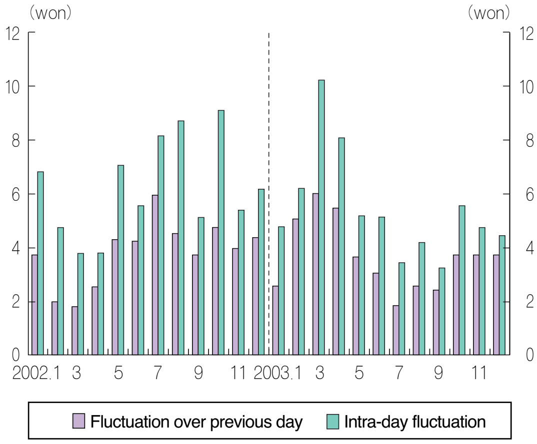
Source: The Financial Supervisory Service.

During the year 2003, the annualized average exchange rate of the Korean won against the US dollar eased by 58.8 won from the previous year's level of 1,250.7 won per dollar to stand at 1,191.9 won per dollar, representing a 4.9% appreciation of the Korean won. The exchange rate, nevertheless, followed a fluctuating path in line with changes in conditions at home and abroad.

During January, the US dollar showed a weakening trend in international foreign exchange markets, influenced by the looming threat of a US war against Iraq, and the Korean won-dollar rate remained on the downward trajectory evident since mid-October 2002. From the beginning of February until the first week or so of April, it shifted to an upward trend in response to the North Korean nuclear issue, the SK Global accounting irregularities and other peninsular issues. The exchange rate's downward trend (Korean won appreciation) carried on until mid-October amid the lowering of geopolitical threats, and the increased scale of inflows of foreign portfolio capital. Most notably, the won-dollar exchange rate dropped to 1,151.2 won per US dollar on September 22, just after the G-7 meeting of finance ministers and central bankers (September 20). From mid-October onwards, the exchange rate rose to stand at the 1,200 Korean won per dollar level, owing to the liquidity problems of credit card companies and so forth. Subsequently,

<Figure Ⅱ-48>

Trends of Won/US$ Fluctuations



<Table Ⅱ-26>

Trends of Changes in Korea's Sovereign Credit Ratings

	S&P	Moody's	Fitch IBCA
1997	A+(Oct.24) A-(Nov.25) BBB-(Dec.10) B+(Dec.22)	A3(Nov.27) Baa1(Dec.10) Ba1(Dec.21)	A+(Nov.18) A(Dec.3) BBB-(Dec.11) B-(Dec.23)
1998	BB+(Feb.17)	-	BB+(Feb.2)
1999	BBB-(Jan.25) BBB(Nov.11)	Baa3(Feb.12) Baa2(Dec.16)	BBB-(Jan.19) BBB(Jun.24)
2000	-	-	BBB+(Mar 30)
2001	BBB+(Nov.13)	Baa2(Nov.30)	-
2002	A-(Jul.24, outlook : S)[1]	A3(Mar.28) upward adjustment of outlook (S→P,Nov.15)[1]	A(Jun.27, outlook : S)[1]
2003	-	downward adjustment of outlook (P→N, Feb.11)[1]	-

Note: 1) P(Positive), S(Stable), N(Negative)
Figures in parentheses refer to the announcement dates.

<Table Ⅱ-27>

Spreads[1] on Foreign Exchange Stabilization Fund Bonds

(bp)

	2002	2003			
	Dec.	Mar.	Jun.	Sep.	Dec.
FESF (2008)	123	161	82	60	45
(2013)[2]	..	..	110	78	45

Notes: 1) Spread over US T-notes. Period-end basis.
2) Issued on May 29, 2003.

sustained inflows of foreign portfolio capital and a large-scale increase in exports caused the exchange rate to dip again, so that the Korean won finished the year at 1,192.6 won per US dollar.

During 2003, the day-to-day range of the won-dollar exchange rate narrowed from the previous year's 3.8 won to 3.4 won and the intraday trading range from 6.2 won to 5.4 won. Seen by quarter, volatility showed a pattern of expanding movements in the first and fourth quarters, owing to the heightened market uncertainty generated in the former case by the war against Iraq and in the latter by the liquidity problems of credit card companies.

(Foreign Borrowings Environment)

Korea's sovereign credit rating retained its investment status unchanged from the previous year. Moody's, nevertheless, adjusted its outlook for the sovereign credit rating from positive to negative on February 11 in consideration of the heightened geopolitical risks associated with the North Korean nuclear issue.

During the course of 2003, the premium on Foreign Exchange Stabilization Fund bonds (FESF, 2008 maturity basis) over US Treasuries widened to 215 basis points on March 12 in response to Moody's downward adjustment of the outlook for the sovereign credit rating and the SK Global accounting scandal. But with the reduction in geopolitical tensions including the greater likelihood of a peaceful resolution of the North Korean nuclear issue, and the buildup of foreign exchange reserves, the premium narrowed to close the year at 45 basis points, a 78 basis point reduction compared to the previous year-end. In the last month of the year, the premium over LIBOR paid by domestic banks on their short-term borrowings

<Table Ⅱ-28>

Spreads on Short-term Borrowings of Domestic Banks

(bp)

	2002	2003			
	Dec.	Mar.	Jun.	Sep.	Dec.
Spread[1]	25	26	23	22	18
Libor[2]	1.41	1.29	1.12	1.14	1.17

Notes: 1) Spread over Libor. Period-average basis.
2) 3 months, %.

showed a 7 basis point fall from the December of the previous year, standing at 18 basis points.