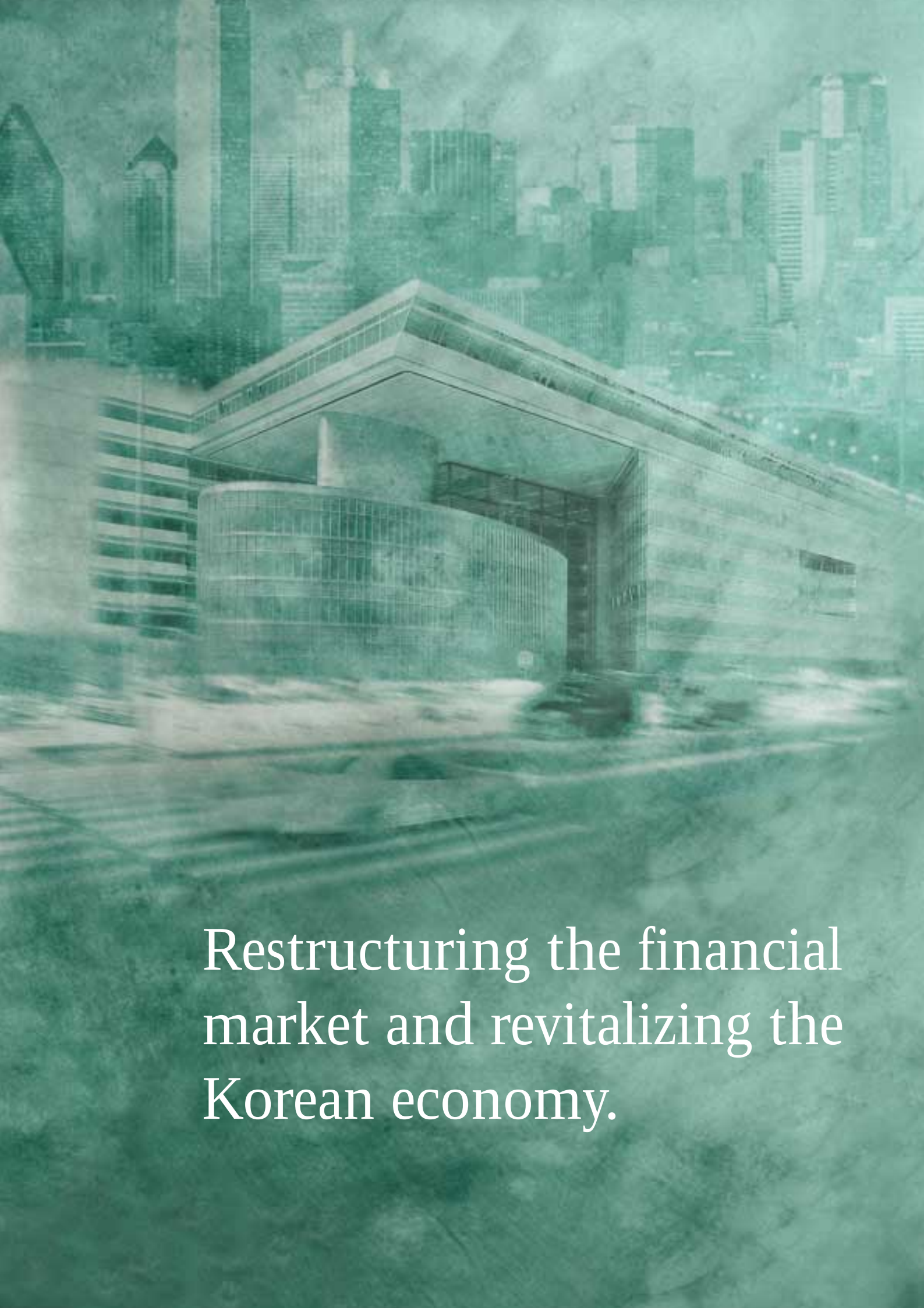




Restructuring the financial
market and revitalizing the
Korean economy.

Review of the Korean Economy

Economic Performance

In 2000, the Korean economy appeared to be going through an adjustment period after recovering rapidly from the foreign exchange crisis. The real GDP growth rate, which stood at 10.9 percent in 1999, slowed down to 8.8 percent.

Looking at the real GDP growth by quarter for the first three quarters of 2000, growth showed a gradual decline with a 12.6 percent, 9.7 percent, and 9.2 percent increase compared with the same quarter of the previous year. In the fourth quarter, the growth rate fell sharply to a rate of 4.6 percent, primarily due to unfavorable conditions such as the slowdown of the U.S. economy, which has a considerable impact on Korean exports, continued financial market instability resulting from the abrupt cancellation of Ford's bid to buy Daewoo Motor, and the outbreak of Hyundai Engineering & Construction's liquidity crisis.

Looking at last year's growth by component of expenditure, private consumption, which increased 11.0 percent in 1999, decreased to a rate of 7.1 percent. This slowdown was mainly due to a weakening in the real purchasing power in households caused by deterioration in the terms of trade.

Machinery & equipment investment recorded a robust growth rate of 34.3 percent in 2000. However, the rate fell significantly to 19.6 percent in the second half from 51.4 percent in the first half. This sharp fall was due to the effects of a slowdown in the domestic economy and a credit crunch in financial markets.

Construction investment decreased in 2000 for the third year in a row. Many construction firms were placed under court receivership or in "workout programs" as a consequence of restructuring of the construction industry. Indeed, the survival of the construction industry appeared at risk with the demise of Dong Ah Construction and HEC's default on notes due.

Exports and imports showed a strong upward trend, although import growth recorded a gradual decline from the second quarter. In 2000, exports increased by as much as 19.9 percent compared with the previous year on a customs clearance basis. Semiconductors, automobiles, and information technology industries led this robust export boom. In particular, despite the fall of DRAM prices to their lowest level, exports of semiconductors showed a positive trend since the volume of exports increased.

Imports increased 34.0 percent mainly due to the rise in crude oil and raw material prices. However, imports leveled off from the second quarter due to the slowdown in the domestic economy. The trade surplus in 2000 registered US\$ 11.8 billion.

The consumer price index (CPI) remained moderate at around 2.3 percent in 2000. Increases in cost factors, including oil prices and public service fees mainly accounted for the rise in consumer prices. However, a stable KRW/USD exchange rate and no significant pressure from the demand side moderated the inflation rate.

Meanwhile the producer price index marked a 2.0 percent increase from 1999 following the upturn in prices of raw materials including crude oil and intermediate goods.

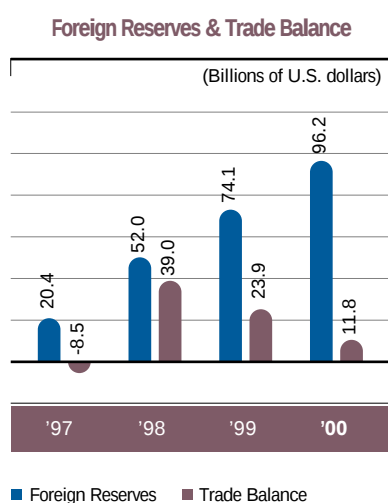
The unemployment rate posted 4.1 percent in 2000. This rate decreased by 2.2 percentage points compared with the previous year. The number of unemployed, which stood at 889,000 in 2000, decreased by 464,000 compared with 1999. However, as Daewoo Motor was declared bankrupt and other non-viable companies were liquidated, the effects of restructuring came into effect from the fourth quarter, resulting in a rise in the unemployment rate from the fourth quarter.

Korea's sovereign credit rating was upgraded in 1999 thanks to the economic recovery and the accumulation of foreign currency reserves. Fitch IBCA upgraded Korea's sovereign rating from BBB to BBB+ in March 2000 and it has remained unchanged until the present. S&Ps and Moody's rate Korea at BBB and Baa2 respectively, comparatively low ratings when considering the pre-crisis levels.

The government has been seeking to upgrade Korea's sovereign credit rating by implementing the second stage of corporate and financial restructuring. It has been imperative for the government to utilize the growing sense of crisis as an effective momentum to accelerate structural reform. Therefore, the government provided new impetus to financial reform efforts by disclosing a list of 52 non-viable companies recommended for court receivership or liquidation programs, and by consolidating the commercial banking system through the establishment of holding companies as well as facilitating mergers.

Financial Markets

At the beginning of the year 2000, the Daewoo liquidity problem and the ensuing massive redemption of Daewoo bonds contributed to insecurity in the financial markets. Moreover, the onset of the Hyundai Engineering & Construction liquidity crisis and the court receivership of Daewoo Motor in the course of implementing financial restructuring increased the uncertainty of the financial markets. As a result, financial institutions have been reluctant to extend credit not only because of increased uncertainties as to the financial viability of client firms, but also because they are trying to meet the required BIS standards.



In 2000, the yield on 3-year Treasury Bonds (TBs) showed a downward trend, falling to its lowest level of 6.7 percent at the end of the year from 9.04 percent in the beginning of the year. The yield on 3-year corporate bonds followed the same trend, falling to its lowest level of 8.1 percent at the end of the year from 10.3 percent in the beginning of the year. This trend was mainly due to a flight to quality by financial institutions. Due to the uncertainty of financial markets and despite the abundant liquidity at financial institutions, purchase of risk-free bonds such as TBs and Monetary Stabilization Bonds (MSBs) was intense. The wide spread in rates of corporate bonds between AA- and BBB- reflected this unstable market situation.

The KRW/USD rate remained steady until mid-November, ranging between W1,100 and W1,150, but rose rapidly to over W1,200 against the U.S. dollar during the last ten days of November. The depreciation can be accounted for by factors such as anxiety in the local and offshore stock markets, ongoing structural reforms in the financial and public sectors, slowing economic growth and the weakening of many Asian currencies against the U.S. dollar. The Won as of year-end 2000 stood at W1,264.5 against the U.S. dollar, depreciating 10.0 percent from W1,138.0 at year-end 1999.

The stock price index marked a decreasing trend during the year 2000, due to the instability brought on by the credit crunch in financial markets and unfavorable external factors such as falling semiconductor prices and high crude oil prices. As of year-end 2000, the KOSPI stood at 504.62 points, a drop of 52.4 percent compared to the high of 1,059.04 in January 2000.

Korea's foreign reserves increased to US\$96.2 billion at the end of 2000, an increase of US\$22.1 billion from year-end 1999. This can be attributed to the continuing trade surplus and the high foreign direct investment which reached US\$15.69 billion by the end of 2000.