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KOREA'S ECONOMIC STABILITY AND RESILIENCE IN TIME OF CRISIS

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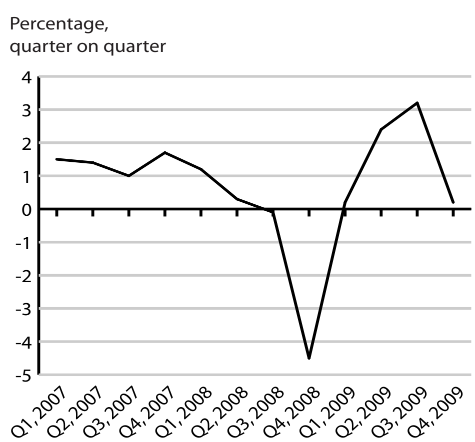
Crisis and Recovery

In the wake of the fall of Lehman Brothers, in the fourth quarter of 2008 and the first quarter of 2009 Korea was faced with its biggest economic challenge since the 1997 Asian financial crisis. The U.S. financial crisis hit the global economy hard, and its consequences spread to developing and emerging economies. The entire world was concerned and fearful about the "Great Recession" and the ever-deepening global slump.

Witnessing the crisis unfolding in the world economy, Korea saw its economy was also shrinking at a faster pace. In the fourth quarter of 2008, Korea's GDP growth contracted by 4.5 percent quarter on quarter (***Figure 1***).

Figure 1: **Growth of Gross Domestic Product (GDP) in Korea, 2007–09, percentage**



Source: Bank of Korea, March 2010.

The sudden contraction was mainly due to the abrupt tightening of global financial conditions and the sharp decline in domestic demand and international trade. Amid collapsing exports, the Korean economy, facing volatile capital flows and the risk of instability in financial and foreign exchange markets, responded decisively, swiftly, and sufficiently to the financial crisis. In the first quarter of 2009, it showed hopeful signs of stabilization with a 0.2 percent GDP growth quarter-on-quarter. In the second quarter, the Korean economy achieved 2.4 percent GDP growth. In the third quarter and fourth quarter, it recorded 3.2 percent and 0.2 percent growth, respectively.

Save for the possibility of a recurrence of unexpected and massive external shocks, Korea is expected to continue to strengthen its growth momentum in 2010. During the last two years, the Korean economy registered a dramatic upswing that brought the nation's economy back to precrisis conditions. Accordingly, there are policy reasons and other factors that can explain why the Korean economy, compared with other countries' economies, was poised to present its strength and resilience in time of crisis.

Economic Conditions and Outlook Based on Stability and Resilience

With the seizure of international financial markets in September 2008, Korea could not avoid experiencing a sharp reduction in its credit lines, a decline in equity markets, and a dollar shortage in foreign exchange. Shortly thereafter, Korea faced its largest export decline, which was negative 34.5 percent in January 2009. At the height of the crisis, in March 2009, the equity market fell by more than 20 percent compared with the average monthly index of September 2008 (***Table 1***).

The nominal exchange rate on an average monthly basis rose more than 28 percent from September 2008 to March 2009. In September 2008, consumer goods sales fell by 1.9 percent, and in March 2009 the figure fell by 5.2 percent compared with the previous year.

Owing to the government's active role and unprecedented level of stimulus efforts and easing of international financial strains, the Korean economy and financial market seemed to stabilize during the first half of 2009 and showed its continuous momentum in the following quarters. For example, from December 2008 to January 2010, the Korean stock market index (KOSPI) grew about 42.5 percent, a substantial increase compared with other major countries (***Table 2***).

Over the period, the Korean economy was brushing itself off and beginning its climb out of the deeper recession. Korea became one of the fastest-growing economies among member countries of the Organization for Economic Cooperation and Development, registering 0.2 percent in the first quarter and 2.4 percent in the second quarter of 2009.

Korea registered a surprising performance record in terms of economic growth in the third quarter of 2009. The growth rate spiked from negative 4.5 percent in the fourth quarter of 2008 to a positive 3.2 percent in the third quarter of 2009, quarter-on-quarter (***Table 3***). Exports leaped from a negative 34.5 percent growth in January 2009 to a positive 33.7 percent growth in December 2009. The number of unemployed decreased from about 219,000 in May 2009 to 10,000 in November 2009 because of job creation measures in the public sector. Industrial production has also improved. For instance, mining and manufacturing production in the second and third quarters of 2009 increased 11.3 and 7.2 percent, quarter-on-quarter, despite summer holidays. It has recorded consecutive positive growth since the second quarter of 2009 and has been picking up growth momentum since January of 2009.

With the clear recovery in exports, the current account surplus became a bright spot for Korea's economy. It stood at about $21.7 billion for the first six months of 2009. In the second half of 2009, it recorded approximately $21.0 billion. The surplus in 2009 rose to about $42.7 billion, which was a reversal from the 2008 deficit of about $5.8 billion.

Building on the crisis, Korea spared no effort to turn the crisis into an opportunity to shore up Korea's market share in international trade, and Korea was well placed to profit from solid growth in developing and emerging markets. As a result of the government's supportive policy roles and Korea's performance in trade, the Korean economy gathered steam to record 0.2 percent growth in 2009, year-on-year, and it is expected to achieve about a 5 percent GDP growth in

Table 1: **Korea's Major Economic Indicators at Height of Financial Crisis, 2008–09**

Indicators	**September 2008**	**December 2008**	**March 2009**
KOSPI (average monthly, point)	1,447	1,115	1,140
Exchange rate (average monthly, *won*/dollar)	1,137	1,369	1,453
Exports (year-on-year, percentage)	27.6	-17.9	-22.5
Sales of consumer goods (year-on-year, percentage)	-1.9	-4.5	-5.2

Source: Bank of Korea; Statistics Korea; Ministry of Strategy and Finance.
Note: KOSPI is the Korean stock market index.

Table 2: **Equity Indexes of Major Countries, December 2008–January 2010**

	Korea (KOSPI)	**United States (DJIA)**	**Japan (Nikkei 225)**	**China (CSI 300)**	**UK (FTSE 100)**
December 2008[a]	1124.5	8776.3	8859.5	1820.8	4434.1
January 2010[a]	1602.4	10067.3	10198.0	2989.3	5188.5
Change (%)	42.5	14.7	15.1	64.2	17.0

Source: Author's records.
[a] As of the end of the month.

Table 3: **Comparison of Economic Indicators during the Crisis and Recovery Periods in Korea, 2008–10**

Indicators	Crisis period	Recovery period
Economic growth (quarter-on-quarter, percentage)	-4.5 (Q4, 2008)	3.2(Q3, 2009)
Employment growth (10,000 persons, year on year)	-21.9 (May 2009)	-1.0 (Nov. 2009)
Exports (year-on-year, percentage)	-34.5 (Jan. 2009)	33.7 (Dec. 2009)
Current account (U.S.$100 million)	-16.1 (Jan. 2009)	15.2 (Nov. 2010)

Source: Ministry of Strategy and Finance, Seoul.

2010. Recently, the Bank of Korea raised its outlook from its December 2009 forecast of 4.6 percent growth to 5.2 percent growth; such bright predictions are also expected from other economic institutions.

Key Reasons for Korea's Stability and Resilience

These encouraging economic signs of recovery in 2009 did not come from robust consumption and demand. Weakness in Korea's labor market is not likely to disappear soon, and Korea still faces uncertainties and risks in the global market. The economy's surprising economic performance, stability, and resilience to date are mainly driven by three important factors: (1) strengthened banking and corporate sectors since the 1997 Asian financial crisis, (2) diversified export products and markets, and (3) the government's strong and decisive policy responses combined with the spirit of togetherness of the Korean people and international coordination such as the Group of 20 (G-20).

The first reason implies better initial conditions: the Korean economy stood well prepared, with a relatively sound banking and corporate sector that developed in the wake of the 1997 Asian crisis (***Table 4***).

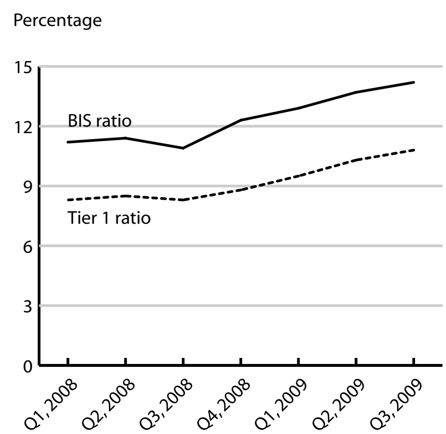
Table 4: **Nonperforming Loans in Selected Countries, 2008, percentage**

Countries	Percentage
Thailand	5.3
Indonesia	3.8
United States	1.7
Taiwan	1.5
Hong Kong	1.2
Korea	1.1

Source: Financial Supervisory Service, Seoul.

Since the crisis, the Korean government has made every effort to strengthen economic fundamentals and enhance the soundness of the banking and corporate sectors. In the banking sector, as of December 2008, the nonperforming loan ratio in Korea was 1.1 percent, which was smaller than in many other economies. The Bank for International Settlements ratio has also been enhanced, to levels higher than the Tier 1 ratio, enough to raise significantly the soundness of Korea's banking sector (***Figure 2***).

Figure 2: **Korea's Bank for International Settlements (BIS) Ratio, 2008–09, percentage**

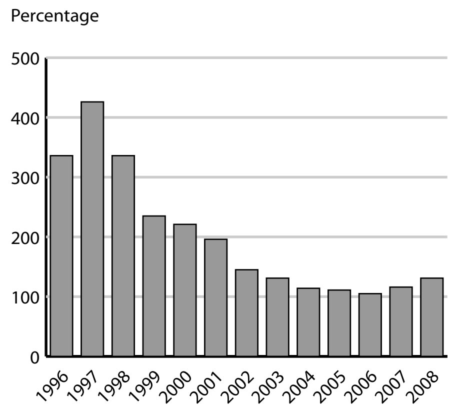


Source: Bank of Korea.

In the corporate sector, since the Asian financial crisis, Korea's corporate financial structure has been improved greatly. In 1997, when the crisis erupted, the debt-to-equity ratio was 426 percent, but by 2008 it stood at 131 percent (***Figure 3***).

The second major factor contributing to stability and resilience in this time of crisis was the high degree of diversification of Korea's export markets and products.

Figure 3: **Trend in Korea's Debt-to-Equity Ratio, 1996–2008, percentage**



Source: Financial Supervisory Service, Seoul.

Korea's dependence on major trading partners such as the United States, Europe, and Japan has been substantially reduced during the past decade (***Table 5***).

Table 5: **Diversification of Korea's Export Markets, 2009, percentage**

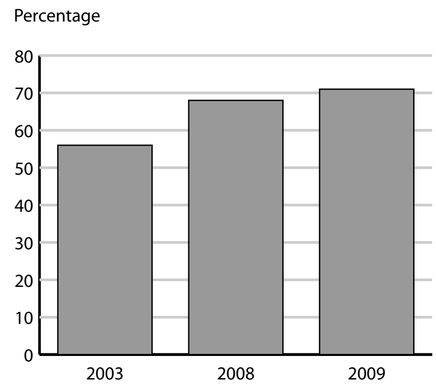
Country	Percentage of trade
China	23.9
European Union	12.8
North America	11.3
ASEAN	11.3
Middle East	6.6
Japan	6.0
Others	28.1

Source: Korea International Trade Association, Seoul.

Between 2003 and 2009 Korea increased the proportion of its exports to developing countries from 56 percent to 71 percent (***Figure 4***).

In terms of export items, Korea remains competitive in a wide range of high technology products and fields, such as shipbuilding, mobile communication, automobiles, and semiconductors. Despite the slowdown in the overall economy during the crisis period, Korean companies making automobiles and liquid crystal displays (LCDs) performed better and actually enjoyed an increase in their global market share. Because of Korea's reforms in response to the 1997 crisis as well as its diversification, Korea's economy was poised to overcome the financial crisis that had been bedeviling its economy during the past two years.

Figure 4: **Korea's Exports to Developing Countries, 2003, 2008 and 2009, percentage**



Source: Korea International Trade Association, Seoul

In addition to Korea's reforms and diversification, also important is Korea's ability to shore up the stability and resilience of its economy, and for this Korea's active and expansionary government policies and measures are important. During the economic downturn, the Korean government's fiscal stimulus responses have been a critical line of defense to counter the sharp contraction in demand. A wide range of monetary, financial, and foreign exchange policies were also implemented to ensure stability in the markets.

To keep the crisis at bay, the government introduced an unprecedented level and extent of fiscal, monetary, and financial measures. The government implemented a fiscal stimulus package of 70.5 trillion *won*, including public spending and tax cuts, for the period between 2008 and 2010. The ratio of expansionary fiscal support to the country's GDP during the period has been 6.9 percent compared with 5.6 percent in the United States, 4.7 percent in Japan, and 1.9 percent in the United Kingdom. More specifically, in April 2009, the largest supplementary budget of 28.4 trillion *won* was rapidly approved by the National Assembly to support employment and growth.

Regarding the speed of fiscal expenditures, in order to maximize the positive effect of the fiscal stimulus on the economy, the government made utmost efforts to front-load fiscal spending. In the first half of 2009, for example, the government spent 64.8 percent of its total budget (***Table 6***). The size of the fiscal stimulus and the speed of its execution was vital for helping the economy weather the crisis.

In addition, the government has taken a wide range of unconventional measures to stabilize monetary, financial, and foreign exchange markets by cutting the key rates six times—from 5.25 percent to 2 percent—and providing adequate liquidity for the markets. With compassion and care for the members of the vulnerable sectors of society, who were hit the hardest, the government pursued job-sharing and job-creation policies and prepared measures to stabilize the livelihoods of low- and middle-income groups in our society. The Korean government has recently taken additional steps to ensure working- and middle-class-friendly policies.

Given such support through expansionary policies, the economy registered positive growth in the first quarter of 2009 and turned the corner toward more robust performance in terms of year-on-year economic growth in the third quarter of 2009. The government assumed much more of the burden in order to promote economic growth after the fourth quarter of 2008. Specifically, the government contributed 1.9 percent and 1.3 percent, respectively, to the first and the third quarter GDP growth year on year in 2009 (***Table 7***).

At the bilateral level, the Korean government concluded currency swap agreements of $30 billion each with the United States, China, and Japan to ease concerns in its foreign exchange market. At the regional and global levels, the government has successfully engaged in international policy coordination, such as in the ASEAN Plus Three and G-20 to deal with the crisis. The importance of global coordination in addressing the Great Recession cannot be overemphasized. Back during the Great Depression in the 1930s, countries took measures individually without intergovernmental coordination, which prolonged the crisis. By contrast, during 2008 and 2009, global coordination led by the G-20 played a tremendous role in holding off the worst of the present crisis.

On top of these policies, the government spared no effort to restore public confidence; therefore, the Korean people held their ground courageously and worked in unison throughout the economic crisis.

Table 6: **Government Budget Spending Target and Execution in Korea, 2004–09, percentage**

	2004	2006	2008	2009
First quarter	26.9 (26.9)	26.8 (25.6)	24.9 (22.7)	29.5 (32.5)
Second quarter	28.0 (28.1)	25.3 (27.4)	27.1 (26.9)	31.1 (32.2)
First half of year	54.8 (55.0)	52.0 (53.0)	52.0 (49.6)	60.6 (64.8)

Source: Ministry of Strategy and Finance, Seoul, January 2010.
Note: Spending targets are not enclosed in parentheses; percentage spent is shown inside parentheses.

Table 7: **Contribution to GDP by Government and Private Sector in Korea, 2008–09, percentage**

	Q1.08	Q2.08	Q3.08	Q4.08	Q1.09	Q2.09	Q3.09
GDP growth (%)	5.5	4.3	3.1	-3.4	-4.2	-2.2	0.9
Government (%)	0.2	0.5	0.6	0.6	1.9	1.9	1.3
Private sector (%)	5.3	3.8	2.5	-4.0	-6.1	-4.1	-0.4

Source: Ministry of Strategy and Finance, Seoul, January 2009.
Note: All percentages are year-on-year.

Conclusion

Aside from crisis intervention measures, the Korean government has also been preparing policies and measures to enhance future prosperity. The government is committed to efforts to open the economy, to continue to enhance flexibility in labor market conditions, and to create a better environment for foreign investment. The government is also committed to efforts to advance its services sector. Moreover, the government announced “low carbon, green growth” as a national agenda, using it as an engine to promote sustainable growth and create new markets and jobs. It also introduced the Green Growth Five Year Plan in July 2009 and will invest 2 percent of GDP as public spending on green growth between 2009 and 2013.

While there are welcome prospects for continued recovery in 2010, active policy support to strengthen the ingredients of a lasting recovery should be continued. Uncertainties and risks in the global financial market, such as sovereign vulnerabilities in some countries, will likely remain for a period of time although the Korean government, in line with the brighter outlook of international institutions, is upbeat about its growth prospects in 2010.

It is important for government to sustain its support until an enduring pattern for recovery is secured while it prepares for future policies to enhance growth potential. With courage and perseverance to take bold and effective policies for today and tomorrow, the Korean economy has been successful at showing its stability and resilience. Accordingly, Korea is expected to continue its commitment to building its economy on a platform of stability and prosperity, combined with fruitful international cooperation as in, for example, the G-20.

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