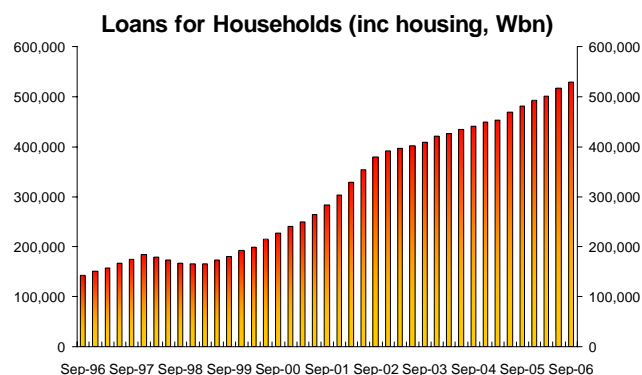
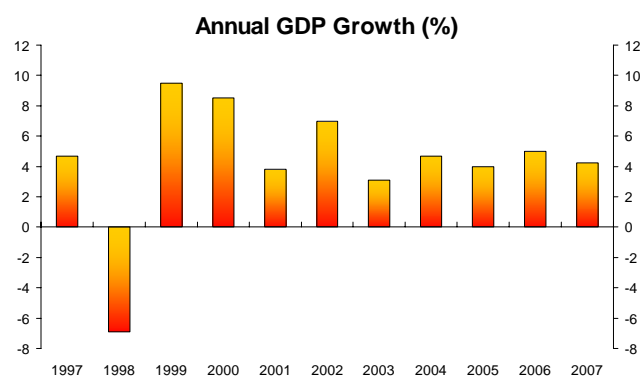


South Korea: housing boom fuels debt growth

Key trends

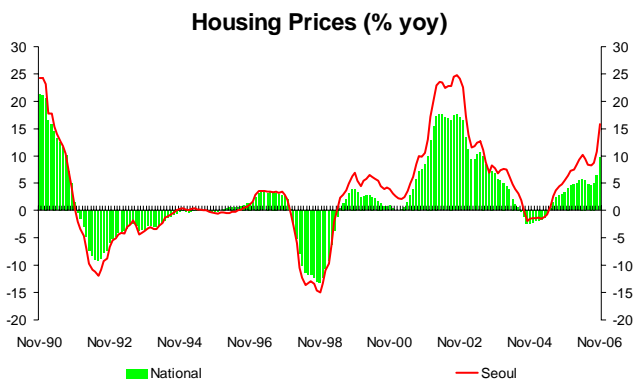
- House prices in South Korea are rising rapidly, raising fears of a bubble with negative consequences for the economy.** In particular, the growing household debt burden associated with rising house prices is weighing down prospects for consumer spending. Combined with slowing economic growth, this has resulted in a sharp increase in individual bankruptcies. We recall that the collapse of a previous consumer credit card bubble in late-2002 served to depress household consumption for several years, holding down overall economic growth.
- Household debt growth is occurring against a backdrop of modest income and employment growth, making it more difficult for households to repay debts.** By the end of September 2006, household debt had climbed to an all-time high of W558.8 trillion, or 10.4% higher than in September 2005 and about three times larger than before the 1997-98 financial crisis. At this level, household debt was equivalent to almost 67% of GDP, up from around 38% of GDP prior to the crisis.
- The continued rise in house prices presents a case for further increases in interest rates.** But, with most household debt carrying floating interest rates (the proportion of market interest rate based mortgage loans to total loan products stood at 95.3% in July 2006), authorities are likely to be hesitant in raising rates further, especially given the outlook for slower economic growth, and will probably resort to further administrative measures - notwithstanding the fact that previous measures to rein in house prices have been ineffective.



Housing prices growing strongly

House prices in Korea are rising rapidly, raising fears of a bubble, with negative consequences for the economy. In particular, growing household debt is weighing down prospects for spending amid already modest income and employment growth, fueling concerns about an economic crisis, especially if there is a correction in house prices.

According to the Kookmin Bank's house price series, national housing prices rose by 9.8% yoy in November, or by 3.1% over the previous month, which was the largest monthly increase in almost 17 years. The increase in housing prices was led by particularly rapid increases in Seoul, where prices increased by 15.9% yoy in November, or by 4.8% over the previous month.

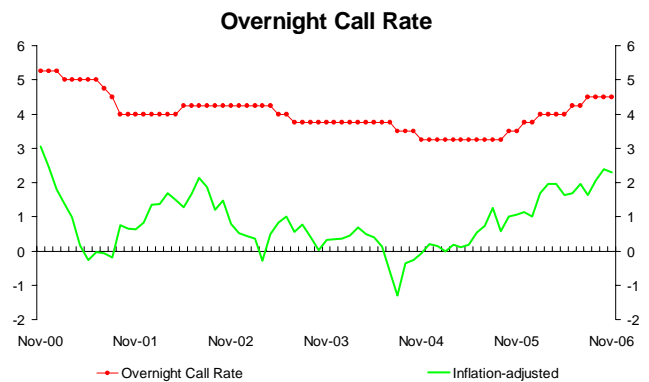


Kookmin Bank House Price Index

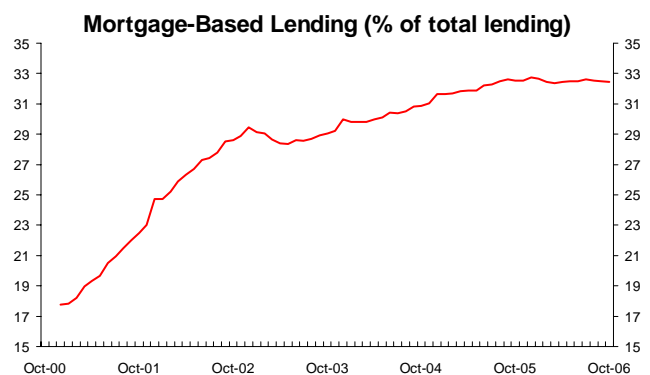
	Nov06 yoy	Nov-05 yoy	Nov-06 mom
National House Price Index	9.8	3.4	3.1
- single house	4.4	0.6	1.1
- row house	10.9	0.2	3.2
- apartment house	11.7	5.2	3.9
Seoul House Price Index	15.9	5.4	4.8
- single house	9.6	3.3	2.7
- row house	12.0	1.5	3.3
- apartment house	20.3	8.1	6.2

The housing market is being buoyed by three factors:

- Interest rates are historically low - official rates are just 4.5%, or around 2¼% in real inflation-adjusted terms. This has encouraged buyers to take on debt.

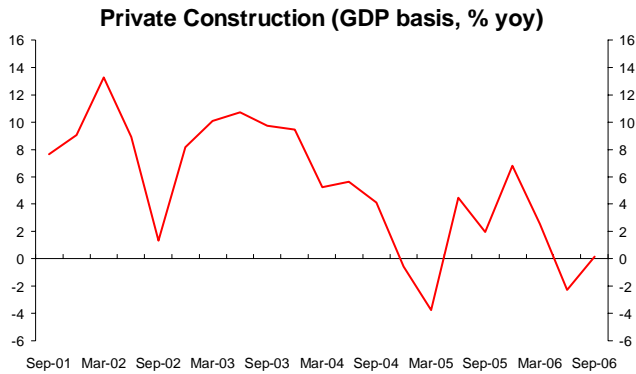


- The deregulation of South Korea's financial markets in the wake of the Asian crisis in 1997-98 resulted in rapid diversification of bank lending portfolios (mortgage based household lending now accounts for more than 32% of all bank loans, up from around 17% at the end of 2000). This has increased the scope for speculation in the real estate market.



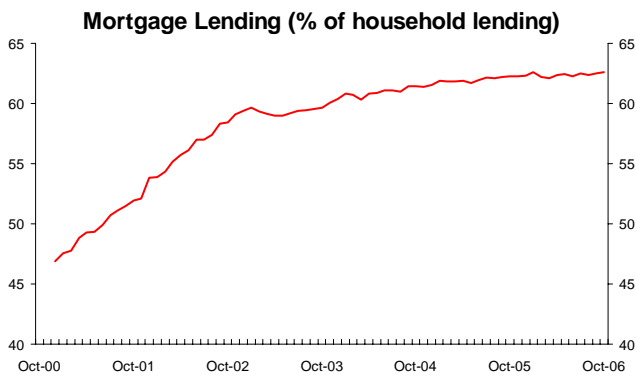
- A series of measures introduced by the government in late-2003 designed to curb real estate speculation has created a housing shortage in parts of the country

(especially in and around the capital city of Seoul), which has also helped drive up housing prices to record highs.

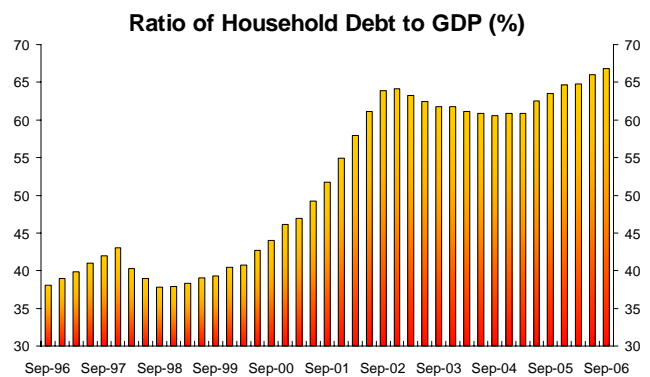


Household debt rising rapidly

The increase in housing prices has underpinned a rapid build up in household debt as households have borrowed more to finance their purchases. BOK data shows that mortgage-based bank loans were growing by more than 12% yoy in October 2006. Moreover, mortgage-based lending accounted for almost 63% of bank lending to households, up from less than 50% in 2001, as banks engaged in heavy competition to tap this market, while demand for mortgage financing continues to be fuelled by expectations of further house price increases.



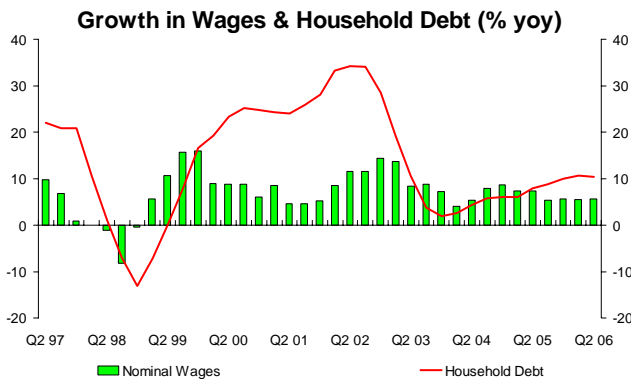
Consequently, household debt is also rising at a very rapid rate and this is occurring against a backdrop of very modest income and employment growth, making it more difficult for households to repay debts. By September 2006, household debt had climbed to an all-time high of W558.8 trillion, or 10.4% higher than in September 2005 and about three times larger than before the 1997-98 financial crisis. At this level, household debt was equivalent to almost 67% of GDP, up from around 38% of GDP prior to the crisis. The average Korean household now owes a record W35 million (around US\$37,000) and the BOK sees this figure rising in the December quarter as the recent surge in house lending is not covered in the September quarter debt statistics.



The fear is that the rapid rise in household debt will dampen consumption spending and hurt the economy by putting more households in danger of bankruptcy - and there is evidence that this is already occurring. As household debt has been growing at a much faster rate than incomes, the number of individuals filing for bankruptcy has risen sharply. The latest data shows that individual bankruptcies reached 85,455 in September 2006, more than double the figure of 38,773 in September 2005.

With the rapid growth in household debt, the number of individual bankruptcies is expected to continue climbing as GDP growth is now officially forecast to slow from an estimated 5% this year to 4.4% in 2007 (we are forecasting

4¼%), while the jobless rate is officially forecast to rise as companies remain reluctant to hire new employees due to the uncertain business outlook under a new labour reform bill. The Supreme Court of Korea expects the number of individual bankruptcies to exceed 110,000 in 2006.

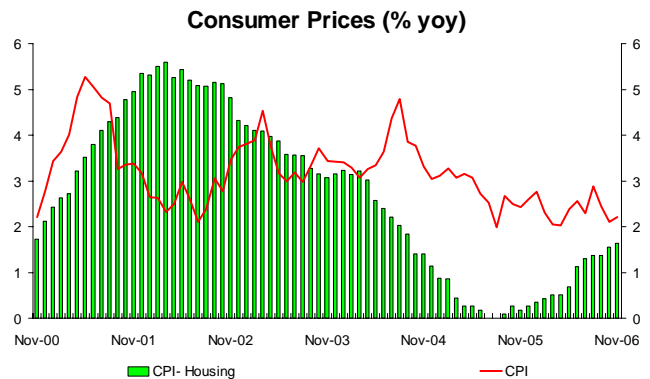


The BOK’s biannual stability report provides an insight into the weakening of households’ debt repayment capabilities. Household loans grew by 8.6% in the first half of 2006, while financial assets increased by just 3.7% due to a decline in stock prices. Consequently, households’ capital gearing ratio rose to 44.3% at the end of June, from 43.2% at the end of 2005 (comparable figures were 32% in the United States, 26% in Japan and 17% in Taiwan). Meanwhile, the average ratio of debt to disposable income rose to 1.41 at the end of June 2006 from 1.36 at the end of 2005.

The IMF has warned that rapidly rising household debt levels in Korea could also threaten the health of the financial system - although it is not a problem now. For example, the delinquency ratio for household mortgages at Kookmin Bank (the largest home-lender in Korea), fell to 1.7% in September 2006, down from 1.93% one year ago, while the delinquency ratio for retail loans at Shinhan Bank, the second biggest lender, stood at 0.87% in September.

Nevertheless, financial regulators have called on banks to strengthen credit criteria for housing-backed loans to slow

the rise in house prices. In mid-November, the government announced another set of measures to stem speculation in the housing market. The measures included plans to increase the number of homes built in and around Seoul over the next five years (the government expects that long-term house price stabilisation will be achieved from 2008 on the back of constructing more than 360,000 to 400,000 homes a year). Tighter policies were also announced regarding loans extended by banks, with reserve requirements raised on short-term deposits for the first time in 16 years in an attempt to squeeze liquidity at banks and reduce funds available for mortgage lending. This was the eighth package unveiled in three years.



The continued rise in house prices presents a case for further increases in interest rates. But, with most household debt carrying floating interest rates (the proportion of market interest rate based mortgage loans to total loan products stood at 95.3% in July 2006), authorities are likely to be hesitant in raising rates further, especially given the outlook for slower economic growth. To this end, it will be helped by subdued inflation, which was running at just 2.2% yoy in November. Instead, the authorities will probably resort to further administrative measures to rein in the housing boom - notwithstanding the fact that previous measures to rein in house prices have been ineffective.

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