

COUNTRY REPORT
KOREA - 2014

*The Credit
Finance
Association of
Korea*

1. Macroeconomic Situation in 2014¹

In 2014, GDP growth (in real terms) in the Korean economy rose from 2.9 percent in the previous year to 3.3 percent, mainly due to the moderate recovery of the global economy led by U.S. and to improved facilities investment. However, the domestic economic recovery remained anemic overall due to a slowdown in private consumption.

Economic growth rate¹⁾
(Quarter-on-quarter)

(Unit : %)

	2013		2014p			
	Year		I	II	III	IV
G D P	2.9	3.3	1.1 (3.9)	0.5 (3.4)	0.8 (3.3)	0.3 (2.7)
Final consumption	2.2	2.0	0.4 (2.7)	-0.1 (1.7)	1.1 (2.0)	0.4 (1.8)
Fixed capital formation	3.3	3.1	2.6 (5.8)	0.6(3.3)	0.5 (3.3)	-2.9 (0.7)
Changes in inventories ²⁾	-1.0	0.5	-1.3 (-0.5)	0.2 (0.9)	0.5 (1.0)	0.9 (0.7)
Exports	4.3	2.8	1.4 (4.2)	1.3 (3.4)	-1.7 (2.2)	0.4 (1.4)
Imports	1.7	2.1	-1.1 (3.2)	1.2 (2.9)	-0.7 (2.3)	0.7 (0.1)
G N I	3.7	3.8	1.0 (4.8)	1.0(3.5)	0.2 (3.2)	1.6 (3.7)

Notes: 1) Figures in parentheses are year-on-year rates.

2) Contribution to growth rate of GDP(%p).

Source: The Bank of Korea.

Consumer prices marked an average annual increase of 1.3 percent, low growth and similar to that seen in the previous year. This low inflation rate is attributable mostly to a decline in prices of petroleum and agricultural products, a development that was also widely witnessed in major advanced nations.

Exports (custom-clearance basis) registered 572.7 billion dollars, a rise of 2.3 percent over the previous year, mainly due to IT products.

¹ The Bank of Korea, 2015, "2014 Annual Report", March 2015.

Imports (custom-clearance basis) grew by 1.9 percent over the previous year to stand at 525.5 billion dollars.

2. Financial Market Situation in 2014²

(1) Interest Rates

Yields on Treasury bonds (3-year) fluctuated from the beginning of the year until early June within a narrow range of 2.81 to 2.92 percent due to heightened geopolitical risk in the Ukraine combined with shifting expectations regarding an early raising of its policy rate by the U.S. Federal Reserve. From mid-June, yields on Treasury bonds fell to reach the lowest point for the year at 2.07 percent in late November under the influence of the sluggishness of the economic recovery resulting from the Sewol ferry disaster, the Bank of Korea's two-step Base Rate cut of 0.25 percentage points on August 14 and again on October 15³, and expectations of a further Base Rate cut generated by additional easing by the central banks of major countries⁴. Subsequently, Treasury bond yields rebounded slightly, reaching 2.10 percent at the end of the year, down by 0.76 of a percentage point year-on year. Secondary market yields on corporate bonds (AA-, 3-year) followed a similar pattern of movements to Treasury bond yields, registering 2.44 percent at the end of 2014, down by 0.93 percentage points from one year earlier.

² The Bank of Korea, 2015, "2014 Annual Report", March 2015.

³ The Bank of Korea lowered the Base Rate by 0.25 percentage points each on two occasions, from 2.50 percent to 2.25 percent on August 14 and from 2.25 percent to 2.00 percent on October 15.

⁴ Following the Bank of Japan's launch of additional quantitative easing on October 31, the People's Bank of China also lowered interest rates on loans and deposits on November 21.

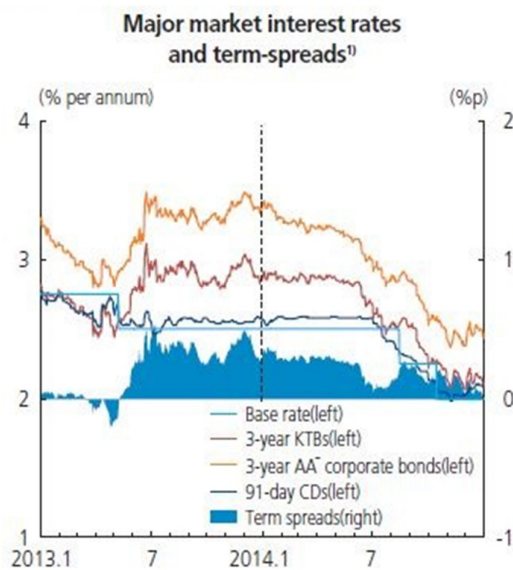
Yields on Monetary Stabilization Bonds (91-day), the benchmark short-term interest rate, remained steady in the first half of 2014, but continued on a downward trend in the second half, driven by the two-step reduction in the Base Rate. However, they subsequently rebounded slightly in December under the influence of a fall in short-term deposits⁵ caused by the year-end demand for funds.

Meanwhile, with both short- and long term market interest rates on the decline, there was an inversion of the yield curve between the interest rates of Treasury bonds and the Base Rate in late July (July 23 and July 25) and again in early October (October 1), but it soon resolved itself.

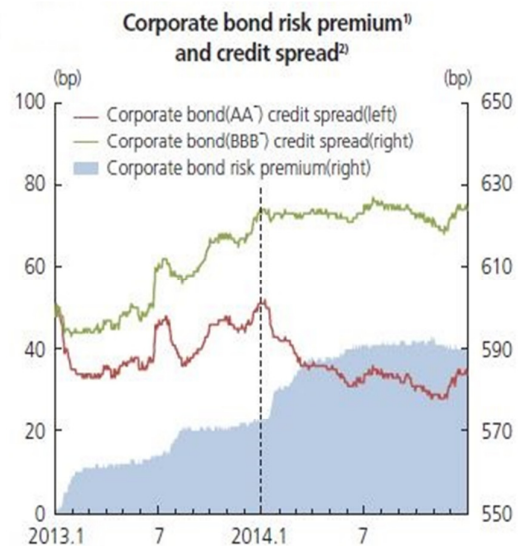
Corporate bond credit spreads (secondary market yields on 3-year AA– corporate bonds versus those on 3-year Treasury bonds) decreased from 0.51 percentage points at the beginning of the year (January 2) to 0.28 percentage points on November 25, affected by the growing investment demand for high-grade corporate bonds resulting from the reduced issuance of special bonds and a decline in yields on Treasury bonds. However, this credit spread rose slightly in December thanks to the burden of reduced credit spreads and falling demand from institutional investors at the end of the year.⁶ Corporate bond credit spreads (credit rating BBB– versus credit rating AA–) widened as heightened credit risk aversion eroded demand for low-grade corporate bonds.

⁵ Asset management companies' outstanding money market fund (MMF) deposits shrank from 95.0 trillion won in late October to 93.8 trillion won in late November and to 82.4 trillion won in late December.

⁶ In December, credit spreads tend to widen as institutional investors close their books, reducing investment in corporate bonds.



Note: 1) Yields difference between 3-year KTBS and Base Rate.
Sources: The Bank of Korea, Korea Financial Investment Association.



Notes: 1) Yields difference between 3-year corporate bonds and 3-year KTBS.
2) Yields difference between 3-year AA⁺ corporate bonds and 3-year BBB⁺ corporate bonds.
Source: Korea Financial Investment Association.

(2) Loans by Financial Institutions

Corporate and household loans grew on a significantly larger scale than in the previous year, centering around bank loans.

In regard to banks' corporate lending, lending to large companies increased by 9.5 trillion won, a moderate expansion over the preceding year, due to a rise in loan demand owing to the depressed corporate bond market. Loans to SMEs increased by 34.7 trillion won, a considerable rise compared to the previous year, under the influence of the government's encouragement of credit loans to technology-based SMEs and the moderation of banks' lending stance.⁷ Lending to sole trader businesses, which are also classified as SME loans, continued on its upward

⁷ The revision of the Enforcement Decree of the Framework Act on Small and Medium Enterprises with effect from March 25, 2009 narrowed the scope of SMEs starting from 2011, resulting in some corporate lending that had formerly been considered lending to SMEs being classified as lending to large companies. The value of the re-classified lending stood at 5.5 trillion won in 2014, while the value of the increase in lending to SMEs also expanded based on pre-reclassification standards, from 36.1 trillion won in 2013 to 40.2 trillion won in 2014.

growth track, driven by banks' efforts to expand their loan books.

Meanwhile, the scale of growth of corporate lending by non-bank financial institutions widened as the growth rate of loans by mutual savings banks and mutual credit cooperatives commenced an upward trend, following on from the previous year's decline.

Household loans by banks (excluding loans assigned to the Korea Housing Finance Corporation) marked considerably higher growth, increasing by 38.7 trillion won compared to the previous year. This was mainly due to substantial growth in the demand for mortgage loans in response to the relaxation of loan-to-value (LTV) and debt-to-income (DTI) ratios⁸, an increase in housing transactions and the continuance of low interest rates following the two-step reduction of the Base Rate⁹.

However, household loans by non-bank financial institutions saw only a slight expansion of 27.7 trillion won, its growth greatly reduced from the previous year's. Credit co-operatives' lending, including that by mutual credits and community credit cooperatives, continued on a robust upward trend based on the favorable increase in their deposit-taking. In contrast, the expansion of lending by other financial intermediaries shifted to a decrease, owing to a considerable expansion of the scale of redemption of the Korea Housing Finance Corporation's policy mortgage loans including conforming and Bogeumjari loans¹⁰.

⁸ From August 1, 2014, the Korean government unified the LTV ratio for banks (50 to 60 percent) and non-bank financial institutions (60 to 70 percent) at 70 percent, and the DTI ratio for bank loans, which had differed by region (50 percent in Seoul, 60 percent in Incheon and Gyeonggi Province), at 60 percent.

⁹ Mortgage loans by banks (excluding loans assigned to the Korea Housing Finance Corporation) increased by 36.8 trillion won throughout 2014, considerably higher than the average expansion of 13.9 trillion won during the 2008 to 2013 period.

¹⁰ However, from the fourth quarter, policy mortgage lending shifted back to an increase, growing significantly, following the launch in late June of adjustable interest rate mortgage loans eligible for assignment and the steady reduction of loan interest rates

Financial institutions' loans
(Changes in loans)

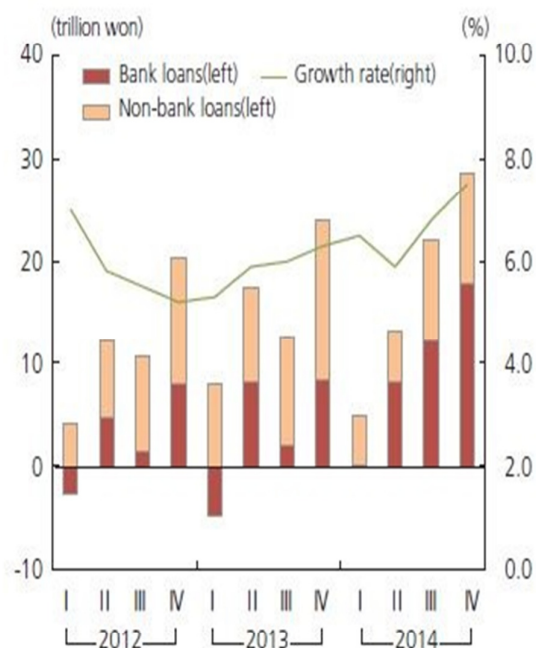
(Unit : trillion won)

	2013	2014				
		Year	I	II	III	IV ⁴
Bank loans	55.0	86.0	17.0	25.5	23.7	19.9
Large corporations	8.6	9.5	5.6	7.8	1.2	-5.1
SMEs	27.4	34.7	10.7	8.7	9.2	6.1
Sole traders ¹⁾	17.1	18.8	3.0	4.9	5.2	5.6
Household	13.9	38.7	0.1	8.3	12.3	17.8
Non-bank loans						
Corporations and others ²⁾	5.6	14.9	2.7	4.0	4.6	3.7
Household ³⁾	43.1	26.5	4.7	4.8	8.5	8.5
Credit corporatives	13.3	19.2	3.6	6.5	4.7	4.4
Insurance institutions	6.8	4.9	-0.0	0.9	1.2	2.8
Other financial intermediaries	16.6	-1.2	-0.3	-3.9	-0.6	3.6

- Notes: 1) According to simple survey.
 2) Based on loans by mutual savings banks, credit unions, mutual credits, community credit cooperatives, and insurance companies.
 3) Based on loans by mutual savings banks, credit unions, mutual credits, community credit cooperatives, insurance companies, pension funds, specialized credit financial companies, and public financial institutions, etc.
 4) Figures are the amounts excluding the volumes of corporate sector bank lending by the Korea Finance Corporation, which were included in the total loan amounts following the merger between Korea Development Bank and Korea Finance Corporation, non-bank loans are advance estimates.

Sources: The Bank of Korea, Financial Supervisory Service.

Changes¹⁾ and growth rate²⁾ in household loans



- Notes: 1) Compared with the previous period.
 2) Year-on-year.

Source: The Bank of Korea.

3. Market Description

As of July 1st of 2015, there are 50 leasing business companies (hereinafter "leasing companies"), which include 25 lease companies and 25 specialized credit financial business companies registered in the leasing business. Specialized credit financial business companies consist of 4 credit card companies, 17 installment finance companies and 4 venture capital companies.

The total amount of facility investment (sum of machinery and transport equipment) was KRW 127.0 trillion. Market penetration level increased from the previous year's 8.8% to 9.8% in 2014. **(Table 1)**

The total outstanding of Loans for Equipment (Includes loans and discounts, CB & SB Banks, Merchant banking corporations, Trust companies, Mutual savings banks, Credit union, etc) reached KRW 306.0 trillion as of the end of 2014 and the leasing volume was KRW 12.4 trillion, taking up 4.06% of the total. **(Table 2)**

The leasing acquisition volume by items as of the end of 2014 were; transportation equipment (67.3%), industrial machinery equipment (17.2%), medical appliance (7.5%), educational, scientific & technological equipment (5.1%). **(Table 3)**

The industrial machinery equipment had taken up 59.4% (KRW 7.7 trillion) of the total leasing contracts volume in 1997. At the time Korea was experiencing the financial crisis. In contrast, it took only 17.2% (KRW 2.1 trillion) as of the end of 2014, a remarkable decline in terms of volume and proportion. **(Table 3)**

Automobile lease has propelled the recovery of the leasing market since 2000. Its leasing acquisition volume remained just at 5.2% in 2000. But in 2014, it is serving as a growth engine for the domestic leasing market. The amount of automobile lease in Korea reached KRW 7.9 trillion as of the end of 2014, taking 63.9% out of the total lease volume. **(Table 5)**

Table 1: Leasing Volume & Leasing Market Penetration in Korea*

Year	Contact Vol (A)		Acquisition Vol(B)		Facilities investment* (C)	Leasing market penetration (B/C)
	in Wbn	Growth rate (%)	in Wbn	Growth rate (%)		
1993	11,368.1	21.1	7,379.0	10.2	38,307.1	19.3
1994	19,243.2	69.3	10,436.0	41.4	49,231.2	21.2
1995	20,587.4	7.0	14,328.5	37.3	58,535.8	24.5
1996	16,874.3	-18.0	13,786.7	-3.8	65,930.5	20.9
1997	8,602.6	-49.0	12,987.7	-5.8	62,726.3	20.7
1998	1,403.5	-83.7	3,234.4	-75.1	43,198.7	7.5
1999	1,276.8	-9.0	1,064.7	-67.1	57,103.4	1.9
2000	1,331.5	4.3	1,214.2	14.0	77,762.2	1.6
2001	2,118.2	59.1	1,564.2	28.8	72,586.0	2.2
2002	2,474.6	16.8	2,466.2	57.7	76,975.0	3.2
2003	3,676.1	48.6	3,018.4	22.4	76,753.3	3.9
2004	4,534.9	23.4	4,060.9	34.5	80,618.5	5.0
2005	5,764.9	27.1	5,569.1	37.1	83,505.9	6.7
2006	7,497.3	30.1	7,090.8	27.3	88,061.1	8.1
2007	10,910.4	45.5	9,668.7	36.4	93,944.5	10.7
2008	10,021.3	-8.1	10,017.2	3.6	102,965.9	9.7
2009	7,756.7	-22.6	7,449.9	-25.6	103,508.3	7.2
2010	9,954.8	28.3	9,977.0	33.9	121,621.4	8.2
2011	10,151.7	2.0	10,601.8	6.3	127,711.2	8.3
2012	10,025.2	-1.2	10,262.7	-3.2	128,284.6	8.0
2013	10,463.5	4.4	10,806.7	5.3	122,999.2	8.8
2014	11,592.1	10.8	12,409.2	14.8	126,954.0	9.8

* Statistics are revised in accordance with the 9th revision of KISC(Feb.1.2008)

* Facilities investment: sum of machinery and transport equipment (Source: Bank of Korea)

Table 2: Total Loans for Equipment VS Leasing Volume

(As of the end of year, in billions KRW & %)

Year	Total Loans for Equipment(A)*	lease volume(B)	(B/A)
1996	53,820.7	13,786.7	25.62
1997	62,994.4	12,987.7	20.62
1998	57,817.5	3,234.4	5.59
1999	56,006.6	1,064.7	1.90
2000	58,697.5	1,214.2	2.07
2001	49,219.2	1,564.2	3.18
2002	55,439.6	2,466.2	4.45
2003	58,309.7	3,018.4	5.18
2004	59,581.7	4,060.9	6.82
2005	64,182.6	5,569.1	8.68
2006	79,235.4	7,090.8	8.95
2007	110,405.5	9,668.7	8.76
2008	141,744.9	10,017.2	7.07
2009	162,301.1	7,450.0	4.59
2010	176,349.4	9,977.0	5.66
2011	206,359.2	10,601.8	5.14
2012	232,700.8	10,262.7	4.41
2013	261,767.8	10,806.7	4.13
2014	305,990.0	12,409.2	4.06

* Statistics are revised in accordance with the 9th revision of KISC(Feb.1.2008)

* Includes loans and discounts, CB & SB Banks, Merchant banking corporations, Trust companies, Mutual savings banks, Credit union, etc.

Table 3: Leasing analysis by Asset Type

(As of the end of year, in billions KRW & %)

Asset Type	2014	(%)	2013	2012	2011
Industry machinery equipment	2,132.8	17.2%	2,177.1	2,119.9	2,294.5
Industry machinery	716.3	5.8%	765.8	810.7	1,152.6
Electrical machinery	99.0	0.8%	9.5	21.4	44.5
Machine tool	1,317.5	10.6%	1,401.8	1,287.7	1,097.4
Transportation equipment	8,347.0	67.3%	6,729.7	6,288.6	6,524.7
Motor vehicles	7,928.8	63.9%	6,417.1	5,824.7	6,180.4
Construction equipment	176.2	1.4%	129.1	161.2	142.6
Vessels	238.0	1.9%	176.3	281.7	197.7
Planes	0.6	0.0%	7.2	21.0	4.0
Railroad vehicles	3.4	0.0%	-	-	-
Medical equipment	924.6	7.5%	976.9	922.5	890.3
Anti-Pollution equipment	-		0.7	-	1.0
Educational, scientific & technological equipment	635.5	5.1%	374.0	540.3	525.3
Office equipment	58.3	0.5%	53.0	33.9	49.5
Computer	386.9	3.1%	270.0	403.6	414.7
Others	190.3	1.5%	51.0	102.8	61.1
Communication equipment	105.1	0.8%	124.9	127.5	122.1
Machinery & equipment for distribution industry	24.3	0.2%	34.3	20.6	36.8
Others	239.9	1.9%	389.1	243.3	207.1
Total	12,409.2	100.0%	10,806.7	10,262.7	10,601.8

Table 4: Leasing analysis by Industry

(As of the end of year, in billions KRW & %)

Industry	2014	(%)	2013	2012	2011
Agriculture & Fishing	30.0	0.2%	22.9	30.0	14.7
Mining	32.0	0.3%	24.9	8.0	10.5
Manufacturing	3,893.5	31.4%	3,550.0	3,122.6	3,331.4
Construction	368.4	3.0%	320.9	341.6	364.2
Wholesale & Retail	1,463.7	11.8%	1,132.4	957.9	1011.0
Hotels & Tourism	135.1	1.1%	78.4	51.6	63.9
Transport & Storage	244.8	2.0%	284.9	316.3	335.5
Communication	85.2	0.7%	93.3	119.8	93.1
Financing, insurance & business service	414.9	3.3%	338.6	264.8	354.8
Medical treatment	962.8	7.8%	939.1	885.0	842.6
Environmental industry (Anti-pollution)	17.4	0.1%	14.1	12.9	12.1
Community & personal services	1,420.7	11.4%	1,194.5	999.2	1,157.6
Others	3,340.7	26.9%	2,813.6	3,153.0	3,010.4
Total	12,409.2	100.0%	10,806.7	10,262.7	10,601.8

Table 5: Automobile Leasing in Korea

(As of the end of year, in billions KRW & %)

Classification	2014	2013	2012	2011
Total lease	12,409.2	10,806.7	10,262.7	10,601.8
Automobile lease	7,928.8	6,417.1	5,824.7	6,180.4
%	63.9	59.4	56.8	58.3