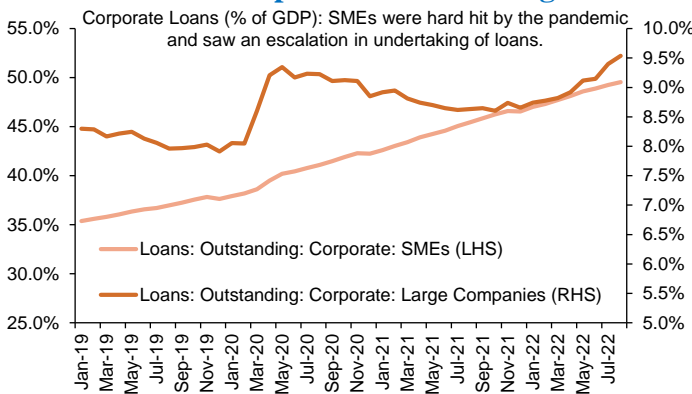


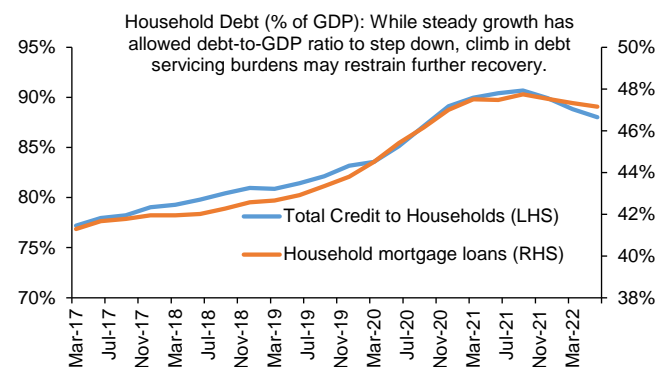
Korea: Rising Debt, Rates & Risks

In a nutshell: The pandemic had worsened the **debt situation in Korea** which in turn complicates the **Bank of Korea's (BoK) policy calculus to curb inflation** especially amid them grappling with neutral rate territory. This debt situation is fully appreciated considering the *surge in SME loans which has reach 49.5% of GDP in August 2022 (from 35.4% in Jan 2019)* while large companies also saw an increase in loans to 9.5% in GDP. Going forward as interest rates rise, **loan servicing will be arduous** given that a *large proportion of corporate loans are on floating rates*. With **household debt to GDP ratio** also near record highs, rising interest rates will increase the burden on consumers and erode disposable incomes. This problem is certainly not helped by a **rising proportion of loans being on floating rates** which stands at 78.5%. While the authorities have put in place policies to assist businesses and households who are most at risk of default/losing their homes, the reactions of multiple-home owners should be monitored to prevent downward spiralling of house prices which feedback into negative housing equity. While **arresting inflationary pressure remains the BoK's utmost priority as they continue hiking policy rates, the central bank will be cognisant not to exacerbate existing domestic risks.**

Household and Corporate Burdens: High For Longer



Source: CEIC; Mizuho Bank



Source: CEIC; Mizuho Bank

Note: GDP computed using 4qma of nominal GDP. Debt comprise of mortgage, merchandise credit and other loans.

From the perspective of aggregate outstanding loans, the **‘stock’ perspective gives a presentation of the debt situation relative to the size of the economy**. Thereafter, we can examine the ‘flow’ perspective to understand the **strains from rising interest rates**. On the **corporate front, the rise in bank loans was largely undertaken by SMEs during the pandemic** which saw their loan to GDP ratio increase from 35.4% in January 2019 to 49.5% to August 2022. Large companies which tend to be better capitalised saw a smaller increase in loan uptake from 8.3% of GDP in January 2019 to 9.5% in August 2022. Admittedly, *bank loans may understate indebtedness for large companies, which better access to capital markets.*

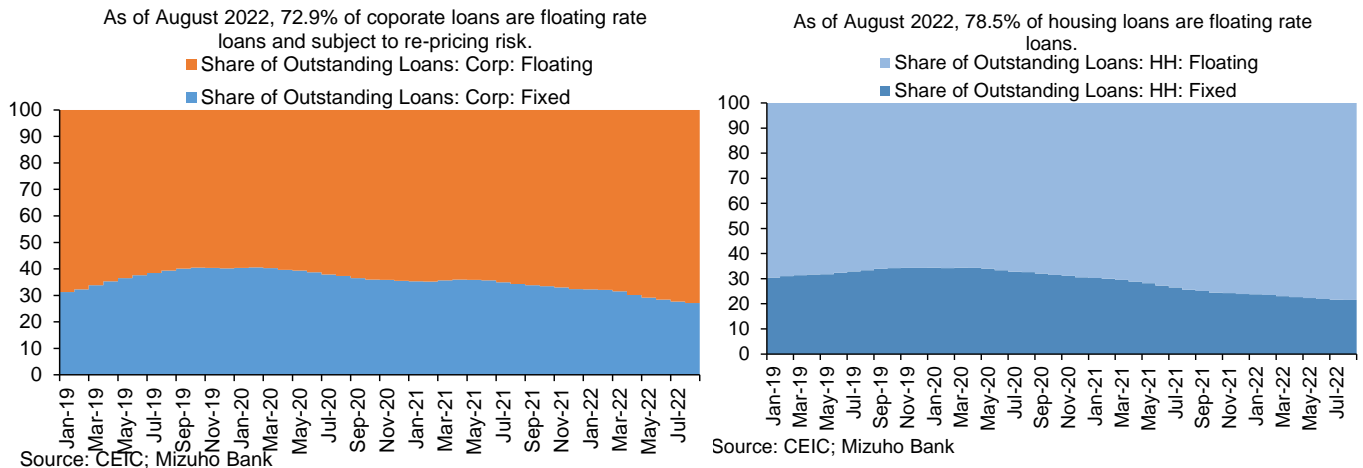
Understandably, small enterprises which employed a large majority of the labour force have also been the concern of the authorities who announced on 30 September to **extend loan maturity for up to 3 years and defer repayments until September 2023** for businesses which were experiencing difficulties in their recovery from the pandemic. The latest **extension was the fourth time** in the past two years as the scheme was set to expire at the end of September.

Households saw a worsening of their debt situation due to the pandemic, though some relief came through in Q2 2022 in the form of higher incomes. As of June 2022, total household debt stands at 88% of GDP with mortgage loans at 47% of GDP which implies that **more than half of household debt is**

taken up by mortgages. The other drivers of household borrowing are personal loans and merchandise credit.

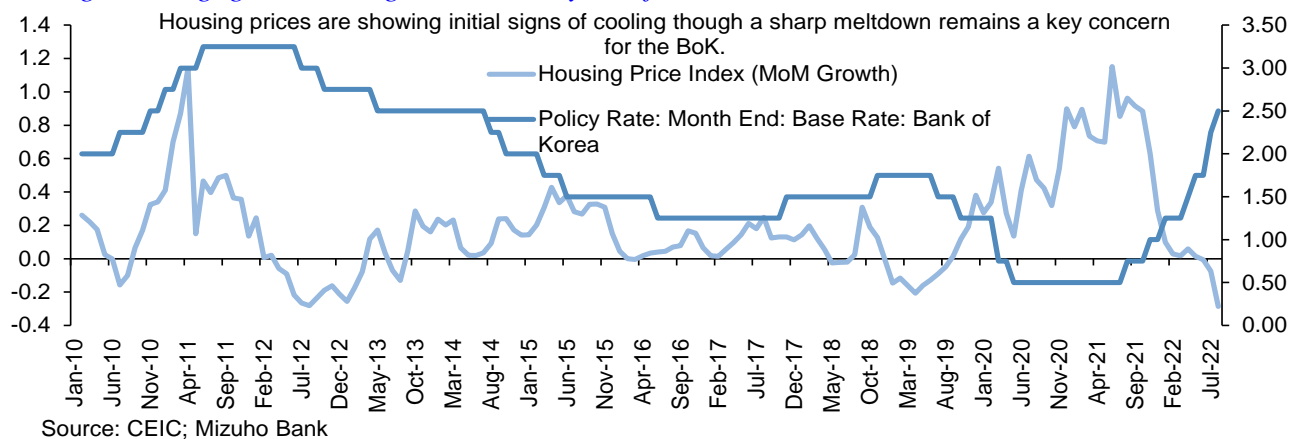
On the whole, from the stock perspective, the **debt situation for household and corporates are certainly non-trivial as the debt to GDP ratios remain close to record highs.** Furthermore, the trouble is that they may set to remain at a high as **a large part of these loans will be subject to increasing strains from rising interest rates which hinders principal repayments.**

Rising Tide of Interest Rates



Crucially, the **debt situation is certainly not helped by a substantial proportion of loans being on floating rates.** For *corporate loans*, the share of floating rate loans has increased from 68.7% in January 2019 to 72.9% in August 2022. For *housing loans*, the proportion of floating rate loans increased from 69.5% to 78.5%. What this means is that the **immediate shock of rising interest rates will be felt by a large** (and in fact *now increased*) **proportion of household and corporate borrowers.**

Cognisant of these risks to vulnerable segments, the Financial Services Commission has announced the **Relief Conversion Loans** (on 5 October) *targeted at single property owners of small sized units to allow refinancing to mortgages with long term maturity and fixed interest rates.*



All in, the **debt risks in Korea warrants continued close watch.** On the comforting front, the authorities have put in place policies to assist businesses and households who are most at risk of default/losing their homes. That said, the reactions of owners of more than one houses, which stands at 15.8% of total home owners, in the face of rising interest servicing burden should be monitored to prevent downward spiralling of house prices which feedback into negative housing equity. These risks will form part of the BoK's calculus as they embark on further rate hikes next week. **While arresting inflationary pressure remains the BoK's utmost priority, they will be cognisant not to exacerbate existing domestic risks.**

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