THE WALL STREET JOURNAL. ONLINE

October 8, 2002

PAGE ONE

Korea Faces Bubble In Consumer Spending

By PHILLIP DAY and HAE WON CHOI
Staff Reporters of THE WALL STREET JOURNAL

How do you fix an economy that is both overheating and cooling down? South Korean policy makers are arguing over the answer.

How Korea deals with what may already be a bubble in its consumer sector is a question being closely watched in the rest of Asia, as the economy that has recently become the model for growth in the region starts to show cracks.

Asia's economic crisis five years ago showed Korean officials that their export-dominated economy needed to be diversified. They didn't hold back, cutting taxes and promoting spending, even giving tax breaks to consumers for using credit cards. They have kept interest rates low and nudged banks into making it easy for consumers to borrow. The banks, burned by large corporate failures in the wake of the crisis, have gone after consumer lending with a vengeance.

Household debt increased by a third in the second quarter from a year earlier. That brought household-debt levels to 70% of Korea's annual gross domestic product, up from less than 50% before the financial crisis and fast approaching the U.S. level of 80% of GDP, or the value of all goods and services produced by a nation.

All that easy credit has resulted in an unprecedented personal-consumption boom in Korea that hasn't gone unnoticed in the rest of Asia. Malaysia, Thailand and the Philippines, each with a large and fast-growing middle class, have tried to emulate Korea's success. The lessons of Japan, where years of massive government spending have failed to turn the economy around, haven't been missed either. Instead of just pouring government money into make-work projects, the Southeast Asians have been pushing consumer spending as a way to lessen their reliance on the crests and troughs of global-trade flows.

KOREAN CONSUMER

- Asian Consumers Are Bleak About the Economic Future[3] 08/07/02
- In Asia, Saving Is Out and Bankruptcies Soar[4] 07/25/02
- Korea's Credit-Card Growth May Slip After Hefty Charge[5] 07/19/02
- Credit-Card Companies Warn Users to Think Before Buying[6] 07/11/02
- Korea's Consumer Outlay Prompts Focus on Advertising, Marketing[7] 07/09/02

The Korean model has begun to look vulnerable. Worries are growing that consumer spending has come too far, too fast. At **Hana Bank**, South Korea's fifth-largest bank, loans to the retail sector make up about 42% of its total lending. Two years ago, less than a quarter of the bank's loans went to consumers. It is the same story at **Shinhan Bank**, where retail lending has jumped to 50% of loans from 31% in 2000. Kim Young Il, an executive vice president in charge of the consumer division at **Kookmin Bank**, the country's biggest, estimates that a third of Koreans over 20 years old, or about 10 million people, have borrowed money from a Korean bank. Mr. Kim says those people owe an average of $31,670 each -- and that doesn't cover most credit-card debt, because in Korea the biggest card issuers are nonbank companies.

Lee Hyun Sook, a 28-year-old computer engineer in Seoul, watched as a close friend notched up eight million won ($6,518) in credit-card debt by maxing out her cards and getting new cards to pay off the old ones. When her friend reached bottom last year and couldn't find any more credit, Ms. Lee got a five-million-won loan herself from a bank to help pay off her friend's overdue loans.

"I never thought I would borrow money from a bank," says Ms. Lee. "What can you do? She was my best friend and she needed help."

Korean officials have already been putting the brakes on consumer borrowing in the face of growing defaults. But the Bank of Korea is suggesting it may soon be time to slow the domestic economy the traditional way, by raising interest rates.

The central bank raised rates a quarter percentage point in May, to 4.25%, hoping to slow areas of the economy that appeared to be overheating, such as the housing sector. But that increase hasn't worked. Mortgage loans more than doubled to 3.61 trillion won in the second quarter from the first quarter.

The Ministry of Finance and Economy has also been trying to put the brakes on the housing sector and stem some of the other excesses of consumer-spending growth. But it has made clear that it doesn't want interest rates to go up.

That's because Korea's traditional export-led economy is facing a very real risk of slowing as demand from the U.S., its biggest trading partner, looks increasingly likely to fade at the beginning of next year. Companies like **Samsung Electronics** Co. are watching closely as U.S. economic indicators show increasing signs of a slowdown ahead. Samsung, one of South Korea's biggest exporters, made a third of its 32.4 trillion won in sales last year in North and South America, much of that in the U.S.

Slowing the domestic economy now won't be painless for consumers either. Even the central bank says raising rates will push many overextended consumers into insolvency.

Park Hee Chul, an assistant manager of the public-relations team at **LG Card** Co., South Korea's largest credit-card company, says, "We are concerned that a possible hike in interest rates would put pressure on cardholders, especially those with heavy debts."

If the central bank makes the wrong decision, the consequences could be disastrous. If a rate increase is accompanied by an export slowdown, the two main drivers of the economy could be hit at the same time.

If the government and the central bank tighten fiscal policy and interest rates now, it would be "highly dangerous for the Korean economy," wrote Daniel Yoo of Salomon Smith Barney in a report for clients last week. But if the consumer sector is in a bubble, waiting to prick it will just mean greater pain later on.

"I'm not sure if we are in a bubble yet," says Hwang In Seong, a senior economist at the Samsung Economic

Research Institute. But if the growth of household debt and consumer spending isn't reined in, Korea could end up with a situation similar to what Japan experienced in the early 1990s, he says. Mr. Hwang says bursting that big a bubble would have the same result as it did in Japan: Real-estate prices would crash, household bankruptcies would soar and a recession would ensue.

Write to Phillip Day at phil.day@wsj.com[1] and Hae Won Choi at haewon.choi@wsj.com[2]

URL for this article:
http://online.wsj.com/article/0,,SB1034015542781400913.djm,00.html

Hyperlinks in this Article:
(1) mailto:phil.day@wsj.com
(2) mailto:haewon.choi@wsj.com
(3) http://online.wsj.com/article/0,,SB1028645116696135360,00.html
(4) http://online.wsj.com/article/0,,SB102753132672629240,00.html
(5) http://online.wsj.com/article/0,,SB1027010461632084840,00.html
(6) http://online.wsj.com/article/0,,SB1026308603751538480,00.html
(7) http://online.wsj.com/article/0,,SB102616126464891520,00.html

Updated October 8, 2002