

**FOR
AGENDA**

SM/08/264
Supplement 1

August 11, 2008

To: Members of the Executive Board

From: The Secretary

Subject: **Republic of Korea—Staff Report for the 2008 Article IV Consultation—
Informational Annex**

The attached informational annex is being issued as a supplement to the staff report for the 2008 Article IV consultation with the Republic of Korea (SM/08/264, 8/11/08), which is tentatively scheduled for discussion on **Monday, September 8, 2008**. At the time of circulation of this paper to the Board, the Secretary's Department has not received a communication from the authorities of the Republic of Korea indicating whether or not they consent to the Fund's publication of this paper; such communication may be received after the authorities have had an opportunity to read the paper.

Questions may be referred to Mr. Schiff (ext. 38717) and Mr. Syed (ext. 39967) in APD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the WTO Secretariat on Tuesday, August 19, 2008; and to the Organisation for Economic Cooperation and Development, following its consideration by the Executive Board.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. This supplement is not being disseminated in hard copy. It can be accessed in the Institutional Repository. A link to this document can be found in the daily list (<http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm>) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF KOREA

Staff Report for the 2008 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department

August 8, 2008

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Annex I: Korea—Fund Relations

(As of June 30, 2008)

I. Membership Status: Joined August 26, 1955; Article VIII

II. General Resources Account:	SDR Million	% Quota
Quota	2,927.3	100.0
Fund Holdings of Currency	2,711.2	92.6
Reserve Position in Fund	216.1	7.4

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	72.9	100.0
Holdings	53.2	72.9

IV. Outstanding Purchases and Loans: None

V. Latest Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
Stand-by	12/04/1997	12/03/2000	15,500.00	14,412.50
Of which: SRF	12/18/1997	12/17/1998	9,950.00	9,950.00
Stand-by	07/12/1985	03/10/1987	280.00	160.00
Stand-by	07/08/1983	03/31/1985	575.78	575.78

VI. Projected Obligations to the Fund

(SDR million; based on existing use of resources and present holdings of SDRs):

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Principal					
Charges/Interest	0.30	0.60	0.60	0.60	0.60
Total	0.30	0.60	0.60	0.60	0.60

VII. Exchange Rate Arrangement:

Korea's exchange rate system is classified as "independently floating." Previously, the exchange rate against the U.S. dollar was allowed to float only within specified margins around the previous day's weighted average exchange rate in the interbank market. The margins were widened five times between March 1990 and November 1997 (most recently to +/-10 percent), and on December 16, 1997 were eliminated altogether. On August 7, 2008, the exchange rate was W 1016.5=US\$1. Korea maintains exchange restrictions for security reasons, in accordance with UN Security Council Resolutions, which have been notified to the Fund under the procedures set forth in Executive Board Decision 144-(52/51).

VIII. Last Article IV Consultation:

Korea is on a 12-month consultation cycle. Staff discussions for the 2007 Article IV consultation were conducted on a mission to Seoul during May 31-June 13, 2007. The Article IV consultation was concluded by the Executive Board on September 12, 2007. In addition, a staff visit took place during November 1–8, 2007.

IX. FSAP and ROSC Participation:

MCM: The final FSAP mission was conducted during October 2002. The mission completed the FSAP by assessing the short-term vulnerability of the financial sector to macroeconomic and sectoral shocks and analyzing overall financial sector soundness and developmental challenges, including issues arising from the draft standards assessments. A follow-up technical assistance mission on the supervision of derivatives markets was held in Seoul during January 9–20, 2003. The Financial System Stability Assessment report has been published (country report No. 03/81) and is available on the web through the following link: <http://www.imf.org/external/np/fsap/fsap.asp>.

FAD: Discussions on fiscal transparency were held in Seoul during June 2000, and a report was drafted and finalized in November 2000, with input from APD staff. The report has been published (SM/01/22) and is available on the web through the following link: <http://www.imf.org/external/np/rosc/kor/fiscal.htm>.

STA: Discussions on Korea's data dissemination practices against the IMF's Special Data Dissemination Standard (SDDS) were held in Seoul during April 2001, and a report was drafted and finalized on November 28, 2001. The report has been published and is available on the web through the link: <http://www.imf.org/external/pubs/ft/scr/2003/cr03127.pdf>.

X. Technical Assistance:

FAD: A technical assistance mission visited Seoul during January 8–19, 2001 to evaluate current practices in budgeting and public expenditure management and to provide advice on setting up a medium-term fiscal framework. A mission visited Seoul during August 31–September 16, 2005 to provide technical assistance on the reform of tax policy and administration.

MCM: Technical assistance missions visited Seoul to provide advice on macroprudential and derivatives supervision during October 27–November 7, 2005, on the reform and development of the foreign exchange market during March 30–April 13, 2006, on strengthening the debt management function and further development of the government securities market during September 20–October 2, 2006, and on measures to deepen the money market during December 4–14, 2007.

STA: Technical assistance missions visited Seoul during March 29–April 12, 2000 to provide advice on balance of payments and external debt statistics, with a view toward improving the recording of financial derivatives and developing an international investment position statement, and during November 28–December 11, 2007 on the GFSM 2001 framework.

XI. Resident Representative:

The resident representative office in Seoul was opened in March 1998 and will be closed in September 2008. Ms. Meral Karasulu has been the Resident Representative since September 2006.

Annex II: Korea—Statistical Issues

Data provision is adequate for surveillance. Korea has been a subscriber to the Special Data Dissemination Standard (SDDS) since September 1996. During 2007–08, most SDDS requirements were met. Korea makes use of the timeliness flexibility option for two data categories: the analytical accounts of the banking sector and public sector operations. Recently, central government operations data have been disseminated with delays due to temporary technical capacity constraints. A data ROSC was published in May 2003.

Real Sector Statistics

The overall structure of the **national accounts** follows the recommendations of the *1993 System of National Accounts*. Constant price (base year 2000) and nominal GDP estimates are compiled using the production and expenditure approaches; nominal GDP estimates are also compiled using the income approach. While the size of the informal sector has not been measured, informal activities (including some illicit activities) are expected to be reflected in the next revision of the national accounts. The commodity flow technique could be improved by moving to the Supply and Use Table framework, but there have been difficulties in developing requisite source data.

The **Consumer Price Index** (CPI) covers 38 urban areas (about 80 percent of the urban population) and is defined to exclude farm and fishing households. The CPI could be further improved by extending coverage to rural areas. The consumption basket is updated every five years; currently, expenditure weights are derived from the *2005 Family Income and Expenditure Survey*. The geometric mean of price changes should be used as a suitable alternative to the ratio of arithmetic means of prices.

The **Producer Price Index** (PPI) covers all domestic industrial activities and a large segment of service activity, as well as free trade zones and bonded warehouses. The weights are based on 2000 revenue shares. The PPI could be improved by making more use of imputing missing prices using the prices of similar commodities, rather than carrying forward the last reported price. A geometric mean of price relatives should be used rather than an arithmetic mean.

Government Finance Statistics

Two sets of government finance statistics (GFS) are compiled for the **central government**, one using national definitions and the other using internationally recognized standards. Concepts and definitions used in the latter generally follow the recommendations of the *Manual on Government Finance Statistics 1986*. The data cover the budgetary units of the central government (including social security funds owned and/or managed by the government) and the extra-budgetary funds owned or managed by these units. These statistics are produced by the National Financial Information System (NAFIS), which integrates the preparation of budget data, accounting reports, and the generation of fiscal statistics on a monthly basis. The NAFIS provides for automatic crosschecks at different levels of the compilation process.

Consolidated data on the **general government** consistent with international standards are not compiled. The central government accounts for about 75 percent of general government operations. The last year for which GFS were reported for publication in the IMF's *GFS Yearbook* was 2005.

Monetary and Financial Statistics

Following the recommendations of the 2001 data ROSC mission, revised monetary aggregates have been compiled since early 2002. These aggregates almost fully comply with the IMF's *Monetary and Financial Statistical Manual*. Data relating to foreign assets and foreign liabilities are affected by the Bank of Korea's (BOK) practice of valuing its financial assets and liabilities at book value (rather than at market value) and revaluing its foreign currency denominated assets and liabilities twice yearly (rather than on a monthly basis). Also, some banks are using nationality rather than the residency criteria (as defined in the *Balance of Payments Manual*, fifth edition) to distinguish between resident and nonresident individual and household accounts, affecting the accurate measurement of net foreign assets of the banking sector. The authorities have begun reporting monetary data to STA using Standardized Report Forms, but the data show discrepancies from those reported using the old forms. The authorities have been informed of the problem, and resolution is pending.

Korea participated in the pilot project—Coordinated Compilation Exercise—for *Financial Soundness Indicators* (FSIs) conducted by the IMF's Statistics Department. Indicators as of end-2005 were submitted along with metadata, which are now available to the public through the IMF's website at:

<http://dsbb.imf.org/Applications/web/fsi/fsicountrycategorylist/?strcode=KOR>.

External Sector Statistics

The overall quality of quarterly **balance of payments** statistics is good. The BOK implemented the fifth edition of the IMF's *Balance of Payments Manual (BPM5)* in early 1998, but some deviations remain in the classification and sectorization of certain transactions. There is also incomplete coverage of transactions via intercompany accounts, nonresident won-denominated accounts with domestic banks, and non-cash transactions. Data on reinvested earnings on direct investment are not compiled, except for the net profits/losses of overseas branches of domestic banks. In the financial account, the direct investment data do not include trade credits or short-term loans with affiliated entities, which are recorded as part of other investment.

The quality of the quarterly **external debt** statistics has greatly improved since the financial crisis. In early 2007, the BOK switched from annual to quarterly reporting of the **International Investment Position**. Data dissemination on international reserves and foreign currency liquidity generally meets the **SDDS specifications**. Since April 2006, the authorities have disseminated foreign reserves data on a monthly basis rather than twice a month, as had been done since 1997.

Annex II: Korea—Table of Common Indicators Required for Surveillance

(As of July 29, 2008)

	Date of Latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶	Memo Items:	
						Data Quality – Methodological Soundness ⁷	Data Quality – Accuracy and Reliability ⁸
Exchange Rates	7/29/2008	7/29/2008	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Jun. 2008	Jul. 2008	M	M	M		
Reserve/Base Money	Jun. 2008	Jul. 2008	M	M	M	LO, O, LO, LNO	LO, O, O, O
Broad Money	May 2008	Jul. 2008	M	M	M		
Central Bank Balance Sheet	Jun. 2008	Jul. 2008	M	M	M		
Consolidated Balance Sheet of the Banking System	May 2008	Jul. 2008	M	M	M		
Interest Rates ²	7/29/2008	7/29/2008	D	D	D		
Consumer Price Index	Jun. 2008	Jul. 2008	M	M	M	O, LO, O, O	O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	NA	NA	NA	NA	NA	O, LNO, LO, O	O, NA, O, NA
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	Mar. 2008	Jun. 2008	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Q4 2007	May 2008	Q	Q	Q		
External Current Account Balance	Jun. 2008	Jul. 2008	M	M	M	O, LO, LO, LO	LO, O, O, O
Exports and Imports of Goods and Services	Jun. 2008	Jul. 2008	M	M	M		
GDP/GNP	Q1 2008	Jun. 2008	Q	Q	Q	LO, LO, O, LO	O, LNO, O, O
Gross External Debt	Q1 2008	Jun. 2008	Q	Q	Q		
International Investment Position ⁹	Q1 2008	Jul. 2008	Q	Q	Q		

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

⁷ Reflects the assessment provided in the data ROSC or the Substantive Update (published on May 2003, and based on the findings of the mission that took place during April 11-25, 2001) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

⁸ Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, and revision studies.

⁹ Includes external gross financial asset and liability positions vis-a-vis nonresidents.