

A POTTED HISTORY OF KOREAN FINANCE



Russell Clark's
Market Views

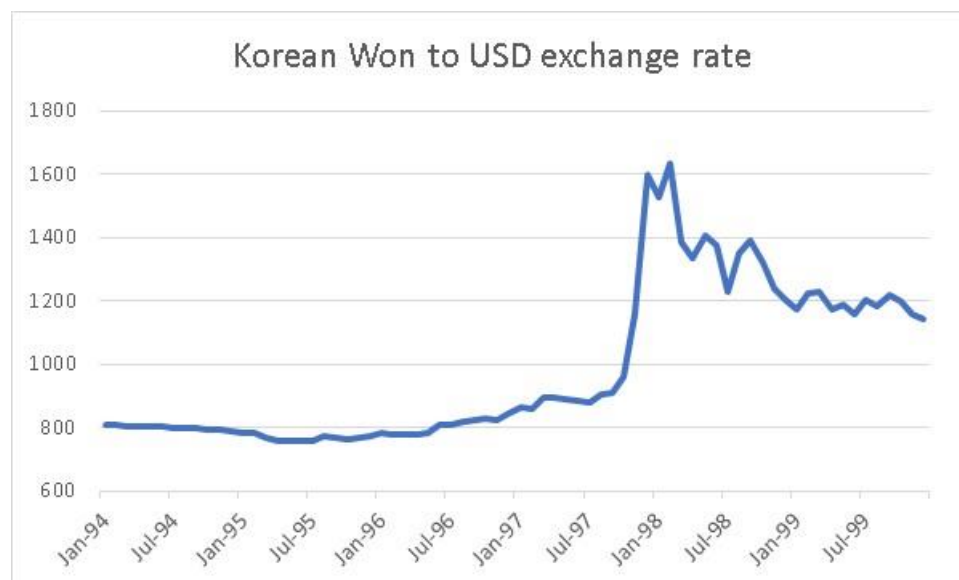
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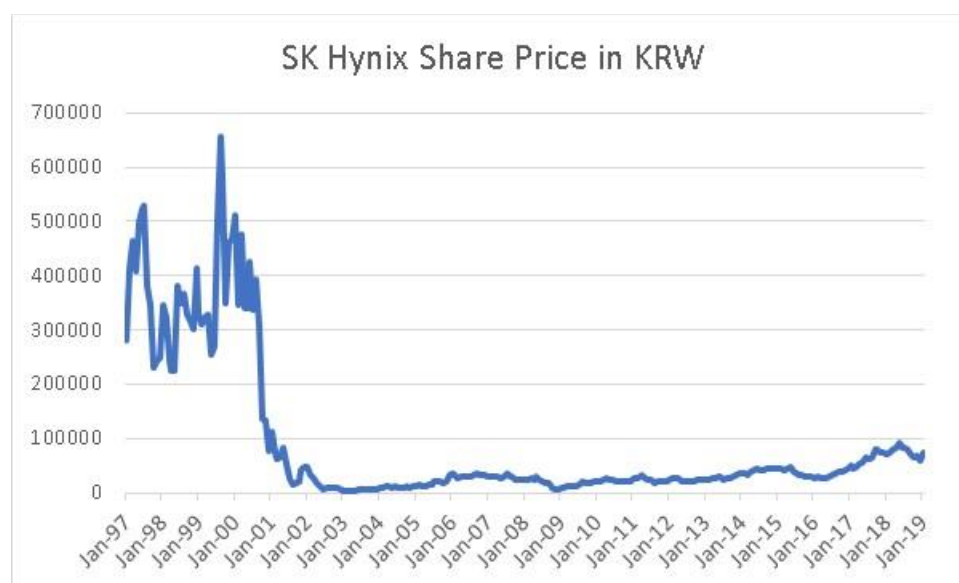
When asked about Korea's place in global finance, most commentators would probably identify Korea as having a pivotal role in the Asian Financial Crisis. While this is undoubtedly true, Korea has a compelling record of being a large player in many of the big market blow ups of the last two decades. The Asian Financial Crisis was driven by fixed exchange rates in Asia, that encouraged borrowing in US dollar, and when the countries were forced to devalue, this created huge financial problems. From BIS data, we can see that the Korean financial system was very short USD before it devalued.



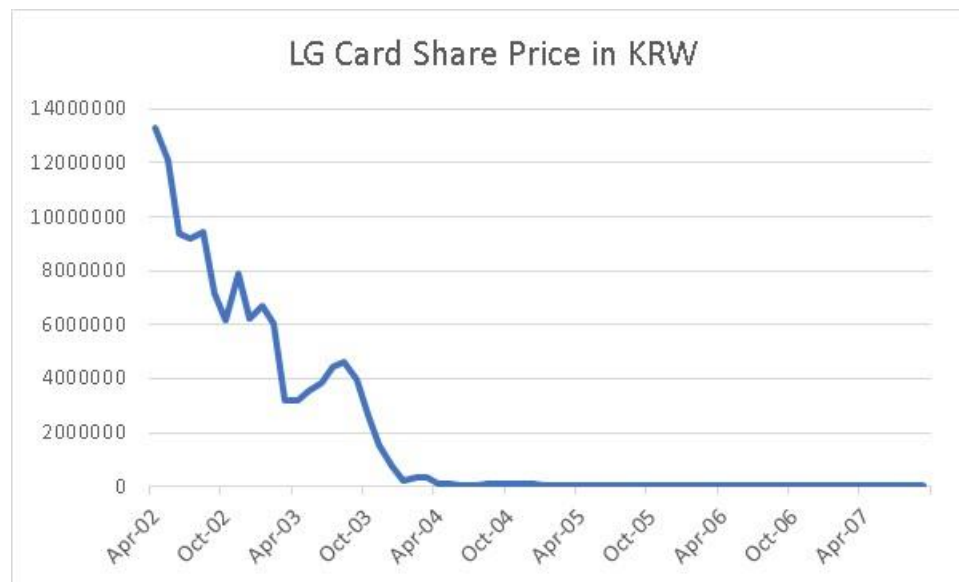
This build up in USD debt eventually led to a large currency devaluation, and a financial crisis.



Korea's recovery from this crisis was helped by having invested heavily into the new hot area of semiconductors. Unfortunately, excessive investment, led to collapse, and eventual government intervention in the industry. SK Hynix only emerged from the governments Corporate Restructuring Program in 2005. SK Hynix is now one of the worlds largest semiconductor companies. Its share prices since listing gives an indication of the problems it encountered. Market cap fell from 9bn USD to 1bn USD.



After the slowdown caused by the dot com bust, Korea liberalised its credit card market to help promote growth. BIS summarise the crisis here (<https://www.bis.org/publ/bppdf/bispap46k.pdf>). Credit cards in issue went from 39m in 1999 to 105m in 2002. Total assets grew even faster, with credit card debt reaching 20% of all bank loans by 2002. In the subsequent bust, credit card assets fell by over 60%. LG Card was the poster child of the era.



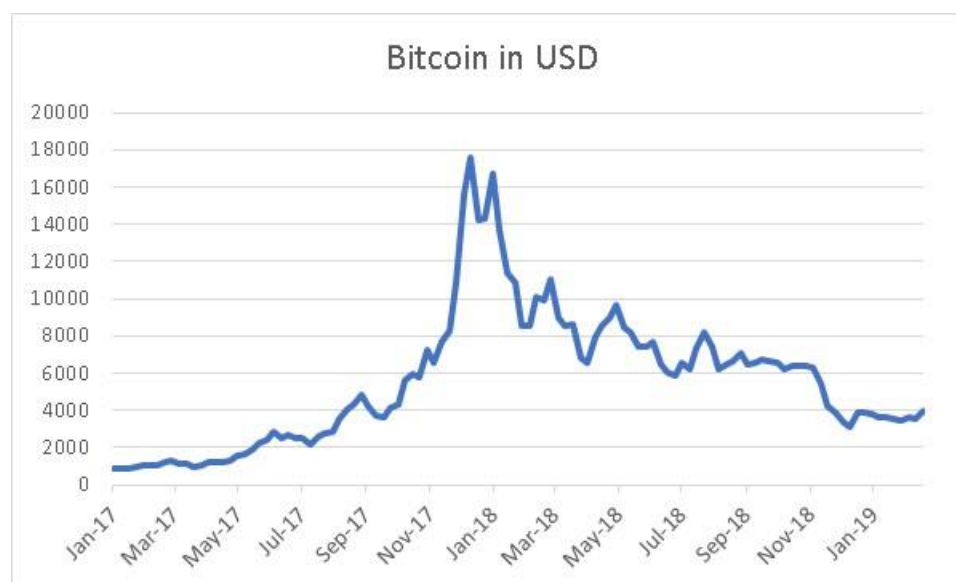
Koreans were not conspicuously involved in the mortgage backed security market that helped bring about the global financial crisis. However, Korean SMEs became entangled in shorting USD. Again, the BIS data showed that the Korean banking system became very short the US dollar.



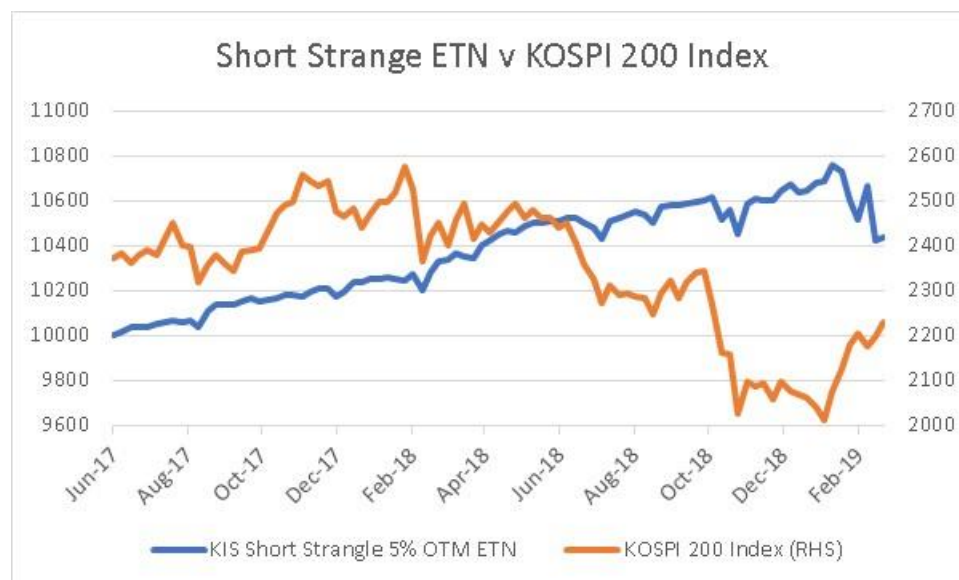
The big product were KIKO (knock in, knock out) currency options (<https://www.euromoney.com/article/b1322mh2bzqqs0/derivatives-koreas-kiko-fiasco> - gives an overview). Korean businesses continued to bet on the Korean won strengthening, after it had been in a steady bull market against the dollar from 2002 to 2007. The Korean won then fell 70% in 2008.



During the bull run in Bitcoin in 2017, Koreans became so enamoured with crypto currencies, a “kimchi” premium appeared. (<https://www.coindesk.com/bitcoin-price-kimchi-premium-eroding>) Coindesk estimate that a 50% premium emerged on bitcoin in Korea in January of 2018. The chart of bitcoin prices shows that this was near the top for Bitcoin.



This of course begs the question, what are the Koreans involved in now? Korea is the largest single market for equity linked autocallables. These products essentially bet that key markets such as KOSPI 200, Euro Stoxx 50, Nikkei 225 and HSCEI will continue to remain within a range and volatility will stay low. We have written extensively on the subject. Koreans have also been attracted to “short strangle” trades. A short strangle is where you sell both put and call options. You are not betting on markets moving higher or lower, but that volatility will stay low, or that the market will move slowly. The Short Strangle ETN has only recently begun to lose money.



When Korean retail investors bet large on an investment theme, historically the big money is made going the opposite direction. Korea, via autocallables and short strangle ETN is betting that volatility and option prices will stay low.

INFORMATION

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