



Misconceptions and Facts about Current Liquidity and Exchange Rate Conditions

Monetary Policy Department

Economist **Goodeon Lee**, **Wonsuk Chung**, Senior Economist **Taesaup Kim**

2026.1.20.

Need to assess Claims that Excessive Korean Won Liquidity Has Driven US Dollar/Korean Won Exchange Rate Depreciation

Since the end of last year, the US dollar/Korean won exchange rate has risen to the mid-to-high KRW 1,400 range. Against this backdrop, some have continued to argue that excessive growth in domestic liquidity (M2) has led to a depreciation of the Korean won. However, such claims do not consistent with the data or with economic realities. They have been amplified through various channels despite lacking a factual basis, and risk fueling unwarranted expectations of further exchange rate depreciation. For these reasons, it is necessary to set the record straight.

Below, we assess these claims by examining the data, organizing the discussion around four key issues related to money supply and the exchange rate, with the aim of enhancing economic agents' understanding.

① Has money supply growth recently become excessive?

→ Recent money supply growth remains below its historical average and around the middle among major economies

Growth in the money supply (M2) declined rapidly beginning in 2022 and rebounded somewhat after 2024, but it remains below its historical average. [Figure 1] Looking at the post-pandemic period, M2 growth rose to around 11 to 12 percent in 2020 - 21 amid COVID-19 policy responses, but has since fallen to 4 to 5 percent and fluctuated in the range¹).

In comparison with major economies, Korea's recent M2 growth is around the middle of the distribution among 10 major economies²⁾. Across major economies, money supply growth generally followed a common pattern—expansion during the pandemic, deceleration amid monetary tightening in response to high inflation, and a modest recent uptick—and Korea has exhibited a similar trajectory. Some have claimed that Korea's money supply growth exceeds that of the United States; however, US M2 growth expanded to as high as 25 to 27 percent year on year during the quantitative easing period and then fell to as low as -4 to -5 percent during quantitative tightening, exhibiting the largest swings among the 10 major economies. More recently, M2 growth rates in Korea and the United States have shown similar level fluctuating within a comparable range. [Figure 2]

Meanwhile, some have recently asserted that the Bank of Korea supplied an enormous KRW 488 trillion in liquidity last year through RP purchases. This claim is based on a simple accumulation of RP purchase amounts, which substantially overstates the scale of liquidity provision and reflects a misunderstanding of the mechanics of RP transactions. RP purchases typically have maturities of only two weeks, and upon maturity the reverse transaction automatically occurs, withdrawing the funds. By way of analogy, if one were to borrow KRW 100,000 for one week and repay it, repeating this process every week for a year, the amount of money in one's wallet would be KRW 100,000—not KRW 5.2 million (KRW 100,000 × 52 weeks). Accordingly, the appropriate measure of the scale of the Bank of Korea's RP purchases is the average outstanding balance, not the simple cumulative transaction amount.

Moreover, RP purchases are only one of several open market operation instruments. Taken as a whole—including Monetary Stabilization Bonds and RP sales—open market operations have continued to be conducted with a stance of large-scale absorption of reserve balances³⁾. The Bank of Korea's open market operations function as an ex-post adjustment mechanism to keep the total amount of reserve balances—which fluctuates as a result of economic agents' diverse fiscal and financial activities—at the required level. They are not an active tool intended to directly increase or decrease market liquidity⁴⁾.

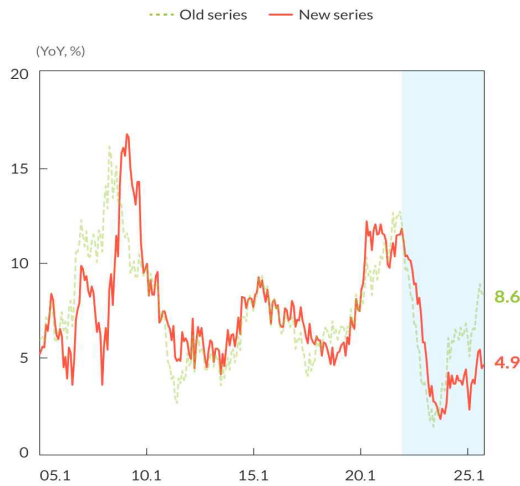
1) Under the old series, the growth rate appears higher, mainly reflecting the sharp increase in beneficial certificates such as ETFs since April last year. Meanwhile, the Bank of Korea has revised its monetary aggregates in line with the IMF's updated Monetary and Financial Statistics Manual, reconstructing the new M2 series—which excludes beneficial certificates—back to October 2003, and has been publishing the revised data since December 2025. This revision was not a short-term measure undertaken in response to recent changes in M2 growth; rather, it was implemented as part of a long-term project incorporated into the Third National Statistical Development Master Plan in January 2023, with completion targeted by 2025. To prevent unnecessary misconception arising from the change in indicators, the Bank of Korea is publishing the old and new series in parallel for one year.

2) Based on a sample of ten economies: United States, United Kingdom, Canada, Euro area, Australia, New Zealand, Japan, China, Taiwan, and Korea.

3) If the Bank of Korea had unintentionally supplied reserve balances in excess of the required level, the call rate—the key price indicator in the reserve market—would have persistently fallen below the policy rate. In practice, however, the call rate generally remained slightly above the policy rate last year.

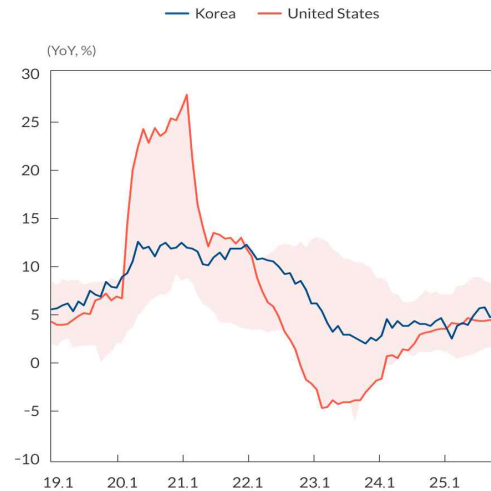
4) For more details, please refer to "Misconceptions Regarding Bank of Korea's RP Purchases and Liquidity Supply" Bank of Korea Blog (January 16, 2026).

Figure 1. Korea's M2¹ Growth Rate



Note: 1) NSA, End of period
Source: Bank of Korea

Figure 2. M2¹ Growth Rate Range of 10 Major Economies and M2 Growth Rate of Korea and US²



Notes: 1) NSA, End of period
2) Shaded area indicates maximum and minimum value ranges by countries
Source: Each central banks

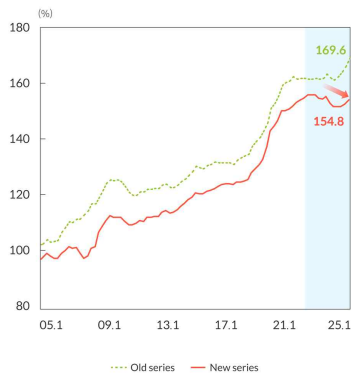
② How should the recent level of the money supply relative to GDP be assessed?

→ The M2-to-GDP ratio has recently stabilized, and cross-country differences reflect financial market structures

The M2-to-GDP ratio has shown a slight decline followed by broadly sideways movement since the fourth quarter of 2022. [Figure 3] This recent stabilization largely reflects the continued deleveraging of household debt, driven by the Bank of Korea's monetary policy stance that takes financial imbalances into account, as well as coordinated macroprudential policy efforts with the government, and the slowdown in corporate lending. From a longer-term perspective, it is true that the M2-to-GDP ratio has trended upward, mainly due to the steady expansion of the domestic banking sector in the process of financial deepening, along with enhanced financial support during the COVID-19 crisis.

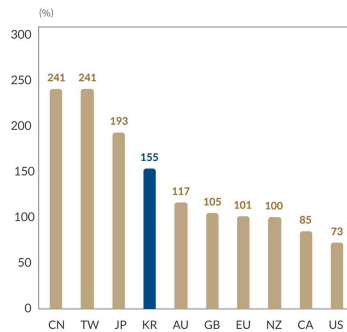
The M2-to-GDP ratio varies widely across countries, with Korea ranking somewhat above the median among major economies. [Figure 4] However, cross-country differences in this ratio primarily reflect structural characteristics of national financial systems, making it inappropriate to assess liquidity conditions on this basis alone. More specifically, since M2 is defined as cash-equivalent assets held by economic agents at depository corporations, the M2-to-GDP ratio differs depending on the relative importance of banks (depository corporations) versus capital markets in each country's financial system. In general, Asian economies—where economic agents rely more heavily on banks—tend to exhibit higher M2-to-GDP ratios, whereas economies such as the United States and Canada, where reliance on capital markets is greater, tend to show lower ratios. [Figure 5] Notably, despite common perceptions, the United States—whose financial markets are unparalleled in terms of importance and scale—records the lowest M2-to-GDP ratio among major economies, at roughly half the level observed in Korea⁵).

Figure 3. Korea's M2¹/GDP Ratio



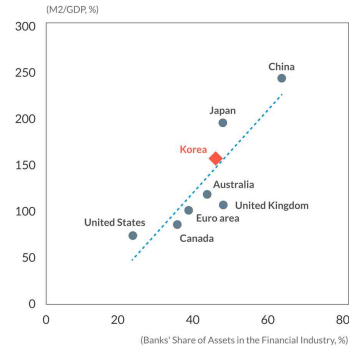
Note: 1) NSA, End of period
Source: Bank of Korea

Figure 4. M2/GDP^{1,2} Ratio of Major Economies³



Notes: 1) Q3 2025
2) Australia and New Zealand, which do not publish M2, use similar indicators.
3) CN: China, TW: Taiwan, JP: Japan, KR: Korea, AU: Australia, GB: United Kingdom, EU: Euro area, NZ: New Zealand, CA: Canada, US: United States
Source: Each central banks and statistics bureaus

Figure 5. M2/GDP ratio and Bank Share of Assets in the Financial Industry¹



Note: 1) End of 2023
Source: FSB(2024), Each central banks and statistics bureaus

③ Has money supply growth driven the recent rise in the exchange rate?

→ There is no statistical evidence to support the claim that money supply growth led to exchange rate depreciation

The argument that an expansion in the money supply has caused the exchange rate to rise is grounded in the theory of Purchasing Power Parity (PPP), which posits that countries with higher money supply growth tend to experience higher inflation, leading to a depreciation of their currency. In other words, when domestic prices rise relative to those abroad, demand shifts away from domestic goods toward foreign goods, increasing demand for the US dollar and, in turn, pushing up the US dollar/Korean won exchange rate.

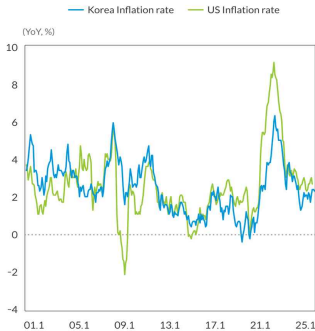
However, since late 2024, money supply growth rates in Korea and the United States have been broadly similar, while inflation rate has consistently remained higher in the United States than in Korea. Against this backdrop, it is difficult to attribute the recent weakness of the Korean won to differences in money supply growth. [Figure 6] Even over a longer horizon, Korea's inflation rate has generally remained stable since the mid-2010s—excluding the COVID-19 period—making the claim that money supply growth translated into higher inflation and subsequently into exchange rate depreciation unconvincing.

Some emphasize a relationship between money supply growth and the exchange rate based solely

5) This is because banks account for only about 23 percent of total financial institution assets in the United States—roughly half the 45 to 46 percent share in Korea—and this difference is inevitably reflected in the M2-to-GDP ratio.

on data from a specific period, but this approach is statistically inappropriate. Properly assessing the correlation between the two variables requires the use of sufficiently long time-series data. When the relationship between the Korea - US money supply growth differential and the US dollar/Korean won exchange rate is examined over a long horizon, little correlation is observed for most periods, and more recently the two have even moved in opposite directions. [Figure 7] Moreover, a statistical analysis using long-run data since 2005 shows that the correlation between the Korea - US money supply growth differential and the change of US dollar/Korean won exchange rate is very low (0.10). [Figure 8]

Figure 6. Inflation Rate of Korea and US



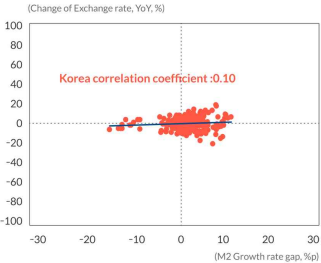
Source: Ministry of Data and Statistics, FRED

Figure 7. Korea-US M2¹ Growth Rate Gap and USD/KRW



Note: 1) NSA, End of period
Source: Bank of Korea, FRED

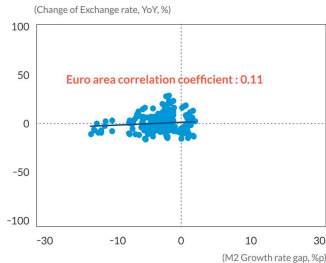
Figure 8. Korea-US M2^{1,2} Growth Rate Gap and Change of Exchange Rate



Notes: 1) NSA, End of period
2) Jan.05~Oct.25 (excluding the global financial crisis)
Source: Bank of Korea, FRED

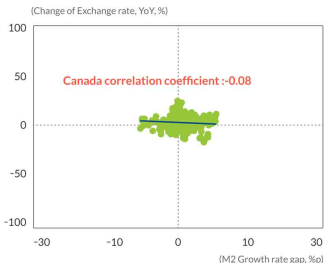
Such weak correlations between money supply growth and exchange rates are a common feature across most economies where inflation expectations are well anchored. [Figures 9 - 11] Despite this statistical evidence, claims that money supply growth directly and mechanically triggered exchange rate depreciation—without any intermediate transmission channels—continue to spread through various channels in the market. These assertions, which are not grounded in actual data, are raising concerns as they appear to be influencing expectations of further exchange rate depreciation.

Figure 9. Euro area-US M2^{1,2} Growth Rate Gap and Change of Exchange Rate



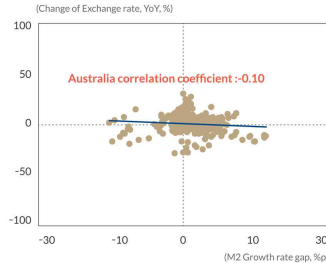
Notes: 1) NSA, End of period
2) Jan.05~Oct.25 (excluding the global financial crisis)
Source: ECB, FRED

Figure 10. Canada-US M2^{1,2} Growth Rate Gap and Change of Exchange Rate



Notes: 1) NSA, End of period
2) Jan.05~Oct.25 (excluding the global financial crisis)
Source: BOC, FRED

Figure 11. Australia-US M2^{1,2} Growth Rate Gap and Change of Exchange Rate



Notes: 1) NSA, End of period
2) Jan.05~Oct.25 (excluding the global financial crisis)
Source: RBA, FRED

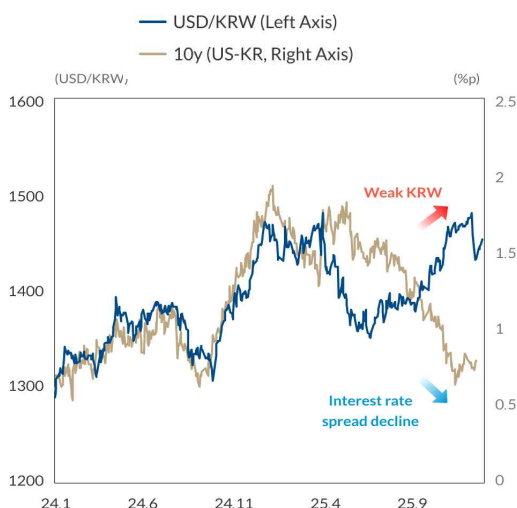
④ If not money supply growth, what explains the recent rise in the exchange rate?

→ The recent increase in the exchange rate reflects not only economic fundamentals but also market sentiment and supply - demand conditions

Longer-term factors such as interest rate differentials and economic growth rate gaps may have played some background role in the recent rise in the exchange rate, and it is indeed necessary to address these factors over the medium to long term. However, it is difficult to fully explain recent exchange rate movements solely on the basis of such fundamental factors. While the reversal of the Korea - US interest rate differential has persisted for an extended period, the policy rate differential narrowed from 200 basis points to 125 basis points after May last year. Even in terms of long-term government bond yields (10-year maturity), the differential declined from around 170 basis points to the 70-basis-point range. Meanwhile, Korea’s year-on-year economic growth rate increased from 0.0 percent in the first quarter of last year to 1.8 percent in the fourth quarter (based on the November 2025 forecast), rapidly narrowing the growth gap with the United States. Despite these developments, the US dollar/Korean won exchange rate continued to rise over the same period.[Figures 12 and 13] Similar inconsistencies between exchange rates and growth or interest rate differentials can be observed in other economies as well. In particular, in the euro area, growth and interest rate differentials vis-à-vis the United States widened, yet the euro appreciated substantially last year.[Figure 13]

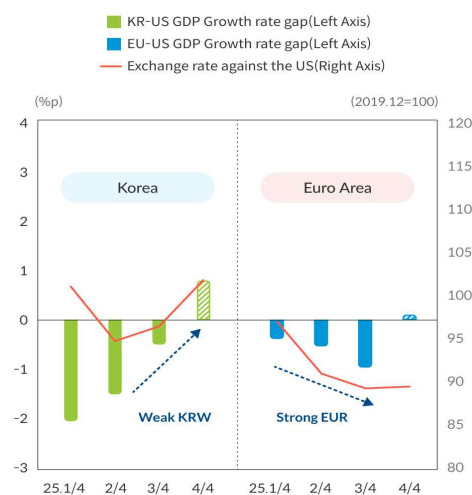
Taken together, these observations suggest that the recent rise in the exchange rate has been driven not only by economic fundamentals—such as interest rate and growth differentials—but also by supply - demand conditions and market sentiment, which have exerted upward pressure. In fact, while Korea recorded a current account surplus of USD 101.8 billion during January - November last year, residents’ portfolio investment in foreign securities increased to USD 129.4 billion, significantly exceeding the surplus and adding to upward pressure on the exchange rate. This trend has continued into this year.

Figure 12. Korea-US Interest Rate Spread and USD/KRW



Source: Bank of Korea, Bloomberg

Figure 13. Korea-US and Euro area-US Growth Rate Gap¹ and Exchange rate



Note: 1) Hatched areas indicate forecasts
Source: Each central banks, Bloomberg

Continue Efforts, Together with the Government, to Stabilize the Foreign Exchange Market

Claims that excessive growth in Korean won liquidity has led to a sharp rise in the exchange rate are not consistent with objective facts. Moreover, recent exchange rate movements appear to have been influenced to a considerable extent by market sentiment and supply-demand conditions, deviating somewhat from underlying economic fundamentals.

Against this backdrop, the Bank of Korea has implemented a range of market-stabilization measures in close coordination with the government, and their effects are expected to materialize over time. Going forward, the Bank will continue to closely monitor market conditions and make sustained efforts to mitigate one-sided expectations and imbalances in supply and demand. More fundamentally, continued efforts are needed to strengthen growth potential and improve capital markets in order to enhance economic fundamentals. The Bank of Korea's publication of structural reform research and policy recommendations to boost Korea's economic growth momentum has been part of these efforts.

Meanwhile, some have even suggested the need for a direct monetary policy response to stabilize the exchange rate. However, the Bank of Korea does not conduct monetary policy with the exchange rate as a direct target; rather, it takes into account the impact of exchange rate movements on inflation as part of its policy decision-making process. Were the Bank to pursue monetary policy with the exchange rate as an explicit objective, the resulting side effects on economic activity could be substantial, adversely affecting various economic agents and potentially undermining exchange rate stability itself. Accordingly, monetary policy should be conducted with a comprehensive view, taking into account the effects of exchange rate movements on prices, growth dynamics, and financial stability, so as to promote overall macroeconomic stability.