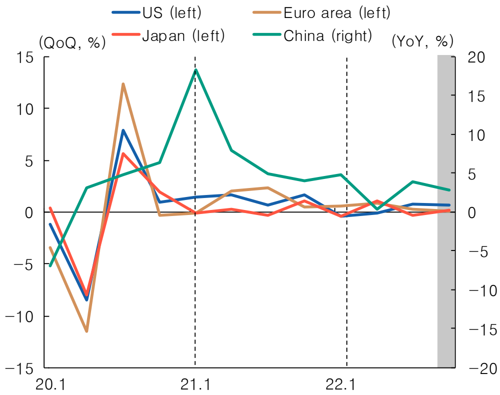
Executive Summary

[Monetary Policy Operating Conditions]

1 A look at financial and economic conditions at home and abroad between December 2022 and February 2023 finds the following. The global economic slowdown continued, affected by the ongoing monetary policy tightening in major economies and the spread of COVID-19 in China, but the degree was milder than expected. In the United States, the growth rate in the fourth quarter last year was higher than expected amid a solid labor market, and the number of persons employed and retail sales also rose in January this year. In the euro area, the trend of an economic slowdown continued, but contrary to concerns the economy recorded positive growth as energy supply-demand conditions did not worsen in line with efforts at energy replacement and reduction in energy demand, and with unusually warm weather. China's growth was tepid in the fourth quarter last year due to the spread of COVID-19, but signs of improvement appeared in line with the reopening of its economy this year. Japan's economic growth continued, driven by domestic demand, but its growth momentum weakened due to sluggish exports.

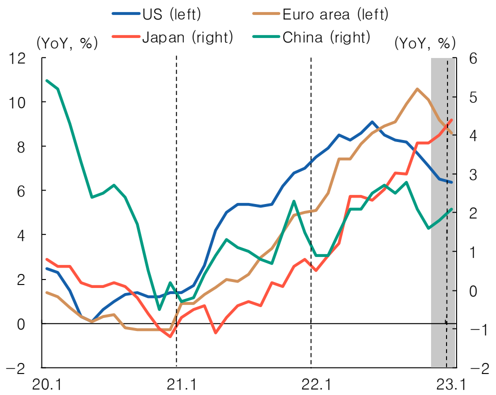
Global inflation slowed gradually after having reached its peak in the second half of last year, but it still remained elevated in most countries. In the U.S., the rise in inflation slowed, led by goods prices, but the pace of slowdown was not fast due to the persistence of an upward trend in services prices. In the euro area, although the rise in energy prices slowed, inflation remained high, driven by services

Economic growth in major economies



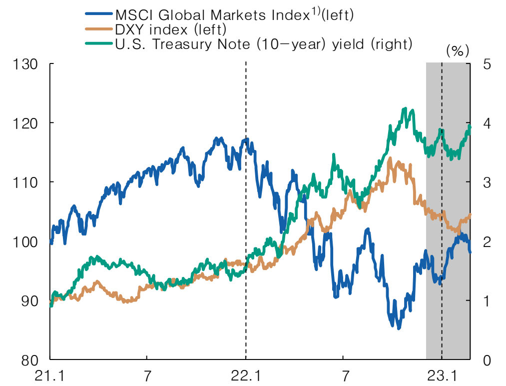
Sources: U.S. Bureau of Economic Analysis (BEA), Eurostat, Statistics Bureau of Japan, National Bureau of Statistics of China.

Consumer price inflation in major economies



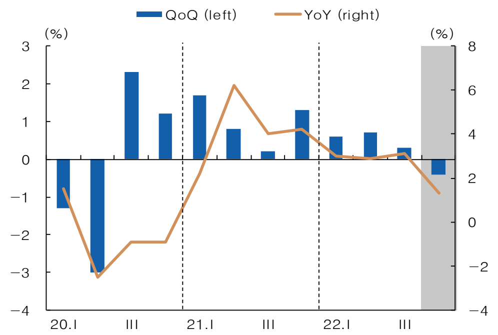
Sources: U.S. Bureau of Labor Statistics (BLS), Eurostat, Statistics Bureau of Japan, National Bureau of Statistics of China.

U.S. interest rate, global stock price index and dollar index



Note: 1) January 1, 2021 = 100.
Source: Bloomberg.

Real GDP growth[1]



Note: 1) Reflects preliminary figures.
Source: Bank of Korea.

prices. On the other hand, inflation rose in Japan and China, mainly in food prices.

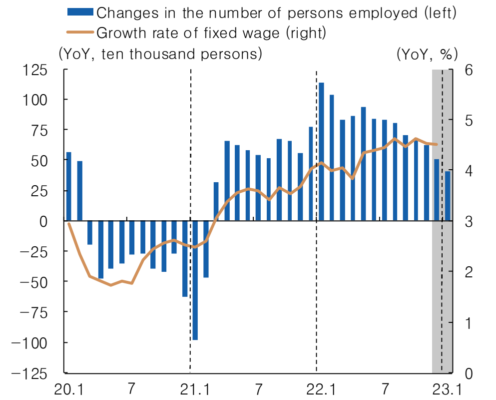
In international financial markets, the risk-off sentiment continuously lessened through January this year, as concerns over monetary policy tightening in major economies eased due to the global inflation slowdown and because China's virus restrictions were lifted earlier than expected. U.S. Treasury bond yields fell significantly as expectation of the U.S. Federal Reserve's adjustment in the pace of interest rate hikes spread due to slowing inflation. Global stock prices rose, and the weakening of the U.S. dollar continued, as well. However, as concerns about the Federal Reserve's further monetary tightening reemerged due to robust U.S. economic indicators released after February, long-term market rates in major economies climbed and the U.S. dollar turned strong, exhibiting greater volatility in global financial markets.

[2] Korea's economic growth continued to slow as exports became more sluggish and the recovery in consumption weakened. In the fourth quarter last year, private consumption declined, improvements in facilities investment weakened, and exports fell sharply owing to the global economic slowdown and to a contraction in demand for IT products. Accordingly, real GDP growth in the fourth quarter shrank by 0.4% from the previous quarter (+1.3% year-on-year). By sector, private consumption decreased, affected by weaker pent-up demand and a greater burden of principal and interest repayments. Regarding facilities investment, transportation equipment investment decreased, while machinery investment grew by a smaller margin, especially in semiconductor manufacturing equipment.

Exports reversed to a decline, as semiconductor exports decreased substantially due to the fall in unit prices of semiconductors and weak demand from downstream industries, and as sluggish exports to China continued. Since January, exports have continued their downward trend and the recovery in private consumption and facilities investment has weakened.

Employment conditions remained favorable in general, but the number of persons employed increased by a smaller margin. In January, growth in the number of employed persons in the service industry continued thanks to the return to normal life, led by the face-to-face service industry. Meanwhile, the number of persons employed in the manufacturing industry shifted to a decline for the first time in 15 months owing to sluggish exports. Nominal wage growth remained high, driven by fixed wages of regular workers.

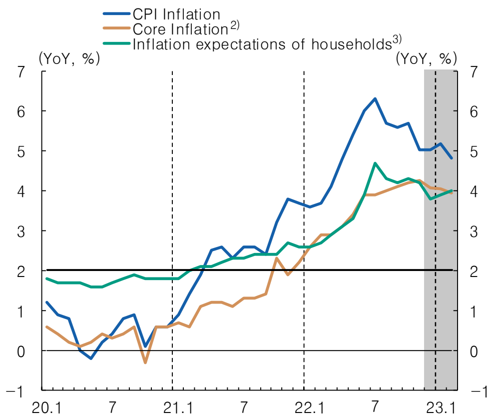
Changes in number of persons employed and nominal wage growth



Sources: Statistics Korea, Ministry of Employment and Labor.

③ Consumer price inflation continued to slow after having peaked in July last year. It somewhat rose in January led by the rise in electricity bills and the strong upward trend of processed food prices. However, it sustained its slowing trend, declining to slightly lower than 5% in February due to the fall in petroleum and livestock product prices. Core inflation declined at a slower pace to 4% in February this year, having continuously slowed after peaking in November last year. Meanwhile, short-term inflation expectations of households rose from the upper 3% level to the 4% level in February.

Inflation[1)]



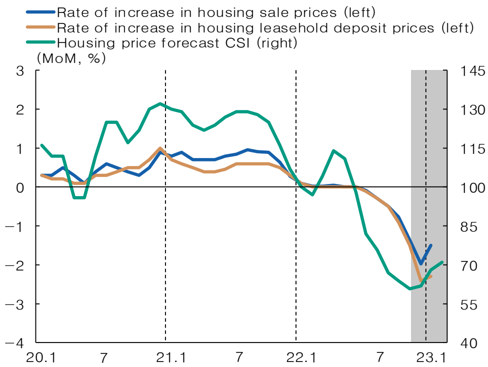
Notes: 1) The bold line indicates the inflation target.
2) Excluding food and energy.
3) Expectations for the consumer price inflation rate over the next 12 months.
Sources: Bank of Korea, Statistics Korea.

Nationwide housing sale prices continued to decline, affected by rising interest rates and worsening purchase sentiment. However, due to the government's easing of regulations, the degree of fall narrowed in January this year. Nationwide leasehold (*jeonse*) deposit prices continued to fall as demand for *jeonse* shifted to demand for monthly rent owing to the high level of lending rates.

4 In domestic financial and foreign exchange markets, in line with changes in expectations of monetary policy in major countries, interest rates and foreign exchange rates declined substantially and then rebounded in February. Since December, Treasury bond yields and the Korean won/U.S. dollar exchange rate fell sharply, due to expectations for a pace adjustment of interest rate hikes due to weak economic indicators at home and abroad. However, they rebounded owing to the reemergence of concerns about the persistent monetary tightening in major economies since the U.S. employment indicators and inflation data released in February. Meanwhile, interest rates had risen considerably in the CP and corporate bond markets following the issues surrounding PF-ABCP in Gangwon Province, but they declined and investor sentiment improved on the back of market stabilization measures taken by the Bank of Korea and the government.

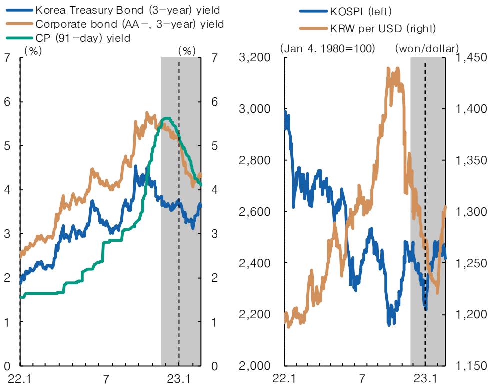
Looking at credit supply by deposit-taking banks, household lending decreased due to rising lending rates and government regulations. Growth in corporate lending also declined slightly despite a continuous upward trend of lending to large corporations owing to the stress in the corporate bond market, largely due to the considerable fall in SME lending growth in line with high lending rates and the contraction in the real estate market.

Housing sales and leasehold (*jeonse*) deposit prices rate of increase and housing price forecast CSI



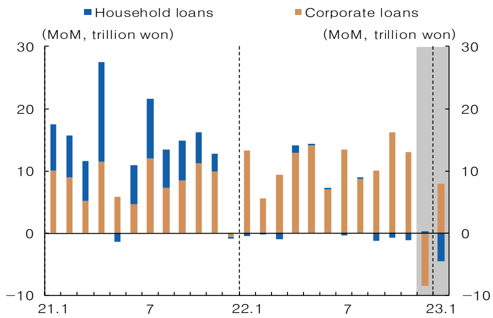
Sources: Bank of Korea, Korea Real Estate Board.

Domestic interest rates, stock prices and exchange rate



Sources: Bank of Korea, Korea Financial Investment Association, Koscom Corporation.

Changes in loans by deposit-taking banks[1)2)]



Notes: 1) Including mortgage transfers by Korea Housing Finance Corporation.
2) Figures for January 2023 are based on Bank of Korea advanced estimate.

Source: Bank of Korea.

Meanwhile, direct corporate financing, especially corporate bonds, was lagged in general. In January, however, direct corporate financing grew as corporate bonds shifted to a net issuance and the net issuance of CP and of short-term corporate bonds (non-financial corporations) continued, thanks to the resumption of institutional investor fund operations at the beginning of the year, as well to an improvement in investor sentiment.

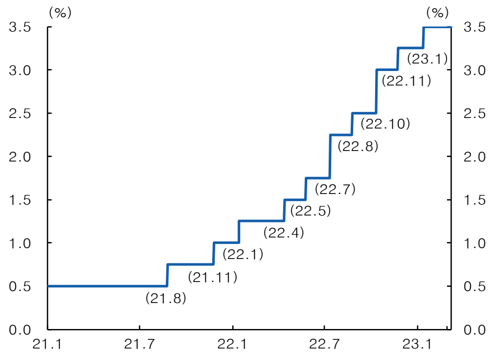
[Conduct of Monetary Policy]

5 The Bank of Korea conducted monetary policy in order to stabilize consumer price inflation at the target level (2%) over a medium-term horizon as it monitored economic growth, while paying attention to financial stability. While maintaining the restrictive policy stance with an emphasis on ensuring price stability, the Bank thoroughly assessed the pace of inflation slowdown, the economic downside risks and financial stability risks, monetary policy changes in major countries, and geopolitical risks. Under this policy stance, the Bank raised the Base Rate by 25 basis points in January 2023 (3.25% → 3.50%) and left it unchanged at 3.50% in February.

The 25 basis point hike in January was based on the judgment that inflation still remained high and was projected to be above the target level for a considerable time, although the domestic economic growth rate was expected to be below the November forecast.

The Bank of Korea decided to leave the Base Rate unchanged at 3.50% in February, as it was forecast

Bank of Korea Base Rate[1)]

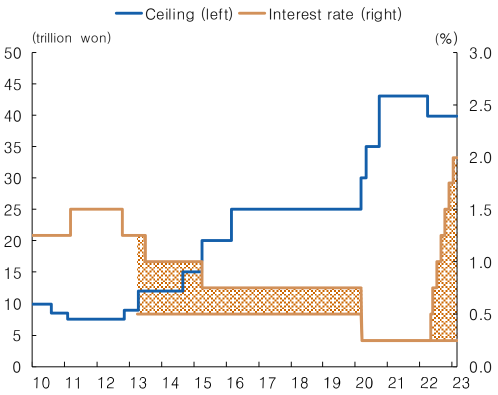


Note: 1) Figures in parentheses refer to the months of Base Rate adjustments
Source: Bank of Korea.

that inflation would continue to be above the target level throughout the year, although it was projected to gradually decrease, and uncertainties surrounding the policy decision, such as the trend of growth and financial stability conditions, were also judged to be high. The Bank, therefore, saw that it would be appropriate to judge whether the Base Rate needed to rise further while assessing the pace of inflation slowdown and developments in uncertainties.

⑥ The Bank of Korea is using various policy instruments to promote smooth credit flows and stability in financial and foreign exchange markets. With regard to the Bank Intermediated Lending Support Facility, the Bank of Korea raised the interest rate by 25 basis points from 1.75% to 2.00%, reflecting the Base Rate hike on January 13. However, concerning the Support Programs for SMEs Affected by COVID-19 and Small Businesses that were terminated at the end of September last year, the Bank maintains its support for existing loans until their maturities (up to 1 year), and keeps the interest rate at a low level (0.25%) regardless of the Base Rate increases so far.

Ceiling and interest rates of Bank Intermediated Lending Support Facility[1)]



Note: 1) Shaded area represents the time frame where interest rates were different for each program.
Source: Bank of Korea.

Meanwhile, the Bank of Korea extended by three months, from the end of January to the end of April, the expiration date of a temporary three-month expansion in November of the range of eligible collateral for its lending facilities and for guaranteeing net settlements, as well as for securities eligible for RP transactions under open market operations, aimed at ensuring stability in the short-term money markets and in the bond market. In keeping with this action, the Bank postponed again by three months the implementation of its previously announced plan to increase in a phased manner the ratio of collateral for guaranteeing net settlements. In order to respond preemptively to spreading concerns about funding by financial institutions and corporations ahead of the year-end, and to the prospect of an intensification of the short-term money market crunch, the Bank facilitated smooth flows of funds by purchasing bonds in repo auctions amounting to 13.23 trillion won on eight occasions between November 2022 and January 2023. Furthermore, the Bank of Korea provided liquidity to financial institutions participating in capital calls for the bond market stabilization fund, by purchasing bonds in repo auctions on three occasions between December 2022 and January 2023, aimed at easing their financing burdens.

[Future Monetary Policy Directions]

⑦ Domestic economic growth will continue its slowdown for a considerable time, due to global economic sluggishness and to interest rate hikes. But in the second half of this year, it is expected to improve gradually as the Chinese economy and the IT industry recover. However, uncertainty in the outlook is high. Korea’s real GDP is projected to grow by 1.6% in 2023 and by 2.4% in 2024. Private consumption is expected to continue to recover only gradually due to the slowdown in the rise of purchasing power, to the rise in debt servicing costs, and to the contraction in housing market activity. Facilities investment is expected to contract compared to last year, caused by the global economic slowdown and the increased cost of capital. Construction investment is projected to show sluggishness, due to the slowdown in housing market activity and to decreases in the budget for SOC expenditures. Exports are projected to slow further for a considerable time, but will gradually improve in the second half of this year thanks to the recovery in the Chinese economy and in the IT industry.

There are potential uncertainties surrounding the growth outlook path. The upside risks to growth include a strong recovery in the Chinese economy, a fast rebound in the IT sector, and early relief of geopolitical instability, such as the Ukraine war. Among the downside risks are intensified monetary policy tightening in major countries due to continuing high inflation rates, deepening fragmentation, and deepening sluggishness in the domestic housing market.

CPI inflation is expected to decelerate significantly from last year's 5.1% to 3.5% this year, as both supply and demand side price pressures ease, reflecting lower crude oil prices and the slowdown in economic activity. On the future inflation outlook path are huge uncertainties stemming from various upside and downside risks. The upside risks include further increases in international oil prices, a faster-than-expected economic recovery at home and abroad, and a resurgence of the Korean won to US dollar exchange rate. Among the downside risks are deepening economic slowdowns at home and abroad, the curbing of rises in public utility charges, and continuing declines in international oil prices.

8 The Bank of Korea will continue to conduct monetary policy in order to stabilize consumer price

inflation at the target level (2%) over a medium-term horizon as it monitors economic growth, while paying attention to financial stability.

Inflation is projected to remain high above the target level although the domestic economic growth rate will decline, and uncertainties surrounding the policy decision are high. The Bank of Korea, therefore, deems it warranted to judge whether the Base Rate needs to rise further while maintaining the restrictive policy stance for a considerable time with an emphasis on ensuring price stability. In this process the Bank will thoroughly assess the pace of inflation slowdown, the economic downside risks and financial stability risks, the effects of the Base Rate raises, and monetary policy changes in major countries.