Executive Summary

[Monetary Policy Operating Conditions]

1 A look at financial and economic conditions at home and abroad between February and May 2022 finds the following. The recovery of the global economy slowed, affected by the Ukraine crisis and lockdown measures in China. US economic growth was subdued due to a slowdown of consumption growth, affected by high inflation and acceleration of policy rate hike in response to it amid slowing external demand. The momentum of recovery in the euro area weakened, due to the prolongation of the Ukraine crisis. China's growth slowed sharply, due to its lockdown measures in major cities including Shanghai. Meanwhile, Japan showed signs of gradual recovery as the spread of COVID-19 subsided.

Economic growth in major economies[1)]

(%)

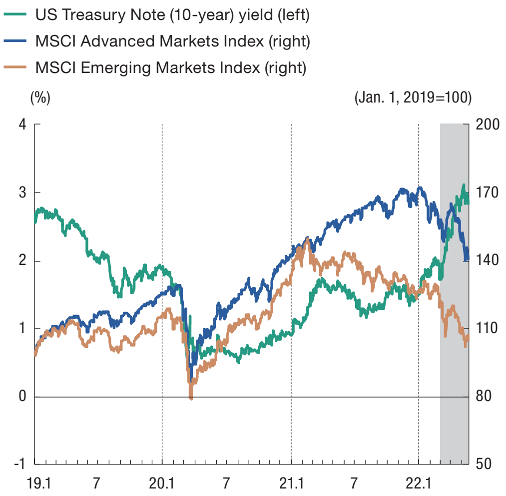
	2019	2020	2021					2022
	Year	Year	Year	Q1	Q2	Q3	Q4	Q1
US	2.3	-3.4	5.7	1.5	1.6	0.6	1.7	-0.4
Euro area	1.6	-6.4	5.4	-0.1	2.2	2.2	0.3	0.3
China	6.0	2.2	8.1	18.3	7.9	4.9	4.0	4.8
Japan	-0.2	-4.5	1.7	-0.3	0.5	-0.7	0.9	-0.2

Note: 1) The quarterly rates of growth are quarter-on-quarter (seasonally adjusted) for the US, Japan and the euro area, and year-on-year for China.
Sources: Individual countries' published statistics.

Global inflation sustained its strong upward trend, influenced by surging energy and food prices in line with the Ukraine crisis and global supply constraints. This rise in inflation in the US and the euro area appeared to expand broadly due to supply shocks coupled with demand pressure. Inflation rose in Japan and China, owing to the depreciation of the yen and to the increase in food prices, respectively.

In the international financial market, investor sentiment contracted and the volatility of price variables increased, influenced by rapid monetary policy normalization by major economies in response to elevated inflation, the prolongation of the Ukraine crisis, and concerns about China's economic slowdown. The US Treasury yield began to rise entering March, and the extent of rise increased further as the US Federal Reserve raised the interest rate at the FOMC meeting and the expected frequency of rate hikes was revised upward. The yield climbed further on growing expectations for an even faster pace of monetary policy normalization by the US Federal Reserve going forward due to the persistence of high inflation after April. Stock prices in advanced economies fell sharply following March due to the prolongation of the Ukraine crisis, economic slowdown stemming from China's lockdown measures, and concerns over the rise in inflation. Affected by global investor sentiment, stock prices in emerging countries moved generally in line with those of advanced economies. Meanwhile, the US dollar remained strong after March, supported by preference for safe assets and stronger expectations for acceleration of monetary policy normalization by the US Federal Reserve.

US long-term interest rate, share price indices of advanced and emerging markets



Source: Bloomberg.

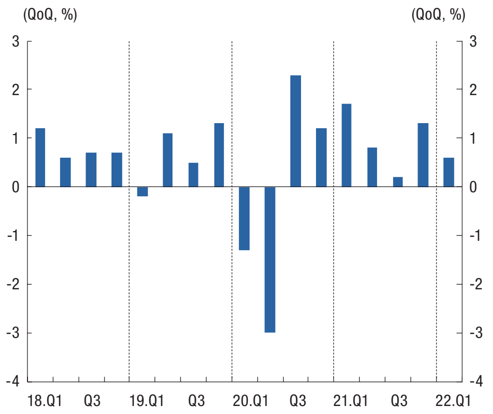
2 The Korean economy sustained its trend of recovery despite growing uncertainties abroad. The recovery of domestic demand somewhat slowed affected by the spread of COVID-19 and global supply chain disruptions in the first quarter. However, as exports sustained their buoyancy, the real GDP growth rate rose by 0.6% from the preceding quarter (+3.0% year-on-year). Private consumption picked up rapidly after mid-March mainly in services consumption boosted by an easing of COVID-19 restrictions, but facilities investment was sluggish, affected by global supply constraints, and exports growth slowed, negatively affected by China's lockdown measures.

By sector, private consumption (based on GDP) declined 0.5% compared to the previous quarter (+4.3% year-on-year) as external activities contracted in line with the rapid spread of COVID-19 in the first quarter. However, private consumption showed a rapid recovery led by services consumption after mid-March on the back of the improved pandemic situation and the government's easing of COVID-19 restrictions. In April in particular, when social distancing measures were mostly lifted, consumption in face-to-face services such as food and accommodation, leisure and entertainment, and transportation improved substantially, and retail sales of goods related to outdoor activities such as clothing increased. However, the Retail Sales Index for April announced by Statistics Korea decreased 0.2% from the previous month (+0.5% year-on-year) as demand for non-durable goods such as medicine and ingredients was reduced in response to improvement in the pandemic situation. Government consumption in the first quarter maintained a level similar to that of the fourth quarter (+6.6% year-on-year), with the rise in goods expenses being offset by the reduction in health insurance reimbursements.

Facilities investment decreased 3.9% from the previous quarter (-6.2% year-on-year) in the first quarter, affected by global supply constraints. The Equipment Investment Index for April announced by Statistics Korea was down 7.5% compared to the previous month (-11.9% year-on-year), mainly led by sluggish investment in machinery. Construction investment fell 3.9% from the previous quarter in the first quarter (-5.5% year-on-year), due to a rise in the costs of construction materials, construction halts stemming from strengthened safety inspections on construction sites, and delayed execution of the SOC budget. In April, the value of construction completed announced by Statistics Korea grew 1.4% from the preceding month (-1.1% year-on-year), thanks to the resolution of cement and remicon supply disruptions.

Exports (customs-clearance basis) sustained their buoyancy in the first quarter, with the export value hitting a record high in March. Exports of IT products grew substantially led by semiconductors and computers. For non-IT products, exports of petroleum products and steel exhibited sharp increases. After April, exports to the US and the euro area remained solid, but export growth slowed mainly in chemical products, steel and machinery, affected by the reduction in China's import demand due to its lockdowns.

Real GDP Growth[1)]

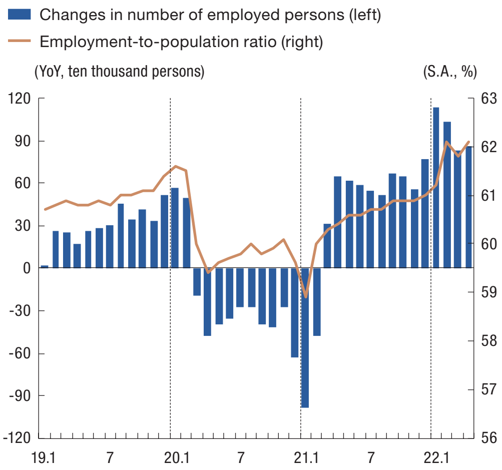


Note: 1) Reflecting preliminary figures
Source: Bank of Korea

Recent employment conditions have continued to improve with a substantial margin of growth sustained in the number of persons employed. Total payrolls increased by 865,000 year-on-year in April. Private nonfarm payrolls (excluding agriculture and fisheries, public administration, and health and social welfare) have continued to improve, increasing by 476,000. The (seasonally-adjusted) employment-to-population ratio stood at 62.1% in April, rising slightly from the preceding month (61.8%).

Nominal wages rose 7.2% year-on-year in the first quarter, showing a larger increase from the fourth quarter last year (5.2%). Wages of regular workers continued to increase rapidly led by special wages, and the degree of increase in wages for temporary workers also widened slightly.

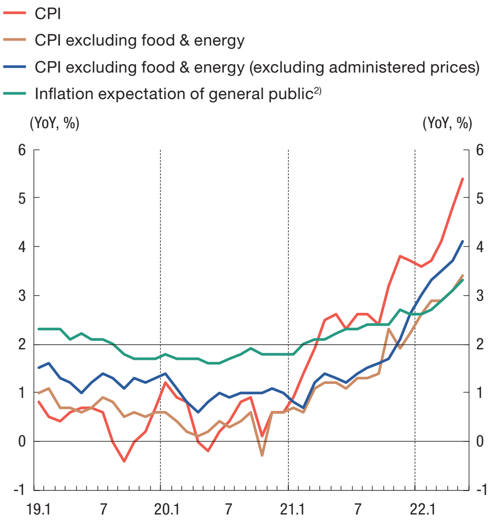
Changes in number of employed persons and employment-to-population ratio



Source: Statistics Korea.

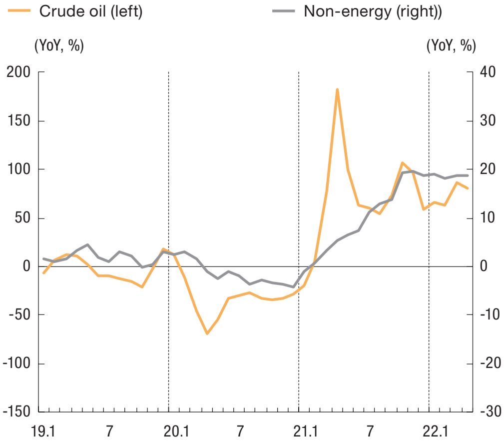
3 Consumer price inflation exceeded 4% in March this year and climbed rapidly to 5.4% in May, exhibiting the highest figure since the global financial crisis. This high level of inflation was attributable to the greater increase in energy and food prices caused by the prolongation of the Ukraine crisis, along with rising inflationary pressure from the demand side caused by consumption recovery in line with the lifting of social distancing measures. Looking at overseas factors affecting consumer price inflation, crude oil and non-energy import price growth remained high due to growing international oil and commodity prices and a rise in the Korean won to US dollar exchange rate. As for domestic factors, the upward trend of personal service prices accelerated in line with the sustained recovery of demand. Core inflation (excluding changes in food and energy prices from the CPI) reached the mid-to-upper 2% level in the first quarter this year and went up higher to the lower-to mid-3% level in April and May. Taking into account the significant effect that government policies have on core inflation, core inflation excluding administered prices showed an even higher increase at around the 4% level in April and May. The short-term inflation expectations of the general public and an expert group (1-year ahead) rose to the 3% level, greatly exceeding the Bank of Korea's inflation target (2%). However, the long-term inflation expectations of the expert group (5-year ahead) remained generally stable at around the target level (2%).

Inflation[1)]



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

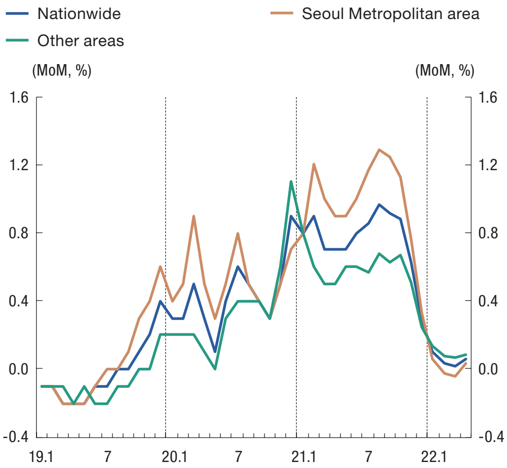
Import prices (Korean won basis)



Source: Bank of Korea.

Nationwide housing sales prices changed little after February due to strengthened loan management by financial institutions and lending rate hikes, and shifted to a slight increase in April owing to expectations that the new government would ease regulations on the real estate market. Nationwide leasehold (jeonse) deposit prices exhibited slower growth as the demand for *jeonse* shifted to that for monthly rent owing to lending rate hikes, and recently the prices remained unchanged.

Housing sales price growth rate

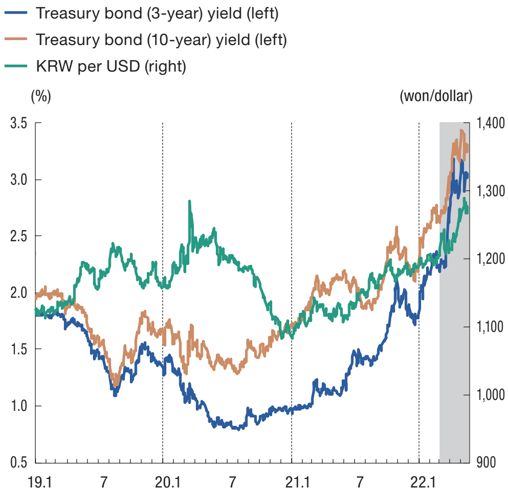


Source: Korea Real Estate Board.

④ Korea Treasury bond yields rose significantly due to a mix of factors: external factors such as accelerating moves toward monetary policy normalization by major central banks and the Ukraine crisis, and domestic factors such as concerns over the drawing up of a supplementary budget. The yields declined temporarily on preference for safe assets at an early stage of the Ukraine crisis at end-February. However, the upward pressure on the yields increased significantly owing to policy rate hikes by major central banks in response to the spread of global inflation. Domestically, uncertainties over the second supplementary budget, Base Rate hikes, high inflation exceeding 4% in March and May, and sell-offs of Treasury bond futures by domestic institutional investors acted as factors pushing the yields higher.

Having risen to the 1,240 won level in early March, the Korean won to US dollar exchange rate declined to the 1,210 won level as geopolitical tensions were somewhat mitigated. The exchange rate then soared to the 1,280 won level, affected by the US Federal Reserve's policy rate hike of 50bp, concerns about global economic slowdown due to broader lockdowns in China and the prolongation of the Ukraine crisis, and the demand for currency conversion for foreigners' domestic stock dividends and funds from stock sales. The rate later decreased slightly to the 1,260-1,270 won level due to expectations for easing of China's lockdowns.

Korea Treasury bond yields and exchange rate (KRW per USD)

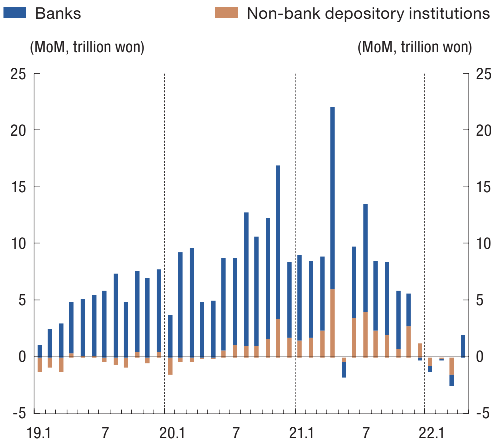


Sources: Bank of Korea, Korea Financial Investment Association.

⑤ Household lending switched to a decline in the first quarter, owing to the continued management of household lending by the financial sector, lending rate hikes, and sluggish housing transactions. In April, however, household lending came back to a slight increase as the rate of increase in mortgage loans was sustained, mainly led by group loans and leasehold (*jeonse*) deposit loans, and the extent of decrease in other loans narrowed due to eased management of unsecured loans by the banking industry.

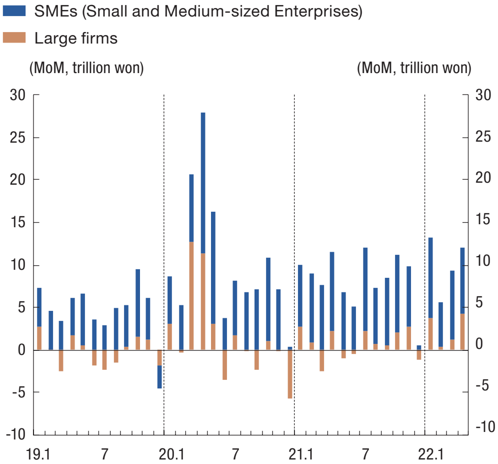
Corporate financing sustained its pace of high growth entering this year. Corporate lending by banks, especially to small and medium-sized enterprises (SMEs), increased by a larger margin from the previous quarter in the first quarter, and rose sharply in April as well due to stronger sales activities for corporate lending. Regarding direct corporate financing, net issuance of corporate bonds grew only modestly but net issuance of CP and short-term bonds increased significantly, and stock issuance also rose sharply due to some companies' paid-in capital increases.

Changes in household loans[1)2)]



Notes: 1) Including mortgage transfers
2) Figures for April 2022 are based on the Bank of Korea advance estimate for banks and have not been released for non-bank depository institutions.
Source: Bank of Korea.

Changes in corporate loans[1)]

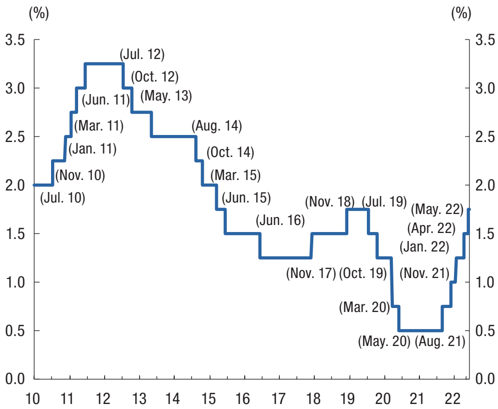


Note: 1) Based on banks
Source: Bank of Korea.

[Conduct of Monetary Policy]

6 The Bank of Korea conducted monetary policy in order to sustain the recovery of economic growth and stabilize consumer price inflation at the target level (2%) over a medium-term horizon, while paying attention to financial stability. In this process, it thoroughly assessed the trends of growth and inflation, the risk of a buildup of financial imbalances, inflation movements and monetary policy changes in major economies, and external economic conditions including geopolitical risks. Under this policy stance, the Bank of Korea adjusted the degree of monetary policy accommodation by raising the Base Rate by 25 basis points in April 2022 and by another 25 basis points in May (1.25%→1.5%→1.75%).

Bank of Korea Base Rate[1)]



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

A detailed look at the background of the Base Rate decisions during this period is as follows. At the April meeting, the Board raised the Base Rate from 1.25% to 1.50%, in consideration of the points that the Korean economy continued to recover, that inflation had persisted for a considerable time, and that there was a need to pay continued attention to the risk of financial imbalances. Although facilities investment had slowed due to global supply constraints, the Korean economy continued to recover, as exports had sustained their buoyancy and private consumption had shown modest improvement thanks to the easing of domestic COVID-19 restrictions. Going forward, the economy was expected to sustain its recovery albeit partly affected by the Ukraine crisis, as exports were expected to continue their solid trend of growth and private consumption was likely to improve. Consumer price inflation had risen significantly to the lower-4% level due to soaring prices of petroleum products as well as the accelerating increase in the prices of industrial products and personal services. Looking ahead, it was forecast that consumer price inflation would remain high in the 4% range for some time. On the financial stability side, market liquidity was expected to maintain strong growth, mainly led by corporate lending, while household loans had decreased slightly and housing prices had fallen slightly, especially in the Seoul Metropolitan area.

At the May meeting, the Board decided to raise the Base Rate by 25 basis points as in April, considering that the Korean economy was forecast to maintain growth of the upper-2% level for the year amid increased external risk factors and that inflationary pressures were expected to grow to a much greater extent than originally forecast and that there was a need to reduce the risk of financial imbalances in terms of their underlying trend. Looking at the Korean economy, private consumption had improved rapidly supported by the lifting of social distancing restrictions, while facilities investment had continued to slow due to global supply constraints and exports had moderated. Going forward, the economy was likely to sustain its recovery supported by the improvement in private consumption, despite slower export growth owing to moderation in global economic growth. GDP growth this year was projected at 2.7%, somewhat below the February forecast of 3.0%. Consumer price inflation had risen significantly to the upper-4% level due to the accelerating increase in the prices of petroleum and industrial products, the ongoing sharp rise in the prices of personal services, and increases in electricity and gas fees. It was forecast that consumer price inflation would remain high in the 5% range for some time, and run at 4.5% for the year overall, substantially above the February forecast of 3.1%. With respect to financial stability, although household loans had grown slightly and housing prices had remained steady, the need to pay attention to the risk of a buildup in financial imbalances was judged to still remain high.

7 The Bank of Korea is using various policy instruments to promote smooth credit flows and stability in the financial and foreign exchange markets.

With regard to the Bank Intermediated Lending Support Facility, the Bank of Korea has continued to provide support for small businesses and SMEs facing increased funding difficulties due to COVID-19 by extending the period of the temporary financial support measure and changing the way it is implemented. However, the Bank terminated operation of some regular programs under the facility that had achieved their intended goals and, in reflection of this, cut the ceiling by 3.2 trillion won. The Bank meanwhile raised the interest rates on the programs under the facility to 0.75% in April and May in reflection of the Base Rate hike. However, the Bank decided to leave the interest rate on the Support Programs for SMEs Affected by COVID-19 and Small Businesses at 0.25%, given that they remained in financial hardship.

As of end-April 2022, the volume of loans handled by domestic banks under the Bank of Korea's Support Programs for SMEs Affected by COVID-19 and Small Businesses recorded 31.7 trillion won and 6.5 trillion won, respectively.

Furthermore, in March 2022, the Bank of Korea urgently allocated 60 billion won from the ceiling reserves of the Bank Intermediated Lending Support Facility for supporting SMEs hit by forest fires in the east coast regions.

Programs under the Bank Intermediated Lending Support Facility

(trillion won, %)

Programs		Ceiling		Interest rate		
		Before	!st Adjustment[1)]	Before	!st Adjustment[2)]	2nd Adjustment[3)]
Support Program for Trade Financing		1.5	1.5	0.25	0.5	0.75
Support Program for New Growth Engine Development and Job Creation		13.0	13.0	0.25	0.5	0.75
Program for Stabilization of SME Lending		3.5	0.3	0.25	0.5	0.75
Support Program for Regional SMEs		5.9	5.9	0.25	0.5	0.75
Ceiling Re-serves	Support Program for SMEs Affected by COVID-19	13.0	13.0	0.25	0.25	0.25
	Support Program for Small Businesses	6.0	6.0	0.25	0.25	0.25
	Others	0.1	0.1	0.25	0.5	0.75
Total		43.0	39.8	-	-	-

Notes: 1) Effective as of April 1, 2022
2) Effective as of May 2, 2022
3) Effective as of May 26, 2022
Source: Bank of Korea.

Meanwhile, the Bank of Korea conducted outright purchases of Treasury bonds worth 2 trillion won (on April 5), to ease the sharp increase in the volatility of Treasury bond yields due to the spread of global inflation and the acceleration of monetary policy normalization by major central banks. The Bank also reduced the volume of Monetary Stabilization Bond issuance in March and April.

8 The Bank of Korea continuously monitored movements in the financial and FX markets at home and abroad. While operating an emergency financial market monitoring and response system activated in the event of increased market volatility, it has also closely looked into the evolution of domestic and global risk factors as well as their impacts on financial and FX markets. More specifically, the Bank held Conditions

Review Meetings (on March 17 and May 5) to discuss the domestic and global financial market responses to and impacts from the results of FOMC meetings. Furthermore, as the geopolitical risks surrounding Ukraine continue, the Bank is operating a 24-hour monitoring system to closely examine the evolution of the crisis and its impact on financial markets and economies at home and abroad.

In addition, at its Financial Stability Meeting, the Bank of Korea strengthened monitoring of risk factors from increasing uncertainties surrounding financial and economic conditions, such as geopolitical risks, growing inflationary pressures at home and abroad, and the acceleration of monetary policy normalization by major central banks, amid the accumulation of financial imbalances.

The Bank of Korea has continued to perform technical and institutional research on central bank digital currency (CBDC) in order to effectively cope with the rapid progress toward a digital economy. In particular, in the phase 2 pilot test on CBDC to be completed in June 2022, the Bank has been implementing extended functions of CBDC involving offline settlements, digital asset transactions and cross-border remittances, and has been examining the applicability of new IT technologies such as enhanced technologies for information protection. The Bank has also stepped up its research on the impacts of the adoption of CBDC on the central bank's major roles and responsibilities regarding monetary policy and financial stability, jointly with members of academia.

Furthermore, the Bank of Korea is reviewing a plan to establish a fast payment system based on real-time gross settlement (RTGS) in order to reduce credit risks and prepare for possible cross-border integration of payment and settlement systems. In this process the Bank will closely monitor major countries' adoption of fast payment systems and discussions on cross-border integration of payment and settlement systems and promote communication with relevant external agencies in establishing such systems.

[Future Monetary Policy Directions]

9 Looking ahead, although worsening external conditions such as China's lockdown measures and the Ukraine crisis will act as downside risks, the Korean economy is forecast to maintain its recovery boosted by the easing of domestic COVID-19 restrictions and the effects of a supplementary budget. Accordingly, the GDP growth rate is projected to be around 2.7% in 2022 and 2.4% in 2023.

Private consumption has been recently picking up rapidly affected by the easing of domestic COVID-19 restrictions, and is expected to continue its recovery driven by the lifting of social distancing restrictions and improvement in income conditions. Facilities investment has continued to slow recently affected by global supply constraints but is forecast to exhibit a gradual recovery, led by the semiconductor industry. Construction investment is expected to be sluggish for some time but to improve gradually in the second half of this year. Growth in exports has been faltering somewhat due to the contraction in import demand from China, and is expected to slow gradually in line with the weakening of economic growth in major countries.

There are still high potential uncertainties surrounding the growth outlook. The upside risks to growth include a stronger consumption recovery, expanded investment in new growth industries, and China's expansion of stimulus measures. Among the downside risks are China's continued lockdown measures, a prolongation of the Ukraine crisis, and worsening global financial conditions.

Economic growth outlook[1]

(YoY, %)

	2021[2]	2022e			2023e		
	Year	H1	H2	Year	H1	H2	Year
GDP	4.1	2.8	2.5	2.7	2.3	2.5	2.4
Private consumption	3.7	3.9	3.5	3.7	3.1	2.3	2.7
Facilities investment	9.0	-5.4	2.6	-1.5	6.4	-2.1	2.1
Intellectual property products investment	4.4	4.7	3.3	4.0	3.4	3.9	3.7
Construction investment	-1.6	-3.4	2.2	-0.5	3.9	1.5	2.6
Goods exports	10.5	5.8	1.1	3.3	0.6	3.6	2.1
Goods imports	12.8	5.3	1.5	3.4	2.4	2.4	2.4

Notes: 1) Figures are the forecast as of May 2022.
2) Reflects fourth quarter preliminary figures of 2021.
Source: Bank of Korea.

Consumer price inflation this year is expected to rise significantly to 4.5%, driven by a rise in prices of commodities including crude oil and grains, and by worsening supply disruptions. Core inflation for items other than food and energy is also forecast to rise substantially to exceed 3%, boosted by increased demand-side pressures following the recovery in domestic demand and by the second-round effects of supply-side factors. Meanwhile, consumer price inflation and core inflation for next year are projected to be in the upper-2% range and in the mid-2% range, respectively.

There is a high degree of uncertainty on the future inflation outlook path, with upside risks predominating. The upside risks include a continued sharp rise in prices of commodities such as oil, grains and natural gas, worsening supply chain disruptions, a stronger recovery in consumption in line with the lifting of social distancing restrictions, and continued US dollar appreciation. Among the downside risks are slowing economic recoveries at home and abroad, improvement in commodity supply and demand conditions, and the curbing of rises in public utility charges.

Inflation outlook[1]

(YoY, %)

		2021	2022e			2023e		
		Year	H1	H2	Year	H1	H2	Year
CPI inflation		2.5	4.4	4.6	4.5	3.3	2.5	2.9
Core inflation	CPI excluding food & energy	1.4	3.0	3.3	3.2	2.8	2.3	2.6
	CPI excluding agricultural products & oil	1.8	3.5	3.8	3.6	3.4	2.8	3.1

Note: 1) Figures are the forecast as of May 2022.
Source: Bank of Korea.

10 The Bank of Korea will continue to conduct monetary policy in order to sustain the recovery of economic growth and stabilize consumer price inflation at the target level (2%) over a medium-term horizon, while paying attention to financial stability.

The Bank of Korea will need to conduct monetary policy with more emphasis on inflation for some time, as the Korean economy is expected to continue its recovery and inflation to run above the target level for a considerable time, despite underlying uncertainties over domestic and external conditions. In this process the Bank will determine when to further adjust the degree of accommodation while thoroughly assessing trends of growth and inflation, the risk of a buildup of financial imbalances, monetary policy changes in major countries, and external economic conditions including geopolitical risks.