

Executive Summary

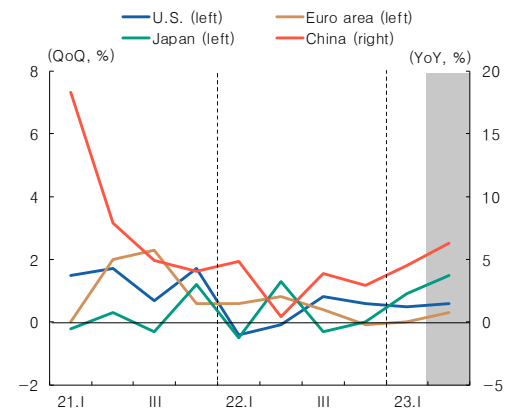
[Recent Economic and Financial Developments]

1 A look at economic and financial developments at home and abroad between June and August 2023 finds the following. Even though manufacturing sectors were sluggish, global economic growth was running above the expectation particularly in advanced economies, thanks to the sustained favorable growth in service sectors. In the United States, steady increase in service consumption, coupled with a rebound in private investment, resulted in higher-than-expected economic growth. In the euro area, even with the continued sluggishness in manufacturing sectors, the economy showed a slight growth, mainly driven by the recovery in service sectors, including tourism industry. The Chinese economy has been experiencing a weakening recovery momentum since the second quarter, due to the downturn in the real estate market and weak external demand. The Japanese economy saw an expansion in its recovery, as the slump in goods exports, including automobiles, was moderating, and service exports improved with increasing number of foreign tourists.

Global inflation had been stabilizing quickly, but has experienced a slower decline since August, owing to rising energy prices. Core inflation remained at a high level, driven by tight labor market conditions and solid service consumption.

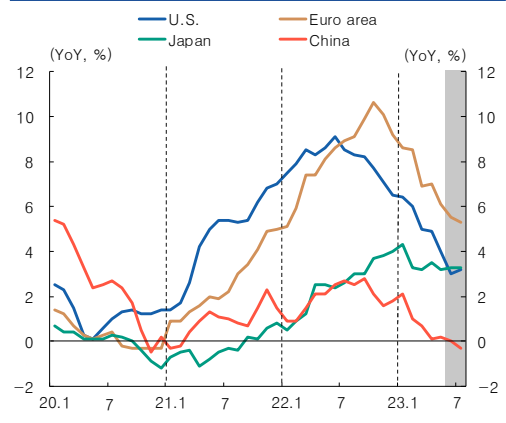
In the international financial markets, there had been a continued preference for risky assets, driven by factors such as the resolution of debt ceiling

Economic growth in major economies



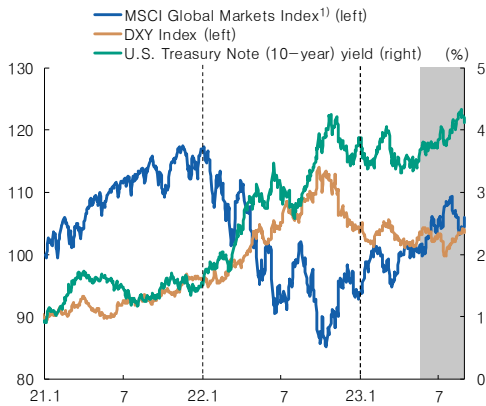
Sources: U.S. Bureau of Economic Analysis (BEA), Eurostat, Statistics Bureau of Japan, National Bureau of Statistics of China.

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.

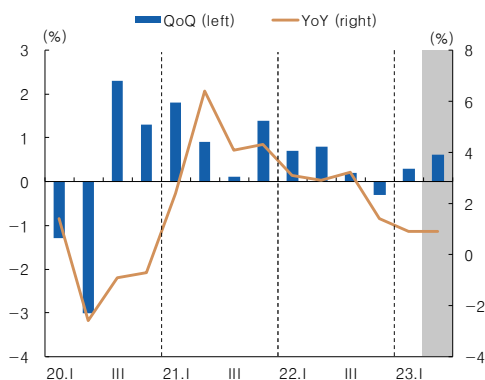
U.S. interest rate, global stock price index and dollar index



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

negotiations and expectations of a soft landing in the U.S. economy. However, since late July, volatility has gradually increased due to rising U.S. Treasury bond yields and growing concerns about risks related to China. The U.S. Treasury bond yields has shown slight fluctuations, then rose significantly, influenced by expectations of the prolonged monetary tightening stance by the U.S. Federal Reserve and growing expectations of a soft landing in the U.S. economy. Global stock prices had continued to rise, driven by favorable economic growth in advanced economies and the strong corporate earnings but then declined due to valuation pressure stemming from rising long-term interest rates and to concerns about a slowdown in the Chinese economy. The U.S. dollar had weakened, as inflation indicators fell below expectations, then turned strong again, driven by solid economic indicators in the U.S. and lowered expectations for additional tightening by ECB and BOE.

Real GDP growth¹⁾



Note: 1) Reflects preliminary figures for 2022 and 2023.
Source: Bank of Korea.

② The trend of recovery in Korean economy slowed somewhat, particularly in domestic demand. As the contribution of net exports increased, real GDP growth in the second quarter went up by 0.6% from the preceding quarter (+0.9% year-on-year). By sector, private consumption decreased due to weakened pent-up demand and temporary factors such as frequent rainfall. Meanwhile, facilities investment increased, with IT equipment investment showing a slight rebound after experiencing significant contraction earlier this year. Exports continued to decline, influenced by factors such as the downturn in the semiconductor industry and weakened recovery in the Chinese economy. However, the extent of the decline has moderated.

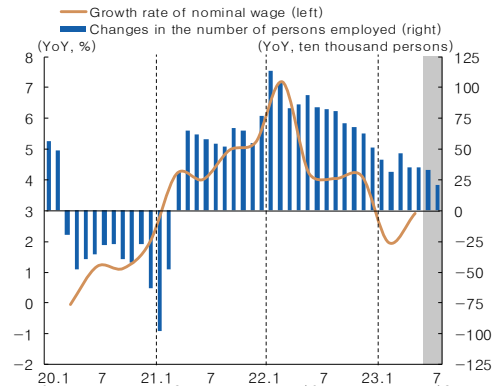
Since July, consumption and investment have decreased due to deteriorating weather conditions and the stagnation in the global manufacturing industry, while the sluggishness in exports have been alleviated.

While employment conditions remained favorable overall, the pace of growth in the number of persons employed has continued to slow moderately. In July, the number of persons employed in the manufacturing industry continued to decrease due to lackluster exports, but the number of persons employed in the service industry sustained a strong upward trajectory, led by the face-to-face and health & welfare services. Nominal wages increased by 2.9% year-on-year in the second quarter, marking a slowdown in the upward trend.

3 Consumer price inflation had been sustaining its slowing trend since July last year and declined to the 2% range during June and July this year. However, it rebounded to 3.4% in August, driven significantly by base effect and rapid surge in petroleum and agricultural product prices. Core inflation had considerably declined in June and continued to slow at a moderate pace since then, as the upward momentum of personal service prices gradually weakened. Meanwhile, short-term inflation expectations of households have continued to fall since March, reaching the low- and mid-3% level in the third quarter.

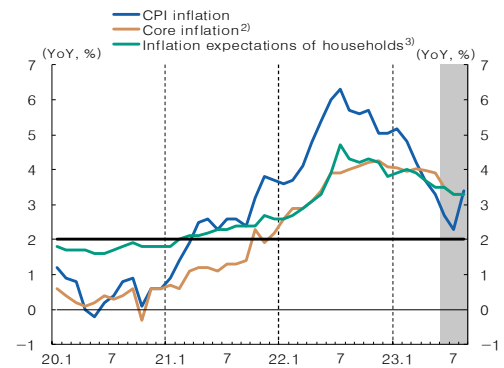
Nationwide housing sale prices showed smaller declines from this year, influenced by government's housing market stabilization measures and lowered lending rates for new loans compared to the beginning of this year, then turned to an increase in

Changes in number of persons employed and nominal wage growth¹⁾



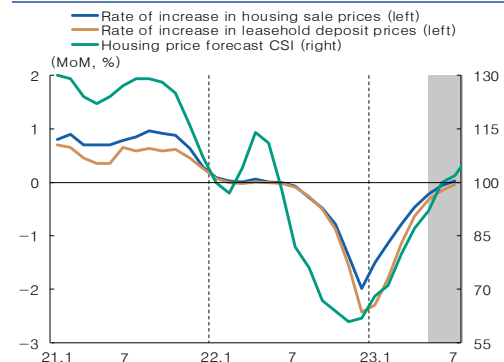
Notes: 1) Nominal wage growth is based on quarterly data.
Sources: Statistics Korea, Ministry of Employment and Labor.

Inflation¹⁾



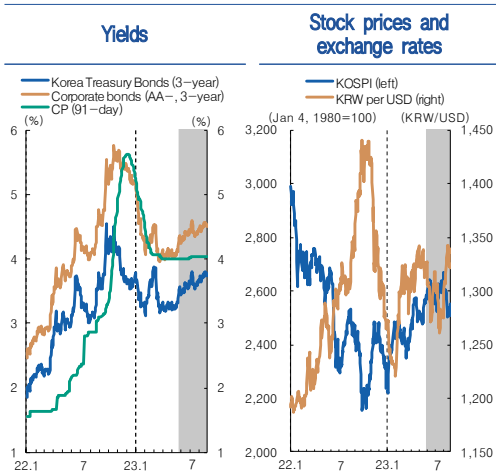
Notes: 1) The bold line indicates the inflation target.
2) Excluding food and energy.
3) Expectations for the consumer price inflation rate over the next 12 months.
Sources: Bank of Korea, Statistics Korea.

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



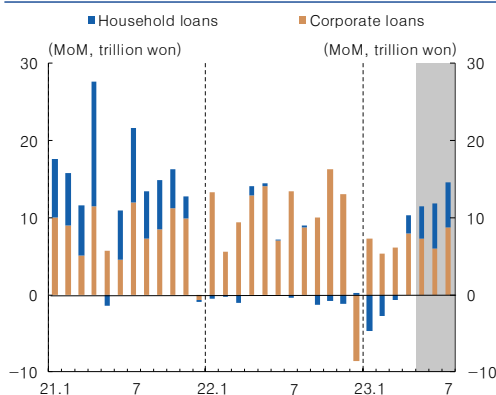
Sources: Bank of Korea, Korea Real Estate Board.

Domestic interest rates, stock prices and exchange rates



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

Changes in loans by deposit-taking banks¹⁾²⁾



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

Source: Bank of Korea.

July. Sentiment indicators including housing price forecast CSI (Consumer Sentiment Index) has continued to rise, surpassing the benchmark level (100) in the second half of this year. Nationwide leasehold deposit (*jeonse*) prices also have shown smaller declines since this year, as lending rates declined.

④ In domestic financial and foreign exchange markets, Treasury bond yields increased considerably and the Korean won/U.S. dollar exchange rate fluctuated, due to the expectations of strengthened and prolonged monetary policy tightening by the U.S. Federal Reserve. In July, the interest rate and exchange rate decreased as the inflation in major economies decelerated. However, since late July, growing expectations that the tightening stance of the U.S. Federal Reserve would become protracted and worries about the supply of U.S. Treasury bonds have led to a significant increase in the U.S. Treasury bond yields, resulting in substantial rise in Korea Treasury Bond yields as well. The exchange rate has also risen considerably, due to the factors such as strong U.S. dollar and growing concerns over the Chinese economy.

Meanwhile, growth in household lending has been expanding, driven by policy supports including Special *Bogeumjari* Loan, eased loan regulations, and demand for funds related to housing purchases since it had shifted to an increase in the second quarter. Corporate lending, following an increase in the second quarter, also saw a significant expansion in July. As for lending to large corporations in particular, the expansion was attributed to corporate demand for working capital and debt financing.

Direct corporate financing shifted to a net redemption in the second quarter, led by corporate bonds. In the case of corporate bonds, the volume of issuance decreased, as some companies secured refinancing funds in advance and expanded their funding through bank loans.

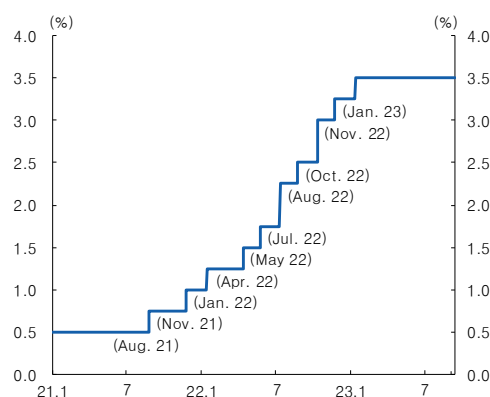
[Monetary Policy Implementation]

⑤ The Bank of Korea maintained the restrictive policy stance with an emphasis on ensuring price stability in order to stabilize consumer price inflation at the target level (2%) over the medium-term horizon as it monitored economic growth, while paying attention to financial stability. In this process, the Bank thoroughly assessed the pace of inflation slowdown, financial stability risks, downside risks to growth, monetary policy changes in major countries, and household debt growth, maintaining the Base Rate at 3.50%.

The Bank of Korea decided to leave the Base Rate unchanged at 3.50% in July, as inflation was forecast to be above the target level for a considerable time although it had continued to slow. In addition, the decision was also based on the judgment that uncertainties regarding monetary policy in major countries still remained, and it was necessary to monitor household debt trends.

The Base Rate was also maintained at 3.50% in August. Although inflation had continued to slow, it was forecast that there would be a considerable period of time before inflation converges on the target level, and uncertainties regarding monetary policy and economic conditions in major countries

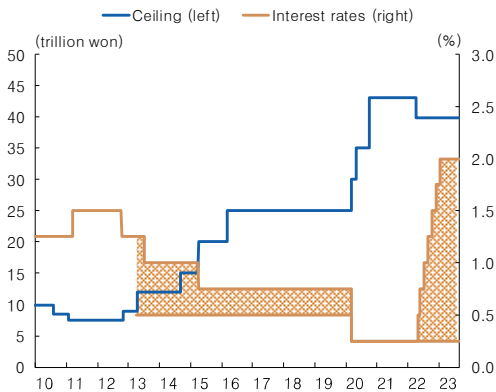
Bank of Korea Base Rate¹⁾



Note: 1) Figures in parentheses refer to the months of Base Rate adjustments

Source: Bank of Korea.

Ceiling and interest rates of Bank Intermediated Lending Support Facility¹⁾



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

Source: Bank of Korea.

increased. It was also necessary to closely monitor household debt trends. The Bank, therefore, deemed that it was appropriate to maintain its current restrictive policy stance.

⑥ The Bank of Korea is using various policy instruments to promote smooth credit flows and stability in financial and foreign exchange markets. As for the Bank Intermediated Lending Support Facility, ceilings for each program are as follows: 1.5 trillion won for Trade Financing, 13 trillion won for New Growth Engine Development and Job Creation, 0.3 trillion won for Stabilization of SME Lending, 5.9 trillion won for Regional SMEs, 13 trillion won for SMEs Affected by COVID-19, and 6 trillion won for Small Businesses. The total ceiling is 39.8 trillion won including 0.1 trillion won in ceiling reserves.

Meanwhile, the Bank of Korea reformed its lending facility in a way to strengthen its role as a liquidity backstop for depository institutions. For banks, it adjusted the lending rates and the range of eligible collateral for Liquidity Adjustment Loans, one of regular lending facilities of the Bank of Korea currently, to alleviate the negative perceptions about banks using this facility and to enhance their access to the facility. In particular, the range of eligible collateral was expanded to include municipal bonds, bonds issued by public institution, and prime corporate bonds, which greatly increased the available lending resources. In addition, the Bank plans to pursue ways to add loans receivable held by banks to the list of eligible collateral for lending and to review whether to include loans receivable by non-bank depository institutions to the range of eligible collateral if institutional conditions are met.

7 The Korean economic growth is expected to improve gradually with a modest recovery in consumption, a rebound in the IT sector and the influx of Chinese tourists. Accordingly, Korea's real GDP growth is projected to be 1.4% in 2023 and 2.2% in 2024. Private consumption will continue to recover, but the pace of recovery is forecast to be limited due to increased debt service burden of households and uncertainties surrounding external conditions. Facilities and construction investments are projected to be sluggish due to delayed improvement in global manufacturing sector and declines in commencement of new constructions, respectively. Exports will show a slow recovery for some time, but are projected to exhibit visible improvement as the semiconductor industry recovers toward the end of this year. Uncertainties remain elevated regarding the growth forecast path due to factors such as the development of the Chinese economy and its spillover effects on the Korean economy, economic situations in major advanced economies, and the timing of a rebound in the IT industry.

Consumer price inflation is expected to be generally in line with the previous forecast (3.5%) in May, fluctuating at around 3% in the fourth quarter of this year as the upward trend in personal service prices continues to slow. Core inflation is projected to be slightly higher than the previous forecast (3.3%) at 3.4%, as the spillover effect of accumulated cost pressures persists although demand-side inflationary pressures have weakened somewhat. Future inflation path is forecast to be affected by changes in

international commodity prices, weather conditions, and economic trends at home and abroad.

⑧ The Bank of Korea will continue to conduct monetary policy in order to stabilize consumer price inflation at the target level (2%) over the medium-term horizon as it monitors economic growth, while paying attention to financial stability.

The domestic economic growth will gradually improve, and inflation is projected to remain high above the target level for a considerable time, and uncertainties surrounding the policy decision remain elevated. The Bank of Korea will judge whether an additional Base Rate hike is needed while maintaining the restrictive policy stance for some time with an emphasis on price stability. In this process, the Bank of Korea will closely monitor the pace of inflation slowdown, financial stability risks and downside risks to growth, effects of previous Base Rate hikes, monetary policy changes in major economies and household debt growth.