Unofficial Translation

Please refer to the original report in Korean for more accurate content.

Overall Assessment: Financial system remains generally stable supported by solid resilience

Domestic and External Conditions	(-) Uncertainty persists in global trade environment (-) Growth rate of real economy slowed both domestically and globally

FSI	Rose slightly "Warning" stage	FVI	Rose slightly Below its long-term average

Financial Stability Situation

Household & Corporate Credit	Downward trend in private credit leverage	Upward trend in loan delinquency rate
Financial & Asset Markets	Stabilization of corporate bond credit spreads	Divergence across regional housing markets
Financial Institutions	Solid resilience of financial institutions	Deterioration in asset quality at non-bank financial institutions
External Sectors	Robust external payment capacity	Elevated exchange rate volatility

Risk Factors

Household & Corporate Credit	Acceleration in household debt growth, heightened corporate credit risk
Financial & Asset Markets	Increased financial market volatility, faster rise in housing prices
Financial Institutions	Potential increase in risks at non-bank financial institutions
External Sectors	Persistent external uncertainties, including global trade policies and geopolitical risks

Policy Recommendations

 Continued efforts to stabilize financial markets	• Enhanced monitoring of domestic and external risk developments • Timely implementations of market stabilization measures in response to market stress
 Preventation of financial imbalances through coordinated policy responses	• Conduct of monetary policy to reflect both macroeconomic conditions and financial stability • Preemptive and consistent implementation of macroprudential regulations • Improvement in housing policy finance operations with consideration for policy coordination
 Response to corporate credit risk	• Development of differentiated policy responses based on industry and corporate characteristics • Support and restructuring for self-employed business owners based on individual circumstances
 Enhancing resilience of financial institutions	• Continued efforts to strengthen financial institution resilience against systemic risk • Enhanced monitoring of liquidity conditions and risk factors at non-bank financial institutions

Overall Assessment of Financial Stability

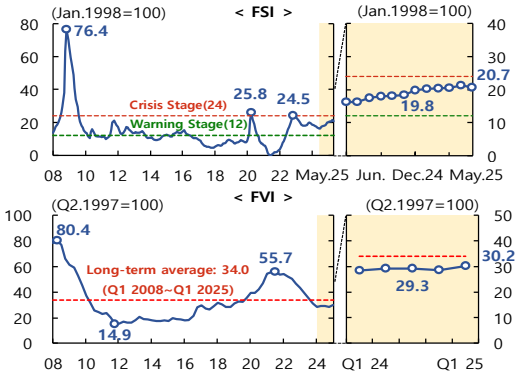
Korea's financial system has remained stable overall, supported by the strong resilience of financial institutions and an overall robust external payment capacity. However, volatility in the financial and foreign exchange markets has heightened due to global trade tensions, a domestic and global economic slowdown, and geopolitical risks. Potential sources of instability include rising risks among vulnerable household borrowers, the corporate sector, and non-bank financial institutions (NBFIs), all amid hightened domestic and global uncertainties. In addition, persistently rising housing prices in certain Seoul metropolitan areas could lead to the accumulation of financial imbalances.

In response to the economic downturn, and taking into account financial stability conditions, such as exchange rates and household debt, the Bank of Korea shifted its monetary policy direction to an easing cycle in October 2024. Since then, the Bank has implemented two additional rate cuts so far in 2025, in February and May. Household debt growth has been managed within the growth rate of nominal GDP, supported by the coordination between monetary and macroprudential policies. However, it is crucial to exercise caution as housing prices continue to rise in certain Seoul metropolitan areas, leading to a renewed increase in household debt. Corporate credit growth has been modest due to credit risk management at financial institutions.

Delinquency rates among vulnerable groups, namely the self-employed business owners (SEBOs) and small and medium-sized enterprises (SMEs), have reached high levels, leading to a deterioration in the asset quality at financial institutions. However, the resilience of financial institutions, namely their capital ratios, has remained solid.

The Financial Stress Index (FSI)[1], which provides a comprehensive measure of short-term instability across the financial system, remained at the "warning" stage, at 20.7 in May 2025, up from 19.8 in December 2024. Meanwhile, the Financial Vulnerability Index (FVI)[2], a metric for assessing medium- to long-term vulnerability in the financial system, stood at 30.2 in the first quarter of 2025, remaining below its long-term average of 34.0 since 2008, but slightly up from 29.3 in the third quarter of 2024.

Financial Stress Index(FSI)[1)3)], Financial Vulnerability Index(FVI)[2)3)]



Notes: 1) A comprehensive index (on a scale of 0-100) is derived by normalizing 20 monthly indicators from the financial and real sectors, representing short-term financial system instability. Thresholds for the "warning" and "crisis" stages are set at 12 and 24, respectively.
2) A comprehensive index (on a scale of 0-100) is derived by normalizing 39 indicators related to three assessment factors (asset prices, credit accumulation, and financial system resilience), representing medium- to long-term financial vulnerability.
3) The index value may change in the future due to the time-varying nature of the parameters.

Source: Bank of Korea.

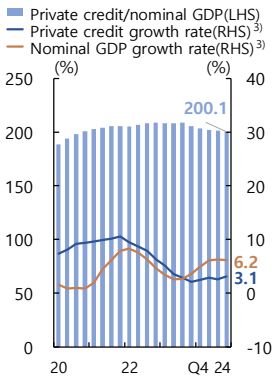
1) The FSI is a comprehensive index (0-100) that is calculated by normalizing 20 monthly stress indicators from the real economy and financial sectors. The thresholds for the "warning" and "crisis" stages are set at 12 and 24, respectively, based on the noise-to-signal method. For details, refer to Box 7. "Results of Financial Stress Index (FSI) Reform" in the Financial Stability Report, December 2023.

2) The FVI is a comprehensive index (0-100) that is calculated by normalizing 39 indicators related to three assessment factors: asset prices, credit accumulation, and financial system resilience.

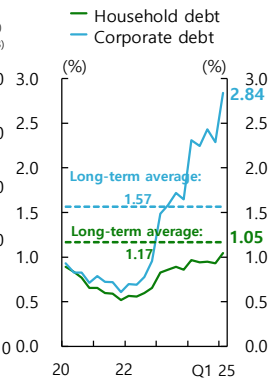
Financial Stability by Sector

The following sections examine financial stability by sector. First of all, regarding **household and corporate credit**, household debt recorded modest growth in the first quarter of 2025, but the growth rate picked up again from April driven by increased housing transactions in certain Seoul metropolitan areas. Household debt delinquency rates rose somewhat, particularly at regional banks and NBFIs, despite a reduction in the debt servicing burden resulting from interest rate cuts. Meanwhile, corporate debt growth remained subdued, as financial institutions tightened their lending stances. Delinquency rates appeared relatively high among SMEs and NBFIs. Private credit leverage (private credit to nominal GDP ratio) continued on a downward trend.

Private Credit[1] Leverage[2]



Delinquency Rates on Household and Corporate Debt[4]

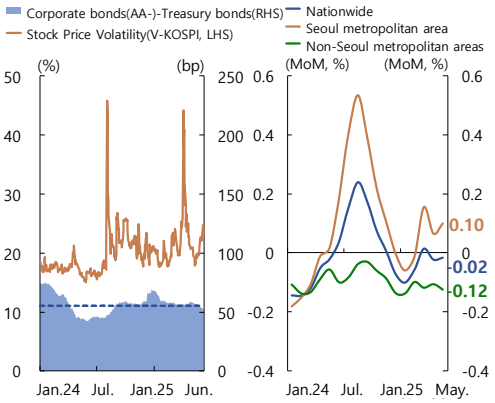


Notes: 1) Based on flow of funds statistics.
2) Sum of nominal GDP for the given and three preceding quarters.
3) Year-on-year.
4) Long-term average is the average between Q1 2010 and Q1 2025.
Sources: Bank of Korea, Financial Institution Business Reports.

In **financial and asset markets**, stock prices have shown high volatility due to global trade tensions and geopolitical risks. However, corporate credit spreads have remained stable, hovering around the long-term average. Housing prices have continued to exhibit diverging trends, with an upward trend continuing in the Seoul metropolitan area, while a downward trend persisted in non-Seoul metropolitan areas. As Seoul and certain other areas have continued to experience a sharp increase in housing prices, heightened caution is warranted. In the commercial real estate sector, the office market has generally improved, while the retail property market has remained sluggish, characterized by rising vacancy rates and declining rental prices.

Stock Price Volatility & Credit Spread[1]

Rates of Increase in Housing Prices



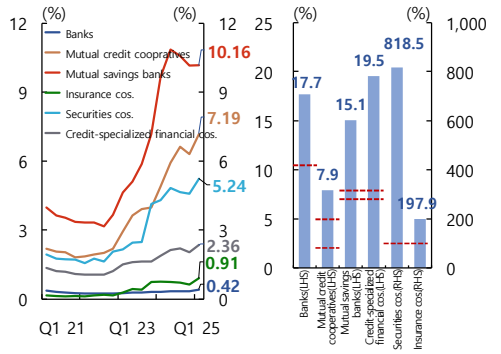
Note: 1) Dotted line represents the long-term average since 2010.
Sources: Bloomberg, Financial Investment Association, Korea Real Estate Board.

The **soundness of financial institutions** weakened moderately, primarily driven by the non-banking sector. Bank profitability remained generally solid, although asset quality weakened slightly. In most segments of the non-banking sector, profitability remained weak, and asset quality declined, as reflected in a rise in the substandard-or-below loan ratio. Meanwhile, **financial institution resilience**, their capacity to absorb shocks, was assessed to have remained relatively strong for both the bank and non-banking sectors. Although capital adequacy ratios declined in most sectors, they continued to exceed the regulatory standards, and liquidity ratios also remained stable. With respect to financial sector

interconnectedness, transactions among financial institutions increased, mainly driven by transactions between banks and non-banks, as well as within the non-banking sector. This was mainly attributable to an increase in FX derivative transactions and to greater fund inflows into investment funds.

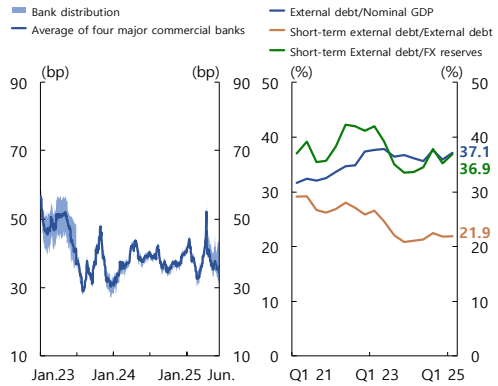
a net inflow on a cumulative basis, while overseas portfolio investment by Korean residents showed an increase in net outflows. Korea's external payment capacity is assessed to be sound, as reflected in the decline in the external debt-to-GDP ratio and in the share of short-term external debt.

Substandard-or-Below Loan Ratio **Capital Adequacy Ratio[1]**



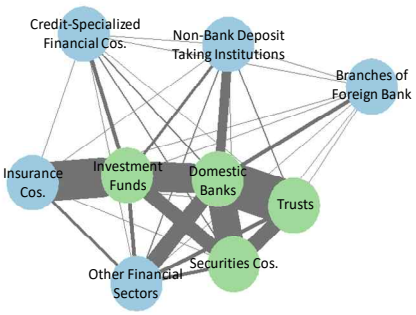
Note: 1) Red dotted lines represent regulatory standards for each segment.
Source: Financial Institution Business Reports.

Commercial Bank CDS Premiums[1] **External Soundness Indicators**



Note: 1) Based on 5-year maturity.
Sources: Bank of Korea, Markit.

Interconnectedness[1)2)] Among Financial Sectors, as of End-2024



Notes: 1) A green circle ● represents the top four sectors in terms of volume of inter-sector transactions.
2) A network visualization technique was used, with the thickness of the lines proportional to the volume of inter-sector transactions.
Source: Bank of Korea.

In the **external sector**, the USD/KRW exchange rate exhibited heightened volatility, initially rising sharply and then declining, due to U.S. tariff policies. FX funding markets remained robust overall, as indicated by favorable FX funding conditions, including lower borrowing spreads and CDS premiums. This year, domestic portfolio investments by foreigners recorded

In terms of the operation of **financial regulations and policies** aimed at maintaining domestic financial system stability, regulations concerning household debt have been amended to place greater emphasis on a borrower's repayment capacity, thereby enhancing macroprudential soundness. This includes the implementation of the third-stage stressed DSR regulations scheduled for July 1. Additionally, the Countercyclical Capital Buffer (CCyB) has been applied at a level of 1.0%p since May 2024, and that level has been maintained. The easing of some of the financial regulations that had been introduced in response to funding market instability since April 2020 is being gradually removed. Other financial policies are also expected to contribute to financial stability. These include an increase in the deposit protection limit, scheduled for Sept. 1, and enhancements to prudential regulations in response to heightened risks related to land trusts, scheduled

for July 1. Furthermore, risks in major payment and settlement systems, such as BOK-Wire+, have also been managed reliably.

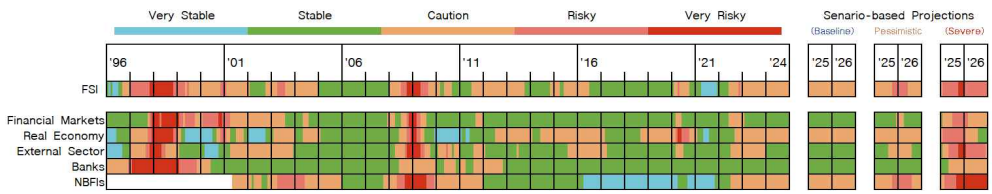
Major Financial Stability Risk Assessment

As discussed above, Korea's financial system has remained stable. However, greater attention should be paid to the potential impact of rising domestic and external uncertainties on financial stability. In particular, as the domestic real economy has experienced a notable slowdown, changes in the international trade environment and geopolitical risks could heighten volatility in financial and foreign exchange markets. Domestic financial system stability is expected to be influenced by pockets of vulnerability. These include a weakening of repayment capacity among vulnerable sectors, such as SEBOs[3], rising corporate credit risk and the resulting deterioration in financial institutions' asset quality, including regional banks and NBFIs, as well as rising housing prices in certain Seoul metropolitan areas[4] amid ongoing interest rate cuts, and a potential pickup in household debt growth.

This Financial Stability Report closely examined the aforementioned risk factors. Through the Analysis of Financial Stability Issues, the report closely covers 1) the impacts that increased corporate credit risks stemming from continued uncertainties at home and abroad may have on financial institutions and financial markets, and 2) the risks confronting NBFIs, classified by risk type (credit, liquidity, or market). Furthermore, this report also conducted an in-depth analysis of structural challenges related to financial system stability in Korea, such as housing policy finance, over a medium- to long-term horizon.

An analysis of the ways in which major domestic and external uncertainties affect corporate credit risk indicates that a sluggish real estate market in non-Seoul metropolitan areas is expected to negatively impact the construction and real estate sectors. In addition, heightened uncertainties surrounding the global trade environment are likely to reduce exports from manufacturing industries, such as automobiles and electronics, which have a high reliance on the U.S. market, and on the export of intermediate goods. This could lead to a domestic economic slowdown, possibly affecting the non-manufacturing sectors, as well. Moreover, increased exchange rate volatility was found to have divergent impacts on export-oriented industries and on domestic demand and cyclical sectors. A stress test assuming the materialization of these domestic and external risks revealed a potential deterioration

Financial Stress Index Heatmap[1]



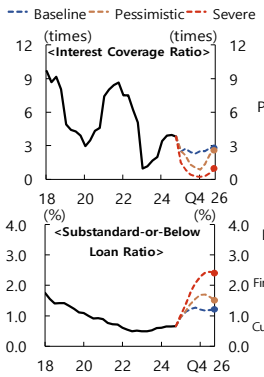
Note: 1) "Very Risky" indicates a financial stress level exceeding two standard deviations above the mean.
Source: Bank of Korea.

3) For details, refer to Box 1. "Assessment of the Recent Debt Servicing Capacity of the Self-Employed Business Owners, and its Implications."
4) For details, refer to Box 2. "Characteristics of the Recent Housing Market and Implications."

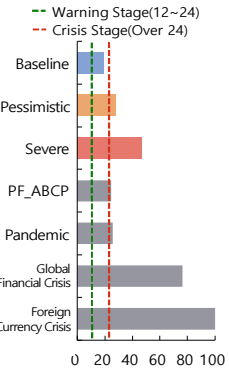
in the repayment capacity of export companies and a significant weakening of financial soundness in the construction and real estate industries. Nevertheless, despite the decline in corporate repayment capacity, the overall soundness of domestic banks does not yet warrant serious concern. However, attention should be paid to the possibility that the expansion of corporate credit risks may lead to a contraction in the credit supply to businesses, and that the slump in the real economy may heighten not only financial market volatility, but also the level of financial instability in the overall financial system, led by the external and non-banking sectors.[5)6)]

Impact of Domestic and External Uncertainties on Financial Stability[1)]

Interest Coverage Ratio and Substandard-or-Below Loan Ratio of Domestic Banks By Scenario



FSI by Scenario



Note: 1) Based on stress test results by scenario.
Source: Bank of Korea.

A review of risks facing NBFIs, categorized by risk type, either credit, liquidity, or market, found that credit risk was on the rise with persistent real estate PF risks, particularly PF businesses in non Seoul metropolitan areas, and their growing exposure to cyclical businesses (e.g., whole & retail trade, accomodation & food, and transportation) and to vulnerable household borrowers. As NBFIs face an increasing share of short-term debt and concerns over asset quality, some sectors may encounter funding difficulties. Accordingly, there remains a possibility that credit risk could spill over into liquidity risk. Market risk is also growing, especially at insurance and securities companies, which have significantly increased their investments in securities. Given that NBFIs are relatively vulnerable to both domestic and external shocks, they should closely monitor risk develoments and respond proactively to minimize the potential of contagion across risk types.[7)]

Assessment of Risks Facing NBFIs by Risk Type and Sector[1)]

	Credit Risk	Market Risk	Liquidity Risk
Mutual savings banks	↑↑	–	↑
Mutual credit cooperatives	↑↑	–	↑
Credit-specialized financial cos.	↑	–	↑
Securities cos.	–	↑	↑
Insurance cos.	–	↑	↑

Note: 1) The level of risk escalation was assessed by comprehensively considering changes in key indicators and vulnerability factors. The dash indicates no relevant risk or very small fluctuations.

Housing policy finance in Korea has expanded, led by mortgage loans and guarantees related to leasehold deposits. This has had positive effects on improving housing welfare for genuine end-users,

5) For details, refer to "Analysis of Financial Stability Issues 1. Impacts of Domestic and External Uncertainties on Corporate Credit Risks."

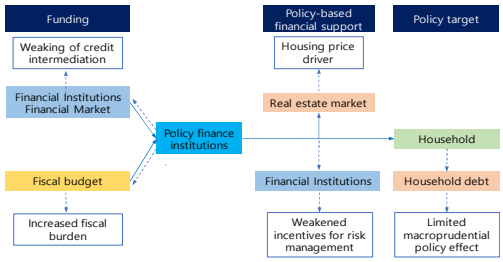
6) The baseline scenario is based on the Bank of Korea Economic Outlook released in May 2025. The pessimistic scenario incorporates a negative outlook on global trade conflicts within a realistically possible range. The severe scenario assumes a crisis situation where domestic demand and exports contract simultaneously amid increased uncertainties both domestically and internationally, leading to heightened credit risks.

7) For details, refer to "Analysis of Financial Stability Issues 2. " Assessment of Risks Facing Non-Bank Finanacial Institutions by Risk Type and its Implications "

enhancing access to loan, and responding to demographic change. However, the increased share of housing policy finance in total household debt could pose challenges to household debt management, as policy loans are currently exempt from DSR regulations. Moreover, if the scale of housing policy finance becomes excessive, it could affect housing prices, depending on housing conditions. It may also lead to increased fiscal burdens due to a deterioration in the financial soundness of policy finance institutions, a weaking of incentives for risk management, and intensified loan competition among private financial institutions.

Therefore, to ensure that the policy goals of improving housing welfare and maintaining financial stability are harmonized, it is necessary to strengthen the operational framework of housing policy finance. It is desirable to gradually expand the application of the DSR to policy loans in order to establish a household debt management framework based on a borrower's repayment capacity. At the same time, eligibility requirements and loan limits should be adjusted to ensure an appropriate level of housing policy finance, while enhancing support for vulnerable groups and genuine end-users. From a medium- to long-term perspective, policy finance should be further promoted for developers that contribute to the housing supply, in parallel with improvements to the project finance (PF) system.[8)]

Potential Risks to Financial Stabilitiy and to the Macroeconomy from the Provision of Housing Policy Finance[1)]



Note: 1) The solid lines indicate flow of funds, while the dotted lines represent the transmission channels of potential risks.

Policy Recommendations

To maintain financial system stability, the Bank of Korea will detect destabilizing factors within the financial system in advance by continuously monitoring the impacts of domestic and external uncertainties on the real economy and financial sectors. If necessary, financial stability-related policies, including market stabilization measures, will be actively pursued in close cooperation with the government. In particular, housing prices continue to rise in certain Seoul metropolitan areas in line with the interest rate cuts, and there is a high likelihood that increased liquidity could lead to a rise in asset prices, not to a recovery in the real economy, such as corporate investment, amid the high level of uncertainty at home and abroad. The Bank will closely monitor the potential accumulation of financial imbalances, such as increasing household debt and rising asset prices, and continue to coordinate monetary and macroprudential policies. The Bank of Korea plans to decide on the pace and extent of any monetary policy easing in comprehensive consideration of upside and downside risks to the real economy and of financial stability risks.

8) For details, refer to "III. Current Status of Housing Policy Finance in Korea and an Assessment."

In addition, the Bank of Korea will maintain its cooperation with relevant policy authorities on the development of new technologies and on other issues that could affect the stability of the macroeconomic and financial system in the medium- to long-term, such as stablecoins[9] and cyber risks[10].

Given the continued elevated uncertainties at home and abroad, such as slowing domestic economic growth, a deteriorating global trade environment, and geopolitical risks, if such risks materialize, their impacts on corporate credit risk are expected to vary by industry. Thus, the government needs to prepare differentiated policies that consider the characteristics of each industry and corporate. For structurally weak sectors, active restructuring efforts should be pursued. Meanwhile, for industries with growth potential that are currently experiencing temporary difficulties, policy support should be provided to prevent any contraction in the liquidity supply due to tighter lending attitudes[11] at financial institutions. Efforts should also be made to improve income conditions and to expand the domestic demand base through the implementation of structural reform policies. In particular, for SEBOs, it is necessary to pursue restructuring measures such as business closure support, while also providing targeted assistance including debt restructuring and re-employment support, taking into account their repayment capacity and business conditions.

In addition, to prevent potential shocks from escalating into systemic risks, financial institutions should continue to enhance resilience by strengthening capital adequacy and liquidity management. Financial authorities also need to preemptively assess and manage liquidity conditions and risk factors, especially in NBFIs that are more vulnerable to shocks. As credit risks are at elevated levels, particularly among non-bank deposit-taking institutions, efforts should be strengthened to reduce insolvencies through the resolution and restructuring of real estate PF, while closely monitoring the soundness of loans to vulnerable borrowers and cyclical businesses. Furthermore, in response to the rising dependence on short-term funding, efforts should be made to reduce the asset-liability duration gap. Given the expansion of market risk exposures, greater attention should be paid to liquidity management, as market losses stemming from heightened domestic and external uncertainties could spill over into liquidity risks.

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9) For details, refer to Box 3. "Trends in Stablecoins and Potential Risks Related to Financial Stability."
10) For details, refer to Box 8. "Impact of Cyber Risks on Financial Stability and Responses by Major Countries."
11) For details, refer to Box 4. "Lending Trends at Domestic Banks and Implications Through a Lending Behavior Survey."