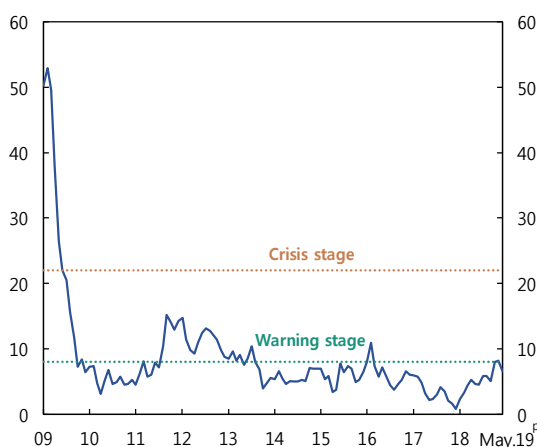


Please refer to the original report in Korean for the most accurate contents.

[Executive Summary]

The Korean financial system has remained stable on the whole. However, attention must be paid to the recent heightening of volatility in the financial and foreign exchange markets, influenced for instance by the escalation of the US-China trade dispute and concerns about a slowdown in global economic growth, and to the slight lessening of corporate financial soundness. Growth in household debt has been slowing, but the debt level is still high. The Financial Stability Index (FSI), showing overall financial system conditions, stood at 8.1 in May 2019 (preliminary), slightly above the lower bound of the warning stage range (8.0-22.0).

Financial Stability Index (FSI)¹⁾²⁾



Notes: 1) A composite index (0-100) calculated by standardizing 20 monthly real and financial sector indicators related to financial stability. The warning and crisis stage thresholds are set at 8 and 22 respectively, using the "noise-to-signal ratio" method.

2) Preliminary figures for April and May 2019.

Source: Bank of Korea.

A look at the financial stability conditions by sector shows, first, that in the credit markets the private credit-to-nominal GDP ratio has continued to increase. The rate of increase in household credit has been falling, influenced for instance by housing market stabilization measures and strengthened loan screening by financial institutions. By type of loan, growth in home mortgage loans is continuing to slow, while the pace of growth in other loans including unsecured loans has fallen significantly. The debt servicing capacities of households are generally solid at present, but the loan delinquency rate has recently been on the rise, especially for loans from non-bank financial institutions. Corporate credit has continued its trend of growth as loans have increased steadily and net issuance of corporate bonds has expanded. By firm size, the rate of growth in lending to small- and medium-sized enterprises has declined, due mainly to strengthened lending standards for sole proprietors, and lending to large corporations has been showing a trend of slight increase. Corporate financial soundness is generally favorable, but the debt servicing capacities of corporations could weaken in the future, influenced for instance by any deterioration in business conditions or sluggishness in exports.

In the asset markets, volatility has expanded, due to the reemergence of concerns about the US-China trade dispute from May this year onward. While long-term market interest rates have fallen, mainly on concerns about the global economic slowdown and on the maintenance of accommodative monetary policy stances in major countries, their volatility has expanded slightly. Stock prices had continued to rise entering

this year, before plunging from May onward, owing for example to sluggish domestic economic indicators and the escalation of the US-China trade dispute. In the housing market, purchase prices have continued to fall both in the Seoul Metropolitan area and in other areas, under the influence for instance of government measures. Leasehold deposits and monthly rental prices have remained on a decline, centering around the Seoul Metropolitan area, in line with an increase in new housing supply.

With regard to financial institutions, the asset soundness of commercial banks has improved, and their profitability has also remained solid. Non-bank financial institutions' soundness has generally been favorable, while asset quality and profitability in some sectors has deteriorated somewhat.

Foreign portfolio investment in domestic markets has recorded a net inflow, mainly in bond investment. Although the likelihood of any sudden outflows of foreign investment is not large in view of Korea's economic fundamentals, there is a possibility that capital flow volatility could expand, depending on changes in external conditions.

The financial system's resilience, i.e. its capacity to withstand domestic and external shocks, has remained in good shape. Capital adequacy ratios have greatly exceeded the regulatory standards at both banks and non-bank financial institutions, and banks' liquidity conditions have also improved. Under a stress scenario assuming double shocks—namely a worsening of global trade disputes and a decline in domestic housing prices—Korean financial institutions were found to be capable of withstanding losses from such shocks. With regard to the nation's external payment

capacity, the official foreign reserves have declined slightly, but net external assets have increased with the short-term external debt ratio remaining at a low level.

The Korean financial system is showing stability overall, as detailed above, but it should be noted that financial system stability could be undermined depending on changes in domestic and external conditions, especially in vulnerable sectors. In this regard, it is necessary to strengthen risk management to prepare against any increase in corporate credit risk, while maintaining the rate of household debt growth at a low level. As there is a possibility that financial and foreign exchange market volatility could increase depending on how global trade negotiations proceed going forward, it is important to enhance the capacity to respond to changes in the markets. The Bank of Korea, while strengthening its monitoring of overall conditions that affect the stability of Korea's financial system, intends to also closely assess the resilience of the financial sector as a whole, through use of its integrated stress test model.

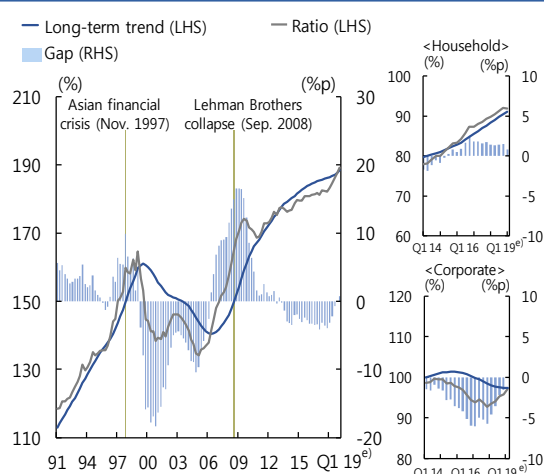
[Financial Stability Situation]

I . Credit Markets

1 The private credit-to-nominal GDP ratio, showing the level of private sector leverage, has continued its upward movement in 2019.

The private credit-to-nominal GDP ratio rose by 1.4%p compared to year-end 2018 to stand at 189.1% at the end of the first quarter of this year. By sector, the household credit-to-nominal GDP ratio stood at 91.9% at the end of the first quarter of this year, remaining unchanged from that at the end of last year, as household credit growth slowed. Meanwhile, the corporate credit-to-nominal GDP ratio stood at 97.2%, having risen by 1.5%p from the end of last year.

Private credit¹⁾-to-nominal GDP²⁾ ratio and gap³⁾



Notes: 1) Estimated figures for Q1 2019.

2) Sum of seasonally adjusted nominal GDPs in quarter concerned and immediately preceding three quarters (figures after 2000 reflect the initial result of the 2015 benchmark revision of Korean National Accounts).

3) Difference between private credit-to-nominal GDP ratio and its long-term trend.

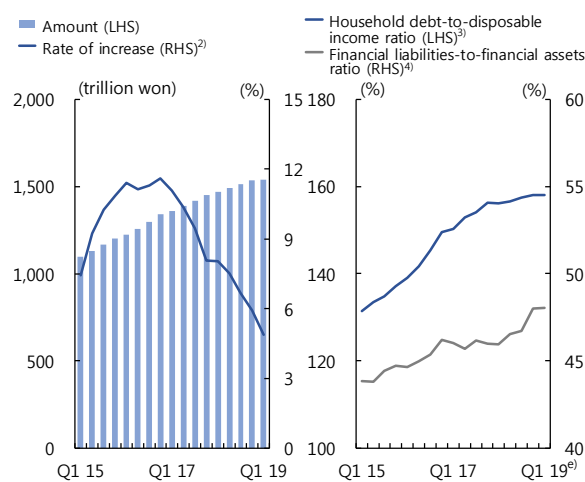
Source: Bank of Korea.

2 The pace of increase in household credit has been slowing greatly, driven by loans from non-bank financial institutions. Household debt (household credit statistics basis) rose by 4.9% year on year to 1,540.0 trillion won at the end of the first quarter of 2019. By type of financial institution, the rate of growth in lending from banks remained at the 7% level, while that in lending from non-bank financial institutions fell sharply to stand at 0.9%. By loan type, the rates of growth in home mortgage lending and other lending both have fallen greatly since the latter half of 2018.

The growth of household debt has slowed but still outpaces that of household income and household financial assets. As a result, the debt servicing burdens of households have increased somewhat. The household debt-to-disposable income ratio rose by 1.9%p year on year to 158.1% (estimated) at the end of the first quarter of 2019. The financial liabilities-to-financial assets ratio (flow of funds statistics basis) was 48.1% (estimated) at end-Q1, showing a 2.1%p rise compared to the same period last year (46.0%).

Household credit risk remains low. Attention should be paid, however, to upward movements in loan delinquency rates, particularly at non-bank financial institutions.

Household credit¹⁾



Notes: 1) Household credit statistics basis.
 2) Year-on-year basis.
 3) Disposable incomes reflect the initial result of the 2015 benchmark revision of Korean National Accounts (Disposable income for Q1 2019 is estimated using the average of the household disposable income-to-gross national income ratios for the immediately preceding three years).
 4) Based on flow of funds statistics; estimated figure for Q1 2019.
 Source: Bank of Korea.

3 Corporate credit has continued to increase, as loans have grown steadily and the net issuance of corporate bonds has expanded. The corporate loans of banks grew by 4.8% year on year to a total of 842.5 trillion won at the end of the first quarter of 2019. By company size, growth in lending to large enterprises has turned positive since the fourth quarter of 2018, while that in lending to SMEs has remained on a decline since the second quarter of last year, led by loans to sole proprietors. The net issuance volume of corporate bonds stood at 6.3 trillion won in the first quarter of this year, the largest since the third quarter of 2012.

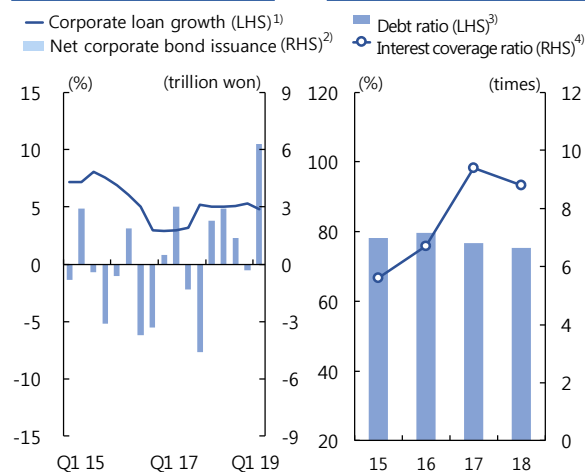
Corporations, and SMEs in particular, have shown slight deterioration in their financial soundness. The corporate debt ratio (debt / equity) has fallen to 75.3% at the end of 2018, thanks mainly to recapitalization, but the debt ratio of SMEs remained unchanged from the end of last

year. The corporate interest coverage ratio (operating income / interest expenses) stood at 8.8 during 2018, showing a fall for the first time since 2015. By company size, the extent of decline in the interest coverage ratio of large enterprises was small (9.7 → 9.2), while that of SMEs was large (3.5 → 2.0).

Meanwhile, given that business conditions have recently become more difficult, stemming for instance from the escalation of the US-China trade dispute and from the domestic and global economic slowdowns, it must be borne in mind that the debt servicing capacities of corporations could weaken in the future.

Corporate credit

Corporate financial soundness

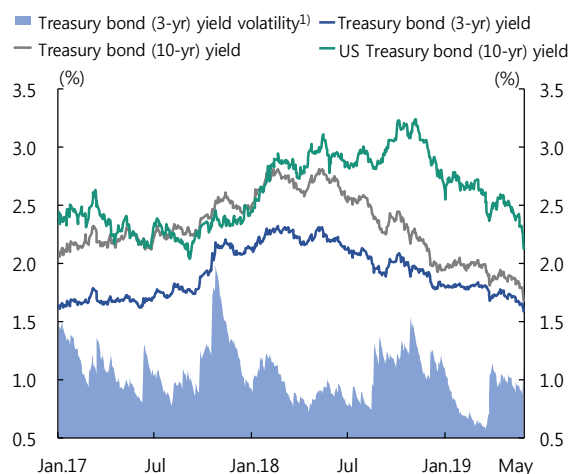


Notes: 1) Based on deposit-taking banks; year-on-year basis.
 2) During the quarter.
 3) Debt / Equity; end-period basis.
 4) Operating income / Interest expenses.
 Sources: Bank of Korea, Korea Securities Depository, KIS-Value, banks' business reports.

II . Asset Markets

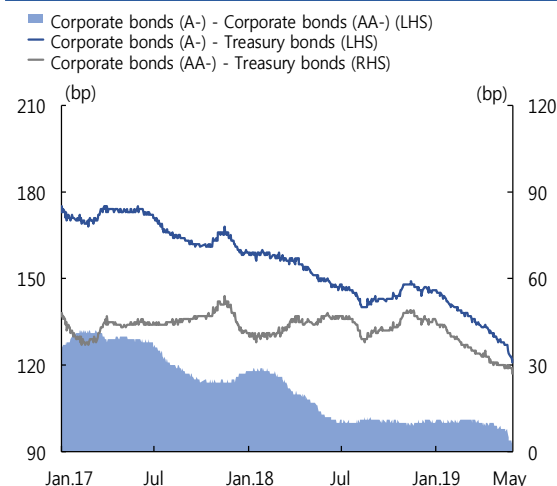
1 Treasury bond yields have fallen since the beginning of 2019, together with interest rates in the US and other major countries, influenced by concerns about the global economic slowdown, and ongoing accommodative monetary policy stances in major countries.

Korean and US Treasury bond yields



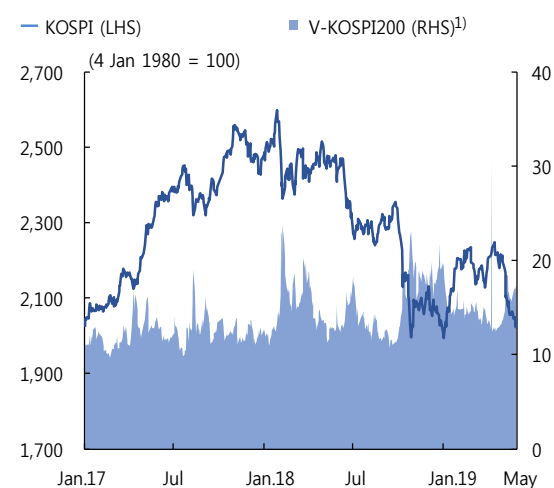
Corporate bond credit spreads have narrowed considerably, due mainly to growing investment demand for those bonds in view of their relatively high expected returns in an accommodative financial environment.

Corporate bond credit spreads,¹⁾ and spread across credit ratings



2 Stock prices have fluctuated this year, driven mainly by the developments in trade tensions between the US and China. Volatility in the stock market has increased sharply since May as concerns about the trade tensions heightened again.

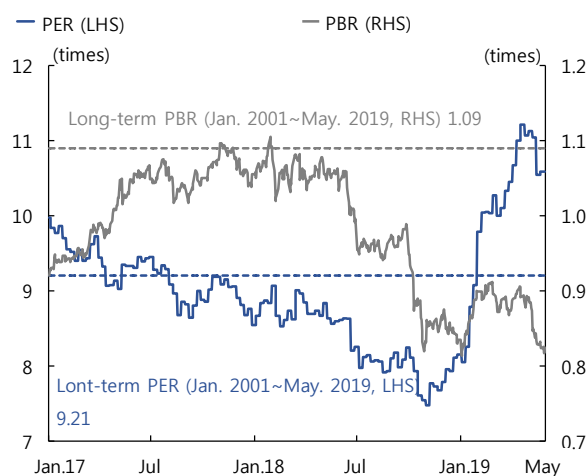
Stock price and stock price volatility indices



The price-to-earnings ratio (PER), showing the level of a firm's stock price relative to its profit, stood at 10.58 at the end of May, exceeding the long-term average of 9.21 as corporate performances slowed this year. The price-to-book ratio (PBR), showing a firm's stock price level relative to its liquidation value, stood at 0.82, falling below the long-term average of 1.09.

The PER and the PBR of listed stocks in Korea were low compared to those of other major economies.

PER¹⁾ and PBR²⁾



Notes: 1) MSCI basis (12-month forward).

2) KOSPI basis.

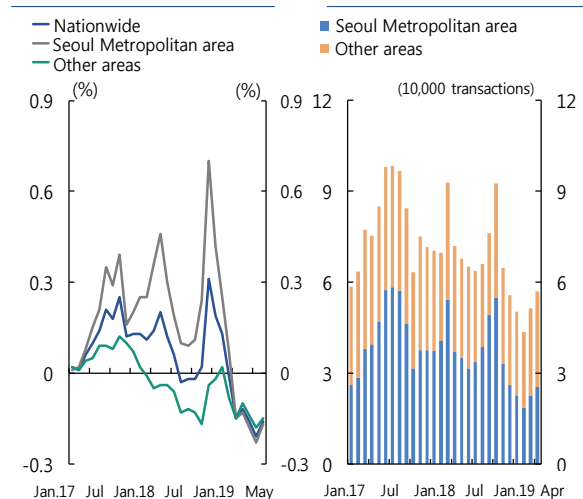
Sources: Bloomberg, Thomson Reuters.

3 Housing purchase prices have continued to show a downward trend, influenced by, for example, the government's Housing Market Stabilization Measures. Prices started declining in the beginning of this year in the Seoul Metropolitan area, as housing purchase sentiment was weakened by the government measures. In other parts of the country, the price decline has been concentrated mainly in areas experiencing economic slumps such as Ulsan and Gyeongnam.

Leasehold deposit and monthly rental prices have shown continued trends of decline centering on the Seoul Metropolitan area, owing to increases in the supply of new housing. The volume of housing purchases contracted in the Seoul Metropolitan area and in other areas, influenced by weakening purchase sentiment.

Rates of increase in housing prices¹⁾

Housing transaction volume



Note: 1) Compared to previous months.

Sources: Korea Appraisal Board, Ministry of Land, Infrastructure and Transport.

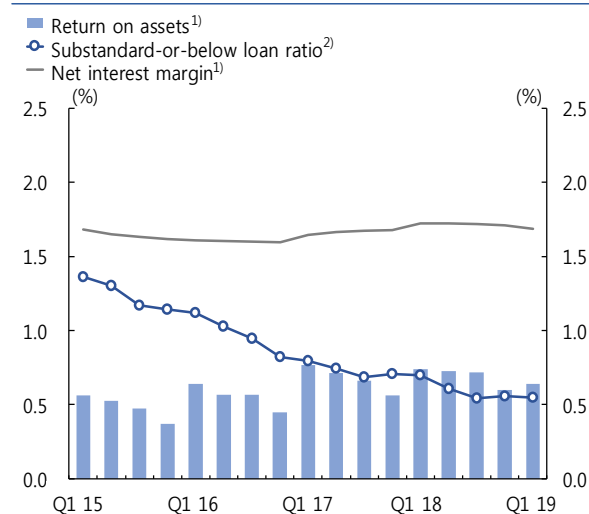
III. Financial Institutions

1 Commercial banks' soundness has continued to be strong entering 2019. Their assets totaled 1,673 trillion won at the end of the first quarter, up by 7.1% year on year.

Commercial banks' asset soundness has been solid, with their substandard-or-below loan ratios remaining at low levels in the 0.5% range. The ratios of regional banks, however, have remained at around 1%, due to sluggishness in the main local industries.

Profitability has declined slightly this year. During the first quarter of this year, commercial banks' return on assets (ROA) was 0.64% (annualized), down by 0.10%p from that (0.74%) in the same period of last year. However this has mainly been a result of temporary factors, including a rise in selling, general and administrative expenses incurred by voluntary retirement schemes. Overall, interest earnings have risen, while loan loss expenses have remained low.

Commercial bank asset soundness and profitability



Notes: 1) Accumulated quarterly incomes annualized.

2) End-period basis.

Sources: Commercial banks' business reports.

2 Non-bank financial institutions (NBFIs) have generally remained sound, but there have been modest declines in asset quality and profitability in some sectors. NBFI assets increased by 8.2% year on year to total 2,680 trillion won at the end of the first quarter of 2019.

Asset soundness has varied across NBFI sectors depending on their business conditions. Mutual credit cooperatives have seen their

delinquency and substandard-or-below loan ratios rising, chiefly in areas where the major industries have been in slumps. The same has been seen in credit-specialized financial companies, as delinquencies in cash advances and card loans have increased. In contrast, the asset soundness of insurance companies and mutual savings banks has improved.

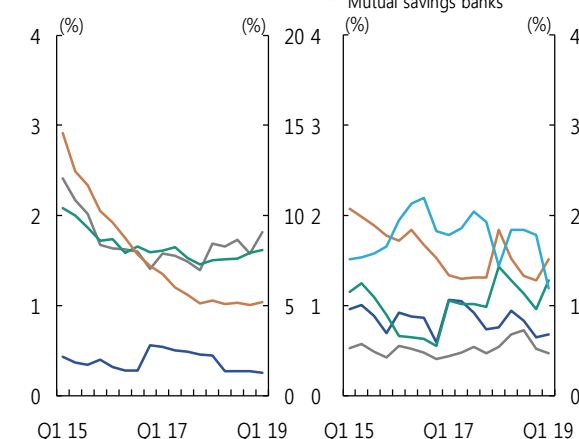
The profitabilities of all NBFI sectors have dropped this year. The ROAs of credit-specialized financial companies and mutual savings banks, in particular, decreased to a larger extent, owing to reduced card commission fees for merchants and a reduced proportion of high interest rate loans, respectively.

NBFI substandard-or-below loan ratios¹⁾

— Insurance cos. (LHS)
— Mutual credit cooperatives (LHS)
— Credit-specialized financial cos. (LHS)
— Mutual savings banks (RHS)

NBFI return on assets (ROAs)²⁾

— Insurance cos.
— Mutual credit cooperatives
— Securities cos.
— Credit-specialized financial cos.
— Mutual savings banks



Notes: 1) End-period basis.

2) Accumulated quarterly incomes annualized.

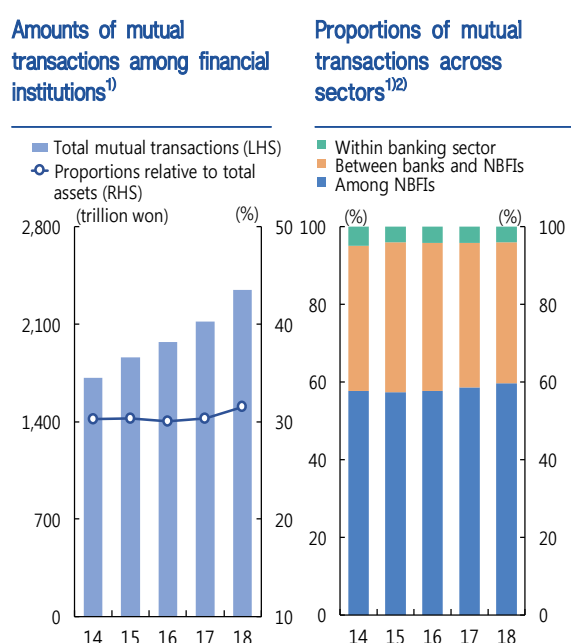
Sources: Financial institutions' business reports.

3 Financial institutions' interconnectedness through fund-raising and operations expanded. The amount of their mutual transactions reached 2,346 trillion

won at the end of 2018, up by 10.7% year on year. The proportion of mutual transactions relative to financial sector assets rose to 31.5%, having risen by 1.2%p from the end of 2017.

Looking at the proportions across financial sectors, the share of mutual transactions among non-bank financial institutions grew by 1.0%p year on year to stand at 59.7% at the end of 2018. Meanwhile, that of mutual transactions between banks and NBFIs stood at 36.3%, and that of mutual transactions within the banking sector came to 4.0%, showing falls of 0.9%p and 0.2%p, respectively.

Based on mutual transactions among financial institutions, we analyzed the risks of default contagion and concentration. The analysis suggests that the risks across financial sectors maintained similar levels to those at the end of 2017, although the risk of default contagion within the banking sector rose slightly.



Notes: 1) End-period basis (flow of funds statistics).
 2) Proportions in total amount of mutual transactions.
 Source: Bank of Korea.

IV. Capital Flows

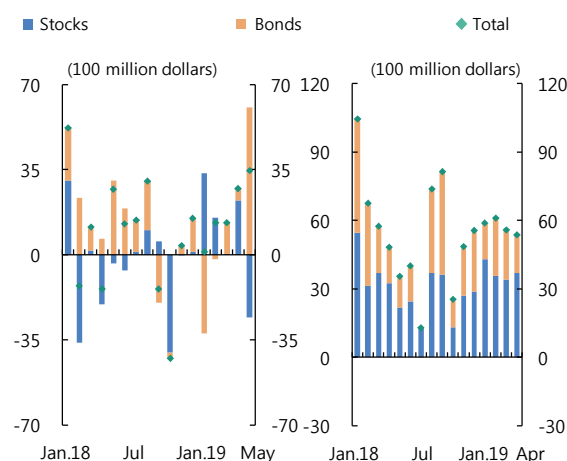
For the first five months of 2019, foreigners' stock investment recorded a net inflow of 4.5 billion dollars and bond investment 4.4 billion dollars. After the funds for investments in stocks showed their streak of inflows between January and April, some of the funds flowed out in May in line with the weakening of investment sentiment by concerns about the escalation of the US-China trade dispute. There were outflows of bond investment early this year, owing to arbitrage sales for profit realization by private sector, but inflows were seen again from March. In May the volume of bond investment inflows expanded greatly, on the back of growing bond purchases at low prices supported by currency depreciation.

Considering the country's economic fundamentals, the possibility of any sudden outflows of foreign investment is assessed not to be high. Depending on developments surrounding the US-China trade dispute, however, it should be kept in mind that capital flow volatility could expand.

Domestic residents' overseas portfolio investment has continued to increase. However, the rate of growth has somewhat slowed, affected by the concerns about the slowdown in global economic growth. The amount of investment from January to April 2019 fell compared to that of the same period last year (27.7 billion dollars) to stand at 22.9 billion dollars.

Changes in foreigners' domestic portfolio investment¹⁾

Changes in residents' overseas portfolio investment²⁾



[Financial System Resilience]

I . Financial Institutions

1 Commercial banks' resilience has remained sound overall in 2019 as well.

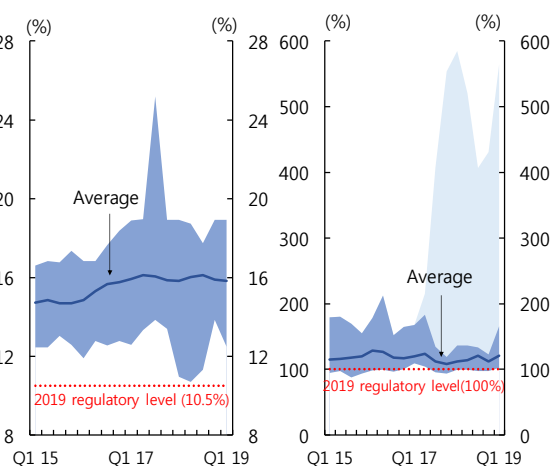
Banks' Basel III total capital ratio, showing their capacities for loss absorption, stood at 15.84% at the end of the first quarter of 2019, a similar level to that of a year earlier. The Common Equity Tier 1 capital ratio registered 13.20%, down 0.17%p year on year, due largely to increased cash dividends by some banks.

Banks' liquidity coverage ratio (LCR), which shows the capacities of banks to respond to sudden net outflows of funds, rose by 3.8%p from the end of the first quarter of last year to stand at 109.6% at the end of the first quarter of 2019.

Commercial banks are expected to maintain their sound resilience going forward as well, but they should continue their efforts to expand capital, and Common Equity Tier 1 capital in particular, in preparation for heightening uncertainties at home and abroad.

Commercial bank total capital ratios¹⁾

Commercial bank liquidity coverage ratios (LCRs)²⁾³⁾



Notes: 1) The shaded area indicates the distributions of individual banks' capital ratios.
2) High-quality liquid assets / Total net cash outflows over next 30 calendar days.
3) The shaded area indicates the distributions of individual banks' LCRs, and the deep shaded area indicates distributions with Internet-only banks excluded.

Sources: Commercial banks' business reports.

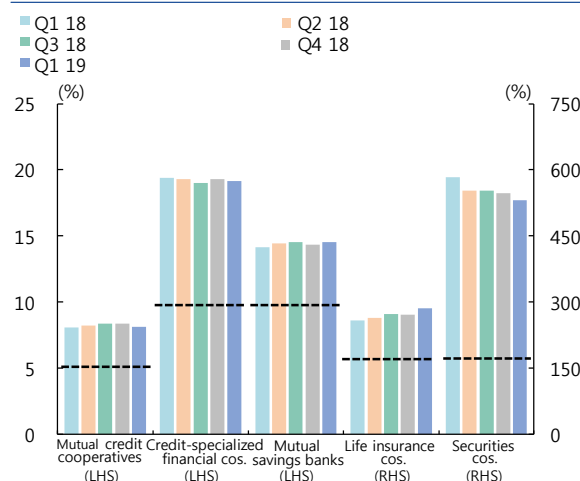
2 Non-bank financial institutions have also maintained sound levels of resilience, with their capital adequacy ratios far exceeding the supervisory standards.

Life insurance companies' risk-based capital ratio rose from 258.2% at end-Q1 2018 to 285.4% at end-Q1 2019, due to their capital expansion in preparation for introduction of the mark-to-market evaluation of insurance liabilities by IFRS 17. Mutual savings banks' BIS capital ratio increased from 14.1% to 14.5%, due to increases in retained earnings. The capital

adequacy ratios of mutual credit cooperatives and credit-specialized financial companies far exceeded the supervisory standards to stand at 8.1% and 19.2%, respectively at the end of the first quarter of this year. Securities companies' net capital ratio, on the other hand, fell from 582.9% to 527.5%, due to factors such as expanded corporate lending and increases in guarantees for real estate project financing (PF) at large securities companies.

It will be necessary for NBFIs to expand their capital buffers, as profitability has recently been falling in most sectors and credit risks may increase centering around loans and PF guarantees, depending on future regional economic and real estate market conditions.

NBFI capital adequacy ratios¹⁾²⁾



Notes: 1) Mutual credit cooperatives' net capital ratio (supervisory standard 2%; 4% for MG community credit cooperatives and 5% for NongHyup), credit-specialized financial companies' adjusted capital ratio (7%; 8% for credit card companies), mutual savings banks' BIS capital ratio (7%; 8% for banks with total assets of 1 trillion won or more), insurance companies' risk-based capital ratio (100%), securities companies' net capital ratio (100%).

2) The dotted lines show the supervisory standards.

Sources: Financial institutions' business reports.

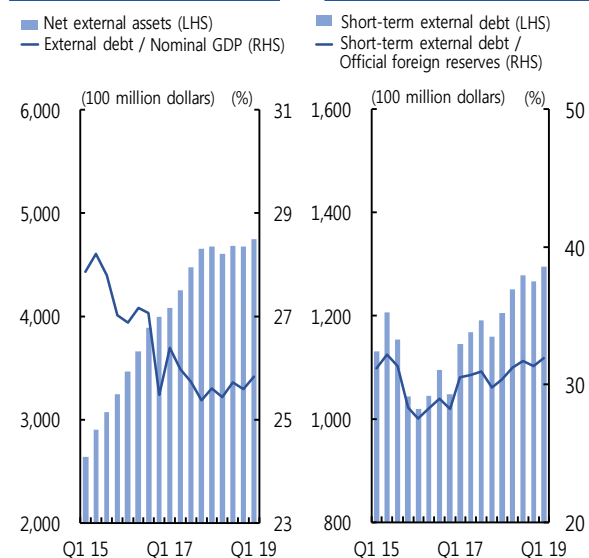
II. External Payment Capacity

Korea's external payment capacity has remained in good shape.

With a continued increase in Korea's net external assets, the external debt-to-nominal GDP ratio has maintained a stable level. Compared to the end of last year, the official foreign reserves declined slightly to 402 billion dollars at end-May 2019, but the ratio of short-term external debt to foreign reserves still remains low.

External debt-to-nominal GDP ratio¹⁾

Short-term external debt-to-official foreign reserves ratio¹⁾



Note: 1) End-quarter basis.

Source: Bank of Korea.

III. Financial Market Infrastructures

BOK-Wire+ and the other major payment and settlement systems have been operated smoothly, with settlement risks managed stably amid the increase of settlement volumes.

The maximum intraday overdraft cap exhaustion rate and the proportion of payment orders in queue for settlement, indicative of the level of settlement liquidity of participants in the nation's large-value payment system, BOK-Wire+, maintained generally stable levels of 21.2% and 4.2% respectively in the first quarter of 2019. The proportion in the total volume of settlements through BOK-Wire+ of those carried out at around the closing time (16:00-17:30) stood at 59.8% during the first quarter of this year, similar to last year's share (60.2%).

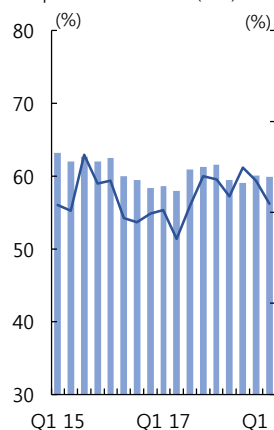
The net debit cap utilization rates, showing settlement risks related to the retail payment systems operated by Korea Financial Telecommunications & Clearing Institute, have also been managed at low levels.

Meanwhile, among all foreign exchange settlements made through the foreign exchange settlement systems, the share of those handled by the CLS payment-versus-payment system, which reduces settlement risk effectively through the settlement of foreign exchange transactions without any time lag, increased to 84.4% in the first quarter of 2019.

Going forward, continuing efforts to ensure the stability of the payment and settlement systems will be necessary, since a steady increase in settlement volume is expected given ongoing changes in the payment and settlement environment by FinTech innovation.

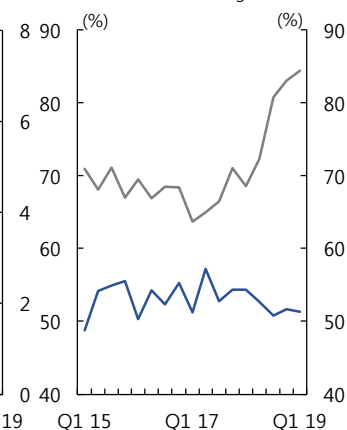
Large-value payment system

■ Proportion of settlement concentration at around closing time (LHS)¹⁾
— Proportion of payment orders in queue for settlement (RHS)²⁾



Retail payment and foreign exchange settlement systems

— Average maximum net debit cap utilization rate³⁾
— Proportion of foreign currency settlements made using CLS system^{4/5)}



- Notes: 1) Amount of settlement processed after 16:00 / Total settlement amount.
2) Amount of payment orders in queue for settlement / Total settlement amount (excluding payment orders in queue for liquidity savings).
3) Simple average of daily maximum net debit cap utilization rates (unsettled net debits / net debit caps) of participants during quarter.
4) Proportions in total CLS eligible FX transactions (trade date basis) of those settled through CLS (continuous linked settlement) system (settlement date basis).
5) Transactions done by domestic banks and foreign banks* branches.

Source: Bank of Korea.