

Executive Summary

[Monetary Policy Operating Conditions]

1 A look at financial and economic conditions at home and abroad between August and November 2021 finds the following. The trend of recovery in the global economy was sustained, despite the continued spread of virus variants and ongoing global supply constraints. Advanced and emerging market economies, having somewhat stagnated in the third quarter, maintained their recoveries in the fourth quarter as global supply disruptions have eased gradually. The US economy continued to recover robustly amid accelerated consumption and employment growth, while the euro area recovered at a somewhat slower pace in line with the resurgence of COVID-19 in some euro area countries. China's growth slowed, in part due to concerns about a potential bankruptcy in China's real estate sector (the Evergrande Group issue) and to power shortages. Japan showed signs of improvement, such as an easing of the effects of automobile production disruptions.

increased, affected largely by major countries' moves toward monetary policy normalization and concerns about default risks in the Chinese real estate sector. The US Treasury yield rose in September amid the US Federal Reserve's looming tapering of its asset purchases, and then shifted to a decline in late October, affected by the sluggishness of some economic indicators and the weakening expectations regarding an early policy rate hike. The yield rose again from early November, as the US consumer price index exceeded market expectations, concerns about continued inflation increased, and expectations for an early Fed rate increase strengthened. Stock prices in advanced economies declined in September owing in part to the hawkish FOMC meeting result, and then rebounded in October on the back of robust corporate performance in the third quarter and the passage of a US infrastructure bill. Stock prices in emerging economies fell in September due mainly to the Evergrande liquidity crisis, and then fluctuated from October in line with financial market developments in advanced countries. The US dollar remained strong against the euro from September, on the forecast that the US and the euro area would show different paces of monetary policy normalization and economic recovery.

Economic growth in major economies¹⁾

(%)

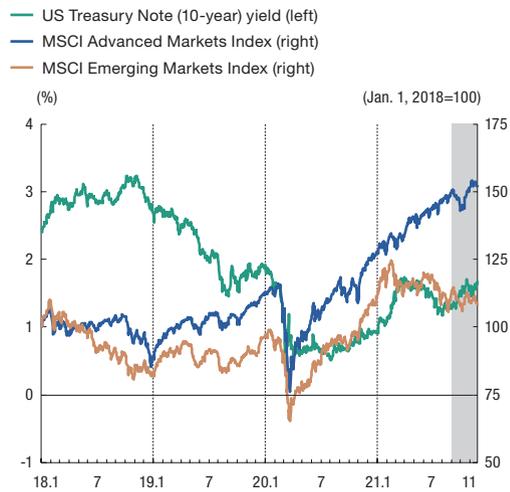
	2019		2020				2021		
	Year	Year	Q1	Q2	Q3	Q4	Q1	Q2	Q3
US	2.3	-3.4	-1.3	-8.9	7.5	1.1	1.5	1.6	0.5
Euro area	1.6	-6.4	-3.5	-11.7	12.6	-0.4	-0.3	2.1	2.2
China	6.0	2.3	-6.8	3.2	4.9	6.5	18.3	7.9	4.9
Japan	0.0	-4.6	-0.6	-8.0	5.4	2.8	-1.1	0.4	-0.8

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.

In the international financial market, risk aversion strengthened and the volatility of price variables

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



Source: Bloomberg.

2 The favorable trend of recovery in the Korean economy has continued. Although investment has been affected somewhat by global supply bottlenecks, exports have sustained their buoyancy and private consumption has rebounded rapidly, boosted chiefly by accelerated vaccinations, the easing of domestic COVID-19 restrictions, and the provision of emergency disaster relief funds. Accordingly, the real GDP growth rate is expected to increase in the fourth quarter compared to the previous quarter (0.3% quarter-on-quarter).

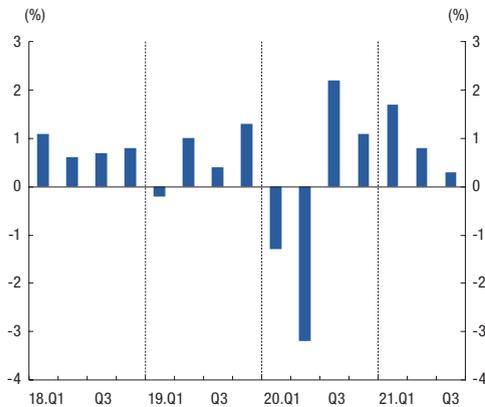
By sector, private consumption (based on GDP) in the third quarter exhibited a slower recovery, declining 0.2% quarter-on-quarter owing largely to the heightened social distancing measures following the resurgence of COVID-19. Private consumption showed a trend of recovery from September, led mainly by accelerated vaccinations and the provision of emergency disaster relief funds. The retail sales index increased 2.4% month-on-month in September, mainly due to

contributions from clothing and cosmetics, and went up by 0.2% month-on-month in October, centered on electronic devices and clothing. Government consumption rose in the third quarter due to increased expenditure on purchases of COVID-19 vaccines.

Facilities investment underwent a slight adjustment, declining 2.4% quarter-on-quarter in the third quarter of this year. In October, the Equipment Investment Index dropped by 5.4% month-on-month as machinery and transportation equipment all decreased due to the shortage of auto semiconductors. Construction investment was also sluggish, falling 3.5% quarter-on-quarter in the third quarter. Both building construction and civil engineering decreased owing to severe weather conditions, soaring costs of construction materials, and the reduced SOC budget. In October, the value of construction completed also declined 1.3% month-on-month, in part due to the effects of substitute holidays and a larger increase in material costs.

Exports (customs-clearance basis) remained favorable in the third quarter, and the daily average export value hit a record high. Exports of IT products and most non-IT products excluding automobiles grew rapidly. Since October as well, there has been a continued year-on-year increase in exports of major products, such as semiconductors, petroleum and chemical goods, and steel.

Real GDP Growth¹⁾



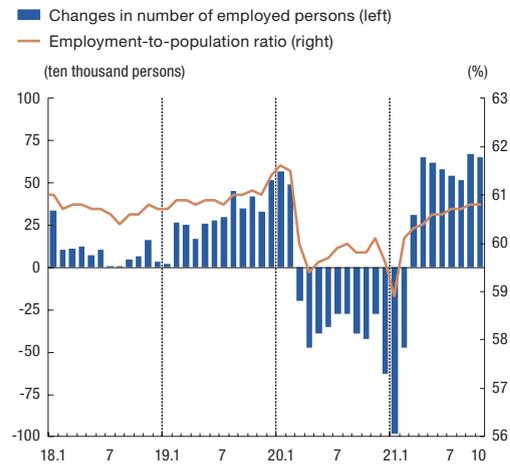
Note: 1) Quarter-on-quarter (seasonally adjusted), reflects preliminary figures.

Source: Bank of Korea.

Employment conditions have continued to improve recently with the sustained growth in the number of persons employed. Total payrolls increased by 652,000 year-on-year in October. Private nonfarm payrolls (excluding agriculture and fisheries, public administration, and health and social welfare) have continued to improve, increasing by more than 300,000 year-on-year as in September. The (seasonally-adjusted) employment-to-population ratio stood at 60.8% in October, remaining at the same level as in the preceding month.

Nominal wages increased by 5.0% year-on-year in the third quarter of 2021, continuing their sharp rise from the second quarter.

Changes¹⁾ in number of employed persons and employment-to-population ratio²⁾

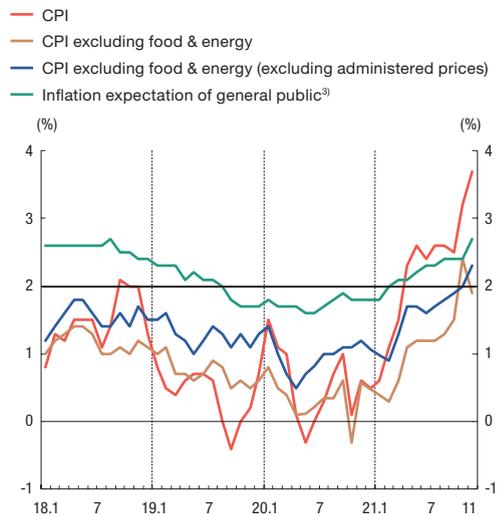


Notes: 1) Year-on-year.

2) Seasonally adjusted.

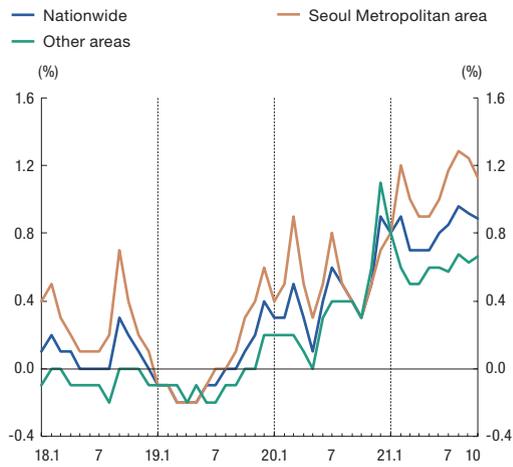
Source: Statistics Korea.

③ Consumer price inflation had remained significantly above 2% since April this year, and then rose to the 3% level during the period between October and November. The recent acceleration in inflation was mainly attributable to gradually rising inflationary pressure on the demand side accompanying economic recovery amid the sustained sharp rise in petroleum product prices. Core inflation (excluding changes in food and energy prices from the CPI) exceeded 2% in October due to the underlying base effect of last year's telecom bill subsidy. In November, with most of the base effect having dissipated, it approached close to 2% level as the inflationary pressure on the demand side increased. When excluding administered prices, core inflation has risen to the 2% level since October. The inflation expectations of the general public have risen to the mid- to upper-2% level.

Inflation¹⁾²⁾

Notes: 1) The bold line indicates the inflation target.
 2) Year-on-year.
 3) Expectations for the CPI inflation rate one-year ahead.
 Sources : Bank of Korea, Statistics Korea.

Nationwide housing sales prices sustained high rates of increase this year. The margin of increase narrowed somewhat from September but still remained elevated, exceeding the levels of previous years. Nationwide leasehold (*jeonse*) deposit prices rose at a faster pace in the third quarter, remaining higher than in previous years.

Housing sales price growth rate¹⁾

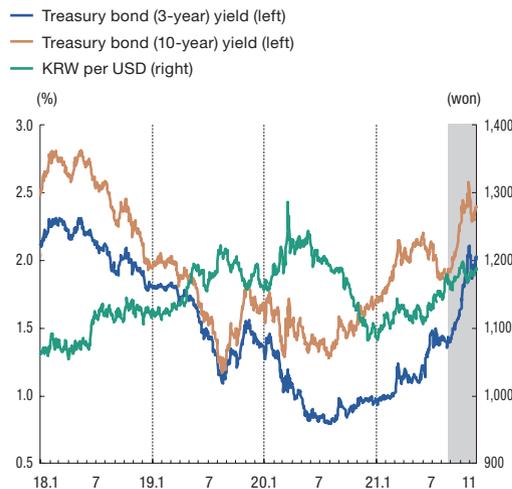
Note: 1) Month-on-month.
 Source: Korea Real Estate Board.

④ Korea Treasury bond yields rose significantly due to changes in expectations about monetary policies at home and abroad. Amid sustained expectations of an additional Base Rate hike since September, the 3-year yield surged to 2.11% (on November 1) and the 10-year yield to 2.58% (on October 29), owing to global inflation concerns, the possibility of a change in major countries' monetary policy stances, and the massive sell-off of bond futures by foreign investors. However, the extent of increase narrowed modestly in November, due mainly to the easing of concerns about a shift in monetary policy stances of major countries and to the policy authorities' market stabilization measures.

The Korean won to US dollar exchange rate sustained its uptrend until mid-October, affected largely by the strong US dollar due to the US Federal Reserve's looming tapering and to inflation concerns, and by concerns about a potential default of China's Evergrande Group, to reach a record high for the year (1,198.8 won on October 12). The margin of increase in the

exchange rate later narrowed to put the rate at the upper-1,160 won level, supported chiefly by improved investment sentiment following solid earnings reports by US companies and the easing of concerns about a potential default of the Chinese real estate company. Entering November, however, the exchange rate rebounded to the 1,180 won level, affected by apprehension about an early rate hike by the US Federal Reserve owing to concerns over the prospect of prolonged US inflation.

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



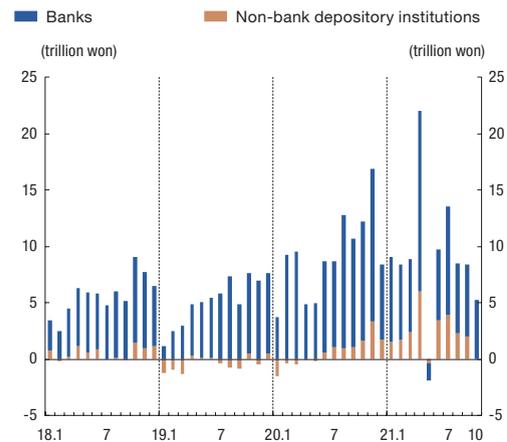
Sources: Bank of Korea, Korea Financial Investment Association.

5 Household lending sustained its high rate of increase, seen in the previous quarter. Growth in banks' household lending expanded slightly quarter-on-quarter in the third quarter. Growth in mortgage loans expanded with the continued demand for funds related to leasehold and sales transactions, while other loans, led by unsecured loans, exhibited slower growth. In monthly terms, the pace of growth in household lending slowed gradually, owing to stronger household loan management by the government and banks and to rising lending rates. In October,

household lending growth fell below the monthly average growth from January to September. Growth in household lending by non-bank depository institutions - mutual credit cooperatives and mutual savings banks in particular - slowed slightly in the third quarter.

Growth in direct and indirect corporate financing has accelerated. Corporate lending, especially SME loans, exhibited faster growth in the third quarter. SME loans maintained strong growth, led by the continued supply of COVID-19 financial support and the increased demand for facilities investment funds. Lending to large enterprises inched up, driven mainly by demand for operating funds. Corporate lending by non-bank financial institutions also continued its steep rise as in the second quarter. Direct corporate financing sustained its upward trend in the third quarter, mainly through the issuance of stocks.

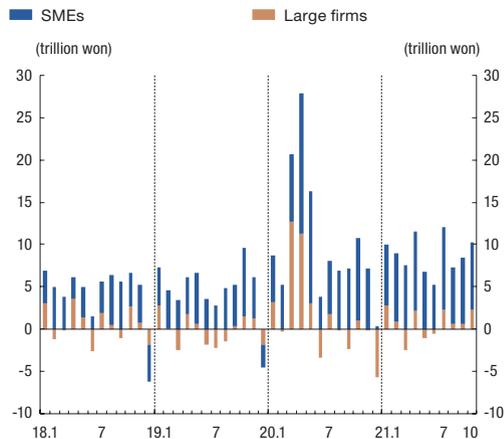
Changes in household loans¹⁾²⁾³⁾



Notes: 1) Month-on-month.
 2) Including mortgage transfers.
 3) Figures for October 2021 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 loans¹⁾²⁾



Notes: 1) Month-on-month.

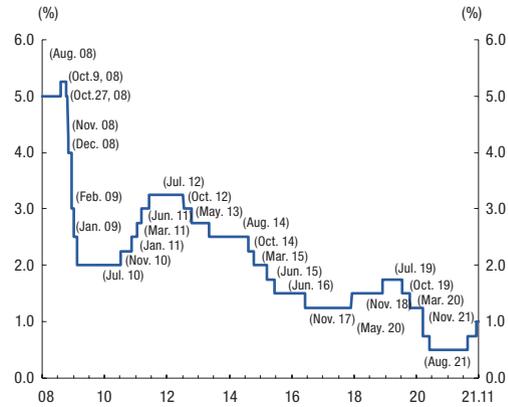
2) Based on banks.

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 global and domestic developments related to COVID-19, changes in the pace of growth and inflation, the risk of a buildup of financial imbalances, and monetary policy changes in major countries. Under this policy stance, the Bank of Korea adjusted the degree of monetary policy accommodation in November 2021 by raising the Base Rate by 25 basis points, from 0.75% to 1.00%.

Bank of Korea Base Rate¹⁾



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

Source: Bank of Korea.

⑦ A detailed look at the Base Rate decisions during this period, and the backdrop, are as follows. At the October meeting, the Board left the Base Rate unchanged at 0.75% and decided it would be necessary to further monitor the impacts of changes in domestic and overseas conditions on the overall economic and financial situation, along with developments of financial imbalances. The domestic economy continued its favorable trend of recovery as exports and facilities investment remained buoyant and private consumption, which had previously slowed due to the resurgence of COVID-19, had also rebounded. It was expected that such trend of economic recovery would continue going forward, as exports were expected to remain robust and private consumption to recover at a faster pace thanks to the relaxation of restrictions on economic activity. Consumer price inflation remained high around the mid-2% level as the upward trend of prices of petroleum products and services had accelerated, and it was expected to sustain the mid-2% level for some time going forward. With respect to financial stability, household loans had grown consider-

ably led by home mortgage loans, while housing prices continued to exhibit high rates of increase in both the Seoul Metropolitan region and other areas.

At the November meeting, the Board raised the Base Rate by 25 basis points, from 0.75% to 1.00%. The Board took into account the following aspects. While the domestic economy sustained its robust growth, inflationary pressure was expected to expand more greatly than initially anticipated and there was still a strong need to exercise caution against the risk of a buildup of financial imbalances. Looking at the domestic economy, exports had sustained their buoyancy and private consumption had picked up rapidly on the back of accelerated vaccinations, the mitigation of containment measures, and the provision of emergency disaster relief funds. In the future, these trends of recovery were expected to continue and the GDP growth rate was projected to be around 4.0% in 2021 and around 3.0% in 2022. Consumer price inflation had risen significantly to the lower-3% level, owing to the accelerating increase in the prices of petroleum products as well as the base effect from the decline in the prices of public services last year, and it was expected to run above the target level (2%) for a considerable period of time. Therefore, consumer price inflation for the next year was expected to record the 2% level, greatly exceeding the previous forecast of 1.5%. On the financial stability side, housing prices had continued to rise while the amount of increase in household loans had lessened somewhat. However, members judged that the risk of accumulation of financial imbalances still demanded close attention. In response, the Bank of Korea raised the Base Rate by additional 25 basis points following August. Going forward, it decided to operate its monetary policy in a direction

that appropriately reduces the degree of accommodation in line with improvement in economic conditions and the financial imbalance situation.

⑧ The Bank of Korea is using various policy instruments to promote smooth credit flows and stability in the financial and foreign exchange markets.

The Bank of Korea operates the Bank Intermediated Lending Support Facility in consideration of the financial and economic situation and SMEs' financing conditions. Given that small businesses and SMEs, especially in the face-to-face service industries, continued to face funding difficulties due to the resurgence of COVID-19, the Bank extended the period of the financial support to those affected by the pandemic by six months and decided to increase the ceiling of the Support Program for Small Businesses by 3 trillion won (3 trillion → 6 trillion won), starting from October 1, 2021. Meanwhile, the ceiling for the Support Program for Regional SMEs, scheduled to expire on August 31, was extended by two years to August 31, 2023. The extension was made to sustain the support for regional SMEs that may face deterioration in their funding conditions due to the heightened social distancing measures. Some temporary support measures, whose operation periods expired at end-September this year, were terminated as scheduled.

Programs under the Bank Intermediated Lending Support Facility

(trillion won, %)

Program	Ceiling		Interest rate	
	Before	After		
Support Program for Trade Financing	2.5	1.5 ³⁾	0.25	
Support Program for New Growth Engine Development and Job Creation ¹⁾	13.0	13.0	0.25	
Program for Stabilization of SME Lending ²⁾	5.5	3.5 ⁴⁾	0.25	
Support Program for Regional SMEs	5.9	5.9	0.25	
Ceiling Reserves	Support Program for SMEs Affected by COVID-19	13.0	13.0	0.25
	Support Program for Small Businesses	3.0	6.0 ⁵⁾	0.25
	Others	0.1	0.1	0.25
Total	43.0	43.0	-	

Notes: 1) The Support Program for High-tech and Other Start-up SMEs was expanded and reorganized as the Support Program for New Growth Engine Development and Job Creation (September 2017).

2) Includes the support that had been formerly provided under the Support Program for Facilities Investment.

3) Effective as of December 1, 2021.

4) The ceiling was reduced by 3 trillion won (5.5 trillion won → 2.5 trillion won) effective as of October 1, 2021, and then increased by 1 trillion won (2.5 trillion won → 3.5 trillion won) effective as of December 1, 2021.

5) Effective as of October 1, 2021.

Source: Bank of Korea.

In addition, the Bank of Korea announced a plan on October 28, 2021 that it would reduce the issuance of Monetary Stabilization Bonds (MSBs) in November and increase the amount of its buyback to improve investor sentiment surrounding Treasury bonds as well as to reduce the volatility of bond yields. This announcement was made against the backdrop of a spike in Korea Treasury bond yields in October as foreign investors sold off Korea Treasury futures amid a surge in interest rates in major economies on widespread concerns over global inflation. More specifically, the Bank decided to scale down its November

issuance by 2.4 trillion won (9.0 trillion won → 6.6 trillion won) from the issuance planned in October, and to increase the volume of buyback by 1.0 trillion won (4.0 trillion won → 5.0 trillion won).

Moreover, the Bank of Korea has supported seamless financing of low-rated companies facing difficulties from the prolonged COVID-19 pandemic. On July 23, 2021, the Bank re-extended the first round of loans provided in July last year to a Special Purpose Vehicle (SPV) that purchases corporate bonds and commercial paper worth 4.4 trillion won as of end-October 2021.

⑨ 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 major contingencies, it has also closely looked into the evolution of domestic and global risk factors as well as their impacts on financial markets at home and abroad. In particular, the Bank held Financial and Economic Conditions Review Meetings (on September 23 and November 4) with regard to FOMC meetings to discuss international financial market trends and the possible impacts on domestic financial and FX markets. The Bank of Korea also shared views and made efforts to come up with countermeasures regarding the key current issues and potential risk factors pertinent to Korea's financial and economic stability through various consultative bodies including the Macroeconomic and Financial Meeting.

The Bank of Korea has continued to do research on and to make technical preparations for central bank digital currency (CBDC) in order to effectively cope with the rapid progress toward a digital economy. In particular, in the phase 1

pilot test on CBDC set out in August this year, the Bank created a cloud-based virtual experimentation environment, examined basic functions of CBDC including its issuance, circulation and redemption, and conducted tests on related IT systems. In the phase 2 pilot test, scheduled to be carried out until June next year, the Bank will examine more sophisticated functions such as offline payments and enhanced protection of private information.

Meanwhile, the Bank of Korea set up a climate change response task force in order to comprehensively review and analyze the role of the central bank in responding to climate change, and published and presented a report on the Bank's measures to deal with climate change.

10 The report illustrated discussions on the role of the central bank when faced with climate change-induced shifts in the economic environment and financial system at home and abroad, and reviewed the seriousness of climate change and the responses by the international community. While analyzing the effects of climate change on Korea's real economy and financial system, the Bank also explored response measures including the review of available policy tools.

[Future Monetary Policy Directions]

The outlooks for growth and inflation are as follows. The GDP growth rate is forecast to record around 4.0% in 2021 and around 3.0% in 2022. The economy is expected to sustain a solid growth trend, as exports are expected to continue increasing, backed by the resumption of economic activities at home and abroad, and the trend of recovery in consumption is expected to accelerate. The recovery of private con-

sumption is projected to accelerate thanks to the government's transition of COVID-19 policy toward a gradual return to normalcy. Facilities investment is also expected to show moderate growth supported by economic recovery at home and abroad and the easing of disruptions in car production. Construction investment is projected to show gradual recovery as civil engineering is likely to increase while building construction continues its trend of improvement. Although exports are expected to grow at a slower pace year-on-year due to a base effect, they are likely to maintain a favorable trend on the back of the global economic recovery. There are various upside and downside risks to the future growth path. The upside risks include a quicker resumption of economic activities in line with the easing of preventive measures across the globe, rapid expansion of vaccinations in EMEs, and early resolution of global supply disruptions. Among the downside risks are intensified spread of COVID-19 in winter at home and abroad, prolonged global supply disruptions and slower growth of the Chinese economy.

Economic growth outlook¹⁾

	(YoY, %)							
	2020	2021		2022 ^o		2023 ^o		
	Year	H1	H2 ^o	Year ^o	H1	H2	Year	Year
GDP	-0.9	4.0	4.0	4.0	3.0	3.1	3.0	2.5
Private consumption	-5.0	2.4	4.7	3.5	4.1	3.2	3.6	2.5
Facilities investment	7.1	12.6	3.9	8.2	-0.5	5.5	2.4	1.5
Intellectual property products investment	4.0	4.0	4.1	4.1	4.1	3.7	3.9	3.8
Construction investment	-0.4	-1.5	0.1	-0.7	2.1	3.1	2.6	2.1
Goods exports	-0.5	14.4	3.5	8.5	1.9	3.3	2.6	2.5
Goods imports	-0.1	12.5	7.8	10.1	2.4	3.7	3.1	2.6

Notes: 1) Figures are the forecast as of November 2021.
Source: Bank of Korea.

Consumer price inflation is projected to exceed the August forecast (2.1%) and to record 2.3% in 2021, as inflationary pressure on the demand side has increased gradually and international oil prices have increased at faster rates than initially anticipated. It is forecast to be around 2.0% in 2022, running above the August forecast (1.5%), as inflationary pressure on the demand side is likely to increase due to economic recovery and the effects of global supply bottlenecks are likely to be partly reflected in durable goods prices. There is a mix of both upside and downside risks to the future inflation outlook path. The upside risks include a sustained upward trend in energy prices such as prices of oil and natural gas, a stronger recovery in consumption in line with accelerated vaccinations and the transition of COVID-19 policy, and greater impacts of supply bottlenecks on inflation. Among the downside risks are a slow recovery in consumption caused by the pandemic resurgence in winter and a decline in energy prices including oil prices.

The Bank of Korea will appropriately adjust the degree of monetary policy accommodation as the Korean economy is expected to continue its sound growth and inflation to run above the target level for a considerable time, despite underlying uncertainties over the virus. In this process the Bank will judge when to further adjust the degree of accommodation while thoroughly assessing developments related to COVID-19, changes in the pace of growth and inflation, the risk of a buildup of financial imbalances, and monetary policy changes in major countries.

Inflation outlook¹⁾

(YoY, %)

	2020		2021		2022 ^e		2023 ^e			
	Year	H1	H2 ^e	Year ^e	H1	H2	Year	Year		
CPI inflation	0.5	1.8	2.8	2.3	2.3	1.8	2.0	1.7		
Core inflation	CPI excluding food & energy		0.4	0.8	1.6	1.2	2.0	1.7	1.8	1.6
	CPI excluding agricultural products & oil		0.7	1.2	2.1	1.6	2.3	1.9	2.1	1.7

Note: 1) Figures are the forecast as of November 2021.

Source: Bank of Korea.

㉞ 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.