

Executive Summary

[Monetary Policy Operating Conditions]

1 A look at financial and economic conditions in Korea and abroad between August and November 2020 finds the following. The global economy showed improvement, boosted by the recovery of consumption in advanced economies and increased investment in China. However, the economic recovery then somewhat weakened due to the rapid resurgence of COVID-19. Growth in the US picked up, led by consumption and employment, but economic activity is partially limited by stronger restrictions on movement following the resurgence of COVID-19. The trend of improvement in the euro area economy, and the services industries in particular, weakened owing to strengthened containment measures in individual countries. China's economy continued to show a solid recovery. Investment increased centered around infrastructure and real estate, and consumption improved.

Economic growth in major economies¹⁾

	2017		2018		2019		2020	
	Year	Year	Year	Q3	Q4	Q1	Q2	Q3
US	2.3	3.0	2.2	0.6	0.6	-1.3	-9.0	7.4
Euro area	2.6	1.9	1.3	0.3	0.0	-3.7	-11.8	12.6
Japan	2.2	0.3	0.7	0.0	-1.8	-0.6	-8.2	5.0
China	6.9	6.7	6.1	6.0	6.0	-6.8	3.2	4.9

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.

Between September and October, the international financial market saw stronger risk aversion due to the resurgence of COVID-19 in major countries, but investment sentiment improved

afterwards, largely owing to a lessening of uncertainties related to the US presidential election and progress in the development of COVID-19 vaccines. Global prices rose sharply, boosted by factors such as eased concerns about increased taxation and stronger regulations after the US presidential election, and expectations for early vaccine rollouts. The US dollar weakened against currencies of major advanced countries, affected for instance by an increased preference for risky assets after the US presidential election in November.

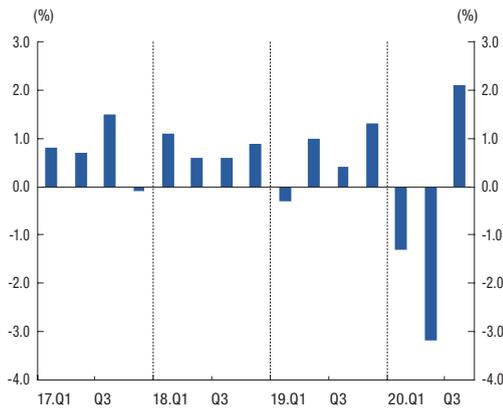
Share price indices of advanced and emerging markets



Source: Bloomberg.

2 In the Korean economy, growth showed moderate recovery, but the recovery varied from sector to sector. Consumption saw slower recovery, influenced for instance by the resurgence of COVID-19, and the adjustment in construction investment continued. However, exports rebounded significantly thanks to the economic reopening in major countries, and facilities investment improved. As a result, real GDP in the third quarter increased by 2.1% compared to the quarter before.

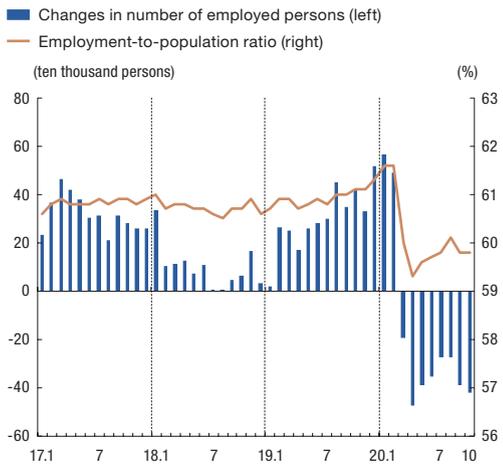
Real GDP growth¹⁾



Note: 1) Quarter-on-quarter (seasonally adjusted).
Source: Bank of Korea.

Employment remained sluggish. After September, the number of persons employed declined by a larger amount (year-on-year) again due to a resurgence of COVID-19 and stronger social distancing measures, and the (seasonally adjusted) employment-to-population ratio also fell slightly.

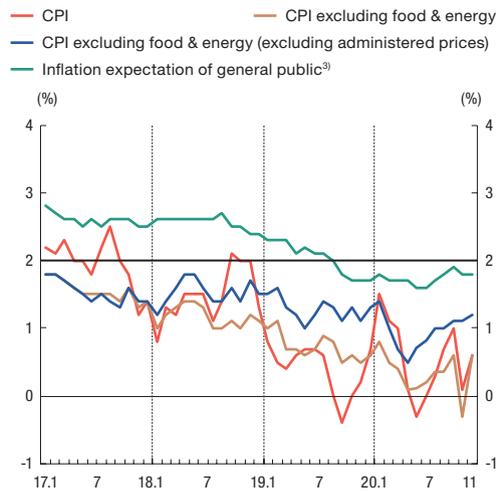
Changes¹⁾ in number of employed persons and employment-to-population ratio²⁾



Notes: 1) Year-on-year.
2) Seasonally adjusted.
Source: Statistics Korea.

③ Consumer price inflation showed increased volatility. It rose to the 1.0% level in September, affected by a hike in agricultural product prices owing to the worsening of weather conditions in the summer. It then fell sharply to 0.1% in October, as the government support for telecommunications fees acted as a temporary downward pressure on inflation. It rose again to the mid-0% range in November, owing to sharply declined effects of the support for telecommunications fees. Core inflation excluding food and energy has recently run in the mid-0% range and the inflation rate expected by the general public remained in the upper-1% range.

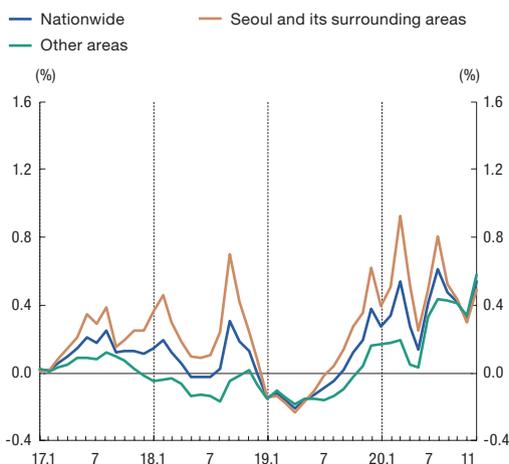
Inflation¹⁾²⁾



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

Entering November, the upward trend of housing sales prices accelerated in Seoul and its surrounding areas (mainly in Gyeonggi province and Incheon), and in the rest of the country (mainly in metropolitan cities), while leasehold (*jeonse*) deposit prices also rose at a higher pace in both Seoul and its surrounding areas and the rest of the country.

Housing sales price growth rate¹⁾

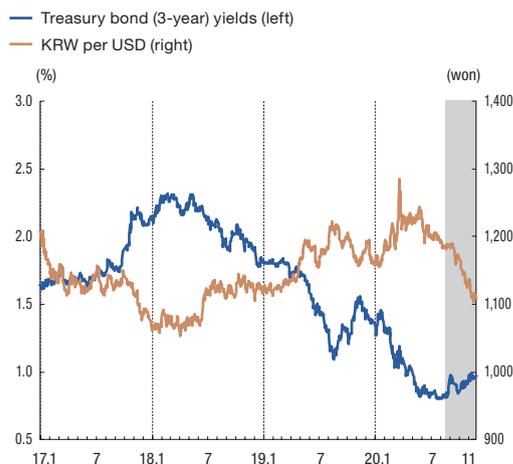


Note: 1) Month-on-month.

Source: Korea Appraisal Board.

④ In the domestic financial markets, long-term market interest rates fluctuated in September, influenced for instance by concerns over the excess supply of bonds related to the government's additional supplementary budget, and the Bank of Korea's announcement of a plan to expand outright purchases of Treasury bonds. The rates then rose after October on improved major domestic and international economic indices, a lessening of uncertainties related to the US presidential election, and expectations for development of COVID-19 vaccines. Stock prices soared after November on a shift to a net inflow of foreign stock investment funds and improvements in investment sentiment at home and abroad. The Korean won/US dollar exchange rate declined on the strengthening of the yuan and global weakening of the dollar, as well as on the perception that the degree of strengthening of the Korean won had been relatively limited.

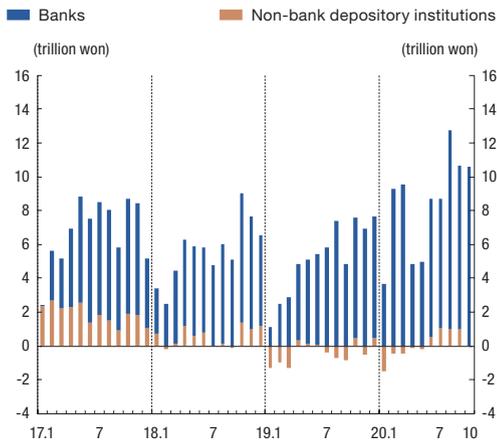
Korean Treasury bond yield and exchange rate (KRW per USD)



Sources: Bank of Korea, KOFIA.

⑤ Household lending increased at a much faster pace, driven by demand for funds for stock investment and for living expenses in addition to increased housing-related demand for funds. Corporate lending continued to grow, led by lending to small and medium-sized enterprises, due to COVID-19-related fund demand and to support from the government, the Bank of Korea, and financial institutions.

Changes in household loans¹⁾²⁾³⁾



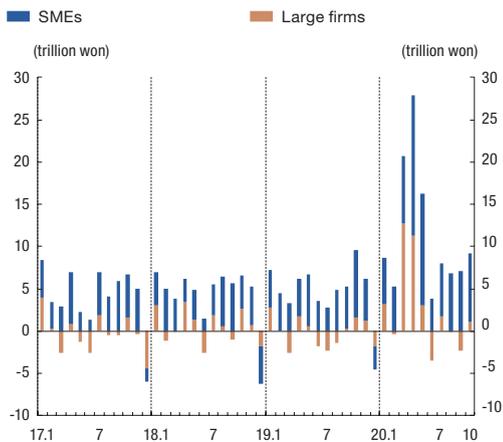
Notes: 1) Month-on-month.

2) Including mortgage transfers.

3) Figures for October 2020 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.

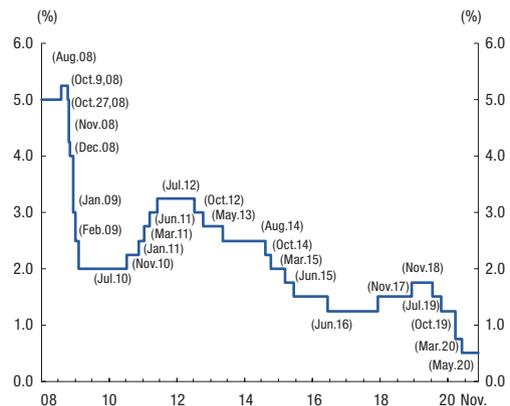
2) Based on banks.

Source: Bank of Korea.

[Conduct of Monetary Policy]

⑥ The Bank of Korea maintained its accommodative policy stance to support the recovery of growth and to help inflation stabilize at the 2% target over a medium-term horizon. In this process, it closely examined risk factors such as the global and domestic development of the COVID-19 pandemic, its financial and economic impacts at home and abroad, and changes in financial stability conditions. Under this policy stance, the Bank maintained the Base Rate at 0.50% per annum.

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 backgrounds behind them, are as follows.

At the October meeting, the Board decided to leave the Base Rate unchanged at 0.50%, considering that it was necessary to monitor the effects of the monetary and fiscal measures taken so far, the development of COVID-19 at home and abroad, and subsequent changes in financial and economic conditions, as the slump

in exports was easing and the expansionary fiscal policy stance was being strengthened under the accommodative financial conditions amid high uncertainties surrounding the growth path. It was expected that the economy would recover gradually, led by exports as the slump in exports eased, although consumption was tepid, affected by the resurgence of COVID-19, and the recovery in facilities investment was subdued. However, it was judged that uncertainties surrounding the growth path were still high due to the spread of COVID-19 worldwide. Consumer price inflation had risen to around 1% in September, driven mainly by a large increase in the prices of agricultural, livestock and fishery products due to severe weather conditions. It was forecast that consumer price inflation would run at the low- to mid-0% level for some time, reflecting weak demand-side inflationary pressures and prolonged effects from the drop in global oil prices. From the financial stability perspective, household loan growth had picked up and housing prices continued on an increasing trend in all parts of the country.

At the November meeting, the Board left the Base Rate unchanged at 0.50%. The Board judged there was a need to maintain the current policy stance as uncertainties surrounding the growth path remained elevated, regarding for example early vaccine rollouts and the development of the global spread of COVID-19, although expectations for an economic recovery were heightened as the development of COVID-19 vaccines reported better-than-expected results. The Korean economy continued to recover at a modest pace overall, but showed varying movements by sector. The improvement in exports continued and facilities investment had started to recover, led by the IT sector, while the recovery in private consumption was slow with the

resurgence of COVID-19, and the adjustment in construction investment continued. Going forward, the domestic economy was likely to recover gradually, led mainly by exports and investment. GDP was projected to grow at slightly below -1% in 2020 and around 3% in 2021. It was forecast that consumer price inflation would remain at the low- to mid-0% level for some time and then moderately increase to around 1% in 2021, owing to improvement in the domestic economy and the base effect of international oil price declines this year. In the meantime, the Board saw a need to closely monitor the effects of the government's housing and macroprudential policies and consequent changes in financial stability conditions, as housing prices in all parts of the country continued their upward trends, and the growth in household loans accelerated.

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

The Bank increased the total ceiling on the Bank Intermediated Lending Support Facility by 8 trillion won from 35 trillion won to 43 trillion won on October 5 to support SMEs and small businesses whose financial difficulties had been aggravated by the resurgence of COVID-19. Specifically, the Bank provided 3 trillion won of new funding to support small businesses affected by COVID-19, and increased the ceiling of the existing program that supports SMEs affected by COVID-19 by 3 trillion won. In addition, another 2 trillion won was used to increase the ceiling of the program that supports facilities investment of startups, of businesses that create jobs, and of material, parts and equipment businesses, all of which can act as growth engines of the Korean economy and contribute to employment.

Programs under the Bank Intermediated Lending Support Facility

(trillion won, %)

Program	Ceiling		Interest rate
	Before adjustment	After adjustment	
Support Program for Trade Financing	2.5	2.5	0.25
Support Program for New Growth Engine Development and Job Creation ¹⁾	11.0	13.0	0.25
Program for Stabilization of SME Lending ²⁾	5.5	5.5	0.25
Support Program for Regional SMEs	5.9	5.9	0.25
Support for SMEs Affected by COVID-19	10.0	13.0	0.25
Support for Small Businesses	-	3.0	0.25
Total	35.0³⁾	43.0³⁾	-

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) Includes reserves of 0.1 trillion won.

Source: Bank of Korea.

In addition, the Bank of Korea announced a plan to expand outright purchases of Treasury bonds to a total of around five trillion won from September to the year-end, as a preemptive response to any possible mismatch in the supply and demand of Treasury bonds and consequent expanded volatility in market interest rates. The Bank purchased Treasury bonds on three occasions, in September (2.0 trillion won), October (1.5 trillion won), and November (1.5 trillion won), with total purchases amounting to 5.0 trillion won.

Outright purchases of Treasury bonds¹⁾

(trillion won)

Date	Amount	Date	Amount
March 20	1.5	September 24 ²⁾	2.0
April 10	1.5	October 28 ²⁾	1.5
July 2	1.5	November 27 ²⁾	1.5
August 31	1.5	Total	11.0

Notes: 1) As of the end of November 2020.

2) Conducted at the month-end according to the plan on the expansion of outright purchases of Treasury bonds.

Source: Bank of Korea.

The Bank extended its Corporate Bond-Backed Lending Facility again by three months to February 3, 2021, in consideration of the continuing COVID-19 pandemic and the still high financial and economic uncertainties at home and abroad. It also continued to support the credit market through an SPV that manages purchases of corporate bonds and commercial paper, including lower-rated ones, established to stabilize the credit securities market. The SPV purchased 2.2 trillion won worth of corporate bonds and CP as of the end of November 2020.

As part of its efforts to secure new policy instruments for FX market stability, the Bank of Korea launched a new facility under which it supplies foreign currency liquidity through transactions of foreign currency bond repurchase agreements in competitive auctions. This facility will be activated when necessary in reflection of foreign currency market conditions.

⑨ The Bank of Korea activated an emergency monitoring mechanism in cases of heightened market volatility and closely monitored developments of COVID-19 and their possible impacts on the domestic and foreign financial sectors and economies, as well as changes in financial and FX market conditions after the Bank's market stabilization measures. The Bank held a Fi-

financial and Economic Conditions Review Meeting during the Chuseok holidays in October to monitor financial and FX market developments induced by domestic and overseas risk factors. In another meeting in November, it reviewed the reactions to and the impacts of the US presidential election in the domestic and global financial markets.

The Bank continued to preemptively identify potential risk factors within the financial system and to carry out related early warning activities. In the September Financial Stability Meeting, the Bank examined how the changes in real and financial sector conditions brought on by the prolonged pandemic could affect Korea's financial system. In mid-October, it also resumed the joint examination of financial institutions, which had been suspended after the coronavirus outbreak, and monitored current issues and potential risks including COVID-19-related financial support and loan soundness management.

The Bank of Korea also continued to strengthen the multi-layered financial safety net, by expanding its bilateral currency swap arrangements with major central banks. In October, it renewed its currency swap arrangement with the People's Bank of China, enabling a more stable supply of sufficient foreign currency liquidity by increasing the amount and lengthening the period of the agreement.

[Future Monetary Policy Directions]

10 A look at the outlooks for growth and inflation is as follows. It is forecast that GDP will record a growth rate of -1.1% in 2020, 3.0% in 2021, and 2.5% in 2022. With the slump in goods exports gradually easing and fiscal policy remaining on an expansionary course, the domestic economy

is expected to recover moderately. Although the recovery of private consumption is predicted to be slow due to the continuing domestic resurgence of COVID-19, facilities investment is expected to continue to increase and construction investment to turn to positive growth. There is a high level of uncertainty surrounding the growth path. The upside risks to growth include an early supply of vaccines and treatments for COVID-19, additional fiscal stimulus at home and abroad, and an improvement in the global trade environment. Among the downside risks are an accelerated spread of COVID-19 at home and abroad, a delay in the semiconductor industry's recovery, and rising tensions between the US and China.

Economic growth outlook¹⁾²⁾

(%)

	2019		2020		2021 ^e		2022 ^e	
	Year	H1	H2 ^a	Year ^a	H1	H2	Year	Year
GDP	2.0	-0.7	-1.4	-1.1	2.6	3.3	3.0	2.5
Private consumption	1.7	-4.4	-4.1	-4.3	2.9	3.2	3.1	2.5
Facilities investment	-7.5	5.6	5.7	5.7	4.9	3.6	4.3	3.2
Intellectual property products investment	3.0	3.3	4.2	3.8	3.8	4.0	3.9	3.7
Construction investment	-2.5	1.7	-2.9	-0.7	-1.8	2.6	0.5	2.1
Goods exports	0.5	-2.9	-0.4	-1.6	9.3	1.9	5.3	2.3
Goods imports	-0.8	-0.9	-0.3	-0.6	7.5	4.5	5.9	3.2

Notes: 1) Year-on-year.

2) Figures are the forecast as of November 2020.

Source: Bank of Korea.

Consumer price inflation is forecast to record 0.5% this year, driven by weaker demand-side inflationary pressures, greater downward pressures on inflation from government policies and lower-than-last-year international oil prices. However, it is expected to pick up next year to around 1.0% as the effects of lower international oil prices dissipate and the economy improves.

Core inflation excluding food and energy prices is forecast to increase from 0.3% this year to 1.0% next year. Upside risks to prices include stronger economic improvement due to COVID-19 vaccine development, and a faster rise in international commodity prices. Among the downside risks are a weak economic recovery resulting from a coronavirus resurgence and a larger appreciation of the Korean won.

Inflation outlook¹⁾²⁾

(%)

		2019		2020		2021 ^e		2022 ^e	
		Year	H1	H2 ^e	Year ^e	H1	H2	Year	
CPI inflation		0.4	0.6	0.5	0.5	0.7	1.2	1.0	1.5
Core inflation	CPI excluding food & energy	0.7	0.4	0.3	0.3	0.7	1.3	1.0	1.3
	CPI excluding agricultural products & oils	0.9	0.6	0.7	0.7	0.8	1.2	1.0	1.3

Notes: 1) Year-on-year.

2) Figures are the forecast as of November 2020.

Source: Bank of Korea.

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

As the recovery in the Korean economy is expected to be modest and inflationary pressures on the demand side are forecast to remain weak, the Bank will maintain its accommodative monetary policy stance. In this process, it will thoroughly assess COVID-19 developments, their impacts on the financial markets and economy, and changes in financial stability conditions such as household debt growth.