



# **Monetary Policy of the Bank of Korea and Economic Challenges**

**November 6, 2018**

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- 1. Introducing the Bank of Korea*
- 2. Monetary Policy Framework*
- 3. Monetary Policy after Global Financial Crisis*
- 4. Challenges Ahead*

# 1. Introducing the Bank of Korea

## (1) History of the Bank of Korea (1/3)

- The Bank of Korea (BOK), the central bank in Korea, was founded in June 1950 under the “Bank of Korea Act.”
  - Granted strong independency and authority to the BOK.
  - Guaranteed neutrality of the monetary policy.
  - Let the BOK in full charge of financial supervisory function for commercial banks.
  
- The BOK Act was revised in 1962 in a way to intensify the Bank’s financial role to support economic development. It meant the dependence of monetary policy shrank while the room for government’s intervention enlarged.
  - Renamed Monetary Policy Board to Monetary Policy Operation Committee and scaled down its role considerably.
  - Granted rights to the Minister of Finance (MOF) to request reconsideration of policy-decisions and to vote on Bank’s budget.

# 1. Introducing the Bank of Korea

## (1) History of the Bank of Korea (2/3)

- The sixth amendment of the Act in December 1997 represented a comprehensive adjustment, ranging from the purpose of monetary and credit policy to the organization of the Bank of Korea. Thereby, the BOK restored its independence to some extent.
  - Defined the objective of the BOK to maintaining price stability.
  - Introduced Inflation Targeting and had the BOK submit Monetary Policy Report more than once a year to the National Assembly.
  - Revived the title of MPB and let Governor take the chairman instead of Minister of Finance and Economy (MOFE).
  - Transferred bank supervisory function to newly established Financial Supervisory Services (FSS).
  - Restricted the voting right over Bank's budget only to payroll costs.

# 1. Introducing the Bank of Korea

## (1) History of the Bank of Korea (3/3)

- In 2011, after the Global Financial Crisis, the Act was amended to promote the BOK's ability to cope with the financial stability promptly and effectively.
  - Explicitly specified the BOK's responsibility for financial stability.
  - Expanded the right to request Financial Supervisory Services for commercial bank's financial statements.
  
- The 9<sup>th</sup> amendment of the Act in 2012 had President take the process of a Personnel Hearing in the National Assembly in appointing Governor of the BOK.

# 1. Introducing the Bank of Korea

## (2) Monetary Policy Board

- Monetary Policy Board decides monetary policies and important matters on the operation of the Bank.
  - Composed of seven members.
    - **Governor** (Chairman) and **Senior Deputy Governor**.
    - **Five other members** recommended respectively by MOEF; the BOK; Financial Supervisory Commission; the Korea Chamber of Commerce and Industry; and the Korea Federation of Banks.
  - The term of each member is four years (3 years for Senior Deputy Governor).
  - Meetings are regularly held twice a month and decisions are adopted by simple majority rule with at least five members present.



# 1. Introducing the Bank of Korea

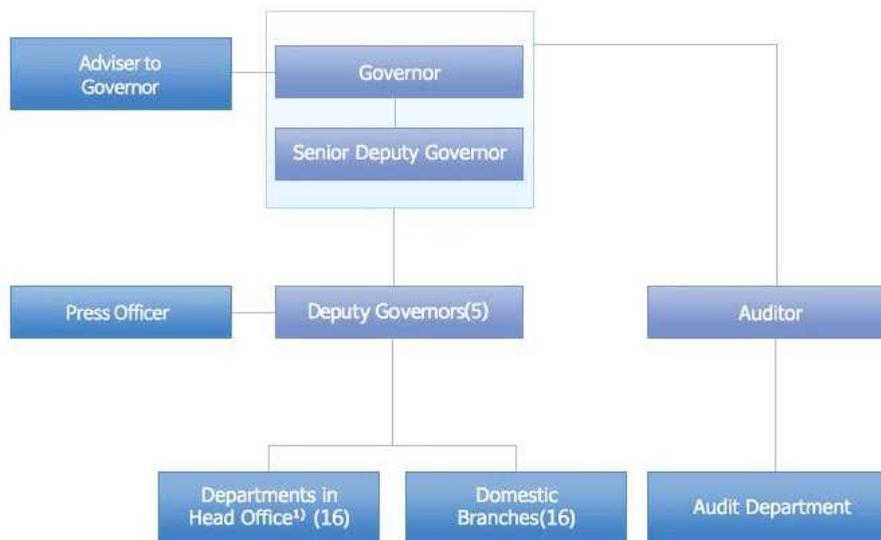
## (3) Executive Offices (1/2)

- The executive body of the Bank of Korea consists of its executive officers and employees.
- The executive officers are the Governor, the Senior Deputy Governor, and the five Deputy Governors.
  - The Governor is appointed by the President on the deliberation of the Cabinet Council. The term of the Governor is four years.
  - The Senior Deputy Governor assists the Governor and is appointed by the President upon recommendation of the Governor.
  - The Deputy Governors are appointed by the Governor and undertake their respective duties; monetary policy and financial market, research and statistics, international and FX market, financial stability and settlement, and management affairs.

# 1. Introducing the Bank of Korea

## (3) Executive Offices (2/2)

- The Bank has 16 departments in its Head Office in Seoul, 16 branches in the nation's major cities, and 5 overseas representative offices in principal international financial centers.



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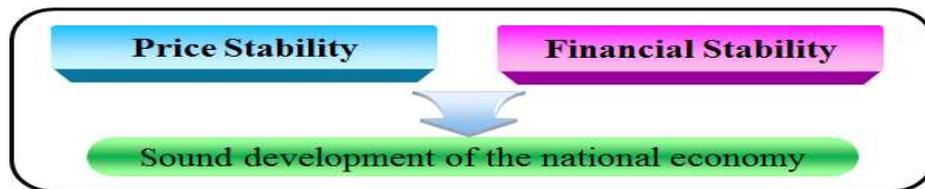
## 2. Monetary Policy Framework

### (1) Objective

- The BOK Act specifies **price stability** as the most important objective.
- It also strives to achieve **financial stability** in carrying out monetary policies.

#### [BOK Act] Article 1 (Purpose)

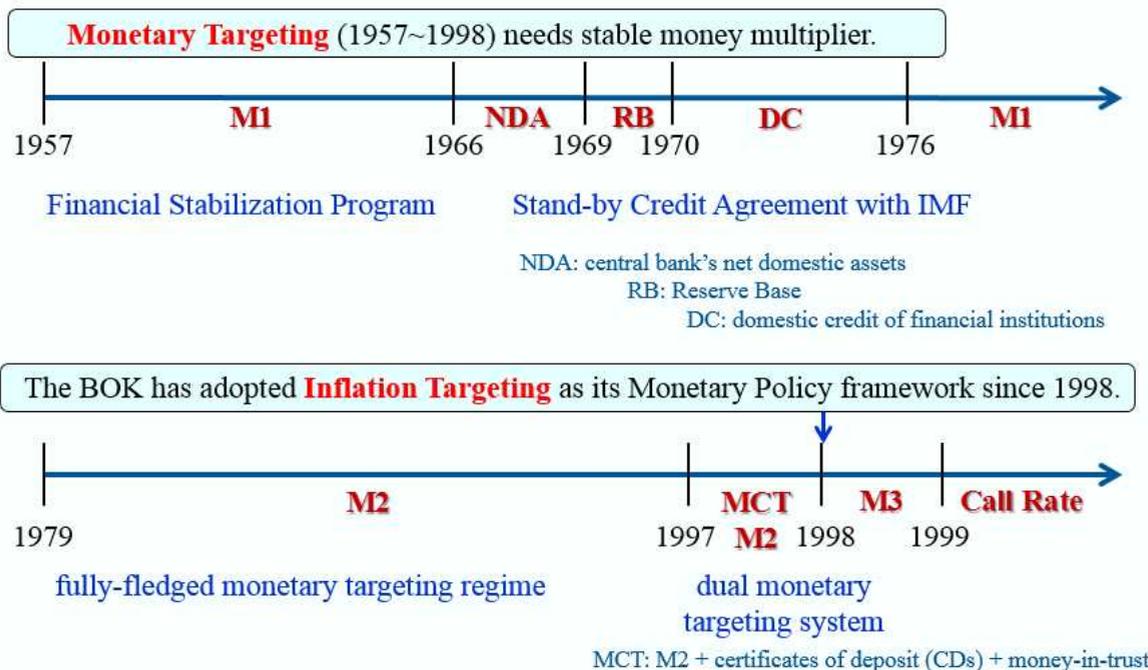
- (1) The purpose of this Act shall be to establish the Bank of Korea and to contribute to the sound development of the national economy **by pursuing price stability** through the formulation and implementation of efficient monetary and credit policies.
- (2) The Bank of Korea shall **pay attention to financial stability** in carrying out its monetary and credit policies.



## 2. Monetary Policy Framework

### (2) Inflation Targeting (1/3)

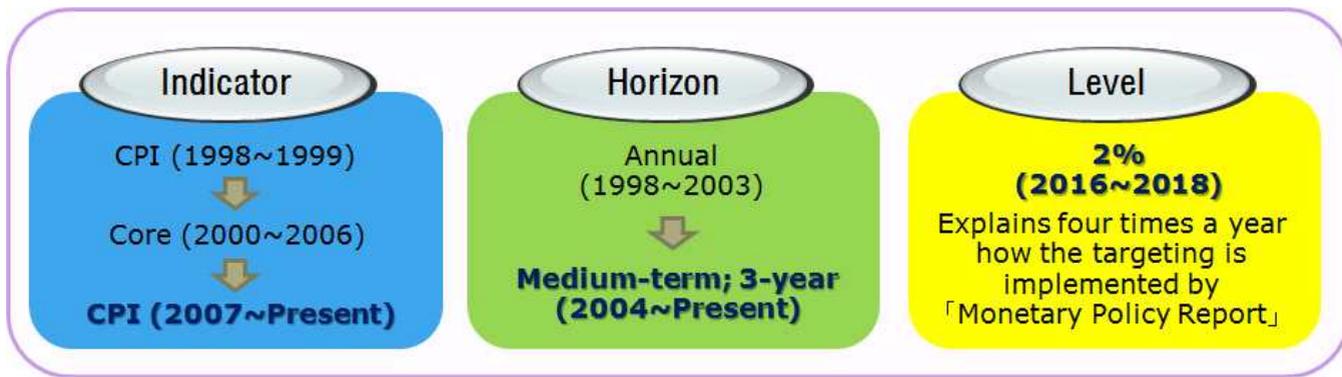
#### History of Monetary Policy Framework at BOK



## 2. Monetary Policy Framework

### (2) Inflation Targeting (2/3)

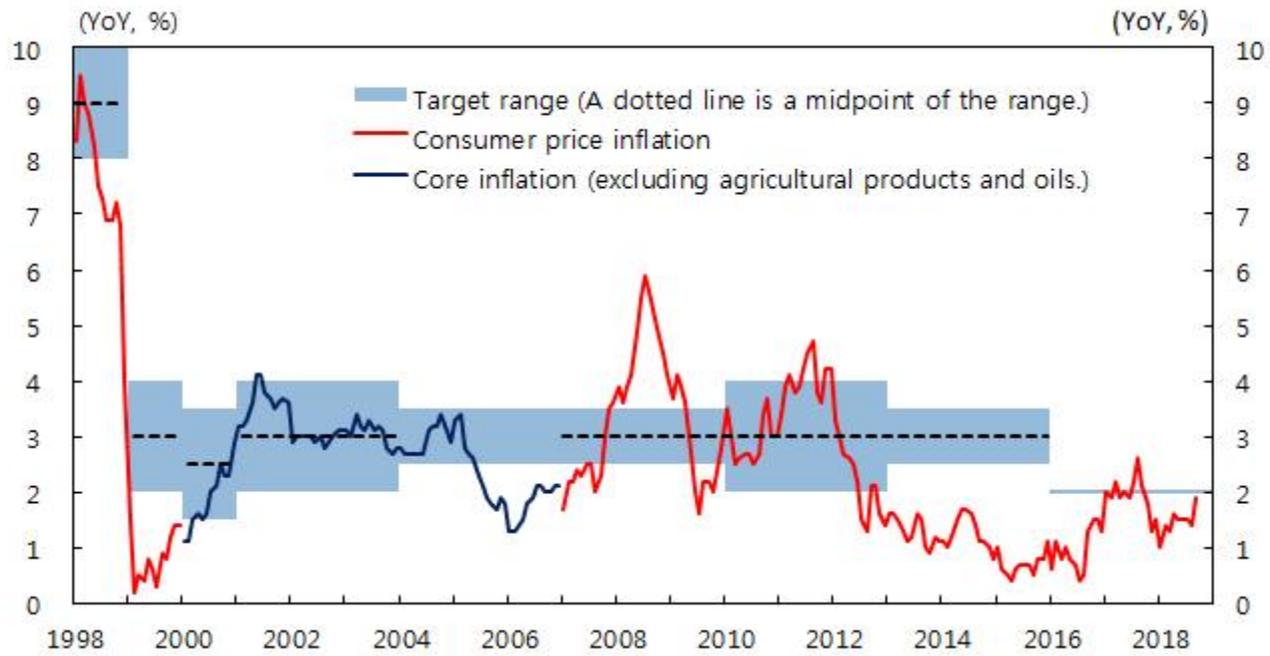
- The Bank of Korea sets the **mid-term inflation target** in consultation with the Ministry of Strategy and Finance.
  - Conducts monetary policy to maintain the annual rate of CPI inflation near the target over a mid-term horizon.



# 2. Monetary Policy Framework

## (2) Inflation Targeting (3/3)

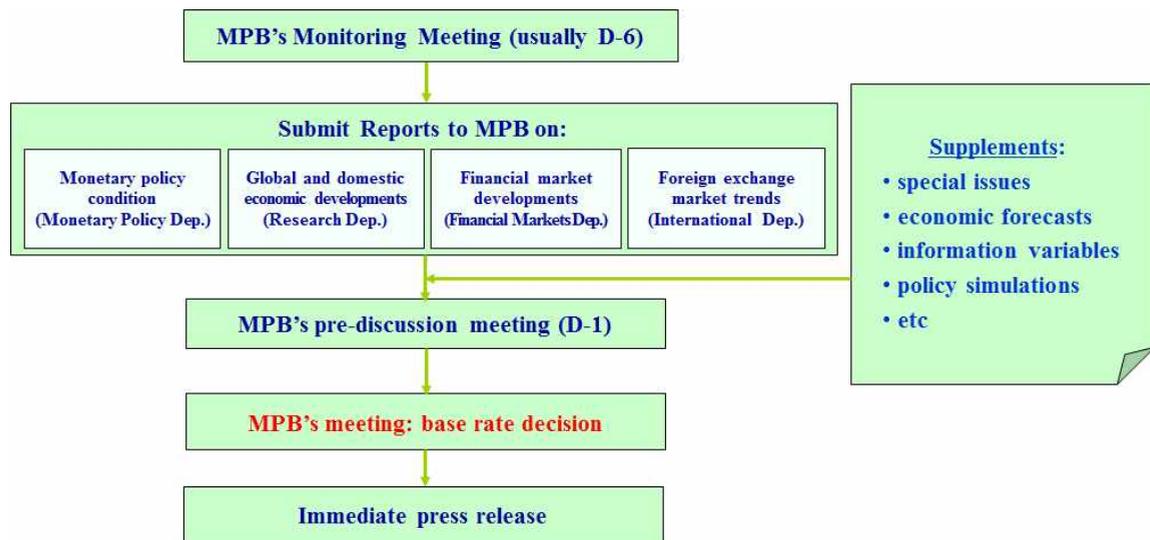
### Actual Inflation and Target



## 2. Monetary Policy Framework

### (3) Monetary Policy Decision (1/2)

- **MPB** decides the **BOK base rate** (generally on Thursday) eight times per year.
- The executive offices provide reports and their opinions to MPB to support its monetary policy decision.



## 2. Monetary Policy Framework

### (3) Monetary Policy Decision (2/2)

- MPB provides background of the decision through the **statement** and **press conference** of the Governor.
  - Meeting opens at 9 am.
  - Decision is made at around 9:30-10 am and is released immediately to the press.
  - MPB statement is released at around 10:30 am.
  - Press conference of the Governor begins at 11:20 am.
  
- In press conference, the Governor explains backgrounds of policy-decision, risk factors ahead, and the future direction of monetary policy.
  - Opens to the public who votes for or against the decision.
  
- Minutes of MPB meeting are posted on BOK website on Tuesday in two weeks.

## 2. Monetary Policy Framework

### (4) Policy Instruments other than Policy Rate (1/2)

#### ■ Open Market Operations

- The Bank purchases or sells securities with financial institution counterparts in open markets to change their funding conditions, thereby adjusting reserve money stock or the short-term interest rate.

#### ■ Reserve Requirements

- The reserve requirement system obliges financial institutions to hold a certain ratio of their liabilities subject to reserve requirements in their accounts with the central bank.

#### ■ Lending & Deposit Facilities

- The Bank can control the supply and demand for funds by extending loans to or receiving deposits from individual financial institutions.

## 2. Monetary Policy Framework

### (4) Policy Instruments other than Policy Rate (1/2)

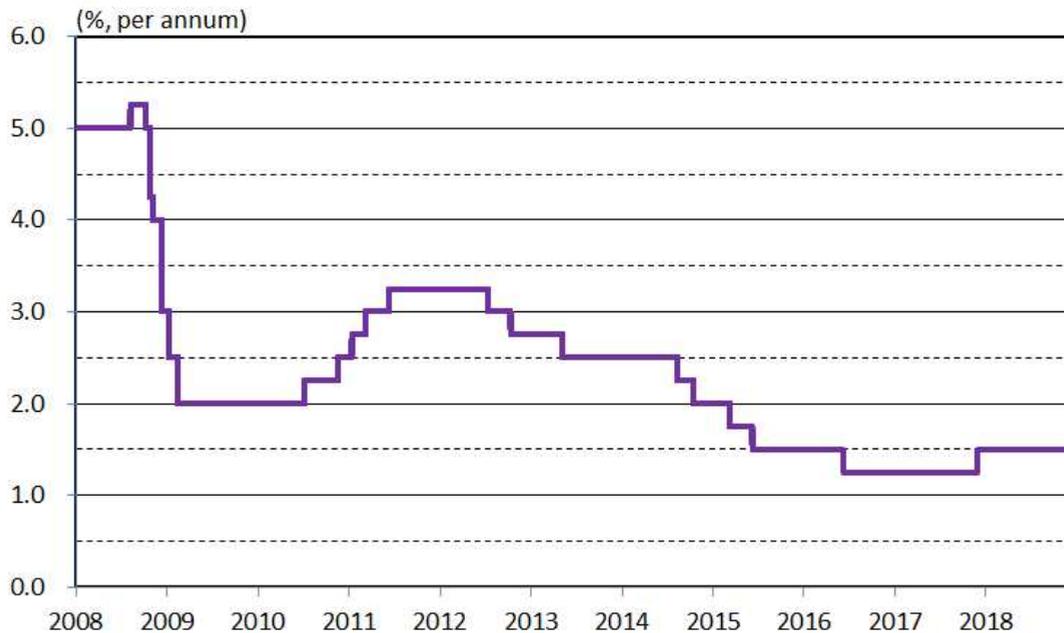
#### Lending Facilities of the Bank of Korea

Facility	Objective	Collateral	Interest rate
Liquidity adjustment loans	Provided to financial institutions facing shortages of funds to ease excessive volatility of short-term rate.	1. Credit securities acquired by financial institutions through loans 2. Government and public bonds 3. Monetary Stabilization Bonds	BOK Base Rate + 100bp
Bank-intermediated lending support facility	Allocated to banks based on SME loan performances, within a given ceiling set by MPB.		0.5~0.75% (annual rate)
Intraday overdrafts	Provided to financial institutions facing temporary shortages of funds for intraday settlement.		Interest-free
Special loans	Extension of loans as the lender of last resort for financial stability or coping with financial crisis.	Specific terms determined by Monetary Policy Board	

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### 3. Monetary Policy after Global Financial Crisis

#### Changes in BOK Policy Rate since the GFC



# 3. Monetary Policy after Global Financial Crisis

## (1) Substantial Rate Cut (Oct. 2008 to Feb. 2009)

- Right after the outbreak of GFC, the Bank of Korea immediately brought down its base rate from 5.25% to 2%.
- Responding to the instability in financial and FX market.
- Preventing the vicious cycle of financial turmoil and economic downturn.

Foreign Exchange Rate



Source: Bank of Korea

Cyclical Component of Coincident Composite Index



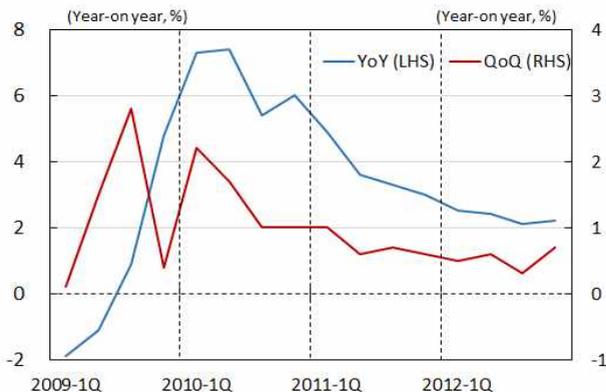
Source: Korea National Statistical Office

# 3. Monetary Policy after Global Financial Crisis

## (2) Stepwise Rate Hike (July 2010 to June 2011)

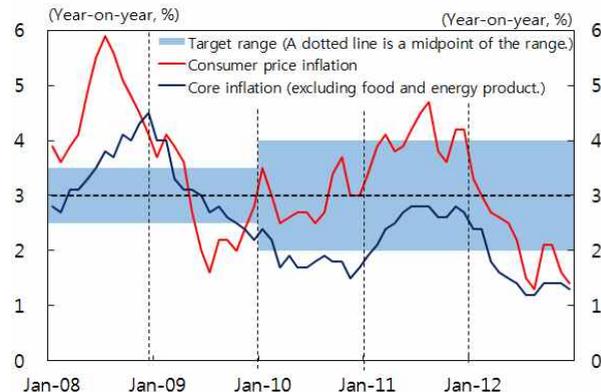
- The BOK reduced the degree of monetary accommodation by raising the base rate on five occasions, from 2.0% to 3.25%.
  - Reflecting the upward trend of domestic economic activity.
  - Moderating upward pressure on price and cooling down the spread of inflation expectation.

**Real GDP Growth Rate**



Source: Bank of Korea

**CPI and Core Inflation<sup>1)</sup>**



Note: 1) Excluding food and energy  
Source: Korea National Statistical Office

## 3. Monetary Policy after Global Financial Crisis

### (3) Gradual Rate Cut (July 2012 to June 2016)

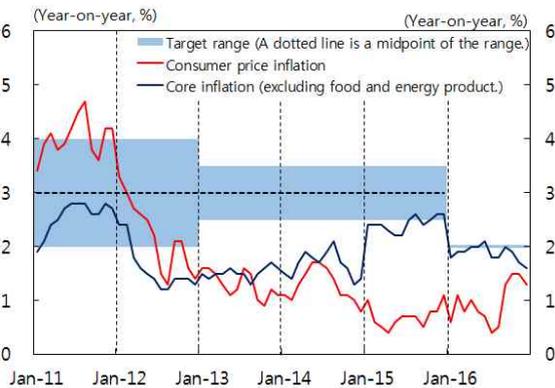
- In response to macroeconomic downward risks, the Bank has lowered its base rate on eight occasions from 3.25% to historically lowest level of 1.25%, at which the base rate unchanged until now.
- In easing monetary policy, the Bank also paid attention to potential risks in financial stability such as the increase in household debt.

**Real GDP Growth Rate**



Source: Bank of Korea

**CPI and Core Inflation<sup>1)</sup>**



Note: 1) Excluding food and energy  
Source: Korea National Statistical Office

## 3. Monetary Policy after Global Financial Crisis

### (4) Slight Reduction of Accommodation (Nov. 2017 ~ present)

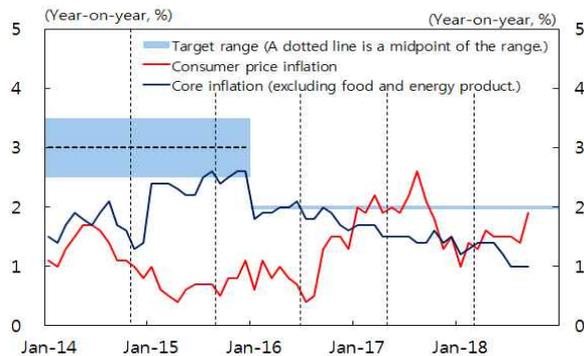
- The BOK reduced the degree of monetary accommodation by raising the base rate on from 1.25% to 1.5% in November, 2017.
- Domestic economy was sustaining steady growth at its potential level.
- CPI inflation was expected to gradually approach the target level.
- Household debt had grown faster than the growth of income, building up the risk of financial imbalances.

#### Real GDP Growth Rate



Source: Bank of Korea

#### CPI and Core Inflation<sup>1)</sup>



Note: 1) Excluding food and energy  
Source: Korea National Statistical Office

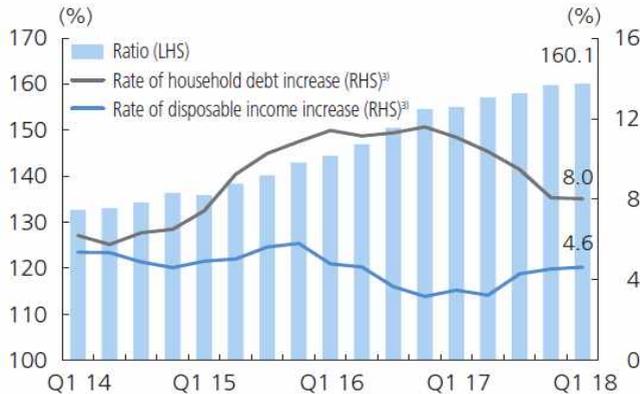
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## 4. Challenges Ahead

### (1) Financial Stability - Household Debt

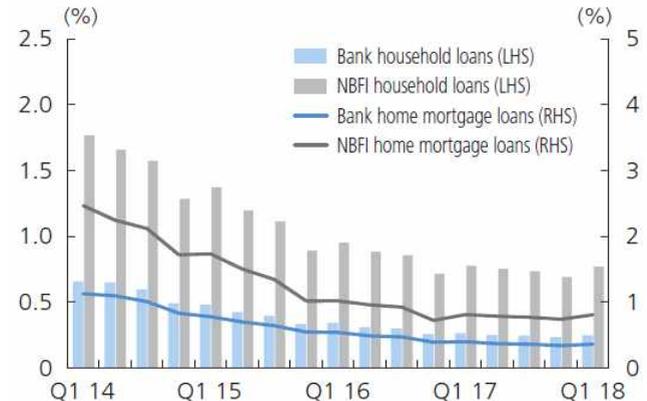
- Rising household debt poses potential risk to financial stability.
  - Household debt-to-Disposable income ratio is estimated to exceed 160%.

#### Household debt-to-disposable income ratio



Source: Bank of Korea

#### Delinquency rates of household loans extended by banks and NBFIs



Source: Bank of Korea

# 4. Challenges Ahead

## (2) Uncertainty in Global Risk Factors

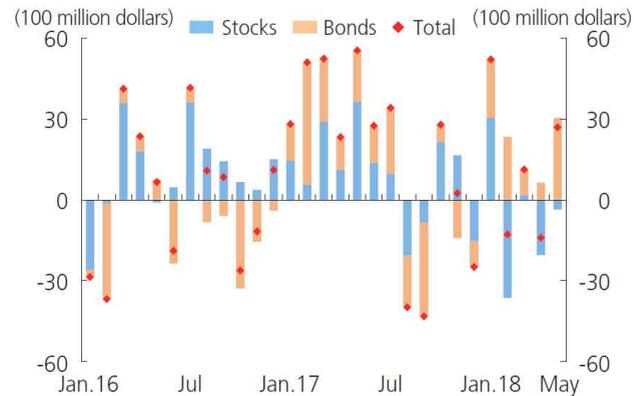
- US Federal Reserve's monetary policy normalization.
- US-China trade conflict.

### BOK's Base Rate and FFR Target



Source: Federal Reserve, Bank of Korea

### Changes in Foreigners' Domestic Portfolio Investment



Source: Bank of Korea

## 4. Challenges Ahead

### (3) Slowdown in Inflationary Pressure

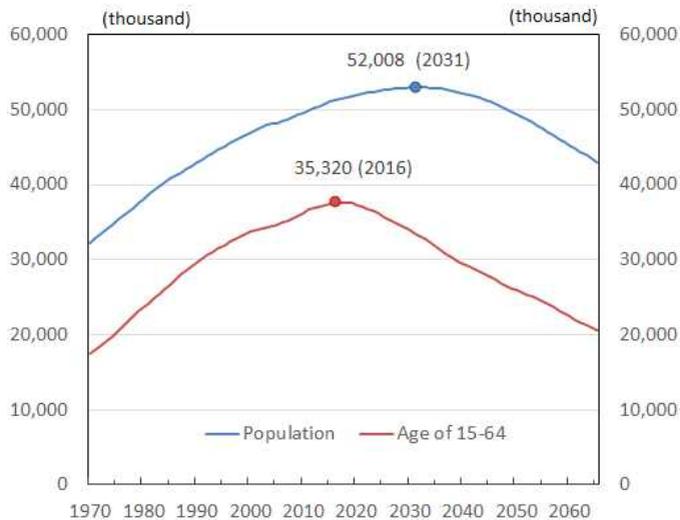
- Relationship between economic growth and inflation has been weakened since GFC, causing the inflationary pressure to slow down.
- Mix of structural and cyclical factors.
  - Structural factors.
    - ① Structural change in labor market.
    - ② Intensified competition due to globalization.
    - ③ Decrease in inflation expectation.
    - ④ Downward pressures in the prices controlled by government.  
(education, medical service, etc.)
  - Cyclical factors.
    - ① 'Slack' still remaining in real economy.
    - ② Transmission lag between real growth and inflation.

# 4. Challenges Ahead

## (4) Structural changes in Population (1/2)

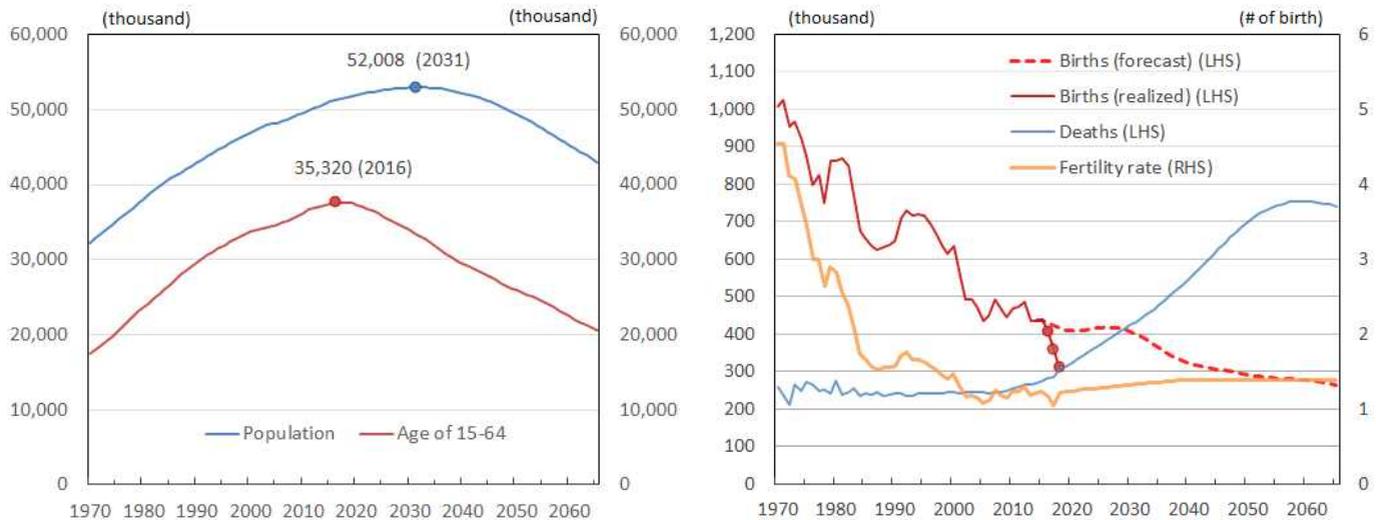
- Aging society.

Number of Population



Source: KOSIS

Number of Births & deaths and Fertility Rate



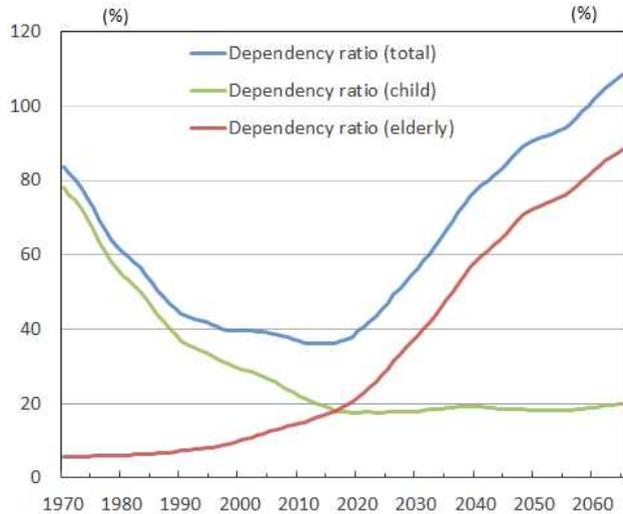
Source: KOSIS

# 4. Challenges Ahead

## (4) Structural changes in Population (2/2)

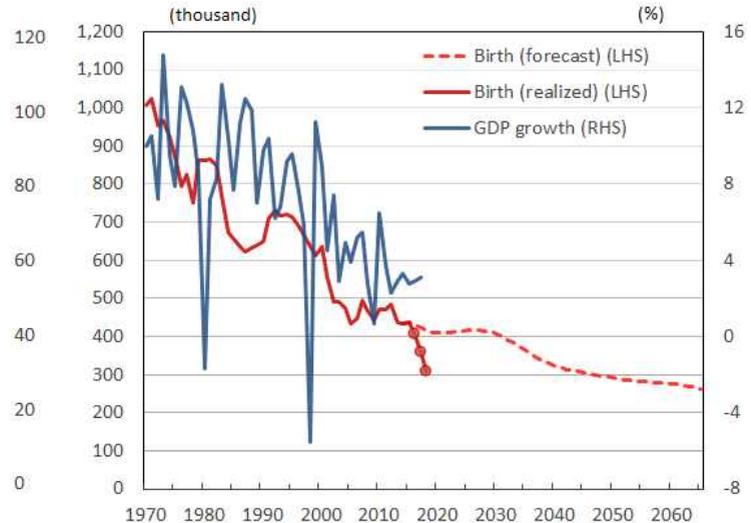
- Implication for the Korean economy.

Dependency Ratio



Source: KOSIS

Number of Births and GDP Growth



Source: KOSIS



**Thank you!**