

Post-Pandemic Monetary Policy in Korea: Toward an Integrated Policy Framework

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I. Introduction

Ladies and gentlemen, distinguished guests, I am Rhee Changyong, governor of the Bank of Korea.

Thank you for joining us at this conference, co-hosted by the Bank of Korea (BOK), the Asian Development Bank (ADB), and the Journal of International Money and Finance (JIMF). I would like to express my sincere appreciation in particular to Dr. Donghyun Park of the ADB and Professor Joshua Aizenman of the JIMF for their invaluable contributions in organizing this gathering.

This year's conference focuses on fiscal and monetary policy in emerging markets. We learn the theories of fiscal and monetary policy through textbooks, but in the real economy, we often experience a great deal of trial and error when applying them. This challenge is even more pronounced in emerging economies, whose economic structures often differ significantly

¹ This keynote speech was prepared with the assistance of Younghwan Park, Choongwon Park, Taesup Kim, Daeseong Han and Jaehoon Kang from the Monetary Policy Department at the BOK.

from those assumed in textbook models based on advanced economies. Accordingly, I believe that gatherings like this are especially valuable. They allow us to share policy experiences and to develop approaches tailored to each country's specific circumstances.

In this context, I would like to share Korea's experience in conducting monetary policy since the COVID-19 pandemic and the key policy lessons we have learned along the way.

Since the pandemic, the BOK's fundamental policy framework has been to pursue price stability through policy rate adjustments under an inflation-targeting regime. In response to a sharp and unexpected surge in inflation, we raised the policy rate from 0.5% to 3.5%. This marked the most rapid and substantial monetary tightening in Korea's history. Thanks to these measures, inflation gradually stabilized toward the target level, and we shifted our policy stance last year. We lowered the policy rate to 2.5% through four rate cuts.

However, we also encountered various policy challenges throughout this process. During the rapid rate hike cycle, we faced a sharp currency depreciation and financial market instability. As we shifted our policy stance, financial imbalances intensified. Afterward, political turmoil emerged, amplifying the trade-offs among policy objectives. In response, the BOK employed a combination of policy tools. These included interest rate adjustments, short-term liquidity provision, foreign exchange market intervention, macroprudential measures, and targeted lending facilities.

This approach aligns with the core principles of the Integrated Policy Framework (IPF). The IPF was formally introduced by the IMF in 2020. Even before that, many emerging market economies had already adopted and implemented such policy practices.

II. BOK's Experience in Managing Trade-Offs Among Policy Objectives

I will now explain the BOK's experience in managing the trade-offs among policy objectives during the three different phases following the pandemic. These were the rapid rate hike phase, the policy transition period, and the rate cut phase.

① Phase of Interest Rate Hikes During the Second Half of 2022: Separate Responses to High Inflation and Instability in the Financial and Foreign Exchange Market

Let me begin with the second half of 2022. During this period, we applied the separation principle to address high inflation and instability in financial and FX markets.

At the time, the BOK had raised interest rates at the fastest and steepest pace in its history to curb inflation. However, throughout this process, financial stress and a sharp currency depreciation emerged at the same time. Amid growing credit risk aversion in financial markets, driven by the rapid rise in interest rates, a debt default at a local government-guaranteed project

triggered turmoil in the real estate project financing (PF) market.² This anxiety quickly spread to the commercial paper (CP) and corporate bond markets, leading to a broad-based credit crunch. In addition to the instability in financial markets, the Korean won sharply depreciated in the FX market as the Federal Reserve tightened its monetary policy stance more aggressively than expected.

Faced with this intensifying conflict between price stability and financial stability, the BOK determined that a timely and effective separate response was necessary. That was a combination of policy measures aimed at stabilizing domestic and external conditions.

On the domestic front, we continued raising interest rates to contain inflationary pressure. At the same time, we provided short-term liquidity to ease excessive risk premiums in the market. To this end, the BOK conducted repo purchases and expanded the range of collateral for lending facilities and securities for open market operations. The government also activated the Bond Market Stabilization Fund and implemented CP and corporate bond purchase programs. As a result of these efforts, market conditions stabilized rapidly. The corporate bond credit spread narrowed from 180 bp in November 2022 to 70 bp by February 2023. The liquidity injection was temporary and targeted in nature, so it did not undermine the overall monetary tightening policy stance. Also, it was in line with Bagehot's dictum,

² On Sept. 28, 2022, Gangwon Province decided to file for corporate rehabilitation on behalf of the Gangwon Jungdo Development Corporation. As a result, 205 billion won in Legoland project financing ABCP (rated A1) backed by the corporation's loan receivables was not repaid on Sept. 29. In response to the growing fallout from the incident, on Oct. 11 Gangwon Province pledged to honor its guarantee obligation and ultimately repaid the 205 billion won on Dec. 15.

as we applied interest rates above market levels.

On the external front, the BOK adopted a policy mix of a “big step” rate hike in October 2022, as well as FX market intervention, in order to moderate the pace of the currency depreciation. In Korea, the FX derivatives market is relatively small and dominated by short-term transactions. This structural feature makes the market particularly vulnerable to rapid depreciation. Sharp exchange rate movements can trigger margin calls on hedging positions, thereby amplifying downward pressure on the currency. Considering this vulnerability, we tried to adjust market expectations smoothly by managing the pace of depreciation rather than targeting a specific exchange rate. This approach contributed substantially to stabilizing the FX market, which shows a classic example of how the IPF can be effectively applied in economies with underdeveloped FX markets.

In addition, the BOK entered into a FX swap agreement with the National Pension Service (NPS) to ease spot FX demand for overseas investments. The NPS also benefited, as hedging was advantageous for risk management and returns during a period of unprecedented sharp currency depreciation. This FX swap agreement was a win-win strategic measure for both institutions.

② Period of Monetary Policy Transition in August 2024:

Response to Intensifying Financial Imbalances

Moving on to the second experience, it concerns the response to worsening financial imbalances in August 2024 during the transition period of monetary policy by combining interest rate adjustments with

macroprudential policy.

Looking at the circumstances, both domestic and external conditions provided sufficient room to moderate the extent of monetary tightening. Inflation had clearly slowed in Korea, as well as in many other countries. In fact, some advanced economies had already begun cutting their policy rates ahead of Korea. However, as expectations of a policy pivot by the Federal Reserve became widespread, domestic market interest rates declined sharply, even before the BOK initiated its rate cut. This led to a rapid easing of financial conditions. As a result, housing prices in Seoul surged at an annualized rate of 20% in August 2024. Household loans also increased by nearly 10 trillion won in a single month.

Against this backdrop, concerns emerged that a policy pivot by the BOK could further accelerate the rise in housing prices and exacerbate financial imbalances. In particular, Korea's household debt-to-GDP ratio stood at around 90%, already high enough to constrain private consumption.³ Moreover, the concentration of credit on the real estate sector, which has low productivity, posed a threat to the long-term growth potential. In addition, real estate accounts for a significantly larger share of household and financial institution assets in Korea than in other major economies. All this made it necessary to address this issue appropriately.

Based on this assessment, the BOK judged it appropriate to first propose to

³ According to Kwon et al. (2023) and to Cecchetti et al. (2011), a panel regression analysis showed that when the household debt-to-GDP ratio exceeds 80% and 85%, respectively, it has a negative impact on economic growth.

the government that it strengthen macroprudential policy measures, and then to adjust monetary policy only after confirming the effectiveness of those measures. Accordingly, we held the policy rate steady in August 2024. Unlike other advanced central banks, the BOK does not have its own macroprudential tools to directly address financial imbalances. Therefore, we proposed strengthening relevant regulations through consultation with the government. In response, the government broadened the scope and raised the interest rate applied to the Debt Service Ratio (DSR) regulations.

Supported by the Bank's rate freeze and by the government's macroprudential strengthening, housing prices and household loans began to moderate after September. As concerns over financial imbalances alleviated, we were able to carry out two consecutive rate cuts in October and November.

This close coordination between monetary and macroprudential policies provides a clear example of how the IPF can be effectively applied in economies that face structural vulnerabilities concerning household debt. It also underscores the importance of maintaining a firm macroprudential stance during the monetary easing phase.

③ Phase of Policy Rate Cut in January 2025:

Increased Domestic and External Uncertainties and Exchange Rate Volatility

Lastly, our third experience was in January 2025 during the easing phase. At that time, domestic political turmoil and heightened external uncertainties

simultaneously intensified downward pressure on growth and increased volatility in the exchange rate. We responded to this situation by combining policy rate adjustments with a lending program.

In December 2024, Korea faced an unexpected declaration of martial law followed by impeachment proceedings. This sharply dampened economic sentiment. The Consumer Sentiment Index fell to levels comparable to those last seen during the Global Financial Crisis (GFC) and during the early stages of the COVID-19 pandemic. The Business Sentiment Index also declined significantly.

Although Korea had gone through impeachment proceedings in 2004 and 2016, the situation then was different. Favorable external conditions at that time, such as China's rapid economic growth and a strong semiconductor market, helped restore sentiment and contain market instability.

This time, however, the external environment was less favorable. Trade uncertainty had heightened, global competition intensified, and the Federal Reserve paused its rate cuts. As a result, the won-dollar exchange rate rose to 1,480, the highest level since the GFC. At the same time, downward pressure on growth further increased and Korea's 2025 growth was expected to fall well below earlier projections.

Given the downside risks, the need for further rate cuts became stronger. However, heightened exchange rate volatility raised concerns that further cuts might worsen depreciation pressure. A rapid decline in the currency's value could not only fuel inflation and threaten financial stability, but could

also undermine international confidence in Korea's political and economic fundamentals. It could potentially raise concerns about a downgrade in the sovereign credit rating.

In light of these risks, the BOK decided to keep the policy rate unchanged in January 2025. Instead, we increased the amount of our Bank Intermediated Lending Support Facility by five trillion won to help offset downward economic pressure.⁴ This facility is a targeted credit program aimed at supporting small and medium-sized enterprises (SMEs) and the self-employed. It provided effective relief to those most affected by weakening consumer sentiment, particularly the self-employed. Meanwhile, its impact on interest rate differentials and exchange rate volatility remained limited. In February, as domestic political conditions began to stabilize, despite continued external uncertainty, we were able to deliver an additional policy rate cut to support the economy. This experience illustrates how lending facilities in conjunction with interest rate policy can serve as an effective policy mix in responding to simultaneous domestic and external shocks.

III. Lessons Learned So Far

In responding to the trade-offs through policy combinations, the BOK has gained many valuable insights. Today, I would like to highlight three key lessons: the importance of policy cooperation between the central bank and

⁴ The BOK's Bank Intermediated Lending Support Facility is a program that provides low-interest funds to banks in proportion to their lending performance. As of the end of 2024, the BOK supported 30 trillion won for 105 trillion won in bank loans (9.8% of banks' total SME loans outstanding).

the government, the challenges of policy communication, and the flexibility of policy mix application.

The first lesson is the importance of policy coordination between the central bank and the government.

Where policy instruments are dispersed across multiple institutions, close cooperation is essential. In Korea, four agencies—the Ministry of Economy and Finance, the BOK, the Financial Services Commission, and the Financial Supervisory Service—convene weekly to share updates on the economic and financial landscape. This regular communication provides a foundation that enables each institution to pursue its own policy mandates independently, while ensuring timely and effective coordination when needed.

However, unlike other advanced economies, the BOK does not possess its own macroprudential policy tools or micro-level supervisory authority. As a result, when there are differences in views concerning the strength or direction of policy, there is a risk that the speed and effectiveness of the response may be compromised. Accordingly, in the longer run, it is important to enhance the legal and institutional framework to strengthen the central bank's role in macroprudential policymaking.

The second lesson concerns the challenges of policy communication.

Under a floating exchange rate regime, monetary policy can be clearly communicated through the message “the exchange rate is left to the market, while macroeconomic stability is pursued through inflation targeting.”

However, when multiple policy tools are used, it becomes more difficult to intuitively convey such an approach to the market. If communication is unclear, policy effectiveness may also be diminished. Therefore, strengthening communication strategies and diversifying the tools become essential.

Indeed, when the BOK applied separation principle in the second half of 2022, some critics raised concerns that the Bank might be placing greater emphasis on financial stability at the expense of price stability. Given these concerns, there was a real risk that inflation could become entrenched if inflation expectations were not managed in a timely manner. In response, in October 2022 the BOK started presenting conditional Base Rate forecasts from Monetary Policy Committee members for the upcoming three-month period. This marked a clear shift away from the strategic ambiguity of the past. It also helped to quantitatively convey the direction of monetary policy and to shape market expectations that the Bank's tightening stance would be maintained and that inflation would stabilize.

Based on this experience, the need remains to further strengthen communication concerning policy direction. However, Korea is a small open economy with limited control over external shocks. Recognizing these constraints, the BOK is exploring ways to provide more concrete and effective guidance to the market.

Our third lesson is that the policy mix should be designed and applied flexibly, in accordance with country- and time-specific conditions.

Economic circumstances vary not only across countries, but also evolve over time within a single country. This means there is no one-size-fits-all solution. What matters is to design an optimal policy mix suited to a country's specific structure and to the nature of the shocks it faces.

Today, Korea has been able to respond more flexibly to currency depreciation than in the past. This is due to foreign exchange reserves exceeding 400 billion dollars and to structural improvements in the FX market. Since the GFC, the main drivers of capital flows have shifted from non-residents to residents, while overseas portfolio investment has expanded significantly. As a result, Korea has transitioned from a net debtor into a net creditor with 1.1 trillion dollars of net external assets.⁵ These changes have significantly strengthened the Korean economy's capacity to absorb any exchange rate shock.

Accordingly, while Korea previously had adopted a fixed or managed floating exchange rate regime, it now allows the exchange rate to be determined, in principle, by market forces. The BOK responds only when exchange rate volatility becomes excessive, using a combination of interest rate adjustments and FX market intervention to moderate the pace of movement.

Going forward, the BOK will continue to respond swiftly to internal and external shocks by conducting monetary policy and flexibly using other policy

⁵ Korea's net international investment position shifted from a negative USD 36.45 billion in 2000 to a positive USD 80.88 billion in 2014, and it reached USD 1,102.04 billion as of the end of 2024.

tools as appropriate to the circumstances. We will also make ongoing efforts to improve the financial and economic structure.

IV. Concluding Remarks

Today, I have shared how the BOK has addressed the growing trade-offs among policy objectives since the pandemic through a range of combined policies and I've touched on some of the key lessons we have learned in the process.

Seeking an optimal policy mix under any given set of economic conditions is a shared challenge not only for Korea, but also for all the policymakers from each country, international organizations, and the academic community gathered here today.

I sincerely hope that Korea's experience and the policy lessons shared today can make a modest yet meaningful contribution to helping other countries find better solutions and to strengthening the theoretical foundation of the IPF.

Thank you for your time and attention.

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