GREEN/20/19

March 23, 2020

Green Statement from Mr. Palei and Mr. Shestakov on the Republic of Korea—Financial System Stability Assessment (SM/20/65)

1. We thank staff for the report on the Financial System Stability Assessment and Mr. Heo, Mr. Shin, and Mr. Yoo for their informative Buff statement. We support the recommendations in the FSSA report and note that staff and the authorities mostly agree on the assessment of the key improvements and remaining challenges in the Korean financial system and related policy recommendations.

2. **We agree with staff's assessment that the Korean financial system is stable and the authorities have achieved commendable progress in strengthening the rules-based regulatory and supervisory regime, which is largely in line with international standards**. The key vulnerabilities are related to lower growth and interest rate environment, fintech developments, and aging population. While the countercyclical buffer for household exposures is desirable, we agree with the view in the Buff statement that, at this stage, the household credit growth does not seem excessive, and stress tests show only marginal increase in solvency risk.

3. **At present, the responsibility for macroprudential oversight in Korea is shared between financial supervisors, the central bank, and the government ministry**. While the formation of a specialized regulatory body with macroprudential oversight as its sole objective is desirable, we warn the authorities against the "one-size-fits-all" template, and think that different institutional options should be carefully considered. The focus should be on the appropriate coordination between monetary and macroprudential policies in the future.

4. **We commend the authorities for the measures to contain the COVID-19 outbreak, including supplementary fiscal resources for disease control efforts, SME support, and sustaining consumption and employment**. At this stage the economic impact of the COVID-19 is still uncertain, but the global shock, which the Korean economy is facing, is probably closer to the "extreme" stress scenario outlined in Appendix III. While the adverse scenario's economic downturn spans over two full years, our concern is that the stress test horizon of 30 days might be inadequate for a shock of this magnitude. We encourage the authorities to consider emergency lending facility from the BOK as an appropriate stimulus.

5. **We welcome the interest rate cut by the BOK to a record low of 0.75 percent**. The BOK considers it as an emergency move to combat economic damage from the COVID-19 outbreak. We would like to underscore macroprudential implications of this decision. According to the

latest SIP ("Evolution of Macroprudential Policies in Korea", April 23, 2019) monetary policy easing has been associated with significant and persistent fall in equity prices. LST results indicate that falls in financial asset prices have only marginal effects on banks liquidity buffers, both KRW and FX. However, in the presence of an adverse supply shock falling asset prices signal a scope for macroprudential policies to mitigate the downturn phase of the financial cycle. We, therefore, welcome the broadening of eligible collateral for open market operations by the BOK as a measure to provide liquidity to the financial markets.

6. **We note commendable progress with incorporating environmental, social, and governance (ESG) principles in the Korean financial system**. The continued integration of ESG risks into firms' business models will ensure financial stability against economic disruptions due to evolving climate policy and extreme weather-related events. The lessons from the Korean ESG experience for the green growth in other countries should be shared more broadly.