

Unofficial Translation

Please refer to the Korean original in case of any discrepancy.

Overall Assessment: Financial system remains broadly stable, but market volatility has increased

Domestic and External Conditions	<p>External: Continued impacts of Middle East developments and persistent volatility in global financial markets</p> <p>Domestic: Solid growth in the domestic real economy, alongside concerns over the pass-through of external shocks into domestic inflation</p>		
Financial Stress Index (FSI)	<ul style="list-style-type: none"> • Rose and then declined • Warning stage 	Financial Vulnerability Index (FVI)	<ul style="list-style-type: none"> • Continued to rise • Slightly above its long-term average

Financial Stability Situation by Sector

Household and Corporate Credit	Declining private credit-to-GDP ratio	Rising delinquency rates and accelerating loan growth
Financial and Asset Markets	Stock prices rose, reflecting improved corporate earnings	Accumulation of asset price increases
Financial Institutions	Sound resilience	Sharp rise in cross-sectoral exposures, driven by non-bank institutions
External Sector	Strong external payment capacity	Persistent exchange rate volatility

Risk Factors

Household and Corporate Credit	<ul style="list-style-type: none"> • Rising share of vulnerable household borrowers • Growing divergence in corporate financial soundness across industries
Financial and Asset Markets	<ul style="list-style-type: none"> • Potential for an increase in long-term market interest rates • Renewed expectations of housing price increases in the Seoul metropolitan area
Financial Institutions	<ul style="list-style-type: none"> • Increasing liquidity management burdens on non-banking financial institutions • Potential spillovers from distressed sectors
External Sector	<ul style="list-style-type: none"> • Persistent uncertainty in external conditions • Continued net outflows of foreign investment from domestic equities

Policy Responses

	Ensuring Market Stability	<ul style="list-style-type: none"> • Strengthening monitoring of risk factors such as leveraged investment and exchange rate volatility • Implementing timely market stabilization measures in times of market stress
	Strengthening Policy Coordination	<ul style="list-style-type: none"> • Conducting monetary policy with due consideration to inflation, economic activity, and financial stability • Strengthening coordination with macroprudential policies to prevent the buildup of financial imbalances
	Risk Management in Non-Banking Sector	<ul style="list-style-type: none"> • Enhancing proactive risk management reflecting the characteristics of each non-bank financial sector • Monitoring funding flows and linkages related to risk transmission across financial sectors
	Structural Reforms in Vulnerable Sectors	<ul style="list-style-type: none"> • Providing financial support based on borrowers' repayment capacity while facilitating debt restructuring and business recovery • Promoting structural transformation through closer coordination of financial, industrial, employment, and welfare policies tailored to each stage of self-employment

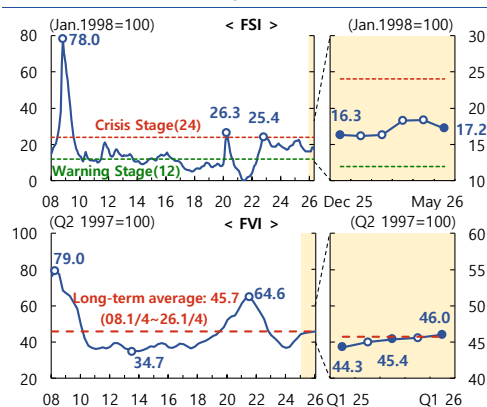
Overall Assessment of Financial Stability

Korea's financial system is assessed to remain broadly stable, supported by the sound resilience of financial institutions and strong external payment capacity, alongside stronger real economic growth, despite geopolitical risks in the Middle East and uncertainty in global financial markets. However, amid significantly heightened volatility in domestic financial and foreign exchange markets, potential sources of instability remain, including the possibility of a further buildup of financial imbalances stemming from a renewed increase in housing prices in the Seoul metropolitan area and an expansion of leveraged investment, as well as concerns over an increase in defaults in vulnerable sectors resulting from changes in financial conditions, such as higher interest rates.

Although the Bank of Korea has maintained the Base Rate at 2.50% since the second half of 2025, it judges that future increases in the Base Rate may be warranted at an appropriate time, taking into account rising inflationary pressure, the outlook for economic improvement, and financial stability risks. During the first half of 2026, growth in both household and corporate credit accelerated, while delinquency rates increased and default risks in vulnerable sectors remained elevated. In financial and foreign exchange markets, volatility in stock prices, interest rates, and the exchange rate all increased substantially. However, the resilience of financial institutions, as reflected in their capital and liquidity ratios, as well as the external sector's payment capacity, remained sound.

The Financial Stress Index (FSI),¹ which provides a comprehensive assessment of **short-term instability** across the financial system, stood at 17.2 in May 2026, the "warning" stage. After rising during March and April, the index **declined** again, but remained above the level of 16.3 recorded in December 2025. Meanwhile, the **Financial Vulnerability Index (FVI)**,² which reflects the financial system's **vulnerability from a medium- to long-term perspective**, rose gradually to 46.0 in the first quarter of 2026, slightly exceeding its long-term average of 45.7 since 2008.

Financial Stress Index (FSI)^{1) 3)} and Financial Vulnerability Index (FVI)^{2) 3)}



Notes: 1) A comprehensive index is derived by normalizing 20 indicators from the financial and real sectors, external sector, and banking and non-banking sectors, representing short-term financial system instability. Thresholds for the "warning" and "crisis" stages are set at 12 and 24, respectively.
 2) A comprehensive index is derived by normalizing 64 indicators related to three assessment factors (credit, asset prices, and financial institution resilience), representing medium- to long-term financial vulnerability.
 3) While re-estimating the model due to additional basic indicators, the relationships between indicators may be reassessed, causing the FSI and FVI values to change.

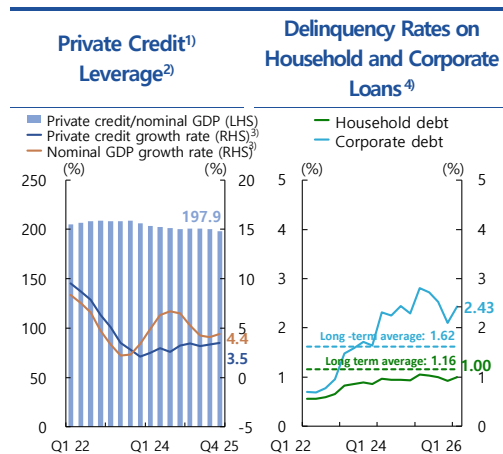
Source: Bank of Korea.

¹ The Financial Stress Index (FSI) is a comprehensive index calculated by normalizing 20 indicators related to financial stress across the financial market, real economy, external, banking, and non-banking sectors. The thresholds for the "warning" and "crisis" stages are set at 12 and 24, respectively, based on the noise-to-signal method. For details, refer to I. Financial Stability Situation by Sector "Box 7. Results of Financial Stress Index (FSI) Reform" in the Financial Stability Report from December 2023.

² The Financial Vulnerability Index (FVI) is a comprehensive index calculated by normalizing 64 indicators related to three assessment factors: credit, asset prices, and financial institution resilience. For details, refer to I. Financial Stability Situation by Sector "Box 1. Revision of the Financial Vulnerability Index (FVI)" in the Financial Stability Report of December 2025.

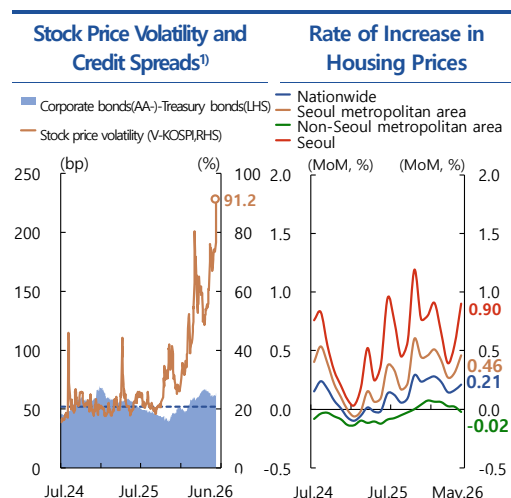
Financial Stability Situation by Sector

This section examines financial stability conditions in Korea by sector. With regard to **household and corporate credit**, household loan growth accelerated, driven in part by increases in housing-related and stock investment-related borrowing ahead of the expiration of the temporary suspension of higher capital gains taxes on owners of multiple homes. As households' debt-servicing burden eased amid income growth and rising asset prices, the delinquency rate on household loans remained below its long-term average. However, the share of vulnerable borrowers with insufficient repayment capacity increased.³ Meanwhile, growth in corporate loans increased modestly, led by lending by banks and loans to large corporations. The delinquency rate on corporate loans turned upward again this year and remained above its long-term average. Corporate financial soundness improved overall, although developments varied across industries.⁴ At the end of 2025, private credit leverage, measured as the ratio of private credit to nominal GDP, stood at 197.9%, with both the household sector (88.2%) and the corporate sector (109.8%) continuing their downward trends.



Notes: 1) Based on flow of funds statistics.
 2) Sum of nominal GDP for the given quarter and three preceding quarters.
 3) On a year-on-year basis.
 4) The long-term average is the average from Q1 2010 to Q1 2026.
 Source: Bank of Korea, financial institution business reports.

In **financial and asset markets**, long-term market interest rates in the bond market rose sharply amid changes in expectations regarding domestic and global monetary policy. Corporate bond credit spreads also widened slightly, remaining above their long-term average. In the stock market, share prices experienced corrections owing to factors such as geopolitical risks in the Middle East. Overall, however, they continued a steep upward trend and high volatility, supported by favorable conditions in the semiconductor industry and expectations of improved corporate earnings. Housing sale prices in the Seoul metropolitan area (SMA) began to rise more rapidly again amid heightened expectations of further price increases. *Jeonse* leasehold deposit amounts and monthly rental prices continued to increase both inside and outside the SMA. In contrast, the commercial real estate market continued to exhibit divergent trends,⁵ with the retail sector remaining weak and the office sector showing relatively favorable performance. Meanwhile, price volatility in crypto asset markets has moderated slightly from the elevated levels seen earlier this year.⁶

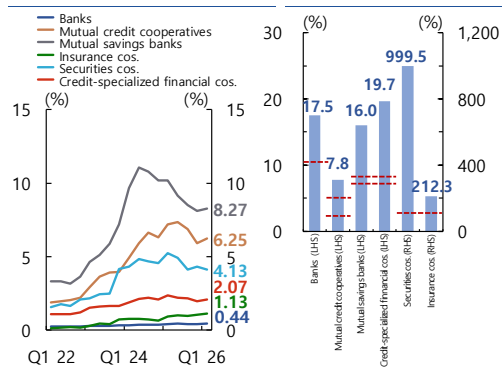


Note: 1) The dotted line indicates the long-term average since 2013.
 Source: Bloomberg, Korea Financial Investment Association, Korea Real Estate Board.

³ For details, refer to Box 1. "Assessment of Household Financial Soundness by Housing Ownership Type."
⁴ For details, refer to Box 2. "Industry-Specific Divergence in Corporate Sector Risks and Its Implications."
⁵ For details, refer to Box 3. "Assessment of Conditions and Risks in the Commercial Real Estate Market."
⁶ For details, refer to Box 4. "Recent Characteristics of Price Volatility in the Crypto Asset Market."

The **soundness** of **financial institutions** improved overall in terms of profitability, although asset quality exhibited divergent trends across sectors. Substandard or below loan ratios increased at banks,⁷ insurance companies, and securities companies, but declined at other non-bank financial institutions. Meanwhile, the **resilience** of financial institutions, as reflected in their shock-absorbing capacity, remained sound. Capital adequacy ratios stayed above the regulatory standards across all sectors, while liquidity ratios also remained at stable levels.

Substandard or Below Loan Ratios Capital Adequacy Ratios^{1) 2)}

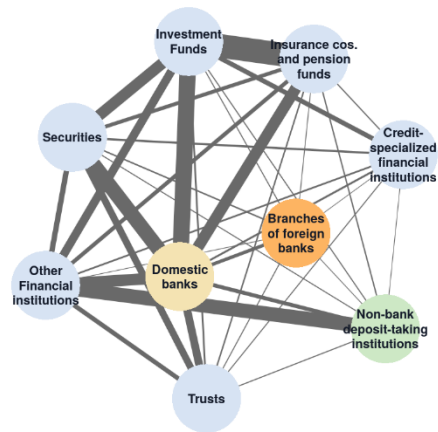


Notes: 1) The red dotted lines indicate the regulatory standards of each sector.
 2) Based on end of the first quarter of 2026 (end of fourth quarter of 2025 for insurance companies).
 Source: Bank of Korea, financial institution business reports.

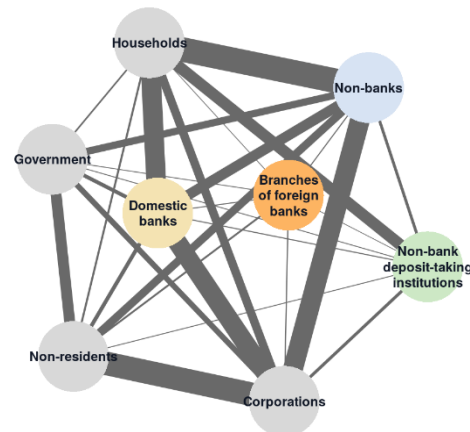
As for **interconnectedness**, linkages among financial sectors within the financial system strengthened overall, particularly through investment funds. In terms of financial sector-real sector interconnectedness, increased domestic and overseas equity investment deepened the intermediation structure whereby the non-banking sector channels funds raised from the household sector to the corporate sector and to non-residents (overseas).

Financial System Interconnectedness^{1) 2) 3)}

Among Financial Sectors



Between Real Economy and Financial System⁴⁾

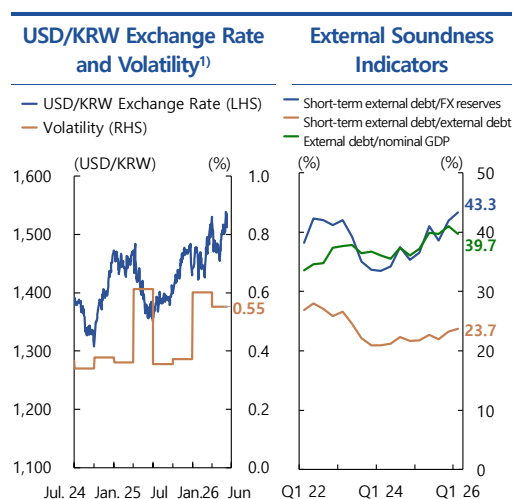


Notes: 1) Based on flow of funds statistics at the end of the fourth quarter of 2025.
 2) A network visualization analysis technique was used, with line thickness proportional to mutual transaction volume between sectors.
 3) Non-bank deposit-taking institutions include mutual savings banks and mutual credit cooperatives. Other financial sectors include financial holding companies, microfinance support institutions, securitization vehicles, and private money lenders. Pension funds include retirement pension funds, excluding the National Pension Service. Government includes central and local governments and social security entities, including the National Pension Service.
 4) The non-banking sector excludes branches of foreign banks and non-bank deposit-taking institutions.

Source: Bank of Korea.

⁷ For details, refer to Box 5. "Factors Behind the Increase in Non-Performing Loans at Domestic Banks and Their Resolution."

In the **external sector**, the USD/KRW exchange rate rose amid heightened volatility, depending on developments in geopolitical risks in the Middle East and the extent of capital outflows. In foreign currency funding markets, however, funding conditions remained generally favorable, as arbitrage incentives narrowed. During the year, foreigners' portfolio investment into domestic securities recorded a net outflow,⁸ led by equity investment, while residents' overseas portfolio investment showed a moderation in net investment. Although external soundness indicators weakened somewhat, they still remained at favorable levels. Accordingly, Korea's external payment capacity is assessed to remain strong.



Notes: 1) Based on the quarterly average of daily volatility, measured as the absolute value of the daily percentage change from the previous day.

Source: Bank of Korea.

As for **financial systems and policies** aimed at stabilizing the domestic financial system, financial authorities announced measures on April 1 to further strengthen household debt management, including the establishment of a target household debt ratio of 80% and restrictions on maturity extensions for loans to owners of multiple homes, with a view to mitigating linkages between the real estate market and the financial sector. In addition, in response to heightened volatility in the USD/KRW exchange rate, authorities implemented measures to flexibly adjust the macroprudential foreign exchange

framework, which had been announced on Dec. 19, 2025, thereby encouraging foreign currency inflows and helping to alleviate imbalances in foreign exchange market supply and demand. Furthermore, the government eased capital regulations on banks and insurance companies in order to expand the supply of funds to productive sectors. Meanwhile, risks associated with major payment and settlement systems, including BOK-Wire+, continue to be managed at stable levels as part of the financial system infrastructure.

Major Financial Stability Risk Assessment

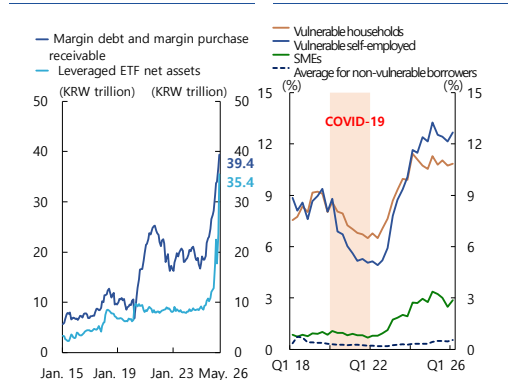
As discussed above, Korea's financial system has remained broadly stable. However, concerns over a further buildup of financial imbalances have increased, as volatility in financial and foreign exchange markets has risen significantly, leveraged investment has expanded, and housing prices in the Seoul metropolitan area have resumed a stronger upward trend. In addition, difficulties faced by vulnerable sectors persist despite improved real economic activity, and attention should also be paid to the possibility that their financial stress could worsen in response to changes in financial conditions. Against this backdrop, this Financial Stability Report closely examines the aforementioned risk factors and assesses the implications of rising market interest rates as well as potential risks in the non-bank sector in analyses of key financial issues. Furthermore, from a medium- to long-term perspective, the report provides an in-depth examination of financial stability risks associated with structural changes in the self-employed sector and explores possible policy responses.

Increases in market interest rates are expected to have the positive effect of mitigating the risk of financial imbalance accumulation. However, combined with domestic and external risk factors, they could also amplify volatility in government bond yields, facilitate the transmission of risks across markets through repurchase agreement transactions, or lead to a contraction in certain credit market segments. In the stock market, in particular,

⁸ For details, refer to Box 6. "Recent Developments in Foreign Investors' Portfolio Investment Flows into Domestic Securities."

given the recent rapid rise in stock prices and the increase in leveraged investing, stock prices are likely to react sensitively to even minor shocks. Meanwhile, in terms of the risk of borrower defaults, given the insufficient improvement in the distress in vulnerable sectors, which rose sharply due to COVID-19, there remains a persistent risk that defaults could spread or become prolonged, particularly in these vulnerable sectors, should lending rates rise. While the impact of rising market interest rates on the resilience of financial institutions is expected to be limited, attention should be paid to a possible increase in short-term financial stability risks.⁹

Leveraged Stock Investment and Delinquency Rates Among Vulnerable Borrowers



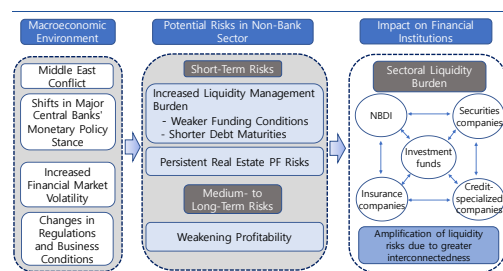
Notes: 1) Corporate loan delinquency rates are based on the combined data for banks and non-bank deposit-taking institutions.
2) Multiple debtors who are either low-income or low-credit-score households or self-employed borrowers.

Source: Korea Financial Investment Association, Bank of Korea estimates, Household Debt Database, and financial institution business reports.

Next, the report examines how recent changes in financial, economic, and institutional conditions have affected the liquidity, asset quality, and profitability of non-bank financial institutions, and analyzes the transmission channels of shocks based on the interlinkages within the financial sector.¹⁰ An

assessment of potential risks in the non-bank sector, whose influence within the financial system has grown over the years as a result of its rapid expansion, shows that funding stability has weakened for non-bank deposit-taking institutions (NBDIs), such as mutual finance institutions and savings banks, and for insurance companies, while the shortening of liabilities at credit-specialized financial companies and securities companies has increased the burden of liquidity management. In addition, although risks associated with real estate project financing (PF) have eased through restructuring, it is assessed that financial soundness has not improved sufficiently in some sectors, and the possibility of further defaults remains. Furthermore, the earnings base of non-bank deposit-taking institutions, credit card companies, and insurance companies has also weakened, partly due to institutional factors. To assess the likelihood that vulnerabilities in the non-bank sector could spread throughout the financial system via interlinkages, a system-wide liquidity stress test was conducted. The results show that, across all sectors, the amount of available liquidity was greater than the projected outflows in the event of a shock, suggesting that overall liquidity resilience remains sound. However, securities companies were found to have relatively stronger linkages with other sectors, making them more likely to transmit liquidity shocks across the financial system.

Types and Transmission Channels of Potential Risks in Non-Bank Sector



⁹ For details, refer to II. Analysis of Key Financial Stability Issues “1: Assessment of Financial System Stability in a Rising Interest Rate Environment.”

¹⁰ For details, refer to II. Analysis of Key Financial Stability Issues “2: Assessment of Potential Risks in the Non-Bank Sector and Policy Implications.”

Given the relatively high number of self-employed individuals in Korea compared to the number in other major economies, and their important role as a pillar of the Korean economy, it is necessary to assess their financial soundness and any potential risks it poses from a financial stability perspective. Loans extended to the self-employed (KRW 1,095.5 trillion as of end-Q1 2026) increased sharply during the COVID-19 pandemic and growth in such loans has recently moderated. Nevertheless, they still account for 28.5% of total financial sector loans and are considered to represent significant exposure within the financial system. Meanwhile, the self-employed sector has undergone simultaneous structural changes over the past decade across markets and industries, as well as demographic and financial dimensions. These include the expansion of online and non-face-to-face consumption, a growing concentration of self-employed workers and lending in the real estate sector, a decline in the number of younger individuals becoming self-employed alongside rising indebtedness among older self-employed workers due to demographic changes, weakening income-based debt-servicing capacity, and an increase in the number of self-employed borrowers who are financially vulnerable. These trends have become even more pronounced since the COVID-19 pandemic. This could lead to financial stability risks, including an increased risk of default among small-scale self-employed businesses and those in face-to-face service industries, a weakening of repayment capacity among self-employed borrowers in the real estate rental sector, the potential for non-bank loan defaults among older self-employed borrowers to spill over to the financial system, and a rise in loan delinquency rates concentrated on vulnerable borrowers. These potential risks could materialize if improvements in income conditions are delayed and if financial conditions become more restrictive in the period ahead.¹¹

Structural Changes in the Self-Employed Sector and Financial Stability Risks

Structural Changes in Self-Employed Sector		Financial Stability Risks
Market	<ul style="list-style-type: none"> Changes in consumption pattern driven by expansion of contactless and online consumption Divergence in business performance across industries 	Rising insolvency risks among small-scale and face-to-face service businesses
Industry	<ul style="list-style-type: none"> High shares of real estate sector in employment and loans High concentration of credit in real estate sector and increased capital allocation inefficiencies 	Increased risks for self-employed real estate operators
Age	<ul style="list-style-type: none"> Declining entry of young entrepreneurs and their falling shares Increases in the number of older self-employed individuals and their share of financial debt Divergence in the distribution of major industries among the self-employed individuals by age group 	Increased insolvency among older self-employed individuals and potential spillovers to non-bank sector
Finance	<ul style="list-style-type: none"> Increasing number of vulnerable self-employed borrowers Deterioration in income-based debt repayment capacity of self-employed households 	Potential materialization of latent credit risks among the self-employed amid tighter financial conditions

Policy Recommendations

To safeguard financial system stability during a shift in its monetary policy stance, the Bank of Korea will seek to identify potential sources of strain within the financial system in the early stages, by closely monitoring developments in domestic and external uncertainties and their impact on the real and financial sectors.¹² If necessary, the Bank will proactively pursue policy responses, including timely market stabilization measures, in close cooperation with the government. In particular, amid persistently elevated volatility in domestic financial and foreign exchange markets and the renewed acceleration of housing price growth in the Seoul metropolitan area, the Bank will conduct monetary policy with comprehensive consideration of inflation developments, economic conditions, and financial stability risks, while maintaining well-coordinated cooperation with macroprudential policies. Furthermore, the Bank will continue to work closely with relevant policy authorities to manage emerging risk factors that could affect the stability of the financial system, including climate change¹³ and advances in artificial intelligence.

First, as rising market interest rates could intensify volatility in financial markets in the short term, priority should be given to maintaining financial market stability. To this end, it is important to proactively address related risks and actively

¹¹ For details, refer to “III. Structural Changes in the Self-Employed Sector: Risks and Policy Responses.”

¹² It is necessary to continue monitoring the domestic spillover effects of external risk factors, including international oil prices, global interest rates, and exchange rates, following the conclusion of negotiations in the Middle East.

¹³ For details, refer to Box 7. “Developments in ESG Disclosure Regulation and Their Implications for Financial Stability.”

manage vulnerabilities in weak sectors. Financial institutions need to strengthen their liquidity management capacity to prepare against heightened long-term interest rate volatility, rollover risks in the repurchase agreement market, and potential difficulties in foreign currency funding. At the same time, the government and relevant authorities need to give due consideration to market conditions when issuing high-grade bonds. In addition, since higher market interest rates may increase debt-servicing burdens for vulnerable borrowers and weaken the soundness of financial institutions, efforts should be made to contain delinquency rates through the disposal of non-performing loans and proactive debt restructuring. Monitoring of short-term funding conditions should also be strengthened, particularly for financially vulnerable firms. Furthermore, excessive flows of profit-taking proceeds in the stock market into the housing market could undermine the effectiveness of higher lending rates in alleviating financial imbalances. It is therefore necessary to consistently manage expectations of housing price increases.

Next, given that non-bank financial institutions generally have weaker funding and investment bases than banks, proactive risk management tailored to the characteristics of each sector is assessed to be essential. NBDIs face the risk of increased deposit withdrawals, while credit-specialized financial companies and securities companies may encounter tighter refinancing conditions owing to higher market interest rates and stress in short-term funding markets. Insurance companies, meanwhile, could experience increased liquidity demand resulting from outflows from savings-type insurance products. Accordingly, these institutions need to maintain adequate liquidity buffers and strengthen their contingency funding plans. As the resolution of distressed real estate PF exposure in the non-bank sector could be delayed, particularly among non-residential projects outside the SMA, it is necessary to continue restructuring based on project viability assessments while establishing differentiated response strategies reflecting regional and property-type characteristics. In addition, it is important to proactively prevent the occurrence of further distressed assets by strengthening loan screening through enhanced PF assessment capabilities at financial institutions. Moreover, if the weakening of their profit-generating capacity resulting from institutional changes and intensifying competition

across financial sectors persists over an extended period, it could also undermine their liquidity management capacity. It is therefore important for relevant policy authorities to continuously monitor the evolution of related risks and strengthen the loss-absorbing capacity of non-bank financial institutions. In addition, considering the growing interconnectedness within the financial sector, particularly centering on the non-bank sector, future risk management should not only focus on identifying sectoral vulnerabilities, but also take into consideration potential risk transmission channels across sectors through stress testing that reflects interconnections within the financial system.

Financial stability risks in the self-employed sector have become increasingly concentrated on small-scale, face-to-face services, real estate, and older self-employed individuals, and on vulnerable borrowers as a result of structural changes. These risks could escalate rapidly depending on changes in interest rate conditions and developments in the service sector. Against this backdrop, future policy responses should focus both on proactively managing distress in vulnerable sectors and on alleviating the structural weaknesses of the self-employed sector. More specifically, building on existing financial assistance and business recovery programs, support systems should be refined to better reflect both borrowers' repayment capacity and business sustainability. Support is also needed to facilitate their digital transformation and enhance their management capabilities to help them better respond to the growing trend of online and contactless consumption. In addition, to enhance the medium- and long-term soundness of the self-employed sector, it is important to ensure that funds are smoothly allocated to more productive sectors. At the same time, financial institutions should strengthen proactive risk management through enhanced loan screening capabilities and prevent the accumulation of exposure to vulnerable sectors. In the medium to long term, a comprehensive policy framework that organically links financial, industrial, employment, and social welfare policies according to different stages of business development should be established in order to strengthen the resilience of the self-employed sector and secure a foundation for sustainable growth.