

DEVELOPMENT OF THE BANKING SYSTEM OF SOUTH KOREA IN THE CONTEXT OF DIGITAL TRANSFORMATION

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South Korea is chosen in order to study and evaluate the report. The Monetary Policy Instruments are briefly described and its Implications are shown that South Korea performs. This paper also analyzes profitability, liquidity, capital adequacy, and asset quality in the banking system for the ten years. All analyses and statistics will be finalized as a conclusion.

The central bank of South Korea is The Bank of Korea (BOK) and issues South Korean Won. BOK was founded on 12th of June 1950, in Seoul. The primary purpose of BOK is the price stability and the main functions of The Bank of Korea are as follows : to issue all currency; to plan and manage monetary and credit policy; to control foreign exchange business; to research major phases of South Korea's financial system and prepare statistics; to standardize and supervise private banks. The Bank of Korea conducts loan and deposit transactions for the government, and all internal banks' keep their solvency via the Bank of Korea. Moreover, the Bank of Korea consists in two department: Monetary Policy Committee and Auditor. Monetary Policy Committee has right to discuss the essential issues on monetary and credit policy, and resolve the subsequent acts of the BOK. The Auditor has to investigate all the bank operations and report to the Government and Monetary Policy Committee. The Governor, Senior Deputy Governor and the last five

Deputy Directors are executive officers of the Bank. The State Council inspects and recommend the candidates and the President (Park Geun-hye currently) appoints one of them as a Governor. The Governor (Kim Choong-soo currently) is elected for four years and can be reappointed only one more time. His/hers main duty is to control the Bank operations and evaluate monetary policies by following the Monetary Policy Committee's formulation. The Senior Deputy Governor (Lee Ju-yeol currently) is appointed by the President as well, but by the recommendation of the Governor. Moreover, Minister of Strategy and Finance, Governor, the Chairman of the Financial Services Commission, the Chairman of the Korea Chamber of Commerce and Industry and the Chairman of the Korea Federation of Banks recommend the candidates for the last five Deputies. . The duration of these positions is three years. All members have to work full-time and none of them can be recharged against their will. The President chooses the Auditor (Byung Moon Park currently) for three years term by following recommendation of the Minister of Strategy and Finance. The Bank of Korea is considered as a central bank, and the banking institutions divides into two parts, which are Commercial and Specialized banks.

According to the General Banking Act (evaluated in 1954), The Bank of Korea can regulate all commercial banks. Commercial banks achieve their assets through public deposits, overseas loans and borrowed money from BOK. Commercial banks operate in short-term loans and discounts. The long-term activities are prioritized by the Specialized banks like Korea Exchange bank, Korea Housing Bank and etc. South Korea has also other three financial development institutions who provide credits to supply businesses and government projects. (i) The Export-Import Bank gives medium and long run credits in order to facilitate services, development sources and international investment. (ii) The Korea Development Bank, who helps to fund the industrial and infrastructural projects. (iii) The Korea Long-Term bank provides financial aids to the equipment investments.

Monetary Policy and Implications

There are three main monetary policy instruments including open market operations, lending and deposit facilities and reserve requirements. The central bank of Korea (BOK) actively implements these monetary policy instruments in order to achieve a stable price in the country.

Open market operations

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By using open market operations, the central bank can buy and sell securities with financial institutions in the open markets. Therefore, this monetary instrument influences the amount of money in circulation and is considered as the main tool of the central banks.

Open market operations are used by BOK mainly to adjust financial institutions' shortages or surpluses of funds that is referred as steering the overnight call rate around the "Base Rate". Furthermore, in times of financial turmoil, by using open market operations, BOK expands its supply of liquidity to the markets and maintains stability in the financial markets. There are mainly three ways through which these financial operations are conducted by BOK, that are buying and selling Monetary Stabilization Bonds (MSBs), carrying out transactions with securities and finally, making commercial bank's deposits in the Monetary Stabilization Account.

Security transactions, which are also referred as selling or purchasing bonds are used by the central bank to supply or withdraw liquidity in markets. When the central bank increases money supply in the market by purchasing bonds in the financial markets, the market receives reserve money. This liquidity decreases in the reverse case when bonds are supplied to the market and money in circulation decreases. Securities which are in use in these transactions are confined to government bonds and government – guaranteed bonds in order to increase the efficiency of the markets and deal with the risks involved in the transactions.

Moreover, transactions are made in two forms including outright transactions and repurchase agreement transactions. Outright operations are referred as selling or repurchasing eligible securities on the market by the central bank. On the other hand, RP transactions are contracts including selling or buying with the conditions. This condition gives the chance to the central bank to buy back securities.

Lending and Deposit Facilities

Lending and Deposit facilities is an instrument of the central bank that supplies loans and receives deposits. This tool's functions refer to lend facilities along with its open market operation and reserve requirement system. Regularly, the central bank provides temporary loans to the individual financial institutions and receives their deposits. In March 2008, The Bank of Korea reformed its surviving landing facilities to turn them as "Lending and Deposit Facilities" and implemented Liquid Adjusted Loans and Deposits. In present, BOK includes (i) Liquidity Adjusted Loans, helps to financial institutions undergoing fund deficit, (ii) Bank Intermediated Lending Support Facility finances small and medium

enterprises, (iii) Intraday Overdrafts provides financial institutions with a daily funds-transfer.

Reserve requirements

The reserve requirement system is that monetary institutions have to hold a convinced ratio of their liabilities in their accounts with the Central Bank. The Central Bank controls liquidity in the market via adjustment of the reserve requirement ratios. Hence, the Central Bank increases the reserve ratio that causes to hold more money as their required reserve and reduces the loanable funds and amount of security purchasing and the volume of circulating money will decline. BOK establishes the reserve ratio regimes to the Commercial and Special Bank. Their ratios differentiates a range of 0 – 7% according bank's deposit liability status. According Bank of

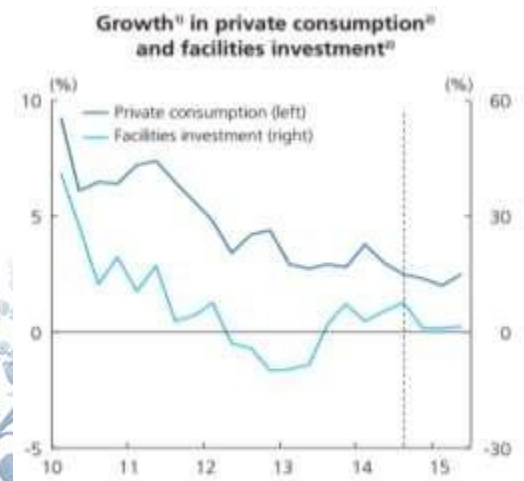
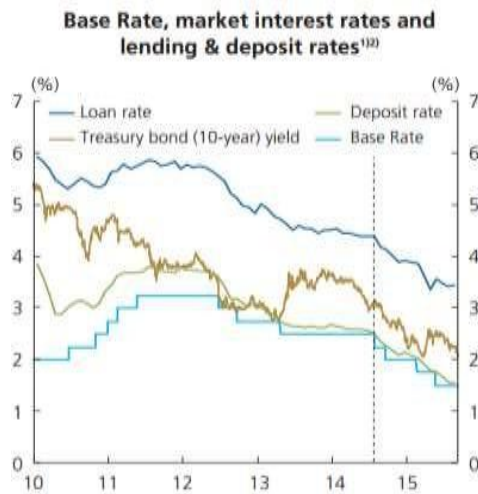
Korea Act (renewed in December 17, 2011), the reserve can be imposed as bank's debenture and/or deposit liabilities. Other monetary based institutions have to maintain their reserves as current deposits and can hold 35% of their reserves as a cash in BOK banknotes only.

Deposit type	Reserve Requirement Ratio
Long-term deposits for housing, Property formation savings	0.0%
Time deposits, installment savings, mutual installment, housing installment	2.0%
Others	7.0%

Source: www.bok.or.kr

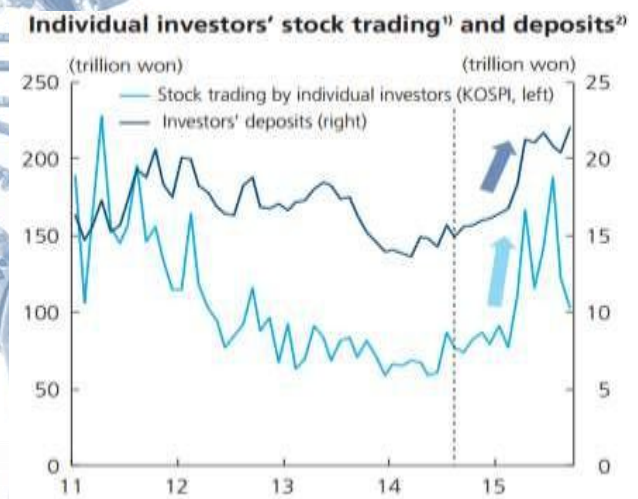
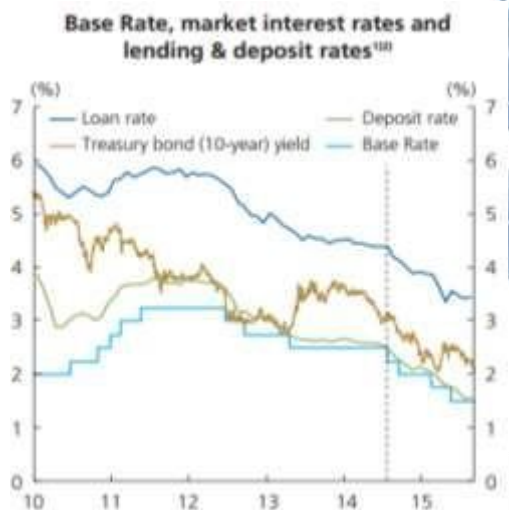
Transmissions Interest Rate Channel

The Bank of Korea adjusts the Base rate that has direct influence on the financial market as a whole, for example, short-term interests such as overnight call rates rises immediately due to increase of the Base Rate. Moreover, deposit and lending rates acts upward tendency and long- run interest rates turn under upward pressure. Altogether effects to aggregate demand for both consumption and investment



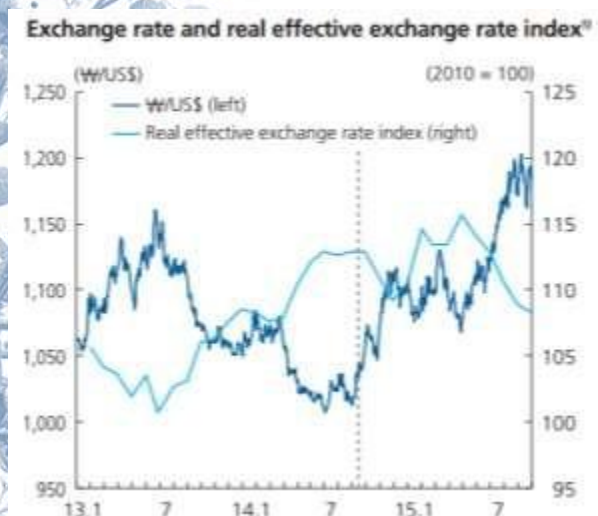
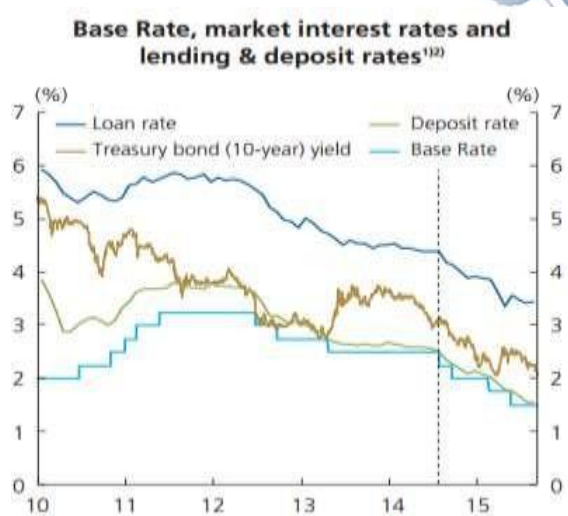
Asset Price and Credit Channel

As the Base Rate change, the price of assets (stocks, bonds, real estate etc.) changes. If the Base ratio remains constantly, banks can lend more actively, which influences to credit-takers by households and investment-consumers who need to rise business capitals. By applying it into business and taking *Ceteris Paribus* in consideration, a decrease of the base rate leads to change financial expenses and consequently to increase in investment. BOK's statistics illustrates the graph below.



Exchange Rate Channel

BOK rises the Base rate while other countries stay untouched and the Korean won will become more attractive asset due to higher return. People start to demand more which leads the appreciation of the won. In turns, appreciation of the currency leads to more demand for imports and lees amount of export because of the price push. By contrast, won devaluation increases to expert domestic goods and services, less export and more cash inflow that have influence to GDP. As Base Rate decreases, demand for the WON also decreases and causes to increase in real exchange rate.

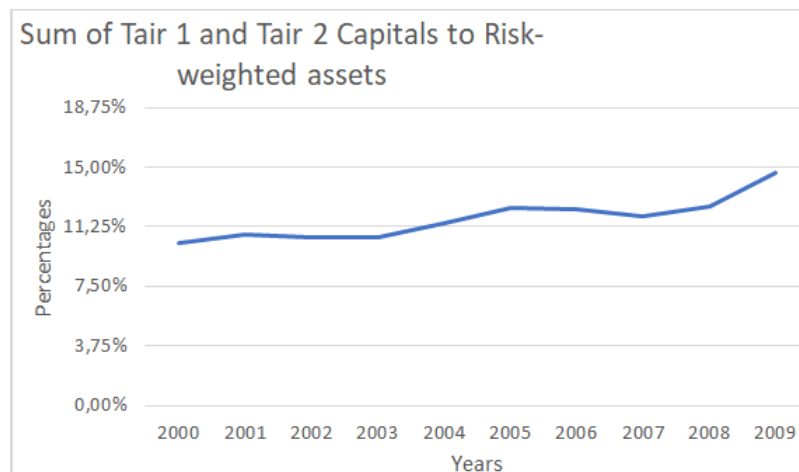


Expectation Channel

Changes in the Base Rate, expected inflation and updates in price reflect to each other as chain base. For instance, BOK are going resolve and make price inflation rate higher. The firms reprises the goods and services which bases real cost-push.

Ratios

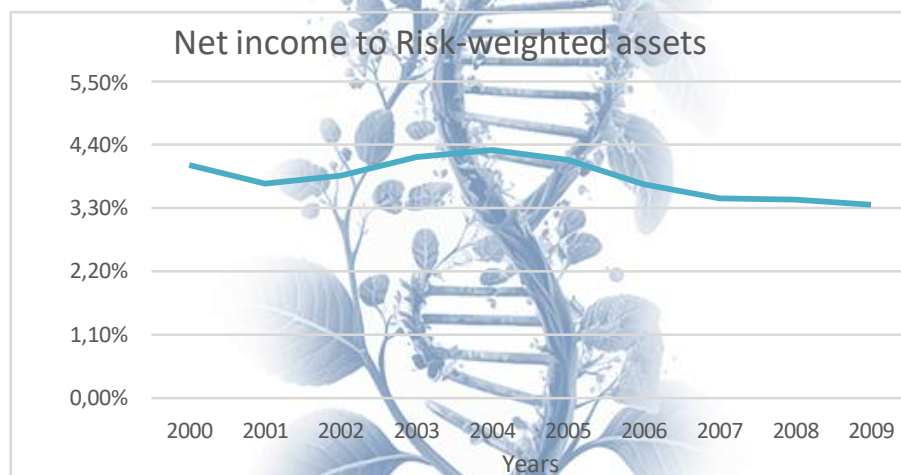
Capital Adequacy



Source: oecd.org

Trend of BOK's capital adequacy trend was upward sloping, during 2000 and 2009 from 10% to 14,66% which is an instrument to measure the capital.

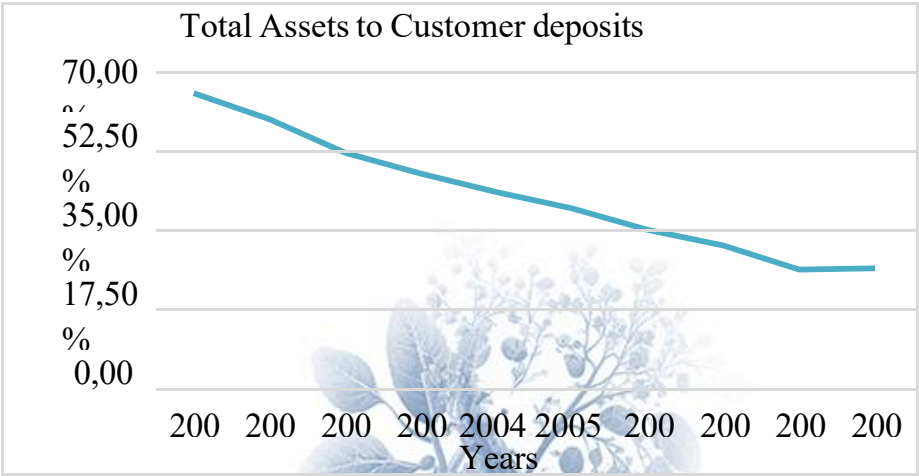
Profitability Ratio



Source: oecd.org

The action of profitability ratio of the Korean banking system changes in the range of 4,05% in 2000 and 3,33% in 2009. Its peak point was in 4,31%, 2004 and it was because of higher transitions in the economy. Afterwards, profitability ratio tended to decline and Middle east respiratory syndrome was reported as a key factor.

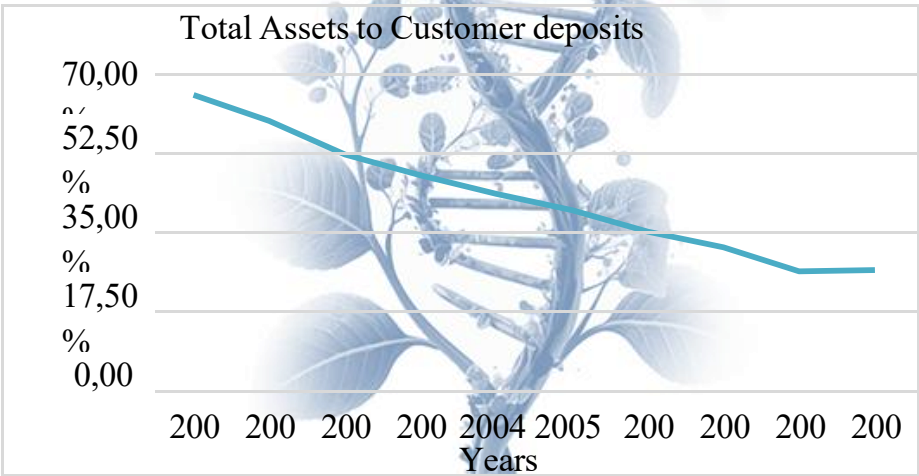
Liquidity Ratio



Source: oecd.org

According BOK’s (2010) annual report, during 2000 and 2008, the liquidity ratio declines from 65,37% to 26,34%, then acted stably. Significant declines in Liquidity ratio proves that Korean Government capability of repurchasing liabilities weakened, as they became due in those periods.

Asset Quality



Source: oecd.org

Korean banking system registered 2,72% Asset Quality in 2000 and yearly fluctuation. Overall, the trend was downward sloping. LLP to loans ratio is the second indicator to analyze Asset Ratio and almost the same results is obtained via using this technique.

Conclusion

In conclusion, the Bank of Korea aims constant economic growth via price stability and monetary stability became as common objective as a central bank that performances throughout the world. South Korea switched from annual inflation targeting to medium run targeting according to the Bank of Korea Act in 2013. Moreover, the BOK altered its policy rate strategy from “call rate target” to “Bank of Korea Base Rate” that strengthened the Korean potentials and introduction of standing facilities as a monetary policy could improve other economic variables.

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