Minutes of the Monetary Policy Board Meeting

August 2023

Bank of Korea

English version

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August 2023

Ⅰ. Outline

1. Date of meeting: Thursday, August 24, 2023

2. Place: Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:
   Rhee, Chang Yong, Chairman (Governor)
   Cho, Yoon-Je
   Suh, Young Kyung
   Shin, Sung Hwan
   Park, Chunsup
   Chang, Yongsung
   Ryoo, Sangdai (Senior Deputy Governor)

4. Monetary Policy Board members absent: none

5. Participants:
   Kang, Sungjun, Auditor
   Min, Jwa Hong, Deputy Governor
   Lee, Sang Hyeong, Deputy Governor
   Lee, Jongryeol, Deputy Governor
   Kim, Woong, Deputy Governor
   Chae, Byung Deuk, Deputy Governor
   Choi, Chang Ho, Director General of Research Department
   Kim, Inkoo, Director General of Financial Stability Department
   Hong, Kyung Sik, Director General of Monetary Policy Department
   Park, Jongwoo, Director General of Financial Markets Department
   Oh, Kum Hwa, Director General of International Department
   Kwon, Min Soo, Director General of Reserve Management Group
   Min, Jun Gyu, Director General of Office of Legal Affairs
   Choi, Yong Hoon, Director General of Monetary Policy Board Secretariat
   Kim, Yong Sik, Press Officer
   Cho, Tae Hyoung, Interim Director General of Economic Research Institute
   Choi, Mun Seong, Head of MPB Administrative Support Team

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1) This English version is an excerpt of each Policy Board member's opinion on the Bank of Korea's Base Rate decision, taken from the Minutes of the Monetary Policy Board Meeting.

Ⅱ. Discussions Concerning Monetary Policy Decision

At the August 24 Monetary Policy Board meeting, each member expressed their opinion on the Bank of Korea’s Base Rate decision.

All members shared the opinion that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to leave the Base Rate unchanged at the current 3.50% level for the intermeeting period.

One member presented the view that it would be desirable to keep the Base Rate at its current level of 3.50%.

The member assessed that the global economy had been slowing due to the accumulated impact of high interest rate policies. The member noted that consumer price inflation in most countries had passed its peak, but that uncertainties as to the inflation outlook path were still high.

Looking at domestic economic conditions, the member stated that even though the rebound in the real economy had been less robust than projected, the unemployment rate had notably remained low, and current accounts were anticipated to improve. The member expressed the view that due to the base-period effect, consumer price inflation had been stablizing at a faster pace and had remained at the 2% range for two consecutive months. Meanwhile, the member added that we couldn’t rule out the possibility that the rate would climb back to around 3%, driven by import prices, including oil prices, and climate conditions.

The member commented that the financial market had shown increased volatility in interest rates and exchange rates due to external factors, such as the rise in U.S. Treasury yields and growing concerns over risks associated with China. However, the member also noted that private capital flows had, for the most part, followed a steady path. The member assessed that as the situation regarding the Korean Federation of Community Credit Cooperatives (KFCC) was gradually resolved, discussions about enhancing oversight of the non-banking sector and managing its soundeness had been gaining momentum. However, the member also pointed out that unless the issue was addressed through concrete and effective structural reforms, there remained a risk of encountering similar challenges in the future. The member further emphasized that it is time for courage and determination to fundamentally improve the system.

The member judged that, despite Korea's high interest rates, there had been insufficient deleveraging of household and corporate debt. The member presented the view that while deleveraging may be painful, it does ensure an economy’s soundness and sustainable economic growth in the long-term. The member added that a somewhat positive aspect was the government debt-to-GDP ratio, which had remained favorable compared to other OECD nations. However, the member noted that if we included the debts of state-owned enterprises accumulated during COVID, the public sector's debt ratio was estimated to be significantly higher than official statistics. The member commented that, considering the trends of a low birth rate and an aging population, along with the anticipated rise in welfare expenditures in the future, our mission would be to pass on a sound fiscal legacy to the next generation.

The member stated that maintaining fiscal soundness, as well as a reduction in private sector debt, were crucial in terms of monetary policy operation. The member added that we had gained clear insight into how substantial fiscal expenditures, which had inevitably heightened during COVID, had impacted inflation. The member added that history has shown that central bank interest rates and monetary policy were not entirely independent from fiscal policies.

The member stated that over the past several decades, the world had been enjoying growth without inflation. However, the member pointed out that it is uncertain whether China would be able to sustain its historical role as a global manufacturing hub, which had supplied affordable products in large quantities. The member commented that the momentum for trade expansion and globalization, which had led us to economic growth with low inflation, became weakened due to the changes in international politics and economic environments. The member added that now is the time for us to keep the Base Rate unchanged at the current 3.50% and to monitor the effects of the high interest rate policy that we have kept so far. At the same time, the member presented the opinion that we needed to put our utmost effort into preparing for uncertainties that may unfold in the future and in enhancing economic resilience.

Another member noted that it would be appropriate to maintain the Base Rate at the current level of 3.50% for this meeting.

The member saw that, while the global economy had maintained relatively robust growth despite ongoing interest rate increases and persistent inflation, there had been an intensification of divergence among countries. The member stated that, in the cases of the U.S. and Japan, growth had exceeded expectations, driven by the recovery in demand for services and favorable employment conditions. However, the member noted that in China the prolonged slump in exports and stress on the real estate market there had led to a heightened risk of a slowdown in structural growth. The member noted that, in our economy, concerns about the future growth trajectory had grown as service consumption had weakened in the midst of a sustained export slump. Nonetheless, the member pointed out some positive factors, such as the increase in semiconductor exports since May, improved conditions for Chinese tourist visits to Korea, and a record-high declared foreign direct investment amount in the second quarter. However, the member also presented the view that it would be difficult to expect a rapid rebound due to the lack of any clear improvement in the export slump, particularly in exports to China, as well as because of intensified constraints on structural growth, including weakening consumption propensity in-line with the population aging, reduced consumption and investment capacity stemming from accumulated debt, and deteriorating job quality. The member projected that consumer prices and core inflation would converge to around 3% in the latter half of this year and to the lower to mid-2% range next year, as initially expected.

The member saw that, on the financial stability front, imbalances between the real and financial sectors were widening again due mainly to the continued increase in private sector debt and the accelerating uptrend in housing prices in the Seoul metropolitan area, although growth and inflation were expected to gradually converge toward more balanced levels. The member noted that, in particular, household debt was maintaining high growth due to a combination of supply factors, such as policy financing support, and demand factors, driven by expectations of housing price increases. The member thus urgently called for a more proactive policy response. Meanwhile, the member noted that in financial markets, long-term market interest rates had risen, affected by expectations of a prolonged tightening stance by the U.S. Federal Reserve. The member argued that, while such a synchronization of the financial cycle with a key currency country could have positive effects in preventing any excessive widening of domestic and foreign interest rate differentials, attention should be paid to the possibility that it could weaken the transmission channel of domestic monetary policy. The member commented that, in foreign exchange markets, the Korean won to U.S. dollar exchange rate had risen significantly due to the strength of the U.S. dollar. The member pointed out that high exchange rate volatility could persist for some time, depending on the movements of major currencies. Therefore, the member saw the need for economic entities to strengthen their preparations for exchange rate fluctuations.

The member assessed that, while inflation would likely generally maintain the initially projected trajectory going forward, the trade-off among policy objectives had grown, as downside risks to growth had increased and as financial imbalances had expanded. The member judged that, taking into comprehensive account these changes in economic and financial conditions, it would be necessary to maintain the Base Rate at the current level at this meeting, while monitoring future changes in domestic and international conditions, such as growth and inflation trajectories, financial stability conditions, major country monetary policies, and economic fluctuations.

Another member expressed the view that it would be appropriate to maintain the Base Rate at the current level of 3.50% for the intermeeting period.

The member noted that major economies had shown more favorable growth than expected, but they were expected to continue to slow going forward. In global financial markets, the member observed that, while long-term government bond yields in major economies had risen rapidly, other price variables, including stock prices and exchange rates, had fluctuated considerably depending on changes in expectations of monetary policy in major countries.

The member viewed that the improvement in domestic economic growth had slowed somewhat. The member saw that, while the decline in exports had expanded again owing to the continuous slump in the semiconductor industry and a weakened recovery trend in China's economy, facilities investment remained sluggish, as well. The member mentioned that the recovery in private consumption had also slowed, affected by aggravated weather conditions and weak pent-up consumption. The member judged that the domestic economic growth trend would be consistent with the May forecast in general, but that uncertainties remained high surrounding major variables on the growth path, such as growth trends in major economies and the timing of the IT sector recovery.

The member stated that consumer price inflation had continued to moderate. The member observed that, as petroleum product prices had fallen significantly owing to the base effect from the surge in global oil prices last year, and as the rise in the prices of personal services and processed food products had continued to slow, consumer price inflation fell to the lower 2% level in July. The member mentioned that core inflation had also slowed at a modest pace. The member expected inflation to fluctuate slightly going forward, but to continue its modest slowdown pace. The member pointed out, however, that it would be necessary to watch the pace of decline in core inflation more carefully. The member added that the key point here was how long the effects of accumulated cost pressure would last.

Concerning financial markets, the member assessed that volatility had heightened due to the rise in government bond yields in major economies and uncertainties over China's economic recovery. Looking at the housing market and household debt conditions, the member noted that housing prices shifted to a rise, led by the Seoul metropolitan area, and that household debt grew by a larger extent driven by mortgage loans. Given these circumstances, the member pointed out the need to be attentive to the possibility of delayed deleveraging of household debt, namely, the resumption of household debt accumulation.

In summary, the member stated that it would be appropriate to maintain the Base Rate at 3.50% at this meeting, given high uncertainties surrounding the future growth path and inflation, as well as the need to prevent financial imbalances from escalating. With respect to the monetary policy direction going forward, the member observed that the Board would have to adjust the extent of policy tightening through further rate hikes, if necessary, while thoroughly monitoring whether major indicators could mean a downward stabilization of inflation and a resolution of financial imbalances.

Meanwhile, another member expressed the view that maintaining the Base Rate at the current level of 3.5% would be appropriate at this meeting.

Concerning the global economy, the member noted that the possibility of a soft landing for the U.S. economy was rising, supported by brisk consumption and production based on solid employment. Meanwhile, the member commented that China was at a stage of possible deflation, as inflation fell amid the slowing economy. The member added that in China there are growing concerns about financial unrest due to the petition for bankruptcy and the potential default of real estate developers. In the euro area, the member stated that Germany had been experiencing difficulties, but that the slump had been somewhat easing overall on the back of an improvement in the service industry, including tourism. The member noted that the Japanese economy showed favorable growth, emerging from the sluggishness that had lasted for the past three decades, thanks to the rise in facilities investment and foreign tourists, but that it remained to be seen whether the growth would continue due to tepid consumption. Regarding the Korean economy, the member assessed that its economic slowdown had been easing gradually and that the economic recovery trend would continue due to an improvement in the IT sector and a rise in the number of Chinese tourists, but that the degree of improvement would differ depending on China's recovery from its recession and on the extent of the recovery in semiconductor unit prices.

Looking at external conditions, the member viewed that the trade account recorded a surplus for two months in a row in June and July, led by an increase in exports of automobiles and vessels, and the decline in imports owing to falling energy prices. The member forecast that, if the sluggishness in the IT sector is eased going forward, the decrease in exports would decelerate and external conditions would improve. The member added that, in the process, it would be necessary to respond more effectively to the trend of global supply chain reorganization. The member noted that the current account switched to a surplus in May, recording a surplus of 2.44 billion dollars in the first half, and, according to the Bank of Korea forecast, it would post a surplus of 27 billion dollars for the year. The member stated that entering this year, private consumption had shown signs of recovery on the back of pent-up demand, but that consumption regarding outside activities, such as food, accommodation, and travel, was sluggish due to the longer-than-usual rainy season and in particular considerable precipitation in May and July. The member anticipated that going forward private consumption would recover modestly, considering the favorable employment conditions and the consumer composite sentiment index.

The member also noted that consumer price inflation in July recorded 2.3% in July, the lowest in 25 months, due to the fall in petroleum product prices and the base effect from last year, but that it would rebound again after August. The member mentioned that core inflation had continued to slow, but that uncertainties remained along the future inflation path regarding international oil price developments, the extent of any increase in public utility charges, such as subway and bus fares, and developments in grain and food prices affected by the Russia-Ukraine war. In terms of the employment situation, the member commented that the employment and unemployment rates remained robust with the number of persons employed in July increasing by 211,000, led by those aged 60 or older and by women, but that the scale of the increase was the lowest in 29 months. The member pointed out that this was attributable to the decline in the number of persons employed in the agricultural, forestry & fisheries sector and to the decline in the number of day laborers affected by torrential rains, in addition to the fall in the number of persons employed in the manufacturing and construction industries. The member forecast that, going forward the employment market would continue to grow driven by the services sector, but that the extent of any increase in the number of persons employed would narrow in-line with the trend of a slowdown in employment in the construction and manufacturing industries.

The member noted that, with respect to financial markets, volatility in the stock, bond, and foreign exchange markets had heightened due to the strength of the U.S. dollar and due to stress in the Chinese real estate market. The member saw that the Korean won to U.S. dollar exchange rate had been fluctuating at the 1,300 won range of late, and that it was expected to stabilize downward in the future due to factors such as a recovery in exports. The member commented that household loans in the financial sector had been increasing for four consecutive months, leading to a rise in household debt, which raised growing concerns that this would pose constraints on future economic operations and threaten financial stability. The member saw that, this year, the volume of apartment transactions had been steadily increasing, leading to an increase in mortgage loans and household debt. Therefore, going forward the member emphasized the need for more careful management to prevent the household debt-to-GDP ratio from rising. In addition, the member stated that corporate loans in July increased by 8.7 trillion won, indicating a continuing upward trend. The member thus demanded that corporate debt be managed, together with household debt, which was at one of the higest levels in the world.

The member noted that, taking into account the conditions surrounding the Base Rate decision for the moment, there was a mix of upside and downside factors at play. The member stated that, while inflation was on a downward trend, it was expected to exceed the target level for a considerable period. The member also saw that risks in vulnerable areas, such as real estate project financing, had not been resolved. The member commented that the economy was somewhat easing from its slump, but that it had not entered a full-fledged recovery phase yet, and household debt was on an increasing trend. The member added that the Korean won to U.S. dollar exchange rate was fluctuating at around the mid-1,300 won level, and that the tightening stance in major countries would likely persist for some time, as there was a possibility of further rate hikes by the U.S. Federal Reserve. In overall consideration of the above mentioned situations, the member suggested that the Base Rate should be maintained at the current level of 3.50%. The member also saw the need to make decisions on matters, including whether to proceed with an additional rate hike, while examining certain factors between now and the next meeting, like trends in core inflation, developments in financial markets, including the Korean won to U.S. dollar exchange rate, the extent of household debt growth, the pace of recovery in the real economy, including the real estate market, and decisions concerning monetary policies in the U.S. and other major countries.

Another member also expressed the view that it would be appropriate to keep the Base Rate at its current level of 3.50% for the intermeeting period.

The member assessed that the global economy had exhibited more favorable growth than expected in the first half of the year, but forecast that downward pressure on the growth path would likely increase due mainly to the cumulative impact of monetary tightening and the possibility of a sluggish recovery in the Chinese economy. Concerning the U.S. economy, the member stated that there were growing expectations of a soft-landing of the U.S. economy based on continued strong consumption and employment, and that inflation had continued to slow. The member, however, presented the view that, since the main factors behind the decline in inflation so far, such as supply chain improvements and declines in global oil and commodity prices, had disappeared, inflation going forward would likely be dependent heavily on employment conditions and wage growth. The member assessed that, as the recent robust U.S. employment situation had been working to limit any decline in service sector prices, there was significant uncertainty regarding potential further declines in inflation, given the large share of the service sector in the U.S. economy. The member added that, in this regard, there were strengthened market expectations of the U.S. Federal Reserve maintaining its monetary tightening stance for a longer period than initially forecast. With regard to China, the member pointed out that the Chinese economy had been experiencing weakening recovery momentum, affected by a slowdown in exports resulting from sluggish overseas demand. The member added that economic uncertainties had increased significantly due to the sluggishness of the real estate market.

Regarding the domestic economy, the member assessed that, although the sluggishness in exports had eased somewhat, uncertainty surrounding the sustainability of the maintained economic recovery had increased, with consumption recovery slowing and investment remaining sluggish. The member commented that employment conditions had been generally consistent with the original forecast, but that the pace of growth in the number of persons newly employed had been slowing, and that these new employees consisted mainly of the elderly and women, and, finally, that they had been mostly hired in the service sector. The member projected that, despite the factors mentioned above, GDP growth for this year would be similar to the previous forecast, boosted by a recovery in exports in-line with the recovery in the global IT industry and also by inflows of Chinese tour groups. The member however assessed that downward pressure on the future growth path had been strengthening owing to persistently high domestic and external uncertainties, and particularly due to factors such as the sluggish recovery in the Chinese economy and rising U.S. Treasury bond yields.

Concerning inflation, the member judged that consumer price inflation and core inflation had slowed, affected heavily by the base-period effect. Going forward, the member assessed that consumer price inflation had the possibility to rebound to the 3% range after the base-period effect dissipates, and that core inflation was expected to continue to slow at a moderate pace. However, the member added that uncertainties still existed owing to international oil price trends and weather conditions.

The member saw that, in financial markets, expectations of a prolonged tightening stance by the U.S. Federal Reserve, along with shifts in supply-demand conditions for U.S. long-term Treasury bonds, had resulted in a significant rise in the U.S. 10-year Treasury yield. The member added that this had led to a synchronization with long-term government bond yields in Korea, further strengthening the degree of tightening of financial conditions. The member added that, owing to the anticipation of housing price increases, particularly in the Seoul metropolitan area, there had been a notable expansion in household loans, primarily in mortgage loans. The member projected that, considering the strong likelihood of ongoing tightening in the U.S. financial landscape over an extended period and the growing potential for prolonged tightening within the domestic financial setting due to the interest rate co-movement of South Korea and the U.S., the risk per unit of household debt had increased. However, the member commented that in order to effectively address the accumulated household debt, it would be desirable to assess not only the overall quantity of household debt, but also its qualitative aspects, including evaluations of risk weighted HH debt amounts based on the distribution of DSR. Meanwhile, the member stated that while the sudden withdrawal issue at certain non-bank financial institutions seemed to be resolved, delinquency rates at both banks and non-bank financial institutions were still on the rise. The member emphasized the importance of thorough preparations to avoid any potential spillover from problems in vulnerable sectors to wider financial system instability. Looking at the domestic foreign exchange market, the member noted that the Korean won to U.S. dollar exchange rate had risen significantly. The member added that this was driven by several factors, including the strength of the U.S. dollar due to strengthened expectations of prolonged tightening at the U.S. Federal Reserve, uncertainties surrounding the recovery in the Chinese economy, and the potential decrease in the U.S. dollar supply from a supply-demand perspective. However, the member judged that, considering the significant scale of the Korean economy's net foreign financial assets and foreign exchange reserves, excessive market intervention or policy responses in terms of monetary policy were deemed undesirable.

Considering these economic and financial conditions at home and abroad, the member judged that it would be desirable to keep the Base Rate unchanged at the current 3.50% for the intermeeting period. The member expressed the view that it would be important to thoroughly assess the direction and scale of any additional adjustments to interest rates, while closely monitoring how factors like growth, inflation, and the conditions of domestic and international financial markets would develop compared to the projected trajectory.

Another member judged that it would be appropriate to maintain the Base Rate at 3.50% at the meeting.

The member stated that recent domestic and overseas economic developments and outlooks appeared to be similar to those during the July meeting. The member argued that, despite rapid policy rate hikes, the U.S. economy had continued to grow, bolstered by a strong labor market and consumption, resulting in a higher likelihood of a soft-landing. The member mentioned that the Chinese economy had been recovering at a slower-than-expected pace due to the country's real estate slump and sluggish exports, while economies in the euro area had been showing weak recoveries due to the sluggishness of the manufacturing sector there, in spite of a recovery in tourism. The member added that the Japanese economy had been emerging from a decades-long recession and showing some recovery, but there seemed to be some uncertainty regarding its sustainability going forward. The member noted that global trade had remained sluggish, probably due to the fact that the global economic recovery since last year had been driven primarily by the services sector, and went on to state that global oil prices had risen, boosted by the extension of production cuts by OPEC+. The member added that inflation in major countries had been slowing, but that it would take a considerable period of time for inflation to stabilize at the target level.

The member noted that the domestic economy had continued to slow but, although the economy had been somewhat sluggish due to recent climate factors, consumption had continued to recover and the sluggishness in exports had been easing somewhat. The member indicated that the semiconductor industry appeared to be bottoming out, boosted by production cuts at major suppliers and by AI-related demand. The member stated that employment had been more favorable than initially projected, although the pace of growth in the number of persons employed had continued to slow gradually. The member mentioned that housing prices had recently shifted to an increase and that the pace of growth in housing prices in the Seoul metropolitan area had been accelerating. The member added that consumer price inflation had slowed considerably due to the base-period effect, but that it was likely to accelerate again starting in August, and the member went on to state that the slowdown in core inflation had been less pronounced than originally expected.

The member assessed that the financial and FX markets had continued to ease overall, while showing high volatility owing to concerns about prolonged monetary tightening by the U.S. Federal Reserve and risks involving China's real estate sector. The member judged that Treasury bond yields had declined substantially and then risen again recently, affected by a rise in U.S. Treasury bond yields, which followed concerns about prolonged monetary tightening by the U.S. Federal Reserve and a possible worsening of Treasury bond supply conditions, and the member added that short-term interest rates had declined, influenced by a rise in MMF deposit-taking. The member argued that it was time to stay on alert against the recent expansion in the extent of growth in household loans in-line with domestic real estate price movements, and also against the accelerating growth in corporate loans. The member added that deliquency rates at banks and non-banks had been rising steadily and that a close watch should still be needed on whether certain non-bank financial institutions would remain stable.

The member stated that, considering all this, it would be appropriate to maintain the Base Rate at 3.50% at this meeting. The member mentioned that, since uncertainties remained high regarding FX market developments in-line with monetary policy trends in major countries, and also regarding the consumer price inflation and core inflation paths toward the target, the possibility of further rate increases should be left open.