Minutes of the Monetary Policy Board Meeting

May 2023

Bank of Korea

English version

Minutes of the Monetary Policy Board Meeting[1)]

May 2023

Ⅰ. Outline

1. Date of meeting: Thursday, May 25, 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
   Lee, Seungheon (Senior Deputy Governor)
   Shin, Sung Hwan
   Park, Chunsup
   Chang, Yongsung

4. Monetary Policy Board members absent: none

5. Participants:
   Kang, Sungjun, Auditor
   Bae, Joon Suk, Deputy Governor
   Min, Jwa Hong, Deputy Governor
   Lee, Sang Hyeong, Deputy Governor
   Lee, Jongryeol, Deputy Governor
   Kim, Woong, Deputy Governor
   Min, Jun Gyu, Director General of Office of Legal Affairs
   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 of Financial Markets Department
   Oh, Kum Hwa, Director General of International Department
   Kim, Yong Sik, Press Officer
   Cho, Tae Hyoung, Interim Director General of Economic Research Institute
   Choi, Yong Hoon, Director General of Monetary Policy Board Secretariat
   Choi, Mun Seong, Head of Monetary Policy Board Team

1) This English version is an excerpt of each Monetary 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 May 25 Monetary Policy Board meeting, each member expressed their opinions 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 projected that, although the global economy had maintained more favorable growth than originally forecast in the first quarter of this year, growth would slow going forward due to the effects of monetary tightening in the midst of potential risks of default in the financial sector. The member indicated that the U.S. economy showed a slow pace of decline in price inflation, as well as moderate growth, bolstered by robust employment and consumption. The member expected a gradual contraction in the U.S. real economy going forward due to banking sector stress. The member noted that the Chinese economy was recovering rapidly, led by domestic demand after the reopening, but that the spillover effects from the reopening were not greater than initially expected, as its external trade had been relatively subdued due to a delayed recovery in the global IT industry and a high level of inventory. The member commented that, going forward, this, combined with structural factors, such as economic and geopolitical fragmentation, and an increase in self-sufficiency in China, would likely work as factors causing uncertainties surrounding the Korean and global economic growth paths.

The member noted that the domestic economy was recovering moderately from a sharp contraction at the end of the previous year caused by one-off factors, but that it remained somewhat sluggish affected by downward pressure from external conditions. The member observed that consumption and production had undergone slight adjustments in April after huge increases in the first quarter, and that investment and exports were also sluggish. The member added that operating profit margins at listed companies in the first quarter were below the long-term average due to a sharp contraction in their operating profits compared to the same period last year. The member commented that, after the second half of the year, it was expected that there would be a gradual recovery as external conditions would improve, but that the pace of recovery is expected to be slower than initially anticipated. Accordingly, the member projected that the growth rate for the year would be 1.4%, slightly lower than the February projection of 1.6%. The member's evaluation was that there is significant uncertainty regarding the timing and pace of the recovery due to a mix of upside and downside risks along the future growth path.

In terms of prices, the member noted that consumer price inflation had shown a clear slowdown due to the base-period effects and a decline in petroleum product prices. The member also commented that, although the growth momentum of core inflation was seen to have weakened, some rigidity still remained, particularly in service charges. The member pointed out that, in the second half of the year, it would not likely be easy for inflation to continue its ongoing slowing trend as the base effects of consumer prices were expected to decrease and the extent of any further decline in international oil prices would likely be limited. Accordingly, the member projected that consumer price inflation and core inflation would exhibit similar movements in the future, influenced by a second round of spillover effects caused by accumulated cost pressures, favorable service demand, labor market conditions, and other factors.

The member remarked that the financial market had generally remained stable as risk aversion sentiment had eased somewhat and as price variables had fluctuated within a limited range. However, the member noted that the amount of delinquent loans had increased significantly, particularly those taken out after the pandemic, and that this had led to a rise in bank loan delinquency rates. The member added that delinquency rates of some non-bank financial institutions, which had significantly increased their exposure to real estate financing, had also continued to increase sharply. The member thus expressed the need to carefully monitor the situation in vulnerable sectors. The member pointed out a need to pay attention to the possibility of increased instability in the overall financial market, taking into account the fact that a simultaneous increase in the issuance volume in the bond market could cause a greater burden from excess bond supply and affect market interest rates, combined with other financial and economic conditions, in the second half of this year. The member noted that, in the domestic foreign exchange market, the Korean won to U.S. dollar exchange rate had risen influenced by supply conditions, but that it had generally remained stable overall, with decreasing volatility.

The member judged that, considering these domestic and international economic and financial conditions, it would be appropriate to maintain the Base Rate at the current level of 3.50% at this meeting. The member remarked that the current interest rate level was estimated to be consistent with economic growth and the inflation outlook. The member judged that the gap between domestic and overseas interest rates would have limited impacts on the exchange rate and on foreign exchange supply and demand. The member mentioned stated that, therefore, it would be desirable to examine a policy direction with a focus placed on domestic conditions, such as growth and inflation, for some time.

Another member assessed that the global economy had been more favorable than originally forecast. Concerning the U.S. economy, the member remarked that, boosted by a robust labor market and consumption, the U.S. continued to experience steady growth. The member observed that although the impact of monetary tightening and credit contraction was still limited, the growth outlook was expected to weaken gradually in the second half of the year. Concerning the Chinese economy, the member assessed that it had exhibited stronger than expected growth with a significant increase in services consumption and sustained growth in fixed asset investment since its reopening, while external trade had been relatively sluggish. The member mentioned that, amid the eased energy risk, the euro area had been showing gradual improvement, particularly in the services sector. The member also noted that international oil prices had dropped to the mid-70 dollar level due to concerns about a slowdown in major economies, and that global trade had remained sluggish, primarily in the goods sector.

The member commented that the domestic economy continued to slow with persistent weakness in the IT sector and a delayed spillover effect from China's reopening. Regarding private consumption, the member assessed that, while credit card usage appeared to be slowing recently after a significant increase in April, the consumer sentiment index had been improving for three consecutive months. The member also pointed out that facility investment remained sluggish due to the slowdown in the IT sector, while construction investment had shifted to a decline as new construction starts had slowed due to a reduced budget for government SOC spending. The member indicated that exports had also remained sluggish, particularly in the IT sector, but that they had eased somewhat recently in terms of average daily exports. The member noted that employment had been more favorable than initially expected, with steady growth in the number of persons employed in the services sector. The member also pointed out that the real estate market had seen a slowing decline in housing sales prices and leasehold deposit prices and an increase in transaction volume. Concerning domestic inflation, the member argued that consumer price inflation had declined substantially due to the base-period effect of petroleum prices, but that the decline was slower than originally expected, with personal service prices sustaining strong growth.

The member judged that the financial and foreign exchange markets had been generally accommodative. The member assessed that, although domestic short-term interest rates had risen somewhat recently, investor sentiment in financial markets had improved on expectations of an end to the U.S. monetary tightening cycle, and foreign exchange supply and demand conditions remained stable. The member noted that in April the COFIX rate had fallen below the Base Rate, household lending had shifted to an increase for the first time in eight months, and corporate lending growth had also accelerated. The member argued meanwhile that, given the volume of the expected issuance of government and public bonds, as well as bank debentures, in the second half of this year, this was likely to put upward pressure on market interest rates. Furthermore, the member argued that the increased level of interest rates had led to a rise in delinquency rates, particularly among vulnerable borrowers of loans to households, the self-employed and SMEs, and that the upward trend in delinquency rates would continue until the end of this year. The member presented the view that the current delinquency rate and the estimated level of future delinquencies were still lower than the average delinquency rate over the past decade and were expected to be at a level that the financial sector could tolerate. However, they went on to argue that it would be necessary to carefully examine and respond to the possibility that loan defaults related to real estate project financing might increase the delinquency rate of some non-bank financial institutions and trigger financial market instability.

The member noted that the Korean won's exchange rate had been stable overall on the market expectation that the U.S. interest rate hike cycle was coming to an end. Furthermore, consumer price inflation had been slowing, albeit slower than initially anticipated, and was expected to stabilize at around 3% by the end of the year. The member also assessed that core inflation remained sticky, raising concerns about inflation persistence, but was expected to decline to the mid- to high 2% range by the end of the year with upward momentum weakening toward the second half of the year.

The member presented the view that, in overall consideration of the above mentioned elements, it would be necessary to keep the Base Rate at its current level of 3.50% for the intermeeting period, while keeping a close watch on growth and inflation trends, stability of the financial sector, the direction of monetary policies in major countries, and developments in foreign exchange and exchange rates. The member also underscored the need to maintain the monetary tightening stance until there is confidence that inflation will stabilize in the 2% range, and went on to argue that the possibility of further rate hikes should not be ruled out if necessary.

Meanwhile, another member recognized that despite banking sector instability, such as the Silicon Valley Bank (SVB) bankruptcy, the world economy exhibited a better than expected trend. The member noted that, while the spillover effects of China's reopening were more delayed than expected and while the expansion of the euro economy was not substantial, the U.S. economy had demonstrated moderate growth backed by solid labor market conditons.

The member mentioned that the domestic economy continued to slow due to sluggishness in the IT industry, including semiconductors, and due to the smaller than expected effects of China's reopening. However, the member predicted that the domestic economy would fare slightly better in the second half of the year than in the first half, supported by the recovery of the semiconductor industry. With regard to external conditions, the member commented that Korea recorded a trade deficit for 14 months in a row through to last month, with exports falling for a seventh straight month since October, and that the Korean won to U.S. dollar exchange rate had been staying at the 1,300 won range. The member noted that, as the recovery of the semiconductor industry had been delayed due to a lagging global IT industry and smaller than expected spillover effects from China's reopening, Korea's economic recovery had been slow. The member argued that the rise in self sufficiency concerning China's intermediate goods worked as a disadvantage for Korea's exports, given the high proportion of intermediate goods among Korea's exports to China. Therefore, the member added that structural changes in export items and a diversification of export destinations were needed. The member mentioned that due to a combination of these factors, Korea posted a current account deficit in the first quarter this year for the first time in 11 years, since 2012. The member judged that, while Korea was expected to record a current account surplus for the year, it would be desirable to take more proactive measures in managing the current account balance going forward.

Regarding private consumption, the member commented that the Composite Consumer Sentiment Index (CCSI) had risen and that private consumption exhibited a modest improvement led by the services sector, while facilities and construction investment were sluggish. The member argued that consumer price inflation slowed at a steady pace, as it reached the 3% level in April for the first time in 14 months, but core inflation was sticky at 4.0% for three months in a row as personal service prices remained elevated. The member noted that with potential destabilizing factors regarding inflation, such as unstable international oil prices stemming from OPEC+'s oil production cuts in the future, the Korean won to U.S. dollar exchange rate trends, and possible additional hikes in electricity and gas fees in the second half of the year, uncertainties along the inflation path remained high. The member mentioned that since the liquidity that had increased during the COVID-19 pandemic was being unwound and since it still acted as a contributor to inflation, it would be necessary to maintain a restrictive monetary policy for the time being. The member also noted that, regarding employment conditions, there was an upward trend in the number of employed women and of those aged 60 and older, driven by the services sector. However, the member added that the number of persons employed in the manufacturing sector had decreased for four months in a row due to decreased exports and a sluggish manufacturing industry, and that there had been a decline in the number of employed young people aged from 15 to 29 for a sixth consecutive month.

The member pointed out that the financial market had been stable recently despite the unrest in the U.S. banking industry. On the interest rate front, the member saw that, as market interest rates had fallen excessively, it could lessen the extent of financial tightening and work as a constraint on monetary policy effects to some degree. The member mentioned that, as interest rates are low and the housing market slowdown had moderated recently, bank lending to households, including mortgages, had turned to an increase. The member noted that, as this will put a drag on the future operation of the economy, including household debt management, it would be necessary to manage the situation more thoroughly. The member commented that savings banks were highly exposed to real estate project financing loans, which experienced a bank run in 2011 due to loan delinquencies. The member noted that, though it is true that the probability of a crisis taking place is low compared to the past, because the delinquency rate has been rising recently and as the industry as a whole has posted net losses in the first quarter, risk management was needed. The member judged that current financial conditions were tight, even considering the Financial Conditions Index (FCI) and the real money gap rate. Therefore, the member added that, as credit risk issues could emerge from some non-bank financial institutions with high exposure to real estate PF loans in the process of any prolonged monetary policy tightening, it would be necessary to properly respond to those problems when the need arises, while closely monitoring market developments. The member commented that the

Korean won to U.S. dollar exchange rate had been stuck at around the 1,300 won range recently, owing to the ongoing trade deficit caused by weak exports. The member assessed that, since the record high interest rate differential between Korea and the U.S. could destabilize exchange rates and expand volatility in the foreign exchange market, it would be important to keep a close eye on foreign exchange movements and prevent any rise in foreign exchange volatility.

In conclusion, the member presented the view that with the destabilizing factors to inflation still present, it would be necessary to maintain a restrictive policy stance until the achievement of price stability becomes certain, and that we needed to pay attention to household debt management and make sure that the record high interest rate gap between Korea and the U.S. does not cause financial market distress. The member assessed that in overall consideration of the domestic economic and financial conditions mentioned above, it would be appropriate to leave the Base Rate unchanged at the current 3.50% at this meeting and judge whether the Base Rate needs to rise further by examining core inflation trends, the growth path, and by monitoring monetary policy changes in major economies going forward.

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

The member commented that, despite high inflation and unrest in the U.S. banking sector, the global economy had been showing a recovery, albeit at a moderate pace, due to accumulated excess savings and improvements in employment. The member indicated that, in Korea, despite the ongoing recovery trend in private consumption, the growth rate in the first half of this year was lower than those in major countries, as the recovery in the IT industry, which had been expected to rebound after bottoming out in the second quarter, was being delayed, and as the spillover effects from China's reopening were being limited. The member noted that uncertainties still remained high related to the timing of a rebound in the semiconductor industry, and to recoveries in China-bound exports and foreign tourist inflows. The member forecast that, in the medium- to long-term, sluggish facilities investment and deteriorating employment quality would act as downside risks to growth potential.

The member commented that, while global inflation was gradually decreasing, it still remained at a high level, particularly in core items, due to the combined effects of the recovery in demand for services and a second round of spillover effects. The member remarked that, although consumer price inflation in Korea decreased to the 3% range in April, core inflation continued to show downward rigidity, exceeding consumer price inflation.

The member noted that the domestic financial market was maintaining a relatively stable situation with volatility in price variables declining and credit spreads falling slightly. However, the member assessed that the volatility could increase again depending on the supply of bonds, such as bank debentures, mortgage-backed securities, and KEPCO bonds. The member added that there were significant potential risks with the delinquency rates for non-bank institutions, especially in vulnerable industries, continuing to rise.

The member presented the view that, in overall consideration of these economic and financial conditions, it would be necessary to keep the Base Rate at the current level and monitor the spillover effects of interest rate policy and the development of domestic and international economic conditions for some time. The member argued that, looking ahead, it would be necessary to maintain the current tightening stance for a considerable time, taking into account a couple of points.

First, the member mentioned that, while disinflation was ongoing, consumer price inflation was expected to remain at the high level of around 3% in the second half of this year, and that the pace of decline in core inflation was expected to be very moderate. The member noted that, looking at the past 30 years of deflationary periods, core inflation generally declined at a slower pace compared to consumer inflation, leading to a narrowing or reversal of the gap between the two. However, the member noted that the current deflationary period had the characteristics of an even more moderate pace of decline in core inflation due to combined effects of a number of price shocks. The member pointed out that, in particular, the highly persistent core service inflation appeared to be because the accumulative cost-increasing factors, such as oil prices, exchange rates, wages, rents, and borrowing costs, were being passed on to consumer prices on the back of the recovery in the services sector since last year. The member expressed the opinion that it was fortunate that the downward trend in inflation expectations had been ongoing since the beginning of this year, but considering the long lag in the transmission of inflationary pressures, it would be necessary to keep a close eye on inflation for a considerable time.

Second, the member recognized the need to take into consideration the fact that there was still significant concern about financial imbalances. The member remarked that, while household loans in the financial sector had deleveraged since September last year, they turned positive in April due to a shift to an increase in home mortgage loans and a slower decline in credit loans. The member presented the opinion that, while this was attributable to an increase in policy financing, such as Special Bogeumjari Loans (Government-Sponsored Mortgage Loans), a decline in market interest rates stemming from weakened expectations for domestic and international rate hikes also had a significant impact.

Third, the member also expressed the need to consider that there is a significant risk of increased exchange rate volatility. The member indicated that the Korean won to U.S. dollar exchange rate had generally been led by the movements of the U.S. dollar index until early this year. However, the member observed that, as domestic factors, such as concerns about the current account, had become more prominent since March, the Korean won to U.S. dollar exchange rate had been showing a weakening trend, accompanied by a weakening of the U.S. dollar. The member argued that volatility of the Korean won could expand again if international financial risks, such as negotiations on the U.S. debt ceiling, increased, and all of this would be occurring in the current situation where there was still room for an additional rate hike by the U.S. Federal Reserve.

The member argued that, taking these factors into account, it would be necessary to maintain the current tightening stance for a considerable time in the conduct of monetary policy, while pursuing price stability and domestic and international financial stability. The member also emphasized the need for stronger collaborative operational efforts with financial and fiscal policies to ensure a stable economic recovery and to achieve structural improvements.

Another member commented that, while world economic growth was projected to decelerate slightly, consumer price inflation in most countries seemed to have peaked, though core inflation still remained elevated. The member noted that there were still high uncertainties concerning external conditions, including financial unrest resulting from the collapse of some banks overseas.

Looking at the domestic economy, the member mentioned that, although economic growth had fallen short of earlier expectations, the number of persons employed maintained a better than expected trend. However, the member remarked that, while the recovery of employment since the COVID-19 pandemic had been driven by the elderly and women, employment of the young and of middle-aged men had been improving at a slow pace. The member noted that this was primarily attributable to the downturn in the manufacturing and construction industries, but that it was also affected by structural changes in those industries. The member therefore judged that the effects of interest rate policy on employment would be somewhat limited.

The member commented that, although various price indices, including consumer price inflation, had seemingly peaked, core inflation has been sticky, as in other countries. Given the potential increases in public utility fees and the Korean economy's characteristics of there being heavy reliance on external conditions, the member argued that it would be imperative for us to maintain a vigilant stance. The member judged that it would be desirable to take a conservative approach to inflation, since it could have great negative effects on the economy across the board if inflation expectations were to become anchored at high levels.

As for the financial and foreign exchange sectors, the member assessed that the impacts of the interest rate differential, as well as the U.S. banking crisis, on exchange rates were limited. However, the member raised concerns that, while many countries had witnessed deleveraging of household debt as a result of interest rate hikes thus far, deleveraging has not been sufficiently achieved in Korea. The member noted that the high household debt ratio could weigh on future policy operations. The member also argued that the rapidly rising delinquency rate on loans to low-credit borrowers and small businesses could be another potential risk factor.

The member noted that, in sum, even though consumer price inflation had peaked and entered a cooling phase, we couldn’t yet afford to be complacent. The member argued that, given that the current monetary policy tightening stance had begun in order to deal with a buildup in financial imbalances and inflation, it would be premature to let our guard down now. The member deemed it warranted to freeze the Base Rate at the current 3.5% amid high uncertainties at home and abroad, and observe whether the policy target would be fully achieved by closely monitoring risk factors to inflation and financial stability.

Another member assessed that the domestic economy continued to experience a slowdown in growth. The member stated that exports and facilities investment had remained sluggish, as downside risks from the overseas sector had materialized, such as the continued contraction of the global IT industry and the delayed spillover effects of China’s reopening. The member however judged that private consumption had sustained its recovery momentum, particularly in the services sector, and added that the favorable employment situation had been supporting household income and partly offsetting the economic downturn.

The member expected this sluggishness to ease into the second half of the year. The member forecast that services consumption would continue its moderate recovery and exports would also improve with the easing of sluggishness in the Chinese economy and the IT sector. The member however projected that the pace of growth recovery would be slower than previously forecast in February. The member pointed to the need to note that this growth path was accompanied by significant inherent upside and downside risks, due to various uncertain factors, such as the timing of the IT sector rebound and the pace of China's economic recovery.

The member noted that inflation remained well above its target. The member assessed that consumer price inflation had declined to the upper 3% level in April, due mainly to stronger base-period effects of supply factors, such as petroleum product prices, while core inflation, excluding food and energy, had been sticky, remaining high at 4.0% for the third consecutive month. The member judged that prices of personal services, which have strong downward rigidity, maintained a strong upward trend, boosted by robust demand for services, while spillover effects from cost increases, such as electricity and gas charges, also added to the upward pressure on core inflation.

The member forecast that consumer price inflation would show a distinct slowdown for some time due to the base-period effect, while core inflation, representing the trend of inflation, is facing increased upside risks. The member assessed that the decline in core inflation had been slower than expected due to the continued pass-through of accumulated cost pressures into prices and the sustained upward momentum of service prices. The member judged that, given the stickiness of prices and inherent uncertainties, it would be necessary to maintain a monetary tightening stance for a considerable period of time in order to anchor inflation to the target path.

Looking at the financial situation, the member assessed that the current Base Rate was analyzed to be in restrictive territory, running well above the neutral rate range, while overall financial conditions had become much less tight compared with the previous year-end. The member noted that both short- and long-term Treasury bond yields had been below the Base Rate since the beginning of the year, and bank deposit and lending rates had also declined substantially. Regarding credit supply, the member indicated that corporate lending continued to show strong growth, and that household lending growth was shifting back to an increase driven by increased demand for housing-related funds. More specifically, the member added that the real estate sector was exhibiting a slower adjustment recently, with real estate price indices declining at a much slower pace and apartment transaction prices showing an upward trend in certain areas.

Meanwhile, the member assessed that the risks of financial instability, which had been a concern, appeared to have eased somewhat. The member argued that the financial and foreign exchange markets in Korea remained stable overall, as instability surrounding small and medium-sized U.S. banks and the debt ceiling issue remained as factors increasing market volatility, but had only limited impact on international financial markets. The member also judged that the risk of real estate-related defaults spreading to the entire market had decreased, as the decline in housing prices had slowed. The member, however, argued that, given deteriorating funding conditions in the real estate and construction sectors, it would be important to closely monitor the soundness of non-bank financial institutions with high exposure to these vulnerable sectors.

The member noted that, taking into consideration these overall situations, it would be appropriate to keep the Base Rate at its current level of 3.50% for the intermeeting period, while continuing to monitor developments in the real economy, including growth and inflation. The member presented the view that, concerning inflation, upside risks had increased due to stickier than expected core inflation, but in terms of growth, there were considerable uncertainties surrounding the IT industry, the Chinese economy, and the U.S. financial situation. The member emphasized that, given the recent slow decline in core inflation, it would be particularly necessary to closely examine whether there is any possibility of inflation deviating from its original forecast path due to financial conditions that had eased significantly compared to the policy stance. The member added that, if convergence of inflation on its target level is deemed to be significantly delayed, aggressive measures should be taken through additional rate hikes.