Minutes of the Monetary Policy Board Meeting

July 2023

Bank of Korea

English version

Minutes of the Monetary Policy Board Meeting[1)]

July 2023

Ⅰ. Outline

1. Date of meeting: Thursday, July 13, 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:
   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 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 Monetary Policy Board Team

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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.

Ⅰ. Discussions Concerning Monetary Policy Decision

At the July 13 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 judged that it would be appropriate to maintain the Base Rate at 3.50% at the meeting.

The member stated that the global economy had continued to grow moderately. The member noted that the U.S. was showing a more favorable growth trend than initially expected, as its growth rate forecast for this year had been adjusted upward despite the steep policy rate hikes so far. The member commented that the euro area, overall, showed a sluggish recovery trend, albeit differentiated from country to country, and maintained high inflation. The member noted that the U.S. Federal Reserve would likely raise its policy rate somewhat from the current level, and that the ECB signaled that there would be additional rate hikes. The member added that major advanced countries, such as the U.K., Canada, and Australia, had continued to raise policy rates. The member mentioned that China had continued to recover since the reopening, led by the face-to-face service industry, but that its recovery trend had been more sluggish than originally forecast.

The member noted that the domestic economy had continued to slow in line with the original forecast path, but that consumption had shown a continued recovery, and that the sluggishness in exports had eased somewhat. The member added that on the employment front, the unemployment rate declined and the employment to population ratio rose, with the increase in the number of persons employed showing a more favorable trend than expected. The member stated that, as for private consumption, retail sales increased, mainly on automobiles and clothing, and credit card usage increased in June, on the back of excess savings and favorable employment conditions, despite reduced consumption capacity stemming from high interest rates and high inflation. The member commented that the sluggishness in facilities investment eased somewhat as it had rebounded slightly after plunging early this year, led by machinery. On the other hand, the member indicated that, concerning construction investment, the negative impacts of the decline in new construction persisted. The member pointed out that, regarding exports, the trade balance shifted to a surplus as the sluggishness that had continued so far eased somewhat. The member projected that expectations for a recovery in exports, such as in the semiconductor industry, were heightening, but that uncertainties seemed to still be high.

The member noted that consumer price inflation had slowed considerably, recording 2.7% last month year-on-year, due to the slowdown in the upward trend of housing rents and personal service prices, and to the base effect from the international oil price spike last year, and that it would likely remain at around 3% until the end of this year. The member stated that consumer price inflation would not deviate greatly from the previous forecast of 3.5% on an annual basis this year, but that core inflation could be slightly above the previous forecast of 3.3% as its pace of slowdown decelerated due to favorable employment conditions and a continued consumption recovery.

The member stated that, as for financial and FX markets, bond market yields at home and abroad rose somewhat as major country central banks stepped up tightening, and that foreign exchange supply and demand conditions and exchange rates remained generally stable. The member noted that the asset insolvency of some non-bank financial institutions with high exposure to the real estate sector had drawn attention in the market as financial imbalances accumulated so far had worsened further during the pandemic. The member judged that this insolvency was already undergoing an expected adjustment process along with interest rate hikes and declines in the real estate market, but that a cautious response is needed. In the meantime, the member commented that housing prices and transactions rebounded in Seoul and its metropolitan area due to the easing of real estate lending regulations and mortgage loan interest rates that had fallen since October last year. The member added that the household loan balance in the banking sector showed acceleration in its growth in May and June after having shifted from a downward trend to an increase in April. The member pointed out the need to remain vigilant that a high household debt ratio and the default issue of real estate PF loans could limit future policy options and dampen consumption, the economic recovery, and market sentiment.

The member stated that, considering all these, it would be appropriate to maintain the Base Rate at 3.50% at this meeting. The member mentioned that this decision was based on the projection that core inflation, which still remained at high levels, would slow gradually, and on the fact that instability factors surrounding non-bank financial institutions persisted, and that business, employment, and external sector trends were not overly fragile. The member pointed out the need to maintain a restrictive stance for longer and to consider the possibility of a further rate hike if needed, given the possibility of additional rate hikes by the U.S. Federal Reserve, uncertainty over the pace of slowdown in core inflation, and the need to rein in household debt to ensure future financial stability.

Another member 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 it would be necessary to examine whether the sustained monetary tightening was fully achieving the intended effects, while closely monitoring real economic indicators, such as the inflation rate and financial stability conditions. With regard to recent external conditions, the member commented that, while countries had been showing differentiated growth at their own paces, the lagged effect of monetary tightening was expected to cause global economic growth to slow gradually. The member noted that global inflation had passed its peak and was declining, driven by the stability of energy and commodity prices, while core inflation remained high in most countries. The member added that, in this regard, even central banks that had kept interest rates unchanged either resumed interest rate hikes or left open the possibility of further rate increases.

Looking at the domestic economy, the member mentioned that the growth rate was lower than initially forecast, while the number of persons employed remained higher than the previous forecasts. The member judged that consumer price inflation had entered the 2% range for the first time in two years, driven by the strong base-period effects from last year’s surge in international oil prices, but was likely to climb back to around 3% by the end of the year. The member argued that, since uncertainties surrounding the growth and price paths remained high, it would be necessary to keep a close eye on changes in external conditions, such as economic conditions in major countries and energy prices.

The member assessed that financial markets had been stabilizing despite demand for deposit withdrawals from the Korean Federation of Community Credit Cooperatives (KFCC). However, the member expressed concern that, as the sluggishness in the housing market had been relieved somewhat, affected by eased real estate and lending regulations, household lending growth had accelerated substantially. The member pointed out the possibility that there could be a rapid increase in household lending in the event of stronger expectations of a rise in housing prices amid eased lending attitudes.

The member stated that financial policy is represented by interest rate policy, which affects the macroeconomy as a whole, and macroprudential policy, which controls systematic risk through regulations. The member commented that rate hikes help households and businesses reduce their debt and refrain from reckless investment and that capacities for consumption and investment, created in the course of deleveraging, would provide a basis for a strong economic recovery and solid growth. The member stated that interest rate policy achieves maximum effects when conducted in harmony with macroprudential policy. The member also argued that, even if liquidity were provided to vulnerable sectors by easing regulations, if needed, it would be desirable to do so while making efforts to reduce the debt-to-GDP ratio.

Another member took the view that it would be appropriate to hold the Base Rate at its current level of 3.50%.

The member projected that world economic growth would slow going forward, affected by a tightening monetary policy stance and China's sluggish recovery, although the global economy showed more favorable growth than originally forecast in the first half of this year. The member assessed that the U.S. exhibited strong growth driven by solid employment conditions and consumption, while inflation had decelerated. The member expected the real economy to gradually contract going forward, due to the impact of the ongoing tightening stance of financial conditions. The member evaluated that, in China, while consumption was recovering, mainly in the face-to-face service sector, downward pressure on the future growth path was increasing somewhat, as the recovery in trade and investment was weakening due to sluggish global demand. The member projected that global economic growth would gradually slow, particularly in major countries, as the accumulated effects of tightening policies would become evident after the end of this year. However, the member added that the extent of economic slowdown would vary depending on developments of various risk factors, such as trends in the U.S. economy, the spillover effects of China's reopening, global business conditions in the IT industry, rising commodity prices stemming from climate change, and geopolitical issues.

The member noted that the domestic economy was showing a moderate recovery as a slump in investment and exports had partially eased. The member judged that, despite a slight adjustment in consumption in the second quarter, the recovery continued as the slump in investment and exports had somewhat improved, thanks to favorable growth in major economies. The member expected the domestic economy to recover gradually after the second half of this year, as private consumption would continue to recover, owing to improved consumer sentiment and favorable employment conditions, and as exports would improve, bolstered by improved business conditions in the IT industry. However, the member anticipated that the pace of domestic economic recovery would be more moderate than initially expected, influenced by external conditions. Consequently, the member saw that economic growth for this year would be generally consistent with the initial projection. The member saw that there was significant uncertainty surrounding the future growth path in both domestic and external conditions, including the possibility of a delayed recovery in the Chinese economy and a potential decline in the contribution of fiscal policy to growth. The member assessed that the downside risks to the growth trajectory were increasing slightly.

Concerning inflation, the member judged that consumer price inflation had slowed markedly, affected heavily by the base-period effect, and core inflation had also slowed further, driven chiefly by a gradual slowing trend in rents and a deceleration in the growth of charges for personal services. Going forward, the member assessed that both consumer price inflation and core inflation would continue to slow, but uncertainties as to the inflation outlook path were high, owing to international oil price trends, domestic and overseas economic trends, fuel tax and public utility tariff policies, and the impacts of climate change.

Regarding financial markets, the member assessed that government bond yields, after having declined excessively, had risen in synchronization with Treasury bond yields in major countries, and consequently the financial conditions had tightened again. The member judged that, amid such circumstances, anxiety had persisted particularly in vulnerable sectors, with delinquency rates at both banks and non-bank financial institutions continuing to rise and risks temporarily materializing at some institutions. The member argued that, despite little likelihood of these risks spreading to the financial system as a whole, it would be necessary to be fully prepared to face the possibility of liquidity and credit risks in vulnerable sectors increasing financial market volatility. The member also presented the view that attention should be paid to the fact that, as housing transactions had been showing some recovery and as household loans had been shifting back to an increase, this could delay or undermine the deleveraging of long-standing household debt accumulation. Looking at the domestic FX market, the member stated that the FX market had been stable overall and that the won-dollar exchange rate had fallen significantly, due to the U.S. dollar's depreciation and due to increased foreign portfolio investment fund inflows, and then rebounded on the back of stronger expectations of monetary tightening in major countries. The member anticipated that the won-dollar exchange rate could rise slightly in the event of a further widening of the interest rate differential between Korea and the U.S., but the that impact would be limited.

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 appropriate to monitor the growth and inflation paths, as well as domestic and overseas financial market conditions, before deciding whether further tightening would be necessary.

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

The member stated that the global economy maintained relatively robust growth in the first half of this year, despite high inflation. However, the member saw that the growth varied from country to country. The member noted that, in the U.S., the growth rate in the first quarter significantly exceeded expectations, and with the Beveridge curve shifted left and downward, expectations of an economic soft landing increased. Nevertheless, the member commented that the prevailing view was that a gradual economic slowdown would be inevitable due to prolonged inflation and rising interest rates. The member saw that, in China, the structural weakening of the recovery was witnessed due to the impacts of U.S.-China trade tensions, government regulations on online companies, and a sluggish real estate market.

The member expected our economy to show higher growth in the latter half of this year compared to the first half thanks to the continued recovery in service sector consumption and to the improvement in the IT business cycle. However, the member presented the opinion that there were significant downside risks, including a reduction in incentives for a consumption shift from excess savings caused by the population aging, a contraction in import demand from China, and a stagnation in the number of tourists coming to Korea.

The member noted that, with respect to prices, both consumer price inflation and core inflation had exhibited increased volatility due to base effects and seasonal factors. However, the member expected them to broadly continue to slow and gradually stabilize at around 3% in the latter half of this year and around the lower to mid-2% range in the first half of next year. The member commented that, on the other hand, household loans, which had been on a decline since the latter half of last year, had expanded again in the second quarter. The member saw that this expansion was attributed to policy factors, such as eased regulations on housing loans and an increased supply of policy loans, combined with expectations of a housing price recovery. The member added that, going forward, the continued increase in household loans would very likely act as a factor intensifying financial imbalances. The member presented the opinion that, although the fund withdrawal issue from the Korean Federation of Community Credit Cooperatives (KFCC) at the end of June had been gradually resolved as of late, it would be necessary to continue monitoring delinquency rates and liquidity conditions, especially in vulnerable sectors, such as real estate and construction, and the impacts on other non-bank financial institutions.

The member saw that, considering the recent overall economic and financial conditions, there were both upside and downside risk factors associated with the policy rate in terms of inflation, growth, and financial stability. Therefore, the member judged that it would be necessary to maintain the Base Rate at the current level at this meeting, while closely monitoring future developments. The member noted, however, that inflation expectations still remained elevated in the mid-3% range, and that there also was the potential risk of a re-expansion of financial imbalances and increased volatility in the foreign exchange market due to the widening interest rate differential. The member thus suggested that the possibility of a further Base Rate hike in the future should be kept open.

Meanwhile, the member expected structural changes, such as population aging, declining labor productivity, fragmentation of global supply chains, and accumulation of private debt, to have a greater impact on monetary and credit policies, as the volatility in domestic and global growth and inflation, which had been heightened by the pandemic crisis and the Russia-Ukraine war, would gradually diminish after next year. The member thus saw the need to continue to monitor related issues and be prepared through a mix of monetary, fiscal, macroprudential, and structural adjustment policies.

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

The member noted that the domestic economic slowdown had eased slightly, led mainly by the improvement in exports of non-IT products, with stronger-than-expected growth in major countries, while private consumption had continued its recovery, supported by a solid labor market. However, the member observed that facilities investment remained sluggish owing to a shrinkage in the global IT business. The member projected that the domestic economy would gradually recover its growth momentum, as exports continue to improve in line with the easing of the IT slump, and as consumption sustains its moderate growth mainly in services. The member viewed, however, that considerable uncertainties remained over the growth path, concerning the timing of the IT business rebound, the pace of any Chinese recovery, major countries' further tightening, and the extent of the consequent economic slowdown.

The member noted that inflation still remained high. The member projected that inflation would rise to around 3% in the second half, although it had fallen to the upper-2% range in June due to the base-period effect from last year's international oil price surge. The member added that core inflation, reflecting the underlying trend of inflation, was in the mid-3% range, significantly above the target level. The member cited continuing demand-side pressures from strong service consumption and the pass through of accumulated cost increases to prices as the main drivers behind the high increase in personal service prices at 5%. The member judged that the uncertainties related to the pace of decline in the underlying inflation trend remained high, although inflation was likely to slow gradually going forward. In view of the elevated personal service prices and their persistent nature, the member expected that core inflation was likely to come down rather slowly, and that it would take considerable time to be anchored at the target level. In addition, the member noted a concern that cost side shocks could exert further pressure on core inflation, given the high uncertainties over international oil price movements and the extent and timing of public utility fee hikes.

On the financial stability front, the member remarked the need to pay attention to the potential increase in financial imbalances in the housing market and household debt. The member pointed out that Korea's private credit, including household debt, had continued to grow without undergoing significant deleveraging, unlike in other major countries, and that its pandemic response focusing on providing aggressive financial support on top of monetary and fiscal policy measures, contrary to that seen in other countries, had accelerated private credit growth. The member viewed that the consequent asset price hikes and rapid private debt growth had increased financial sector instability and undermined price stability, which led the BOK to shift its monetary policy stance toward tightening in 2021. However, the member noted that housing prices had recently shown signs of a rebound and that household debt had shifted to positive growth due to deregulation in the real estate sector and due to the drop in interest rates for home loans, all of which risk ruining the policy achievements made so far. The member suggested that developments in household debt growth be monitored closely, given that it could be accelerated once expectations of a housing price increase are revived.

The member stated that financial markets had been instable with deposits at the Korea Federation of Community Credit Cooperatives being reduced as insolvency had partially materialized among real estate financing. The member noted, however, that strains were easing thanks to favorable soundness of the overall financial sector, except for some institutions, and to active responses by the government. The member judged that any spillover effects onto other institutions or the market would be limited. The member added that the emergence and resolution of insolvency inherent in the financial markets as the tightening policy stance continued was a normal adjustment process of the financial system, and that it was inevitable to maintain system resilience and to recover the financial intermediary function. The member commented that this process should be done in an orderly manner so that it would not develop into a systematic risk.

The member remarked that the rise in inflation was slowing, starting from this year, but that this was due mainly to the base-period effect, and that it was still difficult to be confident that the underlying inflation trend would anchor at the target level. The member also stressed the need to prevent the rebound in some housing prices and relevant increases in household loans from once again leading to the expansion of financial imbalances. In conclusion, the member stated that, in consideration of the above mentioned elements, it would be necessary to maintain the Base Rate at the current 3.50% at this meeting and to induce the Korean economy to stabilize macroeconomically as soon as possible. The member judged that it would be necessary to maintain the current tightening stance for a considerable time in the conduct of monetary policy, since more time would still be needed to confirm any downward stability of the underlying inflation and since the need to respond to any financial imbalances increased. The member added that in the case of any destabilizing factors to inflation materializing or of any financial imbalance risks expanding, it would be necessary to respond actively by raising interest rates further.

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

With regard to the global economy, the member stated that the U.S. had maintained favorable growth, supported by strong employment and consumption expenditures based on excess household savings, while China had been losing momentum across all sectors, from production to consumption, due to the weaker-than-expected effects of its reopening. The member also commented that the euro economy had been growing weakly, affected by high inflation and high interest rates, while Japan had been showing signs of emerging from its sluggishness that had lasted for the past three decades, boosted by pent-up consumption and facilities investment growth. The member expected that the domestic economy would improve in the second half of the year, with the sluggishness of the semiconductor industry easing somewhat.

Looking at external conditions, the member noted that Korea’s trade account had shifted to a slight surplus in June for the first time in 16 months, driven by an increase in exports of automobiles and secondary batteries and a decrease in imports resulting from a fall in oil prices. The member forecast that, if the effect of semiconductor cuts starts to show in earnest and if the semiconductor industry recovers, the decline in exports would slow and external conditions would improve. The member added that the current account had shifted to a surplus in May and, based on the BOK’s forecast, it would record a surplus of 24 billion dollars for the year, led by goods and primary income account surpluses.

The member noted that private consumption had continued to recover at a modest pace, led by a favorable employment trend and improved consumer confidence. The member commented that consumer price inflation had recorded 2.7% in June, entering the 2% range for the first time in 21 months, due to the base-period effects from last year's surge in international oil prices, and that core inflation excluding food and energy had declined to the mid-3% range to stand at 3.5%, in line with slower growth in personal service charges, but still remained high. The member stated that uncertainties remained on the future price path, such as domestic and overseas economic trends, international oil prices, the won-dollar exchange rate, and adjustments to public utility charges. In terms of the employment situation, the member mentioned that employment had continued to slow at a more modest pace than expected, with the number of persons employed in June increasing by 333,000 year-on-year. The member added that the number of persons employed in the manufacturing sector had continued to decline for the sixth consecutive month due to the sluggishness of the manufacturing industry. Moreover, the number of employed youth aged 15-29 had also decreased for an eighth consecutive month, while employment of women and those aged 60 or older had increased, particularly in the services sector. More specifically, the member pointed out that the number of women employed increased by 332,000 as of June, accounting for an absolute majority among the total growth figure of 333,000. The member went on to state that employment of those aged 60 or higher increased by 343,000, offsetting the decline in youth employment.

The member noted that the financial market remained generally stable despite the withdrawal of deposits at the Korean Federation of Community Credit Cooperatives (KFCC). The member assessed that household debt deleveraging could be put in jeopardy, given recent data from the Korea Real Estate Board showing a shift in apartment prices toward an upward trend, and a rise in home mortgage loans that has led to a shift in bank household lending toward an increase since April. In particular, the member saw the need for scrupulous management to prevent market expectations of any DSR deregulation, although the temporary loosening of DSRs for loans taken out to repay leasehold deposits was regarded as necessary to stabilize the leasehold deposit market. Given that the delinquency rate for the banking sector had risen to 0.37% in April, and that that for real estate project financing (PF) at securities firms and savings banks had recorded 15.88% and 4.07% as of end-March, respectively, the member believed that more thorough risk management was needed. The member added that special attention was required for the Community Credit Cooperatives, which had recently experienced a bank run, as their delinquency rate had stood at 6.18% on June 29, nearly double their last year-end rate of 3.59%, and whose internal supervision had been found to be problematic. The member observed that the Korean won to U.S. dollar exchange rate had generally remained stable at a relatively high level, fluctuating at around 1,300 won per dollar. The member added that careful management was needed to prevent any rise in volatility, considering that the all-time high interest rate differential between Korea and the U.S. could potentially destabilize the exchange rate.

Overall, the member stated that inflation was on a downtrend, but was expected to remain above the target level for a considerable period of time, and that the economic slump had been easing somewhat, but had not entered the recovery phase. The member added that risk still remained in some weak areas, such as real estate PF, affected by the interest rate hikes enacted so far. The member presented the view that, in consideration of the above mentioned economic and financial conditions at home and abroad, it would be necessary to keep the Base Rate at the current level of 3.50% for the intermeeting period. The member added that the Board should judge whether or not there would be any need for further rate hikes, while maintaining a tightening stance until it is fully confident about price stability and while monitoring core inflation trends, the economic growth path, household debt growth, and monetary policy decisions in major countries.