Minutes of the Monetary Policy Board Meeting

May 2022

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(May 2022)

Ⅰ. Outline

1. Date of meeting: Thursday, May 26, 2022

2. Place: Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:
   Rhee, Changyong, Chairman (Bank of Korea Governor)
   Cho, Yoon-Je
   Suh, Young Kyung
   Joo, Sangyong
   Lee, Seungheon (Senior Deputy Governor)
   Park, Ki Young

4. Monetary Policy Board members absent: none

5. Participants:
   Kang, Sungjun, Auditor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Bae, Joon Suk, Deputy Governor
   Min, Jwa Hong, Deputy Governor
   Lee, Sang Hyeong, Deputy Governor
   Yang, Seok Jun, Director General of Reserve Management Group
   Kim, Woong, Director General of Research Department
   Lee, Jeong Wook, Director General of Financial Stability Department
   Hong, Kyung Sik, Director General of Monetary Policy Department
   Kim, Jeong Hoon, Head of Financial Market Affairs Team
   Kim, Hyun Kee, Director General of International Department
   Park, Yang Su, Director General of Economic Research Institute
   Park, Young Chool, Press Officer
   Han, Seung Chul, Director General of Monetary Policy Board Secretariat
   Choi, Mun Seong, Head of MPB Team

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1) This English version (summary) of the minutes of the Monetary Policy Board Meeting was produced at a working level, and is not an official document.

II. Summary of Discussions on the Current Economic Situation

After briefings by staff on *Economic Outlook* (May 2022),[2] *FX and International Finance Trends*, and *Financial Market Trends*, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members assessed that, despite slower export growth following lockdown measures in China and sluggish facilities and construction investment, the domestic economy continued to recover, led by a rebound in private consumption boosted by the lifting of social distancing measures. Some members anticipated that, despite external uncertainties on the forecast growth path, the domestic economy would maintain steady growth momentum, supported by accumulated household savings and continued improvement in employment.

In terms of inflation, members assessed upside risks to inflation as having increased significantly, led by sustained inflationary pressure on the supply side, including a rise in commodity and food prices since the Ukraine crisis and production setbacks due to lockdown measures in China, combined with demand-side factors such as consumption demand growth. Some members noted that individual perceptions of prices and inflation expectations had also increased, in line with a substantial number of items in the CPI basket rising significantly and processed food and dining-out prices growing. They also expressed the view that consumer price inflation would run at the mid-4% level for the year overall, substantially above the February forecast and, in this regard, attention should be paid to a secondary effect that could lead to wage increases.

Meanwhile, members assessed that financial market volatility had been expanding as risk aversion had strengthened and asset prices had fallen due to monetary policy changes in major countries and slowing economic growth. Some members mentioned that financial conditions had become tighter but still remained accommodative due to a high level of household debt and continued growth in business credit. Some other members also presented the view that it would be necessary to respond to the risk of financial imbalances, taking into account heavier debt-servicing burdens and rising funding costs in times of interest rate hikes.

Some members also stressed the need to pay close attention to how the domestic economy would be affected by increasing FX and global financial market volatility, capital flows following changes in the gap between domestic and overseas interest rates, and China's economic countermeasures.

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2) An English version of *Economic Outlook* is posted on the Bank of Korea website. (https://www.bok.or.kr/eng/bbs/E0000634/view.do?nttId=10070775&menuNo=400069&pageIndex=1)

Ⅲ. Discussions Concerning Monetary Policy Decision (Summary)

The main details of the MPB members' discussions concerning a change in the Bank of Korea Base Rate were as follows:

All members took the view that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to raise the Base Rate to 1.75% from the current 1.50% at this meeting.

One member judged that it would be appropriate to raise the Base Rate to 1.75% from the current 1.50% at this meeting.

The member assessed that the uptrend in domestic prices had strengthened, growth had weakened somewhat and external condition uncertainties had increased even further since the April meeting.

The member stated that the GDP growth forecast for this year had been adjusted downward to 2.7% from 3.0% and consumer price inflation was expected to remain at around 5% for the next several months to run at approximately 4.5% for the year overall, well above the previous forecast of 3.1%. The member mentioned that, as exports, a key driver for the recovery of growth of the Korean economy, had been slowing due to lockdowns of major cities in China and slowing growth in major countries, the contribution of net exports to growth was likely to decline somewhat. The member on the other hand noted that face-to-face services consumption, having been sluggish so far, had been improving rapidly since April in line with a return to normal life and that private consumption would remain strong, boosted by accumulated household savings, favorable employment conditions and government transfer payments.

Regarding the financial markets, the member mentioned that, although household debt growth had slowed, credit to the corporate sector had maintained strong growth and liquidity growth remained at a high level. The member went on to state that financial conditions had become somewhat tighter due to the four Base Rate hikes since August last year and acceleration of policy rate hikes in major countries but, given the uptrend in prices and the recovery of economic growth, they still seemed to remain accommodative.

The member expressed the view that what called for the most attention in the recent trend of economic conditions included persistent inflationary pressures and heightened uncertainties following the acceleration of monetary tightening in major countries. The member mentioned that inflationary pressures had been increasing, with import prices and producer prices remaining on a sharp rise and consumption demand recovering after having stagnated. The member pointed to a sharp increase in the proportion of CPI items that had exhibited year-on-year growth of 4% or more, leading to stronger inflation expectations among the general public. The member stressed that upward pressures on commodity and food prices following the Ukraine crisis, as well as supply constraints and cost burdens due to China's lockdown measures, would last longer and to a greater extent than previously expected and that caution was required with regard to the possibility of a secondary effect being triggered by corporations' passing-on costs to consumers, rising inflation expectations and demand for higher wages.

The member projected meanwhile that a majority of major countries had been adjusting their monetary easing stances to tackle inflation and, in this process, financial conditions in Korea would continue to be affected by increasing global financial market volatility. The member mentioned that the domestic financial markets had become even more vulnerable to internal or external economic shocks owing to the accumulation of debt held by households, small businesses and SMEs. The member presented the view that rising interest rates and increasing financial market volatility at home and abroad had been dampening the uptrend in asset prices that had been seen throughout the globe, pulling down prices of stocks and crypto assets in particular, and adding to debt repayment burdens of vulnerable groups, and went on to state that it should be carefully monitored how all of this would affect financial stability. The member also emphasized the need to pay attention to pressures on the FX sector placed by the outlook for the gap between domestic and overseas interest rates and expectations of the exchange rate in line with the steep rate hikes by the US Federal Reserve.

Taking all this into consideration, the member judged that it would be appropriate to raise the Base Rate by 25 basis points to 1.75% from the current 1.50% at this meeting. The member noted that it would be necessary to take preemptive monetary policy measures in a situation where inflation was forecast to remain high in the 5% range for some time, the price path was expected to remain substantially above the inflation target next year, and major countries were likely to raise interest rates at fast paces. The member also pointed to the need to closely analyze inflation, growth, monetary policy changes in major countries, and financial and FX market developments and make further adjustments to the Base Rate so that it could become close to the neutral interest rate.

Another member judged that it would be desirable to raise the Base Rate to 1.75% from the current 1.50% at this meeting.

The member mentioned that, despite the contraction in facilities and construction investment, the Korean economy had recently sustained a modest recovery overall, supported by a rebound in private consumption under the improved pandemic conditions, sustained favorable exports, and the expansionary fiscal stance as seen in the supplementary budget. The member however forecast the growth rate for this year to fall somewhat short of the Research Department's February forecast (3%), affected by global supply constraints and the economic slowdown. The member projected that consumer price inflation would significantly exceed the February forecast and run close to the mid-4% level for the year, and that core inflation(excluding changes in food and energy prices from the CPI) was likely to exceed 3% this year.

The member assessed that, as employment had improved along with the recovery of the face-to-face services industry, the number of persons employed had increased by around 850,000 year on year in March and April and the employment and unemployment rates had continued to show solid improvement. The member meanwhile mentioned that, according to Statistics Korea's household income and expenditure survey, the monthly average income per household had risen by 10.1% year on year in the first quarter of this year and wage income by 10.2%, and income by quintile groups had also grown evenly. The member evaluated that, since a rise in production activities driven by exports and the manufacturing industry was seen to have led to a recovery in employment and household income and the uptrend in prices had been spreading due to the pressures on inflation from the consumption demand side following the lifting of social distancing restrictions, there was good reason for maintaining the rate hike stance. The member expressed the opinion that in this regard it would be desirable to raise the Base Rate by 25 basis points to respond to heightened inflation pressures.

The member however noted that, while maintaining the rate hike stance, it would be necessary to respond flexibly to future economic conditions, in consideration of the nature of shocks from the COVID-19 pandemic and the Russia-Ukraine war. Most of all, the member stressed that the COVID-19 pandemic had been an asymmetrical shock that had hit the services sector and consumption harder than the manufacturing sector and exports, and had affected economic agents' activities and welfare unevenly for the past two years, and in this regard, careful attention should be paid not only to aggregate indicators such as the GDP growth rate but also to whether sectors exhibiting much slower growth than in the past had returned to a recovery track. The member also presented the view that, since inflation had been attributable substantially to supply-side factors, it would be necessary to adjust the degree of monetary policy responses and that, with regard to consumer price inflation growth, it would be also ideal to respond differently to changes in non-core inflation and even to core inflation changes caused by supply constraints. The member mentioned that, since all lending to households and corporations in Korea was linked closely to short-term interest rates, a rapid increase in debt-servicing burdens and funding costs could limit the real economic recovery. More specifically, the member emphasized that, since corporate lending rates were linked closely to the Base Rate, attention should be paid to the possibility of a steep rise in the Base Rate causing credit risks to increase and investment to contract. Concerning soaring household debt, the member argued that it would be advisable to ensure that borrower-specific DSR regulations are in place, rather than taking monetary policy responses, to keep household debt under control over a medium- to long-term horizon.

The member stressed that, although inflation would remain high for some time, global aggregate demand had started to exhibit slower growth, and in this regard, it would be necessary to carefully adjust the pace of Base Rate hikes to minimize growth loss.

One member took the view that it would be appropriate to raise the Base Rate to 1.75% from the current 1.50% at this meeting.

The member mentioned that the recovery in the global economy had slowed somewhat and there were high uncertainties, both upside and downside, in line with geopolitical risks, monetary policies in major countries and the development of China's COVID-19 restrictions.

The member took the view that the Korean economy had sustained its recovery despite heightened uncertainties at home and abroad, while export growth had moderated somewhat, affected by China's lockdown measures, and was expected to slow from the second quarter on, combined with a decline in global goods demand. In terms of facilities and construction investment, the member evaluated that its contribution to the GDP growth rate had decreased, owing chiefly to supply constraints, but was likely to increase again once the supply issue is resolved.

The member mentioned that, just as in the previous meeting, it was inflation that was the center of attention at this meeting, and evaluated that upward pressure on inflation had increased significantly following Russia's invasion of Ukraine in March this year and China's lockdown measures to contain the pandemic, and uncertainty concerning the duration of high inflation had also increased accordingly. The member noted that energy, commodity and grain prices had soared globally and China' lockdown measures had led to production setbacks and a delay in logistics in the major manufacturing industries, and that the effects of these factors, combined with Korean industries' heavy dependence on external trade, had been spreading to many industries and increasing costs. The member stated that the share of the CPI items showing 5% or higher year-on-year growth had exceeded 40% and the share of the items showing 10% or higher growth had been nearly 20% this year, and went on to forecast that, with this taken into consideration, consumer price inflation for this year would be in the mid-4% range, far above the February forecast of 3.1%. As to inflation expectations, the member took the view that long-term inflation expectations could be seen as anchored at their target level, given that five-year-ahead inflation expectations among the expert group had been fluctuating at around 2% whereas one-year-ahead inflation expectations had been on the rise, while inflation expectations of the general public, both short- and long-term, had risen.

The member noted that uncertainties surrounding the inflation path were still high and the possibility of agflation in particular was worrisome from various angles. The member stated first that even if the war in Ukraine ended peacefully soon, global grain prices could remain high for a considerable time due to the characteristics of agricultural products, and this would likely affect processed food and dining-out prices in Korea, which was heavily dependent on imported grain. The member went on to argue that since the two items had strong downward rigidity and played a role in perceived prices, they were seen to be closely related to inflation expectations. The member stressed that, in addition to these supply-side factors, a sudden increase in service consumption after the lifting of COVID-19 restrictions could act as a demand-side factor, and this could result in elevated inflationary pressures on both the supply and demand sides. The member also presented the view that, although the uptrend of food and dining-out prices was not directly in the realm of monetary policy, it could place a relatively heavy economic burden on the low-income group which spends heavily on both items, and thus it could cause an issue from the perspective of distribution.

The member noted that, given these points, monetary policy should be used appropriately to control inflation caused by demand factors and inflation expectations, and the monetary policy authorities should place a focus on inflation in the conduct of monetary policy, to the extent that recovery in the real economy was not markedly harmed.

The member saw the need to pay particular attention to domestic and international financial stability in the future, in addition to inflation. The member first noted that, as for the domestic financial market, volatility in price variables had heightened, but there had not been any very noticeable difficulties in corporate financing conditions in consideration of the size of uncertainties at home and abroad. However, the member stated that, particularly since risk aversion was strengthening in the international financial market and there were signs of what was deemed to be preference for safe haven assets or high-quality liquid assets among economic agents in the domestic financial market, capital could be over-concentrated in certain sectors or instruments and thus weaken the financial intermediary function. The member thus stressed the need to closely monitor the relevant indicators. In addition, the member added that it would be necessary to prepare for the impacts on our economy of counter-cyclical measures in China, which is closely linked with our country in terms of finance and the real economy.

Another member judged that it would be appropriate to raise the Base Rate to 1.75% from the current 1.50% at this meeting.

The member judged that the growth momentum of the domestic economy had held steady of late. The member noted that, although the trend of growth in exports had slowed somewhat and facilities investment was going through a correction, private consumption was recovering rapidly, bolstered by normalization of economic activity following the lifting of social distancing measures, and employment conditions were also showing a trend of steady improvement.

The member projected that, while there were a lot of uncertainties surrounding the growth path and economic growth was expected to fall below the February forecast, the domestic economy would maintain growth at the upper-2% level. The member expected consumption to maintain rapid improvement, bolstered by the lifting of COVID-19 restrictions, given the consumption capacity built up so far and the government's support through supplementary budgets. The member forecast that exports would maintain strong growth, driven by the IT sector, and investment would show a trend of recovery in the second half of this year, thanks to the effects of the deferred gradual easing of supply chain constraints. The member added that even if downside risks associated with the Ukraine crisis, slower growth in China and policy rate hikes in major economies materialized, growth would be unlikely to run below the potential level, at least in the short term.

The member stated that prices continued to show a stronger-than-expected upward trend. The member presented the opinion that, although the Research Department had revised the price outlook sharply upward to the mid-4% level for this year and the upper-2% level for next year, upside risks still would appear to predominate in consideration of the rapid improvement in consumption conditions of late, and the prospect of the continuation of factors causing rises in international prices of commodities or grain. The member saw that the recent uptrend in domestic prices were conspicuously seen to be a mid- to long-term inflation phenomenon rather than a transitory fluctuation, and argued that if the steep uptrend continued and a second round of its spillover effects spread, the firm anchoring of long-term inflation expectations could be easily shaken. The member thus stressed the need to pay attention to this point.

Looking at the financial situation, the member stated that financial conditions were continuing to show a reduction in the degree of accommodation, with short-term market interest rates rising substantially on expectations for Base Rate hikes, volatility in long-term interest rates heightening, and stock prices falling considerably. The member suggested that overall financial conditions still remained accommodative, since the credit supply had increased particularly in the corporate sector and was maintaining strong growth exceeding 9%, despite a trend of decline in M2 growth. Meanwhile, the member added that a rise in the Korean won to US dollar exchange rate stemming from the strengthening of the US dollar globally was not only becoming an additional factor causing price rises, but also could work to cause financial instability through the heightened volatility. The member thus expressed the need to pay attention to this point.

Concerning financial imbalances, the member stated that, since household lending had shifted to an increase again and banks' lending attitudes were easing gradually, it would be necessary to keep a close watch on the relevant trends in the future. The member also pointed to the need to keep in mind the high possibility of latent insolvency risks stemming from financial support measures, such as the deferment of principal and interest repayments for corporations and small businesses, and the extension of debt maturities.

The member took the view that, in overall consideration of the growth, inflation and financial conditions of the domestic economy, it would be necessary to maintain the current Base Rate hike stance. The member stressed the utmost importance of preventing the spread and entrenchment of inflation to uphold a stable growth stance, since upside pressures on prices had grown further, while domestic economic growth would remain above the potential level. The member expressed the need to take preemptive measures, since a rapid rise in prices would inevitably call for tighter policy measures and this would eventually lead to greater losses to growth in the future. The member went on to present the opinion that hiking the Base Rate rapidly to the neutral level, to the extent that the domestic economy could withstand it, would be the best option to secure macroeconomic stability over a medium- to long-term horizon.

One member presented the view that it would be appropriate to raise the Base Rate by 25 basis points to 1.75% from the current 1.50% at this meeting.

Looking at the overseas economic environments since the previous MPB meeting, the member judged that global inflation had been strengthened, and recovery in major economies had weakened, due to the war in Ukraine and prolonged lockdowns in China. The member stated that, on the domestic front, growth in exports had slowed due mainly to slower global economic recovery and supply disruptions, and it was difficult to pinpoint significant improvement in private consumption with the effects of supplementary budgets and excessive savings since the COVID-19 outbreak excluded.

Meanwhile, the member stated that we were witnessing the development of unprecedentedly difficult conditions in which pressures on both the supply and demand sides were increasing simultaneously and there was a combination of supply-side shocks from energy, commodities, grain, and exchange rates.

The member noted that in consideration of these changes in domestic and international conditions, the Research Department had revised downward the growth forecasts for this year and the next to the upper-2% range and the mid-2% range, respectively, and revised upward the inflation forecasts to 4.5% and 2.9%, and these directions appeared to be appropriate overall. However, the member judged that, concerning inflation, there would be additional upside risks, particularly since inflationary pressures this time were characterized by combined shocks which made it hard to create dichotomous divisions between supply and demand and between monetary policy and fiscal policy, and the shocks were unprecedentedly serious.

The member judged that it would be appropriate to raise the Base Rate from the current level at this meeting in consideration of recent economic conditions and suggested a few reasons for this judgment.

The member first saw that the gap between the inflation target and actual inflation seemed to be the widest since 2008, given that the inflation forecast of 4.5% for this year was the second highest following that in 2008 (4.7%) since the adoption of the inflation targeting regime, and that the inflation target had since been lowered to 2%. The member noted that comparing the current period with those of past supply shocks, there was clear upward trend in core inflation this time and thus it would be necessary to proactively deal with the second-round effects. The member took the view that, particularly since inflation expectations were rising rapidly and wages led by basic wages were growing, there was an urgent need to ease inflation expectations via a Base Rate hike.

The member stated the need to lessen the risks related to capital flows in Korea, as risk aversion and volatility in the international financial market were increasing. The member commented that there were heavier depreciation pressures on the won and greater incentives for an increase in external debt, as residents' direct and indirect overseas investment had been expanding and foreigners' domestic portfolio investment was continuing to show a net outflow with the current account surplus narrowing sharply entering this year. The member saw that, since the recently rising medium- to long-term bond investment by the public sector was mostly not exchange rate-hedged, the impact of the gap between domestic and international interest rates was substantial. The member thus took the view that maintaining the gap between domestic and international interest rates at an appropriate level could be helpful in preventing a net capital outflow.

The member stated that financial imbalances would need to be constantly addressed since the household debt-to-GDP ratio still remained high and corporate credit and market liquidity were maintaining rapid growth. The member added that an additional Base Rate hike was expected to contribute to improvement in financial imbalances by easing the decline in real financing rates in line with the rise in prices, and strengthening risk aversion.

Meanwhile, the member judged that, although there were concerns about side effects of consecutive Base Rate hikes, such as slower domestic economic recovery, and an increase in private debt repayment burdens, and business failures in vulnerable sectors, the economy was still capable of enduring these effects, considering the results of monitoring via various indicators. The member added that it would be necessary to carry out monetary policy to reduce the accommodative stance rapidly going forward, and a priority should be placed on dealing with inflation in that the inflation gap had widened sharply with the GDP gap remaining positive. However, the member noted that speedy Base Rate hikes could lead to default risk of vulnerable households. The member thus added that it would be necessary to continuously monitor the relevant risks, while stepping up policy efforts to improve the quality of the debt structure.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of the above discussions, the following Monetary Policy Decision statement was compiled. All MPB members supported the decision unanimously.

Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to raise the Base Rate by 25 basis points, from 1.50% to 1.75%.

☐ Currently available information suggests that inflationary pressures have remained high, while the recovery of the global economy has moderated affected by the Ukraine crisis and lockdown measures in China. In global financial markets, government bond yields in major countries have risen and the US dollar has strengthened considerably, due to expectations about a faster pace of the US Federal Reserve's policy normalization. Stock prices have fallen sharply as risk aversion has strengthened. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by global inflation movements, monetary policy changes in major countries, geopolitical risks, and COVID-19 restrictions in major countries.

☐ The Korean economy has continued to recover. Private consumption has improved rapidly supported by the lifting of social distancing restrictions, while facilities investment has continued to slow due to global supply constraints and exports have moderated. Labor market conditions have continued to improve, with the year-on-year increase in the number of persons employed remaining high. Going forward, the economy is likely to sustain its recovery supported by the improvement in private consumption, despite slower export growth owing to moderation in global economic growth. GDP growth this year is projected to be at the upper-2% level, somewhat below the February forecast of 3.0%.

☐ Consumer price inflation has risen significantly to the upper-4% level due to the accelerating increase in the prices of petroleum products and industrial products, the ongoing sharp rise in the prices of personal services, and increases in electricity and gas fees. Core inflation (excluding changes in food and energy prices from the CPI) and the inflation expectations of the general public have increased to the lower-3% level. Looking ahead, it is forecast that consumer price inflation will remain high in the 5% range for some time, and run at the mid-4% level for the year overall, substantially above the February forecast of 3.1%. Core inflation is forecast to rise to the lower-3% level for the year overall.

☐ In domestic financial markets, the Korean won to US dollar exchange rate has risen significantly and stock prices have fallen while long-term market interest rates have fluctuated considerably, mainly driven by acceleration of the US Federal Reserve’s policy rate hikes as well as concerns over slowing economic growth in China. Household loans have shifted to a slight increase and housing prices have remained steady.

☐ The Board will continue to conduct monetary policy in order to sustain the recovery of economic growth and stabilize consumer price inflation at the target level over a medium-term horizon, while paying attention to financial stability. The Board sees it as warranted to conduct monetary policy with more emphasis on inflation for some time, as the Korean economy is expected to continue its recovery and inflation to run above the target level for a considerable time, despite underlying uncertainties in domestic and external conditions. In this process the Board will judge when to further adjust the degree of accommodation while thoroughly assessing the trends of growth and inflation, the risk of a buildup of financial imbalances, monetary policy changes in major countries, and external economic conditions including geopolitical risks.