Minutes of the Monetary Policy Board Meeting

January 2021

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1]
(January 2021)

Ⅰ. Outline

1. Date of meeting: Friday, January 15, 2021

2. Place: Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:
   Lee, Juyeol, Chairman (Bank of Korea Governor)
   Koh, Seung Beom
   Lim, Jiwon
   Cho, Yoon-Je
   Suh, Young Kyung
   Joo, Sangyong
   Lee, Seungheon (Senior Deputy Governor)

4. Monetary Policy Board members absent: none

5. Participants:
   Jang, Ho Hyun, Auditor
   Ryoo, Sangdai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Bae, Joonsuk, Deputy Governor
   Yang, Seok Jun, Director General of Reserve Management Group
   Kim, Woong, Director General of Research Department
   Min, Jwa Hong, Director General of Financial Stability Department
   Lee, Sang Hyeong, Director General of Monetary Policy Department
   Kim, Inkoo, Director General of Financial Markets Department
   Kim, Hyun Kee, Director General of International Department
   Shin, Woon, Director of BOK Economic Research Institute
   Park, Young Chool, Press Officer
   Chae, Byung Deuk, Director General of Monetary Policy Board Secretariat
   Sung, Kwang Jin, Head of MPB Team

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 *Recent Economic Developments*,[2] *FX and International Finance Trends*, and *Financial Market Trends*, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

All members predicted that the domestic economy would show growth generally consistent with the previous forecast. Members, however, judged that uncertainties related to COVID-19 were still high. Looking at specific sectors, members expected exports and facilities investment to maintain their trends of improvement, thanks to recovery in the semiconductor industry, although private consumption was showing sluggishness, influenced by stronger social-distancing measures. Some members, however, pointed out that there was a possibility that the recovery could be illusory due to the semiconductor industry and skewed growth between sectors could intesify, as the real economic recovery would be led by certain industries such as automobiles and semiconductors. Members also raised the concern that, even if employment conditions recovered in the future after having severely worsened due to COVID-19, it could take considerable time to make up for the job losses which heavily impacted vulnerable groups.

Members saw that, although inflation would increase further gradually, mainly due to rising international oil prices and improved economic activity, demand-side upward pressures were still weak.

Members, meanwhile, emphasized that it would be necessary to be more alert to the widening gap between real and financial conditions and the increasing household debt resulting from steeply rising asset prices. Some members presented the view that it would be necessary to pay attention to the possibility that the rising asset prices commonly seen in major countries had come from excessively optimistic expectations about future economic conditions and policy stances.

Members also noted that attention was required as to what effects accommodative monetary policy was having on the distribution of income and assets. Members also presented the view that it would be necessary to preemptively examine insolvency risks that could be obscured by the various corporate support packages implemented since the COVID-19 outbreak.

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2) An English version of *Recent Economic Developments* is posted on the Bank of Korea website.

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 shared the view that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to keep the Base Rate at the current level of 0.50%.

One member presented the view that it would be appropriate to keep the Base Rate at the current level of 0.50%.

The member saw that growth and inflation were generally unlikely to diverge significantly from the paths projected previously, despite the resurgence of COVID-19. The member expected exports and investment to exceed the previous projections, bolstered by recovery in the semiconductor industry, although recovery in private consumption would be slow. The member's evaluation was that the projected economic growth rate of around 3% this year would be consistent with the potential growth rate, given the base-period effect, and thus relatively favorable.

The member, however, assessed that uncertainties related to COVID-19 developments were still high, and economic uncertainties had heightened due to the decoupling between the real and asset markets and to the accumulated debt which was unevenly distributed across sectors. The member noted that the decoupling between the real economy and asset prices was a global phenomenon stemming from the exogenous shock of COVID-19 and from accommodative monetary policy, but the degree of decoupling was higher in Korea, due mainly to a housing policy factor and the skewed recovery of the real economy. The member expressed the opinion that the soaring asset prices which were divorced from the real economy would not only trigger risk on the financial stability side but also work to constrain growth on the macroeconomic side.

The member noted that, in general, growth in debt would drive growth in demand in the short term due to a flow effect, while constraining demand in the long term due to a stock effect from the increased burden of principal and interest payments. The member, however, pointed out that, if increased private debt followed after soaring asset prices, as seen recently, demand growth in the short term could also be limited. The member, however, noted that, with the spread of the pandemic continuing, monetary policy should remain accommodative for some time, with a focus on recovery in the real economy. The member also judged that it would be necessary to pursue improvements in macroprudential policy and measures related to asset markets to slow down the pace of increase in private debt.

The member evaluated the growth divide as having become more serious and employment conditions as having worsened further of late, as recovery in the real economy was led by some export industries, such as IT, and shocks from the COVID-19 pandemic had been concentrated in the low-value-added services industries. The member saw this as owing to the intensification of structural problems in the domestic economy including a delay in industrial structural reforms due to the COVID-19 pandemic, and thus monetary policy had limited capacity to respond. Therefore, the member expressed the opinion that more targeted fiscal and credit policy measures should be implemented, and efforts should be made to take this as an opportunity to make structural improvements from the medium- to long-term perspectives.

Taking all this into consideration, the member judged that it would be appropriate to maintain an accommodative monetary policy stance by holding the Base Rate at its current level, thus supporting recovery in the real economy. The member also emphasized that, to pursue financial stability and improvements in the economic structure, efforts should be made to further strengthen coordination with various policies, including macroprudential, fiscal and structural reform policies.

Another member presented the view that it would be appropriate to keep the Base Rate unchanged from the current level of 0.50%.

Looking at changes in conditions at home and abroad since the Monetary Policy Board meeting in November, the member's evaluation was that recovery momentum in the global economy was weakening due to stronger quarantine measures following the resurgence of COVID-19. The member, however, noted that economic losses were concentrated mainly in the services industries, and exports and the manufacturing sector were showing relatively strong improvement. The member also noticed positive changes including the start of vaccinations and approvals of large-scale economic stimulus packages in major countries. The member thus judged that downside risks to the economic forecast for this year had not grown.

The member saw that the domestic economy continued to recover modestly. The member noted that, although the nationwide spread of COVID-19 since mid-November had caused consumption to shrink again, investment was favorable and export growth had expanded, bolstered by better-than-expected improvement in the semiconductor industry. The member, however, raised concern about accumulated economic losses in the face-to-face services industries accounting for a large job creation effect. For instance, the member pointed out that consumer spending on face-to-face services and sales of small business owners had declined greatly compared to the March figures, and the number of persons employed had declined drastically due to sluggish employment in the relevant industries. The member also noted that there was a growing possibility that with the prolongation of the pandemic the temporary liquidity shortage stemming from the loss of sales could gradually transform into a solvency issue. The member thus emphasized the need for selective support measures targeting vulnerable sectors, through broad discussions on medium- to long-term industrial policy measures. Looking at inflation, the member saw that demand-side pressures would be weak for some time, but international oil prices would rise higher than originally expected. The member thus noted a possibility of consumer price inflation for this year exceeding the previous projection.

Meanwhile, with respect to domestic and international financial markets, the member commented that prices of risk assets had increased dramatically, despite the resurgence of the pandemic. The member cited, as the reason, stronger risk appetite stemming both from higher expectations for economic recovery in line with the start of vaccinations and from the resolution of uncertainties related to the US presidential election and Brexit. The member noted that this trend would enhance the effectiveness of monetary policy by further easing financial conditions and supporting consumption through the wealth effect. The member, however, called for attention to the possibility that, if asset prices rose rapidly in a short period of time, thus leading to wider decoupling with the real economy, this could cause financial instability due to an increased probability of an abrupt asset price correction. The member added that there was a high likelihood of an accumulation of financial imbalance risk, in that the recent rise in asset prices had been accompanied by significant growth in debt.

Taking all this into consideration, the member judged that it would be appropriate to hold the Base Rate at its current level of 0.50% this time and to closely monitor domestic and international financial and economic conditions. The member also expressed the opinion that, in discussions about ending or changing the various financial support measures which had been adopted so far, consideration should be given to the differences in recovery trends by industry, sector, and income class.

One member presented the view that it would be appropriate to keep the Base Rate unchanged from the current level.

The member’s assessment was that, amid a weakening of the global economic recovery due to the resurgence of COVID-19 since the November MPB meeting, the domestic economy was maintaining a moderate recovery thanks to expanded growth in exports, although private consumption was sluggish mainly because of stronger social-distancing measures. The member added that there were positive aspects such as the continued recovery in facilities investment, particularly in the IT sector, and improved leading indicators related to construction investment, which had been undergoing an adjustment. The member specifically noted that the materialization of recovery in the semiconductor industry this year was expected to have positive impacts on the momentum for improvement in exports and facilities investment. The member, meanwhile, saw that employment was very sluggish, particularly in the face-to-face services industries, influenced by the spread of COVID-19, and expected the sluggishness to continue for the time being. The member also projected consumer price inflation to be in the mid-0% range for some time, and then to rise gradually, influenced for instance by increases in international oil prices and improvement in economic activity.

The member's assessment was that the domestic financial and foreign exchange markets remained generally stable and financial conditions remained considerably accommodative overall. The member noted that the paces of increase in household credit, monetary aggregates, and private debt remained high, funds flows to asset markets continued, and asset prices were continuing to increase steeply. The member judged that the accumulated decoupling between the financial sector and the real economy was leading to increases in potential factors that could undermine financial stability in the future. The member thus expressed the need for carefully monitoring of these factors.

The member saw that uncertainties surrounding the recovery path were still elevated, and inflationary pressures were expected not to be high for some time. The member thus stated that monetary policy should maintain an accommodative stance, thus supporting growth and rapid recovery in employment. The member hence judged it appropriate to keep the Base Rate unchanged.

The member, however, emphasized that closer attention should be paid to the points that economic agents' risk appetite had heightened on increased expectations of continued monetary accommodation, and that private debt and asset prices were rising rapidly. The member stated that it would be necessary to carry out an in-depth analysis of insolvency hidden by the liquidity support. The member added that it would also be necessary to continue research on adjustments to industrial and employment structures which would be unavoidable due to structural changes in the economy at home and abroad, as well as on the impacts of sustained accommodative monetary policy on wealth and income inequality.

Meanwhile, another member presented the view that it would be appropriate to keep the Base Rate unchanged from the current level.

The member assessed that global economic growth had slowed down since the previous meeting due to the resurgence of COVID-19 in major countries, and forecast that future global economic trends would depend on how quickly vaccinations and other measures would subdue the pandemic. Looking at the domestic economy, the member noted that the resurgence of COVID-19 and the consequent strengthening of social-distancing measures had contracted private consumption and worsened employment conditions. On the positive side, however, the member pointed to the continued recovery of exports, the increase in facilities investment particularly in the semiconductor industry, and the growth of construction investment.

The member stated that, although the domestic economy would exhibit a modest recovery as originally forecast, the output gap was expected to remain negative and inflation to fall substantially below its target of 2% for a considerable period of time, and judged that the accommodative monetary policy stance should be maintained until the domestic economy showed clearer improvement. The member however expressed the view that it would be necessary to bear in mind the following aspects regarding monetary policy operation:

First, the member mentioned that there had been arguments at home and abroad that monetary policy should support fiscal policy as the latter's role had been increasing in the course of the fight against COVID-19, and went on to note that, just as in major countries that were pursuing quantitative easing, there has been growing interest locally in the size, timing and method of government bond purchases by the central bank and also in relevant forward guidance. The member took the view that government bond purchases might be needed to support real economic recovery and financial market stability, but there should also be comprehensive consideration of issues that might arise in this process.

Next, the member mentioned the need to pay even more attention to financial imbalance problems, such as growing household and corporate debt and a sharp rise in asset prices. The member emphasized that particular attention should be paid to the sudden concentration in the asset markets of liquidity that had increased as a result of the aggressive monetary policy in response to the COVID-19 shock.

Finally, the member called for continued close monitoring and analysis of the pace of the US economic recovery and the direction of related US Federal Reserve policies. The member's further argument was that attention should be paid to the suggestion by some that, if the US economy improved, boosted for example by the Biden administration's fiscal policy, and inflation pressure increased, the Federal Reserve might change its monetary policy stance sooner than expected.

Taking all this into consideration, the member assessed that it would be appropriate to keep the Base Rate at its current level and continue to monitor the trends of the real economy and financial markets at home and abroad.

One member presented the view that it would be desirable to keep the Base Rate unchanged from the current level.

The member's evaluation was that the domestic economy had maintained a modest recovery recently. By sector, the member noted that, although private consumption had been more sluggish than originally expected, export growth had accelerated, particularly in the IT sector, and facilities investment had continued to recover. The member pointed out, however, that uncertainties concerning the future growth path in line with pandemic-related developments remained high. The member mentioned that, although earlier-than-expected vaccinations and future favorable conditions for the semiconductor industry were likely to affect the domestic economy positively, the sustained serious spread of COVID-19 and the emergence of new coronavirus variants had been acting as downside risks.

The member stated that the number of persons employed in December last year had declined at a much faster pace following the third wave of COVID-19, and went on to judge that the worsening of employment conditions since the outbreak of COVID-19 had resulted in a substantial degree of slack in the domestic labor market. The member forecast that consumer price inflation, currently remaining in the mid-0% range, would increase gradually, affected largely by economic improvement, but would remain in the mid- to upper-0% range for the time being.

Concerning the financial markets, meanwhile, the member assessed that accommodative financial conditions had continued amid stronger preference for risk assets. The member mentioned that stock prices had jumped sharply as investor sentiment had improved significantly on vaccine-related news and expectations of stimulus measures by the Biden administration. The member added that market interest rates, and long-term rates in particular, had been rising but were still in an accommodative range and that the USD/KRW exchange rate had shown only a limited decline as the recent weakness of the US dollar had stalled.

The member however pointed out that behind these stable market conditions lay latent risk factors that could undermine financial stability. The member took the view that it would be necessary to examine whether the recent sharp rise in stock prices at home and abroad had been attributable to overly optimistic expectations of future economic trends and policy stances. The member expressed particular concerns that financial imbalances had been widening continuously, as household debt had been increasing to a great extent on the back of the uptrend in housing and other asset prices. The member also stated that the rise in long-term interest rates in major countries was seen to have been based on expectations of higher inflation, and some were raising concerns that a continuation of this trend could result in sudden adjustments in asset prices, such as stock prices.

In conclusion, the member argued that it would be necessary to keep the current monetary easing stance for the time being in consideration of high macroeconomic uncertainties related to COVID-19 and worsening employment conditions, and in doing so, changes in financial stability risks should be assessed carefully.

Another member presented the view that it would be desirable to hold the Base Rate at its current level for the intermeeting period.

The member's evaluation was that the domestic economy had been on a modest upward path amid the sustained recovery of manufacturing production and facilities investment, but employment and consumption had been in extreme slumps following the third wave of COVID-19. The member pointed out that people working in face-to-face services industries, less-educated vulnerable groups and young people had continued to suffer damage. The member expressed concerns that, although face-to-face services industries might recover once vaccinations were well underway, young people as well as less-educated and low-skilled groups would suffer from the long-term aftermath of employment shocks even after the current crisis was over.

The member mentioned that employment sluggishness and the declining income of micro businesses had been contracting consumption capacities and consumer sentiment. The member added that the current pandemic had in effect been encouraging people with stable employment and income to increase savings and cut consumption. The member's assessment was that the consequent overall sluggishness of consumption had kept core inflation within the mid-0% range, and that given the recent household income conditions, employment conditions and demographic factors, major changes were unlikely to be seen in the trends of private consumption and inflation.

Meanwhile, the member pointed to the growing concerns about the gap between the real economy and asset prices due to the surge in stock and real estate prices despite the economic recession. The member took the view that the recent strong stock rally had been driven by expectations of technological innovation in the post-COVID-19 era under the current ultra-low interest rate environment, but questions were raised as to whether such technological innovation would bring about changes comparable to those seen amidst the IT revolutions in the 1990s and the early 2000s.

The member pointed out that what was more concerning was that housing prices in

Seoul and its surrounding areas had risen excessively compared with the income level. The member stated that, although nominal interset rates had fallen to an unprecendentedly low level, real interest rates had declined comparatively less when low inflation was accounted for, and went on to argue that, given real long-term interest rates, there were doubts as to how long real housing prices could increase. Furthermore, the member stated that demographic change which would rapidly unfold going foward would limit growth in the number of households, which formed the basis of housing demand, and meanwhile a social consensus had been formed on the need to increase the housing supply, led by the policy authorities, and thus the current housing price growth could not be expected to continue.

Taking all this into consideration, the member stated that there was no apparent reason for changing the current monetary policy stance preemptively and that it would be desirable to keep the Base Rate at its current level this time. Regarding the recent gap between the real economy and asset prices, the member expressed the view that it would be necessary to closely examine whether overly optimistic expectations had been raising stock prices, and whether excessive anxiety had been lifting housing prices.

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 leave the Base Rate unchanged at 0.50% for the intermeeting period.

☐ Currently available information suggests that the recovery of the global economy has weakened due to the resurgence of COVID-19. In global financial markets, despite the coronavirus resurgence, stock prices and government bond yields in major countries have increased steeply and the US dollar has remained weak, due to the rollout of coronavirus vaccines and the consequent hopes for economic recovery. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the severity of the resurgence of COVID-19 and the status of vaccine distribution, as well as by national policy responses and their effects.

☐ The Korean economy has continued to recover modestly. Although private consumption has contracted due to the recent coronavirus resurgence, facilities investment has continued to recover and export growth has increased, led by the IT sector. Labor market conditions have remained weak, with the number of persons employed continuing to decline sharply compared to the corresponding period last year. Going forward, the economy is likely to recover gradually, led by exports and investment. However, uncertainties surrounding the economic outlook are judged to remain elevated. GDP growth this year is projected to be around 3.0%, generally consistent with the November forecast.

☐ Consumer price inflation has slowed to the lower-0% level due to the sharp decline in the prices of public services. Core inflation (excluding changes in food and energy prices from the CPI) recorded a negative rate, and the inflation expectations of the general public have moved down slightly within the upper-1% range. It is forecast that consumer price inflation and core inflation will run at the low- to mid-0% level for some time and then moderately increase to around 1% in 2021.

□ In domestic financial markets, stock prices have risen considerably and the Korean won to US dollar exchange rate has fallen significantly while long-term market interest rates have risen, affected by various factors such as global financial market movements and improvement of economic indicators. Household loan growth has picked up and housing prices have continued to increase in all parts of the country.

□ The Board will continue to conduct monetary policy in order to support the economy and stabilize consumer price inflation at the target level over a medium-term horizon, while paying attention to financial stability. As the recovery in the Korean economy is expected to be modest and inflationary pressures on the demand side are forecast to remain weak, the Board will maintain its accommodative monetary policy stance. In this process it will thoroughly assess developments related to the pandemic, the impact on the economy and financial markets here and abroad, changes in financial stability such as household debt growth, and the effects of the policy measures taken in response to the pandemic.