Minutes of the Monetary Policy Board Meeting

July 2021

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(July 2021)

Ⅰ. Outline

1. Date of meeting: Thursday, July 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
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Min, Jwa Hong, Deputy Governor
   Kim, Woong, Director General of Research 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
   Park, Young Chool, Press Officer
   Han, Seung Chul, 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:

Members assessed that the domestic economy was showing recovery, led by exports and facilities investment. Members saw that the spread of virus variants and the consequently strengthened social distancing measures would work to contract private consumption. Members, however, expected the negative impacts on consumption to be limited, thanks to increasing vaccine distribution, the government's economic stimulus package, and economic agents' lessened sensitivity to the disease. Meanwhile, some members presented the opinion that attention should be paid to the possibility of a bottleneck in the supply chain causing a delay in manufacturing production.

Members saw that, with respect to prices, consumer price inflation for this year would run above the path projected in May, due not only to upward inflationary pressures on the supply side but to gradually increased pressures on the demand side as well. Members also assessed underlying price movements, including core inflation, to be generally on the rise.

Members saw that financial conditions remained accommodative, and raised concerns that risks on the financial side had built up due to increased search for yield by economic agents and greater expectations for additional price rises in asset markets amid high growth in private-sector leverage. Meanwhile, with respect to housing prices which remained on the sharp rise, some members assessed that there were large upside risks in the short term, presenting the opinion that it would be important to take effective housing supply measures to ensure price stability. Other members pointed out that housing prices were continuing to increase despite the fact that households' mortgage interest rates had recently risen above the pre-pandemic level. They called for an in-depth analysis of the relationship between housing prices and various financial and economic variables, including interest rates.

In addition, members stressed the need to pay close attention to the economic shocks from COVID-19 on vulnerable groups, the US Federal Reserve's monetary policy

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

stance, and the future developments of US long-term bond yields.

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:

Most members shared the opinion that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to keep the Base Rate at its current level of 0.50%, while one member argued for raising it by 0.25 percentage points.

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

The member assessed that the domestic economy was sustaining a trend of export-driven recovery in the second quarter, as in the first quarter. The member saw that, although domestic demand such as private consumption had emerged from its sluggishness, the trend of recovery would likely slow due to greatly strengthened social distancing levels stemming from the recent resurgence of COVID-19. With respect to employment conditions, the member pointed out that, although the number of persons employed had been on the steady rise, the recovery in employment showed an uneven pattern depending on industry and occupational status, and the share of the long-term unemployed had risen. The member also assessed that, although inflation had recently been subject to upward pressures, it was highly likely to run below the target level at the end of this year as the base effect fades. The member presented the opinion that, particularly since consumer price inflation had run in the 0% range for two years in a row and the trend of recovery in consumption was expected to be delayed due to the resurgence of COVID-19, present conditions did not give rise to concerns about upward inflationary pressures over a medium-term horizon.

The member stated that the government had been conducting an expansionary fiscal policy to cope with domestic and international shocks since 2019. The member noted that government spending growth ran far above spending growth in non-government sectors in 2019, and this tendency strengthened further in 2020 due to responses to COVID-19. As a result, the member estimated that, although real GDP in 2020 declined by only 0.9% year on year, spending in non-government sectors fell by about 2.5%. The member saw that, although vaccination was gathering pace, the aftereffects of the pandemic were lasting longer than initially expected. The member also expected that it would likely to take substantial time for the export-driven economic recovery to lead to stable expansion of household income, wages, employment and consumption. The member thus stated the opinion that it was still important for fiscal policy to take an active role, and there was a need for a policy mix with accommodative monetary policy keeping step with fiscal policy until the crisis could be overcome.

The member saw that there were growing expectations for a Base Rate hike since the May MPB meeting, noting that a Base Rate hike is one of various tools to rein in housing price increases and household debt growth. The member, however, pointed out that, since housing price increases of late had not been led by investment by owners of multiple houses actively searching for high returns, it would be very difficult to estimate the effects of an interest rate increase on the housing market. The member added that households' mortgage interest rates were already running above the pre-pandemic level in reflection of the government's lending regulation measures, and policy measures to offset the negative side effects of low interest rates, such as debt service ratio (DSR) rules differentiated by borrower, had also taken effect. The member expressed the view that household debt should be stabilized through macroprudential policy, not monetary policy, stressing the importance of patiently abiding by this principle.

The member assessed that, although the coronavirus shock had been triggered by the spread of an infectious disease, from an economic perspective it was closer to a polarization shock. The member presented the opinion that since the negative impacts were concentrated in vulnerable sectors, groups and borrowers, the trend of their income recovery should be closely observed. The member judged that it would not be late to discuss a Base Rate hike after a sufficient degree of vaccination had been achieved.

Another member expressed the opinion that it would be desirable to keep the Base Rate at the current level of 0.50%.

The member assessed the recovery in the world economy to have strengthened overall. The member saw that, although COVID-19 variants were spreading, there had been a significant decrease in the number of severe cases or deaths, and thus the spread of the virus would likely have limited economic impacts compared to the past. However, the member pointed out the possibility of economic recovery slowing somewhat in some EMEs with low vaccination rates. The member saw that, with respect to global trade, goods trade was sustaining high growth, while recovery in service trade had been delayed.

Looking at the domestic economy, the member expected exports and facilities investment to remain robust, thanks to rapid economic recoveries of our major trading partners, and a trend of recovery in the global IT industry. The member saw that private consumption would contract for some time due to tighter social distancing measures, but the decline in consumption would be smaller than those during past resurgences of the coronavirus, given the plans for large-scale vaccination, the accumulation of household savings, and the lessened sensitivity of the public to the disease. The member anticipated that the domestic economy would maintain a broader recovery in the second half of this year as well, since the constraints on consumption would be offset by expanded consumption stemming from the government's economic stimulus package.

The member assessed that consumer price inflation for this year was highly likely to reach the 2% range, somewhat higher than the May forecast, due to a faster rise in international oil prices of late. In light of the trends of increase in various indexes representing underlying inflation, inflationary pressures were heightening broadly and were not limited to specific items.

The member judged the financial market to remain significantly accommodative. The member's assessment was that the accumulation of financial imbalances was continuing, as leveraged financing by households and corporations was showing high growth, and investment funds were flowing into asset markets due to ample market liquidity and stronger risk-taking appetite.

The member stated that the domestic economy would maintain a trend of recovery overall. The member, however, judged that it would be appropriate to keep the Base Rate unchanged from its current level, given that it would be necessary to wait and observe further the impacts of the current resurgence of the coronavirus on the future growth path, and that economic agents should have more time to communicate the future monetary policy direction with the Bank of Korea, particularly since only about a month had passed since the Bank began to communicate with them a possible adjustment of the degree of monetary policy accommodation within this year. The member, however, expressed the opinion that if future movements of growth and prices did not deviate far from the current predictions, an adjustment to the degree of monetary policy accommodation within the coming months should be considered, as had been discussed in the May MPB meeting. The member added that this would be necessary for the domestic economy to lay a foundation for stable and sustainable growth in the medium to long term.

One member expressed the opinion that it would be desirable to raise the Base Rate to 0.75% from the current level of 0.50%.

The member assessed that growth in the global economy was gathering pace since the last MPB meeting. The member expected trends of economic recovery in major countries to continue in the second half as well, although uncertainties related to the coronavirus conditions were increasing due to the emergence of virus variants.

The member saw that export-driven recovery had been gradually materializing since the beginning of this year and facilities investment remained solid overall. The member also expected construction investment to show improvement in the second half of this year. The member saw that private consumption was unlikely to run well below the level projected in May thanks to the government's economic stimulus package, despite the rapid spread of COVID-19.

With respect to prices, the member assessed that, as consumer price inflation had run above 2% every month since the beginning of the second quarter, prices were somewhat emerging from the low levels they had been recording, with personal service charges, as well as prices of agricultural, livestock and fisheries products and petroleum-based products, showing upward trends.

The member expressed the opinion that there was no urgent need to adjust the Base Rate level, judging from current real economic conditions. The member pointed out that, more importantly, concerns about COVID-19 were increasing due to the emergence of virus variants. The member also assessed that there would still be room for closely watching price developments, since consumer prices were likely to fall to the 1% range next year, even if they rise to the 2% inflation target this year, and core inflation would likely recover to the mid-1% next year from the lower-1% level this year.

However, given financial stability conditions, the member expressed the view that the time had come to adjust the degree of monetary policy accommodation. The member particularly raised the concern that household debt was continuing to grow despite the government's lending regulation measures, and funds were continuing to flow into asset markets such as the real estate. The member assessed that the accommodative monetary policy in place since the COVID-19 outbreak had played an important role in preventing a sharp contraction in the real economy, but had simultaneously caused a rise in asset prices. The member added that these rising financial imbalances were commonly faced by most central banks in advanced economies.

The member stated that there were various opinions as to how the central bank could preemptively respond to an asset market bubble, and it was undeniable that the fundamental mandate of monetary policy, a part of macroeconomic policy, was to give first consideration to the real economy. The member, however, expressed the opinion that more attention should be given to financial stability in the conduct of monetary policy at the present moment. The member noted that it had been often pointed out that an adjustment to the degree of monetary policy accommodation under the current ongoing COVID-19 crisis conditions could increase difficulties faced by vulnerable groups. The member, however, raised the concern that persistent debt growth as seen recently would lead to greater risk of a so-called debt trap, which would make it impossible to normalize interest rates due to the excessive debt burden. The member pointed out that, recalling historical experience, excessive credit had caused bubbles to form and burst, weakening the financial sector's soundness and intermediary role and ultimately worsening the real economy to a great extent. The member thus stressed that it would be extremely important to ensure financial stability for stable domestic economic growth at this point.

The member noted that, taking these points into overall consideration, it would be desirable to give greater weight to financial stability and raise the Base Rate to 0.75% from the current 0.50%. The member added that monetary policy was expected to have a signaling effect on asset markets, although some pointed out that it would be difficult to deal with excessive expectations for price increases in asset markets through a slight interest rate hike. The member expressed the opinion that it was inevitable that the increased burdens on vulnerable groups, including the working-class, the self-employed, and small- and medium-sized enterprises (SMEs), following an interest rate hike would have to be dealt with through fiscal policy which can target specific sectors. The member also stressed the need to consistently push for macroprudential policies aimed at reigning in the pace and size of debt growth.

Meanwhile, the member expressed the need for a thorough analysis of US inflation, which had shown higher-than-expected growth. The member assessed that inflation in the US and the consequent changes in its monetary policy would highly likely to lead the world economy to areas of uncertainty. The member thus raised the concern that reversals of elements that had all moved in only one direction during the pandemic, such as expansionary fiscal policy based on government bond issuance at low rates, rising asset market prices based on leveraged investment, and expansions in household and corporate debt, could trigger unforseen shocks. The member also noted that previous cases had shown that shifts in the US monetary policy stance were accompanied by economic unrest in EMEs, and thus pointed out that attention was needed in this regard.

In addition, the member expressed the view that careful thought should be given to orderly normalization of the emergency measures taken to deal with the pandemic crisis. The member stated that numerous emergency measures had expired so far, but supporting the credit market through an SPV that purchases corporate bonds and commercial paper, and the expansion of the Bank Intermediated Lending Support Facility, were still ongoing. The member added that, if there was a Base Rate hike in consideration of financial imbalances, it would be desirable to maintain these measures aimed at supporting vulnerable groups for some time.

Finally, the member noted that monetary policy alone could not guarantee medium- to long-term economic growth, since it is fundamentally a macroeconomic policy that responds to short-term economic fluctuations. However, the member expressed the view that monetary policy that accounted for financial stability would be able to establish a foundation for stable economic growth in the longer term. The member thus stressed that a foundation for economic stability should be established based on monetary policy, while structural issues to ensure long-term growth of the domestic economy should be dealt with through the government's aggressive economic policy.

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

The member assessed that the domestic economy was sustaining a favorable recovery, with exports and facilities investment maintaining strong growth and the recovery of private consumption strengthening gradually. The member expected the domestic economy to exhibit growth consistent with the path forecast last May, although uncertainties related to COVID-19 had increased again. The member's forecast was that stronger recoveries of the US and other major economies would have positive impacts on exports of and investment in Korea's key industries. The member also projected that consumption would sustain its underlying trend of improvement, since the effects of the spread of the virus variants were unlikely to last long considering the full-scale vaccinations of young and senior age groups and previous measures to combat COVID-19, and the government was implementing policy measures to support income and boost consumption.

Looking at inflation, the member mentioned that consumer price inflation had risen to the mid-2% level, boosted by the accelerating growth in service charges in addition to supply-side upward pressures, and core inflation had also sustained its modest growth of the lower-1% level. The member expected inflation to be somewhat above the May forecast growth path going forward. Meanwhile, the member's evaluation was that housing price growth had accelerated, particularly in Seoul and its surrounding areas, and home purchase sentiment and expectations of higher housing prices were also rising again.

Concerning the financial markets, the member pointed out that market risks were increasing, with continued risk preference and heightened volatility of capital flows between financial institutions. The member noted that there were growing concerns in the stock market about overly optimistic expectations from individual investors and leveraged speculative transactions. The member also assessed that institutional investors had been increasing short-term transactions involving MMFs and RPs and expanding investment in high-risk assets such as non-prime corporate bonds, and in this process the interconnectedness of financial markets had increased, leading to higher interest rate and credit risks throughout the markets. Meanwhile, the member added that household debt had exhibited another sharp rise in June and the rate of growth in M2 and other liquidity indicators remained high.

The member expressed concerns that the increasing imbalances throughout the financial markets could work to weaken financial system resilience and make the domestic economy vulnerable to internal and external shocks. The member argued that financial conditions, which had been eased to an extraordinary extent to cope with the COVID-19 crisis last year, were now acting as a factor worsening financial imbalances, and it would be therefore necessary to adjust the degree of easing appropriately.

In conclusion, the member assessed that, considering the forecast of a strong, sustained recovery of the domestic economy and the continued increase in financial stability risks, it would be necessary to partly adjust the degree of monetary easing in the near future. However, the member expressed the opinion that it would be desirable to keep the Base Rate at its current level of 0.50%, considering the need to observe the developments and effects of the recent resurgence of COVID-19 for a little longer.

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

The member assessed that, since the previous MPB meeting, the global economic recovery had been strengthening, boosted by accelerated vaccination and eased restrictions on economic activity. However, the member pointed out that the possibility could not be ruled out of a subdued economic recovery particularly in emerging market countries with low vaccination rates, since developments of the health crisis remained volatile with the rapid global spread of virus variants.

The member mentioned that the domestic economy had continued to show similar developments to those of the global economy, and projected that a mix of upside and downside risks, such as supply chain bottlenecks, the resurgence of COVID-19, accelerated vaccinations and stimulus measures, would work to increase the volatility of economic activity greatly for the time being. The member expected the manufacturing sector to reverse to an uptrend at any moment, considering the positive forecast for the business climate by corporations and the steady improvement in inventories and in conditions for final demand, such as exports. Concerning the services sector, meanwhile, the member judged that economic losses in face-to-face industries would be inevitable, as the trend of their recoveries had been disrupted greatly in the short term by stricter social distancing rules. The member's assessment was that, since vaccines had proved to be somewhat effective in preventing people from getting infected with COVID-19 and, in case of infections, from getting seriously ill, and since face-to-face economic activities were being replaced with non-face-to-face economic activities based on the lessons learned from previous experiences, the resurgence of COVID-19 was likely to have only limited effects on GDP over a medium-term horizon. The member, however, noted that a careful approach was needed in estimating the economic impacts of the resurgence, since vaccination was proceeding more slowly in Korea than in major countries and the spread of virus variants had started to pick up at a time when face-to-face activities were increasing.

The member assessed that consumer price inflation had exceeded 2% for the third consecutive month, and that supply-side inflationary pressures had declined somewhat but remained higher than originally forecast while demand-side inflationary pressures had also been increasing gradually. The member also mentioned that inflation expectations among the general public had been growing rapidly since the beginning of this year, and added that attention had been paid to whether this uptrend would continue and also to the correlation between inflation expectations and asset inflation.

The member meanwhile assessed the financial markets as remaining relatively stable. The member also expressed concerns about the growing risk of the accumulation of financial imbalances due to the continued search for yield by economic agents and strengthening interactions between increasing private-sector leverage and rising asset prices under accommodative financial conditions. More specifically, the member noted that household credit had maintained strong growth and housing price growth had been accelerating again, raising concerns about their negative impacts. The member pointed out that upward trend in Korea's household debt-to-income ratio had been gaining pace since the outbreak of COVID-19 to substantially surpass the average of major advanced countries, Korea's housing price-to-income ratio (PIR) had also been growing more rapidly than that of other countries, and the ratio's disparity from its long-term equilibrium level had widened significantly. The member presented the view that, if these risks are not appropriately managed, they could undermine future economic growth and financial stability through a potential increase in debt repayment burdens and the possibility of drastic price adjustments, and that in this regard there was a growing need to make monetary policy responses along with implementing various macroprudential measures.

Taking all this into consideration, the member judged that, while the domestic economy had maintained the underlying trend of recovery, consumer price inflation was likely to exceed the May forecast and the risk of financial imbalances, such as increasing private-sector leverage and an over-concentration of funds in asset markets, had been worsening gradually. The member took the view that it would be necessary in this regard to adjust the degree of monetary easing and change the policy stance to meet changing financial and economic conditions. The member, however, expressed the opinion that, since the resurgence of COVID-19 could limit the short-term trend of economic activity and add to uncertainty, it would be desirable to hold the Base Rate at its current level and observe a little longer developments of the health crisis and the economic situation at home and abroad.

Another member presented the view that it would be desirable to hold the Base Rate at its current level of 0.50%.

The member expected Korea's growth rate for this year to be at around 4% as originally forecast, since briefings by the Research Department indicated that the spread of variants was likely to have only limited negative effects on consumption compared with the past due mainly to accelerated vaccinations and loosened vigilance against the pandemic while the supplementary budget was expected to have positive effects. With respect to exports and investment, the member considered it fortunate to see exports and investment buoyant despite the global spread of virus variants, boosted largely by recoveries of major economies and digital innovation. The member, however, presented the view that attention should be paid to possible production setbacks in key manufacturing industries, due mainly to the continued supply chain bottlenecks resulting from a shortage of semiconductor supply, limited logistics facilities, and the spread of COVID-19 in certain regions of the country.

The member forecast consumer price inflation to be nearly 2% this year and core inflation to remain in the lower-1% range with both supply- and demand-side upward pressures strengthening. The member expressed the view that core inflation felt by the general public might be much higher than the actual figures, given that regulated items account for a large share of Korea's statistics on consumer price inflation and owners' equivalent rent (OWR) is excluded from the statistics, and added that this was not irrelevant to the recent rise in inflation expectations.

Concerning the financial sector, the member pointed to the accumulation of risks owing to the unprecedented expansion in leverage and the strengthening risk preference. The member noted that a look at the rates of growth in housing sales prices in the world's major cities and stock price growth rates in major countries since the beginning of last year showed that Korea ranked near the top. The member added that Korea's household debt-to-GDP ratio had become much higher than those of major countries, with financial institution household lending recording its largest-ever increase and the outstanding amount of loans on margin accounts hitting a record high in the first half of this year.

Considering these macroeconomic and financial stability conditions, the member expressed the view that it would be necessary not to wait too long to start adjusting the monetary easing stance. The member however added that, considering the heightened uncertainty surrounding the growth path due to the recent rapid resurgence of COVID-19, it would be appropriate to keep the Base Rate unchanged from the current level and closely monitor future economic developments to determine when to start monetary policy normalization. The member also stressed the need to examine whether the prolongation of the accommodative policy stance in response to the COVID-19 shock was working to increase the risk of financial imbalances. Furthermore, the member added that it would be necessary to consider more direct financial and fiscal support for vulnerable groups hit hardest by the resurgence of COVID-19.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of the above discussions, the following Monetary Policy Decision statement was compiled reflecting the views of the majority.

However, Dr. Koh, Seung Beom expressed clear opposition to keeping the Base Rate at the current level and argued for raising it by 0.25 percentage points.

<u>Monetary Policy Decision</u>

☐ 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 strengthened, supported by accelerated vaccinations and the relaxation of restrictions on economic activity in major countries. In global financial markets, stock prices have continued to rise, reflecting the economic recovery. The US dollar has strengthened, while long-term government bond yields have declined considerably due mainly to the spread of COVID-19 variants. 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 its sound recovery. Exports and facilities investment have sustained their buoyancy and private consumption has shown improvement. Labor market conditions have continued to improve, with the year-on-year increase in the number of persons employed remaining high. Going forward, exports and investment will sustain their buoyancy, while private consumption is forecast to temporarily weaken affected by the coronavirus resurgence but then return to the path of recovery supported by the execution of a supplementary budget. GDP growth this year is projected to be around 4%, consistent with the forecast in May.

☐ Consumer price inflation has remained high at the mid-2% level due to the rising prices of petroleum products and agricultural, livestock, and fisheries products as well as the accelerating increase in service prices. Core inflation (excluding changes in food and energy prices from the CPI) has run at the lower-1% level. The inflation expectations of the general public have risen slightly to the lower-to mid-2% range. Looking ahead, it is forecast that consumer price inflation will continue to run in the lower- to mid-2% range for some time, exceeding the path projected in May. Core inflation is forecast to increase gradually to the mid-1% range.

☐ In domestic financial markets, stock prices and the Korean won to US dollar exchange rate have risen, mainly driven by global financial market movements. The 3-year Korean Treasury bond yield has risen considerably, while the 10-year yield has fallen. Household loan growth has remained high, showing a record level on a first-half basis, and housing prices have continued to increase rapidly in all parts of the country.

☐ 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 will maintain an accommodative stance of monetary policy as there remain uncertainties posed by the virus, although the Korean economy is expected to continue its recovery and inflation to remain at a high level for some time. In this process the Board will judge whether it is appropriate to adjust the degree of accommodation while thoroughly assessing developments related to COVID-19, changes in the pace of growth and inflation, and the risk of a buildup of financial imbalances.