Minutes of the Monetary Policy Board Meeting

May 2020

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]
(May 2020)

Ⅰ. Outline

1. Date of meeting: Thursday, May 28, 2020

2. Place: Monetary Policy Board Meeting Room

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

4. Monetary Policy Board members absent: none

5. Participants:
   Jang, Ho Hyun, Auditor
   Ryoo, Sangdai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Lee, Seungheon, Deputy Governor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Min, Jwa Hong, Director General of Financial Stability Department
   Lee, Sang Hyeong, Director General of Monetary Policy Department
   Kim, Hyun Kee, Director General of Financial Markets Department
   Yang, Seok Jun, Director General of International Department
   Shin, Woon, Director of BOK Economic Research Institute
   Park, Young Chool, Press Officer
   Suh, Myeongguk, Director of Reserve Management Strategy Division (Acting Director General of Reserve Management Group)
   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 *Economic Outlook*,[2] *FX and International Finance Trends*, and *Financial Market Trends*, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members' evaluation was that the global economy had been going through a serious slump due to the COVID-19 pandemic, and as a result, global trade had contracted and oil prices had remained low. Members assessed that risk-off sentiment had moderated considerably in the global financial markets, thanks to aggressive policy measures by countries around the world and expectations of economic reopening, but uncertainties remained high concerning the future path and impacts of the pandemic.

Members expected that the domestic economy would not be hit as hard by COVID-19 as economies of major advanced countries, but the economy was extremely sluggish, recording negative growth in both the first and second quarters, and was likely to exhibit negative growth in annual terms as well. By sector, members judged that private consumption had remained sluggish and the recovery in facilities investment had been subdued. Members expressed concerns that, on top of the slowdown of domestic demand, the sluggishness of exports that had become apparent since the second quarter might limit domestic economic growth. With regard to prices, members pointed out that the slump in aggregate demand, in combination with the drop in global oil prices, had dragged consumer price inflation down to the 0% level, and core inflation had also fallen significantly.

Finally, in the domestic financial markets, members' evaluation was that the volatility of price variables had eased and credit flows had improved, as global financial market conditions had stabilized and the Bank of Korea and the Korean government had taken decisive policy measures. Members stressed, however, that attention should be paid to the possibility of renewed financial market unrest due to the high uncertainty surrounding COVID-19, and also to the widening disparity between the recovery of financial markets and the sluggishness of the real economy.

2) An English version of *Economic Outlook* 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 presented the view that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to lower the Base Rate by 25 basis points.

One member presented the view that it would be appropriate to lower the Base Rate by 25 basis points to 0.50%.

The member mentioned that the global economy had been facing a serious slump caused by the COVID-19 pandemic. Looking at individual countries, the member's assessment was that the Chinese economy had been recovering from the shock of the previous quarter and showing gradual improvement, while economic activities in the US and the euro area had contracted drastically since March. The member noted that, in an effort to cushion economic shocks, most countries had been adopting accommodative fiscal and monetary policies and major countries had been recently easing lockdown measures gradually, resulting in partial economic reopening. The member added that all this had been supporting expectations of economic improvement in the second half. The member's diagnosis, however, was that uncertainties surrounding the future growth path remained high, owing to the uncertainty of pandemic-related developments and to the signs of a reescalation of US-China trade tensions.

Regarding the domestic economy, the member forecast that, although the COVID-19 shock seemed less severe in Korea than in major advanced countries, domestic GDP was projected to contract this quarter, representing two consecutive quarters of negative GDP growth for the first time since 2003. The member forecast that, however, a somewhat different picture could be in sight from the previous quarter in that exports would decline at a much faster pace, particularly to the US and the euro area where preventive measures had been strengthened, while the decline in private consumption would ease gradually, boosted by various policy support measures. However, the member mentioned that caution was required in concluding whether the recent consumption trend could lead to sustainable improvement, since consumer sentiment had contracted substantially, and employment and income conditions were highly likely to worsen further for some time.

With regard to financial markets, meanwhile, the member evaluated that risk-off sentiment had been easing, mostly because of aggressive policy responses by individual countries and expectations of economic reopening. The member assessed that credit risk aversion had not increased further in capital markets, and that ample liquidity had ensured favorable credit supply in indirect financial markets, which accounted for a large share of the funding of Korean businesses. In this regard, the member judged that the possibility of a real-financial vicious circle, in which financial market unrest adds to the real economic shock, had been prevented to some extent. However, the member expressed the view that, since the fundamental cause of the current real economic contraction lay in the pandemic, not in financial issues, it was difficult to consider improvement in financial conditions as a sufficient condition for economic recovery. The member emphasized that attention should be paid to the possibility that price variable volatility would rise again and household and corporate credit risks would increase in the event of a delay in economic recovery due to prolongation of the pandemic.

Taking all this into consideration, the member's projection was that, although financial market unrest caused by the COVID-19 pandemic had been easing substantially, the negative spillover effects on the domestic real economy were expected to last for some time due to the worsening overseas economic conditions. The member also stressed that the possibility of downside risks to the medium- and long-term growth path could not be ruled out, amid uncertainties regarding when the pandemic, the root cause of the shock, would significantly subside. In light of this, the member argued that it would be desirable to cut the Base Rate by 25 basis points to 0.50% this time to provide a buffer against downside risks to the domestic economy.

Another member presented the view that it would be desirable to cut the Base Rate from the current 0.75% to 0.50%.

The member assessed that the COVID-19 pandemic and preventive measures taken in response by countries around the world had put the global economy into a recession unprecedented since the Great Depression. The member stated that Korea had not imposed a large-scale lockdown thanks to its effective preventive measures and was accordingly facing less severe growth loss than major advanced countries. The member, however, added that it still needed to be kept in mind that the ongoing crisis had come amid a falling potential growth rate and a sustained low inflation trend.

The member's evaluation was that, looking at its economic impact, the pandemic was unusual since it affected both supply and demand, but as the domestic economy had been able to avoid an extreme lockdown and shutdowns of production facilities, the shock had been more of a demand nature. The member mentioned that households' average propensity to consume had declined significantly in the first quarter, and that consumer price inflation and core inflation had run at only 0.1% in April. In addition, regional economic activities in March and April, when the dramatic negative impacts had peaked, clearly showed a correlation among consumption, employment and inflation in which a drop in one factor leads to a fall in the others.

The member anticipated that, although the government's accommodative fiscal policy was expected to offset the sluggishness of demand to a certain extent, the negative output gap would inevitably widen. The member's judgment was that, although the Base Rate had been lowered from 1.25% to 0.75% at the interim meeting in March, a further rate cut was inevitable, given the forecasts of the negative output gap exceeding 2%p and low inflation nearing 0%.

For this year in particular, the member forecast that the private sector would exhibit a negative growth rate even though the government sector would not. The member took the view that the current crisis triggered by COVID-19 had been weighing on both the household and corporate sectors and that the worsening of private sector balance sheets might create a cycle of contraction in the overall economy in which a decrease in one sector leads to a decline in another. Regarding government measures such as government bond issuance and expansionary fiscal policy, the member went on to argue that it would be necessary to take measures to reduce overall financial expenses including debt-servicing burdens. The member stressed the need for the central bank to seek market interest rate stability by lowering the Base Rate and buying Treasury bonds, as the central bank needed to play a leading role in overcoming the crisis.

The member in this regard expressed the opinion that it would be advisable to lower the Base Rate from the current 0.75% to 0.50% this time in order to induce a reduction of financial expenses in the private and government sectors, while coping with downward pressures on nominal demand. The member's assessment was that, although the 0.50% Base Rate would be the lowest in the history of the domestic economy, it would not be low enough given the unprecedented current environment in which nominal GDP was almost 0%, nor would it be so low as to trigger sudden capital flows, considering the gap between domestic interest rates and those of major advanced countries.

Finally, the member argued that the monetary easing stance should be maintained for a considerable period of time in order to induce an appropriate level of inflation expectations under the inflation targeting regime. The member judged that there were some concerns about the possibility of a Base Rate cut increasing instability in real estate and other financial sectors, but this should not be a top priority consideration for the monetary authorities in the current crisis. The member, however, emphasized that housing supply policies, tax policies and macroprudential policies should be carried out as planned in order to stabilize the housing market.

One member presented the view that it would be desirable to adjust the Base Rate downward from the current 0.75% to 0.50% this time.

Looking at economic developments since the April MPB meeting, the member assessed that major countries, including the US and European countries, had exhibited much slower growth due to COVID-19, and as a result, world trade had contracted and oil prices had remained low. The member noted that these global economic conditions had been having negative impacts on the domestic real economy as well. The member forecast that private consumption, although having shown some signs of recovery since the second quarter, would exhibit negative growth in annual terms, and facilities investment would be more sluggish than originally projected due to a correction in non-IT investment. The member expressed concerns that the export slump that had persisted since the second quarter, along with the slowdown of domestic demand, might work to restrict growth of the domestic economy this year. Turning to employment conditions, the member noted that deterioration had thus far been seen mostly in the services sector, but predicted that an employment downturn would also become evident in the manufacturing and construction sectors as well. With regard to inflation, the member pointed out that consumer price inflation had fallen close to 0% and core inflation had also declined significantly.

The member evaluated that, in consideration of this situation, the Research Department had made drastic downward adjustments to its growth and consumer price inflation forecasts for this year, but downside risks related to these forecasts might materialize, since the possibility of a second wave of COVID-19 could not be ruled out and the global economy could remain sluggish. The member expressed the view that the negative output gap was currently widening, as was the negative inflation gap due to low demand-side inflation pressures, and in light of this, it would be necessary to strengthen the accommodative monetary policy stance.

Meanwhile, the member judged that uncertainties in the international financial markets had decreased somewhat and the financial and FX markets in Korea had become relatively stable thanks to the effectiveness of aggressive measures adopted by the Korean government and the Bank of Korea. The member stressed the need to continue to closely monitor financial market developments at home and abroad and seek additional responses promptly if needed.

The member mentioned that the current pandemic had occurred at a time when concerns had been raised about the possibility that a surge in liquidity from sustained accommodative macroeconomic policies in Korea and major countries might act as a factor for financial market unrest. The member took the view that, although it had been pointed out for some time that the issues of excessive liquidity and debt should be considered in monetary policy decisions, in times of crisis like this priority should be placed on making policy judgments to cope with the crisis. The member added that it was time to put the debt issue aside for the moment and take bold macroeconomic measures to combat the ongoing crisis.

The member judged that, although the Base Rate had been already lowered to the 0% level and opinions might vary regarding its effective lower bound, the central bank still had room for a further rate cut considering the level of the policy rates of major countries. The member in this regard argued that it would be desirable to cut the Base Rate from the current 0.75% to 0.50%. The member expected that the current rate cut would help ease the burdens on households, small business owners and corporations troubled by the pandemic and also help the government implement fiscal policy in pursuit of economic recovery.

Another member expressed the opinion that it would be desirable to adjust the Base Rate downward by 25 basis points.

The member diagnosed the global economy as suffering huge difficulties, as the negative impacts of COVID-19 were widely seen across the board in both advanced and emerging economies and in both domestic demand and exports. The member added that there were high uncertainties as to how the COVID-19 situation would develop and how severe its impacts would be.

The member noted that the Research Department was projecting growth for this year to stand at -0.2%, 2.3 percentage points lower than the previous forecast, even with the basic assumptions that the global spread of COVID-19 would peak in the second quarter and there would not be a major second wave in Korea. The member pointed out that, although this figure was much more favorable than the forecasts for major economies or the global average, it would represent the first negative growth of the domestic economy since the Asian Currency Crisis, and would consequently make the negative output gap widen further and last longer. The member raised the concern that, if there were a second wave of COVID-19, contrary to the basic assumption, or if downside risks such as an escalation of the US-China trade conflict and the spread of economic crises in EMEs materialized, the additional negative impacts on the domestic economy could be enormous. The member also saw that, with respect to prices, consumer price inflation would slow to the 0% level and fall further short of the inflation target due to sluggishness in aggregate demand compounded by the decline in international oil prices.

The member noted that, in response to this sluggish growth and inflation and to the financial unrest immediately following the spread of COVID-19, the MPB had cut the Base Rate by 50 basis points in March and had supplied liquidity on a large scale by for instance expanding the Bank Intermediated Lending Support Facility and taking various open market operation measures. The member's assessment was that, as a result, financial stability was able to be achieved, with price variables showing less volatility and credit flows improving.

The member, however, pointed out that, on the other hand, there had been concern about whether there was excessive decoupling between sluggishness in the real economy and improvement in the financial markets. The member expressed the opinion that, if the improvement in the financial markets did not lead to improvement in the real economy, the financial markets could undergo a considerable correction. The member added that, in the medium to long term, active monetary accommodation could cause a deepening of financial imbalances through economic agents' stronger search for yield, concentration of liquidity into certain asset markets coupled with rising asset prices, and increased debt servicing burdens and default risk stemming from accumulated debt.

The member noted that, considering the above-mentioned matters, macroeconomic risk and financial stability risk had conflicting implications for monetary policy decision-making. The member, however, expressed the view that it would be appropriate to lower the Base Rate by 25 basis points from 0.75% to 0.50% this time, since it appeared to be more urgent to stimulate growth and inflation than to control the deepening of financial imbalances. The member added that, if the Base Rate were lowered at this meeting, there would be only limited scope for further downward adjustments to the Base Rate, not only in terms of financial imbalances, but also in terms of policy effectiveness and possible capital outflows, although this judgment could of course vary depending upon changes in domestic and international financial conditions and the monetary policy operations of major economies.

One member stated that it would be desirable to adjust the Base Rate downward by 25 basis points.

The member's assessment was that COVID-19 was simultaneously causing negative demand-side and supply-side shocks to the domestic economy, thereby weighing on economic activity and putting downward pressure on prices. The member expressed the opinion that, in response, accommodative monetary policy should be conducted while taking into account interactions with fiscal policy.

The member noted that the Research Department was forecasting growth for this year to record a low level of -0.2% under a baseline scenario in which the number of confirmed coronavirus cases would peak in the second quarter. The member pointed out that Korea could be said to have been less severely impacted by COVID-19 than major countries in that it had opted for a quarantine, not a lockdown. The member, however, pointed out that the negative growth was almost unprecedented and the quality of growth was also very fragile. Specifically, the member expected private consumption to decrease substantially, with the effects of large-scale transfer payments by the government excluded, and facilities investment and exports to be very sluggish with the exception of semiconductors.

The member's assessment was that the sluggishness in the private sector was due to the amplification of the coronavirus shock through interactions with structural vulnerabilities in the domestic economy. The member thus noted that it was necessary to prevent, as much as possible, the coronavirus shock from leading to permanent damage to the foundation for growth. The member went on to present the opinion that, to this end, it was necessary to reduce the financial costs of the private sector and the fiscal burden of the government through an additional Base Rate cut.

The member commented that, with respect to inflation, active response measures were needed, particularly since both consumer price inflation and core inflation remained in the lower-0% range, even raising concerns about deflation. The member's assessment was that, although the Phillips curve had flattened, the recent very large slowdowns in economic activity and employment were having negative impacts on inflation and income levels. The member thus emphasized the importance of preventing a decline in inflation expectations through active policy responses and communications.

Meanwhile, the member acknowledged that concerns about financial imbalances and capital outflows had increased as the Base Rate approached the effective lower bound. The member, however, commented that household debt was showing modest growth, while foreign portfolio investment was recording net inflows unlike periods of international financial unrest in the past thanks to the robust external soundness of the domestic economy. The member thus expressed the opinion that it was necessary to closely watch the relevant developments in the future.

Finally, the member commented that interest rate policy should be conducted flexibly by closely monitoring the possibility of domestic and international economic sluggishness becoming deeper than expected due to a second wave of COVID-19 or the possibility of the economy shifting to a recovery trend thanks to the spread of COVID-19 easing earlier than expected. The member also emphasized the need to continue to give thought to various monetary policy tools.

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 participating in the vote supported the decision unanimously.

Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to lower the Base Rate by 25 basis points, from 0.75% to 0.50%.

☐ Currently available information suggests that the global economy has contracted significantly due to constrained economic activity caused by the COVID-19 pandemic. Unease in global financial markets has moderated considerably. Stock prices in major countries have risen, and the volatility of government bond yields and exchange rates has lessened thanks to aggressive fiscal and monetary measures in major economies and expectations of economic reopening. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the evolution of the pandemic, as well as by the effects of national policy responses.

☐ Economic growth in Korea has slowed considerably. Consumption has remained sluggish, and exports have fallen significantly. While the recovery in facilities investment has been subdued, the correction in construction investment has continued. Labor market conditions have worsened with a sharp decline in the number of persons employed, especially in the service sector. The Board expects that domestic economic growth will remain sluggish for some time due to the impact of the COVID-19 pandemic. GDP growth is projected to fall considerably below the February forecast of 2.1% to around 0%, and uncertainties around the future path of GDP growth are also judged to be very high.

☐ Consumer price inflation has slowed markedly to the lower-0% level due to declining prices of petroleum products and public services as well as slower growth in the prices of agricultural, livestock, and fisheries products. Core inflation (excluding changes in food and energy prices from the CPI) has also moved down to the lower-0% range, and the inflation expectations of the general public have fallen slightly to the mid-1% level. It is forecast that consumer price inflation and core inflation will run at the lower-0% and mid-0% level this year, respectively, due to the drop in global oil prices and weakening demand-side inflationary pressures.

☐ Volatility in domestic financial markets has declined as a result of improved global financial market conditions as well as decisive market stabilization measures. While long-term market interest rates have fallen, stock prices have risen and the Korean won to US dollar exchange rate has fluctuated within a narrow range. The increase in household loans has slowed, and the rate of increase in housing prices has decelerated.

☐ 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 economic growth is expected to be sluggish and inflationary pressures on the demand-side are forecast to remain weak due to the COVID-19 pandemic, 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, and changes in financial stability.