Minutes of the Monetary Policy Board Meeting

May 2021

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(May 2021)

Ⅰ. Outline

1. Date of meeting: Thursday, May 27, 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
   Bae, Joonsuk, Deputy Governor
   Min, Jwa Hong, 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
   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
   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 *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 assessed that the domestic economic recovery had been accelerating significantly, with exports and facilities investment showing favorable movements and private consumption improving gradually. Members projected that upside risks would predominate over downside risks in the growth path going forward, and as a result, the negative output gap would narrow at a faster-than-expected pace. However, some members expressed the view that, considering the slow pace of improvement in face-to-face services industries, it was a bit too early to conclude that domestic demand had started to show a full-fledged recovery.

In terms of inflation, members mentioned that consumer price inflation had been rising significantly owing primarily to supply-side factors, and expected underlying inflation pressures to build up; for example, core inflation was projected to increase steadily with the economic recovery.

Members, meanwhile, expressed concerns that financial imbalances had been worsening, with private-sector credit increasing and economic agents' risk preferences strengthening amid the continued accommodative financial conditions. Some members pointed out that household-sector leverage, in conjunction with prices of assets such as real estate, stocks, and crypto assets, had been expanding even further, and emphasized the need for attention to the possibility that widening financial imbalances could weaken financial market resilience significantly, making the domestic economy vulnerable to internal and external shocks. One member, however, noted that various indicators suggested that financial imbalances might start to ease gradually, and took the view that significant caution was needed when assessing financial imbalances in connection with monetary policy.

Members also noted that it would be necessary to pay more attention to and conduct in-depth research on structural problems of the Korean economy, such as employment by small business owners, from medium- and long-term perspectives.

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 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 desirable to keep the Base Rate at the current level of 0.50%.

The member mentioned that, according to the latest *Economic Outlook*, the domestic economy would grow by 4% this year and 3% next year, led by exports and facilities investment, and the output gap would shift to positive within one year. The member found it encouraging that private consumption growth was forecast to rebound to 2.5% this year and 3.5% next year. The member took the view that this was attributable substantially to base-period effects and government support measures, but the trickle-down effects of wide-ranging export strength and the wealth effects of asset price rises were also responsible. The member, however, pointed out that it was difficult to conclude that domestic demand had started to show a full-fledged recovery, given that it would likely take more than a year for private consumption to return to its pre-COVID-19 level, that household income continued to decrease when the government's transfer payments were excluded, and that the number of persons employed was growing slowly when government-supported employment was counted out.

Concerning inflation, the member mentioned that attention should be paid to the fact that core inflation with regulated prices excluded was projected at around 2% for the second half of this year and the first half of next year. The member added that this suggested inflation pressures were increasing due to demand-side factors as well as supply-side ones.

Regarding the financial markets, meanwhile, the member pointed out that asset prices continued to rise and risk preferences continued to strengthen in the accommodative monetary policy environment since the initial phase of the COVID-19 shock. The member went on to state that, with the increasing leveraged investment in real estate, stocks and crypto assets and the expanding borrowings by financially vulnerable economic agents, vulnerability to an asset price crash and default risk had been building up. The member expressed concerns that, if the current accommodative financial conditions continue, consumption could be restricted by the buildup of debt and the efficiency of resource allocation could be reduced, ultimately having negative impacts on growth that would overwhelm the short-term stimulus effects. In this regard, the member argued that, considering the recent real economic and financial conditions and the trends of economic activity and inflation, it was time to consider adjusting the accommodative monetary policy stance slightly.

The member, however, noted that it was necessary to closely monitor economic and financial developments while holding the Base Rate at its current level for the time being, given the ongoing uncertainty related to COVID-19, insufficient recovery in private consumption and employment despite quantitative improvements in macroeconomic indicators, and low likelihood of the current financial imbalances leading to instability of the entire financial system. The member added that it would be important to think about when to normalize monetary policy and how to communicate appropriately in order to maintain the momentum of economic recovery and at the same time prevent financial imbalances from worsening excessively. The member also emphasized that economic agents should prepare for increased borrowing costs to avoid becoming more vulnerable to them.

The member, meanwhile, stated that the weak income conditions of vulnerable households, sluggish employment conditions at marginal firms, and restructuring of small business owners were structural problems that were unlikely to be solved even when the pandemic is over and unlikely to be tackled effectively with monetary policy alone, and went on to argue that in this regard it would be necessary to pursue fiscal expenditure in a more targeted way and seek institutional improvement.

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

The member mentioned that the recovery of the Korean economy had been expanding rapidly, with private consumption gradually emerging from its slump recently while exports and facilities investment maintained strong growth, and forecast that the domestic economic recovery was likely to strengthen going forward. The member stated that the Bank of Korea had raised the growth forecast for this year significantly as the upside risks mentioned in the previous forecast, such as a stronger global economic recovery, improved consumer confidence following vaccinations, and additional government support measures, had materialized substantially, and went on to argue that, although uncertainties related to the outlook for the recovery of the Korean economy had decreased significantly, uncertainties surrounding the path of COVID-19 and the status of vaccinations remained. Concerning inflation, the member noted that the growth in service charges had been accelerating, coupled with upward pressures on the supply side. The member forecast consumer price inflation to remain at the mid-2% level for the time being and then decline somewhat to fluctuate at around 2%, and core inflation to rise gradually to the mid- to upper-1% level affected by increased upward pressures on the demand side in line with the economic recovery.

Looking at the financial markets, the member's assessment was that preference for high-risk assets had been strengthening based on the accommodative financial conditions and expectations of domestic and overseas economic recoveries. More specifically, the member noted that the recent acceleration in M2 growth in contrast to the slowdown in M1 growth implied that the additional liquidity that had been supplied was being used by economic agents in strengthening their yield-seeking behavior, for example by investing in performance-based dividend products and marketable instruments.

The member expressed concerns that financial imbalances had been worsening, as the continued risk-taking tendencies and yield-seeking behavior of economic agents had caused household debt to build up and asset prices to rise significantly. The member noted that various forms of factors causing market instability, such as surges in long-term market interest rates, herd behavior of individual investors, and plunges in crypto asset prices, had been witnessed in the domestic and overseas financial markets since the second half of last year, and went on to state that some were sounding warnings that the prolongation of the current ultra-accommodative financial conditions could lead to investments based on excessive optimism and ultimately to drastic market corrections. The member pointed out that the widening of financial imbalances would work to weaken financial market resilience significantly and make the Korean economy vulnerable to internal and external shocks, and presented the view that attention should be paid to the fact that the accommodative financial conditions introduced last year to cope with the COVID-19 crisis were now also working to increase financial market unrest.

In conclusion, the member argued that, given the forecast of a stronger domestic economic recovery and growing risks to financial stability, there was a need to consider partially adjusting the current stance of monetary policy that had been eased to an unprecedented extent in response to the COVID-19 crisis, but considering underlying uncertainties surrounding the path of COVID-19, it would be necessary to communicate closely with economic agents about recognition of the changes in economic and financial conditions and the direction of policy in consideration of such changes, while maintaining the current monetary easing stance for the time being. The member in this regard judged that it would be desirable to hold the Base Rate at its current level of 0.50% for the intermeeting period.

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

Looking at the changes in domestic and external conditions since the previous MPB meeting, the member assessed the recovery of the global economy as strengthening gradually, boosted by expansion of vaccine distribution and reopening the economy as well as the economic stimulus in major countries. The member, however, mentioned that caution was needed in forecasting the medium- and long-term growth path of the global economy, since the gap in economic activity between countries remained wide and the evolution of the current health crisis, including the spread of variants, remained uncertain. The member's evaluation was that, boosted by the faster-than-expected recovery of the domestic economy, real GDP had returned to its pre-COVID-19 level in the first quarter and the gap in economic activity between industries and sectors had been narrowing gradually. The member, however, judged that uncertainty surrounding the recovery path had not yet been eased substantially. More specifically, the member pointed out that demand in face-to-face industries remained sluggish compared with the pre-COVID-19 period and, considering the pace of the recent COVID-19 spread and the trend of vaccinations in Korea, it would be difficult to expect such demand to return to normal soon. The member stressed that attention should be paid to the possibility of the overall consumption recovery path being constrained by the sluggishness of employment of vulnerable groups, if improvement in face-to-face industries is delayed for a long time. The member presented the view that in this regard it would be advisable to maintain the current degree of monetary easing for the time being to help private consumption and the employment situation show more robust improvement.

The member noted that attention should be paid to the significant acceleration in consumer price inflation and the sustained strong growth in private-sector credit that had occurred in the meantime. First, in terms of consumer price inflation, the member forecast that, considering that the recent increase in consumer price inflation had been attributable mainly to supply-side inflation pressures and one-off factors, this trend would not continue past the second half of this year. The member, however, expressed the opinion that the possibility should not be ruled out of the upward pressures on underlying inflation growing to a larger extent than expected, since inflation caused by supply-side factors had lasted for longer than usual and inflation expectations were likely to increase further as economic activity normalized.

Next, the member emphasized the need to keep an eye on the negative effects of strong growth in private-sector credit amid the accommodative financial conditions. The member pointed out that an appropriate degree of credit expansion works to enhance economic recovery by acting in a virtuous circle with the real economy, but excessive interactions between credit expansion and asset price rises can lead to the risk of an accumulation of financial imbalances, undermining the sustainability of future financial stability and economic growth. The member's judgment was that, despite various macroprudential policy measures in place to cope with the risk, households' yield-seeking behavior using leverage had been strengthening amid the sustained expectations of a continued accommodative monetary policy stance, while the recent economic recoveries at home and abroad and inflation expectations could act to further increase leverage, and thus there was a growing need to consider related risks when making monetary policy decisions.

Taking all this into consideration, the member took the view that at this point it was necessary to keep the Base Rate at its current level, while keeping a close watch on whether the real economy expands further, the trend of the price path, and the possibility of a worsening of financial imbalances, and gradually adjust the degree of monetary easing at the appropriate time.

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 the domestic economy was sustaining a trend of export-driven recovery since the second half of last year. The member noted that the relatively small contraction in global goods consumption despite the pandemic, and aggressive stimulus measures by major countries, had been positive factors for the recovery of the domestic economy, which is heavily dependent upon manufacturing industries. The member saw that domestic goods exports were likely to maintain strong growth in the future as well.

The member's evaluation was that, although private consumption was emerging from its sluggishness, the pace of recovery was slow due to the modest pace of vaccination and remaining uncertainties about the resurgence of the pandemic. The member raised concern that, with continued sluggishness in self-employed businesses that are largely dependent upon face-to-face services, the trend of decline in owners of self-employed businesses with employees, in particular, did not halt, despite improvements in employment conditions in both manufacturing and services industries, and high rates of growth in working hours. Meanwhile, the member pointed out that indicators were unclear as to whether household income was recovering, which implied that it would likely to take a substantial time for economic recovery to lead to improved household income, even if the economy recovers rapidly, led by exports and facilities investment.

Meanwhile, the member noted that the rising prices accompanying economic recovery were mainly due to base effects, but were also a sign that consumption had begun to emerge from its extreme sluggishness. The member expected consumer price movements to be affected by base effects and supply-side factors, but to be partially influenced by the pace of recovery in employment and household income as well. However, the member added that price inflation would fall short of the inflation target for the year as a whole, and inflation would slow next year due to the disappearance of base effects.

The member presented the opinion that it should be remembered that inflation had remained below the target for nine years since 2012 and had run in the 0% range for two years in a row, despite upward pressures on prices stemming from the economic recovery. The member noted that, unlike exports and manufacturing industries, consumption and services industries were still at the initial stage of recovery. The member thus added that a change in the current monetary policy stance could constrain domestic demand and the pace at which price movements normalize.

The member noted that it was true that household lending had soared, the gap between the real economy and housing prices had widened, and financial imbalances had built up over the past year. The member particularly saw that housing prices in Seoul and its surrounding areas had risen excessively compared with the income level. The member went on to assess that this was attributable to concerns about a shortage of housing and to expectations that low interest rates would persist for a long time. However, the member noted that, despite the unprecedentedly low Base Rate, mortgage lending rates had already risen above the pre-pandemic level, and the housing transaction volume and new lending related to housing sales had been gradually declining of late. The member thus stressed that potential home buyers that depend heavily on loans should pay attention to the facts that the gap between the real economy and housing prices would not persist for a long time, and the current accommodative monetary policy stance would not last forever. The member added that it would be desirable for the overshooting in housing prices to be resolved gradually through the adjustment of home buying sentiment.

Taking these points into overall consideration, the member saw that, although the domestic economy was sustaining a trend of recovery, led by exports and investment, and had emerged from downward inflationary pressures, it would take considerable time for the domestic economy to return to growth at its pre-pandemic potential level. The member also projected that it would take substantial time for GDP growth to lead to expansion in household income, wages, employment and consumption. The member expressed the opinion that it would be desirable to keep the Base Rate at its current level, as inflation was still well below the target and there was no clear reason to preemptively hold back the momentum of economic expansion.

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 April MPB meeting, the global economy was showing a trend of expanded recovery, and this was contributing to buoyancy in the domestic economy, driven by exports and facilities investment. The member noted that exports and investment in the non-IT sector, as well as the IT sector including the semiconductor industry, had been showing growth. The member's assessment was that private consumption was gradually improving thanks to the government's support measures and the easing of social distancing rules, and it was encouraging that the trend in face-to-face services industries was showing a reversal from the significant contraction seen so far. The member commented that the easing of sluggish demand in face-to-face services was leading to improvements in employment conditions, and expected employment in services industries to show modest growth overall. The member noted that consumer price inflation was showing a high uptrend in the second quarter, and saw that core inflation would gradually rise, backed by a trend of economic growth.

The member mentioned that, according to the latest *Economic Outlook*, the growth rate for this year was being revised upward to 4.0%, and expressed the opinion that, although this figure exceeded the financial market's expectations, it did not appear to be excessively optimistic, given the recent trend of faster global economic recovery. The member added that upside risks to the outlook could materialize if the government came up with additional aggressive economic recovery policy measures. The member judged that, despite such favorable real economic conditions of late, the current accommodative monetary policy stance should be kept unchanged due to remaining uncertainties surrounding the pandemic and vaccine rollouts. The member thus argued that it would be desirable to keep the Base Rate at its current level of 0.50% and continue to observe future real economic developments and financial market conditions.

The member noted that it was necessary to focus on a few points before making monetary policy decisions going forward. Most importantly, the member presented the view that there was a need to continuously examine the possibility that the current negative GDP gap would disappear sooner than expected. The member commented that the materialization of upside risks to the outlook would bring forward the timing of the disappearance of the negative GDP gap to the fourth quarter of this year. However, the member saw that pandemic-related developments still remained uncertain and that it would take more time before employment and economic conditions felt by ordinary people and self-employed businesses would recover, and thus consideration should be given to this point as well. Next, the member noted the importance of monitoring US monetary policy and the trends of market interest rates, as higher and persistent global inflation would affect not only the monetary policy of the US Federal Reserve, but also policy decisions of the Bank of Korea. Finally, the member stressed that attention should be paid to the possible worsening of financial imbalances, as leverage was increasing further due to the interaction of ongoing growth in household debt with asset prices, such as real estate, stock and virtual asset prices.

The member commented that market volatility could heighten in line with future trends of global inflation and the consequent changes in the monetary policy directions of major countries. The member thus presented the opinion that it would be necessary to closely analyze and bring attention to this point to ensure that each economic agent could prepare against such a risk.

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

The member saw that the world economy was generally maintaining its recovery, and expected global GDP to return to the pre-crisis level in the second quarter of this year. The member also noted that global trade had been sustaining a trend of recovery since the second half of last year.

The member's assessment was that the recovery was spreading more noticeably, and the positive sentiment of economic agents and the outlook for economic recovery had strengthened further since the April MPB meeting. The member pointed out that concerns about COVID-19 infection had lessened following the higher vaccination rate among senior citizens, and economic activity had been gradually increasing with the Google Mobility Index rising above the pre-pandemic level, although the coronavirus pandemic was still ongoing.

The member noted that, in terms of sectors, manufacturing production remained solid, bolstered by expanded exports, and services production was also gradually emerging from its sluggishness, particularly in face-to-face services production. The member added that retail sales and construction investment were improving, facilities investment was sustaining a strong recovery, and export growth was increasing. The member saw that, in reflection of these movements, growth for this year would likely reach about 4%, much higher than the April forecast, and the negative GDP gap would likely shrink more rapidly than expected. The member presented the view that, looking at risk factors surrounding the latest forecasts, the upside risks were more likely to materialize than the downside risks.

Meanwhile, the member saw that consumer price inflation was likely to run above the 2% range for some time, largely affected by temporary factors such as sustained upward trends in agricultural, livestock, and fisheries product prices, rising international commodity prices, and global supply difficulties. However, the member noted that it would be necessary to pay close attention to price trends, as the global supply difficulties could persist or underlying factors, such as expanded domestic demand or wage growth, could come into play.

The member judged that the financial market remained accommodative, with household lending growing rapidly and corporate credit expanding greatly, even as various macroprudential surveillance regulations were put in place or even reinforced.

The member's assessment was that the unusually accommodative monetary policy, which had been ongoing for over one year after being adopted in the face of an unprecedented crisis of the COVID-19 pandemic, had contributed to the return to economic recovery, by preventing excessive economic contraction and the undermining of future growth potential, and by ensuring stability in the financial market. However, the member pointed out that, in this process, leverage had increased substantially, as private sector credit grew very rapidly, and the risk appetite of economic agents strengthened. The member raised concerns that, if these conditions persisted for a long time, the buildup in financial imbalances would deepen, rapid debt growth would act to constrain consumption and investment in the medium to long term, and an external shock could cause financial instability.

The member expressed the opinion that gradual normalization of the interest rate level would be needed to curb the deepening of financial imbalances and reduce any possibility of future financial instability. The member saw that adjusting the degree of monetary policy accommodation could somewhat negatively affect the trend of economic recovery, but the negative impacts could be buffered considerably, given the strong recoveries in major countries and the stability in the international financial market. Meanwhile, the member pointed out that the prolongation of the current unprecedentedly accommodative monetary policy stance could further increase costs in the future course of interest rate normalization. The member also noted that there would be a need to ensure space for monetary policy to some extent to prepare for a possibility of underlying low economic growth and the future economic cycle. The member thus presented the view that normalization of the current unprecedented monetary accommodation should not be put off for too long.

The member saw that there still were considerable uncertainties related to the solidity of future recovery, although economic recoveries at home and abroad were expanding gradually. The member also judged that the Board should fully communicate with the market in advance, even if the degree of monetary policy accommodation were to be adjusted. The member took the opinion that, from this perspective, it would be desirable to keep the Base Rate at its current level this time, to monitor the progress of the economic recovery for the coming months, and to begin to adjust the degree of monetary policy accommodation in a timely manner, in overall consideration of employment and price trends, and financial market conditions. The member added that this would be helpful to lay a foundation for stable and sustainable economic growth in the medium to long term. The member noted that the Board should not delay adjusting the degree of accommodation for too long, and stressed that the Board should take the ensuing steps in a gradual manner, while cautiously monitoring market reactions and economic conditions.

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 strengthened, supported by the economic stimulus in major countries, accelerated vaccinations, and the relaxation of restrictions on economic activity. In global financial markets, the rise in stock prices in major countries has moderated as risk-taking tendencies were offset by factors such as inflation concerns. Government bond yields have fluctuated within a relatively narrow range. 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 recovery of the Korean economy has strengthened. Exports have sustained their buoyancy and facilities investment has continued to recover robustly, while private consumption has gradually emerged from its slump. Labor market conditions have continued to improve, with the year-on-year increase in the number of persons employed having risen. Going forward, the recovery of the Korean economy is likely to strengthen thanks to the buoyancy of exports and investment as well as the improvement in private consumption. GDP growth this year is projected to be around 4%, significantly above the February forecast of 3.0%.

☐ Consumer price inflation has risen markedly to the lower-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 moved up considerably to the lower-1% level. The inflation expectations of the general public have risen slightly within the lower-2% range. It is forecast that consumer price inflation will run at the upper-1% range this year, considerably exceeding the February forecast of 1.3%. Core inflation is forecast to run at the lower-1% range.

☐ In domestic financial markets, long-term market interest rates have risen, affected mainly by strengthened economic recoveries at home and abroad. Stock prices continued to increase before declining moderately due to global financial market movements. The Korean won to US dollar exchange rate has fluctuated slightly. Household loan growth has remained high, 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 support the economy and stabilize consumer price inflation at the target level over a medium-term horizon, while paying attention to financial stability. While the Korean economic recovery is expected to strengthen and inflation to remain at a high level for some time, there are underlying uncertainties surrounding the path of COVID-19 and inflationary pressures on the demand side are forecast to be modest. Thus, the Board will maintain its accommodative monetary policy stance. In this process the Board will assess developments related to COVID-19 and economic developments in major countries, while paying closer attention to the buildup of financial imbalances such as fund flows concentrated in asset markets and household debt growth.