Minutes of the Monetary Policy Board Meeting

January 24, 2019

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(January 2019)

Ⅰ. Outline

1. Date of meeting: Thursday, January 24, 2019

2. Place : Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:

   Lee, Juyeol, Chairman (Bank of Korea Governor)
   Lee, Il Houng
   Cho, Dongchul
   Koh, Seung Beom
   Shin, Inseok
   Yoon, MyunShik (Senior Deputy Governor)
   Lim, Jiwon

4. Monetary Policy Board members absent: none

5. Participants:

   Jang, Ho Hyun, Auditor
   Lim, Hyung Joon, Deputy Governor
   Huh, Jinho, Deputy Governor
   Shin, Ho Soon, Deputy Governor
   Ryoo, Sang Dai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Suh, Bong Gook, Director General of Reserve Management Group
   Lee, Hwan Seok, Director General of Research Department
   Sohn, Wook, Director of BOK Economic Research Institute
   Shin, Woon, Director General of Financial Stability Department
   Park, Jongseok, Director General of Monetary Policy Department
   Lee, Sang Hyeong, Director General of Financial Markets Department
   Lee, Seung Heon, Director General of International Department
   Kim, Hyun Kee, Press Officer
   Chang, Cheong-Seok, 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 for 2019[2]," "FX and International Finance Trends," and "Financial Market Trends," the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members evaluated that there were growing concerns about downside risks to the global economy, particularly with respect to the euro area and Chinese economies. As for the global financial markets, members mentioned that volatility of major price variables such as stock prices and exchange rates had seen sharp increase in December last year, but had been generally stable since the beginning of this year in line chiefly with changing expectations about the US-China trade negotiations and the pace of the US Federal Reserve's rate hikes.

Concerning the domestic economy, members' evaluation was that the domestic economy had sustained growth centering around exports and consumption, while facilities and construction investment had continued to undergo corrections. The members forecast the domestic economy to grow by 2.6 percent this year and next, with the contribution of fiscal expenditure to growth likely to increase, and mentioned that uncertainties surrounding the future growth path were high, due mainly to changes in monetary and trade policies—particularly in the US—and concerns about a possible Chinese economic slowdown.

Concerning inflation, members forecast consumer price inflation at 1.4 percent for this year and 1.6 percent for next year, in reflection of supply-side factors such as the decline in international oil prices and increased downward pressures on administered prices in line with the government's strengthening of its welfare policy, amid small demand-side

2) English version of "Economic Outlook for 2019" is posted on Bank of Korea website.

inflation pressures.

As to the domestic financial markets, members assessed that the volatility in the stock market had expanded in December last year but then stabilized overall this year, and capital flows and the won-dollar rate had also shown stability. Members pointed out that household debt growth was slowing gradually but continued to outpace income growth, and thus it would be necessary to remain vigilant.

Ⅲ. Discussions Concerning Monetary Policy Decision (Summary)

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

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 1.75 percent for the intermeeting period.

One member stated that there had been no significant changes in domestic economic trends since the previous MPB meeting, concerns remained about the possibility of financial imbalances accumulating, and uncertainties surrounding domestic and external conditions were high, and therefore it would be desirable to keep the Base Rate at its current level of 1.75 percent at this meeting and closely examine future developments.

The member noted that the growth and inflation forecasts had been adjusted downward, but judged that there had been no major changes to the overall macroeconomic trends, as the growth rate was unlikely to deviate far from its potential level and the inflation forecast was being affected chiefly by supply-side factors and the strengthening of welfare policy. The member mentioned, however, that uncertainties surrounding the future growth path remained high, considering various domestic and external factors including US-led changes in monetary and trade policies, the slowdown in Chinese economic growth, political risks in major countries, sluggish domestic employment, and the contraction of private-sector economic sentiment.

The member assessed that domestic and overseas financial markets had seen sharp increases in major price variable volatility in December last year, but had been generally stable since the beginning of this year in line chiefly with changing expectations about the US-China trade negotiations and the pace of the US Federal Reserve's rate hikes.

In terms of financial stability, the member took the view that household debt growth would likely continue to slow this year, affected largely by stronger regulations, housing market sluggishness, and the previous Base Rate hike. The member added, however, that it would be necessary to remain cautious about the possibility of financial imbalances accumulating due to rising household debt, as demand for leasehold deposit loans and collective loans would likely be strong, owing mainly to a rise in the number of move-in ready apartments.

In conclusion, the member expressed the view that it would be appropriate to keep the Base Rate at its current level of 1.75 percent at this meeting and keep an eye on future developments, and went on to argue that it would be desirable to carefully decide whether to further adjust the degree of monetary policy accommodation after comprehensively evaluating economic growth and inflation trends as well as changes in financial stability risks, based on economic indicators.

Another member took the view that it would be desirable to keep the Base Rate unchanged from its current level of 1.75 percent at this meeting, while keeping a close watch on real economic developments, the household lending trend, and international financial market developments.

The member assessed that economic agents' concerns had increased significantly due to the sustained policy uncertainties in major countries and the increased financial market volatility since the previous MPB meeting, and judged that, although this could cause domestic and global economies to slow further, there remained only a limited possibility of growth rate adjustments leading to a full-fledged downturn in the near future. The member noted that attention should be paid to the favorable growth sustained in advanced countries, based on improvements in employment conditions, and to expanded stimulus measures, particularly in EMEs with relatively favorable external soundness. Furthermore, the member noted positively that risk aversion had somewhat eased with anxiety about the pace of the US Federal Reserve's rate hikes having been substantially reduced recently and US-China trade negotiations having resumed. On the other hand, the member pointed out that if uncertainties involving the US-China trade negotiations, the US government shutdown, and Brexit continued for a longer period of time, they could act as additional downside risks to the growth path.

Looking at the domestic economy, the member mentioned that there were significant uncertainties surrounding the medium- and long-term growth forecasts, as the global economic slowdown had been concentrated in regions and sectors where Korean exports are highly dependent on, while various changes had been made to domestic microeconomic policy. However, the member assessed the degree of adjustment in exports as somewhat excessive, since the recent plunge in customs-cleared exports had been attributable mainly to technical factors, including declines in export unit prices affected by semiconductor and oil prices and the impacts of export volume adjustments prior to tariff hikes in major countries. The member added that a more accommodative fiscal policy would be underway this year, enhancing the contribution of fiscal expenditure to growth.

The member forecast that consumer price inflation might run below the current level for some time, affected by international oil prices and administered prices, but is likely to rebound to near the mid- to upper-1 percent level in the medium term, considering movements of prices of items less affected by one-off and policy factors and given the Bank of Korea Research Department’s forecast that Korea’s economic growth would not diverge significantly from its potential level this year.

With regard to financial stability, the member took the view that the current slowing trend, albeit slight, of household debt growth would likely continue, as the effects of strengthened micro-level regulations had started to materialize and were combined with the effects of the reduction in the degree of monetary easing, but continued vigilance would be necessary as household debt growth had continued to outpace income growth and demand for household loans was likely to be substantial amid a rise in the number of move-in ready apartments. As to financial markets, meanwhile, the member evaluated that, although stock price volatility had increased immensely, capital flows and the won-dollar exchange rate had been relatively stable, boosted by favorable external soundness indicators, and went on to mention that the possibility of greater financial market volatility should be closely monitored in consideration of high uncertainties concerning policies in major countries.

In overall consideration of the factors mentioned above, the member judged that it would be appropriate to keep the Base Rate at its current level at this meeting and take more time to observe economic and inflation trends and global financial market conditions.

One other member noted that, while the outlook for economic growth this year had been revised slightly downward, there had been some positive changes on the financial stability side. The member thus took the view that it would be desirable to keep the Base Rate at the current 1.75 percent level at the current meeting, while closely monitoring changes in US monetary policy and economic conditions, as well as trends in the domestic real economy.

With respect to the global economy, the member evaluated that it was still showing growth at the level of the potential growth rate, despite increasing concerns about downside risks since the October forecast last year. The member added that, despite these real economic conditions, the financial markets seemed to have responded quite sensitively in December. As for the US economy, the member noted that the real economy was showing sound growth, despite sluggish survey indicators, and stated that it was important to assess US economic conditions and analyze financial market trends. The member also saw the need for close monitoring of the European economy, which had been somewhat sluggish, and of the Chinese economy, whose growth was expected to slow, adding that attention should be paid to international oil prices and global trade flows.

Looking at the domestic economy, the member saw that, although private consumption had remained relatively stable, adjustments to facilities investment and construction investment had continued, and growth in exports was forecast to be slower this year than last year. The member expected an upturn in the semiconductor industry from the second half of this year, and anticipated that the shipbuilding sector, which had partially started to recover, would supplement exports and investment, albeit to a limited extent. The member predicted that employment conditions would be better than last year, but the pace of recovery would be moderate. As difficulties in some industries were highly likely to continue despite government policies, the member noted that close monitoring should continue.

The member assessed that, in light of the economic outlook presented by Bank of Korea’s Research Department, the GDP gap was estimated to remain slightly negative. The member noted that the ongoing decline in economic indicators and the weakness in sentiment indicators would weigh on the future Korean economy. The member, however, expressed the opinion that the government sector was expected to compensate somewhat for the weakening of economic growth this year, just like last year. The member also stated the view that the accommodative monetary policy stance should be maintained, as demand-side inflationary pressures seemed likely to be mild in the future as well.

With respect to financial stability, the member assessed that there had been some positive changes, such as somewhat diminished stock market volatility and slowing household debt growth, influenced for instance by suggestions that the US Federal Reserve would adjust the pace of its policy rate hikes. The member, however, expressed the view that the effects of government measures should be examined and the relevant developments should be monitored, since household debt growth still exceeded household income growth.

Last, the member noted that a prolongation or widening of the inversion of the US and Korean policy rates could add to market volatility in the long run, and therefore it was necessary to constantly examine the

US Federal Reserve's movements toward monetary policy normalization as well.

In overall consideration of the factors mentioned above, the member judged that it would be desirable to keep the Base Rate unchanged from the current 1.75 percent level, while reviewing developments in the real economy and financial stability conditions.

One member noted that the accommodative monetary policy stance should be maintained due to weak inflationary pressures, and the financial imbalances that had been built up should be dealt with. The member thus presented the view that it would be desirable to keep the Base Rate unchanged from the current 1.75 percent at the current meeting, while continuing to examine the appropriateness of the monetary policy stance.

With respect to the global economy, the member judged that it had temporarily rebounded, led by the US economy, but had then approached its potential rate of growth, which was somewhat weaker than in the past due to various structural issues. The member saw a heightened possibility that global economic growth could weaken, as the scope for macroeconomic policy adjustment in EMEs had narrowed and global trade growth had slowed in the course of US monetary policy normalization. The member, however, assessed that financial markets had remained stable overall and global dollar liquidity conditions had remained favorable.

The member saw that Korea's economic growth was gradually approaching its potential level, as real estate-related construction investment and IT-related facilities investment had undergone adjustments after showing strong growth for the past years. The member commented that the potential growth rate was judged to have declined to the mid-2 percent range or slightly above due to structural problems at home and abroad, including a decrease in the working-age population. The member noted that the Korean economy was sustaining a trend of growth led by exports and consumption, despite huge investment adjustments. The member saw that exports were maintaining strong competitiveness, thanks to some industries such as the IT sector. The member also commented that private consumption was maintaining relatively solid growth, boosted by ongoing income improvements and increased government transfer payments and welfare spending, although sentiment indicators had been sluggish. The member went on to explain that fiscal policy had positively affected private consumption and growth by strengthening redistribution, although the government had shifted to a tightening stance as tax revenues grew faster than fiscal spending in 2018.

Looking at prices, the member noted that the sticky price index and inflation with food and energy product prices excluded stood at the lower-2 percent range and the mid-1 percent range respectively, both with administered items excluded, which was a better indicator of demand pressures than the CPI. On the other hand, the member added that core inflation was only in the lower-1 percent range due to sluggishness in administered items, leasehold deposits, monthly rental payments, and industrial products. The member expected core inflation to remain flat in the lower- to mid-1 percent range, due to weak demand-side pressures, slower growth in housing rents, and low rises in the export and import prices of global industrial products and in public service prices.

Meanwhile, the member assessed that the accumulation of financial imbalances had been easing, as the government's various regulatory policy measures had led to slower growth in real estate-related lending and a trend of decline in housing prices. The member, however, expressed the need for keeping a close eye on the accumulation of financial imbalances, as the over-concentration of capital in the real estate sector was continuing through sole proprietor loans, and the demand for loans was likely to continue to some extent because this year's supply of new housing was expected to be higher than in past years. The member noted that the process of resolving accumulated financial imbalances could weigh on growth in the short term, but this would lay a foundation to further consolidate Korea's economic fundamentals over the medium-term horizon.

The member noted that inflationary pressures were forecast to remain at their current (albeit weak) level, but it would likely be difficult for domestic demand pressures to offset exogenous downward pressures on prices and bring inflation up to its target. The member thus found it necessary to maintain the current accommodative stance. On the other hand, the member noted that there was a possibility of a widening of financial imbalances, and there was also a need for a gradual resolution of imbalances accumulated thus far. The member thus found it desirable to keep the Base Rate unchanged at 1.75 percent at this meeting, while keeping a close watch on economic conditions in the future and assessing the appropriateness of the current monetary policy stance.

Another member took the view that it would be desirable to keep the Base Rate at its current level while closely examining future macroeconomic trends, given that growth momentum in the private sector was weak and prices remained low.

The member stated that real GDP growth stood at 2.7 percent last year, but nominal GDP growth, an indicator of the actual national income, was estimated to be only around 3 percent, the lowest since the Asian Financial Crisis. The member thus judged the degree of actual value added in the economy to be very low. The member added that, by sector, government income growth was estimated to greatly exceed 3 percent, while that in the corporate sector was significantly lower than 3 percent. The member's assessment was that the government's direct consumption had surged and private consumption had also maintained its trend of growth, led by health care and social welfare services where fiscal support had been expanding. The member, however, judged that business conditions had been sluggish in the areas of the private sector not directly linked with fiscal support, and with respect to the labor market as well there was little meaningful employment growth to be found in the private service sector apart from health care and social welfare.

The member presented the view that growth in the private sector was unlikely to gain further momentum in the short term in view of the economic conditions at home and abroad. The member noted that the more moderate expansion of the world economy, particularly in Europe and China, had led to a gradual slowdown of the export growth that had been contributing greatly to the domestic expansion for a year, while investment-related indicators did not suggest the possibility of an investment recovery in the short term. The member, however, commented that the large contribution of fiscal spending to growth was highly likely to continue in view of the government's plan for active fiscal policy.

The member noted that core inflation had remained weak in the lower-1 percent range for over a year, and even when prices of administered items were excluded, the inflation estimate stood in the mid-1 percent range. The member's assessment was that overall consumer price inflation was converging to the level of core inflation in the lower- to mid-1 percent range, as one-off factors were diminishing. Considering recent employment and economic conditions, the member saw little likelihood of a rapid acceleration of core inflation in the short term, and expected overall consumer prices to fluctuate at around the level of core inflation.

The member took the view that, given the aforementioned environment, it would be desirable to keep the Base Rate at its current level, while keeping a close watch on the direction of macroeconomic changes in the future. The member also presented the view that it was necessary to assess the degree to which active fiscal policy would compensate for the lack of private demand, whether self-driven recovery momentum in the private sector would materialize, and whether aggregate demand from the private and government sectors would expand to the extent that low price inflation would converge toward its target.

One other member presented the view that it would be appropriate to keep the Base Rate unchanged from the current level at the present meeting, as the impacts of negative external conditions such as slower real indicators in China were gradually appearing in the Korean economy, and inflationary pressures remained weak.

Concerning the recent state of Korea’s real economy, the member’s assessment was that, with negative developments in the external environment continuing, the trend of domestic growth was also weakening somewhat, with recovery in private consumption slowing. On the international front, the member noted that US real indicators were generally showing favorable movements, but unrest had increased greatly, especially in financial markets. The member also commented that the euro area had witnessed a trend of slower growth, while China had seen significant deterioration in all real economic indicators for the past two months. The member took the view in particular that the shift to a decline in Chinese exports last December had been working to increase downside risks to the growth paths of the world economy and trade.

The member noted that, in line with developments in the external environment, Korean exports had shown favorable movements until October last year but then saw slower growth in November on a customs clearance basis and shifted to a decline in December, showing a pattern similar to exports in China. The member commented that the recent large declines in prices of semiconductors and petrochemical products, Korea’s two main export items, had created a gap between the export value on a customs clearance basis and the export volume. The member expressed the opinion that the decrease in the contribution of exports to real growth would be smaller than the decrease in export value but still considerable.

Looking at domestic demand, the member noted that private consumption had shown 2.8 percent growth last year, stronger than GDP growth. The member went on to mention that consumption growth had exceeded GDP growth for the first time since 2010. The member saw that as the trend of decline in the household propensity to consume had ended in 2017, household consumption growth had technically rebounded, but the propensity to consume had failed to return to past levels. The member thus took the view that there was uncertainty as to whether private consumption growth, which had been robust for the past year, would remain high.

The member expressed the opinion that, given the recent developments in the world economy and real indicators related to domestic demand, the adjusted forecast prepared by Bank of Korea’s Research Department seemed to have some degree of downside risk. The member, however, noted that the ongoing strong growth in government spending since last year could serve as a substantial buffer against slower growth in aggregate demand in the private sector.

Concerning prices, the member argued that, in view of slower growth in the real economy, it would be difficult to expect inflationary pressures to rise this year as well. The member went on to express the view that the Research Department’s adjusted forecasts, revised downward to 1.4 percent for both core inflation and CPI this year, were more consistent with actual price conditions.

The member noted that, taking these points into overall consideration, there were great uncertainties surrounding the external environment, real economic growth was slowing somewhat, and inflation remained low. The member thus took the view that it was appropriate to hold the Base Rate at its current level at this meeting.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of their earlier discussions, the following Monetary Policy Decision statement was compiled and was approved unanimously by the members.

< Ref >

Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 1.75% for the intermeeting period.

☐ Based on currently available information the Board considers that the pace of global economic growth has slowed somewhat. The volatilities in the global financial markets, which had previously expanded, have diminished slightly this year, in line mainly with the possibility of the US Federal Reserve adjusting the pace of its rate hikes and with expectations of progress in the US-China trade negotiations. Looking ahead, the Board sees global economic growth and the global financial markets as likely to be affected by factors such as the degree of the spread of trade protectionism, the paces of monetary policy normalization in major countries, and the uncertainties concerning Brexit.

☐ The Board judges that the domestic economy has sustained a rate of growth at its potential level generally, as the increases in consumption and exports have been sustained, although the adjustments in facilities and construction investment have continued. Employment conditions have been sluggish, with the amount of increase in the number of persons employed having lessened substantially in December. Going forward the Board expects domestic economic growth to fall slightly short of the path projected in October, but to sustain a rate that does not diverge significantly from its potential level thanks to increased government expenditures for example.

□ Consumer price inflation has slowed to the lower-1% level, in consequence mainly of declines in the prices of petroleum products and reductions in the extents of increase in agricultural, livestock and fisheries product prices. Core inflation (with food and energy product prices excluded from the CPI) has been at the lower-1% level, and the rate of inflation expected by the general public has been in the mid-2% range. Looking ahead, it is forecast that consumer price inflation will fluctuate at the 1% level for some time and then steadily increase to the mid-1% level in the second half of this year. Core inflation will also gradually rise.

□ The domestic financial markets saw increased volatility in December last year, but have been generally stable since the beginning of this year. Stock prices had fallen, in line mostly with concerns about the global economic slowdown, but have rebounded on expectations of an easing of the US-China trade dispute for example. Long-term market interest rates, after a decline, have been fluctuating slightly. The Korean won-US dollar exchange rate has been generally stable while moving within a narrow range. The amount of increase in household lending has diminished, while housing prices have continued to slow.

□ Looking ahead, the Board will conduct monetary policy so as to ensure that the recovery of economic growth continues and consumer price inflation can be stabilized at the target level over a medium-term horizon, while paying attention to financial stability. As it is forecast that inflationary pressures on the demand side will not be high for the time being, and that the domestic economy will sustain a rate of growth that does not diverge significantly from its potential level, the Board will maintain its accommodative monetary policy stance. In this process it will judge whether to adjust the degree of monetary policy accommodation further, while closely checking future economic growth and inflation trends. It will also carefully monitor conditions related to trade with major countries, any changes in the monetary policies of major countries, financial and economic conditions in emerging market economies, the trend of increase in household debt, and geopolitical risks.