Minutes of the Monetary Policy Board Meeting

February 2021

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(February 2021)

Ⅰ. Outline

1. Date of meeting: Thursday, February 25, 2021

2. Place: Monetary Policy Board Meeting Room

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

4. Monetary Policy Board members absent: none

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

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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 (February 2021)*,[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 the domestic economy was forecast to maintain its gradual recovery but uncertainties surrounding the future growth path remained high. Looking at each sector, members expected exports and facilities investment to maintain their strong recoveries, thanks to the global economic recovery and improvement in the IT industry, although private consumption would recover slowly due to the worsening of household income conditions. Some members, however, presented the view that it would be necessary to pay attention to the possibility that worsening growth imbalances between consumption and exports/investment could widen the gaps between income groups and between industries.

Members also pointed out that employment sluggishness had worsened, particularly in face-to-face services industries hit hard by the COVID-19 shock, and expressed concerns that it could take a considerable period of time for employment to get back on track. Regarding inflation, members forecast that consumer price inflation would rise slightly, owing primarily to supply-side factors including growth in food and international commodity prices, while core inflation would remain low.

Members, meanwhile, emphasized that it would be necessary to pay continued attention to financial stability risks such as rising financial market volatility at home and abroad and increased leverage in the private sector. In line with this, some members noted the increased sensitivity of financial markets to changes in global financial and economic conditions and expressed the view that the possibility of sudden asset price adjustments could not be ruled out.

Members also expressed the opinion that a careful watch was needed on medium- and long-term monetary policy conditions, including whether the potential growth rate would decline due to the COVID-19 shock and when the output gap would be resolved, as well as changes in the inflation environment at home and abroad. Members also stressed that it would be necessary to thoroughly analyze the background behind the

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

recent hike in long-term market interest rates and its impact on the real economy and cope with it in an appropriate manner.

Ⅲ. Discussions Concerning Monetary Policy Decision (Summary)

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

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

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

The member assessed that the global economic recovery had been weakening somewhat due to the resurgence of COVID-19, but unlike during the early days of the pandemic, goods trade and corporate investment continued to grow and demand had been shifting relatively quickly to non-face-to-face consumption, which had been easing the economic shock from the contraction of face-to-face consumption. The member also evaluated that expectations of an economic recovery over a medium-term horizon had been growing, boosted by increasing vaccine distribution and stimulus package implementation in major countries.

The member mentioned that, while the domestic economy had been showing a similar trend to those of major countries, the gap in economic activity between industries and between sectors had been widening further than originally expected, and caution was required in this regard with respect to its economic and social impacts. The member's assessment was that attention should be paid to the rapid worsening of employment sluggishness, as shown in the employment rate sliding to a record low since the global financial crisis in January this year. The member argued that such sluggishness of employment seemed to have been caused by the negative spillover effects of the pandemic being concentrated in face-to-face service industries with higher employment inducement coefficients, rather than being felt more broadly across the macroeconomy as a whole, and went on to point out that these industries would likely see growing cases of temporary and permanent closures and downsizing of workers due to prolonged social-distancing measures, and that employment sluggishness would be felt more severely by low-income groups with higher marginal propensity to consume, which would likely limit the recovery of consumption for a considerable period of time. The member in this regard emphasized that it would be necessary to continue focusing policy on selective support for vulnerable groups while maintaining a monetary easing stance.

The member meanwhile noted that there was recently growing interest in the coordination of monetary and fiscal policies, and the Bank of Korea’s outright purchases of Treasury bonds in particular. The member expressed the opinion that yields on Treasury bonds, and long-term ones in particular, had been recently rising significantly at home and abroad, and given that an increase in Treasury bond issuance following the expansion of fiscal expenditure could increase financial market volatility, aggressive policy responses might be needed to stabilize the markets. The member however emphasized that attention should be paid to the fact that, since the structure and conditions of domestic capital markets were far different from those in major countries, the central bank’s intervention might not help ease the burden of funding costs on the government and businesses at the same time. The member also mentioned that, with the Base Rate remaining above 0%, unintended policy costs might be incurred while absorbing increased liquidity as a result of Treasury bond purchases. The member took the view that further monetary easing could be considered to solve this problem, but would not be appropriate given recent economic and financial conditions. The member went on to note that the output gap of the domestic economy was expected to narrow gradually, despite high uncertainty surrounding the future recovery path, and that the real policy rate was expected to decline further, considering the trends of consumer price inflation and inflation expectations. Above all, the member’s judgment was that continued caution about possible accumulation of financial imbalances was required since financial conditions had become much more accommodative and leverage in the private sector continued to increase.

Taking all this into consideration, the member judged that it would be appropriate to hold the Base Rate at its current level of 0.50% this time and to closely monitor changes in domestic and international financial and economic conditions.

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 evaluated that, despite the pandemic, the domestic economy had outperformed major advanced economies last year, boosted by effective measures to combat COVID-19 and the boom in the semiconductor industry. By sector, the member noted that investment and net exports had exhibited more favorable movements than expected while private consumption had been sluggish. The member assessed that, although social controversy over fiscal space had limited fiscal expansion, increased government spending and transfer payments had served as a buffer against a decline in aggregate demand.

The member forecast that the domestic economy would recover centering around exports and investment, driven by the government's expansionary fiscal policy and the global economic recovery. The member however took the view that the pace of recovery would depend on the recovery of private consumption and employment. The member stated that households' surplus income, in particular, had increased significantly last year, due mainly to government aid, and forecast that how much of this surplus would be allocated for spending would determine the momentum of the consumption recovery. The member meanwhile expected that employment conditions would improve compared with last year, but looking back at previous experiences, such improvement was unlikely to outpace the recovery of economic growth. The member mentioned that, since growth in non-face-to-face economic activities had become a trend and labor-saving technological advances had been speeding up since the outbreak of COVID-19, the possibility could not be ruled out of an economic structure with ever-present labor slack becoming firmly entrenched. The member in this regard pointed to the need to make up for worsening unemployment through the government's job creation project for the time being, even if those jobs are not of high quality, and went on to argue that it would be necessary to patiently maintain accommodative monetary policy and support measures for households and SMEs until the economy shows a marked trend of recovery.

The member took the view that the current pandemic had reconfirmed which social groups are most vulnerable to economic shocks. The member expressed the concern that, as seen from past experiences, shocks to vulnerable groups could linger for quite some time even following an export-driven economic recovery. The member emphasized that, as it had been reconfirmed that an economic crisis worsens inequality and polarization, it would be necessary to strengthen inclusiveness when implementing financial and monetary policies as well as tax and fiscal policies.

The member expressed the opinion that it was too early for now to talk about normalizing monetary policy out of concerns about inflationary pressures and a further rise in asset prices, and that macroprudential regulations and financial supervision would be of fundamental importance to financial stability. The member added that, amid disinflationary pressures, the Phillips curve had flattened in Korea over the past decade, and that, under these conditions, monetary policy should be implemented flexibly with its focus placed on stabilizing the real economy and employment. The member's judgment was that, due to the inevitable fiscal expansion to support economic recovery and vulnerable groups for the time being and also to structural factors such as population aging, government spending would increase even further and the government's funding costs would become an important economic issue.

Taking all this into comprehensive consideration, the member argued that it would be appropriate to keep the Base Rate at its current level and promote stabilization of long-term market interest rates by making use of instruments such as Treasury bond purchases.

One 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 had been sustaining a modest recovery recently. The member forecast the domestic economy to sustain its recovery, led by continued export growth and improvement in facilities investment, which would more than offset a slower-than-expected recovery of private consumption. The member's evaluation was that, although the Bank of Korea's economic outlook this time put the growth forecast for this year at 3%, the same figure as in November last year, uncertainties surrounding the future growth path remained high due to pandemic-related developments. The member pointed out that vaccinations and increased fiscal stimulus measures in Korea and other countries around the world were expected to have positive impacts on the domestic economy, but the possibility of a domestic spread of virus variants could not be ruled out.

The member pointed out that the employment situation remained sluggish with the number of persons employed continuing to decline significantly in January, and forecast that employment would exhibit a slower-than-expected recovery. With regard to inflation, the member expected consumer price inflation to rise to the lower- to mid-1% level and core inflation to the 1% level this year, due to the gradual reflection of the effects of economic recovery in these indexes, combined with supply-side upward pressures such as hikes in international oil prices and agricultural, livestock and fisheries product prices. The member stated that inflation expectations among the general public had recently increased to the 2% level, and went on to argue that it would be necessary to closely monitor future trends of inflation expectations and their impacts, since inflation expectations are one of the major factors determining the medium-term inflation trend.

Concerning the financial markets, meanwhile, the member mentioned that, amid the continued preference for risk assets, major price variables had fluctuated under the influence of international financial market movements. The member took the view that the recent financial market movements reflected expectations of future economic recovery, but on the other hand, they also included factors increasing financial stability risks. The member noted that the uptrend in long-term market interest rates since the second half of last year could be seen as a process ofeconomic recovery and resolution of low inflation. The member assessed that the sustained asset price rises and household debt growth despite the substantial increase in long-term market interest rates were attributable mainly to interest rates remaining accommodative and to expectations of major countries' accommodative monetary policy stances continuing for the time being. The member however expressed the view that it should be noted that some global financial market movements reflected the possibility of the US Federal Reserve's early monetary policy normalization and that there were growing concerns about the possibility of drastic asset price adjustments in the event of changes in global financial and economic conditions.

In conclusion, the member judged that, although the domestic economy was forecast to maintain a modest recovery, it would be necessary to maintain the monetary easing stance for the time being, considering the continued high macroeconomic uncertainties concerning pandemic-related developments and the continued sluggishness of the employment situation. The member added that in doing so it would be important to continue closely monitoring changes in financial stability risks.

The member in this regard argued that it would be appropriate to hold the Base Rate at its current level of 0.50%.

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

The member noted that domestic exports and investment had improved since the previous meeting thanks to economic recovery in major countries, but private consumption had weakened more than expected, influenced by the resurgence of COVID-19. The member's evaluation was that, although the Bank of Korea had kept its economic growth outlook for 2021 unchanged this time, growth imbalances had deepened, as seen in the gap between exports and domestic demand, the polarization of exports and investment among industries, and the differentiation in private consumption by income group and age. Above all, the member raised the concern that the gap between growth and employment had expanded to an unprecedented degree due to worsened employment conditions, particularly among self-employed and temporary workers, with the decline in the number of persons employed reaching 980,000 in January. The member pointed out that these growth imbalances were highly likely to continue even after the COVID-19 pandemic ends. The member thus presented the opinion that it would be necessary to maintain the current accommodative stance for some time.

Looking at prices, the member stated that, although the outlook for consumer price inflation for this year had been revised slightly upward, that for core inflation was at 1%, well below the target. The member noted that, despite lackluster domestic demand, household and corporate lending had actually grown, on the back of expectations for rising asset prices and continuing demand for living expenses, showing a so-called counter-cyclical trend. The member thus assessed the risk in terms of financial imbalances to have increased.

The member noted that the situations in the real economy and financial stability were serving as conflicting factors for monetary policy decisions, but found it appropriate to maintain the current level of the Base Rate and focus more on domestic demand and price conditions at this juncture. The member, however, emphasized that the Bank of Korea should examine overall risk factors through cooperation with the government and the supervisory authorities to prevent the risk of financial imbalances from excessively heightening, and consistently push for macroprudential policy measures. The member also added that it would be necessary to pay attention to and analyze the possibility of a decline in the potential growth rate of the domestic economy in line with the COVID-19 shock and natural population decline, and the consequent changes in trends in the output gap.

Meanwhile, the member stated that there was an increasing need for fiscal policy to take on an expanded role, and for it to be supported through cooperation with monetary policy, given economic conditions of late. The member also noted the growing importance of the Bank of Korea's role in stabilizing market interest rates. The member, however, saw that the recent rise in long-term market interest rates had been affected by rising US Treasury bond yields which had preemptively reflected expectations for economic recovery in the US, and the upward pressures were highly likely to continue in the future. The member thus presented the opinion that it would be appropriate to devote efforts to curb excessive volatility of market interest rates, instead of directly addressing demand and supply conditions. The member added that the feasibility of funding plans stemming from expanded government spending should be discussed, in consideration of the "fiscal trilemma," i.e. the difficulty of simultaneously achieving the three goals of fiscal expansion, fiscal soundness, and tax reduction.

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

The member assessed that, as the resurgence of COVID-19 weakened somewhat, the global economy was showing a moderate trend of recovery, bolstered by ongoing fiscal stimulus by major advanced economies, and the domestic economy was also maintaining a trend of recovery, albeit modest. The member saw that, by sector, private consumption had contracted more deeply than expected due to the ongoing spread of coronavirus in winter, particularly in the Seoul metropolitan area where economic activities were concentrated. The member also expected the future recovery path to be gradual due to constraints including delayed improvement in income conditions. Meanwhile, the member saw that economic recovery would expand gradually in the future as exports, in the semiconductor industry in particular, appeared set to maintain robust growth, facilities investment showed favorable movements, and the slump in construction investment eased. The member projected that consumer price inflation would rise to the mid-1% level, as rising international oil and grain prices would have an impact with some time lag going forward and economic normalization would lead to an increase in demand-side pressures.

Meanwhile, the member’s assessment was that the sluggishness in employment had deepened with the amount of decrease in the number of persons employed rising greatly in January, against the backdrop of growth in both the number of the unemployed and the number of persons on temporary leave due to the prolongation of the pandemic. The member noted that the number of persons employed had declined drastically in the face-to-face service industries in particular, due for instance to stronger social-distancing measures, and there were increased closures of self-employed businesses of late. The member thus raised the concern that the pace of recovery in employment could be constrained even after the pandemic eases. The member, however, presented the opinion that dealing with this issue by selectively supporting damaged sectors through fiscal policy would be more effective than using monetary policy, the effects of which would be indiscriminate across all sectors.

The member stated that there remained considerable uncertainties surrounding the recovery path of the domestic economy, such as delayed improvements of household consumption conditions following worsened employment conditions, as well as pandemic-related developments such as vaccine supply, innoculations, and coronavirus variants. The member thus saw that it would be necessary to maintain the current accommodative monetary policy stance until the economy exhibits a more clearly marked recovery, and in this regard it would be appropriate to keep the Base Rate unchanged for the intermeeting period.

However, the member stressed the need to continually pay attention to the accumulation of potential factors threatening financial stability in the future including rapid growth in household debt, expansion in corporate credit, and a sustained rise in real estate prices resulting from the continuation of accommodative financial conditions. The member added that, if the domestic economy enters a full-fledged recovery phase in the future, the implementation of monetary policy should be reviewed with greater focus on financial stability.

Another member presented the view that it would be appropriate to keep the Base

Rate unchanged from the current level.

Looking at economic developments since the January MPB meeting, the member assessed that growth in major countries was gradually improving, thanks for instance to fiscal stimulus packages and the rollout of vaccines in major countries. Concerning global trade, the member expected trade in goods to steadily improve, despite the prospect for sustained sluggishness in trade in services.

The member's assessment was that the domestic real economy was moving in conjunction with the developments of COVID-19. Looking at sectors, the member saw that, concerning private consumption, consumption of face-to-face services had been sluggish due mainly to containment measures, and overseas spending was unlikely to reverse course for a considerable time. Meanwhile, the member projected that facilities investment in the IT sector would be solid, and that in the non-IT sector would grow moderately, led by investment in maintenance and repair, while construction investment would reverse to an increase this year from the current decrease. The member also forecast that exports would remain favorable going forward, thanks to a gradual global economic upturn and significant improvement in the semiconductor industry. Meanwhile, looking at employment, the member stated that the number of persons employed had decreased greatly following the resurgence of COVID-19. The member raised the concern that the employment slump in self-employed businesses focused on face-to-face services would deepen, which was highly likely to have negative impacts over a long period of time, although employment in the manufacturing sector was likely to increase, led by an upturn in the IT industry. The member expected consumer price inflation to increase this year due to rising international oil prices and agricultural product prices.

The member presented the opinion that, since uncertainties surrounding the domestic economy were very high, it would be necessary to thoroughly monitor potential upside and downside risk factors. Since there was a growing possibility of a supplementary budget being compiled in the future, the member stressed the need to analyze the extent to which it would contribute to the recovery of the real economy.

The member also noticed that consumer price inflation was still running below the inflation target despite an upward revision this time and the outlook for core inflation remained unchanged at the 1.0% level. The member thus stated that considerable time was likely needed before the negative output gap turned positive, even if the domestic economy showed a moderate recovery. The member judged that it would be necessary to maintain an accommodative monetary policy stance going forward.

The member's evaluation was that the international financial markets were showing stability, and the domestic financial and FX markets were also stable, but volatility had increased of late. The member stressed the need for thorough monitoring, since market participants had become much more sensitive to the outlooks for the US economy and inflation and the related direction of the US Fed's monetary policy.

Taking all this into consideration, the member assessed that it would be desirable to keep the Base Rate at its current level of 0.50%.

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 remained slow due to the ongoing influence of the movement restrictions following the resurgence of COVID-19. In global financial markets, stock prices and government bond yields in major countries have increased, mainly driven by the expectations for economic recovery following the expansion of vaccinations and the prospect of a further fiscal stimulus package by the new US administration. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the severity of the resurgence of COVID-19 and the status of vaccine distribution, as well as by national policy responses and their effects.

☐ The Korean economy has continued to recover modestly. Although private consumption has remained weak as social distancing has been prolonged, exports have sustained their buoyancy led by the IT sector and facilities investment has continued to recover. Labor market conditions have remained weak, as the number of persons employed declined sharply compared to the corresponding period last year. Going forward, the economy is likely to continue its recovery, led by exports and investment. However, uncertainties surrounding the pace of recovery are judged to remain elevated. GDP growth this year is projected to be around 3.0%, generally consistent with the November forecast.

☐ Consumer price inflation has remained at the mid-0% level as the surging prices of agricultural, livestock, and fisheries products were offset by factors such as the decreasing prices of public services. Core inflation (excluding changes in food and energy prices from the CPI) has also remained at the mid-0% level. The inflation expectations of the general public have risen to 2%. It is forecast that consumer price inflation will run at the low- to mid-1% level this year, exceeding the November forecast of 1.0%, largely reflecting the increase in global oil prices and gradual improvement in economic activity. Core inflation is forecast to run at around 1%.

☐ In domestic financial markets, long-term market interest rates and the Korean won to US dollar exchange rate have risen, mainly driven by global financial market movements. Stock prices have fluctuated considerably, affected by both expectations for economic recovery and caution about the recent rally. Household loan growth has accelerated, 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. As the recovery in the Korean economy is expected to be modest and inflationary pressures on the demand side are forecast to remain weak, the Board will maintain its accommodative monetary policy stance. In this process the Board will thoroughly assess developments related to COVID-19 as well as the effects of the policy measures taken in response to the pandemic, while paying attention to changes in financial stability conditions such as fund flows to asset markets and household debt growth.