Minutes of the Monetary Policy Board Meeting

July 18, 2019

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(July 2019)

Ⅰ. Outline

1. Date of meeting: Thursday, July 18, 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
   Shin, Ho Soon, Deputy Governor
   Ryoo, Sang Dai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Lee, Seungheon, Deputy Governor
   Suh, Bong Gook, Director General of Reserve Management Group
   Lee, Hwan Seok, Director General of Research Department
   Shin, Woon, Director of BOK Economic Research Institute
   Min, Jwa Hong, Director General of Financial Stability Department
   Park, Jongseok, Director General of Monetary Policy Department
   Lee, Sang Hyeong, Director General of Financial Markets Department
   Yang, Seok Jun, Director General of International Department
   Kim, Hyun Kee, Press Officer
   Chae Byung Deuk, Director General of Monetary Policy Board Secretariat
   Sung, Kwang Jin, Head of MPB Team

1) This English version (summary) of the minutes of the Monetary Policy Board Meeting was produced at a working level, and is not an official document.

Ⅱ. Summary of Discussions on the Current Economic Situation

After briefings by staff on *Economic Outlook for the Second Half of 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, looking at the global economy, trade growth had slowed significantly and major countries except the US had shown weaker economic growth, amid the prolongation of uncertainties caused by trade conflicts between major countries and by shifts in their policies. As for the global financial markets, members judged that interest rates in major countries had continued to decline in expectation of the US Federal Reserve's accommodative monetary policy, while the volatility of major exchange rates had increased.

Concerning the domestic economy, members' evaluation was that, along with sluggish exports, facilities and construction investment had continued to undergo adjustments, while private consumption had continued to grow albeit slowly. Members judged that the Bank of Korea's downward adjustments to the growth forecasts for 2019 and 2020 reflected the situation that the pace of domestic economic growth had been slower than expected. Members also noted that changes in domestic and external conditions, including growing global economic uncertainties, the global trade slowdown in line with the spread of trade protectionism, and Japan's export restrictions, could act as downside risks to the growth path.

Concerning inflation, members saw that consumer price inflation had remained low, running below 1%, due to the combined effects of structural and cyclical factors. Members forecast demand-side inflation pressures to remain at a low level for the time being.

Finally, as to the domestic financial markets, members saw that market interest rates had fallen significantly and the stock market had been sluggish, but credit market funding conditions had remained stable overall. Members also judged that, while household debt had been continuing to show slower growth, continued attention should be paid to the risk of financial imbalances.

2) An English version of *Economic Outlook for the Second Half of 2019* 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:

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

One member stated that it would be appropriate to cut the Base Rate from the current 1.75% to 1.50%.

The member judged that the domestic economy had continued to slow overall since last year. The member's diagnosis was that, as the semiconductor industry had continued to go through a correction and the negative spillover effects of shrinking global trade in line with the US-China trade dispute had become apparent, the downward trend of exports had been spreading to other items. The member evaluated that the worsening of export sluggishness amid already-shrinking domestic demand affected largely by a correction in construction investment had been slowing down growth in the private sector significantly. In this regard, the member expected the overall economy to remain lackluster for the time being, even when accounting for the government's active fiscal policy. In particular, as the trade conflict between Korea and Japan had been intensifying recently, the member's judgment was that there remained downside risks to the 2019 growth forecast, which the Research Department had adjusted downward this time.

The member also mentioned that the nominal GDP growth rate, representing the rate of growth in the income of all economic agents, had slowed dramatically to 3.1% last year and was forecast to slow much further this year. In particular, the member expressed concerns that it was difficult to expect the corporate sector to regain its growth momentum for the time being, as its disposable income had declined by more than 5% last year, despite the booming semiconductor industry, and was likely to decrease to a greater extent this year.

The member noted that, in line with the decline in economic activities, consumer price inflation and core inflation had remained in the upper-0% range, far below the target. Considering that it would be difficult to expect the economy to recover within a short period of time, the member saw only a slight possibility of the current underlying trend of a slowdown in inflation reversing in the second half of this year.

Considering these economic conditions mentioned above, the member stated that it would be desirable to cut the Base Rate from the current 1.75% to 1.50%. Although it was difficult to expect a 0.25 percentage point cut to lead to tangible economic recovery at this point in time, the member expected the rate cut to act as a buffer against further slowdowns in economic activities and inflation that could occur if a Base Rate adjustment were delayed. Meanwhile, the member added that it would be advisable to steadily strengthen prudential policy to prevent moral hazard, thereby reducing potential risk factors in the financial markets that might stem from household debt.

Another member took the view that a shift in the Base Rate policy stance was needed to cope with the changing economic conditions and, in this regard, it would be desirable to lower the Base Rate to 1.50% at this meeting.

Looking at the real economy, the member's assessment was that the slowdown in global trade growth had become a trend while exports and facilities investment had become more lackluster, and as a result, an economic slowdown had become apparent, with the growth rate far below the potential growth rate.

With regard to major economies, the member mentioned that, while the US had maintained relatively favorable growth, the euro area had remained sluggish and Chinese economic growth had been gradually decelerating. The member added that global trade growth, which affects the Korean economy more directly, had been slowing at a much faster pace than the global real economic trend.

In these external conditions, the member's evaluation was that Korea's exports and investment had undergone a wider range of corrections in the first half of this year, leading a slowdown in overall growth. The member noted that the decline in facilities investment had accelerated to record a two-digit rate of decrease in the first half, and goods exports had reversed to a decrease in terms of both value and volume. The member also assessed that, as the real economic slump had led to sluggish employment, particularly in the manufacturing sector, household income growth had slowed and heightened uncertainties had dampened household consumer sentiment. As a result, the member estimated that the lackluster private consumption of the first quarter had continued in the second quarter. In light of the economic downturn and newly emerging risk factors such as Japan's export restrictions, the Research Department's downward adjustment of its previous growth forecast had been inevitable.

Concerning inflation, the member forecast consumer price inflation for this year not to exceed the upper-0% level, given its movements so far and the recent economic trend. The member expressed the view that Korea's inflation to date had been affected substantially by factors such as global factors and administered prices that are not closely related to domestic monetary policy. Taking a more detailed look at the recent inflation, however, the member assessed that a pattern had become more evident: aggregate demand-pull pressures had been sluggish in line with the economic downturn, leading to a slowdown in inflation.

In terms of financial stability, meanwhile, the member's evaluation was that household debt growth had continued to slow. The member forecast that, although leasehold deposit loans and group loans by the banking sector had remained on the rise, there were no unique factors that would contribute to a further acceleration of household debt growth, and in light of this, it would gradually stabilize downward this year to a level no higher than 5%.

In overall consideration of the above, the member judged that, with domestic demand sluggish in line with a substantial slowdown in global trade, Korea's real economic downturn was progressing rapidly and inflation was stagnating in the 0% range. Due to these changes in economic conditions, the member took the view that it was hard to see the current Base Rate level as an accommodative monetary policy stance. In this regard, the member stated that it would be appropriate to cut the Base Rate to 1.50% at this meeting.

One other member expressed the view that, in consideration of real economic and inflation trends, it would be desirable to cut the Base Rate to 1.50% at this time.

The member saw that, with respect to the global economy, uncertainties related to trade tensions between major countries and policy changes had lasted for a longer period of time and the growth momentum had been slowing gradually. The member estimated that the global economic growth rate during the first half of this year had fallen slightly below that of the second half of last year, and pointed out that the differentiation in economic trends by industry should be noted—the non-manufacturing sector and consumption had remained relatively favorable while the manufacturing sector and investment had stayed sluggish. The member judged that, as uncertainties related to trade disputes had heightened again since May, their negative impacts on global trade and the domestic economy had been increasing substantially.

As to the domestic economy, the member expressed concerns that downside risks to the growth path had increased significantly due to the changes in domestic and external conditions, even though the quarter-on-quarter growth rate was estimated to have shifted to positive in the second quarter. The member pointed out that the decline in the value of customs-cleared exports had accelerated since May while their volume had also reversed to a decrease, and went on to state that Japan's export restrictions had the potential to substantially disrupt Korea's production and exports depending on how the situation developed going forward, and thus it would be necessary to map out and analyze various scenarios concerning potential downside risks. Next, looking at domestic demand by sector, the member assessed that, while the degree of the contribution of public-sector spending to growth had increased and private consumption had shown modest growth, consumption of durables had been relatively weak and corporate investment had remained lackluster. The member added that, although month-on-month declines in machinery and construction orders, known to be leading indicators, had been moderating somewhat, there was little possibility that they would recover significantly within a short period of time, considering that domestic and external uncertainties had been large and corporate sentiment had shrunk.

Concerning inflation, the member's evaluation was that consumer price inflation had remained low at the 0% level in the first half, but with supply-side and one-off factors excluded, underlying inflation had been higher than consumer price inflation. Given that the negative output gap was likely to widen and limit demand-side pressures, however, the member forecast that consumer price inflation would depart from its 2% target for a longer-than-expected period of time.

Given the aforementioned matters, the member expressed the view that it would be appropriate to cut the Base Rate by 25 basis points to 1.50% at this time. Looking back at the policy judgments made over the past several months, the member mentioned that, amid uncertainties related to trade disputes, the slope of the medium-term monetary policy path had been gradually adjusted while a rebalancing had been performed in terms of the effects of policy decisions on the growth and inflation paths versus the risk of an accumulation of financial imbalances. However, the member judged that, as trade tensions had heightened again since May and downside risks that had raised concerns had been partly realized or had become more likely to be realized, it would be desirable to adjust the level of the Base Rate downward to buffer downside risks to the growth path and help get inflation back on track.

Meanwhile, the member expressed the view that continued coordination with other policies would be needed to minimize potential policy costs incident to the Base Rate cut. The member also emphasized that, since it could not be ruled out that more accommodative financial conditions could cause the degree of the accumulation of financial imbalances to increase again, related risks should be monitored continuously. The member added that medium- and long-term policy efforts should be strengthened to enhance growth potential, bearing in mind that the prolongation of low interest rates had in many cases weakened corporate restructuring efforts and that the slowdown in Korea's economic growth had been attributable to several structural problems as well.

One member, meanwhile, presented the view that it would be desirable to lower the Base Rate by 0.25 percentage points from 1.75% to 1.50%, with more focus placed on growth and inflation conditions.

Looking at the domestic economy, the member assessed the sluggishness in exports and investment as having continued, as global growth and trade slowed and the semiconductor business's recovery was pushed back compared to original expectations. In the future, the sluggish trend in global trade, stemming for instance from the escalation of the US-China trade dispute, could continue longer than anticipated. The member added that Japan's restrictions on exports could also cause setbacks in production and investment in Korea's core industries. With respect to prices, the member saw that demand-side inflationary pressures had weakened due to the economic slowdown, while downward pressures from government policy had been sustained.

The member mentioned that, in the financial markets, long-term market interest rates had fallen significantly in reflection of these growth and price conditions. The member, however, saw that household debt growth was showing signs of expansion of late despite concerns about an economic slowdown, after having previously exhibited a slowing trend, and corporate bond issuance and corporate lending, including lending to small- and medium-sized enterprises, had steadily expanded. The member diagnosed these developments as being contrary to the procyclicality of the financial system in general and assessed that they could serve as positive factors partially easing downward pressures on the economy, but could also be factors requiring continued vigilance in terms of financial imbalances.

The member noted that overall macroeconomic and financial stability conditions had been considered in monetary policy decisions made to date. The member saw that, since the economic growth rate was forecast to be below its potential level and consumer price inflation to run well below the target level, the need for accommodative monetary policy had grown in terms of macroeconomic conditions. The member, however, noted that lending to households had expanded again of late, led by bank lending, and housing prices in parts of the Seoul metropolitan region had also been showing signs of a rebound, centering around apartments planned for reconstruction and new presale apartments. The member thus emphasized the need to remain on the alert to risks concerning financial stability.

The member took the view that, although macroeconomic and financial stability conditions had been acting as conflicting considerations for monetary policy decisions, it would be better to lower the Base Rate by 0.25 percentage points from 1.75% to 1.50%, with more focus placed on growth and inflation conditions. The member, however, emphasized that, when cutting the Base Rate, close scrutiny of various risk factors was necessary to prevent a large expansion of financial imbalance risks, which had been cause for concern for some time. The member also expressed the view that the government and the supervisory authorities should also carry out macroeconomic and housing policies for stabilization of household debt and the housing market in a consistent manner. The member noted that the sustained low growth of the Korean economy was largely attributable to economic structural factors such as population aging and slower growth in productivity, and thus it was important not only to implement short-term economic stimulus on the monetary and fiscal policy side but also to work to enhance competitiveness and expand growth potential by carrying out structural reforms in all areas of the economy.

Another member took the view that it would be desirable to cut the Base Rate from 1.75% to 1.50% at this meeting in overall consideration of domestic and overseas economic conditions.

The member assessed that, concerning the global economy, trends of growth in major countries other than the US had been weakening. The member also diagnosed that instability in the Chinese economy could continue due to prolonged US-China trade negotiations, and the spread of other trade disputes had worked to increase concerns about the global economy. The member noted that, accordingly, world trade growth had fallen far below original projections. With respect to the international financial markets, the member pointed out the need for ongoing monitoring, since volatility in major exchange rates had become higher with interest rates in major countries showing a trend of decline due to expectations of accommodative monetary policy by the US Federal Reserve.

The member's evaluation was that, following negative growth in the first quarter, corrections in facilities and construction investment had continued in the second quarter with exports being sluggish. In particular, the member saw that the real economy had been worse than expected since the beginning of May as the US and China had failed to find a way to reach an agreement in their trade dispute. The member also pointed out that, although employment was showing improvement due mainly to a base effect, qualitative improvement had been sluggish with continued deterioration in employment conditions in the manufacturing sector. The member thus presented the view that, although the Research Department had made a large downward adjustment to the economic outlook in consideration of those conditions, there still looked to be downside risks given recent domestic and overseas economic conditions, including the trade issue with Japan. The member voiced concern that there was still a long way to go before the real economy would show a rapid recovery, particularly due to negative synergy effects of growing uncertainties surrounding the global economy, the export slump stemming from the US-China trade dispute, and the difficulties facing Korea's IT industry.

The member saw that inflation would remain very low this year, due to low demand-side inflationary pressures amid the combined interactions of structural and cyclical factors. The member presented the view that, particularly since the output and inflation gaps were both negative, it was necessary to maintain an accommodative monetary policy.

As to the domestic financial markets, the member's assessment was that market interest rates had fallen significantly and the stock market had been somewhat sluggish, due to factors such as the deteriorating performances of Korean companies. The member expressed the view that, although credit market funding conditions had remained relatively stable, attention should be paid to the herding behavior seen in some credit bond markets.

The member, meanwhile, saw that household debt growth had slowed to around 5%, thanks for instance to strong government measures, and judged that this had been a positive change. The member expected household debt growth to remain stable overall, although the volume of household debt growth could increase somewhat in the second half of this year compared to the first half. The member, however, stressed the need to closely monitor the household debt trend in the future as well.

Finally, the member judged that, with the US Federal Reserve highly likely to lower its policy rate in July, concerns about the widening of the interest rate gap between Korea and the US, which had been showing an inversion, could ease to some extent, given a change in the monetary policy stance of the US Federal Reserve.

With the aforementioned domestic and overseas economic conditions taken into consideration, the member expressed the view that it would be desirable to cut the Base Rate from 1.75% to

1.50% at this meeting.

One other member presented the view that it would be desirable to keep the Base Rate at its current 1.75% level at this meeting.

The member saw that, after a temporary rebound in 2017-2018, the world economy looked to have entered a somewhat steep re-correction phase due to the escalation of trade disputes, with the effects of US fiscal policy and the contribution to growth of investment in China weakening. The member noted that this could also be seen in sluggishness in IT and other manufacturing production. On the other hand, the member saw that the leading growth drivers for economic activity in major countries still looked to be services and consumption, but presented the view that it was uncertain how long the virtuous circle led by domestic demand would last. The member noted that major country central banks had been showing movements toward re-expanding their accommodative stances to deal with weakened inflationary pressures. The member went on to voice concern that this could again stimulate prices of financial and real assets, which had already been high.

The member expected domestic economic growth to continue for some time at a level lower than potential growth, which had shown a trend of decline, as growth was being weighed on by the readjustment of real estate and IT investment, on top of the above-mentioned changes in the global environment. The member also anticipated inflation to remain low, influenced by weaker demand-side pressures and administered prices.

The member stated that it was necessary to respond to this situation with expansionary macroeconomic policy. The member, however, noted that the low growth trend was due mainly to domestic and overseas structural factors and readjustment of excess investment, that the narrowing of the current account surplus and the depreciation pressure on the won had appeared simultaneously, and that there still was a risk of financial imbalances. Given these points, the member took the view that an appropriate mix would be to carry out a large expansionary fiscal policy and to maintain the current level of accommodative monetary policy. The member first expected that if fiscal policy was implemented in line with the budget bill, its contribution to economic growth would rise substantially from last year through direct effects of fiscal spending and indirect effects of tax revenues on consumption. The member’s assessment was that monetary policy still remained accommodative, in view of abundant market liquidity conditions. The member commented that even the estimates of proxy indicators of the natural interest rate, such as marginal productivity of capital, confirmed that monetary policy was accommodative. The member added that this was also reflected well by a calculation of the neutral interest rate using expected inflation or price indexes that better capture demand-side pressures.

The member pointed out that, if the degree of monetary policy accommodation were expanded further in the current situation, the possibility could not be ruled out of the policy effects leaning toward rises in asset prices due to oversupply of liquidity. The member added that household debt, together with faster growth in the debt of small- and medium-sized enterprises, which had increased greatly for the past ten years, could put downward pressures on potential growth in the medium term.

However, the member pointed out that, despite the risk of financial imbalances, the weakening inflation expectations stemming from persistent low inflation conditions could not be ignored. The member expressed the opinion that, if the trend of decline in inflation expectations continued, which had been ongoing since the end of last year, the relative importance of concerns about the widening of financial imbalances and the decline in inflation expectations should be reconsidered. The member also emphasized that the global financial and real market trends stemming from changes in the monetary policies of major countries should be closely watched.

Taking into overall consideration the above-mentioned factors, the member took the view that it would be desirable to keep the Base Rate at its current 1.75% level. The member added that, with uncertainties surrounding external conditions increasing sharply, the macroeconomic policy mix should be adjusted carefully in the future, while closely watching future developments in the domestic economy, and the flow of private consumption and inflation expectations in particular.

Ⅳ. Results of Deliberation on Monetary Policy Directions

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

However, Dr. Lee, Il Houng expressed clear opposition to the idea of cutting the Base Rate by 0.25 percentage points and argued for keeping it at its current level.

Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to lower the Base Rate by 25 basis points, from 1.75% to 1.50%.

☐ Based on currently available information the Board considers that the pace of global economic growth has continued to slow as trade contracted mainly due to the US-China trade dispute. Global financial markets have been stable in general, with stock prices in major countries increasing in line primarily with expectations of monetary easing in major countries. 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 changes in the monetary policies of major countries, and geopolitical risks.

☐ The Board judges that the pace of domestic economic growth has slowed as construction investment has continued undergoing an adjustment and the slowdowns in exports and facilities investment have deepened, although consumption has continued to grow moderately. Employment conditions have partially improved, with the increase in the number of persons employed having risen. With respect to future domestic economic growth, the Board expects that the adjustment in construction investment will continue and exports and facilities investment will recover later than originally expected, although consumption will continue to grow. GDP is forecast to grow at the lower-2% level this year, below the April forecast (2.5%).

☐ Consumer price inflation has remained low at the mid- to upper-0% level, in consequence mainly of the continued decline in petroleum product prices. Core inflation (with food and energy product prices excluded from the CPI) has been at the mid- to upper-0% range, and the rate of inflation expected by the general public has been at the low-2% level. Looking ahead, it is forecast that consumer price inflation will fall short of the path projected in April and fluctuate for some time below 1% and then run at the low- to mid-1% level from next year. Core inflation will also gradually rise.

☐ The volatility of price variables in the domestic financial markets has increased. Long-term market interest rates have fallen significantly, in line mainly with concerns about economic slowdowns at home and abroad. Stock prices and the Korean won-US dollar exchange rate have fluctuated considerably, mainly affected by the US-China trade dispute and Japan’s export restrictions. The rate of increase in household lending has continued to slow, while housing prices have continued their downtrend.

☐ 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 expected that domestic economic growth will be moderate and it is forecast that inflationary pressures on the demand side will remain at a low level, the Board will maintain its accommodative monetary policy stance. In this process it will carefully monitor developments such as the US-China trade dispute, Japan’s export restrictions, any changes in the economies and monetary policies of major countries, the trend of increase in household debt, and geopolitical risks, while examining their effects on domestic growth and inflation.