# Minutes of the Monetary Policy Board Meeting

August 30, 2019

Bank of Korea

(English version)

# Minutes of the Monetary Policy Board Meeting[1)]
## (August 2019)

### Ⅰ. Outline

1. Date of meeting: Friday, August 30, 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
   Lee, Seungheon, Deputy Governor
   Park, Jong Seok, 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
   Lee, Sang Hyeong, Director General of Monetary Policy Department
   Kim, Hyun Kee, Director General of Financial Markets Department
   Yang, Seok Jun, Director General of International Department
   Park, Young Chool, 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 *Recent Economic Developments*,[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, global trade growth had continued to slow and economic growth in major countries had shown sluggishness in line with the escalation of trade conflicts between major countries and an increase in geopolitical risks. As for the global financial markets, members judged that preferences for safe-haven assets had strengthened in reflection of these heightened uncertainties.

Concerning the domestic economy, members' evaluation was that, with the trend of decline in exports stemming from the contraction in global trade continuing, facilities and construction investment had continued to undergo adjustments. Members voiced concerns that, as household and business sentiments were contracting, growth in private consumption showed signs of weakening. Members judged that the downside risks to the future growth path had increased in light of these domestic and international conditions.

Concerning inflation, members saw that consumer price inflation had remained low at around the mid-to-upper 0% range, as supply-side factors had acted as downward pressures and demand-side inflationary pressures had weakened. With demand-side inflationary pressures remaining low, members forecast consumer price inflation to decline further, influenced by the base effect of sharp price increases for some items last year, but then to gradually rise to the 1% range.

Finally, as to the domestic financial markets, members saw that volatility had increased greatly with long-term interest rates falling significantly and the stock market slumping. Members also saw that household debt had been continuing to show much slower growth in the first half of 2019. Given that apartment prices were shifting to increases in some areas and the slowdown in household lending was gradually moderating, however, members judged that continued attention should be paid to the risk of financial imbalances. Meanwhile, members' assessment was that, in the foreign exchange markets, the Korean won-US dollar exchange rate had risen considerably and exchange rate volatility had increased, but external soundness indicators remained favorable.

2) An English version of *Recent Economic Developments* 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:

The majority of 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 1.50% for the intermeeting period, while two members called for a 0.25 percentage point cut.

One member presented the view that it would be desirable to keep the Base Rate at its current 1.50% level at this meeting.

The member saw that, as trade disputes had escalated and political uncertainties had heightened since the previous MPB meeting, volatility in the global financial markets had increased and the trend of low growth had become further entrenched. The member noted that uncertainties surrounding service industries, which are assessed to have been drivers of employment and consumption in major countries, looked to have increased, due to ongoing sluggishness in the IT sector and the continued scaling down of manufacturing production.

The member's assessment was that major countries were responding to this situation with accommodative monetary policies, and these policy responses were inevitable from the perspective of inflation targeting. The member, however, noted that even some central bankers had raised doubts about whether such responses could be fundamental solutions to the current problems. The member pointed out that, given that political uncertainties and the structural weakening of the virtuous circle of income and investment caused the demand slump, there was uncertainty as to the extent of macroeconomic policy responses that should be taken and to the amount of costs that would be incurred as a result. The member explained that these doubts had been raised because accumulated financial imbalances may have already been expanded due to interest rates, which should play the most important role in resource allocation, remaining low for a long period.

The member assessed that growth had weakened in Korea as well, due to a combination of structural problems and global issues. The member saw that economic growth was below its potential level, due to a re-correction in the real estate market and a delay in the recovery of IT industry activity. The member noted that inflation remained low in reflection of these domestic and international conditions, and price indices showing demand-side pressures remained flat in the upper-1% range. Although expected inflation had declined slightly in August, as in July, the member expressed the view that for the time being it was necessary to monitor what impacts the recent rate cut and expansionary fiscal policy would have on expected inflation in the future.

Taking the following points into consideration, the member expressed the view that it seemed proper for the Korean economy to use an expansionary macroeconomic policy mix with a focus placed on fiscal policy. The member first saw that sluggish demand was attributable to structural factors. The member commented that, in a situation in which resources are not allocated flexibly due to a number of structural factors, or in which corporate debt ratios are already high owing to prolonged and continued low interest rates, a fiscal policy that selectively supports vulnerable groups could be more efficient. Next, the member pointed out that the possibility of capital becoming concentrated in the real estate market was still high. The member noted that fiscal policy is more effective in stimulating demand while reining in financial imbalances. Last, the member presented the opinion that stimulation of demand through fiscal policy could contribute more to a reduction in exchange rate volatility than that through monetary policy. The member saw that the won was seeking a new equilibrium in reflection of several downside risks to the Korean economy, and as the won was in sync with the yuan, volatility had expanded.

The member meanwhile assessed that, when making a simple comparison among major OECD countries with respect to the combined effects on GDP growth of fiscal stimulus for this year and of recent policy rate changes, Korea was implementing the most expansionary macroeconomic policy. The member judged this policy stance to be appropriate for the moment, but emphasized that close attention should be paid to the possibility that the US-China trade dispute and Japan's export regulations could be prolonged or further expand. Finally, the member emphasized that not only large-scale fiscal expansion but also efficient targeting of expenditure sectors were essential to ensure the efficiency of such a policy mix. The member added that it was urgent to strongly implement mid- to long-term reforms for more fundamental structural problems, thus securing national competitiveness and seeking the creation of value added in new areas.

Another member stated that it would be appropriate to cut the Base Rate from the current 1.50% to 1.25% to secure a buffer against the trend of sluggish demand in the private sector.

The member diagnosed that the Korean economy was in a considerable slump. The member saw that exports were continuing to decline significantly, due to a correction in semiconductor activity and to a contraction in international trade stemming from the US-China trade dispute. The member's assessment was that this was working to cause a decrease in facilities investment through a slump in the manufacturing sector. The member also judged that, while construction investment had not been showing any sign of breaking out of its current correction, private consumption growth had been slowing of late. The member's assessment was that demand in the private sector had stagnated overall, and weak growth dependent entirely on expansionary fiscal policy was continuing.

The member mentioned that inflation was declining in reflection of shrinking aggregate demand. The member saw that consumer price inflation ran at 0.6% in the first half of this year and could decline to around 0% in the second half, albeit temporarily. The member's assessment was that underlying price inflation with temporary factors excluded had remained at around 1% recently, far below the target. The member expressed the opinion that, given recent economic conditions, it was difficult to see what could be a force driving up inflation in the near future.

The member voiced concern that changes in the domestic and international economic environments had been worsening further since the last MPB meeting. The member's assessment was that downside risks to the Korean economy had heightened further due to an escalation of the US-China trade dispute, rising tensions with Japan, and emerging concerns about the US economy, which had maintained solid growth. The member also expressed the view that fiscal policy alone would have limited capacity to sustain growth without any medium-term recovery in private-sector demand, as tax revenue growth stagnated in line with the economic decline. The member diagnosed that, given recent economic conditions, growth for this year could run below 2% and it was difficult to be optimistic about economic recovery for next year.

Accordingly, the member took the view that it was desirable to cut the Base Rate from the current 1.50% to 1.25% to secure a buffer against the trend of sluggish demand in the private sector. The member saw that, judging the monetary policy stance using standard methodology, the 1.25% level of Base Rate could not be assessed to be low under recent macroeconomic conditions, and the expected benefits from deferring the necessary policy adjustment were unclear. Meanwhile, the member added that securing economic recovery in the medium- to long-term would require not only short-term macroeconomic policy but also strengthened policy efforts to enhance competitiveness in the private sector.

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

The member noted that there had even been some concerns about a global recession due to the continuation of slower growth in the world economy. The member assessed domestic growth to be weakening in sync with such global economic conditions. The member saw that, given the Korean economy's high economic openness and its heavy dependence on exports, a deterioration in external conditions could have greater impacts, which seemed to have been reflected in the fact that Korea had recently seen a larger decline in stock prices and more severe currency depreciation than major countries.

The member judged slower global growth to be mainly attributable to so-called slowbalization, or the slowing of globalization. The member's assessment was that decades of progress in globalization, while having generated substantial negative side effects, had also greatly contributed to sustained growth in the world economy based on the international division of labor according to comparative advantages and on the free movement of goods, services, capital, technologies and labor. The member, however, noted that, the recent slowbalization was heightening concern that economic prosperity backed by expanded international trade and market opening could be reversed.

The member saw that slower growth in the world economy looked to be inevitable for some time, due to contractions in trade and investment. The member voiced concern about the possibility of a negative feedback loop whereby the consequent deteriorated financial and real economic indicators and dampened household and corporate sentiments would affect consumption and investment.

The member expressed the opinion that monetary and fiscal policies should be expansionary to mitigate the negative impacts of external shocks. The member, however, added that, if the global supply chain weakened further and the movements of goods and production factors were constrained further—in other words, if a structural supply shock occurred—macroeconomic policies for adjusting aggregate demand would not be a fundamental solution.

The member noted that it was necessary to respond to the contraction in consumer and investment sentiments by operating accommodative monetary policy to cope with slower growth, although monetary policy would not be a fundamental solution. The member commented that the Base Rate had been lowered at the last MPB meeting from this perspective. The member saw that it was desirable to maintain the Base Rate at its current level at this meeting, since it was necessary to give balanced consideration to the burden on the financial stability side, including the following issues: the recent faster growth in banks' household lending; the shift to an increase in apartment prices and increased expectations for higher apartment prices, particularly in Seoul; and the expanded volatility of global capital flows.

One member, meanwhile, presented the view that it would be desirable to keep the Base Rate at 1.50% at this time.

The member's assessment was that, since the previous meeting, trade conflicts between major countries and geopolitical risks had been growing and the growth momentum for the global economy had continued to soften. The member evaluated that, although growth had been slowing relatively gradually, this decline in the growth rate had been seen mostly in the manufacturing and investment sectors that are closely related to global trade and the Korean economy, and went on to express concerns that global manufacturing and investment were not highly likely to show meaningful improvement in the second half of this year. Most importantly, the member mentioned that attention should be paid to the contraction of corporate sentiment amid the extremely unstable policy environment that would affect performance of the tradables sector. The member assessed that the US and other countries with favorable external soundness had been implementing accommodative monetary policies and some of them had been undergoing fiscal expansion, but the recent strengthening of the flight to quality in the financial markets was limiting the transmission channels of these policies. The member went on to argue that uncertainty surrounding the future growth path remained high in this regard.

The member assessed that the domestic economy had maintained weak growth due to a combination of structural and cyclical factors. The member evaluated that the significant rebound in the real GDP growth rate during the second quarter had been attributable mostly to increased government spending while the contribution of the private sector had decreased, and that in this respect, the rebound in real GDP could not been seen as an encouraging result for the growth outlook for the second half. The member noted that recent monthly indicators suggested that corporate and consumer sentiment had been weakening, investment had continued to go through a correction and private consumption had been growing at a somewhat slower pace. Concerning exports, the member stated that the decline in the export volume had slowed somewhat entering the third quarter, but due to growing uncertainties surrounding external conditions, exports would remain sluggish for the time being, with their volatility increasing significantly. The member assessed that there was a growing possibility of the future growth path falling below the July forecast, especially in line with the escalation of the US-China trade dispute and the strengthening of Japan's export restrictions, and added that this could weaken demand-side inflation pressures and act as a factor increasing the time needed for consumer price inflation to get back to the target level.

Meanwhile, the member mentioned that the spread of global risk-off sentiment had increased financial market volatility significantly, and the policy implications of the rising won-dollar exchange rate could be examined from various perspectives. The member took the view that, as the depreciation of a country's currency has a significant impact on its export competitiveness and inflation in both theoretical and empirical terms, the won's depreciation during a phase of economic slowdown could work to partly ease the downside risks to the economy and inflation. On the other hand, however, the member noted that there had been many instances during times of insufficient external soundness when the won depreciated rapidly following external shocks, resulting in financial instability and economic welfare loss. The member assessed Korea's external soundness as currently being substantially favorable, but considering that the current account surplus had been decreasing gradually and the external debt ratio had been showing a modest increase, the member emphasized that it would be necessary to pay keen attention to and monitor various indicators related to external soundness.

In overall consideration of the above, the member judged that growing financial market volatility and uncertainties surrounding domestic and overseas economic conditions had substantially increased the possibility of a realization of the downside risks to growth and inflation that were of concern in the July forecast. However, given that a certain degree of downside risk had already been taken into consideration in the course of making a rate-cut decision at the previous meeting, that the effect of a Base Rate cut spreads with a time lag, that expansionary fiscal policy had been adopted for counter-cyclical purposes, and that the slowdown in the growth rate had been attributable in part to structural factors, the member expressed the view that it would be desirable to keep the Base Rate at 1.50% at the present meeting while taking more time to examine whether the current policy mix would effectively serve as a buffer against downside risks to the medium-term growth and inflation paths.

Another member took the view that an adjustment to the Base Rate policy was needed to keep up with changes in economic conditions, and in this regard it would be desirable to lower the Base Rate to 1.25% at this meeting.

The member assessed that the domestic and external environments had deteriorated since the previous meeting. On the external side, the member noted that, while the continued slowdown in global trade had been negatively affecting major countries' real economies, uncertainties involving the US-China trade dispute and other existing risk factors had been growing and new geopolitical risk factors including protests in Hong Kong had emerged. In this regard, the member pointed out there were growing concerns that the global economy would continue to slow or fall into an even worse slump, unlike the original expectation that the economy would recover in the second half of this year. The member also judged that the longer-than-expected sluggishness of global trade and the consequent global economic slowdown, combined with geopolitical factors, had recently been affecting economic sentiment negatively. The member's evaluation was that capital in advanced market countries was shifting from stock to bond markets, and emerging market countries were seeing their financial asset prices falling and exchange rates showing greater volatility due to capital outflows, suggesting the strengthening of a flight to quality in the international financial markets.

The member assessed that, as the global economic environment had been deteriorating more than expected, Korea's export slump had been worsening somewhat, and facilities investment, which is closely related to exports, had also remained lackluster. The member also expressed concerns that private consumption, having increased gradually in the first half, was exhibiting signs of slower-than-expected growth in the second half. The member evaluated that the continued strong growth in nominal wages was a positive factor, but it seemed to be having only limited effects on improvement in consumer sentiment as well as income conditions of households as a whole. In comprehensive consideration of these trends, the member assessed that there were increasing downside risks to the Research Department's July growth forecast of 2.2% for this year.

The member noted that inflation had remained very low, and from a long-term perspective, it had remained below the target of 2% since 2013. The member also assessed that, since the beginning of this year in particular, core inflation and consumer price inflation had both remained within the 0% range, entering a new phase of sluggishness. The member expressed concerns that inflation was increasingly likely to remain weak next year as well, due to the growing likelihood that Korea's economic slump would be prolonged. The member stressed that it would be necessary to take aggressive measures to manage inflation expectations, considering that sustained low inflation could lead to a decline in inflation expectations. More specifically, the member expressed the view that, aside from adjusting the Base Rate, which is the central bank's direct monetary policy instrument, more aggressive communication policy instruments, such as the forward guidance introduced by major central banks facing similar problems, should be explored and their use should be considered.

The member assessed that, despite the recent increase in international financial market unrest, the trends of CDS premiums and other indicators pointed to the strength of Korea's international credit standing. The member's evaluation was that the won's depreciation reflected mainly changes in the macroeconomic conditions at home and abroad and was not serious enough to raise concerns about a fall in Korea's international credit standing. The member added that flexible fluctuations in the exchange rate would be necessary for nominal macroeconomic variables to return to normal in an economy where interest rate policy is implemented under an inflation targeting regime. Meanwhile, the member argued that, in cases where underlying inflation pressures had built up with respect to items for which prices are administered, which account for a substantial part of Korea's consumer prices, it would be desirable in terms of stable macroeconomic management to actively consider reflecting these factors in price-setting policy.

In summary, the member judged that the economy and inflation had remained sluggish, in line with the worsening of economic conditions led by the global trade slowdown, and assessed downside risks as having increased somewhat compared with the July forecast path. The member expressed the opinion that the Base Rate policy should be adjusted to keep up with changes in economic conditions, and that it would be appropriate to lower the Base Rate to 1.25% in this regard.

One other member presented the view that it would be desirable to keep the Base Rate at its current 1.50% level at this meeting and take more time to observe real economic conditions as well as domestic and overseas financial market trends.

The member assessed that uncertainties in global economy had been increasing, affected largely by the US-China trade dispute. The member noted that US consumption and employment indicators had been exhibiting favorable movements, while the Chinese economic slowdown had been becoming evident. The member expressed concerns that the prolongation of the US-China trade dispute could have negative spillover effects on the Korean and global economies. Moreover, the member noted that various geopolitical risk factors were spreading simultaneously and stressed the need to closely monitor these developments.

The member mentioned that, in line with the sluggishness of the global economy and trade, Korea's facilities and construction investment as well as exports had continued to go through corrections. The member judged that the situation concerning private consumption, having exhibited modest growth, had worsened with retail sales declining for the second consecutive month, and added that private consumption growth was highly likely to fall below the previous forecast in this regard. The member also noted that, amid the sustained sluggishness of semiconductor exports and China-bound exports, there were some concerns about the possibility of facilities investment, previously expected to rebound from the second half, remaining lackluster until the year-end. The member also expressed concerns that the worsening Korea-Japan conflict, along with the US-China trade dispute, would add to downside risks to growth. The member argued that, although employment had been showing improvement due mainly to a base-period effect, it was a little too early to be optimistic about employment, as it had continued to worsen in the manufacturing sector.

The member forecast that inflation could be even lower than the July forecast in the second half. The member mentioned that this would be affected by supply-side factors, such as the stabilization of agricultural, livestock and fisheries product prices, but the fact that core inflation was also running within the 0% range was worrisome. The member expressed the view that it would be necessary to maintain accommodative monetary policy given that downside risks to the consumer price inflation forecast had been increasing amid growing uncertainties concerning the domestic economy in line with global economic instability.

The member judged that, in the domestic financial markets, long-term interest rates had declined significantly, reflecting expectations of an economic slowdown, and the stock market had also been sluggish. Concerning household debt, the member noted that growth in household debt had slowed greatly in the first half, affected largely by strong government measures. The member added, however, that attention should be paid to fact that household debt had generally increased at a faster pace in the second half and went on to argue that continuous monitoring was needed of growing household debt in line with increasing real estate transactions resulting from recent real estate price rises in some regions.

With regard to the international financial markets, the member mentioned that various opinions had been suggested regarding the possibility of additional rate cuts by the US Federal Reserve, and with the US Treasury yield curve having inverted, there had been a keen interest in how the Fed saw the US economy and in which direction it would operate monetary policy. The member emphasized that developments related to the Fed’s monetary policy should be monitored closely given their significant impacts on Korea’s financial markets, while attention should be devoted to making sure that foreign exchange market volatility would not increase excessively.

The member set out the view that, in overall consideration of the domestic and external economic conditions mentioned above, it would be advisable to keep the Base Rate at its current level of 1.50% at the present meeting and take more time to monitor real economic conditions and financial market developments at home and abroad.

## 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. Cho, Dongchul and Dr. Shin, Inseok expressed clear opposition to keeping the Base Rate at its current level and argued for cutting it by 0.25 percentage points.

### Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 1.50% for the intermeeting period.

☐ Based on currently available information the Board considers that the pace of global economic growth has slowed as trade has contracted. Volatility in the global financial markets has increased. Government bond yields and stock prices in major countries have fallen significantly in line mainly with the US-China trade dispute and concerns about the consequent global economic slowdown. 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 remained slow, as consumption growth has weakened, while the adjustment in construction investment and the sluggishness in exports and facilities investment have continued. 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 judges that the uncertainties concerning the growth path forecast have further increased, owing chiefly to the escalation of the US-China trade dispute and the heightened geopolitical risks.

☐ Consumer price inflation has slowed to the mid-0% range, in consequence mainly of the declines in the prices of petroleum products and agricultural, livestock and fisheries products. Core inflation (with food and energy product prices excluded from the CPI) has been at the upper-0% range, and the rate of inflation expected by the general public has been at the 2% level. Looking ahead, it is forecast that consumer price inflation will fluctuate for some time at the lower-0% level as downside risks to the path projected in July have increased, and then run at the low- to mid-1% level from next year. Core inflation will also gradually rise.

☐ The high volatility of price variables in the domestic financial markets has continued, in line mainly with concerns about the US-China trade dispute, geopolitical risks, and the consequent economic slowdowns at home and abroad. Long-term market interest rates and stock prices have fallen significantly, while the Korean won-US dollar exchange rate has risen considerably. The slowdown in household lending growth has weakened somewhat, while housing prices have continued their downtrend but have risen in some parts of Seoul and its surrounding areas.

☐ 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 judge whether to adjust the degree of monetary policy accommodation, while closely examining any changes in macroeconomic and financial stability conditions. It will also carefully monitor the US-China trade dispute, any changes in the economies and monetary policies of major countries, the trend of increase in household debt, and geopolitical risks.