Minutes of the Monetary Policy Board Meeting

August 2020

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(August 2020)

Ⅰ. Outline

1. Date of meeting: Thursday, August 27, 2020

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
   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

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 (August 2020)*,[2] *FX and International Finance Trends*, and *Financial Market Trends*, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members agreed that, since economic recovery is forecast to be delayed due to the resurgence of COVID-19 at home and abroad, it would be necessary to maintain the current accommodative monetary policy to support the real economy and help stabilize inflation expectations.

With respect to the domestic economy, members' evaluation was that the growth rate was highly likely to decline significantly this year due to the resurgence of COVID-19, while downside risks to the growth path were high. By sector, members forecast private consumption to remain sluggish, affected mainly by a strengthening of social-distancing measures, and exports to exhibit a more modest recovery than originally expected due to the resurgence of COVID-19 in major countries and a delay in the recovery of the semiconductor industry. Members also expressed concerns that the structural vulnerabilities of the domestic economy could deteriorate with human capital being undermined by the prolonged employment sluggishness and income distribution worsening.

Members saw that, despite the rebound in global oil prices and the rise in agricultural product prices, inflation would remain low for the time being owing to the weakening of demand-side inflationary pressures. One member pointed to the possibility that inflationary pressures were being underestimated, since housing price rises and imputed rents were not properly reflected in consumer price inflation.

Members meanwhile pointed out that, although domestic and overseas financial and FX markets remained stable overall, it would be necessary to remain on the alert against the possibility of the accumulation of financial imbalances. Members expressed particular concerns about the possibility of the recent rapid increase in household unsecured loans leading to growth in leveraged investment in asset markets. In this regard, some members pointed to the need to examine the effectiveness of unsecured loan regulations. Some other members argued that it would be necessary to pay

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

attention to the sustained strong M2 growth, particularly in the corporate sector, and closely monitor its relationship with the housing market. Finally, most members emphasized that attention should be paid to the possibility of a sudden worsening of funding conditions for SMEs if the pandemic persisted for a long time.

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 forecast that, with the strengthening of social-distancing measures following the resurgence of COVID-19, economic recovery would slow and consumption in particular would shrink. The member also expected that, although the sluggishness of exports had been easing from the second half of this year, the pace of improvement in exports would be modest due to the continued spread of the virus in major countries. The member above all pointed out that demand for semiconductors, one of Korea's major export items, had been slowing recently. The member however forecast that facilities investment and intellectual property product investment would remain relatively favorable.

The member expressed concerns that the recent resurgence of COVID-19 would have negative impacts on labor demand. The member mentioned that, despite the gradual decline in the number of workers on temporary leave, the possibility could not be ruled out of a reversal in this trend. In particular, the member's evaluation was that the COVID-19 outbreak had led to a slump in low- and middle-skilled face-to-face services industries, accelerating structural changes in income distribution and the labor market. The member went on to state that this could be supported by the sharp year-on-year decline in earned income and the worsening of earned income inequality seen in Statistics Korea's household income and expenditure survey for the second quarter of 2020. The member expressed the view that in light of this it would be appropriate to maintain and extend government policy measures to ensure employment retention and income compensation, even if additional fiscal expenditure was required.

The member meanwhile noted that the business climate for SMEs had not shown substantial improvement. The member assessed that their production and capacity utilization ratio seemed to have been recovering since June and July, but due to the resurgence of COVID-19 they were unlikely to emerge from their sluggishness. The member stressed that, since a prolonged spread of COVID-19 increased the possibility of SMEs showing poorer performances and having more difficulty in raising funds, it would be desirable for the Korean government and the Bank of Korea to maintain and extend the current financial support measures.

Taking all this into consideration, the member took the view that, since anxiety and contracted market confidence were likely to continue negatively affecting the domestic economy for a considerable period of time, it would be appropriate to keep the Base Rate at its current level while using monetary policy tools other than rate decisions to respond to the possible cycle of contraction in the overall economy in which a decrease in one sector leads to a decline in another.

Another member expressed the opinion that it would be desirable to keep the Base Rate at the current level of 0.50%.

The member evaluated that the domestic economy had exhibited a slower-than-expected recovery since the July meeting as recoveries in private consumption and facilities investment had been delayed, due mainly to the weakening of the effects of government policy measures and to limited economic activities during the rainy season. The member expected that, in the event of expanded and continued social distancing in line with the rapid resurgence of COVID-19 at home and abroad since mid-August, Korea’s exports and consumption would suffer large negative impacts. With regard to inflation, the member’s anticipation was that, although demand-side inflation pressures would be weak, consumer price inflation would slightly exceed the Bank of Korea’s previous projection this year, with agricultural product prices rising following heavy rains.

The member assessed the financial and FX markets as having remained stable overall, despite the sluggish economic trend and the resurgence of COVID-19. The member also mentioned that corporate financing had been generally favorable and growth in household loans, particularly unsecured ones, had accelerated again. The member took the view that the recent stable trends of the financial and FX markets had been attributable substantially to the Bank of Korea’s aggressive use of various policy tools, such as reducing the Base Rate significantly, expanding the liquidity supply, and concluding a currency swap agreement with the US Federal Reserve, to respond to the spread of COVID-19. The member’s evaluation was that, although this had led to growing concerns about the accumulation of financial imbalances such as the rapid growth in household debt and the over-concentration of capital in the housing market, it also had undoubtedly helped improve the funding conditions of economic agents and facilitate credit flows in general to prevent the real economy from contracting excessively during the COVID-19 crisis.

The member expressed the opinion that it would be appropriate to keep the Base Rate at its current level at this meeting and take more time to observe future developments of COVID-19 and economic trends. The member went on to state that this was because the financial and FX markets were relatively stable, credit flows were favorable overall, and the sluggishness of the domestic economy was expected to ease at a modest pace going forward. The member emphasized that, considering the extreme uncertainty concerning the future growth path in line with pandemic-related developments, it would be necessary to monitor more closely changes in financial and economic conditions and conduct monetary policy prudently.

The member argued that it would be desirable to maintain the accommodative monetary policy stance until it appeared that the impacts of COVID-19 were weakening and the domestic economic recovery was back on track. The member however added that particular attention should be paid to the risk of financial imbalances that might occur due to the prolongation of the accommodative policy stance. The member meanwhile argued that, if COVID-19 spread more excessively than expected, this could lead to an increase in credit risks for SMEs and to a recurrence of financial and FX market instability, and went on to stress the need to further strengthen related monitoring and adjust emergency measures.

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

The member’s evaluation was that the global economy, and the US and Chinese economies in particular, had been exhibiting a modest recovery since the July meeting, but the European and Japanese economies had continued to undergo difficulties. The member expressed concerns, in particular, that signs of a resurgence of COVID-19 in European and other major countries might delay global economic recovery.

Looking at the domestic economy, the sluggishness of exports and consumption seemed to have been easing somewhat since the second quarter, but their outlooks had become substantially uncertain. More specifically, the member forecast that private consumption, which had been picking up since the second quarter, was likely to be more sluggish than expected, despite the government’s various support measures, due mainly to delayed improvement in household income and consumer sentiment following the resurgence of COVID-19. With regard to exports, the member pointed out that exports were unlikely to achieve recovery as originally forecast, affected largely by the resurgence of COVID-19 in major countries and a delay in the recovery of the semiconductor industry. The member, however, evaluated that facilities investment was favorable, boosted by strong IT-sector investment which more than offset a correction in non-IT sector investment, and that construction investment, although currently going through a correction, was also likely to face upside risk to growth, following repairs of damages from heavy rainfalls.

In terms of employment, the member noted that, although the decline in the number of the employed had been slowing gradually, employment remained sluggish in the manufacturing and construction industries. The member argued that it would take time for workers on temporary leave, whose number had increased dramatically since the COVID-19 outbreak, to return to their jobs, and a substantial part of these workers were likely to fall into a state of unemployment. The member thus stated that related monitoring was required in this regard. Concerning inflation, the member expected consumer price inflation to remain within the lower-0% range and core inflation also to remain low, even when inflation pressures following heavy rains were counted in.

The member mentioned that, as shown by the fact that the Research Department suggested both positive and negative scenarios in addition to the basic one when making a large downward adjustment to the original domestic economic growth forecast for this year, future economic conditions would vary depending on the severity of the COVID-19 resurgence. The member expressed the view that, with the negative output gap widening and the large inflation gap continuing, the current accommodative monetary policy stance should be maintained to support a swift recovery of the real economy.

The member meanwhile expressed concerns that, although the global financial markets and the domestic FX and financial markets had been stable, the over-concentration of capital in asset markets had been witnessed in Korea as well as the US and other major countries. More specifically, the member argued that attention should be paid to the fact that household debt had continued to grow despite the government’s stronger macroprudential policy, and that growth in household unsecured debt in particular had been recently leading to leveraged investment in the stock and real estate markets. The member emphasized that in this regard it would be necessary to keep a close watch on asset market trends and steadily draw up measures for encouraging capital flows into productive sectors so that accommodative monetary policy could support real economic recovery.

The member saw that, taking all those points into consideration, it was desirable to maintain the Base Rate at the current level this time.

Meanwhile, one member presented the view that it would be desirable to keep the Base Rate unchanged from the current 0.50%.

Looking at economic conditions since the Monetary Policy Board meeting on July 16, the member noted that the world economy was emerging from a severe economic downturn, thanks to eased sluggishness particularly in the consumption of major countries. The member, however, added that uncertainties surrounding the future recovery path remained high, due to the ongoing global spread of COVID-19 and the continued trade-off between economic activity and the degree of disease control. The member noted that, concerning the domestic economy, expectations for economic recovery had increased, as domestic and international demand conditions showed signs of improvement. The member, however, assessed that the growth trend in the second half of this year was being significantly constrained by the rapid resurgence of COVID-19 recently and the increased negative impacts of natural disasters. The member presented the opinion that, although the Bank of Korea Research Department had revised the economic outlook downward in reflection of those points, there could be additional downside risks due to high uncertainties. The member thus added that there would be a need to support the real economy and stabilize inflation expectations by implementing an accommodative monetary policy for some time.

Meanwhile, with respect to the need for additional policy responses, the member noted that the following points were being considered. The member stated that, despite concern about the resurgence of COVID-19, the degree of financial easing was steadily expanding thanks to improvement in domestic and international financial conditions, which stood in clear contrast with what had been seen during the first wave of the virus. The member judged that, looking at recent movements of major liquidity indices and credit growth for reference, liquidity in the financial market was sufficient to support the real economy. The member, however, commented that volatility in the bond market could become greater due to a crowding-out effect stemming from increased government bond issuance, and domestic and international financial conditions could tighten again owing to a broad resurgence of COVID-19. The member thus pointed out the need for ongoing monitoring.

Next, the member expected domestic consumption and services industries to contract sharply for some time, due to stronger disease control measures. The member, however, saw that, judging from external economic conditions, exports and the manufacturing sector would show a trend of improvement, albeit a moderate one. The member expressed the opinion that the economic shock stemming from the resurgence of COVID-19 might be concentrated mainly on consumption related to face-to-face services rather than the entire macroeconomy, given that facilities investment was usually closely related to the trend of exports, not consumption.

Finally, the member noted that a major cause of the contraction in consumption stemming from the resurgence of COVID-19 lay in stronger disease control measures such as social distancing. The member thus presented the opinion that it would be desirable to place the focus of monetary policy on minimizing the worsening of cash flows of corporations and households that have suffered damage, not on boosting consumption. The member also pointed out the need to consider the possibility that the liquidity problems of afflicted corporations could gradually develop into solvency risks due to the prolongation of the pandemic. The member thus took the view that a more effective way to buffer against downside risks to the growth path in the medium to long term would be utilizing policy programs that can directly and selectively support specific sectors, rather than expanding the degree of monetary policy accommodation through Base Rate adjustments.

The member saw that, taking all those points into consideration, it would be appropriate to maintain the Base Rate at the current level of 0.50% this time.

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

The member's evaluation was that domestic and international economic conditions had shown signs of improvement since the Monetary Policy Board meeting on July 16 but were worsening again. The member assessed that, although the degree of global economic slowdown was improving somewhat, thanks to the easing of restrictions on economic activity, uncertainties and downside risks had become even greater on expectations of a further prolonged COVID-19 pandemic. The member also saw that contrary to original expectations that the domestic economy would not contract to a large degree, bolstered by relatively successful initial disease control and the Chinese economic recovery, the negative shocks would expand due to more-sluggish-than-expected global growth and the domestic resurgence of COVID-19. More importantly, the member assessed that the global trade slump's direct impacts on our exports were unavoidable, that private consumption was continuing to decline significantly, and that recovery momentum in the investment sector was weak.

The member forecast that the growth rate for this year would be below -1% for the third time, following the oil shock in 1980 and the Asian currency crisis in 1998, as the domestic economy recorded sharply negative growth in the second quarter and the future growth path had been adjusted downward. The member raised the concern that, against this backdrop, there was a greater risk of the economic structure becoming more vulnerable, due for example to the worsening of income distribution and erosion of human capital following a significant decline in employment. The member pointed out that, on the inflation side, demand-side pressures still remained weak, although the decline in inflation expectations had fortunately moderated.

The member's assessment was that, while the downside risks to the real economy had increased, the domestic financial market remained stable overall, and upside risks to some asset prices remained. The member noted that market interest rates and the exchange rate had fluctuated within a narrow range and foreign currency funding conditions also remained stable, thanks to the bold policy responses so far, despite the resurgence of COVID-19 of late. The member, however, saw that capital continued to flow into asset markets, such as the stock and real estate markets, and asset prices were still rising rapidly. The member thus pointed out that there remained economic and social concerns in this regard.

The member voiced concern that, as both corporate and household sector debt increased rapidly, the risk of default in some vulnerable sectors could emerge and the increased debt servicing burden could weigh on the economic recovery with a time gap. The member, meanwhile, noted that there would be a need to expand selective financial support, since vigilance against low-credit companies still remained and economic activity could worsen further, despite growth in market liquidity.

The member expressed the opinion that, although further worsening of the real economy was expected, monetary policy should maintain the current accommodative level, while strengthening its cooperative relationship with various policy instruments, in overall consideration of the continued gap between the real economy and financial conditions, and significant deviations even within financial sectors. The member emphasized that it was important to stabilize the expectations for asset prices by making better use of related macroprudential policy measures and inducing the expansion of the supply base in the long term. At the same time, the member presented the view that it would also be necessary to actively utilize supplementary monetary policy instruments to ensure a more seamless functioning of financial intermediation. The member also added that, on the fiscal side, the Bank should actively set forth its views to ensure that the expansion of the fiscal burden would dynamically lead to a virtuous cycle of growth and distribution, while creating a favorable environment for fiscal expansion through low interest rates and purchases of Treasury bonds.

One other member presented the view that it would be appropriate to hold the Base Rate at its current level for the intermeeting period.

The member evaluated that manufacturing production and the capacity utilization rate had increased, due to partial recovery in the world economy and a narrowing of the export decline, while services production had also sustained a modest recovery. The member, however, assessed that the recovery in private consumption had been sluggish since the beginning of July, due mainly to the rainy season and the scaled back individual consumption tax cut, as well as to the effect of reduced household transfer income. The member's assessment was that inflation had somewhat increased of late, due to rising agricultural, livestock and fisheries product prices stemming from the rainy season and heavy rainfall, while inflationary pressures still appeared low.

The member, meanwhile, assessed that the domestic and international financial markets remained stable thanks to the various measures taken by the authorities of major countries and the Bank of Korea to date to increase the supply of liquidity. The member saw that foreign exchange supply and demand conditions also maintained stable movements. The member noted that the funding of domestic corporations was smooth, and corporate and household lending were continuing to increase substantially overall. The member, however, added that there was concern about inflows of abundant market liquidity into asset markets and the subsequent ongoing rises in stock and real estate prices.

The member's evaluation was that there remained high uncertainties surrounding the future domestic and international growth paths due to the ongoing global spread of COVID-19, despite partial recoveries in economic conditions at home and in major countries of late. The member voiced particular concern about an increased possibility that consumption, production and investment could contract again and the economic recovery could be delayed, following the recent accelerated spread of COVID-19 and stronger social distancing rules.

Taking all this into consideration, the member expressed the view that it would be necessary to maintain the current accommodative monetary policy stance and it would be appropriate to hold the Base Rate at its current level for the intermeeting period. The member noted that, under the current domestic and international economic conditions, maintaining the current accommodative stance was inevitable, and this stance would have to be sustained for some time. The member, however, emphasized that it would be necessary to keep a close and careful watch on the potential for this stance to undermine financial stability in the future, as well as on the effects of sustained accommodative monetary policy on domestic asset markets.

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 global economy has continued to rebound from the severe contraction, but the pace of recovery has somewhat slowed due to the ongoing spread of the coronavirus (COVID-19). In global financial markets, stock prices in major countries have risen amid continuing hopes for economic recovery, while the US dollar has weakened and government bond yields have moved up slightly. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the evolution of the pandemic, as well as by the effects of national policy responses.

☐ Economic growth in Korea has remained sluggish. Although the decline in exports has moderated a bit, the improvement in private consumption has weakened. The recovery in facilities investment has been subdued, and the correction in construction investment has continued. Labor market conditions have remained weak, with the number of persons employed continuing to decline sharply. Looking forward, the recovery of domestic economic growth is likely to be slower than previously forecast, largely due to the domestic resurgence of COVID-19. In the Board's central projection, GDP growth falls to slightly below -1% this year, considerably lower than the May forecast of -0.2%. Uncertainties around the future path of GDP growth are also judged to be very high.

☐ Consumer price inflation has risen to the lower-0% level, due to a larger increase in the prices of agricultural, livestock, and fisheries products and to a reduced decline in petroleum product prices. Core inflation (excluding changes in food and energy prices from the CPI) has also increased to the mid-0% level, and the inflation expectations of the general public have risen to the upper-1% range. It is forecast that consumer price inflation and core inflation will run at the mid-0% level this year, reflecting prolonged effects from the drop in global oil prices and weak demand-side inflationary pressures.

☐ Domestic financial markets have been generally stable owing to decreased volatility in global financial markets. The Korean won to US dollar exchange rate has fallen, while long-term market interest rates have fluctuated within a narrow range. Stock prices rose sharply but then reversed some of the earlier gains, mainly due to concerns about the coronavirus resurgence since mid-August. The rate of household loan growth has risen, and housing prices have continued to increase 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 economic growth is expected to be sluggish and inflationary pressures on the demand side are forecast to remain weak due to the COVID19 pandemic, the Board will maintain its accommodative monetary policy stance. In this process it will thoroughly assess the severity of the coronavirus resurgence and its impact on the economy and financial markets, changes in financial stability, and the effects of the policy measures taken in response to the pandemic.