Minutes of the Monetary Policy Board Meeting

August 2021

Bank of Korea

(English version)

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Ⅰ. Outline

1. Date of meeting: Thursday, August 26, 2021

2. Place: Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:
   Lee, Juyeol, Chairman (Bank of Korea Governor)
   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
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Min, Jwa Hong, Deputy Governor
   Kim, Woong, Director General of Research Department
   Hong, Kyung Sik Director General of Monetary Policy Department
   Kim, Inkoo, Director General of Financial Markets Department
   Kim, Hyun Kee, Director General of International Department
   Park, Young Chool, Press Officer
   Han, Seung Chul, Director General of Monetary Policy Board Secretariat
   Choi, Mun Seong, Head of MPB Team

Ⅱ. Summary of Discussions on the Current Economic Situation

After briefings by staff on *Economic Outlook*,[2] *FX and International Finance Trends*, and *Financial Market Trends*, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members forecast that the domestic economy would remain favorable despite the resurgence of COVID-19, as exports and investment were expected to sustain their buoyancy while consumption had not contracted significantly, affected by the expansion of vaccinations, the learning effect of economic agents concerning the pandemic, and the execution of a supplementary budget. One member, meanwhile, noted the possibility of a sales decrease and worsening employment sluggishness in the face-to-face services industry in August and September and expressed the view that it would be necessary to monitor the services industry's business conditions and job recovery trend rather than aggregate indicators such as GDP.

Concerning inflation, members forecast that consumer price inflation would increase to the lower-2% level this year, boosted by gradually increasing inflationary pressures on both the supply and demand sides. Some members evaluated that there were huge upside risks to the price path, noting the possibility of inflation exceeding its forecast for this year influenced chiefly by the uptrend of processed food and dining-out prices and the rise in the exchange rate, and emphasized the need to examine underlying inflation over a medium-term horizon.

Members meanwhile assessed that, amid the continued accommodative financial conditions, household debt and housing prices continued to grow, and mentioned that, due to the accelerating accumulation of financial imbalances in the household sector in particular affected by the sustained risk appetite and over-concentration of capital in the asset market, it might be difficult to properly curb such acceleration solely with macroprudential policy, which is dependent on institutional regulations. Members also expressed concerns about the possibility of the recent strengthening of household debt management creating a balloon effect in which borrowers flock to the non-banking sector and also leading to a hard landing of household debt, and took the view that attention should be paid to possible negative effects of the household debt issue on economic growth.

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2) An English version of *Economic Outlook* 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:

Some members shared the opinion that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to raise the Base Rate to 0.75% from the current 0.50%, while one member argued for keeping it unchanged at its current level.

One member presented the view that it would be appropriate to raise the Base Rate to 0.75% from the current 0.50%.

The member assessed that the domestic economy was maintaining sound recovery despite the resurgence of COVID-19, and forecast that consumption would improve gradually while exports and investment would remain buoyant. The member expected that, although uncertainties related to COVID-19 were unlikely to be resolved in a short period of time, restrictions on economic activities, such as face-to-face consumption, would be eased gradually, boosted by the significant expansion of vaccinations for young adults and middle-aged people. The member added that, taking this into account, the Research Department forecast Korea's growth rate for this year to be at around 4%.

The member expected consumer price inflation to be at the lower-2% level this year, much higher than the May forecast, with supply-side upward pressures lasting for longer than originally expected and service charges growing at a faster pace, and also expected core inflation to be in the low- to mid-1% range, affected chiefly by increasing demand-side upward pressures following economic recovery, and then to rise gradually. The member meanwhile assessed that housing prices had been growing more rapidly, particularly in Seoul and its surrounding areas, and housing purchase sentiment was also strengthening based on expectations for a further rise in housing prices.

Concerning financial markets, the member noted that liquidity continued to exhibit a sharp increase, as M2 growth had remained strong since July amid the sustained highly accommodative financial conditions since the second half of last year. The member added that household loans had been increasing significantly across financial institutions, and the corporate sector had been also expanding fund-raising through the corporate bond and stock markets as well as through borrowing from banks. The member presented the view that the recent liquidity growth had been seen in the financial system as a whole and the accumulation of financial imbalances had been accordingly accelerating in the household sector in particular, which seemed unlikely to be curbed properly by macroprudential policy alone.

The member judged that, considering that prices had been showing higher growth than originally expected amid the sustained strong recovery of the domestic economy and financial stability risk had been worsening combined with liquidity growth, it would be difficult to delay any further the normalization of monetary policy, which had been eased to an unusual level.

The member noted that, if adjustment to the monetary policy stance were delayed in the current environment, the drastic policy adjustment that might occur in the future could increase the volatility of asset market and real economy and aggravate difficulties of vulnerable groups. The member took the view that, if the current monetary easing stance continues, its negative side effects on the economy as a whole could be larger than its effect of supporting vulnerable groups, and in this regard, it would be necessary to use fiscal and financial support measures ensuring selective resource allocation for these groups.

The member presented the view that as the first step toward normalizing monetary policy at a level appropriate for stable growth of the domestic economy, it would therefore be desirable to raise the Base Rate to 0.75% from the current 0.50%. The member however added that the pace and timing of further monetary policy adjustment should be determined based on close monitoring of future changes in growth and inflation trends, as well as of financial imbalances.

Another member expressed the opinion that it would be desirable to raise the Base Rate to 0.75% from the current 0.50%.

The member evaluated that, despite the resurgence of COVID-19 at home and abroad since July, the degree of contraction in economic activity had been limited compared with previous waves, affected by the expansion of vaccinations. The member expected major economies including the US, Europe and China to maintain modest recovery, boosted largely by expanded fiscal expenditure and improved employment, despite a slowdown in sentiment indices and in consumption growth. On the domestic front, the member's forecast was that, although consumption of face-to-face services had shifted to a decline, private consumption growth would be just slightly below the originally forecast path in the second half of this year, boosted chiefly by growth in alternative consumption and the effect of a supplementary budget. The member also expected that, with exports and investment keeping up their robust growth, the economic growth rate for this year would remain at around 4% as originally forecast and the output gap, having remained negative since the first quarter of last year, would shift back to positive early next year.

With regard to consumer price inflation, the member forecast that, with supply-side upward pressures increasing and the spillover effects of agricultural and livestock product price rises becoming apparent amid the recovery of demand, inflation would exceed 2% for the first time since 2012. The member also expected that core inflation excluding administered prices would also come in at the upper-1% level, and estimated that core inflation felt by the general public would be higher when taking into account the recent sharp rise in owners' equivalent rent that is excluded from the consumer price statistics.

Concerning financial markets, meanwhile, the member pointed out that risk appetite was strengthening and the over-concentration of capital in the asset market was continuing, and estimated that the household credit-to-GDP ratio had risen even further with the household debt growth rate from January to July reaching the record high and the household debt growth rate far exceeding the economic growth rate this year. The member added that, unlike in the past when a rise in leasehold deposit prices had translated into an increase in housing sales prices after which the latter declined with a time lag, an unusual situation was continuing in which both housing sales and leasehold deposit prices exhibited strong growth at the same time, and dependence on external funding for housing leasehold deposits and housing purchases had been strengthening gradually. The member noted that the Korean stock market had seen the highest rate of stock price growth among major countries since March last year, while leveraged investment was continuing with the outstanding amount of individuals' loans on margin accounts recording the highest level in history. The member pointed out that such accumulation of financial imbalances had worked to strengthen procyclicality in the financial sector and increase the vulnerability of the Korean economy to internal and external shocks in the future.

The member expressed the view that, in overall consideration of these macroeconomic and financial stability conditions, there was less need for an accommodative monetary policy stance in terms of growth and prices and a greater need to reduce the degree of monetary easing in terms of financial stability. The member judged that in this regard it would be appropriate to raise the Base Rate by 25 basis points to 0.75% at this meeting.

The member expected that, despite a slight increase in the Base Rate in the current environment, growth and prices would remain on their forecast paths, and the Base Rate adjustment would help achieve financial stability by easing risk appetites and thereby curbing leveraged investment, mitigating the inefficient distribution of resources and curbing capital outflows.

The member however mentioned that, since a rise in interest rates was highly likely to increase interest repayment burdens on vulnerable groups at a time when there remained high uncertainties related to COVID-19, it would be necessary to strengthen coordination with other policies such as fiscal policy and the Bank Intermediated Suppor t Facility. The member also added that the accumulation of financial imbalances, such as housing price hikes, household debt growth and a rise in the number of marginal firms, had resulted from the combination of various factors, including not just monetary policy but also real estate policy and changes in the economic structure, and in this regard, it would be necessary to come up with more consistent and effective policy over a medium- to long-term horizon.

One member expressed the opinion that it would be desirable to raise the Base Rate to 0.75% from the current level of 0.50%.

The member assessed that, since the previous MPB meeting, the global economy was continuing its sound recovery, driven by normalization of economic activity in major advanced countries, while the gap in economic activity among countries had been widening again.

On the domestic front, the member noted that the slowing trend of recovery in consumption due to stronger social distancing measures stemming from the spread of COVID-19 could disrupt the trend of economic recovery for some time. Looking at external economic conditions and various high frequency indicators, however, the member judged that the recent strengthening of social distancing measures would have limited negative impacts on the trend of economic recovery over a medium-term horizon. Most importantly, the member noted that exports had maintained solid growth, bolstered by the trend of global economic recovery, and the correlation between the spread of COVID-19 and economic activity had weakened greatly compared to past waves of the virus. The member added that the slowdown of the consumption recovery was not expected to continue past the middle of the fourth quarter, since vaccines had been proven to be effective in preventing severe cases, and the domestic vaccination rollout had gathered pace of late. The member noted that the pattern of developments in the real economy this time was differentiated, to some extent, from those seen in past waves of the virus and in the initial outbreak in particular, and commented that this implied that there was not a great need to maintain the unusually accommodative monetary policy which had been adopted in response to the pandemic.

Concerning consumer prices, the member noted that inflationary pressures on the supply side, such as petroleum product prices and agricultural and marine product prices, remained greater than expected, and inflationary pressures on the demand side had also increased gradually. The member thus assessed that the possibility could not be ruled out that consumer price inflation would exceed the target for a longer period of time than the Research Department’s current projection.

Turning to the financial market, the member stated that financial imbalance risk was growing due to more accommodative financial conditions and continued yield-seeking behavior through increased leverage. The member expressed wariness in particular about the negative impacts of housing price growth and accelerated growth in household credit. The member pointed out that the domestic household sector had little experience in deleveraging, the household debt-to-income ratio in Korea was running well above the average for major advanced countries, and the disparity of Korea’s housing price-to-income ratio (PIR) from its long-term equilibrium level had widened significantly. The member judged that if these risks were not appropriately managed, they could undermine future economic growth and financial stability through a potential increase in debt repayment burdens, the possibility of drastic asset price adjustments, and inefficient resource allocation, and that in this regard it was time to make monetary policy responses, while at the same time implementing existing macroprudential measures.

The member expressed the view that, taking these points into overall consideration, it would be appropriate to raise the Base Rate to 0.75% from the current level of 0.50%. The member presented the opinion that, despite the ongoing spread of the virus, a partial reduction in the degree of monetary policy accommodation while paying more attention to the risk of financial imbalances would be consistent with the medium- to long-term objectives of monetary policy, given the policy signals provided to date, economic and inflation trends, and financial conditions. However, the member added that, since the economic impacts of COVID-19 had been concentrated in certain face-to-face industries, selective support through use of the Bank Intermediated Lending Support Facility should be continued and expanded, while in-depth discussion on long-term industrial policy measures and fiscal support would be needed to prepare for the possibility of structural changes in consumption patterns.

Another member expressed the view that it would be desirable to raise the Base Rate to 0.75% from the current level of 0.50%.

On the global economic front, the member assessed that the US and other advanced countries had sustained strong recoveries overall, despite the spread of the Delta variant.

In terms of the domestic economy, the member saw that the disease control measures which had strengthened due to the fourth wave of COVID-19 were continuing longer than expected, and thus production and consumption would likely be affected, particularly in the face-to-face service industries. However, the member expected the degree of contraction in consumption this time would not be greater than those during the past waves, while exports and facilities investment in particular would continue their solid recoveries. The member expected economic growth for this year to be around 4%, given real GDP growth through the second quarter of this year, construction and facilities investment and export trends, future vaccination plans, and the supplementary budget. The member projected that employment would continue to increase and consumer price inflation for this year would reach the lower-2% level.

The member noted that although volatility had expanded somewhat of late, led by stock prices, the exchange rate, and long-term interest rates, the FX and financial markets had generally remained stable. The member commented that risk preference and the buildup in financial imbalances were continuing due to the ongoing accommodative financial market conditions after the previous year's two Base Rate cuts.

The member expressed the opinion that, despite these economic trends, the Base Rate decision at the current meeting would not be an easy one since uncertainties surrounding the future economic growth path still remained high, due to the possibility that new virus variants would emerge and to the prolonged fourth wave of the coronavirus.

The member commented that the deepening buildup of financial imbalances and the consequently greater possibility of financial instability implied that it would be appropriate to adjust the degree of monetary policy accommodation at this juncture. The member saw that the prolonged sharp increase in household debt and rising housing prices had not only heightened the possibility of future financial instability, but also had been constantly increasing housing expenses. The member particularly raised the concern that a steep rise in housing expenses could work to decrease the real purchasing power of the national income and to undermine the quality of life. The member added that consideration should be given to the young generation's stronger risk preference, and social costs such as delayed marriage and childbirth. The member expected that, if imputed rents were calculated and reflected in consumer prices, the uptrend in consumer prices would be even higher.

In addition, the member pointed out that the sustained increase in leverage in the private sector would work to reduce medium- to long-term domestic economic dynamism, by weakening future consumption and investment capacities. The member voiced concern that the rapid rise in housing prices could cause a reduction in propensities to consume, by widening the wealth gap and future income disparities among households. The member noted that, since pursuing medium- to long-term financial stability and creating a foundation of stable economic growth were the main mandates of the central bank, careful attention should be given to the current sustained buildup in financial imbalances. The member judged that, since using macroprudential regulations alone to address this would have limitations, it would not be appropriate to delay the process of gradually adjusting the unusually accommodative monetary policy.

Meanwhile, the member noted that a Base Rate hike amid high uncertainties surrounding the severity of the COVID-19 outbreak and the duration of the spread of the virus could diminish the solid economic recovery which had been continuing since the first half of this year and increase the interest payment burdens of vulnerable households and corporations. Given these points, the member noted that it could be desirable to continue to monitor the spread of the coronavirus and trend of economic recovery a bit longer and choose to hike the Base Rate when uncertainties were reduced.

However, the member noted that the general public had become much less worried about and sensitive to the spread of the virus, exports and domestic investment had maintained strong growth, and fiscal expansion from a supplementary budget was expected. The member thus saw that the short-term costs of a Base Rate hike might not be high enough to impair the future growth path. The member added that, even with a slight Base Rate hike, monetary policy would still be judged to remain very accommodative.

The member argued that the continuation of the unprecedentedly low interest rate level adopted to prevent a financial market crunch and sudden contraction in economic activity in the face of the coronavirus emergency could have more negative impacts than positive impacts. The member thus expressed the view that, from the perspectives of normalizing interest rate levels and ensuring space for future monetary policy, it would be appropriate not to delay incremental and gradual Base Rate hikes, while carefully observing and analyzing their financial impacts and the trend of economic recovery, even if they were expected to incur small short-term costs.

The member judged that, taking these points into overall consideration, it would be appropriate to raise the Base Rate to 0.75% from 0.50%. The member also emphasized the need for sustaining and expanding the Bank Intermediated Lending Support Facility as well as providing fiscal support for small and medium-sized enterprises and small business owners hit by the prolonged coronavirus pandemic.

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

On the domestic economic front, the member assessed that the recovery in domestic demand had been delayed longer than expectations in the first half of this year, due to the spread of virus variants. The member saw that, even if the domestic economy grew by 4% as projected by the Research Department, bolstered mainly by exports and manufacturing production, this year's GDP would be merely 3% above that of 2019 , before the outbreak of COVID-19, and private consumption would be more than 2% below that of 2019.

The member pointed out that, although the manufacturing sector was expected to see high growth thanks to strong exports, the trend of structural decline in manufacturing employment had not reversed. The member saw that, although the unemployment rate had fallen, the broader unemployment rate encompassing long-term discouraged workers and persons on temporary leave was still higher than the pre-pandemic level. The member thus raised the concern that it would take more time for employment to recover.

The member noted that, even if consumer price inflation for this year rose to around 2%, as projected by the Research Department, consumer price inflation for 2019 and 2020 was only 0.4% and 0.5%, respectively, and core inflation would remain at the 1.2% level. The member thus stated that inflation stemming from aggregate demand-side pressures was not a matter of concern, and inflation expectations implied in long-term interest rates were not high.

The member stressed that, given that the spread of COVID-19 and strengthened social distancing measures were shocks with asymmetric effects on service industries rather than manufacturing, it would be important to observe business conditions in service industries and the trend of recovery in employment, compared to aggregate indicators such as GDP or the GDP gap. The member also expressed the opinion that authorities should take full advantage of the fact that the Korean economy, with favorable external soundness, had fiscal and monetary policy space to support a full recovery of economic activity.

The member expressed concern about the current housing price growth, but was pessimistic about containing volatility in housing prices by fine-tuning the Base Rate. The member noted that monetary policy had historically proven effective in achieving its natural objectives of economic and price stability, but it had not yet proven effective in stabilizing the housing market. The member added that, since it was not easy to take preemptive measures to stabilize the housing market in particular, and the housing cycle and the real economic cycle did not coincide with each other, using monetary policy to stabilize the housing market could conflict with the goal of pursuing stability in economic activity and prices.

With respect to the claim made from various circles that the Base Rate should be raised to rein in the rapid household debt growth seen since the COVID-19 outbreak, the member noted that the trend of increase in the household debt-to-GDP ratio since

2005 implied that household debt is a variable that is difficult to manage with the Base Rate. The member noted that a Base Rate hike could temporarily restrain the increase in household debt, but it would not provide a fundamental solution. The member saw a need for structural changes in household lending practices by financial institutions and in household lending regulations.

The member stressed that before making a major change to the path of monetary policy it must be examined whether the economic situation simultaneously meets criteria in terms of economic activity, prices, employment and financial stability. The member thus presented the opinion that, while keeping the Base Rate at the current level, it would be necessary to carefully monitor the spread of virus variants, the pace and effects of vaccination, changes in social distancing measures, and patterns of improvement in domestic demand and employment.

Ⅳ. Results of Deliberation on Monetary Policy Directions

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

However, Dr. Joo, Sangyong expressed clear opposition to raising 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 raise the Base Rate by 25 basis points, from 0.50% to 0.75%.

☐ Currently available information suggests that the global economy has continued to recover, supported by accelerated vaccinations and the relaxation of restrictions on economic activity in major countries. In global financial markets, government bond yields in major countries have declined affected by the resurgence of COVID-19. The US dollar has strengthened and stock prices in emerging economies have fallen, due mainly to the possibility that the US Federal Reserve would start tapering its asset purchases within the year. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the severity of the resurgence of COVID-19 and the status of vaccine distribution, as well as by monetary policy changes in major countries and their effects.

☐ The Korean economy has continued its sound recovery. Although private consumption has somewhat slowed due to the coronavirus resurgence, exports have sustained their buoyancy and facilities investment has shown a robust trend. Labor market conditions have continued to improve, with a sustained year-on-year increase in the number of persons employed. Going forward, the economy is likely to continue its recovery as private consumption is forecast to improve gradually, affected by the expansion of vaccinations and the execution of a supplementary budget, while exports and investment are expected to sustain their buoyancy. GDP growth this year is projected to be around 4%, consistent with the forecast in May.

☐ Consumer price inflation has remained high at the mid-2% level due to the rising prices of petroleum products and agricultural, livestock, and fisheries products as well as the accelerating increase in service prices. Core inflation (excluding changes in food and energy prices from the CPI) has run at the lower-1% level. The inflation expectations of the general public have risen to the mid-2% level. It is forecast that consumer price inflation will increase to the lower-2% level this year, exceeding the May forecast of 1.8%. Core inflation is forecast to run at the lower-1% level.

☐ In domestic financial markets, stock prices have fallen and the Korean won to US dollar exchange rate has risen considerably, mainly driven by global financial market movements and the domestic resurgence of COVID-19. The Korean Treasury bond yield, in particular the long-term bond yield, has declined. Household loan growth has accelerated and housing prices have continued to increase rapidly in all parts of the country.

☐ The Board will continue to conduct monetary policy in order to sustain the recovery of economic growth and stabilize consumer price inflation at the target level over a medium-term horizon, while paying attention to financial stability. The Board will gradually adjust the degree of monetary policy accommodation as the Korean economy is expected to continue its sound growth and inflation to run above 2% for some time, despite ongoing uncertainties over the virus. In this process the Board will judge when to further adjust the degree of accommodation while thoroughly assessing developments related to COVID-19, changes in the pace of growth and inflation, the risk of a buildup of financial imbalances, and monetary policy changes in major countries.