Minutes of the Monetary Policy Board Meeting

May 24, 2018

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1]
(May 2018)

Ⅰ. Outline

1. Date of meeting: Thursday, May 24, 2018

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, Myun-Shik (Senior Deputy Governor)
   Lim, Jiwon

4. Monetary Policy Board members absent: none

5. Participants:

   Ha, Sung, Auditor
   Lim, Hyung Joon, Deputy Governor
   Huh, Jin Ho, Deputy Governor
   Ryoo, Sang Dai, Deputy Governor
   Suh, Bong Gook, Director General of Reserve Management Group
   Lee, Hwan Seok, Director General of Research Department
   Sohn, Wook, Director of BOK Economic Research Institute
   Shin, Woon, Director General of Financial Stability Department
   Park, Jongseok, Director General of Monetary Policy Department
   Lee, Sang Hyeong, Director General of Financial Markets Department
   Lee, Seung Heon, Director General of International Department
   Seong, Byung Hee, Press Officer
   Chang, Cheong-Seok, Director General of Monetary Policy Board Secretariat
   Lee, Dong Won, 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[2)]

After briefings by staff on 'Recent Economic Developments', 'FX and International Finance' and 'Financial Market Trends', the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members' assessment of **the global economy** was that, although real economic indictors in some advanced economies had weakened somewhat in the first quarter, the global economy had continued its trend of recovery, thanks to expansionary fiscal policies in major countries and favorable business conditions in the IT sector, and global trade had maintained strong growth. Members also evaluated that, with respect to **the global financial markets**, instability in the financial markets in emerging market economies (EMEs), especially in vulnerable EMEs such as Argentina and Turkey, had heightened, due to the US dollar's strength stemming from rising US Treasury bond yields.

Concerning **the domestic economy**, members' evaluation was that, despite a correction in investment, the Korean economy was expected to show growth at its potential level in the future, as exports and consumption continued to show favorable movements. The members, however, judged that there were medium-term uncertainties in the labor market, and added that a close watch should be kept on the possibility that the delayed recovery of the labor market could limit the trend of improvement in consumption. The members also noted that downside risks included the continued rise of oil prices and stronger protectionism, while upside risks included an improved trade environment with China and expanded government spending stemming from a supplementary budget.

Concerning **inflation**, members noted that consumer price inflation had

2) English versions of 'Recent Economic Developments' and 'Financial Market Trends' are posted on the Bank of Korea website.

risen to 1.6% in April, from 1.3% in the first quarter, and core inflation had also picked up in April compared to the first quarter, showing a shift from the previous downward trend in price inflation. The members, however, expected that it would take more time for consumer price inflation to stabilize above the target level.

As to **the domestic financial markets**, members saw that, on the external side, there was financial instability in some EMEs mainly from US monetary policy normalization, and on the domestic side, growth in household lending by the banking sector had expanded, led by leasehold deposit and other loans. Accordingly, the members assessed risks to have grown somewhat.

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:

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 percent for the intermeeting period.

One member took the view that it would be desirable to hold the Base Rate at its current level of 1.50 percent for the intermeeting period.

The member noted that, although the global economy had been maintaining a trend of recovery thanks to expansionary fiscal policies in major countries and favorable business conditions in the IT sector, some EMEs with weak foreign exchange sectors had shown signs of market unrest, due to the strength of the US dollar stemming from the US Federal Reserve's implementation of monetary policy tightening. The member stated that, with respect to the domestic financial markets, the won had maintained relative strength thanks to an improvement in South Korea's relationship with North Korea, and the swap market had generally remained stable. The member commented that, although the expansion in non-IT exports had been more sluggish than expected, and investment was going through a correction as projected, the real economy was showing recovery somewhat beyond its potential growth level, thanks to strong IT exports and moderate improvement in consumption. The member saw that, with the share of labor income having shown stability for the past few years in particular, labor income was distributed more widely due to an increase in the number of persons employed. The member assessed this to have contributed to the trend of improvement in consumption. The member, however, presented the view that the demand recovery had not contributed to inflationary pressures through wage increases because, despite a decline in average working hours, total working hours had increased due to a constant rise in the economic participation rate stemming from the delayed retirements of workers aged 50 and older. The member, however, added that there was a high possibility that the decline of total labor supply due to the shrinking working-age population could contribute to higher average wages beginning this year. Accordingly, the member expected inflation to near its target next year when the base effect would disappear and downside pressures on regulated prices would be offset by the upside pressures on global prices, given current domestic demand pressures and room for future wage hikes.

The member noted that the degree of monetary policy accommodation should be determined in consideration of its impacts on prices and the real economy over a medium-term horizon. The member stated that the accommodative monetary policy for the past years had been driving inflation through boosted domestic demand, but the housing oversupply that would be observed from this year would put downward pressure on housing rents and prices while also showing direct social costs from inefficient resource allocation. The member added that attention should be paid to the possibility of balloon effects being created in various sectors if the current stance remained unchanged. In short, the member saw a need to somewhat reduce the current degree of accommodation, but expressed the view that the monetary policy accommodation stance should be adjusted while closely observing the followings: changes in external conditions, which had undergone rapid changes of late; uncertain balloon effects; and the currently ongoing structural reforms, particularly in the labor market.

Another member expressed the view that it would be desirable to hold the Base Rate at its current level of 1.50 percent this time.

Looking at the recent economic situations since the Monetary Policy Board meeting on April 12th, the member judged uncertainties surrounding the future growth and inflation paths to have heightened somewhat, but saw that there was not a high possibility of the domestic economy significantly deviating from its previously expected trajectory. The member stated that investment was undergoing a correction phase, but exports and consumption remained strong. Pointing to the implementation of a supplementary budget and signs of improvement in trade conditions with China, the member projected the solid trend of economic growth to continue at its potential level in the future. Meanwhile, the member noted that consumer price inflation would likely accelerate to its target of 2.0 percent, as originally forecast. The member, however, presented the view that, given that the Korean economy was maintaining growth at its potential level, the sluggish employment conditions of late seemed to be attributable to structural factors, not cyclical factors, and thus it was necessary to take structural or microeconomic policy measures rather than utilize macroeconomic business cycle adjustment instruments. The member expected the supplementary budget to have some effect in that it was a microeconomic measure focused on the employment sector, including the creation of jobs for the youth.

The member's assessment was that, with respect to financial stability, risks had increased somewhat. The member pointed out that, on the external front, there was a low possibility of financial instability in EMEs spreading to Korea in consideration of its favorable external soundness, but the possibility of continued monetary policy normalization by the US Federal Reserve causing instability in Korea's capital flows and domestic financial market price variables could not be ruled out. The member noted that, on the domestic front, household credit was continuing to grow more rapidly than in the past, and corporate credit had also shown accelerated growth of late. The member went on to comment that, if accommodative financial conditions continued, there was a possibility that the rapid growth of private sector credit would not be contained, which could undermine external confidence. The member thus stressed the need to closely watch the relevant developments.

With respect to the corresponding monetary policy direction, the member expressed the opinion that risks on the macroeconomic side had shown no great changes, with the economy expected to maintain growth at its potential level this year and consumer price inflation to near its target. The member, however, stated that risks on the domestic and international financial stability fronts had increased somewhat. The member thus noted that, at this juncture, it was necessary to reduce the degree of monetary policy accommodation, while giving more attention to financial stability in monetary policy operations. In addition, the member found it desirable to raise the Base Rate to an appropriate level in times of solid growth in order to ensure space for monetary policy in preparation for a possible change in the phase of the business cycle over a longer time horizon. However, the member stated that some had raised concerns about an economic slowdown due to growing uncertainties surrounding domestic and international conditions of late, and that a hike in the Base Rate under these circumstances could deteriorate economic sentiment. The member thus expressed the view that it would be better to keep the Base Rate at its current level of 1.50 percent for the intermeeting period, while keeping a close watch on changes in financial and economic conditions a little longer.

One other member presented the view that it would be desirable to hold the Base Rate at its current level for the intermeeting period, based on the judgment that it would be appropriate to determine when to raise the Base Rate after further examining whether the uptrend in prices would accelerate or continue.

Looking at the real economy, the member's evaluation was that, despite some risk factors, the trend of growth had continued while going through adjustment due to one-off factors. The member mentioned that some real economic indicators had weakened in Europe and other regions, and that the uptrend of US interest rates had led to financial instability in vulnerable

EMEs such as Argentina and Turkey. However, the member stated that such instability was unlikely to develop into a liquidity crunch in the international financial markets, and assessed Korean exports, particularly of semiconductors, as maintaining their strength driven by the continued rapid growth of the global trade volume. In terms of domestic demand, the member also evaluated that, although there were some negative indicators, they were not serious enough to undermine the original forecast of sustained growth. The member went on to state that the April monitoring indicators had suggested signs of a slowdown in consumption and a correction in facilities investment, but these merely represented a technical decline from the previous rapid growth and thus it was a little too early to see this decline as a trend reversal.

Looking at the labor market, meanwhile, the member noted that employment conditions had worsened even further, as shown in the continued sluggish employment in the wholesale & retail and food & accommodation sectors and in the rapid slowdown in the year-on-year change in manufacturing employment in April, while growth in wages, and basic wages in particular, had been accelerating substantially this year. The member attributed the worsening employment sluggishness and faster wage growth to a combination of factors, including cyclical changes in labor demand in line with economic recovery, structural changes in labor demand caused by the restructurings of some manufacturing companies, and structural changes in labor supply following the minimum wage hike, and went on to state that the medium-term uncertainties for the Korean economy came from the labor market.

As for inflation, the member noted that there had been a shift in the downward trend of inflation, with consumer price inflation accelerating from 1.3% in the first quarter to 1.6% in April, and core inflation, excluding the prices of agricultural and petroleum products, increasing from 1.2% to 1.4% over the same period. The member also mentioned that, amid the positive GDP gap, inflation was forecast to accelerate and the real neutral interest rate remained on the rise, as suggested by global economic trends, and thus the member argued that the policy judgment that the future policy rate path should also increase still held. However, the member assessed that, since inflation remained low, the timing of rate hikes could still be adjusted after watching for the forecast of higher inflation to be realized.

Concerning financial stability, the member's evaluation was that the growth in bank lending to households, having exhibited signs of slowing down early this year, had started to accelerate again from March, and added that this faster growth, driven by leasehold deposit and other loans, was different from the expansion in household lending up to 2017, which had been led by group lending. The member also emphasized that, compared with other loans, leasehold deposit loans had inherent factors weakening risk management incentives for banks: such loans were guaranteed by public institutions and their principal was excluded from the DSR calculation, which is why some banks had recently been aggressively marketing them. The member stressed that it would be necessary to carefully reexamine factors distorting risk management incentives for financial institutions involved in leasehold deposit lending.

Meanwhile, one member expressed the view that it would be desirable to keep the Base Rate at its current level of 1.50 percent for the intermeeting period.

The member forecast that the global economy would maintain strong growth exceeding its potential this year and global trade would sustain strong growth for the time being, and assessed the weakening of real economic indicators in some advanced countries during the first quarter as having been attributable to one-off factors. The member added that in the medium and long term, however, the possibility could not be ruled out that the spread of trade protectionism, rising oil prices, and financial instability in some EMEs could act as downside risks to the global economy and trade.

The member stated that the Korean economy had exhibited solid, export-led growth in the first quarter but this faster growth had been attributable also to one-off factors, such as a base effect and increased demand during the Winter Olympic Games, and expected the quarter-on-quarter growth rate to slow down in the second quarter. The member evaluated that, looking at the major economic indicators released since the previous meeting, the average growth rate during the first half of this year would not deviate far from the April forecast, and added that the secular improvement in the output gap had continued.

The member expressed the view that there was, however, a mix of upside and downside risks on the future growth path. As for major downside risks, the member pointed to the possibility of a slower-than-expected recovery in employment that might restrict future improvements in consumption, and went on to argue that, although the pace of increase in nominal wages, and those of regular employees in particular, had been accelerating, any corresponding growth in employment had not yet been seen. Second, the member mentioned that if the recent rise in oil prices persisted for a long time, this might have negative impacts on the real economy, restricting households' real purchasing power and increasing corporate production costs. Third, the member stressed that attention should be paid to the fact that export growth still had been seen mostly in some IT sectors and that the pace of increase in the international prices of related items had recently been slowing significantly, and added that hikes in the prices of oil and other commodities and the spread of trade protectionism might lead companies to make conservative investment and employment decisions. On the other hand, the member expressed the view that improved trade conditions with China, an increased number of foreign tourists, and increased government expenditure following the drawing up of a supplementary budget were likely to act as upside risks. Meanwhile, with respect to the reduction in statutory working hours scheduled to come into effect in July this year, the member mentioned that the effects on business activities and consumption would depend on the specifics of implementation.

Concerning inflation, the member stated that consumer price inflation had accelerated to the mid-1% level and expected upside pressure on inflation to increase gradually if the secular improvement in the output gap continued, but the member also forecast that it would take more time for inflation to stabilize above the target level. The member went on to argue that the price path for the second half of this year might exhibit higher volatility, however, due mainly to the possible persistence of high global oil prices, movements of the Korean won’s exchange rate, and possible hikes in regulated prices following local elections.

Looking at the financial and foreign exchange markets, the member expressed the view that the markets had remained stable overall but attention should be paid to the fact that household lending growth had started to accelerate again and that monetary normalization in major countries might progress more rapidly than expected.

Another member expressed the view that it would be desirable to keep the Base Rate at its current level of 1.50 percent for the intermeeting period.

The member evaluated that, despite financial instability in some EMEs occurring in the course of the recent US monetary policy normalization, the global economy had overall sustained a relatively high rate of growth, and the Korean economy accordingly had continued to exhibit a growth rate close to its potential level, driven by exports. The member pointed out, however, that the export boom had been concentrated in specific industries such as semiconductors, and that concerns had been raised about a possible weakening of structural competitiveness in some other industries. The member also noted that the restructurings of some manufacturing sectors suffering from worsening profitability seemed to have acted as a key factor, along with the recent shock from higher employment-related expenses, causing the pace of growth in the number of persons employed to slow significantly.

The member assessed that, unlike these structural or aggregate supply-side changes, aggregate demand-side changes were difficult to identify. The member also argued that increased government spending, particularly in health and welfare, and signs that the plunge in the number of foreign tourists was easing had partly acted as buffers against insufficient aggregate domestic demand, but there were growing uncertainties regarding how the recent changes in labor market conditions would affect household consumption and corporate investment spending decisions.

The member accordingly argued that, as there were too much uncertainties to predict future growth and inflation at this point of time, it would be necessary to keep the Base Rate at its current level for the time being and, at the same time, to examine whether aggregate demand in the Korean economy was increasing in line with its forecast by closely analyzing the overall macroeconomy, including economic conditions and inflation.

The member, meanwhile, expected capital flow fluctuations, caused partly by US monetary policy normalization, to be absorbed smoothly by flexible exchange rate adjustments. The member went on to state that the household debt problem would be eased gradually by a housing market correction and by continuously strengthening macroprudential policies.

One other member expressed the view that it would be desirable to observe economic and inflation developments as well as international financial market conditions a little longer, while holding the Base Rate at the current level of 1.50% this time.

Concerning the outlook for the global economy, the member expected the trend of growth to continue overall, with some advanced economies recovering from their sluggishness during the first quarter. However, the member also argued that it was necessary to closely monitor the impacts on international financial markets from monetary normalization in major countries in line with their economic recoveries, and also the possibility of consequent financial instability in EMEs.

With regard to the domestic economy, the member’s assessment was that, while the economy had been overall exhibiting modest growth, the recent sluggish employment conditions and other factors might negatively affect private consumption, and attention was needed to be paid to how the slower growth of the real estate market would affect future construction investment. The member stated that exports had remained buoyant overall but concerns had continued about the dependency of the export growth on specific items, including semiconductors. The member went on to argue that Korean exports did not seem to have fully taken advantage of favorable global economic and trade growth, and it would therefore be necessary to examine whether export-related industries were suffering from worsening structural problems. The member also stressed that, as concerns had been raised that the employment sluggishness had been attributable to structural factors relating to the manufacturing industry and the self-employed, it would be necessary to analyze the effectiveness of the government's employment policy measures. The member's assessment was that consumer price inflation had accelerated somewhat while core inflation had remained low, and the member's forecast was that inflation would fail to reach its target of 2 percent this year, even when upside risks from oil price hikes were factored in.

In overall consideration of real economic conditions, the member evaluated that it would be necessary to maintain the current accommodative monetary policy for the time being, since there existed various uncertainties related to business activities, concerns had arisen about labor market conditions, and the inflation gap was highly likely to remain negative this year, although the output gap remained positive.

In terms of financial stability, the member took the view that it would be appropriate to pay more attention to the recent heightening of international financial market volatility while coping with the accumulation of financial imbalances. With respect to household debt, the member called for analysis of the trend of growth in credit lending, and stated that the possibility of continued demand for housing-related loans should not be overlooked, considering factors such as the demand for new apartments. Meanwhile, the member argued that, amid the growing financial instability in EMEs following the appreciation of the US dollar, it would be advisable to prepare against a possible increase in international financial market volatility in line for example with the US Federal Reserve’s rate hike in June.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of their earlier discussions, a statement was compiled with the unanimous consent of all the members.

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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 global economy has continued its robust growth. Financial markets in some emerging market economies with weak external soundness have shown instability, as capital outflows from them have increased. Looking ahead the Board sees global economic growth as likely to be affected by factors such as the paces of monetary policy normalization in major countries, the movements toward spreading trade protectionism, and the directions of the US government's economic policies.

☐ The Board judges that the solid trend of domestic economic growth has continued, as consumption and exports have shown favorable movements although facilities investment has slowed somewhat. Employment conditions have been sluggish, with the extent of increase in the number of persons employed having remained at a low level. Going forward the Board expects domestic economic growth to be generally consistent with the path projected in April. It anticipates that investment will slow but that the trend of steady increase in consumption will continue, and that exports will also sustain their favorable movements thanks to the buoyancy of the global economy.

☐ Consumer price inflation has risen to the mid-1% level, due mainly to increases in the prices of agricultural products. Core inflation (with food and energy product prices excluded from the CPI) has also been in the mid-1% range, and the rate of inflation expected by the general public has remained at the mid-2% level. Looking ahead it is forecast that consumer price inflation, after remaining in the mid-1% range for some time, will pick up and gradually approach the target level from the second half of this year. Core inflation will also gradually rise.

☐ The domestic financial markets have been generally stable. Although long-term market interest rates have increased, under the effects chiefly of rising government bond yields in major countries, the Korean won-US dollar exchange rate has fluctuated within a relatively narrow range, in line mainly with the global strengthening of the US dollar and with the decline in risks related to North Korea. Household lending has sustained its higher rate of expansion than in past years, led by unsecured loans. The paces of increase in housing sales prices have slowed, especially 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 forecast that inflationary pressures on the demand side will not be high for the time being, while the domestic economy is expected to continue its solid growth, the Board will maintain its accommodative monetary policy stance. In this process it will judge carefully whether it is necessary to adjust its accommodative monetary policy stance further, while closely checking future economic growth and inflation trends. It will also carefully monitor any changes in the monetary policies of major countries, conditions related to trade with major countries, the trend of increase in household debt, and geopolitical risks.