Minutes of the Monetary Policy Board Meeting

October 2021

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]
(October 2021)

Ⅰ. Outline

1. Date of meeting: Tuesday, October 12, 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)
   Park, Ki Young

4. Monetary Policy Board members absent: none

5. Participants:
   Kang, Sungjun, Auditor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Min, Jwa Hong, Deputy Governor
   Kim, Woong, Director General of Research Department
   Lee, Jeong Wook, Director General of Financial Stability 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

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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 assessed that the domestic economy continued its recovery, driven by exports and investment. Members expected private consumption to sustain its recovery, influenced by vaccinations and the consequent expansion of economic activity, and the execution of a supplementary budget. Some members expressed the view that a close watch should be kept on the possibility that external risk factors, such as concerns about slower growth in the Chinese economy, global supply chain disruptions, and rising energy prices, could affect the domestic economy.

In terms of inflation, members assessed that upside risks had grown due to bottlenecks in the global supply chain combined with recovery in domestic demand. Some members presented the opinion that, since the current rising prices were affected not only by supply-side pressures, but also by demand-side pressures, the trend of inflation expectations should be observed, while attention should be paid to the possibility of upward inflationary pressures persisting for a long time.

Members, meanwhile, assessed that, although prices of some financial assets had undergone corrections due to stronger expectations for policy rate hikes at home and abroad, financial conditions still remained accommodative. Some members commented that high household lending growth and the trend of housing price increases were ongoing, despite the August Base Rate hike and the government’s efforts to strengthen macroprudential policy measures. Members went on to argue the need to monitor cautiously the trend of widening financial imbalances, particularly in the household sector.

Members also stressed the need to pay close attention to the effects of the August Base Rate hike, the impacts of global inflation on domestic prices, and the increase in the contribution of household credit to M2 growth.

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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, while some members argued for raising it to 1.00% from the current 0.75%.

One member presented the view that it would be appropriate to keep the Base Rate at the current level of 0.75%.

The member assessed that, although the global economy was continuing its solid recovery, led by advanced economies, the growth momentum had somewhat slowed, due to the spread of virus variants, production disruptions caused by supply chain bottlenecks, and real estate risk and power shortages in China.

The member assessed that the domestic economy was maintaining recovery overall, led by exports and investment, despite the resurgence of COVID-19. The member noted that private consumption was continuing to recover, thanks to expansion of vaccinations and the provision of emergency relief funds, and facilities investment also remained solid, led by the IT sector. However, the member commented that construction investment had been somewhat sluggish due to weather conditions. The member added that exports continued to rise, bolstered by solid demand from major economies and increases in unit export prices. The member expected the GDP growth rate for this year to be generally consistent with the August projection since negative external risks, such as global supply disruptions, global inflation, and a slowdown in Chinese economic growth, were predicted to be offset by the possibility of an expansion in domestic demand following a transition in the disease control system in the fourth quarter. The member commented that consumer price inflation had stayed at the mid-2% level due to the accelerating increase in the prices of petroleum products and of services, while the rate of inflation expected by the general public remained at the 2.4% level and the long-term inflation expectations of experts had risen close to 2%.

Concerning international financial markets, the member assessed that investment sentiment had worsened, as upward inflationary pressures were persisting longer than expected, and the possibility of changes in monetary policies of major economies, and a risk related to real estate in China had emerged. The member judged that, although the domestic financial market was continuing its stable trend overall, financial conditions still remained accommodative. The member pointed out that high lending growth and housing price increases were ongoing, and inflows of ample market liquidity into risky assets were being observed.

With respect to domestic and international policy conditions, the member called attention to the point that longer-than-expected supply disruptions were affecting growth and inflation simultaneously. However, the member saw that if bottlenecks in the supply chain gradually ease in the future, this would combine with the excessive savings built up so far and consumption boosting policy measures to strengthen growth engines again.

Concerning the domestic and international inflation trends, the member expressed the need for continued attention to the impacts on inflation of structural factors, such as demand-side inflationary pressures, climate change, and the restructuring of the global supply framework, as well as to the effects of rising housing prices on housing costs after a time lag. The member added that it was necessary to cautiously watch the possibility of recently rising prices leading to increases in inflation expectations and wages or the possibility of inflationary pressures persisting for a long time due to the pass-through of rising production costs to prices.

The member expressed the view that, in overall consideration of the domestic and international economic trends, it would be appropriate for the Bank of Korea to maintain its basic direction of gradual adjustments to the degree of monetary policy accommodation, as has been communicated with the market since May this year. However, the member judged that it would be proper to hold the Base Rate at its current level at the present meeting to observe for a little longer the impacts on the domestic economic recovery and financial market conditions after the August Base Rate hike, recent developments in external factors causing economic instability, and their impacts on the domestic economy.

However, the member added that it would be desirable to raise the Base Rate again at the next meeting if there were no new factors related to domestic and international economic conditions and the current economic trend continued until the next MPB meeting.

Another member expressed the view that it would be desirable to raise the Base Rate to 1.00% from the current level of 0.75%.

The member saw that the global economy was sustaining a solid recovery, led by advanced economies, and it would maintain a trend of recovery going forward, as the spread of the global pandemic would slow. However, the member noted that the differentiated economic recoveries among countries and industries persisted, working to worsen adverse effects such as global supply chain disruptions and rising energy prices.

The member argued that this supply shock was acting to constrain recovery in global demand and to raise concern about global inflation through overshooting of prices of some items. The member presented the view that it was important to prevent the spread of higher inflation expectations, as well as to sustain the recovery of global demand to ensure a successful soft landing of the global economy in the future.

The member assessed that the domestic economy was generally favorable due to the ongoing recoveries in exports and investment in particular, and the relatively gradual decline in private consumption. The member commented that exports were sustaining high growth in various items, thus driving growth in facilities investment. The member expected the trend of recovery in private consumption to strengthen further, thanks to relaxation of social distancing measures and sluggishness that was less severe than expected despite the resurgence of the pandemic.

The member assessed upside risks to the consumer inflation outlook to have increased. The member pointed out that, although upside pressures on prices were mainly attributable to factors less directly related to domestic monetary policy, such as rising import prices in line with global inflation, and a sustained rise in food prices, rising prices were spreading to more items due to the materialization of the second round effects of price increases, such as rising dining-out prices and higher electricity charges, combined with upward inflationary pressure stemming from recovery in demand. The member estimated that the growth rate of the actual cost of living would be higher if owners' equivalent rent and trends of administered prices were taken into account. The member also noted that short-term inflation expectations had risen to the mid-2% level. Therefore, the member presented the view that closer attention should be kept on upside risks to the future inflation trend.

The member assessed that the risk appetite and leveraged investment of economic agents were continuing in the financial market. The member raised the concern that, although stock and bond prices had fallen due to the Evergrande Group issue in China and concerns about global inflation, market liquidity was continuing to expand, with the volume of net equity purchases by individuals using loans on margin accounts actually increasing, household and corporate lending continuing to grow and M2 growth rising to the mid-12% level. The member added that, despite the strengthening of the government's supervisory measures, household lending continued to show a large increase exceeding the monthly average for the last year, and was driving housing price growth in conjunction with expectations of further increases in housing prices.

The member judged that, taking these points into overall consideration, it would be desirable to raise the Base Rate by 25 basis points, given growing concerns from the inflation and financial stability perspectives, although the real economy had been running above the projected path since August. The member presented the view that, even if the Base Rate was raised further, it would still be below the pre-pandemic level and thus was unlikely to constrain economic recovery, and would actually help deal with financial imbalances by easing risk appetite. In addition, the member expected adjustments to the degree of excessive monetary policy accommodation to improve national competitiveness in the post-pandemic era, enhance productivity through effective allocation of resources, and promote stable growth in the medium- to long-term by addressing asset imbalances. However, the member added that it was necessary to continue policy efforts to cushion the shock in the face-to-face services industries hit hardest by the pandemic.

One member judged that it would be appropriate to keep the Base Rate at the current level of 0.75%.

On the global economic front, the member noted that global trade was showing a solid recovery despite existing risks such as uncertainties originating in China, slow recoveries in other emerging market economies, rising energy prices, and supply and demand imbalances. The member projected the global economy to sustain its sound recovery, particularly in advanced economies.

The member assessed that, despite the resurgence of COVID-19, the domestic economy was sustaining a recovery, led by exports and investment, employment continued to improve in terms of the number of persons employed, and private consumption was recovering, backed by the execution of a supplementary budget and the expansion of vaccinations. The member commented that, although the leading economic index had declined slightly of late, this should not be interpreted as a secular decline. The member expected the trend of recovery in the overall domestic economy including face-to-face services industries to continue if the transition to the new disease control policy scheme was undertaken.

The member judged that, although the foreign exchange and financial sectors were affected by external risks, these risks were not yet cause for concern. The member saw that, while long-term interest rates at home and abroad had risen sharply in reflection of global inflation and changes in monetary policy stances, and the Korean won had depreciated against the US dollar, foreign investment in domestic securities had shifted to a net inflow, backed by positive assessments of the domestic economy, and foreign currency liquidity had been managed appropriately. However, the member presented the opinion that from the inflation and exchange rate perspectives, developments in external risk factors should be closely monitored.

Concerning the Base Rate decision at the current juncture, the member expressed the opinion that close attention should be paid to two factors in particular.

First, the member focused on the impacts of global inflation on domestic prices. The member saw that prices were maintaining a strong upward trend in most countries, and these price rises were high even when base effects were taken into consideration. On the domestic front, the member noted that consumer price inflation had been continuing to increase since April to run above 2%, and core inflation and inflation expectations had also risen. The member pointed out that, if the rise in housing costs driven by housing price growth was reflected in consumer prices after a time lag, prices felt by the general public could increase further.

However, the member presented the opinion that there was no great need to respond to price rises immediately with a Base Rate hike at the current juncture. First, the member found it necessary to observe for a little longer to see if global inflation would persist for a long time. The member commented that the domestic price trend should be monitored, while consideration should be given to the price levels and trends in past cases of above-target inflation during the past 10 years or so. The member added that, in doing so, inflation inertia should also be kept in mind.

The member then saw that household lending and housing prices were posing the biggest potential risks at the moment. The member raised the concern that excessively high leverage and housing prices could reduce consumption and investment capacities and worsen economic inequalities in the long term. The member pointed out that, although the Base Rate was a very powerful policy instrument which impacts the entire economy and thus greatly affect leverage and expectations of housing price increases, it was not the only instrument that could affect the two variables, and other policy instruments or a mix of the Base Rate and other instruments could be more effective at times. The member expressed the opinion that it would be desirable to observe the effects of the Base Rate hike and the government’s measures to manage household debt for now before considering additional measures, since the Base Rate had already been raised in August and lending growth was showing signs of moderating due to the recent increase in lending rates and the strengthening of household debt management by the government and the financial sector.

The member expected the domestic economy to maintain solid growth, but saw that the upward and downward uncertainties surrounding the growth path were both high. The member thus found it desirable to observe the effects of the previous Base Rate hike, and the future trend of recovery, as well as how uncertainties related to global inflation and the monetary policy stances of major economies would play out, before taking an additional policy measure. The member also expressed the view that, since the COVID-19 shock had been asymmetric, fiscal support and bank intermediated lending support, which allow selective support for vulnerable groups, should be continued.

Another member expressed the view that it would be desirable to raise the Base Rate to 1.00% from the current level of 0.75%.

Looking at the changes in domestic and external conditions since the previous MPB meeting, the member assessed that the global economy was maintaining a sound recovery and inflation had been accelerating, and forecast that the global economy would grow at a faster pace than its potential growth rate for the time being, boosted largely by the expansion of vaccinations and major countries' stimulus measures. As to the domestic economy, the member judged that the momentum of economic recovery had slowed temporarily due to the resurgence of COVID-19, but this would have only a limited negative impact on aggregate demand and the underlying economic trend over a medium-term horizon.

In determining the monetary policy direction in these macroeconomic conditions, the member took notice of the following matters.

First, the member assessed that downside economic risks posed by the pandemic had been decreasing as the correlation between the pandemic and economic activities had weakened significantly. The member expressed the view that, although the recovery of private consumption had slowed with the strengthening of disease control measures since July, the degree of sluggishness had been more modest than originally expected, thanks to the learning effect from previous experiences and a rapid shift to non-face-to-face consumption, and improvement in employment conditions had also not been severely affected. The member noted that, most of all, the conditions for a rebound in consumption were being created, as disease control measures were expected to be partly eased, the government's policies to support household income and boost consumption had continued, and consumer sentiment had improved somewhat.

Second, the member evaluated that upside risks to inflation had continued to expand. The member mentioned that the rise in prices of raw materials could last longer than expected, due to the combined effect of the recovery in global demand and supply disruptions, and the exchange rate had risen, all of which had added to upside risks to inflation. The member also noted that consumer price inflation was highly likely to exceed the level forecast in August, due to the increasing demand-side inflationary pressures in line with the underlying trend of economic recovery.

Finally, the member pointed out that financial imbalances were continuing to accumulate amid the accommodative financial conditions. The member mentioned that the continued decline in the Korean won's effective exchange rate, not seen during normal economic recovery phases, made financial conditions more accommodative absent a liquidity crunch in the FX swap market, and strengthened the effect of accommodative monetary policy through direct impacts on exports and inflation. The member stated that, since risk-off sentiment had been strengthening recently at home and abroad, prices of some financial assets had been adjusted and the gap between such prices and fundamentals had narrowed somewhat, but credit to the private sector and housing prices remained on the rise and debt and housing prices relative to income continued to grow, and in this regard, monetary policy responses should be maintained in consideration of the risk of financial imbalances.

The member expressed the view that, taking these points into overall consideration, it would be appropriate to raise the Base Rate to 1.00% from the current level of 0.75%. The member judged that, despite concerns about the possibility of consecutive rate hikes limiting the economic upswing, their medium- and long-term benefits would outweigh their short-term costs, when the unusually accommodative financial conditions were taken into consideration. The member however took the view that selective support for vulnerable sectors should be maintained since rate hikes could increase interest repayment burdens on sole proprietors and small businesses, while to prepare for a possible structural change in the pattern of face-to-face consumption, measures for related industries should be developed from medium- and long-term perspectives so that the growth potential would not be undermined.

One member judged that it would be appropriate to keep the Base Rate at the current level of 0.75%.

The member assessed that the global economy had continued to recover along with the rising vaccination rate, but the pace of growth had slowed somewhat, particularly in the United States and China, due to the surge in the prices of international oil and other raw materials and supply chain disruptions. The member saw the domestic economy as remaining on the path of recovery, led by exports and facilities investment, and consumption as recovering boosted by the rising vaccination rate, the easing of social-distancing measures and financial support. The member however pointed out that strong growth was unlikely in the fourth quarter, as the manufacturing Business Sentiment Index had declined for the second consecutive month and construction investment remained sluggish. The member mentioned that, although employment conditions had been improving gradually, the numbers of available potential job seekers and employed persons in time-related underemployment remained high.

The member stated that consumer price inflation had remained above 2%, but this had been led primarily by rises in energy and grocery prices, and the Research Department projected core inflation for this year at around 1.2%.

The member's judgment was that, although 4% growth would materialize and inflation would exceed 2% this year as forecast by the Research Department, it would be insufficient to use this as a basis for raising the Base Rate. The member presented the view that, since GDP for this year would be only 3% higher than its pre-COVID-19 level recorded in 2019 and private consumption was likely to return to its pre-COVID-19 level in the second half of next year at the earliest, it would be necessary to wait a little longer to see whether GDP growth led primarily by exports and the manufacturing sector would lead to expansions in household income, wages, employment and consumption. More specifically, the member emphasized that, since the COVID-19 shock had been asymmetrical, affecting the services sector more severely than the manufacturing sector, the recovery of the services sector and domestic demand would serve as a more important basis for determining whether to adjust the monetary policy path.

The member meanwhile emphasized that inequality and polarization had worsened even further while overcoming the Global Financial Crisis through the expansion of exports, and expressed concerns that the economic recovery could lose its momentum if it were concluded that the crisis is over by looking solely at aggregate indicators, such as GDP or the output gap, or if an impatient approach were taken toward shifting to monetary policy tightening based only on cost-push inflation.

The member argued that, concerning the current crisis in particular, the pace of easing of disease-control and social-distancing measures would be an important factor in making monetary policy decisions, and that a close watch should be kept on the evolution of downside risks to the global economy in line with energy price hikes and supply chain disruptions. The member added that it would not be too late to shift to full-scale tightening after examining the impact of the US Fed's tapering on financial markets.

The member presented the view that, although various circles were pointing out the buildup of financial imbalances that are specific to the domestic economy, real estate policy should be used to achieve housing market stability and macroprudential policy to stabilize household debt, and went on to stress the need to hold to this principle patiently to solve a structural problem that had been building up for a long time.

Another member judged that it would be appropriate to keep the Base Rate at its current level of 0.75%.

The member's judgment was that the domestic economy had recently sustained its sound recovery, as exports had maintained robust growth, facilities investment had shown solid improvement particularly in the IT sector, and private consumption had got back on a recovery track boosted by accelerated vaccinations and improved consumer sentiment following emergency relief payments. The member expected the domestic economy to sustain growth consistent with the path forecast in August, led by continued strong exports and solid growth in investment as well as a gradual recovery in consumption. The member forecast that Korea would see exports and investment grow with major countries speeding up normalization of economic activities, and that the recovery of consumption, and face-to-face consumption in particular, would strengthen gradually as disease-control measures in Korea were eased step by step. The member concluded that, although there remained uncertainties related to COVID-19 developments and concerns were growing about a prolongation of global supply bottlenecks and a Chinese economic slowdown, these would have only limited impacts on the future growth path of the domestic economy.

The member forecast consumer price inflation to be somewhat above the path forecast in August and sustain its strong uptrend at around the mid-2% level for the time being, and core inflation to rise to the upper-1% level affected chiefly by the increased demand-side upward pressures following the economic recovery. The member expected a further rise in inflationary pressures in Korea, as upside risks to global inflation were partly materializing due to the recent signs of a prolongation of supply bottlenecks and the resurgence in international raw material prices. The member meanwhile noted that housing prices had sustained strong growth and home-buyer sentiment and expectations of further housing price rises had also remained strong.

The member considered recent financial conditions as having remained accommodative. Concerning the financial markets, the member pointed out that risk preferences had been weakening somewhat, with interest rates rising substantially and stock prices falling on the back of strengthening expectations of policy rate hikes at home and abroad, while M2 growth had accelerated led by the expansion in private-sector credit supply. The member stated that the contribution of private-sector credit to M2 growth showed a sharp rise, and judged that this had been attributable largely to the continued substantial uptrend in household loans, and housing-related loans in particular, and that the government's effort to strengthen macroprudential policy and the Bank of Korea's Base Rate hike in August had not helped to significantly curb the widening of financial imbalances centering around the household sector.

The member argued that, given that the Korean economy was forecast to sustain a strong recovery, inflation had been increasing to a greater extent than originally expected and the risks posed by the buildup of financial imbalances were growing, it would be desirable to continue the monetary policy normalization begun in August. The member however mentioned that, considering that economic agents including the self-employed, having difficulties going through the pandemic situation, would need some time to adapt to changing conditions such as a higher Base Rate, it would be appropriate to keep the Base Rate unchanged from its current level of 0.75% this time.

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 veiws of the majority.

However, Dr. Lim, Jiwon and Dr. Suh, Young Kyung expressed clear opposition to keeping the Base Rate at the current level and argued for raising 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 0.75% for the intermeeting period.

□ Currently available information suggests that the global economy has continued to recover despite the spread of COVID-19 variants, 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 increased steeply and the US dollar has strengthened while stock prices have fallen, amid growing concerns over the prospect of prolonged global inflation and the rising possibility of the US Federal Reserve’s tapering 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 global inflation movements and monetary policy changes in major countries.

□ The Korean economy has continued its sound recovery. Exports have sustained their buoyancy and facilities investment has continued its robust trend. Private consumption has recently shown improvement again, after having slowed due to the coronavirus resurgence. 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 vaccinations and the consequent expansion of economic activity as well as 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 August.

☐ Consumer price inflation has remained high at the mid-2% level due to the accelerating increase in the prices of petroleum products and of services. Core inflation (excluding changes in food and energy prices from the CPI) has risen to the mid-1% level. The inflation expectations of the general public have remained at the mid-2% level. Looking ahead, it is forecast that consumer price inflation will run at the mid-2% level for some time, exceeding the path projected in August, before declining somewhat. Core inflation is forecast to increase to around the upper-1% level.

☐ In domestic financial markets, long-term market interest rates and the Korean won to US dollar exchange rate have risen significantly while stock prices have fallen considerably, mainly driven by global financial market movements. The increase in household loans remains at a high level, 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 appropriately 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.