Minutes of the Monetary Policy Board Meeting

January 18, 2018

The Bank of Korea

(English version)

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

Ⅰ. Outline

1. Date of meeting: Thursday, January 18, 2018

2. Place : Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:

   Lee, Juyeol, Chairman (Bank of Korea Governor)
   Hahm, Joon-Ho
   Lee, Il Houng
   Cho, Dongchul
   Koh, Seung Beom
   Shin, Inseok
   Yoon, Myun-Shik (Senior Deputy Governor)

4. Monetary Policy Board members absent: none

5. Participants:

   Ha, Sung, Auditor
   Lim, Hyung Joon, Deputy Governor
   Huh, Jin Ho, Deputy Governor
   Jeon, Seung-Cheol, Deputy Governor
   Shin, Ho Soon, Deputy Governor
   Suh, Bong Gook, Director General of Reserve Management Group
   Chang, Min, 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, Hwan Seok, 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 ‘Economic Outlook for 2018’, ‘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 recoveries in emerging economies had been strengthening as advanced countries continued to record robust growth, and that global trade had accordingly shown solid growth as well. Members also evaluated that **the global financial markets** had remained relatively stable even after the US Federal Reserve’s rate hike last year.

Concerning **the domestic economy**, members’ evaluation was that, despite a correction in construction investment, the Korean economy had maintained its modest recovery, with exports remaining strong in line with the global investment expansion and global trade recovery and also with private consumption exhibiting a steady recovery. Members then raised the growth forecast for this year to 3.0 percent from the figure forecast in October last year and projected the economy to sustain growth at its potential level next year.

Concerning **inflation**, members noted that consumer price inflation had fallen to 1.5 percent during the fourth quarter of last year, somewhat below its target, due to weak agricultural, livestock and fisheries product prices and reduced regulated prices, and revised the October 2017 forecast for this year to 1.7 percent.

As to **the domestic financial markets**, members stated that the markets had remained stable but attention should be paid to the possibility of a tightening of financial conditions in line with monetary normalization in

2) English versions of ‘Economic Outlook for 2018’ and 'Financial Market Trends' are posted on the Bank of Korea website.

major countries. Members added that household lending growth, and home mortgage lending growth in particular, had been slowing gradually since the real estate measures announced on August 2nd last year, but a close watch should be kept on the trend of household lending while paying attention to the expansion in credit lending and changes in construction cycle.

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 1.5 percent for the intermeeting period.

One member expressed the opinion that it would be desirable to keep the Base Rate at its current level of 1.5 percent this time.

The member assessed that the domestic economy had continued to show a modest recovery, buttressed by the sustained strength of the global economy and solid growth in global trade, and added that the upward adjustment of the GDP growth forecast from that in October last year seemed appropriate. With the downward adjustment of the inflation outlook, however, the member evaluated that there would be a greater need to keep a closer watch on inflation fluctuations, including on whether demand-side inflation pressures actually materialize. The member assessed that the output gap seemed to have turned slightly positive but, considering that inflationary pressures were not yet large, it would be necessary to keep the current monetary easing stance for the time being, and went on to state that now seemed the time to closely monitor the real economic trend since the previous Base Rate hike and to analyze whether the current economic recovery would be sustainable in the medium and long term. The member also stressed that expanding the growth potential seemed even more important now that burdens from accommodative monetary policy had decreased somewhat, and emphasized that research and analysis on the medium- and long-term structural issues concerning the Korean economy should continue.

With respect to financial stability, meanwhile, the member stated that the need to cope with the accumulation of financial imbalances caused by the accommodative monetary policy stance had been one of the major factors taken into account in deciding to raise the Base Rate in November last year. The member expected the rate hike to have a signalling effect or affect market sentiment, although there would be limitations in addressing household debt with a rate hike, and went on to argue that the central bank should work together with the government to closely examine real estate market conditions and the trend of household debt. The member also expressed the view that, as Treasury bond yields in advanced countries had surged recently and major countries' monetary policies might be normalized sooner than originally expected following the Federal Reserve, considering recent remarks of ECB and Bank of Japan which seemed to suggest tightening, it would be necessary to closely monitor domestic and overseas financial markets.

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

The member assessed that the real economy had maintained overall stable growth path, boosted by the sustained recovery of world trade. The member noted that exports were expected to maintain strong growth this year, leading real economic growth for the time being, while construction investment seemed to have been entering into a correction phase recently and facilities investment, which had grown mainly driven by semiconductor sector, was expected to slow down in 2018 due to a base effect. The member went on to state that decreasing contributions to domestic demand and growth in line with the slowdown in investment growth were being offset by accelerating growth in private consumption, and added that private consumption was forecast to sustain its recent growth going forward. However, the member argued that somewhat negative changes had been seen in labor market-related indicators, pointing out that the number of persons employed had been expected to increase by 350,000 in 2017 according to the 2017 October forecasts but had shown actual growth of

320,000. The member stated that the recent sluggishness in the unemployment and wage growth rates was explainable to some extent, given that in the past the Korean labor market had lagged behind the real economic cycle and that population aging had caused structural changes to the labor market, but the sluggishness in the number of persons employed had come as a bit of surprise, and went on to stress that it would be necessary to closely watch the trend of the number going forward. The member also mentioned that, in terms of the economic outlook, the growth rate for this year was being revised upward by 0.1 percentage points to 3 percent from the October forecast, and added that the overall growth forecast seemed neutral, as there were upside risks to exports and facilities investment but also downside risks to consumption given the recent employment sluggishness.

In terms of inflation, meanwhile, the member noted that consumer price inflation had slowed to the mid-1-percent range in the fourth quarter last year, due mainly to slowed growth in agricultural and livestock product prices and a fall in city gas bills, and added that, despite real economic growth, the wage growth rate and other labor market indicators had not yet exhibited signs of inflation pressures building up in line with improvement in the output gap. In reflection of this, this year's consumer price inflation forecast was revised downward to 1.5 percent for the first half and 1.8 percent for the second half from the October forecasts of 1.7 percent and 1.9 percent, respectively.

Finally, concerning financial stability, the member mentioned that there was a notable sign that household debt was starting to stabilize. The member pointed out that household lending by the banking and non-banking sectors had shown far slower growth in December last year than the growth trend over the past couple of years. Considering that household debt growth had been attributable to the buoyant market for new apartment sales and related group loans, and that household lending rates had been rising and the index of household lending attitudes of financial institutions had tightened, the member stated that the recent stabilization of household debt was expected to continue throughout this year.

The member expressed the view that, taking these points into overall consideration, the real economy had recently maintained overall stable growth, financial stability and household debt in particular had improved, and inflation pressures had not yet shown any sign of materialization, and thus it was appropriate to keep the Base Rate at its current level this month.

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

Looking at economic conditions since the Monetary Policy Board meeting on November 30th, the member noted that the economic growth rate for last year appeared to be above 3 percent, the growth forecast for this year had been revised slightly upward from 2.9 percent to 3.0 percent, and the growth for next year was projected at 2.9 percent, similar to the potential growth level. On this basis, the member found Korea’s underlying economic growth trend to be sound. With respect to inflation conditions, the member saw that consumer price inflation would be running in the low to mid-1 percent range for some time, but since the output gap was shifting into positive territory thanks to a sustained trend of solid growth, the member forecast that consumer price inflation would accelerate and approach its target in the second half of this year.

The member noted that, although the domestic and overseas financial markets were maintaining stability overall, recently concerns had been gradually rising about the possibility that asset prices were overvalued amid protracted accommodative financial conditions around the globe. The member went on to point out that, if monetary policy normalized further going forward, there would be a greater possibility of sudden price adjustments to risky assets including stocks. The member commented that household lending, which was considered one of the biggest potential risk factors in the Korean economy, was growing somewhat slowly, mainly led by home mortgage loans, but constant attention should be paid to its trend of increase, as credit lending, which was generally of low credit quality, had expanded, and the increase in household lending was still outpacing income growth.

Next, concerning the monetary policy response, the member stated that maintaining the current degree of monetary accommodation for a long time with Korea's economic growth remaining at its potential level would constrain the easing of the risk of financial imbalances such as the buildup in household debt. The member thus found it still effective to make additional adjustment to the degree of monetary accommodation. The member, however, stated that it would be desirable to keep the Base Rate at its current 1.50-percent level this time, given that, with inflation running below the target level, more time was required for inflation to converge to the target, and that there was a need to observe a little longer the impacts of the previous Base Rate hike.

One member, meanwhile, expressed 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 advanced economies had been maintaining cyclical recoveries centering around investment, thanks for instance to the rebound of sluggish investment, to reinvestment stemming from IT innovation, and to the upgrade of capital goods to respond to increased competition, but if the trend of increased investment slowed, both exports and production were likely to be affected in the future. In addition, the member saw that the sustainability of consumption was not guaranteed, as household income growth was insufficient due to the low economic participation rate and the declining number of high-quality jobs. The member added that, as IT-related investment, in particular, would cause job quality in sectors other than capital-intensive new industries to continue to decline, average wages would decrease further, thus possibly leading to a reduction in the share of labor income over the medium term.

The member's assessment was that, although Korea's economic growth had been driven by facilities investment related to IT sector exports and by construction investment associated with household debt, the economic recovery had so far not been transmitted fully to household income. The member judged consumer economic expectations to be better than expected, given that consumption had shown robust growth in the second half of last year, despite slow income growth and a reduction of the fiscal deficit. The member saw that, although construction investment and facilities investment would likely slow compared to last year, net exports were expected to improve somewhat with the growth of both facilities investment and imports declining. The member forecast that the government's expansionary fiscal policy would lead to household income growth, thus driving a continued increase in consumption. The member, however, added that there still were uncertainties about the demand in advanced economies for imports of non-IT Korean products and about supply-side responses to the government's policy.

With respect to prices, the member pointed out that the consumer price inflation had fallen to the 1.5-percent level in the fourth quarter of last year due to weak agricultural, livestock and fisheries product prices and a cut in regulated prices, but sticky prices, with personal service prices and regulated prices excluded, remained at the 2-percent level. The member projected that while cyclical inflation would move slightly above their current levels, led by improvements in demand, globally sensitive inflation would hold steady.

The member stated that, although the pace of the accumulation of financial imbalances stemming from monetary accommodation seemed to have eased somewhat, the level of the monetary policy stance should be adjusted in the future while constantly monitoring the trade-off between the achievement of the inflation target and the financial imbalances accumulated thus far. Finally, the member emphasized that macroeconomic policy seemed to have reached the limit of its effectiveness in further driving up the structurally lowered potential growth rate. The member thus emphasized the need for market-oriented structural reform to increase the potential growth rate and to strengthen resilience.

Another member expressed the view that it would be desirable to hold the Base Rate at its current level until the trend of economic recovery firms up such that underlying trend of inflation, represented by core inflation, increases to the target.

The member noted that, as most major advanced economies had been showing rapid growth greatly exceeding their potential growth rates, Korea's exports were recovering, and the Korean economy was also returning to growth around 3%, near its potential growth rate. The member, however, assessed that, since the export growth was led by some capital-intensive industries including semiconductors, its spillover effects on domestic demand and employment were still limited. The member commented that construction and facilities investment had entered a correction phase, the trend of recovery in private consumption remained modest, and in the labor market, the increase of private-sector employment was reducing as well. The member thus assessed the pace of underlying economic recovery to remain modest, and attributed the high growth in the third quarter of last year mostly to a technical phenomenon stemming from the timing of Chuseok holiday.

Meanwhile, the member stated that it was true that household debt, which had been pointed to as a major risk factor for the Korean economy, still remained high in absolute terms. The member, however, noted that the need for additional measures to curb household debt seemed to be declining, as household debt growth had been gradually slowing since the implementation of the August 2nd measures, and the slower growth was also expected to continue going forward as construction investment underwent an adjustment.

Accordingly, the member stressed the need for maintaining the accommodative monetary policy stance until the economy shows solid recovery to ensure that underlying inflation ends its years-long trend of modest decline and increases toward the target level. The member added that, in order to reverse the trend of decline in inflation, economic growth must exceed its potential level for a certain period, and employment conditions should improve more tangibly as well. The member expressed the opinion that, to this end, it would be desirable to actively utilize the favorable world economic environment, in consideration of the impacts of monetary policy on the exchange rate and the macroeconomy.

One other 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's assessment was that, as the buoyancy of exports stemming from expanded global investment and trade recovery had been continuing, and private consumption was showing a trend of steady improvement, the domestic real economy was sustaining a trend of modest recovery, despite adjustments in facilities and construction investment. The member estimated the output gap, which had remained negative, to have mostly turned positive, as the annual growth rate had been adjusted upward and the growth path had moved upward slightly, thanks to temporary faster growth in the third quarter of last year. The member, however, judged the current underlying growth momentum to remain at its potential growth level, in consideration of the slower growth in the fourth quarter, stemming for instance from a base effect.

The member noted that consumer price inflation had been declining greatly, due mainly to supply and regulatory factors such as declines in agricultural product prices and a cut in city gas charges, and forecast that it would be running below the target level for some time, primarily because of a rise in the value of the won, but then would likely accelerate again in the second half, with the impacts of the run-up in commodity prices and increase in the minimum wage being reflected after a time lag. The member, meanwhile, noted that core inflation remained flat at the mid-1-percent range despite the trend of economic recovery, and this implied that demand-side inflationary pressures had still not fully strengthened yet, based on core inflation excluding regulated prices and domestic demand inflationary pressure indicators.

Regarding production slack, the member judged the average capacity utilization ratio to have remained low, due to somewhat weaker production growth in the manufacturing sector as a whole apart from some industries, despite the buoyancy of exports. The member noted that in the labor market as well, the slack in the labor force had increased due to growth in the unemployment, participation, and time gaps on a year-on-year basis. Accordingly, the member pointed out that, despite gradual improvements in the employment rate, substantial spare capacity continued to remain in the labor force, centered on the youth and those at retirement age.

With respect to financial stability conditions, the member stated that, in the capital market, as medium- and long-term interest rates had risen due mainly to global inflation and changes in expectations related to the monetary policies of major countries, the treasury bond yield curve had steepened, but the corporate bond rates and credit spreads had shown stable movements and foreign portfolio investment had returned to a net inflow, particularly into the stock market. The member's assessment was that, with respect to the credit cycle, household credit growth was gradually slowing, with the strengthening of regulations related to household lending and the housing market coming into effect successively. The member judged that overall financial conditions remained stable, with flows of corporate credit gradually recovering and with economic activity improving.

The member stated that, in overall consideration of the aforementioned real economy, inflation, and financial stability conditions, the output gap was estimated to be shifting into slightly positive territory, but the disappearance of the negative inflation gap was expected to be somewhat delayed due to remaining spare capacity in both production and labor force, and the credit gap was also gradually narrowing, with macroprudential regulations strengthening. The member noted that, in light of these factors, there was not much need to make an additional adjustment to the degree of monetary accommodation at this time.

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 pace of global economic growth has accelerated. The global financial markets have shown generally stable movements, with the trend of rising stock prices continuing for example, although government bond rates have risen in line mainly with expectations of monetary policy normalizations in major countries. 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 directions of the US government's economic policies, and the movements toward spreading trade protectionism.

☐ The Board judges that the solid trend of domestic economic growth has continued, as exports have sustained their buoyancy and consumption has improved moderately, although investment has slowed somewhat. The trend of improvement in employment conditions has slowed, with the increase in the number of persons employed in the service sector having declined for example. The Board sees the domestic economy as likely to show a pace of GDP growth at the 3% level this year as well. It expects that investment will slow, but that the trend of steady increase in consumption will continue due in large part to improvements in household income conditions, and that exports will also sustain their favorable movements thanks to the buoyancy of the global economy.

☐ Consumer price inflation has slowed to the mid-1% level, in consequence mainly of declines in the extents of increase in the prices of agricultural, livestock and fisheries products and of a reduction in gas fees. Core inflation (with food and energy product prices excluded from the CPI) has stayed 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 being in the low- to mid-1% range for some time, will pick up and gradually approach the target level from the second half of this year, and for the year as a whole be in the upper-1% range. Core inflation will also gradually rise.

☐ Although long-term market interest rates have shown a trend of rising, affected by increases in interest rates in major countries, the domestic financial markets have displayed generally stable movements, with stock prices having risen for example, on expectations of improvements in corporate performances. The Korean won-US dollar exchange rate has continued its downtrend, in line chiefly with the weakening of the US dollar. The amount of increase in household lending has lessened. Housing sales prices have shown low rates of increase overall, but have risen faster 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.