Minutes of the Monetary Policy Board Meeting

November 29, 2019

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(November 2019)

Ⅰ. Outline

1. Date of meeting: Friday, November 29, 2019

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, MyunShik (Senior Deputy Governor)
   Lim, Jiwon

4. Monetary Policy Board members absent: none

5. Participants:
   Jang, Ho Hyun, Auditor
   Shin, Ho Soon, Deputy Governor
   Ryoo, Sangdai, Deputy Governor
   Lee, Seungheon, Deputy Governor
   Park, Jong Seok, Deputy Governor
   Suh, Bong Gook, Director General of Reserve Management Group
   Lee, Hwan Seok, Director General of Research Department
   Shin, Woon, Director of BOK Economic Research Institute
   Min, Jwa Hong, Director General of Financial Stability Department
   Lee, Sang Hyeong, Director General of Monetary Policy Department
   Kim, Hyun Kee, Director General of Financial Markets Department
   Yang, Seok Jun, Director General of International Department
   Park, Young Chool, Press Officer
   Chae, Byung Deuk, Director General of Monetary Policy Board Secretariat
   Sung, Kwang Jin, Head of MPB Team

1) This English version (summary) of the minutes of the Monetary Policy Board Meeting was produced at a working level, and is not an official document.

Ⅱ. Summary of Discussions on the Current Economic Situation

After briefings by staff on *Economic Outlook (November 2019)*,[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, looking at the global economy, the paces of economic growth in major countries excluding the US had continued to slow due to the ongoing slump in world trade. Members expected the global economy to improve during the next year compared to the current year, but saw that a substantial rebound was unlikely due to high uncertainties surrounding the growth path. Meanwhile, members evaluated that, in the international financial markets, risk aversion had somewhat subsided due to progress in the US-China trade negotiations and expectations related to the accommodative monetary policies of major advanced economies.

Members diagnosed that the domestic economy had been showing weaker-than-expected growth, as the sluggishness in exports and facilities investment had continued and private consumption growth had continued to slow. With respect to growth trends for next year, some members expressed the view that domestic demand and exports were unlikely to show meaningful recovery, while others expected the negative output gap to narrow to some extent since some indicators had been showing signs of improvement.

With regard to prices, members pointed out that consumer price inflation and core inflation both were at low levels, around the 0% range. Members saw that consumer price inflation would rebound somewhat, due to the easing of downward pressures stemming from one-off factors, but a fundamental reversal of the decline in core inflation did not seem likely given economic conditions. Meanwhile, some members raised concerns about the possibility of low inflation affecting inflation expectations.

Finally, in the domestic financial markets, members' evaluation was that bank lending rates had declined and credit in the private sector had expanded, led by corporate credit, although long-term market interest rates had risen since the last MPB meeting. Members saw that the expansion in liquidity could cause negative side effects such as increased investment in high-risk assets and instability in the real estate market. Members thus saw the need to keep a close eye on the possibility of financial imbalances accumulating.

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:

The majority of members presented the view that, in overall consideration of the domestic and international financial and economic environments, it would be desirable to keep the Base Rate at its current level of 1.25%, while one member called for lowering it by 25 basis points.

One member presented the view that it would be appropriate to keep the Base Rate at its current 1.25% level at the current meeting and take more time to closely watch real economic trends and domestic and international financial market conditions.

The member evaluated that, in the global economy, trends of economic growth in major countries excluding the US had continued to slow, and trade had also remained sluggish since the last MPB meeting. The member noted that, in the international financial markets, interest rates and stock prices had risen, in reflection of expectations related to accommodative monetary policies in major advanced economies amid progress in the US-China trade negotiations.

The member evaluated that, while exports and facilities investment remained sluggish, construction investment continued to undergo a correction and private consumption was showing signs of a slowdown. With respect to prices, the member pointed out that core inflation had continued the trend of decline and the rate of inflation expected by the general public was running below 2%.

The member expressed the opinion that, since the slower domestic growth was significantly attributable to global economic factors, the question of whether the global economy would show improvement next year was important for the domestic economy. On the upside, the member pointed to expectations of improvement in the global economy next year led by semiconductors. The member, however, saw that a meaningful rebound was not expected for now, since several uncertainties, such as the US-China trade dispute and the slowdown of the Chinese economy, were unlikely to be resolved easily. The member noted that price conditions would also show improvement compared to the current year, but raised the concern that consumer price inflation and core inflation could still be significantly below the target. The member's assessment was that monetary policy should remain accommodative going forward, given that weak inflationary pressures on the demand side were one of the major causes of the low inflation. The member also noted that there was growing interest as to how effectively monetary policy might be able to respond to sluggish exports and facilities investment. The member thus emphasized the need for in-depth analyses on several issues related to monetary policy, such as monetary policy transmission mechanism and the effective lower bound.

Meanwhile, the member noted that, although the slowing of household debt growth had continued thanks to strong government measures, careful attention should be paid in the future to the possibility that rising real estate prices in some regions would act to increase household debt. The member also noted that corporate lending growth had expanded, following the government measures to curb household debt. The member went on to express the view that constant monitoring was required as to whether the growing corporate lending was flowing into sectors related to the real estate market. The member added that it should be carefully examined whether the sustained low interest rate environment would generate negative side effects, such as exacerbated corporate insolvencies or delayed restructuring of distressed companies.

The member set out the view that, in overall consideration of the domestic and external economic conditions mentioned above, it would be desirable to keep the Base Rate at its current 1.25% level at the present meeting, while taking more time to observe real economic trends and domestic and international financial market conditions.

Another member stated that it would be appropriate to revise the Base Rate downward, but the revision should be deferred to the next meeting.

The member's assessment of the domestic economy was that demand in the private sector had stagnated and weak growth dependent on expanded public sector expenditure was continuing. The member anticipated that, in a broad sense, this pattern would continue next year as well. The member noted that, given that global growth had been modest, it would be difficult to expect exports and facilities investment in Korea to drive a real economic recovery next year that went beyond a technical rebound. Turning to specific industries, the member noted that, while most industry-related indicators remained sluggish, construction-related leading indicators in particular implied that the decline in construction investment would continue for the third consecutive year in 2020, despite the government's plan to expand public investment. The member's evaluation was that, given the modest growth in households' disposable incomes, the possibility of significantly expanded growth in private consumption was not high. Against this backdrop, the member stated that the government's active fiscal expansion would continue to act as a buffer against a decline in the growth rate next year as well. The member, however, expected the negative output gap to actually expand, as the overall growth rate of the domestic economy would run below the potential level, which was estimated at the mid-2% range.

Accordingly, the member pointed out that a years-long trend of decline in underlying price inflation could continue next year as well. The member saw that, although consumer price inflation, which remained at around 0%, would likely rebound slightly due to one-off technical factors, macroeconomic variables such as the output gap, inflation expectations, and overseas inflation were mostly acting to lower price inflation. Given this point, the member assessed that it would not be easy to expect a reversal from a trend of decline in core inflation, which had fallen to the upper-0% range.

The member noted that, given this underlying price inflation, it was difficult to assess the current 1.25% Base Rate as sufficiently accommodative on a real interest rate basis. The member thus stated the position that it was desirable to revise the Base Rate downward to keep up with the current macroeconomic conditions. The member, however, noted that a downward revision should be deferred to the next meeting to respect the intent conveyed in the last Monetary Policy Decision statement to observe the effects of the two Base Rate cuts. The member also emphasized the need to conduct policy based on the market economy principle in order to strengthen the competitiveness in the private sector in the medium- to long-term, and to enhance the effects of boosting the real economy in the short-term through a reduction of the negative side effects of accommodative monetary policy.

Another member presented the view that it would be desirable to keep the Base Rate at its current 1.25% level at the current meeting.

The member noted that prices had declined remarkably in 2019 due to a deepening of the domestic demand slump, after having had shown low growth for the last few years influenced by global factors and administered prices. The member, however, cautiously judged that prices had bottomed out overall, with various indicators such as core inflation excluding administered prices showing slight rebounds of late. The member expressed the opinion that the current year’s sluggish domestic demand was attributable to a rapid decline in growth on top of the already declining potential growth rate stemming from a readjustment of excessive investment. The member commented that low real estate investment and facilities investment were in a way desirable in that they had partially resolved the excessive investment of recent years, but they were also undermining growth in the short term.

The member’s evaluation was that the sluggish domestic demand was mainly attributable to structural factors at home and abroad, but given the stability of economic activity, the currently implemented expansionary fiscal policy and the recent two Base Rate cuts were sufficient policy responses. The member noted that the domestic economy was expected to recover to some extent to the level of potential growth rate next year, as the readjustment to investment would be completed. The member, however, expressed the opinion that downward inflationary pressures and sluggish domestic demand would continue due to a sustained decline in the potential growth rate, and in response the urgent task at the present moment was to pursue structural reforms that could reverse the trend of decline in the potential growth rate, rather than pursue a more expansionary macroeconomic policy. The member noted that, to ensure seamless structural reforms, it was appropriate to supplement growth with fiscal policy first, while maintaining the current accommodative monetary policy stance and keeping an eye on the policy effects. The member added that it was desirable to formulate monetary policy from a medium-term perspective to make the allocation of resources efficient and prevent unnecessary expansion of economic volatility.

The member, meanwhile, expressed the view that it was necessary to consider how to cope with financial imbalances, which were one of the factors causing a reduction in the potential growth rate. The member noted that deadweight losses stemming from financial imbalances could be seen from small- and medium-sized enterprises' increased dependence on debt, from the excessive value of real estate as production capital relative to total production capacity, and from increases in unsold housing units in provincial areas and commercial building vacancy rates. The member noted that any rapid adjustment in the financial imbalances stemming from domestic or external shocks could trigger a financial crisis through mismatches on balance sheets of financial institutions, and mentioned that this was a financial stability issue that required continued attention. The member presented the opinion that, since financial imbalances had worsened further since the global financial crisis, they had emerged as an issue to consider even from a monetary policy perspective. The member explained that this was because an expansion in deadweight losses stemming from financial imbalances could act as downward inflationary pressures, by causing the potential growth rate to decline and thus leading to sluggish domestic demand. The member added that, from this perspective, attention should be paid to the point that, since the financial crisis, major advanced economies had witnessed somewhat reduced financial imbalances due to strong implementation of deleveraging despite steep cuts in interest rates, while some emerging economies including Korea had seen substantial increases in leverage during the same period.

Considering the matters mentioned above, the member found the current macroeconomic policy mix and stance to be appropriate. The member thus expressed the view that it was desirable to keep the Base Rate unchanged at the current 1.25% level.

One member stated that it would be appropriate to cut the Base Rate by 25 basis points to 1.00%.

The member's assessment of the domestic economy was that the economic slump and inflation sluggishness since the end of last year had continued. The member pointed out that the rapid slowdown in global trade, the biggest factor responsible for the economic downturn, had been negatively affecting exports, corporate facilities investment, and ultimately the overall expectations of economic agents. The member mentioned that the US-China trade dispute had been widely cited around the end of last year as a factor behind this global trade slowdown, but considering that global trade had been slowing at an unprecedentedly rapid pace until recently and that the auto and IT industries had been leading the slowdown, the reorganization of the world supply chain known as the GVC could be a fundamental cause. The member expressed the view that, although global trade was expected to improve next year, boosted at the minimum by a technical rebound, fundamental changes in Korea's export environment and related facilities investment environment still appeared unlikely, on the assumption of sustained structural changes such as the reorganization of the GVC.

The member evaluated that, when external demand slows, the relative contribution of household consumption to growth should rise theoretically and serve as a buffer against the economic downturn, but such volatility-reducing dynamics of consumption had not been seen recently in the domestic economy. The member noted that, despite the substantial increase in the government's transfer payments, the decline in household consumption growth has not been eased. The member expressed the view that this had also been witnessed during the period of economic downturn around 2012 and seemed to be related with population aging, a structural factor of the Korean economy. The member's forecast was that, with the economy's potential growth rate expected to decline due to population aging, a rapid economic slowdown like the one seen this year would lead a substantial number of households to make downward adjustments to their future income forecasts. The member also took the view that advanced countries had experienced a sharp drop in the propensity to consume at around retirement age, and the fact that the baby boomer generation, which accounts for a substantial share of households in Korea, was approaching retirement could be a factor causing household consumption to contract. In this regard, the member forecast that consumption was highly likely to remain stagnant for a considerable period of time after an economic slump, as witnessed in 2012. Considering these domestic and external conditions, the member expected the domestic economy to exhibit growth of a maximum of 2% this year and remain on a growth path not deviating far from this level. The member forecast that, as a result, the output gap for this year and next would be at its most sharply negative level since 2012 and 2013.

Looking at inflation, the member pointed out that consumer price inflation had remained in the lower-0% range and core inflation in the mid- to upper-0% range, and judged that there would be more downside risks than upside risks in the outlook for next year, considering economic conditions and the inflation trend. The member noted that it would be hard to expect core inflation, considered to be more stably linked to inflation expectations, to shift back to an increasing trend next year, and argued that the current challenge for monetary policy would be that, with inflation unanchored from the 2% target for a long time, inflation expectations could decline further due to the current economic slump. The member's assessment was that, although there was only a slight possibility that the domestic economy would enter deflation any time soon, there was a substantial probability that inflation would become entrenched below 1%. The member emphasized that, in this case, attention should be paid to the possibility of the real Base Rate with inflation taken into consideration exceeding the real neutral interest rate even when the Base Rate was maintained at a low level, and this could undermine the effectiveness of monetary policy through conventional policy rate adjustments.

In terms of the neutral interest rate, the member's judgment was that, in light of the recent economic conditions and the outlook for next year, Korea's recent real neutral interest rate seemed to have declined at a somewhat rapid pace, exceeding the pace of decrease in the potential growth rate. The member also took the view that, given the inflation outlook, it would be hard to consider the real interest rate suggested by the current Base Rate as being lower than the real neutral interest rate, despite the previous two Base Rate cuts, and it would be difficult to assess the current monetary policy as sufficiently accommodative. The member argued that, in this regard, more aggressive monetary policy measures were required and it would be appropriate to cut the Base Rate by 25 basis points to 1.00%.

Another member presented the view that it would be desirable to keep the Base Rate at its current level of 1.25%.

Looking at global economic and financial conditions since the previous monetary policy decision meeting, the member assessed that, although growth rates had been slowing, particularly in China and the euro area, risk-off sentiment in the financial markets had eased substantially. The member mentioned that this was a result of the judgment that the policies of major countries were moving toward a direction that would ease downward pressures on the growth path, and of expectations that an environment was being created in which the manufacturing slump would be gradually eased. The member argued, however, that uncertainties surrounding the future growth path remained high, owing to geopolitical risks as well as the lack of agreements in trade talks between major countries.

The member's evaluation was that the growth rate of the domestic economy continued to be on a downward trend due to various structural factors, but downward pressures stemming from cyclical factors were seen to have been easing somewhat. Looking at recent economic indicators, the member noted that some leading indicators for the manufacturing industry had been exhibiting gradual improvement and the services industry had been showing more favorable movements than in the first half of this year, which supported expectations that the economic slowdown would not worsen further due to cyclical factors. However, the member argued that, considering the protracted corrections in the construction sector and the continued state of flux in the domestic and overseas policy environments, which would affect the future growth path, more time for observation was needed to judge whether the recent trend would lead to a more significant recovery and a narrowing of the negative output gap.

With respect to consumer price inflation, the member forecast that the gap between consumer price inflation and underlying inflation would gradually narrow with the easing of supply-side downward pressures, but that consumer price inflation would remain below the target for a considerable period of time, affected by weak demand-side inflation pressures and an expansion in social-welfare policy. In this regard, the member presented the view that it would be necessary to observe closely how this inflation trend would affect the formation of inflation expectations going forward.

Regarding the financial markets, meanwhile, the member mentioned that, while long-term market interest rates had risen since August, financial institutions' loan rates, which play a more leading role in credit supply to the corporate sector, had declined, leading to a sharp rise in corporate lending and to an expansion in liquidity. The member pointed out that, although this suggested that monetary policy transmission channels are working smoothly in the financial markets, continued attention should be paid to the possibility of the accumulation of financial imbalances that could be brought about by the continuation of accommodative financial conditions.

In overall consideration of the above-mentioned points, the member expressed the view that it would be appropriate to keep the Base Rate at its current level.

One other member presented the view that it would be desirable to keep the Base Rate unchanged from its current level of 1.25%.

Looking at the recent domestic economy, the member evaluated that the pace of growth was slower than originally expected, as exports and investment had remained sluggish and the rate of growth in private consumption had slowed. The member noted that inflation had been lower than originally forecast, affected largely by these demand-side factors and the strengthening of the government's social-welfare policy. The member stated that in November the Research Department was adjusting the outlooks for the growth rate and consumer price inflation downward for this year and next, and took the view that this had been expected to some extent at the October meeting. The member's assessment was that, according to these economic outlooks, the trend of low growth and low inflation would last, although the growth rate and consumer price inflation would bottom out this year and gradually rise next year and the year after. The member argued that this trend seemed to have resulted substantially from structural factors of the domestic economy as well as common global factors, but the forecast that inflation would remain below the target should be taken seriously by a central bank operating an inflation targeting regime. The member stressed that, as short-term inflation expectations of the general public, unlike long-term inflation expectations of experts, had been recently declining gradually in reflection of the low inflation trend, efforts should be made to strengthen communication concerning inflation conditions so that the credibility of monetary policy would not be undermined.

The member meanwhile evaluated that the transmission mechanism of Base Rate cuts seemed to be working smoothly in the financial markets, as deposit and lending rates had declined and credit to the private sector and liquidity had continued to increase significantly since the two Base Rate cuts. The member pointed out, however, that the recent growth in credit supply and liquidity had worked to increase investment in high-risk, high-return products and had served as a factor causing housing market instability in some regions rather than stimulating real economic activities such as consumption and investment. The member argued that this was a cause for concern from the standpoint of both the sound development and medium- and long-term stability of the national economy.

The member expressed the opinion that, given the Base Rate cut last month in expectation of downward adjustments of the growth and inflation forecasts and the highly accommodative credit and liquidity conditions seen recently, it would be advisable to keep the Base Rate at its current level of 1.25% for the intermeeting period.

Ⅳ. Results of Deliberation on Monetary Policy Directions

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

However, Dr. Shin, Inseok expressed clear opposition to keeping the Base Rate at the current level and argued for cutting 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 1.25% for the intermeeting period.

☐ Based on currently available information the Board considers that the pace of global economic growth has continued to slow as trade has contracted. The global financial markets have been stable in general, as risk aversion has subsided in line mainly with progress in the US-China trade negotiations. Looking ahead, the Board sees global economic growth and the global financial markets as likely to be affected by factors such as the degree of the spread of trade protectionism, the changes in the monetary policies of major countries, and geopolitical risks.

☐ The Board judges that the pace of domestic economic growth has remained slow, as consumption growth has weakened, while the adjustment in construction investment and the sluggishness in exports and facilities investment have continued. Employment conditions have continued to improve in some respects, with the increase in the number of persons employed having risen. With respect to the domestic economy during next year, the Board expects the sluggishness in exports and facilities investment will ease somewhat and the consumption growth rate will moderately rise, although the adjustment in construction investment will continue. GDP is forecast to grow at around 2% in 2019 and the lower-2% level in 2020.

☐ Consumer price inflation was at the 0% level, due largely to a smaller decline in the prices of agricultural, livestock and fisheries products. Core inflation (with food and energy product prices excluded from the CPI) has been at the mid-0% range, and the rate of inflation expected by the general public has remained at the upper-1% level. Looking ahead, it is forecast that during next year consumer price inflation will moderately increase to around 1% and core inflation will be at the upper-0% level.

☐ In the domestic financial markets, long-term market interest rates and stock prices have risen and the Korean won-US dollar exchange rate has fallen, affected chiefly by movements in the global financial markets. The rate of increase in household lending has continued to slow. Housing prices have risen as the pace of increase has expanded in 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 expected that domestic economic growth will be moderate and it is forecast that inflationary pressures on the demand side will remain at a low level, the Board will maintain its accommodative monetary policy stance. In this process it will judge whether to adjust the degree of monetary policy accommodation, while carefully monitoring developments in the US-China trade negotiations, the economies and monetary policies of major countries, the trend of increase in household debt, and geopolitical risks and examining their effects on domestic macroeconomic and financial stability conditions.