Minutes of the Monetary Policy Board Meeting

April 2020

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]
(April 2020)

Ⅰ. Outline

1. Date of meeting: Thursday, April 9, 2020

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
   Ryoo, Sangdai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Lee, Seungheon, Deputy Governor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Suh, Bong Gook, Director General of Reserve Management Group
   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 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:

Looking at the global economy, members assessed that due to the continued worldwide spread of COVID-19, economic activity had contracted significantly and a global economic downturn was materializing, particularly in major advanced economies. Members saw that the international financial markets continued to show instability, with volatility in price variables remaining high, although risk aversion had eased somewhat, thanks to active policy responses of individual countries.

Members pointed out that, due to the influence of COVID-19, private consumption had declined significantly and difficulties in the service sector were increasing, led by the accommodation & food service sector and leisure-related industries. Members diagnosed that a continued slowdown in the production of corporations have been causing a delay in facilities investment, and a contraction in exports would be unavoidable. Members emphasized that it should be kept in mind that if the spread of COVID-19 continued for a prolonged period of time, thus causing a sharp decline in the sales of domestic corporations, financial unrest could intensify and real economic resilience could be undermined.

With regard to prices, members assessed that consumer price inflation had slowed again after rebounding early this year, similar to the movement seen in core inflation. Members saw that, going forward, downside risks to prices would increase further, due to a plunge in international oil prices and the effects from the government’s measures to stabilize people’s livelihoods.

Finally, in the domestic financial markets, members’ evaluation was that price variables had become much more volatile, influenced by the worldwide spread of COVID-19 and heightened volatility in the international financial markets, while the corporate bond market in particular remained highly averse to credit risk. Members noted that market unrest had recently eased somewhat, thanks to active response measures by the government and the BOK. Members, however, emphasized that monitoring of vulnerable sectors should be strengthened further, since there were high uncertainties related to the future developments of the COVID-19 pandemic.

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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 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 0.75%, while two members 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 level of 0.75%.

The member evaluated that financial market unrest, stemming from the influence of a financial shock originating in the US and from a contraction in domestic consumption, was easing to some extent, thanks to a series of policy measures by the government and the BOK. The member thus expressed the opinion that it was desirable to keep the Base Rate unchanged at the current meeting and closely watch the effects of the recent 50 basis point Base Rate cut and of the government's mix of various policies. The member emphasized the need to prepare for a possible sharp expansion of a shock originating in the real economy whereby worsened global trade leads to a drop in the sales of domestic corporations.

Looking at the domestic financial markets, the member's assessment was that uncertainties had eased and liquidity had been kept at an appropriate level. The member added that risk-based differentiation was properly taking place overall, and the credit channel had been operating without any serious crunch. The member, however, presented the opinion that, since the world economy could contract significantly until the second half of this year, additional response measures were needed. The member noted that, if corporate sales declined steeply due to sluggish exports, financial unrest could expand greatly. The member thus emphasized the need for the BOK to prepare response measures. The member, however, saw that, unlike during the global financial crisis period, the current shock had emerged in the real economy and thus it could be difficult to distinguish liquidity risks from solvency risks. The member thus expressed the opinion that the government should provide guarantees for solvency risks in advance to allow the central bank to preemptively respond.

The member noted that, if the contraction in economic activity was expected to spread more deeply to the entire economy despite various measures by the policy authorities, the policy rate should be reduced to the lower bound to minimize the debt burden across the entire economy and to provide funds as needed. Finally, the member emphasized that the best policy to achieve the inflation target under the current economic conditions was to minimize production capacity losses.

The member added that, to this end, every effort should be made to prevent permanent losses in labor and production capacity during the COVID-19 pandemic period, and consideration should also be given to the exit strategy based on the experience of advanced economies.

Another member presented the view that it would be desirable to keep the Base Rate at its current 0.75% level at the current meeting.

The member noted that the continued worldwide spread of COVID-19 had significantly weakened economic activity and severely affected financial conditions. The member saw that risk aversion in the financial markets had eased somewhat, thanks to recent active policy responses by individual countries, but the shock to the real economy was increasing further, due to the implementation of strong quarantine measures, such as lockdowns or business suspensions in major countries, including the US. Considering the proportion in the world economy of these countries, the member saw that the global economy was highly likely to have already entered a downturn phase, and anxiety among economic agents could continue for a considerable time. The member thus judged uncertainties surrounding the medium- to long-term growth path to be very high.

The member noted that, on the domestic economic front, service and manufacturing production had decreased sharply in February, and domestic demand, such as consumption and investment, had also contracted. The member saw that, although exports had shown a relatively gentle correction, this was mainly due to a time lag between export orders and shipments. The member went on to expect that the negative impacts on global trade and domestic exports would be amplified greatly in the second quarter, given that major economies had seen simultaneous downturns since early March. Accordingly, the member forecast that economic growth for this year would run well below the February forecast and the inflation gap would widen more than expected.

The member noted that, in the domestic financial markets, the rapid simultaneous weakening of stock prices, interest rates and exchange rates had eased thanks to various market stabilization measures, but credit risk aversion in the capital markets continued to be heightened, with CP rates rising greatly and credit spreads of corporate bonds widening amid a contraction in funding conditions of the non-banking sector. Meanwhile, with respect to the indirect financial markets which accounted for a large share of domestic corporate financing, the member assessed that credit was being supplied smoothly, with bank lending rates falling and interest spreads for lending remaining stable. The member noted that this market pattern differed somewhat from what was seen in the US and other major advanced economies. The member, however, commented that prolonged real economic sluggishness at home and abroad would increase the debt-servicing risk of corporations, thus leading to worsened asset soundness in the banking sector, and such a risk could even evolve into systemic risk, depending on the situation. The member thus emphasized the need to pay attention to this issue.

The member expressed the opinion that the main worry at this point was that it still remained uncertain when the spread of the COVID-19 pandemic would slow significantly. The member expressed concern that, if the COVID-19 situation continued for a prolonged period of time, and the consequent contraction in demand at home and abroad lasted even after the first half of this year, deterioration in corporate profits and cash flows would lead to employment and investment corrections, closures, and bankruptcies in major industries, thus severely harming the medium- to long-term growth potential. The member was also concerned that the possibility could not be ruled out that this would work to cause serious financial instability through a vicious cycle with financial conditions. The member thus emphasized the need to pursue comprehensive response measures to deal with various risk factors that could be triggered by a prolongation of the COVID-19 pandemic, through close coordination with fiscal and financial policy measures, while carrying out monetary policy flexibly by preparing response measures for various scenarios. The member, however, expressed the view that, given the large Base Rate cut at the interim Monetary Policy Board meeting in March and the implementation of several stabilization measures, it would be appropriate to keep the Base Rate at the current 0.75% at the current meeting and closely monitor changes in domestic and international economic and financial conditions, as well as the effects of policy responses so far.

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

The member raised the concern that, although the Base Rate had been cut by 50 basis points at the March 16 interim meeting to deal with the worldwide spread of COVID-19 earlier in the month, it later became difficult to identify the severity of the relevant shock, due to a mix of a real economic crisis and a financial market crisis resulting from the accelerated spread of COVID-19. The member noted that, with major global institutions and investment banks adjusting their world economic growth outlooks for this year sharply downward, the real economy and financial markets in Korea would be inevitably hit hard by the COVID-19 pandemic. The member thus judged that there were large downside risks to the BOK's forecasts for economic growth and consumer price inflation.

Concerning the domestic economy, the member's evaluation was that private consumption had already been declining significantly, and difficulties in service industries, such as the accommodation & food service sector and leisure-related industries in particular, were increasing. The member added that a slowdown in the production of domestic corporations was continuing in the manufacturing sector, while sluggishness in facilities investment and a contraction in the export sector would be unavoidable.

The member assessed that uncertainties in the international financial markets had heightened substantially, and in the domestic financial markets, stock prices had fallen sharply and difficulties had emerged in some short-term financial markets. The member emphasized that, since the credit spreads of corporate bonds had widened due to aversion to credit risk, it was necessary to closely monitor the relevant developments.

The member noted that, given the continued spread of COVID-19 across the globe, preparations should be made to deal with a possible prolongation and deepening of difficulties in several industries, including the airline industry. The member saw that, if the worldwide spread of COVID-19 slowed and economic activity started to normalize, a rebound in the real economy and stability in the financial markets would be expected, but it would be difficult to expect a rapid recovery at an early stage. The member judged that it was important to carry out an active monetary policy in the current crisis situation, but for now it was also necessary to observe for a little while longer the effects of the measures taken so far. The member thus expressed the opinion that it was desirable to keep the Base Rate at the current level at this meeting and closely monitor real economic conditions and financial market trends in the future.

Meanwhile, the member noted that, since the recent credit crunch in some financial markets looked to be a liquidity supply issue, rather than an interest level issue, responses were urgently required. The member also added that, given that the Base Rate was already approaching the effective lower bound, preparations to use non-traditional monetary policy tools should be made without delay. Finally, the member emphasized that, since difficulties in the real economy and the financial markets were expected for a considerable time, the BOK should continue to play an active role in preventing financial market unrest from spreading, by ensuring proper functioning of financial intermediation, while maintaining stability in the foreign exchange markets.

One member expressed the opinion that it was appropriate to lower the Base Rate from the current 0.75% to 0.50%.

The member's assessment was that, due to the recent COVID-19 outbreak, economic activities had contracted drastically and financial market volatility had increased significantly, and there was high uncertainty as to the future trajectory of the pandemic. The member mentioned that, if the current situation continued longer than expected, the resilience of the real economy could be undermined and Korea's already low underlying inflation could decline even further, raising concerns about deflation risk. The member argued that the current situation in this regard required aggressive measures by the monetary and fiscal authorities and that monetary policy, which is more flexible than fiscal policy, should be operated in a more prompt manner to cope with the emergency.

The member noted that, given that the central bank's monetary policy is aimed at seeking stability of the market as a whole, rather than supporting troubled financial institutions or businesses on an individual basis, a rate cut would be the necessary policy measure under the current situation to stimulate the economy comprehensively and expand the supply of liquidity. The member evaluated that, unlike most advanced countries whose policy rates had been already lowered to the

0 to 0.25% range, Korea still had the capacity for further rate cuts. The member also emphasized that a Base Rate cut would reduce incentives for massive liquidity, currently remaining within the banking sector due to investors' excessive risk aversion and strong preference for cash, to flow back to the BOK, serving as a starting point to ease the credit crunch in the financial markets and help the impacts of monetary policy spread to the real economy. The member added that sufficient Base Rate cuts were a precondition for quantitative easing policy.

The member mentioned that, given the recent uncertain economic conditions, it was important to prepare for a situation where credit market instability undermines effective monetary policy transmission and triggers financial market unrest. In this regard, the member expressed the view that it would be desirable to expand the central bank's recent decision to buy short-term bonds in repo auctions in an unlimited amount. The member also pointed to the need to positively consider buying prime corporate bonds and CP to prepare against the possibility of an excessive financial market crunch due to the real economic slump. In this case, however, the member argued that applying relevant credit spreads is essential in order to prevent moral hazard and minimize the risk of losses by the note-issuing authority, and to this end, the government's cooperation and the National Assembly's approval were important when the BOK took on credit risks. Finally, the member took the view that the BOK's loans to for-profit businesses should be limited to exceptional cases based on the MPB's judgment that the crisis faced by these businesses was not a solvency crisis but rather a temporary liquidity crisis, which would not be resolved for the entire financial markets as well as for the businesses concerned unless lending occurred. The member added that the MPB does not appear authorized to determine whether to support specific for-profit businesses with uncertain medium- to long-term debt servicing capacities.

Considering the above-mentioned matters, the member argued that it would be appropriate to lower the Base Rate to 0.50% this time. The member added that in the event of a further economic slump the logically consistent policy mix would be, in order: further reducing the Base Rate, ensuring market interest rate stability through government bond purchases, and buying corporate bonds.

Another member stated that it would be desirable to keep the Base Rate at its current level of 0.75% for the intermeeting period.

The member assessed that, with the recent global spread of COVID-19, a global economic slump was becoming apparent, particularly in major advanced countries. The member noted that, although countries were strengthening their disease-control efforts and taking strong economic stimulus measures in terms of fiscal, monetary and financial policies, the potential economic recession was said to be more serious than during the global financial crisis.

The member forecast that domestic economic growth would be dampened significantly by COVID-19, with production and retail sales declining and facilities investment delayed. The member however expressed the view that, considering that the number of confirmed cases in Korea had been growing at a slower pace recently and that the services sector, hit hard by the virus outbreak, accounted for a smaller part of the domestic economy than in major advanced countries, the economic slump would be less serious in Korea than in other countries. The member nonetheless expressed concerns that a prolongation of major countries' economic slumps could affect Korea significantly, considering the high uncertainty about the future trajectory of the virus outbreak and Korea's high dependence on external trade.

As to inflation, meanwhile, the member forecast that downward inflation pressures would increase further, due to sluggish demand, international oil price declines and the effects of the government measures to promote the stability of people's livelihoods. The member noted that, in the domestic and overseas financial markets, the volatility of price variables had increased significantly owing to the virus outbreak, while risk-off sentiment had strengthened in line with heightened credit risk aversion. The member added that, although market instability had been somewhat easing recently, substantial risk factors remained, particularly in the credit markets.

The member mentioned that, considering these growth, inflation and financial conditions, it would be necessary to expand the degree of monetary easing in order to reduce downside risks to the macroeconomy and promote financial market stability. The member added however that the BOK had lowered the Base Rate by 50 basis points to a record low level of 0.75% at the interim meeting in March and following this had been providing a massive amount of liquidity by conducting repo auctions to supply an unlimited amount of liquidity at set interest rates. The member added that it should be taken into consideration that the current level of the Base Rate left only limited room for further rate cuts. The member expressed the view that, in this regard, it would be advisable to keep the Base Rate unchanged for the intermeeting period and monitor the ripple effects of the various fiscal, monetary and financial policy measures implemented so far, and to carefully consider the timing of an additional rate cut to maximize its effectiveness. The member emphasized, however, that the central bank should consider all possible monetary policy tools and seek appropriate measures within the range of authority delegated to it, if needed to ensure stability of the macroeconomy and financial system in line with future changes in domestic and external conditions.

Another member expressed the opinion that it would be desirable to adjust the Base Rate downward by 25 basis points to 0.50%.

The member's assessment was that the global economy was on an unprecedented path, as COVID-19 had recently worsened to become a global pandemic. The member evaluated that the domestic economy was affected significantly through two channels: shrinking domestic demand resulting from social distancing, and the negative shock from the de facto suspension of economic activity in major advanced countries. The member stated that it was the first time in the history of the market economy for a natural disaster to have an impact on countries around the globe all at the same time, and went on to express concerns about the high uncertainties regarding the depth of the shock and future path of the global economy.

The member noted that two main scenarios could be mapped out concerning the future path of the domestic economy: a positive scenario in which the spread of the virus was contained not only in Korea but also in major advanced countries from the second quarter, and the global economy consequently rebounded rapidly in the second half of the year; and a scenario in which the spread of the virus was not curbed as soon as originally expected, causing an increase in the cost of coping with the crisis, leading to a structural weakening of major economies and pulling down the potential global economic growth rate. The member evaluated that it would be proper to expect the global economy to rebound from the second half of the year, given that natural disasters had usually developed in line with the positive scenario. The member however expressed concerns that the possibility of the second scenario could not be ruled out, considering that the current virus outbreak affected the whole world and advanced countries in particular, and that it was the first virus pandemic. The member in this regard emphasized that, in addition to normal monetary policy responses in pursuit of price and macroeconomic stability, the central bank should also draw up response plans for crisis management to keep the financial system functioning in case of emergency.

The member expected that, looking at the real economy prior to determining the direction of monetary policy, the domestic economy would exhibit much slower growth of 0% at the highest this year, even under the positive scenario forecasting a rebound in the second half. The member stated that Korea’s output gap had been substantially negative last year due to the sluggishness of global trade, and went on to forecast that this year the domestic economy would see the largest negative output gap since 2000. The member’s assessment was that, considering the domestic economic growth trend, from a historical perspective the current real economic sluggishness could be seen as an economic crisis, and expressed concerns that aggregate demand might show an unusual decrease and a substantial number of businesses and small business owners might be exposed to a liquidity crisis owing to a drastic sales plunge.

Looking at inflation, the member noted that consumer price inflation had rebounded in January this year and then had been slowing again, and expected that both annual consumer price inflation and core inflation would be unlikely to exceed the lower-0% level, with the output gap forecast to be substantially negative this year. The member pointed out that the problem was that core inflation would continue to decline for a long period of time and that inflation expectations were highly likely to decline accordingly this year. The member mentioned that past declines in inflation had been mainly attributable to goods prices while service charges had shown relatively modest decreases, but this year service charges had been leading the decline in inflation. In this regard, the member expressed concerns that the fall in service charges, which was closely related with the livelihood of economic agents, could act as a larger shock causing inflation expectations to decline.

The member added that if an economic emergency led to a wage decrease, there was no small likelihood of downward wage rigidity weakening and the inflation trend entering a new phase.

In summary, the member stated that there was a risk of a temporary liquidity crisis due to an excessive economic slump and, in terms of inflation, there were concerns about inflation expectations declining and the inflation trend entering a new phase, and went on to argue that it would be appropriate in this regard to lower the Base Rate by 25 basis points to 0.50%.

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. Cho and Dr. Shin expressed clear opposition to keeping the Base Rate at the current level of 0.75% 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 0.75% for the intermeeting period.

☐ Based on currently available information the Board considers that the global economy has contracted significantly due to the COVID-19 pandemic. Volatility in global financial markets has increased sharply. Stock prices in major countries have fallen considerably while government bond yields and exchange rates have fluctuated widely, due to concerns of a recession and the sharp drop in global oil prices. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the pathway of the pandemic, as well as by national policy responses and their effects.

☐ The Board judges that economic growth in Korea has slowed considerably. Consumption has decreased substantially and the recovery in facilities investment has been subdued. The correction in construction investment has continued while exports have declined slightly. As for employment, the number of persons employed had continued to rise at a high rate until February, but the number of persons on temporary leave has increased due to the contraction in economic activity. GDP growth is projected to fall considerably below the February forecast of 2.1%, and uncertainties around the future path of GDP growth are also judged to be very high.

☐ Consumer price inflation has slowed to the 1% level due to slower growth in the prices of industrial products. Core inflation (excluding changes in food and energy prices from the CPI) has moved down slightly within the mid-0% range, and the inflation expectations of the general public have remained at the upper-1% level. It is forecast that consumer price inflation and core inflation will run considerably below the February projection (1.0% and 0.7%, respectively) due to the drop in global oil prices and weakening demand-side inflationary pressure.

☐ In domestic financial markets, stock prices have fallen sharply due to the spread of COVID-19 and heightened volatility in global financial markets. The Korean won to US dollar exchange rate rose steeply but then decreased after the establishment of a currency swap arrangement with the Federal Reserve, while long-term market interest rates have fluctuated around the lower-1% level. The rate of household loan growth has risen, while the rate of increase in housing prices has moderated since mid-March.

☐ The Board will continue to conduct monetary policy so as to ensure that the recovery of economic growth is sustained and consumer price inflation can be stabilized at the target level over a medium-term horizon, while paying attention to financial stability. In view of the mounting economic impact of the COVID-19 pandemic, the Board will conduct monetary policy in an accommodative manner in order to mitigate downside risks to the economy and ease volatility in financial markets. In this process it will judge whether to adjust the degree of monetary policy accommodation, while thoroughly assessing the severity of the COVID-19 outbreak, its impact on the domestic economy and financial markets, and changes in financial stability.