Minutes of the Monetary Policy Board Meeting

October 2020

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(October 2020)

Ⅰ. Outline

1. Date of meeting: Wednesday, October 14, 2020

2. Place: Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:
   Lee, Juyeol, Chairman (Bank of Korea Governor)
   Koh, Seung Beom
   Lim, Jiwon
   Cho, Yoon-Je
   Suh, Young Kyung
   Joo, Sangyong
   Lee, Seungheon (Senior Deputy Governor)

4. Monetary Policy Board members absent: none

5. Participants:
   Jang, Ho Hyun, Auditor
   Ryoo, Sangdai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Yang, Seok Jun, Director General of Reserve Management Group
   Kim, Woong, Director General of Research Department
   Min, Jwa Hong, Director General of Financial Stability Department
   Lee, Sang Hyeong, Director General of Monetary Policy Department
   Kim, Inkoo, Director General of Financial Markets Department
   Kim, Hyun Kee, Director General of International Department
   Shin, Woon, Director of BOK Economic Research Institute
   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:

Members' evaluation was that the domestic economy would show growth generally consistent with the previous forecast. Members expected exports to show a trend of improvement, thanks to economic recovery in major countries. Members, however, thought that the recovery in private consumption would be delayed owing to ongoing uncertainties related to COVID-19, despite the easing of social distancing rules. The majority of members stressed the need for selective support for vulnerable groups, noting that attention should be paid to the possibility of the domestic economy becoming less resilient if the deterioration in employment conditions becomes prolonged.

Members saw that, although consumer price inflation had risen at a slightly faster pace due to one-off factors such as rising agricultural product prices, demand-side inflationary pressures were still weak. One member presented the view that attention should be paid to the point that the recent fall in the USD/KRW exchange rate could have a considerable impact on consumer prices. In addition, another member noted that close attention should be devoted to the possibility that changes in the demographic structure were affecting the declining trend of core inflation.

Members noted that, although domestic and international financial and foreign exchange markets generally remained stable, it was necessary to be on the alert to the possibility of an accumulation of financial imbalances. Some members raised concerns about faster growth in household lending amid accommodative monetary and fiscal policy. Other members stressed that attention should be paid to the fact that growth in high-risk asset prices was exceeding the pace of improvement in the real economy, due to stronger yield-seeking behavior of economic agents in the current accommodative financial conditions.

Meanwhile, the majority of members expressed the opinion that, since the impacts of fiscal policy on financial markets and the real economy had become much greater, coordination with fiscal policy had to be considered in the conduct of monetary policy. They added that the Bank of Korea should determine its position and expressly state its

2) An English version of *Recent Economic Developments* is posted on the Bank of Korea website.

view concerning the new fiscal rules recently announced by the government and the controversy surrounding them.

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:

All members shared 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 the current level of 0.50%.

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

The member's evaluation was that, since the August meeting, financial markets had generally remained stable, while sluggish real economic conditions had persisted. Looking at the global economy first, the member noted that the Chinese economy was showing a trend of recovery, while the trends of improvement in the US, major European countries, and Japan were somewhat slowing. The member added that global trade sluggishness was easing, but at a slow pace.

As for the domestic real economy, the member saw that the export slump had been easing to some extent since August, but domestic demand was unlikely to show rapid recovery. The member noted that, first, although private consumption had recovered somewhat from mid-September, it was highly likely to respond sensitively to developments related to COVID-19, since sluggishness in face-to-face services was continuing. The member forecast that, although exports had reversed to an increase in September backed by an increase in the number of days worked, the future of exports would be heavily dependent upon the evolution of the global resurgence of the COVID-19 pandemic. With respect to employment, the member voiced concern that much of the hiring slump since the COVID-19 outbreak continued to be seen in self-employed businesses in the services sector, where business conditions were sluggish. Meanwhile, the member expected the upward trend of consumer prices, which had accelerated in September, to decelerate again in October due to the government support for telecommunications fees.

Taking all this into consideration, the member took the view that the recent real economic developments had remained close to the August outlook. The member presented the opinion that, despite expansionary policy by governments and central banks across the world, full-fledged recovery in the world economy would be highly unlikely until vaccines or treatments for COVID-19 were developed. The member also saw that the future recovery of the domestic economy was dependent upon how the

COVID-19 situation would develop. Therefore, the member stressed that, in order to buffer against excessive contraction in the real economy and ramp up recovery, there still was a need to maintain an accommodative monetary policy stance.

The member meanwhile raised the concern that, while domestic and international financial markets remained stable, household debt was continuing to show growth, despite the government's stronger macroprudential policy. The member noted that, although rising asset prices were commonly seen in major countries including the US and Europe since the outbreak of COVID-19, movements in asset markets should be closely monitored when setting monetary policy. The member commented that, for the moment, no major central banks were attempting to change the monetary policy stance to reflect the overconcentration of funds into asset markets. As for the reason behind this, the member pointed out that accommodative monetary policy was having even larger positive impacts, such as moderating the excessive contraction in the real economy and rapidly regaining stability in financial markets.

Finally, the member's evaluation was that the recent expansionary fiscal policy was influencing the implementation of monetary policy through the government bond market. The member saw that, since the government had signalled that it would implement an expansionary fiscal policy next year as well, a balanced mix of fiscal and monetary policy would become even more important. The member thus stressed that the Bank of Korea should maintain its independence as the central bank, while at the same time working hard to develop ways to strengthen cooperation with the government's policy measures.

The member expressed the view that taking all those points into consideration, it was desirable to maintain the Base Rate at the current level of 0.50%.

Another member expressed the opinion that it would be desirable to keep the Base Rate at the current level of 0.50%.

The member's evaluation was that the two Base Rate cuts and several measures to expand liquidity provision implemented since March had contributed greatly to regaining stability in domestic financial markets following the COVID-19 shock, and to preventing rapid contraction in the real economy.

The member noted that domestic financial markets were maintaining stability overall, with accommodative financial conditions continuing. The member added that foreign exchange supply and demand conditions appeared to remain seamless.

The member diagnosed that, despite some differences across countries, the global economy had been maintaining a trend of improvement since May, and accordingly, the Korea's export slump appeared to be easing. The member also noted that, while manufacturing production was gradually showing recovery, the trends of improvement in private consumption and services production had weakened, and employment also remained on the decline. The member assessed that, considering these points, the domestic economy did not appear to have emerged greatly from its overall sluggishness, despite its partial and moderate recovery.

The member's assessment was that, as the global spread of the COVID-19 pandemic was ongoing, external economic conditions remained highly uncertain. The member saw that the easing of social distancing rules taking effect this week was expected to have positive effects on the recovery of the domestic economy, but expected uncertainties surrounding the growth path to remain high.

The member presented the opinion that, taking all those points into consideration, it was necessary to support improvement in the real economy by maintaining the current accommodative monetary policy stance. The member thus judged that it would be appropriate to keep the Base Rate at the current level of 0.50%.

One member presented the view that it would be desirable to keep the Base Rate at the current level of 0.50%.

The member's assessment was that the domestic economy was showing a trend of moderate recovery. Specifically, the member noted that the trend of improvement in private consumption had weakened due to stronger social distancing rules following the resurgence of COVID-19, and the recovery in facilities investment had been subdued, particularly in the non-IT sector. The member, meanwhile, commented that export sluggishness had been easing gradually, thanks for instance to recovery in the Chinese economy. With respect to prices, the member added that consumer price inflation had risen to 1.0% in September due to a faster rise in agricultural, livestock, and fisheries product prices, and core inflation had also risen slightly to 0.6%. The member saw that, despite some differences across sectors, the recent economic and price trends had generally not diverged significantly from the paths projected in August.

The member diagnosed that, despite ongoing uncertainties related to COVID-19 conditions at home and abroad, it seemed unlikely that the pessimistic scenario laid out in the August forecast would materialize. The member explained that this was because the export slump had gradually been easing, and, on the domestic demand side, the effects of the accommodative monetary and fiscal policy measures taken so far were expected to continually rein in the negative impacts of COVID-19 and drive a recovery in demand from households and corporations.

Looking at financial conditions, the member noted that, although market volatility had expanded to some extent of rate, market interest rates were generally fluctuating at an accommodative level and stock prices had rebounded after a significant correction. The member added that, although the USD/KRW exchange rate had fallen rapidly in the belated reflection of the sharp weakening of the US dollar, this was understood to reflect the relative stability of the domestic economy. The member's evaluation was that the easing of the monetary policy stance, including Base Rate cuts, was seamlessly feeding through to the entire financial markets, and was considerably moderating the negative impacts of COVID-19 on the real economy.

The member, meanwhile, expected the expansionary stance to strengthen further on the fiscal side. The member, however, stressed that attention should be devoted to the accumulation of the risk of financial imbalances, such as expanded household lending growth, in the course of implementing accommodative monetary and fiscal policy.

Taking all this into consideration, the member expressed the view that it would be desirable to hold the Base Rate at its current level of 0.50% and to closely monitor changes in macroeconomic trends and financial stability conditions in line with the future developments of the COVID-19 pandemic.

Meanwhile, one member presented the view that it would be desirable to keep the Base Rate unchanged from the current 0.50%.

Looking at economic conditions at home and abroad, the member noted that the world economy remained sluggish overall but was showing some improvement. The member assessed that, despite the continued spread of COVID-19, advanced economies had been recovering somewhat, centering around commodity consumption, boosted by accommodative financial and fiscal policies. In terms of the domestic economy, the member forecast that it would overall remain at the level forecast in August, as consumption had been sluggish affected largely by the resurgence of COVID-19, although exports to Korea's major trading counterparts such as the US and China had been recovering. However, the member estimated that, since the recent domestic economic recovery had been led by exports and investment in some IT sectors, its trickle-down effects on household income and employment were limited. With regard to employment, in particular, the member pointed out that it remained sluggish, with the number of workers on temporary leave rising again significantly, and the number of persons employed continuing to exhibit a sharp decline, particularly in vulnerable groups including temporary workers, day laborers, and small business owners. The member expressed concerns that this could have aggravated the structural imbalances of the domestic economy and weakened its resilience. Meanwhile, the member forecast that inflation would remain low at the 0% level, influenced chiefly by low demand pressures and government policies.

The member assessed that the gap between financial and real economic conditions was not narrowing, since the real economy was showing a very modest recovery while asset prices and credit to the private sector maintained strong growth. The member mentioned that it is somewhat inevitable for exogenous shocks such as COVID-19 to bring about trade-offs between the real economy and financial stability, and that an accommodative monetary policy stance was needed with priority placed on achieving real economic recovery, even if this stance gave rise to some financial imbalances. However, the member presented the view that additional easing would be unnecessary, considering possible improvement in domestic demand following the recent easing of social distancing measures, concerns about an increase in foreign bond investment fund outflows, and a rise in economy-wide leverage.

The member in this regard emphasized the need to keep the Base Rate at its current level for the time being and monitor the transmission of monetary policy, while strengthening coordination with various policy measures. First, as for fiscal expenditure, the member noted that it would be necessary to examine various funding measures in addition to Treasury bond issuance, as the need to respond to the pandemic was compounded by structural factors such as the increased demand for welfare services. The member also took the view that stronger efforts were needed to focus on spending on sectors with large fiscal multiplier effects and to rationalize the expenditure structure. In addition, the member stressed that the government and regulatory authorities should implement macroeconomic and housing policies consistently in order to promote housing market stability and manage household debt in a stable manner.

The member meanwhile expressed the opinion that it would be necessary to closely examine the effectiveness of the current methodology for measuring inflation indicators during the year-end review aimed at improving the operation of the inflation targeting regime, and also to pay more attention to the results of the recent overhauls of monetary policy frameworks in major countries.

Another member presented the view that it would be appropriate to keep the Base Rate at the current level of 0.50%.

The member evaluated that the global economy had been picking up at a faster-than-expected pace, boosted by the recovery of consumption in advanced countries and China's increased investment. The member stated that the decrease in global goods trade had not been as large as previously forecast and Korea's exports would accordingly recover faster than originally expected. On the other hand, the member mentioned that, although downside risks had eased somewhat following the recent relaxing of social-distancing measures, domestic demand was unlikely to exhibit a strong recovery due to the lingering possibility of the resurgence of COVID-19.

The member's evaluation was that prices had been recently showing only a weak rebound, merely shaking off deflation risk. The member argued that core inflation would run at the lower-0% range this year and remain well under the target of 2% next year as well, and in this regard, the accommodative monetary policy stance should be maintained for some time.

The member expressed the view that, while some had called for particular attention to financial stability due to housing price rises and household debt growth, the focus of monetary policy should be placed on inflation and economic recovery when the real economy is hit by a large demand-side shock. The member noted that, although stabilizing asset prices was one of the considerations taken into account in conducting monetary policy, monetary policy affected the economy as a whole and therefore cost-benefit trade-offs should be closely examined. The member added that, since the current crisis had not arisen from any defects accumulated in the economic and financial systems, a lack of financial system resilience would not act as an obstacle to the economic recovery.

Looking at the housing market, the member stated that housing prices continued to exhibit modest growth, but demand for housing investment was expected to go through a correction and slow gradually due to the strengthening of the housing-related tax and lending systems. The member emphasized that, although housing prices are sensitive to interest rates, it would be necessary to clearly understand that household purchasing power was much more important. Meanwhile, the member argued that, since the housing price rises over the last two to three years were not unrelated to the concentration of population and economic clout in Seoul and its surrounding areas, housing-related policies should be addressed from a long-term perspective and as part of balanced regional development policy.

The member pointed out that the pandemic would end someday, but even if the crisis is controlled, the problems faced by the domestic economy — employment sluggishness, the population decline and aging, and worsening income distribution — would not go away. The member stressed that, regardless of the current crisis, Korea's potential growth rate had shown a downward trend, and the monetary authorities should pay close attention to the decline in the real neutral interest rate resulting from the fall in the potential growth rate. The member also presented the view that the limitations of monetary policy focused on short-term interest rates under these conditions should be acknowledged. The member went on to argue that it would be necessary to examine the effectiveness of non-interest-rate monetary policy instruments that had been introduced in the course of coping with the current crisis, while remaining open to the use of other unconventional policy tools.

With all the above taken into consideration, the member expressed the view that there was currently no need to adjust the monetary policy stance preemptively, and it would be therefore desirable to keep the Base Rate at the current level for the intermeeting period.

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

The member assessed the global economy as having emerged from the severe economic recession and as continuing to show a moderate recovery. The member pointed out that, although the growth rates of major countries had soared in the third quarter, their economies seemed to be improving at an increasingly slow pace. Above all, the member's judgment was that uncertainty surrounding the future recovery path remained high, as measures to combat COVID-19 could be strengthened again and there were various geopolitical risks.

Looking at the domestic economy, the member evaluated that the trend of its improvement had been slowing somewhat due to the strengthening of social-distancing measures from mid-August until recently. The member however expressed the view that, since the negative impacts from the resurgence of the pandemic had been largely confined to face-to-face consumption and non-face-to-face consumption and exports had remained relatively favorable, downside risks to the economic outlook did not seem to have increased further.

The member mentioned that, since the ongoing global economic recession had been caused by a healthcare issue, not an internal economic problem, overall economic developments had been different from normal cyclical fluctuations, with the most noteworthy points being the sluggishness of the services sector and the differentiation in business conditions among industries. The member explained that production adjustments in the manufacturing sector normally acted as a major factor behind global economic fluctuations while the services sector was relatively stable with a lag, but since the outbreak of COVID-19, economic activities in the services sector had also declined significantly, worsening the economic recession. The member went on to state that, as consumption behavior had been changing due to the social-distancing measures, the correlation of individual industries with economic conditions had weakened and the recovery path had differed significantly from sector to sector. The member expected that, although manufacturing production had rebounded since the third quarter and the business climate had been partly improving, it would take substantial time for this trend, coupled with demand conditions, to spread to all industries including the face-to-face services sector. The member noted that the widening gap between business conditions of individual industries and sectors since the outbreak of COVID-19 pointed to the continued need to selectively support damaged sectors in the conduct of macroeconomic policy.

The member meanwhile pointed out that, as financial conditions had loosened and economic agents' yield-seeking behavior had continued to strengthen, growth in high-risk asset prices had been significantly outpacing improvement in the real economy. The member noted that this was in stark contrast with the usual pattern where asset price rises during an economic recovery phase were sequentially observed from low-risk to high-risk product groups in line with real economic improvement. The member thus emphasized that close monitoring would be needed. The member emphasized that, despite having some positive impacts, asset price rises that are extremely rapid or that stimulate household debt heighten financial vulnerability and limit the medium- and long-term growth paths, adding that a longer-than-expected delay in economic recovery could cause drastic asset price adjustments, leading to a rapid contraction of financial conditions. The member went on to stress that continued vigilance and policy preparations were required in this regard.

Taking all this into consideration, the member judged that at this point it was necessary to keep the Base Rate at its current level of 0.50% while continuing to examine the need for selective support for damaged sectors as well as market stabilization measures.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of the above discussions, the following Monetary Policy Decision statement was compiled. All MPB members supported the decision unanimously.

Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 0.50% for the intermeeting period.

☐ Currently available information suggests that the global economy has continued to recover from its earlier sluggishness, but the pace of recovery has slowed due to a resurgence of COVID-19 and measures taken to contain it. In global financial markets, major asset price variables including stock prices and bond yields have fluctuated considerably, due to concerns about a resurgence of the coronavirus and changes in expectations about economic stimulus in major countries. Looking ahead, the Board sees global economic growth and global financial markets as likely to be affected largely by the evolution of the pandemic, as well as by the effects of national policy responses.

☐ The Korean economy has continued to recover, albeit at a slow pace. Although the slump in exports has eased, gains in private consumption have been tepid as the number of newly confirmed cases increased again. The recovery in facilities investment has been subdued, and the correction in construction investment has continued. Labor market conditions have remained weak, with the number of persons employed continuing to decline sharply compared to the corresponding period last year. Going forward, the economy is likely to recover gradually, led mainly by exports. However, uncertainties surrounding the economic outlook are judged to remain elevated. GDP growth is projected to be generally consistent with the August forecast of -1.3%.

☐ Consumer price inflation has risen to around 1%, driven mainly by a large increase in the prices of agricultural, livestock and fisheries products due to severe weather conditions. Core inflation (excluding changes in food and energy prices from the CPI) has also increased slightly within the mid-0% range, and the inflation expectations of the general public have risen to near 2%. It is forecast that consumer price inflation and core inflation will run at the low- to mid-0% level for some time, reflecting various effects such as the drop in global oil prices and weak demand-side inflationary pressures.

☐ In domestic financial markets, the Korean won to US dollar exchange rate has fallen sharply, while long-term market interest rates and stock prices have fluctuated considerably, affected by various factors such as global financial market movements. Household loan growth has picked up and housing prices have continued to increase at high rates in all parts of the country.

☐ The Board will continue to conduct monetary policy in order to support the economy and stabilize consumer price inflation at the target level over a medium-term horizon, while paying attention to financial stability. As the recovery in the Korean economy is expected to be slow and inflationary pressures on the demand-side are forecast to remain weak due to the COVID-19 pandemic, the Board will maintain its accommodative monetary policy stance. In this process it will thoroughly assess the severity of the resurgence of COVID-19, the impact on the economy and financial markets here and abroad, changes in financial stability, and the effects of the policy measures taken in response to the pandemic.