Minutes of the Monetary Policy Board Meeting

May 31, 2019

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(May 2019)

Ⅰ. Outline

1. Date of meeting: Friday, May 31, 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, Sang Dai, Deputy Governor
   Chung, Kyuil, 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
   Park, Jongseok, Director General of Monetary Policy Department
   Lee, Sang Hyeong, Director General of Financial Markets Department
   Lee, Seung Heon, Director General of International Department
   Kim, Hyun Kee, Press Officer
   Chae Byung Deuk, Director General of Monetary Policy Board Secretariat
   Sung, Kwang Jin, Head of MPB Team

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

Ⅱ. Summary of Discussions on the Current Economic Situation

After briefings by staff on *Recent Economic Developments,*[2] *FX and International Finance Trends*, and *Financial Market Trends*, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

Members evaluated that, looking at the global economy, major countries had shown stronger-than-expected growth in the first quarter, but underlying growth had continued to exhibit a slowing trend, and trade growth had also slowed. As for the global financial markets, members judged that, as risk aversion had increased, due for instance to the escalation of the US-China trade dispute, stock prices had fallen and the currencies of emerging economies had depreciated.

Concerning the domestic economy, members' evaluation was that private consumption had continued to grow albeit slowly, although facilities and construction investment had continued to undergo adjustments and exports had remained sluggish. Members expected growth to rebound, aided by the pickup in the government sector in the second quarter, although the growth trend had been sluggish in the first quarter. Members, however, saw that uncertainties concerning the forecast path had risen, due chiefly to the escalation of the US-China trade dispute.

Concerning inflation, members saw that consumer price inflation had remained low, running below 1%, due to the combined effects of structural and cyclical factors. Members saw that there were some upside risks such as the exchange rate and international oil prices. Members, however, assessed the downside risks to the projected path of inflation to have increased somewhat, given the recent inflation trend as well as the government's social-welfare policies and its policy measures to stabilize people's livelihoods.

Finally, as to the domestic financial markets, members saw that market interest rates had fallen significantly and the stock market had been sluggish, but credit market funding conditions had remained stable. Members, meanwhile, noted that household debt had been continuing to show slower growth, but a significant number of apartments were scheduled to be available for sale and to be newly occupied. Members, thus, found the need to keep a close watch on the risk of financial imbalances.

Ⅲ. Discussions Concerning Monetary Policy Decision (Summary)

The main details of the MPB members' discussions concerning a change in the Bank of Korea

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

Base Rate were as follows:

Most 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 1.75% for the intermeeting period.

One member stated that it would be appropriate to keep the Base Rate at its current level for the intermeeting period, despite concerns about weakening inflation expectations, as it was desirable to sustain the current accommodative monetary policy stance given the expansionary fiscal policy, which was being pursued in consideration of a number of structural problems and the current policy operating conditions.

The member noted that, since last monetary policy decision meeting, inflation had remained in the mid-0% range and some indicators of inflation expectations had been responding to this. In addition, the member expressed the view that downside risks to external conditions looked to have expanded and the trend of domestic growth to have weakened, but more accurate assessments could be made using the relevant indicators in the second quarter.

The member found that price inflation in Korea had fallen to a low level compared to those in major countries because the negative contribution of administered prices had continued and the effects from oil price movements had been asymmetric. The member, however, added that a trend of decline, albeit moderate, in prices of personal services with administered prices excluded implied a possible weakening of pressures on the demand side. The member evaluated that the weakening of demand-side pressures was attributable to a decline in the potential growth rate to the mid-2% range or lower. The member noted that significant changes had been seen in the Korean economy, including a rapid rebalancing of the economic structure toward domestic demand-driven economy and an acceleration of population aging. Against this backdrop, the member assessed that adjustments to over-investment in construction and a delay in facilities investment related to the IT sector were increasing downward pressures on the economy. Concerning private consumption, however, the member saw the need to monitor the relevant developments a bit longer, but assessed it to have continued its steady growth in the first quarter as well, given base effects related to the Pyeongchang Winter Olympics and the irregular execution of government spending at the beginning of the year.

The member mentioned that, although financial imbalances had been narrowing, they were still wider than those of other countries. The member judged that, despite ample liquidity, demand for funds to expand production capacities was not great, due to the weakening of the virtuous circle of the economy. The member expressed the need to take action under a broad framework of structural reforms, including macroprudential policy as well as a mix of fiscal and monetary policies, in an effort to increase the potential growth rate and to ease downside pressures on the economy. The member noted that, if demand was stimulated through monetary policy alone without these efforts, the buildup of financial imbalances, along with inflation, could accelerate in another way, thus possibly incurring social costs.

The member expected that fiscal policy would contribute considerably to economic recovery, due to a large year-on-year increase in the managed fiscal deficit. The member also expected selective support for vulnerable groups to increase. The member judged that a policy response to minimize the negative side effects of macroeconomic policy would be a combination of maintaining the current accommodative monetary policy stance and, in terms of fiscal policy, ensuring timely execution of this year's budget. The member, however, stressed the need to keep a close eye on the developments in the domestic economy, as downside risks to external conditions had increased, as exemplified by the delayed recovery of the global IT-related cycle and the continuation of the US-China trade dispute. The member added that, while considering whether to adjust the macroeconomic policy stance in accordance with changes in relevant conditions, efforts should also be made to seek various policy measures to enhance the efficiency of monetary policy and reduce its adverse effects.

Another member took the view that it would be desirable to keep the Base Rate unchanged at the current meeting, while continuing to examine the development of external risks, such as the US-China trade dispute, and continuing to monitor whether the trend of growth in the domestic economy would recover.

The member's assessment was that, with respect to the global economy, the downside risks to growth had been increasing since the April forecast. The member commented that, as the US-China trade negotiations had unexpectedly failed to find a way to reach an agreement, the economies of the two countries had become unstable and concerns about the negative impacts on the economies of other countries had grown. The member added that, with political uncertainties such as Brexit serving as downside risks to the European economy, world trade growth was slowing. The member saw that, in the international financial markets, price variables, such as interest rates, stock prices and exchange rates, were showing instability. As market volatility was highly likely to heighten for some time, the member judged that thorough preparations were needed.

Concerning the domestic economy, the member noted that negative growth had been recorded in the first quarter due to a decrease in the contribution of the government sector. The member also saw that, up until recently, adjustments to facilities and construction investment had continued and exports had remained mired in a slump. The member commented that the Bank of Korea's baseline forecast was that from the latter half of this year, exports and facilities investment would rebound along with a recovery in the semiconductor sector and a resolution of the US-China conflict. The member, however, pointed out that there was also a concern that the intensity of the economic recovery would be weaker than expected. The member noted that employment growth had slowed somewhat in April, but expected employment to improve compared to the original forecast on an annual basis. The member stated that it was necessary to pay continued attention to the deterioration in employment conditions in the manufacturing sector, and to the employment situations in the wholesale & retail and lodging & restaurants sectors. Given these points, the member stated that it had become more important to judge if the Korean economy would recover in the second half of this year in line with the Bank's forecast. The member thus emphasized the need to closely observe growth in the second quarter and make an accurate forecast of second-half growth.

The member noted that consumer price inflation had remained lower than previously forecast. The member stated that this was undoubtedly due to a combination of structural and cyclical factors, but added that, since the economy was sustaining a negative output gap, it was necessary to maintain an accommodative monetary policy.

The member noted that, on the financial stability side, household debt growth was slowing, due mainly to strong government household debt measures, and market interest rates had been declining greatly in the financial markets, while there was a slump in the stock market. The member, however, judged the funding conditions in the credit market to have remained stable. Noting the recently heightened synchronization between the Korean won and the Chinese yuan, the member emphasized that it was necessary to closely monitor developments in the financial and foreign exchange markets through which the impacts of the US-China trade conflict on the real economy could be amplified.

One other member took the view that, since domestic and international economic conditions were not favorable and downside risks to the economy had been materializing, it was desirable to cut the Base Rate by 0.25 percentage points at the current meeting to buffer against the slowdowns in price inflation and business activity in the private sector.

The member saw that, with respect to the domestic economy, the adjustment to construction investment had been sustained and the declines in exports and facilities investment were continuing. Accordingly, the member's assessment was that economic activity generally had weakened and growth in private consumption was gradually slowing. The member judged that overall growth had been fluctuating in accordance with the degree of the growth contribution of the government sector, with growth in the private sector being almost at a standstill since the fourth quarter of last year. The member took the view that, looking at biannual statistics, the slowdown in the Korean economy had become more evident since last year. The member expected that economic growth for the first half of this year was unlikely to rise well above 2%, even with a possible rebound in the second quarter. The member added that the downturn in the nominal growth rate had been steeper, and there was a growing possibility that it would fall to the 1% level, falling below the real economic growth rate in the first half of this year.

The member judged that future economic conditions would not be favorable. The member commented that, amid the ongoing slowdown in the global economy, exports had not been showing any sign of recovery, and it had become more difficult to expect a recovery in exports in the immediate future, due to recently growing uncertainties surrounding the US-China trade dispute. The member added that it was also difficult to expect a significant rebound in private consumption due to ongoing employment sluggishness and the slowing pace of increase in household income. The member expected increased fiscal spending to serve as a partial buffer against the trend of economic downturn. The member, however, took the view that it was uncertain whether such an increase would lead to a rebound in private-sector activity.

The member, meanwhile, noted that consumer price inflation was decelerating further to the mid-0% range, in line with the contraction in economic activity. The member took the view that the decline to the lower-1% level of core inflation with “prices of administered items” excluded, in particular, implied that the recent slowing of inflation was not attributable to one-off disturbances. The member commented that if the current economic downturn continued, underlying inflation could run well below its target for a long time. The member went on to voice a concern that this could undermine the credibility of the inflation targeting regime, thus greatly hampering future monetary policy.

With the aforementioned economic conditions taken into consideration, the member expressed the view that it would be desirable to cut the Base Rate from 1.75% to 1.50%. The member noted that, at this time, the Research Department’s April forecast looked to have significant downside risks, and even if the forecast materialized, it was still difficult to see the Base Rate of 1.50% as low relative to economic fundamentals. The member went on to note that any delay in changing the Base Rate, on the other hand, would lead to accumulated economic and social losses stemming from increased idle resources. The member added that policy measures to enhance macroprudential stability, including the DSR regulations, should be implemented in a consistent and steady manner going forward, since they could gradually reduce potential risks to the financial markets stemming from household debt.

One member, meanwhile, presented the view that although downside risks to the growth forecast had increased, it would be desirable to keep the Base Rate at its current level and take time to examine changes in domestic and external conditions, as growth and inflation were expected to improve gradually.

Looking at the recent changes in domestic and external conditions, the member assessed downside risks to the growth and price paths as having increased somewhat from the April forecast. The member mentioned that global economic and trade growth had been slowing, the US-China trade dispute had intensified unexpectedly, and there were concerns that semiconductor demand might pick up later than expected. The member also expressed the view that, with the risk aversion tendencies in the domestic and overseas financial markets having strengthened, stock prices had fallen and EME currencies including the Korean won had weakened, and as a result, household and corporate economic sentiment had weakened. On the other hand, however, the member noted that major international organizations forecast next year's global economic and trade growth rates to be much higher than this year's and that the prevailing forecast was that the US-China trade dispute would be resolved in some way, although there were concerns about its prolongation. The member stated that the volume of semiconductor exports had been showing faster growth, demand for DRAM chips was likely to increase gradually, and government fiscal spending, having been sluggish in the first quarter, had been growing centering around investment, and the member expected the growth contribution of the government sector to rise. The member mentioned that this forecast implied that the factors that had negatively affected the domestic economy in the first quarter would not do so or would even positively affect the Korean economy going forward.

As for the price path, the member's assessment was that, although factors such as the government's welfare policies would act as downside risks, there were upside risks as well, such as global oil prices and exchange rates, and the member forecast consumer price inflation to rise gradually to run in the low- to mid-1% range in the second half of this year. The member also noted that, although consumer price inflation remained low, the general public's inflation perceptions and expectations were seen to be slightly higher than the 2% target.

Taking into overall consideration the above-mentioned factors, the member took the view that it would be desirable to keep the Base Rate at its current level and monitor how domestic and external conditions would change, since growth and inflation were highly likely to show upward movement as forecast in April this year, despite downside risks. The member also mentioned that continued attention to the risk of financial imbalances was needed, since bank lending to households had expanded somewhat in April and May and a substantial number of apartments were scheduled to be available for sale and to be newly occupied, although household debt growth had significantly slowed recently.

Another member took the view that it would be appropriate to keep the Base Rate unchanged at this meeting and keep an eye on the related developments, since uncertainties surrounding the future growth path had mounted and caution about heightening volatility in domestic and overseas financial markets was needed.

The member assessed that the global economy had achieved better-than-expected growth in the first quarter, particularly in major countries, but this growth was unlikely to be sustained as improvement in the growth rate had been mostly seen in non-manufacturing sectors and one-off factors had made a substantial contribution. The member also judged that uncertainties surrounding the medium- to long-term growth path had increased, with the US-China trade conflict further worsening and financial market volatility heightening. The member stated that risk aversion was spreading at a modest pace thanks to major countries' policy responses to potential downside risks, but expressed concern that if the trade conflict were to be prolonged going forward, corporate investment would remain sluggish due to uncertainties, substantially limiting global trade and manufacturing activities.

The member mentioned that there were growing concerns in the financial markets about the possibility of economic downturn, as Korea’s GDP growth had shifted to negative in the first quarter of this year and destabilizing external factors had emerged. However, since the decline in GDP in the first quarter had been attributable substantially to the volatility of the contribution of the government sector, the member expected a substantial rebound of the growth rate in the second quarter, considering fiscal plans for this year and fiscal spending to date. In addition, the member forecast the growth contribution of the private sector to increase somewhat, as the export volume was shifting to modest growth and the sluggishness of the manufacturing sector was showing signs of easing somewhat. However, with the US-China trade dispute escalating again and consumer and corporate sentiment shrinking, the member judged that the uncertainty of the growth forecast for the second half and onwards had increased even further.

Meanwhile, the member found it noteworthy that the economic slowdown had been attributable partly to structural factors. The member’s evaluation was that, on the external side, trade protectionism had been causing changes to the world trade order and global value chains, dampening intra-regional trade and increasing production costs. On the domestic front, the member expressed the view that, as the working-age population had been decreasing and labor market-related institutional arrangements had been changing, it would be necessary to enhance productivity and improve the economic activity participation rate to maintain the growth potential. The member added that, since domestic and overseas economic conditions were undergoing rapid structural changes, a more careful approach should be adopted with respect to the estimation of the potential growth rate and the output gap.

The member noted that consumer price inflation, although having remained at a low level in April as well, had increased slightly, and expected that the easing of supply-side downward pressures would last for some time, boosting inflation even further. The member added that this forecast was also supported by the fact that increase in inflation indicators not heavily affected by supply-side factors, such as the price index of items sensitive to business cycles, had continued to outpace consumer price inflation.

Looking at the financial conditions, the member noted that volatility in domestic and overseas financial markets had increased significantly with the US-China trade dispute deteriorating again. The member presented the view that there was only a limited possibility of sudden capital outflows, with external soundness indicators remaining favorable, but attention should be paid to the gradual decline in the current account surplus amid high external uncertainties. The member also commented that the risk of the accumulation of financial imbalances should be monitored carefully, as there were strong demand for household loans in line with the increased number of apartments scheduled for sale and occupation.

One other member argued that, although there was a need for a Base Rate cut given the increased downside risks to the growth path and the sluggishness of inflation, it would be desirable to keep the Base Rate unchanged for the intermeeting period, as it would be advisable to signal a change in the policy stance in advance.

With respect to the real economy, the member noted that on the external side conditions were becoming worse as the global economy had continued to decelerate and the US-China trade dispute had been escalating, and on the domestic side there was a growing likelihood of growth slowing even further with the first-quarter growth rate coming in below the original forecast.

The member judged that the US and eurozone economies had exhibited higher-than-expected growth in the first quarter, but looking at the underlying trends, the US economy had been slowing gradually and the eurozone economy had remained sluggish. The member expressed concerns that the US-China trade dispute had been intensifying while the global goods trade volume had not been showing any sign of rebound after its plunge in the fourth quarter of last year, adding to the risk that global trade would remain lackluster this year.

The member noted that Korea's exports and investment had been undergoing adjustments since the end of last year, in reflection of the global economic trend, and household consumption had also exhibited slowing growth since the second half of last year. The member's evaluation was that the economy had been expected to slow this year, due largely to the negative effects of declining semiconductor prices, but the −0.34% GDP growth rate during the first quarter had been worse than expected. The member judged that it would be difficult to view the growth path of the domestic economy as consistent with the Bank of Korea's April forecast of 2.5%, considering that no clear improvement had been seen in indicator trends and external conditions had been deteriorating with the escalation of the US-China trade dispute.

With regard to inflation remaining low, the member's assessment was that, even if the recent weakening of the Korean won worked to increase inflation, there was a growing likelihood of this year's inflation coming in below 1%, considering the inflation trend so far. More specifically, the member noted that the remarkable sluggishness in the domestically-generated inflationary pressure indicator and in the price growth of items sensitive to the business cycle implied that the sluggishness of aggregate demand-pull pressures had been driving the slowdown in inflation.

In terms of financial stability, meanwhile, the member evaluated that housing prices had remained on a downward path and household debt growth had continued to slow. More specifically, the member's judgment was that group loans and individual mortgage loans had remained stable, but banks' leasehold deposit loans had maintained strong growth similar to last year, leading total household loan growth. In terms of leasehold deposit loans, the member presented the view that, since there were policy factors causing increases, such as the exemption from DSR regulations and guarantees by housing guarantee companies, if household debt should be stabilized further, it should be done through macroprudential policy, not monetary policy.

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. Dongchul Cho expressed clear opposition to the idea of keeping the Base Rate at its current level and argued for cutting it by 0.25 percentage points. Dr. Inseok Shin agreed with keeping the Base Rate unchanged from its current level, but disagreed with the phrase in the Monetary Policy Decision stating that “the domestic economy will continue to grow at a rate that does not diverge significantly from its potential level.”

Monetary Policy Decision

□ The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 1.75% for the intermeeting period.

□ Based on currently available information the Board considers that the pace of global economic growth has continued to slow. Volatility in the global financial markets has increased. Government bond yields and stock prices in major countries have fallen while the currencies of emerging economies have depreciated, in line mainly with the escalation of the US-China trade dispute and the sluggishness of economic indicators in major countries. 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 domestic economy has recovered slightly from its slowdown in the 1st quarter, as consumption has continued to grow albeit slowly, although facilities and construction investment have continued undergoing adjustments and exports have been sluggish. On the employment front, the increase in the number of persons employed has lessened while the unemployment rate has increased. Going forward the Board expects the domestic economy will grow at a rate that does not diverge significantly from the path projected in April. Consumption will continue to grow, while exports and facilities investment will also recover gradually in the second half of this year, although the adjustment in construction investment will continue. However, uncertainties concerning the forecast path have risen, chiefly due to the escalation of the US-China trade dispute.

☐ Consumer price inflation has slightly risen within the mid-0% range, in consequence mainly of the smaller decline in petroleum product prices. Core inflation (with food and energy product prices excluded from the CPI) has been at the upper-0% level, and the rate of inflation expected by the general public has been at the low-2% level. Looking ahead, it is forecast that consumer price inflation will fluctuate for some time below 1% and then run at the low- to mid-1% level from the second half of this year, but downside risks to the projected path have increased somewhat. Core inflation will also gradually rise.

☐ The volatility of price variables in the domestic financial markets has increased, in line mainly with movements in the international financial markets and concerns about economic slowdowns at home and abroad. Long-term market interest rates and stock prices have fallen significantly while the Korean won-US dollar exchange rate has risen considerably. The rate of increase in household lending has continued to slow, while housing prices have continued their downtrend.

☐ 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 the domestic economy will continue to grow at a rate that does not diverge significantly from its potential level and it is forecast that inflationary pressures on the demand side will not be high, the Board will maintain its accommodative monetary policy stance. In this process it will carefully monitor developments such as the US-China trade dispute, any changes in the economies and monetary policies of major countries, financial and economic conditions in emerging market economies, the trend of increase in household debt, and geopolitical risks, while examining their effects on domestic growth and inflation.