Minutes of the Monetary Policy Board Meeting

October 16, 2019

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(October 2019)

Ⅰ. Outline

1. Date of meeting: Wednesday, October 16, 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
   Chung, Kyuil, 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
   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

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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 assessed that, looking at the global economy, economic slumps in major countries had worsened due to the growing negative spillover effects of the global trade slowdown, and concerns about downside risks to the global economy had been gradually increasing accordingly. Members evaluated that, in this regard, the US Federal Reserve and major central banks had strengthened their accommodative monetary policy stances.

Concerning the domestic economy, members' evaluation was that the sluggishness in exports and facilities investment had continued and private consumption growth had slowed slightly. Members also judged that the sustained effects from worsening external conditions had increased the possibility of the growth rate for this year falling short of the BOK's July forecast. Some members expressed the view that, without a recovery in private demand, the economy would remain sluggish for a longer period of time than originally expected.

With regard to consumer prices, members saw that inflation had temporarily recorded a negative figure, amid modest demand-side inflationary pressures combined with the effects of government policies and the base effect from last year's surge in agricultural, livestock and fisheries product prices. Some members mentioned that core inflation and other inflation indicators reflecting demand-side inflationary pressures had declined to the lower-1% level, and took the view that attention should be paid to the possibility that the fall in underlying inflation could affect inflation expectations.

Finally, as to household debt, members saw that its growth had slowed owing chiefly to government measures, but judged that attention should be paid to the accelerated rise in unsecured household loans amid the recent hike in housing prices in some regions.

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 lower the Base Rate by 25 basis points at this meeting, while some members called for keeping it at its current level.

One member presented the view that it would be desirable to cut the Base Rate by 25 basis points to 1.25%.

The member saw that the global trade slowdown, which was causing simultaneous slumps in major economies, had recently been worsening and was lasting longer than expected. The member also pointed out that the negative impacts of global trade sluggishness had been increasing, particularly in countries heavily dependent on trade. The member expressed concerns that, as China's economic indicators had recently been deteriorating even further, it was difficult to rule out the possibility that the global economic slump affected by trade sluggishness could be amplified by the Chinese economic slowdown.

The member judged that, as the global economic environment had been deteriorating further, Korea's export slump had also been worsening. The member also noted that, in terms of domestic demand, facilities investment, which is closely related to exports, had remained lackluster and private consumption growth had also remained stagnant at a low level or had even slowed slightly. The member assessed that, in overall evaluation of recent domestic economic developments and the trend of the environment surrounding the domestic economy, the growth rate for this year was increasingly likely to fall below the Research Department's July forecast and the risk of the current economic slump being prolonged had risen.

Looking at prices, the member mentioned that consumer price inflation and core inflation had both fallen to the 0% level and that growth both in domestically generated inflationary pressure indicators with administered prices counted out and in prices of items sensitive to business cycles had recently slowed to the lower-1% level. The member expressed concerns that, although inflation in Korea had been expected to remain low throughout this year, the recent sluggishness of the real economy, inflation, and ultimately the entire economy was increasingly likely to be prolonged. The member argued that, while inflation had remained short of its target since 2013, core inflation had declined to the 0% level this year, entering a new phase of sluggishness. The member pointed out that, although public attention had been focused on the recent first-ever recording of negative consumer price inflation, it would be necessary to pay more attention to the steady decline in core inflation, which is seen to better reflect demand-side inflationary pressures and to be linked to inflation expectations in a more stable manner. The member stated that this sustained and rapid decline in core inflation was unusual, and went on to stress that, since it increased the likelihood of a divergence of inflation expectations from the target, aggressive measures should be taken to manage inflation expectations, which is the ultimate goal of monetary policy.

Looking at current economic conditions in terms of the neutral interest rate, the member judged that, with the potential growth rate continuing to decline, the global trade slowdown had been acting as a shock pulling down the real neutral interest rate. The member's assessment was that, although the accommodative fiscal policy had been acting as a buffer against the real neutral interest rate decline, this would have only a limited effect, considering the sluggish income and inflation indicators. The member added that the fall in the nominal neutral interest rate could be greater due to the sluggish inflation. The member evaluated that, in overall consideration of the above, the current level of the Base Rate could be hardly seen as representing an accommodative monetary policy, and in this regard, it would be desirable to lower the Base Rate by 25 basis points to 1.25% for now.

Another member stated that it would be appropriate to cut the Base Rate by 25 basis points from the current 1.50% to 1.25%.

Looking at the recent domestic and overseas economic conditions, the member noted that there had been growing concerns about a global economic slowdown, particularly in the manufacturing sector, as world trade growth had slowed significantly affected by the spread of trade protectionism such as the US-China trade dispute and by the weakening of the international division of labor. The member assessed that, since a deterioration in external conditions could have greater impacts on Korea due to its high economic openness and heavy dependence on exports, downside risks to domestic growth had been increasing. In terms of inflation, the member judged that, in addition to these demand-side factors, government policies and supply-side factors including agricultural, livestock and fisheries product prices had also contributed to the continuation of downward pressures. The member presented the view that, in consideration of these domestic and foreign economic conditions, it seemed inevitable that the growth and inflation forecasts for this year and the next would be adjusted downward, and in this respect, it would be advisable to lower the Base Rate by 25 basis points.

The member expressed the opinion that, if the Base Rate were cut at the current meeting, it would be consistent with the Bank's external communications that it would maintain its accommodative monetary policy stance to support recovery of economic growth since the Base Rate cut last July. However, the member also evaluated that a Base Rate cut in consideration of the macroeconomic side, such as growth and inflation, could further increase the need to pay attention to the financial stability side. The member mentioned that, since greater borrowing incentives and stronger search for yield under the accommodative financial conditions could add to financial vulnerabilities, it would be necessary to further strengthen the monitoring of domestic flow of funds going forward. The member also pointed out that, with housing prices in the Seoul metropolitan region shifting to a rise recently, unsecured household loans, which had been less strictly regulated, had been showing faster growth, and went on to stress that the government and the supervisory authorities should play even more important roles in order to stabilize the housing market and household debt and ensure the soundness and resilience of financial institutions.

Meanwhile, the member expressed the view that not only cyclical factors but also structural factors such as the plunging birth rate, rapid population aging, and slowdown of productivity growth, as well as institutional factors including increased public welfare support to promote the stability of people's livelihoods had contributed significantly to the prolongation of the low-growth, low-inflation trend, and went on to argue that this could not be resolved by monetary policy measures alone, which are designed to regulate the business cycle. The member added that, in this respect, it would be crucial to step up aggressive structural reform efforts, and went on to state that fiscal policy should be operated to contribute to stimulating the economy in the short term and also to expanding growth potential and enhancing productivity over the medium- to long-term horizon.

One other member presented the view that it would be desirable to cut the Base Rate to 1.25% from the current 1.50% at the present time to serve as a buffer against sluggish demand in the private sector and downward pressures on inflation.

The member's assessment of the domestic economy since the end of last year was that demand in the private sector had stagnated and weak growth dependent on expansion in public sector expenditure was continuing. The member noted that, in reflection of such sluggish domestic demand, inflation was declining as well. The member evaluated that the recent negative consumer price inflation seemed a transient phenomenon reflecting the base effect from the surge in agricultural product prices during the same period of last year, but given that core inflation had remained below 1% recently and it had fallen to the lower-1% level when excluding administered prices, there was a clear trend of underlying price inflation deviating from the target and declining over the past two to three years.

The member took the view that it was difficult to be optimistic about future economic conditions. The member pointed out that there were growing concerns about the global economy due to the signs of an economic slowdown in the US, which had maintained solid growth. On the domestic front, the member's judgment was that, since sluggish domestic demand had not shown any sign of recovery, for the time being it would be difficult to expect any significant economic recovery beyond a technical rebound. The member voiced concern that if the economic sluggishness continued, it could lead to a further decline in underlying price inflation, which would cause a decrease in inflation expectations followed by a rise in the real interest rate, ultimately leading to an economic slump. The member also expressed the opinion that a slowdown in the nominal growth rate following the decline in inflation would make it difficult to maintain tax revenue growth, thereby acting as a major obstacle to expansionary fiscal policy.

Accordingly, the member evaluated that it was desirable to cut the Base Rate from the current 1.50% to 1.25% for now to provide a buffer against sluggish demand in the private sector and downward pressures on inflation. The member's assessment was that the 1.25% nominal level of the Base Rate could not be assessed to be low under recent macroeconomic conditions with the inflation falling to a historically low level, and that the real interest rate with underlying price inflation excluded remained the highest among major advanced countries. The member emphasized, meanwhile, that securing economic recovery in the medium- to long-term would require not only short-term macroeconomic policy but also strengthened policy efforts to enhance competitiveness in the private sector.

One member stated that it would be appropriate to cut the Base Rate from the current 1.50% to 1.25%.

The member stated that downside risks to the world economy had further expanded since the previous MPB meeting. The member raised the concern that, in the domestic economy, the slowdowns in exports and facilities investment had continued, and private consumption, which had seen modest growth, had recently been showing signs of slowing. The member presented the view that employment had seen significant improvement of late due mainly to a base effect, but it was too early to feel the effects from such improvement.

Looking at prices, the member's assessment was that there were growing downside risks to the price outlook, with consumer price inflation recording a negative figure in September. The member was also concerned that core inflation was running within the 0% range and the trend of decline in inflation expectations was continuing. The member noted that, for the moment, growth was falling short of the potential rate, which was estimated in the mid-2% range, and consumer prices also remained lower than the target. The member commented that this showed that low inflationary pressures on the demand side were a major cause of the low inflation. The member presented the view that, in light of this, there was a need to maintain an accommodative monetary policy.

The member, however, pointed out that the slowdown in exports and facilities investment and the worsening of the labor market were attributable more to structural factors, such as the weakened competitiveness of key industries, than to short-term cyclical factors, and thus there would be limits to responding to them through monetary policy. The member thus emphasized that it would be necessary to make constant efforts to increase the potential growth rate and raise the neutral real interest rate by improving economic fundamentals.

The member saw that, although household debt growth had been slowing due mainly to strong government measures, the already greatly increased debt size could work not only to cause instability in the financial markets, but also to constrain private consumption, thus having negative impacts on the real economy. The member thus expressed the opinion that careful attention should be paid in this regard in the future as well. The member noted that a close watch had been kept on real estate market trends when deciding monetary policy, due to concerns about negative side effects from excessive household debt growth. The member noted that, if the recent rise in real estate prices in certain regions was not accompanied by a significant increase in household debt, the real estate market would become a less significant consideration for monetary policy, but it was still too early to be optimistic, with some pointing out that demand related to housing purchases was a cause of the recent growth in unsecured household loans. The member thus added that close monitoring of the relevant developments should continue.

Finally, the member had a positive view with respect to the strengthened accommodative monetary policy stances of central banks of major countries including the US, since they would allow us to focus more on domestic economic sluggishness when making monetary policy decisions.

The member set out the view that, in overall consideration of the domestic and external economic conditions mentioned above, it would be desirable to lower the Base Rate from 1.50% to 1.25% at the present meeting.

Another member presented the view that it would be appropriate to keep the Base Rate at its current 1.50% level at this meeting and take more time to closely watch developments related to the economy and inflation.

The member diagnosed that, in the global economy, trade conflicts between major countries and geopolitical risks had been prolonged, while the growth momentum had continued to weaken. The member evaluated that the growth slowdown had thus far been relatively modest, but the possibility of a more severe slowdown stemming from changes in the policy environments of major countries could not be ruled out. The member also saw that there had been some positive changes, such as the recent slight weakening of risk aversion in the financial markets and the easing of manufacturing sluggishness in some EMEs. The member, however, judged uncertainty surrounding the future growth path to remain high, in that these positive trends could change again depending upon how trade conflicts between major countries unfold in the future.

The member evaluated that the concentration of the global growth slowdown in tradable sectors that were closely related to the domestic economy was putting downward pressures on domestic growth. The member noted that, against this backdrop, the GDP growth rate in Q2 had fallen short of expectations and the recovery of the semiconductor industry was likely to be pushed back further. The member thus saw that the growth rate for this year was highly likely to fall below the Research Department's July forecast. The member, however, noted that some indicators, such as service industry production, consumer sentiment, producer shipments, and facilities investment, had been showing signs of improvement since the last MPB meeting, and thus close attention was being paid to their sustainability. However, the member presented the opinion that, since the domestic and overseas policy environments remained fluid and macro indicators had become more volatile, it was necessary to take a little more time to monitor the relevant indicators to see if the recent developments would lead to meaningful recovery or would be mere one-off events.

The member, meanwhile, noted that there was heightened concern about the possibility of a widening of the negative inflation gap due to the shift to negative consumer price inflation in September. The member, however, expected that consumer price inflation would turn positive again from the end of this year onward, when the base effect would weaken. The member presented the view that, given movements of major asset prices and the counter-cyclicality of the won/dollar exchange rate, it was quite unreasonable to view the recent price decline as a sign of deflation. The member, however, pointed out that close attention should be paid to the possibility that movements of these headline indexes and inflation expectations could influence each other negatively, since year-on-year consumer price inflation had turned negative for the first time.

In overall consideration of the above, the member judged that, as domestic and overseas policy uncertainties persisted, there still remained a high possibility that the downside risks to growth and inflation that were of concern in the July forecast would be realized. However, given that a certain degree of downside risk had already been taken into consideration in the course of making the rate-cut decision in July, and most importantly that downside risks had not heightened further since the August meeting while some indicators related to future economic trends were showing signs of change, the member expressed the view that it would be desirable to take some time to judge the sustainability of these developments. Moreover, the member judged that monetary policy at the current level of the Base Rate was sufficiently accommodative, given overall financial conditions, and added that it should also be considered that an expansionary fiscal policy had been adopted. Accordingly, the member presented the view that the Base Rate should be kept unchanged at 1.50% at the present meeting while future developments in economic activity and prices are further observed.

Another member presented the view that it would be desirable to keep the Base Rate at its current 1.50% level at this meeting and maintain the current macroeconomic policy mix.

The member saw that domestic economic growth remained low due to decreased potential growth and negative base effects in the investment sector. The member assessed that, due to the consequent sluggishness in demand, price inflation was slower than that in major advanced economies, even when one-off supply-side price factors were taken into consideration. The member thus presented the view that it was appropriate to stimulate demand through a macroeconomic policy more accommodative than other advanced economies, as was currently being done. However, the member added that, given the risk of financial imbalances, it was necessary to maintain the current policy mix with a focus placed on expansionary fiscal policy, while paying attention to developments in growth and inflation and adjusting the policy mix if necessary.

The member's assessment was that the recent decline in Korea's potential growth was attributable to sluggish global manufacturing production and the decline in global trade volume. The member saw that in the future domestic economic growth would return to the level of potential growth, which had declined, as the base effect gradually dissipated. The member, however, raised the concern that such a recovery could be pushed back further if the sustainability of private consumption was not secured.

The member noted that a preemptive and more expansionary macroeconomic policy could be considered in the current circumstances. The member, however, expressed the opinion that caution should be exercised for the moment, since on the monetary policy side there remained a potential risk of the accumulation of financial imbalances, while on the fiscal policy front a long-term plan should first be established to prepare for population aging. The member diagnosed that financial imbalances were side effects stemming from excessive investment going beyond the level the economy could absorb, due to inappropriate macroprudential regulations in certain sectors or excessive expansionary macroeconomic policy. The member emphasized that attention should be paid to the points that excessive investment could lead to sluggishness in the capacity utilization ratio and a decline in prices, and that a steep adjustment in financial imbalances caused by domestic and overseas shocks could trigger a financial crisis. The member noted that a relatively high rate of savings had been maintained in Korea. The member, however, commented that assets and debt were expanding rapidly and were concentrated in the real estate market. The member pointed out that, consequently, as the real purchasing power of real estate assets purchased in preparation for population aging continued to decline, the real savings gap was actually widening.

Next, the member assessed that Korea's fiscal position was relatively sound compared to those of other advanced economies. The member saw that caution should be exercised in terms of fiscal space, in consideration of the population aging issue. The member, however, presented the opinion that it was first necessary to ease the shock from the structural decline in growth and protect vulnerable groups.

Considering the level and mix of macroeconomic policies, the member saw that attention should be paid to the points that unintended policy effects could be easily triggered due to the weakening of economy, and that the recent demand slump was caused by the structural weakening of growth, rather than by cyclical factors. The member thus expressed the view that it was desirable to keep the Base Rate unchanged at the present meeting and maintain the current macroeconomic policy mix.

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. Lee, Il Houng and Dr. Lim, Jiwon expressed clear opposition to cutting the Base Rate by 0.25 percentage points and argued for keeping it at the current level.

Monetary Policy Decision

☐ The Monetary Policy Board of the Bank of Korea decided today to lower the Base Rate by 25 basis points, from 1.50% to 1.25%.

☐ 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 shown high levels of volatility, affected mainly by the uncertainties concerning 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 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 partially improved, with the increase in the number of persons employed having risen. Going forward the Board expects domestic economic growth to fall below the July projection, owing chiefly to the continued US-China trade dispute and the heightened geopolitical risks.

☐ Consumer price inflation recorded a negative rate, in consequence mainly of the declines in the prices of petroleum products, agricultural, livestock and fisheries products, and public services. 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 fallen to the upper-1% level. Looking ahead, it is forecast that consumer price inflation will fall short of the path projected in July and fluctuate for some time at around the 0% level, and then run in the 1% range from next year. Core inflation will also gradually rise.

☐ 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, with major price variables fluctuating considerably due to movements in the global financial markets. The rate of increase in household lending has continued to slow. Housing prices have remained steady overall but have risen 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 observing any changes in macroeconomic and financial stability conditions and the effects of the two Base Rate cuts. It will also carefully monitor the US-China trade dispute, any changes in the economies and monetary policies of major countries, the trend of increase in household debt, and geopolitical risks.