Minutes of the Monetary Policy Board Meeting

April 18, 2019

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(April 2019)

Ⅰ. Outline

1. Date of meeting: Thursday, April 18, 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
   Lim, Hyung Joon, Deputy Governor
   Huh, Jinho, Deputy Governor
   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

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

Ⅱ. Summary of Discussions on the Current Economic Situation

After briefings by staff on *Economic Outlook for 2019 (revised)*,[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 the pace of global economic growth had continued to slow and that the rate of global trade growth had declined, affected largely by the US-China trade dispute. As for the global financial markets, members judged that volatility of price variables, such as interest rates in major countries, had increased temporarily but then stabilized with risk-off sentiment easing in accordance chiefly with a reduction in major country policy uncertainties.

Concerning the domestic economy, members' evaluation was that private consumption growth had slowed and exports and facilities investment had been also sluggish, particularly in the semiconductor and other IT sectors. The members forecast that, although the economic outlook for this year had been adjusted slightly downward with first-quarter growth more sluggish than originally expected, the growth momentum would improve going forward as the effects of expansionary fiscal policy gradually increased and semiconductor demand picked up. Meanwhile, some of the members took the view that, despite the recent downward adjustment to the economic outlook, the downside risks seemed to outweigh the upside risks.

Concerning inflation, members saw that consumer price inflation had declined substantially due to supply-side factors, including the government's stronger social-welfare policy and declines in the prices of petroleum products and agricultural, livestock and fisheries products, amid modest demand-side pressures. However, members expected inflation to show modest growth going forward, affected largely by increases in some public utility charges. Meanwhile, the majority of members stressed the importance of the anchoring of inflation expectations, and expressed the view that it would be necessary to closely analyze the recent low inflation and focus on communication concerning underlying inflation.

Finally, as to the domestic financial markets, members assessed them to have stabilized overall, although the volatility of price variables, such as long-term interest rates, had expanded somewhat. Members also noted that growth in household lending had continued to slow, influenced by strengthened micro-level regulations and the reduced degree of monetary easing. However, the majority of members emphasized the need to keep a close watch on financial imbalances, which remained at a high level.

2) An English version of *Economic Outlook for 2019 (revised)* 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:

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 percent for the intermeeting period.

One member stated that it would be advisable to keep the Base Rate at its current level and take time to examine whether the global economy, including the US economy, would rebound, while also watching the trends of the domestic economy, employment, household debt and the real estate market.

The member expressed concerns that the global economy had exhibited slower growth than originally forecast in January and that this trend could continue for some time. The member noted that the US economy, in particular, had been slowing overall and it would be necessary to closely examine the extent to which the economy would rebound from the second quarter. In the global financial markets, stock prices had been rising since the beginning of April and currencies of emerging market countries, except for some vulnerable countries, had exhibited stable movements.

With regard to the domestic economy, the member forecast that government spending would maintain strong growth, but the growth of private consumption would become modest, facilities and construction investment would continue to undergo corrections, and exports would grow more slowly than a year earlier. The member expressed particular concern that exports and facilities investment had remained sluggish, particularly in the semiconductor sector. The member expected exports and facilities investment to start to pick up from the second half with the semiconductor industry improving gradually, but the pace of recovery in facilities investment to be slower than originally forecast. Looking at employment, which had been recently recovering somewhat, the member noted that employment in the services sector was anticipated to improve, while that in the manufacturing sector was forecast to remain lackluster for the time being, and careful monitoring was required in this regard. The member took the view that, although a supplementary budget that the government had been working on would make up for the sluggishness of the domestic economy to a certain extent, the domestic economy would not be able to avoid the effects of the global economic slowdown. However, the member also forecast that, if concerns about external destabilizing factors, such as the US-China trade dispute, were resolved, this could work as an upside risk to economic growth in the second half.

The member took the view that outlook for consumer price inflation this year had been adjusted downward to a larger extent from the January forecast, and that the current monetary easing stance should be maintained since demand-side inflation pressures were unlikely to be large going forward.

The member's assessment of financial stability was positive. The member evaluated that the stock market had remained bullish and the supply of funding to the corporate sector had been seamless amid a favorable credit market. The member added that household debt had remained stable thanks largely to strong government measures. However, the member stressed the need to continuously examine the trends of household debt and the real estate market to determine whether concerns regarding financial imbalances would be clearly resolved.

Finally, the member mentioned that after the March FOMC meeting the market had expected the US Federal Reserve not to raise its policy rate for the time being, but some forecast the Fed to make further rate hikes next year if the US economy picked up in the second half of this year and inflation neared its target. In light of this, the member noted that it would be necessary to thoroughly analyze the US economy and financial market.

Another member took the view that it would be desirable to keep the Base Rate unchanged at the current meeting, since inflation had continued to slow and the domestic and overseas economic slowdowns had been becoming more evident amid sluggish global trade.

With respect to the real economy, the member judged that the domestic economy had been slowing more rapidly than expected, as on the external side the global economy had continued to decelerate and on the domestic side there was a correction in facilities investment, driven by external factors, as well as signs of a slowdown in private consumption. The member pointed out that global trade-related indicators directly affecting the domestic economy had been plunging recently, while the outlook for modest slowdown of US economic growth had strengthened. The member went on to state that it would be necessary to keep an eye on whether the sluggishness of global trade would be temporary. The member assessed that facilities investment had been shrinking further than expected due to the overall sluggishness of exports centering around the IT sector, and that private consumption growth had continued to slow since the second half of last year with households' propensities for consumption failing to maintain recovery. The member noted that the Bank of Korea Research Department had adjusted its growth forecast slightly downward from 2.6 percent to 2.5 percent in expectation of a recovery in the growth rate from the second quarter, but whether this expectation would actually materialize was substantially uncertain. The member added that there remained some downside risks to the inflation forecast as well, given the real economic and inflation trends.

Meanwhile, the member noted that core inflation had remained in the lower-1 percent range for a long period of time, and this sluggishness or gradual decline in inflation was likely to continue rather than be resolved this year, which was a matter of concern to the monetary policy authorities.

The member took the view that, from a long-term perspective, inflation had started to decline in around 2012 and, in statistical terms, this was explained substantially by the decline in underlying inflation resulting mainly from global factors such as oil prices. However, the member also argued that attention should be paid to the increasing role of domestic factors in recent times, including service charges. The member expressed the view that the decline in inflation caused by domestic factors could and must be managed by active policy responses, and stressed that long-lasting low inflation could cause inflation expectations to decline. The member added that, if inflation expectations declined to the 1 percent level, the current Base Rate level would likely become similar to or higher than the neutral interest rate, and argued that attention should be paid to changes in inflation expectations as they could directly affect the degree of monetary easing even if the Base Rate remained unchanged.

The member expressed the opinion that it would be advisable to resolve to some extent the accumulated upward pressures on administered prices so that the overall inflation rate could increase to near its target this year. On the other hand, the member stated that, considering the low inflation trends and the gradual decline in the real neutral interest rate resulting mainly from population aging, the gap between the Base Rate and the neutral interest rate was narrowing rapidly, and that, in light of this, further rate hikes were not likely to become the future direction of monetary policy.

With regard to financial stability, the member's evaluation was that some changes were witnessed to the previous year's trend of household debt growth being led by leasehold deposit loans and credit loans extended by banks. The member added that leasehold deposit loans continued to be extended briskly but their growth rate showed signs of stagnating and growth in credit loans had reversed to a decrease in the first quarter this year, and went on to state that, if growth in leasehold deposit loans continued to be curbed, the overall rate of household debt growth would likely continue to decline gradually.

One other member took the view that, considering inflation and financial stability conditions and the government's expansionary policy stance, it would be important to maintain the current accommodative monetary policy stance to anchor inflation expectations and curb the widening of financial imbalances, and that in light of this it would be desirable to keep the Base Rate unchanged at the current meeting.

The member evaluated that consumer price inflation had recently stood at the mid-0 percent level, but underlying inflation had held steady when accounting for the trends of sticky prices and prices of items sensitive to business cycles. However, the member also expressed the view that, as some indicators of inflation expectations had been weakening, it would be necessary to adopt a mix of macroeconomic policies reflecting the following points so that low consumer price inflation would not be prolonged.

First, the member stressed the importance of an accurate understanding of the current inflation trend. The member argued that an appropriate strategy was needed to anchor inflation expectations, as the sustained low consumer price inflation appeared to have stemmed substantially from administered prices as well as global and structural factors.

Second, the member argued that it would be necessary to rethink the causes underlying the accumulation of financial imbalances. The member stated that financial imbalances seemed to have worsened in Korea due to increased leverage amid a weakened virtuous circle of the economy, and that attention should be paid to the possibility that, if demand is stimulated through monetary policy alone without fundamental problems being resolved, the buildup of financial imbalances, along with inflation, could accelerate in another way. The member also took the view that debt growth and inefficient investment could ultimately act as downward pressures on growth and inflation and, in this regard, it would be necessary to examine policy effects over a more medium-term horizon.

Third, the member stressed the need to look at the cases of advanced countries experiencing difficulties on the inflation front. The member stated that, since the global financial crisis, Europe and Japan had strengthened communication based largely on negative interest rates and quantitative easing, but inflation in these regions had continued to fall short of targets for more than a decade, suggesting that there might have been changes in the dynamics among interest rates, currencies, liquidity and asset prices.

Finally, the member predicted that the volume of tax revenues would correspond with the budget and that fiscal policy would shift to a very expansionary stance.

With the aforementioned matters taken into consideration, the member expressed the view that it would be desirable to maintain the current accommodative monetary policy stance. The member expected that the sustained accommodative stance, combined with the expansionary fiscal policy, would contribute to driving demand-side pressures and maintaining inflation expectations. The member also suggested that monetary policy could create a stable environment in which consumption and investment would be based on economic fundamentals, consequently curbing the widening of financial imbalances, and that fiscal policy could have stronger effects by selectively supporting specific areas. Meanwhile, the member assessed this policy mix as appropriate in terms of macroeconomic balance, as an expansion of Treasury bond issuance was unlikely to weigh on the market and fiscal policy-led stimulation of demand could narrow the current account surplus, reducing excessive upward pressures on the Korean won.

One member, meanwhile, noted that, given the current macroeconomic conditions, the possibility of marked improvement in the slowdowns of economic activity and prices was not high. The member thus expressed the view that it was necessary to keep the Base Rate unchanged from the current level at the present meeting, while paying more attention to buffering against downside risks to the macroeconomy in the conduct of monetary policy going forward.

Concerning the recent Korean economy, the member’s assessment was that the buoyancy seen for the last two years in the semiconductor sector had ended, resulting in an overall weakening of macroeconomic indicators. The member first saw that export growth, which had been heavily dependent upon the semiconductor industry, was declining significantly, and the decrease in facilities investment had become more pronounced, led by the IT sector. The member added that private consumption, which had shown relatively favorable movements, had been slowing since the second half of last year, accompanied by an overall contraction in the macroeconomy. The member noted that the government's active fiscal policy alone was serving as a buffer against a contraction in private-sector economic activity.

The member's assessment was that consumer price inflation had sharply slowed to the mid-0 percent range in the first quarter, due to declines in oil prices and agricultural product prices, and that core inflation had declined to around 1 percent, sustaining the downward trend seen since 2016. The member saw that this slowdown in underlying price inflation was having negative impacts on the economic recovery, by working to increase actual interest burdens.

The member expressed the opinion that, although there were both upside and downside risks to the future outlook, it was not easy to expect tangible reversals of the current slowdowns of economic activity and prices. As positive points, the member mentioned the relative stability of international financial markets, thanks for instance to changes in the monetary policy stances of major advanced economies, and the increasing possibility of an agreement in the US-China trade dispute. The member, however, pointed out that the ongoing decline in trade growth stemming from the slowdown in the world economy would weigh on the Korean economy. The member also presented the view that, although the declining demand for semiconductors seen since the fourth quarter of last year had eased of late, it would be difficult to expect that last year's unprecedented buoyancy of the semiconductor sector would return. The member expressed the view that, on the domestic front, slowdowns in household debt growth and the housing market were highly likely to continue due to the implementation of strong macroprudential policy. The member thought that fiscal policy could be expected to have some degree of counter-cyclical buffer effects, as the government was pursuing a large fiscal expansion.

Another member noted that it would be appropriate to keep the Base Rate unchanged from its current level, since financial conditions remained accommodative and there still were concerns about financial imbalances, despite downward adjustments to the growth and inflation outlooks.

The member noted that the 2019 GDP growth outlook by the Bank of Korea Research Department had been revised slightly downward from the January forecast, which appeared to reflect more-sluggish-than-expected exports and facilities investment. The member saw that weaker global growth and a contraction in global trade, stemming for instance from the US-China trade conflict, and a slowdown in the semiconductor industry had exerted huge negative impacts on the Korean economy, which was heavily dependent upon semiconductor exports and the Chinese economy. The member, however, noted that the possibility had increased of some form of agreement being reached in the US-China trade negotiations, that many experts were forecasting a recovery in the semiconductor sector from the second half onward, and that the effects from an expansionary fiscal policy were expected to increase gradually. Given these points, the member projected the growth momentum to improve going forward. As a result, the member expected the Korean economy to show a trend of growth, not greatly deviating from its potential rate, again in the second half of this year and next year.

With respect to inflation, the member commented that the outlook for consumer price inflation for this year was revised downward to 1.1 percent, which appeared to be attributable to an increase in downward inflationary pressures stemming from non-cyclical factors, such as lower prices of petroleum and agricultural, livestock and fisheries products, and the government's stronger social-welfare policy. The member expected inflation to increase, albeit modestly, due mainly to rises in some public utility fees going forward. The member, however, saw that, given structural downside risks to prices, such as population aging, globalization, and innovations in distribution, inflation could run below its target for a considerable time. The member noted that such persistent low inflation was observed commonly in most major countries, and for central banks adopting inflation targeting, this added to the difficulties in monetary policy operation and public communication. The member commented that, particularly since the Bank of Korea had decided to strengthen its responsibilities of explaining inflation assessment to the public, by for instance regularly publishing a report reviewing its operation of the inflation targeting starting from this year, every effort should be made in this regard.

Last, the member found financial conditions to remain accommodative, in overall consideration of major price variables in the financial markets and of credit and liquidity conditions. The member also presented the opinion that it was necessary to keep in mind that there still were great concerns about the household debt level, a major risk to financial stability.

Another member noted that, given recent developments in the policies of major countries and financial conditions, the growth slowdowns of the domestic and global economies were not expected to deepen further from the second quarter onward, while financial imbalances in the domestic economy were still high. The member thus presented the view that it would be desirable to keep the Base Rate on hold at the present meeting, while closely monitoring overall macroeconomic and financial market conditions for the time being.

The member expressed the view that global growth had continued to slow, with the pace of slowdown estimated to have been deeper than previously expected in the first quarter. Yet, given that policies in major countries and financial conditions had been moving in relatively favorable directions, the member noted that the global growth slowdown was more likely to stabilize eventually, if not rebound, than lead to a full-fledged downturn phase. The member commented that the reduced uncertainty about major country policies had been easing global financial conditions via the retreat of risk aversion, which in turn could work in favor of policy flexibility of the countries where external conditions were not considered sound. The member also noted that some survey indicators had been showing signs of improvement of late. The member saw these changes as positive, but pointed out that, since the US-China trade negotiations had not yet been finalized and global manufacturing and investment still remained sluggish, it was necessary to constantly keep an eye on the relevant developments. The member added that major countries' policy responses were focusing on short-term stimulus measures, not structural improvements, and thus uncertainties surrounding the medium- to long-term growth path still remained high.

The member, meanwhile, presented the opinion that there had been ongoing concerns about a possible domestic economic downturn, as a global economic slowdown had been underway, led by industries upon which Korean exports heavily rely on. The member's assessment was that, although growth in the first quarter was estimated to have slowed significantly, sluggishness in some indicators, including export and employment indexes, had been moderating from the middle of the first quarter onward when controlling for seasonal and irregular factors, and the growth contribution of fiscal expenditures had been rising further. The member, however, added that it was necessary to take some time to monitor whether these movements would lead to a meaningful rebound.

The member saw consumer inflation as likely to remain muted throughout the first half of this year, due to the base effect from last year. The member, however, expected it to pick up from the second half onward, given recent movements of prices of oil and agricultural, livestock and fisheries products, and planned hikes to public utility fees. The member also noted that the rate of increase in the business cycle-sensitive price index and the rate of inflation expected by the general public had been stable.

The member noted that, on the financial stability side, risk from the buildup of financial imbalances had been easing gradually, due to an ongoing slowdown in growth of household lending and real estate-related lending, but the level of financial imbalances was still high. The member emphasized the need for keeping a constant eye on the relevant developments, in consideration of the volumes of apartments allotted and newly built this year in the Seoul Capital area. The member saw that, although domestic and international financial markets had been stable since the beginning of this year, there still were concerns about economic conditions and uncertainties surrounding policies of major countries. The member thus expressed the opinion that attention should be paid to the possibility of increased market volatility.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of their earlier discussions, the following Monetary Policy Decision statement was compiled and was approved unanimously by the members.

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 increased temporarily. Government bond yields in major countries have fallen considerably, in line mainly with concerns about the global economic slowdown and changes in expectations about the monetary policies of such countries, while the exchange rates of some vulnerable emerging economies have risen significantly. 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 the uncertainties concerning Brexit.

☐ The Board judges that the pace of domestic economic growth has moderated somewhat as consumption growth has temporarily slowed, facilities and construction investment have continued undergoing adjustments and export growth has continued to slow. The sluggishness in employment conditions has partially lessened, with the increase in the number of persons employed having risen. Going forward the Board expects that consumption will continue to grow, while exports and facilities investment will also recover gradually toward the second half of this year, although the adjustment in construction investment will continue. GDP is forecast to grow at the mid-2% level this year, slightly below the level projected in January (2.6%).

☐ Consumer price inflation has slowed to the mid-0% range, in consequence mainly of declines in the prices of petroleum products and agricultural, livestock and fisheries products. 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 in the low- to mid-2% range. Looking ahead, it is forecast that consumer price inflation will fluctuate for some time below 1%, lower than the path projected in January, and then run at the low- to mid-1% level from the second half of this year. Core inflation will also gradually rise.

☐ The volatility of price variables in the domestic financial markets has expanded slightly. Long-term market interest rates and stock prices have rebounded after having fallen, affected by movements in the global financial markets in line with projections of weakening growth in major countries and expectations of progress in the US-China trade negotiations. The Korean won-US dollar exchange rate has risen, in line with the strengthening of the US dollar. 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 conditions related to trade with major countries, 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.