Minutes of the Monetary Policy Board Meeting

July 2020

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(July 2020)

Ⅰ. Outline

1. Date of meeting: Thursday, July 16, 2020

2. Place: Monetary Policy Board Meeting Room

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

4. Monetary Policy Board members absent: none

5. Participants:
   Jang, Ho Hyun, Auditor
   Ryoo, Sangdai, Deputy Governor
   Chung, Kyuil, Deputy Governor
   Lee, Seungheon, Deputy Governor
   Park, Jong Seok, Deputy Governor
   Lee, Hwan Seok, Deputy Governor
   Yang, Seok Jun, Director General of Reserve Management Group
   Min, Jwa Hong, Director General of Financial Stability Department
   Lee, Sang Hyeong, Director General of Monetary Policy Department
   Kim, Hyun Kee, Director General of Financial Markets Department
   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 global economy had started to rebound moderately from its sluggishness, as economic activity had resumed in major economies. Members, however, diagnosed uncertainties surrounding the outlook for recovery as remaining high, as the possibility of a second wave of COVID-19 or a protracted pandemic had increased. Members assessed that the international financial markets remained stable overall, influenced for instance by bold responses by individual countries.

With respect to the domestic economy, members saw that downside risks to growth had grown compared to the May forecast, as exports and the capacity utilization ratio still remained sluggish, despite moderate improvements in demand-side conditions, such as private consumption and facilities investment. One member, in particular, expressed concern that there was a repeated pattern in which the domestic economy was excessively reliant on the semiconductor industry. Concerning employment, members' assessment was that there still was no clear sign of recovery in terms of either quality or quantity.

Members saw that the low demand-side inflationary pressures stemming from a continued real economic downturn were ongoing. Members noted that inflation would remain down in the lower-0% range for some time due to a continued decline of public service prices amid weakened demand-side inflationary pressures.

Finally, members evaluated that domestic financial markets were gradually stabilizing, thanks for example to policy rate cuts and various market stabilization measures. Members, however, pointed out that concerns about financial imbalances had heightened, as prices of assets such as housing and stocks had risen rapidly of late and household lending growth had accelerated. Members went on to emphasize the need to bear in mind the fact that rising asset prices divorced from economic fundamentals could work to destabilize markets in the future.

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

Ⅲ. Discussions Concerning Monetary Policy Decision (Summary)

The main details of the MPB members' discussions concerning a change in the Bank of Korea Base Rate were as follows:

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 appropriate to keep the Base Rate at the current level of 0.50%.

The member assessed that, although lockdown measures had been eased, the prospects for a bottoming out of the global economy still remained uncertain as the spread of COVID-19 gathered pace. With respect to the domestic economy, the member saw that private demand was sluggish despite the expansion of government spending. The member especially noted that negative growth would be deeper than expected due to a significant decline in exports. The member assessed that exports in Korea had been hit hard as the coronavirus shock to global trade was larger than originally forecast, with geopolitical conflicts also playing a role. Concerning employment, the member's evaluation was that, although the number of persons employed had declined by a smaller margin, the situation remained serious given the number of persons on temporary leave and the broader unemployment rates. The member also pointed out that, with consumer price inflation remaining around the 0% range, various underlying price indicators such as "core inflation excluding administered prices" and "cyclically sensitive inflation" all remained unusually low in the 0% range.

The member noted that economic and social concerns about overheating asset prices had increased, as prices of assets such as stocks and housing had risen more rapidly while the real economy was more sluggish than expected. The member added that as increased liquidity was allocated to sectors less likely to stimulate production, such as real estate and leasing, there was concern that the productivity of finance was decreasing. Against this backdrop, the member saw that there remained aversion to credit risk in the corporate lending and bond markets, and differentiation based on the financial situations and credit risks of corporations was continuing. The member's assessment was that, contrary to past crises triggered by financial system shocks, the recent economic conditions caused by COVID-19 were by nature a real economic crisis. The member thus commented that, even with monetary policy on an accommodative footing, a significant time gap before the real economy recovered would be unavoidable, and in this process, financial imbalances, including concentration of capital into specific sectors and build up of debt, were inevitable to some extent.

The member expressed the opinion that, overall, monetary policy should maintain its current accommodative stance, prioritizing improvements in macro indicators such as growth, inflation and employment, in response to the wider-than-expected spread of COVID-19 and domestic and international economic sluggishness. The member added that it was necessary to use supplementary monetary policy instruments for a more seamless functioning of financial intermediation, and to make better use of macroprudential policy related to asset prices. The member thus judged that it was appropriate to keep the Base Rate at the current level this month.

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

The member noted that contrary to expectations that the COVID-19 pandemic would ease in the US and other major economies, and their real economies would recover from the third quarter, new confirmed cases across the world had reached a record high while lockdowns had not been lifted much. The member voiced concern that, given the current low global trade growth, it would be hard to expect a rapid recovery of the global economy, and this would negatively affect the domestic economy. The member thus saw that the pace of recovery in domestic private consumption and exports would slow after the second half of this year. The member noted in particular that, since the expectation for improvements in exports was mainly dependent upon IT sectors including semiconductors, the past pattern in which economic growth was excessively reliant on growth in the semiconductor industry was being seen again. The member's evaluation was that downside risks to growth in both exports and domestic demand had increased from the May forecasts, since facilities investment was also mainly dependent upon investment in the IT sector, and construction investment would likely to continue to go through its ongoing adjustment for some time. Concerning employment, the member expressed the view that, although the negative impacts of COVID-19 had been partially eased, employment had not yet recovered from its sluggishness. The member noted that, although the government and the Bank of Korea had been taking various measures to ensure the recovery of the real economy, a failure to properly and swiftly deal with the liquidity issue in the corporate sector could lead to the more serious problem of insolvency. The member thus emphasized the need to continue policy efforts to deal with this in the future as well.

Looking at prices, the member's assessment was that the sluggishness in the real economy so far had increased downside pressures on inflation. In other words, the member was of the view that low demand-side inflationary pressures stemming from the continuation of the negative output gap had been leading to the widening of the negative inflation gap. The member expected that inflation could remain well below the target for a considerable time going forward.

The member, meanwhile, evaluated that the domestic and international financial and foreign exchange markets were gradually regaining stability. The member, however, emphasized that it was necessary to keep in mind that the financial market trends, which had been moving apart from the real economy, could actually work to cause instability if the markets' positive expectations about the real economy were to shift rapidly.

The member noted that accommodative financial conditions were having an effect with respect to rising prices in asset markets, such as stock and real estate markets. The member, however, presented the opinion that the continuation of the accommodative monetary policy stance was inevitable in consideration of real economic conditions, which would remain sluggish for a considerable time. The member noted that issues in some asset markets should be addressed through bold policy responses by the government. The member added that the Bank of Korea, together with the government, had many issues to consider to ensure stability in the financial and foreign exchange markets. The member saw that, taking all those points into consideration, it was desirable to maintain the Base Rate at the current level of 0.50% this time.

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, looking at recent domestic economic conditions, even though private consumption was rebounding, a significant decline in exports was continuing and thus the outlook for the domestic economy was more sluggish than the May forecast. The member, however, expected that the domestic economy would recover gradually, as exports would shift to an increase in line with a recovery in the global economy, although there still were high uncertainties related for example to the evolution of the COVID-19 pandemic at home and abroad. The member added that the recovery could be constrained by the risk of structurally lower growth affected by COVID-19 and by several geopolitical risks such as a rekindling of the US-China trade dispute. The member also forecast that inflation would likely remain in the lower-0% range for some time due to a continued decline of public service prices in line with, for example, the expanded provision of free education, as well as to economic sluggishness.

The member noted that, right after the COVID-19 pandemic began, the Bank of

Korea had actively expanded the degree of monetary accommodation to deal with the real economic slump and financial market unrest, by making large cuts in the Base Rate and increasing the supply of liquidity. The member evaluated that, as a result, financial conditions had improved greatly. The member saw that market interest rates, as well as deposit and lending rates in the banking sector, had fallen to historic lows; growth in private-sector credit and market liquidity had sharply accelerated; and stock prices had recovered to the level seen before the COVID-19 outbreak. The member expected the transmission of these monetary policy measures to the financial markets to have positive effects on the real economy after a time gap. The member, however, pointed out that concern about financial imbalances was increasing with housing prices rising rapidly and household lending growth expanding again. The member voiced concern that amid the current ongoing economic sluggishness, if asset prices were overvalued or debt excessively increased regardless of economic fundamentals, the risk of a sudden adjustment would increase by the same degree.

The member noted that, in consideration of these economic and financial conditions, it would be best to maintain the Base Rate at the current level of 0.50% this time. The member saw the need to maintain an accommodative monetary policy since there still were high uncertainties surrounding the future growth path and downside risks also existed. The member, however, commented that it was necessary to exercise caution with respect to any further easing, considering that recent financial conditions marked by low interest rates and ample liquidity appeared to be sufficient to support the recovery of the real economy. The member also saw that, given recent housing price increases and household debt growth, more consideration should be given to financial stability than in the past in the conduct of monetary policy. The member, meanwhile, emphasized that the role of the government and the supervisory authorities was very important for market liquidity to flow into productive sectors and thereby support the real economic recovery more effectively, in a situation in which maintaining the accommodative monetary policy stance was unavoidable.

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

The member evaluated that there was ample liquidity in the market as a result of two Base Rate cuts and various measures to increase liquidity supply since March. The member's assessment was that financial markets had generally stabilized, although sustained demand contractions at home and abroad due to the COVID-19 outbreak had led to concerns about continued deterioration of corporate profitability and to a delay in improvement in funding conditions of sub-par companies. The member assessed that the international financial markets had also generally stabilized, in terms for example of foreign exchange supply and demand conditions. On the other hand, the member argued that attention should be paid to the increasing factors likely to undermine financial stability, with household and other private sector credit recently growing rapidly and a larger amount of floating money continuing to flow into asset markets.

The member stated that the global economy remained highly uncertain with COVID-19 resuming its rapid spread in major countries, and in this regard, the member forecast that the sluggishness of Korea's exports and uncertainty of its real economy would continue for the time being. The member's assessment was that consumption and facilities investment had been recently showing gradual recovery, while exports had remained lackluster, the manufacturing capacity utilization ratio had remained low and employment had not shown any clearly marked recovery yet. With these taken into account, the member mentioned that the growth rate was highly likely to be lower than the May forecast. The member also anticipated that any substantial inflation pressures would not be seen for some time.

Taking all this into consideration, the member expressed the view that it would be appropriate to hold the Base Rate at its current level of 0.50% for the intermeeting period to maintain the accommodative monetary policy stance. The member also argued that it would be necessary to closely examine the ripple effects of the policy measures implemented so far while monitoring financial market conditions and the real economic trend.

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

Looking at the economic conditions at home and abroad since the previous monetary policy decision meeting, the member evaluated that the economic shocks from COVID-19 appeared to have somewhat passed their peak, but uncertainties surrounding the recovery path seemed to remain high. The member stated that real economic sluggishness in some major countries including the US, euro-area countries and China had been somewhat easing recently, but this was a result of the combined effect of a technical rally in line with a phased resumption of economic activity, recovery of pent-up demand, and various policy support measures, and it was therefore uncertain whether this would lead to a substantial economic recovery in the second half. The member noted that vigilance was needed most of all against the fact that COVID-19, the main cause of the current global economic slump, was likely to abate later than originally forecast. The member argued that, although strong lockdown measures were unlikely to be implemented again, sustained pandemic-related uncertainties and social distancing could limit the degree of consumption recovery considerably, and some companies might go out of business permanently with structural changes caused by the pandemic becoming firmly entrenched.

With regard to the domestic economy, the member mentioned that, although real GDP had recorded further negative growth in the second quarter, demand-side conditions such as private consumption and facilities investment had been improving gradually, which provided relatively strong support for expectations of economic recovery in the second half. However, the member assessed that, considering the fading effects of income growth from the emergency rescue package and the downward trend of semiconductor prices, there was a growing probability of economic recovery falling short of the May forecast in the second half. The member also pointed out that this could weaken demand-side inflation pressures and increase downside risks to the price path.

As to financial conditions, the member's evaluation was that, driven mainly by the Base Rate cuts and various market stabilization measures, financial conditions had improved significantly, with price variable volatility decreasing and credit risk aversion easing gradually in capital markets. The member mentioned, however, that the possibility could not be ruled out of market interest rates rising again or volatility increasing further, as demand for non-prime corporate bonds was sluggish, credit supply to SMEs remained lackluster and a crowding-out effect might occur in the course of Treasury bond issuance to finance the supplementary budget.

The member also noted that the continuing trend of low interest rates at home and abroad had been strengthening the yield-seeking behavior of economic agents, and in this regard, the member was alert to the possibility of increased risk of a buildup of financial imbalances due to the liquidity that had been supplied to support the real economy. More specifically, the member argued that attention should be paid to possible excessive flows of market liquidity into high-risk financial assets or real estate in a domestic financial environment that lacked moderate-risk financial products. The member noted that, despite a possible virtuous circle of stock or housing price increases leading to real economic growth through the wealth effect, if the gap between the asset markets and the real economy widened too much or asset price increases triggered household debt, this could increase financial vulnerabilities and limit the medium- to long-term growth path.

In summary, the member stated that it was necessary to maintain accommodative monetary policy to support the real economy and stabilize inflation expectations, while market liquidity was concentrating in the short-term end of the market. The member thus argued that it would be desirable to maintain rather than expand the current degree of monetary easing and use various policy measures to promote a more effective transmission of financial market liquidity to the real economy. The member also argued that it would be necessary to remain flexible and balanced in deciding on policy options, while preparing for a possible prolongation of the pandemic and keeping in mind that the expansion of the liquidity supply from policy responses to the crisis could act as a financial vulnerability factor.

One other member presented the view that it would be desirable to hold the Base Rate at its current level of 0.50% for the intermeeting period.

The member's assessment was that, although financial markets had been stabilizing and the worst had passed for economic indicators thanks to the aggressive responses to COVID-19 around the world, global economic recovery remained uncertain in line with the growing possibility of a second wave of the pandemic and its prolongation. The member also forecast that, due to the delay in the recovery of global trade, the negative impacts of the pandemic on the domestic economy would last for longer than expected at the initial stage of the pandemic.

Concerning the domestic economy, the member forecast that the cyclical component of leading indexes and various sentiment indexes had been showing signs of recovery, but the economic recovery would be very moderate owing to the sustained emphasis on social distancing amid concerns about a second wave of the pandemic. In this regard, the member pointed to the need to maintain the current trend of low interest rates until the real economy showed a clearly marked recovery.

The member meanwhile expressed the view that the Bank of Korea, which was maintaining an inflation targeting regime, should keep a close eye on the impacts of COVID-19 on inflation. More specifically, the member mentioned that the central bank should note that a slowdown in inflation was more evident outside of the Seoul metropolitan area than in Seoul and its surrounding areas, suggesting that COVID-19 shocks had differed from region to region. The member pointed out that, although the growth and employment slumps in regions other than the Seoul metropolitan area had built up over a long period of time, the COVID-19 pandemic had clearly revealed how serious these problems were. The member also expressed concerns that the pandemic was likely to accelerate the trend of the outflow of population from provincial areas and the inflow of population into Seoul and its surrounding areas, which had slowed for some time.

In addition, the member presented the view that attention should be paid to the gap between general inflation and housing prices. The member's assessment was that the gap was based on economic agents' expectations of the trend of low interest rates becoming firmly entrenched, but was also related with the issue of regional imbalances. The member added that the recent acceleration of growth in apartment sales prices and leasehold deposit prices was more evident in Seoul and its surrounding areas than the rest of the country, which implied that housing prices, as well as business conditions and consumer price inflation, were showing different movements from region to region.

The member expressed the opinion that COVID-19, having broken out in the course of the domestic economy's gradual shift to a low-growth environment in line with demographic changes, was highly likely to strengthen the concentration of population in the Seoul metropolitan area. In this regard, the member stressed that the possibility of a worsening of regional imbalances should be taken into consideration in deciding on the direction of macroeconomic policies and their priorities, and went on to emphasize that the central bank and other financial authorities should work hard to develop ways to provide financial support to revitalize regional economies.

The member assessed that since the March interim meeting the domestic financial and FX markets had stabilized somewhat in the accommodative monetary policy environment as seen in the two Base Rate cuts and the raised ceiling for the Bank Intermediated Lending Support Facility. The member took the view that the monetary easing stance should be maintained for the time being to meet market expectations, while keeping a careful watch on the effect of the expansionary fiscal policy being carried out by the government. The member added that in this regard it would be advisable to keep the Base Rate unchanged at the current meeting, and if needed, to increase Treasury bond purchases to promote the stability of overall market interest rates.

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 started to rebound moderately from the sharp contraction, as economic activity gradually resumes despite the ongoing spread of COVID-19. In global financial markets, risk aversion has subsided on hopes of economic recovery. Stock prices in major countries have risen and the US dollar has weakened, while government bond yields have fluctuated slightly. 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.

☐ Economic growth in Korea has remained sluggish. Although consumption has rebounded with the relaxation of some pandemic-related restrictions on economic activity and the government's stimulus package, exports have continued to decline. While the recovery in facilities investment has been subdued, the correction in construction investment has continued. Labor market conditions have remained weak, with the number of persons employed continuing to decline sharply. Looking forward, facilities and construction investment are expected to grow at a moderate pace; however, the paces of recovery in consumption and exports will be slower than previously forecast. Accordingly, GDP growth this year is likely to be lower than the May forecast of -0.2%.

☐ Consumer price inflation recorded around 0%, held down by declining prices of petroleum products and public services. Core inflation (excluding changes in food and energy prices from the CPI) has also remained at the lower-0% range, and the inflation expectations of the general public have stayed at the mid-1% level. It is forecast that consumer price inflation and core inflation will run at the lower-0% level this year, reflecting prolonged effects from the drop in global oil prices and weak demand-side inflationary pressures.

☐ Domestic financial markets have been generally stable owing to decreased volatility in global financial markets. Stock prices have risen and the Korean won to US dollar exchange rate has fallen considerably, while long-term market interest rates have fluctuated within a narrow range. The increase in household loans has expanded materially, and housing prices have generally accelerated 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 economic growth is expected to be sluggish 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 developments related to the pandemic, 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.