Minutes of the Monetary Policy Board Meeting

February 28, 2019

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(February 2019)

Ⅰ. Outline

1. Date of meeting: Thursday, February 28, 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
   Sohn, Wook, Director of BOK Economic Research Institute
   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 “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 there were somewhat growing concerns about slower global growth, particularly in the euro area and China. As for the global financial markets, members mentioned that volatility had continued to decrease, due to eased risk aversion stemming for instance from lowered expectations of additional rate hikes by the US Federal Reserve.

Concerning the domestic economy, members’ evaluation was that the adjustments in facilities and construction investment had continued, exports had seen a greater decline, and employment conditions in the private sector had continued to be sluggish. Members, however, expected economic growth not to diverge significantly from its potential level, as private consumption had continued to grow modestly and fiscal spending had served as a buffer against the risk of a rapid slowdown.

Concerning inflation, members saw that consumer price inflation had declined sharply, due mainly to a decline in petroleum product prices, and expected that it would fluctuate for some time below 1 percent amid modest demand-side inflationary pressures. Given recent international oil price movements and the government’s plan to raise public utility charges, however, members noted that downward inflationary pressures on the supply side would gradually weaken.

As to the domestic financial markets, members assessed them to have stabilized overall, thanks to the easing of risks in the external sector.

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

Members noted that household lending growth was continuing to slow, influenced for instance by the government's policy measures to stabilize the housing market and by the hike in the Base Rate. Members commented, however, that close attention should be given continually to the risk of financial imbalances building up, considering the continued demand for group loans and leasehold deposit funds.

Ⅲ. Discussions Concerning Monetary Policy Decision (Summary)

The main details of the MPB members' discussions concerning a change in 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 the growth rate of the domestic and global economy had continued to slow, yet not deviating from the expected ranges, while inflation had decelerated further. The member thus presented the opinion that it would be desirable to keep the Base Rate at its current level at this meeting and continue to monitor future changes in conditions at home and abroad a little longer.

The member's assessment was that, since the last MPB monetary policy meeting, the sluggishness of manufacturing output and investment had deepened in major countries while service activity and consumption had remained healthy. The member also saw that risk aversion in the financial markets and anxiety among economic agents had eased, thanks primarily to lessened concerns about US monetary policy normalization and to the ending of the US government shutdown. The member went on to assert that in the past, such developments often formed a virtuous circle with the real sector economy through improved consumer and business sentiment, with some time lag. The member thus judged them to be positive changes. The member, however, expressed the view that since there still were high policy uncertainties in major countries, including the US-China trade negotations, it was necessary to maintain a closer examination of changes in these issues.

Looking at the domestic economy, the member mentioned that concerns about growth outlook had heightened, with the unemployment rate up sharply and exports down further. The member, however, saw that exports weakness partly owed to the unfavorable price effect in petroleum and tech products, also attributing the rise in jobless rate to irregular factors related to the government's job creating policy for the elderly. The member also expected fiscal expenditures to serve as a buffer against the risk of a sharp slowdown in the growth rate. Meanwhile the member raised concern that Korea's export environment itself may have been changing, given that the slowdown of global growth has been concentrated in tradable sectors, which could be related to the protectionsim in major countries. Also, the member added that, on the domestic front, the sluggishness of private sector's employment had persisted in the wake of various microeconomic policies that could affect structural changes in the labor market. These altogether raised caution in estimating the potential growth rate of the domestic economy, the member pointed out.

The member assessed consumer price inflation to have slowed greatly and thought it would likely run considerably below 1 percent for some time. However, given recent international oil price movements and the government's plan to hike public utility charges, the member forecast that downward pressures on the supply side would ease gradually. The member also found it noteworthy that, unlike consumer prices, business cycle-sensitive price indexes had been on the rise, while inflation expectations and core inflation excluding administered prices had been stable.

With regard to financial stability, the member's assessment was that risks of a buildup in financial imbalances were easing somewhat, with lending growth related to housing and real estate slowing generally. The member, however, saw that growth in sole proprietor loans was still high, and group loans and loans for leasehold deposits had maintained solid growth. The member thus mentioned that it would be necessary to monitor future developments a bit more.

Another member took the view that it would be desirable to keep the Base Rate unchanged at the current meeting, since economic improvement in the private sector or a meaningful rebound of inflation did not seem likely in the short run.

With respect to the domestic economy, the member judged that the government's active fiscal policy was serving as a buffer against the trend of slowing business activity in the private sector. The member noted that the government's direct consumption had surged and private consumption associated with fiscal support had continued its moderate growth, but investment indicators had been declining rapidly. The member also took the view that with the corporate sector apart from the semiconductor industry showing poor performances overall, the steep rise in employment-related costs made it difficult to rule out the possibility of the employment slump persisting. The member also noted that there were signs of possible adjustments in household debt and the real estate market, influenced for instance by strong macroprudential policy.

The member assessed uncertainties in external conditions to be reduced somewhat, with tensions in the international financial markets easing considerably after the US monetary policy authorities expressed flexibility regarding their policy stance, and with expectations of progress in the US-China trade negotiations growing. The member, however, noted that concerns about a global economic slowdown remained and a super boom in the business cycle of the semiconductor industry was entering a correction phase, and thus it was necessary to pay attention to the future developments.

Looking at prices last year and this year, the member commented that consumer price inflation had seen major changes in line with severe fluctuations in oil prices, but core inflation with one-off factors excluded had already fallen to the lower-1 percent range last year. The member expressed the view that, since core inflation with administered prices excluded was not running above the mid-1 percent level, aggregate demand-side pressures were implied to be low. The member judged that underlying price inflation was unlikely to rebound significantly for some time, as business conditions in the private sector did not appear likely to improve in the short run.

In consideration of the macroeconomic and financial market environments mentioned above, the member judged that it would be desirable to keep the Base Rate at its current level of 1.75 percent at this meeting, and expressed the opinion that future monetary policy should be based on the directions of additional indicators related to economic activity and inflationary conditions.

One other member took the view that it would be desirable to keep the Base Rate at the current 1.75 percent level at the current meeting, as there had been no significant changes in the Base Rate operating conditions and there were high uncertainties concerning developments in the international financial and economic environments.

With respect to the domestic economy, the member judged that there were growing concerns about a weakening of growth momentum, as exports had been sluggish, affected largely by a slowdown in the growth of the global economy and trade and also in the global semiconductor industry. However, the member expressed the view that private consumption had maintained gradual growth, and the government’s transfer expenditure expansion and measures to revitalize domestic demand were expected to have positive impacts on private consumption, adding that semiconductor exports were likely to recover from the second half of this year. In light of these factors, the member expected the domestic economy to stay close to the path forecast in January and not to deviate far from its potential level.

The member mentioned that consumer price inflation was forecast to fluctuate below 1 percent for the time being, and this low inflation had caused substantial difficulties for policy communication under the inflation targeting framework. However, the member noted that central banks in major countries had been recently experiencing these difficulties as well, and that a substantial part of the low inflation had been attributable to supply-side factors or the government's measures to stabilize people's livelihoods, and went on to state that these factors should be dissociated from demand-side factors, which are the primary concern of monetary policy. Going forward, the member forecast consumer price inflation to rise to the mid-1 percent level in the second half, affected chiefly by increases in public utility bills and the expiration of a fuel tax cut. The member, however, argued that, in this process, consumer price inflation would be likely to exhibit high volatility in monthly terms due mainly to a base-period effect, which could cause confusion in the formation of inflation expectations.

Looking at the financial markets, the member's evaluation was that, despite continued concerns about slower growth, the financial markets had emerged from last December's instability and started to pick up significantly as risk-off sentiment had been eased, mainly because of weaker expectations of the US Fed's further rate hikes. The member forecast that it was highly uncertain whether a positive scenario—continued improvement in financial conditions weakening concerns about a real economic slowdown—or a negative scenario—sustained concerns about a real economic slowdown leading to a correction in the financial markets, as witnessed in December last year—would unfold. With regard to household lending, meanwhile, the member expressed the view that it was necessary to keep an eye on the risk of an accumulation of financial imbalances, since household lending had continued to exhibit slower growth but there remained demand for collective loans and for leasehold deposit funds.

The member took the view that, taking into consideration the aforementioned macroeconomic and financial stability conditions, it would be desirable to keep the Base Rate at its current level at this meeting, and carefully decide whether to make further adjustments to the degree of monetary policy accommodation while comprehensively evaluating changes in macroeconomic and financial stability risks based on financial and economic indicators and economic forecasts henceforth.

One member noted that it would be desirable to keep the Base Rate unchanged from its current level at this meeting, since global economic growth had continued to slow, the growth path for this year was seen to face high downside risks, and inflation had remained low at around 1 percent.

With respect to the domestic economy, the member's assessment was that on the external side global economic growth had continued to slow, and on the domestic front exports and investment related to external factors had been going through corrections. Looking at the US economy, the member judged that real economic indicators were favorable overall, but given indicators such as the spread between long- and short-term yields, economic prospects in the financial markets had not improved. The member, meanwhile, evaluated the euro area economy to have shown a downward trend of the growth path, with the German economy, which had been the axis of regional growth, showing noticeably slowed growth while Brexit and other sustained uncertainties going on. With regard to China, meanwhile, the member mentioned that real economic indicators had remained sluggish, but the recent stabilization of the financial market and the upward movements of M2 and other liquidity growth rates could be seen as positive changes.

In reflection of the global economic trends mentioned above, the member assessed that Korea's exports and investment had been going through corrections since the end of last year. The member judged that customs-cleared exports had been falling in line chiefly with the decrease in semiconductor prices, and with regard to investment, facilities investment had been going through an adjustment, particularly in the IT sector while construction investment had been undergoing a underlying correction as well. The member evaluated that private consumption had seemed to maintain growth that was modest but not strong enough to drive economic growth. The member took the view that the global financial markets had been somewhat stable overall, but high uncertainties remained regarding the growth paths of the global real economy and trade, and in this regard, with the effect of the contribution of government spending to growth excluded, there remained downside risks to the growth path of the Korean economy for this year as well.

Concerning prices, the member noted that consumer price inflation had declined due mainly to slower growth in agricultural product prices and a shift to a decrease in oil prices, and core inflation had remained low at the 1 percent level since the second half of last year. The member mentioned that, considering the domestic and external real economic environments and the trends of oil prices and of the exchange rate, it would be difficult to expect inflation pressures for this year to surpass those of last year, and went on to state that the current situation indicated that downside risks to the January forecast by Bank of Korea Research Department had been growing. The member noted that core inflation in Korea had remained at the upper-1 percent level until 2017, curbing the downward trend of underlying inflation, but it had started to show different movements from 2018, remaining at the lower-1 percent level for a long period of time and went on to state that this trend was forecast to continue this year as well, which was a matter of concern to the monetary policy authorities.

Meanwhile, the member pointed out that the recent low inflation had also been attributable to policy efforts to curb growth in administered prices. The member pointed to a need to keep in mind that the policy efforts to curb administered prices to promote the stability of people's livelihoods could also have unintended effects such as a decline in inflation expectations, and went on to argue that, in terms of stable macroeconomic management, it would be desirable to relieve the upward pressures on administered prices to a certain extent and help the overall inflation rate rise to near its target.

Another member took the view that it would be desirable to keep the Base Rate unchanged from its current level of 1.75 percent at this meeting, as the economic situation at home and abroad had not changed much since the January meeting, nor had domestic demand pressures affecting underlying inflation, and it was necessary to gradually resolve the accumulation of financial imbalances.

The member took the view that the global economy seemed to be stabilizing at the potential growth rate, which was lower than that of the pre-crisis period. The member noted that, with the US Federal Reserve less likely to raise its policy rate further, uncertainties in the global financial markets had been recently decreasing somewhat. However, the member judged that the structural problems had accumulated over a long period of time, particularly in advanced countries and that emerging economies' current rate of growth was unlikely to be sustained because of their structural dependence on advanced countries.

The member stated that Korea's export growth had far exceeded global economic growth until the financial crisis, but had recently been increasing at a rate similar to that of the world economy, and judged that, as Korea's export-oriented economic structure had shifted to focus on domestic demand, its potential growth rate had declined accordingly. The member also explained that investment related to real estate, construction and IT, which had once led economic growth, had continued to undergo corrections, which had seemingly contributed to a fall in the domestic economic growth rate to a level near the downwardly adjusted potential growth rate. The member expected the domestic economy to remain close to the original forecast, although the future growth path faced both upside risks such as accommodative fiscal policy and downside risks including sluggish employment.

The member evaluated that consumer price inflation had declined significantly since December last year but underlying inflation had remained largely unchanged since January. The member stated that sticky prices with administered prices counted out stood at the mid-2 percent level, and inflation expectations, although having recently weakened somewhat, remained above 2 percent and seemed to have anchored at the inflation target to some extent. The member mentioned that core inflation with administered prices excluded, however, remained flat at the mid-1 percent level, and explained that this was because leasehold deposits/monthly rents and industrial products, both highly weighted in the index, had contributed 0 percent over the past several months due to the oversupply of housing and weaker global prices, respectively. The member forecast that core inflation, even when the administered prices were counted out, would remain flat at the mid-1 percent level for the time being, as leasehold deposits and monthly rents as well as industrial product prices were likely to show weak growth for some time.

The member assessed that the pace of accumulation of financial imbalances, caused by the concentration of funds in the real estate market, had been slowing recently, but the degree of accumulation remained higher than that of other countries. The member took the view that leverage in the Korean economy had increased over the past few years through various ways, including guarantees as well as lending, and inefficient investment and higher debt resulting from excessively increased leverage might put downward pressures on medium-term growth and inflation, threatening the achievement of the medium-term inflation target. The member also argued that, in order to resolve the accumulation of financial imbalances, a financial market environment should be created in which asset prices and risks are not distorted but are determined based on fundamentals.

One other member expressed the view that, although concerns about downside risks to the global economy had grown somewhat, the Korean economy had continued to show growth not deviating far from the level forecast in January and inflation pressures were unlikely to be large for the time being. The member thus presented the opinion that it would be desirable to keep the Base Rate unchanged from the current level while continuing to monitor real economic and financial stability conditions.

With respect to the global economy, the member evaluated that concerns about downside risks had grown somewhat larger since the January forecast. The member projected that the US economy would be favorable overall, while the euro area economy was likely to show weaker growth than the forecast in January due to sluggish German economic indicators and political uncertainties. The member pointed out that the Chinese economy was forecast to slow, and close monitoring was needed in that regard. The member also noted that international oil prices had recently rebounded while the pace of global trade growth had been slowing, and attention should be paid to the possible effects of these changes in external conditions on the Korean economy.

Looking at the domestic economy, the member took the view that the continued corrections in facilities and construction investment and the faster decline of exports were causes for concern, although private consumption had maintained modest growth despite sluggish employment. The member noted that the recent export sluggishness had been attributable partly to negative effects from certain items and regions, such as falls in semiconductor and oil prices and the slowdown in China's domestic demand, and it should be closely analyzed how much these factors could be improved going forward. The member added that it would be necessary to examine whether export sluggishness had been attributable to the weaker global competitiveness of Korea's manufacturing sector. Meanwhile, the member noted that major industries such as manufacturing and construction had continued to experience sluggish employment and the wholesale & retail and lodging & restaurant industries had continued to face difficulties. In that regard, the member stressed that it would be necessary to closely monitor the effects of these factors on private consumption going forward. As mentioned above, the member assessed the

Korean economy as maintaining growth not deviating far from the level forecast in January, despite the global economy having slowed somewhat, and expected the government sector to continue to play an active role this year as well and support growth to a certain extent.

The member evaluated that there were growing downside risks to inflation, with consumer price inflation standing at 0.8 percent in January. The member expressed the view that continued monitoring of movements of international oil prices and administered prices including public utility charges would be needed going forward. The member added that demand-side inflation pressures were likely to remain modest, and in light of this, the current accommodative monetary policy stance should be maintained.

With respect to financial stability, the member assessed that the situation appeared more positive than last year. The member stated that the domestic financial markets had been stable and household debt had exhibited slower growth affected largely by strong government measures, and expected this trend to continue this year. However, the member expressed the view that it would be necessary to keep an eye on the trends of real estate prices and household debt growth for some time before judging whether an environment had been created in which financial imbalances could be clearly resolved.

Finally, the member stressed that factors such as the possibility of the US Federal Reserve adjusting the speed of its policy rate hikes had played a huge role in promoting stability in the global financial markets, and it would be necessary to keep a careful watch on future developments of the US economy and the Federal Reserve’s monetary policy direction.

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.

< Ref >

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 somewhat. Volatility in the global financial markets has continued the trend of decrease seen last month, as expectations of an adjustment to the Federal Reserve’s pace of monetary policy normalization and of progress in the US-China trade negotiations have heightened. 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 paces of monetary policy normalization in major countries, and the uncertainties concerning Brexit.

☐ The Board judges that the domestic economy has sustained a rate of growth not diverging significantly from its potential level, as consumption has continued to grow modestly, although the adjustments in facilities and construction investment have continued and export growth has slowed. Employment conditions have been sluggish, with the number of persons employed having increased only slightly. Going forward the Board expects domestic economic growth to be generally consistent with the path projected in January. 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.

☐ Consumer price inflation has slowed to the upper-0% range, in consequence mainly of declines in the prices of petroleum products and reductions in the extents of increase in agricultural, livestock and fisheries product prices. Core inflation (with food and energy product prices excluded from the CPI) has been at the 1% 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%, slightly lower than the path projected in January, and then run at the mid-1% level from the second half of this year. Core inflation will also gradually rise.

☐ The domestic financial markets have been stable. Stock prices have risen mainly on expectations of an easing of the US-China trade dispute. Long-term market interest rates and the Korean won-US dollar exchange rate have fluctuated within narrow ranges. The rate of increase in household lending has continued to slow, while housing prices have fallen slightly.

☐ 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 forecast that inflationary pressures on the demand side will not be high for the time being, and that the domestic economy will sustain a rate of growth that does not diverge significantly from its potential 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 further, while closely checking future economic growth and inflation trends. It will also carefully monitor conditions related to trade with major countries, any changes in the monetary policies of major countries, financial and economic conditions in emerging market economies, the trend of increase in household debt, and geopolitical risks.