Minutes of the Monetary Policy Board Meeting

January, 2020

Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]
(January 2020)

Ⅰ. Outline

1. Date of meeting: Friday, January 17, 2020

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
   Ryoo, Sangdai, 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
   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
   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

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 growth had continued to slow and world trade had remained sluggish. Members evaluated that, despite some improvement in the US-China trade dispute, uncertainties surrounding the growth path remained high due to ongoing geopolitical risks. Meanwhile, members pointed out that, although international financial markets remained stable overall despite external potential risks, attention should be paid to the possibility of greater volatility.

As for the domestic economy, members diagnosed that exports and investment had been gradually showing positive signs and the sluggishness of private consumption had been easing. Members also expected conditions in the semiconductor industry to improve with the completion of semiconductor price adjustments. Meanwhile, some members pointed out that the forecasts for export-oriented industries other than the semiconductor sector remained uncertain, and expressed concerns that domestic economic growth could fall substantially below the potential growth path.

With regard to prices, members forecast that consumer price inflation would rise further for some time, boosted by the easing of supply-side downward inflation pressures. Meanwhile, some members evaluated that there was little chance of the gradual decline in underlying inflation reversing to an increase this year, due to external and domestic uncertainties surrounding the Korean economy.

Finally, in the domestic financial markets, members' evaluation was that overall financial conditions had shown a higher degree of easing on the back of faster growth in private sector credit and market liquidity. However, given housing price hikes in the Seoul metropolitan region and the acceleration of household debt growth, members pointed to the need to pay attention to the possibility of the accumulation of financial imbalances, in order to ensure financial stability. Meanwhile, some members assessed that the recent surge in real estate prices had been limited to specific regions and specific types of housing such as newly-built apartments, and expressed the view that further discussions were needed on appropriate policy measures.

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 keep the Base Rate at its current level of 1.25%, while two members called for lowering it by 25 basis points.

One member presented the view that it would be appropriate to keep the Base Rate at its current 1.25% level at the current meeting.

Looking at the domestic and overseas economic environments since the previous MPB meeting, the member evaluated that global economic growth was estimated to have continued to slow at a modest pace, but conditions related to future economic trends were improving gradually. The member mentioned that trade uncertainty had partly eased with the conclusion of the phase one trade agreement between the US and China and that a growing number of countries had been operating more accommodative monetary and fiscal policies. The member also assessed that, as investor sentiment had been picking up in the financial markets, there was an increasing likelihood of a virtuous circle in which improvement in economic sentiment boosts the real economy and vice versa. More specifically, the member noted that some indicators for the manufacturing sector, which had suffered the brunt of the decline in the growth rate over the last couple of years, had been showing signs of improvement, particularly in Asian emerging economies, and there was a need to watch with keen interest whether this improvement was sustainable. However, the member stressed that, as seen in the escalation of the tensions between the US and Iran, the global economy was exposed to various geopolitical risks and the possibility of a reemergence of trade disputes could not be ruled out, and went on to argue that a careful approach was still required in judging the future growth path.

With regard to the domestic economy, the member's assessment was that the sluggishness of the domestic economy caused by cyclical factors had been somewhat easing, on the back of improvement in global economic conditions and the strengthening of the expansionary macroeconomic policy stance. The member evaluated that, although the average capacity utilization ratio of the manufacturing sector had shown a quarter-on-quarter decrease in the fourth quarter of 2019, major leading indicators related to production as well as investment and exports, both of which are demand-side conditions, had been improving when irregular factors are controlled. However, the member pointed out that the private sector would likely show only a limited recovery in the future compared with those seen during past business cycles, given that the correction phase in the construction sector could be prolonged by the strengthening of regulations and that uncertainties existed due to changes in various microeconomic policies concerning the labor market. The member stated that consumer price inflation had increased in December 2019 as in the month before, in line with the easing of supply-side downward inflation pressures, and forecast that inflation would tick up further for some time, considering the recent price trends of agricultural, livestock and fisheries products and petroleum products.

Meanwhile, the member evaluated that financial conditions had become looser, as risk-off sentiment had eased in the financial markets and market liquidity had exhibited faster growth, led chiefly by credit to the corporate sector. The member pointed out that this could be interpreted as the smooth functioning of monetary policy transmission channels in the financial markets, but it could at the same time suggest a growing need to keep a close eye on possible accumulation of financial imbalances. The member stressed that it should be noted that, while exhibiting a high household debt-to-GDP ratio, Korea had not experienced significant deleveraging, unlike major advanced countries, and real estate-related exposures accounted for a large share of private sector credit in Korea.

The member set out the view that, in overall consideration of the above-mentioned points, it would be desirable to keep the Base Rate at its current 1.25% level at the present meeting.

Another member stated that it would be appropriate to cut the Base Rate by 25 basis points to 1.00%.

The member’s evaluation was that the global and domestic economic environments and domestic economic trends had not changed much since the November meeting. First, the member noted that, although the US-China trade dispute was less likely to deteriorate further, the Iran issue had emerged as a new geopolitical risk and it was therefore difficult to say that positive progress had been made in the global trade environment. The member added that, more fundamentally, there had been a continued underlying trend of changes to global value chains. In terms of domestic demand, the member judged that the consumption and investment trends had not departed from the November forecasts.

The member projected that, because there were no changes that would require a significant revision of the November forecasts, economic growth this year would fall substantially below potential growth as it had last year and the negative output gap was likely to be the largest since the period of 2012 to 2013. With regard to inflation as well, the member forecast that, since no new shocks had emerged since the previous economic outlook, consumer price inflation would fluctuate due to one-off factors, with core inflation in the mid- and upper-0% range acting as an underlying trend.

The member mentioned in this regard that it would be difficult to say that the real interest rate suggested by the current Base Rate was lower than the real neutral interest rate, and in light of this, the previous assessment that current monetary policy was not fully accommodative remained valid. In this regard, the member judged that it would be appropriate to cut the Base Rate by 25 basis points to 1.00%.

The member noted that, if there could be any controversy concerning the appropriateness of this interest rate policy judgment, it would be about financial stability, and more specifically an assessment of household debt and housing prices, rather than about economic and inflation trends. The member went on to state that monetary policy implementation at this point in time could be freer than in the past from financial stability considerations. First, looking at household debt, the member assessed that the household debt growth rate, estimated at the lower-4% level last year, had stabilized. The member pointed out that a further curbing of household debt growth could delay a rebound of the economy and inflation, adding to the burdens of debt relative to nominal income. The member took the view that, if debt growth needed to be further curbed nevertheless, macroprudential measures should be used, considering leasehold deposit loans had been leading household debt growth over the last two years. The member added that growth in leasehold deposit loans, which are guaranteed loans, seemed to have been boosted by the increased guarantees provided by guarantee institutions seeking housing stability for the general public, and in this regard, curbing household debt would require policy instruments aiming at adjusting the degree of growth in leasehold deposit loans.

Next, the member presented the view that the judgment mentioned earlier still seemed proper even when looking at the relationship between housing prices and current monetary policy operations. The member stated that continued attention should be paid to housing price surges, given that, if housing price movements were related with household debt, household debt growth and housing price hikes could create synergy effects, leading to excessive debt growth, excessive housing price hikes, and ultimately, to an outbreak of a crisis. The member went on to point out, however, that the recent housing market movements had not been serious enough to raise concerns in terms of monetary policy. The member noted that, more specifically, the housing price growth rate based on the Housing Price Index had stood at 1.1% in 2018 and -0.4% in 2019, and housing prices outside of the Seoul metropolitan area in particular had continued to fall for the second consecutive year, suggesting that an overall housing price surge related to liquidity conditions was not materializing. The member also explained that, although the rate of growth in the average Seoul apartment sales price and the rate of growth in apartment sales prices felt by the general public had been in double digits, this seemed related with old houses being recently replaced with new apartments reconstructed or redeveloped in Seoul. The member assessed that what was particular about the recent housing market trend was not a surge of general house prices boosted by excessive liquidity but distinct fluctuations in the relative prices of assets, led mainly by supply and demand of specific types of housing, and went on to argue that this should be addressed with housing policy or local policy measures, rather than monetary policy.

In sum, the member presented the view that, since the related authorities had been announcing and implementing decisive measures against household debt and the hike in average Seoul apartment sales prices, the operation of monetary policy with a focus on economic activities and inflation would contribute to an appropriate division of policies.

Another member presented the view that it would be desirable to keep the Base Rate at its current 1.25% level at the current meeting.

The member's judgment was that the recent domestic economic situation had remained sluggish overall, but had been showing partial improvements. The member evaluated that the improvements in US-China trade relations and the semiconductor industry, which had served as major negative factors affecting Korea's exports and facilities, were helping to ease the sluggishness in exports, facilities investment, and even private consumption. As to inflation, the member stated that consumer price inflation had been rising gradually since October 2019 and forecast it to reach the 1% level this year. The member expected both growth and inflation to generally follow the path forecast in November last year. The member also expected that, despite a variety of latent domestic and overseas risk factors, the domestic economy would be positively affected by improvements in the external conditions, such as the phase one trade deal between the US and China and the outlook for the recovery of the semiconductor industry, as well as by the government's aggressive fiscal policy stance.

The member mentioned that, in reflection of these changes in domestic and external conditions, stock prices had risen and the won-dollar exchange rate had declined in the domestic financial markets. The member also assessed overall financial conditions as substantially accommodative, with private sector credit and market liquidity showing faster growth.

With regard to household lending, the member noted that the pace of growth in household loans, particularly those related to housing, had accelerated further in line with housing price hikes. The member expected household lending growth to slow gradually, considering that housing price growth had been slowing somewhat since the government's announcement of housing market stabilization measures on December 16, 2019. However, the member expressed the view that, as the general public continued to expect housing prices to rise further amid very loose financial conditions in general and there were concerns about a possible balloon effect that would raise housing prices in non-regulated areas, continued attention should be paid to household loans from the financial stability perspective.

Meanwhile, the member mentioned that, according to briefings by staff on the effects of two Base Rate cuts last year, the rate cuts had been smoothly spreading to the financial markets through declines in deposit and lending rates and growth in credit to the private sector. The member expected that the real economy would also see positive effects of the rate cuts gradually, through the easing of the interest rate burdens of both households and corporations and improvement in economic sentiment. However, the member stressed the need to pay attention to the possibility of Base Rate cuts acting as a factor easing financial conditions, consequently contributing to credit growth and asset price hikes.

In conclusion, considering that downside risks to the macroeconomy had been decreasing somewhat owing to signs of improvement in some domestic and external conditions, the positive effects of the Base Rate cuts and fiscal expenditure expansion, and improvement in economic sentiment, and that attention should be continuously paid to financial stability matters as private debt growth had been accelerating along with expectations of housing price hikes, the member presented the view that it would be advisable to keep the Base Rate at its current level of 1.25% for the intermeeting period.

One member presented the view that it would be desirable to keep the Base Rate at the current 1.25% level at the current meeting.

The member evaluated that, looking at global economic conditions, trends of economic growth in major countries excluding the US had slowed, and world trade had also remained sluggish. The member noted that, on the domestic economic front, the negative output gap had widened due to last year's slower growth while prices remained low. The member, however, judged that private consumption was showing partial improvements and indicators related to economic activities were also showing positive signs that there would be no further economic decline during this year. The member saw that there were growing expectations that the slowdowns in exports and facilities investment would ease somewhat in line for instance with expectations of improvement in the semiconductor industry and progress in the US-China trade negotiations. The member, however, assessed that it was still too early to have confidence that this would lead to a trend of full-fledged improvement. The member noted that there were uncertainties surrounding the global economy including geopolitical risks, and on the domestic front, it was difficult to easily reverse the current situation of the weakened competitiveness of the manufacturing sector leading to worsened economic sentiment amid a slowdown in the construction industry. The member thus expressed the opinion that attention should be paid to these points.

The member pointed out that, although the international financial markets remained stable overall despite the US-Iran conflict, there still was a possibility of increased volatility. The member thus emphasized the need for constant monitoring to prevent external potential risk factors from causing domestic financial market instability.

The member expressed the opinion that, since monetary policy usually had impacts after a time lag of four to six quarters, the monetary policy direction should be made based on the forecasts for economic activity and price conditions after one to one-and-a-half years. The member thus noted the need for in-depth reviews and analyses of the probability of the BOK's forecasts being realized. The member particularly noted that if the expectations channel, among all monetary policy transmission channels, was operated in linkage with financial stability issues, rather than the real sector, only negative side effects of accommodative monetary policy could emerge. The member thus emphasized the need to pay attention to this. In this regard, the member noted the need to thoroughly examine the possibility whether the sustained low interest policy would actually work to increase the flow of funds into the real estate sector or be used as a tool to prolong the lives of marginal firms, instead of leading to improvements in the real economy.

Meanwhile, from the perspective of financial stability, the member noted that household debt growth had slowed considerably until the first half of last year, thanks for instance to the effects of real estate measures. The member, however, pointed out that the scale of household debt growth had been expanding since the second half of last year, as real estate prices in some regions continued to rise substantially. The member presented the view that household debt growth in association with the trend of rising real estate prices was affected not only by real estate-related policy, but also by expectations about accommodative monetary policy to some extent.

In summary, the member saw that, while the accommodative monetary stance should be sustained for now in consideration of real economic conditions, such as the growth rate and prices, more attention should be paid to financial stability issues as well. The member emphasized that, particularly since various indicators were showing that there was ample liquidity in domestic financial markets, policy efforts to induce capital flows into productive sectors had become more important. The member thus expressed the opinion that it was desirable to keep the Base Rate unchanged at the current 1.25% level at the current meeting.

Another member presented the view that it would be desirable to keep the Base Rate at its current 1.25% level at the current meeting.

The member forecast domestic economic growth to return to the level of potential growth, with the negative base effects of IT-related exports and investment disappearing and the adjustment in construction investment becoming smaller. The member, however, pointed out that attention should be paid to the point that the potential growth rate had been declining due to a slow shift toward new industries and high value-added service industries and due to remaining structural problems amid sluggishness in some manufacturing industries. The member judged prices to have shifted to a trend of recovery, albeit a weak one, as growth had bottomed out. The member, however, found it necessary to closely watch domestic demand pressures since the economic fundamentals of the domestic economy were weakening and there were uncertainties surrounding the forecast for exports, a major growth engine. The member thus expressed the opinion that it was desirable to maintain the current accommodative macroeconomic policy stance. The member, however, noted that a few points should be considered when adjusting the monetary policy stance in the future.

First, the member noted that responding to sluggish domestic demand triggered by weaker potential growth with a stronger easing stance alone, without structural reform, would lead to weaker regenerative capacities of the markets through a possible delay in the restructuring of distressed companies. The member added that in this case, consumer spending capacity would be undermined in the medium term, since investment and consumption would not lead to productive capital expansion and the debt burden would increase instead. The member thus noted that it was necessary to remain alert in this regard.

Second, the member's assessment was that, while the growth gap was narrowing, macroeconomic policy would expand further overall this year given the government's fiscal policy stance, even if the Base Rate remained at the current level. The member thus pointed out the need to consider carefully if this policy stance was the most effective way to use policy space.

Third, the member stressed the need to carry out inflation targeting from a medium-term perspective, within a range that does not allow inflation expectations to be significantly de-anchored from the target, because excessive counter-cyclical actions to deal with the trend of decline in prices could end up re-igniting financial imbalances only.

Fourth, the member's assessment was that monetary policy in Korea had differed from those in advanced economies in terms of method and size since the financial crisis up until now, but it had similar achievements in terms of effectiveness as it had been conducted in line with the economic issues Korea was facing. The member noted that, in other words, the impacts of monetary policy in Korea on the financial markets were similar to those in major advanced economies in terms of decreased lending rates and expanded leverage. The member explained that, looking how the real economy—the ultimate goal—was impacted by such financial market changes, Korea did not differ greatly from major advanced economies in terms of indicators such as the cumulative inflation gap and GDP volatility. The member added, however, that major advanced economies had maintained interest rates lower than Korea over a long period of time, in consideration of the need for deleveraging and the contribution of fiscal policy. The member noted that this had worked to prevent the spread of a financial crisis, but had also brought about a decline in the growth rate, due to inefficient resource allocation, and to growth in debt interlinked with excessive expansion in financial assets. The member expressed the view that, although Korea's starting point differed from those of advanced economies, attention should still be paid to the implications of the domestic debt buildup, of the widening gap between returns on investment related to real estate excluding arbitrage and marginal productivity of other capital, and of growth in marginal firms. The member's judgment was that, given these points, it was desirable to keep the Base Rate at the current 1.25% level.

One member expressed the opinion that it was desirable to lower the Base Rate from the current 1.25% to 1.00%.

The member assessed that the domestic economy had shown weak growth last year dependent upon active fiscal expansion, while exports and investment had decreased significantly. The member estimated that, as a result, even though real GDP growth would likely have been close to 2%, nominal GDP growth would have been at around 1%, the lowest since the 1998 currency crisis.

The member's assessment was that this steep economic decline had been easing somewhat since the fourth quarter of last year, thanks to reduced uncertainties related to the US-China trade dispute, and to eased monetary policy at home and abroad. The member also noted that another positive factor was that semiconductor price adjustments that had been underway were being completed. The member, however, pointed out that the outlook for a number of other export industries was still unclear and overall domestic demand including construction investment was still sluggish. The member saw that the government's expansionary fiscal policy was likely to offset the slower growth rate this year as well, but the negative output gap was unlikely to be narrowed, with the growth rate failing to reach the potential growth rate, which was estimated in the mid-2% range. The member forecast that, even if nominal GDP growth rebounded due to technical factors, it would be very difficult for the nominal rate to reach around 4%, the level that could be seen as consistent with potential growth and modest inflation.

The member's assessment was that, accordingly, it would not be easy to expect a reversal from the trend of gradual decline in underlying price inflation which had been ongoing for several years. The member pointed out that a further deceleration of core inflation, which had deviated from the 2% target and already declined to the mid- to upper-0% range, would entrench lowered inflation expectations, and consequently even a relatively minor shock could raise concerns of deflation.

The member thus expressed the opinion that it was desirable to lower the Base Rate from the current 1.25% to 1.00% and conduct monetary policy with a focus on supporting the economic recovery and reducing the risk of a continued decline in underlying inflation. The member noted that, looking at the current domestic economic growth rate and price inflation from an international perspective, the 1% Base Rate was not assessed to be excessively low. Meanwhile, the member added that it was necessary to have in-depth discussions about the extent to which monetary policy, whose effects are nationwide and indiscriminative in nature, should account for the surge in new and reconstructed apartment prices in Seoul, which seemed to be attributable mainly to supply constraints.

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. Cho, Dongchul and Dr. Shin, Inseok expressed clear opposition to keeping the Base Rate at the current level and argued for cutting it by 0.25 percentage points.

Monetary Policy Decision

□ The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 1.25% for the intermeeting period.

□ Based on currently available information the Board considers that the pace of global economic growth has continued to slow with the ongoing sluggishness in trade. The global financial markets have been generally stable in line mainly with progress in the US-China trade negotiations, while recently volatility temporarily increased due to the escalation of military tensions in the Middle East. Looking ahead, the Board sees global economic growth and the global financial markets as likely to be affected largely by developments in global trade protectionism and geopolitical risks.

□ The Board judges that the sluggishness in the domestic economy has eased somewhat. Facilities investment has slightly increased and consumption growth has expanded, although construction investment and exports have continued to decline. Employment conditions have continued to improve in some respects, with the increase in the number of persons employed having risen. GDP is forecast to grow at the lower-2% level this year, consistent overall with the level projected in November. Although the adjustment in construction investment will continue, the sluggishness in exports and facilities investment will gradually ease and the consumption growth rate will moderately rise.

□ Consumer price inflation has risen to the upper-0% level, due largely to a smaller decline in the prices of agricultural, livestock and fisheries products and to increases in petroleum product prices. 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 remained at the upper-1% level. Looking ahead, it is forecast that during this year consumer price inflation will rise to around 1%, generally in accord with the path projected in November, and core inflation will run at the upper-0% level.

☐ In the domestic financial markets, stock prices have risen and the Korean won-US dollar exchange rate has fallen, affected chiefly by movements in the global financial markets and expectations of a recovery in the semiconductor industry. Long-term market interest rates have rebounded from an earlier decline. The amount of increase in household lending has expanded, and housing prices have shown high rates of increase in Seoul and its surrounding areas especially.

☐ 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 carefully monitoring developments in global trade disputes, the economies of major countries, the trend of increase in household debt, and geopolitical risks and examining their effects on domestic macroeconomic and financial stability conditions.