

Executive Summary

[Monetary Policy Operating Conditions]

1 A look at economic and financial conditions in Korea and abroad between November 2019 and February 2020 finds the following. The pace of global economic growth continued to slow. In the United States, economic activity has been rising at a moderate rate led by consumption, while the euro area saw continued low growth owing to sluggish investment. Growth in Japan remained slow due to weak consumption. In China, economic activity appears to have contracted greatly entering this year, affected by COVID-19.

Economic growth in major economies¹⁾

(%)

	2017	2018	2019				
			Year	Q1	Q2	Q3	Q4
US	2.4	2.9	2.3	3.1	2.0	2.1	2.1
Euro area	2.5	1.9	1.2	1.8	0.6	1.1	0.2
Japan	2.2	0.3	0.7	2.2	2.3	0.1	-7.1
China	6.9	6.7	6.1	6.4	6.2	6.0	6.0

Note: 1) The quarterly rates of growth are annualized quarter-on-quarter rates for the US, Japan and the euro area, and year-on-year rates for China.

Sources: Individual countries' published statistics.

The international financial markets stabilized after the signing of the Phase One trade deal between the US and China, but have seen a significant increase in volatility since late January, owing to concerns about the spread of COVID-19. Interest rates and stock prices in major countries fell by a large margin, while the US dollar mostly strengthened against major currencies and then depreciated due to the US Federal Reserve's policy rate cut in response to the spread of COVID-19.

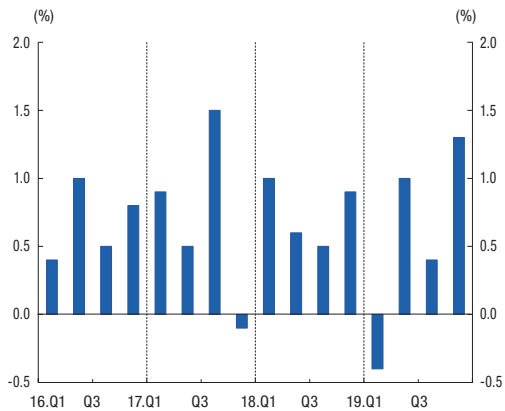
Share price indices of advanced and emerging markets



Source: Bloomberg.

2 In the Korean economy, consumption continued to increase at a moderate pace and the sluggishness in facilities investment eased at the end of last year, while exports appeared to be improving somewhat during January. However, since February, economic growth has weakened due to the spread of COVID-19, led by a contraction in consumption and a slowdown in exports. Meanwhile, employment conditions showed sustained improvement in January, with the pace of increase in the number of persons employed having risen.

Real GDP growth¹⁾

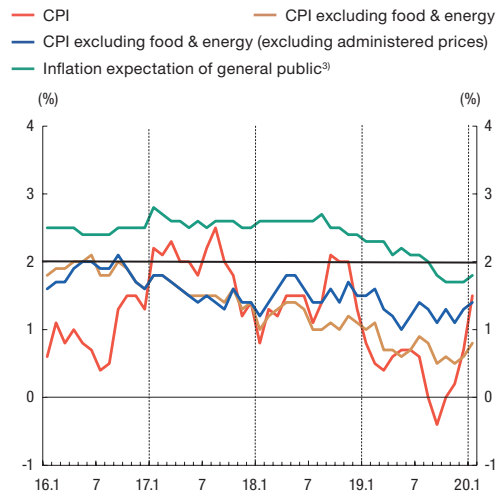


Note: 1) Quarter-on-quarter.
Source: Bank of Korea.

③ Consumer price inflation rose to the mid-1% level in January, despite weak demand-side inflationary pressures and sustained downward pressures from government policy, as the base effects in agricultural, livestock & fisheries product prices dissipated and supply-side downward pressures eased. Core inflation excluding food and energy product prices was at the upper-0% level. The inflation rate expected by the general public fluctuated in the upper-1% range.

Housing sales prices decelerated in Seoul owing to housing market stabilization measures but increased at a high rate in the surrounding areas. The rest of the country showed a continued rise in housing sales prices led by certain metropolitan cities outside Seoul. Leasehold deposit prices have continued to rise since the fourth quarter of 2019, driven by a decline in the supply of new apartments and a pickup in leasehold demand from those waiting for new apartment subscriptions.

Inflation¹⁾²⁾



Notes: 1) The bold line indicates the inflation target.

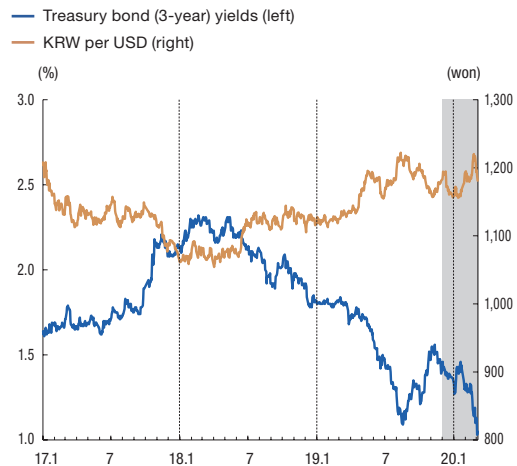
2) Year-on-year.

3) Expectations for the CPI inflation rate one year in the future.

Sources: Bank of Korea, Statistics Korea.

④ In the domestic financial markets, long-term market rates and stock prices rose on the back of growing expectations of an improvement in the domestic economy, but then shifted to a decline in late January, influenced by the spread of COVID-19. The Korean won/US dollar exchange rate fell and then rose significantly.

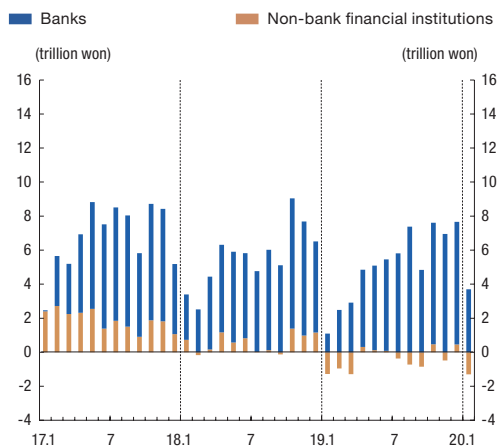
Korean Treasury bond yield and exchange rate (KRW per USD)



Sources: Bank of Korea, KOFIA.

⑤ Household lending increased, driven mainly by housing purchases and demand for leasehold deposits. Corporate lending sustained its growth, led by loans to small and medium-sized enterprises thanks to banks' aggressive lending efforts.

Changes in household loans¹⁾²⁾



Notes: 1) Month-on-month.

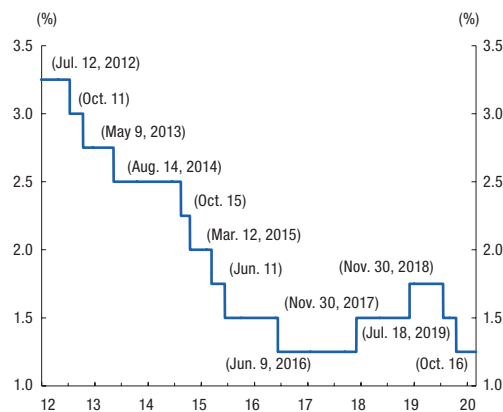
2) Including mortgage transfers.

Source: Bank of Korea.

[Conduct of Monetary Policy]

⑥ The Bank of Korea maintained its accommodative policy stance to ensure that the recovery of growth continues and consumer price inflation can be stabilized at the target level (2.0%) over a medium-term horizon, while conducting its monetary policy with attention to financial stability as well. In this process it closely examined domestic and overseas risk factors such as global trade disputes, the spread and domestic economic implications of COVID-19, household debt growth and geopolitical risks. Under this policy stance, the Bank maintained the Base Rate at 1.25% per annum between November 2019 and February 2020.

Bank of Korea Base Rate¹⁾



Note: 1) Figures in parentheses refer to the dates of Base Rate adjustments.

Source: Bank of Korea.

⑦ A detailed look at the Base Rate decisions by sector, and the backgrounds behind them, follows:

In the January meeting, the Board decided to leave the Base Rate unchanged at 1.25% considering that it was necessary to monitor future economic developments amid somewhat

subdued uncertainties surrounding external conditions due to the progress in the US-China trade negotiations, while paying attention to financial stability risks. In spite of the sustained adjustment in construction investment and the decline in exports, the sluggishness of the domestic economy appeared to have had somewhat eased as facilities investment rose slightly and consumption growth expanded. The Board, therefore, judged that the domestic economy was forecast to grow largely in line with the growth path projected in November. Consumer price inflation had risen to the upper-0% level during December as the pace of decline in agricultural, livestock & fisheries product prices decelerated and petroleum product prices rose, and was forecast to rise to the 1% range. It seemed necessary to stay alert to the changes in risks from the financial stability perspective, given that the amount of increase in household lending had expanded and housing prices in Seoul and its surrounding areas had been rising rapidly.

In the February meeting, the Board kept the Base Rate at 1.25% against the following background. The unexpected outbreak and spread of COVID-19 at the end of January had weakened the domestic economy. Although the sluggishness in facilities investment had eased, the adjustment in construction investment had continued and consumption had contracted owing to growing anxiety, while exports and production activity had been partly disrupted. The growth outlook of the domestic economy for this year, therefore, was adjusted downward from 2.3% to 2.1%, under the assumption that the spread of COVID-19 would peak in March and then start to be contained. However, it was judged that the future growth path was highly uncertain and would depend on future devel-

opments in the COVID-19 outbreak. Meanwhile, consumer price inflation had risen to 1.5% in January, due largely to an upturn in the prices of agricultural, livestock and fisheries products and the larger increase in petroleum product prices. Looking ahead, it was forecast that consumer price inflation would run at the lower-1% level and then fall slightly to record around 1% during this year. In the present situation in which macroeconomic conditions were changing drastically within a short time, it was true that uncertainties surrounding the growth path were high. However, it was judged to be necessary to more closely examine whether COVID-19 would peak in March and then start to ease, or whether it would be prolonged. It was judged that microeconomic policy measures which allow selective support of vulnerable sectors heavily impacted by the spread of COVID-19 were more exigent and effective than policy rate adjustments, since shrinking domestic demand and production activities were mainly attributable to the spread of anxiety stemming from viral contagion risk, rather than to economic factors. It was also taken into consideration that attention should be paid to financial stability as well, particularly since household lending growth was still high and it was necessary to keep a closer watch on whether housing prices would be stabilized after the adoption of the government's measures for the real estate market.

☒ On March 9, the Bank of Korea increased the ceilings of programs under the Bank Intermediated Lending Support Facility by a total of 5 trillion won, from 25 trillion won to 30 trillion won, to strengthen financial support for small and medium-sized enterprises (SMEs) experiencing funding bottlenecks due to the spread of COVID-19. Specifically, the Bank raised the reserve by 5 trillion won in order to support service-related

SMEs in the tourism, food & beverage, and distribution industries, as well as manufacturing SMEs having difficulties in procuring commodities and parts & components from China and those facing difficulties in exporting to China. Furthermore, the Bank increased the ceiling of the Support Program for New Growth Engine Development and Job Creation by 1 trillion won to support economic recovery, using excess funds from the Program for Stabilization of SME Lending.

Programs under the Bank Intermediated Lending Support Facility

(trillion won, %)

Program	Ceiling		Interest rate
	Before adjustment	After adjustment ¹⁾	
Support Program for Trade Financing	2.5	2.5	0.50
Support Program for New Growth Engine Development and Job Creation ²⁾	10.0	11.0	0.50
Program for Stabilization of SME Lending ³⁾	6.5	5.5	0.50~0.75
Support Program for Regional Enterprises	5.9	5.9	0.75
Reserve	0.1	5.1	0.75
Total	25.0	30.0	-

Notes: 1) As of March 9, 2020.

2) The Support Program for High-tech and Other Start-up SMEs was expanded and reorganized as the Support Program for New Growth Engine Development and Job Creation (September 2017).

3) Includes the support that had been formerly provided under the Support Program for Facilities Investment.

Source: Bank of Korea.

the Bank set up and ran a 「COVID-19 Response Task Force」 from January 28 to monitor developments related to COVID-19 and international financial market developments around the clock, and to closely examine their possible impacts on the domestic financial sector and economy. The Bank also managed market liquidity sufficiently by implementing open market operations in a flexible manner. In March, as volatility increased sharply in the domestic and foreign financial and FX markets due to the acceleration of the global spread of COVID-19, the sudden policy rate cut by the US Federal Reserve, and the collapse of international oil prices, the Bank held a 「Monetary and Financial Response Task Force Meeting」 and announced that it would monitor market conditions and use all possible policy measures to seek financial stability as necessary.

The Bank continued its efforts for the preemptive identification of potential risks within the financial system as well. During its December 「Financial Stability Meeting」, the Bank examined sector-by-sector vulnerabilities in household and corporate credit markets, asset markets, and financial institutions, and financial system resilience against tail risks.

⑨ The Bank of Korea continued its efforts for financial and foreign exchange market stability in response to changes in conditions at home and abroad. The Bank held a 「Financial and Economic Conditions Review Meeting」 to examine financial and FX market movements at home and abroad, in line with escalating military tensions between the US and Iran. In addition,

[Future Monetary Policy Directions]

10 Looking at the economic outlook,¹⁾ it is forecast that GDP will grow by 2.1% this year and 2.4% next year under a scenario in which the spread of COVID-19 starts to ease after peaking in March. After a temporary slowdown due to the negative impacts from COVID-19, the domestic economy is expected to recover gradually from the second quarter if the spread of the virus starts to be contained in March, as private consumption and exports rebound amid continued fiscal expansion and a recovery in facilities investment. However, there is a notably high level of uncertainty surrounding the growth path, particularly as to how the COVID-19 situation develops.

Economic growth outlook¹⁾²⁾

	2019 ³⁾			2020 ^{a)}			2021 ^{b)}
	H1	H2	Year	H1	H2	Year	Year
GDP	1.9	2.2	2.0	2.0	2.2	2.1	2.4
Private consumption	2.0	1.9	1.9	1.1	2.6	1.9	2.4
Facilities investment	-12.3	-2.6	-7.7	4.8	4.7	4.7	5.3
Intellectual property products investment	2.8	2.5	2.7	3.2	3.4	3.3	3.3
Construction investment	-5.1	-1.2	-3.1	-2.4	-2.0	-2.2	-0.9
Goods exports	-0.8	1.6	0.5	1.4	2.3	1.9	2.5
Goods imports	-3.2	1.6	-0.8	0.8	3.4	2.1	3.1

Notes: 1) Figures are the forecast as of February 2020.

2) Year-on-year.

3) Reflects fourth quarter preliminary figures (released on March 3).

Source: Bank of Korea.

Consumer prices are forecast to increase by 1.0% in 2020, higher than in 2019. Demand-side inflationary pressures remain weak and the government will maintain its social-welfare policy

stance in 2020. On the other hand, supply-side inflationary downward pressures on prices are expected to ease. While agricultural and live-stock prices increase from those of last year, which fell well below the average for past years, petroleum product prices also seem likely to show higher growth, due for instance to the expiration of a fuel tax cut. The rate of price inflation is expected to pick up to record 1.3% next year, owing to improved economic conditions and the reduced effects of social-welfare policies. Core inflation excluding food and energy prices is forecast to record 0.7% this year, and 1.1% next year. The upside and downside risks to the future inflation path are mixed. Some of the main upside risks are rising international commodity prices in line with the easing of COVID-19, and possible additional hikes in some public service charges. The downside risks, meanwhile, include stronger social-welfare policies regarding communication and healthcare, and a delayed improvement in domestic demand following the spread of COVID-19.

Inflation outlook¹⁾²⁾

	2019			2020 ^{a)}			2021 ^{b)}	
	H1	H2	Year	H1	H2	Year	Year	
CPI inflation	0.6	0.2	0.4	1.0	0.9	1.0	1.3	
Core inflation	CPI excluding food & energy	0.8	0.7	0.7	0.7	0.8	0.7	1.1
	CPI excluding agricultural products & oils	1.0	0.8	0.9	0.8	0.9	0.8	1.2

Notes: 1) Year-on-year.

2) Figures are the forecast as of February 2020.

Source: Bank of Korea.

11 In the future as well, the Bank of Korea will conduct its monetary policy so as to ensure that

1) Based on the Bank of Korea's 「Economic Outlook Report」 published on February 27, 2020

the recovery of economic growth continues and consumer price inflation can be stabilized at the target level (2.0%) 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 demand-side inflationary pressures will remain at a low level, the Bank will maintain its accommodative monetary policy stance. In this process it will judge whether to adjust the degree of monetary policy accommodation, while thoroughly assessing the severity of the COVID-19 outbreak and its impact on the domestic and global economies, the monetary policy responses of major countries, and changes in financial stability conditions such as the trend of increase in household debt. It will also closely monitor the development of global trade disputes and geopolitical risks.