Executive Summary

[Monetary Policy Operating Conditions]

1 A look at economic and financial conditions in Korea and abroad between July and November 2019 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 low growth was seen in the euro area. Growth in Japan also slowed moderately, due mainly to a sustained decline in exports. In China, the growth rate in the third quarter of 2019 decreased compared to the quarter before, as not only exports but also consumption and investment remained sluggish, owing to heightened uncertainties related to the US-China trade negotiations.

Economic growth in major economies[1)]

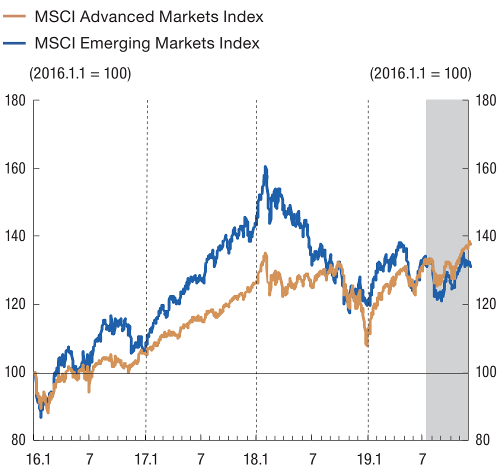
(%)

	2016	2017	2018			2019		
			Year	Q3	Q4	Q1	Q2	Q3
US	1.6	2.4	2.9	2.9	1.1	3.1	2.0	2.1
Euro area	1.9	2.5	1.9	0.8	1.4	1.8	0.7	0.9
Japan	0.5	2.2	0.3	-2.4	1.0	2.6	2.0	1.8
China	6.7	6.8	6.6	6.5	6.4	6.4	6.2	6.0

Notes: 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.

In the international financial markets, volatility expanded from August, due to the US-China trade dispute and the geopolitical risks in Hong Kong and the Middle East. However, markets have remained stable overall since the beginning of October as risk aversion has subsided in line mainly with progress in the US-China trade negotiations and a decrease in concerns about a no-deal Brexit. In major countries, long-term interest rates declined on the continuation of monetary policy accommodation but then rebounded. The share price indices of advanced and emerging market countries all rose.

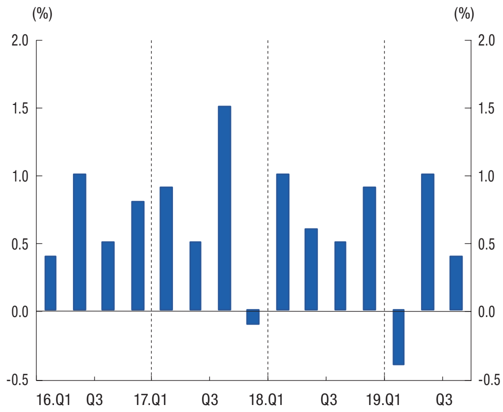
Share price indices of advanced and emerging market countries



Source: Bloomberg.

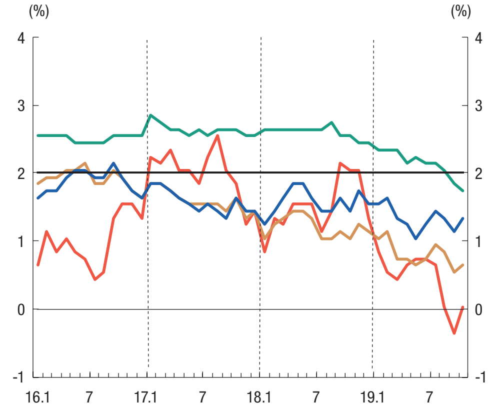
2 In the Korean economy, the pace of domestic economic growth remained slow as consumption growth weakened while the adjustment in construction investment and the sluggishness in exports and facilities investment continued. Meanwhile, employment conditions have continued to improve in some respects, with the increase in the number of persons employed having risen, particularly in services industries.

Real GDP growth[1)]



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

Inflation[1)2)]



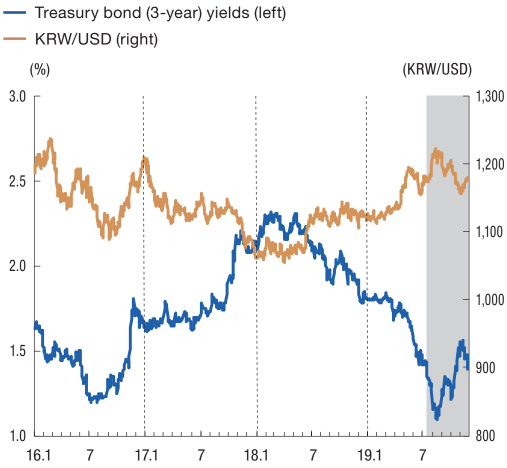
Notes: 1) The bold line indicates the inflation target.
2) Year-on-year.
3) Expectations for the CPI inflation rate one year in the future.
Sources: Bank of Korea, Statistics Korea.

3 Consumer price inflation was at around 0%, as downward pressures on the supply side heightened greatly due to base effects in agricultural, livestock, & fisheries product prices, amid weak demand-side inflationary pressures and sustained downward pressures from government policy. Core inflation excluding food and energy product prices remained low at the mid- to upper-0% level. The inflation rate expected by the general public fell to the upper-1% range.

Housing sales prices decreased at a slower pace and then shifted to an increase at the beginning of October. By region, the increase in housing sales prices in Seoul and its surrounding areas expanded, while the decline in the rest of the country came to a stop. Leasehold deposit prices reversed to an increase entering October, owing to an accelerated pace of increase in Seoul and its surrounding areas stemming from an increase in demand for leasehold housing.

4 In the domestic financial markets, major price variables fluctuated, influenced by developments in the international financial markets. Long-term market interest rates and stock prices fell in August, due to concerns about global economic slowdown and heightened external uncertainties, but then rose owing to the easing of external risks. The Korean won/US dollar rate fell after rising.

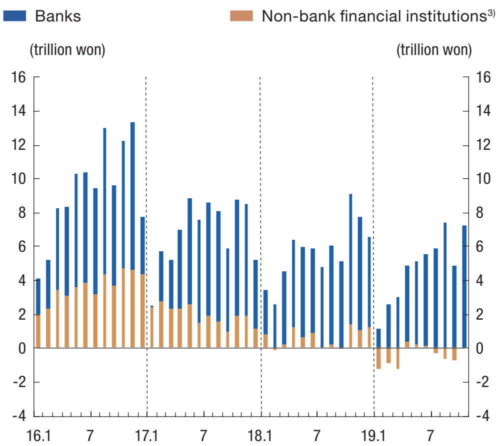
Korean Treasury bond yield and exchange rate (KRW/USD)



Sources: Bank of Korea, KOFIA.

5 Household lending continued to slow moderately. Household lending by banks showed a steady increase due to the demand for lending related to housing, but household lending by non-bank depository institutions remained on a decline, owing to lending regulations. Corporate lending sustained its growth, led by loans to small and medium-sized enterprises, thanks to banks' aggressive efforts to extend loans.

Changes in household loans[1)2)]

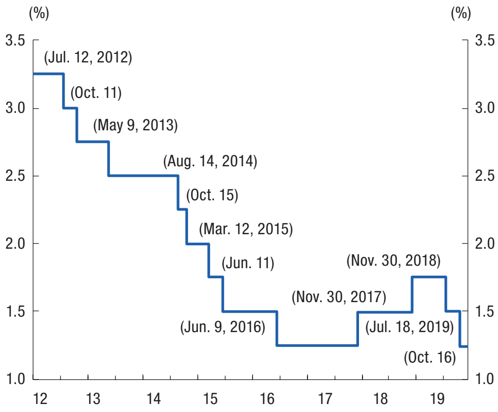


Notes: 1) Month-on-month.
2) Including mortgage transfers.
3) As of September 2019.
Source: Bank of Korea.

[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 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 the US-China trade dispute, changes in the economies and monetary policies of major countries, household debt growth, geopolitical risks, and capital flows. Under this policy stance, the Bank decided at its October meeting of the Monetary Policy Board to lower the Base Rate again by 25 basis points, as in July, to 1.25% per annum.

Bank of Korea Base Rate[1)]



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 August meeting, the Board decided to leave the Base Rate unchanged at 1.50% considering that it was necessary to monitor the developments of external conditions and their impact on Korean economy, particularly since the Base Rate had been cut by 0.25 percentage points in July to cope with growing downside risks to the macroeconomy. Concerning the domestic economy, growth continued to slow, as the adjustments in construction investment and the sluggishness in exports and facilities investment persisted while consumption growth weakened. It was also judged that the uncertainties surrounding the future growth path had risen even further, due to the worsening US-China trade dispute and heightened geopolitical risks. It was seen that downside risks to the price forecast path had increased as consumer price inflation declined to the mid-0% range. In terms of financial stability, while growth in household loans was slowing, it seemed necessary to stay alert to the changes in risks from the financial stability perspective, particularly since expectations for a rise in housing prices had grown and volatility in financial and foreign exchange markets had expanded.

In the October meeting, the Board decided to cut the Base Rate by 0.25 percentage points to 1.25% per annum. The Board made this decision in view of weaker demand-side inflationary pressures and of the expectation that growth would fall short of the July forecast path due to the continued US-China trade dispute and growing geopolitical risks. In terms of the domestic economy, growth continued to slow, as the sluggishness in exports and investment persisted while consumption growth weakened. Consumer price inflation recorded a negative figure in September due to the drops in prices of petroleum products, of agricultural, livestock & marine products, and of public services. It was forecast to stand at the 1% range next year after fluctuating in the 0% range for some time. While the slowing of household lending growth had continued, there was judged to be a need to be cautious of the changes in the housing market and their impacts on household debt, particularly since housing prices in Seoul and metropolitan areas had been rising of late.

Meanwhile, in the November meeting, while the price and growth outlooks were adjusted downward, the Board kept the Base Rate at 1.25% considering that it had cut the Base Rate in October in anticipation of this and that it was necessary to monitor future developments in macroeconomic and financial stability conditions. Slow growth in the domestic economy continued, and in reflection of the recent economic conditions and changes in conditions at home and abroad, the growth outlooks were lowered to around 2% in 2019 and the lower-2% level in 2020. Consumer inflation recorded about 0% this year and is projected to be around 1% next year, falling below the 2% inflation target. In terms of financial stability, it was judged that close attention should be continuously paid to the risks of financial imbalances worsening in line with inflows of funds into risky assets or real estate considering the recent rise in housing prices led by Seoul and and its surrounding areas and the expansion of household lending growth entering October.

8 The Bank of Korea adjusted the ceilings of programs under the Bank Intermediated Lending Support Facility to support the recovery of

the domestic economy and the expansion of the growth potential. The Bank raised the ceiling of the Support Program for New Growth Engine Development and Job Creation by 4 trillion won, in order to strengthen support for companies able to contribute to expanding new growth engines and employment. Furthermore, the Bank increased the ceiling of the Support Program for Trade Financing by 1 trillion won to improve exporters' funding conditions. Excess funds from the Program for Stabilization of SME Lending were used in raising the ceilings of the programs above.

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. As uncertainties in the financial market grew with Japan's export restrictions and the escalation of the trade dispute between the US and China, the Bank of Korea held a 「Financial and Economic Conditions Review Meeting」 in early August to examine financial market movements at home and abroad and their impact on the Korean economy. The Bank closely monitored the international financial markets in preparation for a possible increase in domestic financial market volatility during the Chuseok holiday (September) and before and after the US FOMC meetings.

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

[Future Monetary Policy Directions]

10 It is forecast that the GDP growth rate will rise gradually from 2.0% this year to 2.3% next year. With monetary and fiscal policy set on an expansionary course, facilities investment and exports are expected to improve, while private consumption is projected to recover from the second half of next year. The uncertainties as to the future growth path are high. The major upside risks include the easing of global trade protectionism with a trade deal between the US and China, and the spread of global monetary policy accommodation. Among the downside risks are a delayed recovery of the semiconductor industry, continued sluggishness in global trade, growing geopolitical risks including the escalation of protests in Hong Kong, and a worsening slowdown of domestic demand in China.

Economic growth outlook[1)2)]

(%)

	2018	2019			2020e			2021e
	Year	H1	H2e	Yeare	H1	H2	Year	Year
GDP	2.7	1.9	2.1	2.0	2.2	2.3	2.3	2.4
Private consumption	2.8	2.0	1.8	1.9	1.9	2.2	2.1	2.3
Facilities investment	-2.4	-12.3	-2.9	-7.8	5.7	4.2	4.9	5.2
Intellectual property products investment	2.2	2.8	2.5	2.7	3.3	3.6	3.4	3.3
Construction investment	-4.3	-5.1	-3.6	-4.3	-3.6	-1.2	-2.3	-0.9
Goods exports	3.3	-0.8	0.1	-0.4	2.3	2.1	2.2	2.4
Goods imports	1.6	-3.2	0.0	-1.6	2.4	2.3	2.4	2.9

Notes: 1) Year-on-year.
2) Figures are the forecast as of November 2019.
Source: Bank of Korea.

While headline inflation is expected to increase next year as supply-side inflationary downward pressures ease, it is forecast to stand at around 1.0%, falling short of the 2% inflation target, due to weak demand-side inflationary pressures and the government's continued social-welfare policy stance. Meanwhile, core inflation excluding food and energy prices is forecast to rise gradually to record 0.7% next year. The upside and downside risks to the future inflation path are mixed. Some of the main upside risks are the possibility of economic improvement at home and abroad, and possible hikes in some public service charges. The downside risks, meanwhile, include stronger social-welfare policies regarding communication and healthcare, and weaker demand-side inflationary pressures caused by a delayed recovery of domestic demand.

Inflation outlook[1)2)]

(%)

		2018	2019			2020e			2021e
		Year	H1	H2e	Yeare	H1	H2	Year	Year
CPI inflation		1.5	0.6	0.2	0.4	1.1	0.9	1.0	1.3
Core inflation	CPI excluding food & energy	1.2	0.8	0.7	0.7	0.7	0.8	0.7	1.1
	CPI excluding agricultural products & oils	1.2	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 November 2019.
Source: Bank of Korea.

11 In the future as well, the Bank of Korea will conduct its 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.

The Bank will maintain its accommodative monetary policy stance as inflationary pressures on the demand side are forecast to remain low, while growth of the domestic economy will be moderate. In this process it will judge whether to adjust the degree of monetary policy accommodation, while carefully monitoring developments in the US-China trade negotiations, the economies and monetary policies of major countries, the trend of increase in household debt, and geopolitical risks and examining their effects on domestic macroeconomic and financial stability conditions.