

Minutes of the Monetary Policy Board Meeting

August 13, 2015

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting¹⁾ **(August 2015)**

I . Outline

1. Date of meeting : Thursday, August 13, 2015
2. Place : Monetary Policy Board Meeting Room
3. Monetary Policy Board members present:
Lee, Juyeol, Chairman (Bank of Korea Governor)
Ha, Seong Keun
Chung, Hae-Bang
Chung, Soon Won
Moon, Woosik
Hahm, Joon-Ho
Jang, Byung Wha (Senior Deputy Governor)
4. Monetary Policy Board members absent : none
5. Participants :
Ha, Sung, Auditor
Hur, Jae Sung, Deputy Governor
Suh, Young Kyung, Deputy Governor
Lee, Heung Mo, Deputy Governor
Kim, Minho, Deputy Governor
Yoon, Myun-Shik, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Choi, Woon Gyu, Director of BOK Economic Research Institute
Chang, Min, Director of Research Department
Cho, Jeonghwan, Director General of Financial Stability Department
Huh, Jin Ho, Director General of Monetary Policy Department
Shin, Ho Soon, Director General of Financial Markets Department
Hong, Seung Je, Director General of International Department
Lee, Hwanseok, Director General of Monetary Policy Board Secretariat
Park, Sung Joon, Press Officer
Park, Cheol Won, 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 Situation²⁾

After briefings by staff on ‘Current Economic Developments in Korea’, ‘FX and International Finance’ and the ‘Financial Markets’, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

With regard to **the global economy**, members’ assessment was that the trend of economic growth in the US had been sustained, driven by consumption and exports, and that the pattern of mild improvement in the euro area and Japan had continued. Meanwhile, economic uncertainty in China had increased with growth continuing to slow. Members judged that investor sentiment concerning emerging market economies had contracted greatly in **international financial markets**, owing chiefly to expectations of the US Fed’s policy rate hike and to the unrest in the Chinese equity markets.

As to **the domestic economy**, members noted that, while the economy showed modest economic recovery due to the waning of the effects of the Middle East Respiratory Syndrome (MERS) outbreak, exports had continued to decline.

Concerning **the domestic financial markets**, meanwhile, members observed that stock prices had fallen and the Korean won had depreciated against the US dollar, chiefly under the influence of outflows of foreigners’ portfolio investment funds. They also noted that foreign exchange market volatility had risen greatly, affected by the devaluation of the Chinese yuan.

With regard to **prices**, members observed that, despite the reduction in

2) English versions of 'Current Economic Developments in Korea' and the 'Financial Markets' are posted on the Bank of Korea website.

electricity tariffs, consumer price inflation had still come in at 0.7%, the same as that of the month previous, owing, for example, to hikes in public transport fares. Core inflation excluding agricultural and petroleum product prices was 2.0%, also the same as that of the preceding month.

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:

Members shared the opinion that, in overall consideration of the domestic and international economic environments and the future outlook for them both, it would be desirable this month to hold the Base Rate at its current level for the intermeeting period.

Among them, one member assessed that, although domestic economic activity and price movements had evidenced some heightening of uncertainty due to increasing volatility in the external sector, they were judged to have not strayed far from the path forecast in July. The member then went on to state his view that the Board should hold the Base Rate at its current level for the intermeeting period. He argued, however, that a close watch should be kept on spillover effects from the devaluation of the yuan in the future, since volatility had been mounting with outflows of foreign portfolio investment funds, and stock prices and the exchange rate fluctuating greatly, influenced by the international financial market unrest. The member also argued that the Board should do all it could to manage external sector risk by refining and updating its contingency plans in readiness for any sudden reversal of capital flows.

Another member stated his view that it would be desirable to hold the Base Rate at its current level for the intermeeting period. He pointed out that, although foreign portfolio investment funds had experienced large outflows in July and the won had depreciated against the dollar, this was attributable to a weakening of the won in line with the global strength of the US dollar, and to some EMEs' need to secure foreign currency liquidity, rather than to changes in Korea's economic fundamentals. He then went on to express the view that, since Korea was running a large

current account surplus, provided domestic real economic and international economic conditions did not deviate greatly from their expected trajectory, the possibilities of massive foreign portfolio investment fund outflows and a consequent rapid weakening of the Korean won could be largely discounted. He went on to argue that, given these circumstances, the sharp depreciation of the Korean won, prompted by the abrupt devaluation of the Chinese yuan, appeared to be attributable to excessive herd behavior on the part of economic agents. Appropriate management of this state of affairs was thus called for and there should be unflagging efforts to lessen exchange rate volatility.

One other member took the view that while, despite the high degree of uncertainty, growth and consumer prices were not seen to be deviating far from the path forecast last July, risks in terms of financial stability were considered to have grown, with household lending maintaining strong growth and stock prices and exchange rates showing heightened volatility due mainly to outflows of foreigners' securities investment funds, affected chiefly by expectations of the US Fed's policy rate hike and financial and economic instability in vulnerable emerging market countries. The member elaborated this by stating that in his opinion while keeping the Base Rate at its current level for the intermeeting period, the Bank should redouble its focus on the US Fed's monetary policy normalization process and the movements of the Chinese yuan's exchange rate, and the likely reverberations these two factors would have for the Korean financial and real economic sectors — in/outflows of foreign investment funds and movements of price variables such as interest and exchange rates.

Meanwhile, one member stated his belief that it would be appropriate to leave the Base Rate unchanged this month. He argued that although the growth path for the second half was expected to remain as originally forecast, the upward and downward uncertainties surrounding the growth path were growing even further due to domestic and external factors.

Meanwhile, the significant month-on-month increase in core inflation and the gradual easing of instability in inflation expectations were attributable more to supply-side factors than demand-side ones. A careful watch was therefore needed on the underlying trend of demand-side inflation pressures. Apart from this, the slack in the production sector showed little sign of improvement and that in the employment sector was widening somewhat. The member added that more attention needed to be paid to risk factors, including the possibility of capital outflows, shrugging off Korean economic fundamentals, accelerating to a greater extent than expected in line with changes in global risk conditions, the possibility of a further Chinese economic slowdown and additional yuan depreciation, and the burgeoning household indebtedness showing strong pro-cyclicality to the accelerating upward momentum of the housing market.

Another member stated his view that financial stability risks including household debt should be monitored closely, holding the Base Rate at its current level for the intermeeting period, keeping a close watch on the effects of monetary easing policies and expansion of fiscal expenditure, and paying attention to changes in global financial and economic conditions, the extent of their spillover effects on the Korean financial markets and economy and whether economic agents were regaining their confidence. The member argued that, in order for the Korean economy to shift toward one based on innovation, it would be necessary to break with the incrementalist approach and address future tasks on the basis of clear perspectives and groundbreaking measures. The member went on to present as immediate challenges the examination of emerging market economy risks and pursuit of measures to counter them, the stable management of long-term interest rates and exchange rates, and the in-depth analysis of the Chinese economy, and stressed the necessity of promoting the upgrading of the monetary policy framework to effectively handle the changes in domestic and external conditions, developing new employment-related statistics while constructing a framework for the

assessment of employment indicators-based economic trends, and conducting research on the effects of the spread of electronic payment services and the entry of specialist Internet banks and make preparations in readiness.

One other member also set out his views as to the desirability of holding the Base Rate at its current level for the intermeeting period. The member assessed the four Base Rate cuts since the second half of last year as having contributed to enhancing the vigor of the Korean economy by improving corporate and households' access to loans and lessening the lending rate burden. He mentioned that, although in the course of this the excessive growth of household debt had imposed a burden on the operation of the easing policy, it would be advisable to address this through macro-prudential rather than monetary policy. The member also expressed the opinion that while the comprehensive household debt management measure that the government had recently announced was expected to have some limited effect, more aggressive measures should be taken additionally without hesitation as and when they were called for.

The member also stressed that the monetary authority should examine all possible policy measures and consider how to implement them in response to the slow growth and low inflation dragging on.

Meanwhile, the member emphasized that, as volatility would very likely increase in the financial and foreign exchange markets given the gathering expectations of the US Fed's hike of interest rates at an early stage, the dollars' global strength, the possibility of major countries' competitive currency devaluations and the prospects for the Korean economy's huge current account surplus, the financial authorities should keep a close watch on financial and foreign exchange market trends and if and when needed employ policy measures to ensure orderly market in a timely manner.

IV. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of their earlier discussions, a statement was compiled with the unanimous consent of all members.

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Monetary Policy Decision

- ☐ The Monetary Policy Board of the Bank of Korea decided today to leave the Base Rate unchanged at 1.50% for the intermeeting period.

- ☐ Based on currently available information the Board considers that the trend of economic recovery in the US has been sustained, and that the improvements in the euro area have continued as well. Economic growth in emerging market countries including China has meanwhile continued to slow. The Board forecasts that the global economy will sustain its modest recovery going forward, centering around advanced economies such as the US, but judges that the possibility exists of its being affected by heightened international financial market volatility due to a shift in the US Federal Reserve's monetary policy and to the devaluation of the Chinese yuan, and by the weakening of economic growth in emerging market countries.

- ☐ Looking at the Korean economy, exports have continued their trend of decline but consumption and the sentiments of economic agents, after having contracted due mainly to the shock from the Middle East Respiratory Syndrome (MERS) outbreak, appear to have improved. On the employment front, the employment-to-population ratio in July maintained the same level as that during July of last year, but the trend of increase in the number of persons employed slowed and, due mainly to an expansion in job search activities, the unemployment rate rose compared to that in July last year. The Board forecasts that the domestic economy will show a trend of recovery going forward, owing chiefly to the expansionary

macroeconomic policies and to the ending of the MERS outbreak, but judges the uncertainties surrounding the growth path to be high.

- ☐ Despite cuts in electricity charges, consumer price inflation registered 0.7% in July, the same as in June, in line mainly with the expansion in the extent of increases in service prices. Core inflation excluding agricultural and petroleum product prices was 2.0% in July, the same as in June. Looking ahead the Board forecasts that inflation will continue at a low level, due mainly to the effects of low oil prices. In the housing market, the upward trends of sales and leasehold deposit prices have continued in both Seoul and its surrounding areas and the rest of the country.
- ☐ In the domestic financial markets, influenced mostly by expectations of a policy rate hike by the US Federal Reserve and by the devaluation of the Chinese yuan, stock prices have fallen and the Korean won has depreciated sharply against both the US dollar and the Japanese yen. Long-term market interest rates have fallen slightly, in response mainly to interest rate movements in major countries. Bank household lending has sustained a trend of increase at a level substantially exceeding that of recent years, led by mortgage loans.
- ☐ Looking ahead, while working to sustain the recovery of economic growth, the Board will conduct monetary policy so as to maintain price stability over the medium-term horizon and pay attention to financial stability. In this process it will closely monitor the trend of increase in household debt and external risk factors such as a possible shift in the US Federal Reserve's monetary policy and financial instability in some emerging economies, as well as the trend of capital flows.