

Minutes of the Monetary Policy Committee Meeting

February 17, 2015

The Bank of Korea

(English version)

Minutes of the Monetary Policy Committee Meeting¹⁾ **(February 2015)**

I . Outline

1. Date of meeting : Tuesday, February 17, 2015
2. Place : Monetary Policy Committee Meeting Room
3. Monetary Policy Committee 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 Committee members absent : none
5. Participants :
Song, JaeJung, Auditor
Kang, Juno, Deputy Governor
Hur, Jae Sung, Deputy Governor
Suh, Young Kyung, Deputy Governor
Lee Heung Mo, Deputy Governor
Kim, Minho, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Choi, Woon Gyu, Director of BOK Economic Research Institute
Cho, Jeonghwan, Director General of Financial Stability Department
Yoon Myun-Shik, Director General of Monetary Policy Department
Huh, Jin Ho, Director General of Financial Markets Department
Hong, Seung Je, Director General of International Department
Jeon, Seung-Cheol, Director General of Monetary Policy Committee Secretariat
Park, Sung Joon, Press Officer
Park, Cheol Won, Head of MPC Team

1) This English version (summary) of the minutes of the Monetary Policy Committee 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 Committee (MPC) members covered the following areas:

With regard to **the global economy**, many members’ assessment was that the U.S. had maintained favorable growth and the euro area and Japan had shown trends of modest recovery, while economic growth in China had slowed. Members also judged that, in the **international financial markets**, asset prices had shown high volatility and the strengthening of the U.S. dollar had continued.

As to **the domestic economy**, members noted that the trend of recovery had been weak, as indicators of domestic demand such as consumption and facilities investment, which had risen in December 2014, were estimated based on January monitoring to have declined.

Concerning **the domestic financial markets** meanwhile, members pointed out that stock prices had risen, long-term market interest rates had rebounded after having fallen, and household lending had shown a much faster pace of increase than in the preceding few years.

With regard to **prices**, members noted that, despite a hike in cigarette prices, consumer price inflation was just 0.8% in January, the same as in December due mainly to declines in petroleum product prices. Some members voiced concerns that, although inflation expectations had registered 2.6% in January, just as in December, the proportion of responses expecting inflation of 2% or lower had steadily increased, the consumer

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

sentiments on prospective prices was on a downward path, the inflation rate expected among experts was at around the mid-1% level, and the break-even inflation rate had fallen to a little above 1%. One member on the other hand noted that the concerns about deflation voiced in some quarters were overdone, since prices were expected to shift to an upward trend in the first half of 2015.

III. Discussions Concerning Monetary Policy Decision (Summary)

The main details of the MPC 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 environment and the future outlooks for both, it would be desirable to hold the Base Rate at its current level for the intermeeting period.

One member noted that prices were likely to sustain a very low rate of increase for the time being, influenced by the declines in international oil prices, and that the economy had shown no clear signs of recovery. He went on to argue that it would be desirable to maintain the Base Rate at its current level for the intermeeting period since, due mainly to seasonal factors, there was not enough data to judge the strength of the economic recovery, and there was also a need to further observe the effects of the government's front-loading of its budget implementation and of the BOK's Base Rate cuts.

Another member, after agreeing on the desirability of leaving the Base Rate at its current level for the intermeeting period, observed that Korean exports to Japan and the EU had declined significantly in the fourth quarter of 2014, in line with the quantitative easing by the Bank of Japan

and the ECB. It was now time, he suggested, to work actively to minimize the negative spillover effects of the yen's and the euro's depreciations on the Korean economy. The member added that the abrupt exchange rate fluctuations in the US dollar, the yen and the euro, stemming from policy divergences among major advanced country central banks, signified that the promises made at the Seoul G20 Summit in 2010 were no longer being followed, and expressed the view that, against this backdrop, Korea should not only seek actively to reduce exchange rate volatility, but also devote efforts to securing various possible policy tools.

One other member, while expressing the opinion that it would be better to keep the Base Rate at its current level during the intermeeting period, noted the need for paying close attention when adjusting the Base Rate, given that it was difficult to accurately grasp the underlying macroeconomic trends since major real economic indicators had recently been substantially influenced by irregular and seasonal factors, and it remained unclear how shifts in major countries' monetary policies and the movements of international oil prices would affect domestic and overseas economic conditions. The member went on to state that effective measures should be sought to improve the quality of the household debt structure and curb growth in overall household debt outstanding, and that proposals for supporting the recovery of growth and expansion of the growth potential should be explored, depending on the situation, through the employment of policy instruments other than policy rate adjustment, such as the bank intermediation support facility.

Another member meanwhile presented the view that, although in the present situation there was some scope for additional Base Rate adjustment given that the negative output and inflation gaps, which had widened in the fourth quarter of 2014, had not narrowed to any significant extent and that substantial spare capacities remained at firms and in the labor market,

it would still be appropriate to leave the Base Rate unchanged for the month, considering that the uncertainties about the effects of and potential risks related to Base Rate adjustment remained considerable. The member also noted that the fall in international oil prices and the spread of accommodative monetary policy stances would aggravate the downward pressures on prices, but on the other hand also have the effect of stimulating total demand. He added that the channels for revival of the Korean economic growth potential and for returning to the appropriate price level needed to be examined closely, while also strengthening the macroprudential supervisory framework through cooperation among the related authorities with regard to financial stability risks including the increase in household debt. He at the same time stated that the economy's resilience must be heightened through efforts to increase the efficiency of resource allocation, by for example enlarging the corporate restructuring functions of creditor financial institutions.

Another member stated, taking domestic and overseas financial and economic conditions into overall consideration, that on the overseas side the paces of improvement in economic activities were weak in major countries apart from the U.S., and future economic uncertainties had increased due mainly to expectations of a U.S. policy rate hike, to the expansions in major countries' monetary policy accommodativeness, to political instability in Greece and to the shock of low oil prices, while on the domestic side exports were somewhat feeble, the recovery of domestic demand was sluggish and the pace of improvement in economic agents' sentiment was weak. After advocating that the Base Rate be held at its current level for the inter-meeting period, he added his view that attention needed to be paid to changes in global conditions, while growth- and price-related macroeconomic risks should be considered together with the risks to financial stability, in a balanced manner, to ensure that vulnerabilities related to the growth path did not materialize.

One other member assessed the recent changes in the economic environments at home and abroad as calling for comprehensive examination of the appropriateness of the current Base Rate level, and added that, while holding the rate at its current level for the intermeeting period, the Committee should keep close watch on the future impacts of the accommodative monetary policies in major countries, the downside risks to exports and domestic demand, the trend of increasing household debt, the development of the low inflation situation, in/outflows of foreign capital and foreign exchange market trends, in order to seek the optimal policy response. He went on to note that, as the Korean economy was vulnerable to external sector disturbances owing to its high degree of market openness and external dependency, the possibility was high of the recent monetary policy easing by major countries causing substantial volatility in the Korean economy, and the policy authorities should therefore prepare against such shocks in advance. The member then added that it was necessary to strengthen measures for countering the excessive growth of household debt, to carry out structural innovation of the economy and to construct new engines of growth.

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 Committee of the Bank of Korea decided today to leave the Base Rate unchanged at 2.00% for the intermeeting period.
- ☐ Based on currently available information the Committee considers that, although the trend of a solid economic recovery in the US has been sustained and the euro area has also shown signs of improvement, albeit weak, economic growth in emerging market countries including China has slowed. The Committee forecasts that the global economy will sustain its modest recovery going forward, centering around major advanced economies such as the US, but judges that the possibility exists of its being affected by changes in the monetary policies of major countries, by the weakening of economic growth in emerging market countries, by geopolitical risks, and by the uncertainties over the restructuring of Greek debt.
- ☐ Looking at the Korean economy, while exports have decreased, due mainly to declines in the unit prices for example of petroleum products, the Committee judges that the recovery of domestic demand has not been strong and that the sentiments of economic agents remain weak. On the employment front, the number of persons employed has expanded steadily, led by increases in the 50-and-above age group and in the service sector. The Committee expects that the domestic economy will show a modest trend of recovery going forward, but that the negative output gap will persist for a considerable time.
- ☐ Despite increases in the extents of decline in petroleum product prices, consumer price inflation registered 0.8% in January, the

same as in December, due mainly to an expansion in the scale of increase in prices of industrial products other than petroleum. Core inflation excluding agricultural and petroleum product prices rose sharply from 1.6% the month before to 2.4% in January. Looking ahead, the Committee forecasts that inflation will gradually rise from the second half of this year, after remaining at a low level. In the housing market, the upward trends of sales prices slowed somewhat, while leasehold deposit prices continued their uptrend centering around Seoul and its surrounding areas.

- ☐ In the domestic financial markets, long-term market interest rates, after having fallen in line mainly with monetary policy easing by major countries, have rebounded in response to the improvements in US economic indicators. Stock prices have risen. The Korean won, which had appreciated against the US dollar, has depreciated as the effects of the sustained current account surplus and the dollar's strength globally have intersected. The recent trend of won appreciation against the Japanese yen has meanwhile weakened amid increased demand for safe-haven assets. Bank household lending has sustained its trend of increase at a level greatly exceeding that of recent years, led by mortgage loans.
- ☐ Looking ahead, while supporting the recovery of economic growth the Committee will conduct monetary policy so as to maintain price stability over a medium-term horizon and pay attention to financial stability. In this process it will closely monitor external risk factors such as international oil prices and shifts in major countries' monetary policies, as well as developments related to the spare capacity in the domestic economy and the trends of household debt and capital flows.