# Minutes of the Monetary Policy Board Meeting

February 23, 2017

**The Bank of Korea**

(English version)

# Minutes of the Monetary Policy Board Meeting[1)]

## (February 2017)

## Ⅰ. Outline

1. Date of meeting: Thursday, February 23, 2017

2. Place : Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:

Lee, Juyeol, Chairman (Bank of Korea Governor)
Hahm, Joon-Ho
Jang, Byung Wha (Senior Deputy Governor)
Lee, Il Houng
Cho, Dongchul
Koh, Seung Beom
Shin, Inseok

4. Monetary Policy Board members absent: none

5. Participants:
Ha, Sung, Auditor
Kim, Minho, Deputy Governor
Yoon, Myun-Shik, Deputy Governor
Lim, Hyung Joon, Deputy Governor
Huh, Jin Ho, Deputy Governor
Jeon, Seung-Cheol, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Chang, Min, Director General of Research Department
Park, Jongseok, Director General of Monetary Policy Department
Lee, Hwan Seok, Director General of Financial Markets Department
Suh, Bong Gook, Director General of International Department
Sohn, Wook, Director of BOK Economic Research Institute
Lee, Seung Heon, Press Officer
Chang, Cheong-Seok, Director General of Monetary Policy Board Secretariat
Lee, Dong Won, Head of MPB Team

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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[2)]

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

With regard to **the global economy**, members’ assessment was that it had sustained its modest recovery, led by the US, and the growth momentum of emerging market economies had been improving, due for instance to rising commodity prices and trade growth amid stable financial conditions. Members also evaluated that **international financial markets** had been stable overall, with interest rates exhibiting slower growth and stock prices rising as anxiety eased. Members, however, assessed that the Trump administration’s economic policy directions and the potential policy rate hike by the US Federal Reserve had been causing global financial market volatility to increase.

Concerning **the domestic economy**, members’ evaluation was that, while manufacturing production and facilities investment had continued to improve thanks to the recovery in exports, private consumption had remained weak, due for instance to a contraction in consumer sentiment.

With regard to **the domestic financial markets**, meanwhile, members judged that market interest rates and stock prices had held steady with the stabilization of the international financial markets, but the Korean won-US dollar exchange rate had remained highly volatile.

As to **prices**, members noted that consumer price inflation had risen to the 2% target level in January, in line mainly with oil price base effects and sharp increases in the prices of agricultural, livestock and fisheries products.

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2) English versions of 'Recent Economic Developments' and 'Financial Market Trends' are 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:

Members shared the opinion that, in overall consideration of the changes in the domestic and international financial and economic environments, it would be desirable to hold the Base Rate at its current level of 1.25 percent for the intermeeting period.

One member expressed the opinion that, while maintaining the Base Rate at its current 1.25 percent level for the intermeeting period, the Bank of Korea should keep a close watch on changes in financial and economic conditions at home and abroad, and in particular on developments of domestic and overseas risk factors and their impacts. The member assessed that, while the trend of recovery in the world economy had been strengthening and the international financial markets had remained stable overall, the domestic economy had showed a modest growth trend, boosted by continued improvements in exports, which had more than offset sluggish consumption. Going into more detail, the member first stated that although there were high uncertainties in domestic and overseas economic conditions, the domestic economy was expected to continually hold to the January forecast path. The member then went on to present the opinion that concerns about the possibility of an economic crisis, raised by some, were premised on various risk factors materializing simultaneously, and thus such concerns did not seem reasonable. Next, the member anticipated that, although consumer price inflation in January had risen to the 2% target level, inflation for the year as a whole was unlikely to diverge greatly from the January projection (1.8%), as prices of agricultural, livestock and fisheries products stabilized. Meanwhile, looking at financial conditions, although a movement toward a slower increase in bank lending to households had continued in January 2017 from December last year, this was attributable in part to seasonal factors, and thus, it was difficult to say at this stage that household lending growth would fundamentally slow. The member also noted that the won-dollar exchange rate had fluctuated of late, but this reflected the high openness of the Korean FX market, and thus the negative perceptions of economic agents with respect to high exchange rate volatility should shift toward acceptance of this reality as normal. Last, the member noted that, although the decoupling of the monetary polices of major countries had continued, other major country central banks were showing signs of narrowing the degrees of their monetary easing, and the member called attention to the point that if there are changes in major countries' monetary policy stances, additional Fed rate hikes may have greater-than-expected impacts on the domestic and international financial markets. Taking these points in overall consideration, the member expressed the opinion that it would be appropriate to hold the Base Rate at its current 1.25 percent for the intermeeting period, and keep a close watch on changes in financial and economic conditions at home and abroad, and in particular on developments of domestic and overseas risk factors and their impacts.

Another member expressed the opinion that it would be appropriate to keep the Base Rate unchanged from the current level for the intermeeting period. The member assessed that, in terms of the real economy, the trend of 'sluggish domestic demand and improved exports' had become more evident. In particular, construction investment had shown a gentle correction instead of plunging as initially anticipated, but the consumption slump was fairly significant, with consumption remaining on the decline month-on-month since November last year. The member went on to point out that consumption could pose downside risks to economic growth going forward. Meanwhile, the member noted that, as exports had grown at a faster pace for the fourth consecutive month since November last year, due mainly to increased demand in the global semiconductor market and recoveries in petroleum product exports in line with rising oil prices, there was a heightened possibility that this could represent a trend going forward. The member, however, commented that the Trump government's protectionist trade stance was lurking as a risk factor. Taking these points into overall consideration, the member assessed that the path for the real economy for this year would not diverge greatly from the Bank of Korea Research Department's January outlook. In terms of prices, the member noted that consumer price inflation in January stood higher than expected at 2%, but this was attributable to one-off supply shocks such as rising prices of agricultural, livestock, and fisheries products in line with the outbreaks of avian influenza and foot-and-mouth disease, as well as to rising oil prices. The member accordingly judged that there was little risk of the price inflation path far exceeding the path forecast in January. Given an empirical analysis showing that inflation expectations in small open economies are affected by global price movements, the member anticipated that the recent trend in the world economy of moving away from low inflation was likely to serve as a positive factor in lessening the burden on domestic monetary policy related to achieving the inflation target. Last, in terms of financial stability, the member assessed that household debt growth was stabilizing, with household lending growth having decreased significantly in January 2017 as in December last year. The member, however, noted that, considering that housing transactions are usually in full swing from March and act as a demand-side factor for lending to households, it was appropriate to keep a close eye on actual developments in household debt to determine whether it has been stabilized.

One other member expressed the opinion that it would be desirable to keep the Base Rate unchanged from the current level for the intermeeting period. The member mentioned that, in implementing monetary policy going forward, attention should be paid to the recent inflation trend while taking into consideration predictable causes of economic uncertainty. The member assessed that, although consumer price inflation had risen significantly in January, inflation in 2017 was unlikely to deviate far from the January forecast of 1.8 percent, and went on to argue that, based on the forecast that supply-side inflation pressures would not be large, it would be possible to maintain accommodative monetary policy in consideration of downside pressures to the economy. Meanwhile, the member noted the growing need to maintain monetary accomodation due to the worsening employment situation following corporate restructuring, and mentioned that preventing employment quality from declining would be important to prevent household debt problems from worsening. In terms of financial stability, the member expressed the view that, although the increase in household debt had continued to slow in January as in December last year, it was a little too early to assess that its growth had slowed, considering that January was typically a slow month for the real estate market and thus did not usually register large increases in household debt. The member added that a close watch should be kept on whether the slowdown in household debt growth would continue from March onwards. The member went on to stress that the international financial markets had been stable overall and attention should be paid to potentially destabilizing external factors.

Meanwhile, one member took the view that, while maintaining the Base Rate at its current level, it would be appropriate to estimate the effects on Korea's macroeconomy from domestic demand and exports, which had shown conflicting directions since the fourth quarter last year. The member assessed that the global economy had continued to exhibit a moderate recovery, crude oil and other commodity prices had rebounded, and asset prices had shown an upward trend in advanced countries, which had helped Korea's exports shift to an increase and acted as a factor supporting a rebound in manufacturing production and facilities investment in related industries. However, the member expressed concerns about a number of factors that could weigh on domestic demand: growth in construction investment had slowed as the real estate market had begun to stabilize in line with stronger government regulations and the rebound of market interest rates; the consumer sentiment index had plunged; retail sales and services production had slowed down; and employment had declined following structural reform in vulnerable industries. Concerning prices, the member assessed that consumer price inflation had reached the 2-percent target in January in line with the relatively fast growth in import prices, but core inflation had remained at the mid-1-percent level, and therefore it seemed unlikely that demand-side inflation was increasing. In this regard, the member expressed the opinion that future monetary policy should be implemented based on a thorough analysis of how the conflicting trends of export demand and domestic demand since the fourth quarter of last year would affect Korea's macroeconomy. The member went on to argue that the analysis should focus on whether the recovery in demand from exports, boosted by reflation in the global economy, would sufficiently offset the sluggishness of domestic demand caused by domestic economic problems so that the negative output gap could be resolved and underlying inflation could rise gradually to its target of 2 percent.

One member took the view that it would be appropriate to leave the Base Rate unchanged from its current level of 1.25 percent this month. The member stated that the US-led global economic recovery was gradually gaining momentum and global prices seemed to have shifted to an increase, centering around commodity prices. The member added that there remained, however, substantial uncertainties regarding normalization of the global economy and expressed concerns that US rate hikes could lead to sudden financial market unrest and to US dollar liquidity crunches in some EMEs. With this global situation spreading to Korea, the member mentioned that the following three points should be considered: First, the member pointed out that the fact that improvement in the global economy had boosted the recovery in Korea's exports was a positive development, but it was unclear whether this recovery would continue, and its spillover effects on overall domestic demand could be limited. Second, the member mentioned that increasing volatility in line with the market-determined exchange rate was a great asset to Korea as it faced uncertainties. The member particularly assessed that, as overseas investment was expanding in accordance with investment diversification, increased savings in preparation for the lengthening of life expectancy and reduced domestic-overseas interest rate differentials, upward and downward exchange rate pressures decreased in the regional spot markets, despite the current account surplus, while the domestic market responded more sensitively to the global dollar value and global investors. Third, the member expressed the view that maintaining the current accommodative monetary policy would share the same goal with resolving macroeconomic imbalances, since boosting domestic demand could help reduce an excessive current account surplus. In conclusion, the member's assessment was that Korea's monetary policy stance should be adjusted in line with changes in economic conditions, such as the global economic recovery, growth in Korea's exports, increased domestic demand, domestic and overseas inflation, and developments in the global financial markets, and also according to the consequent channel of the natural rate of interest, and went on to assess that as several uncertainties remained there was currently no great need for an interest rate adjustment within the foreseeable future.

One other member pointed out a number of major considerations for the appropriate conduct of monetary policy. First, the member stated that concerning the domestic real economy, with export volumes as well as export unit prices showing recovery, manufacturing production and facilities investment had continued to improve and construction investment had also shown favorable movements, while growth in domestic demand, including that in the services sector, had been slowing due to the sustained sluggishness in private consumption. The member went on to note that short-term upside and downside risks had seemed to be overall in balance, and uncertainties surrounding the medium-term growth path had remained very high. Second, the member mentioned that inflation had accelerated to reach its target, led mostly by supply-side factors including a surge in agricultural and livestock product prices and the base-period effect of oil prices. Concerning future inflation, the member forecast that upside risks would somewhat predominate in the short term, but with the effects of supply-side factors gradually diminishing, inflation would not deviate far from the January forecast path in the medium term. Third, the member noted that although production slack had grown recently, production had then exhibited signs of picking up somewhat, with exports showing recovery and manufacturing's production growth exceeding its production capacity growth for the second consecutive month, more than offsetting a slight decline in the average capacity utilization rate of the manufacturing sector in December. As for the labor market in January, the member pointed out that the overall slack in the labor force had not shown any significant change, with the unemployment gap increasing and the participation gap decreasing month on month, but the recent trend of improvement had clearly slowed. Fourth, with regard to financial stability conditions, the member stated that foreign bond investment had shifted to a net inflow and the term premiums for long-term bonds and corporate bond credit spreads had remained stable. Meanwhile, the member mentioned that growth in household debt appeared to be slowing somewhat, particularly in the banking sector, due mainly to a drop in housing transaction volume and strengthened risk management, but lending by non-bank financial institutions had shown faster growth than in previous years owing chiefly to the base-period effect of bank lending. In overall consideration of the above-mentioned real economic and inflation trends and financial stability conditions, the member assessed that it was advisable to keep the Base Rate unchanged from the current level of 1.25 percent for the intermeeting period while securing policy space.

## 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 the 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 1.25% for the intermeeting period.

☐ Based on currently available information the Board considers that the global economic recovery has continued to expand. The global financial markets have shown generally stable movements, as the trend of rising stock prices has continued and stock price volatility has diminished as well. Looking ahead the Board sees the global economic recovery as likely to be affected by factors such as the directions of the new US government's economic policies, the pace of monetary policy normalization by the US Federal Reserve, the movements toward spreading trade protectionism, and the political uncertainties in the euro area.

☐ The Board judges that the domestic economy has continued its trend of moderate growth, as exports have improved although the recovery in domestic demand activities has been weak due to a slump in consumption. Employment conditions have been sluggish, with the extent of decline in the number of persons employed having widened in the manufacturing sector and the trend of increase in persons employed in the service sector having slowed as well. The Board sees the domestic economy as likely to continue its trend of moderate growth going forward, and expects growth to be generally in accord with the path projected in January. Compared to the January forecasts the Board judges that consumption will likely fall somewhat below the level projected, due to a continuing deterioration in economic sentiment for example, but that exports and facilities investment will improve more than forecast thanks chiefly to the global economic recovery.

☐ Consumer price inflation has risen to the 2% target level, in line mainly with increases in the prices of petroleum and agricultural, livestock and fisheries products. Core inflation (with food and energy product prices excluded from the CPI) has remained in the mid- to upper-1% range, while the rate of inflation expected by the general public has risen to the upper-2% level. Looking ahead the Board expects that consumer price inflation will for the time being fluctuate at a level close to 2%, but for the year as a whole not diverge greatly from the January projection (1.8%) as the prices of agricultural, livestock and fisheries products recover their trends of stability. Core inflation will maintain a level in the mid- to upper-1% range.

☐ In the domestic financial markets, the volatilities of both stock prices and long-term market interest rates have subsided as the stability in the global financial markets has continued. The Korean won-US dollar exchange rate has fallen to a large extent, owing mainly to a shift to US dollar weakening in line with the new US government’s policies related to the exchange rate. The extent of growth in bank household lending has continued to lessen, but the substantial increase in household lending by non-banks has been sustained. Housing sales prices in both Seoul and its surrounding areas and the rest of the country have remained generally steady.

☐ 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 the inflationary pressures on the demand side are not expected to be high given the moderate pace of domestic economic growth, the Board will maintain its stance of monetary policy accommodation. In this process it will closely monitor the uncertainties in domestic and external conditions and their effects, the progress of monetary policy normalization by the US Federal Reserve, and the trend of increase in household debt.