# Minutes of the Monetary Policy Board Meeting

April 13, 2017

**The Bank of Korea**

(English version)

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

## (April 2017)

## Ⅰ. Outline

1. Date of meeting: Thursday, April 13, 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
Shin, Ho Soon, Director General of Financial Stability 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, boosted largely by the robust growth of the US economy and favorable global manufacturing production, AEs had shown faster growth and EMEs had been recovering from their sluggishness. Members also evaluated that **international financial markets** had been stable overall since the US Federal Reserve’s rate hike in March.

Concerning **the domestic economy**, members’ evaluation was that, with the global economic recovery, exports and facilities investment had been buoyant, construction investment had been more favorable than expected, and domestic demand-oriented companies’ economic sentiment had been showing signs of recovery.

With regard to **the domestic financial markets**, meanwhile, members mentioned that inflows of foreign portfolio investment had expanded, stock prices had risen and the won-dollar exchange rate had declined, but these movements had later reversed, affected chiefly by geopolitical risks.

As to **prices**, members noted that consumer price inflation had exceeded its target of 2 percent during the first quarter, influenced by strong growth in the prices of oil and agricultural, livestock and fisheries products.

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 pointed out a number of major considerations for the appropriate conduct of monetary policy. First, the member stated that the domestic real economy had continued to improve, with growth led by strong exports and facilities investment in line with the global economic recovery. The domestic economy was estimated to have grown faster than originally projected during the first quarter, as construction investment, previously forecast to undergo a correction, had shown more favorable movements than expected, and consumer sentiment and the sentiment of domestic demand-oriented companies, including those in the services sector, had been showing signs of recovery. As a result, the growth trend for the year was expected to move slightly upward from the path forecast in January. Second, inflation had accelerated, due mainly to supply-side factors, to exceed its target. Core inflation, however, had flattened and remained below 2 percent, while demand-side inflationary pressures, examined through core PCEPI and core inflation excluding regulated prices, had not fully strengthened yet. In light of this, despite the likelihood of consumer price inflation exceeding its target in the short term, there was only a limited possibility of this upward trend of inflation spreading to overall prices, and upward pressures were expected to weaken again toward the second half of the year, with the effects of supply-side factors diminishing gradually. Third, slack in the manufacturing sector was seen to have been improving, albeit slightly, with production growth continuing to outpace production capacity growth. The overall slack in the labor force had slightly improved in the labor market in March, with the unemployment and participation gaps narrowing while the time gap widened. Fourth, looking at financial stability conditions, market interest rates and the spread between long- and short-term yields had been stable, while foreign portfolio investment inflows had increased. With regard to household credit, growth in bank lending had continued to slow and non-bank lending, after having maintained higher growth than usual, had been growing somewhat more slowly with the implementation of stronger credit management measures. 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.

Another member presented the view that it would be appropriate to hold the Base Rate at its current level of 1.25 percent to maintain the current monetary policy stance. The member mentioned that the recent recovery of global economic growth seemed to have been led by the accommodative fiscal policies of the US and some other major countries and also by the booming IT sector, and went on to state that expectations of economic recovery had been preemptively reflected in the financial markets, which had boosted consumer and investor sentiment, leading to expansions in production and exports. The member assessed that the Korean economy was highly dependent on the IT industry and thus was benefiting from the IT boom, and added that facilities investment had maintained IT investment-led growth since last year and construction investment had remained more favorable than originally forecast, and thanks to the derived effects of these trends, albeit slight, consumption seemed to have bottomed out somewhat. Taking these into overall consideration, the member forecast this year's growth to exceed the previous projection, and took the view that, as price outlooks were unlikely to be changed much due to the GDP gap narrowing only slightly and as downside risks remained, it would be desirable to keep the Base Rate at its current level of 1.25 percent during the intermeeting period and maintain the current monetary policy stance. In addition, the member stressed the need to consider the following three points in making monetary policy decisions. First, since the current trend of recovery in the Korean economy could not last long, it would be necessary to strengthen market-friendly macroprudential policies to ease the buildup of financial imbalances and improve financial stability. Second, considering that domestic and overseas investors were highly sensitive to the recently heightened geopolitical risks, there was a need to reexamine the stability of the financial system. Third, amid the recent positive external conditions, including the boom in the IT industry, it would be desirable to ensure macroeconomic policy space and promote medium-term growth, rather than adopting short-sighted approaches such as expanding investment and boosting consumption.

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 noted that, concerning the global economy, advanced economies were showing expanded recovery, and emerging market economies were breaking out of their sluggishness. The member also assessed domestic economic activities to have shown improvement, as the sluggishness in private consumption had eased somewhat and exports and facilities investment had increased. The member commented that consumer price inflation had risen above the 2% inflation target, influenced by accelerating upward trends of oil prices and agricultural, livestock and fisheries product prices. The member also judged the domestic financial markets to have remained stable overall. The member noted that, in reflection of such improvements in economic activities, the economic growth rates for this year and next year had each been revised upward by 0.1 percentage point. The member emphasized that, while bearing in mind concerns about greater downside risks, it was necessary to watch if the global economic recovery would continue as a trend. Meanwhile, the member expressed the opinion that, considering that consumer price inflation was anticipated to be below the 2% inflation target in annual terms, and that the domestic economy had thus far been growing at a modest pace, it was necessary to maintain the current accommodative monetary policy stance. Next, the member commented that, although the trend of household debt growth had been slowing somewhat of late, the Bank of Korea should continue to monitor the household debt trend, while being aware of the relevant risks going forward, Concerning the possibility of capital outflows, the member noted that Korea had not been greatly affected, with the trend of capital inflows continuing since the US Fed's March policy rate hike. The member, however, stressed the need to continue working actively to maintain Korea's international credit standing, which set it apart from other emerging market economies, since geopolitical risks had been heightened of late.

Meanwhile, one member expressed the opinion that it would be appropriate to keep the Base Rate unchanged in April. The member noted that, in the real sector, a recovery in exports and the consequent large increase in facilities investment had led an overall rise in economic growth, and a slowdown in construction investment had been delayed, contrary to expectations. The member, however, commented that, although consumption had remained sluggish, the possibility seemed low that consumption would be worse than expected, as consumer sentiment indicators had been improving, due mainly to the easing of domestic political uncertainties, robust exports, and the improved profitability of domestic companies and the consequent rises in their stock prices. Accordingly, the member saw that the real economic trend in the first quarter was slightly above the January outlook released by the Bank of Korea. The member, however, emphasized that forecasts of future economic trends had become more uncertain due to geopolitical risks, such as Korea's deployment of THAAD and the North Korea nuclear issue. In terms of prices, the member noted that overall consumer price inflation was nearing its target of 2%, as a rebound in oil prices had led to a rebound in prices of industrial products, and one-off shock factors, such as avian influenza, had caused prices of agricultural, livestock and fisheries products to rise. The member, however, saw that the risk of the price path for this year significantly overshooting the existing path forecast was unlikely to be high, given that consumption remained sluggish and the trend of real economic growth in the first quarter was mainly attributable to strong exports and facilities investment. Finally, in terms of financial stability, the member commented that there had been two worrisome developments related to household debt, which had shown signs of stabilization this year. The member pointed out that, first, lending to households by non-bank financial institutions had been rising sharply, led by mutual credit firms, and second, optimism that the housing market would stabilize could be premature, since slower construction investment had not materialized, contrary to expectations. The member expressed the opinion in particular that in many cases a sharp increase in the supply of financial resources to a specific sector through an unorthodox financial sector was followed by insufficient credit risk management, and thus caution should be exercised to prevent unreasonable expectations about the revitalization of the housing market in the future, and the business and risk management statuses of mutual credit firms should be continually monitored for soundness. Meanwhile, the member noted that, although some had raised concerns about instability in the foreign exchange and foreign capital markets due to an inversion of or narrowing gap between policy rates in Korea and the US, there had not been any sign of instability so far, and thus it was still possible to conduct monetary policy in reflection of the overall macroeconomic conditions in Korea. The member stated that, taking all those points into overall consideration, it would be appropriate to keep the Base Rate unchanged from the current level in April, while, on the international front, keeping a close watch on the THAAD issue and other geopolitical risks and the developments related to their impacts on the Korean economy, and on the domestic front, monitoring the future household debt trend.

Another member expressed the view that, while maintaining the Base Rate at its current level, attention should be paid to the extent that the gradually spreading global reflation trend would affect the Korean economy. The member evaluated that the reflation trend in the world economy was gradually spreading, as the international financial market and emerging market economies remained stable. The member also noted that, as Korea's exports rebounded with the recovery in world trade, production in the relevant manufacturing sectors had increased and facilities investment was recovering at a faster-than-expected pace. The member, meanwhile, noted that, although some consumer sentiment indicators had rebounded, a recovery could not easily be confirmed yet from the associated real economic indicators, particularly in the service industry, which reflects domestic demand conditions. Accordingly, the member pointed out that private consumption remained sluggish. The member, however, assessed that overall domestic demand, including investment, had not been slowing further, as facilities investment had expanded sharply and a correction in construction investment had not materialized yet. The member commented that these export and domestic demand conditions implied that short-term downside risks to the Korean macroeconomy had generally diminished. The member then expressed the opinion that if the macroeconomic trend seen in recent months continued, the current negative GDP gap would narrow, thus lowering the possibility of an additional slowing of underlying inflation, which was still running below its target level. Therefore, the member presented the opinion that the Bank of Korea should maintain its accommodative monetary policy stance to ensure that underlying inflation reaches the target level, as a recovery in foreign demand would lead to improved domestic demand. The member also stated the view that it was necessary to seek a policy direction that would reduce the possibility of household debt and construction investment escalating into medium-term destabilizing factors in the macroeconomy.

One other member expressed the opinion that, while maintaining the Base Rate at its current 1.25% level for the intermeeting period, the Bank of Korea should keep a close watch on developments of domestic and overseas risk factors and their impacts. The member saw that the recovery in the world economy had been maintained, that the international financial markets remained stable overall after the US Fed's March rate hike, and that the trend of domestic economic growth had expanded further, led by exports and facilities investment. Looking at domestic economic conditions in more detail, the member first stated the opinion that the slight upward revisions to the Bank of Koreas' economic growth forecasts for this year and next year were appropriate in consideration of the recent accelerating growth of exports and facilities investment and the improvement of economic sentiment, despite several downside risks to the future growth path. Second, the member commented that, looking at price conditions, with consumer price inflation rising above the inflation target in March, affected by increasing prices of petroleum products and prices of agricultural, livestock, and fisheries products, it would likely fluctuate around the 2% level for the time being, but the member expected the year-on-year consumer price uptrend to slow somewhat from the fourth quarter on. Third, the member stated the need for further observation to judge if household debt growth would fundamentally slow, as non-banks' household lending was showing higher-than-usual growth and housing prices were also showing a rebound, although slower growth in banks' household lending had continued from the end of last year. Fourth, the member saw that, although the financial markets had remained stable overall, price variables and capital flow volatility could increase going forward, and particularly since a significant portion of foreign bond investment that had flowed in recently was aimed at short-term profit taking, such investment could flow out rapidly if market conditions were to change. The member also noted that the US Fed had implied a possible change in its reinvestment policy from the end of this year. The member thus called for attention to the possibility that such an implication could cause international financial markets to become highly unstable, just as when a Fed chair's implication that US quantitative easing would be tapered off caused the 2013 Taper Tantrum. The member stated that, looking at all these points comprehensively, there was no great need for a change to the existing policy stance of maintaining accommodative monetary policy to support the recovery of economic growth, while continuing to pay attention to risks to financial stability. The member then set out the view that it would be best to keep the Base Rate at its current 1.25% level during the intermeeting period, while closely examining developments of domestic and overseas risk factors and their impacts.

## 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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**<u>Monetary Policy Decision</u>**

☐ 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, with the trend of rising stock prices continuing for example. 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 trend of domestic economic growth has expanded somewhat, as exports and investment have improved although consumption has remained low. The sluggishness in employment conditions has eased, with the extent of decline in the number of persons employed in the manufacturing sector having lessened and the trend of increase in persons employed in the service sector expanded. The Board sees the domestic economy as likely to continue its trend of moderate growth going forward, and forecasts a rate of GDP growth for this year slightly above the January projection (2.5%). Exports will sustain their trend of improvement, thanks chiefly to the global economic recovery, and domestic demand activities will also recover moderately as the deterioration in economic agents' sentiment eases. However, the paces of improvement in exports and domestic demand activities are expected to be limited, owing to changes in conditions related to trade with major countries and to the weak improvement in households' real purchasing power.

□ Consumer price inflation has continued at 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 fallen to the mid-2% level. Looking ahead the Board expects that consumer price inflation will for the time being fluctuate at the 2% level, and for the year as a whole slightly exceed the January projection (1.8%). 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 shown low levels, in reflection for example of stable movements in the global financial markets. After having fallen the Korean won-US dollar exchange rate has rebounded, due mainly to a shift to US dollar strengthening and to geopolitical risks. 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 Seoul and its surrounding areas have risen slightly, and those in the rest of the country have held 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 conditions related to trade with major countries, geopolitical risks, the progress of monetary policy normalization by the US Federal Reserve, and the trend of increase in household debt.