Minutes of the Monetary Policy Board Meeting

June 9, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(June 2016)

Ⅰ. Outline

1. Date of meeting: Thursday, June 9, 2016

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
Suh, Young Kyung, Deputy Governor
Kim, Minho, Deputy Governor
Yoon, Myun-Shik, Deputy Governor
Lim, Hyung Joon, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Chang, Min, Director General 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
Sohn, Wook, Director of BOK Economic Research Institute
Suh, Bong Gook, Press Officer
Lee, Hwanseok, Director General of Monetary Policy Board Secretariat
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 Situation[2)]

After briefings by staff on ‘Current Economic Developments in Korea’, ‘FX and International Finance’ and ‘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, although the US economy was showing recovery from its contraction, uncertainties still existed due to unexpectedly weak employment numbers in the US, that the improvements in the euro area, although weak, had continued, and that the Chinese economy had maintained its moderate growth, boosted by the government’s aggressive policy measures. As to **international financial markets**, most members evaluated global stock prices as exhibiting generally stable movements, due chiefly to the run-up in international oil prices, and Treasury bond yields and exchange rates in major countries as having shown wide fluctuations, influenced for instance by changes in expectations for the Fed rate hike.

Concerning **the domestic economy**, most members assessed that the trend of decline in exports had continued and the trend of improvement in domestic demand had weakened, with consumption and construction investment remaining sluggish.

With regard to **the domestic financial markets**, meanwhile, some members evaluated that, with price variable volatility having increased, influenced for instance by changes in expectations related to monetary policies at home and abroad, long-term market interest rates and the won-dollar rate had significantly fallen in June after having risen, and stock prices had rebounded after having fallen.

As to **prices**, some members noted that consumer price inflation had fallen month-on-month to 0.8 percent, owing chiefly to a slowdown in the extent of increase in agricultural product prices, and that core inflation had also declined slightly month-on-month to 1.6 percent.

2) English versions of 'Current Economic Developments in Korea' and 'Financial Markets' 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 economic environments, it would be desirable to lower the Base Rate by 25 basis points from its current level for the intermeeting period.

One member presented the view that it would be best to lower the Base Rate by 25 basis points from its current level for the intermeeting period, while closely examining the possibility of expanded risks to financial stability brought about by the rate cut. The member noted that, given the recent slow growth and low inflation and several latent downside risk factors surrounding economic conditions at home and abroad, there seemed to be a greater need for more accommodative monetary policy. The member went on to comment that an accommodative monetary policy stance at this point in time can work to preemptively ease the negative impacts of the scheduled full-scale corporate restructuring, and that, if the UK decides to leave the European Union, international financial market volatility may be heightened greatly, and thus measures should be devised in advance to respond to it. Meanwhile, the member emphasized that, as a Base Rate cut could cause household debt growth, the Bank of Korea should more closely monitor the household debt trend and if necessary timely implement macroprudential policy measures in consultation with the government and the supervisory authorities. The member also stressed that, as the current slow growth and low inflation trend is greatly attributable to structural factors, it was necessary to pursue continuous structural reforms and expansionary fiscal policy, as well as accommodative monetary policy.

Another member expressed the opinion that it would be appropriate to lower the Base Rate by 25 basis points from its current level to 1.25% for the intermeeting period to buffer against growing downside risks to the macroeconomy. Concerning recent macroeconomic conditions, the member judged that, although the declining trend in inflation was easing, consumer price inflation was still far below the inflation target of 2%. The member noted that the government's fiscal policy space was reduced, private consumption was restrained by structural factors and thus unlikely to drive economic recovery, and there was no high possibility of exports recovering within a short space of time, as the lack of global growth momentum continued. The member pointed out that, under these circumstances, the restructuring of vulnerable industries scheduled for the second half of 2016 could put heavier downward pressures on the macroeconomy in the short term. Accordingly, the member expressed the view that it was necessary to buffer against downside risks to the macroeconomy through a preemptive Base Rate cut. The member also emphasized the need for close policy cooperation with the financial supervisory authorities to strengthen the management of the soundness of collective loans, loans from non-banking financial institutions, and the Korea Housing Finance Corporation (KHFC) to ensure that the household debt problem, regarded as the biggest negative side effect of the Base Rate cut, did not expand rapidly.

One member expressed the opinion that, in overall judgment of the trend of the real economy, it would be appropriate to cut the Base Rate by 25 basis points this month. First, the member argued that, without timely policy measures, it would be difficult to be optimistic about a recovery of consumption and the economy, noting that downside risks had increased since May as consumption and construction investment had started to decrease in the second quarter while household consumption continued to mark time, due to structural factors such as the rapid progress of population ageing and the worsening of income distribution, and also to strengthening preferences for liquidity and shrinking consumer sentiment in line with growing uncertainties throughout the economy. Meanwhile, the member presented the view that consumer price inflation remained at a low level of around 1 percent year-on-year and, although economic participation and employment rates were recently rising, this was attributable to the gradual expansion in labor market capacity in line with the rising rate of employment of the over-50s offsetting the declining rate of youth employment, and this was unlikely to lead to upward pressures on inflation over a medium-term horizon. In light of this, the member took the view that additional policy measures should be made to pull up consumer price inflation to close to its target of 2 percent, and that in order to minimize potential risks from the Base Rate cut, it would be necessary to carry out corporate restructuring effectively, to manage potential risks to cope with the possibility of a spread of international financial market unrest, to monitor risks involved with household loans that were increasing centering around collective loans, to promote close cooperation for information exchanges among the related authorities and to take flexible policy measures.

Meanwhile, another member expressed the opinion that, in overall consideration of the domestic and international economic environment, it would be desirable to adjust the Base Rate downward from the current 1.5 percent to 1.25 percent this month. The member mentioned that, considering future downside risks, the growth target presented in the April forecast might not be easy to achieve and consumer prices were likely to remain short of their 2 percent target for a considerable period of time. The member went on to stress that a more accommodative monetary policy stance would be needed to prepare for the possibility of a continuation of low growth and slow price rises. The member presented the view that the growth rate should be improved by strengthening economic fundamentals, such as through industrial structural reforms and by supporting such structural reforms with aggressive fiscal and monetary policies, and the member further added that it would be necessary to respond preemptively to the possibility of corporate restructuring acting as a downside risk to investment and consumption in the second half of the year. Meanwhile, the member argued that it would be necessary to cope continuously with household debt problems with supervisory policies, so as to create conditions for the implementation of accommodative monetary policy. In addition, the member noted the analysis that, since the US Fed was highly likely to maintain its stance of gradual rate hikes, overall market instability was unlikely to occur, although capital outflows and a rise in foreign exchange rate volatility might take place in the short term. The member went on to state that now would be the right time for the Bank of Korea to reduce its Base Rate, prior to a possible US rate hike. In conclusion, the member emphasized that it is time to strengthen the monitoring of uncertain external conditions, including a possible Brexit and potential US rate hikes, and to consider above all the sluggish economic situation, in order to respond preemptively to future downside risks.

One other member expressed the opinion that downside risks to economic growth had grown, and as a result the targets presented in the April forecast might not be achieved easily. Looking at cyclical factors, the member mentioned that consumption had been weakening, and if corporate profitability decreased as international oil prices returned to normal, real wages and consumption could be restricted. In terms of structural factors, meanwhile, the member argued that the Korean economy was faced with fundamental problems that included a decline in the global trade volume, excess capacity in the manufacturing industry throughout the globe, and changes in the demand structure, and the member added that heightened uncertainties concerning future incomes and life extension, combined with population aging, led to more savings and thereby weakened consumption capacity more than expected. The member set out the view that restructuring at this point in time was considered highly desirable and essential to enhance the potential growth rate, but if corporate restructuring began in full scale, this could dampen consumer and investor sentiment, and the member added that macroeconomic policy measures needed to be implemented to further boost economic growth. The member went on to argue that, in overall consideration of these factors, it would be appropriate to cut the Base Rate this month by 25 basis points from the current 1.5 percent to 1.25 percent.

Another member presented a number of major considerations for the appropriate operation of monetary policy. First, downside risks to the growth path had increased significantly, as fiscal expenditure capacity had been weakening and negative effects of the progress of corporate restructuring on production and employment, such as the shrinking of investor sentiment, had become apparent, while external demand had remained sluggish for a long time. Second, demand-side inflationary pressures were seen to be somewhat insufficient to pull inflation up to its target over a medium-term horizon, considering the trend of prices of items sensitive to business cycles. Third, slack in the production sector had been expanding, with the average capacity utilization ratio in the manufacturing sector declining to the lowest level since the financial crisis and facilities investment demand pressures decreasing at a faster pace. Looking at the labor market, the member also noted that overall slack had not improved due to the widening unemployment rate gap, and there existed a high level of instability with corporate restructuring taking shape. Based on the examination of these considerations, the need for a Base Rate adjustment seemed to have increased month-on-month from a macroeconomic perspective, and considering that it takes some time for a policy measure to take effect, it would be desirable to lower the Base Rate from the current 1.50 percent to 1.25 percent this month. Cutting the already record-low Base Rate could entail a substantial amount of costs and risks in terms of financial stability. In this regard, in the future efforts should be made to minimize the negative side effects of policies with attention paid to changes in the credit cycle and the trend of related risks, to international financial market instability caused by the possibility of Brexit and changing expectations of the US Fed’s rate hikes, and to the spread of risks involving the real economy and financial stability in line with the implementation of corporate restructuring.

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 lower the Base Rate by 25 basis points, from 1.50% to 1.25%.

☐ Based on currently available information the Board considers that the US economy has appeared to be emerging from its temporary slowdown. The improvements in the euro area, although weak, have continued, and the Chinese economy has maintained its moderate growth. The Bank of Korea forecasts that, while the global economy will maintain its weak recovery going forward, it will be affected by factors including the monetary policy normalization by the US Federal Reserve, financial and economic conditions in emerging market countries, and international oil price movements.

☐ Looking at the Korean economy, exports have continued their trend of decline and the improvements in domestic demand activities such as consumption have weakened, while the sentiments of economic agents have also been sluggish. On the employment front, although the pace of increase in the number of persons employed slowed somewhat in April, the employment-to-population ratio and the unemployment rate maintained the same levels as in April of last year. The Bank of Korea forecasts that the domestic economy will sustain its trend of modest growth going forward, but in view of economic conditions domestically and abroad judges that the downside risks to the growth path forecast made in April have expanded.

☐ Consumer price inflation fell from 1.0% the month before to 0.8% in May, owing chiefly to a slowdown in the extent of increase in agricultural product prices. Core inflation excluding agricultural and petroleum product prices also declined to 1.6%, from 1.8% in April. Looking ahead the Bank of Korea forecasts that consumer price inflation will continue at a low level, under the influence of the low oil prices for example. In the housing market, sales and leasehold deposit prices showed low rates of increase.

☐ In the domestic financial markets since May, stock prices have risen after having previously fallen, in reflection mainly of global stock market movements, and long-term market interest rates have declined, influenced mostly by the sluggishness of some economic indicators. The Korean won has fluctuated to a large extent against the US dollar, affected mainly by changes in the expectations for a policy rate hike by the US Federal Reserve. The won has meanwhile depreciated against the Japanese yen. Household lending has sustained a trend of substantial increase at a level exceeding that of recent years, led by mortgage loans.

☐ Looking ahead, the Bank of Korea will conduct monetary policy so as to ensure that the recovery of economic growth continues and consumer price inflation approaches the target level over a medium-term horizon, while paying greater attention to financial stability. In this process it will closely monitor the possibility of a British exit from the European Union, any changes in the monetary policies of major countries and capital flow movements, the progress of corporate restructuring, and the trend of increase in household debt.