Minutes of the Monetary Policy Committee Meeting

October 15, 2014

The Bank of Korea

(English version)

Minutes of the Monetary Policy Committee Meeting[1)]

(October 2014)

Ⅰ. Outline

1. Date of meeting : Wednesday, October 15, 2014

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
Kim, Jun Il, Deputy Governor
Kang, Juno, Deputy Governor
Hur, Jae Sung, Deputy Governor
Suh, Young Kyung, Deputy Governor
Lee Heung Mo, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Choi, Woon Gyu, Director of BOK Economic Research Institute
Shin, Woon, Director General of Research Department
Cho, Jeonghwan, Director General of Macroprudential Analysis Department
Yoon Myun-Shik, Director General of Monetary Policy & Markets Department
Kim, Minho, Director General of International Department
Jeon, Seung-Cheol, Director General of Monetary Policy Committee Secretariat
Park, Sung Joon, Director of Press Office
Huh, Jin Ho, Director of Financial Markets Division
Moon, Han Geun, Head of MPC Administrative Support 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 Situation[2)]

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, while the US economic recovery had continued, the recovery in the euro area had been sluggish. Members also noted that the **international financial markets** had shown increasing volatility, due mainly to concerns about an early policy rate hike by the US Federal Reserve, to geopolitical risks, and to worries about the economic slowdowns in China and the euro area.

As to **the domestic economy**, many members’ appraisal was that, while consumption had increased and exports had sustained a favorable pattern, the economic recovery was insufficient, with facilities investment declining for example.

Concerning **the domestic financial markets**, meanwhile, members noted that long-term interest rates had declined, the KRW/USD exchange rate had risen, and stock prices had fallen significantly.

With regard to **prices**, members noted that consumer price inflation stood at 1.1%, lower than in the previous month, and forecast that the possibility was also high that it would be below the inflation target for the time being.

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

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:

Most members shared the opinion that, in overall consideration of the domestic and international economic environments and their future outlooks, it would be desirable to lower the Base Rate by 25 basis points from its current level for the intermeeting period.

One member advanced the opinion that the Base Rate should be cut by 0.25 of a percentage point because, if the changes in domestic and international financial and economic conditions during the previous month were considered comprehensively, the growth path of the Korean economy appeared to have shifted slightly downward, on a contraction in consumption and the sluggishness in facilities investment for example, while the situation of low inflation was expected to persist longer than in the previous forecast.

Another member expressed the view that, although determining the direction of the Base Rate was very difficult, cutting it by 0.25 of a percentage point would be desirable in view of the following points: firstly, that the time when the negative GDP gap would disappear was highly likely to be delayed beyond that originally anticipated, given the downward adjustment of the economic growth rate forecast; secondly, that the lower-than-expected inflationary pressures provided scope to support growth further in terms of monetary policy, and thirdly, that the contraction in economic agents' sentiment was remaining a downside risk to future growth.

One other member stated his opinion that it would be necessary to reduce the Base Rate by 0.25 of a percentage point this month because the potential risks of keeping it unchanged were judged to outweigh the side effects of its being cut. He argued in justification that the forecast growth path had been adjusted downward and the time of negative GDP gap resolution might be delayed even longer, that due to the continuation of low inflation the confidence in price stability might weaken and deflation expectations might form, and that some scope for an additional Base Rate cut had arisen since the appropriate Base Rate level in consideration of the real neutral rate was analyzed to have declined owing to the prolongation of the negative GDP and price gaps, while the real interest rate was rising due to the slowdown in inflation. Apart from this, the household credit cycle was not considered to currently be in an overheating phase where excessive household credit expansion cause systemic risk, while the outflows of foreign investment funds following a Base Rate cut were judged unlikely to lead to fundamental market disturbances.

Another member mentioned that the recovery of the overall global economy had weakened, that amid the continuing trend of low inflation uncertainties about the domestic economic recovery were persisting, and that price variable volatility in the financial and foreign exchange markets was rising as anticipations for and concerns about changes in domestic and foreign economies and policies were intersecting. He went on to state that it would be desirable to lower the Base Rate by 0.25 of a percentage point for the month.

One other member, after expressing the view that it would be appropriate to cut the Base Rate by 0.25 percentage point, noted that this would strengthen the public signalling of the monetary authorities' policy intention, and at the same time was expected to contribute to boosting the capacity for adapting to the recent changes in the external environment, to the revival of the sluggish domestic demand, and to controlling the prolongation of the low inflation trend.

Another member expressed the opinion that it would be desirable to leave the Base Rate unchanged at 2.25 percent for the intermeeting period, commenting then that the Korean economy's recovery being a little weaker than expected was due to exports having been more sluggish than originally forecast and so, since exports were contributing more to Korean economic growth than consumption, solid export growth was an essential precondition for a rapid economic recovery. With regard to concerns about disinflation the member also noted that, unlike disinflation caused by an aggregate demand shortage, disinflation attributable mainly to fiercer corporate competition triggered by innovations in distribution and an expansion in imports could be considered a positive phenomenon for the Korean economy. He went on to state that, given that core inflation excluding the prices of agricultural and petroleum products had been continually rising since passing through its trough in December 2012, and that the low inflation was expected to last until the second half of 2015 when the output gap was forecast to disappear, it was difficult to consider any shortfall in demand as being the main cause behind the recent low inflation phenomenon. The member added that the recent low inflation seemed attributable largely to distribution innovations following the increased numbers of megastores and online stores, as well as to growth in imports including through the expansion of trade with China, and considering that the downward pressures on inflation would grow further, due for example to the Korea-China FTA expected to be concluded in the future, Korea's current inflation target of 2.5～3.5 percent was judged to be at a higher than appropriate level and, rather than responding to the recent low inflation through a policy of expanding demand, priority thus needed to be placed upon resetting the appropriate level of inflation target.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of the discussions held earlier, a statement was compiled reflecting the views of the majority.

However, Mr. Moon, Woosik expressed clear opposition to the idea of lowering the Base Rate by 0.25 of a percentage point, and argued for holding it at its current level.

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Monetary Policy Decision

☐ The Monetary Policy Committee of the Bank of Korea decided today to lower the Base Rate by 25 basis points, from 2.25% to 2.00%.

☐ Based on currently available information the Committee considers that, although the trend of economic recovery in the US has been sustained, the sluggishness of economic activities in the euro area has continued while trends of economic growth in emerging market countries have differed from country to country. The Committee forecasts that the global economy will sustain its modest recovery going forward, centering around the US, but judges that the possibility exists of its being affected by the changes in global financial market conditions stemming from the shift in the US Federal Reserve's monetary policy stance, by the prolongation of economic sluggishness in the euro area, by the weakening of economic growth in some emerging market countries, and by geopolitical risks.

☐ In Korea, while exports have sustained a favorable pattern and consumption has improved somewhat, the Committee judges that facilities investment remains sluggish and that economic agents' sentiment has only partially recovered. 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 negative output gap in the domestic economy will gradually narrow going forward, although the time of its disappearance will be somewhat later than previously forecast.

☐ Consumer price inflation fell from 1.4% the month before to 1.1% in September, due mainly to an increase in the extent of decline in petroleum product prices and to slowdowns in the rates of industrial product price increase. Core inflation excluding agricultural and petroleum product prices fell to 1.9%, from 2.4% in August. The Committee forecasts that, after remaining low due primarily to the stability of agricultural and international oil prices, inflation will gradually rise next year; it judges, however, that inflationary pressures will be somewhat weaker than previously expected. In the housing market, the upward trends of sales prices in both Seoul and its surrounding areas and the rest of the country accelerated. As to leasehold deposit prices, the scale of their increase widened somewhat in Seoul and its surrounding areas, while their uptrend in the rest of the country exhibited a pace similar to that in the preceding month.

☐ In the domestic financial markets, amid heightened international financial market volatility, stock prices have fallen significantly, influenced for example by a shift to net selling of stocks by foreign investors. The Korean won has depreciated rapidly, and long-term interest rates have fallen substantially.

☐ 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 greater attention to financial stability. In this process it will closely monitor external risk factors such as the shift in the US Federal Reserve's monetary policy stance, as well as the trends of household debt and of capital flows.