Minutes of the Monetary Policy Board Meeting

July 14, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(July 2016)

Ⅰ. Outline

1. Date of meeting: Thursday, July 14, 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
Hur, Jae Sung, Deputy Governor
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

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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 ‘Current 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 the US economy had maintained its recovery with its employment indicators improving and private consumption growing, that the improvements in the euro area, although weak, had continued and downside risks had been increasing due mainly to the possibility of the effects of Brexit spreading to the real economy, and that the Chinese economy had maintained its moderate growth, boosted for example by expectations of a delayed rate hike by the US Fed. As to **international financial markets**, some members mentioned that global stock prices had plunged on the Brexit decision but stabilized quickly thanks to prompt policy responses by major advanced countries, and during this process Treasury bond yields in these countries had fallen significantly.

Concerning **the domestic economy**, most members assessed that, although the trend of decline in exports had continued, the economy had been showing improvement centering around domestic demand, with consumption and construction investment growing month-on-month.

With regard to **the domestic financial markets**, meanwhile, some members evaluated that after the Brexit decision stock prices and the won-dollar rate had fallen suddenly but soon recovered, and long-term market interest rates had declined significantly in line with the movements of Treasury bond yields in major countries.

As to **prices**, some members noted that consumer price inflation had remained at 0.8 percent since the previous month, with a sharp decline in agricultural product prices offsetting the continued rise in service fees, and that core inflation had risen slightly month-on-month to 1.7 percent.

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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 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 although the pace of growth was expected to slow somewhat in the second half due mainly to the slowing growth in consumption and construction investment and to a full-scale implementation of corporate restructuring amid a delay in the recovery of world trade, the underlying trend of recovery was expected to continue, albeit at a moderate pace, boosted largely by government policies. However, the member noted that constant examination is needed as to whether any changes in the growth path would occur in line with developments related to uncertainties, including those regarding Brexit. Second, the member argued that the path forecast for consumer prices had been adjusted downward slightly, but core inflation was expected to remain on the rise without any significant changes made to its path. However, the member also stated that to ensure that the inflation target is achieved over a medium-term horizon, demand-side inflation pressures needed to increase slightly from the current level. Third, the member pointed out that in line with recent growth in the volume of exports, the slack in the manufacturing sector improved slightly but substantial slack still remained, and so did the overall slack in the labor market, which was concentrated in the manufacturing sector, in the younger generation and in restructuring-related regions. Based on all of this, the member argued that the growth and price paths did not have solid footing and their uncertainties were extremely high, but considering that this had already been expected during the last month's rate cut, it would be advisable to hold the Base Rate at its current level of 1.25 percent for the intermeeting period. In addition, the member stated that while closely examining ripple effects of the Base Rate cut, details of a supplementary budget, and negative side effects of low interest rates in terms of financial stability, including changes in the behavior of economic agents and in incentives, it would be appropriate to carefully monitor the developments of factors causing uncertainties at home and abroad.

Another member expressed the opinion that it would be appropriate to keep the Base Rate at its current level for the intermeeting period, as domestic economic conditions had not changed much from the previous month and the international financial markets had shown stability in the short term. The member also presented the view that it would be advisable to carefully examine various possible risk factors arising from the continuing trend of low interest rates. First of all, the member argued that attention needed to be paid to the growing proportions of not only household debt but also vulnerable borrowers, including marginal households. The member went on to state that without the recovery of a virtuous circle where boosted consumption leads to corporate investment, related risks would increase gradually. The member also stressed that management and supervision were required to prevent the excessive growth of risks related to yield-searching in the low growth environment. The member further stated the opinion that, given the possibility of the current structural problems of the real economy lasting for a longer period time and also considering potential risks in the financial markets, our major tasks should include creating a macroeconomic environment where economic policies can be operated in an effective manner and making full use of macroprudential policies that ensure financial stability.

One other member expressed the opinion that, considering the preemptive Base Rate cut in June, it would be necessary to hold the Base Rate at its current level for the intermeeting period, while further monitoring progress in the implementation of macroeconomic policies. The member noted that, on top of the preemptive Base Rate cut, if the government pushes ahead with its announced 10-trillion-won supplementary budget, Korea is expected to cope effectively with the contractions in consumer and investor confidence stemming from corporate restructuring. The member then presented the view that the effects of accommodative monetary policy should be monitored not only from a cyclical perspective, but also from the perspectives of risk factors, such as foreign exchange and financial market stability and household debt. The member expressed the opinion that, as household lending continues to grow and real estate prices have risen, led by reconstructed apartments in some districts of Seoul, the real estate market should be monitored closely, bearing in mind the possibility of price instability spreading to the rest of the country. The member also commented that the possibility of collective loans going bad should be examined. The member then noted that, although the financial markets are showing a trend of stability, recovering from the Brexit vote shock thanks to major countries' aggressive policy measures, destabilizing factors still remain in the banking sectors of Italy, Germany and other European countries, and the Brexit issue could also affect the financial and real economy for a considerable period of time, and thus preparation should be made to deal with these issues in the medium to long-term horizon. Meanwhile, the member took the view that the Board should maintain its monetary easing stance going forward, even if the Base Rate remains unchanged this month. The member also emphasized that the active easing would allow the Board to cope with downside risks to the economy and employment expected in the second half, and to play the role of supplementing and supporting the successful structural reform of the Korean economy.

Meanwhile, another member expressed the opinion that, in overall consideration of the financial and economic environment, it would be proper to keep the Base Rate unchanged at this juncture. First, in terms of the real economy, the member judged the domestic economy to have shown a trend of improvement, with sales of durables and semi-durables beginning to increase in May on the demand side, and manufacturing production rebounding on the production side as well. However, the member assessed that, on the international front, with long-term interest rates at home and abroad falling substantially due mainly to the materialization of Brexit, uncertainties surrounding the Japanese economy have heightened owing primarily to uncertainty over the timing of the US Fed’s rate hikes, the strengthening of negative yields on Japanese government bonds, and a rise in the value of the yen. In overall judgement of these factors, the member took the view that, on the domestic economic front, aggregate demand conditions as exemplified by domestic consumption and construction have improved, due mainly to the Base Rate cuts since August 2014 and the government measure to ease household credit, while on the international economic front, foreign demand has dropped, owing primarily to the vulnerability of the Chinese economy and the mixed effects from Abenomics in Japan. The member, meanwhile, assessed prices to be following the expected path, and forecast that, although labor market-side inflationary pressures were not high, inflation would rise gradually by the end of the first half of next year with the effects from the decline in oil prices easing. While expecting economic trends not to break from the pattern in the first half, the member expressed the opinion that there were risk factors at home and abroad, such as Brexit, persistent uncertainties surrounding the Japanese and Chinese economies, and restructuring of domestic companies. The member, however, expected the June Base Rate cut by the Monetary Policy Board and the government's supplementary budget for the second half to act as buffers against these downside risks to the Korean economy. The member then assessed the growth forecast of 2.7% for this year to be neutral at this juncture, under the premise of 3% GDP growth in the first half.

One other member expressed the opinion that, while maintaining the Base Rate at the current 1.25% level for the time being, it was necessary to closely monitor future macroeconomic trends. The member noted that there still were downside risks to the macroeconomy stemming from mounting uncertainties arising from Brexit, as well as from restructuring of vulnerable industries in the second half of this year. The member, however, commented that the government's supplementary budget would act as a partial buffer against downside risks to the economy in the second half, the effects from the Base Rate cut in June were expected to work to improve the economy somewhat going forward, and the extent of downward adjustment in the growth forecast was small relative to those in the past. The member then judged that these factors suggested that the actual macroeconomic trends were not diverging significantly from expected levels. The member also took into account that, although consumer price inflation still remained very low, it was expected to gradually converge to around the 2% target next year, given the recent international oil price movements and core inflation. Accordingly, the member argued that it was desirable to hold the Base Rate at its current level and analyze developments in economic conditions, and that it was necessary to make efforts to preemptively strengthen macroprudential soundness to prevent the spillover effects of any possible negative shocks from spreading. The member also stressed the need for decisive and principled restructuring and for close cooperation with the relevant authorities concerning decisive household debt measures.

Another member took the view that, while holding the Base Rate at its current level of 1.25% for the intermeeting period and closely monitoring the effects of expansionary macroeconomic policy, it would be good to carefully examine the trends of household debt growth, housing market conditions, the spillover effects from Brexit, and capital flow trends. The member noted that, although the outlooks for GDP growth and consumer price inflation were revised slightly downward this time, the Monetary Policy Board had cut the Base Rate by 25 basis points at the June policy decision meeting in anticipation of increasing downside risks to growth and inflation. The member then expressed the view that this measure was likely to contribute to a recovery in demand, with some time lag, and the government's scheduled budget expansion measures, including the compilation of the supplementary budget, would be helpful in supporting growth. The member also stressed that greater attention should be paid to financial stability risk factors, including first, that with household lending maintaining strong growth, housing prices, which are closely interconnected with household lending, were rising sharply, albeit only in certain areas; and second, that there was a possibility of heightened volatility in the financial markets at home and abroad, due mainly to uncertainty related to Brexit.

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 trend of economic recovery in the US has been sustained and that the improvements in the euro area, although weak, have continued. The Chinese economy has meanwhile maintained its moderate growth. The Board forecasts that, while the global economy will maintain its weak recovery going forward, it will be affected by factors including uncertainties related to Britain’s exit from the European Union, changes in the monetary policies of major countries, and financial and economic conditions in emerging market countries.

□ Looking at the Korean economy, while the sentiments of economic agents have been sluggish, the trend of decline in exports has continued but domestic demand activities including consumption appear to be improving. On the employment front, as the number of persons employed has increased, the employment-to-population ratio rose and the unemployment rate fell in June compared to those in June of last year. The Board forecasts that the domestic economy will sustain its trend of modest growth going forward, owing chiefly to expansionary macroeconomic policies, but in view of economic conditions domestically and abroad judges the uncertainties surrounding the growth path to be high.

☐ Consumer price inflation registered 0.8% in June, the same as in May, in line mainly with declines in agricultural product prices. Core inflation excluding agricultural and petroleum product prices rose slightly to 1.7%, from 1.6% in May. In the housing market, sales and leasehold deposit prices showed low rates of increase. Looking ahead the Board forecasts that consumer price inflation will remain at a low level for the time being, and then gradually rise as the effects of the low oil prices diminish.

☐ In the domestic financial markets, stock prices and the Korean won-US dollar and Korean won-Japanese yen exchange rates fluctuated temporarily to large extents after the Brexit decision. Long-term market interest rates have fallen considerably, owing largely to declines in government bond rates in major countries. Household lending has sustained a trend of substantial increase at a level exceeding that of recent years, led by mortgage loans.

☐ Looking ahead, the Board 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 attention to financial stability. In this process it will closely monitor the trend of increase in household debt, the effects of the Brexit, any changes in the monetary policies of major countries, and the progress of corporate restructuring.