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English Version

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Monetary Policy Committee Meeting Minutes

June 10, 2010

Bank of Korea

Monetary Policy Committee Meeting Minutes¹⁾ (June 2010)

I . Outline

1. Date of meeting June 10, 2010 (Thur), 9 AM
2. Place Monetary Policy Committee Meeting Room
3. Monetary Policy Committee members present
 Kim, Choongsoo, Chairman (Governor of Bank of Korea)
 Kim, Dae Sik
 Choi, Dosoung
 Kang, Myung Hun
 Lee, Ju Yeol (Senior Deputy Governor)
 Lim, Seungtae
4. Monetary Policy Committee members absent : None
5. Government representative present
 Yim, Jong-ryong, Vice Minister of Strategy and Finance
6. Participants
 Kang, Tai Hyuk, Auditor
 Kim, Jae-Chun, Deputy Governor
 Jang, Byung-Wha, Deputy Governor
 Lee, Kwang-June, Deputy Governor
 Jang, Seh Geun, Deputy Governor
 Kim, Kyungsoo, Director General of Institute for Monetary and Economic Research
 Lee, Sang Woo, Director General of Research Department
 Chung, Hee-Chun, Director General of Monetary Policy Department
 Min, Sung Kee, Director General of Financial Markets Department
 Ahn, Byung Chan, Director General of International Department
 Yoo, Byoung Gap, Director General of Monetary Policy Committee Secretariat
 Jung, Hee Sik, Director General of Press Office

1) This English version (summary) of the Monetary Policy Committee meeting minutes was produced at the working level and is not an official document.

II. Discussion on Economic Situation (Summary)²⁾

After hearing staff briefings on 'Current Domestic and Overseas Economic Developments' and the 'Financial Markets', the discussions among members of the Monetary Policy Committee (MPC) covered the following areas:

With regard to **the global economy**, most members agreed that the recovery momentum was continuing overall, since emerging markets including China were registering high growth and advanced economies including the US and Japan were showing solid, albeit gradual growth. However, some members commented that the outlook for the global economy was still gloomy, given that leading economic indicators in major advanced countries were showing downward trends and there were still potential risk factors such as the fiscal problems in Europe.

As for **recent domestic economic developments**, most members assessed the domestic economy as having remained on an improving trend in May, as in the month before, centering around exports. One member mentioned that the GDP gap was estimated to be escaping its negative state.

In this connection, most members noted that manufacturing and services **production** continued to rise and **exports** were also favorable, with export performance data on a daily basis hitting a record high in May, boosted by the global economic recovery.

They pointed out in addition that the lackluster month-on-month performance of some domestic demand indicators such as **facilities investment and consumption** in the second quarter had been due to a technical base period effect following their large increases during the first quarter, and deemed overall domestic demand to still remain brisk.

However, some members commented that, taking into account the fact

2) The contents of 'Current Domestic and Overseas Economic Developments' and the 'Financial Markets' are posted in English on the Bank of Korea web site.

that growth in domestic demand was slowing and leading economic indicators were also continuing to decline, there was a likelihood of change in the phase of the business cycle and attention needed to be paid to this matter.

Regarding **the future outlook**, many members forecasted that the trend of stable growth in Korea would not be under great threat during the second half of this year, although downside growth risk might increase to some extent in the case where the fiscal crises in some European countries caused increases in domestic and international financial market volatility.

With respect to **employment**, members considered that the employment situation showed pronounced improvement, pointing to the examples of employment in the private sector returning to its pre-global financial crisis level in April and the sharp fall in the unemployment rate in May. One member, however, forecasted a somewhat limited recovery in the employment sector, noting the facts that restructuring of the small scale services industry, including the wholesale and retail and restaurants & hotels sectors, was continuing, and that the government's job creation schemes were being cut back or replaced by the end of June and the capacity to absorb young employees had weakened.

Many members noted that **the domestic financial markets** had shown instability, as foreign portfolio investment funds had flown from the markets dramatically, and stock prices and the KRW/USD exchange rate had become much more volatile, influenced by the fiscal crises in some European countries and the growing geopolitical risk on the Korean peninsula. One member meanwhile assessed there to be great likelihood of distortions in market fund flows caused by herd behavior, since short-term funds were abundant in the financial markets, and he pointed to the need to step up monitoring of market fund flows.

As to **consumer price inflation**, many members judged that, although it was below the inflation target, it was still higher than the expected level and there was a high possibility that it could exceed the target level at year-end, as consumer prices were rising gradually due to hikes in public utility charges

and mounting demand-pull pressures in line with the economic recovery.

One member noted that major indicators of demand-pull pressures, including the GDP gap rate, the manufacturing capacity utilization ratio and the employment rate, had already converged on or surpassed their long-term average figures.

Regarding **the real estate market**, some members mentioned that the possibility of a restructuring in the real estate market had been steadily raised, with housing transactions turning even more sluggish and prices falling at a faster pace in Seoul and its surrounding areas. One member meanwhile argued that there were concerns about a possible vicious circle, in which the sluggish real estate market might worsen financial conditions in the construction industry, which would increase the delinquency rate of savings banks holding heavy project financing loans and damage their asset quality, consequently leading to a further increase in the downside pressures on real estate prices.

III. Discussion Related to Monetary Policy Decision (Summary)

The Monetary Policy Committee Members' discussions on changes in the Bank of Korea Base Rate were as follows.

Many members judged conditions to be have reached the stage where adjustment of the degree of monetary policy easing was appropriate, given the national economy having gotten back on track and the growing upside risks to prices. Some pointed out the possibility that maintaining the Base Rate at its current level, to which it had been steeply cut to counteract the crisis, might give rise to serious side effects such as herd behavior in the markets, adding that if this should undermine market confidence in the monetary authorities, they would have to shoulder a very heavy cost burden.

Some members mentioned that it was advisable for the central bank to take preemptive monetary policy measures in an effort to mitigate potential

inflationary pressures and prepare for new risks that might arise in the second half of the year.

Some other members meanwhile argued that, given the relatively stable consumer prices, the central bank should wait and see how the global financial market unrest would progress before taking preemptive measures to adjust interest rates, since there was great uncertainty due to the fiscal problems in Southern European countries.

Many members meanwhile noted that, even though not making an upward adjustment of the Base Rate this month, the central bank should send the markets a clearer signal of a possible interest rate increase than in the previous month, in order to prevent herd behavior.

One member expressed the opinion that, although the fiscal crisis in Southern Europe was hardly likely to lead to a global financial crisis, reforms in the financial and foreign exchange markets should be energetically pursued now, so that the domestic economy would be able to cope with such crises in the future.

IV. Remarks by Government Representative

Prior to the members' arguments regarding the Base Rate, the Chairman gave the floor to the Vice Minister of Strategy and Finance present at the meeting, who explained the government's position on and assessment of the current economic situation and measures to mitigate the volatility of capital flows.

Monetary Policy Decision

- ☐ The Monetary Policy Committee of the Bank of Korea decided today to maintain the Base Rate at its current level (2.00%) for the intermeeting period.
- ☐ In the global economy, emerging market economies have sustained their favorable performance, while the economies of major advanced countries such as the US and Japan have continued improvement. There is, however, an underlying risk that the international financial markets may be destabilized at any time due to the government debt problems in some European countries, and that this could exercise an influence on the recovering trend in the global economy.
- ☐ The upward trend of domestic economic activity appears to have been maintained. Even though the increasing trend of domestic demand such as consumption and investment has temporarily faltered, exports have sustained their buoyancy and, led by the private sector, labor market conditions have improved further.

This upward trend is expected to be maintained. Considering the overseas risk factors, however, there still remains uncertainty as to the economic growth path.

- ☐ Consumer price inflation has accelerated slightly, driven mainly by petroleum products, and demand-pull pressure is expected to increase gradually as the upward trend of economic activity continues. In the real estate market, housing sales prices have shown weakness, dragged down by prices in Seoul and its surrounding areas.
- ☐ In the financial markets, price variables such as stock prices and exchange rates have been highly volatile due to the government debt problems in some European countries and the increase in the geo-political risks surrounding the Korean peninsula. The scale of the growth in mortgage lending has widened slightly in response chiefly to reduced lending rates, even though house transactions have been inactive.
- ☐ Looking ahead, the Committee will maintain the accommodative policy stance in such a way as to help the economy sustain its sound growth on a foundation of price stability and, in carrying out policy, it will take overall account of financial and economic conditions at home and abroad.

* However, Mr. Kang, Myung Hun and Mr. Lim, Seungtae dissented from the addition of the expression 'foundation of price stability' to the 'Monetary Policy Decision', while agreeing that the Base Rate be maintained at its current level.