Minutes of the Monetary Policy Board Meeting

April 19, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(April 2016)

Ⅰ. Outline

1. Date of meeting: Thursday, April 19, 2016

2. Place : Monetary Policy Board Meeting Room

3. Monetary Policy Board 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 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
Chang, Min, Director 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
Hong, Seung Je, Director General of International 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 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 steady growth, led by consumption, and the economy in the euro area had showed signs of improvement, centering around domestic demand, while the slowdown in economic growth and the sluggishness of economic activities in China had continued. As to **international financial markets**, most members evaluated stock prices as having risen substantially, Treasury bond yields in major countries as having mostly fallen, and the US dollar as having depreciated considerably, generally due to the run-up in international oil prices, additional easing measures by major countries, and expectations of a slower pace of US policy rate hikes.

Concerning **the domestic economy**, some members assessed that the trend of decline in exports had continued, but domestic demand activities such as consumption, and the sentiments of economic agents appeared to be improving somewhat.

With regard to **the domestic financial markets**, meanwhile, most members noted that, with international financial market volatility having reduced, foreigners’ portfolio investment funds had shifted to an inflow, stock prices had risen considerably, and the won-dollar rate had fallen significantly.

As to **prices**, members observed that consumer price inflation had stood at 1.0 percent, a decrease from the previous month, due mainly to faster declines in petroleum product prices and slower increases in service charges, and that core inflation had also decreased slightly month-on-month to 1.7%.

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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 this month to hold the Base Rate at its current level for the intermeeting period.

Among them, one member noted that, looking overall at changes in financial and economic conditions at home and abroad for the past month and the adjusted economic outlook in April, the inflation path had been partially revised downward, influenced by an additional decline in international oil prices, while the growth path had also been revised slightly downward, affected by the continued downward trend of exports and lackluster domestic demand. The member diagnosed that the downward revision of the growth path was mainly because the growth trend in the first quarter had been lower than original projection, due to mounting uncertainties about external conditions, including the financial and economic instability in China. The member went on to comment that, given that economic sentiment had improved of late and domestic demand was also showing partial signs of recovery, the domestic economy was expected to show a recovering trend, albeit modest, and the Base Rate's current level still seemed accommodative, even in light of changes in economic and price conditions. The member then put forward the view that it would be desirable to keep the Base Rate at its current level of 1.5% for the intermeeting period. The member, however, also pointed out that the remaining downside risks included a policy rate hike by the US Fed, changes in the growth structure in China, and the possibility of Brexit, and expressed the view that attention should be paid to the possibility of increased capital flows and exchange rate volatility stemming from a sudden reversal of global preferences for risky assets.

Another member set forth a number of points for the Board to consider in its operation of appropriate monetary policy. First, the slope of the future growth path was forecast to remain unchanged from its initial level. This was because, although a slight downward shift in the growth path in line with the export shock from sluggish external demand was estimated to have brought about the widening of the negative GDP gap, domestic demand was expected to show a modest recovery due to improved economic sentiment, along with the gradual easing of export sluggishness. Second, although disinflationary pressures were projected to weaken gradually with underlying upward trends of consumer price inflation and core inflation continuing and inflation expectations remaining stable, demand-side cyclical inflationary pressures still seemed insufficient to reach an appropriate inflation level. Third, slack in the production sector had not improved significantly, and although labor market slack had improved slightly, it was concentrated in relatively vulnerable sectors. The member then expressed the view that, although an overall consideration of these points could lead to the conclusion that there is a need for further Base Rate adjustments, it would be desirable to hold the Base Rate at its current level for the intermeeting period, while checking to see if the growth and inflation paths for the second quarter were consistent with the initial projections, and to strengthen the examination of changes in credit, exchange rate and other policy transmission channels and factors causing financial instability at home and abroad, thus maintaining a flexible policy stance. The member went on to note that, concerning future policy operation, the Board should effectively deal with increased volatility of capital flows and the exchange rate and cautiously monitor whether there was any change in the private-sector credit cycle. The member expressed the opinion that monetary policy should focus on the timely easing of downside aggregate demand and inflation pressures accompanying structural reforms, on preventing the erosion of growth potential stemming from expectations of low growth and the hysteresis effect, and on maintaining stability in the financial system despite internal and external shock factors.

One other member presented the view that, in overall consideration of recent economic conditions at home and abroad, it would be desirable to keep the Base Rate at its current level during the intermeeting period. Meanwhile, the member mentioned that, concerning the Korean economy during the last few years, with the persistent trends of slow growth and low inflation, there were growing calls for the central bank to play a more active role, and that the so-called Korean-style quantitative easing was arousing a great deal of interest and controversy, regardless of whether this policy is reasonable or not. With regard to this, the member argued that the Bank of Korea should develop various policy measures tailored to Korean economic conditions as long as these measures do not conflict with the central bank's own functions. The member went on to state that technical innovations in the areas of IT and payments and settlements were expected to have decisive impacts on the central bank's roles and its implementation of monetary policy, and thus particular attention should be paid to these innovations, and the necessary support and investment should be expanded greatly.

Meanwhile, one member expressed the opinion that, in determining this month's Base Rate, a number of factors should be considered in addition to domestic and overseas financial and economic conditions. First, although the forecasts for the growth rate and consumer price inflation for this year had been adjusted slightly downward in the recent economic outlooks, the Korean economy was expected to show a mild recovery and inflation was likely to accelerate gradually from the second quarter, and the Board should therefore continue to monitor changes in upside and downside risks to growth before deciding whether they should take a more accommodative macroeconomic policy stance to support economic recovery. Secondly, although the domestic and overseas financial markets stabilized recently, attention must be paid to the US Fed’s further rate hikes, the slowdown in Chinese economic growth, commodity price instability, increasing credit risks of European banks, the possibility of Brexit, and risks related to household loans. Finally, if Korea’s overall financial conditions are examined in terms of various indicators such as real interest rates, the liquidity growth rate and the MCI, it should be taken into account that Korea’s financial conditions remain accommodative even compared with those of major countries. In this regard, the member put forward the view that, while holding the Base Rate at its current level of 1.5 percent for the intermeeting period, it would be appropriate to closely monitor changes in domestic and overseas economic trends and the development of risk factors in the financial sector. Meanwhile, the member noted that, although Korea’s fiscal soundness is much more favorable than that of major countries, fiscal expenditure is likely to make far less contribution than before to growth, due mainly to the plan to lower the rate of growth in fiscal expenditure in this year’s budget and to the frontloading of budget spending during the first quarter of 2016. In this regard, the member went on to state that, if the situation calls for an additional easing of macroeconomic policy, such as if the growth rate falls far below its forecast path, fiscal policy should be given a more active role, with equal or higher priority than that placed on monetary policy.

Another member stated the opinion that it would be advisable to cut the Base Rate this month by 25 basis points from the current 1.5 percent to 1.25 percent. The member mentioned that a Base Rate cut would contribute to enhancing economic sentiment, improving the sluggishness of exports and domestic demand, and preventing the trend of low inflation from becoming firmly entrenched, and would also help ease the relatively high domestic interest rates due to additional financial easing policies in other countries and the relative strengthening of the Korean won. The member also argued that the US Fed is very likely to raise its policy rate in the second half of this year, which would highly likely lead to further divergence of major countries’ monetary policy stances and to even greater uncertainties and volatility in the financial and FX markets. In light of this, considering that policy transmission takes some time, active measures should be taken so that the Korean economy could restore its inherent resilience and break away from the trend of slow growth and low inflation. The member also assessed the current economic situation as calling for an appropriate expansion of fiscal spending, in addition to more accommodative monetary policy, in order to improve the weakening aggregate demand and infrastructure for growth. The member went on to argue that, along with the implementation of such counter-cyclical measures, the government should make strenuous efforts to carry out structural reforms in major areas of the Korean economy, in order to more fundamentally improve the Korean economy’s inherent resilience and fundamentals and create new engines for growth.

One other member’s diagnosis of domestic and overseas financial and economic conditions since last month’s monetary policy decision was that, with regard to the financial sector, international financial market instability had eased somewhat on the impact of major countries’ easing policies, and volatility in the domestic financial markets had also decreased, but attention needed to be paid to potential risk factors, such as household and corporate debt. The member also judged that, in terms of the business cycle, global economic growth was likely to slow down and there was only weak momentum in the Korean economy moving toward a shift in economic trends, due largely to sluggish exports and uncertainties regarding whether improvements in domestic demand would continue. The member went on to state that, with the Base Rate kept at its current level of 1.5 percent during the intermeeting period, attention should be paid to the trends of major countries’ economic conditions and their monetary and financial policy trends, and also to trends of household and corporate debt and of corporate restructuring, and momentum should also be created to increase economy activity and maintain stable macroeconomic trends. In the short term, the member also called for in-depth examinations of the possibility that the recent inversion of the yield curve might have implications for future economic activities or inflation, while at the same time paying attention to uncertainties regarding US monetary policy and to the possibility of negative responses to the downward adjustment of economic outlooks. The member also pointed out that financial innovation could be of help to monetary policy by enhancing the efficiency of the financial system, but it could also complicate the environment for policy implementation. The member then emphasized that it would be important to examine if monetary policy transmission channels were changing in Korea due for example to the expansion of the market-based financial system, so as to strengthen the effectiveness of monetary policy, and added that it would be also important to ensure resilience of economic and financial structures, to limit any damages from negative shocks at home and abroad. The member also noted that, as the effects of the central bank's monetary policy ultimately depended on the behavior of commercial banks that are at the center of monetary policy transmissions, it would be also important to assess the capacity of Korean commercial banks to create credit and seek measures to enhance such capacity. From a long-term perspective, meanwhile, the member presented the view that it would be necessary to develop effective indicators covering the employment situation and carry out various research, for example on the impacts of monetary policy on employment and wages, so that the central bank could help resolve employment problems with its monetary policy.

Ⅳ. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of their earlier discussions, members compiled a statement reflecting the views of the majority.

Mr. Seong Keun Ha, however, dissented, expressing his clear opposition to keeping the Base Rate at its current level, and arguing for lowering it by 0.25 of a percentage point.

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Monetary Policy Decision

☐ The trend of economic recovery in the US has been sustained and that indications of improvement, although weak, have appeared in the euro area. The economic slowdown in China has shown signs of easing a bit, but economic growth in other emerging market economies has continued to slow, centering around commodity-exporting countries. The Board forecasts that the global economy will maintain its recovery going forward, albeit at a moderate pace, centering around advanced economies such as the US, but judges that it will be affected by factors such as financial and economic conditions in emerging market countries, international oil price movements, and global financial market volatility.

☐ Looking at the Korean economy, the trend of decline in exports has continued but domestic demand activities such as consumption, and the sentiments of economic agents appear to be improving somewhat. On the employment front, the unemployment rate was somewhat higher in March compared to that in March of last year, owing mainly to an expansion in job search activities. The employment-to-population ratio was also increased, however, as the number of persons employed has steadily grown. The Board forecasts that the domestic economy will show a trend of modest improvement going forward, centering around domestic demand activities, but in view of external economic conditions judges the uncertainties surrounding the growth path to be still high.

☐ Consumer price inflation fell from 1.3% the month before to 1.0% in March, owing chiefly to increases in the extents of decline in petroleum product prices. Core inflation excluding agricultural and petroleum product prices also decreased slightly to 1.7%, from 1.8%

in February. Looking ahead the Board forecasts that consumer price inflation will fall considerably short of the 2% inflation target for the time being, due mainly to the low oil prices. In the housing market, sales prices maintained their level of the previous month while the uptrend in leasehold deposit prices slowed.

☐ In the domestic financial markets, stock prices have risen and the Korean won has appreciated against the US dollar since March, as foreigners' securities investment funds have recorded net inflows on the effects of further monetary policy easing by major countries. After having appreciated against the Japanese yen, the won has depreciated somewhat against it again in line with the yen's strengthening. Long-term market interest rates have fallen back after having previously risen, in reflection mainly of interest rate movements in major countries. Bank household lending has sustained a trend of increase at a level exceeding that of recent years, led by mortgage loans.

☐ Looking ahead, while working to support the recovery of economic growth the Board will conduct monetary policy so as to maintain price stability over a medium-term horizon, and also pay attention to financial stability. In this process it will closely monitor any changes in monetary policies or in financial and economic conditions in major countries, the movements of capital flows, and the trend of increase in household debt.