

Minutes of the Monetary Policy Committee Meeting

July 10, 2014

The Bank of Korea

(English version)

Minutes of the Monetary Policy Committee Meeting¹⁾ **(July 2014)**

I . Outline

1. Date of meeting : Thursday, July 10, 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
Chae, Sun Byoung, Director General of Reserve Management Group
Choi, Woon Gyu, Director of Economic Research Institute
Shin, Woon, Director General of Research Department
Cho, Jeonghwan, Director of Macprudential Analysis Department
Kim, Min-Ho, Director General of Monetary Policy & Markets Department
Ryoo, Sangdai, Director General of International Department
Jeon, Seung-Cheol, Director General of Monetary Policy Committee Secretariat
Park, Sung Joon, Director General 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 Situation²⁾

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**, members' assessment was that the trends of economic recovery in the US and other advanced countries had been sustained and the Chinese economy had been exhibiting improvements in major real economic indicators. Members also noted that, with **the international financial markets** showing generally favorable movements, global interest rates had declined and stock prices had risen.

As to **the domestic economy**, members judged that the economic recovery had shown signs of weakening as domestic demand-related indicators had become subdued. Most members expressed concerns about issues such as the contractions in consumer and investor confidence and the weakening of consumption due to structural factors, while some noted the possibility of a further delay in the economic recovery going forward. One member however mentioned that there was also a possibility of the domestic economy returning quickly to its originally forecast growth path, since the effects of the Sewol ferry accident were judged to be limited to only temporary shocks

In **the domestic financial markets**, meanwhile, members noted that long-term interest rates and exchange rates had fallen and that the credit differentiation (where only companies with high credit ratings have access to credit) in the corporate bond market was persisting.

With regard to **prices**, members mentioned that consumer price inflation stood at 1.7%, as in the previous month. Several members anticipated that

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

consumer price inflation would gradually rise but that inflationary pressures would be weaker than initially expected – due chiefly to downward pressures on inflation from the supply side, resulting largely from the decline in import prices with the appreciation of the Korean won and from the continuing weakness in agricultural product prices, as well as to the sluggishness of aggregate demand owing to the domestic demand slowdown.

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

One of them noted that, although the world economy had been gradually improving, the downside risks to growth had been mounting again of late, and although the Korean economy was also continuing its trend of growth, centering around exports, it was unclear whether this trend would remain firmly on track going forward. He went on to express the view that, as the contraction in domestic demand since the Sewol ferry accident had been accelerating, while inflation also remained at an unprecedentedly low level, close monitoring by the policy authorities was necessary.

Another member offered the opinion that, inasmuch as the trends of economic recovery at home and abroad had not been solid, monetary policy should be conducted so that the effects of factors constraining the growth of and causing imbalances between the financial and the real sectors could be minimized and the momentum for economic recovery

found, while economic agents' sentiments were managed stably so as to avoid their falling into a low expectation trap.

One other member noted that, although the downward revision of the economic growth forecast for Korea in 2014, compared to the original forecast, appeared attributable not just to temporary shocks but also to structural factors causing sluggishness in domestic demand, neither the future direction of the growth path nor the trend of narrowing of the output gap were judged to have reversed. This member went on to note that, while the trend of a narrowing of the price gap itself had not changed, there was a possibility that its pace would be quite moderate. He also stated the opinion that, although the current credit cycle was judged to not be in a phase of overheating, the effects that any adjustment to the Base Rate might bring about should be considered with great caution, given the high level of leverage and the structural vulnerabilities of household debt, the polarization of the corporate credit market, and the signs of a contraction in direct financing.

Another member commented that, although judging from economic conditions and prospects at home and abroad some scope seemed to have arisen for more accommodative monetary policy, it was necessary to further observe and examine the impacts of the Sewol ferry accident and risk factors such as the appreciation of the Korean won, since the overall trend of macroeconomic variables remained unchanged even in the revised economic outlook.

One other member noted that the Korean won had appreciated by more than 6% against the US dollar since March of this year, having at one point in July reached 1,008 won to the dollar, and that it was even appreciating against the currencies of Japan and the euro area, with which Korea runs bilateral current account deficits, as Korea's trade surplus with China, which accounts for 70 to 80% of Korea's current account surplus,

is converted and flows into the Korean FX market mostly in US dollars. The member then expressed the opinion that, as the recently agreed upon establishment of markets for direct trade between the won and the yuan was expected to mitigate this excessive appreciation of the won, efforts to facilitate these markets were necessary.

Another member observed meanwhile that the uncertainties concerning the future growth path of and the downside risks to the economy were judged to have increased, while prices were seen likely to continue showing a rate of growth below the inflation target. He went on to argue that, although predicting in advance whether the impact of the Sewol ferry accident would be long-term or only temporary was difficult, the Base Rate should be adjusted downward from its current level this month, since a preemptive response was judged necessary at this juncture owing to concerns about the decline in economic agents' confidence becoming prolonged.

IV. Results of Deliberation of Monetary Policy Directions

Taking into consideration the results of their earlier discussions, members compiled a statement reflecting the views of the majority.

However, Mr. Chung, Hae-Bang expressed clear opposition to the idea of holding the Base Rate at its current level, and argued for a rate cut.

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Monetary Policy Decision

- ☐ The Monetary Policy Committee of the Bank of Korea decided today to leave the Base Rate unchanged at 2.50% for the intermeeting period.
- ☐ Based on currently available information the Committee considers that the trend of economic recovery in the US has been sustained and the sluggishness of economic activities in the euro area appears to have continued to ease, 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 advanced economies, 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 and by the weakening of economic growth in some emerging market countries.
- ☐ In Korea, despite exports having maintained their buoyancy the Committee appraises economic growth to have slowed somewhat, as domestic demand has slackened due largely to the impacts of the Sewol ferry accident. On the employment front, the number of persons employed has shown an uptrend similar to its level of recent years, 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 its pace of narrowing will be moderate.
- ☐ Consumer price inflation registered 1.7% in June, as in May, even despite a narrowing of the extent of decline in agricultural product

prices as the decline in petroleum product prices accelerated. Core inflation excluding the prices of agricultural and petroleum products fell slightly, from 2.2% to 2.1%. The Committee forecasts that inflation will gradually rise, although inflationary pressures appear to be somewhat weaker than previously expected. Housing prices in the country excluding Seoul and its surrounding areas showed a slight upward movement, while leasehold-deposit prices both in Seoul and its surrounding areas and in the rest of the country continued their modest uptrends.

- ☐ In the domestic financial markets, influenced by improvements in economic indicators in and the accommodative monetary policy stances of major countries, as well as by inflows of foreigners' securities investment funds, stock prices have risen, long-term market interest rates have fallen, and the Korean won has appreciated.
- ☐ Looking ahead, the Committee will conduct monetary policy so as to keep consumer price inflation within the inflation target range over a medium-term horizon while supporting the recovery of economic growth. In this process it will closely monitor external risk factors such as shifts in major countries' monetary policies, as well as the possibility of a delay in the domestic demand recovery influenced for example by the Sewol ferry accident.