

Minutes of the Monetary Policy Board Meeting

December 10, 2015

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting¹⁾ **(December 2015)**

I . Outline

1. Date of meeting : Thursday, December 10, 2015
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
Lee, Heung Mo, Deputy Governor
Kim, Minho, Deputy Governor
Yoon, Myun-Shik, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Choi, Woon Gyu, Director of BOK Economic Research Institute
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
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 Situation²⁾

After briefings by staff on ‘Current Economic Developments in Korea’, ‘FX and International Finance’ and ‘Financial Markets’, the discussions of the Monetary Policy Board (MPB) members covered the following areas:

With regard to **the global economy**, members’ assessment was that the trend of economic growth in the US had been sustained, with the nation’s consumption and facilities investment increasing and its housing market and employment situation improving, that the modest improvements in the euro area were continuing, driven by domestic demand, and that China’s economic growth was continuing to slow down, with its exports declining. Members also judged that **international financial market** volatility had heightened, due for example to the divergence in major countries’ policy stances.

As to **the domestic economy**, members assessed that, although domestic demand had sustained its pace of recovery, driven by consumption, the trend of declining exports also had persisted.

Concerning **the domestic financial markets**, meanwhile, most members noted that long-term interest rates had risen, owing mainly to increases in interest rates in major countries and to increased bank debenture issuance, and that stock prices had fallen, affected for example by the global stock price decline and net stock selling by foreign investors. They commented that the Korean won had depreciated against the US dollar, influenced by strengthened expectations of a policy rate hike by the US Federal Reserve. In addition, a number of members noted that bank household lending had sustained its high rate of increase.

With regard to **prices**, most members observed that consumer price inflation had stood at 1.0 percent, up from the previous month, due mainly to greater increases in industrial product prices and services fees, and that core inflation had also increased slightly from the preceding month.

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 domestic and international economic environments and the future outlook for them both, it would be desirable this month to hold the Base Rate at its current level for the intermeeting period.

One member put forward the view that, in overall consideration of economic conditions at home and abroad, it would be desirable to keep the Base Rate at its current level of 1.5% for the month. The member went on to note that the decision in November 2015 to include the yuan in the SDR currency basket was a consequence of the Chinese government's phase-in implementation of its medium-to-long-term plan to make the yuan an international currency. The member then expressed the view that, considering the scales of the Korean economy and trade, and the degree of its capital market openness, it was time for Korea to actively consider making the won an international currency, and thus, with the establishment of the won-yuan direct trading market in Shanghai, China scheduled for 2016, Korea should develop a medium-to-long-term plan to push the successful internationalization of the won, and continue its efforts to improve its financial and economic conditions and systems.

Another member mentioned that, although the trends for inflation and the domestic economy remained overall on the path forecast last October, uncertainties surrounding the future outlook remained very high, due mainly to a slowdown in the recovery of external demand and to the possibility of further declines in oil prices, and that it was also necessary to observe what kind of influence the US Fed rate hike would have on international financial markets. The member then argued that, while keeping the Base Rate at its current level, the Bank of Korea should keep a constant watch on financial market conditions to prevent market unrest from spreading, and strengthen its efforts to bring about market stability if necessary. The member also noted that, although the number of persons

employed had steadily grown, the quality of employment conditions had remained inadequate, and thus it was necessary to draw up more practical measures on the youth employment problem by addressing it not only from the perspective of the total number of persons employed, but also strengthening the micro-level analysis of the issue in terms of occupation and sector.

One other member expressed the opinion that it would be advisable to keep the Base Rate at its current level during the intermeeting period and prepare for the Fed's rate hike, as growth and inflation were not deviating significantly from the path originally forecast, but uncertainty and potential risks seemed to have increased even further during the fourth quarter. In support of this, the member stated that, first, the downside risks to the growth path had been increasing gradually with recovery in aggregate demand and production somewhat weakening, which more than offset the sustained moderate trend of improvement in economic activities led by consumption; second, based on various core inflation indicators, inflation generally remained on the path forecast last October, with its underlying upward trend accelerating at a modest pace; and third, slack in the manufacturing sector had increased and recovery in the labor market had been slowing. The member further stated that, as the current US rate hike cycle would differ from previous instances in that it would occur in the midst of economic downturns in EMEs, during which their financial cycles were coupling excessively with those of AEs and a large amount of global liquidity – mostly securities investment funds – flowed into them, the possibility could not be ruled out that the rate hike's repercussions would be larger than expected. The member went on to argue that domestic macroeconomic policies should be implemented in ways that would offset downward pressures resulting from slowed external demand with a recovery in domestic demand and, at the same time, attention needed to be paid to the widening imbalances in the financial system from a medium-to-long-term perspective.

Meanwhile, one member stated that, taking into overall consideration domestic and overseas economic conditions, the downside risks to growth and prices were seen to have increased somewhat compared with the path

forecast last October, but the economic upturn was likely to continue, and in terms of financial stability, risks seemed to have grown even further, with the possibility of greater financial market volatility in line with a shift in the US Fed's monetary policy direction and with household debt expected to maintain strong growth for a considerable period of time, boosted chiefly by low interest rates and increased extensions of apartment group loans. The member also presented the view that it would be appropriate to keep the Base Rate at its current level during the intermeeting period and closely examine the effect of changes in domestic and external conditions, and of a shift in the Fed's monetary policy in particular, on the international financial markets and domestic foreign exchange and financial markets.

Another member set out the view that, in overall consideration of recent economic conditions at home and abroad, it would be advisable to keep the Base Rate at its current level during the intermeeting period and closely monitor the Fed's interest rate policy and its impact, Chinese economic developments, international oil prices, improvement in domestic demand and slowdown in exports in the Korean economy, and fluctuations in the Korean foreign exchange and financial markets. The member also stated that if the Fed's rate hike leads to a decoupling of major countries' monetary policies, this might give rise to substantial volatility in Korea's financial and foreign exchange markets, which are presently vulnerable to external shocks. The member also asked the policy authorities to be fully prepared to take appropriate market stabilization measures in a timely manner if needed. The member then assessed the Korean economy as facing an unprecedented downward trend of exports as downside risks to the global economy reached a new level, and went on to add that there had arisen an even stronger need for the policy authorities to seek the optimal mix of monetary, fiscal and macroprudential policies in an effort to enhance economic dynamism while easing the problem of excessive debt and risks of herd behavior in the financial and foreign exchange markets, which served as major factors limiting active macroeconomic policy implementation.

One other member set out the view that, while holding the Base Rate

at its current level during the intermeeting period, the government should work to maintain the trend of improvement in domestic demand while paying attention to the risks inherent in global economic trends and in the divergence of major advanced countries' policy stances. The member stressed that, in order to make an accurate diagnosis of and cope with persistently low growth, the government should note difficulties on the supply side as well as a shortage of demand, and focus on investment expansion to increase the economy's production capacity, thereby restoring growth and employment potential. The member mentioned a number of areas that merit consideration and examination, including the effects of weakening oil and commodity prices on exports, growth and prices generally; preparations for the Fed's rate hike; changes in the term and risk premiums in the bond markets and their impact; changes in foreign investment trends; market stabilization measures to prepare against possible foreign exchange liquidity disturbances; and the positive and/or negative effects of the yuan's inclusion in the SDR on the Korean economy. The member went on to argue that financial market stability needed to be strengthened, for example by enhancing the financial sector's liquidity management capacity, as minor changes surrounding the financial markets caused by financial frictions, including information asymmetry and herd behavior, might trigger or worsen credit or liquidity risks. With regard to inflation targeting, the member noted that the central bank should set its inflation target within the larger framework of its monetary policy, and that it needed to cope flexibly with price determinant variables and also strengthen communication. The member then emphasized that capital flows should be improved to facilitate the investment needed for the recovery of growth potential, and stated that a major task to this end included enhancing the effectiveness of the bank intermediation support facility.

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 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 1.50% for the intermeeting period.
- ☐ Based on currently available information the Bank of Korea considers that the trend of economic recovery in the US has been sustained, and that the modest improvements in the euro area have continued. Economic growth in emerging market countries including China has meanwhile continued to slow. The Bank of Korea 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 the possibilities exist of its being affected by heightened international financial market volatility due for example to a shift in the US Federal Reserve's monetary policy, and by the weakening of economic growth in emerging market countries.
- ☐ Looking at the Korean economy, although domestic demand activities have sustained their paces of recovery, driven by consumption, the trend of declining exports has persisted while the improvement in economic agents' sentiments has been inadequate. On the employment front, the number of persons employed has increased steadily, and in October the unemployment rate fell compared to that in October of last year while the employment-to-population ratio maintained the same level. The Bank of Korea forecasts that the domestic economy will continue its recovery going forward, centering around domestic demand activities, but in view of external economic conditions judges the uncertainties surrounding the growth path to be high.
- ☐ Consumer price inflation rose from 0.9% the month before to 1.0% in November, due mainly to a narrowing of the scale of decline in petroleum product prices and to expansions in the extents of

increase in service fees. Core inflation excluding agricultural and petroleum product prices also rose to 2.4%, from 2.3% in October. Looking ahead the Bank of Korea forecasts that inflation will continue at a low level, due mainly to the effects of the low oil prices. In the housing market, meanwhile, the upward trends of sales and leasehold deposit prices have persisted in both Seoul and its surrounding areas and the rest of the country.

- ☐ In the domestic financial markets, influenced mostly by expectations of a policy rate hike by the US Federal Reserve, stock prices have fallen, long-term market interest rates have risen, and the Korean won has depreciated against both the US dollar and the Japanese yen. Bank household lending has sustained a trend of increase at a level substantially exceeding that of recent years, led by mortgage loans.
- ☐ Looking ahead, while working to sustain the recovery of economic growth, the Bank of Korea will conduct monetary policy so as to maintain price stability over a medium-term horizon and pay attention to financial stability. In this process it will closely monitor external risk factors such as any changes in the US Federal Reserve's monetary policy or in economic conditions in emerging market countries including China, the movements of capital flows, and the trend of increase in household debt.