Minutes of the Monetary Policy Committee Meeting

March 12, 2015

The Bank of Korea

(English version)

Minutes of the Monetary Policy Committee Meeting[1)]

(March 2015)

Ⅰ. Outline

1. Date of meeting : Thursday, March 12, 2015

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
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 Financial Markets Department
Hong, Seung Je, Director General of International Department
Lee, Hwanseok, Director General of Monetary Policy Committee Secretariat
Park, Sung Joon, Press Officer
Park, Cheol Won, Head of MPC 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 Situation[2)]

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 U.S. had maintained favorable growth with its employment situation improving, while economic growth in China had slowed due mainly to its sluggish real estate market. Members also judged risk aversion in the **international financial markets** to have eased, owing chiefly to the proliferation of accommodative monetary policy stances and to reduced concerns about Greece.

As to **the domestic economy**, members appraised the trend of recovery as having been weak, with domestic demand such as consumption and facilities investment sluggish and exports declining. Some members noted the possibilities of GDP for the first quarter this year and for the year as a whole coming in below the January forecasts.

Concerning **the domestic financial markets**, meanwhile, members pointed out that stock prices had risen, long-term market interest rates had declined, and the Korean won’s real effective exchange rate had maintained a trend of appreciation.

With regard to **prices**, members noted that consumer price inflation had recorded 0.5%, lower than during the month before. Some members commented that the future price path would remain at a level below that forecast in January.

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

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 the future outlooks for both, it would be desirable this month to cut the Base Rate by 0.25 of a percentage point from its current level for the intermeeting period.

One of these members noted that, with the exception of the household lending trend, all economic developments at home and abroad since the month previous indicated heightened necessity of an additional Base Rate cut. He went on to argue that, in contrast to previous periods of real estate bubble formation, the recent expansion in household debt was attributable mainly to an increased volume of transactions and to a rise in leasehold deposit prices. And considering moreover that it would be appropriate to cope initially with the risks posed by excessive household debt through macroprudential policy measures, it was undesirable at this time for the monetary authorities to hesitate in taking timely measures in response to changes in global economic conditions and to new downside risks to prices and growth. It would therefore be appropriate to cut the Base Rate this month, from its current 2.0% to 1.75%.

Another member noted, in view of overall financial and economic conditions domestically and overseas, the possibility that the negative output gap might continue for a longer period of time than had been expected. He pointed out that, on the external side, the trends of improvement in economic activities in major countries apart from the U.S. were unclear, the uncertainties about the future direction of the global economy had not disappeared, due chiefly to the expectations of a U.S. policy rate hike, to the continuation of monetary policy accommodativeness in major countries, and to the reemergence of the Greek issue. On the domestic front, although economic agent sentiments had shown some signs of improvement the domestic demand recovery remained weak and exports were sluggish. The member went on to advocate the necessity of adjusting the Base Rate downward to 1.75%, to dispel the vulnerabilities in the growth path and prevent materialization of the downside risks to the economy.

One other member noted that, in view of the weaker than expected January and February indicators, it was difficult to say that the growth shock in the fourth quarter of 2014 had been due only to one-off factors including a shortfall in tax revenues. He added that downward adjustment of the forecast price path was unavoidable with the negative output gap widening due to the rapid decline in consumer price inflation , and that, despite the two Base Rate cuts last year, real interest rates were rising again due to declines in consumer price inflation and in inflation expectations, while the real neutral rate was on the other hand showing a gradual trend of decrease due mainly to demographic structural changes. The real effective Korean won exchange rate was meanwhile on the rise, in line with the spread of accommodative monetary policy stances globally. In consideration of all of these points, the member then stated his opinion that it would be necessary to lower the Base Rate to 1.75% this month, to support the economy’s return to its potential growth path by narrowing the negative output and negative price gaps, and to respond preemptively to the possibilities of a future drop in expected inflation and of a spread of deflationary sentiments.

Another member meanwhile presented the views that, with the GDP gap negative there was a possibility of future real economic growth not reaching the potential growth rate, and that the low inflation was expected to persist for a considerable time as well. It was thus necessary to continuously support the recovery of Korean economic growth and expansion of the growth potential, by lowering the Base Rate by 25bp this month while raising the ceiling on the Financial Intermediation Support Facility and adjusting the scope of its coverage. He added that, while still greater attention should be paid to household debt, which was a potential risk to financial stability, improvements in the household debt structure should be pursued effectively through cooperation among the institutions concerned, and macroprudential measures should if necessary also be devised to curb the increase in the total lending amount.

One other member expressed the opinion that holding the Base Rate at its current level for the intermeeting period would be desirable, commenting that, rather than bringing about the promotion of corporate investment or an increase in household consumption, a further Base Rate cut could result instead in actually hindering firms' structural reforms and causing long-term financial instability to intensify by increasing household debt. This member continued by noting that if the Bank Intermediation Support Facility, a non interest-rate policy tool, were utilized, it could minimize the growth of household debt and have an economic stimulus effect by channeling credit into corporate lending only, with household lending excluded. To this end, he remarked, the Bank Intermediation Support Facility should be redesigned to allow counter-cyclical operation and, if necessary, the scope of coverage of its support should be expanded from small and medium-size enterprises at present to also include leading medium-size firms. The member went on to point out that Korea's fiscal spending since the global financial crisis had been inadequate to support economic recovery, and its management had also not been sufficiently counter-cyclical, adding that exerting a direct influence on private investment and consumption through government fiscal policy could be an effective plan.

Another member expressed his own opinion of the desirability of maintaining the Base Rate at its current level for the intermeeting period.

He reasoned, firstly, that although the pace of the domestic economic recovery was somewhat weak compared with that forecast in January, under the recent domestic and international conditions it was necessary to pay greater attention to the employment situation than to economic growth, and it was not desirable to resort to use of the Base Rate only out of concerns about a drop in the growth rate. Secondly, considering the maneuvering room for monetary policy, it was necessary to exercise greater caution in deciding on a Base Rate level that had never been experienced before, and under the current overall accommodative financial conditions a Base Rate cut would have only limited effect. Thirdly, he said, when the price-related data were looked at comprehensively the fears about deflation that had emerged as an issue recently seemed somewhat excessive, while account should also be taken of the concerns about the increase in household debt.

Ⅳ. Results of Deliberation on Monetary Policy Directions

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

However, Mr. Chung, Hae-Bang and Mr. Moon, Woosik expressed clear opposition to the idea of lowering the Base Rate by 0.25 of a percentage point, and argued for holding it unchanged at its current level.

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Monetary Policy Decision

□ The Monetary Policy Committee of the Bank of Korea decided today to lower the Base Rate by 25 basis points, from 2.00% to 1.75%.

□ Based on currently available information the Committee considers that, although the trend of a solid economic recovery in the US has been sustained and improvements, albeit modest, have also continued in the euro area, economic growth in emerging market countries including China has slowed. The Committee forecasts that the global economy will sustain its modest recovery going forward, centering around advanced economies such as the US, but judges that the possibility exists of its being affected by changes in the monetary policies of major countries, by the weakening of economic growth in emerging market countries, and by geopolitical risks.

□ Looking at the Korean economy, the Committee notes that exports have decreased, due mostly to declines in the unit prices for example of petroleum products, that domestic demand activities such as private consumption and facilities investment have exhibited sluggish movements, and that the sentiments of economic agents have also not clearly recovered. On the employment front, the number of persons employed has expanded steadily, led by increases in the 50-and-above age group and in the service sector. The Committee expects that the domestic economy will show a modest trend of recovery going forward, although falling short of the originally forecast growth path. The period of continuation of the negative output gap will as a result also be longer than had been anticipated.

☐ Consumer price inflation fell from 0.8% the month before to 0.5% in February, owing mainly to increases in the extents of decline in petroleum product prices and to the slower paces of increase in prices of industrial products other than petroleum. Core inflation excluding agricultural and petroleum product prices fell slightly to 2.3%, from 2.4% in January. Looking ahead, the Committee forecasts that, due mainly to the effects of the low oil prices, inflation will continue at a level lower than originally expected. In the housing market, the upward trends of sales prices accelerated slightly, while leasehold deposit prices continued their uptrend centering around Seoul and its surrounding areas.

☐ In the domestic financial markets, after having risen on foreigners' net buying of domestic stocks for example, stock prices have recently fallen under the influence mostly of declines in stock prices in major countries. The Korean won has depreciated against the US dollar, affected by the dollar's strength globally and by the synchronization between movements of the won and the Japanese yen following the yen's weakening, while it has fluctuated within a certain range against the yen. Long-term market interest rates had risen, but have since declined. Bank household lending has sustained its trend of increase at a level greatly exceeding that of recent years, led by mortgage loans.

□ Looking ahead, while supporting the recovery of economic growth the Committee 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 international oil prices and shifts in major countries' monetary policies, as well as developments related to the spare capacity in the domestic economy and the trends of household debt and capital flows.