Minutes of the Monetary Policy Board Meeting

March 10, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]
(March 2016)

Ⅰ. Outline

1. Date of meeting : Thursday, March 10, 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
Suh, Young Kyung, Deputy Governor
Kim, Minho, Deputy Governor
Yoon, Myun-Shik, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
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

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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 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 euro area recovery had somewhat weakened with major sentiment indexes slowing, China’s economic slowdown had continued with its exports decreasing significantly, and the US economy was maintaining modest growth with consumption and employment indexes improving. As to **international financial markets**, most members evaluated Treasury bond yields in major countries as having fallen, generally due to concerns about a global economic slowdown and expectations of additional easing measures by the ECB, and stock prices as having started to rise, influenced largely by increases in international oil prices.

Concerning **the domestic economy**, members assessed that the recovery had slowed due to the continued sluggishness of exports and domestic demand.

With regard to **the domestic financial markets**, meanwhile, members noted that, with international financial market instability having eased, outflows of foreigners’ portfolio investment funds had slowed and stock prices had rebounded significantly since mid-February, and the won-dollar rate had fallen back substantially since the beginning of March.

As to **prices**, most members observed that consumer price inflation had stood at 1.3 percent, a substantial increase from the previous month, due mainly to sharp increases in agricultural product prices, and that core inflation had also increased slightly month-on-month to 1.8%.

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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 evaluated that, on the external side, there had been a possibility of greater volatility in the international financial markets, and on the domestic side, there had been no driving force triggering a shift in the economic trend due to sluggish exports and domestic demand, and the member also stated that keen attention should be paid to financial stability issues, such as outflows of foreigners' portfolio investment funds or growth in household and corporate debt. The member went on to state the view that, while holding the Base Rate at its current level for the intermeeting period, attention should be paid to various risks at home and abroad and efforts should be made to discover momentum for improvement in economic activities and to maintain macroeconomic stability. The member stressed that it would be necessary to address the uncertainties felt by economic agents and stop self-reinforcing dynamic adaptation, while sharing the view that it was difficult to expect the domestic economy to grow at more than a modest pace in a situation where exports were unlikely to recover easily. The member also expressed the view that, as the shadow of a crisis cast by global macroeconomic adjustments now taking place in China and EMEs following the US and Europe was revealing itself in slightly different forms of volatility, various external volatility issues needed to be addressed carefully. The member went on to mention the need for the monitoring and continuous management of household debt risks and added that promotion of greater use of non-recourse *Didimdol* loans or mortgage insurances would help reduce vulnerable households' debt risks. The member also presented the views that attention should be paid to the significance and future impact of persistently low growth that added to financial instability, that new technology-based services should be further reflected in GDP statistics, and that efforts should be strengthened to comprehensively analyze various information variables and identify the relationship between business and financial cycles in order to expand monetary policy infrastructure.

Another member expressed the opinion that it would be advisable to cut this month's Base Rate by 25 basis points from the current 1.5% to 1.25%. The member mentioned that this downward adjustment would contribute substantially to the easing the worsening of economic sentiment, to improvements in exports and domestic demand, and to stabilization of the financial and foreign exchange markets. Based on the member's evaluation that global monetary easing was very likely to expand going forward and that global interest rates would remain at ultra low levels for the time being even if the US normalizes its monetary policy, the member stressed that it would be necessary for the Korean economy, with its high dependence upon external trade and high degree of financial openness, to adapt itself flexibly to the easing stances of its major trading partners. The member expressed the opinion that the risk of further foreign capital outflows and greater household debt, having been pointed out as potential policy costs to be incurred by additional rate cuts, had been substantially decreasing recently, and that monetary policy divergence among the US and other major countries was likely to expand, which would limit the Korean monetary authorities' policy space. In addition, the member put forward his view that the related policy authorities should look more closely at economic developments and seek appropriate preemptive measures in order to prevent the formation of a vicious circle in which sluggish economic indicators arouse anxiety among economic agents, leading to a delay in consumption and investment, which in turnerm would make the Korean economy less resilient. The member went on to argue that the policy authorities should work hard to improve economic sentiment by conveying their policy intentions more clearly and by ensuring that they are equipped with various policy instruments and are prepared to implement them.

One other member put forward the view that, although prices had risen temporarily, there had been no major changes in the overall trend, and that, amid slightly weakening signs of improvement in economic activities during January and February, downside risks seemed to have increased somewhat, due mainly to the persistent sluggishness of external demand and the weakening of economic sentiment. The member went on to state that, amid the current structurally weakened economic recovery, providing stimulus through policy rate adjustment had some limitations, and thus it would be advisable to keep the Base Rate at its current level during the intermeeting period, while waiting and observing changes in the monetary policies of the ECB and the US Federal Reserve, movements of international oil prices, and domestic economic situation. The member also noted that, although the domestic economy was likely to maintain its recovery going forward, albeit at a moderate pace, centering around domestic demand, the uncertainties surrounding the growth path going forward were still judged to be high, as the recovery of consumption was likely to be limited due to the weakening of household confidence amid persistently sluggish exports stemming from a shortage of external demand. The member also argued that, since inflows/outflows of foreign securities investment funds were greatly affected by external factors, a close watch should be kept on the possibility that outward pressures of foreign securities investment funds would grow again, if economic instabilities in EMEs increase again or if there is any change in the monetary policies of major central banks.

Meanwhile, one member set forth a number of points that the Board consider in its operation of appropriate monetary policy. First, as the effects of sluggish exports, which had thus far been confined to the manufacturing sector, were gradually spreading to the service sector, economic sentiment and the recovery of domestic demand both had weakened. As a result, growth in the first quarter had fallen short of the original forecast, and thus there was an increased possibility of a widening negative GDP gap. Second, as underlying upward trends of consumer price inflation and core inflation continued and inflation expectations remained stable, disinflationary pressure was gradually weakening. However, there was a need for a little more observation to determine whether demand-side upward pressures on core inflation would increase sufficiently to reach an appropriate inflation level over a medium-term horizon. Third, slack in the production sector had expanded further, and although slack in the labor market 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 room for further Base Rate adjustments, it would be desirable to hold the Base Rate at its current level for the intermeeting period, and to closely examine the extent of actual changes in the growth and price paths and factors causing financial instability at home and abroad, thus maintaining a flexible policy stance. The member also expressed the opinion that, concerning future policy operation, the Board should cautiously examine changes in the policies of major countries, keep a close eye on their effects on the domestic markets and the consequent changes related to risks of capital outflows, and thoroughly analyze major expected monetary policy transmission channels and the policy effects, in consideration of changes in financial and economic conditions at home and abroad. The member went on to mention that the Board should pay attention to the fact that, at this stage, the positive effects of monetary policy could be maximized and its negative side effects could be minimized only if it is implemented as part of an appropriate policy mix, including the implementation of structural reform, the expansion of the role of fiscal policy, and the effective operation of macroprudential policy.

Another member put forward the view that it would be desirable to keep the Base Rate at its current level for the intermeeting period and closely examine changes in external conditions, including international oil prices, the monetary policies of major countries, inflows/outflows of foreign investment funds, and movements of price variables in the financial markets. The member commented that, although downside risks to growth and inflation had increased somewhat since the January forecast, uncertainty over external economic conditions was high, and thus it was necessary to maintain a closer examination of future changes in conditions in order to effectively assess the underlying trends of growth and inflation. The member went on to state the necessity of closely monitoring the effects on the Korean economy of the recent rebound in international oil prices and of the monetary policy decisions of the ECB, the Bank of Japan, the US Federal Reserve and other major country central banks scheduled for this month. The member also put forward the view that, although financial markets at home and abroad were showing a somewhat stable pattern of movements, it was difficult to say that financial market uncertainty had fundamentally eased, so even a minor shock might cause a reoccurrence of heightened market volatility.

One other member put forward the view that, in overall consideration of economic conditions at home and abroad, it would be desirable to hold the Base Rate at its current level for the intermeeting period. The member then noted three options that could be considered to manage household debt, which presently stands at more than 1,200 trillion won. The member stated that the first option--partial debt write-offs--does not address the root of the problem, and the second option, which is to curb the pace of increase in household debt, could cause a conflict between economic recovery and financial stability. The member then stressed the necessity of looking into the third option, which is to boost the housing rental market. Through this option, debt that is concentrated in the household sector can be transferred to other sectors. In this regard, the member stated the view that there was an urgent need to collect micro-data related to household debt in order to gain an understanding of the exact state of household debt in Korea, including lending to self-employed business operators and the debt of unregistered landlords, and to set up a system of managing such data systemically. The member noted that, for actual residential households, it was necessary to reduce demand for housing purchases and leasehold deposit-based rentals by promoting the housing rental industry to ensure that the corporate and public sectors could purchase and rent houses on a monthly basis. Specifically, the member proposed two policy alternatives; first, to have corporations consider expanding their investment in houses by building accommodations for their employees, and second, to have pension funds actively participate in the housing rental business.

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 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 Board considers that the US economy has emerged from its temporary slowdown and shown a trend of moderate growth. However, the trend of economic recovery in the euro area has weakened somewhat, while economic growth in emerging market countries including China has continued to slow. 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 China and other emerging market countries, international oil price movements, and global financial market volatility.

☐ Looking at the Korean economy, the trend of decline in exports and the weakening recovery of domestic demand activities such as consumption are continuing, while the sentiments of economic agents have been sluggish. On the employment front, as the number of persons employed has steadily increased, the employment-to-population ratio rose in January compared to that in January last year, while the unemployment rate fell. The Board 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 to a significant extent in February, from 0.8% the month before to 1.3%, owing chiefly to increases in agricultural product prices. Core inflation excluding agricultural and petroleum product prices meanwhile rose slightly to 1.8%, from 1.7% in January. Looking ahead the Board forecasts that consumer price inflation will continue at a low level, due mainly to the low oil prices. In the housing market, sales and leasehold deposit prices showed low rates of increase in both Seoul and its surrounding areas and the rest of the country.

☐ In the domestic financial markets, influenced by the global stock market recovery and by a subsiding of foreigners' securities investment fund outflows, stock prices have risen sharply since February and the Korean won, after having depreciated, has appreciated to a considerable extent against the US dollar. The won has meanwhile depreciated against the Japanese yen, in line with the yen's strengthening. Long-term market interest rates have rebounded slightly after having declined, in response mainly to 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 sustain the recovery of economic growth, the Board 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 monetary policies of major countries or in financial and economic conditions in China, the movements of capital flows, geopolitical risks, and the trend of increase in household debt.