

# **Minutes of the Monetary Policy Board Meeting**

September 11, 2015

**The Bank of Korea**

(English version)

## **Minutes of the Monetary Policy Board Meeting<sup>1)</sup>** **(September 2015)**

### **I . Outline**

1. Date of meeting : Friday, September 11, 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  
Lee, Hwanseok, Director General of Monetary Policy Board Secretariat  
Suh, Bong Gook, Press Officer  
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<sup>2)</sup>

After briefings by staff on ‘Current Economic Developments in Korea’, ‘FX and International Finance’ and the ‘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 higher than expected, and that the moderate recovery in the euro area had continued. Meanwhile, economic uncertainty in China had remained high with growth continuing to slow. Members judged that volatility in **international financial markets** had heightened greatly, owing chiefly to growing concerns about the US Fed’s policy rate hike and to the unrest in the Chinese equity markets.

As to **the domestic economy**, members noted that, while consumption and services production had shown trends of improvement as the negative effects of the Middle East Respiratory Syndrome (MERS) outbreak subsided, the trend of declining exports had accelerated.

Concerning **the domestic financial markets**, meanwhile, members observed that stock prices had fallen and the Korean won had depreciated against the US dollar due to outflows of foreigners’ portfolio investment funds. They also noted that long-term interest rates had fallen, affected by stronger preferences for safe assets.

With regard to **prices**, members observed that, despite declines in petroleum product prices, consumer price inflation had still come in at 0.7%, the same as that of the previous month, owing, for example, to rises in the prices of other industrial products. Inflation expectations declined slightly from the previous month, but remained generally stable.

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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 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.

Among them, one member assessed that, although consumption and investment in the Korean economy had been showing trends of modest improvement, exports had exhibited a larger-than-expected trend of decline, downside risks to domestic growth and prices had become greater due to the emergence of external uncertainties in line with the global economic slowdown, household debt had maintained strong growth, and volatility and unrest in the foreign exchange market had heightened. The member then argued that it would be desirable to hold the Base Rate at its current level of 1.50% for the intermeeting period, while more closely monitoring major factors affecting the growth and stability of the Korean economy. The member also expressed the opinion that, since the won/dollar exchange rate was expected to fluctuate greatly going forward due to a possible shift in the direction of the US Fed's monetary policy, the potential expansion of competitive exchange rate policies in major countries, and a trend of large-scale widening of Korea's current account surplus, the authorities concerned should perform precautionary checks on potential risks, monitor market sentiment, and prepare to implement market stabilization measures without delay. The member then put forward the view that the policy authorities should analyze the negative effects on corporations of the export decline, which would have significant repercussions on the growth path of the Korean economy, and pursue policy measures to mitigate these effects.

Another member stated the view that it would be desirable to hold the Base Rate at its current level for the intermeeting period. The member then expressed the opinion that, while bearing in mind the heightening of uncertainties in the global economy and finance, there was a need to observe the effects of, for instance, an accommodative policy stance and measures to facilitate consumption. The member also noted the need to strengthen the monitoring of developments related to financial stability, such as household debt and flows of foreign portfolio investment funds. The member then went on to present the opinion that, since some have raised a view with respect to the checks on and preparations against external shocks that the crisis in the Chinese economy had broken out in the course of an economic rebalancing from manufacturing to services, there was no need for excessive concerns, but there still was a need to examine the influences of the weakening of China's role as a consumer in the world economy and as a shock absorber, and that the Bank of Korea should pay attention to the possibility that global interest rates would rise more than originally anticipated in the event of a US Fed rate hike. The member also requested that the Bank prepare against the possibility that there could be several sources of tension in the domestic financial markets, even though they appeared superficially calm, and that the Bank should deliberate on the operation of policy instruments other than interest rate policy, and consider a mix of monetary policy and macroprudential policy. The member also stressed that, since the effects of policy responses focusing on demand stimulation had so far been limited, the Bank should take interest in the search for a driver of economic recovery from the perspectives of strengthening supply-side capacities and of enhancing competitiveness.

One other member argued that downside risks to the future growth and price paths were high, taking into account that although economic activity was expected to follow the path forecast in July, downside risks to the

growth path for the second half had increased due to a prolonged slump in exports and the manufacturing industry, and considering that although consumer price inflation was judged to be falling somewhat short of the path forecast in July due mainly to the decline in international oil prices, core inflation was holding to the original forecast path, and keeping in mind that the slack in the production sector and the overall spare capacity in the labor market had expanded somewhat. However, the member stated the view that it would be desirable to maintain the Base Rate at its present level, citing in support that it was uncertain whether the changes in these paths had been significant enough to support further a easing of monetary policy, and that the risks involved in an additional Base Rate adjustment had expanded, owing primarily to the sustained trend of foreign investment fund outflows and to a rapid rise in household debt. The member then added that a close watch should be kept on the possibility that an expansion of economic unrest in emerging market economies (EMEs) would be transmitted to the Korean economy through the capital and trade channels, on the possibility of heightened financial market volatility in line with foreign portfolio investment fund outflows, on movements of the real effective exchange rate of the Korean won in line with the changes in Korea's major trading partners' exchange rates, as well as the effects of such movements, and on the possibility that the credit cycle would shift rapidly, due to, for instance, its excessive decoupling with the real business cycle.

Meanwhile, one member commented that, while uncertainties about future growth and price movements had expanded, they were judged to have not strayed far from the path forecast in July, financial stability risks were considered to have grown, since there was a possibility of increased domestic and overseas financial market volatility triggered by external shocks, and strong growth in household lending was expected to continue. The member stated the opinion that the Bank of Korea should explain to economic agents that it was important to enhance growth potential by

pursuing effective structural reforms, since expansionary macroeconomic policies alone could provide only limited support to economic recovery because the recent lower-than-expected economic growth was attributable more to structural factors in the Korean economy and to shrinking global demand than to cyclical factors. The member also noted that, to prevent excessive anxiety stemming from the recent heightened volatility in global financial markets, the Bank should assure economic agents that Korea's capacity to respond to external shocks was relatively sound, thanks to its large current account surplus, abundant holdings of official foreign reserves, and banks' safe external debt structures.

Another member noted that some had leveled the criticism that monetary policy had not been sufficiently accommodative, as consumer price inflation had continued to decline since 2012, running below the inflation target. The member stated that this criticism seemed to overlook the fact that prices had been unrelated to economic activity, with the economic growth rate increasing despite a decline in prices. The member then expressed the view that, to enhance the effectiveness of monetary policy in line with the current economic environment, with its weakened link between prices and economic activity, the Bank of Korea needed to think carefully about ways to improve inflation targeting and other aspects of the existing monetary policy operation framework. The member also presented the view that insufficient economic growth despite accommodative monetary policy was a counterexample suggesting that in addition to cyclical factors, structural factors, including a decline in potential growth, had played a significant role in determining the economic growth rate, and thus there was a need to perform separate analyses of the extents to which these kinds of factors are responsible for low economic growth, and to deeply reflect on appropriate monetary policy directions and structural reforms that could raise the potential growth rate.

One other member assessed that, if the changes in domestic and

international financial and economic conditions during the previous month were considered, the future growth and price paths of the Korean economy appeared to have shifted slightly downward in comparison with the July forecast, influenced for instance by the sustained sluggishness of exports and by the decline in international oil prices. However, the member argued that, since this downward shift in the growth and price paths was mainly attributable to changes in external conditions, including economic uncertainties surrounding China and the sluggishness of world trade, there was a need to further observe their developments going forward, and thus the Board should hold the Base Rate at its current level for the intermeeting period. The member also expressed the view that, despite heightened international financial market volatility, financial instability seemed unlikely to spread to Korea, thanks largely to Korea's sustained current account surplus and to sound financial conditions at Korean financial institutions. However, the member then went on to express the view that the Bank of Korea should keep a close eye on the possible spread of external uncertainties in order to prepare for all eventualities, and that the Bank should do all it can to manage external sector risk by refining and updating its contingency plans.



#### **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 Board considers that the trend of economic recovery in the US has been sustained, and that the improvements in the euro area have continued as well. Economic growth in emerging market countries including China has meanwhile 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 the possibility exists of its being affected by heightened international financial market volatility, due to the instabilities in the Chinese financial and foreign exchange markets and 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 the recovery in domestic demand activities such as consumption and investment has continued, the trend of declining exports has persisted while the improvement in economic agents' sentiments has been inadequate.

On the employment front, as the trend of increase in the number of persons employed slowed in August, owing mainly to a base effect, the employment-to-population ratio decreased while the unemployment rate rose compared to those in August of last year. The Board forecasts that the domestic economy will show a trend of recovery going forward, but in view of external economic conditions judges the uncertainties surrounding the growth path to have increased.

- ☐ Despite declines in petroleum product prices, consumer price inflation registered 0.7% in August, the same as in July, in line mainly with expansions in the extents of increase in prices of other industrial products. Core inflation excluding agricultural and petroleum product prices rose slightly to 2.1%, from 2.0% in July. Looking ahead the Board forecasts that inflation will continue at a low level, due mainly to the effects of the low oil prices. In the housing market, the upward trends of sales and leasehold deposit prices have continued in both Seoul and its surrounding areas and the rest of the country.
- ☐ In the domestic financial markets, stock prices have fallen and the Korean won has depreciated against both the US dollar and the Japanese yen, as portfolio investment funds of foreigners have flowed out due to factors such as the instabilities in the Chinese financial and foreign exchange markets. Long-term market interest rates have fallen, influenced mainly by investor preference for safe assets. 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 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 the trend of increase in household debt and external risk factors such as any shift in the US Federal Reserve's monetary policy and the financial instabilities in emerging market countries including China, as well as the trends of capital flows.