Minutes of the Monetary Policy Board Meeting

November 11, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(November 2016)

Ⅰ. Outline

1. Date of meeting: Friday, November 11, 2016

2. Place : Monetary Policy Board Meeting Room

3. Monetary Policy Board members present:

Lee, Juyeol, Chairman (Bank of Korea Governor)
Hahm, Joon-Ho
Jang, Byung Wha (Senior Deputy Governor)
Lee, Il Houng
Cho, Dongchul
Koh, Seung Beom
Shin, Inseok

4. Monetary Policy Board members absent: none

5. Participants:

Ha, Sung, Auditor
Kim, Minho, Deputy Governor
Yoon, Myun-Shik, Deputy Governor
Lim, Hyung Joon, Deputy Governor
Huh, Jin Ho, Deputy Governor
Jeon, Seung-Cheol, Deputy Governor
Chae, Sun Byoung, Director General of Reserve Management Group
Chang, Min, Director General of Research Department
Shin, Ho Soon, Director General of Financial Stability Department
Park, Jongseok, Director General of Monetary Policy Department
Lee, Hwan Seok, Director General of Financial Markets Department
Suh, Bong Gook, Director General of International Department
Sohn, Wook, Director of BOK Economic Research Institute
Lee, Seung Heon, Press Officer
Chang, Cheong-Seok, 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 Situation[2)]

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

With regard to **the global economy**, members’ assessment was that the US had maintained its robust recovery, the euro area had improved, albeit slightly, and the Chinese economy had sustained its stable growth. As to **international financial markets**, members evaluated that major price variables, such as global stocks, bonds and crude oil, had become more volatile, affected by the result of the US presidential election, uncertainties surrounding the US Federal Reserve’s rate hike, and weakening expectations of OPEC reducing its production.

Concerning **the domestic economy**, some members assessed the growth momentum as weakening overall, with the continued trend of decline in exports and slowing improvements in domestic demand activities, such as retail sales and facilities and construction investment.

With regard to **the domestic financial markets**, meanwhile, members evaluated that the volatility of major price variables, including interest rates, stock prices and exchange rates, had increased, as also seen in the international financial markets, and that long-term market interest rates had risen substantially, affected chiefly by expectations of a US policy rate hike and rises in major country Treasury bond yields, while stock prices had fallen due to the increased uncertainties at home and abroad.

As to **prices**, members noted that consumer price inflation had risen from 1.2% the month before to 1.3% in October, owing chiefly to the expiration of a temporary cut in electricity fees, and that core inflation had also risen month-on-month.

2) English versions of 'Recent Economic Developments' and 'Financial Market Trends' 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 financial and economic environments, it would be desirable to hold the Base Rate at its current level of 1.25 percent for the intermeeting period.

One member expressed the opinion that it would be desirable to keep the Base Rate at its current level for the intermeeting period. With regard to the economic outlooks for the fourth quarter this year and for next year, the member noted growing uncertainties in line with the worsening of domestic and external conditions, and went on to argue that, looking at external factors, while the domestic and overseas financial markets had stabilized after having shown heightened volatility after the US presidential election, the possibility of a shift in the US government's economic policies, such as moving toward protective trade policies, might have huge impacts on Korea's real sector, and in-depth analyses of and preparations for this were therefore required. On the home front, the member stressed that more aggressive efforts should be made to cope with growing uncertainties as well as difficult economic conditions, and emphasized the need for a multifaceted analysis of and continuous policy attention on how the implementation of the anti-graft law and corporate restructuring had been affecting consumption, facilities investment and employment. The member also presented the view that, while continuing to examine risk factors such as the possibilities of a US Federal Reserve rate hike, a Chinese economic slowdown, and a post-Brexit global economic slowdown, thought should be given to whether further monetary easing would be needed should future economic conditions turn out to be worse than the current forecast. Meanwhile, the member stated that the household debt issue should be addressed based on steady examination of the effectiveness of related government measures. The member added that, considering various external soundness indicators, Korea was unlikely to be affected greatly by a US policy rate hike, but it would be necessary to work in closer cooperation with the government going forward while strengthening the monitoring of domestic and overseas financial market trends.

Another member meanwhile mentioned a number of points that should be considered in this month's Base Rate decision. First, the member expressed the view that uncertainties over the future growth path had increased due to factors such as the unexpected result of the US presidential election, but it would be necessary to observe a little longer to see how these factors would actually affect growth. Second, the member stated that although the financial and foreign exchange markets were stabilizing after having fluctuated significantly immediately after the US presidential election, there is a possibility that these markets could become volatile again considering the high uncertainties surrounding domestic and overseas conditions. The member then stressed that a close eye should be kept on the possibility of further capital outflows and the heightening of financial and exchange market unrest. The member went on to argue that it should also be considered that the probability of a US Federal Reserve policy rate hike, having temporarily decreased after the US presidential election, had been rising again owing chiefly to the stabilization of financial markets and expectations of stronger inflationary pressures due to the incoming Trump administration's proposed fiscal expansion. Regarding household debt growth and housing market conditions, meanwhile, the member presented the view that, although housing prices in some parts of the Seoul Metropolitan region had stabilized after the government's announcement of its real estate measures on November 3, the housing market could be hardly seen as having become stable, given the sustained excessive demand for housing in popular regions such as Gangnam, Seoul, the persistent trend of low interest rates, and the continued easy availability of housing loans. In this regard, the member argued that it would be desirable to keep the Base Rate at its current level of 1.25% during the intermeeting period and closely monitor any changes in domestic and overseas uncertainties and the related impacts.

Meanwhile, one member pointed out a number of major considerations for the appropriate conduct of monetary policy. First, the member stated that concerning the trend of growth at home, growth momentum had been weakening overall, as the trend of improvement in domestic demand including private consumption and construction investment had decelerated with the continued contraction in manufacturing production stemming from export sluggishness. The member noted that uncertainties surrounding the future growth path had heightened further, as there were factors making for political and economic instability at home and abroad, and as the economy was expected to slow down in the fourth quarter, influenced for instance by discontinued production of some items, corporate restructuring and the anti-graft law. Second, consumer price inflation and core inflation had maintained their gradual uptrends, consistent with their October forecasts. The member commented that, going forward, consumer price inflation was expected to show a gradually faster pace of increase as the effects of low oil prices dissipate, and was anticipated to converge to near the target level in the first half of 2017. Third, slack in the production sector had not improved much, as the average capacity utilization ratio in the manufacturing sector continued at an all-time low due mainly to inventory adjustments, and as facilities investment demand pressures began to decrease. The member noted that, although overall labor force slack had been continuing to improve, the labor market had failed to improve in qualitative terms as growth in employment was seen mostly in self-employed businesses and in the low-wage services sectors. Fourth, looking at financial stability conditions, as short- and long-term interest rates rebounded and foreign bond investment registered a net outflow from the domestic financial markets, the yield curve had steepened, credit spreads of corporate bonds had widened, and stock price volatility had risen. The member also expressed the need for monitoring the effects of the government’s real estate measures, as household debt continued to grow faster than usual. In overall consideration of the above-mentioned real economic and inflation trends, slack in production and financial stability conditions, the member assessed that it was advisable to keep the Base Rate unchanged from the current level of 1.25 percent for the intermeeting period.

Another member presented the view that it would be desirable to hold the Base Rate at its current level for the intermeeting period, as inflation was not seen to have deviated greatly from the original forecast path and was expected to converge to near the inflation target over the medium-term horizon, despite growing uncertainties surrounding real economic conditions and exogenous variables. The member emphasized the following three points with respect to effectively achieving the Bank of Korea’s objectives. The member first pointed out that, although the growth engines that had weakened due to changes in the economic structure could be spurred to some extent through fiscal and monetary policies, there was an issue of resource distribution trade-offs between generations. Next, noting uncertain external variables, the member expressed the view that the heavy dependence of advanced economies on monetary policy to overcome the financial crisis had given rise to various side effects, and the expected US policy rate hike could pave the way for a shift in global interest rate trends. Finally, the member raised concerns about a bias toward accommodative monetary policy. The member presented the view that the introduction of unconventional measures to maintain low interest rates by advanced country central banks had failed to have the desired effects on the real economy because of an excessive reliance on monetary policy.

One other member expressed the opinion that, while maintaining the Base Rate at its current level for the intermeeting period, the Bank of Korea should keep a close watch on the impacts of the recently soaring political and economic uncertainties at home and abroad on the future development of the Korean economy. The member judged the world economy to have maintained modest growth and the Korean economy to have continued its weak growth as well, as the boom in the construction market served as a buffer against sluggish exports. The member also evaluated that pressures for a further decline in underlying inflation had been easing gradually. The member, however, emphasized that a close watch should be kept on the impacts of the recently introduced anti-graft law and the government measures to stabilize the housing market. Looking ahead, the member stressed the need for paying special attention to greatly heightened uncertainties surrounding the Korean economy in line with sharply increasing political uncertainties in Korea and the US. Accordingly, the member suggested that the Bank of Korea should keep a close eye on how these uncertainties might change future Korean macroeconomic trends, while mitigating potential risk factors, such as the buildup of household debt, that could amplify the spillover effects of unforseen negative shocks. The member also expressed the need for harmonization with fiscal policy, which is less likely than monetary policy to bring about the risk of a buildup of financial imbalances in the private sector.

One member presented the view that, in overall consideration of the recent inflation, economic and financial stability conditions, it would be appropriate to hold the Base Rate at its current level. With respect to the real economy, the member noted that, despite continued robust growth in construction investment, the actual GDP growth rate for the fourth quarter may come in below the forecast because of weakened growth, as exemplified by the negative figures seen in September industrial production and retail sales and in October export growth. The member judged the uncertainty of the economic outlook to have heightened further as the unexpected US presidential election result had cast uncertainty on whether the world trade volume would recover, although the growth pattern of recoveries in exports and facilities investment serving as a buffer against slower construction investment was expected for 2017. Meanwhile, the member evaluated inflation to have held to the existing forecast path, and anticipated that consumer price inflation would converge to its target of 2 percent in the first half of next year. In terms of financial stability, the member expressed concern that household debt had continued to sustain a trend of substantial increase in October as well. The member went on to note that, since household debt growth may pose a risk of adjustments to housing prices after their excessive increases, future housing price adjustments could worsen household balance sheets, thus leading to an additional slump in household consumption. Accordingly, the member noted that securing housing price stability by controlling expectations of rising housing prices in Seoul and its surrounding areas would form the core of household debt risk management. The member then emphasized the need for close monitoring of housing market trends for the time being.

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 the 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 1.25% 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 Chinese economy has maintained its moderate pace of growth. The euro area has also shown improvements, although they have been weak. the Bank of Korea forecasts that the global economy will maintain its moderate recovery going forward, while being affected by factors such as changes in US monetary policy, the directions of the new US government’s economic policies, the uncertainties related to Britain's exit from the European Union, and economic conditions in emerging market countries.

☐ Looking at the Korean economy, exports have continued their trend of decline while the improvements in domestic demand activities appear to have weakened a bit. On the employment front, the employment-to-population ratio in October was slightly higher than that in October of last year, as the number of persons employed increased. The unemployment rate meanwhile rose somewhat. The Bank of Korea forecasts that the domestic economy will sustain its trend of modest growth going forward, in line with a recovery of the global economy, but in view of recent changes in domestic and external conditions judges the uncertainties surrounding the growth path to have increased further.

☐ Consumer price inflation rose from 1.2% the month before to 1.3% in October, owing chiefly to the expiration of a temporary cut in electricity fees. Core inflation excluding agricultural and petroleum product prices also rose to 1.5%, from 1.3% in September. In the housing market, the extents of increase in sales and leasehold deposit prices have expanded, centering around the Seoul area. Looking ahead the Bank of Korea forecasts that consumer price inflation will gradually rise, due mainly to the weakening influence of the low oil prices.

☐ In the domestic financial markets since October, influenced mainly by strengthened expectations of a policy rate hike by the US Federal Reserve, and by the result of the US presidential election, long-term market interest rates and the Korean won-US dollar exchange rate have risen to large extents and stock prices have declined. The Korean won-Japanese yen exchange rate has fallen slightly. Household lending has sustained a trend of substantial increase at a level exceeding that of recent years, led by mortgage loans.

☐ Looking ahead, the Bank of Korea will conduct monetary policy so as to ensure that the recovery of economic growth continues and consumer price inflation approaches the target level over a medium-term horizon, while paying attention to financial stability. In this process it will closely monitor the uncertainties in domestic and external conditions and their effects, any changes in the monetary policy of the US Federal Reserve, and the trend of increase in household debt.