

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

July 14, 2011

**The Bank of Korea**

## **Minutes of the Monetary Policy Committee Meeting<sup>1)</sup>** **(July 2011)**

### **I . Outline**

1. Date of meeting : July 14, 2011 (Thu)
2. Place : Monetary Policy Committee Meeting Room
3. Monetary Policy Committee members present :
  - Kim, Choongsoo, Chairman (Governor, The Bank of Korea)
  - Kim, Dae Sik
  - Choi, Dosoung
  - Kang, Myung Hun
  - Lee, Ju Yeol (Senior Deputy Governor)
  - Lim, Seungtae
4. Monetary Policy Committee members absent : None
5. Government representative present :
  - Yim, Jong-ryong, First Vice Minister of Strategy and Finance
6. Participants :
  - Kang, Tai Hyuk, Auditor
  - Kim, Jae-Chun, Deputy Governor
  - Jang, Byung-Wha, Deputy Governor
  - Lee, Kwang-June, Deputy Governor
  - Jang, Seh-Geun, Deputy Governor
  - Park, Won-Shik, Deputy Governor
  - Kim, Jun Il, Director of Economic Research Institute & Chief Economist
  - Lee, Sang Woo, Director General of Research Department
  - Chung, Hee-Chun, Director General of Monetary Policy Department
  - Min, Sung Kee, Director General of Financial Markets Department
  - Kim Jong Hwa, Director General of International Department
  - Kim, Yun Chul, Director General of Monetary Policy Committee Secretariat
  - Lee, Yong Hoi, Director General of Press Office

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1) This English version (summary) of the Monetary Policy Committee meeting minutes was produced at the working level and is not an official document.

## II. Summary of Discussion on Current Economic Situation<sup>2)</sup>

After briefings by staff on 'Current Economic Developments in Korea' and the 'Financial Markets', the discussions by members of the Monetary Policy Committee (MPC) covered the following areas:

Most members assessed that **the global economy** was sustaining its recovery overall, but that uncertainties were deepening further due to latent risk factors. Many members noted that the U.S. economic recovery had slowed owing to the sluggish housing market and the delay in the labor market improvement, that in Europe the mood was one fraught with anxiety as to the possibility of the spread of the sovereign debt problems to neighboring countries, and that potential risk factors sat latent including an overheating economy and surging consumer and asset prices in the emerging market economies.

**The domestic economy** was, most members appraised, maintaining its upward trend boosted by strong exports and the recovery of domestic demand. One member pointed out that manufacturing and services production was growing with the current account having remained in surplus for 15 straight months, and that the employment situation was improving.

Regarding **the future outlook**, most members anticipated that the domestic economy would sustain its long-term trend level of growth, even though July's revised growth forecast was somewhat lower than previously predicted. However, members cautioned that the downside risks to growth had slightly increased due to mounting uncertainty surrounding the external economic environment.

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2) The contents of 'Current Economic Developments in Korea' and the 'Financial Markets' are posted in English on the Bank of Korea web site.

As to **domestic financial markets**, many members attributed the large fluctuation in price variables, including interest rates, stock prices and exchange rates, to external factors such as the possibility of an escalation of the sovereign debt problems in Europe and a slowdown in U.S. economic recovery. However, one member commented that foreign funding conditions were favorable by and large due mostly to inflows of foreign portfolio funds and the current account surplus.

Members pointed out that **consumer prices** were exhibiting a rapid pace of increase in excess of 4% for six straight months, owing to the rapid path-through to general prices of the supply shocks generated by higher agricultural product and global oil prices, and to the steady build-up of inflation expectations. They also noted that core inflation, too, had accelerated to 3.7% in June, after having registered 3.2% in April and 3.5% in May. Many members forecast that the high rising trend of consumer prices would persist for some considerable time, owing primarily to the demand-pull pressures arising from sustained growth and inflation expectations, and that core inflation would rise at a faster pace than headline inflation.

As to **the real estate market**, some members evaluated housing sales prices as being weak in Seoul and its surrounding areas with the dampening of buying sentiment, while exhibiting slower growth in the rest of the country.

### **III. Remarks by Government Representative**

Prior to the members' discussion regarding the Base Rate, the Chairman gave the floor to the 1st Vice Minister of Strategy and Finance, the government representative.

With regard to the current economic situation, the 1st Vice Minister

commented that, although the economy was regaining momentum for a stable recovery with the number of persons employed continuing to grow and the employment-to-population ratio improving, uncertainties still remained high as external conditions were highly volatile and real purchasing power declined.

As to the government's economic policy directions for the second half of 2011 announced on June 30, the 1st Vice Minister remarked that the growth forecast had been revised downward from the initial 5.0% to the 4.5% level and the inflation projection had been adjusted upward from around 3.0% to 4.0%, in reflection of the many changes in conditions at home and abroad since the end of last year, such as the outbreaks of foot-and-mouth disease, the run-up in oil prices and the Great East Japan Earthquake. He then noted that the government's policy focus would be placed on such areas as price stability, boosting domestic demand and expanding the social safety net.

Regarding prices, the 1st Vice Minister mentioned that the government anticipated inflationary pressures would persist for the time being, owing to the recent rises in prices of agricultural and livestock products following the recent unusually severe rain, and to the increase in personal service charges including those for eating-out, and that it was considering steps for price stability such as a sliding tariff on pork and rice, release of government oil reserves, and incentives to hold eating-out prices steady.

Meanwhile, concerning the Comprehensive Measures on Household Debt which the government unveiled on June 29, the 1st Vice Minister noted that, in order to manage household debt and enhance the soundness of financial institutions, the government would pursue measures to accommodate household debt increase at an appropriate level, to encourage fixed-rate, non-deferrable, amortizing mortgages not vulnerable to economic

fluctuations, and to strengthen protection for consumers taking out household loans.

#### **IV. Discussions Related to Monetary Policy Decision (Summary)**

The main contents of the MPC members' discussion concerning a change in the Bank of Korea Base Rate were as follow:

Members agreed that, it would be better to keep the Base Rate at its current level this month since it was necessary to maintain stability in the financial markets following the recent deepening of economic uncertainties surrounding foreign economies, although it was desirable to gradually normalize the Base Rate – considering the possibility of chronic inflation becoming entrenched, with inflation forecasts flirting with the upper bound of the inflation target and expected inflation remaining high, at a time when the economy continued on a long-term trend level of growth.

One member voiced the opinion that policy adjustments should be made at a consistent pace since a back-to-back Base Rate adjustment following the one in June might have to face a heavier-than-necessary burden on economic agents, with the risk of market participants perceiving that the Bank of Korea's stance of steady baby step increase in the Base Rate maintained for some time had been changed.

Meanwhile, some members took the view that it was necessary to signal appropriately to the markets once again the present policy stance of consistently moving forward with Base Rate normalization since putting off a hike in the policy rate might cause inflation expectations to rise, particularly in the current circumstances where a high rising trend of prices was seen to persist for some time.

In addition, one member made the point that rate normalization must be carried forward persistently so as to allow real interest rates to move out of negative territory, in that, should a low interest rate stance prevail for a long time, there was concern that economic imbalances could deepen largely owing to an expansion of household debt and delay in corporate restructuring and that the high level of macro leverage could pose a potential risk for the Korean economy.

After the discussions detailed above, members decided unanimously to keep the Base Rate at its current level.

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### **Monetary Policy Decision**

- ☐ The Monetary Policy Committee of the Bank of Korea decided today to leave the Base Rate unchanged at 3.25% for the intermeeting period.
- ☐ Based on currently available information, the Committee considers that, while emerging market economies have continued to show favorable performances, the recoveries in major advanced economies including the US have exhibited signs of temporarily faltering. Going forward, the Committee forecasts that the global economy will keep up its pace of recovery; nevertheless, the Committee recognizes the possibility of such factors as the sovereign debt problems in Europe and the heightened volatility of economic activity in major countries posing downside risks to the global economy.
- ☐ For Korea, the Committee judges the economy to have maintained its underlying upward trend, given for instance that exports show robust growth and that domestic demand is increasing modestly. Labor market conditions have also remained on a track of improvement, led by the private sector. Going forward, the Committee anticipates that the domestic economy will keep up this underlying trend, even in the presence of external risks.
- ☐ Consumer price inflation rose to the 4.4% level in June, due mostly to sharp rises in the prices of some agricultural and livestock products. The Committee expects the high level of inflation to continue in the coming months, driven largely by demand-side pressures resulting from the underlying uptrend in economic activity and by inflation expectations. Core inflation meanwhile increased to the 3.7% level, as the prices of processed food products and personal services continued to rise; this uptrend in core inflation is seen



persisting for the time being. As for housing prices, those in Seoul and its surrounding areas have weakened, while their pace of increase in the rest of the country has slowed. The rate of increase in leasehold deposits fell in June compared to the previous month, affected mostly by seasonal factors.

- ☐ In the financial markets, the ranges of fluctuation of price variables such as interest rates, stock prices and exchange rates have widened, due mainly to the effects of external risk factors including the sovereign debt problems in Europe. Mortgage lending has posted a steady rise.
- ☐ Looking ahead, the Committee, while taking overall account of financial and economic conditions both at home and abroad, will conduct monetary policy with a greater emphasis on ensuring that the basis for price stability is firmly anchored while the economy continues its sound growth.