Minutes of the Monetary Policy Board Meeting

October 13, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting[1)]

(October 2016)

Ⅰ. Outline

1. Date of meeting: Thursday, October 13, 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, while the US economy had maintained its economic recovery, the euro area still had not shown any signs of improvement, and the Chinese economy had maintained its moderate growth. As to **international financial markets**, members evaluated that major price variables, such as global interest rates and stock prices, had remained generally stable despite fluctuations owing to changes in expectations of major advanced countries’ monetary policies.

Concerning **the domestic economy**, some members assessed that, although exports and facilities investment had been sluggish due to negative external conditions, the economy had continued to improve, led mainly by favorable construction investment and increased government spending.

With regard to **the domestic financial markets**, meanwhile, members evaluated that major price variables had fluctuated, influenced for instance by the possibility of a policy rate hike by the US Federal Reserve and by the rise in global oil prices.

As to **prices**, members noted that consumer price inflation had risen sharply to 1.2% from the previous month’s 0.4% due mainly to increases in agricultural product prices, and that core inflation had also risen month-on-month to 1.3%.

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 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 closely monitor changes in upside and downside macroeconomic risks, housing market conditions, the trend of household debt growth, the future directions of major countries’ monetary policies, and international oil price movements, while maintaining the Base Rate at the current 1.25 percent level for the intermeeting period. The member noted that, according to the October Economic Outlook released by the Bank of Korea Research Department, real GDP is projected to increase by 2.7 percent in 2016 and by 2.8 percent in 2017, figures that are not low considering external conditions and the GDPs of major countries and that do not differ greatly from the Korean economy’s potential growth rate. The member, however, put forward the view that uncertainties surrounding the forecast growth path still remain high, due mainly to the delayed recovery of world trade, possible unstable movements in international oil prices, and the worsened economic sentiment associated with corporate restructuring. The member added that, according to the price inflation outlook, consumer price inflation is expected to rise gradually, influenced for instance by the dissipation of the effect of the temporary electricity fee reduction and the rise in international oil prices, to be at the mid-1% range at around the end of 2016 and to approach the 2% inflation target in the first half of 2017. The member, meanwhile, noted that, in terms of financial stability, caution should be exercised with respect to several risk factors. In particular, the member noted that apartment prices in the Seoul

Metropolitan region have recently risen greatly, a pattern that was likely to spread to other regions or other housing types in view of the current housing market conditions. The member also commented that household lending is highly likely to maintain strong growth for the time being, influenced for instance by the start of the autumn moving season, buoyant sales of new apartments, and the trend of housing price increases. Finally, the member judged that, although international financial markets have recently been relatively stable, there still are factors that could lead to increased volatility in these markets, such as the future directions of major countries' monetary policies, uncertainties related to Brexit, the possibility of European bank insolvencies, and the US presidential election.

Another member expressed the opinion that it would be desirable to maintain the Base Rate at the current 1.25 percent level for the intermeeting period. The member noted that the world economy was sustaining its moderate pace of growth, and the impacts of impending US rate hikes on the international financial markets and the foreign exchange market in Korea were likely to be limited. Concerning the domestic economy, the member commented that although exports had remained sluggish and the restructuring of vulnerable industries had commenced, there had not been changes in macroeconomic conditions that would call for an adjustment to the Base Rate. The member, however, expressed concern that Korea's economic growth in the upper-2 percent range, while consistent with the potential growth rate, was led by construction investment, and housing construction in particular, which was expanding at an unsustainable rate. The member also voiced concern over gradually mounting vulnerabilities related to household debt, which was increasing rapidly in line with construction growth. The member meanwhile anticipated that inflation was likely to settle near the 2 percent target next year. The member also expected that the risk of a further decline in underlying inflation, which the member judged to still run below target at the mid-1 percent range, will be somewhat controllable. Accordingly, the member expressed the need for caution in adjusting the Base Rate and emphasized that, in the interest of macroeconomic stability, there was an urgent need to encourage a soft landing for both the expansion in construction and the rapid increase in household debt.

One other member presented the view that it would be desirable to hold the Base Rate at its current level of 1.25 percent for the intermeeting period, as growth and consumer prices were seen to generally follow the path originally forecast and the inflation target was likely to be achieved over a medium-term horizon given expected changes in exogenous variables and movements in the GDP gap. Meanwhile, the member pointed out that it was more difficult than ever to accurately calculate potential growth and the GDP gap, as Korea, along with many other countries, was entering the era of the 'new normal'. The member argued that domestic and overseas factors, such as the decreasing global trade volume, the declining number of high-quality manufacturing jobs, the rising savings rate and concerns about consumption contraction, would continue to affect the industrial structure of the Korean economy and propensity for consumption and cause changes in potential growth, and went on to stress that if changes occur in the outlook for growth, it would become more important to identify the exact causes behind such changes. The member stated that a small open economy like Korea should take all these matters into consideration in order to maximize the long-term effects of monetary policy on the real economy.

Meanwhile, one member pointed out a number of major considerations for the appropriate conduct of monetary policy. First, the member stated that short-term growth was not expected to deviate far from the path originally forecast and that economic growth next year was forecast to be generally consistent with the pace of potential growth, with improvement in exports and facilities investment boosted by a gradual recovery of global trade more than offsetting a slowdown in construction investment and consumption. The member stated, however, that there was a relatively high degree of uncertainty surrounding the growth path. Second, with regard to inflation, the member argued that the uptrend in consumer prices had slowed owing chiefly to electricity tariff cuts and falls in the exchange rate, but the price path decline was estimated to be limited due to rising agricultural product prices and weakening downside pressures on low oil prices. Looking at various core inflation indicators, the member stated that the underlying trend of inflation had continued and that inflation would likely converge to its 2-percent target over a medium-term horizon. Third, the member argued that the slack in production had been worsening again, as the average capacity utilization rate fell significantly in line with a decline in production due to inventory adjustments and labor strikes at automakers, which more than offset the moderate growth in demand-side pressures from facilities investment in the manufacturing sector. The member mentioned that the slack in the labor force had recently been showing improvement, but the labor market had failed to improve in qualitative terms as growth in employment was seen mostly in the low-wage and services sectors. Fourth, concerning financial stability conditions, the member noted that household debt continued to grow faster than usual and that the uptrend of housing prices, which had thus far been limited to certain markets, was spreading gradually. The member added that the substantial growth in the volume of real estate-related finance was heightening the vulnerability and cyclicality of the financial system to real estate market conditions. 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, in overall consideration of the recent inflation, economic and financial stability situations, it would be appropriate to hold the Base Rate at its current level. After stating that construction investment remained brisk, boosted largely by accommodative monetary policy, while exports and facilities investment remained in a slump due to negative external conditions, the member went on to forecast this year's growth rate at near 2.7 percent, as projected by the Bank of Korea Research Department in July this year. The member noted that inflation had rebounded to 1.2 percent in September from the previous month's 0.4 percent, affected by a rise in agricultural product prices. The member forecast that external factors such as oil prices would act as major variables for the economy and prices for the next year, and also mentioned that a recovery of exports and facilities investment would be needed to keep the growth rate at this year's level, which would also need to be supported by a stronger global economic recovery and a restoration of the income elasticity of trade. The member forecast that if oil prices recover next year as major institutes had projected, faster growth in EMEs would lead to a gradual recovery of the global economy, and inflation in Korea would converge to its target of 2 percent. Concerning the recovery of the income elasticity of trade, however, the member's assessment was that, given a lack of consensus among major institutes on the issue, there was a high degree of uncertainty regarding the outlook for the recovery of related exports and facilities investment. In this regard, the member evaluated that, in the 2017 economic outlook presented by the Research Department, growth forecasts were exposed to higher uncertainty than inflation forecasts. Meanwhile, the member assessed household debt, a major risk factor in terms of financial stability, as maintaining strong growth in September, thereby increasing volatility in the housing market, which would lead to higher risk of greater economic volatility. The member stressed in particular that the trend in the market for new apartments was related to the direction of next year's construction investment and growth outlooks, and that it would therefore be necessary to closely monitor future housing price trends and actual new apartment transactions.

One other member expressed the view that it would be advisable to hold the Base Rate at its current level at this time, and that when operating monetary policy in the future, it would be necessary to monitor the progress of the economy while paying attention to the possibility of rate hikes by the US Federal Reserve. The member stated that the economic growth rate was projected at 2.7 percent for this year and 2.8 percent for next year, but there were various downside risks — on the external side, the possibility of a global economic slowdown resulting from slowing Chinese growth, US Fed rate hikes and Brexit, and on the domestic side, corporate restructuring, a possible contraction of economic sentiment under the anti-graft law, and destabilization of the labor market from strikes and other factors. The member added that it should be carefully examined whether the pace of future economic growth would be as rapid as suggested in the current growth forecast. The member particularly emphasized the need to cope with risk factors while speeding up restructuring efforts, including those for industrial structural reform, and at the same time maintaining accommodative monetary and fiscal policies. In addition, noting the analysis that the uptrend in housing prices would continue for the time being and there was only a slight chance of a collapse in construction activities, the member argued that, although it was important to address household debt with macroprudential policy, recent household debt growth was restricting monetary policy and thus household debt should be thoroughly and continuously monitored. Finally, the member stressed that at the end of last year domestic and overseas financial markets had preemptively reflected the US Federal Reserve’s rate hike, and the member also emphasized that, although the dominant outlook was that the negative effects of US interest rate hikes would be limited this year compared with last year, vigilance should be maintained to prepare for the possibility of greater market volatility.

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.

< Ref >

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 Board 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. However, the improvements in the euro area have remained weak. The Board forecasts that the global economy will maintain its recovery going forward, albeit at a moderate pace, while being affected by factors including changes in the monetary policies of major countries such as the US, 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 declined but domestic demand activities appear to have continued their improvements, driven mainly by investment in construction. On the employment front, the trend of increase in the number of persons employed slowed in September, while the unemployment rate rose compared to that in September of last year. The employment-to-population ratio was meanwhile slightly higher. The Board forecasts that the domestic economy will sustain its trend of modest growth going forward, owing chiefly to a gradual recovery in global trade and to the effects of expansionary macroeconomic policies. However, in view of economic conditions domestically and abroad, it judges the uncertainties surrounding the growth path to be high.

☐ Consumer price inflation rose from 0.4% the month before to 1.2% in September, owing chiefly to increases in agricultural product prices. Core inflation excluding agricultural and petroleum product prices also rose to 1.3%, from 1.1% in August. In the housing market, the upward trends of sales and leasehold deposit prices have continued, centering around the Seoul area. Looking ahead the Board forecasts that consumer price inflation will gradually rise, due mainly to the disappearance of the effect of the temporary cut in electricity fees and to the rebound in international oil prices.

☐ In the domestic financial markets since September, long-term market interest rates and the Korean won-US dollar and Korean won-Japanese yen exchange rates have risen, in line mainly with strengthened expectations of a policy rate hike by the US Federal Reserve. Stock prices have rebounded after having declined, owing in part to the rise in international oil prices. Household lending has sustained a trend of substantial increase at a level exceeding that of recent years, led by mortgage loans.

☐ Looking ahead, the Board 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 trend of increase in household debt, any changes in the monetary policies of major countries, and the progress of corporate restructuring.