

Minutes of the Monetary Policy Board Meeting

November 12, 2015

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting¹⁾ **(November 2015)**

I . Outline

1. Date of meeting : Thursday, November 12, 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
Suh, Bong Gook, Press Officer
Lee, Hwanseok, 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 Situation²⁾

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 Chinese economic growth was continuing to slow down, with the nation’s exports declining, while the US economy was maintaining its recovery, with consumption, facilities investment and the housing market continuing to improve and employment growth accelerating, and the euro area was showing a modest recovery. Members also judged that **international financial markets** had responded sensitively for example to the diverging policy stances of major countries.

As to **the domestic economy**, members assessed that exports had continued to decline, while the economy showed modest recovery, led by domestic demand including consumption and investment.

Concerning **the domestic financial markets**, meanwhile, most members noted that long-term interest rates had risen substantially, owing mainly to improvements in domestic economic indicators and the greater likelihood of a policy rate hike by the US Federal Reserve, and that there was a shift to a net inflow of foreigners’ portfolio investment funds. They also mentioned that bank lending to the household sector had increased significantly, led by mortgage lending, with October recording the strongest growth since the statistics had been first compiled.

With regard to **prices**, most members observed that consumer price inflation had stood at 0.9 percent, up from the previous month, due mainly to greater increases in agricultural product prices and services fees, and that core inflation had also increased slightly from the preceding month.

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 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, amid the accelerating growth in household loans driven chiefly by increased group loans in line with buoyant sales of new apartments, group loans were expected to work to increase household loans for the time being, which might limit the effects of the comprehensive household debt management measure that aims to slow down growth in household debt from next year, and that it would be therefore necessary to develop ways to prepare against the possibility of household debt emerging as a huge burden on the Korean economy. The member also mentioned that, because the traditional channels of interest rate policy transmission to the real and financial sectors were likely to weaken greatly due to the possibility of the trends of slow growth and slow price increases continuing for a considerable period of time, and also because interest rate policy alone could not cope effectively with conflicts among various policy objectives, efforts were urgently needed to develop various monetary policy instruments other than policy rate adjustment and use them in combination. In line with this, the member expressed the opinion that the framework of existing policy instruments, such as open market operations and the bank intermediary support facility, needed urgent improvement to adjust to the changing environment.

Another member stated the view that a little more time would be needed before making an optimistic forecast for future economic activity, as the G2 risks remained on the external side — expectations of a US Fed policy rate hike within the year and concerns about China and EMEs — and as the domestic side has seen a revival of expectations regarding improvements in economic activity but also continuing downside risks,

including sluggish exports. The member noted that it would be important to promote positive views of business conditions and encourage economic agents to carry out economic activities, so that briskness in some parts of domestic demand could lead to growth in terms of overall production capacity. The member also called for diagnoses of and prescriptions for sluggish exports from various perspectives, analyses of the effects of China's five-year plan, and research into current demographic issues in an effort to prepare against highly probable shocks related to growth. The member went on to argue that preparations should be made against the possibility of interest rates showing greater volatility than foreign exchange rates, since there were only slight differences among the fundamentals of advanced economies. The member also presented the view that the existing tools for managing exchange rate volatility should be reexamined in preparation for Korea's joining the Trans-Pacific Partnership, and that overseas markets for direct won trading needed to be gradually adjusted in ways that encourage private sector participation. The member also noted that it should be examined whether shrinking capital markets and the growing dependence on banks undermined balanced development of the financial industry, and that preparations should be made to deal flexibly with herd behavior in the bond market. The member stressed that economic agents had not recovered from damage from the Asian Currency and Global Financial Crises, and since their tendencies and behavior generally suggested their preference for stability rather than growth, active communications with them would be important to prevent worsening of their sentiment.

One other member stated the opinion that it would be desirable to keep the Base Rate at its current level, given that, although the trend of growth in the fourth quarter was holding to the existing forecast overall, uncertainties at home and abroad surrounding future economic trends had grown further; given that, although consumer price movements were generally holding to the growth path forecast in October and the upward trend of consumer prices was expected to pick up, albeit at a modest pace, no small number of upside and downside risks were lurking and the movements of core inflation indicators were not well-balanced; and given

that, although the slack in the production sector saw slight improvement and labor market conditions showed overall improvement, labor force slack was not low, particularly with respect to youth. The member then argued that, since shocks from the decoupling of the real and financial business cycles between advanced and emerging economies had produced a risk of greater instability in the credit market centered around non-blue-chip companies in weakened industries, monitoring of crisis transmission channels should be strengthened and emergency preparedness should be modified, and increasing leverage in the private sector should be preemptively managed at the macroprudential level. The member also put forward the view that, since harmony between macroprudential and structural reform policies had become more important, it was necessary to further strengthen cooperation and coordination among policy institutions to seek an optimal mix of those two policies.

Meanwhile, one member mentioned that, taking into overall consideration domestic and overseas economic conditions, while growth and prices remained generally on the path forecast last October, albeit subject to great uncertainty, financial stability risks had grown as the possibility of increased domestic and overseas financial market volatility had increased in line with a possible Fed rate hike in December, and as household lending was expected to continually show heightened growth, due mainly to increased housing sales prices and higher leasehold deposit prices, and to growth in group loans in line with the rise in the stock of new apartments available for sale. The member then argued that, while holding the Base Rate at its current level for the intermeeting period, it would be necessary to scrutinize the way macroeconomic and financial stability risks were likely to evolve in line with changes in domestic and overseas conditions, and in particular to keep a close watch on the US Fed's monetary policy, and on changes in financial and economic conditions in China and other EMEs and their influences on the Korean finance sector and economy.

Another member set out the view that, while holding the Base Rate at the current level for the intermeeting period, going forward it was necessary to closely monitor the evolution of downside risks to the global economy, shifts in major countries' monetary policies, trends of exports and domestic demand, and trends of fluctuation in Korea's foreign exchange and financial markets, while seeking appropriate policy measures related to the above. After noting that the Bank of Korea should be on the alert to the possibility that credit risk aversion, which had increased in certain industries of late, may rapidly spread to other industries, the member argued that, while carrying out corporate restructuring without delay, the relevant policy authorities should make preemptive efforts to prevent the spread of funding difficulties of blue-chip companies and avert an excessive expansion of financial market volatility. The member noted that volatility in the domestic foreign exchange market had been relatively high compared with other countries, and the high volatility was likely to continue going forward due to the co-existence of factors causing the depreciation of the won, such as a US policy rate hike and the deepening economic slowdown in China, and factors causing the appreciation of the won, including a trend of surplus in the Korean current account and the expansion of monetary easing in major countries. The member went on to present the opinion that the foreign exchange policy authorities should therefore scrupulously and preemptively examine potential risk factors, while developing appropriate measures to bring about market stability under different possible scenarios.

One other member noted, in view of overall financial and economic conditions domestically and overseas during the past month, domestic economic activity and price movements were judged to have not strayed far from the path forecast in October, but the uncertainties surrounding external conditions, such as a possible policy rate hike by the Fed and the Chinese economic slowdown, had increased. The member then set out the

view that it would be appropriate to leave the Base Rate unchanged this month while further strengthening the monitoring of growth in household debt, including group loans, and of corporate restructuring conditions. The member commented that, although employment presented a favorable picture, with the number of persons employed increasing and the employment-to-population ratio rising, youth employment remained weak as the educated unemployment problem deepened, and thus policy efforts should be strengthened to address this problem.

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 modest improvements in the euro area have continued. 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 possibilities exist of its being affected by heightened international financial market volatility due for example 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 domestic demand activities such as consumption and investment have sustained their paces of recovery, while economic agents' sentiments have improved somewhat, the trend of declining exports has persisted. On the employment front, the number of persons employed has increased steadily, and in October the unemployment rate fell compared to that in October of last year while the employment-to-population ratio maintained the same level. 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 from 0.6% the month before to 0.9% in October, due mainly to expansions in the extents of increase in agricultural product prices and in service fees. Core inflation excluding agricultural and petroleum product prices also rose to 2.3%, from 2.1% in September. 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 persisted in both Seoul and its surrounding areas and the rest of the country.
- ☐ In the domestic financial markets, stock prices, after having risen in line mostly with increases in stock prices in major countries and with net inflows of securities investment funds of foreigners, have fallen back as the likelihood of a policy rate hike by the US Federal Reserve has grown. After having appreciated, the Korean won has depreciated against both the US dollar and the Japanese yen. Long-term market interest rates have risen, in response mainly to increases in interest rates in major countries and the improvements in domestic economic indicators. 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 changes in the US Federal Reserve's monetary policy or in economic conditions in emerging market countries including China, as well as the trends of capital flows.