

Minutes of the Monetary Policy Board Meeting

January 14, 2016

The Bank of Korea

(English version)

Minutes of the Monetary Policy Board Meeting¹⁾ **(January 2016)**

I . Outline

1. Date of meeting : Thursday, January 14, 2016
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
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, due mainly to the nation’s sluggish investment and declining exports, while the US economy was showing sustained recovery, boosted by growth in private consumption and housing investment, and the euro area was maintaining a modest recovery led by domestic demand. As to **international financial markets**, members evaluated global interest rates as having fallen overall and global stock prices as having declined substantially, affected chiefly by financial instability in China and declines in international oil prices.

Concerning **the domestic economy**, members assessed that exports had remained sluggish, while the economy maintained its modest recovery led by consumption.

With regard to **the domestic financial markets**, meanwhile, members noted that stock prices had dropped significantly and the won-dollar rate had risen greatly, due to the outflows of foreigners’ portfolio investment funds following financial instability in China and falls in international oil prices, and long-term interest rates had decreased owing chiefly to the preference for safe haven assets due to heightened financial market volatility. Most members also mentioned that bank lending to the household sector had maintained strong growth.

2) English versions of ‘Current Economic Developments in Korea’ and ‘Financial Markets’ are posted on the Bank of Korea website.

As to **prices**, most members observed that consumer price inflation had stood at 1.3 percent, a substantial increase from the previous month, due mainly to greater increases in agricultural product prices and services fees, and that core inflation had remained unchanged from the preceding month at 2.4%.

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 stated the view that, while holding the Base Rate at its current level for the intermeeting period, attention should be paid to the direction of monetary policy in the US and other advanced countries, to global economic trends and to risks in China and other EMEs, and efforts should be strengthened to find momentum for economic improvement. The member stressed that as the global financial markets had been shaken since the very the start of the year amid a bleak global economic outlook, and as there were fewer factors supporting an optimistic view of the Korean economy than supporting a pessimistic view despite growth forecast at 3.0%, continuous efforts should be made to revitalize consumption by promoting qualitative and active communication with economic agents, and to promote facilities investment by improving the investment environment, thereby restoring growth and employment potential. The member mentioned that it was necessary to closely monitor changes in external conditions and in the in/outflows of foreigners' portfolio investment funds to/from the Korean market and seek measures

to diversify these funds. The member also emphasized that efforts should be made to facilitate credit transactions and maintain domestic financial soundness, keeping in mind that credit differentiation and liquidity risks might emerge, and new measures to maintain financial stability needed to be developed while continuously managing the ratio of household debt to disposable income and improving the household debt structure. The member also noted that it would be necessary to analyze whether the continued instability of financial and economic conditions had been triggered by an insufficiently strong accommodative monetary policy stance, by problems in credit flows arising from financial friction, or by a low growth trap caused by structural problems, and to formulate appropriate countermeasures. With regard to the new inflation targeting regime, the member went on to stress that efforts must be made to pursue and maintain consistent and scientific explanations for price fluctuations and, if necessary, policy coordination with related authorities should be promoted and balanced expectations regarding future inflation should be fostered.

Another member expressed the opinion that, while keeping the Base Rate at its current level during the intermeeting period, it would be advisable to closely assess the evolution of major domestic and international conditions and related risks, and to seek optimal policy responses. In support of this, the member stated that, although the downside risks to growth and inflation had substantially expanded, risks related to the Chinese economy, uncertainty related to a US policy rate hike, patterns of outflows of foreign investment funds, and patterns of changes in household and corporate debt were judged to call for cautious and elaborate policy responses. The member went on to argue that, since private consumption and corporate investment sentiment were contracting greatly due to an expansion of financial and economic instability in China and due to the North Korean nuclear test, the relevant policy authorities should devote efforts to stabilize consumption and the investment sentiment

of economic agents. The member further noted that, while supplementing and strengthening measures to improve household debt both in terms of quality and quantity, care should be taken to prevent the financial crunches and funding difficulties that may materialize in the course of corporate restructuring from spreading to normal firms. The member commented that, since Korean firms in particular were under unprecedentedly difficult circumstances, as exemplified by sluggish exports and domestic demand and the consequent decline in operating profits, the government should pursue structural reforms to improve the economy's fundamentals, while seeking multi-pronged policy support measures to manage an expansion of downside risks in the corporate sector as a whole and to revitalize weak growth and employment. The member went on to argue that the monetary authorities should contribute to economic revitalization in Korea through the expansion of corporate investment and employment, and actively seek and implement appropriate measures to support corporate lending for growing small- and medium-sized enterprises, which have significant spillover effects on other sectors.

One other member put forward the view that it would be advisable to keep the Base Rate at its current level during the intermeeting period and to adopt a flexible policy stance to respond to latent risk factors and the uncertainties surrounding the forecast path for this year. In support of this, the member stated that, first, in terms of growth, while private consumption drove the recovery in domestic demand, albeit moderately, the overall growth momentum was weakening somewhat due to the continued sluggishness of exports; second, in terms of price movements, although the consumer price forecast had been adjusted downward due mainly to sustained low oil prices, the underlying upward trend of prices was continuing, based on various supplementary indicators of core inflation; and third, although the slack in the manufacturing sector had expanded, overall labor force slack had been improving somewhat. The member noted that, to prevent a further reduction in the potential growth rate, it

was necessary to identify and resolve potential insolvencies to enhance the efficiency of the capital and labor markets, to reasonably allocate the consequent losses, and to continue to carry out related market and system reforms. The member went on to express the view that economic stabilization policies - including monetary policy - should focus on a medium-term easing of temporary downside aggregate demand and inflation pressures accompanying the facilitation of structural reforms, on preventing the erosion of growth potential, and on maintaining stability in the financial system despite internal and external shock factors.

Meanwhile, another member put forward the view that, in overall consideration of economic conditions at home and abroad, it would be desirable to keep the Base Rate at its current level for the month. The member went on to note that economic outlooks by their very nature involve forecasting economic conditions by fully reflecting information available at the time of the forecast and then performing revisions using newly obtained data, and thus the preception that a revision to the economic outlook implies that there are errors in the original forecast comes from lack of understanding of the forecasting procedure. The member then presented the view that it is advisable to strengthen communication regarding the meaning of the economic outlook. The member went on to stress that, to enhance the accuracy of economic forecasting, it was necessary to increase available information, to improve the procedure for receiving feedback on errors, and to devise a procedure for increasing the accuracy of the original outlook. The member also noted that, concerning the perception of low inflation, it was necessary to examine whether consumer price inflation properly reflects the actual situation. The member then set out the view that, in consideration of the possibility that actual housing cost burdens are undervalued and of the point that the share of housing costs in the consumer price index is smaller in Korea than in other advanced countries, attention should be paid to the interpretation of the consumer price inflation, while measures

to improve and supplement the housing rent index should be continually sought to limit the effects of structural changes in the housing market.

One other member argued that, although the growth path was judged to have been adjusted slightly downward in comparison with the October 2015 forecast, due mainly to the sluggishness in the actual growth rate in the fourth quarter of 2015, and to downward adjustments to the rates of growth of the world economy and global trade, and the price path was judged to have been adjusted substantially downward, as a further decline in international oil prices of late had acted as a downward pressure, these downward adjustments to the paths of growth and prices were mainly attributable to unforeseen changes in external factors, and the Base Rate's current level still seemed accommodative, even in light of the downwardly adjusted outlook. The member then argued that, accordingly, it would be desirable to maintain the Base Rate at its current level for the intermeeting period. The member also noted that remaining downside risks included the possibility of heightened international financial market volatility in line with the pace of rate hikes by the Fed and with the financial instability in China, anemic global trade, further declines in oil prices, and the weakening of growth momentum in emerging market economies. The member also expressed the view that a close watch should be kept on the question of whether the trend of improvement in domestic consumption would continue and on the intensification of the youth unemployment problem.

One member stated that, first, although there were great uncertainties surrounding the domestic economy, it was forecast to show a trend of growth generally consistent with its potential growth level of 3.0~3.2%; second, although consumer price inflation was projected to fall considerably short of the 2% inflation target in 2016, it was expected to rise gradually in the second half of 2016 and converge to the target in 2017, and the low consumer price inflation was attributable in large part

to supply-side factors such as the decline in international oil prices, while core inflation, which shows underlying price movements, was likely to move close to 2%; and last, in view of the possibility of continued negative effects from the financial instability in China on the domestic financial and foreign exchange markets, of high credit risk aversion in the financial markets, and of the growth of household lending, particular attention should be paid to financial stability for the time being. The member then set out the view that it would be best to keep the Base Rate at its current level during the intermeeting period, while closely examining changes in economic conditions of major countries such as the US and China, and developments in the financial and foreign exchange markets at home and abroad.

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 Bank of Korea 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 Bank of Korea 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 factors such as the US Federal Reserve's monetary policy normalization, Chinese financial market conditions, and international oil price movements.
- ☐ Looking at the Korean economy, although domestic demand activities have sustained their paces of recovery, driven by consumption, the trend of declining exports has persisted while economic agents' sentiments have not improved. On the employment front, as the trend of increase in the number of persons employed expanded in December, the employment-to-population ratio rose compared to that in December the year before while the unemployment rate fell. The Bank of Korea 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 1.0% the month before to 1.3% in December, due chiefly to increases in agricultural product prices and to a narrowing of the extent of decline in petroleum product prices. Looking ahead the Bank of Korea forecasts that consumer price inflation will fall considerably short of the 2% inflation target for the time being, owing mainly to the disappearance of the effect from the cigarette price hike and to the recent further declines in international oil prices. Core inflation excluding agricultural and petroleum product prices meanwhile registered 2.4%, the same as in November. In the housing market, the upward trends of sales and leasehold deposit prices slowed somewhat in both Seoul and its surrounding areas and the rest of the country.
- In the domestic financial markets, stock prices and long-term market interest rates have fallen, influenced mostly by instabilities in the Chinese stock market and by the declines in international oil prices, while the Korean won has depreciated substantially against both the US dollar and the Japanese yen, on the effects in addition of Chinese yuan devaluation and increased geopolitical risks. 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 Bank of Korea 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 external risk factors such as any changes in the US Federal Reserve's monetary policy or in financial and economic conditions in China, the movements of capital flows, and the trend of increase in household debt.