

Minutes of the Monetary Policy Board Meeting

February 16, 2016

The Bank of Korea

(English version)

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

I . Outline

1. Date of meeting : Tuesday, February 16, 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 Administrative Support 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 the trend of economic recovery in the US was weakening somewhat, due mainly to sluggish investment and exports, and Chinese economic growth was continuing to slow down, owing primarily to the nation’s declining exports, while the euro area was maintaining its trend of modest recovery, boosted by improvement in consumption and exports. As to **international financial markets**, many members evaluated that Treasury rates in most major countries had fallen and global stock prices had declined substantially, affected chiefly by financial market unrest in China, concerns about the global economic slowdown and declines in international oil prices.

Concerning **the domestic economy**, members assessed that exports had remained sluggish, and the trend of improvement in domestic demand had weakened due to a decrease in consumption.

With regard to **the domestic financial markets**, meanwhile, members noted that interest rates and stock prices had dropped significantly and the Korean won had depreciated against the US dollar, with Korea seeing outflows of foreigners’ securities investment funds brought about in part by developments in international financial markets. A few members also mentioned that bank household lending had sustained an upward trend exceeding that of recent years, although it grew more slowly than in the previous month due mainly to seasonal factors.

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

As to **prices**, members observed that consumer price inflation had stood at 0.8 percent, a substantial decrease from the previous month's 1.3%, owing chiefly to the dissipating effects of the cigarette price hike, and that core inflation also fell from the preceding month to 1.7%.

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:

Many 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 noted that, although the pace of economic recovery had slowed somewhat in comparison with the January forecast, influenced for instance by the persistence of financial and economic unrest in China since the beginning of the year, and by further declines in international oil prices, and although the upward trend of prices had decelerated slightly, the current situation urgently called for securing policy space to brace for heightened uncertainties surrounding the growth and price paths. The member went on to express the view that it would be desirable to maintain the Base Rate at its current level for the intermeeting period, in consideration of the trend of foreign securities investment fund outflows and an increase in household debt. The member also stated the view that the creation of new demand was limited because economic sentiment was souring amid economic uncertainty despite the government's economic stimulus policies, such as fiscal front-loading and the extension of the cut in the individual consumption tax. The member

went on to argue that the employment outlook in the manufacturing sector was uncertain due to the prolonged export slump. Furthermore, taking into account that the Bank of Japan's introduction of negative deposit rates was strongly influencing global investment sentiment, the member stated that it was necessary to closely monitor changes in the policies of major central banks and any related developments, while paying special attention to the outflows of foreign investment funds stemming in part from the decreased incentive for arbitrage trade following reduced interest rate differentials.

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 noted that, although the Bank of Japan had followed in the footsteps of the European Central Bank and some euro area central banks by introducing negative interest rates to encourage loan expansion to deal with a weakening recovery, the BOJ's move had been of limited effectiveness thus far, and there were heightened concerns about negative side effects. The member also expressed the view that there was an increasing need in Korea as well to identify and implement diverse policy instruments to respond to the heightened downside risks to growth caused by deteriorated conditions at home and abroad, and since Korea still had interest rate policy space, now seemed to be an opportune time to develop effective policy instruments, such as by providing interest rate incentives. The member went on to state that, from this perspective, the Financial Intermediation Support Facility is an effective policy tool, which can work to stimulate the economy and to ensure financial stability since it does not affect household lending and selectively provides financial support to industries in need. The member argued that, accordingly, the Bank of Korea should actively use this facility.

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, as

downside macroeconomic and financial stability risks had increased and external uncertainties made it difficult to forecast the future directions of these risks. The member particularly stressed that it would be necessary to take an even closer look at changes in external conditions, in/outflows of foreign investment funds, North Korea-related risks and movements of price variables in the financial markets, while actively seeking market stabilization measures if needed. The member also argued that, in response to downside risks, it would be necessary to support exports and facilities investment through the bank intermediation support facility, and went on to state that efforts should be made to help economic agents understand well the need for careful operation of the policy rate for the time being, as in extremely unstable external conditions a central bank's policy rate adjustment would not have the intended effects and the available policy space would be exhausted.

Meanwhile, one member expressed the opinion that it would be desirable to adjust the Base Rate downward by 25 basis points from the current 1.5 percent to 1.25 percent this month. The member mentioned that the future growth rate was expected to fall substantially below the original forecast, as exports had declined more than expected, improvement in domestic demand had weakened and economic agents' expectations for economic recovery had worsened, and that consumer price inflation was also expected to fall short of the original forecast, owing chiefly to weak demand-side pressures and global oil price declines. The member also stated that due to the global economic slowdown and deflation concerns, countries such as Japan, EU countries and China had implemented or planned to implement additional monetary easing, and that the US was very likely to postpone its plan to reduce monetary easing due mainly to the delay in economic recovery and to the risk of low inflation. The member went on to stress that in the current unprecedented low interest rate environment, it might be argued that a further rate cut could incur

substantial policy costs, such as an increase in foreign capital outflows and growth in household debt, but this possibility seemed to be only limited for the time being given the Korean economy's large trade surplus and sufficient foreign reserves, and given the supervisory authorities' recent strengthening of their control of household debt. Meanwhile, the member presented the view that the related policy authorities should be prepared to closely monitor and stabilize economic sentiment, so as to prevent economic anxiety from spreading excessively. The member also argued that the monetary authorities should actively seek out and implement more practical and varied policy measures to support the corporate sector so as to restore the Korean economy's growth potential, and that the policy authorities needed to strengthen efforts to restructure major sectors of the national economy in order to improve economic fundamentals.

Another member put forward the view that it would be desirable to keep the Base Rate at its current level for the month and closely examine changes in the growth and price paths and factors causing financial instability at home and abroad in order to maintain a flexible policy stance, in overall consideration of the fact that, first, there was a growing possibility of the negative output gap widening again with the pace of growth recovery slower than originally forecast, due mainly to the worsening export slump and the waning effects of stimulus measures; second, demand-side inflationary pressures did not seem strong enough to guarantee achievement of the inflation target over a medium-term policy horizon, as the continued modest upward trend of core inflation was attributable largely to growth in prices of items insensitive to business conditions; and third, although the overall situation in the production sector had improved slightly, substantial slack remained. The member went on to stress the importance of establishing a framework for policy mixes based on thorough analyses of the current economic situation in order to ensure that future monetary policy operation would be appropriate and effective. The member also stated that, first, the degree of economic stimulus should

be determined in overall consideration of how far and how fast external demand shocks from the global economic slowdown would spread to domestic demand; second, monetary policy transmission channels, including the asset price and exchange rate channels, and their effectiveness should be reexamined in consideration of the increasing decoupling of major countries' monetary policies; third, careful preparations and contingency plans should be made in the event of possible shocks to the domestic financial markets from a financial crisis centered in EMEs, such as resource-exporting countries; and fourth, continuous attention should be paid to the trend of household debt and to the soundness of the banking system, and appropriate preparations should be made to tackle the risk of shocks in the capital market and the shadow banking sector spreading to the banking sector.

One other member argued that, while holding the Base Rate at its current level for the intermeeting period, it might be important to pay attention to whether global financial market instability persists, as well as keep a close watch on trends of monetary and financial policies of major countries and foreign capital in/outflows, so as to minimize effects on the Korean financial markets and real economy, and the member also emphasized the importance of maintaining macroeconomic stability by building economic recovery momentum and taking preemptive measures to address potential causes of financial instability. The member went on to mention that, as the global real economy had been recently swayed by financial sector instability, it would be necessary to enhance the central bank's ability to better explain and forecast economic developments based on an accurate understanding of the relationship between the financial sector and real economy. On the domestic side, the member also stressed that, amid growing attention to whether the direction of the January forecast would remain unchanged, export support measures should be developed in light of continuously sluggish exports, and attention needed to be paid to negative asset effects that the weakening stock and housing

markets might have on consumption. On the external side, meanwhile, the member put forward the view that, while paying attention to international policy cooperation, various measures to enhance the foreign exchange market should be considered, such as leading overseas investment assets back to the Korean markets, promoting the sophistication of macroprudential policy instruments, and strengthening incentives that could encourage financial institutions to keep excess foreign currencies in their reserves. With regard to the domestic financial markets, the member stressed that efforts were required to increase supplies of long-term financial assets, to facilitate long-term credit supplies, and to seek measures to encourage foreign capital to stay in the Korean markets for the long term. As to policies, the member argued that it would be necessary to consider a comprehensive policy that seeks to stabilize the financial and foreign exchange markets, to promote stability in household and corporate sentiment and also to grow demand and enhance supply capacity. The member went on to state that efforts needed to be made to develop optimal policy mixes through simulations of various policy options.

IV. Results of Deliberation on Monetary Policy Directions

Incorporating the outcome of their earlier discussions, members compiled a statement reflecting the views of the majority.

Mr. Seong Keun Ha, however, dissented, expressing his clear opposition to keeping the Base Rate at its current level, and arguing for lowering it by 0.25 of a percentage point.

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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 trends of economic recovery in the US and the euro area have weakened somewhat. 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 it will be affected by factors such as financial and economic conditions in China and other emerging market countries, international oil price movements, and global financial market volatility.
- ☐ Looking at the Korean economy, the trend of decline in exports has expanded and the recovery of domestic demand activities such as consumption has also shown signs of weakening somewhat, while the sentiments of economic agents have been sluggish. 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 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 have increased.

- ☐ Consumer price inflation fell from 1.3% the month before to 0.8% in January, owing chiefly to the disappearance of the effect of the cigarette price hike, and core inflation excluding agricultural and petroleum product prices also fell to 1.7%, from 2.4% in December. Looking ahead the Board forecasts that consumer price inflation will continue at a low level, due mainly to the declines in international oil prices. In the housing market, the upward trends of sales and leasehold deposit prices slowed in both Seoul and its surrounding areas and the rest of the country.
- ☐ In the domestic financial markets, influenced by global stock market unrest and by foreigners' continuing net sales of domestic securities, stock prices have fallen and the Korean won has depreciated against the US dollar. The won has depreciated even more against the Japanese yen than the US dollar, on the strengthening of the yen due to investor preference for safe assets. Long-term market interest rates have fallen, in response mainly to declines in interest rates in major countries and to the movements of domestic economic and price 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 external risk factors such as any changes in the monetary policies of major countries or in financial and economic conditions in China, the movements of capital flows, geopolitical risks, and the trend of increase in household debt.