Choongsoo Kim: Central banks and financial stability – lessons and challenges from the crisis

Opening address by Mr Choongsoo Kim, Governor of the Bank of Korea, at the 18th Central Banking Seminar, Seoul, 23 November 2010.

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Opening remarks

Ladies and Gentlemen,

Let me extend a hearty welcome to all central bankers from around the world taking part in the Bank of Korea's "Central Banking Seminar". I would also like to thank Dr. Dosoung Choi of the Bank's Monetary Policy Committee for being here to deliver the keynote address shortly.

This seminar, now in its 18th year, has contributed greatly to the sharing of diverse experiences and ideas among central banks in various countries. It has also provided an opportunity for broadening the networks linking the staff of central banks.

Since the outbreak of the global financial crisis, countries around the world, with the G20 to the fore, have been preparing frameworks that can underpin sustainable and balanced growth.

In this context, the role of central banks, in securing financial stability needs to be heightened further to prevent any recurrence of the crisis. The theme of this seminar, "Central Banks and Financial Stability: Lessons and Challenges from the Crisis", is accordingly one that deserves our particular attention.

Central bank tasks after the global financial crisis

The recent crisis is regarded as the severest since the Great Depression of the 1930s. The crisis has shown us how massive are the imbalances accumulated in the global economy during the period called as the time of "Great Moderation", and how vulnerable it is to systemic risk. We have also come to realize that the development of financial engineering, once believed to disperse risks, has in fact worked to weaken economic agents' vigilance toward them.

The G20, along with international financial institutions including the IMF, the FSB and the BCBS, have devoted much effort to tackling these problems. For their part central banks, in conducting monetary policy, need to consider these problems so as to prevent crises.

First of all, we should seek to find the desirable role of the central bank within a macroprudential policy framework that ensures overall economic and financial stability. The crisis has taught us that, even under low and stable inflation, financial sector imbalances can accumulate through a rapid expansion of credit and sharp run-ups in asset prices, and that these can trigger crises. It is also never simple for us, as the lender of last resort, to mop up a crisis without paying due consideration to the massive social costs that it causes.

It follows that central banks should pursue both price stability and financial stability in a balanced and harmonized way to promote macroeconomic soundness. The central bank must make full use of its expertise in evaluating macro financial risks as well. And when necessary, it should work to counter these risks jointly with the government and the financial supervisory authorities.

As a next step, from a global perspective, we need to work to enhance policy effectiveness through collective policy actions involving governments and central banks around the world. The world economy has become highly integrated, and the complexity and inter-connectivity of economic and financial phenomena have greatly increased. It has therefore become tremendously difficult for any one central bank alone to either prevent a crisis or deal with its aftermath.

In this light, the recent crisis has triggered a realization among policy-makers worldwide of just how important policy cooperation is between the government, the central bank and the financial supervisory authorities. And the building-up of networks to support this cooperation is of course equally important. As I am sure you are aware, the construction of global financial safety nets was adopted as an agenda for the Seoul G20 Summit as a Korean initiative. This may be seen as one prominent example of a collective policy action, having the characteristic of the supply of global public goods.

Lastly, I would point out the need for identifying exactly what influence monetary policy will have in the transformed economic and financial environment following the crisis. This crisis has had a devastating impact on the balance sheets of households, corporations and financial institutions, not to mention the government's fiscal position. The experience of the crisis and the tightening of global financial regulations will also cause vast shifts in economic agents' behavior. Furthermore, the changes in global macroeconomic conditions after the US Federal Reserve's recent additional quantitative easing are looming as new challenges for central banks' monetary policy.

In order to cope with this new world economic regime, we will need to devise necessary countermeasures to deal with the possible changes in the monetary policy transmission channels and the limitation on policy effectiveness. Particularly, given that changes are always and everywhere accompanied by uncertainty, we should endeavor even more strongly to heighten the predictability and credibility of our monetary policy.

Closing remarks

Fellow central bankers,

I hope this seminar provides an opportunity for constructive discussions on how the central bank contributes to economic and financial stability within the macroprudential policy framework. It will also be good to share ideas on how Basel Ⅲ and the strengthened supervision of SIFIs can be put into place seamlessly, without detracting from financial sector dynamism.

Drawing my remarks to a close, let me express my wish that this seminar will contribute to strengthened cooperation among central banks by fostering good fellowship among all participants. I hope as well that, despite your jam-packed schedules, you will enjoy the opportunity to savor the tradition and attractiveness of our Korean culture.

Thank you.