

Choongsoo Kim: The past year in retrospect, challenges and resolutions for 2013

New Year Speech by Dr Choongsoo Kim, Governor of the Bank of Korea, at the Bank of Korea, Seoul, 2 January 2013.

* * *

Dear fellow members of the Bank of Korea,

The Dragon Year of 2012 has passed and 2013, the Year of the Snake, is now upon us. As the New Year begins, I take it as very meaningful that we all gather to reflect together on the past year and firm up our resolve to undertake what we must in the coming year. It is already almost five years since the Global Financial Crisis struck, yet the fact of the matter is that we still have little clue as to how it may be fully resolved. Instead, we may have ourselves become so accustomed to the crisis situation as to even arouse suspicions that we might be becoming gradually desensitized to its seriousness. The current financial crisis is analyzed as originally caused by the side effects of the deepening of global trends, and during the past few years of overcoming the crisis these trends have progressed in ways that have locked in the interconnectedness of all economies of this world even more firmly. We have come to face the irony that our efforts to overcome the various side effects from the rapid progress of global trends have in the end produced an even stronger process of globalization. What this means is that, due to the environment of continuing economic recession the growth of international trade has contracted compared to the past, but the universality of policies and systems has expanded all the more and their interlinkages have been further strengthened. In such an environment, the extent to which a single nation can resolve problems through its own policy tools alone can be said to be growing more and more limited. On the other hand, as the crisis drags on economic agents' patience for enduring the social tensions aroused by the reform agendas that had been pursued in several countries around the world is also showing signs of reaching its limits, and in many countries there even appear to be preoccupations with the short-term resolution of outcomes brought about in the course of handling the crisis, rather than concentration on identifying the nature of the crisis or preventing its reoccurrence.

Corresponding with the changes in global economic conditions, each country has attempted various countermeasures domestically, but their effects in bringing about economic stability and growth while eliminating the uncertainties prevalent in the global economy are considered to have not been sufficient. It goes without saying that it has not seemed possible for Korea, whose growth driver is trade, to be immune to the effects of these global uncertainties. In Korea, in addition to the inevitability of a slowdown of growth, to prepare against the possibility growing of economic instability developing into social risk as uncertainties rise higher, a high priority has been given to risk management policies, so that the household debt problem, the long-term slump in the housing market and the like do not pose economic risks, while considerable policy attention has also been devoted to restraining the aftereffects of the quantitative easing policies in advanced economies.

The economic outlook for this year does not foresee either the global or the Korean economies being markedly better than last year, but at the same time neither can it be said to contain a large number of negative opinions. Since an economy is akin to a living organism, apt to show dynamic movements at any time, it is important that there be flexibility to deal with various scenarios that might occur. The Bank of Korea has already made it public that, while firmly anchoring the basis for price stability, its monetary policy this year will seek to promote financial stability, support the recovery of economic growth, and strengthen support to vulnerable sectors. As for the inflation

target, the Bank had for the past three years set it at a range of 2 to 4%, around a 3% midpoint, but for the next three years this has been narrowed compared to the past to a 2.5–3.5% range. Given that uncertainties in the external environment likely to threaten price stability will remain high, this narrowing of the inflation target range should be recognized as reflecting the Bank of Korea's firm determination for price stability.

Dear members of the Bank of Korea,

The past year in retrospect: continued prevalence of uncertainty

The past year can be referred to as one that ushered in political changes worldwide in the midst of a global financial crisis. Political leaders were newly chosen in all four of the countries surrounding Korea, and there were changes in political leadership in many other countries as well, including France. In Korea, too, a new president was elected, and a new government is to be inaugurated soon. From a global perspective, it was imperative last year that the euro area crisis be resolved, but I would call the state of affairs one in which global efforts to escape this financial crisis in a time of rapid political change could not deliver the results originally expected. The immediate challenges that the world must work on can be classified broadly and summed up as, first, global rebalancing and, second, reforming the shortcomings of the financial regulatory and supervisory system that triggered the financial crisis. The former, as I have emphasized several times, is illustrative of the point that at the bottom of any financial crisis always sit imbalances in the real economy that have nurtured it, and the latter is based on the judgment that the cause of the financial crisis this time around lay in the failure to manage systemic risks, by reason of which reform efforts as represented for instance by Basel III and the Dodd-Frank Act are being undertaken to strengthen the financial regulatory and supervisory framework.

The financial crisis that broke out in New York crossed over to Europe, where it metastasized into a fiscal crisis, and the situation now is one in which real economies around the world cannot properly pull out of recession, as growth in some emerging market countries has declined. Currently, individual countries are drawing up measures to cope with the effects of the U.S. fiscal cliff problem, but our worry lies in the fact that, even if in actuality that issue is appropriately resolved in one form or another, we will not see the Global Financial Crisis come to an end any time soon. Last year, various of the initiatives attempted in the US, Europe and elsewhere in response to the financial crisis involved the introduction of unconventional policies or facilities that had not been tried in the past. It is bound to take time for newly attempted endeavors to take effect, but with the addition on top of this of political uncertainties resulting from the elections of political leaders in these countries economic activities could not be carried out in a stable manner, and I would say that in consequence economic recovery could not be anything other than slow.

Even under such external circumstances, we can say that economic management in Korea was stable last year, to the extent that ours was the only country whose sovereign rating was upgraded by the world's top three credit rating agencies. Although growth slowed and domestic demand was sluggish, a very large current account surplus was recorded on the strength of favorable exports, and prices stabilized. As the supply-side inflationary pressures, including those from energy prices, were relatively eased, and the output gap was negative due to the economic recession, the Bank of Korea was able to keep prices stable at the 2.2% level, well below the 3% midpoint of its inflation target. This was a dramatic change, I would say, compared with the 4.0% of 2011. For the Bank as well, as it operated through the first year after its mandate for financial stability was introduced in the Bank of Korea Act, there was a big change in that it came to regularly submit its *Financial Stability Report* as a statutory report to the National Assembly. The Bank could not avoid difficulties in the process of conducting its monetary policy, however. And needless to say this was

because, with external uncertainties rising economically and politically, it was not easy to grasp the impacts on the Korean economy of the various unconventional policies introduced in the US and Europe. In circumstances in which globalization is intensifying, it is clear that decision-making without careful consideration of the impact on the domestic economy of changes in the external environment is inappropriate, but I must honestly confess that our knowledge and experience were inadequate for understanding these changes, and persuading economic agents of this situation was an even more difficult responsibility to fulfill. Along with this, the Bank also exerted efforts to keep abreast of the new global trend in national economic management, in which the jurisdiction of the central bank cannot but be expanded. It is out of this standpoint that the Bank has considered financial inclusion in the course of carrying out its monetary policy, and has striven to take the first step toward internationalization of the won by partial use of the proceeds of its currency swap arrangement with the People's Bank of China for trade settlement. Meanwhile, it is profoundly encouraging that Bank of Korea staff members' activities outside the Bank have grown vigorous, that their perspectives in viewing economic issues have become global, and that their research and analysis capabilities are being greatly fostered.

Dear friends and colleagues at the Bank of Korea,

Advent of new challenges for central banks: redefining their status and role

The changes that have unfolded over the past five years since the Global Financial Crisis can be seen as a revolutionary shift in the perception of the central bank functions held for the past century. On the one hand, in several advanced economies whose sovereign debt levels are high and their fiscal spaces exhausted, it has become inevitable that monetary policy play an active role in management of the economy; and on the other, although to block outbreaks of financial crisis it is desirable to strengthen financial industry resilience through tight capital- and liquidity-related regulations, the fact of the matter is that concerns are being raised for realistic reasons about such regulations weakening competitiveness in the short run, and causing economic recovery to slow even more thereby. Let me elaborate on the former point. As accommodative monetary policy stances have been kept in place central banks' nominal policy rates have reached the near zero level, and unorthodox measures dubbed quantitative easing (QE) are thus being attempted in many different forms. For monetary policy to have an effect in a situation of realistic constraint at the zero lower bound, communication policies such as forward guidance are being attempted, seeking to nudge the activities of economic agents in appropriate directions. While Korea's policy rate was 5.25% just prior to the financial crisis, that of the US stood at 5.25% in early 2007, and the dynamic changes in the economy that saw it fall to its current 0–0.25% level within only two to three years offer us many lessons. And to expand on the latter point, let me note as a case in point that the reason why the US and Europe cannot move readily toward the Basel III framework as originally planned, as you are well aware, is due precisely to concerns about a decline in the productivity of finance. In particular, in order for a certain regulation to have its intended effect in the global economy the possibility of regulatory arbitrage must be blocked, but the reality is that many countries are facing a dilemma since, in order to achieve this goal, uniform regulations should be applied to countries around the world at different levels of financial development.

In the past century, as overcoming the evils of inflation has been made the number one priority of central banks, a large number of them have included price stability in their articles of purpose and have carried out inflation targeting. This has generally been an effective policy in economies with high inflationary biases, and Korea has also adopted it. It has recently been suggested in academia, however, that the level of nominal GDP should be made the policy goal instead, and one major central bank

has gone so far as to leave open the possibility of its carrying out policy along these lines. This has of course long been proposed in theory, and although it cannot be seen as having yet been tested as an effective alternative, the problem that causes it to be advocated lies in the fact that our existing instruments are not proving effective. As I am sure you are well aware, in economies that have been unable to escape low growth and deflation for extended periods there have recently even been attempts to inflate artificially to overcome this situation. It is not yet known what consequences might result from these attempts, but they too are based on the judgement that the existing policies have failed to deliver their intended effects.

Communication policies related to the central bank policy decision-making process are very crucial even to central banks with scope remaining for policy rate adjustments, and I believe they have brought about changes in our ways of thinking even in the discussions concerning the transparency of the central bank's policy decision-making process. Transparency is regarded as having the advantage of reducing uncertainty, and it can be said to be proxied by precision and conditionality. The US Federal Reserve has recently come out with communication policies hardly conceivable in the past. It has named the unemployment rate, the rate of inflation, and long-term inflation expectations as its three major parameters, and with regard to their levels has explicitly spelled out the two qualifications I just mentioned. This represents a great transformation for central banks. And of course uncertainty does still remain, for instance as to the degrees of deviation to be tolerated should the three variables move in different directions against expectations, and as to what data will be used as reference for information related to the future rather than the past. Although there is no absence of voices tinged with concern about unintended consequences, i.e. the consequence of efforts to enhance transparency having instead further increased the scale of uncertainty or its scope of fluctuation, there is no doubt that we have taken the first step toward a sea change. The reason why such discussions are drawing particular attention is because, if advanced economies show stirrings of recovery, then central banks will have to cope with the possibility of global inflation as feared in some quarters. In addition, changes in the monetary policy stance to absorb the liquidity unleashed through QE could also act as a shock to the international capital markets. Therefore, for central banks that cannot be free from the influence of global inflation and changes in the international financial markets, it is important to understand the preconditions for any changes in advanced country monetary policy stances, and efforts must be devoted *ex ante* to preventing any side effects that could arise in the course of such changes going forward. This is because, if we cannot properly deal with a global shift in the monetary policy stance, the possibility cannot be ruled out of our facing a local crisis. Such attention is in fact related to the policy tasks I mentioned earlier as goals that should be taken up by central banks. There is still a lack of evidence to make the assessment that nominal GDP targeting is more appropriate than inflation targeting, but one thing that is certain is that it is probable that operating the central bank with a reliance on any one yardstick will be judged as perhaps not desirable.

My dear fellow members of the Bank of Korea,

Resolution for 2013: extending ourselves as a global BOK to be a more competent central bank

Even though faced with countless challenges domestically, we must not be negligent in responding appropriately to changes in the external environment. As I explained at some length earlier, the various new policies attempted in several nations will inevitably bring about big changes in the existing order. The Korean economy, whose degree of external dependence is high, falls under the direct sway of their influence. I would say that this is awakening us to the need to always stay on the alert and not bury ourselves in the past when the world outside is changing. I believe that our biggest challenge is how much we can contribute to directing these rapid changes in the global economy. Regarding changes in the global economy, and even our own

central bank functions, we have had a tendency to rely on theory and experience from the West. Concerning the expression “international perspective” as well, the reality is that the definition we have of it is very passive, amounting to having the ability to identify changes in the international economic community and understand what effects they have on the Korean economy. Going a step beyond this, the notion of an international perspective that we must carry with us from this point on includes having knowledge and viewpoints on how the international community should change. Without this shift in perception, we cannot say that we truly possess the ability to make decisions independently. What I am saying is that it is very urgent that we cultivate our capabilities and build up our capacity now for internalization of issues in the global economy. Monetary policy is no panacea, but there is no denying that its content is changing very rapidly.

Simply put, I believe there is no proposition of greater priority to us than that of making a more competent central bank. Propositions carved in stone can rarely exist, but I deem this to be our calling in this era. The aim of becoming a “Global BOK”, standing shoulder to shoulder with leading central banks around the world, is based on this proposition, which is also a precondition for our being able to make decisions independently. Being competent means staying ahead of others and being differentiated from them, and this implies that at times we must not decline to take a lonely road in solitude. Given our inherent nature as a sole organization in the nation, it is only when we imbue this sense of tension, intentionally even, that the vitality of our organization can be maintained.

At the start of this new Year of the Snake, let us all pull together and pledge to ourselves and to others beyond these walls to once again profoundly transform the Bank of Korea. I would like to suggest the following seven points, as attitudes and thoughts that I hope we will hold in our minds throughout this year:

First, the Bank of Korea must not become a place where time has stopped. Time must flow, and the Bank must be an organization of people concerned about the issues of tomorrow. Are we not still pouring our energies into the identification of past crises? What forms will forthcoming ones take? What must we prepare for? In particular, we must not be trapped by the dogmas of yesteryear. Dogmas present other people’s philosophies and experiences, and may even already be obsolete.

Second, we must depart from a domestic-oriented perspective. In an environment in which we live in an open economy, we need to strike a balance between the domestic and the global perspectives. We must exert efforts to understand the pressures on us coming from the external environment, and seek measures to resolve global issues. We must not just look at our peers beside us, but be equipped with the discernment and wisdom to observe our rivals overseas. We must at all times bear in mind our competition and cooperation with international organizations and other central banks.

Third, we must not be content with a reality of mainly undertaking familiar tasks. Rather than just repeating what we did yesterday, we must seek out new tasks. We must evaluate ourselves to see whether while claiming in words to “renew ourselves each day and the next”, we have not in reality been rather more faithfully carrying out our routine work. I believe we cannot expect to obtain different results and to grow while only repeating the same work. The process of overcoming the Global Financial Crisis requires the courage to explore the unknown. As central banks have played pivotal roles in overcoming global economic crises, and are around the world becoming perhaps more scholarly organizations than even academia itself, so we too must from now on be able to propose evidence-based policies, and not those based on unrealistic arguments.

Fourth, we must not continue to take a passive attitude of obediently undertaking only our assigned tasks. We must have an enterprising spirit to voluntarily seek new tasks. The most you can do in carrying out assignments given by others is to get the answers right, however much you may know. This is because there is no involvement of the critical mind and so from here on, we must develop the insight to frame and present issues ourselves. In the social sciences, right answers may not even exist. However, provided that we have a properly working critical mind, I believe we may have the merit of at least heading in the right direction.

Fifth, working internally in isolation must not be our practice. In this global economic environment we must also develop a multi-tasking capacity, to carry out a variety of tasks comprehensively. Positive results must flow from our enhancement of autonomy in line with the abolishing of job groups to this end. We must foster a spirit of mutual collaboration and cooperation with our colleagues and junior and senior staff members. The Bank must become an organization in which diversity coexists. By devoting efforts to mutual cooperation and coordination between the human resource and management departments, between the departments doing research on and analyzing the markets, policy and institutions, among our regional branches and among our overseas offices, we must go about accomplishing our goal of maximizing the synergies therefrom.

Sixth, we must not define the Bank of Korea's operations very narrowly, as in the past. The central bank must be an organization that contributes to the national economy, and it must establish close collaborative relationships with the various institutions in society. That is to say, under no circumstances must we be isolated from the outside world. We must operate with the awareness that information is to be shared and communication to be smooth. Even more important, as a result of this drive to open our doors, is that staff working in the central bank develop as key human resources recognized as indispensable not only within the Bank of Korea but in society as well.

Seventh, we must not forget that all of our actions are the focus of attention at home and abroad. We must be role models for the nation in all our areas of operation. I will reflect the results of the survey of employee opinions on the various institutional changes pursued here over the last two years to transform the Bank of Korea into an advanced central bank, and see to it that our positive transformation to meet the expectations of the public can be constantly sustained. We are in the meantime reflecting on the fact that our scores in the evaluation of anti-corruption competitiveness and integrity conducted by a national agency last year were low, and working to make up for our imperfections. Although the evaluation criteria used for us differed from those applied to other comparable organizations, without making an excuse of this we must, if we are to take pride in being a central bank, exert efforts to not consider any matter of public business as trifling but do our utmost and become role models for others.

None of these are easily achievable tasks, of course, but we must join forces to see all these changes through. And under no circumstances should we ourselves underestimate our potential. Until the Global Financial Crisis ends we must not relax our guard, so as to avoid rigidity and be meticulous in responding flexibly to the changes in global economic conditions. You may well remember that one year ago today, in this place, I urged that we carry out our newly-given financial stability mandate well, achieve the inflation target, and pursue institutional reforms that meet the public's expectations. And I do not think it would be praising ourselves too much even if we say that we have achieved these three goals without difficulty. This goes to show what we are capable of, even under anything but easy conditions at home and abroad, and so let us keep on changing so that one year from now, when we gather again in this same place, we can confirm the changes in ourselves.

We should bear in mind that history has always found its way to new solutions in response to crises, and has not returned to the past. This means that a future we have not expected is unfolding before us. If a crisis has erupted for unexpected reasons, who knows but that the post-crisis economy may also evolve to form a new paradigm of a state beyond our imagination.

It is very difficult to adopt a new attitude. There is an African proverb that says “If you want to go fast, go alone. If you want to go far, go together.” It is said to be because when you are going far you cannot avoid dangerous animals. In the face of the greatest financial crisis of this new century, and even more for us who have worked in a rigid organization for so long, if we are to navigate difficulties like the ones we face today should we not be able to go “together fast” if only for a short while? Can we not change quickly under any circumstances?

The further we venture into the future, the more the past will try to hold us back in the same place. We may even experience the discomfort of having our efforts evaluated by past standards. That is why it is difficult to build a new future. We must overcome all such adversities, however, with dignified and indomitable hearts as proud stakeholders in the central bank, and in that sense may this year go down as a historic one.

In this new Year of the Snake, I wish the very best of fortune to all of you and yours, and to all members of the BOK family.