

## Choongsoo Kim: Bank of Korea's 63rd anniversary

Speech by Dr Choongsoo Kim, Governor of the Bank of Korea, at the commemorating ceremony of the Bank of Korea's 63rd anniversary, Bank of Korea, Seoul, 14 June 2013.

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*Dear fellow members of the Bank of Korea,*

We come together to commemorate the anniversary of the Bank of Korea's establishment each year, wherever we work – in Seoul, and in our domestic branches and overseas representative offices. By honoring the history and tradition established by those who served before us, and by reflecting on what our contributions are to the development of our national economy and of the Bank of Korea, and on what kind of legacy we will leave to those who come after us, we use this as an opportunity to look back on the past, to analyze the present, and to seek future directions. It was on this occasion back in 2010, when we celebrated our 60<sup>th</sup> anniversary and started out on a new sixty-year cycle, that we pledged to ourselves to make the BOK 'a leading advanced central bank' under the banner of a "global BOK". This declared our resolve to develop ourselves to fully qualify as members of a leading world-class organization and to reform the Bank of Korea with strong resolve so that, reborn as a leading central bank, the BOK can play a vital role in steering the course of the Korean economy's development. And three years have now passed already since we began our bank's second sixty-year cycle with this solemn declaration before the nation and the world.

Although countries around the world have over the past five years struggled to emerge from the Great Recession, which is seen as the worst period of economic crisis since the Great Depression of the 1930s, their efforts have until now not borne sufficient fruit. On the one hand countries have tried various new and unprecedented macroeconomic policies, in order to overcome the crisis as quickly as possible and to achieve economic recovery. And on the other hand they have devoted utmost efforts to pursuing global financial regulatory reforms, to forestall a future crisis and prevent crisis from recurring. And the Korean economy is no exception to this trend of change, and is facing a variety of challenges and tasks in line with the changes in environment at home and abroad. This situation can be comparable to the adventure of exploring an unspoiled and unknown world, and the effectiveness of our knowledge and experience are being tested. In the past, of course, the future was always uncertain, but once the uncertainties had lifted we were able to enter into a new economic paradigm. What kind of economic paradigm will take shape before us once we overcome the serious uncertainties we are presently experiencing? What kind of new lessons will our recent ordeals have for us? I believe that the time is not far off when we will be able to look back on our current situation as one which we have been able to overcome wisely, and that it is our responsibility to bring this time forward. Admittedly we were unable to prevent the crisis erupting, but its outcome will be largely decided by our skill in tackling it. As is the way of the world, we must have the wisdom to turn current misfortune to our advantage.

In today's global economy, where all economies are mutually interlinked, efforts on the part of just a few countries to solve global problems can hardly meet with success. Considering the analysis that the high degree of economic interconnectedness together with procyclical policy have increased systemic risks to the economy, and that this was a decisive factor behind the current global financial crisis, it is obvious that the involvement of many countries, and not just a few, is essential to overcoming it. Although the participation of a large number of countries will of course involve the problem of a complicated decision-making process, I do not believe there can be any objection to the view that global problems can only be solved by securing effective momentum toward their solutions through a system of international cooperation. What is important to us now is that, through our active involvement in the international decision-making process, we must express our positions and views and strive to articulate our visions so as to nudge the world economy onto the course of global economic development that we wish. Indeed, we should involve ourselves actively in the clear

awareness that this path coincides with the maximization of our national interests. If we are unable to take part in the international decision-making process, not only will we be unable to secure the reflection of our positions but we will also face the difficulty of not being able to obtain information enabling our timely adoption of appropriate policy responses.

Today, in commemorating the 63<sup>rd</sup> anniversary of the Bank of Korea, I would like to share with you three tasks – related, specifically, to policies for tackling the global financial crisis and the trends of change in the international economic environment, to redefining the role of the BOK in line with the changes in economic conditions at home and abroad, and to the cultivation of the BOK's and its staff's potential.

*Dear friends and colleagues,*

We are paying more attention than ever before to the possibility of policy normalizations in the major advanced economies that implemented quantitative easing policies over the past few years, and to the influences that this will have on the international financial markets and emerging market economies. Needless to say, normalization does not necessarily mean a return to the pre-crisis state. It does, however, comprehensively involve the process of resolving matters such as when advanced economies will end their uses of unconventional tools, how the effects on other countries of their policy normalizations will develop, whether normalization will take place in an orderly manner through appropriate international policy cooperation, and what will be the economic vision in the post-crisis era. And none of these issues are unrelated to the Korean economy. The financial crisis that originated on Wall Street, and the consequent international financial reform efforts including Basel III; the Eurozone sovereign debt crisis caused by spread of the global financial crisis, and the continued unrest in the international financial markets; the fiscal problems in the U.S. including the sequester, and the uncertainties surrounding their resolutions; the unprecedented policy tools, each mobilized for a particular purpose, including Japan's qualitative and quantitative easing (QQE) which have completely changed the basic framework of monetary policy – none of these are by any means easy to analyze, either separately or comprehensively. Some common characteristics of the countries implementing these policies, however, are that their policy rates are close to their zero lower bounds, and that their currencies are key currencies used in international settlement. Monetary policy is in principle conducted through taking into account the domestic economic situation, but key currency countries should understand that their monetary policies inevitably have international spillover effects. If a key currency country overlooks such externalities this can be interpreted as a dereliction of its responsibility to maintain the stability of the international economic order, and its currency may face the risk of possibly losing its credibility as a reserve currency in international community.

For countries like Korea, meanwhile, whose currencies are not key currencies and have not yet been sufficiently internationalized, measures for responding to policies such as the quantitative easing by key currency countries cannot be found in economic textbooks written in the past. A new task for us, therefore, is to find alternative measures appropriate to our domestic circumstances by ourselves, through our own research. Under the assumption of the relative values of currencies being maintained, empirically identifying the effective lower bound of our policy rate, corresponding to the zero lower bounds of the key currency countries, is another homework assignment that we must solve. In an environment in which the magnitudes of change are increasing as globalization spreads more widely than ever before, these are newly emerging policy tasks that we must work proactively to find solutions for. It may sound a bit ironic, but we should always bear in mind that, although one of the causes of the current financial crisis was the further strengthening of interconnectedness among economies due to the rapid progress made in globalization, the process of overcoming this crisis will in its consequences also further strengthen globalization.

Discussions of quantitative easing termination and exit strategies are likely to be at the tops of the agendas in advanced economies in the near future, and reviews of action plans for the normalization process are being carried out. Needless to say, the extent of the impacts of the

normalization process on the world economy will depend upon whether advanced central banks have the capacities to manage market expectations appropriately so that the markets can refrain from overreacting. The importance of communication with the markets thus becomes emphasized still further. Although the pace of economic recovery is understood as a key to determining the timing of a change in monetary policy stance, the fact that the cost of sustaining quantitative easing may become ever larger over time, relative to its benefits, is also working as a factor moving forward the times of changes in policy stances. There is in addition the unavoidable reality that the marginal utility involved has been gradually diminishing as several countries have come to undertake quantitative easing. There are several issues before us in this regard that we must focus on and address.

First, there is the question of whether the normalization will take place in a synchronized or in a sequenced fashion. The former is not all that likely, as the circumstances of the individual advanced economies concerned vary, but if synchronized normalization does actually happen its influence is likely to be enormous. And even in the case of the latter method of normalization, the occurrence of increased capital flow and exchange rate volatility will persist for an extended period, meaning that we can most emphatically not say that its costs will be low. Since the range of fluctuation will depend upon the relative influences of the effects of various policies and systems, we will need to maintain a timely watch on changes in the international financial markets and adopt a flexible stance when responding so as to prevent any excessive volatilities of capital flows or exchange rates. The process of sequenced normalization will meanwhile be sequenced not only across countries, but also across the various different policy tools introduced in each country

Second, the process of normalization will entail rises in interest rates, and we can therefore not rule out the possibility of facing the risk of a global interest rate increase. We need to also pay attention to the increased burdens on the financial sector for maintaining soundness, such as the demand for raising of additional capital due to potential valuation losses on bond holdings. From a historical perspective, the U.S. Federal Reserve's interest rate hikes in the mid-1990s caused long-term Treasury bond rates to rise significantly, and due to the consequent drastic capital outflows Latin American countries experienced a series of financial crises. In contrast, the Fed's interest rate hikes in the late-1990s did not trigger any increase in long-term bond rates, and in the mid-2000s, despite rate hikes by the Fed long-term yields on government bonds even fell, triggering a phenomenon referred to as "Greenspan's conundrum". Bearing in mind that the results of a policy rate hike may therefore vary significantly, we must keep a close eye on market changes. We should note that while the economic crises in many countries during periods of interest rate increases over the past few decades can be traced in part to common phenomena such as rises in funding costs and declines in asset prices, they have also been attributable to large extents to financial institutions' adverse selection. And this is because the adverse side effects and economic vulnerabilities built up through the widespread pursuit of high-risk, high-return investment during periods of low interest rates become evident once rates begin to rise.

Third, we should work internally to identify the effects of our various policy instruments, and make preparations for dealing with any changes in external conditions promptly while at the same time devoting active efforts to eliciting global cooperation. The ratios of exports to GDP stand at only around 10 and 13 percent respectively in the U.S. and Japan, but in Korea reaches nearly 50 percent. We should note that stability in the international economic environment achieved through global cooperation is all the more important for the Korean economy, whose growth is so heavily dependent upon external conditions. Meanwhile, since it is a global rather than a regional equilibrium that must be achieved in order to maintain global economic growth and stability, we need to redouble our efforts to promote global cooperation so as to create an environment that is favorable to us.

*My dear friends and colleagues at the Bank of Korea,*

The revision of the Bank of Korea Act at the end of 1997 gave us a single responsibility, for price stability, and to achieve this goal we have operated an inflation targeting regime. With

the 2011 revision of the Act we have now assumed partial responsibility for financial stability as well, but are all well aware that this can be achieved only through cooperation among the government, the supervisory authorities and the central bank. In light of this, we need to closely examine the cases of the U.S., which operates, as its organization in charge of financial stability a Financial Stability Oversight Council (FSOC), consisting of the Treasury Department, the nation's supervisory organizations and the Fed, and of other countries. All over the world today, central banks are increasingly being asked to participate in the efforts to promote economic growth and prevent future crisis through more active and diverse means. Although based on the premise that it is within the central bank's legal responsibilities, the fact that ECB President Mario Draghi's promise last July to do "whatever it takes to preserve the euro" has been the most frequently mentioned and most strongly supported policy intention since then is direct proof of this. Mr. Draghi's words show us how the central bank's standing and roles are rapidly changing in directions different from in the past. And in fact the roles of the Bank of Korea are also expanding in various ways, in line with changes in our internal and external environments. I would like now to consider the current tasks that we face, by dividing them into four areas:

First, and above all, maintaining price stability is our responsibility stipulated in Article 1 of the Bank of Korea Act. We have set the medium-term inflation target range at from 2.5 to 3.5 percent for the next three years beginning from 2013, and are operating monetary policy accordingly. It is the central bank's primary goal to stabilize and ensure that the medium- to long-term inflation expectations of economic agents converge to the inflation target, but since we use CPI as an inflation indicator, which has a decisive influence on inflation expectations, it is also very important that we manage changes in the CPI appropriately. One of the characteristics of the structure determining inflation in Korea is that price determinants on the supply side, such as oil and vegetable prices, have greater influences than they do in other countries. And the stability of these prices has kept inflation below the lower bound of the target range for the past few months. Since economic agents' inflation expectations remain at around the 3 percent level, however, there still exists an inflationary bias. Moreover, when we look at the international discussions we see two extremes of arguments. Some on the one hand say, considering the sustained low inflation in many countries since the crisis, that inflation concerns have now vanished and we should prepare ourselves instead for the risk of deflation resulting from the hoarding of liquidity. As an aftereffect of the excess liquidity supplied by advanced countries' quantitative easing policies, in contrast, others expect inflation to be unavoidable in the future. And since the Korean economy is very sensitive to changes in external conditions, we, as the nation's central bank, must be prepared to cope with whatever future course the global economy takes.

Second, maintaining financial stability has become one of the major responsibilities of the Bank of Korea, as since the 2011 revision of the Bank of Korea Act we have begun placing greater emphasis on macroprudential issues than before in our joint inspections of financial institutions, and have gained increased access to data from financial institutions. We have also successfully constructed an econometric model for systemic risk assessment, and are working now on improvement of our Financial Stability Report, a statutory report submitted biannually to the National Assembly, so that it can be recognized at the global level. While in the process of overcoming the global financial crisis advanced countries have been managing their own economies in exceptionally low interest rate environments, we must bear in mind the comment that, in such an environment, the possibility should never be overlooked of the accumulation of economic vulnerabilities. The possibility of funds flowing continuously to businesses subject to restructuring can also not be ruled out, and the vulnerabilities of these businesses will become immediately apparent if there is any hike in global interest rates. We must continuously monitor the markets to pick up imperceptible signs of a crisis, closely analyze the data to identify any possibilities of tail risk, and develop capabilities to maintain financial stability. We must also redouble our efforts to ensure that we are not overlooking any tail risks, by closely examining whether the probability distribution that we rely on excessively truncates specific parts of the upper and the lower areas, or

whether the distribution does not represent the entire population of the economy due to any kind of selection bias.

Third, the expanded application of credit policy is a task that the Bank of Korea must also focus on going forward. Despite central banks around the world having adopted accommodative monetary policy stances and provided sufficient liquidity to the markets, this liquidity has not been linking with the real economy, and this fact has been pointed out as the main cause for countries around the world being unable to properly achieve growth. To overcome this, central banks are, through commercial banks, attempting to strengthen their roles in providing funds to small- and medium-sized enterprises (SMEs) with the potentials to contribute to economic growth. The Bank of England's Funding for Lending Scheme (FLS) for SMEs is cited as a good policy example, and the ECB is also considering measures to support SMEs. With the recent introduction of the Supporting Program for High Quality Technology Start-up SMEs, we at the Bank of Korea have also enlarged and reformed our Aggregate Credit Ceiling Loan system dramatically, seeking to contribute to enhancing the nation's growth potential by improving SMEs' productivity. Such policies and financial inclusion policies had previously been considered as falling within the government's brief, but are gradually coming to be considered now to lie within the domain of the central bank. Central banks are endeavoring to play more active roles in the efforts to strengthen the real and financial sector linkages. And by heightening the role of credit policy in complementing monetary policy, we are trying to redefine the expression "monetary and credit policies" specified in Article 1 of the Bank of Korea Act to conform with circumstances of our era.

Fourth, we must redouble our efforts to build up our networking with leading central banks. To ensure global economic growth and stability, we cannot stress too much the importance of the sharing of information among economies and their collaboration and cooperation in policy. The Bank of Korea has, by utilizing the proceeds of the won-yuan swap agreement between the Bank of Korea and the People's Bank of China, initiated use of the domestic currencies in trade settlement from early this year. Although we are still in an initial stage of striving to organize and foster the related systems, we can say that we have taken the first step, albeit cautiously, toward internationalization of the Korean won, and that there may ultimately be a need to examine measures for expanding this effort to all economies with which Korea has concluded FTAs. In order to support economic exchanges involving Islamic banking, an area in which economic cooperation is expected to increase in the future, we signed an MOU with the Central Bank of the United Arab Emirates last week. Going forward we also plan to sign MOUs with central banks in South America, and we would like to meaningfully expand our personnel and resource exchanges with the various central banks that have signed exchange agreements with the Bank of Korea. To my mind, it is only when all of these various efforts bear fruit that a 'Global BOK' will truly be established.

*Dear members of the Bank of Korea,*

If the various wide range of new operations that we have discussed so far is limited to the purview of only a small number of departments, then we can never achieve the sought-after results. Their effects can only be realized when all departments of the Bank of Korea, including our domestic branches and our overseas representative offices, hold them as common goals and put them into practice. I would like to make it clear that no one among the 2,200 staff members of the Bank of Korea is unconnected with these activities. I emphasize this because the operation of our organization must not be rigid, and we can come up with effective alternatives as needed only when we have established a climate of flexible mutual cooperation. If globalization refers to the disappearance of borders between countries, then we can only truly find ways of responding to globalization within our organization when the borders between our departments disappear. The mission given to us is to be able to nurture individuals who are in tune with these changes in our environment, meaning those whose ways of thinking and behavior are globalized. It is in truth impossible to overemphasize the importance of a multi-disciplinary knowledge.

It is my judgment that the education and training of our staff carried out over the past few years, to strengthen their potential capabilities, have come to great fruition. Increases in various kinds of publications written under our staff members' names, as well as the spread in the writing of papers to staff from almost all departments are major features in this regard. For example, the numbers of entries in the BOK Staff Paper Competition were 23 in 2011 and 27 in 2012, and have increased substantially to 38 this year. The numbers of contest participants have also increased during these years – from 38 to 44 and then 56. Another visible change, moreover, is that among these participants there have been eight lead, principal or senior economists. The number of our staff participating in international conferences has meanwhile also increased greatly, from 351 in 2010 to 412 in 2011 and 457 in 2012. Classified by rank, among all of these people in 2012 there were 141 economists, 103 senior economists and 77 principal economists, with marked increases being seen among senior economists and economists. I promoted the participation of lower-ranking staff in working-level conferences in the belief that their experiences there would enable them to play proper roles when they participated in conferences as higher-ranking officials in the future. I believe that this is now starting to show the desired results, and am convinced that the continuation of this trend will lead to a bright future for our Bank.

An even more significant change can be identified by looking at the numbers of joint research projects carried out by our headquarters and domestic branches. These numbers were one in 2010, 35 in 2011 and 64 in 2012. Among them, the number of projects conducted jointly with foreign institutions has exhibited a dramatic change – from zero in 2010 to four in 2011 and 20 in 2012. And even though the first half of this year has not yet passed, there are already 20 such projects currently under way. The number of joint research projects carried out at the domestic branch level was one in 2010, but these projects have also become active recently, increasing to 15 in 2011 and 17 in 2012. In the meantime, collaborative joint research among our domestic branches has begun from this year, and in next month the general managers of all domestic branches and director generals of our headquarters departments plan to meet to discuss three joint research projects among domestic branches. From the next quarter we also plan to release a “BOK Quarterly Regional Economic Report”, in which all domestic branches will take part. We expect to see in this the birth of a Korean “Beige Book, utilized as useful information on our nation’s regional economies. The majority of studies conducted by our domestic branches have meanwhile been recommendations in the studies have been adopted in policy-making by the local governments concerned.

Since their introductions in 2011, the numbers of staff who have participated in job training have been 286 in our Global Initiative Program (GIP) and 144 in our intensive training program for principal and senior economists. There have also been 83 staff from foreign central banks who have participated in the GIP, helping to establish networks between their banks and the Bank of Korea, and the number of foreign central bank applicants for the program has been on the rise. Every year we also have around 10 BOK staff members taking part in the training programs of international institutions and foreign central banks.

In sum, I think that staff with great potential are provided with opportunities to display their potential freely, and that we have seen positive results from this. Intangible assets, which are necessary in order for the Bank of Korea to become a leading advanced central bank, are being accumulated almost without our noticing it. I believe these are proud and inspiring achievements, that have produced considerable changes in a short period of time.

*Dear fellow BOK members,*

At international meetings I have often raised the new issue that an era of central bank competition is on the horizon. I believe that this is a natural outcome of the increased impacts of central banks on their national economies in line with the changes characteristic of our times. Although there were opinions raised at first that the concept of competition applied to central banks seemed somewhat awkward, since the central bank is the only such institution in its country, this is in fact a valid concept since there are a number of different central banks in the global economy as a whole. And as I have stressed to you at every opportunity,

the Bank of Korea's contribution to Korean economic development must not be smaller than those made by the US Federal Reserve, the Bank of England and the People's Bank of China to their own respective economies.

By now we should have the capabilities to comprehend other central banks' activities, and to establish and implement policies tailored to our own national economic conditions as well. Performing such varied functions could be compared to facing a situation in which we sometimes need to aim at a moving target. And in this environment, it cannot be said that we are performing an appropriate role if we simply follow theories or practices established under other economic conditions. We should instead be developing our abilities to create alternatives befitting our own national economy. Fostering the potential to understand what has gone wrong is just as important as the effort to find the answer to a problem. We are living in an era in which people equipped with critical minds and the capacities to uncover new tasks are urgently needed.

If we consider our future by putting together the things I have just said, the global financial crisis facing us now will be ultimately overcome by strengthening the dynamic characteristics of our economy and by eliminating its uncertainties. It should be borne in mind that this crisis was not just a temporary one, and that a new steady-state equilibrium might have been created as the crisis has become prolonged. Low interest rates may have already become entrenched in our economy, for instance, and breaking from them to achieve normalization could carry other costs. To achieve economic recovery to normalcy and thus escape crisis, animal spirits must serve as a catalyst for our economy's dynamic growth, while at the same time its productivity must be enhanced through constant restructuring. In order to contribute to national economic development by encouraging these economic conditions, the Bank of Korea should carry out the four roles that I have discussed above more faithfully. On the macroeconomic policy side, the Bank must support growth until our national economy has recovered to the level of its potential growth, while from the microeconomic policy perspective maintaining its accommodative monetary policy and devising means for financial facilitation to ensure that the productivity of SMEs can increase.

In this process, meanwhile, the importance of financial stability should not be downplayed. We must not forget that during the Great Moderation, in which we enjoyed stable inflation and appropriate growth for a long period of time, we failed to sense that the seeds of a crisis were being sown. We have so far been paying greater social and economic costs due to the uncertainties stemming from the crisis than we have yet realized. The rising corporate savings amid the crisis in most countries clearly indicate a lack of corporate investment due to uncertainty. And the resulting low growth is the price that we have been paying. Since there is a risk of mutual interaction between uncertainty and speculative activities, central banks have the responsibility to closely monitor market conditions in order to reduce the adverse effects caused by disruptive factors stemming from speculative capital.

Before concluding, I would like to say a few more words. Today we have been able to confirm together that there are incalculable challenges lying ahead of us. However, only an organization that confronts rather than shrinks from such challenges will thrive. It has become clear recently that our organization's response capability has been greatly enhanced, and that our employees have been actively utilizing their potentials. Based upon this confidence, let us further cultivate our public servant spirits as central bankers, so as to further strengthen our Bank's status as a central bank held in great respect by the public. We will need to develop ourselves so that our society becomes more interested in and more in demand of our talents. To this end, greater spirits of sacrifice and service should be the foundations of our lives. If we steadily move forward with consistency and a strong belief in our future, the Bank of Korea will be recognized for its contributions to the national economy. Perspiration, tears and pain are the fates of those who sow seeds. I look forward to seeing many such leaders emerging in our Bank.