

Choongsoo Kim: New Year Speech

New Year's address by Dr Choongsoo Kim, Governor of the Bank of Korea, at the Bank of Korea, Seoul, 2 January 2014.

* * *

The following is an unofficial English translation of the Governor's New Year Speech.

The New Year is dawning bright and clear. The Snake Year of 2013 has passed and 2014, the Year of the Horse, is now upon us. It has been almost four years since I first stood before you, to appeal that we all come together to bring about the rebirth of the Bank of Korea as a “leading central bank” under the banner of a “Global BOK”. During this time we have been reforming the Bank, with the primary aim of making it an institution that contributes to the development of the national economy and is loved by the public by bringing the Bank back into the arms of the Korean people, and I believe that we have achieved outstanding changes thanks to your dedication and efforts. Internationally, I can say with confidence that our stature has risen greatly, while internally I see many of our employees filled with a new sense of self-confidence. We are working in an atmosphere where it is no longer novel to be involved in tasks or projects characterized as “being done for the first time since the Bank’s founding.”

This new year is likely to be recorded in history as a turning point when a new economic paradigm took hold across the world, in other words when categorically new initiatives differing radically from those in the past were initiated. We will see signs of advanced economies including the United States breaking slowly free of the chains of the very severe Global Financial Crisis we have experienced over the past five years, the biggest such ordeal in nearly a century. We can also expect to find ourselves at a crossroads: either we turn back to the past, after the last few years when unconventional instruments have become the monetary policy mainstream, or we continue to develop new instruments going forward. Difficult new challenges will arise for us whichever course we choose. For the Korean economy, which is growing ever more deeply dependent upon the external economic environment, understanding of the international financial markets has become an essential factor for the operation of our own domestic policies. Responding swiftly with global insight is increasingly becoming a precondition for the solving of domestic issues. It is true that we have done our utmost to enhance our capacities for response to the shifting external environment. However, continuous efforts are still called for in the future, and for the sake of national economic development there must be no let-up in the pursuit of changes in this direction.

Dear fellow members of the Bank of Korea,

The Fed's decision two weeks ago to taper off its quantitative easing signalled a long-awaited policy shift. It had been noticed for quite some time that various indicators relating to US economic activity and labor market conditions had been showing trends of improvement, and the only remaining issue was what form the adjustment of market expectations related to quantitative easing would take. The Fed is considered to have guided the change smoothly so far, by drawing up a prudent and detailed plan that takes into consideration the impacts of tapering on the global economy, and by actively employing communication policy. Indeed, as the uncertainties about the changes in policy have lessened, stock markets in advanced economies have experienced unprecedented booms. Of course, going forward the questions remain of how the tapering will be undertaken, in terms of its size and pace, and of how interest rate normalization will be engineered. The lack of a global jurisdiction was cited as one of the causes underlying the Global Financial Crisis. However, a global jurisdiction has still not been properly established. And there thus remains a risk of the global economy falling into a multiple equilibria situation, in which a number of limited regional equilibria coexist. Moreover, besides the task of predicting and responding to the changes in US

policy, we are faced with added difficulties of swiftly identifying the effects and undertaking responses when the so-called G4 (the US, the Eurozone, Japan, and the UK), which had coordinated in their QE policies so far, all change their policy stances in different directions. As it is very difficult to forecast the direct and the indirect effects of such developments in advance, we need to respond in a flexible manner by keeping our guards up to ensure that we do not overlook any changes in the domestic and international markets by thinking flexibly.

The immediate response in the aftermath of the global financial crisis was, as you are all well aware, a global drive for financial regulatory reform to prevent recurrence of the crisis. Regulatory tightening as represented by Basel III and the Dodd-Frank Act has made considerable progress. Although the reform efforts will need to be continued going forward, agreement has been reached on a broad framework. Basel III on strengthening capital requirements will take effect globally from this year, and it has been decided that the Volcker Rule, which drew the most attention in the Dodd-Frank Act, will apply from July 2015. Although regulatory reform is crucial for the stable growth of the financial sector, it can also cause negative side effects in the short term by increasing the cost burdens for financial institutions and thus leading to a contraction of financial activities. The fact that an international agreement has been forged, and that the reform efforts have made some progress, has however had the positive effect of reducing the uncertainties about future changes.

The Bank of Korea can take pride in having ensured that domestic economic activity did not become estranged from international trends, by implementing its monetary and credit policies in line with changes in international financial markets, and in having stood up for our national interests by active involvement in the global efforts for regulatory reform. I would stress that the process whereby a substantial number of Bank of Korea staff participate in the G20, the IMF, the FSB and the Basel meetings, convey the meeting results to the Korean economic and financial community, and then report the domestic reactions back to these international meetings, has helped our economic agents to prepare themselves for handling the changes in the global economy and, at the same time, helped to ensure the reflection of our economic conditions in the regulatory and policy decision-making process as much as possible. Of course, we should be careful that this does not have the negative side effect of lessening our reform efforts to bring Korea's economic system into conformity with international norms.

My dear colleagues,

This year there will be many changes in the Bank of Korea's policies, as much as in the external environment. Given the Korean economy's heavy external dependence, in this situation of a rapidly changing and uncertain external environment it is not very realistic or wise for us to conduct economic policies in an inflexible manner by following previously set principles. This is because the downside risk caused by policy failure due to factors that we cannot control may be considerable. However, when the U.S. and other advanced economies begin to show signs of pulling out of their crises, we can achieve a certain degree of growth in line with favorable external economic conditions, and can therefore adopt measures to further strengthen the basis for long-term growth of the domestic Korean economy.

What challenges do you think are before us? As Korea's central bank, we need to pay close attention to the effectiveness and efficiency of our monetary and credit policies in carrying them out. With the G4 economies highly likely for the time being to adopt divergent policies, and to continue to develop new tools, we have to closely analyze the positive and negative effects of the implementation of non-traditional monetary policy tools that have been accumulating over time, and develop countermeasures to cope with them. Although quantitative easing policies, if looked at from the global economic perspective, can be considered to have helped the global economy to pull out of the crisis, we cannot deny that

they have also had side effects in some regional economies including emerging market economies, causing imbalances due to their negative spillover effects. Various measures were needed to correct market failures, but it cannot be said that they have completely cleared away doubts such as of whether moral hazard is widespread, whether market discipline is being established through the current measures at the expected level initially judged necessary to prevent crisis recurrence, and whether the too-big-to-fail behavior will be able to be eliminated. Various forms of liabilities are increasing due to the socialization of the costs of overcoming the crisis. How all of these liabilities, which have to be dealt with at the national level without individual agents assuming any responsibilities, can be resolved, and at what cost, remains a burden on us. Moreover, although the QE tapering decision must have been made based upon a judgment of US economic recovery, some within academia still raise the possibility of secular stagnation. Various factors are pointed out in this regard, including the global imbalances resulting from excessive savings in surplus countries, population ageing, declining productivity and the decreased volume of short-term investment due to the falling relative prices of capital goods, and we should pay attention to the development of this discussion going forward.

Forward guidance policies are prevalent in advanced economies. It is debatable whether it is appropriate for us to carry out forward guidance policies right now, but we may face situations that do not allow us to stay away from such policies for very long. Meanwhile, although we expect the transparency of our monetary policy to be enhanced through the use of this policy tool, the risk that the central bank's credibility may instead be threatened due to inaccurate economic forecasts is emerging. Since we have more difficulty than advanced economy central banks in forecasting the economy, attempting to carry out this policy is a great challenge to us, and this is another reason why the urgent need to develop our economic forecasting ability is materializing.

I have raised these issues, of course, to stress the importance of a good understanding of the relationship between the two major objectives that a central bank seeks to achieve – price stability and financial stability. Over the last year, consumer price inflation has not reached the lower limit of the inflation target range. Given the trend forecasts for economic growth, for inflation expectations and for the rate of wage growth, it would be appropriate to conclude, based on our experience, that the Korean economy is very unlikely to see low prices or deflation. However, in order to maintain monetary policy credibility, we should make further efforts to assist economic agents in understanding this situation. In particular, we need to help them to understand that the recent low inflation has been attributable largely to the downward trends of international oil, commodity and grain prices, and also partially to the government's free childcare and welfare policies on the domestic side.

Looking back on our achievements over the past year, there still remain several areas that need to be included or expanded in the Bank of Korea's responsibilities. Above all, we can confidently say that we have successfully made our activities more visible on both the domestic and the foreign scenes. The Bank of Korea's opinions were presented at renowned international conferences such as those of the Economic Club of New York and the G30, and at special international symposiums of the IMF. Domestically our paper on the changing environment and the challenges for monetary policy was presented to the Korea Economic Association, and we made full use of that occasion to articulate the Bank's position to academia. All of these were our first experiences of doing these things. Some examples of our firsts are as follow:

First, we took our initial step toward internationalization of the Korean won last year. We reached an agreement to use some of the proceeds of the Korea-China swap arrangement for trade settlement purposes, and have devoted much effort to putting this scheme in place. We also entered into swap arrangements with resource rich countries such as the UAE and Malaysia, which have opened the ways for expanding use of the Korean won in trade settlement, and we have reached agreement to sign a swap arrangement with Indonesia in the same context. We should continue our efforts to expand financial

cooperation at the central bank level with the countries that have signed FTAs with Korea, and I firmly believe that, when looking at the larger picture, these efforts will also offer a financial safety net not only for Korea but for our swap arrangement counterparts, to help them to cope with financial crises.

Second, the financial inclusion policy implemented around the world since the global financial crisis, and the Support Program for Credit Loan and Support Program for Small-scale Business Owners, being carried out as parts of our Bank Intermediated Lending Support Facilities, share the same goal, while the Support Program for Trade Financing and Support Program for High Tech Start-ups, for SMEs, are being used as credit policy tools. Since the financial crisis there may be a risk of deterioration of the income distribution structure, which will ultimately affect economic stability, and it is therefore time for central banks to play a certain role in this regard.

Third, while carrying out its responsibility of promoting financial stability, the Bank of Korea has been strengthening its role of representing the national interest in the formulation of international norms. Particularly, as long- and short-term liquidity regulations must be established during the course of finalizing Basel III over the next five years, which will greatly affect Korea's financial industry, we plan to participate more actively in this process.

Fourth, at the initiative of our regional branches, regular publication of the 「Golden Book」 has been launched, drawing much attention. The Golden Book project was carried out in the hope that the BOK's policy experiences will serve as triggers for regional economic development. While on the one hand striving to convey information on regional economic activities promptly, we also want the book to contribute to the formulation of regional economic development strategies, by providing in-depth analyses of a wide range of pressing issues in each region. At the initial stage of the project we consulted other central banks' reports such as the US Fed's 「Beige Book」, long well-known worldwide. We can, however, fairly say that we are blazing a new trail now, and that will before long bring the "Golden Book" international recognition as an unique Bank of Korea report. Alongside the central bank's conduct of monetary and credit policies, this is yet another unique way in which, given its 16 local branches, it can contribute to the national economy.

In the course of overcoming the global financial crisis, the Korean economy's reliance on exports has intensified further still. The challenge facing us is to achieve growth based upon a balance between exports and domestic demand. In other words, we should focus on policies that further promote domestic consumption and investment. While maintaining price and financial stability, it is also desirable that monetary and credit policies be conducted in ways consistent with this policy stance. Expanding domestic demand is also necessary for both improving the people's welfare and increasing employment. Last year outbound direct investment amounted to three times inward foreign direct investment. Although expansion abroad is desirable in terms of the creation of new opportunities, whether this is attributable to the relatively high prices of domestic factor inputs compared to international levels should be a subject of analysis for us going forward.

My fellow Bank of Korea staff members,

Looking back over the past year, we see that there were as many changes as in the previous few years before it. Above all, we carried out a groundbreaking modernization of the educational and training facilities of the BOK Academy, in line with our goal of operating the bank with a top priority given to development of our staff competencies. An old saying comes to mind anew in this regard: "If you want to live for one year, plant grains, and if you want to live for 10 years, grow trees; but if you want to live for 100 years, nurture talent." Using our state of the art facilities, education and training can now be carried out very efficiently, and there are also now places for the entire staff of a Department or an Office to gather for discussions. Staff members' study and analysis activities have become very active. Our published works last year totaled 436 papers in all, including 21 editions of our seven flagship reports including their English-language versions, along with 64 BOK issue

notes/economic reviews and economic studies. Almost half of this published output was related to analyses concerning our regional economies. Meanwhile, the number of international meetings and conferences that we hosted increased greatly as well. While we hosted only 12 international meetings and conferences in 2010, the number of such gatherings increased to 39 in 2013. Currently there are around 119 members of our staff actively involved in 95 international consultative bodies such as committees, fora, working-groups and task forces.

The launch of the 「Golden Book」 has significant implications for us, notably, as it has not only been well received by all of the regional economies but has also owed its success to thorough preparations made over long spans of time. It is even more significant in that its publication has allowed the potential of our regional branches to be unleashed. The importance of the research and study function in our regional offices has come to be recognized, an environment of cooperation has been created, and various initiatives such as the conduct of joint studies with foreign institutions have been actively undertaken. Of course, I strongly believe that restoring the self esteem of our regional branch staff also represents a substantial achievement.

I think the fact that the setting up of the BOK archives is almost in its final stage is another achievement of last year that we should not overlook. The Economic Research Institute has been leading the collection of analytical materials compiled by all Departments over the past few years, and the Reserve Management Group has been separately building its own archive including a database and manuals that will be utilized by connecting it to the BOK archives as a satellite archive. In the course of overcoming the global financial crisis, a commonly acknowledged phenomenon is that central banks have become knowledge institutions even more academic than academia itself. This is because a wide range of unconventional instruments have been designed and implemented by central banks, and they have continuously worked to refine these instruments by analyzing their effects on the markets, contributing thereby to overcoming of the crisis. I believe that it has been the existence of archives that has made such analyses possible. I also expect that the Bank of Korea will be able to take its current in-depth analyses one stage further before long. Looking back in the distant future, it will be judged that it was we here today who laid the foundation for the BOK's becoming a leading central bank. Confidence in the Bank of Korea will be heightened when it becomes a treasure-house of knowledge and information. And in this sense, I take pride in the fact that we have taken such a historically significant step.

Dear fellow BOK staff,

Thanks to our efforts over the past few years, changes can be seen in the culture of the Bank of Korea. Compared to in the past, an enterprising and proactive atmosphere has been encouraged, and I believe that a global and future-oriented mindset has taken hold. While the foundation for cooperation at home and abroad has been broadened, the fields in which we compete actively have also expanded. An atmosphere has been created in which various ideas converge by colliding with each other and by being debated. Perhaps one of the biggest changes over the last few years is that our efforts to narrow the information gaps among staff have borne great fruit. An environment in which staff debate freely as equals irrespective of their grades seems to have been established. I believe that some characteristics that were mentioned as our organization's in the past, such as a lack of openness and conservatism, will no longer be heard of. This, I believe, testifies to a recognition of the importance of the individual excellence of staff members. Provided that we as individuals constantly devote ourselves to honing our qualities, it will I am convinced be only a matter of time before the excellence of our BOK staff is widely acknowledged.

Ahead of us, however, exist many challenges that must be tackled by our staff as a whole. The process of overcoming the global financial crisis over the past few years has come as a chance for us to seriously reflect on the appropriateness of our systems and policies. We should seek to reexamine whether the systems put in place and operated, which

were appropriate to conditions prevailing at particular times before, are still effective. Although it would be risky to reform a system during a crisis, it will be appropriate to build a new one once the crisis has been overcome. It is clear that, if the institutional arrangements or policies in the real and financial sectors introduced at the initial stage of globalization continue to be implemented nowadays, they will pose burdens to operation of the economy. If arrangements no longer in accord with the times are kept in place, we cannot rule out the possibility that this may actually cause the economy to regress to an earlier state, or hinder its future development. I think that there are a multitude of tasks to be examined in drawing up an overall long-term vision concerning the financial, foreign exchange and capital market sectors. This will apply to the institutional arrangements introduced in response to particular Korean conditions at each stage of our economic development, although the effectiveness of specific systems will also need to be looked into in detail. This is not a problem that can be fully resolved in a short span of time, but it is time now to start analyzing their suitability in light of the level of development of the Korean economy and international norms. I believe that it is also an issue closely related to the future role of the central bank.

It is no exaggeration to say that communication policy is a topic raised internationally related to evaluating the performance of the monetary policy authorities. The importance of communication policy is of course greater in advanced economies, but as time goes by Korea will no longer be an exception from this, and it is becoming impossible to not stress sufficiently the importance of communication for all businesses of all economic agents and central banks. In anticipation of this issue, the Bank of Korea set up a department in charge of communication in early 2012, even before it was being discussed seriously in advanced countries. I think that the success of the operation of such a department depends upon how well it can fit in with and network with all of the various other departments of the organization. It seems pointless for it to take charge of communication independently, because success in its operation relies on enthusiasm and an ability to grasp and understand the overall business of the organization. Noise inevitably appears in a situation where uncertainty exists in the market and there is less than a full understanding of economic policy, and so monetary policy should be implemented in such way as to boost the ratio of the signal relative to the noise, with communication policy serving a complementary function in this process.

Meanwhile, the ageing of our organization, one of the Bank's very distinctive characteristics, is a responsibility that we should resolve ourselves. It is a reality for us that, among our close to 2,200 BOK staff, more than 600 have been working for the Bank for 30 years or more while the number of those who have worked here for between 20 and 29 years reaches almost 500, so that around one half of our entire staff have been working here for 20 years or longer. Among about 1,150 staff at the grades of lead manager to economist, more than 300 have been here for 30 years or more. It would be hard to find this type of manpower structure anywhere else. The most difficult challenge for our Bank's human resource and organizational management policy over the past three years has been the revitalization of our organizational operations. We needed to keep in balance with other organizations within our society. Through our experience, we understand well the situation that aged countries and organizations face. And we can overcome this problem only by continuing to improve our productivity by applying very high levels of work discipline to ourselves. We must all remain alert until the moment we retire, and contribute to the development of our organization and the nation through the use of our experience and creation of high added value. As the central bank, which should serve as a model for the nation, I do not think there is any time for us to hesitate in imposing strict working practices on ourselves under this principle. We should bear in mind that the Bank can avoid losing touch with our society as a whole only by continuing our efforts for self-reform.

It is we ourselves who must create the Bank of Korea's standing. We can win respect from others only when we engage in constant self-examination and have the courage and modesty to apply stricter standards to ourselves than to others. Only when we have created an environment in which we can compete against all comers from both within and outside the

organization, based on open-mindedness and open practices, can we keep ourselves on a tight rein and hone our skills. We should constantly bear in mind the question, “What does the Bank of Korea mean to me, and who am I to the Bank of Korea?” If you get into the habit of asking yourself, “What if this organization were to work well without me?” as you go about your business, you will develop yourselves as time passes. The easy way means doing a familiar job, which will only result in following the same old path as in the past. Long-term employees will of course have contributed more greatly to the development of the current organization than short-term employees. However, the future of the organization lies in its young employees, and therefore when institutional consideration is given to younger workers who will work for longer periods to encourage their further development, we can say that they are being treated with respect. We must all understand that this is also a precondition for securing higher quality minds, and that such efforts are a shortcut to establishing a virtuous circle ensuring that the organization develops another stage further as a result.

When we come together like this, to choose the difficult path of reaching out to “the future and to the world”, glorious days will unfold before us. The future belongs to those who are prepared for it. The year 2014 is called the year of the blue horse. Legend has it that it brings people fortune. And what greater fortune for us is there than national economic development and a flourishing Bank of Korea? I hope that 2014 will be a year in which the practice of sowing seeds continuously takes root, rather than that of trying to reap the harvest of those sown in the past many years.

In this new Year ahead of us, I wish the very best of good fortune and happiness to all members of the BOK and their families.

January 2, 2014
Choongsoo Kim
Governor
The Bank of Korea