

Seongtae Lee: The global financial crisis and the Bank of Korea's monetary policy

Keynote address by Mr Seongtae Lee, Governor of the Bank of Korea, at the Euromoney Conference, Seoul, 28 May 2009.

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Greetings

Ladies and gentlemen,

I am delighted to be here to speak at "The Euromoney Korean Capital Markets Congress 2009" with prominent institutional investors, financiers and academic experts from around the world.

My remarks today will focus on the recent global financial crisis, the Bank of Korea's monetary policy response, and the tasks that remain in the future.

Development and impact of the global financial crisis

Ladies and gentlemen,

As you know, this global financial crisis struck as the impact of the US sub-prime mortgage meltdown spread worldwide and it triggered a synchronized global economic downturn.

The main reason that this financial crisis spread with such a wide range and at such unprecedented speed lies in the massive progress made in the integration of the world economy and financial markets over the last two decades.

As this crisis progressed, Korea and other emerging market countries were unable to avoid its impacts even though they did not have large sub-prime mortgage related exposures. Rather they experienced deteriorating foreign currency supply and demand conditions and credit crunches, as funds flowed out due to deleveraging by overseas financial institutions in response to heightened concerns about credit risk. Their real economies also slipped into recessions, as their exports shrank rapidly owing to the contraction of import demand in advanced countries.

The Bank of Korea's policy response and its effects

Ladies and gentlemen,

The Bank of Korea eased its monetary policy aggressively, to soothe the financial market unrest and ward off a sharp contraction of the real economy. It brought its Base Rate down by a total of 3.25 percentage points, to its lowest level of 2%, in six steps from last October until this February. Along with this, it strove to expand provision of liquidity to sectors badly affected by the credit crunch through its open market operations and lending facilities. At the same time, it actively provided foreign-currency liquidity to domestic financial institutions through, for example, the swap market, in order to stabilize the foreign exchange market that was directly hit by the impact of the global financial crisis. It also entered into currency swap arrangements with the central banks of the United States, Japan and China.

The Korean financial and foreign exchange markets have recently been showing a pattern of improved movements helped by these actions. Long- and short-term market interest rates are maintaining downward stability while stock prices and the exchange value of the Korean won have rebounded substantially. In addition, the issuance of corporate bonds is proceeding seamlessly and bank lending to households and SMEs is steadily increasing.

In the real economy, the speed of the downturn has clearly moderated, and some economic and confidence indicators are showing better movements than expected. As a result of these developments, the perception of the Korean economy among foreign investors has improved considerably. There remain, however, downside risks to economic growth for the future, due to the persistence of the global economic downturn and the worsening of domestic labor market conditions.

Tasks ahead

Ladies and gentlemen,

The Bank of Korea will, for the time being, conduct its monetary policy with a main emphasis on supporting the recovery of economic activity and stabilizing the financial markets. It is still uncertain whether the green shoots of recovery in the financial markets and real economy will continue into full leaf. Even if this monetary easing stance is maintained for a while, prices are expected to remain on their downwardly stable track since demand-side inflation pressures are almost absent.

The experience of this global financial crisis has served to spur full recognition of the vital necessity for efforts to secure financial stability. The legal framework in relation to financial stability requires overhauling in this context, but to my mind, in light of past experience, what is of great importance for Korea and other small open economies is to draw up proposals to reduce the potential for financial unrest arising from large-scale in- and outflows of foreign capital. Of course, international agreement should be reached as a prior condition for such proposals, through discussions in forums such as the G-20, since they could restrict market principles and give rise to conflicts of interest among countries.

I would also point out that for Korea, the bilateral currency swap arrangements have been of considerable help in calming foreign exchange market unrest during this crisis. Consequently, we will seek to strengthen our international financial cooperation still further by, for example, striving to construct a framework of multilateral currency swap arrangements among countries in the Asian region.

Closing remarks

Ladies and gentlemen,

Drawing my remarks to a close, let me express my profound hope that everyone at this conference will obtain fruitful information concerning the Korean economy and take part in a lively exchange of opinions. And, as a result, I trust that this conference will contribute to the flourishing development of the institutions represented here and to the stability and growth of the Korean economy.

Thank you.