

## Seongtae Lee: Bank of Korea faces the challenges ahead

Speech by Mr Seongtae Lee, Governor and Chairman of the Bank of Korea, at the Bank of Korea's 59th Anniversary, Bank of Korea, Seoul, 12 June 2009.

\* \* \*

Fellow members of the Bank of Korea,

Today is the 59th anniversary of the founding of the Bank of Korea as Korea's central bank. First, I would like to thank all those who have contributed so much to making the Bank what it is today. I would also give thanks to all of our members for their hard work in tackling the difficulties arising from the global financial crisis.

In the wake of Lehman Brothers' filing for bankruptcy protection in September last year, the financial markets and real economic conditions worsened significantly. Recently, however, the economy has been showing signs of improvement. The economic downturn appears to have flattened out, with some economic and confidence indicators showing favorable movements. In the financial markets, stock prices have rebounded and the flow of funds to the corporate sector is on a steady rise. The Korean won has appreciated and foreign currency liquidity conditions have improved substantially as the current account has shifted to a sizable surplus.

This is thanks partly to the improved external conditions, with the moderation of the global financial market unrest, but chiefly to the wide-ranging policy measures taken by the government and the Bank of Korea. The Bank has actively implemented monetary easing policy, lowering its Base Rate to a record low of 2.0 percent and making use of open market operations and lending facilities to mitigate the credit crunch. Together with this, in order to stabilize the foreign exchange market, the Bank has supplied foreign currency liquidity to financial institutions and established currency swap arrangements with central banks such as the US Federal Reserve.

The Korean economy seems set to continue its recent improving trend, but it will be no easy matter for it to shift to a full-fledged recovery track given the several destabilizing factors that still exist both at home and abroad. First, it will take considerable time for the global financial markets to return to normal, due to the prolonged global economic recession and the delay in cleaning up and adjusting the balance sheets of major countries' financial institutions. There is also the likelihood that the upward trend in prices of oil and other commodities may slow down the economic recovery and hamper price stability. In addition, there are geopolitical risks present concerning the North Korean nuclear issue.

My dear colleagues,

There are many policy tasks to be pursued for our economy to overcome the shocks caused by the global financial crisis, and what is more, to maintain steady growth.

First of all, efforts to build up a foundation for more robust domestic demand should be continued. The global economic outlook makes it difficult to expect a rapid recovery of Korean exports for the time being. A worsening employment situation, moreover, may hinder the recovery of private consumption and, along with sluggish facilities investment, lower the growth potential. In this regard, it is important to promote a virtuous circle of employment and growth and to strengthen economic resilience against external shocks through making continued policy efforts to boost domestic demand and create jobs.

As it seems that the economic crisis has passed its peak, corporate restructuring has to be speeded up. If the resolution of ailing companies is delayed, it will be difficult for the financial markets to return to normal at an early stage with concerns over credit risk left unsolved, while there is also the possibility that the external competitiveness of the Korean economy may be reduced.

The financial and foreign exchange markets presently seem fairly stable, but more efforts need to be devoted to keep them on a firm track. As part of such efforts, it is necessary to develop measures which reduce the possibilities of market unrest from the large-scale in- and outflows of foreign capital, while lessening dependence on short-term external debt. Even when the financial markets and real economic conditions recover from this crisis, there is a need to devise means of preventing financial institutions from becoming locked into excessive competition for asset growth.

There should also be a keen awareness that the accommodative monetary and fiscal policies implemented to tackle this crisis could impose a burden on the economy in the medium- and long-term horizon.

My dear colleagues,

I would now like to talk about what the Bank of Korea should promote as its top priority in the second half of this year and beyond.

The Bank should conduct interest rate policy with a main emphasis on supporting the continuation of the recent improvement in the real economy and the financial markets. The Bank will also pay close attention to the possibilities that a rise in international commodity prices may disrupt the low and stable trend of prices and that rapidly swelling short-term liquidity may cause instability in asset prices such as those of real estate.

The Bank also has to make constant efforts to strengthen the foundation for financial stability. There is a need to examine the desirable scope of the Bank's financial stability role drawing on our experience of this financial crisis, and discussions concerning framework reform proposals and actual instances in major countries. In addition, the Bank should endeavor to ensure that the general stance of emerging market countries, including Korea, is fully reflected in the course of reaching a global consensus on financial stability. To this end, we have to participate actively in discussions at G-20 meetings as well as in the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS), both of which our nation joined in March.

We have to do our best to set the inflation target, to be adopted for the period from next year onward, at an appropriate level. Although inflation targeting per se is assessed to have contributed considerably to price stability, both domestically and internationally, the Bank must also review any shortcomings in the system based on its past experiences. The Bank should make improvements in its operation, if necessary.

Among the key projects we are now pursuing, I would like to mention two in particular. The running of the new BOK-Wire+, which went into operation this May, should be stable and seamless. And every effort must be made to ensure the trouble-free supply and circulation of the 50,000-won banknotes, to be introduced from June 23.

The various other businesses we handle should also be carried out without the slightest slip-up. Settlement risk needs to be managed still more thoroughly to cope with the expanded participation of non-bank financial institutions in the payment and settlement system. We must take great pains to ensure that the systems introduced for improving the efficiency of liquidity management, such as fungible issuance and prior fixed rate tenders for Monetary Stabilization Bonds, achieve their desired results. In the management of the foreign reserves, we should do our utmost to upgrade risk management further and come up with ways to achieve stable returns in this period of low interest rates worldwide.

My dear colleagues,

The direction of financial and economic change at home and abroad remains very uncertain. As a result, the central bank's accurate assessment of the situation and selecting of timely and effective policy options are more important than ever for the national economy. Carrying out this mission, the Bank should arrange its organizational and personnel management in such a way as to maximize its potential. Full consideration also needs to be given to a new

organization in charge of activities related to the international financial institutions that the country has recently joined to ensure that it plays its role to the full.

The Bank should also endeavor to improve internal management. Given that the efficiency of the public sector is now subject to stricter external evaluation and that many people are suffering hardship due to the difficult economic situation, the Bank has to redouble its efforts to get rid of any organizational shortcomings and save costs.

Fellow members of the Bank of Korea,

The Bank of Korea has undertaken active policy initiatives in response to this global financial crisis. These actions have contributed greatly to moderating the economic difficulties.

Yet still the crisis is far from over and new policy tasks are expected to arise even after the crisis passes. Therefore, we should stay vigilant and remember once again that it is our mission to maximize the potential of each and every member of staff in order to achieve the stability of the national economy and its development. Through our unstinted efforts toward this, the economy will return to normal earlier and the public credibility of the Bank of Korea will be anchored still more firmly.

On this special day on which we celebrate the 59th anniversary of our foundation, I once again appreciate your devoted commitment. I wish you and those you hold dear the best of health and the greatest of happiness.

Thank you.