

Choongsoo Kim: 62nd anniversary of the Bank of Korea

Speech by Mr Choongsoo Kim, Governor of the Bank of Korea, commemorating the Bank of Korea's 62nd anniversary, Seoul, 12 June 2012.

The following is an unofficial English translation.

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Dear fellow members of the Bank of Korea,

We are all gathered here today to commemorate the 62nd anniversary of the Bank of Korea's establishment. We take pride in the Bank of Korea's dedicated performance of its role as the central bank of the Republic of Korea during our economy's achievement of remarkable economic development in the world over the past half century, rising from the level of one of the poorest countries to reach the threshold of advanced country status, and there cannot be even the slightest wavering in our resolution to continue sincerely carrying out our duties going forward as well. Exactly one year ago today, in this place, we pledged to make the following year's anniversary ceremony an occasion to confirm the Bank of Korea's heightened stature. We also solemnly expressed it as our call in this age to set up a new stature of the Bank of Korea, standing tall in the world upon the foundation of the enduring history and tradition built up over the many years since our Bank's establishment by those who served before us. I in addition appealed to you to set out together to create a global BOK, with the resolve to be reborn – as the Bank had come to complete what is comparable to a 60-year life cycle in the Orient and embarked on a new one. Each year we have used this anniversary ceremony as an opportunity to straighten our backs and reaffirm our determination. And at this year's ceremony I would like to look first into the domestic and external conditions surrounding us, to examine secondly the changing role of central banks called for since the global crisis, and to then finally examine the waves of change that all of us are together now seeking to push forward. I should like to take this opportunity to reflect once again on our vision and resolution, with a “new self each day and the next” (日日新又日新) conviction embodying the self-discipline to always ceaselessly develop oneself further.

Dear friends and colleagues,

First of all, let us look at the international economic environment surrounding us. Despite the efforts on the parts of individual countries over the past five years the global economy remains unable to pull itself out of the Global Financial Crisis, referred to as the most severe since the 1930s “Great Depression.” Commenting on the gravity of this economic crisis, some scholars say that the “Great Recession” is underway. Not only is there still no way to tell when this crisis will end, but even the conditions for its conclusion cannot be clearly defined. The financial crisis that began on Wall Street in the US spread to Europe and has turned into a sovereign debt crisis, solutions to which are unfathomable. To prevent future outbreaks of financial crisis the introduction of various tasks for global financial reform is being pushed forward, as represented by Basel III, OTC derivatives reforms, publication of the Principles for Financial Market Infrastructures and regulations associated with shadow banking. And in this world, where all economies are interconnected, these reform tasks must be applied in all countries without exception; otherwise the so-called regulatory arbitrage issue will emerge, and the global financial reforms will be unable to show their desired effects.

If these new regulations are introduced uniformly, however, in a situation where the reality is that stages of financial development differ across countries, the issues we will need to worry about will likely number more than just one or two, including whether the level of impact and strain on an individual country's financial competitiveness can indeed be bearable, and whether as a consequence its financial system can be operated smoothly. And although on

the one hand these regulations are expected to be effective in preventing recurrence of the kinds of financial crises observed to date, challenges will continue to emerge concerning whether future financial crises will indeed come in the same patterns as in the past, and if not what crisis defense mechanisms should be devised.

Worldwide economic uncertainty will not disappear unless there is a convergence of opinions among European countries as to whether the eurozone system will be preserved in its current state or take on some new form. The situation urgently requires determination on the part of political leaders. With regard to the Greece problem, I anticipate that the Greek people and the eurozone countries will make wise choices; no matter what political decisions are made, however, the fallouts under various possible scenarios may be assumed to have already been reflected to some extent in market conditions. There will of course be costs of risks accompanying political decisions, but we can say that the uncertainties arising from unexpected events have decreased probabilistically compared to in the past. In the case of Spain's troubled banks, which are being highlighted as a problem recently, I hope that the decision at last weekend's European finance ministers' meeting to provide a massive bailout will provide a lead to solving the problem, and expect that the related governments and financial sectors have developed the capacities for dealing with banking distress, given the learning effects related to the manner in which such distress progresses rapidly.

The problem of whether the single currency system that is the euro will continue to exist may be said to hinge on whether a consensus is formed on a project duly recognized since the early days of the system's establishment, *i.e.* finding a way for members engaging in differentiated economic activities to appropriately share and shoulder the different benefits and costs to each created in the course of their all using a single currency. A pressing issue linked to this is the problem of whether all advanced countries' debt problems will be solved and their fiscal policy soundness ultimately achieved. Debates surrounding the effectiveness of Keynesian policy are not ending. Moreover, the expression "Keynesian Populism" is making an appearance. If austerity policies cause economic contraction and thus further exacerbate recession, the issues then are how far fiscal soundness can be compromised, what the means for expanding government finance unlimitedly are, and what the expected effects are. In the past, such discussions took place within the walls of the fiscal authorities; since the crisis, however, central banks are also participating in these macroeconomic policy discussions. And as I have stressed many times, this is because in overcoming a crisis the role of central banks cannot be neglected.

We have to seriously analyze whether, in the absence of recoveries in the U.S. and Europe of their own economic growth potentials, there is a possibility of the current crisis being resolved by any other means. With their fiscal spaces exhausted, it is not easy to expect them to come up with any growth-inducing measures on their own. If the quantitative easing policies, termed LTRO and QE, are additionally implemented, this should help temporarily in for instance stabilizing the financial markets and enhancing soundness by preventing excessive deleveraging on the parts of troubled banks thanks to their securing of liquidity; in a situation in which such additional supply of money does not fundamentally lead to credit extension to the private sector, however, *i.e.* even when liquidity is injected it is only financial institutions' soundness indicators that are improved, via purchases of government bonds only, what is critical is how measures can be formulated to enable these improvements to be transmitted to the real sector so that the economy runs properly and growth is achieved.

Another real problem is that the political responses to outbreaks of crisis are not swift. When trouble at a financial institution arises, potential problems that had been latent materialize from the moment trouble is first recognized, and their sizes then grow exponentially, but government policies in response, and particularly in the case when a number of nations are involved, are bound to be made slowly since political decisions require reconciling the conflicts of interest among individual countries that inevitably arise. In most cases this then leads to the inferior, sub-optimal results instead of the optimal ones. Consequently, I would say that there is a tendency for the global economy to face a situation in which the trend

shown is for any problem once it arises to instead of improving rather worsen. And this is attributable to the fundamental vulnerability of the global economy, *i.e.* that we live in a global economy but there is no global jurisdiction.

Inducing of global economic growth through growth in regions with high growth potentials can perhaps be considered as a shortcut to resolving this crisis that broke out in advanced economies. Why not apply the basic rule of economic restructuring, whereby capital and labor in sectors having low productivity are shifted to those with higher productivity? The current state of affairs that has resulted is one in which policies are carried out *au contraire* to the economic principles of restructuring, as the world's capital is now concentrated in its least productive areas. In the past as well, the premise of economic recovery was that a certain region of the world had to be growing. There is no doubt, for example, that during the Asian currency crisis U.S. and European economic growth contributed to the Asian economies' recoveries from it.

According to IMF estimates, emerging Asian economies' contribution to global GDP growth has risen from below the 30% level in the 1970s, to the mid-40% range in the 1980s up until the global financial crisis and as high as 50% during the past five years of the crisis, and is expected to be maintained at such a level for the time being going forward as well. It follows, then, that Asia's emerging economies should play a pivotal role in resolving the current economic crisis. To this end, we need to ensure above all that emerging economies' policy responses for maintaining growth are not frustrated due to external risk factors, by developing measures to minimize the negative spillover effects from the quantitative easing policies in the U.S. and Europe, and hence preserving financial system stability. Various types of macroprudential measures can be considered as alternatives in this regard. The key is that emerging economies must take the initiative and devote concerted efforts to convincing various international fora of these proposals and to seeing them through. The crisis-stricken countries will not be able to create such an environment for emerging economies. I believe that Korea, too, has reached the point where it must take the lead in contributing to the creation of such an environment in the international arena, and that the Bank of Korea is also not free from this responsibility.

Dear members of the Bank of Korea,

I should like us to look now into what changes in central bank monetary policies are implied by the changes in the global economic environment we have discussed together so far. Our economy has become one in which macroeconomic management including the conduct of price stability, financial stability and fiscal policies cannot be effective when these are determined separately. Creating an optimal macroeconomic policy mix was certainly a major challenge in the past as well, in terms of maximizing their impact, but as the degree of interconnectedness among all sectors has risen it has now become a necessary condition for achieving results. The reality today is that most advanced economies have been for a long time unable to pull out from the zero-lower bound – which if now were like in the past would have raised concerns about an erosion of monetary policy effectiveness due to liquidity traps. It is an open secret now that our Economics textbooks need to be rewritten in the wake of the global financial crisis. I have emphasized time and again that the global trend has not only caused economic borders to disappear, but also removed pre-existing divisions of business areas in terms of the varieties of economic activities carried out in them. In this world, whose individual economies are all interlinked in one form or another, the strange phenomenon of the tail wagging the body can no longer be deemed exceptional. It has become more important to understand tail risks, which are hard to predict due to their low probability, than it is high probability events. What we have to reflect seriously on is the issue of whether an event that has occurred was from the tail as originally expected, or whether the shape of the distribution had already changed and the event had in fact migrated from the tail to the body but we were oblivious of this change in circumstances and had sought to analyze it as a low probability event based upon an outdated distribution. We can all see ourselves as facing a situation in which even the world's leading financial institution in the area of risk management

suffers huge material and reputational losses on its derivatives transactions, and in which, while the financial industry is said to have contributed to national welfare through the development of financial engineering we are now instead intellectually besieged by the advances made in it, *i.e.* where financial engineering dominates the thinking of market participants. A situation is unfolding in which it would be difficult for us to discuss monetary policy in isolation from risk management, and in this sense we can see that an organic relationship between macroprudential policy and monetary policy is in the making. This is also the reason why the central bank must simultaneously worry about both price and financial stability.

In a situation in which risk management is being pushed anew as an important undertaking amid a prevalence of information asymmetries, I question whether the conduct of monetary policy using a set of several rules established based upon past economic conditions can be said to be proper and valid. The situation has become such that the impact on monetary policy of the negative burdens placed on the central bank's balance sheet in the course of implementing policies of fiscal dominance cannot be ignored. Arguments disputing the effectiveness of inflation targeting policies have been presented by academia. The fact that the first direct trade between the Japanese yen and the Chinese yuan has now been made also makes those of us accustomed to the dollar reserve currency regime think that there is a possibility of a paradigm shift coming. We can see that the importance of building networks among central banks is growing larger by the day, and the role of central banks too is becoming greatly diversified. It is no stretch to say that it is becoming the norm in many countries now for all of their relevant institutions to cooperate in pursuing their nation's macroeconomic and risk management. A consensus has grown that the overcoming of dynamic economic crises we have never encountered before is difficult to achieve if we stick only to our existing knowledge and practices. Under these circumstances, flexibility in our institutional and policy operations is needed, and contemplation and concern to understand new developments demanded. The principle that if all economies are interconnected, then so too must be the pursuit of measures for dealing with this, can be seen as in accord with common sense.

The revision of the Bank of Korea Act last year may be taken as having established the conditions enabling us to adapt to the rapidly changing international financial environment. A variety of opinions can be suggested, from the historical and cultural perspectives, as to which central bank system a country should have and what kinds of relationships it should form with the relevant government departments. One certainty in the global economic trends, however, is that maintaining a domestic system inconsistent with these global trends is undesirable. It is in this sense that I appraise the Bank of Korea Act revision as a highly desirable change, in that it created the minimum conditions enabling the Bank of Korea to act on behalf of national interests on the international stage. It is a global trend for the central bank to carry out financial stability functions, and the Bank of Korea can now take part in doing so. What remains then is for us to fulfill our part. We must build the capacity to properly understand and accommodate the global reform agendas related to financial stability being put together recently, and by so doing be able to identify and handle in advance risk factors that break out on the international scene. We must raise our stature high enough to break from the past, when having immersed ourselves in domestic risk factor analysis alone we could not but plead that we were innocent bystanders when struck by crises driven by international factors.

As important as redefining the role of the Bank of Korea from a global and from a medium- to long-term perspective is, wisely overcoming the difficulties that befall us in the short term is also a very important matter. It is difficult to expect that the uncertain international environment will be conducive to stable growth of our economy. When the US and European economies are not growing as they should, and as a consequence Chinese economic growth is also slowing, we cannot expect the Korean economy, whose dependence on exports is very high, to be unaffected and its economic activity brisk. The negative effects of the US

and European quantitative easing policies are also threatening us. And although their influence is said to be less than in 2008, the adverse effects on our stock and capital markets and on our stable management of foreign exchange rates cannot be overlooked. The consumer price index has been posting a rate of increase in the mid-2 percent range recently, but when adjusted for the effects on its decline attributable to the child care support and other government welfare policies consumer prices are inferred to be running in the lower 3% range still, and since the inflation expectations of the general public sit at the mid-to upper-3% range – although they are showing a downward trend these days – we cannot let our guards down. We are at a point where we must analyze even more diligently the gap and distinction between the CPI, which indexes the costs of living, and our economy's core inflation. The fact that the work that we need to do and agonize over is increasing must not lead to an outcome where we neglect the Bank's price stability mandate, our innate calling.

Dear members of the BOK family,

I should like finally for us to together solidify our resolve once more, while identifying the reform tasks that we must push ahead in order to cope with the changes in economic environment at home and abroad that I have alluded to, and while also going over our achievements to date. We must move forward internally to make the numerous challenges facing us opportunities for growth. Such challenges have always been lurking around us, and we must henceforth proactively detect them and make use of them as opportunities for development, both individually and collectively as an organization. There is not a moment to lose in the task of opening our eyes wide to identify the changes in this world and developing our abilities for responding to them. This age that we live in has become one in which policies not in harmony with the international community cannot be effective, and in which credibility cannot be maintained if we lose touch with domestic society. I suppose that the focus by central banks around the world on communication comes from this same logic.

According to data released just a few days ago, the Bank of Korea has engaged in a total of 84 research projects since 2011: 27 joint research projects with foreign institutions, 20 domestic joint research projects at the headquarters level and 24 at the regional branch level, and 13 collaborative research projects within the Bank itself – of which 49 projects have already been completed. In addition, our executives are participating in 16 working groups of international organizations such as the BIS, and another 63 of our staff members in 50 working groups. When each of these people is viewed as representing the Bank of Korea, the outcome achieved should be taken as having been an expansion in the Bank's presence in the world stage by some tenfold in relative terms. Changes that we could not even imagine just a few years ago are happening this vibrantly before we are even aware of them. We are face to face with dynamic economic change. In addition, the on-the-job training opportunities at international organizations participated in by 10 or so of our staff continue to be available, and our Global Initiative Program (GIP), to which world-renowned figures are invited and which we attend together with staff from other central banks, is also being actively promoted. Our overseas representative offices moreover deliver useful information to headquarters in a timely manner, and at our regional branches as well various high quality joint research is being conducted – all of which things were hard to foresee in the past and of which I am very proud. Self-praise that others might not agree on should of course be cautioned against. The significances of the changes that I have mentioned could be found in the context of their being actual supporting evidence of your potentials coming to be recognized in communities at home and abroad. Needless to say, these changes should be regarded as outcomes produced through the joining of all of our forces, to heighten our organizational strength, rather than through the efforts of only a few people.

Since last summer, and for the first time since the Bank's foundation, gatherings of all of our almost 200 team heads have been held twice. At these meetings changes in our roles in line with the revision of the Bank of Korea Act were discussed, and medium- to long-term visions pledging the Bank of Korea's development were established on our own and announced. Last month an athletic meet was held that brought together all staff from our headquarters

and 16 regional branches – also for the first time since our foundation. I believe that this was an opportunity for all of our members to meet one another and an occasion to confirm our being “one family”. The most prized reward of these gatherings was the instilling of a strong sense of belonging in all employees. In addition, we developed the administrative capacity to organize and run such large events, and together shared an awareness that there are always people serving and sacrificing for the sake of this whole organization – important rewards that I must say cannot be overlooked.

We must renovate our thoughts and behavior, to bring ourselves closer to the international community while at the same time avoiding isolation from domestic society. The Korean economy is no longer small in world society now. We need to develop our abilities to present to the world our ideas for world development and lead international society in the directions that we desire, rather than remaining at the level only of understanding the words that others speak. And our opinions should not be limited to those concerning the impacts of the international environment on our economy; we can be leaders only when we can talk about proposals for world development and our contributions to it. At home as well, we should take one step further from the passive stance of criticizing opinions suggested by others, and strive to actively propose alternatives and enthusiastically contribute to social development. To this end we must possess leadership and a volunteer spirit, to make efforts greater than others and to lead them. It is however difficult to bring about such a change in thinking by remaining complacent behind the walls of the central bank with its monopoly status. We should boldly show ourselves, and play a part in making the Bank of Korea an organization of a higher intellectual level. Making the Bank of Korea a world-class organization is our mandate, and our efforts to achieve this should not halt for even one single moment. And in order for the Bank of Korea to be first-class, each of us must also be first-class. We cannot expect our organization to be first-rate if we ourselves are second-rate.

The Bank of Korea continues to change. And the key to this change is making an organization that invests in people and nurtures talent, has an international eye so as not to fall behind the global trends, and contributes actively to social development. Change must be as well-managed as it is well-initiated if it is to produce the desired effects. Only when the seeds are sown will there be someone who reaps; and now is the time to sow. These are old words, but I would like to paraphrase President Kennedy here, and say that now is the time for many staff members to step forward, asking not what the Bank of Korea can do for them but pondering what they can do for the Bank of Korea. And our “pool of resources” should be enlarged abundantly as a result. I would like in particular to ask our long-serving staff members to make, *i.e.* sow the seeds of, a tradition of without fail leaving behind the footprints of your contributions over the years to the Bank of Korea’s development.

Change will at first generate dust. However, we should strive to incessantly improve ourselves so that once this dust settles we can confirm that our stature has risen another notch. There is nothing that we can gain without sacrifice and pain, and there is no royal road to success. The time when we took pride in protecting the Bank of Korea from outside in a passive sense has now become the past. Let us try to become inscribed in Bank of Korea history as dedicated people who played a leading role through their progressive, aggressive efforts to remake the Bank of Korea as an advanced central bank with an international stature, and a new central bank contributing actively to national economic development.

I would like to conclude my 62nd anniversary remarks now, trusting that when we meet again at this same spot one year from today we will be able to share together great pride in having shaped with all our might a Bank of Korea whose status is one notch higher. I wish the very best of health and fortune to all of you and your families.