Juyeol Lee: Leverage in Asia

Opening address by Mr Juyeol Lee, Governor of the Bank of Korea, at the Bank of Korea-IMF conference "Leverage in Asia: Lessons from the Past, What's New Now?, and Where to Watch Out For?", Seoul, 11 December 2015.

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Greeting

Ladies and gentlemen,

It is a great pleasure for the Bank of Korea, together with the IMF, to host this conference on "Leverage in Asia," which is sponsored by the Korean Ministry of Strategy and Finance. I sincerely welcome all of you attending. My special gratitude goes to Director Siddharth Tiwari of the IMF Strategy, Policy and Review Department, our keynote speaker, and to Deputy Director Kalpana Kochhar of the IMF Asia and Pacific Department, the conference co-organizer. I would also like to thank First Vice Minister Joo Hyung-Hwan of the Ministry of Strategy and Finance, who will deliver the welcoming remarks. Let me express sincere appreciation as well to all of our esteemed conference speakers, discussants, moderators, and panelists.

Leverage in emerging market economies has drawn increased attention lately, given the so-called G2 risks, stemming from U.S. monetary policy normalization and slowing growth in China. At this important juncture, I think today's conference is a very meaningful opportunity to consider the current status of leverage in Asia and the related potential risks, in order to seek effective policy measures in response.

Current status of leverage in Asia

During the global financial crisis, the global economy suffered a severe recession. Asian economies were also affected, but managed to recover from the crisis relatively quickly thanks to their lower leverage compared to the U.S. and Europe.

Whereas advanced countries have carried out deleveraging since the crisis, leverage ratios in Korea and many other Asian countries have been rising. This is due largely to the abundant global liquidity provided by major advanced countries through their unprecedented quantitative easing, and to the accommodative policies pursued in Asian countries. The resulting lower borrowing costs, coupled with easier access to finance, have led to higher leverage in our region.

Effects of increased leverage on the economy

Leverage occurs in the process where economic agents fund their economic activities. Specifically, it increases when households try to smooth out fluctuations in their consumption, when firms raise funds for investment, and when the government spends more than its tax revenues. As long as leverage increases within a manageable extent, it helps to boost growth by promoting economic activities.

If leverage rises excessively, however, relative to the country's fundamentals, it can constrain consumption, investment and other activities as economic agents' debt burdens grow. In an extreme case, it can heighten the credit risks of borrowers and financial institutions, and destabilize the financial system. The country's sovereign rating can fall as a result, with inevitable impacts on the real economy.

Since the global financial crisis, the financial interconnectedness across countries has deepened greatly due to expanded international capital movements. As a result, changes in monetary policy or financial conditions in one country can have considerable effects on those in other countries. And if one country suffers financial instability owing to excessive leverage, then other countries are more likely to face contagion risks now more than ever before.

Policy response measures

In the future, the degree of global financial accommodation is likely to gradually decline with the U.S. Federal Reserve's monetary policy normalization, leading international financial conditions to develop in directions different from those seen until now. In these circumstances, both the public and private sectors need to devote greater attention to stable, appropriate management of their leverage.

Financial institutions need to improve their capabilities for screening when supplying credit to borrowers. This will allow them to manage their leverage well, both quantitatively and qualitatively. They also need to expand the shares of stable funding, to minimize any adverse shocks in case the global financial environment changes.

Borrowers, for their part, need to maintain stable financial structures, by properly managing their risks stemming from future income flows, from changes in interest rates, and from possible maturity mismatches between their assets and liabilities.

On the policy authority side, efforts should be made, using macro-prudential policies, to prevent any excessive rise in leverage.

Corporate restructuring is needed as well, since the continuing operation of inefficient firms only leads leverage to increase. And when deciding on monetary and fiscal policies, the effects of these policies on leverage should also be carefully investigated.

Asian emerging market economies have substantial external debt, and are therefore vulnerable to external shocks, due for example, to U.S. dollar appreciation. Policymakers should thus devote efforts to developing and implementing new measures to ensure external sector stability. Policies for macro-economic stability are of foremost importance, and the strengthening of financial cooperation among countries world wide is also essential.

Conclusion

I am confident that today's conference will be a valuable opportunity for participants to carefully evaluate the potential risks associated with leverage in Asian countries, and to discuss in-depth policies to alleviate them. I also believe that the insightful suggestions made in this conference will help us to find ways of strengthening the financial systems and economic fundamentals of countries in Asia and around the world.

Let me conclude by saying once again how much I appreciate you all taking time from your busy schedules to participate in the conference here today.

Thank you.