Juyeol Lee: Opening address - 2018 Bank of Korea International Conference

Speech by Mr Juyeol Lee, Governor of the Bank of Korea, at the 2018 Bank of Korea International Conference, Seoul, 4 June 2018.

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Ladies and gentlemen,

It is a pleasure for me to bid a warm welcome to you all, to the 2018 Bank of Korea International Conference. I would like to express my sincerest gratitude to Professor Robert Hall, of Stanford University, and Masaaki Shirakawa, former Governor of the Bank of Japan, who will deliver keynote speeches this morning, and to all of our distinguished moderators, speakers and discussants. Let me also say how deeply I appreciate the invaluable contributions of Professor Thomas Sargent to this conference, all the way from the planning stage.

This year marks a decade since the Global Financial Crisis upon the failure of Lehman Brothers. The global economy suffered the worst crisis since the Great Depression of the 1930s, and was long unable to recover from the recession that followed. Fortunately, the global economy is now reemerging from the aftermaths of the crisis: growth has gained momentum, and the markets have stabilized. This is a result of many countries' work in cooperation to make their financial systems more stable. It is also due to their unprecedentedly bold and active monetary policies to support the recovery.

Central banks are now working to normalize the post-crisis policies. The environment for monetary policy has also changed significantly from the one prior to the crisis. In this differing environment, therefore, we have inevitably come to a position to consider how to perform our existing roles, as well as whether there are any new roles demanded to us.

Let me start by talking about some of these changes in the monetary policy environment facing many central banks today, and about the policy concerns arising from them.

First are the concerns about the changing slope of the Phillips Curve. Prior to the crisis, a fall in unemployment during recovery tended to result in a rise in inflation: that is, the Phillips Curve used to slope downward in the short-run. However, we are now having doubts about this relationship, hence are facing difficulties in deciding the policy.

Secondly, there are concerns that the neutral rate of interest—an important guiding measure for policy stance—may have fallen significantly. A lower neutral interest rate means that we have smaller room for policy rate cuts in face of the economic downturn. It makes the interest rate more likely to reach its lower bound, making it difficult for us to address business cycles. Furthermore, the neutral rate may continue to stay low, due to the long-term factors such as population aging, declining productivity and increasing preference for safe assets.

Thirdly, we now need to consider outward spill-overs of one's monetary policy, together with the "spill-backs" to one's own economy. Countries now have closer trade and financial relations than ever, so that the impact of major economies' policies on international financial markets and the world economy comes back to influence themselves. For instance, we saw in 2013 during the Taper Tantrum that the Fed's signal to change its monetary policy stance caused sudden capital outflows from emerging economies and global financial market unrest. Recently also, the US interest rate hikes and the stronger US dollar have contributed to financial unrest in some emerging economies. As advanced economies normalize their monetary policies going forward, these sudden capital outflows and market unrest can recur at any time.

These changes in the monetary policy conditions pose challenges shared by many countries.

Across the world, we see considerable amount of ongoing discussion about how central banks should respond. Hoping to see a similarly valuable discussion in this conference, I would like to make a few remarks.

First of all, we will have to find ways to keep monetary policy effective even in this new environment. When central banks in advanced economies saw policy rates reach the zero lower bound, they mobilized a variety of unconventional measures. We yet need further research that details the conditions for successful large-scale asset purchases, forward guidance and negative interest rates, as well as their long-term effects. We also need to talk about whether countries other than those with a key currency can use such unconventional measures as part of the monetary policy toolkit, and if not, about what are their policy alternatives.

Moreover, to keep our policies effective, we will have to work even further on communication. People feel greater uncertainty about our policies as both the policy environment and the responses are changing, possibly making our monetary policy less effective and less credible. Central banks need to communicate their policies more actively to reduce these uncertainties and manage peoples' expectations. We also need to think about how we can do so more efficiently, given today's widespread use of online and social media.

Additionally, we need to realize the limitations of monetary policy and actively pursue a proper policy mix. In general, government spending does not crowd out demand by much during demand slowdowns as it did not, for example, right after the financial crisis, so that an expansive fiscal policy together with accommodative monetary policy can achieve macroeconomic stability more effectively. Macroprudential policy is crucial as well. In a low-growth/low-inflation environment, financial imbalances are likely to build up as the monetary policy tends to mainly aim at economic recovery. To secure financial stability－another important goal of monetary policy－it is indispensable to coordinate monetary policy with macroprudential policy.

Honored guests, Ladies and Gentlemen!

Due to the recent changes in economic structures and financial environment, our monetary policy is facing new challenges never experienced before. I look forward to seeing here－through the active exchange of your views for two days－many policy options proposed to help overcome the challenges that monetary policy is facing. And I hope that all of us, at the end of the conference, will have gained some profound insights about how central banks will continue to evolve into the future.

Thank you.