

New Year Speech

January 2, 2019

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Governor

The Bank of Korea

Dear fellow members of the Bank of Korea!

Today we start our first tasks of 2019, filled with new hope and resolve. I would like to begin by expressing my heartfelt gratitude to all of you, for so faithfully carrying out your duties throughout the last year.

The Korean economy went through some difficult times last year, due to the heightening of uncertainties at home and abroad. Volatility in the international financial markets increased frequently, in line with the worsening of the global trade environment and with the financial instabilities suffered by some EMEs amid the series of policy rate hikes by the US Federal Reserve. Thanks to our strong international credit standing we were fortunate enough to maintain stability in Korean markets overall, but we still had to remain vigilant. Looking at the real economy, the rate of growth did not deviate far from its potential level, but employment remained sluggish and economic agents' sentiments weakened. The growth in household debt continued to outpace that in household income, leading to concerns that this could undermine financial stability.

In these circumstances the Bank of Korea maintained the degree of its monetary policy accommodation, mindful of the diverse risk factors that could negatively affect the real economy, until in November it then raised the Base Rate by 25 basis points in consideration of the possibility of the financial imbalances worsening.

Dear members of the Bank of Korea!

This year the Korean economy appears likely to maintain a pace of growth similar to last year's. But there still seems to be a tough road ahead of us, both at home and abroad.

There are possibilities that the uncertainties about the monetary policy normalization in the US and the US-China trade conflict could lead international financial market volatility to increase and undermine global economic growth. With its high degree of capital market openness and heavy dependence on external trade, Korea could be particularly vulnerable to the impacts of changes in external risks. We will need to be mindful of and prepared for these possibilities.

We should also pay close attention to the fact that the growth potential of the Korean economy is continually weakening. The productivity growth in our major industries is slowing, while accumulating capital through investment has become difficult as our economy now enters its mature stage. The reduction in our working-age population in consequence of low birthrate and aging population is also weakening our growth potential. I think the concerns about our economy's future result from the recognition of these risks. Excessive pessimism is undesirable, but we do need to stay vigilant and come up with the necessary measures for coping with

these problems.

Major countries have already been accelerating their efforts to advance and converge their industries in order to seize the initiative in this era of the Fourth Industrial Revolution. Our top priority should be to enhance our productivity through restructuring, and to nurture leading industries that will serve to drive the future growth of our economy. We will need to carry out policies to expand our engines for growth in a systematic and consistent manner over a longer-term horizon.

My fellow members of the Bank of Korea,

Let me talk now about the main tasks that the Bank of Korea will need to focus on in its operations this year.

First of all, we will have to conduct our monetary policy so as to ensure that economic growth remains stable, and that consumer price inflation can converge to the target level over a medium-term horizon. Given the forecast that our economy will continue to grow at a rate in the middle- to upper-2% range, and that the demand-side inflationary pressures will not be large, we will need to maintain our accommodative monetary policy stance. In this process we will have to consider, in a balanced manner, macro-economic conditions such as the domestic economic and

inflation trends, together with financial stability conditions including the build-up of household debt.

We will maintain our inflation target at 2%, but from this year will not set a fixed period for achieving it, as is also the practice in other major advanced economies. This change has been made with the aim of anchoring the inflation expectations of economic agents at around the target level, to help them engage in economic activities stably. It will also enable us to operate our monetary policy more flexibly in the medium and long term. We will work as well to enhance economic agents' understandings of inflation conditions by publishing reports reviewing the status of our inflation target operations.

In times of high uncertainty about economic conditions, as at present, the accurate judgment of financial and economic circumstances is more important than ever to enhance our monetary policy's effectiveness. We will need to increase our precision in economic forecasting by expanding the indicators that we use and improving our forecasting models, while also strengthening our analysis of financial stability conditions by improving our methods of financial system risk assessment. And on this foundation, we will have to work to ensure consistency in our policy communication with the public.

We should pay special attention this year to the stability of our financial and foreign exchange markets. In particular, in conditions where the negative policy rate gap between Korea and the US has widened, any increase in risk aversion among global investors, due for example to the ongoing monetary policy normalization by the Federal Reserve, could cause greater capital flow volatility. In view of this, we will need to closely monitor how the changes in external risks affect our financial market variables and capital flows.

Starting from this year the Bank will disclose the details of the market stabilization measures it takes, so that we can elevate the transparency of Korea's FX policy to bring it to global standards. We believe that this will improve the credibility of our policy, and contribute to stabilizing the FX market in the medium and long term. However, given the possibility of unexpected side effects developing under highly volatile market conditions, we will need to strengthen our monitoring. We should in addition devote continuous efforts to faithfully fulfilling our roles in international organizations and cooperative bodies, as befits the heightened global standing of Korea and the Bank, and to strengthening our cooperation channels as well.

Given the changes in our financial and economic environment, we will have to stand up to the new challenges posed to monetary policy operation. With the neutral

interest rate level having fallen worldwide since the global financial crisis, many are concerned that monetary policy might not have sufficient room for maneuver when the global economic cycle enters its next downturn. Based on this recognition, the US Federal Reserve and others have already embarked on active discussions to review their monetary policy operating systems and instruments. In the same vein, our Bank also needs to give deep thought to a policy operating system and instruments of our own suitable to the changes in conditions.

With the rapid spread of the FinTech innovation lately, the payment and settlement environment is changing greatly, as new payment methods are emerging and the participation of non-financial companies is expanding. We will need to support the vitalization of diverse payment services, in order to improve financial consumers' convenience and reduce the settlement fees. We must also redouble our efforts to identify in advance and prevent the risks that accompany these changes. Moreover, considering the huge impacts on our economy overall that could result from any failure in our payment and settlement system, due to a natural disaster for example, we will need to devote our utmost efforts to maintaining the stability and continuity of system operations as well. We must also push ahead as planned with the construction of our next generation BOK Wire+, targeted to begin operation next year, bearing in mind that it will be the foundation of our nation's payment and settlement system of the future.

Dear fellow members of the Bank of Korea,

I know very well that you are all committed to the tasks assigned to you, based on your pride and responsibility as central bankers. However, on this occasion I would like us to redouble our resolve amid the current challenging situations in Korea and abroad.

As I have stressed repeatedly, in order to fulfill our mandate in this rapidly changing environment, heightening our organizational efficiency and productivity is of the utmost importance. Last year we collected suggestions from all staff about ways of realizing desired changes and innovation at the Bank, and by reflecting your recommendations we have made relevant changes in our institutional arrangements. Thanks to the efforts made throughout the Bank, we have made some progress. But in order to keep this change and innovation going, our organizational culture needs to become more dynamic. Nowadays the necessity of an organizational culture capable of responding to this rapidly changing environment is being stressed. There seems to be a growing awareness that complacency will undoubtedly lead us nowhere. Management must take the lead, by initiating small but concrete actions to realize the needed changes. Also, every staff member should spare no effort in thinking outside the box and giving an ear to diverse voices.

Dear fellow members of the Bank of Korea,

In this time of ever increasing uncertainty, we have an all the more grave responsibility to uphold, in that we must assess the situation clearly and precisely, and on the basis of our assessment implement the optimal policy. I would like to ask that you all maintain your utmost, devoted efforts in fulfilling our mandate, by pooling your energies and collective wisdom. In this way we can become a more trusted central bank that meets the public's expectations. As we greet this new year, of the Earth Pig, I want to wish you all the very best of health and good fortune.

Thank you.

January 2, 2019

Governor

Juyeol Lee