Credit Policy : Experiences and Challenges
The Bank of Korea International Symposium
Seoul, Korea
September 30, 2013

Opening Speech

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Distinguished speakers and participants,

I would like to extend my sincere welcome to all those attending the Bank of Korea's International Symposium on Credit Policy.

We are joined at today's symposium by many distinguished guests from the academic community, major central banks, international organizations, as well as from the Korean government and research institutes.

In particular, let me express my deep appreciation to Professor Christian de Boissieu who will be giving the keynote speech and Professor Yoon-Je Cho for moderating the second session. And my thanks also go to Dr. Kobayakawa from the BOJ, Dr. Stubbe from the ECB, Dr. Kim from the Federal Reserve Board, for presenting their respective experiences on credit policy, and to Dr. Sunil Sharma, Director of the IMF-STI, Dr. Schneider from the OECD, and Dr. Yetman from the BIS for acting as discussants.

Central bank credit policy had typically been used in emerging market economies where the demand for credit is high to support high growth but financial markets remain underdeveloped with significant market frictions. This appears to be no longer a case following the global financial crisis, however. In the face of impaired financial intermediation and a severe recession, major central banks began to make or consider good use of credit policy while at the same time undertaking extraordinary monetary easing.

As this September marked the end of 5th year from the collapse of Lehman Brothers and in view of the new experiments with credit policy in major economies, I believe that time is ripe to revisit the role and effectiveness of credit policy. I hope this symposium will offer a good opportunity for us to share our experiences and learn from each other so we can move forward.

At present, the Bank of Korea, similarly to major central banks, is facing policy challenges arising from market frictions and distorted credit flows in the midst of monetary easing. As we are currently working to revamp our credit policy framework, it would be useful for your discussion to briefly update you on our experiences with credit policy.

Significance of credit policy

One may define credit policy as a policy which affects the private sector's flow of funds or credit allocation by changing the asset composition on central bank's balance sheet. It is therefore a leg of central bank policies to achieve its ultimate objectives, along with monetary and macro-prudential policies.

In theory, central banks may turn to credit policy when market failures or frictions are considered to create distortion in funds allocation. Examples of market frictions are many including impaired transmission channels of monetary policy, information asymmetry, herd behavior, and so on.

In the past, credit policy was often used to direct credit to specific sectors of strategic importance to economic growth and development. Since the global financial crisis, as we have seen over the past several years, credit policy has been motivated from a broader perspective to support economic recovery at large and to complement monetary easing. Specific examples would include, among others, central bank funding for bank lending to SMEs in credit crunches, trade financing to support international trade, financial support for long-term financing for infrastructure investment, and support for enhanced financial access by the poor in the context of financial inclusion.

While considered useful to address distortions from market frictions and social concerns related to financial inclusion, credit policy may not be free of its own distortions and inefficiencies. In particular, central banks should be mindful of moral hazard, possible distortions in the price discovery process of financial markets, and policy uncertainty that credit policy could create.

Implementation of BOK's credit policy

Having said that, it would be useful to review very briefly the history of credit policy in Korea. Our experiences at the Bank of Korea with credit policy are diverse, and have evolved with our mandates and changes in economic circumstances. Up until the mid-1990s, credit policy had been geared toward credit allocation to sectors with a limited track record of growth but good prospects for it. After that, the Bank of Korea gradually retreated from credit policy with a view to promoting the market mechanism in financial resource allocation. Nevertheless, it has kept credit policy targeted for SMEs although at a smaller scale than before.

After the global financial crisis, the need for credit policy reemerged but for different reasons from the past. Severe and great uncertainty in financial markets and risk aversion have broken the last segment in monetary policy transmission channels that links financial conditions and the real economy. In particular, many SMEs and small-scale sole traders were denied access to credit at any affordable interest rates.

As part of its policy responses, the Bank has broadened the scope of the existing lending facility. To be specific, a funding program for bank lending to small-scale sole traders was introduced last year. In this year, the funding program was further expanded in scope to support bank lending to start-up SMEs with a promising technology base.

Going forward, we plan to monitor and critically review the performance of the funding program and any associated side effects if any. Such efforts will guide us to a better design of credit policy that can strike the right balance between improved credit flows to where most needed and possible market inefficiencies that credit policy itself can create.

Closing remarks

Ladies and gentlemen,

The global financial crisis and the subsequent Great Recession were a turning point not only for the global economy but also central banking. It has broadened the role of central banks and the scope of their policies in managing macroeconomic and financial stability. While a significant departure from the orthodox view on central banking that had prevailed over the past several decades, it should be kept in mind that the macroeconomic and financial landscape of the future would likely be quite different from what we see now. What we have thought as unconventional may soon be considered conventional.

In this context and also in light of increasing mandates of central banks, I firmly believe that credit policy should receive far more attention than in the past as a useful complement to monetary policy in addressing price and financial stability.

I sincerely hope that this symposium will serve as an opportunity to rethink central bank credit policy and learn from diverse country experiences.

I look forward to productive discussions and the exchange of new ideas among symposium participants.

Thank you.