The 15th Central Banking Seminar

Opening Address

September 18, 2007

Seongtae Lee

Governor

The Bank of Korea

(Opening remarks)

Ladies and gentlemen,

Let me extend a warm welcome to all of you, central bankers gathered from around the world to attend the Bank of Korea's "Central Banking Seminar". I would especially like to express my deep gratitude to our keynote speaker Dr. Mark Spiegel, vice president and director in the Federal Reserve Bank of San Francisco.

This seminar, now in its 15th year, is held to allow the sharing of diverse experiences and ideas relevant to major monetary policy issues. At the same time, we hope it serves to broaden relationships among central bankers.

The theme of this year's seminar, "Increasing Capital Flows among Countries and Monetary Policy", is likely to be of great interest to us all. It is very closely related to the recent international financial market environment, in which price variables are showing heightened volatility triggered by the turmoil in the US sub-prime mortgage market.

(The impact of the increase in cross-border capital flows)

Cross-border capital flows have increased very rapidly this decade, bolstered by the development of information and communication technology, the progress of financial innovation, and the integration of the global economy. The scale of cross-border capital transactions, including those in bonds and shares and direct investment, increased almost threefold between 2002 and 2005, from about 2 trillion US dollars to some 6 trillion US dollars.

This expansion of international capital transactions has brought us a number of beneficial effects.

First of all, it has acted to heighten the vitality of the global economy by allowing investors to disperse investment risk and borrowers to reduce their costs of capital.

It has also helped bring about an upgrading of the financial markets of emerging market countries as well as developed countries, in conformity with global standards.

The meltdown of the US sub-prime mortgage market is of course having a great impact on international financial markets. However, in contrast to the case during the Asian currency crisis of the late 1990s, there are now no nations experiencing severe difficulties. This is one example of how the financial systems of almost all countries have been further strengthened.

On the other hand, we must not be blind to the negative aspects of these expanding capital flows.

The economies of countries around the world have become closely interlinked through a web of capital transactions. In consequence, economic instability in any one country now exercises much greater influence than in the past on the international financial markets and global economy. It follows that in a small open economy such as Korea, domestic share prices, interest rates and exchange rates often show unstable fluctuations even when domestic economic fundamentals remain strong.

In addition, owing to the increased influence of overseas factors, the central bank's ability to control major policy variables such as interest rates has been weakened. Accordingly, its conduct of monetary policy has been made more difficult.

In the case of Korea, we have raised our policy rate seven times since October 2005. Nevertheless, the scale of increase in our long-term interest rates has been limited, and our monetary stock has continued to expand at a higher-than-expected rate. These phenomena are associated with the greatly increased inflows of overseas capital in search of arbitrage profits.

(Policy tasks in response to the increase in cross-border capital flows)

With free flows of capital, the roles of the policy authorities in advanced countries and the world's leading financial institutions are extremely important in securing international financial market and global economic stability.

In view of the immense influence of major advanced countries such as the US and Japan, their governments should have a sense of responsibility toward the global economy in their financial and economic policies.

Major investment banks and other international financial institutions must also take much broader views in their business activities. In the absence of global economic stability, it will be very difficult for them to expand their own business bases.

Individual central banks, for their part, must make every effort to ensure monetary policy effectiveness and financial market stability. To do so, they must build up their capacities for accurate analysis and forecasting of changes in international financial market conditions and of the effects on their domestic economies.

Central banks in every country should also endeavor to enhance the credibility of their monetary policies. Even though the influence of external factors over price variables is great, the channels of monetary policy can still operate effectively when the general public has firm confidence in monetary policy.

Finally, of course, there is another very important task. Central banks should strengthen their international financial cooperation and construct a framework that allows them to cope jointly with the possibility of unstable international capital movements.

(Closing remarks)

Ladies and gentlemen,

I anticipate that this seminar will provide a valuable forum for discussion of policy in response to the increases in cross-border capital flows. I look forward to lively debate here this week, drawing upon all of our various central banks' experiences in operation of policy.

Bringing my remarks to a close, let me express my hope that this seminar will contribute to closer cooperation among our central banks, by fostering friendships among us. Though your days this week may be full, please spare a few moments to gain a taste of Korean culture and enjoy the beauty of the autumn season here.

Thank you.