

## Governor's Speech on the 50th Anniversary of the Bank of Korea's Foundation\*

Colleagues,

On this day fifty years ago, the Bank of Korea was born as the central bank of Korea. Tomorrow, too, will see a momentous event in the modern history of Korea, a South-North summit, held for the first time since the division of peninsula. First of all, I would like to express my gratitude to all those former members of staff who made such a great contribution to the development of the Bank of Korea and to all with us today who have constantly given their dedicated support and cooperative commitment. Also, I would like to give my warmest thanks to you all, the executives and the entire staff of our Bank. Thanks to your commitment and ability, the Bank of Korea has been able to continue its wonderful tradition of achievement.

Looking back, the Bank has done its utmost to secure the stability and growth of the national economy, while coping with the rapidly changing economic environment of the modern world. In the fifties, we spent all our time and energy in tackling the terrible confusion and disaster left by the Korean War, striving to establish a modern financial system. In the sixties, we played an active role in implementing a series of ambitious economic development plans to revitalize the national economy, and contributed to bringing about a prolonged period of rapid and successful economic growth. Since the eighties, our efforts have focused upon building up the foundation for stability and a modern financial system to accommodate the worldwide trends toward globalization and liberalization.

\*This is an edited translation of the speech given by the Governor to the Bank of Korea's staff on June 12, 2000, commemorating the 50th anniversary of the Bank of Korea.

We have to admit, however, that backing the government's growth-first policies in the development period meant that our performance in carrying out our primary role as the central bank of maintaining the value of money necessarily suffered. Nor can it be denied that, along with the government, through failing to exercise sufficient vigilance, we were unable to detect and avoid the recent currency crisis.

Now, the paradigm of our national economy is changing rapidly to one where decisions are made independently on the basis of business judgment and free competition. The patterns of the previous era are fading as a new era opens before us. This deepens our emotion as we celebrate our Bank's 50th anniversary. At the same time, I am very pleased that we have prepared a variety of wonderful events for the occasion. I hope that many people, including all of us here today, will participate in them, enjoying precious opportunities to look back on the 50-year history of the Bank of Korea and ponder its future.

Fellow members of staff,

Let us now look at the current state of the Korean economy.

This year, the overall pattern of economic performance has been sound apart from the rapid narrowing of the current account surplus. As consumption and facilities investment as well as exports steadily increased, real GDP recorded a growth rate of 12.8 per cent in the first quarter. Consumer prices during the January-May period preserved their stability despite the high growth, edging up just 1.4 per cent compared to the same period last year. However, the current account surplus decreased significantly, mainly due to soaring imports, with the account even shifting into deficit in April for the first time since the financial crisis.

In the financial markets, the Bank of Korea maintained the call rate at a relatively low level and supplied liquidity flexibly to hold market interest rates stable and allow smooth fund-raising. There was an ample supply of foreign currency liquidity, thanks to the steady inflow of direct and indirect foreign investment, while the exchange rate continued to maintain comparatively stable trends. The market instability in May caused by uncertainties surrounding the restructuring plans of investment trust companies and Hyundai's financial situation is now calming down. The persistent high degree of sensitivity to corporate credit risk, however, led to the contraction of the cor-

porate bond and commercial paper markets. Financial institutions, too, have shown signs of a more rigorous approach to credit appraisal in their lending operations.

We expect that the Korean economy will continue its upswing in the latter half of the year with inflation stable and a current account surplus, but at the same time we should be aware that there is no room for complacency. Prices have been stable in spite of the high economic growth, but there are several factors present making for inflationary pressures such as increases in wages, housing costs, public utility charges and other items. There is also concern that the current account surplus will shrink dramatically as a result of high oil prices and the surge of imports caused by the economic recovery.

Colleagues,

As I have just mentioned, the national economy is maintaining stable growth, but the future outlook is somewhat uncertain. Therefore, we should not neglect our duty to face up to the problems in our economy and introduce appropriate measures to tackle them.

First of all, we should carry on with the restructuring plans for Korean industry and complete them. It is true that we have made considerable achievements in the restructuring process since the financial crisis. Banking institutions as well as other enterprises have achieved greater transparency in their business activities and financial structure, and profitability has greatly improved. But no one can be sure that the structure of our economy is now strong enough to easily absorb the shock of unexpected changes of the economic climate at home or abroad. If restructuring plans are deferred in this situation where the current account surplus is dwindling, Korea's sovereign rating, which has recently been upgraded, could deteriorate again.

Particularly if the instability currently emerging in the financial markets extends over a long period of time, it will significantly weaken their function of financial intermediation, having a harmful influence eventually upon the real economy. It would be difficult to solve the resulting credit crunch just by adopting monetary policies such as an expansion of liquidity. A better solution is to recover the trust of the markets through the pursuit of efficient bank and corporate sector restructuring.

Secondly, we should consolidate the basis for economic stabilization. We have been successful in bringing about an economic recovery thanks to the correct macroeconomic policies introduced after the financial crisis. Now is the time to prepare for disequilibria that may occur in the future. We should, if necessary, control the speed of economic growth through, control over aggregate demand in order to stabilize prices and maintain a current account surplus.

For this, we should push forward with the government's mid to long-term plans for fiscal soundness and operate monetary policies preemptively and flexibly. America has since the early 1990s put a lot of effort into getting its finances into sound order by implementing monetary policy effectively with a recognition of the time lags in its transmission. This became the driving force for creating long-term non-inflationary growth and bringing an increase in revenue which, in turn, has itself greatly contributed to improving fiscal soundness.

Meanwhile, I have to express my concern that as we in Korea have enjoyed a low rate of inflation since the financial crisis, some are beginning to let down their guard against inflation. Considering that the current low inflation has been made possible mostly by the strength of the Korean won, this is somewhat disturbing. Without persistent efforts to stabilize prices, high inflation could come back at any time triggered by a change in the economic climate at home or abroad. We should learn from watching the activities of central banks in advanced countries including the U.S. and the EU member states. They are always quick to implement preemptive monetary policies to combat inflation, even at times when they are experiencing low inflation thanks to high productivity.

Finally, we should give our concentrated attention to deepening and broadening the foreign exchange market. As a small-sized open economy that has undertaken extensive liberalization of its foreign-exchange and capital markets, the Korean economy has become more susceptible to external shocks. The possibility of acute volatility in macroeconomic variables such as interest rates, share prices and the exchange rate has greatly increased, and so has the likelihood of a consequent impact upon the real economy. The recent increases in interest rates in developed countries led by the U.S. have been followed by a heightened intensity of international capital movements in devel-

oping countries including those in Southeast Asia and the instability of their financial markets. In the face of much uncertainty in the international financial markets, we should strengthen our monitoring of the foreign exchange markets and prepare measures to tackle possible sudden net outflows of foreign capital.

Colleagues,

Considering the current financial and economic situation, we should conduct monetary policy with an emphasis on preparation for possible domestic and external disequilibria so that the Korean economy can remain on a sustainable growth track.

First of all, interest rates should be held stable through flexible open-market operations and, while paying closer attention to the trends of the real economy, we should be ready to deal preemptively with possible internal and external disequilibria.

As for money supply, we will maintain market liquidity at an optimum level, focusing on preventing inflation on a long-term basis.

Although so far this year companies' direct fund-raising through the issue of corporate bonds or stocks has been rather inactive, their overall fund-raising has been relatively smooth, thanks mainly to a large increase in bank lending. Demand for loans is expected to continue to increase from businesses and individuals as the current trend of economic growth is maintained. But conditions for fund-raising will be generally favorable thanks to the ample market liquidity. Having said that, we should be wary about some signs of credit instability in the financial markets today, and take measures to stabilize them and prevent any malign effects on healthy businesses' fund-raising.

As I mentioned before, we intend to introduce a liquidity control loan system in the latter half of this year to strengthen the central bank's function of controlling liquidity and make the most of the interest rate announcement effect. I look to the new system to act as a buffer against financial market instability by providing quick funding support to banking institutions with a temporary lack of liquidity. My wish is to signal the intentions of the central bank to the market by adjusting the interest rate applied on these liquidity control loans, as is the practice in the developed countries. Also, we will take steps to establish firmly the business purchase fund loan system that was intro-

duced recently in order to supply funds to SMEs, so as to reduce the incidence of chain bankruptcies caused by the use of bills.

Colleagues,

With the entry into effect of the revised Bank of Korea Act, we now enjoy a high degree of independence in the formation and conduct of monetary policy. We have worked long and hard to establish and implement advanced monetary policies based on the principles of the market economy. We have introduced an inflation targeting scheme and greatly improved the transparency of our policies. We also made clear the locus of responsibility by opening to public scrutiny the entire decision-making process when we changed the operating target of monetary policy from money supply to interest rates. As a result, our policy intention is now delivered to the market more efficiently and the market response is correspondingly more effective, meaning that a market-friendly monetary policy is beginning to take deep root.

I am well aware that some point out that the role of the Bank of Korea has been weakened by the lessening of its ability to influence commercial banks directly since the separation of the Office of Bank Supervision. On this, I would just say that, in the new financial climate characterized by liberalization and market opening, it is virtually impossible for a policy-making authority to lead the market, quite apart from the fact that the trust of the market cannot be easily won by regulations and controls alone. In this context, as one of the major participants in the financial markets, we will work hard to win the trust of the markets by the consistent and transparent operation of policies based on market principles. At the same time, I have to admit that since the transfer of the right of supervision over banking institutions, we have faced many difficulties in pinpointing problems facing banking institutions and taking measures to tackle them, which, in turn, poses an obstacle to us in carrying out our duties as the lender of last resort. Therefore, I believe that we should cooperate closely with the supervisory authority by *inter alia* the efficient exchange of information to surmount this obstacle and, if need be, we might consider pressing for some improvement of the present system.

In addition, we should remember that the position of the central bank can only be strengthened when people agree on the importance of price stability and give their full

support to its policies. In this context, I think it is very important to make more widely known the details of our policies including the inflation targeting scheme so that the general public can more easily understand and support them. People should know why the central bank worries about prices when inflation is low and the economy is doing well. Many talk about the success of American monetary policies, but this has been possible largely because the Fed could effectively persuade the American people of their necessity.

Colleagues,

At this point of time as we celebrate the 50th anniversary of the Bank of Korea, I suggest that we learn from the past and think deeply about our vision for its future so as to bring about its rebirth as a central bank enjoying the trust and affection of the general public.

Finally, I would like to give special thanks to those who have given their time and energy to prepare the wonderful events that all of us will take part in as we celebrate this very special day. I hope happiness and love will be with you and your families.

Thank you all.

Chol-Hwan Chon  
Governor  
The Bank of Korea