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FINANCIAL SERVICES COMMISSION

IGE/IMF International Conference

Luncheon Remarks

The Global Financial Crisis & Korea's Policy Response

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GREETINGS

Distinguished guests, and ladies and gentlemen,

I am delighted to be with you this afternoon, and I thank IGE Chairman Kim Pyung-Joo and President Lee Young-Tak and Dr. Mahmood Pradhan from the IMF for organizing today's conference and inviting me to speak. I also thank speakers and distinguished participants who are with us today.

In light of the deepening distress in the global financial markets, today's conference, entitled "Lessons from the Recent Global Financial Crisis: Its Implications for the World and Korea," is both timely and of great interest to every one of us.

So I am glad to join you and share with you my perspectives on how the financial crisis emerged, what lessons we can draw from it, and where we go from here.

GLOBAL FINANCIAL CRISIS & KOREAN ECONOMY

The global financial crisis started with collapsing asset prices followed by a debilitating credit crunch.

Expansive monetary policy by the U.S. Federal Reserve since 2001 and a surge in foreign capital inflow since 2004 kept interest rates at record low levels.

Financial deregulation also swept across the major developed countries beginning in the 1980s. During this time, capital market liberalization also picked up the pace among the emerging countries.

This process ultimately led to sharp increases in financial institutions' leveraged activities and asset inflation. In particular, as financial institutions increasingly employed aggressive asset securitization and complex derivatives to sustain high profit growth, a host of new risks began to weigh on the financial system.

For their part, regulators did not fully grasp the situation and preempt the risks. And the global nature of the financial system meant that the systemic risks would be felt and shared by markets around the world.

Domestic financial markets

We are now getting clear indications that a sharp global economic deterioration is on the way and that Korea, like other countries, faces the prospect of slow growth for some time to come.

In the financial markets, the prevailing view is that volatility will continue for the foreseeable future.

Amid mounting concerns over the worsening credit crunch, dwindling investor confidence—particularly among foreign investors—has contributed to large fluctuations in share prices. Moreover, worries over weak current account position, foreign stock sell-off, and imbalances in supply-demand conditions for the dollar have also fueled unpredictable swings in the won-dollar exchange rates. With rising bank-issued debt and inflation pressures, interest rates moved up but now appear more stable with two recent rate cuts by the Bank of Korea.

For its part, the government has taken a series of preemptive steps designed to shore up market stability and keep the economy on track.

On October 19, the government announced a package of liquidity and credit support measures, including guarantee of domestic banks' foreign debt, injection of fresh credit to the banking sector, and expanded pool of credit for SMEs. This was followed by a new package of stimulative measures on November 3. In response to concerns over the availability of the dollar, the Bank of Korea also arranged a new swap facility with the U.S. Federal Reserve on October 30, and provided much needed relief on the won.

As for the overall soundness of domestic financial institutions, our assessment is that current level of capital, along with capital boosting efforts in progress, will provide cushion against the potential risks.

We are closely monitoring the situation and will act swiftly, if needed, to ensure the sustained health of financial institutions and the financial system.

LESSONS OF THE CRISIS AND POLICY DIRECTION

Let me now say a few words about lessons we can draw from the global financial crisis and the near-term policy implications.

Reinforced global cooperation

With markets converging and cross-border financial activities rapidly expanding, we increasingly see problems of global nature that require global approaches.

The deepening financial crisis we currently face is yet another reminder that we must come up with an effective cooperative mechanism that helps regulators deal with problems in the global context.

The recognition of the need for enhanced coordination and cooperation among regulators in the G-20 Summit Communiqué is an encouraging sign that new, concerted efforts will be undertaken in this area. Korea welcomes this development and intends to take an active part in shaping a new global cooperative regime and international financial architecture.

Risk management

Some attribute the failure of Lehman Brothers and Merrill Lynch to the flawed business models of investment banks.

But, at the more fundamental level, what they demonstrated is the failure of prudent risk management; that is, highly-leveraged investing and lending on the back of ineffective internal controls and regulatory oversight.

So, going forward, financial institutions will be expected to significantly step up internal controls and keep a close watch on consolidated risks.

Preemptive financial supervision

The failure of regulators to preempt alarming asset inflation and risk profiles of structured products has also been cited as another contributing factor to the financial turmoil.

More generally, what we see is that, in some crucial aspects, the existing regulation is ill-equipped to cope with rapid financial globalization and widespread trading of new classes of complex securities.

There is now recognition of this shortcoming in the major developed countries, and discussions are under way on regulatory reform needed to address it.

One important goal in this endeavor will be to better identify and preempt risks to the financial system. Korean regulators share the same goal, and will continue to fine-tune our role and function, and make other adjustments necessary to perform our job effectively.

Let me also note that we will stand ready to take timely and targeted responses to market distress such as a major disruption to the flow of credit in the market.

Stimulative measures for the economy

Faced with the increasing likelihood of a prolonged global economic downturn, many countries are now working on a

mix of stimulative fiscal and monetary measures to keep their economy on track.

In times of economic downturn, policymakers must be mindful of the risk of procyclicality. We are certainly aware of this and intend to take steps to make sure that companies facing short-term credit squeeze do not end up insolvent.

This is especially true for small and medium-sized companies, and there are now efforts under way by the state-run policy banks and the commercial lenders to expand the pool of credit available to businesses. The bond market stabilization fund that the government has recently launched to provide fresh liquidity is one example of this.

CLOSING REMARKS

The IMF forecasts a sharp slowdown in the U.S. and projects the global economic growth at about 2% for 2009, compared with 5% for 2007 and 3.7% for 2008.

The international economic outlook has significantly deteriorated, and just about all the signs point to a deep, prolonged recession ahead.

So, more than ever before, this is the time for bold use of policy tools we have to fight the looming recession. We have a deep pool of experiences we can draw from, and I believe the way to move forward is to renew our faith in our collective wisdom and revitalize the fundamentals with the confidence that we will emerge from the crisis wiser and better disciplined.

The 18th century English historian Edward Gibbon famously said that “The winds and waves are always on the side of the ablest navigators.”

I think the wisdom in this maxim is that a crisis can turn into an opportunity to those who can exploit it. So I say we should exploit the winds and waves of the global financial crisis we face to our advantage, draw the right lessons, and pave the way for a brighter, more confident future.

Distinguished Guests,

At the G-20 summit meeting in Washington, world leaders chose Korea, along with Brazil and the U.K., to assume 2009 G-20 leadership and to coordinate actions to be taken by regulators, international financial institutions, and standard-setting bodies for reforms outlined at the G-20 Summit meeting.

I believe Korea’s joint leadership in the global reform efforts bespeaks Korea’s potential to contribute to global challenges. And it is my hope that the discussions and proposals coming out of today’s conference will add to the immediate and mid-term actions spelled out by the G-20 Summit.

The IMF is, and will be, an indispensable institution to the successful resolution of the financial crisis and the economic challenges the world faces.

The IMF is Korea’s valuable partner, and I hope that the conference it organized today with IGE will provide a very useful forum for many constructive policy debates and proposals.

Thank you.