

## Chang Yong Rhee: New Year Speech

New Year's speech by Mr Chang Yong Rhee, Governor of the Bank of Korea, at the Bank of Korea, Seoul, 2 January 2025.

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Ladies and gentlemen,

Before delivering my New Year's speech, I would first like to express my deepest condolences and sympathy to the victims and their families affected by the tragic plane crash.

Today marks the beginning of our first day of work in 2025. I had hoped to greet you with a message of hope and a bright future, but recent events have put a damper on that. I now stand before you with a very heavy heart due to the recent political upheavals and the tragic incident. Amid these circumstances, I would be grateful if you could listen to my speech with an understanding of the difficulties.

My dear colleagues at the Bank of Korea,

Today, we welcome the new year with renewed determination. Let me begin by expressing my heartfelt gratitude to all of you for your best efforts at fulfilling your duties in your respective roles despite challenging circumstances over the past year. I would also like to extend my appreciation to all the members of the Monetary Policy Board for their dedication to the conduct of monetary policy. I also thank your families for their unwavering support for your hard work here.

As we embark on the Year of the Blue Snake, a symbol of wisdom and transformation, I wish all of you will achieve your aspirations and build a healthy and happy home.

Last year, the Bank of Korea concluded its fight against high inflation and shifted away from a prolonged period of tight monetary policy stance, with the Base Rate cuts starting from October. As consumer price inflation, which peaked at 6.3% in July 2022, has stabilized below 2% since September 2024, price stability became evident. However, there was no time to rest as new challenges emerged, including downside risks to the growth and increased exchange rate volatility. The growth contribution of exports weakened due to intensifying competition in key export items, and concerns over the policy direction of the new U.S. administration following the presidential election led to a continued strengthening of the U.S. dollar, increasing exchange rate volatility. In December, the martial law crisis added political unrest on top of this situation, causing the exchange rate to rise significantly again and dampening economic sentiment. Although the government and the Bank of Korea are responding with aggressive market stabilization measures, escalating political conflicts and concerns about a leadership vacuum in the state governance are further intensifying instability in the financial and foreign exchange markets.

This year, the conditions surrounding our economy are expected to be more challenging than ever. Externally, the implementation of the new US administration's protectionist trade policies could make exports more difficult as global trade contracts.

The continued economic boom in the United States may lead to a slower-than-expected rate cut by the Federal Reserve, potentially prolonging the volatility in exchange rates for some time. Additionally, global economic conditions, such as in China and Europe, are not favorable.

The domestic situation is even more serious. While household debt trends have stabilized due to the strengthening of macroprudential policies, continued rate cuts could develop into a risk factor. Thus, constant monitoring with vigilance is required. If uncertainty persists due to political developments, this may intensify the negative impact on the economy, overlapping with already challenging external conditions.

Given the unprecedented rise in political and economic uncertainties, monetary policy needs to be managed with flexibility and agility in response to changing circumstances. We expect to see more trade-offs between policy variables such as inflation, growth, the exchange rate, and household debt. Therefore, the Bank of Korea will continue to flexibly determine the pace of rate cuts in the future while closely examining the development of internal and external risk factors and the resulting changes in economic movements based on incoming data.

However, in the current situation, it is hard to stabilize the Korean economy by monetary policy alone. Recently, the international attention shifted beyond the turmoil in the financial and foreign exchange markets to whether the nation's control tower of governance can regain stability. It is of the utmost importance that the leadership in governance remains stable, as a prolonged government vacuum in the midst of political conflict can have a negative impact on the country's credibility and directly or indirectly contribute to the overall shock to the economy. As emphasized in the recent report of the Bank of Korea, minimizing the negative impact of political uncertainty requires building confidence that the economic system, including monetary policy, operates independently and properly without being affected by political processes (Bank of Korea, 2024a).

The evaluations may differ depending on political interests, but Acting Authority Choi Sang-mok has made a difficult but unavoidable decision based on economics rather than politics to prevent a loss of external credibility and a government vacuum. This decision will mark the starting point of signaling domestically and internationally that our economic system will continue to function normally, independent of political processes. It is time for the parties to work together to ensure the stability of the nation's leadership.

My dear colleagues,

While maintaining a flexible approach to monetary policy in the short term, some of us in the Bank must also reflect on why the trade-offs between monetary policy objectives have increasingly deepened to the point of constraining the policy.

Let us take exports as an example. Concerns are growing about sluggish export growth as a major factor in the economic slowdown of the year, despite exports reaching an all-time high in terms of value last year. The underlying reason lies in the lack of diversification in our export structure, which remains heavily reliant on a few flagship products, such as semiconductors and automobiles. This concentration has made the overall export performance closely tied to the cycles of specific industries and therefore

highly volatile. In addition, China, as a latecomer, has rapidly caught up with us in our major industries. In contrast, we have failed to develop new industries which can drive our future export growth. A stark illustration of this challenge is the comparison of the top 15 companies by revenue in Korea and in the United States: over the past decade, seven new enterprises entered the U.S. list, whereas Korea added only two. And among them, only one seems to be grown through emerging industries, which means that, in effect, there were almost no new entries.

Schumpeter's concept of "creative destruction," which he identified as the major driving force of capitalism, emphasizes destruction as much as creation. The birth of innovative companies inherently involves the exit of those that fail to innovate. The lack of emerging companies and industries in Korea raises a critical question: have we avoided addressing the social conflicts that accompany the process of creative destruction under the guise of pursuing stability?

Currently, there is significant discussion about increasing corporate value, so-called value-up program, to revitalize the stock market. Measures such as raising dividend payouts and improving corporate governance are undoubtedly important. However, it is more essential that new companies lead the stock market through competition and the process of creative destruction, much like how the "Magnificent Seven" companies now drive the U.S. stock market. At least in the economic sector, we must lift the regulations that hinder creative destruction by protecting vested interests and stifling innovation.

The value-up issue is also related to the recently increased level of exchange rates. Although last year's current account surplus is about \$90 billion, the USD/KRW exchange rate increased significantly. This was because foreign and domestic investors moved funds equivalent to the current account surplus out of the Korean stock market. The increase in overseas investments has transformed Korea into a net external financial asset holder, bringing positive effects such as portfolio diversification and reduced default risk from external debt burdens. However, it also reflects the unfortunate reality that the Korean market is no longer attractive, so it is prompting investors to leave. If capital outflows continue, it could prolong a vicious cycle where financing difficulty hampers the growth of new businesses. Without fostering new industries and deregulation to create and nurture emerging companies, there is a risk that the value-up program could end up as empty talk.

The household debt issue is no exception. There has been some criticism regarding why the Bank of Korea takes household debt into account and appears overly cautious when deciding the Base Rate. However, as you know, household debt has steadily increased over the past 18 years closely linked to real estate loans. Fortunately, thanks to restrictive monetary policy and macroprudential measures, the household debt-to-GDP ratio has declined, for the first time in 18 years, to 91%. Despite this progress, it remains still high<sup>1</sup> compared to other major economies.

This year, growing concerns over an economic slowdown have led to stronger calls for prioritizing economic stimulus over household debt management. However, this approach risks repeating the past mistakes of ignoring future risks to reduce immediate pains caused by an economic slowdown. Although micro-level adjustments might be considered for non-real estate related household debt or real estate loans in non-metropolitan areas to address the slowing economy, it is essential to adhere to the

macroprudential policy stance that aims to manage household debt growth rate within the nominal GDP growth rate from a macro perspective. Only in this way will we be able to ensure that financial resources are directed away from the real estate sector and into productive sectors, particularly into innovative companies that will drive our future.

Dear colleagues!

The structural issues mentioned here are not recently emerged but have been raised repeatedly over the years. However, delaying their resolution has led to a decline in Korea's potential growth rate, now down to 2%. It could fall to as low as the 0% range by the late 2040s if we fail to address these issues (Lee *et al.*, 2024). The fact that the potential growth rate is falling below 2% holds significant implications. When assessing economic conditions, we must now set aside memories of past high growth rates and evaluate our economic capacity objectively.

As of last November, the Bank of Korea forecast this year's growth rate to be 1.9%; however, downside risks have since grown. Although it is certainly a historically low figure, it is similar to Korea's current potential growth rate of 2% or the average growth rate of 1.8%<sup>2</sup> for the 26 countries with per capita GDP exceeding \$30,000. It would be an overstatement to equate the current situation to the Asian Financial Crisis, the Global Financial Crisis, or the COVID-19 pandemic.

Of particular note, support for self-employed individuals and small business owners is urgently needed, given the significant challenges they face. However, if we use monetary and fiscal policies as a mere painkiller by simply comparing the absolute growth figure lower than 2% to the past growth rates, it may lead to larger negative side-effects. Alongside short-term stimulus measures, painful but necessary structural adjustments must also be pursued to raise our potential growth rate in the medium to long term. For instance, supplementary budget support for self-employed individuals or small businesses should not focus merely on helping them maintain the status quo. In Korea, the share of the self-employed of all employed persons (23.2%<sup>3</sup>) is excessively higher compared to countries like the United States (6.1%) or the Euro area (14.1%). To make this share decline gradually, the restructuring measures, such as debt restructuring, vocational training, and offering reemployment opportunities for retirees, which would support the self-employed in transitioning to more productive sectors, should be implemented simultaneously. The Bank of Korea, for our society to identify and implement the structural reform measures it needs, will continue to conduct relevant research and present policy alternatives that can garner public consensus.<sup>4</sup>

In addition to monetary policy issues, the Bank of Korea has many tasks to complete this year. It will review and seek improvements to the "Korean dot plot," which reflects the Monetary Policy Committee members' Base Rate forecasts for the next three months, as well as to quarterly economic outlook. The Bank will explore improvements in institutional measures to strengthen the financial stability role of its lending facilities. At the same time, it will focus on promoting the risk-free reference rate (Korea Overnight Financing Repo Rate, or "KOFRR") in the short-term financial market, while introducing AI models, and conducting the pilot project on Central Bank Digital Currency (CBDC) and related global projects (Bank of Korea, 2024b; Bank of Korea, 2024c; BIS, 2024).

We need to ensure that changes in organizational culture and internal management take root deeply within the organization. In particular, this year, let's create a culture that values the "quality" of work over the "quantity." It is not just about working hard and doing a lot, but about presenting high-quality results. To achieve this, we must streamline our work processes to reduce working overtime and evaluate based on the impact of reports rather than the quantity. Employees who propose and test new ideas should be encouraged accordingly. Just as it is important to recruit top talent, it is also essential to create a system that fosters the development of incoming employees to help them grow into skilled and capable professionals. Accordingly, we will ensure that the performance evaluation system that was introduced last year becomes well-established, and we will also explore ways to provide the necessary support for nurturing talent.

My dear colleagues,

Let me extend my heartfelt gratitude once again to all our staff for doing their utmost in their respective areas despite many challenges last year. I would like to express my appreciation to all our staff at regional branches for working for balanced regional development and for fulfilling the roles of ambassadors, and to our staff at overseas representative offices for promptly conveying information about local affairs.

I have not forgotten the hard work of those handling tasks such as customer service, cash processing, security management, and administrative support, all of whom contribute to ensuring that the Bank of Korea fulfills its role. My thanks also go to all the janitorial staff who strive to maintain a clean working environment, to the daycare teachers who provide a comfortable care environment for our employees' children, and to the doctors who take care of our employees' health.

At the Bank of Korea, which is made up of such a diverse group of members, it fills me with immense pride to see over 75% of our staff participate in the year-end voluntary donation event, demonstrating warmth and unity. It was truly meaningful to take a brief break from the pressures of work and share the joy of giving together during our year-end event that celebrated the achievement of the goal. I think it is possible to achieve an 80% donation rate in this year.

Recently, I have been feeling the transformation of our organization into a "louder" Bank of Korea, as employees freely engage in discussions and present research results to the public. I am proud that, as a result of our efforts in communicating with the public through visual contents, such as "Easy-to-Understand Economic Indicator Explanation" and "BOK Market Briefing," our YouTube subscriber count has increased to almost 90 thousand and garnered a lot of attention. Let's continue to work hard and aim to increase the number of our subscribers to hundreds of thousands and to receive the Silver Play Button this year. I have been feeling the change of our organization into a "louder" Bank of Korea in daily life as well. When I see employees who would previously hesitate to take the elevator with me now boarding without hesitation, I sense that the horizontal organizational culture is slowly taking root.

As I said in the beginning, the environment we face in the new year will not be easy. However, just as we have done in the past, I believe we can overcome these challenges once again. Sun Tzu says in the Art of War, "turn adversity into an

advantage," and the Western proverb goes, "never waste the opportunity offered by a good crisis," teaching us the universal truth that a crisis is also an opportunity. If we do not fear adversity, but instead create new opportunities from it by calmly practicing what we can do and what we must do, our economy will be able to leap forward once again.

I sincerely wish you and your precious family all the very best of health and happiness. Thank you.

*I would like to thank Hwayun Lee, Seungmoon Park, and Youngrae Kim for their help in preparing this speech. \* This is an unofficial translation of the original speech released on 2 January 2025.*

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<sup>1</sup> Korea's household debt-to-GDP ratio stood at 91.1% in the second quarter of 2024, ranking 5th out of 44 countries for which the BIS compiles data.

<sup>2</sup> Based on the IMF's October 2024 Economic Outlook

<sup>3</sup> The proportion of the self-employed was calculated using the OECD's criteria (2023) for international comparison, which includes unpaid family workers who can be considered de facto self-employed.

<sup>4</sup> The structural reform report released by the Bank of Korea last year references various studies, including: low birth rates and aging populations (Chae *et al.*, 2024), balanced regional development and college entrance systems (Chung *et al.*, 2024a; Chung *et al.*, 2024b), household debt (Kim & Na, 2024), and challenges including climate change and global supply chains (Kim *et al.*, 2024; Jung *et al.*, 2024; Im *et al.*, 2024).