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I turn to Hur Kyung-Wook, former Ambassador at the OECD and presently President of the Korean Bretton Woods Club and Chairman of the Board of the Korea Center for International Finance.

Hur Kyung-Wook

Thank you very much, Chairman. I would like to make two comments, one about general monetary policy in the advanced countries and whether they can achieve a 2% inflation target, and second, more about the Korean experience of dealing with the current crisis.

On the global monetary policy, I think there is a real danger of overtightening rather than under tightening. There are a couple of reasons for that, number one is that it looks like all the advanced countries central banks are doing their own tightening but there is no coordination between them. When each country does its own tightening, it also kills the demand of other countries, so that altogether it might be overtightening.

The second point is a bit related to what Professor Frieden mentioned about the coordination between monetary and fiscal policy. Normally, the idea is to bring down inflation by tightening monetary and fiscal policy together. However, this time because of the very rapid increase in interest rates, there are vulnerable groups in society that face a danger and that probably requires more support from the fiscal side. In addition, we talk about the US Inflation Reduction Act and the same has been mentioned in Europe, Japan and even Korea, because all this chip industry or EV industry require fiscal support. Another thing is the climate change adaptation costs, we all know after COP27 that we are behind the curve for meeting the target, so there will be a huge demand for fiscal support. When the monetary side is tightening, even with the best intentions of the government, there are many areas that still require fiscal standing. If the tightening is done by the monetary side alone you can end up with overtightening rather than too little tightening.

The third point on the behavioral side, we all know that the Fed was behind the curve at the beginning, they said it was transitory, so they were about six months behind the curve. Behaviorally, there is then a tendency to overcompensate and we have all this famous delay over monetary policies that actually have effect.

One final point, which is also related to the Korean side, is the foreign exchange channel that also requires overtightening. When you look at all the things concerned, we might be able to achieve the inflation target, but we are more likely to have a recession than originally planned by the most recent IMF estimate.

On the Korean experience, the point I am trying to make is that we have had a rollercoaster this year on the foreign exchange market. From April to October, about six or seven months, the Korean won depreciated on the foreign exchange market by 18% against the dollar. We have done almost everything recommended during the Asian financial crisis and the global financial crisis. We have built up huge foreign exchange reserves of over USD 430 billion, we also have net foreign assets of around USD 400 billion and our short-term debt against our reserves is around 40%. We have some capital management, macro prudential measures, so all those things are in place, but when your exchange rate depreciates 18% in a short-period of six or seven months, you cannot absorb all those shocks. The market is very worried and suddenly the business community has to deal with huge uncertainty, high interest rates, a high dollar, a super dollar and then high inflation and there is no way to know where it will end. Finally, because of all this change and expectations in the market, starting from November the dollar actually depreciated, in other words the Korean won appreciated around 7% or 8%, which actually calmed down the market. However, up until November, if you look at the figures and the burden it placed on the monetary policy side, in the first half of the year we had price hikes in energy and food, and then this depreciation so around 80% of our purchase price inflation comes from overseas. That is very difficult for the monetary side to establish a policy based on this type of situation. We have a liquidity squeeze coming in the market, many companies facing difficulties but because of this inflation pressure, which not only comes from commodity price increases but is exaggerated by this exchange rate. In October, we had the full guidance that we would perhaps come up with a small step like 25 basis points, but we ended up with 50 basis points. That is exactly the point that through this foreign exchange channel, some monetary authorities end up with more tightening than desired or warranted by the local situation. Another point in that regard is that our central bank governor famously mentioned that our central bank was independent of the government but not independent of the Federal Reserve. In normal times we can follow with the Federal Reserve with all this capital flow but, as I said, nobody can handle 18% for six months and there is big pressure from business and the political side to come up with some arrangement with the Fed. It is true that we had some arrangement during the global financial crisis, there were nine countries with a non-convertible currency that were given this lifeline, not so much for the money, but more to shore up confidence. This was also given unilaterally by the Federal Reserve during the pandemic from 2020 to 2021. However, now is probably not a good time and even though we have asked for the Fed swap, I do not think they will agree. When you have seen such a big rollercoaster movement on the foreign exchange markets, I still think there must be some more structured way for non-convertible currency countries to have reasonable expectations of access to the Fed, which is still missing. The last one was given unilaterally during the pandemic so that may be something that is missing from international financial architecture up until now.

Jean-Claude Trichet

Thank you very much indeed. Just to be sure that I understood fully what you said, there was a period if I understand correctly of depreciation of the US dollar by 18%. Appreciation of the US dollar. Then you said a rollercoaster, so at a certain moment you had the reverse.

Hur Kyung-Wook

Over 8% in just one month.

Jean-Claude Trichet

Okay. First, depreciation, which we understand pretty well because you did not augment interest rates and the US Fed did massively with a lag.

Hur Kyung-Wook

Exactly.

Jean-Claude Trichet

That is obviously not very surprising, if I understand correctly, the constellation of interest rates between the US and Korea. Then recently there has been some kind of catching up. Is it correct you wanted a swap to correct the fact that there was a substantial interest rate differential?

Hur Kyung-Wook

No. In terms of the REER, you just mentioned when the Fed very rapidly tightened and Korean interest rates also began to follow, despite that the Korean won depreciated 18% within just six or seven months because the tightening was so rapid. That was even with the Korean authorities' best efforts to persuade the markets that it was fundamentally okay, the area is okay, and the problem was not the Korean won but rather the Fed's tightening speed. That did not calm down the market because if you were in business and saw the interest rate and inflation rate going up, and then we are a country that is very dependent on energy and food imports.

Jean-Claude Trichet

I got the point, thank you so much, that is clear enough.