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August 24, 2010

**Statement by Mr. Weber and Mr. Chowdhury on Republic of Korea
(Preliminary)
Executive Board Meeting 10/81
August 25, 2010**

We share staff's favorable assessment of the authorities' macroeconomic management during the global crisis and we concur that the main policy challenge in the near term is to well manage the exit from accommodative macroeconomic and financial sector policies without pulling the rug from under the recent impressive recovery. Although we consider the significant fiscal withdrawal in 2010 as appropriate, downside risks are non-negligible. Further worries about high household indebtedness coupled with a low savings rate must also not be discounted, since these conditions constrain private consumption and investment, entail risks to financial stability, and hamper a rebalancing from external to domestic engines of growth.

As financial conditions have normalized, we encourage the authorities to accelerate the phasing out of public financial assistance to SMEs. We note that several SME-support measures still remain in place. These measures favor existing firms, create barriers to new entrants, and thereby hold back productivity growth in the services sector. Continued significant public support of SMEs will impede the much needed restructuring of the services sector, which would seem essential for spurring private sector-led growth.

We are unconvinced of staff's recommendation to broaden the BOK's monetary policy framework to include an asset price target. A clear hierarchy of targets with price stability as the primary goal should be maintained. Financial stability should only be taken into consideration insofar as it has an impact on price stability and does not undermine the credibility and accountability of the central bank. *How does staff's above recommendation fit with the recent staff paper discussed in the Board, which concludes that vulnerabilities in the financial sector are best addressed by macro-prudential policies?* The central message of this paper is that the "vigorous use of monetary policy to pursue financial stability would almost certainly conflict with the primary objective of maintaining price stability, and could result in greater volatility in real activity."

Staff finds that rapid aging, labor market characteristics, and the design of the retirement system have pushed household savings lower. As demographic factors are expected to cause a further decline in the savings rate in the longer-term, we would have welcomed a more in-depth discussion on the wide-ranging structural policies needed to help arrest the decline in the savings rate. *We ask staff to elaborate on concrete policy plans by the authorities in this regard.*

On the format of the report, given that this is another prototype, we appreciate the separated summaries of staff's and authorities' view after each chapter. We also reiterate our preference for comprehensive documentation with easily accessible information, which would mean including the informational annex in the main document. A standard format for Article IV staff reports is ultimately desirable in order to facilitate access to relevant information, presented consistently across the membership.