



**Conference on  
Global Financial Crisis: Macroeconomic Policy Issues**

**ADBI, Tokyo  
28-29 July 2009**

**Welcome Remarks**

**by**

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Distinguished guests, ladies, and gentlemen. Good morning. Let me express my gratitude to all of you for taking time from your busy schedule to participate in ADBI's conference on the ***Global Financial Crisis: Macroeconomic Policy Issues***. This conference is part of the global financial crisis project that ADBI has been pursuing since the outbreak of the crisis in the fall of 2008.

The conference will address macroeconomic implications of the global financial and economic crisis for Asia. We will particularly focus on developing policy recommendations to improve macroeconomic management in Asia, including monetary policy, fiscal policy, and foreign exchange rate and reserve management policy. In this regard, we will consider both short-term policy responses to stabilize aggregate demand, and longer-term policy measures aimed at rebalancing sources of growth towards domestic and regional demand.

Even though the crisis did not originate in Asia, and Asia generally had strong economic and financial fundamentals going into the crisis, the region still has been hit hard by the downturn in export demand, and, in some cases, by turbulence in foreign exchange and capital markets as a result of a sudden withdrawal of capital. Exports have declined sharply, often by 30% to 40% year-over-year in many Asian economies, although most are now showing signs of recovery. Domestic demand,

especially private capital investment, has weakened in many cases as well, and almost all economies have shown a rapid widening of the output gap.

### **Asian policy success**

Asian policymakers have responded to this crisis with aggressive and appropriate measures to ease monetary and fiscal policy and to support domestic financial systems. Most of the region's central banks have reduced policy rates, and fiscal authorities have adopted expansionary policies. Financial sector authorities have taken measures to stabilize their financial systems. Although it is difficult to estimate the actual impact of these packages on GDP, the Asian Development Bank estimates that fiscal stimulus measures taken by the PRC, Malaysia, Singapore, and Viet Nam exceeded five percentage points of GDP in size, while those of Hong Kong, India, Japan, Korea, the Philippines, Taipei, China, and Thailand amounted to between two and five percentage points of GDP. The recent recovery seen in quarterly GDP growth in the second quarter of this year in the PRC, Korea, and Viet Nam suggests that these policy steps have been working.

The fact that the Asian economies were able to take such substantial measures underscored the dramatic improvement that had taken place in macroeconomic management and fundamentals in these economies since the Asian financial crisis of 1997-1998. A number of regional central banks had achieved low inflation as a result of commitments to non-inflationary policy, while many governments substantially reduced fiscal deficits and levels of public debt. The rise in foreign exchange reserves in the region, which many had criticized as being excessive, played a key role in minimizing currency turmoil in the region, while greater exchange rate flexibility also provided a cushion in the face of turmoil. Notably, no country in the region was forced to raise interest rates to defend the currency value over the past ten months. Korea, which faced unusually large downward pressure on its exchange rate, was able to stabilize the situation by using the currency swap line established with the US Federal Reserve. Indonesia, another country whose exchange rate depreciated sharply, was able to secure funding from Japan and multilateral sources.

Nonetheless, Asian policymakers cannot afford to rest on their laurels. The consistency of some of these policies with longer-term growth goals, as well as the possible side-effects of some of the stimulus measures need to be considered carefully. For example, the PRC's expansionary policies have relied primarily on rapid growth of fixed investment and bank lending. A rapid increase in fixed

investment could lower the efficiency of projects and create excess capacity, without contributing to overall productivity. A rapid expansion of bank loans—for example, at a rate of 34% year-on-year in the first half of this year—raises the risk of a sharp increase in non-performing loans later on, as well as a rise in future inflation.

### **Fiscal policy**

The effectiveness of fiscal stimulus measures needs to be assessed from the perspectives of *both* their short-term multiplier effects and the output gap *and* their longer-term impacts on productivity growth. However, perhaps the biggest question is: what role can fiscal policy play in facilitating a rebalancing of growth toward domestic and regional demand? Asian economies benefited tremendously from export-led growth centered on US and European markets in recent decades. This growth model can no longer be relied upon to sustain the region's economic growth beyond the crisis. US consumer spending will likely remain sluggish over many years to come.

As a result, fiscal resources may be directed at encouraging both domestic consumption and private investment on a sustainable basis. Structural measures to encourage household consumption should be given first priority, particularly the strengthening of social sector protection systems—including those for health, education, unemployment, and pensions—to reduce household needs for precautionary savings. The second priority is to stimulate the supply side, particularly the services sector so that Asia's production is better aligned with its demand. This can be done through promoting not only traditional services sectors, but also IT-related knowledge services and green growth—focusing on renewable energy development, energy conservation, and environmental improvements. Small- and medium-sized enterprises often play a significant role in these areas. These supply side developments can stimulate private investment on a sustainable basis.

### **Monetary policy and exchange rate policy**

The conduct of monetary policy also needs to be reviewed. Although inflation-targeting regimes—or regimes aimed at price stability—served reasonably well during the current crisis, the experience of advanced economies underlines the importance of ensuring financial system stability. Although international consensus has yet to be reached, I believe this should include the prevention of financial crises through pre-emptive action to limit the emergence of asset price bubbles. Also, deflation has become widespread in the region for the first time, with at least seven

economies showing a decline in consumer prices. This, together with the risk of a possible credit crunch or other disruption of the monetary policy transmission mechanism, highlights the need to make use of non-conventional monetary policy when needed.

Finally, the vulnerability of the region to external shocks highlights the importance of the choice of an exchange rate regime in contributing to macroeconomic and financial stability, both at the national and regional levels. This requires prudent capital account opening, a regional reserve pooling arrangement, and relatively stable intraregional exchange rates. We need to have a better analysis of the kind of regimes that allow for international capital flows while not sacrificing too much in terms of macroeconomic, financial, and exchange rate stability. This includes consideration of the dynamic sequencing of capital market liberalization. It seems likely that the US dollar will eventually fall against Asian currencies as part of the global rebalancing process for correcting payments' imbalances and diversifying sources of growth. Therefore, to facilitate this rebalancing process, it is desirable to have a currency system which contributes to a general appreciation of Asian currencies against the US dollar in such an event while maintaining stability of Asian cross exchange rates.

I believe that all of these important issues will be debated here in today's conference. Hopefully, these discussions can point toward key macroeconomic policy recommendations, which can be taken by Asian governments to achieve balanced and sustainable economic growth for all. I thank you for your kind attention.