



Macroeconomic and Financial Stability in Asian Emerging Markets

**A Conference Organized Jointly by
the Asian Development Bank Institute and
Bank Negara Malaysia
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Opening Remarks

**Masahiro Kawai
Dean and CEO
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Assistant Governor Sukudhew Singh, distinguished participants, experts, ladies and gentlemen, good morning.

ADB Institute is delighted to co-host today's conference on *Macroeconomic and Financial Stability in Asian Emerging Markets*. I would like to express my gratitude to our co-host, Bank Negara Malaysia, as well as our conference coordinator, Professor Eswar Prasad of Cornell University and the Brookings Institution.

The theme for today's conference is set against the background of the global financial crisis, including recent uncertainties about the strength of the recovery in the advanced economies and the debate about the timing of exit strategies. One of the lessons of the recent crisis is that a systemic crisis that affects a country's overall financial system is very costly, not only in terms of fiscal resources mobilized to counteract the economic downturn and support the financial system, but also in terms of output and employment lost. Therefore policymakers should make every effort to avoid a systemic financial crisis and maintain financial stability by pursuing sound macroeconomic and regulatory policies, identifying systemic risks when they emerge, and acting on them to reduce the likelihood of a crisis.

The global financial crisis devastated the economies of the United States (US) and Europe, and severely affected the Asian economies through the trade channel. In the most recent *World Economic Outlook* published by the International Monetary Fund

(IMF) in July, projections for global economic growth were further revised to 4.6% this year and 4.3% in 2011. However, there is a large downside risk to these projections due to the sovereign debt crisis in Greece and a few other Southern European countries in the euro zone as well as high unemployment, higher household savings to rebuild wealth, and a sluggish commercial real estate sector in the US. The bright side of the global economy is that a solid recovery is now taking hold in emerging Asia, particularly in the People's Republic of China, India, and ASEAN countries, where the IMF now projects growth of 9.2% this year and 8.5% next year. Malaysia is participating in this strong recovery as well, with the Asian Development Bank projecting growth of 6.8% this year.

Financial systems in Asia have generally not been affected much by the global financial crisis for three reasons. First, Asian authorities undertook significant supervisory and regulatory reforms in the wake of the 1997–1998 financial crisis to improve the quality of balance sheets and risk management practices of their banking institutions. Second, Asian economies have reduced short-term external debt while accumulating sizable foreign exchange reserves, which has helped enhance their capacity to respond to external shocks. Third, Asian financial firms have taken a conservative approach to risk taking—such as utilizing sophisticated derivatives, expanding securitization businesses, and providing complex structured instruments to investors. This is partly due to the authorities' prudent—but often tight—regulation and supervision.

Nevertheless, Asian monetary and financial authorities need to respond to new challenges posed by the global financial crisis and the recent regulatory responses of the advanced economies, including the passage of the financial reform bill in the US, the full implementation of the European Financial Stabilization Mechanism and Facility, the public release of the results of stress tests on European banks, and the latest Basel reform proposals to strengthen bank capital adequacy. With further liberalization of financial market activities and opening of financial services to foreign institutions, emerging Asia's financial services and business activities are expected to become more sophisticated and complex, which will pose additional challenges. Authorities need to continuously upgrade technical and analytical capacity to effectively regulate and supervise financial institutions and markets in order to promote both financial innovation and stability.

First, the authorities need to strengthen microprudential supervision by focusing on the health and stability of individual financial firms. Second, they should improve macroprudential supervision through intensive analysis of the economy-wide system where financial market players operate and interact, so as to identify sources of systemic risks and vulnerabilities, and take necessary macroprudential policy actions to address them. Third, they need to re-examine their monetary policy frameworks to ensure that they give adequate weight to asset prices, financial stability and management of capital flows. Coordination between macroeconomic and supervisory policies at the national level is essential to contain systemic risks and maintain macroeconomic and financial stability, including possibly introducing a powerful “systemic stability regulator.”

The recent crisis, as did the Asian crisis in 1997–1998, also highlighted the need to further develop and deepen financial markets in developing and emerging economies. In economies with rudimentary financial systems, banking sector reform is the first priority to expand banking businesses and facilitate efficient financial intermediation. Efforts in order to promote financial inclusion for both households and small- and medium-sized enterprises are also essential. In economies with sufficiently developed banking sectors, local-currency bond markets and capital market activities—including relatively simple derivatives—should be promoted in order to achieve more efficient and balanced financial intermediation. Economies with relatively deep financial systems could then be linked through liberalization of capital and exchange controls and regional financial cooperation. These efforts could lessen the dependence of Asian economies on volatile capital flows and facilitate the recycling of its large savings to finance long-term investment in the region.

Finally, given the rising financial interdependence in Asia, it is also important for financial authorities in the region—regulators, central banks, and finance ministries—to work together for regional financial stability. The region should further strengthen the multilateralized Chiang Mai Initiative and may consider establishing a forum to facilitate policy dialogue and joint action among the authorities—called an Asian Financial Stability Dialogue—so as to identify regional financial risks and act on them collectively. Such a forum would also be useful in providing Asian inputs to the Financial Stability Board for better global financial reforms.

I hope that we will have active discussions on these issues today.