

Tarisa Watanagase: Financial policy and strategy in ASEAN countries

Address by Dr Tarisa Watanagase, Governor of the Bank of Thailand, at the 4th National Conference of Economists, Chiang Mai, 24 October 2008.

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Distinguished Speakers and Guests,

Ladies and Gentlemen,

It is a great pleasure to be present at this year's National Conference of Economists on the theme of "ASEAN Economic Development". Today, my brief remark on this important topic will focus on two parts. First, I would like to highlight the economic strengths of ASEAN, and how financial policy and strategy have a role in enhancing such strengths. Second, I would like to share my view on the preparations that ASEAN together should make to weather the global financial storm.

First, on the strengths of ASEAN, I would like underscore that ASEAN has always been an important economic and political force. In fact, the region is becoming an important source of growth for the global economy as several ASEAN members are the world's fastest growing economies.

ASEAN has always been active trading nations. Its external trade accounts for almost 5 percent of the world's exports and imports in 2006. This ratio is a big jump from less than 1 percent two decades ago. It also represents a rate of growth over that period of average 34 percent per annum, compared to less than 20 percent growth rate of world trade.

ASEAN exports are not just raw materials and prime commodities. The last few decades saw probably the most rapid industrialization since the industrial revolution occurring in ASEAN. ASEAN became renowned for exports of consumer products of great values. We are now hubs for automobile and electronics production.

Another noteworthy development in recent times also includes trade expansion among ASEAN nations. Intra-ASEAN trade used to represent only about 12 percent of its overall trade in 1993, but today, that figure has increased to around 25 percent. Moreover, this trend is set to accelerate, resulting in trade expansion both within ASEAN itself, and between ASEAN and the rest of the world.

Ladies and Gentlemen,

Today, the importance of ASEAN in the global economy cannot be denied. Size-wise, ASEAN population amounts to 565 million with growing middle class population, which means stronger demand for consumer products and financial services. Looking forward, for ASEAN growth to continue and able to avoid disruptive crises, the economic and financial infrastructure that underpins our economic activities must be strong.

This brings me to the role of financial policy and strategy to enhance ASEAN strengths. For ASEAN to be strong, a necessary condition is that its financial system must be deep and wide. And its financial institutions must function as intermediaries to allocate funds effectively and efficiently. In the past, ASEAN relied on external source of funding, mainly from developed countries. At present, however, new polar source of funding has shifted towards Asia as well as ASEAN. Having well-developed financial system would enable ASEAN to better recycle its surplus capital among its members.

For decades, ASEAN has used its banking system to manage resource allocation. Banking system worked fine in the past. However, in new and volatile financial environments, ASEAN needs to have both strong banking system as well as well-developed capital and bond markets to better service consumers' and businesses' financing needs. Having well-developed capital markets can allow financial risks in the economy to be spread out, shared,

and more efficiently managed. And, the efficient allocation of financial resources would, in turn, allow ASEAN to have better access to capital and for its goods and services to flow in greater quantity.

At the centre of building strong ASEAN finance is ensuring its continued systemic stability and ongoing market developments. In this regard, ASEAN central banks have a clear role in safeguarding price stability and financial institutions stability. On price stability, let me just say that ASEAN generally has a good track record of keeping inflation low. As for financial stability, the framework of policy has moved toward risk-based supervision, and to an adherence to international standards. Indeed, many ASEAN countries have significantly advanced efforts in implementing Basel II and FSAP, which have fostered a stronger and more balanced financial system with greater transparency.

Maintaining financial stability also means that ASEAN must be able to withstand the ebbs and flows of foreign capital. But, as small open economies, keeping balances over any length of time is easier said than done. For ASEAN, avoiding capital account crises will become increasingly more important because the more ASEAN trade with each other, the more closely linked our economies are. Hence, the more contagion there will be, and the faster and wider will crises spread.

Fortunately, we have already seen a region-wide move toward a more flexible exchange rate regime, with a disciplined framework in the conduct of monetary and fiscal policies. Financial policy becomes more flexible, yet proactive, in dealing with changes in the market conditions and practices. When necessary, a traditional fiscal-monetary policy mix has been augmented by appropriate prudential measures of financial institutions, especially to preempt pockets of asset price bubbles developing in the economy.

Ladies and Gentlemen,

I turn now to the second part of my talk on the potential scope of regional cooperation as ASEAN faces yet another common challenge on how to manage the global contagion of the US financial crisis.

Today's global financial crisis is the world's worst since the Great Depression in 1930s with an estimated credit loss of 1.4 trillion US dollars. Trillions of US dollars have been used to provide liquidity and to recapitalize distressed financial institutions. Deposit guarantee has been introduced in a large number of countries to restore investors' confidence. At this juncture, I doubt if any one can predict with any good accuracy when this episode of financial market turbulence would come to an end.

The current global financial crisis reminds us of the lessons we learnt from the Asian financial crisis just one decade back. Indeed, what have happened in advanced economies today are stark reminders of those lessons learnt in Asia. Just like Asia, investors took excessively high risks creating asset price bubbles in advanced economies. Lax prudential policy, along with fragility of the financial system, quickly brought on a crisis of confidence, starting with debt defaults. Credit underwriting behaviors of financial institutions and credit rating agencies are being questioned along with imprudent lending practices and the bloating real estate sector.

Thus far, the effects on emerging market economies in Asia have been minimal. Nevertheless, we are still awaiting final moments of truth as there will be a number of aftershocks following the financial tsunami.

Clearly, having a resilient economy and financial sector that is stable, which I have discussed previously, is only a necessary condition for avoiding crisis. But, it is not sufficient to ensure non-occurrence of crisis. This is because the key pressure points that can lead to difficulties for us can be externally-induced, especially through capital account developments.

We all know that sudden changes in global financial conditions and risk-appetite of investors can create difficulties through spillovers. Mindful of this, ASEAN needs to come up with

cooperation strategy that best fit ASEAN objectives. Here, I wish to raise two key areas on regional cooperation strategy for your further exploration.

First, the new global crisis should hasten ASEAN to think more deeply about the effectiveness of regional surveillance that can detect weakness early on. Waiting for the global community through international financial institutions (IFIs) for regional surveillance may be too little too late for timely policy measures that can safeguard the region from contagion from other parts of the world. While IFIs will remain useful for surveillance and financing balance of payments need when necessary, regional surveillance capacity must be enhanced more quickly. This is one important area where central bank cooperation can be strengthened.

Indeed, it is very important for policymakers in ASEAN with common challenges to put greater efforts in regional cooperation on maintaining financial stability. Having close consultations and sharing experience can usefully avoid potential policy missteps and create policy synergies that eventually foster confidence of investors and other economic agents within and outside ASEAN.

Second, we have to consider making regional liquidity pool sufficient and effective enough in size and automaticity of disbursement in time of need. In the past, stakeholders outside ASEAN have been more concerned about moral hazard problem than the real benefits of regional liquidity pool in time of actual need. The present global situation has reconfirmed the vision set forth by the ASEAN Swap Agreement (ASA) and Chiangmai Initiative (CMI) that Asia needs to have its own liquidity pool to protect itself from contagion, be it caused within the region or from outside.

On the whole, the current financial episode has taught us that, to restore confidence to the public, the authorities' action must be decisive and timely. Coordination and cooperation among ASEAN countries must be further enhanced to ensure that prompt remedial actions can be put in place should a crisis occur.

Ladies and Gentlemen,

In closing, I would like to reiterate that it is important for ASEAN's economic and financial stability that ASEAN central banks continue, individually and collectively, to increase the effectiveness of their policy instruments through domestic reforms of markets and financial systems as well as communication efforts with markets and one another. In this spirit, I am reminded of how ASEAN has risen over the years to common challenges. History has recorded ASEAN as an exciting region second to none. While rich in diversity, ASEAN has always been united in bringing about successful solution to tackle our common challenges. ASEAN, itself, was formed forty years ago against the backdrop of political and security threats to the region. In addition, ASEAN Free Trade Area, or better known as AFTA, was created sixteen years ago to ensure that ASEAN together reap benefits from greater trade liberalization under the WTO.

Going forward, with sustainable growth and development of ASEAN at stake, I have no doubt that we will be able to jointly find ways to overcome the present difficult global environment and together continue to prosper.

Thank you.