

## **Tarisa Watanagase: Financial globalization and market turbulence**

Opening remarks by Dr Tarisa Watanagase, Governor of the Bank of Thailand, at the Bank of Thailand's International Symposium on "Financial Globalization and Emerging Market Economies", Bangkok, 7 November 2008.

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Professors, Distinguished Participants, Fellow Central Bankers, Ladies and Gentlemen,

It is a great pleasure for me to welcome you to the BOT International Symposium 2008 on "Financial Globalization and Emerging Market Economies". This symposium is the third in a series of International Symposia organized by the Bank of Thailand. From its first meeting eight years ago, this symposium series has been a gathering of prominent academics, policy-makers and market participants to discuss current issues on both monetary and macroeconomic policies from an international perspective of either emerging, regional, or global economies.

Over the past several years, a common theme for us as the organizer has been the focus on inflation targeting and its implications on monetary and financial sector policies where appropriate. Through this series of symposia, a body of knowledge has been timely accumulated to be put to great tests from the increasing trend in financial globalization and the accompanying turbulence in recent years.

When the topic for this year's symposium was chosen prior to this current market turmoil, it was not apparent at the time that the turbulence would indeed turn out to be one of the most challenging events since the Great Depression. So this is an extraordinary time for the world financial market and probably most suitable for an international symposium on the subject of financial globalization.

Ladies and Gentlemen,

Financial globalization has certainly made the international financial landscape look very different today compared to just a decade ago. And almost every day, new events continue to re-shape it even further.

One aspect among these changes, however, remains constant. That is, despite the complexity and sophistication of today's financial institutions as well as instruments that are developed to manage all kinds of risks, the remarkable degree of global financial linkage still makes financial turmoil transmit from one country to another at an ever faster pace than we have previously anticipated.

Like all financial crises of the recent past, several weaknesses and excesses were initially submerged and only later found to be much larger than the initial estimates, contributing to the permanent boom-bust cycle that seems to always accompany modern business and finance. Understanding the various causes of the crises is only the initial step towards resolving its short-term impacts and preventing its recurrence, if entirely possible, in the longer-term.

In the meantime, we will probably continue to have to witness an intensification of the financial crisis. As mortgage-related assets deteriorate further, economic growth will inevitably slow down even more, along with the downside risks of financial and the economic outlook. With disheartened creditors and investors, access to capital markets as well as short-term funding markets become increasingly impaired, impeding any possibility of a sustained recovery in the securities and credit markets.

Ladies and Gentlemen,

Global financial markets are now at a critical juncture. Risk aversion across the system has risen to unprecedented levels, and an aggressive deleveraging process is under way. Many

financial institutions need to raise significantly more capital at a time when their ongoing earning power appears to have been permanently reduced. These dynamics will intensify the current global slowdown and have an impact although somewhat indirectly on emerging market economies, despite the relative strength of these countries' financial institutions.

In response to the renewed tensions, the authorities of a number of countries have introduced a number of measures and initiatives to address the problems at both market and individual institution levels. This should eventually encourage private investors to re-enter the market and complete the deleveraging process. Meanwhile, coordinated efforts have been strengthened to ensure adequate liquidity at an appropriate interest rate as inflationary pressure began to subside.

Although it remains uncertain when the current financial storm will end, these international co-operations if properly executed will undoubtedly speed up the resolution of this crisis and ultimately limit its economic and financial consequences worldwide.

Ladies and Gentlemen,

In this context, from an emerging market perspective, the question, therefore, goes way beyond just how to cope with the current turmoil, but reaches deep down into the direction of market development over the medium to longer term as well.

Within the realm of central banks, for example, the traditional science of monetary policy has so far been based on the idea that the central bank's objective should be to maximize the economic well-being of the people in the country by minimizing the deviations of inflation from its optimal rate and the deviations of real economic activity from its so-called natural growth path. However, today it is clear that the central bank's role in fostering financial stability is essential and this role will become more prominent in the world of increasing financial integration.

Experiences of the recent crises indicate that monitoring financial imbalances is crucial in preventing financial turmoil from occurring. It has long been recognized that a weak financial system undermines the efficacy of monetary policy measures and can overburden the monetary authorities. For this reason, it may be desirable for prudential policy frameworks to be strengthened, thereby addressing the build-up and unwinding of the imbalances more effectively. In this context, the Bank of Thailand has also monitored seven areas of financial imbalances, including those in the financial market, real estate, household and corporate sectors on a regular basis.

Going forward to a time when all this global financial crisis is resolved, it may also be appropriate to revisit and rethink the standard financial regulatory framework, particularly in emerging and even in a more developed part of the world. Given the magnitude of market adjustment, volatility and contagion across markets, risk diversification is easier said than done. This is especially true as markets and institutions seem to correlate highly in a crisis situation as risk-aversion intensified. The current financial climate, therefore, highlights the importance of supervisory coordination. This coordination should include both domestic and cross-border dimensions and encompass key regulators and central banks. This is for the benefit of information sharing and elimination of regulatory arbitrage, which has been one of the fundamental causes of this crisis.

Given increasing financial integration, and growing complexity of financial instrument, market, counterparty links, and changing demarcation line between different financial institutions and financial players, we have witnessed emergence of the new channels and process of spread of systemic risk, through broader groups of players – banks, investment banks, insurance companies, and non-banks – all of whom are regulated under different framework, or not even regulated.

Because of this, there is a pressing need to rethink the regulatory framework in order to be in keeping with this new paradigm.

Ladies and Gentlemen,

It has been said that this crisis will soon lead to major changes in the geopolitical world order. These changes are speculated to lead to a marked decline in U.S. influence throughout the world and as a result the much talk about subject of the “new world order”. In our view, however, it might be more fruitful to discuss about the new global framework as a check on global imbalances rather than a new world order.

This is because the ultimate winners or losers from globalization are yet to be decided. A long historical perspective is, therefore, needed in order to put the net social cost and benefit of globalization into a proper context. A new wisdom from financial globalization, however, is emerging. As Professor Rodrik will probably agree, reaping the benefits from globalization is by no means automatic. Globalization, financial or trade liberalization, all need supporting institutions for their gains to materialize. Furthermore, past experiences according to Professor Michael Bordo of Rutgers University, also indicate that although the globalization winners appear to outnumber losers in an increasingly integrated world, it is still possible that the losers (even temporary ones) can create a backlash that will once again cause a retreat in the globalization process.

Ladies and Gentlemen,

It is obvious that a global financial crisis will need a global solution. This symposium on financial globalization is thus very timely and come at a time when policy makers and market participants are in dire need of a better solution. And this year, we are honored to have with us many distinguished speakers from well-regarded institutions to discuss this important topic. We have Professor Dani Rodrik of Harvard University as our keynote speaker on the topic of “The Disappointments of Financial Globalization”, followed by five leading international researchers, namely Dr. Claes Berg, Sveriges Riksbank; Professor Raghuram Rajan, University of Chicago; Professor Jose Antonio Ocampo, Columbia University; Dr. Arvind Subramanian, the Peterson Institute for International Economics; and Dr. Robert McCauley, Bank for International Settlements who will be presenting their in-depth studies over the next two days on broad range of issues, a part of which I have barely begun to touch upon.

This symposium will also be rounded up by a panel discussion on “Financial Globalization in Emerging Market Economies” which should provide an interesting discussion on the implication of financial globalization and the current financial crisis from an emerging market perspective.

Ladies and Gentlemen,

I would like to conclude by saying that the recent developments in financial markets around the world will stimulate considerable review and analysis in the months and years to come. Across the globe, legislatures, regulators, financial supervisors are already hard at work trying to distill the lessons to be drawn from this experience and their implications for future policies. For the private sector, banks, credit-rating agencies, and the investment community are also trying their best in coping and adapting to these developments.

For central banks, the implementation of monetary policy will certainly become a more challenging task as a result of the current financial turmoil. A lasting stabilization of the financial system obviously requires a holistic policy approach which successfully integrates monetary policy objectives into development framework for the financial markets. In the longer term, the response of both public and private sectors to this experience should help create a stronger financial system.

Ladies and Gentlemen,

On this note, I very much look forward to this two-day symposium. I hope that we will have many opportunities to touch upon various issues about monetary policy and regulatory

implications of the ongoing events. I wish you a successful, productive and memorable meeting.

Thank you.