Peter Pang: Managing the next phase of growth in Asia

Welcome remarks by Mr Peter Pang, Deputy Chief Executive of the Hong Kong Monetary Authority, at the IMF's Asia and Pacific Regional Economic Outlook, Hong Kong, 28 April 2011.

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1. Good morning. It is my great pleasure to welcome you all to the launch of the latest issue of the IMF's Asia and Pacific Regional Economic Outlook (REO). We are honoured to have Mr. Anoop Singh, Director of the Asia and Pacific Department of the IMF, and his colleagues to share with us today their views on the region's economic and financial developments, the outlook and the challenges, and what can be done to manage the risks and promote sustainable growth in the years ahead.

2. I like the theme of this issue of the REO – "Managing the Next Phase of Growth" – as this is what concerns us most in Asia at this juncture. We are now some two-and-a-half years after the outbreak of the global financial crisis, and Asia has been leading the global recovery – a recovery that is maturing as rightly pointed out by the IMF. The question is where and how we should move on from here. And looking ahead, managing the next phase of growth is very challenging as we are facing complications of unprecedented scale and dimensions.

3. Specifically, the US and Europe, the two largest markets for Asia's exports, are still facing steep challenges in the adjustment process and the situation is still rather fluid. For the US, the rather sticky structural constraints such as high unemployment and depressed housing markets suggest that self-sustainable growth momentum remains uncertain when policy supports are withdrawn. In the case of Europe, while some progress has been made in resolving the sovereign debt issue, risks remain on whether certain economies can overcome the challenge without substantial debt restructuring. Looking ahead, external demand from these two markets is likely to remain subdued in the near future. Meanwhile, closer to home, the disastrous earthquake and the ensuing nuclear crisis hitting Japan, a key importer and exporter for many economies in the region, is adding further downside risk to export and production growth in the region. Last but not least, political instability in the Middle East and North Africa (MENA) region will likely keep oil prices elevated for some time. This in turn would drag on global economic growth, add upward pressures on inflation and heighten volatilities in the global financial markets.

4. All these complications are making life difficult for policy makers in the region. While Asia, having learned well the lessons from the Asian financial crisis, has managed to get through the recent global crisis relatively unscathed, we are now entering uncharted waters, and there are both imminent and longer-term policy challenges.

5. First and foremost, it is challenging to manage the large capital flows. The divergence in the growth rates of advanced and emerging economies have been driving fund flows to Asia, resulting in signs of overheating in certain pockets of the region. The increasingly negative real interest rates as a result of rising inflation in many regional economies will add fuel to the already high credit growth and heated asset markets. That said, we must also be wary of the risk of reversal of the fund flow. The recent surge in headline inflation and the more favourable near-term cyclical conditions in advanced economies have already brought forward expectations of the start of rising interest rate cycles. With the normalisation of monetary policy stances in the advanced economies becoming more imminent, the risk of an abrupt reversal of international capital flows is increasing. This calls for pre-emptive policy actions to contain the build-up of overheating pressure and another boom-bust cycle in the region before such abrupt reversals of capital flows occur.

6. Secondly, some of the conventional wisdoms in monetary policy may be challenged by paradigm shifts in the next phase of growth. Conventionally it has been suggested that central bank normally may not need to react proactively to commodity price inflation because of their transitory nature and limited pass-through to core inflation. However, the recent increase of commodities prices such as food and oil could be more sustainable because of structural change in demand and supply. For instance, structural factors such as slowing of crop yield growth, fast population growth and higher income elasticity for food in developing countries would continue to support higher food prices. Policy markers would therefore need to pay attention to these developments in calibrating the appropriate degree of monetary tightening.

7. Thirdly, there is also a need to diversify the sources of growth for the region, in order to generate sustainable growth and redress global imbalance. In this regard, it is worth-noting some encouraging developments that are underway in the region. The first one is the deepening intraregional trade and increasing orientation towards domestic consumption. The robust economic growth of the regional economies over the past year has mainly been propelled by strong domestic demand, while the contribution from net exports was either small or negative. In fact, the aggregate trade balance of the region has been gradually declining since 2007, and if intra-regional trade is excluded, it has declined notably from about 4% of the regional GDP in mid-2007 to less than 2% at end-2010, the lowest in more than a decade. This gradual change in trade pattern, with regional economies shifting their export markets from deficit countries like the US to surplus countries in the region, has also been contributing to global rebalancing.

8. We also should not overlook the positive attributes of capital flows. While challenging to manage, capital inflows present important opportunities for boosting broader-based growth. The key is to channel the capital flows into good uses, and particularly towards productive investments. In this regard, promoting capital market development is important to open up additional channels of funding for long-term investments such as infrastructure. The good news is that the region is already taking steps in the right direction by improving the financial infrastructure of bond markets and expanding the investor base. Meanwhile, many economies are also making greater use of public-private partnerships to promote critical infrastructure investment projects.

9. In the face of these significant uncertainties and challenges ahead of us, IMF's assessment of the prospects and risks, as well as advice on policy response for the region is particularly important at this juncture. We look forward to the presentation by IMF and the dialogue during the panel discussions.

10. Thank you.