

Wu Xiaoling: Lessons we should learn from the Asian financial crisis

Remarks by Ms Wu Xiaoling, Deputy Governor of the People's Bank of China, at the International Seminar on the Tenth Anniversary of the Asian Financial Crisis, Beijing, 21 June 2007.

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Ladies and Gentlemen:

Good morning.

It is a great pleasure for me to attend the International Seminar on the Tenth Anniversary of Asian Financial Crisis jointly hosted by the Financial Research Institution of the People's Bank of China, Institute of World Economics and Politics of Chinese Academy of Social Sciences, and the China Business News. Please allow me, on behalf of the People's Bank of China, to welcome the distinguished guests from the World Bank, the International Monetary Fund and other international institutions, and countries and regions including Japan, Korea, Thailand, Malaysia, and Indonesia, etc. and experts and scholars from domestic government agencies and institutions.

This year marks the tenth anniversary of the Asian financial crisis. The world economy has undergone tremendous changes over the past ten years. It is of significance to conduct in-depth discussion on policy-making and reform strategies in China's financial opening-up against today's backdrop of global economic imbalance, excess liquidity and increasingly changing financial market.

1. Lessons we should learn from the Asian financial crisis

In July ten years ago, the attack on Thai Baht by the international hot-money triggered a large scale financial crisis, which severely damaged the economies of Thailand, Malaysia, Indonesia, Japan, Korea, and China's Hongkong SAR and Taiwan province, and pulled Asian countries into an economic and social turmoil.

Reflecting on the reasons behind Asian financial crisis ten years later, we find lessons in many aspects.

- (1) A country's financial opening-up must suit status quo of its financial system. Sound domestic financial system and healthy operations of the enterprises are the micro basis to forestall external shocks, thus we should effectively combine the processes of opening-up and internal reform. An orderly opening-up will help foreign and domestic financial institutions to influence and learn from each other. Inefficiently managed opening-up and a fragile banking system will undermine financial stability.
- (2) More efforts should be made to intensify monitoring on cross-border capital flows, in particular, short term capital flows. The abnormal flow of short-term speculative capital may lead to financial crisis. Relevant countries should adopt exchange rate regime best suited its local characteristics. Rigid and inflexible exchange rate regime will be an easy target of international speculation. Rapid increase of asset prices due to large inflow of foreign capital will not sustain, and the fall of asset prices is always correlated with capital flight and depreciation of local currency, thus we should keep alert to excess investment of foreign capital in domestic assets. Relevant countries should make more research on monitoring of cross border investments by the hedge funds.
- (3) An appropriate crisis management mechanism is the guarantee to prevent crisis and reduce loss from the crisis. Relevant countries should establish crisis management mechanism adaptive to its own financial system. Meanwhile, the increase of cross

border financial cooperation has a bearing on preventing the spread of crisis and reducing loss from the crisis. International institutions should improve rescue methods by adopting prompter countermeasures suitable to specific condition of the rescued.

2. The role and contribution of China, as a responsible big country, in Asian financial crisis

In order to mitigate the impact of Asian financial crisis and help crisis-stricken Asian countries walk out of the plight, then China's Premier Zhu Rongji promised, on behalf of the Chinese government, to the world that the RMB would not depreciate, followed by a series of active measures and policies.

- (1) China made vigorous efforts to participate in the IMF's rescue operations to help related Asian countries. After the outbreak of financial crisis, under the arrangement framework of the IMF, the Chinese government provided a total of over US\$4 billion assistance to Thailand, as well as export credit and emergency free medicine assistance to Indonesia and other East Asian countries, although China had inadequate foreign exchange reserves at that time.
- (2) China actively cooperated with relevant parties to participate in and advance regional cooperation. At the sixth ASEAN informal leaders' meeting, then China's President Jiang Zheming unveiled three proposals of strengthening regional cooperation to refrain the crisis from spreading, reform and improve international financial system, and respect self-selected measures of relevant countries and areas to overcome financial crisis. At the second informal ASEAN+China, Japan and Korea leaders' meeting and the informal ASEAN+China leaders' meeting, then Vice President Hu Jintao emphasized that East Asian countries should vigorously engage in reform and adjustment of financial system, with the most pressing need to intensify the management and supervision over short-term capital flow. He called on the East Asian countries to strengthen exchange on macroeconomic issues such as financial reform, have dialogue between deputy finance ministers and deputy governors of central bank, and form expert team at appropriate time to launch in-depth research on specific measures on managing short term capital flow. The above measures adopted by the Chinese government received positive response and support from most crisis-stricken countries.
- (3) China promised that the RMB would not depreciate. Being a highly responsible country, the Chinese government made the decision of no depreciation of the RMB with an aim of safeguarding regional stability and promoting development, which played a pivotal role in maintaining economic and financial stability of the Asian countries and the world at large, as well as Asian countries' economic recovery and regaining of rapid growth in later years.
- (4) China implemented policies to boost domestic demand and stimulate economic growth. While sticking to no depreciation of the RMB, the Chinese government took a wide range of measures to boost domestic demand and stimulate economic growth, which safeguarded health and stability of domestic economic growth, mitigated difficult situation in the Asian economies, and fueled recovery of Asian economy.

The adoption of these measures by the Chinese government embodied that as a part of Asia, China had a full awareness of collective interests and responsibility and has made its due contribution to the rapid recovery and regaining of growth momentum of the Asian economy.

3. Expedite financial system reform to enhance capability to withstand financial crisis

In the wake of the Asian financial crisis, China attached great importance to financial stability and financial safety by taking a mix of measures to improve sound operation of the microeconomic financial entities, reinforce the role of market mechanism in the allocation of financial resources, push forward the reform of foreign exchange management system and foreign exchange rate regime on a sequenced manner, intensify monitoring and control of financial risks, and enhance the capability to prevent and forestall financial crisis.

- (1) Prudential financial regulatory system was improved. The occurrence of a series of financial crises, such as Latin American debt crisis and Mexico financial crisis, led us to the conclusion that fragile financial regulatory system was the main reason behind financial crisis in many countries. Given under-fledged financial regulatory system, China intensified the building of financial regulatory policies after the Asian financial crisis. Following the establishment of securities regulatory commission, we set up insurance and banking regulatory commissions to materialize separated operation and regulation with a view to strengthening regulation on various financial institutions.
- (2) Reform on property right system was introduced in state-owned commercial banks. The Asian financial crisis made us realize that inefficient operation of state-owned commercial banks had become the main obstacle to the stability of financial system, with bad loans cumulated over the past years and inefficient banking governance structure putting China's financial system into a more vulnerable situation. To deal with the problems of low capital adequacy ratio in state-owned commercial banks and weak risk prevention capability, we took a wide range of measures to reform the state-owned commercial banking system and enhance their risk prevention capability. In 1998, we made 270 billion yuan worth of recapitalization to state-owned commercial banks and transferred 1400 billion yuan non-performing loans from these banks. The top priority in the following years was the reform on state-owned commercial banks. We ushered in the reforms on ownership structures of these banks with the successful listing of the Industrial Commercial Bank of China, the China Construction Bank, and the Bank of China. Governance structures of state-owned commercial banks saw fundamental changes owing to the listing of these banks, corporate transparency enhancement, and supervision based on international accounting standards and external audit requirements. Although facing huge accumulation of foreign exchange reserves, China insisted on introducing foreign strategic investors, encouraging overseas listing of commercial banks, and increasing inflows under capital account during the reform of state-owned commercial banks. It was our hope to break constraints hard to remove under China's current system and promote banking governance structure with the help of international experience and market pressure.
- (3) Greater efforts were made to develop and foster financial markets. Under-developed Asian financial market led to insufficient channels and mechanisms to divert risks, as well as Asian countries' failure to handle financial crisis. Only with the help of a wider open financial sector, game rules in the international market, and diversified and flexible financial instruments can we defeat crisis.

Over the past decade, China has gradually established a financial market system comprised of money, bond, securities, foreign exchange, gold and futures markets featuring multi-layered bourses, diversified products and varied mechanisms. In addition, we embarked on non-tradable shares reform to advance reform of financial systems so as to lay a solid foundation for overall mechanism transformation and full play of the role of capital market. Besides, we made strides in developing bond market by improving assets structure of capital market to address the problems of

simple market structure and mismatch of market size between securities market and bond market so as to facilitate optimal assets management of listed companies and portfolio of investors.

- (4) Reform of the foreign exchange management system proceeded smoothly. The Asian financial crisis made us realize how important a flexible exchange rate regime and foreign exchange rate management system to economic growth was. Therefore, after the full convertibility of RMB under the current account in 1996, we made continuous efforts to push forward the reform of foreign exchange management system by simplifying procedures of RMB convertibility under the current account, gradually lifting restrictions on foreign exchange uses under the capital account, meeting appropriate demands on foreign exchange, followed by a series of reform measures on the foreign exchange rate regime based on market demand and supply. On July 21, 2005, the RMB exchange rate against US dollar was adjusted to 8.11 yuan, and the exchange rate policy featuring a peg to the US dollar was changed to an arrangement with reference to a basket of currencies. From May 21, 2005, the band of trading prices of the RMB against the US dollar on the interbank foreign exchange spot market has widened from 0.3 percent to 0.5 percent, which meant that daily trading prices of the RMB against the US dollar on the interbank foreign exchange spot market could float within a band of 0.5 percent around the central parity released by the China Foreign Exchange Trading System.

Taking into consideration of economic and financial situations both at home and abroad, the PBC will keep regular floating of the RMB exchange rate based on market supply and demand with reference to a basket of currencies so as to keep the RMB exchange rate basically stable at an adaptive and equilibrium level, facilitate broadly balanced BOP, and safeguard the stability of macro economy and financial market.

- (5) Major progress was made on the building of financial legal system, regulatory mechanism and infrastructures. Around 1998, China had enacted or revised a series of laws and regulation to provide stronger support for regulating market activities and safeguarding market order, such as *the Securities Law, the Company Law, the Law on Enterprise Bankruptcy, the Law of Anti-money Laundering and the Property Rights Law*. Thanks to effective coordination and risk monitoring by the financial market regulatory agencies, such as the PBC and the China Banking Regulatory Commission (CBRC), a full-fledged regulatory framework on financial market has taken shape. Infrastructures building made major achievements featuring better systems for transaction, custody and settlement and more efficient interaction of markets.
- (6) Adjustment on economic structures was intensified. It was the most important reform measure we adopted following the Asian financial crisis. One of the reasons behind the crisis was the inappropriate economic structure and weak capability to forestall crisis. Presently, China is confronted with dual challenges of global economic imbalance and domestic economic imbalance. The appreciation pressure of the RMB came from the twin surpluses of China's BOP and was also the reflection of economic structure imbalances.

Without a sense of urgency to expedite structure adjustment, China's economy will face severe difficulties in the years to come. Fully understanding this challenge, Chinese government has pursued a mix of measures to adjust economic structure, including improving foreign exchange management to enhance flexibility of exchange rate, adjusting foreign trade policies of encouraging export and limiting import, enhancing efficiency of foreign investment, improving resource and factor price formation mechanism by intensifying energy conservation assessment in line with stricter environment protection standards, improving fiscal policies, and encouraging consumption, etc.

The purpose of reviewing the Asian financial crisis a decade ago is to prevent occurrences of a new crisis. China is willing to join hands with relevant countries and regions to safeguard the stability of regional and global financial systems.

Thank you.