

Heng Swee Keat: The next stage – policy challenges in Asia

Keynote address by Mr Heng Swee Keat, Managing Director of the Monetary Authority of Singapore, at the Paris Europlace International Financial Forum, Singapore, 26 October 2009.

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Governor Noyer,
Your Excellencies,
Ladies and gentlemen,
Good morning

It gives me great pleasure to join you today at this Paris Europlace International Financial Forum. Let me warmly welcome Governor Noyer and our overseas visitors to Singapore, and welcome Mr Bresson and your team for holding this Forum in Singapore.

Policy challenges ahead

A year ago, the global financial community was grappling with a severe crisis that hit every part of the globe and every sector. We were on the edge of an abyss. The timely and forceful action by authorities, including the use of unconventional monetary policy tools, helped avert the worst. In recent months, the global economy and financial markets are showing signs of stabilization. Though we are yet to see a firm or sustainable rebound in final demand, there is a sense of relief, even optimism.

Now, what's next? What will be the shape of the recovery, and what policy actions are appropriate? It is difficult enough to make policy judgments in normal cyclical downturns. It is even harder now that this downturn is not a garden variety recession. The impact of a financial crisis emanating from the largest economy in the world that also serves as the world's economic locomotive and provides the global reserve currency is likely to be pervasive and longer-lasting. There are no easy precedents, and we have to remain alert to new surprises.

Moreover, the key pillars of economic theories that underpin much of our policy thinking are now being vigorously questioned.

We need much more thinking and empirical work on how economies and people behave to draw out the critical lessons from this crisis. But based on what we know, we need to undertake policy changes to build a more stable, sustainable and resilient global economic and financial system. Much of this has to be globally coordinated, given the extensive linkages among economies and the financial system.

In Asia, we face many policy challenges, and I will touch on three of these: managing the recovery, economic restructuring, and the regulation and development of the financial services sector. My main theme is that we must be cognizant that many Asian economies enter this crisis with different starting conditions, and going forward, face different challenges from those in advanced economies. Understanding these differences, and avoiding a one-size-fits-all approach, will be critical to the design of policies appropriate to each country and region.

Managing the economic recovery

First, the economy. The financial crisis hit Asia with unexpected speed and force. From peak to trough, stock prices fell by more than 60% and a group of Asian economies contracted by an average of about 6.2%, not far from the 8.3% fall during the Asian Crisis. Exports fell by

over 30%, and intra-Asian exports fell even more sharply, by over 48%. These are far worse than even during the Asian Crisis. There was no de-coupling.

Just as the fall was swift and sharp, the initial rebound has been rapid and strong. One quarter after the trough in the present cycle, Asia's GDP grew by 9.4% on a quarter-on-quarter basis, more than twice of the 4.3% rise after the Asian Crisis. Exports have also rebounded swiftly, lifted in part by the sharp increase in shipments to China.

While the outlook has improved, the sustainability of the recovery is not clear at this point. With this uncertainty, managing the cyclical recovery of Asian economies presents several challenges. A withdrawal of government stimulus measures too early risks stifling the recovery, while a withdrawal too late could result in inflationary conditions. A series of carefully calibrated actions will be needed.

Moreover, many analysts and fund managers now hold the view that emerging economies, while not de-coupled, will still grow significantly better than advanced economies for some years to come. Hence, there has been a re-rating of assets in emerging economies. Coupled with extremely accommodative monetary conditions globally, we can expect increasing inflow of funds to many emerging economies, including those in Asia, in search of yields. Managing this inflow so that it supports growth, and not drive excessive asset inflation, will be challenging. Policymakers will need a variety of tools.

Economic restructuring in Asia

Beyond the immediate challenges, the second set of issues that Asian policymakers will have to grapple with relates to the re-structuring of their economies. Business-as-usual policy will not work. The world has enjoyed a positive supply-shock with the entry of emerging economies into the global economy. We have had a period of Great Moderation. But this supply shock also creates new competitive dynamics, which will drive changes in the patterns of trade, production and growth in the coming years. The adjustments to these changes will be neither easy nor smooth. As unemployment in some advanced economies mount, the risk of trade and financial protectionism rises. Rapid changes in the real economy will generate greater uncertainty, and potentially greater volatility in financial markets.

Over the next few years, Asia is likely to grow more slowly compared to pre-crisis days, when external demand from advanced economies weakens. To sustain growth, Asian economies with big domestic markets will need to continue with structural reforms to boost domestic demand. Smaller Asian economies will have to re-orientate their economies to respond to new opportunities in these markets. The cross-border production and supply-chain networks, which have been so efficient in raising Asia's exports to the rest of the world, remains valuable but will have to be increasingly re-orientated towards raising domestic and intra-Asian consumption of final goods and services. Measures to encourage new investments in the corporate sector and in public infrastructure, as well as in education and healthcare, will be necessary for most Asian emerging economies in order to realize their growth potential.

The basic outline of changes is well understood, but crafting the details of these changes, and calibrating the pace of implementation, will need thoughtful work. The build up of domestic demand would probably be a gradual process, as experiences of Japan and Germany suggest that reducing a nation's export dependence involves major structural changes that evolve over an extended period of time. Nevertheless, I am optimistic that Asia will be able to respond to these challenges, to achieve its longer term growth potential and contribute towards more sustainable global growth.

Financial regulations and development

Let me now turn to the third set of challenges: financial regulations and development. Financial authorities are now working intensely in various fora, such as the Financial Stability

Board and Basel Committee, on regulatory reforms and cross-border cooperation. The major themes relate to new capital and liquidity frameworks and linking these to systemic risks; dealing with the moral hazard problem of individual institutions becoming “too big”, or “too connected” to fail; cross-border coordination and resolution regimes; redefining accounting rules and building counter-cyclical buffers to address pro-cyclicality; adherence to global standards and others. In many areas, measures have already been agreed and implemented.

Many of these changes will be relevant to Asia, and we need to abide by global standards. However, following the Asian Crisis, significant financial sector reform has taken place in many parts of Asia. In many economies, the rules have become more conservative. For instance, many jurisdictions here in Asia have strict loan-to-value ratios in mortgage loans and provisioning requirements. There is therefore less need for Asia to have to make drastic changes to meet the new norms.

In fact, Asia’s bigger challenge lies less in having more stringent regulations, but more in development and innovation of financial services to complement its economic development. Saving rates in Asia are high, but these have to be efficiently intermediated to support productive investments. In most parts of Asia, the banking system dominates the intermediation channel.

Developing a stronger second channel through the capital markets, venture funds and private equity to support a range of entrepreneurial activities can raise the efficiency and resilience of the system. This will also provide a wider range of asset classes to meet the investment needs of a rising middle class. Similarly, the insurance and risk management markets will have to be developed further to meet corporate and individual needs. There is already a momentum, with capital markets in China, India and ASEAN economies developing well. In bigger economies, micro-finance, mobile finance and rural finance are also being developed. Cross-border financial activities within Asia are also showing signs of increase. These are positive changes, as the development of a deep and integrated financial system provides a vital support for structural adjustments in the region.

Economic and financial linkages between France and Singapore

Let me now say a few words on how Singapore is responding to these challenges, and how the French business and financial community can collaborate with those in Singapore to promote growth in Asia.

The Singapore government has set up an Economic Strategies Committee to identify policy changes to strengthen Singapore’s value as a vibrant global economic node in the heart of Asia. Singapore’s connectivity enables it to facilitate the flow of goods, services, capital and ideas. The value of Singapore as a stable, trusted hub that respects the rule of law, and its value as a consistent regulatory regime are our core strengths. But these will need to be enhanced with new capabilities in knowledge creation and innovation, as well as the development of deeper talent pool, in order for the business community to seize new opportunities.

The connectivity and ease of doing business is well acknowledged by global businesses. Today, over 26,000 international companies use Singapore as a base for their operations. Between France and Singapore, economic and trade ties are deep and growing. In 2008, total trade between France and Singapore stood at more than eight billion Euros, making Singapore the third largest Asian export market for France, after China and Japan. France, on the other hand, is the sixth largest European investor in Singapore. Some 800 French companies from a wide range of industries including petrochemicals, electronics, telecommunications, aerospace, biomedical sciences, education, and luxury goods are located in Singapore.

French financial institutions have a significant presence here. BNP Paribas is one of Singapore's earlier Qualifying Full Banks. SocGen celebrated its 30th anniversary in Singapore recently. Credit Agricole would count as the oldest French bank in Singapore, through its acquisition of Indosuez which was set up more than a hundred years ago in Singapore in 1905. Natexis has been here for 27 years, while CIC just celebrated its 25th anniversary in Singapore this year. These institutions carry out significant banking and fund management activities here. There are also insurance firms like AXA with a major presence in Singapore.

We appreciate the contribution of French financial institutions. Mr Claude Bebear, Honorary Chairman of AXA, was recently awarded the Public Service Star (Distinguished Friends of Singapore) Medal during our 44th National Day celebration. Mr Bebear is the first representative of the financial sector to receive such an award. This is a special award that recognizes individuals who have contributed significantly to Singapore in business, industry, technology and science.

I hope French financial institutions, with strengths in particular areas of finance, will continue to find ways to serve investors, corporates and governments in the region. Your strengths in Islamic finance, project finance, trade and structured finance are very relevant to Asia's growing needs in building infrastructure, facilitating trade and developing enterprises. Asset managers and insurance firms can serve the growing class of Asian investors, as well as global investors who look towards Asia to grow their assets and diversify risks. We hope that Singapore will continue to serve as a useful base for you to understand and serve the region, and that you will find many valuable partners here.

In this regard, the close collaboration between Singapore and France in research and education in the areas of finance and business will contribute to a deeper understanding of the region. Last year, HEC Paris and the National University of Singapore celebrated their 10th year of collaboration. Two well-known institutions – INSEAD and ESSEC Business School – have established their Asia campuses in Singapore. INSEAD has also set up the Asia-Pacific Institute of Finance in Singapore to conduct regional executive education programmes, as well as conduct Asia-specific financial research.

Financial institutions like AXA and BNP Paribas have also set up training and research centres in Singapore. I understand that there is also well-established financial research infrastructure under the ambit of Paris Europlace and the Europlace Institute of Finance. We look forward to greater collaboration between French and Singapore institutions. In particular, given the importance of risk management in finance, I hope that French institutions specializing in this area can bring their expertise to this region.

Conclusion

In closing, the global financial crisis has presented many lessons for the financial community and policymakers. In Asia, the crisis has accelerated structural reforms. There are many challenges ahead, including the development of the financial services sector in appropriate ways to support economic restructuring. I hope that financial institutions in France and Singapore will contribute meaningfully to this development and help bring about a more resilient and robust global economy.

I wish Paris Europlace every success in hosting this Forum, and look forward to many more such exchanges in the future.