Tarisa Watanagase: The international monetary system

Remarks by Dr Tarisa Watanagase, Governor of the Bank of Thailand, at the Executives' Meeting of East Asia-Pacific (EMEAP) – Eurosystem High Level Seminar, Sydney, 10 February 2010.

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Liquidity challenges after the crisis

While advanced countries at the epicenter of the global financial crisis had to adopt unconventional measures, Asian economies did not face liquidity crunch, hence no need for unconventional measures. In the case of Thailand, our financial institutions have relied entirely on local deposits and not encountered any liquidity problem. Nevertheless, for contingency, the central bank expanded the list of collaterals that can be used to get liquidity from the central bank.

As for the international liquidity, there are bilateral central banks swap lines readily available and IMF's Flexible Credit Line was also a welcomed prompt response. As you know, Asia also has the Chiang Mai Initiative or CMI, which serves to anchor confidence through the psychology channel.

On the broader global liquidity issue, there is the Triffin Dilemma view that the issuer of an international currency can take the advantage of such a special status to stimulate domestic demand and liquidity in the global market. I will return to this point in the later part of my remark.

Lessons learned from the Asian crisis

From my first-hand experience in dealing with the Asian crisis, I believe that it is important to go back to the origin of the vulnerabilities, be it liquidity or solvency problem.

On reflection, I think that the latest global crisis that originated in advanced economies is very similar to that of the Asian crisis a decade ago, particularly the boom-bust cycle caused by excess liquidity. And, in the aftermath of this crisis, advanced countries are taking the path of responses that Asian countries took over the past ten years.

Allow me to put into perspective this similar path of crisis responses, so that we can see more clearly what needs to be done individually and globally.

Experience of Thailand and Asia

In the Asian case, Thailand in particular, premature opening of the financial sector with the opening of offshore banking units led to excessive capital inflows that could not be effectively arrested by the high interest rate policy, given the fixed exchange rate regime and lack of effective policy tools. The macroeconomic mismanagement was aggravated by lax supervision of financial institutions and the lack of adequate risk awareness by the public and private sectors. All these factors led to asset price bubbles that eventually burst.

But, the Asian financial crisis has made Thailand a very different place a decade later with much stronger economic resilience, together with significant progress of regulatory and institutional reforms. Today, our macroeconomic policy framework has emphasized not only monetary stability but also financial stability with a broader and more in-depth surveillance that now covers household, financial, and real estate sectors.

This strengthened surveillance framework has allowed us to take pre-emptive macroprudential measures to tackle potential imbalances in specific sectors before they develop into significant vulnerabilities. In parallel, our financial sector regulations and supervision have been strengthened significantly, aimed at ensuring that financial institutions and markets take prudent risks and have enough buffer to cope with potential systemic risks.

Countries in Asia have progressed on the same path I mentioned after the Asian crisis. In addition to the individual efforts, another important development is the regional efforts on precautionary measures. The latest development of the Chiang Mai Initiative Multilateralization also helps bridge the gap between the IFIs and emerging market economies on the liquidity arrangement and timely disbursement.

What is still ongoing is the establishment of a regional surveillance unit for ASEAN+3 that will facilitate the prompt disbursement of these liquidity facilities and provide us with a better understanding of risk and vulnerabilities in the regional context.

Global crisis: addressing root causes would be the same as the Asian crisis

Looking back at how far Asia has come from the crisis has put into perspective the recent global crisis and policy responses.

In my view, this past crisis was also caused by a combination of excessive liquidity, and inadequate surveillance and supervision of both the regulated and shadow banking sectors in advanced countries. Too much trust was placed on the market mechanism, which was proven to have failed. As in the case of sub-prime markets, risk awareness was not adequate by suppliers and demanders of financial instruments and no preemptive action was taken despite some very risky characteristics.

The responses by crisis countries to prevent the next crisis were no different from what Asian economies did more than ten years ago. The calls made by the G-20 Leaders include putting more focus on financial stability, strengthening financial sector regulations and supervision, enhancing surveillance mechanism at both individual and international levels, especially more effective surveillance role and liquidity support by the IFIs, particularly the IMF, just to mention a few important initiatives. Please allow me a few comments on a few issues that I'd like to highlight.

What has been done and what more needs to be done

Effective surveillance: being good global citizen

One of the immediate responses to the crisis has been to strengthen effective surveillance capacity at national and international levels. We are of course on the right track in this effort to create a more robust and effective surveillance system with a view to ensuring timely policy actions. Tackling the problem at an early stage not only helps lessen the chance that micro shocks can adversely affect the macroeconomy, but also safeguards against spillovers from one country to the rest of the world.

In today's globalized world, this spirit of good global citizenship is essential. Hence, on financial sector surveillance, I support the idea that all systemically important economies need to participate in financial sector surveillance or FSAP, including the stress testing, to support the global surveillance objectives.

As for the overall global surveillance, we need more effective role of the IFIs, in particular the IMF. Effective surveillance means the capacity to ensure right policy actions by the public sector and sufficient risk awareness and management by the private sector so that policies and market responses generate positive feedbacks. Underpinning effective surveillance is of course the credibility and legitimacy of the governance structure of the IFIs. In this regard, I believe that we all need to be sincere in pushing for continued improvement of the IMF for it to be a truly credible and effective organization for surveillance.

Dealing with the inherent instability: developing deep and broad financial markets and a multi-currency system

I'd like to emphasize that even if we have achieved all the above and embraced good global citizenship, it is almost certain that there will be the next crisis. But, hopefully, this will not happen in the immediate future, and it will perhaps come from different sources of vulnerabilities. So, it is imperative that both the public and the private sectors remain very vigilant and risk-focused in identifying the changing nature of risks and new sources of vulnerabilities.

The last point I'd like to touch upon is on the vulnerability in the current international monetary system. Let me return to the Triffin Dilemma discussion mentioned earlier. As the issuer of an international currency can take advantage of its special status to overly stimulating domestic demand, this leads to excess liquidity in global market and can undermine the stability of the international monetary system in the end. However, whether the current vulnerability in the international financial system lies in the Triffin Dilemma or policy blunder is an on-going debate.

Regardless of the nature of the vulnerabilities, it is clear that there have not been enough high quality financial assets in relation to financial investors' demand. This is a factor that no doubt has contributed to the underpricing of risk and more importantly, a high degree of concentration in US financial assets, which have the most liquidity.

This point is especially important because when the global economy resumes its normal path and when emerging market economies further accelerate their growth and development, it is without doubt that wealth will once again accumulate. This will result in greater global resources searching for investment in global financial markets.

Therefore, I believe that there is a need to have more financial and capital markets that are deep and broad enough to have the acceptance of investors to help absorb the increased wealth and provide alternatives for quality investment globally. Looking around, some emerging market economies are certainly in a good position to further develop their financial markets in that direction. This is consistent with the concept of risk diversification.

Over the longer term, the instability, whether inherent or not, would decline if we have more developed financial and capital markets and also, by default, a multi-currency system as they reduce the risk concentration on one individual financial market and currency.

Conclusion

In closing, I believe that policymakers over the world need to focus our effort on all aspects of policy challenges in parallel including surveillance, financial market developments, regulations, and risk management. I strongly believe that market players respond to policy incentives and therefore policymakers have the responsibility to put the right policy and incentives in place.

There is no quick fix and it will take a long time and painful adjustment before countries that were at the epicenter of the global crisis can resume normalcy. In Asia, we have taken a decade to strengthen our economic resilience. Because of our past efforts, we have been able to weather this crisis relatively well.

That said, our work in Asia is still ongoing to strengthen the policy framework and tools to deal with future crisis that will surely not be the same as the last. Importantly, we are mindful that the world will have much less fiscal space to cushion potential global contraction, should the next crisis hit.

While it may be easier to advance these efforts at the national level, achieving policy coordination on the global level will be much more difficult. Time, spirit of cooperation and good global citizenship, as well as maintaining policy and risk focus will be essential for all of us going forward.

Thank you.