

## **Anselmo L S Teng: The international financial crisis – impact on Asia and lessons for Macao**

Speech by Mr Anselmo L S Teng, Chairman of the Monetary Authority of Macao, at the International Symposium on the occasion of the 35th anniversary of the Bank of Mozambique, Maputo, 17 May 2010.

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Dear Governor Gove,  
Dear Delegates,  
Ladies and Gentlemen,

### **Introduction**

- 1) I feel very honoured to have been invited by Governor Ernesto Gove to take part in the celebrating activities to mark the 35th Anniversary of the Banco de Moçambique and to talk about this big topic “The International Financial Crisis – Impact on Asia and Lessons for Macao”. It has been almost three years since I led the delegation of the Macao financial sector for the visit to Maputo in July 2007. I am very pleased to be in Maputo again. First of all, may I wish Banco de Moçambique happy birthday and many happy returns.
- 2) At this moment, it is generally believed that the financial tsunami is behind us. There may be hiccups, but a double dip appears not quite likely, according to recent performance of major financial markets around the world. It however appears that the recent volatility provoked by sovereign risks will be around for some time.
- 3) For this presentation, I am going to talk about the economy of Macao before and after the crisis, then I will touch on Asia and the economy of China post crisis before moving back to introduce the way forward for Macao. The second half of this presentation will be focused on the lessons Macao and the global village have learned from the crisis, which will be followed by the epilogue.

### **The economy of Macao – before and after the crisis**

- 4) Coming back to Macao, we all know that it is a tiny but open economy. It has been known for its tourism services business and cultural heritage. Under the auspices of China and a series of policy measures, the economy has taken leaps and bounds for about 10 years in a row since the return of sovereignty to China. I do not want to throw out a series of statistics, but I can say that GDP has been growing at an average of 12.4% per annum over the past 10 years and per capita GDP jumped from USD14,000 in 1999 to USD39,000 in 2009. On the other hand, The Heritage Foundation of the U.S.A. has been awarding high scores on many aspects of the Macao economy in its assessment. This year, our overall score is 72.5 making Macao the 6th freest economy in Asia Pacific and 20th freest globally.
- 5) Inevitably, we are not immune to the destruction inflicted by the international financial crisis. Our financial sector, which consists of banking arm and insurance arm, experienced a small setback as a result of the contraction of the economy.
- 6) At the beginning of the outbreak, the Macao Special Administrative Region (MSAR) Government took quick and resolute measures to soften the impact. It immediately announced a 100% guarantee on all onshore bank deposits. A series of measures were kicked out, which included accelerated public investment and expenditure; various subsidies; as well as liberal loans extended to small and medium-sized enterprises in order to boost internal demand and employment. The Monetary

Authority of Macao also complemented the efforts of the MSAR Government by adopting measures to enhance liquidity of banks when needed, setting up mechanism to more closely monitor the prudential operations of banks and coordinating with neighbouring authorities in order to ensure normal operations and stability of the financial system.

- 7) The above policies and measures, together with the locomotive effect of the China economy, which I am going to mention later, have enabled Macao to emerge from the tsunami unscathed. The economic contractions for Macao were 12% and 14.8% respectively for the 1st and 2nd quarter of 2009. The 3rd quarter saw a sharp rebound of 8.8% followed by a spectacular growth of 27.4% in the 4th quarter. The overall result for 2009 is a real growth of 1.3%. At the same time, the unemployment rate has been down to an enviable rate of 2.9%. Due to limited exposure to toxic assets, overall bank profit experienced only a minor setback in 2008. It now returns to pre-eruption level, thanks to the ongoing prudence of our practitioners and the effort of the regulator before and during the eruption.

### **Asia and the economy of China – post crisis**

- 8) China adopted very fast action to rescue the economy. It announced a stimulus package of RMB4 trillion, which was mainly intended to boost internal consumption, enhance social security, improve health care and rural development. It is worth mentioning that financial institutions of China have not been appreciably affected by toxic assets and hence suffered less from the financial tsunami. As a result, they are in a better position to extend more liberal credit to enterprises operating in China and finance construction of substantive infrastructures. In the 13 months ending January 2010, banks on the Mainland of China extended new credit valued at RMB11 trillion. The results of all these tremendous stimulus packages, both fiscal and monetary, were spectacular. There was an uplift in sales of electrical appliances, motor vehicles, construction of infrastructures and consumption. In 2009, most major economies in the world suffered a contraction but the economy of China had an enviable growth of 8.7%. Another major economy in Asia, India, also registered a growth of over 7% in 2009.
- 9) The green shoots of China spread to other areas in the world, particularly Asia. In international trade, China has applied strenuous efforts in the hope that increased international trade can pull the world economy out of the doldrums. The efforts of China bear fruit. In line with the tremendous increase in its domestic demand, China has absorbed an increasing amount of imports from neighbouring regions. For instance, Korea's exports to China jumped 59.1% in the first quarter of 2010. Figures for Chinese Taiwan and Malaysia were 76.0% and 95.0%. These may be selective presentations, but statistics show that China's green shoots have benefited another economic giant, Japan, whose exports to China jumped 56.6% in the first three months of 2010. The Asian nations and regions learned a bitter lesson in the Asian Financial Crisis of 1997-1998, after which they accumulated ample foreign exchange reserves. I should say, the impact of the financial tsunami on Asia this time is comparatively less severe. Thanks to the accelerated regional co-operation and the locomotive effect of the China economy and the ample reserves accumulated out of frugality, which is an Asian virtue. The Asian Development Bank recently painted a positive picture of the economic outlook for Asia following the severe recession in advanced economies, forecasting an average growth of 7.5% for developing Asia and the Pacific in 2010 and 7.3% next year. The GDP growth, though rebounding from 5.2% in 2009, would significantly weaken from the high 9.6% in the pre-crisis year of 2007. East Asia continued to lead, with China, India and some small countries in Central Asia predicted to maintain strong growth.

## **The economy of Macao – the way forward**

- 10) The future of Macao appears to be broad and bright in the next few years. Macao has benefited and will continue to benefit from the “closer economic partnership arrangement” (the “CEPA”) signed with China, whereby Macao’s merchandise and services will have a much freer access to the China market. In addition, in consideration of the scarcity of land resources of Macao, which has an area of only 30 sq.km, China allows Macao to make reclamation of land from the seabed up to 3.5 sq.km. The University of Macao is also allowed to relocate to Hengqin Island, a neighbouring island under the jurisdiction of Zhuhai. After all these have been completed, the area of Macao will be enlarged by over 15%. In January 2009, the National Development and Reform Commission of the State Council of the People’s Republic of China released “The Outline of the Plan for Reform and Development of the Pearl River Delta (2008-2020) (the “Outline”). The gist of the Outline is to turn the Pearl River Delta into one of the world’s most competitive conurbations with a high quality of life. The Outline defines Macao as an international leisure destination committed to further its tourism sector. By then, Macao will be connected to other major cities of the Pearl River Delta, including Hong Kong, by land transport through the completion of the Hong Kong-Zhuhai-Macao Bridge. Ultimately, Macao will become part of the Pearl River Delta conurbation which accommodates a population of 50 million with a GDP equivalent to that of a medium-sized sovereign country.
- 11) Another important role to be played by Macao is its bridging function between China and Portuguese-speaking countries in trade and economic aspect. Macao started to acquaint with Portuguese-speaking countries some 450 years ago. Portuguese-speaking countries are a market of more than 200 million consumers and are endowed with abundant natural resources. China is a thriving economic entity with foreign exchange reserves of about USD2.5 trillion. Macao is also a special administrative region of China. All along, it has always played the leading role of a liaison platform servicing the economic and commercial cooperation between China and Portuguese speaking countries. In fact the standing secretariat for the Economic and Commercial Cooperation Forum of China and Portuguese-speaking Countries is domiciled in Macao. The way forward for Macao is bright and we can conclude that Macao together with Asia, has emerged from the international financial crisis stronger than before.

## **Lessons for Macao and for the global village**

- 12) What have Macao and the global village learned from the crisis? There are many, but they all boil down to one word “prudence”. It however appears that we regulators should adopt more measures in order to prevent another eruption of such nature. It is true that we cannot see bubble from forming but certainly we can sense something is going wrong in the process. To put it in a more layman language, we regulators can take away the punch bowl before the party goes wild by applying a little brake on the creation of credit.
- 13) It appears that we have to address the “procyclicality” approach. Procyclicality refers to the interaction between the financial system and the real economy which are mutually reinforcing. A recurring characteristic of financial cycle is that good news fuels credit demand and supply. Asset prices rise in response, creating yet more collateral for more lending. The bursting of the resulting bubble then kills speculation and shrinks debts incurred in the boom. Procyclical interactions amplify the amplitude of the business cycle, thereby enlarging systemic risk. The latest bubble saw a flawed risk management and securitization, which allowed banks to use less capital to support an over-sized volume of business by leverage and off-balance sheet vehicles. Leverage was also implicit in the structure of derivatives and options extensively used in proprietary tradings of financial institutions. Revaluation of

assets also boosts bank capital in booms and shrinks it in downturns, reducing its capacity to lend in recession.

- 14) To address on procyclicality, regulators can design the regulation in a counter-cyclical fashion to dampen procyclical behaviour of financial institutions. The major tool is probably capital requirement which should align with a long-term perspective of risks which not only affect individual banks but also could spill over into the wider system. In this connection, capital buffers may be created in good times to be drawn down in recessions as losses increase.
- 15) Macroprudential supervision can be adopted to restrain build-up of risk either in the overall financial market or in specific asset class, such as the adjustment of loan-to-value ratio on real estate loans and margin requirements for securities and derivatives speculations. There are other measures such as macro-surveillance of the financial system to monitor aggregate risk and revamping of stiff compensation packages.
- 16) The Glass-Steagall Act of 1930 had by and large prevented major financial catastrophes from happening. Regrettably, its repeal in 1999 opened a Pandora's box. I am very much in favour of the recommendations of the financial veteran, Mr. Paul Volcker. He advocates the banning of proprietary trading of deposit taking banks, who should not be allowed to own hedge funds or private equity funds. In addition, a cap is to be imposed on financial institutions to prevent them from growing too big which gives rise to systemic risks. If the Volcker's rules are adopted, we shall have a much stable global financial system.
- 17) It is worthwhile mentioning that both credit rating agencies and derivatives should be put under the microscope of regulators. The woes brought about by rating agencies in rating securities, financial institutions and even sovereign countries have been known too well to our dear audience. I therefore do not want to go into details but call upon regulators globally either to have these agencies to put under supervision or we just discount the ratings in enforcing capital requirement calculations. The rating agencies should be made impartial and should stay away from any conflict of interest.
- 18) The control on derivatives, or otherwise known as "financial weapons of mass destruction" should be put under closer supervision. There is no need for me to state the very obvious "market risk" and "counterparty risk", which led to widespread systemic risk in the last financial crisis. We should seriously consider the requirement that they must be standardized and traded in exchanges and clearing houses.
- 19) It has been proven that international cooperation is paramount before and after the outbreak in the context of financial stability. Therefore cross-border regulatory supervision should be absolutely upheld for multi-national financial institutions. The malpractice of "regulatory arbitrage" should not be allowed to exist. IMF staff have proposed the creation of an integrated framework for crisis management and resolution, including a European Resolution Authority (the "ERA") for cross-border banks in Europe. The existence of such a body will greatly reduce impact on the European financial system when a major financial crisis has erupted. It appears that the idea of ERA may perhaps expand internationally to provide a more stable financial environment in the event that an international financial crisis occurs. Cross-border supervision is particularly important to Macao as the majority of banks operating in Macao are financed by overseas capital.

## Epilogue

- 20) So far, the degree of recovery varies from one economy to another. The Asian ones appear to be doing well; China is trying to dampen its economy from overheating

while India and Australia have raised interest rates a few times in the past 6 months. On the other hand, some economies have focused on fiscal discipline and therefore cannot contemplate any exit strategy. On the regulatory front, there is still a lack of consensus on major financial reform, such as the limitation on size of financial institutions, levy on financial transactions (the FAT or Tobin Tax) and the application of Volcker's rules. Indeed we need global cooperation and consensus to cure our financial disease.

I hope what I have said today may provide food for further thought on our discussion on how to prevent the recurrence of another financial tsunami and how to soften its blow. This is the purpose of my speech today.

Thank you for all your attention.