Eddie Yue: Structural reforms needed to improve Asia's economies

Statement by Mr Eddie Yue, Deputy Chief Executive of the Hong Kong Monetary Authority, and Head of Delegation, Hong Kong, for the 47th Asian Development Bank Annual Meeting, Astana, Kazakhstan, 4–5 May 2014.

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I would like to express my gratitude to the Government of Kazakhstan for hosting the 47th Annual Meeting of the Asian Development Bank (ADB) and the people of Kazakhstan for their hospitality. I would also like to thank the Management and staff of ADB for the excellent organisation of the event.

Since the last ADB Annual Meeting, we have seen a modest and uneven global recovery, with the advanced economies showing a pickup in economic activities while emerging market economies (EMEs) generally experiencing a moderation in growth. Financial markets have turned more volatile in response to the changing pattern of global growth and expectations of a turning point in US monetary policy, and a number of EMEs have seen a sharp reversal of capital flows.

Regional economies have remained relatively resilient in the recent bouts of financial market volatility, thanks mainly to the stronger fundamentals of the region nowadays. Since the Asian financial crisis, many regional economies have implemented reforms to improve their macroeconomic management and fiscal positions, built up foreign reserves and strengthened their financial sectors. For some economies that were more affected by the recent financial market turmoil, they have also taken credible policies to address domestic imbalances and have been successful in restoring investors' confidence so far.

Nevertheless, we cannot afford to be complacent as what we had experienced in the past year was probably a prelude to, rather than the end of, a period of heightened market volatility. The sentiment of global financial markets has turned more sanguine recently amid expectation of prolonged low interest rates in the US. However, the pace of monetary normalisation in the US is very much uncertain and data dependent. With a large part of the cumulated capital inflows to Asia since 2009 still in the region, it is possible that regional economies with domestic vulnerabilities built up during the period of ultra-loose global monetary conditions could experience sharp corrections when capital flows ultimately reverse. It is therefore imperative that regional economies should make use of the current breathing space to put their own house in order, take credible measures to reduce macroeconomic and financial imbalances, step up surveillance and ready contingency plans and liquidity backstops such as the use of foreign reserves and bilateral/multilateral swap lines to mitigate systemic risk in the financial systems when the need arises.

A sharp reversal of capital flows could deal a severe blow to low-income countries, as reduced private capital, exports and remittance could have a disproportionally large impact on their less diversified economic structure. ADB should draw on the experience in the aftermath of the global financial crisis and stand ready to provide timely and flexible crisis-related assistance to its needy members.

While macroeconomic policies and prudential measures could help smooth cyclical economic fluctuations, in the longer term, credible structural reforms are needed to sustain the growth of the region and preserve investors' confidence. The vulnerabilities now faced by some regional economies are in part due to the overheated domestic demand in the past years amid strong capital inflows. However, they also reflect, to a considerable extent, supply-side constraints on potential output and limited capacity of the region's financial markets. While the situation differs across economies in the region, there are a number of structural reform needs that are common to the region and in which the ADB can play an active role.

First, the supply-side constraints in a number of regional economies are linked to weak investments, in particularly infrastructure investments. Many investors have cited that there is no lack of funds or interest in investing in Asian infrastructure projects. The problem, however, is a lack of a pipeline of bankable projects, which in turn is due to fundamental issues such as uncertainties relating to the government's commitment in supporting a specific sector; lack of a credible PPP framework; political force majeure; and project governance. In this regard, the involvement of multilateral agencies such as ADB would be very useful in that not only will it foster investors' confidence if the multilateral agencies put in their own financial resources, but it will also help build the governments' capacity in structuring projects, strengthening the PPP framework and improving project governance to make their infrastructure projects commercially viable.

Secondly, shortfall in educational inputs has been seen as one of the major constraints for some developing economies to enhance productivity and move up the value chain. It has also been a major reason for the remaining pockets of poverty in the region, including in countries where substantial economic progress has been made but a substantial proportion of the population is still living in poverty. We encourage ADB to further strengthen its support for the educational sector and developing human capital, which are essential to enhancing competitiveness, eliminating poverty and addressing the rising inequality in developing Asia.

Thirdly, intra-regional trade has been an important source of growth after the global financial crisis as regional economies increased their domestic demand and reduced their reliance on exports to advanced economies. As the global economy continues to rebalance, the prospect of the region to sustain its growth would very much depend on its ability to hold up domestic demand through sustained productivity enhancement as mentioned above, and further trade integration within the region. While intra-regional trade has been growing fast, a further reduction in trade barriers should help promote deeper regional trade integration and facilitate more efficient resources allocation. A wider use of local currencies in trade settlement and financing would also help diversify sources of trade financing and reduce currency risk and transaction costs.

Lastly, regional economies need to deepen financial market reforms and promote greater financial integration within the region to better channel Asia's surplus savings to meet its own investment needs; to support growing trade integration; and to enhance the absorptive capacity of our financial markets to capital flows. Further liberalisation of the financial sector and improving financial infrastructure such as establishing credit information sharing system and microfinance institutions should also help some regional economies to allocate credits more efficiently. Over the years, ADB has contributed to financial sector development in the region through its own programmes and through supporting regional initiatives such as the Asian Bond Markets Initiative under ASEAN+3, and we welcome the Bank's continued commitment in this regard going forward.

It is noted that a number of the above structural reform areas have been identified as strategic priorities in the Bank's midterm review of Strategy 2020. With its expertise, we believe ADB has an important role to play in helping the region to tackle the challenges arising from the highly uncertain global environment, and embark on structural reforms to raise its long-term growth potential. We look forward to ADB's continued engagement with its members to provide support that will cater for their changing needs as the region continues to progress and transform.