

“The Role of Finance and Banking for the Prosperity of Asia”

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Mr. Timothy Adams, President of the Institute of International Finance,
IIF fellows, distinguished guests, ladies and gentlemen,

A very good afternoon to you all.

I am honoured to be here today and be a part of this remarkable event celebrating the 50th anniversary of the Asian Development Bank. I would like to thank the Institute of International Finance for hosting this lunch seminar and for inviting me to share with you my thought.

Throughout the past five decades of the Asian Development Bank, the ADB has been a trusted development partner of the public and private sectors in Asia. Its lending packages, technical assistance along with policy dialogues have been tailored to specific needs of member countries, and have helped reduce poverty and laid foundations for inclusive and sustainable growth in Asia. Evidently, the number of people living in extreme poverty has fallen markedly across Asia throughout the past decades.

Half a century is an important milestone. It is an opportune time to look back and look forward. **My topic for today is “The role of Finance and Banking for the Prosperity of Asia”.** I will start off briefly with the past journey of Asian development, and then focus on how to prepare our bank centric financial system for challenges and opportunities that lie ahead in this rapidly evolving economic environment and financial landscape. Having a smooth-functioning financial system is of course a necessary condition for growth as finance is often referred to as the life blood of the economy. On the other hand, if the blood is infected, it could lead to severe malfunctions of the body and serious adverse consequences. Thus, going forward, in pursuit of the prosperity of Asia, I propose that the role of finance and banking must focus on **three key words: “productivity, immunity, and inclusion”**. I will come back to these three key words later in my talk.

Ladies and Gentlemen,

Let’s begin by looking back over the past fifty years. Undoubtedly, it has been an incredible journey of Asia’s achievements. From a primarily agrarian and poor region in the 1960s, Asia has transformed itself into today’s key engine of the global economy. According to the latest IMF’s World Economic Outlook, emerging and developing Asia is expected to

grow at 6.4 percent in 2017, making it the fastest growing region and contributing almost half of the world's output growth.

To get to where we stand today, Asia has gone through various rounds of boom and bust cycles. The Asian Miracle decades in the 1980s and 1990s were largely fueled by the industrialization, rapid capital accumulation, migration of cheap labour, urbanization, emergence of middle class, and hot money, largely supported by banks at the core of financial intermediary. The “miracles” eventually turned out to be a crisis in the making, and Asia had learned the lessons the harshest way.

Fortunately, Asia has come a long way after the Asian Financial Crisis. A series of structural reforms were carried out to reduce structural weaknesses, improve growth potential and safeguard monetary and financial stability. Policies, including monetary and exchange rate policies, prudential regulations and supervision, as well as legal and market infrastructures, have been redesigned to prevent distorted incentives that could lead to vulnerabilities or building up of fragility in the system. Thus far, the Asian economies' and financial systems' resilience has been well tested by the Global Financial Crisis and its aftermath.

However, against the backdrop of the increasingly volatile, uncertain, complex, and ambiguous world we live in today, we cannot be complacent and I think it is not an overstatement to say that the real challenges still lie ahead for Asian financial systems.

Ladies and gentlemen,

After the Global Financial Crisis, **the persistently low-growth and low-yield environment has affected Asian banks in various channels.** Deteriorating asset quality with higher credit costs tends to outweigh benefits of the lower funding costs, thereby squeezing profit margins. Furthermore, new flow of credit demand has been sluggish, owing to the low-growth prospect, low private investment, excess capacity in many industries, and low commodity prices. The loan growth prospect has also been hampered by the more attractive funding sources in the capital market. **Debt overhangs** of both corporates and households in many Asian economies have also undermined investment and consumption, while threatening financial stability in some countries. In addition, **the trend towards trade protectionism and growing geopolitical tension** in the Northeast Asia and the South China Sea could jeopardise both growth and stability in our region, leading to financial volatility and possibly much higher cost of funds.

Along with rapidly changing and increasingly volatile economic and financial environment, **technology advancement is fast re-designing financial and business landscape.** Sharing economy will soon become the key feature of modern economy and financial system. Cross-border transactions of e-commerce as well as payment and settlement will become more widespread. New fin-tech firms have offered financial products unbundled from the

longstanding value chain of banks. Certain banks' existing business models might be obsolete and they must be agile enough to keep up with customers' new lifestyle and requirements as well as competitors' new business practices. In the current world, banks having economies of scale and scope might not gain advantages without agility and economies of speed. And, one should not forget that new forms of technology also bring along new forms of risks. Among others, cyber safety should be in the top priority of all banks.

Looking forward, roles of Asian banks as intermediary could be diminished on the back of the growing capital markets and shadow banking, which includes not only traditional ones like asset management companies and savings cooperatives, but also more modern ones like crowd-funding and peer-to-peer lending. Capital account liberalization will also lead to asset diversification abroad. Banks' funding sources are likely prone to be more vulnerable and volatile, with the increasing interconnectedness between banks, non-banks and capital markets. After many years of consolidating our financial systems after the Asian financial crisis, technology could fragment our financial systems in an unprecedented way. Regulatory arbitrage could lead to pockets of vulnerability, particularly in the less-regulated or unregulated areas of shadow banking.

Ladies and gentlemen, the need for rapid transformation in Asia is not limited to only banks and financial institutions. Changing technology, changing demographic structure, and changing global operating environment also necessitate that Asian businesses transform themselves to be able to compete in the new environment, where productivity is key. In addition, they need to improve their risk management and immunity to be able to cope with increasing volatility and uncertainties of the modern world.

It is also crucial that Asian banks and businesses understand developments in the society at large that could affect their operating environment, chief among these is income inequality. The income gap in many Asian countries will widen further and threaten social and economic stability, as those with higher capital can more easily reap benefits from economic growth and new technology, leaving those without access or know-how further behind. Evidence has shown that benefits from economic growth are highly concentrated and not at all broad-based. Rising income inequality has raised social polarization and we have seen it culminated in Asian politics even before the Brexit vote and the U.S. Presidential election.

Ladies and gentlemen,

While all sectors of Asian economies, including businesses, households, banks, financial institutions, as well as authorities, must transform themselves in order to thrive in the new world, I strongly urge that banks and financial institutions look beyond their conventional

financial intermediary function, and get actively involved in addressing the key issues of the economy. After all, the financial system is the blood vessel of the economy.

Facing with these challenges, and aspiring to achieve a sustainable and prosperous Asia for many more years to come, financial system must, at the very least, help with the three key words I mentioned earlier: 1) *productivity*, 2) *immunity*, and 3) *inclusion*.

First, to enhance productivity, the trend in technology advancement together with research and development will be the key enablers to increase productivity in Asia. The IMF's chief, Madame Christine Lagarde, has recently warned that "another decade of weak productivity growth would seriously undermine the rise in global living standards". In this regard, banks have to embrace and employ technologies not only to improve their organisation's own competitiveness, but also to be able to provide more efficient and lower-cost financial services to Asian businesses and households. Regulators also need to establish an ecosystem that encourages financial innovation, competition, and efficiency improvement. **In my view, there are at least two areas that banks and financial institutions could help improve productivity.**

First, digitization will certainly enhance productivity in financial services. In Thailand, electronic payment and digital banking are becoming increasingly widespread. Under the national e-payment program, businesses, households, and the government will significantly benefit from the cost reduction of financial services both in terms of money and time saved. Many initiatives under the national e-payment program, for instance, the new faster payment system or "**PromptPay**" and electronic government payments will provide foundation for many new add-on applications that will improve productivity across different segments of the Thai society. Thai banks have definitely played significant roles in hatching out these initiatives, starting from ideas and all the way through to implementation.

Second, financial connectivity, particularly within our region, will also play a key role in enhancing productivity. Regional cooperation amongst Asian countries, not only in trade and investment, but also in finance has a potential to expand much further. I strongly believe that improved financial connectivity in Asia will be mutually beneficial to all. There are already many ongoing initiatives, for instance, promoting the usage of local currency in the region, the ASEAN Banking Integration Framework, the Asian Payment Network, and the Asian bond and capital market initiatives. Despite progress made thus far, financial institutions and policymakers in the region could step up our joint efforts in various ways.

Let me now turn to immunity, which is equally important under the increasingly volatile, uncertain, complex, and ambiguous world in order to keep the financial system resilient throughout and thus be able to continue to support their clients and the real economy.

As the financial system is the blood vessel of the economy, immunity needs to start from safeguarding against blood infection. We will need to ensure that banks have adequate capital and provisioning cushion to be able to withstand swings of economic cycle and financial volatility. The Bank of Thailand welcomed the post GFC's regulatory reform addressing concerns on systemic risks including the conservation buffer, the countercyclical buffer, G-SIBs and D-SIBs, as well as the recovery and resolution plan to further strengthen financial safety net. To complement these rules, and build a better immune system that is strong and resilient through any cyclical or structural shocks, I believe we need to target the underlying factor contributing to immunity, namely, the culture and behaviour of banks.

Fundamentally, an organisation is predominantly defined by its behaviour and culture. Behaviour and culture influences operations at almost every levels within an organisation, ranging from decision making, strategic positioning, as well as risk appetite and risk taking. The risk-reward incentive structure has to focus more on long term gains rather than short-term profits, and the design of compensation scheme should fully reflect that aim. The strong culture of risk awareness and good governance should be rigorously instilled such that it becomes organisational culture and natural behaviour of bankers. Culture of transparency along with proper check and balance also contribute towards a solid foundation of banks' immune system.

The other area of immunity that will be key for financial institutions is immunity against cyber security risks. Everyone, every bank, every system must be prepared and ready to both prevent and respond effectively to cyber security risks. Incidents of cyber attacks, no matter how small, can undermine the integrity of the financial system. To boost the immune system, it is imperative that cyber resilience and cyber security be given the highest priority.

Ladies and gentlemen,

Financial stability could not exist without social stability, which brings me to my third and last point that requires collaboration from financial institutions. The economic benefit of growth has to be inclusive and financial system can play significant roles in promoting inclusive growth, starting with financial inclusion.

The people at large must have access to basic financial products including payment, savings, credit, and insurance. The pricing has to be lower, choices wider, and access better. Products that we should see more of are, for example, basic savings account with no minimum balance to cater for the low-income group, low-fee payment and transfer services, micro insurance for farmers, and increased information-based lending to small businesses complementing to collateral-based lending.

Despite the high level of access to finance in Thailand relative to other emerging Asian countries, the Bank of Thailand regards financial inclusion as one of our top priorities. In collaboration with both banks and non-banks, we have continually put our efforts to promote financial access in many areas. They include, for instance, SMEs' credit guarantee scheme, free-of-charge fund transfer through our new faster payment system for any amount up to 5,000 Thai Baht (approximately equivalent to 145 US dollar), no-fee bank savings account, nano finance to accommodate small borrowers, as well as the new Business Securities Act to widen the scope of eligible collateral for secured lending. In addition, we will soon launch an unsecured debt restructuring scheme for individual borrowers with multi-creditors to address the household debt overhang.

To ensure a “good quality” financial inclusion, financial literacy and financial technology literacy are crucial life skills for both households and small businesses. Effective financial literacy would help increased consumers' financial discipline and understandings of financial products and their risks. Thus, deepening such basic knowledge and turning concepts into changing behaviour would be particularly helpful to shelter vulnerable businesses and households from getting themselves into over indebtedness or stuck with unsuitable financial contracts.

Besides, as technology advancement permeates into all businesses, all lifestyles, and all sectors, if we also could ensure that households and small businesses that make up the majority of our economic agents can practically apply and benefit from the new technology, while being aware of its associated risks, then we could significantly raise their standards of living.

Ladies and gentlemen,

That brings me to the end of my talk today. To aspire for a better standards of living for all citizens of Asia for the next half century and more, we, all of us, must collectively do our part to ensure inclusive and sustainable growth. **In so doing, banks and financial institutions, as the blood vessels of our economy, have important roles to play to prevent the blood from being infected as well as to ensure the well-functioning of our blood circulation for more productive, better immuned, and more inclusive economies in Asia.**

Thank you very much for your kind attention.