CLOSING REMARKS

Asia, the Financial Crisis, and Global Economic Governance

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I am grateful for the chance to be with you today at this interesting and timely conference. I would like to thank Janet Yellen and the Federal Reserve Bank of San Francisco for inviting me to speak to you on Asia and the global financial crisis.

We remain in the midst of an exceptionally difficult and challenging period. The past year's dramatic bout of financial turmoil, accompanied by large-scale wealth destruction, stunning declines in industrial production and in global trade and worrisome increases in unemployment have been met by an unprecedented policy response. Both the scale of the anticrisis measures and the level of international collaboration have been unique. It is therefore gratifying that consensus views evident at the IMF and World Bank Annual Meetings that just concluded in Istanbul are that the worst has past, and the healing process has begun. As difficult as the past year has been, there is a palpable sense that forceful policy actions succeeded in staving off even more negative outcomes.

Although our base case expectations—as detailed in the latest *World Economic Outlook*—anticipate renewed global expansion, it is only prudent to keep in mind that the global economy still faces considerable risks and challenges. To assure a durable exit from the crisis, and to build in its wake a more stable international monetary system will require continued broad-based international collaboration. In fact, fundamental shifts are under way already in global economic governance, involving new organizations, new methods, and a new sense of flexibility and innovation.

I will focus my remarks today on the role of Asia in this changing landscape, taking into account both the developments of the past year as well as the key challenges—and opportunities—that lie ahead.

The Crisis Response and Underlying Fundamental Changes

I am sure that you are all aware of the basic economic facts. Asia, despite its relatively strong initial condition entering the crisis, was hit hard late last year.

While it was not directly exposed to the financial assets that were at the epicenter of this global crisis, Asia was severely affected by the sharp downturn in the United States and Europe as the trade implications of the global downturn reverberated through the Asian supply chain, capital flowed out of the region, and trade finance stalled. Measured from peak to trough, real GDP has fallen by nearly 4 percent in the United States, but it fell by more than 8 percent in Japan and by about 7 percent in emerging Asia (excluding China, India, and Indonesia).

Fortunately, the global economy has begun to pull out of recession, and Asia looks set to emerge from the downturn both sooner and stronger than any other region. The IMF's most recent *World Economic Outlook* forecasts global economic contraction of about 1 percent this year and expansion of around 3 percent next year. At the same time, Asia is expected to grow by 2¾ percent this year and by 5¾ percent in 2010. Strikingly, the three fastest growing economies in the G-20 are all from Asia—China, India, and Indonesia—with China projected to grow 8½ percent, India 5½ percent, and Indonesia 4 percent this year.

Aside from growth, Asia is doing well when measured by other economic indicators. For example, inflation has virtually disappeared, expected to end the year at a regional average of just under one-half of one percentage point. Also, employment losses in Asia have been much milder during this downturn than in past recessions.

Some have argued that Asia's remarkable recovery reflects a decoupling from the rest of the world. However, the rebound so far reflects largely a return towards normalcy of trade and finance flows following their abrupt collapse at the end of 2008. In fact, those economies with some of the largest initial contractions were the so-called newly industrialized economies—Korea, Singapore, and Hong Kong—with large shares of high-tech and other manufacturing trade with advanced economies. And, just as the U.S. downturn triggered an outsized fall in Asia's GDP because international trade and finance froze, the normalization process is generating a rapid and strong Asian upturn.

The recovery also reflects quick and forceful policy actions in the region, including monetary easing, currency flexibility in many countries, and substantial fiscal stimulus—in fact, larger than the G-20 average. Asian countries also have provided substantial financial sector support, including blanket deposit guarantees, backstopping the issuance of banks' wholesale financing, and offering cover for corporations that had borrowed in foreign currency. The provision of cross-currency swaps, in some cases with the Federal Reserve, also helped to ease pressures in the region.

Finally, Asia's recovery is a testament to its strong fundamentals, including the sound balance sheets of its private sector. When the crisis broke out, Asia's banks and companies had solid capital positions, low leverage, and little exposure to toxic assets. As a result, banks have been both willing and able to lend, which has meant that credit has not slumped by as much as in other regions.

The resilience of Asian economies in this crisis, their substantial contributions to global growth in recent years and the region's importance in international capital flows are underpinning the transformation of international fora. For example, a discussion of global economic cooperation would seem hollow if China—likely the world's third largest economy—were absent. It should come as no surprise then that the G-20—with six representatives from the Asia-Pacific region—has been designated as the premier leadership forum for international economic cooperation among the largest economies.

Changes also are under way with regard to Asia's role at the IMF, as the region is receiving a larger voice in accordance with its growing weight in the global economy. Under the reform of IMF quotas agreed to in April 2008, underrepresented Asian countries stand to gain nearly 3 percentage points in quota shares. Still, the region remains significantly underrepresented and, in the next review of quotas to be completed by January 2011, further gains are to be expected.

Asia's rising influence in the global economy also is being mirrored in its financial assistance to the rest of the world. For example, the region has pledged to provide the IMF with US$178 billion in new lending resources—a third of the total pledged through the New Arrangements to Borrow (NAB) as well as the Note Purchase Agreement—to support countries combating balance of payments pressures brought on by the crisis.

This reshaping of economic governance is timely, and an integral part of the broader effort to reform the global economic and financial framework—and thus to lay the foundations for strong, balanced, and hence sustainable growth in the future. Global cooperation will be necessary if this effort is to be successful.

Challenges and Opportunities Beyond the Crisis Response

Turning now to some of the key challenges in the period ahead, as well as opportunities for building a stronger post-crisis world, the principal near-term risk is that the global recovery could stall. This could occur if private demand does not pick up and replace the policy stimulus and inventory restocking that have recently been the key drivers of growth. Policy support therefore should remain in place until a durable recovery is secured.

Some Asian countries—particularly advanced and export-dependent economies that have experienced a relatively large cyclical weakening of their fiscal positions—are planning to withdraw fiscal stimulus over the course of 2010 in response to the signs of recovery. However, these plans should proceed cautiously until the recovery seems assured. At the same time, fiscal credibility could be enhanced by announcing concrete medium-term consolidation plans. Such plans will be particularly relevant for those countries starting from relatively high debt levels (including Japan, India, and Malaysia) and those facing looming age-related fiscal pressures (such as Japan and the newly industrialized economies of Korea, Singapore, Hong Kong SAR, and Taiwan Province of China). But even for the average Asian country, without fiscal adjustment, debt-to-GDP ratios are projected to remain above pre-crisis levels through 2014.

For the bulk of the region, monetary conditions should remain supportive for longer than has been the case in previous cycles. Inflationary pressures generally remain muted, as the output gap has widened. With the recovery still tentative, inflation risks currently low, and limited asset price increases so far, a near-term tightening of monetary policy would be premature for most countries.

But there are a few exceptions where action may be appropriate sooner then elsewhere. In Australia, the recovery is advancing rapidly and output gaps are starting to close, prompting the Reserve Bank to become the first major country central bank to raise interest rates since the onset of the crisis. In India, core inflation and inflation expectations are rising as industrial production has recovered rapidly. And in China, growth is accelerating and the extraordinary pace of loan growth in the first half of 2009 raises the risk of future loan quality problems.

Over the longer horizon, there are significant risks of anemic global demand if the policy choices are not mutually supportive. Achieving sustained healthy growth for all countries will depend critically on rebalancing the pattern of global demand—not just from public-sector supported growth to private-sector supported growth but also from relative reliance on external demand to domestic demand in surplus countries, and the reverse in deficit countries. Policy collaboration could help to insure that this process will take place in a mutually supportive fashion. In China as well as other emerging Asian countries that run large current account surpluses, the authorities have indicated their intention to emphasize policies that will support increased domestic demand, including via structural reforms. Increased exchange rate flexibility in some countries in the region will also be helpful in this process.

This rebalancing process will involve strengthening consumer confidence and facilitating a pickup in private investment in industries geared toward domestic markets. At the same time, improvements in corporate governance, financial intermediation, the quality of public investment, and social safety nets will help to continue improving productivity and support growth. In particular, research highlighted in the IMF's October 2009 *Asia and Pacific Regional Economic Outlook* notes that improvements in corporate governance and continued financial sector reform have the potential to bring down the high levels of corporate savings in Asia and contribute to global rebalancing.

Global Governance

In Pittsburgh, the G-20 leaders stated clearly their commitment to policy collaboration in order to most effectively address the difficult challenges that lie ahead. Their "Framework for Strong, Sustainable, and Balanced Growth" includes a cooperative, peer-review process—or mutual assessment—of their countries' policy frameworks. And they have asked the IMF to assist in this process, by developing a forward-looking analysis of the overall consistency of individual countries' policy frameworks with the overall goal of balanced and sustained global growth.

The IMF has considerable experience in analyzing members' policy frameworks and their implications for global economic and financial stability. This unique surveillance background has helped the Fund to provide timely and critical inputs to the international policy debate—for example, our call for an early and significant fiscal stimulus to cushion the crisis. The G-20 peer mutual assessment process should help to further enhance the traction and effectiveness of multilateral surveillance.

The Fund is also engaged in other relevant initiatives. We have launched an Early Warning Exercise in cooperation with the Financial Stability Board (FSB), focusing on systemic tail risks and the policy remedies that would be appropriate if such risks were to emerge. And we are improving other activities, such as the Financial Sector Assessment Program—that is conducted jointly with the World Bank—by sharpening the focus of assessments, making them more flexible and nimble, and strengthening their analytical content. And we are actively participating in the regulatory reform work of the FSB. These adaptations and reforms should help facilitate a collaborative approach to shared economic problems.

The IMF also can contribute to a more stable international monetary system and post-crisis global economy if it provides evenhanded and independent surveillance, adequate financial support, and effective technical assistance. Moreover, critical governance reforms—that have been given an important boost by the G-20—should help assure emerging market and developing countries that their views will be reflected fairly. These reforms include aligning the voice and representation of members with their weight in the global economy. As I mentioned earlier, underrepresented Asian countries will gain about 3 percentage points in their Fund quota share as a result of the April 2008 agreement. And they are expected to receive further gains in the new quota discussions that are scheduled to be completed by January 2011.

One issue of importance that will involve directly many Asian economies is that of reserve accumulation and saving surplus. As you well know, many countries have rapidly built up official foreign exchange reserves over the past decade, in part as greater self insurance against balance of payments—primarily capital account—shocks. Global economic efficiency would have been enhanced if the IMF had been able to provide the insurance demanded by these countries, but doubts about the amount of available financing and the conditions attached to this financing have encouraged self-insurance.

Such self insurance is costly both at the country level—given the foregone domestic absorption and the complications for monetary and exchange rate policy—and at the international level, where countries wishing to build up their reserves have tended to generate persistent current account surpluses. There is a real danger that in the wake of the current crisis there could be renewed widespread efforts to add to reserves. It is clear that if such efforts are pursued simultaneously, one result would be to dampen the global recovery.

As the key institution endorsed by the global community for meeting the financial needs of economies in crisis, the IMF has a responsibility to offer effective alternatives to self insurance. The IMF's lending policies were recently overhauled to make them more responsive to the evolving needs of its member countries. Importantly, with the introduction of the Flexible Credit Line (FCL), the IMF now offers a preemptive insurance facility for members with strong policies. Mexico, Poland, and Colombia have used this facility, and their decision to do so was well received by international markets. In Asian countries such as Mongolia and Sri Lanka, traditional IMF programs have played an important role in mitigating the impact of the crisis. Further work is under way on building on the success of our new facilities, for example, by enhancing predictability of access to crisis financing.

Of course, crisis prevention instruments must be backed by sufficient resources in order to be credible, as recent experience has shown that financial crises can lead to an extraordinarily large demand for official resources.

The tripling this year of the IMF's lending resources to US$750 billion has allowed us to deploy financial resources in unprecedented amounts to support a broad array of countries and to help stabilize markets. To date, we have committed funds totaling more than twice the amount that were lent during the Asian crisis.

These resources, are temporary, however, requiring approval every five years, and they are contingent, activated only when a crisis is looming or under way. So, while these resources have proved sufficient so far in this crisis, they may not be enough to reassure markets and members—particularly those emerging Asian countries that are accumulating reserves from a self-insurance motive—that this would necessarily be the case in future. As a result, the overall size of Fund quotas will be reviewed along with the shift in voting shares by January 2011.

Conclusion

In conclusion, the economy is recovering from a crisis, the fallout of which will be with us for years. But this recovery remains somewhat fragile, and there are many risks and challenges to a durable exit from the crisis. At the same time, fundamental changes are under way in global economic governance that bode well for the future. Policymakers have come together in these challenging times, and have strongly committed themselves to finding shared solutions to common problems.

The path out of the crisis will not be easy. But as long as we remain committed to create an effective multilateral process, we will be able to build a more stable and more productive international monetary and financial system that will benefit generations to come.

Thank you.