Preparing Asia for the next financial crisis

The continued challenges of a changing economic environment are not new to the ASEAN+3 region, which consists of the 10 ASEAN members plus China (including Hong Kong), Japan and Korea. The region has weathered several external shocks in the past decade, including the global financial crisis in 2008 and episodes of risk-aversion and capital outflows.

But how prepared is it for the next financial crisis? What more needs to be done?

The region has become much stronger through the increased integration of trade and investment compared with the situation before the 1997 Asian financial crisis. The ASEAN+3 region now accounts for more than a quarter of world GDP and 30 per cent of global trade. But the expansion in international trade and the increasing complexities in financial networks and other activities are increasing the risks of volatile capital inflows and outflows. Mitigating these risks warrants concerted efforts at the national, regional and global levels.

Many risks remain in the short-term, notably the threat of protectionism, tightening global financial conditions and tail risks of geopolitical events. Amid these immediate concerns, the region needs to watch the global, structural forces that affect its economies, especially in the financial sector.

As global trends such as digitalisation, changes in global supply chains and the use of new technology transform the nature of cross-border economic and financial transactions and spillovers, the changed conditions demand not only national but a regional-wide response, desirably in a harmonised manner. The demands and expectations placed on the speed of policy reaction and the clarity of policy communication are rising. Take, for example, capital flows to emerging markets in the region. With technology facilitating lightning-speed trading, sudden shocks in capital flows driven by herd behaviour are risks that policymakers have to grapple with.

Although the International Monetary Fund (IMF), at the centre of the international monetary system, is the best-known firefighter to help governments that find themselves in trouble during a crisis, it is no longer the only one. Nowadays a large part of the world, but not all, is also covered by regional financing arrangements that can mobilise financial resources for countries facing temporary liquidity problems during a crisis. One such arrangement is the Chiang Mai Initiative Multilateralisation (CMIM) that evolved from a system of currency swaps among economies in East Asia after the 1997 Asian financial crisis, with the ASEAN+3 Macroeconomic Research Office (AMRO) as its surveillance arm.

Regional financing arrangements (RFAs) are considered to be a key component of the global financial safety net, the other components of which are foreign reserves, bilateral swap lines between central banks, and the IMF. In an increasingly integrated world, global and regional financial arrangements are being enhanced and must improve cooperation with one another to form a comprehensive and effective safety net against financial crises and contagion.

At the global level, the IMF is reviewing its facilities periodically to ensure that they are adequate to meet the financing needs of its members in light of developments in the global economy and financial markets.

With regional financing arrangements there have been continuous efforts to strengthen their own internal mechanisms, as well as at collaboration among RFAs and between RFAs and other layers of the global financial safety net. Although challenges remain in anticipation of any possible crises in the future, the strong upswing of the global economy is an opportune time to undertake a more comprehensive review and reform of these regional arrangements.

In East Asia, AMRO, in its support function of the CMIM, has supported its member authorities over the past three years to undertake joint test runs with the IMF to enhance the operational readiness of CMIM facilities. Recognising the importance of cooperation among different layers of the global financial safety net, AMRO has strengthened relationships with various partners to draw on the expertise and knowledge of each institution.

Building a robust regional safety net is a long-term project. In the changing regional and global economy, there are several aspects that need to be enhanced to boost regional financing arrangements’ contribution to the global safety net.

The first is enhancing coordination among multiple layers of the global financial safety net. This is the prerequisite to provide timely and efficient support for countries that are in need of financing to support their external position. Countries should be able to combine the use of different tools to generate synergies in terms of timing and size of intervention, sequencing and conditionality design.

Second, we need to strengthen regional economic integration and the role of regional financing arrangements. With rising protectionist risks in major economies as well as changes in production networks, there is a need to strengthen intra-regional connectivity and integration in many areas to meet growing intra-regional demand and improve the region's resilience against external shocks.

Third, it is important for regional financing arrangements, in addition to its role to provide short-term liquidity support, to upgrade its function to provide policy recommendations for their members to achieve macroeconomic and financial stability, in particular, during crisis time. The specific aspects of the beneficiary country and strong sense of the ownership of its government is important in implementing such policy recommendations. Those will be the key when the recommended policies will be adopted by the country. Those consideration will enhance the positive impact on the economy when it is well in place in the domestic policies and legal structures.

Besides enhancing the regional financial safety net, and the build-up of foreign reserves by individual economies, authorities are looking at using local currencies to invoice trade. At present regional trade is heavily reliant on the use of the US dollar, even though intra-regional trade has grown substantially.Increasing regional currency use will help reduce exchange rate risks vis-a-vis the US dollar. It will also help to reduce the amount of foreign reserves in US dollars needed as a liquidity buffer for trade purposes. About US$6.2 trillion of the world's US$12.7 trillion worth of US dollar foreign reserves is held by the authorities in our region.

In the highly interconnected global economy and financial markets, financial crises are bound to recur every now and then, although it cannot be predicted when and where. That is why the region must prepare for the coming crisis now.

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