

Executive Comment:

Financial Imperatives For Sustainable Economic Growth In Asia

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Table Of Contents

In the financial markets, common regional imperatives exist

Infrastructure financing cannot be overlooked

Demographics trends are a key factor

A global-local approach will help develop Asia's markets

Cross-border opportunities for financial markets

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(Editor's Note: This article is based on a speech delivered by Standard & Poor's Executive Managing Director and Head of Asia-Pacific, Tom Schiller, at the World Knowledge Forum held in Korea in mid-October, 2009.)

Recent data suggest there is cause to be cautiously optimistic about Asian growth prospects as we move toward 2010. Many of the region's economies, particularly the relatively less affluent ones, are expanding--and China and India are currently the world's fastest growing economies with much of their momentum driven by domestic factors. But as the region's policymakers, regulators, and market participants should be aware, the path to sustainable long-term economic growth needs to be navigated in an intuitive, intelligent, and holistic manner. The financial markets have a key role to play in steering this course.

In the financial markets, common regional imperatives exist

In Asia, the financial markets are at various stages of development and sophistication. And yet, despite this diversity, there are certain common imperatives for the region if it is going to make the most of its recent resilience and growth momentum--relative to other parts of the globe--and continue to be a driver of global recovery over the medium-to-long term. While central banks and governments continue the important task of fine-tuning fiscal and monetary policies to stabilize their economies, our financial markets must develop and mature to ensure that they keep up with the pace of intraregional trade and growth momentum in the real economy.

Globally, the need for strategic financial-sector development is now on the front burner; it will be a top agenda item for bodies such as the G-20 and World Economic Forum (WEF) for some time to come. This is not to suggest a cookie-cutter approach, in which all countries will follow one set formula. Each country's strategy must be embedded in its specific historical, institutional, legal-regulatory, and cultural context. Appreciable differences between countries aside, however, it is quite clear that shared challenges, needs, and risks exist in the world's financial systems--and that common functionalities need to be developed. It is the speed and efficiency with which these functionalities are created that will determine whether or not our financial systems will be able to transform in the ways now being seen as critical to providing global stability.

Simply put, a functional financial system has to be able to do two things very efficiently. First, it has to ensure that resources flow into the activities that generate the best returns, in turn driven by competitiveness. Second, it has to ensure that the risks associated with any allocation are fully identified, measured as completely as possible, and provided for or hedged against as fully and as cheaply as possible. This involves the complementary efforts of institutions, markets, and regulators to offer both providers of funds (savers) and users of these funds (businesses and governments) a range of options from which to choose. To this end, strategic financial-sector development requires continuous mapping of requirements and capabilities--and continuous fine-tuning to keep the two in balance.

Infrastructure financing cannot be overlooked

Ensuring private-sector funds are mobilized for infrastructure investment is one area that cannot be overlooked. During the global economic slowdown, reduced foreign direct investment was one of the main constraints on growth in infrastructure-starved countries such as India. In Asia generally, the public sector has historically provided most of the resources for infrastructure but, looking forward, the region's requirements will far exceed the capacity of its governments--particularly in the aftermath of significant stimulus spending. Financial-market reforms that help create an attractive operating environment for private-sector investment--especially that which is directed toward much-needed infrastructure development--are exactly the type of policies and regulations that will lead to sustainable economic growth and improved quality of life and social stability in emerging economies.

Demographics trends are a key factor

From the consumer side, there's the region-wide imperative for the financial markets to understand the ebbs and flows of demographics in each country. First, there's an urgent need to confront the phenomenon of aging--everywhere, but particularly in China, India, Japan, and Indonesia (which account for the majority of incremental growth in senior citizen numbers). Again, public-sector capacity to meet the needs of aging populations is already strained and will become more so as regional demographics evolve. The region's financial systems will need to address the needs of the ever-growing legions of self-funded retirees who form an increasingly powerful and populated source of consumer demand potential. A long-term imperative for the financial sector will be the development of long-term savings instruments, and, importantly, putting in place the regulatory measures to ensure such instruments are secure and perform well.

Financial markets participants will also need to understand where working-age (15-64 years) population growth is on the rise. Recent Global Insight data show that about 62% of incremental working-age population growth will come from India, with Pakistan, China, and Indonesia also contributing. The dynamics of both the working-age and senior groups have significant long-term implications for the region's financial systems in terms of priorities and the areas in which both innovation and oversight are needed most.

A global-local approach will help develop Asia's markets

As organizations such as the WEF work to identify what's needed in terms of global financial reform and development, it rests with regional market participants to use their local expertise to help achieve the financial markets' shared global imperatives. An important development for Asia will be the increasing demand for international services by both foreign and domestic investors seeking global portfolio diversification. The Standard & Poor's ASEAN ratings scale can be seen as one recent effort to facilitate global and regional financial integration by creating a common risk assessment platform for issuances across a group of economies and, in doing so, providing both issuers and investors with larger pool of securities to tap into. At the same time, this regional scale is helping those outside the region make informed decisions about investing in ASEAN markets. It's an illustration of how innovation--and an awareness of the need for products that assist global and regional integration--can help improve the overall functionality of the financial system.

The ease and efficiency with which cross-border flows of funds can occur will become increasingly important to the

functionality of the region's financial systems. For the next few decades, Asia will be the world's fastest-growing region with a rapidly expanding pool of investable resources and financial requirements. At the same time, Asia's emerging economies are at broadly similar stages of financial sector development as measured by a recent WEF report. This provides the opportunity for a coordinated approach to financial sector development--one that balances country-specific contexts with the need for common regional functionalities. It is important to note, too, that data gathered by the WEF for its Financial Development Index show that while China and India are at relatively low levels of financial development--compared with, say, Germany or the U.S.--these are the two Asian countries in which the lion's share of the region's growth opportunities lie. Over the long term, the mandate for all those involved in the development of our financial markets will be to ensure that such growth opportunities can be embraced and enjoyed in a sustainable way such that our increasingly integrated region, as a whole, benefits.

Cross-border opportunities for financial markets

Generally, a long-term imperative for the region's financial markets will be the challenge of keeping pace with, and anticipating the needs of, the region's real economies with their growing number of free trade agreements (FTAs) and, more recently, Comprehensive Economic Cooperation Agreements (CECAs) and Economic Partnerships (EPs). While FTAs typically provide preferential access to commodities and manufactured goods, CECAs and EPs widen the scope to include services and investments. As this network of agreements expands, as appears likely, opportunities for cross-border financial services will also grow. Taking a long-term view, this trend represents an opportunity for the financial markets, regionally, to play a significant role in intraregional growth and development.

Finally, the region's banking systems are bound to continue their significant role in financial-market reform and development. With minimal direct exposures to troubled assets, and with track records of relative prudence in lending habits, Asia's banks have shown greater stability and more resilience to global conditions than peers in other parts of the world. In this light, a "flight to banks" is the most likely short-to-medium-term direction for financial sector policy. But as we move forward, an important challenge for policymakers and regulators will be to find the right balance between the influence wielded by banks and that by the markets.

In conclusion, Asia's ability to become less dependent on demand outside the region to sustain its strong growth is going to hinge on its ability to develop its financial systems such that they meet the need to better allocate savings and generate demand within each economy and across the region. It is imperative that the finance sector addresses the key opportunities the region presents including: creating alternative financing for the region's massive infrastructure requirements; providing better investment options for the long-term savings of Asia's citizens; and integrating the region's financial market activity so that it supports the momentum and needs of its real economy.

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