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Towards Regional Prosperity in Asia

How Can Japan and Other Asian Countries Contribute to Enhancing Financial Markets?

Held at Grand Prince Hotel Kyoto
On the Occasion of the 40th Annual Meeting
of the Board of Governors of the Asian Development Bank

MUFG Mitsubishi UFJ Financial Group, Inc.

Institute for International Monetary Affairs

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Preface

This year marks the tenth year after the Asian currency crisis that hit many countries in the region. Despite the hardships brought by the crisis, Asian countries have since strived for and achieved highly stable economic growth, with strengthened mutual cooperation.

More recently, however, some clouds of destabilizing financial stability and sustainable economic growth have begun to emerge; growing economies are now faced with stronger currencies, excess liquidities, and bubbles in the stock markets. In order to materialize prolonged and stable economic growth in the region, it is critical that Asian countries make efforts not only to further develop and deepen their financial cooperation in the areas of the Asian Bond Markets Initiative and the Chiang Mai Initiative, but also to foster the regional financial markets in Asia, while promoting overall integration in economic and trade areas.

The Institute for International Monetary Affairs, together with the co-sponsorship of Mitsubishi UFJ Financial Group Inc. held a seminar on May 6, 2007 on the occasion of the 40th Annual Meeting of the Asian Development Bank in Kyoto. The seminar, titled “Towards Regional Prosperity in Asia---How can Japan and other Asian countries contribute to enhancing financial markets?---”, was participated by the prominent panellists who discussed the future direction of the regional financial markets and Japan’s contribution to their orderly development and economic prosperity, based on the experience of the past regional financial cooperation developed after the Asian crisis.

This is the record of the seminar and we hope this will help suggest a lot to the people who are interested in the cooperation of Asian countries.

Contents

１．Opening Remarks by Mr. Norimichi Kanari

Deputy President, The Bank of Tokyo-Mitsubishi UFJ, Ltd

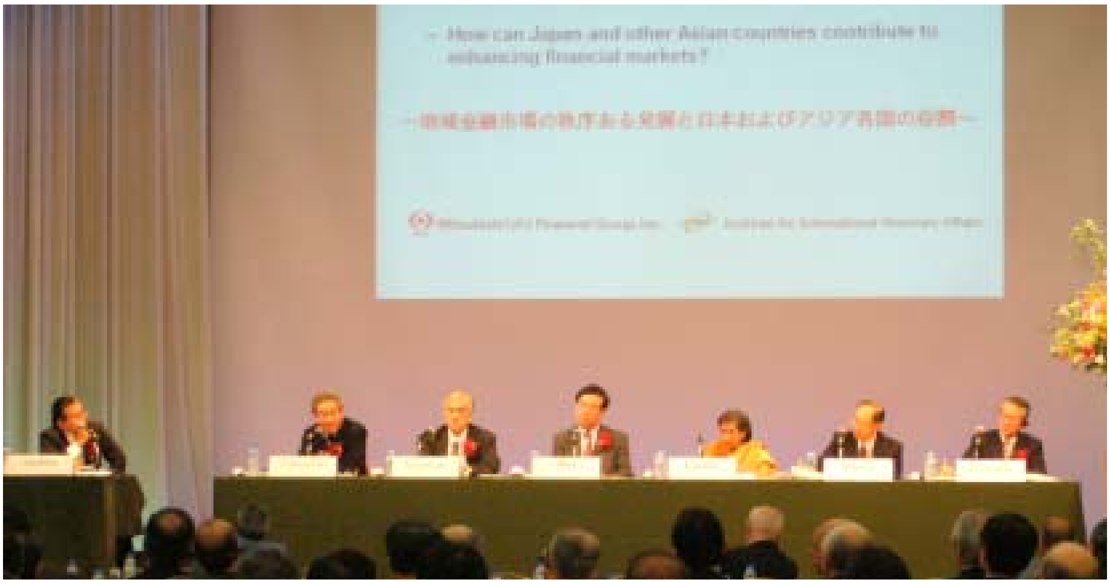
Thank you for your introduction and good afternoon, Ladies and Gentlemen. On behalf of the Mitsubishi UFJ financial group and Institute for International Monetary Affairs as sponsors, I just would like to extend our heartfelt appreciation for joining this symposium today. And we are extremely happy to have this kind of symposium on such a commemorative occasion – the 40th annual meeting of ADB here in Kyoto.

As you may know, this year coincides with the 10th year after what we call the Asian Currency Crisis. We all remember the magnitude of the impact we have had throughout Asia – and after the crisis, the public and private sectors in Asian countries made every effort to pursue structural reforms and encourage regional financial partnerships. As a result, the fundamentals of Asian countries improved dramatically. Over the last several years, we all know that the Asian region has made a remarkable recovery and that Asia is now playing a vital role as the driving force of the global economy. In order to promote further progress, I think an active economic policy dialogue among us is extremely important.

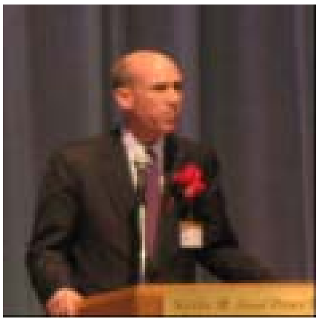
This situation in Asia reminds me of our own country's situation back in 1956, when the Japanese economic White Paper in that period gave us the phrase "we are no longer in the post-war period." I believe the intention of the White Paper was to stress that technology and innovation were vital for economic development. If we look back at it today, that year marked a turning point of the Japanese economy toward a miracle recovery ahead. Along the same context, I would like to say, in this epoch-making date, 10 years after the Asian Currency Crisis, we are now no longer in the Asian Currency Crisis. Asian economic development in the coming years will be supported by the regional cooperation among us.

This is the message that we would like to deliver to you today. Therefore, we have titled today's symposium 'Towards Regional Prosperity in Asia – How can Japan and Other Asian Countries contribute to enhancing financial markets?' To discuss this topic, we have invited distinguished guests, who are well-known to all of us, as speakers and panelists today. I will be delighted if the symposium stimulates ideas on the themes –

cooperation of Japan and Asia as well as Japan developing together with a dynamic Asia. Thank you again for joining us today and I hope you enjoy this symposium. Thank you very much.



2. Opening remarks by Mr. Lawrence Greenwood
Vice President of the Asian Development Bank



Thank you and good afternoon, ladies and gentlemen. On behalf of President Kuroda of the Asian Development Bank, let me first thank the IIMA and the Mitsubishi UFJ Financial Group for arranging this very interesting symposium very timely. Ten years have passed since the financial crisis, and banks have been restructured, financial systems have been strengthened, regulations have been modified and strengthened, foreign direct investment has returned to the region and bond markets are beginning to develop. Growth has re-emerged. But still much more needs to be done: in order to sustain that growth well into the future and one part of that work that remains to be done is further strengthening of financial markets and further integration of financial markets in Asia. National financial markets are still over-dependent on bank lending, bond and equity markets remain under-developed in many countries in the region and shallow markets mean more volatility and less predictability, so clearly it is an issue and I have just come from the governors' business meeting over at the convention center and one governor said something that I thought was very interesting, which was that trade integration has not been served well by the lack of financial integration as we are talking about, and called for more movement in removing controls on capital mobility within the region.

Now investment has been relatively stagnant in the years following the financial crisis, but that is beginning to change and we're seeing signs now of an explosion of investment – of course, we've seen it for a while in China, but outside of China, we are seeing it throughout the region, in South Asia and South East Asia. So this is going to be a test for the changes we've seen since the financial crisis, so I think this is a very, very timely session, because I think it is a very important time.

The ADB is very proud to play a part in the strengthening of financial markets and financial integration in the region. My colleague, Dr. Kawai, will talk in more detail about what the ADB is doing, but we have been working, as many of you know, to assist the Asian bond markets initiative, to back up and support the ASEAN plus 3 initiatives, including follow-up to the Chiang Mai Accord, surveillance activities and also we've been helping develop bond markets through our own bond activities and issuance, most recently of a multi currency bond. So we look forward to continuing that role in the region and again, I want to thank the organizers for bringing together this impressive line up of experts and wish the seminar the best success. Thank you.

Introductory Remarks by Mr. Toyoo Gyohten,
Moderator of the seminar, and
President, Institute for International Monetary Affairs

Good afternoon ladies and gentlemen. On behalf of all the panelists on the stage, I would like to thank you for your attendance today to this supposedly quite fascinating session. Well, I think I should tell you first of all about the framework of this session. Since we have such illustrious speakers today with us, I think we should benefit from their wisdom and experiences as much as possible, so in the beginning I would like to ask each one of the panelists to make their respective initial presentation on the broad theme of today's seminar and after we have listened to their presentations, I, as moderator, would like to take the advantage of acting as a sort of representative of the audience and try to pose questions to each one of them. In doing so, I would like to make my best efforts to gather where the interests of the audience should be. This is because of the time constraints and I would like to make that session as interesting as possible. Well, having said that, I would like to open the first part of our program – that is the presentation by our panelists.

Mr. Gyohten

As is indicated in our program, our first panelist is the Finance Minister Chalongphob from Thailand. You will find his illustrious career in your program. He is an accomplished economist, he is an accomplished policy maker and he is now carrying out probably one of the most challenging jobs in Asia now. I hope that Minister Chalongphob can share with us his experiences and views and his efforts in coping with the very dynamic situation taking place, not only in his own country, but also in Asia as a whole. So Minister Chalongphob, the floor is yours.

3. Presentation by Mr. Chalongphob Sussangkarn
Finance Minister, Royal Kingdom of Thailand

Thank you very much, Mr. Gyohten. I would like to thank the Mitsubishi-UFJ Financial Group and the Institute for International Monetary Affairs for inviting me to address this seminar. It's a pleasure actually for me to participate because my relationship with the IIMA goes back many years and actually started directly as a result of the crisis in 1997. In 1999, my previous research institute, the Thailand Development Research Institute, was invited by the IIMA to carry out a joint research study on how to strengthen the region in the aftermath of the crisis. Actually, that study was one of the earliest studies that talk about the need to develop a mechanism to recycle surplus savings in the region for long term financing in the region. And I had the pleasure to work with Mr. Gyohten and Mr. Shinohara, Managing Director of the IIMA under that particular study.

Now obviously the 1997 crisis was very much a surprise to everybody, including to the affected countries, who thought that they were quite strong economically. Just a few years before the crisis, you remember that the World Bank mentioned something about the East Asian miracle and I think that was part of the problem as to why we got into the crisis, because in our case, anyway, there was over-confidence in the strength of our own economy and that over-confidence led us to pursue policies that basically did not adequately deal with the risks that arose from the volatile capital flows that were really increasing rapidly in the early part of the 1990s. We opened up our financial sector too rapidly and also we used the wrong macroeconomic combination of policies, what is called the impossible trinity of Professor Mundell, i.e. we used fixed exchange rate, we allowed capital flow to come out easily and we tried to use an independent interest rate policy. So this led to basically a huge increase in capital inflow into Thailand and unfortunately, most of them were short term capital flows, i.e. they were bank lending with a maturity of less than one year. Because we mismanaged the policies when the economy weakened back in 1996, there were pressures against the value of the baht and there were speculators speculating that the baht would be devalued. And at that time, the Bank of Thailand made a major mistake of using nearly all our reserves to try to defend the value of the currency. So we ended up being basically almost insolvent. We had to float the baht on July 2nd 1997, and then we had to ask assistance from the IMF.

Anyway since that time, we have learned many lessons from that particular crisis and we have carried out many reforms that should lead to a more resilient economy that would be able to withstand the kind of risks that exist from the global financial environment. Particularly there are a number of areas which I could point to. First of all, we have now developed much better data for economic management. Back before the crisis, for example, we only had annual GDP data. This came with a lag of about one year, so we really had no adequate information about what was happening to the economy. Now we have monthly data available in abundance, you can get quarterly GDP data etc., since data is very important for managing the economy. Secondly, of course, we now have the new exchange rate and monetary policy regime. We have a managed floating exchange rate with an inflation targeting monetary policy regime and we have carried out many reforms of the financial sector. There are laws pending, which will be passed within this government, on deposit insurance, on the Bank of Thailand, on financial institutions, on the social security exchange commission, etc. So basically, when I came into office, I put it as one of the rules or priorities for myself is that I would try to push through laws and policies that would lead to a more effective system to manage monetary and fiscal policy and that would look after some of the key risks we will be facing in future.

On the financial and monetary side, I have already mentioned about a number of laws. These have already passed the cabinet and they are now being considered by the Council of State, which is like the legal advisors to government. Once that is finished, then it will go to the national legislative assembly, so I hope that many of the key laws will be passed within this government. To complement this, there are some gaps on the fiscal side, which I am now developing with some of my team. One is to develop a more transparent fiscal system, in the sense that under the previous government, we saw that many measures used to stimulate the economy were basically off-budget measures in which the contingent liability to the government was not really made explicit and there was no clear information available to the public on what contingent liabilities result from these policies. So we are now trying to look at ways to make our fiscal information much more transparent, so we actually make it available to the public, and actually this aspect also reflected in the draft of the new constitution, so I think this would help in the sense that in the future, clearly there will be governments that will pursue many populist policies, because now the public seems to find these policies – they like them and so the policies will have to provide for this. As long as we have a transparent fiscal system, then we can keep track of the contingent liabilities and this means that we can have an adequate early warning system to make sure that we don't get into fiscal stress in the future. Another area is also to look at a much more effective way of handling macro projects, because we know that unless you analyze these projects carefully, then you can end up doing projects, which will not be viable in the end and this will lead to all kinds of problems, therefore, for the government in the future. So that is on the domestic side and of course, there are other areas, which if I have not covered adequately in this initial presentation, then I am sure Mr. Gyohten will ask me.

At the regional level, of course, the region has done many things to try to strengthen the region, to deal with all the risks and volatilities. Yesterday, at the ASEAN +3 finance ministers' meeting, there was some progress made on the Chiang Mai Initiative(CMI). So basically, the ministers agreed unanimously that the way to move forward on the Chiang Mai Initiative multilateralization, is through a system of self-managed pooling of reserves with a single contractual arrangement. Of course the details will have to be worked out by officials, but within a year or so, we may begin to see a clear shape for this CMI initiative. On the Asian bond market initiative, here I think we have made some progress, although people may say that we have not integrated enough on the financial side. In fact, I think we have integrated quite substantially but of course there is a long way to go and I will talk a little bit more about this later.

In the case of both Thailand and the region, what can be said now, 10 years after the crisis? I think both Thailand and the region as a whole are much better able to cope with the kind of crisis that arose in 1997 because we now tend to understand what factors led to the crisis and therefore we can act in time to make sure that, for example, short term debt does not increase too much and we have an adequate management system to deal with it.

However, the risk factors that led to the 1997 crisis are still with us today. Basically, the 1997 crisis rose from basically very volatile and large capital flows. Today we have exactly the same situation. The difference is that in 1997, the risk arose from the outflow of capital – of short term capital. Today, for a country like Thailand, the risk arises from the rapid inflow of capital and at the end of last year, we witnessed this quite dramatically. In the last quarter of last year, there was a huge amount of capital inflow into Thailand. The Central Bank was buying up foreign currencies at the rate of 800 million dollars per week. They were doing this for ten weeks in a row. Yet, during that time, the value of the baht strengthened at the most rapid pace ever. The Bank of Thailand was under pressure to do something about it at that time because at that moment, really, the only engine of growth which is working is exports. So we have a lot of complaints from exporters that if the baht keeps on strengthening then eventually they cannot compete any more. However, the problem with that is there has not been enough thought given to what would be appropriate measures to take if you need to manage your capital flows. Because basically, most of the international financial institutions have taken the view all along that the best is to open 100%. In the case of Thailand, we said opening 100% is really not an option, but what instrument to use? No guidance. And therefore, the mistake made at that time, was that the Bank of Thailand basically copied some policies of Chile used in the early 90s, and obviously, the financial system in the early 90s is very different to what is around today and therefore there was a huge impact once the Bank of Thailand introduced the 30% reserve requirement and then, after one day, when the stock market crashed by more than 15%, they then had to reverse it on flows that came into the stock market. This led to all kinds of problems.

Anyhow, when I assumed office, back in early March, the Bank of Thailand had already announced alternative measures. That if you want to bring money into Thailand to invest, say, in the bond market, you don't have to go through the 30% reserve requirement route any more. What you can do is that you bring your money, say a million dollars, you change it to baht, all you have to do is make a forward – a swap contract – to buy back your foreign currency three months from now, which means that the rate at which you buy back will be similar to the rate today, so you won't be able to benefit if the baht strengthens in the meantime. And at the moment, there are these two routes. Obviously nobody – hardly anybody – brings money in through the 30% route, because under that route, you have to keep your investment in the country for at least one year. And basically, people don't have cold money to sit around for one year. The only reason why it is still maintained on the books, the 30% measure is that the Bank of Thailand wants to evaluate if the alternative route can be an effective way to control these inflows because, remember, they did not expect the crash of the stock market back in December, therefore they are not sure whether this alternative is going to work. But if they are to see stability, then eventually the 30% measure will be removed from the books.

But this basically shows that for countries like Thailand, we do need a lot of guidance from the international community, from the multilateral agencies, on how best to deal with these inflows. In the past, there were not enough studies or research to provide that particular guidance and this is what Thailand has proposed, that the ADB should have a bigger role to play in this area. Now the current situation is that these inflows or the risk of these inflows are disrupting middle income countries or emerging markets and this is likely to continue. The IMF, for example, foresee that the global imbalance will remain for many years and at the same time, apart from the global imbalance, which is injecting a lot of liquidity into the global financial market, we also have basically a transitional period right now when the regional capital markets are converging. Remember, this was exactly what we were trying to do, when we designed the Asia bond market initiative and when we talked about fund recycling of the surplus saving in the region. So what we are getting now is basically we are recycling of some of the surplus, say in Japan, to some of the emerging markets in Asia and because of this convergence of these capital markets and the large amount of flows, of the yen carry trade, for example, it is creating many strains on the other economies, particularly on an economy like Thailand.

So the solution, I think, apart from measures at the level of individual countries, is that we also need regional solutions. This is something we need to discuss at a regional level – how we can bring about a greater convergence of capital markets, while at the same time, making sure that particular countries do not suffer too much from the consequences of that convergence. And this is to do with possibly greater convergence in exchange rate policy – of course I'm not talking about any kind of single currency, but simply greater convergence in terms of the direction in which countries manage their exchange rate policies. And this will mean that basically, a country which is more flexible will not be suffering more, because other countries are less flexible and this is something, I think, that we need to discuss at a regional level.

I would also like to suggest the way that Japan can play a bigger role. One of the main problems is that everybody is using US dollars for everything. Because of that, we know that if the US dollar is going to weaken, all the currency is going to appreciate, and because in the different ways the countries manage their exchange rate policies, the appreciation takes place at different pace and therefore this creates all kinds of problems. We've talked about this for many, many years; about the need to develop a bigger role for the regional currencies and of course here, the yen is the prime currency for that development. At the moment, the yen is not adequately internationalized and that is why even in trade between Thailand and Japan, most of that trade is denominated in US dollars and therefore when the US dollar and the yen changes, in terms of the exchange rate, it has all kinds of problem, and here, I think, we need leadership from Japan, to develop a more extensive market between the yen and other major currencies in the region. In Thailand, we do not have a direct market between yen and baht. We have to go through a 2 step process, yen-dollar, dollar-baht, and what happens is that the gap between the buying and selling of the yen with respect to the baht is about 2 to 3 times bigger than the gap between the baht and the dollar and this means that using the yen as the currency for contracts is costly because every time you buy back and forth you lose a lot of money and so it's important to begin to get people to utilize currency like the yen more in their transactions with each other.

Also, of course there is a need for the regional economies to try to assert a greater leadership role on the global financial market. Particularly, we all know that the East Asia region as a whole has the majority of the world's foreign reserves and basically, the way countries in this region decide to manage these reserves has huge implications for everything, from the exchange rate between major currencies to the interest rates on bonds and also on the yield-curve, because we are the major investors on US government bonds. So these policies are the kind of thing that I think the region needs to begin to think about as it should be able to play some role in the unwinding of the global imbalance in an ordinary way. We don't want the market to decide when the unwinding will occur, because whenever the market decides, that leads to chaotic unwinding, and that is the last thing we want, otherwise we may go back to the kind of volatility similar to the 1997 crisis. Thank you very much.

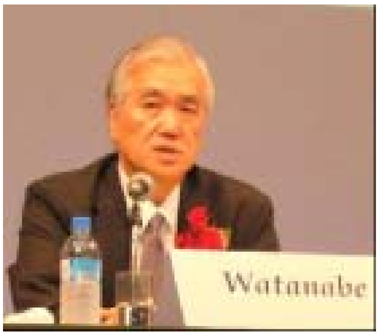
Mr. Gyohten

Thank you very much, Minister Chalongphob, for your very down to earth and also pragmatic analysis and recommendations. Well, as you suggested, I would like to ask a couple of questions after this first part is over. Thank you very much indeed.

Mr. Gyohten

Now our next speaker is the Vice Minister for International Finance in the Japanese Finance Ministry, Mr. Hiroshi Watanabe. His career is also shown on the biodata in your programs, so I won't go much into detail, but he has spent a long career in the Japanese Ministry of Finance in different sections, so he is very well versed, not only in international issues but also domestic issues, such as tax and others, so Mr. Watanabe, I'd like to listen to your views, from your own perspective, about the current situation in the regional cooperation, particularly in monetary issues, from the Japanese point of view. Thank you very much, Mr. Watanabe, the floor is yours.

４. Presentation by Mr. Hiroshi Watanabe
Vice Minister of Finance for International Affairs, Ministry of Finance, Japan



Thank you Mr. Gyohten and it is my great honour to be invited to the ADB seminar, jointly sponsored by the Mitsubishi UFJ Financial Group and the Institute for International Monetary Affairs. （Today please allow me to take advantage to speak in Japanese in Japan, because we have so many Japanese audience members, so earphones please）

（Based on simultaneous interpretation）

This year marks the 10th year after the financial crisis took place in 1997. Despite the hardships brought by the crisis, the economies in Asia have managed to regain their position as a global growth center after a very dramatic transformation. Today, I would like to review with you the progress of the regional financial cooperation that has been implemented since the Asian financial crisis and would like to discuss the importance of developing the Asian financial capital market and what would be required for the sustainable growth of the Asian economies.

The Asian financial crisis started in the fall of 1997 was a result of the major contagion effect among the countries in Asia that resulted from the combination of the fixed exchange rate regime to the dollar and the double mismatch- the currency and duration mismatch, where the short term borrowed money in foreign currency was offered for long term loans for the domestic capital investments or real estates investments in local currency. Deteriorating market confidence on some of the Asian currencies under a vulnerable financial system induced a rapid capital flight out of these countries which spread quickly to other Asian countries and they experienced a severe financial crisis. Based on the lessons learnt during the Asian financial crisis, various initiatives, such as the Chiang Mai initiative, have been activated to deal with a future crisis and also the Asian bond markets initiative for dealing with normal situations, mainly in the framework of ASEAN + 3.

Now the spirits that underpinned the development of the Asian economies up to now have two features. One includes the spirit of harmony and cooperation and the other is the spirit of competition by learning from others' good examples. I believe a good balance has been struck up to now between these two mindsets in the effort of regional cooperation and the system has been designed by taking into account these mindsets. Now yesterday, in the ASEAN + 3 ministerial meeting, thanks to the wonderful chairmanship of minister Chalongphob, we had a very productive discussion. Now the Chiang Mai initiative has aimed to establish a network of bilateral swap arrangements among the countries in the region to address short term liquidity difficulties, so this has the characteristic of the first aid in the analogy of medicine. However, there needs to be some cure of the fundamental problems and that was discussed among the financial ministers in the ASEAN + 3 meeting yesterday and in order to make a more rapid and smooth swap activation, multilateralization of this bilateral swap arrangement was agreed upon.

There have also been guidance and instructions given by the ministers to their deputies to work out the details for a multilateralization, in which an additional function of so-called complete medical check will be given to this Chiang Mai initiative. The ministers agreed yesterday on the further need for strengthening the economic surveillance process to expand the first-aid function to include more fundamental analysis of the economic situations. I consider it valuable and necessary for the countries to get together at a meeting like this to exchange the views on their economic policies and discuss the necessary economic measures that would allow the countries to compete by learning good examples from others, while maintaining harmony in the region. And I believe that this kind of good competition based on the sharing of the same recognition of the regional problems would lead to the more effective economic management of each country, thus to harmonious regional prosperity, which is one of the themes of today's seminar.

Now the Asian bond markets initiative, another important pillar of financial cooperation, aims to develop bond markets in Asia to strengthen the fundamental power of the region, by enabling better utilization of Asian private savings for long term investment essential for regional economic development. As was mentioned by minister Chalongphob, there has been excessive saving in the Asian region, but this has long been wasted in terms of an effective investment in Asia. Therefore, this Asian bond markets initiative got started in around 2003 to improve the situation by fostering the local currency bond markets to utilize the Asian savings directly in Asia.

At yesterday's ministerial meeting of the ASEAN + 3, there was a new initiative agreed upon that was jointly proposed by Japan and Thailand, for the development of new types of bonds and further securitization of existing bonds to make efficient use of capital to be used for infrastructure development. This is expected to open a new dimension for the diversification of issuers and lengthening of maturity.

These measures that I have introduced to you have focused the harmony and cooperation side. However, I think it is time for us to begin some discussions extensively on the bottlenecks or regulatory and institutional issues that each country faces. Even so, the level of development of capital markets or more broad financial markets of the ASEAN + 3 countries are quite diversified; therefore we should not make haste for rapid convergence of capital and financial markets in Asia. I believe that it would be preferable to seek a common standard of the markets, but if it is difficult to establish a common standard overnight, we should initiate a study to compile best practices in the region, so that the countries would at least make the effort to make their regulations closer to the best standard or a common standard identified. Therefore, each country would compare their regulations with the best practice and carry out self-assessment and compare their regulations with regulations of other countries, which is also an example of competition by learning from others' good examples that would promote more enhanced cooperation.

So these are measures implemented in the framework of ASEAN + 3. I would like to extend to the development of the respective financial and capital market and the roles the private sector can play in this respect. Now, when we discuss what needs to be newly developed in the Asian financial and capital markets, or what is lacking, we often face the problem of which comes first, the chicken or the egg? For example, in order to make entry into the Asian market, people view it as a necessity to have a certain level of liquidity or well-established regulations set in place. However, there are also cases where a fair amount of up front investment would promote the expansion of the immature market giving a good pressure to change the market. And so with regards to the development of the bonds settlement system. There are some views on the one hand that the sophistication of the bonds settlement system may be implemented along with the volume increases. On the other there are debates that the sophistication of the system would increase the volume and these debates often lead us to the deadlocked situation. In these cases, why not can we be more positive? I think we should not stop here by sticking too much about the conditions that need to be abided by or being obsessed with the limitations that are attached to such debates.

Now, when we look at the current status of the Asian markets, the liquidity level is improving and, in many countries in the world, the fertility rate is declining and the society is ageing and the expanded pension funds are moving, or drifting, through the various capital markets looking for investment opportunities of higher returns. Now they are seeking a very good investment target in the emerging markets, including the countries in Asia, where the level of return is high despite some risks. So the emerging Asia's markets are facing a good opportunity to get access to the capital. These markets, although limited in size in some aspects, are gradually growing. I am not sure whether the egg has completed hatched. However, small chicks, at least, are peeking through the cracks that are made in these eggs and I think we are now at this transition point. If we push a little, they will be completely hatched and the markets will begin to grow.

Now, under such circumstances and based on the lessons learned from the financial crisis in 1997, what can we make it realized? In order to realize our major vision, active participation from the private sector is welcomed. As minister Chalongphob mentioned earlier, the role that the Japanese financial institution can play in this region can be very large. I have to admit my personal feeling that the Japanese financial institutions were quite reluctant to go abroad since 1997.

In this sense I hope that the Japanese banks will become more active to go to Asian markets or more broadly to international markets. Positive competition or friendly rivalry among the Japanese financial institutions, those of Europe and America as well as local Asian institutions will help promote the growth of overall financial market in this region.

And as the Thai minister pointed out earlier, there is no arrangement established at the moment for a direct swap contract between the Japanese yen and the major Asian currencies. This means very high costs and various risks involved so I hope the Japanese financial institution or the private institutions in general would aggressively work towards establishing an arrangement for a direct swap transaction between, say, the Thai baht and the yen, without going through the US dollar in between. This may be again a discussion, to some extent, of a chicken or an egg, though

Anyway, the financial markets constitute the basis for economy and industry not only for Japan but also for all countries. Now Japan also has overcome its financial crisis of the last decade or so, and the banks have now almost disposed of their non-performing loans to start the next step and there is now a debate ongoing for the possible measures to be taken for the internationalization or deepening of the Tokyo market.

Then how should Japan contact with the Asian countries and how can Japan enhance the Japanese market and prosper together with the Asian markets? In these aspects we should be humble to reflect on our own ways and try to improve our market. Now, frankly speaking, the Japanese markets have developed much further ahead of other markets of Asia. However, we have hit the limitation and we have lacked flexibility and currently, we are in some parts lagging behind other Asian markets in terms of market sophistication, and we need to aggressively improve this situation so that we can improve the financial intermediary function of Tokyo market for the Asian and global financial market. At least the Japanese government has started making effort to this end and I really hope that many private financial institutions would join hands in this undertaking.

Currently, there are various discussions and reviews ongoing in Japan. For example, there is a discussion on the propriety of carrying out mutual complementary implementation of the role-based regulation and the principle-based regulation in the Japanese financial and capital markets, or to what extent we should promote high risk product transaction, if only limited to such professional sophisticated investors as institutional investors, or in what way viable firewall regulations should be introduced for the banking and securities businesses while ensuring their appropriate competitiveness in the global markets. We are to improve the bottleneck situation in this country, so that the user friendly market would be created and that would lead to a deepening of the markets in the Asian region.

Now, I briefly mentioned just a second ago about a firewall being established between the separation of the banking and the securities business. This has a connection with the Asian bond markets initiative. Under this initiative, the issuance of sovereign and other bonds is promoted in many Asian countries to diversify the investment that has been biased towards deposits as in Japan. But there is a discussion on where to open the sales windows of these bonds or mutual funds. Which should be promoted, the Japanese approach or the American approach? In Asia, banks have an overwhelming advantage with their network development. These deposit institutions including postal savings have already established very wide networks, therefore sales of bonds and mutual funds may be handled via this pre-established network, which I personally believe would be an option.

So Japan shall continue to prioritize the harmony in this region, but also at the same time, be in a friendly rivalry with the ASEAN + 3 countries, so that we can come up with an enhanced market in this region. The Japanese government will make every effort in this direction. Thank you very much.

Mr. Gyohten

Thank you, Mr. Watanabe. I'm afraid I have to rush to ask our next panelist to make his presentation. Now we have Mr. Wei Benhua. He is the Deputy Administrator of the State Administration of Foreign Exchange, People's Republic of China, which is, as you know, a holder of the largest foreign exchange reserves in the whole world. So I am sure Mr. Wei can tell us something about his work. Mr. Wei, please.

5. Presentation by Mr. Wei Benhua

Deputy Administrator, State Administration of Foreign Exchange, People's Republic of China

Thank you Chairman and also let me thank you for inviting me to address this distinguished forum. It's always a great pleasure for me to attend activities sponsored by the Asian Development Bank, as you can see as my background; I worked with ADB for several years. In my presentation, I'm going to speak on two major issues – one is the reform policies with our foreign exchange administration and the other part is regarding the reserve management in China.

In recent years, the Chinese economy has been growing steadily at a fast pace with robust import and export growth. In the last year, the volume of external trade was over 1.7 trillion US dollars, increased almost 24% compared with the previous year, while the amount of FDI reached almost 70 billion US dollars. With this backdrop, China's foreign exchange reserve increased rapidly, as a consequence of the substantial trade surplus, and the surplus from the capital account. As of the end of the first quarter of this year, the foreign exchange reserve has reached 1.2 trillion US dollars. As the administration body for foreign exchange policy in China, the State Administration of Foreign Exchange, which has the objective to achieve a general equilibrium of its external account, has launched a series of reform measures for liberalizing the capital account. On the one hand, we have been actively promoting the market-oriented reform and development for the forex market. On the other hand, we have accelerated reforms in current account and capital account in a gradual manner, while making sure that the risks are under control. In line with the reform of the RMB exchange rate mechanism, China has made great efforts in promoting the foreign exchange market reform and development since 2005. We have implemented measures including enlarging the participating institutions of inter-bank spot forex markets and allowing qualified non-bank financial institutions and non-financial enterprises to participate in the market; allowing participants to set up forward forex businesses and RMB swap businesses, increasing products in the forex market and improving RMB exchange regime through the mechanism of market makers. The above measures are conducive for revitalizing the forex market, increasing liquidity, enhancing the market mechanism in deciding the price and perfecting the formation of the RMB exchange rate regime. We are to successfully implement the QFII system and we will continue to extend this system. China's Security Regulatory Commission and SAFE are approving QFII quotas, based on the status of the balance of payments and investment performance of QFII institutions. The QFII operation has a profound impact in promoting the formalization and internationalization of the Chinese stock market. On QDII mechanism, a program was launched in April 2006, which allows banks, insurance and securities companies to make portfolio investments in overseas markets. By the end of 2006, 15 commercial banks were granted a quota of 1.35 billion US dollars, 15 insurance companies were granted a quota of 5.2 billion US dollars, and an investment fund was granted a quota of 500 million dollars respectively. Within those quotas, they could purchase foreign exchange and invest them in overseas markets.

Another point I should mention is to allow foreign institutions to have access in domestic bond markets. In 2005, SAFE made a decision that allows international entities to issue RMB bonds in China. We have granted approval for IFC and the Asian Development Bank to issue RMB bonds with the amount of 1 billion and 1.13 billion RMB respectively. We have also simplified the procedures and documents for foreign exchange purchasing and settlement by individuals. Nowadays, Chinese individuals could purchase 50,000 US dollars foreign exchange and change them back to RMB without presenting any documents each year.

With the implementation of the above reform measures, the issue of disequilibrium of the balance of payments in China has been improved to a certain extent. However, it is clear that a longer term challenge facing us is to deal with the disequilibrium of the balance of payments. Firstly, while adhering to the principles of initiality, graduality and controllability, we will make further efforts in improving the formation of RMB exchange rate system and increasing the flexibility of the exchange rate. Secondly, enhance the management of foreign exchange reserves to secure safety, liquidity and profitability. Thirdly, continue to deepen the foreign exchange administration reform by putting great emphasis in nurturing the forex market, developing and increasing forex products, with the purpose of cultivating and enhancing the risk prevention ability of enterprises. Fourthly – in terms of capital account management, we will continue to implement a coordinated policy, through balancing the inflow and outflow of capital and to move steadily towards convertibility of capital account. We're also going to improve the approach and method of management to strictly control the inflow of speculative short-term capital. In the meantime, we will continue to enhance the monitoring capacity and strengthening the early warning function to prevent risks relating to capital flows.

Now let me turn to the second part of my speech, regarding the foreign exchange reserve management. What would be an adequate level of foreign exchange reserve for a country? As you have observed, developing countries and emerging economies and oil exporting countries have witnessed fast and continued accumulation of foreign exchange reserve in recent years. According to IMF statistics, the global foreign exchange reserve has reached almost 5 trillion US dollars by the end of last year, of which developing countries accounted for 72% and developed countries accounted for 28%. In terms of the level of reserve, the accumulated reserves of most countries have now exceeded adequate levels to be judged by conventional indicators. For instance, from the perspective to cover import payment, Japan, Russia, India and China's reserve holdings have all exceeded the amounts necessary for meeting the need of import payments of 3 to 6 months as a traditional indicator. In our opinion, the adequate level is no longer confined to conventional needs, arising from trade but is increasingly related to the combined economic factors, such as the size and the growth rate of the national economy, the openness of the economy, the development of foreign trade, the scale and structure of external debt, the vulnerability of the financial system and the effectiveness of macro-economic control. Thus when we comment on the appropriate level of reserve for a country, we cannot make a conclusion just on the absolute size of the reserve itself. Instead we should take into consideration comprehensive factors mentioned above before we come to a reasonable and rational judgement.

What should be emphasized here is that the currencies of most of the developing countries are inconvertible and most of the developing countries still have controls or restrictions on their capital account transactions. Thus it is very necessary for developing countries to maintain a sufficient level of reserves to prevent the risks from the attacks by short term cross border capital flows, especially given the large volatility of exchange rate movements of the major currencies.

On the issue of reserve management, on the conditions of security and liquidity, a growing number of central banks are beginning to shift their focus to returns by diversifying their holdings from traditional government debt instruments to a wider range of asset classes; either by establishing investment funds or investment companies. Under such circumstances, the central bank reserve management is facing challenges from both a changing external economic climate and the ongoing transformation in management practices. The increasing volatility in international financial markets has made the diversification of reserve portfolios more difficult. With deepening financial and economic integration, the correlation between the foreign exchange market and the bond market in major economies has increased, making it more difficult to diversify their assets through investing in different markets. Meanwhile, the increased market volatility also makes optimal currency and asset allocation more challenging. Moreover, in today’s information age, significant central bank movements in currency and asset allocation might increase market volatility, which in turn constrains the central bank’s actions in adjusting their reserve composition. The current interest rate environment makes it difficult for central banks to achieve higher yield for their reserve assets. Although a number of countries have been raising short-term interest rates, the long term rates have been slow to follow the trend. The yield curve has flattened or even become inverted. With flattening yield-curves and increasing portfolios, central banks have to balance between long-term and short-term strategies to secure returns. A tilt towards short-term products may come at the expense of long-term investment opportunities, while favouring long-term bonds balance doesn’t remove the risk. The central bank’s increasing risk tolerance has also led to growth in credit exposures. The past decades have seen central banks investing in a wide area of securities and markets; expanding from traditional treasury holdings to risk-bearing instruments, including agency bonds, corporate bonds, emerging markets securities and even equities and commodities for better returns. As shown by the Central Banking Publication’s latest survey of central bank reserve managers, conducted by the Bank of England, 48 central banks are currently investing in the new asset classes listed in the survey. Among these, 32 central banks invest in agency bonds, 10 in corporate bonds rated BBB or above, and two in corporate bonds, which is below the investment grade. Assets backed securities, mortgage backed securities and index linked bonds, each received attention from 12 central banks and equities and alternative products are each invested in by 4 central banks. With a favourable financial climate, relatively small credit risk premium and low market fluctuation, investment in lower-rated instruments enables central banks to obtain a higher return for their reserve assets.

Yet once the credit environment worsens, central banks' risk management would face challenges. The recent incidents of sub-prime mortgage securities in the U.S. have caused a serious attention for investors. The continued increase in reserve accumulation has led to changing features and ongoing transformations in modern reserve management. More and more countries are beginning to regard some of their reserves as sovereign wealth and manage them through investment companies as illustrated by Singapore's GIC, the Korean Investment Corporation, and the Norway Government Pension Fund (the former Petroleum Fund). The wealth management has the advantage of increasing the value of the long-term reserve assets for both exporters and major reserve holders. As for specific questions, such as how to balance reserve management with wealth management and how to establish a mechanism of sovereign wealth management appropriate for the domestic circumstances, we believe that each central bank should seek their own answer in pursuing more active reserve management based on reality in their own country.

As I mentioned earlier, by the first quarter of this year, China's foreign exchange reserve stood at 1.2 trillion US dollars. The rapid growth is mainly due to the twin surpluses of current and capital accounts. As a consequence of the well performing economy, China's foreign exchange reserves increase is the result of macroeconomic performance. I should emphasize, it is not a deliberately pursued objective by the government. In fact the government objective is to achieve a general balance with its external accounts. Maybe it is better for a developing country to achieve certain surplus with its BOP, which is not necessarily big. With all of a decade's efforts, we have established a reserve management framework, while fitting China's own circumstances, which is characterized by a benchmark-oriented investment framework, sound and up-to-date risk management, and an increasingly sophisticated internal control system. Meanwhile, we are also striving to build a team of high professionalism. Our reserve assets are mainly invested in highly rated government bonds and notes, as well as in agencies, supranational and corporate bonds. Adhering to the objectives of the security, liquidity and returns, our reserve portfolios are managed under a long-term strategy, rather than oriented towards short-term returns or speculation in the foreign exchange market. As a responsible participant in the international financial markets, we will continue to be committed to the global financial stability and development. Let me stop here, thank you Mr. Chairman.

Mr. Gyohten

Thank you very much, Mr. Wei, for your very clear and informative presentation. Well, we are very fortunate today to have distinguished representative from India. I would like to present you Madam Sindhushree Khullar, the additional Secretary of the Ministry of Finance in New Delhi, India. Madam Khullar, the floor is yours.

6. Presentation by Madam Sindhushree Khullar
Additional Secretary, Ministry of Finance, India

Thank you very much, Mr. Gyohten. Firstly, it is indeed more than a pleasure, it's an honour to be part of this very distinguished panel. I also am glad that I provide minimum gender balance in the room as well as in the panel.

Having said that, I must also state that I come from a completely different perspective from the majority of the distinguished panelists here. I am a hands-on development administrator and have been so for the last 30 years. And now, the portfolio that I have in the Ministry of Finance, involves not only multilateral and bilateral aid, it also involves looking at the reforms in the financial sector, where are we going, what is India going to do? Having again said that, I will stick to my presentation, the issues which were indicated in advance, that is, the features of your rapid economic growth in recent years and future challenges for dealing with the shadows of success and secondly, approaches for stabilizing domestic financial markets and measures taken to improve the efficiency of the market. On the issue of regional cooperation, I will touch marginally, as a number of distinguished panelists have already placed their views on the table.

Coming from the Indian perspective, the high or the lowest point for the economy was not 1997, but 1991, when the debt crisis faced the country, with less than 2 months of reserves, which is even lower than the 3 to 6 months level that is considered cautious, even in present day times. I am proud to say that the country has come a very long way since then. The Indian economy has experienced vigorous growth in GDP, resulting from a resurgent industrial sector and a dynamic services sector during the last financial year. There has also been a marked upsurge in the rate of investment in the economy, both domestic and foreign. During 2006/7, the GDP grew at about 9.2% at constant prices, which came on top of growth of 9% in the year prior to that, namely 2005/6. Given the fact that the economy had got used to a trajectory of 2 to 3 to 4% for a number of years, it not only improved the confidence of the economy in itself but it also made the nation look inwards as to the things that were going right with its economy.

The robust growth in GDP has been generating additional savings and investment, necessary for capital expansion and sustained growth. The increasing trend in gross domestic saving, as a proportion of GDP, has continued with the savings ratio rising from 26.4% in 2002/3 to 32.4% in 2005/6. In line with the rise in the rate of gross domestic saving, there has been a marked increase in gross domestic capital formation or investment. The GDCF (Gross Domestic Capital Formation) for 2004/5 and 2005/6 has been estimated to be 31.5% and 33.8% respectively. The growth of GDP during the last decade has been characterized by structural changes in the economy, while the share of agriculture and allied sector in GDP, for long years and decades, the mainstay of the Indian economy and the backbone of the Indian people, has declined from about 32% in 1991 to 19.7% in 2005/6 and there has been a corresponding increase in the share of the services sector, from 41% to 54.1% in 2005/6. The growth of the agricultural sector has been subdued and agriculture and allied sectors are estimated to have grown at a much slower pace of 2.7%, which has been the cause of widespread concern domestically, particularly as large proportions and populations still live off agriculture.

Inflation was also much higher, at 5.74% for the 53rd week ending March 31st 2007, as compared to 3.98% in the corresponding week last year. Overall, we have progressed well on the fiscal consolidation front, the fiscal deficit of the central as a proportion of GDP has come down from 6.2% to 2001/2 to 3.7% in 2006/7. In addition, the Fiscal Responsibility and Budget Management Act, the law, mandates that this deficit be brought down gradually in the next three years to zero. And I am happy to say that this process is totally on track and it is expected that by 2009, the FRBM targets will be met. Even though accelerating growth has been accompanied by a rise in inflation and a widening of the current account deficit, the overall macroeconomic fundamentals continue to be strong. Reserves are at about 200 billion dollars. And despite that, with the process of fiscal consolidation continuing to be on course, the economic outlook continues to be upbeat – extremely positive and outward-looking.

The issues that have been already placed on the table relating to reserve management and capital accounts are indeed matters which are engaging the attention of the Indian government very actively and it is hoped that a roadmap will be worked out very quickly to see where we are going on both. The central bank is of the view that since the current account is still in deficit, the reserves are not exactly open for being used or utilized in any manner as of now. At the same time, on the capital account, there has been a lot of attention being paid and a report has recently been received, popularly known as Tarapore II, that is towards fuller capital account convertibility. The government is examining the report and will come up with some recommendations and is consulting the central bank and the regulators on the various recommendations to move towards greater flexibility on the capital account. On the same level of engagement is a recent expert committee report recommending Mumbai as an international financial center. The report actually is not looking so much at Mumbai, but is looking at a roadmap and the process of financial sector reforms, and how slow or how fast should India go on this road, given the experience of the rest of Asia and the kind of experiences that have engaged the Asian economies in the recent past. The Indian capital market has been on a development trajectory and has emerged as one of the credible markets in the region. As of now, the most important among these are systems for gathering, monitoring and disseminating information to markets and regulators, international standards for economic management, competent and effective regulatory standards for enforcing those standards. And in the current year's 2007/8 budget announcement, the Finance Minister of India has announced certain steps which will further strengthen the capital market. These include taking forward the idea of self-regulating organizations for different market participants under regulations that will be made by the Securities and Exchange Board of India, and if necessary, supported by an enabling law, promoting the flow of investment to the infrastructure sector, by permitting mutual funds to launch and operate dedicated infrastructure funds. Third, converging the different regulations that allow individuals and Indian mutual funds to invest in overseas securities by permitting individuals to invest through Indian mutual funds. Fourth, allowing short selling settled by delivery and securities lending and borrowing to facilitate delivery by institutions and finally putting in place an enabling mechanism to allow Indian companies to unlock a part of their holdings in group companies for meeting their financing requirements via the issue of exchangeable bonds.

In sum, therefore, my assessment is that India has a robust, well-regulated equity market, where the oversight and regulatory mechanisms are in place, with an effective fiduciary responsibility and government supervision. Insofar as the short term debt market is concerned, the measures being taken will serve to strengthen their credibility and enhance their functioning. The accumulation of reserves is expected to cushion the economy against vulnerability to external shocks. As I mentioned earlier, the central bank maintains the view that given the current account deficit, the reserves are not yet open to being used in activities and interventions of the financial market as of now. Efforts are on to strengthen the long term debt market and deepen the bond market that will serve the objective of increasing efficiency and better managing the financial flows.

The development of a long term debt market in India has become urgent, in view of the requirement to access low cost long term debt for infrastructure projects, a requirement that has been assessed as US dollars 200 to 350 billion in the next 5 years, if we are to keep pace with the 8% growth of the economy. To further this objective, a non-banking financial company called India Infrastructure Finance Company limited, IIFCL, has been set up, with an authorized capital of US dollars 250 million approximately. The IIFCL is expected to borrow money from the international markets on the strength of government guaranteed bonds. These will be long duration bonds, more than 10 years maturity. The IIFCL can also raise money from organizations such as the World Bank, the EDB and international debt markets, as I mentioned earlier. India’s demand for long term financing of infrastructure projects has also drawn an encouraging response in the form of a PPP initiative called Infrastructure Finance Initiative. This is a partnership characterized by the government between infrastructure development finance corporation and Citigroup for raising US dollars 2 billion equity in 2 funds of US dollar 1 billion each and the remaining US dollar 1 billion to be raised from the market. The IIFCL will also contribute to this fund. It is our endeavour to deepen the capital market further, to ensure that the fruits of globalization benefit the Indian capital markets fully. This will further aid our goal towards more inclusive growth.

India is the largest capital market in the South Asia region and willing to support other countries in their efforts to develop capital markets and enhance regional cooperation. As an observation, I would mention that on the lines of ASEAN + 3, the SARC finance ministers, the South Asian Association of Regional Cooperation and Finance Ministers, met yesterday and they also discussed the issues relating to capital markets. My observations would be purely in a personal capacity. At this moment, I am willing to hazard only a guess that the regional groupings and the regional integrations are, themselves, very subjective, whether they are going to be on the ASEAN + 3, ASEAN

+ 6, SARC, primarily driven by the political economy of the region or will it be through the multilaterals and the ADB, as was discussed yesterday as one of the recommendations coming out of the EPG, that is the ADB act a financial intermediary and promote the financial integration among the region. My observation is that these groupings – the political or semi-political groupings based on geopolitics – are not the same as the Asian Development Bank or the private sector groupings or even the groupings created by fund flows in the private sector financial markets in the financial centers, either in Asia or in the world. So where exactly the regional cooperation will be driven will primarily be an event that we will watch with interest and as of now, from a government perspective, this is still in a very, very nascent form.

Having said this, India today faces a challenge of ensuring that the growth trajectory includes the excluded areas and excluded populations. We are a billion plus people with a trillion dollar economy that contains a million people who live on one dollar a day. This is simply not acceptable and certainly not sustainable. To bring them together as partners in development is our goal and ladies and gentlemen, you will agree with me that that is indeed the raison d'etre for finance and financial markets. People, after all, are at the end of this pipeline. Thank you.

Mr. Gyohten

Thank you very much, Madam Khullar, for your very informative, but at the same time, as you say, very thought-provoking presentation. Thank you very much. Well our last speaker in this first part is Mr. Nobuo Kuroyanagi, who is President and CEO of Mitsubishi-UFJ Financial Group Incorporated. Well, Mr. Kuroyanagi, the floor is yours.

7. Presentation by Mr. Nobuo Kuroyanagi
President and CEO, Mitsubishi-UFJ Financial Group, Inc.

(Based on simultaneous interpretation)

It is indeed a great pleasure for me to be able to jointly organize with the International Institute for Monetary Affairs this seminar on the occasion of the 40th commemorative annual meetings of the Asian Development Bank. Owing to this opportunity, I am happy to be able to share this podium with prominent Asian leaders of the international financial community, which I consider to be a great honor. In line with the theme of the seminar, I would like to first of all share with you an overview of the challenges confronting the Asian economies that have continued to develop so rapidly as to earn the epithet of growth engine of the world economy and also would like to discuss what is needed to be done to ensure the sustainable economic growth of the region and also how the Asian and financial capital markets should be. And also I would like to share with you some of my views about the roles the private sector financial institutions here in Japan should be playing.

As is well known, the Asian economy continued to keep high growth in the last several years, and even in 2007, the growth rate of Asian economy is forecasted to be 7.6%. Although somewhat slower than 8.3% growth achieved last year, it is still very high growth to be achieved here in Asia. And as you may already know, between 1990 and 2005, the world trade as a whole tripled, and the amount of trade in East Asia, including Japan, approximately quadrupled. Furthermore, what we need to keep in mind is that the ratio of intra-regional trade within Asia increased to 53% in 2004, surpassing the intra-regional trade ratio of the NAFTA region. And there are, of course, many factors driving such economic development, but at the foundation, I believe, were important lessons learned from the Asian currency crisis and these lessons were applied in the real sector. This year marks the 10th year since the Asian currency crisis, and the Asian region has made substantial progress in terms of financial institutions' disposal of non-performing loans and financial system reform. The fundamentals have improved in many countries and current account surpluses were accumulated with foreign exchange reserves built up. At the same time, the importance of regional financial cooperation in Asia was strongly recognized by many countries and as a result of efforts made by individual countries, including multilateral swap agreements, the Asian economies have become much more resilient in both monetary and financial fields. This, I think, is a very important factor. Furthermore, an important role is being played by the conclusion of free trade agreements (FTA) or economic partnership agreements (EPA) in enhancing the inter-dependence of the Asian region, including Japan. Such a deepened inter-dependence in Asia, in both trade and finance, is believed to have made significant contribution in making the Asian economic growth more robust, self-reliant and sustainable.

Buoyant as they are, however, the Asian economies are also confronted with various challenges, to which they must urgently respond. One of these is the so-called global imbalance, the improvement of which represents a very important challenge in the medium to long term time frame.

The US current account deficit last year stood at 6.5% of the GDP, expanding somewhat from the previous year. On the other hand, the aggregate amount of current account surplus of emerging market economies, primarily Asia and oil exporting countries combined, has reached a colossal amount. In addition to such imbalances of the real sector of the economy, international monetary flows have poured into the US financial and capital markets and from there, they have again flowed out as investment. Such a u-turn structure has been established and this U-shaped structure is highly risky and in fact, should there be a dislocation in the US financial and capital markets triggered by, for example, certain plunge of the dollar, the entire global money flow would become unsettled and this concentrated risk structure could, indeed, be a very disruptive factor to economic stability in Asia, which we need to be very mindful of. And in order to improve the situation, needless to say, the United States itself is called on to take measures to reduce budgetary deficit as well as other policy measures. But at the same time, the Asian countries, including Japan, that have large current account surpluses, must, on the one hand, accept exchange rate adjustment through market mechanism. On the other hand, especially when one looks at Asia as a whole, these countries are also expected to take measures to expand domestic demand, although this will be a challenge in terms of the real sector of the economy.

And in order to promote improvements in the real sector of the economy and correct the structure of risk concentration, it is of vital importance that common measures be taken for the improvement of financial and capital markets of Asia as a whole. Needless to say, US financial and capital markets are important for the entire world economy, but despite the fact that the size of the economy of Asia has expanded to a level that is on a par with the United States, the financial infrastructure that channels the funds generated within the Asian region to be directly invested within the region is not well developed and this is a very important common challenge that requires further improvement.

However, Asian countries are in different stages of economic development and poverty still remains a serious problem. It took over 50 years for the EU to take its current shape as we know it today. And therefore, the sustainable growth of Asia requires abiding dialogue and thus we must engage in such dialogues in a tireless manner going forward.

Under the direct initiative of the Prime Minister of Japan, an Asia Gateway Initiative has been discussed since last year, and also discussions have taken place in various working groups in the Council on Economic and Fiscal Policy in consideration of "Japan growing together with Asia" and they represent part of the efforts in this context. And such developments, I believe, would lead to the further development and improvement of financial capital markets in Asian countries through policy dialogues between government and private sectors. And improved financial and capital markets will, in turn, facilitate a cross border flow of funds within Asia, which can pave the way towards strengthening the circulation of the private sector capital of Asia that supports the Asian growth going forward. Furthermore, as countries further develop financial and capital markets, the economic policies of a country will be checked through the market mechanism, which would also lead to the more efficient allocation of resources within the private sectors.

Facing these challenges, the Mitsubishi UFJ Financial Group is in a position to directly heed the needs of customers daily in the regional financial sector in its daily business, using the extensive network it has in Asia. In considering the provision of new financial instruments, sometimes local financial system or infrastructure availability makes the provision of such new products difficult. Why is it difficult? Through giving direct feedback to policy authorities on the concrete aspects of those difficulties, we have assumed the role of providing materials or stimuli for discussion between policy authorities in Asia. I believe the timely and accurate conveying of private sector financial institutions to the policy authorities the concrete real issues and challenges they face can add further importance to the policy dialogue between the public and private sectors.

Regarding the reform and improvement of Asian financial and capital markets, MUFG has made various efforts using its network. For example, in relation to the measures to foster bond markets under the Asian bond markets initiative (ABMI), we have built up track records in Thailand, Malaysia and Indonesia, and since the beginning of this year, we were also able to make achievements in the Islamic finance area, which I think is all the result of our efforts in facilitating such dialogue. And leveraging these records, we at MUFG would like to make further efforts in terms of providing diverse types of financing, including securities business or asset-backed financing, in addition to bank loans in the Asian region.

For Asian economies to grow in a sustainable manner, it is very important for Japanese financial and capital markets to develop hand in hand together, fulfilling their roles properly as financial markets in Asia. It is vital that Japan, with its public and private sectors in cooperation, provide full-fledged financial services so that the Japanese market becomes more attractive for Asian corporations and investors for both investment and fund-raising, and I think there are numerous things that the private sector financial institutions can do as a part of these business efforts. For example, we at MUFG are promoting the distribution of government bonds and other bonds to overseas investors through the affiliated securities companies. In this context, and, the exemption of withholding tax when non-residents purchase JGBs would contribute toward revitalizing Japanese financial markets through the expanded holding and trading of Japanese government bonds by non-residents and this will further enhance the flows of funds within Asia. Although it has been decided that the same treatment be applied to local government bonds as well, it is desirable that the range of applications be further enlarged and also the application screening standards be further simplified, so that they be made user-friendly for the overseas investors as well.

Furthermore, the Japanese household sector holds financial assets in excess of 1,500 trillion yen already. Given the ageing of the society here in Japan, with low birth rate, the Japanese government is taking the policy of shifting the savings to investment, and individual investors here in Japan are seeking more advantageous investment opportunities and a huge amount of such funds held by individual investors is flowing overseas via investment trusts. The amount of outstanding investment trusts has reached 70 trillion yen, of which half is distributed over the bank counter and 40% of investment trusts are invested in financial assets denominated in foreign currency. Among them, the distribution of investment trusts destined for Asia is growing very rapidly, and the trend is expected to continue.

This makes it all the more important to further improve and develop financial and capital markets in the growing Asian region. When the markets become well developed, those investment flows will be directly channeled to Asian region, thus facilitating the intra-regional flow of funds further. And I believe this will be conducive to further facilitating a shift from savings to investment that Japan is trying to promote and establishing a win-win relationship in the financial sector, between Asian economies and Japan. In that sense, further development of financial and capital markets infrastructure in the Asian countries and enhancement of transaction transparency are indispensable. Japan has a well developed communications infrastructure, as well as settlement or payment systems. We have expertise and human resources, with experience in developing financial infrastructure as well and we, ourselves, need to devise a means of utilizing that expertise or those capabilities. It is very important to explore the ways how we can make good use of those capabilities from the standpoints of private sector and we intend to make continued efforts to contributing in making policy dialogues more concrete between Japan and Asian countries. Thank you for your attention.

8. Panel Discussions

Mr. Gyohten

Thank you very much Mr. Kuroyanagi for your real voice from the private sector. Well, ladies and gentlemen, because our panelists' presentations were so rich and so informative as you have seen, I'm afraid we're running behind schedule, so what I would propose is that you would let me put one question to each panelist, so that we can finish this seminar in good timing. We have about 15 minutes to go, so maybe, you have to be quite precise and compact in responding to my question.

I would like to start with Minister Chalongphob, as I said, your account of the situation was very vivid and extremely informative. You remember that when that mini-crisis hit Thailand toward the end of last year, there were arguments in the media, that one of the factors which made this crisis happen was either mismanagement or lack of understanding on the part of the authorities of the possible response of the market. The collapse of the stock price was certainly created by the very unfavourable response on the part of the market to the actual stake by the government. Do you think that was an accurate judgement of the situation and if so, what do you propose in future to avoid that kind of lack of understanding or misunderstanding between the markets and the authorities. What do you think will be necessary to improve the situation?

Mr. Chalongphob

Well, the authorities concerned obviously misunderstood the way in which the market was going to react. I think they thought that, and this is because they went by the experience in Chile in the early 90s, they thought that the measures were actually not that strong. Well the reasoning is that if you bring your money in and you intend to invest, say, in long term, you can buy government bonds, one year government bond with a 5% interest rate, okay. If you have to set aside 30% of your investment in a non-interest earning account, then it means that your return basically declines by 1.5%. But they forgot that basically there are very few people with money to leave for a year, in any country, because most of the investment is basically short term and it's the major cost to have to keep it for a year, and therefore that was the major shock and as I said, the problem is that we did not have good guidelines on what would be appropriate capital control measures to use. One week after they announced the measures, we held a press conference at my institute and I said that in times of volatility of capital flows, a country like Thailand needs some measures to control capital flows, but of course not those that were instituted, because they were too strong.

And then, whether that measure would be still to remain is an open question and this is where we need guidance from the international community. It is not simply just Thailand. As I have mentioned, many other middle income countries, countries like Turkey for example, have exactly the same problem. They have a lot of capital inflow over the last year or so, it led to a strengthening of their currency, meaning they are looking for solutions. Thailand is now like a guinea pig. So people are following very carefully what is the outcome of the measures that we are currently using, whether this works and of course, if it works then they may want to use it in their own country in times of volatility. My position is that in times of normal volatility and normal flows of capital inflow and outflow, we don’t need any measures, but in times of excessive inflows, we do need some measures to deal with it. Otherwise, the change in the exchange rate is too rapid for the economy to handle and this affects our competitiveness vis-à-vis other countries and so on.

When I became minister, there were speculations that I would come in and then order the Bank of Thailand to do this, that or the other and the thing is that they were speculating on that to take advantage of it, because if I had done something to create a shock in the policies, then there are people who would be benefiting from the rapid strengthening of the baht. So there were basically speculators waiting for it to happen, therefore I made my position very clear, that there would be no shocks in terms of changes in policy, and that is still true today, because at the moment the policy we have seems to be reasonably adequate. But of course, the thing is that managing the exchange rate is really an art. It’s not just pure science. And this is something where, I think, central bankers in general may need to have better touch with how the market works. Unfortunately, I think it is true for many central banks. I think once you get into a central bank, they tend to be somewhat divorced from how the market operates and particularly now the markets find new instruments all the time, so we may have to consider sending some of our younger central bankers to work with hedge funds for a year or so, and then they will know better how things work. Thank you.

Mr. Gyohten

Thank you very much for your very candid remarks, I am sure everybody would appreciate that. Well, now, minister Watanabe, I would like to pose you a very journalistic question, that is about yen carry trade, because these days, everybody is talking about yen carry trade and some said that the amount is almost one trillion dollars, others say that’s nonsense. But I think, the fact that this issue is discussed so heavily in these days, well I think it shows some substance. So I would appreciate it very much if you could shed some light on that issue. How do you view the real situation about this yen carry trade and where does it come from? Low interest rates? And what does it bring about? Weak yen? I think that the real problem is whether there will be real unwinding of that situation, depending on the situation, so I would appreciate your remarks about that, thank you.

Mr. Watanabe

Well thank you Mr. Gyohten, it’s a very fashionable question. As you suggested, of course some people say the size of the total yen carry trade reaches one trillion dollars, but I think that is rather over-exaggerated. And also, as you suggested, if the yen carry trade or any carry trade becomes troublesome, only when there is a high possibility of unwinding in the bandwagon type or herding, but when we see the narrow type of the carry trade, which means one sells the yen in the short term and one buys the other currencies, also the short term, it is kind of really very speculation, but the size of this is somewhat limited. Sometimes, I have shared views with the Financial Times, the late margin in the Financial Times has a column and they said the size of such a kind of speculation or yen carry trade. The size would be about 100 billion dollars, so I think that is not so much different from the figure I have in my mind, so and also some portion of this in a narrow sense could be unwound but I think that is very much limited in comparison with the total size of the transaction in the foreign exchange market on that.

Of course there would be other three categories of yen carry trade but I think they will not be unwound in a hasty way on that. The first one is the very traditional foreign bond investment by Japanese institutional investors, including insurance companies and also pension funds. As the last three decades, we could enjoy some interest differential between Japan and the United States and Japan and Europe, so in that case, we continue to make some kind of investment on that, so I think even though there will be some signs of change in foreign exchange rate, there will be no such hasty unwinding on that category. The second category is very new one, this is done by the Japanese individual investors and now they are going to diversify from deposits to the other instruments, like trust funds or bonds and stocks and also they are going to diversify from the home country bias to much more open, – to the international instrument on that – so I think even in this field, there are no real fears for the unwinding in a hasty way or a herdting way on that. And the last category is very unique. These days European people are going to get housing loans which are denominated in yen, because they can enjoy very low rates on that. But the nature of the housing loan means it is very difficult to shift one to the other on that, so I think the last three categories, even though yen carry trade existed, it is not the subject to the unwinding on that. So of course we should not be complacent and we should closely monitor the situation, but as Mr. Gyohten suggested, the size of outstanding is rather exaggerated and also the size of possible unwinding is also over-exaggerated. That is my understanding.

Mr. Gyohten

Thank you for your clarification. Some of us must feel very assured, some may not! Well, Mr. Wei, I quite agree with you when you said that each central bank should seek their own devices or mechanism to achieve better management of reserves. I think you are quite right. And you suggested that in China, the central bank is also studying your own best way to manage. Well, I'm sure that process is still in the stage of preparation and you may not be able to tell us very much in detail, but I would very much appreciate it if you could give us at least some hints of what you are going to do. So my question is; are you going to set up a new agency and how much of your reserves are you going to transfer to that agency and in what asset classes are you going to manage? Well, if you can give us as much information as possible, that would be very much appreciated. Mr. Wei?

Mr. Wei

Thank you Mr. Gyohten for your, how to say, very sensitive question and in fact, at the end of yesterday's ASEAN + 3 ministers' conference, Minister Chalongphob, I think, was the sole person in answering all the questions on regional financial cooperation himself. I remember, only one question was raised for our minister, and it was a similar question as yours. First I need to repeat what minister Jin said yesterday. And he said very clearly, preparation is going on and when it is ready, you will know. It is simple. I might add a little more information, hopefully it might be helpful to the audience.

Firstly, decision has already been made by the state council that there would be a particular foreign exchange investment company to be established. The second point is, the preparation is under the strong leadership of Mr. Lou, Lou Jiwei, who used to be the Vice Minister of Ministry of Finance. Thirdly, the third aspect regarding this company is many economic agencies in China are participating in this preparatory process. So you can imagine, there will be a lot of coordination work among these agencies in order to achieve the objective of this new company. And then on substance, regarding the most difficult part of the question, how much would be the capital of this company, I am very frank, it is being discussed and I don't think it is already decided, but as media talking about, the maximum might go to 200 billion dollars, but this is mentioned in the media, not my own judgement. And I would like to make it clear and where are they going to have this capital? There might be different options. One is, people are talking about the Chinese MOF will issue special bond in the denomination of RMB, then they will use the proceeds to purchase foreign exchange from the central bank. I believe this option is being discussed very intensively. So what I can say at this moment is like this and another aspect is, of course, regarding timing, when it will be ready. Maybe I go a little step forward, I am sure it should be ready before the end of this year. Thank you.

Mr. Gyohten

Well thank you very much for your cooperation. I think we learned a lot. Madam Khullar, India is growing – fast, robust but at the same time, as you mentioned, the inflationary situation is getting a bit out of hand, I'm afraid, in fact your central bank has been raising the interest rate gradually. Well, at the same time, you said you will have this current account deficit and exports are quite viable to sustain growth, but if you raise interest rates that will suddenly exert upward pressure on your currency, which, in turn, will hurt your exports. So it seems to me that there is a kind of dilemma for Indian monetary policy operations. Can you comment on that, am I right or wrong?

Madam Khullar

Mr. Gyohten, absolutely on the dot. It has been causing a lot of concern, because inflation per se hurts most parts where the political economy is concerned and I say this most candidly that a number of states of India were going to elections and the issue of inflation became the uppermost issue in people seeking elections from that point of view. The inflationary pressures, as was discussed even last week in the Indian parliament, had two sources. One was the supply shocks and the shortfall in the supply of some commodities, essential commodities, especially food items. But your basic food items, and, including pulses, sugar and some amount of shortfall in the production of wheat. Rice did quite well. Now this was managed in the short run by opening up imports, to an extent, now where the central bank was struggling was, in trying to do this delicate balancing act of raising interest rates and at the same time, not hurting the growth momentum in any manner. In the last credit policy, which was announced on the

24th of April, there has been no further measures from the central bank and the clear indication seems to be that let us watch the situation as it develops and by all forecasts, the inflation is to be under whatever it was last year in another four weeks, so whatever pressures were being exerted were, on both counts, domestic and external and the domestic issues were managed by opening imports. Certainly, the major cause of concern is exactly as you said, that the appreciating rupee was hurting exports, but at the same time the raising of interest rates created discomfort for investors, as a result of which the credit policy of last month has a very restrained – has shown a lot of restraint in that sphere and therefore a lot of courage I will say. We expect that in the next month or so, there will be a better appreciation of whether the inflationary pressures are here to stay and what exactly is causing them. The general expectation is that they will come down.

Mr. Gyohten

Thank you very much! Well, we are running out of time, but I have to ask Mr. Kuroyanagi, one question, you mentioned in your presentation the importance of policy dialogue between the government and the private sector. I think you are quite right. Can you tell us some concrete ways you are trying to achieve this?

Mr. Kuroyanagi

Well in the interests of time, I would like to limit sharing with you one or two examples. Now, from the Japanese point of view, Asian economies have developed and in addition to their positioning as a manufacturing site, they are now positioned as a very critical sales and marketing site, which means that in these countries, local currency denominated assets, mainly accounts receivables, have come to accumulate. So from the perspective of improving the efficiency of assets, the requirements of asset financing are increasing. And Japan also had experienced the same situation in the past and for the securitization of assets, introduction of laws like the so-called SPC (Special Purpose Company) law would be essential, so recently, with the advancement of the ABMI, there is now talk about the need for securitization and also the development of new financial instruments. In this vein, a dialogue between government and private sectors should be vital to utilize the experience of Japan.

Mr. Gyohten

We have our last panelist, from ADB, Mr. Kawai. I am sorry I have kept you waiting for so long and I'm sorry that I cannot give you too much time, but anyway, as we have been listening to all the panelists' discussions, I think there was a broad consensus about the need for more collective efforts in this region and as we listen to the eminent persons group report and also responses to them from governors, well I think ADB is in a very critical juncture to define your near term policy objectives, particularly as sort of a hub of various efforts of collective regional efforts. Mr. Kawai, can you give us, in a very brief fashion, your views on what would be the ADB's primary policy objective in the near term as far as the regional financial collaboration is concerned?

Mr. Kawai

Thank you, I am here to represent ADB and ADBI. I should be speaking the least and I should be listening and I am very glad that very rich discussions took place. Yesterday, there was the governors' seminar on the eminent person's group report. I encourage you to read a very, very good report. There they are suggesting what the ADB should be doing for 2020 when substantive poverty will have been eradicated. They, the eminent persons group, suggest to us that we should be focusing on infrastructure development, financial development, and other issues like energy and environment, technology, knowledge, but here, just in a minute, what I want to say in this context, is that Asia still needs a lot of infrastructure. ADB estimates that in the next 10 years, at least 300 billion dollars of infrastructure investment would be needed and of course for the private sector investment, more money would be needed.

Savings – money is there – money is abundant. Japan has a lot of savings. China has a lot of savings. ASEAN countries still have savings. And how to recycle these savings would be the biggest challenge, at least from a financial perspective and this can be most efficiently done through regional cooperation and focusing on national efforts to strengthen capital market infrastructure to address cross border barrier issues of various kinds. Countries collectively working and addressing the common issues, as minister Chalongphob said and Mr. Watanabe also said, this is a collective effort, and ADB is here as a facilitator, as a supporter, as a catalyst. ADB has got public money and this public money can be used for catalytic purposes. Of course, ADB wants to work with many governments and in particular, with the private sector. How the private sector feel comfortable in participating in this process is an extremely important part, so the ADB is here for the Asian developing countries, economic growth and economic development. Thank you very much.

Mr. Gyohten

Well thank you very much, Mr. Kawai for your very encouraging remark. Well, I was supposed to sum up remarks but I have no time and also I am sure there is no need for that because you have tremendously been enlightened and learnt a lot from really wonderful presentations from our 6 panelists, so will you join me in expressing our gratitude for the excellent performance of all these 6 panelists. Thank you very much.

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