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Appropriate measures essential to insulate Asia from international financial markets turmoil: Dr Akhtar

Dr Shamshad Akhtar, Governor State Bank of Pakistan has said that Asia's inherent strength and resilience allowed the region to withstand turmoil in the international financial markets but appropriate policy responses are critical to contain the impact of such external shocks.

Dr Akhtar was delivering a lecture on 'Asia: Impact of Recent Global Developments and Central Bankers' Response' in Madrid, Spain yesterday where she was invited by Emerging Markets Newspaper, a part of Euromoney Institutional Investor Plc., to deliver a keynote address. In line with its tradition, Emerging Markets Newspaper invites the central bankers of the region, who have won an award for the region's best central banker, to deliver the keynote lecture in an event organized on the side lines of the Asian Development Bank's Annual General Meeting held in Madrid. Dr Akhtar was conferred with the 'Best Central Bank Governor for Asia 2007' award by the Emerging Markets Newspaper.

Dr Akhtar said that Asia's inherent strength and resilience remains intact supported by all-time high reserves being fed by surpluses in external current account boosted regularly by robust export growth which in case of net oil exporting countries has received additional impetus from oil export revenues. "This has allowed the region to withstand these shocks but appropriate policy responses are critical to contain the impact of these shocks," she asserted.

SBP Governor said there is now a broad consensus that slowdown of US and Europe is likely to have a more distinct impact on Asia. "Impact has been slow to filter down to Asia in 2007, but is predicted to impact 2008 economic growth," she said and added that Asian slowdown is driven largely by set-backs to IT exports, electronic and certain categories of exports whose impact is now being felt by these industries. With nontraditional export and diversification of trade to newer markets, Asian exports did grow in a number of countries by double digit, she said.

Dr Akhtar said that the size and scale of interaction between Asia and America brings immeasurable benefits when the going is good, but it will also bring a measure of misery when the economy is in trouble. "Asian central banks and governments need to better integrate with each other to mitigate and hedge such risks in the future, take advantage of the higher returns, and take part in the developments in their own region," she opined.

SBP Governor said that losses on account of subprime mortgage markets were limited on the balance sheets of banks and financial institutions that have been written off. In the financial sector, the steepest decline was registered in securities markets that were fast to recover with the

Federal Reserve's and European Central Bank's policy stance, however, the markets remained volatile with corrections in valuations already factored in.

She said that intertwined with financial market turmoil is risk aversion to financial innovative products, and investors move' to global commodities whose demand pressures broke all historical price behavior patterns and reached new levels. "This price spiral of strategic commodities such as oil, wheat and other products has created a dilemma as pass-through are augmenting inflationary pressures, while not passing through is complicating macroeconomic management," she added.

She said Asia's central banks faced additional but different challenges than their counterparts in the West. Rise in oil prices towards the end of 2007 and its subsequent surge in 2008 reaching $120 per barrel, and the food supply shortages in economies that had approached self sufficiency are two major problems, she said and added that oil importing economies are now facing high external current accounts deficits whose stress has resulted in currency depreciation. In other economies, rise in US dollar price of oil has been offset by an appreciation of exchange rates.

Dr Akhtar said the inflationary pressures and expectation are on the rise as (i) Government's allow full or partial pass through to food and oil prices, (ii) core inflation rises due to fiscal pressures magnified by subsidies on food, agriculture inputs and oil products, and budgets recourse to central bank borrowings, and (iii) investors seek safe havens in the commodities exchange markets. The depreciating dollar can also be given its share of blame for the record high price of oil, almost double its price just one year ago (from $63/barrel to $120/barrel). Given the fast pace of economic activity, it has not taken long for price changes in metals, commodities, and oil to manifest themselves in higher labor costs and increased prices of many finished goods and services, she added.

"Asia in any case has been in a monetary tightening phase since 2007 or somewhat earlier and in some cases demand pressures have led monetary tightening via adjustments in reserve ratios while holding policy rates," she said, and added that greater vigilance remains essential in order to ensure that commodity prices does not set off second round inflationary expectations leading to rising core inflation which in some cases in already rising because of domestic overheating or over-borrowings from Government. To the extent inflation rate is being contained through fiscal measures this in turn will also impact the monetary trends and require further tightening, she added.

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