

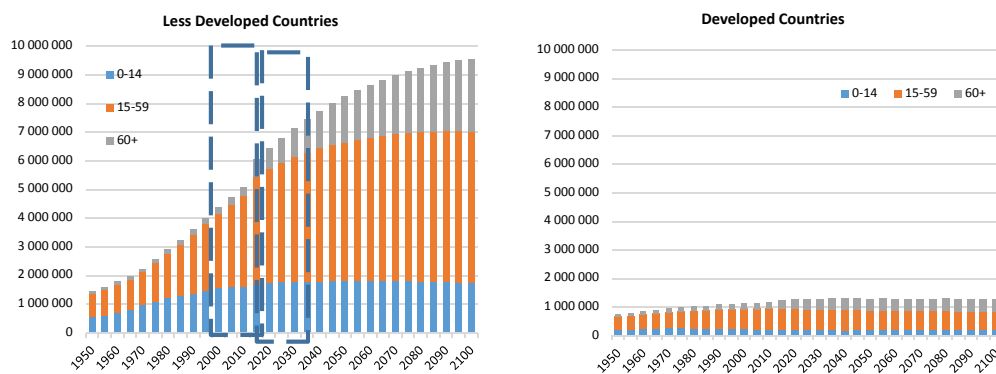
# Risks and Opportunities in the New Norm: or Fatigue? Market Solution

Il Houn Lee

2015 PECC Singapore Conference  
“Achieving Inclusive Economic Growth in the New Normal”  
Co-Organized by SINCEPEC & PPECC, 26-27 February 2015



**EMs are expected to continue to grow, lifting more people out of poverty and into higher living standard: The “New Norm” will continue for the next two decades**

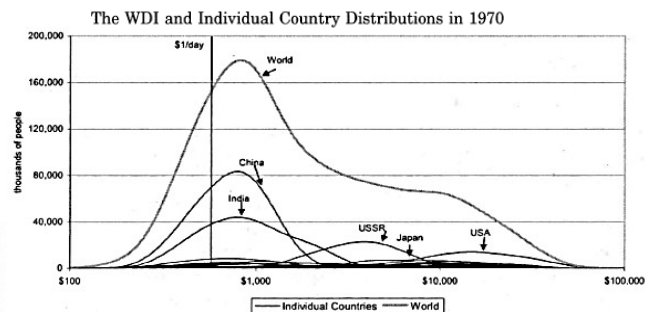
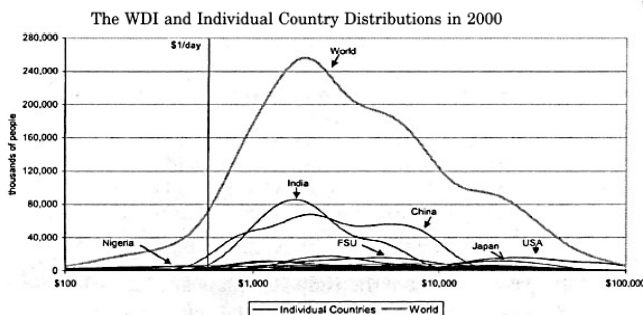


Source: UN, Department of Economic and Social Affairs, Population Division (2013). World Population Prospects: The 2012 Revision, DVD Edition.

**The large influx of labor was absorbed by strong demand in advanced economies; which in turn was partly facilitated by large increase in liquidity**

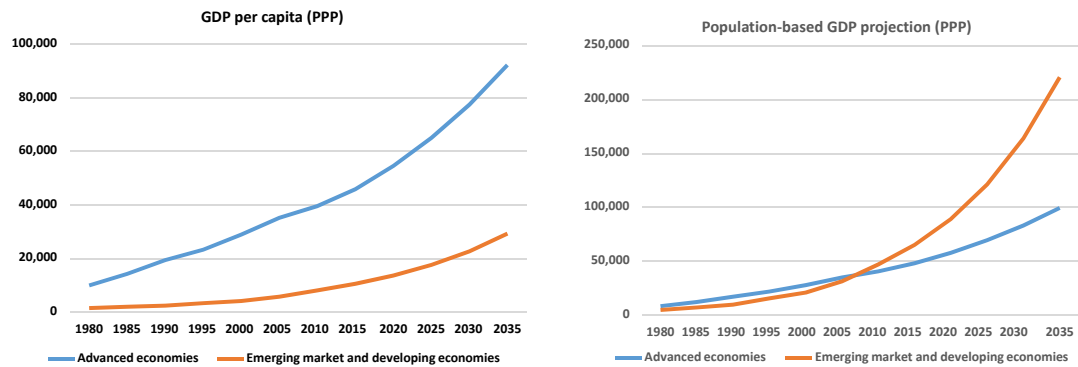


**Rapid growth in EMs has introduced a major shift in income levels and employment conditions across the world**

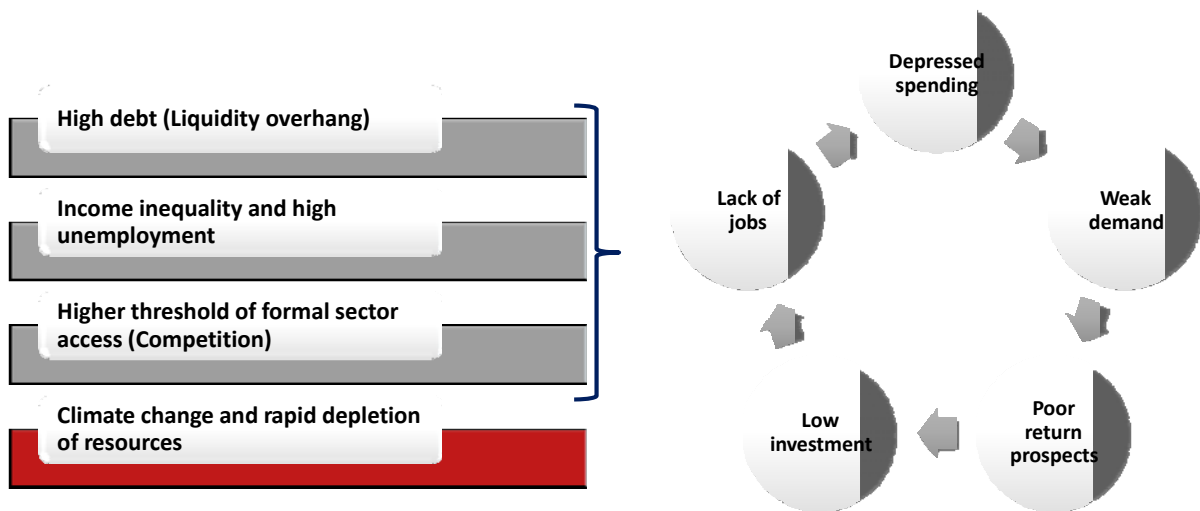


The World Distribution of Income: Falling Poverty and... Convergence, Period  
 Author(s): Xavier Sala-i-Martin  
 Source: The Quarterly Journal of Economics, Vol. 121, No. 2 (May, 2006), pp. 351-397

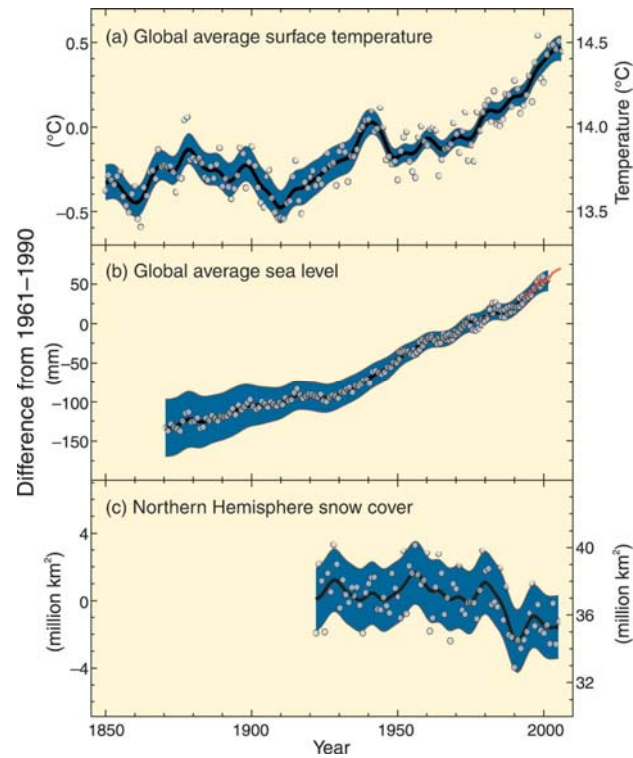
**If current trends continue, EMs' GDP will be twice as large as those of ADs; but it is unlikely to do so as "growth fatigue" has already set in**



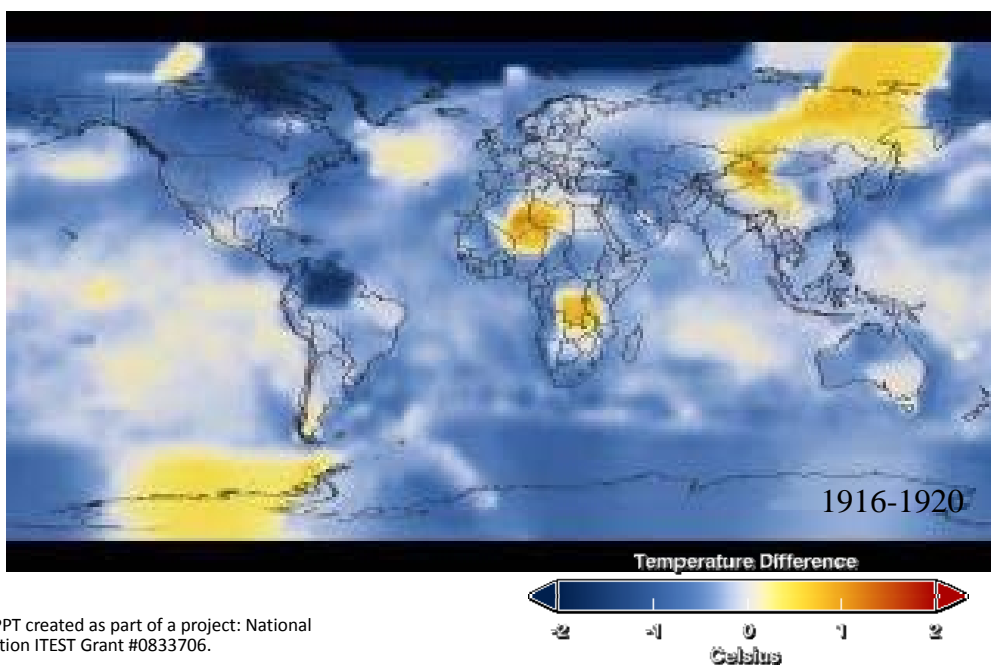
**Growth fatigue in developed countries and the planet earth are clearly visible**



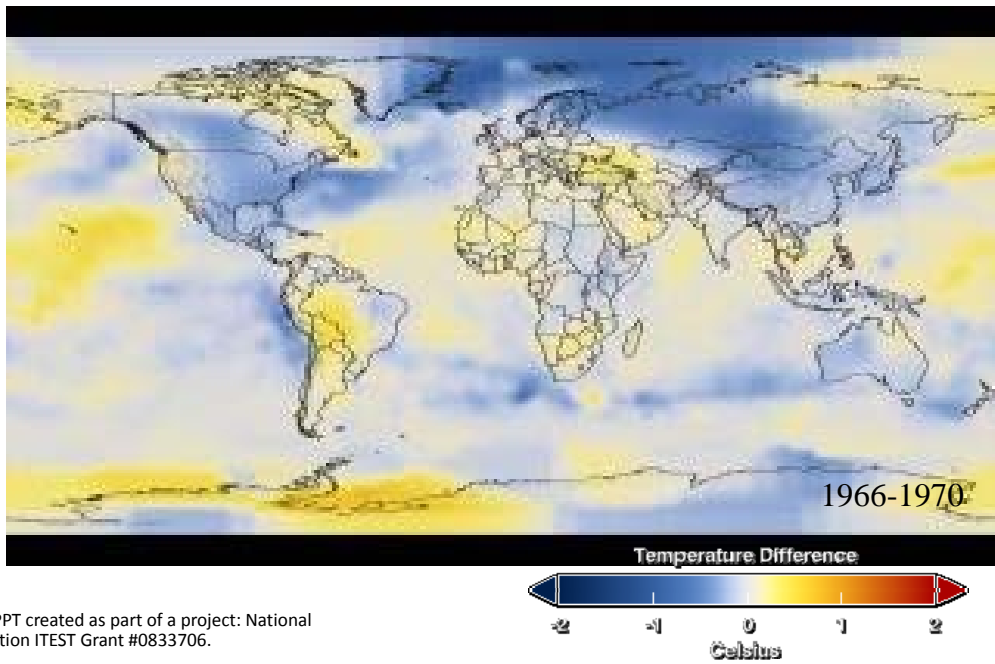
## Climate change



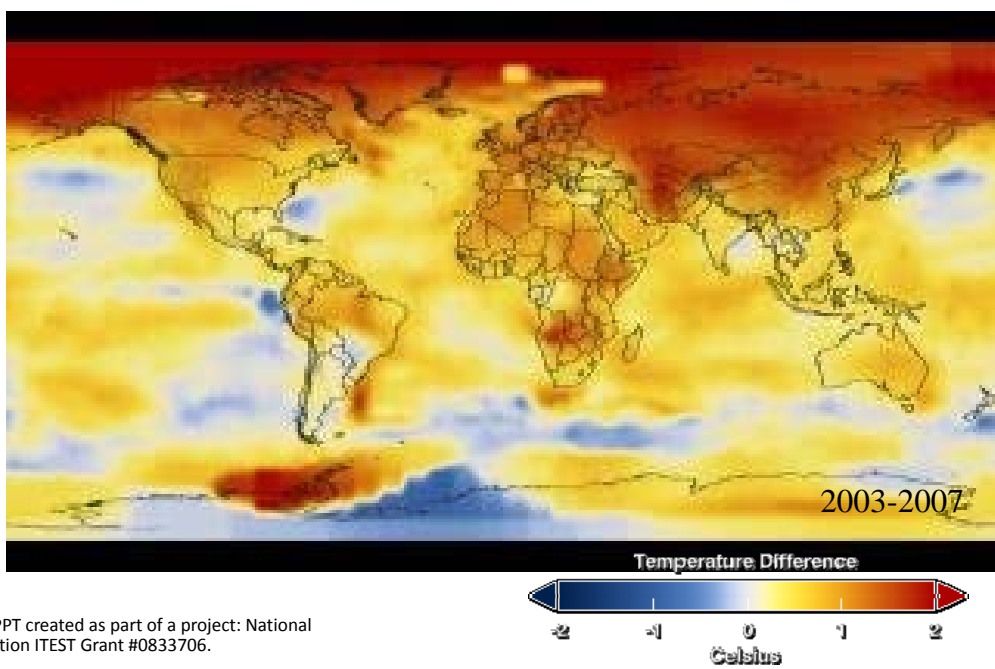
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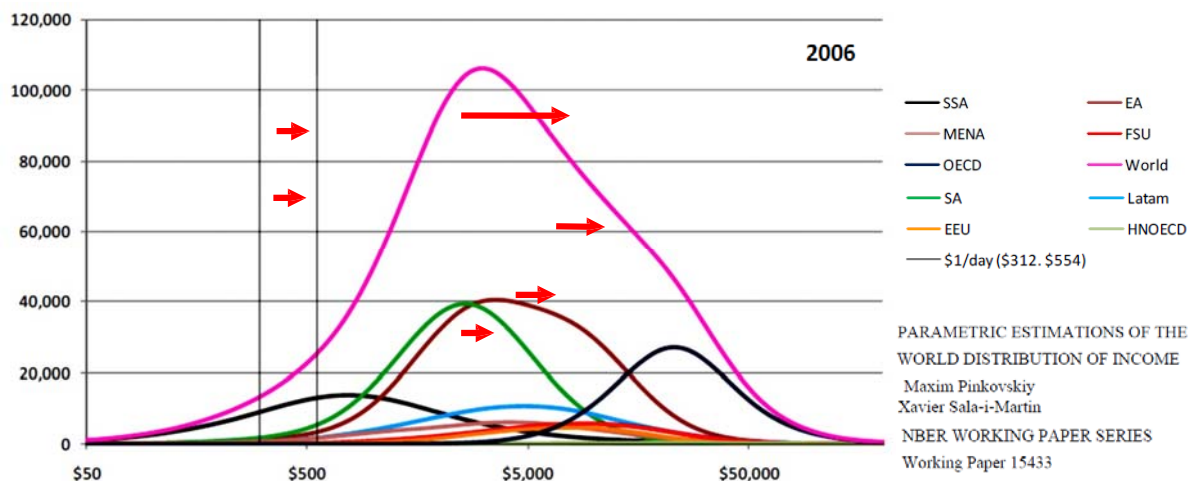
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The next step would be to ensure that continuing influx of new workers find decent jobs and thereby create its own demand to ultimately allow more people to enjoy a higher standard of living



## How do we ensure a market-based solution to the current impasse?

### Better designed regulation and greater reliance on market force



Incentives to encourage technical innovations that will reduce negative externalities, less resources (natural) and capital intensive



Better market regulation, including enhanced competition, to ensure lower natural rate of unemployment



Bold structural reforms in the labor market (both supply and demand side), and in the financial market



Reforms to strengthen the role markets can play and enforce discipline (better reflect risks and costs, and opportunities)



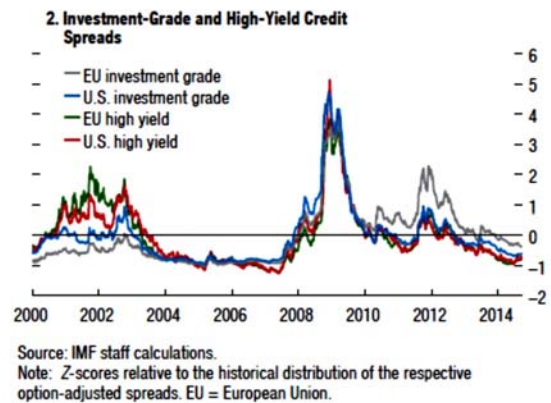
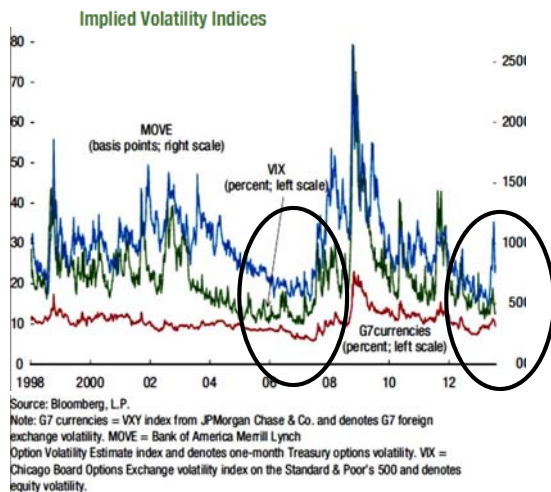
Better policy coordination to ensure that saving is generated and channeled to the right places with long term considerations

**“Opportunity” to lift more people out of poverty  
or “Risk” if fail to make this work**



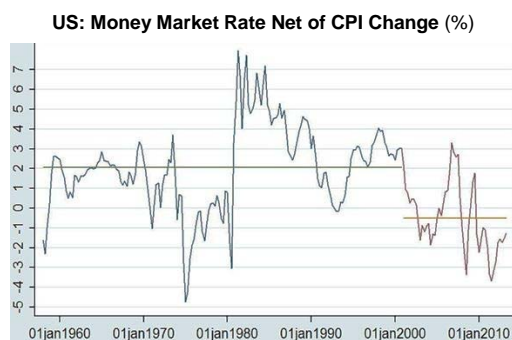
**Say's law?  
Keynesian?**

## What is not working properly: Risks were mispriced and likely to be the case again

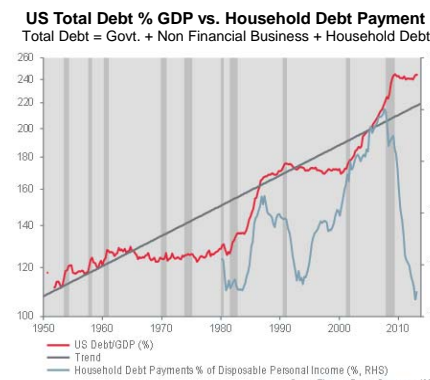


Source: IMF GFSR October 2014

## What is not working properly: Low real interest rate allowed debt to rise beyond capacity to repay (e.g., cost of borrowing—why is basic market mechanism not working?)



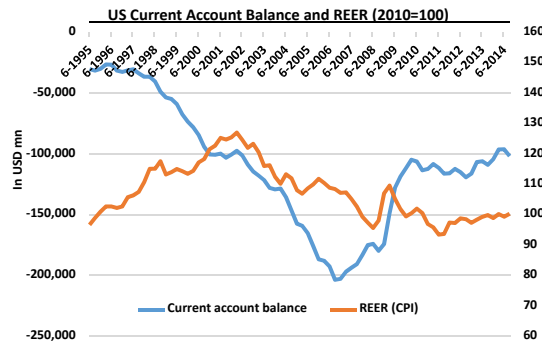
Source: IMF database (IMF e-Library)



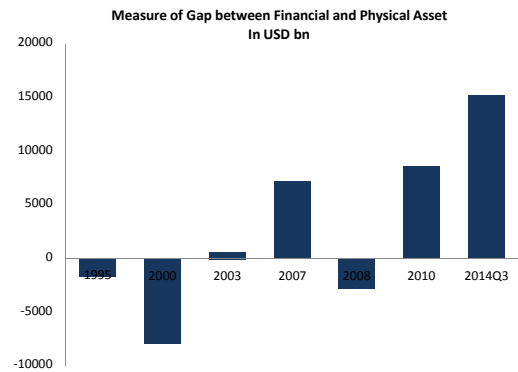
From Nicolas Ferres Presentation; Eastspring Investments (Singapore) Limited, October 2013



**What is not working: Despite widening current account, lack of global institutions, the normally expected self-correcting market discipline did not kick in (or kicked in abruptly)**



Source: CEIC



Source: US Flow of Funds; author's estimate

### One Example:

**Ways to allow greater independence of US monetary policy and flexibility of nonconvertible currencies vis a vis the USD**



Reforming the International Monetary System

- USD
- Euro



Facilitating a three polar currency system

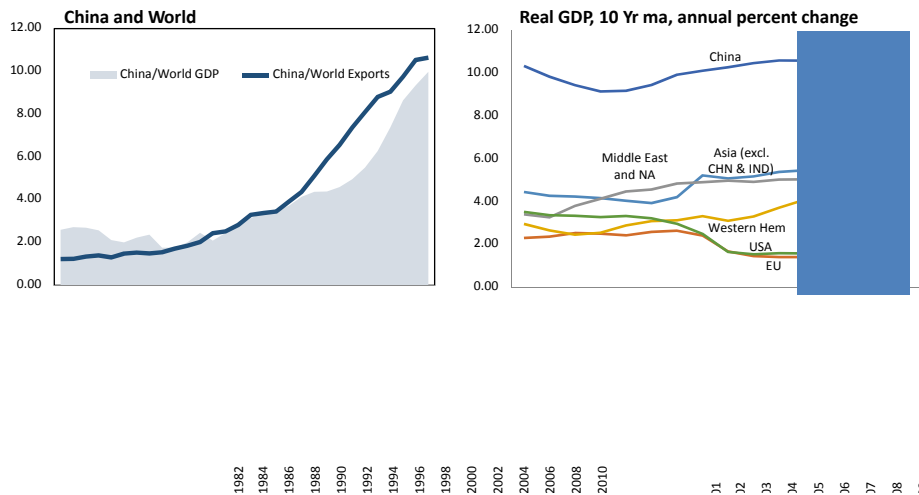
- USD
- Euro
- RMB

China has the “necessary economic conditions” to support RMB internationalization

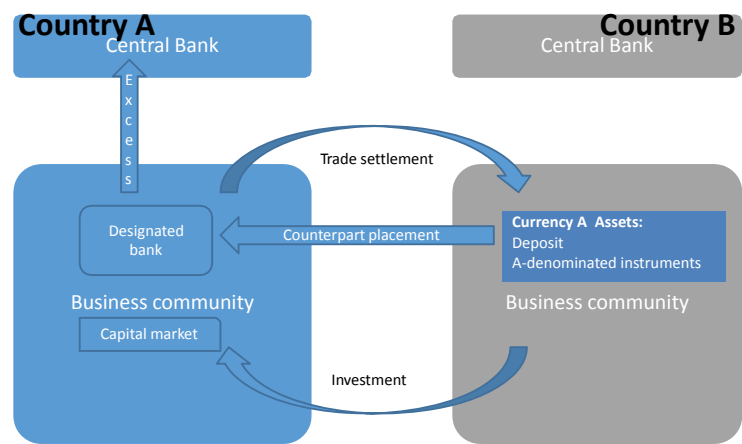
Key variables identified as important (necessary conditions) are

- GDP; Trade value; Depth of the financial market; Infrastructure/institutions

(Hongyi Chen, Wensheng Peng, Chang Shu)

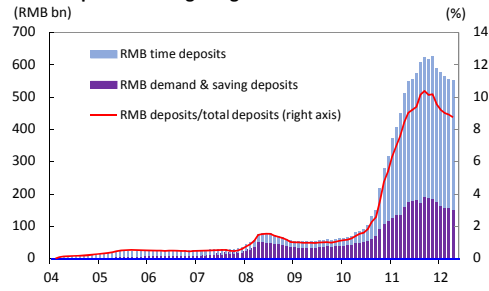


Starting at the regional level by using each other’s currency for trade settlement



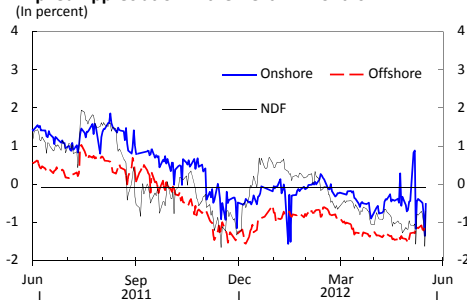
## RMB liquidity expanded rapidly in Hong Kong SAR but demand was largely affected by relative capital gains and availability of RMB assets

**RMB Deposits in Hong Kong**



Source: HKMA and Fund staff estimates

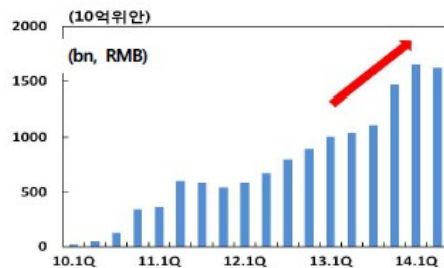
**Implied Appreciation in the Next 12 Months**



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## Trade settlement in mainland and HK POC continues to increase steadily backed by currency swap with several central banks

**RMB trade settlement in China**

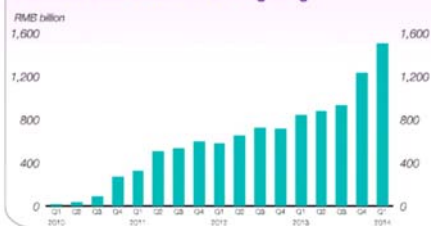


자료 : CEIC

Local Currency Swap  
International Forum

Note by the Staff of the Bank of Korea

**Renminbi trade settlement in Hong Kong**

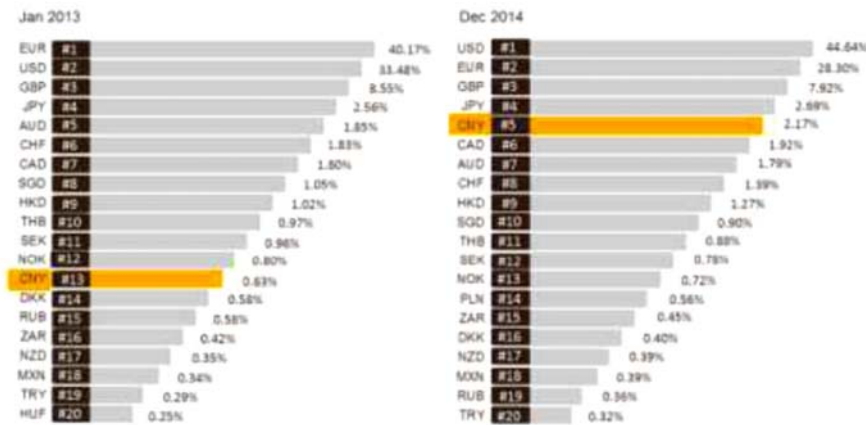


The Premier Offshore Renminbi Business Centre

HKMA, May 2014

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RMB as World payment currency in value may continue to rise, but most likely only up to a certain threshold



RMB as world payments currency in value

SWIFT RMB Tracker

Customer initiated and institutional payments. Inbound + Outbound traffic. Based on value.

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It could be supplemented with a few selective Asian currencies for CA transaction settlement

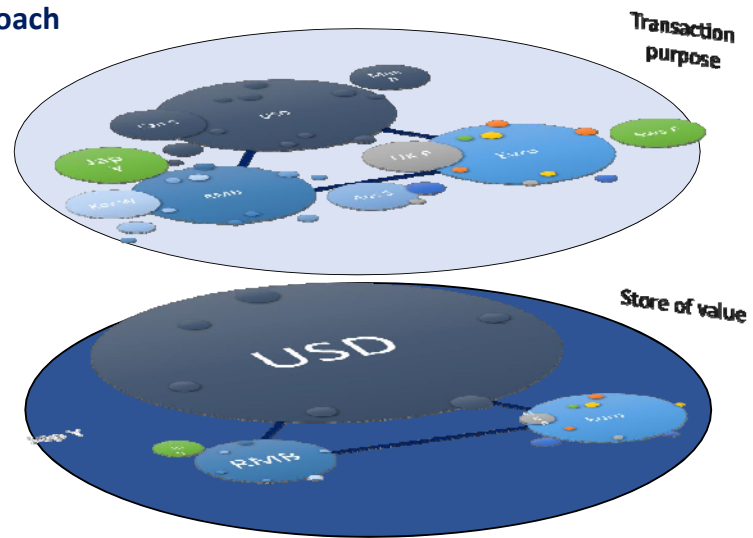
Table 6: National Currency Outflows from the Multilateral Trade Settlement Scheme in Local Currencies, 2012 (\$ million)

	Export to									
	Hong Kong, China	PRC	Japan	Republic of Korea	Indonesia	Malaysia	Philippines	Thailand	Singapore	Net
Hong Kong, China		123,811	18,576	7,606	2,674	3,712	2,901	5,384	7,222	171,885
PRC	177,630		126,788	73,313	34,291	28,756	12,888	24,820	36,937	515,422
Japan	24,662	160,591		61,515	20,273	17,701	11,855	43,696	23,290	363,583
Republic of Korea	28,265	138,664	38,796		13,955	7,723	8,211	8,221	22,888	266,723
Indonesia	291	24,002	30,135	15,050		11,280	3,708	2,634	17,135	104,235
Malaysia	6,957	31,551	26,879	8,202	8,954		3,398	12,231	30,944	129,116
Philippines	4,776	6,159	9,881	2,862	840	1,018		2,446	4,861	32,843
Thailand	13,041	26,702	23,320	4,752	11,142	12,351	4,830		10,763	106,901
Singapore	40,454	48,391	18,826	16,580	43,332	50,432	6,337	16,622		239,973
Net	296,076	559,872	293,201	189,880	135,461	132,973	54,127	115,053	154,039	1,930,681
	Net based on exports									
	Hong Kong, China	PRC	Japan	Republic of Korea	Indonesia	Malaysia	Philippines	Thailand	Singapore	Net
Hong Kong, China		-53,819	-6,086	-20,659	2,383	-3,245	-1,875	-7,657	-33,233	-124,191
PRC			-33,803	-65,351	10,289	-2,795	6,729	-1,883	-11,454	-98,269
Japan				22,719	-9,862	-9,177	1,973	20,376	4,464	30,493
Republic of Korea					-1,095	-479	5,349	3,470	6,308	13,553
Indonesia						2,326	2,668	-8,508	-26,197	-29,511
Malaysia							2,379	-120	-19,487	-17,228
Philippines								-2,384	-1,477	-3,861
Thailand									-4,856	-4,856
Singapore										0
Net	0	-53,819	-39,890	-63,291	1,715	-13,370	17,424	3,293	-85,934	-233,873

PRC = People's Republic of China.

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**A trip-polar system**  
**Two stage approach**



**Thank you!**