

OPENING REMARKS

**DARMIN NASUTION
GOVERNOR OF BANK INDONESIA**

**IMF-BI-BKPM JOINT CONFERENCE ON
"COPING WITH ASIA'S LARGE CAPITAL INFLOWS
IN A MULTI-SPEED GLOBAL ECONOMY"**

BALI, 11 MARCH 2011

Bismillahirrahmanirrahim,

Assalamu'alaikum warahmatullahi wabarakatuh,

Peace be upon us,

Distinguished Guests, Ladies and Gentlemen,

I would like to welcome all of you to the conference on *Coping with Asia's Large Capital Inflows in a Multi-speed Global Economy* commencing today. It is a great honor for Bank Indonesia, along with the IMF and the Indonesian Investment Coordinating Board, to host this important forum and have before us a group of distinguished speakers and guests.

I am personally thrilled just to imagine the collective wealth of knowledge and experience, on capital flow as well as international macroeconomics and finance, accumulated in this room. We have prominent speakers and participants coming from diverse background, from central bankers, government officers and academics, to investment bankers, asset management professionals and sovereign wealth fund managers.

It is also no accident that we have chosen Bali as the venue for this conference. We want you to find this event as important as it is enjoyable. It is our hope that Bali's unique culture, sights and sounds, will play a significant part in relaxing us, while at the same time stimulating our senses, innovativeness and creativity, the basic ingredients for a fruitful discussion.

Distinguished Guests, Ladies and Gentlemen,

As we convene today in the serenity of this peaceful Island, where time elapses rather slowly, the fast changing dynamics of global recovery has been throwing at us a two-speed global economy. Such recovery has led to the resumption of large capital flows to many emerging market countries, reflecting largely their better growth outlook.

It has been almost three years since the big quake that shook the very foundation of the global economy started. The turmoil has led to the biggest global financial crisis after the great depression. Now, emerging market economies in Asia have regained their pre-crisis momentum. Some have even performed better than before the crisis. That is indeed an encouraging development. However, another dimension of the recovery has turned out to be a source for concern.

A return of capital flows to Asia should help fast-growing economies fund their investment and development needs. Sharp surges in capital inflows have been posing policy challenges, especially on how to manage the inherent risks, while at the same time exploiting the opportunities provided.

Those who have taken ample time to study the dynamics of capital flows, in particular during the post Bretton-Woods era, can easily pinpoint an important challenge that has regularly re-appeared. That challenge has been how to maintain both the internal and external balance amidst the presence of a policy trilemma: managing volatility of capital flows, responding to exchange rate overshooting, and containing domestic liquidity expansion. Two of these three are unavoidably in conflict.

A particular risk that has pre-occupied policy makers from time to time has been that, massive capital inflows being mostly portfolio in nature could be very sensitive to changing expectation, which might lead to subsequent capital reversals. As such inflows permeate into the domestic financial markets; the domestic economy could suffer from unwanted consequences, such as asset price bubble, inflationary pressure, deterioration of current account surplus, or a combination of the three.

The resulting internal and external imbalances, in turn, could affect confidence on the sustainability of the flows, and on the perceived level of economic vulnerabilities that the country could withstand. As shown repeatedly in history, this unfavorable game of perception, if not managed properly, can lead to a sudden stop and even reversal of the flows. Furthermore, the corresponding instability could severely halt progress on the real economy.

Distinguished Guests, Ladies and Gentlemen,

As an integral part of the overall policy to maintain stability, a number of countries have implemented a mix of policy measures. This mix includes judicious interest rate response, greater exchange rate flexibility, foreign exchange reserve accumulation, and various administrative as well as macroprudential measures.

In my opinion, equally important measures are structural reforms on the real side of the economy. In this century of heightened global competition, emerging economies are required to be mindful of their relative positioning in the global value chain, so as to enable them to capture the full range of benefits that economic globalization has to offer.

This reality, which reflects the growing importance of physical capital, human capital, as well as technology, means that cheap labor and exchange rate management will become less of determining factors when competing globally. In other words, economies that fail to recognize the importance of advancing and accelerating research activities, human capital development, and technological progress, will be left behind in the global race to attract the more sustainable FDI flows, and become more prone to risks accompanying the large “hot money” flows. Hence, countries that are less mindful of the lack of hard and soft infrastructures will be more vulnerable and prone to future economic crisis.

Therefore, the policy mix in dealing with large capital flows must also include structural and development measures that promote investment in

both hard and soft infrastructures, from roads and IT broadband to legal and regulation. The latter should include building health and educational infrastructures to boost aggregate human capital level, and setting up various institutional frameworks to foster technological progress. Only with such additional ingredients to our menu, in my opinion, fast growing emerging economies in Asia could sustain the growth rate and build resilience to the risks associated with large capital inflows amidst the two-speed global recovery.

Distinguished Guests, Ladies and Gentlemen,

This conference is designed to provide us with plenty opportunity to discuss recent developments in capital flows and practices for effectively managing such inflows. It will also enable us to enrich each other so that we can find a new breakthrough, hopefully in terms of concept, methodology and policy combination, in dealing with and managing capital flows. I am looking forward to hearing the views of the speakers, and to learn from leading academics as well as policy makers in attendance, on the subject of this conference.

I am confident that by the end of this forum we will arrive at some fresh perspectives and be able to put forward fruitful contributions to manage, and to reap the full benefit of, capital inflows. So, let us begin. On behalf of other participants I am honored to request Professor Jeffrey Frankel of Harvard to deliver his keynote address.

Thank you. *Wassalamu'alaikum warahmatullahi wabarakatuh.*