G-20/EBRD/RBWC Conference on Local-Currency Finance and Local Capital Markets

Astana, 18-19 May 2011

Concluding Remarks by Benoît Coeuré

I would like to thank all speakers and discussants and command the European Bank for Reconstruction and Development and Reinventing Bretton-Woods Committee for what has been a very rich conference. What is particularly valuable is the evidence-based approach, based on firm-level facts and countries experiences. This is about building capital markets, an area where nuts and bolts do matter. And the mind-boggling venue of Astana's 'Pyramid of Peace' did a lot to reinforce the intellectual excitement.

I have been tasked by Erik Berglöf and Marc Uzan with the daunting mission of wrapping up the last two days' discussions. Tentatively, I will draw three conclusions.

1. **Efforts to develop capital markets should be multi-faceted**

It can be concluded from the discussions today and yesterday that demand for local-currency products should be originated both in local and in foreign markets. This is a condition to build-up liquidity, and as a consequence resilience of these young markets. This calls for a broad set of actions aimed at:

- Developing the local investor base and particularly long-term oriented institutional investors such as sovereign wealth funds, insurers and pension funds.

- Devising in an appropriate manner the joint sequence of local capital-market development and capital-account opening. Let me note *en passant* that convertibility is not a precondition for capital-account opening, as evidenced by the fast development of the offshore RMB market in Hong Kong - the 'CNH' market. The offshore market has developed without full convertibility: this may not last forever, but is shows that there is ample room for financial experiment within the existing convertibility framework.

- Building strong market infrastructures such as clearing and settlement, money markets, well-functioning funding markets including for repos, etc. This has been discussed at length in this morning's session.

- Providing a diversified supply of securities, *e.g.* extended yield curves and contingent securities such as inflation-protected bonds. Let me note however that there is a trade-off between asset diversification and liquidity, which can be overcome only when markets have grown larger.

None of these items is new. As a former sovereign debt manager, I remember the days when France was striving to develop its financial markets and attract foreign investors, both in French Franc and in Ecu. I see no substantial difference between the challenges faced today by emerging markets and those faced by more mature markets ten or twenty years ago. This is a cause for optimism. There is a vast pool of experience and knowledge, both public and private, which can be tapped to help emerging-market countries move faster along the learning curve.

Another conclusion is that there is a need both to encourage local-currency debt and to discourage excessive foreign-currency debt. This calls for a review of the regulatory and macro-prudential framework, and for the creation of instruments to provide risk mitigation.

2. Market-building should be market-driven

The macro-economic and macro-prudential frameworks matter a lot to set the incentives right. In particular, exchange-rate regimes can influence profoundly the risk environment: fixed exchange rates provide implicit guarantees for foreign-currency exposure, while exchange-rate flexibility, while overly desirable, may result in excessive volatility and discourage foreign investors. That said, fresh ideas can only come from market participants, both from the corporate and financial sectors. Any program to develop domestic financial markets and local-currency instruments should therefore be based on public-private initiatives.

3. **Discussions have highlighted strong complementarities between various G-20 workstreams**

When listening to your discussions, I have been struck by the strong complementarities between several G-20 work streams. Let me highlight a view of these, based on today's conclusions:

- The macro policy framework matters. This underscores the importance of ongoing G-20 work on global imbalances and the Mutual Assessment Process. There is a double causality here: reduced global imbalances will be conducive to a more stable macro environment and support the development of local financial markets; and conversely, deeper local financial markets will help domestic savings be invested locally and therefore reduce external imbalances. This also points to the need to strengthen surveillance both at a global and at a regional level, including on exchange rate misalignments and exchange rate regimes, and on cross-country spillovers. Here, global means IMF and local means arrangements such as the European Union or the ASEAN+3 Chiang Mai Initiative-Multilateralized. This is an important dimension of the G-20 IMS reform project.

- The financial regulatory framework matters. This underscores the importance of completing the FSB work program on global regulatory standards. This is all the more important as new regulatory standards, such as the new Basle III rules on capital adequacy and liquidity or the EU Solvency II rules for insurance and occupational pensions, will exert a profound influence on the structure of financial intermediation. Here, the devil is in the detail. However desirable in principle, these rules will be self-defeating if they are implemented in a way that hampers long-term investment. They may very well result in *more* securitization and short-term transactions because financial intermediaries would not be willing to make full use of their balance sheets. This would not be conducive to the development of local financial markets, which requires the presence of long-term investors.

- Countries' macro-prudential frameworks do matter as well. G-20 ministers and governors have vowed in Washington last April to reach coherent conclusions on the management of capital-flows. Macro-prudential measures to limit excessive foreign-currency indebtedness will obviously be part of these.

- The orderly development of new reserve currencies matters. As suggested this morning, a criteria-based path to broaden the SDR basket can provide a relevant framework to review in a cooperative way all issues related to the internationalization of emerging-market currencies. This was discussed in depth at the high-level seminar on reforming the International Monetary System in Nanjing last March and will be integrated in further G-20 work.

I would like to thank again Erik Berglöf, Marc Uzan and the EBRD and RBWC teams for the excellent organization. Reflection will now be pursued in the G-20 setup, with contributions expected by the World Bank and regional development banks. We look forward to putting all recommendations together in preparation of the Leaders Summit next November in Cannes, then handing it over to our Mexican colleagues.