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Title	The post-Brexit world: how should East Asian finance cope?
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Citation	Pitakdumrongkit, K. (2016). The post-Brexit world: how should East Asian finance cope? (RSIS Commentaries, No. 160). RSIS Commentaries. Singapore: Nanyang Technological University.
Date	2016
URL	http://hdl.handle.net/10220/40840
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Brexit and Its Aftermath

The Post-Brexit World: How Should East Asian Finance Cope?

By Kaewkamol Pitakdumrongkit

Synopsis

The post-Brexit world is now bracing for the immediate effects on financial markets, including in East Asia. More enhanced macroeconomic policy coordination is needed. Yet, a strong political will is required for successful joint effort.

Commentary

AFTER MUCH heated debate, Brexit has become a reality. The United Kingdom has voted in a referendum to leave the European Union (EU). No one knows for sure in the long run how much Brexit will affect the global economy, especially in the realms of international trade, and financial stability and system. Uncertainty is now a certainty.

Although the actual UK withdrawal does not happen overnight as there will be a two-year transition period to allow for exit negotiations, the effect of Brexit has taken a toll on financial markets around the globe. East Asia has not been spared. Its stock markets plunged. The Nikkei was down 7.92% and KOSPI was off by 3.09%. Hang Seng and Shanghai Composite finished lower at 2.95% and 1.30% respectively.

East Asian Responses

The turmoil triggered swift responses by some regional states. The Japanese government convened to discuss how to lessen the impact of Brexit on its financial market. Finance Minister Taro Aso announced that Tokyo was ready to roll out actions to address wild swings. Also, the Bank of Korea held a meeting to figure out

ways to tame the local turmoil. According to its Vice Finance Minister Choi Sang-Mok, Seoul “will do its best to minimise any adverse impact of the Brexit outcome on the South Korean economy”.

The spokesperson of the Monetary Authority of Singapore declared that the entity “will continue to be vigilant and stay in close contact with fellow central banks and regulators, as uncertainty is likely to persist following the referendum outcome”. The last statement demonstrates a good sign reflecting the government’s plan to work together with the others to jointly address a potential financial roller-coaster.

Policy Coordination to Face Future Uncertainty

As uncertainty lingers, East Asian nations should further enhance their macroeconomic policy coordination. The benefits of such course of action are clear: Firstly, policy coordination could boost information exchanges between the governments. Such sharing is useful as it improves their ability to evaluate the situations and diagnose problems at stake, and together devise feasible policy actions.

Given that the East Asian economies are intertwined in the regional production networks, cooperating helps the countries avoid implementing measures that lead to undesirable effects, such as an upward pressure on neighbouring countries’ currencies which can disrupt international trade and investment flows.

Also, policy coordination can reduce future turmoil. Financial markets are influenced by ideas and perceptions. History teaches us that some rumours trigger herd behaviour such as rapid sell-offs which led to stock market plummet and value loss. By working together, the regional states can jointly prevent rumours from spreading and becoming the “truth” in investors’ minds.

More regular meetings between East Asian officials should be held because they could signal to the market about the governments’ commitment to collectively address regional financial issues. Moreover, joint press conferences or statements after the meetings should be delivered. Such communication is necessary as it lessens the probability that international investors would misinterpret states’ intentions and actions. It also helps counter baseless rumours, reducing the likelihood of financial panic and chaos.

East Asia’s Role in Shaping Global Policy

Moreover, such effort can increase East Asia’s roles in shaping global policy coordination. The regional states have been active participants in several platforms at the global level such as the Group of Twenty (G-20) and Financial Stability Board. Some successful actions and approaches adopted by East Asian nations can be proposed at the global platforms as ways to lessen or avoid market volatility.

How would regional macroeconomic policy coordination be improved? Among the possible modalities, one pathway that analysts agree is to build upon the existing architectures, namely the ASEAN+3 process. The framework has provided foundations in the areas of reserve sharing/liquidity provision (under the Chiang Mai

Initiative Multilateralisation or CMIM), capital market development (as reflected by the Asian Bond Markets Initiative or ABMI), and surveillance mechanisms (such as the ASEAN+3 Macroeconomic Research Office or AMRO).

Despite these achievements, more work is needed to boost policy coordination which could be done, for example, by creating regional guidelines or blueprints for actions regarding the management of short-term capital flows and undertaking joint inflation targeting. Admittedly, these actions face challenges as they require policy adjustments of the involved stakeholders. As a result, there is a clear need for strong political will to realise successful coordination.

Governments must convince one another that collective effort will better address financial problems than individual actions which can potentially offset the effect of the other states' policies. In short, regionalist interests must be seriously taken into account as well.

How the future of East Asian financial regionalism will unfold is still unclear. With Brexit now a fact, would the regional states use this event as an opportunity to foster more joint policy coordination? Or would they end up undertaking macroeconomic management on their own?

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