



Banks and financial intermediation in Asia: what has changed?

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Outline of this presentation

- Asia's banking system: taking stock of the recent dimensional changes.
- Implications for Asia's financial intermediation and global integration.
- Policy challenges going forward



Three-dimensional changes in Asia's banking system

- Asian banks have been substantially restructured since the 1997-98 crises.
- Corporate sector disintermediation is accompanied by increased household intermediation.
- And, the region has seen rapid internationalisation of banking services.



Structure of the banking system

- Substantial bank consolidation since the 1997-98 crises (a large number of banks have been privatised, merged, and closed).
- Increased foreign ownership of the banking system.
- Improved banking sector health.

**Bank consolidation**

	Number of banks privatised between 2000 and 2005	Number of mergers and acquisitions between 2000 and 2004	Changes in the number of commercial banks between 1999 and 2004 (in percent)
China	14 joint stock commercial banks sold shares to foreign investors.	1	91
India	A large number of banks were divested in the equity market under majority government ownership.		-13
Indonesia	15 banks, accounting for 70% of total assets, sold in IPOs.		-21
Korea	4 banks nationalised during 1997-98 crisis and sold.	7	-19
Malaysia		16	-29
Philippines		13	
Thailand	3 large banks out of 5 taken over during 1997-98 crisis and sold.	2	
Hong Kong		14	-27
Singapore		8	-19

Source: BIS Papers 28, Bank for International Settlements.

**Share of bank assets held by foreign banks¹**

	1990	2004 ²	in per cent of GDP	in billions of USD
Emerging Asia				
China	0	2	4	71
Hong Kong	89	72	344	570
India	5	8	6	36
Korea	4	8	10	65
Malaysia	...	18	27	32
Singapore	89	76	148	159
Thailand	5	18	20	32
Latin America				
Argentina	10	48	20	31
Brazil	6	27	18	107
Chile	19	42	37	35
Mexico	2	82	51	342
Peru	4	46	14	11
Venezuela	1	34	9	9

¹ Percentage share of total bank assets. ² Or latest available year.

Source: Committee on Global Financial System. (2004)



Structural bank indicators in Asia

	Non-performing loans ¹		Capital asset ratio		Operating costs ¹		Return on assets	
	1999	2004	1999	2004	1999	2004	1999	2004
China	19.0	6.0	5.3	3.9	1.3	1.1	0.1	0.8
India	6.1	3.3	11.3	12.9	2.4	2.3	0.5	1.2
Hong Kong SAR	7.2	2.1	17.8	15.4	0.7	0.8	0.4	1.7
Singapore	7.2	2.6	20.9	16.1			1.2	1.3
Korea	9.2	1.8	12.0	11.8	1.6	1.5	-1.3	0.9
Indonesia	6.6	1.8	-6.7	20.9	2.8	3.2	-8.7	2.6
Malaysia	8.5	6.4	12.8	14.3	1.7	1.5	0.7	1.4
Philippines	12.3	12.7	15.7	18.4	3.3	3.1	0.4	0.9
Thailand	32.4	8.5	12.4	13.1	2.1	2.0	-5.7	1.3
<i>Memorandum:</i>								
United States	0.5	0.4	8.4	10.3	3.1	2.4	1.3	1.3
Germany	1.7	2.0	4.1	4.4	1.4	1.3	0.2	0.1

¹ As percent of total commercial bank assets.



The credit ratings of banks

	Moody's Bank Financial Strength Ratings ¹		Fitch Individual Ratings ²	
	Dec 1998	Dec 2005	Dec 1998	Dec 2005
China	D (24)	E+ to D- (11)	.	D/E to D (16)
India	D- to D (8)	D to D+ (10)	.	D (31)
Indonesia	E (11)	E to E + (9)	E (3)	D to C/D (12)
Korea	E+ to D- (19)	D to D (15)	E to D/E (8)	C to B/C (12)
Malaysia	D- (5)	D+ to C- (11)	D/E to D (6)	C/D (12)
Philippines	D to D+ (11)	D- to D (11)	D to C/D (5)	D to C/D (13)
Thailand	E to E+ (10)	D- to D (10)	E to D/E (12)	C/D (10)
<i>Memorandum:</i>				
United States	C+ to B (117)	B to B+ (154)	B to A/B (106)	B/C to B (252)
Germany	C to C+ (35)	C- to C (43)	D to C/D (21)	C/D to C (65)

¹ The Bank Financial Strength Rating is Moody's assessment of whether a bank is likely to require financial support from shareholders, the government or other institutions. The ratings range from A (highest) to E (lowest).

Sources: Moody's Investors Services and Fitch *Bankscope*; BIS calculations.



Significant changes in bank intermediation

- Corporate sector is moving away from bank credit – a process driven by large profits, de-leveraging and the growth of domestic bond and equity markets.
- Banks are rapidly expanding credit to the household sector – both cyclical and structural forces are contributing to this expansion.
- And banks in several countries are accumulating risk-free government (and central bank) securities – a process driven by risk aversion and sterilised intervention.

**Composition of bank credit¹**

	Housing credit			Consumer credit			Business credit		
	1994	1999	2004	1994	1999	2004	1994	1999	2004
Asia									
India			10			12		7	7
Hong Kong SAR	7	15	15	2	3	3	86	76	73
Singapore	14	20	26	13	12	15	60	51	39
Indonesia		5	6		7	18		60	37
Korea		9	33		18	17		69	47
Malaysia	10	18	28		8	16		64	45
Thailand	9	7	10	4	3	6	64	71	68

¹ Of commercial banks. As a percentage of total domestic credit of commercial banks. ² The data in the middle columns refer to 2002.

Source: BIS Paper 28, Bank for International Settlements.

**International financing of non-bank sector**

Asia	As % to GDP	
	1999	2005
China	3	3
India	4	5
Hong Kong SAR	31	55
Singapore	20	55
Indonesia	22	9
Korea	14	12
Malaysia	23	31
Philippines	32	44
Thailand	19	11

¹ Non-bank cross-border liabilities to BIS reporting banks and international debt securities outstanding.

**Local currency corporate bonds by residence of issuer**

At end-2004

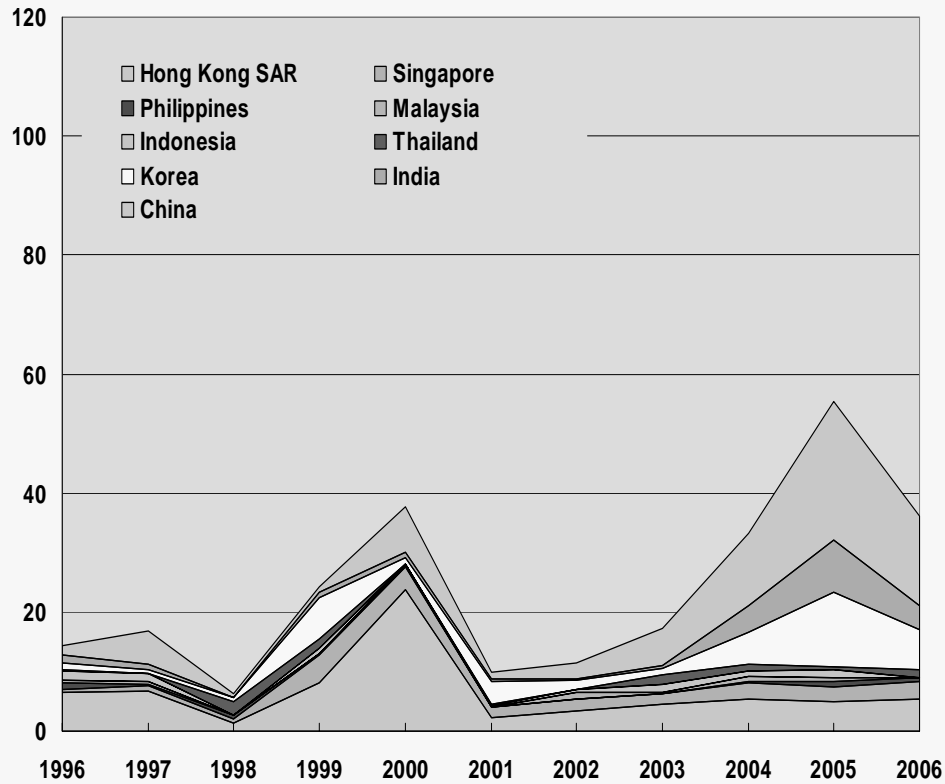
	Residents (USD billions)	As a percentage of total	Non-residents (USD billions)	As a percentage of total
Australia	134.0	71.5	53.5	28.5
China	195.9	100.0	0.0	0.0
Hong Kong SAR	27.3	44.1	34.6	55.9
India	24.5	100.0	0.0	0.0
Indonesia	6.8	99.8	0.0	0.2
Japan	1,646.1	82.2	355.9	17.8
Korea	355.2	99.9	0.4	0.1
Malaysia	49.5	99.6	0.2	0.4
New Zealand	4.1	13.8	25.8	86.2
Philippines	0.2	86.8	0.0	13.2
Singapore	13.9	64.0	7.8	36.0
Thailand	31.8	99.8	0.1	0.2
<i>Memo: United States</i>	13,535.9	89.5	1,580.7	10.5

Sources: Gyntelberg, Ma and Remolona (2005)., BIS Quarterly review (December 2005)

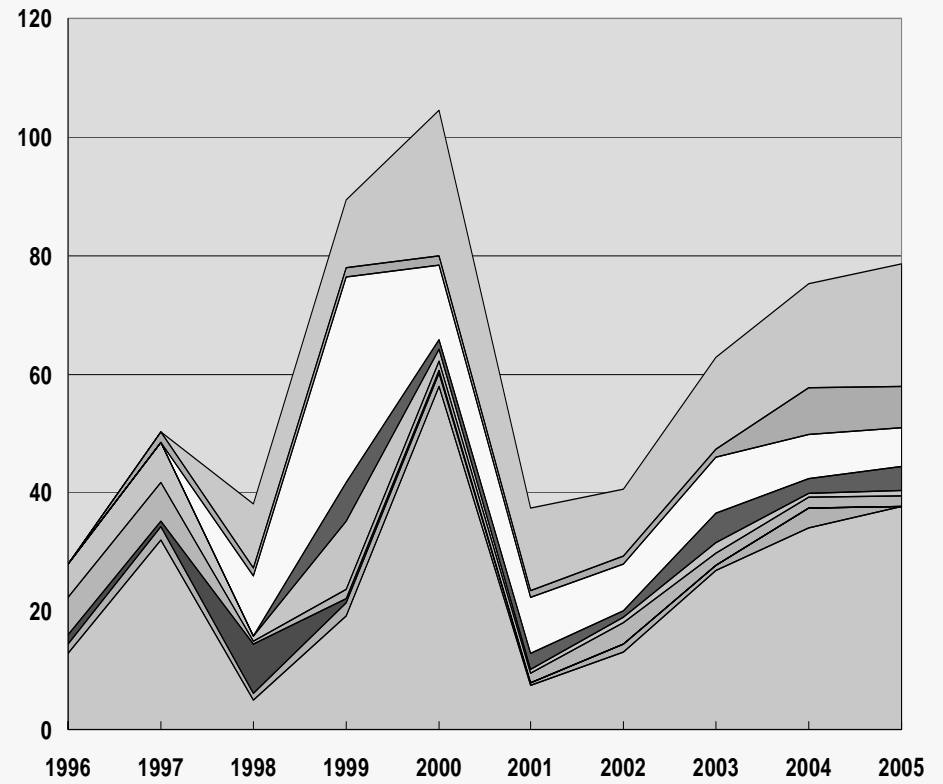


Equity issuance in Asia In billions of US dollars

International issuance



Domestic issuance¹

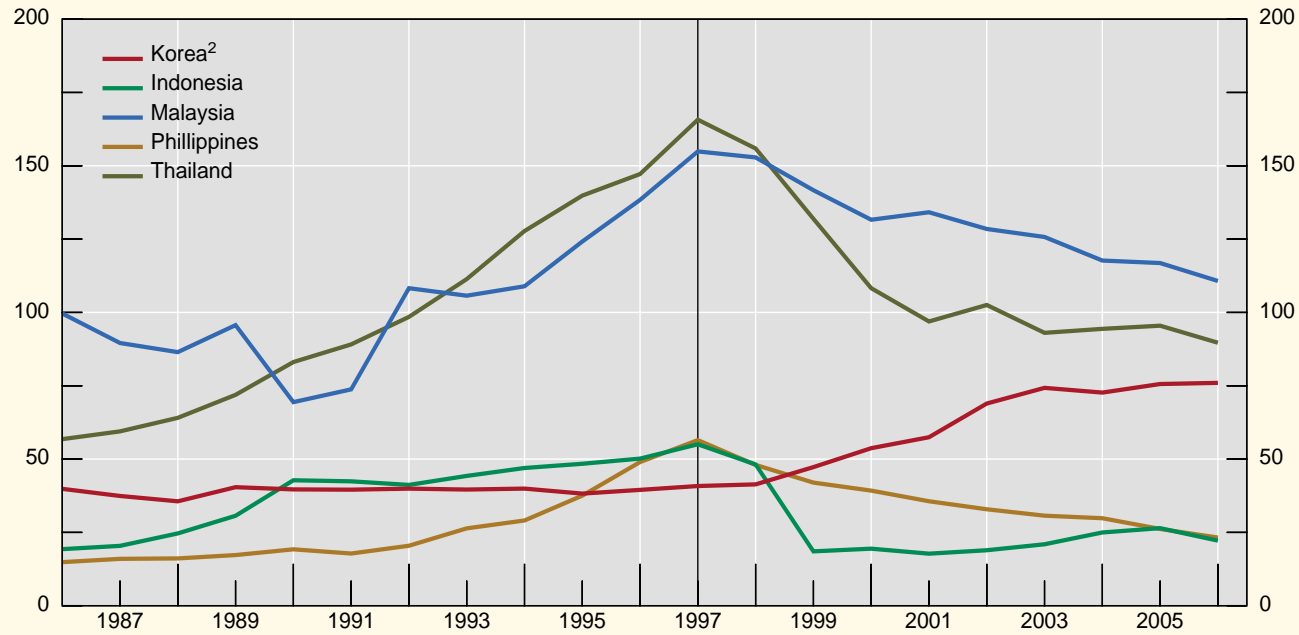


¹ Includes rights issues. For China, total capital raised excluding H shares.



Bank credit to the private sector before and after banking crises¹

As a percentage of GDP



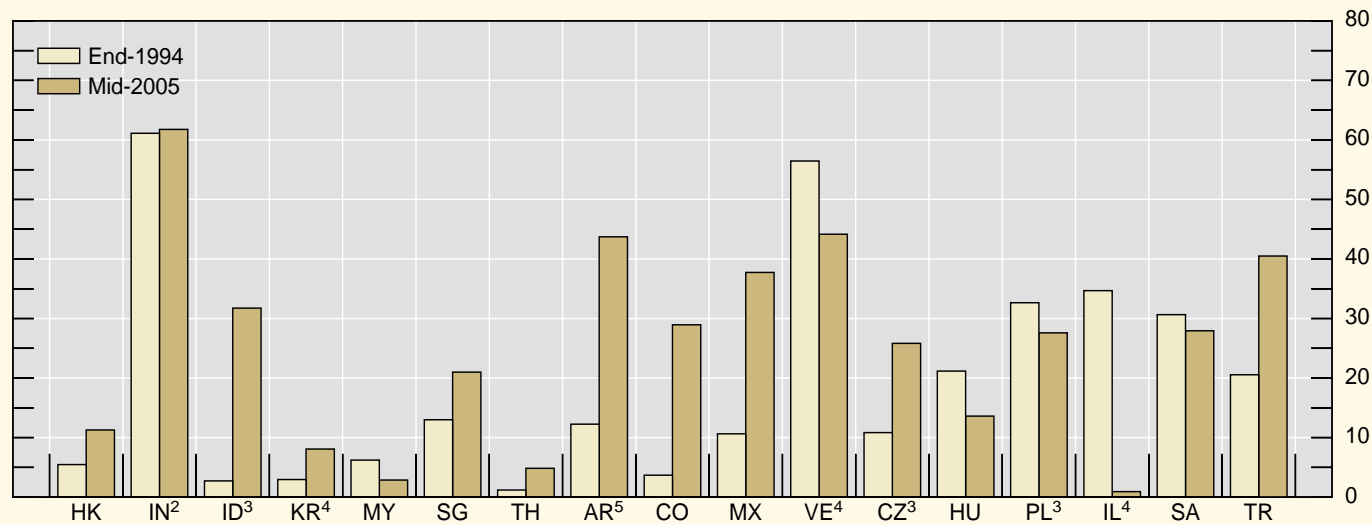
¹ End of period. Data for 2006 refer to second quarter credit data and a GDP estimate. ² Total bank loans.

Sources: IMF, *International Financial Statistics*; IMF, *World Economic Outlook*; national data.



Government securities held by commercial banks

As a percentage of total domestic credit¹



¹ Of commercial banks. ² The first column refers to end-1997. ³ The first column refers to end-1996. ⁴ The second column refers to end-2004. ⁵ The first column refers to end-1998.

Sources: National data (questionnaire).

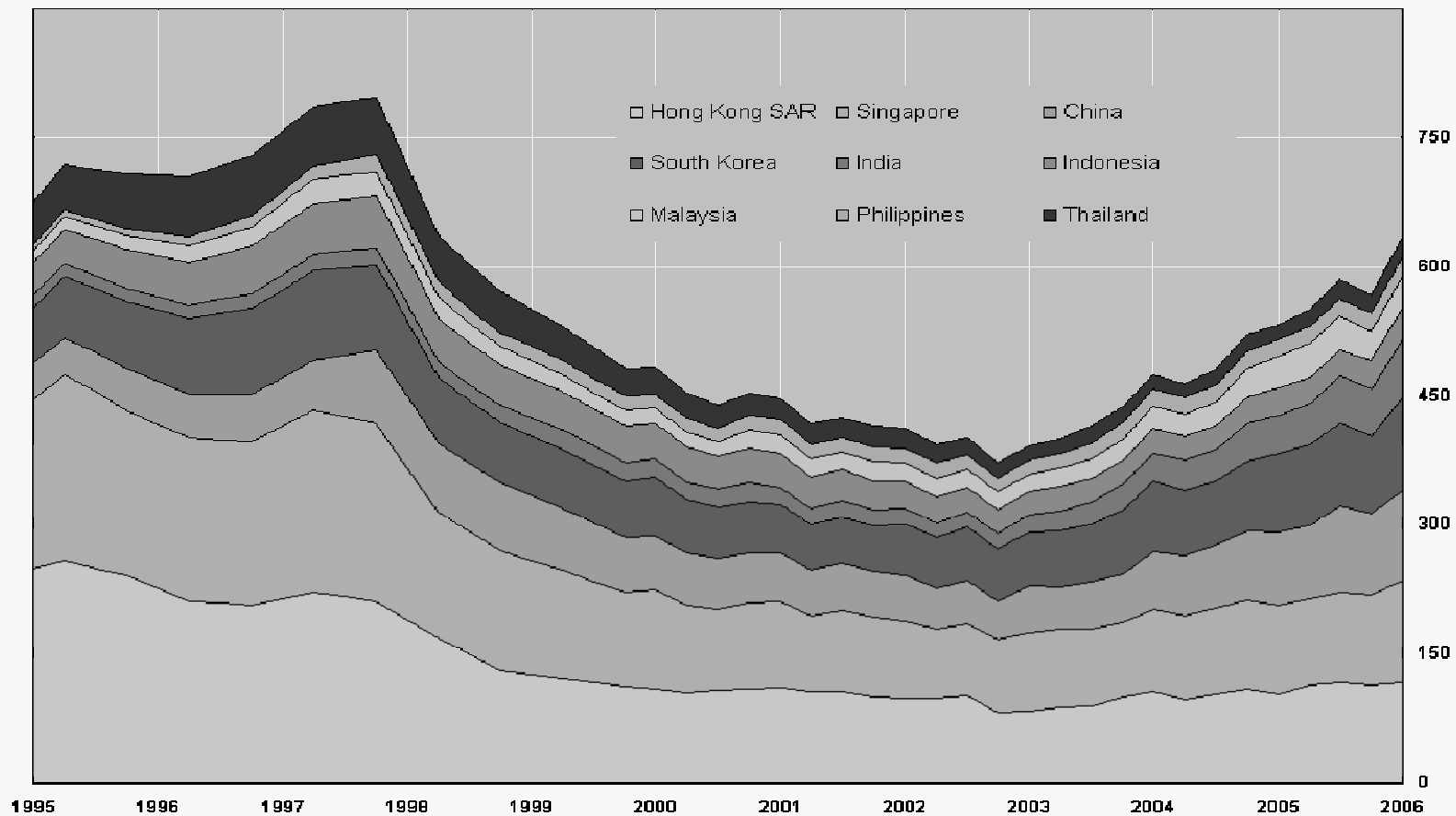


Asia's international financial integration is growing

- Cross-border bank lending to the region has revived.
- Local currency lending by international banks to the region is increasing.
- Issuance of international bonds by the region is growing rapidly.



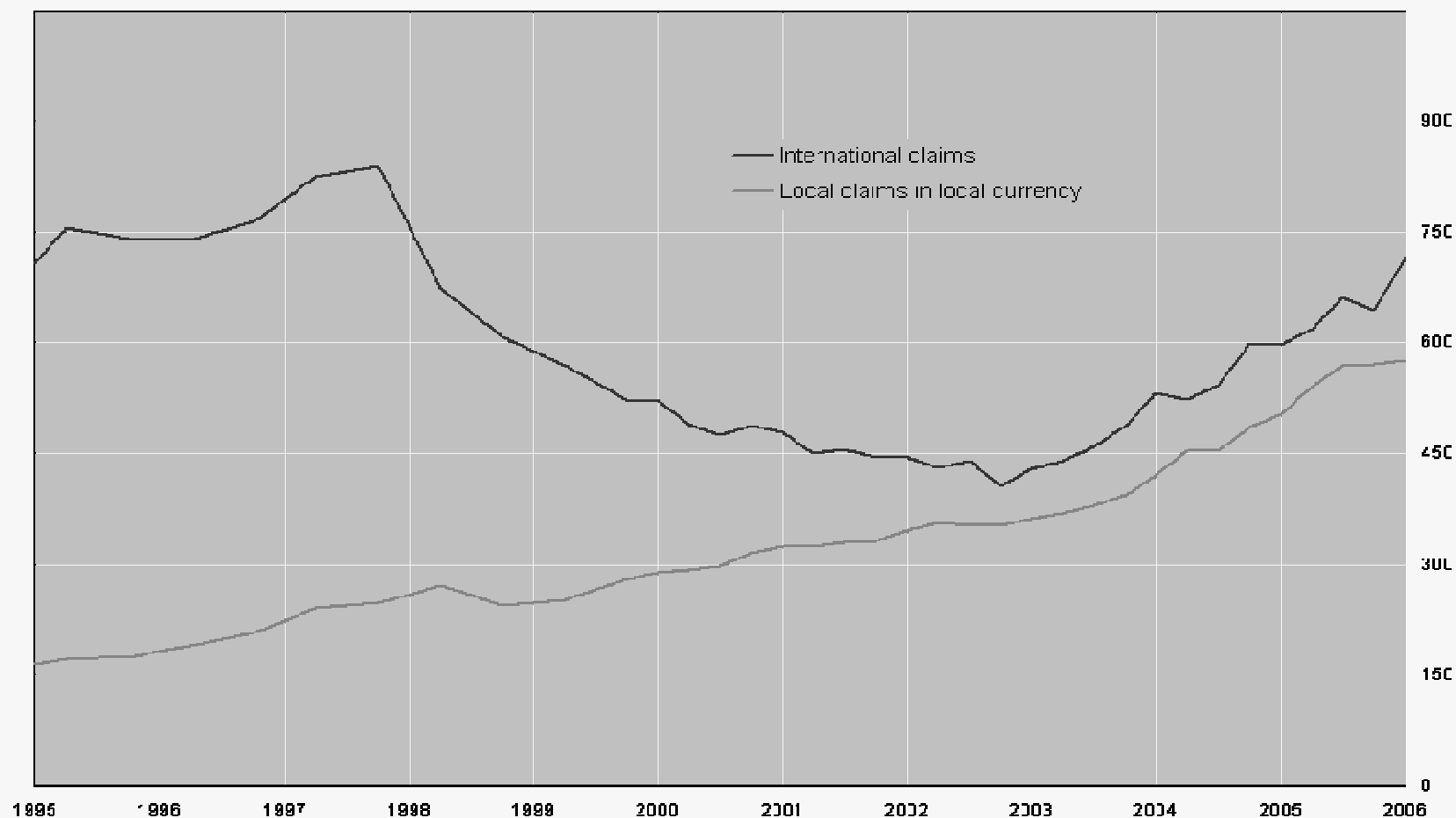
Consolidated international bank claims, in billions of USD



Source: BIS international consolidated banking statistics



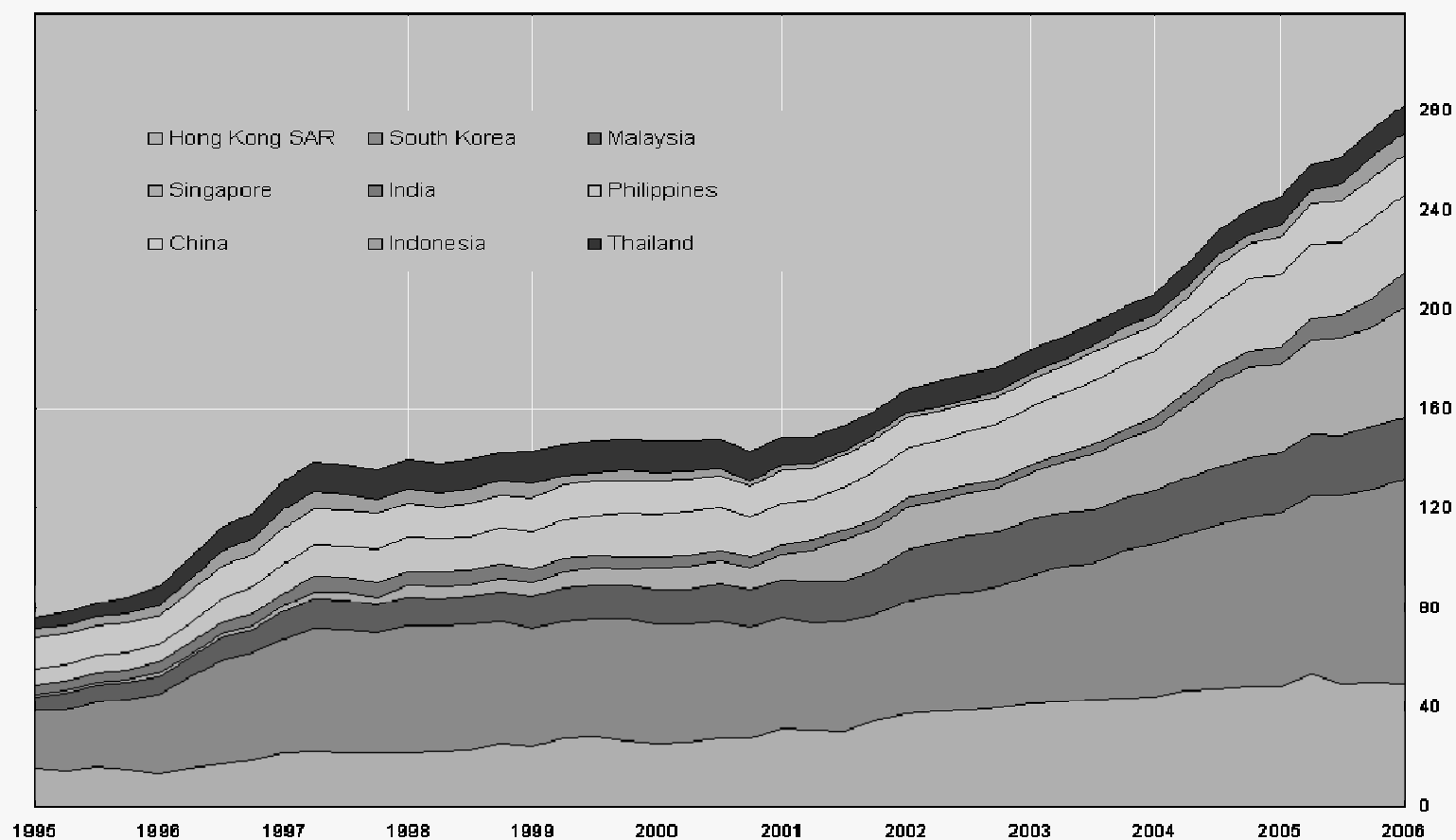
International and local claims of BIS reporting banks, in \$ bln



Source: BIS international consolidated banking statistics



International debt securities by residence of issuers, in \$ bln



Source: BIS international debt securities statistics

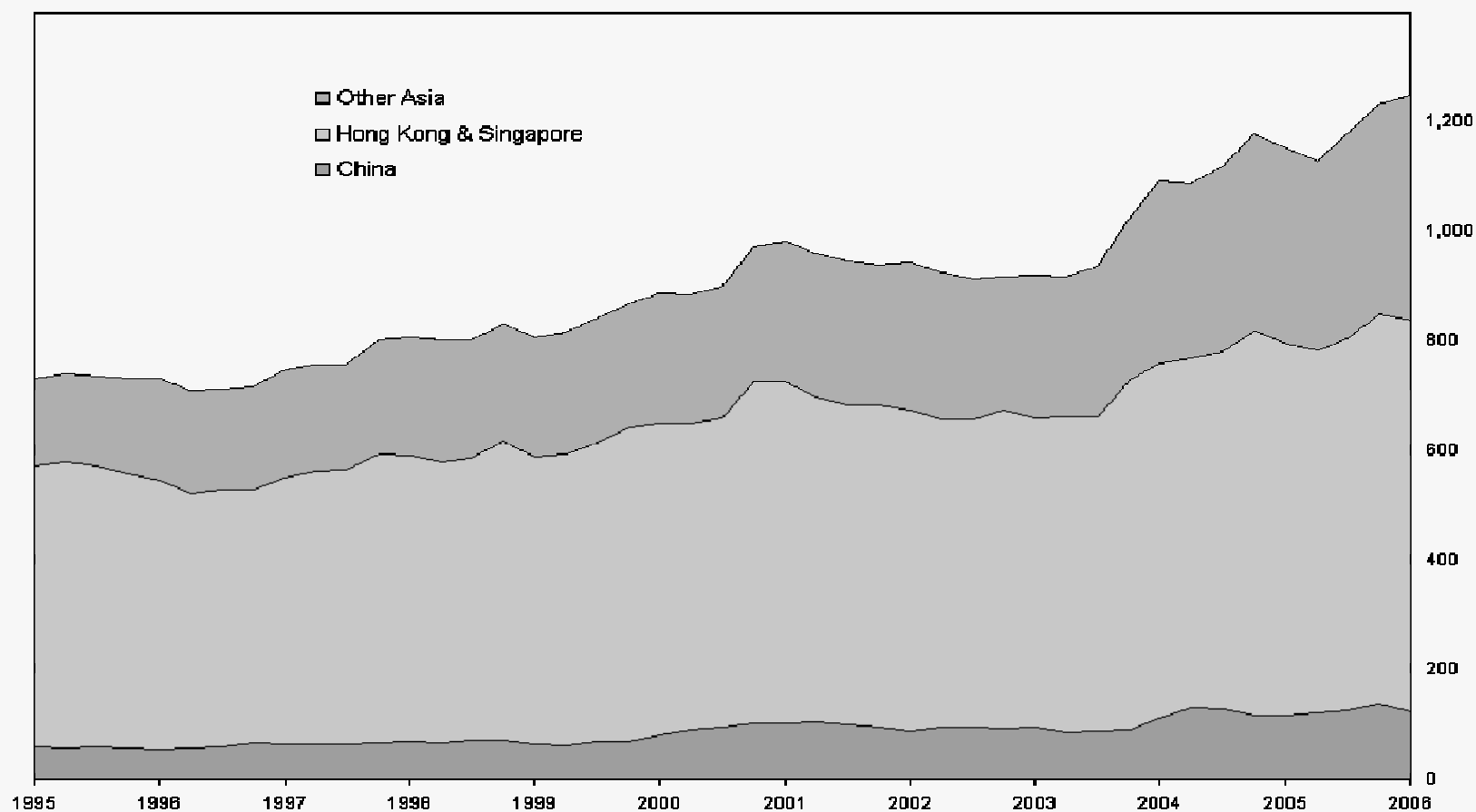


Aspects of both-way global financial integration

- The dominant view: Developing countries are net importer of capital.
- This paradigm has changed: Asia's lending to the rest of the world is rising.
- Total investment by Asian economies in the rest of the world has taken a quantum jump over the past six years.
- This is both because of the region's large current account surplus and growing portfolio diversification.



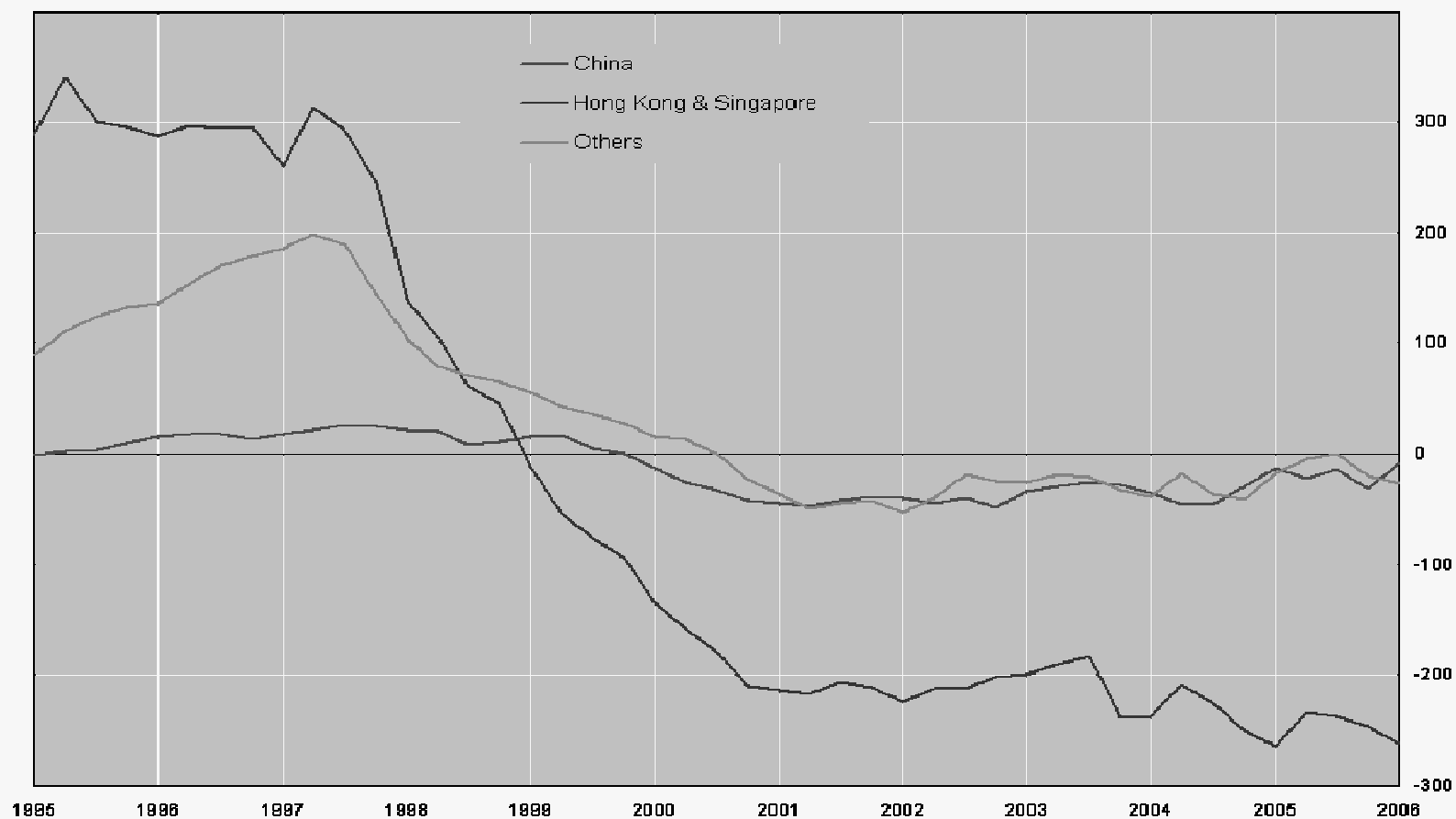
International liabilities of BIS reporting banks to Asia, in \$ bln



Source: BIS international locational banking statistics



Net claims of BIS reporting banks to Asia, in \$ billions

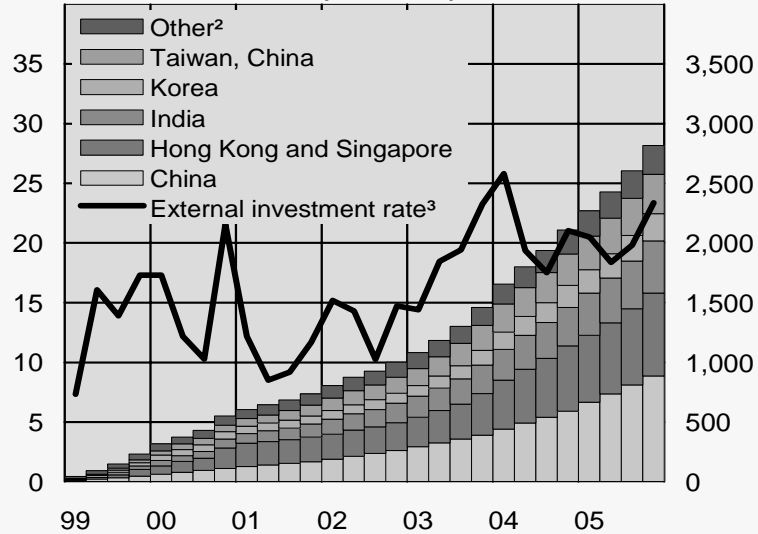


Source: BIS international locational banking statistics

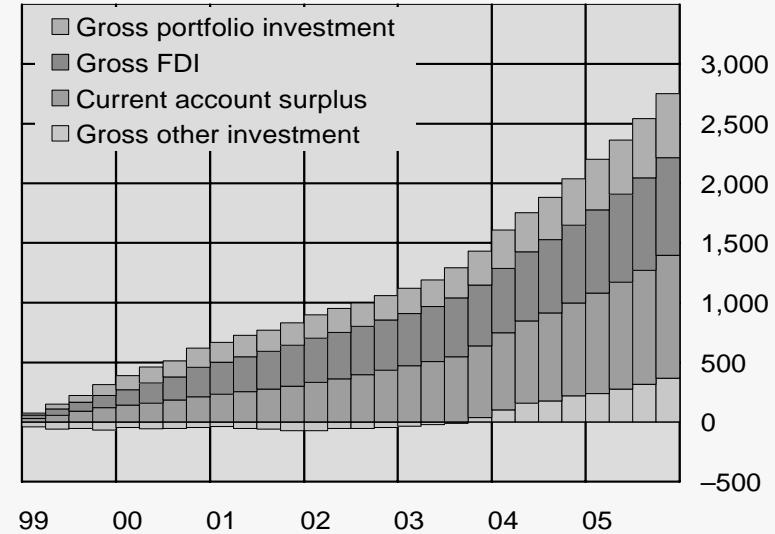


Asia's invested funds¹

Invested funds, by country



Sources of invested funds⁴



¹ Change in reserves plus gross portfolio investment, FDI and other investment, cumulated since end-1998; in billions of US dollars.

² Indonesia, Malaysia, the Philippines and Thailand. ³ Calculated as the ratio of invested funds to total gross external funds received, comprising total export and other foreign income plus gross financial inflows; aggregate for all Asian countries.

⁴ Breakdown of financial flows to Asia.

Source: McGuire and Tarashev (2006): "The international banking market", *BIS Quarterly Review*, June.



Exploring implications

- First, greater global integration of the Asian financial system is leading to cross-border risk diversification.
 1. Asia is attracting riskier capital and investing in less-risky and liquid assets as well as repaying debt (McCauley 2003).
 2. Increased local currency lending by international banks is reducing exchange rate risks for the economy as a whole.
 3. Greater foreign ownership of the banking system is leading to more efficient financial systems.



Exploring implications

- Second, banks are engaged in domestic risk diversification in major ways to strengthen their balance sheets.
 1. Increased household lending is reducing risk concentration for banks and growth uncertainty for the economy.
 2. Banks are shifting a major part of their risks (by shortening maturities, lending at floating rates, and securitising loan portfolios) to others.



Exploring implications

- Corporate sector disintermediation is both led and helped by attempts to develop regional domestic bond markets.
 1. A well-developed corporate bond market will not only improve firms access to cheaper funding but will increase diversification opportunities for investors and lead to more intra-regional capital inflows.
 2. Nevertheless, regional corporate bond markets are still relatively illiquid and requires greater efforts by authorities to improve the investor base (particularly opening up to foreign investors), market microstructure, transparency, information flows between issuers and investors, and regulatory and legal reforms.



Sustainability of the current trend

- The current cross border risk diversification is led by the government rather than the private sector.
 1. The public sector is accumulating large external risk exposures (might distort incentives for the private sector).
 2. The costs of intervention is rising (not only carrying costs and valuation losses but also risks to the financial system).
 3. Large issuance of short-term central bank sterilisation bills can adversely affect development of a domestic bond market.
 4. Portfolio diversification by the private sector (particularly households) remains very small – a problem associated with asymmetric capital account policies.



- Household credit expansion is a welcome trend and its sustainability might be helped by several factors:
 1. Low household debt and leverage ratios in several countries.
 2. High profitability and low defaults rates in residential lending sector.
 3. Regulations guaranteeing repayment of household credit (experience of India).
 4. Development of the mortgage-backed security market reduces risk concentration with banks.



- There are nevertheless several downside risks.
 1. Distorted incentive systems may lead to risks of over-borrowing.
 2. Bank lending may outpace development of financial infrastructure to manage household credit risks (the role of robust credit information systems).
 3. Concentration of risks in household sector where they are least likely to be managed.



Conclusion

- Increased internationalisation and household orientation of the Asian banking system is improving its efficiency and resilience.
- However, there are costs from international risk diversification primarily through government intervention.
- In the long run, institutional reforms and further capital account liberalisation would be necessary for promoting efficient allocation of capital.
- The sustainability of household finance (and domestic risk diversification opportunities) depends on the development of a robust risk assessment and regulation system as well as legal reforms.