

An Asian Perspective on Global Financial Reform

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Outline

- 1. Global Financial Crisis and Eurozone crisis**
- 2. Asian Financial Systems**
- 3. Asian Perspectives on Global Regulatory Reform**
- 4. Challenges for Emerging Asia**
- 5. Conclusions**

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1. Global Financial Crisis

Four claimed policy mistakes behind the global financial crisis (GFC)

- (1) Failure of macroeconomic policy, particularly monetary policy, to contain the buildup of financial vulnerabilities and systemic risk
- (2) Flaws in financial regulation and supervision:
 - Inadequacy of macroprudential approach
 - Shadow banking, outside of regulatory perimeter
 - “Too-big-to-fail” problems
 - Insufficient capital adequacy and liquidity standards
 - Inadequate transparency on derivative products
 - Procyclicality

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Were Asians responsible for the GFC?

- (3) Weak global financial architecture
 - IMF and FSF unable to forcefully identify risks and issue strong warnings
- (4) Global payments imbalance
 - The arguments by Greenspan (“conundrum”) and Bernanke (“savings glut”) suggest that East Asia supplied ample liquidity to the US and kept the US long-term interest rate too low
- However, we believe the importance of the fourth cause is less:
 - The current account deficit was concentrated in the US while there were many surplus countries
 - The financial crisis concentrated in the US & Europe
 - Not all countries had housing bubbles or crises (eg, Australia and Canada managed well)

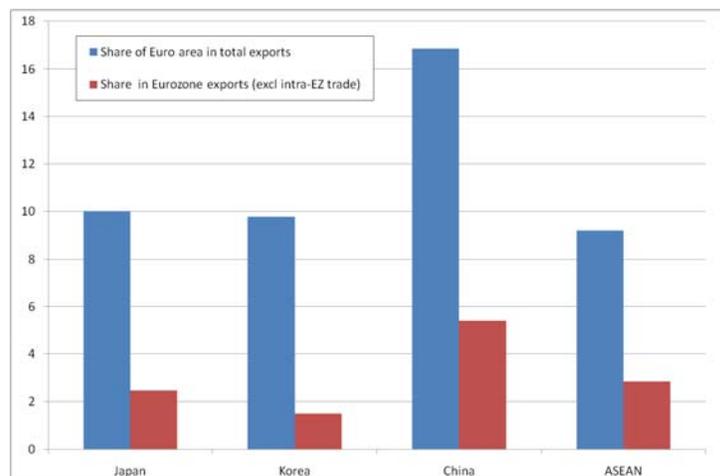
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Post-GFC crisis/turbulence in Europe

- Zero-interest rate policy and quantitative easing (QE) by the US Fed
- Sovereign debt problem (US) and sovereign debt & banking crisis (eurozone)
 - US government lost AAA-rating
 - Europe: Ongoing debt crises in Greece, Ireland, Italy, Portugal and Spain, affecting the European banking system
 - Growth likely to remain sluggish in coming years
 - QE3 on next in the US?
- Implications for Asia—trade and financial channels
 - Export weakness to US and Europe highlights importance of rebalancing growth toward domestic and regional demand
 - Continued low interest rates, the debt problem and sluggish growth in the US and the sovereign debt & banking crisis in Europe point to the need to maintain financial stability through defenses against large-scale and volatile capital flows

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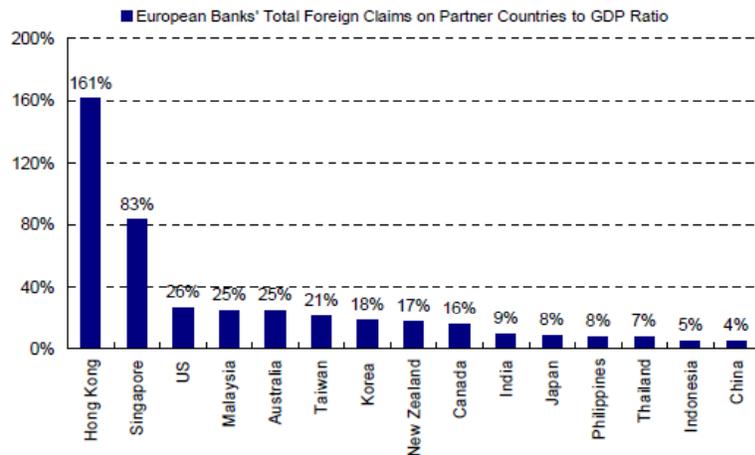
Asian Exposure to Europe Trade (2009)



Source: CEPII-CHELEM

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Asian exposure to European financial contagion (2011)



Source: BIS, 1H2011 data (Huang 2011)

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2. Asian Financial Systems

Asian strengths

- Asian financial systems were relatively unscathed from the GFC and the ongoing Eurozone crisis, reflecting sound balance sheets, prudent risk management, and modest exposure to toxic assets
- Asia already has sizable non-banking financial firms
- Large foreign exchange reserves provided a cushion against volatile capital flows in most cases
- Asian regulatory frameworks were more “conservative,” with less regulatory capture and less ideology about virtues of free financial markets
- Asian regulators already had some macroprudential policies (administrative guidance to limit bank-credit growth, real estate loan caps, etc)

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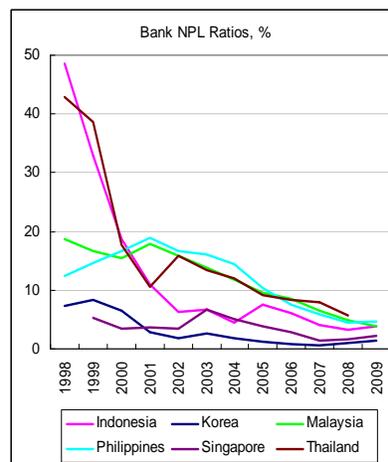
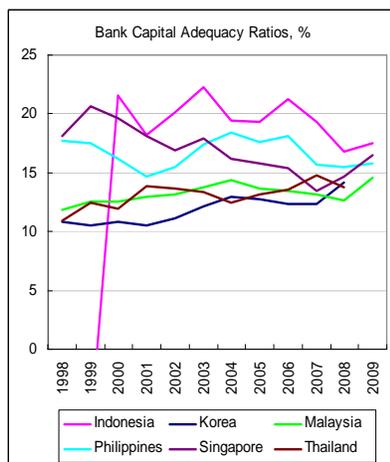
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Development of Asian corporate sector funding (1990, 2000, 2010)

% of GDP	Private credit by deposit money banks			Stock market capitalization			Private bond market capitalization			Total		
	1990	2000	2010	1990	2000	2010	1990	2000	2010	1990	2000	2010
PRC	74.3	106.4	120.0	--	48.5	81.0	2.9	7.0	21.3	77.3	161.9	222.4
Hong Kong	--	150.9	168.1	108.5	368.6	1207.9	0.2	17.2	14.4	108.7	536.7	1390.4
India	24.2	26.4	49.7	12.2	32.2	93.5	0.3	0.5	5.7	36.6	59.1	148.8
Indonesia	38.1	17.8	24.1	7.1	16.3	51.0	--	1.4	1.5	45.1	35.5	76.6
Japan	168.2	195.3	102.8	95.5	67.6	74.6	39.8	47.4	36.3	303.4	310.4	213.6
Korea	47.2	69.7	98.4	42.1	32.2	107.4	28.3	51.5	63.0	117.5	153.4	268.7
Malaysia	77.0	123.1	109.3	110.4	124.7	172.6	18.8	32.9	43.5	206.2	280.7	325.4
Philippines	17.0	38.2	29.4	13.4	32.0	78.8	--	0.2	1.1	30.4	70.5	109.3
Singapore	78.2	96.7	96.1	93.1	164.8	166.2	14.6	16.9	11.4	185.9	278.5	273.7
Taipei, China	--	116.5	124.5	60.5	80.4	175.0	14.7	24.4	21.8	75.2	221.3	321.4
Thailand	72.3	116.3	91.7	28.0	24.0	87.1	6.5	11.8	17.9	106.8	152.0	196.7
Viet Nam	--	30.4	109.7	--	--	19.7	--	--	--	--	30.4	129.3

Sources: IFS Dec 2011 CD, CEIC Data Company, BIS Quarterly Review June 2011, WDI.

Asian banking sector fundamentals remained strong through GFC



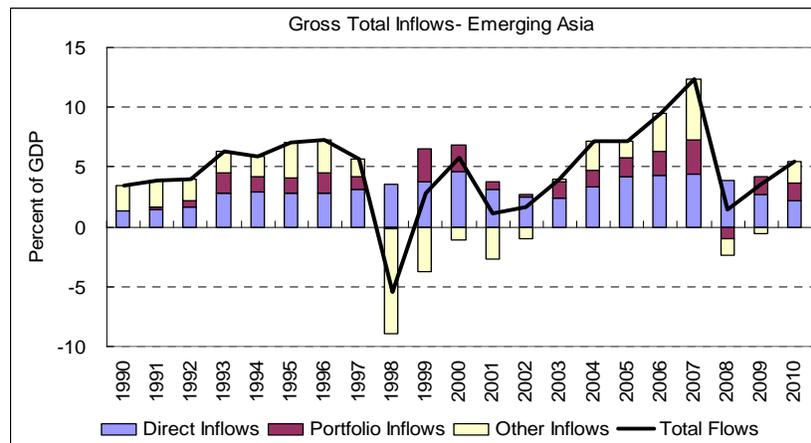
Source: IMF (2011)

Asian weaknesses

- Asian financial systems still relatively bank-dominant, with smaller bond markets and modest role for securitization, derivative products, etc.
- Low degrees of regional financial integration in portfolio investment, still depends on London/NY
- Limited regulatory capacity to address procyclicality, exposure to activities of large global financial firms, growing non-bank financial activities, and rising financial complexity over time
- Vulnerable to volatile capital flows and “double mismatches”

Capital inflows in emerging Asia

Emerging Asian economies have received large-scale capital inflows, which have been volatile over the last 20 years



Notes: Emerging Asia: PRC, Hong Kong, India, Indonesia, Korea, Malaysia, Philippines, Singapore, and Thailand
Source: CEIC accessed on 15 January 2012

3. Asian Perspectives on Global Regulatory Reform

- G20 agreements reached so far:
 - Requirements for greater quantity and quality of capital
 - Liquidity requirements
 - Leverage ratio
 - Standards for OTC derivatives markets (by 2012)
 - Identification, surveillance, regulation and resolution of systemically important financial institutions (SIFIs), especially global ones (G-SIFIs)
- G20 issues expected to be finalized soon
 - Strengthened oversight of shadow banking
 - Compensation and credit rating agencies
 - Development of macroprudential frameworks and tools
 - Convergence to strengthened international accounting standards
 - Strengthened adherence to international supervisory and regulatory standards

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Asia's challenge to balance financial regulation with development

- Asian financial systems were resilient to the GFC and EZC, but this partly reflected immature financial systems that need to develop further to accommodate sustainable economic growth, while promoting financial stability
- Much of the G20 debate on financial regulation mainly reflects the viewpoints and problems of the US and Europe, not necessarily so relevant for emerging economies
- Developing Asian economies are promoting financial inclusion to support farmers, SMEs, etc
- Asia's regulatory capacity can improve

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Implications for emerging Asian economies

- Need to avoid the “one size fits all” approach
 - Most Asian banks can meet more stringent capital, liquidity, and leverage requirements under Basel III
 - But regulations to address weaknesses in Western banks should not be applied to Asia, as complex derivatives products are less developed in the region and many Asian banks have large retail funding bases
 - Asian regulators need to review macroprudential policy best practices
- Need to strengthen regulatory capacity
 - Data requirements for Basel III implementation may impose considerable burden on some economies
- Need for global and regional cooperation on global and regional SIFIs

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Reform of the international monetary and financial system

- Improve IMF surveillance
 - Systemically important economies (US, EU, etc)
 - G20 Mutual Assessment Process (MAP): Agreement needed on standards for assessing currency misalignments and macroeconomic imbalances
- Strengthen global financial safety nets
 - Expansion of IMF resources
 - Improved coordination of IMF and RFAs (including Chiang Mai Initiative Multilateralization), both pre-crisis and post-crisis

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4. Challenges for Emerging Asia

Deepen and integrate financial markets

- Asia needs to integrate financial markets
 - Liberalize cross-border capital flows
 - Harmonize capital market regulations
 - Introduce mutual recognition to capital markets
- This would encourage recycling of Asian savings for Asian investment within the region, thereby helping to avoid "double mismatches" and facilitating growth rebalancing
- Previous initiatives of local-currency bond market development need to be strengthened:
 - Asian Bond Funds, Asian Bond Markets Initiative, Credit Guarantee and Investment Facility

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Manage capital flows to reduce systemic risk

- **Structural measures**
 - Develop and deepen financial market
 - Improve financial regulation
 - Liberalize imports and capital outflows
- **Macroeconomic measures**
 - Sterilized FX market intervention
 - Ease monetary policy
 - Tighten fiscal policy
 - Allow exchange rate flexibility/appreciation
- **Macroprudential measures**
 - Tighten macroprudential supervision and regulation over domestic markets
 - Develop countercyclical macroprudential tools
 - Control short-term capital inflows

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Improve regional approaches to financial stability

- Transform the Chiang Mai Initiative Multilateralization (CMIM), a regional financial safety net, into an Asian monetary fund (AMF):
 - Expand size
 - Introduce precautionary instruments
 - Delink IMF programs
 - ASEAN+3 Macroeconomic Research Office (AMRO) to become a full-fledged surveillance secretariat
- Coordinate regional exchange rate policies
- Create an Asian financial stability dialogue (AFSD) among central banks, regulators and finance ministry officials
- Work with IMF for large-scale crises

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Asian and global financial governance can be complementary

Function	Global	Asia
Development finance	World Bank <i>Global public goods: MDGs, climate change, health</i>	Asian Development Bank <i>Regional public goods: regional infrastructure</i>
Macro-economic cooperation	International Monetary Fund (IMF) <i>Surveillance, global stability, crisis lending</i>	Asian Monetary Fund (to evolve from CMIM/AMRO) <i>Regional surveillance, stability, crisis lending</i>
Financial system stability	Financial Stability Board (FSB) <i>Global systemic stability, colleges of regulators</i>	Asian Financial Stability Dialogue <i>Regional regulatory initiatives</i>

Source: Kawai, Petri and Sisli-Ciamarra (2010) 20 Kawai – Asian Perspective

5. Conclusions

- Reforms of Asian financial systems since the Asian financial crisis served them well during the GFC & EZFC
- The need for tighter financial regulation and supervision must be balanced with needs for financial development, deepening and integration as well as financial inclusion, to support sustainable growth in the region
- Regional financial integration can also contribute to growth rebalancing
- Volatile capital flows remain a major risk factor for emerging Asia, and a set of policy measures (structural, macroeconomic, and macroprudential) may be needed to secure financial stability
- Development of regional institutions can contribute to:
 - Regional financial stability: CMIM, AMRO, and an Asian financial stability dialogue (AFSD), in cooperation with the IMF and FSB
 - Local-currency bond market development: Asian Bond Markets Initiative, Asian Bond Funds, Credit Guarantee and Investment Facility

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