

Financial sector reforms in Asia: taking greater global responsibility

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Outline

1. Crisis and Impact on Asia
2. Asia's Financial Systems
3. Financial Sector Reform
4. Global and Regional Cooperation

1. Crisis and Impact on Asia

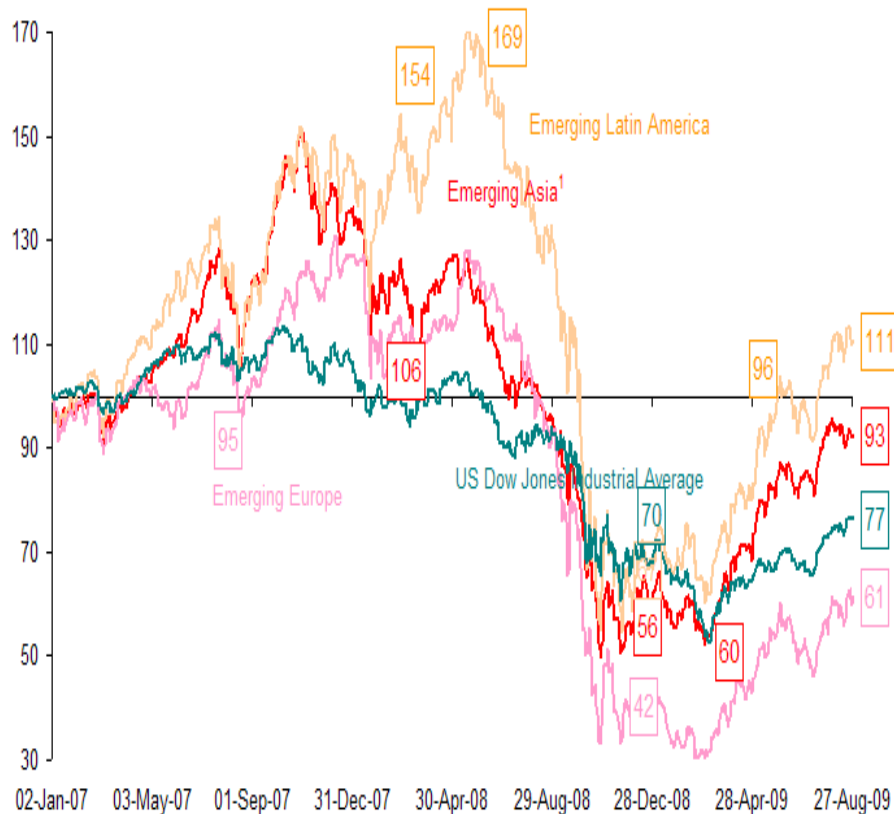
- The crisis revealed weaknesses in modern financial systems
 - Globalized finance without global regulator
 - Complexity and opacity of financial innovation
 - Excessive leverage and risk taking
 - Misaligned incentives
 - Regulatory gaps

Asian financial markets hit hard by the crisis

- Visible impact through equity and offshore bond markets
- Reversal in capital flows, esp. short-term
- Increased volatility in currencies
- Yet, resilient banking sector

Asian financial markets hit hard

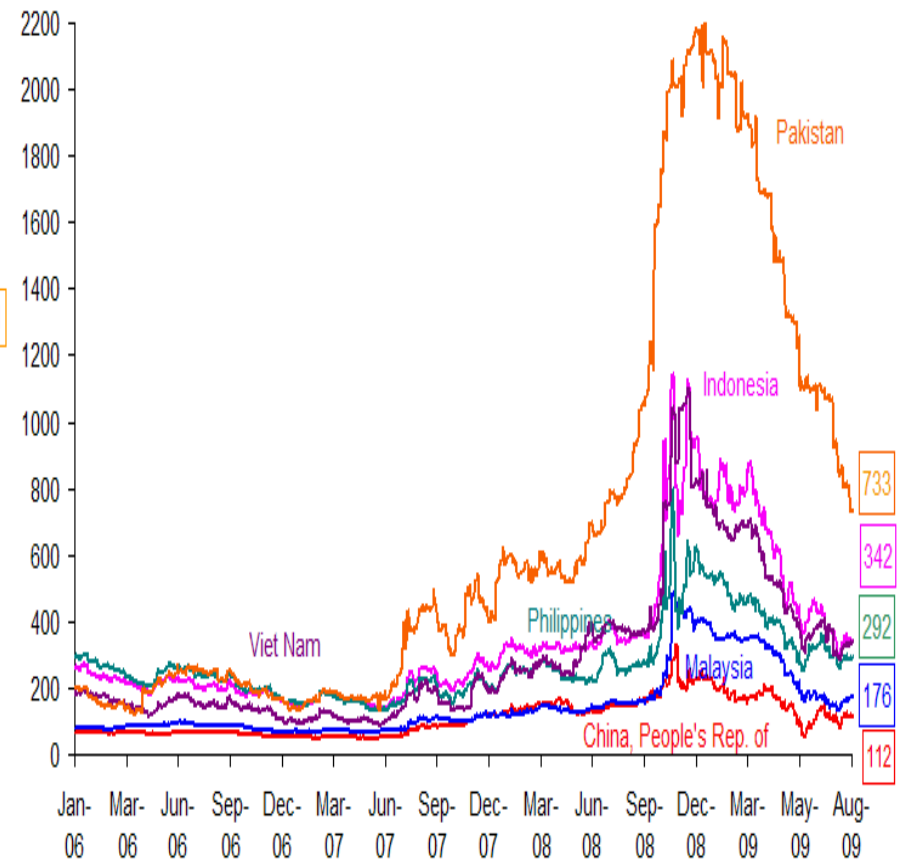
MSCI Indexes (2 Jan 2007=100)



¹Includes China, People's Rep. of; India; Indonesia; the Republic of Korea; Malaysia; Pakistan; Philippines; Taipei, China and Thailand.

Sources: Morgan Stanley Capital International (MSCI) Barra and Bloomberg.

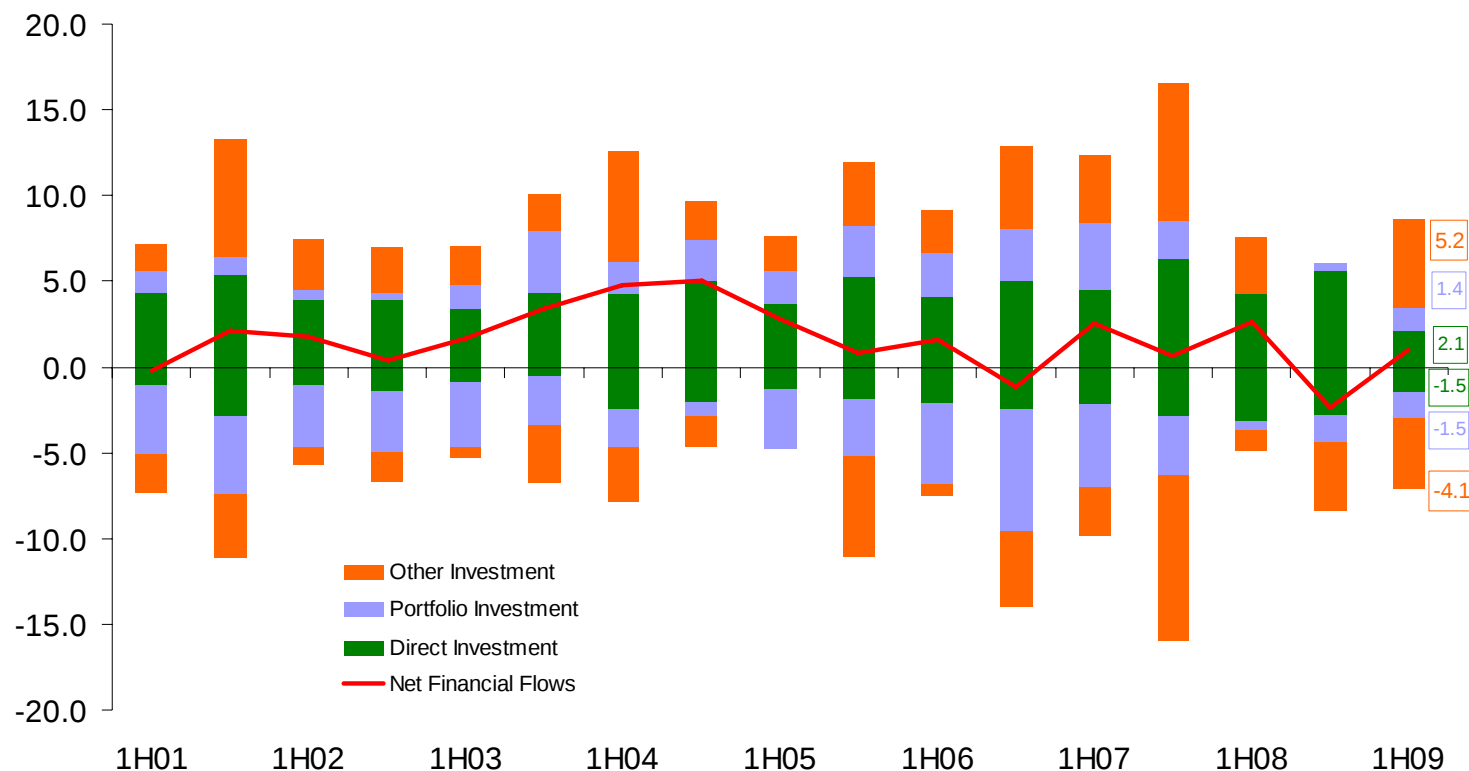
JP Morgan EMBI Sovereign Stripped Spreads (basis points)



Source: Bloomberg.

Risk aversion triggers reversal in capital flows

Financial Account (% of GDP)



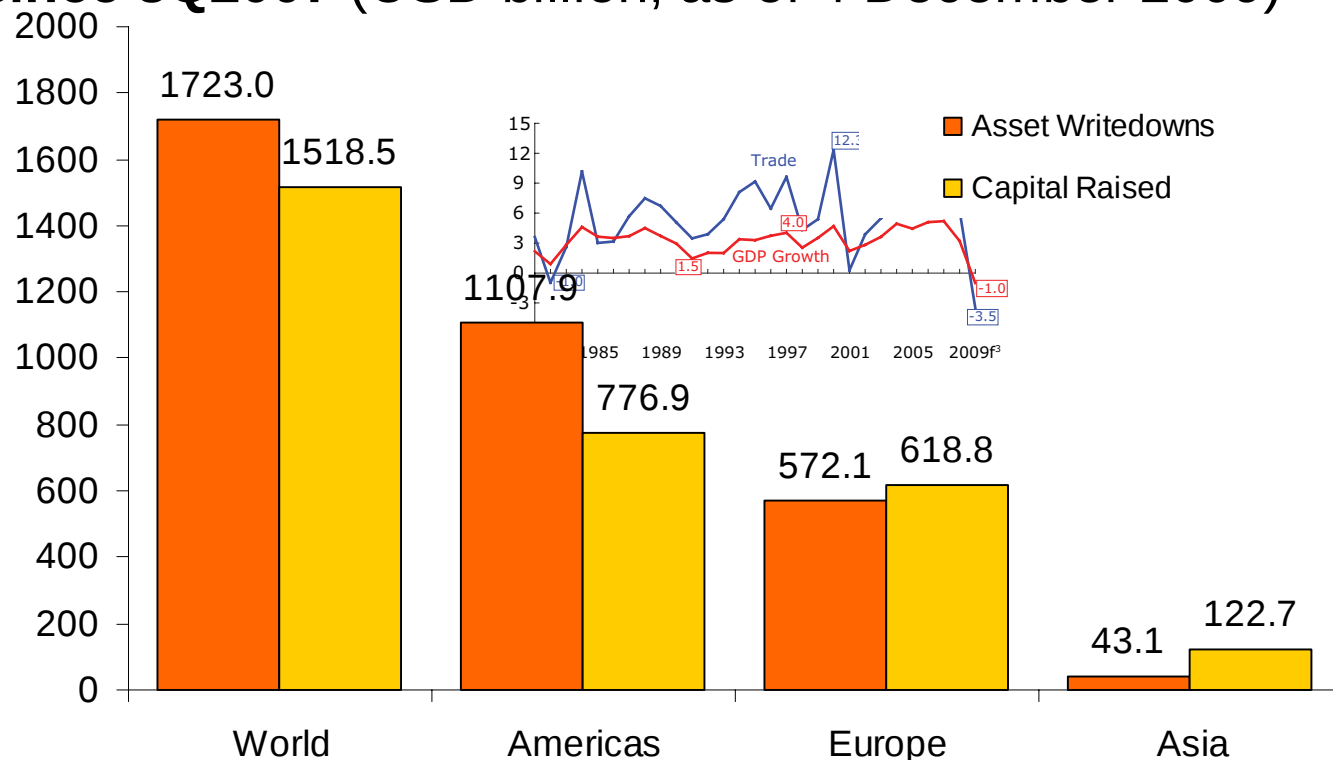
Notes: Figures include People's Rep. of China (PRC); Hong Kong, China; Indonesia; Rep. of Korea; Malaysia; Philippines; Taipei, China; Thailand; and Singapore. Other Investment includes financial derivatives.
Sources: OREI staff calculations based on data sourced from the *International Financial Statistics*, International Monetary Fund and national sources.

2. Asia's Financial Systems

- Asia's financial systems less affected by the crisis given their limited exposure
- Vulnerabilities remain:
 - Unfinished agenda in the post-1997/98 crisis reform
 - New challenges from changing global financial landscape

Asian financial systems less affected

Writedowns and Capital Raised by Major Banks since 3Q2007 (USD billion, as of 4 December 2009)



Source: Bloomberg.

Banking Sector Soundness Indicators (%)

	Nonperforming Loans to Total Loans ¹		Bank Regulatory Capital to Risk-Weighted Assets ²		Bank Provisions to Nonperforming Loans ³		Private Sector Loans to Deposit ⁴	
	2000	2008	2000	2008	2000	2008	2000	2008
China, People's Rep. of	22.4	2.5	13.5	8.2	4.7	115.3	95.2	69.6
Hong Kong, China	5.9	1.2	17.8	14.7	—	—	66.7	47.3
India	12.8	2.3	11.1	13.0	—	52.6	63.0	75.3
Indonesia	20.1	3.2	12.5	16.8	36.1	98.5	39.2	80.1
Korea, Republic of	6.6	1.2	10.5	12.7	81.8	155.4	111.5	134.1
Malaysia	9.7	2.2	12.5	12.2	57.2	88.9	108.8	92.8
Philippines	15.1	3.5	16.2	15.7	43.7	86.0	82.0	78.3
Singapore	3.4	1.4	19.6	14.3	87.2	119.9	99.7	85.3
Taipei, China	5.3	1.5	10.8	10.8	24.1	76.6	77.5	73.1
Thailand	17.7	5.3	11.9	14.1	47.2	97.9	102.3	97.7
Average⁵	11.9	2.4	13.6	13.3	47.7	99.0	84.6	83.4
Median	11.3	2.3	12.5	13.6	45.5	97.9	88.6	79.2
eurozone ¹	—	1.5	—	7.9	—	—	135.0	138.5
Japan	5.3	1.5	11.7	12.3	35.5	24.9	58.5	73.9
United States	1.1	2.3	12.4	12.5	146.4	84.7	110.6	109.2

Source: *Global Financial Stability Report*, and *International Financial Statistics*, International Monetary Fund; and national sources.

Corporate Sector Soundness Indicators¹

	Return on Assets (%)		Sales Growth (% , y-o-y)		Interest Expense/Assets (%)		Interest Coverage Ratio		Debt-Equity Ratio	
	2000	2008	2000	2008	2000	2008	2000	2008	2000	2008
China, People's Rep. of	4.5	4.6	621.5	38.5	2.7	1.3	5.1	9.3	0.6	0.3
Hong Kong, China	11.6	7.4	9.7	24.5	1.7	1.2	9.0	11.5	0.2	0.1
India	5.7	8.5	33.0	25.7	2.9	1.8	5.2	9.0	0.5	0.5
Indonesia	6.5	6.5	0.0	35.5	5.2	1.9	3.4	9.9	1.1	0.5
Korea, Rep. of	3.0	2.0	1.3	26.9	3.9	1.3	3.4	7.6	0.8	0.6
Malaysia	4.1	4.6	10.3	22.5	2.3	1.7	4.5	6.7	0.5	0.4
Philippines	3.3	4.4	0.5	16.8	3.1	2.5	3.4	5.2	0.8	0.5
Singapore	4.4	6.7	5.8	25.3	1.1	1.0	8.1	12.7	0.0	0.2
Taipei, China	7.5	3.1	19.7	6.0	1.3	0.9	11.2	13.9	0.3	0.2
Thailand	0.8	4.7	3.0	36.2	4.8	1.6	2.3	9.3	1.9	0.6
Average²	5.2	5.2	70.5	25.8	2.9	1.5	5.5	9.5	0.7	0.4
Median	4.4	4.6	7.8	25.5	2.8	1.5	4.8	9.3	0.6	0.4
eurozone	3.9	3.8	-1.4	-0.8	1.5	1.6	8.2	7.0	0.5	0.7
Japan	0.8	2.0	1.1	1.3	1.2	0.6	6.4	18.3	0.9	0.6
United States	5.7	4.6	7.0	10.6	2.2	1.8	6.7	7.2	0.7	0.6

¹Data for all listed non-financial companies.

Source: OREI staff calculations using data from Datastream.

Household Sector Soundness Indicators

	Household Indebtedness (% of GDP) ¹		Household Mortgage Loans (% of GDP) ¹		Housing Prices Change (in %, y-o-y) ²		LTV Limit (in %) ³	DTI Limit (in %) ³	Mortgage Delinquency Ratio ⁴
	2001	2008	2001	2008	Average 2001–2007	2008	Current	Current	Latest
China, People's Rep. of	—	—	5.1	11.6	6.3	7.1	80	55	—
Hong Kong, China	61.3	52.3	49.8	38.8	3.2	17.3	60–90	45–50	0.1
India	3.1	10.5	1.2	5.5	—	—	75	—	—
Indonesia	5.6	11.6	1.2	2.5	6.9	5.5	—	—	2.3
Korea, Rep. of	24.7	37.9	13.3	23.4	6.7	4.0	40–60	40	0.7
Malaysia	43.8	48.5	24.4	26.0	3.1	4.0	—	—	5.6
Philippines	2.2	6.4	1.4	2.1	—	—	—	—	7.5
Singapore	—	50.8	28.0	34.8	2.1	13.4	90	none	0.5
Taipei, China	43.3	54.0	26.6	38.4	—	—	—	—	—
Thailand	10.8	17.9	7.1	9.6	3.1	-1.1	70–90	none	—
Average⁵	24.3	32.2	15.8	19.3	4.5	7.2	81.7	47.5	2.8
Median	17.7	37.9	10.2	17.5	3.2	5.5	80.0	47.5	1.5
eurozone	44.4	52.7	28.6	37.6	6.4	1.7	—	—	—
Japan	19.7	22.4	15.0	19.5	-4.2	-1.2	90	25–40	—
United States	95.6	120.8	76.4	102.6	6.7	-5.7	70–95	45	7.9

— = not available. DTI = mortgage debt to income ratio, GDP = gross domestic product, LTV = mortgage loans to value ratio, y-o-y = year-on-year.

Source: National sources accessed through CEIC and various websites; Federal Reserve System; European Central Bank; and *World Economic Outlook Database* (April 2009), International Monetary Fund.

Relatively resilient Asian banks continue to fund

Growth of Bank Credit to Private Sector (y-o-y, %)

	2004	2005	2006	2007	2008
Cambodia	44.1	20.4	54.9	77.8	54.5
China, People's Rep. of	7.6	10.1	14.3	18.7	13.3
Hong Kong, China	3.7	6.0	1.8	9.7	6.2
India	30.6	26.2	27.5	20.4	22.3
Indonesia	34.7	25.2	12.2	25.1	31.4
Korea, Rep. of	1.3	7.4	14.5	12.5	14.9
Malaysia	4.9	8.1	5.1	8.6	12.9
Singapore	4.4	2.0	4.9	16.9	15.2
Sri Lanka	21.5	26.0	23.7	19.2	7.3
Thailand	7.0	6.1	3.6	5.0	7.9

Asian financial systems dominated by banks

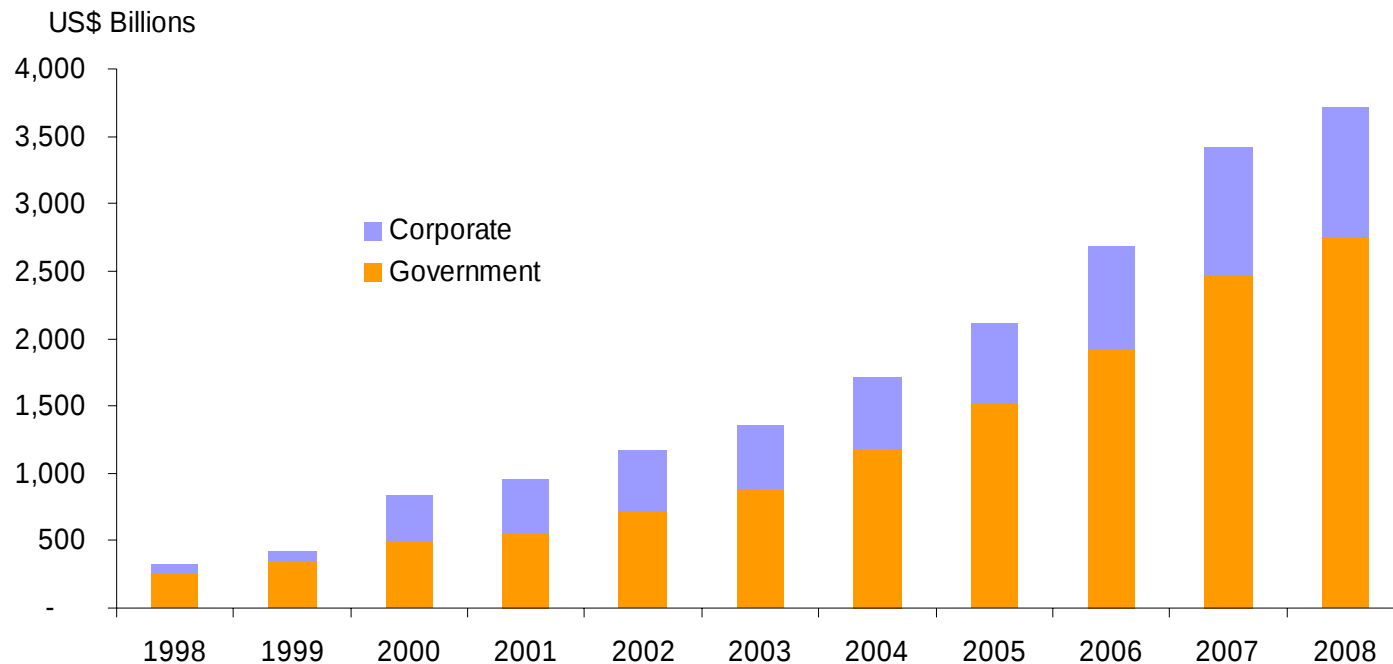
Size and Composition of Financial System (% of GDP)

	Financial Sector Assets ¹				Market Capitalization ²		Total Bonds Outstanding	
	Deposit-taking Financial Institutions		Non-bank Financial Institutions					
	2000	2008	2000	2008	2000	2008	2000	2008
China, People's Rep. of	168.8	204.5	8.8	33.9	27.1	32.3	16.9	50.3
Hong Kong, China	505.5	640.7	196.4	573.8	363.9	610.9	35.8	42.9
India ³	61.6	91.6	15.4	32.8	33.3	59.7	24.6	35.3
Indonesia	63.6	48.6	8.8	13.7	18.7	21.7	31.9	13.4
Korea, Rep. of	147.9	192.7	44.1	62.6	31.2	56.3	66.5	86.2
Malaysia	154.2	190.3	16.5	20.2	124.7	89.6	74.8	73.5
Philippines	99.2	78.8	22.4	18.5	76.8	54.3	27.6	33.7
Singapore	683.8	707.9	39.1	47.1	243.7	148.0	48.0	70.8
Taipei, China	259.9	289.6	29.8	80.6	81.7	94.7	7.7	7.7
Thailand	132.3	137.7	10.7	33.0	26.0	39.2	25.3	51.6
Average ⁴	227.7	258.2	39.2	91.6	102.7	120.7	35.9	46.5
Median	151.1	191.5	19.5	33.4	55.1	58.0	29.8	46.6
eurozone	230.0	315.8	142.1	169.3	—	—	124.2	69.4
Japan	227.5	230.9	118.5	132.1	71.7	55.8	97.4	193.4
United States	78.3	104.8	283.2	306.1	117.5	64.6	41.8	55.3

Source: OREI staff calculations using data from national sources (accessed through CEIC and websites); AsianBondsOnline; Bloomberg; World Economic Outlook Database (April 2009), and World Federation of Exchanges.

Local currency bond market development needs to continue

Total Government and Corporate Bonds Outstanding



Source: AsianBondsOnline and Bank for International Settlements.

Financial innovation still lags in Asia

Outstanding Securitization Market in Selected Economies, 1985–2006 (\$ trillion)



Financial contagion through strong foreign participation

Total Portfolio Investment Liabilities (\$ million)

Economy	Total Portfolio Investment Liabilities in million US\$			Domestic Market Capitalization in million US\$			Ratio of Foreign Portfolio Investment to Domestic Market Capitalization (%)		
	2003	2005	2007	2003	2005	2007	2003	2005	2007
China, People's Rep. of	54,163	114,888	413,153	512,979	401,852	4,478,867	10.6	28.6	9.2
Hong Kong, China	108,082	148,007	348,183	714,597	1,054,999	2,654,416	15.1	14.0	13.1
India	48,699	116,476	332,765	531,556	1,069,046	3,479,197	9.2	10.9	9.6
Indonesia	18,712	30,377	57,630	54,659	81,428	211,693	34.2	37.3	27.2
Korea, Rep. of	125,214	247,008	366,346	298,248	718,011	1,122,606	42.0	34.4	32.6
Malaysia	35,186	49,650	100,922	160,970	180,518	325,290	21.9	27.5	31.0
Philippines	16,741	22,878	40,468	23,190	39,818	103,007	72.2	57.5	39.3
Singapore	55,186	86,460	171,430	148,503	257,341	539,177	37.2	33.6	31.8
Sri Lanka	292	487	1,331	2,711	5,720	7,553	10.8	8.5	17.6
Thailand	26,989	33,130	51,515	119,017	123,885	197,129	22.7	26.7	26.1

3. Financial Sector Reform

- Agenda for regulatory reform
 - Broaden regulatory parameters
 - Strengthen prudential requirements
 - Establish macro-financial stabilization framework
 - Enhance corporate governance
 - Promote better cross-border cooperation
- Challenges for Asian financial systems

Lessons Learned from the Global Financial Crisis

- Weak domestic and regional capital markets are unable to place high domestic and regional savings in domestic long-term investments.
- A lack of sufficient and prompt liquidity support in the early stage of the crisis exacerbate the liquidity situation.
- Globalization and fast financial integration could limit the scope of policymakers in pursuing macroeconomic policies without regard to complementary regional responses.

Depth and liquidity of domestic capital markets must improve

- Strengthen legal and regulatory frameworks
- Remove impediments to market entry and investment
- Broaden investor base and increase investor awareness
- Enhance regulatory capacity and
- Improve related market infrastructure—clearing and settlement, credit ratings, and data collection

4. Global and Regional Cooperation

- Global crisis requires global solution
- G20 pledges
 - Reform global financial architecture
 - Keep stimulus in place for now
 - Bring down trade imbalances
- Asia's role
 - Link regulatory reform to the renewed global financial architecture
 - Avoid mistimed exit strategies
 - Rebalance growth toward greater domestic and regional demand

Goals of Regional Monetary and Financial Cooperation

- Stable monetary and financial conditions
- Efficient, well-functioning financial markets
- Prevention of currency and financial crisis
- Enhancing regional capacity for the crisis management

Key Elements to Promote Regional Monetary and Financial Integration

- Policy Dialogue and Surveillance
- Effective mechanisms for cross-border financial support in a crisis
- Strong, resilient, and open financial markets and institutions
- Cooperative exchange rate and monetary policy regimes

Building institutions for effective monitoring and surveillance

- Strengthening the surveillance mechanisms is important in the regional financial architecture.
 - Establish independent monitoring and surveillance unit for the region
 - Enhance economic policy coordination
 - Provide consultation agreed upon by the members

Building effective cross-border liquidity support mechanism

ASEAN+3 Chiang Mai Initiative Multilateralization (CMIM)

- Goal

- Provide short-term liquidity when needed, supplementing existing international financial arrangements

- Recent progress

- Expanded reserve pool
- Agreement on key implementation arrangements

Develop Regional Bond Markets

ASEAN+3 Asian Bond Markets Initiative (ABMI)

- Develop local currency bond market and build legal infrastructure
 - Provide tools for long-term financing in place of a reliance on short-term borrowing
 - Reducing the problem of a maturity mismatch
 - Diversifying the currency risk
 - Help develop national bond markets and foster regional financial intermediation

Establish Regional Forum to Safeguard Financial Stability

Asian Financial Stability Dialogue

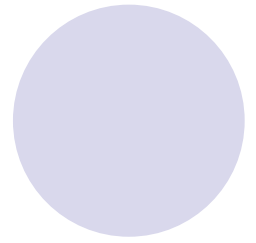
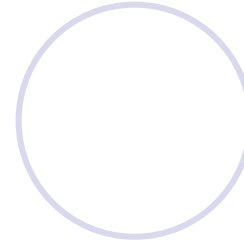
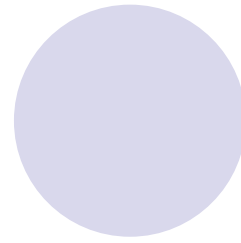
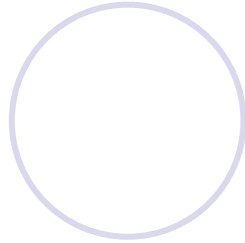
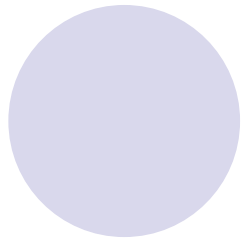
- Financial Stability Board at the regional level
 - Discuss Asia's common interests
 - Present "Asia's view" at global table
 - Identify development challenges and incorporate them in the global financial sector reform
 - Promote FX policy coordination

Cooperate to safeguard financial stability

- Coordinate exit strategies
- Expedite existing regional initiatives—ASEAN+3 CMIM and ABMI
- Establish Asian Financial Stability Dialogue

Conclusion

- A new financial architecture in East Asia requires a region-wide political commitment;
- The ultimate goal is to further economic development and prosperity through facilitating trade and financial liberalization;
- Regional cooperation has the potential to be a very importance tool to deliver development, growth, and stability in the region.



Thank you

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