GLOBAL FINANCIAL CRISIS AND REGIONAL INTEGRATION

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Growing intraregional trade and political presence
• The bigger, the stronger.

Economic activities / problems are globalized while economic policy making is still nationalized.
• Growing intraregional trade and investment
• Asian currency crisis 1997-8 and GFC 2007-8 caused domino effects in the region, requiring collective actions.
• Optimal currency area (Mundell, 1961)

Sense of community
• Ethnic communities cut across national borders.
• Cultural similarity and geographic proximity
<table>
<thead>
<tr>
<th></th>
<th>United States</th>
<th>Japan</th>
<th>Developing Asia</th>
<th>European Union</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exports</strong></td>
<td>393,872</td>
<td>218,610</td>
<td>375,458</td>
<td>436,750</td>
</tr>
<tr>
<td><strong>Imports</strong></td>
<td>150,579</td>
<td>247,427</td>
<td>422,482</td>
<td>249,695</td>
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<tr>
<td><strong>Total</strong></td>
<td>544,451</td>
<td>466,037</td>
<td>797,940</td>
<td>686,445</td>
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</tbody>
</table>

*Source: Direction of Trade Statistics, IMF*
Deepening economic linkages

Asia’s increasing Intraregional Trade Shares (%)

Note: East Asia consists of Southeast Asia (ASEAN) and Northeast Asia (PRC: Hong Kong, China; Japan; Republic of Korea; Mongolia; and Taipei, China). Figures refer to total trade (exports plus imports).

Source: ADB (2010), *Institutions for regional integration*
Asian economies differ.

- Large and small economies (by population)
- Low, middle and high income economies
- Agricultural / primary products, manufacturing, services industry
- Resource endowment
  - Oil and other minerals
- Net / high saving economies and net borrowing ones.
  - Net / high savers: Singapore, Malaysia, Brunei
  - Net borrowers: Vietnam, Cambodia

➤ Exploit the **comparative advantages** within by integration.
Asia needs to mobilize domestic/regional demand

- EU and US can no longer be the consumer of last resort.

- Asia has a large demand base within.
  - ASEAN alone has nearly 600 million pop’n, plus China, India, Bangladesh, Pakistan, Japan, Korea, etc.

- Need to encourage consumption by reducing precautionary savings while mobilizing long-term savings to finance infrastructure investments.
  - Enhance the social security and pension system, particularly in ageing economies, e.g., Singapore, Korea, China, Thailand.

- Provide financial access to the traditionally underserved to generate employment and mobilize new demand.
  - SME finance, micro / consumer finance; PPP for infrastructure finance
Note: The survey was conducted in August–September 2007 and collected responses from 600 Asian opinion leaders in business, media, government, and academia. The study covered 12 countries, with roughly equal representation from East Asia, Southeast Asia, and South Asia.

Source: ADB (2008) *Emerging Asian regionalism*
Regional forums

- ASEAN, ASEAN+3, APEC, SAARC, CAREC, etc

Source: ADB (2010), *Institutions for regional integration*
Yet, Asia differs from Europe

- No comparable institutional capacity
  - Council of European Union,
  - European Parliament,
  - European Commission,
  - European Central Bank
  - Euro

- Widely different development levels and economic size.
- Developing Asia depends on Europe and the US instead of competes with them.
Note: Asia means the 14 countries for which data are available: Bangladesh; People’s Republic of China; Hong Kong, China; India; Indonesia; Japan; Republic of Korea; Malaysia; Pakistan; the Philippines; Singapore; Taipei, China; Thailand; and Viet Nam.

Source: ADB (2010), *Institutions for regional integration*
Chronic excess liquidity, subprime loans, and flaws in securitization resulted in a burst of property bubbles in the US. Toxic assets created repercussions in Europe.

Lehman’s failure caused a further contraction of liquidity. Interbank money market shrank drastically, which called for interventions by ECB and Fed.

Did the collective high savings and reserve accumulation by Asia contribute to the global imbalance?
- Each country acted rationally in self-defense.
- The use of national currency of a single country (i.e., US dollar) is a more fundamental issue.
Asia prior to GFC

- Abundant international reserves at the national level
  - With modest investment and high savings

- Increasingly sound and stable financial sector
  - Strengthened prudential regulation,
  - Reduced NPLs.

- Healthy fiscal finance and public debt.
  - Strengthened public debt management, e.g., Thailand, Indonesia, etc.
  - High growth, high tax revenue
  - Need to invest more in infrastructure?

- In immediately prior to GFC, some Asian economies were overheated and trying to cool down.
  - China, Indonesia, India, Vietnam, etc.
  - Asset bubbles (stock, real estate), inflation
Risk of overheating?: can we cope the issue regionally?

Bank Lending Growth – ASEAN 4

Bank Lending Growth – NIEs

Bank Lending Growth – PRC

Real Estate Loans (% of total loans)

Source: Asian Economic Monitor December 2010
External demand for Asian products shrank.
   • Asian exports (as well as imports) declined, and the growth slowed.
   • Asian currencies came under pressure.

Debate over whether Asia could decouple and support the global economic growth.
Export Growth¹
(y-o-y, % change of the USD value)

1 Values computed as the year-on-year change of the three-month moving average of the USD value of exports. ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand and Viet Nam. NIEs-4 includes Hong Kong, China; Rep. of Korea; Singapore; and Taipei, China.

Source: OREI staff calculations using national data accessed through CEIC database.
Exchange Rate Indexes—NIEs and PRC
(local currency vis-à-vis USD, 2 January 2008 = 100)

Exchange Rate Indexes—ASEAN-4
(local currency vis-à-vis USD, 2 January 2008 = 100)

Source: OREI staff calculations based on Reuters data.
Asian economies showed resilience.
  - Prior to GFC, some Asian economies were trying to contain overheating by canceling/postponing public investments, while tightening macro and micro prudential measures as well as monetary policy.
  - They had large room to respond quickly when the crisis hit.
  - Their support for SMEs and export sector with tax break and credit guarantee was also effective to sustain the employment.

Asia’s corporate bond market responded as bank credits shrank globally, playing the role of “spare tire.”
  - Fruits of the country effort and Asian Bond Market Initiative (ABMI) of ASEAN+3.
ECB and Fed adopted expansionary M-policy (e.g., QE 1 & 2).
  - QE2 caused capital flows into emerging economies. Once depreciated Asian currencies started appreciating (since early 2009)

Indonesia and Malaysia are receiving strong portfolio inflows.
  - 30% of Indonesia’s govt bonds are now held by foreigners while stock market is booming by foreign investment.

Capital flows are necessary for regional integration.
  - The region includes net savers and net borrowers and wishes to recycle the excess savings for investment in the region.

Long-term inflows are welcome while short-term speculative ones are not.
  - Need to be able to closely monitor and distinguish them.
Current surveillance topic: How can we cope with capital inflows?

Net Foreign Portfolio Investment in Equities—Republic of Korea and ASEAN-4

Foreign Holdings of Local Currency Government Bonds (% of total)

Source: Asian Economic Monitor December 2010
Existing regional financial cooperation initiatives

- Chiang Mai Initiative Multilateralization (CMIM), ASEAN+3
  - Provide liquidity when a member is in urgent need.

- Asian Bond Market Initiatives (ABMI), ASEAN+3
  - Credit Guarantee & Investment Facility (CGIF)
  - Regional settlement of cross border bond trades
  - Regional credit ratings
  - Regulatory harmonization
  - Cross border / currency issuance of infrastructure bonds.

- ASEAN Economic Community 2015
  - ASEAN Central Bank Forum
  - ASEAN Capital Market Forum

- Other regional bond market initiatives
  - Asian Bond Funds by EMEAP
  - Asian Currency Note Program (ADB)
Chieng Mai Initiative (CMIM) – ASEAN +3 financial cooperation

- After the 97-98 crisis, Asian countries accumulated large international reserves as the first line of defense against external shocks on the FX liquidity.
- In May 2009, ASEAN+3 agreed to multilateralize CMI into CMIM by pooling $120 billion as the second line of defense.
- ASEAN+3 Macroeconomic Research Office (AMRO) was established in March 2011 to operationalize CMIM.
- CMIM is hoped to reduce the need of precautionary savings in the form of national reserves and contribute to reducing the global imbalance while supporting the region’s financial stability.
Since 2003
Double mismatch as a background.
To promote the region’s bond markets and their integration.
Market has grown in size, but the integration is slow
- Now, 8% share in the world bond market from 2% at end 1996. China’s market alone is larger than Germany’s and nearly as big as France’s, while Korea’s is becoming comparable to UK’s.
- Multi-currency environment
Task Force 1: Promoting Issuance of LCY Bonds
- CGIF,
- Securitization,
- Medium Term Note Program

Task Force 2: Facilitating Demand for LCY Bonds
- Asian Bond Market Summit,
- LCY Bond Market Liquidity Survey,
- TA on Broadening Investor Base,
- Directory of Institutional Investors

Task Force 3: Improving Regulatory Framework
- Strengthening the regulatory and supervisory framework
- Facilitating collaboration among bond dealers’ associations

Task Force 4: Improving Bond Market Infrastructure
- Regional securities settlement
- Increasing liquidity of bond market
- Fostering credit culture
- Developing financial service profession
ADB serves as Secretariat for ABMI

**ASEAN+3 Finance Ministers** - Meet annually

**ASEAN+3 Deputy Finance Ministers** - Meet semi-annually

**ABMI Steering Group**

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**Task Forces**

**TF1** - Promoting Issuance of Local Currency Denominated Bonds
- Credit guarantee and investment facility
- Promotion of Asian Currency Note Programme
- Promoting issuance of structured finance instruments

**TF2** - Facilitating the Demand of Local Currency-Denominated Bonds
- Development of investment environment for institutional investors
- Development of repo markets
- Enhancing cross-border transactions
- Information dissemination

**TF3** - Improving Regulatory Framework
- Strengthening regulatory and supervisory framework for securities
- Facilitating collaboration among SROs in the region
- Improving bankruptcy procedures related to bond transaction
- Promoting application of international accounting and auditing standards

**TF4** - Improving Related Infrastructure for the Bond Market
- Infrastructure for securities settlement
- Increasing liquidity of bond markets
- Fostering credit culture
- Developing professional services

**TACT** - Technical Assistance

**Working Team**

- Monitor progress and coordinate future plans
Freer movement of goods/service, money/capital, and people

ADB supports:
- ASEAN Capital Market Forum: Capital Market Integration
- ASEAN Central Bank Forum: Financial Service Liberalization

Financial services liberalization
- Each ASEAN country is integrated more globally than regionally.
- Wish to have a common market for the financial services.

*How far, how fast, in what steps?* Should ASEAN promote its own SIFIs operating across national borders? What are preconditions for the members (for each and all) to move along this?
In some, bank failures caused public debt crisis, while in others, public debt crisis caused banking crisis.

- Huge banking system relative to the underlying economy operating across national borders (e.g., Iceland, Ireland).
- Banks’ holding of govt debt of countries whose fiscal finance and public debt are in turmoil.

In the US, spending including the bailing of SIFIs fueled the growth of public debt and caused a political deadlock on the borrowing limit, leading to the sovereign credit downgrading.

Govt guarantee is no use, while banks can’t continue to finance the govt, calling for central bank financing despite its harm.
Asia’s banks are financially sound (NPL has been reduced) while the government finance and public debt are healthy. Should EU and US be worried about an exodus of their financial institutions to emerging markets?

Asia needs to keep pace with EU and US to avoid creating regulatory gaps / uncertainty and regulatory arbitrage.

Dilemma
- Stricter capital and liquidity requirements (and ring-fencing, Volker rule, push-out clause, etc.) reduce the efficiency of intermediation.
- They limit the financial access for poor households and SMEs. Basel III is also not trade finance-friendly.

Need to strike a right balance between stability and efficiency and coordinate globally.
Lessons for Asia

- Monetary integration without fiscal integration is difficult to sustain. Monetary integration of economies with widely different levels of development may not be even desirable.
  - Productivity of the economies that anchors their currency value (Balassa, Samuelson) improves at different paces.

- An economy with a huge banking system relative to the size of the underlying economy is vulnerable to a banking crisis.
  - Is Singapore (and Hong Kong?) vulnerable like Iceland or Ireland?

- Macro (and micro) prudential measures are necessary to deal with BOP problems in addition to conventional fiscal and monetary measures.
  - Some Asians already used them very well to prevent own crisis (so far).
Thank you!
Macro prudential measures

- **Bank focused ones:**
  - Control of credit growth
  - Allowing high credit growth only to certain sectors, e.g., SMEs, exports
  - Tightening LTV for real estate financing.
  - Tightening the margin requirements for stock purchase.

- **BOP focused ones (Capital control):**
  - Limit inflows by approval (e.g., QFII) or taxing them
  - Taxing outflows when an investor attempts to exist in short-term.
  - Essential to closely monitor and understand the nature of the flows (Korea’s monitoring system, LEI proposed by US, etc.)

- **Other interesting measures:**
  - Narrowing the price band of the stock market (difficult to exit)
  - Tightening the supply of FX while requiring an official rate to sell FX to local banks (similar to taxing).