

# **Enhancing Regional Cooperation in Asian Capital Markets \***

**High-Level Expert Group Meeting on Responding to  
the Global Financial Crisis: Revisiting the Role of  
Monetary and Financial Cooperation in the Asia-  
Pacific Region**

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\* The views expressed here are those of the author and do not necessarily reflect the views of the Asian Development Bank (ADB) or ADB's Board of Governors or the countries they represent.

# Outline: Three Questions

1. Why financial development, and why regional integration?
2. How are Asian financial markets integrating and countries cooperating?
3. Where do we go from here and how can ADB assist?

## 1.1 Why Financial Development?

- Enables economic growth -- efficiently mobilizing and allocating financial resources across competing needs (savings and investment).
- Promotes financial stability -- better risk management by investors.
- Broadens access to finance by the poor and vulnerable groups.
- But, there are risks from finance that need to be managed.

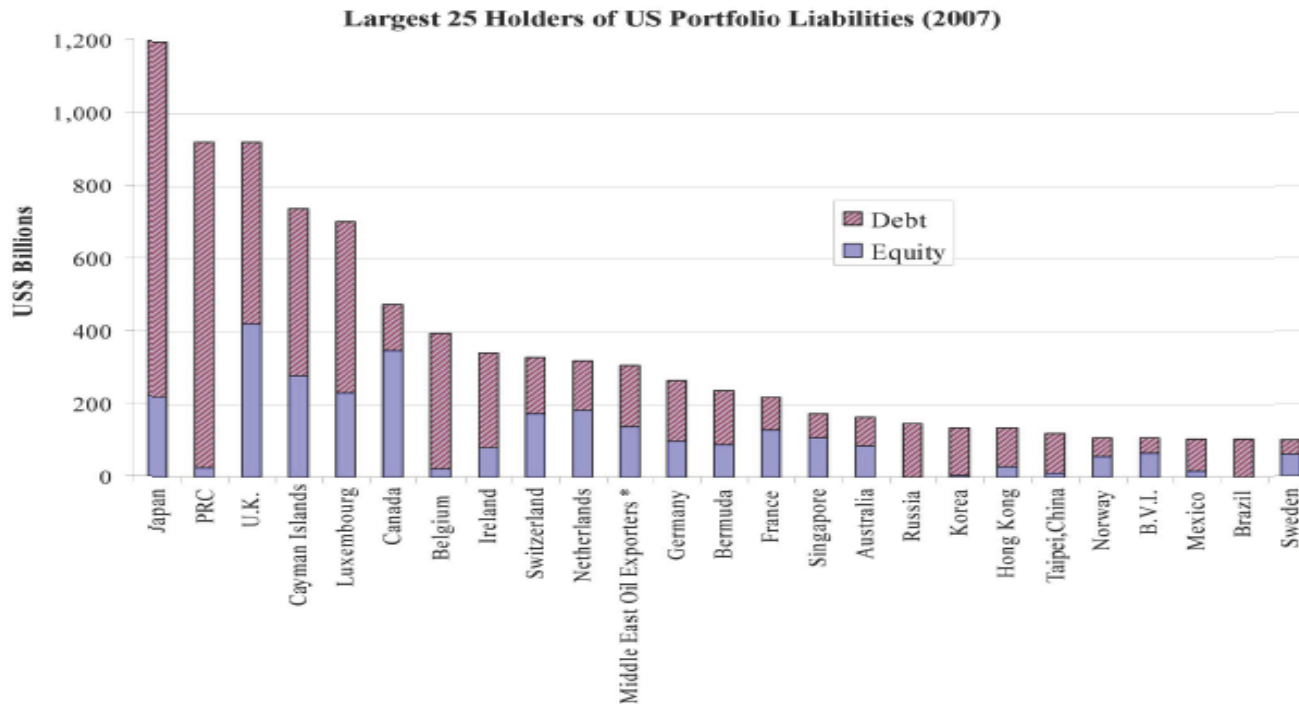
## 1.2 Financial Deepening: Stylized Stages & Sequencing

- Emergence of banks – good at dealing with asymmetric information through relationship lending and maturity transformation.
- Emergence of stock markets – provides an instrument banks are not good at: long-term commitment of risk capital while still giving investors a liquid form of investment.
- Emergence of fixed income markets (bond and money markets) – bond markets provide suitable instruments for long-term investors, e.g., pension funds and insurance companies; money markets manage short-term liquidity needs in large quantities.
- Final stage – derivatives markets and securitization – derivatives help hedge risks and securitization allows risks to be redistributed across investors (the so-called originate-to-distribute models).

## 1.3 Why regional financial integration?

- Size matters
  - bigger markets tend to be more liquid, stable, and efficient (lower cost of capital)
- Geographical proximity helps
  - countries closer to each other tend to trade more, and the larger the trade flows, the larger are the financial flows.
  - geographical proximity also tends to reduce information asymmetry
- Could help reduce global payments imbalance
- An integrated Asian financial/capital market
  - good for the countries involved, good for the region, good for the world at large.

# 1.4 Inadequate financial development drives Asia to export capital to the U.S.



Notes: Based on USG data released on 4/30/2008. Includes official and non-official sector holdings.  
\* Bahrain, Iran, Iraq, Kuwait, Oman Qatar, Saudi Arabia & United Arab Emirates.

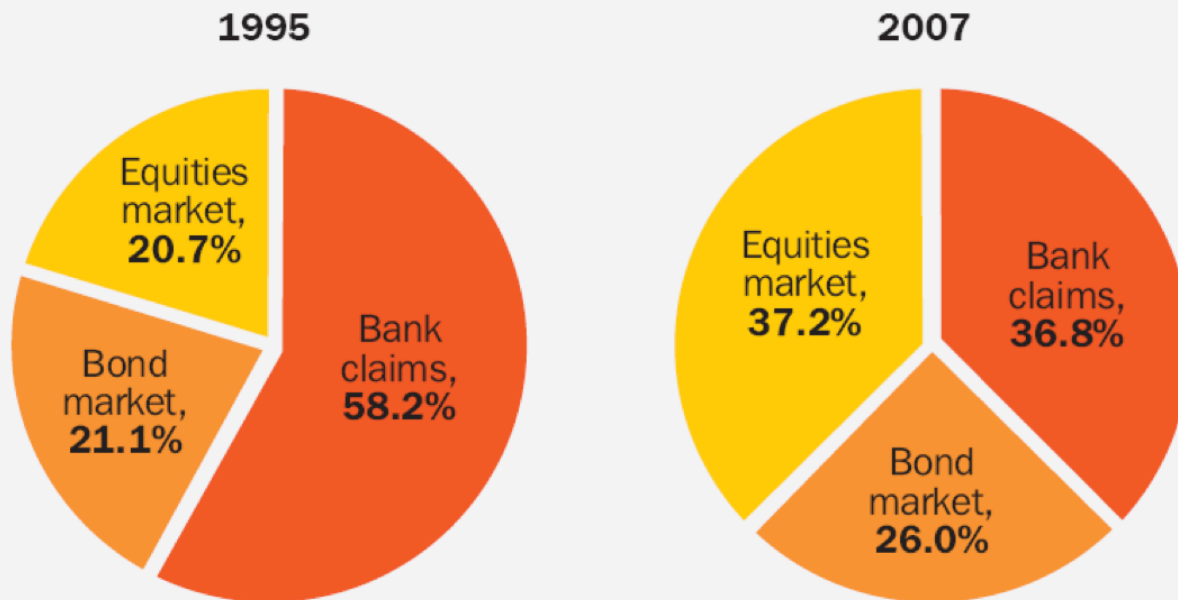
Source: Forbes, Kristin J. "Why do foreigners invest in the United States?" (NBER Working Paper, April 2008).

## **2.1 How are Asian financial markets integrating and countries cooperating?**

- Financial systems starting to diversify
- Debt markets taking their place
- Price indicators converging
- Stock price correlations increasing
- East Asian countries enhancing regional cooperation (ASEAN+3, ASEAN, EMEAP, ABF)

## 2.2 Financial systems starting to diversify

**Increasing share of capital markets**  
(share of total Asian financial assets)



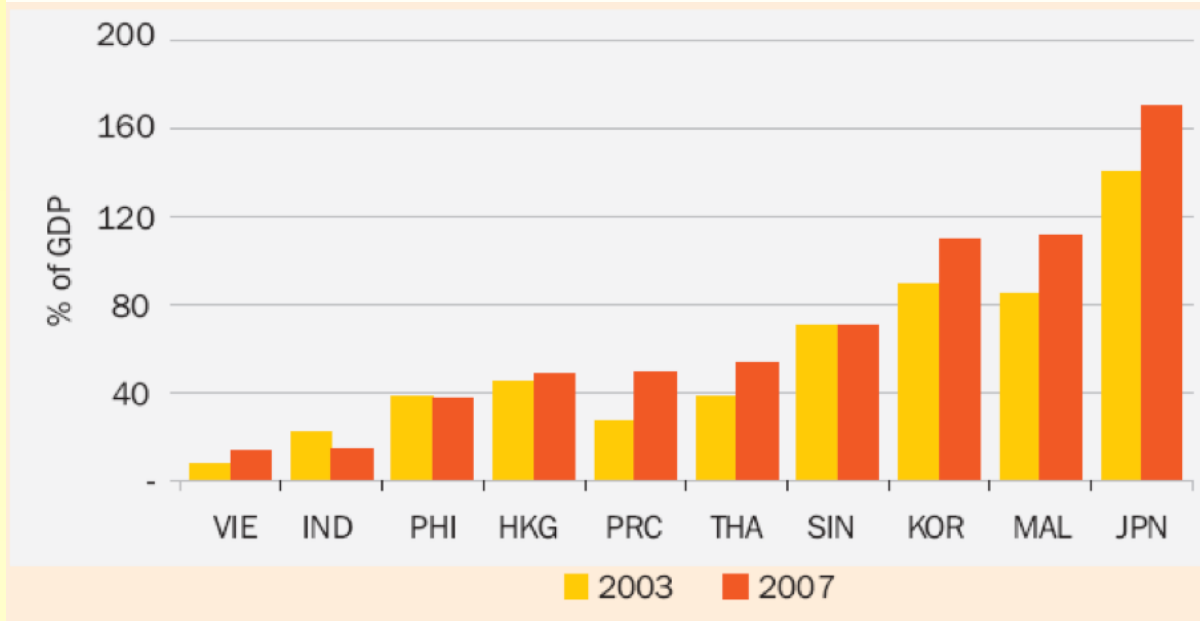
Source: ADB, *Emerging Asian Regionalism: A Partnership for Shared Prosperity*.



## 2.3 Debt markets taking their place (partly due to regional initiatives)

### Local-currency bond markets

(share of total issuances in GDP—2003 and 2007)

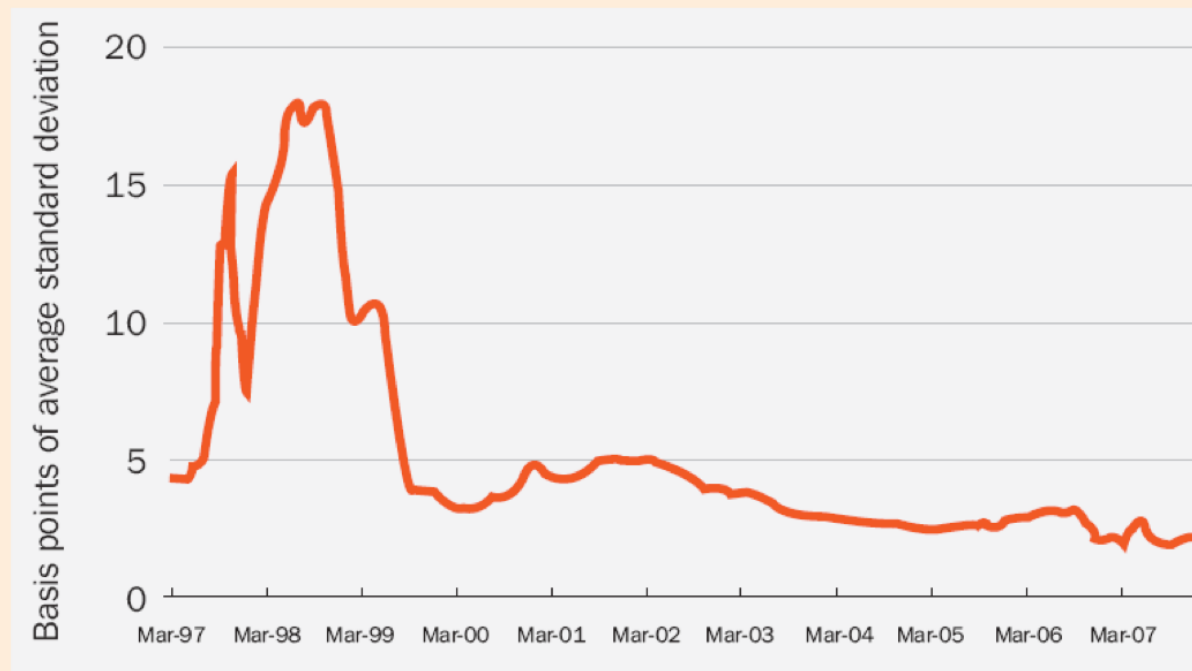


Source: ADB, *Emerging Asian Regionalism: A Partnership for Shared Prosperity*.

## 2.4 Price indicators converging

### Declining interbank rate differentials

(Standard deviation of cross-market overnight interbank rate differentials)

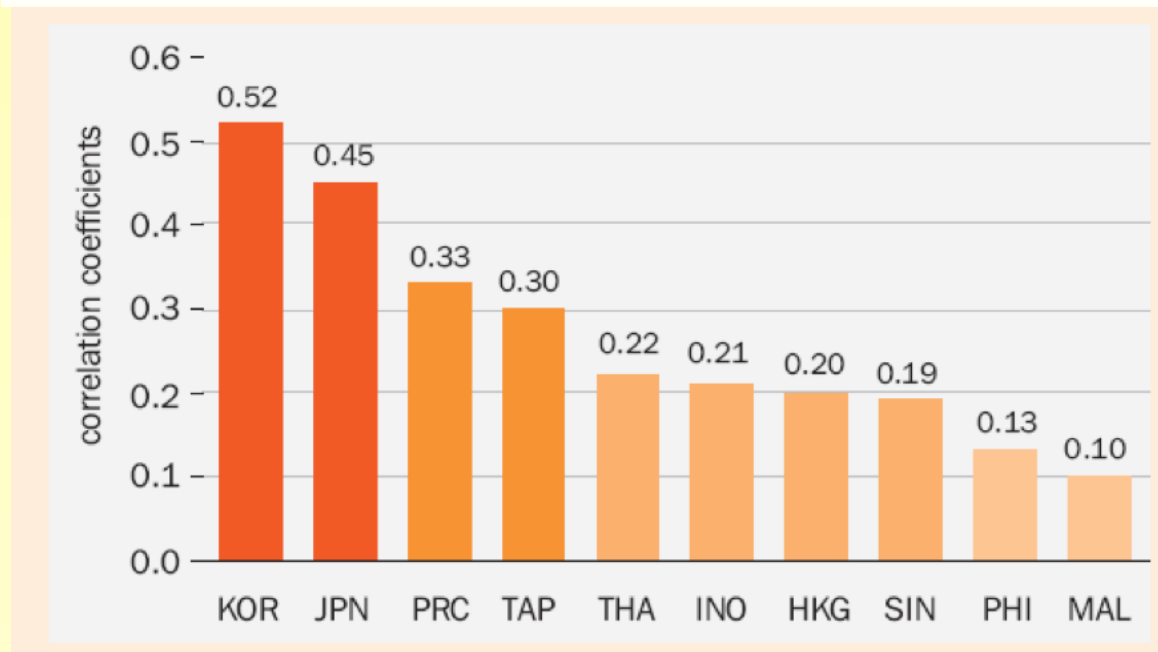


Source: ADB, *Emerging Asian Regionalism: A Partnership for Shared Prosperity*.

## 2.5 Stock price correlations are increasing

### Correlation of Asian stock price indexes

Absolute changes in the average of bilateral correlation coefficients precrisis (1990Q2–1996Q4); postcrisis (2000Q1–2006Q2)



Source: ADB, *Emerging Asian Regionalism: A Partnership for Shared Prosperity*.

## **2.6 ABMI- An ASEAN+3 initiative with a four-fold objective**

- Promoting issuance of local currency bonds,
- Facilitating the demand for local currency bonds,
- Improving the regulatory framework, and
- Improving related infrastructure for bond markets.

## 2.7 ABMI's action plan

- Creation of new securitized debt instruments,
- Establishment of a regional credit guarantee investment mechanism (CGIM),
- Establishment of a regional settlement and clearing system, and
- Enhancement of credit rating.
- Key focus: Harmonization of standards, practices, and policies.

## 2.8 Three broad themes of ASEAN capital market integration by 2010

- Creating an enabling environment for regional integration
  - Harmonization and mutual recognition framework
- Creating the market infrastructure and regionally focused products and intermediaries
  - ASEAN exchange alliance and governance framework;
  - Promoting new products and building ASEAN as an asset class;
  - Strengthening bond markets
- Implementing domestic policies to support regional integration
  - Aligning domestic capital market development plans to support regional integration

## 3.1 Where do we go from here?

### Lessons from the current global financial crisis

- Complexity is not innovation
- Leverage is not credit
- Risk dispersion is not risk reduction
- Market discipline is no substitute for regulation—“voluntary regulation does not work” (SEC Chairman Christopher Cox)
- In good times prepare for bad—case for countercyclical regulation

## **3.2 Developing nationally strong, regionally integrated, and globally connected Asian capital markets.**

- Streamlining regulatory framework
- Strengthening legal framework and bankruptcy code
- Improving infrastructure for trading and intermediation
- Balancing financial innovation and financial stability (or market freedom with government regulations).
- Keeping markets open to global issuers and investors



### **3.3 ADB's role in Asian financial capital market development and integration – lending and non-lending operations**

- Strategy 2020 - Regional cooperation and integration and financial sector development – two of the five core areas of operations for ADB (infrastructure, environment, and education being the other three).
- Lending operations focus mainly on microfinance, SME financing, and capital market development.
- Non-lending operations (NLO) gaining increasing importance, especially for middle income DMCs.

## 3.4 ADB's role in Asian financial capital market development and integration – technical assistance

- Technical assistance - a key tool for working with DMCs.
- Closely working with ASEAN+3 on ABMI, and with the ASEAN on the capital markets integration plan:
  - Technical inputs and implementation support (e.g., CGIM, ASEAN Exchange Alliance)
  - Capacity building and institutional strengthening (training banking and securities regulators on best practices)
  - Research and information dissemination (Asia Capital Markets Monitor, Asia Bond Monitor, working papers)

**Thank you**

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