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An Asian Perspective on Global Financial Reform: Comments



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ADB

The paper



- Overview of major regulatory reforms
- Review of literature on quantifying the impacts of Basel III capital adequacy rules
- Own model and findings

Potential impact of Basel III



- **Substantial benefits are expected in the form of**
 - Reduced risk of financial crises
 - Greater resilience of banks and other financial institutions during the financial turbulence
 - Enhanced transparency
 - Improved economic and financial stability
 - Better international cooperation
- **But costs may be significant as well:**
 - Increased regulatory burdens
 - Higher transactions costs
 - Delay in financial sector development
 - Growth slowdown

Quantifying the impact



- Economic impacts vary widely
- Public studies tend to report smaller effects (0.03% per year)
- IIF reports a 3.2% decline on average in the level of GDP for the US, Euro Area, Japan, UK and Switzerland compared to the baseline scenario after five years (an output loss of 0.7% per annum)
- Morgan and Pontines (2013) reports very marginal impact in early years for 4 ASEAN countries, followed by quick and substantial recovery

Qualifications



- The paper estimates the effect of higher capital requirements under Basel III for 4 ASEAN countries using VAR
- How about liquidity requirements and other regulations?
 - CAR is unlikely to have strong impact on Asian banking systems, as most of them are well capitalized
 - The impact of new liquidity requirements may be considerable in emerging Asia as its financial system is more bank-dominant
 - New regulations on SIFI, OTC, shadow banking may hamper innovation and financial sector development—potential long-term effects on economic growth

Financial Development in Asia

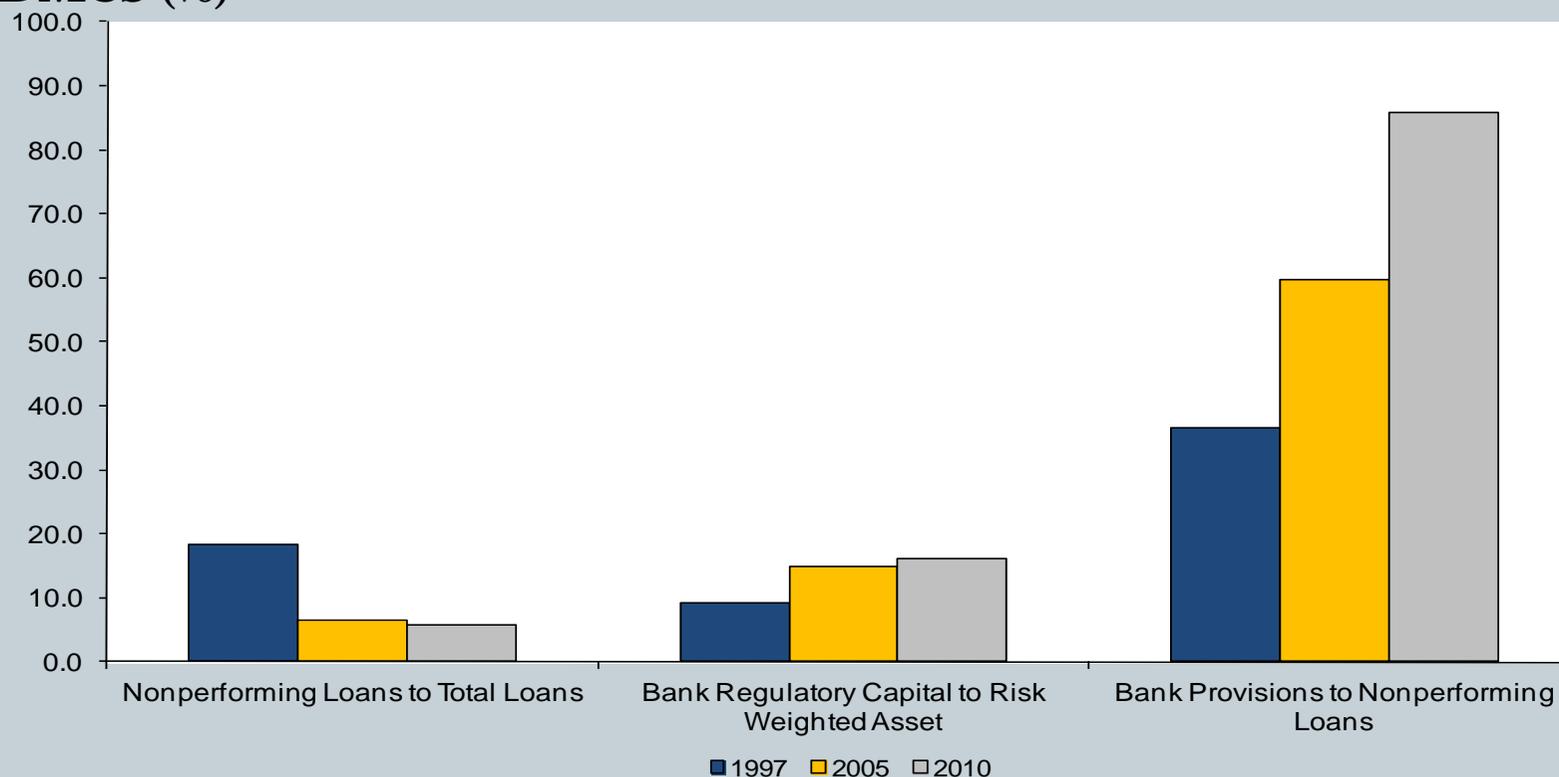


- **Limited crisis impact on Asian banking and financial systems**
 - Limited exposure to toxic assets
 - More prudent risk management practice
 - Stronger financial regulation and supervision since the 1997-98 crisis
 - Reduced external vulnerability on the back of better macroeconomic and financial management
- **But, a large scope of improvement remains in terms of efficiency, inclusivity, diversity and stability**

Lessons learned from the 1997-98 crisis (1)



Banking Sector Soundness Indicators—Average of Selected Asian DMCs (%)



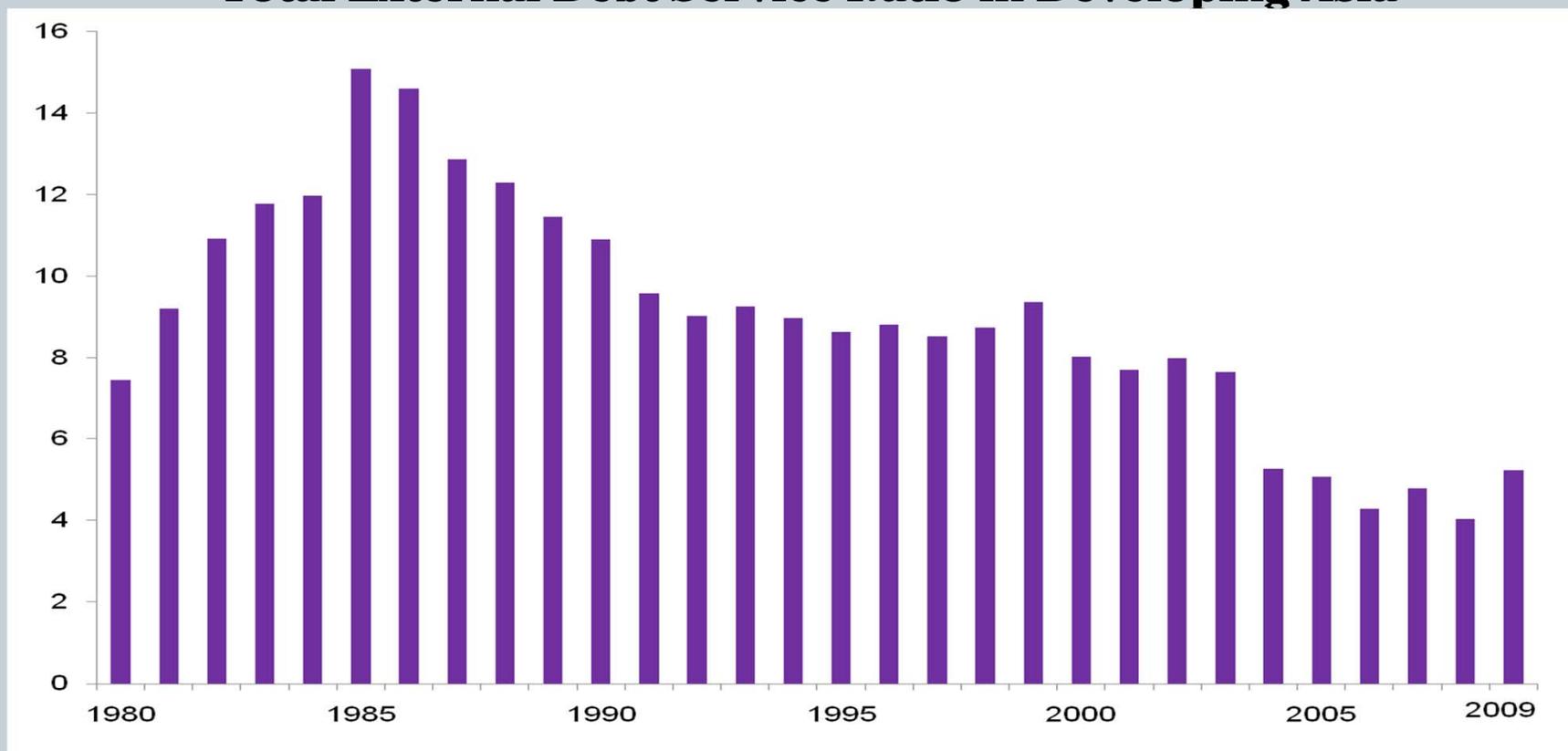
Note: Developing Asia includes Armenia; Bangladesh; People's Republic of China; Georgia; Hong Kong, China; India; Indonesia; Kazakhstan; Republic of Korea; Malaysia; Pakistan; Philippines; Singapore; and Thailand.

Source: Author's calculations using data from International Monetary Fund 2011b; and national sources.

Lessons learned from the 1997-98 crisis (2)



Total External Debt Service Ratio in Developing Asia



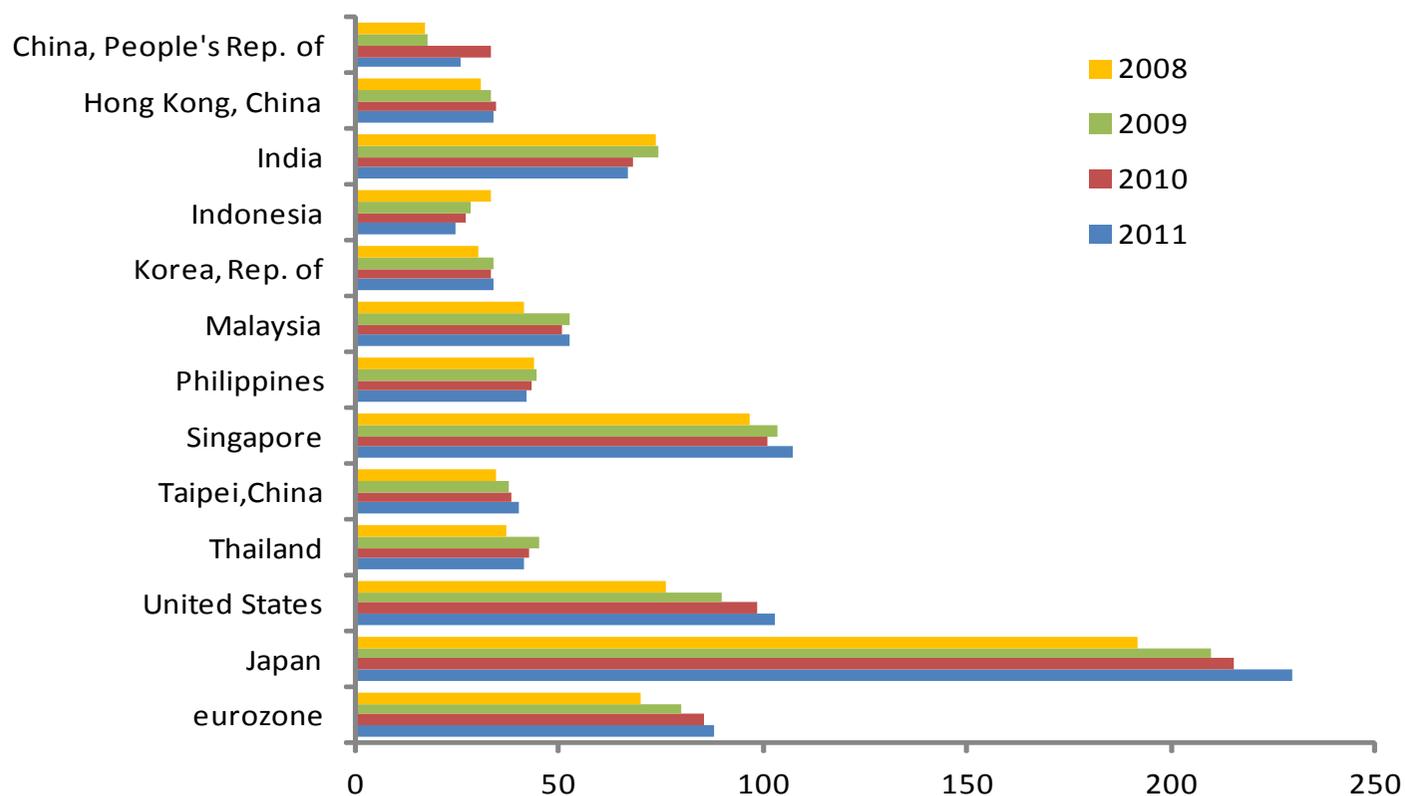
Note: Data does not include Taipei, China; Cook Islands and Nauru.

Source: *World Development Report* and *Global Development Finance Database*, World Bank

Fiscal space to fight off another recession



Public Debt—Emerging Asia and G3, 2008-2012 (% of GDP)



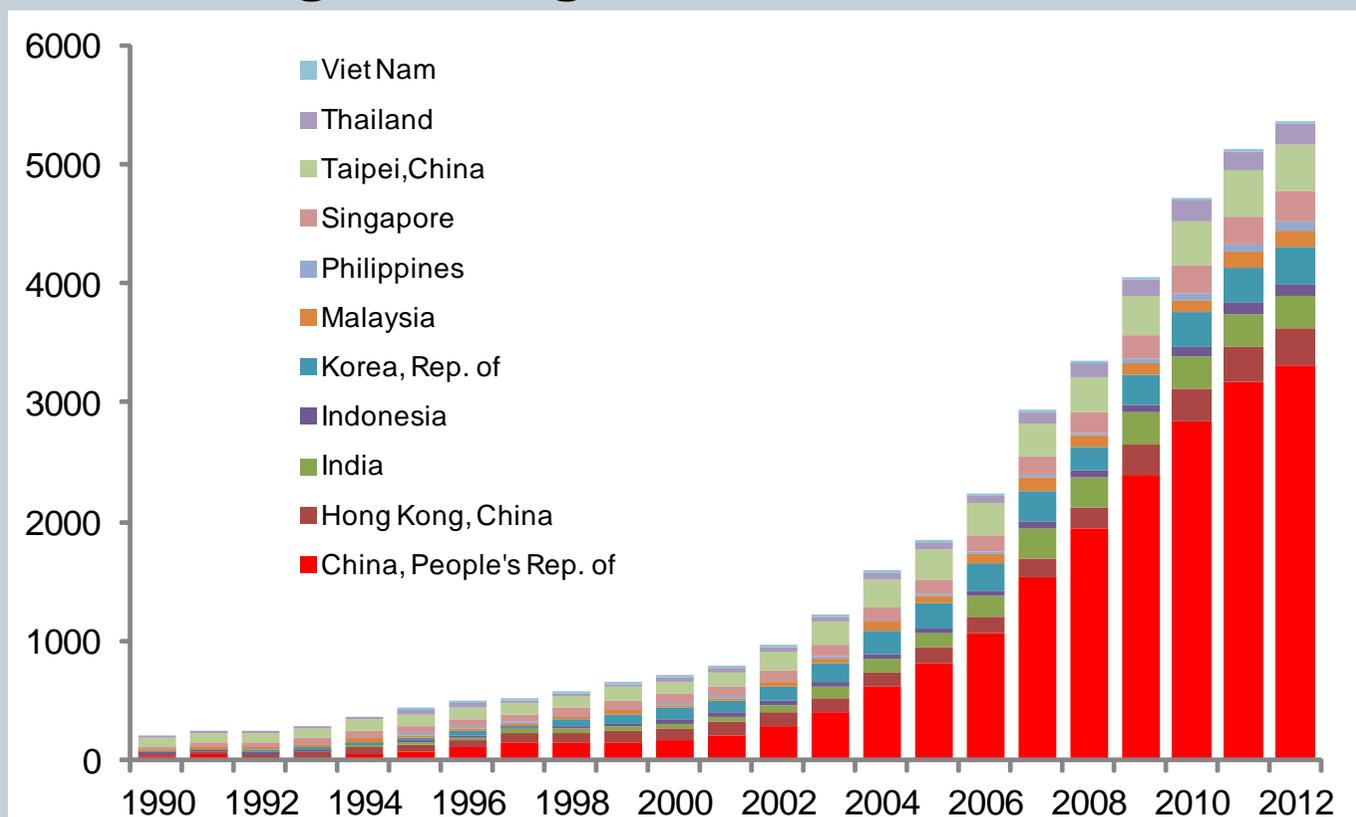
Note: Values refer to general government gross debt as defined in World Economic Outlook Database.

Source: World Economic Outlook, International Monetary Fund.

Ample ammunition in FX reserves offers a buffer



Foreign Exchange Reserves, (in US\$ billion)



Note: Data for 2012 for Indonesia, Philippines and Viet Nam are as of end-2011.

Source: *International Financial Statistics*, International Monetary Fund; and CEIC Database.

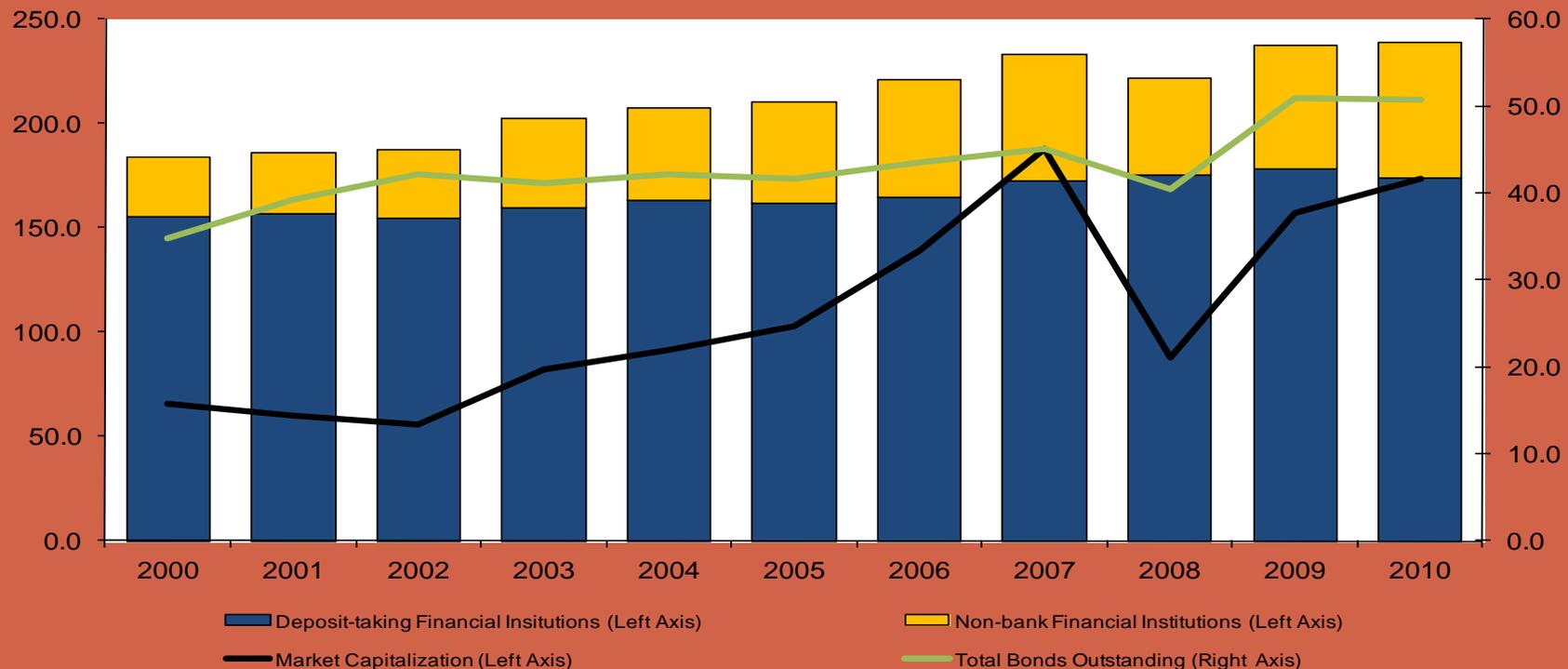
What are the priorities of FSD?



- **Efficiency**
- **Inclusivity**
- **Diversity**
- **Stability**

Asian financial sectors and markets have broadened and deepened...

Size of financial assets—Selected Asian DMCs (% of GDP)

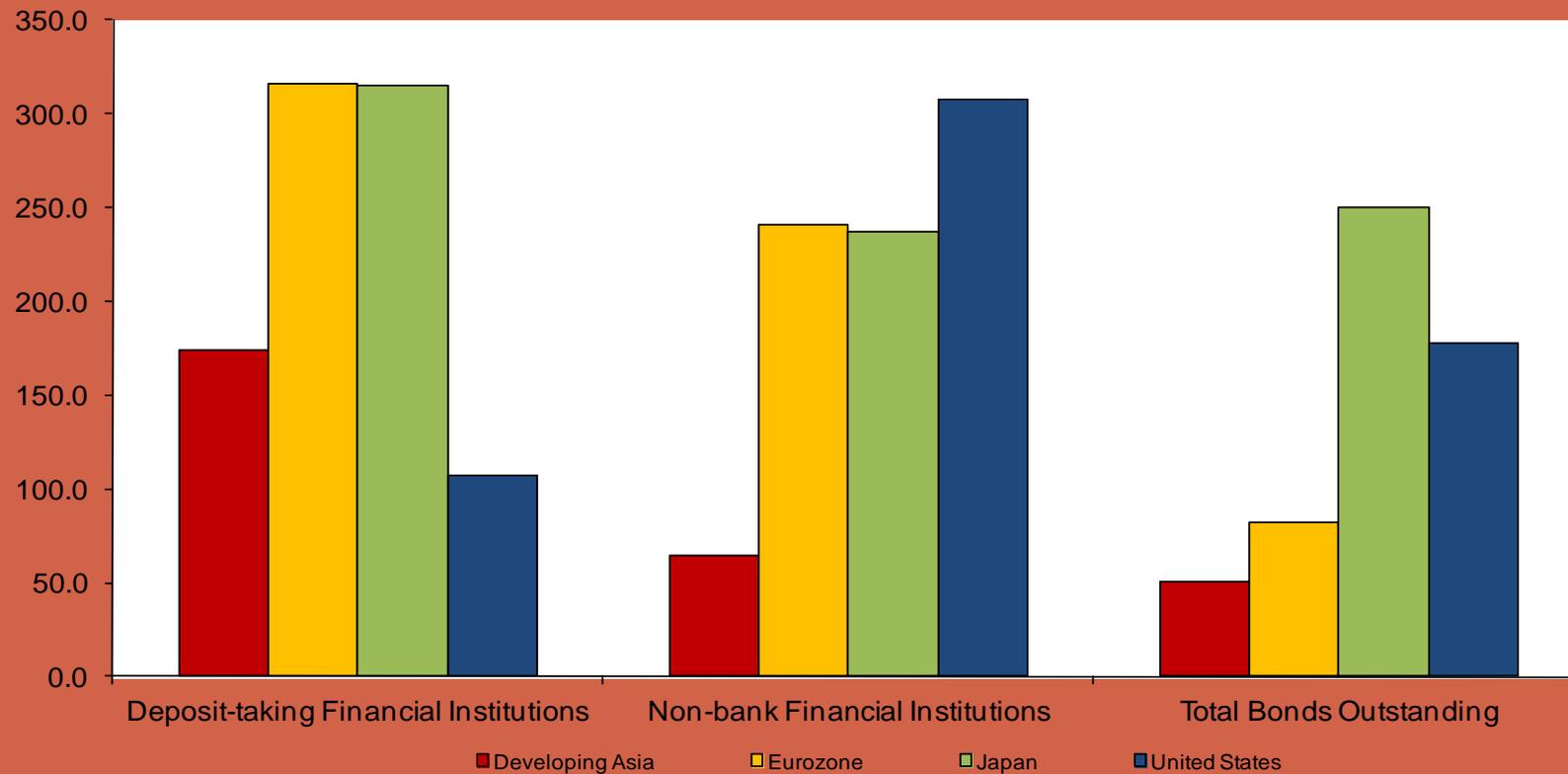


Note: Market capitalization data includes listed stocks. Total bonds outstanding data includes local and foreign currency issuances following BIS Table 16A. Values estimated using available data. Developing Asia includes Bangladesh; People's Republic of China; Hong Kong, China; India; Indonesia; Kazakhstan; Republic of Korea; Lao PDR; Malaysia; Nepal; Pakistan; Philippines; Singapore; Sri Lanka; Taipei, China; and Thailand.

Source: Author's calculations using data from AsianBondsOnline; Bank for International Settlements; CEIC Data; World Federation of Exchanges; and International Monetary Fund 2012.

...yet Asian financial sector remains smaller compared to advanced economies

Comparison of Financial Asset Sizes, 2010 (% of GDP)

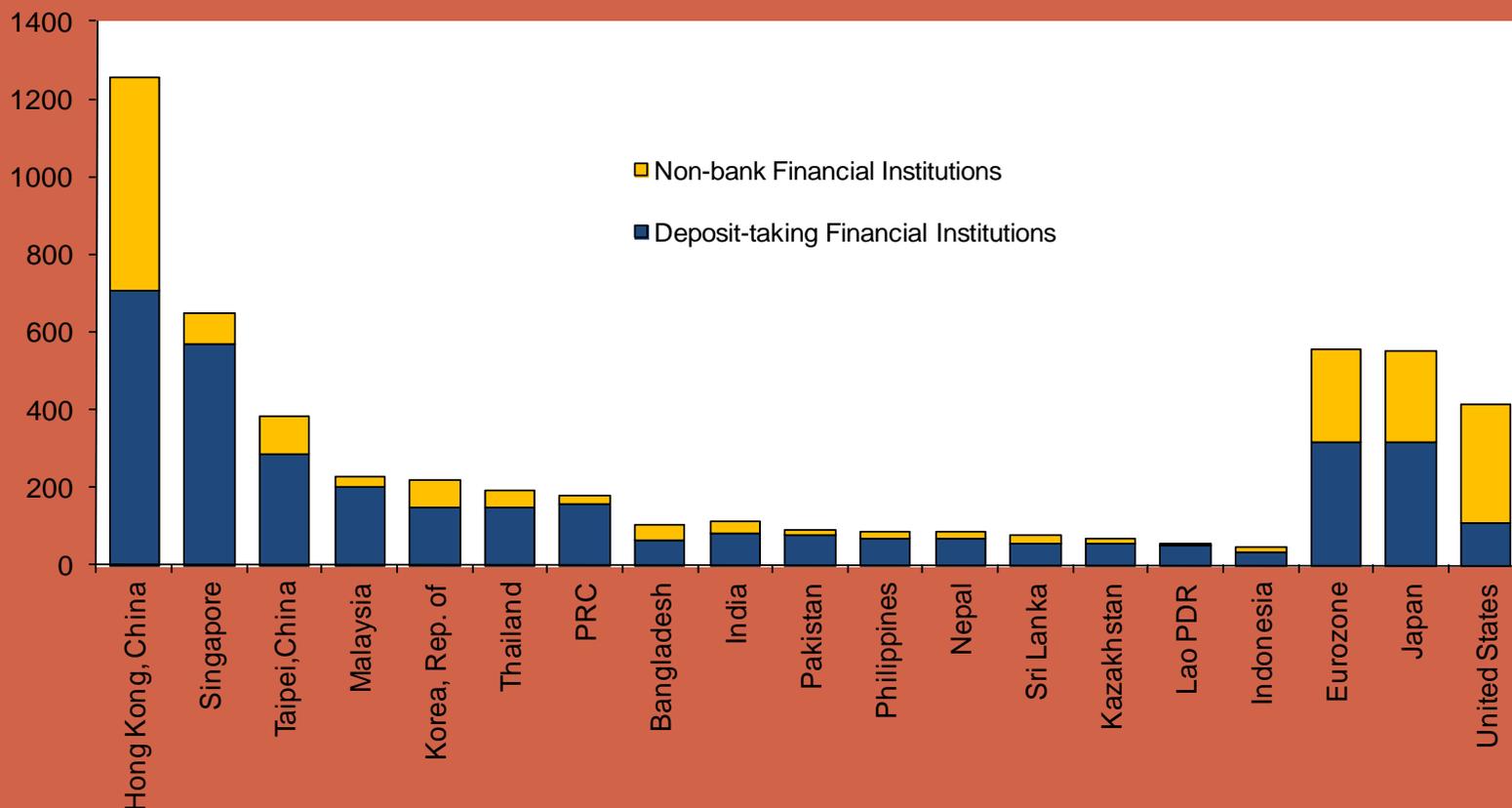


Note: Market capitalization data includes listed stocks. Total bonds outstanding data includes local and foreign currency issuances, following BIS Table 16A. Some values are estimated using available data. Developing Asia includes Bangladesh; People's Republic of China; Hong Kong, China; India; Indonesia; Kazakhstan; Republic of Korea; Lao PDR; Malaysia; Nepal; Pakistan; Philippines; Singapore; Sri Lanka; Taipei, China; and Thailand. Eurozone includes members of the eurosystem.

Source: Author's calculations using data from AsianBondsOnline; Bank for International Settlements; CEIC Data; World Federation of Exchanges;

Banks continue to dominate, especially in low income developing economies

Financial Sector Assets of Selected Asian DMCs, 2010 (% of GDP)

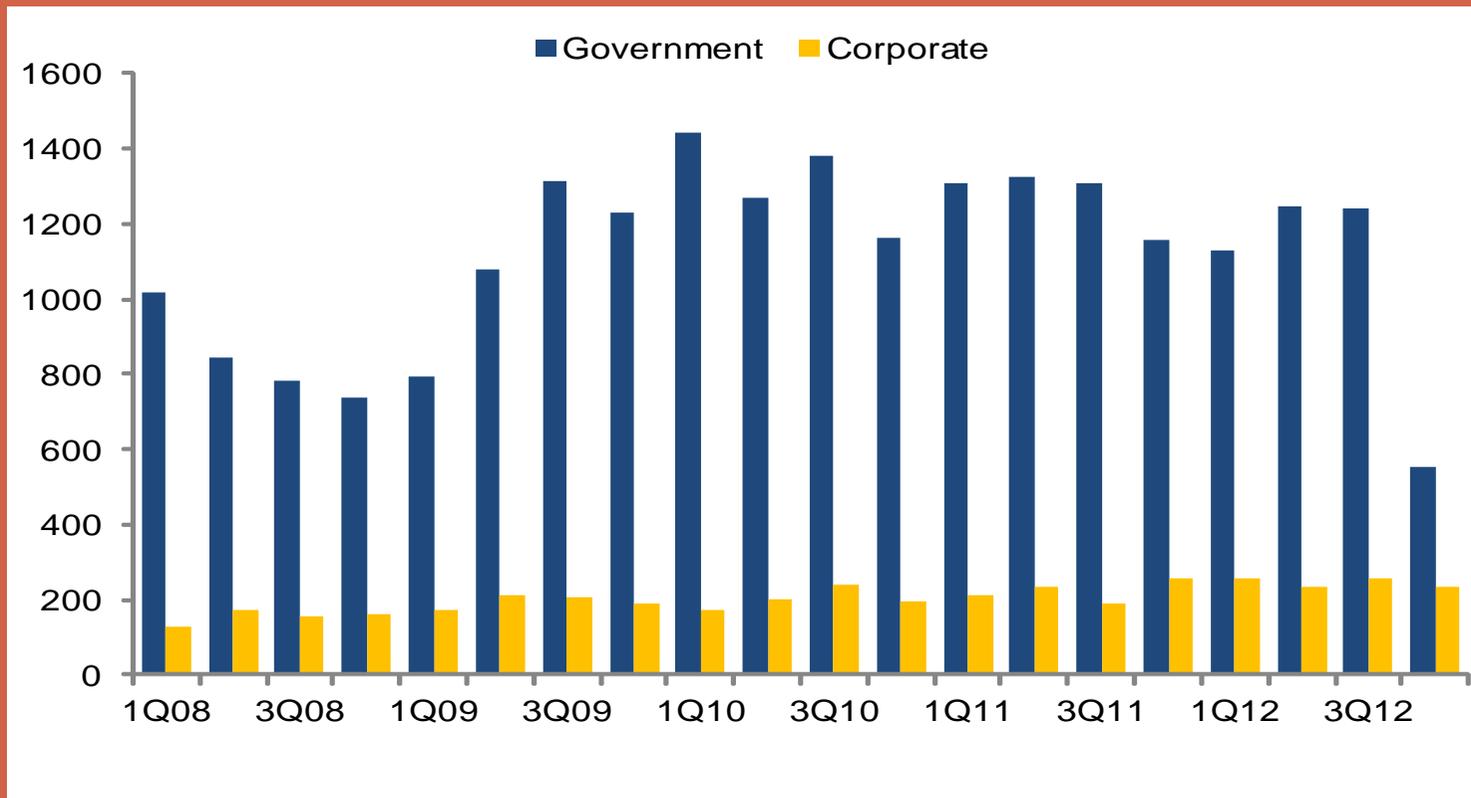


Note: Values estimated using available data. Eurozone includes members of the eurosystem.

Source: Author's calculations using data from AsianBondsOnline; Bank for International Settlements; CEIC Data; World Federation of Exchanges; and International Monetary Fund 2012.

Corporate bond development lags behind government bond market development.

Government and Corporate Bond Issuance, (US\$ billion)



Note: Country coverage includes People's Rep. of China; Hong Kong, China, Indonesia; Rep. of Korea; Japan; Malaysia; Philippines; Singapore; Thailand; and Viet Nam. Government bonds include treasury, central bank, and SOEs.

Source: *AsianBondsOnline*, Asian Development Bank.

Clear need to focus efforts on FSD to support inclusive and balanced growth



- **Support economic growth and development**
 - Provide adequate funding for infrastructure and support economic activity
- **Increase access of the poor households and SMEs to formal credit**
 - Encourage innovative ways to serve traditionally underserved sectors
- **Maintain balance between growth and stability; between innovation and regulation**

Establish foundations of finance and financial infrastructure



- **Encourage and manage financial market development without stifling innovation.**
 - Rapid penetration of financial innovation in some parts of the region's largely underdeveloped financial systems is a significant regulatory concern, while authorities need to support innovations that could broaden financial access and promote financial sufficiency and resiliency.
- **Build/enhance institution and support system for financial sectors and markets**
 - Legal and regulatory framework (including solvency and dispute resolution mechanisms)
 - Effective payment systems
 - Clear and transparent property rights
 - Information infrastructure
 - Corporate governance structure

Safeguard financial stability



- Financial stability as a public good
- Create comprehensive framework for crisis prevention and management with contingency plan ready
- Strengthen regional cooperation for:
 - Economic cooperation
 - Policy coordination
 - Crisis assistance
- Actively participate in global forums for:
 - Global financial regulatory reforms
 - International financial architecture
 - Global financial safety nets.

Thank you.



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