

Regional Financial Integration and Financial Regulatory Cooperation —The Importance of Asia's Bond Markets

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Workshop: The Global Financial Crisis and the
Reform of the Financial Regulatory Framework

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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.

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Main messages

- Financial integration is increasing in emerging Asia
- Financial markets are less bank focused
- Local currency bond markets have shown strong growth but remain underdeveloped
- Regional initiatives
 - strengthen market infrastructure for bond markets
 - can serve as model for developing bond markets
 - enhance regional integration and cooperation

Financial integration

- Facilitates the smooth implementation of monetary policy and the balanced transmission of its effects throughout the region
- Contributes to financial stability by creating larger, more liquid and competitive markets which offer increased possibilities for risk diversification and risk sharing
- Fosters economic growth and welfare because it is beneficial to the further development and efficiency of the financial system

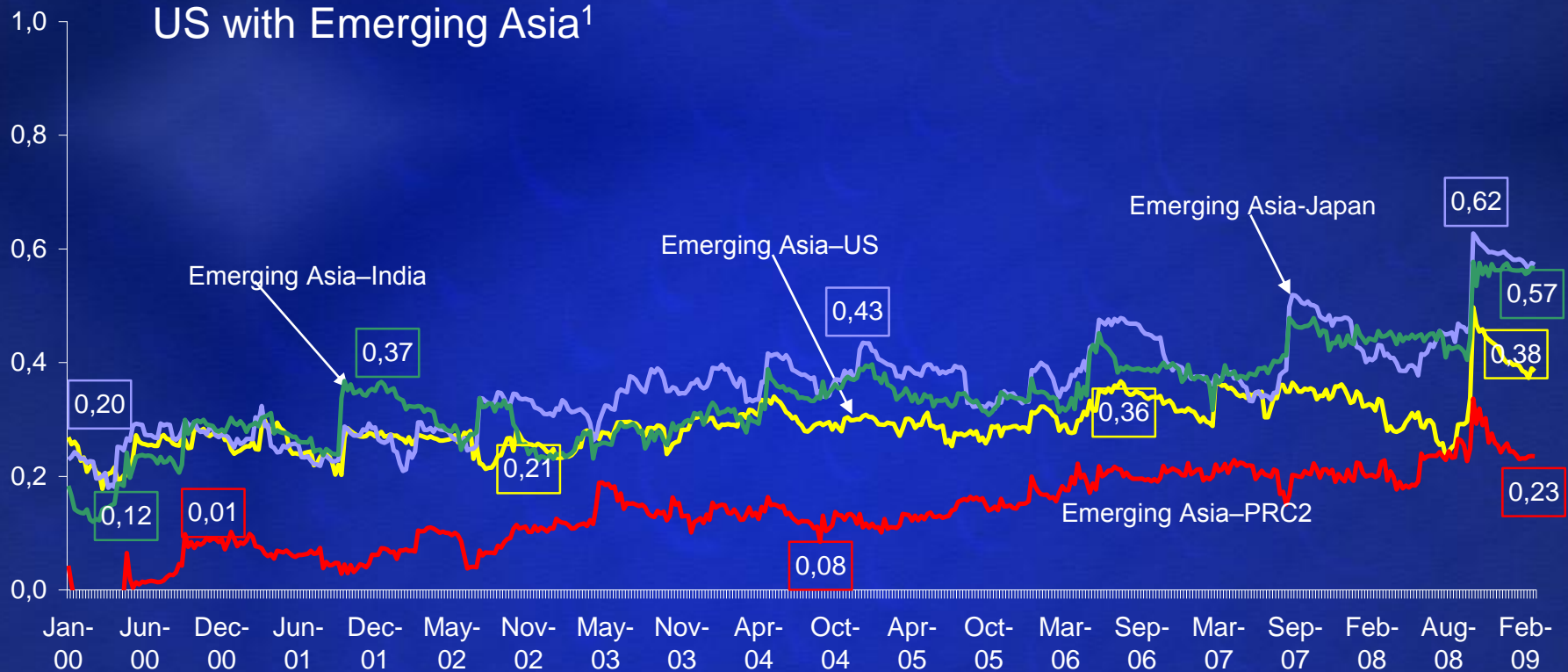
Noticeable upward trend in Asia–US market correlation



¹ Refers to China, People's Rep. of; Hong Kong, China; India; Indonesia; Japan; Korea, Republic of; Malaysia; Philippines; Singapore; Taipei, China; and Thailand.
Source: OREI staff estimates.

Individual major Asian equity markets are increasingly integrated with emerging Asia

Conditional Correlations of Equity Markets—India, Japan, PRC, and the US with Emerging Asia¹



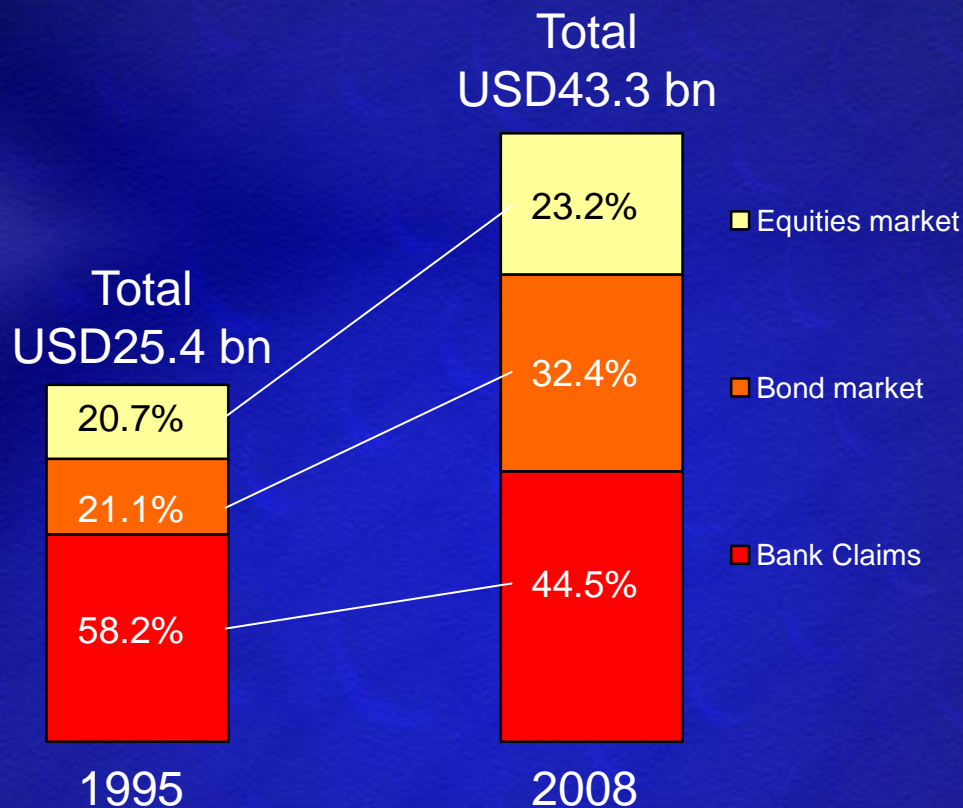
¹ Refers to China, People's Rep. of; Hong Kong, China; India; Indonesia; Korea, Republic of; Malaysia; Philippines; Singapore; Taipei, China; and Thailand. Excluding China, People's Rep. of (in the case of China); and excluding India (in the case of India).

² PRC = People's Republic of China.

Source: OREI staff estimates.

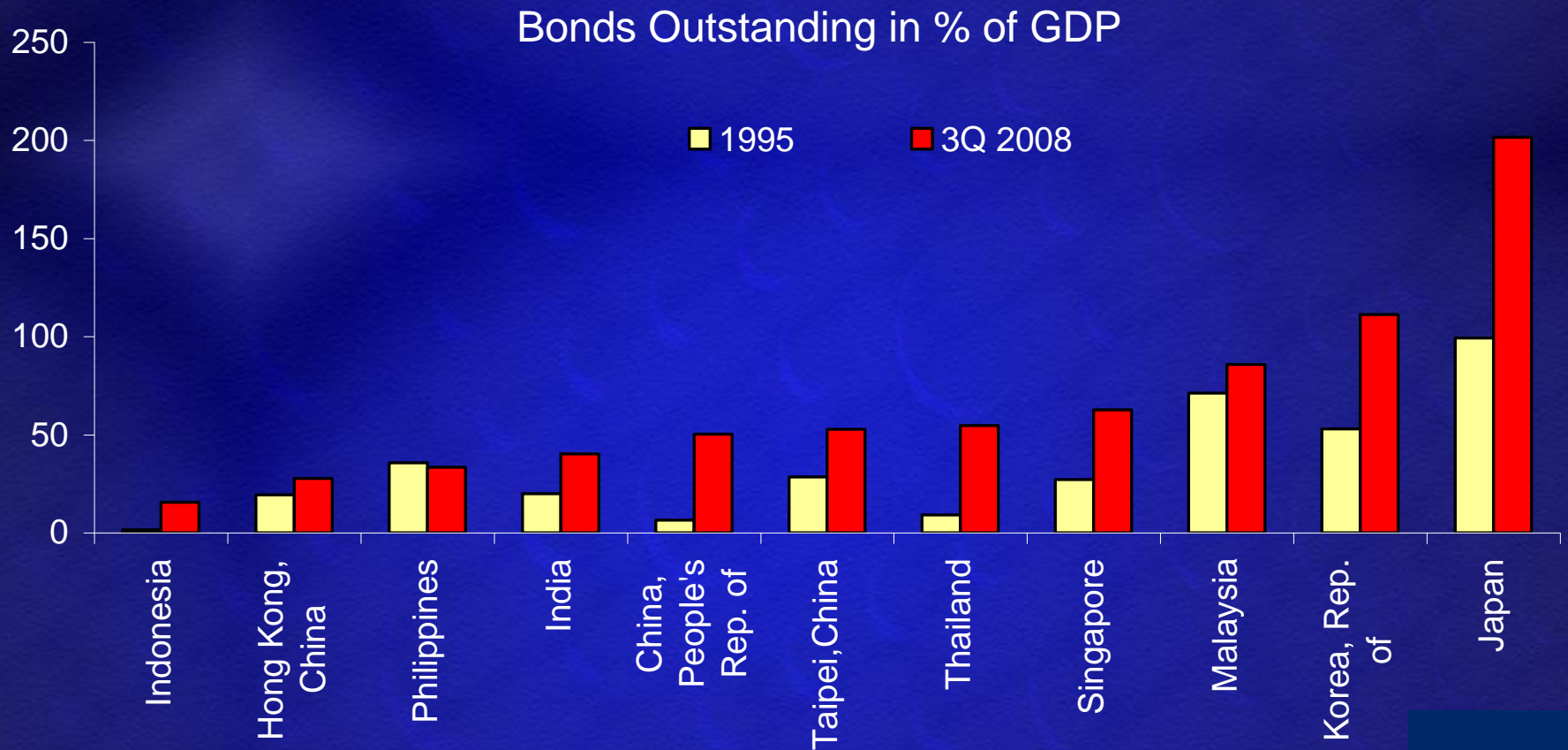
Markets are less bank focused

—increasing share of capital markets



domestic financing, total billion USD and shares in percent of total

... and local currency bond markets are increasing in size



Development of bond markets is one avenue toward financial stability

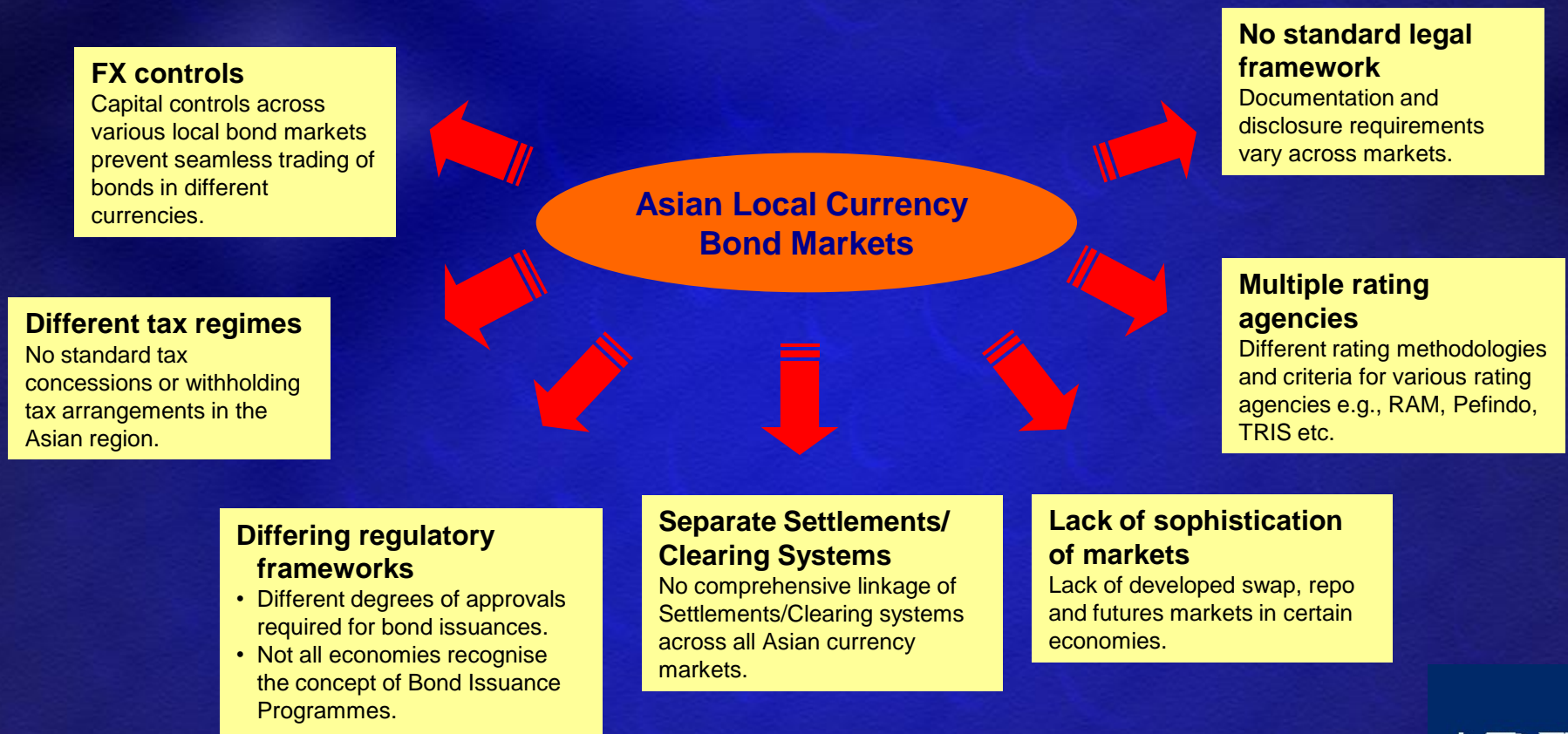
- Reduce the double mismatch problem (currency & maturity)
- Reduce over-dependence on bank borrowing and diversify financial risks
- Reduce information asymmetries
- Reduce risk of governments relying too heavily on central bank funding
- Provide alternative sources of financing for (long-term) private and public investment
- Provide alternative mode of wealth holding for Asian households
- Influence effectiveness on central bank's monetary policy

Successful development of the regions bond markets depend on the enabling environment

- Efficient bond markets are characterized by
 - Competitive market structure
 - Low transaction costs
 - Low levels of fragmentation
 - Robust and safe market infrastructure
 - High level of heterogeneity among market participants

... but emerging Asian local currency bond markets remain underdeveloped

The underdevelopment of financial markets and institutions in East Asian economies is an impediment to financial integration



Issues and challenges in developing local bond market across the region

- Concentrate on the establishment of basic prerequisites
 - Prudently ease capital controls
 - Develop reliable and liquid government benchmark yield curve
 - Improve market liquidity and efficiency
 - Strengthen transparency
 - Develop market infrastructure
 - Remove discriminatory taxes and the withholding of interest and capital gains taxes earned by foreign investors
 - Broaden the institutional investor base
 - Strengthen financial supervision and regulation
- ... in addition
 - Credible and stable government
 - Sound fiscal and monetary policy

Regional cooperation can contribute to deeper and more sophisticated markets

- Regional initiatives

- Help strengthen market infrastructure for bond markets
- Can serve as model for developing regional bond markets and for enhanced regional integration and cooperation

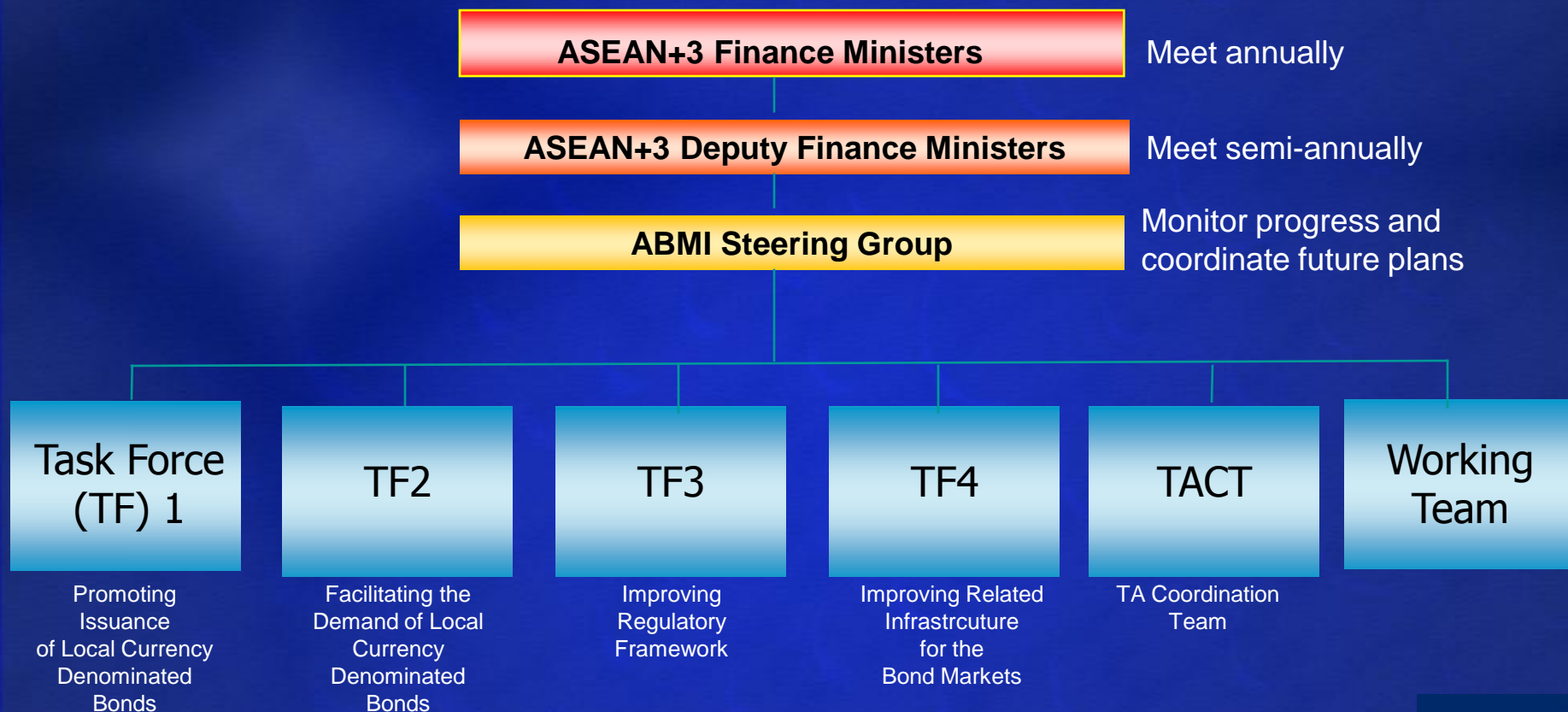
- ASEAN+3

- Asian Bond Markets Initiative
- Chiang Mai Initiative
- Economic Review and Policy Dialogue

ADB initiatives to develop local currency bond markets

- Provide technical and research assistance to the ASEAN+3 ABMI
- Stimulate market activities by issuing local currency bonds
- Provide technical assistance and policy advice
- Promote information dissemination through Asia Bond Monitor, Asia Capital Markets Monitor, working papers

Asian Bond Markets Initiative



TF1: Credit Guarantee Investment Mechanism (CGIM)

- Objective of CGIM is to
 - Support the issuance of local currency bonds
 - Contribute to developing regional bond markets
 - Business scope, leverage ratio and country limit to be further discussed
 - Effective by the 2010 AFMM+3
- Established as a **trust fund** of ADB with an initial capital of **USD500 million**

TF1: Asian Currency Note Program

—key features

- Programme established in September 2006: Note issuances up to the Programme limit of USD10 billion
- Programme tenor is 30 years
- Notes cleared under domestic clearing systems
- Programme documentation achieves a single issuance platform by using a common set of documents governed by English law
- Consistent with efforts under ABMI to harmonize regulations in the region and to establish deep and liquid bond markets
- Serves as a model for regional and international issuers interested in tapping regional markets
- The single structure allows Asian or multilateral leading issuers to access several Asian financial markets simultaneously and helps reduce legal and transactions costs
- HK, MY and SG have provided necessary approvals for ADB to issue HK dollar, MY ringgit and SG dollar notes, each with a USD1 billion equivalent tranche amount
- Korea, the Philippines, Taipei, China and Thailand in the pipeline

TF 2: AsianBondsOnline website

- AsianBondsOnline Website
 - Launched May 15 2004—a one-stop information site on ASEAN+3 bond markets
 - Average daily hits over 23 000 per day.
 - <http://asianbondsonline.adb.org>
- Unique features
 - Promote public awareness of the ABMI
 - Hub for local currency bond markets
 - Deepen engagement with institutional investors
 - Facilitate information exchanges among member countries on developments in the local currency markets
 - Broaden interaction with market regulators

TF 3: Harmonization of Bond Standards

- Harmonization of Bond Standards
 - Report to ABMI early next year on harmonization developments in (i) secondary market for government and corporate bonds, (ii) self regulatory agencies

TF 4: Regional Settlement Intermediary

- Regional Settlement Intermediary (RSI)
 - Group of Experts established to conduct feasibility study of RSI options and identify barriers for cross-border bond transactions and settlements in the region
 - Recommendations to ABMI in April 2010 on (i) cost and benefits of each option, (ii) regulatory requirements, and (iii) next steps

ADB Local Currency Bond Issuance

—has increased the supply of high quality domestic currency bonds

Country	Coupon (%)	Amount	Issue Date	Maturity Date
Hong Kong	3.75	HKD 200,000,000	08-Nov-07	08-Nov-10
Hong Kong	4.00	HKD 1,500,000,000	18-Jan-07	18-Jan-12
Kazakhstan	6.80	KZT 6,000,000,000	08-Aug-07	08-Aug-12
Malaysia	4.00	MYR 500,000,000	08-Feb-07	08-Feb-17
Philippines	5.23	PHP 5,000,000,000	24-May-07	24-May-12
Singapore	3.27	SGD 250,000,000	08-Feb-07	08-Feb-12

Source: ADB Treasury

Technical Assistance and Policy Advice

- Address impediments to domestic bond market development
- Create the enabling environment and supporting market infrastructure
- Provision of credit and guarantees

Information Dissemination

- Asia Bond Monitor
 - Quarterly publication
- Asia Capital Markets Monitor
 - Annual publication
- ADB Working Paper Series on Regional Economic Integration
 - See Asia Regional Integration Center
<http://aric.adb.org>

... in addition, the Asian Bond Fund (ABF)

is a low-cost, low denomination, and transparent fund potentially appealing to a broad spectrum of institutional and retail investors

- Initiated by EMEAP to strengthen the demand side
- ABF-1 June 2003, USD1 billion
 - Invest in sovereign and quasi-sovereign US dollar bonds issued by 8 members
- ABF-2 December 2004, USD2 billion
 - Pan-Asian Bond Index Fund, a single bond fund index investing in sovereign and quasi-sovereign local currency bonds issued by 8 members
 - Open to investment by the public

Conclusion

- To take advantage of increased financial integration policy makers in Asia need to promote the development local currency bond markets
- Introducing uniform policy coordination—including institutional and regulatory reforms—an help promote bond market integration in Asia
- Regional initiatives play a key role in strengthening market infrastructure for bond markets, can serve as model for developing bond markets in regions other than Asia and enhance regional integration and cooperation

Thank You

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