FINANCIAL DEVELOPMENT IN ASIA:
THE ROLE OF POLICY AND INSTITUTIONS

Discussant

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Thoughtful Paper (as expected)

- Balanced view of financial developments since the Asian crisis: banks versus debt finance
- Uses indicators of financial development and cross country evidence: Asia has come a long way in terms of bond market development (with some caveats)
- Role of financial openness in speeding up financial development
- A note of caution on excess financialization
- Policy prescriptions: “quality” versus “quantity”
Large shock in 2008-2009

Advanced Economies: Real GDP (2008=100; Seasonally adjusted)

Global Trade and Asian Exports (2008 = 100)
Increased resilience (so far) : This time is different for Asia? No large current account adjustment in Asia. Different from 1997-1998

This time is different for Asia?

Red means banking crises, very red systemic crises

Sources: IMF, Laeven and Valencia (2012)
Paper’s focus is not on macroeconomic policies, or level of reserves but on structure of financial markets: development of bond markets.

There are interesting complementarities between macroeconomic policies and bond market development (see paper by Rose and Spiegel at the ABFER on links between inflation and bond market-long maturities).

Would have been interesting to have data on maturity structure. Liquidity of bond markets also depends on existence of benchmark yield curve.

Would have been interesting to have data on currency composition.
“Quantity” based: outstanding stocks of local bonds, bond market cap to GDP ratios

Figure 1. Local Bond Market in Asia (ex. Japan)
Asia’s Financial Sector – still small but growing ....

Sources: BIS, Securities Statistics; Bloomberg; Haver Analytics; IMF, International Financial Statistics and World Economic Outlook database; and IMF staff estimates.
Asia’s Financial Sector – Derivatives markets are growing rapidly (from a low base)

Sources: BIS, Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity; Bloomberg; IMF, U.S. FSSA for 2010 FSAP; Wind; and IMF staff estimates.
Schizophrenia

- Debt as % of GDP, measure of financial development but may be also of financial stability risk, of debt overhang.
- Example: China’s local government debt. Majority of issuance in East Asia ex Japan is China.
- Could say: focus on development of private debt markets but correlation with credit booms?
- And as we know private versus public debt is not a reliable dichotomy (especially if debt is issue by financial corporations)
As the paper points out, rapid development of bond markets can also come with problems:
- hot money flows and their reversals
- lack of monitoring and "toxic assets"
- 2008 crisis losses across countries positively correlated with measures of financial innovation, deregulation

We have to try to disentangle cyclical and excessive debt borrowing from sustainable form of financing-
SIGNIFICANT VOLATILITY

Equity Funds
(billions of US dollars; weekly flows)

Bond Funds
(billions of US dollars; weekly flows)

Volatility of equity flows* (right-axis)

VIX index (right-axis)

Source: EPFR Global. Gulde (IMF)

Source EPFR Global. Gulde (IMF)
Effect of financial openness

- Table 5-8 “openness of capital account is among the positive and significant determinants of bond market depth”: hard to see in the tables….

- Literature finds it hard to establish a causal link

- Question of sequencing between development of bond market infrastructure, deregulation of credit market and liberalisation of financial flows is key in particular for China
Conclusions

- Wise paper
- Further questions that could be addressed:
  - Implications of the push for internationalisation of the RMB for development of bond markets in the region
  - Development of investor base via RMB balances held outside of China (AIIB) may have a large effect on bond market development