

# FINANCIAL DEVELOPMENT IN ASIA: THE ROLE OF POLICY AND INSTITUTIONS

*Discussant*

Hélène Rey

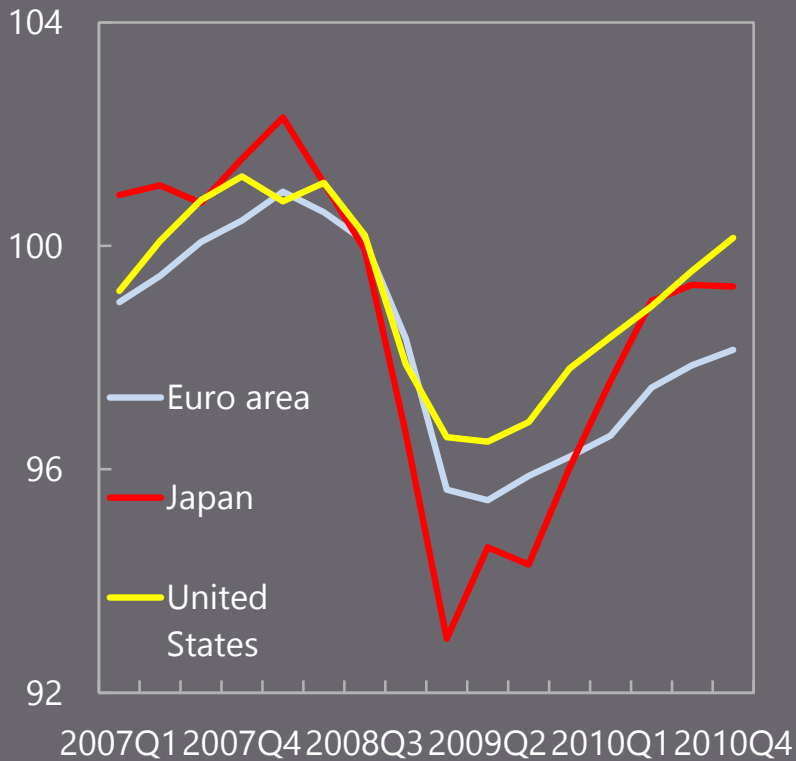
London Business School, CEPR and NBER

# Thoughtful Paper (as expected)

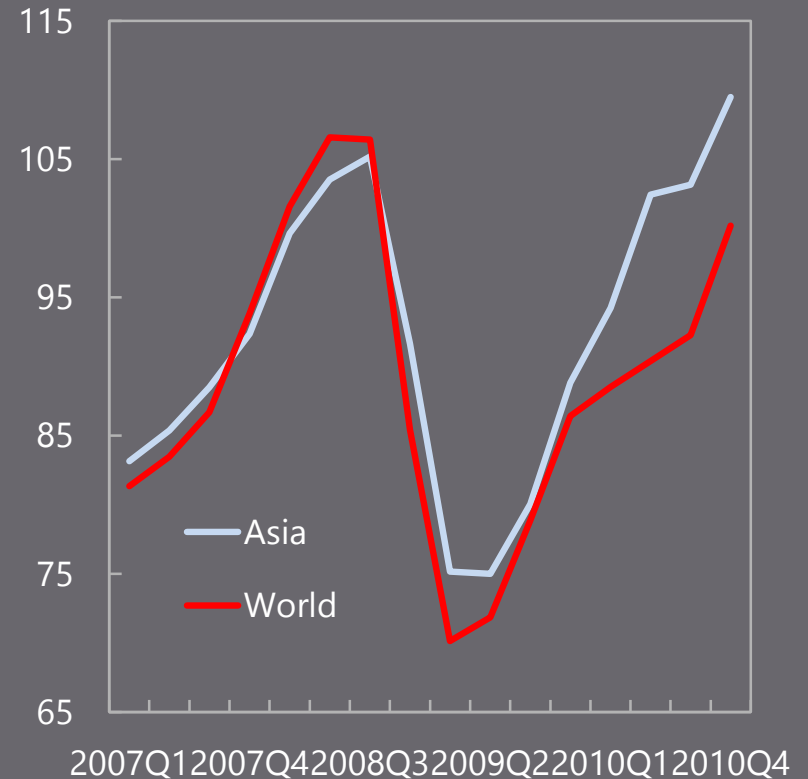
- ▣ Balanced view of financial developments since the Asian crisis: banks versus debt finance
- ▣ Uses indicators of financial development and cross country evidence: Asia has come a long way in terms of bond market development (with some caveats)
- ▣ Role of financial openness in speeding up financial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

# Large shock in 2008-2009

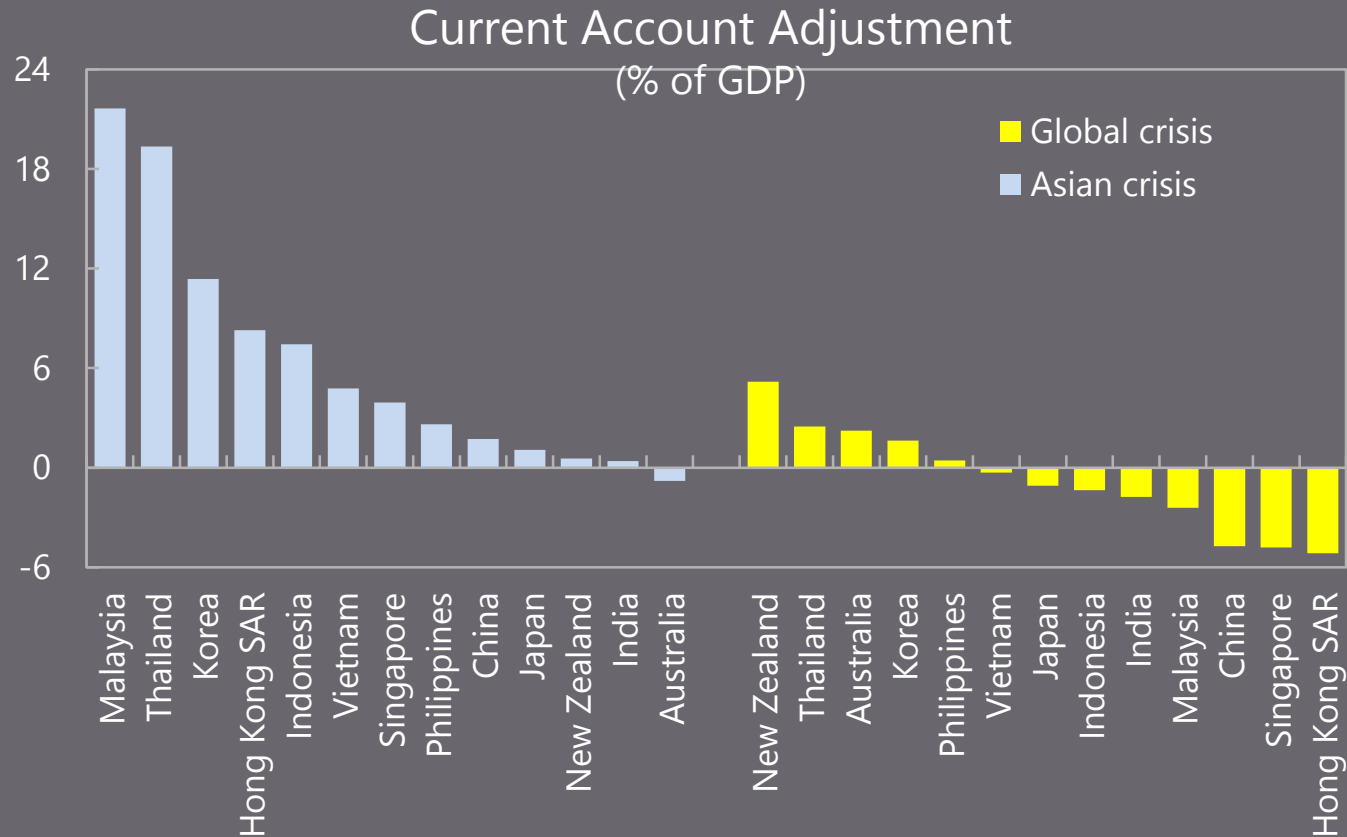
Advanced Economies: Real GDP  
(2008=100; Seasonally adjusted)



Global Trade and Asian Exports  
(2008 = 100)



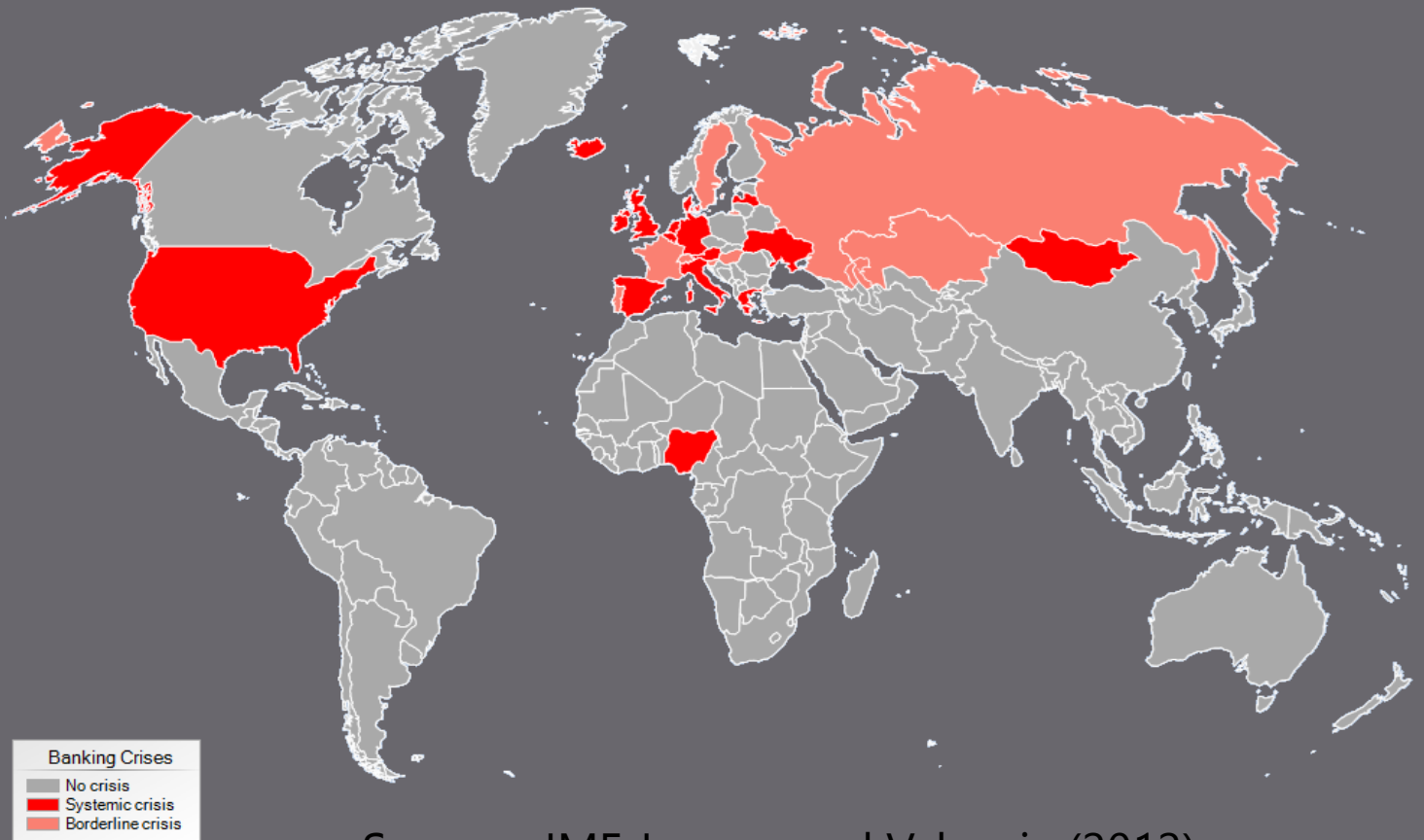
# Increased resilience (so far) : This time is different for Asia? No large current account adjustment in Asia. Different from 1997-1998



Difference between 1995-96 and 1998-99 averages for the Asian crisis, and between 2006-07 and 2009-10 averages for the global crisis. Sources: IMF, Direction of Trade Statistics and World Economic Outlook database; Laeven and Valencia (2012)

# This time is different for Asia?

Red means banking crises,  
very red systemic crises



Sources: IMF, Laeven and Valencia (2012)

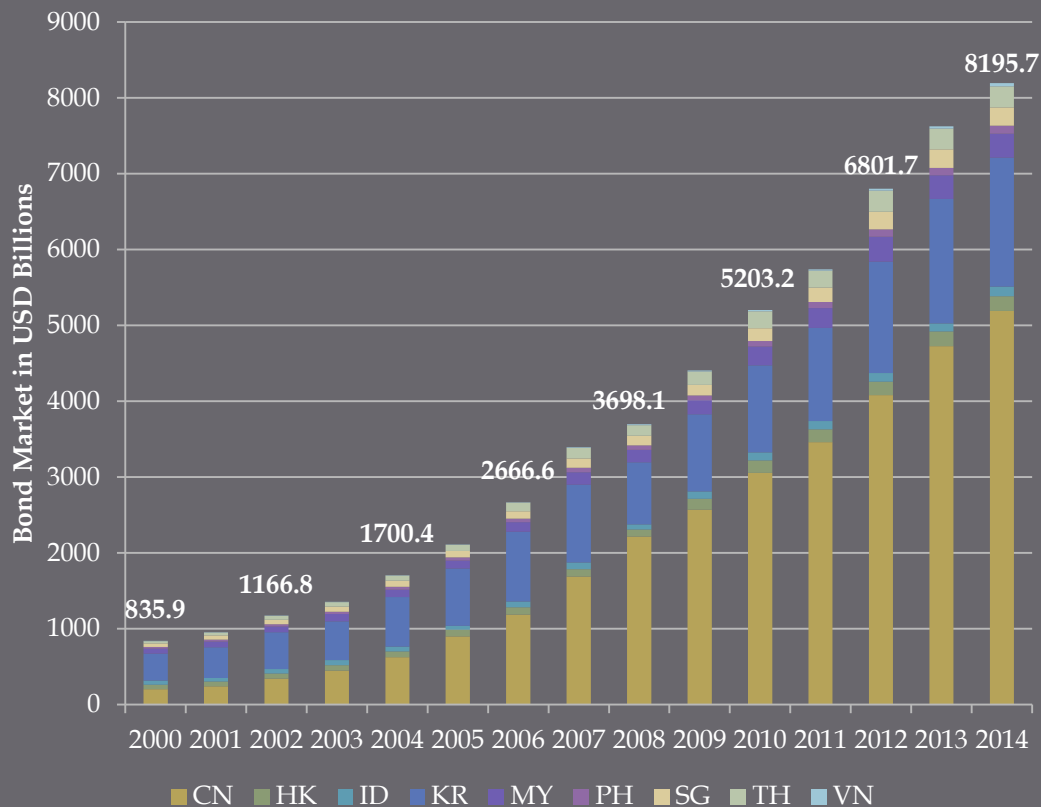
# What has changed?

- ▣ 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

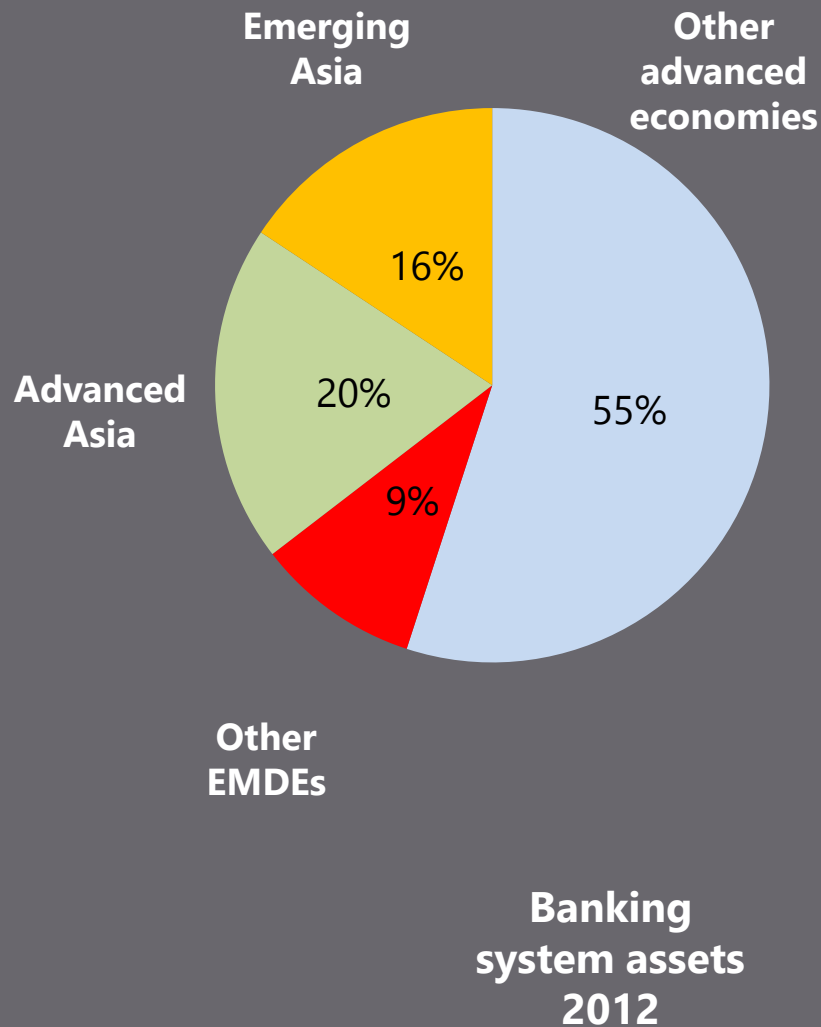
# Indicators of Financial Development

- ▣ “Quantity” based: outstanding stocks of local bonds, bond market cap to GDP ratios

Figure 1. Local Bond Market in Asia (ex. Japan)



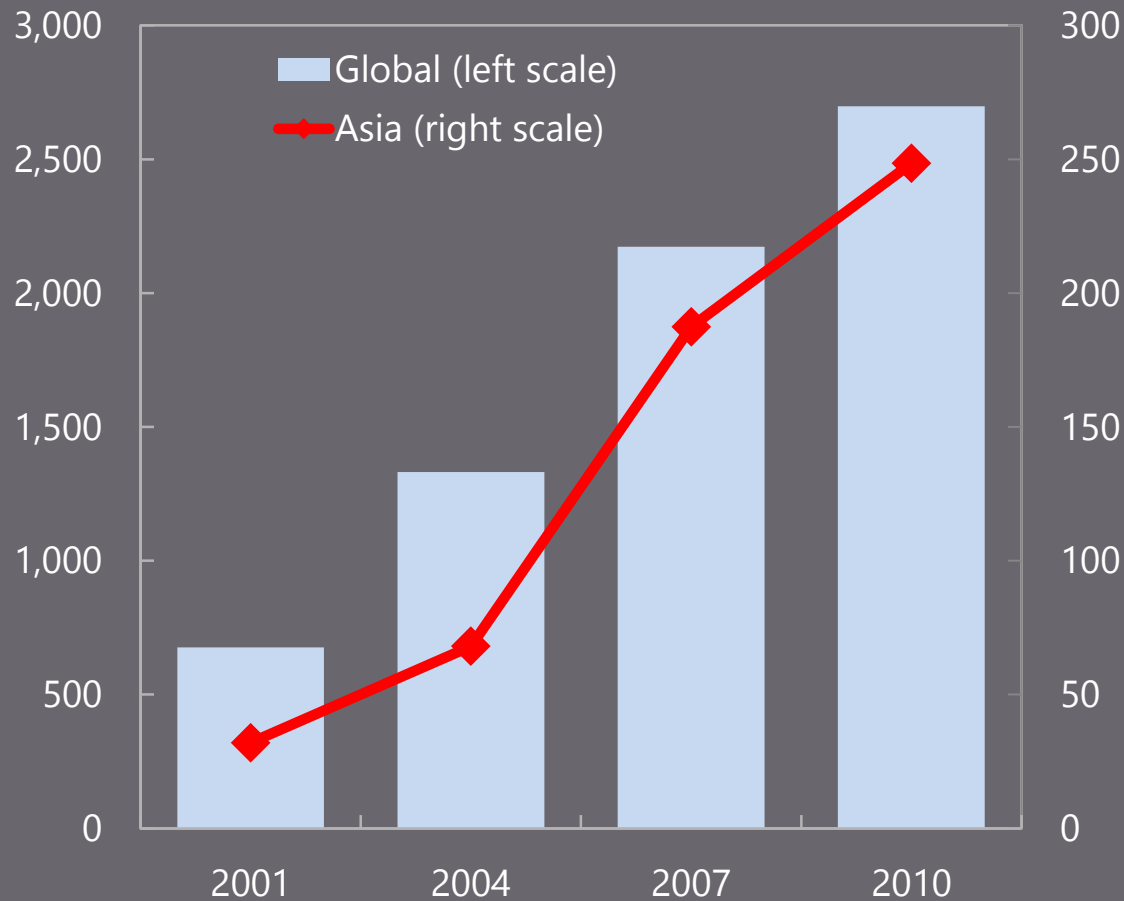
# Asia's Financial Sector – still small but growing ....





# Asia's Financial Sector – Derivatives markets are growing rapidly (from a low base)

Daily Turnover of OTC Interest Derivatives  
(In billion U.S. dollars)



# 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 dby financial corporations)

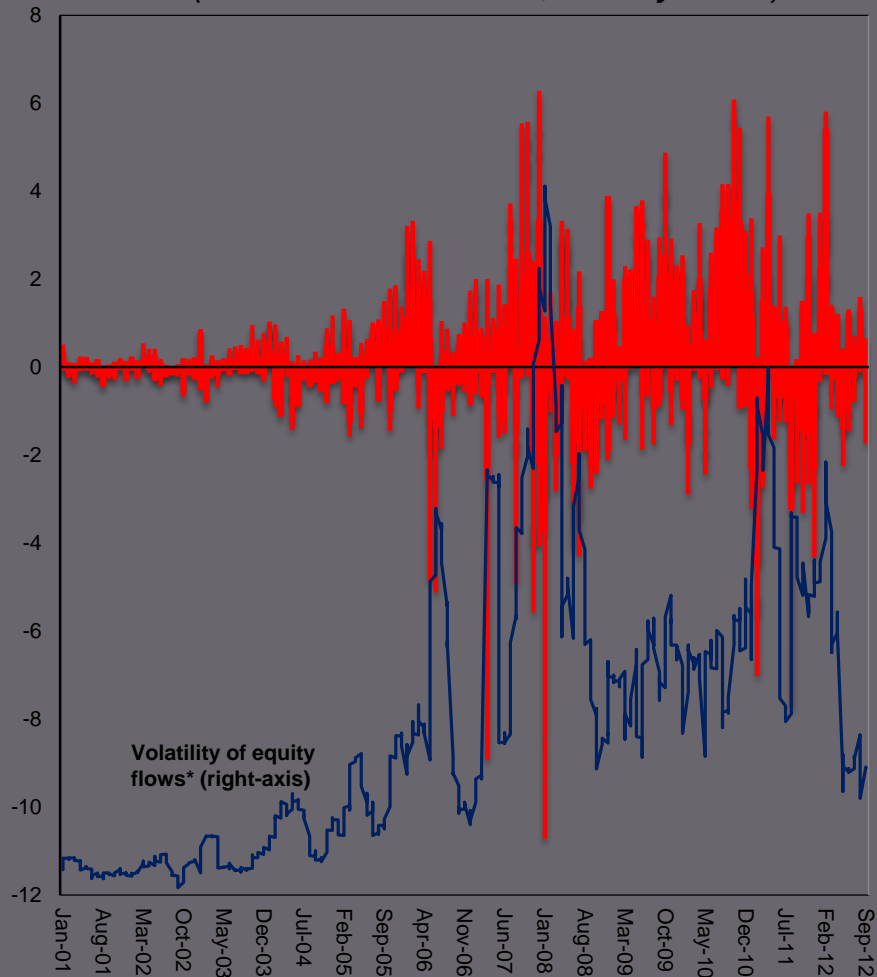
# Schizophrenia bis

- ▣ 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

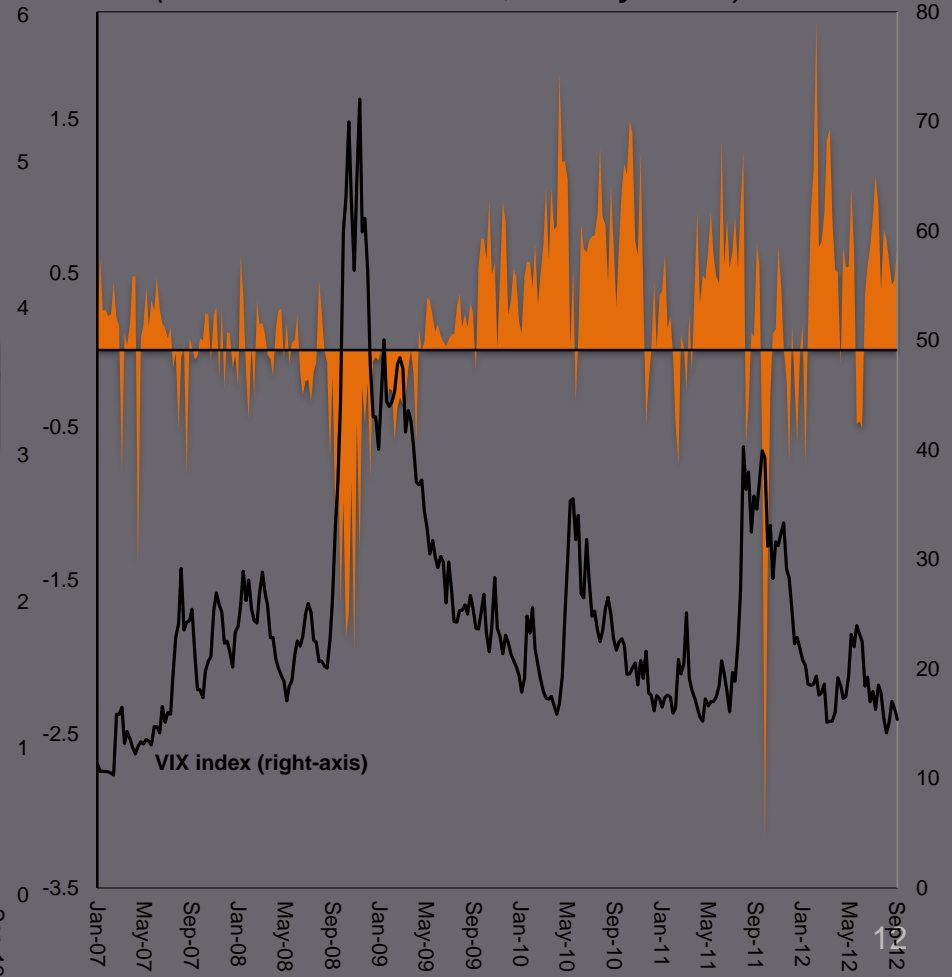
## Equity Funds

(billions of US dollars; weekly flows)



## Bond Funds

(billions of US dollars; weekly flows)



Source: EPFR Global.

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