Toward Greater Financial Cooperation in Asia

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Asian Experience in Financial & Monetary Cooperation

1. Liquidity Support and Management – Chiangmai Initiative (CMI)
2. Regulatory Cooperation/Coordination
3. Asian Reserves for Development

I - Brief History of Asian Cooperation & Integration

- 1992 – creation of ASEAN Free Trade Area
- 1997 – Asian Financial Crisis - proposal of Asian Monetary Fund (AMF) opposed by US/IMF
- Dec 1997- first ASEAN+3 meeting to explore regional econ & fin cooperation
- Thereafter yearly ASEAN+3 Finance Ministers Meeting
- Feb 1998 – ASEAN Surveillance Process

Asian Integration History

- Regular EMEAP (Executive Meeting of East Asia Pacific Central Banks)
- Established Asian Bond Markets Initiative (ABMI) in 2001
- 2001 - ASEAN+3 Economic Review and Policy Dialogue
- 2010 – AMRO (ASEAN+3 Macroecon Research Organization)-became legal international orgzn 2014 – econ surv

II - Liquidity Management - CMI

- 1997 Asian Fin Crisis -speculative attacks on currencies; failure of int'l fin institutions to assist Asia led to
- Regional reserve pooling cooperation – Chiang Mai Initiative (CMI) in 2000
- Pre-1997 facility of bilateral swaps of $200m raised to $1 billion

CMI went thru many changes since 2000

- It became multi-lateralized
- Fund size increased to $120
- Initially IMF conditionality 90% of drawn down

CMIM Swap Lines in Dec 2009

	Contributors	Contributions (US$ Billion)	Borrowing Multiplier	Borrowing Quota
1	Brunei	0.01	5	0.05
2	Kampuchea	0.12	5	0.60
3	PRC	34.2	0.5	17.10
4	Hong Kong	4.2	2.5	10.50
5	Indonesia	4.77	2.5	11.93
6	Japan	38.4	0.5	19.20
7	Korea	19.2	1	19.20
8	Lao PDR	0.03	5	0.15
9	Malaysia	4.77	2.5	11.93
10	Myanmar	0.06	5	0.30
11	Philippines	3.68	2.5	9.20
12	Singapore	4.77	2.5	11.93
13	Thailand	4.77	2.5	11.93
14	Vietnam	1	5	5.00
	TOTAL	**120.0**		**129.0**

Korean Experience Oct 2008

- Korea strong macro economic fundamentals but high ST external debt, free capital flows, high level of foreign equity & bond holdings
- Had $260 billion reserves – 6th largest in the world
- Spent $60 bn in few months to defend won but couldn't stop self-reinforcing vicious downward spiral with decline in reserves

Korean Experience

- Only $30 bn US swap line stemmed the confidence crisis
- Plus also had $30 bn bilateral swap lines each with PBOC and BOJ
- Why didn’t access CMIM?
- Why swap line with PRC and Japan outside of CMIM framework?

CMIM further boost in 2012 >

- Fund size doubled to $240 bn
- Non-conditionality increased to 30% in 2013 and 40% in 2014
- Length of swap maturity increased fr 3>12 mths (IMF portion); 3>6 mths (non IMF)
- Support period increased fr 2>3 yrs (IMF); 1>2 yrs (non-IMF)

Short-comings

- Why it has never been used despite Korea and Indonesia liquidity problems in 2008 financial crisis?
- Still a self-managed pool of reserves, process is lateralized but not facility
- Only commitment but no actual pyt
- Size still not adequate
- 60% borrowing quota still linked to IMF conditionality

Issues & Lessons fr CMI

- Recent imprvt in global econ environt reduced urgency for CMI
- Internal probs – small ctries want more but big econs not interested
- Practical issues unresolved – no pooling of reserves;only commitment
- Mechanism for use not clear
- Geo-political conflicts impact CMI

Issues & Lesson fr CMI

- So far it exists only as market confidence measure; never been tested
- AMRO - strengthened information sharing & dialogue btw policy makers

Suggestions

- Increase size of fund and draw-down quota
- Reduce conditionality quota
- Multi-lateralize approval process
- Strengthening AMRO critical
- Adequate duration of swap
- Diversify away from US$ swap line
- Adequate space for counter-cyclical
- Expand participating countries

III - Regional Coordination in Capital Controls ?

- Malaysia, Thailand & S. Korea introduced different degrees of capital controls with diffnt degree of success
- Countries exchange some information on capital control measures
- Such measures more effective if they are coordinated

Malaysia -Capital Account Controls 1998

- Ringgit pegged to US$ 1= 3.8
- Offshore ringgit a/c & trading banned
- Moratorium on repatriation of proceeds fr sale of securities
- All off-shore ringgit repatriated home
- Foreign currency borrowing by residents ltd to RM5mm equivalent
- Cap controls led to early econ stabzn

Thailand's experience Dec 2006

- Introd URR (unremunerated) reserve requirement) on foreign cap inflows
- 30% unremunerated deposit with central bank for all foreign funds except for trade and FDIs
- Full refund if funds held for > 1 year but only 2/3 refund if < 1 yr
- Led to stock mkt crash
- Early 2007 URR regulation removed

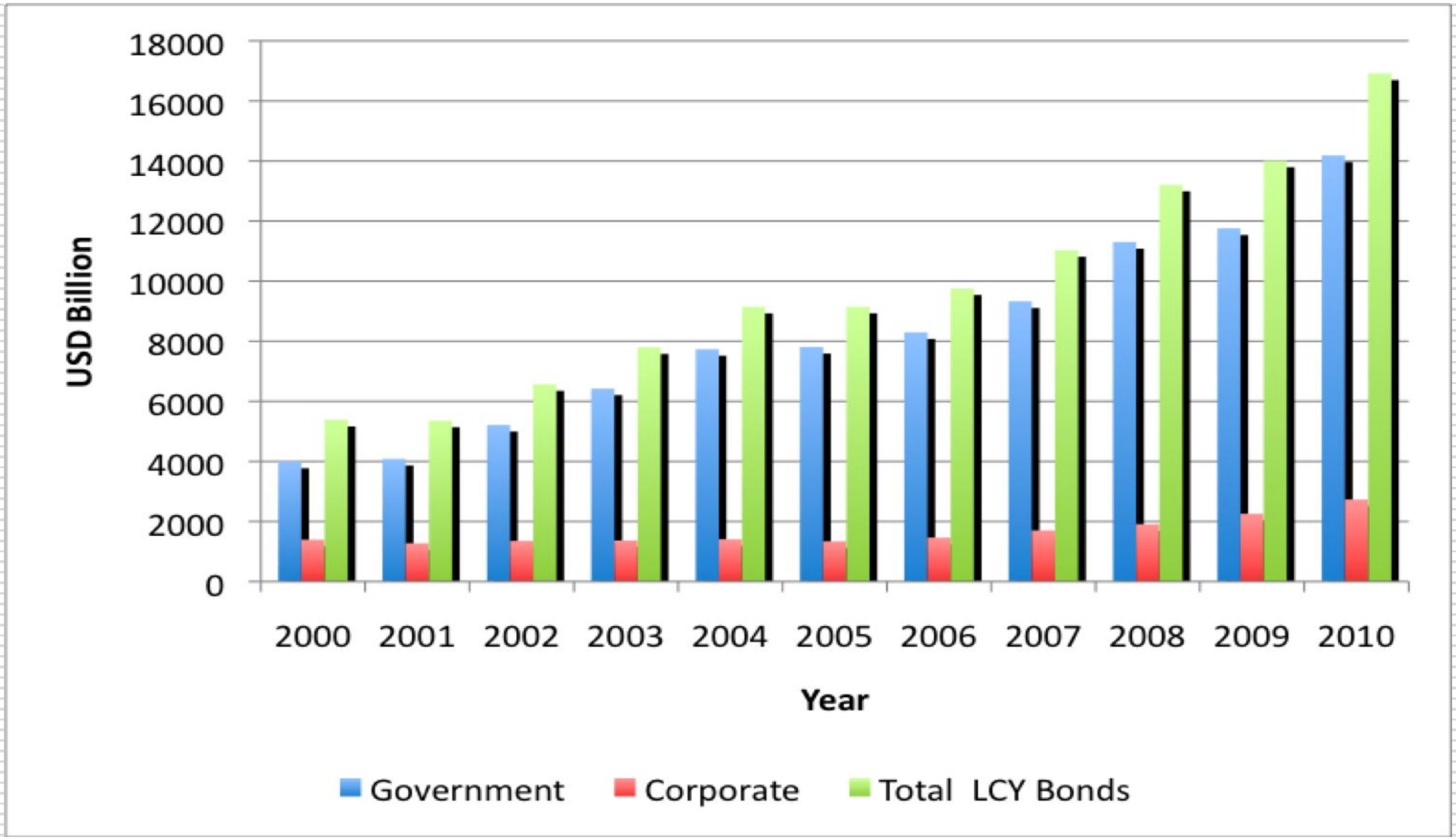
IV -Asian Local Currency Bond Markets

- Promoted as key element in financial deepening and integration
- Asian fin crisis – problem seen as Asia's over dep on bank financing
- Problems of Currency and maturity mismatch
- Local currency bond mkts seen as panacea
- Also to utilize vast Asian for reserves

Standard View of Bond Markets

“Financial integration, including the development of regional bond market, promotes more efficient allocation of resources, contributes to efficient price discovery… improves access to financial services, lowers cost for such services” (MAS, 2007)

Bond Markets Performance – 8 East Asian countries 2000-2010



Issues of Bond Markets – liquidity & effiency

- Trade-off btw liquidity of capital mkts & macro-econ & financial stability
- Vulnerability to sudden inflow & outflow
- Unable to regulate capital flows & exchange rates

Liquidity–Stability Trade Off

- Raison d'etre of cap mkts – liquidity
- ADB- common trading stds make it cheaper and faster for investors to **dip in and out of markets**
- Keynes – no such thing as liquidity for market as a whole. Liquidity is an individual investor concept not a system concept

Liquidity vs Stability

- Problem is exacerbated where investments are from foreign sources and recipient economies are small
- Divergence btw benefits of liquidity to investors but macro-economic costs to recipient countries i/t of financial and economic instability as evidenced in AFC and in recent GFC

Regional Long Term Credit and Development (LTCD)Banks

- Set aside small percentage of reserves to fund regional LTCD Banks
- Avoid problem of currency & maturity mismatch better, without volatility & instability of bond markets

Principles of LTCD Bank

- Promote long-term stable growth
- Government equity but professional and hands-off approach in operation, credit evaluation & loan allocation
- Should not follow fetish of Economic Value Added business model
- Propose socially acceptable rate of return

Principles of LTCD Bank

- Take long term view and adopt anti-cyclical policies e.g. build up reserves in good time and lending in difficult time
- More inclusive lending to small economies and SMEs unlike bond markets that just cater to big corporations

- **THANK YOU**