



# Financial Resilience & Stability in Asia

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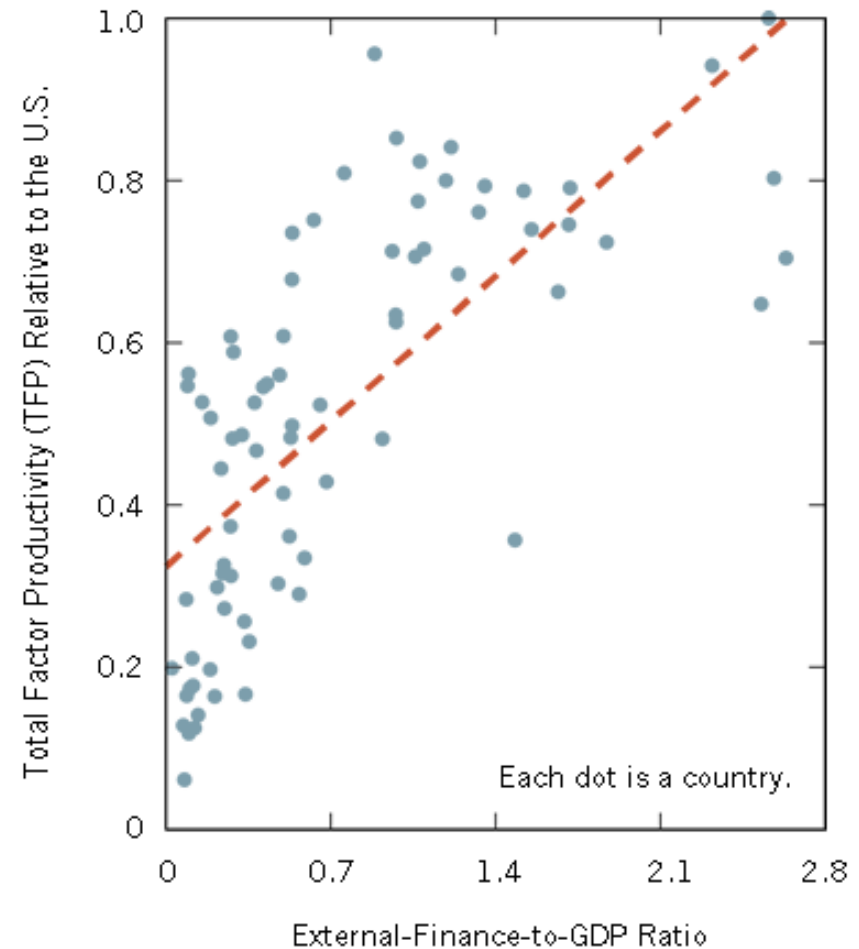
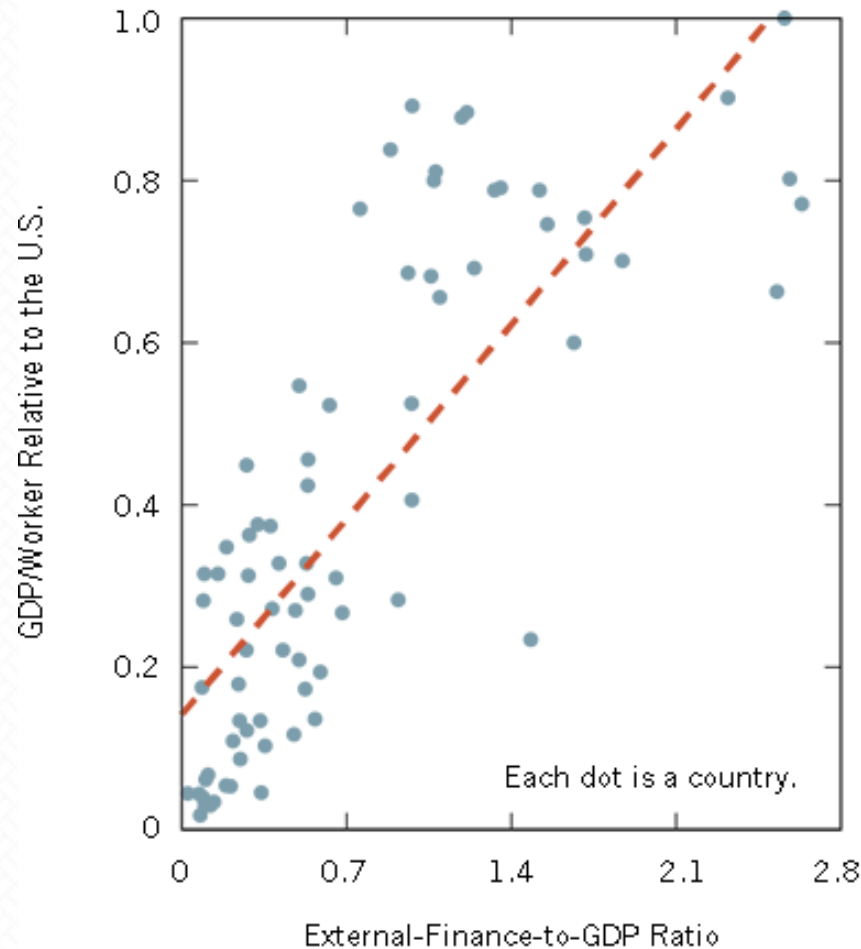
# Key Questions

- What must economies do to improve domestic financial resilience and stability?
  - What further reforms are needed to help this process?
  - How must the regulatory framework evolve to ensure further financial sector development without upsetting financial stability?
- How should financial institutions and markets reduce the key impediments to broader financial access?
- What are the primary international factors that affect financial resilience and stability?
- What are the opportunities and risks of divergent monetary policies—impending US tightening versus continued easing in Europe and Japan?
  - Can policy coordination play a significant role globally and regionally to promote financial resilience and stability?
- Are current financial safety nets adequate?
- Can macro-prudential policies and capital flow management measures mitigate the destabilizing impact of capital flows?

# How is finance connected to economic growth?

- Long history on whether economic growth leads finance or vice versa (Shumpeter vs. Robinson; Goldsmith, McKinnon & Shaw)
  - Now largely settled in favor of a positive relationship between a well-functioning financial system and growth (Rajan & Zingales; Buera et al)
- Channels for growth effects
  - Less costly matching of savers and investors
    - Better management of information asymmetries
    - Benefits of pooling
  - Possible effects on the size of savings and the return on investment
  - Reductions in risk that lower the volatility of growth
  - Allocation of risk to holders more desirous of holding it

# Firms with high external financing needs grow faster with deeper financial markets, in part because they have higher TFP



Source: Buera, Francisco, J Kaboski and Y. Shin, "Finance and development: A tale of two sectors." *American Economic Review*, August, 2011.

# Where does financial instability come from?

- Finance is the surrender by a saver/investor of value today for the promise of a greater (though riskier) value in the future
  - Information/expectations about the future are, therefore, always integral to the process; so are the cognitive/decision making biases of people
    - Herd behavior; loss aversion; money illusion; gambler's fallacy, etc.
- Financial innovation, like all innovation, is subject to Knightian uncertainty
  - It's not risk, which is quantifiable on the basis of past examples
  - CDO-Squared
- Experience matters—it is the basis for holding more informed views of the risks and of parsing information
- The costs of altering contracts and allocating losses affects stability and resiliency



## Local Financial Structure Issues

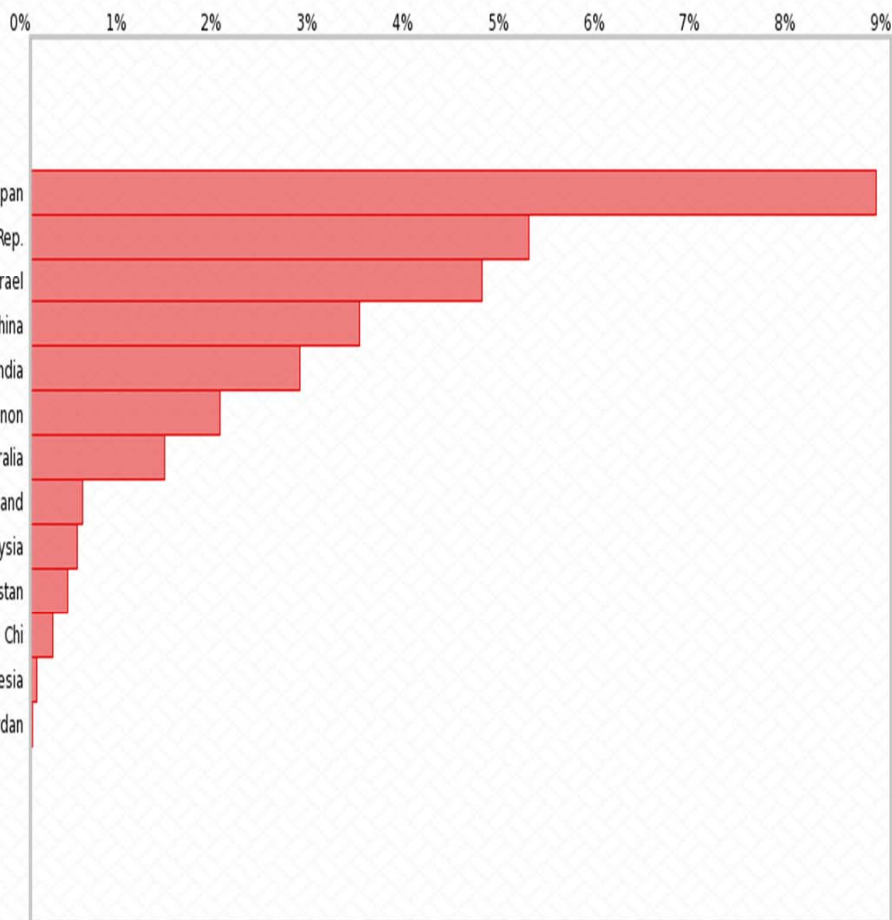
# What must economies do to improve domestic financial resilience and stability?

- If financial efficiency comes from balancing risks and returns, then regulation needs to ensure the this occurs
  - Greater availability of reliable information about investments, their returns and their risks
  - Minimizing principal/agent problems
    - Ensuring that intermediary firms maintain a franchise value so that the discipline of repeated games keeps intermediaries from taking excessive risks
    - Pricing explicit guarantees so as to avoid abuse of the put to taxpayers that comes with systemically important financial firms
- Since the future is uncertain:
  - Minimizing the costs of breaking and revising contracts; shrinking bankruptcy costs; facilitating moving capital and labor across different sectors of the economy

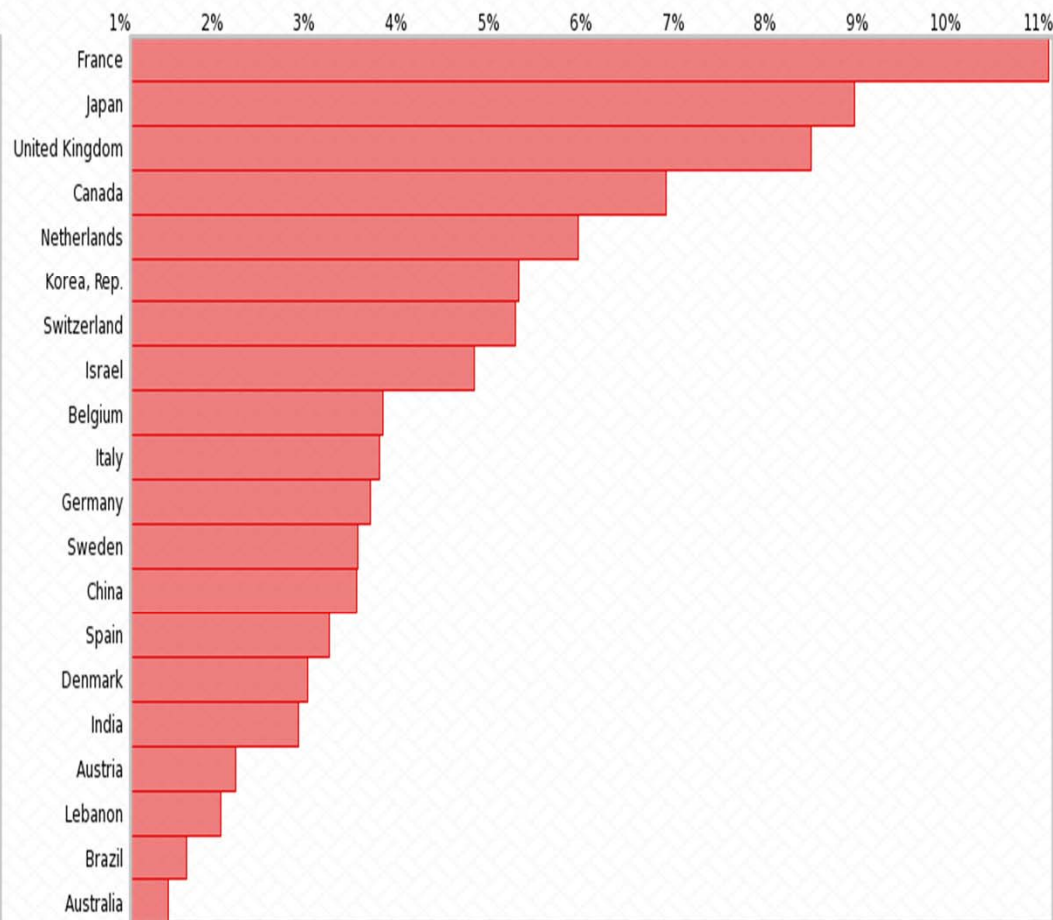
# Measuring System Risk of Loss Is a Means of Tracking Resiliency

## Systemic Risk of Loss by Country as a Share of GDP

SRISK / GDP



SRISK / GDP

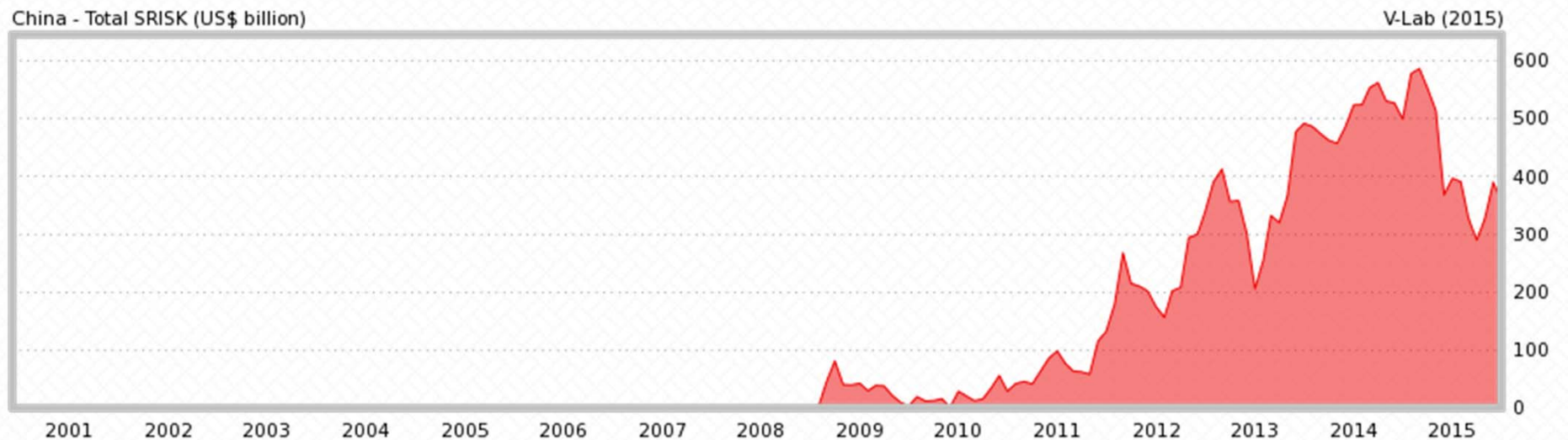
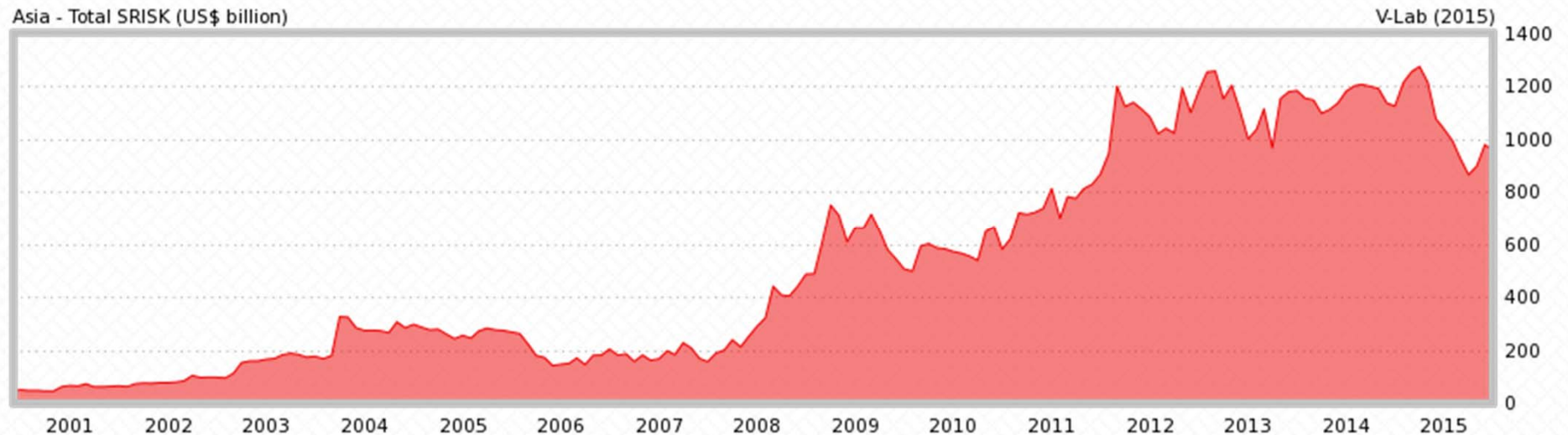


Source: V-Lab, NYU Stern, <http://vlab.stern.nyu.edu/welcome/risk/>

Note: For an explanation of the methodology see [http://vlab.stern.nyu.edu/public/static/capital\\_shortfall-2012.pdf](http://vlab.stern.nyu.edu/public/static/capital_shortfall-2012.pdf)



# Asia's Systemic Risk of Loss Has Tended to Decline Lately Driven by China



Source: V-Lab, NYU Stern, <http://vlab.stern.nyu.edu/welcome/risk/>

Note: For an explanation of the methodology see [http://vlab.stern.nyu.edu/public/static/capital\\_shortfall-2012.pdf](http://vlab.stern.nyu.edu/public/static/capital_shortfall-2012.pdf)

# There is Tremendous Scope to Benchmark

Economy	Getting Credit				
	Rank	Strength of legal rights index (0-12)	Depth of credit information index (0-8)	Credit registry coverage (% of adults)	Credit bureau coverage (% of adults)
Australia	4	11	7	0	100
Bangladesh	131	6	0	0.9	0
China	71	4	6	33.2	0
Germany	23	6	8	1.3	100
Greece	71	3	7	0	82.5
Hong Kong SAR, China	23	7	7	0	96.1
India	36	6	7	0	22.4
Indonesia	71	4	6	46.4	0
Italy	89	2	7	24.6	100
Japan	71	4	6	0	100
Korea, Rep.	36	5	8	0	100
Malaysia	23	7	7	56.2	78.6
Mongolia	61	5	6	32.7	0
Myanmar	171	2	0	0	0
Nepal	116	7	0	0	1
New Zealand	1	12	8	0	100
Pakistan	131	3	3	7.3	4.5
Philippines	104	3	5	0	11.3
Singapore	17	8	7	0	50.8
Spain	52	5	7	50	15.3
Sri Lanka	89	3	6	0	44.5
Switzerland	52	6	6	0	26.3
Taiwan, China	52	4	8	0	87.9
Thailand	89	3	6	0	52.7
United Kingdom	17	7	8	0	100
United States	2	11	8	0	100
Vietnam	36	7	6	41.8	1.4

Source: Doing Business 2015

# There is Tremendous Scope to Benchmark

Economy	Resolving Insolvency										
	Rank	DTF	Time (years)	Cost (% of estate)	Outcome (0 as piecemeal sale and 1 as going concern)	Recovery rate (cents on the dollar)	Commencement of proceedings index (0-3)	Management of debtor's assets index (0-6)	Reorganization proceedings index (0-3)	Creditor participation index (0-4)	Strength of insolvency framework index (0-16)
Australia	14	81.6	1	8	1	81.9	2.5	6	0.5	3	12
Bangladesh	147	29.49	4	8	0	25.8	2	2	0	1	5
China	53	55.31	1.7	22	0	36	3	5	2.5	1	11.5
Germany	3	91.78	1.2	8	1	83.4	3	6	3	3	15
Hong Kong SAR, China	25	75.06	0.8	5	1	87.2	3	2	1	3	9
India	137	32.6	4.3	9	0	25.7	2	3	0	1	6
Indonesia	75	46.75	1.9	21.6	0	31.7	3	5	0.5	1	9.5
Italy	29	71.29	1.8	22	1	62.8	2.5	5.5	2	2	12
Japan	2	93.74	0.6	3.5	1	92.9	3	6	3	2	14
Korea, Rep.	5	90.06	1.5	3.5	1	83.1	2.5	6	3	3	14.5
Malaysia	36	65.61	1	10	1	81.3	2	2	0	3	7
Mongolia	90	43.93	4	15	0	17.8	2.5	6	0.5	2	11
Myanmar	160	23.51	5	18	0	14.7	2	2	0	1	5
Nepal	82	45.41	2	9	0	43.7	2	4	1	0	7
New Zealand	28	71.56	1.3	3.5	1	83.6	3	3	0.5	2	8.5
Pakistan	78	46.18	2.7	5.6	0	39.4	2	3	0	3	8
Philippines	50	56.74	2.7	32	0	21.2	3	5.5	3	3	14.5
Singapore	19	77.94	0.8	3	1	89.7	3	4	0.5	2	9.5
Spain	23	75.89	1.5	11	1	71.3	3	6	2	1	12
Sri Lanka	72	47.81	1.7	10	0	42.4	2.5	3	0.5	2	8
Switzerland	41	63.1	3	3.5	0	47.6	3	4	1	4	12
Taiwan, China	18	78.41	1.9	4	1	81.8	3	5.5	0.5	2	11
Thailand	45	58.73	2.7	36	1	42.3	2	4	2.5	3	11.5
United Kingdom	13	82.04	1	6	1	88.6	3	5	1	2	11
United States	4	90.12	1.5	8.2	1	80.4	3	6	3	3	15
Vietnam	104	41.27	5	14.5	0	18.6	3	4	2	1	10

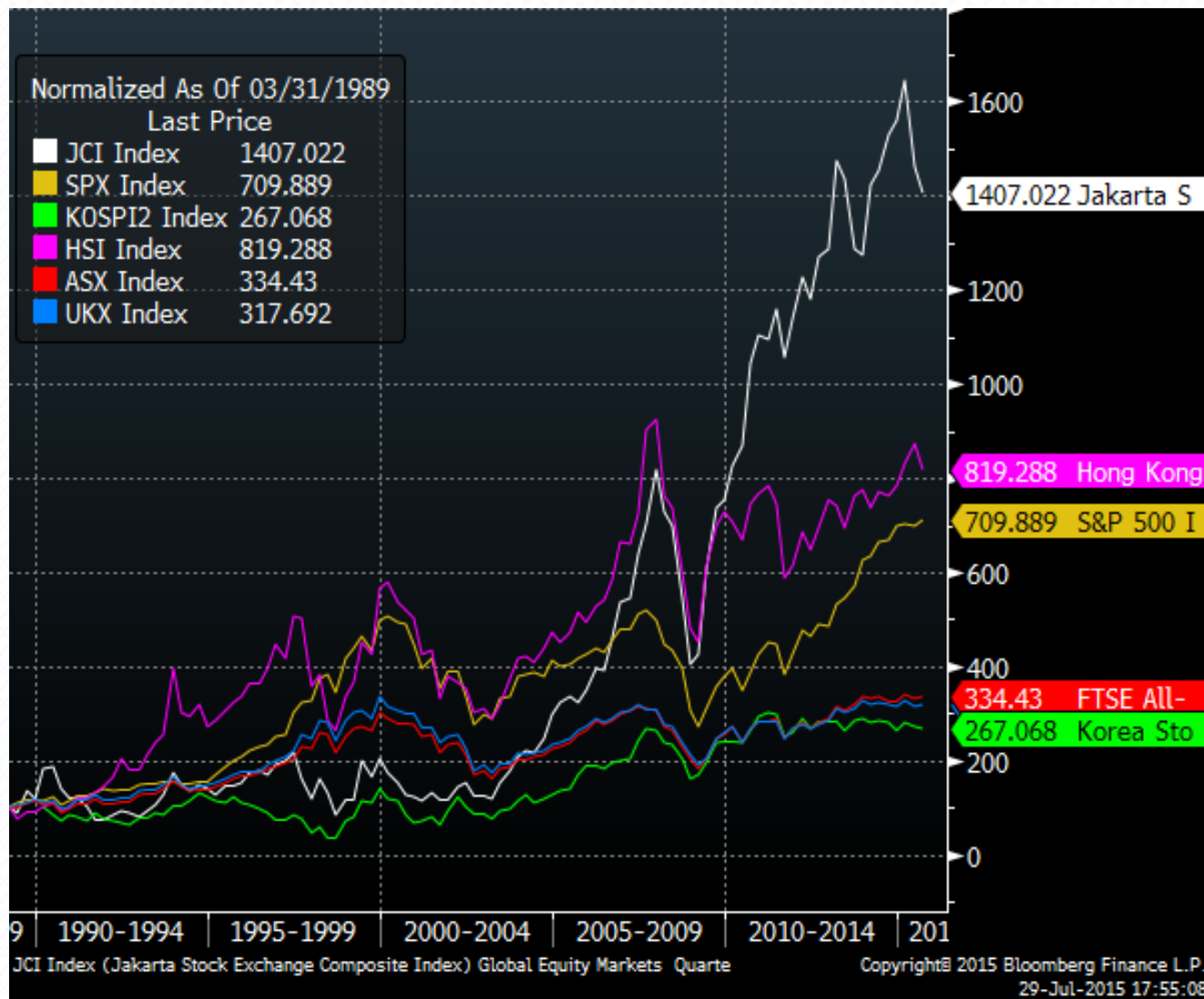
Source:  
Doing  
Business  
2015



# International Financial Structure Issues

# What are the primary international factors that affect financial resilience and stability?

- The degree of financial market integration/contagion



# What are the opportunities and risks of divergent G3 monetary policies? What is priced in to yield curves?

91) World Map		92) Refresh		Market Implied Policy Rates												
Regional		Policy				Implied Policy					Analyze 1Y		Range		Historical	
Country	Rate	Efctv	Basis	Meeting	3M	6M	1Y	2Y	3Y	Curve	Total Change 1Y	1Y Over 30 Days				
												Low	Range	High		
<b>1) Americas</b>																
10) United States	0.13	0.14	2	07/29	0.22	0.37	0.69	1.37	1.86		57		0.58		0.75	
11) Canada	0.50	0.52	2	09/09	0.44	0.38	0.41	0.74	1.09		-9		0.27		0.67	
12) Mexico	3.00	3.31	31	07/30	3.17	3.62	4.05	5.04	5.89		105		3.86		4.47	
13) Chile	3.00	3.00	0	08/13	3.01	3.00	3.19	3.93	4.18		19		3.11		3.53	
14) Colombia	4.50	4.38	-12	07/31	4.54	4.66	4.59	5.31	5.79		9		4.51		4.86	
<b>2) EMEA</b>																
20) Eurozone	0.05	-0.11	-16	09/03	0.04	0.04	0.04	0.14	0.35		-1		-0.02		0.08	
21) United Kingdom	0.50	0.46	-4	08/06	0.54	0.62	0.86	1.38	1.72		36		0.82		1.06	
22) Switzerland	-0.75	-0.74	1	09/17	-0.84	-0.82	-0.81	-0.59	-0.32		-6		-0.94		-0.80	
23) Norway	1.00	1.27	27	09/24	0.78	0.76	0.72	0.95	1.32		-28		0.71		0.78	
24) Sweden	-0.35	-0.24	11	09/03	-0.46	-0.38	-0.33	0.17	0.72		2		-0.34		-0.10	
25) Denmark	0.00	0.04	4	--	-0.35	-0.28	-0.21	0.14	0.32		-21		-0.48		1.13	
26) Czech Republic	0.05	0.30	25	08/06	-0.05	-0.09	-0.08	0.15	0.38		-13		-0.30		0.04	
27) Hungary	1.35	1.36	1	08/25	1.38	1.42	1.56	2.00	2.50		21		1.55		1.72	
28) Poland	1.50	1.72	22	09/02	1.45	1.42	1.48	1.83	2.14		-2		1.46		1.73	
<b>3) Asia/Pacific</b>																
30) Australia	2.00	2.00	0	08/04	1.88	1.80	1.78	2.01	2.32		-22		1.76		1.94	
31) New Zealand	3.00	3.00	0	09/09	2.75	2.65	2.61	2.90	3.06		-39		2.56		2.79	
32) Japan	0.08	0.07	0	08/07	0.07	0.06	0.05	0.07	0.13		-2		0.05		0.07	
33) China	2.00	2.46	46	--	2.01	2.01	2.08	2.18	2.46		8		1.64		2.20	
34) India	7.25	7.20	-5	08/04	7.34	7.31	6.91	6.98	7.06		-34		6.85		7.23	
35) Korea	1.50	1.64	14	08/13	1.45	1.41	1.44	1.64	1.80		-6		1.44		1.62	

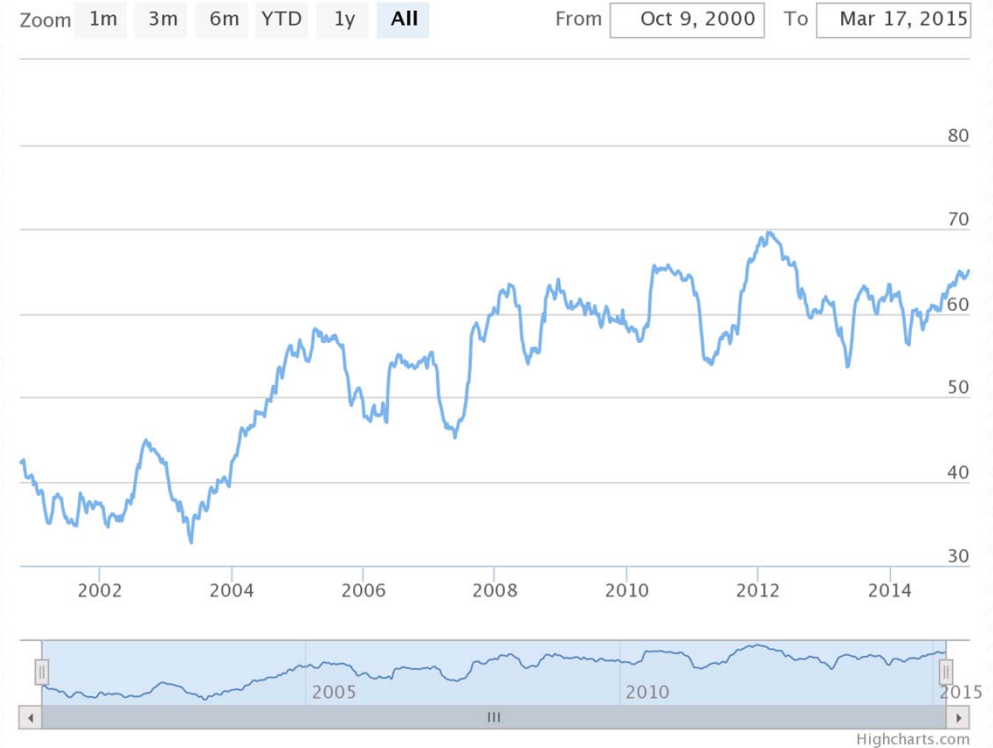
Source: Bloomberg; 29Jul2015 18:05 GMT+8

# Volatility Connectedness Can Help Avoid Surprises

Sovereign Bond Markets – Volatility Connectedness Index



Foreign Exchange Markets – Volatility Connectedness Index



Source: <http://financialconnectedness.org/index.html>



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