



Going regional: how to deepen ASEAN's financial markets

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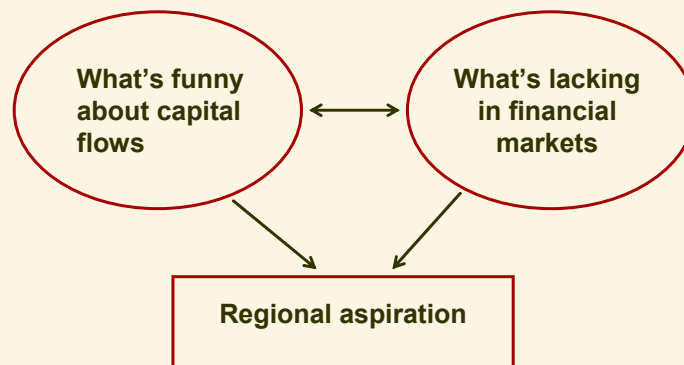


Going regional: how to deepen ASEAN's financial markets

- ❑ The recycling of Asian savings
- ❑ The downside of capital mobility
- ❑ The role of capital controls
- ❑ Financial market development in ASEAN countries
- ❑ Why regional instead of global?
- ❑ Three bold proposals



Capital flows and financial markets

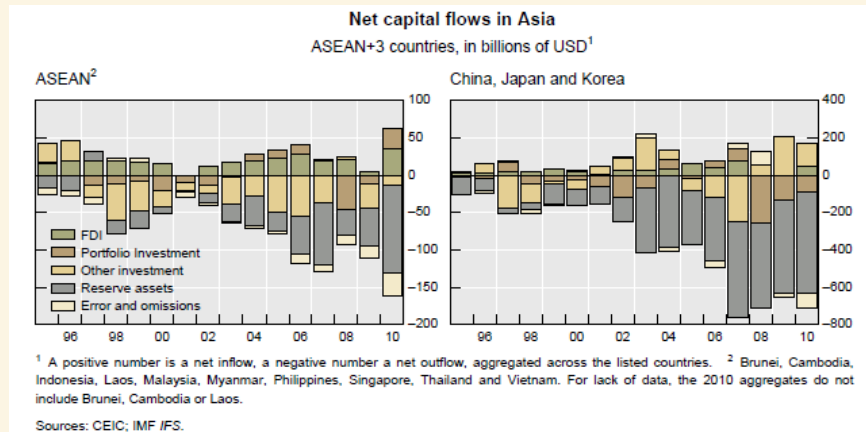


Capital mobility: theory and practice

- ❑ Theoretical benefits of capital mobility
 - ❑ Consumption smoothing
 - ❑ Risk diversification
 - ❑ Investment in countries with better projects
- ❑ The empirical reality: why dollars are not widgets
 - ❑ Feldstein-Horioka puzzle
 - ❑ Home bias puzzle
 - ❑ Lucas paradox
- ❑ The costs are very real
 - ❑ Procyclicality, sudden stops, current account reversals
 - ❑ Exorbitant global recycling of savings



What's funny about capital flows



Capital controls: what works in emerging Asia?

- ❑ Bautista and Francisco (2011) find capital controls are tricky
 - ❑ Differences in income levels matter
 - ❑ Restrictions reduce both debt inflows and outflows, reduce FDI inflows
 - ❑ Restrictions on FDI and equity outflows perversely increase these outflows
- ❑ They conclude:
 - ❑ Restrictions *not* first and only tool to use
 - ❑ Macprudential measures needed



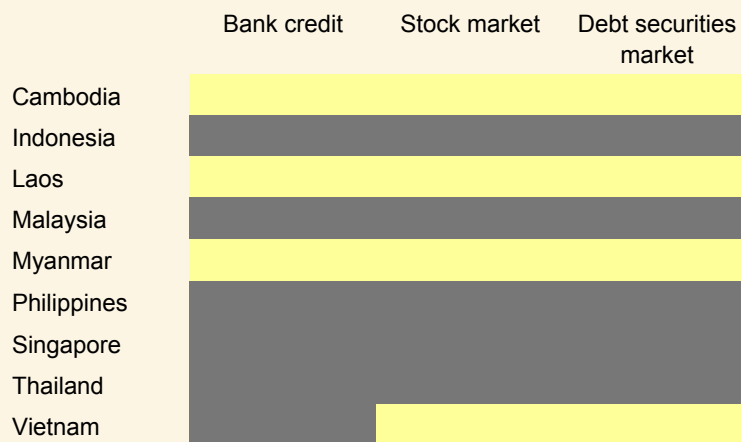
The ASEAN bond market agenda

- ❑ The ABMI's 2 goals
 - ❑ Develop local-currency bond markets
 - ❑ Develop regional bond market
- ❑ Task forces
 - ❑ TF1: Promote local-currency issuance
 - ❑ TF2: Expand demand for local-currency issues
 - ❑ TF3: Improve regulatory framework
 - ❑ TF4: Improve infrastructure
- ❑ The Credit Guarantee and Investment Facility



Financial deepening in ASEAN

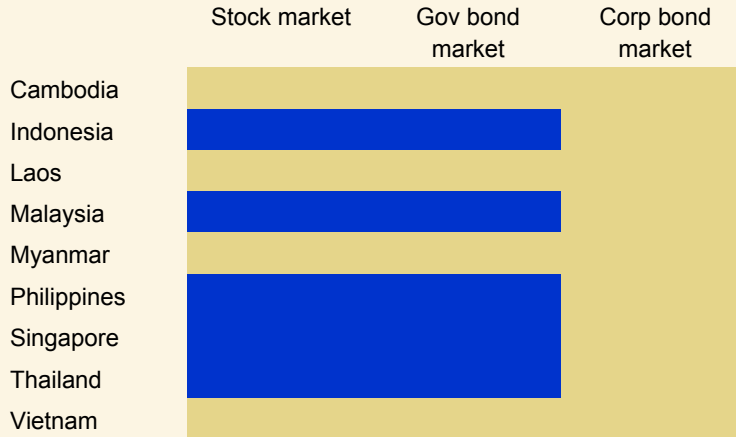
Sector size as ratio to GDP





What's lacking in financial markets?

Which ASEAN markets are deep and liquid?



Evidence of deep and liquid bond markets:

Interdealer voice brokers in government bond markets

Interdealer brokers

Indonesia	BNI, Danareksa, OSK
Malaysia	Affin (Tullet Prebon), Amanah Butler, Harlow's & MGI
Philippines	AFS, ICAP, Tullet Prebon
Singapore	ICAP, Tullet Prebon, Tradition
Thailand	ICAP, Wallstreet Tullet Prebon

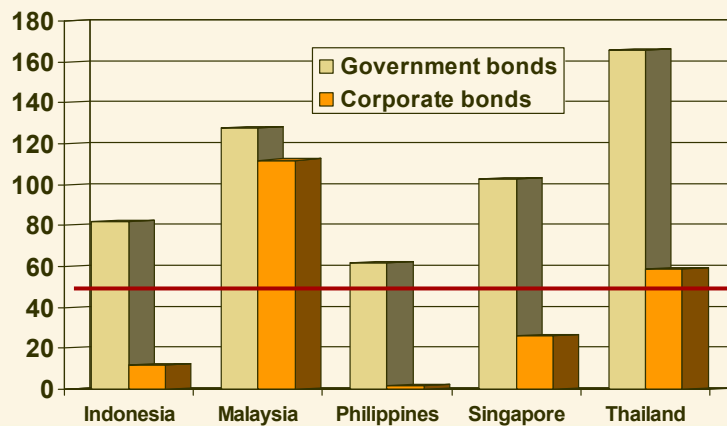


Markets are information networks: they need critical mass



Government bonds vs corporate bonds

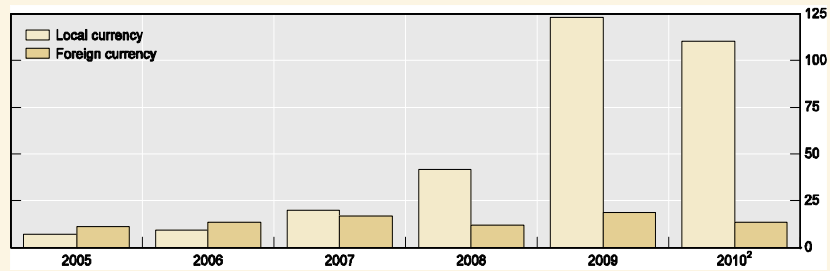
ASEAN 5, billions of US dollars, end 2010





The good news: corporate bond issuance in Asian emerging markets

52 large issuers, in billions of US dollars



Why regional instead of global?

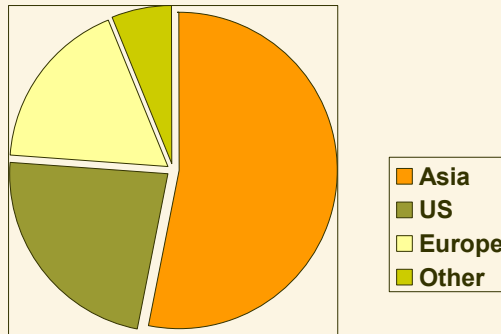
The geography of information versus network externalities

- Geography of information pulls towards localization of markets
 - Explains why gravity models work for capital flows
 - Explains home bias
- Network externalities pull towards regional and global markets
 - Critical mass essential for depth and liquidity
 - Components need to be compatible
 - History leads to lock-in effect



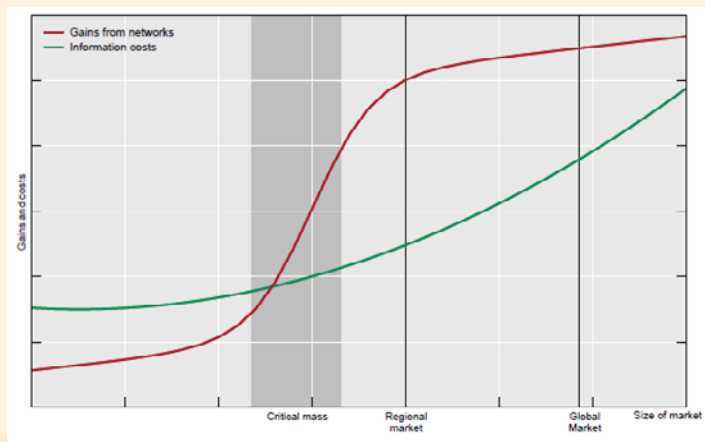
Home bias of investors

International bond issues by Asian corporate borrowers, 31 issues for total of USD17 billion, Jan-Aug 2011



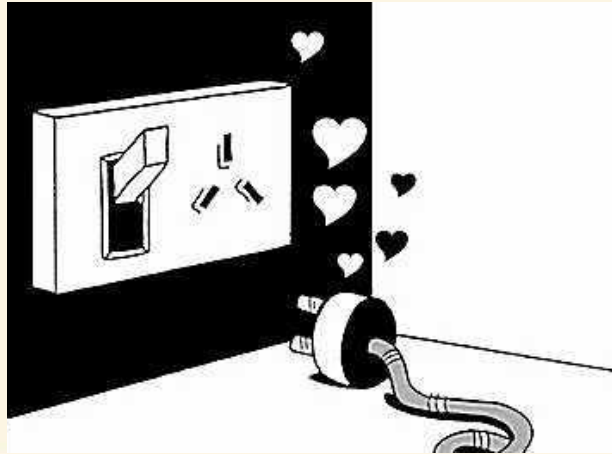
The big hypothesis: a regional sweet spot

The geography of information versus network externalities in corporate bonds





Going regional: connectivity requires compatibility



Three bold proposals

- ❑ Create ASEAN+3 zone of free capital mobility
 - ❑ An AFTA for capital flows
 - ❑ Harmonize macroprudential rules within zone
- ❑ Promote regional corporate bond market
 - ❑ Agree on common standards for issuance
 - ❑ Build central counterparty for regional CDS market
- ❑ Extend CMIM to regional repo market
 - ❑ Central banks to accept cross-border collateral
 - ❑ Operate CMIM as source of liquidity even without crisis