Going regional: how to deepen ASEAN’s financial markets

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Asian Development Bank
14 November 2011, Manila

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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

What’s funny about capital flows

What’s lacking in financial markets

Regional aspiration

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
  - Macroprudential 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

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<th>Country</th>
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### What’s lacking in financial markets?
Which ASEAN markets are deep and liquid?

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#### Evidence of deep and liquid bond markets:
Interdealer voice brokers in government bond markets

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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

- 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