Would the Integration of Asian Financial Markets Benefit From Regional Rating Agencies?

presentation at ADB on 24 July, 2006 by: Giovanni Ferri

[Chairman – Depart. of Economics – Bari University – Via C. Rosalba, 53 – 70124 Bari – Italy – email: g.ferri@dse.uniba.it]

SUMMARY

Why is the development and integration of financial markets in Asia progressing much more slowly than GDP growth and productive integration? The obvious answer is that Asia lacks yet either a single currency or a strong exchange rate agreement. But, as the Euro-zone experience tells us, reaching a monetary union may not suffice to secure private financial market progress. This suggests that other background factors affect financial development.

In this presentation, looking at Asia, we focus on the role of Credit Rating Agencies (RAs), nowadays perhaps the most important infrastructure to support financial markets. Specifically, we reach the conclusion that the progress of Asian financial markets would be enhanced by the development of one or more Regional Credit Rating Agencies (RRAs).

We start observing that, differently from the rest of the world, Asia enjoys the presence of several National Credit Rating Agencies (NRAs) alongside the global ones: Moody's, S&P and Fitch (GRAs). Drawing on ongoing research, we conclude that: (i) financial market development is positively correlated with the presence of NRAs; (ii) in four studied Asian countries, NRAs seem to complement rather than substitute GRAs, since NRAs specialize in rating smaller-sized/domestic-focused companies while GRAs concentrate on rating larger-sized/internationalized companies. Thus, in our view, the presence of NRAs may have already contributed to boost the extent of rated companies and financial market development in Asia, beyond what could be reaped based on GRAs only.

Next, we conjecture that Asian financial market development would be further enhanced by the presence of one or more RRAs. Our inference runs as follows. Firstly, we observe that the current Asian situation, based on the operation of several NRAs, is not entirely satisfactory because of two limits: (i-a) NRAs may not reach the degree of independence required to provide financial markets with high quality information on issuers and, accordingly, (i-b) NRAs' reputation is still sub-optimal; (ii) even when NRAs are independent and reputable, they assign ratings to national issuers according to country-specific scales, which makes NRA ratings little comparable across Asian countries, thus perpetuating the segmentation of national financial markets. Secondly, we posit that both of the mentioned NRAs' limits would be overcome by the inception of RRAs: (i-a) RRAs could be more independent since their ownership would not coincide with their market of operation; (i-b) the larger regional market would give RRAs stronger incentives – than for NRAs – to be reputable and provide high quality information on issuers; (ii) RRAs would assign ratings based on a region-wide scale, thus favoring Asian financial market integration.

Finally, we discuss possible ADB actions to promote the foundation of RRAs in Asia. Specifically, we envisage three actions. First, ADB could promote more thorough studies of NRAs' merits and limits, to make a stronger case for RRAs. Second, it could encourage Asian countries to utilize Basel II as a unique opportunity to favor a market-driven development of RRAs in the area. Third, ADB could eventually consider sponsoring the merger of some Asian NRAs.

JEL classification codes: G2, G3
Key words: national & regional vs. global credit rating agencies; financial market development in Asia.