

Financial Deepening in East Asia: What Have We Learned?

Raymond Atje and Widdi Mugijayani
CSIS Jakarta

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Outline

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- Financial Development in East Asia
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Background

- East Asia is a highly diverse region in terms of economic development, financial development, legal system, culture etc.
- Financial system evolves in the following order:
 - Banking system
 - Capital market
 - Bond market
 - Markets for derivatives
- In finance liquidity/size matters

Selected Financial and Economic Indicators (2008)

Country Name	Domestic credit provided by banking sector (% of GDP)	Market capitalization of listed companies (% of GDP)	Bond Market Capitalization (% of GDP)	GDP per capita (constant 2000 US\$)	GDP growth, 2000 - 2008 (%)
China	126	65	49	1,965	9.9
Hong Kong SAR, China	125	218	23	34,587	4.8
Indonesia	37	19	20	1,087	5.2
Japan	293	66	204	40,455	1.3
Korea, Rep.	113	53	112	15,447	4.8
Malaysia	115	84	93	5,151	5.6
Philippines	n.a.	31	32	1,225	4.9
Singapore	84	99	54	27,991	5.4
Thailand	131	38	57	2,640	4.7
United States	224	83	177	37,867	2.4

Source: BIS Statistics, Financial Structure Data and World Development Indicators

Finance – Growth Nexus (1)

- Financial development fosters economic growth:
 - It facilitates migration of funds from savers to the best users
 - It ensures investors against idiosyncratic risk and therefore encourage investors to invest in projects with higher returns
 - Well developed financial markets lower transaction costs and therefore encourage specialization; etc.

Finance – Growth Nexus (2)

- Empirical evidence:
 - King and Levine find positive correlations between GDP growth and various financial development indicators
 - Levine and Zervos find positive correlations between GDP growth and various measures of stock market development
 - Demirgug-Kunt and Maksimovic show that active stock market and well-developed legal system facilitate firms growth; etc.
- But, no conclusive evidence for causality to run from financial development to economic growth
- It is conceivable that the causality runs both ways

Financial Development in East Asia

- Banking sector still dominates financial intermediation in EA
- The banking sector is increasing more prudent as well as more efficient across EA
- Malaysia and Indonesia has introduced Sharia banking but the size is relatively small in both countries
- There is an increasing trend of firms turning to stock markets to raise capital
- Bond market is relatively young in some countries in the region

Selected Indicators of Financial Intermediation Development

Country Name	Domestic credit provided by banking sector (% of GDP)			Market capitalization of listed companies (% of GDP)			Bond Market Capitalization (% of GDP)		
	2000	2007	2008	2000	2007	2008	2000	2007	2008
China	120	132	126	48	184	65	15	44	49
Hong Kong SAR, China	136	125	125	369	561	218	26	25	23
Indonesia	61	41	37	16	49	19	31	19	20
Japan	309	294	293	68	102	66	126	199	204
Korea, Rep.	89	102	113	32	107	53	73	107	112
Malaysia	179	113	115	125	174	84	78	90	93
Philippines	67	46	n.a.	34	72	31	29	35	32
Singapore	89	78	84	165	212	99	42	55	54
Thailand	138	132	131	24	79	38	26	51	57
United States	201	241	224	155	145	83	145	172	177

Source: BIS Statistics, Financial Structure Data and World Development Indicators

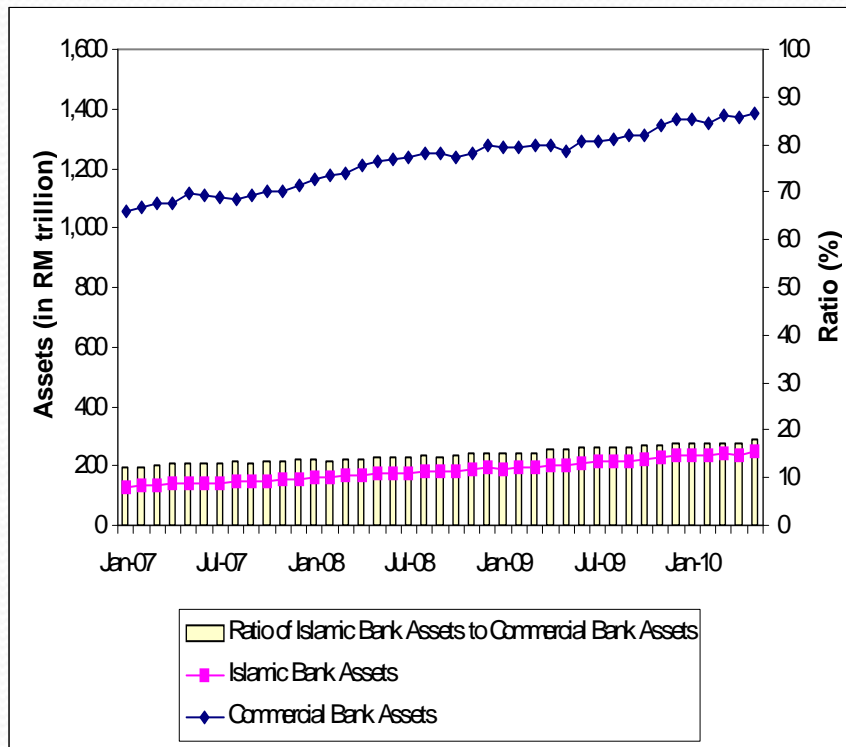
Selected Structural Indicators for the Asian Banking Sector (in percent)

Country Name	Non-Performing Loans			Capital assets ratio			Return on assets		
	2000	2007	2008	2000	2007	2008	2000	2007	2008
China	22.4	6.2	2.4	13.5	8.4	12.0	0.2	0.9	1.0
Hong Kong SAR, China	7.3	0.8	1.2	17.8	13.4	14.8	0.8	1.9	1.8
Indonesia	21.8	4.1	3.2	21.6	19.3	16.8	0.3	2.8	2.3
Japan	6.1	1.4	1.6	12.2	12.3	12.4	0.3	0.3	-0.2
Korea, Rep.	8.9	0.7	1.1	10.5	12.3	12.3	-0.6	1.1	0.5
Malaysia	15.4	6.5	4.8	12.5	13.2	12.7	1.1	1.5	1.5
Philippines	24.0	5.8	4.5	16.2	15.7	15.5	0.4	1.3	0.8
Singapore	3.4	1.5	1.7	19.6	13.5	14.7	1.3	1.3	1.1
Thailand	17.7	7.9	5.7	11.9	14.8	13.8	-0.2	0.1	1.0
United States	1.1	1.4	2.9	11.7	12.8	12.8	1.2	0.8	0.0

Source: IMF Global Financial Stability Report

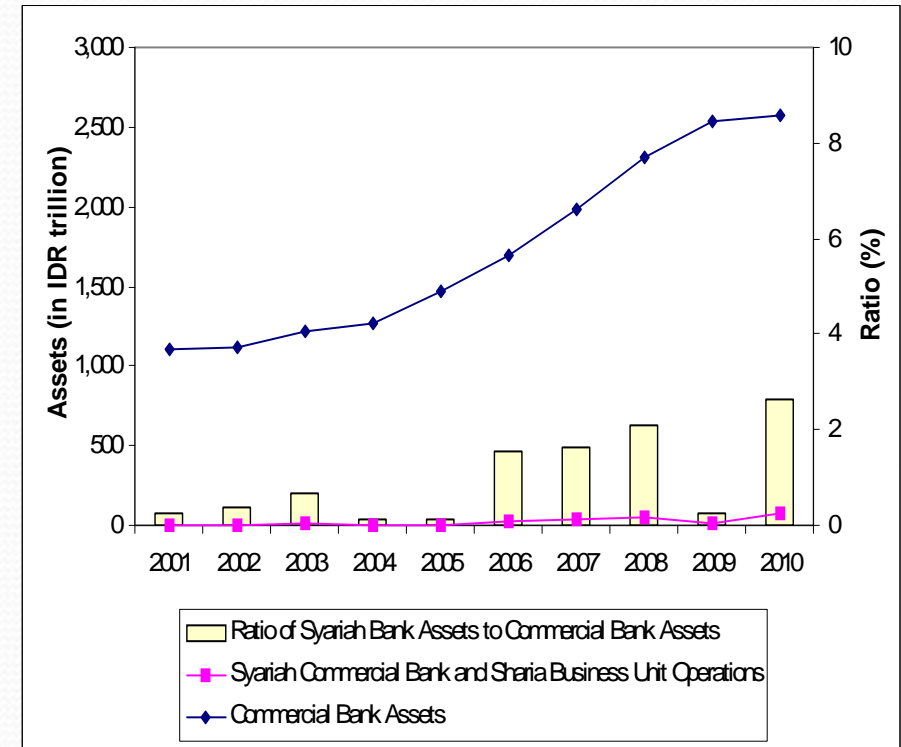
Sharia and Commercial Bank Assets in Malaysia and Indonesia

Malaysia



Source: Bank Negara Malaysia

Indonesia



Source: Bank Indonesia

Market Capitalization and New Capital Raised by share (in US\$ million)

	2009		P/E ratio		2006			2007		
	Market Capitalization	%	2008	2009	Initial public offerings	Secondary public offerings	Total	Initial public offerings	Secondary public offerings	Total
Shanghai SE	2704778.50	32.38	14.9	28.7	11817.7	4734.6	16552.3	57770.0	29395.5	87165.5
Hong Kong Exchanges	2305142.80	27.60	7.3	18.1	42972.4	24465.0	67437.4	37485.9	36541.4	74027.3
Shenzhen SE	868374.00	10.40	28.9	33.3	2029.1	3937.9	5967.0	5670.7	7405.6	13076.3
Korea Exchange	834596.90	9.99	9	23.7	2853.3	2473.3	5326.6	3170.0	3806.9	6976.9
Taiwan SE Corp.	657609.50	7.87	9.8	110.5	751.5	1361.0	2112.5	566.1	1550.2	2116.3
Singapore Exchange	481246.70	5.76	6.2	18.1	4800.2	924.1	5724.3	5159.8	4588.3	9748.1
Bursa Malaysia	286157.30	3.43	8.5	19.8	322.9	645.3	968.2	317.4	2157.5	2474.9
Indonesia SE	214941.50	2.57	12.6	15.0	364.9	1464.7	1829.6	1976.3	3446.5	5422.8
EAST ASIA EMERGING MARKET TOTAL	8352847.20	100.00			65912.0	40005.9	105917.9	112116.2	88891.9	201008.1

Source: World Federation of Exchange

Slow Development of Bond Market

- In some countries such as China and Indonesia bond market is relatively new
- But others such as Hong Kong and Singapore have well-developed bond market.
 - Eichengreen and Leungnaruemitchai identify a number of factors that inhibit the growth of bond market in Asia:
 - Many economies in the region are relatively small
 - Failure to adhere to international accounting standard
 - Corruption
 - Low bureaucratic quality

Way Forward (1)

- East Asian countries should continue to develop their financial sector
 - They should aim at developing well-regulated competitive financial systems. This requires:
 - Improvement in regulatory systems in which market operates and in the provision of information to market participants
 - Reasonably-developed legal system that protect minority shareholders, among other things
 - High standard accounting system in place

Way Forward (2)

- They should also allow foreign competition because it tends to raise the standard of domestic institutions
- They should also allow domestic firms to have access to global capital markets.
- But it requires strong domestic financial institutions and stable macroeconomic condition to minimize the adverse effects of such openness
- Openness may also lead to migration of local firms to international financial centers such as New York or London
- Q: should every economy regardless of its size aim at developing the entire range of financial institutions including stock markets or should it be more selective?
- What would be the guiding principle?