Asian Banking in Challenging Financial Times

On June 25, 2009, the Federal Reserve Bank of San Francisco held a symposium entitled “Asian Banking in Challenging Financial Times.” The symposium was part of the Country Analysis Unit’s Asia Program, which aims to share information on issues and developments in Asian financial sectors with business and community leaders in the 12th Federal Reserve District and more broadly. This Asia Focus provides a brief summary report on the discussions held at that symposium. A complete video record of each of the panel sessions is available at: http://www.frbsf.org/banking/asiafocus/events/2009/0625/index.html.

The Economy: Projections and Issues for Asian Growth

Throughout the symposium, speakers noted that the origin and impact of the financial crisis has been very different in Asia than in the West. In Europe and the US, it has been both a financial and economic crisis, beginning with the seizing of capital markets that originated with subprime-related complex financial products, the collapse of housing prices and the ripple effect of financial market instability on employment, business, and trade. In Asia, on the other hand, banks did not generally hold significant subprime-related instruments and they were not seriously affected by the initial wave of credit market turmoil in the US and Europe. Asian countries were not drawn into the global crisis until the failure of capital markets impacted macroeconomic conditions, making it difficult for Asian exporters to both finance their trade and sell to Western countries hit by recession.

From the viewpoint of many symposium participants, Asian economies appear to be recovering from the worst effects of the current financial crisis—for Asia ex-Japan, GDP growth in the first half of 2009 was approximately 4%. Although slowed from peak levels, growth in China and India has remained positive throughout the current period. While other Asian economies have experienced more pronounced impacts, the region is beginning to see signs of improvement. For example, even in Taiwan and Korea, where industrial production fell significantly as global trade declined, inventories have stabilized to the point where these sectors are poised to return to positive growth. Across Asia, economies have benefited not only from limited subprime-related exposures, but also from aggressive monetary policies and strong, directed government spending.

While inflationary pressures eased in Asia ex-Japan during this period, they are expected to begin rising in the second half of 2009 as the recovery takes hold. In line with this forecast, several Southeast Asian central banks have announced an end to policy rate cuts and have started to unwind other measures implemented at the height of the crisis. For example, a number of governments are discussing plans to phase out increases in deposit insurance coverage. By mid-2010, symposium speakers said, policy rates are expected to rise as inflationary pressures increase.

While GDP measures are showing signs of recovery, several symposium speakers highlighted uncertainties about Asian economic growth models. To some symposium attendees, this crisis suggests that the export-driven growth model—with its reliance on the US and EU as primary markets for Asian goods—may not be sustainable. Increasing domestic sources of demand in high-growth China, as well as in the other markets in Asia, could help to balance the export-driven growth of recent years, with less volatile, domestically driven demand.

The Banking Sector in Asia

Speakers noted that, overall, Asian banks’ conditions and prospects, with the notable exception of Japan’s mega banks, have been improving since the beginning of 2009. For example, bank stock prices have risen, and CDS premia are dramatically lower, reflecting renewed market confidence gained, in part, from prompt government actions taken to address the present crisis. Asian governments—like others around the world—moved quickly to provide liquidity to banks and to develop programs to ensure capital ade-
quacy at institutions in need. In Korea, new foreign currency debt was guaranteed, in large part to address the significant role of such debt in funding operations of Korean banks and manufacturing companies. Other temporary steps taken by Asian central banks include the expansion of deposit insurance coverage, the imposition of short-sale restrictions, and the relaxation of mark-to-market rules early in the crisis. Banking sectors in three countries—Japan, Singapore, and China—were considered in greater detail at the symposium.

**Japan**

Over 50% of Japan’s GDP is export dependent and the slowdown in global trade has adversely affected both GDP and Japanese banks in the current recession. For the first time in six years, the three mega Japanese banks were unprofitable; collective net losses totaled US$12 billion for the fiscal year ended March 31, 2009. Losses have come both from provisions for credit losses and from equity portfolio losses, and there is some concern that rising levels of NPLs will continue to put pressure on bank earnings. However, assets tied to US subprime markets have not contributed significantly to asset quality issues for Japanese banks.

The business model for the largest Japanese banks remains one of the biggest hurdles to recovery in the years ahead, according to several speakers and participants. Although major Japanese banks have had recent successes in raising capital and have maintained their loyal and stable individual and corporate deposit bases, symposium speakers acknowledged the problem of traditionally low profitability among Japanese banks. Combined with higher capital requirements that could result from the global impetus toward macro-prudential supervision, low profitability would depress returns on equity. Consequently, banks in Japan are making greater efforts to generate fee income by offering corporate customers services such as investment banking that are needed to support global market expansion.

**Singapore**

In Singapore, market indicators provide strong evidence that the reforms initiated after the 1997-1998 Asian Financial Crisis have created a banking sector capable of performing well in strained financial markets. In particular, risk management policy changes initiated after 1997 have led to banks being capitalized well above regulatory minima, with historically low NPL ratios and robust net interest margins. A strong government stimulus package aimed at small- and medium-sized enterprises has also been an important factor in stabilizing business and banking activity beginning in 2008. Although the Singapore economy is continuing to contract—one speaker projected GDP would decline 6% in 2009—local banks have been able to boost lending and build their local customer bases.

**China**

Banking indicators in China remain relatively positive at present, with robust levels of loan loss provisions and continued profitability. However, the Chinese banking sector faces risks stemming from the loan growth that has accompanied the large government spending package announced in November 2008. According to China’s central bank, RMB lending increased 7.37 trillion yuan (US$1.1 trillion) in the first half of 2009, which is roughly three times the amount of new credit issued during the first half of 2008. As of June 30, 2009, RMB lending totaled 37.7 trillion yuan (US$5.5 trillion), reflecting a year-on-year rise of 34.4%. Symposium speakers suggested that the Chinese banking sector may be somewhat complacent about the future performance of these new loans, as many banks seem to have made an implicit assumption that the government will cover some portion of future loan losses. Moreover, this complacency could stifle momentum among banks to make additional governance and risk management reforms in the near term. Chinese banking sector regulators have begun tightening guidelines on loan loss coverage ratios and capital levels to address these concerns.

**Conclusion**

Symposium participants noted that today’s global financial crisis did not begin in Asia and Asian banks were mostly insulated from the initial impact of the crisis. However, the subsequent financial contagion and contraction in economic activities in the US and EU severely hurt Asia’s export-driven economies. Asian banks were not immune from those effects. At the same time, Asian banks entered the current financial crisis following a decade of improving fundamentals, in large part as a result of reforms implemented following the 1997-1998 economic crisis. The current financial crisis challenges both public and private sector constituents to develop new approaches to further strengthen financial system architecture and regulatory oversight.
Welcoming Remarks

Teresa Curran
Group Vice President, Banking Supervision and Regulation, Federal Reserve Bank of San Francisco

Opening Keynote Address

Michael Mussa
Senior Fellow, the Peterson Institute for International Economics

Panel I: Impact of the Global Financial Crisis on Asian Economies

David Fernandez
Managing Director, JP Morgan (Singapore)

Stephen Lumpkin
Principal Administrator, Financial Markets and Policies, Financial Affairs Division, OECD

Robert Madsen
Senior Fellow, MIT Center for International Studies

Dana Green (moderator)
Director, Banking Supervision and Regulation, Federal Reserve Bank of San Francisco

Panel II: Asian Banking in a Global Recession

Sally Davies
Section Chief, International Banking and Finance, Board of Governors of the Federal Reserve System

Jason George
Senior Financial Sector Specialist, Financial Stability Institute, Bank for International Settlements, Representative Office for Asia/Pacific

Walter Yao (moderator)
Senior Manager, Banking Supervision and Regulation, Federal Reserve Bank of San Francisco

Panel III: Asian Banks: A Closer Look

Yoshiaki Kawamata
CEO for the Americas, Bank of Tokyo-Mitsubishi UFJ

Charles Ong
General Manager, Overseas Chinese Banking Corporation

Wang Jun
Lead Financial Sector Specialist, East Asia and Pacific Region, the World Bank

Nick Hope (moderator)
Director, the Stanford Center for International Development

Closing Remarks

Masaaki Tanaka
President and CEO, Union Bank

Contacts: Walter Yao (walter.yao@sf.frb.org) and Nkechi Carroll (nkechi.carroll@sf.frb.org)
Written by: Chris Sigur
SAVE THE DATE!

June 7 & 8, 2010

Global Recovery:
Asia and the New Financial Landscape

A two-day conference examining trends and issues that will impact banking and financial sectors both in Asia and in the United States. Specifically, we will take an in-depth look at the opportunities, and challenges for Asia as the global economy emerges from financial crisis. Participants at this upcoming conference will share their views on Asian economies in the context of the global recovery, the role of Asian financial markets, regulatory reform and what that could mean for Asia, the new landscape for banking, and a range of additional timely topics specific to Asia.