Global Recovery: Asia and the New Financial Landscape

On June 7 and 8, 2010, the Federal Reserve Bank of San Francisco’s biennial Conference on Asian Banking and Finance considered the “Global Recovery: Asia and the New Financial Landscape.” The Conference is the fourth in a series begun in 2007 to examine the role of Asia in global finance.

This Asia Focus report provides highlights of perspectives on the global financial crisis that were shared at the conference by Asian and American banking regulators, financial policy makers, corporate leaders, and representatives from international finance organizations. Conference participants discussed the global and regional policy environment that has emerged since the crisis, examined regulatory responses, and considered banking sector concerns as the region continues to recover. While the conference covered issues in many countries in Asia, this report focuses on two—Australia and Korea—whose regulatory framework and policy decisions were described as having lessened the economic impact of the crisis and contributed to their more rapid return to growth.

The complete record of the conference—including handouts and audio recordings of all speakers and Q&A sessions—is available at the following URL: http://www.frbsf.org/banking/asiasource/events/2010/0607.

Crisis and Recovery

Conference presenters recognized that the international coordination of monetary policy and fiscal stimulus helped mitigate the contagion effects of the global financial crisis. They also pointed out the need for closer collaboration between central banks and governments during non-crisis periods, to help prevent crises from occurring.

Speakers acknowledged that the global economy is currently in recovery, but that efforts to unwind stimulus policies must be implemented with caution. The timing of government and central bank efforts will be critical; tightening too early risks choking off a nascent recovery, while providing stimulus for too long risks sparking inflation. One speaker noted that policymakers should be ready to respond with stimulus efforts should tail risks reemerge that could slow the economic recovery.

Speakers noted that the global financial crisis effectively ended discussion of Asia’s “decoupling” from the US and EU markets. Most specifically, lingering sluggishness of demand in developed economies has slowed Asia’s recovery. As one speaker observed, however, the crisis also invigorated discussion, especially in China, of the need to modify the fixed investment and export-led model that has been the engine of Asian growth since the end of World War II.

The new model shifts investment away from capital-intensive export-oriented industries, toward labor-intensive consumption and services sectors. The model—to be revealed, according to this speaker, later in 2010 before being codified in China’s 12th Five Year Plan—addresses several economic and social development challenges in China, which were exacerbated by the global financial crisis. Using fiscal, monetary, and social policy tools, the model aims to provide incentives to rural areas to promote development and to address income disparity relative to urban areas. Several speakers commented that these policies are intended to build a stronger social safety net—including enhanced programs for social security, private pensions, medical care, and unemployment insurance—all of which are expected to expand consumption by decreasing the precautionary savings bias.

Regulatory Perspectives

Asian bank regulators suggested that one reason banks in the region fared relatively well through the crisis compared to their Western counterparts is the general “vaccination effect” that resulted from exposure and response to the 1997–1998 Asian financial crisis.
Japanese regulators also highlighted some of the steps taken during their banking crisis earlier in the decade. These steps included quickly identifying bad assets, removing them from bank balance sheets, and providing injections of public money to spur credit expansion. Japan was also an early adopter of the Basel II framework which strengthened bank capital and limited Japanese banks’ exposure to the toxic assets that damaged Western institutions during the current crisis. Legislatively, Japan introduced a crisis management framework that provides for capital injections, the temporary nationalization of banks, unlimited deposit protection, and, if necessary, an ex-post levy on financial institutions to recover costs of these measures.

The large scale and cost of the global crisis illustrate the need for stronger and more effective regulation. Speakers noted several points to consider in the context of the Basel Committee’s global financial reform agenda being proposed in the wake of the crisis, especially with regard to global capital and liquidity standards. First, it is vital that the definition of Tier 1 capital is clear and provides some flexibility. One speaker noted, for example, that some banks’ Tier 1 capital could drop substantially unless adequate flexibility is incorporated into the definitions. Only when clear and appropriately flexible definitions are agreed upon can minimum levels for capital and liquidity ratios be determined. Finally, ample lead time must be built into the implementation phase of any new standards.*

Regulators also spoke of improving corporate governance in various ways including direct regulatory requirements regarding the composition of boards of directors, clear compensation guidelines for management, and active supervisory roles in the appointment of banks’ senior management.

Banking Industry Views

The smooth functioning of global trade, direct foreign investment, and capital and equity markets depends on large financial corporations that have the management skills and asset size to attract the capital and to take the risks necessary for growth, an Asian policy maker noted. Asian bankers, on the other hand, acknowledged that Asian banks are not yet able to play that role. One speaker suggested that the regional financial sector (ex-Japan) remained at the developmental level equivalent to that of the United States at the end of World War II. The retail banking model remains prevalent in Asia, limiting the development of bond and equity markets, and more sophisticated securitized asset markets. One industry observer stated that Asia generally has an “underdeveloped risk-taking capacity” reflected in the fact that American and European investors are the most active participants in equity offerings by Asian companies.

Bankers echoed regulators in expressing caution about the timing of the implementation of Basel III initiatives. Capital requirements are less of a worry for Asian banks because local regulatory capital standards have typically been higher than those in more developed countries. One speaker did, however, express concern about the possibility of inter-country arbitrage should global standards not be implemented in a coordinated fashion.

Australia’s Effective Policy Development

The Australian effort to control the national impact of the global recession was presented as a case study of an effective policy program. Australia’s economy has continued to grow during the crisis period, jobs have been added, and the financial system has remained stable. An Australian policy maker attributed this success to the following fiscal, monetary, and regulatory policy factors:

- Australia strengthened its financial regulatory framework in the 1990s in response to a banking crisis in the early part of the decade by creating an integrated regulator with authority over the banking and insurance industries. The central bank remains the locus of monetary policy and is responsible for systemic stability.

- The country’s “four pillar” banking system, dating in its current form to 1997, legally prevents the merger of any of the four largest banks—the National Australia Bank, the Commonwealth Bank of Australia, Westpac Bank, and the Australia and New Zealand Bank (ANZ). The system enforces the regulators’ stated goal of balancing stability and competition in the banking sector, and helps address moral hazard and “too big to fail” issues.

- The government established its credibility in the market by adhering to a “timely, targeted, and temporary” framework in the fiscal policy actions it took. An example cited was the special purpose vehicle, OzCar, created to maintain credit in the auto loan market serviced mostly by foreign banks.

*The Basel Committee on Banking Supervision announced on September 12 a substantial strengthening of capital requirements which, together with a global liquidity standard, will be implemented gradually, starting January 1, 2013.
The federal government also guaranteed bank deposits, underwrote wholesale funding by banks, and guaranteed state government borrowing.

**Korea’s Integrated Supervisory Model**

Like Australia, Korea’s financial regulatory regime has evolved since the late 1990s into an integrated supervisory model, a Korean policy maker said. The Asian financial crisis of 1997 and 1998 had a major negative impact on the Korean economy. Reforms related to fiscal and monetary policy authority and bank supervision have been ongoing since then. Throughout this period, the main focus of regulatory reform in Korea has been on improving information sharing and building collaborative relationships among policy, regulatory, and supervisory agencies, in order to create a more systemic view of risks to the financial sector.

By early 2008, financial policy and regulatory oversight for banking, insurance, and the securities industries were housed together in the Financial Supervisory Commission (FSC). The FSC works with the Ministry of Strategy and Finance and the Bank of Korea to coordinate fiscal, monetary and financial regulatory policies, but is independent from those institutions. Supervision of financial institutions is carried out by the Financial Supervisory Service (FSS), a non-governmental agency supporting the FSC.

Regulators at the conference generally agreed that Korea’s integrated supervisory model succeeded in achieving its objectives: information sharing, policy coordination, and the promotion of best practices across market and industry segments thereby raising overall supervisory standards.

**Conclusion**

The conference highlighted a number of reasons why global economic and financial policy makers and regulators pay close attention to developments in Asia. First, the Asian financial crisis of the late 1990s triggered reforms that helped Asian banks and economies weather the recent crisis and relatively quickly put their economic and financial systems back on a path to growth. Second, conference discussants emphasized the notion that decoupling is no longer a valid concept—Asia does not function independently of other markets. Asian economies cannot avoid the impact of downturns in Western markets and, perhaps more importantly, the international coordination of fiscal and monetary policies to address financial and economic crises must involve Asia as a key player. Finally, and partly due to the global crisis, Asian economies are pursing new growth models which, as in the case of China, are directed at boosting consumer demand, lessening dependence on exports, growing the services sector, and enhancing the social safety net. Those new growth models will have important trade and investment effects both in Asia and across the world.

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JUNE 7

Master of Ceremonies - Steve Hoffman, Executive Vice President, Federal Reserve Bank of SF

Janet Yellen, President, Federal Reserve Bank of San Francisco
Welcoming Remarks

Lunch Keynote Address: The Honorable Tharman Shanmugaratnam, Minister for Finance, Singapore

Stephen Roach, Chairman, Morgan Stanley, Asia
Asian Economies and the Global Recovery

Pedro Rodeia, Director for Asian Financial Institutions, McKinsey & Co.
Asian Financial Sector – The Changing Landscape

Atsushi Saito, President and CEO, Tokyo Stock Exchange
Asian Equity Markets: Strengths, Vulnerabilities and Future Direction

GLOBAL FINANCIAL SUPERVISION

Stephen Cecchetti, Economic Advisor and Head of the Monetary and Economic Department, Bank for International Settlements
Current Efforts to Enhance Global Financial Supervision

Joo Hyun Kim, Secretary General, Financial Services Commission (Korea)
Regulatory Responses and Lessons Learned in Korea

Alvir Alberto Hoffmann, Deputy Governor, Central Bank of Brazil
Regulatory Responses and Lessons Learned in Brazil

Closing Address: Lael Brainard, Under Secretary for International Affairs, U.S. Dept. of the Treasury

JUNE 8

Master of Ceremonies - Teresa Curran, Group Vice President, Federal Reserve Bank of SF

Justin Lin, Chief Economist & Senior Vice President, The World Bank
Paths to Recovery

Gordon de Brouwer, Deputy Secretary Economic, Domestic Policy Group, Department of the Prime Minister & Cabinet, Australia
Australia and the Crisis: Lessons Learned

Jesse Wang, Executive Vice President & CRO, China Investment Corporation, in conversation with Larry Greenwood, Vice President Asian Development Bank

PANEL I – A Discussion with Asian Banking Regulators

Teo Swee Lian, Deputy Managing Director, Monetary Authority of Singapore

Tatsuo Yamasaki, Deputy Commissioner for International Affairs, Financial Services Agency (Japan)

Bandid Nijathaworn, Deputy Governor, Bank of Thailand

Eli Remolona (moderator), Chief Representative for Asia and the Pacific, Bank for International Settlements

PANEL II – A Conversation with Asian Banking Leaders

Piyush Gupta, CEO, DBS Group Holdings

Jaime Zobel de Ayala, CEO, Ayala Corp

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