



Challenges in Global Finance: The Role of Asia

On June 11-12, 2012, the Federal Reserve Bank of San Francisco (FRBSF) held its fifth Conference on Asian Banking and Finance in San Francisco, entitled “Challenges in Global Finance: The Role of Asia.” Launched in 2007, this biennial conference series brings together prominent policy makers, bankers, regulators, commentators, and analysts to consider the current and future global economic and financial climate through an Asian perspective. This year, conference participants discussed how the ongoing economic and financial uncertainties in Europe will impact the Asian economies, banking sectors and trade flows, and how Asian banks and financial institutions themselves are addressing these issues.

While the conference covered a wide range of topics, this *Asia Focus* summarizes underlying themes discussed over the two days. The complete record of the conference proceedings, including video recordings of all speakers and Q&A sessions, is available at:

<http://www.frbsf.org/banking/asiaprogram/events/2012/0611/agenda.html>

Asian Banks’ Resilience to External Shocks

While Asian banks do not have significant direct exposure to the ongoing crisis in Europe (hereafter referred to as the “Eurocrisis”), most Asian regulators and bank executives at the conference expressed concern about secondary effects transmitted through the real economy, particularly through trade linkages. An economic slowdown in Europe could dampen trade flows with the region, which would also slow growth in export-oriented Asian economies and affect foreign capital flows. It was noted, for example, that Singapore’s trade figures dropped by approximately 30% month-on-month after the Lehman crisis. In particular, some

speakers were concerned that weaker trade flows would have a disproportionate impact on small- and medium-sized exporters, which tend to rely more heavily on banks for credit and access to working capital. The trickle-down effect of a European crisis would impact the operating environment of the Asian banks, despite their high levels of capitalization. While the conference speakers generally conceded that the European crisis will affect Asia, they stated that the magnitude and precise areas of impact are uncertain.

Some regulators opined that Asian banks would be inherently able to withstand a Eurocrisis shock because their business models are different from those in the United States and the European Union. Asian banks are mostly rooted in traditional banking, relying on deposit taking and lending operations, and are not as heavily involved in complex financial instruments. Implementing lessons learned from the 1997/98 Asian financial crisis, Asian banks tend to maintain high capital levels with their capital adequacy ratios in the double digits, well above the 8.0% Basel Accord minimum requirement. Moreover, some Asian banking systems are well prepared for Basel III to the extent of implementing the new capital requirements in 2013, ahead of the 2015 deadline and at higher, “gold-plated” capital levels¹. Some Asian regulators also noted that they were concerned about foreign banking organizations that operate within their jurisdictions, as these entities have direct exposure to European banks.

Regulators are working on different approaches to strengthen and protect their domestic banks from external shocks. Japan’s Financial Services Agency is trying to identify channels through which a Eurocrisis shock could affect the domestic

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economy. The speaker from MAS further commented that whether the previous crisis was a result of the lack of regulation or the failure of supervision remains uncertain. To limit contagion effects, the China Banking Regulatory Commission is developing “firewalls” between capital markets and the banking system to safeguard deposits.² On a broader level, one speaker suggested the development of macroeconomic “capital management” tools to be used only if the exchange rate is in line with its real value and capital flows are hurting financial stability.³ On the nature of banking supervision, the speaker from the Monetary Authority of Singapore (MAS) emphasized the importance of striking a balance between having the necessary regulations in place and ensuring the appropriate enforcement of those regulations. She further commented that whether the previous crisis was a result of the lack of regulation or the failure of supervision remains uncertain.⁴

Global Economic Interconnectivity

Asian economies have become increasingly interconnected with the global economy through cross-border transactions and channels such as trade, manufacturing chains, financial transactions, and other economic activities. As such, all economies engaged globally are vulnerable to external shocks, whether systemic financial crises on different continents or natural disasters. This growing interconnectivity appears to have increased the level of systemic risk in the market and is reflected in a closer linkage of economic and systemic financial crises.

One speaker presented ongoing research showing how economic activities can be used to map different clusters of economies in a “hub system”. Each hub comprises a core group with “gatekeepers” that serve as the link to all other economies engaged in those activities, such as trade, financial and manufacturing activities. As pivot points, these gatekeepers can be used to identify the weaknesses and strengths in the hub system and to stabilize the system in times of crisis. Thus, gatekeepers are important to understanding systemic risk. This research also explains how a vertically integrated supply chain from manufacturing activities has driven trade integration, which in turn has given rise to financial integration. As each economy has a place in the hub system, it is vulnerable to external

shocks based on the growing level of interconnectivity even if it has no direct exposure to any particular scenario. As a result, the greater role Asia plays in the global manufacturing supply chain, the more vulnerable the region becomes to external shocks.⁵

Multilateral Efforts in Stabilizing the Global Financial System

Based on this global interconnectedness, certain speakers at the conference highlighted the need for a coordinated and multilateral regulatory response to stabilize the global financial system, particularly in the wake of the ongoing European crisis. Given the extent of the global operations and size of global systemically important banks (GSIBs), certain Asian regulators expressed concern over the home-country governance of the foreign banks that operate under their jurisdiction. For example, MAS noted that while Singapore does not have any domestic GSIBs, it hosts all 29 GSIBs. The regulators highlighted the importance of international regulatory standards and called for greater cooperation with home-country regulators, including a sharing of the GSIBs’ global resolution plans in times of crisis.

In addition to acknowledging the success of the G-20 response in the 2007/8 financial crisis, some speakers called for greater Asian participation in multilateral institutions and fora, particularly the IMF and G-20 talks. While some speakers and participants looked towards the G-20 as a current or potentially effective mechanism to resolve crises, other speakers expressed greater skepticism at the G-20’s ability to contribute to solutions. They further noted the difficulty that individual economies have regarding the lack of political will to implement domestic policy changes to address structural problems at the global level.

Some speakers advocated for deeper cooperation through regional initiatives, such as the Chiang Mai Initiative (CMI), Asian Bond Market Initiative (ABMI), ASEAN Free Trade Agreement, and the China-Japan-South Korea trilateral talks, among others, and Asia’s initiatives to boost domestic consumption to diversify from the export-led growth model. One speaker called for greater Asian leadership in the IMF and the formation of an Asian Monetary Fund, which should work closely with the IMF, particularly on surveillance and early warning

activities. He commended the expansion and multilateralization of the CMI, which is a multilateral currency swap arrangement between ASEAN members, China, Japan, and Korea with reserves of USD 240 billion. He further recommended that the CMI be expanded into a regional monetary facility, whose operations should be consistent with as well as complementary and supplementary to the IMF. The speaker advocated that the CMI have preventative mechanisms as opposed to only remedial ones. He also noted that the CMI needs to address the problem of the stigma in the financial community of being the first economy to use the facility. Further, most economic cooperation in Asia originated from ad hoc, market driven initiatives, particularly free trade agreements. As such, Asian economies should take a more deliberate and proactive approach towards financial cooperation initiatives for greater ownership of developments in the global economy.⁶

Conclusion

Conference participants broadly agreed that while the Asian financial sector is exposed to systemic risk originating from other regions through trade linkages and global economic interconnectivity, Asian banks have so far remained relatively resilient to the European crisis. In fact, they have stepped into roles left by withdrawing foreign banking organizations in the local market, such as trade financing transactions, while remaining well grounded in traditional banking roles. As Asian banks often maintain high capital levels, they should be well positioned to support domestic growth and economic development needs. While both Western and Asian economies have their own internal structural imbalances to address, Asian economies may be in a position to play a more active role with a stronger voice in multilateral fora as policy makers review the complexities of the global financial and economic system.

Endnotes:

1. “Gold-plating” refers to a practice in which banks keep capital levels beyond Basel III requirements.
2. Panel discussion (and question and answer session), “Bank Regulators' Views on Challenges in Global Finance,” available at: <http://www.frbsf.org/banking/asiaprogram/events/2012/0611/agenda.html>.
3. Question and answer session, Keynote address, “Asia in a Changing World,” Zhu Min, International Monetary Fund, available at: <http://www.frbsf.org/banking/asiaprogram/events/2012/0611/video-Keynote-address-Zhu-Min-question-answer.html>.
4. Panel discussion (and question and answer session), “Bank Regulators' Views on Challenges in Global Finance,” available at: <http://www.frbsf.org/banking/asiaprogram/events/2012/0611/agenda.html>.
5. Keynote address, “Asia in a Changing World,” Zhu Min, International Monetary Fund, available at: <http://www.frbsf.org/banking/asiaprogram/events/2012/0611/video-Keynote-address-Zhu-Min.html>.
6. Keynote address, “Asia's Role Toward Sustainable and Balanced Global Growth,” Sakong II, Institute for Global Economics (Seoul), available at: <http://www.frbsf.org/banking/asiaprogram/events/2012/0611/video-Keynote-address-Sakong-II.html>.

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Day 1 - June 11, 2012

Day 2 - June 12, 2012

Welcoming Remarks

John C. Williams, President and CEO,
Federal Reserve Bank of San Francisco

Keynote Address: Asia's Role toward Sustainable and Balanced Global Growth

Sakong II, Chairman, Institute for Global Economics, Seoul

Panel: Asia's Role toward Sustainable and Balanced Global Growth: a Discussion

Robin Harding, US Economics Editor,
Financial Times

Robert Madsen, Senior Fellow,
Center for International Studies,
Massachusetts Institute of Technology

Keynote Address: Asia in a Changing World

Zhu Min, Deputy Managing Director,
International Monetary Fund

Panel: Finance, Banking and Growth in Asia

Chris Cooper, Partner, National Leader,
US Chinese Services Group, Deloitte & Touche LLP

Rafael Gil-Tienda, Member, Senior Advisor Board,
Olivier Wyman Hong Kong

Jesper Koll, Japan Director of Research,
JP Morgan

Keynote Address: The Era of Linkages among Asia and across the Pacific Ocean (via video conference)

Masaaki Shirakawa, Governor, Bank of Japan

Keynote Address: Shadow Banking after the Financial Crisis

(via video conference)

Daniel Tarullo, Governor, Board of Governors of the Federal Reserve System

Regulatory Panel: Challenges in Global Finance: Bank Regulatory Views

Toshihide Endo, Deputy Director-General,
Financial Services Agency, Japan

Brandon Khoo, Executive General Manager,
Australian Prudential Regulation Authority

Liao Min, Director-General, Shanghai Branch,
China Banking Regulatory Commission

Michael Taylor, Advisor, Financial Stability Board

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

Asian Bank Leadership Panel: Present and Future Challenges to Banking in Asia

Chng Sok Hui, CFO, DBS Bank

Nicholas Hope, Director, Stanford Center for International Development

Takashi Morimura, Deputy President and Chief Executive, Global Business Unit,
The Bank of Tokyo-Mitsubishi UFJ. Ltd.

Closing Remarks

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