

Asian Financial Collaboration at a Crossroads

- From ABMI to ACMI -

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I. From ABMI to ACMI

The Recycling of Capital Flows in Asia:

Major Foreign Holders of US Treasury Securities

- ❖ Asian countries are major investors in US treasury securities. Seven of the top fifteen are Asian nations

(USD Billion)

	Country	Amount	Share (%)
1	China	868.4	20.6
2	Japan	836.6	19.9
3	United Kingdom	448.4	10.6
4	Brazil	165	3.9
5	Hong Kong	137.8	3.3
6	Taiwan	130.2	3.1
7	Russia	129	3.1
8	Switzerland	106.6	2.5
9	Canada	103.4	2.5
10	Luxembourg	79.1	1.9
11	Thailand	60.9	1.4
12	Germany	58.7	1.4
13	Singapore	52.7	1.3
14	Ireland	42	1.0
15	Korea	41.6	1.0
	Grand Total	4212.9	

Source: Department of the US Treasury, Federal Reserve Board(2010)

The Recycling of Capital Flows in Asia: Investors in Asian Securities

❖ However, Asian nations' investments in securities issued by Asian nations are relatively small compared to investments by non-Asian countries

— This shows that recycling is poor within the region

(USD Million)

	China		Indonesia		Japan		Korea		Malaysia		Philippines		Singapore		Thailand	
1	HK	5704.54 (39.60)	US	4142 (28.90)	FR	44467.16 (17.59)	HK	11229.34 (13.92)	US	5163 (23.12)	US	2816 (21.96)	US	6453 (27.54)	US	873 (22.50)
2	US	1606 (11.15)	LUX	2801.49 (19.54)	UK	40656.67 (16.09)	JP	11129.48 (13.79)	HK	3370.73 (15.09)	JP	1388.43 (10.83)	JP	2853.99 (12.18)	SG	753.4 (19.42)
3	UK	1372.84 (9.53)	SG	2595.26 (18.10)	US	39656 (15.69)	US	10450 (12.95)	SG	3227.09 (14.45)	LUX	1068.83 (8.34)	HK	2500.58 (10.67)	JP	451.79 (11.65)
4	LUX	1210.78 (8.40)	MAU	955.4 (6.66)	LUX	10813.51 (4.28)	SG	9787.7 (12.13)	LUX	2815.41 (12.61)	SG	980.41 (7.65)	MAU	2226.2 (9.50)	UK	336.11 (8.66)
5	SG	1122.84 (7.79)	JP	837.47 (5.84)	NW	10717.71 (4.24)	FR	8066.87 (10)	JP	2170.8 (9.72)	UK	864.76 (6.74)	LUX	2091.73 (8.93)	HK	305.55 (7.88)
Total		14406.83		14334.6		252760.40		80690.51		22334.97		12821.94		23435.20		3879.36

Source: IMF, CPIS (2008). HK: Hong Kong, LUX: Luxembourg, SG: Singapore, FR: France, NW: Norway, MAU: Mauritius, JP: Japan.

Financial Cooperation in Asia: CMI & ABMI

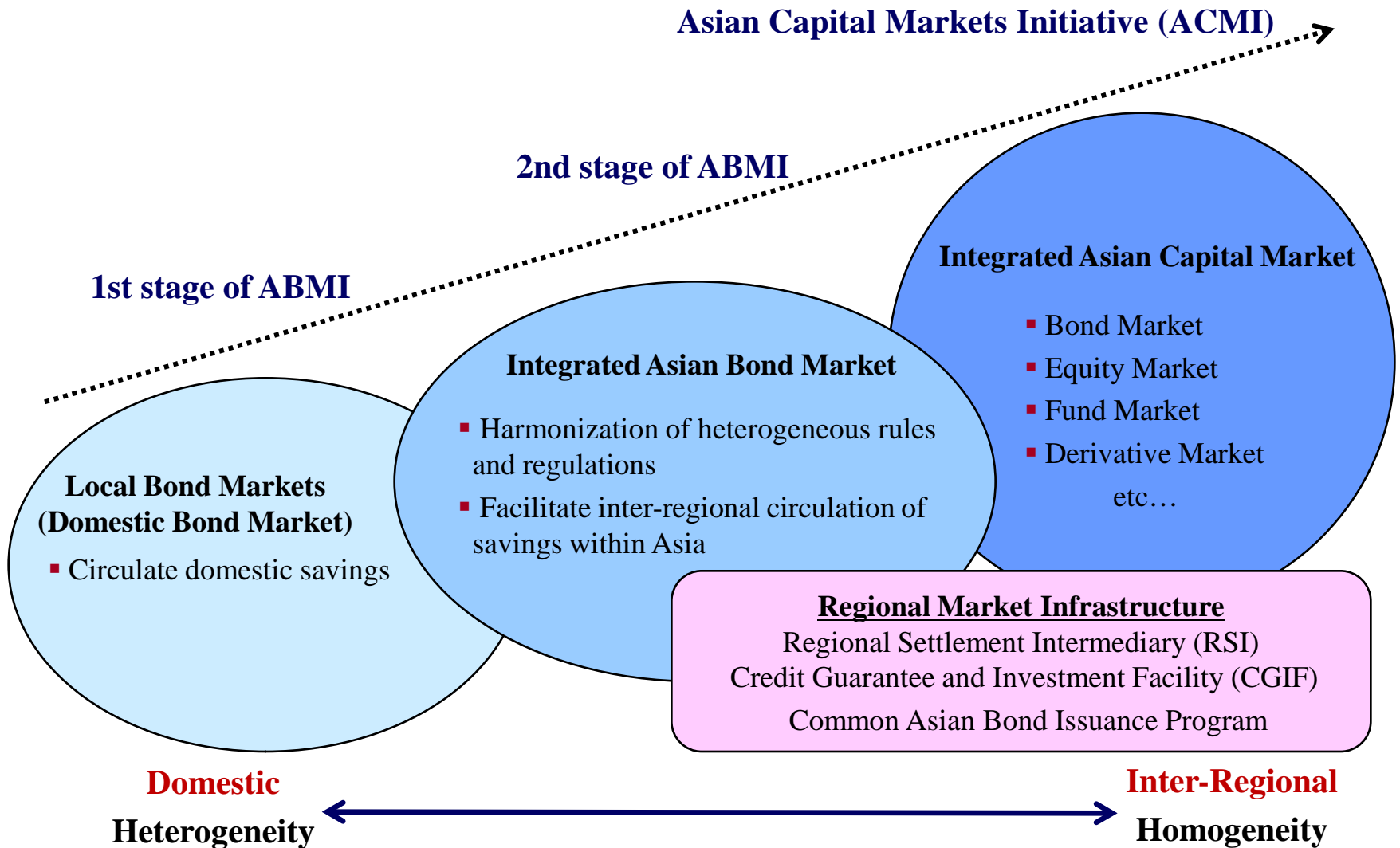
❖ Chiang Mai Initiative (CMI)

- Multilateral currency swap arrangement to manage regional short-term liquidity problem
- Regional economic surveillance
- ASEAN+3 macroeconomic research office (AMRO)

❖ Asian Bond Markets Initiative (ABMI)

- Recycle more Asian savings intra-regionally
- Credit guarantee and investment facility (CGIF)
- Regional settlement intermediary (RSI)
- ASEAN+3 Bond Market Forum (ABMF)

Asian Capital Markets Initiative (ACMI): Beyond Asian Bond Markets Initiative



II. Asian Fund Markets Initiative (AFMI)

The Potential of the Asian Fund Markets

❖ Despite Asian fund markets enormous growth potential, there is limited cross-border financial intermediation in the region

- Relatively high potential for economic growth
- Room to expand financial assets
- Demand for collective investment schemes continues to grow

<Forecasting the Asian Asset Management Markets Size>

	AUM , 2006 (US\$ billion)	Forecast AUM in 2015 (US\$ billion)	Compound Annual Growth Rate (%)
China	92	640	24.1
Hong Kong	62	140	9.5
India	59	230	16.3
Japan	809	890	1.1
Korea	66	310	18.8
Singapore	94	150	5.3
Taiwan	4	56	34.1

Sources: Allianz Dresdner Economic Research, Matrix Services Ltd.

Benefits of Asian Fund Markets Initiative (AFMI)

❖ AFMI aims at making cross-border fund products by utilizing a fund passport in the region

- The fund registered in one country could be sold in other countries without an additional registration process
- A single license for both funds and asset managers (asset management companies) across the region

❖ Benefits of AFMI

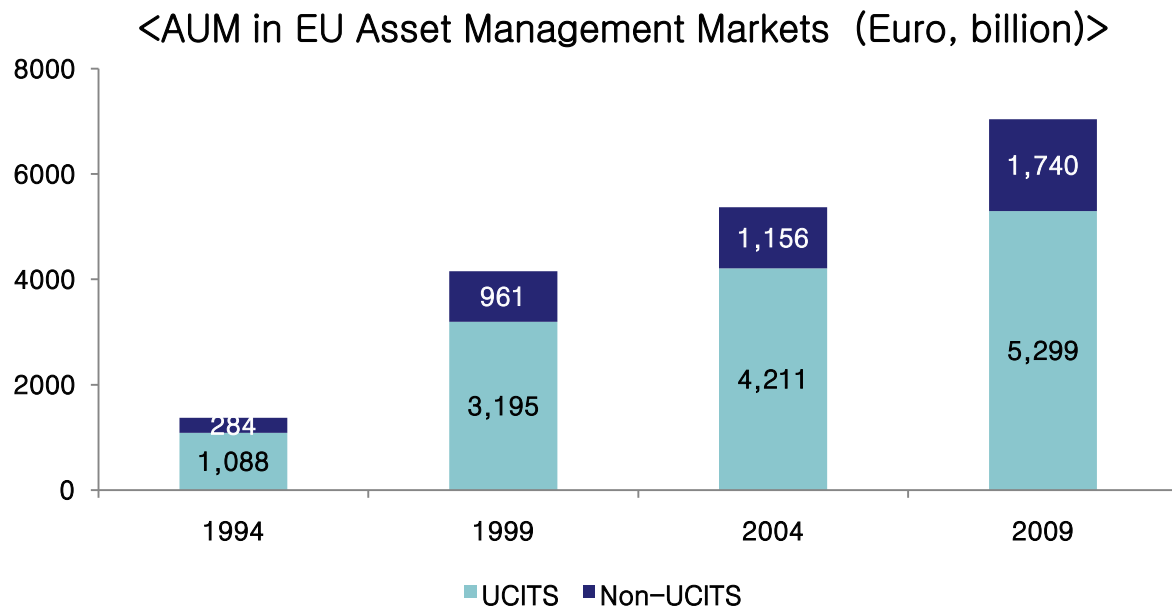
- Recycling Asian savings within Asian capital markets rather than exporting the bulk of excess capital to US and EU. As a result, it will mitigate sudden stop of capital flows
- Unlocking savings from real estate investments and banks through the creation of viable domestic and cross-border fund industry to the benefit of businesses and governments in the region
- Further developing the Asian capital (fund) markets and their local financial expertise

Role Model of AFMI: UCITS Funds in the EU

❖ Undertaking for Collective Investments in Transferable Securities (UCITS) Funds

- An unified single license for funds in the EU. The funds registered in a specific country can be distributed in other EU countries without additional registration
 - Unified regulation across EU countries for the UCITS funds
 - UCITS is a driving force for extending fund markets in the EU and penetrating fund markets in Asian countries (e.g. Hong Kong , Singapore)

❖ Due to the very different and more fragmented environment and the lack of a unifying political - economic system, AFMI is unlikely to take the same form as UCITS



Obstacles to Asian Fund Markets Initiative (AFMI)

❖ No unified currency like the Euro

- Currency risk and settlement problems
- Using the dollar still has a problem of exchange risks between countries in the region

❖ Differences of the fund market development in the region

- Globalized markets / strong fundamentals: Australia, Hong Kong, Japan, Singapore
- Big markets / weak fundamentals: China, India, Korea
- Very small markets / merely no fundamentals: Other countries

❖ Differences of the regulatory structures in the region

- Registration process for the funds and managers, restrictions on asset management, investor protection, etc.

❖ Different tax system

- Different tax treatment in the capital markets across countries in the region: tax rates, tax regimes (capital gains tax, transaction tax, etc.)
- Different tax treatment between domestic and foreign investors for funds

Strategies for Asian Fund Markets Initiative (AFMI)

❖ Regulatory framework for Asian Fund Markets Initiative (AFMI)

- New and separate regulatory framework is preferred to unifying existing fund regulatory structures of participating countries (e.g. UCITs directive)
- Stepwise extension of participating countries

❖ Collaboration stage for Asian Fund Markets Initiative (AFMI)

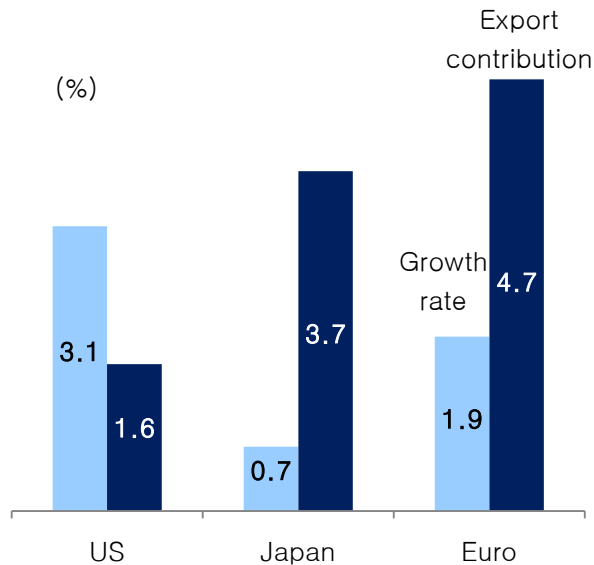
- 1st Stage: building up an unified regulatory structure for single license funds
 - Fund styles, restrictions on asset management, disclosure, investor protection, tax, etc.
 - Initial participating countries: Group 1, Group 2
- 2nd Stage: starting a funds passport in two groups (Group 1 / Group 2) separately
- 3rd Stage: applying a funds passport across all Group 1 and Group 2 countries
- 4th Stage: including other countries

III. Regional Currency Collaboration

Sources of Currency Disputes (1)

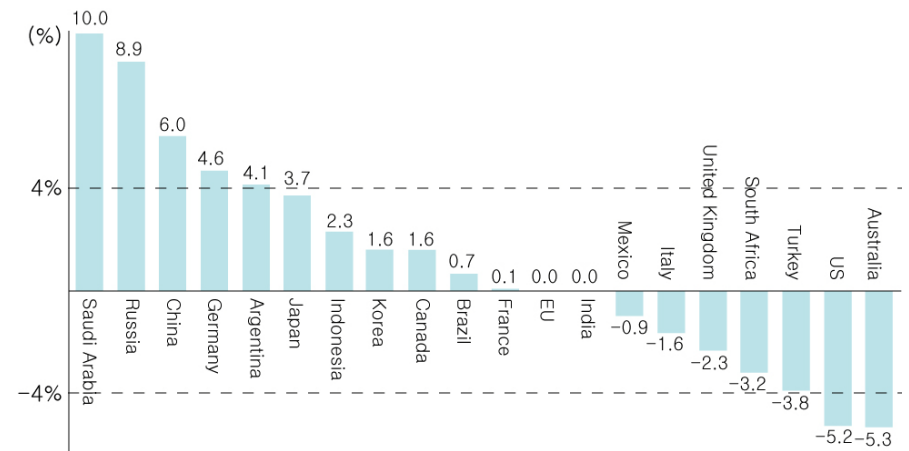
- ❖ After the recent crisis, each country relies more heavily on exports for its economic growth

<Contribution of Exports to Growth>



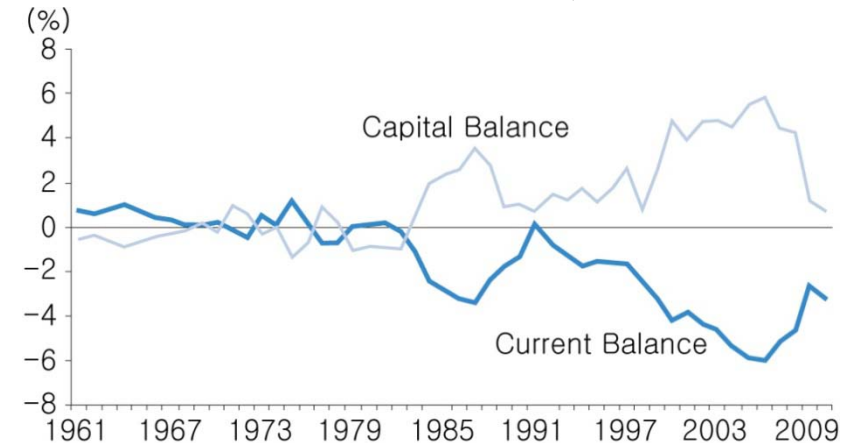
Source : DataStream (2009~2010)

<Current Balance/GDP of G20 Nations>



Source: IMF, DataStream (2002~2008 Average)

<US Current Balance and Capital Balance>

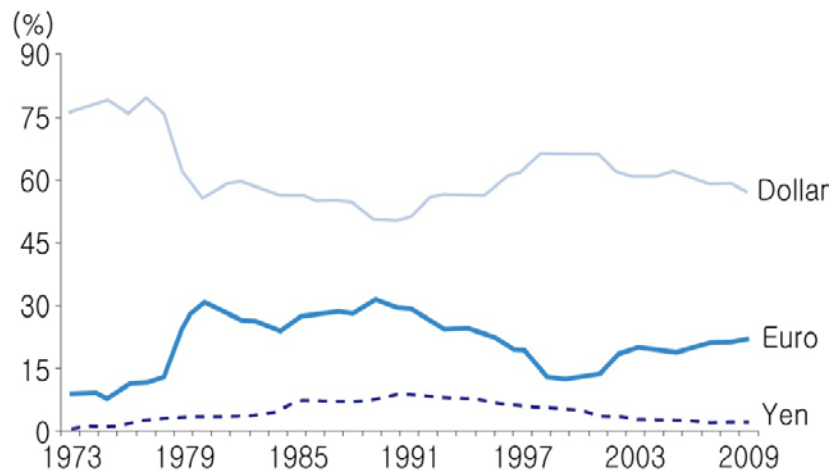


Source : IMF

Sources of Currency Disputes (2)

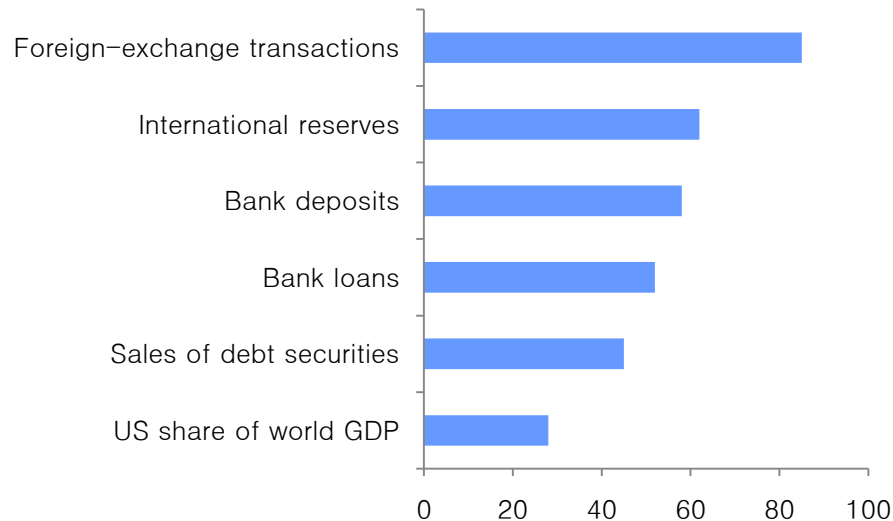
- ❖ Although the US dollar has decreased in relative proportion of foreign reserves, in every respect, it is still the key currency

<Currency Composition of Foreign Reserves>



Source : IMF

<US Dollar's Share of World Total, %>



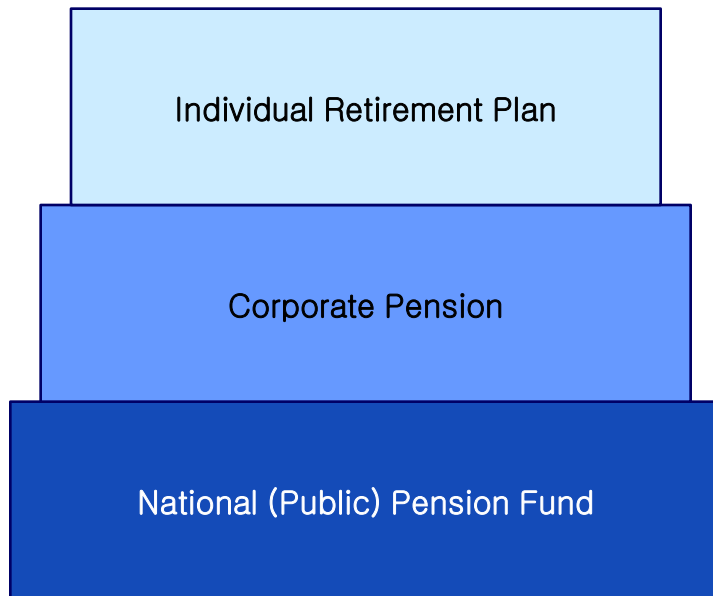
Source : IMF, The Economist

G20 Summit Seoul Action Plan: Monetary and Exchange Rate Policies

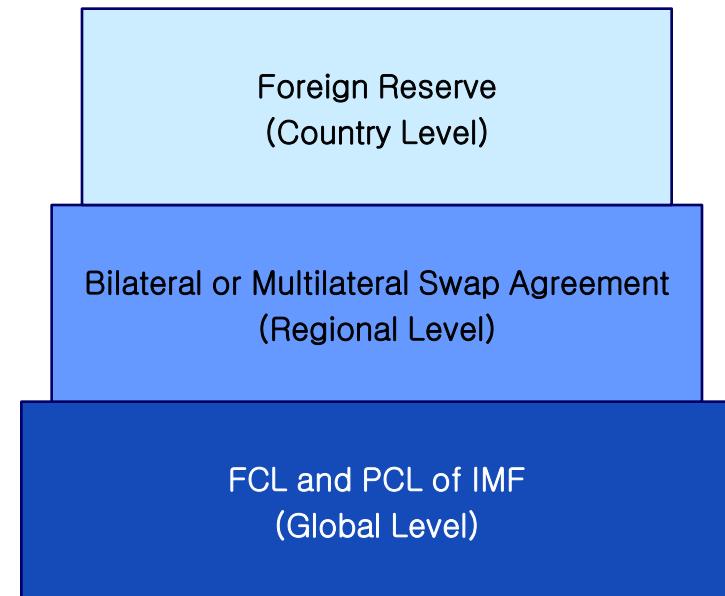
- ❖ Move toward more market-determined exchange rate system and enhance exchange rate flexibility to reflect underlying economic fundamentals**
- ❖ Refrain from competitive devaluation of currencies**
- ❖ Advanced economies with reserve currencies will be vigilant against excess volatility and disorderly movements in exchange rates**
- ❖ In circumstances where countries are facing undue burden of adjustment, policy response in emerging market economies with adequate reserves and increasingly overvalued flexible exchange rates may also include carefully designed macro-prudential measures**

Global vs Regional Financial Safety Net

<Post-retirement Safety Net>



<Global Financial Safety Net>



FCL: flexible credit line

PCL: precautionary credit line

New Order in the International Currency System

- ❖ **The reform of the international currency (monetary) system and the related key currency issue will be the core of the agenda at the G20 Summit in Paris (2011)**
- ❖ **There have been several ideas about how the international currency system should be reformed**
 - Basket of gold and major currencies (World Bank President Robert Zoellick)
 - IMF SDR (China, Brazil)
- ❖ **Another idea is for each region to develop and have its own “reserve currency” e.g., an Asian currency for Asia**
 - For this to be possible, Asian nations need to collaborate and coordinate their capital markets and the currency markets issues as well

Currency Market: Systemically Important Market in Korea

- ❖ **The main source of systemic risk is different country by country**
 - From Korea's standpoint, the foreign exchange market is a systemically important financial market. Too-big-to-fail problem is not that serious
- ❖ **In designing Korea's financial regulatory architecture, Korea needs to build-up a architecture that fully reflects its economic and financial properties**
- ❖ **We must start with the recognition that the source of systemic risk is different for each country**
 - In Korea, the foreign exchange market is a systemically important market
 - Korea should build a regulatory paradigm, especially macro-prudential regulations, that can best recognize and manage its systemic risk

IV. RMB Internationalization

The Need for RMB Internationalization

- ❖ **China's GDP, already the second largest globally, is matched by the parallel growth of China related transactions in the global goods and services trade arena**
- ❖ **However, the currency of transaction even in the current account section is predominantly the US dollar**
 - US dollar accounts for 42.5% of daily transactions on average, followed by 19.6% for the euro and 9.5% for the Japanese yen (BIS, 2010.04)
 - However, the Chinese Renminbi (RMB) only accounted for 0.2%
- ❖ **The +3 trillion US dollar foreign reserve, held by China is posing serious challenges**
 - Need to diversify to avoid macro risks

Policy Initiatives for RMB Internationalization

❖ Chinese government is encouraging wider inter-regional RMB trade settlements

- Five cities including Shanghai and Guangzhou launched a pilot program on RMB cross-border settlement in trade with Hong Kong, Macau and ASEAN member in April 2009
- In June 2010, the program covered additional 18 provinces and the pilot program is no longer restricted to Hong Kong, Macau and the ASEAN members
- The RMB trade settlement is carried out through RMB clearing banks in Hong Kong or Macau, or commercial banks in China, with recent addition of Singapore
- China is also allowing RMB denoted foreign direct investment into the mainland

❖ Drastic increase on the way

- During the first quarter of this year, RMB settled international trade amounted to 260 billion yuan, accounting for 7% of the total international settlement
- This is 20 folds increase compared with the same period of last year

Impacts of RMB Internationalization

- ❖ **The ultimate goal would be to render RMB fully convertible both in current and capital transactions**
 - In order to achieve this goal, flexible foreign exchange regime and robust local currency capital market is needed, along with removal of capital flow restrictions
- ❖ **In the long term, China's accommodation of necessary reforms and successful RMB internationalization will be beneficial for both China and the global economy**
 - China's reform will gradually shift the economy towards more consumption oriented model and industrial restructuring
 - China's capital market development will contribute to the regional recycling of reserve surplus and will ameliorate the global imbalance problem

Korea and RMB Internationalization

- ❖ **Korea must prepare for the growing RMB exposure in both the current and capital account**
 - Either the surplus or deficit in the current account must be supplemented by reciprocal flows in the capital account
 - This implies that the Chinese capital market has to be ready to accommodate the surplus yuan held by its trading partner countries
 - Korea should closely monitor the developments in the opening up of the Chinese money and capital market and seek opportunities for business development in the brokerage, investment and related infrastructure services

- ❖ **Korea must also be ready for a change in the RMB exchange rate regime**
 - Although a floating exchange rate regime is not a prerequisite for RMB internationalization, China in the long-run is likely to embrace a free floating regime
 - There will be opportunities to develop RMB derivative services in order to cater to the risk management demands