

Capital Market as Financial Safety Nets

Iwan J. Azis

(iazis@adb.org; ija1@cornell.edu)

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Iwan Azis

Main Arguments

- While FS in Asia exceeds average emerging markets, bonds market is an exception → needs to expand domestic base & cross-border flows (requires harmonization)
- Yet, FS can be useful for financial safety nets (FSN): Global and regional FSN cannot substitute domestic FSN (balancing macroprudential policy and capital market development) → crisis prevention and crisis resolution
- Overreliance on banks with pro-cyclicality versus capital market (esp LCY bond market): crisis-related stimulus policy, avoiding double mismatch & infra development
- *“.....making a conjecture that Asia is always resilient is a show of bravado. We don't learn from past mistakes if we believe domestic safety net is sufficient to deal with a future shock.....”* from Azis, Iwan J (2012), “Asian Regional Financial Safety Nets? Don't Hold Your Breath” Public Policy Review, JMOF, Vol 8: 3, July

Variable	Expected Sign	Ordinary Least Squares			
		Private Credit/GDP	Stock Market Capitalization/GDP	Private Bond Market Capitalization/GDP	MOF-Issued Public Bonds/GDP
Log real GDP	+	0.111 ** (2.78)	0.208 (1.25)	0.253 *** (12.21)	
One lag of	+	0.138 *** (3.61)	-0.0181 (-0.24)	-0.0454 *** (-5.19)	0.0925 *** (4.58)
One lag of * Republic of Korea	+		1.961 *** (5.18)		
Year dummy in 1998	-		-0.476 ** (-3.20)		
Year and country in 2007 ⁴	+ ^a				0.101 *** (5.11)
Public bond	+/-	-0.353 *** (-4.21)	-1.231 *** (-3.73)	0.182 *** (5.78)	
Private bond	+/-				-0.153 ** (-2.11)
CPI, 3-year	-	-0.0184 *** (-3.58)	0.0269 (1.56)	-0.00894 *** (-3.91)	
Governance	+	0.096 * (1.82)	0.708 *** (4.12)	-0.156 *** (-7.50)	0.00701 (0.35)
ASEAN3HI	+	0.273 *** (5.75)	0.499 ** (2.39)	0.248 *** (10.28)	0.145 *** (5.66)
Growth of	-				-0.227 * (-1.66)
Government	+				0.0257 *** (9.86)
Constant	+/-	-0.342 (-0.85)	-1.575 (-1.00)	-2.293 *** (-11.59)	0.62 *** (10.18)
Period		1998-2009	1998-2009	1998-2009	1998-2010
Number of observations		192	214	208	190
R ²		0.706	0.509	0.62	0.65

Note: The numbers in parentheses are t-statistics. *significant at 10%; **significant at 5%; ***significant at 1%.

^aExpectation of a positive sign for the MOF-issued public bonds equation.

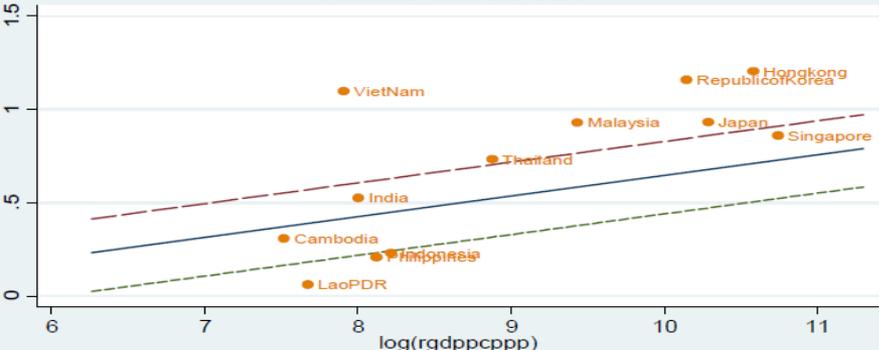
¹The log of real GDP PPP per capita was instrumented by its own lag by 1 period to address the issue of

²This variable includes the four World Bank governance indicators which were averaged using weights from factor analysis.

³Region=1 if a member of ASEAN10, Japan, Republic of Korea, PRC, Hong Kong, China, and India; Region=0 if

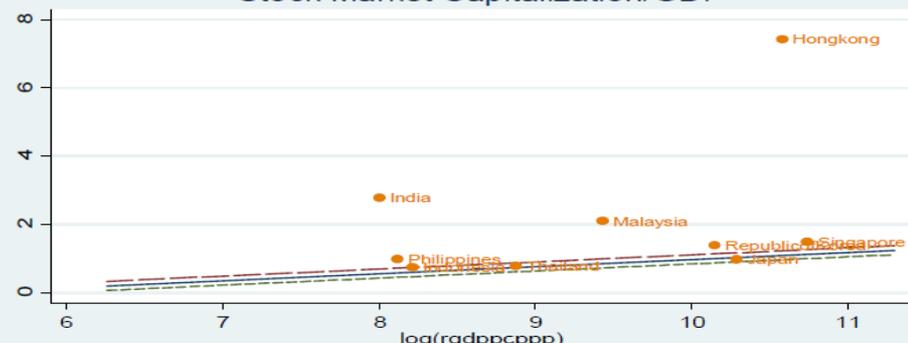
⁴MOF-bond issuance for these countries began to rise in 2007: Brunei Darussalam, Egypt, Peru, Philippines, and South Africa.

Private Credit/GDP



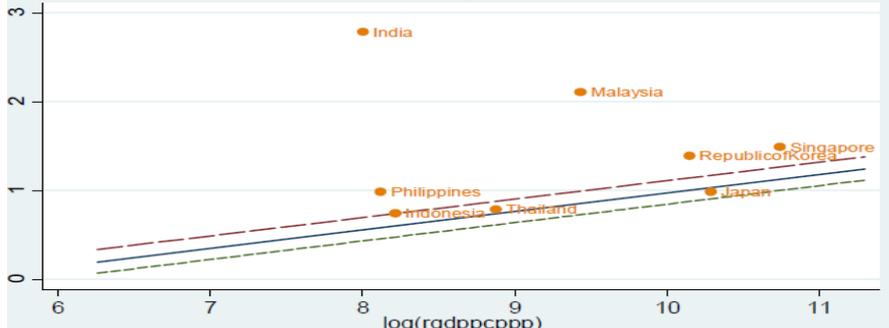
— Fitted: All Countries - - Fitted: ASEAN3HI
 - - Fitted: Non-ASEAN3HI ● private credit by depmonbanks/GDP WBdeflated

Stock Market Capitalization/GDP



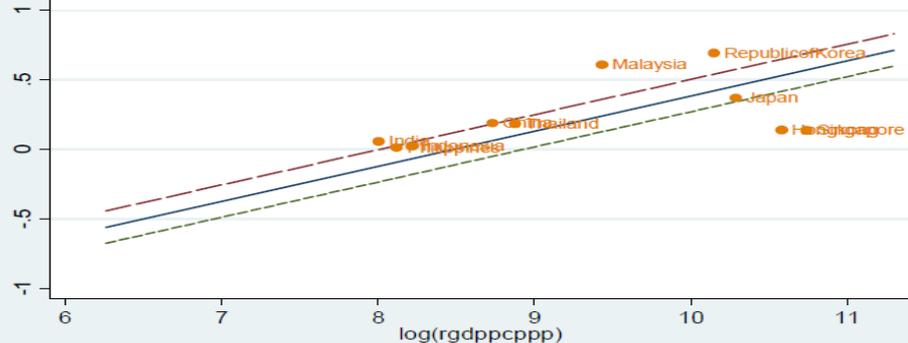
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Stock Market Capitalization/GDP



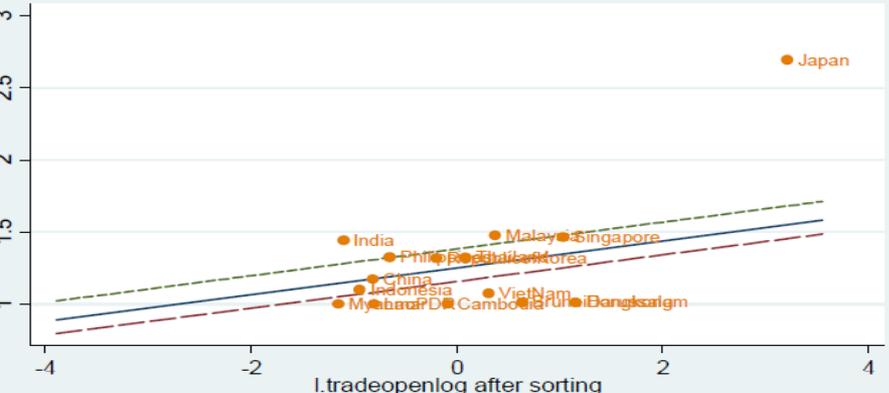
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Private Bond Market Capitalization/GDP



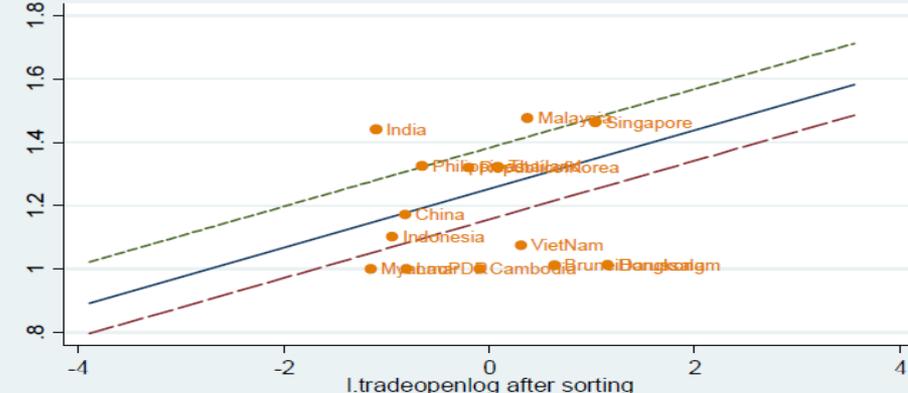
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 - - Fitted: Non-ASEAN3HI ● prbondgdp

MOF-Issued Public Bonds/GDP



— Fitted: All Countries - - Fitted: ASEAN3HI
 - - Fitted: Non-ASEAN3HI ● pbbondmofgdp_add1

MOF-Issued Public Bonds/GDP



— Fitted: All Countries - - Fitted: ASEAN3HI
 - - Fitted: Non-ASEAN3HI ● pbbondmofgdp_add1

- 2000 (Chiang Mai): CMI
- 2010 (Tashkent): CMIM-AMRO, \$120 bill & 80% IMF link
- 2012 (Manila):
 - Double to \$240 bill & IMF link to 70% with a view to 60% in 2014 *“subject to review should conditions warrant”*
 - Maturity & period
 - IMF link: 90 days to 1 year, and 2 to 3 years
 - IMF de-linked: 90 days to 6 mo and 1 to 2 years
 - CMIM Precautionary Line
- 2013 (Delhi): ERPD Matrix, AMRO status as IO



Attended by representatives of the G20 Finance Ministries and Central Banks, academicians and experts from different anti-crises funds (CMIM, ESM, FLAR, AMF and ACF), focusing on further work in developing current Principles of the IMF and RFAs cooperation, and discussed institutional features of existing RFAs and their role in International Financial Architecture.

Seminar on "Regional Financial Arrangements: RFA's role in International Financial Architecture and their cooperation with the IMF" on the eve of the IMF & WB Spring Meeting held on April 17, 2013 in Washington D.C

Merits of LCY Bonds Market

- FSN: Avoid double mismatch; source for stimulus policy (precautionary fiscal support) & long term infrastructure; market diversity & reduce overreliance on banking sector
- Keep tax rates stable (less distortion) and allowing net assets to fluctuate; fiscal stimulus
- Monetary policy: efficient implementation, information on transmission and policy efficacy via yield curve
- Benchmark yield & price discovery can reduce servicing costs to government
- Low-risk and long-term asset, including for risk-averse investors & liquid hedging instrument
- Efficient risk management (via active secondary mrkt)
- Collateral for repo with little effect on securities prices (indirectly) and liquidity (temporary)

Bank

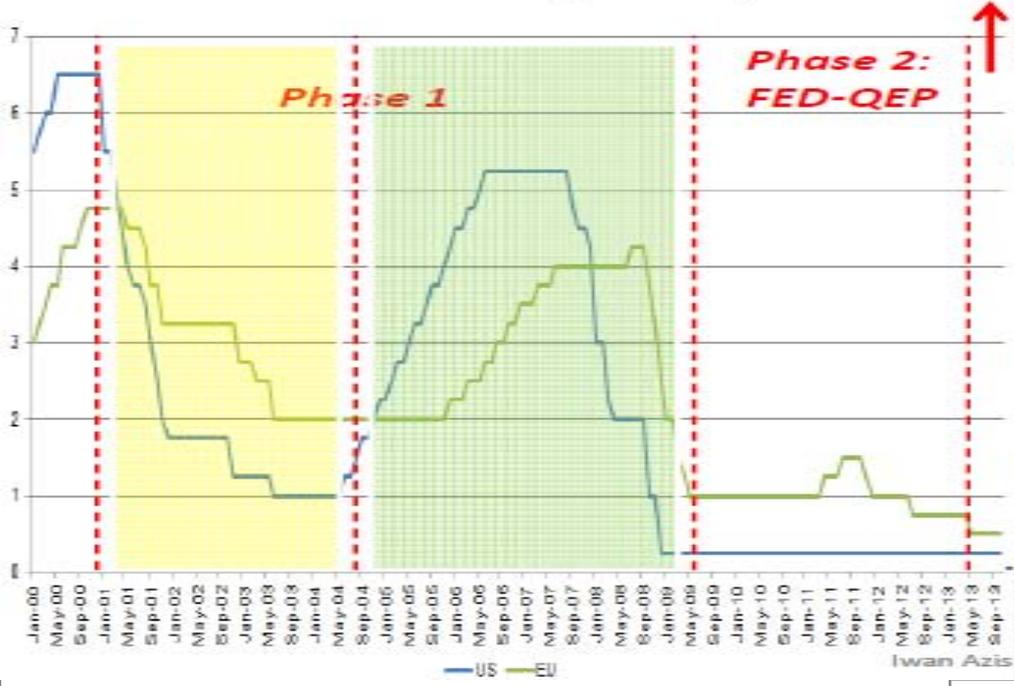
Assets

- Cash
- Core: Loans
- Non-Core: Securities 

Liabilities

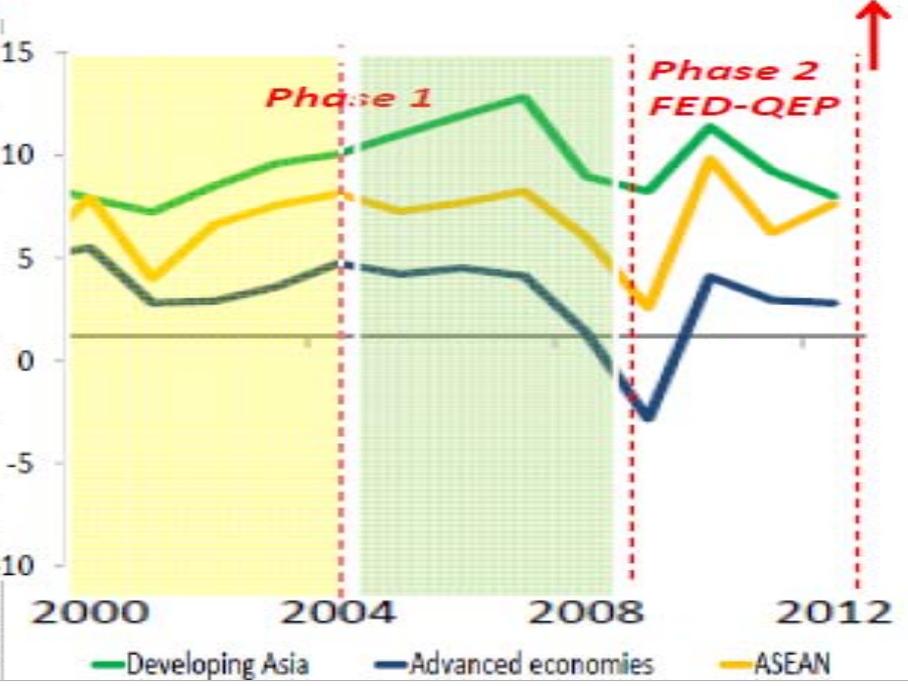
- Core: Deposits
- Non-core: Loans etc 
- Equity
- Savings

Interest Rates (US & EU)



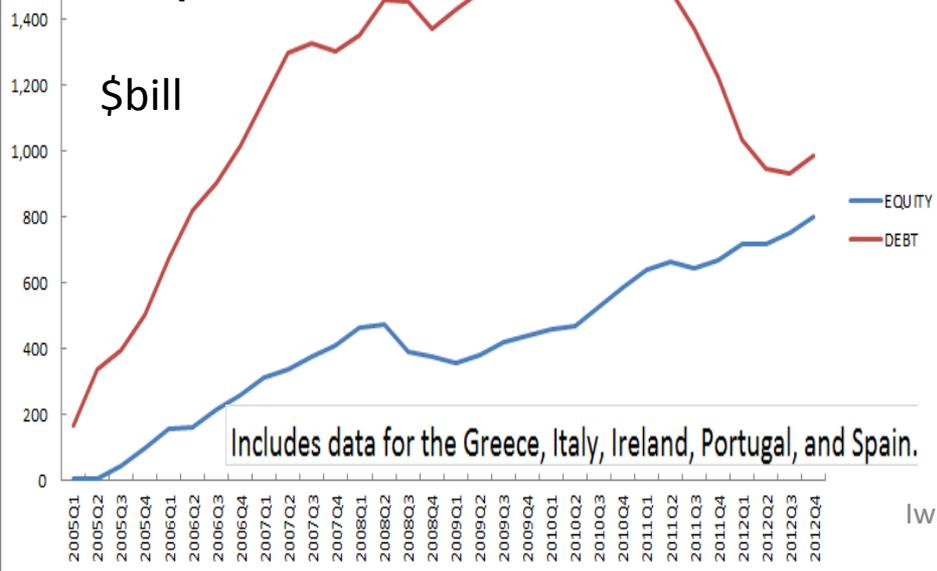
Phase 3

Real GDP Growth

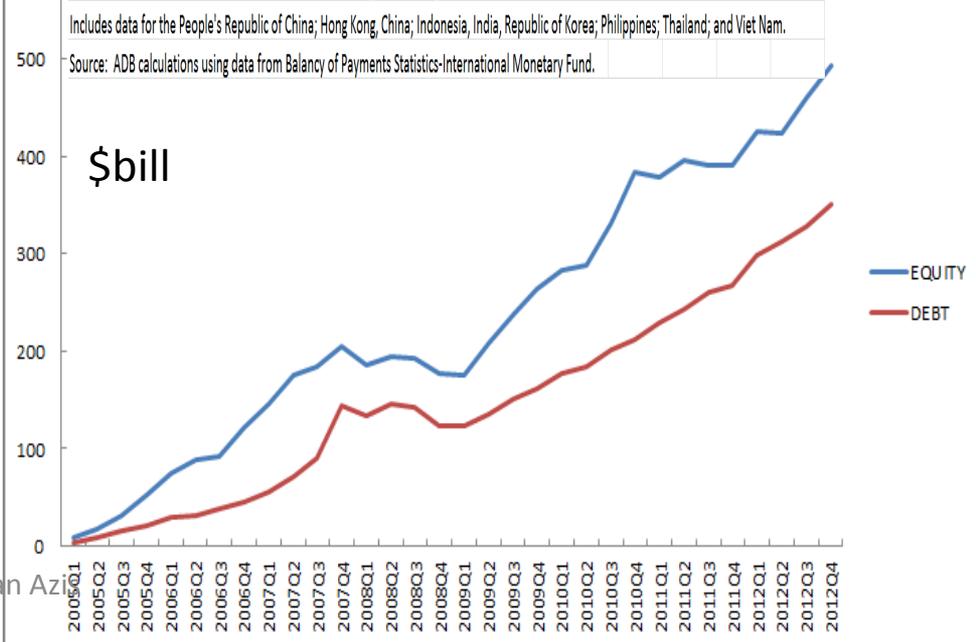


Phase 2: FED-QEP

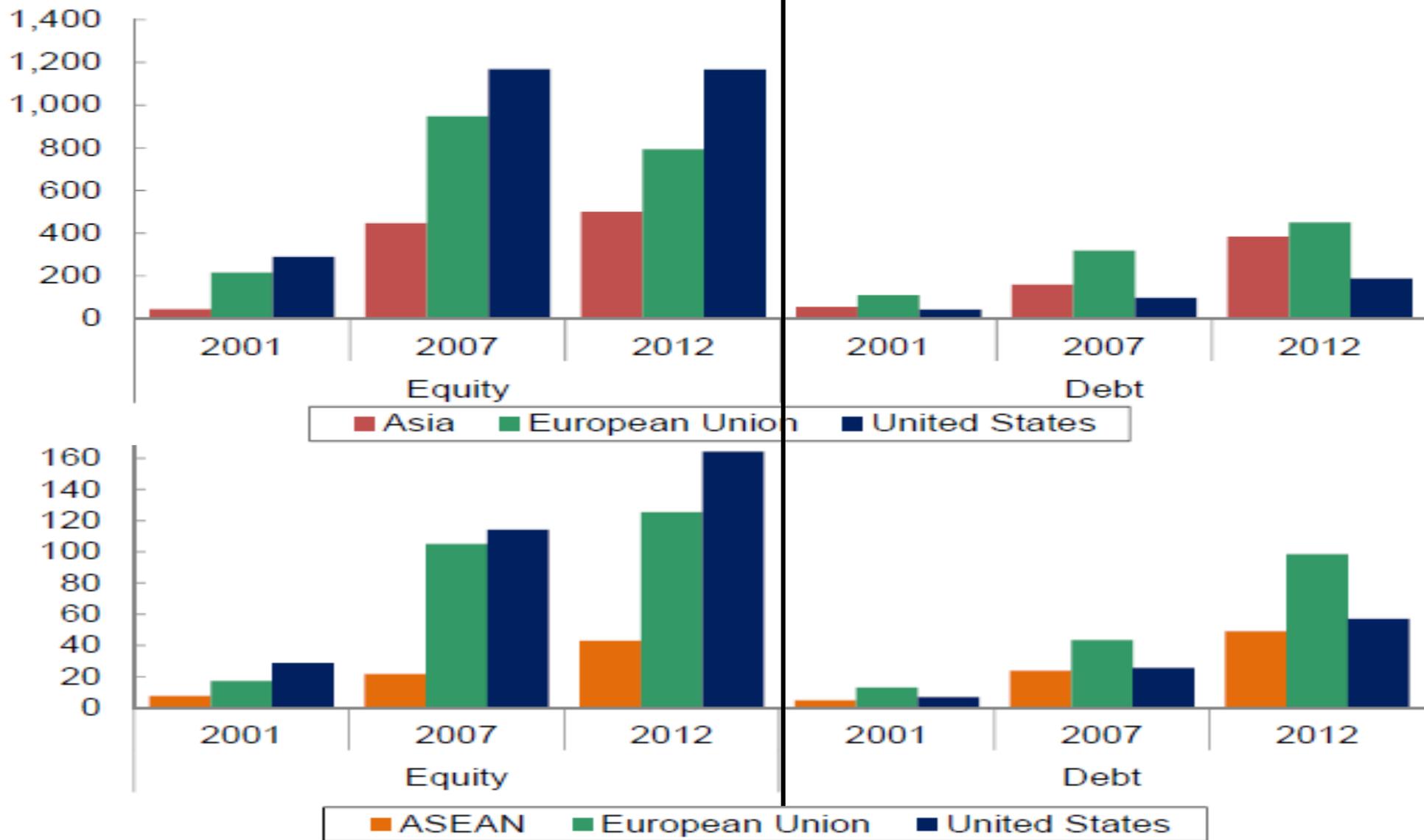
Inflows Into Equity and Bonds Market: Europe EM



Inflows Into Equity and Bonds Market: Asia



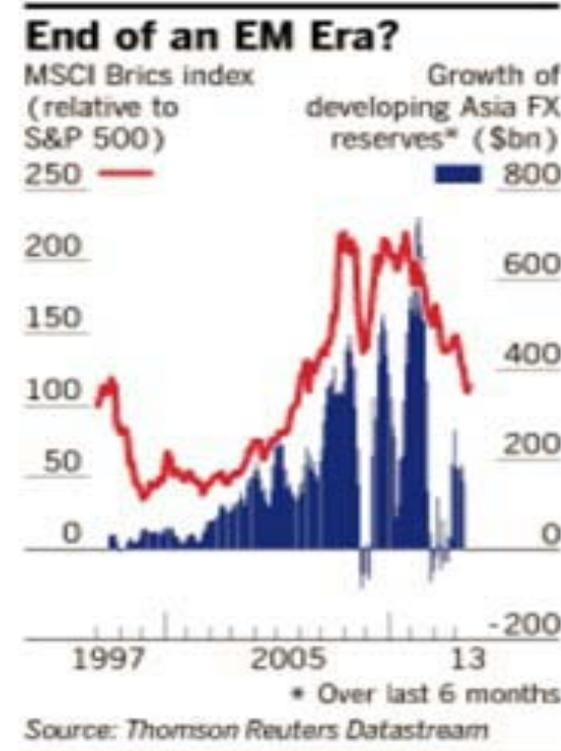
Asia & ASEAN Financial Integration: Equity & Debt Market (\$billion)



The region's financial sector remains more integrated with the rest of the world

Market Asymmetry or Over-reaction?

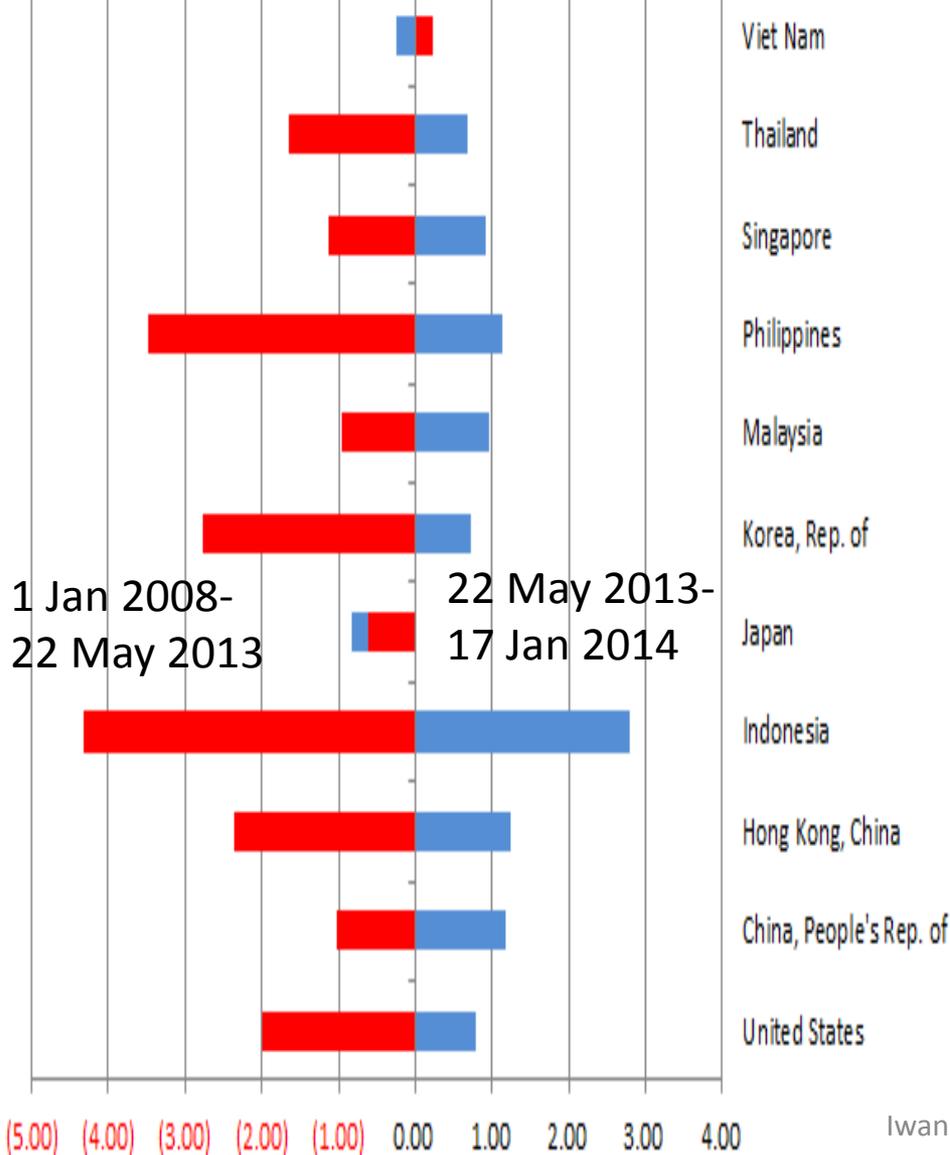
- During bond market rally, for 100 bp fall of US Treasury yields the corresponding fall of yields in EM bonds was 20 bp (based on NY Fed study), but during the post-QE tapering period yields on US treasury rose by 80 bp, while EM government 10-y bonds yield rose by 100 bp (due to higher risk of EM bonds).
- At first, high US yields hurt EM bonds yields; this is normal. But now they also hurt global equities return



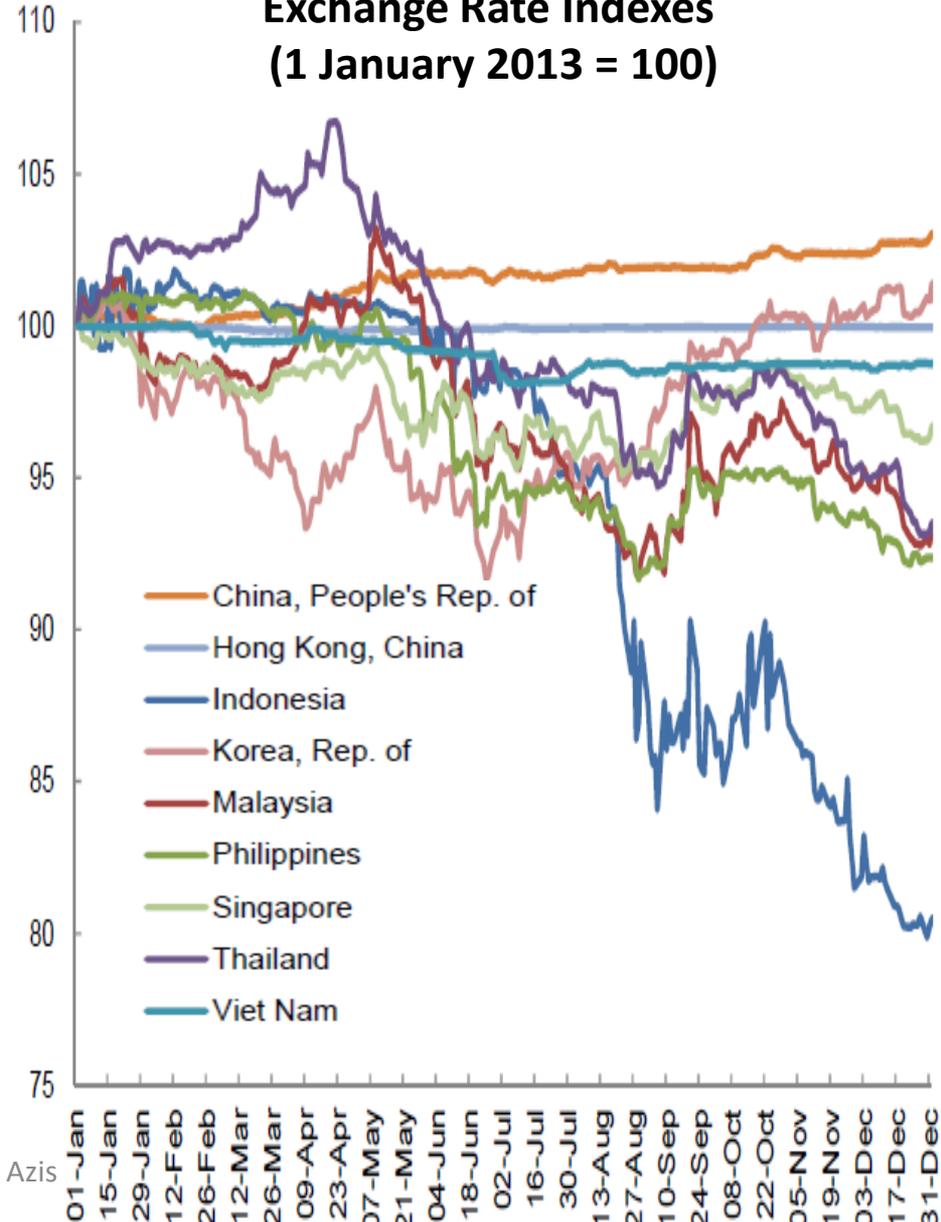
10Y-bond yield				Yield Change: 1 Jan 2008 to 22 May 2013	Yield Change: 22 May 2013 to 17 January 2014
10-year Yields	1-Jan-08	22-May-13	17-Jan-14		
United States	4.02	2.04	2.82	(1.98)	0.78
Asia	5.22	3.41	4.33	(1.81)	0.91

Market Over-reaction in Some Countries

10-Y Bonds Yield



Exchange Rate Indexes (1 January 2013 = 100)



Multivariate GARCH

The shock origins are: ust=US Treasury; usc=US high yield corporate bonds; eucg=EU composite government bond; euc= European corporate bond. The impacted countries are: pph= Philippines; my= Malaysia; id=Indonesia; kr=Korea; cn=China; jp=Japan. The impacted markets are: mm=money market; bm=bonds market; eq=equity market; fx=currency market