

Financial Centers in the Asia-Pacific Region—Recent Trends and Scope for Development

PECC International Conference on Competition
Among Financial Centers in the Asia-Pacific

Seoul, Korea

October 16, 2007

David Cowen

Regional Office for Asia and the Pacific (Tokyo)

International Monetary Fund



Overview

- Asian financial centers—should competition matter?
- Macro-trends—supportive of financial center growth
- Asian financial centers—trends and developments
- Quality of domestic financial markets and capital flows
- Financial center development—further reforms?



Competition Among Asia Financial Centers— Should it Matter?

- Regulatory forbearance/tax competition—little evidence in region that regional practices are exposing economies to heightened risk.
 - Excessive volatility—financial center development may actually lower volatility by broadening, deepening markets
 - Less financial integration—with right reforms, could increase cross-border flows, as investors/firms tap regional markets for lowest cost funding and highest risk-adjusted returns
- 

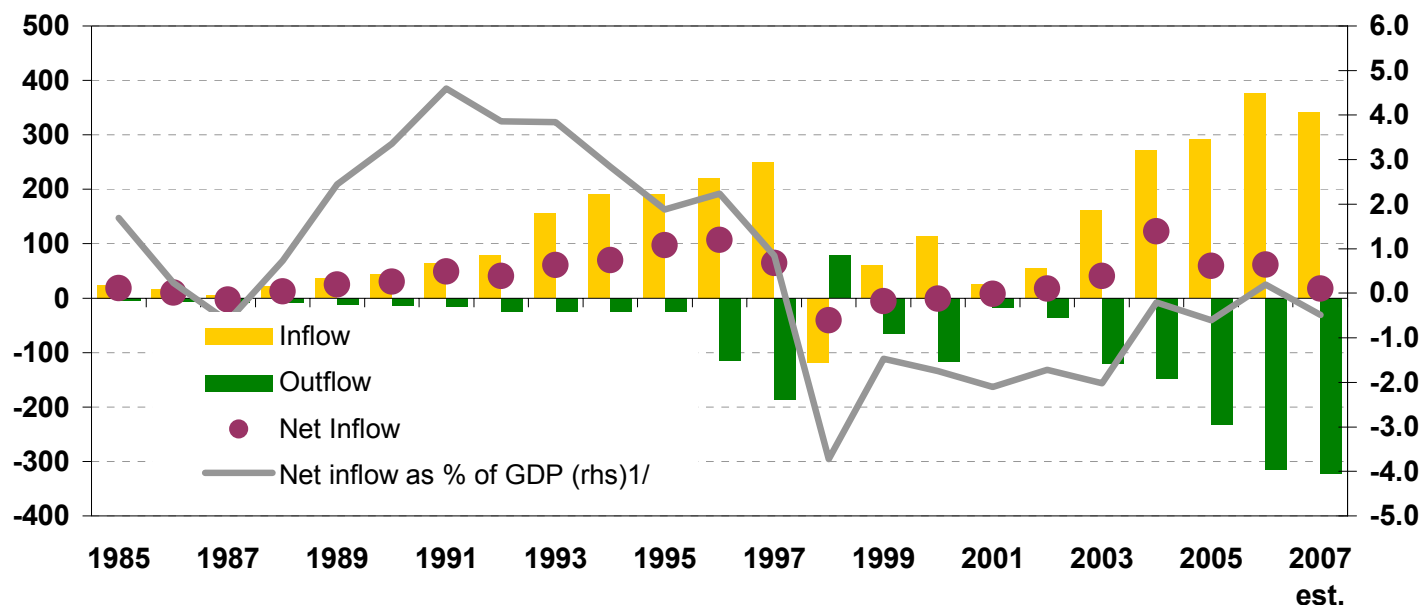
Macro-Trends Supportive of Growth in Asian Financial Center Activity

- Large, underutilized private savings
 - Increased capital inflows and outflows in the region
 - Greater impetus for intra-regional investment
 - Build-up in foreign reserves, improved fiscal positions, and emergence of sovereign wealth funds
 - Surge in hedge fund activity and more private equity interest
 - Underweighted foreign institutional investors in emerging Asia
- 

Emerging Asia Capital Flows—Recent Surge

Emerging Asia: Gross vs Net Capital Inflows

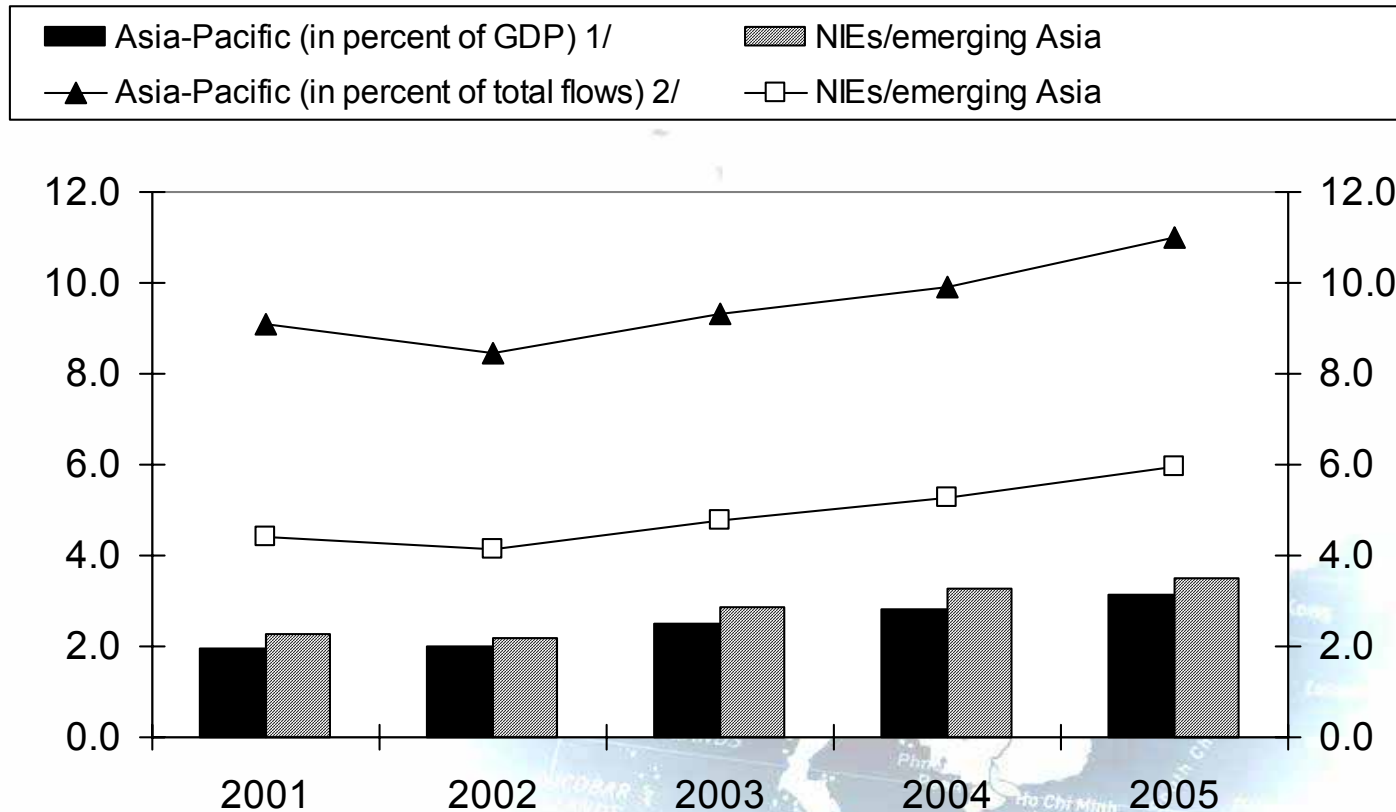
(In billions of U.S. dollars)



1/ Simple average

Source: IMF, WEO database (April 2007)

Asia-Pacific Intra-Regional Portfolio Investment



1/ Asia-Pacific portfolio outflows to region as a share of regional GDP.

2/ Asia-Pacific portfolio outflows to region as a share of as a share of total portfolio

Source: IMF, Coordinated Portfolio Investment Survey.

Emergence of Sovereign Wealth Funds in the Asia-Pacific Region

Sovereign Wealth Funds in Asia

(in billions of U.S. dollars)

Country/economy	Assets	Amount	Source of Funds
Australia	Future fund	0.049	Fiscal surplus
China	China Investment Corporation	up to 200	Current account surplus
Hong Kong SAR	Exchange Fund (Investment Portfolio)	120	Fiscal surplus
Korea	Korea Investment Corporation	20	Current account surplus
Singapore	General Investment Corporation	100	Multiple 1/
Singapore	Temasek	100	Multiple 2/

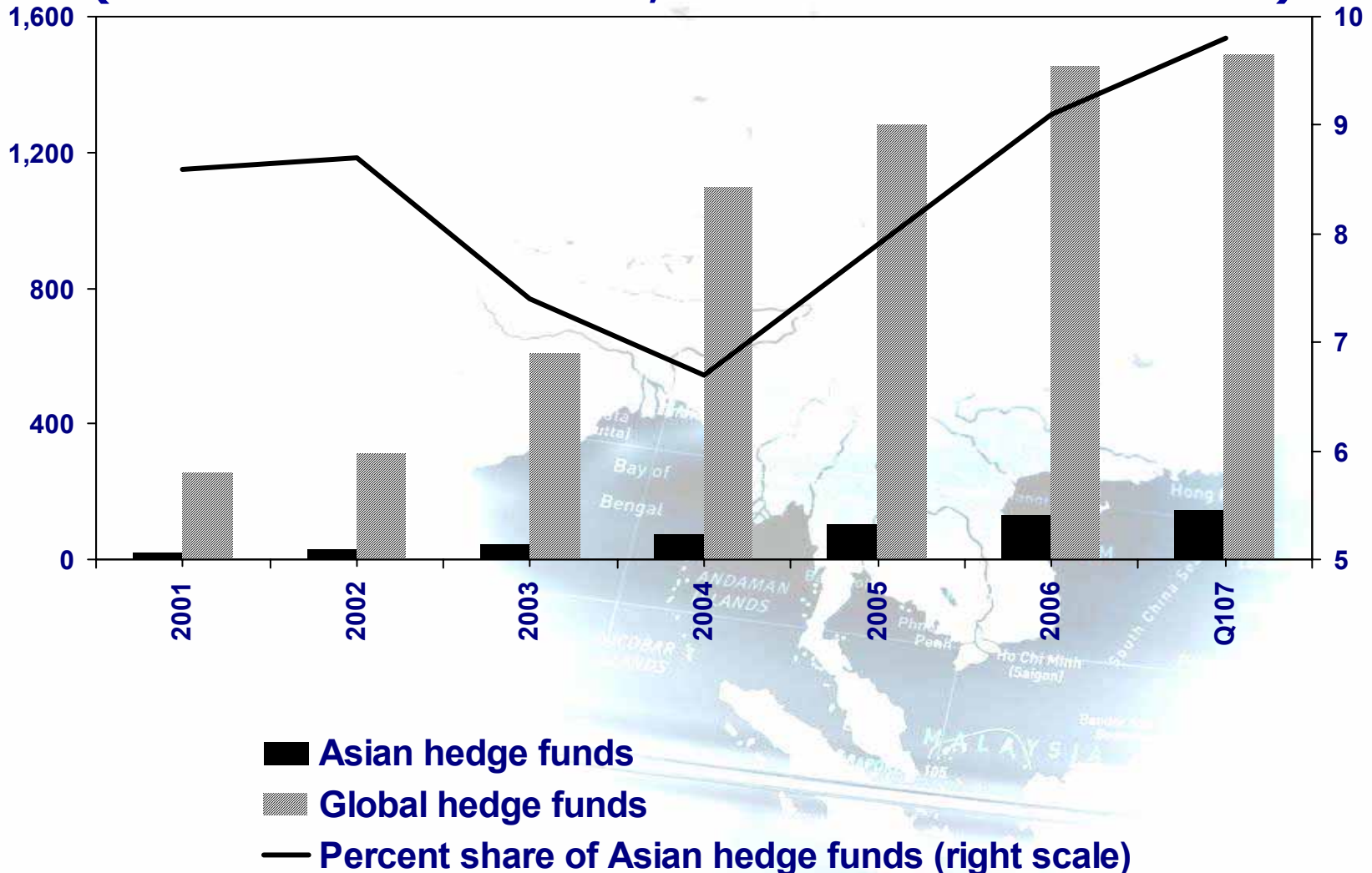
Sources: Country authorities; IMF staff estimates.

1/ Fiscal and current account surplus and proceeds from the sale of government bonds to the Central Provident Fund.

2/ Initial transfer of holdings, retained earnings, and borrowing.

Growing Presence of Asia-Focused Hedge Funds

**Assets Under Management of Asian and Global Hedge Funds
(in billions of U.S. dollars, unless otherwise indicated)**



Asia Financial Centers—Trends and Developments

- Strengthened domestic financial systems
- Deepened domestic financial markets
- Continued building of market infrastructure (clearing and payments systems, credit rating agencies, etc.)



Asia Financial Centers—Trends and Developments (concluded)

- Further liberalization of capital account and trade in services and removal of exchange controls
- Increased securitization of domestic assets
- Rapid growth in Islamic finance



Have Changes Mattered?

Quality of Domestic Financial Markets and Capital Flows

- IMF *Global Financial Stability Report* (Chapter 3), September 2007
- Focuses on domestic factors affecting capital inflows in developed and emerging economies 1/
- Goes beyond macroeconomic fundamentals to consider whether financial and institutional factors attract capital flows to emerging markets.

1/ 56 developed and emerging economies comprising 81 percent of world capital inflows in 2005.



Panel Least-Squares Estimation of Determinants of Capital Inflows, 1998-2006 1/

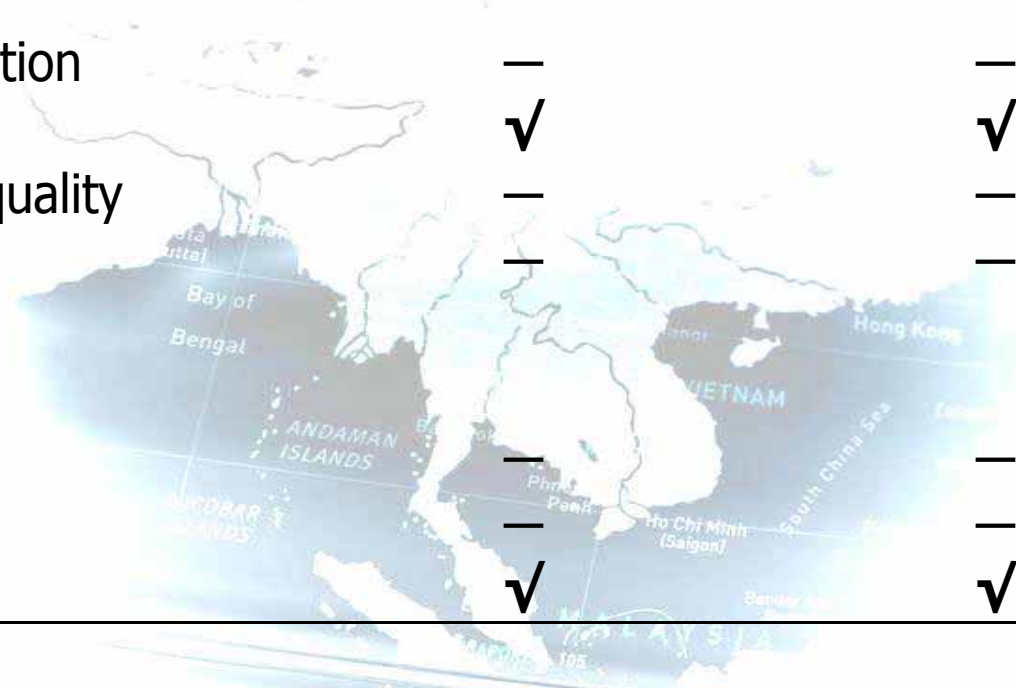
	All Countries	Emerging Markets
Financial Development Indicators		
Equity market turnover	√	√
Equity market capitalization	—	—
Financial openness	√	√
Corporate governance quality	√	—
Accounting standards	—	—
Macroeconomic Factors		
Growth expectation	√	√
Interest rate differential	√	√
Global liquidity	—	—

Source: IMF, *Global Financial Stability Report* (Chapter 3), September 2007.

1/Total capita inflows/GDP. √ = statistically significant.

Panel GMM Estimation of the Determinants of the Volatility of Capital Inflows, 1998-2006 1/

	All Countries	Emerging Markets
Financial Development Indicators		
Equity market turnover	—	—
Equity market capitalization	—	—
Financial openness	√	√
Corporate governance quality	—	—
Accounting standards	—	—
Macroeconomic Factors		
Growth expectation	—	—
Interest rate differential	—	—
Global liquidity	√	√



Sources: Source: IMF, *Global Financial Stability Report* (Chapter 3), September 2007.
 1/Standard deviation of total capita inflows/GDP. √ = statistically significant.

Financial Center Development—Areas for Further Reforms

- Development of institutional investor base
- Improvements in corporate governance
- Enhancements to market depth and liquidity



Greater development of institutional investor base, broadening and deepening capital markets

Further growth aided by:

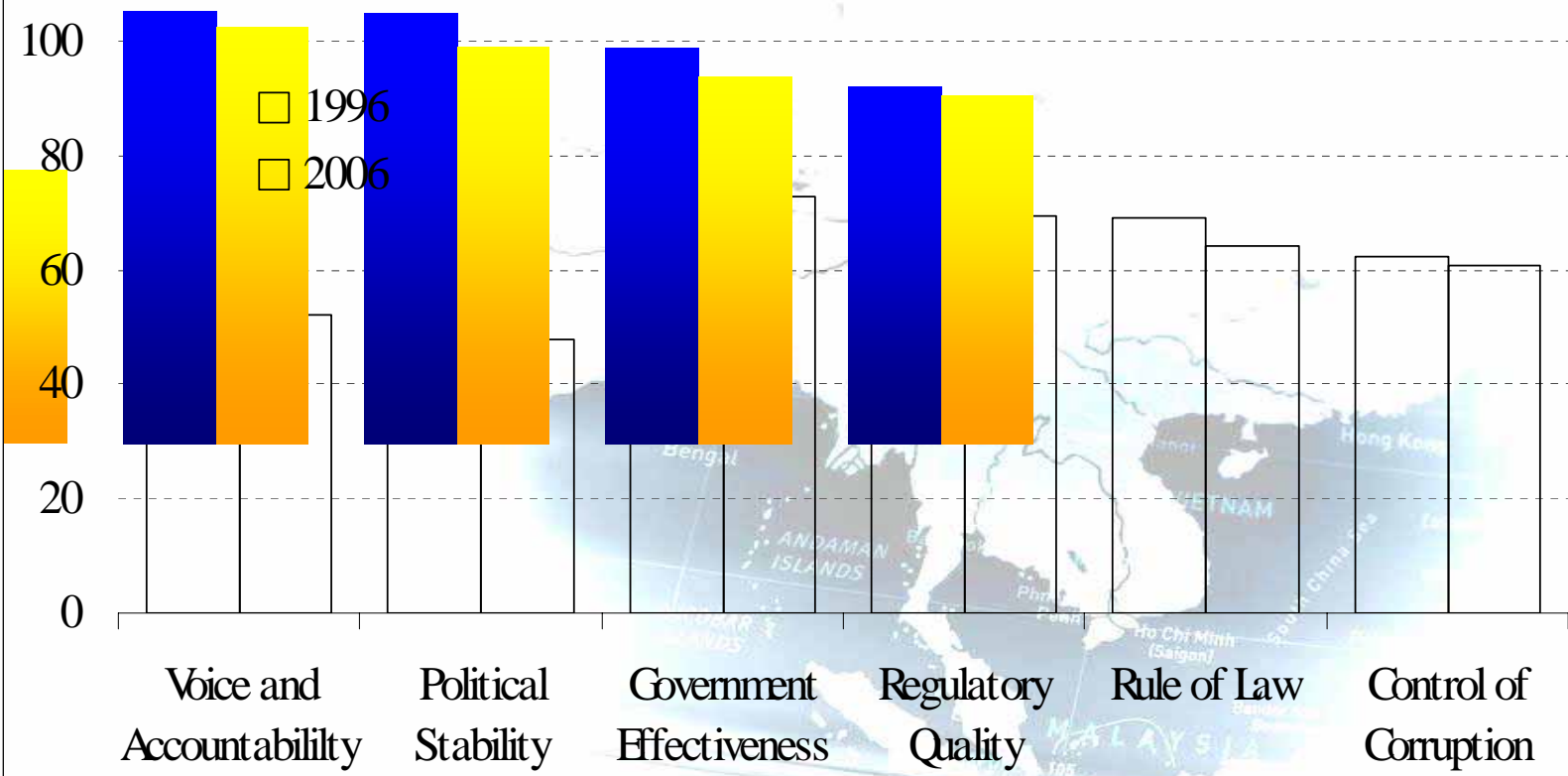
- Appropriate tax treatment and adequate transparency for long-term savings products
- Ease of entry by domestic institutions into foreign markets
- Level playing field vis-à-vis banks for household savings
- Pension reforms allowing additional moves from state-sponsored plans, greater choice between in pensions types, and new regulations improving risk management



Improved corporate governance, creating a more attractive investment climate

Emerging Asia: Governance Indicators¹

(Average, top ranking = 100)



Source: World Bank, Governance Indicators Database.

¹ Excludes China.

Enhanced market depth and liquidity

Focusing on Asian bond markets, development has been rapid the past decade, but more efforts to enhance liquidity—namely in secondary markets

- Better transparency to promote market participation
 - Micro level– greater information disclosure about general issuance strategy and secondary market trading activity
 - Macro level—more predictable information (including timely data) and policies, in particular with regards to taxation, regulation, and accounting standards
- Further development of institutional investor base (two-way street, as these investors tend to focus more on “micro” financial factors)
- More markets/facilities to improve risk management (futures, swaps, repos, securities lending)