Overview of Trends and Issues in Asia-Pacific Financial Development and Integration

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APFF, August 10, 2015
Benefits and Risks of Financial Integration

**Benefits**

Financial globalization yields collateral benefits...

Traditional view

- More efficient international allocation of capital
- Capital deepening
- International risk sharing

GDP growth
- Consumption volatility

A different perspective

Traditional channels

Potential collateral benefits
- Financial market development
- Institutional development
- Better governance
- Macroeconomic discipline

GDP/TFP growth
- Consumption volatility

**Risks**

... but initial, or threshold, conditions are a complication.

Threshold conditions
- Financial market development
- Institutional quality
- Governance
- Macroeconomic policies
- Trade integration

Above thresholds
- GDP/TFP growth
- Risks of crises

Below thresholds
- GDP/TFP growth
- Risks of crises

Note: TFP denotes total factor productivity

Indicators of Financial Integration

ASIA: FOREIGN PORTFOLIO INVESTMENT

Source: IMF, Coordinated Direct Investment Survey and Coordinated Portfolio Investment Survey database; and staff calculations.
Integration Through Portfolio Investment

**Sources of Portfolio Inward Investment (End-2013)**

**Destinations of Portfolio Outward Investment (End-2013)**

Source: IMF, Coordinated Portfolio Investment Survey database; and staff calculations.
Regional Integration Initiatives

FINANCIAL COOPERATION AREAS OF KEY REGIONAL FORA

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<th>Liquidity support</th>
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<th>Financial market development</th>
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RECENT INITIATIVES ON FINANCIAL INTEGRATION

- **APEC: Cebu Action Plan (September 2015)**
  - Roadmap towards a more **financially integrated, transparent** and **resilient** APEC region
  - Promoting financial integration by enhancing:
    - Supply chain financing
    - Financial inclusion and literacy
    - Financial services liberalization
    - Capital account liberalization

- **ASEAN: Establishment of the ASEAN Economic Community (end-2015)**

Source: Jung, J., 2008, *Regional financial cooperation in Asia: challenges and path to development*, BIS Papers No 42; and IMF staff
REGIONAL COOPERATION

- Promoting an integrated market for banking by specifying:
  - Minimum requirements for entry
  - Permissible banking activities
  - Regional arrangements for effective cross-border bank supervision and resolution
  - Regional institutions to set standards and rules and oversee national compliance
- Prepare for orderly capital account liberalization
- Mitigate risks, including in collaboration with the IMF

INDIVIDUAL ECONOMIES

- Design and implement policies that support an integrated banking system
- Harmonize regulatory and supervisory frameworks
- Strengthen supervisory capacity
- Collaborate, including with IMF support, on economic surveillance, liquidity support arrangements, and capacity development
Closer financial integration has the potential to increase real incomes and accelerate real convergence within APEC.

Financial integration requires long-term investments in financial infrastructure.

Reliance on flexible and sound policy frameworks and a strengthened regional financial safety net should be part of the agenda.

Risk mitigation could be realized within regional bodies and helped by collaboration, including with the support of the IMF.
Thank you!