Key issues in building deep, liquid and integrated capital markets in APEC

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Financial Intermediation: The Basics

» Channels funds from savings to borrowers, playing a critical role in household wealth formation, economic activity, economic growth, and the functioning of government

» Transforms savings instruments into different borrowing instruments to satisfy the different desires of savers and borrowers w.r.t. maturity, risk, and liquidity

» Funding can take place solely within the banking system or can be supplemented by funding through the capital markets

» Bank intermediation places one party, the bank, at the center of the intermediation process; whereas, capital markets funding requires a much richer financial ecosystem
Asian Corporates Are Funded More by Bank Loans Than Are North American and European Corporates


Dependence on Bank Loans Widely Observed for Asia

Source: “Domestic Bond Market in Asia,” presentation by Thiam Hee Ng, ADB, 2015.
Why Grow Asia’s Domestic Bond Markets?

» While domestic banks are often successful at leveraging local expertise and offering client confidentiality, they can also be opaque and face limited competition, giving rise to cronyism and inefficiency

» Their “essentiality” can put the government on the hook for bailouts to avoid the risk of economic meltdown

» Foreign funding can substitute in good times, but can also induce volatility when foreign investors retreat

» In a downturn, bank capital constraints can lead to a sudden stop in lending

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US Corporate Bond Finance Remained Resilient during the Financial Crisis as Banking Lending Collapsed

What Is Needed to Grow Asia’s Bond Markets?

» Moody’s has been closely involved in an APFF work stream that has created self-assessment tools that help economies evaluate the type and amount of information investors have access to in any market

» Trust is an important foundation of any functioning market
  – Investors have to trust the information they use to evaluate risk
    » Reliable information (e.g., disclosure regimes)
  – Investors and Issuers need to trust that the system is functioning well with risks properly identified and disclosed
    » Operational resilience (e.g., clearing and settlement systems)
  – Investors and issuers must understand their rights and trust the government will protect and enforce them
    » Predictable outcomes (legal infrastructure/insolvency regime)

Our Panelists Will Discuss Other APFF Efforts Focused on Capital Markets

» Asia Region Funds Passport
  – Supporting the growth of institutional investors that might by domestic bonds

» Development of repo markets
  – Facilitating the short-term financing of long-term bonds

» Legal frameworks for over-the-counter derivatives
  – Providing certainty with regard to legal standing

» Financial market infrastructure
  – Providing confidence around operational resiliency
Conclusion

» When domestic markets are built upon sound foundations that meet international best practice standards, it is much easier to connect them to global markets

» Public-private sector dialogue, like we have here in ABAC, is invaluable to this process