



THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

Document: AGFSCB 28-020 Draft: FIRST Source: ADBI Date: 8 May 2008 Meeting: Moscow, Russian Federation

Second Meeting 2008
14 May 2008
The Atrium
Hotel Baltshug Kempinski
Moscow, Russian Federation

Meeting Paper 5-D

RESEARCH PROJECT

IMPLICATIONS OF THE SUBPRIME CRISIS

ON ASIA'S GROWTH AND ASIA'S RESPONSE

Prepared by the Asian Development Bank Institute

Implications of the Subprime Crisis on Asia's Growth and Asia's Response

Concept Paper

1. Project Objectives

The global financial turmoil originating from the US subprime mortgage market crisis seems to be deepening and broadening. As this turmoil continues, conditions in global financial markets remain uncertain and volatile. Even though sizable liquidity injections and other policy measure in developed economies have been made by concerned authorities, the contagious effects of the crisis on financial markets have prevailed not only in developed economies but also in emerging market economies. Short-term financial market has been almost frozen for a while and high-risk financial products have been traded on a very limited basis. However, many have insisted that the spillover effects of the crisis to the Asian financial market has been and will be relatively small and capital inflows from developed countries will remain strong.

There are several factors that may explain this resilience in Asian economies. First, the region's financial institutions have been less exposed to the US subprime mortgage and structured financial products. Many financial institutions in the region were still in the process of strengthening their balance sheets when structured financial products were widely marketed. Second, strong economic growth potential and sound external positions in emerging Asian economies attract the attention of international investors. Despite the subprime crisis and looming recession in the US, Asia's economic growth was better than expected across the region in 2007, and according to recent updated forecast by the IMF and the ADB, economic growth in the region remains strong. Exports continue to be an important driver of growth in the region. Moreover, domestic demand is making an increasing contribution in a number of Asian economies. Third, enhanced macroeconomic management since the Asian crisis and reformed financial institutions have helped mitigate the impact of external shocks.

Nonetheless, a question has been raised whether Asia's economic growth, in general, and financial market growth, in particular, can continue in a period when the US economy enters into a prolonged stagnation and the rest of the world feel the effects of the subprime crisis. After all, the economic growth in the region more or less depends on the economic conditions in the US and Euro area. Therefore, there will be real sector adjustment in 2008 and beyond, which will feed into the financial sector.

This project will examine the extent of the impact of the ongoing subprime crisis on Asian economies. This will include an assessment of how Asia's current financial systems can cope with the pressure arising from the subprime loan crisis. Furthermore, this project will examine current supervisory and regulatory framework of Asian financial systems for structured financial products including ABCP, CDO, CBOs, etc. At the same

time, it will look into the possibility of formulating regional cooperation that can make Asia's financial architecture stronger and more resilient to new types of internal or external financial shocks such as the US subprime crisis.

2. Approach

Before formally launching the project, ADBI shall conduct a brainstorming meeting to discuss the specific issues to be tackled in this study, the best approach to conduct the study, the expected outputs and the timeframe for the project as well as to identify researchers who will conduct the studies. The total number of participants in this meeting will be twelve who will come from:

- ADBI and ADB;
- Market players (ABAC and private sector participants);
- Academics; and
- Financial sector supervisors and regulators.

The expected output of the brainstorming session is a detailed activity profile of the proposed project. This meeting shall be held in August 2008.