

# Introduction

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This volume is a collection of the speeches, presentations and papers from a conference on “The international financial crisis and policy challenges in Asia and the Pacific”. The event was co-hosted by the People’s Bank of China (PBC) and the Bank for International Settlements (BIS) to mark the formal completion of the BIS Asian Research Programme. It was held on 6–8 August 2009 in Shanghai, China, at the same location where the establishment of the Programme was first announced in 2006. Senior officials from all 12 Asian Consultative Council (ACC) central banks, as well as academic scholars and economists from the BIS Representative Office for Asia and the Pacific attended the conference. The formal addresses included speeches by Jaime Caruana, General Manager of the BIS, Zeti Akhtar Aziz, Chair of the ACC and Governor of the Central Bank of Malaysia, and Zhou Xiaochuan, Governor of the PBC.

The conference formally wrapped up the BIS Asian Research Programme (<http://www.bis.org/arp>). From September 2006 to August 2009, the Asian Research Programme focused on policy-oriented studies of topics of interest to central banks and supervisory authorities in Asia and the Pacific, and it co-organised a series of conferences, seminars and workshops in the region. The objectives of the three-year programme were to contribute to a better understanding of the policy challenges and to establish a lasting research footprint for the BIS in the region. Topics of interest included improving monetary policy and operations, developing financial markets, maintaining financial stability and strengthening prudential policy.

The conference also provided an opportunity to re-examine the existing approaches to preserving monetary and financial stability in Asia and the Pacific, in the light of the lessons of the international financial crisis. Even though the impact of the crisis was more muted in this region than elsewhere, there are many lessons to be learned.

## Summary of the conference papers

The conference showcased a special background paper written especially for the event by the staff of the Asian Research Programme, offering a unique Asian Office perspective on the crisis. Three sessions then followed, reflecting the broad themes of the programme: the development of financial markets, monetary policy and exchange rates, and financial stability. Each session began with a keynote address from a pre-eminent academic scholar. This was followed by presentations of two BIS research papers produced in the Asian Research Programme, which in many cases were joint research efforts of the Asian Office and central bank colleagues from the region. Each session concluded with a high-level policy panel discussion.

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## **The international financial crisis in Asia-Pacific**

The first presentation was based on a paper written by the economists of the Asian Office that outlines the impact of the international financial crisis on Asia and the Pacific. It offers a timeline of the developments in the region, as well as identifying key factors that help to explain the cross-country variations of the crisis in different economies. The policy challenges of the crisis for central banks in the region are highlighted.

## **Developing financial markets**

The first full session focused on the development of financial markets in the region. The keynote address, by Suresh Sundaresan (Columbia University), offered several insights. First, financial market development in the region should take account of the large number of households who are effectively unbanked, given the potential for positive feedback effects between financial markets, economic growth and stability. Second, there is a need for fundamental banking reforms of capital structures and liquidity sources to mitigate bankruptcy risks, as well as the cost to taxpayers of insolvency and bailouts. Third, credit disintermediation in the shadow banking system, as seen during the crisis, represents a new development and requires corresponding changes in regulatory and policy frameworks to ensure a smooth transition to a more open and transparent financial system.

This first session also explored the remarkable developments in regional bond markets, based on two papers by Anella Munro and Philip Wooldridge, and Susan Black (Reserve Bank of Australia) and Munro respectively. The papers document the significant increases in non-resident involvement over the past decade, in both local currency and offshore bond markets. The growth can be explained in large part by a combination of gains in the competitiveness of domestic credit issuance and the development of efficient swap markets. The data show that borrowers across the region face different transaction costs in different markets. They therefore seek out opportunities to issue bonds in the lowest-cost markets and then swap the proceeds into the desired currency.

In the second paper of the session, Jacob Gyntelberg, Mico Loretan and Tientip Subhani (Bank of Thailand) examine a unique set of daily data to identify the sources of equity price and exchange rate fluctuations in Thailand. They find that non-residents' equity transactions are driven primarily by private information and that only the relatively small portion of the net capital flows linked to these equity transactions has a permanent impact on the exchange rate. These results demonstrate that close monitoring of interactions between foreign exchange and capital markets can yield important information to policymakers.

## **Monetary policy and exchange rates**

The second session explored key monetary policy and exchange rate issues in the region. In his keynote address, Charles Engel (University of Wisconsin) makes the case for stabilising exchange rates. He argues that large swings in exchange rates can lead to inefficient resource allocations and, therefore, justify a pro-active role for central banks to lean against such swings. However, he also raises some political economy concerns about whether policymakers can achieve the best outcome by intervening in foreign exchange markets in a benign way. He suggests that, given the counterproductive incentives for competitive devaluations, efforts to control exchange rate fluctuations may best be made in the context of cooperation among policymakers.

Andrew Filardo and Hans Genberg then examine the central bank experience in achieving price stability in the region. They compare the experiences of six Asia-Pacific central banks that adopted formal inflation targets with six that employ more eclectic approaches to monetary policy. The authors find that formally adopting an inflation target is not a dominant factor in accounting for differences in cross-country performance. The paper also argues that the inflation control and financial stability can reinforce each other in a properly designed monetary policy framework.

The second presentation in this session, based on a paper by Michael Devereux (University of British Columbia) and James Yetman, develops a model that seeks to account for international contagion during the recent international financial crisis. The key mechanism works through private sector balance sheets. During periods of financial turmoil, a collapse in asset prices that impair balance sheets in one country can lead, through a negative “international finance multiplier”, to a vicious circle of asset price declines across economies. In contrast, during normal times, balance sheet considerations have little effect on macroeconomic outcomes, and financial market developments are relatively independent across countries.

## **Financial stability**

The final session addressed financial stability issues in Asia and the Pacific. The keynote address by Charles Goodhart (London School of Economics) compares the attractiveness of two different models of commercial banking, specifically the Anglo-Saxon model and the Asian model. The author argues that the Anglo-Saxon model imploded during the crisis for good reasons. He discusses the potential for a synthesis of the two models as a way forward, drawing on the desirable elements of the Asian model together with desired improvements to the Anglo-Saxon model based on lessons learnt during the crisis.

The presentation that followed, based on a paper by Don Kim (Yonsei University), Mico Loretan and Eli Remolona, explored the nature of the contagion from the West to Asia by looking at credit default swap (CDS) contracts and expected default frequencies (EDF). They argue that contagion in Asia during the crisis stemmed mainly from a rise in global risk premia, rather than a deterioration in the credit quality of Asian firms. The implications of this distinction for macroprudential policy are carefully spelled out.

The final paper, by Eloisa Glindro (Bangko Sentral ng Pilipinas), Tientip Subhanij (Bank of Thailand), Jessica Szeto (Hong Kong Monetary Authority) and Haibin Zhu, analyses the determinants of house prices in Asia and the Pacific. They characterise house prices as being made up of three factors: a fundamental factor; the deviation from the fundamental factor that can be attributed to frictions in the housing market; and a “bubble” component driven by overly optimistic expectations. Applying this approach to regional real estate, the authors find little evidence of generalised bubble behaviour in the past decade, despite evidence of frothy housing prices in some jurisdictions at times.

Electronic versions of the papers and presentations can be found at [http://www.bis.org/arp/conf\\_0908.htm](http://www.bis.org/arp/conf_0908.htm).