



November 28, 2017  
Bank of Japan

---

**Asian Financial Markets -- 20 Years since the Asian  
Financial Crisis, and Prospects for the Next 20 Years --**

*Keynote Speech at 2017 Annual General Meeting of Asia  
Securities Forum in Tokyo*

**Haruhiko Kuroda**

*Governor of the Bank of Japan*

## **Introduction: The Past 20 Years**

Good morning ladies and gentlemen. It is my great pleasure to join you this morning at the Annual General Meeting of Asia Securities Forum.

The year 2017 marks twenty years since the Asian Financial Crisis. Before the crisis, the region was highly praised for its strong economic growth. But at the same time, weaknesses had been accumulating, such as large current account deficits, high external debt, and massive non-performing loans. When a combination of economic, financial, and corporate problems triggered a sharp loss of confidence and capital outflows from the region, the crisis erupted and countries faced extreme recessions.

Twenty years later, Asia is now the largest contributor to global growth, accounting for 57 percent of global growth in real terms for 2016.<sup>1</sup> Domestic demand, especially consumption, has become the engine of growth and major cities in the region have prospered, being often characterized by the simple phrase, "lively and vibrant." Here in Tokyo, the surging number of Asian tourists to Japan is itself evidence for the strength of growing consumption in Asia.

I cannot but think of the significant changes that the economies of Asia, including Japan, have experienced over the past twenty years. These changes have been made possible through countless painstaking efforts, initiatives, and policies that countries in the region have introduced, both individually and collectively. I myself have been at the forefront of policy making in orchestrating crisis responses and enhancing regional cooperation in Asia for almost two decades, at Japan's Ministry of Finance, the Asian Development Bank (ADB), and the Bank of Japan (BOJ). Confirmation of the region's greater resilience against a major economic shock is deeply reassuring.

Let me touch upon the responses taken in the region after the crisis two decades ago. First, Asian countries improved their current account balances and strengthened foreign exchange reserves. The increase in net external assets has enhanced resilience against possible capital outflows. Second, the ratio of non-performing loans has decreased, and regulatory and

---

<sup>1</sup> The percentage share is based on real GDP (constant 2010 U.S. dollars), taken from the World Bank's *World Development Indicators*. "Asia" in this context includes Asia & Pacific and South Asia.

supervisory frameworks have been strengthened. Third, many countries in the region have adopted more flexible exchange systems. Last but not least, financial markets, especially local currency bond markets, have continued to develop.

The development of local currency bond markets was aimed at addressing two issues. One was the so-called double mismatches, that is, currency mismatches and maturity mismatches, and the other was a bank-centric financial system. Financial institutions in the region were borrowing short-term debt in dollars to finance longer-term lending in domestic currencies. This double mismatch was particularly damaging as the significant depreciation of their currencies inflated borrowers' debt burden. This led foreign lenders to refuse rolling short-term debt, which then triggered massive defaults of banks and firms. Twenty years later, the degree of the double mismatches has been reduced. Local currency bond markets have grown, as can be seen in Chart 1, providing an alternative intermediation channel to bank-financing. Today, the capitalization of Asian local bond markets is equivalent to 3.7 trillion U.S. dollars, more than 100 times larger than before the crisis.<sup>2</sup> We have certainly made progress. Economies have become more resilient to exogenous shocks, and the financial sector has developed significantly.

In addition to these individual efforts, various initiatives have been established through regional cooperation. For example, a regional financial safety net, the Chiang-Mai Initiative Multilateralization, has been set up by the ASEAN countries, together with China, Japan, and Korea, or ASEAN+3. The Asian Bond Market Initiative (ABMI) was launched in 2002 by ASEAN+3, and this has contributed to the development of local currency bond markets. Market associations and self-regulatory organizations, such as yourselves, have also played an important part in enhancing the efficiency and transparency of the markets.

---

<sup>2</sup> The total is as of June 2017 and covers nine countries and regions, including China, Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Singapore, Thailand, and Vietnam. The scaling factor compares June 2017 with June 1997 with reference to comparable four countries and regions, including China, Hong Kong, Korea, and Thailand. Data are taken from *Asian Bonds Online*.

### **Challenges Remaining**

However, important challenges still remain. Today, I will focus on the importance of further developing local currency bond markets, partly because I am surrounded here by people from the securities industry.

As I have mentioned, local currency bond markets have grown over the last twenty years. At the same time, bank financing still dominates as a primary source of funding in the region. You can see this from Chart 2. Bank credit, as a source of corporate funding, has outgrown both stock market capitalization and corporate bonds outstanding over the years.

The strong reliance on bank-financing may be explained by Asian corporate culture, which puts high priority on business relationships. Bond financing is often not the first choice for domestic firms when financing their business. To make my point clear, I am not proposing that Asian corporates should rely on market-financing over bank-financing, as is the case in some other countries. I would rather like to stress the importance of diversifying the sources of funding to reduce the direct effect on the corporate sector, should the banking sector face economic or financial shocks.

Along with this cultural issue, domestic firms are deterred by the cost of bond-financing when compared with bank loans. One of the factors that explain the unattractiveness of bond-financing may be the lower levels of market activity and less liquidity in the secondary market. With lower liquidity in the secondary market, investors require additional premiums, which increase the cost of issuance. In such an environment, domestic firms are more likely to rely on banks for financing.

In this regard, developing highly efficient and liquid local currency bond markets is essential. Past initiatives in the region have enriched the primary markets. We may therefore need to put more focus on developing liquid secondary markets.

As presented in Chart 3, according to a survey conducted by *Asian Bonds Online*, there is no single factor that inhibits the development of the secondary markets. Survey respondents were asked how important each of the eight structural issues was, with respect to local

currency bond market liquidity. The survey results in recent three years show that "Greater Diversity of Investor Profile" was the most important structural issue for promoting the market liquidity. Another structural issue, "Transaction Funding," which also marked a relatively high score, may also be worth noting as an important impediment.

Let me elaborate these two structural issues. First, the issue of investor base diversification. Since banks are the dominant financial institutions in the region, they are often the largest investor group as well. The presence of buy-and-trade investors like mutual funds, and active investors like hedge funds is relatively low, and this may be one of the causes of low liquidity in the secondary market. But it has to be borne in mind that merely increasing the size of the domestic investor base does not necessarily improve market functioning. In the region, demand for local currency bonds exceeds supply. In this situation, if a few dominant buy-and-hold type investors become even larger, they may take bonds out of circulation, leaving fewer investable bonds in the market. It is therefore important to increase the variety of investor types, attracting those who have different investment objectives and strategies.

The second issue is that of transaction financing. Improving it would require the development of repo markets. Repo markets are a key instrument for banks to trade cash while controlling counterparty risks. A well-functioning repo market is also a precondition for feasible market-making by dealers, and would increase two-way trading in both equity and bond markets. However, repo transactions in many Asian emerging markets are still restricted or small in transaction volume, as uncollateralized short-term funding conditions are easy and many investors do not have the incentive to use such instruments.

I have discussed the importance of developing local currency bond markets from the viewpoint of preparing for exogenous shocks and adverse circumstances. I would like to add another perspective related to the main theme of this meeting, "Ways for building a sustainable future."

It has often been said that, in order to achieve sustainable growth, the region must narrow its large infrastructure gaps. The ADB estimates that this will require funding of over 1.7 trillion

U.S. dollars a year, through 2030.<sup>3</sup> This magnitude of financing is well beyond the current funding capabilities of individual national governments, international organizations, and banks that operate as project finance lenders in the region.

In the financing of infrastructure assets, bond finance offers a number of advantages over bank loan finance. Infrastructure assets often generate stable long-term cash flows that make infrastructure debt an attractive investment opportunity for bond investors. Insurers and pension funds who have long-dated liabilities are seeking to match them with long-dated assets. Bond markets are able to provide opportunities to issue longer-tenor debt at fixed interest rates, thereby reducing the risks associated with refinancing shorter-tenor debt and the necessity of having to enter into long-term interest rate swaps to manage the risk of interest rate fluctuation. Also, as revenues from most infrastructure projects are denominated in local currencies, local currency infrastructure bonds will be able to mitigate the risk of currency mismatch.

### **Central Banks' Initiatives**

Let me now explain some measures taken by central banks in the region. Along with the Ministries of Finance, central banks of ASEAN+3 are taking part in the ABMI that I mentioned earlier, and have contributed especially to the discussion of cross-border payment and settlement issues.

Furthermore, the Executives' Meeting of East Asia Pacific (EMEAP) central banks, a group of 11 central banks and monetary authorities in the East Asia and Pacific region, set up the Asian Bond Fund (ABF) initiative in 2003, in order to develop local currency bond markets. The region has seen several advancements since the launch of the ABF initiative. They include (1) accelerated tax reforms to exempt nonresident investors from withholding tax, (2) enhancement of the regulatory framework for exchange-traded funds, (3) liberalization of foreign exchange administration rules, (4) improvements in regional market infrastructure, and (5) the adoption of documentation in line with international best practices. These

---

<sup>3</sup> ADB (2017), *Meeting Asia's Infrastructure Needs*.

advancements could perhaps have been achieved sooner or later without the ABF initiative, but the initiative certainly had a positive effect in facilitating these developments.<sup>4</sup>

The EMEAP central banks have also been engaged in promoting analysis of financial market developments in the region. In 2014, EMEAP published a report that assessed the developments and challenges in the repo markets in the region.<sup>5</sup> In addition to the benefits of efficient repo markets that have been noted, repos are an essential instrument in the open market operations of central banks, and therefore important to the transmission of monetary policy. The deeper these markets are, the more scope they offer central banks in their liquidity management operations.

Along with intra-regional initiatives, individual central banks have also introduced measures aimed at facilitating repo transactions. For example, the Monetary Authority of Singapore launched the Securities Repo Facility to promote their market-making activities. The central banks in Malaysia, Thailand, and Indonesia, have set up programs to increase awareness of repo markets among market participants, including corporate treasuries. Many other central banks are also working with investors, issuers, and intermediaries, to assess what can be done to facilitate active repo markets.

We, at the BOJ, have been participating in discussions at EMEAP to enhance the ABF initiative, and have been active in conducting market reviews. Assistant Governor Maeda of the BOJ currently chairs the Working Group on Financial Markets, leading further work in this area. The Bank also contributes to capacity-building with other authorities.

### **Concluding Remarks: Initiatives for the Next 20 Years**

I have discussed the importance of developing local currency bond markets, its remaining challenges, and initiatives taken by central banks in the region. Let me now summarize some

---

<sup>4</sup> For example, see Mizen, P., and Tsoukas, S. (2014), "What Promotes Greater Use of the Corporate Bond Market? A Study of the Issuance Behaviour of Firms in Asia," *Oxford Economic Papers*, Vol. 66 (1), pp. 227-253.

<sup>5</sup> *EMEAP Repo Markets: State of Play -- A Report by the EMEAP Working Group on Financial Markets 2014* (available from <http://www.emeap.org/index.php/publications/>).

of the wide range of benefits that can be gained by developing deep and liquid local currency bond markets. First, it makes possible for governments and firms to borrow in local currencies at longer maturities. This will reduce the risks associated with currency and maturity mismatches. Second, the development of such bond markets will enable borrowers to diversify their sources of funding by complementing bank-financing. At the same time, investors will gain more investment opportunities. With enhanced investment opportunities, abundant savings in the region could be recycled within the region. It could also fill part of the large infrastructure funding gap. Lastly, well-functioning primary and secondary bond markets reinforced by an expanded investor base will improve the overall efficiency of financial markets, which in turn will aid macro-economic policy implementation.

Over the past two decades, there have been many fruitful initiatives and programs to develop local currency bond markets. However, this is still work in progress and more needs to be done. As the market is a place of interaction, all stakeholders must play their roles. A successful implementation strategy must identify critical paths and appropriate sequencing to achieve the optimal result. Cooperation among authorities and private market participants is the key to further development.

The ASEAN+3 Bond Market Forum (ABMF) was set up in September 2010 by the ASEAN+3 countries as a common platform to foster standardization of market practices and harmonization of regulations related to cross-border bond transactions in the region. Members comprise experts drawn from both public and private sector organizations, such as those present at this forum today. This type of forum is a practical step toward achieving the ultimate common goal of Asia's bond market development.

The global economy continues to recover and the financial system has been maintaining stability. As the IMF's Managing Director expressed in her Global Policy Agenda at the last International Monetary and Financial Committee (IMFC) meeting, current economic and financial conditions provide "a window of opportunity" to tackle key challenges. Stakeholders in the region must maintain the will to further develop and deepen the market. Through these concerted efforts, the challenges in fostering bond markets can be overcome.



On the 10th anniversary of the Asian Financial Crisis, at a BOJ symposium, the then Governor Zeti of Bank Negara Malaysia, stated: Asia, especially the ASEAN tigers, is back and poised to leap on to the next wave of economic advancement and prosperity.<sup>6</sup> How correct she was. Asia's economy has developed much more vigorously than many had anticipated. Economic integration in the region has further deepened through the development of global value chains.

Looking ahead to the next twenty years, Asia's economy will continue to be at the core of world economic growth and we will experience further integration. Along with such developments, it is natural to seek more developed and integrated regional financial markets. We can anticipate that twenty years from now, Asia's financial markets will have developed to become as efficient and liquid as other major financial centers in the world.

Thank you for your kind attention.

---

<sup>6</sup> "Ten Years after the Asian Currency Crisis: Future Challenges for Asian Economies and Financial Markets," a speech at the international symposium hosted by the Center for Monetary Cooperation in Asia (CeMCoA) of the BOJ on January 22, 2007 in Tokyo (available from [https://www.boj.or.jp/en/announcements/release\\_2007/index.htm/](https://www.boj.or.jp/en/announcements/release_2007/index.htm/)).



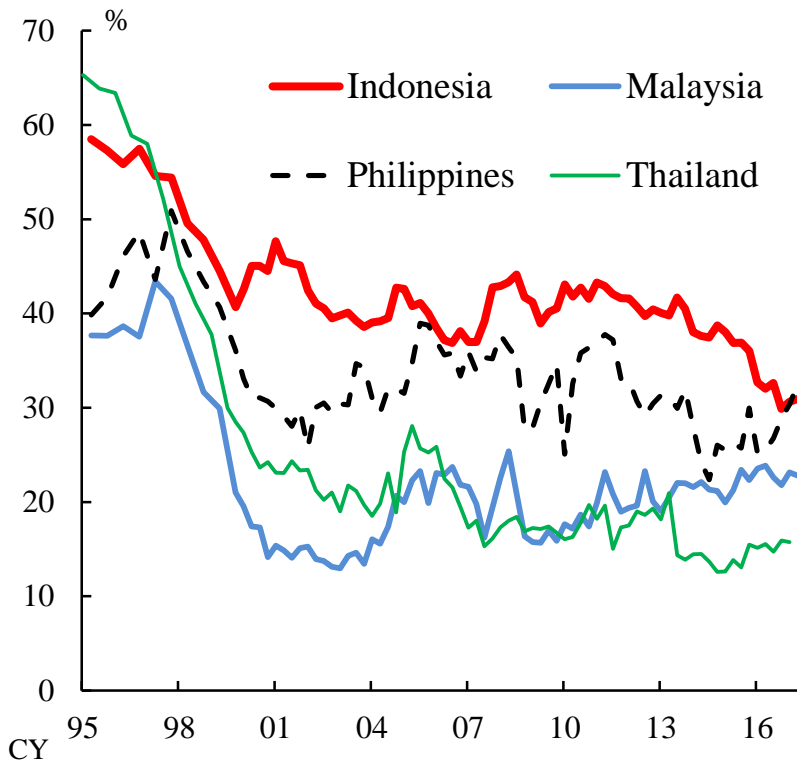
Asian Financial Markets  
— 20 Years since the Asian Financial Crisis,  
and Prospects for the Next 20 Years —

November 28, 2017

Haruhiko Kuroda  
*Governor of the Bank of Japan*

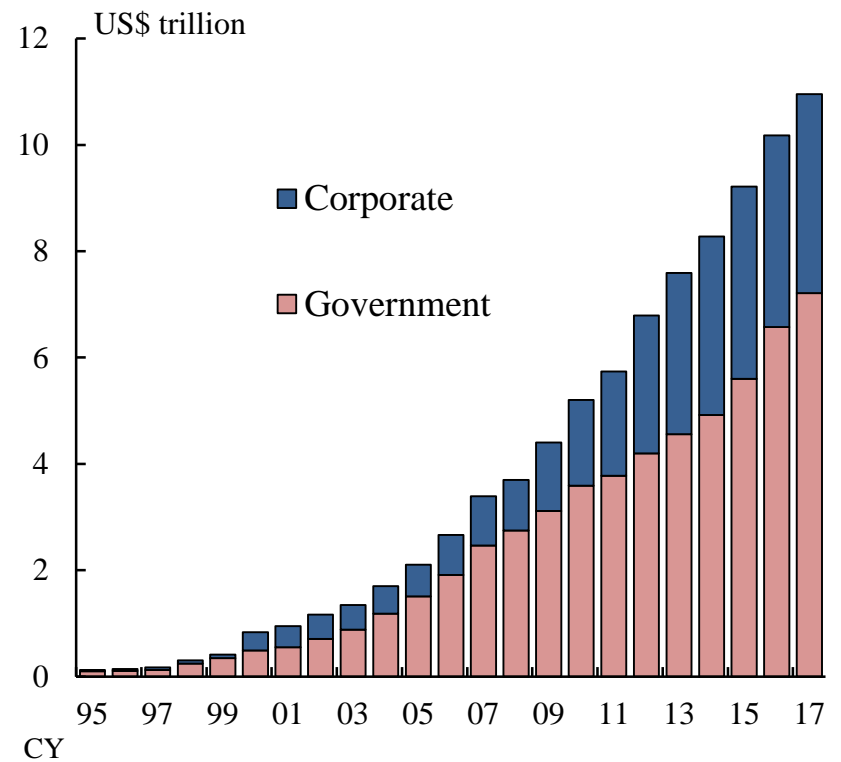
# Increased Resilience

Less reliance on foreign-currency-denominated short-term funding



Notes : 1. The figures are the ratios of foreign currency-denominated short-term claims to all claims of foreign banks.  
 2. The latest data are as of end-June 2017.  
 Source: BIS.

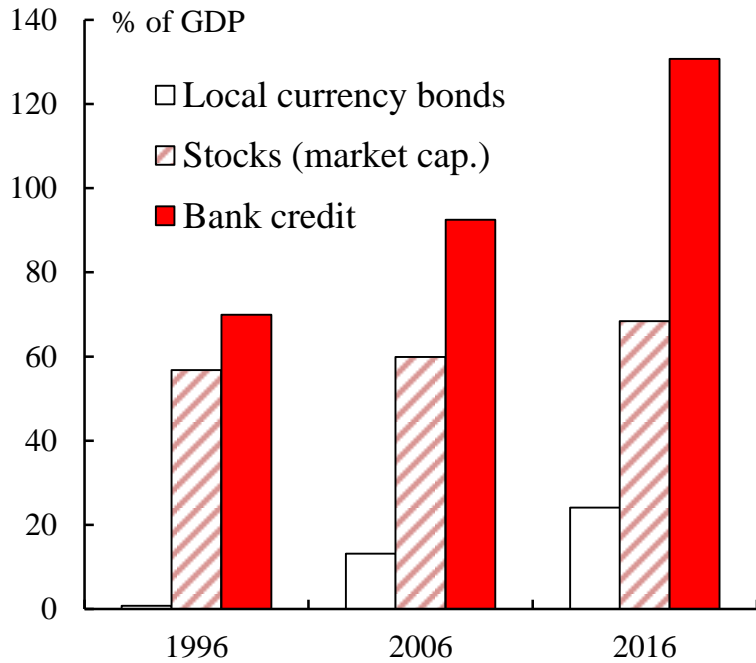
Growth of Asian local currency bond markets



Notes: 1. Aggregates of China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand, and Vietnam.  
 2. The figures for 2017 are as of end-June 2017.  
 Source: Asian Bonds Online.

# Bank-Dominated Financial Systems

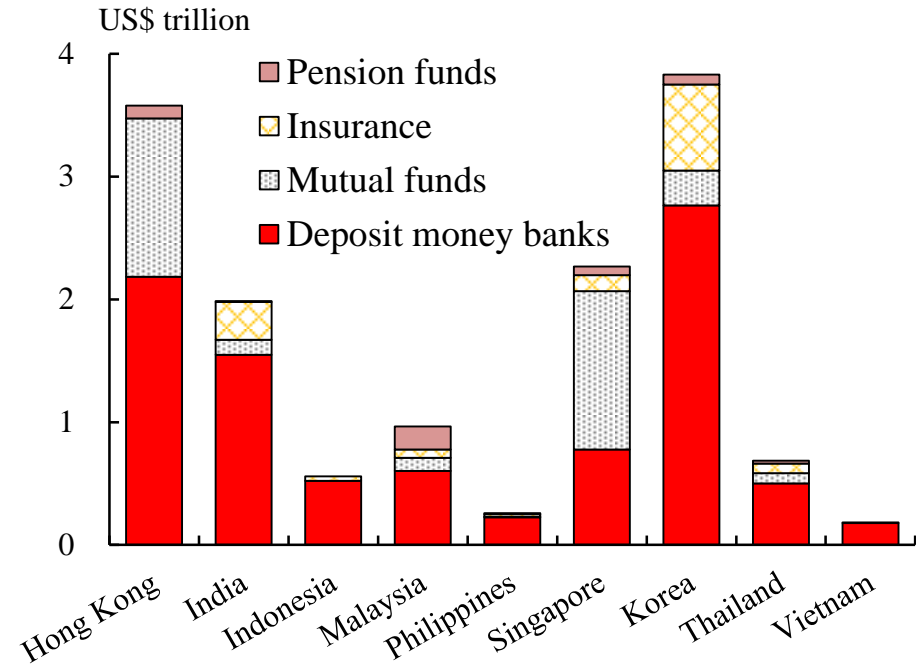
## Corporate financing in Emerging Asia



Note: Emerging Asia is the aggregate of China, India, Indonesia, Korea, Malaysia, Philippines, Thailand, and Vietnam.

Sources: *Asian Bonds Online*; The World Bank, *World Development Indicators*.

## Investor base in Emerging Asia



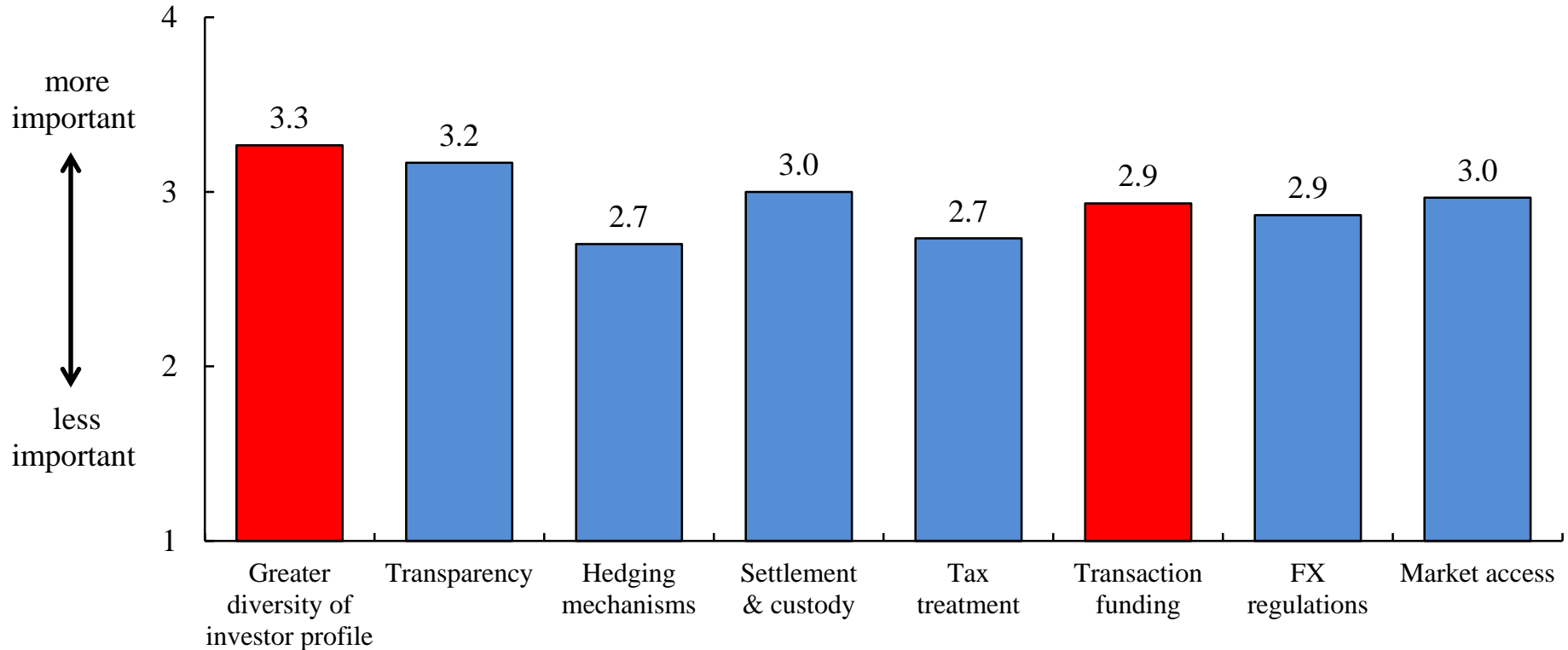
Notes: 1. As of end-2013 except for India's deposit-money-banks figure which refers to end-March 2014.

2. Figures for Pension funds and Mutual funds for Indonesia and Vietnam, and Insurance for Hong Kong are not available.

Sources: The IMF, *International Financial Statistics*; National central banks; The World Bank, *Global Financial Development Database*.

# Structural Issues in Local Currency Corporate Bond Markets in Emerging East Asia

## Annual Bond Market Liquidity Survey



Notes: 1. Emerging East Asia comprises China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

2. Averages of four scores answered (1: not important, 2: somewhat important, 3: important, 4: very important) in 2015-2017.

Source: *Asian Bonds Online*.