

Global Financial Crisis: Implications for Asia*

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** The views expressed here are those of the author and do not necessarily reflect the views of the Asian Development Bank (ADB) or ADB's Board of Governors or the countries they represent.*

1. Global Financial Crisis: Have we reached bottom?

- Deleveraging continues in global financial systems
- Liquidity tight, despite interventions
- Default risks high



Deleveraging continues in global financial systems

Writedowns and capital raised by major banks since the third quarter of 2007
(US dollar billions)

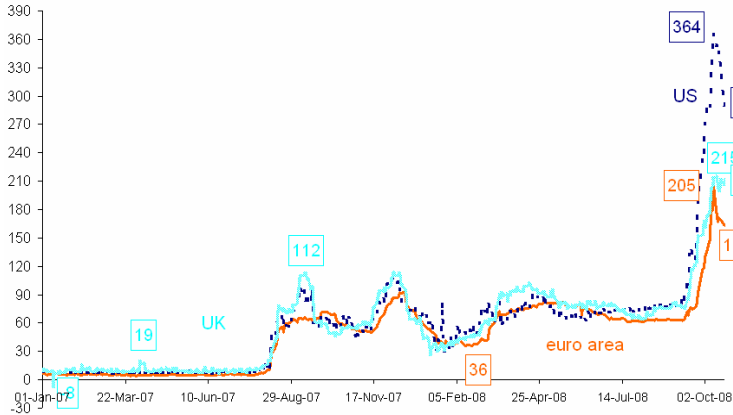


Source: Bloomberg.



Liquidity tight, despite interventions

3-month Libor minus Overnight Index Swap (OIS) Spreads (basis points)



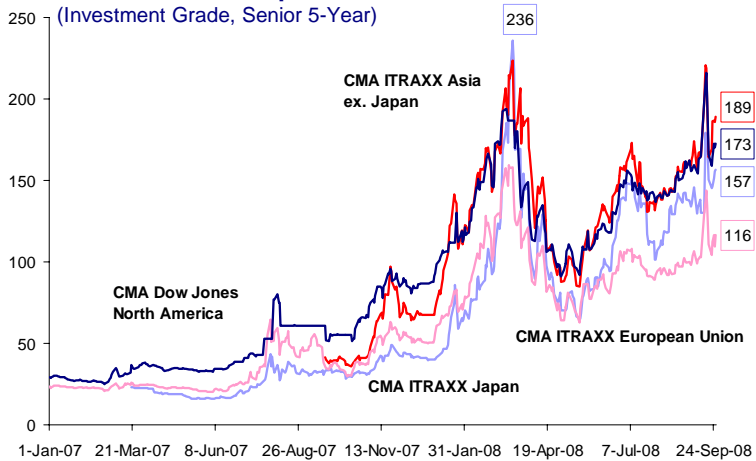
Source: Bloomberg.



Default risks high

Credit Default Swap Indexes

(Investment Grade, Senior 5-Year)



Source: Datastream.



2. Impact on Asia

- Ripple effects hit Asian financial markets
 - Equities
 - Currencies
 - External funding conditions
- Credit crunch reaches Asian shores
 - Dollar shortages
 - Domestic interbank markets under pressure
- Exporters feel the pinch

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Ripple effects hit equities...

Composite Stock Price Indexes (last daily price , 2 January 2007 = 100, local index)



¹ Daily stock price indexes of Hang Seng (Hong Kong, China), JCI (Indonesia), KOSPI (Korea), KLCI (Malaysia), PCOMP (Philippines), STI (Singapore), TWSE (Taipei, China) and SET (Thailand) weighted by market capitalization.

² Daily stock price indexes of combined Shanghai and Shenzhen Composite, weighted by their respective market capitalization (PRC). Source: OREI staff calculations based on Bloomberg data.

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...and currencies

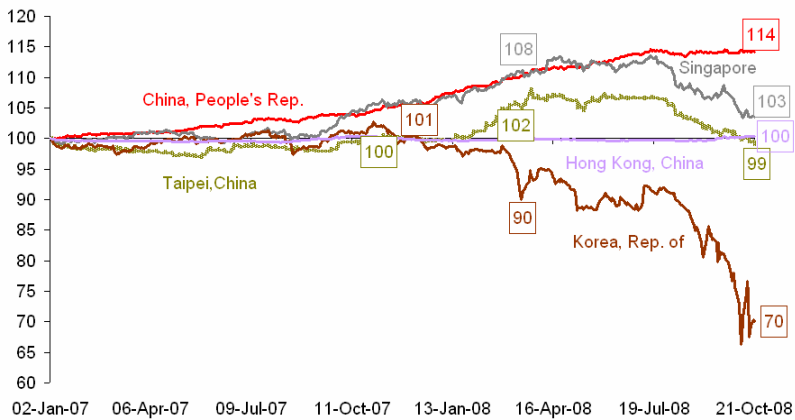
Exchange Rate Indexes—ASEAN-4 (local currency vis-à-vis US\$; 2 January 2007=100)



Source: OREI staff calculations based on Bloomberg data.

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Exchange Rate Indexes—NIEs and People's Rep. of China (local currency vis-à-vis US\$; 2 January 2007=100)

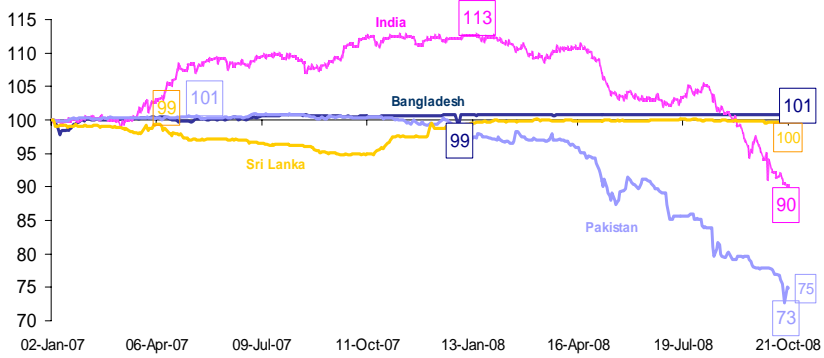


Source: Bloomberg.

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Exchange Rate Indexes—South Asia

(local currency vis-à-vis US\$; 2 January 2007=100)



Source: OREI staff calculations based on Bloomberg data.



Exchange Rate Indexes—Others

(local currency vis-à-vis US\$; 2 January 2007=100)



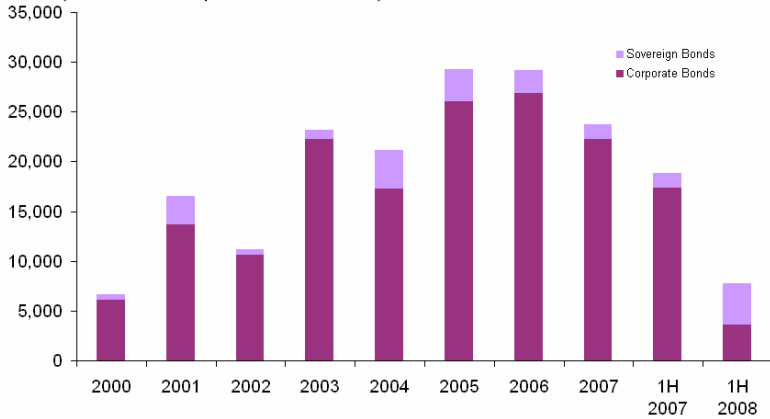
Source: OREI staff calculations based on Bloomberg data.



And external funding becomes difficult..

Corporate and Sovereign Eurobond Volume

(Asia¹ exc Japan, in \$ million)

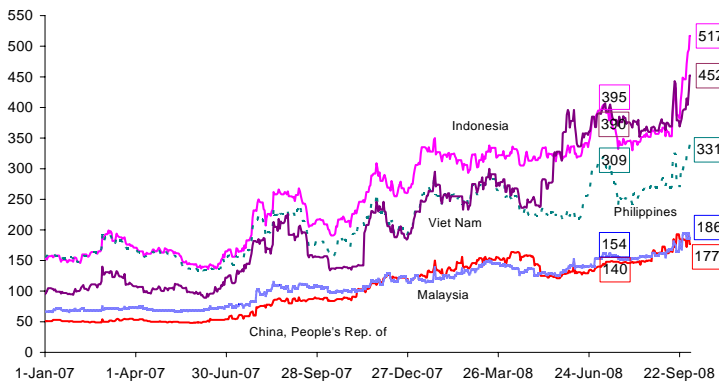


¹ Refers to PRC, Hong Kong, China, Indonesia, Rep of Korea, Macao, China, Malaysia, Philippines, Singapore, Taipei, China, Thailand, and Viet Nam.
Source: Dealogic.



...with higher risk premiums

JP Morgan EMBI Sovereign bond credit risk premium (basis points)

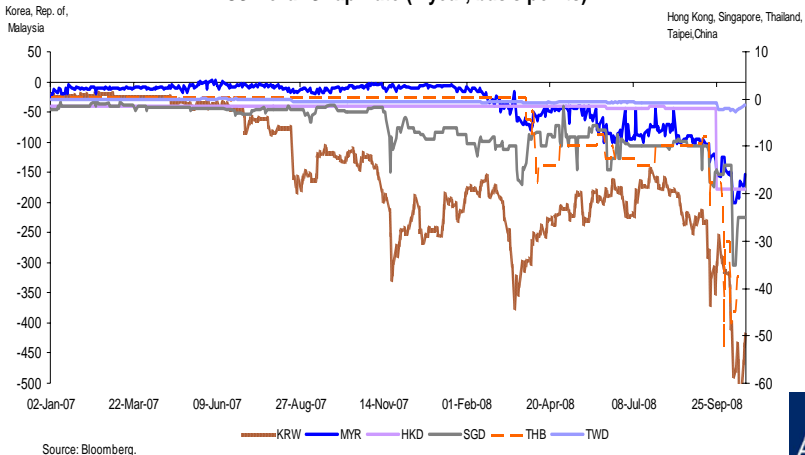


Source: Bloomberg.



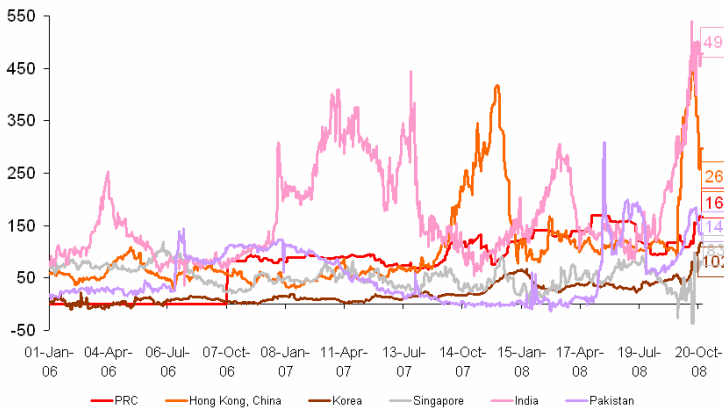
Credit crunch reaches Asian shores: banks scrambling for dollars

US Dollar Swap Rate (1-year, basis points)

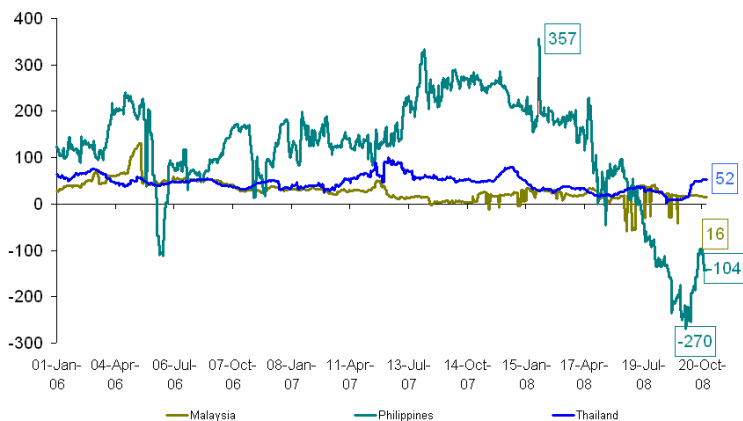


...and domestic funding tight

IBOR minus Local Currency Government Bond Yields (3-months, basis points)



IBOR minus Local Currency Government Bond Yields (3-months, basis points)



Source: Staff calculations based on Bloomberg data.



Exporters feel the pinch

Merchandise Export Growth¹ (\$ value, y-o-y, %)



¹ 13-month moving average.

² Refers to NIEs, ASEAN-4 and Viet Nam; does not include Brunei Darussalam, Cambodia, Lao People's Democratic Republic, and Myanmar, for which monthly data are not available.

³ PRC = People's Rep. of China.

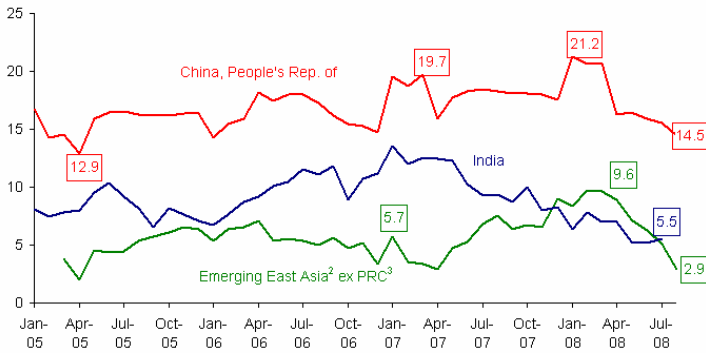
⁴ South Asia includes Bangladesh, India, Pakistan, and Sri Lanka.

Source: DREI staff calculations based on CEIC data.



And industrial growth slows

Industrial Production Growth¹ (y-o-y, %)



¹ 3-month moving average.

² Refers to ASEAN-4; Korea, Rep. of; Singapore; Taipei, China; and Thailand, does not include Hong Kong, China, Brunei Darussalam, Cambodia, Lao People's Republic, Myanmar, and Viet Nam, for which monthly data are not available.

³ PRC = People's Rep. of China

Source: OREI staff calculations based on CEIC data.

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3. Outlook and Banking Environment

- Growth expected to slow further in 2009
- Inflationary pressures receding
- Regional banking systems healthy
 - Comfortable capital adequacy
 - Small non-performing loans

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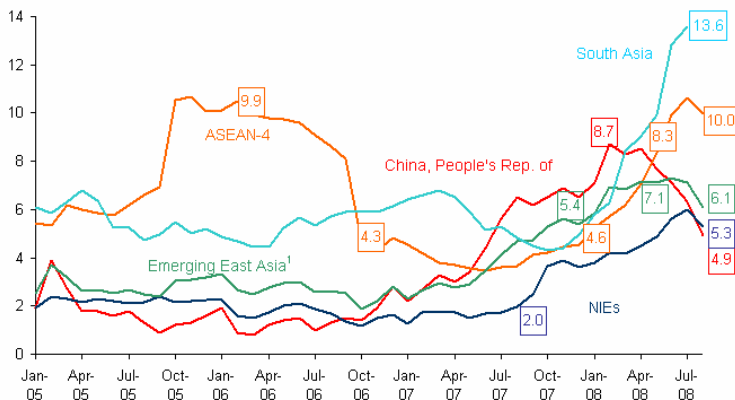
Growth expected to slow further in 2009

	2005	2006	2007	2008H1	2008		2009	
					ADB (Sep)	IMF (Oct)	ADB (Sep)	IMF (Oct)
Developing Asia⁷	8.1	8.9	9.0	...	7.5	7.3	7.2	6.6
Emerging East Asia^{1,2}	7.8	8.7	9.0	8.1	7.5	7.2	7.3	6.7
ASEAN^{1,2}	5.7	6.0	6.5	5.8	5.4	5.2	5.4	4.7
Indonesia ³	5.7	5.5	6.3	6.4	6.2	6.1	6.2	5.5
Malaysia ⁴	5.3	5.8	6.3	6.7	5.6	5.7	5.3	4.8
Philippines ⁵	5.0	5.4	7.2	4.6	4.5	4.4	4.7	3.8
Thailand	4.5	5.1	4.8	5.7	5.0	4.7	5.0	4.5
Newly Industrialized Economies¹	4.8	5.6	5.6	4.9	4.5	4.0	4.5	3.3
Hong Kong, China	7.1	7.0	6.4	5.8	4.5	4.1	4.5	3.5
Korea, Rep. of	4.2	5.1	5.0	5.3	4.6	4.1	4.5	3.5
Singapore	7.3	8.2	7.7	4.5	4.2	3.6	4.6	3.5
Taipei, China	4.2	4.9	5.7	5.3	4.2	3.8	4.6	2.5
China, People's Rep. of	10.4	11.6	11.9	10.4	10.0	9.7	9.5	9.3
South Asia	9.0	8.9	8.6	...	7.1	7.6	6.7	6.4
Bangladesh	8.0	8.6	6.4	...	6.2	7.0	6.5	5.6
India	9.4	9.6	9.0	8.4	7.4	7.9	7.0	6.9
Pakistan	9.0	5.8	6.8	...	5.8	5.8	4.5	3.5
Sri Lanka	6.2	7.7	6.8	...	6.0	6.1	6.0	5.1
Japan	1.9	2.4	2.1	1.0	1.0	0.7	1.0	0.5
US	3.1	2.9	2.2	2.3	1.3	1.6	1.0	0.1
eurozone	1.6	2.8	2.6	1.7	1.4	1.3	1.4	0.2



Inflationary pressures receding

Headline Rates (y-o-y, %)



¹Refers to ASEAN-4, NIES, People's Rep. of China, and Viet Nam; does not include Brunei Darussalam, Cambodia, Lao People's Democratic Republic, and Myanmar for which monthly data are not available.
Source: OREI staff calculations based on CEIC data.



Asian banks in healthy shape

Risk-Weighted Capital Adequacy Ratios (% of risk-weighted assets)

	2000-2004 Average	2004	2005	2006	2007 ¹	2008 ²
Hong Kong, China	16.1	15.4	14.8	14.9	13.4	14.3
Bangladesh	7.6	8.8	7.3	8.3	10.0	...
India	12.0	12.9	12.8	12.3	12.3	12.6
Indonesia	12.0	19.4	19.5	20.5	19.3	17.1
Korea, Rep. of	11.2	12.1	13.0	12.7	12.3	11.4
Malaysia	13.4	14.3	13.6	13.1	12.8	12.5
Pakistan	11.6	11.4	11.9	13.3	13.8	12.6
Philippines	17.0	18.7	17.7	18.5	19.4	15.7
Singapore	17.7	16.2	15.8	15.4	14.0	...
Sri Lanka	9.6	10.3	12.8	12.7	...	...
Taipei, China	10.5	10.7	10.3	10.1	10.6	10.6
Thailand	13.2	13.0	14.2	14.5	15.4	15.5
Viet Nam	...	...	...	...	...	...

... = not available.

¹Data for Singapore as of Sep 2007; Philippines as of Jun 2007.

²Data for Indonesia, Malaysia, and Thailand as of Aug 2008; Korea and Taipei, China as of Jun 2008; and Hong Kong, China, India, Pakistan, and the Philippines as of Mar 2008.

Sources: CEIC, national sources, and *Global Financial Stability Report*, International Monetary Fund.



Nonperforming Loans (% of commercial bank loans)

	2000-2004 Average	2004	2005	2006	2007 ¹	2008 ²
Bangladesh	26.8	17.6	13.6	13.2	14.0	13.2
China, People's Rep. of	21.0	13.2	8.6	7.1	6.2	...
Hong Kong, China ³	4.8	2.3	1.4	1.1	0.9	0.8
India	10.1	7.2	5.2	3.3	2.5	2.8
Indonesia	10.6	5.7	8.3	7.0	4.6	3.9
Korea, Rep. of	3.5	1.7	1.1	0.8	0.6	0.6
Malaysia ³	8.9	6.8	5.6	4.8	3.2	2.5
Pakistan	15.9	9.0	6.7	5.7	6.3	6.9
Philippines ³	14.8	12.7	8.2	5.7	4.4	4.0
Singapore	5.3	5.0	3.8	2.8	1.8	...
Sri Lanka	13.0	8.9	6.8	5.5	...	...
Taipei, China	5.2	2.8	2.2	2.1	1.8	1.6
Thailand	13.5	10.9	8.3	4.1	3.9	3.4
Viet Nam	...	...	...	...	...	...

... = not available

¹Data for Singapore as of Sep 2007.

²Data for Indonesia and Malaysia as of Aug 2008; Philippines as of Jul 2008; Korea, Taipei, China, and Thailand as of Jun 2008; and Bangladesh, India, Hong Kong, China, and Pakistan as of Mar 2008.

³Reported nonperforming loans are gross classified loan ratio of retail banks.



4. Risks and Vulnerabilities

- Countries with weaker fundamentals more vulnerable than others
- Global credit crisis, asset price declines, and slower growth pose risks to regional banking systems
- Sources of vulnerability:
 - High domestic credit growth
 - Household indebtedness
 - Private sector leverage



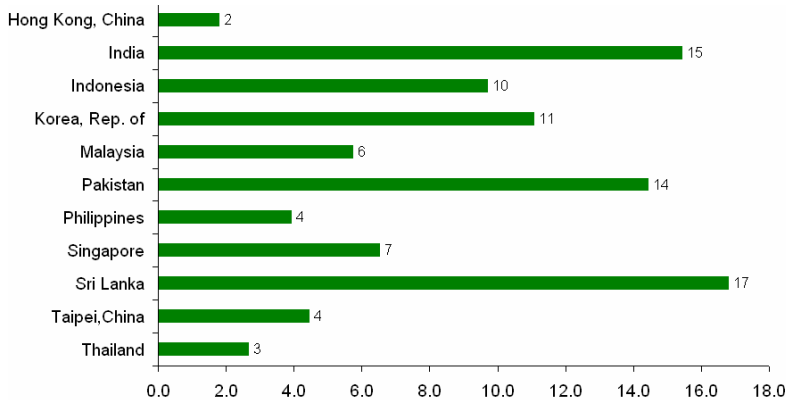
Countries with weaker fundamentals are more vulnerable

	Inflation (Latest)	Loans to Private Sector (as of Jun08, yoy)	Fiscal balance-to-GDP ratio (2008E)	Government Debt-to-GDP ratio (2007)	Current Account to GDP ratio (2008E)	External debt to GDP (2007)	Short-term debt to forex reserves ratio
ASEAN							
Indonesia	12.1 (Sep)	32.7	-2.1	35.7	0.1	31.5	53.3
Malaysia	8.5 (Aug)	11.4	-3.1	41.6	14.8	30.4	23.6
Philippines	11.9 (Sep)	3.9	-1.4	56.7	2.4	45.5	49.9
Singapore	6.4 (Aug)	19.8	6.3	41.4	19.2	...	87.5
Thailand	6.0 (Sep)	8.3	-2.0	24.3	3.1	25.1	12.5
Viet Nam	27.9 (Sep)	54.4	-5.2	36.0	-11.7	34.3	34.9
ASEAN+3							
China, People's Rep. of	4.9 (Aug)	15.4	0.8	12.6	9.5	11.7	8.1
Korea, Rep. of	5.1 (Sep)	16.2	1.6	32.8	-1.3	40.3	72.7
South Asia							
Bangladesh	10.0 (Aug)	24.7	...	...	1.0	...	25.3
India	11.8 (Sep)	26.6	-3.6	83.7	-2.8	15.8	27.4
Pakistan	23.9 (Sep)	18.5	-7.0	55.1	-8.7	26.7	37.8
Sri Lanka	24.3 (Sep)	19.2	...	...	-7.5	...	60.7
Others							
Hong Kong, China	5.1 (Sep)	11.7	0.1	1.2	11.7	...	78.6
Taipei, China	3.1 (Sep)	...	-0.1	36.0	7.8	23.9	17.3

Vulnerabilities rise with leverage

Domestic credit growth

(average annual growth rate for 2000-07, %)



Source: *International Financial Statistics* International Monetary Fund and Central Bank of China.



Some regional banks more exposed to asset price declines..

Securities Investment to Total Bank Assets of Commercial Banks (%)

	2000-2004 Average	2004	2005	2006	2007	Aug- 2008 ¹
China, People's Rep. of		71.1	66.7	...	...	...
Hong Kong, China	16.9	19.2	19.6	20.2	17.7	15.5
Bangladesh	...	...	...	...	...	...
India	30.6	33.3	30.4	25.3	22.2	...
Indonesia	18.3 ¹	20.2	18.0	24.8	27.8	17.4
Korea, Rep. of	23.2	20.8	22.1	20.2	18.6	17.4
Malaysia	12.7	10.6	9.6	9.3	5.5	4.4
Pakistan	14.0	13.2	13.0	10.3	13.0	...
Philippines	26.6	31.6	32.0	30.0	28.3	29.1
Singapore	16.9	17.1	16.5	15.9	15.8	14.8
Sri Lanka	10.6	11.5	10.7	11.3	11.8	12.1
Taipei, China	13.6	14.2	12.1	12.0	11.9	12.0
Thailand	15.2	16.0	16.0	15.8	15.9	15.0

... = not available.

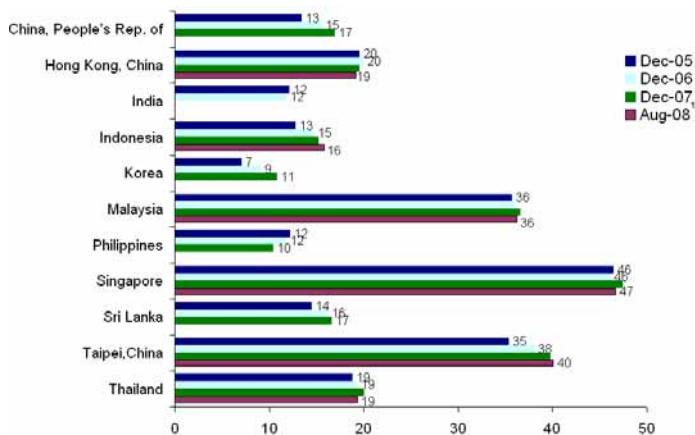
¹Data for Korea as of Jun 2008, Philippines as of Feb 2008, and Sri Lanka as of Jan 2008..

Sources: CEIC, Hong Kong Monetary Authority, Bank Indonesia, and Bangko Sentral ng Pilipinas.



...and housing bubbles

Real Estate Loans (% of total loans)



Sources: People's Bank of China, Bank Indonesia, Financial Supervisory Service (Korea), Bank Negara Malaysia, Bangko Sentral ng Pilipinas (Philippines), Bank of Thailand, Hong Kong Monetary Authority, Monetary Authority of Singapore, and CEIC.

¹ Hong Kong, China and Thailand as of Jun 2008.

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...through highly leveraged households

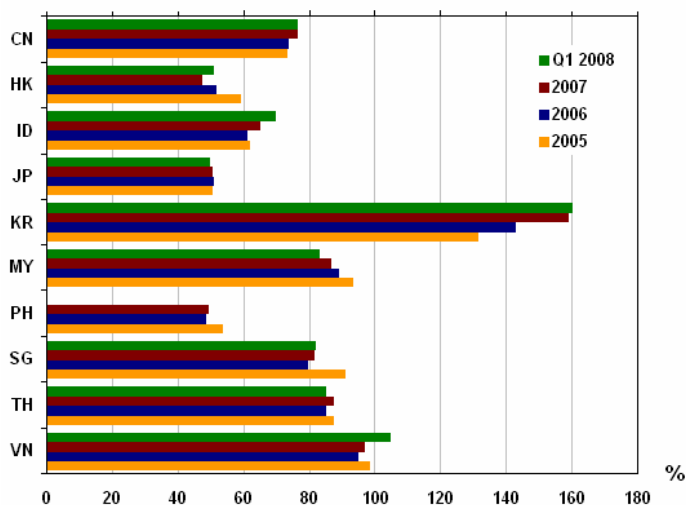
Household Indebtedness (% of GDP)

	2000-2004 Average	2004	2005	2006	2007	2Q2008
Indonesia	6.2 ¹	8.2	9.1	8.5	8.9	8.6
India	3.7	5.7	7.1	8.5	9.2	...
Hong Kong, China	59.3	58.1	55.5	52.0	51.4	53.8
Korea, Rep. of	29.7	35.3	37.6	40.8	40.3	41.0
Malaysia ²	45.4	50.0	52.2	53.0	50.8	48.9
Philippines	5.5	5.2	4.7	4.2	4.3	4.1 ³
Singapore ⁴	...	50.1	48.1	44.9	45.3	44.8
Taipei, China	45.9	53.0	57.9	55.8	53.5	54.4
Thailand	...	24.5	24.6	23.6	23.4	23.0

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..and over-extended corporate sectors

Private Sector Loans to Deposit Ratio



5. Policy Implications

Lessons from the current meltdown...

- Risk dispersion is not risk reduction
- Leveraging is not credit creation
- Market discipline is no substitute for regulation
- In good times prepare for bad—the case for countercyclical regulation



Immediate steps

- Strengthen crisis management frameworks
- Enhance liquidity risk management
- Strengthen risk management and supervision
- Coordinate emergency efforts

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Medium- to Long-Term Challenges

- Strengthen market infrastructure
- Broaden domestic financial systems
- Devise countercyclical policies
- Balance innovation with financial stability; market freedom with government regulation
- Reinforce regional cooperation

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