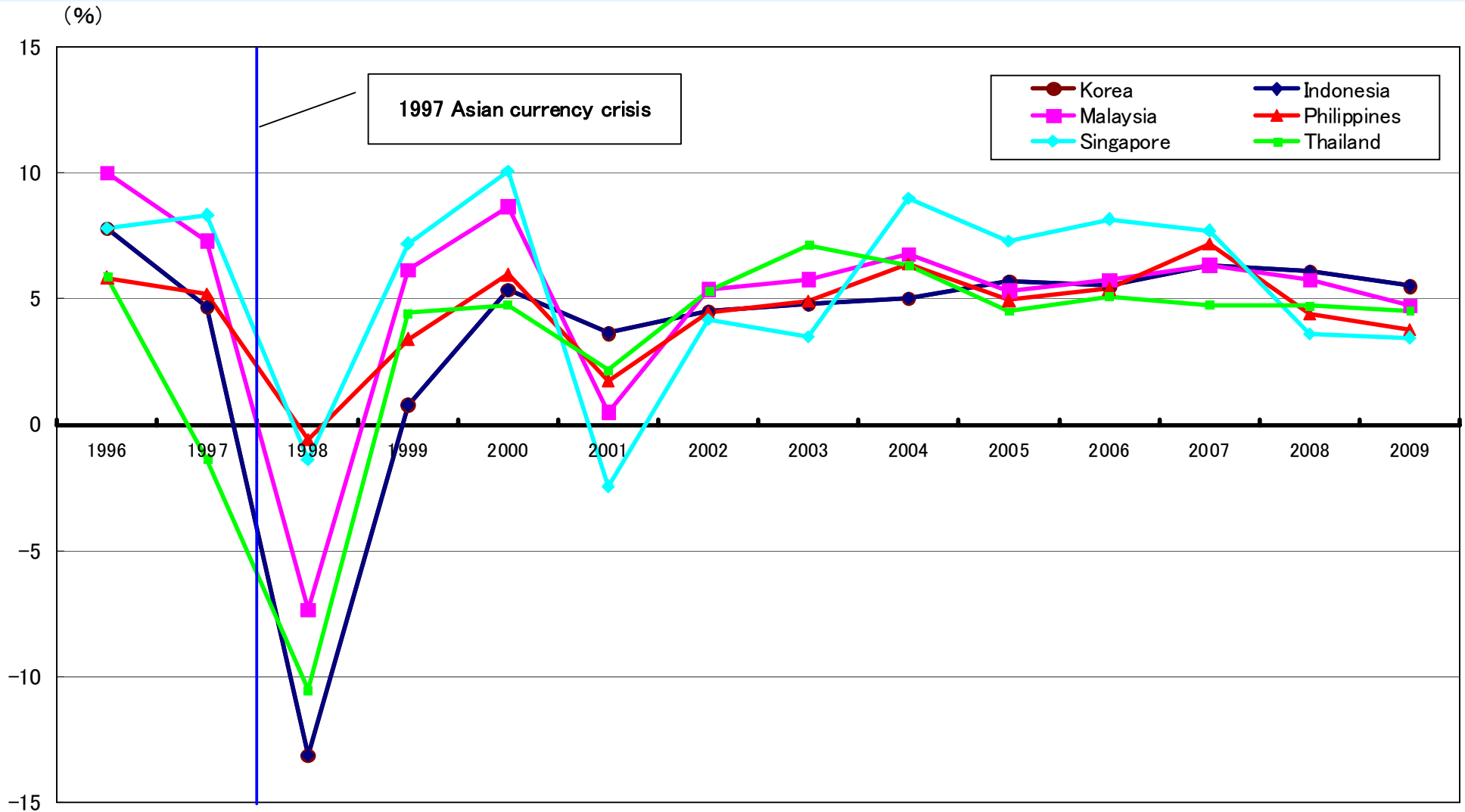


Capital Flows in Asia and Recent Developments in Regional Financial Cooperation

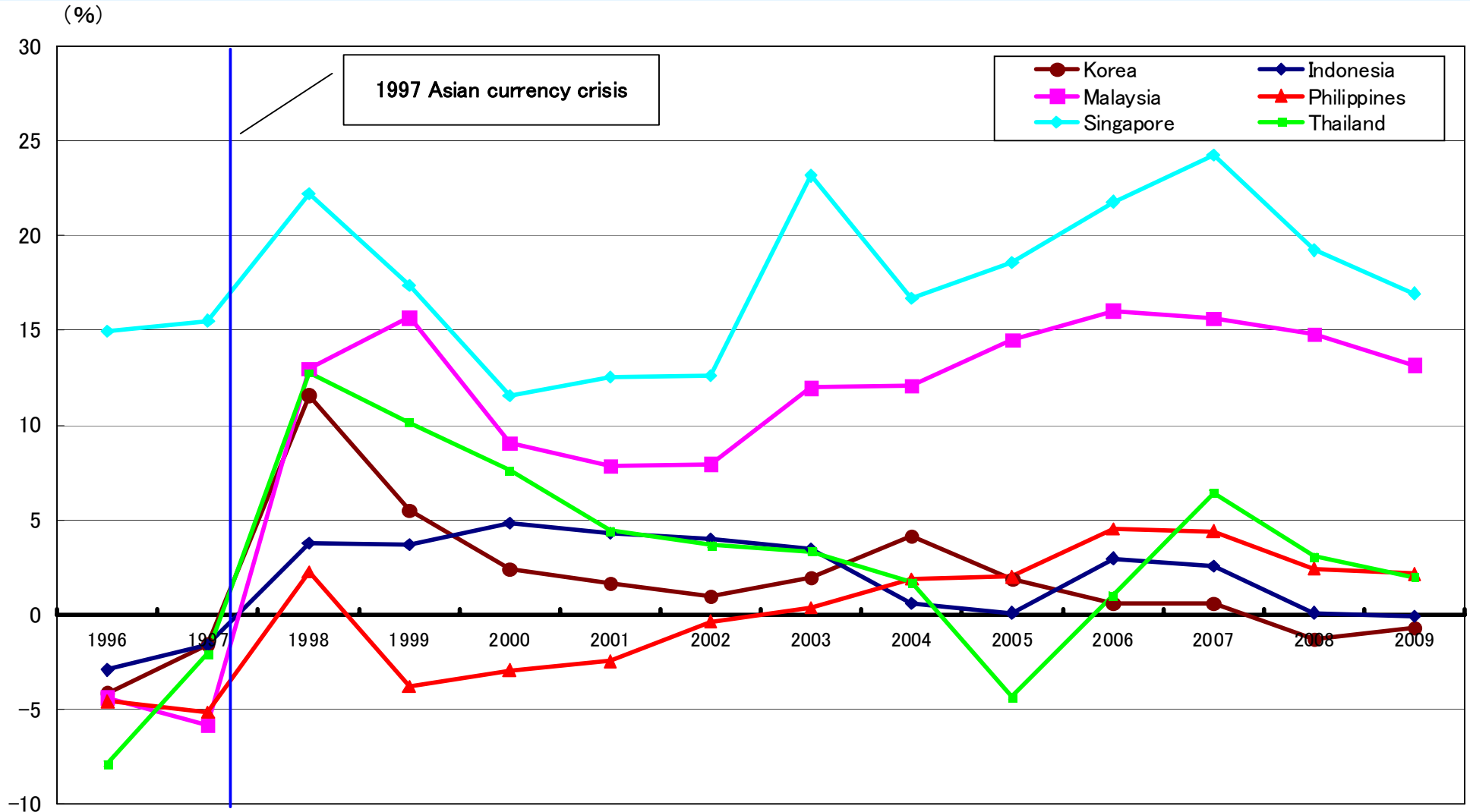
Masanori Yoshida
Regional Financial Cooperation Division
International Bureau
Ministry of Finance, Japan

Real GDP Growth Rate



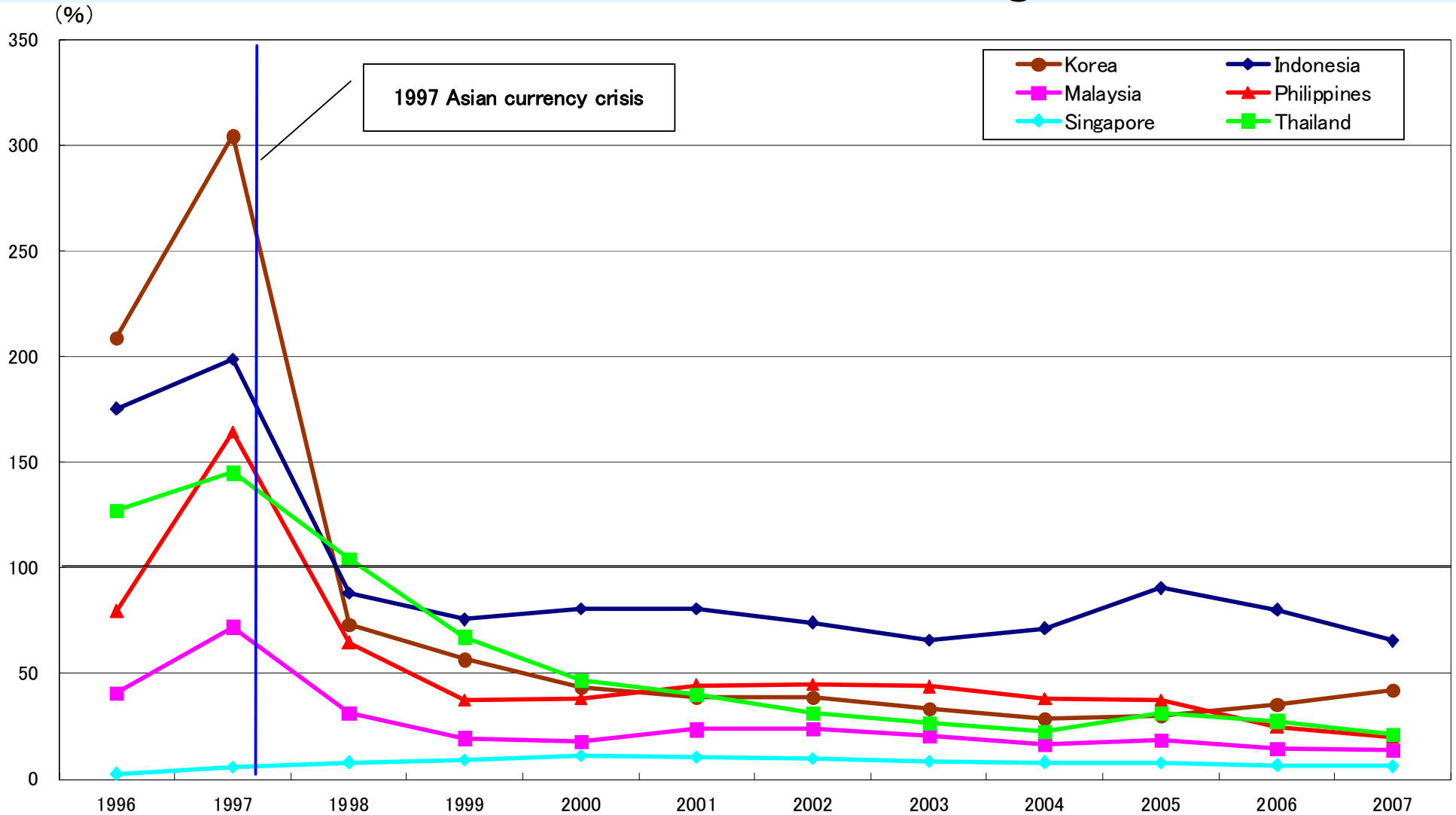
(Source) IMF, World Economic Outlook, October 2008

Current Account Balance / GDP



(Source) IMF, World Economic Outlook, October 2008

External Short-term Debt / Foreign Reserves



(Source) IMF, International Financial Statistics, December 2008 and EIU Country Data

Lessons Learned from the Asian Currency Crisis

The currency crisis that happened in 1997 affected heavily the Asian economies.

Lesson

- ⇒ It is difficult to react to the currency crisis swiftly and sufficiently only through the existing framework.
- ⇒ The currency crisis could quickly spread across the region because of economic interdependence among East Asian countries.



- Motivation for having self-help and support mechanism in the region.
- Establishing a regional financing arrangement to provide funds to each other when a crisis hits.

Lesson

- ⇒ The dominant financing tools in most Asian countries continued to be short-term bank loans. Bond markets in the region remain underdeveloped.
- ⇒ The savings deposited in local banks in the region were channeled to international financial centers and then back to the region through financial institutions operating internationally.
- ⇒ This flow of funds caused maturity and currency mismatches and makes the region vulnerable to fluctuations of international capital movements.



- It is crucial to rely on domestic savings, rather than capital inflows, to promote domestic investment.
- It is important to foster bond markets in Asia in order to long-term capital without maturity and currency risks.

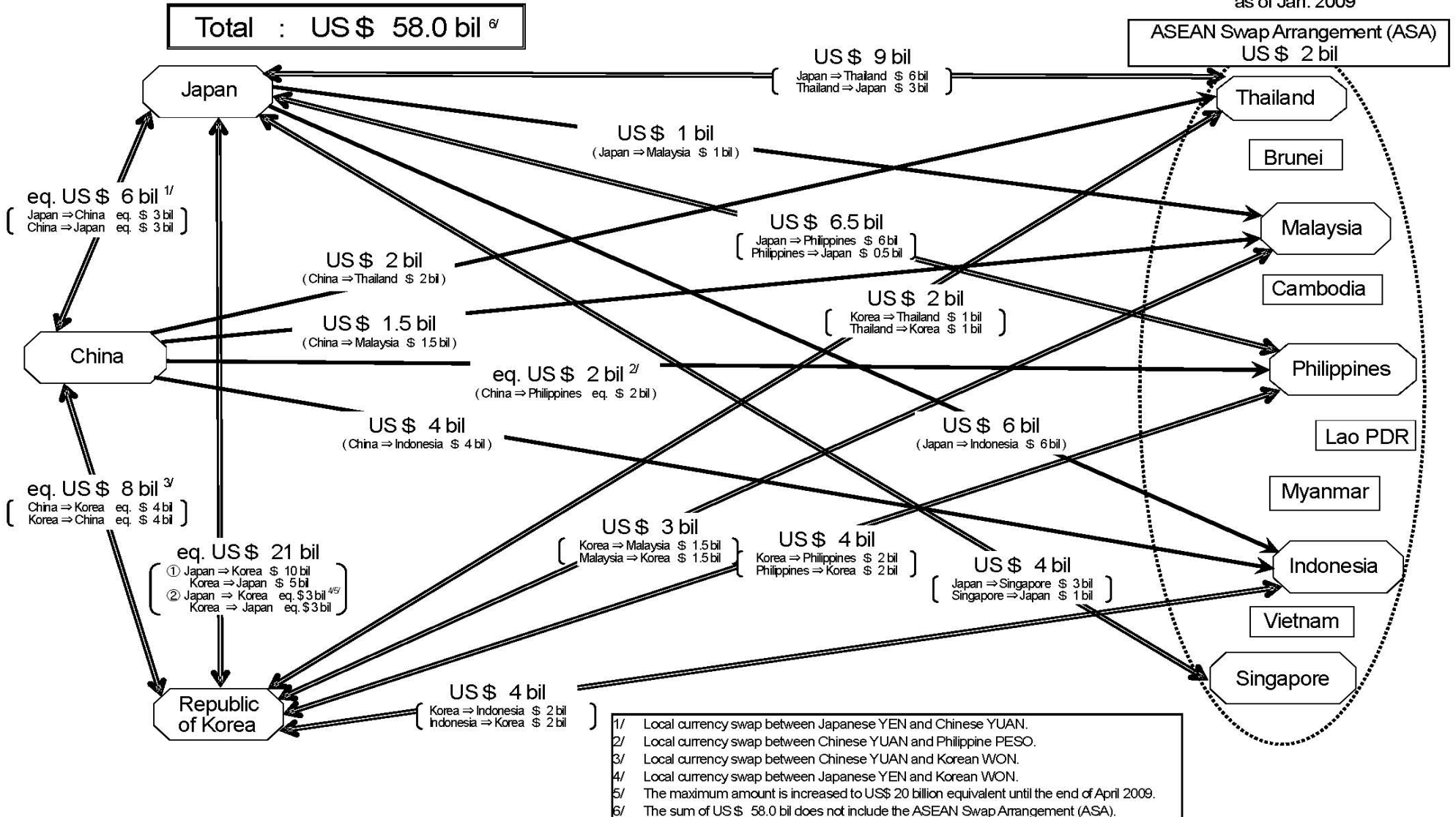
Chiang Mai Initiative (CMI)

■ Core Objectives

- Enhancement of bilateral swap network to address short-term liquidity difficulty in the region
- Supplement the existing international financial arrangements

Network of Bilateral Swap Arrangements (BSAs) under the Chiang Mai Initiative (CMI)

as of Jan. 2009



CMI Multilateralisation

(Post - Chiang Mai Initiative)

■ Agreement at 10th ASEAN+3 Finance Ministers' Meeting in Kyoto (May 5, 2007)

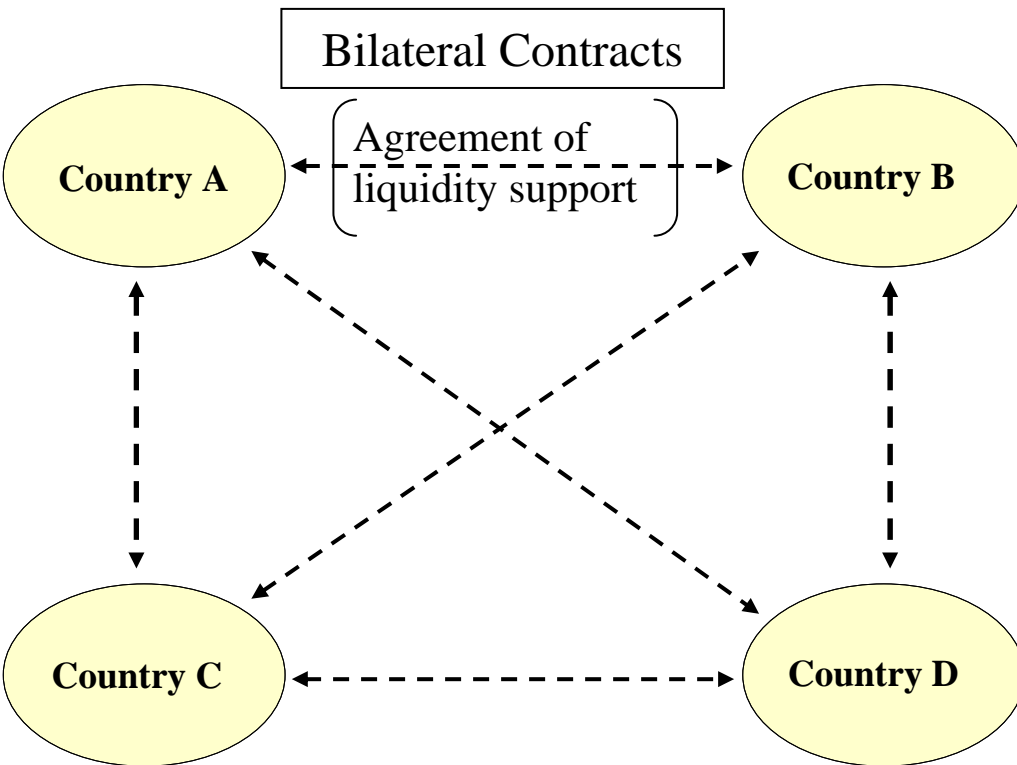
Agreed on the basic direction of the Post-CMI

- Self-managed reserve pooling arrangement
- Single contractual agreement
- Maintaining the two core objectives of the CMI
 - (i) to address short-term liquidity difficulties in the region
 - (ii) to supplement the existing international financial arrangements

Comparison : Current and New CMI Framework

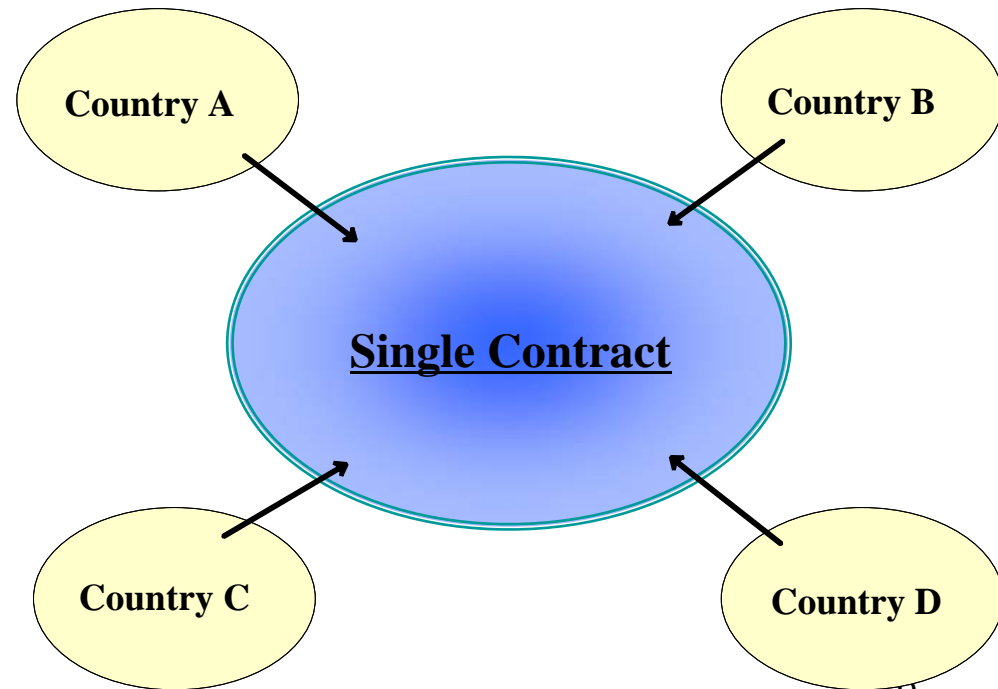
【Current CMI】

- Bilateral contracts (8 Countries, 16 Arrangements)
- Bilateral lending from Swap Providing Countries to Swap Requesting Countries



【Multilateralised CMI】

- Single contract (13 Countries, One Arrangement)
- Bilateral lending from Swap Providing Countries to Swap Requesting Countries



Progress at 11th ASEAN+3 Finance Ministers' Meeting in Madrid (May 4, 2008)

Agreed on the key elements of the multilateralisation of the CMI (1)

1. Basic Modality

The necessary liquidity would be provided to the requesting country in the form of a swap transaction of U.S. dollars and the local currency of the requesting country.

2. Size

The size would be at least US\$ 80 billion.

3. Amount of Contribution

The proportion of the amount of contribution between the ASEAN and the Plus Three countries would be "20:80"

4. Borrowing Accessibility

Each member country would have access to resources up to a multiple of its contribution.

5. Activation Mechanism

A basic consensus on the key concepts and the flow of the activation mechanism.

Agreed on the key elements of the multilateralisation of the CMI (2)

6. Surveillance

On strengthening surveillance, various measures would be implemented to strengthen the current Economic Review and Policy Dialogue (ERPD), such as increasing the frequency of the dialogues and developing a standardized format for the provision of necessary information and data.

7. Future Work

Commitment to further accelerate the work in order to reach consensus on all of the elements which include concrete conditions eligible for borrowing and contents of covenants specified in borrowing agreements.

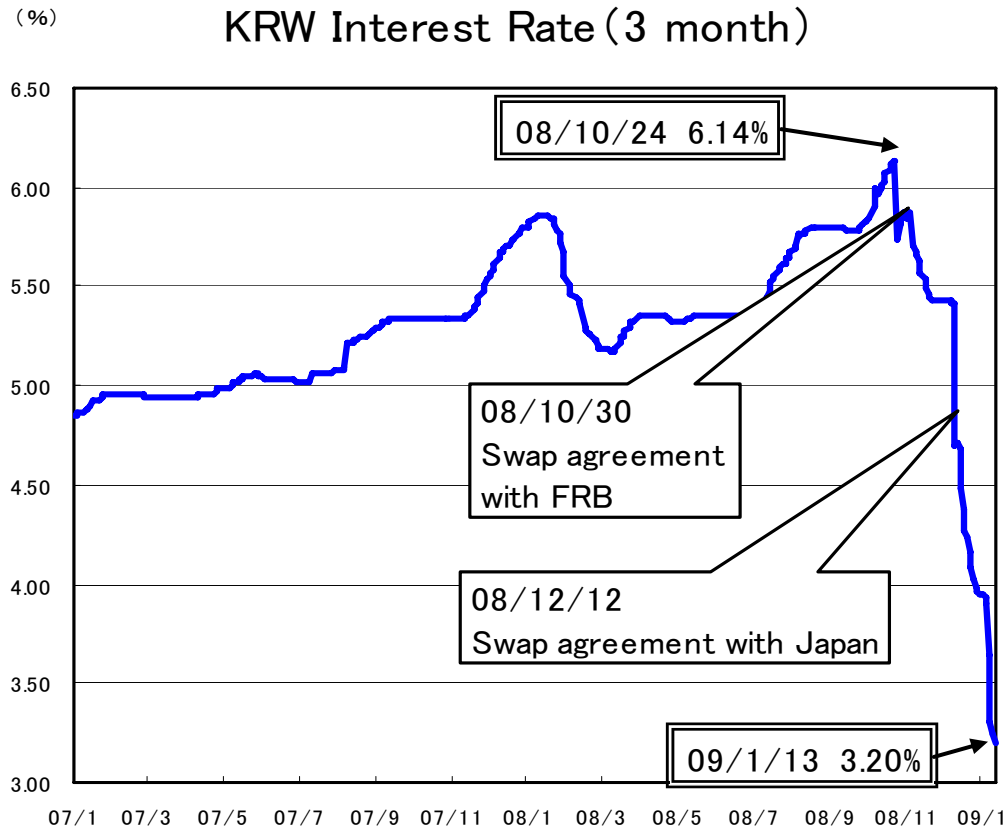
The Joint Ministerial Statement of the 11th ASEAN+3 Finance Ministers' Meeting 4 May 2008, Madrid, Spain

=Excerpt=

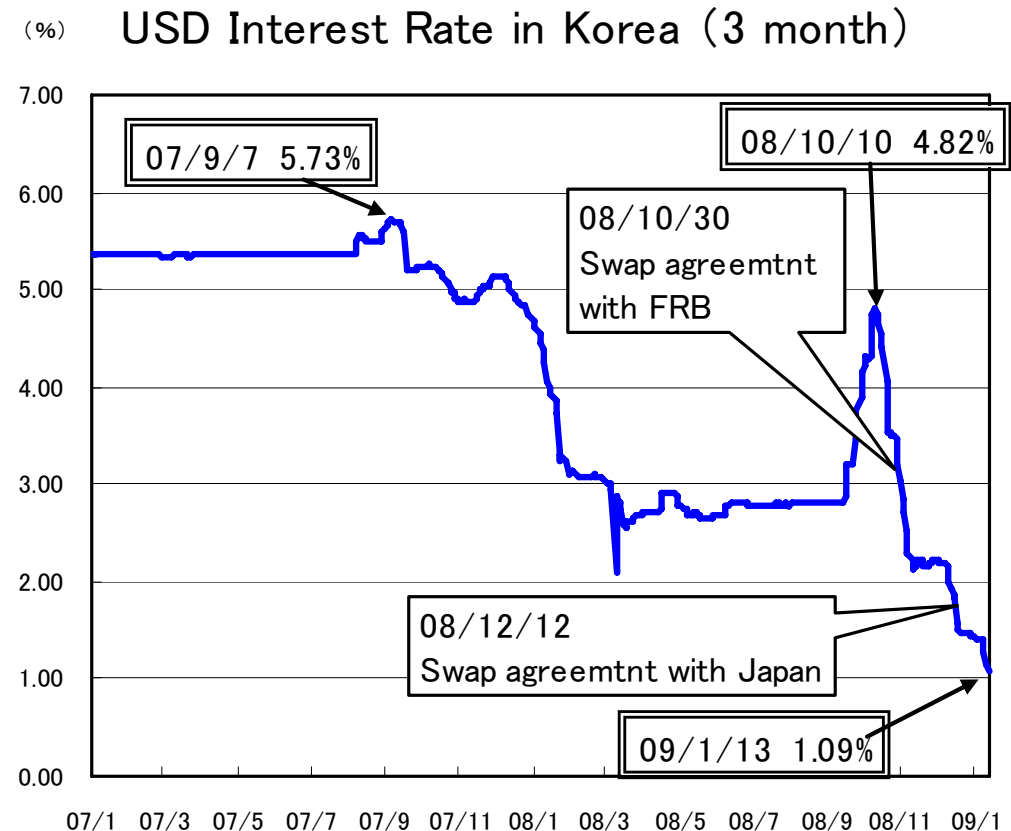
- On the Chiang Mai Initiative (CMI), we have been carrying out work on the key elements of the multilateralisation of the CMI since our last Meeting in Kyoto, following the principle agreement that a self-managed reserved pooling arrangement governed by a single contractual agreement is an appropriate form of multilateralisation.
- We agreed that CMI Multilateralisation will be underpinned by rigorous principles to govern its key aspects, including economic surveillance, borrowing accessibility, activation mechanism, decision making rules and lending covenants, while keeping to timely disbursement.
- We agreed that it is indispensable to build a credible system in ASEAN+3 to monitor the economic and financial situation of the member countries. As a start, we agreed to implement measures to strengthen the current Economic Review and Policy Dialogue (ERPD), such as increasing the frequency of the dialogues and developing a standardized format for the provision of necessary information and data. Such strengthened regional surveillance system will contribute to smooth and efficient decision making.
- We also agreed that the total size of the multilateralised CMI would be at least US\$ 80 billion, and that the proportion of the amount of contribution between the ASEAN and the Plus Three countries would be "20:80". We further agreed on key concepts of the borrowing accessibility, the activation mechanism and other elements.
- Based on the progress made thus far on some of the key elements of the multilateralisation of the CMI, we are committed to further accelerate our work in order to reach consensus on all of the elements which include concrete conditions eligible for borrowing and contents of covenants specified in borrowing agreements.

Recent Turmoil in Capital Markets (The example of Korea)

KRW Interest Rate (3 month)



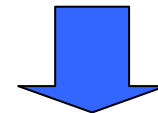
USD Interest Rate in Korea (3 month)



(Source) Bank of Korea

Increase in the Size of Swap Arrangements between Japan and Korea (12 December 2008)

	JMOF-BOK Type	BOJ-BOK Type
Objective	Support for the maintenance of balance of payments and short-term liquidity	Short-term liquidity support for the stabilization of financial markets
Currency	USD-Local Currency	JPY-KRW
Parties	Foreign Reserve Managers	Central Banks
Maximum Amount	(JPN→ROK) 10 bil. USD (ROK→JPN) 5 bil. USD	(JPN↔ROK) 3 bil. USD equivalent JPY·KRW



Increase up to 20bil. USD eq.

(Until the end of April 2009)

Japan-China-ROK Trilateral Summit
Joint Statement on the International Finance and Economy
13 December 2008, Fukuoka

=Excerpt=

The three leaders stressed the importance of further enhancing regional cooperation to address the turmoil of financial markets. They welcomed the results of the Trilateral Finance Ministers' Meeting among China, Japan and Korea on 14 November 2008 in Washington D.C. and the recent decisions on the increase in the size of the bilateral swap arrangements among the three countries. They also welcomed the setting up of the Tripartite Governors' Meeting of the Three Central Banks to be held on a regular basis, announced on 10 December 2008. They also reiterated their commitment to work with ASEAN members to expedite the process of the Chiang Mai Initiative Multilateralization and strengthen the regional surveillance mechanism for effective monitoring on the regional economy and financial markets.

Asian Bond Markets Initiative (ABMI)

Prior to the 1997 Asian Currency Crisis

- Asian currencies were pegged to the dollar and borrowing was largely short-term and in dollars. This was then used to make long-term investments in local currencies.
("Double Mismatch")
 - This led to both maturity and currency mismatches.
 - Under this fragile financial system, trust in some Asian currencies was eroded and rapid outflows of capital occurred. These movements rapidly spread to other Asian countries.

The August 2003 Asean+3 Finance Ministers Meeting in Manila

- In response to the Asian Currency Crisis, it was agreed to take measures to develop local currency-denominated bond markets in order to allow the regional private savings to be used for regional development, by facilitating necessary investment.
 - Under this initiative, The ADB and other international institutions, along with JBIC and government financial bodies, have issued local currency-denominated bonds, and financial institutions have issued securitized instruments of loan receivables. This has contributed to the diversification, and expanded the scale, of regional bond markets.

The May 2008 Asean +3 Finance Ministers Meeting in Madrid

- A new ABMI Roadmap was agreed, aimed at the further development of Asian bond markets
 - Alongside Asean+3 countries, measures will be taken to increase the effectiveness and liquidity of bond markets.

Size of Local Currency-denominated Bond Markets in ASEAN+3 Countries

(Unit : USD Billions)

	1997	2002	2007	2008 (end of March)
China (Excluding Hong Kong)	83.6	342.3	1,690.0	1,888.8
Indonesia	4.6	58.2	85.6	85.8
Korea	153.2	534.1	1,076.9	1,053.1
Malaysia	57.0	84.4	179.4	186.1
Philippines	16.8	27.6	54.2	57.6
Singapore	23.8	56.4	103.7	113.1
Thailand	10.5	48.3	140.1	158.1
Vietnam	-	-	9.8	12.3
Subtotal	349.5	1,151.3	3,339.7	3,554.9
Japan	4,202.9	6,417.0	8,956.1	10,260.5
Hong Kong	43.4	58.0	65.1	64.3
Total	4,595.8	7,626.3	12,360.9	13,879.7

(Note) All figures are the sum of amount outstanding of government bonds and corporate bonds.

(Source) Asian Development Bank "Asian Bonds Online"

(Reference)

	1997→2008(end of March)	2002→2008(end of March)
ASEAN+3 (Excluding Japan, Hong Kong)	10.2 - fold	3.1 - fold
ASEAN+3	3.0 - fold	1.8 - fold

New ABMI Roadmap

Renewed Strong Commitment to Promote Further Progress of the ABMI on the Occasion of its Fifth Anniversary

Focusing on the four key areas

- (i) Promoting issuance of local currency-denominated bonds (e.g. infrastructure financing)
- (ii) Facilitating the demand of local currency-denominated bonds (e.g. developments of the investment environment for institutional investors)
- (iii) Improving regulatory framework (e.g. regulatory harmonization by applying best practices)
- (iv) Improving related infrastructure for the bond markets (e.g. infrastructure for securities settlement)

Main Issues for Each Task Force

【TF1】

Promoting issuance of local currency-denominated bonds

- Credit guarantee and investment mechanism
- Promotion of Medium-term Note Programme
- Debt instruments for infrastructure financing
- Development of derivatives and swap markets

【TF2】

Facilitating the demand of local currency-denominated bonds

- Development of an investment environment for institutional investors
- Development of repo markets
- Enhancing cross-border transactions (Regulations on capital movement, Taxation system for nonresidents)
- Disseminating the efforts under the ABMI to institutional investors in the ASEAN+3 countries

【TF3】

Improving regulatory framework

- Strengthening the regulatory and supervisory framework
- Facilitating collaboration among securities dealers associations
- Promoting application of accounting and auditing standards broadly consistent with international standards

【TF4】

Improving related infrastructure for the bond markets

- Facilitating discussion by private sector participants on desirable regional settlement systems
- Increasing liquidity of bond markets (Developing and maintaining a benchmark yield curve)
- Fostering credit culture (Development of a credit risk database)

The Joint Ministerial Statement of the 11th ASEAN+3 Finance Ministers' Meeting 4 May 2008, Madrid, Spain

=Excerpt=

- Along with the effort and progress made under the ABMI since 2003, the Asian bond markets have recorded remarkable growth in terms of size and diversity of issuers.
- To further develop the Asian bond markets, we endorsed the New ABMI Roadmap. This New Roadmap shows our renewed strong commitment to the concrete progress of ABMI, on the occasion of its fifth anniversary.
- First, the new ABMI Roadmap focuses on the four key areas: (1) promoting issuance of local currency-denominated bonds, (2) facilitating the demand of local currency-denominated bonds, (3) improving regulatory framework, and (4) improving related infrastructure for the bond markets.

Second, we agreed to make further voluntary efforts to contribute to more accessible regional bond market development in a concerted manner. In this regard, each country will make periodic self-assessments of its progress in line with the objectives of ABMI. The reference will be introduced for this purpose.

Third, we recognized that the private sector plays an important role in the development of bond markets. In this regard, we welcomed the launch of a group consisting of private sector participants to discuss the cross-border bond transactions and settlement issues.

Thank you.