



# **Governance & Development: Views from G20 Countries**

**Session 4**

**Presentation**

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**Reforming the Global Financial System-  
Implications for long term investment finance**

**YOSHIHIRO WATANABE**

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Governance and Development: View from G20 Countries  
ICRIER, September 19, 2013

Reforming the Global Financial System-  
Implications for long term investment finance

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Points of discussion

- Financial stability and growth
- Risk Index developed by IIMA
- Facilitating trade finance
- Facilitating infrastructure finance

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Some of topics to be explored for Asia Pacific Financial Forum

- through APEC Finance Minister Process

### **'Linkages and Structural Issues'**

Promote understanding of the interaction of policy and regulatory proposals on financial markets, linkages and structures through capital flow and finance

- What are the likely impacts of contemporary (global and regional) macroeconomic developments on financial market connectivity in the Asia-Pacific?
- How can the unintended consequences of international regulatory standards be limited and those standards calibrated to meet regional economic development/growth needs?

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## **Developing financial regulation and international capital flow**

Challenges remain

(Consistency)

- between stringent regulation on financial transaction, financial institution and macro economic policy

(insufficient impact study, risk weight of governmental bonds, curbing bank lending in spite of efforts on economic recovery)

- international regulation and national implementation

- unregulated shadow banking

(Global grand design of regulation and macro-prudential policy)

(International capital flow and monetary policy of major economy)

- QE or QQE to pull international investor's confidence in financial products

- financial bubbles are growing due to gap between real economy and finance

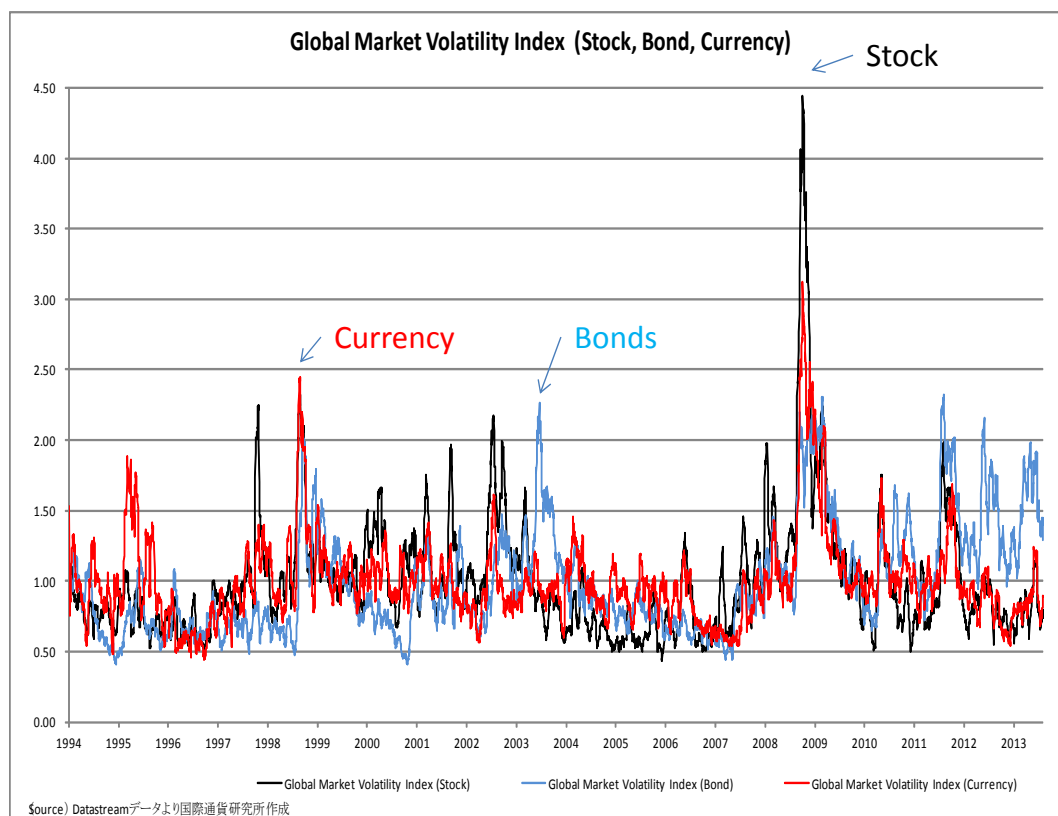
(Regulatory efforts for stability may not necessarily lead economic growth)

## Risk Index based on volatility -stocks, bonds and currencies

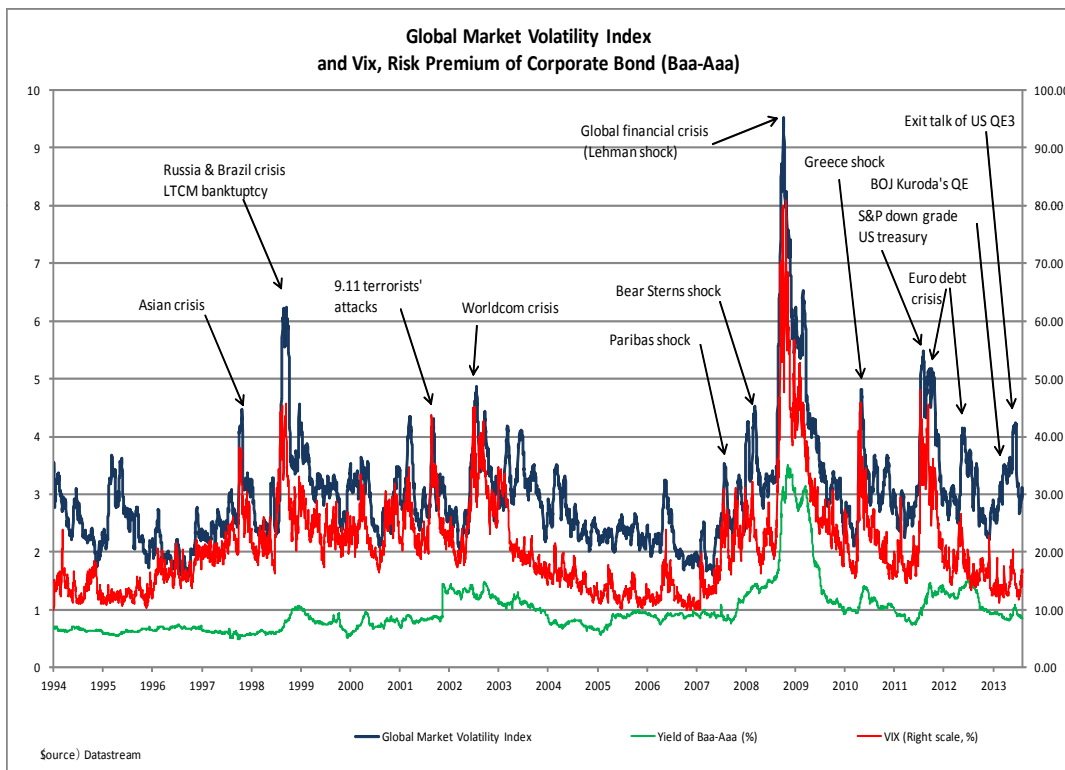
### Investor's confidence gauged

-confidence by real economic growth and monetary easing

-global and national market volatility gap be compared



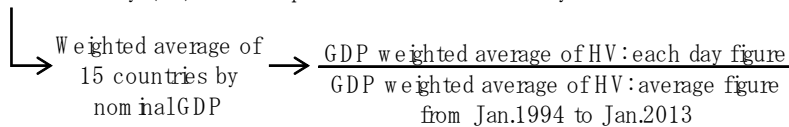
# Market volatility and events



# How to calculate the index

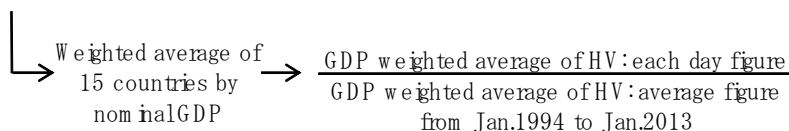
## Stock market

Historical volatility (HV) of stock price index in each country for the latest 20 business days



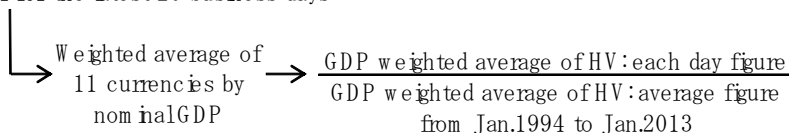
## Bond market

Historical volatility (HV) of 10 year gov't bond yield in each country for the latest 20 business days



## Foreign exchange market

Historical volatility (HV) of foreign exchange rate of each currency against US dollar for the latest 20 business days



add all three => GMVI

Units: times  
If the each day figure becomes the same as the average of the whole period, the index becomes 1 + 1 + 1 = 3.

## Purpose of the index

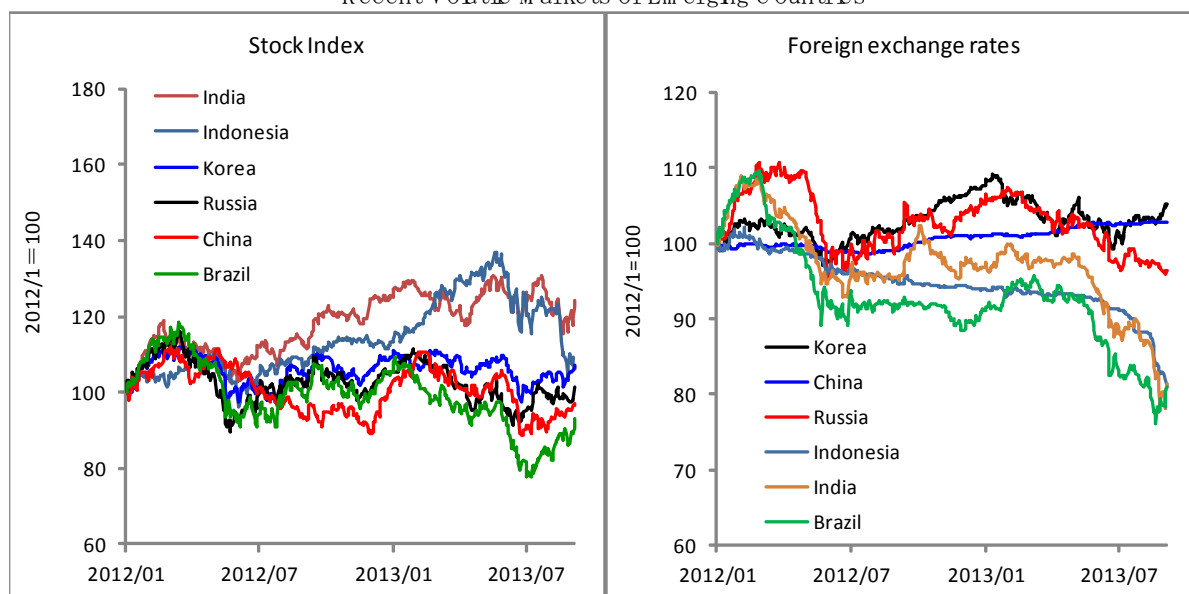
- to measure risk appetites of global investors and to gauge tense of markets

	Weight	Market Indicators
Data	Nominal GDP (in current US dollar) x 15 countries	Stock price index x 15 countries
		10 year government bond yield x 15 countries
		Foreign exchange rate against US\$ x 11 countries
Frequency	Yearly	Daily
Start	1994.01 ~ today	

\* Existing similar indicators are the Chicago Board Options Exchange Market Volatility Index (VIX) and the risk premium of US corporate bonds (Baa – Aaa).

## Recent volatile markets of emerging countries

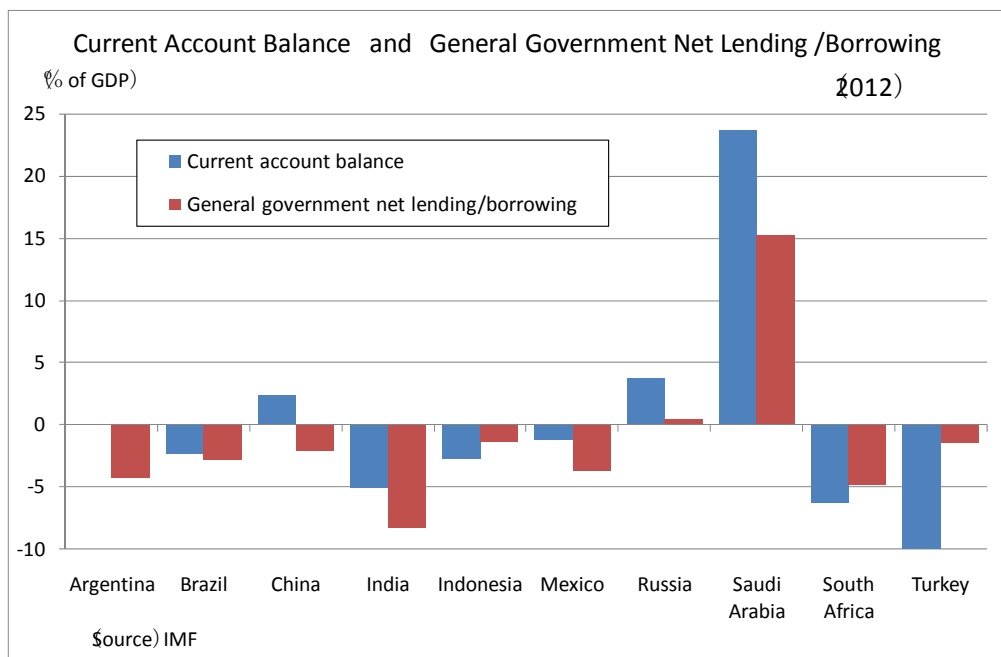
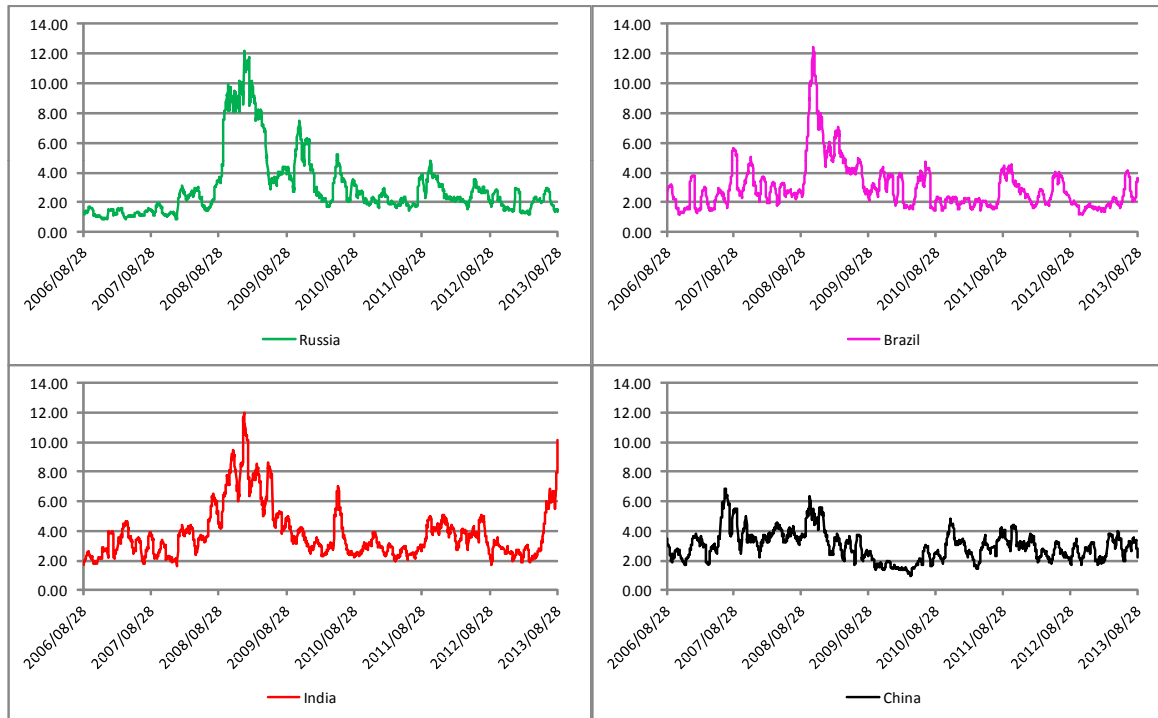
Recent Volatile Markets of Emerging Countries

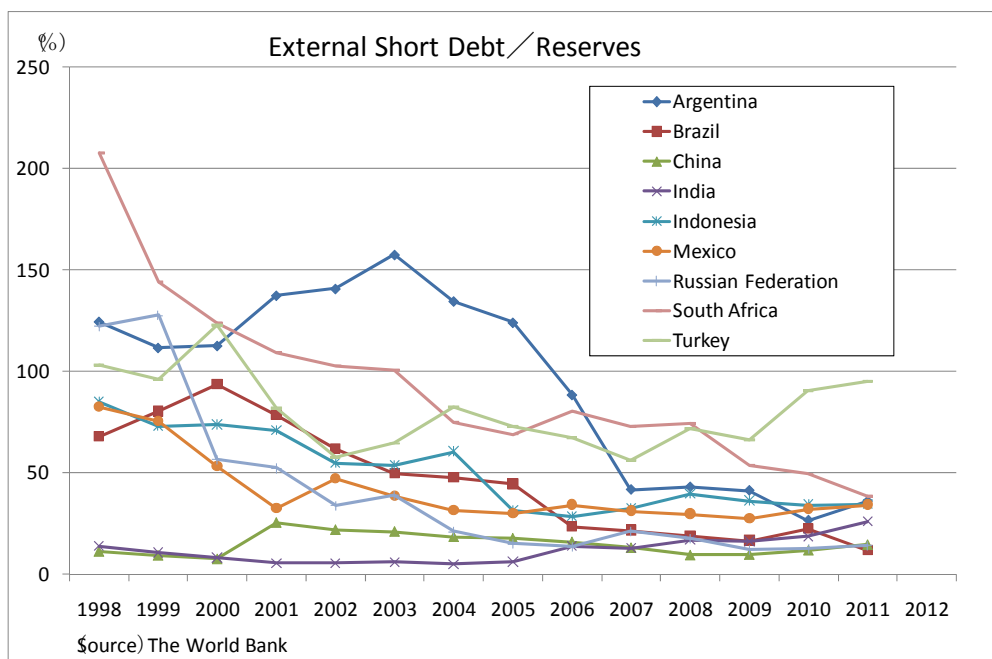
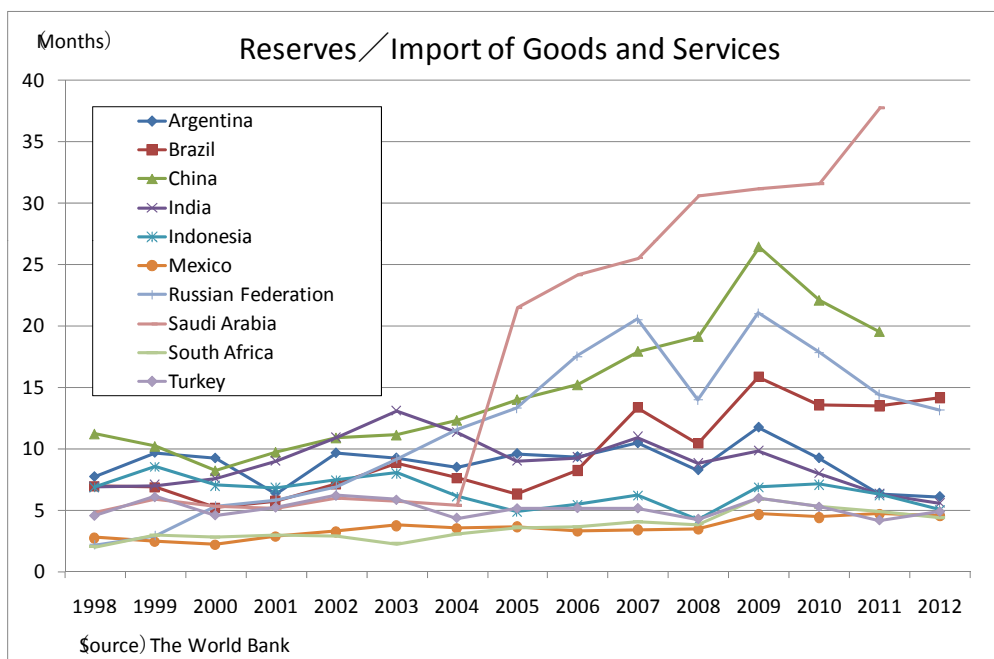


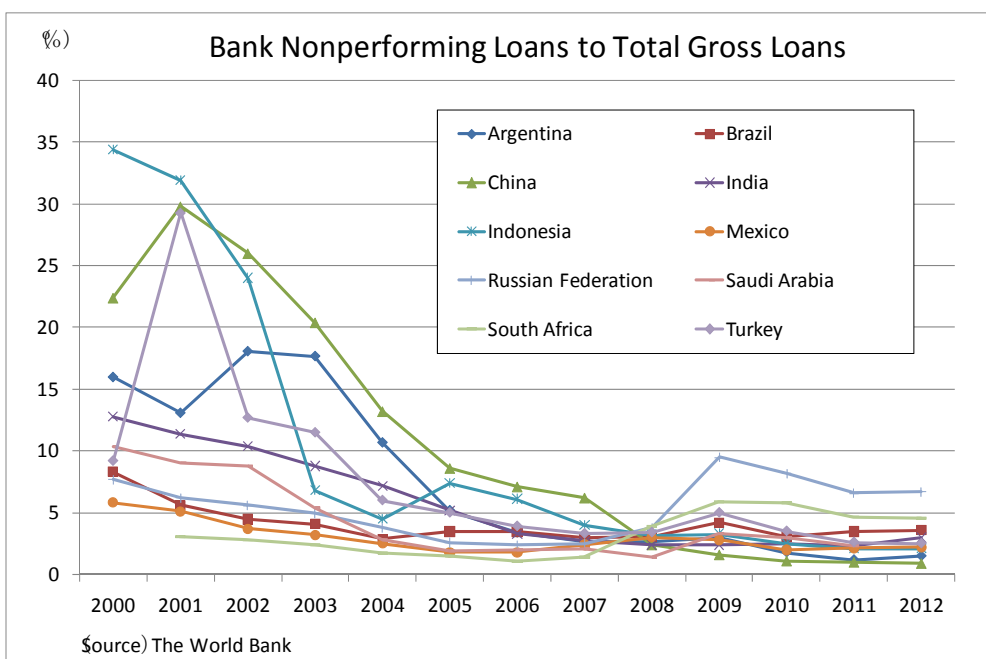
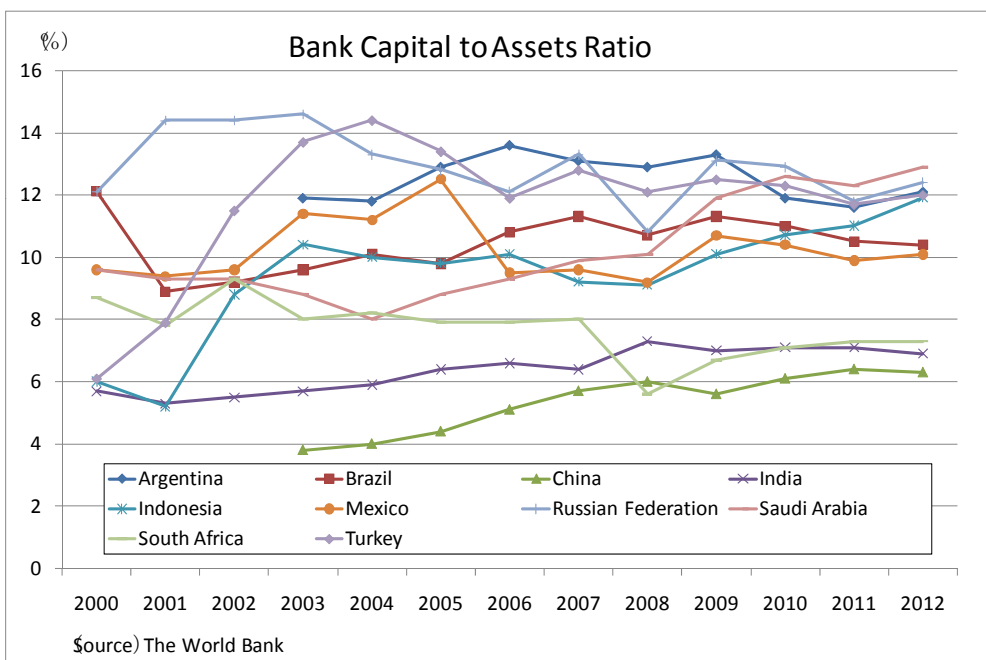
(Source) Datastream

# GMVI shows a particular strain in Indian markets

Volatility average between 2006.8 and 2013.8 of each forex, bond and stock market is 1. That of whole three markets in each country is 3.







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## For financial stability and growth

Now the priority needs not only on stability but also growth

- the banking sector's capital and liquidity requirements, as well as identifying and managing the sources of systemic risk



Financial regulation, financial inclusion and financial markets infrastructure development  
Regional development should be accounted carefully

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## Features of Asian Banks

- Assets: dominant lending portfolio to low trading assets
- Liability: funded highly by domestic deposits
- Non performing assets: improved from 2005 to 2012
- Lending to private sector/GDP : more than 100% except India, Indonesia, Philippines at 2012
- Lending growth: Indonesia and India increased lending over 4 times from 2006 to 2012
- Local currency lending to deposit: Thailand and Vietnam over 100%, Korea 93.7%



- Regulation on large borrower, lending to deposit, reserve to deposit, interest rate and lending rate
- BIS regulation is not best fitted to Asian banks

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## Points of business recommendation

### Collateral management

- which will be a critical condition to address new liquidity constraints to finance the economy (the collateral chain such as central infrastructures, securities services)

### Financial Transaction Tax

- that is expected to have multi-layer negative consequences and uncertain benefits

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## Avoiding adverse effects

### Trade financing (SMEs), and infrastructure financing

- European authorities have taken a number of positive steps to address some of the potentially adverse impacts of Basel III, through amendments to CRD 4 ( Capital Requirements Directives) which recognize **the real risk levels** and **positive economic impacts of revised regulatory requirements for trade finance and corporate hedging** (for example, credit valuation adjustment-CVA)

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## Facilitating trade finance

To ensure economic growth

European legislators adopt reforms

**-Capital**

waiving the one year maturity floor

Introducing trade finance risk curve by

Asset Value Correlation and Probability of Default

**-Liquidity**

equal outflow rates for trade finance contingents

**-Leverage**

Credit Conversion Factor of 20%

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## Facilitating infrastructure finance

-External commercial borrowing limitation

-Make brown field project a leverage to induce investment into green field projects

privatization, securitization, transfer of concession right

- Proper risk allocation among investors and host government