Crisis to opportunity—Asia and the Pacific are more integrated since 2008

Asia and the Pacific have deepened economic integration through trade and foreign direct investment since the early 1990s. But financial market integration within the region has not progressed as quickly.

ADBI research examining cross-border portfolio assets and liabilities in Asia and the Pacific from 2001 to 2017 shows that rapid increases in portfolio foreign assets and liabilities have taken place, particularly after the global financial crisis of 2008–2009. The crisis and the subsequent unconventional monetary easing adopted by the United States, Europe, and Japan have affected the movement of cross-border portfolio capital flows in Asia and the Pacific. When the crisis started, portfolio investment flowed out of the region. Later on during the crisis, when advanced economies eased monetary policies, and after the crisis, a new wave of cross-border portfolio investment from the United States and Europe flowed into the region in search of higher yields.

ADBI researcher Eric Alexander Sugandi collaborated with ADBI visiting scholar Sayuri Shirai on the study. Sugandi summarizes their findings:

> First, equity has been a dominant source of foreign liabilities, notwithstanding efforts to develop bond markets in the region. One exception is Australia, where foreign liabilities have been largely in the form of debt securities. Limited capital inflows to debt securities issued by emerging Asia may be attributed to the early stages of bond market development.
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> Second, in contrast, debt securities have remained dominant as foreign assets held by the region. This mostly reflects Japan's preference for debt securities. Other Asia and Pacific economies have invested more heavily in foreign equity.

> Third, Japan, which has the most domestic capital, has remained exposed to the United States and Europe. Within the region, debt securities issued by Australia have increasingly attracted Japan's capital.
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> Fourth, the region's assets and liabilities linkages have remained overwhelmingly strengthened against the United States and Europe. Nonetheless, the post-crisis period has witnessed greater financial integration within the region. The intra-regional linkages have been deepest between Hong Kong, China and the People's Republic of China, where the former has become a major financier of equity issued by the latter. Singapore is increasingly investing in equity in China, Japan, Republic of Korea, and the economies of the Association of Southeast Asian Nations or ASEAN. Integration within ASEAN has been noticeable but it's not as strong as integration between the People's Republic of China and Hong Kong, China.
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> To conclude, intra-regional financial integration has risen, centered around China with growing linkages with Hong Kong, China and Singapore.

Other examples show how cross-border integration has taken hold in Asia and the Pacific. Sugandi continues:

> Malaysia's and Thailand's portfolio assets in securities issued by Hong Kong, China increased rapidly after the crisis. Thailand also increased its portfolio assets in the Republic of Korea during the same period. And the Philippines has increased its portfolio investment in Indonesia, strengthening the growing financial links within ASEAN.

The destinations of foreign portfolios and assets can tell another story about Asia-Pacific integration. Foreign portfolio assets and liabilities of Hong Kong, China and Singapore grew more rapidly than those of Japan after the crisis, suggesting that both economies are now significant international financial centers. Regional integration has assured Hong Kong, China's role as a gateway to the People's Republic of China.

Indonesia, Malaysia, the Philippines, Singapore, and Thailand are increasingly investing in China. China has heavily invested in short-term debt securities issued by Hong Kong, China.

Financial integration depends on workable instruments. A typical problem for bond market investors is a lack of liquidity. Yet financial integration in Asia and the Pacific has succeeded despite this hazard.

Sugandi explains:

> **Although the bond markets have been growing in the Asia and Pacific economies, liquidity problems have remained due to relatively low trading volumes in both the government and corporate bond markets. Meanwhile, the region's equity markets have grown more rapidly than bond markets.**

As before the crisis, Asia-Pacific countries' portfolio assets held in the world financial market remain dominated by debt securities. But post-crisis equity investors have aggressively targeted emerging markets that underwent major corrections during the crisis.

These investors have been from Asia and the Pacific. The result? An 11% increase in the share of equity to total portfolio assets held by these investors after the crisis. While equity still dominates Asia-Pacific portfolio liabilities toward the world, the share of debt securities has increased in the post-crisis period.

Japan has persistently preferred to park its portfolio assets in long-term debt securities. As described by Sugandi:

> **Japan's debt securities have been heavily skewed toward advanced economies that have large, deep, and mature associated markets. Japan's debt securities in the United States and European Union have been disproportionately larger than its assets in post-crisis Asia and the Pacific. Australia is also a preferred destination. Japanese investors generally prefer high-rated bonds.**

Indonesia, Malaysia, Philippines, and Thailand are all international debtors in both equity and debt securities. Japan; Singapore; and Hong Kong, China were net creditors against the world, having more cross-border assets than liabilities, before and during the global financial crisis, and continue to be so.

Clearly, intra-regional financial integration has been growing, with China as a focus. It has attracted equity investment not only from Hong Kong, China and Singapore but also from Indonesia.

This episode was based on research by Sayuri Shirai, a visiting scholar at the Asian Development Bank Institute and former member of the Bank of Japan's policy board; and economist Eric Alexander Sugandi, an ADBI consultant, formerly with Standard Chartered Bank, Citibank, and Bank Mandiri in Indonesia.

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