Asian Financial Markets: A Review

Gordon de Brouwer (ed)., *Financial Markets and Policies in East Asia*, London: Routledge, 2002, ISBN 0-415-27388-9

When Thailand was forced to devalue its currency in July 1997, no one predicted the financial turmoil that would follow. Over the next two years, financial crises took a heavy toll on the economies of Indonesia, South Korea, Malaysia, the Philippines, Hong Kong, Russia and Brazil. Indeed, few developing countries emerged unscathed. Thus, it is hardly surprising that no event of the past fifty years has generated more calls for a reexamination of the institutions, structures and policies aimed at crisis prevention and resolution than the Asian financial crisis of 1997.

This excellent volume moves beyond providing the now familiar story of the origins and impact of the crisis. Rather, the fourteen well-organised chapters competently address three critically interrelated issues. Chapters 2 to 4 provide a concise discussion about the changing patterns of finance in East Asia. Chapters 5 to 7 document and assess the financial restructuring and liberalisation with particular focus on the five worst affected economies, including China. Chapters 8 to14 provide wide-ranging analyses of financial policies in the region, with special emphasis on monetary and exchange rate policy, including how they are related.

Following the editor's concise introduction, Dominic Wilson's valuable piece lucidly reviews what has been happening in regional financial markets since the crisis, as well as offering some thoughts on prospects and concerns. He reviews recent evidence on why financial development and diversity matter to economic growth. He then analyses trends in share markets, the cost of capital, market capitalisation and liquidity, mergers and acquisitions and general financing. Wilson argues that while equity and bond markets are clearly important, bank intermediation remains the mainstay of regional financing. Put bluntly, reform and recovery of the banking system is essential to achieve stable, broad-based economic growth. Wilson also competently assesses regional developments and the outlook for the region. He notes some positive legacies of the crisis, including efforts to improve liquidity and efficiency in financial markets. He notes that while greater involvement of foreign financial institutions will be controversial, it nevertheless serves as an important catalyst for markets to move to best practice.

Other noteworthy chapters include Kim, Park and Chung's "Patterns of Bank Intermediation and Structure: A Korean Perspective." The authors clearly examine the changing asset structure of Korean banks and the factors that have driven bank disintermediation. They compellingly argue that strong enforcement of Bank for International Settlements (BIS) capital adequacy rules during the process of financial restructuring discouraged banks from lending to business and caused them to shift to investments in securities. Rajan and Siregar's rigorous chapter critically assesses recent developments in regional capital flows. The authors examine some of the models used to explain financial crises and then review the combination of push and pull factors that have influenced capital flows both before and after the crisis. They note that the post-crisis rebound was accompanied mostly by a sharp resurgence in portfolio capital flows. The authors use correlation analysis and Granger-causality tests to explore the determinants of private capital flows. They find some evidence that economic growth and currency movements affect the decision to undertake portfolio investments in East Asia.

Albeit rather dated now, Masahiro Kawai's chapter 5, "Bank and Corporate Restructuring in Crisis-Affected East Asia" provides an informative discussion of financial and corporate restructuring in Indonesia, Korea, Malaysia and Thailand. Similarly, in chapter 6 Mari Pangestu and Manggi Habir provide a nuanced overview of the process of bank restructuring and reform in Indonesia. They lucidly analyse the state of the banking system before, during and after the crisis, and how various economic, social and political vulnerabilities interacted with the banking crisis. The authors also provide an insightful review of Indonesia's bank restructuring and recapitalisation programme, and aptly conclude that given the sheer magnitude of the problem in Indonesia, recovery there will take time. Fan Gang's well-written chapter critically assesses the concept of capital-account sequencing. He argues that while capital and technology may be highly mobile, other factors, such as the ability to manage institutions and markets are not so mobile because they tend to be country-specific. Clearly, this relative immobility of management and regulatory oversight puts developing countries on an unequal footing. While Fan does not dispute the desirability of liberalisation and argues that developing countries should speed up reform to accelerate the process of 'compatible opening', he cautions against 'excessive opening.' According to Fan one of the reasons China was able to withstand the crisis better than most is because it followed compatible opening.

David Nellor's thoughtful chapter highlights the need for consistency in the macroeconomic policy mix -- after all, he reminds us that inconsistency between the settings of monetary policy and exchange rate policy (resulting in high domestic interest rates, fixed exchange rates and poor risk management) -- was at the root of the crisis. In his chapter, "Fixed or Floating: Is it Still

Possible to Manage in the Middle?" Reuven Glick nicely assesses this debate and examines what is happening to the "missing middle." He argues that the middle ground is fast shrinking because intermediate regimes are becoming increasingly difficult to maintain. Glick thoughtfully discusses the feasibility of alternative exchange rate arrangements in East Asia. He maintains that as openness to trade and finance increases in the region, countries will have little choice but to allow greater flexibility in their exchange rates – although he cautions policymakers against attempting to keep the exchange rate within a particular range for extended periods of time. In chapter 11 appropriately entitled "Comparing Monetary Policy Operating Procedures in Indonesia, Korea, Malaysia and Thailand", Claudio Borio and Robert McCauley critically assess how monetary policy is being implemented in these countries. Indeed, this chapter provides an important reference on monetary policy operating procedures and deserves careful reading. In his excellent chapter, "Does A Formal Common-Basket Peg in East Asia Make Economic Sense?" de Brouwer assesses the proposal that countries in East Asia should peg their exchange rates to a common basket of the yen, dollar and euro. While the rationale for a common-basket peg is that it minimises variability between exchange rates in the region and, on average, against the major currencies, de Brouwer argues that a formal peg is only viable if it is consistent with a country's economic structure and policy regime. He concludes that it is not clear, at this stage at least, whether common currency arrangements would suit East Asia.

Overall, this is a valuable and timely volume which can be used with profit in advanced under-graduate and graduate classes.

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