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Developing International Bond Markets in East Asia to Enhance Regional Monetary Cooperation

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1 Introduction

Many of the East Asian countries that were hit by the East Asian financial crisis (1997-98), gave priority to the development of the domestic bond market, in the course of restructuring their financial markets. This policy was based upon the reflection that the crisis would have been avoided, or the damage would have been mitigated, if a mechanism had been in existence to channel the region's high level of savings to industry in the form of long-term funds. The ultimate objective in building a bond market is to develop the corporate bond market, but many East Asian countries had to develop the government bond market first, to provide a benchmark for the corporate bond market. The development of the bond market will encourage structural reform of individual domestic capital markets, which will help the countries to avoid future crisis. Five years after the financial crisis, government-led efforts to develop domestic bond markets are gradually producing positive results centered on government bonds.

Under these circumstances, Prime Minister Thaksin of Thailand recently proposed an Asian bond market initiative that has attracted much attention in the region. With such political initiative gaining momentum, it is felt that governmental efforts to develop domestic bond markets should be carried out under a regional framework.

International bond markets, such as the euro or Yankee bond markets, are global and highly competitive among financial services industries. Many multinational companies and international financial institutions, which actively raise funds in the international bond markets, closely follow market developments in order to tap the most "efficient market", whenever they need to raise funds. Underwriters (financial intermediaries) compete with each other to win a mandate for a bond issue, making international bond markets competitive. Among the international markets, the euro and

Yankee markets are generally considered to be the most "efficient markets", attracting more than half of total international bond issues. An "efficient market" is one that offers a readily available issues market, a deep and liquid secondary market, transparent regulation and market rules, a clear and flexible taxation system, a reliable settlement and custody system, a trust-worthy credit rating system and, last but not least, a competitive issuing cost. In addition, an "efficient market" needs to be supported by a well-developed financial and derivatives market. A comprehensive approach is thus necessary to develop a domestic bond market.

This paper argues that when the domestic bond market develops to a certain level and economic and other conditions permit, the creation of an international bond market will promote the development of an "efficient market" domestically, and will enhance regional cooperation. The paper first looks at the three active international bond markets in the region. Then, the paper looks at the current status of bond markets in Korea, Malaysia and Thailand and discusses the possibility of creating an international bond market. The paper also refers to China and the likelihood of opening its bond market that would have a significant impact on the region's currency regime and capital markets. The paper discusses the role of international bond markets and the functions of financial intermediaries. Then it will argue finally that international bond markets in the region will help promote regional cooperation.

2 International Bond Markets in the East Asian Region

In East Asia, three international capital markets, i.e. Tokyo, Hong Kong and Singapore, and in Oceania, the Sydney market have been created, allowing non-residents to invest and to issue bonds in the domestic currency[1].These international bond markets also facilitate foreign currency bond issues, mostly for structured bonds like dual-currency bonds in Tokyo, or short-term money market transactions like FRNs or FRCDs in Hong Kong and CDs in Singapore. The "efficient market" that the governments have been endeavoring to create is primarily a domestic currency-denominated market and therefore, this paper only deals with such a market[2]

The Tokyo Foreign Bond Market (the so-called "Samurai Market") was created in 1970, with a public offering of yen bonds by the Asian Development Bank (ADB). Japan was then one of the largest debtors of the World Bank. Supported by consecutive current account surpluses, the government decided to create the Samurai market, graduating from the World Bank and becoming a capital-exporting country. Market access was first given to international financial institutions of

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1 The paper discusses the three markets in East Asia, but bond market development should not be considered just within East Asia, but with an open perspective including international markets in the proximity such as Sydney.

2 Several US dollar denominated straight bond issues were offered in the Tokyo market (the market was then called the "Shogun market") and also US dollar denominated straight bonds were issued by the Asian Development Bank targeting markets in Taiwan, Hong Kong and Singapore. These markets did not develop further as they were not as "efficient" as the euro or Yankee markets.

which Japan was a member, and gradually expanded over the years to sovereign, government agencies and other international institutions. In 1979, the market was finally opened to foreign corporate issuers. Although the market has been occasionally affected by events such as the Nixon shock (1971), the first oil shock (1973) and the second oil shock (1979), the market has been performing its capital exporting function until now.

The average annual amount of issues in the Samurai market during 1991-2000 was yen 1.2 trillion, compared to yen 10.7 trillion in the euro yen bond market. As shown by the fact that almost half of the euro yen bonds were issued by non-Japanese and non-Japanese related companies, many foreign bond issuers preferred the euro yen to the Samurai market. Compared to the euro yen bond market in terms of market function, the Samurai market is not considered to be an "efficient market" because, (1) timely access is not warranted due to procedural requirements[3] . (2) expenses, like legal fees and bank charges, are more expensive than those of the euro yen bond market and (3) withholding tax is levied. In addition, there are various structural issues that have a negative impact on the Samurai market, in particular, the fact that the Japanese yen has not been actively used in international transactions as expected.

The Samurai market was once expected to play the role of an international capital market in the region, comparable to the euro and Yankee markets, but the market has in fact been dwindling. Revitalization of the Samurai market, which has the backing of the largest domestic market in the region, should be reviewed from the point of view of regional bond market development.

Hong Kong Market

With the introduction of the Exchange Fund Bills and Notes program in 1990, the Hong Kong government put forward a carefully designed plan to develop an efficient capital market. Although a budgetary surplus made it unnecessary for the government to raise funds at that time, the government continued to issue Bills and Notes in order to establish a benchmark that is essential for the development of a corporate bond market. In 1992, an international bond market was created with the ADB's HK dollar bond issue, which was followed by other prominent issuers like the World Bank, IFC, GE Capital, etc. In the beginning, the newly created bond market was dependent upon financial institutions such as banks, but the market gradually attracted institutional investors by extending the maturity of bonds and by making the secondary market more liquid. The number of new issues and turnover in the secondary market increased and products became well diversified.

The market completed a paper-less settlement and custody system by the Central Moneymarkets Unit (CMU) and also introduced the real time gross settlement system (RTGS) in 1996. These

[3] Market defects are as follows:

① It takes 15 days after filing a registration form with the authorities, for the issue to become effective.

② Registration documents need to be written in Japanese.

③ Separate treatment between resident and foreign issuers with respect to registration documentation.

systems are expected to help develop cross border transactions in the future by linking bond markets in the region.

A characteristic of the bond market in Hong Kong is that it is the most open capital market in the region guided by the HKMA, while it is well regulated by the Securities and Futures Commission (SFC) which promotes corporate governance[4]. Although the HK dollar is an international currency under the currency-board regime, it has hardly been used for international transactions, and therefore, proceeds of bond issues by non-residents are mostly swapped out. For this reason, only high-rated issuers are accepted as swap counter parties. The Hong Kong market is a unique market with the backing of the huge Chinese economy. While Hong Kong will compete with Shanghai as a financial center in the long run, the Hong Kong market holds the potential to expand enormously, if capital transactions in RMB are permitted in Hong Kong as China moves to liberalize capital transactions.

Singapore Market

In 1998, the Monetary Authorities of Singapore (MAS) announced a plan to develop the government bond market as a liquid "efficient market" and to establish an international bond market to make Singapore a world-class financial center[5]. MAS carried out comprehensive measures including the building of infrastructure for the bond market. Despite consistent budgetary surpluses, it has been issuing government bonds constantly to establish a benchmark necessary for the development of the corporate bond market. As a result, the outstanding amount of government securities (bonds and Treasury bills) reached S$58 billion, or about 37% of GDP at the end of 2002 and the daily volume of trading increased to S$1.97 billion in 2002 from S$0.36 billion in 1997. The corporate bond market has also developed with a well-functioning disclosure, accounting and auditing system, allowing corporate governance to work well. The outstanding amount of corporate bonds increased from S$20 billion in 1998 to S$48 billion in 2001.

A characteristic of the Singapore market is that under the foreign exchange controls, non-residents are neither permitted to hold Singapore dollars, except for investment purposes in Singapore, nor trade the currency in the offshore market. Therefore, the proceeds of a bond issue by a non-resident must be swapped out into a foreign currency. As in the case of Hong Kong, an issuer is screened since it must be accepted as a swap counter party. Although it has become less restrictive, the Singapore government is likely to maintain its policy of non-internationalization of its currency. The Singapore bond market, as it stands now, is considered to be a matured market.

3 Domestic Bond Market Development and the Creation of an International Bond

4 Securities and Forward Ordinance prepared by the SFC became effective April 1 this year, establishing market supervision and a regulatory framework.

5 Before 1998, the amount of bonds a non-resident could issue or borrow in Singapore was limited to S$5 million.

Market

After the Asian crisis, government-led reforms in bond markets in the region, in particular Korea, Thailand and Malaysia have made remarkable progress. This section looks at the possibility of opening their bond markets by looking at their current status. In addition, the paper discusses China, which after having joined the WTO in 2001, is expected to develop a bond market relatively swiftly, and is certain to have a strong impact on the region's currency regime and capital market development[6].

Korea

A characteristic of the Korean bond market is the dominance of the corporate bond market, although it is heavily dependent upon banks, which play an important role as investors and provide guarantees to corporate bonds. On the other hand, the government bond market had been inactive before the Asian crisis because of budgetary surpluses. However, after the crisis, the Korean government started issuing a huge amount of government bonds to stimulate the economy and to assist banks in their disposal of non-performing loans. At the end of 2002, the outstanding amount of bonds reached Korean won (KRW) 360 trillion, the equivalent of 61% of GDP, and the ratio of government bonds to private sector bonds stood at about 1:2.6. About 60% of outstanding government bonds are held by banks and investment trusts which tend to hold them up to maturity.

Of the total outstanding amount of private sector bonds, which was KRW 262 trillion at the end of 2002, KRW 82 trillion was issued by financial institutions and KRW 180 trillion by private corporations. Most of the corporate bonds carry a maturity of three years. More than 70% of corporate bonds are held by banks and investment trusts and thus concentration is also an issue for corporate bonds.

After the Asian crisis, the Korean government carried out major reforms in the domestic bond market, by introducing a primary dealer system for government bonds, listing government bond futures on an exchange and establishing a settlement system (DVP)[7]. In view of investor preference for medium-term bonds, the attempt was made to extend maturity by issuing 10-year government bonds in 2000. In order to build a long-term yield curve, it is important to continue issuing long-term government bonds. Secondary market transactions including the repo market are very thin partly due to the concentration of bonds in the hands of a few investors.

While Korea's external debt has been declining from US$160 billion in 1997 to US$135 billion in 2002, foreign exchange reserves increased during the same period from US$20 billion to US$121

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[6] The source of figures related to external debt, balance of payments, official reserves of Korea, Malaysia and Thailand in 2002 including estimates are from the Institute of International Finance (IIF).

[7] In 1999, the Bank of Korea submitted to the Ministry of Finance and Economy, a comprehensive proposal entitled "The Direction of the Government Bonds Market Development and Issues to be Tackled". Major market reforms have been carried out on the basis of the recommendations contained in this proposal.

billion. The current account surplus remains positive at around 1-2.7% of GDP, although it has been declining in the past few years. While Korea is cautious in the use of won in international transactions, it already permits non-residents to invest in Korean bonds. In 1995, 7-year won-denominated bonds were issued by the ADB, and it is expected that Korea will further allow bond issuers by non-resident issuers in the future.

Malaysia

The outstanding amount of bonds increased sharply from 56% of GDP in 1998 to 76% at the end of 2002, with private bonds accounting for 54.5% of the total outstanding amount of bonds, exceeding the share of public sector bonds (mostly government bonds) of 45.5%(Bank Negara Malaysia). While the amount of government bonds was small before the crisis, due to the balanced budget, it increased after the crisis as a result of the fiscal deficit of 1-2% of GDP. The government has been issuing government bonds consecutively to build a yield curve. Due to the concentration of government bonds in the hands of a few institutional investors, such as provident funds, the development of the secondary market has been somewhat slow, although it has improved since 2000. Compared to Thailand, the corporate bond market has been playing an important role as a source of funds than the equity or bank loan markets. The secondary market of corporate bonds is inactive mainly due to the small amount of individual issues.

The Securities Commission launched the Capital Market Master Plan 2001-2010 in February 2001, providing the framework for a 10-year capital market development program. The Plan sets forth a comprehensive approach including infrastructure and the legal, regulatory and administrative framework. The bond market is expected to develop further as the plan makes steady progress as scheduled.

Malaysia’s outstanding external debt, as of the end of 2002, is estimated to amount to US$48 billion, which is equivalent to about 51% of GDP, slightly lower than its peak of US$50 billion in 1997. The current account surplus in 2002 is estimated at 6.8% of GDP but it is expected to decline in the coming years. Foreign exchange reserves have increased from US$21 billion in 1997 to US$35 billion in 2002. In September 1998, the government introduced foreign exchange controls together with a fixed exchange rate system, and the use of the Malaysian ringgit (RM) by non-residents was prohibited, while repatriation of proceeds of portfolio investment in Malaysia was restricted. The restrictions on capital outflows have been reduced gradually since then, and at present, short-term transactions are subject to only a few restrictions. However, the “non-internationalization policy” of the RM, strictly prohibiting non-residents from using the RM in international transactions, is considered an important measure to stabilize capital movement and is expected to be maintained in the medium to long-term.

According to the “Capital Market Master Plan”, the opening of the RM-denominated bond issues market to high-quality, non-resident issuers, such as international financial institutions and multinational corporations, will be considered for implementation in phase 2 (2004-05). The Plan is based upon the evaluation of the benefits of establishing an international bond market and is likely to be realized as planned.

Thailand

Government bonds had not been issued from the early 90s until the Asian crisis, due to a fiscal surplus. In July 1998, the government started issuing bonds in order to compensate for losses in the Finance Institutions Development Fund (FIDF) as a result of financial assistance provided to ailing financial institutions after the crisis. Since 1999 the government has been issuing bonds to finance an annual budgetary deficit of over 3% of GDP. Despite its improvement, the budgetary deficit will remain for some time, and the government bond market will expand further. The outstanding amount of bonds at the end of 2002 was baht 2.2 trillion, an equivalent to 41% of GDP, 51% of which were government bonds, 18% state enterprise bonds and 25% private sector bonds (Thai Bond Dealing Center). Corporate bonds have also increased since 1999 as the economy recovers from the crisis. Trading volume rose more than seven times in 2001 compared to that of 1996.

Based upon the Thai Economic Reform Program announced in November 1999 and the Master Plan announced in January 2002, the bond market underwent major reforms in such areas as reorganization of the issue and the secondary market, the taxation system, creation of a settlement system and development of a repo market. Although the bond market made remarkable progress, there are many issues that remain to be solved such as the legal and taxation system, accounting, information disclosure and the corporate governance, all of which require major improvements. Since government bonds are concentrated in the short and medium term, the government should continue to issue bonds without interruption to improve the maturity distribution.

The external debt of the country sharply declined from US$109.4 billion in 1997 to US$63.8 billion in 2002, while foreign exchange reserves increased from US$26.2 billion in 1997 to US$38.1 billion in 2002. The current account surplus is expected to remain in the range of 4-6% of GDP in the coming years. The external balances have improved recently and GDP recovered to the pre-crisis level. However, public debt has increased from 36% of GDP in 1997 to 58% in 2001(IIF). Since it will take more time to develop the bond market, the government may take a cautious approach at least for the time being to opening the market, even if the external balances are strengthened.

China

Of the total amount of outstanding bonds as of the end of 2001, government bonds accounted for 62%, bank debentures 34% and corporate bonds 4%. The bond market in China is dominated by government bonds that have expanded rapidly since 1998, when the government started issuing bonds in a major way to fill the budgetary deficit that resulted from the government's adoption of a more aggressive fiscal policy. The outstanding amount of government bonds amounted to RMB 1.6 trillion at the end of 2001, which is equivalent to 16.3% of GDP. Government bonds are classified into three categories, (1) book-entry government bonds, (2) savings bonds and (3) investor-targeted bonds. The first two categories of bonds account for more than 90% of the total amount. The book-entry government bond market is further divided into (a) the inter-bank bond market in which banks trade and (b) the exchange market in which securities dealers trade. The savings bond market is for individual investors. Bonds in the book-entry market which account for more than 60% of new issues are subscribed to through a competitive bidding system, whereas terms and conditions of savings bonds, in which individuals invest, are determined by the Ministry of Finance. Individual investors hold about 40% of the total outstanding amount of government bonds in the form of savings bonds. These savings bonds are in a registered form and may not be sold to other investors[8]. The secondary market is mostly traded on a repurchase base and there is few spot trading. The new issue and secondary government bond markets are fragmented into different groups disturbing market functions and allowing government intervention.

China agreed to open its domestic financial markets in accordance with its accession to the WTO (2001). Five years after the accession (2006), many of the restrictions placed upon foreign banks, such as on the use of RMB and banking transactions with Chinese companies, will be removed. China is now undergoing structural reforms in its financial system in order to cope with market liberalization. With regard to the liberalization of capital transactions, China is not under any obligation in the WTO accords. Under the current foreign exchange regulations, non-residents are prohibited from transacting in RMB and may not invest in domestic bonds. The foreign exchange position of foreign banks is strictly controlled and forward contracts are not permitted.

It is certain that China will try to avoid the appreciation of its currency against the US dollar, despite pressures from many corners. Instead, it will gradually liberalize capital account transactions, as reforms of the domestic financial markets progress. Already, RMB is in circulation not only in Hong Kong and Macao, but also in Mongolia and Myanmar, and it has been said that a massive irregular outflow of capital from China has been taking place. In Hong Kong and Singapore, the non-deliverable forward (NDF) market, a forward market for RMB, are becoming active. In fact, the use of the RMB has been increasing in international transactions including informal transactions. Under the circumstances, the government needs to respond to the reality in one way or another, and liberalization of capital transaction will become unavoidable. The Chinese government introduced in December 2002, a system called "Qualified Foreign Investment Institution (QFII)" whereby a few foreign institutional investors, subject to restrictions such as repatriation of funds, are now permitted

[8] An investor may sell bonds, subject to a reduction of fees, at the bank from which the investor bought the bonds. The bank that purchases the bonds must hold them until maturity.

to invest in Chinese securities such as bonds. Furthermore, if a Qualified Domestic Investment Institution (QDII) system is introduced in the future, it will permit domestic investors to invest overseas.

Although it is difficult to predict when the opening of the capital market will take place, China will probably not withhold or delay its decision to liberalize capital transactions, as long as it records a current account surplus and accumulates foreign exchange reserves. Japan joined the GATT in 1955 and decided to open its bond market in 1970, following the Tokyo Olympics that took place in 1964. Likewise, China may consider the liberalization of capital account transactions as an important policy agenda with the upcoming events of the Beijing Olympics in 2008 and the World Fair of Beijing in 2010. In addition to outside pressure, the demand to open capital transactions will also come from inside China, as a growing number of Chinese companies invest overseas and demand the free use of RMB. Therefore, while completing domestic financial market reforms through 2006 as agreed, China will gradually move towards capital account liberalization. The establishment of an international bond market will be considered in due course. One of the choices available as the first phase of liberalization is to permit capital transactions in RMB, including RMB-denominated bond issues by non-residents, in the open capital market in Hong Kong.

4 The Function of an International Bond Market

To open the domestic bond market is to permit a two-way capital movement by non-residents, (1) portfolio investment (inflow of capital) and (2) bond issues denominated in the domestic currency (outflow of capital). Opening of the bond issues market to non-resident issuers will place a burden on the balance of payments and it therefore requires appropriate macro-economic management. This process highlights the importance of coordinating policy at the regional level through surveillance on capital movements. As long as proper macro-economic management is in place, in and out long-term capital flows, distinctively different from short-term capital flows that triggered the East Asian crisis, will not be considered a disturbing element in the market, but rather as contributing to the development of the domestic bond market.

There are several practical merits in opening the domestic bond market to non-resident investors and issuers.

(1) The creation of a free and competitive international bond market will stimulate reforms in the domestic bond market which tends to be restricted by rules and regulations, for instance, pre-determined issue conditions that do not reflect market conditions, limited access to the issues market divided by types of issuers and rigid investment restrictions imposed on individual institutional investors. Two-way long-term capital flows will deepen the market, by attracting more and diversified market participants both in and out of the country, creating a better profile of the domestic bond market.

(2) Bond issues by high-quality foreign issuers will create new investment opportunities in the domestic currency for domestic investors. This is particularly useful to diversify investment for investors such as pension funds, which tend to concentrate their portfolio in risk-free government bonds. Also, foreign currency debt owed by a domestic entity can be replaced with long-term domestic currency debt through swap transactions with a non-resident issuer with proceeds of a bond issue.

(3) By allowing bond issues by a foreign company, foreign direct investment (FDI) can be funded in long-term local currency funds. This will eliminate currency risks for investors and create room for additional investment, thus inducing FDI flows.

(4) As a number of international bond markets develop in the region, an incentive to cooperate among them will be created in such areas as standardization of market practices, making regional markets compatible to facilitate cross-border transactions, and the settlement and custody system.

5 Role of Intermediaries

Domestic securities companies play an important role in the development of the domestic bond market. They must become more sophisticated, when an international bond market is created, to be able to compete with foreign investment banks. In the bank dominated financial system of the region, underwriting has often been carried out by a securities company, which is a subsidiary of a bank. In the region's major financial markets, local and foreign banks have been competing but at the same time playing complementary roles. Likewise, in the international bond markets, domestic securities companies which are familiar with the domestic market, and foreign securities companies which have expertise in international capital markets, have been cooperating with each other. Foreign investment banks will contribute towards market development by introducing high quality issuers, forming an underwriting syndicate, and introducing a range of financial products.

Once a government opens the bond market, private market intermediaries will become the driving force. As financial intermediaries, mandated securities companies (investment banks) determine the appropriate pricing for a bond issue through a price discovery process, place bonds in the firm hands of investors and engage in trading in the secondary market. Private market intermediaries are the engine of the market, so the market needs to be designed in such a way that they can operate to the fullest extent. When multinational corporations or international financial institutions issue publicly offered bonds denominated in the region's currency through intermediaries, a spread in relation to benchmark government bonds is established. Also, by comparing all-in-cost to the issuer after swaps with other markets like the euro or the Yankee, the market's efficiency will be evaluated. International bond markets are linked through these international issuers.

Furthermore, efforts to improve and standardize market practices will be promoted by securities companies through underwriting and trading in the secondary market. The standardization of market practices and the improvement in infrastructure can only be realized by effective cooperation between financial authorities and financial intermediaries. The linking of domestic bond markets that have been operating independently will help promote standardization and provide a basis of further cooperation among them.

6 International Bond Markets and Regional Monetary Cooperation

With the expansion of intra-regional trade and investment, and the deepening of economic inter-dependence in the region, an East Asian economic zone has been de facto formed. Although Japan, China, Korea and ASEAN members have not been active signatories to free trade agreement (FTAs), they are now entering into bilateral negotiations with several countries[9]. It is a widely shared view that bilateral FTAs will eventually evolve into a regional arrangement such as the East Asia free trade area. As inter-dependence between economies in the region grows through deepening trade and investment, it will become necessary to develop a stable currency system.

With regard to a currency system, necessary measures to promote regional cooperation in an exchange rate mechanism in order to streamline trade, investment as well as capital flows, will be actively discussed. Already, a basket of currencies mechanism has been proposed by academia and the lessons that can be learned from Europe's history of regional integration has been discussed at various occasions. At the ASEM finance ministers' meeting held in Copenhagen in June 2002 the report "Kobe Research Project", which was prepared by a group of European and Asian think tanks, was submitted together with proposals and discussed[10]. The report deals with comprehensive discussions on the European experience of regional economic integration and its implication for the East Asian region. It is encouraging that the move towards regional integration based upon a long-term perspective in the areas of both trade and currency system has been taking place. However, compared to the European Union which introduced a single currency in 1999, and NAFTA which may reach an agreement by 2005 on a Free Trade Agreement of the Americas (FTAA), the efforts to integrate East Asian economies started much later, only after the outbreak of the East Asian crisis.

In the East Asian region, countries like China, Hong Kong and Malaysia now maintain a fixed exchange rate system, whereas other countries adopted the so-called managed float in place of a US dollar-peg system that prevailed before the crisis. One possible measure to stabilize the exchange mechanism is to establish a common currency to which the currencies in the region may be linked[11].A common currency may be either the US dollar, a basket of currencies consisting of the US

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[9] In East Asia, two FTAs have been concluded, The Japan-Singapore Economic Partnership Agreement and AFTA.

[10] According to the decision made by the ASEM finance Ministers' meeting in 2001 held in Kobe, the Institute of International Monetary Affairs together with European and Asian think-tanks prepared a report entitled "Kobe Research Project" which was submitted to the ASEM meeting held in Copenhagen in 2002. The report discusses exchange rate regime, regional financial cooperation, regional economic integration, and banking sector reform and capital market development focusing upon European experience.

[11] Europe created the European Monetary System (EMS) in 1972, a regional exchange rate arrangement in which

dollar, euro and yen, or an Asian currency unit (ACU) consisting of convertible currencies in the region. The first two measures are mechanisms with a fixed exchange rate to the US dollar or to a basket of international currencies. The third contemplates a so-called Asian Monetary System, an Asian version of the EMS, with a fixed exchange rate to the ACU as the anchor currency.

In a few years time, a few international bond markets will be created in the region, further developing the domestic bond market and overcoming balance of payments issues through appropriate macro-economic management. With regard to the use of a currency in international transactions, there are countries like Singapore and Malaysia that impose restrictions through their policy of non-internationalization of their currencies. If Malaysia creates an international bond market, their currency is likely to be subject to such a restriction. A stable currency mechanism will be necessary to activate long-term capital transactions through the international bond market, in spite of such restrictions.

In accordance with the Chiang Mai initiative, a total amount of nearly US$40 billion of bilateral swaps has been concluded. The purpose of the initiative is to help resolve future financial crisis. The objective in developing the domestic bond market is to strengthen the domestic financial and capital markets in order to avoid future financial crisis. Creation of the international bond market will stimulate the development of the domestic Bond markets in the region. As the bond market develops, savings in the East Asian region will be effectively channeled to borrowers in the region rather than drifting to other financial centers like New York or London.

7 Conclusion

It is up to the government to decide whether it will permit portfolio investments or bond issues by non-residents by creating an international bond market. The crisis-ridden countries have recently made remarkable progress in developing government bond markets to attain its benchmark function. If the domestic bond markets make further progress, and if economic conditions such as the balance of payments permit, more international bond markets will be created within a decade in East Asia, in addition to the three international markets which already exist. The Korean market that has undergone government-led reforms and the Malaysian market that is scheduled to implement market liberalization in a few years time, are possible candidates. China's bond market may also change swiftly and quite dramatically depending upon the new government policy.

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regional currencies were linked to each other moving within a narrow band called a snake, freeing them from the US dollar. The EMS evolved into the European Monetary Union (EMU) in 1979, under which the ECU, a common currency, was created. The EMU lasted for 20 years until the single currency mechanism was created in 1999. The driving force that has led European integration to a single currency system was political, a no-war treaty between Germany and France. Since East Asia does not have a strong political motivation as the Franco-German treaty, the creation of a single currency system is unrealistic, at least for the time being. But if interdependence in the East Asian economic sphere deepens, in trade and investment, there will be a greater need to create a foreign exchange stabilizing mechanism within the region.

In the medium to long-term perspective, it is likely that there will be several international capital markets in East Asia, with individual currencies competing, while at the same time maintaining close relations, like Europe in the 1980s[12].

While East Asia's regional integration makes progress with growing intra-regional trade and investment, the development of the domestic bond market in each economy will provide a base to establish a regional mechanism that will increase a healthy flow of long-term capital to industries. With the development of the corporate bond market, short-term foreign currency debt of a private company will be replaced by long-term domestic currency denominated debt, strengthening its balance sheet against future financial crisis. If such a replacement spreads throughout the region, the debt profile of private companies will become healthier. The possibility of establishing a robust bond market will increase if countries that suffered from the financial crisis actively cooperate with each other. A well functioning surveillance mechanism will be indispensable for the development of regional financial cooperation. At the same time, in order to push the process of building robust bond markets forward, a mechanism should be established to promote close policy dialogue among regional governments where "peer pressure" works, while enhancing the dialogue between the public and private sectors.

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[12] In addition to markets in the UK, Germany and France, there were international bond markets operating in their currencies in Italy, Netherlands, Belgium, Luxemburg, Switzerland and Austria.