

# Newsletter



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## Toward Asian Stock Market Initiative <sup>1</sup>

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Institute for International Monetary Affairs have conducted a research project concerning Asian Stock Markets commissioned by Ministry of Finance Japan during last fiscal year<sup>2</sup>.

As we consider Asian stock markets are important issues, we have been continuing our research even after the project was completed.

This paper is based on our recent research on the current status of Asian stock markets.

Asian stock markets are expanding rapidly and the importance to their economy is growing.

Meanwhile, it has structural problems such as dependence on foreign capital inflow and the differences in characters with respect to each economy. So we have to take into account of those issues when we consider Asian stock market initiative.

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<sup>1</sup> This paper is the script of a speech delivered at the 3<sup>rd</sup> ABAC Meeting on August 25th, 2009 in Vietnam.

<sup>2</sup> The final report (available only in Japanese) could be found on the following website.

<http://www.mof.go.jp/jouhou/kokkin/tyousa/2101eastasia.htm>

## 1. Overview of Asian stock markets

### (1) Asian stock markets are expanding rapidly

The total market capitalization of world stock markets has increased approximately 1.5 times from 42 trillion dollars in 2005 to 61 trillion dollars in 2007, based on the figures of World Federation of Exchanges (WFE) (Figure 1).

During the same period, market capitalization of Asian stock markets increased more than 11 times in Mainland China, and 1.5 to 2.6 times in ASEAN economies respectively.

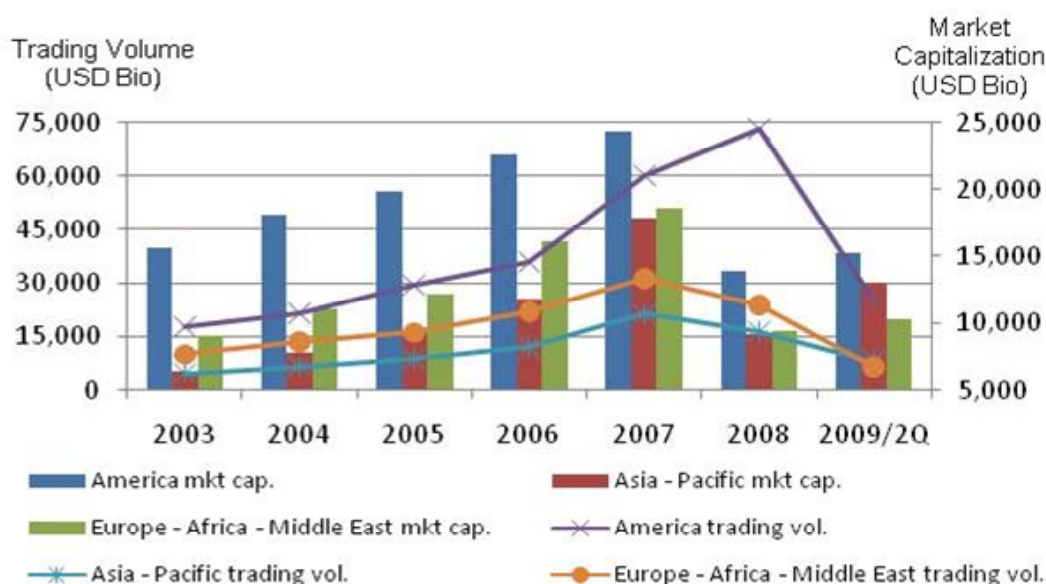
The growth of market capitalizations is partly due to increase in stock prices. From year 2005 to 2007, stock price index rose 18% in the United States. On the other hand, market capitalization increased only 15%. In the United Kingdom, stock price index rose 15%, while market capitalization increased 9%.

When we look to Asian Economies, for example, Shanghai, the market capitalization increased 12 times while the stock price index rose 5 times.

This indicates that in ASEAN economies, market capitalization expanded more than the rise of stock price, which means that the market actually grew.

In addition, Asia-Pacific region surpassed Euro/Africa/Middle-East region in both trading volume and market capitalization in this 2nd quarter.

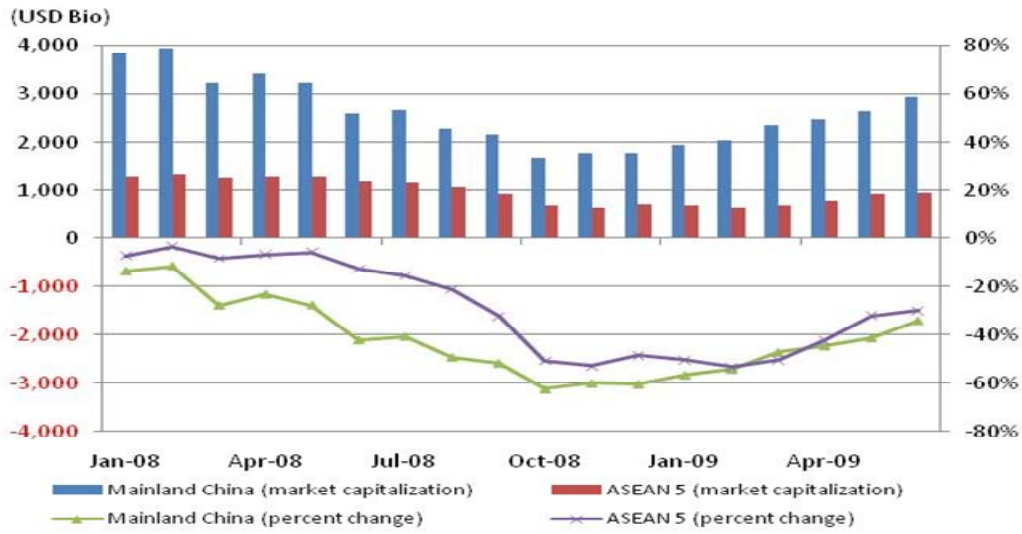
Figure 1: Market capitalization and trading volume



(Source) WFE

Another remarkable point is that Asian stock market has turned toward a recovery swiftly compared to other markets during this global financial crisis (Figure 2).

Figure 2: Trends of Asian stock markets during the crisis



(Note) Percent change is compared to the end of 2007.  
 (Source) WFE

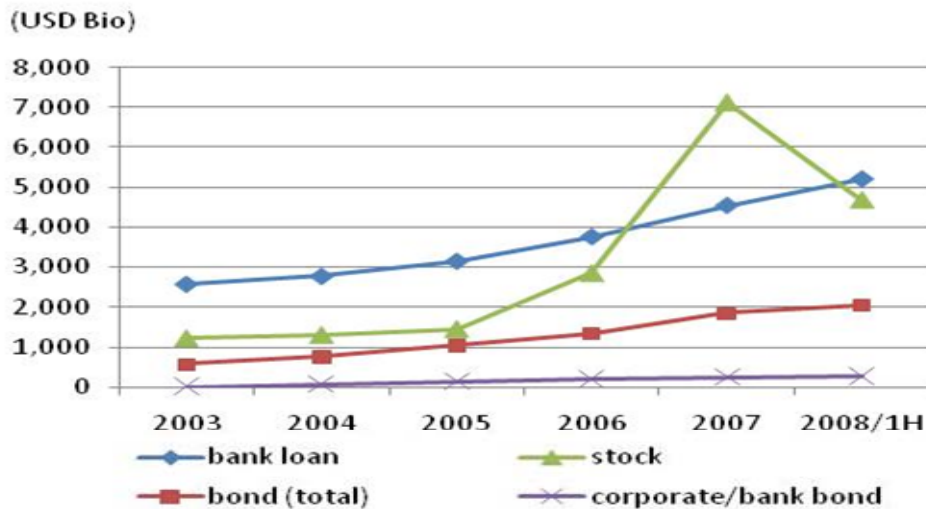
**(2) Stock markets are growing in importance**

Along with the expansion of Asian stock markets, the importance of stock markets to the economy is growing in Asia.

Major fund raising instruments for companies are bank loans and stocks. Fund raising through bond issuance is still limited in Asian economies.

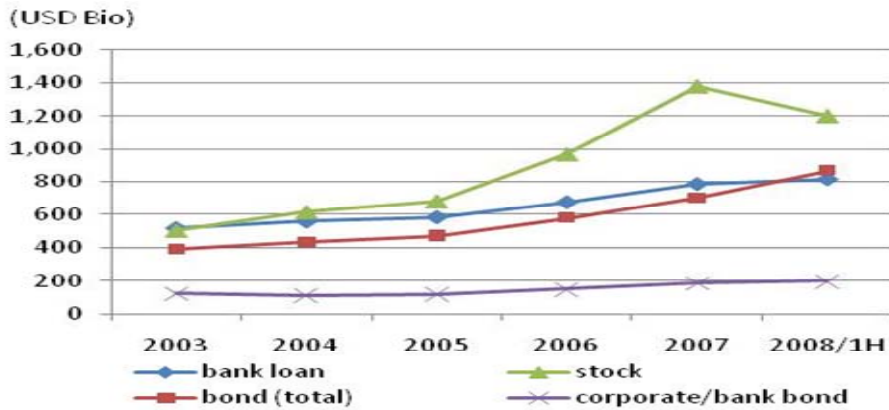
The trends of fund raising tools can be seen in the following figures. Figure 3 is for Mainland China and Hong Kong, and Figure 4 is for ASEAN economies.

Figure 3: Trends of fund raising (Mainland China + Hong Kong)



(Note) loan, bond: outstanding, stock: market capitalization  
 (Source) ADB, IMF, WFE

Figure 4: Trends of fund raising (ASEAN 5)



(Note) - loan, bond: outstanding, stock: market capitalization  
 - ASEAN 5: Singapore, Malaysia, Thailand, Indonesia and Philippines.  
 (Source) ADB, IMF, WFE

Funding through stock markets are increasing more rapidly than bank loans, in both Chinese and ASEAN economies.

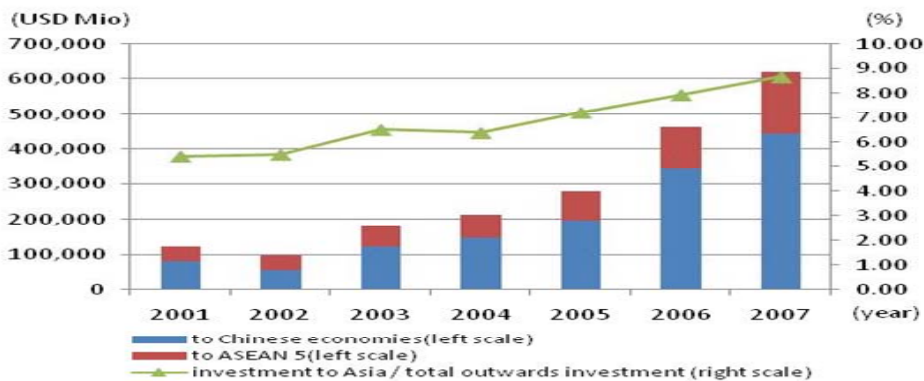
In terms of private companies' fund raising and investment choice, stock markets are becoming the most important resource in Asia.

### (3) Advanced economies are increasing investment to Asian Stock Markets

Advanced economies, United States, Europe and Japan, are boosting their portfolio investment to Asian stock markets in recent years (Figure 5). Especially after 2005, the investment ratio toward Chinese economies is increasing remarkably.

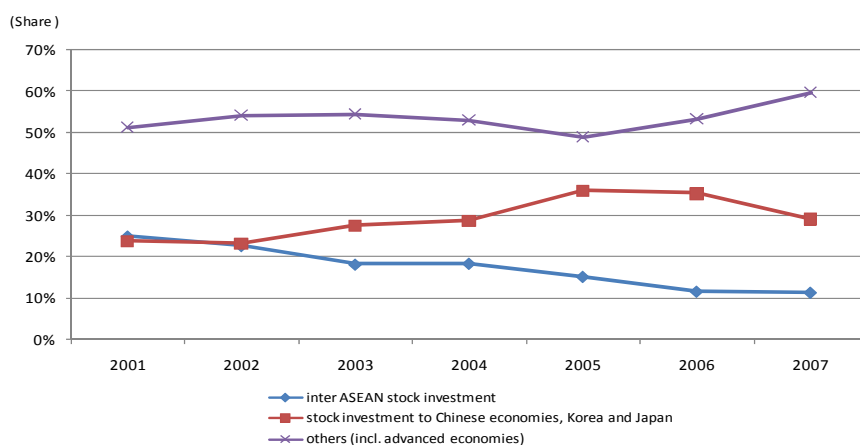
This indicates that current expansion of Asian stock markets are supported mainly by inflow of foreign investment funds from the advanced economies.

Figure 5: Advanced economies' investment to Asian Stock Markets



(Note) advanced economies: United States, United Kingdom, France, Germany and Japan.  
 Chinese economies: Mainland China, Hong Kong and Taiwan.  
 ASEAN5: Singapore, Malaysia, Thailand, Indonesia and Philippines.  
 (Source) IMF

Figure 6: Regional diversification of outward portfolio investment of ASEAN  
(Asset Balance)



(Note) Chinese economies: Mainland China, Hong Kong and Taiwan.

(Source) IMF

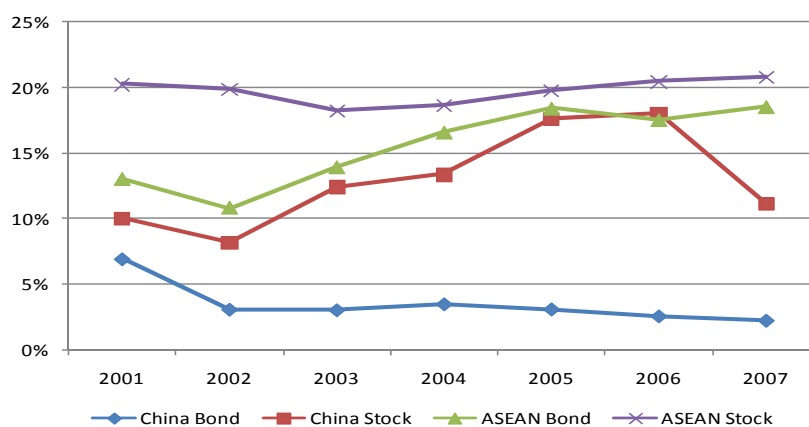
At the same time, ASEAN economies are increasing outward stock investment (Figure 6).

Looking into the destination of investment, most of them are outside of Asia. For example, in 2007, stock investment ratio toward advanced markets was almost 60%.

While Asian stock markets were expanding, the inter-ASEAN cross border investment ratio was going down in the contrary. Although investments of Asian economies are increasing, most of them are headed outside of the region.

This indicates that Asian excess savings still have a room to be recycled into investment in the region.

Figure 7: Foreign investor ratio (ASEAN and Chinese economies)



(Note) China = Chinese Economies (excl. Taiwan for Bond), ASEAN = ASEAN 5

Ratio = Asset of foreign investors / Total outstanding (bond), market capitalization (stock)

(Source) WFE, Asian Bonds Online

Examining the breakdown of investors by economy groups (Chinese economies and ASEAN economies) and products (stocks and bonds), you can see that foreign investor ratio of ASEAN stock markets are the highest in 2007, which account for 20% (Figure 7).

Although the figure is larger than that of Chinese economies, the percentage itself is not so high, compared to advanced markets.

But there is a particular back ground that domestic investors in Asian stock markets tend to take the “buy and hold” strategy.

As a result, the activities of foreign investors are likely to have a relatively big influence on the market. This is one of the reasons why Asian stock markets are quite volatile.

## 2. Diversity of Asian Stock Markets

### (1) Chinese and ASEAN markets have different characters

Figure 8: Overview of Chinese and ASEAN stock markets

(at the end of 2008)

stock exchange	market capitalization (USD Bio)	listed companies	trading value (USD Bio)
<b>Chinese economies</b>	<b>3,464.3</b>	<b>3,587</b>	<b>6,308.3</b>
Shanghai	1,425.4	864	2,600.2
Shenzen	353.4	740	1,248.7
Hong Kong	1,328.8	1,261	1,629.8
Taiwan	356.7	722	829.6
<b>ASEAN 5</b>	<b>708.1</b>	<b>2,910</b>	<b>596.2</b>
Malaysia	189.2	976	93.8
Indonesia	98.8	396	109.4
Philippines	52.0	246	17.1
Singapore	265.0	767	259.9
Thailand	103.1	525	116.0
(memo)			
New York	9,208.9	3,011	33,638.9
Tokyo	3,115.8	2,390	5,607.3

(Note) Figures of New York Stock Exchange exclude Euronext.

(Source) WFE

Since the characters of stock markets differ by economies (Figure 8), we had better roughly divide the region into two groups, Chinese economies (which consist of Mainland China, Hong Kong and Taiwan,) and ASEAN economies (which are from Singapore, Malaysia, Thailand, Indonesia and Philippines).

Even among ASEAN economies, Singapore has a different character, since it is

recognized as one of the international financial centre in Asia.

Stock markets in Chinese economies are expanding rapidly. At the end of 2008, they overtook Tokyo Stock Exchange in terms of market capitalization, number of listed companies and trading volume.

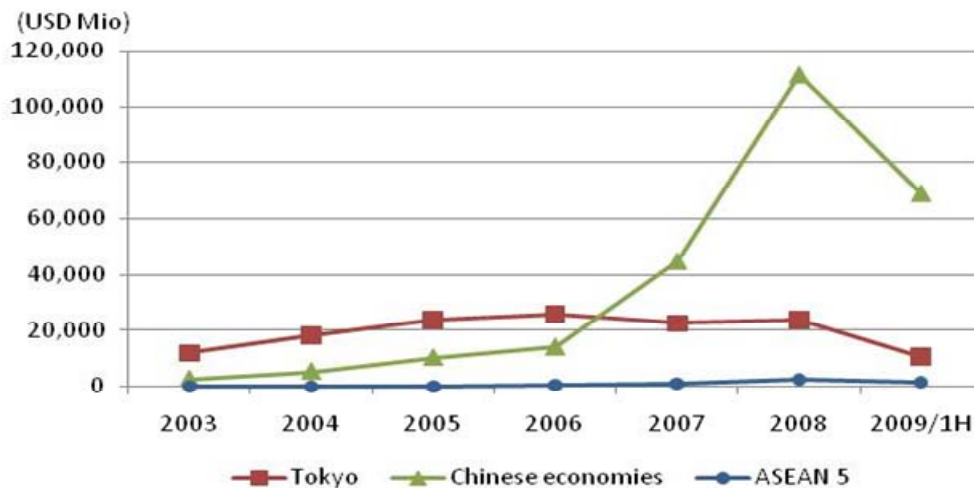
Although stock markets in ASEAN economies are growing gradually, the market capitalization is still only 20% of Chinese stock markets.

From the point of market size, variety of financial instruments and financial regulations, these two market groups should not be categorized as the same.

## (2) ETF trading is exploding

Trading of ETFs is growing rapidly in Asia. In the last 18 months, ETF markets of Asian economies are expanding 20%, especially in Chinese economies (Figure 9).

Figure 9: Trends of ETF trading (Value of trading)



(Source) WFE

Chinese economies are planning to start cross-listing of ETFs among Shanghai, Shenzhen, Hong Kong and Taiwan Stock Exchange. Korea is also keen on developing ETFs and derivative products.

To attract investors in stock markets, diversification of financial products is the key factor. Witnessing the explosion of ETF transactions in the region, ETF could be considered as one of the effective tools.

As we looked through, stock markets of Asian economies are growing as a whole. Now it is time to consider more of the importance of these markets.

### 3. Toward development of Asian stock markets

What kinds of initiatives are taken toward development of capital market in Asian economies?

As you may know, there are projects such as ABMI and ABF carried out to foster the bond market.

On the other hand, for stock markets, initiatives are taken under the framework of ASEAN (Figure 10).

Figure 10: Initiatives by ASEAN (abstract)

- (a) Creation of an “interlinked ASEAN securities market” by 2015
  - ☛ ASEAN Board (2009)
  - : Thailand, Singapore, Malaysia, Indonesia and Philippines
  
- (b) Introduction of Regional Standard (Disclosure, Accounting/Auditing etc.)
  - ☛ Disclosure Standard (2009.7)
  - : Singapore, Malaysia and Thailand

#### <Roadmap to Asian Stock Market Initiative>

There is a wide scope for supporting the development of stock markets in the region. To further cultivate the institutional investor base, increase in the numbers of listed companies and so on, is in need.

From the perspective of further developing overall Asian stock markets, what kind of measures should be taken?

We would like to recommend 4 points from the investors’ viewpoint, reflecting the comments from the actual market participants in the region as follows;

- (a) Establishing a common or one-stop access point for Asian stock market information,
- (b) Creating settlement infrastructure, such as Asian ICSD or CSD Linkage,
- (c) Encouraging greater diversity of products, including promoting the use of exchange-traded funds (ETFs), as well as hedging tools,
- (d) Promoting application of rules harmonized to international standards.

But how and where should we start from?



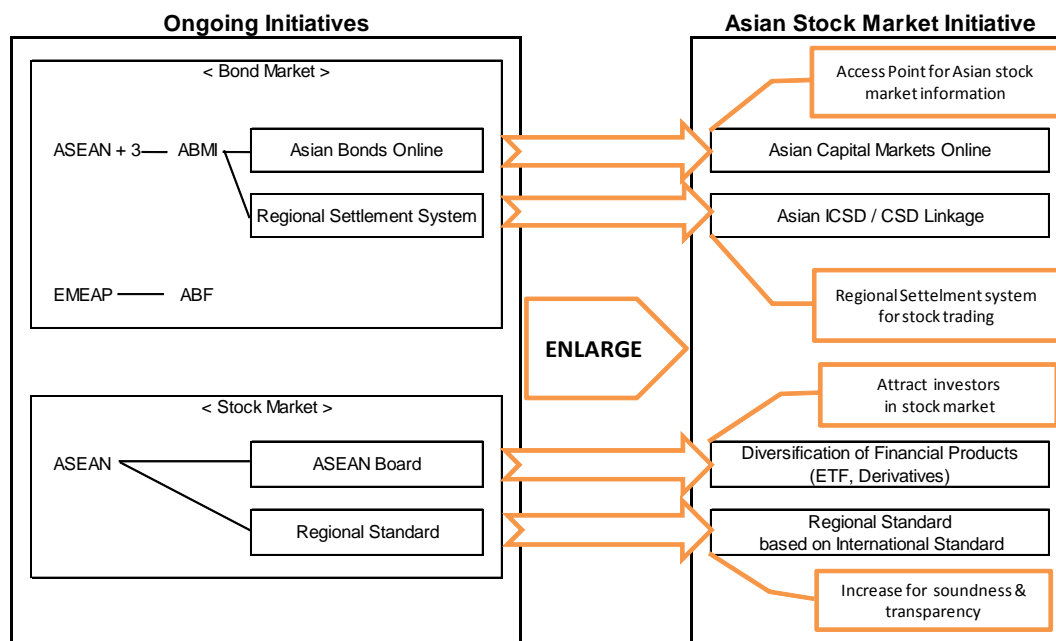
Thankfully, we have many ongoing initiatives in the region such as ABMI and ASEAN.

As illustrated in Figure 11, we can utilize these existing frameworks by enlarging and strengthening the coverage to start an Asian Stock Market Initiative (ASMI).

Considering the recent expansion of Asian stock markets, it is time to create **Asian Stock Market Initiative (ASMI)**, which would be a part of **Asian Capital Market Initiative (ACMI)** made up of **ABMI** and **ASMI**.

Referring the contents of this presentation, ABAC, at the meeting in Da Nang, Vietnam, decided to include “Asian Stock Market Initiative” in its annual recommendations which will be submitted to APEC Finance Ministers in this November.

Figure 11: Illustration diagram of Asian Stock Market Initiative



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