

HONG KONG, CHINA
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I would like to take this opportunity to express my gratitude to the people and Government of the United States (US) for their generous hospitality in hosting this year's Annual Meeting of the Asian Development Bank (ADB). I would also like to thank the ADB's management and staff for the excellent arrangements. I also join others in adding our special welcome to our new member of ADB, Turkmenistan.

I would like to take this opportunity to welcome the successful conclusion of the seventh replenishment of the Asian Development Fund, which should enable ADB to continue with its program in offering much needed relief to the poorest people in Asia.

While ADB has done a commendable job in seeking to reduce poverty in the region, many Asian economies are still suffering from the devastation caused by the financial crisis that erupted a few years ago. The crisis had led to massive destruction of wealth and caused enormous damage to the banking and financial systems of many Asian economies. There are more people now living below the poverty line than before. According to the World Bank estimates, nearly 50 percent of the population in East Asia, or 857 million people, live on less than \$2 a day. Out of them, 236 million people live on less than \$1 dollar a day.

So the Asian financial crisis has made the work of poverty reduction more daunting and pressing. The recent slowdown in the US economy and the renewed weakness in the Japanese economy have heightened the risks and uncertainties of the economic prospects of many Asian economies, at least in the short term. This is a timely reminder to all of us of the fragility of the Asian recovery in an era of globalization of markets with highly volatile capital flows. It will be difficult for the Asian economies to return to the track of stable and sustainable growth if we do not persevere with sound macroeconomic policies and with the structural reforms. While the reform agenda is a long one, I would like to underscore the importance of one element: financial sector restructuring. In the past year, ADB has, rightly so, emphasized lending to social infrastructure, transport and communications, and the agricultural sector. But restructuring of the financial sector should not be overlooked. The financial system, in particular the banking system, is the foundation for economic growth, since a crippled financial sector will be unable to intermediate between savings and investments, thereby leading to prolonged liquidity crunch and inefficient allocation of resources. I therefore hope that ADB will be able to devote more resources, both in terms of finance as well as technical assistance, to help member economies to restructure and rebuild their banking and financial systems.

In the process of reforming the financial sector, there is the long-standing problem arising from the underdevelopment of the Asian bond market. In Asia there are very few liquid and deep domestic bond markets. At the regional level, the cross-border flows of funds through the bond market are even more limited, resulting in unduly heavy reliance on short-term bank finance. At the same time, a large part of the very

substantial savings in Asia, both public and private, would first flow to the OECD markets before returning to the region as bank lending, portfolio investments, and foreign direct investment. We have witnessed during the Asian financial crisis how volatile this kind of flow can become and how destabilizing a sharp reversal of inflows can be.

So the Asian bond market is underdeveloped and is not functioning properly. But what can we do? There are many structural impediments blocking the development of bond markets in Asia. These factors include fragmentation and small size of the markets, lack of harmonization in the issuance procedures, tax and accounting treatment, poor corporate governance within the region, etc. However, I would highlight one particular problem that has received relatively little attention so far. It is the gap between the low credit ratings of the Asian issuers and the minimum acceptable ratings required by the official reserve managers and institutional investors in Asia.

According to Standard & Poor's, bond issuers of below single "A" rating comprise 91 percent of all the rated foreign currency bond issuers in Asia. However, many Asian institutional investors are required to invest in bonds not lower than single "A" rating. This means that there is a big gap between the credit ratings of the Asian issuers and the risk appetite of the Asian investors. It is therefore not surprising that, while the Asian economies collectively hold more than \$1 trillion of official reserves, the bulk of these reserves are financial assets issued in the G-7 markets due to credit as well as liquidity considerations.

The low credit ratings of Asian issuers will take a long time to resolve because many of the problems are structural in nature. The question is whether there is anything that we can do in the near to medium term to address the credit quality gap between the Asian issuers and investors. Assuming that the Asian investors are not overly keen to lower their minimum credit rating requirement, I believe that securitization, together with credit guarantee would offer a partial solution to the credit quality problem.

Securitization offers comfort to investors in that the debt securities are backed by a segregated pool of collateral or future cash flows. At the same time, credit guarantee provides additional protection to investors against default risk. It is therefore possible for a corporate to issue asset-backed securities with credit rating far higher than what it gets on its own. This allows borrowers to tap the capital market and broaden the investor base that will otherwise not be accessible. As the experience in the US suggests, asset-backed securities and the use of credit guarantee arrangements can play a crucial role in the development of the bond market in narrowing the gap between the investors' appetite and the borrowers' credit rating. I think that there is a great deal to be gained by studying the usefulness of securitization and credit guarantee in Asia and how they can be promoted to facilitate the development of the regional bond market.

In closing, I will point out that a number of useful studies, including those by the multinational development banks, have been undertaken to identify the impediments that caused the underdevelopment of bond markets in this region. It is now time to take the necessary concrete steps by the national authorities and policy makers. In this

connection, I urge ADB to play a catalytic role in the development of the Asian bond markets by providing the financial as well as technical resources to those who are in need of help.